Korea: booming tax revenues brighten fiscal outlook

- **Strong chip exports and financial market activity is providing a significant boost to Korea's tax revenues. Korea's 2026 tax revenue is likely to record KRW478.6trn, KRW63.2trn more than the government's previous expectation of KRW415.4trn.**
- **The Korean government is likely to use excess tax revenue to reduce KTB issuance or to conduct emergency buybacks if rates rise too much. If not, the government is likely to use this in the Future Response Fund.**
- **We revise our Korea CPI inflation and current account (% GDP) forecasts for 2026 and 2027.**



Yeon Jin Kim
Emerging Market Analyst
+852 2826 5756
yeonjin.kim@ca-cib.com



Eddie Cheung CFA
Senior EM Strategist
+852 2826 1553
eddie.cheung@ca-cib.com

More tax revenue to support the KTB market

According to the Korean government, tax revenue in 2026 is likely to reach KRW478.6trn, KRW63.2trn more than its previous expectation of KRW415.4trn, which was already revised up from the main budget.

The main drivers of this revision were corporate tax and income tax revenue. Corporate tax revenue is likely to reach KRW136.4trn, KRW35.1trn more than the previous expectation, due to strong earnings by Korean chip makers. Income tax revenue is expected to record KRW152.4trn, KRW15.6trn more than the previous expectation, as bonuses are likely to be larger than in other years in the chip and financial industries and dividend income tax & capital gains tax revenue are likely to be bigger than expected with chip sector dividend payouts and increased housing transactions.

While not yet decided, the Ministry of Finance and Economy stated that some of the excess tax revenue may be used to reduce KTB issuance or to conduct emergency buybacks if rates rise too much. If not, the government is likely to use this in the Future Response Fund. When the 2027 government budget proposal was announced in early September, the Korean government announced to establish the Future Response Fund, funded by excess tax revenues in 2026 and beyond. From this fund, it is estimated that KRW109.4trn, or KRW172.6trn if the recalculated tax revenue is added, can be allocated to equities and bonds, which would be supportive of KTBs in 2027.

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2026 tax revenue to record KRW478.6trn, up by 28% YoY



Source: Ministry of Planning and Budget, Crédit Agricole CIB

Corporate tax to be larger than previously expected



Source: Ministry of Planning and Budget, Crédit Agricole CIB

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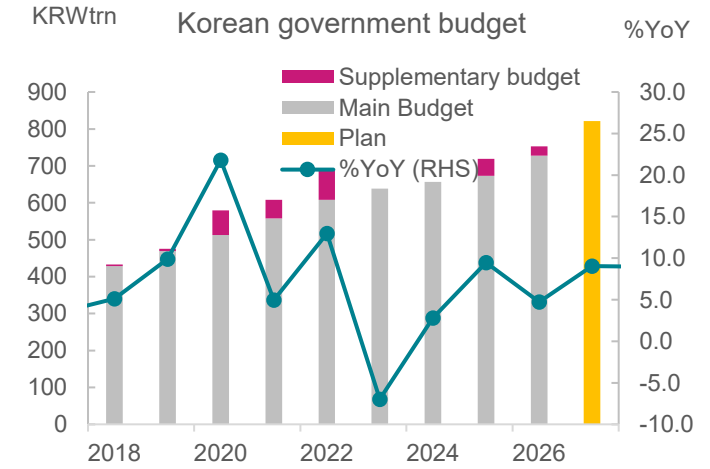
The numbers today are also supportive of our trade idea to buy the 2Y KTB.

Korea's 2027 government budget to increase

On 1 September, the Korean government announced that its 2027 main budget would be KRW820.9trn, increasing by 12.8% YoY from the 2026 main budget and by 9.0% YoY from the 2026 total budget (which includes the April supplementary budget). This is mostly in line with market expectations.

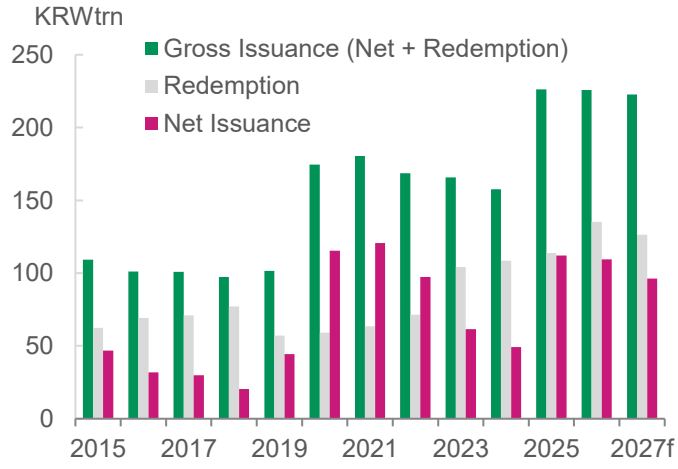
Regarding KTB issuance, 2027 gross issuance is expected to be KRW222.8trn in 2027, KRW2.9trn smaller than KRW225.7trn. While this is larger than the market expectation of KRW190-220trn, the net issuance will be KRW96.3trn, KRW13.1trn less than in 2026, giving some comfort to the market. Meanwhile, redemption amount will be KRW110.7trn, KRW20.2trn more than that of 2026 and the market making amount will be KRW15.9trn, KRW9.9trn smaller than that of 2026.

Korean government budget to grow



Source: Ministry of Planning and Budget, Crédit Agricole CIB

KTB net issuance to decrease

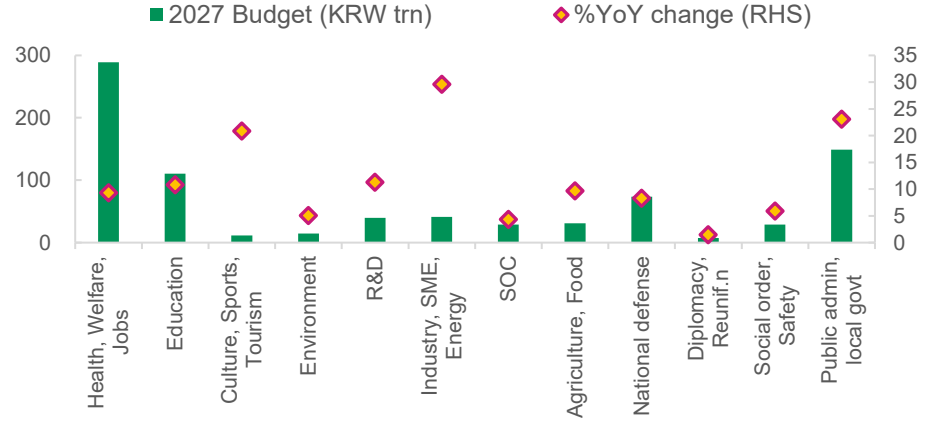


Source: Ministry of Planning and Budget, Crédit Agricole CIB

With a larger 2027 government budget, the budget for each sector would be increased compared to the 2026 main budget. Within the top five biggest sectors, the "industry, small and medium enterprises and energy" budget will grow the most, by 29.6% YoY. The government will focus more on growing the semiconductor and AI industry as well as energy infrastructure.

The public administration and local government budget will also be increased by 23.0% YoY. This will include KTB interest payments, support for the young generation and children as well as subsidies for local governments.

More budget allocated to Industry, SME & Energy, public administration



Source: Ministry of Planning and Budget, Crédit Agricole CIB

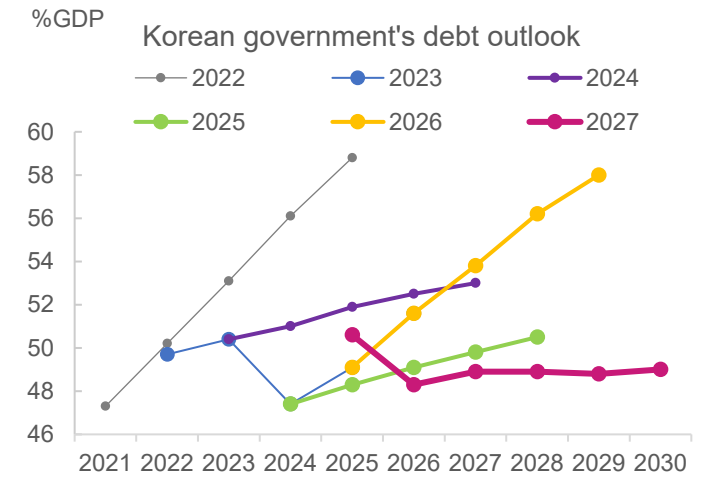
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The government's fiscal outlook looks better

With larger than previously expected tax revenue and stronger GDP growth outlook, the government's fiscal outlook has widely improved. While the government expected its government debt to reach 53.8% of GDP in the 2026 outlook, the government now expects debt to improve to 48.9% of GDP.

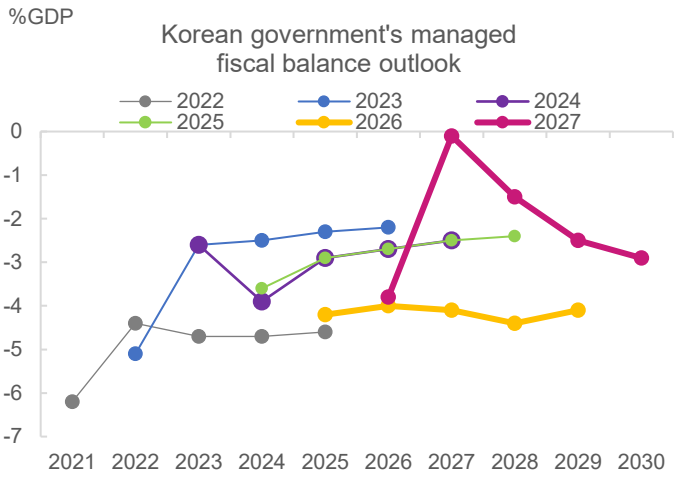
In the 2027 outlook, the government's managed fiscal balance, which excludes the social security fund balance, is expected to be almost in balance, at -0.1% of GDP in 2027 due to large tax revenue expected from Korean chip makers. This is a significant improvement from the government's previous expectation of -4.1% of GDP in the 2026 outlook. Though the managed fiscal balance is expected to worsen after 2027, the overall expectation in the coming years is also much improved relative to previous years' estimates.

Government debt to GDP to improve



Source: Ministry of Planning and Budget, Crédit Agricole CIB

A balanced fiscal outlook expected for 2027



Source: Ministry of Planning and Budget, Crédit Agricole CIB

What is the Future Response Fund?

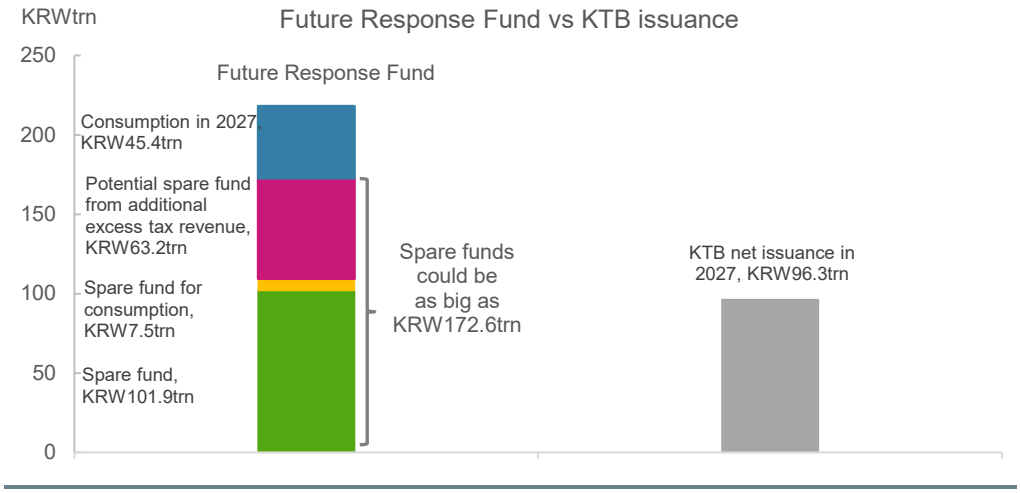
The Korean government plans to establish the Future Response Fund, funded with excess tax revenues in 2026 and beyond. Rather than spending excess tax revenues in one year, the fund aims to undertake future-oriented investments in order to mitigate the volatility in fiscal conditions in the future and to raise the country's potential growth rate.

According to the government, KRW162.3trn will be allocated to the Future Response Fund. In 2027, KRW52.9trn will be allocated across four areas: regional growth (KRW15.3trn), growth momentum (KRW14.3trn), youth (KRW13.3trn) and education (KRW10.1trn). KRW45.4trn will be spent, reflected in the 2027 government expenditure plan. But KRW7.5trn will be kept as a spare fund. Separately, KRW12.5trn is allocated to reduce KTB issuance amount.

The total spare funds, including KRW7.5trn above, will be KRW109.4trn. If additionally expected tax revenue of KRW63.2trn is added, KRW172.6trn will be managed to generate profit. This amount exceeds the anticipated net KTB issuance of KRW96.3trn in 2027.

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Breakdown of Future Response Fund and comparing with KTB net issuance



Source: Ministry of Planning and Budget, Crédit Agricole CIB

With the spare fund investment, the government aims to outperform its minimum required return rate which is the 3Y KTB yield. The funds may be parked into the KTB market but we think it would seek higher return. While details for asset management are still to be decided, if there are inflows into the bond market, there could be some indirect positive spill-over impact to the KTB market.

Korea current account (% GDP) forecast update: much stronger

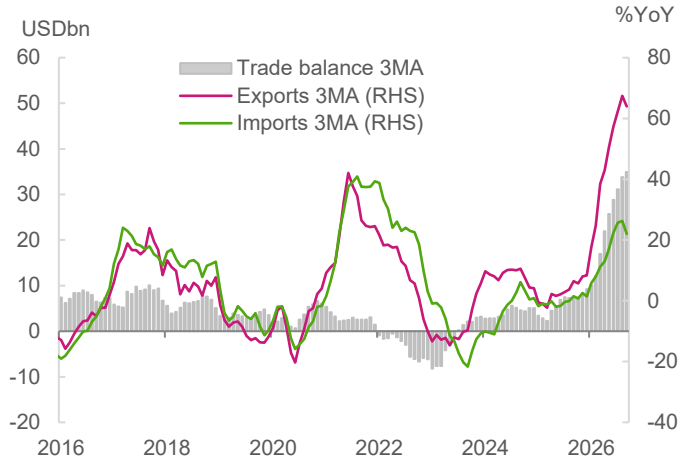
Considering strong Korean exports driven by semiconductor exports, we revise up Korea's 2026 and 2027 current account as a percentage of GDP to 22.0% and 23.4% respectively, from 12.0% and 11.8% previously.

Korea's exports have jumped by more than 50% YoY in the first eight months of 2027 while imports have increased by about 19% YoY. During the same period, semiconductor exports rose by 171% YoY, accounting for 40% of total exports. While automobile exports, accounting for 6.6% of total exports, decreased by 3.4% YoY, other major product exports such as petroleum products (41.3% YoY, 6.1% share), computer (302.4% YoY, 4.6% share) and petrochemistry (6.5% YoY, 4.5% share) increased in the first eight months. We expect Korea's annual exports in 2026 to grow by about 56% YoY and imports to grow by 20% YoY, boosting the trade balance surplus significantly.

In 2027, though import growth is likely to be impacted by global energy prices, we expect exports to maintain double-digit growth with the expansion of chip manufacturing plants in Korea as well as higher prices for advanced chips such as HBM (high bandwidth memory). According to TrendForce, average HBM selling prices in 2027 are expected to rise by 12% YoY. Given that Korean chip makers hold more than 80% of global market share, higher prices would continue to support Korean semiconductor exports.

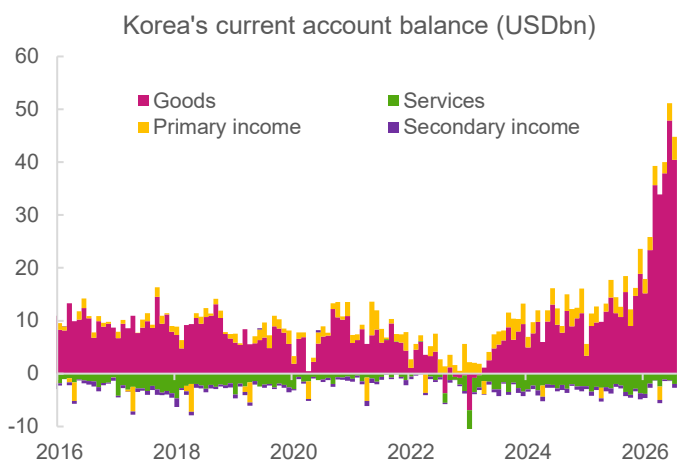
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Korea exports surged with tech exports



Source: CEIC, Crédit Agricole CIB

Korea's local oil prices are more stable

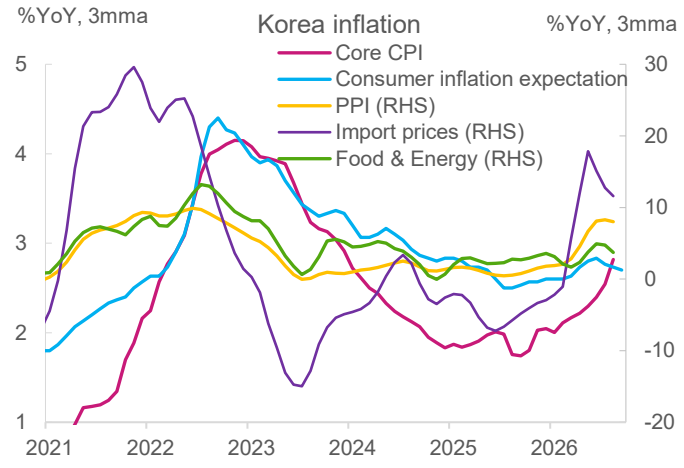


Source: CEIC, Crédit Agricole CIB

Korea CPI inflation forecast update: above 2% for longer period

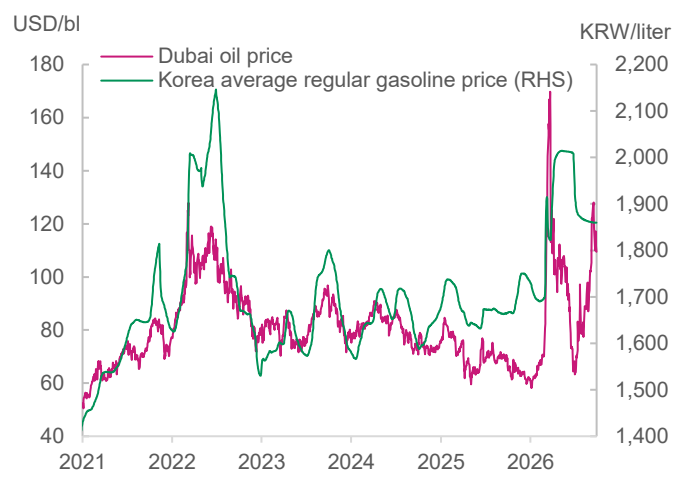
We revise down our Korea's 2026 CPI inflation forecast to 2.7%, down from 2.9% previously. Despite higher global oil prices, the Korean government's fuel price cap has been keeping local energy prices more stable. While Dubai crude oil prices, which is used as benchmark by Korean refiners, rose by more than 60% YoY in September, regular gasoline prices in Korea only rose by 12% YoY. Also, the government has been aiming to stabilise food prices through price monitoring and food price discounts as well as fuel prices through toll exemption and fuel price discounts during the Chuseok holiday in September. While we think Korea's CPI inflation is likely to remain above the BOK's 2% target, the policy efforts are likely to keep inflation around 2.7% in 2026.

Korea's inflation still elevated



Source: CEIC, Crédit Agricole CIB

Korea's local oil prices are more stable

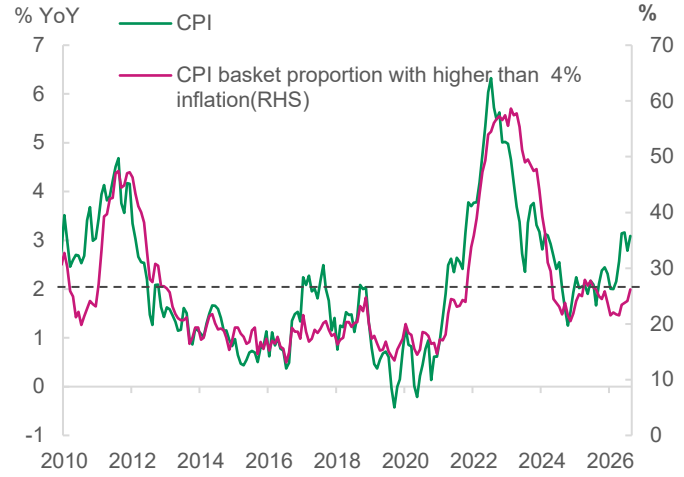


Source: CEIC, Crédit Agricole CIB

For 2027, we revise up our CPI inflation to 2.4%, from 2.3% previously. The minimum wage in 2027 will be hiked by 3.7% YoY, which is larger than the 2.9% hike in 2026. Strong chip export growth would gradually push income growth from tech to the service sector. There will be very large bonus payments from Samsung Electronics and SK Hynix, which are expected to be around KRW50trn (USD36.8bn), estimated by Korean media. Within the KRW50trn bonus payout, about KRW30trn, 3.6% of the 2027 government budget, would be available for consumption in 2027 while the remainder will be delayed to 2028 and 2029. So this could have positive spillovers for demand side inflation and broaden inflation pressure. The supply side inflationary impact could soften due to the base effect from 2026.

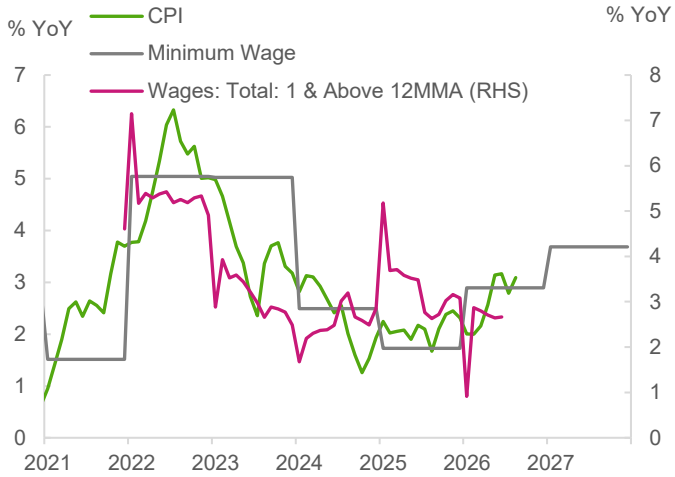
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Inflationary pressure still limited but may broaden



Source: CEIC, Crédit Agricole CIB

Wage hikes may be inflationary



Source: CEIC, Crédit Agricole CIB

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Global Markets Research contact details

Jean-François Paren Head of Global Markets Research +33 1 41 89 33 95

	Asia (Hong Kong, Singapore & Tokyo)		Europe (London & Paris)		Americas (New York)
Macro Strategy	Takuji Aida Chief Economist Japan +81 3 4580 5360	Ken Matsumoto Macro Strategist Japan +81 3 4580 5337	**Louis Harreau** **Head of Developed Markets Macro & Strategy** **+33 1 41 89 98 95**	Valentin Giust Global Macro Strategist +33 1 41 89 30 01	Nicholas Van Ness ** Chief US Economist +1 212 261 7601
Interest Rates			**Jean-François Perrin** **Head of Rates and Inflation Research & Strategy** **+33 1 41 89 73 49** Matthias Loise Inflation Strategist +33 1 41 89 20 06	Guillaume Martin Interest Rates Strategist +33 1 41 89 37 66 Riccardo Lamia Interest Rates Strategist +33 1 41 89 63 83 Monna Dimitrova Interest Rates Strategist +33 1 41 89 05 61	Alex Li ** Head of US Rates Strategy +1 212 261 3950
Emerging Markets	Xiaojia Zhi Chief China Economist Head of Research, Asia ex-Japan +852 2826 5725 Eddie Cheung CFA Senior Emerging Market Strategist +852 2826 1553	Jeffrey Zhang Emerging Market Strategist +852 2826 5749 Yeon Jin Kim Emerging Market Analyst +852 2826 5756	**Sébastien Barbé** **Head of Emerging Market Research & Strategy** **+33 1 41 89 15 97**		Olga Yangol ** Head of Emerging Market Research & Strategy, Americas +1 212 261 3953
Foreign Exchange	David Forrester Senior FX Strategist +65 6439 9826		**Valentin Marinov** **Head of G10 FX Research & Strategy** **+44 20 7214 5289**	Alexandre Dolci FX Strategist +44 20 7214 5064	
Quant Research			Alexandre Borel Data Scientist +33 1 57 87 34 27		

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MiFID II contact details

Andrew Taylor MiFID II Research contact andrew.taylor@ca-cib.com	Please send your questions on MiFID II to: research.mifid2@ca-cib.com

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