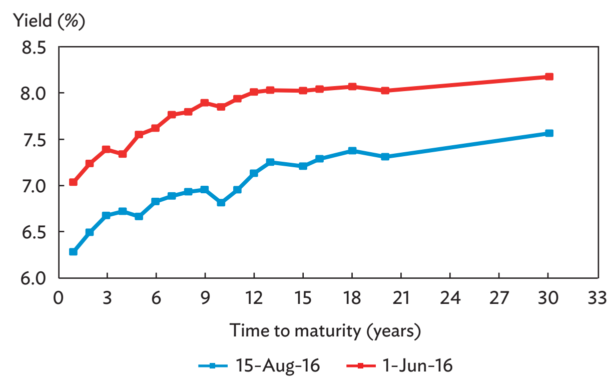
Indonesia

Yield Movements

Between 1 June and 15 August, local currency (LCY) government bond yields in Indonesia declined for all tenors, which caused the entire yield curve to shift downward **(Figure 1)**. The yield for the 10-year maturity dropped the most, shedding 104 basis points (bps). Bond yields for all other tenors from the shorter-end through the longer-end of the curve declined an average of 80 bps. As a result, the yield spread between the 2-year and 10-year maturities narrowed to 32 bps on 15 August from 62 bps on 1 June.

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



Source: Based on data from Bloomberg LP.

Declining yields across the length of the curve reflected, in part, strong demand from foreign investors as they continued to shore up their holdings of IDR-denominated bonds in search of yields. The delay in the United States Federal Reserve's interest rate hike has led offshore funds into emerging market assets amid a relatively low interest rate environment globally.

Also supportive of the overall drop in yields were more stable macroeconomic factors, including a generally benign inflation outlook, a stable Indonesian rupiah vis-à-vis the United States dollar, and a narrower current account deficit. In addition, policy and regulatory reforms initiated by the government, such as the Tax Amnesty Law, have helped boost sentiment in the LCY bond market (see Policy and Regulatory Developments).

The overall decline in yields across the curve was also driven by Bank Indonesia's accommodative monetary policy stance as it lowered the benchmark policy rate by 25 bps in June, reducing the previous policy rate by a cumulative 100 bps since the start of the year. Subsequently, Bank Indonesia introduced a new policy rate—the 7-day reverse repurchase rate—on 19 August to achieve a more "effective monetary policy transmission."

In its Bank of Governors meeting on 18–19 August, Bank Indonesia decided to keep the 7-day reverse repurchase rate steady at 5.25%. Bank Indonesia also kept unchanged the deposit facility rate at 4.50%, while it lowered by 100 bps the lending facility rate to 6.00%. Bank Indonesia noted that there is room for further monetary easing as long as macroeconomic stability is maintained.

Inflation is expected to remain within Bank Indonesia's target range of 3.0%–5.0% for full-year 2016. Consumer price inflation slowed to 3.6% year-on-year (y-o-y) in April and further to 3.3% y-o-y in May. A slight uptick in inflation to 3.5% y-o-y was noted in June, which coincided with increased demand for goods and services during the Muslim fasting month of Ramadan. However, inflation subsequently eased again to 3.2% y-o-y in July and 2.8% in August.

Indonesia's real gross domestic product (GDP) growth climbed to 5.2% y-o-y in the second quarter (Q2) of 2016 from 4.9% y-o-y in the first quarter (Q1) of 2016 on faster growth in consumption spending by the private sector (5.0% y-o-y) and the government (2.9% y-o-y). On the other hand, investment growth eased to 5.1% y-o-y and both exports and imports contracted during the quarter in review. On a quarter-on-quarter (q-o-q) and nonseasonally adjusted basis, real GDP growth climbed to 4.0% in Q2 2016 after contracting 0.4% in Q1 2016.

Size and Composition

The LCY bond market in Indonesia reached a size of IDR2,003.0 trillion (USD152 billion) at the end of June, climbing 5.2% q-o-q and 20.1% y-o-y in Q2 2016 **(Table1)**. Growth was driven by increases in both government and corporate bonds. Conventional bonds accounted for the largest component of the

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	IDR	USD	IDR	USD	IDR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,668,177**	**125**	**1,903,610**	**144**	**2,003,006**	**152**	**2.4**	**13.8**	**5.2**	**20.1**
Government	1,429,181	107	1,649,687	125	1,732,935	131	2.0	14.5	5.0	21.3
Central Govt. Bonds	1,356,434	102	1,575,115	119	1,646,846	125	3.9	19.9	4.6	21.4
of which: *Sukuk*	156,209	12	204,222	15	218,948	17	7.6	54.2	7.2	40.2
Central Bank Bills	72,748	5	74,572	6	86,089	7	(24.3)	(37.7)	15.4	18.3
of which: *Sukuk*	8,458	0.6	7,038	0.5	7,470	0.6	(4.0)	24.5	6.1	(11.7)
Corporate	238,996	18	253,923	19	270,071	20	5.0	9.9	6.4	13.0
of which: *Sukuk*	7,944	0.6	9,216	0.7	9,561	0.7	12.2	14.2	3.7	20.4

( ) = negative, IDR = Indonesian rupiah, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second 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-June stood at IDR260.5 trillion.
Sources: Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; Indonesia Stock Exchange; Otoritas Jasa Keuangan; and Bloomberg LP.

aggregate bond stock with an 88.2% share of the total at the end of June. *Sukuk* (Islamic bonds) represented an 11.8% share.

Government Bonds. The outstanding amount of government bonds expanded to IDR1,732.9 trillion at the end of June, rising 5.0% q-o-q and 21.3% y-o-y. Growth stemmed largely from central government bonds, which comprise debt securities issued by the Ministry of Finance. The stock of central bank bills, known as *Sertifikat* Bank Indonesia (SBI), while smaller in size also contributed to overall growth in Q2 2016.

Central Government Bonds. The outstanding size of central government bonds, which comprise Treasury bills and bonds, reached IDR1,646.8 trillion at the end of June, up 4.6% q-o-q and 21.4% y-o-y. The government awarded more than its targeted amount in 11 out of the 13 auctions it conducted in Q2 2016, taking advantage of lower borrowing costs and increased demand from both onshore and offshore investors.

Domestic investors began shoring up their government bond portfolios following a regulation passed by Otoritas Jasa Keuangan earlier this year requiring insurance companies and pension funds to hold 20% of their portfolio in government bonds (conventional and *sukuk*) in 2016 and 30% in 2017. Also, foreign investors remain attracted to Indonesia's government bond market amid the low interest rate environment in the global market.

In Q2 2016, central government bond issuance stood at IDR118.3 trillion, down 26.1% q-o-q but up 32.8% y-o-y. On a q-o-q basis, issuance slowed due to the base effects generated by the high level of retail *sukuk* issuance in Q1 2016. New bond issuance in Q2 2016 comprised the government's weekly auctions of conventional and Islamic Treasury instruments. All seven auctions of Islamic bills and project-based *sukuk* during the quarter were awarded either in full or above target.

Following revisions to the 2016 budget that were approved by Parliament in late June, the government needs to fund a larger deficit estimated at IDR296.7 trillion, or the equivalent of 2.35% of GDP, which is up from IDR273.2 trillion, or 2.15% of GDP. As a result, net government securities issuance increased from IDR327.2 trillion to IDR364.9 trillion. The bulk of the issuance (74%) will be issued in local currency and the remaining amount (24%) will be sourced from international bond issuance. The budget deficit is expected to be funded partly by increased revenue collections from the Tax Amnesty Law.

Central Bank Bills. The outstanding amount of central bank bills, or SBI, climbed to IDR86.1 trillion at the end of June on double-digit growth rates of 15.4% q-o-q and 18.3% y-o-y. The central bank issues SBI as part of its monetary policy tools for liquidity management. Bank Indonesia auctions both conventional and shariah-compliant SBI on a monthly basis for maturities of 9 months and 1 year. Total issuance of SBI reached

IDR28.9 trillion in Q2 2016, down 24.4% q-o-q. On a y-o-y basis, however, SBI issuance increased 13 fold in Q2 2016 due to a low base effect as Bank Indonesia temporarily ceased issuance of conventional SBI in Q2 2015 while opting to utilize other tools for managing liquidity.

Corporate Bonds. The outstanding size of LCY corporate bonds in Indonesia totaled IDR270.1 trillion at the end of June, posting growth of 6.4% q-o-q and 13.0% y-o-y in Q2 2016. The corporate bond segment constitutes a small share of the LCY bond market in Indonesia, accounting for only 13.5% at the end of June. Conventional bond issues continued to comprise a majority of the corporate bond total, representing a share of 96.5%.

At the end of June, the top 30 LCY corporate bond issuers in Indonesia had aggregate LCY bonds outstanding that reached IDR207.3 trillion **(Table 2)**. These 30 issuers together comprised 76.7% of the total LCY corporate bond stock, with 20 firms among them tapping both the bond and equity markets for their financing needs. Eleven state-owned firms were among the top 30 corporate issuers at the end of June, including the three largest. The top 30 list was dominated in Q2 2016 by firms from the banking and financial sectors, while a few names from capital-intensive industries (e.g., energy, telecommunications, building construction, and property and real estate) were also included.

The top three issuers of corporate bonds at the end of June were all state-owned firms. Leading the list was Indonesia Eximbank, which maintained its rank as the largest corporate bond issuer in Indonesia in Q2 2016. Its aggregate bond stock increased to IDR25.5 trillion at the end of June, accounting for a 9.5% share of the total corporate bond stock. Climbing to the second spot was Bank Rakyat Indonesia, which ranked ninth in Q1 2016, with an outstanding bond stock of IDR12.0 trillion. Energy firm PLN dropped to the third spot with outstanding bonds valued at IDR11.7 trillion.

The volume of new corporate debt issues more than doubled in Q2 2016 to IDR32.9 trillion, up 139.2% q-o-q. On a y-o-y basis, new corporate debt issuance rose 39.5% in Q2 2016. In Q2 2016, a total of 21 firms tapped the debt securities market for their funding requirements, taking advantage of lower borrowing costs. Most issuers of corporate bonds were from the banking and financial sectors. A total of 47 bond series were issued during the quarter, all of which were conventional bonds except for Maybank Indonesia's issuance of *sukuk mudharabah* (profit-sharing bonds).

Table 3 lists some of the largest corporate bond issuers in Q2 2016. Bank Rakyat Indonesia issued a total of IDR4,350 billion worth of bonds in three tranches in May, the largest issuance in terms of aggregate size in Q2 2016. Indonesia Eximbank also raised IDR4,000 billion from a triple-tranche bond sale in June, while Federal International Finance raised IDR3,375 billion from a dual-tranche bond sale in April.

In Q2 2016, the new corporate bonds issued were mostly short-dated in terms of maturity, with 33 out of 47 bond series carrying maturities of 3 years or less. There were nine bond series carrying a maturity of 5 years and four bond series with 7 years. Among the new corporate bond issuance in Q2 2016, the longest-dated bond series was a 10-year maturity issued by Pelindo Gerbang Nusantara.

Foreign Currency Bonds. In June, the Indonesian government raised a total of EUR3.0 billion from a dual-tranche offering. The bond sale comprised a EUR1.5 billion 7-year bond priced to yield 2.772% with a coupon rate of 2.625%, and a EUR1.5 billion 12-year bond priced to yield 3.906% with a coupon rate of 3.75%. The bonds were well received, with the order book reaching EUR8.36 billion.

Also in June, the government sold JPY100 billion worth of samurai bonds via private placement to institutional investors in Japan. The offering comprised JPY62 billion of 3-year bonds with a coupon rate of 0.83% and JPY38 billion of 5-year bonds with a coupon rate of 1.16%. The samurai bonds were issued without a guarantee from the Japan Bank for International Cooperation.

Investor Profiles

Central Government Bonds. Foreign investors continued to shore up their holdings of Indonesian LCY government bonds, increasing their share to 39.1% of total LCY central government bonds outstanding at the end of June 2016 from 38.2% a year earlier **(Figure 2)**. In absolute value terms, foreign investors held a total of IDR644.0 trillion of central government bonds at the end of June. Foreign funds continue to invest in Indonesian government bonds

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	25,539	1.93	Yes	No	Banking
2.	Bank Rakyat Indonesia	12,000	0.91	Yes	Yes	Banking
3.	PLN	11,733	0.89	Yes	No	Energy
4.	Indosat	11,033	0.84	No	Yes	Telecommunications
5.	Bank Tabungan Negara	10,950	0.83	Yes	Yes	Banking
6.	Adira Dinamika Multifinance	10,198	0.77	No	Yes	Finance
7.	Astra Sedaya Finance	9,395	0.71	No	No	Finance
8.	Telekomunikasi Indonesia	8,995	0.68	Yes	Yes	Telecommunications
9.	Bank Internasional Indonesia	8,880	0.67	No	Yes	Banking
10.	Federal International Finance	7,681	0.58	No	No	Finance
11.	Bank Pan Indonesia	7,560	0.57	No	Yes	Banking
12.	Perum Pegadaian	7,059	0.53	Yes	No	Finance
13.	Bank CIMB Niaga	6,865	0.52	No	Yes	Banking
14.	Bank Permata	6,482	0.49	No	Yes	Banking
15.	Sarana Multigriya Finansial	6,241	0.47	Yes	No	Finance
16.	Jasa Marga	5,900	0.45	Yes	Yes	Toll Roads, Airports, and Harbors
17.	Bank OCBC NISP	4,785	0.36	No	Yes	Banking
18.	Waskita Karya	4,675	0.35	Yes	Yes	Building Construction
19.	Toyota Astra Financial Services	4,591	0.35	No	No	Finance
20.	Agung Podomoro Land	4,575	0.35	No	Yes	Property and Real Estate
21.	Indofood Sukses Makmur	4,000	0.30	No	Yes	Food and Beverages
22.	Surya Artha Nusantara Finance	3,541	0.27	No	No	Finance
23.	Bank Mandiri	3,500	0.26	Yes	Yes	Banking
24.	Medco-Energi International	3,500	0.26	No	Yes	Petroleum and Natural Gas
25.	Bumi Serpong Damai	3,315	0.25	No	Yes	Property and Real Estate
26.	Indomobil Finance Indonesia	3,114	0.24	No	No	Finance
27.	Antam	3,000	0.23	Yes	Yes	Mining
28.	Wahana Ottomitra Multiartha	2,828	0.21	No	Yes	Finance
29.	Mandiri Tunas Finance	2,825	0.21	No	No	Finance
30.	Summarecon Agung	2,500	0.19	No	Yes	Property and Real Estate
Total Top 30 LCY Corporate Issuers		**207,260**	**15.69**			
Total LCY Corporate Bonds		**270,071**	**20.44**			
Top 30 as % of Total LCY Corporate Bonds		**76.7%**	**76.7%**			

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

Table 3: Notable Local Currency Corporate Bond Issuance in Q2 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Bank Rakyat Indonesia		
370-day bond	7.50	1,212
3-year bond	8.20	2,437
5-year bond	8.70	701
Indonesia Eximbank		
370-day bond	7.50	688
3-year bond	8.20	1,060
5-year bond	8.70	2,252
Federal International Finance		
370-day bond	8.50	868
3-year bond	9.15	2,507
Bank Pan Indonesia		
5-year bond	9.15	2,000
7-year bond	9.60	100
Waskita Karya		
3-year bond	9.25	2,000
Bank OCBC NISP		
370-day bond	7.50	837
2-year bond	8.00	380
3-year bond	8.25	783
Astra Sedaya Finance		
370-day bond	7.95	770
3-year bond	8.50	1,230

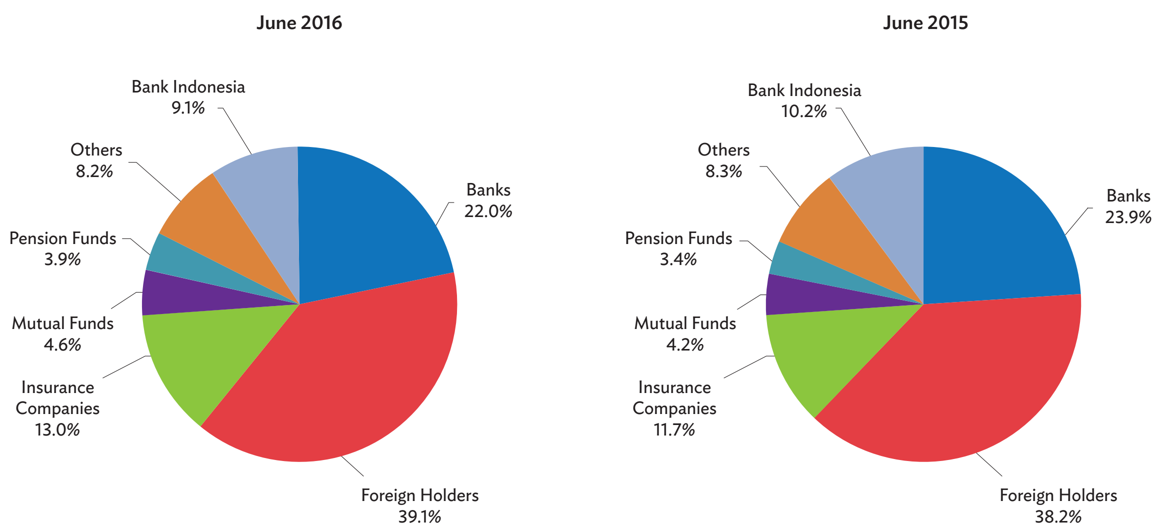
IDR = Indonesian rupiah, Q2 = second quarter.
Source: Indonesia Stock Exchange.

as the yields are among the highest in emerging East Asia. In addition, foreign governments and central banks also hold Indonesian LCY government bonds as part of their foreign reserves.

Foreign investors increased their holdings of long-term maturities, with a 47.7% share of their holdings at the end of June placed in bonds with maturities of more than 10 years, compared with 44.7% at the end of December. **(Figure 3)**. About 35.9% of their holdings were in medium-dated tenors, which are those with maturities of between more than 5 years and 10 years. Bonds with maturities of 2 years or less accounted for only 5.3% of aggregate foreign holdings.

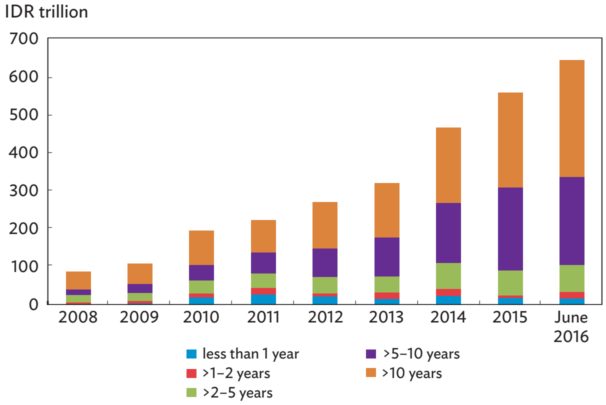
Among domestic investors, banking institutions were the largest holders of Indonesian Treasury instruments in Q2 2016. However, their share declined to 22.0% at the end of June from 23.9% a year earlier. On the other hand, insurance companies and pension funds increased their holdings of central government bonds at the end of June to 13.0% and 3.9%, respectively. Partly contributing to this increase was the regulation issued by Otoritas Jasa Keuangan earlier this year requiring insurance companies and pension funds to keep 20% of their portfolios in government bonds in 2016 and 30% in 2017.

Figure 2: Local Currency Central Government Bonds Investor Profile



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

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

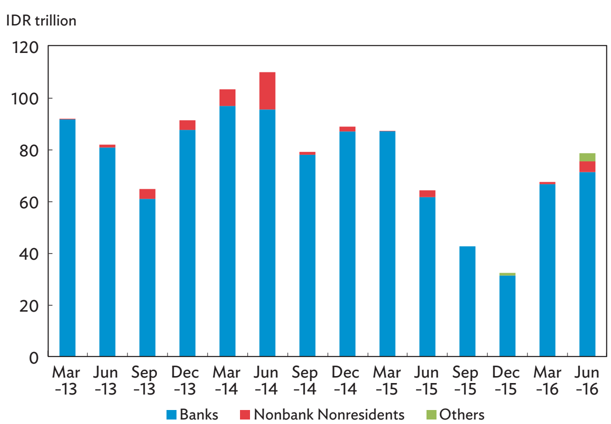


IDR = Indonesian rupiah.
Source: Directorate General of Budget Financing and Risk Management, Ministry of Finance.

Other nonbank investors, particularly mutual funds and other investors, recorded increases in their holdings of central government bonds, although their shares of the total remained small at less than 10.0% each. Meanwhile, Bank Indonesia's holdings of Treasury instruments declined to 9.1% at the end of June from 10.2% a year earlier.

Central Bank Bills. Central bank bills, or SBI, were still largely held by banking institutions, which had a share of 90.7% at the end of June **(Figure 4)**. Nonbank nonresident investors accounted for a 5.3% share, while the remaining 4.0% was accounted for by other investors.

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.

Ratings Update

In June, S&P Global Ratings affirmed Indonesia's sovereign credit rating at BB+. The outlook on the rating was positive. S&P Global Ratings cited Indonesia's improved policy and institutional settings, credible monetary policy, and buoyant economic growth as the key factors in its decision.

Policy, Institutional, and Regulatory Developments

Finance Ministry Removes Withholding Tax on Interest Payments for Foreign Currency Government Bonds

In June, Indonesia's Ministry of Finance provided tax incentives to investors in conventional and Islamic foreign currency-denominated government bonds by removing the withholding tax on interest payments. A withholding tax of 15% had been levied for Indonesian residents while a 20% tax was levied for nonresidents. The removal of the withholding tax will help lower the government's borrowing costs on its foreign currency government bonds. This will also help corporate bonds receive better pricing as government bonds are normally used as a benchmark for pricing. The regulation is effective retroactively from 1 January 2016.

Parliament Approves Tax Amnesty Law

In June, Parliament approved the Tax Amnesty Law to lure wealthy residents to repatriate funds parked in tax havens. The new law levies tax rates of 2.0%–5.0% for assets that are declared and repatriated and 4.0%–10.0% for assets that are only declared. Investment instruments have been prepared by the government for the placement of repatriated funds, which will need to be placed in the Indonesian capital market for a period of at least 3 years.

The government estimates that the measures will attract IDR4,000 trillion in declared assets and IDR1,000 trillion in repatriated funds. The government expects to raise IDR165 trillion in revenues from this program, which will help fund the larger deficit included in the 2016 revised budget. The tax amnesty program runs from 18 July 2016 to 31 March 2017.

Parliament Approves 2016 Revised State Budget

On 28 June, the Indonesian Parliament approved the revised 2016 state budget, which widened the programmed budget deficit to IDR296.7 trillion, or the equivalent of 2.35% of GDP from the equivalent of 2.15% of GDP in the original budget. The revised state budget estimates revenue of IDR1,786.2 trillion against spending of IDR2,082.9 trillion. Parliament also approved cuts in diesel subsidies and in the budgets for most ministries. The underlying macroeconomic assumptions for the revised budget were (i) annual GDP growth of 5.2%, (ii) annual inflation of 4.0%, (iii) an exchange rate of IDR13,500 per USD1, (iv) a 3-month Treasury bill rate of 5.5%, and (v) an Indonesian crude oil price of USD40 per barrel.