

Analyst

Travis Tan Wei Xuan

Lead Global Macro Analyst

travistan@u.nus.edu

Basic Information

Nominal GDP (USD bn)	445.3
M2 (USD bn) (Dec 25)	3.13
CPI YoY (Q4 25)	2.3%
GDP YoY (Q4 25)	1.5%
PPI YoY (Q4 25)	1.9%
Con. Confidence (Jan 26)	110.8
Currency	Won (KRW)
Exchange Rate (USD/KRW)	1,446.18

Growth Outlook

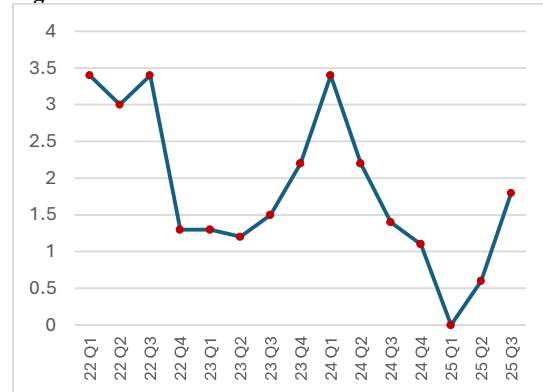
A Transition Year of Sub-Potential Expansion

Korea's growth outlook for 2025 is characterised by a modest and below-potential expansion, reflecting a transition year between the post-export rebound phase and a more broad-based recovery expected in 2026. Real GDP growth is projected at approximately 1.2% YoY in 2025, slowing from 2.0% in 2024, as the impulse from export growth moderates and domestic demand recovers only gradually.

Quarterly growth momentum improved through 2025, with GDP expanding 1.2% QoQ in Q3, driven primarily by private consumption and exports, lifting Q3 GDP growth to 1.7% YoY from 0.6% in the prior quarter. However, forward-looking indicators suggest that this momentum is unlikely to accelerate meaningfully into year-end.

From a structural perspective, Korea continues to face a declining potential growth rate, driven by weak productivity trends and adverse demographics. As a result, even cyclical improvements in activity translate into relatively subdued headline growth, reinforcing 2025's profile as a stabilisation year rather than a strong recovery phase.

Figure 1: South Korea GDP YoY



Source: Bloomberg

Domestic Demand

Gradual Consumption Recovery, Investment Divergence

Private consumption is expected to grow by around 1.3% YoY in 2025, improving from weaker levels seen in 2024 but remaining below historical averages. Consumption recovery has been supported by easing financial conditions and improving labour market sentiment. However, household balance sheet constraints continue to cap discretionary spending, particularly high debt burdens.

Government consumption has provided an additional buffer to domestic demand, contributing positively to overall growth during the year. However, this support does not fully offset weakness in fixed investment.

Investment dynamics remain bifurcated. Equipment investment expanded modestly by 2.5% YoY, almost entirely driven by semiconductor-related capital expenditure, while investment in most other manufacturing segments remained subdued. This underscores the economy's continued reliance on a narrow set of high-tech industries for growth.

Construction investment remains the main drag, contracting sharply by -9.1% YoY in 2025, as the translation of construction orders into actual activity continues to lag. Despite some increase in new orders, tight financing conditions and project restructuring have delayed on-site

execution, particularly in residential and project-finance-linked developments.

Exports

Semiconductor-Led Resilience Amid Slowing External Demand

Korea’s external sector remains resilient but is losing momentum in 2025. Export volumes are estimated to grow 4.1% YoY, down from stronger gains in the earlier part of the cycle, as front-loading effects fade and external demand softens.

The export mix remains highly uneven:

- Semiconductor exports continue to outperform, benefiting from strong global demand for high-end memory and logic chips, rising memory prices, and tight supply conditions for legacy chips.

Figure 2: YoY Growth of Chip vs Non-Chip Exports
Export Growth Is Increasingly Concentrated in Semiconductors



Figure 3: Monthly Chip Output and Shipments
Semiconductor Inventories Continue to Normalise



Source: CEIC

- Exports to the United States declined sharply, reflecting the impact of tariff hikes.
- Exports to China also weakened, constrained by soft domestic demand and continued stress in China’s property sector.

- In contrast, semiconductor shipments to Taiwan and other Asian economies surged, helping to stabilise aggregate export growth.

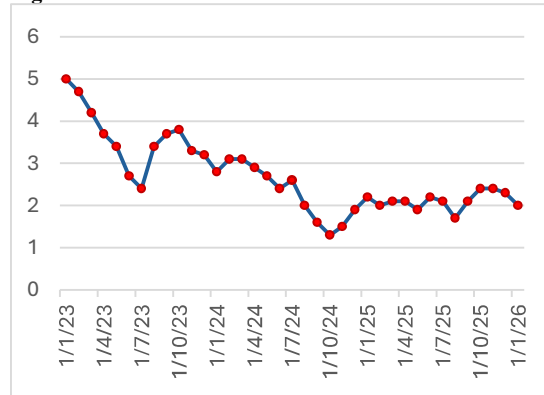
Despite moderating export growth, Korea continues to run a large current account surplus, supported by favourable terms of trade and relatively subdued import growth. The current account balance is estimated at approximately USD 115.9bn in 2025, reinforcing Korea’s external buffer strength.

Inflation

Anchored Near Target, Gradual Firming Ahead

Inflation in 2025 remains well-anchored, with headline CPI rising around 2.1% YoY, broadly in line with the Bank of Korea’s target and little changed from 2024 levels. Disinflationary forces from lower global energy prices have been offset by improving domestic demand and exchange-rate-related import price pressures.

Figure 4: South Korea CPI YoY



Source: Bloomberg

Core inflation (excluding food and energy) averaged approximately 1.9% YoY, indicating that underlying demand-driven price pressures remain contained. While services inflation has shown signs of firming alongside consumption recovery, weak construction activity and cautious household spending continue to limit broad-based inflation acceleration.

Looking ahead, inflation dynamics in late-2025 are likely to remain stable rather than re-accelerative, with Q4 CPI at 2.3% YoY, setting the stage for modest inflation firming only in 2026 as domestic demand strengthens further.

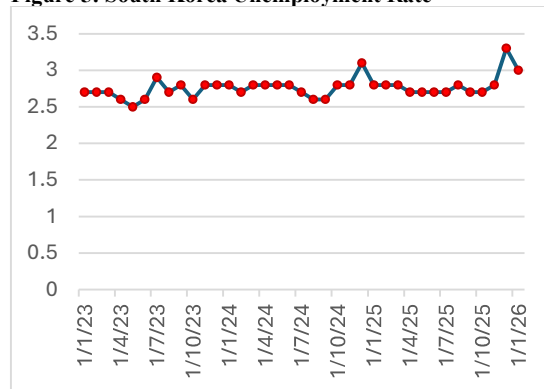
Labour Market

Structurally Tight, Gradually Improving

Labour market conditions improved modestly in 2025, with employment gains concentrated in service sectors supported by public programmes. The number of employed persons increased by approximately 170,000, though this represents a slower pace than historical norms due to demographic headwinds.

The unemployment rate remained low at around 2.8%, reflecting structural labour market tightness rather than cyclical strength. Labour supply constraints continue to limit upside potential for employment growth, reinforcing the view that improvements in household income will remain gradual.

Figure 5: South Korea Unemployment Rate



Source: Bloomberg

Market Implications

From a market perspective, Korea in 2025 remains characterised by:

- High growth concentration in semiconductors and related upstream industries.
- Limited spillover into broader investment and construction activity.
- Stable inflation that limits near-term macro volatility.
- Strong external balances that provide resilience against global shocks.

This macro configuration leaves Korean assets highly sensitive to global semiconductor cycles and external demand conditions, while domestic growth engines are only slowly re-engaging. As a result, 2025 sets up as a transitional year, with

limited upside surprises but improving macro foundations heading into 2026.

Fiscal Policy

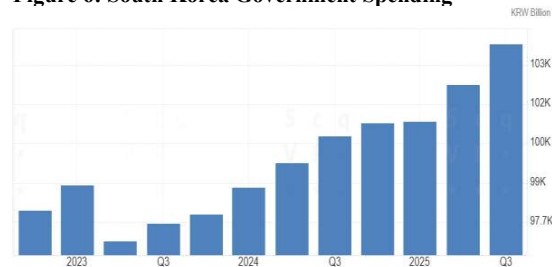
Prolonged Expansion Amid Rising Structural Deficits

Korea's fiscal policy has decisively shifted toward a prolonged expansionary stance, reflecting persistent growth underperformance and limited traction from private-sector demand. President Lee Jae-myung has explicitly stated that the government has "no choice" but to maintain expansionary fiscal policy for the time being, signalling that fiscal support will remain a key macro stabiliser through at least 2027, including in the formulation of the 2027 budget.

This policy direction is grounded in the government's assessment that the economy remains on a downward or sub-trend trajectory, requiring state intervention to arrest further deceleration and engineer a cyclical bottom. With GDP growth estimated at 1.5% YoY in Q4 2025 and full-year growth at around 1.2%, well below Korea's estimated potential growth rate of around 1.9%, fiscal policy has increasingly taken on a counter-cyclical role in supporting domestic demand.

The expansionary shift is most evident in the scale of fiscal spending. The government's budget proposal sets total expenditure at KRW 728 trillion, marking the first time headline spending has exceeded KRW 700 trillion in a main budget. The KRW 55.3 trillion YoY increase represents the largest nominal spending hike on record, underscoring the strength of the fiscal impulse.

Figure 6: South Korea Government Spending



Source: Trading Economics

Looking ahead, expenditure growth is projected to remain elevated, as total spending is expected

to surpass KRW 800 trillion by 2028 and reach KRW 834.7 trillion by 2029.

Total expenditure is projected to grow at an average annual rate of 5.5% from 2025 to 2029, significantly outpacing trend GDP growth. This reflects a deliberate effort to use fiscal policy as the primary lever to support activity amid weak private-sector momentum.

While spending has accelerated sharply, revenue growth has lagged, exacerbating fiscal imbalances. Total fiscal revenue is projected to grow at an average annual rate of 4.3%, constrained by factors like slow economic growth and a narrowing tax base.

For 2026, total revenue is projected at KRW 674.2 trillion, implying a headline fiscal deficit of KRW 53.8 trillion. More concerning from a fiscal sustainability perspective is the managed fiscal balance (excluding social security surpluses such as the National Pension Service), which is projected to show a deficit of KRW 109 trillion. This deficit is expected to widen further to KRW 128.9 trillion by 2028, surpassing the previous record of KRW 117 trillion recorded in 2023.

The consolidated fiscal balance is expected to remain in deficit by more than 4% of GDP each year, suggesting that fiscal loosening is not merely cyclical but increasingly structural in nature.

As fiscal deficits are financed primarily through bond issuance, public debt dynamics are deteriorating steadily. Korea’s debt-to-GDP ratio, estimated at 49.1% at end-2025, is projected to rise to 51.6% by end-2026, breaching the psychologically important 50% threshold for the first time.

In the near term, expansionary fiscal policy is likely to remain effective in supporting consumption and cushioning downside risks.

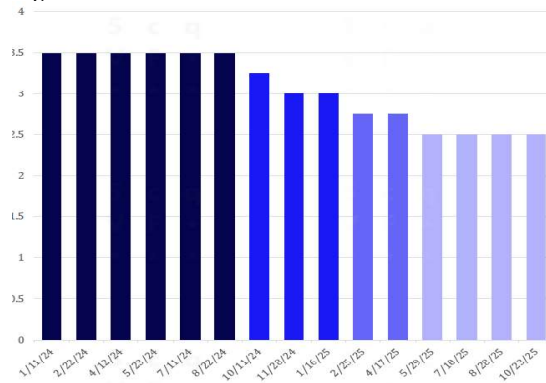
However, excessive reliance on short-term fiscal stimulus risks causing large deficits without addressing Korea’s declining potential growth, which is increasingly driven by structural factors such as weak productivity growth and demographic decline.

Monetary Policy

From Easing to Cautious Neutrality

The BOK has moved decisively away from an explicit easing bias, signalling that the rate-cut cycle that began in late 2024 is nearing its end. After cutting rates four times since October 2024, the BOK has kept its benchmark seven-day repurchase rate unchanged at 2.50% for four consecutive meetings through November 2025.

Figure 7: BOK Base Rate



Source: Bloomberg

Crucially, in its November policy statement, the BOK drifted away from a dovish tone, replacing it with more conditional guidance that future decisions will depend on inflation, growth and financial-stability risks. Governor Rhee Chang-yong has emphasised that the policy rate is now “around the level of the neutral rate”, suggesting that monetary policy is neither clearly restrictive nor stimulative at current settings.

While the BOK has stopped short of formally declaring the end of easing, the shift in communication marks a transition toward a data-dependent, risk-management framework, rather than an outright growth-supportive stance.

Financial stability considerations have become the dominant constraint on monetary policy. The BOK has repeatedly highlighted risks stemming from:

- Rising housing prices, particularly in the Seoul metropolitan area, where apartment prices have risen for over 40 consecutive weeks

- Renewed household debt accumulation, with mortgage lending increasing by KRW 11.6 trillion in Q3 2025
- Heightened FX market volatility, driven by capital outflows and overseas equity investment by domestic residents and pension funds
- The won initially strengthened before reversing, as the BOK refrained from commenting on currency levels
- Rate markets have begun to price a prolonged hold, rather than further near-term easing

The central bank has warned that additional rate cuts could reignite speculative activity in the property market, further exacerbating household leverage. At the same time, the weak won raises concerns about inflation pass-through and balance-sheet effects for domestically oriented firms, widening the gap between export-oriented winners and domestic-focused sectors.

In response, the BOK has signalled that it will:

- Strengthen FX market monitoring
- Stand ready to deploy market-stabilisation measures in the event of excessive volatility or herd behaviour
- Coordinate closely with the government on financial-stability and liquidity provisions

These considerations help explain why the board's tolerance for further easing has declined despite still-subdued underlying growth.

Policy deliberations within the BOK have become increasingly finely balanced. At the November meeting, board members were evenly split on whether to keep the option of a cut open or to maintain rates, highlighting growing internal divergence. Surveys of economists show expectations for the next rate cut being pushed back to late-2026, with a growing consensus that the easing cycle may already be complete.

Market reaction to the BOK's recent decisions reflects this reassessment:

- 3-year government bond yields rose following the removal of the easing-bias language

The BOK has been careful to avoid pre-committing to either direction, repeatedly emphasising that future moves will depend on incoming data, the Fed's policy trajectory, and domestic financial conditions.

Looking ahead, monetary policy is likely to remain on extended hold through most of 2026, with the policy rate anchored at 2.50% unless either a clear deterioration in growth or renewed widening of the output gap is shown, or a inflation or financial-stability risks materialises, which would firmly close the easing window and entrench a neutral stance

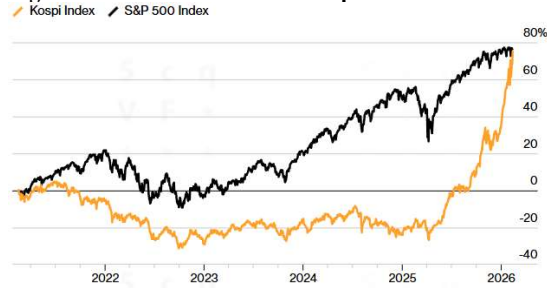
In this context, Korea's monetary policy framework is best characterised as one of constrained optionality: the BOK retains theoretical room to cut, but rising housing, FX and inflation risks have materially raised the bar for further accommodation.

Equities

AI-Driven Rally, Concentrated Leadership

South Korea's equity market has delivered an exceptional performance in 2025, marking one of the strongest rallies in its modern market history. The KOSPI Composite Index has surged by over 76% year-to-date, making it the best-performing major equity index globally in 2025 and putting the market on track for its strongest annual gain in roughly 25 years. As of the latest close, the index stands at around 4,220, with market participants increasingly discussing the possibility of a break above the 5,000 level should momentum persist.

Figure 8: KOSPI's Fierce Catch Up to S&P 500



Source: Bloomberg

South Korea's 2025 equity rally has been overwhelmingly driven by memory semiconductors, with Samsung Electronics (+125% YTD) and SK Hynix (+268% YTD) accounting for roughly 30% of KOSPI index weight and contributing close to half of total index gains. Strong demand for high-bandwidth memory (HBM), DDR5 and enterprise NAND has triggered a sharp earnings upgrade cycle and sustained valuation re-rating.

Industry trackers increasingly characterise the current upturn as a "memory supercycle", with tight supply conditions expected to persist until at least 2027 and limited new capacity coming online before 2028. Korea's dominance in advanced memory positions the sector as the primary conduit through which global AI capex translates into domestic earnings and equity performance, reinforcing its central role in the market outlook.

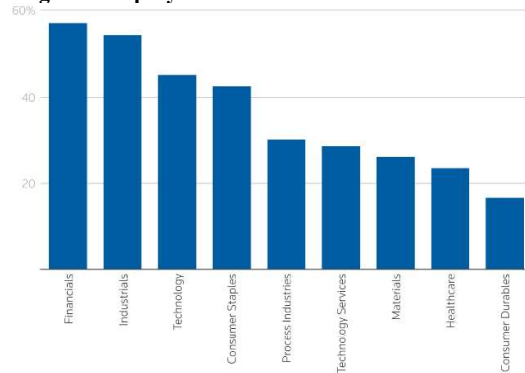
Beyond semiconductors, investor attention has broadened to AI-linked infrastructure, particularly power generation, grid equipment and nuclear energy. Companies such as Hyosung Heavy Industries (+426.33% YTD) and Doosan Enerbility (+259.16% YTD) have seen outsized gains as markets increasingly recognise that AI deployment is ultimately constrained by electricity availability rather than compute alone.

The rapid expansion of global data-centre capacity has led to expectations of a multi-year surge in electricity demand, driving re-rating across power and grid-related stocks. With Korea well-positioned in high-end transformers, nuclear equipment and grid technology, this segment is increasingly viewed as a structural, long-duration beneficiary of the AI cycle, rather than a short-term thematic trade.

The defence sector has emerged as another key pillar of Korea's equity performance, supported by rising global defence spending and shifts in geopolitical alliances. Korean contractors have benefited from their ability to deliver advanced systems at competitive costs and on shorter timelines compared with Western peers.

Companies such as Hanwha Aerospace (+89.72% YTD) and Hanwha Ocean (+96.16% YTD) have posted strong gains on the back of large export orders, particularly to Europe. With global re-armament increasingly viewed as a multi-year structural trend, defence is likely to remain a durable earnings growth sector, less exposed to domestic cyclical fluctuations.

Figure 9: Equity Returns on Various Sectors in 2025



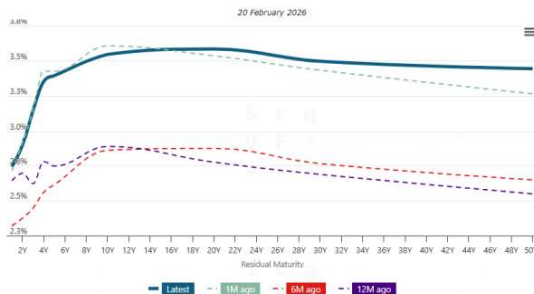
Source: Reuters

While South Korea's equity market has delivered exceptional headline returns, performance remains highly concentrated in a narrow set of sectors tied to the global structural themes of AI, semiconductors and defence. This concentration amplifies upside during favourable cycles but also increases sensitivity to sector-specific shocks. As such, selective sector exposure rather than broad index positioning is likely to remain critical for navigating Korea's equity market going forward.

Treasuries

Curve Steepening, Supply Pressure and Rising External Sensitivity

Figure 9: South Korea Yield Curve



Source: World Government Bonds

South Korea's government bond market has undergone a sharp repricing in early 2026 as expectations for further monetary easing both domestically and in the United States have diminished. As of end-January, the 3-year Korean Treasury Bond (KTB) yield rose to 3.138%, up 18.5bp month-on-month, while the 10-year KTB climbed to 3.607%, marking a 22.2bp increase over the same period. The sell-off reflects a combination of domestic policy recalibration. This was followed by the BOK's decision to hold its policy rate at 2.50%, as well as external spillovers from higher US and Japanese yields.

The removal of explicit easing language by the BOK, coupled with firmer inflation readings (CPI at 2.3% YoY in Q4) and resilient activity data (Q4 GDP at 1.5 % YoY), has led markets to reassess the probability of near-term cuts. In parallel, the Federal Reserve's steady policy stance and strong US macro data have pushed US Treasury yields higher, further tightening global financial conditions and reducing the buffer for lower-yielding markets such as Korea.

A defining feature of recent moves has been the steepening of the KTB curve, driven by both domestic and global catalysts. The yield spread between 3-year and 10-year KTBS has widened toward ~50bp, the steepest since 2022. Bloomberg analysis indicates that South Korea's sovereign curve is the most sensitive in emerging Asia to US Treasury curve steepening, with the Korean curve steepening by approximately 0.41bp for every 1bp move in the US curve during prior episodes.

This vulnerability stems from two structural factors:

1. **Low yield buffer:** Korean yields remain relatively compressed compared with US Treasuries, making them more exposed to global duration repricing.
2. **High foreign participation:** Foreign holdings have risen to approximately 12% of outstanding KTBS, the highest level since 2009, with roughly \$93 billion in net inflows over the past 12 months.

Foreign investors, many of whom hedge currency exposure, are drawn by attractive cross-currency adjusted yields (10-year KTB hedged yield ~4.88% vs ~4.30% on US Treasuries). However, this positioning increases sensitivity to global curve shifts and capital flow reversals.

Figure 10: 10 Yr KGB Yield Trend



Source: Trading Economics

Domestic supply dynamics are also contributing to upward pressure on yields. The volume of maturing bank and financial bonds in Q1 next year totals KRW 72.4 trillion, approximately 17.9% higher than the three-year average. In addition, corporate bond maturities next year are estimated at around KRW 78 trillion, exceeding this year's level by roughly KRW 10 trillion.

At the sovereign level, fiscal expansion implies sustained high issuance. With total government expenditure projected at KRW 728 trillion and the fiscal deficit widening to KRW 53.8 trillion, government bond issuance will remain elevated. Expectations of a potential supplementary budget (estimated at ~1.5% of GDP if implemented) further reinforce the risk of additional supply in 2026.

These factors, combined with rising global yields (including upward pressure from Japan and Western Europe), create an environment in which long-term rates may remain structurally biased higher, particularly in the absence of renewed BOK easing.

Despite upward pressure on yields, the ultra-long end of the KTB curve remains structurally supported. Korean life insurers have been significant buyers of 30-year KTBs, with net purchases reaching nearly KRW 8 trillion in 1Q25, the highest in three years. This demand is linked to capital regulation requirements (K-ICS), encouraging duration matching and long-end accumulation.

Additionally, South Korea's scheduled inclusion in the World Government Bond Index (WGBI) from April is expected to attract KRW 75–90 trillion in foreign inflows over time. However, the timing of these inflows limits their ability to alleviate first-quarter supply pressure, suggesting near-term volatility may persist.

The near-term outlook for Korean Treasuries remains biased toward continued curve steepening, driven by global yield dynamics and domestic supply pressures. While front-end yields may stabilise if the BOK signals a prolonged hold at 2.50%, long-end rates are likely to remain sensitive to:

- US Treasury curve moves
- Supplementary fiscal measures
- Inflation expectations amid currency volatility
- Bond supply concentration in early 2026

Overall, South Korea's bond market is transitioning from a rate-cut-driven rally phase to a supply- and global-duration-driven regime, with heightened sensitivity to both external shocks and domestic fiscal expansion.

Trade Idea: Short USD/KRW NDF

Investment Thesis

We recommend positioning short USD/KRW via NDF, targeting a move toward 1420 in the near term, with scope for a medium-term extension toward 1400–1380 should capital inflows remain sustained.

Figure 11: USD/KRW NDF 1D Chart



Source: TradingView

South Korea's macro configuration in 2025 presents a constructive backdrop for KRW appreciation. While growth remains below potential, the economy is characterised by:

- A large and persistent current account surplus (~USD 115.9bn)
- Semiconductor-led export resilience
- Stable inflation anchored near 2%
- A monetary policy stance that has shifted toward neutral, reducing policy-driven depreciation risks

Most importantly, Korea's equity market has become a key FX driver. The KOSPI's strong outperformance and the memory supercycle narrative have attracted renewed foreign investor interest. Moreover, foreign investors added USD 2.01bn WTD into Korean equities, reinforcing structural demand for KRW.

Technical Backdrop

USD/KRW has broken below 1444 (100DMA), triggering follow-through technical selling and accelerating the move toward 1432 intra-day lows. Daily momentum indicators are turning mildly bearish, with RSI declining and risks skewed to the downside.

Key technical levels:

- Support: 1435 (23.6% Fibonacci), 1420 (January low)
- Resistance: 1444 (100DMA), 1452 (50% Fibonacci), 1459 (61.8% Fibonacci, 21 & 50 DMA cluster)

A softer-than-expected US CPI print could reinforce USD weakness and open a test of 1420. Conversely, upside US inflation surprises may trigger short-term USD rebounds, but structural drivers for KRW remain constructive.

Macro Drivers Supporting KRW Strength

1. Semiconductor Cycle Upswing

The ongoing memory supercycle provides earnings visibility and export support through at least 2026, improving Korea's external balance dynamics.

2. Current Account Strength

Korea continues to run a sizeable surplus, reducing vulnerability to external shocks.

3. Neutral BOK Policy Stance

The Bank of Korea has moved away from an easing bias, reducing the probability of rate-driven KRW depreciation.

4. Risk Appetite and Global AI Theme

Broad USD softness and resilient global risk sentiment favour high-beta Asian FX, particularly those tied to technology exports.

Risks to the Trade

- Stronger-than-expected US CPI leading to renewed Fed hawkish repricing
- Sudden reversal in global risk appetite
- Property or financial-stability stress prompting BOK policy shifts
- Abrupt correction in semiconductor equities

Near-term price action may remain sensitive to US data surprises and positioning dynamics, but structural drivers favour a gradual appreciation bias.

Disclaimer

This research material has been prepared by NUS Invest. NUS Invest specifically prohibits the redistribution of this material in whole or in part without the written permission of NUS Invest. The research officer(s) primarily responsible for the content of this research material, in whole or in part, certifies that their views are accurately expressed and they will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this research material. Whilst we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee its accuracy or completeness, and you should not act on it without first independently verifying its contents. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. You may wish to seek advice from a financial adviser regarding the suitability of the securities mentioned herein, taking into consideration your investment objectives, financial situation or particular needs, before making a commitment to invest in the securities. This report is published solely for information purposes, it does not constitute an advertisement and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expressed or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. The research material should not be regarded by recipients as a substitute for the exercise of their own judgement. Any opinions expressed in this research material are subject to change without notice.