

Indonesia

Yield Movements

Indonesian local currency (LCY) government bond yields rose for most tenors in the belly and longer-end of the curve between end-March and end-July, while falling at the shorter-end, resulting in the steepening of the yield curve (**Figure 1**). Yields shed 8 basis points (bps) at the very short-end of the curve. Meanwhile, the 3-year maturity's yield increased 25 bps, the biggest increase among any tenor. The drop in yields at the short-end can be attributed to a sustained downward trend in inflation in recent months. In July, inflation eased to 4.5% year-on-year (y-o-y), marking the first time since June 2013 that inflation came within Bank Indonesia's 2013 and 2014 target range of 3.5%–5.5%.

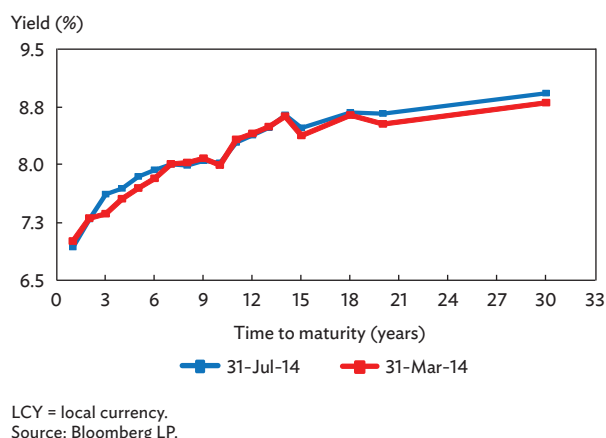
Bond yields, however, remained under pressure on concerns over a widening current account deficit. The current account deficit reached US\$9.1 billion in 2Q14, equivalent to 4.3% of gross domestic product (GDP), up from US\$4.2 billion in 1Q14, equivalent to 2.1% of GDP. Bank Indonesia however expects the current account deficit to be lower in the second half of the year as the spike in 2Q14 was due mainly to Eid celebrations when imports normally rise ahead of the expected surge in domestic demand.

Other domestic factors also weighed on the bond market, dragging down sentiments as the rupiah remained weak, higher borrowing requirements due to revisions in the state budget, and uncertainty surrounding the presidential election results.

Economic growth in Indonesia slowed to 5.1% y-o-y in 2Q14, from revised 5.2% growth in 1Q14. The slower growth was due mainly to weak exports as regulations prohibiting raw mineral ore exports acting as a drag on GDP. Imports and government spending also slowed on a y-o-y basis in 2Q14. Meanwhile, domestic consumption and investment remained strong, expanding 5.6% and 4.5%, respectively. On a quarter-on-quarter (q-o-q) basis, the economy grew 2.5% in 2Q14.

Given these developments, Bank Indonesia continued to maintain a tightening bias toward its monetary policy and kept its benchmark rate steady at 7.5% in its meeting

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



held on 14 August. The benchmark rate has stayed at this level since November 2013. Bank Indonesia noted that at its current level, the policy rate remains consistent with efforts to steer inflation toward its 2014 target range of 3.5%–5.5% and to lower the current account deficit to a more sustainable level.

Size and Composition

The outstanding size of LCY bonds in Indonesia reached IDR1,465.8 trillion (US\$123 billion) at end-June on growth of 4.8% q-o-q (**Table 1**). On a y-o-y basis, the bond market grew at a pace of 24.2%.

The outstanding stock of LCY government bonds stood at IDR1,248.4 trillion, up 5.6% over the previous quarter and 28.0% over the previous year. Growth in the government sector was driven by increases in central government bonds, comprising treasury instruments issued by the Ministry of Finance, and central bank bills, known as *Sertifikat Bank Indonesia* (SBI), issued by Bank Indonesia.

Central Government Bonds. The stock of central government bonds rose 5.5% q-o-q and 27.4% y-o-y to reach IDR1,131.6 trillion at end-June. Growth was largely driven by increases in the stock of conventional fixed-rate bonds and project-based *sukuk* (Islamic bonds).

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

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	IDR	US\$	IDR	US\$	IDR	US\$	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,180,422	118	1,398,996	123	1,465,790	123	2.2	12.4	4.8	24.2
Government	975,057	97	1,181,628	104	1,248,379	105	1.7	10.3	5.6	28.0
Central Govt. Bonds	888,514	89	1,072,741	94	1,131,630	95.3	3.1	12.3	5.5	27.4
of which: <i>Sukuk</i>	79,750	8	96,764	9	101,329	9	7.5	32.5	4.7	27.1
Central Bank Bills	86,543	9	108,887	10	116,749	10	(10.6)	(6.8)	7.2	34.9
of which: <i>Sukuk</i>	4,623	0.5	5,377	0.5	6,792	0.6	(4.8)	48.4	26.3	46.9
Corporate	205,365	21	217,369	19	217,412	18	4.5	23.6	0.02	5.9
of which: <i>Sukuk</i>	7,538	0.8	7,194	0.6	6,658	0.6	(10.1)	13.0	(7.5)	(11.7)

(-) = 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 nontradable bonds as of end-June stood at IDR270.0 trillion.

Sources: Bank Indonesia, Indonesia Debt Management Office, Indonesia Stock Exchange, Otoritas Jasa Keuangan, and Bloomberg LP.

In 2Q14, the government raised a total of IDR69.6 trillion worth of Treasury bills and bonds in line with its quarterly target. There were seven auctions of conventional bonds, where the government issued benchmark series, and six auctions of Islamic instruments. As in the past, auctions of conventional bonds were either fully awarded or upsized from the targeted amount, while Islamic bond auctions fell below target except for one auction during the review period.

Central government issuance in 2Q14 was 16.0% lower than in 1Q14, but was 46.7% higher than in the previous year. The government continued with its frontloading policy into the second quarter, in which it issued a huge amount of bonds early in the year to take advantage of lower rates. Interest rates are expected to rise later this year with the anticipated end of the United States Federal Reserve's asset purchase program in October.

Based on the revised 2014 state budget, the government raised nearly 60% of its net government securities issuance target for the year, including foreign-currency denominated bonds, through end-June.

Central Bank Bills. The stock of SBI rose to IDR116.7 trillion at end-June, gaining 7.2% q-o-q and 34.9% y-o-y. Bank Indonesia issues SBI as one of its monetary tools for liquidity management. In 2Q14, new issuance of SBI and *shari'a*-compliant SBI with 9-month tenors totaled IDR28.1 trillion.

Corporate Bonds. LCY corporate bonds outstanding in Indonesia reached IDR217.4 trillion at end-June, rising by 0.02% q-o-q and 5.9% y-o-y. *Sukuk* comprised about 3% of the total corporate bond stock at the end of 2Q14.

The top 30 LCY corporate bond issuers in Indonesia in 2Q14 had aggregate outstanding bonds worth IDR161.9 trillion, accounting for 74.5% of total corporate bonds (**Table 2**). By industry type, banks and financial institutions accounted for two-thirds of the firms on the list. State power firm PLN maintained the top spot with outstanding LCY bonds valued at IDR15.6 trillion, followed by state-owned Indonesia Eximbank (IDR12.6 trillion). Completing the top three was Astra Sedaya Finance, which rose up one spot from 1Q14, with outstanding bonds amounting to IDR12.3 trillion at the end of 2Q14.

New issuance of corporate bonds totaled IDR16.8 trillion in 2Q14, more than a three-fold increase from IDR5.2 trillion in 1Q14. On a y-o-y basis, however, corporate bond issuance declined 14.4% at end-June. A total of 15 corporate entities raised funds from the bond market in 2Q14; all of the issues were conventional bonds, including one issue of subordinated debt. New corporate names issuing bonds in 2Q14 included Bank UOB Indonesia, Express Transindo Utama, Sarana Multi Infrastruktur, and Sumber Alfaria Trijaya.

Eleven bond series carried 3-year maturities, with coupon rates ranging from 9.25% to 11.40%. There were seven

Table 2: 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	15,573	1.31	Yes	No	Energy
2.	Indonesia Eximbank	12,608	1.06	Yes	No	Banking
3.	Astra Sedaya Finance	12,341	1.04	No	No	Finance
4.	Adira Dinamika Multi Finance	11,612	0.98	No	Yes	Finance
5.	Bank Tabungan Negara	7,950	0.67	Yes	Yes	Banking
6.	Bank CIMB Niaga	7,930	0.67	No	Yes	Banking
7.	Bank Internasional Indonesia	7,000	0.59	No	Yes	Banking
8.	Bank Pan Indonesia	6,800	0.57	No	Yes	Banking
9.	Bank Permata	6,478	0.55	No	Yes	Banking
10.	Indosat	6,190	0.52	No	Yes	Telecommunications
11.	Perum Pegadaian	5,739	0.48	Yes	No	Finance
12.	Jasa Marga	5,600	0.47	Yes	Yes	Toll Roads, Airports, and Harbors
13.	Federal International Finance	4,875	0.41	No	No	Finance
14.	Bank Tabungan Pensiunan Nasional	4,820	0.41	No	Yes	Banking
15.	Agung Podomoro Land	4,350	0.37	No	Yes	Property, Real Estate, and Building Construction
16.	Indofood Sukses Makmur	4,000	0.34	No	Yes	Food and Beverages
17.	Sarana Multigriya Finansial	3,511	0.30	Yes	No	Finance
18.	Bank Mandiri	3,500	0.29	Yes	Yes	Banking
19.	Medco-Energi International	3,500	0.29	No	Yes	Petroleum and Natural Gas
20.	Indomobil Finance Indonesia	3,059	0.26	No	No	Finance
21.	Antam	3,000	0.25	Yes	Yes	Petroleum and Natural Gas
22.	Telekomunikasi Indonesia	3,000	0.25	Yes	Yes	Telecommunications
23.	Bank OCBC NISP	2,907	0.24	No	Yes	Banking
24.	Toyota Astra Financial Services	2,795	0.24	No	No	Finance
25.	Bumi Serpong Damai	2,750	0.23	No	Yes	Property, Real Estate, and Building Construction
26.	Bank Jabar Banten	2,124	0.18	No	Yes	Banking
27.	BCA Finance	2,100	0.18	No	No	Finance
28.	Bank Rakyat Indonesia	2,000	0.17	Yes	Yes	Banking
29.	Garuda Indonesia	2,000	0.17	Yes	Yes	Infrastructure, Utilities, and Transportation
30.	BII Finance	1,824	0.15	No	No	Finance
Total Top 30 LCY Corporate Issuers		161,935	13.64			
Total LCY Corporate Bonds		217,412	18.31			
Top 30 as % of Total LCY Corporate Bonds		74.5%	74.5%			

LCY = local currency.

Notes:

1. Data as of end-June 2014.

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.

bond series with maturities of 370 days and coupon rates ranging from 8.25% to 11.00%, and seven bond series with 5-year tenors and coupon rates ranging from 9.75% to 12.40%. Two bond series had 7-year tenors, with coupons of 11.35% and 13.0% each. Some of the notable corporate bonds issued in 2Q14 are presented in **Table 3**.

Foreign Currency Bonds. As of end-June, foreign currency (FCY) government bonds outstanding reached US\$34.2 billion. In January, the government raised a total of US\$4 billion from the sale of US\$-denominated bonds. Subsequently, in July, the Indonesian government sold its first EUR-denominated bonds amounting to EUR1 billion.

Table 3: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Indonesia Eximbank		
370-day bond	8.25	803
2-year bond	8.50	134
3-year bond	9.25	1,594
5-year bond	9.75	1,469
Indofood Sukses Makmur		
5-year bond	10.13	2,000
Astra Sedaya Finance		
370-day bond	9.60	1,135
3-year bond	10.50	740
4-year bond	10.60	75
Adira Dinamika Multi Finance		
370-day bond	9.60	687
3-year bond	10.50	363
5-year bond	10.75	450
Bank UOB Indonesia		
7-year bond	11.35	1,000
Express Transindo Utama		
5-year bond	12.25	1,000
Sarana Multi Infrastruktur		
3-year bond	9.60	100
5-year bond	10.00	900
Sumber Alfaria Trijaya		
3-year bond	10.50	1,000

LCY = local currency.
Source: Indonesia Stock Exchange.

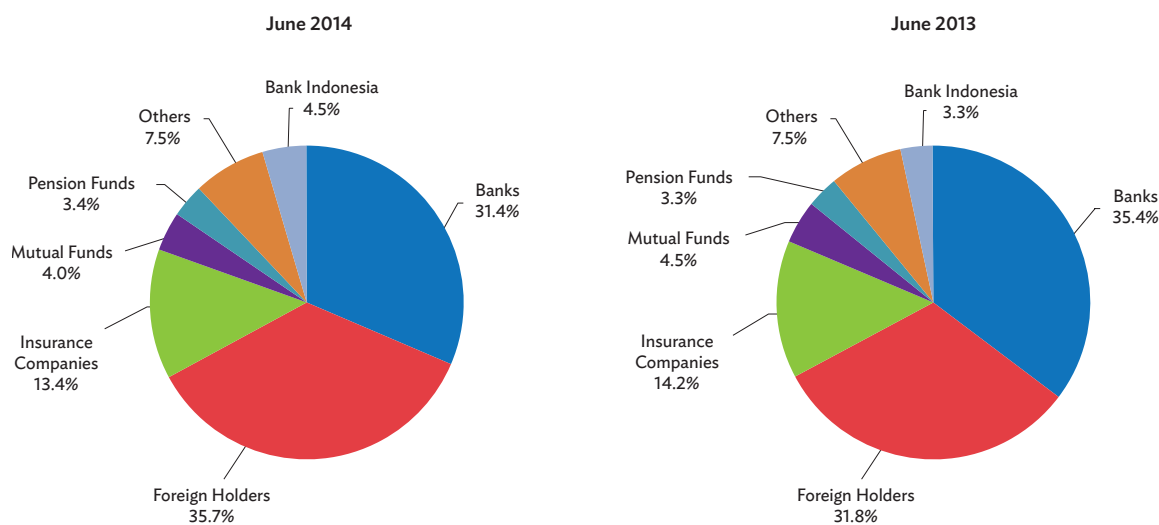
The bonds carried a maturity of 7 years and a coupon of 2.875%. The bond sale was oversubscribed with the orderbook reaching EUR6.7 billion.

Investor Profiles

Central Government Bonds. Foreign investors now hold more than a third of Indonesia's LCY central government bonds, making them one of the biggest players in Indonesia's bond market. At end-June, the share of LCY central government bonds held by foreign investors climbed to 35.7% from 31.8% a year earlier (**Figure 2**). In absolute terms, outstanding bonds held by foreign investors climbed to IDR403.6 trillion at end-June. Indonesian bonds continued to attract interest from foreign players due to attractive yields that are the highest (at the longer-end of the curve) among all emerging East Asian markets except Viet Nam.

At end-June, about 42% of government bonds held by foreign investors had maturities of more than 10 years, slightly lower compared with end-December's level (**Figure 3**). However, the share of medium-term bonds (maturities of more than 5 years to 10 years) held by these investors increased slightly over the same period from about 32% to about 33%. The biggest change in terms of foreign ownership of bonds occurred for bonds with maturities of 2 years–5 years, with the share of foreign holdings climbing from about 13% at end-December to about 16% at end-June.

The second largest investor group comprised banking institutions, with a share of 31.4% of central government bonds at end-June, down from 35.4% a year earlier.

Figure 2: LCY Central Government Bonds Investor Profile

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

Banking institutions comprise state recap banks, private recap banks, non-recap banks, regional banks, and *shari'a* banks.

Meanwhile, central government bond holdings of other domestic investors were broadly unchanged in 2Q14, except for insurance companies, whose share of central government bond holdings dropped to 13.4% from 14.2% in 2Q13. Mutual funds' holdings of government bonds also declined to a share of 4.0% from 4.5% a year earlier. The only other significant increase in holdings was noted for Bank Indonesia, whose share of government bonds climbed to 4.5% at end-June from 3.3% a year earlier.

Central Bank Bills. At end-June, central bank bills, or SBI, were primarily held by banking institutions, which accounted for a share of 86.9% of the total (Figure 4). Foreign non-bank investors accounted for the remaining 13.1% of SBI holdings. The share of SBI held by non-residents has markedly increased since June 2013 when Bank Indonesia lowered the minimum holding period for SBI from 6 months to 1 month.

Rating Changes

On 28 April, Standard & Poor's affirmed its BB+ sovereign credit rating for Indonesia. The outlook on the rating was stable. In making its decision, Standard & Poor's cited as key factors Indonesia's favorable fiscal and debt metrics, and moderately strong growth outlook.

Policy, Institutional, and Regulatory Developments

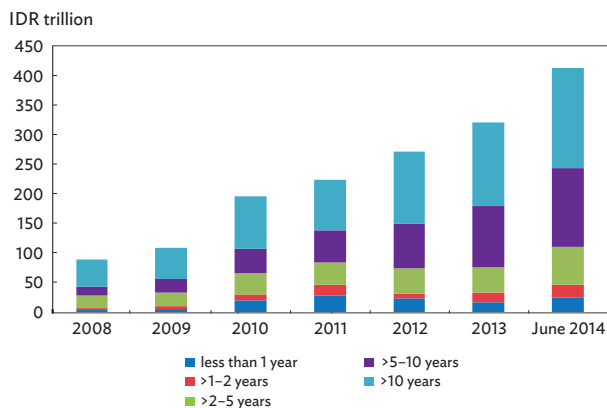
Parliament Approves Revised 2014 State Budget

In June, the House of Representatives approved the 2014 revised state budget, which projects a deficit equivalent to 2.4% of GDP, compared with 1.7% in the original budget. The revised 2014 state budget raised the net government securities financing requirement to 2.6% of GDP. In absolute terms, the net government securities financing requirement is up 29.2% from the original budget to IDR265.0 trillion. The underlying macroeconomic assumptions for the revised state budget include (i) GDP growth of 5.5%, (ii) annual inflation of 5.3%, (iii) an exchange rate of IDR11,600 to US\$1, and (iv) a 3-month treasury bill rate of 6.0%.

Bank Indonesia Issues *Shari'a* FCY Term Deposits

On 25 July, Bank Indonesia announced plans to issue *shari'a* FCY term deposits as part of efforts to develop *shari'a* banking and deepen the *shari'a* financial market. The term deposits are FCY-denominated Islamic monetary instruments that will complement FCY liquidity management in the *shari'a* financial market. They will be based on a *ju'alah* contract, which is backed by a commitment to provide a specific return after completion of a job, and carry a tenor of between 1 day and 12 months. The first auction was subsequently held on 20 August.

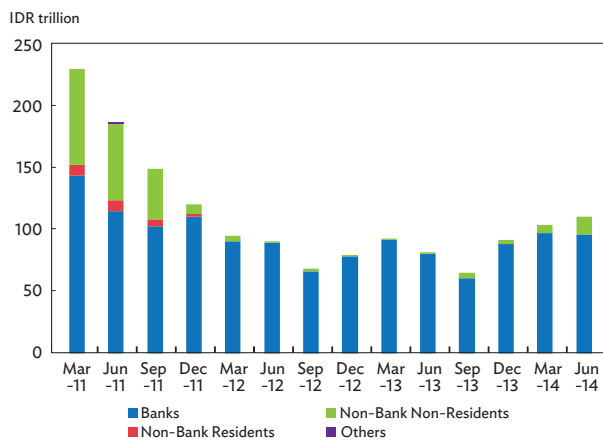
Figure 3: Foreign Holdings of LCY Central Government Bonds by Maturity



LCY = local currency.

Source: Indonesia Debt Management Office.

Figure 4: LCY Central Bank Bills Investor Profile



LCY = local currency.

Source: Bank Indonesia.