

## Republic of Korea

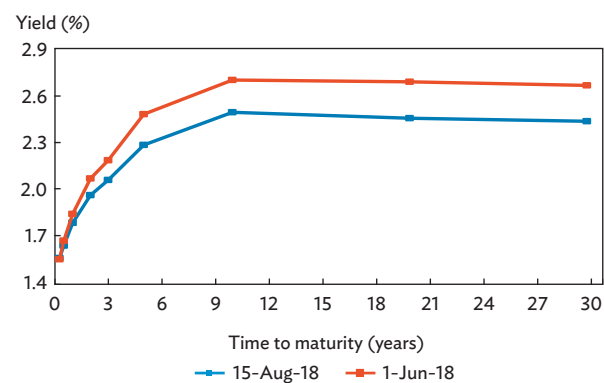
### Yield Movements

Between 1 June and 15 August, local currency (LCY) government bond yields in the Republic of Korea fell for all tenors except the 3-month tenor, which was barely changed (**Figure 1**). The drop was most pronounced at the longer-end of the curve with the 20-year and 30-year bonds falling 23 basis points (bps) each. Yields for tenors of between 2 years and 10 years fell 16 bps on average, while yields for the 6-month and 1-year bonds declined an average of 4 bps. The spread between the 2-year and 10-year yields fell to 53 bps from 63 bps, resulting in a flattening of the yield curve.

Yields fell in the Republic of Korea during the review period due to increased market expectations that the Bank of Korea would not raise its base rate this year; the last rate hike was in November 2017. Recent domestic and global developments have weighed on the Republic of Korea's economic growth prospects, further contributing to speculation that the Bank of Korea will maintain its current monetary policy. These include concerns over recent employment figures as monthly job creation in 2018 has been low relative to previous years. The creation of new jobs has been one of the new administration's main policies to boost economic growth and the program behind the supplementary budget requested and approved this year. The ongoing trade conflict between the People's Republic of China (PRC) and the United States (US) also poses a downside risk as exports have been one of the main drivers of the Republic of Korea's economic growth. Given subdued inflation, the Bank of Korea is expected to maintain an accommodative monetary policy stance.

In its 12 July meeting, the Monetary Policy Board of the Bank of Korea decided to leave its base rate unchanged at 1.50%. The central bank noted continued growth in the global economy and volatility in financial markets caused by rising trade protectionism and the strengthening US dollar. On the domestic front, the economy continues to be supported by consumption and exports, while inflation remains subdued due to the slow pace of price increase for agricultural and livestock products despite rising global oil prices.

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



Source: Based on data from Bloomberg LP.

The Bank of Korea also lowered its gross domestic product growth forecasts for 2018 and 2019 to 2.9% year-on-year (y-o-y) and 2.8% y-o-y, respectively, from April forecasts of 3.0% y-o-y and 2.9% y-o-y. The inflation forecast for 2018 was maintained at 1.6% y-o-y, while for 2019 it was lowered to 1.9% y-o-y from 2.0% y-o-y.

The Republic of Korea's economy grew 2.8% y-o-y in the second quarter (Q2) of 2018, unchanged from the first quarter (Q1) of 2018. Growth was mainly driven by the acceleration in the growth of exports to 4.8% y-o-y in Q2 2018. Meanwhile, consumption posted a slower annual increase of 3.3% y-o-y and gross fixed capital formation contracted 1.3% y-o-y in Q2 2018. On a seasonally adjusted quarter-on-quarter (q-o-q) basis, the Republic of Korea's economy grew 0.6% in Q2 2018, down from the 1.0% growth posted in the prior quarter.

Consumer price inflation in the Republic of Korea remained subdued during the April–July period. Inflation for April was 1.6% y-o-y; it eased to 1.5% y-o-y in May and was unchanged in June and July.

Foreign demand for the Republic of Korea's LCY government bonds remained high during the review period. Recent financial market volatility in major emerging markets has resulted in a flight to quality, making the Republic of Korea's domestic bonds attractive

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2017		Q1 2018		Q2 2018		Q2 2017		Q2 2018	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>2,138,183</b>	<b>1,869</b>	<b>2,186,525</b>	<b>2,056</b>	<b>2,221,054</b>	<b>1,993</b>	<b>2.1</b>	<b>3.6</b>	<b>1.6</b>	<b>3.9</b>
Government	892,171	780	915,090	860	937,267	841	2.3	4.6	2.4	5.1
Central Government Bonds	552,288	483	568,774	535	589,426	529	3.6	6.9	3.6	6.7
Central Bank Bonds	174,810	153	174,790	164	174,630	157	(0.03)	(3.6)	(0.1)	(0.1)
Others	165,073	144	171,526	161	173,211	155	0.6	6.4	1.0	4.9
Corporate	1,246,012	1,089	1,271,435	1,195	1,283,787	1,152	1.9	2.9	1.0	3.0

( ) = negative, KRW = Korean won, LCY = local currency, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second 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.

to foreign investors. Net foreign bond investments in June amounted to KRW2.1 trillion, easing to USD1.4 trillion in July but remaining high.

Recent global trade tensions have put pressure on most currencies in the region, with the Korean won the second most impacted next to the Chinese renminbi. The Korean won, which had been generally stable in the first 5 months of 2018, depreciated 5.1% against the US dollar between 1 June and August 15. The close trade links between the Republic of Korea and the PRC raised concerns over the impact of PRC–US trade tensions on domestic economic growth.

## Size and Composition

The Republic of Korea’s LCY bond market expanded to reach a size of KRW2,221 trillion (USD1,993 billion) at end June on 1.6% q-o-q growth (**Table 1**). The growth was driven by both its government and corporate bond segments.

**Government bonds.** The Republic of Korea’s LCY government bond market rose 2.4% q-o-q in Q2 2018 to reach a size of KRW937 trillion. This was largely driven by the 3.6% q-o-q growth in the stock of its central government bonds. Meanwhile, the outstanding size of Monetary Stabilization Bonds issued by the Bank of Korea slightly fell 0.1% q-o-q in Q2 2018 despite higher issuance for the quarter due to an even larger volume of maturities. Government bonds issued by government-related entities inched up 1.0% q-o-q in Q2 2018.

Issuance of government bonds rose in Q2 2018, up 6.8% q-o-q to KRW94 trillion. The main driver of growth was the issuance of central bank bonds, which rose 11.7% q-o-q. Meanwhile, issuance of central government bonds remained high in Q2 2018, albeit up only 4.6% q-o-q due to a high base in Q1 2018 when the government implemented its frontloading policy. This is in line with the government’s plan to increase borrowing and spending in 2018 to boost growth.

**Corporate bonds.** The Republic of Korea’s LCY corporate bond market inched up 1.0% q-o-q to reach a size of KRW1,284 trillion at the end of June. The marginal growth was due to maturities despite a jump in issuance during the quarter. **Table 2** lists the top 30 LCY corporate bond issuers in the Republic of Korea with aggregate bonds outstanding of KRW814 trillion at the end of June, comprising 63% of the total LCY corporate bond market. Financial institutions, particularly banks and securities and investment firms, continued to comprise a majority of the top 30 LCY corporate bond issuers in the Republic of Korea. Korea Housing Finance Corporation, a government-related institution providing financial assistance for social housing, remained the largest issuer with outstanding bonds of KRW117 trillion.

Issuance of corporate bonds surged 22.0% q-o-q in Q2 2018 to KRW127 trillion. **Table 3** presents notable corporate bond issuances in Q2 2018. Financial firms such as Nonghyup Bank and NH Investment Securities continued to lead corporate bond issuances in the Republic of Korea. Seoul Metro, one of the two major

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	117,202	105.1	Yes	No	No	Housing Finance
2.	Mirae Asset Daewoo Co.	63,778	57.2	No	Yes	No	Securities
3.	NH Investment & Securities	61,646	55.3	Yes	Yes	No	Securities
4.	Korea Investment and Securities	54,389	48.8	No	No	No	Securities
5.	Industrial Bank of Korea	45,370	40.7	Yes	Yes	No	Banking
6.	KB Securities	40,881	36.7	No	No	No	Securities
7.	Hana Financial Investment	37,216	33.4	No	No	No	Securities
8.	Korea Land & Housing Corporation	36,812	33.0	Yes	No	No	Real Estate
9.	Samsung Securities	26,423	23.7	No	Yes	No	Securities
10.	Shinhan Bank	23,503	21.1	No	No	No	Banking
11.	Korea Electric Power Corporation	23,380	21.0	Yes	Yes	No	Electricity, Energy, and Power
12.	Kookmin Bank	21,837	19.6	No	No	No	Banking
13.	Korea Expressway	21,620	19.4	Yes	No	No	Transport Infrastructure
14.	KEB Hana Bank	21,170	19.0	No	No	No	Banking
15.	Korea Deposit Insurance Corporation	19,430	17.4	Yes	No	No	Insurance
16.	Korea Rail Network Authority	19,150	17.2	Yes	No	No	Transport Infrastructure
17.	Woori Bank	17,940	16.1	Yes	Yes	No	Banking
18.	The Export-Import Bank of Korea	15,240	13.7	Yes	No	No	Banking
19.	NongHyup Bank	14,680	13.2	Yes	No	No	Banking
20.	Korea Gas Corporation	13,299	11.9	Yes	Yes	No	Gas Utility
21.	Mirae Asset Securities	13,071	11.7	No	Yes	No	Securities
22.	Shinhan Card	12,980	11.6	No	No	No	Credit Card
23.	Shinyoung Securities	12,447	11.2	No	Yes	No	Securities
24.	Small & Medium Business Corporation	12,373	11.1	Yes	No	No	SME Development
25.	Hyundai Capital Services	12,231	11.0	No	No	No	Consumer Finance
26.	Daishin Securities	11,970	10.7	No	Yes	No	Securities
27.	KB Kookmin Bank Card	11,278	10.1	No	No	No	Consumer Finance
28.	Samsung Card Co. Ltd.	10,878	9.8	No	Yes	No	Consumer Finance
29.	Korea Student Aid Foundation	10,810	9.7	Yes	No	No	Student Loan
30.	Nonghyup	10,600	9.5	Yes	No	No	Banking
<b>Total Top 30 LCY Corporate Issuers</b>		<b>813,603</b>	<b>730</b>				
<b>Total LCY Corporate Bonds</b>		<b>1,283,787</b>	<b>1,152</b>				
<b>Top 30 as % of Total LCY Corporate Bonds</b>		<b>63.4%</b>	<b>63.4%</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 30 June 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.

operators of the Seoul Metropolitan Subway, issued a KRW350 5-year bond. Lotte Shopping also issued KRW310 billion worth of 5-year bonds.

**Table 3: Notable Local Currency Corporate Bond Issuance in the Second Quarter of 2018**

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Nonghyup Bank		
2-year bond	2.29	700
3-year bond	2.40	300
10-year bond	3.39	150
NH Investment Securities		
5-year bond	2.97	350
3-year bond	2.72	300
Seoul Metro		
5-year bond	2.68	350
Lotte Shopping		
5-year bond	2.96	310
Korea Rural Community and Agricultural Corp.		
3-year bond	2.35	300
KEB Hana Bank		
10-year bond	3.32	300
Kookmin Bank		
10-year bond	3.31	250

KRW = Korean won.

Source: Based on data from Bloomberg LP.

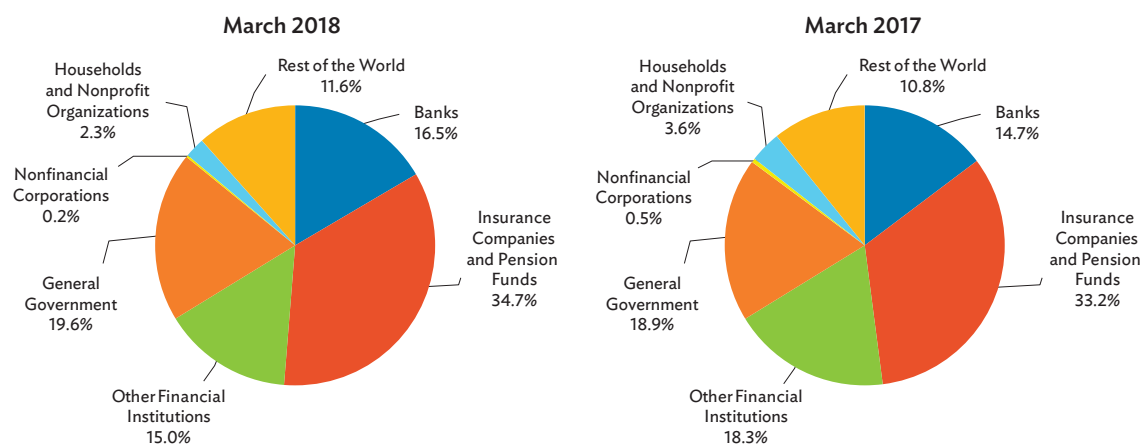
## Investor Profile

Insurance companies and pension funds remained the top holders of the Republic of Korea's LCY government bonds with a market share of 34.7% at the end of March, up from 33.2% a year earlier (**Figure 2**). The general government was second with a share of 19.6%, slightly higher than the 18.9% share in March 2017. The share of banks increased to 16.5% at the end of March from 14.7% a year earlier. Meanwhile, the share of other institutions and households fell on a y-o-y basis at the end of March, while foreign holdings of LCY government bonds inched up to 11.6% from 10.8%.

In the Republic of Korea's LCY corporate bond market, insurance companies and pension funds held the largest share at 38.5% at the end of March, up from 35.8% a year earlier (**Figure 3**). The share of other nonbank financial institutions rose to 33.2% from 31.2% during the review period. The shares of the general government and banks were almost unchanged at 12.8% and 6.8%, respectively. Foreign holdings of the Republic of Korea's LCY corporate bond market remained negligible.

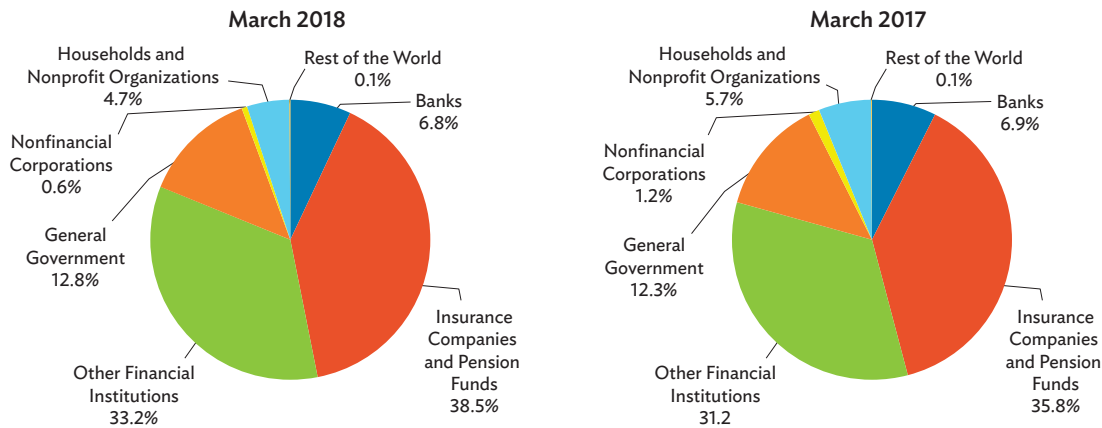
Net foreign inflows into the Republic of Korea's LCY bond market remained high during the May–July period (**Figure 4**). Following an easing to KRW708 billion in April, partly due to the steep rise in US interest rates

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



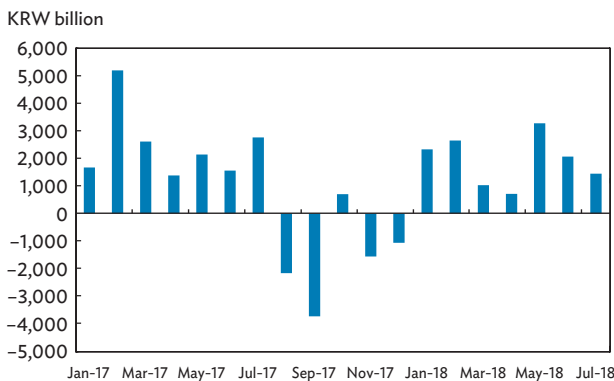
Sources: AsianBondsOnline and the Bank of Korea.

**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.

and the strengthening of the US dollar, foreign inflows rebounded to KRW3.3 trillion in May. This was the highest monthly total posted in 2018 as geopolitical tensions eased, which was coupled with a stable Korean won relative to other currencies in the region. Foreign inflows remained high in June and July, but slightly eased to KRW2.1 trillion and KRW1.5 trillion, respectively, due to the trade spat between the PRC and the US. Despite this, the Republic of Korea is still deemed a safe haven in the region, particularly as other economies in the region

continue to experience weakening domestic currencies and capital outflows.

## Policy and Regulatory Developments

### Ministry of Economy and Finance Announces Economic Policies for Second Half of 2018

In July, the Ministry of Economy and Finance (MEF) released its assessment of economic policies implemented in the first half of 2018 and the planned program for the second half. The MEF reiterated its focus on consumption as a driver of growth through improved employment, wages, and innovation. For the first half of the year, the MEF described positive trends in exports and consumption, but noted risks such as the trade conflict between the PRC and the US, rising oil prices, and financial market volatility in some emerging markets. Employment growth has been slowing in major industries amid a decline in the working-age population. Improvements are expected in the second half of the year with the implementation of the supplementary budget. For the remainder of the year, policies will continue to focus on creating new jobs and improving (and working on passage of) new regulations promoting innovation. To continue with an expansionary fiscal policy, the government will increase spending by around KRW4 trillion.