

Indonesia

Yield Movements

Local currency (LCY) government bond yields in Indonesia rose for all tenors between 2 March and 15 May, resulting in an upward shift of the yield curve (**Figure 1**). Yields gained between 90 basis points (bps) and 116 bps from the 2-year tenor through the long-end of the curve, while yield at the very short-end rose 75 bps. The yield spread between the 2-year and 10-year maturities narrowed to 30 bps from 37 bps in the period under review.

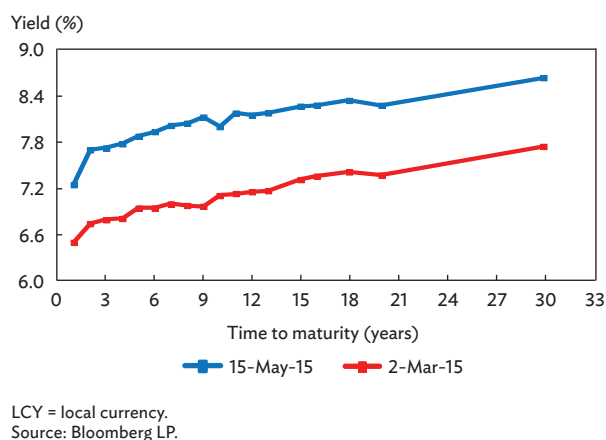
The overall rise in yields was reflective of concerns over the timing of a likely United States (US) Federal Reserve interest rate hike. In addition, rising yields at the short-end of the curve posit rising inflationary expectations as global oil prices have shown some recovery. Coupled with the government's removal of fuel subsidies at the beginning of the year, this is contributing to additional price pressures. There is also an upside risk to inflation as demand for goods normally picks up during the Muslim fasting month of Ramadan.

Consumer price inflation has thus far remained above Bank Indonesia's 2015 target range of 3.0%–5.0%. Inflation slowed to 7.0% year-on-year (y-o-y) in January and 6.3% y-o-y in February, before rising again to 6.4% y-o-y in March and 6.8% y-o-y in April. The uptick in April inflation was due mainly to increases in fuel costs and food prices.

With inflation remaining elevated above its target range, Bank Indonesia continued to maintain its tight monetary policy stance. The benchmark interest rate has been kept at 7.50% since February. Bank Indonesia's tight monetary bias also remains in place in order to reduce the current account deficit to a more sustainable level. To spur growth, Bank Indonesia said that it plans to loosen macroprudential measures by revising its policies for the loans-to-deposit and loan-to-value ratios for mortgage loans and down payments for automotive loans.

Foreign investor interest in Indonesia's LCY bond market has slightly weakened in March due to risk aversion following investor concerns that US will raise interest rates. Net foreign capital outflows were recorded in March, with the share of foreign holdings of Indonesian LCY bonds slipping to 38.6% from 40.3% at end-January.

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



Foreign holdings' share had further declined to 38.1% as of 15 May.

Meanwhile, gross domestic product (GDP) growth in Indonesia slipped to 4.7% y-o-y in 1Q15 from 5.0% y-o-y in 4Q14. GDP growth in 1Q15 was at its slowest since 2009, resulting from weak exports and falling crude oil prices, according to Statistics Indonesia. Growth in government spending also slowed to 2.2% y-o-y in 1Q15 from 2.8% y-o-y in 4Q14. On the other hand, private consumption, which accounts for about 56% of GDP, rose 5.0% in 1Q15 to match 4Q14's growth rate. Bank Indonesia is projecting economic growth to improve in 2Q15 as the government increases infrastructure spending to stimulate growth.

Size and Composition

The outstanding size of Indonesia's LCY bond market continued to climb at end-March, rising to IDR1,629.1 trillion (US\$125 billion). Overall growth of the bond market remained strong at 6.5% quarter-on-quarter (q-o-q) and 16.5% y-o-y (**Table 1**). Indonesia's LCY bond market was still largely dominated by conventional bonds, accounting for about 90% of total outstanding bonds at end-March. The remaining 10% were *sukuk* (Islamic bonds).

The outstanding stock of government bonds expanded to IDR1,401.6 trillion at end-March on growth of 7.2% q-o-q and 18.6% y-o-y. Growth came mainly from an increase in

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

	Outstanding Amount (billion)						Growth Rate (%)			
	1Q14		4Q14		1Q15		1Q14		1Q15	
	IDR	US\$	IDR	US\$	IDR	US\$	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,398,996	123	1,529,810	123	1,629,143	125	6.8	21.1	6.5	16.5
Government	1,181,628	104	1,306,990	106	1,401,586	107	8.3	23.3	7.2	18.6
Central Govt. Bonds	1,072,741	94	1,209,961	98	1,305,486	100	7.8	24.5	7.9	21.7
of which: <i>Sukuk</i>	96,764	9	110,704	9	145,229	11	11.0	30.4	31.2	50.1
Central Bank Bills	108,887	10	97,029	8	96,100	7	13.3	12.4	(1.0)	(11.7)
of which: <i>Sukuk</i>	5,377	0.5	8,130	0.7	8,810	0.7	14.1	10.8	8.4	63.8
Corporate	217,369	19	222,820	18	227,557	17	(0.4)	10.7	2.1	4.7
of which: <i>Sukuk</i>	7,194	0.6	7,105	0.6	7,078	0.5	(4.8)	(14.2)	(0.4)	(1.6)

(-) = 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-March stood at IDR263.1 trillion.

Sources: Bank Indonesia, Directorate General of Budget Financing and Risk Management Ministry of Finance, Indonesia Stock Exchange, Otoritas Jasa Keuangan, and Bloomberg LP.

the stock of central government bonds, which comprised Treasury instruments issued by the Ministry of Finance. On the other hand, the stock of central bank bills, which are known as *Sertifikat Bank Indonesia* (SBI), contracted in 1Q15.

Central Government Bonds. The outstanding size of central government bonds climbed 7.9% q-o-q and 21.7% y-o-y to reach IDR1,305.5 trillion. Growth was largely driven by increases in the stock of conventional fixed-rate bonds, and Islamic Treasury instruments, particularly Islamic Treasury bills, retail *sukuk*, and project-based *sukuk*.

The government raised a total of IDR114.1 trillion worth of Treasury bills and bonds in 1Q15. As in the past, the government has adopted a frontloading policy with regard to issuance, choosing to issue a larger volume of debt instruments in the first 6 months of the year. In 2015, the government's target is to complete about 60% of gross LCY bond issuance in the first half of the year. Also, the government plans to issue 79.9% in the form of conventional bonds and the remaining 20.1% as *sukuk*.

In 1Q15, new issuance by the central government was notably higher on both a q-o-q and y-o-y basis as the government conducted weekly auctions of Treasury instruments and issued retail *sukuk* through a bookbuilding process. Most of the treasury auctions during the quarter were fully subscribed or oversubscribed, including some *sukuk* auctions.

In March, the government issued the retail *sukuk* series SR-007, raising IDR21,965 billion from the bond sale. The retail *sukuk* carried a maturity of 3 years and a rate of return of 8.25%. SR-007 was issued following the *ijarah* principle, which refers to Islamic bonds backed by a lease agreement. The retail *sukuk* were only sold to individual investors and required a 1-month holding period before it can be traded.

Central Bank Bills. The stock of SBI fell to IDR96.1 trillion at end-March, down on both a q-o-q and y-o-y basis. Bank Indonesia issues SBI as one of its tools for liquidity management. New issuance of SBI and *shari'a*-compliant SBI with 9-month tenors amounted to IDR27.2 trillion in 1Q15, significantly lower from the earlier quarter and year ago levels. There were three auctions of SBI during the quarter, one per month, with issuance of both conventional and *shari'a*-compliant SBI.

Corporate Bonds. At end-March, the outstanding stock of LCY corporate bonds in Indonesia reached IDR227.6 trillion on growth of 2.1% q-o-q and 4.7% y-o-y. Most corporate bonds were conventional issues, with *sukuk* only accounting for about 3% of the total. Indonesia's corporate bond segment remains small, accounting for only about 14% of the aggregate bond stock.

At end-March, the top 30 LCY corporate bond issuers in Indonesia had a total outstanding bond stock of IDR171.3 trillion, or a 75.3% share of total LCY corporate bonds outstanding (Table 2). Dominating the list were

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.	Indonesia Eximbank	21,712	1.66	Yes	No	Banking
2.	PLN	14,073	1.08	Yes	No	Energy
3.	Adira Dinamika Multifinance	11,005	0.84	No	Yes	Finance
4.	Astra Sedaya Finance	10,125	0.77	No	No	Finance
5.	Bank Internasional Indonesia	8,360	0.64	No	Yes	Banking
6.	Indosat	7,962	0.61	No	Yes	Telecommunications
7.	Bank Tabungan Negara	7,950	0.61	Yes	Yes	Banking
8.	Bank CIMB Niaga	7,750	0.59	No	Yes	Banking
9.	Bank Permata	6,482	0.50	No	Yes	Banking
10.	Bank Pan Indonesia	6,000	0.46	No	Yes	Banking
11.	Jasa Marga	5,900	0.45	Yes	Yes	Toll Roads
12.	Perum Pegadaian	5,419	0.41	Yes	No	Finance
13.	Bank OCBC NISP	5,378	0.41	No	Yes	Banking
14.	Sarana Multigriya Finansial	4,955	0.38	Yes	No	Finance
15.	Agung Podomoro Land	4,575	0.35	No	Yes	Property, Real Estate, and Building Construction
16.	Bank Tabungan Pensiunan Nasional	4,420	0.34	No	Yes	Banking
17.	Federal International Finance	4,070	0.31	No	No	Finance
18.	Indofood Sukses Makmur	4,000	0.31	No	Yes	Food and Beverages
19.	Bank Mandiri	3,500	0.27	Yes	Yes	Banking
20.	Medco-Energi International	3,500	0.27	No	Yes	Petroleum and Natural Gas
21.	Antam	3,000	0.23	Yes	Yes	Petroleum and Natural Gas
22.	BCA Finance	3,000	0.23	No	No	Finance
23.	Telekomunikasi Indonesia	3,000	0.23	Yes	Yes	Telecommunications
24.	Bumi Serpong Damai	2,750	0.21	No	Yes	Property, Real Estate, and Building Construction
25.	Indomobil Finance Indonesia	2,608	0.20	No	No	Finance
26.	Toyota Astra Financial Services	2,223	0.17	No	No	Finance
27.	Garuda Indonesia	2,000	0.15	Yes	Yes	Infrastructure, Utilities, and Transportation
28.	Permodalan Nasional Madani	2,000	0.15	Yes	No	Finance
29.	BII Finance	1,824	0.14	No	No	Finance
30.	Bank Jabar Banten	1,724	0.13	No	Yes	Banking
Total Top 30 LCY Corporate Issuers		171,265	13.10			
Total LCY Corporate Bonds		227,557	17.41			
Top 30 as % of Total LCY Corporate Bonds		75.3%	75.3%			

LCY = local currency.

Notes:

1. Data as of end-March 2015.

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.

firms from the banking and finance sectors. Some of the largest bond issuers came from capital intensive industries such as energy (PLN) and telecommunications (Indosat), and a toll road operator (Jasa Marga).

In 1Q15, Indonesia Eximbank remained the top corporate bond issuer of LCY bonds as its outstanding bond stock climbed to IDR21.7 trillion. Indonesia Eximbank issued twice in 1Q15—once in January and once in March. State power firm PLN was the second largest issuer with outstanding LCY bonds valued at IDR14.1 trillion at end-March, while Adira Dinamika Multifinance was third with an outstanding bond stock of IDR11.0 trillion.

New corporate bond issuance fell to IDR12.3 trillion in 1Q15 from IDR17.4 trillion in 4Q14. A total of nine corporate firms raised capital from the bond market, mostly in the banking and financial sectors. There were 19 new corporate bond series issued in 1Q15, all of which were conventional. In terms of maturity, most of the new bonds issued carried a maturity of 1–3 years, six bond series had maturities of more than 3 years to 5 years, and one bond series had a 7-year tenor. The largest corporate bond issuances in 1Q15 are shown in **Table 3**.

Foreign Currency Bonds. Taking advantage of the low interest rate environment, the Indonesian government priced a total of US\$4.0 billion worth of bonds in a dual-tranche sale in January. The issue comprised a US\$2.0 billion 10-year bond carrying a coupon of 4.125% and a yield of 4.200%, and a US\$2.0 billion 30-year bond with a coupon of 5.125% and a yield of 5.200%. The bonds were oversubscribed, with the combined order book reaching US\$19.3 billion. Investors were based in Asia, Europe, and the US.

In May, the Indonesian government priced a US\$2.0 billion *sukuk*, the largest US\$-denominated *sukuk* sale by Indonesia to date. The bonds carried a maturity of 10 years and were priced at par to yield 4.325%. The bonds were issued following the *wakala* principle (Islamic bonds backed by an agency agreement). The bond sale was oversubscribed, with the order book exceeding US\$6.8 billion

Based on the revised 2015 budget, the maximum limit for the government's international bond issuance is set at 22.6% of total gross issuance. The government plans to issue in all G3 currencies: euros, Japanese yen, and

Table 3: Notable LCY Corporate Bond Issuance in 1Q15

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Indonesia Eximbank		
370-day bond	8.25	575
3-year bond	9.00	1,298
3-year bond	9.25	800
5-year bond	7.25	700
5-year bond	9.50	2,727
OCBC NISP		
370-day bond	9.00	1,095
2-year bond	9.40	670
3-year bond	9.80	1,235
BCA Finance		
370-day bond	8.25	438
2-year bond	8.50	140
3-year bond	9.00	422
BFI Finance		
370-day bond	9.88	345
2-year bond	10.50	105
3-year bond	10.88	550

LCY = local currency.
Source: Indonesia Stock Exchange.

US dollars. The government issues foreign currency bonds to complement its domestic issuance and to provide a benchmark for corporate debt.

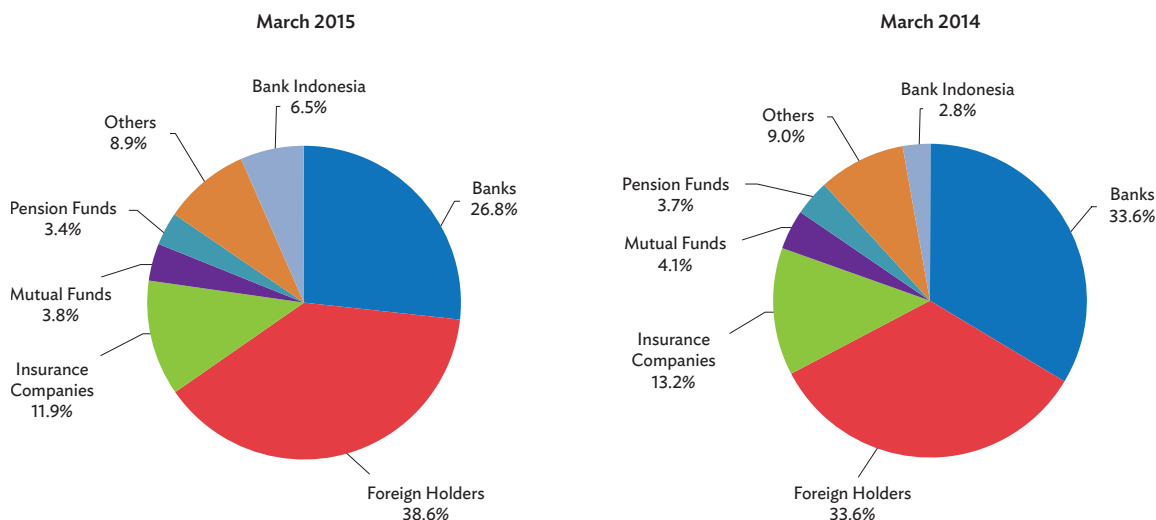
Investor Profiles

Central Government Bonds. Foreign investors were still the largest investor group in Indonesia's LCY government bond market at end-March. Foreign investor holdings rose to a share of 38.6% of total LCY central government bonds at end-March from a share of 33.6% a year earlier (**Figure 2**). In absolute terms, outstanding bonds held by foreign investors soared to IDR504.1 trillion at end-March from IDR360.9 trillion in the same period a year earlier. Foreign investors continue to chase the higher yields of Indonesian LCY government bonds, compared with other emerging East Asian markets.

Foreign investors were mostly attracted to long-term maturities, with about 44% of their bonds held in maturities of more than 10 years at end-March. Foreign holdings of more than 5 years to 10 years comprised a share of about 35% in 1Q15 (**Figure 3**).

In 1Q15, banking institutions were the second largest investor group in the central government bond market with a share of 26.8% at end-March, which was down

Figure 2: LCY Central Government Bonds Investor Profile



LCY = local currency.
Source: Directorate General of Budget Financing and Risk Management Ministry of Finance.

from 33.6% a year earlier. All other domestic investors posted y-o-y declines in their share of government bond holdings at end-March. The only exception was Bank Indonesia whose holdings of central government bonds rose to a share of 6.5% in 1Q15 at end-March from 2.8% a year earlier.

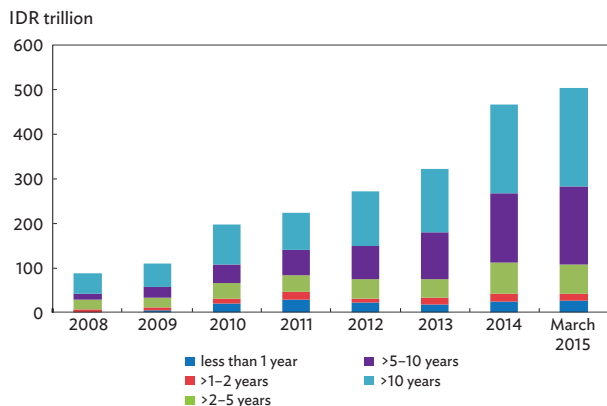
Central Bank Bills. Central bank bills, or SBI, are held almost exclusively by banking institutions (Figure 4). At end-March, bank holdings of SBI rose to a share of 99.8%

of the total from 93.8% a year earlier. The remaining share of SBI holdings was accounted for by foreign nonbank investors.

Ratings Update

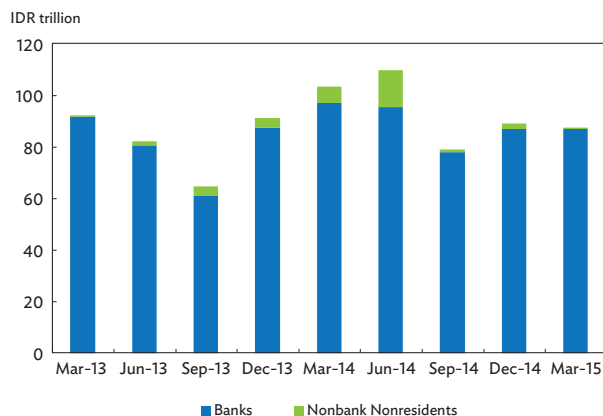
In March, Ratings and Investments (R&I) affirmed Indonesia’s sovereign credit ratings at BBB- with a stable outlook. R&I cited the following factors to support its ratings decision: (i) Indonesia’s expanded fiscal space,

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



LCY = local currency.
Source: Directorate General of Budget Financing and Risk Management Ministry of Finance.

Figure 4: LCY Central Bank Bills Investor Profile



LCY = local currency.
Source: Bank Indonesia.

(ii) the government's commitment to implementing structural reforms, and (iii) fading concerns over foreign currency liquidity.

On 21 May, Standard and Poor's (S&P) affirmed Indonesia's BB+ sovereign credit rating and revised the outlook to positive, indicating a possible rating upgrade in the next 12 months. In making its ratings decision, S&P cited "improvements in Indonesia's policy framework which have enhanced monetary and financial sector management."

Policy, Institutional, and Regulatory Developments

Government Approves 2015 Revised State Budget

In February, the House of Representatives approved a revised 2015 state budget that reduced the deficit to the equivalent of 1.9% of GDP from the 2.2% of GDP estimated in the original budget. The revised state budget calls for spending of IDR1,984.1 trillion versus

revenue of IDR1,761.6 trillion. To help finance the deficit, the legislative assembly authorized the Ministry of Finance to issue bonds worth IDR297.7 trillion, compared with IDR277.0 trillion in the original budget. The underlying macroeconomic assumptions for the revised 2015 state budget include: (i) annual GDP growth of 5.7%, (ii) annual inflation of 5.0%, (iii) an exchange rate of IDR12,500–US\$1, (iv) a 3-month Treasury bill rate of 6.2%, and (v) an Indonesian crude oil price of US\$60 per barrel.

Bank Indonesia Refines Framework for Determining JIBOR

In March, Bank Indonesia issued new regulation for determining the Jakarta Interbank Offered Rate (JIBOR). The regulation allows contributor banks—those that submit an indicative rate for short-term maturities (1 year and less)—to lend the rupiah at the indicative rate submitted by the bank while fulfilling certain time limits. This new regulation is seen to boost JIBOR as a credible market reference rate for short-term maturities.