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MACRO MORNING BRIEFING

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Korean Assets Demonstrate Resilience

Following the turbulent events there in recent weeks, South Korea has become the key focus in APAC. While the worst panic and shock may have passed, political uncertainty is likely to linger in the near term as the ruling party seeks to induce President Yoon to step down in an orderly manner as the opposition party pushes for impeachment. We will continue to monitor political developments closely, but we believe the market focus will soon shift back to economic fundamentals. In today’s report, we look at investor and financial asset dynamics over the past week in more depth.

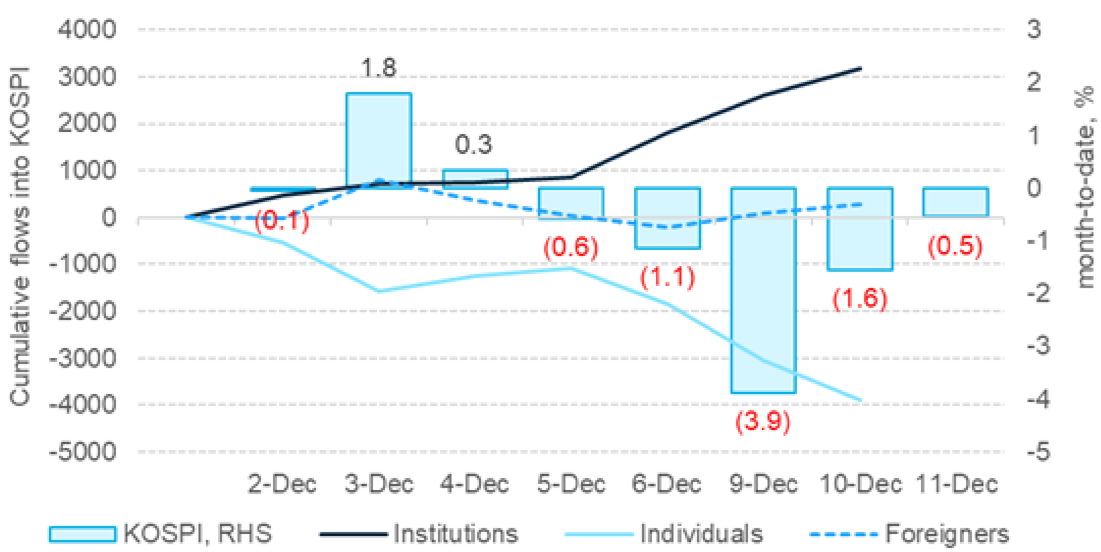
Korean assets have experienced extreme market volatility over the past week. On December 3, USDKRW spiked to an intraday high of 1,444, before dropping back to 1,409 the next day, and then drifting higher to around 1,430 as of this writing. Month-to-date, KRW is down more than 2% against a depreciation of less than 0.5% in the Asian dollar index. Higher USDKRW spot prices have not led to a rise in short-term volatilities. USDKRW 1-week and 1-month at-the-money volatilities hit highs of 11.35 and 9.74, respectively, last week, far below the highs of around 21 and 13.43, respectively, at the beginning of November heading into the US presidential election. Over a period of four days, the KOSPI index of Korean equities shed more than 5% before recovering nearly half its losses this week.

Looking at the fixed income complex, the market remains incredibly resilient. Demand for Korean government bonds (KTB) was strong. Rather than yields moving higher on credit risk and premiums, KTB has enjoyed a safe-haven bid with the 10yr KTB-US Treasury bond yield spread at a new historical low of around 155bp. The resilient sentiment can also be seen in a relatively calm corporate funding market. The 3-month certificate of deposits (CD) and commercial paper (CP) spread, a gauge of funding stress, remains at historically low levels of less than 10bp.

The swift stabilization of sentiment and the limited spillover of market panic is, in our view, in large part due to the immediate and forceful response by the central bank and federal government. The Bank of Korea promised unlimited liquidity in financial markets and signaled its willingness to promptly implement market stabilization measures when necessary, including a KRW 10 trillion stock market stabilization fund, a KRW 40 trillion bond market stabilization fund, the corporate bond and commercial paper (CP) purchase program, and the supply of foreign currency liquidity through the Korea Securities Finance Corporation.

In terms of capital flows, data provided by the Korea Exchange showed that the bulk of the selling pressure has come from individual investors. Foreign investors have been surprisingly calm, while institutional investors, who had a selling bias for the first 10 months of the year, have become buyers since November. On the month, individuals sold a net KRW 3,903bn worth of KOSPI against net buying of KRW 3,329bn by institutions and a net buying of KRW 70bn by foreigners.

Exhibit #1: KOSPI Flows by Investor Type



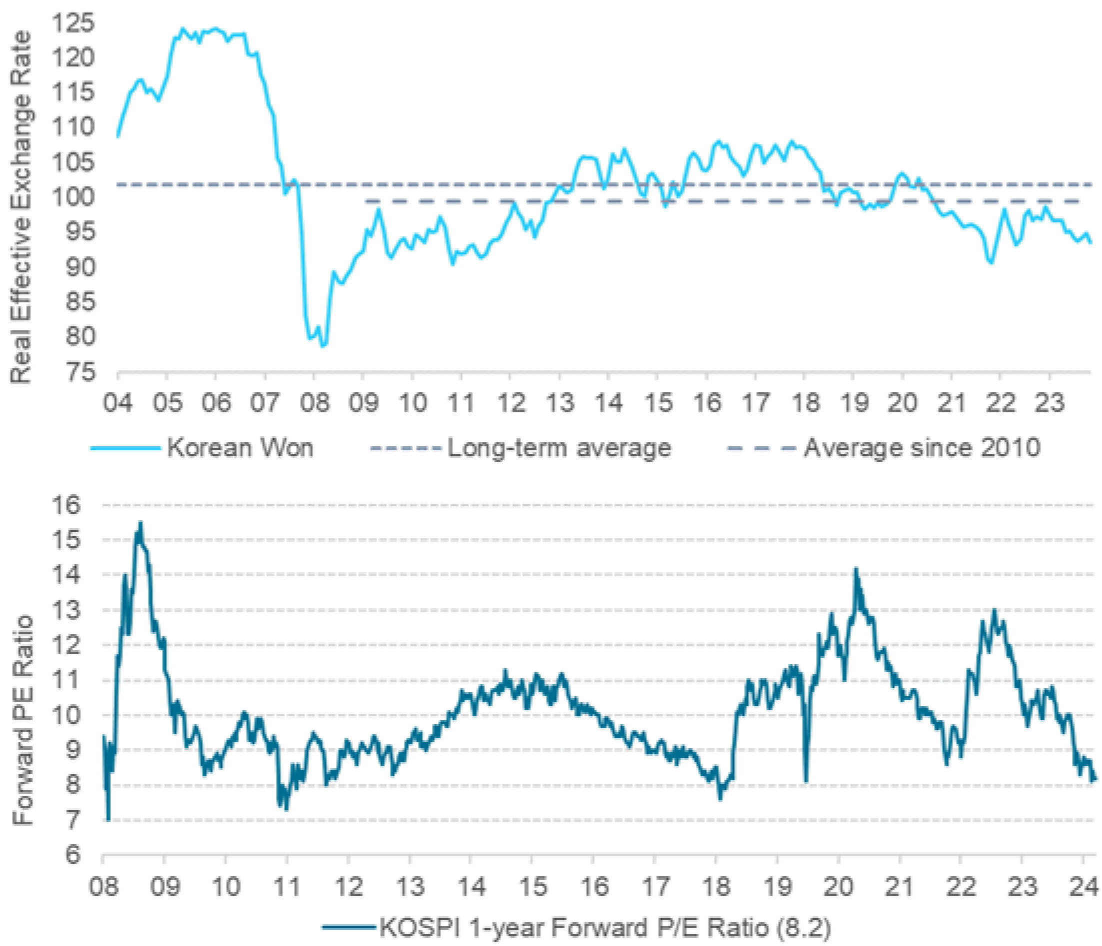
Source: BNY, Bloomberg L.P.

Domestic macro developments are likely to be the primary driver of Korean assets, but this is complicated by the uncertainty surrounding President Trump’s tariffs.

However, we believe the Korean authorities will redouble their efforts to ensure effective implementation of the program to revive the domestic capital market, especially the value-up program. Weakening growth momentum risks the return of a fiscally expansive strategy last seen in 2022.

The valuation of Korean assets is attractive, with Korean real effective exchange rates at recent lows. At 8.2, the KOSPI equity index 1-year forward P/E ratio is near an all-time low.

Exhibit #2: Attractive Valuation of Korean Won and KOSPI

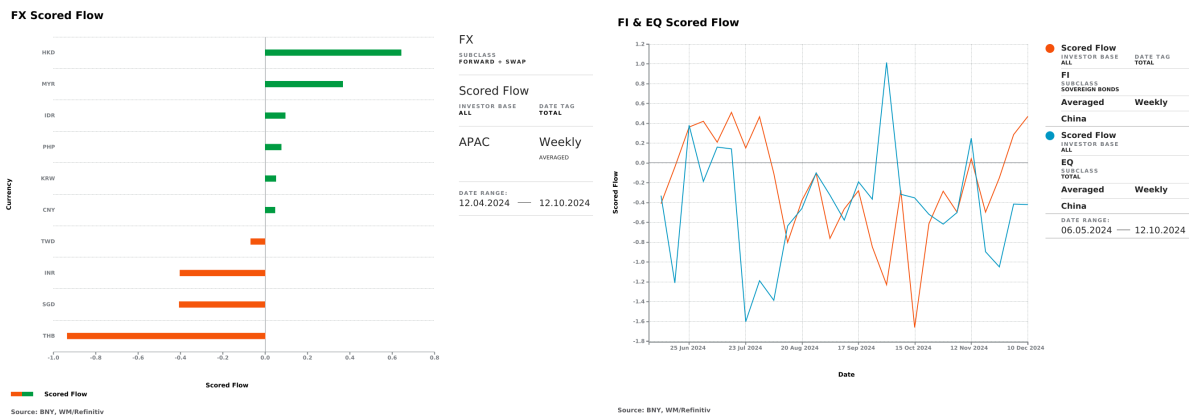


Source: BNY, Bloomberg L.P.

iFlow showed mixed FX flows in APAC last week. Flows were dominated by HKD inflows against outflows in THB. Flows into Korean won and Chinese yuan were especially noteworthy. KRW flows over the past week were marginally positive. The resilience of KRW is worth noting considering Korea’s heightened political uncertainty and downside asset volatility.

In terms of other asset classes, the pickup in demand for Chinese sovereign bonds following a long period of selling since the beginning of August is notable. That said, foreign investors have been skeptical, remaining on the sidelines of Chinese equities despite the recent policy-related rally. There have been only two weekly inflows since the September.

Exhibit #3: iFlow Shows Demand for Chinese Government Bonds



Source: BNY, Bloomberg L.P.

Please direct questions or comments to: iFlow@bny.com

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