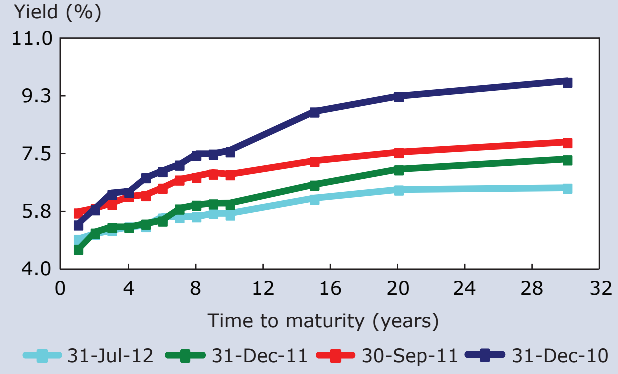
Indonesia—Update

Yield Movements

The local currency (LCY) government bond yield curve in Indonesia continued to flatten between end-December 2011 and end-July 2012, with yields at the longer-end of the curve falling more than at the shorter-end **(Figure 1)**. Indonesian government bond yields fell amid fears that Europe's debt crisis would dampen economic growth. Yields fell across all tenors with the exception of the 1- and 6-year maturities, which rose 30 basis points (bps) and 9 bps, respectively. Yields fell between 4 bps and 85 bps from the 2-year maturity through the end of the curve. Yields at the longer-end of the curve (15-, 20-, and 30-years) fell between 43 bps and 85 bps. As a result, the yield spread between the 2- and 10-year maturities narrowed to 59 bps at end-July from 86 bps at end-December.

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



LCY = local currency.
Source: Bloomberg LP.

Consumer price inflation accelerated slightly in July to 4.56% year-on-year (y-o-y) from 4.53% in June on higher food prices. This, however, was still within the central bank's target range of 3.5%–5.5% for the year. According to the Central Statistics Agency (BPS), the increase in inflation is considered normal and was driven by seasonal factors such as the start of the fasting month of Ramadan and the start of the new academic year. On a month-on-month (m-o-m) basis, consumer prices rose 0.70% in July, following a rise of 0.62% in June.

On 9 August, Bank Indonesia's (BI) Board of Governors decided to keep the benchmark rate steady at 5.75%. The BI rate has been kept at its current record-low level since February. The central bank said that at its current level, the BI rate remains consistent with low and controlled inflation as targeted for the year. The central bank also said that it will remain vigilant about the rising current account deficit caused by the weaker export performance as the global economy slowed.

Weak global demand and declining commodity prices continued to affect Indonesian exports, resulting in a 16.4% y-o-y contraction in June, after declining a revised 8.0% in May. Import growth eased to 10.7% y-o-y in June from a revised annual growth rate of 14.9% in May. Indonesia reported a trade deficit for a third consecutive month in June, posting a record-high deficit of US$1.3 billion. In August, BI and the government initiated policy measures aimed at addressing the widening current account deficit. (See **Policy, Institutional, and Regulatory Developments** for more detail.)

In 2Q12, the real gross domestic product (GDP) growth rate of Indonesia accelerated to 6.4% y-o-y, compared with a 6.3% annual growth rate in 1Q12, led mainly by private consumption and investment. Domestic consumption grew 5.0% y-o-y and investment growth climbed 12.3%. All major industry sectors reported positive growth in 2Q12 compared with year-ago levels, led by transport and communications (10.1%), hotels and restaurants (8.9%), construction (7.3%), and financial services (7.0%). Between 1Q12 and 2Q12, the economy expanded 2.8%. BI estimates full-year 2012 economic growth to settle between 6.1% and 6.5%.

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

	Amount (billion)								Growth Rate (%)						
	Mar-12		Apr-12		May-12		Jun-12		Mar-12		Apr-12	May-12	Jun-12		
	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	1,013,454	111	1,026,071	112	1,035,125	109	1,050,246	111	(1.6)	2.0	1.2	0.9	3.8	3.6	1.5
Government	858,644	94	870,982	95	879,099	93	884,029	94	(5.5)	1.4	1.4	0.9	0.5	3.0	0.6
Central Govt. Bonds	760,580	83	772,330	84	780,275	82	791,180	84	12.7	5.1	1.5	1.0	14.5	4.0	1.4
Central Bank Bills	98,064	11	98,652	11	98,824	10	92,849	10	(58.0)	(20.4)	0.6	0.2	(50.9)	(5.3)	(6.0)
Corporate	154,810	17	155,089	17	156,026	16	166,217	18	27.8	5.3	0.2	0.6	25.9	7.4	6.5

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.
4. The total stock of non-tradable bonds as of end-June stood at IDR278.4 trillion

Source: Bank Indonesia, Indonesia Debt Management Office, Indonesia Stock Exchange, and Bloomberg LP.

Size and Composition

The size of Indonesia's LCY bond market climbed to IDR1.05 quadrillion (US$111.3 billion) in 2Q12, expanding 3.8% y-o-y after declining 1.6% in 1Q12 **(Table 1)**. On a quarter-on-quarter (q-o-q) basis, bonds outstanding grew 3.6% in 2Q12, compared with 2.0% in the previous quarter. Growth in Indonesia's bond market was mostly driven by the corporate sector.

At end-June, LCY government bonds outstanding had grown at a marginal rate of only 0.5% y-o-y to reach IDR884.0 trillion. Growth in the government bond market was mainly driven by central government bonds, which comprise treasury bills and bonds issued by the Ministry of Finance. The stock of central bank bills, known as *Sertifikat* Bank Indonesia (SBI), continued to drop significantly, falling 50.9% y-o-y and 5.3% q-o-q.

Central Government Bonds. The stock of central government bonds rose 14.5% y-o-y to IDR791.2 trillion in 2Q12. On a q-o-q basis, central government bonds rose a modest 4.0%. Government bonds accounted for nearly 85% of Indonesia's total LCY bonds outstanding.

At end-June, some 68.4% of the total LCY government bonds were fixed-rate bonds and 16.4% were variable-rate bonds **(Table 2)**. Conventional treasury bills and retail bonds accounted for 3.6% and 3.8%, respectively, of the total, while *sukuk* (Islamic bonds) as a whole accounted for 7.6%. Among the Islamic instruments, retail *sukuk* accounted for 3.7% of total government bonds outstanding and Islamic treasury bills and project-based *sukuk* each accounted for 2.0% or less.

In 2Q12, new issuance of treasury bills and bonds reached IDR40.5 trillion for a 2.4% increase over a year earlier. On a q-o-q basis, however, central government bond issuance fell 32.9%. Issuance volume in 2Q12 was less than the government's target of IDR46.5 trillion.

The government raised during the first 6 months of 2012 a total of IDR117.6 trillion through bond

Table 2: Government Bonds Outstanding by Type of Bond (as of end-June 2012)

Government Bonds	Amount Outstanding (IDR billion)	% Share
Treasury Bills (SPN)	28,180	3.6
Fixed-Rate Bonds	540,732	68.35
Variable-Rate Bonds	129,773	16.40
Zero Coupon Bonds	2,512	0.32
Retail Bonds	29,775	3.8
Islamic Treasury Bills	1,185	0.15
Sukuk	17,137	2.17
Retail *Sukuk*	28,989	3.66
Project-Based *Sukuk*	12,897	1.63
Total	**791,180**	**100.00**

Source: Indonesia Stock Exchange.

Table 3: Corporate Bonds Outstanding by Type of Bond (as of end-June 2012)

Corporate Bonds	Amount Outstanding (IDR billion)	% Share
Conventional Bonds	137,387	82.66
Subordinate Bonds	22,611	13.60
Conversion Bonds	150	0.09
Zero Coupon Bonds	500	0.30
Sukuk Ijarah	4,480	2.70
Sukuk Mudharabah	775	0.47
Sukuk Mudharabah Subordinate	314	0.19
Total	**166,217**	**100.00**

Notes:
1. *Sukuk Ijarah* refers to Islamic bonds backed by a lease agreement.
2. *Sukuk Mudharabah* refers to Islamic bonds backed by a profit-sharing scheme from a business venture or partnership.

Source: Indonesia Stock Exchange.

sales (including international bond issuance), representing 73.7% of the 2012 revised state budget target of IDR159.6 trillion. According to the Ministry of Finance's Debt Management Office, government issuance in the second half of 2012 is expected to reach IDR42 trillion. The government will continue to prioritize issuance of IDR-denominated government securities as part of its financing strategy. In addition, the government plans to issue global *sukuk* and *samurai* bonds.

Corporate Bonds. The corporate bond market in Indonesia continued to post strong growth in 2Q12 as it expanded 25.9% y-o-y. On a q-o-q basis, corporate bonds grew a more modest 7.4%. Corporate bonds only comprise a small share of Indonesia's LCY bond market, with a share of 15.8% of total LCY bonds.

About 83% of total corporate bonds outstanding in 2Q12 were conventional bonds **(Table 3)**. Subordinated bonds accounted for some 13.6% of total outstanding corporate bonds. *Sukuk* issues by corporate entities represented a small percentage of total corporate bonds, with a share of only 3.4% at end-June.

The top 30 LCY corporate bond issuers in Indonesia accounted for nearly 80% of total corporate bonds outstanding at the end of 2Q12 **(Table 4)**. Total bonds issued by the top 30 corporate issuers reached IDR130.6 trillion. State-power firm PLN remained the top issuer of LCY corporate bonds with total bonds valued at IDR14.2 trillion. Telecommunications firm Indosat rose to the second spot with bonds outstanding of IDR9.4 trillion. Automotive leasing company Adira Dinamika Multifinance dropped to the third spot with bonds outstanding of IDR8.0 trillion at end-June.

Issuers from the banking and financial sectors dominated the top 30 list at end-June, accounting for 73% of the firms listed. Ten companies on the top 30 list were state-owned firms. More than half of the 30 firms were listed on the Indonesia Stock Exchange.

Corporate bond issuance surged in 2Q12, with total issuance reaching IDR25.0 trillion on 42 bond series from 19 corporate entities. Compared with 2Q11 and 1Q12, corporate issuance in 2Q12 was up 67.2% y-o-y and 131.7% q-o-q, respectively, albeit from a low base. New corporate bond issues in 2Q12 were mostly conventional bonds, except for three subordinated bond issues and two *sukuk*. More than half of total corporate issuance in 2Q12 carried maturities of 3 years–5 years, and two bond issues carried maturities of 10 years. **Table 5** lists some notable corporate bonds issued in 2Q12.

Motorcycle financing company Federal international Finance raised a total of IDR4.0 trillion of bonds through a triple-tranche bond sale in April. The proceeds from the sale will be used to help boost

Table 4: Top 30 Issuers of LCY Corporate Bonds in Indonesia (as of end-June 2012)

Issuers	Outstanding Amount		State-Owned	Privately-Owned	Listed Company	Type of Industry
	LCY Bonds (IDR billion)	LCY Bonds (US$ billion)				
1. PLN	14,208	1.51	Yes	No	No	Energy
2. Indosat	9,350	0.99	No	Yes	Yes	Telecommunications
3. Adira Dinamika Multifinance	8,032	0.85	No	Yes	Yes	Finance
4. Federal International Finance	7,379	0.78	No	Yes	No	Finance
5. Astra Sedaya Finance	7,355	0.78	No	Yes	No	Finance
6. Bank Tabungan Negara	7,150	0.76	Yes	No	Yes	Banking
7. Indonesia Eximbank	7,034	0.75	Yes	No	No	Banking
8. Bank Pan Indonesia	5,500	0.58	No	Yes	Yes	Banking
9. Jasa Marga	5,000	0.53	Yes	No	Yes	Toll Roads, Airports, and Harbors
10. Perum Pegadaian	4,664	0.49	Yes	No	No	Finance
11. Bank CIMB Niaga	4,480	0.47	No	Yes	Yes	Banking
12. Bank Internasional Indonesia	4,000	0.42	No	Yes	Yes	Banking
13. Bank Tabungan Pensiunan Nasional	3,650	0.39	No	Yes	Yes	Banking
14. Indofood Sukses Makmur	3,610	0.38	No	Yes	Yes	Food and Beverages
15. Bank Mandiri	3,500	0.37	Yes	No	Yes	Banking
16. Antam	3,000	0.32	Yes	No	Yes	Petroleum and Natural Gas
17. Telekomunikasi Indonesia	3,000	0.32	Yes	No	Yes	Telecommunications
18. Sarana Multigriya Finansial	2,812	0.30	Yes	No	No	Finance
19. Bank Danamon Indonesia	2,800	0.30	No	Yes	No	Banking
20. Bank Jabar Banten	2,750	0.29	No	Yes	Yes	Banking
21. BCA Finance	2,708	0.29	No	Yes	No	Finance
22. Toyota Astra Financial Services	2,500	0.27	No	Yes	No	Finance
23. Medco-Energi Internasional	2,487	0.26	No	Yes	Yes	Petroleum and Natural Gas
24. Bank Permata	2,450	0.26	No	Yes	Yes	Banking
25. Indomobil Finance Indonesia	2,225	0.24	No	Yes	No	Finance
26. Bank Rakyat Indonesia	2,000	0.21	Yes	No	Yes	Banking
27. Japfa	2,000	0.21	No	Yes	Yes	Animal Feed
28. Surya Artha Nusantara Finance	1,995	0.21	No	Yes	No	Finance
29. Bank Bukopin	1,500	0.16	No	Yes	Yes	Banking
30. Bank DKI	1,500	0.16	No	Yes	No	Banking
Total Top 30 LCY Corporate Issuers	**130,637**	**13.85**				
Total LCY Corporate Bonds	**166,217**	**17.62**				
Top 30 as % of Total LCY Corporate Bonds	**78.6%**	**78.6%**				

LCY = local currency.
Source: Indonesia Stock Exchange.

Table 5: Notable LCY Corporate Issuance, 2Q12

Corporate Issuers	Amount Issued (IDR billion)
Federal International Finance	4,000
Indosat	3,000
Bank Tabungan Negara	2,000
Indofood Sukses Makmur	2,000
Adira Dinamika Multifinance	1,850
BCA Finance	1,700
Medco-Energi Internasional	1,500
Indomobil Finance	1,300
Toyota Astra Financial Services	1,300
Sarana Multigriya Finansial	1,250
Mayora Indah	1,000
Others	4,124
Total	**25,024**

Source: Indonesia Stock Exchange.

the company's lending business. The bond sale comprised the following series:

- 370-day bonds worth IDR998 billion, coupon of 6.40%;
- 2-year bonds worth IDR1.3 trillion, coupon of 7.35%; and
- 3-year bonds worth IDR1.6 trillion, coupon of 7.65%.

Indosat, an Indonesian mobile operator, issued a total of IDR3.0 trillion worth of bonds in a three-tranche bond sale in June. The proceeds from the bond sale will finance the company's operations and fund its bond buyback program. The bond issue consisted of the following series:

- 7-year bonds worth IDR1.2 trillion, coupon of 8.625%;
- 10-year bonds worth IDR1.5 trillion, coupon of 8.875; and
- 7-year *sukuk* worth IDR300 billion, coupon of 8.625%.

Bank Tabungan Negara issued a total of IDR2 trillion of 10-year conventional bonds in June. The bonds carry a coupon of 7.90%. Proceeds from the bond sale will be used for credit expansion and to settle maturing debts.

Indonesian noodle manufacturer Indofood Sukses Makmur issued a IDR2 trillion 5-year bond in May. The bond carries a coupon of 7.25% and was given a rating of idAA+ from Pefindo. The sale was oversubscribed with the order book reaching IDR6 trillion.

Automotive financing firm Adira Dinamika Multifinance issued a total of IDR1.85 trillion through a triple-tranche bond sale in May. The bonds consisted of the following series:

- 1-year bonds worth IDR786 billion, coupon of 6.50%;
- 2-year bonds worth IDR200 billion, coupon of 7.50%; and
- 3-year bonds worth IDR864 billion, coupon of 7.75%.

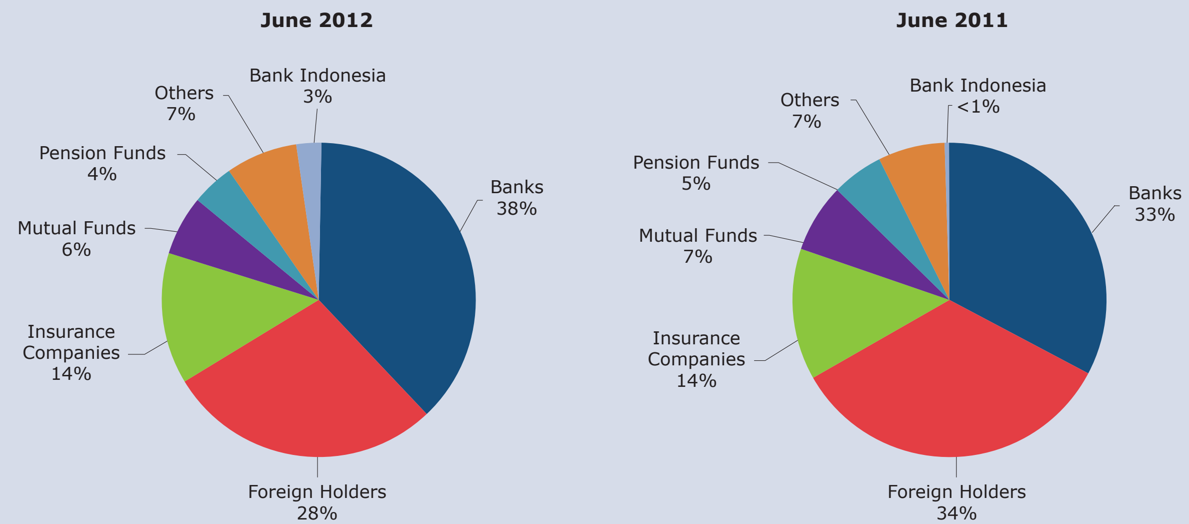
Automotive financing company BCA Finance raised a total of IDR1.7 trillion worth of bonds in May. The proceeds from the bond sale will be used to boost the company's financing requirements. The bonds consisted of the following series:

- 1-year bonds worth IDR650 billion, coupon of 6.35%;
- 2-year bonds worth IDR200 billion, coupon of 7.35%;
- 3-year bonds worth IDR250 billion, coupon of 7.60%; and
- 4-year bonds worth IDR600 billion, coupon of 7.70%.

Investor Profile

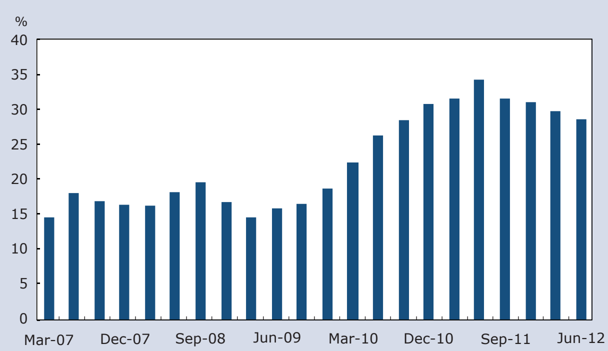
Central Government Bonds. At the end of 2Q12, banking institutions were the largest holders of central government bonds in Indonesia **(Figure 2)**. The share of banking institutions climbed to 38% in 2Q12 from 33% in the same period a year earlier. Banking institutions include state banks, private banks, non-recap banks, regional banks, and *shari'a* (Islamic law) banks. Among these institutions, state banks accounted for nearly 50% of total bond holdings.

Figure 2: LCY Government Bonds Investor Profile



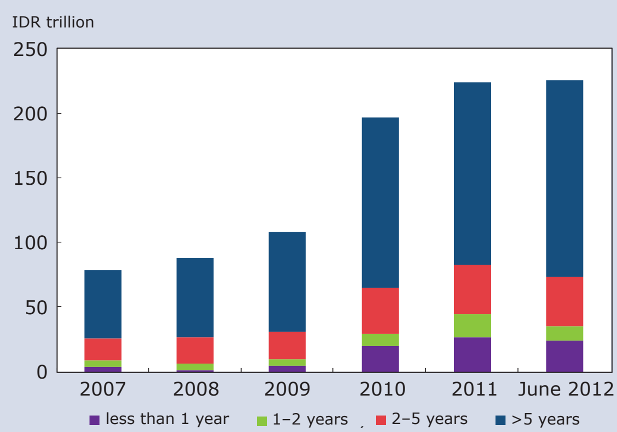
LCY = local currency.
Source: Indonesia Debt Management Office.

Figure 3: Quarterly Foreign Investor Share of LCY Government Bonds, March 2007–June 2012



LCY = local currency
Source: Indonesia Debt Management Office.

Figure 4: Foreign Holdings of LCY Government Bonds by Maturity, 2007–June 2012



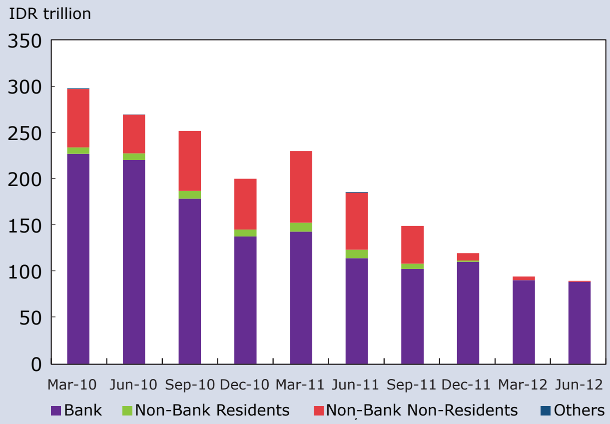
LCY = local currency.
Source: Indonesia Debt Management Office.

Between end-June 2011 and end-June 2012, the share of central government bonds held by foreign investors fell from 34% to 28% **(Figure 3)**. Foreign investors began selling government bonds heavily in September 2011. While concerns over the eurozone crisis have led foreign investors to reduce their exposure to emerging market assets, their share of the Indonesian LCY bond market remains the highest in the region.

In 2Q12, 67.3% of LCY bonds held by foreigners were in long-dated tenors (maturities of 5 years or more) **(Figure 4)**. This was an increase from the 63.2% share of the total recorded at end-2011. Offshore holdings of short-dated tenors (bonds with maturities of less than 1 year) dropped to 10.6% at end-June from a share of 11.9% at end-December.

At end-June, the share of LCY government bonds held by BI climbed to 3.0%, reaching IDR20.4 trillion from only IDR3.1 trillion at end-

Figure 5: LCY Central Bank Bills Investor Profile, March 2010–June 2012



LCY = local currency.
Source: Bank Indonesia.

June 2011. The central bank has actively supported the LCY bond market through the purchase of government bonds as part of efforts to stabilize market prices.

Meanwhile, the share of contractual savings institutions' holdings of government bonds in Indonesia remained low in 2Q12 compared with other markets in the region. The share of insurance companies was steady at 14.0% at end-June, the same share as a year earlier. On the other hand, the share of pension funds fell slightly to 4.0% from 5.0% over the same period.

Central Bank Bills. At end-June, SBI were held almost entirely by banking institutions, with an ownership share of 99.0%, compared with 95.7% in 1Q12 and 92.2% in 4Q11 **(Figure 5)**. The remaining 1.0% was held by foreign investors, a share that has dropped substantially since March 2011 after reaching a high of 33.0% in early 2011. The central bank's implementation of a 6-month holding period for SBI effectively negated foreign investor interest in SBI.

Rating Changes

On 23 April, Standard & Poor's (S&P) affirmed Indonesia's short- and long-term sovereign ratings at B and BB+, respectively, with the outlook remaining positive for both **(Table 6)**. According to S&P, "the rating on Indonesia balances institutional and economic constraints with a moderately strong fiscal, external, and monetary profile." The rating agency also said "the positive outlook signals the potential for an upgrade if the country's growth prospects improve further and financial markets deepen with steadier policy implementation."

Table 6: Selected Sovereign Ratings and Outlook for Indonesia

	Moody's	S&P	Fitch	R&I
Sovereign FCY LT Ratings	Baa3	BB+	BBB–	BB+
Outlook	Stable	Positive	Positive	Positive

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

On 16 July, Moody's Investors Service (Moody's) maintained its stable outlook on Indonesia's Baa3 sovereign rating. The rating agency cited Indonesia's strong growth, low government debt, and recent track record of prudent fiscal management as the reasons for its ratings action. Earlier this year, Moody's raised Indonesia's foreign currency (FCY) and LCY ratings to Baa3 from Ba1, with a stable outlook for both.

Policy, Institutional, and Regulatory Developments

Government Postpones Issuance of Project-Financing *Sukuk*

In April, the government announced that its plan to issue project-financing *sukuk* (Islamic bonds issued to finance new projects) would be postponed until 2013 due to administrative reasons. Approval from the House of Representatives is required for issuance of *sukuk* backed by project financing. Currently, the National Development Planning Agency (Bappenas) is still in the process of selecting projects proposed by ministries and agencies. The government had previously announced plans to issue project-financing *sukuk* in 2H12 to complement the existing stock of project-based *sukuk* (Islamic bonds backed by infrastructure projects).

BI Issues FCY Term Deposit

In June, BI began offering a term deposit instrument for FCY. The new instrument involves the placement of FCY by banks with BI. According to the central bank, the term deposit will be managed through various foreign exchange (FX) transactions to increase the FX supply in the market and enhance monetary policy operations through FX swap operations. The FCY term deposit facilities will carry maturities of 7, 14, and 30 days, and will be auctioned every Wednesday, or on other days as specified by BI. The central bank held its first auction on 13 June, consisting of 7- and 14-day term deposits. The auction was oversubscribed as bids reached US$1.6 billion compared with a target of US$700 million.

BI Signs MOUs with Australia and the Republic of Korea on Cross-Border Bank Supervision

In June, BI entered into memorandums of understanding (MOUs) on cross-border banking supervision with the Australian Prudential Regulation Authority and the Republic of Korea's Financial Services Commission (FSC) and Financial Supervisory Service (FSS). The MOUs, which became effective on 6 June, promote mutual exchanges of information and enhance cooperation in the area of banking supervision. In 2010, BI also signed a similar agreement with Bank Negara Malaysia, the China Banking Regulatory Commission, and the Monetary Authority of Singapore.

PBOC and BI Interbank Bond Market Agreement

On 21 June, the People's Bank of China (PBOC) and BI signed an Agency Agreement that will allow BI to invest in the interbank bond market of the PRC. The agreement reflects close collaboration between the PBOC and BI, and represents cooperation as a follow-up to their bilateral swap agreement. According to BI, access to the PRC bond market will facilitate efforts to diversify its FX reserves. As of end-June, Indonesia's foreign exchange reserves totaled US$106.5 billion.

BI Announces New Regulations on Bank Ownership

In July, BI announced new regulations limiting investor ownership of Indonesians banks. Under the new rules that became effective 13 July, the new acquisition of a domestic commercial bank by a financial institution is limited to a 40% ownership stake, a non-financial institution to 30%, and families or individuals to 20%. State-owned banks and banks undergoing a recovery are exempt from the new rules. Also, exemptions can be granted for new acquisitions of listed banks exhibiting financial strength and possessing a Tier 1 capital ratio of more than 6%.

BI and the Indonesian Government Announce Measures to Address Increasing Current Account Deficit

In August, BI and the government held a coordination meeting to discuss measures to help the economy cope with a rising current account deficit. New measures announced on the part of BI include the following: (i) BI will allow investors to hedge their FX transactions with financial instruments carrying a minimum tenor of 1 week from a minimum of 3 months previously, effective 14 August; (ii) BI raised the floor of its deposit facility rate by 25 bps to 4.0% from 3.75%; the upper limit remains at 6.75%; (iii) BI also plans to tighten credit growth by strengthening the implementation of Loan-to-Value (LTV) limit, including a plan to ban the use of unsecured personal loans for credit advances. On the government side, a number of policies will be pursued to strengthen the current account to boost exports, manage imports, and improve the investment climate through fiscal instruments. In particular, anticipatory measures have been undertaken by the government with respect to taxation and custom duties.