

Republic of Korea—Update

Yield Movements

The government bond yield curve in the Republic of Korea shifted downward between end-2009 and end-2010. Yields, however, rose for all maturities between end-2010 and 28 February, with the yield hikes ranging from 13 basis points for the 20-year tenor to 51 basis points for the 1-year tenor (**Figure 1**). Meanwhile, the yield spread between 2- and 10-year maturities narrowed by 17 basis points between end-2010 and 28 February. The jump in yields, which were relatively high from the short-end up to the belly of the curve, may be attributed to concerns over rising inflationary pressures and expectations of policy rate hikes.

Advance estimates of 4Q10 gross domestic product (GDP) in the Republic of Korea showed that GDP growth improved to 4.8% year-on-year (y-o-y) in 4Q10 from 4.4% in 3Q10 on the back of strong export growth. On a quarter-on-quarter (q-o-q) basis, the 4Q10 GDP growth rate stood at 0.5%, lower than the previous quarter's 0.7%. GDP growth for the full-year 2010 leveled off at 6.1%. Meanwhile, consumer price inflation accelerated to 4.5% y-o-y in February from 4.1% in January and 3.5% in December, mainly due to relatively sharp food price hikes. The Bank of Korea (BOK) raised

its 7-day repurchase rate by 25 basis points to 3.0% in March, after keeping it steady in February. A previous 25-basis points hike in the policy rate was made in January.

Size and Composition

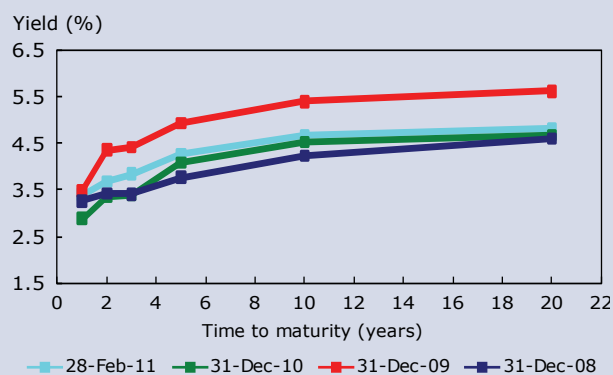
The Republic of Korea's local currency (LCY) bond market expanded by 9.4% y-o-y and 1.2% q-o-q to reach KRW1,293.9 trillion (USD1.1 trillion) as of end-December (**Table 1**). The annual growth in LCY bonds outstanding was led by buoyant growth in both government and corporate bonds.

The size of the LCY government bond market grew 7.2% in 2010, but fell 2.0% q-o-q in 4Q10, leveling off at KRW554.2 trillion (USD492 billion) at end-December. Central government bonds outstanding climbed 9.0% in 2010, but declined 2.1% q-o-q in 4Q10 on the back of a 2.6% quarterly drop in the amount of outstanding Korean Treasury Bonds (KTBs). LCY bonds issued by the BOK, or Monetary Stabilization Bonds (MSBs), increased 9.6% y-o-y, but fell slightly by 0.6% on a quarterly basis. Industrial finance debentures registered declines of 20.1% y-o-y and 7.5% q-o-q.

The LCY corporate bond market in the Republic of Korea grew 11.1% y-o-y and 3.7% q-o-q to KRW739.7 trillion (USD657 billion) as of end-December. The annual growth was due largely to an increase in issuance of both private corporate and special public bonds. Private corporate bonds soared 22.9% y-o-y and 13.5% q-o-q, reaching KRW289.9 trillion (USD257 billion). Special public bonds also rose 14.6% y-o-y, but fell 2.7% from the previous quarter, leveling off at KRW243.7 trillion (USD217 billion). In contrast, financial debentures (excluding the Korea Development Bank) dropped 5.2% y-o-y and 0.7% q-o-q to KRW206.2 trillion (USD183 billion).

In 4Q10, the top three issuers of LCY corporate bonds were Industrial Bank of Korea, which sold KRW6.9 trillion worth of bonds for the quarter, Korea Finance Corporation (KRW3.8 trillion), and

Figure 1: The Republic of Korea's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Table 1: Size and Composition of the LCY Bond Market in the Republic of Korea

	Amount (billion)						Growth Rate (%)											
	Sep-10		Oct-10		Nov-10		Dec-10		Sep-10		Oct-10		Nov-10		Dec-10			
	KRW	USD	KRW	USD	KRW	USD	KRW	USD	Y-o-y	Q-o-Q	M-o-M	Y-o-y	Q-o-Q	M-o-M	Y-o-y	Q-o-Q	M-o-M	
Total	1,278,906	1,122	1,283,715	1,141	1,294,691	1,117	1,293,940	1,149	1,149	8.7	1.8	0.4	0.9	0.9	9.4	1.2	0.1	0.1
Total Government	565,376	496	565,092	502	565,028	487	554,223	492	492	4.6	1.2	(0.1)	(0.0)	(0.0)	7.2	(2.0)	(1.9)	(1.9)
Central Bank Bonds	164,470	144	164,300	146	164,080	142	163,530	145	145	5.9	(1.9)	(0.1)	(0.1)	(0.1)	9.6	(0.6)	(0.3)	(0.3)
Central Government Bonds	370,643	325	371,515	330	372,233	321	362,690	322	322	10.9	3.7	0.2	0.2	0.2	9.0	(2.1)	(2.6)	(2.6)
Industrial Finance Debentures	30,263	27	29,277	26	28,714	25	28,003	25	25	(40.5)	(10.5)	(3.3)	(1.9)	(1.9)	(20.1)	(7.5)	(2.5)	(2.5)
Corporate	713,530	626	718,623	639	729,663	629	739,717	657	657	12.1	2.3	0.7	1.5	1.5	11.1	3.7	1.4	1.4

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:

1. Calculated using data from national sources.
2. Central government bonds include Korean Treasury Bonds, National Housing Bonds, and Seoul Metropolitan Subway Bonds.
3. Bloomberg LP end-of-period LCY-USD rates are used.
4. Growth rates are calculated from LCY base and do not include currency effects.

Source: Bank of Korea and KoreaBondWeb.

Export-Import Bank of Korea (KRW3.4 trillion). The largest issuer of special public bonds for the quarter was Korea Finance Corporation; the largest issuer of financial debentures was Industrial Bank of Korea; and the largest issuer of private corporate bonds was LH My Home 2nd Securitization Specialty Inc., which issued KRW1 trillion worth of asset-backed securities.

As of end-December, the top 50 issuers of LCY corporate bonds had total outstanding bonds of KRW548 trillion (USD487 billion), which is about 74% of the total corporate bond market in the Republic of Korea (**Table 2**). About 67% of the top 50 are financial institutions—mostly banks and securities companies. In addition, about 48% of the top 50 are publicly listed on the Korea Exchange (KRX) and 46% are privately-owned. Korea Land & Housing Corp., a state-owned real estate entity, stood as the largest issuer of LCY corporate bonds at KRW56.1 trillion (USD50 billion).

Foreign Currency Bonds

Foreign currency (FCY) bonds outstanding in the Republic of Korea as of end-December stood at USD129.4 billion, which is 10.5% higher than in the previous year. Around 75% of these bonds were in United States (US) dollars, 10% were in Japanese yen, 5% were in euros, and another 5% were in emerging East Asian currencies.

Investor Profile

In the Republic of Korea, the general government (consisting of central government, local government, and social security funds) continued to be the largest holder of LCY government bonds, with 24% of the total as of end-December 2010 (**Figure 2**). This was followed by insurance firms and pension funds with a combined 23% share of the total, while banks and other financial institutions held 19% and 18%, respectively. Meanwhile, foreign investors owned 10% of LCY government bonds. Compared with end-December 2009, the shares of foreign investors and financial institutions (other than banks and insurance firms/pension funds) rose by 3 and

Table 2: Top 50 Issuers of LCY Corporate Bonds in the Republic of Korea (as of December 2010)

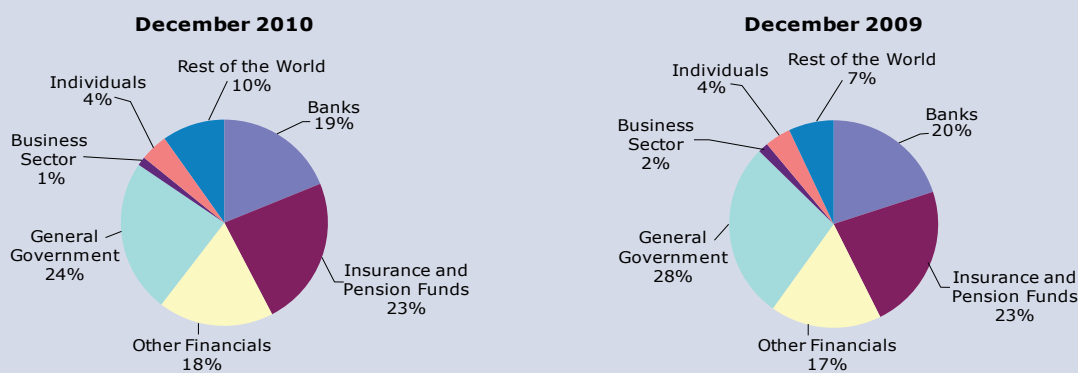
Issuer	Outstanding Amount		State-Owned	Privately-Owned	Listed In		Sector
	LCY Bonds (KRW billion)	LCY Bonds (USD billion)			KOSPI	KOSDAQ	
1. Korea Land & Housing Corp.	56,139	49.9	Yes	No	No	No	Real Estate
2. Industrial Bank of Korea	34,534	30.7	Yes	No	Yes	No	Bank
3. Korea Housing Finance Corp.	33,667	29.9	Yes	No	No	No	Financial
4. Kookmin Bank	29,504	26.2	No	Yes	No	No	Bank
5. Korea Deposit Insurance Corp.	27,061	24.0	Yes	No	No	No	Insurance
6. Korea Finance Corp.	26,570	23.6	Yes	No	No	No	Financial
7. Korea Electric Power Corp.	20,840	18.5	Yes	No	Yes	No	Utility
8. Daewoo Securities	19,930	17.7	Yes	No	Yes	No	Securities
9. Shinhan Bank	19,217	17.1	No	Yes	No	No	Bank
10. Woori Bank	18,502	16.4	Yes	No	No	No	Bank
11. Korea Highway	17,320	15.4	Yes	No	No	No	Infrastructure
12. Nonghyup (National Agricultural Cooperative Federation)	15,355	13.6	Yes	No	No	No	Bank
13. Hana Bank	14,696	13.1	No	Yes	No	No	Bank
14. Small & Medium Business Corp.	14,503	12.9	Yes	No	No	No	Financial
15. Woori Investment and Securities	14,433	12.8	Yes	No	Yes	No	Securities
16. Korea Investment and Securities	11,244	10.0	No	Yes	No	No	Securities
17. Korea Rail Network Authority	10,765	9.6	Yes	No	No	No	Infrastructure
18. Korea Gas Corp.	10,500	9.3	Yes	No	Yes	No	Utility
19. Tong Yang Securities	9,217	8.2	No	Yes	Yes	No	Securities
20. Shinhan Card	9,202	8.2	No	Yes	No	No	Financial
21. Hyundai Securities	8,705	7.7	No	Yes	Yes	No	Securities
22. Mirae Asset Securities	7,662	6.8	No	Yes	Yes	No	Securities
23. Hyundai Capital Services	6,810	6.1	No	Yes	No	No	Securities
24. Shinhan Financial Group	6,370	5.7	No	Yes	Yes	No	Financial
25. Export-Import Bank of Korea	6,340	5.6	Yes	No	No	No	Bank
26. Korea Railroad Corp.	6,330	5.6	Yes	No	No	No	Infrastructure
27. Standard Chartered First Bank Korea	5,853	5.2	No	Yes	No	No	Bank
28. Hana Daetoo Securities	5,543	4.9	No	Yes	No	No	Securities
29. Hyundai Card	5,169	4.6	No	Yes	No	No	Financial
30. Kiwoom Securities	5,103	4.5	No	Yes	Yes	No	Securities
31. Samsung Securities	4,938	4.4	No	Yes	Yes	No	Securities
32. SH Corp.	4,861	4.3	No	Yes	No	No	Manufacturing
33. KT Corp.	4,470	4.0	No	Yes	Yes	No	Telecoms
34. Korea Water Resources	4,331	3.8	Yes	No	Yes	No	Utility
35. Samsung Card	4,110	3.7	No	Yes	Yes	No	Financial
36. Dongbu Securities	4,084	3.6	No	Yes	Yes	No	Securities
37. Korea Student Aid Foundation	3,760	3.3	Yes	No	No	No	Education
38. Woori Financial Group	3,660	3.3	Yes	No	Yes	No	Financial
39. Korea Exchange Bank	3,520	3.1	No	Yes	Yes	No	Bank
40. Incheon Urban Development Corp.	3,491	3.1	Yes	No	No	No	Infrastructure
41. Posco	3,300	2.9	No	Yes	Yes	No	Manufacturing
42. Korean Air Lines	3,240	2.9	No	Yes	Yes	No	Air transport
43. Shinhan Investment Corp.	3,105	2.8	No	Yes	No	No	Securities
44. National Federation of Fisheries Cooperatives	3,095	2.7	Yes	No	No	No	Financial
45. GS Caltex Corp.	2,940	2.6	No	Yes	No	No	Utility
46. SK Energy	2,930	2.6	No	Yes	Yes	No	Utility
47. SK Holdings	2,920	2.6	No	Yes	Yes	No	Diversified

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Table 2 continued

Issuer	Outstanding Amount		State-Owned	Privately-Owned	Listed In		Sector
	LCY Bonds (KRW billion)	LCY Bonds (USD billion)			KOSPI	KOSDAQ	
48. Kyobo Securities	2,874	2.6	No	Yes	Yes	No	Securities
49. Hyundai Steel	2,640	2.3	No	Yes	Yes	No	Manufacturing
50. Hana Financial Group	2,630	2.3	No	Yes	Yes	No	Financial
Total Top 50 LCY Corporate Issuers	547,982	486.7					
Total LCY Corporate Bonds	739,717	656.9					
Top 50 as % of Total LCY Corporate Bonds	74.1%	74.1%					

KOSPI = Korea Composite Stock Price Index, KOSDAQ = Korean Securities Dealers Automated Quotations, LCY = local currency.
Source: *AsianBondsOnline*, Bloomberg LP, and *KoreaBondWeb*.

Figure 2: Investor Profile for LCY Government Bonds in the Republic of Korea

LCY = local currency.
Source: The Bank of Korea.

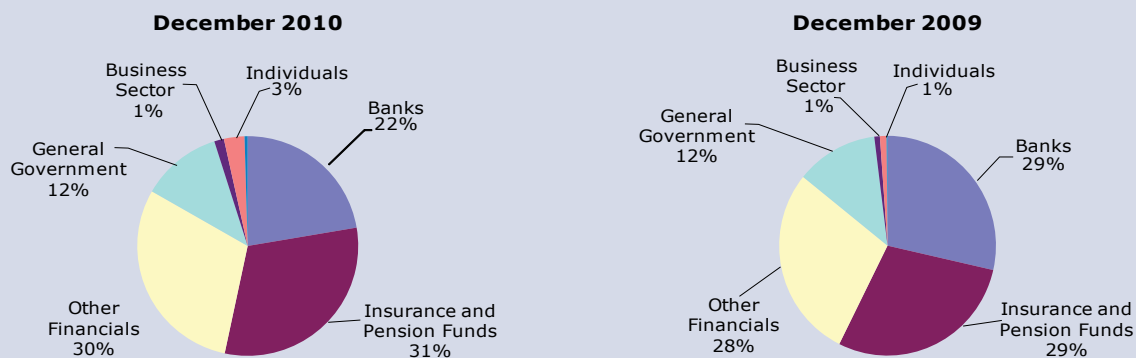
1 percentage point(s), respectively. In contrast, the shares of the general government and banks dropped by 4 and 1 percentage point(s), respectively.

The financial sector in the Republic of Korea continues to be the dominant investor group in LCY corporate bonds (**Figure 3**). As of December last year, banks, insurance firms/pension funds, and other financial institutions owned 22%, 31%, and 30% of total LCY corporate bonds, respectively, while the general government held 12%. Compared with December 2009, the shares of financial institutions (other than banks and insurance firms/pension funds), local individual investors, and insurance firms/pension funds climbed by 2 percentage points each. On the other hand, the share of banks plunged by 7 percentage points.

Policy, Institutional, and Regulatory Developments

Withholding Tax Reimposed on Foreign Investors' LCY Government Bond Holdings

The government reimposed a 14% tax on interest income and a 20% tax on capital gains from KTBs and MSBs held by foreign investors, effective 1 January. This was made following the passage of legislative bills in December calling for the restoration of the withholding tax in order to help mitigate capital flow volatility and minimize systemic risks to the domestic economy.

Figure 3: Investor Profile for LCY Corporate Bonds in the Republic of Korea

LCY = local currency.
Source: The Bank of Korea.

New Measures to Stabilize Prices and Combat Inflation

In January, the government of the Republic of Korea announced new measures to help mitigate spikes in prices and curb inflationary pressures. Among these measures were the lowering of import tariffs and the provision of financial and tax incentives to private and public sector entities that support the stabilization of prices.

Regulatory Measures to Enhance Derivatives Trading Introduced

New regulatory measures to improve the trading of derivatives products were introduced in January by the Financial Services Commission and the Financial Supervisory Service, together with the Korea Exchange and the Korea Financial Investment Association. These measures aim to reduce settlement risk, mitigate shocks in the market, and enhance financial soundness.

Macro-Prudential Stability Levy Imposed on Non-Deposit FCY Liabilities of Banks

The government announced in December that it plans to impose a macro-prudential stability levy on the non-deposit FCY liabilities of local and foreign banks. This proposal was made in order to curb volatility in capital flows as well as to provide liquidity to support the domestic economy in managing external shocks. It is expected that the levy will take effect in the second half of 2011.