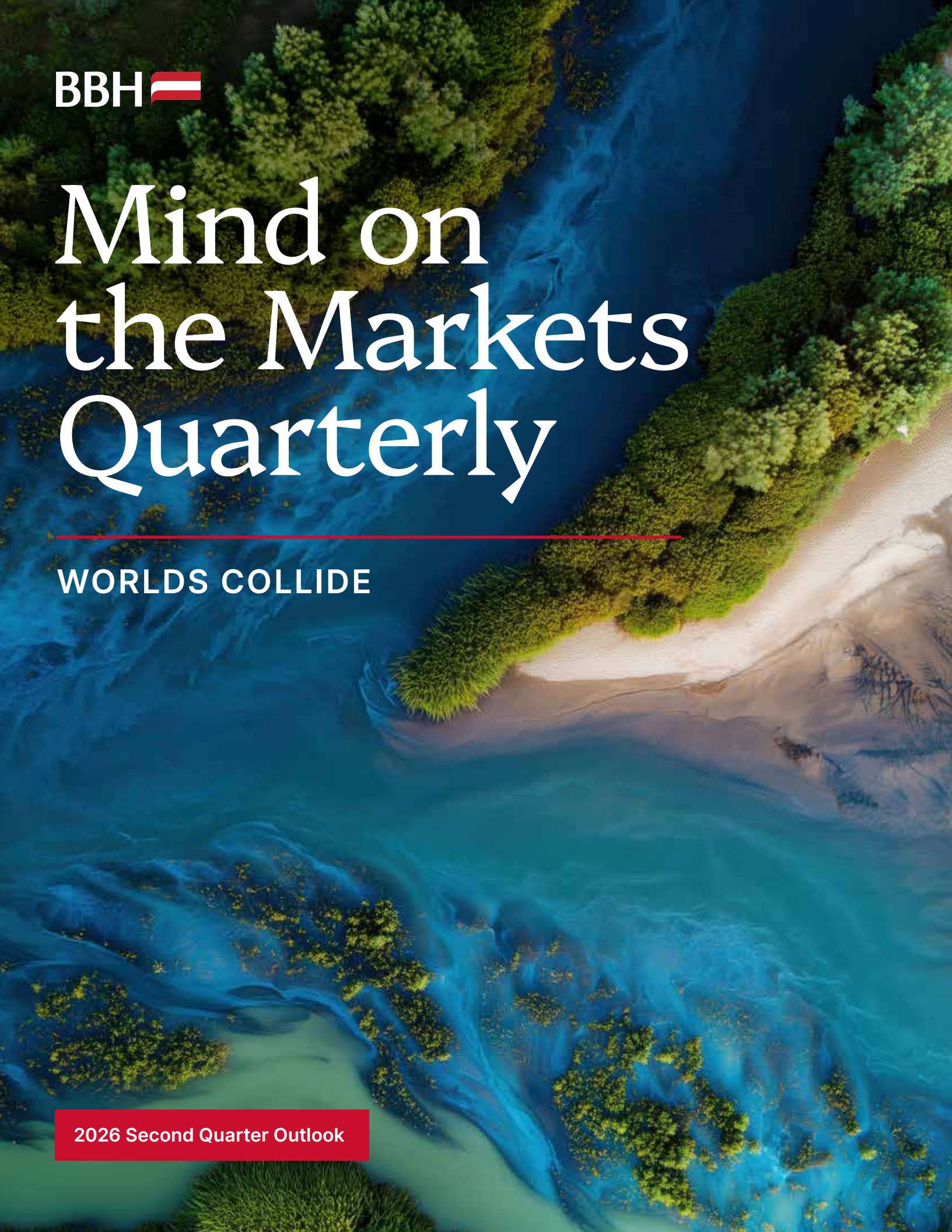

BBH

Mind on the Markets Quarterly

WORLDS COLLIDE

2026 Second Quarter Outlook

CONTENTS

1 Worlds Collide

7 EMERGING MARKETS IN THE NEWS:

- **Market dynamics**: South Korea's efforts towards alignment
- **Macro perspective**: South Korea's Positive Outlook – Addressing Geopolitical Turmoil with Credibility and Responsiveness

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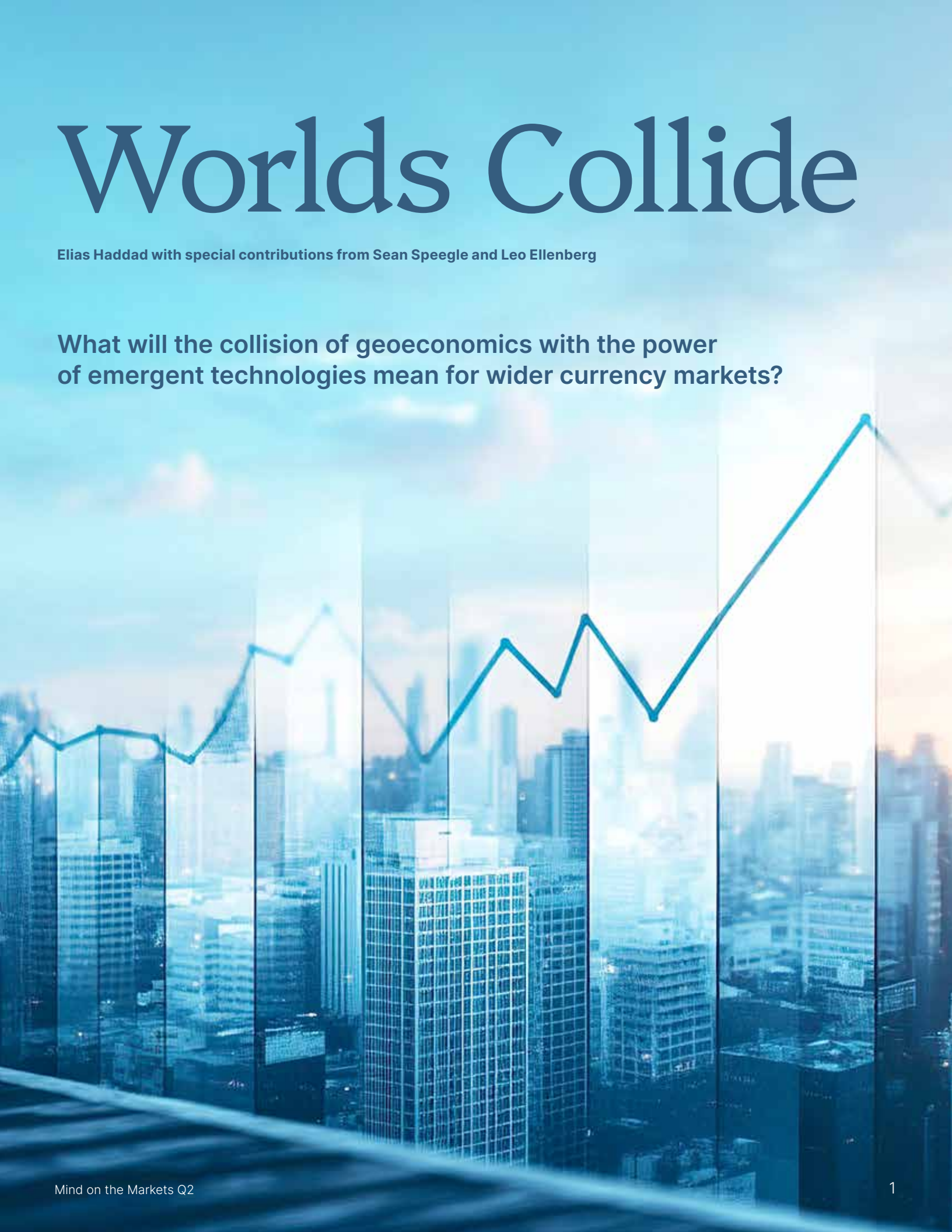
Worlds Collide

Elias Haddad with special contributions from Sean Speegle and Leo Ellenberg

What will the collision of geoeconomics with the power of emergent technologies mean for wider currency markets?



Two structural forces are colliding, geoeconomics – the use of economic means to gain leverage in international disputes - and technology, creating a financial market environment ripe for turbulence.

The shift from a unipolar to a multipolar world is making global politics more contested and crisis prone, with major powers increasingly weaponizing trade, capital flows, and supply chains. In parallel, artificial intelligence (AI) is making data, talent, computing power, and adoption capacity the key source of competitive advantage.

Here, we examine which currencies are fragile and which are "antifragile" in the face of these twin forces. In our framework, currency winners and losers depend on a country's commodity leverage, global supply-chain dependency, AI preparedness, and external vulnerability.

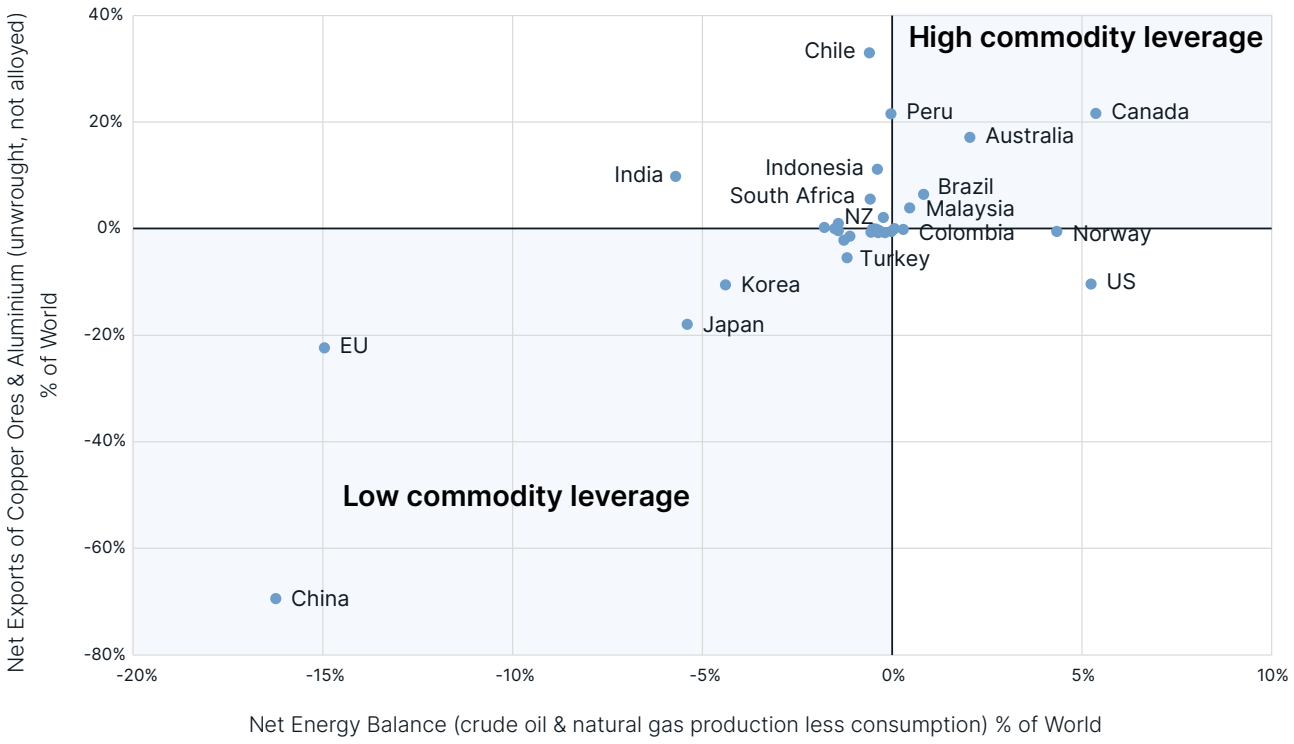
Commodity leverage

We believe countries that control strategic commodities linked to energy, defense spending, and AI infrastructure are better positioned to benefit. Combining a country's copper and aluminum exposure with its net energy balance (crude oil and natural gas production less consumption) is a straightforward way to gauge a country's commodity leverage.

Copper provides the backbone of the AI boom because it powers the electricity infrastructure that makes large scale computing possible. Aluminum tops the list of NATO's critical raw materials because it helps produce lightweight yet robust military aircraft and missiles.

Chart 1 shows commodity leverage is highest in Canada, Australia, and Brazil. The countries with the lowest commodity leverage are China, the Eurozone, Japan, and South Korea.

Chart 1: Commodity Leverage



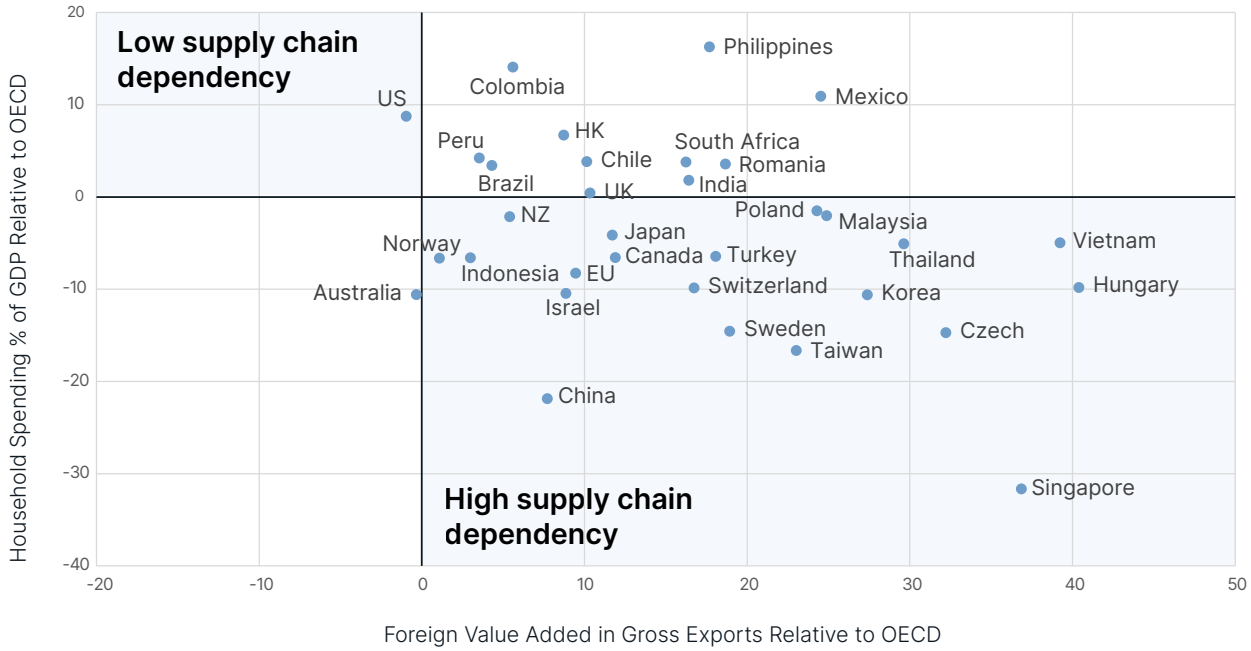
Source: World Bank, World Integrated Trade Solution & EI Statistical Review of World Energy.

Supply chain dependency

Countries that are less integrated into the global value chain and which have a domestic demand driven economy are less vulnerable to supply shocks. We assess a country's supply chain dependency through the lens of foreign value-added (FVA) trade and the share of household spending to the economy. FVA in gross exports reflects the portion of a country's exports that is made up of imported intermediate inputs.

A high FVA in gross exports and low household spending to GDP mix signal an economy deeply embedded in the global supply chain, while a low FVA in gross export and a high household spending to GDP mix point to an economy less integrated into the global supply chain. **Chart 2** shows the US with the lowest global supply chain dependency. Supply chain dependency is notably highest in Singapore, Vietnam, Hungary, and Czechia.

Chart 2: Supply Chain Dependency



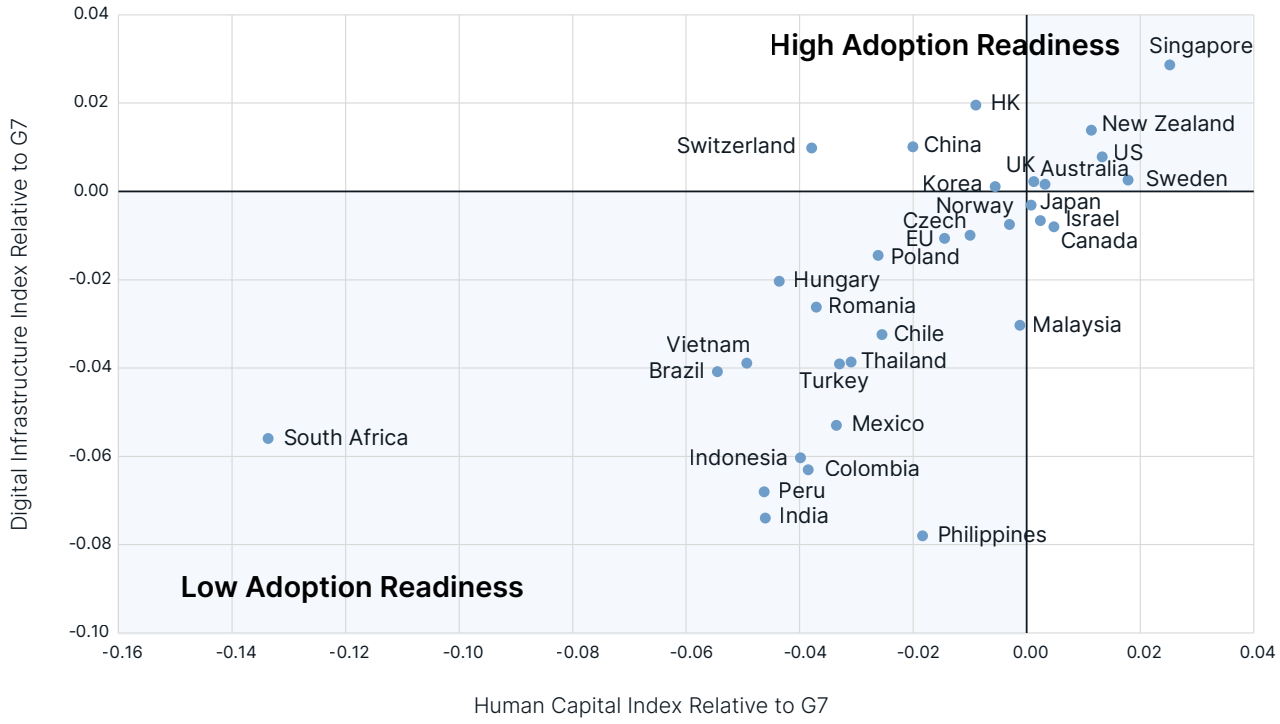
Source: Source: OECD, Trade in Value Added..

AI preparedness

A country's ability to benefit from the AI revolution depends on its ability to deploy, absorb, and scale the technology across the economy. That can be captured in large part by a country's digital infrastructure and human capital. The IMF quantifies digital infrastructure by a country's internet connectivity and e-commerce infrastructure. The IMF's human capital pillar reflects education and digital skills and labor market flexibility.

Chart 3 shows that South Africa lags far behind some other countries in AI adoption readiness. In contrast, Singapore, New Zealand, US, Sweden, Australia, and the UK have relatively high AI adoption readiness.

Chart 3: AI Preparedness



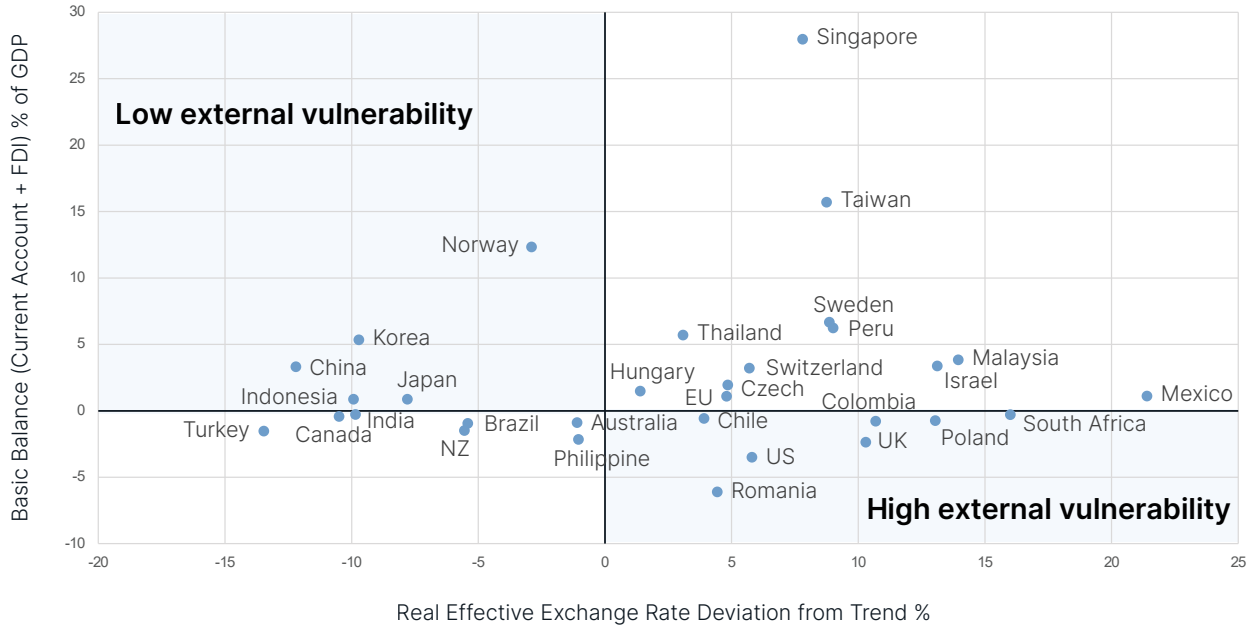
Source: IMF.

External vulnerability

Countries with limited reliance on external financing with an undervalued exchange rate are generally more resilient to external shocks and less vulnerable to abrupt capital flow reversals. We assess a country's external vulnerability via its basic balance (current account balance plus net foreign direct investment) and real effective exchange rate deviation from trend.

A basic balance surplus alongside an undervalued exchange rate signals low external vulnerability. In contrast, a basic balance deficit alongside an overvalued exchange rate signals high external vulnerability. **Chart 4** shows external vulnerability is lowest in China, South Korea, Indonesia, Japan, and Norway while highest in Romania.

Chart 4: External Vulnerability



Source: IMF & BIS.

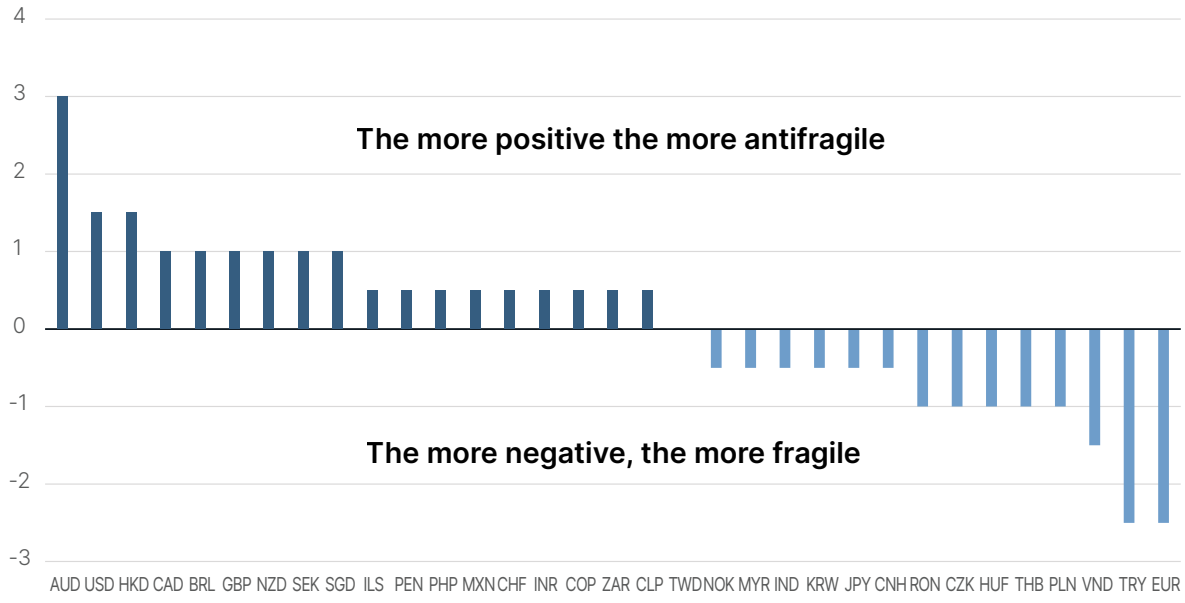
Bottom line

No single currency emerges as a clear winner or loser across all four lenses. But to better distinguish between currencies, we derive a ranking of the four factors using a simple scorecard **(chart 5)**: currencies receive +1 when a factor is a tailwind, -1 when it is a headwind, and +0.5 for mixed exposure.

On balance, the Australian Dollar (AUD) stands out as the most antifragile currency, supported by strong commodity leverage and AI preparedness.

In emerging markets, the Brazilian Real (BRL) is the most antifragile currency underpinned by strong commodity leverage, and limited supply chain and external vulnerabilities. Conversely, the Euro (EUR) and Turkish Lira (TRY) are the most fragile currencies reflecting their countries' low commodity leverage, high supply chain dependency, and relatively low AI preparedness.

Chart 5: Scorecard



Source: BBH calculation.

MARKET DYNAMICS:

South Korea's efforts towards alignment

Julian Bolton

As South Korea continues to generate new headlines amid a raft of recent announcements, let's revisit what's been going on.

Investors are glued to the Korea Composite Stock Price Index (KOSPI) performance, which has surged 176% since its low on April 9, 2025, the day after US President Donald Trump's tariff announcements, to its high on February 26, 2026.* Like much of the rest of the world as geopolitical tensions in the Middle East escalate, higher volatility has followed. Beneath the surface, however, Korea has been undertaking a deliberate effort to modernize its financial architecture, overhauling FX access and aligning itself with developed market standards.

Eliminating the Korea discount

Korean equities have long traded at a persistent "Korea discount", reflecting a mix of corporate governance concerns, the Chaebol conglomerate structure, and difficulties for foreign investors accessing the market.

Recently, policymakers have pushed to modernize the market structure, with the goal to achieve developed market status across indices and eliminate the "Korea discount".

Among these efforts, the Ministry of Economy and Finance (MOEF) removed the Investor Registration Certificate (IRC) requirement when opening investment accounts in South Korea in 2023. In 2024, it implemented the Registered Foreign Institution (RFI) program, allowing offshore foreign institutions access to the onshore FX market, and extended FX market hours through the London close.

These market initiatives were key contributors to FTSE Russell's reclassification of the Market Accessibility Level for South Korea from 1 to 2, as well as the April 2026 inclusion of Korean government bonds in the FTSE World Government Bond Index (WGBI).

With South Korean authorities achieving their goal on the fixed income side, their sights are now set on achieving MSCI developed market status.

Steps to developed market status

Despite being Asia's fourth largest economy, South Korea has been classified as an emerging market by MSCI since 1992. While placed on the watch list for developed market inclusion in 2008, it was removed in 2014 with MSCI stating Korea did not meet Market Accessibility criteria due to its:

– FX market liberalization level

– Investor registration and account setup

– Clearing and settlement

The Roadmap for FX and Capital Market Reform

Taking MSCI's feedback in its stride, the MOEF released its Roadmap for FX and Capital Market Reform for MSCI developed market inclusion, mapping out various planned advancements to its market structure throughout 2026 and into 2027.

The centerpiece to the MOEF's roadmap is a structural overhaul of Korea's FX market, tackling MSCI's biggest concern: the inability for global investors across time zones to easily access the market. Roadmap initiatives include:

– Beginning July 2026, Korea intends to implement 24-hour trading, comparable to other developed markets.

– Refining Korea's Market Average Rate (MAR) fixing system and methodology by extending the pricing window and introducing additional benchmarks.

– Working with the London Stock Exchange Group (LSEG) to pursue more accurate World Markets Reference (WMR) benchmarks. Today after the local market closes, the WMR fixing rate is re-printed throughout the rest of the day. The goal of these benchmark reforms is to make the WMR and MAR more reflective of the actual FX market, especially as Korea implements a 24-hour trading cycle.

Addressing the 'pipes' in the market, the MOEF is

* Bloomberg

establishing a 24-hour settlement system to enable foreign financial institutions to settle Korean won (KRW) trades throughout the day and working to adopt ISO 20022 to enhance compatibility with the SWIFT global communication network. It is also allowing foreign financial institutions the ability to open KRW nostro accounts in the market. These enhancements are planned for 2027, with a trial phase set for September 2026.

The MOEF will allow global custodians to open and manage an omnibus account structure, moving away from the current structure where settlement accounts are opened for each end investor, and will be working to link with global standards systems like CTM, ALERT, and CLS to automate settlement processes and enhance accuracy. Lastly, the MOEF plans to normalize the use of intraday KRW overdrafts to prevent settlement failure – with a target go-live set for the first half of 2026.

Looking ahead at a more open and investor-friendly market environment

Overall, the MOEF's comprehensive roadmap is structured to deliver visible progress to Korea's FX and capital markets within MSCI's evaluation windows, including being placed on the watchlist for potential upgrade in the June 2026 review.

However, full developed market reclassification may take until 2027 or 2028, contingent upon the successful implementation and utilization of the reforms required by MSCI.

Regardless, the MOEF's roadmap exemplifies a country that is taking market reforms seriously, as Korea looks to align itself with developed market standards and remove longstanding frictions that have been in place for years. The key here is not the timeline for MSCI DM inclusion, it is the direction of travel – towards a more open, liquid, and investor-friendly market environment.

We at BBH are excited about the proposed reforms to KRW's FX and capital markets. Consequently, we are closely monitoring the developments in Korea and working with our local providers to support the market changes.

MACRO PERSPECTIVE:

South Korea's positive outlook: Addressing geopolitical turmoil with credibility and responsiveness

Reviewing the South Korean market with Jay Foraker

We maintain our positive outlook for South Korea based on current actions, recent momentum, and historical progress. Real GDP growth, according to the IMF, accelerated from 1.0% at the end of 2025 to 1.9% at the end of 1Q2026, with CPI up only 0.4% (from 2.1% to 2.5%) during the same period.[1]

Amid the unfolding Middle East crisis, South Korean officials in late March announced an extraordinary fiscal stimulus of 173 billion won (approximately 1% of GDP) to mitigate the shock caused by disruptions to energy supplies.[2] This move is welcome given the country's significant energy dependence. South Korea is the world's fifth largest net importer of energy after China, the US, India, and Japan,[3] with 20% of its liquified natural gas imported from Qatar and Oman[4] and thus leaving it significantly exposed to supply disruptions.

The timeliness of the government's response is only matched by its credibility: South Korea stands out among its peers as having comparatively lower debt levels, allowing it more room for fiscal response.

[1] https://www.imf.org/en/countries/kor

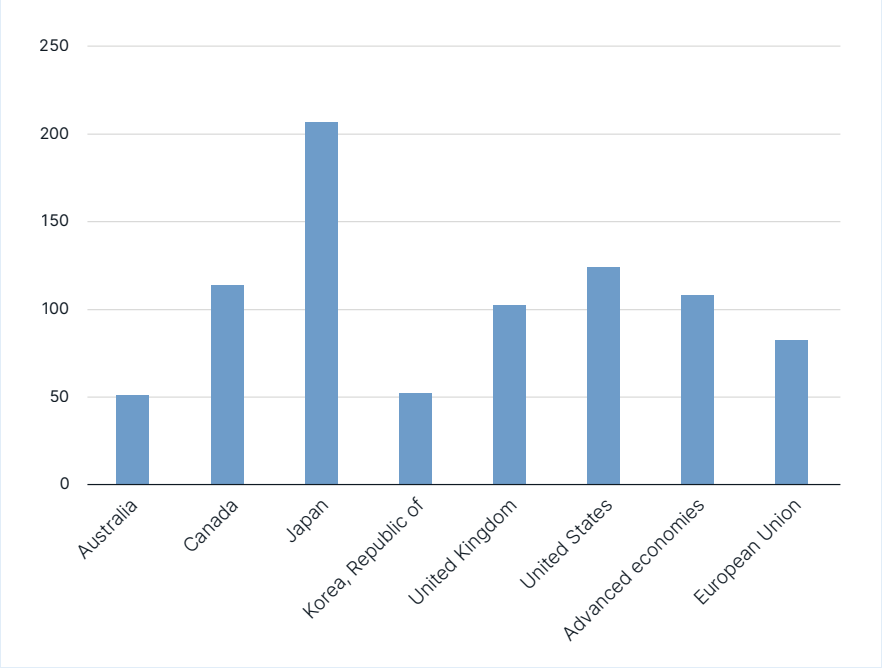
[2] https://www.reuters.com/world/asia-pacific/south-korea-proposes-173-billion-extra-budget-mitigate-middle-east-shock-2026-03-31/

[3] https://www.iea.org/countries/korea/energy-mix-#where-does-korea-get-its-energy

[4] https://keia.org/the-peninsula/the-iran-war-is-stress-testing-south-koreas-energy-model/

Indeed, even in the wake of COVID stimulus and economic disruption, South Korea's public debt only rose from 39.7% of GDP in 2019 to 52.3% in 2025. It is forecast to remain below 60% for the next few years, which is favorable considering the average for countries designated by the IMF as Advanced Economies is 108 (see **below**).[5]

General government gross debt (Percent of GDP, 2025)



Source: IMF, 2026

Further stimulus in the form of strategic investment will also maintain South Korea's momentum. Announced in August 2025, the new administration's Economic Growth Strategy has committed fiscal resources to 30 flagship technologies, AI, and innovation projects as well as to a new 150 trillion won ($101 billion) National Growth Fund.[6] South Korea's long history of industrial policy, dating to the 1960s, has helped it to establish itself as a global hub of technology exports and AI innovation today. This leadership is evidenced by its strong current account balance of 6.6% of GDP as of the end of 2025,[7] which was led by goods (notably semiconductor) exports.[8]

It is therefore reasonable to expect that South Korea will continue to prioritize fiscal policy to stimulate demand rather than shifting to a more accommodative monetary policy, which will be supportive of the won. In April the Bank of Korea (BoK) left the policy rate unchanged at 2.50% for a seventh consecutive meeting, in a unanimous decision and with policy bias remaining somewhat neutral. The BoK, which will see a change in leadership in May, stressed that "uncertainty around the future path of inflation remains very high."

[5] https://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/KOR/ADVEC/EU/AUS/CAN/JPN/GBR/USA

[6] International Monetary Fund. Asia and Pacific Dept "Republic of Korea: 2025 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Republic of Korea", IMF Staff Country Reports 2025, 308 (2025), https://doi.org/10.5089/9798229029063.002, p.42.

[7] https://www.imf.org/en/countries/kor

[8] International Monetary Fund. Asia and Pacific Dept "Republic of Korea: 2025 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Republic of Korea", IMF Staff Country Reports 2025, 308 (2025), https://doi.org/10.5089/9798229029063.002, p.35.

It is also worth noting that South Korea recently achieved two important distinctions, which should lead to enhanced capital inflows, further supporting the won.

1. FX and capital market reform has led to South Korea's inclusion in the MSCI Developed Markets Index.

2. South Korea's inclusion in the FTSE Russell World Government Bond Index (WBGI) begins in April, with monthly increases in the inclusion weight until November. By then, Korea's expected inclusion weight in the WGBI is 2.05%, making it the ninth largest among all included countries.

As noted in our previous MotM Quarterly, South Korea has the distinction of being one of a few countries that has successfully escaped the "middle income trap," first achieving the IMF's $13,875 per capita GDP (at current prices) in 1995. Since then, its strong growth has continued, with per capita GDP of over $37,000 today, which is expected to exceed $44,000 by 2030.[9]

Resilience against uncertainty

Longer-term structural headwinds – from demographics and dependence[10] on unpredictable US trade policy – are not to be ignored. South Korea's record of resilience, however, alleviates immediate concerns. Despite having the lowest birth rate in the world (at 0.72 children per woman in 2023, according to the OECD[11]), South Korean authorities are addressing potential labor supply constraints directly by raising the retirement age from 60 to 65, while expanding visa quotas for skilled workers and extending visas for "high performing" seasonal migrant workers.[12]

More uncertain is how South Korea-US trade will evolve and warrants monitoring as a potential risk to the country's growth prospects. Domestic political turmoil in South Korea during the first half of 2025 hampered its ability to respond to high-velocity changes in American trade policy, and overall exports to the US were down approximately 8% from late 2024 to late 2025.[13] Further, under the trade deal reached last July, South Korea pledged to invest $350 billion in the US. Assuming the investment is spread over ten years, that works out to $35 billion per year, which would be roughly a third of South Korea's current account surplus. Concrete details of such investments remain forthcoming. Meanwhile, South Korea gained little relief from the recent US Supreme Court tariffs decision, as it remains a target of US Section 301 trade investigations.

On balance and despite recent geopolitical turmoil, our outlook on the South Korean economy and the KRW continues to be strong given the South Korean government's timely and credible responses to the Middle East crisis and successful history of investment-led growth.

[9] https://www.imf.org/en/countries/kor

[10] Before the Trump II administration, U.S.–South Korea bilateral trade (goods and services) was worth $239.6 billion in 2024, making the United States South Korea's second-largest export market and South Korea the United States' sixth-largest trade partner. https://ustr.gov/countries-regions/japan-korea-apec/korea

[11] OECD (2024), OECD Economic Surveys: Korea 2024, OECD Publishing, Paris, https://doi.org/10.1787/c243e16a-en

[12] https://www.straitstimes.com/asia/east-asia/south-korea-overhauls-immigration-policy-to-attract-more-highly-skilled-workers

[13] https://www.csis.org/analysis/south-koreas-response-us-demands-minimize-risk-maximize-reward

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