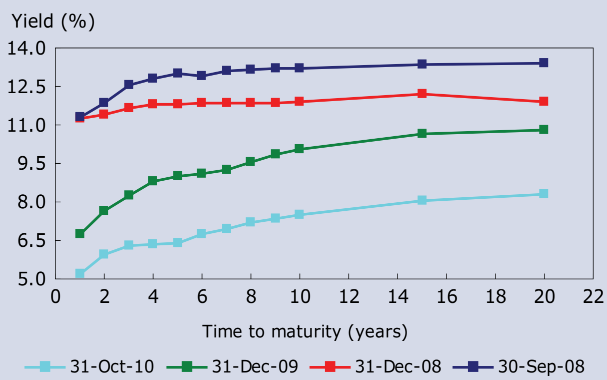
Indonesia—Update

Yield Movements

The government bond yield curve for Indonesia shifted downward as yields fell for all maturities between end-December 2009 and end-October 2010 **(Figure 1)**. The yield curve flattened from the short-end through the long-end of the curve, as yields fell between 155 and 263 basis points. The 15-year tenor fell the most, shedding 263 basis points by end-October. The yield spread between 2-year and 10-year maturities narrowed to 156 basis points in mid-October from 241 basis points at end-December.

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



LCY = local currency.
Source: Bloomberg LP.

Yields for the shortest-dated tenor (1-year treasury bills) have remained below the Bank Indonesia (BI) rate since early July. The central bank's regulation requiring a 1-month holding period for Sertifikat Bank Indonesia (SBI), which took effect in July, led some investors to switch from SBIs to treasury bills. The subsequent increase in demand for treasury bills has resulted in a lower yield rate. A+ end-October, 1-year bills fetched a yield of only 5.219%, which was down more than 1 percentage point from end-December 2009.

On 4 November, BI's Board of Governors decided to keep its benchmark interest rate at a record-low level of 6.5%. The BI rate has been kept at this level since August 2009. According to BI, this rate was consistent with the achievement of its 2010 inflation target and remained conducive to safeguarding financial stability and promoting bank intermediation for supply-side response to accelerated demand. The central bank has repeatedly announced that it will refrain from raising interest rates as long as inflation falls within its target range. The stability of BI's monetary policy has contributed to the growth of foreign investor interest in Indonesia's local currency (LCY) bond market.

In October, consumer price inflation eased to 5.7% year-on-year (y-o-y), following 5.8% y-o-y inflation in September and 6.4% y-o-y in August. For the first 10 months of the year, inflation averaged 5.4%, which fell within the central bank's inflation target of 4.0%–6.0% for 2010.

The economy grew 5.8% y-o-y in 3Q10, down slightly from 6.2% growth in 2Q10. Household consumption expanded 5.2% y-o-y, while exports and investments grew 11.3% and 8.9%, respectively. On a quarter-on-quarter (q-o-q) basis, the economy expanded 3.5%. BI estimates that gross domestic product (GDP) growth will range between 6.0% and 6.3% for the full year.

Size and Composition

The size of Indonesia's LCY bond market climbed 14.9% y-o-y and the total volume of LCY bonds outstanding reaching IDR995.8 trillion (USD112 billion) as of end-September **(Table 1)**. On a q-o-q basis, however, growth in LCY bonds outstanding was marginal in 3Q10 at 1.1%.

Total government bonds outstanding rose 13.3% y-o-y to reach IDR892.7 trillion (USD100 billion) at end-September, as both central government bonds (treasury bills and

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

	Amount (billion)								**Growth Rate** (%)						
	Jun-10		**Jul-10**		**Aug-10**		**Sep-10**		**Jun-10**		**Jul-10**	**Aug-10**	**Sep-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	985,359	109	965,406	108	1,016,788	112	995,822	112	13.8	(0.03)	(2.0)	5.3	14.9	1.1	(2.1)
Government	892,328	99	861,700	96	913,357	101	892,687	100	13.5	(0.1)	(3.4)	6.0	13.3	0.04	(2.3)
Central Govt Bonds	621,226	69	626,976	70	645,358	71	645,077	72	12.3	4.7	0.9	2.9	13.7	3.8	(0.04)
Central Bank Bills	271,103	30	234,724	26	267,999	30	247,610	28	16.5	(9.7)	(13.4)	14.2	12.2	(8.7)	(7.6)
Corporate	93,030	10	103,706	12	103,431	11	103,135	12	16.5	0.9	11.5	(0.3)	30.7	10.9	(0.3)

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—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.

bonds issued by the Ministry of Finance) and central bank bills (bills issued by BI in the form of SBIs) posted double-digit growth. The stock of central government bonds climbed 13.7% y-o-y, which was up slightly from 12.3% y-o-y growth in 2Q10. On a q-o-q basis, however, growth in central government bonds rose 3.8% in 3Q10.

In 3Q10, central government issuance consisted of both conventional and Islamic treasury bills and bonds. Total central government issuance for 3Q10 reached IDR32.1 trillion (USD3.6 billion), up 22.2% y-o-y. On a q-o-q basis, however, central government issuance fell 24.8%.

In August, the government issued its seventh series of retail bonds, raising IDR8.0 trillion from the sale. The government initially planned a IDR5.0 trillion offering, but raised its target to IDR8.0 trillion due to strong demand from investors. The retail bonds carried a maturity of 3 years with a coupon of 7.95%. Retail bonds constitute 7.18% of total central government bonds.

Through end-September, the government had issued about IDR145.3 trillion worth of bonds (gross) in 2010. The Ministry of Finance announced in July that it would reduce its issuance of debt securities as the budget deficit was estimated to be equivalent to only 1.5% of GDP, compared with an original estimate of 2.5% of GDP in the revised state budget.

Finally, the Ministry of Finance acknowledged the failure of its *sukuk* (Islamic bond) treasury auctions this year, and is now planning to negotiate rates with potential investors through a book building process instead of conducting auctions. Indonesian investors are demanding higher returns from *sukuk* because they are not actively traded.

SBI Market Developments. Growth in central bank bills eased to 12.2% y-o-y in 3Q10, compared with 16.5% in 2Q10. The growth rate in central bank bills, while remaining positive on a y-o-y basis, has exhibited a declining trend in recent months as new regulations governing SBIs took effect in 3Q10. On a q-o-q basis, the outstanding amount of central bank bills contracted 8.7% in 3Q10, following a decline of 9.7% q-o-q in 2Q10.

In 3Q10, three SBI auctions were held at a rate of one per month. Also, SBI issuance for the quarter comprised longer-dated tenors consisting of 3-, 6-, and 9-month tenors. BI issued its first 9-month SBI tenor in August of this year. The central bank was scheduled to issue a 12-month SBI tenor in September, but decided to delay its issuance to give investors time to switch to longer-dated tenors of SBI as well as to avoid hurting demand for 1-year treasury bills.

In November, BI cancelled the sale of its 3-month SBI in its monthly auction. The central bank chose to issue 6- and 9-month, tenors and 1- and 2-year term deposits.

Corporate Bond Market Trends. Corporate bonds outstanding rose to IDR103.1 trillion (USD12 billion) in 3Q10, expanding a notable 30.7% y-o-y. On a q-o-q basis, corporate bonds outstanding grew 10.9% in 3Q10, driven by a 57.4% increase in corporate bond issuance.

The top 30 corporate issuers in Indonesia accounted for nearly 80% of total corporate bonds outstanding at end-September **(Table 2)**. State-power firm PLN remained Indonesia's top corporate issuer of LCY bonds, with a total outstanding amount of IDR15.1 trillion. Taking the second spot was telecommunications firm Indosat, with IDR8.1 trillion in outstanding LCY bonds. Bank Tabungan Negara and toll operator Jasa Marga each had outstanding LCY bonds of IDR4.2 trillion. The top 30 LCY bond issuers hailed mainly from the financial sector (63%).

In 3Q10, corporate bond issuance rose to IDR11.5 trillion (USD1.3 billion) from only IDR7.3 trillion (USD0.8 billion) in 2Q10 **(Table 3)**. Corporate bond issuers in 3Q10 mainly comprised firms in the financial sector. Most of the bonds issued during the quarter carried coupons ranging from 9.0% to 10.0%. Some notable issues during 3Q10 are listed in Table 3.

Table 2: Top 30 Corporate Issuers, September 2010

Top 30 Corporate Issuers	Outstanding Amount	
	LCY Bonds (IDR billion)	LCY Bonds (USD billion)
PLN	15,100	1.69
Indosat	8,090	0.91
Bank Tabungan Negara	4,150	0.47
Jasa Marga	4,150	0.47
Bank Panin	3,900	0.44
Indofood Sukses Makmur	3,610	0.41
Bank Mandiri	3,500	0.39
Indonesia Eximbank	3,000	0.34
Perum Pegadaian	3,000	0.34
Telkom	3,000	0.34
Federal International Finance	2,845	0.32
Astra Sedaya Finance	2,660	0.30
Oto Multiartha	2,500	0.28
Bank Ekspor Indonesia	2,341	0.26
Bank Tabungan Pensiunan Nasional	2,050	0.23
Bank Rakyat Indonesia	2,000	0.22
Excelcom	1,500	0.17
Medco Energi Internasional	1,500	0.17
Bank CIMB Niaga	1,380	0.15
Bentoel	1,350	0.15
Berlian Laju Tanker	1,340	0.15
Bank Danamon	1,250	0.14
Danareksa	1,080	0.12
Bank Negara Indonesia	1,000	0.11
Bank Jabar	1,000	0.11
Bank Mega	1,000	0.11
Sarana Multigriya Finansial	978	0.11
Bank OCBC NISP	880	0.10
Pupuk Kaltim	791	0.09
WOM Finance	775	0.09
Total Top 30 Corporate Issuers	**81,720**	**9.17**
Total Corporate Bonds Outstanding	**103,135**	**11.57**
Top 30 as % of Total Corporate	**79.24%**	**79.24%**

LCY = local currency.
Source: Indonesia Stock Exchange.

Table 3: Notable Corporate Issuance in 3Q10

Corporate Issuers	Amount Issued (IDR billion)
Indonesia Eximbank	3,000
PLN	3,000
Telkom	3,000
Bank CIMB Niaga	1,380
Sarana Multigriya Finansial	727
Others	390
Total	**11,497**

Source: Indonesia Stock Exchange.

Indonesia Eximbank (formerly Bank Ekspor Indonesia) raised IDR3.0 trillion, compared with a target of IDR2.5 trillion, in a four-tranche bond deal in July. The bond issue comprised the following tranches:

- 1-year bonds worth IDR1.250 trillion with a coupon of 7.55%,
- 3-year bonds worth IDR425 billion with a coupon of 8.85%,
- 5-year bonds worth IDR250 billion with a coupon of 9.6%, and
- 7-year bonds worth IDR1.075 trillion with a coupon of 10.0%.

Eximbank also plans to issue either a *samurai* bond or a global G3-bond next year.

The state power firm, PLN, issued bonds worth IDR3.0 trillion in July after raising IDR3.0 trillion earlier in 2010. The bond issue comprised the following tranches:

- 5-year bonds worth IDR645 billion with a coupon of 9.7%,
- 5-year *sukuk* worth IDR160 billion with a coupon of 9.7%,
- 12-year bonds worth IDR1.855 trillion with a coupon of 10.4%, and
- 12-year *sukuk* worth IDR340 billion with a coupon of 10.4%.

Telecommunications provider PT Telekomunikasi issued IDR3.0 trillion worth of bonds in July. The bond issue comprised the following tranches:

- 5-year bonds worth IDR1.005 trillion with a coupon of 9.6%, and
- 10-year bonds worth IDR1.995 trillion with a coupon of 10.2%.

The state-owned mortgage financing company, Sarana Multigriya Finansial, issued IDR727 billion worth of bonds in a two-tranche deal:

- 2-year bonds worth IDR500 billion with a coupon of 9.25%, and
- 3-year bonds worth IDR227 billion with a coupon of 9.75%.

Foreign Currency Bonds

In early November, the Indonesian government raised JPY60.0 billion in 10-year *samurai* bonds. The bonds were issued at a coupon rate of 1.6%, or 55 basis points above the yen swap rate. This was Indonesia's second issue of *samurai* bonds since selling JPY35.0 billion in 10-year *samurai* bonds in July 2009.

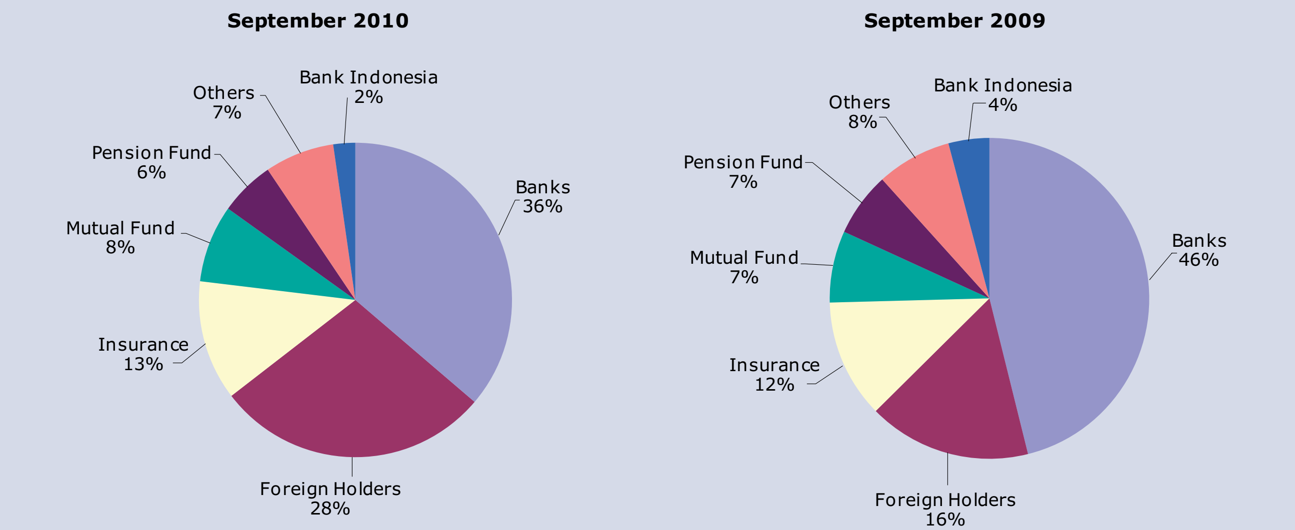
Investor Profile

Banking institutions remained the biggest holder of Indonesian LCY central government bonds as of end-September **(Figure 2)**. However, banks' share of total LCY central government bonds, which were valued at IDR234.0 trillion at end-September, dropped to 36% from 46% a year ago. Banks' share of total central government bonds outstanding has declined significantly since 2002, when it was as high as 82%.

The second biggest holder of Indonesian LCY central government bonds as of end-September were foreign investors with a share of 28%, which was up significantly from 16% in September 2009. Foreign investors' share has exhibited an upward trend since 2002, when it stood at only 0.46% **(Figure 3)**. At end-September, nearly 70% of bonds held by foreign investors were long-dated tenors (i.e., maturities of more than 5 years). On the other hand, only 10% of bonds held by foreign investors carried maturities of less than 1 year.

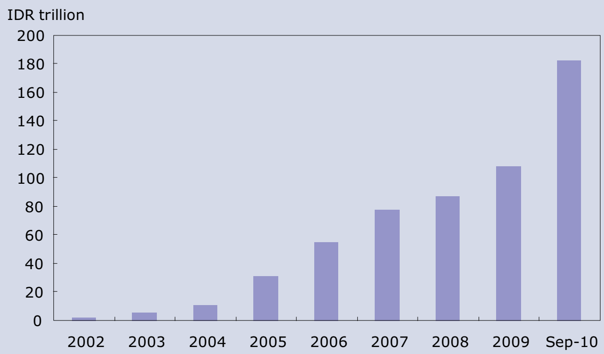
Banks were also the primary holders of SBIs, with a share of 71% at end-September **(Figure 4)**. However, banks' share in SBI holdings has fallen considerably from a high of 89% in June 2009. Foreign interest in SBIs continued to rise in 3Q10 despite the new requirement of a 1-month holding period for SBIs. The share of non-residents' holdings of SBIs rose to 26% at end-September, compared with 16% at end-June and 17% at end-September 2009. Meanwhile, the share of non-bank residents was flat, compared with both end-June and end-September 2009, at about 3%.

Figure 2: LCY Government Bonds Investor Profile



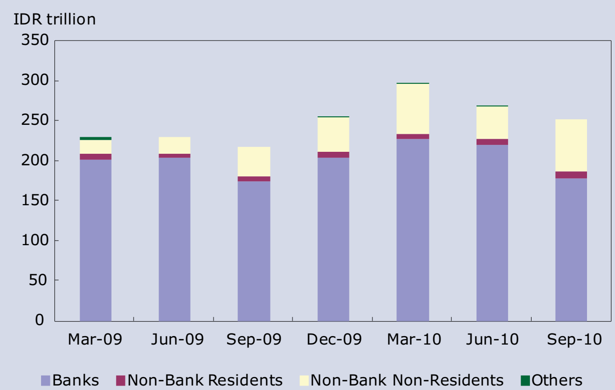
LCY = local currency.
Source: Indonesia Debt Management Office.

Figure 3: Foreign Holdings of LCY Government Bonds



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

Figure 4: LCY Central Bank Bills Investor Profile



LCY = local currency.
Source: Bank Indonesia.

Rating Changes

On 13 July, Indonesia's sovereign rating was raised to investment grade by Japan Credit Rating Agency (JCR). Specifically, Indonesia's foreign currency long-term debt and local currency long-term debt were upgraded by JCR to BBB- (from BB+) and BBB (from BBB-), respectively, while the rating outlook for both was stable. According to JCR, the upgrade reflects the country's sustained growth, which is being accompanied by strong domestic demand; a reduced public debt burden; increased resilience to external shocks; improved political and social stability; and government efforts to deal with structural issues.

On 14 October, Rating and Investment Information (R&I) affirmed Indonesia's foreign currency issuer rating at BB+ and changed the outlook to positive from stable **(Table 4)**. R&I believes that a rating upgrade to BBB is possible once Indonesia is able to sustain balanced economic growth by boosting investment in infrastructure. The rating agency also affirmed Indonesia's foreign currency short-term debt rating at a-3.

Table 4: Selected Sovereign Ratings and Outlook for Indonesia

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

FCY = foreign currency, LT = long term.
Source: Rating agencies.

Policy, Institutional, and Regulatory Developments

BI Announces New Regulations on Reserve Requirements and Bank Lending

In September, BI announced new regulations on reserve requirements and bank lending to help contain inflation and boost economic growth. Beginning in November, the primary reserve requirement will be raised to 8.0% of deposits—from 5.0%—while the secondary reserve requirement will remain at 2.5%. Banks that are able to comply with the new primary reserve requirement will earn 2.5% interest on the amount covering the 3-percentage-point increase in primary reserves. On the other hand, those banks that fail to meet the new 8.0% primary reserve requirement will be fined the equivalent of 125% of the average 1-day overnight Jakarta Interbank Offered Rate (JIBOR). BI also announced a regulation designed to give banks incentives for maintaining their loan-to-deposit ratios within a range of 78%–100%, effective 1 March 2011.

BI Plans to Offer New Term Deposits

In October, BI announced that it is planning to issue new term deposits as it seeks to reduce currency volatility following a surge in capital inflows. The central bank is looking at offering term deposits with maturities of 3, 6, and 9 months. Currently, 1- and 2-month deposits are being offered. The central bank has yet to decide when to issue the new term deposits.