



THE PENINSULA

Economic Challenges Await South Korea's New President

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New South Korean President Lee Jae-myung takes office at a time of serious economic challenges in South Korea. Real GDP fell by 0.2 percent in the first quarter of 2025, with private consumption, fixed investment and exports all reporting declines.

The political crisis triggered by Yoon Suk Yeol and his martial law declaration late last year was a blow to already weak domestic demand. It was exacerbated by higher U.S. tariffs and uncertainty about further increases. Indeed, President Trump announced a doubling of tariffs on steel and aluminum to 50 percent on June 4, the day of President Lee's inauguration. These shocks have resulted in a substantial decline in business and consumer confidence, which closely tracks real GDP growth (Figure 1). President Lee has called for another supplementary budget and said he plans to work quickly with President Trump to reach an agreement on tariffs.

Figure 1. Business and consumer confidence has weakened



Forecasters Bode Poorly for South Korea's Economy

The OECD, which last December had projected a 2.1 percent increase in Korea's real GDP in 2025, revised its outlook to 1.0 percent in its June 3rd economic outlook (Table 1). The expected slowdown is well above the 0.4 percentage-point decline projected for the OECD and the world economy (Figure 2).

The OECD 2025 projection matches the IMF's April forecast but other projections are even lower. The Korea Development Institute (KDI) halved its 2025 real GDP outlook from 1.6 percent in its February forecast to 0.8 percent in May, citing the combined impact of rising U.S. tariffs and faltering domestic demand. It expects growth of just 0.3 percent in the first half of 2025, followed by a pick up to 1.3 percent in the second. The Bank of Korea (BoK) also projected 0.8 percent growth for 2025 in its May outlook. Some private financial institutions, such as Citigroup and ING Group (0.6 percent), JPMorgan Chase (0.5 percent) and Société Générale (0.3 percent) are even more pessimistic.

Korea's annual growth rate has fallen below 1 percent only twice in the 21st century, first during the global financial crisis in 2008 (0.8 percent), and second during the COVID-19 pandemic in 2020 (-0.7 percent).

U.S. trade policy adversely affected Korea in the first quarter of 2025. The U.S. effective tariff (the average tariff paid across all imports) on Korea's exports to the United States had been 1 percent, thanks to the U.S.-Korea Free Trade Agreement (KORUS FTA). However, the effective rate has jumped to 16 percent, driven by a baseline 10 percent tariff on all countries and products and product-specific tariffs, such as steel, aluminum and cars.

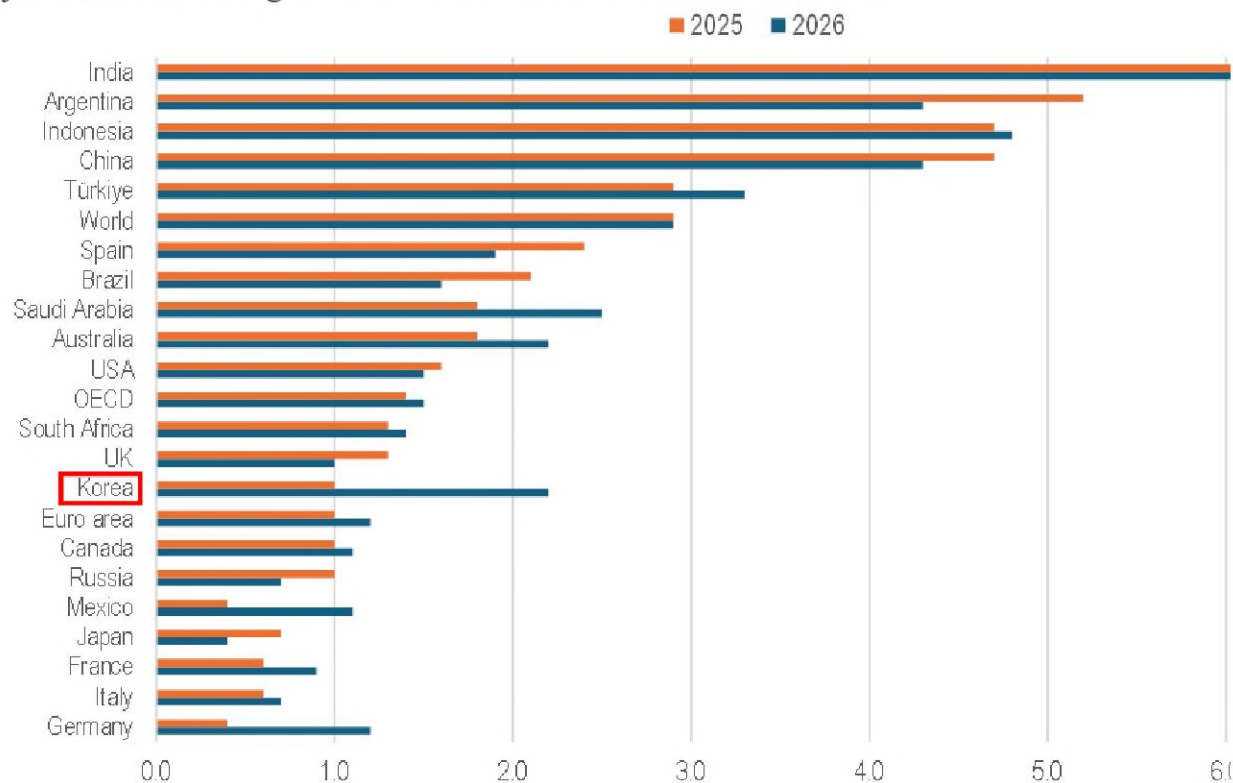
Table 1. OECD projections for Korea in 2025 and 2026

	2022	2023	2024	2025	2026
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	Percentage changes, volume				
GDP at market prices	2.7	1.4	2.3	1.0	2.2
Private consumption	4.2	1.8	1.1	1.2	2.4
Government consumption	4.0	1.3	1.8	2.1	1.8
Gross fixed capital formation	-0.2	1.4	-0.7	-1.8	2.5
Final domestic demand	2.7	1.6	0.7	-1.8	2.5
Stockbuilding ¹	0.1	-0.2	-0.5	0.3	0.0
Total domestic demand	2.8	1.4	0.2	0.8	2.3
Exports of goods and services	3.9	3.6	7.1	0.3	3.5
Imports of goods and services	4.2	3.5	2.5	0.0	3.8
Net exports ¹	0.0	0.0	1.9	0.2	0.0
<i>Memorandum items</i>					
GDP deflator	1.8	1.9	4.1	2.8	1.9
Consumer price index	5.1	3.6	2.3	2.1	2.0
Core inflation index ²	3.6	3.4	2.2	2.0	2.0
Unemployment rate (percent of labor force)	2.9	2.7	2.8	2.9	2.8
Household saving ratio, net (percent of disposable income)	7.4	4.8	3.5	3.5	3.2
General government financial balance (percent of GDP)	0.0	-0.7	-3.0	-3.0	-2.4
General government gross debt (percent of GDP)	46.2	48.9	50.7	52.8	54.2
Current account balance (percent of GDP)	1.3	1.8	5.3	5.7	5.6

Note: Contributions to changes in real GDP; Consumer price index excluding food and energy.

Figure 2. OECD projections for the G20 countries in 2025 and 2026



Countries ranked in descending order by projected GDP growth rate in 2025

Higher tariffs have a significant impact on the Korean economy, as the United States accounted for 18.3 percent of Korea's total exports in 2024. In the GDP report, Korea's exports of goods and services fell 0.6 percent in the first quarter of 2025, contrary to expectations of an increase driven by the front-loading of imports by the United States in anticipation of the imposition of tariffs. In April 2025, Korea's exports to the United States fell 6.8 percent (value terms, year-on-year basis), while total exports rose by 3.7 percent. For the year 2025, the OECD expects exports to increase slightly (0.3 percent) in 2025 (Table 1). But there is uncertainty about whether the 25 percent reciprocal tariff on Korea announced on April 2 will ever go into effect, and if so, for how long.

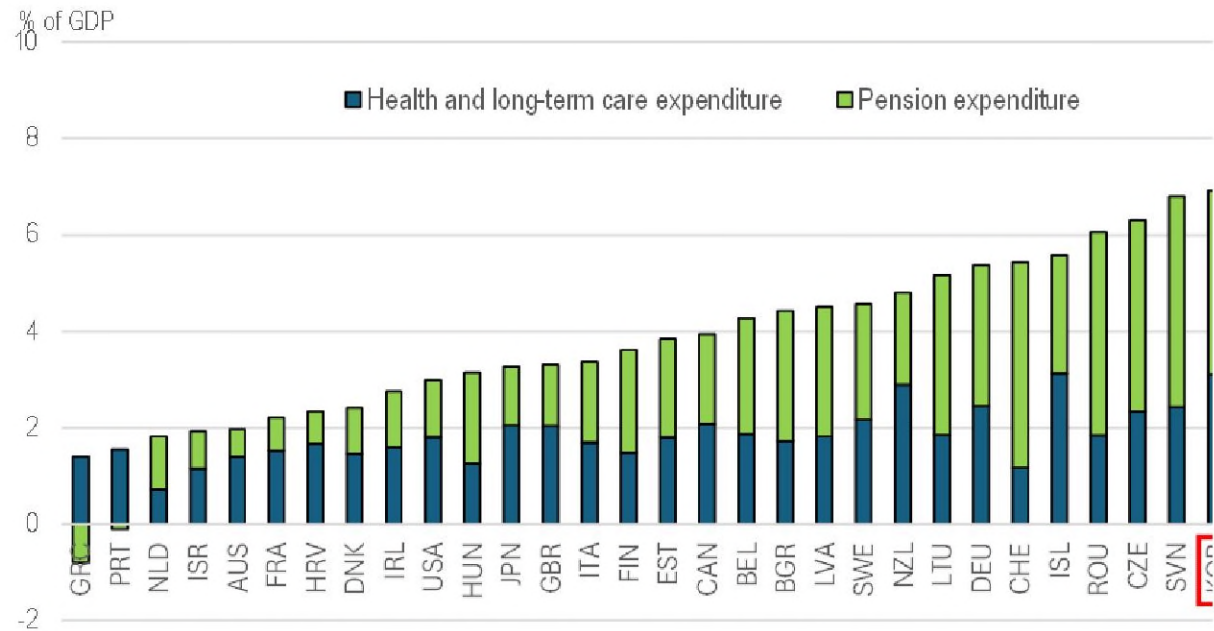
The OECD projects that Korean business investment will decline by 1.8 percent in 2025 primarily due to increased tariffs and uncertainty (Table 1). In addition, housing prices and construction orders have been decreasing. Although retail sales volumes fell in early 2025, private consumption, nearly half of GDP, is expected to rebound in the second half of the year as uncertainty subsides and real wages continue to rise.

Fiscal Response to the Downturn

During his campaign, President Lee called for at least a USD 22.1 billion (KRW 30 trillion) supplementary budget on top of the supplementary budget the National Assembly passed on May 1, which is less than half this amount and 0.5 percent of GDP. The main objective is to boost consumption. Additional budgetary support would strengthen the economic recovery, but it should be done cautiously, given recent fiscal trends and within the framework for long-term fiscal sustainability.

While government gross debt remains relatively low at an estimated 53 percent in 2025 (Table 1), about half the OECD average, Korea's government financial deficit is expected to remain at 3 percent in 2025. Reducing the deficit has proven difficult. A sound fiscal framework would help cope with rising spending resulting from population aging. Korea's outlays on pensions and health and long-term care is projected to rise by seven percentage points of GDP during the next 35 years (Figure 3).

Figure 3. Korea's aging-related spending will be one of the highest in OECD countries



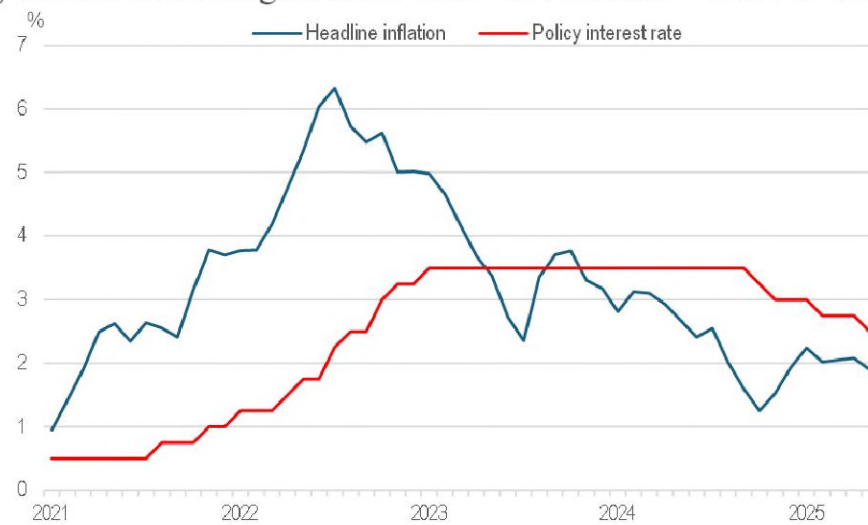
Projected change in aging-related spending between 2025 and 2060

Scope for Further Monetary Policy Easing

Korea's headline and core inflation rates have remained stable in recent months around the BoK's 2 percent inflation rate (Figure 4). Short-term inflation expectations fell from 2.8 percent in April to 2.6 percent in May.

On May 29, the central bank lowered its policy rate to 2.5 percent, its fourth cut since October 2024, despite concerns about the growth of household debt and increased volatility in foreign exchange markets. The BoK noted that following the contraction in the first quarter of 2025, the domestic economy continued its sluggish pace in April due to a slower recovery in domestic demand, notably consumption and construction investment, and decelerating export growth. Moreover, the BoK signaled that it envisions further policy rate reductions ahead "to mitigate downside risks" to the economy.

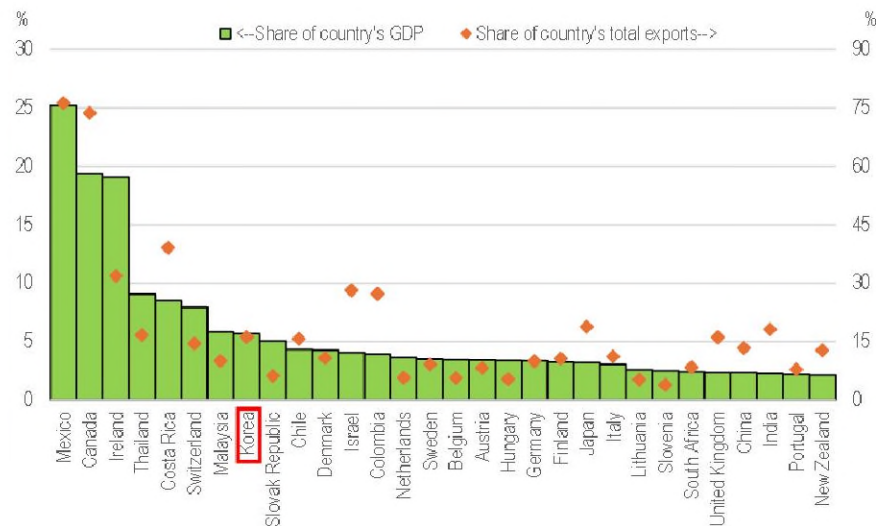
Figure 4. Korea's inflation is steady at 2 percent



Conclusion

The election of President Lee Jae-myung brings an end to the political turbulence that has negatively affected the Korean economy during the past six months. Successfully resolving the tariff issue with the United States is also essential for a strong economic recovery. Exports to the United States accounted for 5.6 percent of Korea's GDP in 2023, the eighth highest globally (Figure 5). In contrast, exports to the United States by Japan and China account for 3.2 percent and 2.3 percent of their GDP, respectively.

Figure 5. Korea's exports to the United States, as a share of its GDP, is one of the highest



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All figures and charts draw on data from the *OECD Economic Outlook, Volume 2025 Issue 1*.
Photo from the *South Korean President's Office*.

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