Indonesia

Yield Movements

Local currency (LCY) government bond yields declined for most tenors in Indonesia between 1 June and 15 August (**Figure 1**). Bond yields fell across the curve—except for the 7-, 9-, and 30-year maturities—by an average of 9 basis points (bps). Yield dropped the most at the very short-end of the curve, shedding 21 bps for the 1-year tenor. Bond yield also declined 19 bps for the 20-year tenor during the review period. The spread between the 2-year and 10-year maturities rose from 41 bps on 1 June to 45 bps on 15 August.

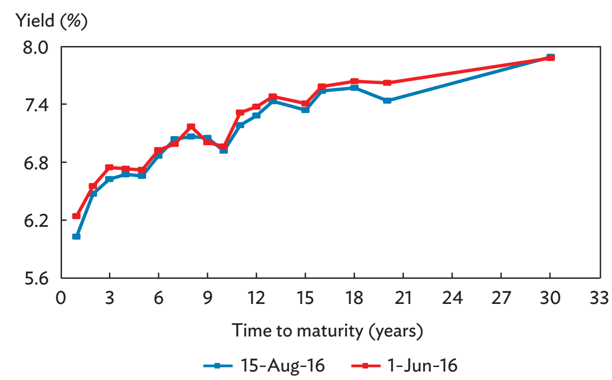
Bonds yields initially fell in June before rising in July amid concerns of a wider budget deficit equivalent to 2.9% of gross domestic product (GDP) in the revised state budget for 2017. Yields fell again after the Ministry of Finance indicated that the budget deficit may only reach the equivalent of 2.7% of GDP.

Overall, renewed investor optimism in Indonesia's bond market drove yields lower during the review period, buoyed by the sovereign rating upgrade from S&P Global in May. As a result, foreign investors continued to increase their holdings of Indonesian government bonds. At the end of June, the foreign holdings' share climbed to 39.5% of the total central government bond stock, where it remained little changed in July at 39.4%.

The uptick in inflation since the start of the year has not deterred nonresident investors from chasing Indonesian government bonds. While overall yields have declined since the start of the year, government bond yields are high relative to other markets in emerging East Asia. Consumer price inflation exceeded 4.0% year-on-year (y-o-y) in each of April, May, and June, before easing to 3.9% y-o-y in July. The uptick in inflation stemmed largely from electricity tariff adjustments and the timing of Muslim religious celebrations, when demand for goods and services normally increases.

The y-o-y inflation remained within Bank Indonesia's target range of 3.0%–5.0% in January–July, allowing the central to hold its policy rate steady in the first 7 months of the year. Subsequently, on 21–22 August, the Board of Governors of Bank Indonesia decided to cut by 25 bps each the 7-day reverse repurchase rate to 4.50%, the deposit facility rate to 3.75%, and the lending facility rate to 5.25%. In its assessment, Bank Indonesia noted that inflation remained low and the current account deficit was manageable, providing some space for easing its monetary policy. The rate cut is expected to promote credit growth, strengthen financial stability, and boost economic growth.

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



Source: Based on data from Bloomberg LP.

Real GDP growth reached 5.0% y-o-y in the second quarter (Q2) of 2017, the same pace of growth as in the previous quarter. Domestic consumption remained the largest driver of growth, gaining 5.0% y-o-y. Gross domestic fixed capital formation also supported growth, rising 5.4% y-o-y in Q2 2017. In contrast, government consumption remained weak due to delayed spending, contracting 1.9% y-o-y during the quarter in review. By type of industry, the manufacturing industry was the major contributor to GDP growth in Q2 2017. It was followed by construction, information and communication, and wholesale and retail trade. On a nonseasonally adjusted quarter-on-quarter (q-o-q) basis, Indonesia's GDP growth stood at 4.0%. Bank Indonesia expects the economy to grow between 5.0% and 5.4% in full-year 2017.

Size and Composition

The size of the LCY bond market in Indonesia climbed to IDR2,331.2 trillion (USD175 billion) at the end of June. Growth moderated to 1.8% q-o-q and 16.4% y-o-y

(**Table 1**), driven largely by central government bonds, which comprise Treasury bills and bonds issued by the Ministry of Finance. Corporate bonds also helped boost growth due to hefty issuance volume during the quarter.

Indonesia's LCY bond market is largely dominated by government bonds, accounting for 85.7% of the aggregate bond stock at the end of June. The remaining share comprised corporate bonds. LCY bonds in Indonesia are mostly conventional in nature, with *sukuk* (Islamic bonds) accounting for only a 13.7% share of the total bond stock at the end of June. However, the overall share of *sukuk* in Q2 2017 reflected an increase of 0.7 percentage points from a 13.0% share in the previous quarter.

Government bonds. At the end of June, total LCY government bonds outstanding stood at IDR1,998.7 trillion, rising 1.5% q-o-q and 15.3% y-o-y. Growth stemmed solely from increases in the stock of central government bonds as the outstanding stock of central bank bills, or Sertifikat Bank Indonesia (SBI), declined during the quarter in review.

Central government bonds. The outstanding amount of central government bonds reached IDR1,952.2 trillion at the end of June. Growth rates slowed in Q2 2017 to 3.2% q-o-q and 18.5% y-o-y from Q1 2017. In Q2 2017, the government tapered its frontloading issuance plan and reduced government securities issuance targets. The government initially planned to issue 64.4% of government securities (including foreign currency bonds) in the first semester; the share was lowered to 57.4%. The targeted LCY government securities share for the first semester was also reduced from 46.9% to 42.7%. However, government securities issuance in the first semester slightly exceeded the revised targets, with all government securities comprising 57.7% of total issuance in the first half of the year and LCY government securities accounting for 43.1%.

New LCY issuance of central government bonds totaled IDR115.8 trillion in Q2 2017, lower on both a q-o-q and y-o-y basis. The government failed to meet its target amount in six out of 12 scheduled auctions held during the quarter. Most of the partially awarded auctions during Q2 2017 were for Islamic debt securities. However, there was no pressure for the government to raise more funds immediately due to improving revenue collection and the prefunding of its budget requirements through a USD-denominated issuance in December 2016 and the issuance of USD- and JPY-denominated bonds in the first half of the year.Subsequently, in July, the government raised additional funds through a dual-currency issuance of EUR- and USD-denominated sovereign bonds.

Central bank bills. The outstanding amount of central bank bills declined to IDR46.5 trillion at the end of June on contractions of 41.2% q-o-q and 46.0% y-o-y. Beginning this year, Bank Indonesia ceased issuing

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2016		Q1 2017		Q2 2017		Q2 2016		Q2 2017	
	IDR	USD	IDR	USD	IDR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**2,003,006**	**152**	**2,290,966**	**172**	**2,331,240**	**175**	**5.2**	**20.1**	**1.8**	**16.4**
Government	1,732,935	131	1,970,089	148	1,998,689	150	5.0	21.3	1.5	15.3
Central Govt. Bonds	1,646,846	125	1,891,043	142	1,952,234	146	4.6	21.4	3.2	18.5
of which: *Sukuk*	218,948	17	274,492	21	297,424	22	7.2	40.2	8.4	35.8
Central Bank Bills	86,089	7	79,047	6	46,455	3	15.4	18.3	(41.2)	(46.0)
of which: *Sukuk*	7,470	0.6	12,273	0.9	9,421	0.7	6.1	(11.7)	(23.2)	26.1
Corporate	270,071	20	320,877	24	332,550	25	6.4	13.0	3.6	23.1
of which: *Sukuk*	9,561	0.7	11,834	0.9	13,385	1.0	3.7	20.4	13.1	40.0

( ) = negative, IDR = Indonesian rupiah, LCY = local currency, 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 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-June stood at IDR232.6 trillion.
Sources: Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; Indonesia Stock Exchange; and Bloomberg LP.

conventional SBI and limited its issuance of central bank bills to shariah-compliant SBI, resulting in a significant decline in the outstanding stock of such instruments. Bank Indonesia shifted to using term deposits and foreign exchange bills in lieu of SBI for its monetary operations. In Q2 2017, new issuance of shariah-compliant SBI reached IDR1.1 trillion, resulting in double-digit declines on both a q-o-q and y-o-y basis. One auction was conducted for each month during the quarter, with issuance of 9-month and 1-year shariah-compliant SBIs.

Corporate bonds. Total LCY corporate bonds rose 3.6% q-o-q and 23.1% y-o-y to reach IDR332.6 trillion at the end of June. A total of 109 firms comprised Indonesia's corporate bond market in Q2 2017. Relative to its peers in emerging East Asia, Indonesia's LCY corporate bond market ranks as the third smallest in terms of bonds outstanding. While its government bond market segment is more developed, the corporate bond segment lags behind. Most corporates still prefer to secure bank loans instead of raising capital through the sale of bonds.

Bond issued by financial institutions accounted for the largest share of total corporate bonds at 64.4% at the end of June. The next largest share was for firms from the infrastructure, utilities, and transportation sector, representing 17.2% of the total, and the property and real estate sector at a 6.9% share. All other industry sub-groups had a share of 2.8% or less.

The 30 largest corporate bonds issuers had aggregate outstanding bonds of IDR245.2 trillion at the end of June, or the equivalent of 73.7% of the total market (**Table 2**). The top-30 list comprised mostly financial institutions. Other firms on the list came from capital-intensive industries including telecommunications, property and real estate, and petroleum and natural gas.

The three largest corporate bond issuers have remained the same since the end of December. State-owned lender Indonesia Eximbank retained the top spot at the end of June with outstanding LCY bonds valued at IDR33.7 trillion, accounting for about 10% of the total corporate bond stock. The second spot was held by another state-owned lender, Bank Rakyat Indonesia, with bonds valued at IDR19.0 trillion. Telecommunications firm Indosat was third with outstanding bonds of IDR15.4 trillion. Bank Rakyat Indonesia and Indosat both issued new bonds during the quarter.

In Q2 2017, total corporate bond issuance reached IDR34.4 trillion, up 53.6% q-o-q and 4.4% y-o-y. There was a notable increase in corporate bond issuance in Q2 2017, with 18 firms tapping the bond market versus 13 in Q1 2017. New corporate bond series totaled 46 issues in Q2 2017, up from 34 bond series in the previous quarter.

The largest new corporate debt issues during the quarter are presented in **Table 3**. Leading the list in Q2 2017 was Bank Mandiri's multitranche issuance in June amounting to IDR6.0 trillion. Bank Mandiri's issuance included a 3-year zero-coupon bond, which marked the first issuance by an Indonesian bank of such a bond. Second on the list of new corporate debt in Q2 2017 was Bank Rakyat Indonesia's multitranche issuance in April valued at IDR5.1 trillion. Federal International Finance raised a total of IDR3.5 trillion from a dual-tranche issue in May, and Semen Indonesia raised IDR3.0 trillion from a single-tranche 3-year bond in June. Telecommunications firm Indosat issued a total of IDR3.0 trillion from the sale of multitranche conventional bonds and *sukuk* in May.

Foreign currency bonds. In June, the government raised JPY100 billion from a triple-tranche bond sale. The sale comprised a JPY40 billion 3-year bond with a coupon rate of 0.65%, a JPY50 billion 5-year bond with a coupon rate of 0.89%, and a JPY10 billion 7-year bond with a coupon rate of 1.04%. The bonds were offered via public offering, representing the first bond sale by Indonesia through this method. The bond sale was well received by investors, including asset management and pension funds, among others.

In July, the government raised EUR1.0 billion with the sale of a 7-year bond priced to yield 2.178% and carrying a coupon rate of 2.15%. The bond was well-received with total orders reaching EUR4.3 billion. Also, the government raised a total of USD2.0 billion from a dual-tranche sale comprising a USD1.0 billion 10-year bond priced to yield 3.9% with a coupon rate of 3.85% and a USD1.0 billion 30-year bond priced to yield 4.8% with a coupon rate of 4.75%. The orderbook totaled USD4.0 billion and USD3.2 billion for the 10-year and 30-year bonds, respectively. The latest issuance was part of the government's funding plan for 2017.

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	33,684	2.52	Yes	No	Banking
2.	Bank Rakyat Indonesia	19,025	1.43	Yes	Yes	Banking
3.	Indosat	15,351	1.15	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.	Bank Mandiri	11,000	0.82	Yes	Yes	Banking
7.	Federal International Finance	10,780	0.81	No	No	Finance
8.	PLN	10,683	0.80	Yes	No	Energy
9.	Adira Dinamika Multifinance	10,602	0.79	No	Yes	Finance
10.	Telekomunikasi Indonesia	8,995	0.67	Yes	Yes	Telecommunications
11.	Astra Sedaya Finance	8,215	0.62	No	No	Finance
12.	Bank Maybank Indonesia	7,320	0.55	No	Yes	Banking
13.	Sarana Multigriya Finansial	6,714	0.50	Yes	No	Finance
14.	Perum Pegadaian	6,592	0.49	Yes	No	Finance
15.	Waskita Karya	6,557	0.49	Yes	Yes	Building Construction
16.	Medco-Energi International	6,434	0.48	No	Yes	Petroleum and Natural Gas
17.	Bank CIMB Niaga	6,230	0.47	No	Yes	Banking
18.	Sarana Multi Infrastruktur	5,900	0.44	Yes	No	Finance
19.	Bank Permata	5,810	0.44	No	Yes	Banking
20.	Toyota Astra Financial Services	4,864	0.36	No	No	Finance
21.	Indofood Sukses Makmur	4,000	0.30	No	Yes	Food and Beverages
22.	Surya Artha Nusantara Finance	3,862	0.29	No	No	Finance
23.	Agung Podomoro Land	3,700	0.28	No	Yes	Property and Real Estate
24.	Mandiri Tunas Finance	3,675	0.28	No	No	Finance
25.	Hutama Karya	3,583	0.27	Yes	No	Non-Building Construction
26.	Permodalan Nasional Madani	3,433	0.26	Yes	No	Finance
27.	BFI Finance Indonesia	3,350	0.25	No	Yes	Finance
28.	Bumi Serpong Damai	3,315	0.25	No	Yes	Property and Real Estate
29.	Bank Bukopin	3,305	0.25	No	Yes	Banking
30.	Maybank Indonesia Finance	3,225	0.24	No	No	Finance
Total Top 30 LCY Corporate Issuers		**245,239**	**18.37**			
Total LCY Corporate Bonds		**332,550**	**24.91**			
Top 30 as % of Total LCY Corporate Bonds		**73.7%**	**73.7%**			

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

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Bank Mandiri		
3-year bond	7.80	1,000
5-year bond	8.00	1,000
7-year bond	8.50	3,000
10-year bond	8.65	1,000
Bank Rakyat Indonesia		
370-day bond	7.20	1,131
3-year bond	8.10	1,744
5-year bond	8.30	925
10-year bond	8.80	1,301
Federal international Finance		
370-day bond	7.35	1,424
3-year bond	8.45	2,076
Semen Indonesia		
3-year bond	8.60	3,000
Indosat		
370-day bond	7.00	844
370-day *sukuk ijarah*	7.00	17
3-year bond	8.15	628
5-year bond	8.55	312
5-year *sukuk ijarah*	8.55	160
7-year bond	8.90	378
7-year *sukuk ijarah*	8.90	60
10-year bond	9.25	538
10-year *sukuk ijarah*	9.25	63

IDR = Indonesian rupiah.
Notes:
1. Bank Mandiri's 3-year bond is a zero-coupon bond. The figure indicated under the coupon rate refers to yield at issuance.
2. *Sukuk ijarah* are Islamic bonds backed by a lease agreement.
Source: Indonesia Stock Exchange.

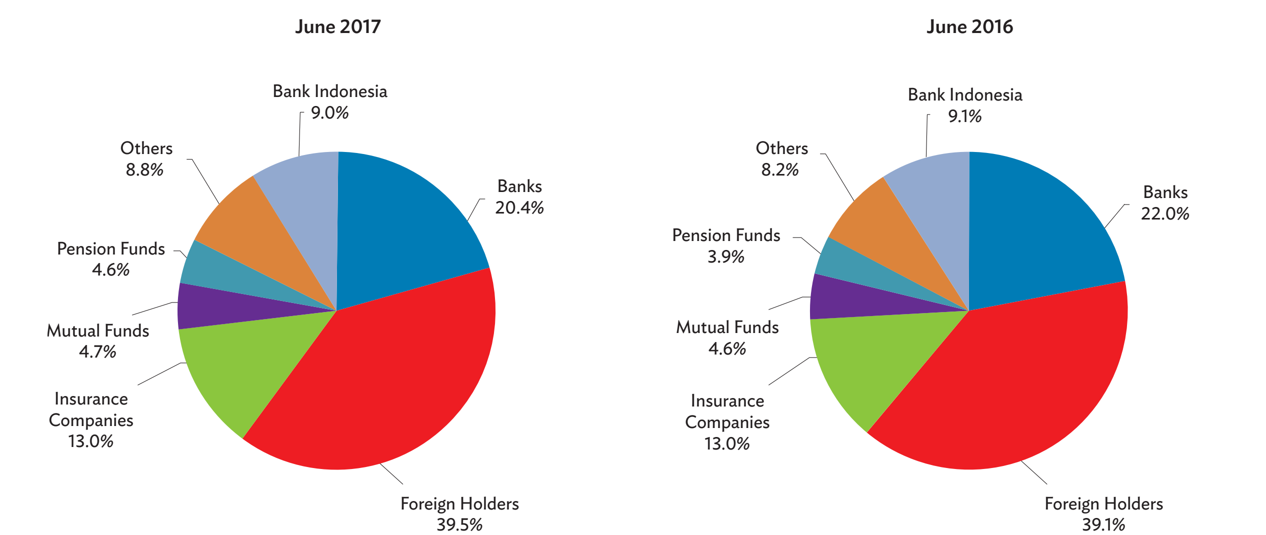
Investor Profiles

Central government bonds. Nonresident investors shored up their holdings of Indonesian LCY government bonds following the rating upgrade from S&P Global. Foreign investors' holdings of LCY bonds climbed to a share of 39.5% at the end of June, up from 38.2% at the end of March and 39.1% from the same period a year earlier (**Figure 2**). While bond yields for all tenors fell an average of 90 bps between 1 January and 15 August, investors remained attracted to Indonesian government bonds, which command the highest yields in emerging East Asia.

At the end of June, foreign holdings of LCY government bonds reached IDR770.6 trillion, up from IDR723.2 trillion at the end of March and IDR644.0 trillion at the end of June 2016. Nonresidents continued to comprise the largest investor group in Indonesia's LCY government bond market in Q2 2017.

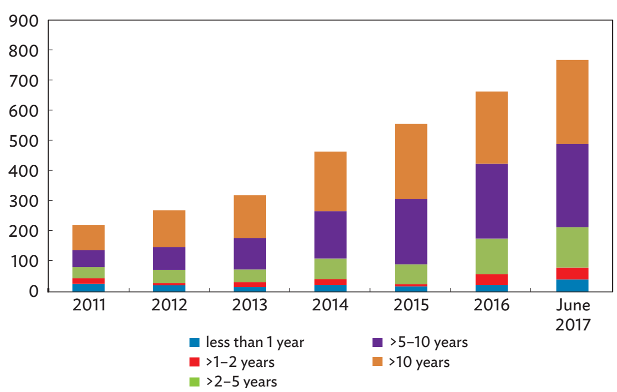
While a large share of foreign ownership in Indonesia's bond market poses the risk of destabilizing capital flight, most foreign investors in Indonesian LCY government bonds are considered high-quality, long-term investors. Foreign investors include nonresident banks, fund and asset managers, securities houses, insurance institutions, and pension funds. At the end of June, 36.2% of nonresident holdings were invested in bonds with maturities of over 10 years, and 35.9% were placed in maturities of more than 5 years to 10 years (**Figure 3**).

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.

Nonresident holdings of government bonds with maturities of 1 year or less accounted for only 5.4% of total foreign holdings.

On the other hand, banking institutions, which account for the largest investor group among domestic investors, continued to see their holdings' share of LCY government bonds decline. At the end of June, banks' holdings of LCY government bonds accounted for an equivalent of 20.4% of the total market, declining from 26.2% at the end of March and 22.0% at the end of June 2016.

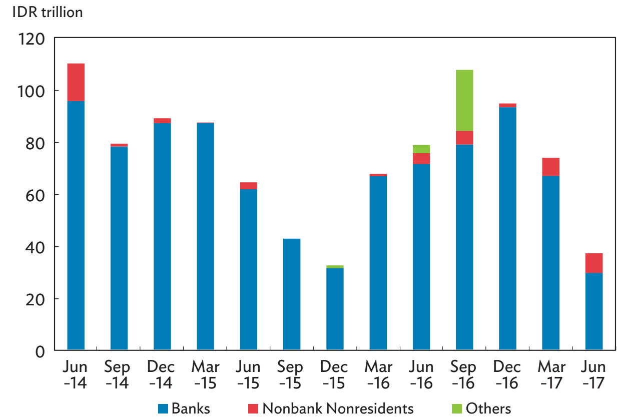
Pension funds raised their holdings of LCY government bonds to a share of 4.6% at the end of June. The shares of bond holdings of insurance, mutual funds, and Bank Indonesia were broadly unchanged from June 2016.

Central bank bills. At the end of June, SBI were largely held by banking institutions. Bank holdings of SBI accounted for 79.6% of central bank bills outstanding, a decline from a 90.6% share at the end of March (**Figure 4**). On the other hand, nonbank nonresident investors increased their holdings to a 20.4% share from 9.4% at the end of March.

Ratings Update

On 19 July, Fitch Ratings (Fitch) affirmed Indonesia's long-term foreign currency and LCY issuer default ratings at BBB–. The ratings were given a positive outlook.

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.
2. In March 2016, nonbank nonresidents held IDR0.9 trillion of Sertifikat Bank Indonesia.
Source: Bank Indonesia.

In its assessment, Fitch took note of Indonesia's low government debt burden, favorable growth outlook, and limited sovereign exposure to banking sector risks. Fitch also cited its concern over Indonesia's external exposure and some structural factors that need improvement.

Policy, Institutional, and Regulatory Developments

Bank Indonesia to Allow Non-Dollar Currency Swaps for Hedging

In July, Bank Indonesia announced that it will allow non-dollar currency swaps for hedging transactions. Initially, the central bank will enter into hedging transactions for Japanese yen swaps, which will be followed by swaps denominated in euros and Chinese renminbi. The move by Bank Indonesia is expected to reduce dependence on the US dollar for trade and finance.

Indonesian Parliament Approves Revision to 2017 State Budget

On 27 July, the Indonesian Parliament approved the government's proposed revision to the 2017 state budget. The revised state budget now estimates marginally lower revenue of IDR1,736.1 trillion and higher spending of

IDR2,133.3 trillion. As a result, the budget deficit was projected to reach an equivalent of 2.9% of GDP, up from 2.4% in the original budget. To fund the budget gap, the government will increase its bond issuance in 2017 to IDR467.3 trillion. The underlying macroeconomic assumptions for the revised budget include (i) annual GDP growth of 5.2%, (ii) annual inflation of 4.3%, (iii) an exchange rate of IDR13,400 per USD1, (iv) a 3-month Treasury bill annual rate of 5.2%, and (v) an Indonesian crude oil price of USD48 per barrel.

Bank Indonesia Releases New Regulations for Commercial Paper Issuance

Bank Indonesia released new regulations for the issuance of commercial paper by nonbank corporate entities. The new regulations, which came into effect on 4 September, allow corporates to issue commercial paper with a maturity of 1 year or less, subject to certain requirements. The new rules governing commercial paper issuance require issuing companies to have a healthy financial position for a period of 3 years and an assessment from a rating agency.