

# Republic of Korea—Update

## Yield Movements

Government bond yields in the Republic of Korea fell for all tenors between end-December 2011 and end-July 2012, with the decline ranging from 49 basis points (bps) for both the 3- and 5-year tenors to 79 bps for the 20-year tenor (**Figure 1**). The decline in yields has been attributed to expectations of a slowdown in the country's economic growth, amid sluggish economic performances among major trading partners and market concerns over the eurozone's sovereign debt and banking problems. The yield spread between 2- and 10-year tenors narrowed 12 bps between end-December and end-July—as the fall in the yield of the 10-year tenor was greater than in the 2-year.

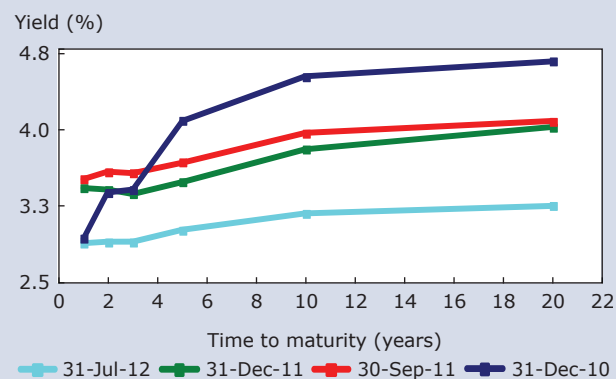
The Bank of Korea's Monetary Policy Committee decided on 9 August to keep the base rate—the 7-day repurchase rate—steady at 3.0%. In its previous meeting in July, the committee decided to lower the base rate by 25 bps. Inflationary pressures in the Republic of Korea have moderated, as the year-on-year (y-o-y) inflation rate based on the consumer price index dropped for 8 consecutive months, reaching 1.2% in August.

Real gross domestic product (GDP) growth slowed down to 0.3% quarter-on-quarter (q-o-q) in 2Q12 from 0.9% in 1Q12. Manufacturing activity fell 0.2% q-o-q in 2Q12, following 2.0% growth in the previous quarter. Private consumption rose 0.4% q-o-q, while government expenditure decreased 0.3%. Gross fixed capital formation and total exports contracted 2.9% and 0.6% q-o-q, respectively. On a y-o-y basis, real GDP grew 2.3% in 2Q12 after expanding 2.8% in 1Q12.

## Size and Composition

Total local currency (LCY) bonds outstanding in the Republic of Korea grew 9.7% y-o-y

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



LCY = local currency.  
Source: Bloomberg LP.

and 2.1% q-o-q to KRW1,491 trillion (US\$1.3 trillion) as of end-June (**Table 1**). The outstanding amount of LCY government bonds stood at KRW601.2 trillion, up 3.0% y-o-y and roughly unchanged from the previous quarter. Central government bonds, which include Korea Treasury Bonds (KTBs), posted positive growth rates of 5.5% y-o-y and 1.1% q-o-q to level off at KRW408.4 trillion. On the other hand, central bank bonds, or Monetary Stabilization Bonds (MSBs), recorded declines of 1.5% y-o-y and 2.0% q-o-q to settle at KRW164.6 trillion, while industrial finance debentures, or Korea Development Bank (KDB) bonds, fell 4.4% y-o-y and 5.0% q-o-q to KRW28.2 trillion.

In 2Q12, issuance of LCY government bonds amounted to KRW66.8 trillion, which was 1.5% lower than in the previous quarter. The quarterly decline stemmed from a 44.0% q-o-q drop in issuance of industrial finance debentures. Meanwhile, central government bond issues in 2Q12 totaled KRW22.6 trillion, which was only 0.3% higher than in the previous quarter. Central bank bond issues also rose marginally by 0.5% q-o-q to KRW42.5 trillion.

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

	Amount (billion)						Growth Rate (%)									
	Mar-12		Apr-12		May-12		Jun-12		Mar-12		Apr-12		May-12		Jun-12	
	KRW	US\$	KRW	US\$	KRW	US\$	KRW	US\$	Y-o-Y	Q-o-Q	Y-o-Y	Q-o-Q	Y-o-Y	Q-o-Q	Y-o-Y	Q-o-Q
Total	1,461,197	1,290	1,468,452	1,299	1,488,483	1,261	1,491,463	1,302	1,302	10.0	3.2	0.5	1.4	9.7	2.1	0.2
Government	601,437	531	603,049	534	609,077	516	601,162	525	525	4.6	2.4	0.3	1.0	3.0	(0.05)	(1.3)
Central Bank Bonds	167,970	148	165,690	147	166,950	141	164,580	144	144	(0.3)	1.9	(1.4)	0.8	(1.5)	(2.0)	(1.4)
Central Government Bonds	403,751	356	408,552	362	413,276	350	408,361	357	357	6.7	2.8	1.2	1.2	5.5	1.1	(1.2)
Industrial Finance Debentures	29,716	26	28,807	25	28,851	24	28,221	25	25	5.9	(0.6)	(3.1)	0.2	(4.4)	(5.0)	(2.2)
Corporate	859,760	759	865,403	766	879,406	745	890,301	777	777	14.1	3.7	0.7	1.6	14.7	3.6	1.2

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.

Total LCY corporate bonds outstanding at end-June stood at KRW890.3 trillion, representing a 14.7% y-o-y and 3.6% q-o-q increase in the size of the market. Private corporate bonds, which accounted for 43.8% of the total, expanded 22.8% y-o-y and 5.1% q-o-q to KRW389.8 trillion. Meanwhile, special public bonds climbed 16.9% y-o-y and 4.3% q-o-q to reach KRW296.0 trillion, or about one-third of total LCY corporate bonds outstanding. On the other hand, the outstanding stock of financial debentures (excluding KDB bonds) shrank 0.6% y-o-y and 0.3% q-o-q to level off at KRW204.5 trillion.

The top 30 LCY corporate bond issuers at end-June had combined bonds outstanding of KRW552.2 trillion, representing 62% of total LCY corporate bonds (**Table 2**). Korea Land & Housing Corp. continued to be the largest corporate issuer with total bonds outstanding of KRW55.9 trillion.

LCY corporate bond issuance in 2Q12 reached KRW98.2 trillion, which was 12.2% lower than issuance in the previous quarter, as issuance fell for special public bonds, financial debentures, and private corporate bonds. However, corporate bond issues increased 16.8% from the same quarter in the previous year.

## Liquidity

The turnover ratio for LCY government bonds climbed to 1.02 in 2Q12 from 0.96 in 1Q12. This was on the back of an increase in the turnover ratio for central government bonds, mostly KTBs, to 1.06 in 2Q12 from 0.95 in 1Q12. In contrast, the turnover ratio for MSBs fell to 1.13 in 2Q12 from 1.18 in 1Q12.

Trading activity improved in the KTB futures market, as the number of traded KTB futures contracts increased from 9.1 million in 1Q12 to 9.3 million in 2Q12. Furthermore, the share of 10-year KTB futures as a portion of the total market has been steadily on the rise and that of 3-year KTB futures has been on the decline (**Figure 2**).

**Table 2: Top 30 Issuers of LCY Corporate Bonds in the Republic of Korea** (as of end-June 2012)

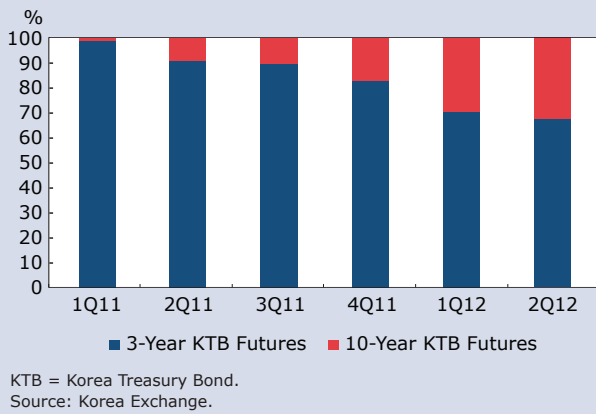
Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed on		Type of Industry
	LCY Bonds (KRW billion)	LCY Bonds (US\$ billion)			KOSPI	KOSDAQ	
1. Korea Land & Housing Corp.	55,865	48.8	Yes	No	No	No	Real Estate
2. Korea Housing Finance Corp.	42,216	36.9	Yes	No	No	No	Financial
3. Korea Deposit Insurance Corp.	36,090	31.5	Yes	No	No	No	Insurance
4. Korea Finance Corp.	35,390	30.9	Yes	No	No	No	Financial
5. Industrial Bank of Korea	28,152	24.6	Yes	No	Yes	No	Bank
6. KDB Daewoo Securities	27,584	24.1	Yes	No	Yes	No	Securities
7. Korea Electric Power Corp.	27,120	23.7	Yes	No	Yes	No	Utility
8. Woori Investment and Securities	23,287	20.3	Yes	No	Yes	No	Securities
9. Korea Investment and Securities	20,089	17.5	No	Yes	No	No	Securities
10. Kookmin Bank	19,540	17.1	No	Yes	No	No	Bank
11. Korea Expressway Corp.	19,290	16.8	Yes	No	No	No	Infrastructure
12. Shinhan Bank	19,047	16.6	No	Yes	No	No	Bank
13. Mirae Asset Securities	17,075	14.9	No	Yes	Yes	No	Securities
14. Woori Bank	16,082	14.0	Yes	No	No	No	Bank
15. Tong Yang Securities	16,078	14.0	No	Yes	Yes	No	Securities
16. Small & Medium Business Corp.	15,038	13.1	Yes	No	No	No	Financial
17. Korea Rail Network Authority	13,270	11.6	Yes	No	No	No	Infrastructure
18. Korea Gas Corp.	12,665	11.1	Yes	No	Yes	No	Utility
19. Hana Bank	12,614	11.0	No	Yes	No	No	Bank
20. Hyundai Securities	10,646	9.3	No	Yes	Yes	No	Securities
21. Hana Daetoo Securities	10,477	9.1	No	Yes	No	No	Securities
22. Standard Chartered First Bank Korea	9,330	8.1	No	Yes	No	No	Bank
23. Korea Water Resources	9,254	8.1	Yes	No	Yes	No	Utility
24. Korea Eximbank	9,030	7.9	Yes	No	No	No	Bank
25. Shinhan Card	8,700	7.6	No	Yes	No	No	Financial
26. Shinhan Investment Corp.	8,567	7.5	No	Yes	No	No	Securities
27. Hyundai Capital Services	7,508	6.6	No	Yes	No	No	Securities
28. Shinhan Financial Group	7,490	6.5	No	Yes	Yes	No	Financial
29. Korea Railroad Corp.	7,440	6.5	Yes	No	No	No	Infrastructure
30. Nonghyup Bank	7,300	6.4	Yes	No	No	No	Bank
<b>Total Top 30 LCY Corporate Issuers</b>	<b>552,233</b>	<b>482.1</b>					
<b>Total LCY Corporate Bonds</b>	<b>890,301</b>	<b>777.3</b>					
<b>Top 30 as % of Total LCY Corporate Bonds</b>	<b>62.0%</b>	<b>62.0%</b>					

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

Meanwhile, the turnover ratio for LCY corporate bonds slipped to 0.16 in 2Q12 from 0.18 in 1Q12, as the turnover ratio for financial debentures fell to 0.32 in 2Q12 from 0.36 in 1Q12, while that

for private corporate bonds decreased to 0.07 in 2Q12 from 0.09 in 1Q12. On the other hand, the turnover ratio for special public bonds inched up to 1.06 in 2Q12 from 0.95 in 1Q12.

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



### Investor Profile

Insurance companies and pension funds were the largest investor group in LCY government bonds in 1Q12, holding 25% of total government bonds at end-March (**Figure 3**). They were followed by the general government—consisting of the central government, local governments, and social security funds—which held 24% of the total. Banks and other financial companies posted shares of 19% and 18%, respectively, while foreign investors held 11%. Compared with a year earlier, the share of insurance companies and pension funds increased 2 percentage points, while the shares of banks and foreign investors

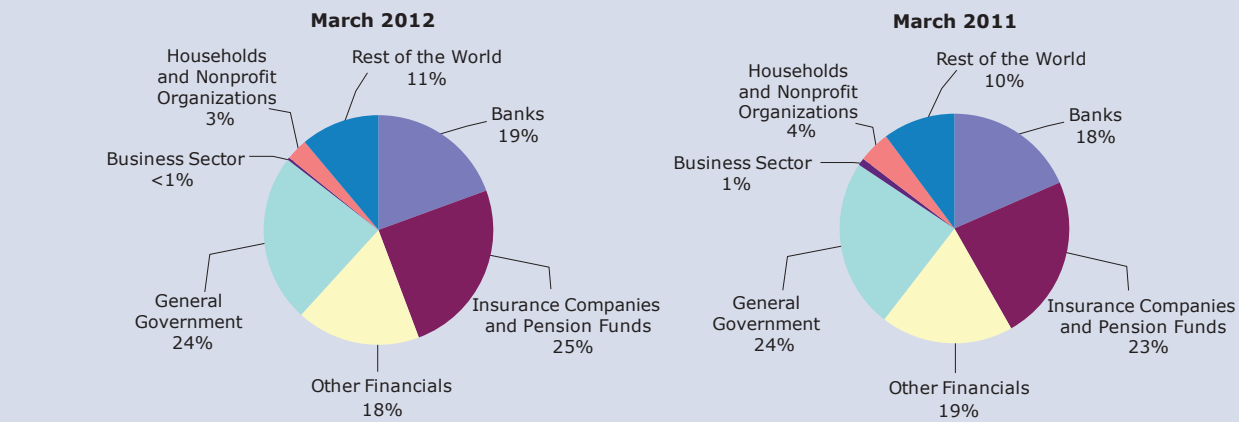
climbed 1 percentage point each. In contrast, a 1 percentage point fall was evident in the shares of other financial companies, and households and nonprofit organizations.

The largest investor group in LCY corporate bonds at end-March was insurance companies and pension funds, which held 33% of total corporate bonds (**Figure 4**). Financial companies other than banks, insurance companies, and pension funds were the next largest holders at 29%, followed by banks (18%), the general government (12%), households and nonprofit organizations (5%), non-financial companies (2%), and foreign investors (1%). Compared with end-March 2011, the shares of insurance companies and pension funds, non-financial companies, and foreign investors climbed 1 percentage point each, while that of households and nonprofit organizations rose 2 percentage points. In contrast, the share of banks dropped 4 percentage points and the share of other financial companies declined 1 percentage point.

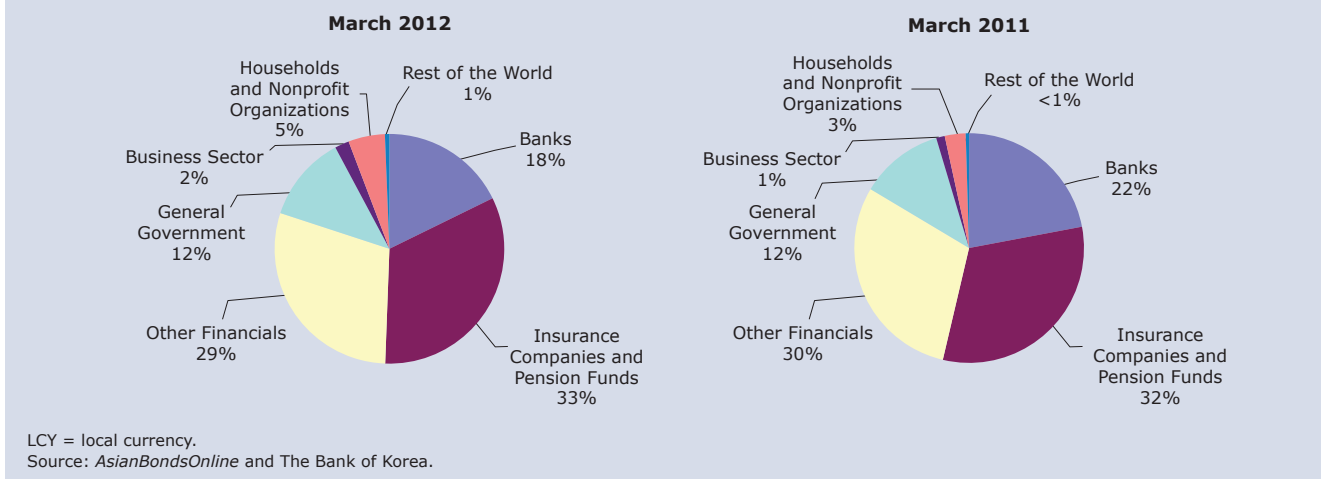
### Rating Changes

Rating and Investment Information, Inc. (R&I) announced in April that it had affirmed the Republic of Korea’s foreign currency (FCY) and LCY issuer ratings at A+ and AA–, respectively, and that the

**Figure 3: LCY Government Bonds Investor Profile**



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

**Figure 4: LCY Corporate Bonds Investor Profile****Table 3: Selected Sovereign Ratings and Outlook for the Republic of Korea**

	Moody's	S&P	Fitch	R&I
Sovereign FCY LT Ratings	Aa3	A	AA-	A+
Outlook	Stable	Stable	Stable	Stable

FCY = foreign currency, LT = long term.  
Source: Rating agencies.

outlook for both ratings was stable (**Table 3**). R&I reported that the country has “sound fiscal conditions,” a stable financial system, and a “sustained current account surplus.” Moody’s Investor Service (Moody’s) stated in August that it upgraded the country’s government bond rating to Aa3 from A1 due to its strong fiscal fundamentals, reduced banking sector vulnerability, and high degree of competitiveness and economic resilience.

## Policy, Institutional, and Regulatory Developments

### Regulation on Corporate Bond Underwriting Amended

According to the Financial Supervisory Service (FSS), the regulation on underwriting corporate bonds was amended in April to require lead arrangers to conduct due diligence on corporate bond issuers and carry out demand forecasting in order to determine investors’ level of demand and desired pricing for the bond.

### MOSF Reports Economic Policy for 2H12

The Ministry of Strategy and Finance (MOSF) reported in June that the economic policies of the Republic of Korea in the second half of the year would focus on minimizing the adverse effects of the global economic crisis on the domestic economy, conducting economic reforms, and supporting the working class. MOSF mentioned seven important tasks for the government to pursue, including (i) dealing with global financial turmoil effectively, (ii) continuing with fiscal stimulus by raising budgetary spending and providing supplementary budgets, (iii) establishing a facility investment fund to support such investment, (iv) keeping consumer price inflation at or near 2.0%, (v) generating 400,000 jobs within the year, (vi) promoting microfinance and housing support programs, and (vii) nurturing certain sectors as future growth engines.

### FSC Forms Task Force for Legislation of Covered Bond Act

In July, the Financial Services Commission (FSC) formed a task force that will help legislate the Covered Bond Act and thereby encourage banks to issue covered bonds. The FSC has reported that with the legislation of the Covered Bond Act, issuance of covered bonds will help banks lower their funding costs. The FSC expects that the draft bill will be submitted to the National Assembly for approval in November.