

# Republic of Korea

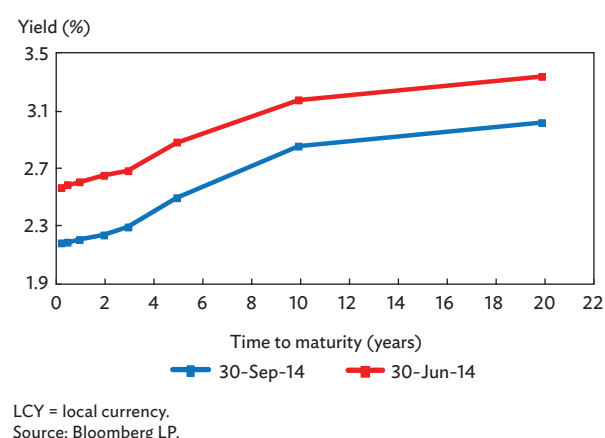
## Yield Movements

Local currency (LCY) government bond yields in the Republic of Korea fell for all tenors between end-June and end-September, leading the yield curve to shift downward (**Figure 1**). The drop in government bond yields in 3Q14 can be attributed to market expectations of a policy rate cut to support the recovery of the domestic economy amid low inflationary pressures. Meanwhile, the yield spread between the 2- and 10-year tenors widened 9 basis points (bps) between end-June and end-September, resulting in a steepening of the yield curve.

The Bank of Korea's Monetary Policy Committee decided on 15 October to lower the base rate 25 bps from 2.25% to 2.00% to support economic growth in the Republic of Korea and ensure price stability in the domestic economy. This was the second time in 2 months that the base rate was reduced 25 bps by the committee, with the previous policy rate cut made on 14 August. (On 12 September, the committee decided to maintain the base rate at 2.25%.)

Real gross domestic product GDP growth in the Republic of Korea stood at 0.9% quarter-on-quarter (q-o-q) and 3.2% year-on-year (y-o-y) in 3Q14, based on advance estimates released by The Bank of Korea in October. Meanwhile, The Bank of Korea also reported that it was revising its GDP growth outlook downward to 3.5% for 2014 and 3.9% for 2015 from previous forecasts made in July of 3.8% and 4.0%, respectively.

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



Consumer price inflation continued to moderate in 3Q14, as the inflation rate, based on the Consumer Price Index, stood at 1.1% y-o-y in September, down from 1.4% in August and 1.6% in July. In October, the inflation rate was 1.2% y-o-y. Meanwhile, in October, the central bank revised downward its annual inflation outlook to 1.4% (from 1.9%) in 2014 and 2.4% (from 2.7%) in 2015.

## Size and Composition

The LCY bond market of the Republic of Korea continued to expand as the existing stock of all LCY bonds in the economy recorded positive growth on both a q-o-q and y-o-y basis in 3Q14 (**Table 1**). Growth in the LCY

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

	Outstanding Amount (billion)						Growth Rate (%)			
	3Q13		2Q14		3Q14		3Q13		3Q14	
	KRW	US\$	KRW	US\$	KRW	US\$	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>1,680,687</b>	<b>1,564</b>	<b>1,779,533</b>	<b>1,759</b>	<b>1,821,497</b>	<b>1,726</b>	<b>1.8</b>	<b>10.4</b>	<b>2.4</b>	<b>8.4</b>
Government	645,333	601	700,464	692	723,074	685	1.3	6.9	3.2	12.0
Central Bank Bonds	164,880	153	174,000	172	177,650	168	(0.3)	1.5	2.1	7.7
Central Government Bonds	444,599	414	485,792	480	502,457	476	1.3	7.4	3.4	13.0
Industrial Finance Debentures	35,854	33	40,671	40	42,967	41	9.3	31.4	5.6	19.8
Corporate	1,035,354	963	1,079,069	1,066	1,098,423	1,041	2.2	12.6	1.8	6.1

(-) = 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.

4. Central government bonds include Korea Treasury bonds, National Housing bonds, and Seoul Metro bonds.

Sources: EDAILY BondWeb and The Bank of Korea.

government bond market was led by increases in the outstanding size of central government bonds, which include Korea Treasury Bonds (KTBs); central bank bonds, which are known as Monetary Stabilization Bonds (MSBs); and industrial finance debentures, which comprise bonds issued by the Korea Development Bank (KDB).

The outstanding size of LCY corporate bonds likewise expanded on both a q-o-q and y-o-y basis. The q-o-q growth was induced by increases in the stocks of special public bonds, financial debentures, and bonds issued by private corporates. Meanwhile, y-o-y growth during the quarter was due to hikes in the stocks of special public bonds and private corporate bonds. The top 30 LCY corporate bond issuers at end-September had a combined stock valued at KRW681.1 trillion, which was 62.0% of total LCY corporate bonds outstanding (**Table 2**). Korea Land & Housing Corporation, which surpassed Korea Housing Finance Corporation as the largest LCY corporate bond issuer in 2Q14, remained the largest issuer at end-September.

Issuance of LCY corporate bonds gathered pace in 3Q14, expanding 50.4% q-o-q and 14.9% y-o-y. Of the five largest LCY corporate bond issues in 3Q14, three were made by banks, one by a financial group, and one by a public urban developer. Three of these bonds have tenors of 1 year and the other two have maturities of 5 years (**Table 3**).

## Liquidity

The turnover ratios for LCY central government and central bank bonds declined in 3Q14 as q-o-q growth in central government and central bank bonds outpaced the quarterly increase in the trading volume of these bonds; this suggests a tightening in the liquidity of the LCY government bond market for the quarter (**Figure 2**).

In the KTB futures market, liquidity appears to have improved on a quarterly basis as the combined value of 3-year and 10-year KTB futures contracts traded increased to 7.9 million in 3Q14 from 6.6 million in 2Q14; however, on an annual basis, liquidity in the KTB futures market was down from a year earlier when the total value of traded contracts reached 8.8 million in 3Q13 (**Figure 3**).

LCY corporate bond market liquidity appears to have tightened further in 3Q14, as the turnover ratio for LCY corporate bonds stood at 0.12, down from 0.13 in both 2Q14 and 3Q13. The quarterly slip was led by q-o-q decreases in the turnover ratios of LCY financial debentures and private corporate bonds, while the y-o-y decline was brought about by an annual drop in the turnover ratio of LCY private corporate bonds (**Figure 4**).

## Investor Profile

Insurance companies and pension funds remained the largest investor group in the LCY government bond market in the Republic of Korea, with a 29.4% share of the market at end-June, up 1.3 percentage points from a year earlier (**Figure 5**). Other investor groups that showcased a y-o-y increase in their share of the LCY government bond market in 2Q14 were other financial institutions and households and nonprofit institutions. In contrast, the respective shares of the general government and foreign investors dropped 2.8 and 0.8 percentage points, respectively, from end-June 2013.

Insurance companies and pension funds were also the largest investor group in the LCY corporate bond market, with a 33.2% share of the market, at end-June (**Figure 6**). Insurance companies and pension funds recorded the highest y-o-y increase in LCY corporate bond holdings in 2Q14, with a share that rose 2.4 percentage points from a year earlier. Most other investor groups posted y-o-y decreases in their respective LCY corporate bond holding shares.

Net foreign investment in the Republic of Korea's LCY bond market turned positive in September, amounting to KRW0.5 trillion for the month, after recording net bond outflows of KRW0.1 trillion in August, based on Financial Supervisory Service (FSS) data (**Figure 7**). The reversal stemmed from a sharper monthly increase in foreign investor net bond purchases when compared to bond redemptions; in September, foreign investor net bond purchases jumped 80.6% month-on-month (m-o-m) to KRW4.2 trillion, while bond redemptions climbed 53.8% m-o-m to KRW3.7 trillion. Net foreign bond investment was valued at KRW0.9 trillion in 3Q14, down from 2Q14's KRW2.6 trillion. On a year-to-date basis, foreign net bond investment stood at KRW3.5 trillion in January–September, down from KRW7.3 trillion recorded in the first 9 months of 2013.

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 Land & Housing	57,309	54.3	Yes	No	No	Real Estate
2.	Korea Housing Finance	54,584	51.7	Yes	No	No	Financial
3.	Korea Finance	46,981	44.5	Yes	No	No	Financial
4.	Korea Deposit Insurance	41,850	39.7	Yes	No	No	Insurance
5.	KDB Daewoo Securities	40,790	38.7	Yes	Yes	No	Securities
6.	Woori Investment and Securities	38,567	36.5	Yes	Yes	No	Securities
7.	Korea Investment and Securities	38,511	36.5	No	No	No	Securities
8.	Korea Electric Power	30,600	29.0	Yes	Yes	No	Utilities
9.	Hana Daetoo Securities	27,645	26.2	No	No	No	Securities
10.	Mirae Asset Securities	27,583	26.1	No	Yes	No	Securities
11.	Industrial Bank of Korea	27,559	26.1	Yes	Yes	No	Bank
12.	Korea Expressway	21,230	20.1	Yes	No	No	Infrastructure
13.	Kookmin Bank	18,251	17.3	No	No	No	Bank
14.	Korea Rail Network Authority	17,100	16.2	Yes	No	No	Infrastructure
15.	Hyundai Securities	16,059	15.2	No	Yes	No	Securities
16.	Korea Gas	15,354	14.6	Yes	Yes	No	Utilities
17.	Small & Medium Business Corp.	15,005	14.2	Yes	No	No	Financial
18.	Shinhan Bank	14,404	13.7	No	No	No	Bank
19.	Shinhan Investment	13,960	13.2	No	No	No	Securities
20.	Woori Bank	13,952	13.2	Yes	No	No	Bank
21.	Standard Chartered First Bank Korea	11,490	10.9	No	No	No	Bank
22.	Korea Railroad	11,210	10.6	Yes	No	No	Infrastructure
23.	Samsung Securities	10,776	10.2	No	Yes	No	Securities
24.	Tong Yang Securities	10,717	10.2	No	Yes	No	Securities
25.	Korea Water Resources	10,463	9.9	Yes	Yes	No	Utilities
26.	Hana Bank	10,302	9.8	No	No	No	Bank
27.	Korea Student Aid Foundation	10,240	9.7	Yes	No	No	Financial
28.	Daishin Securities	10,062	9.5	No	Yes	No	Securities
29.	Korea Eximbank	9,520	9.0	Yes	No	No	Bank
30.	Shinhan Card	9,046	8.6	No	No	No	Financial
<b>Total Top 30 LCY Corporate Issuers</b>		<b>681,119.7</b>	<b>645.5</b>				
<b>Total LCY Corporate Bonds</b>		<b>1,098,423.0</b>	<b>1,041.0</b>				
<b>Top 30 as % of Total LCY Corporate Bonds</b>		<b>62.0%</b>	<b>62.0%</b>				

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

Notes:

1. Data as of end-September 2014.

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

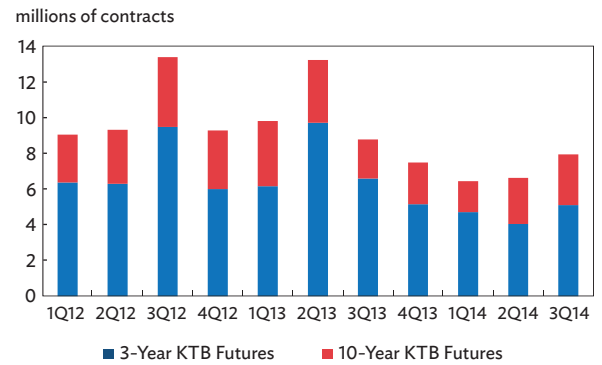
Sources: *AsianBondsOnline* calculations based on Bloomberg and EDAILY *BondWeb* data.

**Table 3: Notable LCY Corporate Bond Issuance in 3Q14**

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Industrial Bank of Korea		
1-year bond	2.24	450.0
1-year bond	2.24	400.0
Hana Financial Group		
5-year bond	2.74	500.0
Woori Bank		
1-year bond	2.25	450.0
Gyeonggi Urban Innovation		
5-year bond	3.00	400.0

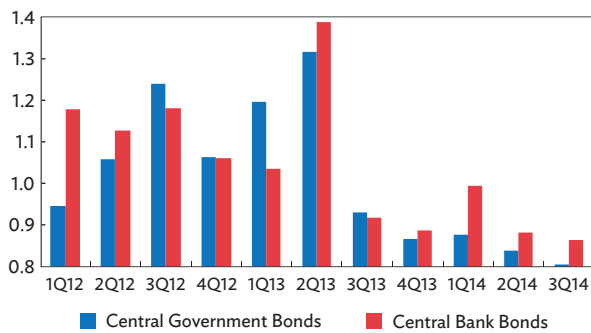
LCY = local currency.  
 Note: Coupon rates for 1-year bonds of Industrial Bank of Korea and Woori Bank are indicative yields as of end-September 2014.  
 Source: Bloomberg LP.

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



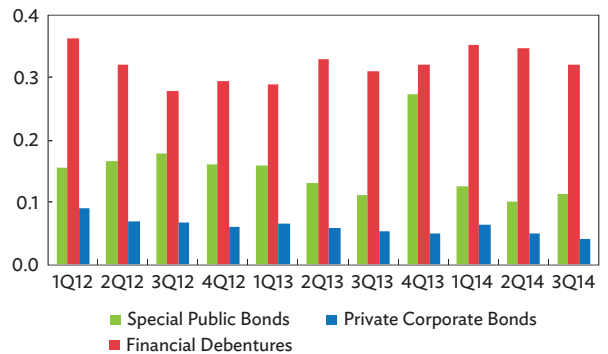
KTB = Korea Treasury Bond.  
 Source: Korea Exchange.

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



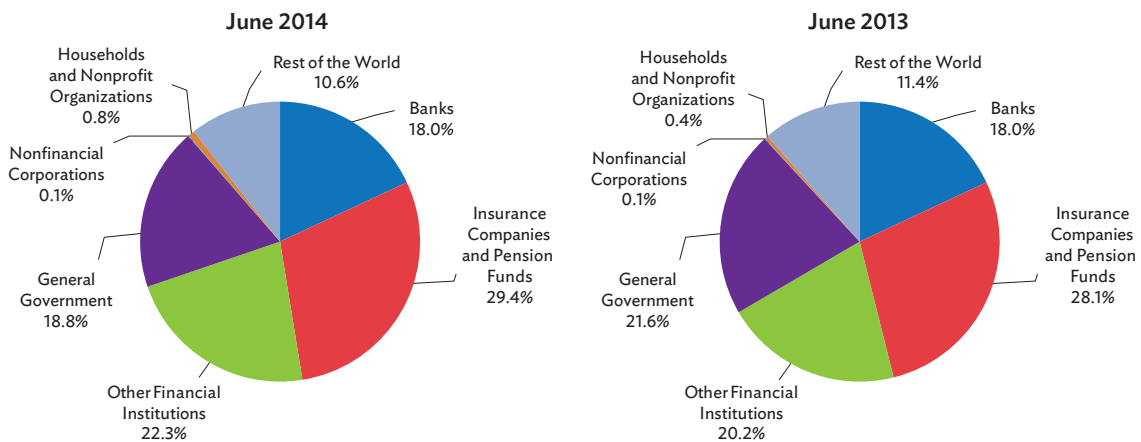
Note: Central government bonds include Korea Treasury Bonds and National Housing Bonds.  
 Sources: The Bank of Korea and EDAILY BondWeb.

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



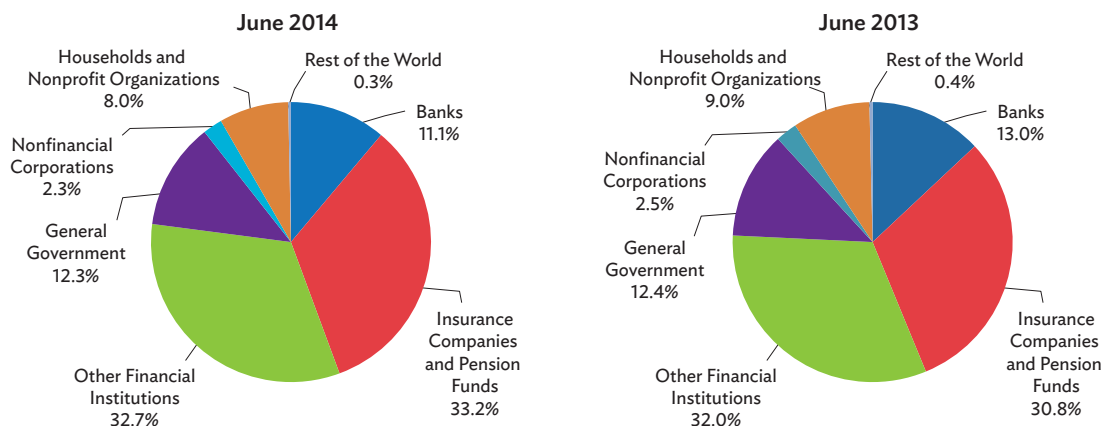
Source: EDAILY BondWeb.

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



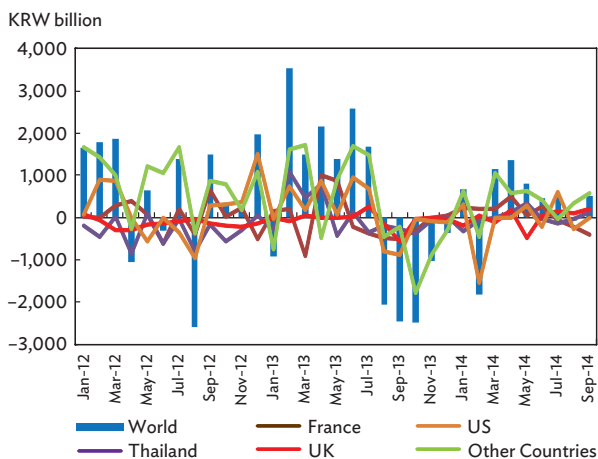
LCY = local currency.  
 Sources: AsianBondsOnline and The Bank of Korea.

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



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

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



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

## Policy, Institutional, and Regulatory Developments

### Basel III LCR Introduced in the Banking Sector

In August, the FSC introduced Basel III’s liquidity coverage ratio (LCR) to banks conducting business in the Republic of Korea. The FSC stated that domestic banks are obliged to meet the minimum LCR of 100% starting January 2015; domestic branches of foreign banks are required to meet the minimum ratio of 20% starting in 2015, and the ratio will be raised 10 percentage points each year to reach 60% by 2019; and the minimum ratio for specialized banks and policy banks will start at 60% in 2015 and climb by 10 percentage points per year to reach 100% by 2019.

### Prudential Regulation Reform for the Asset Management Industry

The Republic of Korea’s Financial Services Commission (FSC) announced in September plans for the reform of prudential regulations governing the country’s asset management industry. The plans involve replacing the net capital ratio—which has been utilized since April 1997 as a standard for “prompt corrective action” covering asset management and securities companies—with a minimum capital requirement for the equity holdings of asset management companies. The plan is expected to take effect in April 2015.