

INDONESIA

SECURITIES

SUMMARY

Indonesia's capital market expanded rapidly over the last decade, led by growth of the equity market. Trading on the Jakarta Stock Exchange (JSX) – the dominant securities market in the country – increased from only 27,000 shares per day in 1988 to 254 million shares per day in mid-1998. Like the banking sector, however, the stock market was hard hit by the economic crisis that struck Indonesia beginning in mid-1997. Market capitalization declined by 30 percent in Rupiah terms from May 1997 to May 1998, and by an even more dramatic 83 percent in U.S. dollar terms. Indonesians described this collapse with the proverb, "already brought down, then hit by the falling ladder."

The lack of a well-developed bond market remained a limiting factor for Indonesia's financial sector, and arguably contributed to the financial and economic crisis. Lacking a deep domestic market for bond financing, and facing relatively high domestic interest rates for bank loans, many rapidly expanding Indonesian companies borrowed abroad during the early 1990s, running up private offshore debts of about US\$80 billion by 1997. These loans were largely unhedged, because companies counted on the Rupiah's continuing depreciation at a slow and predictable rate against the U.S. dollar. The loans were also largely short-term, but it was common practice for lenders to roll over the principal on a yearly basis.

When the exchange rate crisis hit in mid-1997, companies suddenly faced loan payments that were very large in Rupiah terms. In addition, lenders balked at providing new loans and became increasingly reluctant to roll over short-term loans. The supply of foreign capital that Indonesia had come to rely on abruptly dried up. The flow of capital reversed course as foreigners and Indonesians alike began taking their wealth out of the country. As of mid-1998, a priority issue for the Indonesian government and business sector was to restore confidence so that capital inflow would resume. A longer-term issue was development of a more vibrant and self-reliant domestic capital market.

Foreign firms generally enjoy ready access to the Indonesian securities market. Financial reforms introduced in 1987 allowed foreign firms to form joint ventures with Indonesian partners in the securities market as underwriters, broker-dealers, and investment managers. Merrill Lynch operates a joint-venture brokerage firm in Jakarta. Morgan Stanley and Bankers Trust are also active. The 49 percent restriction on foreign purchases of all listed firms, with the exception of banks, was lifted in 1997. Discriminatory capital requirements on foreign securities firms were expected to be removed in 1998.

DESCRIPTION OF THE MARKET

Structure of the Market

The securities industry is still under development in Indonesia, and is dominated by the equity market. Indonesia has two stock exchanges: the JSX and the much smaller Surabaya Stock Exchange. The Indonesian government created the JSX in 1977, and for the next 15 years an agency called BAPEPAM operated the exchange and regulated securities trading. In 1987, the government of Indonesia took steps to deregulate the capital market and began encouraging companies to go public. In 1992, the JSX was privatized; BAPEPAM became solely a regulatory body like the U.S. Securities and Exchange Commission. By mid-1998, there were 287 companies listed on the Jakarta and Surabaya stock exchanges, compared with only 25 companies in 1988.

Rapid growth of the Indonesian economy translated into rapid growth of the stock market, but the market took a severe beating in 1997-98. Market capitalization expanded rapidly from US\$33 billion at the beginning of 1994 to US\$100 billion in mid-1997. But the collapse of the rupiah and the severe economic contraction that followed effectively erased the previous years' growth, reducing market capitalization to only US\$17 billion by May 1998. Market value remained concentrated among the largest companies. In May 1998, the 20 largest firms accounted for over 70 percent of equity market capitalization.

The Indonesian market for bonds and other debt instruments remained small. About US\$1.8 billion worth of bonds were outstanding as of April 1998. Only about US\$100 million worth of bonds were traded on the JSX in May 1998. The domestic debt market lacked a benchmark government bond, since the Indonesian government is not allowed to borrow domestically. Instead, the principal debt instruments were issued by Bank Indonesia: SBI (Sertifikat Bank Indonesia), a bill that the central bank uses to conduct open-market operations; and SBPU (Surat Berharga Pasar Uang), a corporate promissory note endorsed by commercial banks. In April 1998, there were Rp 20.6 trillion (US\$2.8 billion) in SBIs and Rp 3.3 trillion (US\$440 million) in SBPUs outstanding. In 1998, the government of Indonesia was seriously considering changing its laws in order to permit the issuance of government bonds.

Lacking an active domestic bond market, many Indonesian companies issued bonds and commercial paper abroad in the 1990s. Indonesian firms raised US\$10.7 billion on international capital markets in 1996.

In a significant step, the government of Indonesia in September 1997 removed the 49 percent limit on foreign ownership of companies' shares listed on the Jakarta and Surabaya Stock Exchanges, with the exception of banks. (The limit on foreign ownership of bank stocks was expected to be removed in 1998.) Foreigners have been important participants in the growth of the market, and they owned 25 percent of Indonesian stocks, by value, as of April 1998. There were no restrictions on foreign

ownership of debt instruments or on foreign joint-venture securities firms underwriting fixed-income debt issues.

In 1997-98, the U.S. Agency for International Development provided assistance to the government of Indonesia to establish a futures trading system for key agricultural commodities. The system, still in its early stages as of mid-1998, is governed by a body called BAPEPTI (Commodity Trading Oversight Board) under the authority of the Ministry of Industry and Trade.

Regulatory Structure

The Capital Market Law of 1995 governs the Indonesian securities sector. The Ministry of Finance, which has authority over BAPEPAM, determines capital market policy. BAPEPAM licenses and regulates companies that act as broker-dealers, underwriters, and investment managers. It also regulates prospectuses and other disclosure documents. Finally, BAPEPAM oversees the Clearing Guarantee Corporation and the Central Securities Depository.

Since 1996, BAPEPAM has had on-line facilities to monitor price movements on the JSX, allowing it to check for signs of unusual trading activity or market manipulation. Even so, episodes of alleged insider trading have continued.

U.S. PRESENCE IN THE MARKET

Merrill Lynch established a joint venture brokerage operation in 1995; by May 1998 it was the eighth most active brokerage firm on the JSX, in terms of trading. Bankers Trust has a joint venture brokerage as well. Morgan Stanley has equity participations with one of the largest domestic brokerages, PT Makindo.

Other major U.S. brokerage houses participate in the Jakarta stock market through their regional offices based in Hong Kong and Singapore.

The largest custodians in the market are foreign banks. Citibank continues to play a significant role in this market.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

U.S. and other foreign firms generally enjoy good access to the Indonesian securities market, both as purchasers and brokers. Indonesia took a significant step in opening up its capital markets in 1987, when it authorized foreign firms to act as broker-dealers, investment managers, and underwriters in partnership with Indonesian firms. The joint-venture requirement has not changed,

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but Indonesia is expected to lift discriminatory capital requirements on foreign firms in 1998. There are relatively tight limits on the number of foreign personnel who can be employed by securities firms; these restrictions apply to firms in other industries as well.

Current levels of openness to foreign participation in the stock market are not fully bound under GATS. For example, in September 1997, the government of Indonesia lifted limits on foreign purchases of shares on the JSX, allowing 100 percent foreign ownership of all firms except for banks; the banking law was being revised in late 1998 to remove this remaining exception.

Jakarta Stock Market Statistics			
	May 1997	May 1998	Percent Change
Market Size			
Market Capitalization (Rp trillions)	246	175	-29%
Market Capitalization (US\$ billions)	101	17	-83%
Listed Companies	261	287	10%
Bond Market Capitalization (Rp trillions)	0.7	0.6	-14%
Bond Market Capitalization (US\$ billions)	0.3	0.1	-80%
Daily Average Activity			
Trading Value (Rp billions)	268	494	84%
Trading Volume (million shares)	251	254	1%
Foreign Ownership			
Net Purchases during month (Rp billions)	57	-35	

Source: Jakarta Stock Exchange homepage: www.jsx.co.id, as of mid-July 1998.

Exchange Rates Used:

May 1997	2,440 Rupiah/US\$
April 1998	7,500 Rupiah/US\$
May 1998	10,525 Rupiah/US\$