BOND MARKET UPDATE

THE COUNTERCYCLICAL POLICY EFFECT ON THE INDONESIAN BOND MARKET

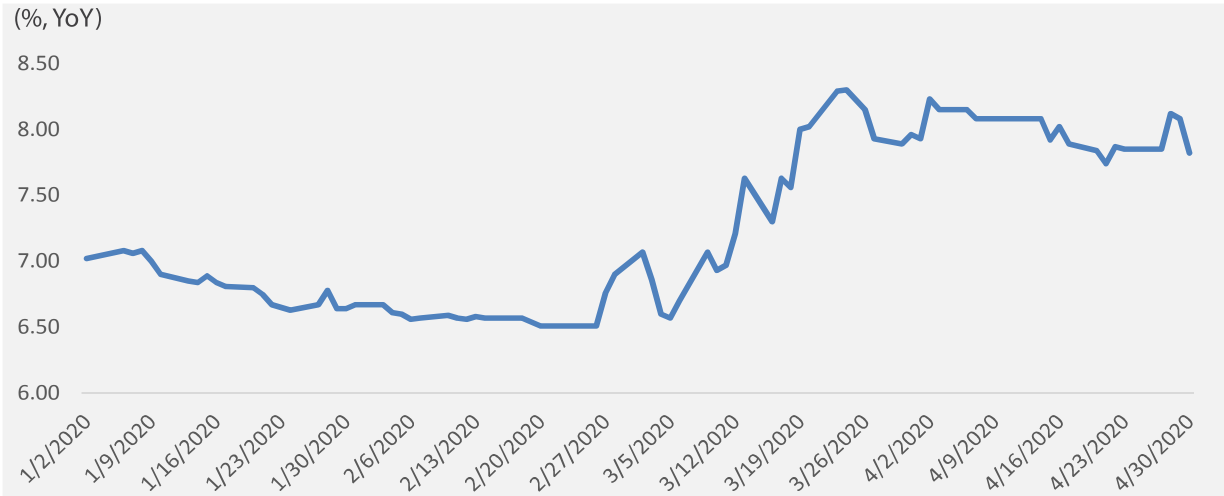
PEFINDO is of the view that soon after the World Health Organization (WHO) declared COVID-19 a pandemic on March 11, the global financial market rapidly moved into unprecedented territory. The yield on Indonesia's 10-year government bond jumped 140 basis points (bps) from 6.97% on March 11 to 8.37% on March 24. Pressure further increased when global oil prices tumbled below zero for the first time in history. Luckily, the countercyclical policy response with ultra loose monetary policy and fiscal stimuli from many countries, including Indonesia, gives rise to expectations that economic conditions would soon ease and economies will start to recover.

PRESSURES ON GOVERNMENT BOND MARKET

By mid-April 2020, the International Monetary Fund (IMF) had determined that the global economy had fallen into a recession, due to disrupted global supply chains and a drop in commerce induced by the pandemic. It is too soon to determine what the pandemic's overall impact will be on various industries and companies over the next few months. Globalization is in question, as global commerce has dwindled due to supply chain constraints, along with varying rules and restrictions among countries on cross-border transactions.

The higher probability of a global recession has made Indonesia's economy riskier, with investors becoming risk averse and choosing to flee. In Indonesia, the pandemic forced several local governments to implement large-scale social restrictions (PSBB) in different areas, which some market actors perceived would slow down economic growth in the second quarter of 2020. As a result, the rupiah depreciated to a low of more than IDR16,000 per US dollar by April 8.

FIGURE 1. YIELD OF 10-YEAR INDONESIAN GOVERNMENT BOND



Source : WSJ (2020)

At the same time, the risk perception of Indonesia sharply increased, with Indonesia's 5-year credit default swap (CDS) rate shooting up from below 100 points throughout January and February to more than 200 points from March 16 until the end of April. Consequently, the yield of Indonesia's bond market also sharply increased from only 6.76% at the end of February to more than 7.0% by March 3, then further up to 8.0% on March 20.

The pressures on government bonds also reflected the demand on the government bond primary market. Demand weakened to its lowest level of IDR27.6 trillion on April 14, compared to the demand at the latest incoming bid on February 20 that reached IDR127.7 trillion.

STIMULI REDUCES INSTABILITY

After the US Congress passed its USD2.2 trillion stimulus plan at the end of March — the largest in itshistory to provide critical funds through US government debt issuance in the form of short-term Treasury bills — the global bond market calmed down.

In Indonesia, Government Regulation in Lieu of Law (Perppu) No. 1 of 2020 concerning State Financial Policy and Financial System Stability — which allows Bank Indonesia to purchase government bonds not absorbed by the market starting April 28 — created another push factor for the bond market to become more stable.

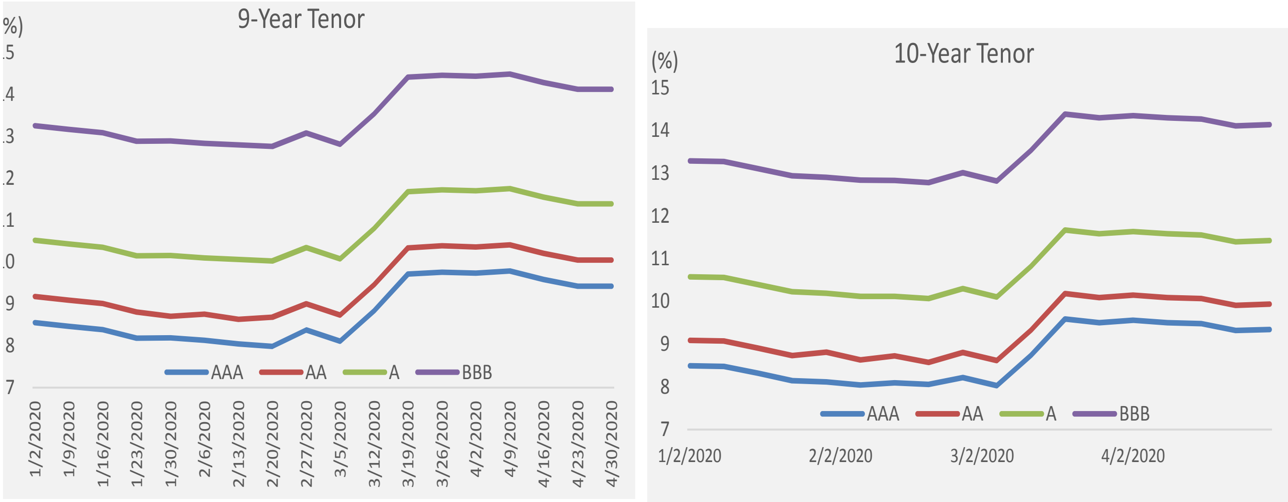
TABLE 1. RESULTS OF INDONESIAN GOVERNMENT CONVENTIONAL SECURITIES ISSUANCE AUCTIONED IN MARCH AND APRIL 2020

Auction Date	Total Incoming Bids (IDR Million)	Total Awarded Bids (IDR Million)	Bid to Cover Ratio (Times)
3-Mar-20	78,413,500,-	17,500,000,-	4.48
17-Mar-20	51,307,800,-	17,050,000,-	3.01
31-Mar-20	33,515,000,-	22,220,000,-	1.51
14-Apr-20	27,653,200,-	16,880,000,-	1.64
28-Apr-20	44,399,000,-	16,620,000,-	2.67

Source : Directorate General of Budget Financing and Risk Management, or DJPPR (2020)

The safeguard strategy of Bank Indonesia to buy bonds on the primary market slowly reduced the 10-year government bond yield to 7.88% by April 30, from 8.30% on March 24. Consequently, the yield of corporate bond issuance also decreased.

FIGURE 2. YIELD OF INDONESIAN CORPORATE BONDS WITH 9- TO 10-YEAR TENOR



Source : Bloomberg (2020)

For corporate bonds with an AAA rating, the yield for the 9- to 10-year tenor stood at 9.50% at the end of March before declining to 7.85% to 7.96% at the end of April. Over the same period, the yield for AA rated bonds with the same tenor moved from 10.09% to 9.31%, and the yield for A rated bonds decreased from 11.58% to 9.90%.