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Korea Views: Korea—Riding Stronger and Longer AI Tailwinds

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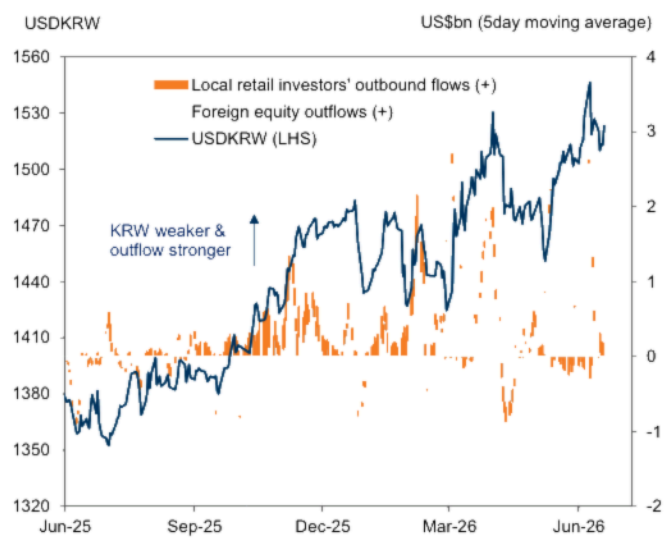
- The AI capex boom is proving stronger and longer than expected for Korea's chip cycle, as reflected in our tech team's upgrade to the memory demand outlook. We expect the AI-driven super surplus to accelerate into year-end, pushing total exports above USD1 trillion and the current account surplus to a record high of around 15% of GDP.
- We raise our real GDP growth forecasts to 2.7% in 2026 (+10bp) and 2.3% in 2027 (+40bp), both above consensus, on a stronger and more durable AI impulse through capex, R&D, and wealth effects. We leave inflation unchanged at 2.6% and 2.2%, under our updated base-case scenario for reopening of the Strait of Hormuz, and extend the hiking cycle into 2027 and lift our terminal policy-rate forecast to 3.25% from 3.0%.
- Domestic transmission remains uneven. First-half data show a wider gap between semiconductors and the rest of the economy: memory-led exports are surging, while non-tech exports, retail sales, consumption, and tech-sector job creation remain subdued. Wage and inflation spillovers also look contained. The tech wage base is small, and low margins elsewhere should limit broad wage inflation. We expect headline inflation pressure to come mainly from import prices and forex rates, while core goods inflation has remained contained this time, unlike in 2022. Housing risks are more localized. Seoul metropolitan area prices have re-accelerated since mid-May, but prices elsewhere remain stable.
- Fiscal balances could be substantially stronger than projected a year ago. We estimate additional memory-related tax revenue of about 2% of GDP in 2026, which together with a recent decision to save some excess revenues could reduce the consolidated deficit from a planned 1.9% of GDP to less than 0.5% of GDP.
- The stronger fiscal and external positions reinforce our market view: KRW looks too weak relative to fundamentals and the policy direction, while rates markets are pricing in an increasingly hawkish policy path. Policy is already leaning towards countering potential overheating, as reflected in hawkish guidance on monetary policy and the decision to avoid procyclical spending increases. KRW stabilization is likely to become a broad policy priority, given strong forex pass-through to inflation and equity-rally-related forex pressures from rebalancing needs and leveraged positions. Monetary tightening is unlikely to move rapidly, however, given still-limited domestic demand pressures and high household debt-service burdens. Risks to our updated policy-rate views are balanced: upside from wage pressures and downside from KRW appreciation.

1. The AI boom is boosting Korea's chip demand more strongly and for longer than previously expected, as reflected in a recent upgrade to the memory demand outlook by our tech team. Korea's current account reached a record high of 15% of GDP in Q1, and we expect the AI-driven super surplus to accelerate into year-end, pushing total exports above USD1 trillion (Exhibit 1) and the current account surplus in excess of 15% of GDP in 2026. High frequency data show that almost all the surplus in the first half was recycled offshore through record-high net foreign equity outflows (rebalancing needs and leveraged positions), weakening the KRW despite a sharp improvement in the current account balance (Exhibit 2).

Exhibit 1: Exports of goods on track to reach USD 1 trillion in 2026 on strong memory demand

Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 2: Recent surge in foreign equity outflows outweighed gains in the current account, weakening KRW



Source: Haver Analytics, Goldman Sachs Global Investment Research

2. We raise our growth forecasts to 2.7% in 2026 (+10bp) and 2.3% in 2027 (+40bp), both above consensus, on a stronger and more durable AI impulse (Exhibit 3). The revision is driven mainly by capex, including R&D, with a smaller contribution from wealth effects. Consistent with a recent BOK study, we keep the estimated wealth effect modest, reflecting the concentration of equity investors among wealthy and older households, higher local equity-market volatility, and small financial assets relative to property assets, similar to Australia. Our inflation forecasts remain unchanged at 2.6% and 2.2%, versus consensus of 2.7% and 2.1%, under our updated base-case scenario for reopening of the Strait of Hormuz, which assumes normalization in oil exports from Gulf producers by late August. In line with these macro revisions, we now forecast the hiking cycle to extend into 2027 with a terminal policy rate of 3.25%, up from 3.0% previously.

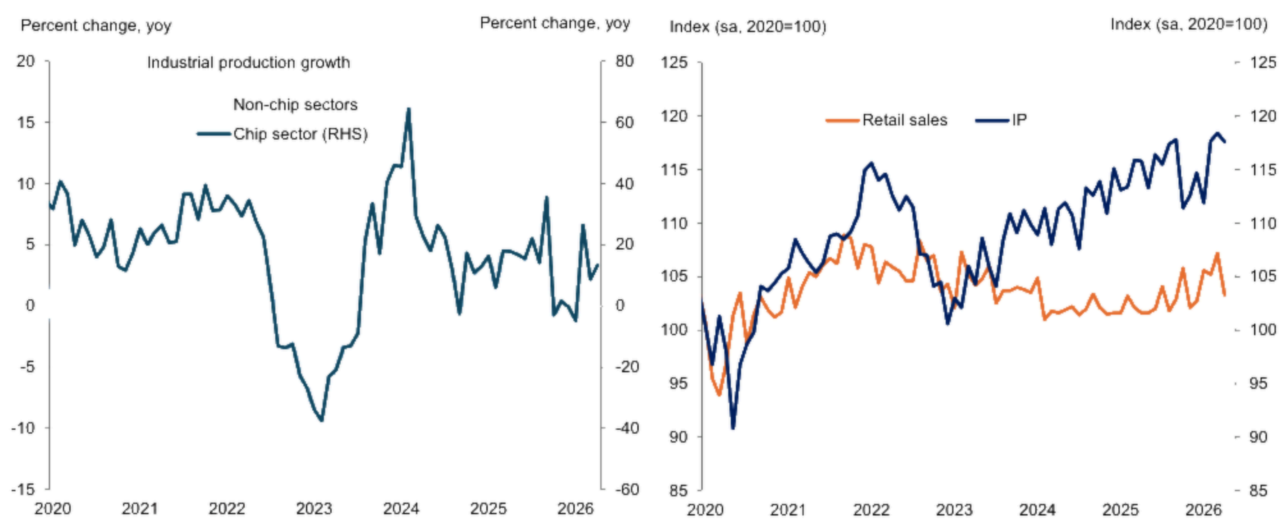
Exhibit 3: We expect growth meaningfully higher in 2027 than consensus

Macro forecasts	2025	2026	2027
Real GDP growth			
GS forecast	1.1	2.7	2.3
BOK forecast		2.6	2.1
BBG consensus		2.6	2.0
Headline CPI inflation			
GS forecast	2.1	2.6	2.2
BOK forecast		2.7	2.3
BBG consensus		2.6	2.1

Source: Goldman Sachs Global Investment Research

3. The stronger AI cycle is lifting Korea's external balances and growth outlook, but its domestic transmission remains narrow. First-half data show a widening divergence between semiconductors and the rest of the economy (Exhibit 4). Memory-led exports continued to surge, while non-tech exports remained stagnant and retail sales stayed subdued (Exhibit 4). Overall consumption also remained soft, despite recent pickups in luxury goods sales.

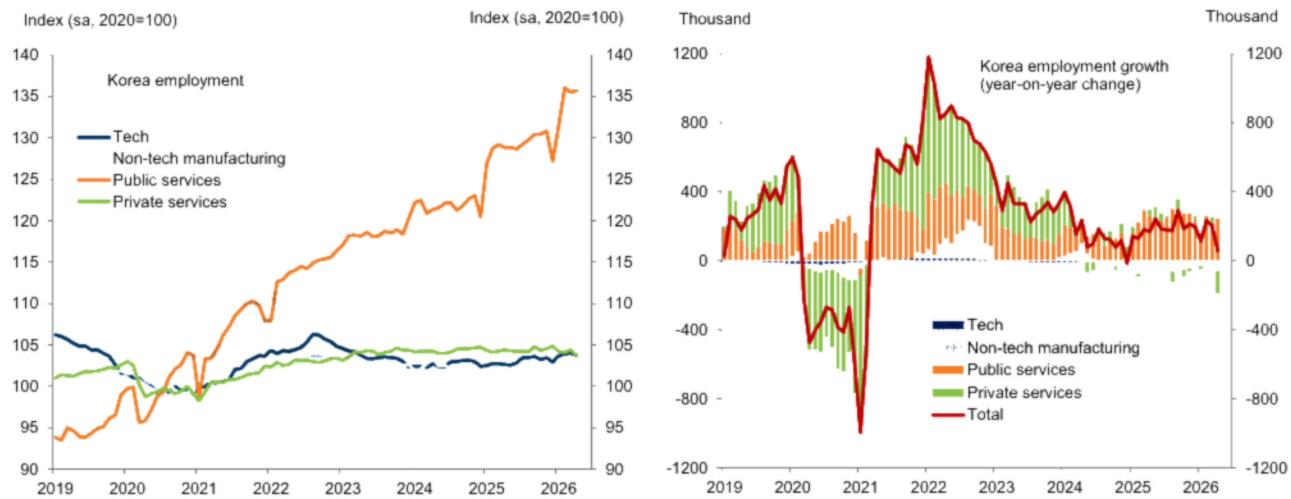
Exhibit 4: K-shaped cycle—tech vs non-tech and production vs consumption



Source: Haver Analytics, Goldman Sachs Global Investment Research

4. This uneven transmission is also visible in the labor market. Job growth has shifted increasingly toward public services, including healthcare, public administration, and defense, rather than the tech sector. Public services have more than fully accounted for job growth since 2025, after contributing less than 50% in 2019. This reflects demographic headwinds and related government job programs that have expanded public employment for more than a decade, largely at the expense of non-tech manufacturing jobs (Exhibit 5). Overall labor markets remain lackluster, with subdued wage growth and little support from tech-sector hiring, as semiconductor job creation has been broadly flat since 2024 given the sector's heavy capex orientation.

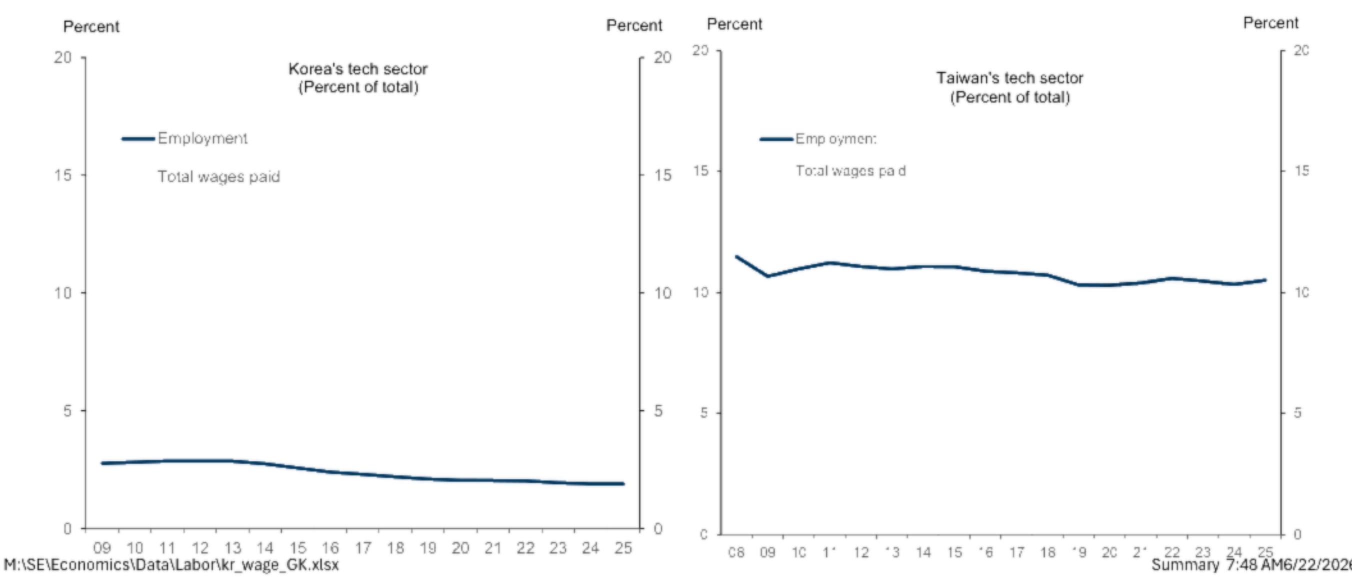
Exhibit 5: Increasing dominance of public sector jobs in labor markets in Korea



Source: Haver Analytics, Korea Statistics Office

5. The same limited labor-market transmission should also contain wage spillovers. Recent wage agreements at major semiconductor companies should have only a limited near-term impact on overall wage growth, given the small tech wage base. Tech-sector wages accounted for around 3% of total wage bills, or 1.2% of GDP in 2025—less than one-third of Taiwan's share—while wage bills of major memory companies accounted for just 0.4% of GDP (Exhibit 6). Tech-sector wages are set to rise on strong chip earnings and related performance payments. Even so, we estimate that post-tax bonus payments at major memory companies would remain around 0.5% of GDP in 2026 and 0.9% of GDP in 2027, equivalent to a relatively small supplementary budget early this year. The main offsets are special-bonus payment terms, mostly in locked-up equities, and high tax rates of nearly 50%, reflecting the top personal income tax rate and various mandatory social contributions.

Exhibit 6: Korea's tech sector accounts for far smaller jobs and total wages paid than Taiwan

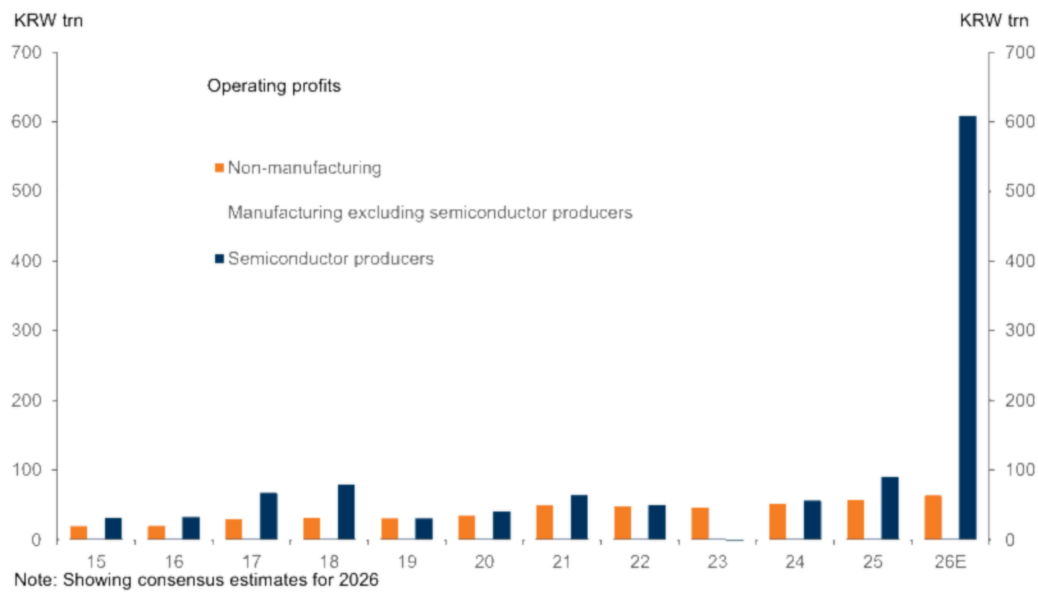


Source: CEIC, Haver Analytics, Goldman Sachs Global Investment Research

6. The key question, then, is whether higher memory-sector wages could spill over to the

rest of the economy. We think this spillover risk is constrained by weak profitability outside semiconductors. Nearly 80% of jobs are in non-manufacturing sectors such as retail, construction, education, and healthcare, where margins have historically been below 5%. Within manufacturing, non-tech profit margins have also weakened in recent years to cyclical lows of around 5%, due to sustained regional overcapacity and competitive global markets. The divergence in earnings is also stark: operating profits of semiconductor companies will rise more than 6 times year-on-year in 2026, compared with just 40% for non-tech listed companies and 10% for non-manufacturing companies (Exhibit 7).

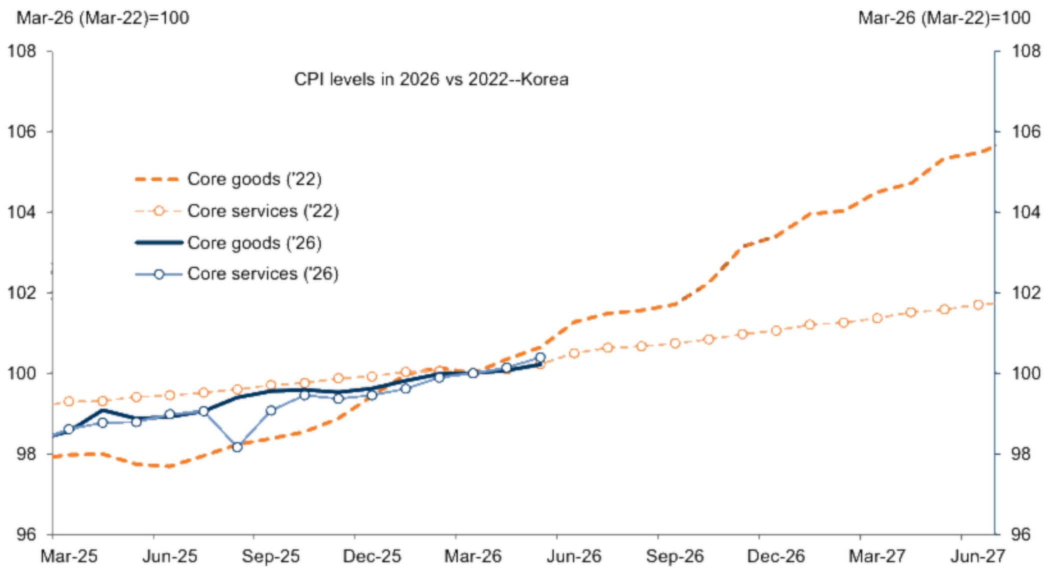
Exhibit 7: Large divergence in profits between chip and other sectors



Source: Quantiwise

7. With broader wage spillovers likely contained, inflation pressures should come mainly through imported goods prices and exchange rates. Headline inflation has picked up on surging energy prices, largely as expected. Core price pressures, however, remain contained. Core goods prices, excluding food and fuel, rose only moderately through May, unlike in 2022, when they had increased a cumulative 3.4% from March to December and 4.0% yoy in December (Exhibit 8). In contrast, core services prices, excluding eating out, utilities, and transportation services, increased only moderately in Korea in both cycles, rendering further support for limited second-round effects from imported inflation.

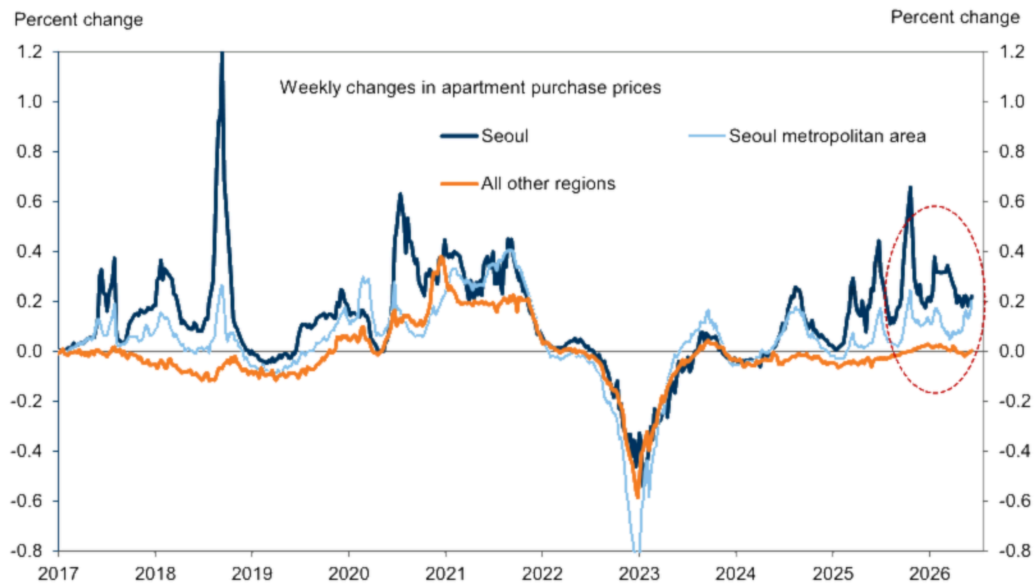
Exhibit 8: Korea's core goods prices have been stable relative to those during the post-pandemic inflation cycle



Source: Haver Analytics, Goldman Sachs Global Investment Research

8. The main domestic policy concern, however, is shifting from broad inflation to localized financial-stability risks. Seoul metropolitan housing prices have re-accelerated since early May, while housing prices elsewhere have remained stable since early April, after initial signs of modest recovery. This stands in sharp contrast to the broad housing boom during the pandemic period (Exhibit 9). This combination points to a policy mix that can remain targeted rather than broadly restrictive, especially as stronger fiscal and external balances create additional room for macro stabilization as discussed before.

Exhibit 9: Housing prices in Seoul metropolitan area have recently re-accelerated but those elsewhere have remained stable



Source: Haver Analytics, Kookmin Bank

9. Fiscal balances in 2026 and 2027 could be substantially stronger than projected a year ago. The 2026 budget assumed a consolidated deficit of KRW52.7trn on KRW390trn of tax revenue. Given the sharp improvement in semiconductor earnings prospects, we estimate roughly KRW60trn of additional tax revenue (approximately 2% of GDP) could be collected in 2026, on top of the KRW25trn already reflected in the government's March supplementary budget (Exhibit 10). As a result, the consolidated budget deficit could fall from a planned 1.9% of GDP to less than 0.5% of GDP, even if a second supplementary budget were passed in the second half with spending similar to the first one.[1] Semiconductor-related corporate tax upside could remain significant in 2027 as well, at roughly 5% of GDP above the amounts projected last year.

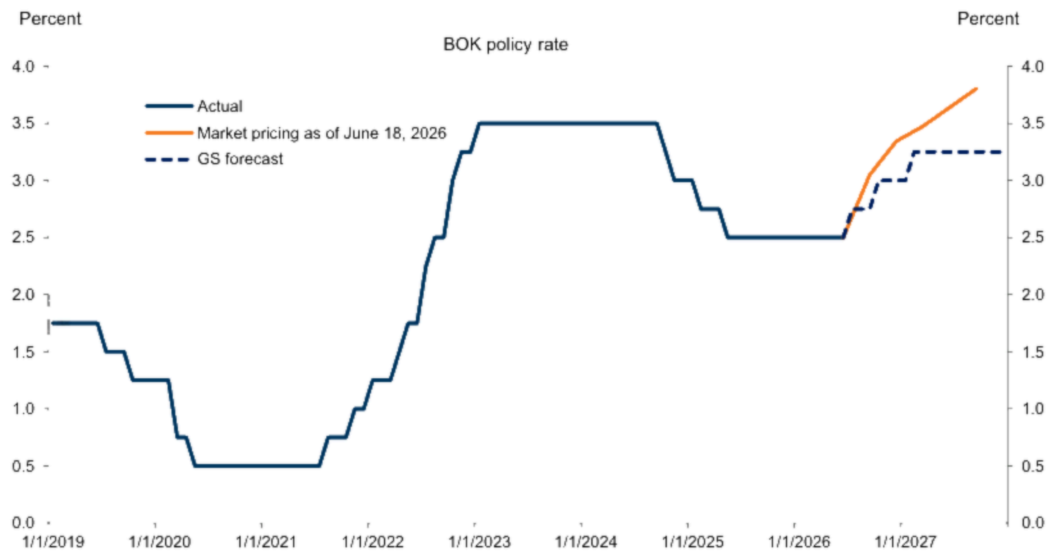
[1] Corporate tax payables accrued by semiconductor producers in 2026, estimated at approximately at 5% of GDP by our tech analysts, would be more than twice their actual tax payments for the year, with the remainder to be paid in early 2027.

Exhibit 10: The AI boom strengthens Korea's fiscal outlook materially

Source: Haver Analytics, Goldman Sachs Global Investment Research

10. Korea's stronger external and fiscal positions together with narrow domestic transmission reinforce our market view: KRW looks too weak relative to fundamentals and policy direction, while rates markets price an increasingly more hawkish policy path (Exhibit 11). Policy is already leaning towards countering potential overheating. The government has chosen to save large excess revenues to lift growth potential rather than increase procyclical spending, while the BOK has provided hawkish guidance on monetary policy. KRW stabilization is likely to become a broad policy priority, given strong forex pass-through to inflation and equity-rally-related forex pressures from rebalancing needs and leveraged positions. Even so, monetary tightening is unlikely to proceed rapidly, given still-limited domestic demand pressures and an elevated household debt-service burden. The BOK is hence more likely to focus on managing inflation expectations and supporting broader policy efforts to counter overheating in metropolitan housing markets. Risks to our updated policy-rate views are balanced, with upside risk from wage pressures and downside risk from KRW appreciation.

Exhibit 11: Market pricing of policy rates is more hawkish than our view



Source: Haver Analytics, Goldman Sachs Global Investment Research