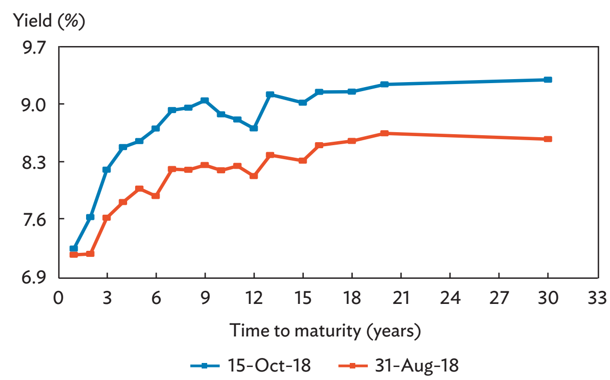
Indonesia

Yield Movements

Local currency (LCY) government bond yields in Indonesia climbed for all tenors between 31 August and 15 October, shifting the curve upward (**Figure 1**). Yields gained an average of 65 basis points (bps) across the curve excluding for the 1-year tenor, which rose 7 bps. The spread between the 2-year and 10-year tenors widened from 101 bps on 31 August to 124 bps on 15 October.

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



Source: Based on data from Bloomberg LP.

The overall rise in bond yields was largely influenced by the policy rate hikes undertaken by Bank Indonesia as a preemptive move to maintain the attractiveness of its financial market. Bank Indonesia has raised the 7-day reverse repurchase (repo) rate five times since mid-May for a cumulative increase of 150 bps. In its meeting on 22–23 October, the central bank took a pause from the hikes and held steady the 7-day reverse repo rate at 5.75%.

The Indonesian LCY bond market is highly sensitive to developments in the global market as foreign investors account for the largest investor group in government bonds. Foreign investor holdings of government bonds have been on a downtrend after accounting for over 40% of the total market at the end of January. The share of nonresident holdings declined to 37.6% at the end of August and further to 37.0% on 15 October, reflecting investors' risk-off sentiment toward emerging markets. Also, the United States (US) Federal Reserve is proceeding with the normalization of its monetary policy as previously announced, leading US Treasury rates to edge higher and the US dollar to appreciate.

As a result, the Indonesian rupiah was heavily battered, hitting the IDR15,000–USD1 mark in early October, a level last seen during the 1997/98 Asian financial crisis. Between 31 August and 15 October, the Indonesian rupiah weakened the most among all emerging East Asian currencies, with its value falling 3.4% versus the dollar. In response, Bank Indonesia has been intervening in the foreign exchange market to support the rupiah and undertaking bond buybacks to stabilize prices in the government bond market.

Despite the market sell-off, foreign investors were still attracted to Indonesian government bonds as real interest rates remained high. The government has effectively managed inflationary pressures, with year-to-date inflation reaching 1.9% as of September, well within range of the central bank's full-year 2018 target of 2.5%–4.5%. Consumer price inflation slowed to 2.9% year-on-year (y-o-y) in September from 3.2% y-o-y in both August and July.

The domestic economy remains resilient, with real gross domestic product (GDP) growth climbing to 5.3% y-o-y in the second quarter (Q2) of 2018, up from 5.1% y-o-y in the first quarter. Bank Indonesia expects economic growth to come in at the lower end of its full-year growth forecast of 5.0%–5.4%.

Size and Composition

Indonesia's LCY bond market was the fastest growing in emerging East Asia on a quarter-on-quarter (q-o-q) basis, with growth rebounding strongly to 5.9% in the third quarter (Q3) of 2018 from only 0.5% in Q2 2018. On a y-o-y basis, growth rose at a faster pace of 13.9% in Q3 2018 versus 12.0% in the previous quarter. Total bonds outstanding climbed to IDR2,764.3 trillion at the end of September (**Table 1**). Much of the growth was driven by government bonds, while corporate bonds contributed to a lesser extent.

Government bonds accounted for a growing share of the market in Q3 2018 at 84.8% of the LCY bond stock at

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2017		Q2 2018		Q3 2018		Q3 2017		Q3 2018	
	IDR	USD	IDR	USD	IDR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**2,426,060**	**180**	**2,611,428**	**182**	**2,764,341**	**185**	**4.1**	**12.7**	**5.9**	**13.9**
Government	2,066,296	153	2,208,882	154	2,345,354	157	3.4	10.7	6.2	13.5
Central Govt. Bonds	2,046,933	152	2,196,915	153	2,306,641	155	4.9	17.0	5.0	12.7
of which: *Sukuk*	329,039	24	354,277	25	378,115	25	10.6	37.2	6.7	14.9
Central Bank Bills	19,363	1	11,967	0.8	38,713	3	(58.3)	(83.4)	223.5	99.9
of which: *Sukuk*	12,626	0.9	11,967	0.8	10,642	0.7	34.0	33.7	(11.1)	(15.7)
Corporate	359,763	27	402,546	28	418,987	28	8.2	25.5	4.1	16.5
of which: *Sukuk*	13,958	1	14,692	1	16,982	1	4.3	29.9	15.6	21.7

( ) = negative, IDR = Indonesian rupiah, LCY = local currency, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third 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-September stood at IDR230.5 trillion.

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

the end of September, broadly unchanged from 84.6% at the end of June. Conventional bonds also accounted for a bigger share of the market, also little changed at 85.3% from 85.4% of the total in the same period. The share of *sukuk* (Islamic bonds) was steady at about 15% of the total at the end of September.

Government bonds. The outstanding size of LCY government bonds climbed to IDR2,345.4 trillion at the end of September on expansions of 6.2% q-o-q and 13.5% y-o-y. Treasury bills and bonds, which are issued by the Ministry of Finance to fund the budget deficit, drove much of the growth. The stock of central bank bills, which are known as Sertifikat Bank Indonesia (SBI), also contributed to the overall growth. Growth in government bonds outstanding was buoyed by higher issuance volume in both central government bonds and central bank bills during the quarter.

Central government bonds. At the end of September, the outstanding amount of central government bonds reached IDR2,306.6 trillion on growth of 5.0% q-o-q and 12.7% y-o-y. During the quarter, the Ministry of Finance accepted bids more than the targeted amount in nearly all scheduled Treasury auctions, fulfilling its funding needs after a slowdown in issuance in Q2 2018. Issuance volume per week reached over IDR15 trillion in Q3 2018 for conventional bonds and over IDR4 trillion for *sukuk*, compared with regular volume of IDR8 trillion–IDR10 trillion for conventional bonds and about IDR4 trillion for *sukuk*.

Normally, the Ministry of Finance frontloads its issuance by opting to issue in bigger volumes in January–June. However, volatile market conditions led the government to pare most of its issuances in Q2 2018 as investors sought higher yields.

Central bank bills. The outstanding stock of SBI rose more than threefold to IDR38.7 trillion at the end of September from IDR12.0 trillion at the end of June. The faster growth stemmed from Bank Indonesia's resumption of conventional SBI issuance beginning in July to boost foreign portfolio investment in the Indonesian market. Higher foreign portfolio inflows were expected to help stabilize the Indonesian rupiah. Bank Indonesia had ceased issuance of conventional SBI beginning in January 2017. As with the trend for Treasury bonds, conventional SBI issuance tends to be higher in volume than its *sukuk* counterpart.

Corporate bonds. At the end of September, the LCY corporate bond stock reached IDR419.0 trillion on growth of 4.1% q-o-q and 16.5% y-o-y. The increase in corporate bonds outstanding stemmed from modest issuance volume and fewer bond maturities during the review period.

A total of 113 corporate entities comprised the Indonesian corporate bond market at the end of September. **Table 2** presents the 30 largest issuers of corporate bonds during the review period. Collectively, their outstanding bonds totaled IDR312.1 trillion, representing a 74.5% share of the

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	36,322	2.44	Yes	No	Banking
2.	Bank Rakyat Indonesia	24,445	1.64	Yes	Yes	Banking
3.	PLN	19,385	1.30	Yes	No	Energy
4.	Indosat	17,519	1.18	No	Yes	Telecommunications
5.	Bank Tabungan Negara	17,050	1.14	Yes	Yes	Banking
6.	Bank Pan Indonesia	15,427	1.04	No	Yes	Banking
7.	Sarana Multi Infrastruktur	14,400	0.97	Yes	No	Finance
8.	Waskita Karya	14,211	0.95	Yes	Yes	Building Construction
9.	Bank Mandiri	14,000	0.94	Yes	Yes	Banking
10.	Federal International Finance	12,790	0.86	No	No	Finance
11.	Adira Dinamika Multifinance	11,103	0.75	No	Yes	Finance
12.	Perum Pegadaian	9,599	0.64	Yes	No	Finance
13.	Sarana Multigriya Finansial	9,175	0.62	Yes	No	Finance
14.	Pupuk Indonesia	9,076	0.61	Yes	No	Chemical Manufacturing
15.	Telekomunikasi Indonesia	8,995	0.60	Yes	Yes	Telecommunications
16.	Bank CIMB Niaga	7,237	0.49	No	Yes	Banking
17.	Astra Sedaya Finance	7,000	0.47	No	No	Finance
18.	Hutama Karya	6,825	0.46	Yes	No	Non-Building Construction
19.	Medco-Energi Internasional	6,454	0.43	No	Yes	Petroleum and Natural Gas
20.	Bank Maybank Indonesia	6,247	0.42	No	Yes	Banking
21.	Permodalan Nasional Madani	5,746	0.39	Yes	No	Finance
22.	BFI Finance Indonesia	5,541	0.37	No	Yes	Finance
23.	Bank OCBC NISP	5,356	0.36	No	Yes	Banking
24.	Maybank Indonesia Finance	4,400	0.30	No	No	Finance
25.	Bank Pembangunan Daerah Jawa Barat Dan Banten	4,252	0.29	Yes	Yes	Banking
26.	Bank Permata	4,060	0.27	No	Yes	Banking
27.	Indofood Sukses Makmur	4,000	0.27	No	Yes	Food and Beverages
28.	Indomobil Finance Indonesia	3,899	0.26	No	No	Finance
29.	Bank UOB Buana	3,800	0.25	No	No	Banking
30.	Adhi Karya	3,747	0.25	Yes	Yes	Building Construction
Total Top 30 LCY Corporate Issuers		**312,061**	**20.94**			
Total LCY Corporate Bonds		**418,987**	**28.11**			
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 30 September 2018.
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.

corporate stock at the end of September. Firms from the banking and financial industry continued to account for the bulk of those on the list. Half of the firms on the list were state-owned. This is consistent with the information gathered in the annual *AsianBondsOnline* Liquidity Survey, which indicated that the most liquid bonds were those issued by state-owned entities and finance-related companies. The top 30 list is dominated by such institutions.

Three state-owned firms topped the list of corporate issuers at the end of September. In the lead was Indonesia Eximbank (IDR36.3 trillion), followed by Bank Rakyat Indonesia (IDR24.4 trillion). Both firms maintained their respective rank from Q2 2018. Energy firm PLN moved up to the third spot with total bonds outstanding valued at IDR19.4 trillion.

During the quarter, 25 corporate institutions tapped funding from the bond market, issuing an aggregate of IDR33.4 trillion. A total of 68 new bond series were issued in the market, including two series of green bonds and 10 series of *sukuk*. In July, Sarana Multi Infrastruktur issued 3-year and 5-year green bonds for an aggregate issuance worth IDR500 billion. It also issued 3-year and 5-year *sukuk mudharabah* (Islamic bonds backed by a profit-sharing scheme from a business venture or partnership) worth a total of IDR1 trillion. Sarana Multi Infrastruktur is a state-owned financial institution rated $_{id}$AAA by Pemeringkat Efek Indonesia (Pefindo).

Two other types of *sukuk* were issued in Q3 2018 aside from *mudharabah*. Medco Power Indonesia raised IDR600 billion from a triple-tranche issuance in July of *sukuk wakalah* (Islamic bonds backed by an agreement nominating another entity to act on its behalf). Five series of *sukuk ijarah* (Islamic bonds backed by a lease agreement) were also issued by PLN and valued at a total of IDR750 billion.

The largest corporate bond issuances during the quarter are presented in **Table 3**. Leading the list were three state-owned companies. Bank Mandiri raised IDR3.0 trillion from the sale of 5-year bonds in September. State-owned port services provider Pelabuhan Indonesia IV issued an aggregate of IDR3.0 trillion from a triple-tranche deal in July. Next on the list was Indonesia Eximbank, which issued an aggregate of IDR2.5 trillion from a four-tranche bond deal in September.

Table 3: Notable Local Currency Corporate Bond Issuance in the Third Quarter of 2018

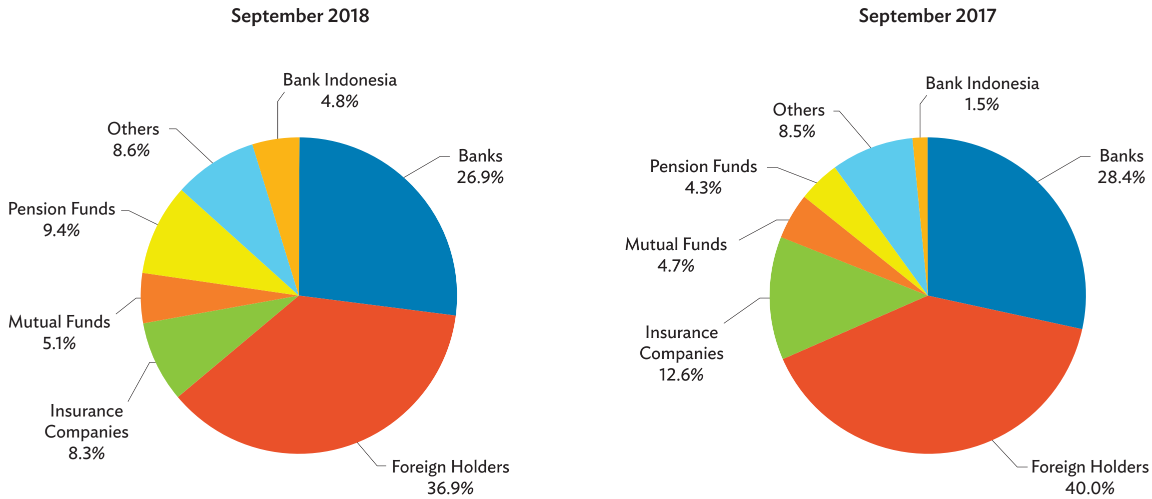
Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Bank Mandiri		
5-year bond	8.50	3,000
Pelabuhan Indonesia IV		
5-year bond	8.00	380
7-year bond	9.15	1,820
10-year bond	9.35	800
Indonesia Eximbank		
370-day bond	7.00	724
3-year bond	7.50	190
5-year bond	8.40	276
7-year bond	8.75	1,324
Adira Dinamika Multi Finance		
370-day bond	7.50	696
2-year bond	8.00	119
3-year bond	8.50	716
4-year bond	9.00	269
5-year bond	9.25	461
PLN		
5-year bond	7.80	79
5-year *sukuk ijarah*	7.80	127
7-year bond	8.35	442
7-year *sukuk ijarah*	8.35	150
10-year bond	8.40	138
10-year *sukuk ijarah*	8.40	258
15-year bond	8.90	281
15-year *sukuk ijarah*	8.90	105
20-year bond	9.00	339
20-year *sukuk ijarah*	9.00	110

IDR = Indonesian rupiah.
Note: *Sukuk ijarah* are Islamic bonds backed by lease agreements.
Source: Indonesia Stock Exchange.

Investor Profiles

Central government bonds. Despite the market sell-off in the LCY government bond market, foreign investors remained the largest holder of LCY government bonds in Indonesia. Their holdings, however, had fallen to a 36.9% share of the total at the end of September from 40.0% a year earlier (**Figure 2**). Foreign holdings began exhibiting a downtrend in February as US Treasury yields picked up and the US dollar strengthened against most major currencies. In addition, risk-off sentiment toward emerging markets prevailed amid concerns of contagion from the financial woes of Argentina and Turkey. Nonetheless, foreign investors remained attracted to Indonesian bond yields due to their high real returns,

Figure 2: Local Currency Central Government Bonds Investor Profile



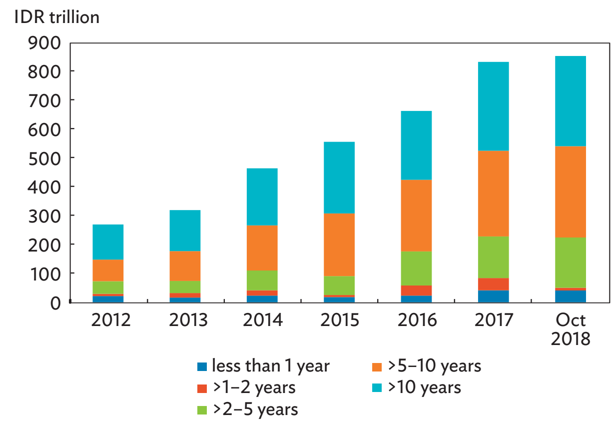
Source: Directorate General of Budget Financing and Risk Management, Ministry of Finance.

given that inflation has been relatively tame so far in 2018.

In nominal terms, foreign bond holdings climbed to IDR850.9 trillion at the end of September from IDR819.4 trillion in the prior year. Holdings of foreign governments and central banks increased to IDR161.0 trillion at the end of September, representing nearly 20% of the aggregate holdings of nonresidents. This is reflective of the view that Indonesia continues to enjoy strong economic fundamentals despite external risks.

Foreign investors continued to place a large share of their holdings in longer-dated maturities. As of 3 October, their aggregate bond holdings in maturities of 10 years or more and from 5 to 10 years each accounted for about 37% of total foreign holdings (**Figure 3**). Bonds with maturities of 1 year or less had a share of about 5%.

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



IDR = Indonesian rupiah.
Note: Data for October 2018 is as of 3 October 2018.
Source: Directorate General of Budget Financing and Risk Management, Ministry of Finance.

Leading all domestic investor groups were commercial banks despite their bond holdings declining to 26.9% of the total central government bond market at the end of September from 28.4% in September 2017. Bond holdings of insurance companies fell to an 8.3% share from 12.6% during the same period.

Domestic investors that exhibited increases in their bond holdings during the review period were pension funds, Bank Indonesia, mutual funds, and other investors. Pension fund holdings rose to a 9.4% share at the end of September from 4.3% a year earlier as they sought to comply with investment holding limits on government bonds set out by the government. In the case of Bank Indonesia, its bond holdings increased in line with central bank intervention in the market via bond buybacks.

Ratings Update

On 2 September, Fitch Ratings (Fitch) affirmed Indonesia's long-term foreign currency and LCY issuer default ratings at BBB. The ratings were given a stable outlook. In making its decision, Fitch took note of Indonesia's low government debt burden and favorable GDP growth outlook amid risks in the global environment. Fitch expects Indonesia's annual GDP growth to reach 5.1% in 2018, 5.2% in 2019, and 5.3% in 2020.

Policy, Institutional, and Regulatory Developments

Bank Indonesia Lowers the Minimum Transaction Limit for Foreign Exchange Swaps to USD2 Million

In August, Bank Indonesia lowered the minimum transaction limit for conducting foreign exchange hedging via swaps to USD2 million from USD10 million. With the reduced floor for hedging transactions, Bank Indonesia expects the volume of hedging transactions to increase. The hedging facility is available for transactions involving US dollars, Japanese yen, euros, and Chinese renminbi. In addition, the central bank is planning to relax documentary requirements for tapping the facility.

Indonesia and Japan Agree on an Enhanced Bilateral Swap Arrangement

In October, the Bank of Japan and Bank Indonesia agreed to enhance their existing Bilateral Swap Arrangement. The amendment allowed for the use of the local currencies of both markets through the swap of Indonesian rupiah into Japanese yen. Prior to this enhanced agreement, the swap facility only involved tapping funds in US dollars. The bilateral swap agreement between Indonesia and Japan amounted to an equivalent of up to USD22.8 billion.

Bank Indonesia Commences Nondeliverable Forward Transactions

On 1 November, Bank Indonesia commenced the trading of nondeliverable forwards settled in Indonesian rupiah as part of measures to help stabilize the local currency. The Jakarta Interbank Spot Dollar Rate will be used as the reference price for domestic nondeliverable forwards, which may be offered by banks to investors and corporates as an alternative hedging tool against exchange rate volatility. To enter into a domestic nondeliverable forward transaction, underlying transactions—such as trade documents, proof of investments, and bank loans in a foreign currency used for the purpose of trade or investment—will be required.