

Republic of Korea

Yield Movements

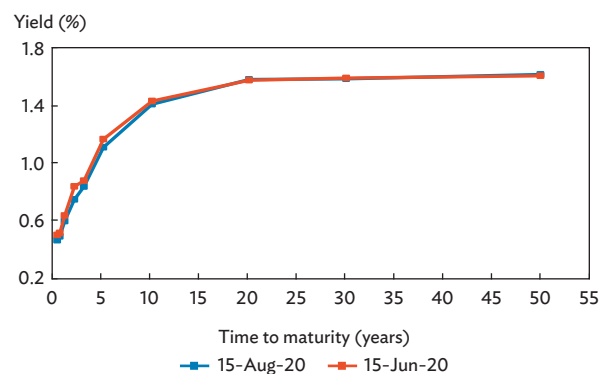
The Republic of Korea's local currency (LCY) government bond yields remained range-bound between 15 June and 15 August (**Figure 1**). The yields for short-term tenors from 3 months to 1 year fell 3 basis points (bps) on average. The 2-year tenor fell the most, dipping 9 bps, while for tenors of 3–10 years the average decline was 4 bps. Yields for long-term tenors of 20–50 years moved either up or down by less than 1 bp. The spread between the 2-year and 10-year yields slightly rose to 66 bps from 59 bps during the review period.

Yields moved marginally during the review period given market expectations that the Bank of Korea would maintain the base rate at its 16 July meeting following a 50-bps rate cut in May. In particular, the prior rise in yields for long-term paper observed from March to May tapered during the current review period as increased bond supply concerns, generated by the passage of the first two supplementary government budgets, abated. The rise in yields were tempered by expectations of a Bank of Korea bond purchase program to address the oversupply of bonds in the market. However, a rise in yields at the long-end of the curve was observed in August due to talks over a fourth supplementary budget and as the market anticipated the release of the 2021 fiscal budget.

On 16 July, the Bank of Korea decided to leave its base rate unchanged at 0.50%. The central bank noted a moderate rebound in global economic growth and a reduction in financial market volatility, while also noting the ongoing effects of the coronavirus disease (COVID-19) pandemic. Domestic economic growth remained weak despite the rebound in consumption, as exports continued to contract. Given this, the Bank of Korea stated that growth for 2020 is projected to be below the May forecast of 0.2% year-on-year (y-o-y). Consumer price inflation is expected to be in the lower 0% level as a result of low global oil prices and weak demand.

The contraction of the Republic of Korea's real gross domestic product (GDP) accelerated to 3.2% quarter-on-quarter (q-o-q) in the second quarter (Q2) of 2020 from 1.3% q-o-q in the first quarter (Q1), based on preliminary estimates from the Bank of Korea. The sharper decline

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



Source: Based on data from Bloomberg LP.

of 16.1% q-o-q in exports in Q2 2020 from 1.4% q-o-q in Q1 2020 drove the Republic of Korea into a technical recession, highlighting the economic impact of the pandemic. Gross fixed capital formation also contracted 0.4% q-o-q in Q2 2020 after a marginal increase of 0.5% q-o-q in the previous quarter, while government spending growth slowed to 1.1% q-o-q from 1.4% q-o-q. Meanwhile, private consumption rebounded in Q2 2020, posting growth of 1.5% q-o-q after a decline of 6.5% q-o-q in Q1 2020. The Republic of Korea's economy fell 2.7% y-o-y in Q2 2020 following growth of 1.4% y-o-y in the previous quarter. Consumer prices fell 0.3% y-o-y in May, were flat in June, and increased 0.3% y-o-y in July.

The Republic of Korea continued to register monthly net foreign inflows from May to July. Foreign demand remained strong, as the economy is considered a safe haven relative to its peers, and on the back of government policies to reduce volatility in financial markets and maintain a stable Korean won. Moreover, LCY government bonds continued to offer higher yields compared to other markets in the region and similarly rated developed markets.

The Korean won strengthened during the review period, appreciating 2.7% to KRW1,198.47 per USD1 as of 15 August. This was primarily due to the weakness of the United States (US) dollar, and the additional support from the extended currency swap agreement between the Bank of Korea and the US Federal Reserve.

Size and Composition

The Republic of Korea's LCY bond market grew 3.1% q-o-q to KRW2,553.7 trillion (USD2,123.3 billion) at the end of June (**Table 1**), up from the 2.8% q-o-q growth posted in Q1 2020. Growth in the domestic bond market continued to be driven by the rising stock of government bonds, particularly central government bonds. Corporate bonds also posted growth but at a slower pace. The Republic of Korea's LCY bond market expanded 9.5% y-o-y in Q2 2020, up from the 8.7% y-o-y growth posted in Q1 2020.

Government bonds. The Republic of Korea's LCY government bonds outstanding were up 4.6% q-o-q and 9.7% y-o-y at the end of June, breaching the KRW1,000 trillion level to reach KRW1,038.1 trillion. Growth continued to stem from the rising stock of central government bonds, which were up 5.1% q-o-q on a sustained increase in issuance in Q2 2020. Government agency bonds outstanding also posted rapid growth of 5.3% q-o-q to KRW190.2 trillion as they have been part of the government's funding source for COVID-19 economic response programs. Monetary Stabilization Bonds issued by the Bank of Korea inched up 1.9% q-o-q to KRW168.9 trillion.

The issuance pace of central government bonds slowed in Q2 2020 but still rose to KRW49.1 trillion from KRW42.5 trillion in Q1 2020. The sustained high level

of issuance was needed to fund the larger annual fiscal budget and the two supplementary budgets approved in the first half of the year. The same trend is expected to continue in the remainder of the year to finance the third supplementary budget passed in July and other programs to boost economic growth.

Corporate bonds. The Republic of Korea's LCY corporate bond market posted marginal growth of 2.1% q-o-q to reach a size of KRW1,515.6 trillion at the end of June as issuance for the quarter remained tepid. **Table 2** lists the top 30 LCY corporate bond issuers in the Republic of Korea with aggregate total bonds outstanding of KRW936.7 trillion at the end of Q2 2020, which comprised 61.8% of the LCY corporate bond market. Financial companies such as banks and securities and investment firms continued to dominate the list of the 30 largest corporate bond issuers. State-owned Korea Housing Finance Corporation remained the largest issuer with outstanding bonds of KRW137.8 trillion. Private firm Mirae Asset Daewoo Corporation was the second largest with bonds outstanding of KRW72.6 trillion.

Issuance of corporate bonds in the Republic of Korea remained tepid in Q2 2020, particularly in April and May, declining 4.1% q-o-q due to the contraction in economic activity as a result of the COVID-19 pandemic. **Table 3** lists notable corporate bond issuances in Q2 2020, which mainly came from financial institutions such as NongHyup Bank, Sinbo Securitization, and Kookmin Bank.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2019		Q1 2020		Q2 2020		Q2 2019		Q2 2020	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	2,331,705	2,019	2,476,170	2,032	2,553,743	2,123	2.4	5.0	3.1	9.5
Government	946,417	820	992,346	814	1,038,139	863	1.7	1.0	4.6	9.7
Central Government Bonds	599,552	519	645,928	530	679,020	565	2.7	1.7	5.1	13.3
Central Bank Bonds	171,580	149	165,710	136	168,870	140	0.3	(1.7)	1.9	(1.6)
Others	175,285	152	180,708	148	190,249	158	(0.3)	1.2	5.3	8.5
Corporate	1,385,288	1,200	1,483,824	1,218	1,515,604	1,260	2.9	7.9	2.1	9.4

() = 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	137,831	114.6	Yes	No	No	Housing Finance
2. Mirae Asset Daewoo Co.	72,611	60.4	No	Yes	No	Securities
3. Korea Investment and Securities	65,838	54.7	No	No	No	Securities
4. Industrial Bank of Korea	64,280	53.4	Yes	Yes	No	Banking
5. KB Securities	54,861	45.6	No	No	No	Securities
6. Hana Financial Investment	51,210	42.6	No	No	No	Securities
7. NH Investment & Securities	44,743	37.2	Yes	Yes	No	Securities
8. Samsung Securities	34,966	29.1	No	Yes	No	Securities
9. Korea Land & Housing Corporation	29,641	24.6	Yes	No	No	Real Estate
10. Korea Electric Power Corporation	29,060	24.2	Yes	Yes	No	Electricity, Energy, and Power
11. Shinhan Bank	28,762	23.9	No	No	No	Banking
12. Korea Expressway	24,210	20.1	Yes	No	No	Transport Infrastructure
13. The Export-Import Bank of Korea	24,135	20.1	Yes	No	No	Banking
14. Shinhan Investment Corporation	23,145	19.2	No	No	No	Securities
15. Woori Bank	19,770	16.4	Yes	Yes	No	Banking
16. Shinyoung Securities	19,471	16.2	No	Yes	No	Securities
17. Korea Rail Network Authority	19,070	15.9	Yes	No	No	Transport Infrastructure
18. Kookmin Bank	18,324	15.2	No	No	No	Banking
19. NongHyup Bank	17,450	14.5	Yes	No	No	Banking
20. Hanwha Investment and Securities	16,814	14.0	No	No	No	Securities
21. KEB Hana Bank	16,200	13.5	No	No	No	Banking
22. Korea SMEs and Startups Agency	15,888	13.2	Yes	No	No	SME Development
23. Shinhan Card	15,375	12.8	No	No	No	Credit Card
24. Meritz Securities	15,101	12.6	No	Yes	No	Securities
25. Hyundai Capital Services	14,355	11.9	No	No	No	Consumer Finance
26. KB Kookmin Bank Card	13,600	11.3	No	No	No	Consumer Finance
27. Standard Chartered Bank Korea	13,170	10.9	No	No	No	Banking
28. Korea Deposit Insurance Corporation	12,720	10.6	Yes	No	No	Insurance
29. Korea Gas Corporation	12,129	10.1	Yes	Yes	No	Gas Utility
30. NongHyup	11,980	10.0	Yes	No	No	Banking
Total Top 30 LCY Corporate Issuers	936,710	778.8				
Total LCY Corporate Bonds	1,515,604	1,260.1				
Top 30 as % of Total LCY Corporate Bonds	61.8%	61.8%				

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 2020.

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.

Investor Profile

Insurance companies and pension funds remained the largest investor group in the Republic of Korea's LCY government bond market at the end of March with a share of 35.1%, up from a 34.6% share a year earlier (**Figure 2**). Banks surpassed the general government as the second-largest holder of government bonds with a share of 17.7%, which was only marginally changed from 17.2% in March

2019. The share of the general government fell to 16.9% from 18.1% during the same period. The share of other financial institutions slightly fell to 14.5% from 14.9%, while that of foreign investors rose to 12.8% from 11.0%.

At the end of March 2020, other financial institutions topped insurance companies and pension funds as the largest investor group in the Republic of Korea's LCY corporate bond market, with its share rising to 37.5% from

Table 3: Notable Local Currency Corporate Bond Issuance in the Second Quarter of 2020

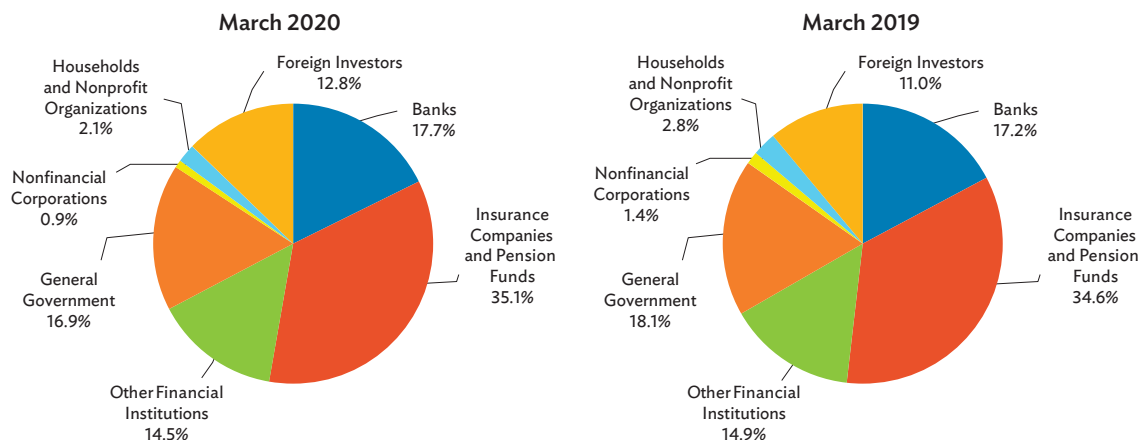
Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
NongHyup Bank		
5-month bond		400
1-year bond	0.89	700
1-year bond	0.91	330
1-year bond	1.01	550
1-year bond	1.03	250
3-year bond	1.19	360
Sinbo Securitization		
2-year bond	1.34	250
3-year bond	1.28	675
3-year bond	1.28	315
3-year bond	1.35	491
3-year bond	1.39	412
Kookmin Bank		
1-year bond	0.76	350
1-year bond	1.15	400
2-year bond	0.99	400
10-year bond	2.13	450

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
HMM Company		
30-year bond	3.00	720
Kia Motors		
3-year bond	2.02	480
Hana Financial Group		
Perpetual Bonds	3.20	450
Citibank Korea		
2-year bond	1.13	410
Standard Chartered		
1-year bond	0.85	400
Hyundai Motor		
3-year bond	1.74	390
Lotte Shopping		
3-year bond	2.33	350
SK Energy		
3-year bond	1.95	340

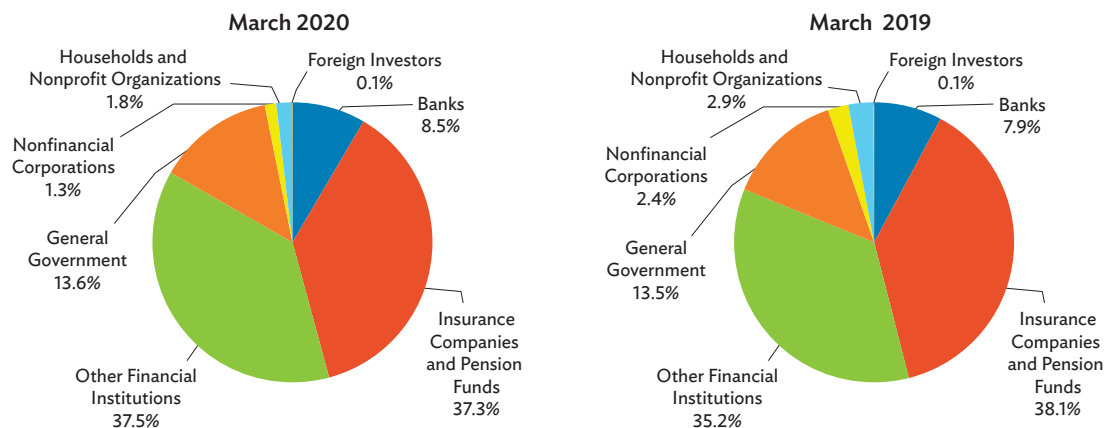
KRW = Korean won.

Source: Based on data from Bloomberg LP.

Figure 2: Local Currency Government Bonds Investor Profile



Sources: AsianBondsOnline and the Bank of Korea.

Figure 3: Local Currency Corporate Bonds Investor Profile


Sources: AsianBondsOnline and the Bank of Korea.

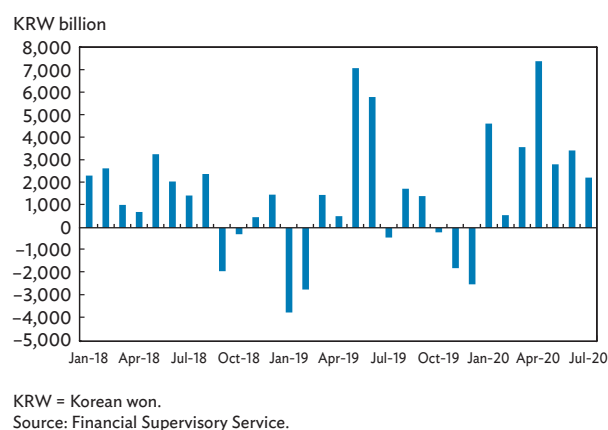
35.2% in March 2019 (Figure 3). The share of insurance companies and pension funds declined to 37.3% from 38.1% during the same period. The share of the general government was barely changed at 13.6%, while that of banks was up to 8.5% from 7.9%. Foreign holdings of LCY corporate bonds remained negligible at 0.1%.

Strong net foreign flows into the Republic of Korea's LCY bond market continued in May, June, and July, with monthly totals reaching KRW2,821 billion, KRW3,436 billion, and KRW2,235 billion, respectively (Figure 4). The Republic of Korea was among the markets in the region that attracted strong foreign demand amid a surge in global liquidity, a result of the easing of central banks in response to the COVID-19 pandemic. The economy's high credit rating and robust external balances, the stable Korean won, and higher yields relative to its peers continued to be the main drivers of the strong foreign inflows.

Policy, Institutional, and Regulatory Developments

The Republic of Korea's National Assembly Passes Third Supplementary Budget

On 3 July, the National Assembly of the Republic of Korea passed the third supplementary budget worth KRW35.1 trillion. The amount approved was lower than the proposed KRW35.3 trillion, yet it was still the largest of the three supplementary budgets passed

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


in 2020 in response to the economic impact of the COVID-19 pandemic, bringing the aggregate amount of supplementary budgets to KRW54.4 trillion and the total policy package to KRW277 trillion.

The Bank of Korea and the Federal Reserve Announces Extension of Currency Swap Agreement

On 29 July, the Bank of Korea and the US Federal Reserve announced the extension of the USD60 billion currency swap agreement for another 6 months until 31 March 2021. The swap agreement is expected to continue to aid in the stabilization of financial markets, including the

foreign exchange market, as it will provide more dollar funding to businesses and households in the Republic of Korea.

The Government of the Republic of Korea Submits 2021 Fiscal Budget

On 3 September, the Government of the Republic of Korea submitted the 2021 fiscal budget proposal totaling KRW555.8 trillion, primarily to aid in economic recovery and support the Korean New Deal. The 2021 budget is 8.5% higher than the original 2020 budget and 1.6% higher than the final 2020 budget that included three supplementary budgets in response to the COVID-19 pandemic. Government revenues in 2021 are projected to grow 1.2% to KRW483 trillion. A fiscal deficit equal to 5.4% of GDP and aggregate government debt equal to 46.7% of GDP are expected. In addition, the government also submitted to the National Assembly its 2020–2024 fiscal management plan.