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Indonesia Market Commentary

December 2017

Macroeconomics

Monthly inflation recorded at 0.71% in December 2017 to bring the full year 2017 number to 3.61% year-on-year (yoy), up from November's 3.3% yoy. Food price increase was the primary contributor to December inflation, while holiday season also brought up transportation cost. Bank Indonesia (BI) maintained 7-days reverse repo rate (7DRRR) at 4.25%, as they see that previous monetary easing have been sufficient to support economic recovery momentum. In addition, they also see risks on exchange rate on the back of policy normalization of advanced countries and geopolitical risk. Hence instead of tweaking monetary policy, it will introduce a macro-prudential measure that will improve banking intermediation.

November trade balance saw a surplus of USD 127mn, bringing 11M-17 surplus to USD 12bn, up from USD 8.4bn recorded in the same period last year. November surplus figure came lower than market expectation as imports grew higher than expected at 19.6% yoy with consumer and capital goods as the biggest contributors, indicating domestic demand remain intact. On the other hand, Exports growth of 13.2% yoy came relatively in line with expectations, as export price softened on the back of easing commodity prices.

Equity

Market Update

December has been another record month for Indonesian equities, as it closed at a record high of 6,356, up 6.8% during the month to bring the full year 2017 gain to 20%. Despite foreign outflow of IDR 4.3tn during the month, the index still managed to break all-time high. All in all, foreign investors posted a total outflow of IDR 40tn in 2017. December's average daily transaction was recorded at IDR 6.1tn, up from IDR 5.4tn recorded a month earlier as activities started to increase near the year-end.

On sector performance, Consumer was the biggest gainer at 11.8%. Basic Industry and Chemicals rebounded from last month and came in second place at 9.4%. Financial sector followed closely at 8.8%. On the other hand, Agriculture continued to be one of the weakest sectors at -3.9%. The Mining and Construction Property & Real Estate sectors were second and third worst performers at 0.6% and 1.2%, respectively, as next year's outlook continues to be relatively lackluster with respects to commodity prices, government budget, and political uncertainty prior to election period.

Strategy

Global market registered mixed performance in December 2017, the US and Eurozone performed better versus Asia region. In December, US equities closed the year pushing to yet another all-time high as market tracks Trump's highly anticipated tax bill and November jobs report was stronger than expected at an unemployment rate of 4.1%. This was also one of the reasons why Federal Reserve decided to raise rates by 0.25% and indicating three more rate hikes next year. The Fed also raised 2018 GDP growth projections from 2.1% to 2.5%. However, progress of Republican's business-friendly tax overhaul, which would include a reduction in corporate tax rate from 35% to 21%, continued to be the main driver for US equities as market closely tracks political progress of the bill. Asian equities struggled as tech stocks, including index heavy weight Tencent, and commodity stocks cooled some of the world's best performing indices. Meanwhile, Japanese stocks were also hit as Yen strengthened against the US dollar. The currency was not much affected by Bank of Japan's (BOJ) decision to maintain its 10-year bond yields at around zero while its short-term deposit rate remains at minus 0.1%. The BOJ also plans to continue the aggressive monetary easing at an annual rate of 80 trillion yen, while giving no indication for potential policy change or interest rate hike, keeping index relatively subdued. Meanwhile, government data also revealed household spending rose

1.7% in November, which helped support the index. Euro equities also reacted positively on the resolution of Irish border issue which allows negotiations to advance to its second phase. UK November inflation also hit its highest level since March 2012 at 3.1%, 1% higher than the Bank Of England's target, which supported the decision to keep interest rates unchanged at 0.5% after November's hike.

Looking ahead, we are seeing a better momentum in Global GDP growth which provides a supportive background to Indonesian equity this year. We are not seeing macro risk this year as inflation remains to be under control. With a high base in first-half 2017 because of rise in electricity price, economists are expecting first-half 2018 to post a sub 3% yearly inflation, which will bring full year inflation expectation to 3.8%, while fiscal budget remains to be manageable. The street view of stable USD should also bode well for our currency and enable BI to continue its accommodative monetary policy.

BI expects 2017 GDP growth to accelerate to 5.10% yoy, up from 5.02% yoy recorded in 2016 on the back of improvement in investment, while consumption remains subdued. For 2018, BI forecasts the following: (i) 5.1-5.5% GDP growth, (ii) 9-11% third-party fund growth and (iii) 10-12% loan growth. We one of the main drawbacks in Indonesian equity in 2018 is the weak economic growth recovery and political uncertainty ahead of election. The hope for consumption recovery comes from the low-end spending, after being hammered by adjustment in electricity price in the 1Q-17, and higher social subsidy spending, while Jokowi's cash-for-work program should provide support on low-end consumption. However, the overall growth recovery will remain muted as the consumption recovery might be slightly offset by low capex spending and weak investment due to political uncertainty ahead of election. We expect overall credit growth remains lukewarm at 8% mostly from consumer loan. We forecast investment credit growth remains modest due to low business confidence and moving towards automation.

In 2017, the JCI index performed very strongly while earnings growth is relatively lower. Last year's earnings growth mainly attributed from banking and commodity sectors. However, we expect 2018 earnings growth to be lower due to high base on banking and commodity sectors, while we expect consumers to register better earnings after a very weak year, anticipating a better purchasing power coming from higher social subsidies while margin should improve on lower raw material price. In terms of flow, last year market already saw IDR 40tn of net outflow, despite the record-breaking index level supported by local buying. There are three big events which will impact the market performance this year, 1) regional elections, 2) completion of infrastructure project with the connectivity of Trans-Java toll road (from Jakarta to Kertosono) and 3) automation and digital disruption which could be a double edge sword, benefitting manufacturing for cost efficiency and also bad for employment.

Fixed Income

Market Update

Fitch Ratings surprised the market with an upgrade on Indonesia's sovereign credit rating to BBB (stable) from BBB- previously. Main reasons for the upgrade are: 1) Indonesia's macro policies have consistently move towards maintaining stability; 2) structural reform have improved investment and FDI; 3) GDP growth that is higher than average BBB countries; and 4) relatively low general government debt to GDP ratio of 28.5% in 2017 (the BBB-rated countries averaged 41%). However, the rating agency mentioned that external challenges remained, including potential emerging market pressure in the context of the US Fed policy normalization. Negative rating triggers include sustained external shock to investor confidence and a weakening in macroeconomic prospects. This upgrade was being cheered by the fixed income investor as the 10-year bond yield went down by around 20bps in December.

US Treasury 10-year yield increased to 2.5% in mid-December before returning to 2.4% level by month-end. The long-awaited tax reform bill was finally passed after going through both US house and senate votes. The Fed also hiked rates by 25 bps to 1.25-1.5% as expected.

As announced in the previous month, the Indonesian government cancelled bond auction in December. Foreign holdings still increased by IDR 5.3 trillion, bringing their ownership at 39.8% of total outstanding amount by the end of the month. This also helped foreign exchange reserve to increase to USD 130.2bn, from USD 126bn in the previous month.

Strategy and Outlook

Corporate bond issuance from non-financial sector may continue amid low yield environment. Demand remains concentrated in tenors below 5 years.

We expect global geopolitical risk and rate direction to play important role in affecting local bond market

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