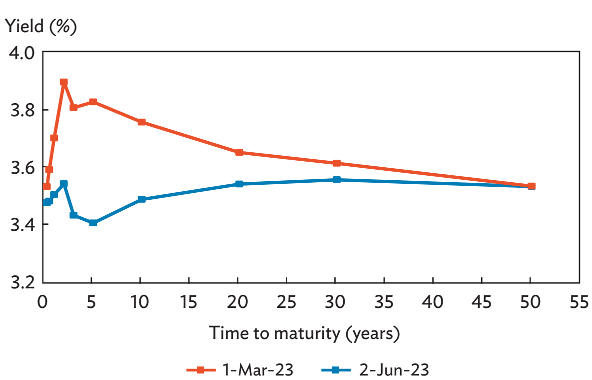
Republic of Korea

Yield Movements

The Republic of Korea's local currency (LCY) government bond yield curve flattened between 1 March and 2 June, with the drop in yields most pronounced for medium-term bonds (Figure 1). Bond yields fell due to the Bank of Korea's decision to maintain the base rate at 3.50% in its monetary policy meetings in April and May, amid slowing inflation and economic growth and on increased expectations that the US Federal Reserve would hold rates steady in its June monetary policy meeting.

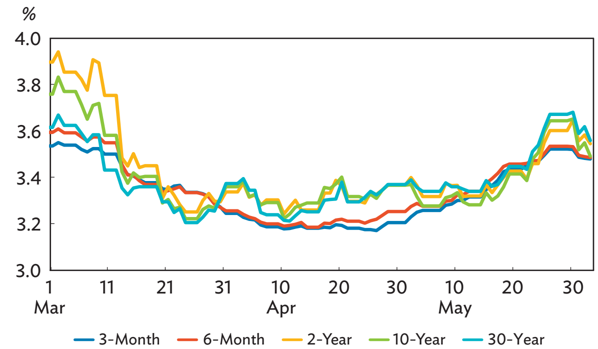
Yields fell sharply for all tenors in March, with tenors between 1-year and 10-year posting the largest declines, as they tracked the decline in United States (US) Treasury yields following the collapse of Silicon Valley Bank. However, in April, domestic bond yields remained range-bound amid easing concerns over the US banking system and as market participants awaited further signals from the Federal Reserve on the timing as to the end of the rate-hike cycle (**Figure 2**). Also in April, the Bank of Korea maintained the base rate at 3.50%, as both inflation and economic growth were observed to have slowed. Subsequently, in its 25 May monetary policy meeting, the Bank of Korea again maintained the base rate; and lowered its 2023 and 2024 growth forecasts to 1.4% year-on-year (y-o-y) and 2.3% y-o-y, respectively, from January forecasts of 1.6% y-o-y and 2.4% y-o-y. Meanwhile, the inflation forecast for 2023 was maintained at 3.5%, while for 2024 it was lowered to 2.4% from 2.6%. In May, domestic bond yields started to pick up again, largely for the short- and long-term bonds tracking the rise in US Treasury yields, as market participants awaited the result of the debt ceiling deal negotiations in the US.

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



Source: Based on data from Bloomberg LP.

Figure 2: Local Currency Government Bond Yields—Selected Tenors



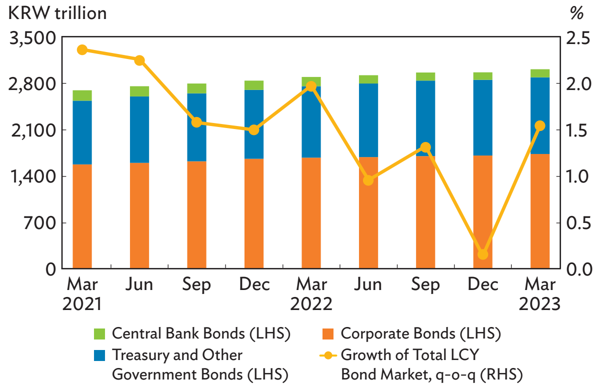
Note: Data coverage is from 1 March to 2 June 2023.
Source: Based on data from Bloomberg LP.

Local Currency Bond Market Size and Issuance

The Republic of Korea's LCY bond market reached a size of KRW3,014.2 trillion (USD2.3 trillion) at the end of March. Overall growth accelerated to 1.5% quarter-on-quarter (q-o-q) in the first quarter (Q1) of 2023 from 0.1% q-o-q in the previous quarter, and was mainly driven by the 1.3% q-o-q increase in the stock of corporate bonds. Meanwhile, the stock of Treasury and other government bonds rose at a slightly slower pace of 1.2% q-o-q on increased issuance during the quarter. Corporate bonds continued to comprise 57.4% of the Republic of Korea's LCY bond market at the end of March, declining somewhat from a share of 58.4% at the end of Q1 2021 (**Figure 3**). Meanwhile, the share of Treasury and other government bonds had been steadily increasing to 38.5% at the end of March.

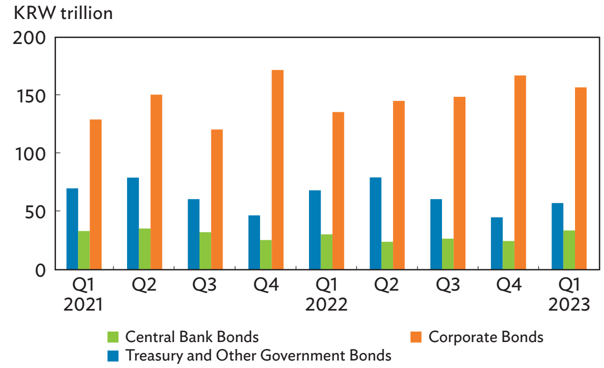
LCY bond issuance rose 4.7% q-o-q to KRW247.2 trillion in Q1 2023. Growth was largely driven by the increase in issuance of Treasury and other government bonds as corporate bond issuance fell during the quarter (**Figure 4**).

Figure 3: Composition of Local Currency Bonds Outstanding in the Republic of Korea



KRW = Korean won, LCY = local currency, LHS = left-hand side, q-o-q = quarter-on-quarter, RHS = right-hand side.
Sources: Bank of Korea and KG Zeroin Corp.

Figure 4: Composition of Local Currency Bond Issuance in the Republic of Korea



KRW = Korean won, Q1 = first quarter, Q2 = second quarter, Q3 = third quarter, Q4 = fourth quarter.
Sources: Bank of Korea and KG Zeroin Corp.

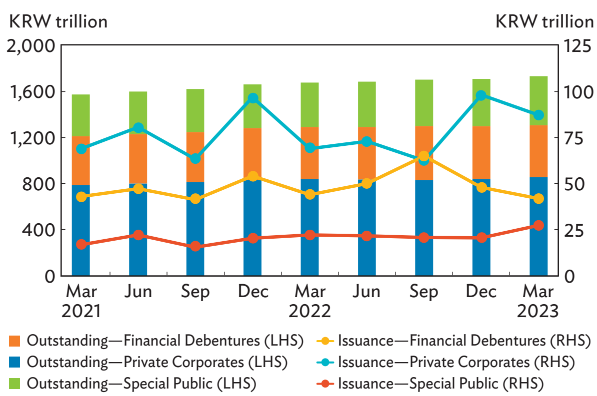
Issuance of Treasury and other government bonds rose 27.2% q-o-q, in line with the frontloading policy of the Government of the Republic of Korea, under which it plans to release 65% of its 2023 budget in the first half of the year.

Half of all outstanding corporate bonds comprised bonds issued by private companies at the end of March, while financial debentures and special public bonds accounted for a quarter share each. Total corporate bond issuance in Q1 2023 fell 6.2% q-o-q, led by the decline in issuances from private companies and financial institutions; only special public bonds posted a q-o-q increase in Q1 2023 (**Figure 5**). The quarterly decline was mostly due to a high base of issuances from private companies in December 2022 as firms refinanced their maturing debts. One of the notable corporate bond issuances in Q1 2023 included the KRW1,210 trillion 3-year and 5-year bond issuances by SK hynix, the second-largest memory chipmaker in the world.

Investor Profile

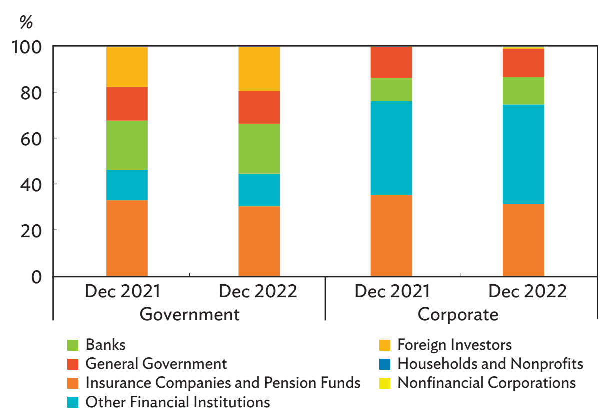
Insurance companies and pension funds continued to be among the largest investor groups in the Republic of Korea's LCY bond market. In the government bond segment, insurance companies and pension funds held the largest share at the end of

Figure 5: Composition of Local Currency Corporate Bonds Outstanding and Issuance in the Republic of Korea



KRW = Korean won, LHS = left-hand side, RHS = right-hand side.
Source: KG Zeroin Corp.

Figure 6: Local Currency Bonds Outstanding Investor Profile

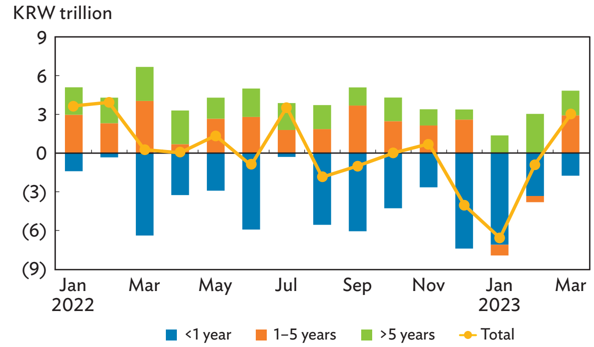


Sources: *AsianBondsOnline* and Bank of Korea.

December 2022 with 30.4% of the total (**Figure 6**). Banks and foreign investors followed with shares of 21.7% and 19.1%, respectively. In the Republic of Korea's LCY corporate bond market, insurance companies and pension fund holdings' share of 31.5% was second to that of other financial institutions at 43.3%. The foreign holdings of domestic corporate bonds remained negligible at the end of December 2022.

Aggregate net foreign flows into the Republic of Korea's LCY bond market remained negative in Q1 2023. A record KRW6.6 trillion of net foreign outflows was registered in January, with foreign investors selling and taking profits on their short-term investments, as short-term yields dropped during the month following an upward trend in 2022. The bulk of the foreign selling in January was in securities with tenors of less than 1 year (**Figure 7**). Net foreign outflows continued in February but at a smaller amount of KRW0.8 trillion, as net buying of long-term bonds increased, nearly offsetting the selling in short-term and medium-term bonds. This trend was reversed in March, with the domestic bond market posting net inflows of KRW3.1 trillion, the highest net inflows since July 2022. Foreign demand rose in March on increased expectations that the Bank of Korea would start cutting interest rates this year as inflation decelerates, providing an upside to foreign investors. However, the net foreign inflows in March were not enough to offset the massive net outflows in January, resulting in aggregate net foreign outflows of KRW4.3 trillion in Q1 2023.

Figure 7: Net Foreign Investment in Local Currency Bonds in the Republic of Korea by Remaining Maturity



KRW = Korean won.
Source: Financial Supervisory Service.