

Republic of Korea—Update

Yield Movements

Government bond yields in the Republic of Korea fell for all maturities between end-September and end-December, with the fall ranging from 6 basis points (bps) for the 20-year tenor to 21 bps for the 3-year tenor (**Figure 1**). The drop in yields during this period has been largely attributed to increased concerns over the eurozone's sovereign debt crisis. Between end-December and 15 March, however, yields rose for most maturities amid inflation expectations.

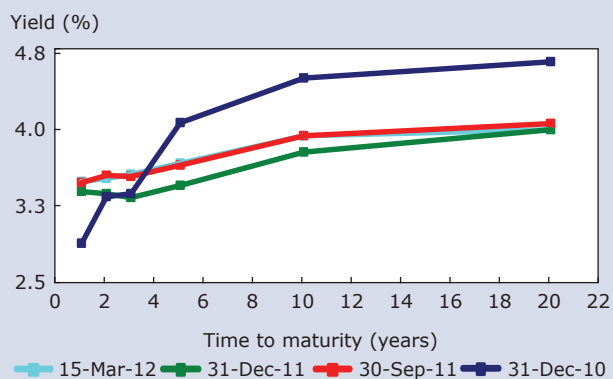
The yield spread between 2- and 10-year tenors widened 2 bps between end-September and end-December—as the fall in the 2-year was larger than that in the 10-year, and increased 1 bp between end-December and 15 March—as the rise in the 10-year was larger than that of the 2-year.

The Bank of Korea's Monetary Policy Committee decided on 13 April to keep its base rate—the 7-day repurchase rate—steady at 3.25%; it was the tenth consecutive month that the policy rate was left unchanged. The committee noted that the global recovery will be moderated by sluggish economic activity in Europe and weakening growth in emerging markets. It also noted the presence of high inflationary expectations amid geopolitical tensions in the Middle East.

Consumer price inflation decelerated to 2.6% year-on-year (y-o-y) in March from 3.1% in February and 3.4% in January. Food and non-alcoholic beverage prices climbed 4.9% y-o-y for the month, while housing and utility costs rose 5.4%. On a month-on-month (m-o-m) basis, consumer prices decreased 0.1% in March, led by a 0.8% monthly drop in education costs.

Economic growth moderated in 4Q11 on the back of weakening personal and government consumption, investment spending, and exports. Based on preliminary data from The Bank of Korea, real gross domestic product (GDP) growth

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



LCY = local currency.
Source: Bloomberg LP.

eased to 0.3% quarter-on-quarter (q-o-q) in 4Q11 from 0.8% in the previous quarter. The slowdown in growth has been attributed to (i) a 0.5% q-o-q fall in final consumption expenditure—as personal consumption and government expenditure both declined, (ii) negative 1.5% q-o-q growth in gross fixed capital formation, and (iii) a 2.3% q-o-q decline in exports of goods and services. On the supply-side, manufacturing production contracted 0.3% q-o-q in 4Q11, following 1.1% growth in the previous quarter, and construction activity also declined 0.2% for the quarter. On an annual basis, real GDP grew 3.3% y-o-y in 4Q11, lower than the 3.6% growth in 3Q11. For the full-year 2011, real GDP growth stood at 3.6%, lower than the growth rate of 6.3% in 2010.

Size and Composition

The Republic of Korea's local currency (LCY) bond market continued to expand in 4Q11, with total LCY bonds outstanding increasing 9.5% y-o-y and 2.0% q-o-q to reach KRW1,416 trillion (US\$1,229 billion) at end-December (**Table 1**). Government bonds outstanding stood at KRW587.3 trillion, which was up 6.0% y-o-y but down 0.5% q-o-q. Central government

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

	Amount (billion)						Growth Rate (%)										
	Sep-11		Oct-11		Nov-11		Dec-11		Sep-11		Oct-11		Nov-11		Dec-11		
	KRW	US\$	KRW	US\$	KRW	US\$	KRW	US\$	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	1,389,038	1,179	1,400,338	1,261	1,415,673	1,239	1,416,376	1,229	8.6	2.1	0.8	9.5	2.0	1.1	6.0	2.0	0.0
Government	590,429	501	589,293	531	594,633	520	587,316	510	4.4	1.2	(0.2)	4.4	(0.5)	0.9	6.0	(1.2)	(1.2)
Central Bank Bonds	169,420	144	167,220	151	168,770	148	164,760	143	3.0	1.4	(1.3)	3.0	(2.8)	0.9	0.8	(2.8)	(2.4)
Central Government Bonds	391,213	332	392,847	354	397,291	348	392,675	341	5.5	1.1	0.4	5.5	0.4	1.1	8.3	0.4	(1.2)
Industrial Finance Debentures	29,796	25	29,226	26	28,572	25	29,881	26	(1.5)	1.0	(1.9)	(1.5)	0.3	(2.2)	6.7	0.3	4.6
Corporate	798,609	678	811,045	731	821,040	719	829,060	719	11.9	2.9	1.6	12.1	3.8	1.2	12.1	3.8	1.0

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. Bloomberg LP end-of-period LCY-US\$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.

Source: EDAILY BondWeb and The Bank of Korea.

bonds, which include Korea Treasury Bonds (KTBs), increased 8.3% y-o-y and 0.4% q-o-q to reach KRW392.7 trillion. Meanwhile, central bank bonds, known as Monetary Stabilization Bonds (MSBs), rose a marginal 0.8% y-o-y, but posted negative q-o-q growth of 2.8%, to level off at KRW164.8 trillion. Industrial finance debentures—bonds sold by the Korea Development Bank (KDB)—expanded 6.7% y-o-y and increased a marginal 0.3% q-o-q to reach KRW29.9 trillion.

Government bond issuance in 4Q11 totaled KRW66.5 trillion, which was down 9.7% q-o-q. Central bank issuance, which comprised 62% of total government issuance, fell to KRW41.4 trillion from KRW47.1 trillion in the previous quarter. On the other hand, issuance of central government bonds increased slightly in 4Q11 to KRW22.3 trillion from KRW21.1 trillion in 3Q11, as KTB issuance rose 5.5% q-o-q to KRW19.6 trillion.

The outstanding stock of LCY corporate bonds jumped 12.1% y-o-y and 3.8% q-o-q to KRW829.1 trillion at end-December, spearheading growth in the overall LCY bond market. Private corporate bonds surged 22.0% y-o-y and 6.5% q-o-q to KRW353.6 trillion. Similarly, special public bonds expanded 10.1% y-o-y and 2.6% q-o-q to KRW268.3 trillion. Meanwhile, financial debentures (excluding KDB bonds) increased marginally, rising 1.0% y-o-y and 0.5% q-o-q, to level off at KRW207.2 trillion.

As of end-December, the combined bonds outstanding of the top 30 corporate issuers amounted to KRW515.9 trillion, accounting for 62% of total corporate bonds outstanding (**Table 2**). The top 30's share of the total was about the same in 4Q11 as in the previous quarter. Korea Land & Housing Corp. continued to be the largest corporate issuer with total bonds outstanding of KRW57.0 trillion.

In 4Q11, LCY corporate bond issuance amounted to KRW95.3 trillion, of which 52% were private corporate bonds, 28% financial debentures, and 20% special public bonds. Compared with

Table 2: Top 30 Issuers of LCY Corporate Bonds in the Republic of Korea (as of end-December 2011)

Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed on		Type of Industry
	LCY Bonds (KRW billion)	LCY Bonds (US\$ billion)			KOSPI	KOSDAQ	
1. Korea Land & Housing Corp.	57,032	49.5	Yes	No	No	No	Real Estate
2. Korea Housing Finance Corp.	38,547	33.4	Yes	No	No	No	Financial
3. Korea Finance Corp.	32,960	28.6	Yes	No	No	No	Financial
4. Industrial Bank of Korea	31,474	27.3	Yes	No	Yes	No	Bank
5. Daewoo Securities	26,057	22.6	Yes	No	Yes	No	Securities
6. Korea Deposit Insurance Corp.	25,280	21.9	Yes	No	No	No	Insurance
7. Korea Electric Power Corp.	24,220	21.0	Yes	No	Yes	No	Utility
8. Kookmin Bank	21,205	18.4	No	Yes	No	No	Bank
9. Shinhan Bank	19,297	16.7	No	Yes	No	No	Bank
10. Woori Investment and Securities	19,253	16.7	Yes	No	Yes	No	Securities
11. Korea Highway	18,560	16.1	Yes	No	No	No	Infrastructure
12. Woori Bank	16,692	14.5	Yes	No	No	No	Bank
13. Korea Investment and Securities	16,104	14.0	No	Yes	No	No	Securities
14. Small & Medium Business Corp.	14,738	12.8	Yes	No	No	No	Financial
15. Hana Bank	13,834	12.0	No	Yes	No	No	Bank
16. Tong Yang Securities	13,256	11.5	No	Yes	Yes	No	Securities
17. Korea Rail Network Authority	12,660	11.0	Yes	No	No	No	Infrastructure
18. Mirae Asset Securities	12,232	10.6	No	Yes	Yes	No	Securities
19. Korea Gas Corp.	12,155	10.5	Yes	No	Yes	No	Utility
20. Nonghyup (National Agricultural Cooperative Federation)	10,710	9.3	Yes	No	No	No	Bank
21. Hyundai Securities	10,334	9.0	No	Yes	Yes	No	Securities
22. Shinhan Card	9,331	8.1	No	Yes	No	No	Financial
23. Korea Water Resources	8,778	7.6	Yes	No	Yes	No	Utility
24. Hana Daetoo Securities	7,918	6.9	No	Yes	No	No	Securities
25. Korea Eximbank	7,630	6.6	Yes	No	No	No	Bank
26. Standard Chartered First Bank Korea	7,550	6.6	No	Yes	No	No	Bank
27. Hyundai Capital Services	7,482	6.5	No	Yes	No	No	Securities
28. Shinhan Financial Group	7,290	6.3	No	Yes	Yes	No	Financial
29. Korea Railroad Corp.	7,110	6.2	Yes	No	No	No	Infrastructure
30. KB Kookmin Card	6,240	5.4	No	Yes	No	No	Financial
Total Top 30 LCY Corporate Issuers	515,929	447.7					
Total LCY Corporate Bonds	829,060	719.4					
Top 30 as % of Total LCY Corporate Bonds	62.2%	62.2%					

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

the previous quarter, issuance of corporate bonds jumped 22.9%, led by a 37.9% spike in private corporate bond issues. On a y-o-y basis, corporate bond issuance surged 18.5% on the back of double-digit growth in special public bonds, financial debentures, and private corporate bonds. The largest corporate bond issue in 4Q11 was the Korea Development Insurance Corp.'s 3-year bond worth KRW1.2 trillion with a coupon rate of 3.8%.

Liquidity

The turnover ratio for LCY government bonds fell from 1.30 in 3Q11 to 1.08 in 4Q11 as liquidity conditions tightened for both central government and central bank bonds. The turnover ratio for central government bonds—largely comprising KTBs—decreased to 1.10 in 4Q11 (from 1.32 in 3Q11), while it also declined for MSBs from 1.51 in 3Q11 to 1.25 in 4Q11.

In the KTB futures market, trading activity weakened in 4Q11 compared with 3Q11, with the number of traded KTB futures contracts falling to 7.6 million in 4Q11 from 11.9 million in 3Q11. In 1Q12, however, trading activity rebounded as the number of traded KTB futures contracts increased to 8.3 million.

The share of 10-year KTB futures has been steadily increasing in recent quarters—from 1.3%

in 1Q11, it climbed to 17.2% in 4Q11, and further rose to 23.3% in 1Q12 (**Figure 2**). In contrast, the share of 3-year KTB futures dropped from 98.7% in 1Q11 to 82.8% in 4Q11, and further declined to 76.7% in 1Q12.

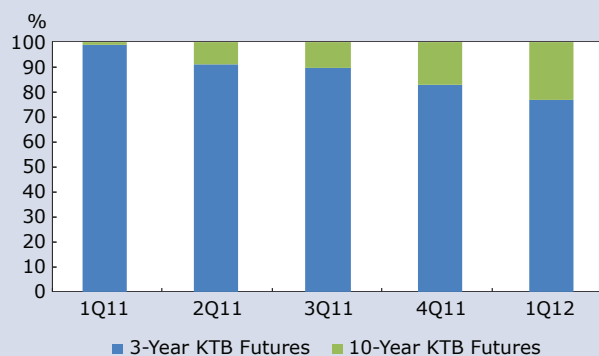
Liquidity in the LCY corporate bond market has improved in 4Q11, with the turnover ratio increasing to 0.18 in 4Q11 from 0.16 in 3Q11. This was led by financial debentures and private corporate bonds, with their turnover ratios rising to 0.38 from 0.34 and 0.10 from 0.08, respectively. Meanwhile, the turnover ratio for special public bonds remained unchanged from the previous quarter at 0.13.

Investor Profile

The largest investor group in LCY government bonds at end-December was insurance companies and pension funds with a 25% share followed by the general government—consisting of the central government, local government, and social security funds—at 24% (**Figure 3**). Banks and other financial institutions held 18% and 17% of the total, respectively, while foreign investors owned 11%. Between end-December 2010 and end-December 2011, the share of households and nonprofit organizations rose 2 percentage points while the shares of foreign investors and insurance companies and pension funds increased 1 percentage point each. Conversely, the share of banks dropped 2 percentage points and the shares of other financial institutions and non-financial companies declined 1 percentage point each.

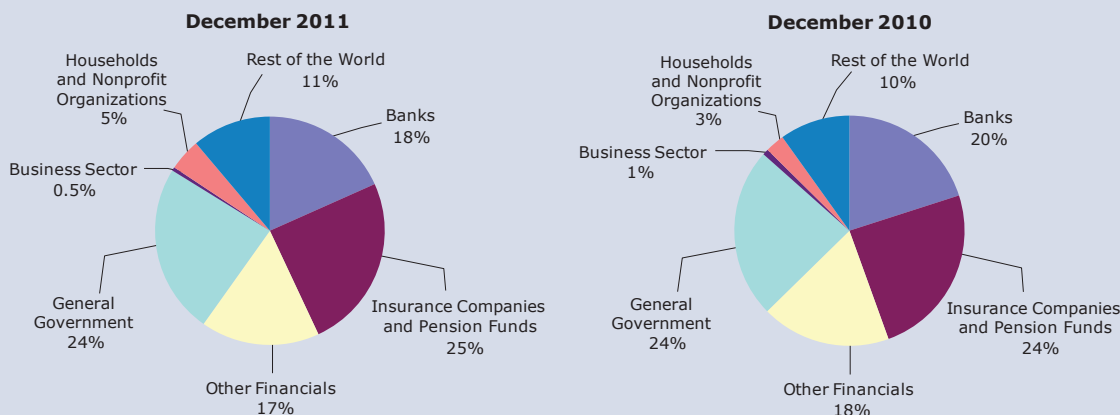
The largest investor group in LCY corporate bonds as of end-December was insurance companies and pension funds, which held a share of 32% of total corporate bonds, followed by other financial institutions with a 31% share (**Figure 4**). Banks held 18% of corporate bonds and the general government accounted for 12%. Compared with December 2010, the shares in corporate bonds increased by 4 percentage points for insurance companies and pension funds, and by 1 percentage point each for foreign investors and other financial

Figure 2: Trading Volume of KTB Futures Contracts, 1Q11–1Q12 (%)



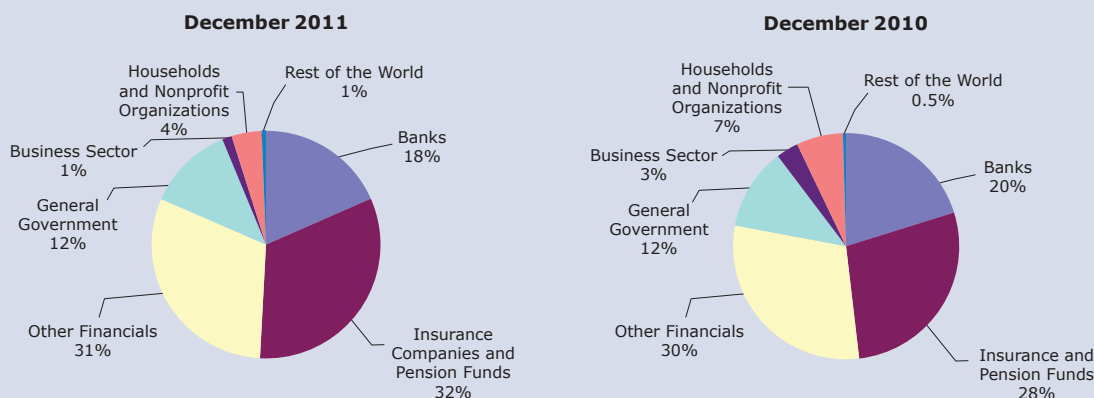
KTB = Korea Treasury Bonds.
Source: Korea Exchange.

Figure 3: LCY Government Bonds Investor Profile



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

Figure 4: LCY Corporate Bonds Investor Profile



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

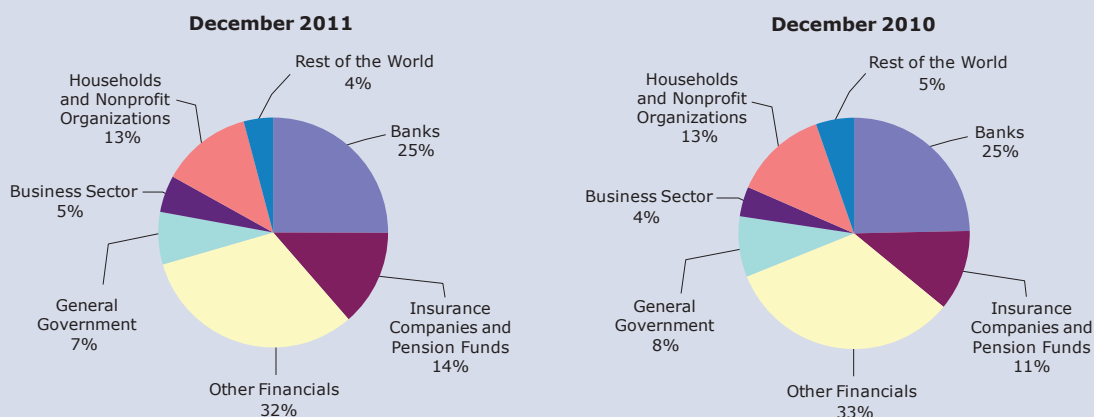
institutions. In contrast, the share of households and nonprofit organizations dropped 3 percentage points, and the shares of banks and non-financial companies fell 2 percentage points each.

The largest investor group in LCY financial debentures (including KDB) as of end-December was financial institutions other than banks with a 32% share (**Figure 5**). Banks had the second-largest share at 25%, followed by insurance firms and pension funds with 14%, and households and nonprofit organizations with 13%. The shares of insurance companies and pension funds, and

non-financial companies, climbed 3 percentage points and 1 percentage point, respectively, from end-December 2010 levels. In contrast, the shares of the general government, foreign investors, and other financial institutions each fell by 1 percentage point.

Rating Changes

On 2 April, Moody’s changed the outlook on the Republic of Korea’s A1 government bonds rating from stable to positive (**Table 3**). The change in the ratings outlook stemmed from

Figure 5: LCY Financial Debentures Investor Profile

LCY = local currency.

Note: Financial debentures data include KDB.

Source: *AsianBondsOnline* and The Bank of Korea.

(i) the sovereign's strong and improving fiscal fundamentals, (ii) a relatively robust medium-term outlook for GDP growth, (iii) resilience in the government's external financing position, and (iv) reduction in the domestic banking sector's external vulnerability.

Table 3: Selected Sovereign Ratings and Outlook for the Republic of Korea

	Moody's	S&P	Fitch	R&I
Sovereign FCY LT Ratings	A1	A	A+	A+
Outlook	Positive	Stable	Positive	Stable

FCY = foreign currency, LT = long term.

Source: Rating agencies.

Policy, Institutional, and Regulatory Developments

QFII License Granted to the Bank of Korea, Korea Investment Corporation, and National Pension Service

The China Securities Regulatory Commission (CSRC) granted qualified foreign institutional investor (QFII) licenses to The Bank of Korea and the Korea Investment Corporation—a sovereign wealth fund—in December, and to the National Pension Service in January. The licenses will allow the three institutions to invest in CNY-

denominated assets—such as bonds and stocks—that are listed on the Shanghai and Shenzhen stock exchanges.

FSC Sets 2012 Financial Policy Agenda

In January, the Financial Services Commission (FSC) announced its 2012 financial policy agenda, which contains three policy goals: (i) better crisis preparation, (ii) the promotion of entrepreneurship and business growth, and (iii) low-income households' increased access to financial services. The agenda also includes six key steps to achieve these policy objectives: (i) taking preemptive actions to ensure market stability, (ii) advancing the financial system, (iii) creating a financial environment that is conducive for the growth of start-up businesses and SMEs, (iv) ensuring financial services for sustainable development, (v) widening access to financial services for low-income households, and (vi) raising the social contribution of financial institutions and enhancing financial consumer protection.

2012 Treasury Bill Issuance Plan Introduced

In February, the Ministry of Strategy and Finance introduced its issuance plan for treasury bills

in 2012. The plan indicated that issuance in February–March would include 63- and 182-day bills amounting to KRW5 trillion. In an initial step, the government issued 63-day treasury bills totaling KRW1 trillion in February.

KOFIA to Launch Trading Platform for SME Bonds

The Korea Financial Investment Association (KOFIA) plans to establish a trading platform—an electronic over-the-counter system—for the bonds of small and medium-sized enterprises (SMEs). The issuers of the bonds will be local unlisted firms with asset sizes of less than KRW500 billion. The trading system is expected to be launched in May.