

Republic of Korea

Yield Movements

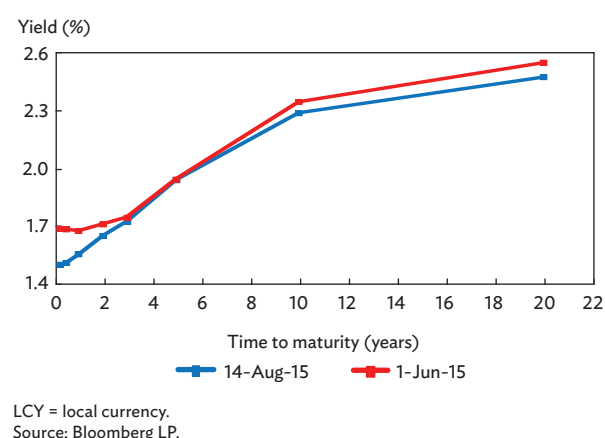
Local currency (LCY) government bond yields in the Republic of Korea fell for all tenors between 1 June and 14 August, with yields for shorter-term tenors registering the largest declines (**Figure 1**). Expectations of a sluggish domestic economy and low inflationary pressures partly contributed to the decrease in yields. Meanwhile, the yield spread between the 2-year and 10-year tenors was broadly unchanged.

Real gross domestic product growth in the Republic of Korea decelerated in 2Q15—leveling off at 0.3% quarter-on-quarter (q-o-q) and 2.2% year-on-year (y-o-y) per the Bank of Korea’s advance estimates released in July—down from 0.8% q-o-q and 2.5% y-o-y in 1Q15. The Bank of Korea also announced in July that it had lowered its 2H15 real gross domestic product growth forecast for the Republic of Korea to 2.8% y-o-y from a previous projection of 3.1% y-o-y reported in April.

The policy rate in the Republic of Korea was lowered once in 2Q15. On 11 June, the Bank of Korea’s Monetary Policy Committee decided to reduce the base rate by 25 basis points (bps) to 1.50% amid a sluggish export performance and the adverse impacts of the Middle East Respiratory Syndrome on household consumption. On both 9 July and 13 August, the committee decided to keep steady the policy rate at its current level.

Inflationary pressures inched up throughout 2Q15, as consumer price inflation rose to 0.7% y-o-y in June from

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



0.5% y-o-y in May and 0.4% y-o-y in April, based on Statistics Korea data. In July, consumer price inflation remained at 0.7% y-o-y.

Size and Composition

The Republic of Korea’s LCY bond market exhibited relatively strong growth in 2Q15 as the outstanding amount of bonds expanded 3.1% q-o-q and 10.0% y-o-y, compared with growth of 2.3% q-o-q and 8.3% y-o-y in 1Q15 and 1.4% q-o-q and 7.8% y-o-y in 2Q14 (**Table 1**). At end-June, Korean LCY bonds outstanding totaled KRW1,958.3 trillion (US\$1,756 billion), of which 41.1% were government bonds and 58.9% were corporate bonds.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q14		1Q15		2Q15		2Q14		2Q15	
	KRW	US\$	KRW	US\$	KRW	US\$	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,779,533	1,759	1,900,194	1,712	1,958,273	1,756	1.4	7.8	3.1	10.0
Government	700,464	692	789,741	712	805,593	722	3.5	9.9	2.0	15.0
Central Bank Bonds	174,000	172	184,940	167	188,310	169	1.9	5.2	1.8	8.2
Central Government Bonds	485,792	480	513,685	463	527,583	473	4.1	10.6	2.7	8.6
Industrial Finance Debentures	40,671	40	91,116	82	89,700	80	3.7	24.0	(1.6)	120.5
Corporate	1,079,069	1,066	1,110,453	1,001	1,152,680	1,033	0.1	6.5	3.8	6.8

(-) = 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.

LCY government bonds outstanding at end-June totaled KRW805.6 trillion, up 2.0% q-o-q and 15.0% y-o-y. A relatively large portion of this amount came from outstanding LCY central government bonds, which were at valued KRW527.6 trillion at end-June and exhibited growth rates of 2.7% q-o-q and 8.6% y-o-y, led by an increase in the existing stock of Korea Treasury Bonds. The outstanding amount of central bank bonds, or Monetary Stabilization Bonds, also rose in 2Q15—recording growth rates of 1.8% q-o-q and 8.2% y-o-y—to reach KRW188.3 trillion at end-June. Meanwhile, the stock of industrial finance debentures exhibited a mixed performance in 2Q15 with negative q-o-q and positive y-o-y growth to level off at KRW89.7 trillion at end-June.

Issuance of LCY government bonds exhibited a mixed performance in 2Q15, falling 3.1% q-o-q but rising 6.4% y-o-y. The q-o-q decline was largely due to decreased bond issuance by the central government, while the y-o-y increase was mostly a result of increased issuance of central bank bonds.

The outstanding amount of LCY corporate bonds expanded 3.8% q-o-q and 6.8% y-o-y in 2Q15, a faster clip compared with 1Q15's growth of 1.6% q-o-q and 3.0% y-o-y, and 2Q14's 0.1% q-o-q and 6.5% y-o-y. The q-o-q increase in 2Q15 stemmed from growth in the existing stock of special public bonds, financial debentures, and private corporate bonds. Meanwhile, the y-o-y expansion occurred on the back of positive growth in financial debentures and private corporate bonds.

At end-June, the combined LCY bonds outstanding of the top 30 corporate issuers in the Republic of Korea reached KRW724.6 trillion, which accounted for 62.9% of total LCY corporate bonds outstanding (**Table 2**). The largest LCY corporate bond issuer continued to be Korea Housing Finance Corporation. Issuance of LCY corporate bonds was up 34.5% q-o-q and 118.2% y-o-y in 2Q15 amid positive growth in the issuance of special public bonds, financial debentures, and private corporate bonds. Of the five most notable LCY corporate bonds issued in 2Q15, three were from special public agencies and two were from a domestic bank (**Table 3**).

Investor Profile

Insurance companies and pension funds remained the largest investor group in the Republic of Korea's LCY

government bond market, comprising 31.3% of the total market at end-March (**Figure 2**). Compared with end-March 2014, the share of insurance companies and pension funds was up 1.4 percentage points, while the share of banks slid 1.6 percentage points, the most of any investor group.

Insurance companies and pension funds were also the largest investor group in the LCY corporate bond market, with a 35.4% share at end-March (**Figure 3**). Between end-March 2014 and end-March 2015, the share of LCY bonds held by insurance companies and pension funds climbed 1.8 percentage points, an increase second only to that of households and nonprofit institutions, which climbed 2.0 percentage points. On the other hand, the share of banks fell 3.0 percentage points during the same period, the largest y-o-y drop among all investor groups.

Net foreign investment in the Republic of Korea's LCY bond market reached KRW2,779 billion in 2Q15, up from 1Q15 and 2Q14 levels of KRW2,067 billion and KRW2,590 billion, respectively. On a monthly basis, net foreign bond investment stood at KRW143 billion in April and climbed to KRW3,197 billion in May; however, foreign investors sold Korean LCY bonds in June and July, generating net outflows of KRW561 billion and KRW2,618 billion, respectively, amid the Greek debt crisis and expectations of a policy rate hike in the United States (**Figure 4**).

Ratings Update

Fitch Ratings (Fitch) in July affirmed the Republic of Korea's long-term foreign currency issuer default rating and long-term LCY issuer default rating at AA- and AA, respectively. The outlook for both ratings was stable. According to Fitch, the Republic of Korea's sovereign ratings are supported by a strong macroeconomic performance, sound external balances, and moderate government debt.

Rating and Investment Information (R&I) reported in July that it has affirmed the Republic of Korea's foreign currency issuer rating at A+ and domestic currency issuer rating at AA-. It also maintained a stable outlook for both ratings. According to R&I, its ratings are partly based on the economy's "prudent fiscal management" and low government debt.

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.	82,784	74.2	Yes	No	No	Financial
2.	Korea Land & Housing Corp.	55,415	49.7	Yes	No	No	Real Estate
3.	NH Investment & Securities	53,736	48.2	Yes	Yes	Yes	Securities
4.	KDB Daewoo Securities	49,440	44.3	Yes	Yes	No	Securities
5.	Korea Investment and Securities	44,782	40.1	No	No	No	Securities
6.	Korea Deposit Insurance Corp.	35,810	32.1	Yes	No	No	Insurance
7.	Industrial Bank of Korea	35,017	31.4	Yes	Yes	No	Bank
8.	Mirae Asset Securities	33,188	29.8	No	Yes	No	Securities
9.	Korea Electric Power Corp.	27,270	24.4	Yes	Yes	No	Utilities
10.	Hana Daetoo Securities	23,558	21.1	No	No	No	Securities
11.	Korea Expressway	22,100	19.8	Yes	No	No	Infrastructure
12.	Hyundai Securities	21,885	19.6	No	Yes	No	Securities
13.	Kookmin Bank	18,720	16.8	No	No	No	Bank
14.	Korea Rail Network Authority	18,220	16.3	Yes	No	No	Infrastructure
15.	Woori Bank	17,715	15.9	Yes	No	No	Bank
16.	Shinhan Bank	16,913	15.2	No	No	No	Bank
17.	Samsung Securities	15,486	13.9	No	Yes	No	Securities
18.	Korea Gas Corp.	15,449	13.8	Yes	Yes	No	Utilities
19.	Daishin Securities	14,997	13.4	No	Yes	No	Securities
20.	Small & Medium Business Corp.	14,555	13.0	Yes	No	No	Financial
21.	Standard Chartered First Bank Korea	12,140	10.9	No	No	No	Bank
22.	Korea Student Aid Foundation	11,810	10.6	Yes	No	No	Financial
23.	Shinhan Investment Corp.	11,803	10.6	No	No	No	Securities
24.	Korea Railroad Corp.	10,800	9.7	Yes	No	No	Infrastructure
25.	Hana Bank	10,710	9.6	No	No	No	Bank
26.	Korea Water Resources Corp.	10,676	9.6	Yes	Yes	No	Utilities
27.	Korea Eximbank	10,070	9.0	Yes	No	No	Bank
28.	Hyundai Capital Services	10,004	9.0	No	No	No	Financial
29.	Shinyoung Securities	9,957	8.9	No	Yes	Yes	Securities
30.	Shinhan Card	9,596	8.6	No	No	No	Financial
Total Top 30 LCY Corporate Issuers		724,606.3	649.6				
Total LCY Corporate Bonds		1,152,680.0	1,033.3				
Top 30 as % of Total LCY Corporate Bonds		62.9%	62.9%				

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

Notes:

1. Data as of end-June 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.

Table 3: Notable LCY Corporate Bond Issuance in 2Q15

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Korea Deposit Insurance Corporation		
3-year bond	1.86	900.0
5-year bond	2.12	680.0
Industrial Bank of Korea		
9-month bond	1.56	400.0
1-year bond	1.61	360.0
Korea Rural Community Corporation		
3-year bond	1.89	520.0

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 13 August 2015.

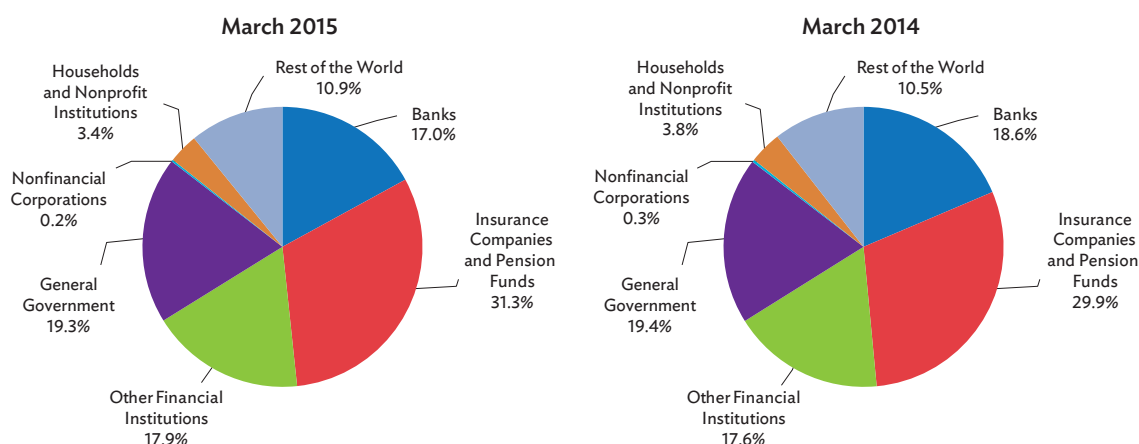
Source: Bloomberg LP.

Policy, Institutional, and Regulatory Developments

MOSF Announces 2015 Supplementary Budget

The Ministry of Strategy and Finance (MOSF) announced in July a supplementary budget for 2015. About KRW5.4 trillion will be used to finance the revenue shortfall in 2015, while KRW6.2 trillion will be utilized to augment budget expenditures—specifically for water resources management and support of the working class, and to deal with the adverse effects of

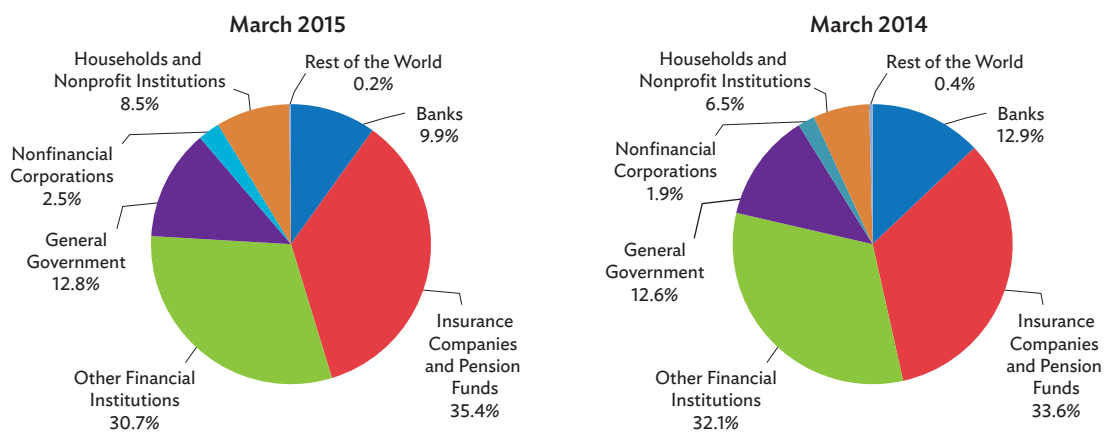
Figure 2: LCY Government Bonds Investor Profile



LCY = local currency.

Sources: AsianBondsOnline and The Bank of Korea.

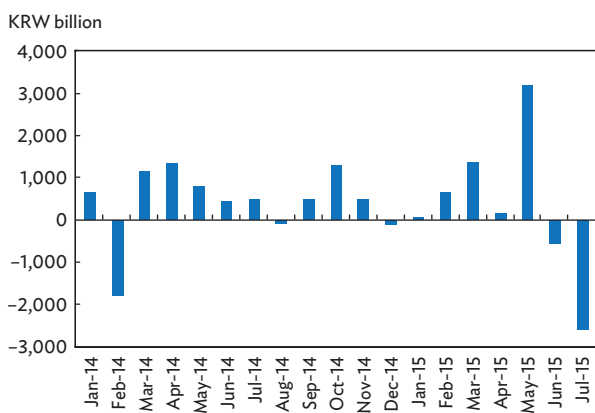
Figure 3: LCY Corporate Bonds Investor Profile



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.

Source: Financial Supervisory Service.

the Middle East Respiratory Syndrome. MOSF stated that the supplementary budget will be largely funded by government bonds.

FSC to Enhance KRX's Competitiveness

The Financial Services Commission (FSC) reported in July plans to improve the competitiveness of the Korea Exchange (KRX). Specifically, the FSC intends to establish a holding company for KRX, which will have as its subsidiaries the Korea Stock Price Index exchange, the Korean Securities Dealers Automated Quotations exchange, and the derivatives exchange. Revisions to the Financial Investment Services and Capital Markets Act are planned to allow for the creation of this holding company.

FSC Introduces Measures to Manage Household Debt

In July, the FSC launched a set of measures that will manage household debt in the Republic of Korea. According to the FSC, these measures are aimed at (i) accelerating the improvement of the quality of household loans, (ii) enhancing the assessment of borrowers' ability to repay, (iii) tightening the management of household debt in the nonbanking sector, and (iv) strengthening the ability of banks to respond to shocks.