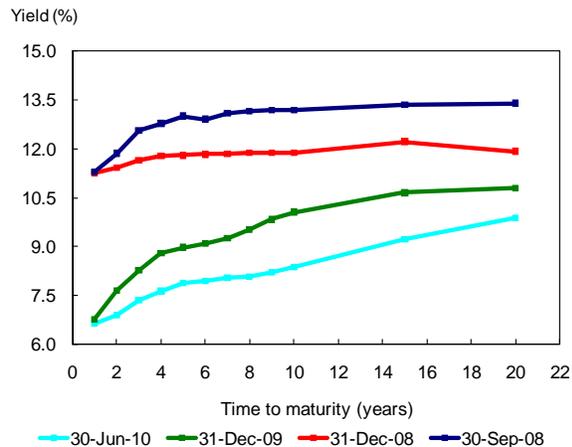


# Indonesia—Update

## Yield Movements

Indonesia's government bond yield curve shifted downward for all maturities between end-December 2009 and end-June 2010 (**Figure 1**). The government bond yield curve flattened from its short end up until the 10-year maturity, but steepened modestly for maturities beyond 10 years. Yields fell the most for the 10-year tenor, shedding 168.10 basis points. The yield spread between 2-year and 10-year maturities narrowed to 147 basis points in end-June from 241 basis points at end-December 2009.

**Figure 1: Indonesia's Benchmark Yield Curve—Local Currency Government Bonds**



Source: Bloomberg LP.

Bank Indonesia (BI) decided to keep its benchmark rate at a record-low level of 6.5% for the eleventh consecutive month in July. According to BI, the current rate remains consistent with the achievement of its 2010 inflation target of between 4.0% and 6.0%, and is conducive to measures for bolstering the economic recovery. Consumer price inflation rose to 5.05% year-on-year (y-o-y) in June as the end of the harvest season put upward pressure on food prices. Recent BI estimates indicate that inflation for 2010 may reach 5.5%, taking into account a planned electricity price hike in July.

Gross domestic product (GDP) expanded 5.7% y-o-y in 1Q10, boosted by solid growth in private consumption, domestic investments, and exports. The economy expanded in 1Q10 at its fastest pace since 3Q08. Private consumption expanded 3.9% y-o-y in 1Q10 and accounted for 57.7% of Indonesia's GDP. Exports rose 19.6% y-o-y in 1Q10 in a reversal from the 18.7% contraction in 1Q09. On a quarter-on-quarter (q-o-q) basis, Indonesia's economy expanded 1.9% in 1Q10, following a contraction of 2.4% in 4Q09. For 2010, BI's GDP growth target is estimated at 5.8% based on the 2010 revised state budget.

## Size and Composition

In the first quarter of 2010, the size of Indonesia's local currency (LCY) bond market expanded 15.6% y-o-y and 6.0% q-o-q (**Table 1**), with the total volume of Indonesia's LCY bonds outstanding reaching IDR985.62 trillion (USD108 billion).

Total government bonds outstanding increased 14.6% y-o-y to IDR893.42 trillion (USD98 billion) as both central government bonds (issued by the Ministry of Finance) and central bank bonds (issued by BI in the form of *Sertifikat Bank Indonesia* [SBI]) posted positive growth. The stock of central government bonds rose 8.5% y-o-y and 2.0% q-o-q. On a month-on-month basis, however, central government bonds fell 0.8%.

The government continued to implement a strategy of frontloading its financing requirements through the issuance of bonds in domestic and global markets. The Ministry of Finance expects treasury bond issuance in the first semester to cover more than 50% of its gross target for the year. The Ministry also disclosed that bond issuance will focus on IDR-denominated bonds. In 1Q10, the government issued both conventional and Islamic bonds (*sukuk*).

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

	Amount (billion)								Growth Rate (%)							
	Dec-09		Jan-10		Feb-10		Mar-10		Dec-09		Jan-10		Feb-10		Mar-10	
	IDR	USD	IDR	USD	IDR	USD	IDR	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m	
Total	930,063	98	981,458	105	995,551	107	985,619	108	19.4	7.3	5.5	1.4	15.6	6.0	(1.0)	
Government	841,612	89	890,225	95	904,939	97	893,420	98	19.2	6.8	5.8	1.7	14.6	6.2	(1.3)	
Central Govt Bonds	581,748	61	590,148	63	597,820	64	593,165	65	10.7	2.5	1.4	1.3	8.5	2.0	(0.8)	
Central Bank Bonds	259,864	27	300,077	32	307,119	33	300,255	33	44.3	17.8	15.5	2.3	29.0	15.5	(2.2)	
Corporate	88,452	9	91,233	10	90,612	10	92,199	10	21.2	12.1	3.1	(0.7)	25.8	4.2	1.8	

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 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 February, the government raised IDR8.03 trillion from the sale of retail sukuk. The sale was nearly three times oversubscribed based on a target of IDR3 trillion. The Islamic retail bonds carried a maturity of 3 years with a coupon of 8.7%.

In June, the Ministry of Finance conducted a buy-back of short-dated government debt in exchange for longer-tenor paper. The swap allowed investors to exchange bonds maturing between 2011 and 2013 for 10-year bonds maturing in 2020. The debt exchange was valued at IDR80 billion.

Other planned LCY government bond issues for this year include the following:

- Retail bonds—the government has chosen 23 selling agents for its next issue of retail bonds, which are expected to be issued in August.
- Retail *sukuk*—the government is planning another issue of retail *sukuk* in 4Q10.

Meanwhile, the stock of central bank bills rose 29.0% y-o-y and 15.5% q-o-q in 1Q10. The growth in SBI bonds outstanding continues to be robust as SBI remain a very attractive investment instrument among domestic lenders and foreign investors.

The amount of Indonesia's corporate bonds outstanding rose significantly to reach IDR92.2 trillion (USD10 billion) in 1Q10, growing 25.8% y-o-y and 4.2% q-o-q.

As of end-March, the top 10 corporate issuers in Indonesia accounted for 52.1% of total corporate bonds outstanding (**Table 2**). State power firm PLN remains Indonesia's top corporate issuer, with total LCY bonds outstanding valued at IDR12.1 trillion. Telecommunications firm PT Indosat ranked second with IDR8.1 trillion in outstanding bonds, while toll operator Jasa Marga was third with outstanding bonds of IDR4.2 trillion.

**Table 2: Top 10 Corporate Issuers**

Top 10 Corporate Issuers	Bonds Outstanding (IDR billion)
PLN	12,100
Indosat	8,090
Jasa Marga (Toll operator)	4,150
Bank Panin	3,950
Indofood Sukses Makmur	3,610
Bank Mandiri	3,500
Perum Pegadaian (Pawnshop)	3,270
Bank Tabungan Negara	3,250
Astra Sedaya Finance	3,062
Bank Ekspor Indonesia	3,050

Source: Indonesia Stock Exchange.

**Table 3: Notable Corporate Issuance in 1Q10**

Notable Corporate Issuers	Issued Amount (IDR billion)
PLN	3,000
Astra Sedaya Finance	1,500
Bank Permata	700
BCA Finance	600
Bank Sulut	500
Garuda	366
Mandiri Tunas Finance	350
Federal International Finance	300
Surya Artha Nusantara	300
Others	525

Source: Bloomberg LP.

In 1Q10, new corporate bond issuance stood at IDR8.14 trillion. Many of these bonds carried coupons of 10% or more and new issues this year have been consistently over-subscribed. Some notable issues in 1Q10 are listed in **Table 3**.

In January, state electricity firm PLN issued bonds worth IDR3 trillion. Bapepam-LK, the country's securities regulatory agency, allowed the firm to upsize its issue as the bonds were oversubscribed. PLN will use the issuance to finance its investment projects. The issue consisted of a

- 7-year conventional bond worth IDR920 billion and with a coupon of 11.95%,
- 10-year conventional bond worth IDR1.783 trillion and with a coupon of 12.55%,
- 7-year *shari'a* bond worth IDR130 billion and with a coupon of 11.95%, and
- 10-year *shari'a* bond worth IDR167 billion and with a coupon of 12.55%.

In March, the automotive financing company PT Astra Sedaya Finance increased its issuance target from an initial plan of IDR1.0 trillion to IDR1.5 trillion as its bonds were oversubscribed by as much as 2.5 times. The company will use the proceeds from the issue for working capital. The issue consisted of a

- 1-year bond worth IDR430 billion with a coupon of 8.47%,

- 2-year bond worth IDR275 billion with a coupon of 9.0%,
- 2-year bond worth IDR250 billion with a coupon of 10.0%,
- 3-year bond worth IDR106 billion with a coupon of 10.4%,
- 3-year bond worth IDR69 billion with a coupon of 10.75%, and
- 4-year bond worth IDR370 billion with a coupon of 10.9%.

Also in March, Bank Permata issued a 10-year unsecured subordinated medium-term note worth IDR700 billion to finance its business expansion plans. The bonds carried a coupon of 6.5954%.

BCA Finance sold IDR600 billion worth of conventional and subordinated bonds in March. The bonds were divided into five tranches, including a

- 1-year bond worth IDR212 billion with a coupon of 8.65%,
- 2-year bond worth IDR89 billion with a coupon of 9.05%,
- 3-year bond worth IDR100 billion with a coupon of 10.45%,
- 4-year bond worth IDR100 billion with a coupon of 10.95%, and
- 5-year subordinated bond worth IDR100 billion with a coupon of 11.2%.

The senior bonds were rated idAA- by Pefindo and AA from Fitch Ratings Indonesia. The subordinated bonds were rated idA+ and AA-.

In addition, Bank Sulut sold a total of IDR500 billion of bonds in March. The bond issue comprised IDR50 billion in subordinated bonds with a coupon of 12.2% and IDR450 billion of 5-year bonds with a coupon of 12.0%.

#### *Foreign Currency Bonds*

In January, the government sold USD2 billion of 10-year bonds at a yield of 6.0%, which was about 2.28 percentage points higher than comparable United States (US) treasuries. The yield on Indonesia's global bond issue was also higher than the yield on Philippine 10-year bonds, which were sold a week earlier at 5.67%.

Indonesia's 10-year bond issue was 2.3 times oversubscribed with demand reaching USD4.5 billion. The government also planned to offer 30-year bonds before cancelling this issuance.

According to the Ministry of Finance, the government now plans to sell USD650 million of *sukuk* in October. The government also delayed its planned issue of *samurai* bonds until the second half of the year.

## Rating Changes

**Table 4: Selected Sovereign Ratings and Outlook for Indonesia**

	Moody's	S&P	Fitch
Sovereign FCY LT Ratings	Ba2	BB	BB+
Outlook	positive	positive	stable

FCY = foreign currency, LT = long term.

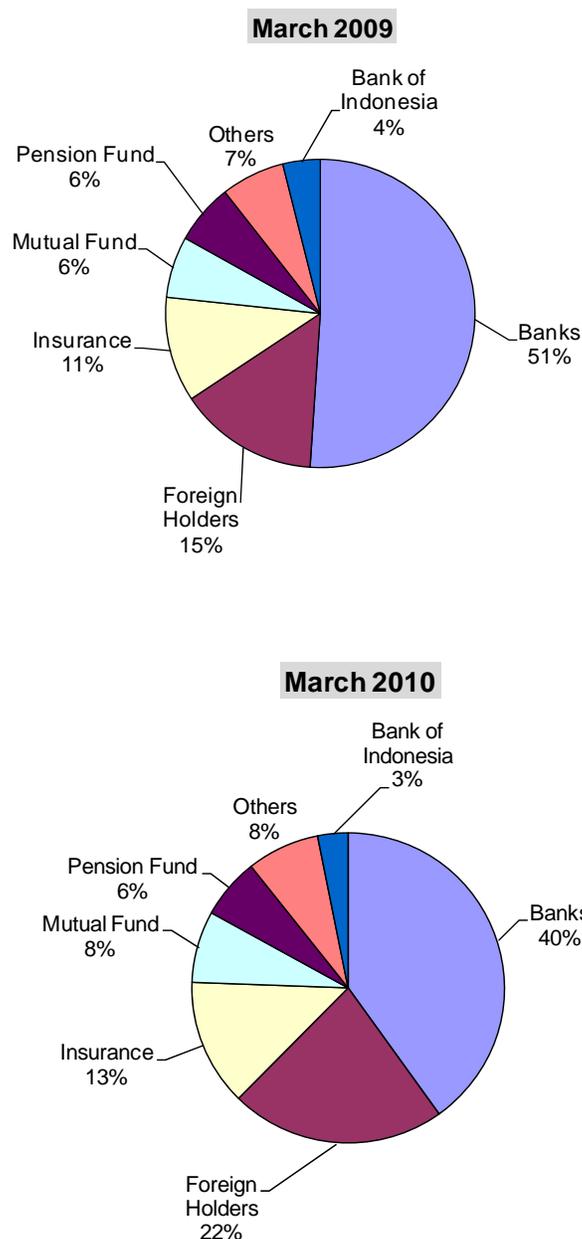
Source: Rating agencies.

In June, Moody's Investor Service (Moody's) revised the outlook for Indonesia's sovereign credit rating to positive. The revised outlook applies to the Ba2 level for Indonesia's LCY and foreign currency (FCY) sovereign ratings, as well as to the Ba1 FCY bond ceiling and Ba3 FCY deposit ceiling. According to Moody's, the positive outlook reflects the country's capacity for sustained strong growth, overall stability and effectiveness of its fiscal and monetary policies, and expectations of further improvement in the government's financial and debt positions.

## Investor Profile

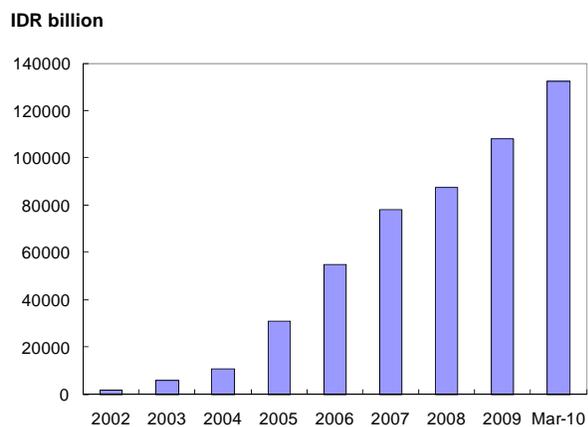
At end-March, banking institutions remained the major holders of Indonesian LCY government bonds, with holdings equivalent to 41% of the total government bonds outstanding (**Figure 3**). However, the banks' share of total holdings has declined significantly in recent years. In 2002, banks were holding as much as 82% of total government bonds outstanding.

**Figure 3: Investor Profile for Local Currency Government Bonds**



Source: Indonesia Debt Management Office.

**Figure 4: Foreign Holdings in Government Bonds**



Source: Indonesia Debt Management Office.

Foreign investors are the second biggest holder of Indonesian government bonds. Their share rose to 22% in 1Q10 from 15% in 1Q09. As of end-March, bonds held by foreign investors reached IDR132.46 trillion (**Figure 4**).

The share in LCY bond holdings of insurance companies and mutual funds also increased as of end-March.

## Policy, Institutional, and Regulatory Developments

### Bank Indonesia to Hold Monthly Auctions of SBI Beginning in June

In March, BI announced that it will hold monthly auctions of SBI, instead of on a weekly basis, beginning in June. BI will also extend SBI maturity by issuing long-dated tenors (3-months and 6-months) rather than the popular 1-month bills. This new policy is meant to encourage banks to manage liquidity over a longer period as well as to facilitate transactions in the interbank money market. There will be a 3-month transition period beginning in March before the policy becomes fully effective.

### 2010 Revised State Budget Bill Passed Into Law

In May, Indonesia's Parliament approved the 2010 Revised State Budget Bill. Government revenue is estimated at IDR992.4 trillion, up IDR42.7 trillion from the original budget. Government spending was also revised upwards

to IDR1,126.1 trillion from IDR1,047.7 trillion. The fiscal deficit in the revised budget increased to IDR133.7 trillion, or the equivalent of 2.1% of GDP, compared with IDR98 trillion (1.6% of GDP) in the original.

The revisions in the budget were based on agreed changes in macroeconomic assumptions, including

- economic growth of 5.8%,
- annual inflation of 5.3%,
- a 3-month SBI rate of 6.5%,
- an exchange rate of IDR9,200 per USD1,
- Indonesia crude price at USD80 per barrel, and
- oil lifting at 0.965 MBCD.

In the revised budget, financing through net treasury bonds increased to IDR107.5 trillion from IDR104.4 trillion.

### Policy Package to Strengthen Monetary Management and Develop Financial Markets

In June, BI announced a policy package that aims to boost the effectiveness of monetary policy transmission, shore up financial system stability, and encourage financial market deepening. The package includes the following:

- Effective 17 June, BI widened the range of its overnight interbank money market rate from 6.0%–7.0% to 5.5%–7.5%.
- Effective 1 July, the net open position holding limit of foreign exchange by banks will be capped at 20% of capital.
- Effective 7 July, a minimum 1-month holding period is required for investors of SBI with 1-month maturities. Also, new monetary instruments, in the form of term deposits, will be introduced.
- BI will begin issuing longer-tenor SBI with maturities of 9-months (effective the second week of August 2010) and 12-months (effective the second week of September 2010).
- By 2011, BI will introduce three-party repurchases of government bonds.

According to BI, these policies are not being instituted to control the foreign exchange market, but rather to support sustainable macroeconomic stability and strengthen the momentum of economic recovery.