South Korea: Yoon's presidency formally ends, but uncertainty remains

The Constitutional Court upheld the impeachment of President Yoon Seok Yeol and markets welcomed the news. However, the relief rally may be short-lived as more uncertainty lies ahead

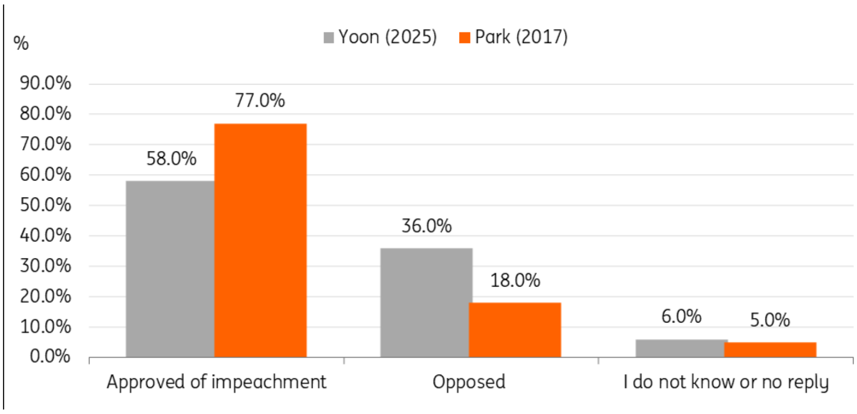
The Constitutional Court upheld the impeachment of President Yoon Seok Yeol in a unanimous 8-0 decision. South Korean financial markets rallied as the biggest risk factor was removed. However, the outlook remains clouded by delayed fiscal support, the negative impact of US tariffs and political uncertainty ahead of the presidential election. We expect the relief rally to be short-lived as political uncertainty and deep divisions surrounding the presidential election rattle sentiment and fresh waves of reciprocal tariffs hit the economy.

The presidential election is set for 3 June

Yoon's criminal charges are separate from his impeachment. As such, the political noise surrounding it will linger throughout the presidential campaign, further dividing the country. Markets will quickly shift focus to the election in June. There is much uncertainty about the presidential candidates and their policies.

As of now, the ruling People's Power Party (PPP) has no prominent candidate. This means the primary race could be quite tough and face a short period to prepare campaigns. Also, the opposition Democratic Party (DP) faces the risk of election law violations, which will complicate to run a campaign. Recent polls show the DP is ahead of the PPP but the gap between the two parties (not candidates) remains within a small margin of error. Given the short race period and the lack of a clear frontrunner, we expect more bickering than substantive policy debates this election season.

Political division deepens in 2025 compared to 2017



Source: Korea Gallup

Delay in extra budget should limit impact of fiscal stimulus

The ruling and opposition parties have discussed the budget for the past few months, but have yet to reach a conclusion. While both parties agree on the need for a supplementary budget, there's no agreement on spending specifics or spending. The government has sought bipartisan support for a 10 trillion won supplementary budget bill to cope with repair damage from the recent wildfires in the southern Korean peninsula and support exporters. Even if passed, the bill's modest size and delayed implementation make it unlikely to have a meaningful stimulus effect.

We believe there will be another round of extra spending if the DP wins the presidential election as the DP has proposed a 35 trillion won budget. With the DP already holding a majority of seats in parliament, we expect more progressive policies and an expansionary fiscal policy. If the PPP wins, the scale of government spending is likely to be somewhat smaller than in the other case as the PPP proposed around 15 trillion won budget, but the fiscal stance itself will still lean towards easing. However, political gridlock will make it difficult for the government to pursue its policy agenda. In any case, the overall impact on growth this year should be weaker than we initially expected.

Extra budget plan : PPP vs DP

People Power Party

Around 15 trillion won

- 1 million won energy voucher per small business owner
- issuance of prepaid cards worth up to 500K won per socially vulnerable person to improve consumption capacity
- voucher support worth up to 2 million won per small business owner to improve aging facilities and purchase equipment

Democratic Party

Total of 34.7 trillion won, consisting of two parts:
- Consumption stimulation – 23.5 trillion
- Economic growth – 11.2 trillion

(tn)	Consumption stimulation
13.1	consumption coupon – 250K won per person (51.2m people), 350K won per socially vulnerable person (3.6m people)
2.4	10% cashback program for consumption increase
0.5	consumption vouchers in eight areas - accommodation, tourism, performance, movie, exhibition, sports, dining, agriculture & fishery
2.0	10% discount support for local currency
2.8	compensation and support for small businesses' losses
1.3	support for agriculture and fishing industry
0.5	support for socially vulnerable groups
0.9	reinforcement of national security

(tn)	Economic growth
1.1	public housing & SOC investment
0.5	support for job creation and start-ups
5.0	support for AI semiconductors and expansion of R&D *1 tn for RE100, climate crisis response is double counted
0.8	expansion of power grids and support for renewable energy for RE100
1.0	EV subsidy and climate crisis response
2.6	reinforcement of local governments' budgets
1.2	free high school education, and childcare for five-year-olds

Source: PPP, DP websites

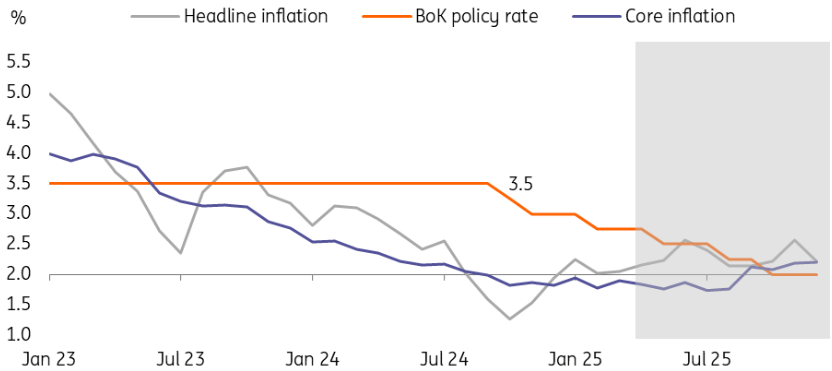
To be fair, the government is attempting to front-run its ordinary spending in the first half by promoting job creation programmes and speeding up publicly-funded projects. But, this is not enough to cushion the growth slowdown.

In terms of spending plans, the main difference between the two parties' plans is their preference for universal versus targeted welfare. Still, we expect cash transfer-related programmes to account for a significant share of the budget in both cases as implementation can be quite quick and politically easy to buy. Given that the multiplier effects of such stimulus measures are lower than for facility investment or research and development capital spending, the overall positive impact on growth may be limited. It's also likely that a portion of the budget will be allocated to AI investments, but the amount seems like to be fairly limited.

The Bank of Korea will ease monetary policy further throughout 2025

The Bank of Korea cut rates a total of 75 basis points in the last two quarters. Markets widely expect the BoK to extend its easing cycle. But markets are split on the timing and how low the terminal rate will go. The BoK faces a difficult situation: despite growing downside risks to already weak growth, inflation is likely to accelerate in the near term due to the weak KRW. The stabilization of the KRW and the delay in fiscal support will prompt the BoK to cut rates in May. But, if the US tariffs weigh on Korean economy more than expected, the timing of the BoK's rate cut could be accelerated. For now, we expect the BoK to cut its policy rate by 25 bp in May, August, and December, bringing it down to 2.00% by the end of the year.

Bank of Korea outlook



Source: CEIC, ING estimates

Delays in trade talks will be a drag on the KRW

The USDKRW peaked at 1,473 at the end of March, but now traded much lower at 1,430 on the uphold decision. In the short term, we expect the KRW to strengthen further as a key risk factor fades. Yet, once the market digests political events, won trading will be driven by tariff negotiations between the US and Korea. Given that Korea's current account surplus with the US has widened considerably over the past five years, we expect a tougher US stance initially. Furthermore, if the US imposes additional tech export bans on China, it would significantly harm Korea and investor sentiment. Although the share of Chinese exports has been declining, China is still Korea's largest trading partner. Our base case scenario is that tariffs will end up being less harsh after negotiations. However, given the political vacuum ahead of the presidential elections, the negotiations will not come into play until the third quarter of 2025, so the KRW is likely to be under pressure in the second quarter then come down in second half. In April, dividend payouts should drive the weak KRW.

Author

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com