

## Republic of Korea

### Yield Movements

Local currency (LCY) government bond yields in the Republic of Korea fell for most tenors between 1 March and 15 May. Bonds with yields of less than 1 year up to 10 years registered declines, while yields increased for 20-year and 30-year tenors (**Figure 1**). The yield spread between the 2-year and 10-year tenors fell 2 basis points.

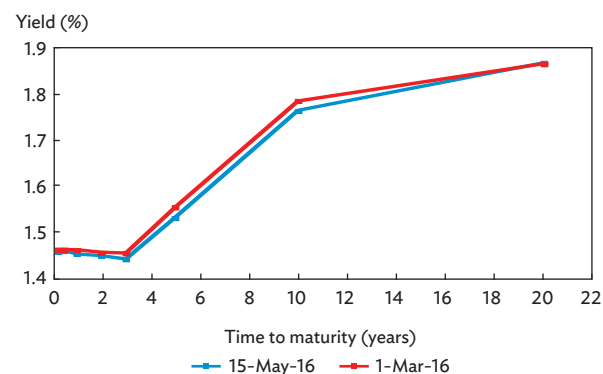
The policy interest rate in the Republic of Korea remained unchanged in the first 5 months of 2016, with the Bank of Korea's Monetary Policy Board deciding to maintain the base rate at 1.50% in meetings held on 14 January, 16 February, 10 March, 19 April, and 13 May.

The Republic of Korea's real gross domestic product (GDP) growth decelerated to 2.8% year-on-year (y-o-y) in the first quarter (Q1) of 2016 from 3.1% y-o-y in the fourth quarter (Q4) of 2015, according to the Bank of Korea's preliminary estimates released in April. The growth slowdown in Q1 2016 was due to a moderation in y-o-y increases in final consumption expenditure, gross fixed capital formation, and exports and imports of goods and services on the expenditure side; and a slackening in y-o-y output growth in the manufacturing, services, and utilities sectors on the production side. On a seasonally adjusted basis, real GDP growth slowed to 0.5% quarter-on-quarter (q-o-q) in Q1 2016 from 0.7% q-o-q in Q4 2015.

Consumer price inflation in the Republic of Korea hovered around 1.0% in the first 4 months of the year, with the y-o-y inflation rate at 0.8% in January, 1.3% in February, and 1.0% in both March and April. The month-on-month (m-o-m) inflation rate registered 0.0% in January, 0.5% in February, -0.3% in March, and 0.1% in April.

The Bank of Korea reported in April that it had revised downward its 2016 economic outlook for the Republic of Korea, lowering its annual GDP growth forecast to 2.8% from a previous projection of 3.0% made in January. The central bank also lowered its 2016 forecast for headline consumer price inflation to 1.2% from 1.4%.

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



Source: Based on data from Bloomberg LP.

### Size and Composition

The Republic of Korea's LCY bond market size continued to grow in Q1 2016, with the outstanding bond stock climbing 1.2% q-o-q and 7.6% y-o-y to reach KRW2,044.4 trillion (USD1,788 trillion) at the end of March (**Table 1**). In the LCY government bond market, the amount of outstanding bonds rose 2.1% q-o-q and 6.3% y-o-y to KRW839.6 trillion, led by relatively strong growth in central government bonds. The issuance of LCY government bonds in Q1 2016 stood at KRW86.4 trillion, up 2.6% q-o-q amid quarterly increases in the issuance of both central bank and central government bonds. LCY government bond issuance was down 5.4% y-o-y due to a relatively sharp decline in central bank bond issues.

In the LCY corporate bond market, the outstanding stock of bonds rose 0.5% q-o-q and 8.5% y-o-y in Q1 2016, reaching a total of KRW1,204.8 trillion at the end of March. In contrast, issuance of LCY corporate bonds fell 15.2% q-o-q and 12.7% y-o-y to KRW88.5 trillion in Q1 2016.

The top 30 issuers of LCY corporate bonds had a cumulative outstanding bond stock worth KRW775.7 trillion at the end of March, constituting about 64% of the total LCY corporate bond market (**Table 2**).

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2015		Q4 2015		Q1 2016		Q1 2015		Q1 2016	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>1,900,194</b>	<b>1,712</b>	<b>2,020,522</b>	<b>1,720</b>	<b>2,044,415</b>	<b>1,788</b>	<b>2.3</b>	<b>8.3</b>	<b>1.2</b>	<b>7.6</b>
Government	789,741	712	821,993	700	839,618	734	3.2	16.7	2.1	6.3
Central Bank Bonds	184,940	167	180,930	154	181,390	159	3.9	8.3	0.3	(1.9)
Central Government Bonds	513,685	463	548,724	467	566,919	496	3.8	10.1	3.3	10.4
Industrial Finance Debentures	91,116	82	92,340	79	91,309	80	(1.0)	132.3	(1.1)	0.2
Corporate	1,110,453	1,001	1,198,529	1,020	1,204,797	1,054	1.6	3.0	0.5	8.5

( ) = negative, KRW = Korean won, q-o-q = quarter-on-quarter, Q1 = first quarter, Q4 = fourth quarter, USD = United States dollar, y-o-y = year-on-year.

Notes:

1. Calculated using data from national sources.

2. Bloomberg LP end-of-period local currency-USD rates are used.

3. Growth rates are calculated from local currency 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.

Korea Housing Finance Corporation continued to be the largest issuer of LCY corporate bonds. Five of the most notable LCY corporate bonds issued in Q1 2016 were short-term bonds issued by two domestic banks (**Table 3**).

## Investor Profile

Insurance companies and pension funds remained the largest investor group in the Republic of Korea's LCY government bond market, accounting for a combined 32.6% share of the total market at the end of 2015 (**Figure 2**). Insurance companies and pension funds also had the largest y-o-y increase in the share of LCY government bond holdings among all investor groups. Nonfinancial corporations had the smallest share of LCY government bond holdings among all investor groups at the end of 2015, comprising only 0.6% of the market.

Insurance companies and pension funds were also the largest investor group in the LCY corporate bond market at the end of 2015, with a 37.3% share of the market, and recorded the fastest rate of annual growth in the share of holdings among all investor groups (**Figure 3**). Foreign investors held the smallest share of the LCY corporate bond market at the end of December at only 0.2%.

Foreign investors' net LCY bond sales in the Republic of Korea soared to KRW4,149 billion in Q1 2016 from KRW605 billion in Q4 2015, largely driven by net bond sales of KRW487 billion in January and KRW4,232 billion in February. In March and April, on the other hand, foreign investors were responsible for net bond investments

totaling KRW570 billion and KRW631 billion, respectively (**Figure 4**).

## Ratings Update

Fitch Ratings (Fitch) announced in February that it had affirmed the Republic of Korea's long-term foreign currency (FCY) issuer default rating at AA- and its long-term LCY issuer default rating at AA, with a stable outlook for both. The rating agency also affirmed the Republic of Korea's senior unsecured FCY- and LCY-denominated bonds at AA- and AA, respectively. Fitch stated that its rating decision was based on its assessment of the Republic of Korea as having a strong macroeconomic environment and robust external finances. These factors were balanced by the Republic of Korea's geopolitical risk and low gross domestic product per capita relative to its peers.

## Policy, Institutional, and Regulatory Developments

### Financial Services Commission to Invigorate Financial Advisory Services

The Republic of Korea's Financial Services Commission (FSC) announced in March its plan to amend regulations to invigorate the Republic of Korea's financial advisory services sector. The FSC will amend the Enforcement Decree of the Financial Investment Services and Capital Markets Act in the first half of 2016 in order to create a new registration category for financial advisers covering certain types of financial products—such as derivative-

Table 2: Top 30 Issuers of Local Currency Corporate Bonds in the Republic of Korea

	Issuers	Outstanding Amount		State-Owned	Listed on		Type of Industry
		LCY Bonds (KRW billion)	LCY Bonds (USD billion)		KOSPI	KOSDAQ	
1.	Korea Housing Finance Corporation	94,178	82.4	Yes	No	No	Housing Finance
2.	NH Investment & Securities	59,371	51.9	Yes	Yes	No	Securities
3.	KDB Daewoo Securities	56,470	49.4	Yes	Yes	No	Securities
4.	Korea Land & Housing Corporation	52,275	45.7	Yes	No	No	Real Estate
5.	Korea Investment and Securities	48,658	42.6	No	No	No	Securities
6.	Mirae Asset Securities	40,652	35.6	No	Yes	No	Securities
7.	Industrial Bank of Korea	39,543	34.6	Yes	Yes	No	Banking
8.	Hana Financial Investment	34,900	30.5	No	No	No	Securities
9.	Korea Deposit Insurance Corporation	31,230	27.3	Yes	No	No	Insurance
10.	Korea Electric Power Corporation	25,030	21.9	Yes	Yes	No	Electricity, Energy, and Power
11.	Hyundai Securities	22,905	20.0	No	No	No	Securities
12.	Korea Expressway	22,620	19.8	Yes	No	No	Transport Infrastructure
13.	Korea Rail Network Authority	19,390	17.0	Yes	No	No	Transport Infrastructure
14.	Kookmin Bank	18,497	16.2	No	No	No	Banking
15.	Shinhan Bank	18,423	16.1	No	No	No	Banking
16.	Samsung Securities	17,682	15.5	No	Yes	No	Securities
17.	Woori Bank	16,715	14.6	Yes	Yes	No	Banking
18.	Daishin Securities	16,345	14.3	No	Yes	No	Securities
19.	Korea Gas	15,499	13.6	Yes	Yes	No	Gas Utility
20.	NongHyup Bank	14,800	12.9	Yes	No	No	Banking
21.	Small & medium Business Corporation	13,830	12.1	Yes	No	No	SME Development
22.	Korea Eximbank	12,750	11.2	Yes	No	No	Banking
23.	Standard Chartered First Bank Korea	12,120	10.6	No	No	No	Banking
24.	Korea Student Aid Foundation	12,020	10.5	Yes	No	No	Student Loan
25.	K-Water	10,594	9.3	Yes	No	No	Water
26.	Hyundai Capital Services	10,499	9.2	No	No	No	Consumer Finance
27.	Shinhan Card	9,889	8.6	No	No	No	Credit Card
28.	Korea Railroad Corporation	9,820	8.6	Yes	No	No	Transport Infrastructure
29.	Shinyoung Securities	9,801	8.6	No	Yes	No	Securities
30.	NongHyup	9,190	8.0	Yes	No	No	Financial
<b>Total Top 30 LCY Corporate Issuers</b>		<b>775,696.0</b>	<b>678.4</b>				
<b>Total LCY Corporate Bonds</b>		<b>1,204,797.0</b>	<b>1,053.7</b>				
<b>Top 30 as % of Total LCY Corporate Bonds</b>		<b>64.4%</b>	<b>64.4%</b>				

KOSDAQ = Korean Securities Dealers Automated Quotations, KOSPI = Korea Composite Stock Price Index, KRW = Korean won, LCY = local currency, USD = United States dollar.

Notes:

1. Data as of end-March 2016.

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

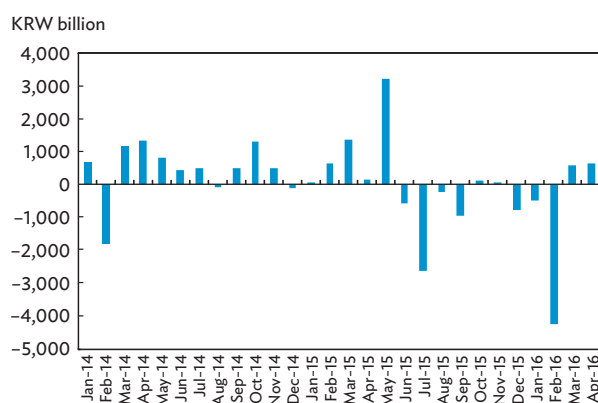
Sources: *AsianBondsOnline* calculations based on Bloomberg and EDAILY *BondWeb* data.

**Table 3: Notable Local Currency Corporate Bond Issuance in Q1 2016**

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
<b>NongHyup Bank</b>		
0.25-year bond	1.55	770
0.25-year bond	1.54	450
0.5-year bond	1.54	460
1-year bond	1.55	750
<b>Industrial Bank of Korea</b>		
1-year bond	1.54	550

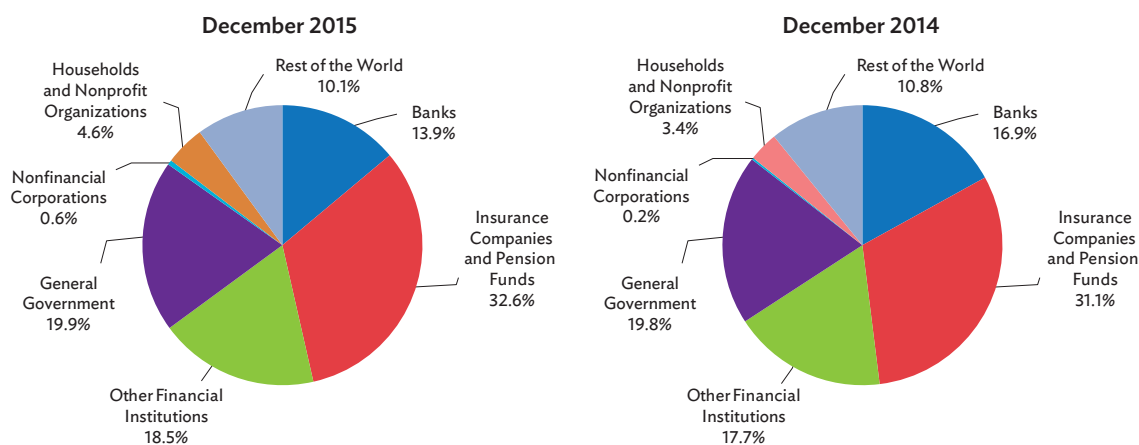
KRW = Korean won, Q1 = first quarter.  
 Note: Coupon rates for the bonds of NongHyup Bank and Industrial Bank of Korea are indicative yields as of end-March 2016.  
 Source: Based on data from Bloomberg LP.

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



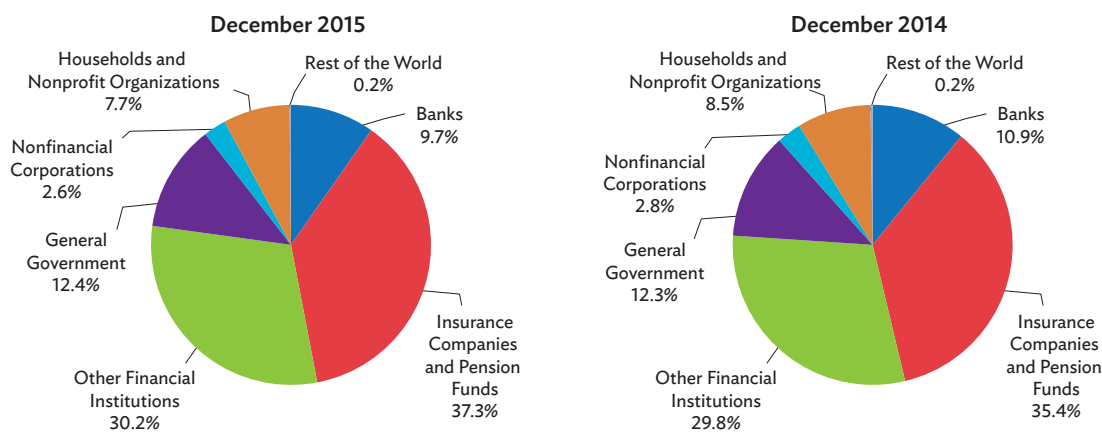
KRW = Korean won.  
 Source: Financial Supervisory Service.

**Figure 2: Local Currency Government Bonds Investor Profile**



Sources: AsianBondsOnline and The Bank of Korea.

**Figure 3: Local Currency Corporate Bonds Investor Profile**



Sources: AsianBondsOnline and The Bank of Korea.

linked securities, funds, and savings products—and to lower their capital requirements to KRW100 million from KRW500 million. Planned amendments to the Financial Investment Services and Capital Markets Act are also aimed at allowing eligible “robo-advisors” to directly render front-office services to their clients. The FSC has plans to (i) propose amendments to the Regulation on Financial Investment Business that will introduce detailed requirements for Independent Financial Advisers, and (ii) create best practice guidelines for financial advisory providers for investor protection purposes.

### Financial Services Commission Outlines Corporate Restructuring Plan

The FSC announced its corporate restructuring plan in April, focusing on financially distressed firms and vulnerable sectors. The plan has three tracks that focus on (i) cyclically vulnerable sectors such as the shipbuilding and shipping industries, (ii) main debtor groups and individual companies, and (iii) oversupplied sectors such as the petrochemical and steel industries.