

ASIFMA Virtual Event:

Co-host



# Korean Capital Market Analysis: **OVERVIEW & INVESTMENT OPPORTUNITIES**

(in collaboration with KOFIA)

THURSDAY, 22 OCTOBER 2020

3:00PM – 4:45PM HKT/

4:00PM – 5:45PM KST

## Agenda:

Time (HKT)	Session
3:00-3:05pm	<b>Welcome Remarks</b> <ul style="list-style-type: none"><li>• <b>J. C. Na</b>, Chairman &amp; CEO, <b>KOFIA</b></li><li>• <b>Lyndon Chao</b>, Managing Director, Head of Equities and Post Trade, <b>ASIFMA</b></li></ul>
3:05-3:20pm	<b>Macro outlook for Korean Economies</b> <ul style="list-style-type: none"><li>• <b>Jaechul Chang</b>, Managing Director, Chief Economist, <b>KB Securities, KB Financial Group</b></li></ul>
3:20-3:35pm	<b>Korean Securities Market</b> <ul style="list-style-type: none"><li>• <b>Woochang Chung</b>, Head of Global Equity Research Team, <b>Mirae Asset Daewoo</b></li></ul>
3:35-3:50pm	<b>Korean Bond Market</b> <ul style="list-style-type: none"><li>• <b>Myoungsil Kim</b>, Head of Fixed Income Team, Research Center, <b>Shinhan Investment Corp</b></li></ul>
3:50-4:35pm	<b>Panel Discussion: Overseas Investors' View on the Korean Market</b> <ul style="list-style-type: none"><li>• <b>Simon Williams</b>, Managing Director, APAC Head of Equity Trading, <b>BlackRock</b></li><li>• <b>Ross Whittaker</b>, Managing Director, Co-Head of APAC Advanced Execution Services (AES) Electronic Trading, <b>Credit Suisse</b></li><li>• <b>Nicholas Peach</b>, Managing Director, Head of Electronic Trading, <b>Goldman Sachs</b></li><li>• <b>Lyndon Chao</b>, Managing Director, Head of Equities and Post Trade, <b>ASIFMA</b> (moderator)</li></ul>
4:35-4:45pm	<b>Q&amp;A Session</b>

## Welcome Remarks:



**J. C. Na**  
Chairman & CEO  
**KOFIA**

## Welcome Remarks:



**Lyndon Chao**  
Managing Director, Head of Equities and Post Trade  
**ASIFMA**

## Macro Outlook for Korean Economies:



**Jaechul Chang**  
Managing Director, Chief Economist  
KB Securities, KB Financial Group

## 2021 Korea Macro

### Post-Corona Recovery, Returning to Potential

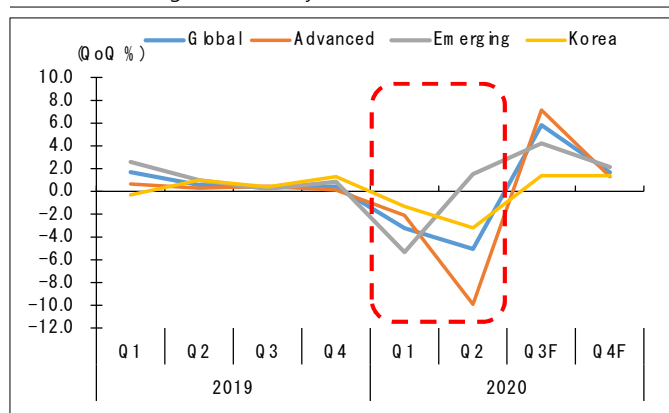
Jaechul Chang, Ph.D.  
Chief Economist  
KB Securities/KB Financial Group  
02-6114-2924  
jaechul.chang@kbfsg.com



# 2020 corona crisis and 1H recession

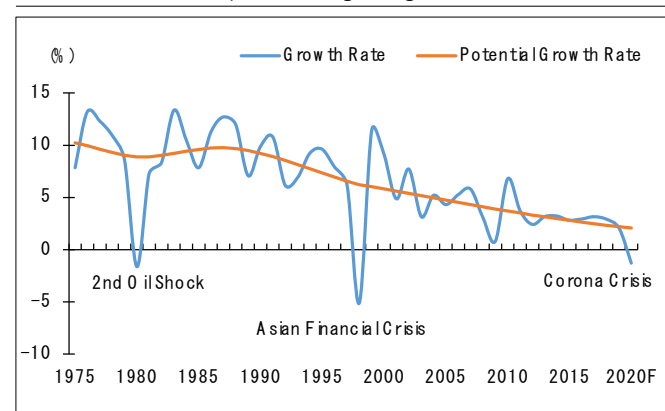
- The global economy fell into recession in the 1<sup>st</sup> half of 2020, followed by a better-than-expected recovery in 3Q 2020
  - The recovery in 3Q was mostly driven by China and the U.S.
- The Korean economy also fell into recession in the 1<sup>st</sup> half, but the recovery may not be as strong as in China and the U.S.
  - Korea is expected to record its third period of negative growth (-1.3%) since the BoK reported GDP data
- The BoK lowered its base rate to 0.5% and the government implemented four supplementary budgets (KRW61.7tn or ~3% of GDP)
  - The BoK adopted an unlimited liquidity support facility and increased loans via CBBLF, BILSF, etc.

Corona crisis led global economy to recession in 1H



Source(s): CEIC, BoK, KB Securities forecasts

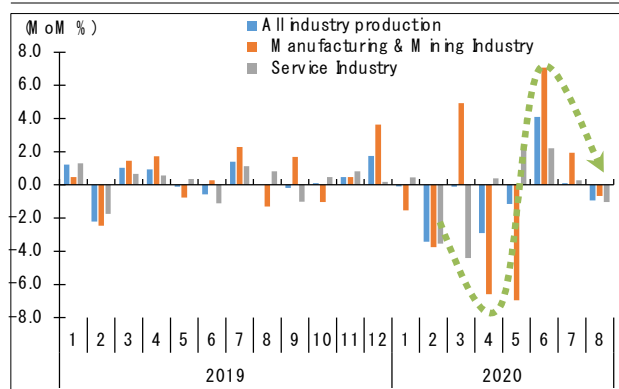
Korean to record third period of negative growth since 1953



Source(s): BoK, KB Securities estimates

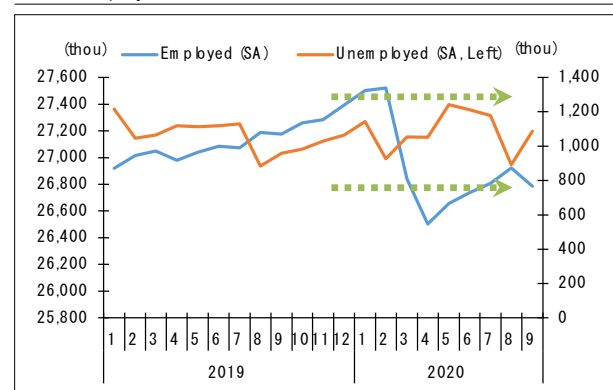
# Recovery seems tepid with subdued inflation

Rapid recovery of industrial production recently slowed



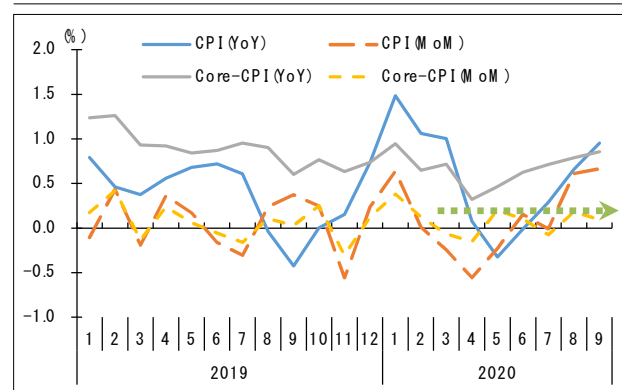
Source(s): KOSIS, KB Securities

No. of employed remains below level before Covid-19



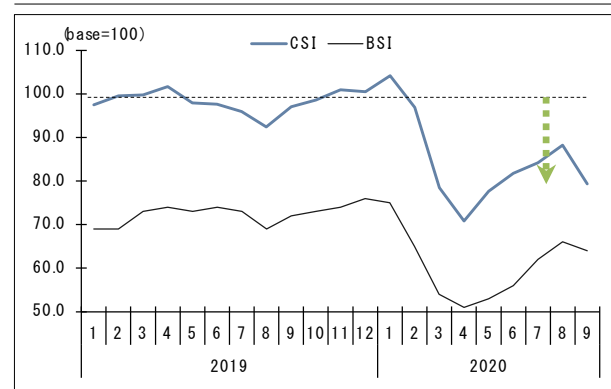
Source(s): KOSIS, KB Securities

Headline CPI picked up (at 1%) while Core CPI remains subdued



Source(s): KOSIS, KB Securities

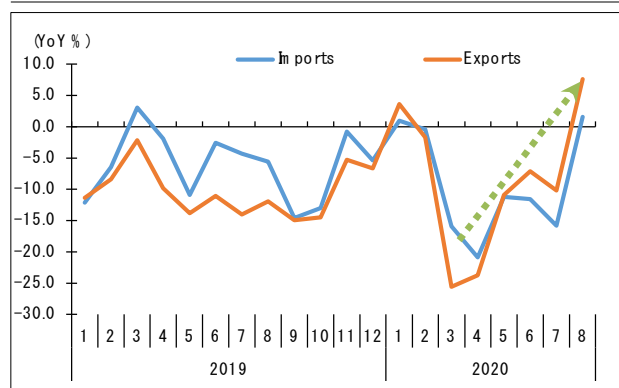
Consumer and business sentiment remain weak



Source(s): BoK, KB Securities

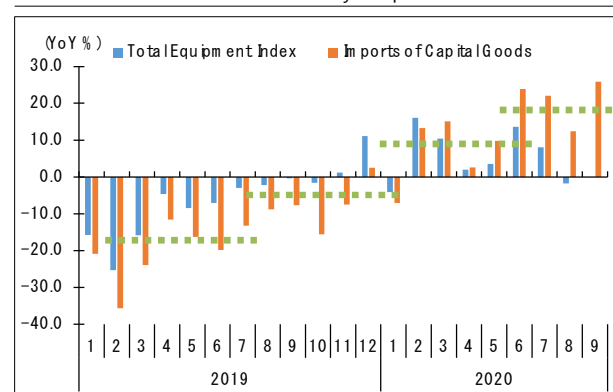
# Leading indicators hint at further recovery

Trade recovery on the way



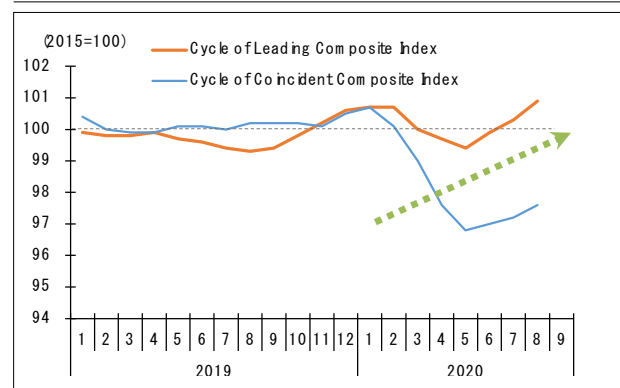
Source(s): KITA, KB Securities

Investment indicators show resiliency despite base effect



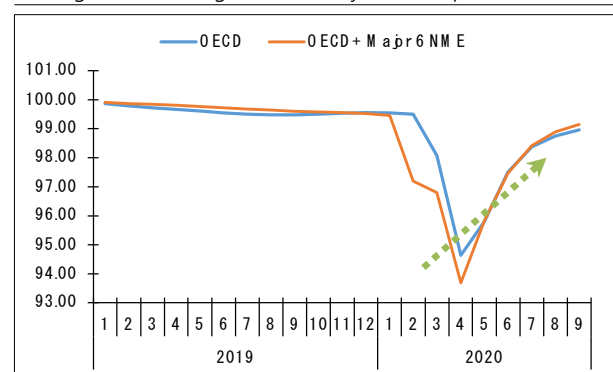
Source(s): KOSIS, KITA, KB Securities

Leading indicators hint at further recovery



Source(s): KOSIS, KB Securities

Leading indicators of global economy also on uptrend



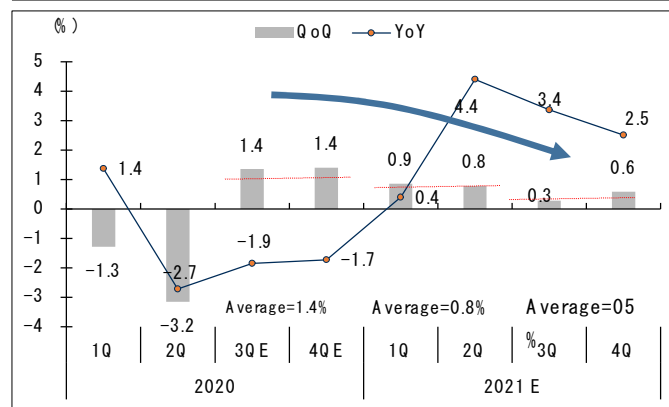
Source(s): OECD, KB Securities

Note: Six NMEs are China, Brazil, India, Indonesia, Russia Federation, South Africa

## 2021: Post corona recovery, economic growth at 2.7%

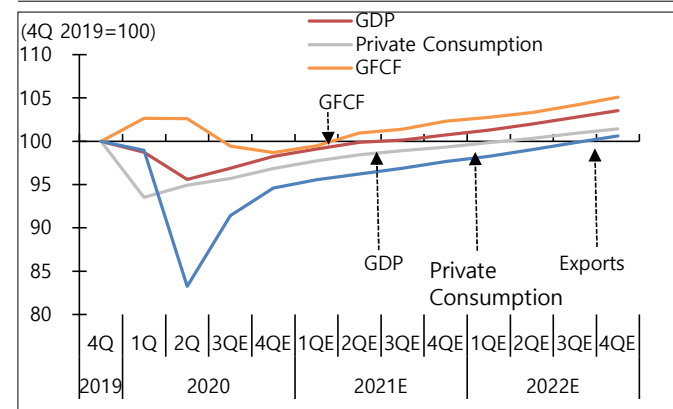
- Key assumptions:
  - The U.S.-China conflict will not escalate to become a meaningful shock to global trade and financial markets
  - The vaccine for Covid-19 will be distributed widely in 1H 2021 with no serious "knockdowns"
- The economic growth rate will rebound to 2.7% from negative growth (-1.3%) in 2020
- Consumption and exports will likely lead the economic recovery
  - The recovery will continue in 2H but at a slower pace, alongside improvements in economic sentiments and global trade

Economic growth continues but at slower pace in 2H 2021



Source(s): BoK, KB Securities forecasts

Time to recovery back to pre Covid-19 level



Source(s): BoK, KB Securities estimate



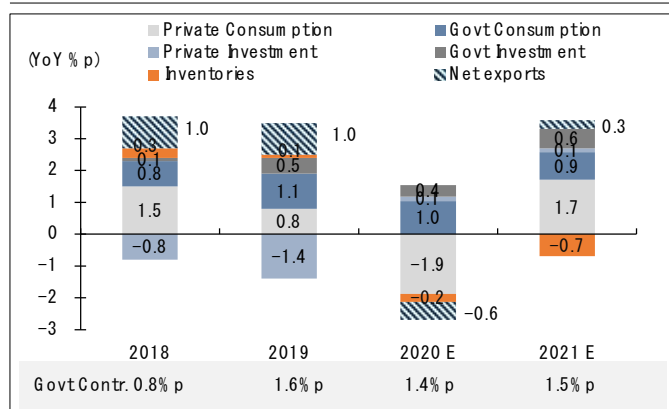
## Gradual recovery amid low inflation, BoK will stay put

- Private consumption will increase by 3.5% along with steady job growth despite less supports from government income transfers
- Customs-based exports and imports to grow 7.3% and 7.0%, respectively, from -72% and -8.8% in 2020
  - Sectors with good prospects: semiconductor, auto, and machinery, as well as those related to Covid-19 bio and medical products
- Facilities investment is expect to grow by 6.3%, continuing two consecutive years of expansion along with a recovery in exports
  - The semiconductor sector seems to lead investments; the government's digital and green "New Deal" will be another driver
- Construction investment is likely to contract by 0.3% YoY because of sluggish commercial/industrial building construction
  - However, there is some upside potential coming from increased SOC budgets and expansion of New Deal' related business
- Job growth of 220,000 (vs. -217,000 in 2020) due to economic recovery and government's safety net policy and New Deal
  - Job growth will be driven by manufacturing as exports rebound
- CPI inflation to rebound 1.0% (vs. 0.6% in 2020), below BoK target (2%)
  - Deflationary factors: Free education (high school), strong KRW, cuts to special consumption tax, public utility fees, etc.
  - Inflationary factors: Increase in oil price (WTI USD50.00/bbl; 27.3%YoY), higher rents and base effects
- All of the above indicate that the economy will be in recovery mode, approaching potential levels gradually amid low inflation
- Therefor, the BoK is expected to hold the base rate at the current 0.5% level until the end of 2021

# Recovery still needs boost from government spending

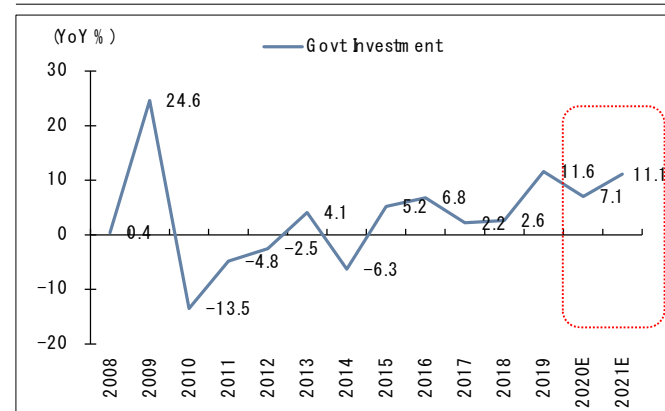
- Government spending for stimulus measures is likely to shift to public investments from various transfer payments
  - Contribution of government spending to economic growth will remain at ~1.5%p
- Fiscal multiplier may rise as government spending of resources may create large spillover effects
  - The government allocated KRW21.3tn in digital and green investments in 2021 out of total KRW160tn of 2020-25 "Korean New Deal Project"
- However, the 2021 budget is almost the same as in 2020 if four supplementary budgets are considered
  - Expect a supplementary budget in 2021 to add growth momentum if domestic demand remains weak

Government contribution to growth will remain at ~1.5%p in 2021



Source(s): BoK, KB Securities estimates

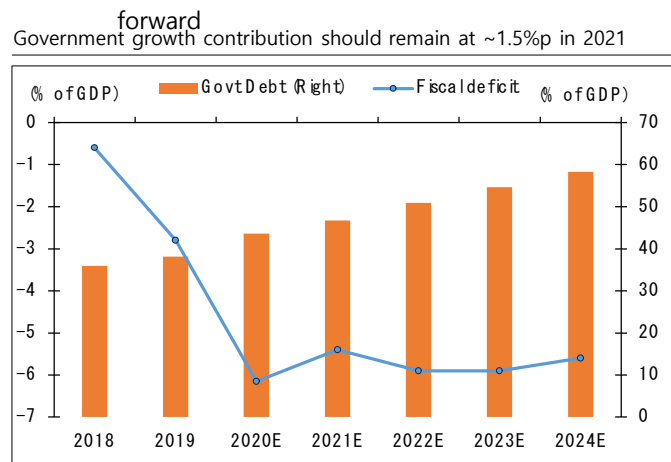
Government investment growth to be in double digits in 2021



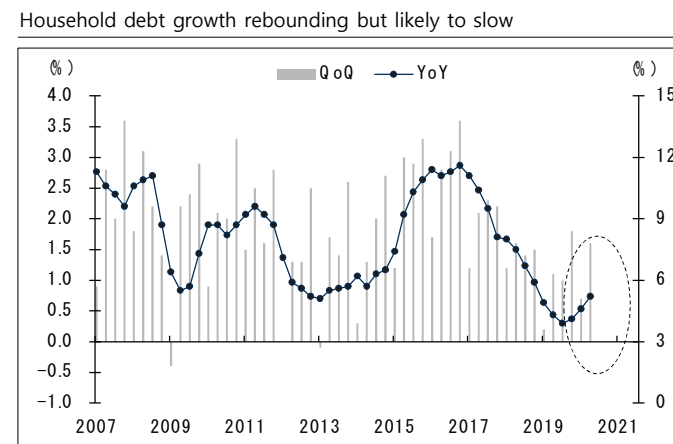
Source(s): BoK, KB Securities estimates

# Household debt stabilizes while public debt expands

- Fiscal burden increases due to large fiscal demands: Covid-19 issues, "New Deals", aging population, etc.
  - Fiscal deficit of ~5% of GDP is expected to continue until 2024; and government debt to rise to 58% of GDP
- Household debt (163% of GDP) is increasing, but at slower pace in 2Q 2020 (5.2% YoY) than 2010-19 average (7.7% YoY)
  - Housing market regulations in July slowed debt growth, esp. mortgage loan growth, which slowed to 5.4% YoY in Aug (vs. 6.4% in 2Q)
  - ...however, other loans to households in Aug increased by 11% YoY via balloon effect
  - As the government is likely to hold its current policy stance on the housing market, household debt growth likely slow going forward



Source(s): Ministry of Economy and Finance, KB Securities



Source(s): BoK, KB Securities estimate

## Korea economic forecasts (2019-2022 )

		2019	2020 E	2021 E	2022 E	2020 E				2021 E			
						1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
GDP	% QoQ					-1.3	-3.2	1.4	1.4	0.9	0.8	0.3	0.6
	% YoY	2.0	-1.3	2.7	2.4	1.4	-2.7	-1.9	-1.7	0.4	4.4	3.4	2.5
Private Consumption	% YoY	1.7	-3.9	3.5	2.0	-4.8	-4.0	-3.6	-3.2	4.5	3.7	3.4	2.6
Construction Investment	% YoY	-2.5	0.7	-0.3	0.5	4.2	-0.1	4.0	-4.1	-4.0	-1.5	1.4	2.2
Facilities Investment	% YoY	-7.5	2.6	6.3	5.1	7.3	4.1	1.4	-2.0	1.3	4.9	7.9	11.0
Exports (G & S)	% YoY	0.5	-4.8	5.0	3.0	6.3	-11.5	-7.7	-5.4	-3.4	15.6	6.0	3.2
Imports (G & S)	% YoY	-0.8	-1.8	4.6	3.1	3.1	-4.8	-3.1	-2.3	1.2	7.6	5.3	4.5
Current Account Balance	US\$ bn	600	649	671	602	133	58	242	215	181	115	169	206
Exports (FoB)	% YoY	-10.4	-7.2	7.3	5.8	-1.8	-20.3	-3.2	-3.0	0.2	18.3	6.5	5.7
Imports (C F)	% YoY	-6.0	-8.8	7.0	5.3	-1.8	-16.1	-9.1	-8.1	-2.2	10.9	12.7	7.6
CPI	% YoY	0.4	0.6	1.0	1.3	1.2	-0.1	0.6	0.5	0.3	1.4	1.1	1.3
Policy Rate (BoK Base Rate)	% EoP	1.25	0.50	0.50	0.50	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Unemployment (SA)	%	3.8	3.9	3.9	3.8	3.7	4.2	3.8	3.7	3.7	4.1	4.0	3.8
USD /KRW	EoP	1156	1165	1130	1150	1217	1203	1170	1165	1175	1155	1145	1130
	Avg	1165	1191	1158	1140	1194	1220	1187	1165	1175	1165	1150	1140

Source(s): BoK, KB Securities Forecast (10/21/2020)



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## Korean Securities Market:



**Woochang Chung**  
Head of Global Equity Research Team  
**Mirae Asset Daewoo**

# Korean Equity Market

## Issues and Strategy

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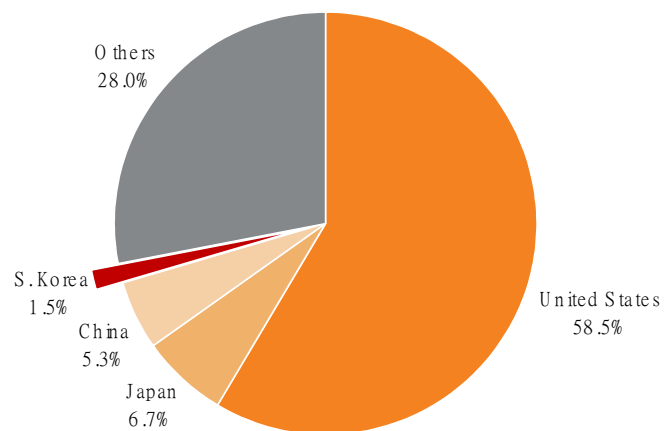
# Korea Equity Market Overview

Korea represents 1.5% of MSCI AC World

- Korea ranks eleventh in MSCI AC World Index, representing 1.5% of Index value (as of Oct20)
- In MSCI EM Index, Korea ranks third, with a 12.1% stake

S. Korea has 1.5% weight in MSCI AC World Index

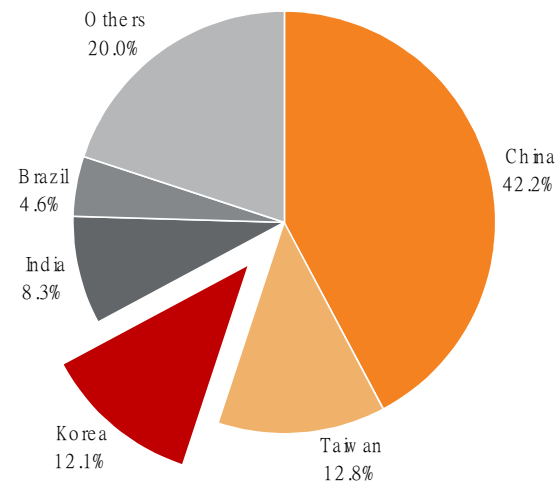
Country weight(%) in MSCI AC World Index



Source: Factset, Mirae Asset Daewoo Research

S. Korea has 12.1% weight in MSCI EM Index

Country Weight(%) in MSCI EM Index



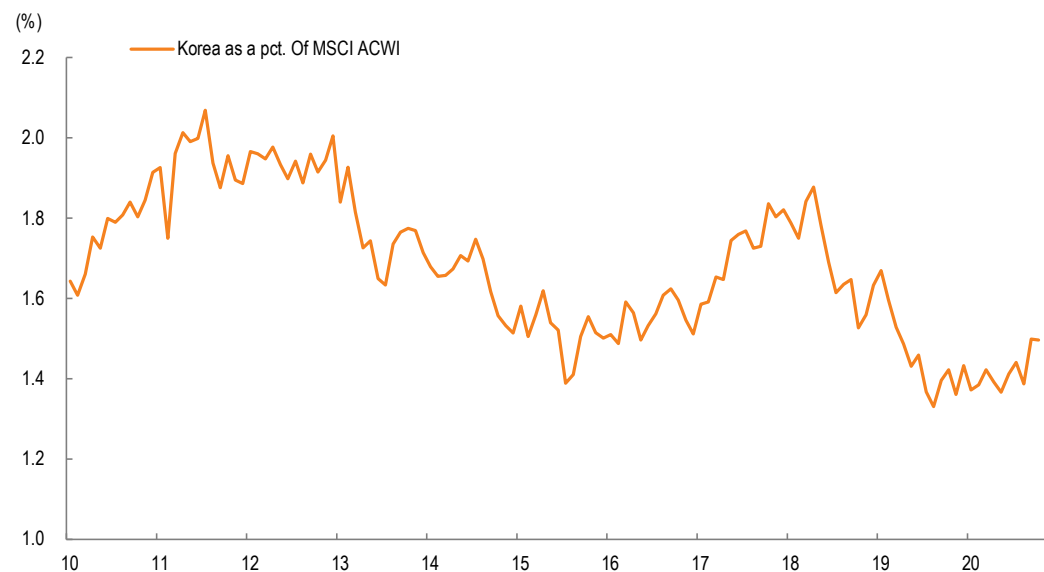
Source: Factset, Mirae Asset Daewoo Research

# Korea Equity Market Overview

## Uphill battle

- Due to slowing corporate earnings growth prospect, tighter regulations and aging demographics, Korea has lost its share in MSCI World Index to 1.5% from its historical peak of 2.1%

Korea as a pct. of MSCI AC World Index



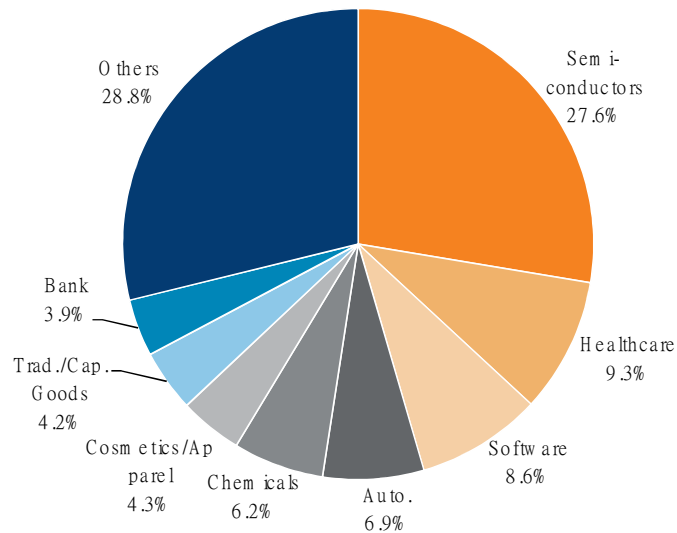
Source: Bloomberg, Mirae Asset Daewoo Research

# Korea Equity Market Overview : KOSPI sector allocations

## Semicon: 27.6% of total Index

- Semicon represents the largest portion at 27.6% of total Index
- Followed by healthcare (9.3%) and Software/Internet (8.6%) and Auto/Auto parts (6.9%)
- Non-manufacturing has growing faster than manufacturing

KOSPI Sector weight by market cap.



note: 10/13 last price  
Source: Quantwise, Mirae Asset Daewoo Research

KOSPI Market cap. Top 10

Rank	Company	Market cap. (KRW tril.)	Sector
1	Samsung Electronics	363.6	Semiconductors
2	SK Hynix	64.2	Semiconductors
3	NAVER	48.5	Software
4	Samsung Biologics	47.8	Health Care
5	LG CHEM.	45.5	Chemicals
6	Hyundai Motors	38.2	Automobiles
7	Celltrion	36.5	Health Care
8	Kakao	32.8	Software
9	Samsung SDI	30.6	IT Appliances
10	LG H&H	24.2	Cosmetics, Apparel, Toys

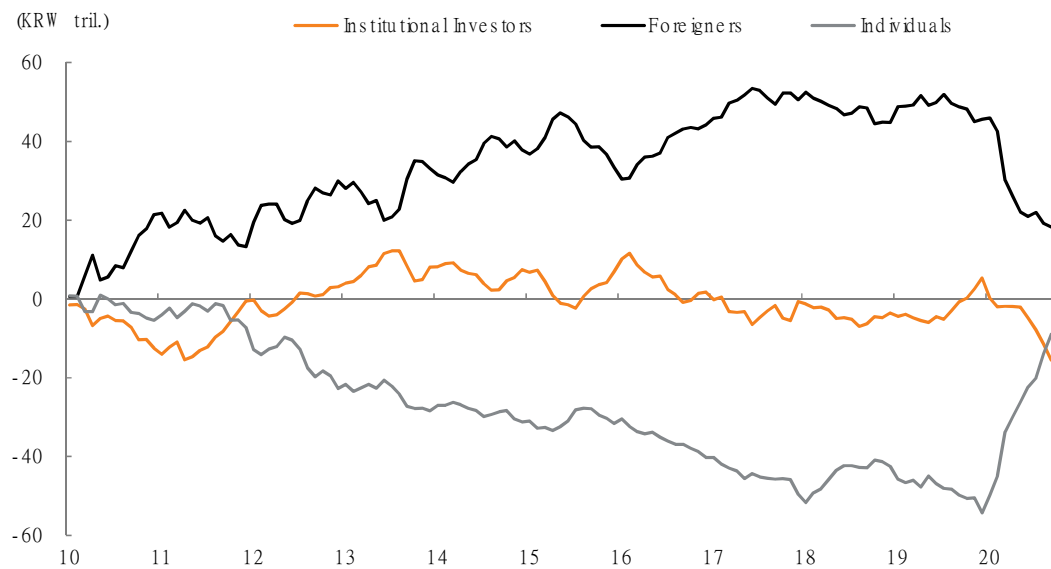
note: 10/13 last price  
Source: Quantwise, Mirae Asset Daewoo Research

## Korea Equity Market Overview : investor breakdown

### KOSPI: Foreign investor holdings down to 34.5%

- Foreign investors own 34.5% holdings in KOSPI (as of 14 October)

Accumulated net purchase amount by type of investors



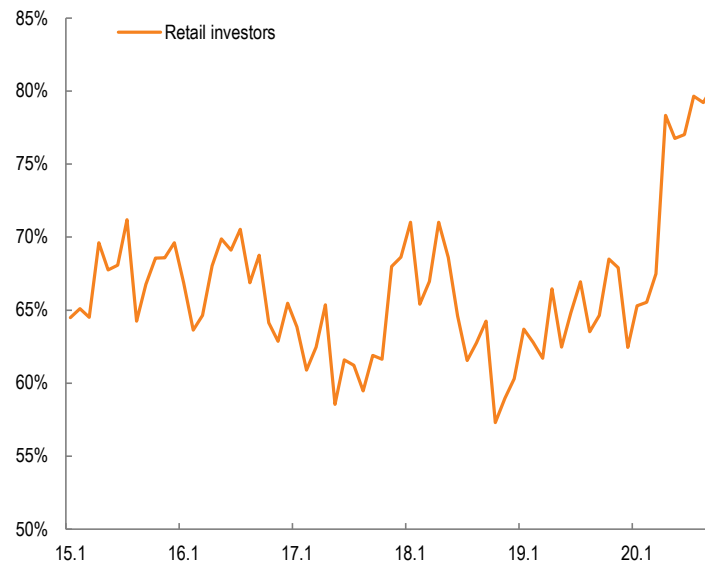
Source: Quantwise, Mirae Asset Daewoo Research

## Korea Equity Market Overview : investor breakdown

**Retail buying: the main drivers of KOSPI rerating since early this year**

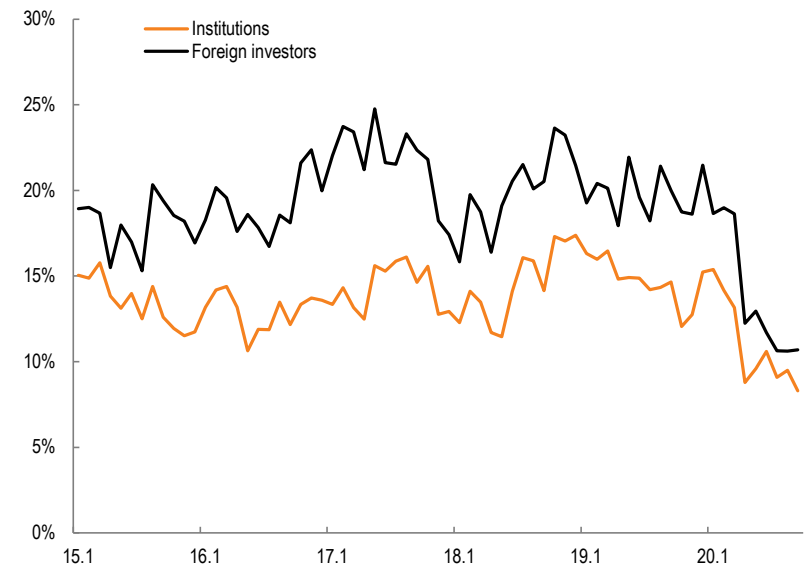
- Since beginning this year, retail buying has been one of main drivers of KOSPI re-rating
- Retail flow now accounts for over 80% of market turnover

Domestic stock trading share by Retail investors



Source: Quantiwise, Mirae Asset Daewoo Research

Domestic stock trading share by Institutions & Foreign investors



Source: Quantiwise, Mirae Asset Daewoo Research

## Korea Equity Market issues: 1. Changes in majority shareholder rule

### Lower threshold for capital gains taxes

- Investors, including family members, which owns KRW300m+ in shares of any company, are liable for up to 33% of capital gains taxes from 2021
- The threshold of KRW300m is significantly lower than what it is now at KRW1bn
- High net-worth retail investors' possible efforts to lower their holdings below the threshold could aggravate market volatility

Major Shareholder standard modification might trigger sell-off in Korean stock market

	Before	After
Major Shareholder Date of Record	End of 2019	End of 2020
Transfer Tax Applied Date	2020.4.1~	2021.4.1~
Major Shareholder Standard (KOSPI)	Over 1 Bn KRW / 1% per stock	Over 300 Mn KRW / 1% per stock
Major Shareholder Standard (KOSDAQ)	Over 1 Bn KRW / 2% per stock	Over 300 Mn KRW / 2% per stock

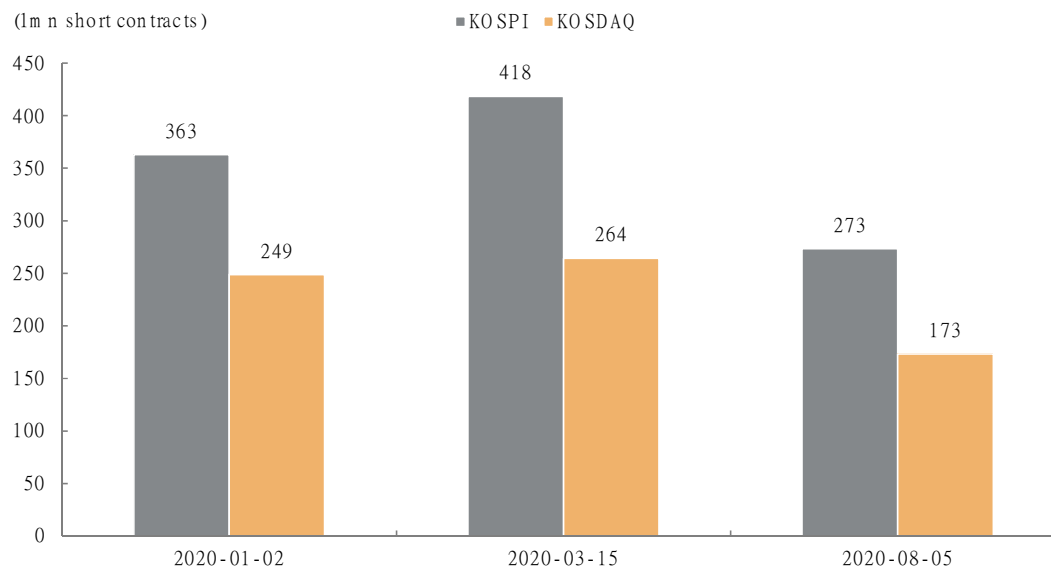
Source: dongA.com, Mirae Asset Daewoo Research

## Korea Equity Market issues: 2. Extended ban on short-selling

### Extended ban on short-selling to March 2021

- The Financial Services Commission (FSC)'s temporary ban on short-selling activities of all listed Korean shares will be extended to March 2021, immediately after the current six-month restriction expires in September
- After the initial temporary ban on short-selling, KOSPI has been up 37.7%

Remaining short-selling balance after banning short-selling



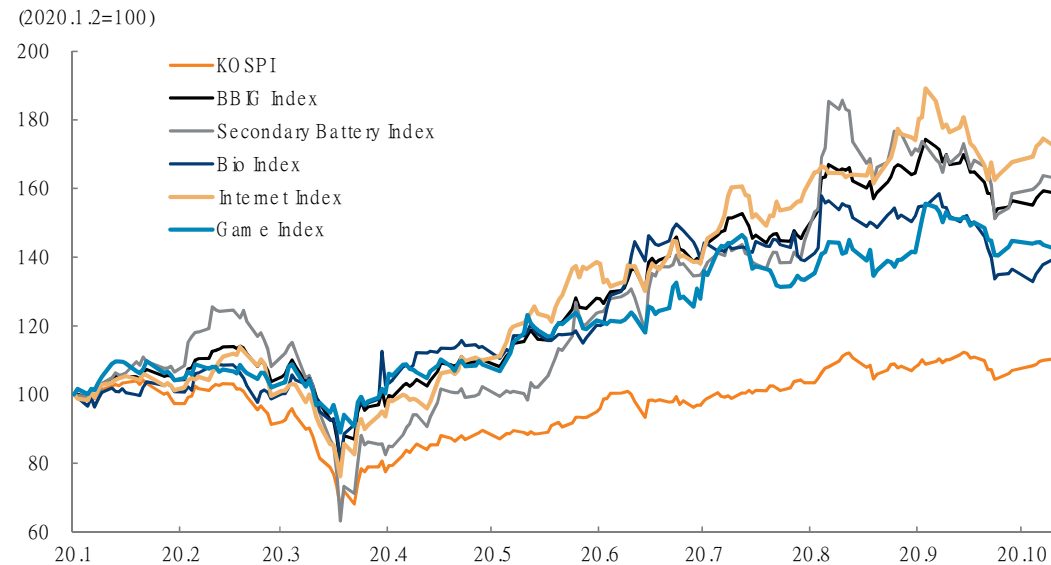
Source: KRX, Mirae Asset Daewoo Research

## Korea Equity Market issues: 3. New BBIG Index launch

### KRW launch of BBIG indices and ETFs

- The Korean government announced plan to launch of 'new deal' investment funds and indices, which will be financed with KRW4tn from state-owned banks like KDB, KRW3tn from the government, and KRW13tn from the private sector
- The KRX also launched five indices in BBIG (Battery, Bio, Internet, and Game), promoting these 'new deal' beneficiaries

K-New Deal Indexes outperformed KOSPI



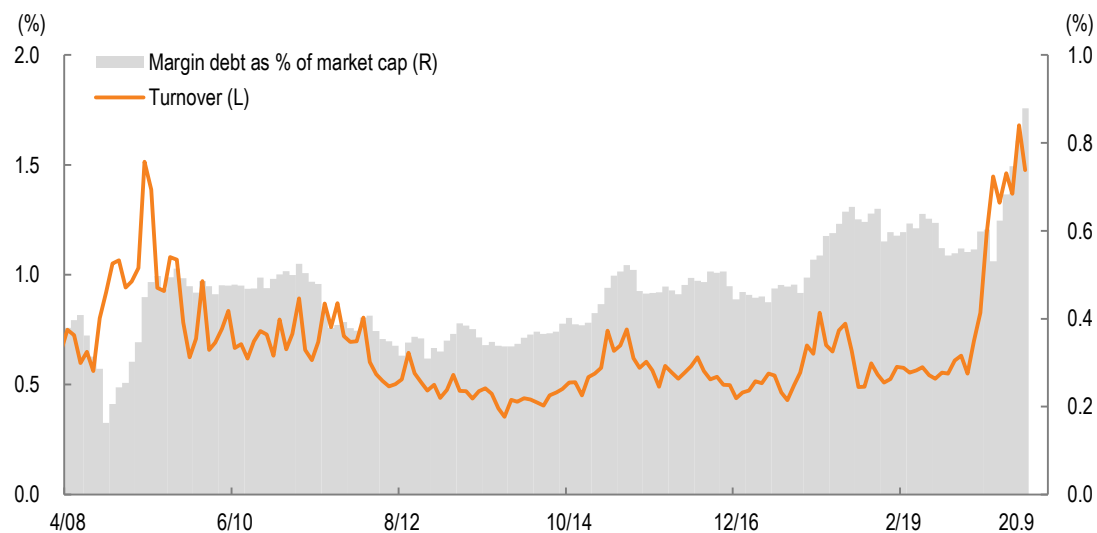
Source: KRX, Mirae Asset Daewoo Research

## Korea Equity Market issues: 4. Liquidity

### Rise in credit loan and margin debt: pressuring on retail buying?

- KOSPI rally has been partly driven by retail buying, which is supported by credit loans
- Credit loans (excluding house loan credits) have increased sharply for the past few months
- Accordingly, the regulator has recently ordered banks to tighten credit loans
- Brokerage firms have already started to tighten margin debts, which peaked in September at KRW17.9tn

Market cap turnover and margin debt as % of market cap



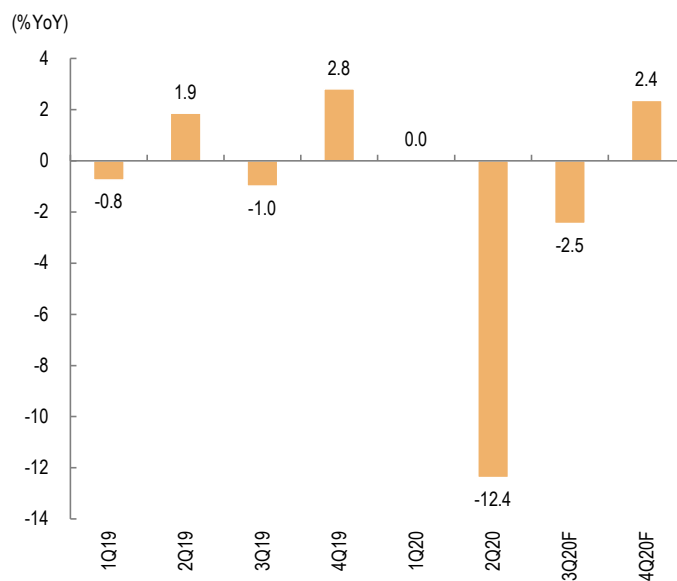
Source: KRX, Mirae Asset Daewoo Research

# Korea Equity Market Strategy: 2H20 Earnings recovery

## Our Quant's key update for 3Q/4Q20 earnings

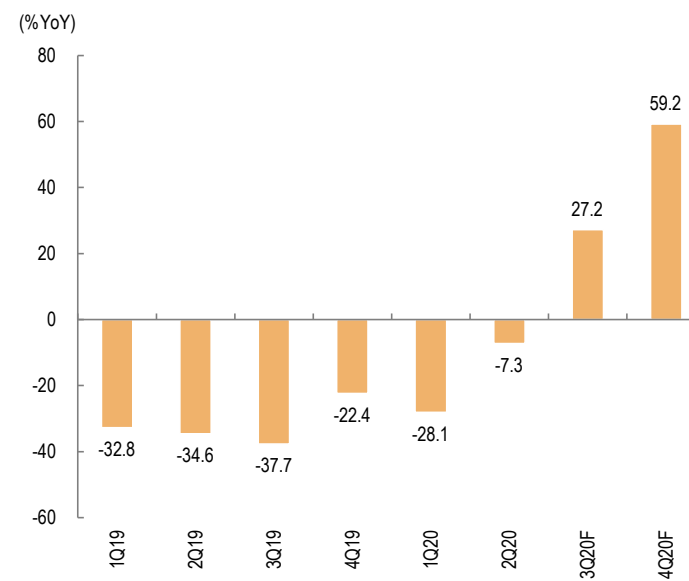
- 3Q/4Q operating profit consensus +18.7%/+52%YoY, 1st turnaround after 7 quarters of decline
- Earnings turnaround led by Semi, 1M consensus revised up +2.5% in last 1M as Semi +6.8% revised up
- We have already started to see strong 3Q so far, kicked off by better earnings from SEC, LGE and LG CHEM

Aggregated revenue growth in 2H20



Source: Quantwise, Mirae Asset Daewoo Research

Aggregated operating profit growth in 2H20



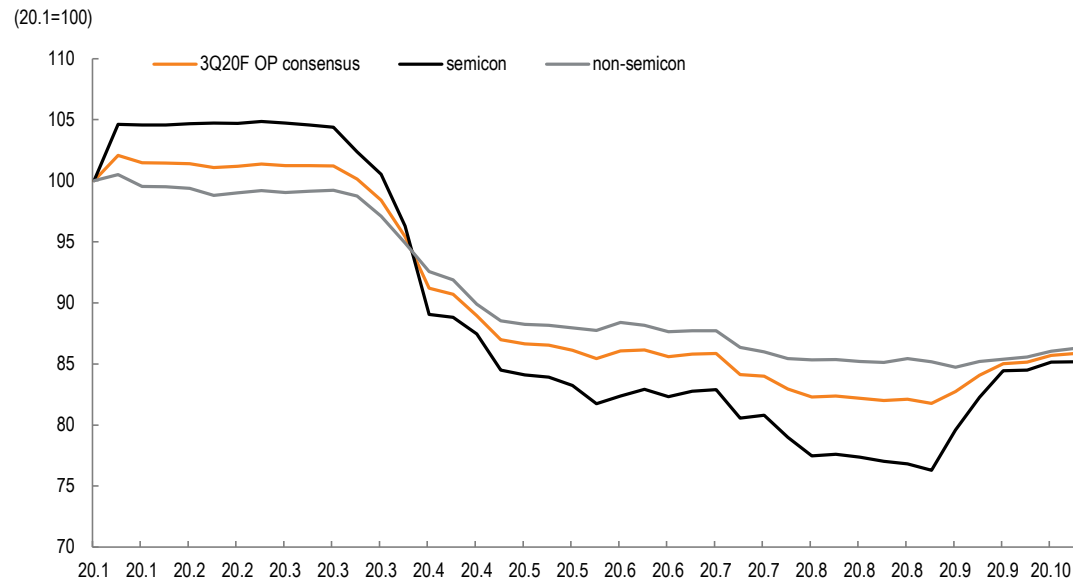
Source: Quantwise, Mirae Asset Daewoo Research

## Korea Equity Market Strategy : 2H20 Upward earnings revision

### Upward earnings revision on the way

- Aggregated 3Q20 OP consensus has been up 3.6% for past one month
- Semicon has highest upward revisions at 7% vs non-semicon's 2%
- Among non-semicon, display, brokerage, steels and healthcare see decent upward revisions

3Q20 OP consensus revision trend



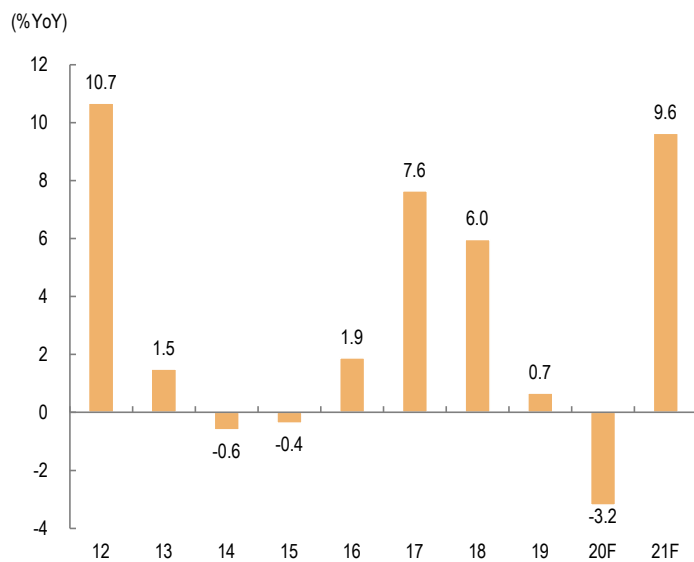
Source: KRX, Mirae Asset Daewoo Research

# Korea Equity Market Strategy: 21F Earnings recovery

## 21F operating profit growth +38.6%YoY

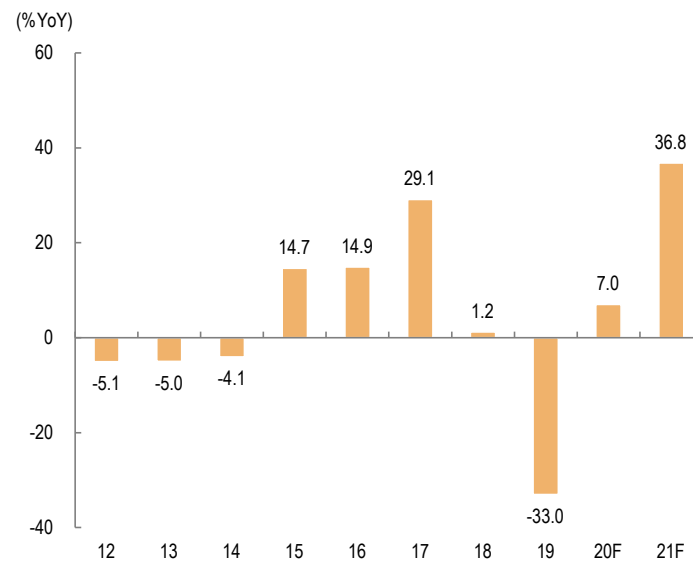
- For investors looking at next year, there will be a low base effect that's favorable in 1H. Along with a low base, eyes on recovery of Semi sector
- Consensus currently looks for 4Q to be bottom while seeing recovery from 1Q21. Semi export have been somewhat indicative of this as Aug/Sept Semi export have showing strong YoY growth albeit some of that from Huawei's pull-in demand

Aggregated revenue growth in FY21



Source: Quantiwise, Mirae Asset Daewoo Research

Aggregated operating profit growth in FY21



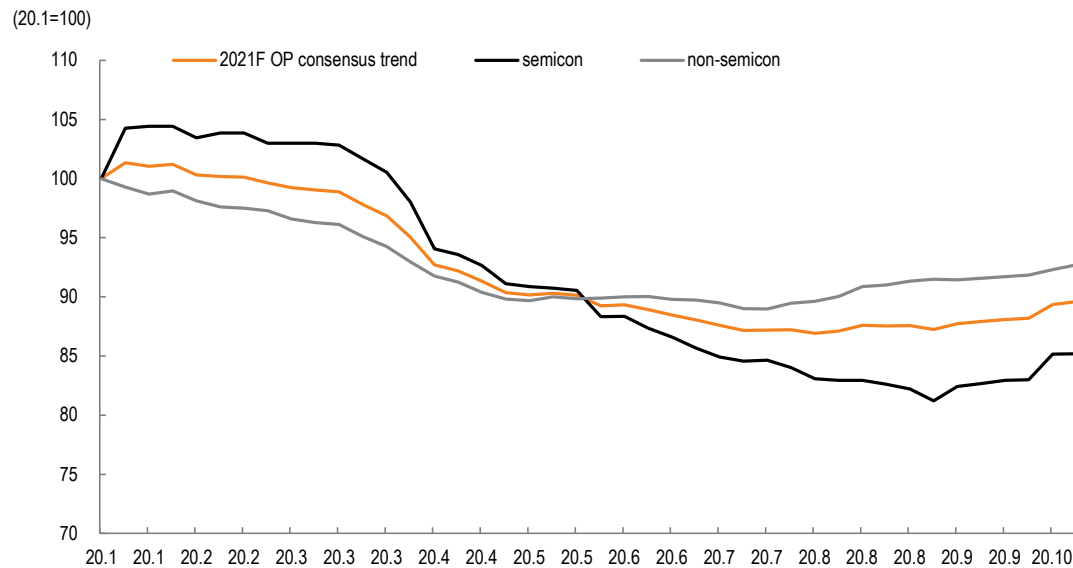
Source: Quantiwise, Mirae Asset Daewoo Research

# Korea Equity Market Strategy : 21F Upward earnings revisions

## Upward earnings revision on the way

- Aggregated FY21 OP consensus has risen 2.0% for one month (Semicon: 3.3%, non-semicon: 1%)
- We expect accelerating momentum in upward earnings revisions in chemicals, healthcare, auto, semicon sectors

FY21 OP consensus revision trend



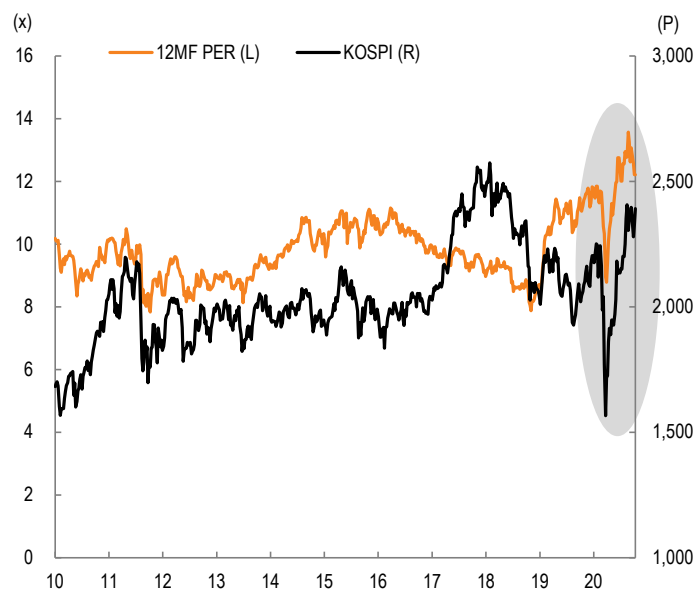
Source: Quantiwise, Mirae Asset Daewoo Research

# Korea Equity Market Strategy: Valuation

Valuation: still not as demanding as it looks

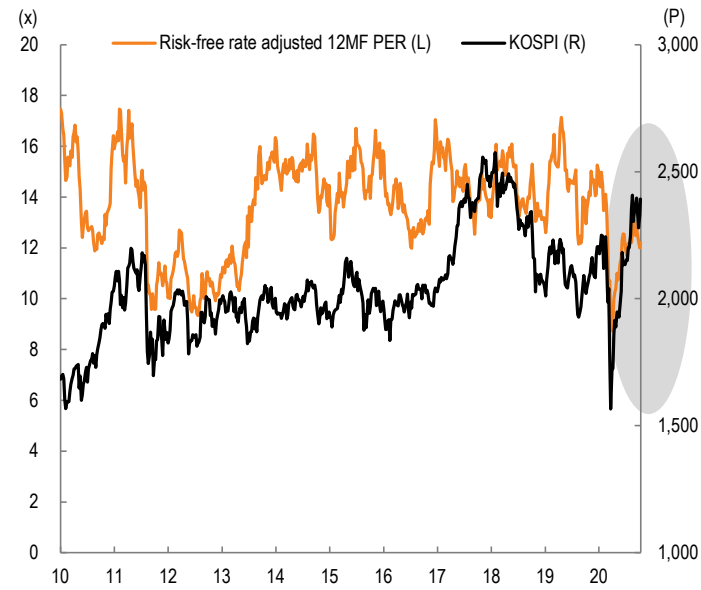
- 12M forward P/E for KOSPI has reached 12x (vs historical average of 10x since 2010), trading at above +2 STD
- However, adjusting for historical risk free rate, current 12M forward P/E would still trade at a discount to its historical average of 13.7x

KOSPI 12F PER (unadjusted)



Source: Bloomberg, Mirae Asset Daewoo Research

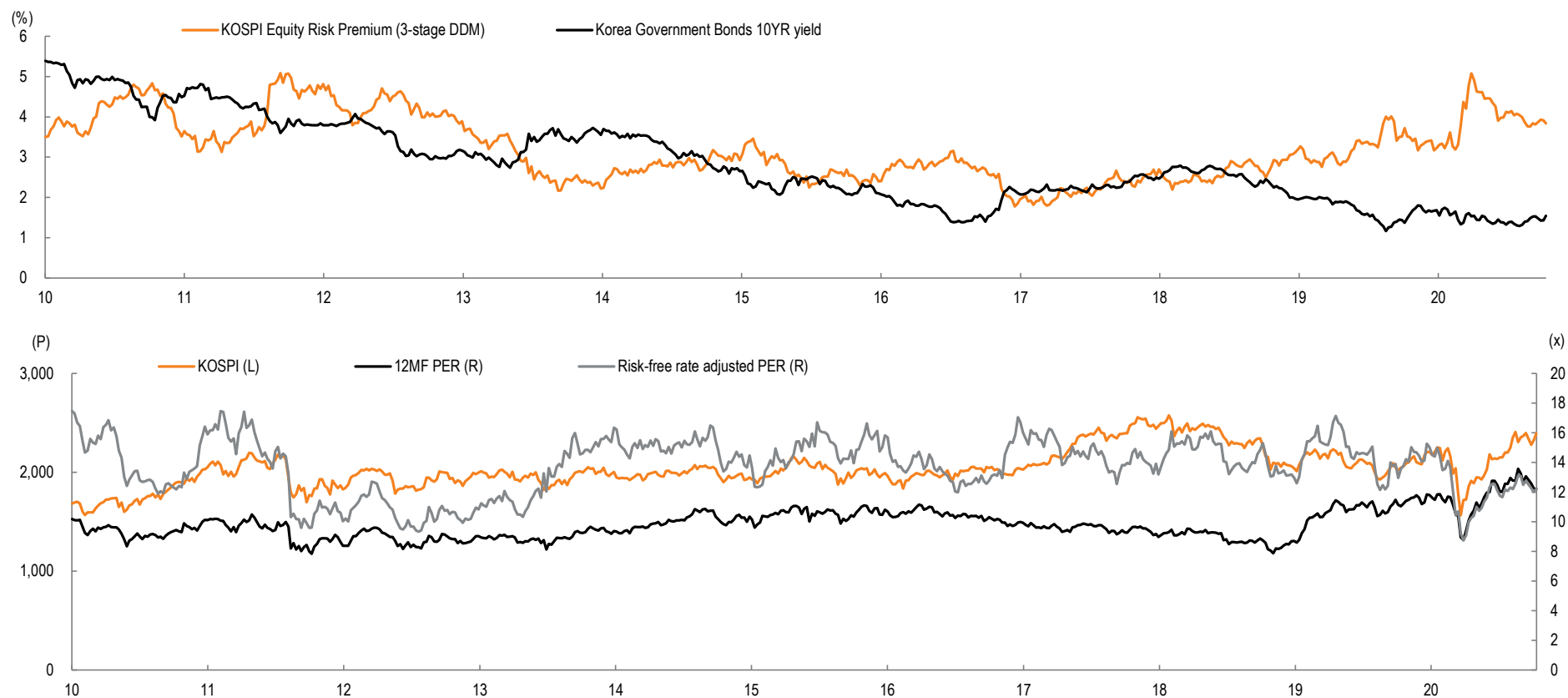
KOSPI 12F PER (risk free rate adjusted)



Source: Bloomberg, Mirae Asset Daewoo Research

# Korea Equity Market Strategy: KOSPI valuation

## KOSPI ERP interest rate trend

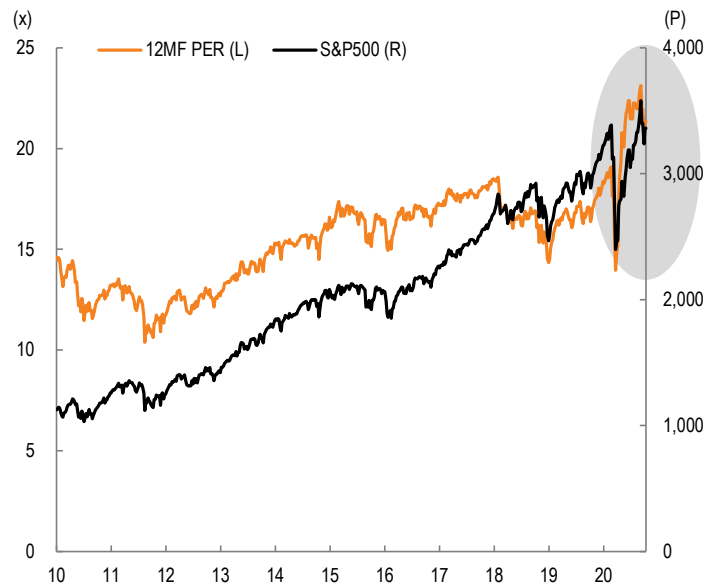


Source: Quantwise, Mirae Asset Daewoo Research

## Korea Equity Market Strategy: S&P valuation

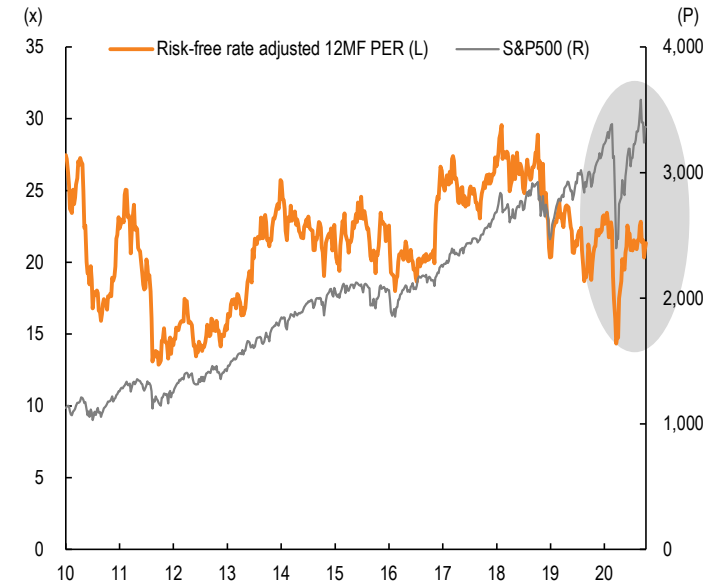
- Growing concerns over S&P500's demanding valuation. 12MF P/E is trading at 20x (vs. historical average of 17x)
- But, reflecting recent lower interest rates, 12MF P/E would trade still slightly below historical average

S&P 500 12MF PER (unadjusted)



Source: Bloomberg, Mirae Asset Daewoo Research

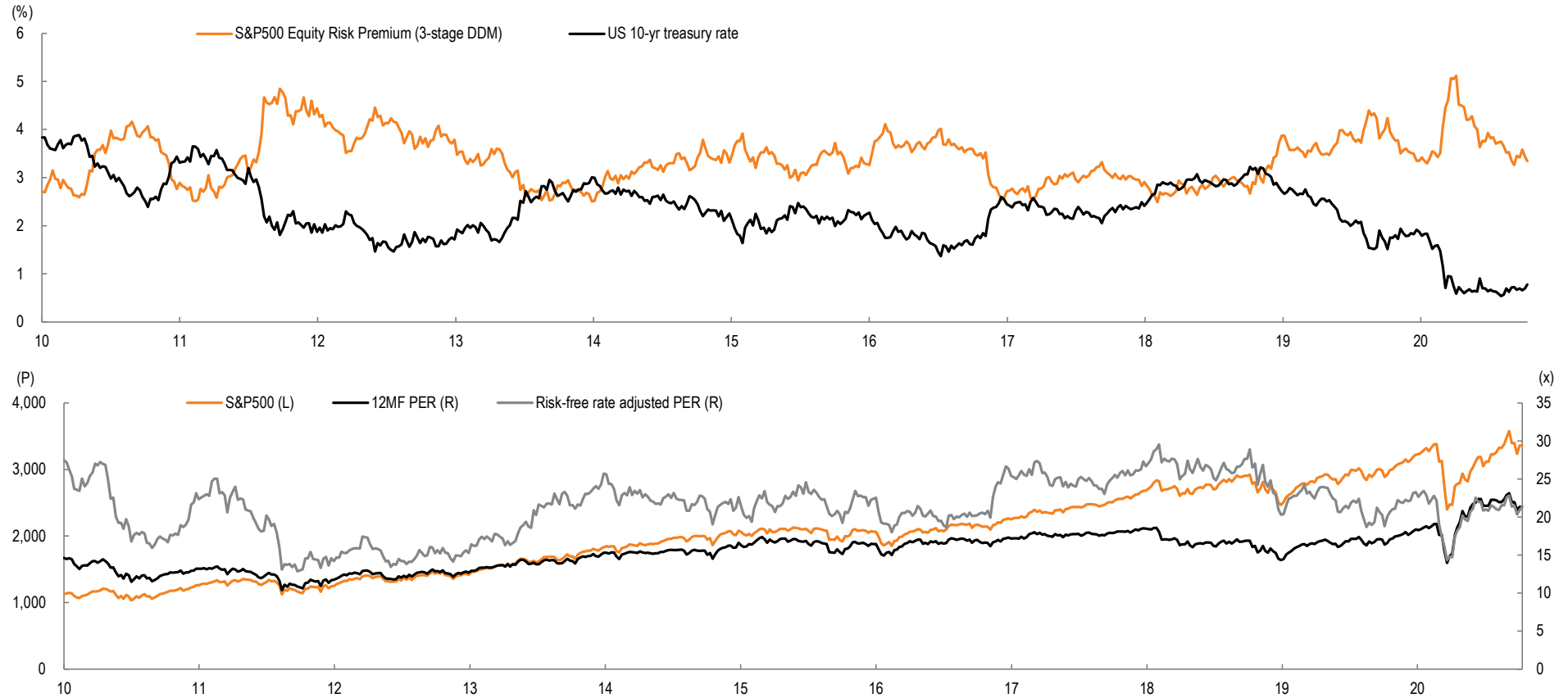
S&P 500 12MF PER (risk free rate adjusted)



Source: Bloomberg, Mirae Asset Daewoo Research

# Korea Equity Market Strategy : S&P valuation

## S&P500 ERP interest rate trend



Source: Quantwise, Mirae Asset Daewoo Research

## Korean Bond Market :



**Myoungsil Kim**  
Head of Fixed Income Team, Research Center  
**Shinhan Investment Corp**

# Domestic bond market outlook

## Suspicious numbers

[ Research Center ] MyoungSil Kim

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✉ [msbond@shinhan.com](mailto:msbond@shinhan.com)

 Shinhan Investment Corp.





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# I. Intro

History-making moments of 2020

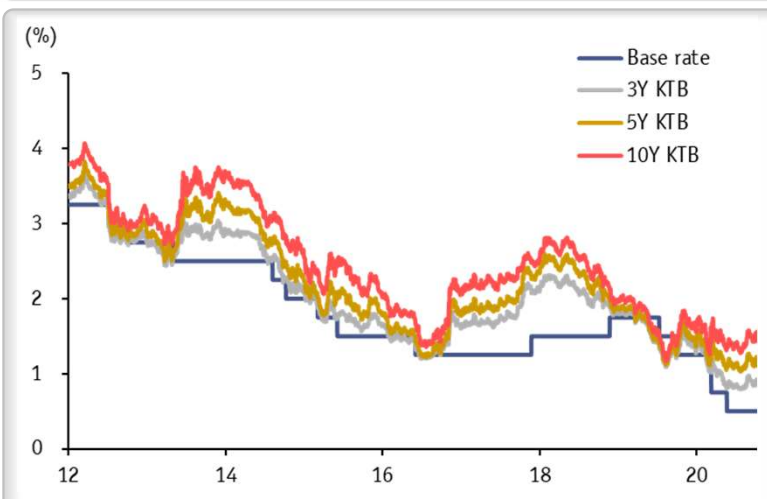


# I. Intro: Domestic bond market trend 2020 (1)

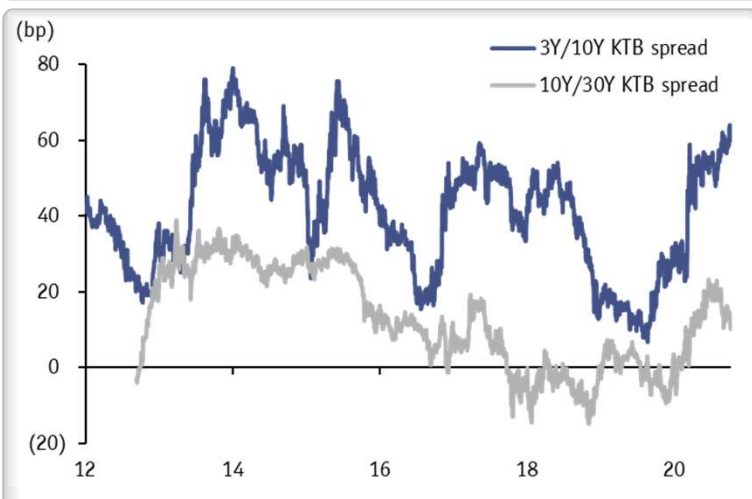
## Bond market hit by COVID-19-sparked economic shock but stabilized on policy response

- With COVID-19 spreading globally from February, the Korean government and Bank of Korea (BOK) have taken all-out measures to protect the real economy and stabilize the financial markets.
- Monetary easing drove down market rates to record-low levels at end-July, but bond market volatility rose again from September due to increased supply and weak US Treasuries.
- 3Y and 10Y KTB yields have fallen by 45.8bp and 16bp YTD, respectively, leading to a roughly 30bp rise in 3Y/10Y spread to 62bp.

Base rate and KTB yields



3Y/10Y and 10Y/30Y KTB spreads

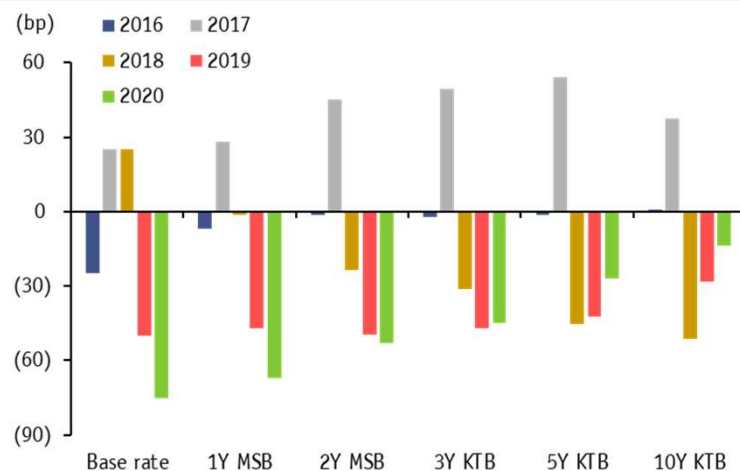


# I. Intro: Domestic bond market trend 2020 (2)

## YoY drop in annual bond return on greater volatility

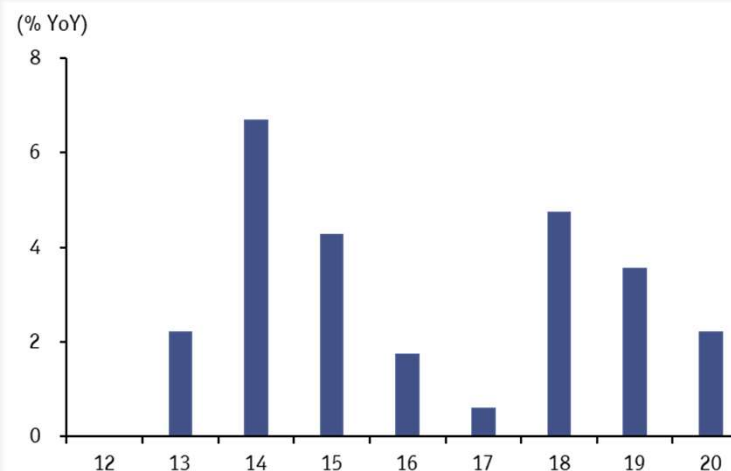
- Domestic bonds should continue to post a positive annual return at 2.2% for 2020, though down 1.4%p vs. 2019's 3.6%.
- Bond returns are buoyed by: 1) base rate cuts; 2) BOK's outright purchase of KTBs; and 3) rising concerns over economic slump.
- But the upside should be limited due to unfavorable supply/demand conditions (largest-ever KTB issuance in 2020, etc.).

YoY change in base rate and market rates



Source: Yonhap Infomax, Shinhan Investment Corp. / Note: MSB = monetary stabilization bonds

KRX Bond Index (Total Return Index)



Source: Yonhap Infomax, Shinhan Investment Corp.

## II. Monetary policy & demand

Time to take supplementary measures

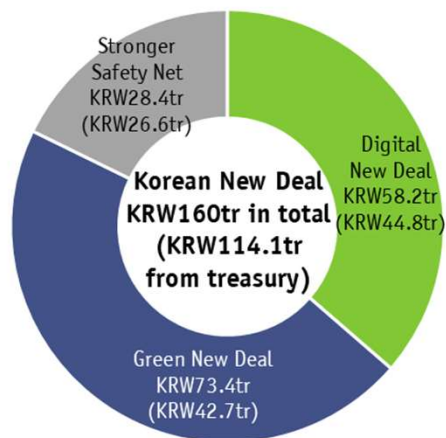


## II. Monetary policy: Rate freeze in 2021

### Base rate likely to be kept low under the Korean New Deal initiative

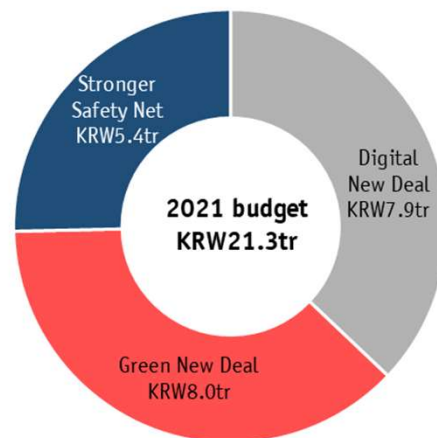
- The 2020-2024 fiscal management plan points towards fiscal expansion to provide a potent stimulus for the economy.
- Government expenditure is projected to grow at a CAGR of 5.7% in 2020-2024, while revenue should increase only 3.5% per annum.  
→ Need to secure a stable flow of fiscal funds
- The BOK faces growing calls to play a supportive role in fiscal expansion. → Base rate likely to be kept low for a long time

Korean New Deal: Project costs by focus area



Source: Ministry of Economy and Finance, Shinhan Investment Corp.

Korean New Deal: 2021 budget allocation by focus area

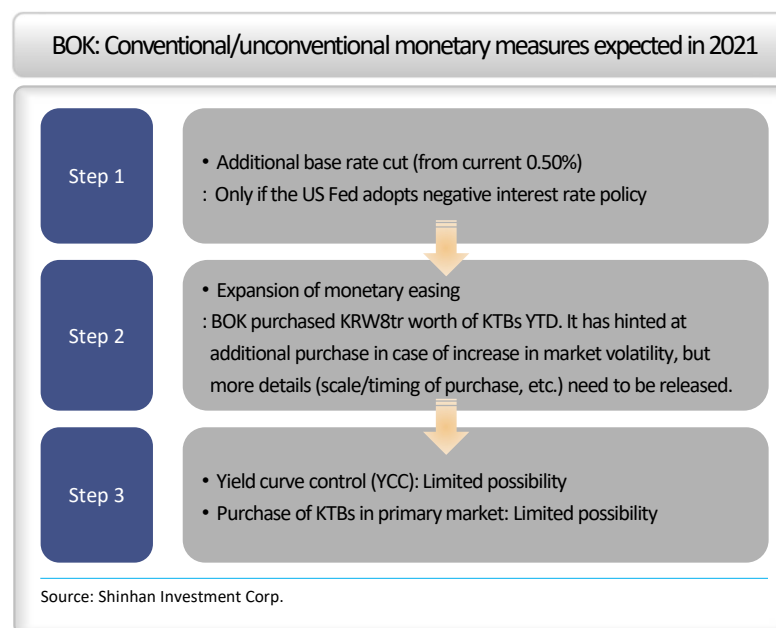
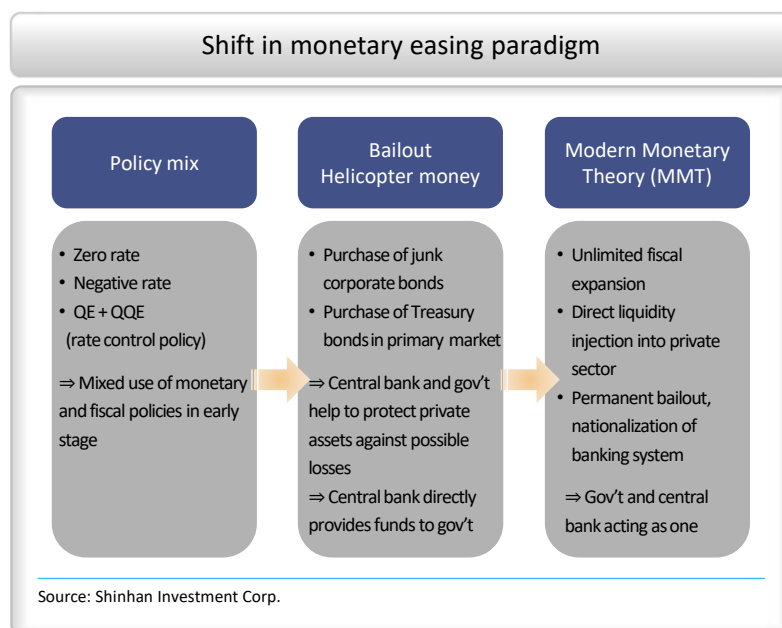


Source: Ministry of Economy and Finance, Shinhan Investment Corp.

## II. Monetary policy: Gov't-BOK cooperation

### Close cooperation between government and BOK required for fiscal expansion

- A stable flow of fiscal funds is needed, but additional issuance of debt is a burden for both the government and the bond market.
- The BOK needs to build trust in financial markets to reduce the burden from any additional debt issuance (hints at mid-term KTB market intervention, etc.).
- It may pledge to supplement its existing asset purchase plan and provide forward guidance of low rates for the long term.



## II. Monetary policy: Review on outright purchase

### Review on BOK's outright purchase program in 2020

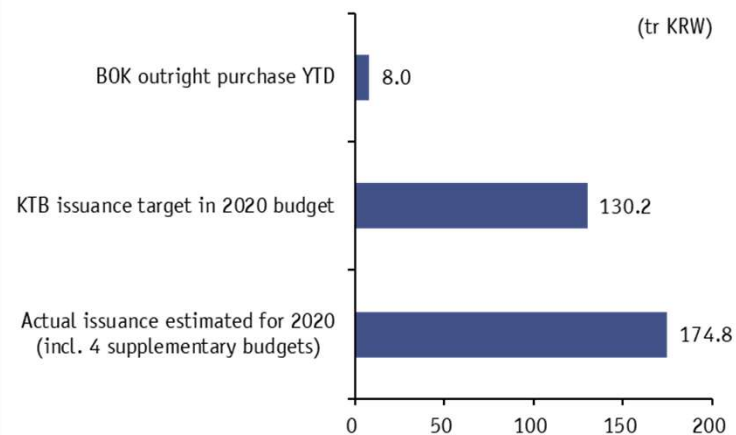
- The BOK has mostly purchased non-benchmark 10Y KTBs under its outright purchase program, with benchmark KTBs accounting for a mere 2.1%. → Limited impact on the market
- The BOK's market intervention seems insufficient with KRW8tr worth of KTBs purchased YTD, given that actual KTB issuance in 2020 will likely exceed the originally planned amount by KRW44.6tr due to massive supplementary budgets.

BOK's YTD outright purchase of KTBs by maturity

	Maturity	Amount (100mn KRW)	Share (%)
Non-benchmark	3Y	5,200	6.5
	5Y	8,800	11.0
	10Y	52,300	65.4
	20Y	12,000	15.0
Benchmark	5Y	1,700	2.1

Source: Yonhap Infomax, Shinhan Investment Corp.

2020 KTB issuance: Original plan vs. actual issuance (estimate)



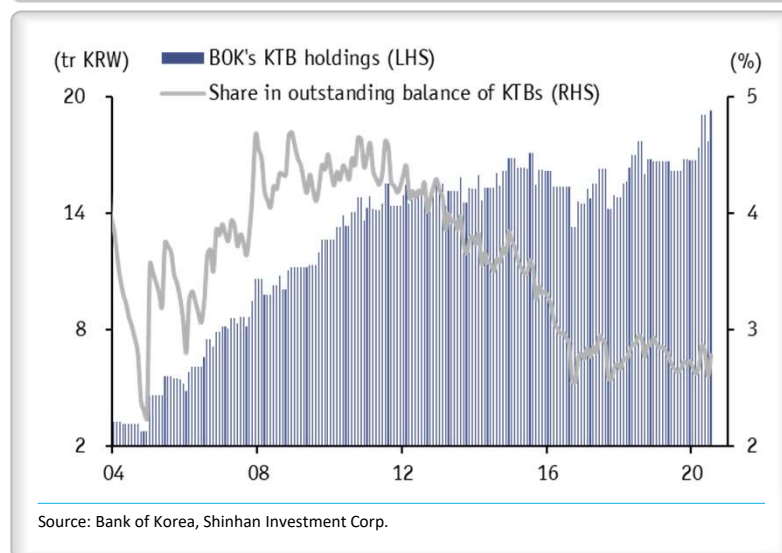
Source: Bank of Korea, Shinhan Investment Corp.

## II. Monetary policy: Supplementary measures

### BOK to supplement outright purchase program in 2021

- The portion of benchmark KTBs needs to be raised to make a bigger impact on the market.
- The BOK needs to expand the share of long-term/ultra-long-term KTB purchases to make up for the void in demand from long-term/ultra-long-term institutional investors.
- More details (purchase criteria, scale, timing) should be released through communication channels such as Monetary Policy Board meetings. → Forward guidance in a broad sense

BOK's KTB holdings and share in outstanding balance



2019-2020 KTB issue share by maturity (target/actual)

(%)		Short-term (3·5Y)	Mid-term (10Y)	Long-term (20·30·50Y)
2019	Target (actual)	40±5 (38.4)	25±5 (25.7)	35±5 (35.9)
2020	Target	40±5	25±5	35±5

\* Long-term KTB target is set at or above the middle of the target band (35%) considering excess demand.

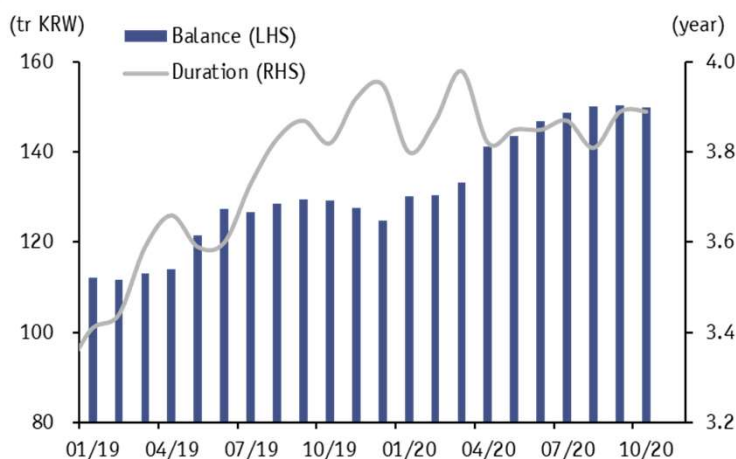
Source: Ministry of Economy and Finance, Shinhan Investment Corp.

## II. Demand: Foreign investors

### Foreign demand to remain solid on favorable market conditions

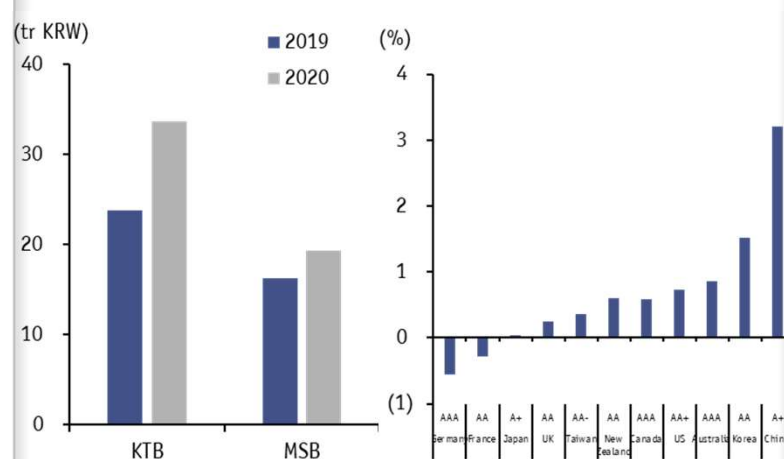
- The balance of KRW-denominated bonds held by foreigners hit an all-time high of KRW150.9tr in August, in contrast to what we witnessed during the global financial crisis in 2008.
- We note that foreign investors expanded purchase of long-term KTBs, with cumulative net buying of 10Y KTBs reaching KRW8.3tr vs. KRW5.9tr for 5Y and KRW3.7tr for 3Y.
- Foreign demand for KRW-denominated bonds should remain solid, given: 1) attractive absolute yield; 2) positive foreign exchange hedging premium; 3) low credit default swap (CDS) risk premium and stable foreign exchange rates.

Balance and duration of foreign bond holdings



Source: Yonhap Infomax, Shinhan Investment Corp.

Foreign net buying of KTBs/MSBs and 10Y government bond yields



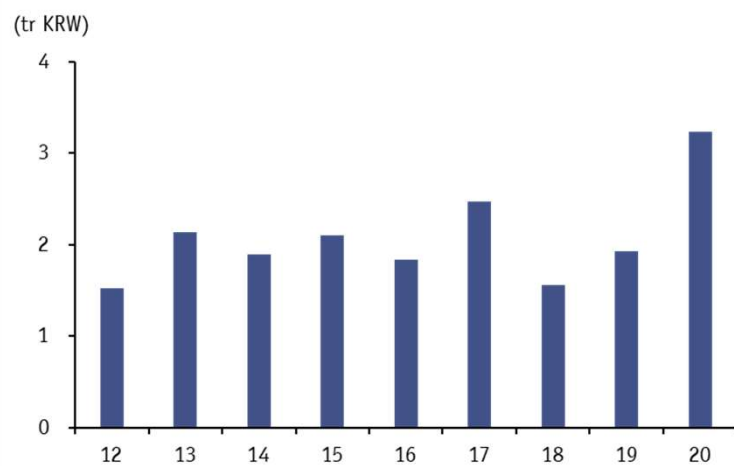
Source: Yonhap Infomax, Shinhan Investment Corp.

## II. Demand: Insurers

### Demand from insurers remaining steady, but...

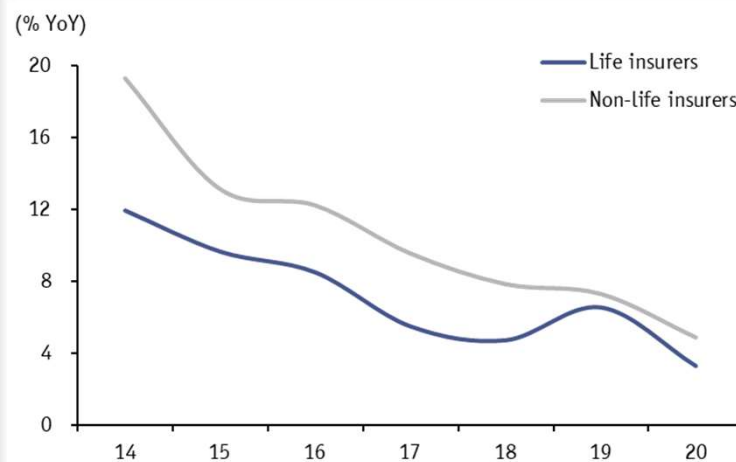
- Demand from insurers has been steadier than expected in 2020, with the monthly average net buying of KTBs by insurers up by KRW1.3tr YoY at KRW3.2tr for the year.
- Regulatory changes will raise the cap on foreign currency assets for insurers from late 2020, but impact will likely be limited due to the unfavorable climate for overseas investment such as the rise in hedging costs.
- Asset growth at insurers has been on a steady downtrend with the growth rate dropping to 3% levels for life insurers and to 4% levels for non-life insurers in 2020.

Net buying of KTBs by insurers



Source: Yonhap Infomax, Shinhan Investment Corp.

Asset growth at life vs. non-life insurers



Source: Korea Life Insurance Association, General Insurance Association of Korea, Shinhan Investment Corp.

### III. 2021 issue checklist

FX trend/inflation/spread/long-term KTB issuance

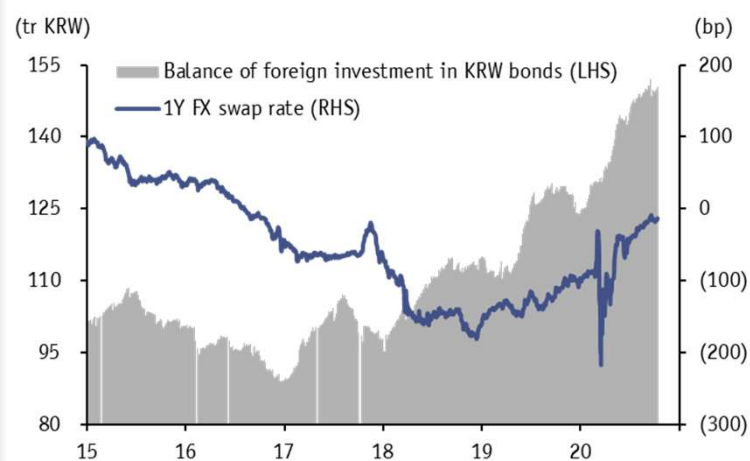


### III. 2021 issue checklist

#### ① Weaker USD/stronger KRW trend to continue

- Weaker USD/stronger KRW trend will likely continue, with the USD/KRW rate expected to average around KRW1,100 in 2021.
- FX trends favorable for foreign investment in KRW-denominated bonds, but unfavorable for domestic insurer investment in overseas bonds.
- Likely to offset impact of slower asset growth at insurers and increased cap on foreign currency assets  
→ Positive for bond supply and demand conditions

Foreign investment in KRW-denominated bonds and 1Y FX swap rate



Source: Yonhap Infomax, Shinhan Investment Corp.

Key points of the revised Insurance Business Act

Progress	Passed the National Assembly on April 29, 2020
Key changes	Cap on foreign currency assets raised from 30% to 50% for general accounts and from 20% to 50% for special accounts to grant more autonomy in asset management
	Insurers required to provide a pre-contractual info package in addition to documents on insurance policies to ensure adequate understanding by consumers
	Fines for failing to notify consumers the right to request interest rate cuts will be imposed on the insurance company instead of board members
Implementation	Slated to go into effect six months from promulgation

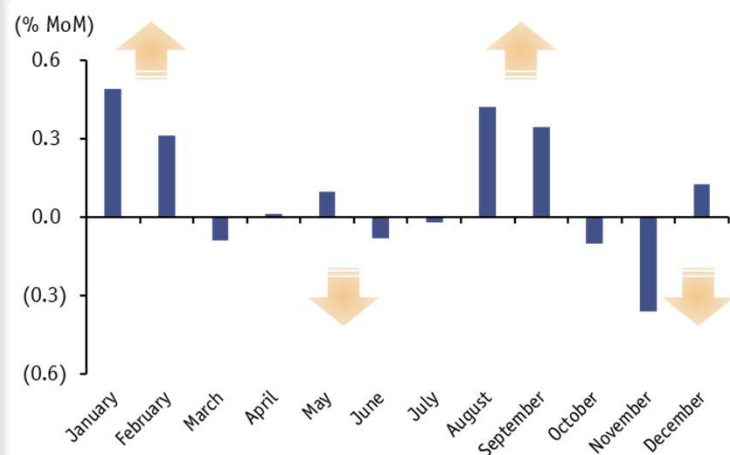
Source: Shinhan Investment Corp.

### III. 2021 issue checklist

#### ② Inflation/deflation

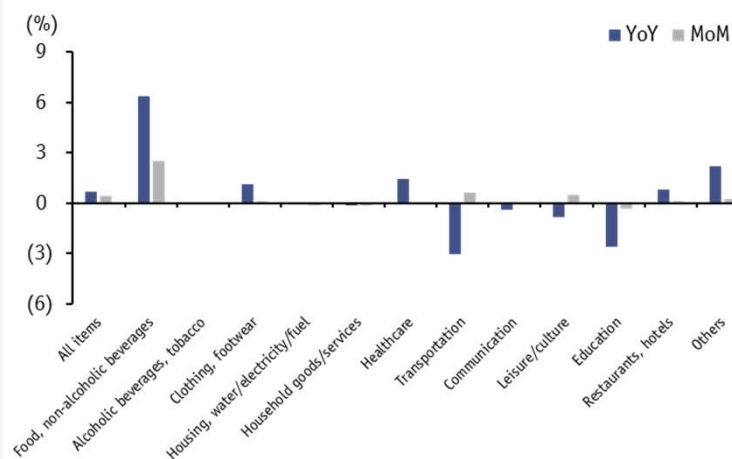
- Global central banks turning increasingly tolerant to higher inflation over the longer run (e.g., US Fed's Average Inflation Targeting, ECB's consideration of inflation overshooting)
- In Korea, inflation expectations are low with prices temporarily rebounding on seasonality but long-term factors (prices of oil/transportation/education and policy factors) pointing to a downtrend → price indexes linked to policy support expected to fall
- Steadier food prices to limit additional upturn → Need time for CPI to point toward recovery in consumption and investment

Average MoM changes in CPI since 2012



Source: Bank of Korea, Shinhan Investment Corp.

3-month average changes in CPI by expenditure category

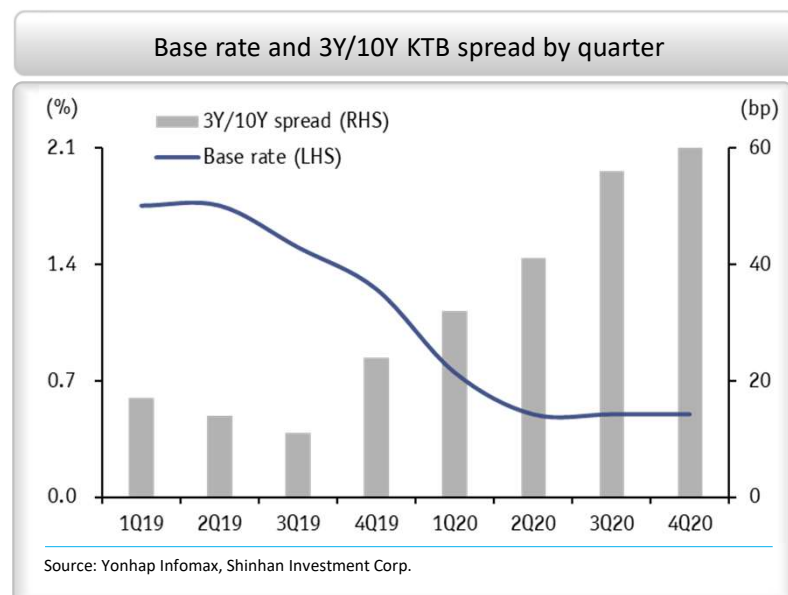


Source: Bank of Korea, Shinhan Investment Corp.

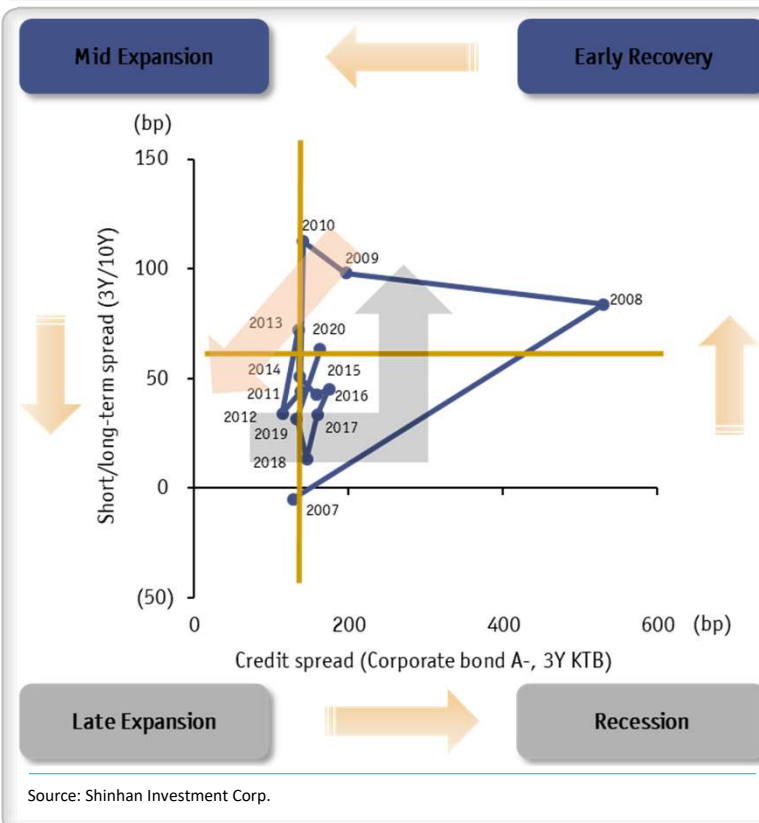
### III. 2021 issue checklist

#### ③ 2021F 3Y/10Y KTB spread

- 3Y/10Y KTB spreads are closely related to economic conditions, which rapidly transitioned from a late expansion phase in 2019 to an early recovery phase in 2020 due to the COVID-19 pandemic.
- Short/long-term spreads will recover to reasonable levels upon the return to the economic trajectory of 2018-2019, between a late expansion phase and recession.



Economic trajectory based on short/long-term and credit spreads

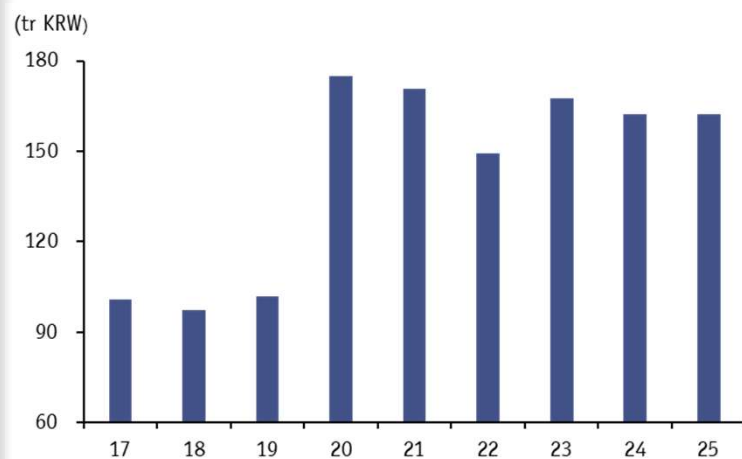


### III. 2021 issue checklist

#### ④ KTB issuance scenario based on 2020-2024 fiscal plans

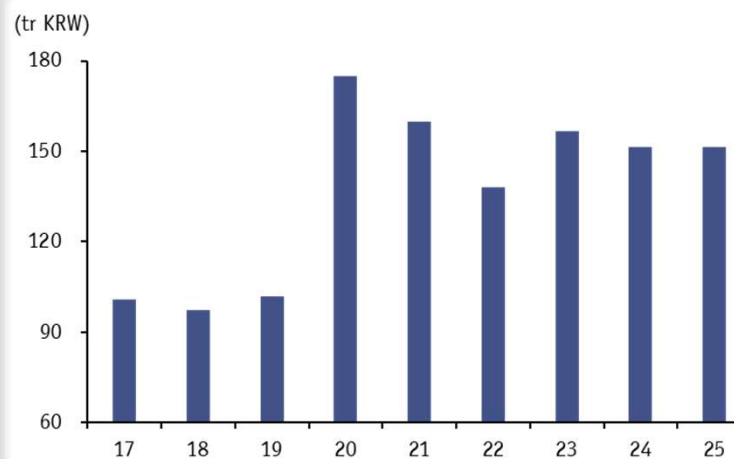
- KTB issuance notably increased in 2020 after remaining under KRW100tr per year through 2018-2019.
- Expansionary fiscal efforts such as the Korean New Deal are expected to be funded mainly by the issuance of deficit-financing KTBs.
- KTB issuance in 2020-2025 will likely exceed KRW160tr per year. Primary market shock is expected to lead to long-term impact on the bond market as a whole.

KTB issuance assuming government spending is 100% funded by deficit-financing KTBs



Source: Ministry of Economy and Finance, Shinhan Investment Corp.

KTB issuance assuming government spending is 50% funded by deficit-financing KTBs



Source: Ministry of Economy and Finance, Shinhan Investment Corp.

## IV. Investment strategy

Another open ending for monetary policies in 2021

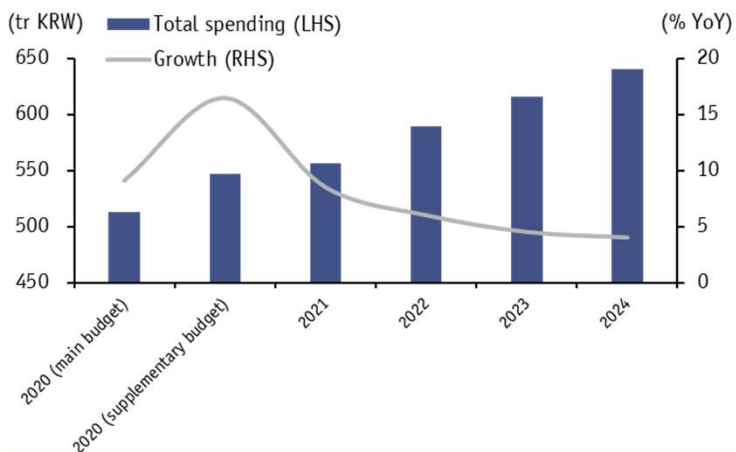


## IV. Investment strategy

### ① Fiscal expansion, ② KTB issuance risks followed by ③ BOK's KTB purchases, ④ debt fatigue

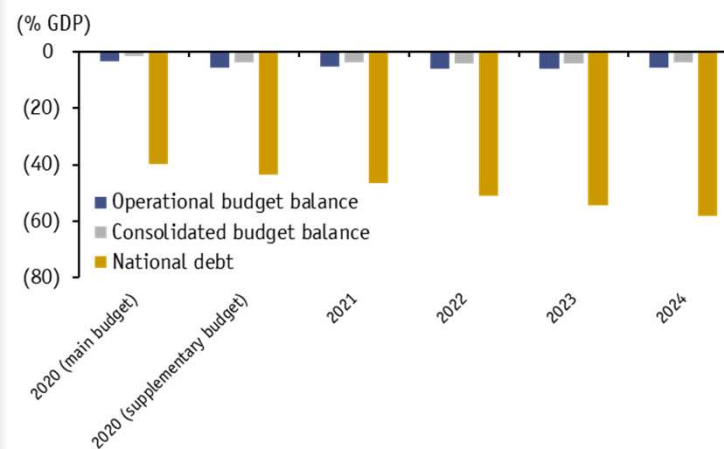
- Long-term default risks presented by expansionary fiscal policies and increased issuance of KTBs expected to be priced into yields to a certain extent.
- After a time gap, Bank of Korea's KTB purchases should help to offset the supply burden in the market. Debt fatigue will likely set in, slowing down the pace of economic recovery as a result.
- Risk exposure seen inevitable through late-2020 to 1Q21 with base effect to add to the burden. However, yields should stabilize downward on closer cooperation between the government and central bank.

Medium-term fiscal spending plan



Source: Ministry of Economy and Finance, Shinhan Investment Corp.  
Note: Based on 3rd supplementary budget; 4th supplementary budget to push up 2020 total to KRW554.7tr

Fiscal balance and national debt since 2020

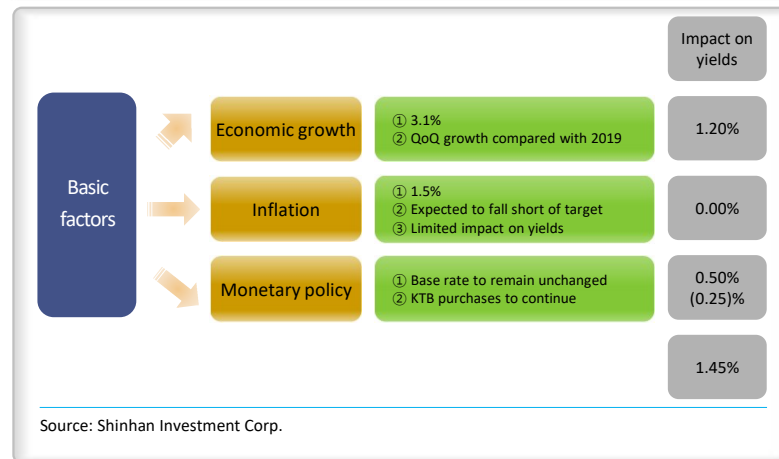


Source: Ministry of Economy and Finance, Shinhan Investment Corp.

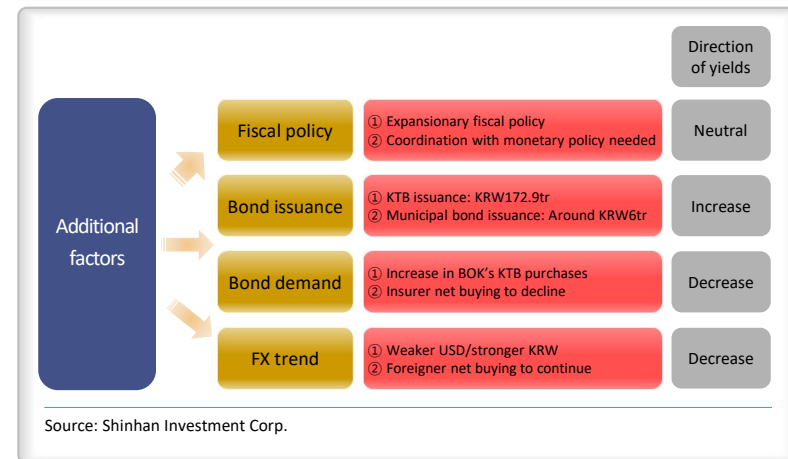
## IV. Investment strategy



2021 bond market outlook – basic factors



2021 bond market outlook – additional factors



2019	2019				2020				2021			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
(%)												
Base rate (term-end)	1.75	1.75	1.50	1.25	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3Y KTB (average)	1.798	1.641	1.278	1.411	1.233	0.914	0.853	0.85	0.90	0.80	0.70	0.70
5Y KTB (average)	1.861	1.677	1.325	1.505	1.365	1.170	1.125	1.20	1.25	1.10	1.00	1.00
10Y KTB (average)	1.977	1.785	1.395	1.660	1.560	1.429	1.409	1.50	1.55	1.40	1.30	1.30
30Y KTB (average)	2.008	1.814	1.382	1.613	1.584	1.575	1.587	1.60	1.65	1.50	1.40	1.40

## Panel Discussion: Overseas Investors' View on the Korean Market



**Simon Williams**  
Managing Director,  
APAC Head of Equity  
Trading  
**BlackRock**



**Ross Whittaker**  
Managing Director,  
Co-Head of APAC  
Advanced Execution  
Services (AES)  
Electronic Trading  
**Credit Suisse**



**Nicholas Peach**  
Managing Director,  
Head of Electronic  
Trading  
**Goldman Sachs**



**Lyndon Chao**  
Managing Director,  
Head of Equities  
and Post Trade  
**ASIFMA**  
**(moderator)**

Thank you for attending!  
We hope to see you at our next event:

**ASIFMA Virtual Event:**  
**ESG and Sustainable Finance in Asia: the Fintech and Data Challenge**  
**(in collaboration with the Future of Sustainable Data Alliance)**

Wednesday, 28 October 2020  
4:00PM – 5:30PM (HKT/SIN)



[www.asifma.org/events](http://www.asifma.org/events)

## Speakers:



**Ramesh Subramaniam**  
Asian Development Bank



**Gabriel Wilson-Otto**  
BNP Paribas Asset  
Management



**Kamran Khan**  
Deutsche Bank



**Eugène Goyne**  
EY



**Helena Fung**  
FTSE Russell



**Helene Li**  
Fintech Association of  
Hong Kong; GolImpact



**Julia Walker**  
Refinitiv



**Matthew Chan**  
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