

OPINION

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Reassessing the Role of Korea Treasury Bonds in the Korean Financial Market

In Korea's financial market, the role of Korea Treasury Bonds (KTBs) has expanded significantly across multiple dimensions. Above all, KTBs serve as a primary instrument for financing the government's fiscal activities. As the role of fiscal policy expands, the government has increasingly relied on KTB issuance, a trend expected to gain momentum amid weakening private-sector growth and increasing demand for welfare spending. In addition, KTBs function as a key financial instrument for attracting foreign portfolio investment. Sustained foreign investment in KTBs, even in the context of a persistently weak Korean won, has contributed to easing pressures on the foreign exchange supply-demand dynamics. Lastly, as KTBs are widely used as collateral in financial transactions, supported by their status as safe assets, KTB-related markets, including the repo and securities lending markets, are expanding rapidly. The wide use of KTBs as collateral not only enhances the efficiency and stability of funding and investment activities, but also supports price discovery across the financial market.

To ensure that KTBs continue to perform these functions reliably, it is critical to maintain the long-term sustainability of government debt. Korea's fiscal health remains relatively strong compared to major economies, which helps alleviate the short-term fiscal risk. However, the potential slowdown in economic growth driven by low birth rates and population aging is likely to cast a shadow on Korea's mid- to long-term fiscal outlook. In this context, fiscal policy should be geared toward improving the efficiency of fiscal expenditures to support sustainable economic growth. Meanwhile, it is important to note that the increased leverage through KTB-related markets could pose a risk to the financial market. A more effective policy approach would focus on close monitoring rather than imposing overly restrictive leverage regulations.

* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

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Korea Treasury Bonds (KTBs) not only serve their primary function as a means of financing public spending, but also play critical roles in the domestic financial market by attracting foreign capital inflows, easing pressures on the foreign exchange supply-demand dynamics and enhancing market stability via their use as collateral. This article examines the increasingly multifaceted role of KTBs and discusses their implications for policy and market dynamics.

KTBs' growing role for supporting fiscal spending

The fundamental function of KTBs is to efficiently raise fiscal resources through the capital market to support government spending. As the role of fiscal policy expands amid a slowdown in economic growth,¹⁾ the share of government consumption in the national economy is increasing (see Figure 1). However, the accompanying fiscal resources, such as tax revenues, have not kept pace with this trend. Since the surge in public spending during the Covid-19 pandemic in 2020, Korea's fiscal balance with social security funds excluded has consistently posted a deficit exceeding 3% of GDP (see Figure 2). With rising fiscal deficits, the role of KTBs in financing this shortfall has been expanding accordingly.

Figure 1. Government spending as a percentage of GDP

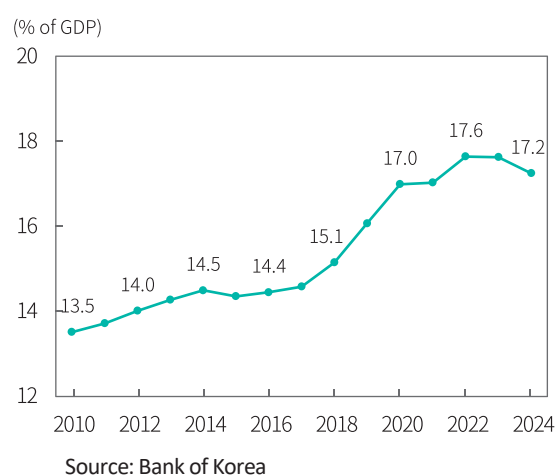
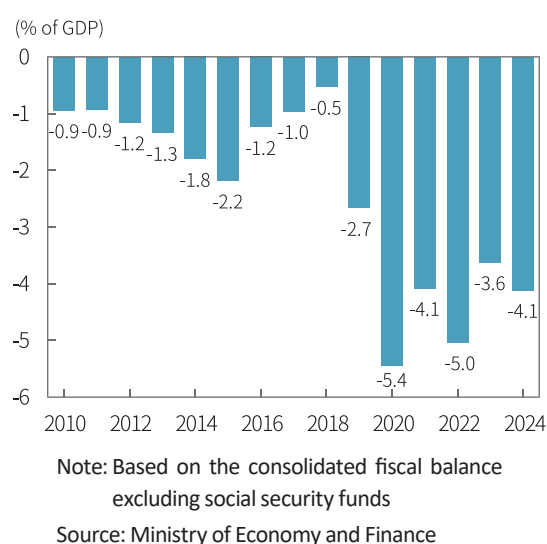


Figure 2. Fiscal balance



1) Looking at average annual GDP growth in a five-year period, the rate has declined from 3.9% during 2010–2014 to 3.0% during 2015–2019, and further to 2.0% during 2020–2024.

As the government becomes more reliant on KTB issuance to raise fiscal resources, KTBs have accounted for a steadily growing share of total government debt (see Table 1). Looking ahead, due to low birth rates and population aging, private-sector growth is expected to weaken, and demand for welfare spending will increase. In this context, the government's role is expected to expand further, reinforcing the role of KTBs in supporting fiscal policy.

Table 1. Share of KTBs in national debt

(Unit: KRW trillion, %)

	2010	2012	2014	2016	2018	2020	2022	2024
National debt (A, KRW trillion)	392.2	443.1	533.2	626.9	680.5	846.6	1,067.4	1,175.2
KTBs (B, KRW trillion)	310.1	362.9	438.3	516.9	567.0	726.8	937.5	1,047.1
Share (B/A, %)	79.1	81.9	82.2	82.5	83.3	85.8	87.8	89.1

Note: KTBs represent KTB outstanding balance, excluding Korea Savings Bonds for retail investors

Source: Ministry of Economy and Finance

Attracting foreign portfolio investment into domestic securities

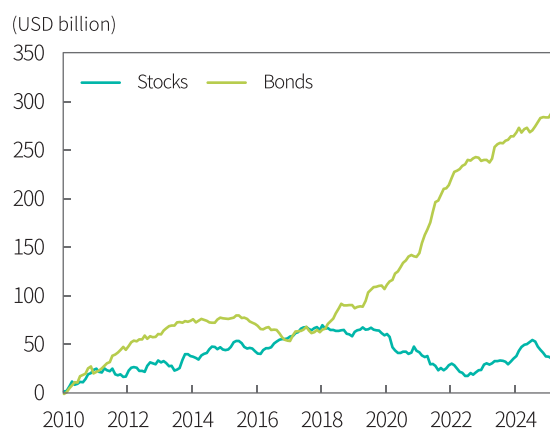
In addition to its core function as a government financing instrument, KTBs also serve as a principal vehicle for foreign portfolio investment. Figure 3 presents the cumulative foreign portfolio investment in Korean stocks and bonds since 2010.²⁾ Between January 2010 and February 2025, non-resident investment in Korean bonds amounted to USD 287.7 billion, substantially exceeding USD 35.4 billion in stocks. A breakdown of bond holdings by foreign investors indicates that the vast majority consists of KTBs (Figure 4), underscoring their central role in attracting cross-border securities investment.

Given the recent surge in outbound portfolio investment by Korean residents and the elevated USD/KRW exchange rate levels above the historical average, continued foreign capital inflows into KTBs could help alleviate pressures in the foreign exchange supply-demand imbalance. Moreover, KTBs are set to undergo phased inclusion in the FTSE World Government Bond Index (WGBI), with their index weight scheduled to gradually increase over an eight-

2) The foreign portfolio investment includes non-residents' investment in securities issued abroad by Korean residents, but the vast majority is non-residents' investment in domestic securities. Thus, the statistics are treated as foreign investment in domestic securities.

month period starting in April next year.³⁾ This development is expected to attract foreign investment inflows tracking the WGBI, thereby contributing to stability in domestic foreign exchange supply and demand.

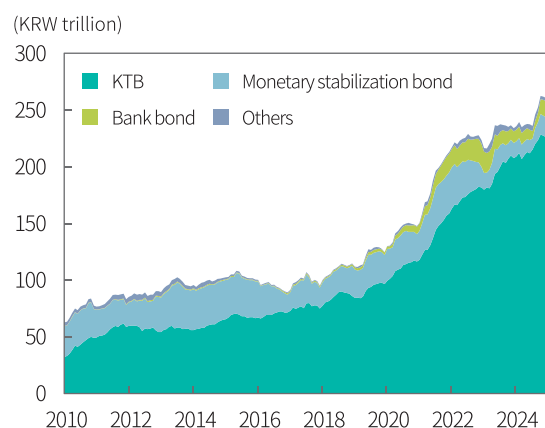
Figure 3. Foreign investors' portfolio investment in domestic securities



Note: 1) Based on portfolio investment under the financial account in the balance of payments
2) Cumulative inflows of portfolio investment since January 2010

Source: Bank of Korea

Figure 4. Foreign bond holdings by type



Note: Foreign bond holdings are estimated based on buy and sell transactions in the OTC bond market, as well as matured bonds.

Source: Yonhap Infomax

KTBs as collateral in the financial system

As Korea's representative safe asset, KTBs retain high liquidity and stable value even during periods of heightened financial market volatility, making them widely used as collateral in the Korean financial system. In the repurchase agreement (repo) market, a key short-term funding market, the party in need of funds provides securities as collateral and borrows cash, with KTBs frequently used as collateral due to their high credit rating and liquidity. In the institutional repo market, the active use of government bonds as collateral is supporting the rapid market growth (Figure 5). As of the end of 2024, government bonds accounted for KRW 144 trillion, or 57%, of the total market value of collateral securities, and given that most of these are KTBs,⁴⁾

3) When Korea's inclusion in the WGBI was first announced in October 2024, index weights were to increase quarterly over one year starting in November 2025. However, reflecting feedback from index stakeholders, the schedule was revised to monthly increases over an eight-month period starting in April 2026.

4) As of the end of 2024, KTBs accounted for KRW 1,047 trillion, or 92.9%, of the KRW 1,127 trillion in total outstanding government bonds (based on face value).

it is evident that KTBs constitute the dominant form of collateral in the repo market. KTBs also serve as the primary form of eligible collateral for meeting margin requirements in non-centrally cleared over-the-counter (OTC) derivatives transactions.⁵⁾

The increased use of KTBs as collateral has in turn driven demand for KTB lending in the securities lending market (Figure 6). Outstanding securities lending balances of KTBs, which were around KRW 20 trillion in the early 2010s, surged to approximately KRW 130 trillion by 2024. While KTB lending is conducted for various purposes,⁶⁾ a significant portion of demand appears to stem from the need to utilize KTBs as collateral in repo transactions. As the repo and KTB lending markets continue to expand, the growing use of KTBs as collateral not only supports more efficient and stable funding and investment activities but also enhances price discovery across the broader financial market.

Figure 5. Market value of collateral (purchased securities) in institutional repos

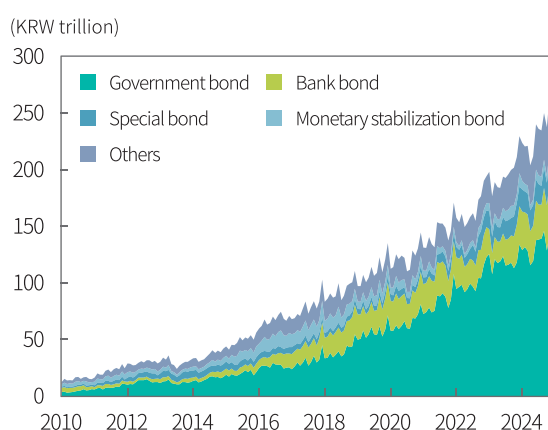
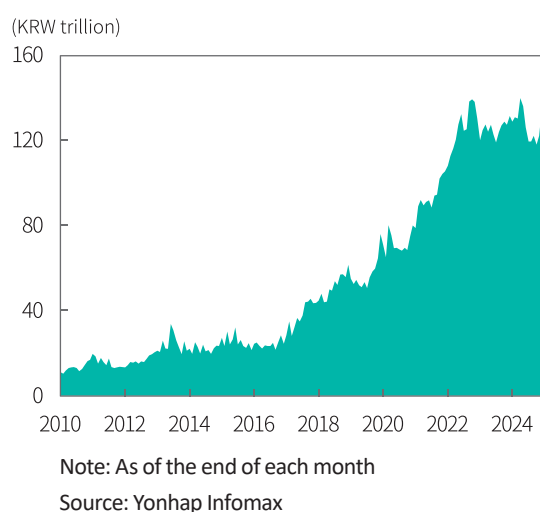


Figure 6. Outstanding KTB lending balance



5) According to data from the Korea Securities Depository, of the KRW 10.6 trillion in collateral exchanged between financial institutions under the “Guidelines for Margin Requirements for Non-Centrally Cleared OTC Derivatives” as of end-2024, KTBs accounted for KRW 9.5 trillion (89.7%).

6) Cash-futures arbitrage trading due to undervalued KTB futures may also drive demand for KTB lending. When futures prices fall significantly below spot prices, investors can profit by shorting borrowed KTBs in the spot market and buying cheaper futures, thereby leading to an increase in KTB lending transactions.

Implications

As discussed, KTBs serve as a cornerstone in the Korean financial market, not only as instruments for financing fiscal expenditures, but also as key products for attracting foreign portfolio investment and as widely used collateral within the financial system. To ensure that KTBs continue to perform these critical functions reliably, it is crucial to maintain the sustainability of government debt. Recently concerns over fiscal health have led to sovereign credit rating downgrades in countries such as France and China.⁷⁾ A deterioration in sovereign creditworthiness may trigger capital outflows by foreign investors and drive up government borrowing costs. In Korea, interest payments on KTBs have been rising due to higher market interest rates and increased outstanding balances (Figure 7), highlighting the importance of maintaining sovereign credit stability. Korea's government debt-to-GDP ratio remains relatively low compared to other major economies, alleviating immediate concerns about fiscal sustainability.⁸⁾ However, the country faces unfavorable long-term prospects, as government debt is expected to grow rapidly over the mid- to long-term due to demographic challenges such as low birth rates and population aging.⁹⁾ In this context, fiscal policy should be geared toward prioritizing the efficiency of public expenditures to support sustainable economic growth.

Meanwhile, it is important to note that the increased leverage through KTB-related markets, such as the repo and securities lending markets, could pose a risk to the financial market. Leverage in privately placed bond funds with domestic investment area has expanded markedly (Figure 8).¹⁰⁾ If an unexpected shock were to trigger rapid deleveraging by these funds, it could amplify market volatility. Nonetheless, in the current environment of increasing public- and private-sector bond issuance, leveraged investment also plays a positive role by enhancing the

7) In December 2024, Moody's downgraded France's sovereign credit rating from Aa2 to Aa3, citing concerns over deteriorating public finances driven by political fragmentation. In April 2025, Fitch revised downward China's rating from A+ to A, citing continued weakening of public finances and rapidly rising public debt.

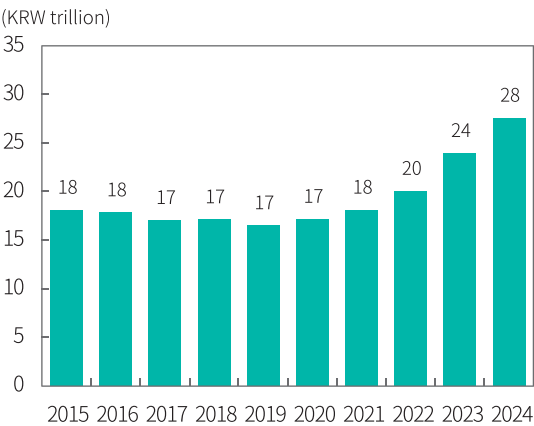
8) According to the October 2024 IMF Fiscal Monitor, Korea's general government gross debt as a percentage of GDP (D2) stood at 51.5% in 2023, falling short of the G20 average (118.2%) and the average of advanced economies (108.7 %).

9) According to the "2025–2072 Long-term Fiscal Projections" released by the National Assembly Budget Office in February 2025, under current laws and systems, Korea's government debt as a percentage of GDP (D1) is projected to rise from 47.8% in 2025 to 80.3% in 2040, 107.7% in 2050, and 136.0% in 2060.

10) Privately placed bond funds are largely composed of so-called "repo funds" that actively employ leverage through repo transactions (Bank of Korea Financial Stability Report, December 2024). These funds typically pledge corporate bond holdings as collateral to borrow KTBs in the securities lending market, and then use the borrowed KTBs as collateral for borrowing cash in the repo market, which is subsequently used to purchase additional corporate bonds.

market’s capacity to absorb growing volumes of bond issuance without disruption. Thus, rather than imposing overly restrictive leverage regulations, a more effective policy approach would focus on close monitoring and risk management to ensure that leverage-related exposures remain manageable within the financial system.

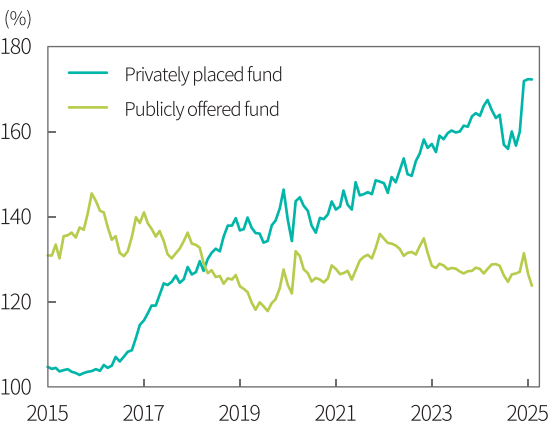
Figure 7. Interest payments on KTBs



Note: Based on estimated interest payments on KTB coupon payment dates, which may differ from accrued interest payments in financial statements

Source: Koscom, Korea Securities Depository, author’s calculation

Figure 8. Leverage in bond funds



Note: 1) Based on bond funds with domestic investment area

2) Total assets to net assets ratio

Source: Korea Financial Investment Association, author’s calculation