



# BOND MARKET UPDATE



## ACTIVATING HISTORIC STIMULUS PACKAGES

Sizeable economic stimulus packages will prevail in the short term. We expect developed countries to maintain loose fiscal and monetary policies to stimulate their economies amid the threat of a recession due to the COVID-19 pandemic, and, as a result, liquidity in global financial markets will soon be abundant.

We expect the United States, the Eurozone, and Japan to keep interest rates low. The US has suffered economic shocks, with real GDP contracting 9.5% year-on-year (YoY) in the second quarter of 2020, prompting a significant increase in its economic stimulus program. The Eurozone and Japan economies contracted 15.0% YoY and 1.7% YoY, respectively, in the same period.

The US Federal Reserve (Fed) and the US government are seriously committed to restoring the US economy. The Fed is expected to keep its benchmark interest rate close to 0%, and the government's fiscal package could also reach USD1-1.5 trillion.



### GOVERNMENT BONDS BOND YIELDS LIKELY TO REMAIN LOW, BUT WITH INCREASED RISK

We expect bond yields to remain relatively low in the next two months. We are of the view that lower interest rates and stable demand from the domestic market will keep yields low for the time being, but some risks still need to be watched out for. In addition to increasing supply in the secondary market, shocks to the global economy can drain foreign investment in the government bond market. The movement of the rupiah may also be vulnerable to depreciation pressures.

The government bond yield was 6.8% as of August 7, 2020, down 25.9% year-to-date (YtD). This decline is relatively moderate compared to other Southeast Asian countries such as Malaysia, Thailand, and the Philippines.

## EXHIBIT 1. COMPARING COUNTRIES' 10-YEAR TENOR GOVERNMENT BONDS

Country	Latest Yield (%)	YtD Change (in bps)
China	2.99	-15.7
Indonesia	6.80	-25.9
Japan	0.01	+2.3
South Korea	1.33	-34.5
Malaysia	2.45	-86.4
Philippines	2.70	-176.6
Singapore	0.82	-91.8
Thailand	1.22	-26.1
Vietnam	2.94	-47.8

Source: Asianbondonline

Bank Indonesia and the Indonesian government are focused on maintaining expansionary economic policies to revive the economy. In mid-July 2020, BI lowered the benchmark interest rate by 25 basis points (bps) to 4%. Inflation was also low at 1.54% in July 2020, due to a contraction in demand and economic activity, below the central bank target of  $3\% \pm 1\%$ .

We expect the demand for government bonds will remain large. Amid the threat of a recession, reallocating asset classes to government bonds is a more sensible option. Domestic investors do not appear to have the courage to invest in the stock market because of the increased risk. Falling real sector performance (as indicated by a recession) worsens the stock market's performance.

Funding needs will remain significant, considering the fiscal package will take up more of the budget. With the real sector collapsing, the government cannot rely on revenue from taxes. The government estimates the budget deficit will reach 6.34% of GDP, as stated in Presidential Regulation Number 72/2020, so bond market supply is expected to be higher this year, limiting further yield cuts.

External shocks can be the most significant risk and draw foreign capital out of Indonesia. Even though the signs are not visible at this time, we are using the assumption of external shocks as our worst-case scenario. Recessions in developed countries can lead to depression, spread to other countries, shrink international trade and evaporate hot money in developing countries.



## REALLOCATION OF ASSETS BY DOMESTIC INVESTORS BENEFITS DEMAND FOR GOVERNMENT BONDS

We expect domestic investors to allocate more of their assets to government bonds because they are safer. This is indicated by auction results and the bid-to-cover ratio, which is the ratio between the rupiah amount of bids received in the auction and the amount sold.

As of July 28, 2020, the government had issued IDR747.8 trillion in securities, 48.8% of its 2020 target. In the last two months, the bid-to-cover ratio has always been above 3-times, at 4.01 times in June 2020 and 3.04 in July 2020, higher than 1.98 in April 2020 and 2.36 in May 2020. The increase in the ratio indicates an increase in enthusiasm for government debt securities.

### EXHIBIT 2. NET PURCHASE (SELL) AND OUTSTANDING OF TRADABLE GOVERNMENT BONDS

Investor	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20*	Outstanding*	Share*
Commercial banks	64.7	-41.0	52.9	133.0	85.0	-44.4	-1.1	988.9	31.0%
Foreigners	-28.9	-121.3	-2.1	7.1	5.2	8.8	-2.9	942.9	29.6%
Central bank	-5.1	140.0	6.6	-13.5	-39.9	79.9	13.1	301.2	9.4%
Insurance	1.2	8.0	41.8	9.6	0.1	0.8	-1.4	277.1	8.7%
Pension funds	4.5	7.6	-43.8	0.1	2.0	1.4	0.3	231.8	7.3%
Mutual funds	-0.1	-0.7	3.1	1.1	2.5	3.6	3.5	143.2	4.5%
Others	2.8	14.9	19.0	2.6	0.2	21.1	-0.5	302.9	9.5%
Total	39.2	7.4	77.4	139.9	55.2	71.1	11.0	3188.0	100.0%

\*as of August 6, 2020

Source: Director General of Debt, Ministry of Finance

Looking ahead, we need support from a looser monetary policy by Bank Indonesia. Aside from using interest rates, the central bank can also inject liquidity into the market and increase the money supply through open market operations. An expansionary monetary policy means Indonesian banks will buy government securities, and money will flow into the economy.

In July, Bank Indonesia booked a net purchase of IDR79.9 trillion on the secondary market, the highest among domestic investors. The central bank buys securities from commercial banks as a measure of open market operations. At the same time, commercial banks posted net sales of IDR44.4 trillion.

As of August 6, 2020, commercial and foreign banks were the two largest investors in government bonds, with commercial banks at IDR988.9 trillion (31.0% of outstanding in the secondary market) and foreigners at IDR942.9 trillion (29.6%).



## CORPORATE BONDS

# EFFECTIVE YIELD OF CORPORATE BONDS FELL IN LINE WITH GOVERNMENT BONDS

Low government bond yields pushed down corporate bond yields, which should make new funding costs less expensive. The effective yields of three-year and five-year corporate bonds fell from 8.043% and 8.598% at the end of March 2020 to 6.561% and 7.172%, respectively, on August 7, 2020.

**EXHIBIT 3. YIELD OF AAA-RATED CORPORATE BONDS**



Source: Bloomberg, IBPA

Yields are expected to remain low in the coming months, following trends in the government bond market. Supply will tend to be lower as economic growth slips. From the supply side, although the absorption capacity of domestic investors is quite large, the reallocation of assets makes the bond market appear less attractive. Investors are still hunting down government bonds to secure their portfolios.



## NEW BOND ISSUANCE AND TRANSACTIONS ON SECONDARY MARKET WEAKEN

Up to July 2020, the issuance of corporate bonds was IDR39.1 trillion, 26.7% of the realization in 2019. Specialized financial institutions were the largest issuers at IDR8.1 trillion, followed by the power and energy industry (IDR6.7 trillion) and multi-finance companies (IDR6.4 trillion).

A contraction forces firms to streamline operations rather than expand. Financial profile and cash flow pressures discourage them from issuing new bonds. Most of the issuance of debt securities so far have been for refinancing needs. Weak bond issuance is likely to continue in the next few months until the economy fully recovers from COVID-19.

### EXHIBIT 4. NEW ISSUANCE OF DEBT SECURITIES

Investor	2017	2018	2019	2020*
Special financial institutions***	19.6	17.9	31.4	8.1
Power and energy	8.9	7.5	11.0	6.7
Multifinance	29.4	23.9	26.4	6.4
Banking	50.5	26.1	24.3	3.7
Financing**	4.1	8.0	6.8	3.2
Mining	6.3	2.1	2.2	2.3
Pulp and paper	4.7	12.1	4.5	2.2
Telecommunications	11.4	7.5	9.0	2.1
Plantations	1.1	1.7	2.9	1.9
Chemicals	2.6	1.7	1.3	1.0
Other	46.4	24.0	26.7	1.6
<b>Total</b>	<b>185.0</b>	<b>132.4</b>	<b>146.5</b>	<b>39.1</b>

\*as of Jul 2020

\*\*Pegadaian (Persero), Permodalan Nasional Madani (Persero), and Indonesia Infrastructure Finance.

\*\*\*Lembaga Pembiayaan Ekspor Indonesia (Indonesia Eximbank), Sarana Multi Infrastruktur (Persero) and Sarana Multigriya Finansial (Persero)

Source: KSEI, PEFINDO Database

This sluggishness also occurred for corporate bond trading transactions in the secondary market. In semester one, secondary market transactions averaged 146 times a day, with an average transaction value of IDR1.4 trillion, slightly below the previous year's average.

Investors are more interested in the government bond market to secure their portfolios. Transactions on the secondary market surged, with the frequency increasing from an average of 951 times a day in 2019 to 1,671 in 1H2020. The average transaction value also jumped from IDR26.9 trillion to IDR37.98 trillion.

## EXHIBIT 5. AVERAGE DAILY TRADING

	Corporate Bonds		Government Bonds		Stock Market	
	Value (IDR bn)	Freq (x)	Value (IDR bn)	Freq (x)	Value (IDR bn)	Freq (x)
2013	744	81	7,606	493	5,526	154
2014	679	91	11,552	655	6,026	213
2015	756	91	13,845	691	5,757	221
2016	908	99	15,075	862	7,454	264
2017	1,355	126	16,426	890	7,658	312
2018	1,354	125	20,934	1,019	8,500	387
2019	1,570	149	26,918	951	9,106	469
2020*	1,405	146	37,981	1,671	7,668	514

\*Jan 1, 2020 – June 30, 2020  
Source: Jakarta Stock Exchange (IDX)







## REALLOCATION OF ASSETS MAKES CORPORATE BONDS LESS ATTRACTIVE

By end of July 2020, mutual funds were the largest holders of corporate bonds, with a value of IDR97.9 (24.3% of total sales), followed by insurance and banks at IDR97.3 trillion (24.1%) and IDR83.9 trillion (20.8%), respectively.

Insurance companies were the most aggressive in investing in corporate bonds, while other institutional investors tended to reduce their holdings. YtD, insurance companies bought IDR24.3 trillion in corporate bonds, with a share of ownership increase from 17.2% in December 2019 to 24.1% in July 2020.

### EXHIBIT 6. YTD NET PURCHASE (SELL) IN CORPORATE BOND MARKET

Investor	Dec-19	Mar-20	Jun-20	Jul-20	Share*
Mutual funds	26.0%	25.2%	24.6%	24.3%	97.9
Insurance	17.2%	17.4%	24.3%	24.1%	97.3
Banks	21.4%	21.6%	21.0%	20.8%	83.9
Pension funds	20.2%	20.3%	14.4%	14.4%	58.2
Foreigners	7.5%	7.4%	7.5%	7.8%	31.4
Individuals	4.1%	4.1%	4.3%	4.4%	17.8
Corporations	1.6%	1.7%	1.8%	2.1%	8.4
Foundations	1.0%	1.0%	1.0%	1.0%	4.0
Securities companies	0.2%	0.4%	0.1%	0.2%	0.8
Others	0.8%	0.8%	0.9%	0.9%	3.6
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>403.4</b>

\*As of Jul 31, 2020  
Source: KSEI