

Republic of Korea

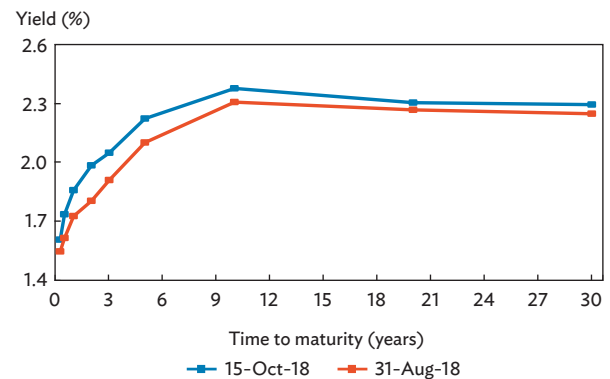
Yield Movements

Between 31 August and 15 October, local currency government (LCY) bond yields in the Republic of Korea rose for all tenors, averaging an increase of 10 basis points (bps) (**Figure 1**). The rise in yields was most pronounced for tenors from 6 months to 5 years, which increased an average of 14 bps, and for the 2-year tenor, which posted the biggest yield gain at 18 bps. For the 3-month tenor and for tenors of 10 years and longer, yields rose an average of 5 bps. The spread between the 2-year and 10-year yields fell to 40 bps from 51 bps during the review period, further flattening the Republic of Korea's yield curve.

The rise in yields toward the end of the review period, on expectations of a policy rate hike by the Bank of Korea, reversed the downward trend in place since May. Yields had fallen since May as the market no longer expected the Bank of Korea to change its monetary policy stance given the possibility of an economic slowdown and subdued inflation. However, a statement by the Prime Minister on 12 September on the possibility of a rate hike reversed this trend. Yields rose further in early October due to the sharp rise in United States (US) Treasury yields following the release of US economic data supporting the likelihood of another Federal Reserve rate hike in December. A statement by the Bank of Korea governor in early October also hinted at a policy rate hike before the year ends. The statement noted the need to address financial imbalances, particularly the continued rise in household debt and housing prices.

At its monetary policy meeting on 18 October, the Bank of Korea decided to leave its base rate unchanged at 1.50%, noting that domestic economic growth would be sustained at its potential level, supported by consumption and exports. However, growth is expected to fall below the July forecasts, albeit remaining within its potential level, due to a slowdown in investments. In line with this, the Bank of Korea lowered its gross domestic product (GDP) growth forecasts for both 2018 and 2019 to 2.7% year-on-year (y-o-y) from July GDP forecasts of 2.9% y-o-y and 2.8% y-o-y, respectively.

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



Source: Based on data from Bloomberg LP.

The Republic of Korea's economic growth eased to 2.0% y-o-y in the third quarter (Q3) of 2018 from the 2.8% y-o-y growth posted in the second quarter (Q2), based on advance estimates from the Bank of Korea. By type of expenditure, the slower GDP growth was driven by the accelerated decline in gross fixed capital formation of -6.5% y-o-y in Q3 2018 versus -1.3% y-o-y in the previous quarter. Export growth also slowed to 3.1% y-o-y from 4.8% y-o-y in Q2 2018. Private and government consumption expenditures also posted slower annual increases in Q3 2018. On a quarter-on-quarter (q-o-q) basis, the Republic of Korea's economy expanded 0.6% in Q3 2018, unchanged from Q2 2018.

Inflation has been at the mid-1% level, with July and August inflation at 1.5% y-o-y and 1.4% y-o-y, respectively. A slight uptick to 1.9% y-o-y was registered in September. The Bank of Korea expects inflation to remain range-bound and maintained its 2018 forecast at 1.6% y-o-y, while lowering the 2019 forecast to 1.7% y-o-y from 1.9% y-o-y.

Strong net foreign investment inflows into the Republic of Korea's LCY government bond market continued in Q3 2018 with net inflows rising to KRW2.4 trillion in August from KRW1.4 trillion in July. The Republic of Korea remained an attractive investment destination given its relative economic stability and healthy external balance

position. However, outflows of KRW1.9 trillion were registered in September due to maturities, the rate hike by the Federal Reserve, and concerns over risks to economic growth brought about by global trade disputes.

The ongoing trade tensions between the PRC and the US continued to weigh on the Korean won. The recent slump in US equities spread to the region as well, further contributing to the depreciation of the domestic currency. The Korean won fell 1.9% between 31 August and 15 October, and was the second-worst performing currency in the region during the review period.

Size and Composition

The Republic of Korea's LCY bond market size was barely changed in Q3 2018, marginally up 0.1% q-o-q to KRW2,224 trillion (USD2.0 trillion) at the end of September from KRW2,221 trillion at the end of June (**Table 1**). The minimal growth was solely driven by the corporate bond segment, which posted an increase of 0.9% q-o-q, while the government bond market declined 0.9% q-o-q.

Government bonds. The outstanding size of the Republic of Korea's LCY government bond market declined 0.9% q-o-q in Q3 2018 to KRW928 trillion due to lower issuance volume and large maturities of Korea Treasury Bonds. The stock of central bank bonds issued by the Bank of Korea was barely changed at KRW175 trillion in Q3 2018. Meanwhile, government bonds issued by government-related entities inched up 0.9% q-o-q.

Issuance of government bonds fell 10.6% q-o-q in Q3 2018 to KRW84 trillion. The government issued a smaller volume of central government bonds in Q3 2018, with issuance declining 15.8% q-o-q in line with the government's frontloading policy. The volume of Monetary Stabilization Bonds issued by the Bank of Korea also fell 15.1% q-o-q in Q3 2018.

Foreign Exchange Stabilization Bonds. The Republic of Korea issued USD1.0 billion worth of Foreign Exchange Stabilization Bonds on 14 September. These bonds are issued to promote foreign exchange market stability; the resulting rates will also serve as a guide for prospective companies planning to issue bonds offshore. The issue comprised USD500 million worth of 10-year bonds priced at 3.572% (a 60-bps spread over the 10-year US Treasury), and USD500 million worth of 30-year bonds priced at 3.875% and with a yield of 3.957% (an 85-bps spread over the 30-year US Treasury).

Corporate bonds. The Republic of Korea's LCY corporate bond market continued to post marginal growth in Q3 2018, inching up 0.9% q-o-q to KRW1.3 trillion at the end of September. **Table 2** lists the top 30 LCY corporate bond issuers, with aggregate bonds outstanding of KRW829 trillion at the end of September, accounting for 64% of the total LCY corporate bond market. Financial institutions—such as banks, securities, and investment firms—continued to dominate the list. Korea Housing Finance Corporation, a government-related institution providing financial assistance for social housing,

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2017		Q2 2018		Q3 2018		Q3 2017		Q3 2018	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	2,145,667	1,873	2,221,054	1,993	2,224,067	2,005	0.3	3.3	0.1	3.7
Government	880,399	769	937,267	841	928,477	837	(1.3)	2.9	(0.9)	5.5
Central Government Bonds	549,308	480	589,426	529	579,104	522	(0.5)	6.2	(1.8)	5.4
Central Bank Bonds	166,060	145	174,630	157	174,600	157	(5.0)	(7.6)	(0.02)	5.1
Others	165,030	144	173,211	155	174,773	158	(0.03)	3.9	0.9	5.9
Corporate	1,265,268	1,105	1,283,787	1,152	1,295,590	1,168	1.5	3.6	0.9	2.4

() = negative, KRW = Korean won, LCY = local currency, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third quarter, USD = United States dollar, y-o-y = year-on-year.

Notes:

1. Q3 2018 data for "Others" based on *AsianBondsOnline* estimates. "Others" comprise Korea Development Bank Bonds, National Housing Bonds, and Seoul Metro Bonds.

2. Calculated using data from national sources.

3. Bloomberg LP end-of-period LCY-USD rates are used.

4. Growth rates are calculated from local currency (LCY) base and do not include currency effects.

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

Sources: The Bank of Korea and *EDAILY BondWeb*.

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	117,359	105.8	Yes	No	No	Housing Finance
2.	Mirae Asset Daewoo Co.	64,934	58.5	No	Yes	No	Securities
3.	NH Investment & Securities	60,693	54.7	Yes	Yes	No	Securities
4.	Korea Investment and Securities	55,630	50.1	No	No	No	Securities
5.	Industrial Bank of Korea	49,190	44.3	Yes	Yes	No	Banking
6.	KB Securities	43,124	38.9	No	No	No	Securities
7.	Hana Financial Investment	38,240	34.5	No	No	No	Securities
8.	Korea Land & Housing Corporation	34,412	31.0	Yes	No	No	Real Estate
9.	Samsung Securities	26,924	24.3	No	Yes	No	Securities
10.	Shinhan Bank	26,292	23.7	No	No	No	Banking
11.	Korea Electric Power Corporation	25,210	22.7	Yes	Yes	No	Electricity, Energy, and Power
12.	Kookmin Bank	22,916	20.7	No	No	No	Banking
13.	Korea Expressway	22,050	19.9	Yes	No	No	Transport Infrastructure
14.	KEB Hana Bank	21,850	19.7	No	No	No	Banking
15.	Woori Bank	19,810	17.9	Yes	Yes	No	Banking
16.	Korea Rail Network Authority	19,650	17.7	Yes	No	No	Transport Infrastructure
17.	Korea Deposit Insurance Corporation	18,790	16.9	Yes	No	No	Insurance
18.	The Export-Import Bank of Korea	16,185	14.6	Yes	No	No	Banking
19.	NongHyup Bank	13,830	12.5	Yes	No	No	Banking
20.	Shinhan Card	13,610	12.3	No	No	No	Credit Card
21.	Hyundai Capital Services	13,301	12.0	No	No	No	Consumer Finance
22.	Small & Medium Business Corporation	13,163	11.9	Yes	No	No	SME Development
23.	Shinyoung Securities	12,486	11.3	No	Yes	No	Securities
24.	Korea Gas Corporation	12,449	11.2	Yes	Yes	No	Gas Utility
25.	KB Kookmin Bank Card	11,713	10.6	No	No	No	Consumer Finance
26.	Standard Chartered Bank Korea	11,200	10.1	No	No	No	Banking
27.	Daishin Securities	11,017	9.9	No	Yes	No	Securities
28.	Korea Student Aid Foundation	10,950	9.9	Yes	No	No	Student Loan
29.	Samsung Card Co. Ltd.	10,808	9.7	No	Yes	No	Consumer Finance
30.	Nonghyup	10,720	9.7	Yes	No	No	Banking
Total Top 30 LCY Corporate Issuers		828,508	747				
Total LCY Corporate Bonds		1,295,590	1,168				
Top 30 as % of Total LCY Corporate Bonds		63.9%	63.9%				

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 September 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.

remained the largest issuer with outstanding bonds of KRW117 trillion.

Issuance of corporate bonds slumped 20.0% q-o-q in Q3 2018 to KRW101 trillion as companies remained on the sidelines given uncertainty in the direction of yield movements. **Table 3** lists the notable corporate bond issuances in Q3 2018. Banks such as the Industrial Bank of Korea, Shinhan Bank, and Kookmin Bank continued to be the top issuers during the quarter.

Investor Profile

Insurance companies and pension funds again had the largest share of the Republic of Korea's LCY government bonds at the end of Q2 2018, with the share rising to 34.7% at the end of June from 33.2% in June 2017 (**Figure 2**). The general government was next with a share at the end of June almost at par with a year earlier (19.4% versus 19.1%). Banks held 16.6% of government bonds at the end of June, up from 15.0% and surpassing the share of other financial institutions, which declined to 14.7% from 18.1%. Foreign holdings of the Republic of Korea's LCY government bonds rose to 12.0% of the total at the end of June from 10.9% in June 2017 on strong net foreign inflows.

Insurance companies and pension funds, and other financial institutions, remained the two largest holders of the Republic of Korea's LCY corporate bonds, with shares

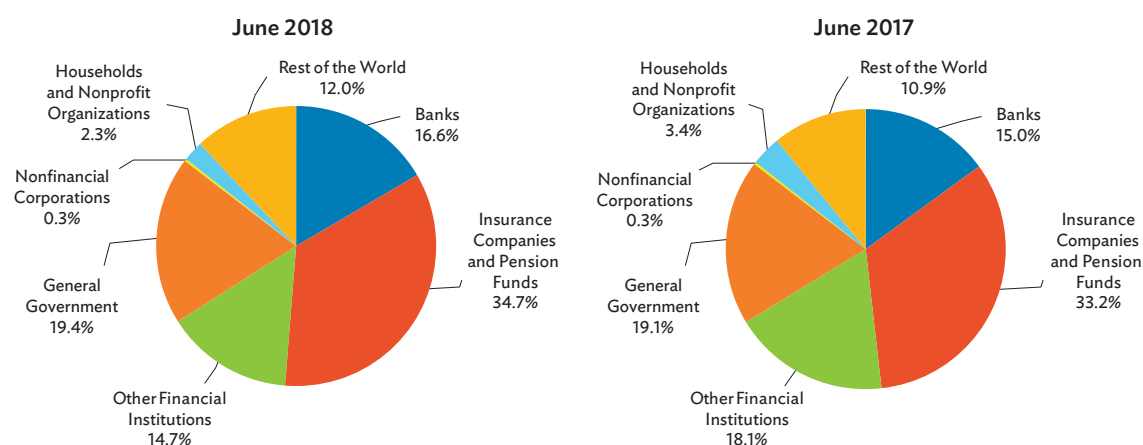
Table 3: Notable Local Currency Corporate Bond Issuance in the Third Quarter of 2018

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Industrial Bank of Korea		
3-year bond	2.06	300
3-year bond	2.05	300
3-year bond	2.17	200
10-year bond	2.74	600
Shinhan Bank		
1.5-year bond	2.01	150
2-year bond	2.01	250
2-year bond	2.09	200
2-year bond	2.10	150
3-year bond	2.09	200
3-year bond	2.15	200
Kookmin Bank		
2-year bond	2.19	230
2-year bond	2.17	120
3-year bond	2.23	200
3-year bond	2.28	200

KRW = Korean won.
Source: Based on data from Bloomberg LP.

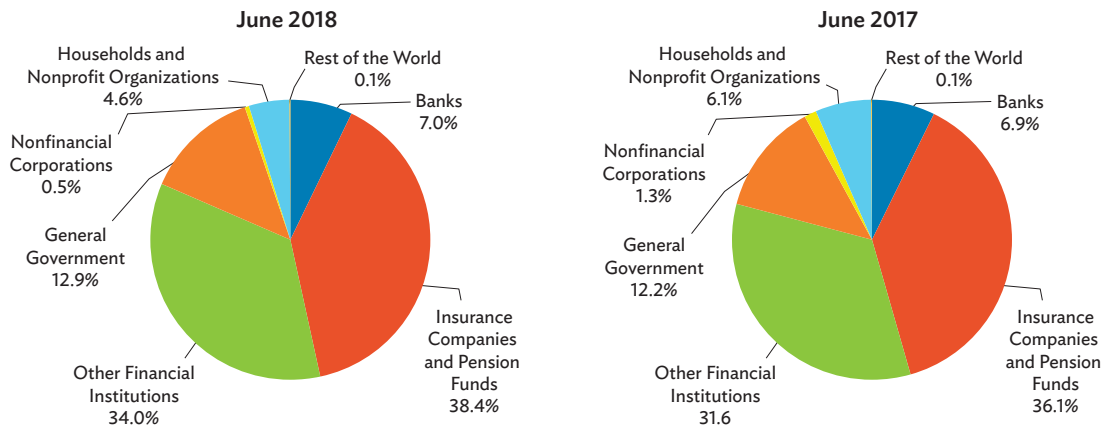
rising to 38.4% and 34.0%, respectively, at the end of June from 36.1% and 31.6% in June 2017 (**Figure 3**). The shares of the general government and banks were almost at par from a year earlier at 12.9% and 7.0%, respectively. The share of foreign investors remained negligible at 0.1%.

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.

Net foreign inflows into the Republic of Korea’s LCY bond market rose to KRW2.4 trillion in August from KRW1.4 trillion in July. However, September saw monthly outflows amounting to KRW1.9 trillion (Figure 4). This was partly due to the large volume of maturing government bonds. Foreign demand eased as the Federal

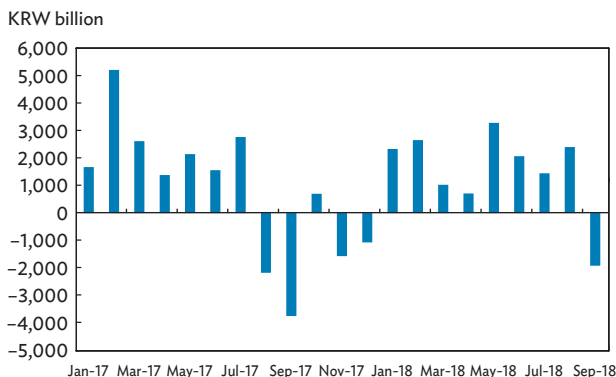
Reserve rate hike in September exacerbated the widening interest rate differential between LCY bond yields and US Treasury yields. The ongoing trade disputes between the PRC and the US also weighed on foreign demand.

Policy and Regulatory Developments

Government Announces Measures to Promote Investment and Boost Employment

In October, the Government of the Republic of Korea announced measures to promote investment and boost employment, noting the slowdown in growth as investment and employment continued to be weak. To help economic growth regain momentum, the government plans to promote private sector investment, increase public investment, pursue innovation-driven growth, and support the job market. Measures include the allotment of KRW2.3 trillion in the first quarter of 2019 to projects that have been delayed due to financial and regulatory challenges. A total of KRW15.0 trillion worth of facility investment support programs will be launched within the year. The government will also pursue the development of new markets such as remote health-care services and the sharing economy.

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



KRW = Korean won.
Source: Financial Supervisory Service.