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MACRO PICTURE:

**South Korea: Economy Stalls Amid Political
Turmoil and US Trade Pressure**

By

Nato Balavadze



13 June 2025

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For information about Rosa&Roubini Associates, please send an email to info@rosa-roubini-associates.com or call +44 (0)20 7101 0718.

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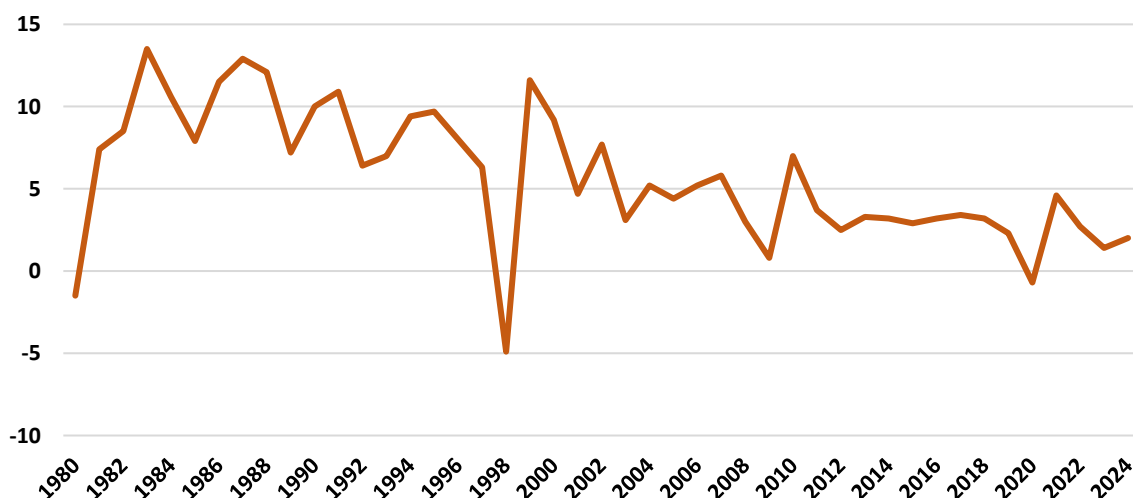
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Executive Summary

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- ✦ President Yoon was impeached after an attempted power grab, triggering only the second snap election in democratic South Korean history; opposition leader Lee Jae-myung won, campaigning on economic justice and redistribution.
- ✦ Lee ran as a “Korean Bernie Sanders,” promising jobs, fairness, and stronger social support, though his legal troubles remain a polarizing issue.
- ✦ Economic slowdown deepens. South Korea’s GDP shrank 0.2% in Q1, with exports, investment, and consumption all stalling amid delayed stimulus and US tariff pressure.
- ✦ While consumer sentiment rebounded to 101.8 in May (from 91.2 in January) due to reduced political uncertainty and potential U.S. tariff relief, manufacturing (PMI: 47.7) and exports remain weak. A slight Q2 rebound is possible, but leadership delays and existing trade barriers limit upside.
- ✦ Productivity growth has stagnated, especially in services and SMEs, with post-pandemic scars including weak corporate investment and labor market exits.
- ✦ Once a driver of growth, the export-led model now faces challenges from weakened global demand and US trade barriers, with manufacturing activity in continued decline.
- ✦ Though risks from Trump’s tariffs may have peaked, a full recovery is unlikely; negotiations on a “July package” to lift tariffs have slowed amid leadership transition.
- ✦ While Lee advocates stimulus, right-wing parties and financial markets are wary. Bond yields are rising on fears of increased debt issuance.
- ✦ The interim government has already enacted austerity, and Lee is constrained by growing defense needs and market pressure, making it hard to expand social spending.
- ✦ Lee proposes tax breaks and support for domestic producers to weather global protectionism.

Key Picture: Annual Real GDP Growth (%)



Source: IMF

Korea is Asia's fourth-largest economy, but real GDP contracted in the first quarter of this year as exports and consumption stalled, amid fears over the impact of Washington's aggressive tariffs as well as the political turmoil at home. Korea has been in trade talks with the US and is seeking a waiver from Trump's tariffs, as Trump pressures Seoul to resolve the large trade imbalance with the US.

Recent Political Developments

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The early presidential election held on 3 June 2025 marked a pivotal moment in South Korea's recent political history. Democratic Party nominee and former opposition leader Lee Jae-myung defeated the ruling People Power Party nominee Kim Moon-soo and Reform Party nominee Lee Jun-seok. Triggered by the Constitutional Court's decision on 4 April to impeach and remove President Yoon Suk-yeol from office, this was only the second snap presidential election in the country's democratic era. In accordance with constitutional requirements, a new vote had to be held within 60 days of the vacancy.

The impeachment came after months of escalating political crisis. Yoon, a right-wing leader lacking a parliamentary majority, had attempted to arrest opposition leaders and shut down the National Assembly, a move widely seen as a failed autogolpe (self-coup). Not only was he ousted from power, but he also now faces trial for abuse of office. Despite resistance from the ruling People Power Party, the judiciary upheld the constitution, facilitating a swift and unprecedented transfer of power.

Against this backdrop of democratic turbulence, Lee Jae-myung, the Democratic Party nominee and former opposition leader, emerged victorious. Having narrowly lost the 2022 election to Yoon by a margin of just 0.7%, Lee's return to the political stage was marked by resilience. In 2024, he survived an assassination attempt, reinforcing his image as a political figure embattled by entrenched elites.

Lee's campaign has consistently emphasized class justice and redistribution. Often invoking the language of economic populism, he has described his mission as that of a "successful Bernie Sanders," pledging to create jobs and build a "fair society." His life story—from growing up in poverty and sustaining a permanent injury in a factory accident at the age of 13, to becoming a key opposition figure—has resonated with South Korea's working class and youth facing economic insecurity.

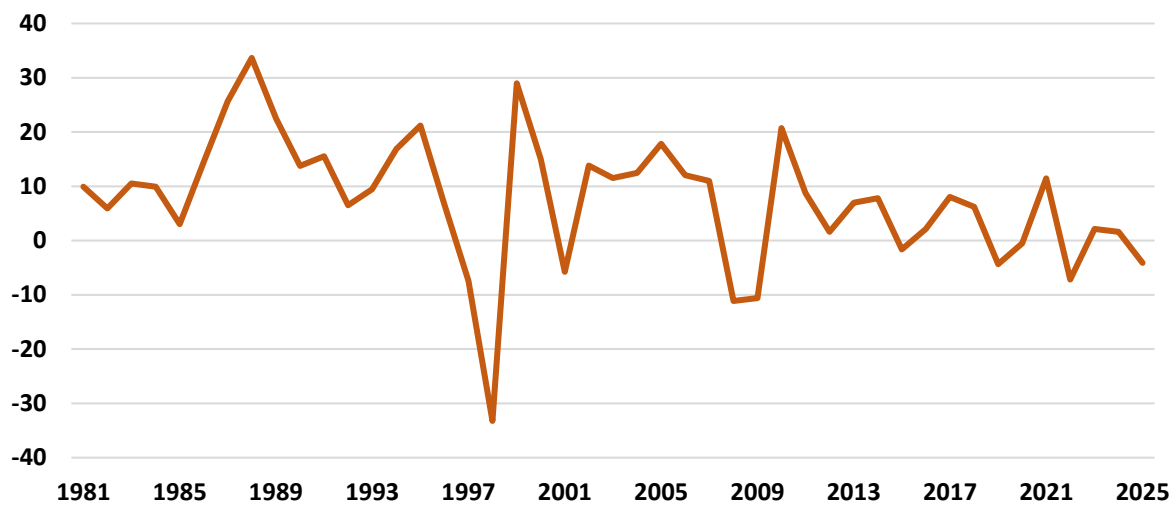
Nevertheless, Lee remains a polarizing figure. He carries multiple legal liabilities, including a conviction for drink driving and ongoing investigations tied to his time as mayor—most notably concerning alleged misuse of public funds and a bizarre corruption scandal involving an underwear manufacturer and purported lobbying efforts toward North Korea. Supporters argue that these charges are politically motivated attempts to suppress a progressive challenger; critics see them as signs of populist opportunism wrapped in personal ambition.

Lee's victory reflects both a rejection of Yoon's authoritarian drift and a broader yearning among the electorate for redistributive change amid deepening inequality and stagnant social mobility. It also opens a new chapter in South Korea's political development—one shaped by a fragile democratic recovery, the rehabilitation of progressive forces, and an electorate increasingly skeptical of elite impunity.

The Korean Economy: From Export Powerhouse to Structural Slowdown

Long hailed as a model of capitalist success, South Korea's economic trajectory has been defined by rapid industrialization, export-led growth, and strategic state intervention. Since 1988, the economy has grown at an average annual rate of 5.5%, largely driven by an impressive 9.3% annual increase in exports. Per capita GDP soared from a mere US\$67 in the early 1950s to over \$34,000 by 2019—a transformation frequently cited as one of the most remarkable economic miracles of the post-war era (**Figure 1**).

Figure 1: Annual Real Per Capita GDP Growth



Source: IMF

This transformation was underpinned by a state-led industrial policy, wherein the government fostered tight partnerships with large family-run conglomerates, or chaebols, such as Samsung and Hyundai. These entities became engines of growth and global competitiveness, especially in heavy industries, electronics, and automobiles.

However, the momentum of this export-industrial complex has weakened over the past decade. Since the 2008 global financial crisis, South Korea has experienced a marked deceleration in both investment and productivity. Labor productivity, which had increased at an average annual rate of 5.5% between 1990 and 2011, has largely stagnated since. The problem is particularly acute in the service sector, where productivity remains only half that of manufacturing and is especially low in small and medium-sized enterprises (SMEs).

The COVID-19 pandemic exposed and deepened existing vulnerabilities. While South Korea's public health response was relatively effective—limiting the GDP contraction to just 1% in 2020, outperforming most advanced economies—the post-pandemic recovery has been subdued. Since 2020, economic growth has slowed to an average of just 2.3% annually. The scars of the pandemic remain evident: corporate profitability has weakened, holding back both investment and hiring; labor market participation has declined due to rising workforce exits; and structural productivity challenges persist.

Recent Macroeconomic Developments

Domestic political turmoil, US tariffs, and delayed policy support have pushed South Korea's economy toward contraction. South Korean economy shrank by 0.2% q-o-q (*c*: -0.2%; *p*: -0.1%) in Q1. GDP showed no year-on-year growth, remaining flat (**Key Picture**).

In Q1, on the expenditure side, private consumption slipped 0.1% as higher spending on goods was offset by lower spending on services. Government consumption was flat. The main drag was investment spending. Construction investment fell 3.1% due to weaker building activity, while facilities investment declined 0.4%, driven by reduced spending on machinery, including semiconductor equipment. Exports declined by 0.6%, driven by weaker shipments of chemical products and machinery. Imports fell by 1.1%, mainly due to reduced energy imports, including crude oil and natural gas. In response, the Bank of Korea cut rates to 2.5%—its fourth cut in six meetings and the lowest since August 2022—while larger fiscal support is expected.

Near-term prospects are also bleak. The bank's decision came alongside a downgrade of the central bank's GDP growth forecast for South Korea. [GDP is forecast to grow just 0.8% in 2025](#), as construction slows and trade

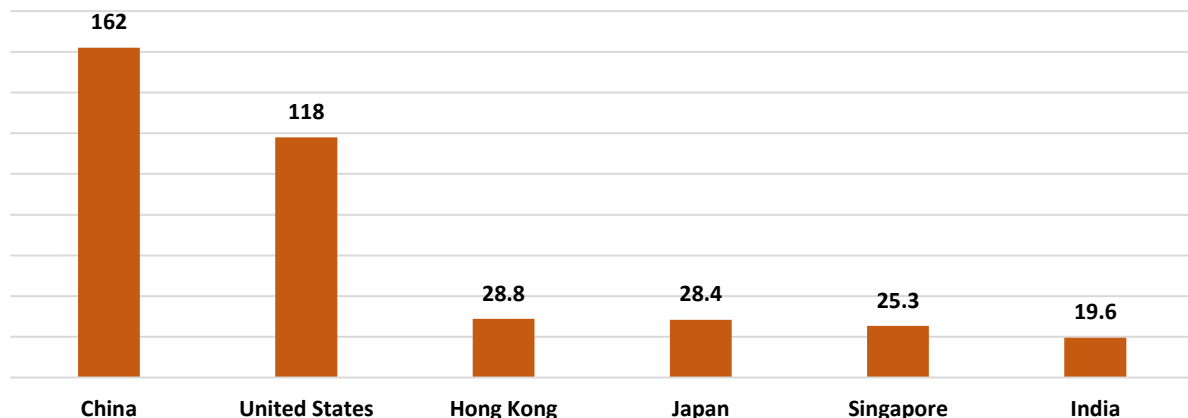
conditions worsen. In the beginning of the year, consumer sentiment has collapsed, with the index falling to 91.2 in January but since then surged to 101.8 in May, marking its highest level since October 2024 when it last reached the same reading. The sharp rebound was driven by reduced political uncertainty and optimism about a possible tariff deal with the U.S., just ahead of South Korea's presidential election following Yoon Suk-yeol's ousting.

Meanwhile, manufacturing remains in a deep slump, with activity well below expansionary levels. The S&P Global South Korea Manufacturing PMI edged up to 47.7 in May 2025 from 47.5 in April, marking a fourth consecutive month of contraction. Output and new orders declined more sharply, with new orders dropping at the fastest pace since June 2020. Export demand weakened, and both purchasing activity and backlogs continued to decline.

Growth may rebound slightly in Q2, supported by easing political uncertainty since April, increased election-related spending. However, consumer sentiment improved only marginally, underscoring the fragility of the recovery.

On the external front, while tariff risks appear to have peaked with President Trump's softer stance toward China, existing tariffs are still expected to weigh on exports. Even if some are lifted, a sharp export rebound is unlikely. South Korea and the US agreed in late April to develop a "July package" to remove tariffs before Trump's 90-day pause ends. However, leadership turmoil has stalled progress. [President-elect Lee said](#) there's no need to rush and suggests reconsidering the July 8 deadline. His silence on trade issues during the campaign was a strategic choice, according to a party official.

Figure 2: Destination of South Korean Exports (\$, Billion)



Source: OIC

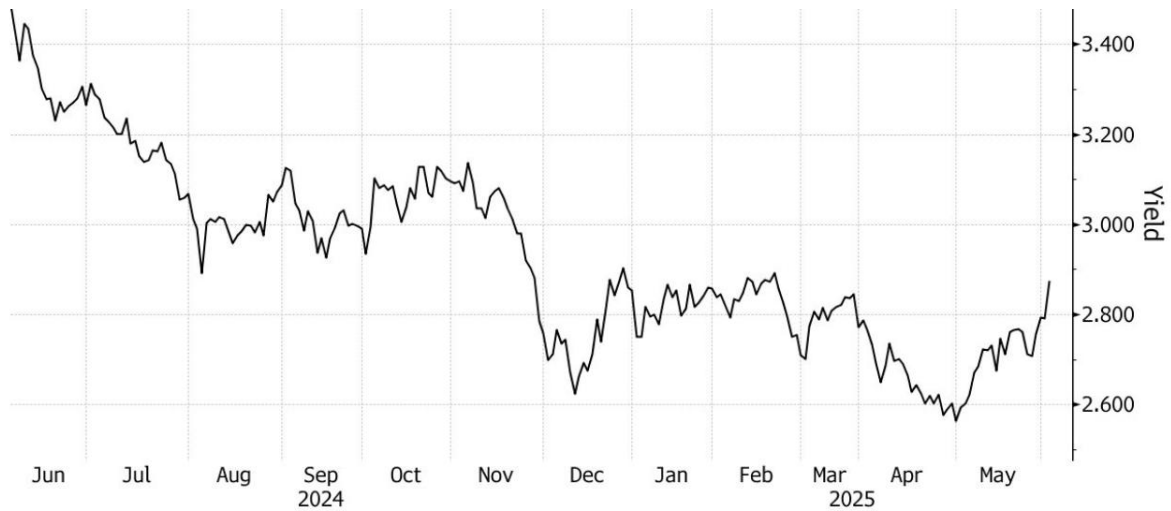
Lee's Economic Plan

Lee's proposed response to economic stagnation is increased government spending and investment, but this fiscal approach faces strong opposition from right-wing parties and the financial sector. South Korean bonds already face pressure as markets brace for fiscal expansion (**Figure 3**). In the beginning of June, 10-year yields jumped over 10 bps to 2.90%, while a 30-year bond auction saw the weakest demand since April 2022, reflecting concerns over rising debt supply. The finance ministry plans to issue 207.1 trillion won (\$150.7 billion) in government bonds this year. Morgan Stanley expects a Q3 stimulus of at least 35 trillion won, while ING forecasts 40–45 trillion. A 30 trillion won package could add 25 trillion won in bond issuance, pushing total 2025 issuance to 230 trillion won, [according to SK Securities](#).

The interim government has already moved toward austerity, [planning cut discretionary spending by over 10%](#), excluding essential costs, and for the first time, may review adjustments to legally mandated expenditures like

basic pensions and education grants. While Lee may not fully reverse these measures, growing pressure to boost defense spending, further constrains social expenditure.

Figure 3: South Korean 10-Year Yields



Source: [Bloomberg](#)

Large fiscal support is expected for export-oriented industries in response to Trump's tariffs. South Korea's pharmaceutical exports totaled \$9.59 billion in 2024, making up just 1.4% of total exports, with 16% going to the US. [Celltrion Chairman Seo Jung-jin said](#) the company is delaying its decision on US contract manufacturing by six months but expects minimal impact from new US policies due to strong price competitiveness.

[President Lee also plans](#) to offer tax breaks to firms in key sectors that produce and sell locally, aiming to bolster domestic industry amid rising global protectionism. The move may draw criticism from the US Trade Representative, which has previously opposed policies favoring local production.