

Republic of Korea

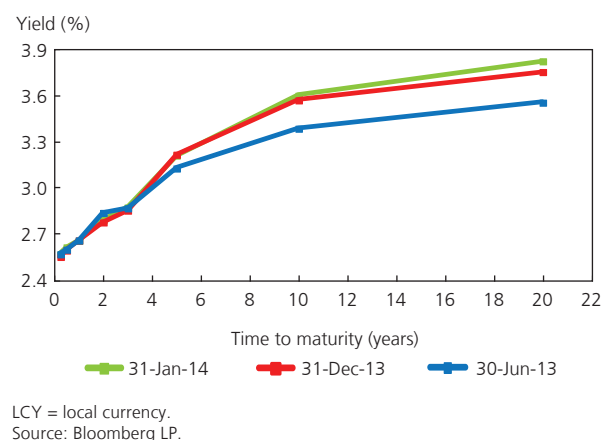
Yield Movements

The Republic of Korea's local currency (LCY) government bond yield curve steepened between end-June 2013 and end-January 2014 as yields rose relatively more at the longer-end of the curve (**Figure 1**). The rise in longer-term yields was most pronounced in November, amid expectations of a tapering in the asset purchase program of the United States (US) Federal Reserve by the end of the year. Moreover, the further increase in yields for most tenors in January was induced by increased expectations of an inflation uptick and a better-than-expected economic recovery, both domestically and globally. Meanwhile, the yield spread between 2- and 10-year tenors widened 26 basis points (bps) between end-June 2013 and end-January 2014.

Real gross domestic product (GDP) of the Republic of Korea grew 0.9% quarter-on-quarter (q-o-q) and 3.9% year-on-year (y-o-y) in 4Q13, based on advance estimates released by The Bank of Korea in January. Compared with 3Q13, real GDP growth was lower on a q-o-q basis but higher on a y-o-y basis. For full-year 2013, real GDP growth stood at 2.8%, higher than 2012's growth of 2.0%. On the demand side, the biggest annual improvement came from gross fixed capital formation, which rebounded with 3.8% growth in 2013 following a 1.7% contraction in 2012. On the production side, the agriculture, forestry, and fishery sector and the construction sector were the most improved sectors in 2013, posting annual growth rates of 5.6% and 3.7%, respectively, following negative growth in the previous year. Meanwhile, The Bank of Korea also released in January its latest economic outlook for the Republic of Korea, maintaining its GDP growth rate projections at 2.8% for 2013 and 3.8% for 2014.

Inflationary pressures remained relatively low in 4Q13, as the y-o-y inflation rate based on the consumer price index (CPI) hovered around 1.0% in each month of the quarter. For the full-year 2013, the headline CPI inflation rate stood at 1.1%, lower than the 2.2% rate recorded in 2012. For the month of January, consumer price inflation stood at 1.1% y-o-y and 0.5% month-on-month (m-o-m). The Bank of Korea in its economic outlook released in January forecasted headline

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



consumer price inflation to be at 1.3% in 2013 and 2.3% in 2014. Meanwhile, the policy interest rate was kept unchanged by the central bank throughout 4Q13. On 9 January, The Bank of Korea's Monetary Policy Committee decided to maintain the policy interest rate at 2.50% in support of economic growth amid a low inflation environment.

Size and Composition

The Republic of Korea's LCY bond market expanded in 4Q13, on both an annual and quarterly basis, as LCY corporate and government bonds outstanding both rose in nominal terms (**Table 1**). The increase in the outstanding amount of government bonds, which accounted for 38% of the overall bond market, was led by steady growth in central government bonds, particularly Korea Treasury Bonds (KTBs), which rose 2.6% q-o-q and 10.4% y-o-y, outweighing the anemic y-o-y growth and slight q-o-q decline in central bank bonds, which are also known as Monetary Stabilization Bonds (MSBs). The government issued more bonds in 4Q13 than in the previous quarter, with issuance rising 3.8% q-o-q and 8.0% y-o-y.

Corporate bonds outstanding expanded at a much faster pace than government securities in 4Q13. This was buoyed by growth in the outstanding bonds of

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

	Outstanding Amount (billion)						Growth Rate (%)			
	4Q12		3Q13		4Q13		4Q12		4Q13	
	KRW	US\$	KRW	US\$	KRW	US\$	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,565,704	1,471	1,680,687	1,564	1,722,720	1,641	2.8	10.5	2.5	10.0
Government	609,035	572	645,333	601	657,309	626	0.9	3.7	1.9	7.9
Central Bank Bonds	163,070	153	164,880	153	163,670	156	0.4	(1.0)	(0.7)	0.4
Central Government Bonds	416,113	391	444,599	414	455,858	434	0.5	6.0	2.5	9.6
Industrial Finance Debentures	29,852	28	35,854	33	37,781	36	9.4	(0.1)	5.4	26.6
Corporate	956,669	899	1,035,354	963	1,065,411	1,015	4.1	15.4	2.9	11.4

() = 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.

private sector corporates (3.4% q-o-q and 14.1% y-o-y) and of special public companies (2.7% q-o-q and 10.8% y-o-y). Meanwhile, outstanding financial debentures, excluding Korean Development Bank (KDB) bonds, also grew, albeit at a slower pace compared with the overall growth of corporate bonds. Meanwhile, LCY corporate bond issuance increased 27.4% q-o-q and 5.7% y-o-y in 4Q13, induced by solid growth in gross bond sales of financial companies and private sector corporates.

By the end of 2013, the value of outstanding bonds sold by the top 30 LCY corporate issuers as a share of total corporate bonds stood at 64%, which was 2 percentage points higher than what was recorded in the previous quarter (**Table 2**). Korea Housing Finance remained the largest issuer of LCY corporate bonds, followed by Korea Land and Housing.

Of the five relatively large LCY corporate bond issues during 4Q13, two were made by banks (Industrial Bank of Korea and Woori Bank), one by a utility company (Korea Gas), one by a steel company (POSCO), and one by a transport infrastructure company (Korea Rail Network Authority) (**Table 3**).

Liquidity

The LCY government bond market in the Republic of Korea appeared to be less liquid in 4Q13, as the turnover ratio for government bonds was lower compared with 3Q13 and 4Q12. Moreover, the latter half of 2013 saw relatively low turnover ratios for central government

and central bank bonds, as trading of KTBs and MSBs was down during this quarter (**Figure 2**).

Similarly, liquidity in the KTB futures market tightened in 4Q13, as the total number of 3- and 10-year KTB futures contracts traded fell to 7.5 million from 8.8 million in the previous quarter (**Figure 3**). Between 3Q13 and 4Q13, the volume of 3-year KTB futures contracts traded as a share of the total fell from 75% to 69%, while the share of the volume of 10-year KTB futures contracts traded climbed from 25% to 31%.

In the LCY corporate bond market, liquidity trends during the second half of 2013 appear to have been mixed; on one hand, the turnover ratios for the outstanding bonds of financial institutions and private sector corporates remained roughly unchanged between 3Q13 and 4Q13, while on the other hand, the turnover ratio for the debt securities of special public companies soared during the last quarter of the year (**Figure 4**).

Investor Profile

Insurance companies and pension funds—the largest investor group holder of LCY government bonds in the Republic of Korea—and financial institutions (other than banks, local insurers, and pension funds) each registered a 2 percentage point increase in their respective shares of government bond holdings between end-September 2012 and end-September 2013, showcasing their increasing demand for

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	61,956	59.0	Yes	No	No	Financial
2. Korea Land & Housing	58,663	55.9	Yes	No	No	Real Estate
3. Korea Finance	46,520	44.3	Yes	No	No	Financial
4. Korea Deposit Insurance	45,850	43.7	Yes	No	No	Insurance
5. KDB Daewoo Securities	34,889	33.2	Yes	Yes	No	Securities
6. Industrial Bank of Korea	33,175	31.6	Yes	Yes	No	Bank
7. Korea Investment and Securities	31,945	30.4	No	No	No	Securities
8. Korea Electric Power	30,750	29.3	Yes	Yes	No	Utility
9. Woori Investment and Securities	30,437	29.0	Yes	Yes	No	Securities
10. Mirae Asset Securities	25,783	24.6	No	Yes	No	Securities
11. Hana Daetoo Securities	24,836	23.7	No	No	No	Securities
12. Shinhan Investment	24,276	23.1	No	No	No	Securities
13. Korea Expressway	20,760	19.8	Yes	No	No	Infrastructure
14. Kookmin Bank	19,325	18.4	No	No	No	Bank
15. Korea Rail Network Authority	17,250	16.4	Yes	No	No	Infrastructure
16. Shinhan Bank	16,064	15.3	No	No	No	Bank
17. Small & Medium Business Corp.	15,365	14.6	Yes	No	No	Financial
18. Tong Yang Securities	14,925	14.2	No	Yes	No	Securities
19. Korea Gas	14,855	14.2	Yes	Yes	No	Utility
20. Woori Bank	14,492	13.8	Yes	No	No	Bank
21. Hyundai Securities	12,963	12.3	No	Yes	No	Securities
22. Hana Bank	12,285	11.7	No	No	No	Bank
23. Standard Chartered First Bank Korea	10,860	10.3	No	No	No	Bank
24. Samsung Securities	10,639	10.1	No	Yes	No	Securities
25. Korea Water Resources	9,951	9.5	Yes	Yes	No	Utility
26. Hyundai Capital Services	9,235	8.8	No	No	No	Financial
27. Korea Railroad	9,200	8.8	Yes	No	No	Infrastructure
28. Shinhan Card	8,861	8.4	No	No	No	Financial
29. Korea Student Aid Foundation	8,820	8.4	Yes	No	No	Financial
30. NongHyup Bank	8,600	8.2	Yes	No	No	Bank
Total Top 30 LCY Corporate Issuers	683,532	651.1				
Total LCY Corporate Bonds	1,065,411	1,014.9				
Top 30 as % of Total LCY Corporate Bonds	64.2%	64.2%				

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

Notes:

1. Data as of end-December 2013.

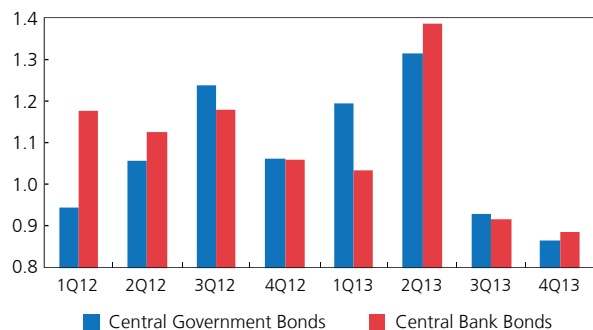
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.

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

Table 3: Notable LCY Corporate Bond Issuance in 4Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Industrial Bank of Korea		
10-year bond	3.97	500.0
Korea Gas		
3-year bond	3.14	300.0
Korea Rail Network Authority		
5-year bond	3.54	370.0
POSCO		
5-year bond	3.35	330.0
Woori Bank		
10-year bond	3.89	500.0

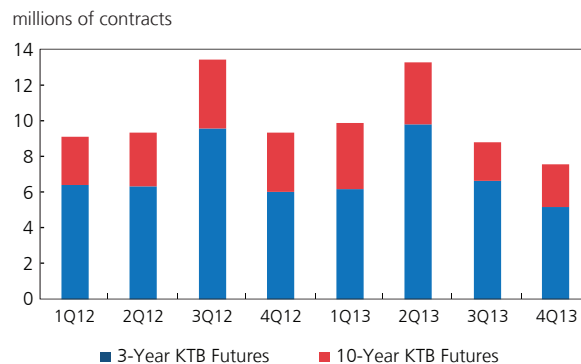
LCY = local currency.
Source: Bloomberg LP.

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

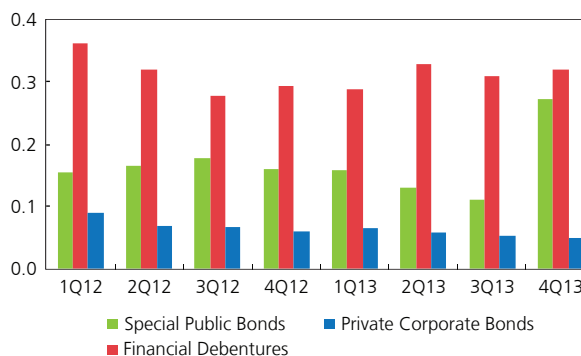
Note: Central government bonds include Korea Treasury Bonds and National Housing Bonds.
Sources: The Bank of Korea and EDAILY *BondWeb*.

government debt securities (**Figure 5**). In contrast, the shares of government bond holding of households and nonprofit organizations, non-financial corporations, and the general government—comprising the central government, local governments, and social security funds—all posted annual declines, while government bond holding shares remaining the same for banks and foreign investors.

Insurance companies and pension funds remained the largest investor group in the Republic of Korea's LCY corporate bond market at end-September, holding 35% of all corporate bonds, with their share of corporate bond holdings climbing 2 percentage points from September 2012 (**Figure 6**). Similarly, the share of corporate bond holdings of households and nonprofit organizations rose 2 percentage points on an annual basis at end-September. On the other hand, the share

Figure 3: Trading Volume of KTB Futures Contracts

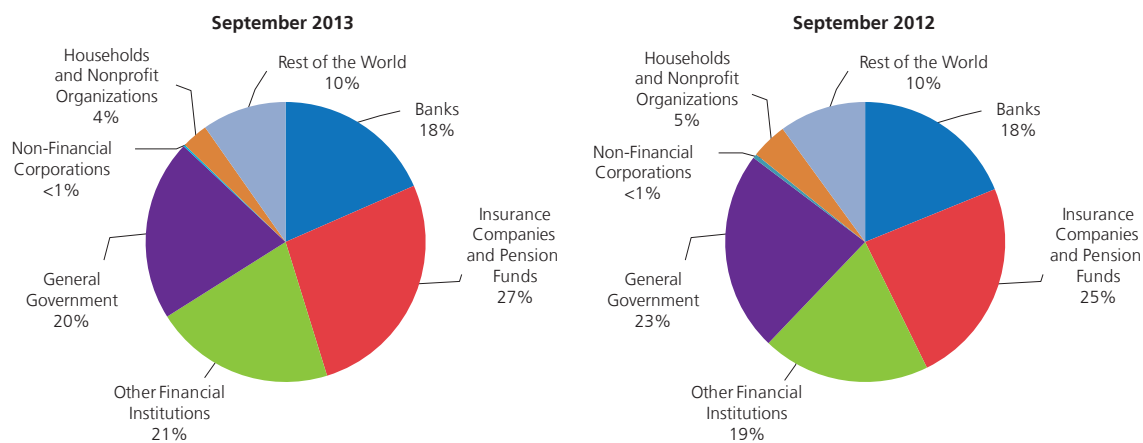
KTB = Korea Treasury Bond.
Source: Korea Exchange.

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

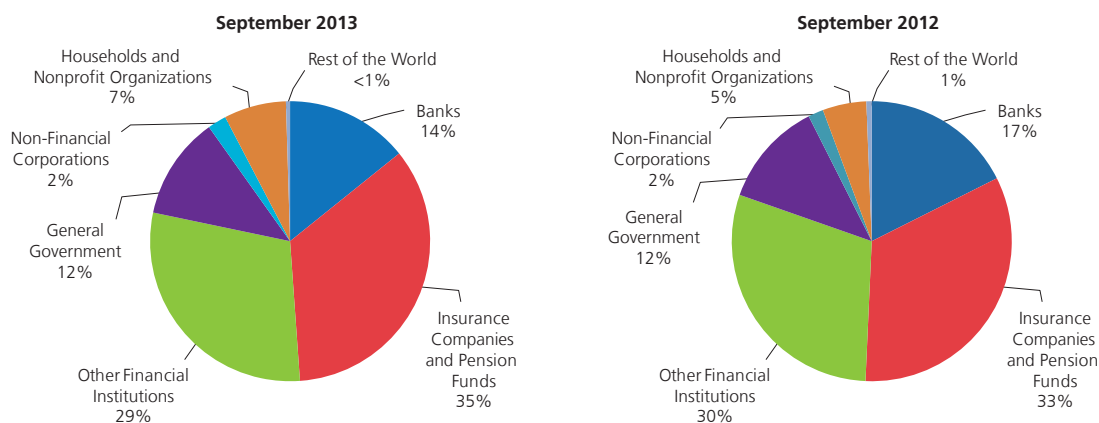
Source: EDAILY *BondWeb*.

of corporate bonds held by non-financial corporations remained steady, while the shares of corporate bonds held by banks, other financial institutions, and foreign investors all fell between end-September 2012 and end-September 2013.

Net foreign investment in the Republic of Korea's LCY bond market turned positive in January after being negative for five consecutive months, according to Financial Supervisory Service (FSS) data (**Figure 7**). Relatively large bond purchases by foreign investors, compared with bond redemptions, contributed to the net foreign bond inflow position for the month. Meanwhile, foreign investor net investment in the Republic of Korea's bond market in full-year 2013 totaled KRW3.5 trillion, substantially lower than the net bond inflow of KRW7.4 trillion in 2012; the lower 2013 figure stems from the massive net bond

Figure 5: LCY Government Bonds Investor Profile


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

Figure 6: LCY Corporate Bonds Investor Profile


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

sales during 2H13 amid concerns over potential tapering by the US Federal Reserve of its asset purchase program.

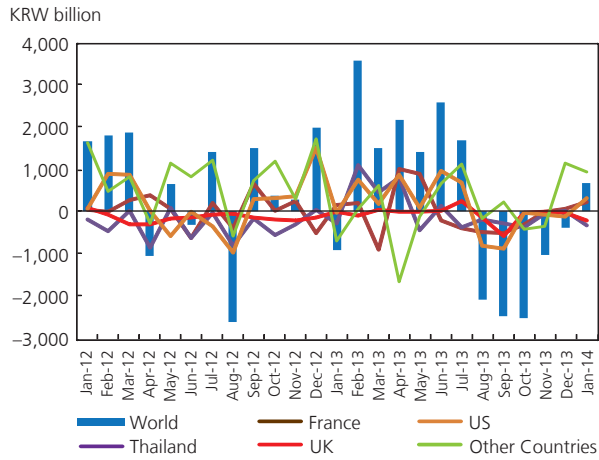
Policy, Institutional, and Regulatory Developments

MOSF Introduces Policy Directions for KTB Market

The Ministry of Strategy and Finance (MOSF) announced in December policy measures for the management and development of the KTB market. MOSF specifically

noted the need for smooth fiscal fund-raising through the stable issuance of KTBs. To achieve this, MOSF cited maintaining the monthly KTB issuance volume at KRW8 trillion, optimizing the proportion of KTB issuance by tenor, and making slight adjustments to KTB issuance plans based on market conditions. In addition, MOSF also aims to promote KTBs as a benchmark in capital markets and cited the need for consolidation of data and information on KTBs managed by different institutions, amendments on KTB futures by tenor (e.g., introducing the issuance of longer-term KTB futures), and extensive revision of the relevant act on government bonds.

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).

MOSF Revises Regulations on KTB Issuance and the Primary Dealer Management System

MOSF revised regulations on KTB issuance and the primary dealer management system, effective 1 January. Among the major revisions were the strengthening of the role of primary dealers in holding KTBs; adding the trading performance of primary dealers in “off-the-run” KTBs listed on the Korea Exchange as an evaluation item; reducing the interval in the differential pricing auction for 10-year KTBs from 3 bps to 2 bps; and equal treatment in the evaluation of both conversions and buy-backs, with evaluations to be conducted on a monthly basis instead of a quarterly basis.