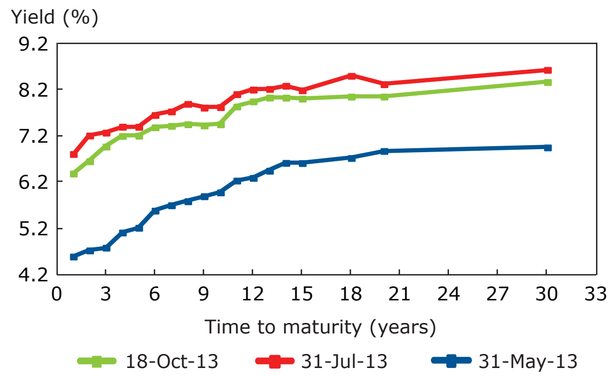
Indonesia

Yield Movements

Local currency government (LCY) bond yields in Indonesia rose dramatically and shifted the entire curve upward between end-May and end-July **(Figure 1)**. Yields gained more at the shorter-end of the curve than at the longer-end, resulting in the flattening of the yield curve. The steep rise in yields reflected negative sentiments stemming from both domestic and external factors. Bond yields have been on the rise since May on concerns that the United States (US) Federal Reserve will begin to taper its asset purchase program in the latter part of the year. On the domestic front, several issues weighed on market sentiment, including rising inflation expectations, a widening current account deficit, a weakening rupiah exchange rate, higher financing requirements for the state budget, and warnings of a possible rating downgrade.

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



LCY = local currency.
Source: Bloomberg LP.

Between end-July and 18 October, government bond yields fell across the curve, shifting the yield curve downward. Yields dropped the most for the 2-year maturity, shedding 56 basis points (bps). Yields fell 42 bps at the shortest-end of the curve and 26 bps at the longest-end. The spread between the 2-year and 10-year maturities narrowed to 62 bps at end-July before it widened again to 80 bps by mid-October.

Since mid-September, LCY bond yields have recovered following the decision of the US Federal Reserve to maintain its quantitative easing program. Immediately after the US Federal Reserve announcement on 18 September, 10-year bonds rebounded with yields falling below the 8.0% level. Bond yields further corrected through mid-October after US lawmakers agreed to end the federal government shutdown and raise the debt ceiling to avoid a possible default. The 10-year bond yield rose to nearly 9.0% in early September, and bottomed at 7.5% on 18 October. However, Bank Indonesia (BI) continues to take a cautious stand and is not overly optimistic in its outlook for the global economy, due in part to the US Congress having to vote again on raising the US debt ceiling in early 2014.

The correction in bond yields was also boosted by improving domestic economic fundamentals as coordinated stabilizing efforts by the government and the central bank began to show positive signs. For example, consumer price inflation slowed to 8.3% year-on-year (y-o-y) in October and 8.4% in September, after rising to 8.6% and 8.8% in July and August, respectively. (Indonesia's inflation rate, however, remains the highest in emerging East Asia.) In addition, a trade surplus was recorded in August. More recent data, however, show a trade deficit amounting to US$657 million in September.

BI's policy bias has changed from neutral to tightening with the cumulative 150 bps hike in the benchmark rate between June and September. The rate hikes provided a confidence boost to investors who were worried about the widening current account deficit and external funding risks. On 8 October, the meeting of BI's Board of Governors concluded with the benchmark rate being maintained at 7.25%. BI also kept the lending facility and deposit facility rates steady at 7.25% and 5.50%, respectively. BI said that it will continue to monitor global and domestic economic developments, and further synergize its monetary and macroprudential policy mix, to ensure that inflationary pressures are contained, rupiah exchange rate stability is maintained, and the current account deficit is reduced to a sustainable level.

Meanwhile, economic growth in Indonesia fell below 6.0% y-o-y in 2Q13 for the first time since September 2010. Real gross domestic product (GDP) growth eased to 5.8% in 2Q13 compared with annual growth of 6.0% in 1Q13. Domestic consumption and investments moderated to 5.1% and 4.7%, respectively, in 2Q13. Growth in government spending, on the other hand, rose to 2.1% in 2Q13 from 0.4% in the previous quarter. On a quarter-on-quarter (q-o-q) basis, however, the economy grew 2.6% in 2Q13 following a 1.4% expansion in 1Q13. BI forecasts economic growth to slow to 5.6% in 3Q13, with growth of between 5.5% and 5.9% for the year as a whole.

Size and Composition

LCY bonds outstanding in Indonesia rose to IDR1,226.3 trillion (US$108 billion) at end-September, climbing 3.9% q-o-q **(Table 1)**. On a y-o-y basis, the bond market rose at a faster pace of 16.3%.

Outstanding LCY government bonds posted 3.7% q-o-q and 14.5% y-o-y growth rates to reach IDR1,011.4 trillion at end-September. Growth in the government bond sector was mainly driven by central government bonds, comprising treasury bills and treasury bonds issued by the Ministry of Finance. Central bank bills, which are also known as *Sertifikat* Bank Indonesia (SBI), continued to post negative growth on both a q-o-q and y-o-y basis.

Central Government Bonds. The stock of central government bonds climbed 6.1% q-o-q to IDR942.9 trillion at end-September. On a y-o-y basis, central government bonds grew at a robust rate of 16.0%. Conventional fixed-rate bonds, which account for the bulk of the central government bond stock, continued to drive growth, rising 6.8% q-o-q and 18.0% y-o-y in 3Q13 **(Table 2)**. Short-term instruments—treasury bills and Islamic treasury bills—also contributed to growth (albeit from a low base).

In 3Q13, new issuance of treasury bills and treasury bonds totaled IDR98 trillion, rising a notable 64.0% q-o-q and 91.7% y-o-y. There were six auctions of conventional bonds and five auctions of *sukuk* (Islamic bonds) during the quarter. At these auctions, the government awarded a higher amount than what was targeted, with the exception of three of the *sukuk* auctions. Demand for treasuries was strong as reflected by

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

	Outstanding Amount (billion)						**Growth Rate** (%)			
	3Q12		**2Q13**		**3Q13**		**3Q12**		**3Q13**	
	IDR	**US$**	**IDR**	**US$**	**IDR**	**US$**	**q-o-q**	**y-o-y**	**q-o-q**	**y-o-y**
Total	**1,054,800**	**110**	**1,180,422**	**118**	**1,226,334**	**108**	**0.4**	**7.4**	**3.9**	**16.3**
Government	883,479	92	975,057	97	1,011,443	89	(0.1)	4.2	3.7	14.5
Central Govt. Bonds	812,796	85	888,514	89	942,859	83	2.7	16.7	6.1	16.0
Central Bank Bills	70,683	7	86,543	9	68,584	6	(23.9)	(53.3)	(20.8)	(3.0)
Corporate	171,321	18	205,365	21	214,891	19	3.1	27.2	4.6	25.4

( ) = negative, LCY = local currency, 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 IDR267.8 trillion.
Sources: Bank Indonesia, Indonesia Debt Management Office, Indonesia Stock Exchange, and Bloomberg LP.

Table 2: Central Government Bonds Outstanding by Type of Bond

Government Bonds	Outstanding Amount (IDR billion)	% Share	Growth Rate (%)	
			q-o-q	y-o-y
Treasury Bills	34,600	3.7	66.4	22.6
Fixed-Rate Bonds	674,138	71.5	6.8	18.0
Variable-Rate Bonds	122,755	13.0	0.0	(3.4)
Zero-Coupon Bonds	0	0.0	–	–
Retail Bonds	23,677	2.5	(30.7)	10.2
Islamic Treasury Bills	9,578	1.0	217.2	958.3
Sukuk	17,137	1.8	0.0	0.0
Retail *Sukuk*	35,924	3.8	0.0	23.9
Project-Based *Sukuk*	25,051	2.7	5.8	67.0
Total	**942,860**	**100.0**	**6.1**	**16.0**

( ) = negative, – = not applicable, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Note: Data as of end-September 2013.
Source: Indonesia Stock Exchange.

Table 3: Corporate Bonds Outstanding by Type of Bond

Corporate Bonds	Outstanding Amount (IDR billion)	% Share	Growth Rate (%)	
			q-o-q	y-o-y
Bonds	182,681	85.0	4.9	28.8
Subordinated Bonds	24,886	11.6	6.0	10.1
Convertible Bonds	150	0.1	0.0	0.0
Zero Coupon Bonds	500	0.2	0.0	0.0
Sukuk Ijarah	4,095	1.9	(3.1)	(6.7)
Sukuk Mudharabah	1,079	0.5	0.0	39.2
Sukuk Mudharabah Subordinate	1,500	0.7	(17.3)	34.6
Total	**214,891**	**100.0**	**4.6**	**25.4**

( ) = negative, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Data as of end-September 2013.
2. *Sukuk Ijarah* refers to Islamic bonds backed by a lease agreement.
3. *Sukuk Mudharabah* refers to Islamic bonds backed by a profit-sharing scheme from a business venture or partnership.

Source: Indonesia Stock Exchange.

bids reaching IDR173.5 trillion against a 3Q13 issuance target of IDR54 trillion.

On 8 October, the government raised IDR20.2 trillion from the sale of retail bonds. The amount awarded was slightly higher than the government’s target of IDR20 trillion. The bonds carry a coupon of 8.5% and a maturity of 3 years. This latest offering was Indonesia’s 10th series of retail bonds (ORI010) and attracted a total of 26,824 investors, including employees of private firms, entrepreneurs, and housewives.

Central Bank Bills. At end-September, the stock of central bank bills (SBI) stood at IDR68.6 trillion, contracting 20.8% q-o-q and 3.0% y-o-y. In 3Q13, new issuance of SBI and *shari’a*-compliant SBI rose 5.9% q-o-q, but declined 31.2% y-o-y. SBI are issued by the central bank as one of its monetary tools to help contain inflation. In August, BI reduced the minimum holding period for SBI from 6 months to 1 month.

Corporate Bonds. Indonesia’s LCY corporate bond market continued to post strong growth in 3Q13 to reach a size of IDR214.9 trillion, expanding 4.6% q-o-q and 25.4% y-o-y. Growth came mainly from an increase in outstanding conventional corporate bonds and subordinated bonds. A breakdown of corporate bonds outstanding by type of bonds at end-September is presented in **Table 3**. Conventional corporate bonds, which accounted for 85% of total corporate bonds, grew 4.9% q-o-q and 28.8% y-o-y. Subordinated bonds, which accounted for about 12% of total corporate bonds, rose 6.0% q-o-q and 10.1% y-o-y.

The top 30 LCY corporate bond issuers in Indonesia in 3Q13 accounted for 76.7% of total corporate bonds with an outstanding amount of IDR164.9 trillion **(Table 4)**. The top 30 issuers were once again largely dominated by financial and banking institutions, which accounted for two-thirds of the firms in the list. The composition of the top three corporate issuers remained the same from the previous quarter. State-power firm PLN topped the list with outstanding LCY corporate bonds of IDR15.2 trillion, followed by Indonesia Eximbank with an outstanding bond stock valued at IDR12.6 trillion. The third largest corporate bond issuer was Astra Sedaya Finance with a total bond stock valued at IDR10.6 trillion.

In 3Q13, new issuance of corporate bonds totaled IDR11.9 trillion, representing a 39.4% decline on a q-o-q basis. On a y-o-y basis, however, corporate bond issuance rose 19.5% at end-September. Corporate bond issuance was still

Table 4: Top 30 Issuers of LCY Corporate Bonds in Indonesia

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (IDR billion)	LCY Bonds (US$ billion)			
1. PLN	15,208	1.33	Yes	No	Energy
2. Indonesia Eximbank	12,569	1.10	Yes	No	Banking
3. Astra Sedaya Finance	10,641	0.93	No	No	Finance
4. Adira Dinamika Multifinance	10,277	0.90	No	Yes	Finance
5. Bank Tabungan Negara	8,850	0.78	Yes	Yes	Banking
6. Federal International Finance	7,901	0.69	No	No	Finance
7. Indosat	7,820	0.69	No	Yes	Telecommunications
8. Jasa Marga	7,100	0.62	Yes	Yes	Toll Roads, Airports, and Harbors
9. Bank Internasional Indonesia	7,000	0.61	No	Yes	Banking
10. Bank Pan Indonesia	7,000	0.61	No	Yes	Banking
11. Bank CIMB Niaga	6,480	0.57	No	Yes	Banking
12. Perum Pegadaian	5,739	0.50	Yes	No	Finance
13. Bank Tabungan Pensiunan Nasional	5,385	0.47	No	Yes	Banking
14. Medco-Energi International	4,487	0.39	No	Yes	Petroleum and Natural Gas
15. Bank Permata	4,250	0.37	No	Yes	Banking
16. Bank OCBC NISP	3,880	0.34	No	Yes	Banking
17. Sarana Multigriya Finansial	3,709	0.33	Yes	No	Finance
18. Indofood Sukses Makmur	3,610	0.32	No	Yes	Food and Beverages
19. Agung Podomoro Land	3,600	0.32	No	Yes	Property, Real Estate, and Building Construction
20. Bank Mandiri	3,500	0.31	Yes	Yes	Banking
21. Antam	3,000	0.26	Yes	Yes	Petroleum and Natural Gas
22. Telekomunikasi Indonesia	3,000	0.26	Yes	Yes	Telecommunications
23. BCA Finance	2,850	0.25	No	No	Finance
24. Bank Danamon Indonesia	2,800	0.25	No	No	Banking
25. Bumi Serpong Damai	2,750	0.24	No	Yes	Property, Real Estate, and Building Construction
26. Toyota Astra Financial Services	2,595	0.23	No	No	Finance
27. Indomobil Finance Indonesia	2,518	0.22	No	No	Finance
28. Bank Jabar Banten	2,400	0.21	No	Yes	Banking
29. Bank Rakyat Indonesia	2,000	0.18	Yes	Yes	Banking
30. Garuda Indonesia	2,000	0.18	Yes	Yes	Infrastructure, Utilities, and Transportation
Total Top 30 LCY Corporate Issuers	**164,917**	**14.46**			
Total LCY Corporate Bonds	**214,891**	**18.84**			
Top 30 as % of Total LCY Corporate Bonds	**76.7%**	**76.7%**			

LCY = local currency.
Notes:
1. Data as of end-September 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Indonesia Stock Exchange data.

robust through July, with 12 firms raising a total of IDR9.3 trillion. However, issuance stalled in August amid increasing inflation expectations and rising borrowing costs. Issuance by corporates resumed in late September as bond issues by two firms amounted to a combined IDR2.6 trillion.

A total of 14 corporate firms issued 28 bond series during the quarter. Of these bonds, all were conventional except for one *sukuk ijarah* and one subordinated bond. In terms of maturity, 17 bond series carried maturities of 3–5 years, 5 series had maturities of 7 years, and 1 series had maturities of 10 years. Corporate bonds issued in July carried coupons ranging from 7.25% to 11.5%, while those issued in late September carried coupons ranging from 8.4% to 9.75%. Some notable corporate bonds issued in 3Q13 are shown in **Table 5**.

Foreign Currency Bonds. At end-September, foreign currency (FCY) government bonds outstanding reached US$32.7 billion, or the equivalent of about 40% of the government's LCY bonds outstanding, which stood at US$82.7 billion. The government raised a total of US$5.5 billion from the sale of US$-denominated bonds this year. Of which, two issues were sold in 3Q13 for a combined amount of US$2.5 billion.

Table 5: Notable LCY Corporate Bond Issuance in 3Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Jasa Marga		
370-day bond	8.40	700
3-year bond	8.70	400
5-year bond	8.90	1,000
Garuda Indonesia		
5-year bond	9.25	2,000
Perum Pegadaian		
370-day bond	7.25	430
3-year bond	7.40	17
5-year bond	7.75	177
7-year bond	8.00	601
PLN		
7-year bond	8.00	182
7-year *Sukuk Ijarah*	8.00	121
10-year bond	8.25	697
Permodalan Nasional Madani		
5-year bond	9.20	1,000
Bank Tabungan Pensiunan Nasional		
3-year bond	7.75	450
5-year bond	8.25	350

LCY = local currency.
Source: Indonesia Stock Exchange.

In July, the government sold US$1 billion of 10-year bonds. The bonds were priced to yield 5.45% and carry a coupon of 5.375%. The bonds were oversubscribed with the order book reaching US$1.9 billion. Nearly half of the bonds were sold to investors from the US, while 26% were taken by European investors and the remainder by Asian investors. The bonds were rated Baa3 by Moody's, BB+ by Standard & Poor's, and BBB– by Fitch Ratings.

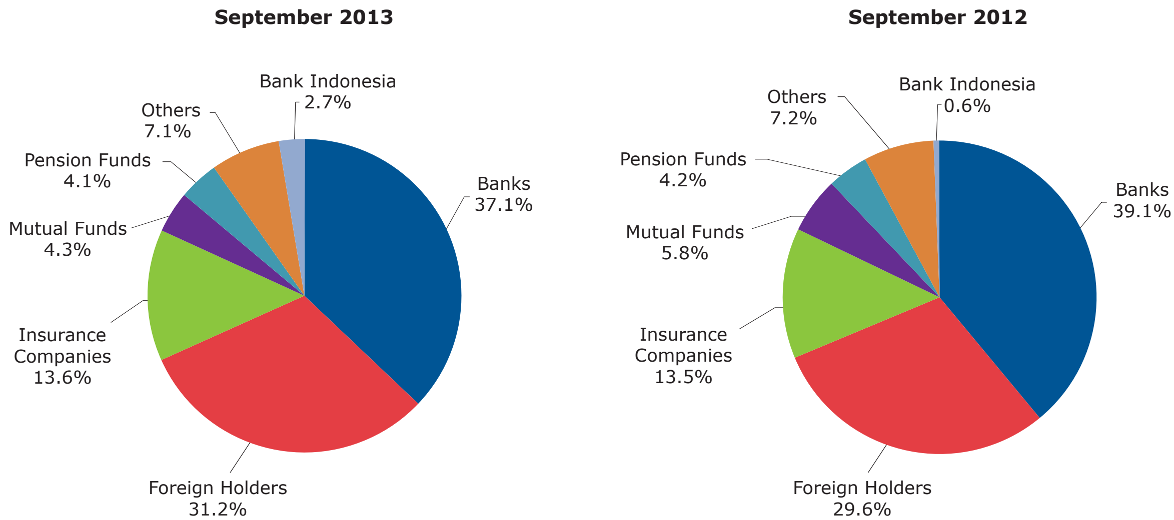
Also, the government raised US$1.5 billion from the sale of Islamic bonds in September, its fourth issuance of global *sukuk* and the biggest in terms of size since 2009. The bonds carry a maturity of 5.5 years and were sold at par to yield 6.125%. The bonds were oversubscribed with demand reaching US$5.7 billion. Investors from Asia took 25% of the bonds, while investors from the US, Middle East, and Europe bought 24%, 20%, and 16%, respectively. The remaining 15% was taken by domestic investors.

Investor Profile

Central Government Bonds. At end-September, the share of government bonds held by banking institutions dropped to 37.1% of the total with bond holdings valued at IDR350 trillion **(Figure 2)**. This was down from a share of 39.1% a year earlier, but higher in terms of nominal value. Banks remained the largest holder of central government bonds. Banking institutions comprise state recap banks, private recap banks, non-recap banks, regional banks, and *shari'a* banks. Among these institutions, state recap banks are the largest holder of central government bonds.

The share of LCY central government bonds held by foreign investors increased to 31.2% in 3Q13 from 29.6% a year earlier. Their share, however, was almost unchanged from an end-June 2013

Figure 2: LCY Central Government Bonds Investor Profile

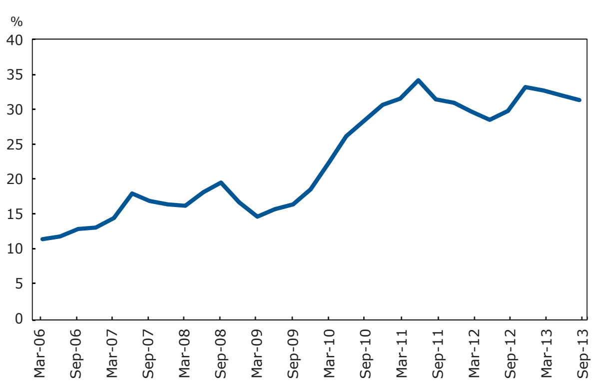


LCY = local currency.
Source: Indonesia Debt Management Office.

level of 31.8% **(Figure 3)**. Foreign investors play an active role in Indonesia's bond market as they are among the largest players in the market. In absolute terms, outstanding bonds held by foreign investors reached IDR294.1 trillion at end-September 2013.

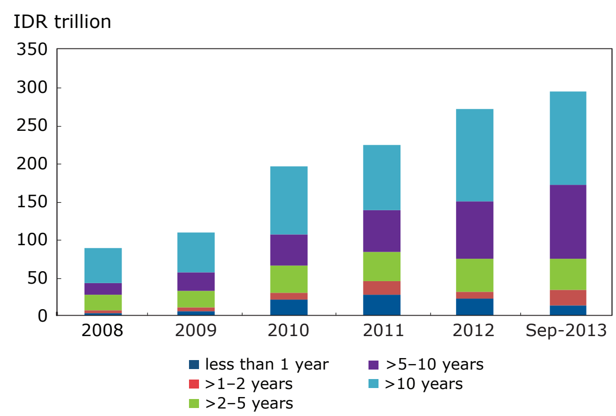
Despite volatile market conditions in 3Q13, foreign investors continued to shore-up their holdings of longer-dated bonds. At end-September, 42% of government bonds held by offshore investors carried maturities of more than 10 years **(Figure 4)**. These investors also increased the share of medium-term bonds (maturities of more than 5 years to 10 years) among their total holdings to 33% in 3Q13 from 30% in the previous quarter. Meanwhile, the share of shorter-dated maturities (bonds with maturities of 1 year or less) among foreign investors' total holdings accounted for a 4% share in 3Q13.

Figure 3: Foreign Investor Share of LCY Central Government Bonds



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

Figure 4: Foreign Holdings of LCY Central Government Bonds by Maturity

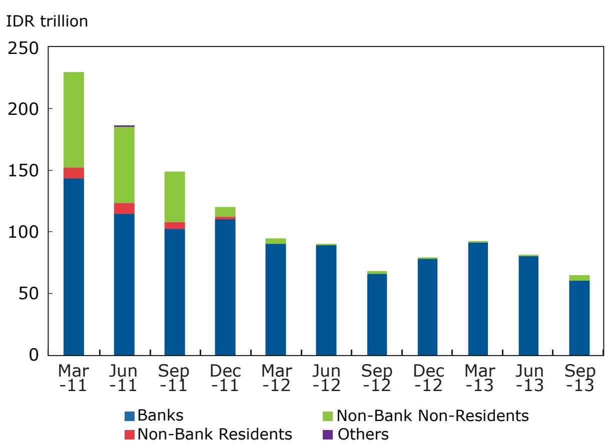


LCY = local currency.
Source: Indonesia Debt Management Office.

Central government bond holdings of other domestic investors either hardly changed or declined slightly in 3Q13 on a y-o-y basis. Mutual funds' holdings of government bonds fell to a share of 4.3% from 5.8% a year earlier. While most other investor classes, including insurance companies and pension funds, registered negligible changes in their respective holdings of government bonds. The only other significant change in investor holdings were those of BI, whose share of government bonds climbed to 2.7% of the total at end-September from 0.6% in the previous year.

Central Bank Bills. At end-September, central bank bills (SBI), were primarily held by banking institutions with holdings equivalent to a share of 94% of the total. In absolute terms, outstanding SBI held by banks reached IDR60.9 trillion at end-September, compared with IDR80.8 trillion in the previous quarter **(Figure 5)**. Foreign non-bank investors accounted for the remaining 6% of SBI holdings. The marked increase in foreign holdings of SBI during 3Q13 was due to BI's decision in late August to reduce the minimum holding period of SBI from 6 months to 1 month. The reduced holding period is expected to attract renewed interest in SBI from offshore funds. Foreign investors' share had dropped significantly after the central bank implemented the 6-month holding period for SBI in 2011. The all-time high for foreign holdings' share of SBI was in March 2011 at 34% based on nominal holdings of IDR77.4 trillion.

Figure 5: LCY Central Bank Bills Investor Profile



LCY = local currency.
Source: Bank Indonesia.

Rating Changes

On 11 October, Ratings and Investment Information (R&I) affirmed its BBB– sovereign credit rating for Indonesia. The outlook on the rating was stable. In making its decision, R&I took note of Indonesia's ability to achieve sustainable economic growth in the long-term, conservative fiscal management, sound banking sector, and low level of government debt. R&I also stated that Indonesia would able to maintain adequate foreign exchange reserves to service its external debt even amid pressures on the exchange rate.

Policy, Institutional, and Regulatory Developments

BI and PBOC Extend Bilateral Swap Arrangement

On 2 October, BI signed an extension of its bilateral swap arrangement with the People's Bank of China (PBOC) amounting to CNY100 billion (IDR175 trillion). The new agreement will run for 3 years and is subject to an extension depending on an agreement between the two parties. The new bilateral swap arrangement is expected to boost trade and direct investment between Indonesia and the People's Republic of China, and bolster the availability of short-term liquidity.

BI Introduces Regulation on Hedging

On 9 October, BI announced that it will regulate the hedging activities of local residents and corporates based in Indonesia in order to deepen the country's foreign exchange market. Specifically, it seeks to regulate the use of hedging instruments, such as foreign exchange forwards and swaps, by individuals and corporates, including state-owned firms. The central bank stated that individuals need to present documents showing the economic rationale underlying the hedging transaction such as international trade, investments, or payment of foreign debt.

Indonesia and the Republic of Korea Establish Bilateral KRW–IDR Swap Arrangement

On 12 October, the ministries of finance and central banks of Indonesia and the Republic of Korea agreed to establish a bilateral KRW–IDR swap arrangement. The size of the swap arrangement is up to KRW10.7 trillion–IDR115 trillion (equivalent to US$10 billion). The agreement will run for 3 years and is subject to an extension depending on an agreement between the two parties. The bilateral swap arrangement aims to promote bilateral trade and further strengthen financial cooperation between the two countries.

House of Representatives Approves the 2014 National Budget

On 25 October, the House of Representatives approved the 2014 national budget. The underlying macroeconomic assumptions included in the budget are (i) economic growth of 6.0%; (ii) an inflation rate target of 5.5%; (iii) an IDR–US$ exchange rate of IDR10,500–US$1; (iv) a 3-month treasury bill yield of 5.5%; (v) an Indonesian crude oil price of US$105 per barrel; and (vi) oil and gas lifting volumes set at 0.87 million barrels per day and 1.24 million barrels per day, respectively. The 2014 budget estimates central government revenues of IDR1,667.1 trillion and expenditures of IDR1,842.5 trillion, resulting in a budget deficit of IDR175.4 trillion, or the equivalent of 1.7% of GDP.