



20 January 2025

Economic Letter from Asia: On Korea

A Haver Analytics publication

Link to online article: <https://haverproducts.com/economic-letter-from-asia/>

Written by [Tian Yong Woon](#)

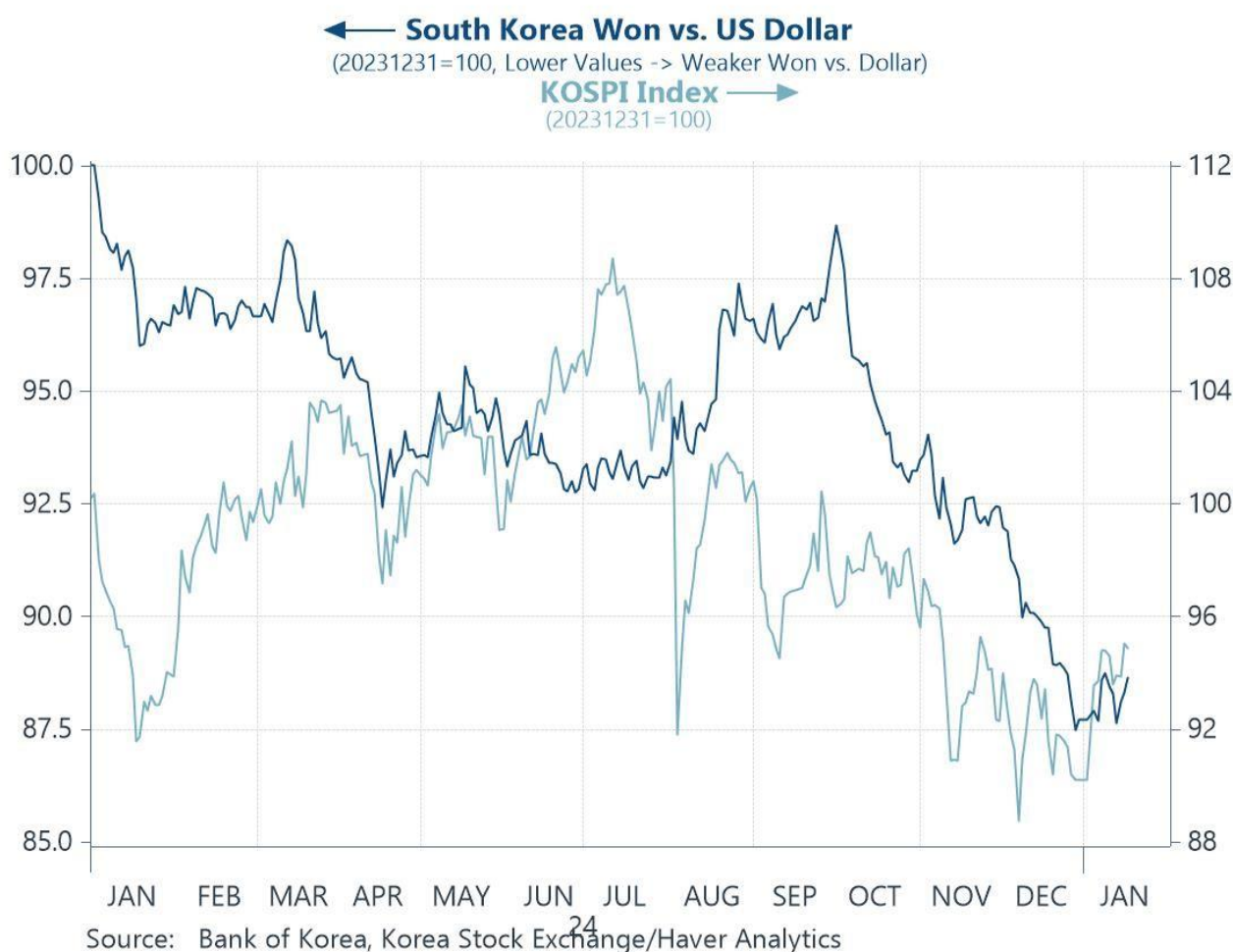
This week we focus on South Korea, where ongoing political uncertainty continues to weigh on the economy. The Korean won remains under pressure, and equities are struggling to mount a meaningful recovery (Chart 1). The political instability has also dampened both consumer and business sentiment (Chart 2), posing a risk to economic activity if the situation persists or worsens. Focusing on the manufacturing sector, recent PMI readings indicate that the economy has struggled to maintain expansion, suggesting that factors beyond political instability, including external pressures, have been contributing to the challenges (Chart 3). Despite these headwinds, the Bank of Korea (BoK) opted to hold interest rates steady last week, pausing its easing cycle for now, despite the aforementioned economic constraints (Chart 4). A closer look reveals both domestic and external factors likely influenced the BoK's decision. Domestically, the interim political flux has certainly played a role. Externally, considerations include more muted market expectations of Fed rate cuts this year (Chart 5) and potential trade-related actions from the newly re-elected Trump administration (Chart 6).

Impacts of recent political developments

Political uncertainty continues to weigh heavily on South Korean financial markets, with the won remaining on the back foot after being the worst-performing Asian currency last year. The South Korean won has weakened significantly in recent months, particularly against the US dollar (Chart 1), depreciating by around 11% since early October. While the broader impact of a strengthening dollar has contributed to this decline, the won has been especially impacted by domestic political turmoil, notably following President Yoon's short-

lived declaration of martial law last December. Although the currency saw some temporary relief after Yoon's impeachment and arrest, it has yet to mount a substantial recovery, reflecting ongoing instability in South Korea's political landscape. Meanwhile, equities are still struggling to recover from last year's losses. For context, Yoon declared martial law in early December of last year, accusing the main opposition party of engaging in "anti-state activities" and collaborating with "North Korean communists." This drastic decision followed months of Yoon's deep unpopularity, which some political commentators believe contributed to the opposition party's landslide victory in the parliamentary elections earlier that year. However, Yoon quickly rescinded the declaration just hours after it was made, following its overwhelming rejection by lawmakers and widespread public protests.

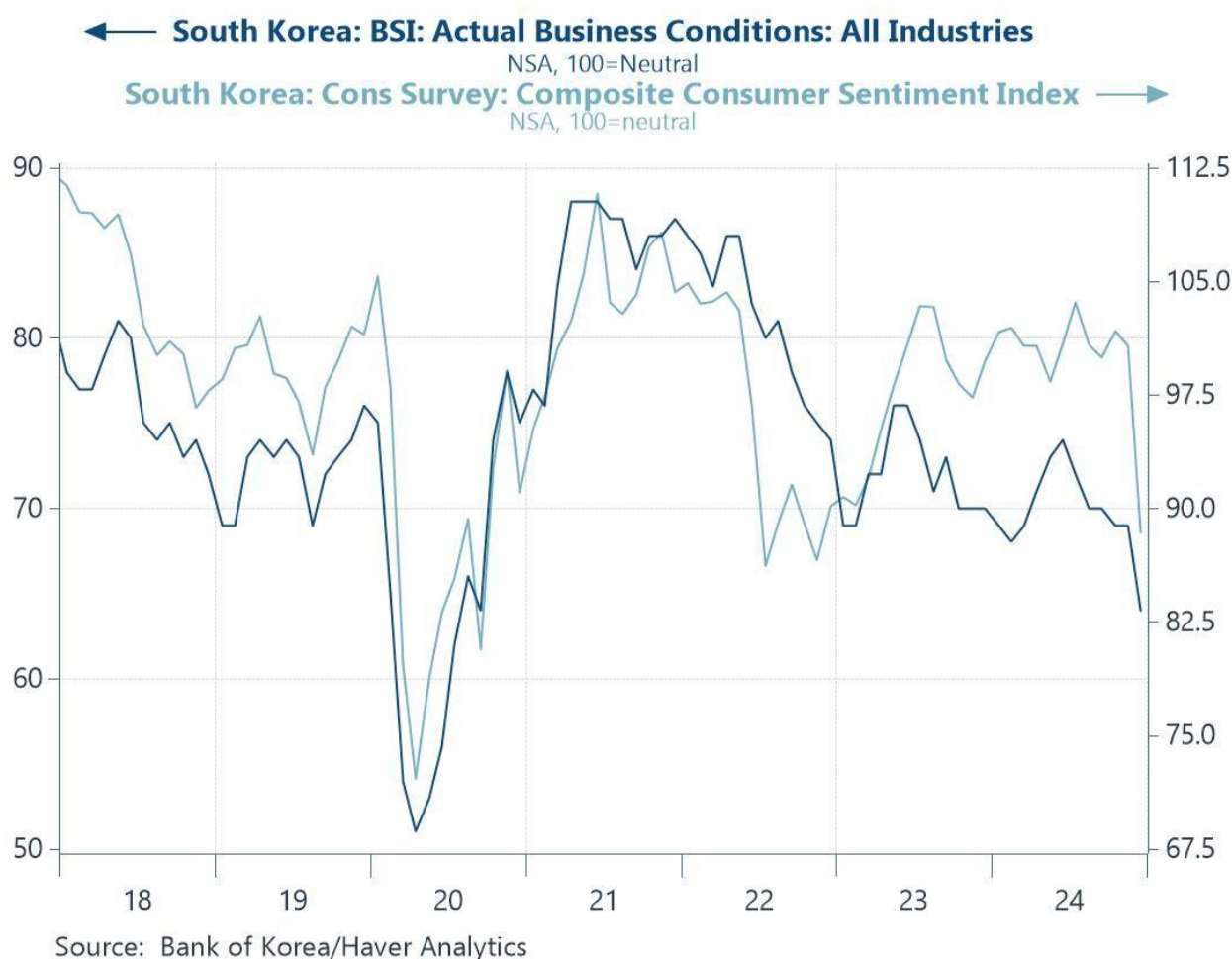
Chart 1: South Korean won and the KOSPI stock index



The dampened sentiment surrounding South Korea is reflected not only in financial markets but also in recent business and consumer sentiment surveys, which have plunged amid political turmoil. Specifically, consumer sentiment dropped by over 12 index points in December 2024, marking the first negative sentiment reading in

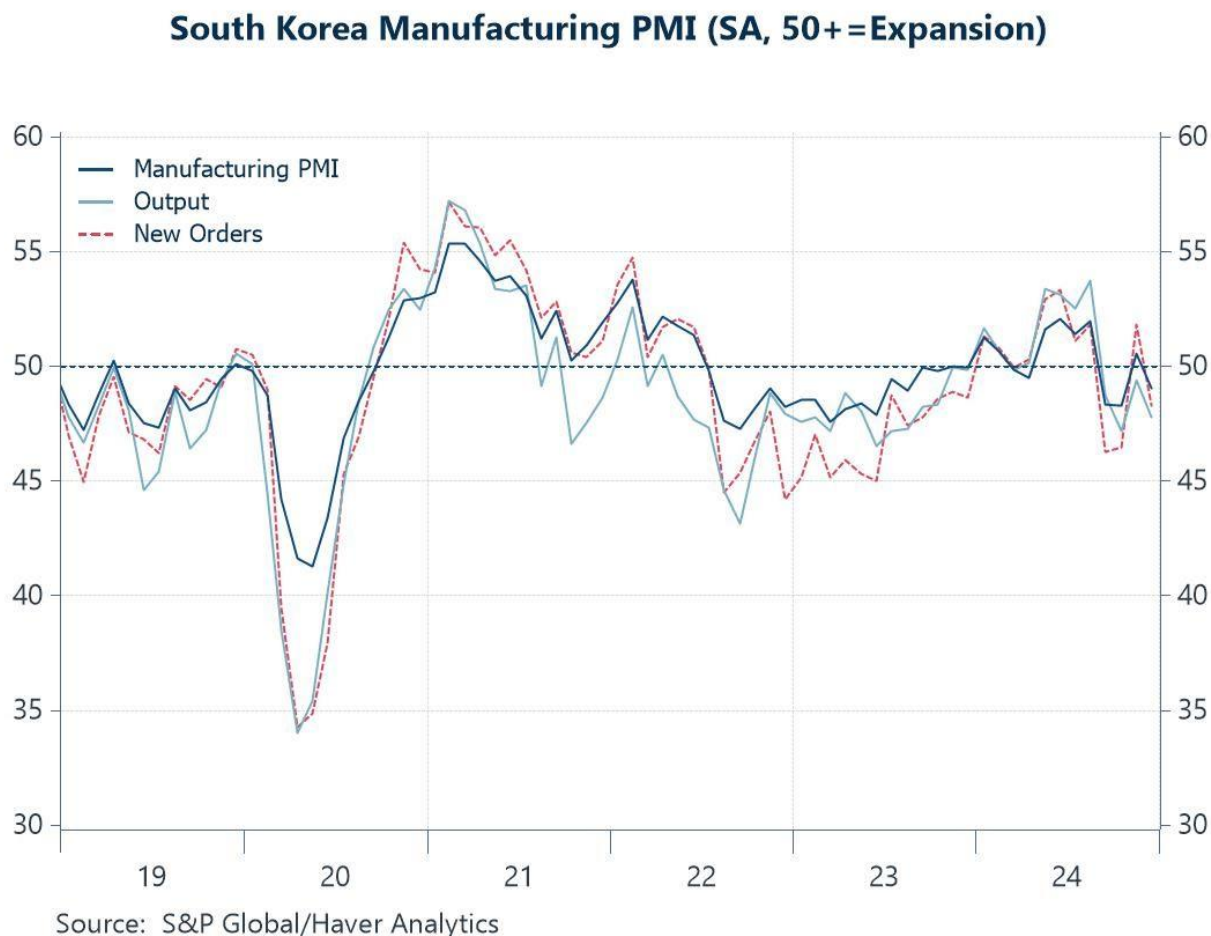
more than six months (Chart 2). Business sentiment also declined, though to a lesser degree, dipping further into negative sentiment territory during the period. While not yet fully reflected in hard economic data, sentiment indicators like those discussed above can often influence actual economic behaviour. As such, South Korea's ongoing political instability risks adversely affecting economic activity, especially if it persists.

Chart 2: South Korea business and consumer sentiment



Turning to other survey results, South Korea's latest PMI readings also showed deterioration in December. Specifically, the manufacturing sector slipped back into contraction, driven by declines in both output and new orders (Chart 3). However, it is important to note that South Korea's manufacturing sector, as indicated by the PMI, has struggled to stay in expansionary territory for several months, suggesting that factors beyond recent political instability have been at play. In particular, external factors have been weighing on the manufacturing sector, a theme we will explore further below.

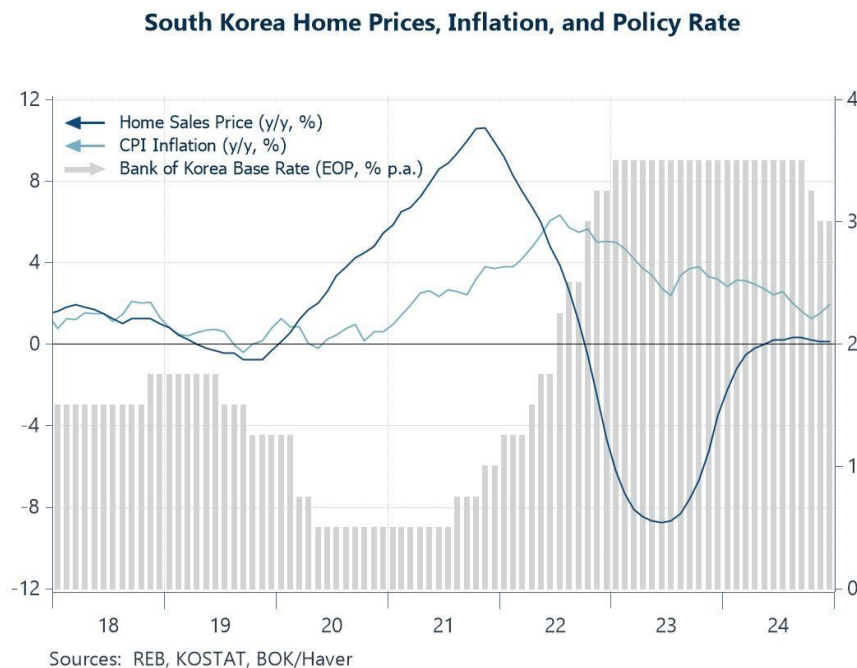
Chart 3: South Korea manufacturing PMI



The Bank of Korea

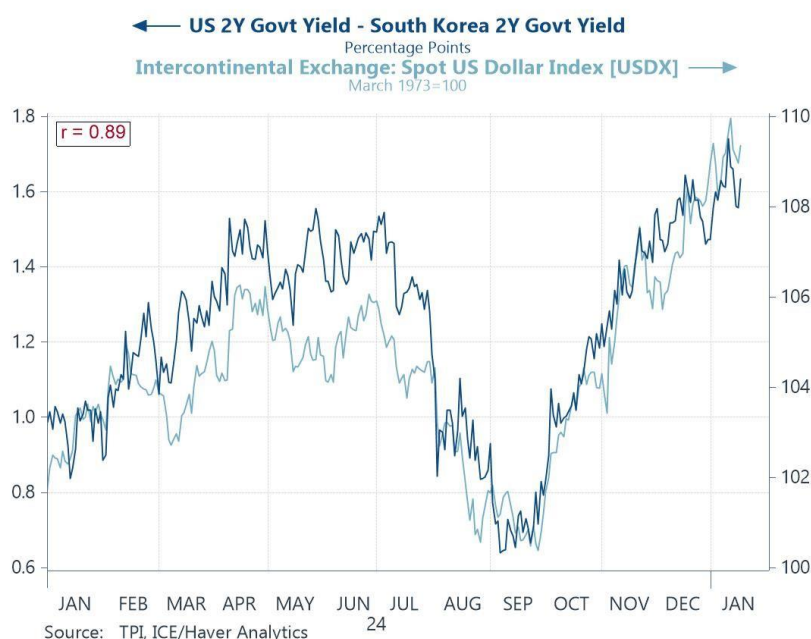
The Bank of Korea (BoK) surprised investors last week by keeping its policy rates unchanged, effectively pausing its easing cycle for now (Chart 4). This decision, taken despite the sentiment-dampening developments outlined earlier, is justifiable for two key reasons. First, on the external front, the BoK sought to avoid exacerbating downward pressure on the won, which could have been triggered by a widening of yield differentials had it opted for further rate cuts. Second, its cautious, wait-and-see approach amid ongoing domestic political uncertainty, allows the central bank to make more informed decisions once the political landscape stabilizes. However, one could argue that withholding further monetary easing could leave struggling sectors without the support they need. Given the ongoing uncertainties, the BoK has also indicated that South Korea's GDP growth is likely to fall below its November forecasts of 2.2% for 2024 and 1.9% for 2025.

Chart 4: South Korea home sales prices, inflation, and policy rate



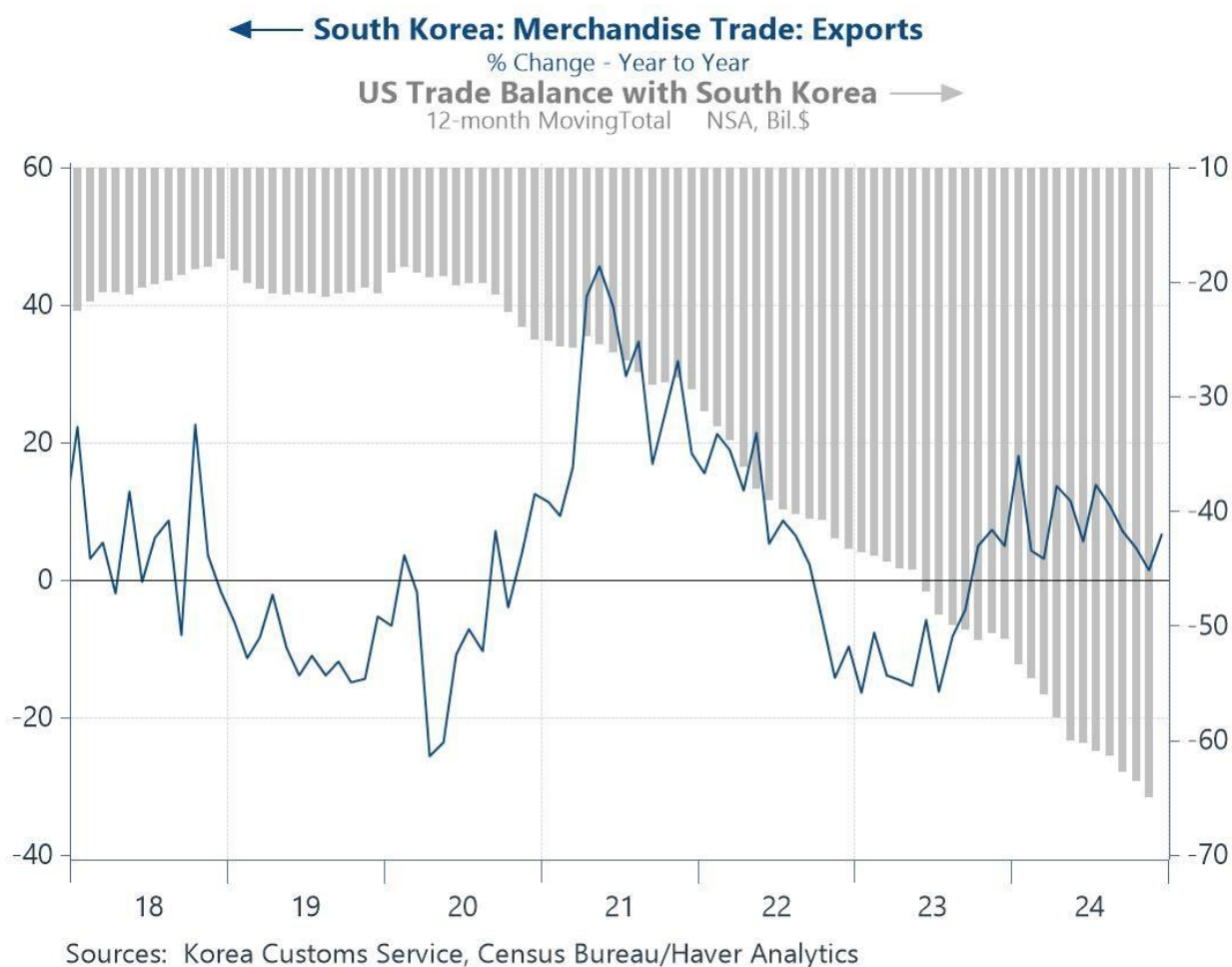
Delving deeper into the external considerations mentioned earlier, the BoK has had to contend with a strengthening US dollar as markets increasingly scaled back expectations of further US Fed easing this year. The reduction in Fed rate cut expectations has pushed US yields significantly higher since his electoral victory last year (Chart 5). This, in turn, has made US yield differentials with other economies, including South Korea, less favourable. As a result, investor demand for the US dollar has increased, leading to sell-offs of other currencies, including the won. It is likely that the BoK took these yield differential considerations into account when deciding to hold its policy rate last week.

Chart 5: The US dollar and yield differentials between the US and South Korea



Considerations regarding Fed policy are likely not the only concerns South Korea faces from the US. The potential direct impact of trade-related actions by US President Trump’s administration is also a significant worry. This is especially true given Trump’s hawkish stance on trade and his goal of reducing the US trade deficit through tariff-related measures. In this context, South Korea has particular reason for concern, as it recorded the 8th largest trade deficit with the US in 2023. This is concerning because exports have been a key driver—often the main driver—of South Korea’s recent GDP growth. Notably, the US has increasingly accounted for a larger share of South Korea’s exports, reaching just over 18% in 2024. In response, South Korean authorities have already begun considering measures, such as purchasing more oil and gas from the US, to help reduce the trade surplus with the US. However, it remains to be seen whether these actions will be enough to significantly reduce the surplus and avoid potential US countermeasures.

Chart 6: South Korea's export growth and the US’ trade balance with South Korea



About the author



Haver Analytics is pleased to bring [Tian Yong Woon's](#) commentaries on the state of the global economy to its clients.

Tian Yong joined Haver Analytics as an Economist in 2023. Previously, Tian Yong worked as an Economist with Deutsche Bank, covering Emerging Asian economies while also writing on thematic issues within the broader Asia region. Prior to his work with Deutsche Bank, he worked as an Economic Analyst with the International Monetary Fund, where he contributed to Article IV consultations with Singapore and Malaysia, and to the regular surveillance of financial stability issues in the Asia Pacific region. Tian Yong holds a Master of Science in Quantitative Finance from the Singapore Management University, and a Bachelor of Science in Banking and Finance from the University of London.

Data featured in this commentary:

Chart 1: South Korean won and the KOSPI stock index

Series 1: `index((1 / X542USE@INTDAILY),20231231=100)`

1

X542USE@INTDAILY [Korea: US\$ Exchange Rate: Basic Rate (Won/US\$)]

Series 2: `index(S542CEX@INTDAILY,20231231=100)`

S542CEX@INTDAILY [Korea: Stock Price Index: KOSPI (Jan-4-80=100)]

Chart 2: South Korea business and consumer sentiment

Series 1: `N542VB@EMERGE`

N542VB@EMERGE [South Korea: BSI: Actual Business Conditions: All Industries (NSA, 100=Neutral)]

Series 2: `N542VCC@EMERGE`

N542VCC@EMERGE [South Korea: Cons Survey: Composite Consumer Sentiment Index (NSA, 100=neutral)]

Chart 3: South Korea manufacturing PMI

Series 1: `S542M@MKTPMI`

S542M@MKTPMI [Korea PMI: Manufacturing (SA, 50+=Expansion)]

Series 2: `S542MG@MKTPMI`

S542MG@MKTPMI [Korea PMI: Manufacturing Output (SA, 50+=Expansion)]

Series 3: `S542MO@MKTPMI`

S542MO@MKTPMI [Korea PMI: Manufacturing New Orders (SA, 50+=Expansion)]

Chart 4: South Korea home sales prices, inflation, and policy rate

Series 1: `yyr%(N542HJ@EMERGEPR)`

N542HJ@EMERGEPR [South Korea: Home Sales Price (NSA, Jun-21=100)]

Series 2: `yyr%(N542PC@EMERGEPR)`

N542PC@EMERGEPR [South Korea: CPI: All Items (NSA, 2020=100)]

Series 3: N542RCT@EMERGEPR

N542RCT@EMERGEPR [South Korea: Bank of Korea Base Rate (EOP, % p.a.)]

Chart 5: The US dollar and yield differentials between the US and South Korea

Series 1: (R111M2Y@INTDAILY - R542M2Y@INTDAILY)

R111M2Y@INTDAILY [United States: 2 Year Treasury Bond Mid Yield (% p.a.)][I]

R542M2Y@INTDAILY [South Korea: 2 Year Treasury Bond Mid Yield (% p.a.)][I]

Series 2: DXYSPOT@FFUTURES

DXYSPOT@FFUTURES [Intercontinental Exchange: Spot U.S. Dollar Index [USDY] (March 1973=100)]

Chart 6: South Korea's export growth and the US' trade balance with South Korea

Series 1: yyr%(N542IXD@EMERGEPR)

N542IXD@EMERGEPR [South Korea: Merchandise Trade: Exports (NSA, Mil.US\$)]

Series 2: movt(TMBCO@USECON,12)

TMBCO@USECON [Trade Balance: Republic of Korea: Customs Value (NSA, Mil.\$)]

For more info on our databases, please email sales@haver.com

