

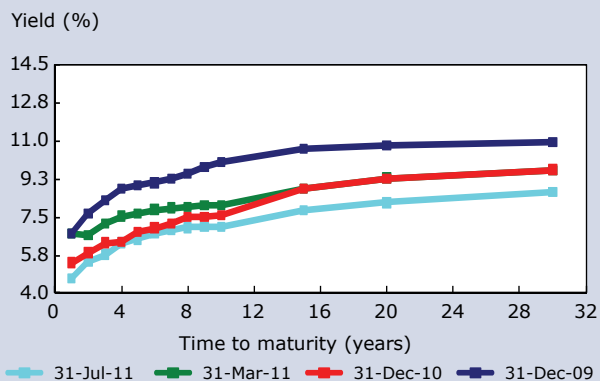
Indonesia—Update

Yield Movements

The government bond yield curve in Indonesia rose across all tenors, except for the 30-year maturity, between end-December 2010 and end-March (Figure 1). However, by end-July, bond yields in Indonesia had dropped across all tenors compared with end-December 2010 levels, which resulted in the shifting of the entire curve downward. Yields at the short-end of the curve shed between 53 basis points (bps) and 72 bps, while yields from the belly through the 10-year tenor fell between 7 bps and 57 bps. Yields at the long-end of the curve fell between 98 bps and 109 bps. The yield spread between the 2-year and 10-year maturities widened to 161 bps at end-July, compared with a spread of 135 bps at end-June, while narrowing slightly compared with a spread of 174 bps at end-December 2010.

Consumer price inflation eased for a sixth consecutive month in July to 4.6% year-on-year (y-o-y) from 5.5% in June. On a month-on-month (m-o-m) basis, consumer prices were up 0.7% as food prices rose ahead of the celebration of Ramadan. Core inflation however eased slightly to 4.55% y-o-y from 4.63% in June.

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



LCY = local currency.
Source: Bloomberg LP.

Bank Indonesia's (BI) full-year 2011 inflation target stands at between 4% and 6%.

In its meeting held on 9 August, BI's Board of Governors decided to keep its reference rate steady at 6.75%. The BI rate has been kept at this level since February. According to BI, the current rate is consistent with expectations of a robust, yet stable, environment for economic growth. In addition, BI stated that it is confident that the impact on domestic financial markets of the recent turmoil in global markets due to the US credit rating downgrade by Standard and Poor's (S&P) will be limited and can be contained through monitoring and coordination with the government.

Indonesia's economy expanded 6.5% y-o-y in 2Q11, growing at the same pace it did in 1Q11 on the back of strong exports and investment. Exports grew 17.4% y-o-y in 2Q11 compared with a 12.3% expansion in 1Q11, while investment rose 9.2% y-o-y from 7.3% growth in 1Q11. Also, household and government spending posted strong growth in 2Q11, rising 4.6% and 4.5% y-o-y, respectively. On a quarter-on-quarter (q-o-q) basis, gross domestic product (GDP) growth was reported at 2.9%, up from 1.5% in 1Q11. The government's 2011 State Budget is targeting annual GDP growth of 6.4%.

Size and Composition

The size of Indonesia's local currency (LCY) bond market expanded 2.4% y-o-y in 2Q11, rising to IDR1.0 quadrillion (US\$118 billion) at end-June (Table 1). On a q-o-q basis, the size of Indonesia's bond market fell 1.7% in 2Q11.

At end-June, outstanding LCY government bonds had fallen 1.7% y-o-y to IDR877 trillion. The negative growth in LCY bonds was due mainly to the significant drop in the stock of central bank bills known as *Sertifikat Bank Indonesia* (SBI). On the other hand, the stock of central government bonds, comprising treasury bills and bonds issued by the Ministry of Finance, posted modest growth.

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

	Amount (billion)						Growth Rate (%)										
	Mar-11		Apr-11		May-11		Jun-11		Mar-11		Apr-11		May-11		Jun-11		
	IDR	US\$	IDR	US\$	IDR	US\$	IDR	US\$	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	1,026,228	118	1,033,376	121	1,012,955	119	1,008,959	118	118	4.1	7.0	0.7	7.0	2.4	2.4	(1.7)	(0.4)
Government	905,058	104	909,111	106	885,236	104	876,979	102	102	1.3	7.2	0.4	7.2	(1.7)	(1.7)	(3.1)	(0.9)
Central Govt Bonds	674,910	78	679,040	79	687,365	80	691,033	81	81	13.8	5.3	0.6	5.3	11.2	2.4	0.5	0.5
Central Bank Bills	230,148	26	230,071	27	197,871	23	185,946	22	22	(23.3)	13.3	(0.03)	13.3	(31.4)	(19.2)	(6.0)	(6.0)
Corporate	121,170	14	124,265	15	127,719	15	131,980	15	15	31.4	5.5	2.6	5.5	41.9	8.9	3.3	3.3

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–US\$ 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.

Central Government Bonds. The stock of central government bonds stood at IDR691 trillion in 2Q11, up 11.2% y-o-y and 2.4% q-o-q. In 2Q11, issuance by the central government reached IDR40 trillion, down 7.4% from 2Q10. Treasury issuance was also down nearly 30% in 2Q11 on a q-o-q basis. LCY bond issues during the quarter consisted of treasury bills, fixed rate bonds, and *sukuk* (Islamic bonds). Two scheduled auctions for *sukuk* were postponed in 2Q11 as the government awaited for approval of the underlying assets that are to be used as a guarantee for issuing the Islamic debt instruments (see **Policy, Institutional, and Regulatory Developments** for more details).

In May, investors swapped a total of IDR50 billion of LCY government bonds with maturities due in 2011–2014 for 15-year bonds. The government regularly conducts debt switches as a strategy to reduce refinancing risk.

As of 7 July, the government had raised IDR124.6 trillion from gross bond sales in 2011, including international bond issuance. For the full-year 2011, the State Budget estimates a deficit amounting to IDR124.7 trillion, or the equivalent of 1.8% of GDP. However, the actual budget deficit for 2011 may be higher, falling in a range of 1.9% to 2.1%, as the government is planning to raise fuel subsidy quotas. The Finance Ministry is currently holding discussion with the House of Representatives to finalize the revised 2011 State Budget.

Central Bank Bills. The stock of central bank bills declined further in 2Q11. Outstanding SBI stood at IDR185.9 trillion in 2Q11, falling 31.4% y-o-y and 19.2% q-o-q. During the quarter, BI conducted a total of only three auctions (one per month) of 9-month SBI and 9-month *sharia'h* (Islamic law)-compliant SBI.

A new regulation governing SBI, effective 13 May, extended the holding period for SBI to 6 months before they can be traded in the secondary market. The measure is part of BI's strategy to minimize the effects of sudden capital flow reversals.

Corporate Bonds. Corporate bonds outstanding grew significantly in 2Q11 to IDR132 trillion, up 41.9% from 2Q10. Although growth in the corporate sector was significant, corporate bonds still comprise a small percentage of Indonesia's total LCY bond market. At end-June, corporate bonds accounted for only about 13% of total LCY bonds outstanding in Indonesia.

The top 50 corporate bond issuers in Indonesia accounted for about 92% of total corporate bonds outstanding at end-June (**Table 2**). State-power firm PLN remained the top LCY issuer in Indonesia with outstanding bonds valued at IDR15.1 trillion. Bank Pan Indonesia took the second spot with bonds valued at IDR6.9 trillion. Telecommunications firm Indosat was the third largest issuer with bonds valued at IDR6.4 trillion.

The list of the top 50 corporate bond issuers was dominated by banking and financial institutions, which accounted for 60% of all companies on the list. Eleven issuers were state-owned firms, with four of them among the ten largest.

LCY corporate bond issuance expanded significantly in 2Q11, albeit from a relatively small base. Corporate issuance rose 104.9% y-o-y to IDR15.0 trillion in 2Q11, compared with IDR7.3 trillion in 2Q10. Corporate bond issuers in 2Q11 were mainly firms from the banking and financial sectors. Corporate bonds issued in 2Q11 included conventional bonds, *sukuk*, and subordinated bonds. Notable issues during 2Q11 are shown in **Table 3**.

Financing company Federal International Finance raised IDR3 trillion in April to fund its working capital requirements. The bonds comprised the following tranches:

- (i) 370-day bonds worth IDR621.5 billion, coupon of 7.8%;
- (ii) 2-year bonds worth IDR480 billion, coupon of 8.8%; and
- (iii) 3-year bonds worth IDR1.9 trillion, coupon of 9.6%.

Automotive financing company Adira Dinamika Multifinance issued IDR2.5 trillion worth of bonds in May. Proceeds from the bond sale will be used to fund its automotive financing business. The bonds comprised the following tranches:

- (i) 1-year bonds worth IDR612 billion, coupon of 8.0%;
- (ii) 2-year bonds worth IDR160 billion, coupon of 8.8%;
- (iii) 3-year bonds worth IDR567 billion, coupon of 9.6%; and
- (iv) 4-year bonds worth IDR1.2 trillion, coupon of 10.0%.

Bank Permata issued IDR1.75 trillion of subordinated bonds in June. The subdebt issue carried a coupon of 11.0% and a maturity of 7 years. The deal was an upsize from an original plan of IDR1 trillion. Proceeds from the issue will be used to fund the bank's Lower Tier 2 capital requirements.

In May, Bank Internasional Indonesia issued IDR1.5 trillion of subordinated bonds. The subdebt bonds carried a coupon of 10.75% and a maturity of 7 years. The proceeds from this issue will be used to help meet the bank's 20% loan expansion target for 2011.

Home mortgage provider Bank Tabungan Negara sold IDR1.3 trillion of 10-year bonds in June. The bonds carried a coupon of 9.5%. Proceeds from the bond sale will be used to support the expansion of the bank's housing loan program.

Also in June, BCA Finance raised a total of IDR1.1 trillion from a five-tranche bond sale. The bonds comprised the following tranches:

- (i) 1-year bonds worth IDR392 billion, coupon of 7.9%;
- (ii) 1-year bonds worth IDR178 billion, coupon of 8.1%;
- (iii) 2-year bonds worth IDR230 billion, coupon of 8.7%;
- (iv) 3-year bonds worth IDR200 billion, coupon of 8.9%; and
- (v) 4-year bonds worth IDR100 billion, coupon of 9.0%.

Table 2: Top 50 Issuers of LCY Corporate Bonds in Indonesia (as of June 2011)

Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed Company	Type of Industry
	LCY Bonds (IDR billion)	LCY Bonds (US\$ billion)				
1. PLN (Persero)	15,100	1.76	Yes	No	No	Energy
2. Bank Pan Indonesia Tbk	6,900	0.80	No	Yes	Yes	Bank
3. Indosat Tbk	6,350	0.74	No	Yes	Yes	Telecommunication
4. Bank Tabungan Negara (Persero)	5,450	0.64	Yes	No	Yes	Bank
5. Indonesia Eximbank	5,341	0.62	Yes	No	No	Bank
6. Jasa Marga (Persero) Tbk	5,000	0.58	Yes	No	Yes	Toll Road, Airport, Harbor, and Allied Products
7. Adira Dinamika Multifinance Tbk	4,903	0.57	No	Yes	Yes	Financial Institution
8. Federal International Finance	4,742	0.55	No	Yes	No	Financial Institution
9. Bank Danamon Indonesia Tbk	4,050	0.47	No	Yes	Yes	Bank
10. Astra Sedaya Finance	3,660	0.43	No	Yes	No	Financial Institution
11. Bank Tabungan Pensiunan Nasional Tbk	3,650	0.43	No	Yes	Yes	Bank
12. Indofood Sukses Makmur Tbk	3,574	0.42	No	Yes	Yes	Food and Beverages
13. Bank Mandiri (Persero) Tbk	3,500	0.41	Yes	No	Yes	Bank
14. Perum Pegadaian	3,000	0.35	Yes	No	No	Financial Institution
15. Telekomunikasi Indonesia Tbk	3,000	0.35	Yes	No	Yes	Telecommunication
16. Bank CIMB Niaga	2,980	0.35	No	Yes	Yes	Bank
17. Bank Jabar Banten	2,750	0.32	No	Yes	Yes	Bank
18. Bank Permata Tbk	2,250	0.26	No	Yes	Yes	Bank
19. Bank Rakyat Indonesia (Persero) Tbk	2,000	0.23	Yes	No	Yes	Bank
20. Oto Multiartha	2,000	0.23	No	Yes	No	Financial Institution
21. Wahana Ottomitra Multiartha Tbk	1,990	0.23	No	Yes	Yes	Financial Institution
22. Summit Oto Finance	1,865	0.22	No	Yes	No	Financial Institution
23. Bank Internasional Indonesia Tbk	1,500	0.17	No	Yes	Yes	Bank
24. Bank DKI	1,500	0.17	No	Yes	No	Bank
25. Excelcomindo Pratama Tbk	1,500	0.17	No	Yes	Yes	Telecommunication
26. Medco Energi Internasional Tbk	1,500	0.17	No	Yes	Yes	Crude Petroleum and Natural Gas Production
27. BCA Finance	1,489	0.17	No	Yes	No	Financial Institution
28. Bank OCBC NISP Tbk	1,480	0.17	No	Yes	Yes	Bank
29. Bentoel International Investama Tbk	1,350	0.16	No	Yes	Yes	Tobacco Manufacturers
30. Berlian Laju Tanker Tbk	1,340	0.16	No	Yes	Yes	Transportation
31. Danareksa (Persero)	1,250	0.15	Yes	No	No	Others Finance
32. Indomobil Finance Indonesia Tbk	1,204	0.14	No	Yes	No	Financial Institution
33. Sarana Multigriya Finansial (Persero)	1,190	0.14	Yes	No	No	Financial Institution
34. Bank Jabar Banten	1,000	0.12	No	Yes	Yes	Bank
35. Bank Mega Tbk	1,000	0.12	No	Yes	Yes	Bank
36. Bank Negara Indonesia (Persero) Tbk	1,000	0.12	Yes	No	Yes	Bank
37. Pupuk Kalimantan Timur	791	0.09	No	Yes	No	Chemicals
38. Salim Ivomas Pratama	730	0.09	No	Yes	No	Plantation
39. BW Plantation	700	0.08	No	Yes	Yes	Plantation
40. Bank Pembangunan Daerah Sumatera Barat	681	0.08	No	Yes	No	Bank
41. Lontar Papyrus Pulp & Paper Industry	675	0.08	No	Yes	No	Pulp and Paper
42. Bakrie Telecom Tbk	650	0.08	No	Yes	Yes	Telecommunication
43. Mobile-8 Telecom Tbk	604	0.07	No	Yes	Yes	Telecommunication
44. Surya Arya Nusantara Finance Tbk	600	0.07	No	Yes	No	Financial Institution
45. Mandiri Tunas Finance Tbk	600	0.07	No	Yes	No	Financial Institution
46. Bumi Serpong Damai Tbk	600	0.07	No	Yes	Yes	Property and Real Estate
47. Arpeni Pratama Ocean Line Tbk	600	0.07	No	Yes	Yes	Transportation

continued on next page

Table 2 continued

Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed Company	Type of Industry
	LCY Bonds (IDR billion)	LCY Bonds (US\$ billion)				
48. Apexindo Pratama Duta Tbk	600	0.07	No	Yes	No	Crude Petroleum and Natural Gas Production
49. Surya Citra Televisi	575	0.07	No	Yes	No	Advertising, Printing, and Media
50. Matahari Putra Prima Tbk	528	0.06	No	Yes	Yes	Retail Trade
Total Top 50 Corporate Issuers	121,292	14.14				
Total Corporate Bonds Outstanding	131,980	15.38				
Total Top 50 LCY Corporate Issuers	91.9%	91.9%				
Total LCY Corporate Bonds	114,817	12.76				
Top 50 as a % of Total LCY Corporate Bonds	94.1%	94.1%				

LCY = local currency.
Source: Indonesia Stock Exchange.

Table 3: Notable Corporate Issuance in 2Q11

Corporate Issuers	Amount Issued (IDR billion)
Federal International Finance	3,000
Adira Dinamika Multifinance Tbk	2,500
Bank Permata Tbk	1,750
Bank Internasional Indonesia Tbk	1,500
Bank Tabungan Negara (Persero)	1,300
BCA Finance	1,100
Indomobil Finance Indonesia Tbk	1,000
Others	2,813
Total	14,963

Source: Indonesia Stock Exchange.

Automotive financing firm Indomobil Finance Indonesia issued a total of IDR1.0 trillion of bonds in June. The bonds comprised the following tranches:

- (i) 1-year bonds worth IDR75 billion, coupon of 8.0%;
- (ii) 3-year bonds worth IDR400 billion, coupon of 10.15%; and
- (iii) 4-year bonds worth IDR525 billion, coupon of 10.65%.

Foreign Currency Bonds

In May, the government issued US\$2.5 billion worth of 10-year bonds. The US\$-denominated bonds were issued with a coupon of 4.875% to yield 5.1%. The bond sale was oversubscribed by 2.76 times. The bonds were allocated to asset managers (70%), banks (24%), insurance and

pension funds (3%), and private banks (3%). In terms of distribution, 29% were sold to investors in Asia, 22% in Europe, and 49% in the United States (US).

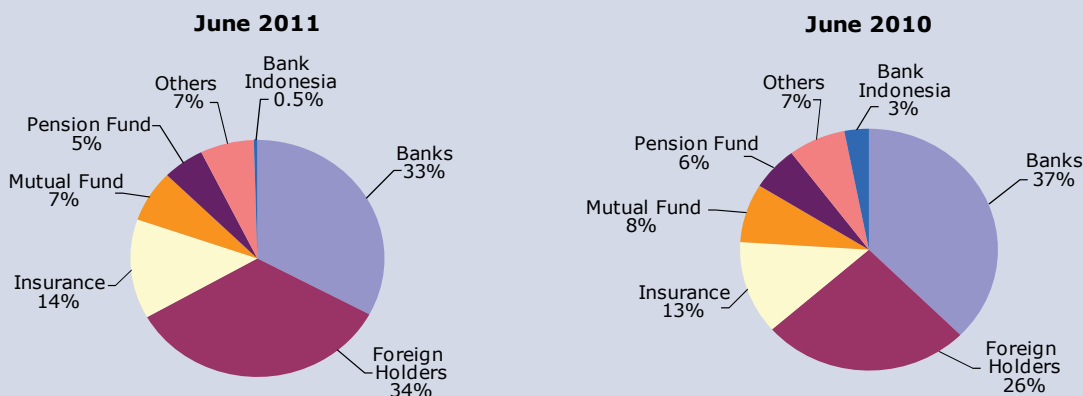
Investor Profile

Central Government Bonds. Banking institutions, which were the largest holder of LCY government bonds in Indonesia at end-June 2010, ranked second after foreign holders at end-June 2011. Banks' share of central government bonds fell to 33% from 37% over this period (**Figure 2**). In 2002, banks held as much as 82% of total LCY government bonds.

Foreign investors as a group became the largest holder of Indonesian LCY bonds in 2Q11, with their share rising to 34% at end-June compared with 26% in June 2010. Foreign holders include non-resident private banks, fund and asset management firms, securities firms, insurance companies, and pension funds. The holdings of foreign investors have steadily grown from only IDR2 trillion (0.5%) in 2002 to IDR235 trillion (34%) in 2011 (**Figure 3**).

Of the bonds held by foreigners at end-June, 63% carried maturities of more than 5 years (**Figure 4**). However, this reflected a drop from 67% in 2010 and 71% in 2009. Meanwhile, the share of bonds held by foreign investors in short-dated tenors (bonds with maturities of less than 1 year) jumped

Figure 2: LCY Government Bonds Investor Profile



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

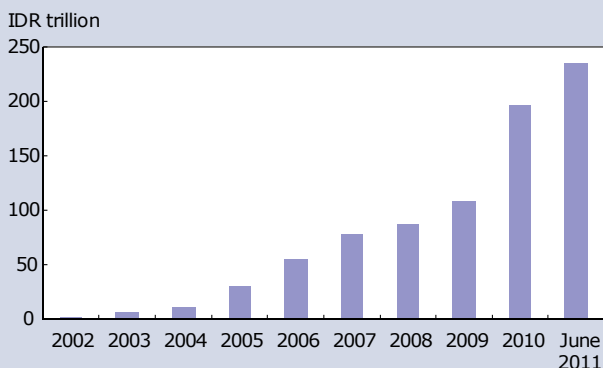
to 12% in June 2011, compared with only 10% in 2010 and 5% in 2009. Some investors may have shifted their investments to short-dated treasury instruments as the central bank issued regulations concerning SBI (see **Policy, Institutional, and Regulatory Developments** for more details).

The share of insurance companies grew marginally to 14% at end-June from 13% at end-June 2010. The share of mutual funds and pension funds fell slightly to 7% and 5%, respectively, compared with their June 2010 levels of 8% and 6%.

Central Bank Bills. SBI remain an attractive investment instrument among domestic lenders as well as foreign investors because of their high yields and short duration. As of end-June, banks remained the largest investor in SBI with a 62% share of the total (**Figure 5**). This, however, was a steep decline from the banks' share of 82% in June 2010. The share of bank holdings of SBI reached a high of 89% in June 2009.

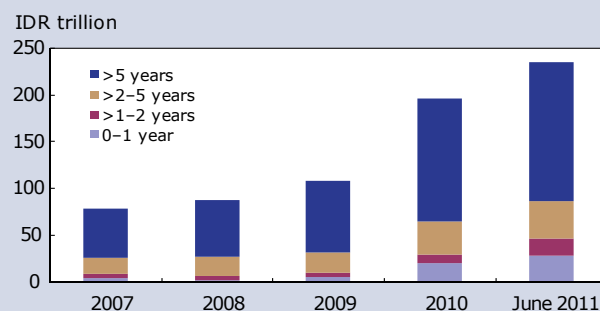
Foreign investors' SBI holdings continued to grow in 2011 as the share of non-residents more

Figure 3: Foreign Holdings of LCY Government Bonds

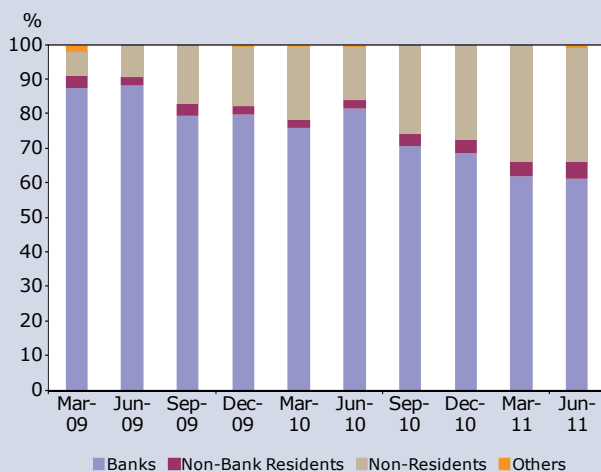


LCY = local currency.
Source: Indonesia Debt Management Office.

Figure 4: Foreign Holdings of LCY Government Bonds by Maturity



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

Figure 5: LCY Central Bank Bills Investor Profile

LCY = local currency.
Source: Bank Indonesia.

than doubled to 33% at end-June from 16% in June 2010. Also, non-bank residents' share increased to 5% at end-June compared with 3% in June 2010.

Rating Changes

On 8 April, S&P raised Indonesia's long-term foreign currency sovereign ratings to BB+ from BB, and affirmed its long-term LCY rating at BB+ (**Table 4**). The outlook for both ratings is positive, indicating a potential upgrade in the near future. S&P cited improvements in the government's balance sheet and external liquidity as the main factors for the upgrade.

Policy, Institutional, and Regulatory Developments

Finance Ministry Issues 3-Month Treasury Bills

On 22 March, the Finance Ministry issued treasury bills with a 3-month tenor for the first time ever. The issuance of 3-month bills was initiated as part of efforts to deepen the market for short-term financial instruments following a BI announcement

Table 4: 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.

in February that it would no longer issue SBI with maturities of less than 9 months.

IBPA Sets Daily Fair Market Price for *Mudharaba Sukuk*

In April, the Indonesia Bond Pricing Agency (IBPA) commenced setting daily fair market prices for *mudharaba* (risk and profit sharing) *sukuk* to serve as a benchmark for investors in determining price valuation for any *sukuk* issued by private companies and listed on the Indonesia Stock Exchange. Prior to this, IBPA provided fair market price for government bonds, *sharia'h*-compliant government bonds, conventional corporate bonds, and *ijarah* (lease and buy back) corporate *sukuk*.

Holding Period for SBI of 6 Months

Effective 13 May, the holding period for SBI—the amount of time before they can be sold by investors in the secondary market—was extended to 6 months. This policy aims to reduce the potential for sudden reversals of foreign short-term funds.

Indonesia's Parliament Approves IDR30.2 Trillion of Underlying Assets for *Sukuk*

In June, the House of Representatives approved the government's proposal to use state properties valued at IDR30.2 trillion as underlying assets for government-issued *sukuk*. The state properties that will be used to back the *sukuk* consist of buildings and land owned by ministries and other government institutions. Two scheduled auctions of IDR-denominated *sukuk*—on 31 May and 14 June—were postponed as the government waited for approval of the underlying assets.

Fitch Changes Bond Rating Process

Fitch Ratings announced that it has changed the process for rating proposed bond issuances in Indonesia’s domestic bond market, effective 7 July. According to Fitch, it will no longer assign initial expected ratings and subsequent final national ratings. It will now provide only one rating for a proposed bond issue. For bond issuers involved in both domestic and international markets, any international rating already assigned will not be affected by this new practice.

Finance Ministry Issues Islamic Treasury Bills

On 2 August, the Finance Ministry issued its maiden Islamic treasury bills, as part of efforts to diversify and increase the liquidity of Islamic bond instruments. The first issue of Islamic treasury bills carried a maturity of 6 months.