

OPINIONMacro-Financial
Analysis Division**Key Macroeconomic Issues for 2025**

This article examines key macroeconomic issues for 2025, primarily focusing on three factors: the trade policies of the first Trump administration and their implications; the potential recovery of private consumption; and the exchange rate conditions and outlook. First, during his first term, President Trump pursued aggressive trade policies to secure more favorable trade terms, amplifying uncertainty and adversely affecting US economic growth. With the inauguration of his second administration, trade policy uncertainty has intensified, further weighing on Korea's export sector and adding downside risks to the country's growth trajectory. Second, private consumption in 2025 is unlikely to stage a rapid recovery, as it remains constrained by slowing exports and weakening consumer sentiment. However, the lagged effects of key interest rate cuts are expected to support a moderate rebound in private consumption in the second half of the year. Finally, the KRW-USD exchange rate is projected to decline gradually in the second half of 2025, driven by easing domestic uncertainties and increased capital inflows following Korea's inclusion in the FTSE World Government Bond Index (WGBI). Notably, despite these positive signals, the KRW-USD exchange rate is likely to exhibit downward rigidity due to the persistent strength of the US dollar and Korea's economic slowdown, which requires caution regarding the potential for elevated volatility in the near term.

Background of economic forecasts and issues

In 2024, the Korean economy followed an unstable growth trajectory. While annual GDP grew by 2.0%, reflecting year-over-year improvements, quarterly developments raised concerns. The country's GDP expanded robustly by 1.3% quarter-over-quarter in the first quarter of 2024 but contracted in the second quarter. Then it ended up posting marginal

* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

growth of 0.1% in both the third and fourth quarters. Exports, the primary driver of growth in 2024, are expected to lose momentum in 2025 due to mixed conditions across different sectors. Meanwhile, private consumption and capital expenditures are likely to remain subdued in the first half of 2025 amid heightened domestic and global uncertainties, limiting the prospects for a strong recovery in domestic demand. Against this backdrop, Korea's GDP growth for 2025 is projected to slow to 1.6% compared to the previous year. Consumer price inflation is expected to rise by 2.0%, given that global commodity price fluctuations remain contained and demand-side pressures, such as a widening negative GDP gap, exert a downward influence.¹⁾ As inflation converges toward the Bank of Korea (BOK)'s target and concerns over a slowdown in the real economy persist, monetary policy is anticipated to shift its focus toward growth. This is likely to result in a total 75-basis point cut in the key interest rate in 2025.

One of the primary risk factors in this macroeconomic outlook is the trade policy stance of the Trump administration. Recently, the US government unexpectedly announced plans to impose steep tariffs on Mexico and Canada, though implementation was temporarily postponed. Given that the first Trump administration maintained aggressive trade policies as a consistent strategy, not as one-off or short-term one, it is crucial to reassess those policies and their implications. Meanwhile, as export growth is expected to slow amid worsening external conditions, the recovery of domestic demand, particularly private consumption, will play a pivotal role in shaping Korea's growth trajectory in 2025. This highlights the need to examine the key determinants of private consumption and their potential impact and forecast future paths. Furthermore, although monetary policy measures are crucial for supporting economic recovery, a resulting high KRW-USD exchange rate could delay rate cuts and amplify negative effects, such as higher import prices. This suggests that exchange rate dynamics will likely emerge as a key driver of macroeconomic conditions going forward. Against this backdrop, this article explores three critical issues including: an assessment of the first Trump administration's trade policy and its implications; the prospects for a recovery in private consumption; and the outlook for exchange rate movements and their economic impact.

1) If the high exchange rate persists, with the KRW-USD exchange rate averaging in the mid-KRW 1,400 range for the year, consumer price inflation is projected to rise by an additional 0.1 to 0.2 percentage points compared to the current forecast.

Key macroeconomic issue 1: Analysis and implications of the first Trump administration's trade policy

President Trump recently signed executive orders imposing steep tariffs on imports from Canada and Mexico, through implementation has been suspended by one month. Furthermore, sweeping tariffs on Chinese imports have been raised by 10 percentage points, while the administration has increasingly threatened to impose tariffs on key EU industries, including automobiles. A 25% tariff on steel and aluminum imports has also been announced. Given that the Trump administration implements tariff measures more rapidly and extensively than initially expected by major forecasters, it has become challenging to predict future developments in US trade policy.

In his first term, President Trump imposed tariffs on solar panels, washing machines, steel, and aluminum, while progressively expanding tariff coverage on Chinese goods through four phases (see Table 1). At the time, the administration escalated trade disputes aggressively, leveraging them as bargaining tools to secure concessions from trading partners. By engaging in steel-related disputes, the US renegotiated free trade agreements with South Korea, Canada, and Mexico. Against China, the administration phased in tariff hikes on Chinese imports, ultimately leading to the signing of the Phase One trade deal, which required China to increase its purchases of US exports. Similarly, the recent executive orders targeting Canada and Mexico have been used to reach agreements on issues such as illegal immigration and drug control.²⁾ Notably, the 10 percentage point tariff increase in Chinese imports, which is deemed relatively moderate, may be interpreted as the administration's intention to leave room for a Phase Two trade deal.

2) The US may have won a diplomatic victory through this process, which, however, did not translate into substantive economic benefits. In the case of the US-China Phase One trade deal, trade tensions eased, but actual economic gains for the US remained dubious. Furthermore, as both countries shifted their focus to pandemic control amid the spread of Covid-19, the implementation of the trade agreement was pushed back on the priority list. In negotiations with Canada and Mexico, they agreed to deploy a certain number of troops along the borders to curb illegal immigration and drug trafficking. However, the actual size of troops agreed hardly differed from previous deployment levels.

Table 1. Timeline for US tariff hikes on Chinese imports during the first Trump administration

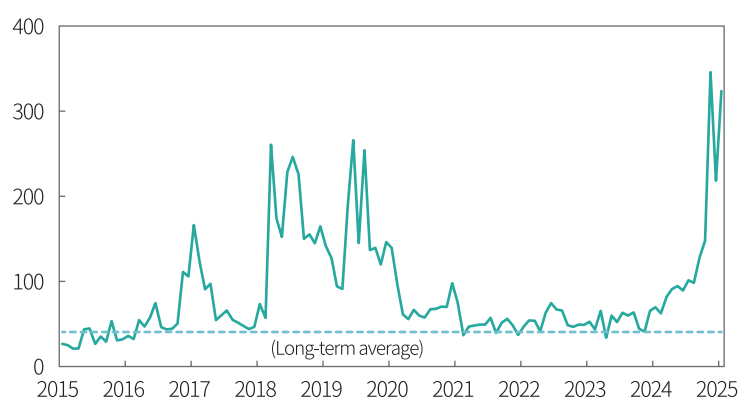
Date		Key measures
2018	Feb.	▪ Tariffs imposed on solar panels and washing machines under Section 201 (Safeguard) of the Trade Act of 1974
	Mar.	▪ Tariffs imposed on steel and aluminum under Section 232 (National Security) of the Trade Expansion Act of 1962 ▪ Announcement of a plan to impose tariffs on \$50 billion worth of Chinese imports under Section 301 (Unfair Trade) of the Trade Act of 1974
	Jul.	▪ Tariffs (25%) imposed on List 1 Chinese imports worth \$34 billion
	Aug.	▪ Tariffs (25%) imposed on List 2 Chinese imports worth \$16 billion
	Sep.	▪ Tariffs (10%) imposed on List 3 Chinese imports worth \$200 billion
2019	Jun.	▪ Increase in tariffs on List 3 Chinese imports (\$200 billion) from 10% to 25%
	Aug.	▪ Announcement of a plan to impose tariffs on List 4 Chinese imports worth \$300 billion
	Sep.	▪ Tariffs (15%) imposed on a portion of List 4 Chinese imports (List 4a, \$112 billion) ▪ Plan to impose tariffs in December on the remaining portion of List 4 Chinese imports (List 4b, \$160 billion)
	Dec.	▪ Under the US-China Phase One trade deal, the planned tariffs on List 4b were withdrawn, and the tariffs on List 4a were reduced from 15% to 7.5%

If Trump's tariff threat is primarily employed as a negotiating tool to secure more favorable trade terms and actual tariff impositions remain short-lived, will the trade policy have only a limited economic impact? Beyond the direct consequences of tariff imposition, the Trump administration's trade war introduces indirect effects stemming from trade policy uncertainty. Previous studies indicate that such uncertainty delays corporate capital expenditures and triggers financial market instability, ultimately hindering economic growth. As illustrated in Figure 1, US trade policy uncertainty surged significantly during the 2018-2019 period, far surpassing its long-term average since 1960. With Trump's reelection, uncertainty has already spiked beyond the 2018-2019 levels. An analysis of the economic impact of trade policy uncertainty during his first term³⁾ suggests that it reduced US economic growth by

3) This analysis was conducted using a modified version of the Boer & Rieth (2024) model, which is a vector autoregression (VAR) model composed of US tariff revenues as a percentage of GDP, imports, price index, trade policy uncertainty index, VIX, and GDP. Sign restrictions were used to identify shocks, and trade policy uncertainty shocks were defined as increases in both the trade policy uncertainty index and VIX.

approximately 0.2 to 0.3 percentage points. Given that the new administration has introduced various tariff measures early in its term, creating uncertainty in both the real economy and financial markets, US and global economic growth forecasts are likely to be revised downward. In the face of heightened policy uncertainty, exceeding levels observed during Trump's first term, external instability is expected to weigh on Korea's export sector anticipated to slow further, adding downside risks to growth. An empirical analysis indicates that if trade policy uncertainty and actual tariff implementation influence economic growth in 2025 and 2026, respectively, with the level of intensity observed during Trump's first term,⁴⁾ Korea's economic growth is projected to decline by 0.25 percentage points in 2026. However, if tariffs directly target Korea's key export items, the negative impact on growth is likely to be both greater and more immediate than the current projections suggest.

Figure 1. US trade policy uncertainty



Note: The long-term average refers to the mean value since 1960.

Source: Caldara et al. (2020)

Key macroeconomic issue 2: Prospects for private consumption recovery

With export-driven growth anticipated to weaken in 2025, the recovery of private consumption will emerge as a key determinant of Korea's economic growth trajectory. Among the primary factors affecting private consumption, exports and consumer sentiment are likely to exert downward pressure, whereas monetary policy is expected to provide support. Specifically, the slowdown in export growth (Figure 2) is likely to constrain household income. In addition,

4) Under this assumption, US economic growth is projected to decrease by 0.2 percentage points in 2025 and 0.6 percentage points in 2026.

heightened external uncertainty following the inauguration of the new Trump administration, combined with Korea's increased domestic uncertainty, will likely dampen consumer sentiment (Figure 3), further weighing on private spending. In contrast, the interest rate cut cycle initiated in the fourth quarter of 2024 is projected to expand household consumption capacity and incentivize spending over saving. The dynamic effects of these conflicting forces warrant a close examination of the potential for a private consumption recovery in 2025.

Figure 2. Export growth

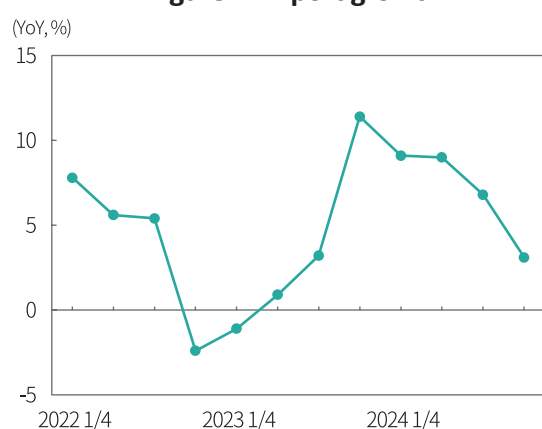
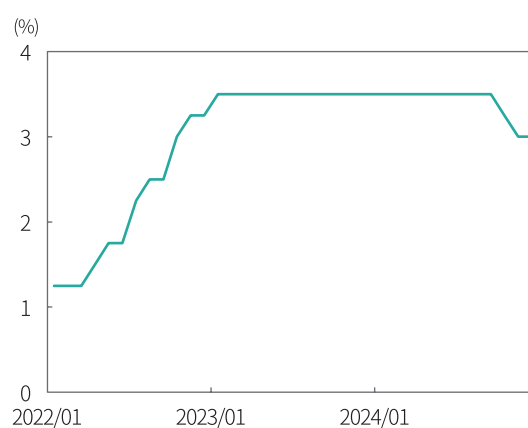


Figure 3. Consumer sentiment



Figure 4. Key interest rate



Source: Bank of Korea

Figures 5 to 7 present the impulse responses of private consumption to a slowdown in export growth, deteriorating consumer sentiment, and key interest rate cuts.⁵⁾ The analysis

5) For this analysis, a block-exogenous vector autoregression model was employed to estimate impulse response functions. The model includes the US trade policy uncertainty index, Korea's export growth, Korea's private consumption growth, Korea's consumer sentiment index (log-transformed), and the call rate as endogenous variables. Dummy variables during the global financial crisis as well as the Covid-19 pandemic are added as exogenous variables.

reveals that a shock to export growth induces the sharpest contraction in private consumption within the same quarter, with significant effects persisting into the following quarter. A consumer sentiment shock reaches its peak impact after one quarter, before gradually fading by the third quarter. Conversely, interest rate cuts have the strongest consumption-boosting effects three to four quarters after implementation. Although these effects weaken gradually over time, they remain significant for an extended period. In summary, slowing export growth and worsening consumer sentiment lead to an immediate decline in private consumption, while the stimulative effects of rate cuts unfold with a longer time lag.

Figure 5. Private consumption response to an export slowdown shock

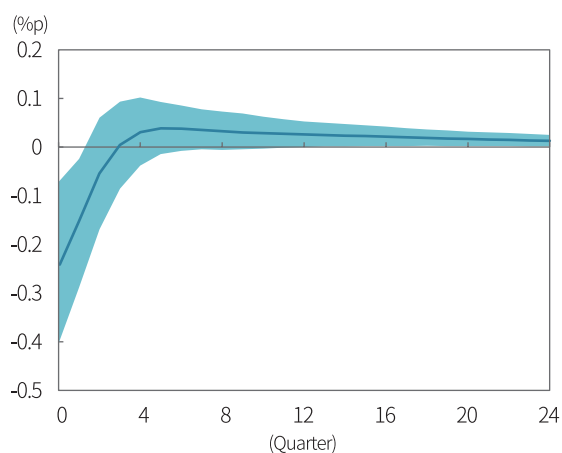


Figure 6. Private consumption response to a consumer sentiment deterioration shock

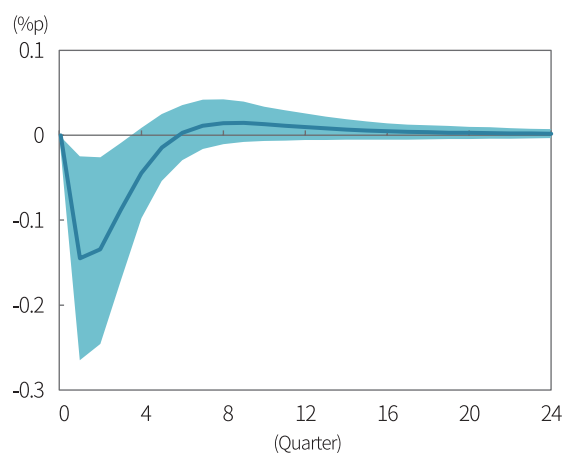
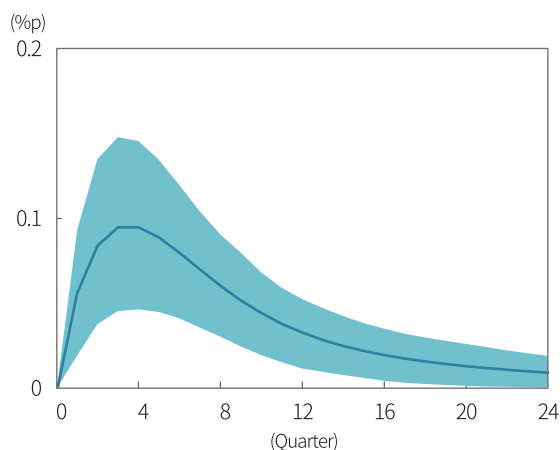


Figure 7. Private consumption response to a key interest rate cut shock



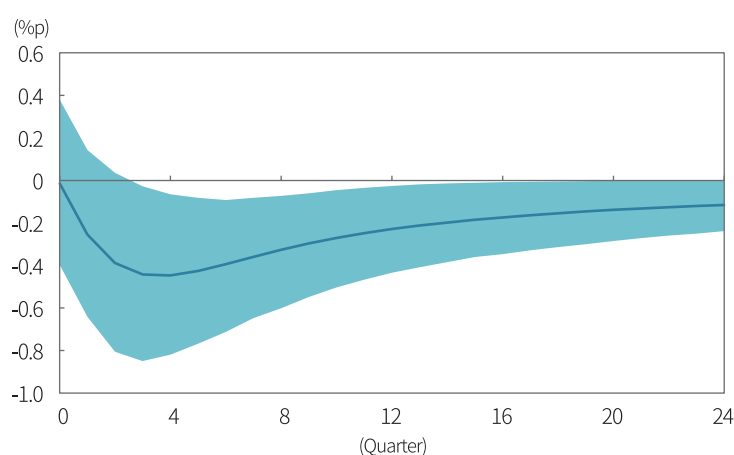
Note: 1) Private consumption response over time (quarters) following a one standard deviation shock to each variable.

2) The shaded area represents the 68% confidence interval.

Source: Korean Capital Market Institute

Taken together, the recent export slowdown and weakening consumer sentiment are expected to constrain private consumption recovery in the first half of 2025. In contrast, the effects of monetary easing are likely to become more pronounced in the second half of the year, gradually improving consumption conditions. However, it should be noted that heightened trade policy uncertainty following the second Trump administration could further disrupt Korea's export conditions with a lag (Figure 8), posing additional downside risks to private consumption through export channels. This calls for close monitoring of the potential amplification of US trade policy uncertainty and its broader economic implications.

Figure 8. Export response to increased US trade policy uncertainty



Note: 1) Export responses over time (quarters) following a one standard deviation shock.

2) The shaded area represents the 68% confidence interval.

Source: Korean Capital Market Institute

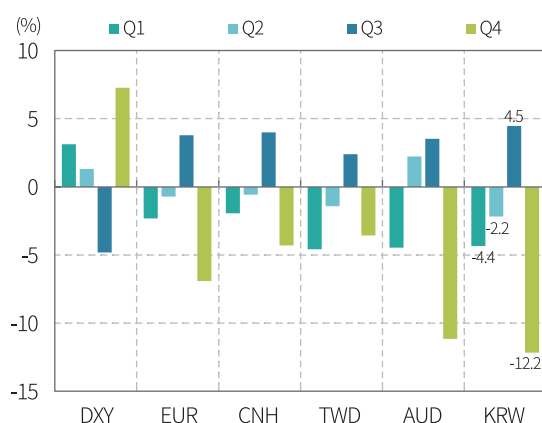
Key macroeconomic issue 3: Exchange rate conditions and outlook

Throughout 2024, the KRW-USD exchange rate showed an upward trend driven by a persistently strong US dollar, a delayed domestic demand recovery, and heightened internal and external uncertainties. The US Federal Reserve (Fed)'s rate cut in the third quarter led to a decline in the exchange rate. However, the dollar's rebound following President Trump's election victory, coupled with rising domestic uncertainty and the shock from Korea's key rate cut in November, led to a sharp depreciation in the Korean won in the fourth quarter, outpacing the decline of other major global currencies against the dollar (Figure 9). Unlike previous episodes of the Korean won depreciation,⁶⁾ which were largely influenced by external factors

6) According to Lee (2024), the correlation coefficient between the KRW-USD exchange rate and the DXY during the 2020-2023

such as movements in the US Dollar Index (DXY) and changes in global risk appetite, Korea's domestic factors played a more prominent role in driving the exchange rate higher in 2024. A historical decomposition of exchange rate drivers suggests that domestic factors contributed +10.7% to KRW-USD exchange rate fluctuation, significantly outweighing the impact of external factors such as the DXY (+4.4%) and the MSCI Emerging Markets (EM) Index (-1.0%) (Figure 10). From a macroeconomic perspective, Korea's economic growth trajectory, monetary policy adjustments, and rising uncertainty appear to have been key drivers of changes in other domestic factors throughout 2024. Specifically, fluctuations in other domestic factors during the first half of the year closely aligned with growth trends.⁷⁾ Moreover, the increased downward pressure on the Korean won, largely driven by other domestic factors, coincided with the timing of Korea's key rate cuts and heightened domestic uncertainty.

Figure 9. Major currency appreciation by quarter in 2024

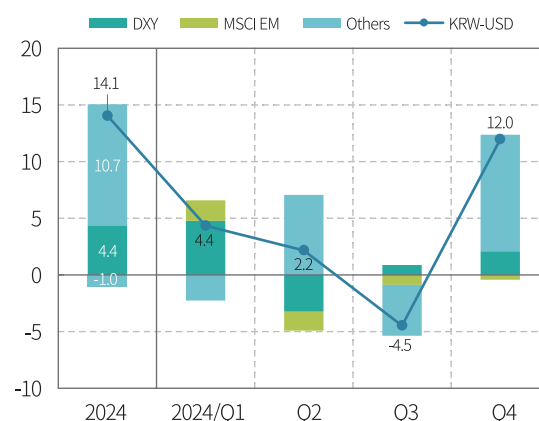


Note: 1) QoQ variation (negative figures indicate the weakness of the respective currency)

2) DXY refers to the US Dollar Index

Source: Bloomberg, Korea Capital Market Institute (KCMI)

Figure 10. Factors for KRW-USD exchange rate fluctuations in 2024



Note: Historical decomposition of KRW-USD exchange rate fluctuations based on regression analysis (2011-2024, using quarterly changes). Other factors represent residuals from the regression model.

Source: Bloomberg, KCMI

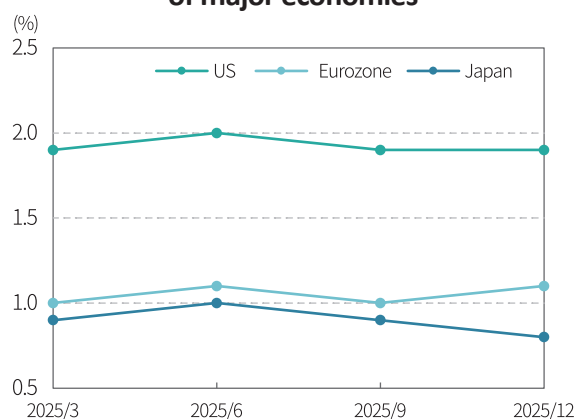
In 2025, overall conditions are expected to support the strength of the US dollar while sustaining the downward pressure on the Korean won. On the external front, the US economy is projected to maintain a stronger growth trajectory relative to Japan and the Eurozone (Figure

period stood at 0.96, a significant increase from past levels.

7) As previously mentioned, the Korean economy experienced strong growth in the first quarter (up 1.3% QoQ) but reversed into negative growth in the second quarter.

11). This pronounced divergence in growth momentum will likely work in favor of US dollar appreciation in the near term. On top of that, with the Fed expected to delay policy rate cuts following Trump's inflationary policy, other advanced economies facing greater downside risks are likely to continue easing monetary policy. This could further widen the divergence in monetary policy trajectories (Figure 12). Additionally, elevated global risk stemming from trade tensions between the US and major economies is expected to sustain demand for safe-haven assets, further supporting the strong dollar and exerting depreciation pressure on the Korean won throughout 2025.

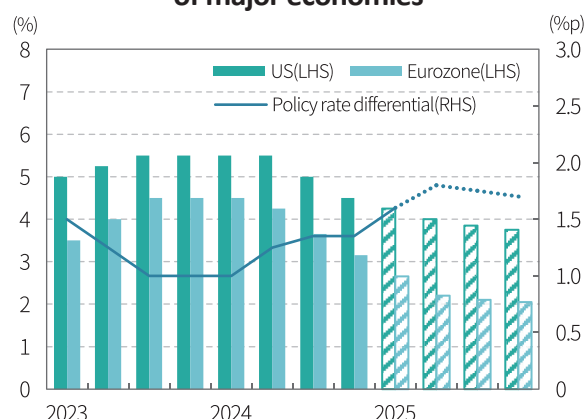
Figure 11. Economic growth forecasts of major economies



Note: Dotted and solid lines indicate forecasts based on Bloomberg data.

Source: Bloomberg

Figure 12. Policy rate trends of major economies

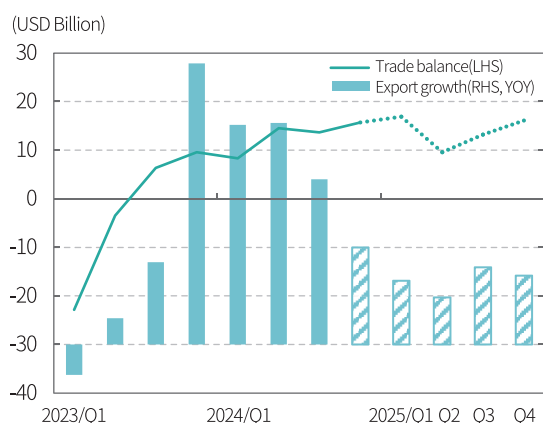


On the domestic front, downward pressure on the Korean won is also expected to persist in 2025. Notably, a potential sharp slowdown in Korea's export growth, fueled by shifts in US trade policy, alongside sluggish domestic economic conditions is likely to keep the KRW-USD exchange rate elevated throughout the year. However, given that heightened domestic uncertainty is less likely to have a fundamental impact on exchange rate movements, these uncertainties are anticipated to subside in the second half of the year, contributing to a stabilization of the KRW-USD exchange rate. Furthermore, the inclusion of Korean government bonds in the FTSE World Government Bond Index (WGBI) is expected to attract capital inflows⁸⁾ in the latter half. Meanwhile, conditions in residents' outbound equity investment will likely

8) According to Kim (2023), Korea's inclusion in the WGBI is estimated to lead to an appreciation of the Korean won against the US dollar by up to 4.8%.

incentivize the liquidation of foreign equity holdings, creating more favorable conditions for the KRW-USD exchange rate.

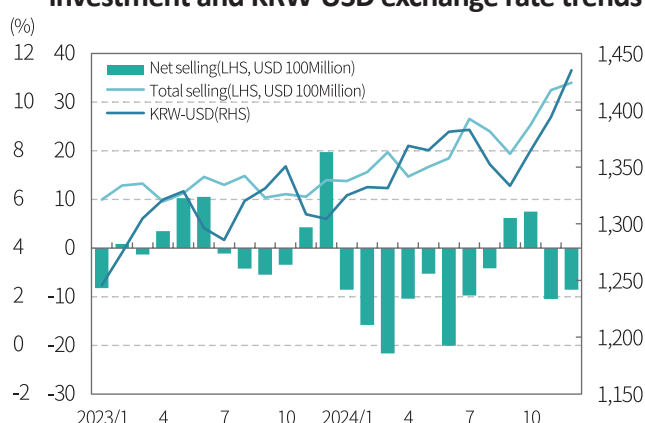
Figure 13. Export growth and trade balance



Note: Dotted and solid lines indicate forecasts based on KCMI data, and the trade balance is based on customs clearance data.

Source: BOK, Korea Securities Depository, KCMI

Figure 14. Retail investors' outbound equity investment and KRW-USD exchange rate trends



Considering these internal and external factors, the KRW-USD exchange rate is likely to experience heightened volatility relative to other major currencies in the first half of 2025 before gradually stabilizing in the second half. While conditions for a weak won are expected to persist, supported by the sustained US dollar strength and Korea's economic slowdown, downward pressure on the currency is likely to ease somewhat in the second half as domestic uncertainty diminishes. Nonetheless, given that the strength of the US dollar prevails globally, the KRW-USD exchange rate is projected to exhibit downward rigidity throughout the year. Furthermore, if domestic uncertainties like the recent political turmoil persist for an extended period, they could amplify depreciation pressures on the won, potentially triggering abrupt volatility spikes. This highlights the need for Korean policymakers to take proactive measures to avoid risks associated with excessive exchange rate fluctuations.

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