

# Outlook for KRW and treasury bonds: Fed rate cut should boost the won

Over the next 12 months, changes in the global financial market environment are expected to have a greater impact on Korean assets



A Fed rate cut of either 25bp or 50bp in September is likely to be beneficial for the KRW

## Summary

Despite the limited scope for rate cuts by the Bank of Korea (BoK) in this easing cycle, we still believe that curve steepeners are the way forward for KTBs (Korean Treasury Bonds). Over the next 12 months, key drivers of the KTB market will include issuance levels, rate decisions by central banks (including the BoK), and decisions regarding the World Global Bond Index (WGBI) inclusion.

As for the Korean won (KRW), the financial market is currently the primary driver, and we anticipate only modest appreciation in the KRW.

## KTB: Outlook favours curve-steepeners for KTBs

The government released its 2025 budget plan last month, which showed KTB issuance of KRW201.3 trillion. This was a 27.0% year-on-year (42.8 trillion KRW) increase from the 2024 approved budget, with net issuance surging 67.9% (33.9 trillion KRW).

The government has covered tax revenue shortfalls over the past two years with public fund

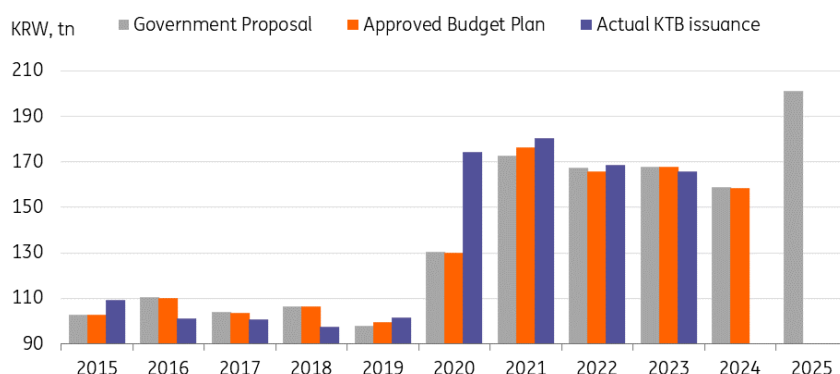
revenues. But next year it will need to replace them with debt issuance. Redemption issuance has also increased by 102.2 trillion KRW – a significant uplift, with a large portion of post-pandemic KTB bonds maturing in 2025.

Given the current government's tight fiscal stance, the 68% net increase in government bonds next year was much higher than market expectations, and longer maturity KTBs reacted quickly with an increase of around 7bp on the day of the announcement.

## What previous KTB issuance tells us

The Special Committee will deliberate the budget plan on Budget and Settlement, and a final draft will be presented to the National Assembly by the end of December. There have been changes between line items in the past, but these have only ever been minor alterations from the government's initial draft. The difference between the initial government proposal and the actual issuance in the following year is more important. Barring 2022 (when the actual issuance rose by more than KRW20 trillion than the proposal due to the Covid-related spending rise), the actual issuance of KTBs has tended to be only slightly different (about KRW 0.2 trillion) from the government's proposal.

## Comparison between budget plan and actual KTB issuance

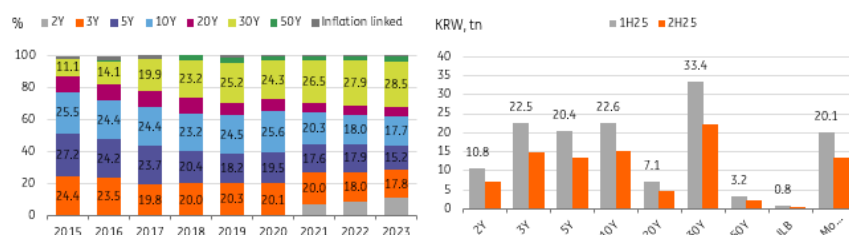


Source: Ministry of Economy and Finance

## KTB issuance estimation for 2025

Given the historical issuance rate of around 60% in the first half of the year, the monthly issuance supply is expected to reach KRW 20 trillion in the first half of 2025. By maturity, the issuance of long-term bonds has shown the largest increase, while the issuance of 3-10-year bonds has slowed over the past decade. Estimating based on the latest three years' average, we expect issuance at the 30Y tenor to rise the most.

## KTB breakdown by maturity and issuance estimation for 2025



Source: Ministry of Economy and Finance, ING estimates

## Central bank decision and WGBI inclusion

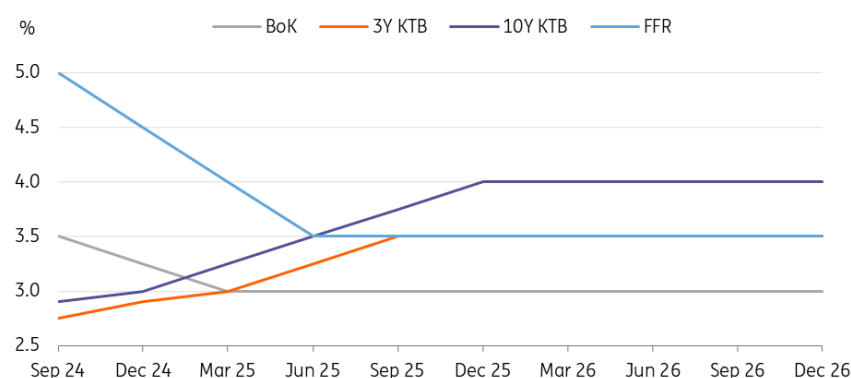
Although the larger-than-anticipated 2025 KTB issuance initially dampened market sentiment, this was quickly overshadowed by improved global market sentiment due to expectations of Fed easing. In the coming months, KTB markets will be influenced by the pace of rate cuts from both the Fed and the Bank of Korea, as well as the outcomes related to the WGBI.

If we see lower-than-expected rate cuts by central banks and if KTBs were left out of any WGBI expansion (announced at the end of September), this could roil current market expectations and lead to a substantial rate rebound. On the flip side, if KTB inclusion in the WGBI is confirmed, potentially \$40-50bn of WGBI-related funds will flow into KTBs, and improved demand conditions could partially offset the additional bond supply.

In terms of central bank easing, we expect the BoK's terminal rate in this easing cycle to be 3.00%. Our house view for US rates is for the Fed funds rate to be cut from 5.5% to 3.5% by the end of 2025.

The impact of the BoK's rate decisions has to be considered relative to those of the Fed. We expect the BoK to cut policy rates by just 50bp, with an upside risk of 75bp of easing. The short end of the KTB curve moves more closely with the BoK policy rates, but longer tenors move more closely with the US Treasury (UST) market. As ING expects the UST yield curve to be steepened gradually from the fourth quarter of this year, we also expect the KTB yield curve to mirror slope changes in USTs.

## ING forecast on rates



Source: ING estimates

## KRW: An appreciation window opens for the KRW, but is unlikely to last

As market expectations of the Fed's first rate cut have grown strongly since early August, the KRW has risen 2.5% over the month, almost as much as the dollar has weakened. However, KRW gains have been quite modest given Korea's favourable external macroprudential conditions compared to other Asian economies. On further inspection, we find that there has been a fundamental shift in the key drivers of the KRW, and as a result, there has been a change in how we think the KRW will move over the medium term.

### Near-term outlook for the KRW

We have argued in favour of KRW appreciation in the third quarter, and the recent strengthening of the won supports this position. In September, the KRW has been trading within a range of 1,325 to 1,345, significantly lower than its July level of around 1,390.

Regardless of whether the Fed cuts by 25bp or 50bp in September, this should still be favourable for the KRW as long as there are no clear signs of a recession in the US. For our forecast to be correct, markets should interpret the Fed's cut as an orderly unwinding of restrictive monetary policy in response to a clear improvement in inflation putting it on-track to achieve the Fed's target range. This should not be viewed as a response to a sudden slowdown of the economy.

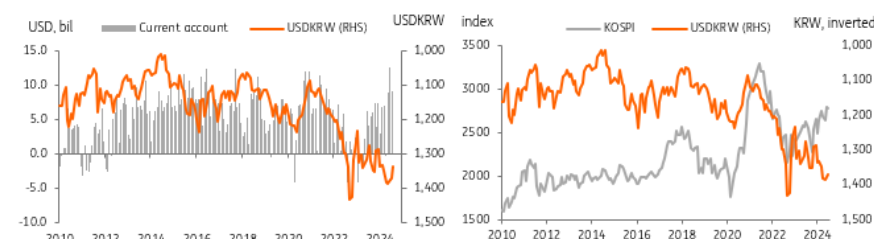
Compared to the Fed, the BoK's room for rate cuts is quite limited. As a result, even with some appreciation, we still expect KRW to remain above the 1,300 level by the end of this year.

Scope for market volatility to increase surrounding the Fed's decisions and the US presidential election remains high, however. And as the presidential race is quite tight, this uncertainty could persist until the outcome is clear.

### Puzzled by recent KRW moves

Korea's fundamentals improved in 2024, but this wasn't enough to deliver KRW appreciation. Large current account surpluses and improved global trade conditions used to be the main drivers of KRW appreciation in the past. There has also traditionally been a positive correlation between the KOSPI and the KRW in the past, as inflows of foreign investment have influenced the currency markets. But this relationship has been broken for some time.

### Widened current account surplus and gains in KOSPI have not lead to KRW appreciation since 2023

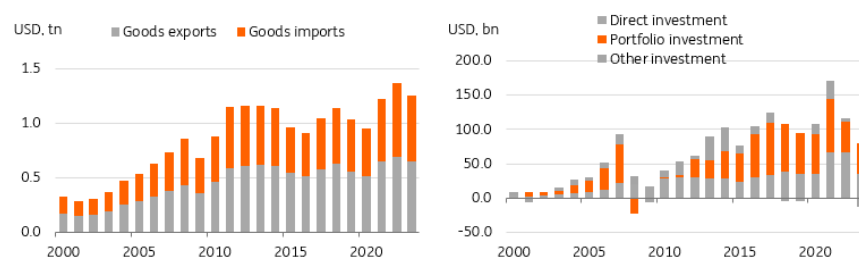


Source: Source: CEIC

## Faster growing financial account is becoming more relevant for the KRW

Merchandise trade – both goods exports and imports – has more than tripled since 2000. However, on the financial account, overseas assets held have risen 13-fold over the same period (looking at a five-year average). We think the rapid increase in financial account balances has probably had a larger impact on the foreign exchange (FX) market than the trade in goods. Also, the government's efforts to make the Korean FX market more flexible and accessible are likely to have increased capital flows, increasing the influence of financial account flows.

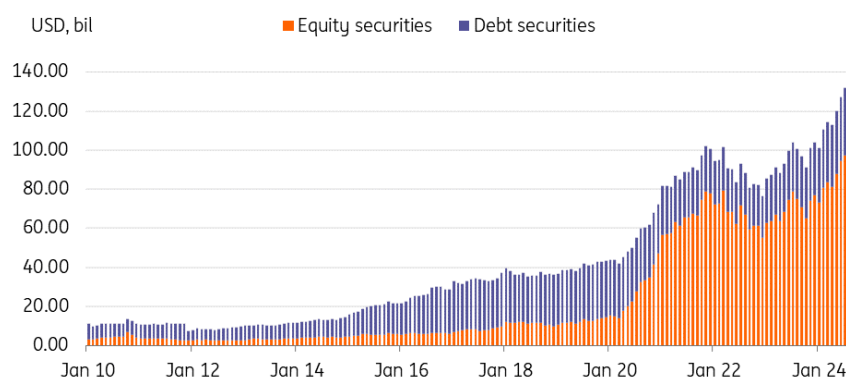
## Financial account grew faster than the merchandise account



Source: Bank of Korea

According to Korea Securities Depository statistics, foreign equity securities holdings have surged since 2020. The two main reasons are a large increase in US equities held by individuals and institutions, and capital gains.

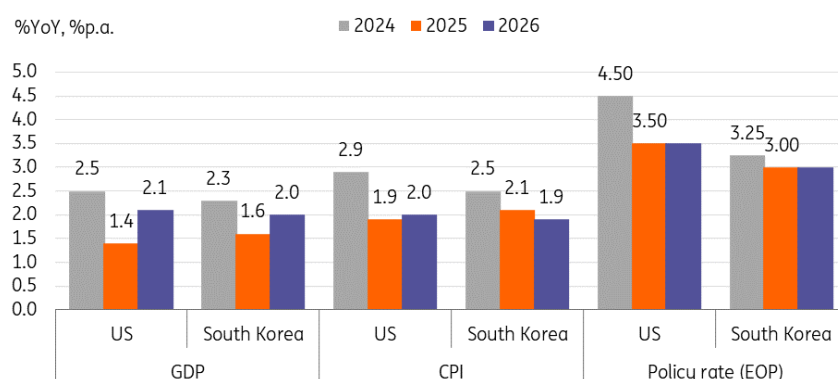
## Korean investor foreign asset holdings have surged since 2020



Source: KSO, Seibro

We expect the rate difference between the US and Korea won't be reversed in the coming easing cycle, while US GDP growth should outperform Korean GDP growth. This suggests that Korean assets' expected returns will still be lower than US assets. As financial instruments continue to diversify, foreign portfolio investment is expected to grow, which will eventually limit the further appreciation of the KRW.

## Macro outlook: US vs South Korea



Source: ING estimates

### Author

#### Min Joo Kang

Senior Economist, South Korea and Japan

[min.joo.kang@asia.ing.com](mailto:min.joo.kang@asia.ing.com)

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