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MACRO MORNING BRIEFING

August 29, 2024

Korea Budget: Sub 3% Deficit in 2025

South Korea's 2025 budget has continued the theme of fiscal prudence under the Yoon administration. Overall, fiscal conditions are heading in the right direction. The most significant development is that the deficit is expected to fall below 3% of GDP in 2025. That said, the mission is not accomplished - the upward trajectory of government and national debt is yet to be addressed.

Planned expenditure for 2025 is set at KRW 677.4trn, KRW 20.8trn. The 3.2% increase in expenditure is higher than the 2.8%y/y expected in 2024. It is expected to rise further in the coming three years, averaging 3.7% y/y between 2026 and 2028. Health/Welfare/ Employment, Public administration/local government and Education account for more around two-thirds of the entire expenditure at KRW 249trn (36.7% share), KRW 111.3trln (16.4%) and KRW 98.5trn (14.5%). Research and Development's budget increased by 11.8% from KRW 26.5trn to KRW 29.7trn, with a focus on Artificial Intelligence, semiconductors and biotech. Note that expenditure restructuring continues to average KRW 20trn a year under the current administration.

Total projected revenue is projected to be around KRW 651.8trn, a rise of 6.5% y/y before easing to an average of 3.9% revenue growth in the coming three years from 2026 to 2028. The sharper jump for 2025 is in part driven by an anticipated drop of revenue this year at KRW 612.2trn from KRW 626trn in 2023. Unlike the situation in much of G10, inflation across APAC has not high enough to drive nominal receipts higher, especially through items such as income tax and value-added tax. This underscores the differences in both government support during the pandemic and the nature of the subsequent reopening.

South Korea's managed fiscal balance, which excludes social security funds, is projected at -2.9% of GDP, may fall below 3% of GDP for the first time since 2019 (2.7% of GDP). The overall budget deficit is seen to improve gradually to -2.7%, -2.5% and -2.4% of GDP in the coming years, as outlined in the 2024-2028 National Fiscal Management Plan.

However, aggregate debt levels will continue to rise. Government debt is seen at KRW 1277trn or 48.3% of GDP in 2025. It is expected to rise gradually to 49.1%, 49.8% and 50.5% in the coming three years from 2026 to 2028. There is no room for complacency even though these levels are considered low by developed-market standards. The high level of indebtedness remains a structural concern considering the demographic outlook and rising dependencies ratios. On a positive note, the debt-to-GDP projection is now more than 3% lower compared with the original forecast set out in the 2024 Budget released last year (see Exhibit 1), with the decline helped by the revision of Korean National Accounts this year.

Overall, we consider the 2025 budget as relatively steady and the rapid improvement in the deficit to -2.9% of GDP after a plunge to -3.6% of GDP this year from -2.6% of GDP in 2023. Such improvement would support real yields, but the announcement of an expansion in Korean government bonds sales at KRW 201trn in 2025 from KRW 158.4trn in 2024 has generated an offset, sparking higher government bond yield on supply concern. However, we do not expect the reaction to be sustainable. In addition to fiscal consolidation falling inflation and a dovish BoK policy stance is likely to be supportive for bonds over the medium-term. The 10yr KTB yield at 3.06% at the time of writing against 10yr average of 2.50%.

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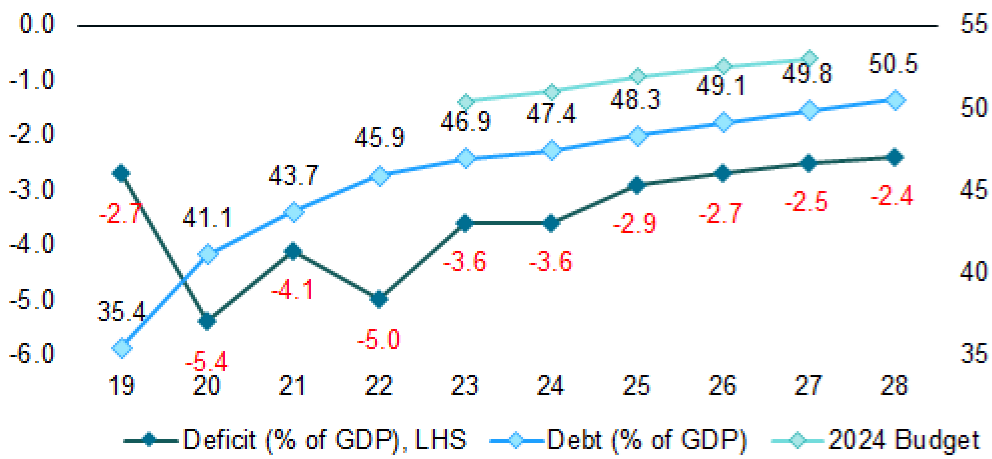
Exhibit #1: 2025 Budget Proposal and 2024-2028 National Fiscal Management Plan

	2024	2025	2026	2027	2028
Revenue (KRW trn)	612	**652**	678	706	732
- of which tax revenue	367	382	400	421	444
Expenditure (KRW trn)	657	**677**	704	730	756
y/y, %	2.8	**3.2**	4.0	3.7	3.5
Fiscal Balance	2024	2025	2026	2027	2028
Managed, KRW trn	**-91.6**	**-77.7**	-75.8	-73.1	-72.2
(% of GDP)	-3.6	-2.9	-2.7	-2.5	-2.4
Budget 2024, as of Aug23	*-92.0*	*-72.2*	*-69.5*	*-65.8*	
(% of GDP)	*-3.9*	*-2.9*	*-2.7*	*-2.5*	
Government Debt, KRW trn	1196	1277	1354	1433	1512
(% of GDP)	**47.4**	**48.3**	**49.1**	**49.8**	**50.5**
Budget 2024, as of Aug23	*1196.2*	*1273.3*	*1346.7*	*1417.6*	
(% of GDP)	*51.0*	*51.9*	*52.5*	*53.0*	

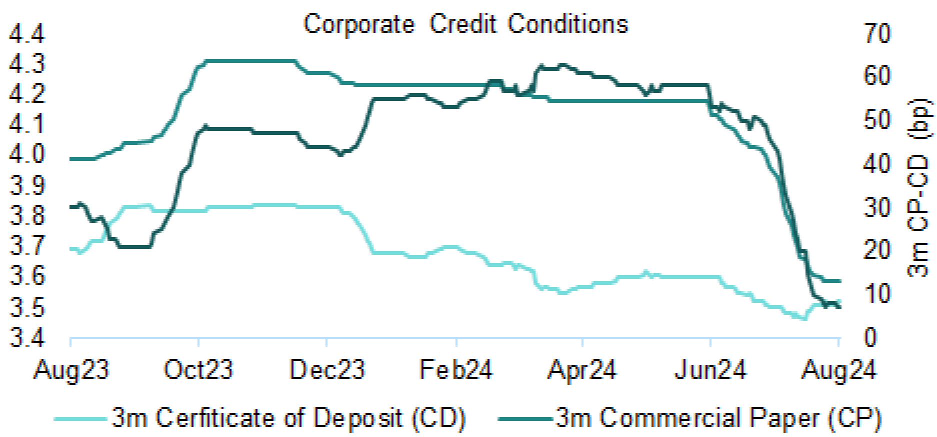


Source: BNY, Bloomberg L.P. Ministry of Economy and Finance https://www.moef.go.kr/

Overall, the Korean Won and Korean assets are in a good place. We see ongoing normalisation in corporate credit conditions as measured by 3-month Commercial Paper and Certificate of Deposit spreads. Persistent foreign investors' inflows into both equities and fixed income and ongoing strengthen in tech-driven export growth are positive for KRW in the near term. The recent softness in the US dollar has also boosted KRW valuations, while USDKRW has broken below key technical supports level around 1340. Given the improvement in JPY and to a lesser extent, the CNY, there is room for peers in Asia to allow additional strengthening in their own currencies without excessively affecting real effective exchange rates, which could lead to some downside pass-through risk. In addition, with the market putting a premium on economies with sound public finances, the narrowing of deficit as projected in the 2025 budget is likely to provide medium-term support for the currency, especially as real and nominal yields decline elsewhere and undermines outright carry interest.

Exhibit #2: BoK Macro Forecast and Normalisation of Credit Conditions

	2024			2025		
Economic Growth	H1	H2	Year	H1	H2	Year
GDP	2.8	2.0	**2.4**	1.8	2.4	**2.1**
> Private Consumption	1.0	1.8	1.4	2.2	2.3	2.2
> Good exports	8.4	5.6	**6.9**	3.1	2.6	**2.9**
> Good Imports	-1.4	4.6	1.6	5.2	2.1	3.6
Inflation	H1	H2	Year	H1	H2	Year
Headling CPI	**2.8**	2.2	**2.5**	**2.2**	2.1	**2.1**
CPI excl food & energy	2.4	2.1	2.2	2.1	2.0	2.0
	H1	H2	Year	H1	H2	Year
Current account	37.7	35.3	**73.0**	32.0	30.0	**62.0**



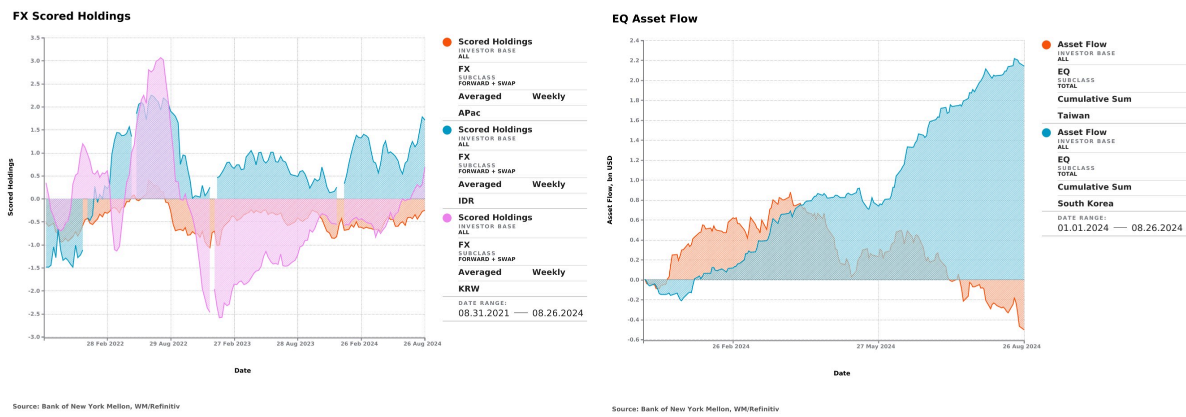
Source: BNY, Bloomberg L.P.

Within APAC, the Korean Won and Indian Rupee are the strongest recipient of flows over the past month, in contrast to selling pressure in the Thai baht and the Taiwanese dollar. However, through Jackson-Hole week which was generally seen as unfavourable for the US dollar, the Korean Won posted marginal outflows, which was the first weekly outflow after 19 consecutive weekly inflows since April.

Overall, the persistent inflows have led to a sharp turnaround of KRW positions with scored holdings turning positive or overheld since mid-July 2024, and for the first time since September 2022. KRW has since shifted deeper into overheld, joining the SGD in APAC as a traditional funding currency with this status (scored Holdings at 0.64 as of this week).

In term of asset interest, iFlow show a notable acceleration in demand for Korean equities since June against outflows in Taiwanese equities. This is an interesting divergence of flows considering similarities between the tech-export-driven economy. Meanwhile, flows for Korean sovereign bonds and corporate bonds has been muted over the past month.

Exhibit #3: KRW Turned Overheld and Persistence Demand in Korean Equities



Source: BNY, Bloomberg L.P.

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Please direct questions or comments to: iFlow@BNY.com

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