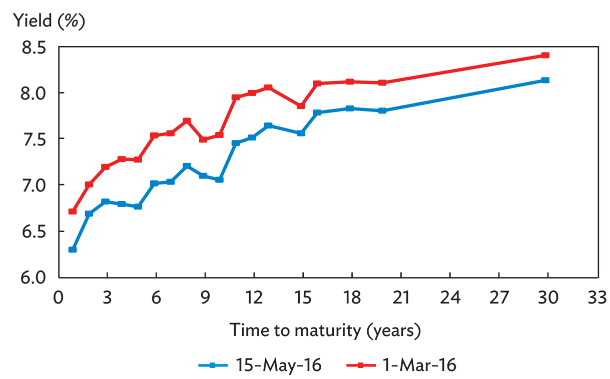
Indonesia

Yield Movements

Between 1 March and 15 May, local currency (LCY) government bond yields in Indonesia fell for all tenors, resulting in the downward shift of the yield curve (**Figure 1**). Across the curve, yields shed an average of 41 basis points (bps). Yields fell the most in the belly of the curve—bonds with maturities of 4 years to 8 years—which declined an average of 51 bps. Yields at the very long-end of the curve—bonds with maturities of 15 years or more—shed the least, falling an average of 30 bps. The spread between the yield on 2-year and 10-year bonds narrowed from 54 bps on 1 March to 37 bps on 15 May.

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



Source: Based on data from Bloomberg LP.

The overall decline in yields is reflective of improved investor sentiment that has been buoyed by confidence in Indonesia's government bond market amid improving macroeconomic and financial conditions. Foreign investors have returned to the bond market since the start of the year, increasing their holdings of government bonds to a share of 38.2% of the total at the end of March and further to 39.1% at the end of April. In addition, revisions in the sovereign rating outlook by Fitch Ratings in December and Moody's Investors Services in February fueled expectations of a sovereign rating upgrade by Standard and Poor's (S&P) Global Ratings. Other regional rating agencies, including Ratings and Investment Information (R&I) and Japan Credit Rating Agency (JCR), have also revised their outlook for Indonesia. These rating agencies took note of Indonesia's prudent fiscal deficit, manageable external debt, and efforts to improve the investment climate through policy reforms. Expectations were proven correct later on as S&P subsequently raised Indonesia's sovereign rating to investment grade on 19 May.

While consumer prices have accelerated since the start of the year, the annual inflation rate has remained within Bank Indonesia's target range of between 3.0% and 5.0% for full-year 2017. Inflation climbed to 3.5% year-on-year (y-o-y) in January and 3.8% y-o-y in February before easing to 3.6% y-o-y in March. It rose again to 4.2% y-o-y in April following the second phase of electricity tariff adjustments.

Despite the uptick in inflation, Bank Indonesia has refrained from raising its policy rate. In a meeting held on 17–18 May, Bank Indonesia's Board of Governors held steady the 7-day reverse repurchase (repo) rate at 4.75%. It also kept unchanged the deposit facility rate at 4.00% and the lending facility rate at 5.50%. The current levels were deemed consistent with Bank Indonesia's efforts to maintain macroeconomic and financial system stability, and at the same time taking note of an improving global economic outlook. The central bank, however, remains vigilant with regard to global risks such as monetary policy normalization and overall policy direction in the United States, and other geopolitical risks in other regions. On the domestic front, Bank Indonesia vowed to monitor administered price inflation.

Real gross domestic product (GDP) growth inched up to 5.0% y-o-y in the first quarter (Q1) of 2017 from 4.9% y-o-y in the fourth quarter of 2016. Domestic consumption, which gained 4.9% y-o-y, continued to drive the economy, accounting for the largest contribution to GDP. The recovery in exports and gross fixed capital formation also contributed to the faster growth in Q1 2017. On a non-seasonally adjusted and quarter-on-quarter (q-o-q) basis, however, GDP contracted 0.3%.

Size and Composition

Indonesia's LCY bond market continued to expand in Q1 2017, rising to IDR2,291.0 trillion (USD172 billion) at the end of March from IDR2,190.3 trillion at the end of December (**Table 1**). Growth was robust at 4.6% q-o-q and 20.3% y-o-y in Q1 2017, making it the fastest-growing LCY bond market in the region. Central government bonds, comprising Treasury bills and bonds issued by the Ministry of Finance, largely contributed to the growth. To a lesser extent, corporate bonds also contributed to the overall growth.

At the end of March, government bonds accounted for a dominant share of Indonesia's LCY bond market at 86.0% of the aggregate LCY bond stock. The remaining 14.0% was accounted for by corporate bonds. Conventional bonds also dominated Indonesia's LCY bond market, representing 87.0% of the total stock at the end of March, while *sukuk* (Islamic bonds) accounted for the remainder.

Government Bonds. The outstanding size of government bonds reached IDR1,970.1 trillion, up 4.9% q-o-q and 19.4% y-o-y. Much of the growth in government bonds was driven by central government bonds. The outstanding volume of central bank bills, or Sertifikat Bank Indonesia (SBI), declined during the review period.

Central Government Bonds. The stock of central government bonds climbed to IDR1,891.0 trillion at the end of March on gains of 6.6% q-o-q and 20.1% y-o-y. The government continued to adopt a frontloading policy for its bond issuance, in which it plans to issue about 60% of its gross issuance target for the year (including foreign currency bonds) within the first semester. The frontloading policy allows the government to lock in low borrowing cost as the Federal Reserve moves to normalize its monetary policy. Also, the frontloading policy allows the government to secure funding for its spending early in the year when public revenues are still low.

In Q1 2017, new issuance of central government bonds reached IDR176.6 trillion. Of this amount, IDR162.6 trillion was raised through weekly auctions of conventional bonds and project-based *sukuk*. The government issued bonds as planned, awarding in full or above target 12 of 13 scheduled auctions held during the quarter. Improved domestic market conditions buoyed investor confidence and provided the government an opportunity to issue bonds as targeted. Demand for government Treasury instruments remained strong in Q1 2017 with total incoming bids averaging at IDR27.8 trillion, up from IDR18.7 trillion in the same period a year earlier. The only time a Treasury auction fell short of its target amount was during the week coinciding with the Federal Reserve's March meeting when the federal funds target rate was increased by 25 bps.

The government also raised IDR14.0 trillion through bookbuilding for the sale of retail *sukuk* (series name

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2016		Q4 2016		Q1 2017		Q1 2016		Q1 2017	
	IDR	USD	IDR	USD	IDR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,903,610**	**144**	**2,190,326**	**163**	**2,290,966**	**172**	**8.8**	**16.8**	**4.6**	**20.3**
Government	1,649,687	125	1,878,648	139	1,970,089	148	9.9	17.7	4.9	19.4
Central Govt. Bonds	1,575,115	119	1,773,279	132	1,891,043	142	7.7	20.7	6.6	20.1
of which: *Sukuk*	204,222	15	245,708	18	274,492	21	28.3	40.6	11.7	34.4
Central Bank Bills	74,572	6	105,369	8	79,047	6	93.3	(22.4)	(25.0)	6.0
of which: *Sukuk*	7,038	0.5	10,788	0.8	12,273	0.9	12.1	(20.1)	13.8	74.4
Corporate	253,923	19	311,679	23	320,877	24	1.6	11.6	3.0	26.4
of which: *Sukuk*	9,216	0.7	11,578	0.9	11,834	0.9	(6.0)	30.2	2.2	28.4

( ) = negative, IDR = Indonesian rupiah, LCY = local currency, 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 LCY–USD rates are used.
3. Growth rates are calculated from an LCY base and do not include currency effects.
4. The total stock of nontradable bonds as of end-March stood at IDR235.8 trillion.
Sources: Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; Indonesia Stock Exchange; and Bloomberg LP.

SR-009) in March. This latest retail *sukuk* carried a maturity of 3 years and a coupon rate of 6.9%. A total of 29,838 investors purchased the retail *sukuk*.

The government's issuance plan for 2017 also targets increased issuance of Surat Perbendaharaan Negara Indonesia, or Treasury bills, of about IDR5 trillion per auction for conventional short-term bills and IDR2 trillion per auction for Islamic Treasury bills. In 2016, average Treasury bill issuance for conventional short-term bills was only around IDR1.5 trillion per auction and IDR1.0 trillion for Islamic Treasury bills. This increase in issuance is directed at providing more liquidity for the short-term tenors to better reflect current market rates, which is used as a benchmark reference for the pricing of financial products.

Central Bank Bills. The stock of central bank bills declined to IDR79.0 trillion at the end of March on a 25.0% q-o-q contraction. On a y-o-y basis, however, the outstanding stock of SBI inched up 6.0%. In Q1 2017, Bank Indonesia ceased issuance of conventional SBI and only conducted monthly auctions for *shariah*-compliant central bank bills for maturities of 9 months and 1 year. This resulted in double-digit declines for SBI issuance on both a q-o-q and y-o-y basis. Reduced issuance of central bank certificates was due to Bank Indonesia's plan of gradually replacing it with short-term Treasury bills for its monetary operations.

Corporate Bonds. The stock of LCY corporate bonds climbed to IDR320.9 trillion at the end of March, rising 3.0% q-o-q and 26.4% y-o-y. The entire corporate bond market comprises 109 firms and bond issuance is largely dominated by financial institutions, which account for a 65.3% share of the total outstanding stock. The pace of growth of Indonesia's corporate bond market has remained slow relative to the growth of government bonds. Most corporates tend to borrow from banks due to the lengthy issuance process needed for raising funds from the bond market.

At the end of March, the 30 largest issuers of corporate bonds had an aggregate bond stock of IDR239.2 trillion, representing 74.5% of the total (**Table 2**). This was higher compared with the top 30 list at the end of December, which totaled IDR228.0 trillion and had a share of 73.2%. The top 30 list at the end of March was largely dominated by firms from the financial sector (banks and nonbank financial institutions). A few corporate names that made it to the top 30 list came from highly capitalized industries such as telecommunications, energy, and property and real estate.

The composition of the top three largest corporate bond issuers remained the same from the end of December. Taking the top spot was state-owned lender Indonesia Eximbank as the largest corporate bond issuer. Eximbank's total outstanding LCY bond size further rose to IDR36.0 trillion at the end of March. Another state-owned lender, Bank Rakyat Indonesia, took the second spot with IDR15.1 trillion. Rounding out the top three corporate bond issuers was telecommunications firm, Indosat, with outstanding bonds valued at IDR13.7 trillion.

Comprising the top 30 list were 12 state-owned entities, with five of the state-owned firms landing in the top 10. Also, more than half of the firms in the list have tapped the equities market for funding.

New corporate bond sales in Q1 2017 reached IDR22.4 trillion, lower on a q-o-q but higher on a y-o-y basis. Bond issuance during the quarter came from 13 corporate entities. It was only in mid-February when issuance of corporate bonds resumed. A total of 34 bond series were issued in Q1 2017. New corporate debt issues during the quarter comprised conventional bonds and few series of *sukuk mudharabah* (bonds backed by a profit-sharing scheme).

The largest new corporate bond issue in Q1 2017 was that of Indonesia Eximbank, with a multitranche sale in February amounting to IDR5.2 trillion. The state-owned lender will use the proceeds to further expand its financing portfolio. Astra Sedays Finance followed with a triple-tranche issuance in March with an aggregate amount of IDR2.5 trillion. Adira Dinamika Multifinance and Bank Pan Indonesia each issued IDR2.4 trillion worth of bonds in March. Adira Dinamika Multifinance issued both conventional and Islamic bonds, while Bank Pan Indonesia raised funds from a single tranche of 7-year bonds. **Table 3** presents some of the largest corporate debt issues during the quarter.

Foreign Currency Bonds. In March, the government raised USD3 billion from a dual-tranche offering of global *sukuk*. The bond sale comprised a USD1 billion 5-year *sukuk* priced at par to yield 3.4% and a USD2 billion 10-year *sukuk* priced at par to yield 4.15%. This latest offering

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	35,966	2.70	Yes	No	Banking
2.	Bank Rakyat Indonesia	15,137	1.14	Yes	Yes	Banking
3.	Indosat	13,721	1.03	No	Yes	Telecommunications
4.	Bank Tabungan Negara	12,950	0.97	Yes	Yes	Banking
5.	Bank Pan Indonesia	12,085	0.91	No	Yes	Banking
6.	Adira Dinamika Multifinance	10,965	0.82	No	Yes	Finance
7.	PLN	10,683	0.80	Yes	No	Energy
8.	Astra Sedaya Finance	9,725	0.73	No	No	Finance
9.	Telekomunikasi Indonesia	8,995	0.68	Yes	Yes	Telecommunications
10.	Federal International Finance	8,148	0.61	No	No	Finance
11.	Bank Internasional Indonesia	7,320	0.55	No	Yes	Banking
12.	Waskita Karya	7,232	0.54	Yes	Yes	Building Construction
13.	Sarana Multigriya Finansial	7,040	0.53	Yes	No	Finance
14.	Medco-Energi International	6,662	0.50	No	Yes	Petroleum and Natural Gas
15.	Perum Pegadaian	6,592	0.49	Yes	No	Finance
16.	Bank CIMB Niaga	6,230	0.47	No	Yes	Banking
17.	Sarana Multi Infrastruktur	6,000	0.45	Yes	No	Finance
18.	Bank Permata	5,810	0.44	No	Yes	Banking
19.	Toyota Astra Financial Services	5,464	0.41	No	No	Finance
20.	Bank Mandiri	5,000	0.38	Yes	Yes	Banking
21.	Jasa Marga	4,500	0.34	Yes	Yes	Toll Roads, Airports, and Harbors
22.	Surya Artha Nusantara Finance	4,422	0.33	No	No	Finance
23.	Bank OCBC NISP	4,115	0.31	No	Yes	Banking
24.	Indofood Sukses Makmur	4,000	0.30	No	Yes	Food and Beverages
25.	Agung Podomoro Land	3,700	0.28	No	Yes	Property and Real Estate
26.	Permodalan Nasional Madani	3,433	0.26	Yes	No	Finance
27.	BFI Finance indonesia	3,350	0.25	No	No	Finance
28.	Mandiri Tunas Finance	3,325	0.25	No	No	Finance
29.	Bumi Serpong Damai	3,315	0.25	No	Yes	Property and Real Estate
30.	Bank Bukopin	3,305	0.25	No	Yes	Banking
Total Top 30 LCY Corporate Issuers		**239,190**	**17.95**			
Total LCY Corporate Bonds		**320,877**	**24.09**			
Top 30 as % of Total LCY Corporate Bonds		**74.5%**	**74.5%**			

IDR = Indonesian rupiah, LCY = local currency, USD = United States dollar.
Notes:
1. Data as of end-March 2017.
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 the First Quarter of 2017

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Indonesia Eximbank		
370-day bond	7.40	861
3-year bond	8.40	1,339
5-year bond	8.90	748
7-year bond	9.20	1,007
10-year bond	9.40	1,266
Astra Sedaya Finance		
370-day bond	7.40	1,000
3-year bond	8.50	1,125
5-year bond	8.75	375
Adira Dinamika Multifinance		
370-day bond	7.50	913
370-day *sukuk mudharabah*	7.50	274
3-year bond	8.60	860
3-year *sukuk mudharabah*	8.60	105
5-year bond	8.90	241
5-year *sukuk mudharabah*	8.90	7
Bank Pan Indonesia		
7-year bond	10.25	2,400
Sarana Multigriya Finansial		
370-day bond	7.50	677
3-year bond	8.40	1,000
Waskita Karya		
3-year bond	8.50	747
5-year bond	9.00	910
Toyota Astra Financial Services		
370-day bond	7.65	800
3-year bond	8.50	755

IDR = Indonesian rupiah.
Note: *Sukuk mudharabah* are Islamic bonds backed by a profit-sharing scheme from a business venture or partnership.
Source: Indonesia Stock Exchange.

attracted USD790 million worth of funds from investors in the United States.

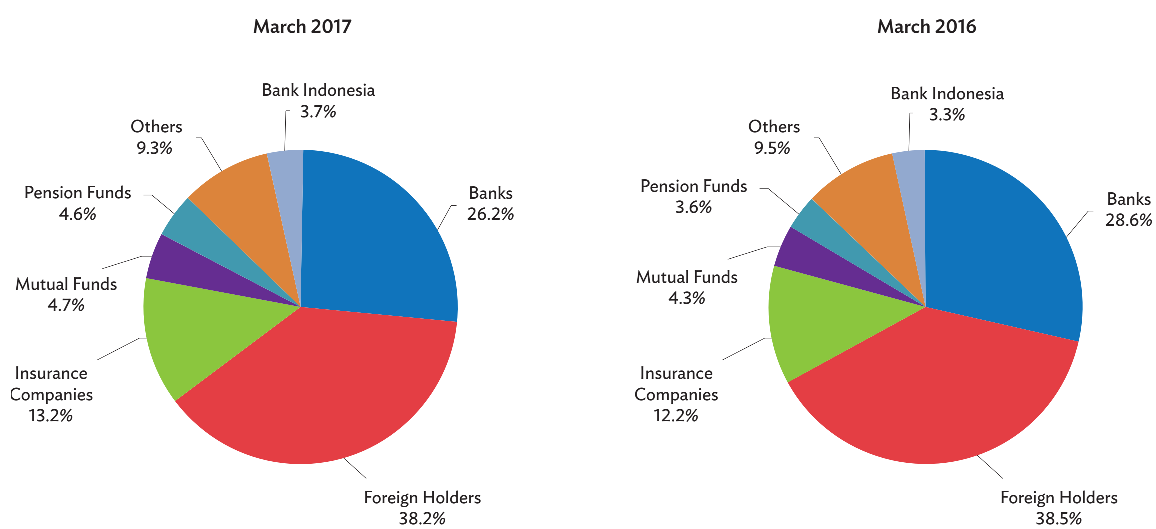
Investor Profiles

Central Government Bonds. Offshore investors returned to Indonesia's LCY government bond market in Q1 2017, following a bond market rout in Q4 2016 that saw their share of the total bond stock slipping to 37.6%. Investor sentiment turned positive at the start of the year on the back of improved domestic conditions amid continued uncertainties in the global market. While government bond yields have declined, foreign investors remain attracted to Indonesian government bond yields as they remain the highest among all peers in emerging East Asia.

Foreign investors remained the largest investor group in Indonesia's LCY government bond market with a share of 38.2% at the end of March and holdings valued at IDR723.2 trillion (**Figure 2**). Compared with March 2016, however, the share of offshore investors was marginally lower.

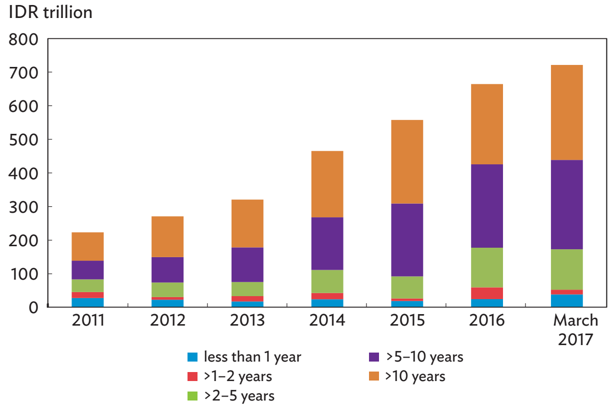
Nonresident holdings of government bonds in long-term maturities—bonds with maturities of over 10 years—further climbed at the end of March, representing a 39.2% share of aggregate foreign holdings (**Figure 3**). Total nonresident holdings of government bonds with maturities of more than 5 years to 10 years were still substantial at a 36.9% share of total foreign ownership, although this share slightly slipped during the review

Figure 2: Local Currency Central Government Bonds Investor Profile



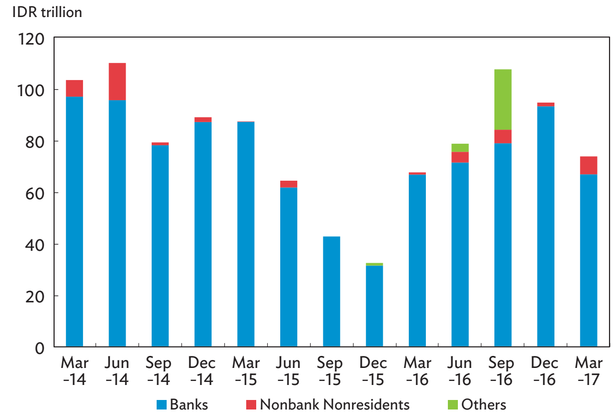
Source: Directorate General of Budget Financing and Risk Management, Ministry of Finance.

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



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

Figure 4: Local Currency Central Bank Bills Investor Profile



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

period. The share of government bonds with maturities of 1 year or less climbed to 5.2% of total foreign holdings.

Among domestic investors, banking institutions were the largest investor group, accounting for a share of 26.2% of the total stock of LCY central government bonds at the end of March. This, however, represents a decline in holdings from a share of 28.6% at the end of March 2016. Banks shed the most in terms of bond holdings among all investor groups.

Government bond holdings by insurance firms and pension funds increased at the end of March as both investor groups are now required to hold 30% of their assets in government bonds effective this year. In 2016, the regulatory requirement was set at 20% of their respective assets. Holdings of insurance firms and pension funds rose by 1 percentage point each at the end of March from their respective holdings a year earlier. Holdings of mutual funds and Bank Indonesia also climbed 0.4 percentage points each during the review period.

Central Bank Bills. SBI were mostly held by banking institutions at the end of March, representing a share of 90.6% of the total central bank stock (**Figure 4**). In contrast, the share of nonbank nonresident investors climbed to 9.4% after falling to 1.5% at the end of December.

Ratings Update

On 7 March, JCR revised Indonesia's sovereign rating outlook to positive from stable and affirmed its BBB– issuer credit rating. In making its decision, JCR noted two drivers of the change in the sovereign rating outlook: (i) an improved investment climate and (ii) contained private external debt.

On 31 March, RAM Ratings affirmed Indonesia's global rating of $_{g}BBB_{2}$(pi)/stable/P2(pi) and its ASEAN-scale rating of $_{sea}AA_{3}$(pi)/stable/P1(pi). In the decision to affirm its ratings, RAM Ratings forecast that Indonesia will sustain its economic growth and continue to accelerate infrastructure development. Also, the rating agency noted that Indonesia's fiscal deficit and government debt ratios were at manageable levels.

On 5 April, R&I revised Indonesia's sovereign rating outlook to positive from stable and affirmed its BBB– investment grade issuer rating. In making its decision to change Indonesia's sovereign rating outlook, R&I cited the improvement in Indonesia's external position as reflected by a narrowing current account deficit and rising foreign reserves and stable growth in private sector external debt. R&I noted the fiscal discipline evident in Indonesia's prudent deficit management and low government debt levels. The rating agency also cited the government's strong commitment to policy reforms.

On 19 May, S&P raised Indonesia's sovereign credit rating to investment grade. Indonesia's long-term sovereign credit rating was raised to BBB- and short-term sovereign credit rating to A-3. The rating was given a stable outlook. In making its decision, S&P cited reduced risk in Indonesia's fiscal metrics.

Policy, Institutional, and Regulatory Developments

Bank Indonesia and the Bank of Korea Renew Bilateral Currency Swap Arrangement

On 6 March, Bank Indonesia and the Bank of Korea agreed to the renewal of their bilateral local currency swap arrangement to promote bilateral trade and financial cooperation between the two markets. The agreement calls for the exchange of local currencies up to KRW10.7 trillion–IDR115 trillion for a period of 3 years, subject to an extension with the consent of both parties.

Bank Indonesia Issues New Regulation to Boost the Trading of Negotiable Deposit Certificates

In March, Bank Indonesia issued a new regulation to boost the trading of negotiable deposit certificates and encourage financial institutions to invest excess cash in these instruments. The new regulation, which will take effect on 1 July, provides guidance on the approval process for issuers, transactions, and supervision, among others. Bank Indonesia is also looking at issuing regulations for commercial paper transactions.