

Indonesia—Update

Yield Movements

Indonesia's government bond yield curve shifted downwards in June from end-December levels for most maturities under 15 years (**Figure 1**). The shift reflects improving confidence in the economy as inflationary pressures continued to ease and macroeconomic conditions have improved. Consumer price inflation dropped to 2.71% in July after peaking at 12.14% in September of last year.

Easing inflationary pressures and improving macroeconomic conditions allowed Bank Indonesia (BI) to lower its benchmark rate to a record low of 6.5%. The central bank has reduced its key rate by a total of 275 basis points year-to-date.

Indonesia's economy expanded 4.0% year-on-year (y-o-y) in 2Q09 as domestic consumption remained strong. The Finance Ministry is optimistic that signs of recovery will be more evident during the second half of the year, following a slower pace of decline in exports in the second quarter.

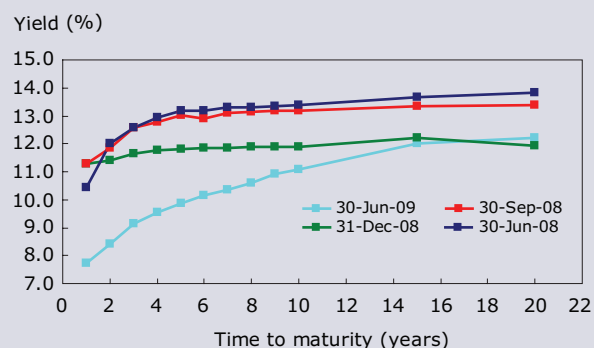
As BI continues its policy of monetary easing, commercial bank lending is expected to improve in the second half of 2009. Bank lending grew by only 2.09% in the first half of 2009 from December 2008 levels, as lenders were cautious in providing credit amid a business slowdown. However, loans grew 16.0% on a y-o-y basis.

Size and Composition

Indonesia's total local currency (LCY) bond market reported strong y-o-y growth in 2Q09. In terms of LCY base, the bond market grew 12.3% y-o-y. On a quarter-on-quarter (q-o-q) basis, the size of the LCY bond market grew 1.0% (**Table 1**).

In 2Q09, the stock of central government bonds rose 6.6% y-o-y. The government resumed its issuance of treasury instruments in early January,

Figure 1: Benchmark Yield Curve—Local Currency Government Bonds



Source: Bloomberg LP.

following the cancellation of all scheduled auctions during 4Q08 amid volatile market conditions.

The Finance Ministry has tapped various treasury instruments to raise funds to finance its budget deficit, which was projected to be 2.5% of gross domestic product (GDP) this year. However, recent developments suggest that the budget deficit might reach 2.6% of GDP as the government has revised its economic growth projection for 2009 downward from 4.5% to 4.3%.

In addition to the regular auctions of treasury bills and treasury bonds, the government has tapped alternative options for funding. For example, the first retail *sukuk* (Islamic bonds) were issued in February, raising IDR5.556 trillion. The Finance Ministry is also conducting a bond exchange program offering long-term bonds for short-term paper. In August, the Finance Ministry swapped IDR189 billion worth of bonds. This most recent bond swap generated a smaller amount compared to previous swaps (e.g., IDR1.248 trillion in May and IDR562 billion in June). About IDR210 trillion worth of LCY government bonds are scheduled to mature during 2009–2013. The Finance Ministry is planning to conduct debt exchanges on a regular basis in a bid to extend its debt maturity profile.

Table 1: Size and Composition of Local Currency Bond Market

	Amount (billion)												Growth Rate (%)					
	Mar-09		Apr-09		May-09		Jun-09		Mar-09		Apr-09		May-09		Jun-09			
	IDR	USD	IDR	USD	IDR	USD	IDR	USD	y-o-y	q-o-q	m-o-m	y-o-y	q-o-q	m-o-m	y-o-y	q-o-q	m-o-m	
Total	852,664	73	857,569	80	859,425	84	861,167	84	7.6	9.5	0.6	12.3	1.0	0.2	12.3	1.0	0.2	
Government	779,358	67	782,311	73	784,236	76	785,957	77	10.0	10.4	0.4	14.9	0.8	0.2	14.9	0.8	0.2	
Central Govt. Bonds	546,658	47	548,858	51	560,633	54	553,227	54	9.7	4.0	0.4	6.6	1.2	2.1	6.6	1.2	(1.3)	
Central Bank Bonds	232,700	20	233,453	22	223,603	22	232,731	23	10.6	29.2	0.3	40.9	0.0	(4.2)	40.9	0.0	4.1	
Corporate	73,306	6	75,258	7	75,188	7	75,210	7	(12.8)	0.4	2.7	(8.9)	2.6	(0.1)	(8.9)	2.6	0.0	

y-o-y = year-on-year, q-o-q = quarter-on-quarter, m-o-m = month-on-month.

Note:

1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY-USD rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.

Source: Bank Indonesia, Indonesia Stock Exchange, and Bloomberg LP.

In August, the government sold its sixth series of retail treasury bonds, receiving a warm response from investors as sales reached IDR8.54 trillion compared to a target of IDR8.42 trillion. The retail bonds carried a maturity of 3 years with a yield of 9.35%.

To date, the government has sold more than 80% of its planned bond issuance for 2009, raising nearly IDR120 trillion from its target of IDR144.5 trillion. The government's revised state budget for 2009 indicated a budget deficit in the amount of IDR133 trillion. This will be funded by the domestic issuance of government bonds and bills, as well as *shari'a*-compliant bonds.

Meanwhile, the central bank continued to actively issue *Sertifikat Bank Indonesia* (SBI) bills in 2009 as part of its sterilization efforts. The stock of central bank bills outstanding rose 40.9% y-o-y in 2Q09. However, on a q-o-q basis, central bank bills remained flat.

The stock of corporate bonds, while lower in June at IDR75.21 trillion compared with one year earlier, showed signs of recovery. Corporate bonds outstanding rose 2.6% q-o-q in 2Q09. Since June of last year, the amount of corporate bonds outstanding had recorded quarterly declines. The top 10 corporate issuers in Indonesia, which are listed in **Table 2**, accounted for more than 50% of total corporate bonds outstanding as of end-June, with PT PLN as the single largest corporate issuer. The list of the 10 largest issuers of corporate bonds was dominated mostly by banks and financial institutions.

Corporate bonds outstanding are expected to rise in 2H09 given the notable increase in corporate announcements of planned bond issuance in recent months. The Finance Ministry also shares this view and is also expecting an increase in the number of corporate issues in the second semester.

Table 2: Top 10 Corporate Issuers

Top 10 Corporate Issuers	Outstanding Amount (IDR billion)
PLN	9,100
Indosat	6,590
Jasa Marga (Toll operator)	4,150
Indofood Sukses Makmur	3,610
Bank BTN	3,250
Bank Ekspor	3,200
Bank Panin	3,150
Astra Sedaya Finance	2,380
Federal International Finance	2,200
Perum Pegadaian (Pawn shop)	1,770

Source: Indonesia Stock Exchange.

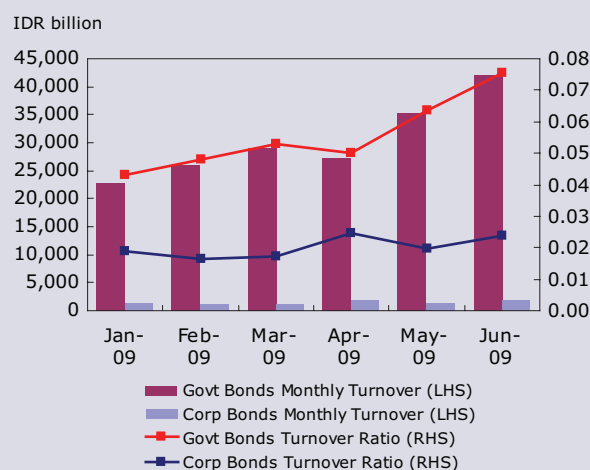
Foreign Currency Bonds

In March of this year, the government raised USD3 billion from a global bond issue comprising USD2 billion in 10-year notes and USD1 billion in 5-year notes. The government also issued a sovereign 5-year *sukuk* (Islamic bond) in April, raising USD650 million from an issue of 5-year bonds.

In July, Indonesia sold JPY35 billion in *samurai* bonds through a private placement. The bonds had a maturity of 10 years at a coupon of 2.73%. The Japan Bank for International Cooperation (JBIC) provided a guarantee for issuance of up to USD1.5 billion. However, the Finance Ministry recently announced that it does not currently have plans to issue *samurai* bonds up to the full amount of USD1.5 billion as provided by the guarantee.

Planned Issuance

The government plans to auction IDR1 trillion worth of *sukuk*, which will represent the first time that *sukuk* will be auctioned. Previous issuance of *sukuk* was done through bookbuilding.

Figure 2: Monthly Bond Trading Volume and Turnover Ratio

Source: Indonesia Stock Exchange.

Turnover

The monthly government bond turnover ratio in Indonesia recovered to 0.08 in June, after dropping to a low of 0.04 in December. Trading value has also steadily risen, reaching IDR41.94 trillion in June (**Figure 2**).

Corporate bond turnover has remained relatively flat since the beginning of the year at 0.02, while corporate trading value reached IDR1.80 trillion in June.

Rating Changes

In January, Fitch affirmed Indonesia's long-term foreign currency (FCY) and LCY rating at BB, with a stable outlook. R&I also affirmed a BB+ on Indonesia's long-term FCY rating, with a stable outlook.

On 11 June, Moody's Investor Service upgraded its outlook on Indonesia's Ba3 sovereign rating from stable to positive. According to Moody's, the move was prompted by Indonesia's relatively strong growth prospects, and an increasingly effective macroeconomic policy framework.

	Moody's	S&P	Fitch
Sovereign FCY LT Ratings	Ba3	BB-	BB
Outlook	positive	stable	stable

Investor Profile

As of end-June, banking institutions held nearly 50% of outstanding government bonds amounting to IDR272 trillion. While this figure was down by 2.5% from the first quarter, banks remained the largest holders of government bonds as they continued to seek safe havens and generate higher returns, given that benchmark interest rates are on a downward trend. The Finance Ministry recently noted that banks have slowed their rate of loan expansion amid heightened risk of default. **(Figure 3)**

Foreign investors held nearly 16% of all central government bonds at the end of 2Q09. Government bonds held by foreign investors reached IDR87.15 trillion in June, which was 9% higher than the end-March amount of IDR79.83 trillion. The amount of bonds held by foreigners peaked in September 2008 at IDR105.49 trillion **(Figure 4)**.

Policy, Institutional, and Regulatory Developments

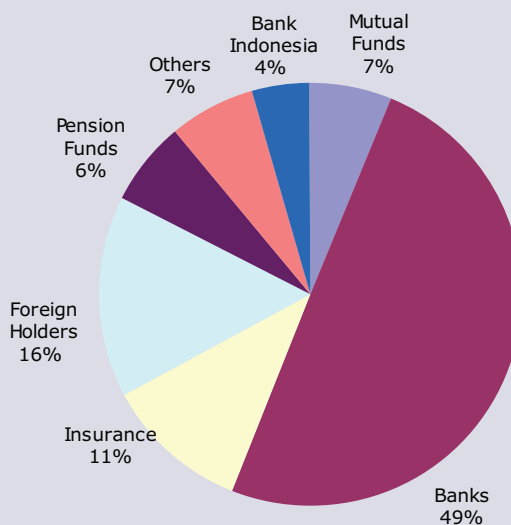
IDR73.3 Trillion Fiscal Stimulus

In February, the House of Representatives endorsed Indonesia's 2009 fiscal stimulus package in the amount of IDR73.3 trillion. The package consists mainly of tax savings and subsidies—amounting to IDR56.3 trillion—and infrastructure spending—including business and job subsidies—at IDR15.0 trillion. The current stimulus package is about 1.4% of GDP.

Currency Swap Arrangements

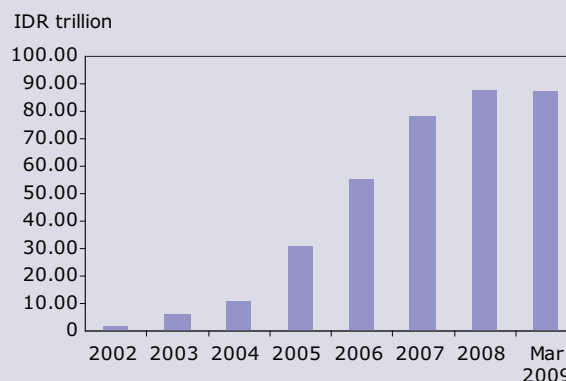
On 23 March, the governments of Indonesia and the People's Republic of China (PRC) entered into an agreement on a bilateral currency swap arrangement amounting to CNY100 billion—

Figure 3: Investor Profile for Local Currency Government Bonds (June 2009)



Source: Indonesia Debt Management Office.

Figure 4: Foreign Holdings of Government Bonds



Source: Indonesia Debt Management Office.

IDR175 trillion (USD15 billion). The currency swap arrangement is expected to provide short-term foreign exchange liquidity as well as boost bilateral trade and investment agreements between the two countries. The currency swap will be valid for 3 years and subject to a possible extension.

In April, the Bank of Japan and BI agreed to increase the maximum amount of the bilateral swap arrangement under the Chiang Mai Initiative of the ASEAN+3 (Association of Southeast Asian Nations [ASEAN] plus the PRC, Japan, and Republic of Korea) Finance Ministers. The agreement allows Indonesia to swap Indonesian rupiah up to an equivalent of USD12 billion should a liquidity problem arise.

Indonesia Bond Pricing Agency to Provide Reference Pricing for Corporate Bonds and *Sukuk*

The Indonesia Bond Pricing Agency (IBPA) expects to begin publishing daily reference prices for corporate bonds and *sukuk* by 3Q09. This move is expected to help improve transparency and make Indonesia's debt market more attractive to investors. Currently, IBPA provides daily pricing for LCY government bonds.

The availability of a reference price could help firms planning a bond issuance to more accurately estimate their cost of borrowing, while providing a benchmark for those seeking to trade bonds. Plans to provide reference prices for other types of *sukuk* and other assets—such as USD-denominated government bonds, bond futures, and interest rate futures—are also under consideration by IBPA.