

Indonesia—Update

Yield Movements

In September, the government bond yield curve in Indonesia fell dramatically across all maturities from its end-December and end-June levels (**Figure 1**). Yields declined the most at the shorter end of the curve, shedding 171 basis points for the 1-year maturity. The yield curve also flattened from the belly through the longer end of the curve. As a result, the spread between 2- and 10-year bonds narrowed to 216 basis points at end-September from 269 basis points at end-June.

The downward shift in yield curves reflects improving confidence in Indonesia's economy. Indonesia's economy expanded 4.2% year-on-year (y-o-y) in 3Q09, boosted by strong domestic demand. Private consumption and government consumption grew 4.7% y-o-y and 10.2% y-o-y, respectively. The Finance Ministry is optimistic that the full year annual GDP target of 4.3% will be met.

The Indonesian rupiah strengthened substantially against the United States dollar in 3Q09 amid increased investor appetite for IDR-denominated assets. The IDR–USD exchange rate appreciated to IDR9,665–USD1 in September from IDR10,208–USD1 in June.

Slight upticks in consumer price inflation were noted for August (2.75%) and September (2.83%) compared to July. Despite these inflationary spikes, year-to-date consumer price inflation has been kept to only 2.28%, substantially below Bank Indonesia's (BI) 2009 inflation target of 3.5%–5.5%. Subsequently, BI has kept its benchmark interest rate at a record low of 6.5% since July of this year.

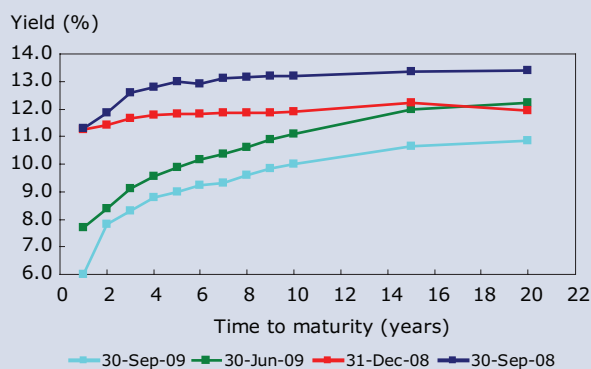
Size and Composition

The size of the local currency (LCY) bond market in Indonesia contracted marginally month-on-month (m-o-m) in August (**Table 1**). However, total bonds outstanding in August grew 13.09% y-o-y.

As of end-August, outstanding government bonds stood at IDR788.55 trillion. Government bonds consist of central government bonds (issued by the Ministry of Finance) and central bank bonds (issued by BI as *Sertifikat Bank Indonesia* [SBI]). The stock of central government bonds was up 2.0% m-o-m in August and rose further in September, rising 0.5% m-o-m and 4.7% y-o-y. As of end-August, the stock of SBI had risen substantially for the year—up 48.86% y-o-y—while falling 5.2% m-o-m.

The Finance Ministry has tapped various treasury instruments—including treasury bonds, treasury bills, retail bonds, *shari'a* compliant securities, and *samurai* bonds—to raise funds to finance its budget deficit. In mid-October, the government started auctions for Islamic bonds, or *sukuk*, which will be conducted twice a month. Previously, the issuance of *sukuk* was done through the bookbuilding method. The first scheduled auction for *sukuk* was held on 13 October. The auction failed as the average yields asked were higher than yields of comparable treasuries in the secondary market.

Figure 1: Benchmark Yield Curve—Local Currency Government Bonds



Source: Bloomberg LP.

Table 1: Size and Composition of Local Currency Bond Market in Indonesia

	Amount (billion)						Growth Rate (%)										
	Jun-09		Jul-09		Aug-09		Sep-09		Jun-09		Jul-09		Aug-09		Sep-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	861,167	84	869,387	88	868,140	86	—	—	12.3	1.0	1.0	—	—	—	—	—	—
Government	785,957	77	789,640	80	788,552	78	—	—	14.9	0.8	0.5	—	—	—	—	—	—
Central Govt Bonds	553,227	54	553,604	56	564,776	56	567,367	59	6.6	1.2	0.1	2.0	4.7	2.6	4.7	2.6	0.5
Central Bank Bonds	232,731	23	236,036	24	223,776	22	—	—	40.9	0.0	1.4	(5.2)	—	—	—	—	—
Corporate	75,210	7	79,747	8	79,588	8	78,930	8	(8.9)	2.6	6.0	(0.2)	1.3	4.9	1.3	4.9	(0.8)

— = data not available, 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.

Table 2: Top 10 Corporate Issuers as of end-June 2009

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
Perum Pegadaian (Pawn shop)	3,270
Bank BTN	3,250
Bank Panin	3,150
Bank Ekspor Indonesia	3,050
Astra Sedaya Finance	2,202
Federal International Finance	2,200

Source: Indonesia Stock Exchange.

The stock of corporate bonds in August stood at nearly IDR80 trillion. The amount of corporate bonds outstanding had risen in June and July before declining slightly in August (-0.2% m-o-m) and September (-0.8% m-o-m). Nonetheless, the September level of corporate bonds outstanding reflected growth of 1.3% y-o-y and 4.9% q-o-q.

The top 10 corporate issuers in Indonesia made up about 52% of total corporate bonds outstanding as of end-September (**Table 2**). PT PLN remained Indonesia's top corporate issuer of LCY bonds at IDR9.10 trillion. The next two largest issuers were the telecommunications company, Indosat, and toll operator, Jasa Marga. Meanwhile, banks and financial institutions dominated the lower end of the top 10 list.

According to the Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK), corporate bond issuance in 2009 may exceed its initial target of IDR15.0 trillion. The agency released a list of planned corporate bond issues in the next 3 months, including Bank Mandiri (IDR3 trillion), PT Indosat (IDR1 trillion in conventional bonds and IDR500 billion in *shari'a* bonds), Otomobil Artha (IDR600 billion), and Mitra Adi Perkas (IDR500 billion).

Foreign Currency (FCY) Bonds

The volume of FCY bond issuance by Indonesian corporates and the government in 2009 reached USD7.57 billion in early November. This figure may grow to over USD8 billion by the end of the year as a number of corporate issuers announced plans to issue FCY-denominated bonds. The recent USD800 million bond issue of mining company PT Adaro—priced to yield 7.75%—was well received by a market that has been starved of high yield issues over the last 2 years.

Rating Changes

Moody’s upgraded Indonesia’s foreign and local currency sovereign debt ratings to Ba2 from Ba3 on 16 September (**Table 3**). The outlook was stable. According to Moody’s, the ratings upgrade was prompted by Indonesia’s relatively strong resilience to the global recession as well as its healthy medium-term growth prospects.

S&P revised Indonesia’s outlook to positive from stable on 23 October. It also affirmed ratings of BB- for long-term FCY, BB+ for long-term LCY, and B for short-term debt. The change in outlook took

Table 3: Selected Sovereign Ratings and Outlook for Indonesia

	Moody’s	S&P	Fitch
Sovereign FCY LT Ratings	Ba2	BB-	BB
Outlook	stable	positive	stable

FCY = foreign currency and LT = long-term.

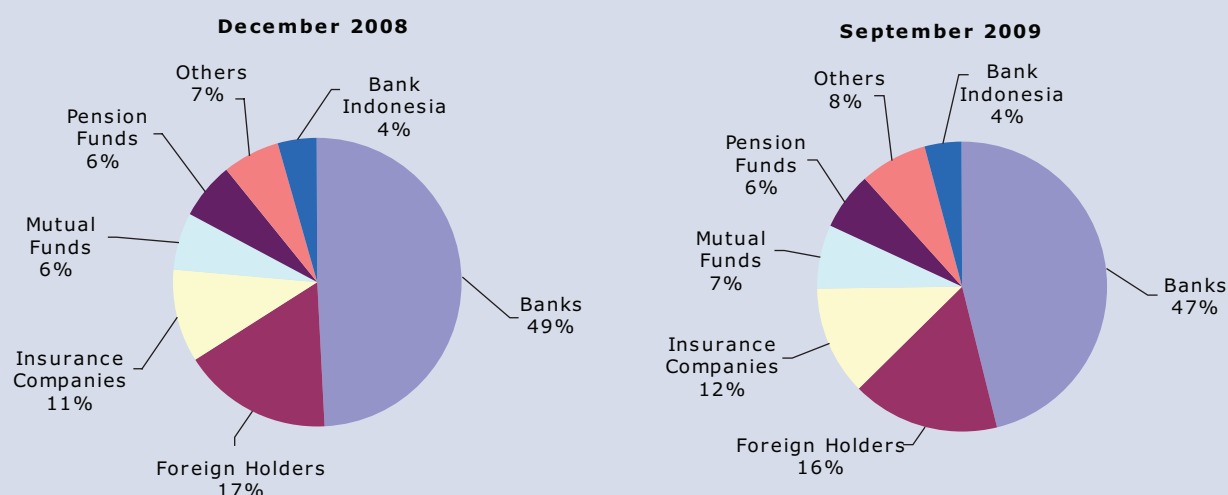
Source: Rating agencies.

into account S&P’s expectation that debt reduction and cautious fiscal management would remain key elements of the government’s macroeconomic policy.

Investor Profile

As of end-September, banking institutions remained the biggest holder of government bonds at IDR261.8 trillion, which is equivalent to 47.0% of total bonds outstanding. However, this was less than the banking institutions’ 49.0% share of holdings at end-December (**Figure 2**). The share of foreign holders in LCY government bonds was almost unchanged at 16.4% despite a 6.4% increase in the value of bonds held by them. As of end-September, bonds held by foreign investors had steadily grown to IDR93.2 trillion—the highest level in one year.

Figure 2: Investor Profile for Local Currency Government Bonds



Source: Indonesia Debt Management Office.

In addition, there was a notable increase in the share of insurance companies' LCY bond holdings (from 10.6% to 12.0%), mutual funds (from 6.3% to 7.3%), and pension funds (from 6.3% to 6.5%) between end-December and end-September.

Policy, Institutional, and Regulatory Developments

Bank Indonesia Requires 2.5% Secondary Reserve Requirement

Effective 24 October, BI required commercial banks to comply with a 2.5% secondary reserve requirement for unexpected liquidity needs. The secondary reserve requirement can be held in Treasury bonds, Treasury bills, SBIs, and/or excess reserves. This regulation is expected to bolster Treasury bond prices as banks are likely to invest in Treasury bonds to meet the additional reserve requirement.

Bank Indonesia to Set New Capital Requirements

In September, BI announced plans to assign capital requirements for commercial banks based on a bank's level of risk. Under current rules, banks in Indonesia have until the end of 2010 to meet the minimum capital requirement of IDR100 billion. Banks that cannot meet the requirement are encouraged to merge to increase their capitalization.