

Global Emerging Markets

A letter from South Korea...

In this report we discuss the recent presidential election in South Korea which has sparked optimism for economic reform and stock market growth in the country. President Lee's administration has announced an ambitious agenda to address the longstanding 'Korea discount' and target KOSPI 5,000 through comprehensive developments. Corporate governance is a key factor in Northcape's proprietary sovereign risk discount factor, and the reform agenda has put the country under positive watch.

In June the Northcape Emerging Markets team visited Seoul, the sprawling metropolis of 9.4 million people that sits just 50km from the border with South Korea's belligerent neighbour to the north. It was an opportune time to be in the capital following the presidential election on 3 June, and we held a range of meetings with companies, political experts, and economists. The resounding victory of Lee Jae Myung's progressive Democrat Party and his bold agenda for reform offers hope that the long-term 'Korea discount' will diminish through a sustained re-rating of the country's stock market.

Exhibit 1: The Inauguration Ceremony of Lee Jae Myung (Source: Republic of Korea government)



In a landmark election (see Exhibit 1 for inauguration), Lee won with the widest margin of votes (2.89 million) in nearly three decades against conservative candidate Kim Moon-soo of the People Power Party (PPP). The PPP's poor showing was in large part a consequence of the spectacular own goal of then-president Yoon (of the PPP) declaring martial law during a televised address in December 2024, which was followed ten days later by his impeachment and subsequent arrest and indictment. Lee ran on a reform-oriented platform focused on reducing inequality, boosting domestic economic growth, and removing the 'Korea Discount' of low local stock market valuations.

Importantly, Lee's Democratic party also has a majority (56%) of seats in South Korea's National Assembly (the country's legislature), giving the government the ability to push through new legislation with ease. Further, Lee's term runs until 2030 and the next elections for the National Assembly are not until April 2028, giving the Democratic Party a three-year window (at least) in which to pass new laws.

At a press conference 30 days into his term, Lee pledged that the country "will spare no investment in future industries such as artificial intelligence, semiconductors [and] renewable energy". He emphasised that his government "will prepare for the 'KOSPI 5000' era", referencing the government's ambitious target for the main local stock index (some 50% above the current level).

On 23 June the Lee administration added credibility to the KOSPI 5000 target through the establishment of a dedicated Special Committee. Kim Byung-kee, the Democratic Party's floor leader, said at the launch ceremony, "We will create a foundation of trust where foreigners can invest with confidence, ending the 'Korea Discount' (see Exhibit 2), and ushering in an era of 'Korea Premium'."

On 3 July, the government proved that there is substance to the positive words, with a torrent of significant changes to South Korean corporate law. The amendments to the Commercial Act included:

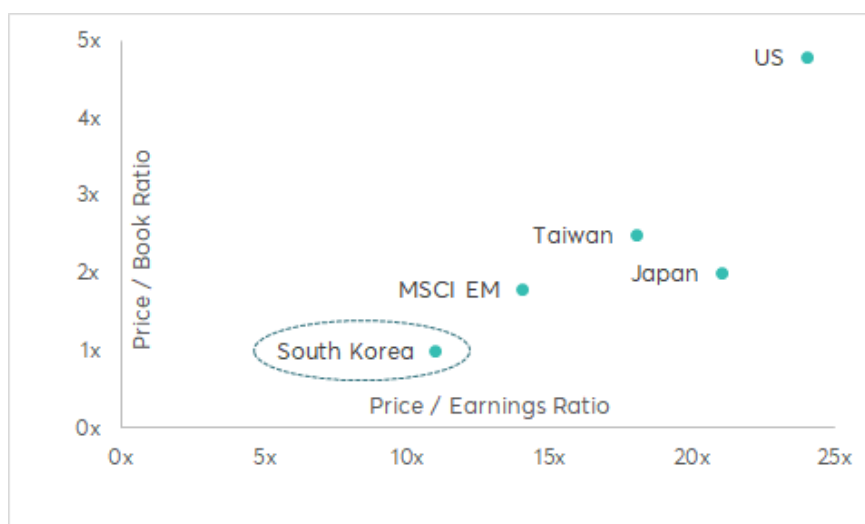
- Expanding the fiduciary duty of directors to shareholders (from "the company" previously);
- Mandating electronic (i.e. online) shareholder meetings (offshore investors had previously been disadvantaged as companies had the option of holding in-person meetings where investors who were not physically present could not vote); and
- Limiting the voting of majority shareholders and related parties to 3% when appointing an auditor.

Further investor friendly initiatives which have been tabled but have not yet passed into law include the mandatory cancellation of treasury shares, and mandatory cumulative voting (a mechanism which gives minority shareholders greater influence over director selection). The Lee government has also pledged to implement global best practice to tackle insider trading, market manipulation, and corporate fraud.

The policy changes already appear to be having an effect. The IMF revised up its 2026 GDP growth rate forecast for South Korea to 1.8%, a 0.4% increase from previous forecast, and the Korean Won ended the first half of this year +6% versus the USD. The local share market is also starting to reflect the changes with KOSPI index ending the month of July up +20.5% in USD since the 3 June election, outperforming the MSCI EM index which is +8.5% over the same period.

There was a small hiccup when right at the end of the month the government announced proposed changes to Korean tax law, which spooked the market resulting in a -3.9% sell off in the country's KOSPI index on 1 August.

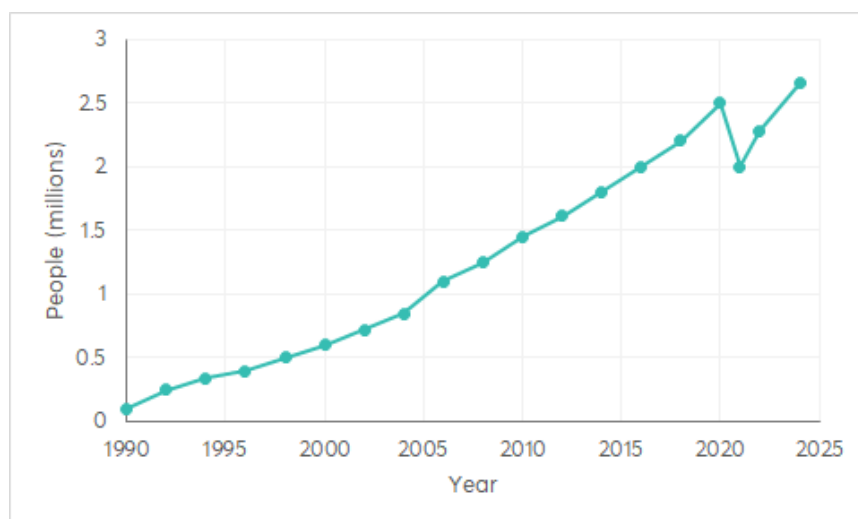
Exhibit 2: South Korea is One of the Cheapest Markets Globally: P/E & P/B Ratios, Selected Markets
(Source: Bloomberg data, Northcape analysis)



The proposal included a 1% increase in the corporate tax rate, capital gains tax on individuals holding more than KRW1 billion in a single stock and a watering down of the plans to cut dividend taxes. In addition to the stock market sell-off, over the following weekend some 114,000 retail investors signed a petition against the tax proposals and the government responded that it will consider the negative market reaction and make amendments before the final bill is proposed. The government's willingness to incorporate investor feedback and commitment to not derailing the KOSPI 5000 project is encouraging.

One of the main concerns with South Korea is the country's "catastrophic" demographics, with a fertility rate of just 0.78. However, Northcape's recent trip to the country highlighted that there are some underappreciated positives in this area. The female participation rate remains fairly low (56% vs 75% in the UK for example); increasing this would give a near term boost to the workforce. In the longer term, much like Japan, South Korea is quietly accepting more immigration. In 2024 the foreign-born population reached a record 5.2% of the population, totalling 2.65 million people (see Exhibit 3).

Exhibit 3: South Korean Foreign-Born Population
(Source: Korean Ministry of Justice)



Further, the country is embracing automation to offset the expected decline in manufacturing workers. Hyundai, one of the country's leading auto manufacturers, purchased Massachusetts-based Boston Dynamics in 2021 with the goal of deploying its Atlas humanoid robot across its factories (see Exhibit 4). "Boston Dynamics and robotics AI will play a crucial role in achieving the Group's goals," said Jaehoon Chang, Vice Chair of Hyundai Motor Group. "Physical AI and humanoid robots will transform our business landscape to the next level." Hyundai plans to roll out humanoid robots globally, offsetting demographic headwinds in South Korea and saving costs in countries like the US – where the company plans to utilise humanoid robots to ultimately produce 500,000 cars annually at its Georgia factory. The Georgia plant is already home to the 'Spot' robot, Boston Dynamics' famous dog-like machine, which is used in the facility for inspection.

The Lee administration plans to boost South Korea's competitiveness through cheaper electricity costs and has pivoted from the previous government's focus on growing the share of renewable energy to a focus instead on "carbon-free power". This opens the door to more aggressive investment in nuclear power, which

already makes up 30% of the country's electricity generation. Under its 11th Basic Plan for Long-Term Electricity Supply and Demand, South Korea aims to increase the share of nuclear power in electricity generation to 35.2% by 2038. This will be supported by the construction of three additional reactors and one small modular reactor by 2038 for an additional 4.4GW of capacity. Overall, the government targets 70% carbon-free electricity generation by 2038 (from 39% in 2023).

Whilst the election of Lee Jae Myung appears to bode well for the country's financial markets and carbon emissions, some questions remain in the area of foreign policy. As Chae Jeong, writing for the Lowy Institute, recently noted "Lee's presidency is...not just a domestic political reset. It is a live test of how a middle power navigates great-power competition" referring to the need for South Korea to steer a path between the U.S. and China. The latter relationship is particularly fraught given that China's single formal alliance globally is with North Korea, with the two countries sharing a mutual defence treaty. For the time being at least Lee appears to be focused on a fairly neutral stance towards both America and China, saying "there is no reason to narrow our range of movement by choosing one or the other side. It is competent diplomacy to make the U.S. and China choose to cooperate with us." If his administration can successfully balance the two key bilateral relationships, whilst pushing through financial and economic reform, then the next few years could prove to be a golden period for South Korea.

Exhibit 4: Atlas Robot at Work in an Auto Plant
(Source: Hyundai)



For more information, please contact our distribution team:

Katie Orsini
Client Director

p: +61 2 8234 3629
e: katie.orsini@northcape.com.au

Wendy Hammond
Client Manager

p: +61 2 2 8234 3638
e: wendy.hammond@northcape.com.au

Eliza Clarke
Client Manager

p: +61 2 2 8234 3606
e: eliza.clarke@northcape.com.au

Northcape Capital

Sydney

Level 24, 45 Clarence
Street Sydney NSW 2000
Australia
P: +61 2 8234 3600

Melbourne

Level 18, 90 Collins Street
Melbourne VIC 3000
Australia
P: +61 3 8626 8000

ABN: 53 106 390 247

AFSL: 281767

www.northcape.com.au

This material has been prepared by Northcape Capital Pty Ltd ABN 53 106 390 247 AFSL 281 767 (Northcape). It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. Northcape believes this document has been prepared with all reasonable care, Northcape accepts no responsibility or liability for any errors, omissions or misstatements however caused. Past performance is not indicative of future performance.