

## Asia FI & FX Strategy Watch

# KRW: Understanding the Foreign Exchange Stability Fund

### The FESF made its first KRW-issuance in 21 years

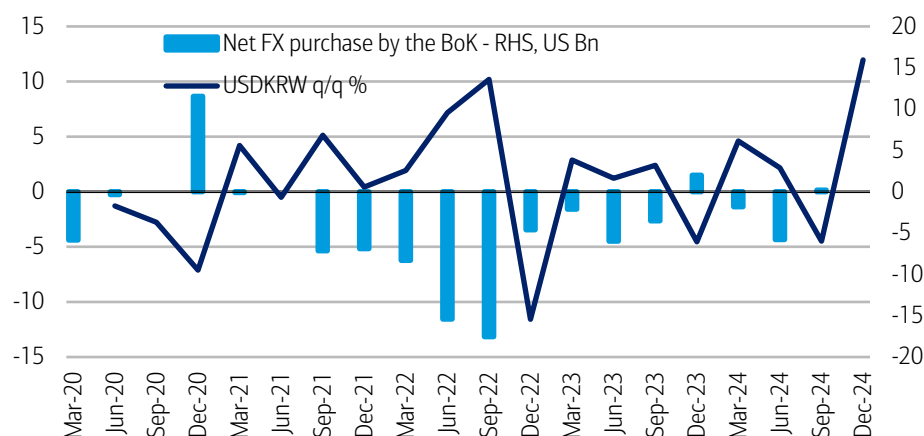
On January 23, 2025, the Korean government issued KRW-denominated bonds under the Foreign Exchange Stability Fund (FESF) for the first time in 21 years. This caused some confusion among investors as to whether these KRW-denominated bonds are meant to shore up resources with defend the Korean Won. Given the active defense the BoK and NPS are deploying to prevent a sharp rise in USDKRW, such an issuance would be consistent with that stated goal. However, upon closer inspection of the recent contributions of the FESF, it is more likely the KRW-issuance meant to shore up the Korea government's domestic finances and to prevent Korea government debt and deficit from exceeding their target threshold.

### The KRW-issuance by the FESF is more likely to plug a fiscal gap than to defend the KRW

In the past two fiscal year, the Korean government has relied on extracting funds from existing funds to bridge a fiscal gap due to the shortfall in tax revenue. In 2024, the Korean government faced a KRW 30tn shortfall in tax revenue and took KRW 4-6tn from the FESF, and along with funding from other fund, to bridge this fiscal gap. Given the relatively small size of the withdrawal and Korea's FX reserve remaining at US\$ 415bn in December 2024, we think resources remain ample in the FESF to continue to conduct FX smoothing operations. Lastly, as all KRW-issuances under the FESF will be 1-year in tenor, we do not think this will crowd out KTB issuances and cause supply pressures.

#### Exhibit 1: Net FX transaction by the BoK and q/q change in USDKRW

Since 2020, on average, the BoK has sold 540mn for every 1% increase in quarterly increase USDKRW



Source: BoK, Bloomberg

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GEM FI & FX Strategy  
Asia

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FESF – Foreign Exchange Stability Fund

KTBs – Korea Treasury Bonds

BoK – Bank of Korea

NPS – National Pension Service

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# KRW: Understanding the Foreign Exchange Stability Fund

**KRW-issuance by the FESF caused some confusion.** On January 23<sup>rd</sup>, 2025, the Korea government issued its first KRW-denominated Foreign Exchange Stabilization Bond in 21 years. This headline caused some confusion among investors as these issuances are occurring at the time when the Korea government is actively defending KRW depreciation through strong verbal and actual interventions by both the BoK and the NPS (see: [EM Alpha: Long USDKRW after the relief rally 22 January 2025](#) for more details on the recent FX activities of the NPS and BoK). This note serves to clarify some of the confusion behind the Foreign Exchange Stability Fund (FESF) and the role it plays in Korea's FX market, and more recently, as a tool to supplement fiscal revenue.

**What is the FESF?** Following the aftermath of the Asian Financial Crisis in the late-90s and the subsequent IMF bail-out, Korea made a strategic priority to accumulate FX reserves and avoid a repeat of the painful experience of a FX-crisis. Thus, the Korea government formed the FESF which is carved out from its FX reserves. The true size of the FESF is unknown. The latest public figure available came from a parliamentary testimony in December 2023 which puts the FESF at KRW 270tn, or around US\$ 190bn. Korea's FX reserves at the time stood at US\$ 420bn which puts the FESF at around 45% of Korea's total FX reserves.

**Who controls the FESF?** On a legal basis, the FESF is controlled by the Ministry of Economy and Finance (MoEF). The decision-making regarding FX intervention lies with the MoEF but the execution is conducted by the Bank of Korea. The MoEF will determine the scale of the intervention and the BoK will determine how best to execute the intervention, such as whether such buying or selling of FX would be conducted on a sterilized or non-sterilized basis.

**The BoK discloses high-level characteristics of their foreign assets in their annual report.** There is little public information on the asset split of the FESF as the MoEF and the BoK would want to keep the market guessing on the true extent of their fire power. Once a year, BoK discloses to the public a breakdown of its breakdown asset foreign assets in their annual report. This annual breakdown gives the market an idea of the resources the BoK has readily available to conduct FX intervention. The BoK's annual report is released every March resulting and the latest data available is from 2023.

## Exhibit 2: BoK percentage shares in foreign assets (%)

Compared to before 2022, the BoK's short-term liquidity tranche rose as the need for FX intervention increases

	2019	2020	2021	2022	2023
Shor-term liquidity tranche	4.6	5.1	5.2	10	7.2
Investment tranche					
Internally-managed	74.6	73.9	72	65.7	68.5
Externally-managed	20.8	21	22.8	24.3	24.3
By currency					
US Dollar	69.1	67.7	68.3	72	70.9
Others	30.9	32.3	31.7	28	29.1
By asset class					
Deposits	5	7.1	6.9	12.6	8.5
Government bonds	44.6	44.5	44.9	39.4	44.8
Agency bonds	15.8	14.4	14.1	14.1	13.3
Corporate bonds	13.4	13.6	12.9	11	10.8
Securitized products	12.5	11.5	10.8	11.5	11.7
Equities	8.7	8.9	10.4	11.4	10.9

Source: Bank of Korea Annual Reports

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**A 33.9% of the BoK's foreign assets are allocated into higher return-generating assets.** From the annual discloses, we can see that the BoK allocates a substantial portion of its foreign asset outside the traditional risk-free assets such as government



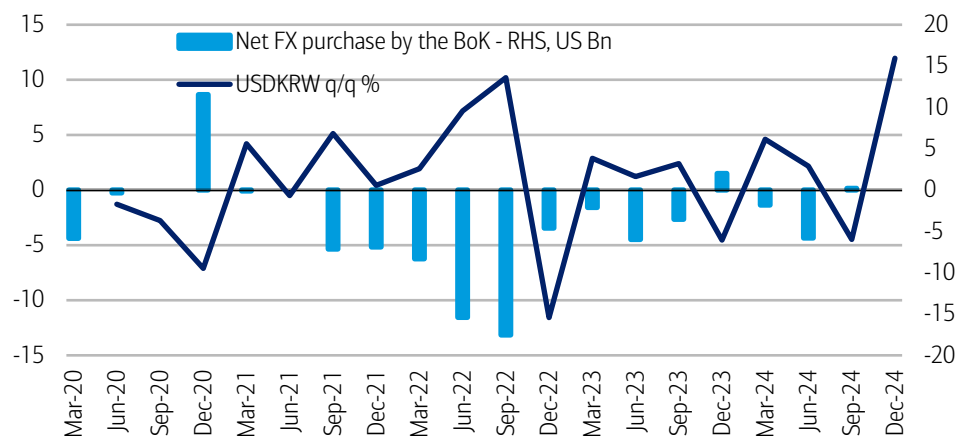
and agency bonds. In 2023, corporate bonds, securities products and equities made up 33.9% of the BoK's total foreign asset showing the asset return, along with liquidity, remains important in the return requirements for the BoK.

**Relative to pre-2022, the BoK has a higher allocation into its short-term liquidity tranche.** Since the beginning of the period of aggressive Fed hikes and the stronger USD in 2022, the BoK has been allocating larger share to its short-term liquidity tranche as the demand for FX intervention increased. Moreover, the share of US\$ assets has also increased.

**What is the scale of BoK interventions in recent years?** The BoK provides net FX transaction on a quarterly basis with a quarterly lag. The latest disclosure was made on Dec 31, 2024 for 3Q24. **Exhibit 3** shows the BoK operates as a smoothing agent in the FX market as its net activity are typically in the opposite direction of the market, behaviour which is consistent with their state goal to contain FX volatility. Since 2020, on average, the BoK has sold 540mn for every 1% increase in quarterly increase USDKRW. If this historical pattern holds, the abrupt rise in USDKRW in 4Q24 likely led the BoK to net sell around US\$ 20bn over that quarter. The funds the BoK would use to conduct such smoothing operations would be from the FESF.

#### Exhibit 3: Net FX transaction by the BoK and q/q change in USDKRW

Since 2020, on average, the BoK has sold 540mn for every 1% increase in quarterly increase USDKRW



Source: BoK, Bloomberg

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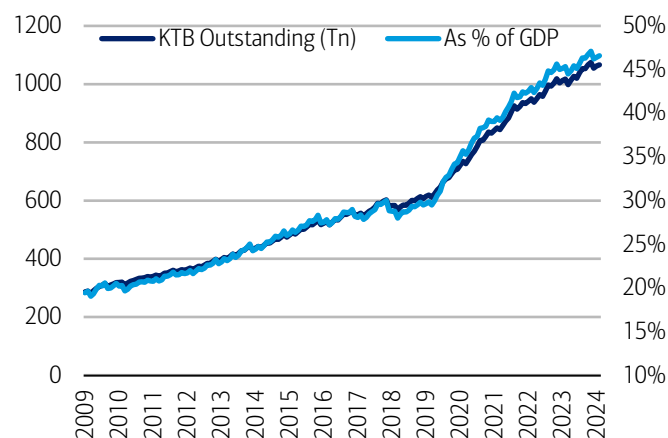
**What fiscal role has the FESF played in recent years?** Although details on the FESF are scant, FX intervention by the FESF is not surprising given quarterly data the BoK provides on FX intervention. However, in the past two years, the FESF has increasingly played a fiscal role in plugging the gap caused by revenue shortfall. For the past two fiscal year, due to shortfall in expected versus realized tax revenue, the Korean government has been trying to find ways to bridge the deficit without resorting to higher KTB issuances. In the most recent fiscal year, the government extracted KRW 30tn from government-controlled funds to plug the deficit with the FESF contributing around KRW 4-6tn (~US\$ 2.8b-4.2bn) of the shortfall.

**The KRW-issuance by the FESF is likely more tied to fiscal financing than to rising resources for FX intervention.** Circling back to the KRW-issuance by the FESF, in the budget passed on Dec 10<sup>th</sup>, 2024, the government approved a KRW 20tn (US\$ 14bn) issuance in FESF KRW-denominated bonds for 2025. The first batch, KRW 800bn in size, was issued on January 23, 2025. One of the possible reasons for why the Korean government may be using the FESF to issue bonds because it is not considered part of KTB issuances. As shown by **Exhibit 4**, outstanding KTBs is currently at 47% of GDP and total government debt is projected to be 48.1% of GDP, as passed by the 2025 Budget.

**Korea's medium-term plan is to maintain debt-to-GDP at around 50% of GDP.** In August 2024, during the proposal to the 2025 budget, the Korea government set out its '2024-2028 National Fiscal Management Plan' where they promised to maintain the deficit-to-GDP at below 3% and the total debt at around 50% by 2028. The commitment to stabilizing the debt-to-GDP may be why the Korean government is trying to find way to plug the fiscal gaps, including by using various resources deposits in government funds, including in the FESF.

#### Exhibit 4: KTBs outstanding

KTBs outstanding is rising close to 50% of GDP

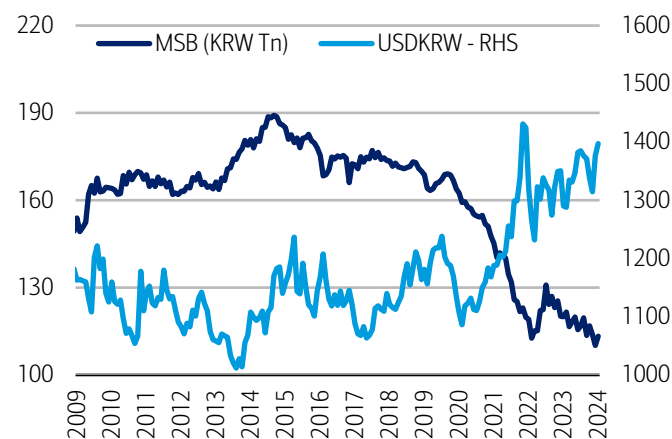


Source: CEIC, Bloomberg

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#### Exhibit 5: Outstanding MSBs and USDKRW

The volume of outstanding MSBs have been declining as the BoK conducts sterilized selling of USD in the past three years



Source: CEIC, Bloomberg

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**Net issuances of MSBs have rapidly declined in the past three years the BoK conducts sterilized FX interventions.** However, one category of Korean bonds that have been in sharp decline are monetary stabilization bonds (MSBs). Net MSB issuances is the mirror transaction to the FX intervention conducted by the BoK. If the BoK does not want to impact the monetary base with its FX activities, it would have to sterilize the currency it has injected/ removed through net issuances/ redemption of MSBs. Because of the strong net FX selling the BoK has done in the past three years (see **Exhibit 3**), to prevent a decline in the monetary base, the BoK would have to either redeem or cut net issuances in MSBs. The latest data in **Exhibit 5** is until Nov-2024 and we should expect a large contraction in the outstanding volume of MSBs in Dec-2024 given the strong US\$ selling the BoK did to counteract the rapid rise in USDKRW following the beginning of Korea's political uncertainties.

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