

## Republic of Korea

### Yield Movements

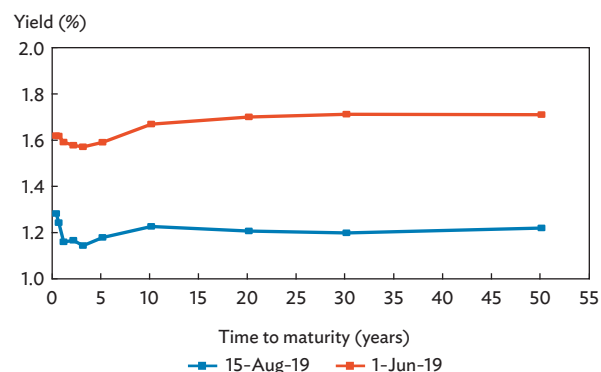
Between 1 June and 15 August, local currency (LCY) government bond yields in the Republic of Korea fell for all tenors (**Figure 1**). The decline in yields was more pronounced at the longer end of the curve, with tenors of 20, 30, and 50 years falling an average of 50 basis points (bps). For securities with tenors of between 1 year and 10 years, yields fell 43 bps on average. Meanwhile, yields for the 3-month and 6-month tenors fell 34 bps and 38 bps, respectively, resulting in a slight inversion of the Republic of Korea's yield curve. The yield spread between the 2-year and 10-year tenors slightly fell to 6 bps from 9 bps.

Yields fell during the review period due to heightened expectations of a rate cut by the Bank of Korea in its July monetary policy meeting and further rate cuts before the year ends. This sentiment was driven by developments both domestically and in major economies, particularly the United States (US). On the domestic front, low levels of inflation, and the quarter-on-quarter (q-o-q) contraction in gross domestic product (GDP) growth in the first quarter (Q1) 2019 contributed to monetary easing by the Bank of Korea. The recent imposition of trade restrictions by Japan on the Republic of Korea's exports also contributed to the decline in yields. Tensions between the two economies pose an additional downside risk to domestic economic growth and could lead to a further deterioration in export performance.

Developments in major economies have contributed to the downward trend in yields. These include the rate cut by the US Federal Reserve in its July meeting and uncertainty over US monetary policy direction. The ongoing trade tensions between the US and the People's Republic of China (PRC), weaker global economic growth outlook, and dovish stances among central banks in developed markets continue to drive down yields in the Republic of Korea.

At its monetary policy meeting on 18 July, the Bank of Korea decided to cut its base rate by 25 bps to 1.50%, the first cut since 2016. The central bank noted that domestic economic growth eased and inflation remained low. Moreover, the Bank of Korea lowered its

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



Source: Based on data from Bloomberg LP.

GDP growth forecasts for 2019 and 2020 to 2.2% year-on-year (y-o-y) and 2.5% y-o-y, respectively, from April forecasts of 2.5% y-o-y and 2.6% y-o-y. Inflation forecasts for 2019 and 2020 were also lowered to 0.7% y-o-y and 1.3% y-o-y from 1.1% y-o-y and 1.6%, respectively.

The Republic of Korea's real GDP growth rose to 2.0% y-o-y in the second quarter (Q2) of 2019 from 1.7% y-o-y in Q1, based on estimates from the Bank of Korea. By type of expenditure, the faster GDP growth in Q2 2019 was primarily driven by higher growth rates in private and government consumption expenditure and a rebound in exports. On a q-o-q basis, the economy grew 1.0% in Q2 2019 following a 0.4% contraction in Q1 2019. Meanwhile, inflation remained subdued in Q2 2019 at a monthly average of 0.7% y-o-y before easing to 0.6% y-o-y in July.

The Republic of Korea's LCY government bond market witnessed a surge in net foreign bond inflows in May and June on expectations of a rate cut by the central bank and the resulting capital gains due to declining yields. However, foreign bond flows eased and reversed to marginal outflows in July following the rate cut on 18 July.

The Korean won was the worst-performing currency in the region during the review period, depreciating 2.0% and breaching the KRW1,200 per US dollar level

in August. The continued weakening of the Korean won reflects the vulnerability of the Republic of Korea to external factors. These include the impact of the ongoing trade disputes between the PRC and the US given that both are major trading partners of the Republic of Korea. Recent trade restrictions imposed by Japan also led to the further weakening of the Korean won.

## Size and Composition

The size of the Republic of Korea's LCY bond market rose 2.4% q-o-q to KRW2,332 trillion (USD2 trillion) at the end of June from KRW2,277 trillion at the end of March (Table 1). The growth was led by the 2.9% q-o-q rise in the stock of corporate bonds, while government bonds increased at a slower pace of 1.7% q-o-q.

**Government bonds.** The outstanding size of LCY government bond market expanded 1.7% q-o-q in Q2 2019 to KRW946 trillion, largely driven by the 2.7% q-o-q rise in central government bonds, which reached KRW600 trillion at the end of June. Meanwhile, the stock of central bank bonds posted a marginal increase of 0.3% q-o-q to KRW172 trillion. The amount of outstanding bonds issued by government-related entities declined 0.3% q-o-q to KRW175 trillion.

Issuance of government bonds inched up 1.1% q-o-q to KRW81 trillion, however the issuance volume for the quarter is still high compared to previous quarters.

The government continued with its frontloading policy in 2019, with issuance of central government bonds up 2.4% q-o-q in Q2 2019. The government earlier announced that it plans to spend 70% of its 2019 budget in the first half of 2019. Issuance of Monetary Stabilization Bonds by the Bank of Korea also rose 1.8% q-o-q in Q2 2019.

**Corporate bonds.** The LCY corporate bond market posted growth of 2.9% q-o-q to reach KRW1.4 trillion at the end of June, primarily due to higher issuance during the quarter. Table 2 lists the top 30 LCY corporate bond issuers at the end of June, with aggregate bonds outstanding of KRW859 trillion comprising 62% of the total LCY corporate bond market. Financial institutions, particularly securities and investment firms and banks, continued to dominate the list, accounting for around two-thirds of the top 30 corporate bond issuers. Korea Housing Finance Corporation, a government-related institution providing financial assistance for social housing, remained the largest issuer with outstanding bonds of KRW119 trillion.

Issuance of corporate bonds recovered in Q2 2019, with issuance up 28.2% q-o-q to KRW134 trillion as companies took advantage of declining interest rates. Table 3 lists the notable corporate bond issuances in Q2 2019. Major banks in the Republic of Korea such as Woori Bank, Shinhan Bank, and Kookmin Bank continued to be the top issuers of bonds during the quarter.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2018		Q1 2019		Q2 2019		Q2 2018		Q2 2019	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	2,221,054	1,993	2,277,392	2,006	2,331,705	2,019	1.6	3.9	2.4	5.0
Government	937,267	841	930,886	820	946,417	820	2.4	5.1	1.7	1.0
Central Government Bonds	589,426	529	584,006	514	599,552	519	3.6	6.7	2.7	1.7
Central Bank Bonds	174,630	157	171,150	151	171,580	149	(0.1)	(0.1)	0.3	(1.7)
Others	173,211	155	175,730	155	175,285	152	1.0	4.9	(0.3)	1.2
Corporate	1,283,787	1,152	1,346,506	1,186	1,385,288	1,200	1.0	3.0	2.9	7.9

(-) = negative, KRW = Korean won, 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 local currency-USD rates are used.
3. Growth rates are calculated from local currency 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.

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	118,793	102.9	Yes	No	No	Housing Finance
2.	Mirae Asset Daewoo Co.	75,224	65.1	No	Yes	No	Securities
3.	Korea Investment and Securities	63,901	55.3	No	No	No	Securities
4.	Industrial Bank of Korea	52,150	45.2	Yes	Yes	No	Banking
5.	NH Investment & Securities	51,898	44.9	Yes	Yes	No	Securities
6.	KB Securities	49,735	43.1	No	No	No	Securities
7.	Hana Financial Investment	44,632	38.6	No	No	No	Securities
8.	Samsung Securities	31,413	27.2	No	Yes	No	Securities
9.	Shinhan Bank	30,712	26.6	No	No	No	Banking
10.	Korea Land & Housing Corporation	30,160	26.1	Yes	No	No	Real Estate
11.	Korea Electric Power Corporation	27,300	23.6	Yes	Yes	No	Electricity, Energy, and Power
12.	Korea Expressway	22,200	19.2	Yes	No	No	Transport Infrastructure
13.	Woori Bank	20,830	18.0	Yes	Yes	No	Banking
14.	KEB Hana Bank	19,030	16.5	No	No	No	Banking
15.	Kookmin Bank	18,874	16.3	No	No	No	Banking
16.	Shinyoung Securities	18,616	16.1	No	Yes	No	Securities
17.	Korea Rail Network Authority	18,370	15.9	Yes	No	No	Transport Infrastructure
18.	Korea Deposit Insurance Corporation	15,630	13.5	Yes	No	No	Insurance
19.	The Export-Import Bank of Korea	15,165	13.1	Yes	No	No	Banking
20.	Hyundai Capital Services	14,856	12.9	No	No	No	Consumer Finance
21.	Shinhan Card	14,205	12.3	No	No	No	Credit Card
22.	Korea SMEs and Startups Agency	13,633	11.8	Yes	No	No	SME Development
23.	KB Kookmin Bank Card	12,260	10.6	No	No	No	Consumer Finance
24.	Korea Gas Corporation	12,159	10.5	Yes	Yes	No	Gas Utility
25.	NongHyup Bank	12,020	10.4	Yes	No	No	Banking
26.	Hanwha Investment and Securities	11,780	10.2	No	No	No	Securities
27.	Standard Chartered Bank Korea	11,580	10.0	No	No	No	Banking
28.	Nonghyup	10,990	9.5	Yes	No	No	Banking
29.	Korea Student Aid Foundation	10,980	9.5	Yes	No	No	Student Loan
30.	Meritz Securities Co.	9,514	8.2	No	Yes	No	Securities
<b>Total Top 30 LCY Corporate Issuers</b>		<b>858,609</b>	<b>744</b>				
<b>Total LCY Corporate Bonds</b>		<b>1,385,288</b>	<b>1,200</b>				
<b>Top 30 as % of Total LCY Corporate Bonds</b>		<b>62.0%</b>	<b>62.0%</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 2019.

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 Second Quarter of 2019**

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Woori Bank		
1-year bond	1.88	400
2-year bond	1.85	600
Shinhan Bank		
2-year bond	1.86	400
3-year bond	1.88	400
Kookmin Bank		
5-year bond	1.61	400
5-year bond	1.90	400
Standard Chartered Bank		
5-year bond	1.66	500
SK Hynix		
3-year bond	1.96	410

KRW = Korean won.

Source: Based on data from Bloomberg LP.

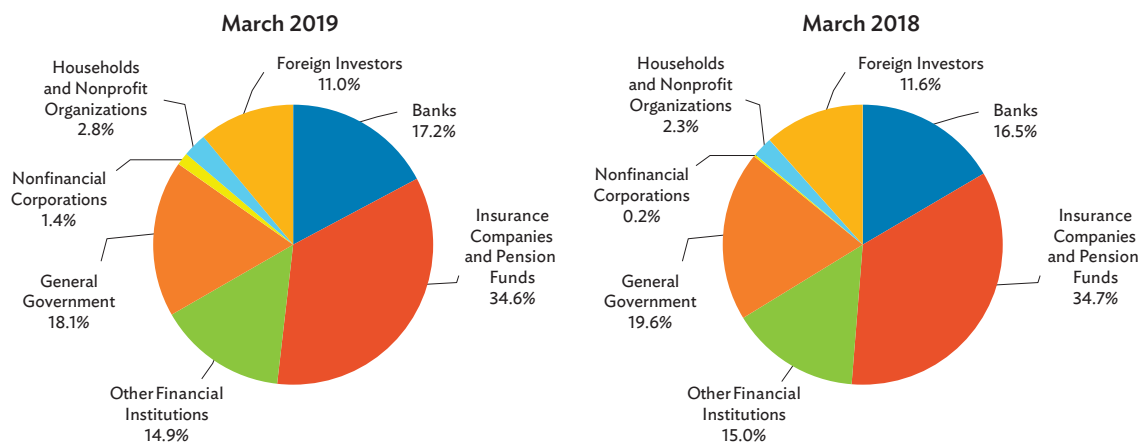
**Foreign Exchange Stabilization Bonds.** The Republic of Korea issued USD1.5 billion worth of Foreign Exchange Stabilization Bonds on 12 June. These bonds are issued to secure the Republic of Korea's foreign exchange reserves amid increasing volatility in the market. The resulting rates also serve as a guide for prospective companies planning to issue bonds offshore. The issue comprised USD500 million worth of 5-year Green and Sustainability Bonds with a coupon of 2.0% and a yield of 2.177%

(30 bps over the 5-year US Treasury) and USD1.0 billion worth of 10-year bonds with coupon of 2.5% and yield of 2.677% (55 bps over the 10-year US Treasury).

## Investor Profile

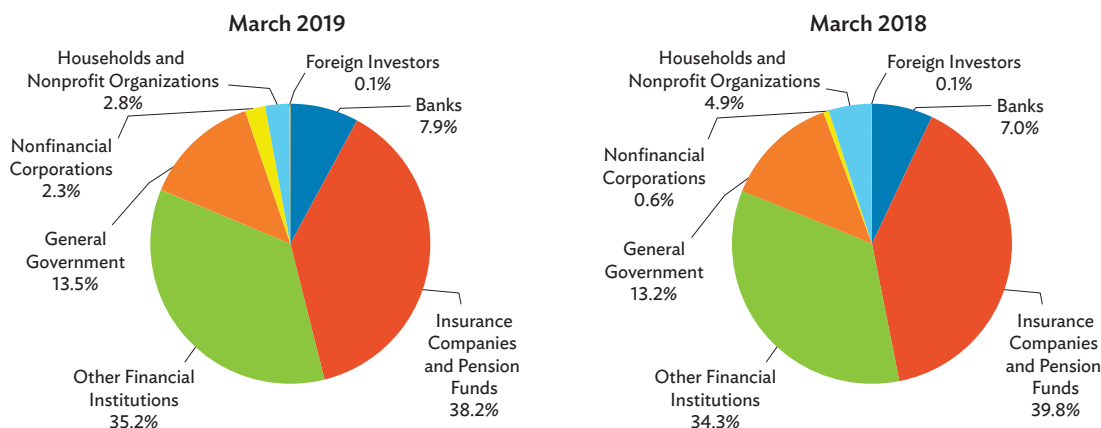
Insurance companies and pension funds remained the largest holders of the Republic of Korea's LCY government bonds, accounting for 34.6% of all holdings at the end of March, almost at par with its share in the same period in 2018 (**Figure 2**). The general government continued to be the second-largest holder with its share slightly lower at 18.1% versus 19.6% in March 2018. The share of banks rose to 17.2% at the end of March from 16.5%, while the share of other financial institutions was marginally changed at 14.9% versus 15.0% at the end of March 2018. Foreign holdings of the Republic of Korea's LCY government bonds remained low at 11.0% in March 2019.

Insurance companies and pension funds and other financial institutions continue to be the two largest holders of the Republic of Korea's LCY corporate bonds (**Figure 3**). The share of insurance companies and pension funds slightly fell to 38.2% at the end of March 2019 from 39.8% in March 2018, while the share of other financial institutions inched up to 35.2% from 34.3%. The shares of the general government and banks were almost unchanged from a year earlier at 13.5% and 7.9%, respectively. The share of foreign investors remained negligible during the review period at 0.1%.

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

Sources: AsianBondsOnline and the Bank of Korea.

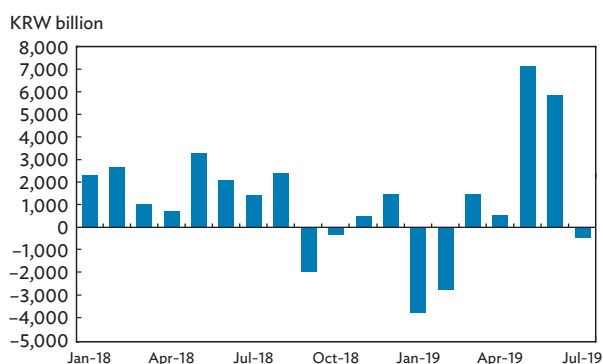
**Figure 3: Local Currency Corporate Bonds Investor Profile**



Sources: AsianBondsOnline and the Bank of Korea.

The Republic of Korea’s LCY bond market saw a surge in net foreign inflows in May and June of KRW7,076 billion and KRW5,801 billion, respectively, as investors anticipated capital gains from declining yields ahead of an expected rate cut by the Bank of Korea at its 18 July monetary policy meeting (Figure 4). The foreign bond flows reversed in July, with a monthly outflow amounting to KRW421 billion, following the eventual rate cut.

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



KRW = Korean won.  
Source: Financial Supervisory Service.

## Policy and Regulatory Developments

### National Assembly Passes 2019 Supplementary Budget

In August, the National Assembly passed the 2019 supplementary budget to help boost the economy and improve public safety. The supplementary budget was KRW856.8 billion short of the KRW6.7 trillion budget submitted in April. The budget included additional allotments of KRW273.2 billion for spending on manufacturing supplies and KRW94.5 billion for disaster-stricken areas and programs aimed to improve air and water quality, and waste management.

### The Bank of Korea and Financial Regulators Establish Cooperation to Avoid Sudden Volatility

In August, the Bank of Korea, Financial Services Commission, and Financial Supervisory Service held a meeting to discuss recent developments in financial markets and pledged cooperation to address any sudden volatility. Risks related to the current financial market volatility were stated, particularly the ongoing trade tensions between the PRC and the US, uncertainties

over monetary policy direction in the US, and the sudden devaluation of the Chinese renminbi. The agencies also highlighted the Republic of Korea's record-high foreign exchange reserves and strong foreign net lending balance. The government will continue to monitor the markets. For the stock market, contingency plans include allowing stock buybacks and tightening short-selling rules. The government will also disburse 75% of the supplementary budget in August and September to support exports. In relation to this, the government will continue to conduct talks with Japan to address its imposition of trade restrictions on Korean exports.

### **Government to Provide Financial Support to Firms Affected by Japan's Export Restrictions**

In August, the Financial Services Commission held an emergency meeting to discuss financial support for firms affected by the imposition of trade restrictions by Japan. Measures include rolling over maturing loans; disbursing fresh loans worth KRW6 trillion; and funding long-term investments related to the material, components, and equipment industries.