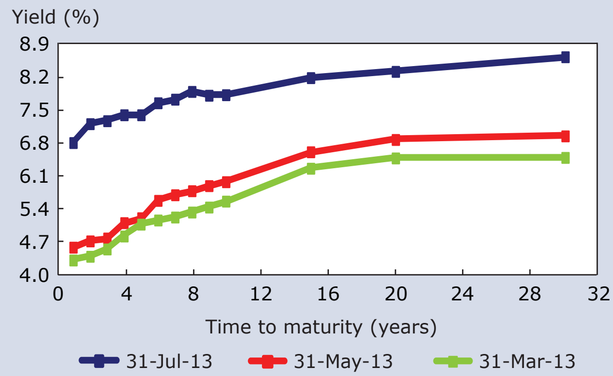
Indonesia

Yield Movements

Between end-March and end-May, Indonesia's local currency (LCY) government bond yields rose across all maturities. Yields rose the most for 7-year maturities, rising 47 basis points (bps), while climbing 46 bps for both 9- and 30-year maturities.

Between end-May and end-July, government bond yields rose dramatically, shifting the curve further upward **(Figure 1)**. Yields climbed between 145 bps and 250 bps across the length of the curve, rising more at the shorter-end than at the longer-end, resulting in a flattening of the yield curve. The yield spread between 2- and 10-year maturities narrowed to 62 bps at end-July from 117 bps at end-March and 126 bps at end-May.

Figure 1: Indonesia's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Bond yields have been on the rise since May over uncertainty related to United States (US) monetary policy. The remarks made by US Federal Reserve (Fed) Chairman Ben Bernanke on 19 June signaling that the Fed may begin to taper its bond purchase program toward the latter part of the year resulted in a significant increase in bond yields and a sell-off in the rupiah bond market.

The Indonesian bond market is still largely influenced by external factors as nearly one-third of government bonds are held by foreign investors, leaving the market vulnerable to the risk of sudden capital outflows. Immediately after the Fed announcement, the Indonesian rupiah breached the psychological IDR10,000–US$1 barrier, and has remained above that level since then. Data from the Indonesia Debt Management Office showed foreign investors as net sellers of bonds in June with a capital outflow of IDR15.76 trillion.

These developments coupled with other domestic factors—including (i) rising inflation expectations as the government was pressured to cut fuel subsidies, (ii) a widening current account deficit and weakening rupiah, (iii) greater budget financing requirements to be funded by increased issuance of bonds, and (iv) warnings from rating agencies of a possible sovereign rating downgrade—dampened bond market sentiments in 2Q13.

The government's decision to raise fuel prices by an average of 33%, effective 22 June, pushed Indonesia's inflation rate to the highest level in emerging East Asia. Inflation jumped to 8.6% year-on-year (y-o-y) in July and 8.8% in August, from relatively stable levels of 5.6%, 5.5%, and 5.9% in April, May, and June, respectively. The celebration of *Ramadan*, which commenced in July, also contributed to pressure on the prices of goods and services. For the January–August period, inflation stood at 7.9%, breaching Bank Indonesia's (BI) annual target of between 3.5% and 5.5%.

Rising inflation expectations led BI's Board of Governors to raise the benchmark interest rate by 25 bps to 6.0% in June, 50 bps to 6.5% in July, and 50 bps to 7.0% in August. The central bank also raised its deposit facility rate twice in June by a combined 75 bps to 4.75%, and another 50 bps to 5.25% in August. The lending facility rate was also raised by 25 bps to 7.0% in August. The rate hikes were initiated to contain inflation, stabilize the rupiah exchange rate, and ease the current account deficit.

Economic growth in Indonesia fell below 6.0% y-o-y in 2Q13 for the first time since September 2010. Real gross domestic product (GDP) growth eased to 5.8% y-o-y in 2Q13 from 6.0% in 1Q13. Domestic consumption and investment moderated to 5.1% and 4.7% y-o-y, respectively, in 2Q13. Growth in government spending, on the other hand, rose to 2.1% y-o-y in 2Q13 from 0.4% in the previous quarter. On a quarter-on-quarter (q-o-q) basis, the economy grew 2.6% in 2Q13 compared with 1.4% in 1Q13. BI expects Indonesia's annual economic growth to fall to between 5.8% and 6.2% in 2013, based on a forecast that has economic growth rising marginally to 5.9% in 3Q13 before further accelerating in 4Q13.

Size and Composition

Total LCY bonds outstanding in Indonesia climbed to IDR1,180.4 trillion (US$118 billion) at end-June, expanding a modest 2.2% q-o-q **(Table 1)**. On a y-o-y basis, the bond market grew at a robust pace of 12.4%.

At end-June, growth in LCY government bonds moderated to 1.7% q-o-q and 10.3% y-o-y to reach IDR975.1 trillion. Growth in the government bond sector was mainly driven by central government bonds, comprising treasury bills and treasury bonds issued by the Ministry of Finance. Central bank bills, on the other hand, recorded negative growth on both a q-o-q and y-o-y basis.

Central Government Bonds. The stock of central government bonds rose 3.1% q-o-q to IDR888.5 trillion in 2Q13. On a y-o-y basis, central government bonds rose 12.3%. Fixed-rate bonds, which accounted for 71% of total central government bonds outstanding in 2Q13, were the main drivers of growth, expanding 3.7% q-o-q and 16.7% y-o-y **(Table 2)**. Islamic treasury instruments, such as Islamic treasury bills and project-based *sukuk* (Islamic bonds), also contributed to the growth.

New issuance of treasury bills and treasury bonds totaled IDR47.4 trillion in 2Q13, declining 31.3% q-o-q. Since May, most treasury auctions have failed to meet their target as investors seek higher yields. On a y-o-y basis, however, issuance of treasury instruments rose 17.1%.

Based on the revised state budget for 2013, the government needs to issue a total of IDR231.8 trillion (net) this year to fund a deficit equivalent to 2.4% of GDP. To fulfill the additional budgetary requirements, the government plans to issue treasury bills, retail government bonds, fixed-rate bonds, and foreign currency (FCY) bonds. The allotment for FCY bond issuance was increased from 14% to a maximum of 18%–20% of total government debt issuance for the year. The

Table 1: Size and Composition of the LCY Bond Market in Indonesia

	Outstanding Amount (billion)						**Growth Rate** (%)			
	2Q12		**1Q13**		**2Q13**		**2Q12**		**2Q13**	
	IDR	**US$**	**IDR**	**US$**	**IDR**	**US$**	**q-o-q**	**y-o-y**	**q-o-q**	**y-o-y**
Total	1,050,246	111	1,154,804	119	1,180,422	118	3.6	3.8	2.2	12.4
Government	884,029	94	958,369	98	975,057	97	3.0	0.5	1.7	10.3
Central Govt. Bonds	791,180	84	861,515	88	888,514	89	4.0	14.5	3.1	12.3
Central Bank Bills	92,849	10	96,854	10	86,543	9	(5.3)	(50.9)	(10.6)	(6.8)
Corporate	166,217	18	196,435	20	205,365	21	7.4	25.9	4.5	23.6

( ) = negative, LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. The total stock of non-tradable bonds as of end-June stood at IDR269.1 trillion.
Sources: Bank Indonesia, Indonesia Debt Management Office, Indonesia Stock Exchange, and Bloomberg LP.

Table 2: Central Government Bonds Outstanding by Type of Bond

Government Bonds	Outstanding Amount (IDR billion)	% Share	Growth Rate (%)	
			q-o-q	y-o-y
Treasury Bills (SPN)	20,790	2.3	(4.3)	(26.2)
Fixed-Rate Bonds	631,067	71.0	3.7	16.7
Variable-Rate Bonds	122,755	13.8	0.0	(5.4)
Zero-Coupon Bonds	0	0.0	–	–
Retail Bonds	34,153	3.8	0.0	14.7
Islamic Treasury Bills	3,020	0.3	87.0	154.9
Sukuk	17,137	1.9	0.0	0.0
Retail *Sukuk*	35,924	4.0	0.0	23.9
Project-Based *Sukuk*	23,669	2.7	21.3	83.5
Total	**888,515**	**100.0**	**3.1**	**12.3**

( ) = negative, – = not applicable, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Note: Data as of end-June 2013.
Source: Indonesia Stock Exchange.

Table 3: Corporate Bonds Outstanding by Type of Bond

Corporate Bonds	Outstanding Amount (IDR billion)	% Share	Growth Rate (%)	
			q-o-q	y-o-y
Conventional Bonds	174,112	84.8	6.2	26.7
Subordinated Bonds	23,486	11.4	(4.9)	3.9
Convertible Bonds	150	0.1	0.0	0.0
Zero-Coupon Bonds	500	0.2	0.0	0.0
Sukuk Ijarah	4,224	2.1	(10.0)	(5.7)
Sukuk Mudharabah	1,079	0.5	(15.6)	39.2
Sukuk Mudharabah Subordinate	1,814	0.9	62.8	477.7
Total	**205,365**	**100.0**	**4.5**	**23.6**

( ) = negative, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Data as of end-June 2013.
2. *Sukuk Ijarah* refers to Islamic bonds backed by a lease agreement.
3. *Sukuk Mudharabah* refers to Islamic bonds backed by a profit-sharing scheme from a business venture or partnership.
Source: Indonesia Stock Exchange.

government still plans to issue US$-denominated bonds in the domestic market as part of its debt strategy for 2013.

Central Bank Bills. The stock of central bank bills known as *Sertifikat* Bank Indonesia (SBI) declined 10.6% q-o-q and 6.8% y-o-y to reach IDR86.5 trillion at end-June. Issuance of SBI and *shari'a* (Islamic law)–compliant SBI fell 34.2% q-o-q. On a y-o-y basis, however, issuance rose 31.1% in 2Q13. SBI are issued by the central bank as one of its monetary tools to help contain inflation.

Corporate Bonds. The LCY corporate bond market in Indonesia reported robust growth in 2Q13, expanding 4.5% q-o-q and 23.6% y-o-y. Total corporate bonds outstanding stood at IDR205.4 trillion. Growth came mainly from an increase in outstanding conventional corporate bonds and *sukuk mudharabah* (profit-sharing) subordinated bonds. **Table 3** presents a breakdown of corporate bonds outstanding by type of bond as of end-June. Conventional corporate bonds, which grew 6.2% q-o-q and 26.7% y-o-y, comprised a large chunk of the total with a share of 84.8% in 2Q13. *Sukuk mudharabah* subordinated bonds grew at a much faster pace of 62.8% q-o-q and 477.7% y-o-y in 2Q13, albeit while coming from a low base.

LCY bonds outstanding among the top 30 corporate bond issuers in Indonesia reached IDR160.5 trillion at the end of 2Q13, representing 78.1% of total corporate bonds outstanding **(Table 4)**. Financial and banking institutions dominated the list of the top 30 issuers of corporate bonds in 2Q13. About one-third of the firms are state-owned or those in which the government holds a 50% (or more) ownership stake. State-power firm PLN led the list with LCY corporate bonds outstanding valued at IDR14.2 trillion. It was followed by state-owned Indonesia Eximbank with outstanding stock amounting to IDR13.0 trillion. The third largest corporate bond issuer was automotive leasing company Astra Sedaya Finance with a total bond stock amounting to IDR10.7 trillion.

Corporate bond issuance in 2Q13 remained strong on a q-o-q basis, posting a significant 31.5% hike. On a y-o-y basis, however, corporate bond issuance fell 21.6% in 2Q13. A total of 30 bond series were issued by 16 corporate entities during the quarter. Most of the bonds carried maturities of between 3 years and 5 years. The new corporate bond issues in 2Q13 were all conventional bonds except for one of each of the following: subordinated bond, *sukuk*, and *sukuk mudharabah*. Corporate

Table 4: Top 30 Issuers of LCY Corporate Bonds in Indonesia

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (IDR billion)	LCY Bonds (US$ billion)			
1. PLN	14,208	1.42	Yes	No	Energy
2. Indonesia Eximbank	12,994	1.30	Yes	No	Banking
3. Astra Sedaya Finance	10,710	1.07	No	No	Finance
4. Adira Dinamika Multifinance	10,277	1.03	No	Yes	Finance
5. Bank Tabungan Negara	8,850	0.88	Yes	Yes	Banking
6. Federal International Finance	7,901	0.79	No	No	Finance
7. Indosat	7,820	0.78	No	Yes	Telecommunications
8. Bank Internasional Indonesia	7,000	0.70	No	Yes	Banking
9. Bank Pan Indonesia	7,000	0.70	No	Yes	Banking
10. Bank CIMB Niaga	6,480	0.65	No	Yes	Banking
11. Jasa Marga	5,000	0.50	Yes	Yes	Toll Roads, Airports, and Harbors
12. Bank Tabungan Pensiunan Nasional	4,585	0.46	No	Yes	Banking
13. Perum Pegadaian	4,514	0.45	Yes	No	Finance
14. Medco-Energi International	4,487	0.45	No	Yes	Petroleum and Natural Gas
15. Bank Permata	4,250	0.42	No	Yes	Banking
16. Sarana Multigriya Finansial	3,936	0.39	Yes	No	Finance
17. Bank OCBC NISP	3,880	0.39	No	Yes	Banking
18. Indofood Sukses Makmur	3,610	0.36	No	Yes	Food and Beverages
19. Agung Podomoro Land	3,600	0.36	No	Yes	Property, Real Estate, and Building Construction
20. Bank Mandiri	3,500	0.35	Yes	Yes	Banking
21. Antam	3,000	0.30	Yes	Yes	Petroleum and Natural Gas
22. Telekomunikasi Indonesia	3,000	0.30	Yes	Yes	Telecommunications
23. BCA Finance	2,850	0.28	No	No	Finance
24. Bank Danamon Indonesia	2,800	0.28	No	No	Banking
25. Bumi Serpong Damai	2,750	0.27	No	Yes	Property, Real Estate, and Building Construction
26. Toyota Astra Financial Services	2,716	0.27	No	No	Finance
27. Indomobil Finance Indonesia	2,518	0.25	No	No	Finance
28. Bank Jabar Banten	2,400	0.24	No	Yes	Banking
29. Bank Rakyat Indonesia	2,000	0.20	Yes	Yes	Banking
30. BII Finance Center	1,824	0.18	No	No	Finance
Total Top 30 LCY Corporate Issuers	**160,458**	**16.04**			
Total LCY Corporate Bonds	**205,365**	**20.53**			
Top 30 as % of Total LCY Corporate Bonds	**78.1%**	**78.1%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Indonesia Stock Exchange data.

bonds issued in recent months carried coupons ranging from 6.75% to 9.25%. **Table 5** presents some notable corporate bonds issues in 2Q13.

Investor Profile

Central Government Bonds. Banking institutions remained the biggest holder of central government bonds in Indonesia in 2Q13 **(Figure 2)**. The stock of bonds held by banks stood at IDR314.3 trillion in 2Q13, representing a 35.4% share of the total. However, banks' share of government bonds has steadily declined from highs of 70%–80% between 2003 and 2006.

The second largest holder of LCY central government bonds in 2Q13 was foreign investors whose share climbed to 31.8% at end-June from 28.4% a year earlier. In contrast to bank holdings, foreign investors' share in LCY government bonds has steadily increased since 2008 **(Figure 3)**. In absolute amounts, outstanding bonds held by foreign investors reached IDR283.0 trillion at end-June.

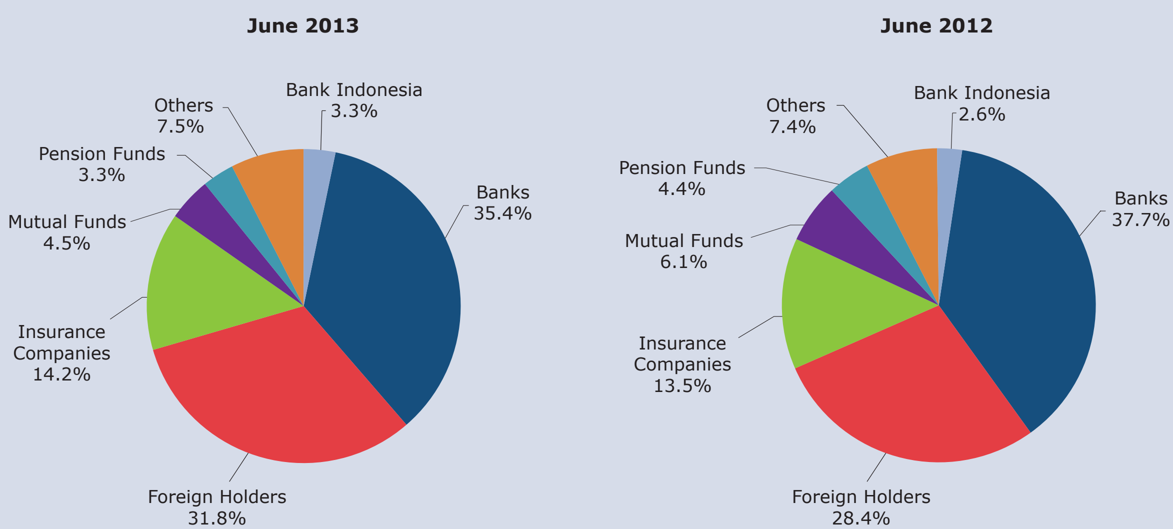
Long-term investors comprise a significant share of foreign investors in Indonesia's LCY central government bond market. At end-June, 44% of

Table 5: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Indonesia Eximbank		
370-day bond	6.15	1,920
3-year bond	6.40	1,940
Federal International Finance		
370-day bond	6.75	710
3-year bond	7.75	1,690
Bumi Serpong Damai		
5-year bond	8.375	1,750
Astra Sedaya Finance		
370-day bond	6.75	650
2-year bond	7.25	100
3-year bond	7.75	950
BCA Finance		
370-day bond	6.50	750
3-year bond	7.50	350
4-year bond	7.60	200
BII Finance		
3-year bond	7.75	775
5-year bond	8.25	525
Agung Podomoro Land		
5-year bond	9.25	1,200
Toyota Astra Financial Services		
370-day bond	6.60	400
3-year bond	7.60	700
4-year bond	7.65	100

LCY = local currency.
Source: Indonesia Stock Exchange.

Figure 2: LCY Central Government Bonds Investor Profile



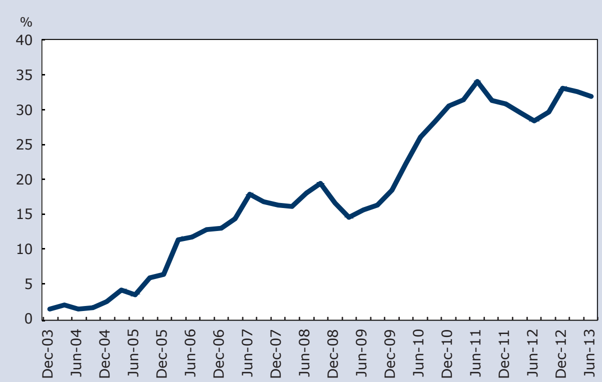
LCY = local currency.
Source: Indonesia Debt Management Office.

bonds held by offshore investors were in maturities of more than 10 years, while foreign investors' holdings of bonds with maturities of more than 5 years and up to 10 years accounted for 30% **(Figure 4)**. Offshore holdings of short-dated tenors (bonds with maturities of 1 year or less) only accounted for a 4% share.

Among domestic investors, only insurance companies increased their share of central governments bond holdings in 2Q13, which rose to 14.2% from 13.5% a year earlier. Mutual fund and pension fund holdings of government bonds remained relatively small compared with other investor classes, accounting for shares of only 4.5% and 3.3%, respectively, at the end of 2Q13. Meanwhile, the share of government bonds held by BI rose slightly to 3.3% as central bank actively supported the bond market in recent months.

Central Bank Bills. Central bank bills were held primarily by banking institutions, which had a share of 98.6% at end-June **(Figure 5)**. In absolute terms, outstanding SBI held by banks stood at IDR80.8 trillion at end-June, down from IDR91.7 trillion at end-March. Foreign investors accounted for the remaining 1.4% share of SBI holdings. Their share dropped significantly after the central bank implemented a 6-month holding period for SBI in 2011.

Figure 3: Foreign Investor Share of LCY Central Government Bonds

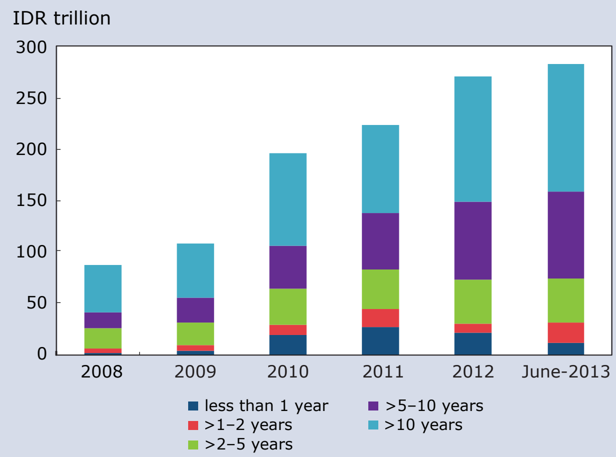


LCY = local currency.
Source: Indonesia Debt Management Office.

Rating Changes

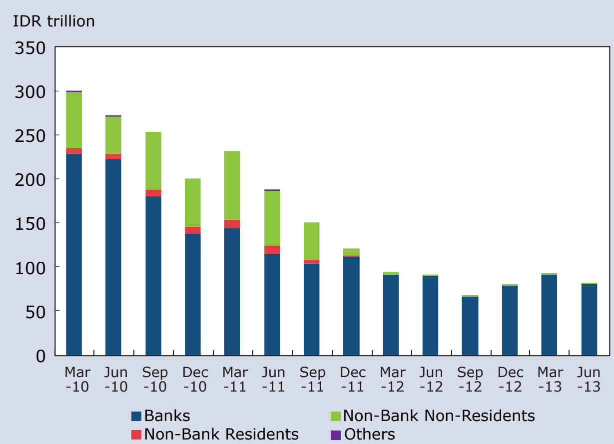
On 2 May, Standard and Poor's (S&P) revised Indonesia's ratings outlook to stable from positive and affirmed its long-term and short-term sovereign credit ratings at BB+ and B, respectively. According to S&P, Indonesia's weakening policy environment may ultimately have a negative impact on the country's growth prospects and its generally sound economic conditions. S&P also noted that the external sector is experiencing vulnerability as evidenced by the

Figure 4: Foreign Holdings of LCY Central Government Bonds by Maturity



LCY = local currency.
Source: Indonesia Debt Management Office.

Figure 5: LCY Central Bank Bills Investor Profile



LCY = local currency.
Source: Bank Indonesia.

current account deficit and increasing private sector external debt.

On 22 July, the Japan Credit Rating Agency (JCR) affirmed Indonesia's sovereign credit rating at BBB–. The outlook for the rating was stable. JCR took note of the following factors in its decision to affirm Indonesia's ratings: (i) sustainable economic growth outlook, (ii) low-level of public debt, and (iii) resilience to external shocks.

Policy, Institutional, and Regulatory Developments

MOF to Conduct Debt Switch of US$-Denominated Bonds

In May, the Ministry of Finance (MOF) announced plans to exchange some of its outstanding US$-denominated bonds for longer-term debt as part of this year's liability management strategy. The government in the past has conducted debt switches involving IDR-denominated bonds.

Parliament Approves 2013 Revised State Budget

In June, Indonesia's House of Representatives approved the 2013 revised state budget, which paved the way for the government to raise fuel prices. The revised budget includes a deficit target equivalent to 2.4% of GDP, up from 1.6% in the original budget. The fuel price hike took effect on 22 June, with prices for gasoline rising 44% and diesel rising 22%.

BI's First FX Swap Auction Oversubscribed

BI's first foreign exchange (FX) swap auction received a warm response from market participants, with bids reaching US$1.2 billion compared with a target of US$500 million. BI awarded a total of US$600 million worth of FX swaps in its first auction held on 17 July. The FX swap action is BI's newest monetary tool to help boost rupiah liquidity in the market and increase FX reserves.

BI Tightens Monetary Policy in August

In a meeting held on 15 August, the central bank said that it will continue to strengthen its policy mix to curb inflation and maintain a more sustainable balance of payments. BI will continue to conduct monetary operations to absorb excess liquidity. In line with this, the central bank plans to issue a new short-term instrument—a BI Deposit Certificate—which will only be sold to domestic banks and will not be offered to foreign investors. BI will also raise the secondary reserve requirement of banks to 4.0% from the current 2.5%, while keeping the primary reserve requirement at 8.0%. The central bank also plans to revise the loan-to-deposit ratio reserve requirements. Other measures to be undertaken by BI include the following: (i) conduct rupiah long-term exchange rate stabilization in line with economic fundamentals, (ii) conduct supervisory actions to control relatively high credit growth among several banks and sectors, and (iii) improve policies to develop the domestic FX market and increase the FX supply.

On 29 August, BI's Board of Governors decided to introduce supplementary measures to strengthen its monetary and macro-prudential policy mix to curb inflation, stabilize the rupiah exchange rate, ease the current account deficit, and ensure macroeconomic and financial system stability. BI decided to raise its benchmark rate 50 basis points (bps) to 7.0%. It also raised the lending facility rate 25 bps to 7.0% and the deposit facility rate 50 bps to 5.25%. The minimum holding period for its central bank certificates, or *Sertifikat* Bank Indonesia, was reduced from 6 months to 1 month.