Republic of Korea

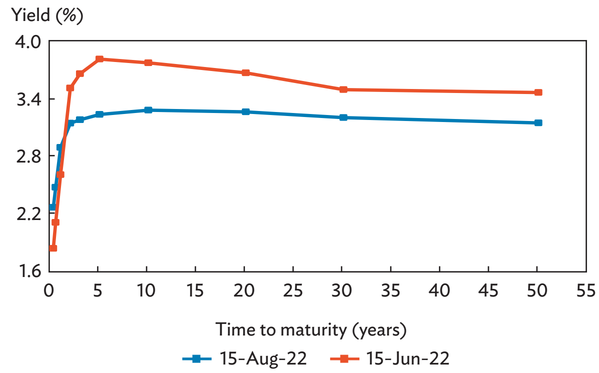
Yield Movements

The Republic of Korea's LCY government bond yield curve flattened between 15 June and 15 August as yields for short-term bonds rose while those for the rest of the curve fell (**Figure 1**). Yields for tenors of between 3 months and 1 year rose 36 basis points (bps) on average, with the 3-month tenor posting the largest increase at 43 bps. Meanwhile, yields for the 2-year through 10-year tenors fell 48 bps on average, with the 5-year tenor posting the largest increase of 58 bps. Yields for the 20-year to 50-year tenors fell 34 bps on average. The spread between the 10-year and 2-year tenors narrowed to 14 bps from 26 bps during the review period.

Yields rose at the short-end of the curve, reflecting the recent rate hikes and expectations of further policy tightening by both the Bank of Korea and the United States (US) Federal Reserve. At its 13 July and 25 August meetings, the Bank of Korea raised the base rate by 50 bps and 25 bps, respectively, to 2.50% to arrest the acceleration in inflation. This brought cumulative rate hikes for the year to 150 basis points. Inflation quickened to 6.3% year-on-year (y-o-y) in July, a more than 20-year high from quarterly averages of 3.8% y-o-y and 5.4% y-o-y, respectively, in the first quarter (Q1) and second quarter (Q2) of 2022, due to the continued rise in commodity prices and supply disruptions. Upward pressure on yields also stemmed from the aggressive monetary policy tightening of the Federal Reserve, which raised the federal funds rate target range by 75 bps each at its June and July monetary policy meetings to a range of 2.25%–2.50%.

The decline in long-term yields reflects concerns of a global and domestic economic slowdown. Downside risks have been exacerbated by the sharp weakening of the Korean won, making imports costly and further dampening private consumption, and an economic slowdown in the People's Republic of China, which is a major trade partner of the Republic of Korea. At its 25 August monetary policy meeting, the Bank of Korea lowered its full-year 2022 and 2023 economic growth forecasts to 2.6% and 2.1%, respectively, from May forecasts of 2.7% and 2.4%, primarily due to weakening exports. Meanwhile, inflation is projected to be 5.2% in 2022 and 3.7% in 2023, higher than May forecasts of 4.5% and 2.9%.

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 slowed further to 2.9% y-o-y in Q2 2022 from 3.0% y-o-y in Q1 2022 and 4.2% y-o-y in the fourth quarter of 2021, based on preliminary estimates by the Bank of Korea. The lower growth was primarily driven by the continued contraction of 2.9% y-o-y in gross fixed capital formation in Q2 2022, following a 3.5% y-o-y decline in the previous quarter. Both private and public consumption posted smaller annual increases in Q2 2022 at 3.9% y-o-y and 3.7% y-o-y, respectively, from 4.3% y-o-y and 6.6% y-o-y in Q1 2022. Export growth also decelerated to 4.6% y-o-y in Q2 2022 from 7.3% y-o-y in the previous quarter. On a quarter-on-quarter (q-o-q) basis, domestic economic growth inched up to 0.7% in Q2 2022 from 0.6% in the previous quarter.

Aggressive tightening by the Federal Reserve and a stronger US dollar led to a sell-off in bond markets across the region. The rise in US Treasury yields resulted in a decline in the spread and eventually an interest rate inversion between the US and Korean markets, making domestic bonds less attractive. Net foreign inflows into the Republic of Korea's LCY bond market declined to KRW36 billion in April before recovering to KRW1,370 billion in May. In June, the Republic of Korea registered net outflows of KRW934 billion following the 75 bps rate hike by the Federal Reserve. The declining monthly net inflows (and ultimately, net outflows) were also largely driven by the continued depreciation of the Korean won, which reached a low of USD1,326.2 per

USD1.0 on 15 July, representing a 10.3% depreciation from the start of the year despite market intervention by the Bank of Korea to support the currency. In July, foreign investors returned to the market with net inflows of KRW3,561 billion, as market participants expected a slowdown in the Federal Reserve policy tightening.

Size and Composition

The Republic of Korea's LCY bonds outstanding inched up 1.0% quarter-on-quarter (q-o-q) to reach KRW2,925.7 trillion (USD2,252.7 billion) at the end of June, which was slower than the 2.0% q-o-q posted in the previous quarter (**Table 1**). Growth was largely driven by the government segment as the corporate sector posted only minimal growth. On an annual basis, the size of the Republic of Korea's LCY bond market rose 6.1% y-o-y, compared with a 7.5% y-o-y increase posted in Q1 2022.

Government bonds. The Republic of Korea's LCY government bond market expanded 1.6% q-o-q in Q2 2022 to KRW1,242.0 trillion, down from the 3.4% q-o-q growth in the previous quarter. This was mostly due to the high base in Q1 2022 when the government frontloaded its issuance to meet budgeting needs. Growth for the quarter was mainly driven by the 3.4% q-o-q rise in the stock of central government bonds, while the amount of central bank bonds declined 10.2% q-o-q. Meanwhile, other government bonds rose 1.9% q-o-q during the quarter.

Issuance of government bonds rose 4.9% q-o-q to KRW102.9 trillion in Q2 2022, driven by the 37.8% q-o-q increase in bond issuance from government-owned entities. Central government bonds issuance also rose but at a slower pace of 9.7% q-o-q in Q2 2022. Meanwhile, issuance of Monetary Stabilization Bonds by the Bank of Korea fell 21.2% q-o-q. The Bank of Korea scaled down issuance of these bonds beginning in late 2021 to ease yield volatility, as the central bank was already tightening liquidity via policy rate hikes.

Corporate bonds. The outstanding size of the Republic of Korea's LCY corporate bond market posted a marginal increase of 0.5% q-o-q to reach KRW1,683.8 trillion (USD1,296.4 billion) at the end of June, which was lower than the 1.0% q-o-q increase posted in the previous quarter. **Table 2** lists the top 30 LCY corporate bond issuers in the Republic of Korea, with aggregate bonds outstanding of KRW998.5 trillion at the end of June, comprising 59.3% of the total LCY corporate bond market. Financial institutions involved in banking and securities investments continued to dominate the list with a collective share of 63.2%. Korea Housing Finance Corporation, a government-related institution providing financial assistance for social housing, remained the single-largest corporate bond issuer with outstanding bonds of KRW151.2 trillion. Industrial Bank of Korea and Korea Investment and Securities followed with total bonds outstanding of KRW73.4 trillion and KRW53.0 trillion, respectively.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2021		Q1 2022		Q2 2022		Q2 2021		Q2 2022	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**2,756,445**	**2,448**	**2,898,057**	**2,391**	**2,925,746**	**2,253**	**2.3**	**7.9**	**1.0**	**6.1**
Government	1,158,252	1,029	1,222,359	1,009	1,241,968	956	3.2	11.6	1.6	7.2
Central Government Bonds	807,725	717	884,103	730	914,183	704	5.0	19.0	3.4	13.2
Central Bank Bonds	154,230	137	140,190	116	125,910	97	(1.9)	(8.7)	(10.2)	(18.4)
Others	196,297	174	198,065	163	201,875	155	0.3	3.2	1.9	2.8
Corporate	1,598,193	1,419	1,675,698	1,383	1,683,778	1,296	1.6	5.4	0.5	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. Bloomberg LP end-of-period local currency–USD rates are used.
2. Growth rates are calculated from local currency base and do not include currency effects.
3. "Others" comprise Korea Development Bank Bonds, National Housing Bonds, and Seoul Metro Bonds.
4. Corporate bonds include equity-linked securities and derivatives-linked securities.

Sources: The Bank of Korea and KG Zeroin Corporation.

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	151,207	116.4	Yes	No	No	Housing Finance
2.	Industrial Bank of Korea	73,360	56.5	Yes	Yes	No	Banking
3.	Korea Investment and Securities	52,999	40.8	No	No	No	Securities
4.	Meritz Securities	49,640	38.2	No	Yes	No	Securities
5.	Hana Securities	48,548	37.4	No	No	No	Securities
6.	Mirae Asset Securities	48,480	37.3	No	Yes	No	Securities
7.	Shinhan Investment Corporation	48,422	37.3	No	No	No	Securities
8.	Korea Electric Power Corporation	45,940	35.4	Yes	Yes	No	Electricity, Energy, and Power
9.	KB Securities	45,631	35.1	No	No	No	Securities
10.	NH Investment & Securities	34,568	26.6	Yes	Yes	No	Securities
11.	Korea Land & Housing Corporation	32,577	25.1	Yes	No	No	Real Estate
12.	Shinhan Bank	28,445	21.9	No	No	No	Banking
13.	The Export-Import Bank of Korea	27,690	21.3	Yes	No	No	Banking
14.	Korea Expressway	27,430	21.1	Yes	No	No	Transport Infrastructure
15.	Samsung Securities	26,091	20.1	No	Yes	No	Securities
16.	Woori Bank	23,860	18.4	Yes	Yes	No	Banking
17.	KEB Hana Bank	23,111	17.8	No	No	No	Banking
18.	NongHyup Bank	21,880	16.8	Yes	No	No	Banking
19.	Kookmin Bank	21,044	16.2	No	No	No	Banking
20.	Korea SMEs and Startups Agency	20,298	15.6	Yes	No	No	SME Development
21.	Korea National Railway	19,320	14.9	Yes	No	No	Transport Infrastructure
22.	Shinhan Card	17,220	13.3	No	No	No	Credit Card
23.	Shinyoung Securities	16,004	12.3	No	Yes	No	Securities
24.	Hyundai Capital Services	15,680	12.1	No	No	No	Consumer Finance
25.	Hanwha Investment and Securities	14,773	11.4	No	No	No	Securities
26.	KB Kookmin Bank Card	14,245	11.0	No	No	No	Consumer Finance
27.	Standard Chartered Bank Korea	13,710	10.6	No	No	No	Banking
28.	NongHyup	12,830	9.9	Yes	No	No	Banking
29.	Samsung Card Co.	12,248	9.4	No	Yes	No	Credit Card
30.	Korea Railroad Corporation	11,230	8.6	Yes	No	No	Transport Infrastructure
Total Top 30 LCY Corporate Issuers		**998,481**	**769**				
Total LCY Corporate Bonds		**1,683,778**	**1,296.4**				
Top 30 as % of Total LCY Corporate Bonds		**59.3%**	**59.3%**				

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 2022.
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.

Corporate bond issuance rose 5.7% y-o-y to KRW143.3 trillion in Q2 2022 from KRW135.5 trillion in the previous quarter. Issuance remained tepid in Q2 2022 due to continued yield volatility amid the monetary policy tightening by both the Bank of Korea and the Federal Reserve. **Table 3** lists the notable corporate bond issuances in Q2 2022, including from financial firms such as Industrial Bank of Korea, Export–Import Bank of Korea, Kookmin Bank, and NongHyup Bank.

Investor Profile

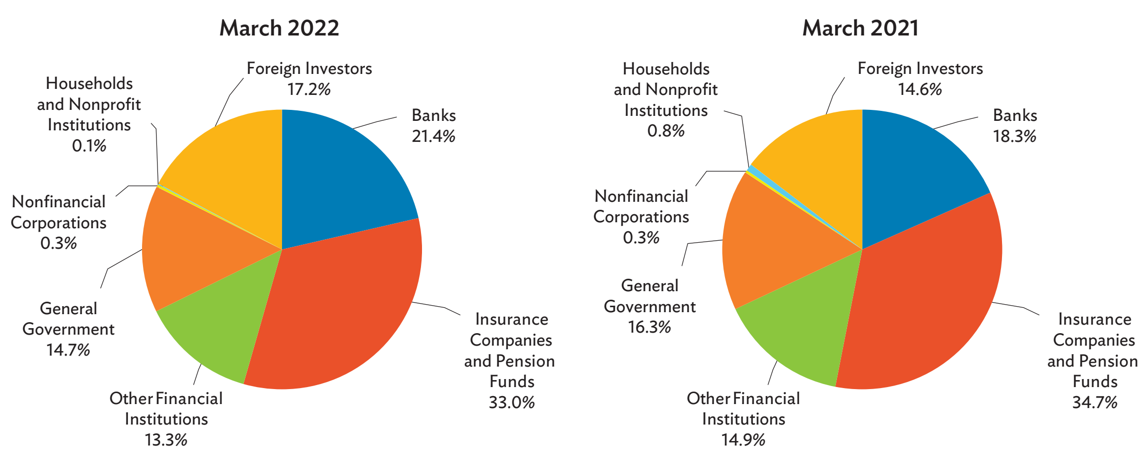
Insurance companies and pension funds remained the top holders of the Republic of Korea's LCY government bonds at the end of March, comprising 33.0% of the market (**Figure 2**). However, this was down from 34.7% in Q1 2021, as the share of banks rose to 21.4% from 18.3% during the review period. The shares of general government and other financial institutions also fell in

Table 3: Notable Local Currency Corporate Bond Issuances in the Second Quarter of 2022

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Industrial Bank of Korea[a]		
5-month bond	–	400
7-month bond	3.03	480
7-month bond	3.03	320
1-year bond	2.92	360
2-year bond	3.77	410
5-year bond	4.13	590
Export–Import Bank of Korea[a]		
2-month bond	–	350
1-year bond	3.04	490
1-year bond	3.01	490
1-year bond	–	390
1-year bond	2.92	340
1-year bond	–	290
Kookmin Bank[a]		
1-month bond	3.14	620
1-year bond	3.26	440
1-year bond	2.45	360
1.3-year bond	3.14	450
1.5-year bond	2.82	480
NongHyup Bank[a]		
1-year bond	2.92	510
1-year bond	2.92	480
1-year bond	2.92	340
1-year bond	2.92	290
1.5-year bond	2.71	290

– = not available, KRW = Korean won.
[a] Multiple issuance of the same tenor indicates issuance on different dates.
Source: Based on data from Bloomberg LP.

Figure 2: Local Currency Government Bonds Investor Profile



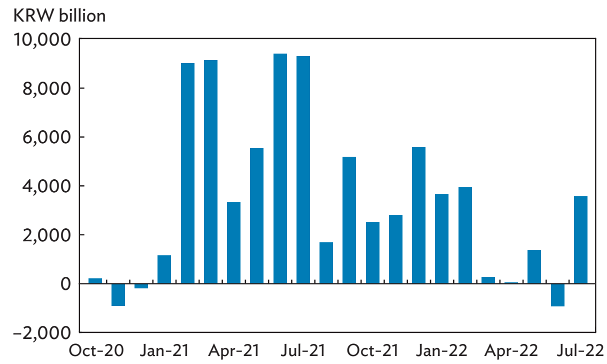
Source: *AsianBondsOnline* and The Bank of Korea.

Q1 2022 to 14.7% and 13.3%, respectively, from 16.3% and 14.9% in the same period in 2021. Foreign holdings of LCY government bonds jumped to 17.2% in Q1 2022 from 14.6% in Q1 2021 due to high levels of foreign inflows in 2021 through the first quarter of 2022.

In Q1 2022, other financial institutions remained the largest investor group in the Republic of Korea's LCY corporate bond market (**Figure 3**), while also posting the largest share increase of 2.2 percentage points to 41.1%. Insurance companies and pension funds comprised the second-largest investor group with a 34.0% market share at the end of March, but this was lower than the 36.3% share in the same period in 2021. The holdings share of the general government also fell to 12.8% from 13.5%, while the share of banks rose to 11.0% from 9.8%. Meanwhile, the share of foreign holders remained negligible at 0.1%.

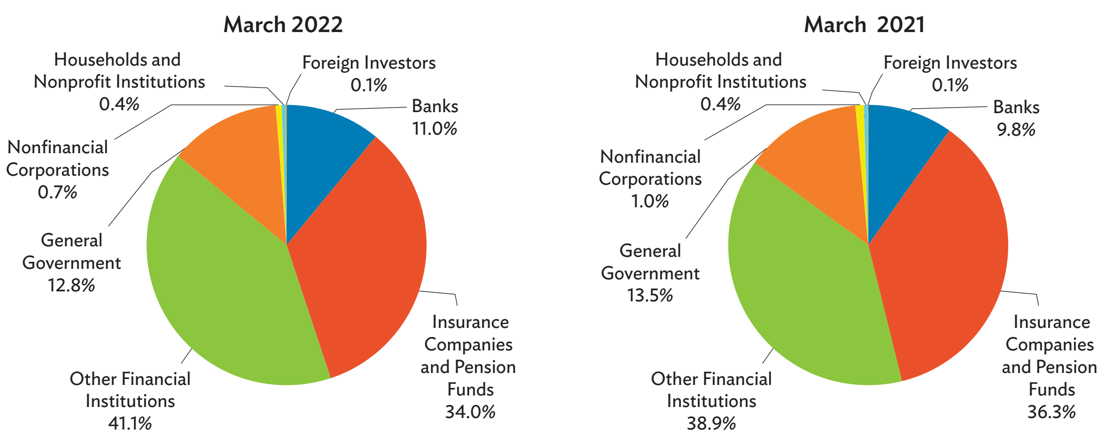
Foreign demand for the Republic of Korea's LCY bonds weakened in Q2 2022, with net inflows declining to KRW36 billion in April from KRW279 billion in March (**Figure 4**). The low levels of foreign inflows were largely driven by the sell-off in the region following the start of rate hikes by the Federal Reserve in March. Net foreign inflows recovered to KRW1,370 million in May, but this was still relatively low as the market expected the Federal Reserve to continue with its aggressive monetary policy tightening. The sharper rise in US Treasury yields relative to domestic interest rates narrowed the interest rate differential between the two markets, with periods of rate inversion during the quarter. Coupled with the continued depreciation of the Korean won, this has made domestic bonds less attractive. The differential was magnified by the Federal Reserve's 75 bps rate hike in June, which led to net outflows of KRW934 billion during the month. Increased expectations of an economic slowdown also contributed to muted foreign demand for domestic bonds. Foreign outflows have been concentrated in bonds with remaining maturities of less than 1 year (**Figure 5**). However, in July, foreign investors returned to the market with net inflows of KRW3,561 billion as market participants priced in a slowdown in the Federal Reserve's rate hikes for the rest of the year.

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



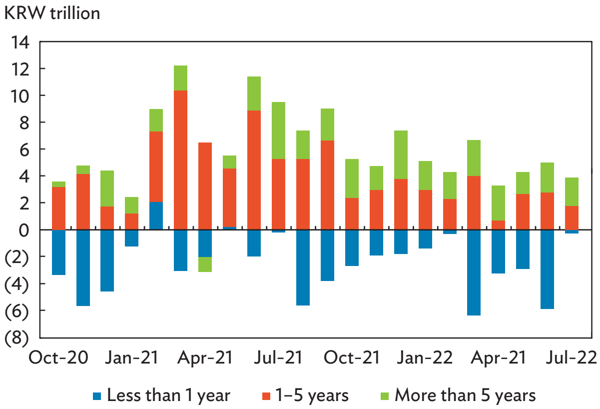
KRW = Korean won.
Source: Financial Supervisory Service.

Figure 3: Local Currency Corporate Bonds Investor Profile



Source: *AsianBondsOnline* and The Bank of Korea.

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

The Government Announces Plans to Improve Fiscal Soundness and Manage Global Economic Challenges

On 28 July, the Bank of Korea, Financial Services Commission, and Financial Supervisory Service held an emergency meeting to discuss the impact of the US Federal Open Market Committee's July meeting on the domestic financial market. Representatives from these institutions stated that the Republic of Korea's strong fundamentals and responses to the challenges had more impact on capital flows than the interest rate reversal between US Treasuries and domestic bonds, citing that Korean securities continued to register net foreign inflows in July. They also stated that the Republic of Korea is equipped to respond to these challenges, highlighting its high sovereign credit ratings and large foreign reserves. Nevertheless, the institutions will continue to monitor and increase the Republic of Korea's fiscal soundness and prepare preemptive measures and reforms to manage global economic challenges. These include, among others, (i) implementation of measures such as the government's emergency buyback of Korea Treasury Bonds (KTBs) and the Bank of Korea's buyback of KTBs in case of excessive volatility in the market; (ii) improvement of foreign investors' accessibility to domestic financial markets; and (iii) efforts for the Republic of Korea to join the FTSE World Government Bond Index via the introduction of a new tax scheme that will exempt income and corporate income tax on capital gains earned from nonresidents' and foreign corporations' investment in KTBs and central bank bonds.