

Republic of Korea

Yield Movements

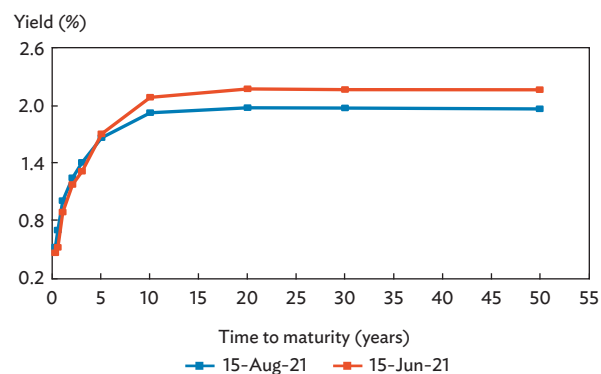
The Republic of Korea's local currency (LCY) government bond yield curve slightly flattened between 15 June and 15 August as yields for short-term to medium-term tenors rose, while those for long-term tenors fell (**Figure 1**). Correspondingly, the spread between the 2-year and 10-year tenors fell to 68 basis points (bps) from 91 bps during the review period. Yields for the 3-month and 6-month tenors rose 6 bps and 18 bps, respectively. Yields between the 1-year and 3-year tenors rose 9 bps on average, while that of the 5-year tenor fell 4 bps. Yields for long-term tenors of between 10 years and 50 years fell 19 bps on average.

Yields at the shorter-end of the curve rose on increased expectations of a rate hike by the Bank of Korea before the year ends. The expectations were driven by increased inflationary pressures as inflation has hovered above 2.0% since April, reaching a high of 2.6% in May and July. In addition, the need to arrest the rise in household debt and housing prices also contributed to market expectations of a rate hike. Subsequently on 26 August, the Bank of Korea decided to raise the base rate by 25 bps to 0.75%.

Meanwhile, yields at the longer-end of the curve fell, tracking the global downward trend in long-term yields on weakening optimism and expectations of a slowdown in the global economic recovery amid the rise in cases of the more transmissible delta variant of COVID-19. The resurgence in domestic cases and the slow vaccination rollout has resulted in the tightening and extension of social distancing measures in the Republic of Korea and is expected to dampen consumption. In addition, bond supply concerns eased as the government announced in June that the funding of the second supplementary budget for 2021 will not involve the issuance of additional government bonds. The National Assembly on 24 July passed a second supplementary budget of KRW34.9 trillion to support small businesses, households, and local governments, and for the procurement of additional vaccines.

On 26 August, the Bank of Korea decided to raise the base rate to 0.75%, after leaving it unchanged on its 15 July monetary policy meeting. The central bank noted the continued recovery in the domestic economy and

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



Source: Based on data from Bloomberg LP.

maintained its economic growth forecast for 2021 at 4.0%. Meanwhile, 2021 inflation forecast was revised upward to 2.1% from May projection of 1.8%. Given these conditions, the Monetary Board stated that it will gradually adjust the degree of monetary policy accommodation, taking into consideration developments in COVID-19, risk of a buildup in financial imbalances, and monetary policy changes in advanced economies.

The Republic of Korea's economic growth accelerated to 6.0% y-o-y in the second quarter (Q2) of 2021 from 1.9% y-o-y in the first quarter (Q1), based on preliminary estimates by the Bank of Korea. The higher growth was driven by private consumption, government spending, and an acceleration in export growth. However, on a quarter-on-quarter (q-o-q) basis, domestic economic growth slowed to 0.8% in Q2 2021 from 1.7% in Q1 2021.

The Republic of Korea's LCY bond market continued to register high levels of foreign inflows in Q2 2021, with net inflows of KRW3,346 billion and KRW5,516 billion in the months of April and May, respectively. Foreign inflows surged to a record KRW9,387 billion in June and further to KRW9,290 billion in July. Investor confidence in the Republic of Korea's economic recovery and favorable external balances, and the high interest rate differential over United States (US) Treasuries drove this trend.

The Korean won was one of the weakest currencies in the region during the review period, depreciating

4.5% to KRW1,169.02 per USD1.0 as of 15 August. The resurgence in domestic cases and foreign selling of Korean equities contributed to the depreciation of the currency.

Size and Composition

The size of the Republic of Korea's LCY bond market increased to KRW2,756.4 trillion at the end of June on growth of 2.3% quarter-on-quarter (q-o-q) (Table 1), which is slightly lower than the 2.4% q-o-q expansion registered in the previous quarter. Growth for the quarter was largely driven by the government sector, while the corporate sector grew at a slower pace. From the same period in 2020, the Republic of Korea's bond market grew 7.9% y-o-y, slower than the 8.9% y-o-y growth posted in Q1 2021.

Government bonds. The outstanding size of the Republic of Korea's LCY government bond market rose 3.2% q-o-q to KRW1,158.3 trillion. Growth stemmed from the 5.0% q-o-q expansion in the stock of central government bonds to KRW807.7 trillion, which more than offset the decline in central bank bonds. Monetary Stabilization Bonds issued by the Bank of Korea declined 1.9% q-o-q to KRW154.2 trillion. Meanwhile, outstanding bonds issued by other government-owned entities inched up 0.3% q-o-q to KRW196.3 trillion.

Issuance of government bonds was up 11.1% q-o-q in Q2 2021 to KRW114.3 trillion, led by central government bonds, which rose 17.3% q-o-q to KRW59.1 trillion. This was consistent with the frontloading policy of the

government, which announced plans to spend 67% of its 2021 budget in the first half of the year. The higher issuance for the quarter may also be attributed to the funding of the first supplementary budget of 2021 (KRW14.9 trillion) passed on March.

Corporate bonds. The Republic of Korea's LCY corporate bond market grew 1.6% q-o-q to KRW1,598.2 trillion at the end of June, with growth accelerating from the 1.2% q-o-q increase posted in Q1 2021. Table 2 lists the top 30 LCY corporate bond issuers in the Republic of Korea at the end of June. The top 30's bonds outstanding reached an aggregate size of KRW955.4 trillion and comprised 59.8% of the total LCY corporate bond market. Financial companies such as banks and securities and investment firms continued to dominate the Top 30 list with a collective share of 64.1%. Korea Housing Finance Corporation remained the single-largest corporate bond issuer in the market with total bonds outstanding of KRW152.6 trillion and a 16.0% share of the top 30's aggregate bonds. Industrial Bank of Korea and Mirae Asset Securities were the next largest LCY corporate bond issuers with total bonds outstanding of KRW71.5 trillion and KRW62.6 trillion, respectively.

The higher q-o-q growth in the Republic of Korea's corporate bonds outstanding in Q2 2021 was driven by the 16.6% q-o-q surge in issuance to KRW150.5 trillion from KRW129.1 trillion in Q1 2021. Higher issuance volumes were registered in all categories—special public entities, financial debentures, and private companies—as institutions ramped up their issuance amid increased expectations of a rate hike before the year ends.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2020		Q1 2021		Q2 2021		Q2 2020		Q2 2021	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	2,553,743	2,123	2,695,546	2,382	2,756,445	2,447	3.1	9.5	2.3	7.9
Government	1,038,139	863	1,122,368	992	1,158,252	1,028	4.6	9.7	3.2	11.6
Central Government Bonds	679,020	565	769,339	680	807,725	717	5.1	13.3	5.0	19.0
Central Bank Bonds	168,870	140	157,230	139	154,230	137	1.9	(1.6)	(1.9)	(8.7)
Others	190,249	158	195,799	173	196,297	174	5.3	8.5	0.3	3.2
Corporate	1,515,604	1,260	1,573,178	1,390	1,598,193	1,419	2.1	9.4	1.6	5.4

() = 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: KG Zeroin Corporation and The Bank of Korea.

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	152,640	135.5	Yes	No	No	Housing Finance
2.	Industrial Bank of Korea	71,530	63.5	Yes	Yes	No	Banking
3.	Mirae Asset Securities Co.	62,584	55.6	No	Yes	No	Securities
4.	Korea Investment and Securities	58,252	51.7	No	No	No	Securities
5.	KB Securities	50,252	44.6	No	No	No	Securities
6.	Hana Financial Investment	49,716	44.1	No	No	No	Securities
7.	NH Investment & Securities	35,070	31.1	Yes	Yes	No	Securities
8.	Shinhan Investment Corporation	33,479	29.7	No	No	No	Securities
9.	Korea Land & Housing Corporation	31,516	28.0	Yes	No	No	Real Estate
10.	Samsung Securities	30,251	26.9	No	Yes	No	Securities
11.	Shinhan Bank	29,612	26.3	No	No	No	Banking
12.	Korea Electric Power Corporation	26,800	23.8	Yes	Yes	No	Electricity, Energy, and Power
13.	Korea Expressway	25,150	22.3	Yes	No	No	Transport Infrastructure
14.	Meritz Securities Co.	24,486	21.7	No	Yes	No	Securities
15.	The Export-Import Bank of Korea	23,675	21.0	Yes	No	No	Banking
16.	Woori Bank	21,310	18.9	Yes	Yes	No	Banking
17.	KEB Hana Bank	20,665	18.3	No	No	No	Banking
18.	Kookmin Bank	20,164	17.9	No	No	No	Banking
19.	Korea National Railway	19,450	17.3	Yes	No	No	Transport Infrastructure
20.	NongHyup Bank	18,530	16.5	Yes	No	No	Banking
21.	Hanwha Investment and Securities	18,433	16.4	No	No	No	Securities
22.	Korea SMEs and Startups Agency	18,418	16.4	Yes	No	No	SME Development
23.	Shinyoung Securities	18,365	16.3	No	Yes	No	Securities
24.	Shinhan Card	16,505	14.7	No	No	No	Credit Card
25.	Hyundai Capital Services	14,425	12.8	No	No	No	Consumer Finance
26.	KB Kookmin Bank Card	14,290	12.7	No	No	No	Consumer Finance
27.	Standard Chartered Bank Korea	13,250	11.8	No	No	No	Banking
28.	NongHyup	13,160	11.7	Yes	No	No	Banking
29.	Samsung Card Co.	12,048	10.7	No	Yes	No	Credit Card
30.	Korea Gas Corporation	11,369	10.1	Yes	Yes	No	Gas Utility
Total Top 30 LCY Corporate Issuers		955,394	848.3				
Total LCY Corporate Bonds		1,598,193	1,419.0				
Top 30 as % of Total LCY Corporate Bonds		59.8%	59.8%				

KOSDAQ = Korean Securities Dealers Automated Quotations, KOSPI = Korea Composite Stock Price Index, KRW = Korean won, LCY = local currency, SMEs = small and medium-sized enterprises, USD = United States dollar.

Notes:

1. Data as of 30 June 2021.

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 KG Zeroin Corporation data.

Table 3: Notable Local Currency Corporate Bond Issuances in the Second Quarter of 2021

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)	Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Shinhan Bank^a			Nonghyup Bank^a		
1-year bond	0.77	600	1-year bond	1.14	490
1-year bond	0.12	310	1-year bond	0.80	370
1-year bond	0.81	220	1-year bond	zero	360
1-year bond	0.82	200	1-year bond	zero	200
1-year bond	0.88	170	2-year bond	1.26	400
1-year bond	0.82	150	2-year bond	1.08	210
2-year bond	1.07	430	3-year bond	1.31	400
2-year bond	2.58	400	5-year bond	1.83	240
2-year bond	1.07	260	29-year bond	2.32	140
3-year bond	1.15	350	Sinbo Securitization Specialty^a		
3-year bond	1.20	300	2-year bond	1.237	149
Woori Bank^a			2-year bond	1.26	148
1-year bond	0.81	500	2-year bond	1.64	119
1-year bond	0.12	500	3-year bond	1.47	493
1-year bond	0.89	430	3-year bond	1.45	400
1-year bond	0.79	200	3-year bond	1.78	392
2-year bond	1.07	500	3-year bond	1.45	171
2-year bond	1.01	400	3-year bond	1.47	108
2-year bond	1.05	350			
10-year bond	2.64	300			

KRW = Korean won.

^a Multiple issuance of the same tenor indicates issuance on different dates.

Source: Based on data from Bloomberg LP.

Table 3 lists the notable corporate bond issuances in Q2 2021. Financial firms such as Shinhan Bank, Woori Bank, Nonghyup Bank, and Sinbo Securitization had some of the largest aggregate issuance totals during the quarter.

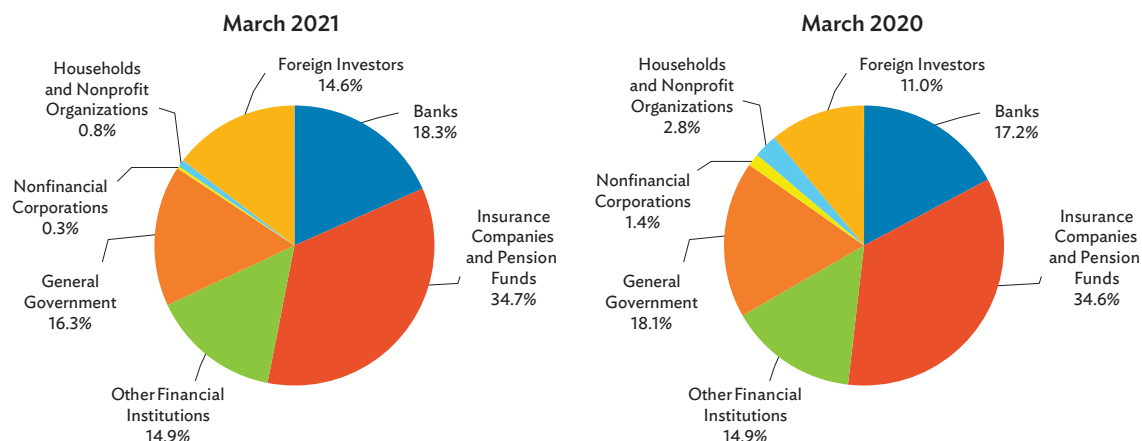
Investor Profile

Insurance companies and pension funds continued to be the largest investor group in the Republic of Korea's LCY government bond market at the end of March 2021 with a share of 34.7%, which was almost at par with their 34.6% share in March 2020 (**Figure 2**). Banks surpassed the general government as the second-largest investor group at the end of March 2021. The share of banks rose to 18.3% (from 17.2% in March 2020) and the general government's share declined to 16.3% (from 18.1%). The share of other financial institutions remained the same at 14.9%, while nonfinancial corporations and households registered sharp declines. Foreign holdings of LCY government bonds registered the highest percentage increase during the review period, rising to 14.6% from 11.0%, as foreign bond inflows surged in Q1 2021.

Other financial institutions held the largest share of the Republic of Korea's LCY corporate bonds at the end of Q2 2021 with their share rising to 38.9% from 37.5% in the same period in 2020 (**Figure 3**). Meanwhile, the share of insurance companies and pension funds fell during the review period to 36.3% from 37.3%. The share of the general government was almost unchanged at 13.5% versus 13.6%, while the share of foreign holders remained negligible.

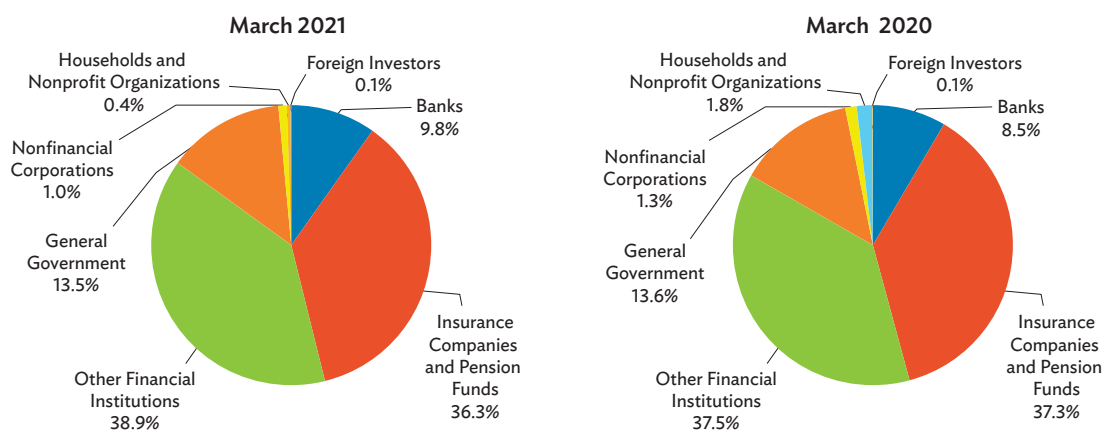
Foreign demand for the Republic of Korea's LCY bonds continued to remain high in Q2 2021, posting net inflows of KRW3,346 billion and KRW5,516 billion in the months of April and May, respectively, and reaching KRW9,387 billion in June and further to KRW9,290 billion in July (**Figure 4**). Strong foreign demand has been driven by the high interest rate differential of Korean LCY bonds over United States Treasuries. This was primarily due to a rise in domestic government bond yields, particularly for tenors of between 1 year and 5 years, on expectations of a rate hike later this year. Domestic bonds with remaining maturities of 1–5 years also registered the highest net foreign inflows during the review period (**Figure 5**). The Republic of Korea continued to be a safe haven relative

Figure 2: Local Currency Government Bonds Investor Profile



Source: AsianBondsOnline and The Bank of Korea.

Figure 3: Local Currency Corporate Bonds Investor Profile



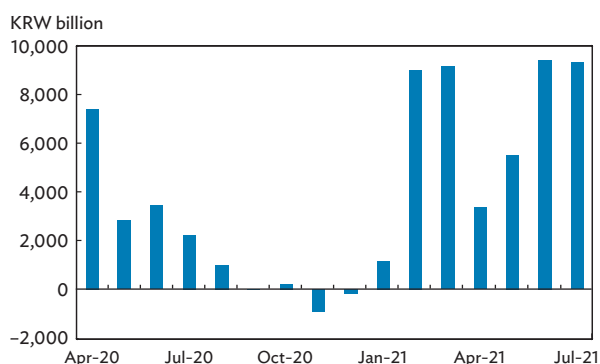
Source: AsianBondsOnline and The Bank of Korea.

to other bond markets in the region due to its strong domestic economic recovery and favorable external balances. The decline in the 5-year credit default swap spread from a peak of 26.0 bps in January to 18.5 bps at the end of July reflected strong investor confidence.

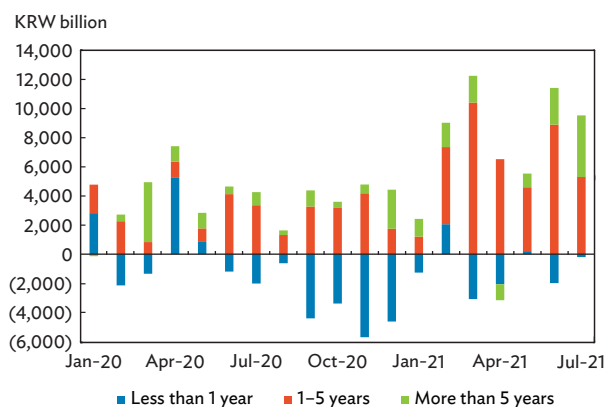
Ratings Update

On 21 July, Fitch Ratings affirmed the Republic of Korea's sovereign credit ratings at AA- with a stable outlook. The rating agency cited the Republic of Korea's "robust external finances, resilient macroeconomic performance, and modest fiscal headroom" as the reasons behind the rating affirmation. Downside risks remained following a

recent rise in domestic COVID-19 cases; however, the expanded vaccine rollout is expected to mitigate any new outbreak. In addition, the second supplementary budget is expected to support the recovery in consumption. Fitch Rating forecast that 2021 gross domestic product (GDP) growth will reach 4.5%. Meanwhile, the fiscal deficit is expected to widen to 4.4% of GDP in 2021. Despite the rise in government debt, the Republic of Korea's record of fiscal prudence, along with the government's proposal for a debt ceiling of 60% of GDP and an annual fiscal deficit limit of 3% of GDP, is expected to further support fiscal management. The rating agency also expects the Bank of Korea to hike policy rates by 25 bps in the second half of 2021 and by another 50 bps in 2022.

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


KRW = Korean won.
Source: Financial Supervisory Service.

Figure 5: Net Foreign Investment in Local Currency Bonds in the Republic of Korea by Remaining Maturity


KRW = Korean won.
Source: Financial Supervisory Service.

Policy, Institutional, and Regulatory Developments

National Assembly Passes Second Supplementary Budget

On 24 July, the National Assembly passed the second supplementary budget for 2021 worth KRW34.9 trillion, which was KRW1.9 trillion higher than the proposed amount. This was the sixth supplementary budget related to the government's response to the pandemic since 2020: KRW14.9 trillion was allotted for pandemic relief packages, KRW12.6 trillion for local economic support and subsidies to local governments, KRW4.9 trillion for vaccine purchases and disease prevention efforts, and KRW2.5 trillion for employment support and low-income household aid. The supplementary budget brought the overall budget for 2021 to KRW604.9 trillion from an original amount of KRW558 trillion. The new 2021 budget is expected to produce a fiscal deficit equal to 4.4% of GDP and cumulative government debt equal to 47.2% of GDP.

The Bank of Korea Announces Changes to Monetary Stabilization Bonds Issuance System

On 2 August, the Bank of Korea announced changes to the issuance system of Monetary Stabilization Bonds (MSBs) to enhance liquidity management efficiency. Regular auctions of 182-day MSBs will be suspended given the introduction of 3-year MSBs. Meanwhile, the issuance of 1-year, 2-year, and 3-year MSBs will be held once a month. Issuance of 91-day MSBs—at auctions to be held once a week—will be slightly expanded to around KRW1 trillion. Finally, the issuance of 1-year and 2-year MSBs will be significantly reduced due to the issuance of 3-year MSBs. The new system will be implemented effective 1 September.