

# Republic of Korea

## Yield Movements

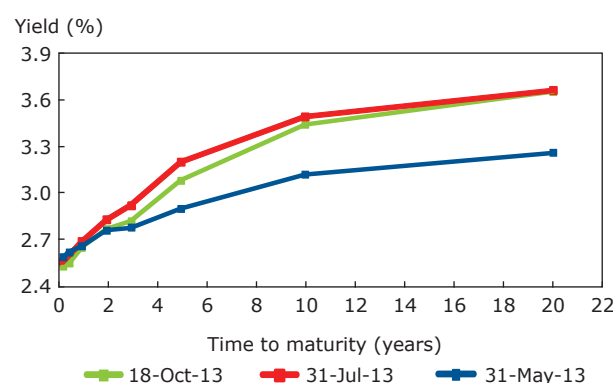
Yields of local currency (LCY) government bonds in the Republic of Korea rose for most tenors between end-May and 18 October (**Figure 1**). During this period, yields climbed for tenors of more than 1 year, with the increases ranging from 1 basis point (bp) for the 2-year tenor to 39 bps for the 20- and 30-year tenors, while yields fell for tenors of 1 year or less. The yield hike in most tenors was relatively strong between end-May and end-July amid expectations of a tapering in the asset purchase program of the United States (US) Federal Reserve. But yields later fell at a less rapid pace for all tenors between end-July and 18 October amid the US Federal Open Market Committee's decision in September to maintain its asset purchase program at its current pace. Meanwhile, the yield spread between 2- and 10-year tenors widened 31 bps between end-May and 18 October.

The Bank of Korea's Monetary Policy Committee decided on 10 October to keep the base rate steady at 2.50%, forecasting that the global economy would sustain its recovery and that a negative output gap and low inflationary pressures would persist in the domestic economy for the time being.

Consumer price inflation decelerated in the Republic of Korea to 0.7% year-on-year (y-o-y) in October from 0.8% in September, induced by an annual fall in the prices of food and non-alcoholic beverages and transport costs. The price indices for food and non-alcoholic beverages and transport dropped 1.8% and 1.4% y-o-y, respectively.

The Bank of Korea released its latest economic outlook for 2013 and 2014 in October. The central bank maintained its 2013 gross domestic product (GDP) growth rate projection for the Republic of Korea at 2.8%. On the other hand, it revised downward its 2014 GDP growth rate forecast to 3.8% from a forecast of 4.0% made in July.

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



LCY = local currency.  
Source: Bloomberg LP.

Meanwhile, advance GDP growth estimates of The Bank of Korea revealed that the country's real GDP growth rate in 3Q13 stood at 1.1% quarter-on-quarter (q-o-q), the same as in 2Q13, and 3.3% y-o-y, an improvement from the previous quarter's 2.3%. The acceleration in y-o-y GDP growth was led by faster annual growth in private consumption expenditure and gross fixed capital formation on the demand side, and increased production in the agriculture, forestry, and fishing; manufacturing; construction; and services sectors on the supply side.

## Size and Composition

The size of the LCY bond market in the Republic of Korea amounted to KRW1,681 trillion (US\$1.6 trillion) at the end of 3Q13, up 1.8% q-o-q and 10.4% y-o-y (**Table 1**). In 3Q13, LCY government bonds outstanding rose 1.3% q-o-q and 6.9% y-o-y to reach KRW645.3 trillion at end-September, led by an expansion in central government bonds, which accounted for 69% of the outstanding stock of LCY government bonds. Specifically, LCY central government bonds outstanding grew 1.3% q-o-q and 7.4% y-o-y

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

	Outstanding Amount (billion)						Growth Rate (%)			
	3Q12		2Q13		3Q13		3Q12		3Q13	
	KRW	US\$	KRW	US\$	KRW	US\$	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>1,528,239</b>	<b>1,370</b>	<b>1,650,267</b>	<b>1,445</b>	<b>1,680,687</b>	<b>1,564</b>	<b>2.1</b>	<b>9.6</b>	<b>1.8</b>	<b>10.4</b>
Government	603,590	543	637,277	558	645,333	601	0.4	2.2	1.3	6.9
Central Bank Bonds	162,460	146	165,420	145	164,880	153	(1.3)	(4.1)	(0.3)	1.5
Central Government Bonds	413,848	372	439,059	384	444,599	414	1.3	5.8	1.3	7.4
Industrial Finance Debentures	27,283	25	32,798	29	35,854	33	(3.3)	(8.4)	9.3	31.4
Corporate	919,279	827	1,012,990	887	1,035,354	963	3.3	15.1	2.2	12.6

( ) = negative, LCY = local currency, 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.

Sources: EDAILY BondWeb and The Bank of Korea.

in 3Q13 to level off at KRW444.6 trillion, buoyed by Korea Treasury Bonds (KTBs), which stood at KRW390.6 trillion at the end of the quarter. Similarly, outstanding LCY industrial finance debentures issued by Korea Development Bank (KDB) surged 9.3% q-o-q and 31.4% y-o-y to reach KRW35.9 trillion at end-September. In contrast, LCY central bank bonds outstanding slipped 0.3% q-o-q, but rose 1.5% y-o-y in 3Q13, leveling off at KRW164.9 trillion.

Issuance of LCY government bonds during 3Q13 surged 17.7% y-o-y, but contracted 2.3% q-o-q. The y-o-y increase in LCY government bond issuance came from annual increases in the issuance of central government bonds, central bank bonds, and industrial finance debentures. On the other hand, the q-o-q fall in LCY government bond issuance was largely a result of quarterly declines in LCY bond issuance by the central bank and KDB that more than offset the quarterly increase in LCY central government bond issuance.

The outstanding amount of LCY corporate bonds stood at KRW1,035 trillion at end-September, having expanded 2.2% q-o-q and 12.6% y-o-y. Private sector corporate bonds, which occupied 46% of the corporate bond market, grew 1.6% q-o-q and 16.0% y-o-y; special public bonds, which accounted for 33% of total corporate bonds outstanding, increased 2.8% q-o-q and

13.0% y-o-y; and financial debentures (excluding KDB bonds), which comprised 21% of the corporate bond market, were up 2.6% q-o-q and 5.3% y-o-y.

Issuance of LCY corporate bonds fell 10.1% q-o-q and 15.5% y-o-y during 3Q13 as private corporate bond issues, which accounted for 47% of total LCY corporate issuance in the quarter, dropped 21.3% q-o-q and 21.9% y-o-y. Meanwhile, LCY bond issues by special public companies plunged 19.1% y-o-y, but were up 5.4% q-o-q in 3Q13. In contrast, issuance of financial debentures (excluding KDB bonds) climbed 0.5% q-o-q and 5.3% y-o-y.

At end-September, the top 30 LCY corporate bond issuers had outstanding bonds of KRW640.3 trillion, accounting for 61.8% of total LCY corporate bonds (**Table 2**). Korea Housing Finance Corporation became the largest issuer of LCY corporate bonds in 3Q13, surpassing Korea Land and Housing Corporation, with bonds outstanding of KRW60.7 trillion.

The five largest LCY corporate bonds issued in 3Q13 included NongHyup Bank's KRW500 billion 10-year bond offering a 4.03% coupon, KRW350 billion 30-year bond with a 4.88% coupon, and KRW320 billion 3-year bond with a 3.13% coupon; Kookmin Bank's KRW400 billion

**Table 2: Top 30 Issuers of LCY Corporate Bonds in the Republic of Korea**

Issuers	Outstanding Amount		State-Owned	Listed on		Type of Industry
	LCY Bonds (KRW billion)	LCY Bonds (US\$ billion)		KOSPI	KOSDAQ	
1. Korea Housing Finance	60,659	56.4	Yes	No	No	Financial
2. Korea Land & Housing	59,219	55.1	Yes	No	No	Real Estate
3. Korea Finance	44,730	41.6	Yes	No	No	Financial
4. Korea Deposit Insurance	43,770	40.7	Yes	No	No	Insurance
5. Industrial Bank of Korea	33,296	31.0	Yes	Yes	No	Bank
6. KDB Daewoo Securities	31,160	29.0	Yes	Yes	No	Securities
7. Korea Electric Power	30,640	28.5	Yes	Yes	No	Utility
8. Woori Investment and Securities	29,384	27.3	Yes	Yes	No	Securities
9. Korea Investment and Securities	28,077	26.1	No	No	No	Securities
10. Mirae Asset Securities	23,652	22.0	No	Yes	No	Securities
11. Korea Expressway	20,450	19.0	Yes	No	No	Infrastructure
12. Kookmin Bank	18,895	17.6	No	No	No	Bank
13. Tong Yang Securities	18,160	16.9	No	Yes	No	Securities
14. Shinhan Bank	17,938	16.7	No	No	No	Bank
15. Korea Rail Network Authority	15,810	14.7	Yes	No	No	Infrastructure
16. Small & Medium Business	15,105	14.1	Yes	No	No	Financial
17. Hana Daetoo Securities	13,780	12.8	No	No	No	Securities
18. Woori Bank	13,602	12.7	Yes	No	No	Bank
19. Korea Gas	13,315	12.4	Yes	Yes	No	Utility
20. Hyundai Securities	12,111	11.3	No	Yes	No	Securities
21. Hana Bank	11,835	11.0	No	No	No	Bank
22. Shinhan Investment	11,282	10.5	No	No	No	Securities
23. Standard Chartered First Bank Korea	10,350	9.6	No	No	No	Bank
24. Samsung Securities	10,020	9.3	No	Yes	No	Securities
25. Korea Water Resources	9,849	9.2	Yes	Yes	No	Utility
26. NongHyup Bank	9,050	8.4	Yes	No	No	Bank
27. Shinhan Card	8,643	8.0	No	No	No	Financial
28. Korea Eximbank	8,640	8.0	Yes	No	No	Bank
29. Korea Railroad	8,600	8.0	Yes	No	No	Infrastructure
30. Korea Student Aid Foundation	8,310	7.7	Yes	No	No	Financial
<b>Total Top 30 LCY Corporate Issuers</b>	<b>640,332.0</b>	<b>595.9</b>				
<b>Total LCY Corporate Bonds</b>	<b>1,035,354.0</b>	<b>963.4</b>				
<b>Top 30 as % of Total LCY Corporate Bonds</b>	<b>61.8%</b>	<b>61.8%</b>				

KOSDAQ = Korean Securities Dealers Automated Quotations, KOSPI = Korea Composite Stock Price Index, LCY = local currency.

Notes:

1. Data as of end-September 2013.

2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.

Source: *AsianBondsOnline* calculations based on Bloomberg and EDAILY *BondWeb* data.

**Table 3: Notable LCY Corporate Bond Issuance in 3Q13**

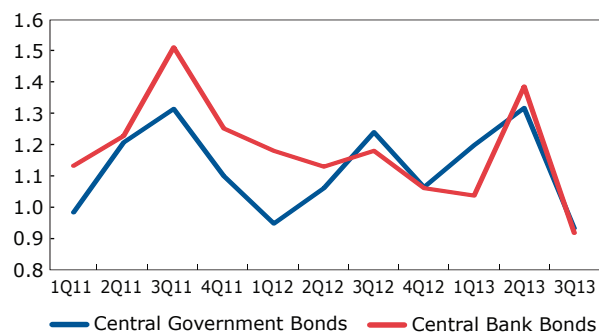
Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
NongHyup Bank		
3-year bond	3.13	320
10-year bond	4.03	500
30-year bond	4.88	350
Kookmin Bank		
7-year bond	3.82	400
Samsung Everland		
5-year bond	3.52	350

LCY = local currency.  
Source: Bloomberg LP.

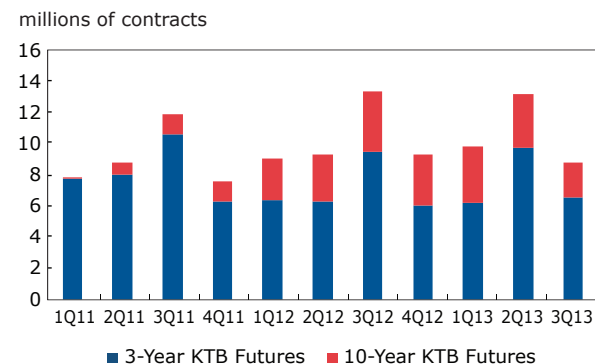
7-year bond carrying a 3.82% coupon; and Samsung Everland's KRW350 billion 5-year bond offering a 3.52% coupon (**Table 3**).

## Liquidity

Liquidity in the LCY government bond market appears to have tightened in 3Q13, on both a quarterly and annual basis, as the turnover ratio for government bonds fell to 0.87 in 3Q13 from 1.27 in 2Q13 and 1.16 in 3Q12. By government bond type, the turnover ratio for central government bonds—mostly KTBs—dropped to 0.93 in 3Q13 from 1.32 in 2Q13 and 1.24 in 3Q12, while the ratio for central bank bonds decreased to 0.92 in 3Q13 from 1.39 in 2Q13 and 1.18 in 3Q12 (**Figure 2**).

**Figure 2: Turnover Ratios for Central Government and Central Bank Bonds**

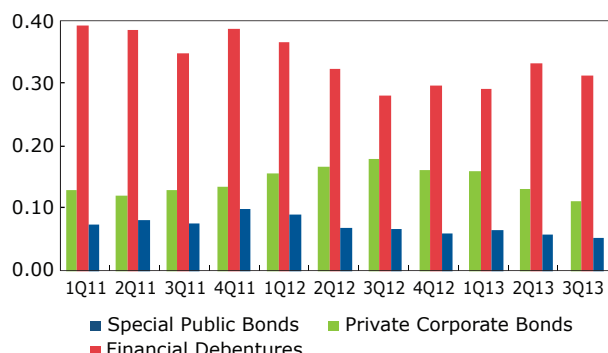
Note: Central government bonds include Korea Treasury Bonds and National Housing Bonds.  
Sources: The Bank of Korea and EDAILY BondWeb.

**Figure 3: Trading Volume of KTB Futures Contracts**

KTB = Korea Treasury Bond.  
Source: Korea Exchange.

Meanwhile, liquidity in the KTB futures market appears to have tightened as well in 3Q13, as the total number of 3- and 10-year KTB futures contracts traded fell to 8.8 million from 13.2 million in the previous quarter (**Figure 3**). Between 2Q13 and 3Q13, the share of 3-year KTB futures contracts traded climbed from 73% to 75% of all KTB futures contracts traded, while the share of 10-year KTB futures contracts traded fell from 27% to 25%.

In the LCY corporate bond market, liquidity conditions appear to have tightened in 3Q13, albeit marginally, as the turnover ratio for corporate bonds fell slightly to 0.13 from 0.14 in the previous quarter. The turnover ratio for all

**Figure 4: Turnover Ratios for Special Public Bonds, Financial Debentures, and Private Corporate Bonds**

Source: EDAILY BondWeb.

three types of corporate bonds fell between 2Q13 and 3Q13—from 0.13 to 0.11 for special public bonds, from 0.33 to 0.31 for financial debentures, and from 0.06 to 0.05 for private corporate bonds (**Figure 4**).

## Investor Profile

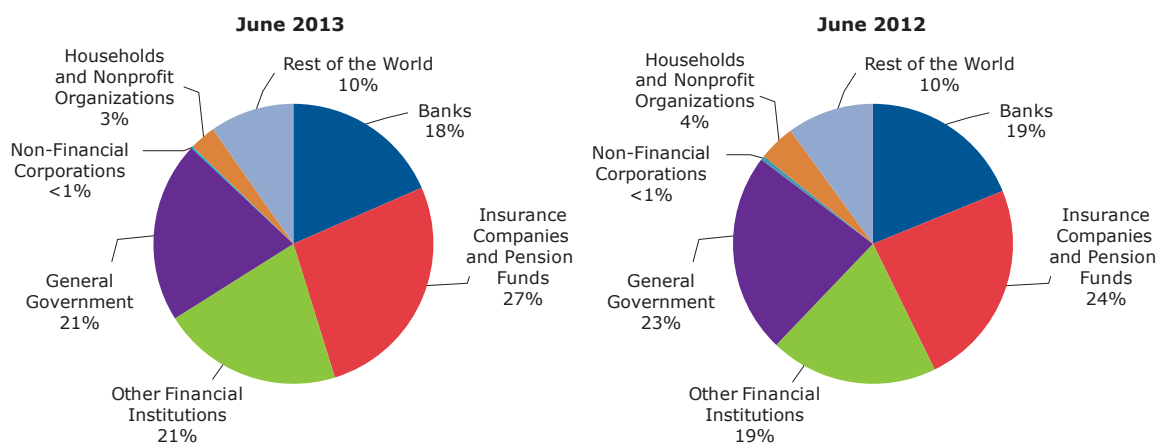
At end-June, the largest investor group in the LCY government bond market comprised insurance companies and pension funds with a combined 27% share of the total market (**Figure 5**), a 3 percentage point gain in market share from a year earlier. Meanwhile, general government entities—the central government, local government, and social security funds—and financial institutions (other than banks, insurance companies, and pension funds) had investor shares of 21% each. Compared with a year earlier, the share of general government entities dropped 2 percentage points at end-June, while that of financial institutions (other than banks, insurance companies, and pension funds) climbed 2 percentage points. Between June 2012 and June 2013, the shares of banks and households and non-profit organizations slipped 1 percentage point each to 18% and 3%, respectively. In addition, the share of non-financial corporations stood at 0.2% at end-June, down 0.3 percentage

points from a year earlier. Lastly, the share of foreign investors in LCY government and public bonds at end-June remained the same at 10%.

Insurance companies and pension funds continued to hold the largest amount of LCY corporate bonds among all investor groups with a combined 34% share of the total market at end-June, an increase of 1 percentage point from a year earlier (**Figure 6**). The second-largest investor group in LCY corporate bonds at end-June with a 28% share was financial institutions (other than banks, insurance companies, and pension funds). However, this represented a 2 percentage point decline from a year earlier. Meanwhile, the share of LCY corporate bonds held by banks dropped to 14% from 18% over the same period. Similarly, the share of foreign investors' holdings in the LCY corporate bond market slipped 0.5 percentage points to 0.5% at end-June.

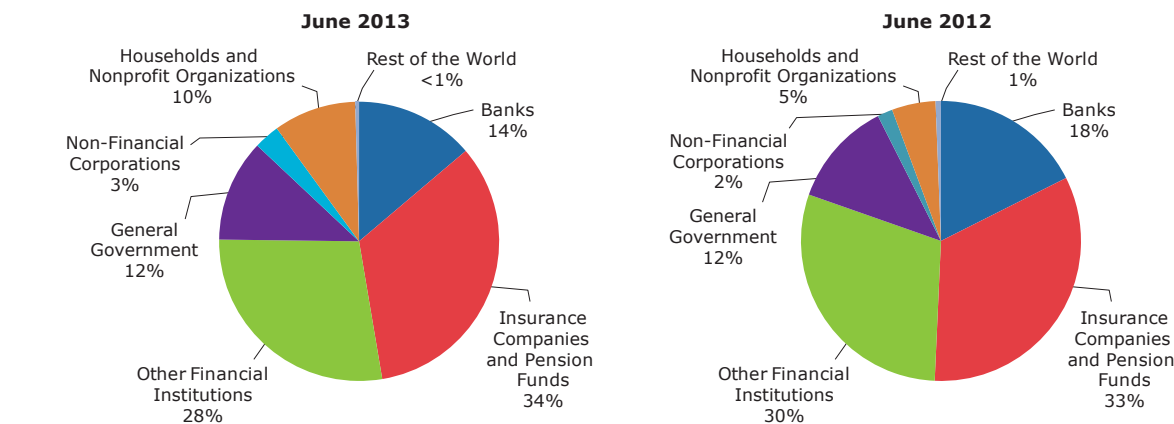
In contrast, the share of non-financial corporations' holdings of LCY corporate bonds rose 1 percentage point to 3%, and the share of households and non-profit organizations climbed 5 percentage points to 10%. Meanwhile, the share of general government entities' holdings of LCY corporate bonds remained unchanged between end-June 2012 and end-June 2013 at 12%.

**Figure 5: LCY Government Bonds Investor Profile**



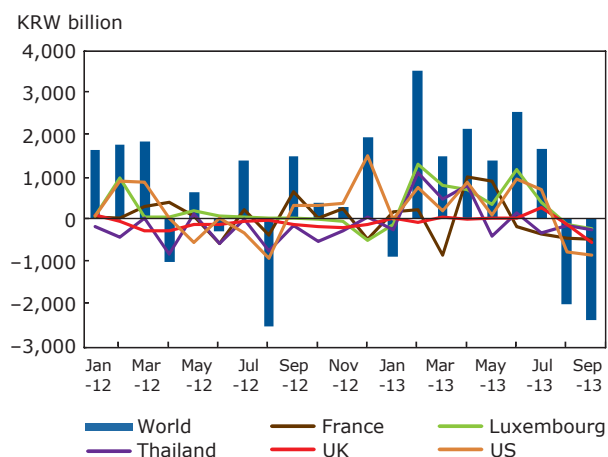
LCY = local currency.

Source: AsianBondsOnline and The Bank of Korea.

**Figure 6: LCY Corporate Bonds Investor Profile**

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

Net foreign investments in the Republic of Korea's LCY bond market were negative for the second consecutive month in September, according to Financial Supervisory Service (FSS) data (**Figure 7**). Net bond purchases by foreign investors amounted to only KRW100 billion in September, down significantly from August's KRW1.6 trillion. On the other hand, bond redemptions by foreign investors were valued at KRW2.5 trillion in September, down from KRW3.7 trillion in the previous month. As a result, net bond sales by foreign investors rose to KRW2.4 trillion in September from KRW2.1 trillion in August. In January–September, net foreign bond investments in the Republic of Korea stood at KRW7.3 trillion, an increase over the KRW4.8 trillion posted in the first 9 months of 2012.

**Figure 7: Net Foreign Investment by Country in LCY Bonds in the Republic of Korea**

LCY = local currency, UK = United Kingdom, US = United States.  
Source: Financial Supervisory Service (FSS).

## Rating Changes

Standard and Poor's (S&P) announced in September that it was affirming its foreign currency (FCY) and LCY credit ratings for the Republic of Korea at A+/A-1 and AA-/A-1+, respectively, with its outlook for both long-term ratings being stable.

S&P stated that its credit ratings for the Republic of Korea reflected the country's "favorable policy environment, sound fiscal position, and broadly balanced external liability position."

## **Policy, Institutional, and Regulatory Developments**

### **Republic of Korea and UAE Establish Bilateral Currency Swap Arrangement**

The Bank of Korea and the Central Bank of the United Arab Emirates (UAE) announced in October the establishment of a 3-year KRW–AED swap arrangement. The size of the bilateral currency swap arrangement is up to KRW5.8 trillion–AED20 billion (US\$5.4 billion). The arrangement can be extended upon agreement by both parties and is aimed at promoting bilateral trade and financial cooperation between the Republic of Korea and the UAE.

### **Republic of Korea and Malaysia Establish Bilateral Currency Swap Arrangement**

The Bank of Korea and Bank Negara Malaysia announced in October the establishment of a 3-year KRW–MYR swap arrangement. The size of the bilateral currency swap arrangement is up to KRW5 trillion–MYR15 billion. The arrangement can be extended upon agreement by both parties and is aimed at promoting bilateral trade and financial cooperation between the Republic of Korea and Malaysia.

### **Republic of Korea and Indonesia to Establish Bilateral Currency Swap Arrangement**

The central banks and ministries of finance of the Republic of Korea and Indonesia agreed in October to establish a bilateral KRW–IDR swap arrangement. The size of the swap arrangement is up to KRW10.7 trillion–IDR115 trillion (US\$10 billion). Its effective period is 3 years with a possible extension upon a joint agreement by the two parties. The swap arrangement is expected to foster bilateral trade and financial cooperation between the Republic of Korea and Indonesia.

### **2013 Tax Revision Bill Finalized**

The 2013 Tax Revision Bill was finalized in September, according to the Ministry of Strategy and Finance (MOSF). The revisions included increases in income tax deductions for long-term mortgage payments and rental payments, increases in the earned income tax credit and charitable donation tax credit, and reductions in sales taxes for rental houses and income taxes for small rental homes.