The Won's Long Winter

South Korea's 2025 Underperformance and the Case for a High-Beta 2026 Recovery

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Abstract

South Korea entered 2025 as the sick man of North Asia. A constitutional crisis that began with December 2024's short-lived martial law episode, the subsequent impeachment saga, and a bruising trade renegotiation with Washington combined to drag real GDP growth down to roughly 1.1%, less than half of trend and the weakest non-pandemic print since 2009. The won sagged past 1,400 to the dollar, construction contracted, and household balance sheets bent under debt near 90% of GDP. Yet beneath the political wreckage, the export engine kept firing: HBM and DRAM shipments from Samsung and SK Hynix rode the global AI capex wave. This paper argues that Korea is a high-beta cyclical trade, not a structural allocation. We see growth recovering toward 1.8% in 2026 as politics normalize and the memory cycle broadens, but the recovery is levered to two exogenous forces, the AI capex durability and US trade policy, that Seoul does not control. We stay tactically Underweight with a defined path to add.

1. The Anatomy of a Lost Year

No major Asian economy underperformed its own potential in 2025 by more than South Korea. Consensus entered the year expecting growth near 2.0%, roughly in line with the Bank of Korea's estimate of potential. Instead, the economy limped to approximately 1.1%, a shortfall of nearly a full percentage point that reflects an unusual convergence of a political shock, a policy paralysis, and an external squeeze arriving in the same twelve months.

The political rupture set the tone. The December 2024 martial law declaration, rescinded within hours but not before it detonated confidence, opened a six-month period of impeachment proceedings, an acting presidency, and a Constitutional Court ruling that consumed the state's bandwidth through the first half of the year. Fiscal policy stalled while the executive was contested. Corporate capex decisions outside the chip complex were deferred. Consumer sentiment, as tracked by the Bank of Korea's monthly composite, fell to levels last seen during the pandemic and stayed depressed well into the second quarter.

The external squeeze arrived on schedule. The United States moved a reciprocal tariff framework into force during 2025, and although Korea negotiated its headline rate down from the threatened 25% to roughly 15% on most goods, the settlement came bundled with a large investment pledge toward the US and lingering uncertainty over autos and steel. For an economy where exports approach 40% of GDP and the US and China together absorb the bulk of shipments, even a managed tariff outcome is a drag. WTO projections for global merchandise trade volume growth of only about 0.5% in 2026, down from above 2% across 2024 and 2025, frame the headwind Korea's trade-geared model now leans into.

Our view: 2025 was not a structural break in Korea's growth model. It was a cyclical air pocket produced by a self-inflicted political shock landing on top of a global trade slowdown. That distinction matters, because it is the basis for expecting mean reversion rather than decline in 2026.

2. The Two Koreas Inside the Data

The single most important feature of the 2025 data is its bimodality. There were effectively two Korean economies in 2025 moving in opposite directions, and any coherent 2026 view has to account for both.

2.1 The semiconductor economy that never stopped

Memory was the bright spot, and it was blindingly bright. High-bandwidth memory, the stacked DRAM that sits beside AI accelerators, ran structurally short of supply all year. SK Hynix consolidated a commanding lead in HBM3E qualification into the leading US accelerator supply chains and posted record quarterly operating profit, while Samsung, after a slower HBM qualification cycle, re-established momentum through the second half. Conventional DRAM and NAND prices, which had languished in oversupply, inflected higher as capacity was diverted toward HBM and as server demand tightened the commodity segment. Korean semiconductor exports set successive monthly records through the autumn, and the chip line item alone accounted for the lion's share of total export growth.

2.2 The domestic economy that seized up

Everything not plugged into the AI supply chain struggled. Construction was the clearest casualty. Both building and civil works contracted, project financing strains among developers and savings banks lingered from the prior real estate downturn, and construction investment subtracted from growth for most of the year. Private consumption was tepid, weighed by the confidence shock and by households allocating income to debt service rather than spending. Petrochemicals, steel, and lower-end manufacturing faced direct competition from Chinese overcapacity and China's persistent deflation, which exports disinflation across the region. The result was an economy where a single sector masked broad-based domestic weakness in the headline number.

Indicator	2024	2025 (est)	2026 (Darmine)
Real GDP growth	2.0%	1.1%	1.8%
CPI inflation (avg)	2.3%	2.0%	1.9%
BOK base rate (year-end)	3.00%	2.25%	2.00%
KRW per USD (year-end)	1,470	1,430	1,320
Semiconductor exports (yoy)	+44%	+22%	+12%
Construction investment (yoy)	-1.5%	-4.5%	-1.0%
Household debt (% of GDP)	91%	89%	88%
Current account (% of GDP)	5.3%	5.0%	4.5%

Darmine estimates and forecasts. Historical figures compiled from Bank of Korea, Statistics Korea, and Korea Customs Service releases through Q3 2025. Semiconductor export growth reflects value, not volume; HBM mix lift flatters the figure.

3. The Won, the Bank, and the Debt

The won was the region's clearest expression of Korea's 2025 malaise. It weakened past 1,400 and traded near 1,430 into year-end, among the worst-performing major Asian currencies. Three forces pressed on it at once: the political risk premium, a policy rate that the Bank of Korea was cutting into a widening gap with the Federal Reserve, and the mechanical drag of Korea's large offshore portfolio outflows as residents diversified savings into US equities.

3.1 Bank of Korea: easing into a growth hole

The Bank of Korea was among the region's more dovish central banks in 2025, trimming the base rate to roughly 2.25% by year-end from 3.00% as it prioritized the growth shortfall and a soft labor market over currency defense. That stance sits within our house map of a divergent Asia, where the BOJ is normalizing toward 0.75 to 1.0%, the PBoC runs a moderately loose bias against deflation, the Fed is cutting, and the MAS lets the Singapore dollar appreciate gradually. Korea's cutting cycle is closer to China's easing pole than to Japan's tightening pole, which is precisely why the won carried a soft bias against both the dollar and the yen.

The constraint on the Bank of Korea is not inflation, which is running near the 2% target and drifting lower, but financial stability. Household debt near 89% of GDP is among the highest in the OECD, and a large share is floating-rate and housing-linked. Cutting too aggressively risks reigniting the Seoul property market and the leverage that comes with it; cutting too slowly starves a weak domestic economy. The Bank has managed this with macroprudential tightening on mortgages running alongside rate cuts, a two-track approach we expect to persist into 2026 with perhaps one further cut to a 2.00% terminal rate.

> **Our view:** We expect the won to be the highest-beta expression of the Korea recovery trade. A move from roughly 1,430 toward 1,320 through 2026 is our base case, driven by political normalization compressing the risk premium and by the current account surplus reasserting itself. The won is the cleanest way to express a constructive Korea view without taking single-stock memory risk.

4. The Memory Cycle Is the Whole Thesis

Strip away the politics and the currency and the Korea 2026 call reduces to a single question: does the AI capex boom that drove HBM and DRAM demand in 2025 sustain into 2026, or does it roll over? Everything else is second order.

The bullish case rests on capex durability. Hyperscaler capital spending guidance from the major US cloud platforms continued to rise through 2025, and J.P. Morgan's framework has Taiwan and Korea capturing roughly 30% of global AI capex, the mechanism behind our house expectation of 12 to 13% EPS growth for Asia ex-Japan in 2026. HBM is sold forward under long-term agreements, giving Korean suppliers unusual revenue visibility into 2026. The diversion of wafer capacity toward HBM has tightened conventional DRAM, so even the commodity memory segment, historically the source of brutal boom-bust cycles, entered 2026 with firmer pricing than a normal cyclical upswing would deliver.

The bearish case is equally coherent, and we take it seriously. AI capex is concentrated among a handful of buyers whose return-on-investment case is unproven at current spending levels; a single guidance cut from a hyperscaler would ripple straight through Korean memory earnings. Chinese memory makers are climbing the technology ladder with state backing, threatening the commodity segment on a two to three year horizon. And the HBM boom is, by construction, cyclical: pricing that goes up on tight supply comes down when capacity catches up, and Samsung, SK Hynix, and Micron are all adding capacity.

> **Our view:** This is why Korea is a tactical trade and not a structural allocation. The upside is real and levered, but it is owned by two variables Seoul cannot influence, the durability of US hyperscaler capex and the trajectory of US trade policy. We are constructive on the 2026 memory cycle, but we size Korea as a high-beta cyclical position that we expect to trim into strength, not a compounding hold. For structural conviction in Asia we look to India; Korea is the beta overlay on top of it.

5. Korea in the Regional Frame

Korea's 2026 story only makes sense against the regional backdrop. Asia-Pacific is set to grow roughly 4.4% in 2026 and to contribute close to 60% of world GDP growth, but that aggregate masks enormous dispersion. India leads at about 6.5% on domestic demand; Vietnam and Indonesia sit near 5 to 6.5% on manufacturing FDI and downstreaming; China grows about 4.4 to 4.5% but with fading exports and entrenched deflation; Japan normalizes policy against 1.6% inflation and 5.5% Shunto wage settlements. Against this field, Korea's projected 1.8% places it near the bottom of the regional growth table, alongside Thailand.

The comparison with Thailand is instructive because it clarifies what kind of laggard Korea is. Thailand's roughly 1.8 to 2.5% reflects structural problems: an aging demographic, a stranded auto industry mid-transition, high household debt, and dependence on Chinese tourism that has not recovered. Korea's low headline number is cyclical and political, sitting atop one of the world's most sophisticated export complexes. Two economies can print similar growth for opposite reasons, and the investment implication diverges accordingly: Thailand is a structural Underweight, Korea a tactical one with a recovery path.

5.1 The AI capex axis versus the trade-exposure axis

Two forces sort the region in 2026. The first is exposure to AI capex, which rewards Taiwan and Korea most directly, with Malaysia benefiting through packaging and Singapore through data-center and equipment demand. The second is exposure to the global trade slowdown and US tariffs, which punishes the most open, China-linked exporters. Korea sits uncomfortably at the intersection: maximally geared to the AI upside through memory, yet also among the most trade-exposed to the tariff and China-overcapacity downside. That dual exposure is the definition of high beta, and it is why Korea will likely be the region's most volatile equity market in 2026 in both directions.

Economy	2026 GDP	Chip-cycle beta	Darmine stance
India	~6.5%	Low	Overweight (structural)
Indonesia	~5.0%	Low	Overweight / accumulate
Singapore	2.0-4.0%	Medium	Overweight (quality)
Vietnam	6.0-6.5%	Medium	Market weight
China	4.4-4.5%	Medium	Underweight domestic demand
Japan	~1.6% infl.	Medium	Market weight (financials)
Malaysia	Moderate	High	Market weight
South Korea	~1.8%	Very high	Underweight / tactical
Thailand	1.8-2.5%	Low	Underweight (structural)

Chip-cycle beta is Darmine's qualitative assessment of an economy's equity-market sensitivity to the global memory and AI accelerator demand cycle. Japan row shows FY2026 inflation as a policy reference rather than growth.

6. The 2026 Recovery: Path, Not Certainty

Our 1.8% growth forecast for 2026 is a recovery, but a modest one, and it rests on a sequence of conditions rather than a single assumption. Understanding the sequence matters more than the point estimate.

First, political normalization. With the leadership question resolved and a functioning executive in place, the fiscal and policy paralysis of the first half of 2025 lifts. A supplementary budget and restored administrative capacity should support a rebound in confidence and a stabilization in construction, which stops being the growth drag it was. This is the single largest swing factor in the domestic economy and the one we have most conviction on, simply because the 2025 base was so depressed that mean reversion does much of the work.

Second, the memory cycle broadens without breaking. Our base case is that AI capex sustains through 2026 at a pace that keeps HBM tight and pulls conventional DRAM and NAND pricing higher, so the chip contribution to growth stays positive even as the year-on-year export comparison decelerates from the torrid 2025 pace toward a still-healthy 12%. We do not need memory to accelerate; we need it not to collapse.

Third, trade policy does not deteriorate further. The roughly 15% US tariff settlement is a known quantity that the economy can plan around. The risk is not the current level but a renegotiation or a sectoral escalation on autos or semiconductors. A stable, if unfavorable, trade regime is sufficient for our forecast; further escalation is the primary downside scenario.

> **Our view:** The three conditions are not equally likely to fail. Political normalization is close to banked. Trade stability is probable but exogenous. The memory cycle is our genuine source of forecast risk, both to the upside and the downside. If we are wrong on Korea in 2026, it will be because we were wrong on AI capex, and that is a call about California and Seattle, not Seoul.

7. How We Would Trade It

A high-beta tactical view demands a disciplined expression, because the same volatility that makes Korea attractive on entry makes it dangerous to hold through a cycle turn. We separate the trade into three legs.

- Currency as the core expression. Long the won against the US dollar, targeting a move from roughly 1,430 toward 1,320, captures the political-normalization and current-account recovery without concentrated single-name memory risk. This is our preferred vehicle for a constructive Korea view.
- Memory equities as the beta amplifier, sized small and traded actively. Exposure to the leading HBM franchises offers the highest torque to the AI capex thesis, but we treat it as a position to trim into strength rather than a hold, given the cyclicality embedded in memory pricing and the concentration of end demand.
- Domestic recovery plays as the diversifier. Financials benefit from a steeper curve and stabilizing credit, and construction-linked names are deeply washed out after a multi-year downturn. These offer a way to own the political-normalization leg with lower AI-capex correlation than the chip names.

The unifying discipline is that Korea is a trade with an exit, not an allocation to compound. We enter on the recovery thesis, we monitor a short list of catalysts that would invalidate it, and we are prepared to reduce quickly. The asymmetry we want is to participate in a levered 2026 recovery while retaining the option to step aside the moment the memory cycle or trade regime turns, because in a very-high-beta market the round trip is unforgiving.

> **Our view:** The single most important portfolio instruction on Korea for 2026 is behavioral, not analytical: do not fall in love with the position. The memory cycle that carries it up will eventually carry it down, and the discipline to sell strength is what separates a good high-beta trade from a bad structural bet.

Portfolio Positioning Summary

Overweight: None within Korea at the portfolio level; Korea is not a house Overweight. Where forced to express constructive Korea exposure, we prefer the won over equities and financials over memory single-names.

Market weight: Korean financials and select domestic-recovery cyclicals, which offer geared exposure to political normalization and a steeper curve with lower AI-capex correlation than the chip complex. Sized as a tactical, monitored position.

Underweight: South Korea overall relative to Asia-Pacific benchmarks. The 2026 recovery to roughly 1.8% is real but modest, levered to two exogenous variables (US hyperscaler capex and US trade policy) that Seoul does not control. High beta warrants tactical sizing, not a structural allocation. For structural Asian conviction we look to India, Indonesia, and Singapore.

Key catalysts to reassess: Reassess to add on: (1) confirmation of sustained hyperscaler AI capex guidance into 2026; (2) HBM long-term agreement renewals at firm pricing; (3) won stabilizing below 1,400 with portfolio outflows easing; (4) a supplementary budget and construction stabilization. Reassess to cut on: (a) any hyperscaler capex guidance reduction; (b) US sectoral tariff escalation on autos or semiconductors; (c) Chinese memory makers achieving HBM-class qualification; (d) a renewed Seoul housing-leverage spiral forcing the BOK to hold or hike.

Conclusion

South Korea's 2025 was a lost year, but it was lost to a political accident and a trade squeeze rather than to any decay in the underlying export machine. That is the crux of the case for 2026. When the cause of underperformance is a self-inflicted confidence shock landing on a depressed base, the most likely path forward is mean reversion, and our 1.8% growth forecast, a currency recovery toward 1,320, and a broadening memory cycle all follow from it. Korea should be one of Asia's better cyclical performers in 2026, precisely because it was one of its worst in 2025.

But better is not the same as owned. Korea's recovery is levered to forces set in California, Seattle, and Washington rather than Seoul, and the same beta that makes the upside compelling makes the position hazardous to hold through a turn. We stay tactically Underweight, express constructive views through the won and, selectively, financials, and keep our structural conviction reserved for India. Korea is a trade with an exit. We intend to take it, ride the 2026 thaw, and sell the strength before the next winter arrives.

Sources and Further Reading

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