

Indonesia—Update

Yield Movements

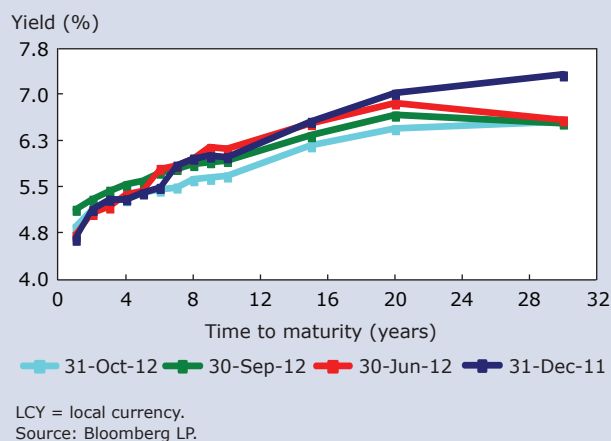
Between end-June and end-September, the local currency (LCY) government bond yield curve for Indonesia flattened, as yields rose from the short-end of the curve through the 5-year maturity, while yields fell from the belly through the long-end of the curve (**Figure 1**). Yields rose the most at the shortest-end of the curve (1-year maturity), climbing 43 basis points (bps) on inflation concerns. Yields from the 10-year maturity through the long-end of the curve fell between 4 bps and 23 bps.

Between end-September and end-October, however, yields fell across all tenors on positive sentiment after Standard and Poor's (S&P) stated that modest improvements in the country's political and policy dynamics might result in a ratings upgrade. In addition, foreign fund inflows into the Indonesian bond market resumed following the announcement of stimulus measures by the United States (US) Federal Reserve Bank. Indonesia's bond market continues to attract foreign investor interest as its bond yields are among the highest in the region. The yield spread between the 2- and 10-year maturities narrowed to 55 bps at end-October from 64 bps at end-September and 105 bps at end-June.

Consumer price inflation slowed to 4.3% year-on-year (y-o-y) in September from 4.6% in August. However, inflation inched up again in October, rising 4.6% y-o-y on higher prices for food, beverages, and tobacco products. The inflation rate, however, remained within Bank Indonesia's (BI) target range of 3.5% to 5.5% for the year. On a month-on-month (m-o-m) basis, inflation accelerated to 0.16% in October from 0.01% in September. Inflation for the rest of the year is expected to remain tame and end near the midpoint of BI's target range.

On 8 November, BI's Board of Governors decided to hold its benchmark interest rate steady at a

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



record-low level of 5.75% to support economic growth. The BI rate has been kept at this level since a 25 bps cut in February. According to BI, the policy rate at its current level remains consistent with an inflation forecast that expects price increases to remain low and contained. BI also noted that external balances have started to improve, with a declining current account deficit and the overall balance of payments turning into a surplus. The Indonesian rupiah also moved according to market condition as depreciation pressures abated.

In 3Q12, Indonesia recorded a US\$0.8 billion balance of payments surplus, a turnaround from a US\$2.8 billion deficit in 2Q12. The current account deficit eased to US\$5.3 billion in 3Q12 compared with US\$7.7 billion in 2Q12 due largely to an improving trade balance. The capital and financial account surplus rose to US\$6.0 billion in 3Q12, amid robust inflows of foreign direct investment and a reduction in offshore deposits held by residents. Also, portfolio investments contributed to the surplus due to foreign buying of stocks and local currency (LCY) government bonds. BI expects these trends to continue into 4Q12.

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

	Amount (billion)						Growth Rate (%)										
	Jun-12		Jul-12		Aug-12		Sep-12		Jun-12		Jul-12		Aug-12		Sep-12		
	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	1,050,246	111	1,053,322	111	1,058,174	111	1,054,800	110	110	3.8	3.6	0.3	0.5	7.4	0.4	0.3	(0.3)
Government	884,029	94	884,500	93	886,902	93	883,479	92	92	0.5	3.0	0.1	0.3	4.2	(0.1)	(0.4)	(0.4)
Central Govt. Bonds	791,180	84	799,660	84	803,053	84	812,796	85	85	14.5	4.0	1.1	0.4	16.7	2.7	1.2	1.2
Central Bank Bills	92,849	10	84,840	9	83,849	9	70,683	7	(50.9)	(5.3)	(8.6)	(1.2)	(53.3)	(23.9)	(15.7)	(15.7)	(15.7)
Corporate	166,217	18	168,822	18	171,272	18	171,321	18	18	25.9	7.4	1.6	1.5	27.2	3.1	0.0	0.0

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-September stood at IDR277.2 trillion
- Source: Bank Indonesia, Indonesia Debt Management Office, Indonesia Stock Exchange, and Bloomberg LP.

Buoyed by strong domestic consumption and investment, economic growth in Indonesia expanded 6.2% y-o-y in 3Q12 after posting annual growth of 6.4% in 2Q12. Domestic consumption climbed 5.7% y-o-y and investment grew 10.0% in 3Q12. According to BI, economic growth is expected to accelerate and will continue to be supported by private consumption and investment. Export performance is also expected to improve as the economies of some of Indonesia's main trading partners strengthen, although uncertainty remains in the global economy. BI is forecasting economic growth of 6.3% in 2012 and between 6.3% and 6.7% in 2013.

Size and Composition

The amount of LCY bonds outstanding in Indonesia grew marginally to IDR1.05 quadrillion (US\$110 billion) in 3Q12, expanding 0.4% quarter-on-quarter (q-o-q) (Table 1). On a y-o-y basis, the bond market saw modest 7.4% growth. The corporate sector continued to drive growth in Indonesia's bond market.

At end-September, outstanding LCY government bonds were almost unchanged at IDR883.5 trillion, down 0.1% on a q-o-q basis. On a y-o-y basis, however, growth in government bonds climbed 4.2%. Growth in the government bond market was driven by central government bonds, comprising treasury bills and treasury bonds issued by the Ministry of Finance. The stock of central bank bills, known as *Sertifikat Bank Indonesia* (SBI), continued to decline steeply in 3Q12. Government bonds accounted for 83.8% of total LCY bonds in Indonesia at the end of 3Q12.

Central Government Bonds. The stock of central government bonds grew a modest 2.7% q-o-q to IDR812.8 trillion in 3Q12 (Table 2). On a y-o-y basis, central government bonds rose 16.7%.

As of end-September, fixed-rate bonds accounted for 70.3% of total LCY central government bonds and variable rate bonds accounted for 15.6%.

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

Government Bonds	Amount Outstanding (IDR billion)	% Share	Growth Rates (%)	
			y-o-y	q-o-q
Treasury Bills (SPN)	28,220	3.5	22.7	0.1
Fixed-Rate Bonds	571,434	70.3	22.6	5.7
Variable-Rate Bonds	127,123	15.6	(5.9)	(2.0)
Zero-Coupon Bonds	2,512	0.3	0.0	0.0
Retail Bonds	21,476	2.6	(32.1)	(27.9)
Islamic Treasury Bills	905	0.1	-	(23.6)
<i>Sukuk</i>	17,137	2.1	4.7	0.0
Retail <i>Sukuk</i>	28,989	3.6	38.5	0.0
Project Based <i>Sukuk</i>	15,000	1.8	-	16.3
Total	812,796	100.0	16.7	2.7

Source: Indonesia Stock Exchange.

Conventional treasury bills and retail bonds accounted for 3.5% and 2.6%, respectively. The share of *sukuk* (Islamic bonds) was equivalent to 7.6% of the total. Among the different types of Islamic instruments, retail *sukuk* accounted for 3.6% of total central government bonds at the end of 3Q12, while project-based *sukuk* and Islamic treasury bills accounted for 1.8% and 0.1%, respectively.

In 3Q12, new issuance of treasury bills and bonds was flat on a q-o-q basis at IDR40.6 trillion. Issuance of treasury instruments, however, rose 8.7% in 3Q12 compared with a year earlier. Issuance during the quarter consisted of fixed-rate bonds, treasury bills, Islamic treasury bills, and project-based *sukuk*. Of the 11 scheduled auctions during the quarter, two *sukuk* auctions failed as investors sought higher yields.

As of 25 September, the government raised a total of IDR212.1 trillion in bond sales (including international bond issuance), representing 78.4% of gross issuance (IDR270.4 trillion) as stated in the 2012 revised state budget. In the same period, total redemptions and buybacks reached IDR75.4 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* in 4Q12 to help finance the budget deficit.

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

Corporate Bonds	Amount Outstanding (IDR billion)	% Share	Growth Rates (%)	
			y-o-y	q-o-q
Conventional Bonds	141,781	82.8	30.5	3.2
Subordinated Bonds	22,611	13.2	12.3	0.0
Convertible Bonds	150	0.1	-	-
Zero-Coupon Bonds	500	0.3	-	-
<i>Sukuk Ijarah</i>	4,390	2.6	(12.8)	(2.0)
<i>Sukuk Mudharabah</i>	775	0.5	(7.6)	0.0
<i>Sukuk Mudharabah</i> Subordinated	1,114	0.7	-	-
Total	171,321	100.0	27.2	3.1

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.

Central Bank Bills. The stock of central bank bills continued to fall, dropping 23.9% q-o-q and 53.3% y-o-y to IDR70.7 trillion at end-September. However, issuance of SBI and *shari'a*-compliant SBI climbed during the quarter, rising 101.7% q-o-q and 48.7% y-o-y, although this was coming from a low base. SBI are issued by BI as one of its monetary operation tools to help manage liquidity.

Corporate Bonds. The size of Indonesia's LCY corporate bond market rose to IDR171.3 trillion in 3Q12, expanding 3.1% q-o-q and 27.2% y-o-y. Corporate bonds, however, only comprise a small share of Indonesia's LCY bond market, accounting for just 16.2% of total LCY bonds. Relatively high yields on corporate bonds issued in recent months, ranging from 6.5% to 10.5%, have made the Indonesian corporate bond market an important part of Asia's nascent high-yield bond sector.

Conventional corporate bonds accounted for 82.8% of total corporate bonds outstanding in 3Q12, while subordinated bonds represented 13.2% (**Table 3**). *Sukuk* issues by corporate entities remained small, accounting for a share of only 3.7% at end-September.

The amount of total bonds outstanding from the top 31 corporate bond issuers in Indonesia stood at IDR133.5 trillion at end-September (**Table 4**),

Table 4: Top 31 Issuers of LCY Corporate Bonds in Indonesia (as of end-September 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	1.48	Yes	No	No	Energy
2. Adira Dinamika Multifinance	9,659	1.01	No	Yes	Yes	Finance
3. Indosat	9,350	0.97	No	Yes	Yes	Telecommunications
4. Federal International Finance	7,379	0.77	No	Yes	No	Finance
5. Bank Tabungan Negara	7,150	0.75	Yes	No	Yes	Banking
6. Astra Sedaya Finance	7,105	0.74	No	Yes	No	Finance
7. Indonesia Eximbank	7,034	0.73	Yes	No	No	Banking
8. Bank Pan Indonesia	5,500	0.57	No	Yes	Yes	Banking
9. Jasa Marga	5,000	0.52	Yes	No	Yes	Toll Roads, Airports, and Harbors
10. Bank Tabungan Pensiunan Nasional	4,900	0.51	No	Yes	Yes	Banking
11. Perum Pegadaian	4,664	0.49	Yes	No	No	Finance
12. Bank CIMB Niaga	4,480	0.47	No	Yes	Yes	Banking
13. Bank Internasional Indonesia	4,000	0.42	No	Yes	Yes	Banking
14. Indofood Sukses Makmur	3,610	0.38	No	Yes	Yes	Food and Beverages
15. Bank Mandiri	3,500	0.36	Yes	No	Yes	Banking
16. Antam	3,000	0.31	Yes	No	Yes	Petroleum and Natural Gas
17. Telekomunikasi Indonesia	3,000	0.31	Yes	No	Yes	Telecommunications
18. Bank Danamon Indonesia	2,800	0.29	No	Yes	No	Banking
19. BCA Finance	2,530	0.26	No	Yes	No	Finance
20. Medco-Energi Internasional	2,487	0.26	No	Yes	Yes	Petroleum and Natural Gas
21. Bank Permata	2,450	0.26	No	Yes	Yes	Banking
22. Agung Podomoro Land	2,400	0.25	No	Yes	Yes	Property and Real Estate
23. Bank Jabar Banten	2,400	0.25	No	Yes	Yes	Banking
24. Sarana Multigriya Finansial	2,312	0.24	Yes	No	No	Finance
25. Indomobil Finance Indonesia	2,225	0.23	No	Yes	No	Finance
26. Bank Rakyat Indonesia	2,000	0.21	Yes	No	Yes	Banking
27. Surya Artha Nusantara Finance	1,995	0.21	No	Yes	No	Finance
28. Toyota Astra Financial Services	1,905	0.20	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
31. Japfa	1,500	0.16	No	Yes	Yes	Animal Feed
Total Top 31 LCY Corporate Issuers	133,541	13.92				
Total LCY Corporate Bonds	171,321	17.86				
Top 31 as % of Total LCY Corporate Bonds	77.9%	77.9%				

LCY = local currency.
Source: Indonesia Stock Exchange.

accounting for nearly 80% of total corporate bonds outstanding. State-power firm PLN remained the largest issuer of LCY corporate bonds in Indonesia with bonds outstanding valued at IDR14.2 trillion. Automotive leasing company Adira Dinamika Multifinance climbed to the second spot with total bonds of IDR9.7 trillion. Telecommunications firm Indosat dropped to the third spot with bonds outstanding of IDR9.4 trillion at end-September.

The list of the top 31 LCY corporate bond issuers was dominated at end-September by firms from the banking and financial sector. Other bond issuers were from energy, telecommunications, toll roads, food and beverages, petroleum and natural gas, and property and real estate. About a third of the companies on the list were state-owned firms with total bonds valued at IDR51.9 trillion.

In 3Q12, corporate bond issuance totaled IDR10.0 trillion, a significant 60.2% q-o-q decline but a 71.1% increase over a year earlier. Corporate issuance during the quarter comprised 24 bond series issued by 10 corporate entities. The new corporate bond issues in 3Q12 were all conventional bonds except for one *sukuk* issue. Most of these new bond issues had a maturity of 3–5 years. **Table 5** lists a number of notable corporate bonds issued in 3Q12.

Automotive leasing company Adira Dinamika Multi Finance raised a total of IDR1.6 trillion through a triple bond sale in September. The proceeds from the bonds will be used to repay maturing debts and finance the firm's business operations. The

bond issue was the third part of the company's IDR6 trillion continuous bond issuance program. The bond sale comprised the following issues:

- 370-day bonds worth IDR376 billion, coupon of 6.50%;
- 3-year bonds worth IDR578 billion, coupon of 7.75%; and
- 5-year bonds worth IDR673 billion, coupon of 8.75%.

Mid-sized lender Bank Tabungan Pensiunan Nasional sold a total of IDR1.25 trillion worth of bonds in a dual-tranche bond sale in August. The proceeds from the bond sale will be used to boost its lending business. The bond issue consisted of the following series:

- 3-year bonds worth IDR525 billion, coupon of 7.75%; and
- 5-year bonds worth IDR725 billion, coupon of 8.25%.

Media firm Global Mediacom raised a total of IDR1.25 trillion of bonds from a two-tranche bond sale in July. The proceeds from the bond sale will be used to fund the company's capital expenditure and working capital, and to develop media-related business. The bond issue consisted of the following series:

- 3-year bonds worth IDR250 billion, coupon of 9.75%; and
- 5-year bonds worth IDR1 trillion, coupon of 10.5%.

Property developer Agung Podomoro Land issued IDR1.2 trillion of 5-year bonds in August. The bonds carry a coupon of 9.38%. Proceeds from the bond sale will be used to finance its property development projects.

Property developer Bumi Serpong Damai raised a total of IDR1 trillion from a triple-tranche bond sale. About 70% of the bond sale proceeds will be used to support the development and expansion of the company's BSD City project, and the remaining 30% will be used for working capital.

Table 5: Notable LCY Corporate Issuance in 3Q12

Corporate Issuers	Amount Issued (IDR billion)
Adira Dinamika Multi Finance	1,627
Bank Tabungan Pensiunan Nasional	1,250
Global Mediacom	1,250
Agung Podomoro Land	1,200
Bumi Serpong Damai	1,000
SMART	1,000
Tunas Baru Lampung	1,000
Others	1,630
Total	9,957

Source: Indonesia Stock Exchange.

The bonds were rated IdA+ by Pefindo. The bond sale comprised the following issues:

- 3-year bonds worth IDR85 billion, coupon of 8.0%;
- 5-year bonds worth IDR479 billion, coupon of 9.25%; and
- 7-year bonds worth IDR436 billion, coupon of 9.5%.

Sinar Mas Agro Resources and Technology (SMART), an Indonesian plantation firm, raised a total of IDR1 trillion from a dual-tranche bond sale. About 60% of the bond sale proceeds will be used by the company to expand the capacity of its refineries, and the remaining 40% for working capital. The bonds were rated idAA- by Pefindo. The bonds consisted of the following series:

- 5-year bonds worth IDR900 billion, coupon of 9.0%; and
- 7-year bonds worth IDR100 billion, coupon of 9.25%.

Palm oil company Tunas Baru Lampung sold IDR1 trillion of 5-year bonds. The bonds carry a coupon of 10.5%. Proceeds from the bond sale will be used to finance a new refined sugar plant and other investment projects.

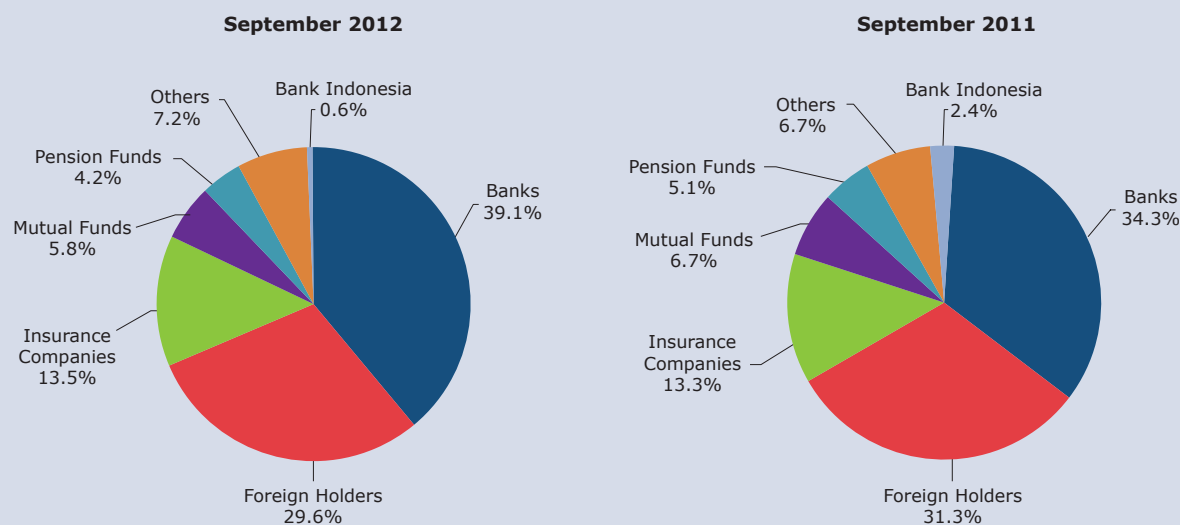
Investor Profile

Central Government Bonds. Banking institutions were the largest holder of central government bonds in Indonesia at the end of 3Q12 (**Figure 2**). The share of banking institutions climbed to 39.1% in 3Q12 compared with 34.3% in the same period a year earlier. Banking institutions include state recap banks, private recap banks, non-recap banks, regional banks, and *shari'a* banks. Among the banking institutions, state banks hold the largest chunk of central government bonds with a share of 45% of banks' total bond holdings.

Foreign investors were the second largest holder of Indonesian LCY central government bonds at end-September. The share of foreign investors tapered off to 29.6% at end-September from 31.3% a year earlier. However, this reflected an improvement as the share of foreign investors had been steadily declining since the start of the year. The share of foreign investors was 32.1% in January before dropping to 29.5% in March and 28.4% in June (**Figure 3**). Foreign investors include non-resident private banks, fund and asset management firms, securities firms, insurance companies, and pension funds.

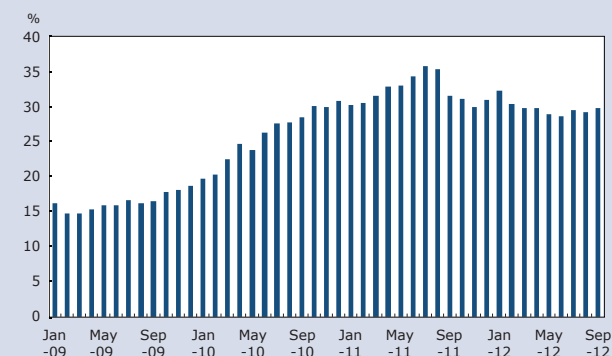
As of end-September, 70.1% of LCY bonds held by foreign investors were in long-dated tenors

Figure 2: LCY Government Bonds Investor Profile



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

Figure 3: Monthly Foreign Investor Share of LCY Government Bonds, January 2009–September 2012



LCY = local currency

Source: Indonesia Debt Management Office.

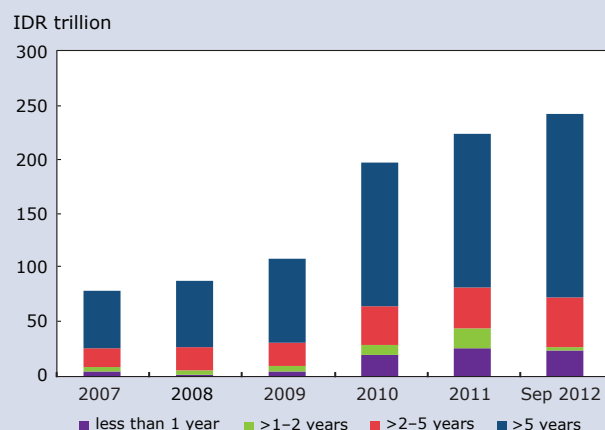
(maturities of 5-years or more) (**Figure 4**). This was an increase from the 63.2% share of the total recorded at end-2011. Offshore investor holdings of short-dated tenors (bonds with maturities of less than 1 year) dropped to 9.8% at end-September, while bonds with maturities of more than 1 year to 2 years declined to 1.5%.

By type of foreign investor, offshore financial institutions owned more than half of bonds (58.6%) held by foreign investors at end-September (**Figure 5**). This was followed by mutual funds with an ownership share equivalent to 28.5% of the total bonds held by non-residents. Insurance companies, pension funds, corporate investors, and securities companies hold shares of 2.8% or less.

Meanwhile, the share of insurance companies was steady at 13.5% in 3Q12 compared with the same period a year ago. On the other hand, the share of pension funds fell to 4.2% in 3Q12 from 5.1% in 3Q11. Mutual fund holdings of LCY central government bonds also dropped to 5.8% at end-September.

Central Bank Bills. At end-September, banking institutions held a dominant share of central bank bills, although their ownership share fell to 96.7% from 99.0% in 2Q12 (**Figure 6**). The total amount of SBI held by banks reached IDR65.9 trillion at end-September. Market analysts believe

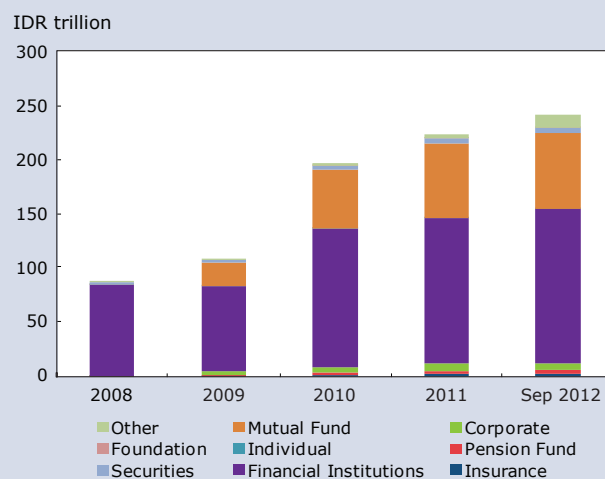
Figure 4: Foreign Holdings of Indonesian LCY Government Bonds by Maturity, 2007–September 2012



LCY = local currency.

Source: Indonesia Debt Management Office.

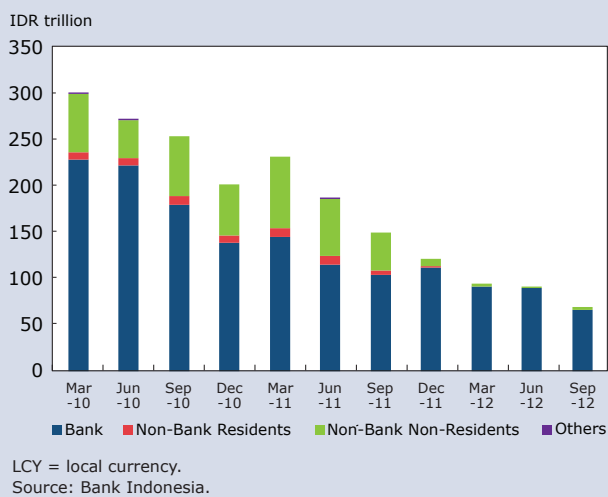
Figure 5: Foreign Holdings of LCY Government Bonds by Type of Investors, 2008–September 2012



LCY = local currency.

Source: Bank Indonesia.

that some banks liquidated SBI holdings to boost their funds and diversify their portfolio holdings into other investment instruments. Offshore investors held the remaining 3.3%, an improvement of about 1 percentage point since end-June following a steady decline in foreign investors' share that began after the central bank implemented a 6-month holding period for SBI last year.

Figure 6: LCY Central Bank Bills Investor Profile, March 2010–September 2012

Rating Changes

On 18 October, Ratings and Investment (R&I) raised Indonesia's sovereign credit rating to BBB- from BB+ (**Table 6**). The outlook on the rating was stable. R&I cited Indonesia's economic resilience amid the downturn in the global economy, conservative fiscal management, low debt burden, and stable financial system as the reasons for the ratings action.

Policy, Institutional, and Regulatory Developments

BI to Impose Capital Requirements on Foreign Lenders

In August, BI announced plans to require foreign banks to comply with minimum paid-up capital requirements. Current regulations require domestic banks to meet a IDR3 trillion capitalization. Foreign banks that will be affected by this new regulation are those that were set up at a time when BI allowed foreign lenders to open branches without establishing a locally incorporated company.

Table 6: Selected Sovereign Ratings and Outlook for Indonesia

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

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

BI to Require *Shari'a* Banks to Comply with LTV Rule

In August, BI announced plans to require *shari'a* banks to comply with the loan-to-value (LTV) rule currently applied to conventional banks. The LTV rule requires a minimum down payment amount for those seeking housing and automotive loans, effective 15 June. The minimum down payment requirement is 25% for two-wheeled vehicles and 30% for 4-wheeled vehicles. *Shari'a* banks were excluded from the regulation as Islamic rules do not require down payments.

Government Raises IDR12.7 Trillion from Sale of Retail Bonds

In September, the Indonesian government raised a total of IDR12.7 trillion from the sale of its ninth series of retail bonds. Due to huge demand, the government decided to increase its target by IDR1 trillion a day prior to the close of the offer period. The retail bonds carry a coupon of 6.25% and a maturity of 3 years.

Government Sells JPY60 Billion of 10-Year Samurai Bonds

On 6 November, the Indonesian government priced JPY60 billion of 10-year *samurai* bonds with a coupon of 1.13%. The bonds were offered via a private placement and launched through the Japan Bank for International Cooperation's (JBIC) Guarantee and Acquisition Toward Tokyo Market Enhancement (GATE) program. According to the Directorate General of Debt Management, the deal was well received, with strong demand coming from central and regional banking accounts, and life and non-life insurers.