

## Republic of Korea

### Yield Movements

Between 1 March and 15 May, local currency (LCY) government bond yields in the Republic of Korea exhibited mixed movements. Yields for tenors of less than 3 years were barely changed, declining between 0.4 basis point (bp) and 2 bps (**Figure 1**). Yields for tenors of 3 years to 10 years rose between 4 bps and 15 bps, while yields for tenors of 20 years and 30 years rose 21 bps and 24 bps, respectively. The spread between the 2-year and 10-year yields widened to 72 bps on 15 May from 56 bps on 1 March.

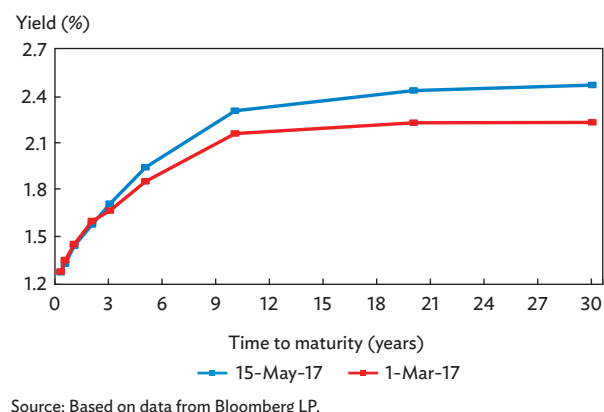
Yields rose in the first half of March as the market awaited the Constitutional Court of Korea's ruling on the presidential impeachment trial and the impending rate hike by the United States (US) Federal Reserve on 15 March. Yields, however, immediately corrected and subsequently remained range-bound, lacking clear direction amid uncertainty over both domestic and foreign macroeconomic policies.

On the domestic front, weakening economic growth led to expectations of a rate cut by the Bank of Korea. However, the market also considered that lower interest rates could pose a risk to further growth in household debt. Uncertainty in the direction of US macroeconomic policies and the pace of the Federal Reserve rate hikes still remain.

An uptick in yields was observed in May, ahead of the presidential election on 9 May. Better-than-expected economic growth in the first quarter (Q1) of 2017 and the possibility of a supplementary budget by the new administration also contributed to the steepening of the yield curve. This has lessened expectations of a rate cut by the Bank of Korea.

At its 25 May monetary policy meeting, the Bank of Korea decided to maintain its base rate at 1.25%. The central bank cited expansion in domestic growth, supported by exports and investments as consumption remained weak. The economy is expected to maintain its pace of expansion in 2017 with annual gross domestic product growth forecast to be slightly above the 2.6% year-on-year (y-o-y) April projection. Inflation is expected to stay

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



close to the 2.0% y-o-y target level for the time being, and full-year 2017 inflation is expected to be near the 1.9% projection made in April. The central bank noted that it will monitor the process of monetary policy normalization in the US, trade conditions with major countries, the new government's economic policies, the growth of the household debt, and geopolitical risks.

The Republic of Korea's GDP growth rose to 1.1% quarter-on-quarter (q-o-q) in Q1 2017 from 0.5% q-o-q in the fourth quarter (Q4) of 2016. By type of expenditure, the higher growth in Q1 2017 was led by increased gross fixed capital formation, higher private consumption expenditure, and a rebound in exports. On a y-o-y basis, the Republic of Korea's economy grew 2.9% in Q1 2017 versus 2.4% in Q4 2016.

Consumer price inflation in the Republic of Korea picked up in the first 4 months of 2017 to a monthly average of 2.0% y-o-y from an annual average of 1.0% in full-year 2016. The rise in inflation was driven by a rebound in oil prices and a pickup in economic activity.

### Size and Composition

The Republic of Korea's LCY bond market grew 1.4% q-o-q to reach KRW2,095 trillion (USD1,873 billion) at the end of March (**Table 1**). The rise was most notable in the government bond sector as the corporate bond

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2016		Q4 2016		Q1 2017		Q1 2016		Q1 2017	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>2,044,415</b>	<b>1,788</b>	<b>2,066,453</b>	<b>1,714</b>	<b>2,094,915</b>	<b>1,873</b>	<b>1.2</b>	<b>7.6</b>	<b>1.4</b>	<b>2.5</b>
Government	839,618	734	847,537	703	872,215	780	2.1	6.3	2.9	3.9
Central Government Bonds	501,171	438	516,908	429	533,303	477	3.3	10.3	3.2	6.4
Central Bank Bonds	181,390	159	168,390	140	174,860	156	0.3	(1.9)	3.8	(3.6)
Others	157,057	137	162,239	135	164,052	147	0.7	4.4	1.1	4.5
Corporate	1,204,797	1,054	1,218,916	1,011	1,222,700	1,093	0.5	8.5	0.3	1.5

( ) = negative, KRW = Korean won, LCY = local currency, 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 LCY–USD rates are used.
3. Growth rates are calculated from local currency (LCY) base and do not include currency effects.
4. “Others” comprise Korea Development Bank Bonds, National Housing Bonds, and Seoul Metro Bonds.
5. Corporate bonds include equity-linked securities and derivatives-linked securities.

Sources: The Bank of Korea and EDAILY BondWeb.

market exhibited only a marginal increase from the previous quarter. On a y-o-y basis, the LCY bond market increased at a faster pace of 2.5%. Total government bonds outstanding reached KRW872 trillion, while corporate bonds amounted to KRW1,223 trillion.

**Government Bonds.** LCY government bonds outstanding rose 2.9% q-o-q to KRW872 trillion at the end of March. The growth was mainly driven by a 3.2% q-o-q increase in the outstanding stock of central government bonds, due to higher issuance of Korea Treasury Bonds. This is in line with the government’s efforts to prop up the economy, frontloading almost one-third of its budget in Q1 2017. The outstanding stock of central bank bills also increased 3.8% q-o-q to KRW175 trillion at the end of March. Other government bonds rose 1.1% q-o-q to KRW164 trillion.

Government bond issuance in Q1 2017 surged 30.4% q-o-q to reach KRW88.4 trillion, driven by higher issuance of Korea Treasury Bonds and Monetary Stabilization Bonds. The surge was also partly due to the relatively low base in Q4 2016 as both the Ministry of Finance and Bank of Korea decreased their issuance to help stabilize market volatility following the US elections in November.

**Corporate Bonds.** LCY corporate bonds marginally rose 0.3% q-o-q to KRW1,223 trillion at the end of March.

**Table 2** presents the top 30 LCY corporate bond issuers in the Republic of Korea at the end of March. The top 30 issuers comprised 64.8% of the total LCY corporate bond

market, with aggregate bonds outstanding amounting to KRW792 trillion. Securities companies and banks continued to dominate the top 30 largest debt issuers with total bonds outstanding worth KRW325 trillion and KRW140 trillion, respectively. Of those in the list, 16 were state-owned firms, including the Korea Housing Finance Corporation, which continued to top the list with outstanding corporate bonds worth KRW111 trillion.

Corporate bond issuance slowed in Q1 2017, down 3.8% q-o-q to KRW96 trillion from KRW99 trillion in the previous quarter. **Table 3** lists notable corporate bond issuances in Q1 2017. The National Agricultural Cooperative Federation, a holding company with interests in agriculture, banking, and insurance, topped the list. Other top issuers of bonds for the quarter were from the banking sector, including Woori Bank and KEB Hana Bank.

## Investor Profile

Insurance companies and pension funds continued to account for the largest holdings share of LCY government bonds at the end of December 2016, with an aggregate share of 33.6%, up from 32.6% a year earlier (**Figure 2**). General government comprised the second largest investor group, accounting for 19.3%, which was down slightly from a year earlier. The share of other financial institutions at 18.7% was almost unchanged from a year earlier. The share of banks rose to 14.3% from 13.9% during the period in review. Meanwhile, foreign investors held 10.5% of LCY government bonds at the end of December 2016.

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	110,682	99.0	Yes	No	No	Housing Finance
2.	NH Investment & Securities	66,000	59.0	Yes	Yes	No	Securities
3.	Mirae Asset Daewoo	58,281	52.1	No	Yes	No	Securities
4.	Korea Investment and Securities	51,350	45.9	No	No	No	Securities
5.	Korea Land & Housing Corporation	44,548	39.8	Yes	No	No	Real Estate
6.	Hana Financial Investment	36,756	32.9	No	No	No	Securities
7.	Mirae Asset Securities	36,206	32.4	No	Yes	No	Securities
8.	Industrial Bank of Korea	35,920	32.1	Yes	Yes	No	Banking
9.	KB Securities	27,169	24.3	No	No	No	Securities
10.	Korea Deposit Insurance Corporation	27,090	24.2	Yes	No	No	Insurance
11.	Korea Electric Power Corporation	22,480	20.1	Yes	Yes	No	Electricity, Energy, and Power
12.	Samsung Securities	21,446	19.2	No	Yes	No	Securities
13.	Korea Expressway	21,370	19.1	Yes	No	No	Transport Infrastructure
14.	Korea Rail Network Authority	19,320	17.3	Yes	No	No	Transport Infrastructure
15.	Shinhan Bank	19,122	17.1	No	No	No	Banking
16.	Woori Bank	18,755	16.8	Yes	Yes	No	Banking
17.	Kookmin Bank	18,146	16.2	No	No	No	Banking
18.	Daishin Securities	17,092	15.3	No	Yes	No	Securities
19.	Korea Gas Corporation	14,469	12.9	Yes	Yes	No	Gas Utility
20.	The Export-Import Bank of Korea	13,360	11.9	Yes	No	No	Banking
21.	NongHyup Bank	12,890	11.5	Yes	No	No	Banking
22.	Small & Medium Business Corporation	12,610	11.3	Yes	No	No	SME Development
23.	KEB Hana Bank	11,710	10.5	No	No	No	Banking
24.	Korea Student Aid Foundation	11,510	10.3	Yes	No	No	Student Loan
25.	Shinhan Card	11,206	10.0	No	No	No	Credit Card
26.	Hyundai Capital Services	10,974	9.8	No	No	No	Consumer Finance
27.	Standard Chartered Bank Korea	10,960	9.8	No	No	No	Banking
28.	Shinyoung Securities	10,956	9.8	No	Yes	No	Securities
29.	Korea Railroad Corporation	10,290	9.2	Yes	No	No	Transport Infrastructure
30.	Korea Water Resources Corporation	9,637	8.6	Yes	No	No	Water
<b>Total Top 30 LCY Corporate Issuers</b>		<b>792,306</b>	<b>708.4</b>				
<b>Total LCY Corporate Bonds</b>		<b>1,222,700</b>	<b>1,093.2</b>				
<b>Top 30 as % of Total LCY Corporate Bonds</b>		<b>64.8%</b>	<b>64.8%</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 2017.

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

3. Corporate bonds include equity-linked securities and derivatives-linked securities.

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

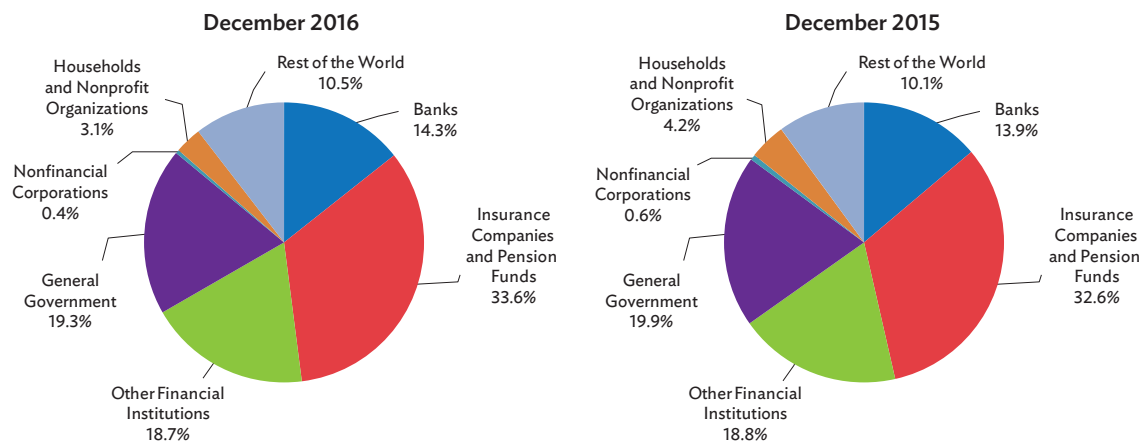
Table 3: Notable Local Currency Corporate Bond Issuance in the First Quarter of 2017

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)	Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
National Agricultural Cooperative Federation			3-year bond	1.94	200
3-year bond	1.81	380	5-year bond	2.10	250
3-year bond	1.80	260	5-year bond	2.06	110
3-year bond	1.95	210	KEB Hana Bank		
3-year bond	1.82	170	2-year bond	1.69	100
3-year bond	1.92	120	2-year bond	1.67	100
5-year bond	1.98	350	2-year bond	1.71	100
5-year bond	2.07	50	2-year bond	1.68	100
7-year bond	2.20	70	2-year bond	1.70	100
10-year bond	2.26	30	2-year bond	1.76	100
Woori Bank			3-year bond	1.81	100
2-year bond	1.70	100	3-year bond	1.80	100
2-year bond	1.71	200	3-year bond	1.82	100
2-year bond	1.73	200	3-year bond	1.82	100
2-year bond	1.70	230	3-year bond	1.81	100
3-year bond	1.82	100	3-year bond	1.83	100
3-year bond	1.85	100	3-year bond	1.83	100
3-year bond	1.85	100	10-year bond	2.81	200

KRW = Korean won.

Source: Based on data from Bloomberg LP.

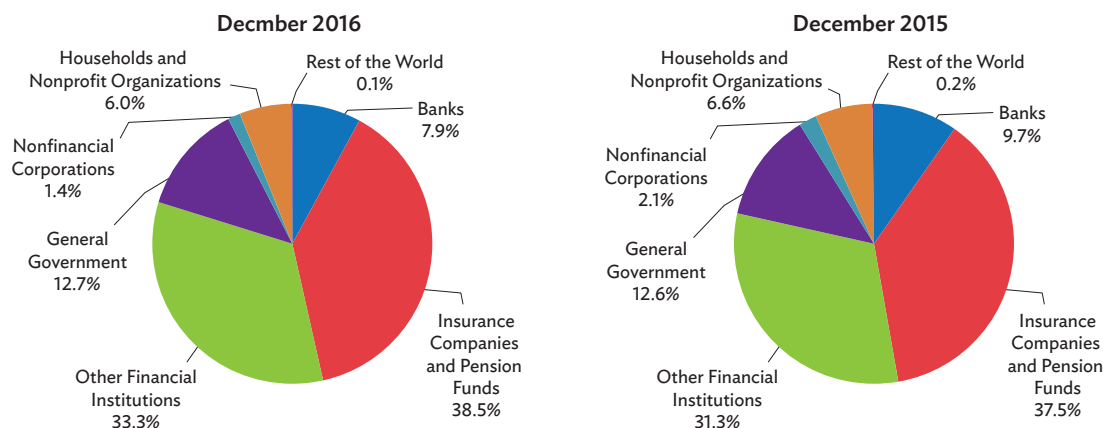
Figure 2: Local Currency Government Bonds Investor Profile



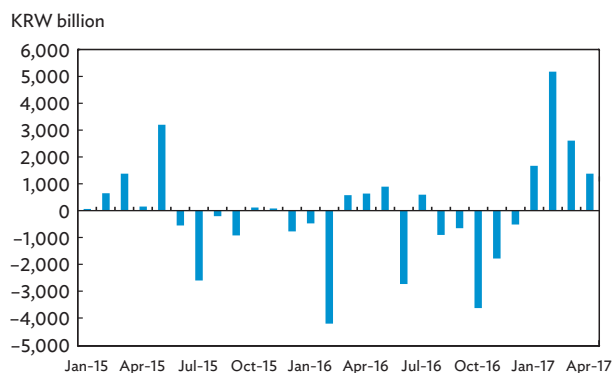
Sources: AsianBondsOnline and the Bank of Korea.

The investor profile of the Republic of Korea's corporate bond market was barely changed at the end of December 2016 compared with a year earlier (Figure 3). Insurance companies and pension funds remained the largest investor group with a share of 38.5%, up from 37.5% in December 2015. Other financial institutions were the second largest group, accounting for a third of total holdings. The share of foreign investors in the Republic of Korea's corporate bond market remained negligible.

Net foreign investments in the Republic of Korea's local currency bond market surged in the first 4 months of 2017 following net investment outflows in most of 2016 (Figure 4). Net foreign investments amounted to KRW1,665 billion in January and reached a peak of KRW5,186 billion in February before easing to KRW2,607 billion in March and further to KRW1,375 billion in April.

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


Sources: AsianBondsOnline and the Bank of Korea.

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


KRW = Korean won.  
Source: Financial Supervisory Service.

Foreign funds returned to the region at the start of the year as the market stabilized following volatility posed by the unexpected outcome of the US presidential election in November. The high demand was partly due to the market taking advantage of the appreciation of the won, which strengthened 5.7% against the US dollar to KRW1,138 at the end of April from KRW1,206 at the end of December 2016.

## Policy, Institutional, and Regulatory Developments

### Financial Services Commission Announces New Approach to Corporate Restructuring

On 13 April, the Financial Services Commission announced a new approach to corporate restructuring in the Republic of Korea. This is to complement the existing framework and introduce more market-based restructuring schemes where capital market players, particularly private equity funds, will have an active role. The new approach includes a review and revision of banks' existing credit-risk evaluation models and frameworks. Companies that are included under a workout program are to be reevaluated and a more appropriate plan will be considered. This may be a continuation of the workout program or a buyout plan by private equity funds. A public-private joint fund worth KRW8 trillion will also be raised over the next 5 years. State-run banks will provide KRW4 billion and the remaining half will be funded by the private sector. The fund is intended to provide sufficient liquidity in the corporate bond market and encourage more private investments in corporate restructuring.