

Republic of Korea

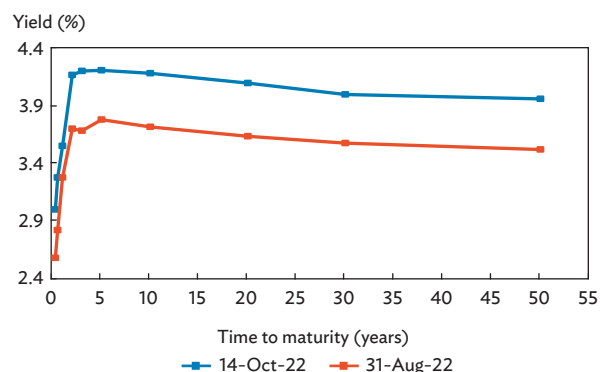
Yield Movements

The Republic of Korea's LCY government bond yield curve shifted upward between 31 August and 14 October (Figure 1). Yields for the 3-month and 6-month tenors rose 44 basis points (bps) on average, while the 1-year tenor rose 28 bps. Yields for tenors between 2-year and 10-year rose 47 bps on average, with the 3-year tenor posting the biggest increase of 52 bps. Meanwhile, yields for 20-year to 50-year tenors rose 44 bps on average. The spread between the 10-year and 2-year tenors remained almost negligible at 1 bp on 14 October, little changed from 2 bps on 31 August.

Yields rose sharply across the curve during the review period, tracking the rise in United States (US) Treasury yields, on expectations of further rate hikes by both the US Federal Reserve and the Bank of Korea. Following speculation of a possible slowdown in its aggressive monetary tightening, Chair Jerome Powell, in his Jackson Hole speech in late August, sent a clear signal that the Federal Reserve had no intentions of slowing the pace of rate hikes in the near term. He also reiterated the Federal Reserve's commitment to fight high inflation even as the US economy slows. Subsequently, at its 20–21 September meeting, the Federal Reserve raised the federal funds rate target range by 75 bps to between 3.00% and 3.25%, while also lowering its gross domestic product (GDP) growth forecast and raising its inflation forecast.

On the domestic front, the Bank of Korea, in its 12 October monetary policy meeting, raised the base rate by another 50 bps to 3.0%, following a 25 bps rate hike in August. This brought total policy rate hikes year-to-date to 200 bps. The Bank of Korea continued with its monetary policy tightening stance, despite a slowdown in inflation, as inflationary pressure remained high and in order to provide support to the foreign exchange market. Inflation peaked at 6.3% year-on-year (y-o-y) in July before easing to 5.7% y-o-y in August and 5.6% y-o-y in September, and slightly inching up to 5.7% y-o-y in October. Meanwhile, the Korean won fell sharply during the review period, reaching a more-than-a-decade low of KRW1,440.2 to USD1.0 on 28 September, and falling 16.8% year-to-date as of 14 October to

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



Source: Based on data from Bloomberg LP.

KRW1,429.0 per USD1.0. This was largely due to the continued strengthening of the US dollar and concerns of an economic slowdown in the People's Republic of China, which is one of the Republic of Korea's major trading partners. The Bank of Korea has been actively intervening in the foreign exchange market to support the Korean won, with its foreign exchange reserves posting a large monthly drop of USD19.7 billion in September to USD416.8 billion at the end of the month. In efforts to stabilize the sharp rise in domestic yields, the Bank of Korea purchased KRW3.0 billion worth of government bonds on 29 September.

The Republic of Korea's economic growth inched up to 3.1% y-o-y in the third quarter (Q3) of 2022 from 2.9% y-o-y in the second quarter (Q2) of 2022, remaining above the Bank of Korea's 2.6% full-year growth forecast for 2022. The higher growth was primarily driven by the rebound in gross fixed capital formation, which expanded 1.0% q-o-q in Q3 2022 following a 2.9% y-o-y contraction in Q2 2022. Private consumption also posted higher growth of 5.9% y-o-y in Q3 2022 from 3.9% y-o-y in the previous quarter. Meanwhile, public consumption growth slowed to 2.4% y-o-y from 3.7% during the same period. Export growth held steady on an annual basis at 4.6% y-o-y in Q3 2022. However, on a quarter-on-quarter (q-o-q) basis, GDP growth slowed to 0.3% q-o-q in Q3 2022 from 0.7% q-o-q in the previous quarter.

Foreign investors returned to the Republic of Korea's LCY bond market in July, registering net foreign inflows of KRW3,561 billion following net outflows of KRW934 million in June. The reversal can be attributed to expectations at the time of a pending slowdown in the Federal Reserve's policy tightening. However, the impact was only temporary as the Federal Reserve, in the release of the minutes of its July Federal Open Market Committee meeting and Chair Jerome Powell's subsequent Jackson Hole speech in August, clarified that it would continue with its aggressive monetary tightening. Narrowing yield premiums between Korean bonds and US Treasuries, with periods of reversals, and the sharp depreciation of the Korean won drove foreign fund outflows of KRW1,852 billion and KRW980 billion from the LCY bond market in August and September, respectively.

Size and Composition

The Republic of Korea's LCY bond market grew 1.3% q-o-q to reach KRW2,964.4 trillion (USD2.1 trillion) at the end of September, which was slightly higher than the 1.0% q-o-q growth posted in the previous quarter (**Table 1**). On an annual basis, growth slowed to 5.9% y-o-y from 6.1% y-o-y in Q3 2021.

Government bonds. The Republic of Korea's LCY government bond market reached a size of KRW1,264.0 trillion at the end of September, posting 1.8% q-o-q growth in Q3 2022, up slightly from 1.6% q-o-q in Q2 2022. Growth was largely driven by

the 2.1% q-o-q rise in the stock of central government bonds in Q3 2022 to KRW933.1 trillion; however, this was a slowdown from the 3.4% q-o-q growth in the previous quarter. Bonds of government-owned entities also posted growth of 3.0% q-o-q, up from 1.9% q-o-q in Q2 2022. Meanwhile, the stock of Monetary Stabilization Bonds issued by the Bank of Korea fell 2.3% q-o-q in Q3 2022.

Issuance of government bonds fell 15.5% q-o-q to KRW86.9 trillion in Q3 2022, driven by the 37.3% q-o-q drop in the issuance of central government bonds. This was due to a high issuance volume in Q2 2022 in line with the government's debt frontloading policy in the first half of the year. Meanwhile, issuance of bonds by government-owned entities and central bank bonds rose 10.7% q-o-q and 11.7% q-o-q, respectively, in Q3 2022.

Corporate bonds. The Republic of Korea's LCY corporate bond market inched up 1.0% q-o-q to KRW1,700.4 trillion at the end of September, slightly higher than the 0.5% q-o-q growth posted in the previous quarter. **Table 2** lists the top 30 LCY corporate bond issuers in the Republic of Korea, which had an aggregate outstanding bond stock of KRW1,015.4 trillion and accounted for 59.7% of the total LCY corporate bond market. Financial institutions, particularly banks and securities firms, comprised 63.0% of the top 30 list. Korea Housing Finance Corporation, a government-related institution providing financial assistance for social housing, remained the largest corporate issuer in the market with total bonds outstanding of

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2021		Q2 2022		Q3 2022		Q3 2021		Q3 2022	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	2,799,920	2,365	2,925,746	2,253	2,964,362	2,071	1.6	7.6	1.3	5.9
Government	1,179,746	996	1,241,968	956	1,263,967	883	1.9	10.4	1.8	7.1
Central Government Bonds	831,745	703	914,183	704	933,074	652	3.0	17.5	2.1	12.2
Central Bank Bonds	151,050	128	125,910	97	123,020	86	(2.1)	(9.4)	(2.3)	(18.6)
Others	196,951	166	201,875	155	207,874	145	0.3	1.2	3.0	5.5
Corporate	1,620,174	1,369	1,683,778	1,296	1,700,395	1,188	1.4	5.7	1.0	5.0

() = 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. 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 Zerin 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	152,099	106.3	Yes	No	No	Housing Finance
2. Industrial Bank of Korea	74,500	52.1	Yes	Yes	No	Banking
3. Meritz Securities	61,783	43.2	No	Yes	No	Securities
4. Korea Electric Power Corporation	52,380	36.6	Yes	Yes	No	Electricity, Energy, and Power
5. Korea Investment and Securities	50,247	35.1	No	No	No	Securities
6. Hana Securities	48,288	33.7	No	No	No	Securities
7. Shinhan Investment Corporation	46,635	32.6	No	No	No	Securities
8. Mirae Asset Securities	46,565	32.5	No	Yes	No	Securities
9. KB Securities	43,129	30.1	No	No	No	Securities
10. NH Investment & Securities	34,502	24.1	Yes	Yes	No	Securities
11. Korea Land & Housing Corporation	32,421	22.7	Yes	No	No	Real Estate
12. Shinhan Bank	31,795	22.2	No	No	No	Banking
13. The Export-Import Bank of Korea	28,280	19.8	Yes	No	No	Banking
14. Korea Expressway	27,600	19.3	Yes	No	No	Transport Infrastructure
15. Woori Bank	25,170	17.6	Yes	Yes	No	Banking
16. KEB Hana Bank	24,611	17.2	No	No	No	Banking
17. Samsung Securities	23,793	16.6	No	Yes	No	Securities
18. Kookmin Bank	22,484	15.7	No	No	No	Banking
19. NongHyup Bank	21,290	14.9	Yes	No	No	Banking
20. Korea SMEs and Startups Agency	21,178	14.8	Yes	No	No	SME Development
21. Korea National Railway	19,060	13.3	Yes	No	No	Transport Infrastructure
22. Shinhan Card	17,100	11.9	No	No	No	Credit Card
23. Hyundai Capital Services	15,930	11.1	No	No	No	Consumer Finance
24. Shinyoung Securities	15,783	11.0	No	Yes	No	Securities
25. KB Kookmin Bank Card	14,515	10.1	No	No	No	Consumer Finance
26. Standard Chartered Bank Korea	14,070	9.8	No	No	No	Banking
27. Hanwha Investment and Securities	13,991	9.8	No	No	No	Securities
28. NongHyup	12,670	8.9	Yes	No	No	Banking
29. Samsung Card Co.	11,848	8.3	No	Yes	No	Credit Card
30. Korea Railroad Corporation	11,720	8.2	Yes	No	No	Transport Infrastructure
Total Top 30 LCY Corporate Issuers	1,015,435	709.5				
Total LCY Corporate Bonds	1,700,395	1,188.1				
Top 30 as % of Total LCY Corporate Bonds	59.7%	59.7%				

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 September 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 Zerin Corporation data.

KRW152.1 trillion at the end of Q3 2022. The Industrial Bank of Korea and Korea Investment and Securities were the next largest issuers at KRW74.5 trillion and KRW61.8 trillion, respectively.

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

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Industrial Bank of Korea ^a		
2-month bond	-	720
2.5-month bond	-	710
6-month bond	3.02	620
1-year bond	4.03	660
1-year bond	-	630
1-year bond	-	610
Kookmin Bank ^a		
1-year bond	3.58	920
1-year bond	3.65	900
1-year bond	3.68	600
Shinhan Bank ^a		
6-month bond	3.60	560
1-year bond	3.86	510
1.5-year bond	3.60	650
1.5-year bond	3.90	600
KDIC Special Account Bond		
3-year bond	3.70	720
NongHyup Bank		
3-year bond	4.04	650

- = not available, KRW = Korean won.

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

Source: Based on data from Bloomberg LP.

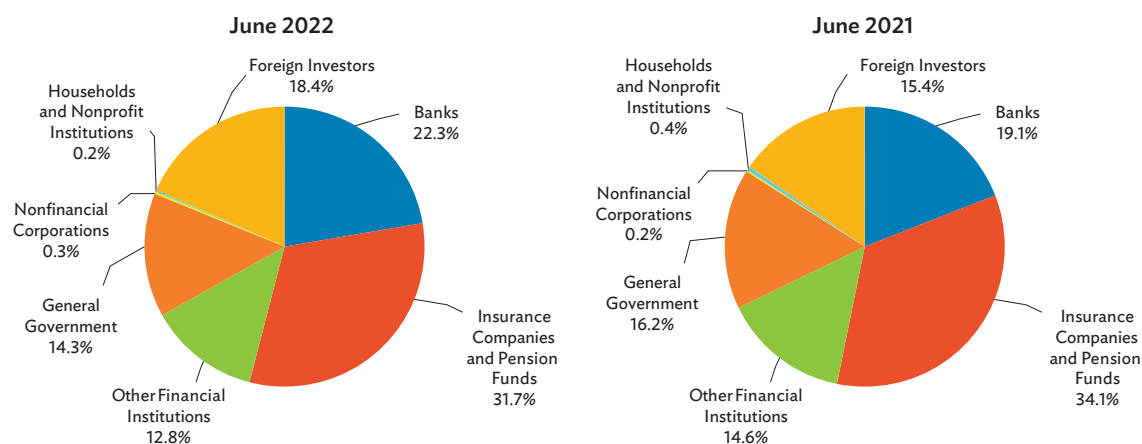
The marginal growth in the Republic of Korea's LCY corporate bond market was driven by the 2.4% q-o-q growth in issuance, which was slower than the 7.1% q-o-q increase in Q2 2022. Issuance remained relatively low in Q3 2022 due to continued yield volatility in the market. **Table 3** lists the notable corporate bond issuances in Q3 2022, including those from financial firms such as Industrial Bank of Korea, Kookmin Bank, and Shinhan Bank.

Investor Profile

Government Bonds. Insurance companies and pension funds remained the largest investor group in the Republic of Korea's LCY government bond market at the end of June (**Figure 2**). However, this group also posted the largest decline in terms of market share, falling to 31.7% from 34.1% a year earlier. Banks were the second-largest investor group with a share of 22.3%, up from 19.1% in Q2 2021. The share of foreign investors' holdings also posted a large increase from 15.4% to 18.4% during the same period due to foreign net inflows in the LCY government bond market during most of the review period. Meanwhile, the shares of the general government and other financial institutions declined in between June 2021 and June 2022.

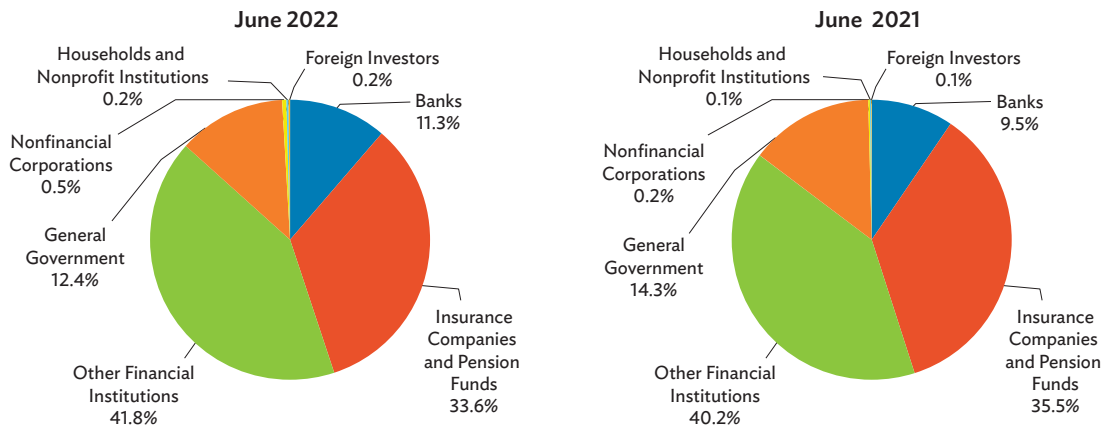
Corporate bonds. Other financial institutions held the largest share of the Republic of Korea's LCY corporate bonds at the end of June, with their share rising to 41.8% from 40.2% a year earlier (**Figure 3**).

Figure 2: Local Currency Government Bonds Investor Profile



Source: AsianBondsOnline and The Bank of Korea.

Figure 3: Local Currency Corporate Bonds Investor Profile



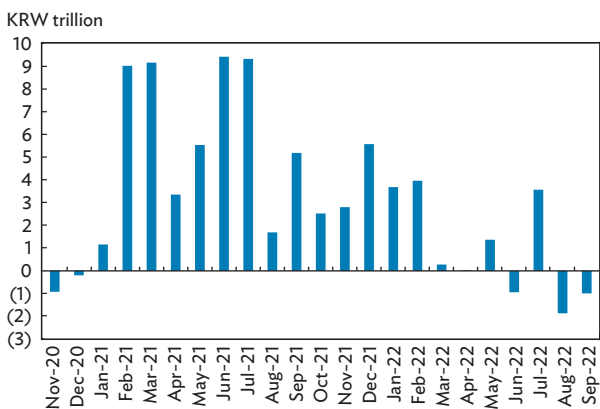
Source: AsianBondsOnline and The Bank of Korea.

Meanwhile, the shares of insurance companies and pension funds and the general government fell at the end of June to 33.6% and 12.4%, respectively, from 35.5% and 14.3% a year earlier. The share of foreign holders continued to remain negligible.

Foreign fund flows. Net foreign flows into the Republic of Korea’s LCY bond market turned positive in July, posting KRW3,561 billion following net outflows of KRW0.9 billion in June (Figure 4). This was largely due to expectations of a slowdown in monetary policy tightening by the Federal Reserve. However, the Republic of Korea registered net foreign outflows of KRW1.9 billion in August as US Treasury yields rose

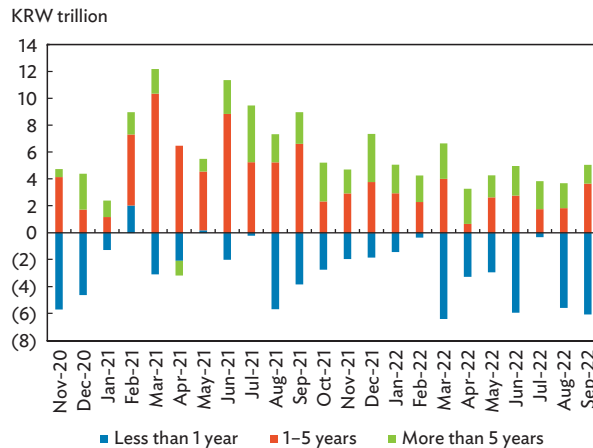
once again following the release of the minutes of the July Federal Open Market Committee meeting in which the Federal Reserve highlighted its resolve in fighting high inflation via aggressive monetary policy tightening. Chair Jerome Powell’s Jackson Hole speech in late August confirmed this sentiment. Subsequently, the Federal Reserve raised the federal funds rate target range by an additional 75 bps in September. This move resulted in KRW980 billion of net foreign outflows from the Republic of Korea’s LCY bond market in September. The foreign sell-off during Q3 2022 was most significant in bonds with remaining maturities of less than 1 year (Figure 5).

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



(-) = negative, KRW = Korean won.
Source: Financial Supervisory Service.

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



(-) = negative, KRW = Korean won.
Source: Financial Supervisory Service.

Ratings Update

On 28 September, Fitch Ratings affirmed the Republic of Korea's sovereign credit ratings of AA- with a stable outlook. The rating agency cited the Republic of Korea's robust external finances, resilient macroeconomic performance, and dynamic export sector as some of the reasons behind the rating affirmation. It also highlighted the Republic of Korea's sufficient fiscal space to accommodate the government's rising debt-to-GDP ratio in the near term, following the recently announced consolidation plans. The rating agency forecast that GDP growth would slow to 2.6% in 2022 amid a slowdown in global growth as well as in domestic exports and facilities investment.

Policy, Institutional, and Regulatory Developments

The Government Announces 2023 Budget Proposal

On 30 August, the Government of the Republic of Korea announced its 2023 budget proposal totaling KRW639 trillion. This represented a 5.2% increase from the original 2022 budget, which is less than the average yearly increase of 8.7% over the last 5 years. The proposed

2023 budget is also 5.9% less than the 2022 final budget, which includes the supplementary budget. The smaller annual increase in the budget is in line with government efforts to reduce spending as part of its 2022–2026 fiscal management plan to improve fiscal sustainability. The proposed budget is projected to result in a 0.6% fiscal-deficit-to-GDP ratio, which is lower than the 2.5% ratio for 2022. Priorities in the budget include the expansion of protections for low-income and vulnerable households, support for the private-sector-led economy, and improvements to national safety and security.

Fiscal Rules Introduced

In its 13 September emergency ministerial meeting on economic affairs, the Government of the Republic of Korea announced its plans to introduce rules to improve the government's fiscal soundness. This includes the use of the managed fiscal balance as a standard for fiscal rules instead of the consolidated fiscal balance. In addition, the managed fiscal balance shall have an upper limit of 3% of GDP, and it will be reduced to 2% when government debt exceeds 60% of GDP. However, this shall not be applied in the case of exceptional situations such as wars, national disasters, and economic downturns. The rules shall be established on a legal basis via inclusion of fiscal rule management standards in the National Finance Act and will be used in the design of the 2024 budget proposal.