South Korea's new president faces daunting array of economic challenges

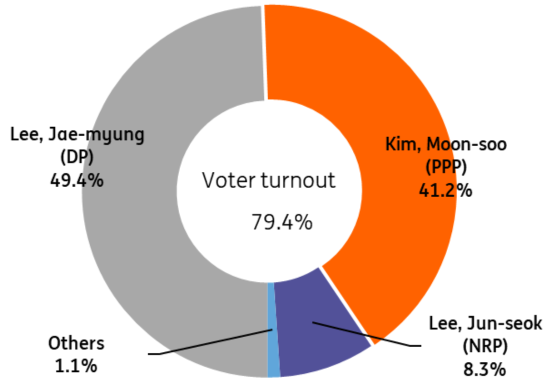
South Korea's new president, Lee Jae-Myung, inherits a weak and fragile economy, battered by domestic political turmoil, natural disasters, and US tariffs. His immediate priorities will be stimulating growth and restoring business and consumer confidence. The Korean Treasury bond curve is expected to steepen, while the KRW is seen appreciating

Source: Shutterstock

The opposition wins, as expected

Lee Jae-myung, representing the main opposition Democratic Party (DP), was elected the 21st President of the Republic of Korea. With a voter turnout of 79.4%, the highest in nearly 30 years, President-elect Lee beat Kim Moon-soo of the ruling People Power Party (PPP). With the ballots counted Wednesday morning, Lee received 49.4% of the total, compared to Kim's 41.2%.

Lee wins the race



Source: National Election Commission of the Republic of Korea

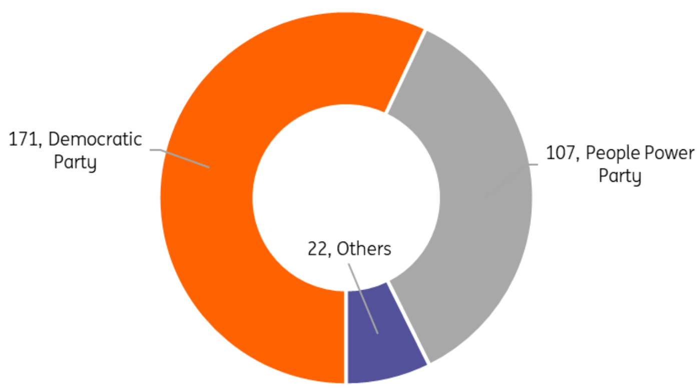
Pivot from left-leaning to centrism

When Lee last ran for president in 2022, he emphasised left-leaning policies that prioritised fairer wealth distribution and a substantial increase in social spending. Yet during the current election campaign, he shifted towards the centre, focusing more on growth than distribution and watering down plans to introduce universal income and increasing the property wealth tax.

Overall, we believe his policies remain aligned with the principles of a progressive party, prioritising improvements to social welfare and market fairness. We expect to see more government spending to support households and small-and-medium-sized enterprises and government-led growth (including AI), alongside a greater focus on the rights of minority shareholders and corporate governance.

Regardless of his political roots, boosting growth will be a key challenge. Even before President Trump's tariffs hit exports, the economy contracted by 0.2% quarter on quarter, seasonally adjusted, in the first three months of the year. The figures highlighted fragile business activity and private consumption. In the short term, the most relevant issues for markets will be fiscal policy and trade negotiations with the US. With the DP in the majority in the National Assembly, the president-elect will be able to implement policy changes and expansionary spending without much resistance in the legislative process.

Lee will be supported by national assembly

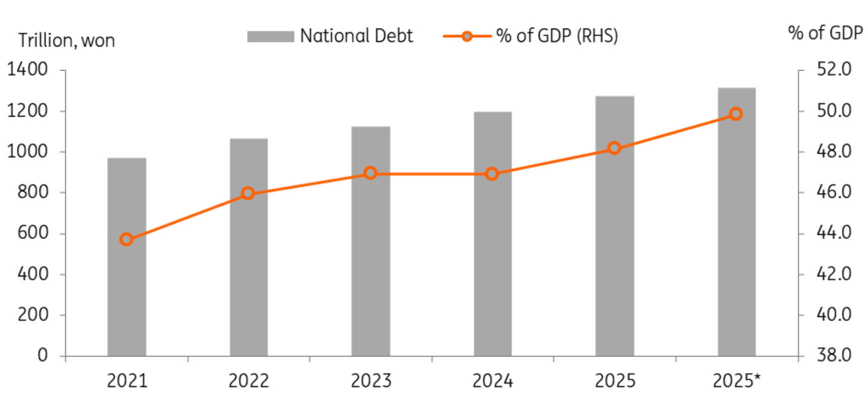


Source: National Assembly

Fiscal policy: More stimulus in the short term, but at the expense of fiscal soundness

Lee and the DP have been arguing for larger fiscal support throughout the year. The party proposed a second supplementary bill of at least KRW35 trillion (1.2% of GDP) during the campaign. A KRW13.8 trillion supplementary budget was passed in early May, but we expect another bill to come very soon. Its size could be as large as KRW40-45 trillion, bigger than market expectations. We believe that a larger share will go to aid households and save local economies, through cashout programmes and shopping vouchers, which usually have a lower multiplier impact on growth. The big investment in AI and R&D, which will need more structural support, is likely to be included in next year's budget. The coming budget is expected to be expansionary.

A super-sized supplementary budget to boost short-term growth, but at the cost of mid-term fiscal soundness



Source: CEIC, * ING estimates that the supplementary budget will be at least 35 trillion won

Property market policy

Construction has been a key drag on domestic growth for several quarters, and thus should be a policy priority. In our view, the ongoing restructuring of the construction sector will continue. There had been excessive investment sector since Covid-19. Restructuring is necessary, as the new government agrees. We don't think Lee will intervene in the property market by introducing strict regulations or taxation, key factors in the former DP government's earlier loss. The new government is likely to adopt a two-way approach to the real estate market. This will involve increasing supply in metropolitan Seoul, while loosening mortgage rules and offering tax incentives for housing markets outside the capital city. Household debt is expected to rise at a faster pace in the second quarter. The government's macroprudential measures won't be eased any time soon. Yet, there will be more incentives for the economically vulnerable and younger generations. Household debt is expected to rise at a faster pace in the second quarter. As such, the government's macroprudential measures won't be relaxed in the near term.

Trade negotiations with the US and foreign policy

In terms of foreign policy, Lee will likely pursue “pragmatic” diplomacy based more on Korea’s real-world interests than ideology. He is likely to strengthen cooperation between Korea, the US and

Japan, the "trilateral alliance". In this way, he would be able to keep the strong defence alliance with the US, but also seek better terms for securing the nation's economic security.

Lee has indicated that he would like to take a more cautious approach to the trade negotiations, probably benchmarking other countries' negotiations before Korea finalises an agreement. Korea and the US agreed to draft a package deal by 8 July. Lee is expected to request an extension. We believe that the deal will involve increased military spending on US troops in South Korea, greater direct investment in US automotive, steel and infrastructure sectors, and the import of more US goods, particularly agricultural produce and commodities. In return, Korea will demand the elimination of reciprocal tariffs and a temporary tax exemption on auto exports.

What to expect from market reactions

The Korean won is expected to rise on expectations that the new government will reduce policy uncertainty. The expected appreciation is also due to the USD's broader weakness against Asian currencies. Although the KRW will remain volatile and subject to global market sentiment, it appears that the worst of the volatility has passed in the second quarter.

In the Korean Treasury bond market, the yield curve has already steepened in anticipation of further bond issuance. However, we believe that the second **stimulus bill** will be larger than expected, allowing for an increase in long-end yields. Nevertheless, more stimulative fiscal policy could result in smaller-than-expected interest rate cuts by the Bank of Korea, limiting the scope for a decline at the short end of the curve. We also flag the concern that a fiscal imbalance could raise concerns about the fiscal soundness. This could cause yields to rise rapidly. However, we believe that even if the nation's debt level exceeds 50% of GDP, which is still lower than that of other major economies, the risk remains low.

Author

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