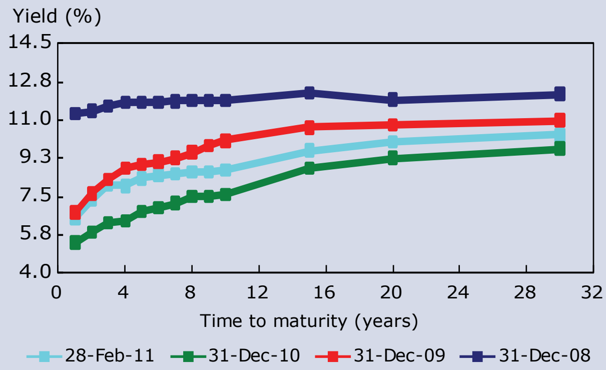
Indonesia—Update

Yield Movements

Between end-December 2009 and end-December 2010, the government bond yield curve for Indonesia shifted downward across all maturities **(Figure 1)**. However, the yield curve shifted upward again between end-December 2010 and end-February, rising more at the short-end of the curve, as Bank Indonesia (BI) raised its policy rate to dampen growing inflationary pressures. Yields at the short-end of the curve were almost identical to their end-2009 levels.

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



LCY = local currency.
Source: Bloomberg LP.

Yields from the short-end through the 10-year maturity rose more than 100 basis points by end-February from their end-December levels. The yield for the 3-year maturity climbed the most among all maturities between end-December and end-February, rising 169 basis points. Meanwhile, the 5-year and 10-year maturities rose by 152 and 113 basis points, respectively. The yield spread between the 2-year and 10-year maturities narrowed to 138 basis points by end-February from a spread of 174 basis points at end-December.

For the first time in 4 months, consumer price inflation eased, falling to 6.84% year-on-year (y-o-y) in February from 7.02% in January. On a month-on-month (m-o-m) basis, consumer price inflation slowed to 0.13% in February on account of lower food prices following improvement in the supply of some volatile food items (e.g., rice and chili peppers). However, the core inflation rate (excluding volatile items) rose to 4.36% y-o-y in February from only 4.18% in the previous month. The central bank's inflation target stands at 4.0%–6.0% for 2011.

In a meeting held on 4 February, BI's Board of Governors decided to raise its reference rate by 25 basis points to 6.75% to curb the renewed onset of inflationary pressures. This was the first rate hike since October 2008 when BI last raised its interest rate by 25 basis points to 9.5%. According to BI, it will keep a close watch on inflationary pressures and allow the rupiah's exchange rate versus the United States (US) dollar to strengthen as needed. In addition, BI will continue to implement its macro-prudential policies introduced in 2010. Subsequently, in its meeting held on 4 March, BI's Board of Governors decided to keep its reference rate steady at 6.75%.

Indonesia's gross domestic product (GDP) grew 6.9% y-o-y in 4Q10 on account of strong domestic consumption and investment. Household consumption expanded 4.4% y-o-y, while investment rose 8.7%. Most major industry sectors registered higher annual growth in 4Q10 compared with the previous quarter, led by transport and communications, which expanded 15.5% y-o-y. On a quarter-on-quarter (q-o-q) basis, however, the economy contracted 1.5% in 4Q10. For the full-year 2010, the economy recorded GDP growth of 6.1%, compared with 4.6% in 2009. For 2011, the Ministry of Finance is targeting GDP growth of 6.4% based on the 2011 State Budget.

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

	Amount (billion)								Growth Rate (%)						
	Sep-10		Oct-10		Nov-10		Dec-10		Sep-10		Oct-10	Nov-10	Dec-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	999,992	112	973,330	109	966,960	107	956,142	106	15.3	1.5	(2.7)	(0.7)	2.8	(4.4)	(1.1)
Government	896,857	101	867,994	97	856,374	95	841,325	94	13.8	0.5	(3.2)	(1.3)	(0.03)	(6.2)	(1.8)
Central Govt Bonds	645,077	72	642,984	72	642,814	71	641,215	71	13.7	3.8	(0.3)	(0.03)	10.2	(0.6)	(0.2)
Central Bank Bills	251,780	28	225,010	25	213,560	24	200,110	22	14.1	(7.1)	(10.6)	(5.1)	(23.0)	(20.5)	(6.3)
Corporate	103,135	12	105,336	12	110,586	12	114,817	13	30.7	10.9	2.1	5.0	29.8	11.3	3.8

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.

Size and Composition

Total local currency (LCY) bonds outstanding in Indonesia expanded 2.8% y-o-y as of end-December to reach IDR956.1 trillion (USD106.3 billion) **(Table 1)**. On a quarter-on-quarter (q-o-q) basis, however, bonds outstanding fell 4.4% in 4Q10. The negative growth in LCY bonds outstanding was due mainly to a drop in the stock of government bonds.

As of end-December, the growth in total government bonds outstanding was flat on a y-o-y basis mainly on account of a notable drop in the stock of central bank bills issued by BI in the form of *Sertifikat* Bank Indonesia (SBI). On the other hand, the stock of central government bonds (treasury bills and bonds issued by the Ministry of Finance) rose 10.2% y-o-y in 4Q10, which was still down from 13.7% growth in 3Q10. On a q-o-q basis, government bonds contracted 6.2%, with both central government bonds and central bank bills posting negative growth.

In 4Q10, issuance by the central government totaled IDR10.6 trillion (USD1.2 billion), down 26.5% compared with IDR14.4 trillion a year earlier. On a q-o-q basis, treasury issuance dropped 67.0%. Bond issues during the quarter comprised both conventional and Islamic treasury bills and bonds.

In 2010, the government was able to raise IDR161.9 trillion in bonds (gross). Issuance was reduced in the second half of the year as the budget deficit for 2010 was revised downward. According to the Ministry of Finance, the final budget deficit for 2010 was equivalent to only 0.6% of GDP, compared with an initial forecast of 2.1%.

For 2011, the Finance Ministry's Debt Management Office has chosen four state bond series (FR0055, FR0053, FR0056, and FR0054) as its benchmark bonds **(Table 2)**. The selection of the government's benchmark bonds takes into account the results of the Preference Structure of Government Securities Portfolio survey and inputs from primary dealers, as well as liquidity, outstanding amounts, and the coupon of each series. The outstanding amount of these bonds, however, added up to a relatively small IDR21.6 trillion, equivalent to only 3.4% of outstanding central government bonds as of end-December.

Table 2: Indonesian Government Benchmark Bonds for 2011

Bond Series	Outstanding Amount (IDR billion)	Coupon (%)	Maturity Date
FR0055	4,100	7.35	15-Sep-16
FR0053	6,372	8.25	15-Jul-21
FR0056	3,750	8.38	15-Sep-26
FR0054	7,722	9.50	15-Jul-31
Total Benchmark Bonds	21,944		
Total Central Government Bonds	641,215		
Benchmark Bonds as % of Total	3.42%		

Source: Indonesia Stock Exchange.

SBI Market Developments. The stock of central bank bills contracted 23.0% y-o-y in 4Q10, compared with 14.1% growth in 3Q10. Regulations imposed by the central bank in the second half of 2010 reduced the frequency of SBI auctions and required a 1-month holding period for SBIs. Subsequently, this led to a significant drop in the stock of central bank bills during the review period. On a q-o-q basis, central bank bills dropped 20.5%, after declining 7.1% in 3Q10.

In 4Q10, three SBI auctions were held, with one auction each month. SBI issuance for the quarter consisted mostly of longer-dated tenors (6- and 9-months). In November, the central bank stopped issuing 3-month SBI and instead began offering term deposit instruments to absorb excess bank liquidity and limit foreign holdings. However, these term deposit instruments were only offered to banking institutions.

In February, BI announced that it would no longer issue SBI with maturities of less than 9-months. The central bank also began issuing term deposits with tenors of more than 1 month to absorb excess liquidity. Specifically, the central bank began issuing term deposits with a 5-month maturity in January and a 6-month maturity in February.

Corporate Bond Market Trends. Corporate bonds outstanding grew 29.8% y-o-y to IDR114.8 trillion (USD12.8 billion) in 4Q10. On a q-o-q basis, corporate bonds outstanding rose by 11.3% in 4Q10. The positive growth rates on a y-o-y and q-o-q basis in corporate bonds were driven by double-digit growth rates in issuance: 19.5% y-o-y and 23.5% q-o-q.

The top 52 corporate issuers in Indonesia accounted for almost 95% of total corporate bonds outstanding as of end-December **(Table 3)**. Indonesia's top corporate issuer of LCY bonds was the state-power firm PLN, with bonds valued at IDR15.1 trillion (USD1.7 billion). Telecommunications firm Indosat followed with IDR7.5 trillion (USD0.8 billion) in outstanding LCY bonds. Bank Pan Indonesia was in the third spot with outstanding LCY bonds of IDR6.9 trillion (USD0.8 billion).

Financial institutions dominate the list of the top 52 corporate issuers in Indonesia, accounting for nearly half of the list. Financial institutions include banks, securities companies, and other specialized companies engaged in finance (e.g., pawnshop, leasing). In addition, 12 state-owned companies were on the list, with five state-owned companies in the top 10. Also, about two-thirds of the top 52 companies are listed on the Indonesia Stock Exchange. This is an indication that these firms are tapping both equity and fixed-income instruments as sources of funding. Among the companies listed in Table 3, 40 companies are privately-owned entities.

Corporate LCY bond issuance rose to IDR14.2 trillion (USD1.6 billion) in 4Q10 from IDR11.5 trillion (USD1.3 billion) in 3Q10. The corporate bond issuers in 3Q10 were mostly firms from the financial sector, except for two—Jasa Marga (toll operator) and BW Plantation. Most corporate bonds issued in 4Q10 carried coupons ranging from 8.0%–10.0%. Some notable corporate bond issues in 4Q10 are listed in **Table 4**.

Bank Pan Indonesia raised a total of IDR3.0 trillion in a bond offering in November. The proceeds from the bond issue will be used to support the bank's

Table 3: Top 52 LCY Corporate Bond Issuers (as of 31 December 2010)

Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed Company	Type of Industry
	LCY Bonds (IDR billion)	LCY Bonds (USD billion)				
1. PLN (Persero)	15,100	1.68	Yes	No	No	Energy
2. Indosat Tbk	7,450	0.83	No	Yes	Yes	Telecommunication
3. Bank Pan Indonesia Tbk	6,900	0.77	No	Yes	Yes	Bank
4. Indonesia Eximbank	5,341	0.59	Yes	No	No	Bank
5. Jasa Marga (Persero) Tbk	5,000	0.56	Yes	No	Yes	Toll Road, Airport, Harbor and Allied Products
6. Bank Tabungan Negara (Persero)	4,150	0.46	Yes	No	Yes	Bank
7. Bank Danamon Indonesia Tbk	4,050	0.45	No	Yes	Yes	Bank
8. Indofood Sukses Makmur Tbk	3,574	0.40	No	Yes	Yes	Food and Beverages
9. Bank Mandiri (Persero) Tbk	3,500	0.39	Yes	No	Yes	Bank
10. Bank Tabungan Pensiunan Nasional Tbk	3,150	0.35	No	Yes	Yes	Bank
11. Perum Pegadaian	3,000	0.33	Yes	No	No	Financial Institution
12. Telekomunikasi Indonesia Tbk	3,000	0.33	Yes	No	Yes	Telecommunication
13. Bank CIMB Niaga	2,980	0.33	No	Yes	Yes	Bank
14. Federal International Finance	2,845	0.32	No	Yes	No	Financial Institution
15. Adira Dinamika Multifinance Tbk	2,544	0.28	No	Yes	Yes	Financial Institution
16. Astra Sedaya Finance	2,460	0.27	No	Yes	No	Financial Institution
17. Oto Multiartha	2,300	0.26	No	Yes	No	Financial Institution
18. Bank Rakyat Indonesia (Persero) Tbk	2,000	0.22	Yes	No	Yes	Bank
19. Summit Oto Finance	1,900	0.21	No	Yes	No	Financial Institution
20. Bank Jabar Banten	1,750	0.19	No	Yes	Yes	Bank
21. Excelcomindo Pratama Tbk	1,500	0.17	No	Yes	Yes	Telecommunication
22. Medco Energi Internasional Tbk	1,500	0.17	No	Yes	Yes	Crude Petroleum and Natural Gas Production
23. Bank OCBC NISP Tbk	1,480	0.16	No	Yes	Yes	Bank
24. Bentoel International Investama Tbk	1,350	0.15	No	Yes	Yes	Tobacco Manufacturers
25. Berlian Laju Tanker Tbk	1,340	0.15	No	Yes	Yes	Transportation
26. Danareksa (Persero)	1,080	0.12	Yes	No	No	Others Finance
27. Bank Negara Indonesia (Persero) Tbk	1,000	0.11	Yes	No	Yes	Bank
28. Bank Mega Tbk	1,000	0.11	No	Yes	Yes	Bank
29. Pupuk Kalimantan Timur	791	0.09	No	Yes	No	Chemicals
30. Wahana Ottomitra Multiartha Tbk	775	0.09	No	Yes	Yes	Financial Institution
31. Bank DKI	750	0.08	No	Yes	No	Bank
32. Salim Ivomas Pratama	730	0.08	No	Yes	No	Plantation
33. Sarana Multigriya Finansial (Persero)	727	0.08	Yes	No	No	Financial Institution
34. BCA Finance	725	0.08	No	Yes	No	Financial Institution
35. BW Plantation	700	0.08	No	Yes	Yes	Plantation
36. Lontar Papyrus Pulp & Paper Industry	700	0.08	No	Yes	No	Pulp and Paper
37. Bakrie Telecom Tbk	650	0.07	No	Yes	Yes	Telecommunication
38. Bakrieland Development Tbk	650	0.07	No	Yes	Yes	Property and Real Estate
39. Thames Pam Jaya (Aertra Air Jakarta)	615	0.07	No	Yes	No	Water Utilities
40. Mobile-8 Telecom Tbk	607	0.07	No	Yes	Yes	Telecommunication
41. Apexindo Pratama Duta Tbk	600	0.07	No	Yes	No	Crude Petroleum and Natural Gas Production
42. Arpeni Pratama Ocean Line Tbk	600	0.07	No	Yes	Yes	Transportation
43. Bumi Serpong Damai Tbk	600	0.07	No	Yes	Yes	Property and Real Estate
44. Surya Citra Televisi	575	0.06	No	Yes	No	Advertising, Printing and Media
45. Matahari Putra Prima Tbk	528	0.06	No	Yes	Yes	Retail Trade
46. Indah Kiat Pulp & Paper Tbk	501	0.06	No	Yes	Yes	Pulp and Paper

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Table 3 continued

Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed Company	Type of Industry
	LCY Bonds (IDR billion)	LCY Bonds (USD billion)				
47. Adhi Karya (Persero) Tbk	500	0.06	Yes	No	Yes	Building Construction
48. Ciliandra Perkasa	500	0.06	No	Yes	No	Plantation
49. Duta Pertiwi Tbk	500	0.06	No	Yes	Yes	Property and Real Estate
50. Japfa Comfeed Indonesia Tbk	500	0.06	No	Yes	Yes	Animal Feed
51. Lautan Luas Tbk	500	0.06	No	Yes	Yes	Wholesale (Durable and Non-Durable Goods)
52. Bank Permata Tbk	500	0.06	No	Yes	Yes	Bank
Total Top 52 Corporate Issuers	**108,068**	**12.01**				
Total Corporate Bonds Outstanding	**114,817**	**12.76**				
Top 52 as % of Total Corporate	**94.12%**	**94.12%**				

LCY = local currency.
Source: Indonesia Stock Exchange.

Table 4: Notable LCY Corporate Bond Issuance in 4Q10

Corporate Issuers	Amount Issued (IDR billion)
Bank Pan Indonesia Tbk	3,000
Bank Danamon Indonesia Tbk	2,800
Adira Dinamika Multifinance Tbk	2,000
Bank CIMB Niaga	1,600
Jasa Marga (Persero) Tbk	1,500
Summit Oto Finance	1,500
Others	1,800
Total	**14,200**

LCY = local currency.
Source: Indonesia Stock Exchange.

loan expansion and to strengthen its capital. The bonds consisted of the following series:

(i) 5-year bonds worth IDR540 billion, coupon of 9.0%; and
(ii) 7-year subordinated bonds worth IDR2.46 trillion, coupon of 10.5%.

Bank Danamon Indonesia also issued a total of IDR2.8 trillion in bonds in December to support its loan expansion. The bonds comprised the following tranches:

(i) 3-year bonds worth IDR1.88 trillion, coupon of 8.75%; and
(ii) 5-year bonds worth IDR921 billion, coupon of 9.0%.

Automotive financing company Adira Dinamika Multifinance issued IDR2.0 trillion through a five-tranche bond deal in October. The bonds consisted of the following series:

(i) 1.5-year bonds worth IDR229 billion, coupon of 7.60%;
(ii) 2-year bonds worth IDR238 billion, coupon of 8.25%;
(iii) 2.5-year bonds worth IDR577 billion, coupon of 8.70%;
(iv) 3-year bonds worth IDR284 billion, coupon of 9.0%; and
(v) 4-year bonds worth IDR672 billion, coupon of 9.25%.

Bank CIMB Niaga raised IDR1.6 trillion from the sale of subordinated bonds in December, an upsize from its original plan of IDR500 billion. The sub-debt will mature in 10 years and carries a coupon of 10.85%. The proceeds from the sub-debt issue will be used to strengthen the bank's capitalization.

State-owned toll road operator Jasa Marga issued IDR1.5 trillion in bonds in October to pay its debts and to finance toll road expansion. The bonds consisted of the following series:

(i) 3-year bonds worth IDR500 billion, zero coupon; and
(ii) 10-year bonds worth IDR1.0 trillion, coupon of 9.35%.

Automobile financing company Summit Oto Finance raised IDR1.5 trillion in a four-tranche bond sale. The bond issue comprised the following series:

(i) 370-day bonds worth IDR300 billion, coupon of 7.3%;
(ii) 2-year bonds worth IDR300 billion, coupon of 8.4%;
(iii) 3-year bonds worth IDR600 billion, coupon of 9.5%; and
(iv) 4-year bonds worth IDR300 billion, coupon of 9.75%.

Foreign Currency Bonds

In November, the government raised JPY60 billion from an issue of *samurai* bonds. The bonds have a 10-year maturity and were issued with a coupon rate of 1.6%, or 55 basis points above the yen swap rate. This was the second issue of *samurai* bonds by Indonesia since selling JPY35 billion of 10-year *samurai* bonds in July 2009.

Investor Profile

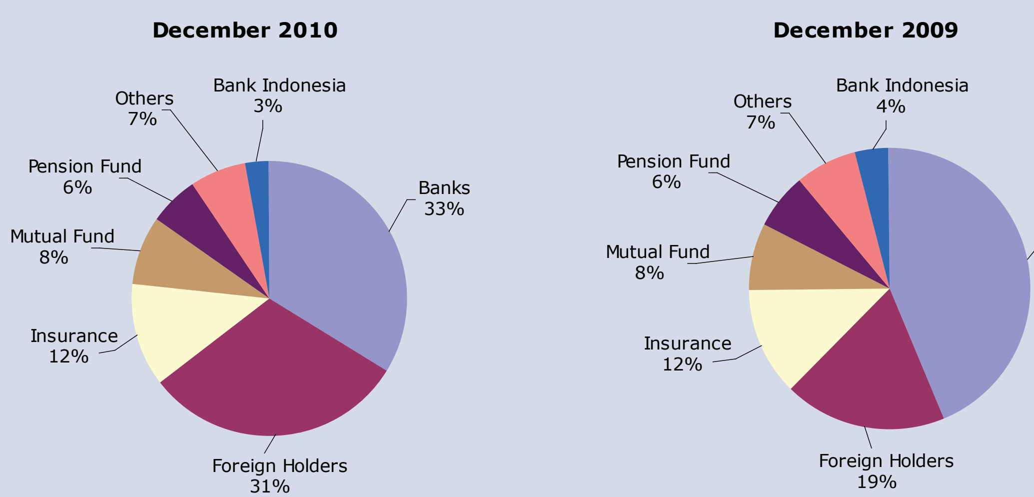
Central Government Bonds. At end-December, banking institutions remained the biggest holders of Indonesian LCY central government bonds, with 33% of total central government bonds outstanding **(Figure 2)**. However, banks' holdings have dropped significantly from 44% at end-December 2009, and from as high as 82% in 2002.

Foreign investors are the second biggest holder of Indonesian LCY central government bonds, with a share of 31% at end-December, compared with only 19% at end-December 2009. The share of foreign investors' holdings has steadily risen from only 0.48% in 2002. Foreign holders include non-resident private banks, fund/asset management firms, securities firms, insurance companies, and pension funds.

As of end-December, the share of bonds held by foreign investors in short-dated tenors (bonds with maturities of less than 1 year) rose to 10.2% from only 1.9% in 2008 and 4.5% in 2009 **(Figure 3)**. The 1-month holding period for SBIs may have led investors to shift into treasury bills. Foreign investors' holdings of long-dated tenors (maturities of more than 5 years) fell to 67.0% at end-December from 71.0% a year earlier.

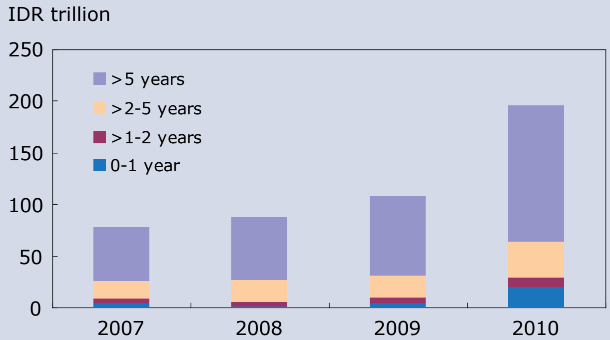
Meanwhile, the share of insurance companies, mutual funds, and pension funds' holdings of LCY

Figure 2: LCY Government Bonds Investor Profile



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

Figure 3: Foreign Holdings of LCY Government Bonds by Maturity



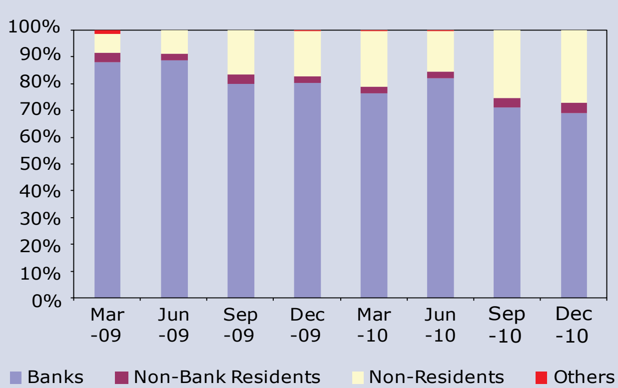
LCY = local currency.
Source: Indonesia Debt Management Office.

bonds outstanding remained flat at end-December 2010 from a year earlier.

Central Bank Bills. At end-December, banks were the major holders of SBIs, with a 69% share **(Figure 4)**. However, this was down from banks' 80% share at end-December 2009. The share of banks' holdings of SBIs reached a high of 89% in June 2009.

Foreign interest in SBIs remained strong as the share of non-residents rose significantly to 27% at end-December from only 17% in the previous year. In addition, non-bank residents' share rose to 4% at end-December from 3% a year earlier.

Figure 4: LCY Central Bank Bills Investor Profile



LCY = local currency.
Source: Bank Indonesia.

Rating Changes

On 14 October, Rating and Investment Information (R&I) affirmed Indonesia's foreign currency (FCY) issuer rating at BB+ and changed the outlook to positive from stable **(Table 5)**. 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 FCY short-term debt rating at a-3.

Moody's Investors Service (Moody's) raised Indonesia's sovereign credit rating to one notch below investment grade. On 17 January, Moody's raised Indonesia FCY and LCY debt ratings to Ba1 from Ba2. The outlook for both ratings was stable. The rating upgrade came after Moody's conducted a review in December. Moody's cited the following reasons for the upgrade: (i) economic resilience and sustained macroeconomic balance, (ii) the government's improved debt position and the central bank's adequate FCY reserves, and (iii) improved prospects for foreign direct investment inflows.

On 24 February, Fitch Ratings (Fitch) affirmed Indonesia's long-term foreign and local currency issuer default ratings at BB+ and upgraded the outlook on both ratings to positive from stable. Fitch cited Indonesia's strong economic growth as one of the factors for the upgrade.

Table 5: Selected Sovereign Ratings and Outlook for Indonesia

	Moody's	S&P	Fitch	R&I
Sovereign FCY LT Ratings	Ba1	BB	BB+	BB+
Outlook	stable	positive	positive	positive

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

Policy, Institutional, and Regulatory Developments

New Regulations on Reserve Requirements and Bank Lending

In November, new regulations on reserve requirements took effect to help contain inflation and boost economic growth. The primary reserve requirement was raised from 5.0% to 8.0% of deposits, while the secondary reserve requirement remained at 2.5%. In addition, a new regulation designed to give banks incentives for maintaining their loan-to-deposit ratio within a range of 78%–100% went into effect on 1 March 2011.

State Firms to Purchase Government Bonds in the Event of Sudden Capital Outflow

In early January 2011, the Ministry of Finance and the State Enterprises Ministry signed a memorandum of understanding requiring state-owned firms to act as standby purchasers of government bonds in the event of sudden capital outflows. Under the scheme, a bond stabilization fund will be created to help protect the economy in case of sudden capital flight. The government has appointed 13 major state companies and financial institutions to participate in the bond stabilization fund. These 13 companies comprise four banks (Bank Mandiri, Bank Rakyat Indonesia, Bank Negara Indonesia, and Bank Tabungan Negara), and nine non-banks and insurance companies (including Jaminan Kredit Indonesia and Asuransi Kredit Indonesia).

BI Implements Measures to Minimize the Risk of Capital Flight

In January, BI reintroduced a measure that limits overseas short-term borrowing by Indonesian banks to 30% of their capital. Also, BI announced that it will require Indonesian banks to increase their foreign exchange reserves deposited with BI as part of measures to absorb foreign exchange liquidity. The central bank will require banks to increase their foreign exchange reserves to 5.0% of foreign exchange deposits in March and 8.0% in June.