

SOUTH KOREA

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BETWEEN THE ENERGY SHOCK AND THE AI BOOM, GROWTH IS FINDING A NEW BALANCE

South Korea is one of the countries most exposed to the global energy shock, yet it also reaps substantial benefits from soaring demand for artificial intelligence-related products. Despite the country's dependence on hydrocarbon imports, with the vast majority transiting through the Strait of Hormuz, short-term growth forecasts remain highly optimistic, bolstered by a robust export sector. Factors such as inflationary pressures, the depreciation of the won, and rising household debt, justify monetary tightening. In the longer term, the government is banking on an integrated AI ecosystem, encompassing data centres, robotics and advanced materials to strengthen its key position in global value chains.

HIGHLY VULNERABLE TO THE ENERGY SHOCK, THE COUNTRY ACTED SWIFTLY

Since the beginning of the year, the Korean economy has had to deal with both the energy shock caused by the war in Iran and a global surge in demand for semiconductors.

South Korea imports almost all of its energy. Over 70% of its crude oil imports and over 20% of its liquefied natural gas imports pass through the Strait of Hormuz. However, from the beginning of the conflict, the authorities announced that substantial crude oil supplies had been secured from various partners, including Saudi Arabia, for the remainder of 2026, using alternative routes to the Strait of Hormuz.

THE ENTIRE ECONOMY IS BENEFITING FROM THE AI CYCLE

Against a backdrop of rising energy prices, Korea's structural growth imbalances (the polarisation of growth between exports and the domestic market, as well as between technology and non-technology sectors) call for caution in short- and medium-term forecasts.

The figures for the first quarter have far exceeded expectations. Real GDP growth reached 3.8% y/y (up from 1.6% in Q4 2025), driven by unexpectedly strong exports (11.6% y/y in volume), while household consumption and private investment saw a notable resurgence, challenging the hypothesis of a « K-shaped » growth.

Data from the second quarter confirmed this impression: total export value continued to rise, reaching a year-on-year growth of 70% in June (up from 53% in May), primarily driven by semiconductors. Semiconductor exports more than tripled year-on-year, bolstered by rising chip prices for artificial intelligence (AI) infrastructure. This performance supported industrial activity: the sector's production index grew at a rate comparable to that of export volumes.

The first signs of the technology sector's gains beginning to permeate the rest of the economy are starting to emerge. Despite inflationary pressures, domestic demand continues to recover, aided by measures announced by the government at the beginning of the conflict (amounting to nearly 1.5% of GDP), which include price caps, tax relief, budgetary support, and the acceleration of the energy transition. Retail sales (up nearly 4% y/y in May, following a sluggish 2025) are gradually recovering, while household and investor confidence indicators remain positive.

TOWARDS A NEW INDUSTRIAL STRATEGY

In the short term, any stabilisation of tensions in the Middle East is likely to underpin economic activity, despite the ongoing uncertainty, the scale of the government's expansionary policy and the continuing AI cycle.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	2.6	1.4	2.0	1.0	3.1	2.2
Inflation, CPI, year average, %	5.1	3.6	2.3	2.0	2.6	2.3
Central gov. balance / GDP, %	-5.0	-3.6	-4.1	-4.5	-4.8	-4.5
Gen. Gov. debt / GDP, % (EU standards)	46.2	48.8	50.6	52.5	54.2	56.1
Current account balance / GDP, %	1.4	1.8	5.3	6.6	8.2	7.4
External debt / GDP, %	38.6	39.5	37.5	40.5	37.4	34.0
Forex reserves, USD bn	418.3	415.3	410.8	423.0	412.7	418.0
Forex reserves, in months of imports	7.8	6.2	6.6	6.5	6.7	6.2

TABLE 1

e: ESTIMATES & FORECASTS

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

The rise in tech exports has offset the rise in energy imports

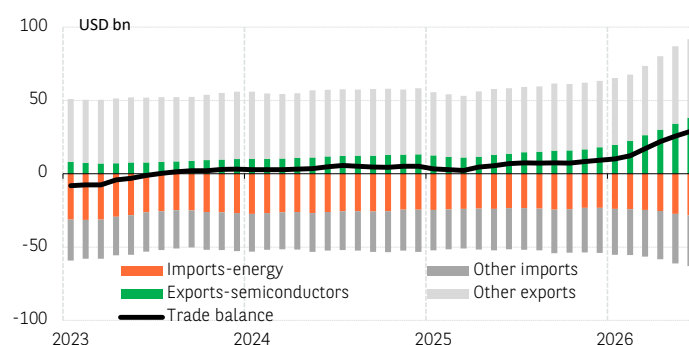


CHART 1

SOURCE: KOREA CUSTOMS SERVICE

Despite the rise in energy imports, the current account surplus was exceptionally high in Q1 (nearly 15% of GDP on an annualised basis, up from 8% in Q4 2025), representing the largest quarterly surplus ever recorded. For 2026, goods exports (including semiconductors) are expected to significantly offset the rise in imports (associated with higher energy prices and equipment investments). Similarly, the increase in tourism revenue is expected to facilitate a rapid reduction in the services trade deficit. A current account surplus of more than 8% of GDP is expected in 2026.


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In the longer term, the large-scale public and private investment plan announced by the government at the end of June could mark a turning point in Korea's industrial policy. While the previous economic strategy primarily concentrated on consolidating sectors where the country already had a comparative advantage, the government now intends to establish a comprehensive artificial intelligence ecosystem. This ecosystem will encompass semiconductor production, physical infrastructure through the construction of dedicated data centres, as well as advanced packaging, materials, infrastructure and robotics. The goal is not to develop national AI models, but to make South Korea a key supplier of the essential components needed for their operation.

While the specifics of the implementation are yet to be defined, this strategy reflects a desire to strengthen South Korea's position in the most strategic segments of the global AI value chain. Investment, which is expected to reach a level close to 20% of GDP and span several decades, should also be accompanied by an increase in production capacity and a geographical redistribution of industrial activities (which are currently largely concentrated in the Seoul metropolitan area), to achieve a more equitable distribution of economic activity. This initiative also seeks to alleviate pressures in the Seoul property market.

FIRST INCREASE IN THE POLICY RATE

In June, inflation reached 3.2% y/y, its highest level in eighteen months, primarily driven by the surge in transport prices (+11% y/y) and the depreciation of the won by over 8% against the US dollar between March and late June. This inflationary pressure has now extended beyond energy prices, as evidenced by the rise in service prices (+3.4% y/y), which has exceeded the 3% threshold for the fifth consecutive month.

Although Brent prices have stabilised since May, remaining significantly below the Bank of Korea's projection (USD95/barrel) for the second half of 2026, uncertainties persist, particularly due to potential wage pressures. In addition, the price diffusion index calculated by the central bank, a key indicator of domestic demand, has reached its highest level since 2010 (excluding the pandemic period). In this context characterised by sustained economic growth, ongoing inflationary pressures and exchange rate challenges, the central bank began to tighten its monetary policy at its meeting on 16 July. An initial rate hike of 25bps has brought the rate to 2.75%. According to the statement released by the central bank, the economy is deemed sufficiently robust to withstand monetary tightening, despite the energy shock.

The won is expected to face continued pressure in the short term due to capital outflows, geopolitical risks and sustained demand for dollars linked to foreign investors' hedging operations.

Finally, the high level of household debt (87% of GDP in Q1) requires enhanced scrutiny. The central bank has identified two particularly troubling trends: i) the rapid increase in property prices in Greater Seoul (up more than 14% y/y in June, driven by a shift in demand from *Jeonse*¹ to home purchases), while the national house price index is rising more moderately (+3.5%), which could lead to a new wave of mortgage loans despite the tightening of credit conditions and the macroprudential measures recently announced by the authorities, and ii) the increase in « other loans », particularly those related to stock market investments, which is fuelling a rise in credit risks in a context of volatile financial markets.

¹ *Jeonse* is a rental system in which the tenant pays the landlord a very high deposit (usually between 50% and 80% of the property's value) instead of a monthly rent. The deposit is returned in full at the end of the tenancy.

The real estate market remains tight in Seoul

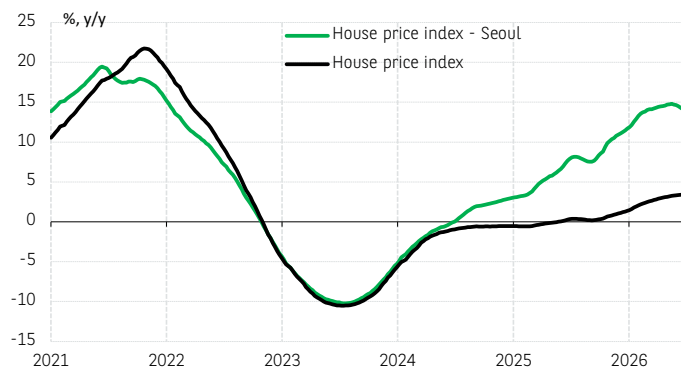


CHART 2

SOURCE: BOK

AN EXPANSIONARY AND PROCYCLICAL FISCAL POLICY, BUT PUBLIC FINANCES REMAIN SOUND

Public finances remain remarkably strong. Given the scale of the measures announced by the government, which amount to nearly 1.5% of GDP, fiscal policy will take a more expansionary stance in 2026, despite an economy already buoyed by the export sector. This strategy is primarily aimed at cushioning the effects of the energy shock on households and businesses, while accelerating investment in sectors deemed strategic. As a result, the public deficit is expected to rise slightly in 2026, to 4.8% of GDP from 4.5% in 2025. The overshoot in the deficit is expected to be mitigated by increased revenues from the semiconductor sector and the implementation of a comprehensive fiscal reform aimed at broadening the revenue base. This reform includes, among other initiatives, an increase in the corporation tax rate to 25% from the current 24%, and the planned introduction of a 20% tax on gains from digital assets in 2027. Nevertheless, the deficit is set to rise for the third consecutive year.

Consequently, public debt is also expected to continue its upward trajectory, reaching 54% of GDP by the end of 2026. The debt profile remains very favourable, characterised by long-term maturities exceeding 10 years and a diversified investor base, both nationally and internationally. Finally, while ownership of Korean sovereign bonds has been on the rise in recent years, it still constitutes less than 25% of the total outstanding.

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