BOND MARKET UPDATE

GLOBAL SENTIMENTS

PERSISTENT STIMULUS

The global economy enters the new decade in a much stronger position than it had in 2010. But a number of threats could potentially ruin the foundations of global economic progress for the next decade. Several economists and policymakers expect the uncertainties posed by the trade war and geopolitical risk to warrant attention in the year ahead.

Therefore, most economic agents (producers, investors, and consumers) expect policymakers to maintain an expansionary policy, to stimulate the economy, and to ensure the global economy continues to grow at a modest rate in the next year. The US, as the anchor of the global economy, still needs stimulus to keep domestic inflation at 2% as its optimum economic objective, as stated in the Philips Curve and Okuns Law. Although the US Federal Reserve in its most recent press release (December 11, 2019) signaled the Fed rate would be kept stable, three former chairpersons — Allan Greenspan, Ben Bernanke, and Janet Yellen — agreed the Fed should also consider using the negative short-term rates shortly.

China's central bank, the People's Bank of China (PBOC), at the end of December announced it would inject USD115 billion into the economy by freeing up banks to lend more money. The cash injection into its financial system suggests Beijing remains concerned about faltering growth, despite signs the world's second-largest economy was stabilizing. The move comes after similar action in September. While PBOC cut its commercial bank reserve requirement ratio, expected to effectively allow banks to lend an additional 800 billion yuan (USD115 billion), both monetary policies are assumed to be to tackle US President Donald Trump's trade war, which has already hit the Chinese economy. Higher tariffs have made it more expensive to sell Chinese-made goods to American customers, denting China's factory activity and consumer confidence. However, the trade truce since the beginning of December could limit the damage, but still leave many tariffs in place.

EXHIBIT 1. BENCHMARK POLICY RATE IN CENTRAL BANKS (%)

Source: *Bloomberg*

Former European Central Bank (ECB) president Mario Draghi said governments across the eurozone need to take more significant steps to reboot growth by ramping up public spending and cutting taxes. This was followed by ECB President Christine Lagarde's 2020 remarks pushing for greater coordination between the region's policymakers, with a joint fiscal push to help jump-start the euro area's sluggish economy. The ECB plans to pump EUR20 billion every month into the financial markets. These policies hopefully will help the manufacturing sector grow amid the uncertainty risk of Brexit, the trade war, and the high level of public and private debt.

Japan's inflation was only 0.5% YoY in November 2019, below the 2% goal of the Bank of Japan (BoJ), indicating domestic demand was still fragile. The government responded in December by announcing a JPY13.2 trillion (USD122 billion) fiscal package to support growth.

YIELDS EXPECTED TO BE LOW

For bond market agents, the stimulus packages from several global benchmark countries are expected to reduce global sovereign yields. The lower yield will also see capital flow to higher yield countries, especially emerging markets. The inflow of foreign portfolio investment is also pushed by a wider yield spread between emerging market countries and the US. The consequences underpin the strengthening of bond performance in several emerging countries.

EXHIBIT 2. SPREAD YIELD BETWEEN SEVERAL EMERGING COUNTRIES' 10-YEAR SOVEREIGN BONDS TO US (BASIS POINTS - BPS)

Source: *Bloomberg*

As the middle-eastern geopolitical risk of US-Iran tensions is rising, capital flow to emerging markets could be hampered, and an extreme case would be a Black Swan event and the reversal of capital flow.

GOVERNMENT BONDS

The year 2019 was one of the most positive ones for the bond market in the last five years, apart from 2017. Government bond yields continued to decline in line with capital inflow. 10-year government bond yields were 7,063% as of December 31, 2019, down 95 bps compared to the end of the previous year. Yields fell again and closed at 6,813% as of January 20, 2020.

EXHIBIT 3. INDONESIA GOVERNMENT BOND YIELD (%)

Source: *Bloomberg*

EXHIBIT 4. RUPIAH EXCHANGE RATE (IDR/USD)

Source: *Bank Indonesia, Bloomberg*

The rupiah is also relatively stable, with an appreciative tendency, supporting capital inflow. It dropped to IDR13,866 per USD, falling 3.6% year-on-year (YoY) from IDR14,390 per USD at the end of the previous year.

Lower capital inflow and a trade deficit reduced the pressure on rupiah depreciation. The Central Statistics Agency reported the deficit fell from USD8.7 billion in 2018 to USD3.2 billion.

EXHIBIT 5. NET PURCHASE OF GOVERNMENT BOND BY TYPE OF INVESTOR (IDR TRILLION)

Investor	Outstanding	17-Jan-20	2019	2018	2017
Bank	725.7	144.4	-71.4	161.2	92.1
Bank Indonesia	108.6	-153.9	139.2	-18.5	7.6
Foreign Investor	1,084.1	22.3	151.9	73.8	170.3
Insurance	215.3	0.3	11.5	52.7	-87.4
Pension Fund	257.8	1.2	39.1	19.5	110.8
Mutual Fund	130.9	0.1	10.5	16.4	18.3
Others	353.3	-153.7	173.3	14.5	22.3

Source: *Directorate General of Budget Financing and Risk Management – Ministry of Finance*

In the government bond market, foreign investors booked net purchases of USD151.9 trillion in 2019. In early 2020, they bought USD22.3 trillion to January 17. Foreign inflows became a catalyst, not just for government bond yields, but also the movement of the rupiah. Bloomberg data shows the rupiah spot exchange rate closed appreciating by -1.6% to IDR13,639 as of January 20, 2020.

YIELDS EXPECTED TO REMAIN RELATIVELY STABLE LOW OVER NEXT TWO MONTHS

Although we expect demand to continue to be strong, the government's front-loading policy will make supply relatively large. To reduce demand, the government says it will not necessarily offer interest that is too cheap. We expect future yield movements to be in the range of +/- 2.5% from the current level of 6.6%-6.9%.

DEMAND EXPECTED TO REMAIN POSITIVE

Indonesia has become a global investment magnet because of high returns. Its closest competitor is India, and it faces pressure due to high inflation and tighter policies regarding foreign investment. As of January 20, 2020, for 10-year tenor bonds Indonesia offered a premium of 501 basis points (bps) above the US Treasury. India provided a premium of 480 bps.

The positive development of the trade balance is expected to remain positive, supporting the movement of the rupiah not to be too volatile. The low exchange rate risk attracts foreign investment because it reduces the translation risk foreign investors bear.

EXHIBIT 6.
GOVERNMENT ISSUANCE TARGET IN 2020

	Budget 2020	Budget Realization (as of January 8, 2020)	% Realization to Budget 2020
Government Securities Net	389,322,046	50,416,170	12.95%
Issuance Need for 2020	737,517,201	63,416,170	8.62%
Government Debt Securities (GDS)		63,416,170	
IDR Denominated GDS		20,000,000	
- Coupon GDS		17,000,000	
- Conventional T-Bills		3,000,000	
- Private Placement		-	
- Retail Bonds		-	
Foreign Denominated Bonds		43,416,170	
- SEC USD*		27,838,000	
- SEC EURO*		15,578,170	
- Samurai Bonds		-	
- USD Onshore Bonds		-	
Sovereign Sharia Securities (Sukuk)		-	
Domestic Sovereign Sharia Securities		-	
- IFR/PBS/T-Bills Sukuk (Islamic Fixed Rated Bond/Project Based Sukuk)		-	
- Retail Sukuk		-	
- Private Placement		-	
Global Sukuk		-	

**Dual-currency bonds issuance using SEC format amounted USD2 bn and EUR1 bn on Wednesday, January 8, 2020 (BI mid day exchange rate; 1 USD = 13,919 IDR & 1 EUR = 15,578.17 IDR)*
***Source:** IBPA, Bloomberg*

FRONT-LOADING POLICY CREATES AMPLE SUPPLY IN EARLY 2020, ALTHOUGH OVERALL ISSUANCE IS ESTIMATED TO BE LOWER THAN IN 2019

The government plans to issue IDR735.5 trillion (gross) debt securities in 2020, lower than IDR904.08 in 2019. After deducting the need for redemption and maturing debt, the net supply value entering the debt securities market is IDR389.3 trillion. Of the gross value, the government plans to issue 82%-86% of rupiah-denominated debt securities, while the rest is denominated in foreign currencies.

We expect realization to reach 30.0%-35.0% of the total gross issuance target by March 2020 - in nominal terms, the value will reach IDR 220.7-IDR 257.4 trillion. The issuance of new debt securities at the beginning of the year is also more attractive due to the development of low yields, allowing lower issuance costs.

CORPORATE BONDS

A decline in the benchmark yield on government bonds brought bond yields down. Yields on corporate bonds rated AAA for three-year, and five-year tenors fell by 188 bps and 171 bps, to 7,349% and 7,538%, respectively.

From the corporate debt issuance side, short to medium term tenors remain dominant. Some 41.8% of the issuance value is debt instruments with a maturity of three years, 24.9% with a maturity of five years, and 18.4% with a maturity of one year. Approximately 55.8% of the value of new debt securities has an AAA rating, 18.0% has an AA rating, and 20.1% has an A.

EXHIBIT 7. EFFECTIVE AAA-RATED CORPORATE BOND YIELD (%)

Source: *IBPA, Bloomberg*

ALTHOUGH CORPORATE BOND YIELDS HAVE FALLEN, CORPORATE DEBT COUPONS ARE STILL RESISTANT TO GOING DOWN TO A COMPARABLE RATE

We see this because the market is not liquid and demand is smaller than the government bond market. Many institutional investors still favor the government debt market; as a result they still have high returns to absorb the corporate debt. They usually also buy and hold bonds until maturity rather than transacting them for capital gains.

EXHIBIT 8. AVERAGE COUPON FROM NEW ISSUANCE OF CORPORATE DEBT SECURITIES (%)

Tenor	AAA		AA		A		BBB	
	1H19	2H19	1H19	2H19	1H19	2H19	1H19	2H19
1	7,85	7,49	8,24	7,94	9,00	8,48	11,74	11,24
2	8,45	7,78	9,15	9,15	10,47	10,37	11,50	10,63
3	8,69	8,36	9,39	9,07	10,55	10,47	11,98	11,16
4	NA	NA	NA	9,50	10,65	10,65	NA	NA
5	9,23	8,58	9,34	9,03	10,52	10,04	11,75	11,78
7	9,64	8,86	9,10	9,24	11,10	11,10	NA	11,50
10	9,91	9,48	NA	NA	NA	NA	NA	NA

Source: *KSEI, processed by PEFINDO*

BANKS AND MUTUAL FUNDS STILL MOST SIGNIFICANT ABSORBERS OF NEW CORPORATE DEBT SECURITIES

Banks posted a net purchase of IDR11.0 trillion, and mutual funds IDR12.5 trillion. Most investment managers package corporate debt securities like mutual funds. Outstanding corporate debt packaged into mutual funds reached IDR161.8 trillion -the highest among other institutional investors.

The increase in bank ownership of corporate debt is related to the central bank's latest financing to funding ratio policy. The policy categorizes the purchase of corporate debt securities as loans. Therefore, amidst relatively stagnant growth in several key sectors such as manufacturing and trade, purchasing corporate bonds is the right option to maintain this ratio.

EXHIBIT 9. NET PURCHASE AND OUTSTANDING OF CORPORATE DEBT SECURITIES (IDR TRILLION)

Investors	Outstanding	Net purchase				
		2019	2018	2017	2016	2015
Insurance	93.4	9.9	9.0	17.9	18.2	3.3
Pension Fund	91.7	4.3	-52.7	67.3	2.3	8.6
Bank	109.3	11.0	-8.9	46.2	13.8	5.0
Mutual Fund	161.8	12.5	12.2	55.6	25.7	13.3
Corporate	12.8	-0.9	1.2	4.7	-1.5	-1.0
Foreign	34.5	2.8	-3.8	16.0	1.2	-3.0
Other	60.1	2.6	-23.9	41.7	3.9	0.9

Source: *KSEI, processed by PEFINDO*

WE EXPECT NEW ISSUANCE IN 2020 WILL BE PROSPECTIVE

We predict the value to reach IDR158.5 trillion, from IDR146.2 trillion in 2019. The increase is inseparable from the need for refinancing, by which the value of corporate debt securities maturing is IDR130.7 trillion.

EXHIBIT 10. NEW ISSUANCE CORPORATE DEBT SECURITIES BASED ON INDUSTRY (IDR TRILLION)

Industry	2014	2015	2016	2017	2018	2019
Special financial institution*	11.022	9.651	23.150	19.620	17.940	31.375
Multifinance	16.046	21.768	26.442	29.365	23.926	26.421
Banking	7.617	13.282	43.496	50.542	26.073	24.287
Telecommunication	3.500	12.500	4.490	11.350	7.455	8.970

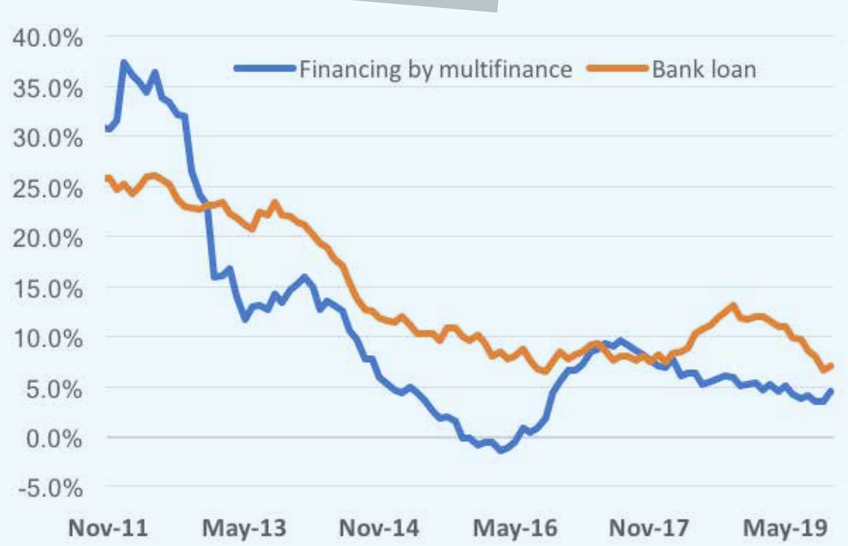
Industry	2014	2015	2016	2017	2018	2019
Finance industry	1.460	2.900	3.000	4.100	7.970	6.794
Construction	1.300	2.100	4.800	14.069	7.404	6.275
Property	2.876	2.471	4.583	4.605	1.782	6.095
Mining	NA	NA	3.509	6.336	2.076	2.239
Food and beverage	2.250	500	1.700	3.050	764	NA
Others	7.322	2.647	11.620	41.968	37.034	33.740
Total	**53.393**	**67.819**	**126.790**	**185.004**	**132.423**	**146.195**

Source: *KSEI, PEFINDO. Special financial institutions include Indonesia Eximbank, Sarana Multigriya Finansial (Persero), and Sarana Multi Infrastruktur (Persero)*

Special financial institutions are one of the main drivers of increased issuance from IDR132.4 trillion in 2018 to IDR146.2 trillion in 2019. They consist of three companies - Indonesia Eximbank, Financial Multigriya Facility (Persero), and Sarana Multi Infrastruktur (Persero) Persero) - and the total value of the three issuances increased from IDR17.9 trillion in 2018 to IDR31.4 trillion in 2019. The issuance of the two other major sectors - multifinance and banks - rose 10.4% to IDR26.4 trillion and decreased 6.8% to IDR24.3 trillion in 2019.

The need for funding by the finance sector and banks is not too large, considering weak business growth. Financing by the finance industry grew only 4.5% YoY as of November 2019, down from 5.1% YoY in the same period the previous year. Bank loans slowed from 11.9% YoY as of November 2018 to only 7.0% YoY in November 2019. Thus, especially in the multi-finance industry, new issuance was driven more by refinancing needs rather than funding for expansion needs.

EXHIBIT 11. WEAK BUSINESS GROWTH PERFORMANCE (% YOY)



Source: *IBPA, Bloomberg*