

# Focus

## SOUTH KOREA

### South Korea: Political turmoil and consequences for the economy

Since South Korean President Yoon Suk-jeol unexpectedly declared a short-lived martial law on December 3 last year, the country has been in a chaotic and at the very least delicate political situation. Democracy itself is (once again) under severe pressure in the country.

To understand how this country, which actually stands for stability in the region, got into the current situation, it is worth taking a look at the past. As is so often the case, political polarization is the result of decades of political and economic developments, which make the current crisis seem less surprising.

The direct economic impact of the political crisis on South Korea and its partners is still limited. However, the effects are also difficult to assess because South Korea's economy was already weakening. Like Europe and the USA, the country has had to contend with a tough inflationary trend following the pandemic and is facing a number of challenges. Intensified competition with China, global protectionism, demographics and weak consumption among Koreans themselves are just some of them.

Depending on how the situation develops, there will also be a noticeable impact on the German economy. As mutually important trading partners, the two economies are well connected. It is therefore also important for the German economy to keep a close eye on the situation.

## Contents

### Page 2

From martial law to chaos

From the colony to the miracle of the Han River

### Page 3

The architect of prosperity?

Legacy and reception of the upswing years

### Page 4

The reality of the Han River

### Page 5

South Korea and Germany - important partners

### Page 6

Effects on the German economy

### Page 7

Endurance test for democracy

### Page 9

Imprint and disclaimer

## From martial law to chaos

On December 3, 2024, it suddenly went around the world: South Korea's president had declared martial law and thus dismissed parliament. This was preceded by a budget dispute, a political gridlock that President Yoon hoped to end that way. However, his actions led to nationwide protests, horror in parliament and even a lack of understanding from within his own party. The very next morning he had to back down. A short time later, he was removed from office by the reconvened parliament and two proceedings are now underway against him. Impeachment proceedings by the Constitutional Court and an investigation by the anti-corruption authority for sedition and abuse of power. He has been in custody for the latter case since January 17. His arrest was preceded by failed attempts in which the police were initially unable to arrest him. Supporters and his bodyguard from the military prevented them from entering the presidential palace where Yoon was holed up. It took 3,000 police officers to succeed in arresting the president.

Yoon himself said he had turned himself in to prevent bloodshed, but does not consider himself guilty. He wanted to try to break through the "legislative dictatorship". This neologism, which requires at least some explanation, if not being meaningless in itself, comes from the fact that the president and his conservative People Power Party do not have a majority in parliament. Not only that: the opposition, the socially liberal Democratic Party, has actually had an absolute majority in parliament since the parliamentary elections in April last year. Two years into his five-year term, Yoon is no longer able to pass laws. He has to listen to parliament, which usually has a different opinion to his - as is the case with the budget. However, the opposition in parliament is just as incapable of dictating, as the president has a veto. As a result, Yoon himself and the government as a whole have become "lame ducks".

Yoon is now the first sitting president to be imprisoned and is to remain in custody for the time being. On January 20, his detention was extended after 48 hours. Supporters broke the windows of the court and stormed and vandalized parts of the building. There are now a few more days of hearings in the impeachment process before a decision is expected at the beginning of March. At least until then, the incumbent president will remain in custody, with experts now expecting an unanimous impeachment by the constitutional judges.

In the meantime, the interim president has also been removed from office by parliament and protests from both camps continue unabated. The president's supporters believe he has been unjustly stripped of his power, while the opposition sees him as a rebel who wants to get rid of parliament. To understand the reasons for all this chaos, it is worth taking a look at Korea's history.

## From colony to miracle on the Han River

South Korea's recent history is essentially characterized by an economic boom that was so successful that it was dubbed "The Miracle of the Han River", named after the river that flows through the capital Seoul.

From 1910 to 1945, Korea was a colony of the Japanese Empire. The reality was an oppressed society and an economy geared towards exploitation in Japan's favor. The raw materials of the North and the agricultural goods of the South were systematically removed from the country.

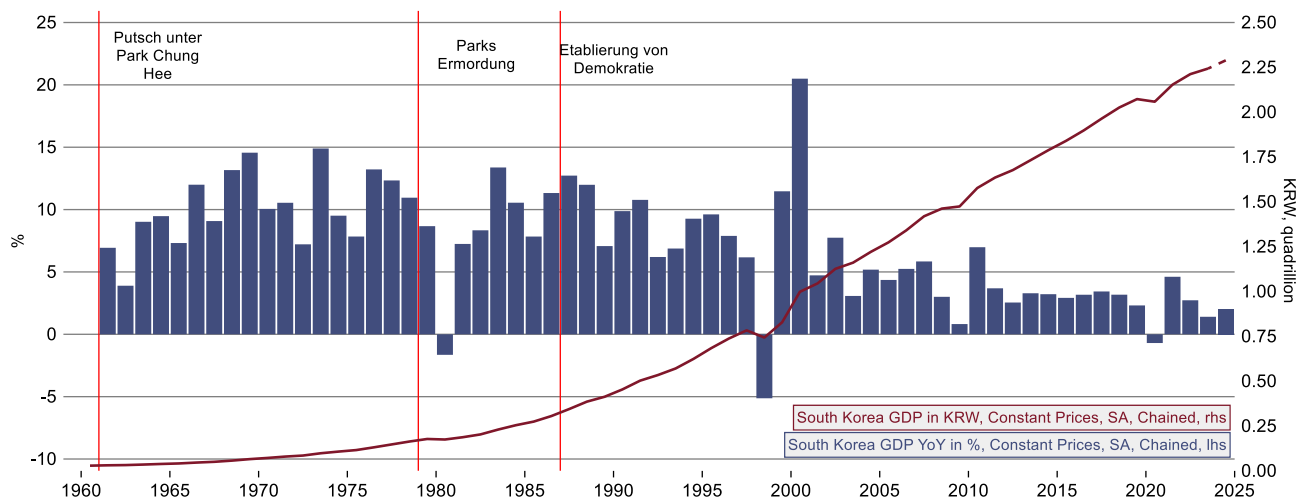
Liberation from Japan was followed by occupation by the victorious powers, the USA and the USSR, and from 1950-1953 by the Korean War and the division of the country. This war ultimately resulted in the current state territory of South Korea. The raw materials of the now hostile North were no longer available and the infrastructure that existed before the war was largely destroyed. There was no progress in the years that followed. Korea's first elected president, Rhee Syng-man, failed to revitalize the country. Instead, his style of government became increasingly autocratic. The government was accused of mismanagement and corruption was also blatant at the time.

## The architect of prosperity?

The upswing only came with another political turning point. In 1961, Park Chung-Hee staged a coup in South Korea. The general took advantage of the uncertainty in the country following a wave of protests against the Rhee government and seized power for almost two decades. During his military dictatorship, press freedom, human rights and democracy were predictably still in a very poor state. Park was assassinated in 1979, but it was not until 1987 that democracy was re-established in South Korea.

The economy, on the other hand, experienced a fabulous boom. The proximity of politics and business gave rise to large companies. So-called chaebols (direct translation: "rich clans"), which still exist today, are family-run companies that are supported by the state. The support came in the form of tax benefits, protection from foreign competition and direct state subsidies, for example. Samsung, LG and Hyundai are just a few examples of today's very large and successful companies that were established at that time. GDP growth rates averaged over 10% during the 1960s and 1970s.

### South Korea, Gross Domestic Product



Source: Macrobond, HCOB Economics, OECD (Organisation for Economic Co-operation & Development)

The miracle of the Han River is by no means a success of the free markets. The state gave the domestic economy a strong helping hand and did not shy away from deep intervention. By completely banning or restricting certain imports and massively subsidizing its export economy, South Korea was able to develop into an export nation in the long term. Farmers were forced to sell food cheaply and thus live in poverty. Workers' rights simply did not exist and were deliberately not granted. There was also a lot of politically motivated economic aid from the USA to non-communist Korea, which was supposed to prove its systematic superiority.

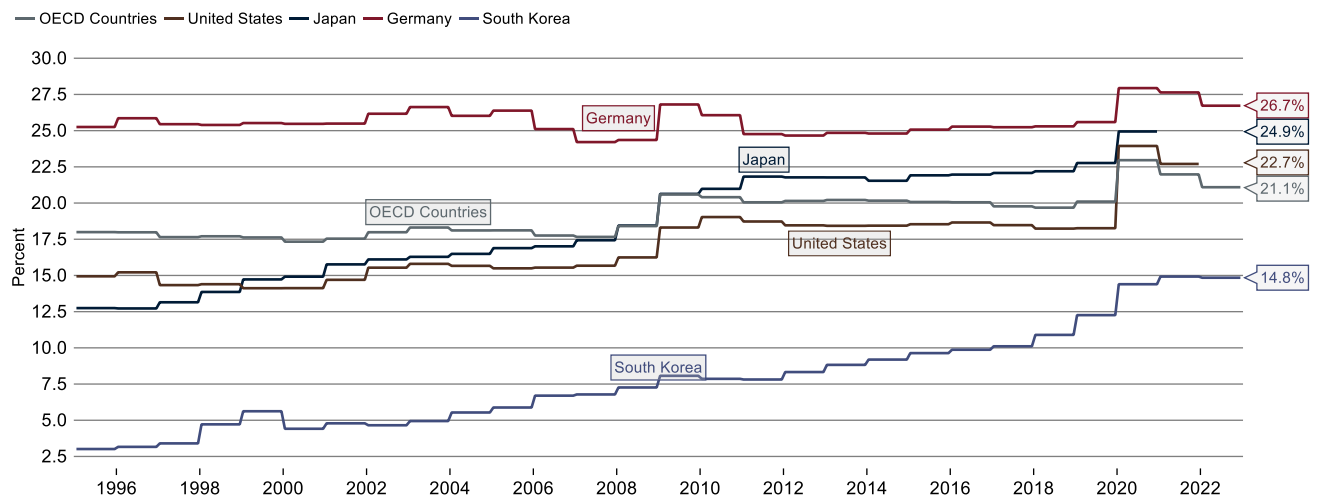
Nevertheless, with the upswing in the country, people's standard of living improved over time. There were many more goods and the state also invested heavily in education. This rise in the standard of living was attributed to Park, who is still regarded by many today as the architect of the newfound prosperity.

## Legacy and reception of the upswing years

The upswing in the years of the Park dictatorship still makes many Koreans overlook some things today and take the view that economic policy should continue in much the same way. After all, it is the agenda that led an impoverished ex-colony from the ruins of war to prosperity. It is symptomatic of this widespread view that, despite Park's dictatorial leadership, his daughter was elected president in 2012. She was removed from office in 2017 for corruption and was later imprisoned.

However, the negative consequences of this economic policy have also become apparent, particularly recently. Even years after the harsh policies of the years of strong growth, South Korea is still a country with very low social spending. Measured against GDP, social spending the lowest of all OECD countries. By no means all people have benefited from the economic upturn and government agencies have not closed this gap. This is an issue in society: if we look at the two most successful screen productions from Korea, we have the four-time Oscar-winning film "Parasite" and the hit series "Squidgame". The dramatic plots of both are based on extreme socio-economic discrepancies between the respective protagonists.

### Social Expenditure (SOCX) as a Percentage of GDP



Source: Macrobond, HCOB Economics, OECD (Organisation for Economic Co-operation & Development)

Furthermore, trade union influence is extremely low, with only around 5% of all workers being members. This is also due to the fact that many people are employed irregularly or are self-employed and often try to find work in the gig economy. The poverty rate also reflects this reality and is one of the highest among OECD countries. These social differences favor the rise of left-wing parties that want to address precisely this divide. Last year, the social-liberal DP led by Lee Jae-Myung won an absolute majority in the parliamentary elections. The leader of the DP is also polarizing. His proposals for redistribution, a basic income and, most recently, a 4-day week have been met with both approval and the greatest lack of understanding.

The government is now practically incapable of acting at a time when the country's economy is weakening and its divided society is feeling the effects of slower growth.

### The reality of the Han River

South Korea's economy has left the high growth rates of previous decades behind. While growth has averaged just under 3% since 2010, the country is struggling with a number of factors that are weighing on growth. The rate of expansion in 2024 was only 2.2%, lower than the initial estimate of 2.4

Firstly, inflation in Korea, similar to the USA and the eurozone, remains relatively high even now after the pandemic shock. The Bank of Korea therefore also had to raise interest rates in 2021, thereby curbing the economy. The key interest rate only fell again for the first time in the second half of 2024, from 3.5% to 3.0%.

In addition, key South Korean industries in particular are increasingly struggling with seemingly overpowering Chinese competition. One example is shipbuilding, which is traditionally an important industry for Korea. Here, China has a clear competitive advantage on the global market due to low local steel prices and wages. Chinese cars from companies such as BYD are also taking market shares that Hyundai, Kia and SsangYong were previously able to claim for themselves.

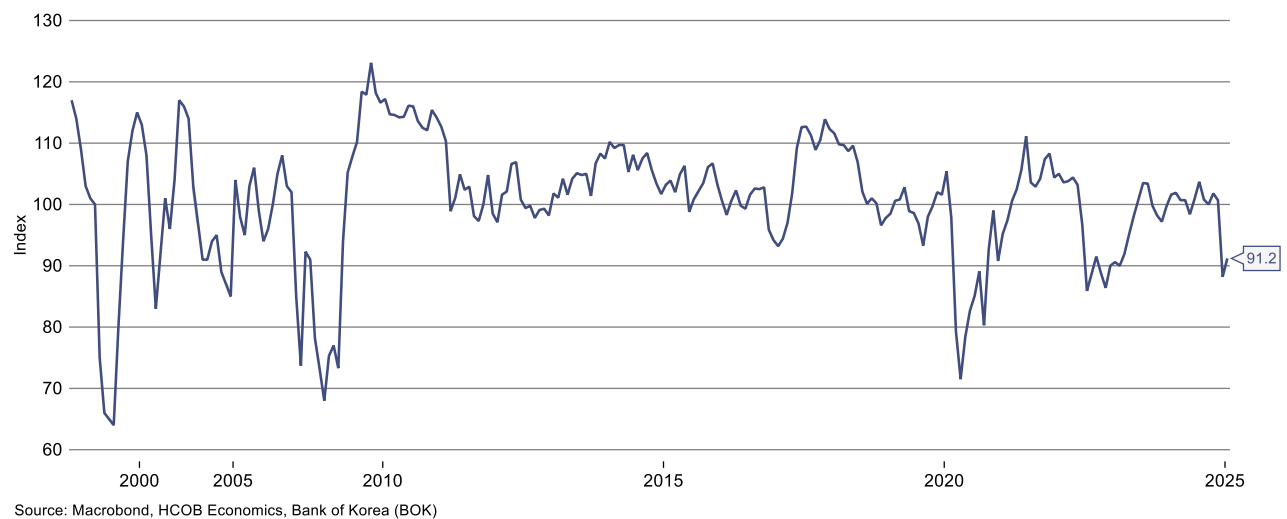
Unfavorable demographics also play a role and will play an increasingly important role. As the country with the lowest birth rate in the world, Korea is suffering from an ageing society. With a retirement age of 60, this also has a

particularly severe economic impact. The birth rate also emphasizes the lack of light-heartedness among the population, because people who are worried, have to work a lot, may live precariously and receive no support from the state likely prefer not to have children.

Consumers have become much more cautious and consumption has grown much less in recent years, only just under one percent last year. In addition, the Korean economy and its trade surplus are threatened by possible tariffs and protectionism, particularly from the US.

Surprisingly, the political unrest since December has so far had no lasting impact on the markets for Korean equities, bonds and the Won. There were losses for all three towards the end of the year, but these have been recovered, at least for the time being. Looking back over more than a year, these movements are hardly significant. Other minor negative developments as a result of political news have always been quickly ironed out in 2025.

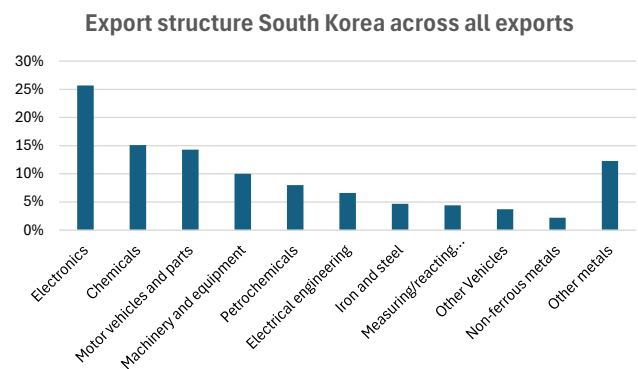
### Composite Consumer Sentiment Index, Bank of Korea



The Bank of Korea's consumer sentiment survey seems more alarming. This value indicates positive consumer expectations if it is above 100 and negative expectations otherwise. After slightly positive expectations prevailed in November, the value plummeted to 88 in December, the first month of the crisis, but recovered slightly to 91.2 points in January. This value could be an indicator of how people are feeling in economic terms about this crisis before broader data is available. For the time being, the mood seems at least cloudy.

### South Korea and Germany - important partners

As a globalized economy, there are relatively close economic ties between South Korea and Germany. Among other things, South Korea is one of Germany's most important trading partners. The balance of trade is in Germany's favor, as Germany exports more than it imports from Korea. In terms of direct investment, German funds in South Korea are estimated to have amounted to 15.5 billion euros at the end of 2023. A good two thirds of this was in the form of direct investments in South Korean companies. By contrast, the Republic of Korea had a stock of direct investments in Germany of just over six billion euros at the same time.

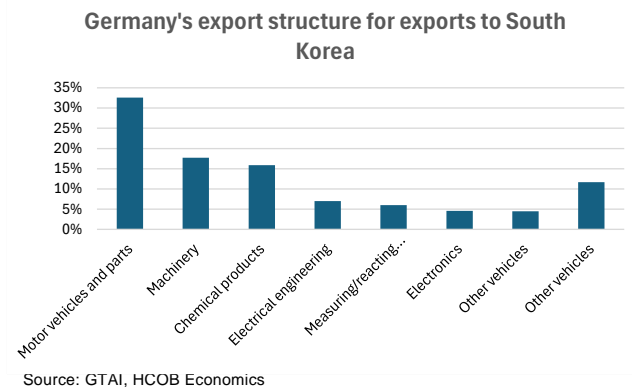


Source: GTAI, HCOB Economics

Germany is even Korea's most important trading partner in Europe. From a German perspective, Korea has slipped to third place among the most important Asian export destinations in 2024, behind China and Japan. A free trade agreement has been in place between Korea and the EU since 2011. As a result of these relations, South Korea was the 18th most important buyer of German goods in 2023 and accounted for 1.3% of all German exports.

While Korean consumers demand German cars, household appliances and medicines, the major technology companies mainly purchase inputs from German companies or buy machinery for their own production. German consumers also value their trading partner's cars and both private and commercial customers buy electronic devices and batteries from Korea. Many of them also buy from the world market leaders that the state helped to build up in the 1960s.

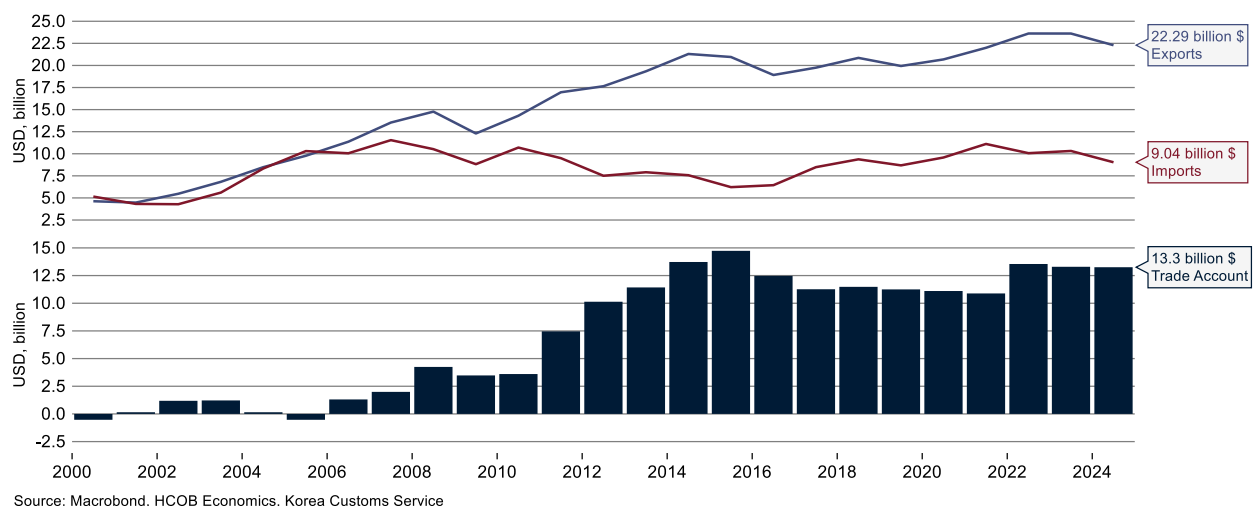
For both countries, cars are the most important export good to the other country. However, Germany has over 30% of this product in its export mix, while Korea only has around half as much. Korea appears to be generally better diversified with its exports, partly because the large tech companies offer a wide range of products. Exports are broadly diversified across the technology sector, which accounts for around 40% of exports to Germany.



## Effects on the German economy

If we combine economic relations with the economic and political challenges South Korea is facing, there are certainly some risks for the German economy.

### South Korea - Germany, Foreign Trade, German Perspective



If consumption in South Korea continues to weaken and the mood to buy declines due to uncertainty, German car manufacturers would be hit the hardest. Cars, especially German brands, which tend to be more upmarket, have a price-elastic demand and would be much less in demand in economically difficult times.

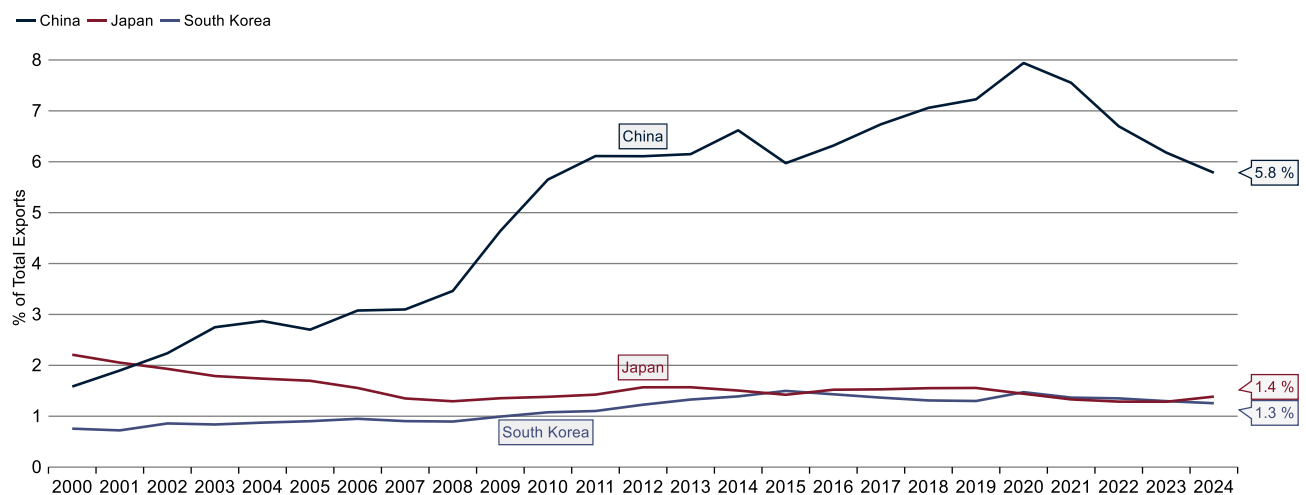
However, it is much more important to consider which political developments in South Korea would affect the German economy and how. The opposition DP, which has an absolute majority in parliament, is considered to be more China-oriented and strives for a balance between the US and China. It is therefore conceivable that German imports could be replaced by Chinese imports if the DP were to become a political force with the necessary executive power to pass laws.

If the conservative camp were to come up with the idea and have the strength to pursue a Park-style economic policy again, this would also have negative consequences for Germany. Certain imports could be banned or hindered again, meaning that German exports to South Korea could be partially or completely stopped in order to strengthen domestic producers.

And then there is the political worst-case scenario of further unrest and a possible collapse of democracy. This could result in EU sanctions. Or exports to the country could dry up due to an economic slump in the wake of political unrest.

If, for example, Korean consumers only demanded half as many cars from Germany as they did in 2024, there would be a shortfall of a good three billion euros in exports. This in turn would reduce the positive trade balance from over 13 billion to a corresponding ten billion Euros. On the other hand, there are also opportunities in every crisis. Even in the early days of the political unrest, Lee Jae-Myung called on people to invest in the country now while it was still reasonably priced. He recently proposed an investment package of 30 trillion Won (approx. €20 billion).

### Germany, Foreign Trade, Shares of top 3 Asian partners in total exports



Source: Macrobond, HCOB Economics, German Federal Statistical Office (Statistisches Bundesamt)

### Endurance test for democracy

South Korea's democracy is definitely facing a test. At the age of 38, it has to prove her steadfastness in a turbulent phase. The current unrest, Yoon's arrest and his possible impeachment are currently dominating the headlines. According to political observers, however, the big test would be possible new elections. Society will then have to vote again and it will become clear whether a new government capable of taking action can get laws passed. Be it to include the whole society or to stimulate the economy by further unleashing the markets.

Stability will be the most important factor for the economy. Consumers will only spend money if they can be sure that they will still have a job tomorrow and do not feel that they have to save it for worse times. An appropriate environment must be created for this - nationwide protests and "lame ducks" in government will not help. Otherwise, the conditions are not bad. Digitalization is at a top level worldwide, people are generally well educated and the country has many leading companies in various important and very future-oriented sectors.

Growth in the second half of the last century was undoubtedly impressive, perhaps even miraculous. However, it must be remembered that given the extremely low level of prosperity from which Korea started in the 1950s, double-digit growth rates can be achieved relatively quickly, especially if this is done with a kind of economic policy accelerator such as under Park. In hindsight, however, it is clear what can happen if not everyone participates sufficiently in the upswing, because it creates problems for the entire economy and not "only" problems for those who have fallen by the wayside.

It therefore remains to be hoped that society will find an orderly democratic way out of the current crisis and quickly find its way back to a policy capable of taking action. Because whatever the right path for South Korea may be, a lame duck will not be able to take it.

A message of hope came on February 10. A South Korean delegation traveled to the USA to discuss the tariffs. Representatives of both parties are on board, who are making this trip to pull together for their country.

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