

Republic of Korea

Yield Movements

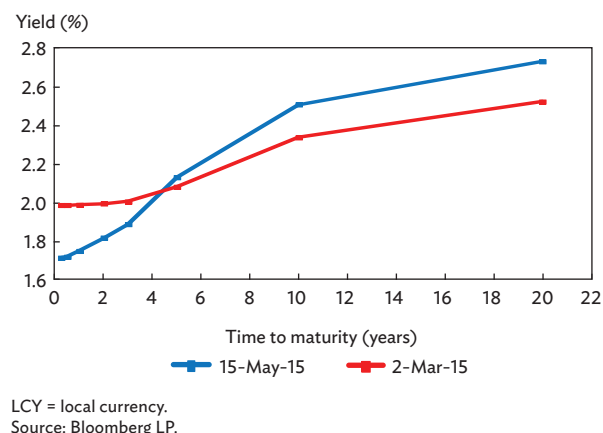
The Republic of Korea's yield curve for local currency (LCY) government bonds steepened between 2-March and 15-May as yields fell at the shorter-end of the curve and rose at the longer-end of the curve (**Figure 1**). The drop in short-term yields was partly induced by low inflationary pressures and market expectations of a policy rate cut. Meanwhile, the increase in long-term yields was partly induced by global yield hikes. Over the same period, the yield spread between the 2-year and 10-year tenors widened 35 basis points (bps).

The Bank of Korea's Monetary Policy Committee lowered the base rate by 25 bps from 2.00% to 1.75% in March, after keeping it steady in both January and February, in order to support recovery in domestic growth. In its subsequent meetings held on 9 April and 15 May, the committee decided to maintain the policy interest rate at 1.75%.

Real gross domestic product (GDP) growth in the Republic of Korea was 0.8% quarter-on-quarter (q-o-q) and 2.5% year-on-year (y-o-y) in 1Q15, according to preliminary estimates of The Bank of Korea. Q-o-q growth in 1Q15 was up from the previous quarter's 0.3%, while y-o-y growth was down from 2.7% in the previous quarter.

Consumer price inflation moderated throughout 1Q15 as the inflation rate slid from 0.8% y-o-y in January to 0.5% y-o-y in February and further down to 0.4% y-o-y in March, according to Statistics Korea. In April, the y-o-y inflation rate remained at 0.4%. On a month-on-month

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



(m-o-m) basis, the Consumer Price Index (CPI) rose 0.5% in January, remained unchanged in February and March, and inched up 0.1% in April.

The Bank of Korea reported in April that it had revised downward its GDP growth outlook for 2015 to 3.1% from its previous forecast of 3.4% made in January, and cut its 2015 inflation forecast to 0.9% from 1.9%.

Size and Composition

The LCY bond market in the Republic of Korea recorded growth rates of 2.3% q-o-q and 8.3% y-o-y in 1Q15, leveling off at KRW1,900.2 trillion (US\$1.7 trillion) at end-March (**Table 1**). This expansion was led by 3.2% q-o-q and 16.7% y-o-y growth in the stock of LCY

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

	Outstanding Amount (billion)						Growth Rate (%)			
	1Q14		4Q14		1Q15		1Q14		1Q15	
	KRW	US\$	KRW	US\$	KRW	US\$	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,754,188	1,648	1,857,739	1,703	1,900,194	1,712	1.8	8.6	2.3	8.3
Government	676,491	635	765,008	701	789,741	712	2.9	8.6	3.2	16.7
Central Bank Bonds	170,800	160	178,000	163	184,940	167	4.4	1.8	3.9	8.3
Central Government Bonds	466,463	438	495,016	454	513,685	463	2.3	9.3	3.8	10.1
Industrial Finance Debentures	39,227	37	91,992	84	91,116	82	3.8	39.5	(1.0)	132.3
Corporate	1,077,697	1,012	1,092,731	1,002	1,110,453	1,001	1.2	8.6	1.6	3.0

(-) = 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 bonds—including Monetary Stabilization Bonds (MSBs) issued by The Bank of Korea and central government bonds, largely consisting of Korea Treasury Bonds (KTBs). Issuance of LCY government bonds during 1Q15 was up 18.0% q-o-q and 14.9% y-o-y.

The LCY corporate bond market also exhibited positive growth in 1Q15 of 1.6% q-o-q and 3.0% y-o-y, stemming

from increases in the existing stock of financial debentures and private corporate bonds. The top 30 LCY corporate bond issuers at end-March had combined bonds outstanding of KRW696.8 trillion, which was 62.8% of total LCY corporate bonds outstanding (**Table 2**). Korea Housing Finance Corporation remained the largest LCY corporate bond issuer at end-March.

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 Corp.	59,282	53.4	Yes	No	No	Financial
2. Korea Land & Housing Corp.	55,651	50.1	Yes	No	No	Real Estate
3. NH Investment & Securities	49,308	44.4	Yes	Yes	Yes	Securities
4. KDB Daewoo Securities	46,872	42.2	Yes	Yes	No	Securities
5. Korea Investment and Securities	44,103	39.7	No	No	No	Securities
6. Korea Deposit Insurance Corp.	37,630	33.9	Yes	No	No	Insurance
7. Industrial Bank of Korea	35,100	31.6	Yes	Yes	No	Bank
8. Mirae Asset Securities	32,084	28.9	No	Yes	No	Securities
9. Hana Daetoo Securities	31,368	28.3	No	No	No	Securities
10. Korea Electric Power Corp.	28,230	25.4	Yes	Yes	No	Utilities
11. Korea Expressway	21,500	19.4	Yes	No	No	Infrastructure
12. Hyundai Securities	20,921	18.9	No	Yes	No	Securities
13. Kookmin Bank	18,140	16.3	No	No	No	Bank
14. Woori Bank	18,082	16.3	Yes	No	No	Bank
15. Korea Rail Network Authority	17,800	16.0	Yes	No	No	Infrastructure
16. Shinhan Bank	16,093	14.5	No	No	No	Bank
17. Korea Gas Corp.	15,954	14.4	Yes	Yes	No	Utilities
18. Small & Medium Business Corp.	14,895	13.4	Yes	No	No	Financial
19. Daishin Securities	13,977	12.6	No	Yes	No	Securities
20. Samsung Securities	13,708	12.4	No	Yes	No	Securities
21. Shinhan Investment Corp.	12,817	11.6	No	No	No	Securities
22. Standard Chartered First Bank Korea	11,880	10.7	No	No	No	Bank
23. Korea Railroad Corp.	11,260	10.1	Yes	No	No	Infrastructure
24. Korea Student Aid Foundation	10,940	9.9	Yes	No	No	Financial
25. Korea Water Resources Corp.	10,628	9.6	Yes	Yes	No	Utilities
26. Hana Bank	10,230	9.2	No	No	No	Bank
27. Korea Eximbank	10,020	9.0	Yes	No	No	Bank
28. Shinhan Card	9,750	8.8	No	No	No	Financial
29. Shinyoung Securities	9,358	8.4	No	Yes	Yes	Securities
30. Hyundai Capital Services	9,263	8.3	No	No	No	Financial
Total Top 30 LCY Corporate Issuers	696,843.7	628.0				
Total LCY Corporate Bonds	1,110,453.0	1,000.7				
Top 30 as % of Total LCY Corporate Bonds	62.8%	62.8%				

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

Notes:

1. Data as of end-March 2015.

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.

LCY corporate bond issuance was down 13.8% q-o-q in 1Q15 but up 13.6% y-o-y. Of the five largest LCY corporate bond issues in 1Q15, four were from banks and one from an industrial firm (**Table 3**).

Table 3: Notable LCY Corporate Bond Issuance in 1Q15

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Woori Bank		
1-year bond	1.75	430
2-year bond	2.09	550
Industrial Bank of Korea		
0.8-year bond	1.74	520
NongHyup Bank		
10-year bond	2.77	500
Samsung Heavy Industries		
3-year bond	2.51	500

LCY = local currency.

Note: Coupon rates for 1-year bond of Woori Bank and 0.8-year bond of Industrial Bank of Korea are indicative yields as of end-March 2015.

Source: Bloomberg LP.

Investor Profile

The largest investor group in the LCY government bond market of the Republic of Korea is insurance companies and pension funds, as they held 31.3% of the total amount of LCY government bonds at end-December (**Figure 2**). They were followed by the general government, which held 19.3% of the total. Between end-2013 and end-2014, the share of insurance companies and pension funds

climbed by 1.3 percentage points, while the share of the general government fell by 1.5 percentage points.

Insurance companies and pension funds also comprised the largest investor group in the LCY corporate bond market, with a 34.8% share at end-December (**Figure 3**). Insurance companies and pension funds recorded the largest y-o-y increase in LCY corporate bond holdings, with a share that rose by 2.8 percentage points between end-2013 and end-2014. In contrast, the holdings share of banks fell the most on a y-o-y basis, decreasing by 1.8 percentage points to reach 10.9% at end-December.

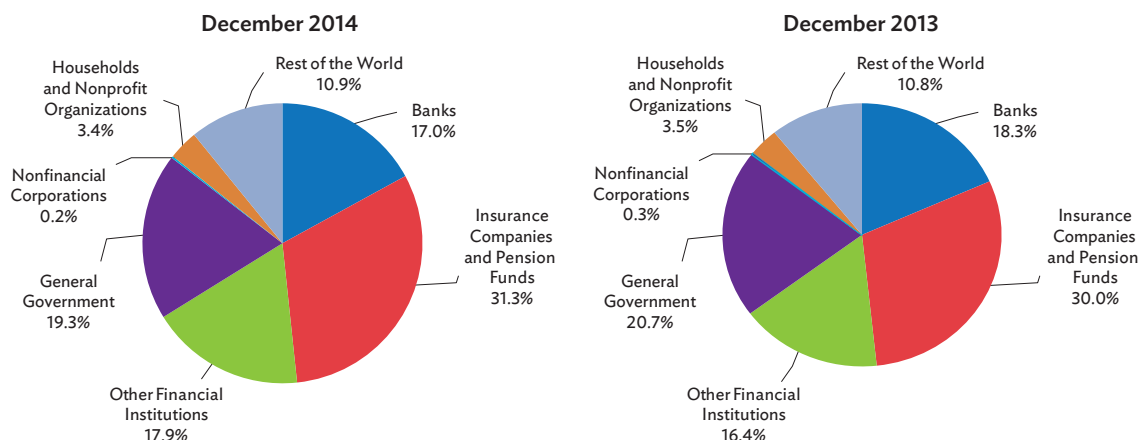
Net foreign investment in the Republic of Korea's LCY bond market rose throughout 1Q15—reaching KRW1,370 billion in March from KRW642 billion in February and KRW55 billion in January—but fell to KRW143 billion in April, based on Financial Supervisory Service data (**Figure 4**). On a quarterly basis, net foreign bond investment climbed to KRW2,067 billion in 1Q15 from KRW1,669 billion in 4Q14.

Policy, Institutional, and Regulatory Developments

FSC Introduces Financial Market Infrastructure Guidelines

The FSC introduced in March its Business Guideline for Financial Market Infrastructures, aiming to implement

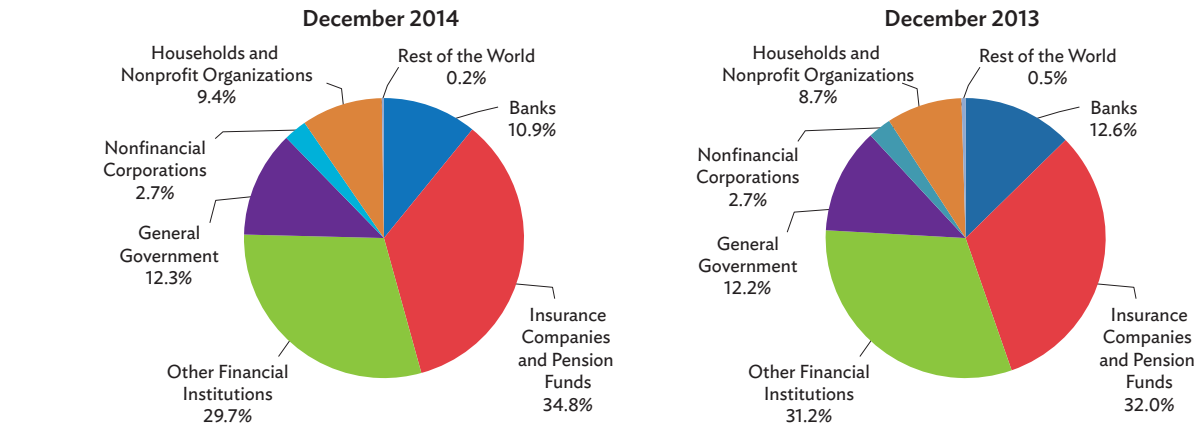
Figure 2: LCY Government Bonds Investor Profile



LCY = local currency.

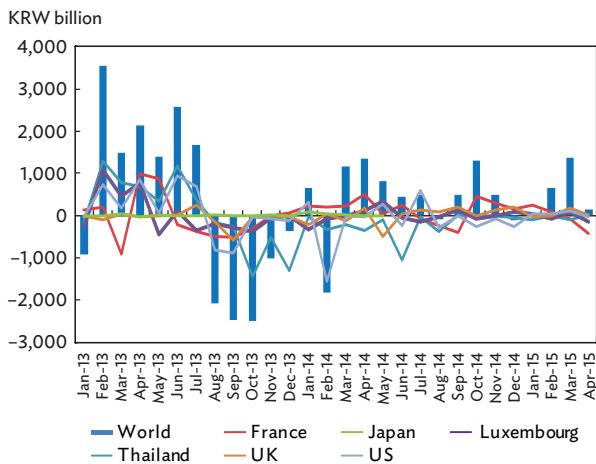
Sources: AsianBondsOnline and The Bank of Korea.

Figure 3: LCY Corporate Bonds Investor Profile



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

Figure 4: Net Foreign Investment in LCY Bonds in the Republic of Korea



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

business standards for the Korea Exchange and Korea Securities Depository that are consistent with the Principles for Financial Market Infrastructures launched in April 2012 by the Bank for International Settlements' (BIS) Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (IOSCO).

FSC Announces Capital Market Reforms

The Republic of Korea's Financial Services Commission (FSC) announced in April a series of policy directions and tasks for reforming the country's capital markets. The tasks include promoting the country's private bond market, which would support the FSC's policy directive of boosting investments in start-up and venture capital companies, as well as invigorating the country's derivatives market.