

# Republic of Korea

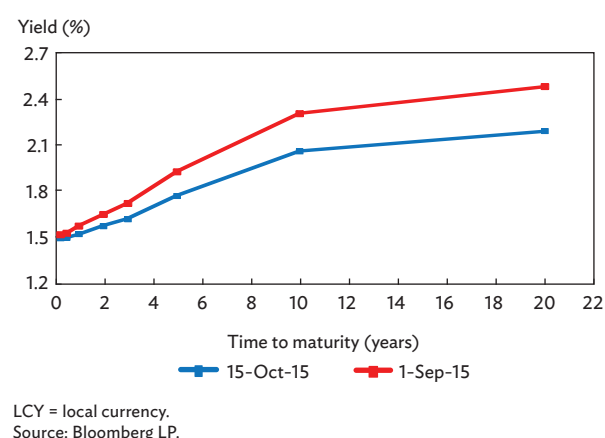
## Yield Movements

Local currency (LCY) government bond yields in the Republic of Korea decreased for all tenors between 1 September and 15 October, with yields for longer-term tenors registering the largest declines (**Figure 1**). The drop in yields was partly induced by market expectations of a low policy interest rate environment that aims to support the Korean economy. The yield curve flattened during the review period with the yield spread between 2-year and 10-year tenors falling 17 basis points (bps).

Real gross domestic product (GDP) growth in the Republic of Korea accelerated to 2.6% year-on-year (y-o-y) in 3Q15 from 2.2% y-o-y in 2Q15, according to advance estimates from the Bank of Korea, buoyed by improved growth in domestic demand and expansion in the construction, manufacturing, and utilities sectors. In 3Q15, y-o-y growth accelerated for private consumption, gross fixed capital formation, and imports of goods and services; and growth reversed from negative to positive for exports of goods and services. On the production side, y-o-y growth accelerated for manufacturing and utilities; shifted from negative to positive for construction; and contracted less rapidly for agriculture, forestry, and fishing. On a quarter-on-quarter (q-o-q) basis, real GDP growth accelerated to 1.2% in 3Q15 from 0.3% in 2Q15.

The Bank of Korea's Monetary Policy Board decided on 15 October to keep the base rate steady at 1.50%, marking the fourth consecutive month that the policy interest rate was kept unchanged. Inflationary pressures remained

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



low throughout 3Q15 as consumer price inflation stood at 0.7% y-o-y in July and August, and 0.6% y-o-y in September. In October, consumer prices rose 0.9% y-o-y.

In October, the Bank of Korea revised downward its 2015 GDP growth forecast to 2.7% from a July estimate of 2.8%, and lowered the 2015 inflation forecast to 0.7% from 0.9%.

## Size and Composition

The size of the local currency (LCY) bond market in the Republic of Korea grew 3.1% q-o-q and 11.5% y-o-y in 3Q15, reaching KRW2,018.6 trillion at the end of September (**Table 1**). The existing stock of LCY

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

	Outstanding Amount (billion)						Growth Rate (%)			
	3Q14		2Q15		3Q15		3Q14		3Q15	
	KRW	US\$	KRW	US\$	KRW	US\$	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	1,810,149	1,715	1,958,273	1,756	2,018,573	1,703	1.7	7.7	3.1	11.5
Government	711,726	674	805,593	722	832,855	703	1.6	10.3	3.4	17.0
Central Bank Bonds	180,580	171	188,310	169	186,350	157	3.8	9.5	(1.0)	3.2
Central Government Bonds	488,180	463	527,583	473	552,452	466	0.5	9.8	4.7	13.2
Industrial Finance Debentures	42,967	41	89,700	80	94,053	79	5.6	19.8	4.9	118.9
Corporate	1,098,423	1,041	1,152,680	1,033	1,185,718	1,000	1.8	6.1	2.9	7.9

( ) = 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.

5. 3Q15 data for central government bonds and industrial finance debentures are *AsianBondsOnline* estimates.

Sources: EDAILY *BondWeb* and the Bank of Korea.

government bonds, which comprise about 41% of total LCY bonds, climbed 3.4% q-o-q and 17.0% y-o-y in 3Q15. Quarterly growth was buoyed by an increase in the stocks of central government bonds and industrial finance debentures, while annual growth was driven by central government and central bank bonds, as well as industrial finance debentures.

LCY government bond issuance fell 4.3% q-o-q in 3Q15, mainly due to a drop in central bank bonds issued, which more than offset the q-o-q hikes in the issuance of central government bonds and industrial finance debentures. On the other hand, LCY government bond issuance was up 1.6% y-o-y in 3Q15, led by double-digit growth in the issuance of central government bonds and industrial finance debentures that eclipsed the decline in central bank bond issues.

LCY corporate bonds outstanding climbed 2.9% q-o-q and 7.9% y-o-y in 3Q15. The q-o-q growth stemmed from increases in special public bonds, financial debentures, and private corporate bonds, while the y-o-y uptick was driven by financial debentures and private corporate bonds. LCY corporate bond issuance dropped 26.2% q-o-q but was up 7.0% y-o-y.

The combined LCY bonds outstanding of the top 30 corporate issuers in the Republic of Korea were valued at KRW757.0 trillion at the end of September, representing 63.8% of the total LCY corporate bond stock (**Table 2**). Korea Housing Finance Corporation remained the largest corporate issuer of LCY bonds. Overall LCY corporate bond issuance exhibited a mixed performance in 3Q15, decreasing 26.2% q-o-q but rising 7.0% y-o-y. Of the five most notable LCY corporate bonds issued in 3Q15, two came from special public agencies, two from banks, and one from a department store (**Table 3**).

## Investor Profile

Insurance companies and pension funds held 32.3% of LCY government bonds in the Republic of Korea at the end of June, remaining the largest investor group in the LCY government bond market (**Figure 2**). Compared with a year earlier, the share of insurance companies and pension funds rose 2.5 percentage points, the largest hike across all investor groups during the review period. The biggest drop between 2Q14 and 2Q15 was in the share of banks at 3.2 percentage points.

Insurance companies and pension funds also remained the largest investor group in the LCY corporate bond market at the end of June with a 35.5% share (**Figure 3**). In contrast, foreign investors were the smallest investor group with a share of 0.2%. The share of insurance companies and pension funds rose 2.3 percentage points y-o-y at end-June, the biggest increase among all investor groups. In contrast, banks posted the largest y-o-y drop at 2.1 percentage points.

Foreign investor net LCY bond sales in the Republic of Korea totaled KRW3,771 billion in 3Q15, a reversal from 2Q15's foreign net bond investment of KRW2,779 billion. On a monthly basis, foreign investor net LCY bond sales stood at KRW937 billion in September, the fourth consecutive month of foreign capital outflows from the Korean LCY bond market amid expectations of an eventual interest rate hike in the United States (**Figure 4**).

## Ratings Update

In September, Standard & Poor's (S&P) raised its long-term foreign currency (FCY) sovereign rating for the Republic of Korea to AA- from A+, and its short-term FCY rating to A-1+ from A-1. S&P also affirmed its short- and long-term LCY ratings at A-1+ and AA-, respectively. The credit rating agency stated that the rating upgrades were due to its assessment that the Republic of Korea's economic growth would outpace most developed economies for the next 3-5 years; its fiscal position is sound; and risks to external financing have moderated, buoyed by a reduction in Korean banks' external debt.

## Policy, Institutional, and Regulatory Developments

### Korea Exchange Is Designated as a Trade Repository

The Financial Services Commission (FSC) announced in August that the Korea Exchange has been designated as a trade repository that will compile, manage, and analyze data on over-the-counter derivatives transactions. The FSC stated that this will strengthen the credibility and international competitiveness of the Republic of Korea's financial market infrastructure.

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.	90,350	76.2	Yes	No	No	Finance
2.	NH Investment & Securities	55,542	46.9	Yes	Yes	Yes	Securities
3.	Korea Land & Housing Corp.	55,042	46.4	Yes	No	No	Real Estate
4.	KDB Daewoo Securities	51,760	43.7	Yes	Yes	No	Securities
5.	Korea Investment and Securities	47,087	39.7	No	No	No	Securities
6.	Industrial Bank of Korea	37,323	31.5	Yes	Yes	No	Banking
7.	Mirae Asset Securities	35,770	30.2	No	Yes	No	Securities
8.	Hana Financial Investment	35,182	29.7	No	No	No	Securities
9.	Korea Deposit Insurance Corp.	33,610	28.4	Yes	No	No	Insurance
10.	Korea Electric Power Corp.	27,010	22.8	Yes	Yes	No	Utilities
11.	Hyundai Securities	23,145	19.5	No	Yes	No	Securities
12.	Korea Expressway	22,350	18.9	Yes	No	No	Infrastructure
13.	Kookmin Bank	19,158	16.2	No	No	No	Banking
14.	Korea Rail Network Authority	18,320	15.5	Yes	No	No	Infrastructure
15.	Shinhan Bank	18,063	15.2	No	No	No	Banking
16.	Woori Bank	17,795	15.0	Yes	No	No	Banking
17.	Samsung Securities	16,668	14.1	No	Yes	No	Securities
18.	Daishin Securities	15,953	13.5	No	Yes	No	Securities
19.	Korea Gas Corp.	15,499	13.1	Yes	Yes	No	Utilities
20.	Small & Medium Business Corp.	14,380	12.1	Yes	No	No	Finance
21.	Standard Chartered First Bank Korea	11,730	9.9	No	No	No	Banking
22.	Korea Student Aid Foundation	11,580	9.8	Yes	No	No	Finance
23.	Shinhan Investment Corp.	11,387	9.6	No	No	No	Securities
24.	Korea Eximbank	10,980	9.3	Yes	No	No	Banking
25.	Korea Water Resources Corp.	10,509	8.9	Yes	Yes	No	Utilities
26.	Hana Bank	10,300	8.7	No	No	No	Banking
27.	Korea Railroad Corp.	10,270	8.7	Yes	No	No	Infrastructure
28.	Hyundai Capital Services	10,174	8.6	No	No	No	Finance
29.	Shinyoung Securities	10,114	8.5	No	Yes	Yes	Securities
30.	Shinhan Card	9,906	8.4	No	No	No	Finance
<b>Total Top 30 LCY Corporate Issuers</b>		<b>756,957.6</b>	<b>638.6</b>				
<b>Total LCY Corporate Bonds</b>		<b>1,185,718.0</b>	<b>1,000.3</b>				
<b>Top 30 as % of Total LCY Corporate Bonds</b>		<b>63.8%</b>	<b>63.8%</b>				

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

Notes:

1. Data as of end-September 2015.

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

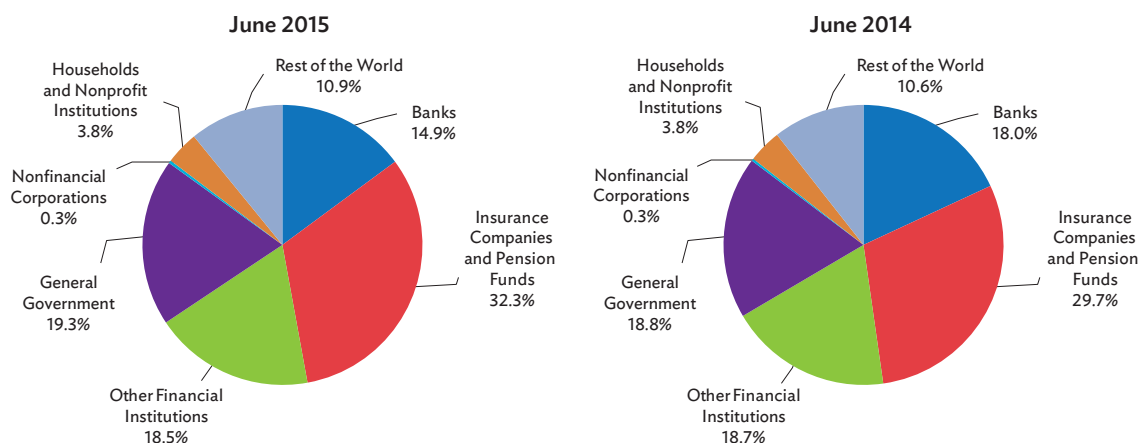
Sources: *AsianBondsOnline* calculations based on Bloomberg and EDAILY *BondWeb* data.

Table 3: Notable LCY Corporate Bond Issuance in 3Q15

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Industrial Bank of Korea		
10-year bond	2.55	400
Hyundai Department Store		
3-year bond	1.94	300
KEB Hana Bank		
10-year bond	2.78	300
Korea Land & Housing Corporation		
30-year bond	2.66	280
Korea Deposit Insurance Corporation		
3-year bond	1.79	270

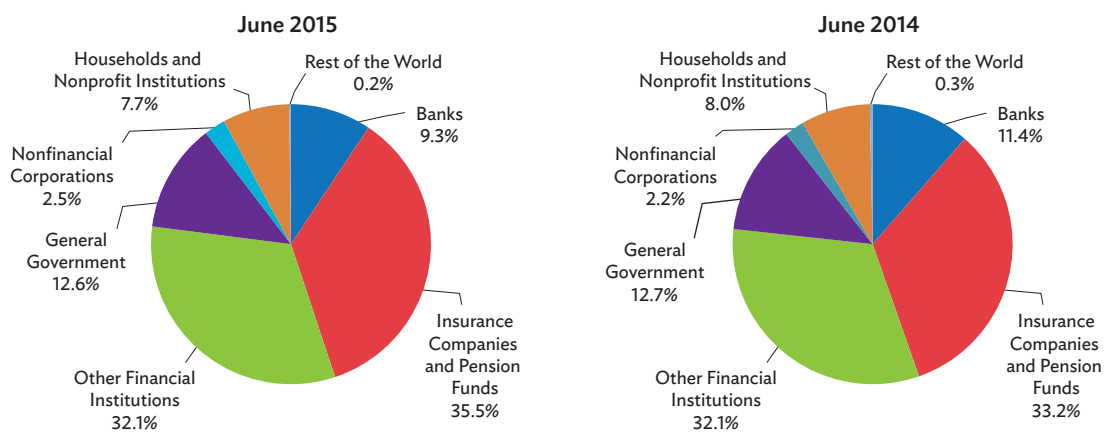
LCY = local currency.  
Source: Bloomberg LP.

Figure 2: LCY Government Bonds Investor Profile



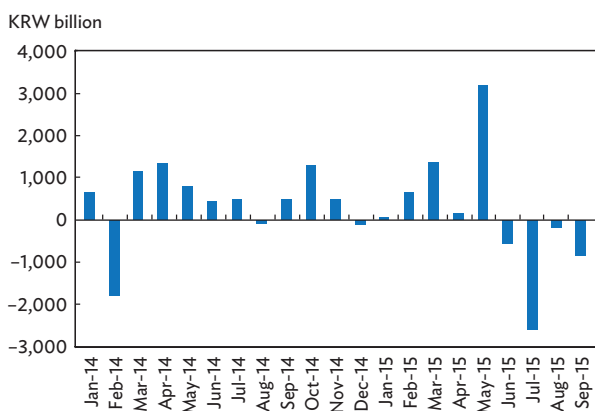
LCY = local currency.  
Sources: The Bank of Korea.

Figure 3: LCY Corporate Bonds Investor Profile



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

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



LCY = local currency.

Source: Financial Supervisory Service.

## FSC to Improve Competitiveness of Financial Investment Business Entities

The FSC announced in October that it will introduce measures to enhance the competitiveness of financial investment business entities in the Republic of Korea. The planned measures are aimed at improving the corporate financing functions of brokerage firms, widening the scope of business activities of securities companies, and easing regulatory restrictions in order to diversify certain types of financial services. Among the FSC's plans are to allow companies with total assets worth less than KRW2 trillion to issue private placements of securities, and to revise regulations to allow the investment banking departments of securities companies to engage in certain brokerage activities such as buying and selling short-term bonds.