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ENERGY SHOCK AND ECONOMIC RESILIENCE: SOUTH KOREA AND THE IRAN WAR

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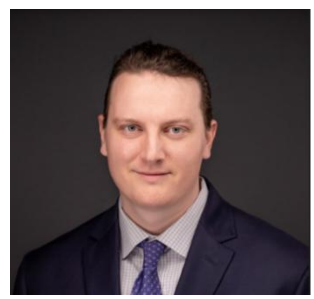

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Energy Shock and Economic Resilience: South Korea and the Iran War

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The Iran War and its associated spillover conflicts in the Middle East may portend a period of turbulence for South Korea's economy and access to key materials, but it does not yet entail a full-scale disruption to the country's overall macroeconomic stability. The underlying strength of the country's advanced industries and continued investor optimism in its stock market and financial system will likely steady its growth trajectory for the long-term, albeit with mild to moderate reductions from the beginning of the year. The main short-term reverberations will remain centered on energy prices, the exchange rate, and overall supply chains.

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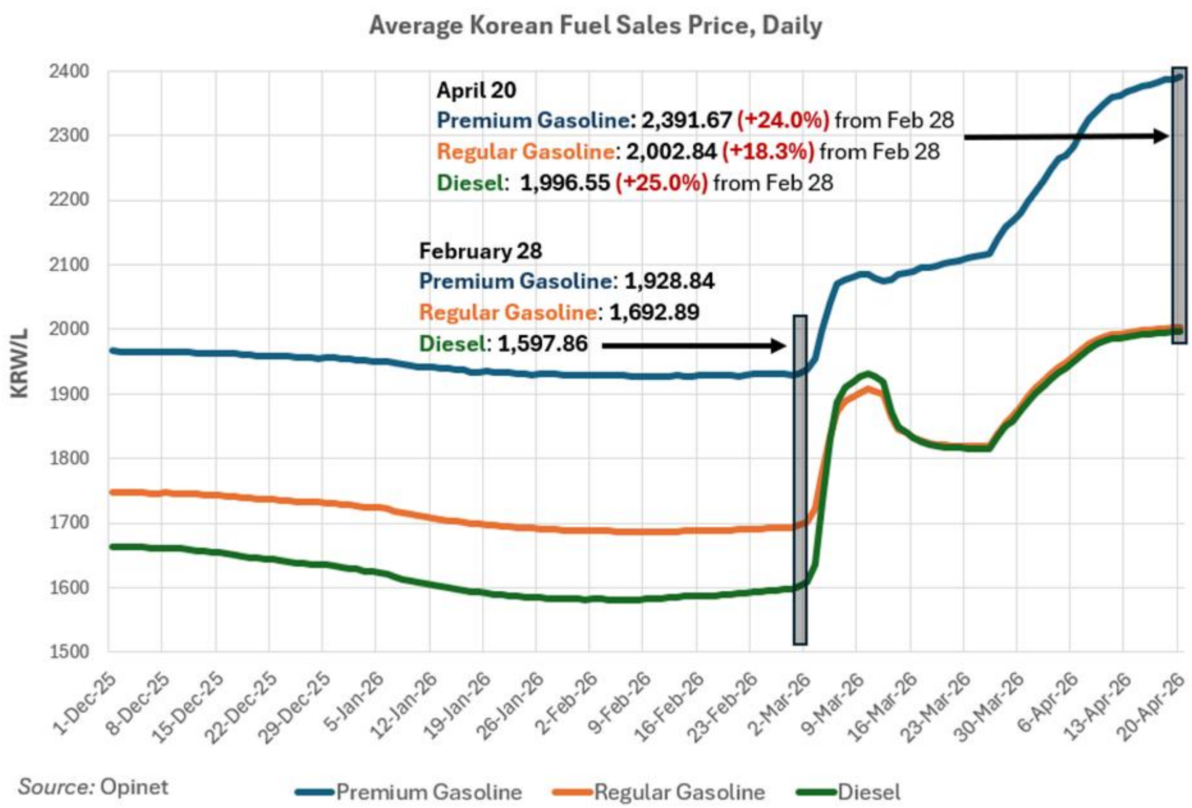
Energy, Exports, and Supply Lines

First, the Iran War has highlighted Korea's energy exposure and supply chain vulnerabilities. As of 2024, Korea imported up to 94 percent of its energy resources. Up to 72 percent of its crude oil comes from terminals in the Middle East—65 percent of which passes through the Strait of Hormuz (which has intermittently been blocked by both the United States and Iran)—while 19.7 percent of Korea's Liquified Natural Gas (LNG) resources pass through the Strait. According to CSIS, on March 31, 26 Korean ships were waiting to transit the Strait of Hormuz as a result of the conflict—the majority of which were crude and oil tankers.

More than the renewed attention this raises as to how Korea sources its energy, rising oil prices have had spillover effects on the Korean economy. The use of petroleum-derived plastics in Korean products has led Korean packagers to raise unit prices, leading to public consternation about costs for items such as grocery bags and instant ramen.

Likewise, in 2021, airfreight exports accounted for roughly 36 percent of Korea's overall exports. Air freight costs rising 70 percent on particular routes may substantially impact Korea's export numbers for the duration of the conflict. Higher jet fuel costs may also limit the availability and pricing of flights, putting a dent on both tourism numbers for the region and airline revenues, together. This is particularly significant given that Korea is also the world's number one exporter of jet fuel and accounts for 70 percent of U.S. imports of it.

Where mandatory export limits on petroleum products are now in place in Korea and Korean oil supplies are prioritized for domestic use, long-term supply contracts have been deferred. This could have a lasting impact on orders, even if the conflict is resolved soon. In tandem with this, higher gas prices in Korea as a result of the conflict will affect day-to-day transportation costs and consumer confidence, in accordance with their independent effects on inflation. As of April 20, prices for regular gasoline were up 18.3 percent from before the war.



Bottlenecks of certain industrial, chemical, and agricultural inputs like naphtha, helium, ammonia, and bromine, which depend on Middle-Eastern sources, have similarly exposed supply chain gaps—to which the government has responded through securing U.S. substitutes and subsidizing key materials. The Korean government has also dispatched the Korean Navy's Cheonghae Unit to assist with monitoring and support for Korean vessels transiting through alternative supply routes in the Red Sea.

Another knock-on effect has been an extended pause in Korean used-car shipments to the Middle East. Ports surrounding Dubai in the Hormuz-blocked United Arab Emirates act as entrepots for their import into markets throughout the Middle East and Africa, providing significant revenue streams for Korean exporters, where Middle Eastern countries accounted for over half of Korea's volume of used car exports in 2025. Even as negotiations to let ships pass through the Strait have provided intermittent success, the blocking of the Strait of Hormuz has impeded shipments to the region as cars sit idle in Korean ports. This could have a substantial impact on Korea's used-car export numbers for the first and second quarters of the year.

Likewise, shipbuilding and construction revenues also stand to be impacted. Delivery schedules for Korean-built LNG carriers to clients in Qatar and Australia could be hampered by disruption to Middle Eastern gas facilities, which may delay construction contracts or reduce demand for LNG tankers. Construction orders with Korean companies from the Middle East were also down 88 percent in March from the month before, dropping the Middle East's share of overall overseas contracts by 52.4 percent. The Korean government previously maintained a goal of USD 50 billion in overseas construction orders for 2026.

Nonetheless, in some areas, Korea may benefit economically from the conflict. The conflict may boost the continued popularity of so called "K-Defense" products like missile interceptors, armored vehicles, and self-propelled artillery system in foreign countries as they demonstrate their successful use in Middle East defense. Korea may, moreover, play a role in rebuilding Middle Eastern energy infrastructure after the Iran War—potentially offsetting the losses caused by the initial loss of construction contracts.

GDP

As for hard economic indicators, the costs of the Iran War are showing up in tangible signs like transportation costs and the exchange rate, but annual figures do not yet prognosticate a full-blown crisis. Korea's original 2026 GDP growth goal was originally predicted to be 1.9 percent for the year by the IMF and 2.1 percent by the OECD. Although the International Monetary Fund (IMF) has maintained its own 1.9 percent GDP forecast for Korea, the OECD has reduced Korea's 2026 growth forecast moderately, but not dramatically, by -0.4 percent from its original December outlook, citing the potential for energy shortages to affect production activities and Korea's high reliance on energy imports from the Middle East. Mitigating this, the Korean government has passed a USD 17.7 billion supplementary budget intending to increase growth by roughly 0.2 percent. The country's strong overall exports may also do well to keep GDP afloat in the short-term.

Inflation

With inflation, the effects are largely concentrated in specific cones. Outside of the transportation sector, headline inflation in Korea has been relatively limited since the start of the Iran War. The March Consumer

Price Index (CPI) was at 2.2 percent year-over-year—a 0.2 percent increase from February's rating—while core inflation (the rate of inflation excluding items like food and energy) was down 0.2 percent from its February rating at 2.3 percent. Only the transportation CPI showed a dramatic increase to 5 percent in March from 1.1 percent in February. It will likely take more months of economic and inflation data for the more protracted costs of the Iran War to appear, but in the interim, the IMF has raised its 2026 inflation forecast for Korea to 2.5 percent up from 1.8 percent, meaning price shocks are expected to reverberate through the end of the year.

Korean Monthly Inflation Indicators

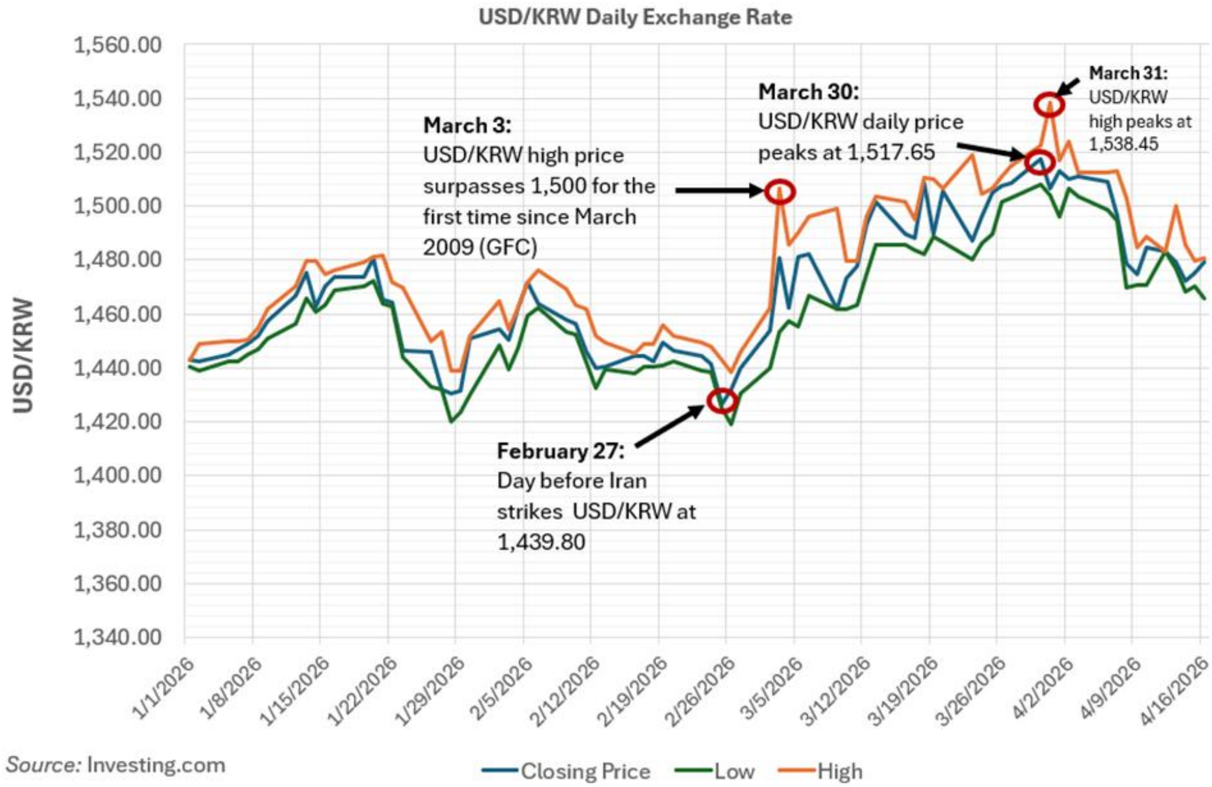
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Core Inflation Rate YoY	2.3%	1.9%	2.4%	2.5%	2.3%	2.3%	2.3%	2.5%	2.3%
CPI Rate YoY	2.1%	1.7%	2.1%	2.4%	2.4%	2.3%	2.0%	2.0%	2.2%
CPI Transportation Rate YoY	-0.2%	0.1%	1.2%	3.4%	3.2%	3.2%	1.1%	1.1%	5.0%

Source: Trading Economics, Statistics Korea, Bank of Korea

The Korean Won

The War also runs parallel to a prolonged foreign exchange crisis with the Korean won. The won-dollar exchange rate had been trending upward in the lead-up to the Iran strikes, owing in part to Korea's outsized gross equity outflows as well as a U.S.-Korea interest rate gap which has drawn Korean investors into the United States in search of higher yields. Following the strikes on Iran, the exchange rate's daily high price surpassed 1,500 KRW to USD for the first time since March 2009—when the Global Financial Crisis was at its peak—and has since reached as high as 1,538.45 KRW to USD on March 31.

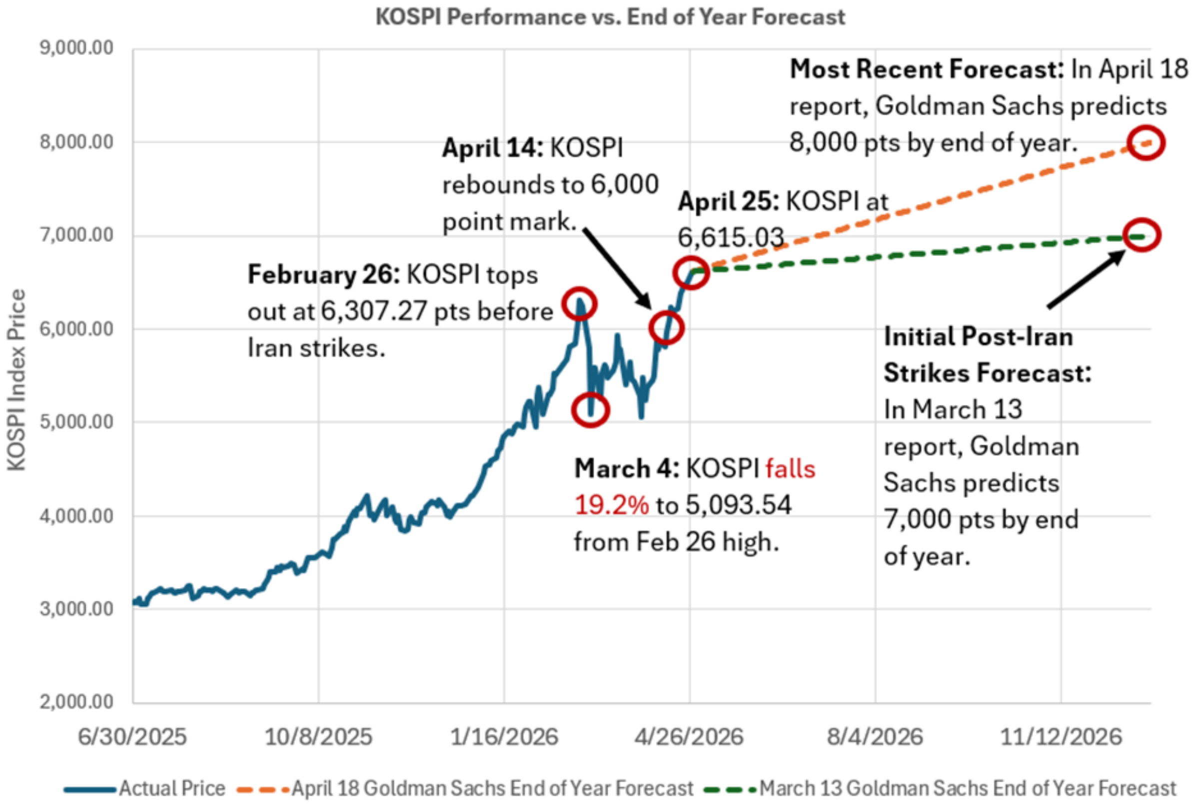
Given the volatility in energy prices worldwide, the weakened exchange rate will likely persist for the foreseeable future. This has the potential to be ameliorated, however, once both the new Bank of Korea governor and new Federal Reserve Chairman in the United States are firmly in place, where new policies could serve to narrow the interest rate gap, depending on the direction either one takes. A high-performing Korean stock market could also help to bring some investor money back into Korea.



Source: Investing.com

Equity Valuations

Although the conflict initially exposed the Korean stock market's vulnerability to events in the international news cycle with its largest-ever single-day fall as a result of the conflict, the KOSPI index's quick subsequent rebound to the 6,000-point mark less than a month after the outset of the war highlights the Korean economy's overall resilience. Prior to the February 28 attack on Iran, the KOSPI had been breezing past growth records, topping out above 6,300 points just a day before the attack. Major catalysts of this record-breaking growth include the role of Korean semiconductors, including DRAM, NAND, and high-bandwidth memory (HBM) chips in powering a global AI transition. Some of this excitement also came from the inroads the Korean government was making toward addressing the "Korea Discount," by instituting market-wide regulatory reforms.



Sources: Investing.com, Goldman Sachs

Although the Iran War briefly disrupted that streak—pulling the KOSPI back into the 5,000-point range in its immediate aftermath—the KOSPI has already shown signs of recovering. JPMorgan analyst estimates just before the Iran strikes had pinned a maximum year-end value of 7,500 points for the index driven by a "memory semiconductor supercycle." Initial Goldman Sachs estimates just after the strikes maintained a record-breaking 7,000-point denouement for the end of the year, which has since been updated to 8,000 points as recently as an April 18 report. Among other factors pushing the year-end high, Goldman Sach's April report cited optimistic corporate earnings and a strong semiconductor sector. Its March report moreover cited Korea's "history of bouncing back from equity correction episodes not followed by a U.S. recession." JPMorgan has since raised its KOSPI high price outlook to 8,500.

Continued Conflict and End of the Liberal International Order?

Nonetheless, such optimistic valuations for the Korean stock market and relatively mild forecasts for the Korean economy are likely predicated on the Iran War reaching a ceasefire or relatively quick conclusion. Scenarios involving the expansion of the conflict's scope to involve North Korea, Russia, or even China—alongside additional slow-burn conflicts throughout the Middle East—could lead to protracted supply-chain struggles and long-term industry price increases not foreseen in initial forecast scenarios. This would likely ensure a continued crisis with the Korean won and material shortages for the long-term.

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In such a case, however, Korea would only be one of a large group of countries facing stunted growth. Seoul would likely find itself amid a consortium of partners seeking ways to respond to one of the largest major challenges to global stability and freedom of navigation since World War II. With the U.S.-Korea alliance facing new stress tests as a result of U.S. military response to the conflict, this would further work to redefine Korea's place in the global order, and the extent to which Seoul remains a regional and global diplomatic and military actor. It also remains to be seen whether this presently marks the end of the "Liberal International Order" as it has existed until now.

The Path Ahead

Although the conflict has definitively disrupted Korean supply chains, transportation costs, and access to energy, the lack of a severe downgrade to Korea's growth forecasts according to metrics such as GDP and the stock market is a testament to its economy's overall strength. Taking everything into account, the conflict may raise broader issues surrounding how Korea sources its energy and supply chain materials. Accordingly, Korea may mitigate future energy supply shocks through a continued pivot to renewable and alternative energy (such as nuclear) as well as eco-friendly vehicles under the auspices of its original net-zero 2050 initiative. Korea may also begin to look beyond partners in the Middle East while continuing to strengthen its reliance on U.S. energy, as the terms of the U.S.-Korea tariff deal encourage.

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For the latter, in addition to energy purchases and infrastructure development from and in the United States, this may comprise exploring alternative Western Hemisphere energy sources from Canada's western coast or Venezuela, benefiting from planned infrastructure potentially delivering oil to the Pacific from Canada's interior and a new political environment between Washington and Caracas working to ease restrictions on petroleum exports from the country. Alternative pipeline networks in the Middle East, such as the East-West Pipeline bringing oil to the Red Sea may also help to mitigate the war's immediate economic impacts—but these efforts could be complicated if Iran begins to further involve proxies, such as the Houthis, off the coast of Yemen.

As for issues with inflation and the exchange rate, these will be areas for BOK governor Hyun-Song Shin to address in his new term. Among other things, Shin has stated his intention to use monetary policy to respond to price pressures in the economy alongside the promotion of the internationalization of the won. His first monetary policy board meeting on May 28 will likely serve as the first public examination of his strategies. Until the crisis is solved, however, a rethinking on energy and supply chain issues will be sure to remain. In whatever way Korea emerges from the crisis, it will come out with a redefined approach to how it manages its role in the new international system.

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The US-ROK Policy Brief is a joint publication between the Seoul National University Institute for Peace and Unification Studies (IPUS) and The George Washington University Institute for Korean Studies (GWIKS) dedicated to exploring current Korea-related policy matters within regional and global contexts.