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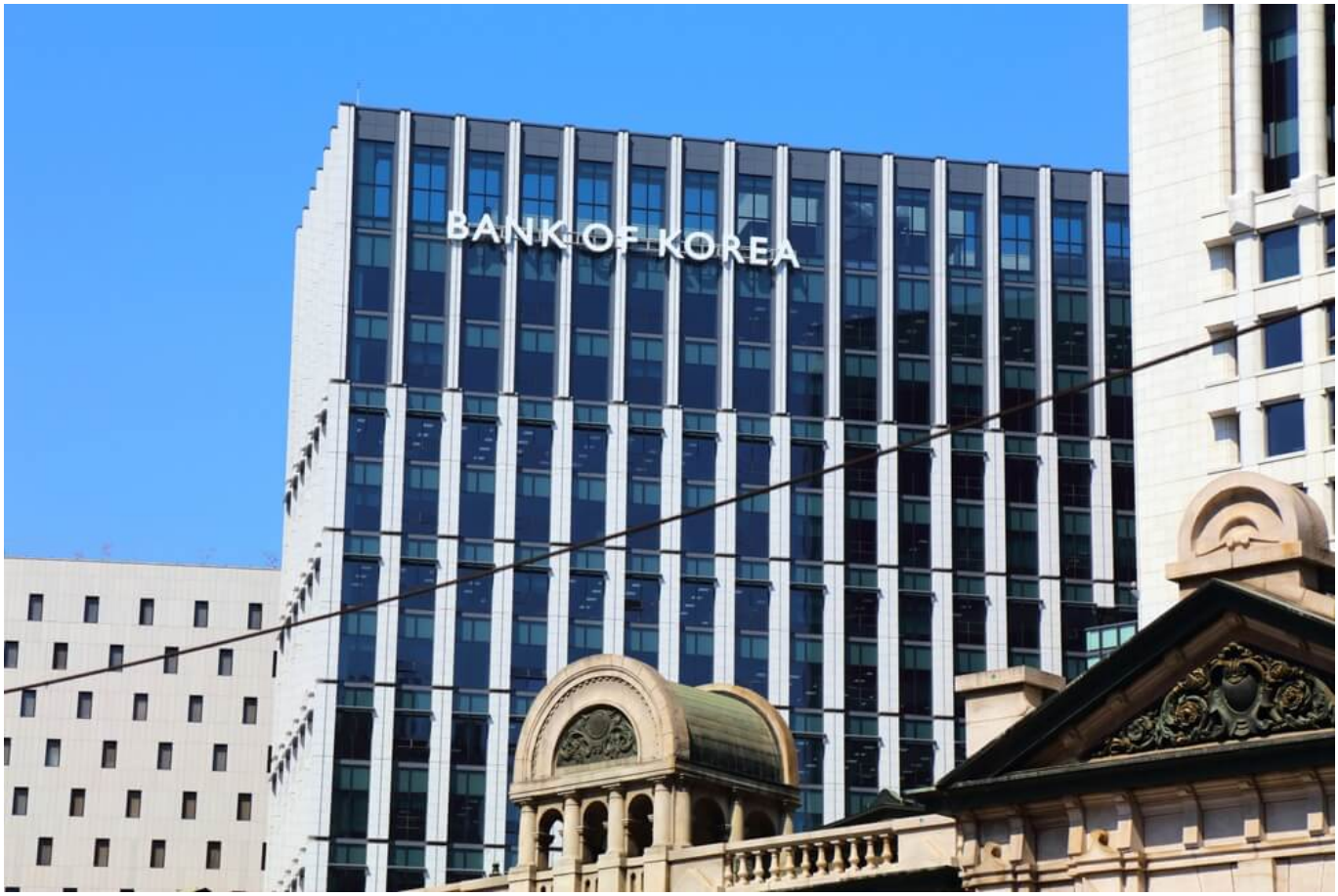
By: TA | AP Brief

Bank of Korea raises key interest rate to fight inflation



South Korea's central bank on Thursday raised its benchmark interest rate for the third time since July, aiming to tighten money supply in the face of inflationary pressure driven by the war in the Middle East and the country's booming semiconductor exports fueled by global demand related to artificial intelligence.

In raising its policy rate by a quarter-percentage point to 3.25%, the Bank of Korea also lifted its growth forecast for South Korea's economy to 3.9% from 3.3% for 2026, and to 4.1% from 2.9% for 2027, following months of strong exports.

Despite the robust performance in trade, analysts have noted that consumer spending has remained subdued due to rising prices, stagnant wages and the burden of servicing South Korea's notoriously high household debt.

Consumer prices rose 2.8% in October from a year earlier, above the bank's 2% target.

Core inflation, which strips out volatile food and energy prices to better gauge underlying price pressures, rose 2.7% over the same period.

The bank said in a statement that raising borrowing costs was necessary as inflation was expected to remain above target for a "considerable period" and also cited "persistent risks on the side of financial stability."

The bank said the global economy was maintaining modest growth despite the conflict in the Middle East, mainly driven by AI-related investments, but price pressures would continue to grow, driven by increasing energy costs.

It warned that the rising house prices in the capital Seoul and the metropolitan area could further aggravate the country's household debt, which reached an all-time high of 2,030 trillion won ($1.51 trillion) as of the third quarter, nearing the size of the country's annual gross domestic product, according to the bank's data.

Preemptive move

Shin Hyun Song, the bank's governor, said household borrowing is continuing to rise amid expectations of further home price increases in the greater capital area, making it necessary for policymakers to "remain vigilant regarding the risks of financial imbalances."

He said the rate hike was also a preemptive move to curb inflationary pressures and that consumer prices are expected to remain above the bank's target until sometime in 2028.

> The bank's decision to raise the policy rate was not a unanimous decision

Shin said it would take time for the country's export gains to translate into meaningful increases in consumers' spending capacities and that the bank's tight monetary policy should be complemented by fiscal measures to ease the burden on households.

The bank's decision to raise the policy rate was not a unanimous decision, with two of the seven members of its monetary policy committee arguing to keep the rate at 3%.