

## Republic of Korea

### Yield Movements

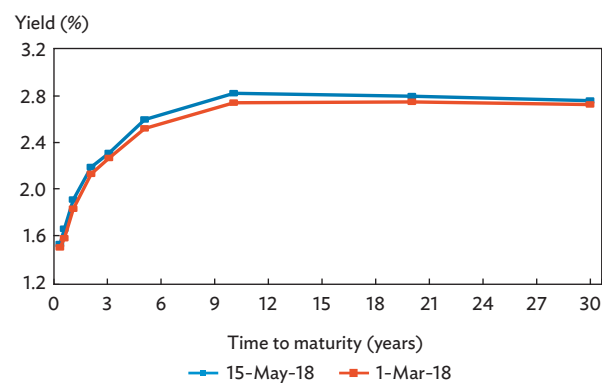
Between 1 March and 15 May, local currency (LCY) government bond yields in the Republic of Korea rose for all tenors, albeit marginally (**Figure 1**). The rise was most pronounced for tenors from 6 months to 10 years, which increased 7 basis points (bps) on average. Meanwhile, the yield for the 3-month tenor rose 3 bps, while those of the 20-year and 30-year tenors rose 5 bps and 3 bps, respectively. The spread between the 2-year and 10-year yields was barely changed from 60 bps on 1 March to 63 bps on 15 May.

Yields in the middle to longer-end of the curve showed a downward trend from 1 March through the middle of April as geopolitical tensions eased. The market expected the Bank of Korea to leave its policy rate unchanged in its 12 April monetary policy meeting on concerns of slowing growth and following a rate hike in its November meeting.

A gradual rise in yields was observed from the middle of April, reversing the earlier downward trend. Upward pressure on yields stemmed from the sustained rise in United States (US) interest rates, particularly after the release of the minutes of the March US Federal Reserve meeting that signaled the possibility of accelerated rate hikes in 2018. Moreover, uncertainty over the possibility and timing of a rate hike by the Bank of Korea remain. In its April monetary policy meeting, the central bank maintained its growth forecast but noted domestic and external risks. The central bank also lowered its inflation forecast from its January forecasts. Despite these developments, some market participants are still pricing in a rate hike this year that would narrow the interest rate differential as US interest rates have surpassed domestic yields.

In its monetary policy board meetings on 14 April and 24 May, the Bank of Korea left its key policy rate, the base rate, unchanged at 1.50%. The central bank stated that the domestic economy continued to post solid growth that is supported by consumption and improved exports. The growth is expected to be sustained as forecasts are still

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



Source: Based on data from Bloomberg LP.

in line with projections made in April of 3.0% growth in full-year 2018. Inflation is also expected to remain benign, but will pick up and trend upward to the target level of 1.6% y-o-y in the second half of 2018. The Bank of Korea stated that it will maintain its accommodative monetary policy stance given benign demand-side inflationary pressures and solid economic growth. However, it will continue to monitor changes in monetary policies in (and trade relations with) advanced economies, rising household debt, and geopolitical risks.

The Republic of Korea's real gross domestic product grew 2.8% year-on-year (y-o-y) in the first quarter (Q1) of 2018, according to the preliminary estimates of the Bank of Korea, the same growth posted in the fourth quarter (Q4) of 2017. By type of expenditure, final consumption expenditure led the growth, rising 4.0% y-o-y in Q1 2018. Exports also improved in Q1 2018 reversing a decline in the previous quarter. Meanwhile, gross fixed capital formation posted a slower increase in Q1 2018. On a quarter-on-quarter (q-o-q) basis, the Republic of Korea's economy expanded 1.0% in Q1 2018, reversing the 0.2% q-o-q contraction posted in Q4 2017.

Consumer price inflation in the Republic of Korea remained subdued in Q1 2018 with a quarterly average of 1.2% y-o-y, down from an average of 1.5% y-o-y in

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2017		Q4 2017		Q1 2018		Q1 2017		Q1 2018	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>2,094,915</b>	<b>1,873</b>	<b>2,155,898</b>	<b>2,020</b>	<b>2,186,525</b>	<b>2,056</b>	<b>1.4</b>	<b>2.5</b>	<b>1.4</b>	<b>4.4</b>
Government	872,215	780	882,781	827	915,090	860	2.9	3.9	3.7	4.9
Central Government Bonds	533,303	477	546,715	512	568,774	535	3.2	6.4	4.0	6.7
Central Bank Bonds	174,860	156	170,860	160	174,790	164	3.8	(3.6)	2.3	(0.04)
Others	164,052	147	165,205	155	171,526	161	1.1	4.5	3.8	4.6
Corporate	1,222,700	1,093	1,273,117	1,193	1,271,435	1,195	0.3	1.5	(0.1)	4.0

( ) = 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.

Q4 2017. Inflation slightly picked up in April to 1.6% y-o-y from 1.3% y-o-y in March due to higher food prices.

## Size and Composition

The Republic of Korea's LCY bond market grew 1.4% q-o-q in Q1 2018 to reach an outstanding size of KRW2,187 trillion (USD2,056 billion) at the end of March (**Table 1**). The quarterly growth was solely driven by the Republic of Korea's government bond market as the stock of corporate bonds fell.

**Government bonds.** The Republic of Korea's LCY government bond market posted robust growth of 3.7% q-o-q in Q1 2018 with outstanding bonds amounting to KRW915 trillion at the end of March. Positive growth rates were registered across all securities issued by government entities, led by the rise in the stock of central government bonds, which were up 4.0% q-o-q to KRW569 trillion as issuance of Korea Treasury Bonds rose during the quarter. The Republic of Korea again implemented a frontloading policy in 2018, resulting in relatively high issuance volume in Q1 2018. The stock of central bank bonds and other government bonds issued by government-related entities also rose in Q1 2018.

Issuance of government bonds surged 24.9% q-o-q to KRW88 trillion in Q1 2018, largely driven by the 37.2% q-o-q jump in issuance of central government bonds as a result of the aforementioned frontloading policy and a low base in Q4 2017. Issuance volume in

Q4 2017 was tepid as the government had already met its annual funding requirement in previous quarters. Issuance of Monetary Stabilization Bonds by the Bank of Korea also posted a high growth rate of 13.0% q-o-q.

**Corporate bonds.** The outstanding amount of LCY corporate dipped slightly in Q1 2018, falling 0.1% q-o-q to KRW1,271 trillion at the end of March due to the higher volume of maturities relative to new issuance. **Table 2** lists the top 30 LCY corporate bond issuers in the Republic of Korea at the end of March. Their aggregate bonds of KRW811 trillion comprised 64% of the total LCY corporate bond market. Financial companies such as banks and securities and investment firms continued to dominate the top 30 list in the Republic of Korea. Korea Housing Finance Corporation, a government-related company that provides financial assistance for social housing, remained the largest issuer with outstanding bonds of KRW118 trillion.

Issuance of corporate bonds fell 7.0% q-o-q in Q1 2018 to KRW104 trillion as rising interest rates made it costly for companies to raise funds via the bond market.

**Table 3** lists the notable corporate bond issuances in Q1 2018. LG Chemical led all issuers in Q1 2018 with a KRW1.0 trillion multitranch offer comprising KRW300 billion worth of 10-year bonds, KRW270 billion of 7-year bonds, KRW240 billion of 5-year bonds, and KRW190 billion of 3-year bonds. The proceeds are to be invested in the expansion of its production facilities and other financing requirements.

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	117,782	110.7	Yes	No	No	Housing Finance
2.	NH Investment & Securities	65,549	61.6	Yes	Yes	No	Securities
3.	Mirae Asset Daewoo Co.	64,064	60.2	No	Yes	No	Securities
4.	Korea Investment and Securities	53,584	50.4	No	No	No	Securities
5.	Korea Land & Housing Corporation	39,606	37.2	Yes	No	No	Real Estate
6.	Industrial Bank of Korea	39,172	36.8	Yes	Yes	No	Banking
7.	KB Securities	37,957	35.7	No	No	No	Securities
8.	Hana Financial Investment	36,654	34.5	No	No	No	Securities
9.	Samsung Securities	26,849	25.2	No	Yes	No	Securities
10.	Korea Electric Power Corporation	23,680	22.3	Yes	Yes	No	Electricity, Energy, and Power
11.	Shinhan Bank	22,312	21.0	No	No	No	Banking
12.	Kookmin Bank	21,826	20.5	No	No	No	Banking
13.	Korea Expressway	21,620	20.3	Yes	No	No	Transport Infrastructure
14.	Korea Deposit Insurance Corporation	19,930	18.7	Yes	No	No	Insurance
15.	Woori Bank	19,465	18.3	Yes	Yes	No	Banking
16.	Korea Rail Network Authority	19,300	18.1	Yes	No	No	Transport Infrastructure
17.	Mirae Asset Securities	16,506	15.5	No	Yes	No	Securities
18.	KEB Hana Bank	16,380	15.4	No	No	No	Banking
19.	NongHyup Bank	15,650	14.7	Yes	No	No	Banking
20.	The Export-Import Bank of Korea	15,610	14.7	Yes	No	No	Banking
21.	Korea Gas Corporation	13,459	12.7	Yes	Yes	No	Gas Utility
22.	Daishin Securities	13,203	12.4	No	Yes	No	Securities
23.	Shinhan Card	12,147	11.4	No	No	No	Credit Card
24.	Small & Medium Business Corporation	12,143	11.4	Yes	No	No	SME Development
25.	Hyundai Capital Services	11,839	11.1	No	No	No	Consumer Finance
26.	Shinyoung Securities	11,479	10.8	No	Yes	No	Securities
27.	Korea Student Aid Foundation	11,050	10.4	Yes	No	No	Student Loan
28.	KB Kookmin Bank Card	10,841	10.2	No	No	No	Consumer Finance
29.	Standard Chartered Bank Korea	10,750	10.1	No	No	No	Banking
30.	Samsung Card Co. Ltd.	10,668	10.0	No	Yes	No	Consumer Finance
<b>Total Top 30 LCY Corporate Issuers</b>		<b>811,075</b>	<b>763</b>				
<b>Total LCY Corporate Bonds</b>		<b>1,271,435</b>	<b>1,195</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, KRW = Korean won, LCY = local currency, SME = small and medium-sized enterprise, USD = United States dollar.

Notes:

1. Data as of 31 March 2018.

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 2018**

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)	Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
<b>LG Chem</b>			<b>Kookmin Bank</b>		
10-year bond	3.29	300	2-year bond	2.22	300
7-year bond	3.07	270	2-year bond	2.34	210
5-year bond	2.88	240	2-year bond	2.30	110
3-year bond	2.56	190	<b>Hyundai Steel</b>		
<b>Industrial Bank of Korea</b>			7-year bond	3.18	100
2-year bond	2.22	300	5-year bond	2.91	330
2-year bond	2.30	300	3-year bond	2.53	170
<b>NH Investment Securities</b>			<b>SK Hynix Inc</b>		
5-year bond	2.97	350	5-year bond	3.01	300
3-year bond	2.72	300	<b>KCC Corp</b>		
<b>National Agricultural Cooperative</b>			3-year bond	2.68	300
5-year bond	2.75	290	<b>Hana Financial Group</b>		
5-year bond	2.74	250	10-year bond	2.96	280
3-year bond	2.46	100			

KRW = Korean won.

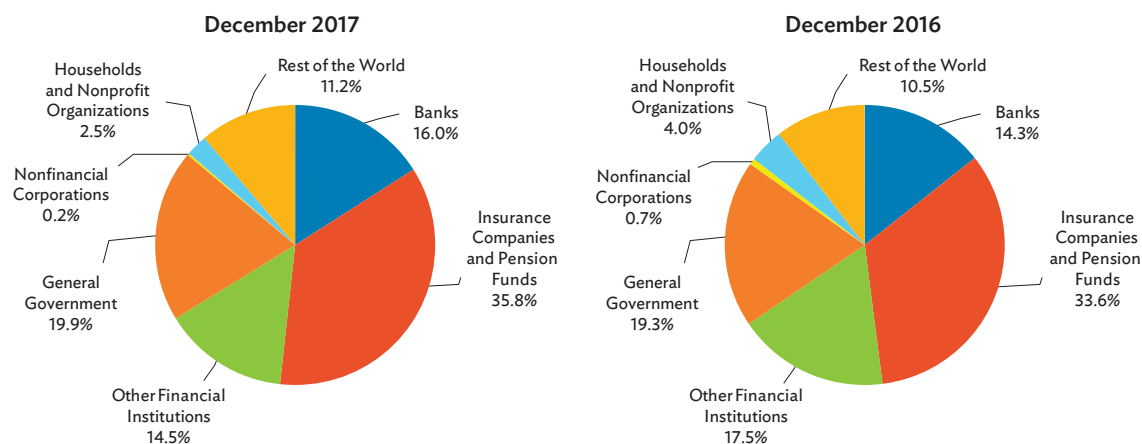
Source: Based on data from Bloomberg LP.

## Investor Profile

The holdings share of insurance companies and pension funds in the Republic of Korea's LCY government bond market rose to 35.8% in December 2017 from 33.6% in December 2016, making it the largest investor group in the LCY government bond market once again (**Figure 2**). The general government was the largest holder with a share of 19.9% in December 2017, up from 19.3% a year earlier. Banks also saw their share rise to 16.0%, while that

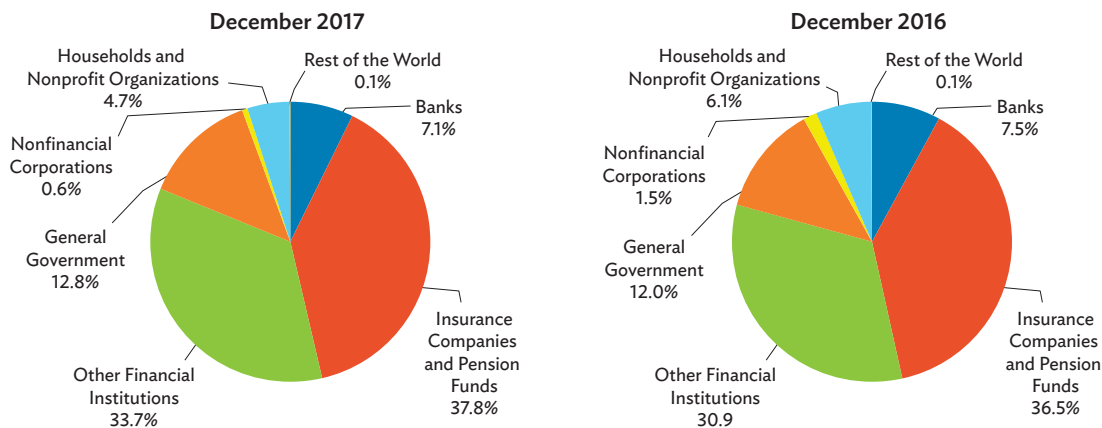
of other financial institutions declined to 14.5%. Foreign holdings of LCY government bonds inched up to 11.2% from 10.5% during the review period.

The holdings share of insurance companies and pension funds in the Republic of Korea's LCY corporate bond market remained the largest among all investor groups in December 2017, rising to 37.8% from 36.5% in December 2016 (**Figure 3**). The shares of other financial institutions and the general government also rose to 33.7% and 12.8%

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


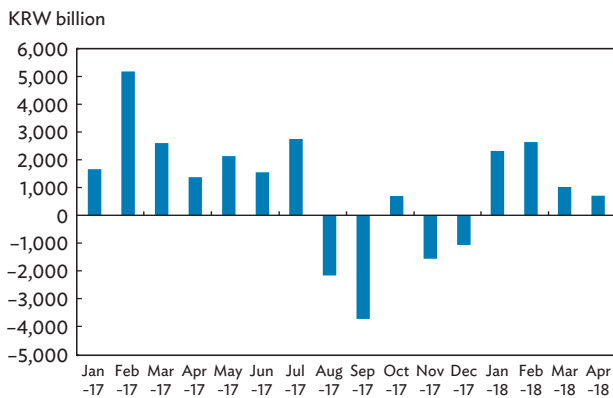
Sources: AsianBondsOnline and the Bank of Korea.

Figure 3: Local Currency Corporate Bonds Investor Profile



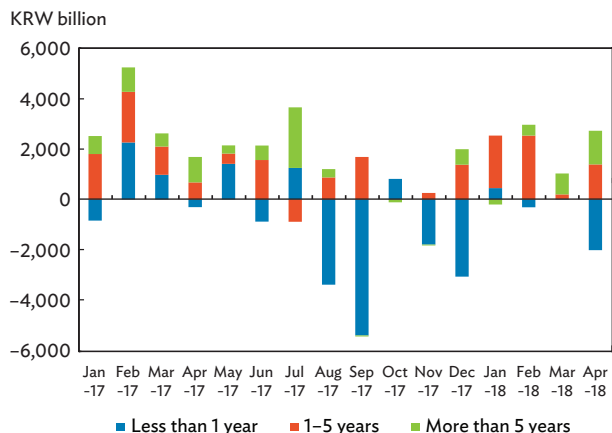
Sources: AsianBondsOnline and the Bank of Korea.

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



KRW = Korean won.  
Source: Financial Supervisory Service.

Figure 5: Net Foreign Investment in Local Currency Bonds in the Republic of Korea, by Tenor



KRW = Korean won.  
Source: Financial Supervisory Service.

from 30.9% and 12.0%, respectively. The share of banks fell to 7.1% from 7.5%. Foreign holdings in the Republic of Korea’s LCY corporate bond market remained negligible.

Net foreign inflows in the Republic of Korea’s LCY bond market rebounded in 2018 following outflows in Q4 2017, particularly in November and December (Figure 4). The net inflows came amid easing geopolitical tensions and a stable currency relative to other economies in the region. January saw net foreign investment inflows of KRW2,322 billion as the large foreign institutional funds that sold their holdings in December, due to portfolio

adjustments, reinvested in the market. Net foreign inflows rose further in February to KRW2,641 billion on easing geopolitical tensions as the potential for talks between the Republic of Korea and the Democratic People’s Republic of Korea started.

Foreign inflows eased in March to KRW1,024 billion, partly due to the anticipated rate hike by the Federal Reserve, and were mostly concentrated in bonds with tenors of more than 5 years (Figure 5). April saw capital outflows from financial markets peaking in the region as US interest rates continued to rise and amid the sustained

strength of the US dollar and the possibility of accelerated rate hikes by the Federal Reserve. However, the Republic of Korea was an exception, seeing net inflows in April, albeit at lower volumes than in previous months, given the relatively stable Korean won resulting from the Republic of Korea's positive economic fundamentals and current account surplus. Net foreign inflows into the Republic of Korea's LCY bond market amounted to KRW708 billion in April.

## Policy, Institutional, and Regulatory Developments

### The Republic of Korea Plans KRW3.9 Trillion Supplementary Budget

In April, the Government of the Republic of Korea drafted a KRW3.9 trillion supplementary budget proposal to fund programs to support young adult employment and the promotion of local economies. Of the total, KRW2.9 trillion has been set aside to focus on raising incomes of young adults by providing funding for their startup businesses and creating new jobs, among other projects. A budget of KRW1.0 trillion will be allotted for programs that will widen support for local enterprises. The government plans to finance the budget with KRW2.6 trillion from 2017 fiscal account surpluses and the remaining KRW1.3 trillion from public fund surpluses.