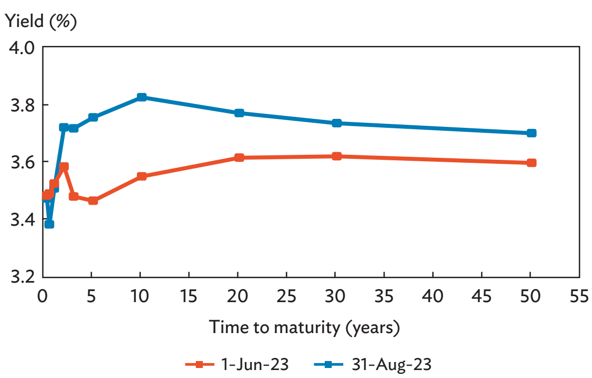
Republic of Korea

Yield Movements

The Republic of Korea's local currency (LCY) government bond yields rose for most tenors between 1 June and 31 August, tracking the rise in United States Treasury yields on continued Federal Reserve monetary tightening and solid economic conditions (Figure 1). Upward pressure on yields also stemmed from expectations that the Bank of Korea (BOK) will keep the base rate at 3.50% in the near term as it forecasts inflation to start picking up again. In its 13 July and 24 August monetary policy meetings, the BOK stated that although inflation has slowed, it is expected to rise again and remain above the target level for a considerable time. Also in its August monetary policy meeting, the BOK maintained its May inflation forecasts for 2023 and 2024 at 3.5% year-on-year (y-o-y) and 2.4% y-o-y, respectively. Moreover, the growth forecast for 2023 was maintained at 1.4% y-o-y, while that for 2024 was lowered to 2.2% y-o-y from 2.3% y-o-y.

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

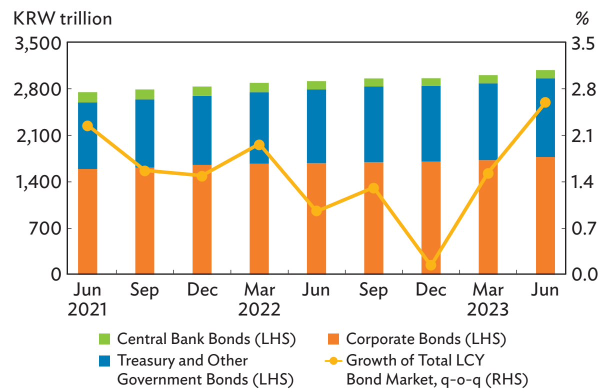


Source: Based on data from Bloomberg LP.

Local Currency Bond Market Size and Issuance

The Republic of Korea's LCY bonds outstanding grew 2.6% quarter-on-quarter (q-o-q) in the second quarter (Q2) of 2023, driven by both the government and corporate bond segments. The Republic of Korea's LCY bond market reached a size of KRW3,092.6 trillion at the end of June. Corporate bonds, which comprise over half of the total LCY bond market, posted growth of 2.7% q-o-q in Q2 2023, up from 1.3% q-o-q in the first quarter (Q1) of 2023, due to a rebound in issuance during the quarter (**Figure 2**). The stock of Treasury and other government bonds increased 2.5% q-o-q to KRW1,191.2 trillion, exceeding the 1.2% q-o-q growth posted in Q1 2023. Treasury and other government bonds accounted for 38.5% of the Republic of Korea's LCY bond market at the end of June, unchanged from its share in Q1 2023.

Figure 2: Composition of Local Currency Bonds Outstanding in the Republic of Korea

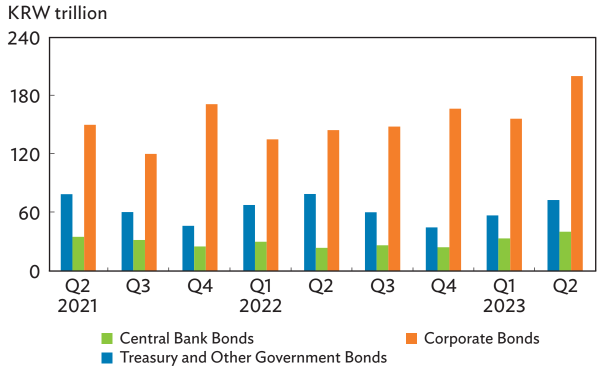


KRW = Korean won, LCY = local currency, LHS = left-hand side, q-o-q = quarter-on-quarter, RHS = right-hand side.

Sources: Bank of Korea and KG Zeroin Corp.

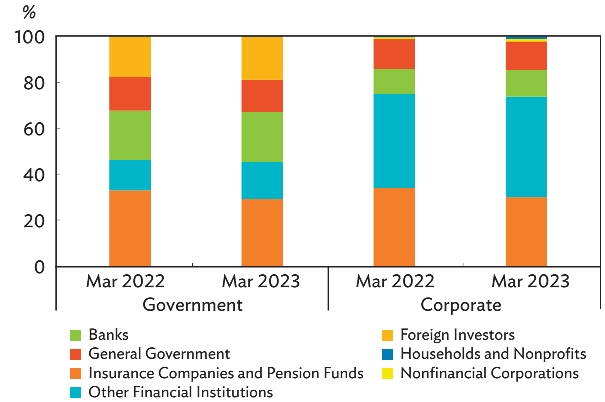
Total LCY bond issuance jumped 26.6% q-o-q to KRW312.9 trillion in Q2 2023, up from 4.7% q-o-q in Q1 2023, driven by higher issuance volumes in both the corporate and government bond market segments. Corporate bond issuance rebounded in Q2 2023, posting a 28.0% q-o-q increase in Q2 2023, following a 6.2% q-o-q contraction in Q1 2023 (**Figure 3**). The gains were led by the higher quarterly issuance volumes of private companies and financial debentures. Firms also took advantage of the favorable environment to issue bonds in anticipation of a rise in yields as the Federal Reserve was expected to implement another set of rate hikes before the end of the year. One of the largest corporate bond issuances

Figure 3: 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.

Figure 4: Local Currency Bonds Outstanding Investor Profile



Sources: *AsianBondsOnline* and Bank of Korea.

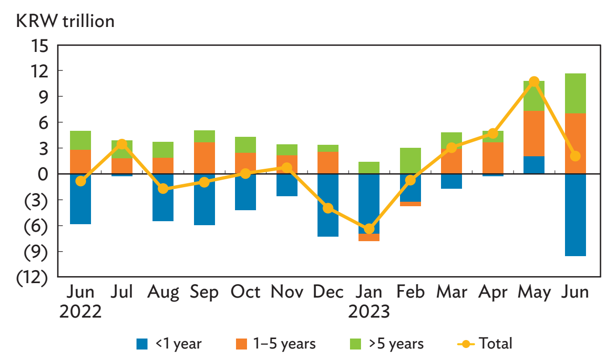
in Q2 2023 was the KRW1.0 trillion multitranche bond issued by LG Energy Solutions in June. Issuance of Treasury and other government bonds posted rapid growth of 27.2% q-o-q in Q2 2023. The Government of the Republic of Korea continued to issue a high volume of Treasury bonds during the quarter to fund its frontloading policy of expending 65% of its 2023 budget in the first half of the year to help prop up the economy.

Investor Profile

Insurance companies and pension funds continued to hold the largest share of the Republic of Korea's LCY bonds outstanding at the end of March. The investor group held 29.4% of government bonds outstanding at the end of Q1 2023, which reflected a decline from its share of 33.0% a year earlier (**Figure 4**). Banks were the second-largest investor group with a share of 21.6%, while the share of foreign investors rose to 18.6% from 17.2% during the same period. In the corporate bond market, other financial institutions were the largest investor group with a share of 43.9%, followed by insurance companies and pension funds at 30.0%. The foreign holdings share of LCY corporate bonds remained negligible at 0.4% at the end of March.

Foreign investors returned to the Republic of Korea's LCY bond market in Q2 2023. Aggregate net foreign bond inflows reached a record high of KRW17.6 trillion in Q2 2023, a reversal from the KRW4.3 trillion of net bond outflows in Q1 2023 and the highest quarterly net

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.

bond inflows since Q2 2021. Net foreign bond inflows to the Republic of Korea's LCY bond market totaled KRW15.6 trillion in April and May as market participants were expecting the Bank of Korea to cut its policy rate before the end of the year due to slowing domestic inflation and the Federal Reserve continuing to ease the pace of its monetary policy tightening (**Figure 5**). In June, however, net foreign bond inflows slowed to KRW2.1 trillion following a Bank of Korea statement on 8 June that it would continue its current monetary policy as upward pressure on inflation remained. Foreign demand declined as the Bank of Korea's statement was seen as lowering the chance of another rate cut this year.