Indonesia—Update

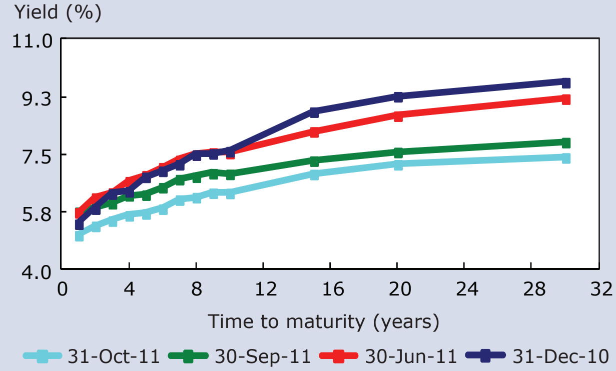
Yield Movements

The government bond yield curve in Indonesia continued to flatten between end-June and end-September, as bond yields fell across all tenors except at the very short-end of the curve **(Figure 1)**. By end-October, bond yields had fallen across all tenors compared with end-September, resulting in the shifting of the entire government bond yield curve downward. Yields at the very short-end fell the most, shedding 71 basis points (bps), while yields from the 2-year maturity through the 10-year maturity fell 52 bps–65 bps. Yields at the long-end of the curve fell 38 bps–46 bps. The spread between the 2- and 10-year maturities narrowed to 100 bps at end-October, compared with 135 bps at end-June and 102 bps at end-September. The overall bullish trend in Indonesia's government bond market can be viewed as a positive response to measures taken by Indonesian authorities.

Consumer price inflation slowed to 4.4% year-on-year (y-o-y) in October from 4.6% in September on account of lower prices for most food items. On a month-on-month (m-o-m) basis, consumer prices fell 0.1% in October—after rising 0.3% in the previous month—driven by lower prices of food, jewelry, and transportation. Core inflation, which excludes volatile food and oil prices, eased to 4.4% y-o-y from 4.9% in September.

On 10 November Bank Indonesia's (BI) Board of Governors decided to lower its benchmark interest rate by 50 bps to 6.00%. This was the second consecutive rate cut following a 25 bps cut in October. The latest cut brings the BI rate to a new record-low level. According to BI, the move was in line both with decreasing inflationary pressures and BI's efforts to narrow the interest rate term structure. The rate cut was also intended to help minimize the impact on the domestic economy of worsening global economic prospects.

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



LCY = local currency.
Source: Bloomberg LP.

Indonesia's economy expanded 6.5% y-o-y in 3Q11, growing at the same pace as in 2Q11. In 3Q11, domestic consumption remained as the main driver of growth and continued to support the economy. In addition, exports and investments continued to post strong annual growth of 18.5% and 7.14% y-o-y, respectively. On a quarter-on-quarter (q-o-q) basis, gross domestic product (GDP) growth was reported at 3.5% in 3Q11, up from 2.9% in 2Q11.

Size and Composition

The size of Indonesia's local currency (LCY) bond market shrank on both a y-o-y and q-o-q basis in 3Q11 **(Table 1)**. Total bonds outstanding stood at IDR982.4 trillion (US$110 billion) at end-3Q11, after rising to IDR1.0 quadrillion in 2Q11.

As of end-September, outstanding LCY government bonds had fallen 5.6% y-o-y to IDR847.8 trillion. Negative growth in LCY bonds in 3Q11 was mainly attributed to the significant drop in the stock of central bank bills known as *Sertifikat* Bank Indonesia (SBI). The stock of central government bonds (treasury bills and bonds issued by the

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

	Amount (billion)								Growth Rate (%)						
	Jun-11		Jul-11		Aug-11		Sep-11		Jun-11		Jul-11	Aug-11	Sep-11		
	IDR	US$	IDR	US$	IDR	US$	IDR	US$	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	1,012,001	118	1,017,591	120	1,012,034	119	982,415	110	2.7	(1.7)	0.6	(0.5)	(1.8)	(2.9)	(2.9)
Government	880,021	103	883,783	104	877,026	103	847,778	95	(1.4)	(3.1)	0.4	(0.8)	(5.6)	(3.7)	(3.3)
Central Govt. Bonds	691,033	81	700,183	82	703,979	82	696,561	78	11.2	2.4	1.3	0.5	8.0	0.8	(1.1)
Central Bank Bills	188,988	22	183,600	22	173,047	20	151,217	17	(30.3)	(19.1)	(2.9)	(5.7)	(40.1)	(20.0)	(12.6)
Corporate	131,980	15	133,808	16	135,008	16	134,637	15	41.9	8.9	1.4	0.9	30.5	2.0	(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–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.

Ministry of Finance) posted modest growth on a y-o-y basis.

Central Government Bonds. The stock of central government bonds rose 8.0% y-o-y to IDR696.6 trillion at end-3Q11. On a q-o-q basis, the growth in central government bonds was negligible.

Issuance by the central government in 3Q11 totaled IDR33.2 trillion, representing a 3.3% increase over 3Q10. However, treasury issuance fell 16.2% on a q-o-q basis. LCY bond issues during the quarter consisted of treasury bills, fixed-rate treasury bonds, and *sukuk* (Islamic) treasury bills and treasury bonds. The government issued its first *sukuk* treasury bills during an auction on 2 August as part of efforts to diversify Islamic debt instruments and increase their liquidity.

As of 28 September, the government's total gross bond sales (including international bond issuance) in 2011 had reached IDR155.2 trillion, and the government's net financing (defined as gross issuance less redemption and buyback) had reached IDR83.2 trillion. The 2011 revised state budget included an estimated deficit of IDR150.8 trillion, equivalent to 2.1% of GDP.

In September the Finance Ministry conducted a series of bond buybacks in the secondary market as part of government measures to stabilize the bond market. A total of IDR3.13 trillion in bond buybacks were recorded between 14 September and 23 September, surpassing the Finance Ministry's planned amount of IDR3.07 trillion in bond buybacks for the full-year 2011.

Central Bank Bills. The stock of central bank bills continued to decline sharply in 3Q11. Outstanding SBI stood at IDR151.2 trillion at end-September, representing declines of 40.1% y-o-y and 20.0% q-o-q. During the quarter, BI conducted only three auctions (one per month) of 9-month SBI and 9-month *shari'ah* (Islamic law)-compliant SBI.

Corporate Bonds. Corporate bonds continued to post double-digit growth in 3Q11 on a y-o-y basis, rising 30.5% to IDR134.6 trillion. On a q-o-q basis, however, growth in corporate bonds was only a marginal 2.0%.

Corporate bonds comprise a small percentage of Indonesia's LCY bond market, accounting for only 14% of total LCY bonds outstanding at end-September. Furthermore, the top 30 corporate bond issuers in Indonesia account for almost 80% of total corporate bonds outstanding **(Table 2)**. The top three issuers in 3Q11 remained the same as in 2Q11: (i) state-power firm PLN was the top issuer with outstanding LCY bonds valued at IDR15.1 trillion, (ii) Bank Pan Indonesia was next with outstanding bonds of IDR6.9 trillion, and (iii) telecommunications firm Indosat was the third-largest issuer with outstanding bonds of IDR6.4 trillion.

Of the top 30 LCY corporate bond issuers at end-September, 70% of the firms were from the banking and financial sectors. The list of top 30 issuers was also dominated by privately owned firms. About two-thirds of the top 30 issuers have shares listed on the Indonesia Stock Exchange, indicating that these firms are tapping both the equity and bond markets as funding sources.

In 3Q11 LCY corporate bond issuance was IDR5.8 trillion, which was down on both a y-o-y and q-o-q basis. Due to uncertain market conditions resulting from the debt crisis in the eurozone, a number of firms decided to postpone planned bond issuances scheduled for the second half of the year.

New corporate bond issues in 3Q11 were dominated by firms from the banking and financial sectors. Furthermore, corporate bond issues in 3Q11 were all conventional bonds except for one subordinated bond issue. **Table 3** highlights notable corporate bond issues in 3Q11.

Automotive financing firm Toyota Astra Financial Services issued IDR1.2 trillion of bonds in three tranches in July. The proceeds from the bond sale will be used to bolster the company's working capital. The bonds comprised the following tranches:

- 370-day bonds worth IDR595 billion, coupon of 7.85%;
- 2-year bonds worth IDR121 billion, coupon of 9.0%; and
- 3-year bonds worth IDR484 billion, coupon of 9.5%.

Property firm Agung Podomoro Land issued IDR1.2 trillion worth of bonds in August. Proceeds from the bond sale will be used to fund its automotive financing business. The bonds consisted of the following series:

- 3-year bonds worth IDR325 billion, coupon of 10.0%; and
- 5-year bonds worth IDR875 billion, coupon of 11.0%.

Bank Sumut issued a total of IDR1.0 trillion of conventional and subordinated bonds in July. The bonds consisted of the following series:

- 5-year bonds worth IDR600 billion, coupon of 10.13%; and
- 7-year subordinated bonds worth IDR400 billion, coupon of 11.35%.

Automotive leasing company Serasi Autoraya raised a total of IDR900 billion from a three-tranche bond sale. The bonds consisted of the following series:

- 1-year bonds worth IDR245 billion, coupon of 7.9%;
- 2-year bonds worth IDR185 billion, coupon of 9.1%; and
- 4-year bonds worth IDR470 billion, coupon of 10.2%.

Investor Profile

Central Government Bonds. At end-September, banks were the top holder of LCY government bonds in Indonesia **(Figure 2)**, although their share of 34.3% was down from a 36.3% share in September 2010.

Table 2: Top 30 Issuers of LCY Corporate Bonds in Indonesia (as of September 2011)

Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed Company	Type of Industry
	LCY Bonds (IDR billion)	LCY Bonds (US$ billion)				
1. PLN	15,100	1.69	Yes	No	No	Energy
2. Bank Pan Indonesia	6,900	0.77	No	Yes	Yes	Banking
3. Indosat	6,350	0.71	No	Yes	Yes	Telecommunications
4. Bank Tabungan Negara	5,450	0.61	Yes	No	Yes	Banking
5. Jasa Marga	5,000	0.56	Yes	No	Yes	Toll Roads, Airports, and Harbors
6. Adira Dinamika Multifinance	4,903	0.55	No	Yes	Yes	Finance
7. Federal International Finance	4,742	0.53	No	Yes	No	Finance
8. Bank Danamon Indonesia	4,050	0.45	No	Yes	Yes	Banking
9. Indonesia Eximbank	3,941	0.44	Yes	No	No	Banking
10. Bank Jabar Banten	3,750	0.42	No	Yes	Yes	Banking
11. Bank Tabungan Pensiunan Nasional	3,650	0.41	No	Yes	Yes	Banking
12. Indofood Sukses Makmur	3,574	0.40	No	Yes	Yes	Food and Beverages
13. Bank Mandiri	3,500	0.39	Yes	No	Yes	Banking
14. Astra Sedaya Finance	3,480	0.39	No	Yes	No	Finance
15. Telekomunikasi Indonesia	3,000	0.34	Yes	No	Yes	Telecommunications
16. Bank CIMB Niaga	2,980	0.33	No	Yes	Yes	Banking
14. Perum Pegadaian	2,664	0.30	Yes	No	No	Finance
18. Bank Permata	2,250	0.25	No	Yes	Yes	Banking
19. Oto Multiartha	2,000	0.22	No	Yes	No	Finance
20. Bank Rakyat Indonesia	2,000	0.22	Yes	No	Yes	Banking
21. Wahana Ottomitra Multiartha	1,990	0.22	No	Yes	Yes	Finance
22. Summit Oto Finance	1,865	0.21	No	Yes	No	Finance
23. Medco Energi Internasional	1,500	0.17	No	Yes	Yes	Petroleum and Natural Gas
24. Excelcomindo Pratama	1,500	0.17	No	Yes	Yes	Telecommunications
25. Bank DKI	1,500	0.17	No	Yes	No	Banking
26. Bank Internasional Indonesia	1,500	0.17	No	Yes	Yes	Banking
27. BCA Finance	1,489	0.17	No	Yes	No	Finance
28. Bank OCBC NISP	1,480	0.17	No	Yes	Yes	Banking
29. Bentoel International Investama	1,350	0.15	No	Yes	Yes	Tobacco
30. Berlian Laju Tanker	1,340	0.15	No	Yes	Yes	Transportation
Total Top 30 LCY Corporate Issuers	**104,797**	**11.71**				
Total LCY Corporate Bonds	**134,637**	**15.04**				
Top 30 as % of Total LCY Corporate Bonds	**77.8%**	**77.8%**				

LCY = local currency.
Source: Indonesia Stock Exchange.

The share of LCY government bonds held by foreign investors rose from 28.3% at end-September 2010 to 31.3% at end-September 2011. However, foreign investors' share actually declined from 34.0% at end-June. Beginning in early September, foreign holdings of LCY bonds declined on the back of fears that global financial conditions would worsen due to the unresolved eurozone debt crisis. A sell-off in LCY government bonds by offshore investors resulted in a sharp drop in their holdings to IDR218.1 trillion at end-September from a high of IDR251.2 trillion on 9 September **(Figure 3)**. Since the BI rate cut on 11 October, however, foreign holdings of LCY government bonds have recovered somewhat.

Nearly two-thirds of all LCY government bonds held by foreigners are in long-dated tenors (5 years or more) **(Figure 4)**. The share of long-dated tenors among foreign-held bonds has declined slightly from about 67% at end-2010 and 71% at end-2009. Offshore holdings of short-dated tenors (bonds with maturities of less than 1 year) dipped to 7.7% at end-September, compared with 10.2% at end-2010.

Table 3: Notable Corporate Issuance in 3Q11

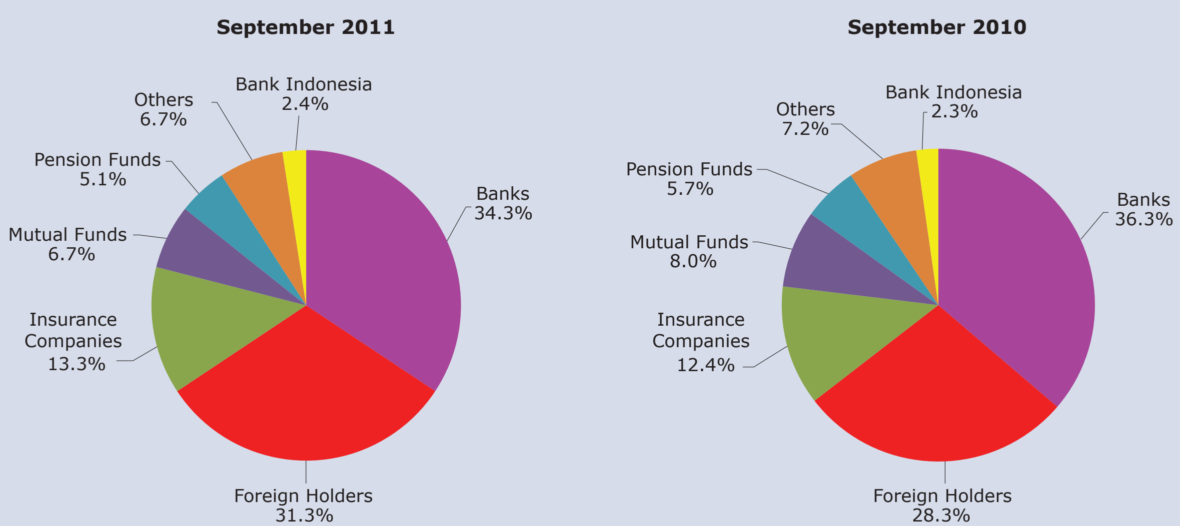
Corporate Issuers	Amount Issued (IDR billion)
Toyota Astra Financial Services	1,200
Agung Podomoro Land	1,200
Bank Sumut	1,000
Serasi Autoraya	900
Others	1,520
Total	**5,820**

Source: Indonesia Stock Exchange.

BI's share of government debt rose marginally to 2.4% at end-September compared with the same period a year earlier. However, BI's holdings of LCY bonds rose significantly, especially during the latter part of the month, to reach IDR17.0 trillion. This represented a quadrupling of BI's holdings of LCY bonds in the month of September from end-August due to intervention in the foreign exchange market as BI bought government bonds to counter the sharp depreciation of the Indonesian rupiah against the dollar. The central bank has said that it will continue to intervene until the foreign exchange market stabilizes.

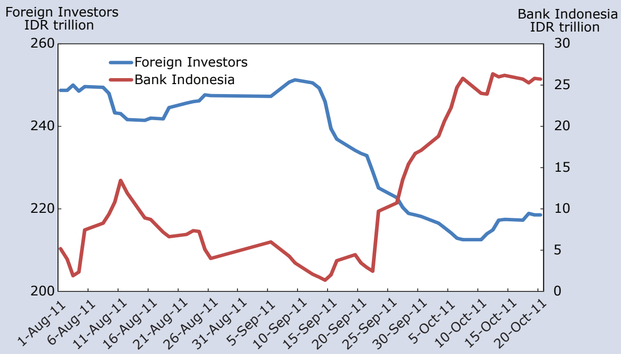
The holdings of LCY government debt by insurance companies was steady at 13.0% at end-September compared with the same month a year earlier. Meanwhile, the shares held by mutual funds and pension funds fell slightly on a y-o-y basis to about 7% and 5%, respectively.

Figure 2: LCY Government Bonds Investor Profile



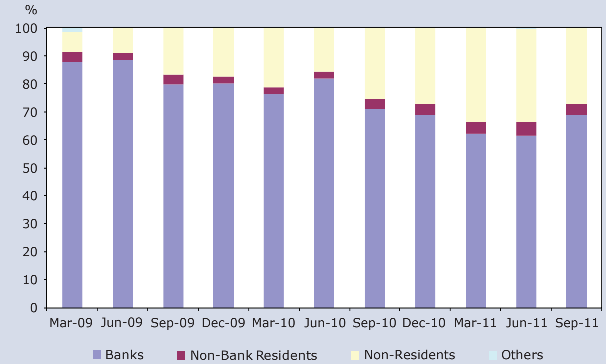
LCY = local currency.
Source: Indonesia Debt Management Office.

Figure 3: LCY Government Bond Holdings of Foreign Investors and Bank Indonesia, August–October 2011



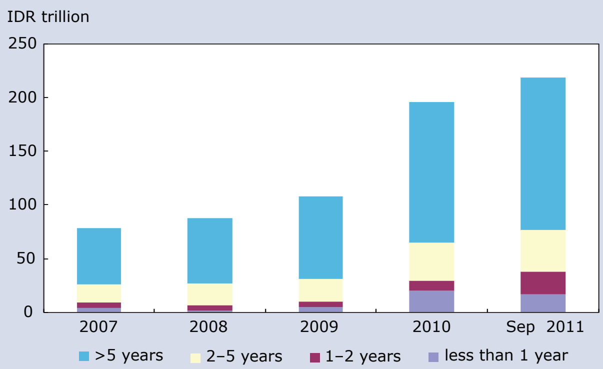
LCY = local currency
Source: Indonesia Debt Management Office.

Figure 5: LCY Central Bank Bills Investor Profile, March 2009–September 2011



LCY = local currency.
Source: Bank Indonesia.

Figure 4: Foreign Holdings of LCY Government Bonds by Maturity, 2007–2011



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

Central Bank Bills. At end-September, banks were still the largest investor in SBI with a share of about 70%, which was up from 62% at end-2Q11 and nearly identical to end-3Q10 **(Figure 5)**. The share of banks' holdings of SBI reached a high of 89% in June 2009.

Foreign investors trimmed their holdings of SBI to a share of 27.4% at end-September from 33.1% at end-June. The foreign share of SBI government debt was still higher than the 25.7% share at end-September 2010. The share of foreign holdings reached a high of 38.9% at end-May before steadily dropping to its current level. The BI regulation that came into effect in May and extended the SBI minimum holding period to 6 months may have led foreign investors to shift to other short-dated instruments such as treasury bills.

Rating Changes

On 24 August, the Japan Credit Rating Agency (JCR) affirmed Indonesia's long-term foreign currency (FCY) senior debt rating at BBB– and long-term LCY senior debt rating at BBB **(Table 4)**. The outlook for both ratings was stable. According to JCR, its ratings reflect Indonesia's sustainable economic growth outlook, which is underpinned by solid domestic demand, a reduced public debt burden, and resilience to external shocks.

Table 4: Selected Sovereign Ratings and Outlook for Indonesia

	Moody's	S&P	Fitch	R&I	JCR
Sovereign FCY LT Ratings	Ba1	BB+	BB+	BB+	BB–
Outlook	Stable	Positive	Positive	Positive	Stable

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

On 14 November, Ratings and Investment Information (R&I) affirmed Indonesia's foreign FCY sovereign ratings at BB+ with positive outlook. R&I also affirmed its FCY short-term debt rating for Indonesia at a–3. According to R&I, Indonesia's economy is becoming more resilient to the deteriorating external environment. R&I also stated that the rating could be upgraded if Indonesia can maintain macroeconomic stability in the face of the global economic and financial instability.

Policy, Institutional, and Regulatory Developments

BI Issues New Regulations on Export Proceeds and Foreign Debt Withdrawals

On 30 September BI issued new regulations governing export proceeds and foreign debt withdrawals. Under the new policies exporters will be required to transfer their proceeds from offshore banks into domestic banks within a period of 3 months after the date included on the Export Declaration Form. This policy will become effective on 2 January 2012. During the transition period exporters will be given up to 6 months from the date on the Export Declaration Form to comply with the new measure.

Another new regulation issued by BI requires debtors to conduct their foreign borrowing through domestic banks. The new regulations apply to borrowing in cash, non-revolving loan agreements, and debt securities.

According to BI, the main objective of these new policies is to strengthen macroeconomic stability, particularly exchange rate stability. BI governor Darmin Nasution said that the policies will improve the sustainability of foreign exchange flows into the domestic market by reducing dependence on short-term funding.

Indonesia's First Project-Based *Sukuk* Auction Fails

The Finance Ministry did not accept offers for its planned issue of project-based *sukuk* on 11 October as the Islamic bonds failed to attract a high number of investors. Investors who bid also sought higher yields for the two *sukuk* series (6-years and 21-years). The bonds would have been Indonesia's maiden issue of project-based *sukuk* and were to be backed by over 1,000 infrastructure projects such as roads and railways.

Indonesia Raises IDR11 trillion from its Eighth Series of Retail Bonds

The government raised IDR11 trillion from the sale of its eighth series of retail bonds (ORI008) issued on 26 October. The initial target set by the government was IDR10 trillion, but the government increased the size with final bids reaching IDR12.3 trillion. The retail bonds carried a coupon rate of 7.3% and a maturity of 3 years.

Indonesia Passes Bill to Create Financial Services Supervisory Authority

On 28 October Indonesia's House of Representatives passed a bill that will pave the way for the creation of a new financial superbody to supervise the country's financial sector by early 2013. The Financial Services Supervisory Authority (OJK) will assume Bank Indonesia's current supervisory role on commercial banks. OJK will also oversee capital markets and non-banking institutions that are currently monitored by the Capital Market and Financial Institution Supervisory Board (Bapepam LK).

Indonesia Raises US$1 Billion from Global *Sukuk* Sale

On 14 November, the Indonesian government successfully raised US$1 billion from the sale of global *sukuk*. The sale was Indonesia's second issue of global *sukuk* following an initial sale of US$650 million in April 2009. The most recent *sukuk* carried a maturity of 7-years and was priced to yield 4.0%. (The *sukuk* issued in April 2009 carried a maturity of 5-years and a coupon of 8.8%.) The global *sukuk* generated as much as US$6.5 billion in demand from about 250 investors.