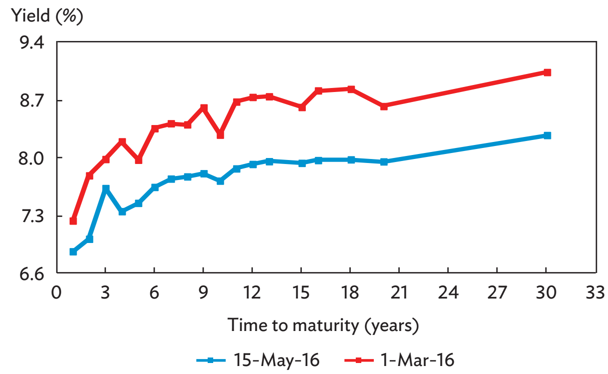
Indonesia

Yield Movements

Local currency (LCY) government bond yields in Indonesia fell for all tenors between 1 March and 15 May, which resulted in the entire yield curve shifting downward **(Figure 1)**. Except for the 1-year and 3-year maturities, where yields fell 37 basis points (bps) and 35 bps, respectively, all other tenors shed an average of 73 bps. The spread between the 2-year and 10-year tenors widened to 71 bps on 15 May from 49 bps on 1 March.

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



Source: Based on data from Bloomberg LP.

The fall in yields was reflective of positive sentiments in the Indonesian LCY bond market on account of Bank Indonesia's easing of its monetary policy, slowing inflation, and the strengthening of the Indonesian rupiah. Combined with sluggish and still weak growth expectations in the external environment, this resulted in an overall decline in yields.

Bank Indonesia reduced its benchmark interest rate by a cumulative 75 bps between January and March. The central bank in its Board of Governors meetings held on 20–21 April and 18–19 May, however, took a pause and held steady its benchmark interest rate at 6.75%. Bank Indonesia kept unchanged the deposit facility rate at 4.75% and the lending facility rate at 7.25%. The central bank also maintained the 7-day repo rate at 5.5%, which will become the new policy rate effective 19 August 2016.

Inflationary pressures eased on account of reductions in electricity tariffs, airfare costs, and nonsubsidized fuel costs. Food prices also declined amid adequate supplies coinciding with the harvest season. Consumer price inflation eased to 3.6% year-on-year (y-o-y) in April, after climbing to 4.1% y-o-y in January, 4.4% y-o-y in February, and 4.5% y-o-y in March. Bank Indonesia expects inflation for full-year 2016 to remain within its target range of 3.0%–5.0%.

The Indonesian rupiah appreciated 3.7% year-to-date against the US dollar through 15 May, supported by a steady inflow of foreign funds and an increased supply of foreign exchange among corporate entities.

Economic growth in Indonesia was lower than expected in the first quarter (Q1) of 2016, as real gross domestic product (GDP) growth slowed to 4.9% y-o-y from 5.0% y-o-y in the fourth quarter (Q4) of 2015. Domestic consumption, which accounts for about 58% of GDP, rose 4.9% y-o-y, while government spending expanded 2.9% y-o-y. Investments climbed 5.6% y-o-y in Q1 2016, while both exports and imports contracted during the quarter in review. On a quarter-on-quarter basis, GDP contracted 0.3% in Q1 2016.

Size and Composition

Indonesia's LCY bond market continued to expand in Q1 of 2016 to reach a size of IDR1,903.6 trillion (USD144 billion) at the end of March **(Table 1)**. Total outstanding bonds rose 8.8% quarter-on-quarter (q-o-q) and 16.8% y-o-y in Q1 2016, both of which were up compared with Q4 2015. Conventional bonds continued to account for the bulk of the aggregate bond stock with a share of 88.4% at the end of March. At the same time, *sukuk* (Islamic bonds) increased their share of the total bond stock in Q1 2016 to 11.6% from 10.0% in Q4 2015.

Government Bonds. At the end of March, the outstanding amount of government bonds stood at IDR1,649.7 trillion on growth of 9.9% q-o-q and 17.7% y-o-y. Growth came largely from a larger increase in the stock of central government bonds, comprising Treasury bills and bonds issued by the Ministry of Finance. Central bank bills, known as *Sertifikat* Bank Indonesia (SBI), also recorded positive growth during the review period.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2015		Q4 2015		Q1 2016		Q1 2015		Q1 2016	
	IDR	USD	IDR	USD	IDR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,629,143**	**125**	**1,750,306**	**127**	**1,903,610**	**144**	**6.5**	**16.5**	**8.8**	**16.8**
Government	1,401,586	107	1,500,426	109	1,649,687	125	7.2	18.6	9.9	17.7
Central Govt. Bonds	1,305,486	100	1,461,846	106	1,575,115	119	7.9	21.7	7.7	20.7
of which: *Sukuk*	145,229	11	159,236	12	204,222	15	31.2	50.1	28.3	40.6
Central Bank Bills	96,100	7	38,580	3	74,572	6	(1.0)	(11.7)	93.3	(22.4)
of which: *Sukuk*	8,810	0.7	6,280	0.5	7,038	0.5	8.4	63.8	12.1	(20.1)
Corporate	227,557	17	249,880	18	253,923	19	2.1	4.7	1.6	11.6
of which: *Sukuk*	7,078	0.5	9,802	0.7	9,216	0.7	(0.4)	(1.6)	(6.0)	30.2

( ) = negative, IDR = Indonesian rupiah, q-o-q = quarter-on-quarter, Q1 = first quarter, Q4 = fourth quarter, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period local currency–USD rates are used.
3. Growth rates are calculated from local currency base and do not include currency effects.
4. The total stock of nontradable bonds as of end-March stood at IDR261.8 trillion.
Sources: Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; Indonesia Stock Exchange; Otoritas Jasa Keuangan; and Bloomberg LP.

Central Government Bonds. The stock of Treasury bills and bonds climbed to IDR1,575.1 trillion at the end of March, posting 7.7% q-o-q and 20.7% y-o-y growth, on increased bond issuance during the quarter in review. Growth stemmed from increases in the stock of conventional fixed-rate bonds and Treasury bills and Islamic Treasury instruments, particularly Islamic Treasury bills and project-based *sukuk*.

As the Government of Indonesia continued to pursue its policy of debt issuance frontloading, central government bond issuance increased on both a q-o-q and y-o-y basis in Q1 2016. New issuance of Treasury bills and bonds climbed to IDR160.1 trillion in the first 3 months of the year. Of this amount, IDR128.6 trillion was raised from the government's weekly auctions of conventional and Islamic Treasury instruments, and IDR31.5 trillion was raised through bookbuilding from the issuance of retail *sukuk* in March, which marked the largest issuance of such bonds since their first offering in 2009.

The government accepted more than its targeted amount in 10 of the 13 auctions held in Q1 2016. Of the 13 auctions, only one auction fell below the government's target amount. All auctions for *sukuk* were successfully placed and either fully awarded or above target.

The government plans to issue a total of IDR546.6 trillion in government bonds, including foreign-currency-denominated bonds, to help fund its budget shortfall. The 2016 budget deficit is estimated to reach IDR273.2 trillion, which is equivalent to 2.15% of gross domestic product. The government is planning to issue 76% of its gross issuance target through conventional bonds; the remaining 24% will comprise *sukuk*. The government also capped foreign currency bond issuance at 30% of the gross issuance target for the year.

Central Bank Bills. The outstanding stock of central bank bills, or SBI, rose to IDR74.6 trillion at the end of March, up 93.3% q-o-q but down 22.4% y-o-y. Bank Indonesia issues SBI as one of its monetary policy tools to mop up excess liquidity in the market.

In Q1 2016, the issuance of SBI climbed to IDR38.2 trillion, up on both a q-o-q and y-o-y basis. Bank Indonesia conducts monthly auctions of SBI with maturities of 9 months and 1 year that comprise conventional and *shari'ah*–compliant SBI.

Corporate Bonds. The outstanding amount of Indonesia's LCY corporate bonds reached IDR253.9 trillion at the end of March on growth of 1.6% q-o-q and 11.6% y-o-y. Corporate bonds accounted for only 13.3% of the aggregate LCY bond stock at the end of March. The corporate bond segment remains dominated by conventional bond issues, which represent a 96.4% share of the total corporate total. Corporate *sukuk* accounted for only 3.6% of Indonesia's total LCY corporate bond stock at the end of March.

The top 30 LCY corporate bond issuers in Indonesia, which are presented in **Table 2**, had aggregate outstanding bonds valued at IDR193.2 trillion at the end of March, accounting for a 76.1% share of the total LCY corporate bond stock. Eleven state-owned firms were on the list, six of which landed among the top 10 in terms of size. Most firms on the top 30 list came from the banking and financial sectors. Also included on the list were capital-intensive industries such as energy, telecommunications, and property and real estate, among others.

Table 2: Top 30 Issuers of Local Currency Corporate Bonds in Indonesia

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (IDR billion)	LCY Bonds (USD billion)			
1.	Indonesia Eximbank	25,040	1.89	Yes	No	Banking
2.	PLN	13,268	1.00	Yes	No	Energy
3.	Indosat	11,642	0.88	No	Yes	Telecommunications
4.	Bank Tabungan Negara	10,950	0.83	Yes	Yes	Banking
5.	Adira Dinamika Multifinance	10,198	0.77	No	Yes	Finance
6.	Telekomunikasi Indonesia	8,995	0.68	Yes	Yes	Telecommunications
7.	Astra Sedaya Finance	8,345	0.63	No	No	Finance
8.	Perum Pegadaian	7,959	0.60	Yes	No	Finance
9.	Bank Rakyat Indonesia	7,650	0.58	Yes	Yes	Banking
10.	Bank Internasional Indonesia	7,380	0.56	No	Yes	Banking
11.	Federal International Finance	6,935	0.52	No	No	Finance
12.	Bank CIMB Niaga	6,865	0.52	No	Yes	Banking
13.	Bank Permata	6,482	0.49	No	Yes	Banking
14.	Jasa Marga	5,900	0.45	Yes	Yes	Toll Roads, Airports, and Harbors
15.	Bank Pan Indonesia	5,460	0.41	No	Yes	Banking
16.	Sarana Multigriya Finansial	5,296	0.40	Yes	No	Finance
17.	Agung Podomoro Land	4,575	0.35	No	Yes	Property and Real Estate
18.	Toyota Astra Financial Services	4,489	0.34	No	No	Finance
19.	Indomobil Finance Indonesia	4,059	0.31	No	No	Finance
20.	Indofood Sukses Makmur	4,000	0.30	No	Yes	Food and Beverages
21.	Bank Mandiri	3,500	0.26	Yes	Yes	Banking
22.	Medco-Energi International	3,500	0.26	No	Yes	Petroleum and Natural Gas
23.	Antam	3,000	0.23	Yes	Yes	Mining
24.	Bank OCBC NISP	2,785	0.21	No	Yes	Banking
25.	Waskita Karya	2,675	0.20	Yes	Yes	Building Construction
26.	Bumi Serpong Damai	2,665	0.20	No	Yes	Property and Real Estate
27.	Bank UOB Indonesia	2,500	0.19	No	No	Banking
28.	Summarecon Agung	2,500	0.19	No	Yes	Property and Real Estate
29.	Wahana Ottomitra Multiartha	2,303	0.17	No	Yes	Finance
30.	Bank Tabungan Pensiunan Nasional	2,260	0.17	No	Yes	Banking
Total Top 30 LCY Corporate Issuers		**193,176**	**14.59**			
Total LCY Corporate Bonds		**253,923**	**19.18**			
Top 30 as % of Total LCY Corporate Bonds		**76.1%**	**76.1%**			

IDR = Indonesian rupiah, LCY = local currency, USD = United States dollar.
Notes:
1. Data as of end-March 2016.
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.

The largest corporate bond issuer in Indonesia remained state-owned lender Indonesia Eximbank with bonds valued at IDR25.0 trillion at the end of March. In the second spot was state-owned energy firm PLN with an outstanding bond stock of IDR13.3 trillion. In the third spot was Indosat, a telecommunications company with bonds valued at IDR11.6 trillion.

In Q1 2016, new corporate debt issues totaled IDR13.8 trillion, up 30.1% q-o-q and 12.2% y-o-y. Only eight firms tapped the bond market for their funding requirements in Q1 2016, all of which came from the banking and financial sectors. A total of 20 new bond series were issued during the quarter, including one series of *sukuk mudharabah* (profit-sharing bonds) by Bank Nagari. Some of the largest corporate issuers in Q1 2016 are presented in **Table 3**. The largest corporate issuance came from Bank Rakyat Indonesia's multi-tranche bond sale worth IDR4.7 trillion. Indonesia Eximbank also added IDR4.0 trillion to its bond stock.

In terms of maturity, most of the new corporate debt issued in Q1 2016 was short-dated. About 13 out of the 20 new bond series during the quarter carried maturities of between more than 1 year and 3 years. The longest-dated was a bond series carrying a 7-year maturity. The rest of the new issues comprised one bond series with a maturity of 4 years and five bond series with a maturity of 5 years.

Table 3: Notable Local Currency Corporate Bond Issuance in Q1 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Bank Rakyat Indonesia		
370-day bond	8.50	808
3-year bond	9.25	1,019
5-year bond	9.60	2,824
Indonesia Eximbank		
370-day bond	8.50	657
3-year bond	9.25	1,647
5-year bond	9.60	1,732
Indomobil Finance		
370-day bond	9.60	592
3-year bond	10.50	444
4-year bond	10.65	464
Adira Finance		
370-day bond	8.75	73
3-year bond	9.50	331
5-year bond	10.25	698
BFI Finance		
370-day bond	9.75	200
3-year bond	10.25	142
5-year bond	10.75	658

IDR = Indonesian rupiah, Q1 = first quarter.
Source: Indonesia Stock Exchange.

Foreign Currency Bonds. In March, the Indonesian government raised USD2.5 billion from a dual-tranche sale of USD-denominated *sukuk.* The bond sale comprised USD750 million of 5-year *sukuk* and USD1.75 billion of 10-year *sukuk.* The 5-year *sukuk* was priced at par with a profit rate of 3.4% and the 10-year *sukuk* was priced at par with a profit rate of 4.55%. The *sukuk* was well received with the order book reaching USD2.1 billion for the 5-year tranche and USD5.6 billion for the 10-year tranche.

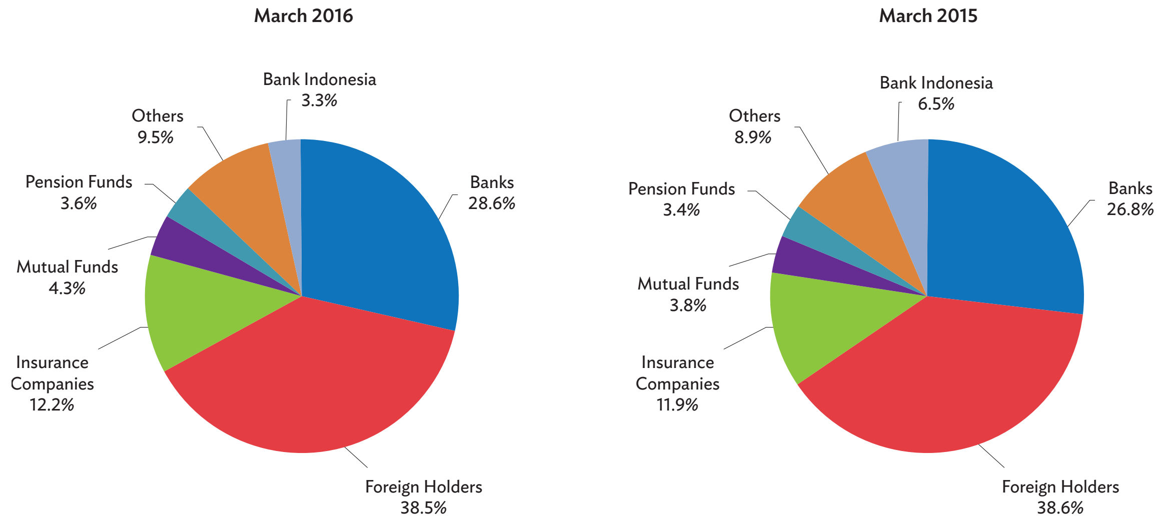
Also, Bank Indonesia issued a total of USD2.0 billion from the sale of USD-denominated foreign exchange (FX) bills between January to April. These FX bills are short-term tradable debt instruments issued in foreign currency (mostly in USD) by Bank Indonesia. The issuance of which is part of Bank Indonesia's measures to help stabilize IDR–USD exchange rate, and to strengthen foreign exchange reserves. Bank Indonesia first issued these FX bills in December 2015. Bank Indonesia will be issuing these USD-denominated FX bills regularly with tenors of between 1 month and 12 months.

Investor Profiles

Central Government Bonds. Foreign investors remained the largest holder of Indonesian LCY government bonds at the end of March **(Figure 2)**. Foreign investors accounted for a share of 38.5% of the central government total, which was broadly comparable to their share of 38.6% in the same period a year earlier. In absolute terms, overseas investors held IDR606.1 trillion worth of government bonds at the end of March. Foreign investors include nonresident private banks, fund and asset managers, securities firm, and insurance companies and pension funds, among others. These foreign institutions remain attracted to Indonesian LCY government bonds by their yields, the highest among emerging East Asian markets. In addition, 7.1% of Indonesian LCY government bonds are held by foreign governments and central banks as part of their foreign exchange reserves.

At the end of March, most foreign investors remained positioned at the long-end of the yield curve. Nearly

Figure 2: Local Currency Central Government Bonds Investor Profile

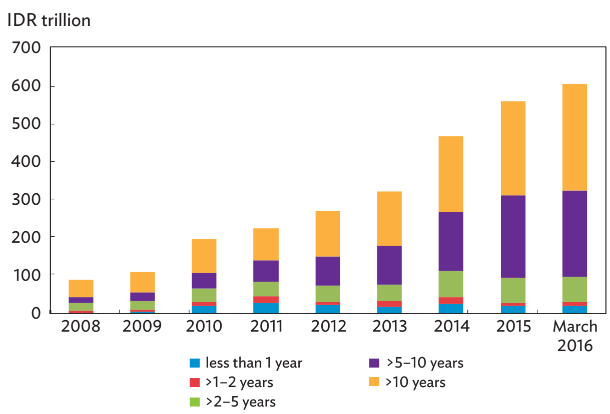


Source: Directorate General of Budget Financing and Risk Management, Ministry of Finance.

47% of foreign investor holdings were placed in long-dated maturities (more than 10 years), while 37.5% of their holdings were in medium-dated tenors (5 years to 10 years) **(Figure 3)**. Bonds with maturities of between more than 2 years and 5 years accounted for 10.8% of their holdings. Short-dated tenors (2 years or less) accounted for less than 5.0% of their aggregate holdings.

Banking institutions were the second largest holders of Indonesian central government bonds in Q1 2016. At the end of March, banks accounted for a 28.6% share compared with a share of 26.8% a year earlier. Insurance companies increased their holdings of central government bonds to 12.2% in Q1 2016 from 11.9% in Q4 2015. Other nonbank investors particularly mutual funds, pension funds, and other investors, also increased their holdings of central government bonds in Q1 2016, but their respective shares of the total remained small at less than 10.0%.

Figure 3: Foreign Holdings of Local Currency Central Government Bonds by Maturity



IDR = Indonesian rupiah.
Source: Directorate General of Budget Financing and Risk Management, Ministry of Finance.

On the other hand, Bank Indonesia's holdings of central government bonds dropped by about one-half to 3.3% of the total at the end of March from 6.5% a year earlier.

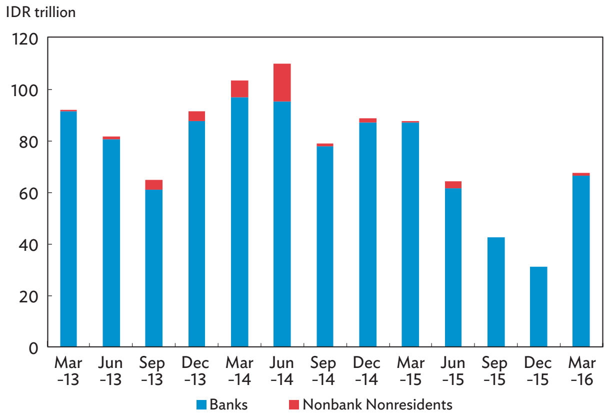
Central Bank Bills. The stock of central bank bills, or SBI, was mostly held by banking institutions at the end of March with a share of 98.7% **(Figure 4)**.

Ratings Update

In April, Ratings and Investment Information (R&I) affirmed Indonesia's sovereign credit rating at BBB– with a stable outlook. R&I took note of the following factors for its decision: (i) solid economic growth, (ii) a restrained budget deficit and healthy public debt levels, (iii) sound banking sector balance sheets, and (iv) the economy's resilience to external shocks.

Also in April, RAM Rating Services Berhad (RAM) affirmed its ratings for Indonesia at gBBB2(pi) with a stable outlook. According to RAM, the rating is reflective

Figure 4: Local Currency Central Bank Bills Investor Profile



IDR = Indonesian rupiah.
Notes:
1. For end-September and end-December 2015, nonresidents had no holdings of *Sertifikat* Bank Indonesia (SBI).
2. For end-March 2016, nonresidents held IDR0.9 trillion of SBI.
Source: Bank Indonesia.

of expected modest economic growth for Indonesia and commendable fiscal position.

In May, Fitch Ratings (Fitch) affirmed Indonesia's sovereign credit ratings at BBB- with a stable outlook. Fitch cited Indonesia's low government debt burden, favorable growth outlook, and limited sovereign exposure to banking sector risks as the key factors for its decision.

Policy, Institutional, and Regulatory Developments

Bank Indonesia Allows Islamic Banks to Hedge Foreign Exchange Risk

Bank Indonesia issued a new regulation allowing Islamic banks to engage in hedging activities. The rule, which took effect on 26 February, will allow Islamic banks to hedge their foreign exchange risks. Bank Indonesia expects that the new regulation will contribute to the further development of Islamic-based financial markets.

Bank Indonesia to Shift Policy Rate to 7-Day Repo Rate

On 15 April, Bank Indonesia announced that it would shift its policy rate from the reference rate to the 7-day repo rate. According to the Governor of Bank Indonesia, "the move aims to improve the effectiveness of monetary policy transmission." The move to the new policy rate will take effect on 19 August.