

Republic of Korea

Yield Movements

Local currency (LCY) government bond yields in the Republic of Korea climbed for all tenors between 31 October and 18 November, shifting the entire yield curve upward (**Figure 1**). Bond yields for maturities of 2 years and less shed an average of 17 basis points (bps), while yields from the 3-year through 30-year tenors climbed an average of 42 bps. As yields rose faster at the longer end than at the shorter end of the curve, the spread between the 2-year and 10-year tenors widened from 22 bps on 31 October to 45 bps on 18 November.

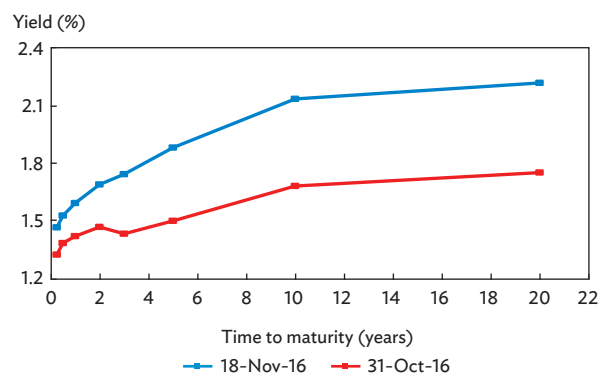
Bond yields rose in October on increased expectations of a United States (US) Federal Reserve rate hike in December following the release of stronger US economic growth in the third quarter (Q3) of 2016. Yields continued to rise in November amid uncertainty over the economic policies of the new US administration.

On 11 November, the Monetary Policy Board of the Bank of Korea decided to maintain the base rate at 1.25% as it has done with its past four monetary policy decisions. The central bank expects that both the domestic and global economies will maintain modest growth. However, the board also noted that risks have increased and therefore it will continue to monitor the domestic and global environments.

Consumer price inflation in the Republic of Korea remained moderate, climbing to 1.3% year-on-year (y-o-y) in October from 1.2% y-o-y in September. On a month-on-month basis, consumer prices inched up 0.1% in October after increasing 0.6% in September.

Real gross domestic product (GDP) growth in the Republic of Korea moderated to 2.7% y-o-y in Q3 2016, according to advance estimates from the Bank of Korea, down from 3.3% y-o-y in the second quarter of 2016. Slower GDP growth in Q3 2016 resulted from declining y-o-y growth in private consumption and weaker y-o-y growth in construction, manufacturing, and services; as well as y-o-y contractions in agriculture, forestry, and fishing production. On a quarter-on-quarter (q-o-q) basis, real GDP growth stood at 0.7% in Q3 2016.

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



Source: Based on data from Bloomberg LP.

In its October economic outlook, the Bank of Korea forecast real GDP to grow 2.5% y-o-y in the second half of 2016 and 2.7% in full-year 2016. It also projected consumer price inflation to level off at 1.1% y-o-y in the second half of 2016 and average 1.0% in full-year 2016.

Size and Composition

The Republic of Korea's LCY bond market expanded 0.6% q-o-q and 3.9% y-o-y in Q3 2016 to reach KRW2,076.6 trillion (USD1,886 billion) at the end of September. The expansion was buoyed by growth in both the government and corporate bond markets (**Table 1**). The outstanding amount of government bonds grew 0.3% q-o-q and 5.2% y-o-y to KRW855.8 trillion on the back of relatively strong growth in central government bonds, led by Korea Treasury Bonds. Government bond issuance was valued at KRW76.9 trillion in Q3 2016, down 11.6% q-o-q and 8.6% y-o-y on lower quarterly bond sales for both the central bank and the central government.

In the LCY corporate bond market, outstanding bonds grew 0.8% q-o-q and 3.0% y-o-y to reach KRW1,220.8 trillion at the end of September, fueled by relatively fast growth in financial debentures. Issuance of LCY corporate bonds were down 9.8% q-o-q and 18.9% y-o-y to KRW81.5 trillion in Q3 2016.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2015		Q2 2016		Q3 2016		Q3 2015		Q3 2016	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,999,322	1,687	2,064,024	1,792	2,076,602	1,886	2.1	10.5	0.6	3.9
Government	813,604	686	853,009	741	855,763	777	1.0	14.3	0.3	5.2
Central Bank Bonds	186,350	157	181,420	158	179,680	163	(1.0)	3.2	(1.0)	(3.6)
Central Government Bonds	536,884	453	583,402	507	585,836	532	1.8	10.0	0.4	9.1
Industrial Finance Debentures	90,370	76	88,188	77	90,247	82	0.7	110.3	2.3	(0.1)
Corporate	1,185,718	1,000	1,211,015	1,051	1,220,839	1,109	2.9	7.9	0.8	3.0

() = negative, KRW = Korean won, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third 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.

The outstanding LCY bonds of the top 30 corporate issuers at the end of September amounted to KRW775.1 trillion, or the equivalent of 63.5% of total LCY corporate bonds outstanding. Korea Housing Finance Corporation remained the largest corporate bond issuer (**Table 2**). Most of the notable LCY corporate bond issues in Q3 2016 were made by domestic financial institutions such as Industrial Bank of Korea, Korea Eximbank, and Mirae Asset Securities (**Table 3**).

Investor Profile

The largest investor group in the LCY government bond market at the end of June were insurance companies and pension funds, which held 31.7% of the market's total outstanding stock of LCY government bonds at the end of June (**Figure 2**). The next-largest investor group were other financial institutions, accounting for a 20.5% share of the total stock. Other major investor groups include general government and banks with shares of 19.3% and 13.4%, respectively.

Insurance companies and pension funds were also the largest investor group in the LCY corporate bond market, with their holdings accounting for 37.7% of the total market at the end of June (**Figure 3**). In the 12 months through the end of June, insurance companies and pension funds registered the biggest increase in a holdings share at 2.2 percentage points. The largest drop was in the

holdings of households and nonprofit organizations at 1.5 percentage points.

Foreign investors sold a net KRW992 billion of the Republic of Korea's LCY bonds in Q3 2016, down from KRW1,229 billion in Q2 2016 and KRW4,149 billion in the first quarter of 2016. On a monthly basis, foreign investors' net bond sales amounted to KRW663 billion in September, down from KRW917 billion in August (**Figure 4**).

Policy, Institutional, and Regulatory Developments

Financial Services Commission Announces Law on Corporate Governance for Financial Companies

The Financial Services Commission announced in August the State Council's approval on 26 July of the Enforcement Decree of the Act on Corporate Governance of Financial Companies as well as the effectivity of the decree on 1 August. The decree aims to promote the sound and transparent corporate governance of financial companies. Among its key provisions are disqualification criteria for directors and officers, recommended composition of the board of directors, a fit-and-proper rule for the largest shareholder, and performance-based pay for officers and employees.

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	97,834	88.8	Yes	No	No	Housing Finance
2.	NH Investment & Securities	60,743	55.2	Yes	Yes	No	Securities
3.	Mirae Asset Daewoo Securities	55,611	50.5	No	Yes	No	Securities
4.	Korea Investment and Securities	49,345	44.8	No	No	No	Securities
5.	Korea Land & Housing Corporation	49,049	44.5	Yes	No	No	Real Estate
6.	Mirae Asset Securities	40,653	36.9	No	Yes	No	Securities
7.	Industrial Bank of Korea	39,831	36.2	Yes	Yes	No	Banking
8.	Hana Financial Investment	35,411	32.2	No	No	No	Securities
9.	Korea Deposit Insurance Corporation	29,450	26.7	Yes	No	No	Insurance
10.	Hyundai Securities	24,272	22.0	No	No	No	Securities
11.	Korea Electric Power Corporation	23,410	21.3	Yes	Yes	No	Electricity, Energy, and Power
12.	Korea Expressway	22,320	20.3	Yes	No	No	Transport Infrastructure
13.	Shinhan Bank	20,391	18.5	No	No	No	Banking
14.	Korea Rail Network Authority	18,470	16.8	Yes	No	No	Transport Infrastructure
15.	Samsung Securities	18,288	16.6	No	Yes	No	Securities
16.	Kookmin Bank	17,963	16.3	No	No	No	Banking
17.	Woori Bank	17,495	15.9	Yes	Yes	No	Banking
18.	Daishin Securities	16,706	15.2	No	Yes	No	Securities
19.	NongHyup Bank	15,070	13.7	Yes	No	No	Banking
20.	Korea Gas Corporation	14,919	13.5	Yes	Yes	No	Gas Utility
21.	Small & medium Business Corporation	12,990	11.8	Yes	No	No	SME Development
22.	Korea Eximbank	12,120	11.0	Yes	No	No	Banking
23.	Korea Student Aid Foundation	11,340	10.3	Yes	No	No	Student Loan
24.	Standard Chartered First Bank Korea	11,190	10.2	No	No	No	Banking
25.	Shinhan Card	10,789	9.8	No	No	No	Credit Card
26.	Hyundai Capital Services	10,489	9.5	No	No	No	Consumer Finance
27.	Korea Water Resources Corporation	10,481	9.5	Yes	No	No	Water
28.	Shinyoung Securities	9,618	8.7	No	Yes	No	Securities
29.	Korea Railroad Corporation	9,550	8.7	Yes	No	No	Transport Infrastructure
30.	NongHyup	9,340	8.5	Yes	No	No	Diversified
Total Top 30 LCY Corporate Issuers		775,138.7	703.9				
Total LCY Corporate Bonds		1,220,839.0	1,108.7				
Top 30 as % of Total LCY Corporate Bonds		63.5%	63.5%				

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-September 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 LP and EDAILY *BondWeb* data.

Table 3: Notable Local Currency Corporate Bond Issuance in Q3 2016

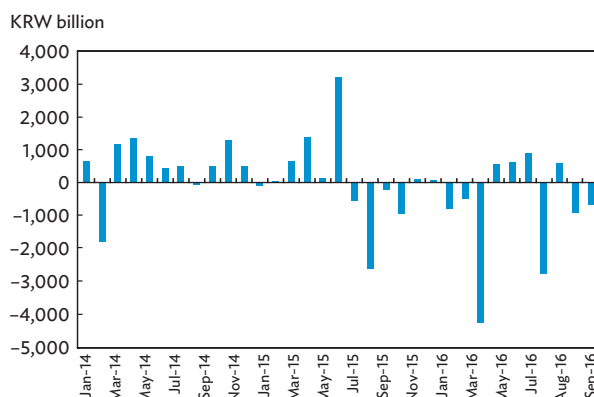
Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Industrial Bank of Korea		
0.5-year bond	1.36	320
0.6-year bond	1.36	410
2-year bond	1.45	300
3-year bond	1.32	300
Perpetual bond	3.16	290
Korea Eximbank		
1-year bond	1.40	310
Mirae Asset Securities		
5.5-year bond	3.50	300

KRW = Korean won, Q3 = third quarter.

Note: Coupon rates for 0.5- and 0.6-year bonds of Industrial Bank of Korea and 1-year bond of Korea Eximbank are indicative yields at end-September 2016.

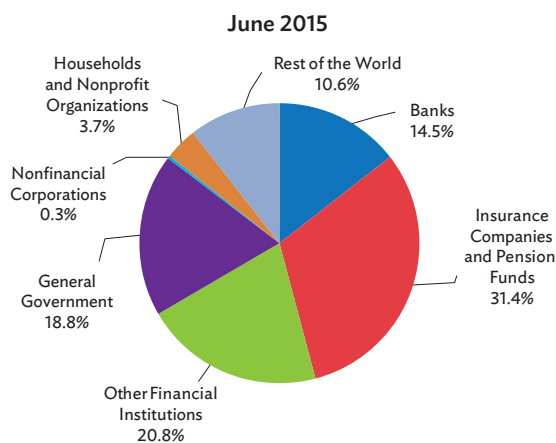
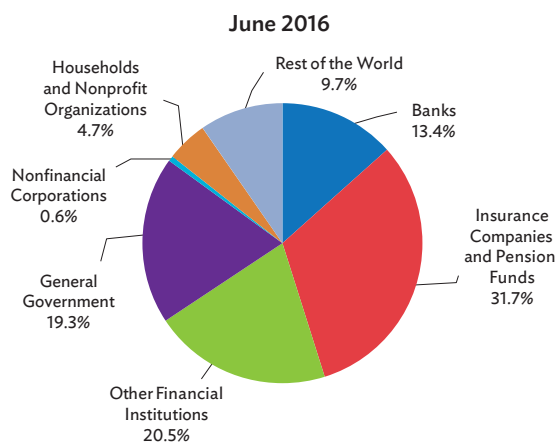
Source: Based on data from Bloomberg LP.

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



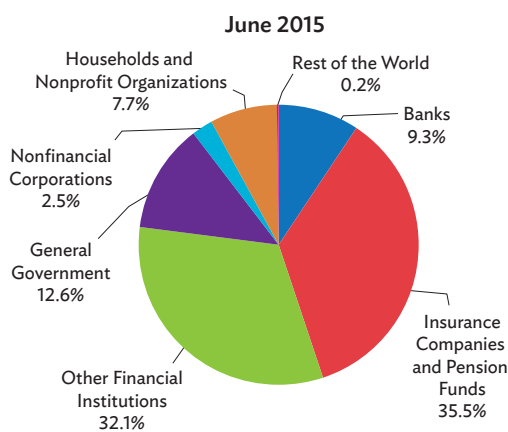
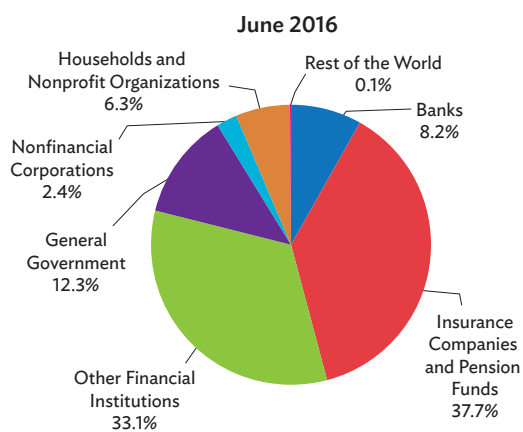
KRW = Korean won.
Source: Financial Supervisory Service.

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.