

Republic of Korea

Yield Movements

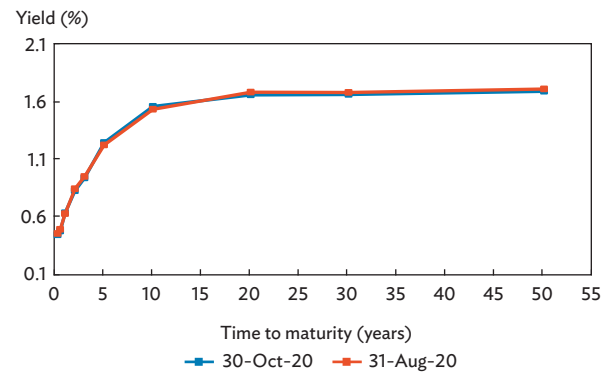
Between 31 August and 30 October, the Republic of Korea's local currency (LCY) government bond yield curve barely moved. Government bond yields remained range-bound during the review period, with yield changes almost negligible (**Figure 1**). Yields for 1-year, 5-year, and 10-year bonds rose 2 basis points (bps) on average. Meanwhile, the yield for tenors of less than 1 year fell 1 bp on average, and the yield for the remaining tenors fell 2 bps on average. The spread between the 2-year and 10-year yield inched up to 73 bps from 69 bps during the review period.

Yields at the shorter-end were almost unchanged amid expectations of the Bank of Korea maintaining the base rate in its October monetary policy meeting. Meanwhile, yield movements in the rest of the curve were minimal given continued supply–demand imbalances in the government bond market and uncertainties in the economic policy measures of major developing economies. Oversupply concerns continued to impact market sentiment amid expectations of increased bond issuance following the approval of the fourth supplementary budget and the release of the proposed 2021 fiscal budget.

In September, yields for tenors of more than 1 year saw a decline, albeit by only 10 bps on average, as the announcement of the Bank of Korea in the early part of the month—of plans to purchase up to KRW5 trillion of Korea Treasury Bonds by the end of 2020—was not enough to ease supply concerns. The pessimistic outlook on the Republic of Korea's economic growth also contributed to the downward trend. However, this trend was almost reversed in October leading up to the monetary policy meeting and as market players awaited the result of elections in the United States (US).

On 22 September, the National Assembly approved the fourth supplementary budget to be used to provide support to various sectors hit by the coronavirus disease (COVID-19) pandemic. The approved budget amounted to KRW7.8 trillion, bringing the aggregate supplementary budgets to KRW62.2 trillion. Earlier in the month, the government also submitted its 2021 fiscal budget plan of KRW555.8 trillion, an 8.5% increase from the original

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



Source: Based on data from Bloomberg LP.

2020 budget. In October, the Ministry of Economy and Finance announced fiscal rules to address the rapid increase in national debt resulting from increased bond issuances.

On 14 October, the Bank of Korea decided to leave the base rate unchanged at 0.50% amid uncertainties that could affect the global and domestic economic outlook. The global economic recovery has slowed due to a resurgence in virus cases and uncertainties in economic policy measures to be implemented in major developing markets. The same trend has been observed in the domestic economy. Despite the recovery in exports, private consumption was dampened by the reimposition of lockdown measures as the number of new virus cases rose. The Bank of Korea expects risks to the economic outlook to remain elevated, maintaining its August forecast of a 1.3% contraction in economic growth in full-year 2020.

The Republic of Korea's economy rebounded in the third quarter (Q3) of 2020, posting growth of 1.9% quarter-on-quarter (q-o-q) in real gross domestic product (GDP) growth, based on advance estimates from the Bank of Korea, following a contraction of 3.2% q-o-q in the second quarter (Q2) of 2020. This was largely driven by the 15.6% q-o-q jump in exports in Q3 2020 after a sharp 16.1% q-o-q decline in the previous quarter. However, both government and private consumption declined in

Q3 2020. Private spending fell 0.1% q-o-q in Q3 2020, a reversal from the 1.4% q-o-q increase in Q2 2020, as stricter lockdowns were re-implemented. Government spending also posted a decline of 0.1% q-o-q from 1.5% q-o-q growth in the previous quarter. Meanwhile, gross fixed capital formation fell at a faster pace of 1.9% q-o-q versus 0.4% q-o-q during the same period in review. Consumer price inflation turned positive in July, reaching 0.3% y-o-y before gradually rising to 0.7% in August and 1.0% in September.

The Republic of Korea's LCY bond market registered its first net foreign outflows for the year in September at KRW31 billion as foreign investors took profits, particularly for short-term securities with tenors of less than 1 year. The outflows from this category surpassed the foreign buying volume of mid- to long-term tenors.

The Korean won strengthened during the review period, appreciating 4.7% versus the US dollar to KRW1,134.8 per USD1.0 as of 30 October. This can be attributed to the weakening of the US dollar. Furthermore, the currency appreciation has been tied to the strengthening of the Chinese yuan, as both currencies are linked through the People's Republic of China being one of the Republic of Korea's major trading partners.

Size and Composition

The size of the Republic of Korea's LCY bond market inched up 1.9% q-o-q to KRW2,602.1 trillion (USD2,223.7 billion) at the end of September (**Table 1**).

The marginal growth was lower than the 3.1% q-o-q growth posted in Q2 2020. Growth for the quarter continued to be mainly driven by the government sector, particularly the rise in the stock of central government bonds, while the corporate segment rose at a slower pace. Compared with the same period in 2019, the Republic of Korea's domestic bond market rose 9.8% year-on-year (y-o-y), almost at par with the 9.5% y-o-y increase posted in Q2 2020.

Government bonds. The outstanding size of the Republic of Korea's LCY government bond market rose 3.0% q-o-q to KRW1,069.1 trillion at end-September. The main driver of the growth was the 4.2% q-o-q rise in central government bonds to KRW707.7 trillion. Bonds issued by state-owned entities also posted an increase of 2.3% q-o-q to KRW194.6 trillion. Monetary Stabilization Bonds issued by the Bank of Korea registered a decrease of 1.3% q-o-q to KRW166.7 trillion.

Issuance of government bonds declined in Q3 2020 to KRW99.1 trillion due to there being a higher base after issuance surged in Q2 2020 as the government needed to fund the supplementary budgets and other fiscal measures implemented to lessen the economic impact of the pandemic.

Corporate bonds. The Republic of Korea's LCY corporate bond market posted marginal growth of 1.1% q-o-q in Q3 2020, increasing the corporate bond stock to a size of KRW1,533.0 trillion at the end of September. **Table 2** lists the top 30 LCY corporate bond

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2019		Q2 2020		Q3 2020		Q3 2019		Q3 2020	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	2,370,666	1,982	2,553,743	2,123	2,602,081	2,224	1.7	6.6	1.9	9.8
Government	953,854	797	1,038,139	863	1,069,062	914	0.8	2.8	3.0	12.1
Central Government Bonds	607,015	507	679,020	565	707,681	605	1.2	4.8	4.2	16.6
Central Bank Bonds	170,960	143	168,870	140	166,750	143	(0.4)	(2.1)	(1.3)	(2.5)
Others	175,879	147	190,249	158	194,631	166	0.3	0.8	2.3	10.7
Corporate	1,416,812	1,184	1,515,604	1,260	1,533,019	1,310	2.3	9.4	1.1	8.2

() = negative, KRW = Korean won, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third 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	141,841	121.2	Yes	No	No	Housing Finance
2.	Mirae Asset Daewoo Co.	72,365	61.8	No	Yes	No	Securities
3.	Industrial Bank of Korea	71,380	61.0	Yes	Yes	No	Banking
4.	Korea Investment and Securities	61,858	52.9	No	No	No	Securities
5.	KB Securities	54,091	46.2	No	No	No	Securities
6.	Hana Financial Investment	51,684	44.2	No	No	No	Securities
7.	NH Investment & Securities	41,928	35.8	Yes	Yes	No	Securities
8.	Samsung Securities	33,479	28.6	No	Yes	No	Securities
9.	Korea Electric Power Corporation	28,510	24.4	Yes	Yes	No	Electricity, Energy, and Power
10.	Korea Land & Housing Corporation	28,239	24.1	Yes	No	No	Real Estate
11.	Shinhan Bank	26,712	22.8	No	No	No	Banking
12.	Shinhan Investment Corporation	24,606	21.0	No	No	No	Securities
13.	The Export-Import Bank of Korea	24,025	20.5	Yes	No	No	Banking
14.	Korea Expressway	24,010	20.5	Yes	No	No	Transport Infrastructure
15.	Shinyoung Securities	19,920	17.0	No	Yes	No	Securities
16.	Kookmin Bank	19,614	16.8	No	No	No	Banking
17.	Korea Rail Network Authority	19,100	16.3	Yes	No	No	Transport Infrastructure
18.	Woori Bank	19,070	16.3	Yes	Yes	No	Banking
19.	KEB Hana Bank	18,960	16.2	No	No	No	Banking
20.	NongHyup Bank	18,270	15.6	Yes	No	No	Banking
21.	Hanwha Investment and Securities	16,791	14.3	No	No	No	Securities
22.	Korea SMEs and Startups Agency	16,528	14.1	Yes	No	No	SME Development
23.	Shinhan Card	15,945	13.6	No	No	No	Credit Card
24.	Meritz Securities Co.	15,152	12.9	No	Yes	No	Securities
25.	Hyundai Capital Services	14,325	12.2	No	No	No	Consumer Finance
26.	KB Kookmin Bank Card	14,020	12.0	No	No	No	Consumer Finance
27.	Standard Chartered Bank Korea	13,360	11.4	No	No	No	Banking
28.	Korea Deposit Insurance Corporation	12,720	10.9	Yes	No	No	Insurance
29.	NongHyup	12,430	10.6	Yes	No	No	Banking
30.	Korea Gas Corporation	11,759	10.0	Yes	Yes	No	Gas Utility
Total Top 30 LCY Corporate Issuers		942,692	805.6				
Total LCY Corporate Bonds		1,533,019	1,310.1				
Top 30 as % of Total LCY Corporate Bonds		61.5%	61.5%				

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 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.

issuers in the Republic of Korea at the end of September with their outstanding bonds reaching an aggregate size of KRW942.7 trillion and comprising 61.5% of the total LCY corporate bond market. Financial companies such as banks and securities and investment firms continued to dominate the list. Government-related entity Korea Housing Finance Corporation remained the largest corporate bond issuer in the market with total bonds outstanding valued at KRW141.8 trillion. Financial companies Mirae Asset Daewoo and Industrial Bank of Korea were the next largest bond issuers with total bonds outstanding of KRW72.4 trillion and KRW71.4 trillion, respectively.

The marginal increase in the size of the LCY corporate bond market was due to tepid issuance during Q3 2020, particularly from both special public entities and private companies, while financial debentures saw

increased issuance. Market volatility and economic uncertainty continued to have an impact on the decline of corporate bond issuance during the quarter. **Table 3** lists the notable corporate bond issuances in Q3 2020. Financial firms such as KEB Hana Bank, Kookmin Bank, Sinbo Securitization, and Nonghyup Bank had the largest aggregate issuances during the quarter.

Foreign Exchange Stabilization Fund Bonds. On 10 September, the Government of the Republic of Korea issued USD1.4 billion worth of Foreign Exchange Stabilization Fund Bonds. The issuance consisted of EUR700 million worth of zero coupon 5-year euro bonds with a yield of -0.059% and USD625 million worth of 10-year dollar bonds with a yield of 1.198% and a coupon of 1.000%. The issuance is expected to push down yields of sovereign bonds and provide lower-yield guidance for the foreign borrowings of other private Korean entities.

Table 3: Notable Local Currency Corporate Bond Issuances in the Third Quarter of 2020

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)	Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
KEB Hana Bank			Sinbo Securitization Specialty		
1-year bond	0.75	500	2-year bond	1.09	188
1-year bond	0.76	390	3-year bond	1.22	507
1-year bond	0.75	250	3-year bond	1.19	411
2-year bond	0.92	250	3-year bond	1.19	211
2-year bond	0.98	220	3-year bond	1.15	210
2-year bond	0.88	200	3-year bond	1.15	147
2-year bond	0.92	200	Nonghyup Bank		
2-year bond	0.92	200	1-year bond	0.90	400
2-year bond	0.88	200	2-year bond	0.99	410
3-year bond	0.92	300	2-year bond	1.03	100
10-year bond	2.14	340	3-year bond	1.12	200
Kookmin Bank			3-year bond	1.01	110
2-year bond	0.75	300	3-year bond	1.07	100
2-year bond	0.90	300	5-year bond	1.33	260
2-year bond	0.57	300	Woori Bank		
2-year bond	0.90	250	1-year bond	-	300
2-year bond	0.91	250	1-year bond	0.91	200
2-year bond	0.79	200	2-year bond	0.93	200
2-year bond	0.79	350	3-year bond	1.01	300
2-year bond	0.93	220	3-year bond	1.02	250
2-year bond	1.02	220	5-year bond	1.32	300
10-year bond	2.05	500	Korea Investment Securities		
			6-year bond	3.30	470
			Shinhan Financial Group		
			29-year bond	3.12	450

- = not applicable, KRW = Korean won.
Source: Based on data from Bloomberg LP.

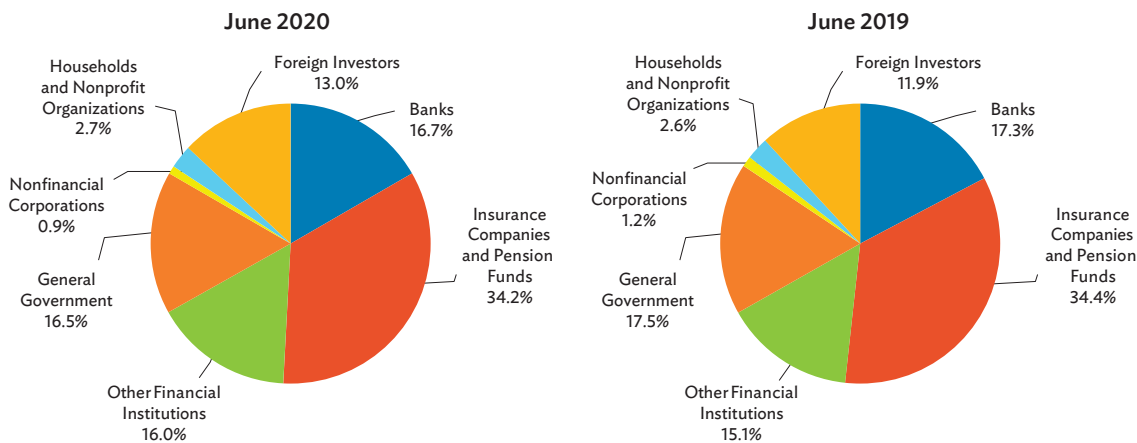
Investor Profile

Insurance companies and pension funds remained the largest holders of the Republic of Korea’s LCY government bonds at the end of June 2020 with a share of 34.2%, almost at par with its share of 34.4% in June 2019 (Figure 2). Banks surpassed the general government as the second-largest investor group at the end of Q2 2020. However, both of their respective shares declined from a year earlier, with banks’ share falling to 16.7% at the end of Q2 2020 from 17.3% and the general government declining to 16.5% from 17.5%. Meanwhile, the share of other financial institutions rose to 16.0% from 15.1% during the review period. Foreign holdings of LCY

government bonds also increased to 13.0% at the end of June 2020 from 11.9% a year earlier.

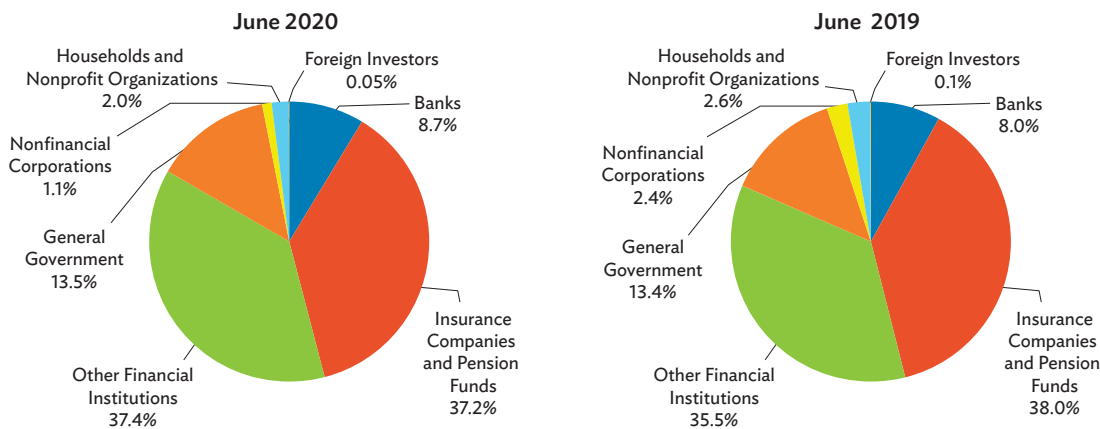
Other financial institutions surpassed insurance companies and pension funds as the largest investor group of the Republic of Korea’s LCY corporate bonds at the end of June 2020, with its share rising to 37.4% from 35.5% in the same period in 2019 (Figure 3). Meanwhile, the share of insurance companies and pension funds declined to 37.2% from 38.0% during the review period. The share of the general government was almost unchanged at 13.5%, while the share of foreign holders remained negligible.

Figure 2: Local Currency Government Bonds Investor Profile



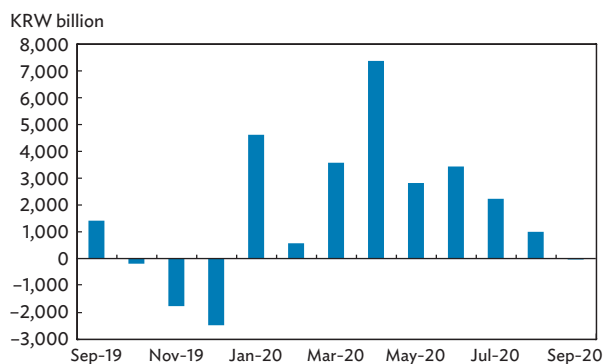
Source: The Bank of Korea.

Figure 3: Local Currency Corporate Bonds Investor Profile



Source: 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.

Foreign investors continued buying the Republic of Korea's LCY bonds in August, albeit at a smaller value of KRW997 billion versus a monthly average of KRW3,521 billion in the first 7 months of the year (**Figure 4**). However, this was reversed as the bond market registered net foreign outflows of KRW31 billion in September, due to profit-taking by foreign investors, particularly for securities with tenors of less than 1 year. Selling in this category surpassed net inflows registered in bonds with mid- to long-term tenors.

Ratings Update

On 6 October, Fitch Ratings affirmed the Republic of Korea's sovereign credit rating at AA- with a stable outlook. The rating agency cited the Republic of Korea's "steady macroeconomic performance, robust external finances, and sufficient fiscal headroom" as the reasons behind the rating affirmation. These, along with other government policies to control the spread of the virus, have helped mitigate the economic impact of the COVID-19 pandemic, especially in comparison with its similarly rated peers. In addition, the rating agency also forecast a 1.1% economic contraction in 2020, based on a gradual recovery in the second half of the year supported by the rebound in exports in recent months. The fiscal

deficit for 2020 is also expected to widen to 4.4% of GDP in 2020 given the rise in government debt following financial stimulus to address the economic impact of the virus, but it is still considered modest compared to its peers.

Policy, Institutional, and Regulatory Developments

The National Assembly Passed the Fourth Supplementary Budget

On 22 September, the National Assembly passed the fourth supplementary budget of 2020 worth KRW7.8 trillion. This brings the aggregate amount of all four supplementary budgets to KRW62.2 trillion. The budget is expected to fund additional COVID-19 relief programs to support small businesses and low-income households.

The Republic of Korea Announces New Fiscal Rules

On 5 October, the Government of the Republic of Korea announced new fiscal rules to address the rapid increase in national debt. Although the economy's fiscal soundness and debt ratios are still considered low compared to its similarly rated peers, the government aims to maintain its fiscal sustainability. One rule is to maintain the government-debt-to-GDP ratio below 60% and the consolidated fiscal balance deficit at 3% or less of GDP. Implementation is expected to take effect starting in 2025 after a transition period of 3 years.

The Bank of Korea and the People's Bank of China Renew Currency Swap Agreement

On 22 October, the Bank of Korea and the People's Bank of China signed the renewal of the Korean Won-Chinese Yuan Bilateral Currency Swap Agreement for another 5 years. The swap amount was also increased to KRW70 trillion-CNY400 billion from KRW64 trillion-CNY360 billion.