

South Korea rates analysis: Key trends and implications

We want to identify some key drivers of Korean rates. Supportive factors include expected rate cutting and long-end buying. But we see a potential overshoot to the downside in rate cuts, as the neutral official rate will ultimately need to normalise higher. We contextualise this in both a fixed-float and a cross-currency analysis, with a macro spin to boot

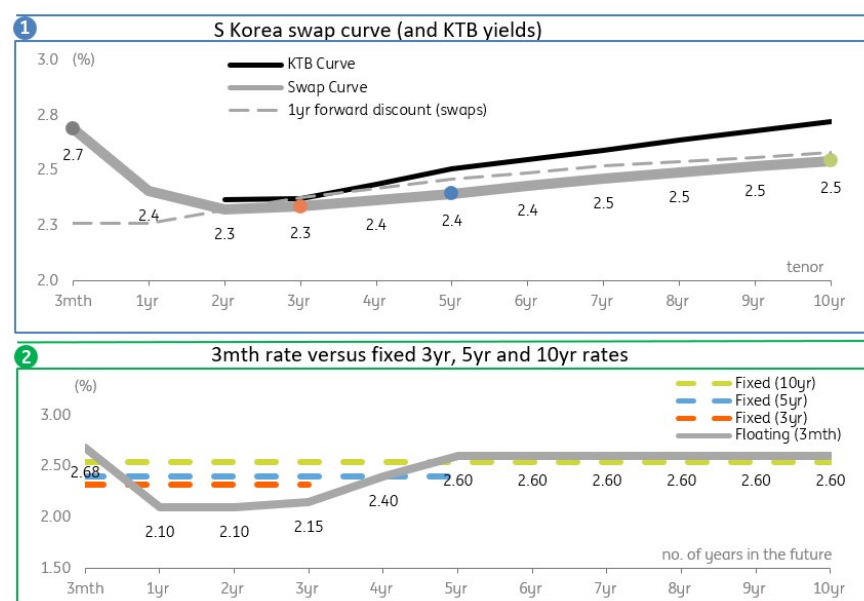


The Bank of Korea in Seoul

Support for entire curve coming from both ends - a fixed versus float analysis

We explain further below why we think the Bank of Korea (BoK) will cut its key rate to 2% (now 2.75%) by year-end. It should hold there for 2026, and beyond that, we'd identify a neutral leaning for the key rate at around 2.5%. That's premised on a tendency for inflation to average at or about 2% in the past 15 years, and inputs a modest real rate of around 0.5% on top of that. Something like 2.5% is the rate a floating rate payer should expect on average over the medium term.

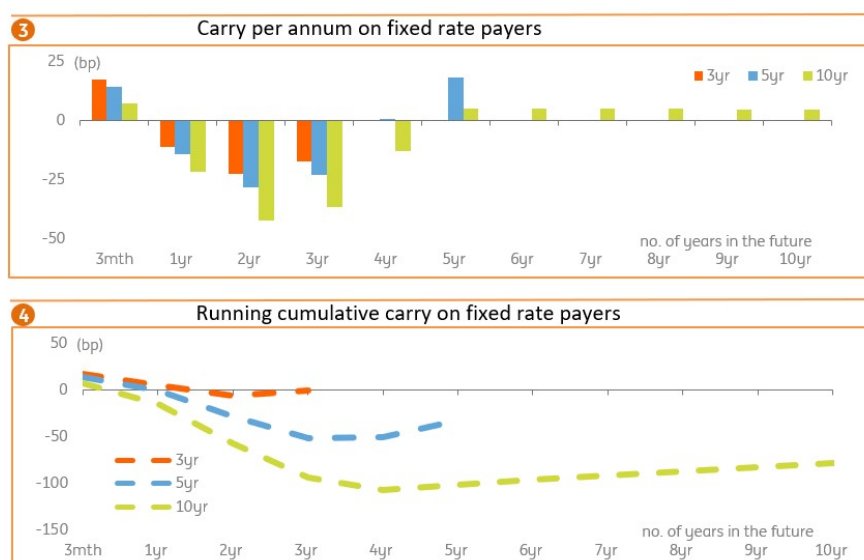
South Korea curve and swap rates versus official rate outlook



Source: Macrobond, ING estimates

Fixed lock-in rate alternatives for liability managers currently sit in the 2.3% to 2.5% range. Given the BoK's rate trajectory, lock-ins today reflect moderate full-term carry costs in the area of -5bp to -10bp per annum. Notably, the 30yr payer benefits from cumulative carry effects (not shown). The chart below highlights a move into negative carry as the BoK cuts, followed by medium-term reversion to a neutral average.

Carry calculations on fixed rate payers set today



Source: Macrobond, ING estimates

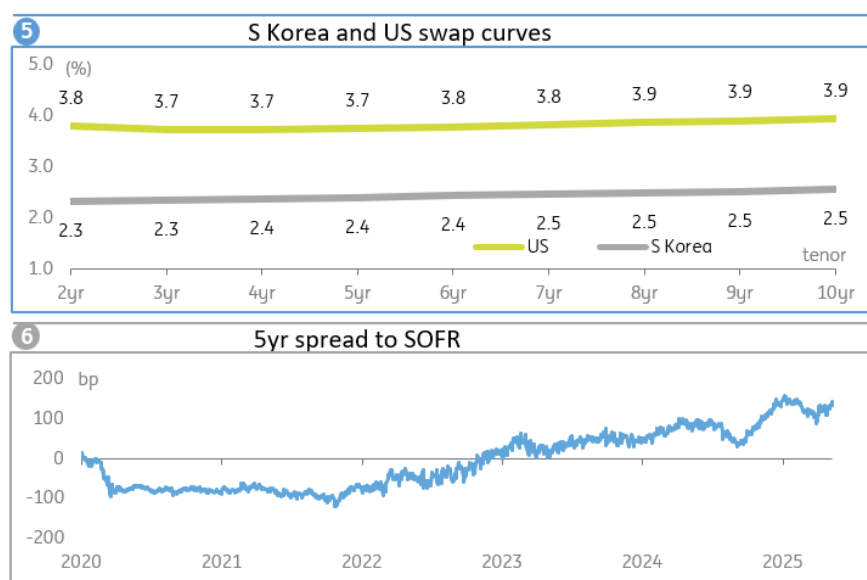
The inversion on the curve beyond the 30yr and out to the ultra longs is in part an ongoing reflection of strong demand for 30yr Korean Treasury Bonds (KTBs) by the life insurance firms, and

an implied bias to receive fixed rates for cover rate purposes when necessary. In fact, Lifers' net purchases of bonds reached nearly 8 trillion won in 1Q25, the most in three years, with a significant rump of the funds going into long dates. That continues to help dampen the curve from the long end.

The positive carry play on the spread to the US - a cross-currency analysis

Spreads versus SOFR remain quite elevated right along the curve. The baseline expectation is for them to remain quite wide, and especially in longer tenors, where there will be a tendency for further widening. The rate-cutting profile is pretty similar in both, but the US long end is a tad more vulnerable from inflation (tariff) and fiscal risks. Market dynamics suggest there could be a c.25bp spread widening potential in the 10yr maturity in the coming months.

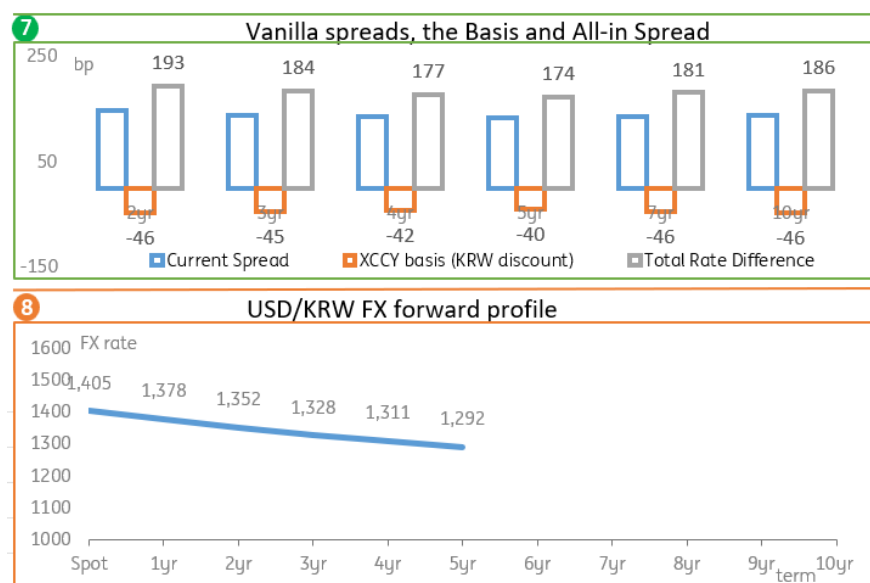
Spreads versus the US (SOFR)



Source: Macrobond, ING estimates

Cross-currency spreads are further amplified by a reasonably impactful negative basis attached to the KRW leg, which adds c.45bp on most tenors. That all-in spread profile is reflected in the FX forward profile, which shows a pronounced KRW appreciation versus the USD. A positive carry setup—borrowing in KRW and investing in USD—could prove advantageous if the won does not strengthen as much as forward pricing suggests. Our own FX forecast suggests the USD/KRW rate could trend in the 1400 area, perhaps with only a mild downtrend. If that is realised, the carry play comes with minimal FX deterioration.

The basis, all-in spreads, and the FX forward breakeven line



Source: Macrobond, ING estimates

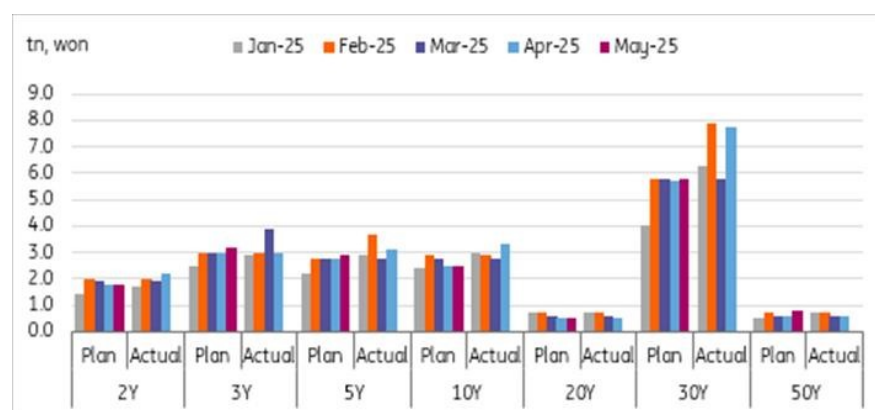
Korean Treasury Bonds and Asset Swaps

While the rate-cutting narrative impacts the front end, on the back end, the 30yr KTB remains in high demand due to Korean lifers' K-ICS. Lifers' net purchases of bonds reached nearly 8 trillion won in 1Q25, the most in three years, with the bulk of the funds going into long-term KTBs, a move that is likely to help them meet capital regulations (K-ICS).

Demand for long-term Treasuries is expected to expand further as the BoK cut policy rates. Also, from April next year, KTBs will be included in the WGBI index, which should be another factor driving the strong long-term KTBs. The strong interest in the 30yr maturity in particular has been met by higher issuance than planned, muting the impact.

Overall though, the asset swap spread environment should remain contained. There had been some prior widening pressure, as KTBs cheapened to swaps. But looking ahead, we suspect this trend should moderate, with spreads likely to stabilise or tighten, helped by KTB buying.

KTB issuance versus planned YTD

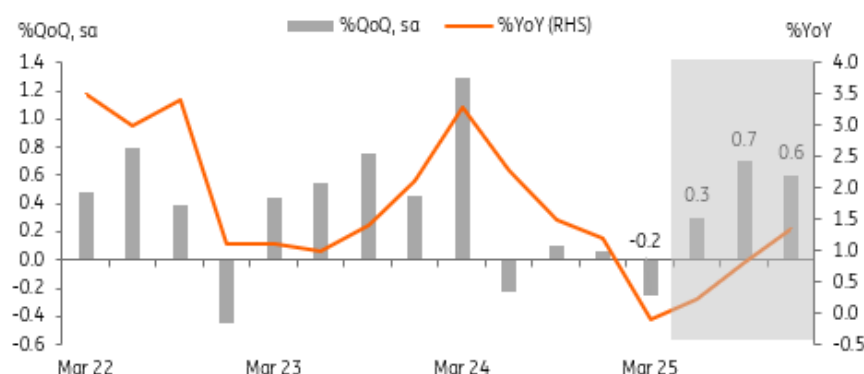


Source: MOEF

The macro story is improving and rates could be cut further

The South Korean economy suffered a major setback in the first quarter of the year. On top of the Trump-triggered tariff war, domestic political turmoil sparked by the declaration of martial law further weighed on the economy. The good news is that the economy is starting to pick up again (0.3% quarter-on-quarter, seasonally-adjusted), following a prior quarter contraction (-0.2%). Despite the high level of uncertainty in the global economy, we see the early signs of recovery in high-frequency data.

The GDP growth profile



Source: CEIC, ING estimates

We expect domestic demand to improve more meaningfully after the snap election on 3 June. The largest risk factor has been removed following the formal departure of former President Yoon Seok Yeol, and we have observed a gradual recovery in sentiment compared to the previous quarter. Recent surges in capital goods imports suggest that equipment investment is likely to rise meaningfully, while government spending is also expected to accelerate.

In addition, counter-cyclical measures in monetary and fiscal policy will bolster the economy. The Bank of Korea (BoK) is still in an easing cycle. Also, high volatility in the foreign exchange market has subsided, and inflation hovering around 2% enables the BoK to focus on supporting growth. We expect the central bank to lower its policy rate from the current 2.75% to 2.0% by the end of

this year.

Regarding fiscal policy, the long-awaited supplementary budget was passed in early May, and an expansionary fiscal stance for 2026 is anticipated, regardless of the outcome of the election. If the Democratic Party candidate, who is currently leading by a sizable margin in the polls, were to win the presidential election, it would result in another supplementary budget worth 1.5% of GDP.

Lastly, South Korea is likely to benefit from the recent ceasefire in the US-China trade war, given that these are two of its largest export partners. Although we still anticipate that exports will hinder growth for the remainder of the year, the expected downturn is now thought to be less severe following the recent 90-day pause.

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