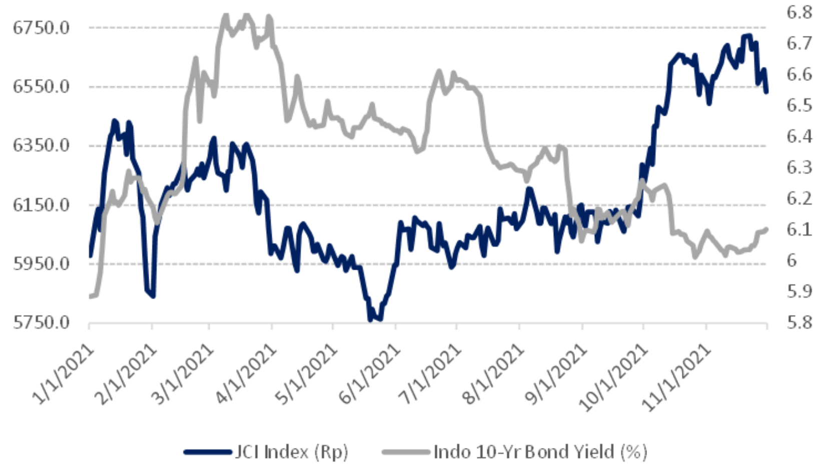
Schroders

MACRO & MARKET OUTLOOK 2022

The year 2021 was a recovery year as the world is transitioning to new normal amidst the ongoing pandemic. For 2022, we believe that it will be the year for equities as economic recovery continues globally while monetary policy reversal may slow down fixed income's performance.

The year 2021 was a recovery year as the world is transitioning to new normal amidst the ongoing pandemic. Throughout the year, we have seen some ups and downs in both the Indonesian equity and bond markets following series of volatilities in covid cases, inflation, flows to and from the capital market. YTD November, the equity market has posted a strong return of 9.3% while the bond market has posted a softer return of 5.4%. However, as vaccination rates picking up and governments have started to adjust to life with covid, we are seeing our transition from a pandemic to an endemic as we enter 2022. This transition signals a positive development for the market in hopes for countries to be able to recover normally so that we can see a more proper structural economic growth.

Figure 1. JCI and 10 year government bond yield performances YTD November



Source: Bloomberg

Figure 2. Global COVID-19 vaccination rate comparison

	Doses administered	Total population vaccinated		7DMA daily
		1st dose	2nd dose	vaccination rate ('000)
Singapore	10.1	89%	88%	0.5
China	2,499.8	88%	77%	8,146.7
South Korea	85.1	82%	79%	249.9
Malaysia	53.5	79%	77%	183.6
Japan	197.1	79%	77%	132.6
UK	115.5	76%	69%	417.1
Brazil	307.8	78%	71%	822.4
Australia	39.2	78%	74%	86.4
US	460.8	70%	59%	1,157.4
India	1,241.4	58%	32%	8,080.3
Thailand	92.4	69%	59%	465.5
Indonesia	234.9	51%	35%	1,231.6
Philippines	81.3	42%	33%	682.0
South Africa	25.6	29%	25%	106.5
Bangladesh	96.4	36%	22%	869.0
Egypt	39.9	26%	15%	429.7

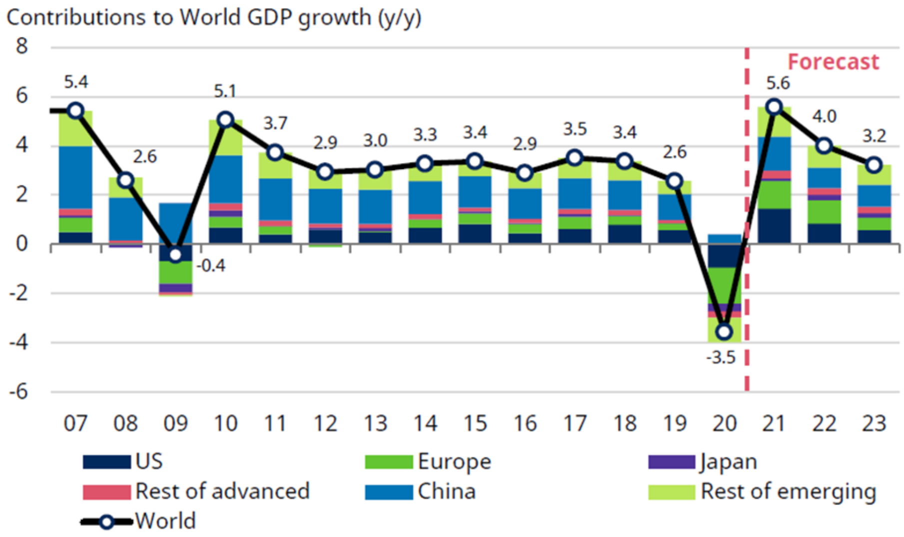
Source: CLSA, Ministry of Health, Bloomberg

For 2022, we believe that it will be the year for equities as economic recovery continues globally while monetary policy reversal may slow down fixed income's performance. The monetary policy reversal would also mean asset rotation from the mid-to-small cap equity names to more blue chip names which are more proxies to economic recovery and return of foreign fund flow. For fixed income, we continue to prefer the mid-to-short tenor series given the expected domestic driven bond market. Though covid would remain as risk, we think that the availability of vaccine and covid treatment pills would lower the risk of market volatility in 2022. One major risk worth monitoring would be inflation as supply chain disruption and pent-up demand may push up overall inflation.

An overall picture of 2022 macro economy

Our global economist is expecting global GDP growth to ease from 5.6% YoY in 2021 to 4.0% YoY in 2022. The slowdown is mainly attributed to cuts in stimulus while inflation starts to pick up worldwide. The US experience phenomenal rebound in GDP growth in 2021 so far as pent-up demand built up while government stimulus also supported consumer spending during the year. However, as the US government start to cut down stimulus, we expect consumption to start easing while inflation remains high with tightening monetary policy. Meanwhile, tightening policies and government interventions in the private sector has been pressuring the Chinese economy. Hence, we have already started seeing slower Chinese economic growth which we expect will last through the middle of 2022. On the other hand, pent up demand and economic reopening continues to be supportive for Europe. Though inflation on energy is expected to pick up and may add pressure to growth in the Eurozone. The Bank of England has already announced plans for tightening, but the ECB is expected to remain dovish for next year.

Figure 3. 2022 global GDP growth to ease down due to stimulus cuts and higher inflation



Source: Schroders

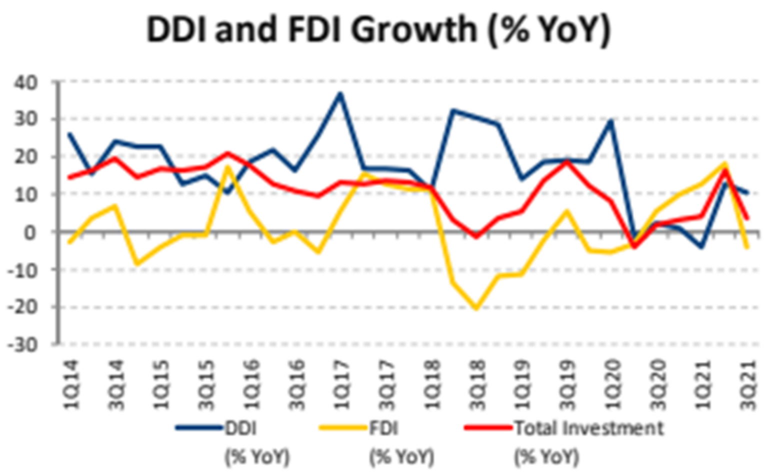
Figure 4. Government is aiming for Indonesia GDP growth of 5.2% YoY in 2022

State Budget Assumption	2017 Realization	2018 Realization	2019 Realization	2020 Realization	2021 Govt Outlook	2022 Draft Budget	2022 Approved Budget
Economic growth (%)	5.1	5.2	5.0	-2.1	3.7 -4.5	5.0 - 5.5	5.2
Inflation (% yoy)	3.6	3.1	2.7	1.7	1.8 - 2.5	3.0	3.0
Exchange Rate (Rp/USD)	13,384	14,247	14,141	14,577	14,200 - 14,600	14,350	14,350
SPN 3 months (%)	5.0	5.0	5.6	3.2			
10-year government bonds yield (%)					6.34 - 7.24	6.82	6.80
Oil price (USD/barrel)	51.2	67.5	62.4	40	55 – 65	63	63
Oil lifting (thousands barrels/day)	804	778	746	707	680 – 705	703	703
Gas lifting (thousands barrel/day)	1,142	1,145	1,060	983	987 – 1007	1,036	1,036

Source: Ministry of Finance, Mandiri Sekuritas

The Indonesian government is currently estimating 2022 GDP growth of 5.2% YoY in accordance to the 2022 state budget up from its 2021 target of 3.7-4.5% YoY. We expect recovery to mostly come from consumption and investments as the covid cases in Indonesia has continued to improve while mobility restrictions are eased. Though developments in covid conditions in Indonesia would remain to be a moving factor as worsening conditions may give downside risks to our economic growth. We expect the mid-to-high end consumer segment to drive the consumption recovery first as the middle-low would still prioritize savings. In 1H21, we have seen strong recovery in FDI as it grew by over 15% YoY driven not only by China but also western countries as borders reopened.

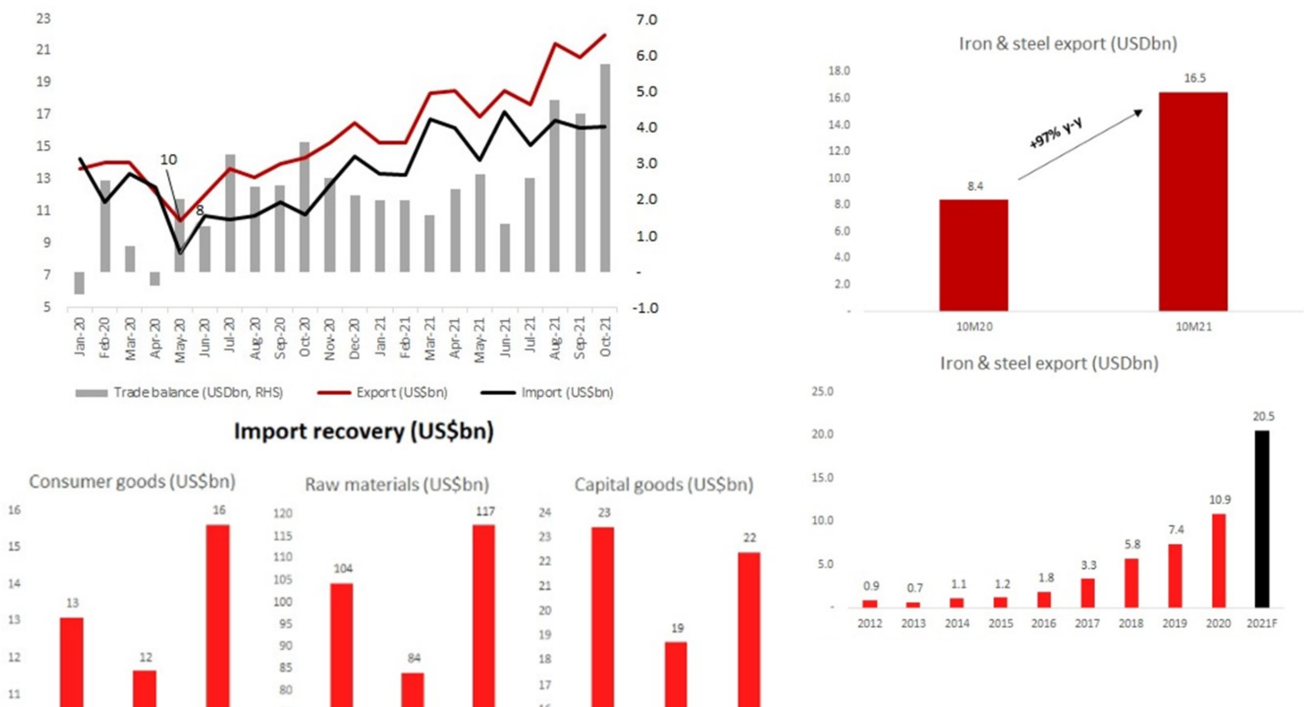
Figure 5. FDI growth started to pick up despite the pandemic



Source: BKPM, Mandiri Sekuritas

We expect investments in base metal industry will continue to grow in response to growing global demand of EV and batteries. We also have yet to see impacts from Omnibus Law and the sovereign wealth fund, INA, which would pose upside to investments. As the 2022 state budget also indicated high infrastructure budget, we think that capital expenditures would also help support investments. Meanwhile, the government is aiming for flattish growth in spending for 2022 at about 0.6% YoY for overall government spending or 0.9% YoY for central government spending. The slower spending is due to lower healthcare and social spending as the covid conditions in Indonesia has improved.

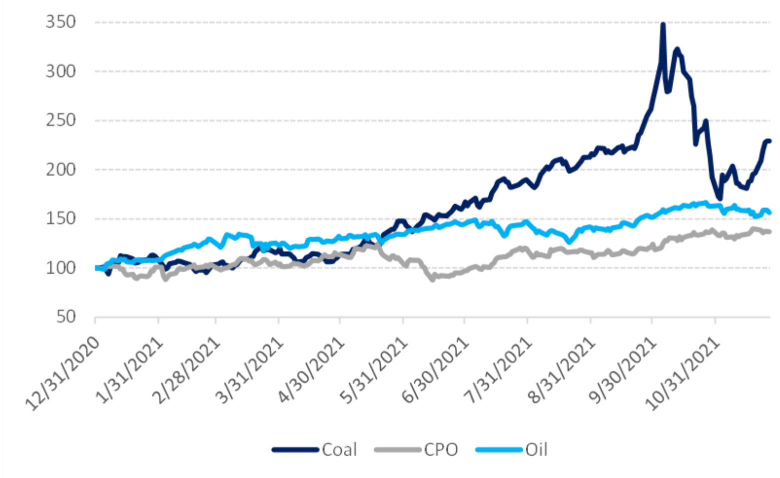
Figure 6. Indonesia has been posting strong monthly trade surpluses in 2021



Source: Verdhana, BPS

We expect net exports to remain supported in 1H22 as commodity price should still be elevated throughout the winter season in the northern hemisphere though we expect exports to ease in 2H22 while imports should pick up along with recovery in consumptions. Hence, the strong commodity price would also help support the trade balance and Rupiah. We have seen strong trade balance and hence narrower CAD in 2021 YTD due to strong commodity exports and sluggish imports. We expect to see this trend to continue until mid 2022. As we expect imports to start picking up in 2H22, we estimate CAD to widen as well and may give some pressure in 2H22. All-in-all we expect the CAD to slightly widen in 2022 though still at lower level compared to pre-covid level of 2.5-3.0% of GDP. Therefore, the Rupiah would remain manageable and float close to current level. We think risk of Rupiah depreciation due to portfolio flows is limited at this juncture given the low foreign ownership in IndoGB at about 21% compared to pre-covid levels of 39%.

Figure 7. YTD absolute performances of commodity prices



Source: Bloomberg

Figure 8. Both CAD and BoP have been strong in 2021 supported by strong exports and financial flow

US$ mn	3Q19	4Q19	2019	1Q20	2Q20	3Q20	4Q20	2020	1Q21	2Q21	3Q21
Current account	**(7,504)**	**(8,077)**	**(30,359)**	**(3,442)**	**(2,895)**	**1,003**	**847**	**(4,487)**	**(1,075)**	**(1,965)**	**4,474**
Goods	**1,362**	**306**	**3,508**	**4,507**	**3,952**	**9,791**	**9,969**	**28,218**	**7,628**	**8,337**	**15,027**
General merchandises	685	(33)	1,647	3,192	2,468	8,726	10,099	24,485	7,707	8,437	15,231
Non-oil & gas	2,744	3,203	11,965	5,809	3,289	9,441	11,332	29,871	9,976	11,581	18,120
Oil & gas	(2,060)	(3,237)	(10,319)	(2,617)	(821)	(715)	(1,233)	(5,386)	(2,269)	(3,144)	(2,889)
Other merchandises	678	339	1,861	1,314	1,485	1,065	(130)	3,734	(79)	(100)	(204)
Services	**(2,269)**	**(2,032)**	**(7,721)**	**(1,728)**	**(2,129)**	**(2,761)**	**(3,108)**	**(9,726)**	**(3,389)**	**(3,713)**	**(3,634)**
Primary income	**(8,423)**	**(8,324)**	**(33,775)**	**(7,912)**	**(6,158)**	**(7,399)**	**(7,442)**	**(28,911)**	**(6,745)**	**(8,054)**	**(8,337)**
Secondary income	**1,826**	**1,974**	**7,629**	**1,692**	**1,440**	**1,371**	**1,428**	**5,932**	**1,432**	**1,465**	**1,417**
Capital account	**13**	**20**	**39**	**1**	**6**	**7**	**24**	**37**	**2**	**5**	**9**
Financial account	**7,449**	**12,479**	**36,614**	**(3,046)**	**11,044**	**888**	**(995)**	**7,858**	**5,699**	**1,638**	**6,087**
Direct investment	**5,220**	**3,109**	**20,053**	**4,269**	**4,433**	**979**	**4,301**	**14,093**	**4,381**	**5,313**	**3,281**
Asset	(615)	(1,415)	(4,462)	(702)	(725)	(2,751)	(854)	(5,029)	(945)	(734)	(1,181)
Liabilities	5,835	4,524	24,516	4,971	5,158	3,730	5,156	19,122	5,326	6,047	4,462
Portfolio investment	**4,600**	**7,278**	**21,990**	**(6,343)**	**9,744**	**(1,984)**	**1,952**	**3,369**	**4,904**	**3,990**	**1,144**
Asset	(44)	332	410	(88)	(181)	(277)	(653)	(1,199)	(323)	(670)	(344)
Liabilities	4,644	6,946	21,581	(6,255)	9,924	(1,707)	2,605	4,567	5,227	4,659	1,488
Financial derivative	**86**	**9**	186	**(326)**	**125**	**18**	**201**	18	**110**	**24**	**172**
Other investment	**(2,456)**	**2,082**	**(5,616)**	**(646)**	**(3,257)**	**1,876**	**(7,450)**	**(9,621)**	**(3,696)**	**(7,688)**	**1,490**
Asset	(3,295)	271	(11,803)	(4,182)	(1,060)	438	(7,105)	(12,038)	(2,981)	(2,664)	(5,629)
Liabilities	838	1,812	6,188	3,537	(2,197)	1,438	(345)	2,417	(715)	(5,024)	7,119
Total	**(41)**	**4,423**	**6,294**	**(6,487)**	**8,155**	**1,898**	**(124)**	**3,408**	**4,626**	**(322)**	**10,571**
Net error & ommission	(4)	(144)	(1,618)	(2,058)	1,090	155	(32)	(811)	(562)	(128)	119
Overall balance	**(46)**	**4,279**	**4,676**	**(8,545)**	**9,245**	**2,053**	**(156)**	**2,597**	**4,065**	**(450)**	**10,690**
FX reserve position	**124,332**	**129,183**	**129,183**	**120,969**	**131,718**	**135,153**	**135,897**	**135,897**	**137,095**	**137,093**	**146,870**
In months of imports and government external debt payment	6.9	7.3	7.3	7.0	8.1	9.1	9.8	9.8	9.7	8.8	8.6
Current account (% of GDP)	**(2.61)**	**(2.83)**	**(2.71)**	**(1.25)**	**(1.18)**	**0.38**	**0.31**	**(0.42)**	**(0.38)**	**(0.68)**	**1.49**

Source: CEIC, Mandiri Sekuritas

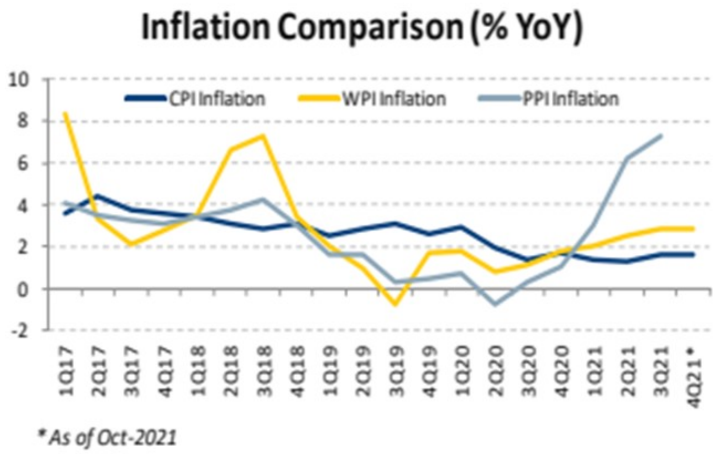
Strong commodity price should also bode well for our fiscal balance as it would boost the government revenue. At this juncture, we expect the fiscal deficit to fall below the government's target of 5.7% of GDP in 2021 as revenue has been growing strong while expenditures fell YoY. As of October, the fiscal deficit was recorded at 3.3% of GDP. At the same time, the government also has issued IDR1,081tn worth of government bonds YTD, or about 80% of FY21 target, and has cancelled issuance for the rest of the year. Hence, there are excess financing available to be used for next year. The 2022 state budget targets revenue growth of 6.4% YoY and expenditure growth of 0.6% YoY. As we expect 2021 fiscal deficit to fall below 5.7% while the government is aiming for further cut in spending while boosting revenue, we think that the government should be on track to achieve the 2022 fiscal deficit target of 4.85% of GDP.

Figure 9. 2022 State budget

Rp tn	2019 Realization	2020 Realization	2021 Gov't Outlook	2022 Draft Budget	2022 Approved Budget	2019 Realization	2020 Realization	2021 Gov't Outlook	2022 Draft Budget	2022 Approved Budget
A. Revenue and Grant	**1,960.63**	**1,647.8**	**1,735.7**	**1,840.7**	**1,846.1**	**0.9%**	**-16.0%**	**5.3%**	**6.0%**	**6.4%**
I. Domestic Revenue	**1,955.1**	**1,628.9**	**1,733.0**	**1,840.1**	**1,845.6**	**1.4%**	**-16.7%**	**6.4%**	**6.2%**	**6.5%**
1. Tax revenue	1,546.1	1,285.1	1,375.8	1,506.9	1,510.0	1.8%	-16.9%	7.1%	9.5%	9.8%
a. Domestic tax	1,505.1	1,248.4	1,324.7	1,466.8	1,468.9	2.2%	-17.1%	6.1%	10.7%	10.9%
b. International Trade Duty	41.1	36.7	51.2	40.1	41.1	-10.5%	-10.6%	39.4%	-21.7%	-19.7%
2. Non-tax revenue	409.0	343.8	357.2	333.2	335.6	-0.1%	-15.9%	3.9%	-6.7%	-6.1%
II. Grant	**5.50**	**18.8**	**2.7**	**0.6**	**0.6**	**-64.7%**	**242.6%**	**-85.7%**	**-78.5%**	**-78.5%**
B. Government Expenditure	**2,309.3**	**2,595.5**	**2,697.2**	**2,708.7**	**2,714.2**	**4.3%**	**12.4%**	**3.9%**	**0.4%**	**0.6%**
I. Central Government Expenditure	**1,496.3**	**1,833.0**	**1,927.0**	**1,938.3**	**1,944.5**	**2.8%**	**22.5%**	**5.1%**	**0.6%**	**0.9%**
1. Personnel+ Material + Capital+ Social	1,000.8	1,196.3	1,212.5	1,107.7	1,095.8	3.9%	19.5%	1.4%	-8.6%	-9.6%
4. Interest payment	275.5	314.1	366.2	405.9	405.9	6.8%	14.0%	16.6%	10.8%	10.8%
5. Subsidy	201.8	196.2	248.6	207.0	207.0	-7.0%	-2.8%	26.7%	-16.7%	-16.7%
a. Energy subsidy	*136.9*	*97.4*	*128.5*	*134.0*	*134.0*	*-10.8%*	*-28.8%*	*31.9%*	*4.3%*	*4.3%*
b. Non-energy subsidy	*64.9*	*98.8*	*120.1*	*72.9*	*72.9*	*2.5%*	*52.2%*	*21.5%*	*-39.3%*	*-39.3%*
6. Grants Expenditure	6.5	6.3	6.5	4.8	4.8	325.9%	-3.1%	3.2%	-25.5%	-25.5%
8. Other expenditures	11.7	120.0	93.2	212.9	231.1	-27.6%	926.0%	-22.4%	128.4%	148.0%
II. Transfer to Region and Village Fund	**813.0**	**762.5**	**770.3**	**770.4**	**769.6**	**7.3%**	**-6.2%**	**1.0%**	**0.0%**	**-0.1%**
1. Transfer to region	743.16	691.4	698.4	702.4	701.6	6.5%	-7.0%	1.0%	0.6%	0.5%
2. Village fund	69.81	71.1	71.9	68.0	68.0	16.6%	1.8%	1.1%	-5.4%	-5.4%
C. PRIMARY BALANCE	**(73.1)**	**(633.6)**	**(595.3)**	**(462.2)**	**(462.2)**					
D. FISCAL SURPLUS/DEFICIT (A-B)	**(348.7)**	**(947.7)**	**(961.5)**	**(868.0)**	**(868.0)**					
As a percentage of GDP	**-2.20%**	**-6.14%**	**-5.82%**	**-4.85%**	**-4.85%**					

Source: Ministry of Finance, Mandiri Sekuritas

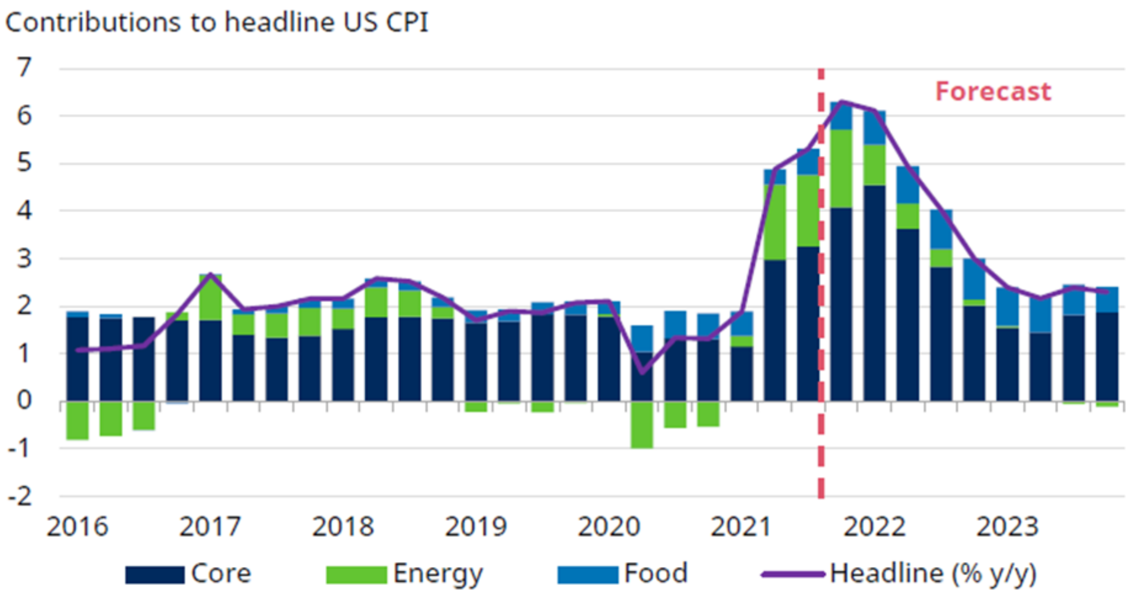
Figure 10. Inflation has picked up on the producer side but still yet to translate to the consumer side



Source: Mandiri Sekuritas, BPS

In terms of monetary policies, we expect Bank Indonesia to start tightening gradually in 2022 when inflation start to pick up. At the moment, we have started to see inflation from the producer side as indicated by the PPI of 7% YoY in 3Q21, however, CPI growth remains benign below 2% YoY. High commodity price played a role in the inflation while boosted by consumption recovery. However, in contrast to the demand explosion in the US which pushed CPI, we have yet to see a spike in demand in Indonesia. The large stimulus from the US government has been a major driver of consumption in the US. Thus, we think that inflation growth in Indonesia would be more manageable at 3-4% YoY in 2022 compared to in the US. Governor Perry Warjiyo previously mentioned that Bank Indonesia will start tightening through asset purchase cut followed by adjustments in reserve requirement rate. We only expect Bank Indonesia to start raising policy rate starting as early as end of 2022 of about 25-50bps.

Figure 11. US inflation spike is transitory though would remain elevated through 2022



Source: Schroders

We have seen the US inflation spiked to 6.4% in 2Q21 driven by high commodity price, supply chain disruption, and pent up demand. The Fed also recently announced that it will begin tapering starting at a cut of USD15bn in its asset purchases though there has yet a firm decision on when the US central bank will start to conduct policy rate hike. In addition, Fed Chairman Jerome Powell's term was renewed by President Biden with Lael Brainard as his vice chairwoman. Ms. Brainard of the Democratic party is said to be more dovish in policies and is more in-line with President Biden in terms of agenda. We will see the rest of the elected members of the Fed board in the coming months. As Chairman Powell continues his position, we think that there would be less surprises in the market coming from Fed policies.

What are the common themes facing the market in the coming year?

1. COVID PANDEMIC

We are in the view that the current pandemic is transitioning into an endemic. The rise and fall of covid cases globally have been a major moving factor for the market in the past 1.5 years as investors get concerned on the potential impact a lockdown would bring to the economy. However, we are seeing countries rushing to boost their vaccination rates in the past year with developed countries in the lead. In addition, some regions have also been building up herd immunities particularly in regions with low vaccination rates. Hence, we think the spread of the virus would not be as fast as it was previously while future hospitalization and mortality rates would be more under control. In addition, we have seen countries such as Singapore or the US who are more reluctant in re-implementing full scale lockdown whenever there is an uptick in cases.

Figure 12. Indonesia covid condition has significantly improved

Source: Ministry of Health, Verdhana

We believe that governments now are trying to adjust more towards life with covid and limit mobility restrictions to keep the economy from falling. Thus, would limit downside risk to the market from covid volatilities. Lastly, two companies, Merck and Pfizer, have now developed COVID-19 treatment pills where distribution starts in end of 2021. Studies have shown that the pills are capable to lower risk of hospitalization by almost 90%. Thus, we think the pill would further be a game changer and bring the world closer to an endemic. A major risk would be if there is a new variant that could easily breakthrough vaccine protections. At the moment, the world is facing a new variant, Omicron, from Southern Africa which is said to spread faster than the Delta. However, current indication shows that the symptoms are milder albeit based on a very small sample. Hence, we would need to wait and see to get better understanding on the variant especially on the transmission rate, vaccine efficacy, and mortality rate. Though we think that higher vaccination rates this time around would make the population more protected against covid in general compared to back during the Delta outbreak. Vaccine producers such as Pfizer and Moderna are producing updated vaccines as we speak which would better protect recipients against the Omicron variant.

Figure 13. Potential scenarios regarding the Omicron outbreak

Name	R_e*	R_0†	Description	Evidence to watch for	Likelihood
0 – Baseline (Delta)	1	6	Situation until recently. Endemic. ~85% of South Africans have immunity.	NA	
A - Delta++	2	10	Key difference is being even more infectious and so virulent.	Very high hospitalisations/deaths. Hospitalisations concentrated among unvaccinated / people who hadn't been infected before	Low
B – Some Immune escape	2	6	As infectious as Delta but with some immune escape, causing ~20% of people with prior immunity to now be susceptible	Rapid rise in hospitalisations and deaths in South Africa and neighbouring countries	Medium
C – High escape / low virulence combination	2	4	40-50% of people with prior immunity now susceptible as the virus has found a set of mutations that aren't quite transmissible as Delta but effective at reinfecting people	Less big rise in hospitalisations/deaths relative to cases, with most cases reinfections. Possibly lots of 'silent spread' from asymptomatic / cold-like infections.	High
D – Very high immune escape	4	6	60% of people with prior immunity now susceptible as the virus very rapidly reinfects lots of people	Spectacular growth in cases and test positivity rates in South Africa (until restrictions / behaviours change)	Medium
E – Total immune escape	4	4	All immunity against infection lost. Likely to be less virulent.	Spectacular growth. Lab studies finding total loss of effectiveness of neutralising antibodies	Low

* - R_e = Effective R in South Africa, as currently prevailing in affected regions

† - R_0 = Fundamental R0 in urban South Africa, i.e. how good it is at spreading if everyone was susceptible and behaving normally

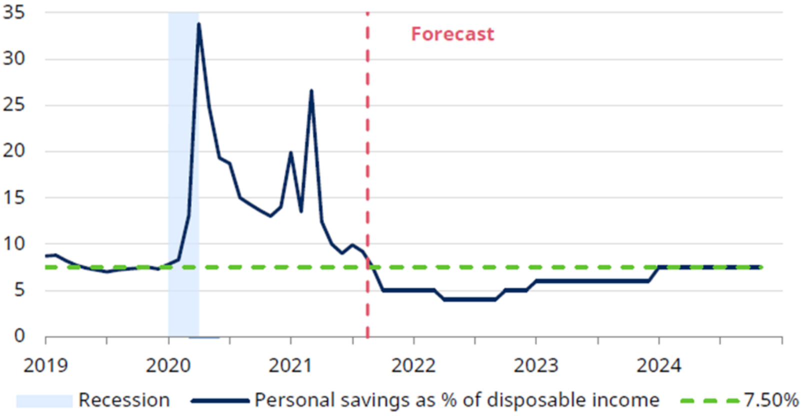
Source: Schroders

2. RISING INFLATION GLOBALLY

We have seen the US facing spike in inflation as a result of supply chain disruption, demand explosion, and high commodity price. Though we believe the current inflation is transitory, we think that the inflation level will remain elevated compared to previous levels. We believe that surging cost from logistics would start to normalize as global shipping indices eases.

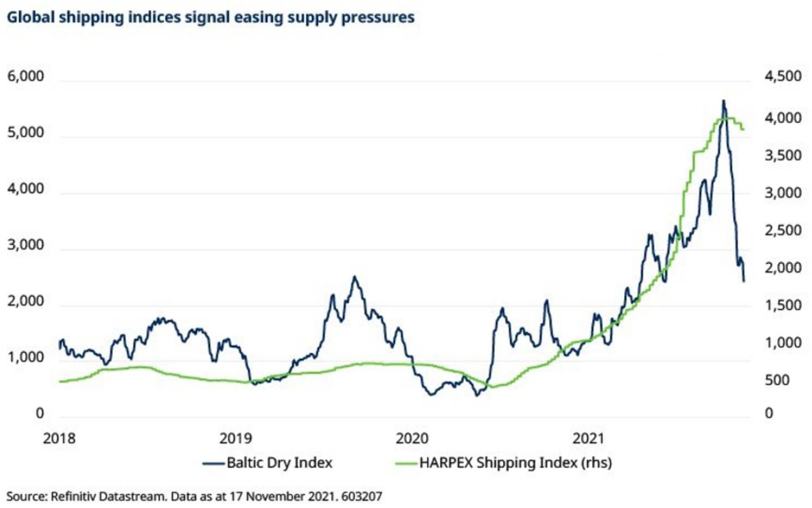
As the US economy recovers and borders reopened, the surge in demand has outpaced the supply level, hence, the high inflation. Would the same case occur in Indonesia? We think not... or maybe not as fast. Though covid cases have come down in Indonesia and mobility restrictions slowly being eased, we have not seen demand pull inflation in Indonesia just yet. Based on the PPI level, there indeed may be risks of cost push inflation which would lead us to believe inflation could reach 3-4% YoY in 2022. However, we think that demand recovery will be much gradual compared to that in the US. Government stimulus on private consumption in Indonesia is not as big as the ones given by the US government while fiscal room in Indonesia is also rather limited at this juncture. Meanwhile, we have seen previously that the mid-to-high income segment lead the recovery when covid cases in Indonesia fell as the mid-to-low income segment are still saving money. Therefore, we would need to monitor the movement of inflation in 2022

Figure 14. US Savings rate fell dramatically as the country reopened



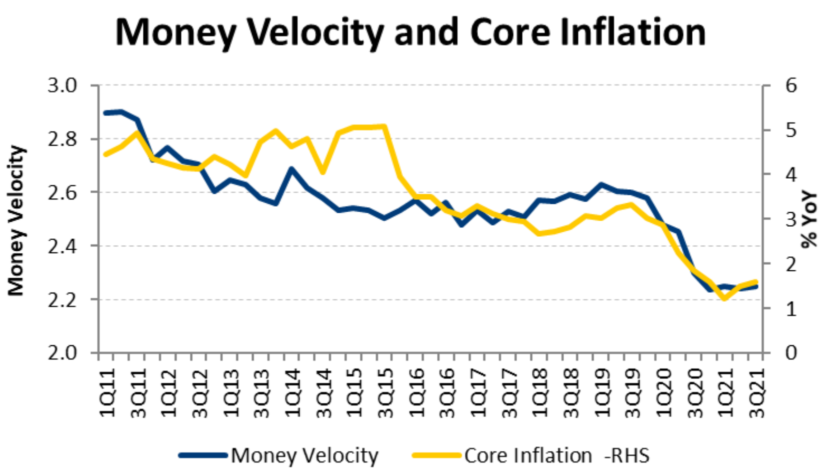
Source: Schroders

Figure 15. Global Shipping indices has eased down



Source: Schroders

Figure 16. Money velocity has yet to pick up which explains Indonesia's soft inflation so far



Source: Mandiri Sekuritas, BPS

3. FISCAL & MONETARIES POLICIES

When the COVID-19 pandemic started governments and central banks both aggressively push for both fiscal and monetary stimulus to support their economies. As we are reaching an endemic, governments and central banks are now discussing on progressively cutting down stimulus. We have seen the Fed announcing that it will start to conduct tapering of its asset purchases. However, Indonesia's external macro position is better off compared to back in 2013 with higher forex reserve, narrower CAD, and lower foreign ownership in IndoGB. Thus, we think impact of Fed tapering to Indonesia would be more manageable this time around.

Figure 17. Indonesia external macro position is more defensive to face Fed tapering now

Macro Indicators	2012	2013	2014		2019	2020	2021F	2022F**
GDP growth (%)	6.03	5.56	5.01		5.02	-2.07	3.69	5.20
Inflation (%)	3.65	8.08	8.36		2.72	1.68	2.00 - 2.30	3.00 – 3.50
Current Account (% of GDP)	-2.66	-3.19	-3.09		-2.72	-0.45	-0.50 to 0.10	-2.00 to -2.50
BoP (% of GDP)	0.02	-0.80	1.71		0.42	0.24		
Rupiah	6.86	11.16	13.80		-0.74	2.84	-2.36	1.41
Rupiah (peak)	9.11	27.28	14.54		4.12	23.30	5.18*	
Loan Growth (%)	23.08	21.60	11.58		6.10	-2.40	2.21*	
Output Gap (%)	0.38	-0.02	-0.49		-0.01	-6.60	0.00	0.60
FX Reserve (USD bn)	105.91	99.40	111.90		129.20	135.90	146.9*	
FX Reserve (months of import)	6.60	5.60	6.70		7.60	10.20	8.9*	

**as of Sep-2021*
***Preliminary forecast*

Source: CEIC, Bank Indonesia, Mandiri Sekuritas

Bank Indonesia is expected to follow suit in 2022 when inflation picks up in Indonesia. Meanwhile, the US market has previously been shaken due to the US government's plan to slowly cut down its covid relief fiscal stimulus. The 2022 Indonesian state budget has indicated that spending would be flattish at 0.6% YoY. The national economic recovery program (PEN) stimulus is also expected to be lower in 2022 from 2021 with cuts under the healthcare and social safety net stimulus. Meanwhile, the government also plans to boost revenue to meet its target of fiscal deficit below 3% by 2023. Hence, we do expect government to be more aggressive in taxation as shown from its recently announced tax reforms.

The reform includes higher VaT, a second tax amnesty program, introduction of carbon tax, and new income tax bracket. Excise hike is another area where the government can chase revenue particularly on cigarette and plastic excises. Hence, the rollout of these tightening monetary and fiscal policies is important so that it does not cause a shock to the market.

Please see the detail of government's tax reform plans in figure.18.

Figure 18. Government's tax reform plans

Key Reforms	Details
Income Tax	1.) The tax reform law introduces a new layer of personal income tax bracket, in which individuals with annual income of >Rp5bn will be taxed at 35%.
	2.) The government will increase the minimum annual income on the lowest bracket of PPh 21 to Rp60mn from Rp50mn.
	3.) The government will maintain the corporate income tax rate at 22% from 2022 onward. Thus, the second phase of the corporate tax cut (from 22% to 20% next year in initial plan) will be canceled.
	4.) MSMEs, which incur a final income tax of 0.5% (PP 23/2018) and generate annual revenue of max. Rp500mn, will not need to pay income tax.
	5.) The government will impose income tax for fringe benefits (compensations in the form of goods and services).
Value Added Tax (VAT)	1.) The VAT rate will be raised gradually, from 10% to 11% in Apr-2022 and to 12% in Jan-2025 at the latest.
	2.) The government cancels the implementation of multi-tariff VAT.
	3.) The government could impose final VAT for specific goods/services/sectors to simplify the tax payment process. It will be regulated further in a finance minister regulation (PMK).
Voluntary Disclosure Program (VDP)	1.) The government will conduct the Voluntary Disclosure Program (VDP) in Jan–Jun 2022, which is similar to tax amnesties in 2016-2017.
	2.) The tariffs will be set at 6–11% for assets acquired in 1985-2015 and 12–18% for assets acquired in 2016-2020 (vs. 2–10% in the 2016 Tax Amnesty).
	3.) The asset repatriation (for offshore assets) should be done at the latest by 30-Sep-2022, and if the assets were invested in certain sectors and government bonds to obtain lower tariff, the minimum investment horizon is five years.
Carbon Tax and Carbon Trade	1.) The government will implement carbon tax and trade with "cap and tax" scheme. In detail, if an entity plans to produce emissions more than the cap set by the government, it should purchase emission permit (SIE) from entities that generate emissions below the cap or buy carbon offset certificate (SPE). If the purchased SIE and/or SPE is not sufficient to offset the excess emission, the entity has to pay a carbon tax (equivalent with the emission value above the cap minus SIE and/or SPE value)
	2.) The carbon tax rate has been determined to be higher than or equal to the carbon emission price in the market, with a minimum tariff of Rp30/kgCO2eq (kilogram of carbon dioxide equivalent).
	3.) The carbon tax and carbon trade will be implemented starting Apr-2022, limited to coal power plants. The policy will be fully applied to other sectors starting 2025.
Other Reforms	1.) Excise: i.) Strengthening the mechanism to determine (add/deduct) goods that incur excise. Specifically, the government will propose a change in the list of excise. ii.) Adjusting the administrative sanction for criminal violation on excise.
	2.) The tax reform bill will allow citizen registration numbers (NIK) to be utilized as taxpayer numbers (NPWP).
	3.) The tax administration sanction will be eased to improve law certainty.
	4.) The tax criminal sanction will also be adjusted by prioritizing the state revenue loss recovery.
	5.) The tax reform bill also regulates the appointment of third party as tax collector, especially for electronic-based products/services.
	6.) The law regulates international cooperation in tax collection.

Source: Ministry of Finance, Mandiri Sekuritas

4. CHINA ECONOMY SLOWDOWN

China led the economic growth so far in 2021 as it entered the pandemic earlier and reopened earlier as well. However, starting in 3Q21, we have seen further tightening in the Chinese government's policies. Market turned volatile when the government started to intervene its private sectors including tech, healthcare, and property. Hence, we saw capital outflow from China to other countries including EM countries such as Indonesia.

The recent Evergrande panic also added oil to investors' concerns on China at that time. We have enjoyed recent inflow from foreign investors to Indonesia due to events happening in China. However, should we be worried regarding our economy due to impact of China's slowdown?

We think that in terms of economic growth, Indonesia should be fine as it is driven by domestic demand. However, slower trades with China may impact our trade balance and CAD and ultimately the Rupiah. Despite so, we think that elevated commodity prices should give protections to our CAD for the time being. Thus, would limit impact from China's economic slowdown for now.

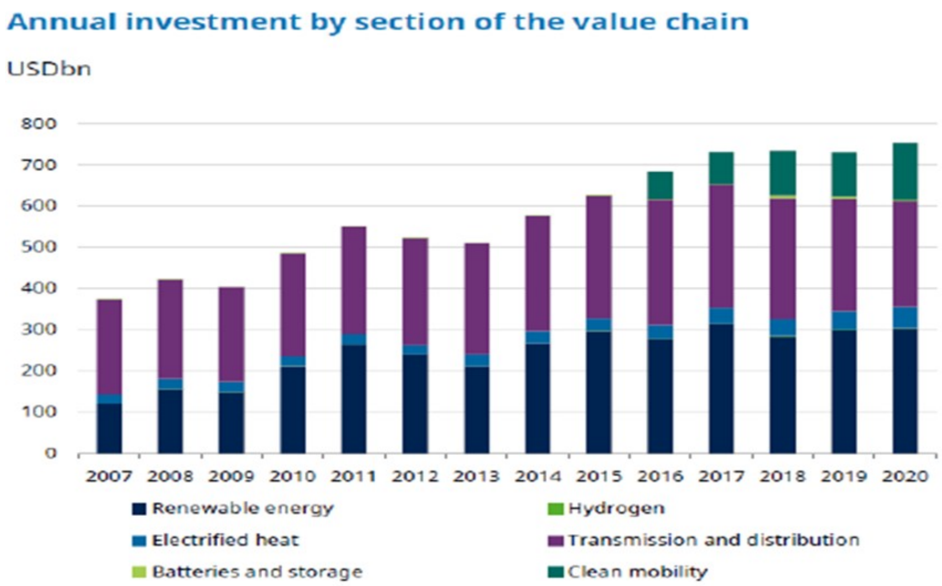
Figure 19. China slowdown will continue on through mid 2022

Source: Schroders

5. GROWING IMPORTANCE OF ESG

Globally, investors are now focusing more on ESG in their investments which would ultimately impact performances of securities. Carbon emitting commodities and tobacco are among industries that are on spotlight due to weak ESG aspects. On the other hand, many countries and corporates are now racing in developments of renewable energy and green technology. Hence, the growing importance of EV, batteries, and metal commodities. We have seen coal miners in Indonesia exploring into green energy and sources such as hydro and nickel mining. We think that Indonesia is still at its early stage in adopting ESG investments compared to developed countries. However, this is a topic that continues to be more important in future investments.

Figure 20. Investments into green energy is projected to reach USD100tn by 2050



Source: Schroders

What are the overall impacts to the equity and fixed income markets?

YEAR OF RECOVERY IS A YEAR FOR EQUITIES

We remain positive on equities for 2022 on the back of reform story, lagging valuation compared to peer countries, potential listings of new economy names, and strong commodity prices. Though the JCI index has performed well YTD November at 9.3%, it is still trading at 18.15x PE behind compared to developed markets and even India at 22.86x PE.

We think that Indonesia will continue to be beneficiary of asset reallocation from China. As Indonesia is a beneficiary of high commodity price while its economy is dependent on domestic demand, we think that it is among the preferred play among the Southeast Asia countries.

In the past few months, JCI has been performing well following the improvements in the covid conditions in Indonesia where the positivity rate dropped significantly to below 1% nationwide. Hence, we think that the covid recovery has been close to fully reflected into the JCI's strong performance YTD.

Therefore, upside on JCI for 2022 would need to come from the structural reform stories from economic growth, Omnibus Law, and the sovereign wealth fund, INA's developments. Upcoming capital market activities and deals would also help propel the Indonesian equity market with more names that are attractive to foreign investors such as the new economy, sustainability, and tech names.

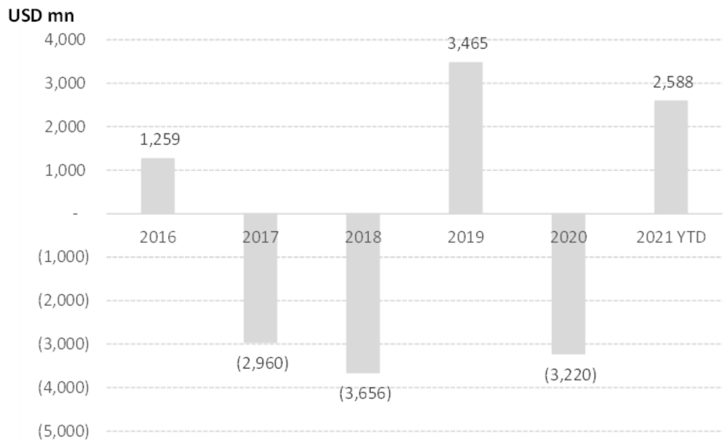
In terms of stock selections, we prefer the large caps or blue chip names compared to the mid-to-small cap names which already performed strong in 2021. Blue chip names are beneficiary of foreign fund inflow into Indonesia as foreign investors tend to prefer the more liquid large cap names. Due to the lagging valuation and improving covid conditions in Indonesia, we think that foreign flow would remain strong going into 2022. Meanwhile, comparing the JCI index with the

Figure 21. JCI trails behind India and developed markets despite strong recent performance

Index Names	31-Dec-20	30-Nov-21	YTD Performance (%)	P/E Ratio FY21
SPX Index	3,756.1	4,567.0	21.6%	21.83
NIFTY Index	13,981.8	16,983.2	21.5%	22.86
CAC Index	5,551.4	6,721.2	21.1%	15.43
CCMP Index	12,888.3	15,537.7	20.6%	33.98
INDU Index	30,606.5	34,483.7	12.7%	17.73
DAX Index	13,718.8	15,100.1	10.1%	14.23
JCI Index	5,979.1	6,533.9	9.3%	18.15
UKX Index	6,460.5	7,059.5	9.3%	11.60
SET Index	1,449.4	1,568.7	8.2%	18.33
STI Index	2,843.8	3,041.3	6.9%	13.98
SHCOMP Index	3,473.1	3,563.9	2.6%	13.20
NKY Index	27,444.2	27,821.8	1.4%	16.88
PCOMP Index	7,139.7	7,200.9	0.9%	21.22
KOSPI Index	2,873.5	2,839.0	-1.2%	10.26
FBMKLCI Index	1,627.2	1,514.0	-7.0%	15.43
HSI Index	27,231.1	23,475.3	-13.8%	11.72

Source: Bloomberg

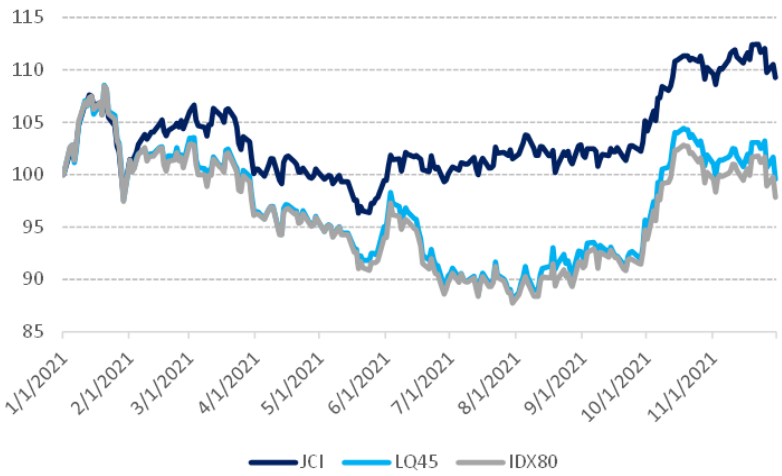
Figure 22. Foreign investors started to post consistent inflows into the equity market in 2021



Source: Bloomberg

LQ45 and IDX80 indices, JCI has outperformed both LQ45 and IDX80 YTD with large gap though it has narrowed from the start of the year. The underperformance of LQ45 and IDX80 indicates that market has been driven by mid-to-small cap names YTD and that the blue chip lagged significantly. Since the gap between the indices are still large, with LQ45 at 9% and IDX80 at 11% discounts to JCI, we think that the blue chip names would continue to perform to narrow the performance gaps.

Figure 23. Blue chip indices, LQ45 and IDX80, have been underperforming JCI index YTD



Source: Bloomberg

In terms of sector, we prefer big banks as the main proxy of economic recovery. Healthcare and selected consumer names would play well as the defensive picks. We also like selective tech names as a long term play given Indonesia's recent boom in the sector. Select infrastructure names are also attractive as reopening play. Meanwhile, we think that metal names are the preferred play for commodities given the long term EV and green energy developments.

Key risks to the equity market include:

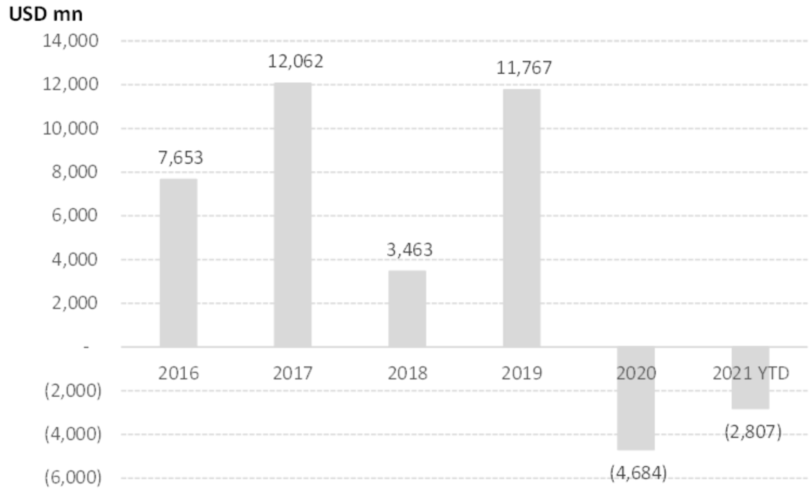
- **Resurgence of covid cases and lockdowns.** Though we are reaching an endemic, the risk of resurgence of covid does exist albeit more manageable with more vaccines and covid pills introduced. Meanwhile we think the governments around the world are more reluctant to conduct full scale lockdowns in order to avoid pressure to their economies. The biggest risk would be discovery of a new variant that is immune to vaccines. Though we believe the risk is minimum at this juncture.
- **Inflationary pressure.** As inflation starts to pick up, investors may go wary on impacts to purchasing power and consumption. Though some level of inflation should be manageable, an overshoot would hurt private consumptions and economic recovery.
- **Easing stimulus.** As the pandemic is transitioning to an endemic, the government may start to cut down stimulus to businesses and individuals. The smooth transition is important so that it does not cause a shock to the economy and drag growth. Hence, government's communication and implementation is critical.
- **Tight fiscal room.** The government's duty to bring down fiscal deficit below 3% by 2023 definitely limits fiscal room at this juncture. Hence, aside from lower stimulus, a more aggressive taxation may pose adverse effect to economic growth whether it is taxation to corporates or individuals.
- **China economic slowdown.** Slower China economy and trade may negatively impact the Rupiah as slower trade would widen the CAD. However, elevated commodity price should limit this risk at the moment.

PRESSURE FROM MONETARY TIGHTENING MAY PULL THE BRAKE ON FIXED INCOME

We are neutral on the fixed income market as we see pressures from inflation and monetary tightening though low foreign ownership in IndoGB and high real yield would help limit downside to the bond market. Hence, we are keeping our duration close to neutral for 2022 with preference remain in the mid-to-short tenor series given the stronger demand from the local investors.

We may look into select long tenor series should demand indicate positive trend. However, in the short term shorter tenor series is preferred due to weak foreign demand and risk of monetary policy reversal.

Figure 24. The bond market has seen flow reversal due to anticipation of tightening monetary policy



Source: Bloomberg

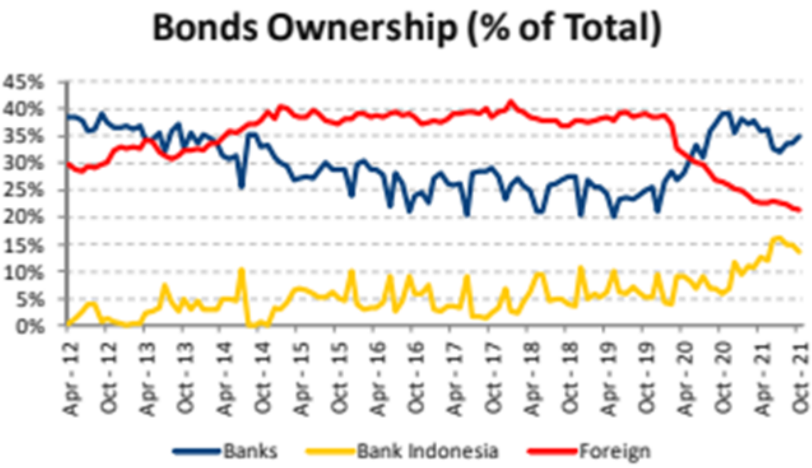
Figure 25. Indonesia's real yield is still among the highest

Major 10Yr	S&P Rating	Yield	Changes Weekly	Changes Monthly	Changes YTD	Benchmark Rate	Inflation	Real Benchmark Rate	Real Yield
South Africa	BB-	9.86	0.42%	0.39%	1.17%	3.75	5.00	(1.25)	4.86
Indonesia	**BBB**	**6.23**	**0.03%**	**-0.01%**	**0.13%**	**3.50**	**1.66**	**1.84**	**4.57**
Pakistan	B-	11.95	1.08%	0.96%	2.02%	8.75	9.20	(0.45)	2.75
India	BBB-	6.34	-0.02%	-0.05%	0.44%	4.00	4.48	(0.48)	1.86
Mexico	BBB	7.69	0.22%	0.16%	2.39%	5.00	6.24	(1.24)	1.45
Brazil	BB-	11.71	-0.03%	-0.23%	4.73%	7.75	10.67	(2.92)	1.04
Malaysia	A-	3.52	-0.04%	-0.07%	0.84%	1.75	2.90	(1.15)	0.62
Philippines	BBB+	5.00	1.97%	2.05%	0.56%	2.00	4.60	(2.60)	0.40
Russia	BBB-	8.43	0.04%	0.44%	2.52%	7.50	8.13	(0.63)	0.30
Turkey	B+	20.11	7.99%	7.10%	8.18%	15.00	19.89	(4.89)	0.22
Japan	A+	0.08	0.01%	-0.02%	0.05%	(0.10)	0.10	(0.20)	(0.03)
Chile	A+	5.76	2.95%	2.96%	2.67%	2.75	6.00	(3.25)	(0.24)
Thailand	BBB+	2.00	0.01%	0.02%	0.84%	0.50	2.38	(1.88)	(0.38)
South Korea	AA	2.27	-0.12%	-0.30%	0.54%	1.00	3.20	(2.20)	(0.94)
Hungary	BBB	4.32	0.14%	0.33%	2.17%	2.10	6.50	(4.40)	(2.18)
Romania	BBB-	5.64	2.18%	2.03%	1.04%	1.75	7.94	(6.19)	(2.30)
United Kingdom	AA	0.81	-0.06%	-0.22%	0.62%	0.10	4.20	(4.10)	(3.39)
Netherlands	AAA	-0.19	0.01%	-0.14%	0.29%	-	3.40	(3.40)	(3.59)
Poland	A-	3.11	-0.16%	0.39%	1.86%	1.25	6.80	(5.55)	(3.69)
Nigeria	B-	12.29	7.56%	7.44%	0.73%	11.50	15.99	(4.49)	(3.70)
United States	**AA+**	1.52	-0.11%	-0.05%	0.61%	0.25	6.20	**(5.95)**	**(4.68)**
Germany	AAA	-0.34	0.00%	-0.16%	0.24%	-	4.50	(4.50)	(4.84)
Bulgaria	BBB	0.70	0.30%	0.30%	0.30%	-	6.00	(6.00)	(5.30)
Average		*4.82*	*1.27%*	*1.30%*	*0.67%*	*2.17*	*7.15*	*(4.98)*	*(4.30)*
Minimum		*(0.34)*	*-0.16%*	*-0.30%*	*0.05%*	*(0.10)*	*0.10*	*(6.19)*	*(5.30)*
Maximum		*20.11*	*7.99%*	*7.44%*	*8.18%*	*15.00*	*19.89*	*(0.20)*	*1.04*

Source: Trading Economics, WorldGovernmentBonds

The upcoming monetary policy reversal may give headwinds to the bond market as Bank Indonesia and central banks around the world are getting ready to start cutting asset purchases and increase policy rates in the coming months. As the Fed has announced its tapering plans, we have seen foreign investors posting outflows of about IDR57tn from September to November.

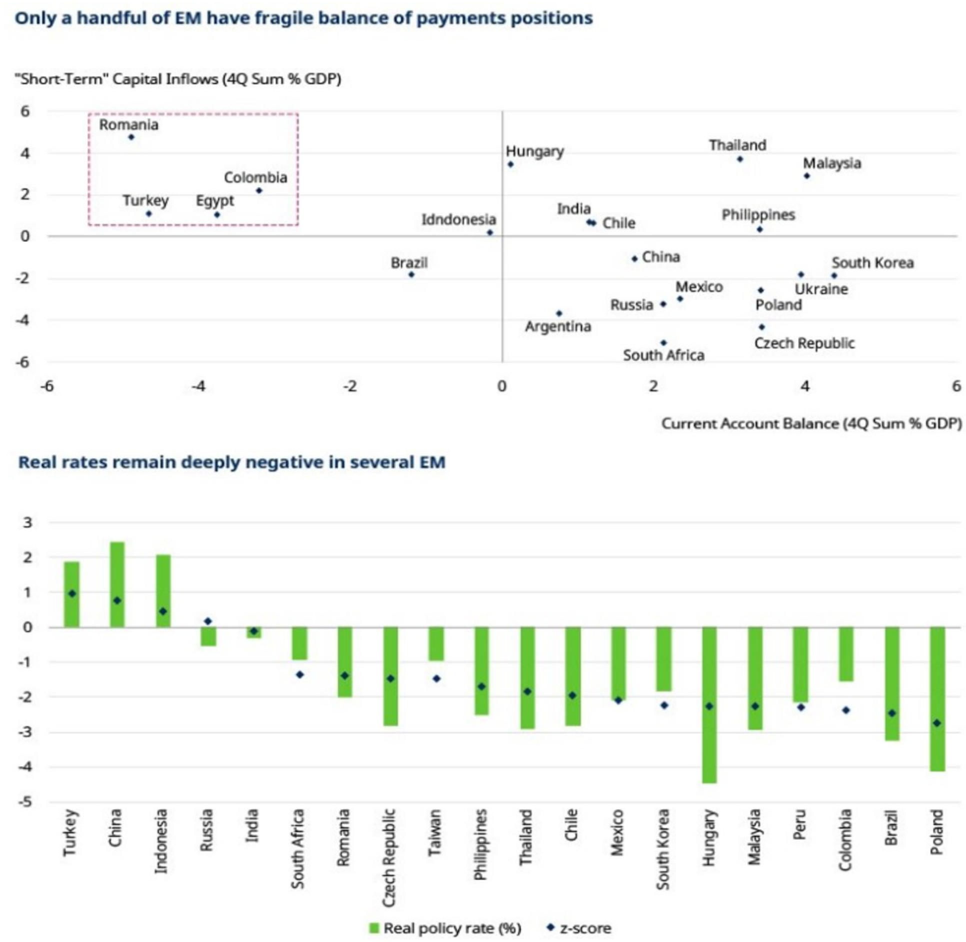
Figure 26. Foreign ownership in IndoGB is at 21% compared to pre-covid level of 39%



Source: Mandiri Sekuritas, Ministry of Finance, CEIC

However, despite the massive foreign outflow, the 10 year government bond yield remained stable at about 6.1%. We believe that abundant liquidity in the banking system and low banking deposit rate still support demand for IndoGB from local investors. Meanwhile, low foreign ownership in IndoGB of about 21% compared to pre-covid level of about 39% also put our bond market in a more defensive position against massive foreign outflow.

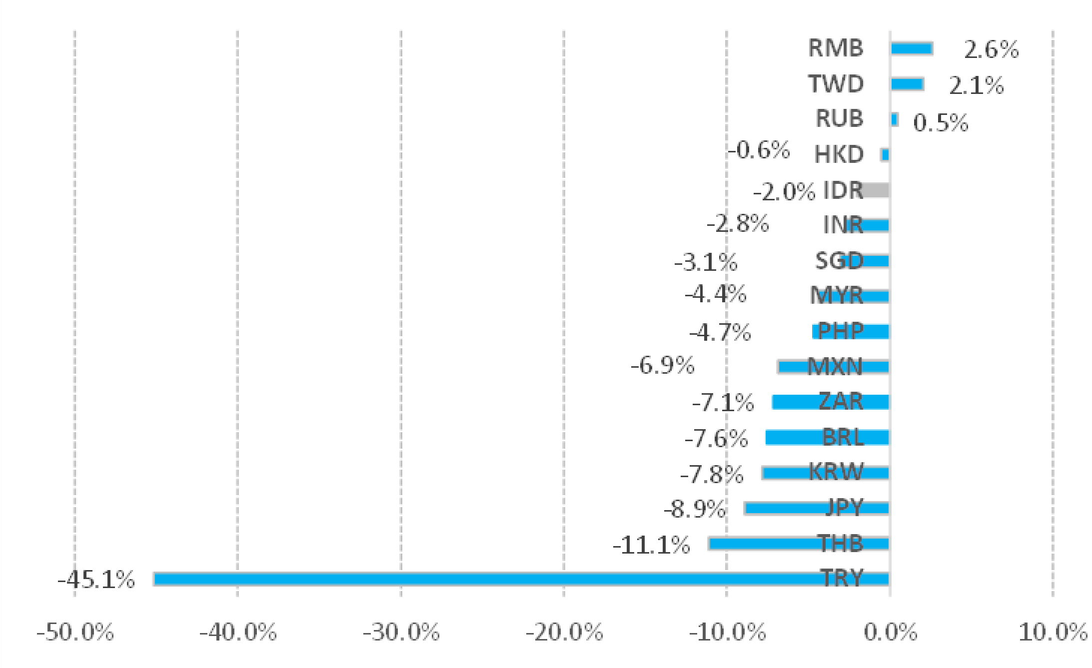
Figure 27. Better external macro conditions and positive real yield still make IndoGB appealing



Source: Schroders

Indonesia's high forex reserve of USD146bn as of October 2021 and narrower CAD position also made the country more resilient against the Fed tapering risk this time around compared to back in 2013. Hence, despite potential risks from tightening monetary policies, we think that downside to IndoGB is rather limited at this juncture. Indonesia's relatively lower inflation and stable Rupiah as well as high real yield still appeals to foreign investors. Thus, we think that should there be massive correction in the bond market, foreign investors would start to re-enter into IndoGB and bring yields back down.

Figure 28. Rupiah has been performing well YTD compared to peers



Source: Bloomberg

The rise of inflation has been another factor causing volatilities in the bond market this year albeit more driven by the rising US inflation. We think that inflation in Indonesia would start to move up in 2022 as we have already seen PPI climbing up as a result of supply chain disruptions and high commodity prices. However, we expect inflation to climb up to about 3-4% YoY in Indonesia in 2022, much more benign compared to inflation in the US due to lack of demand explosion. The rising inflation may cause some pressure to the bond market which have enjoyed lower than average inflation during the pandemic. Though we think that the 2022 inflation level should still be at manageable level. We expect Bank Indonesia to increase its policy rate by about 25-50bps to keep the real rate positive.

On the other hand, improving covid conditions in Indonesia has been a positive driver for the bond market as it alleviates concerns on risk of higher spending needs on covid relief stimulus which would widen the budget deficit. As of mid of November, the government has only realized about 67% of its PEN stimulus for 2021. With higher vaccination rate and discoveries of covid treatment pills, we think that risks coming from covid on the bond market would be smaller in 2022 compared to 2021. The improving covid conditions would also help keep foreign investors sentiments more positive on Indonesia. Another positive factor is the strong commodity price which has been keeping our trade balance and Rupiah strong. We think that the strong commodity price would keep the Rupiah strong until mid 2022 and hence give support to IndoGB. However, potential wider CAD in 2H22 may blow some headwinds to the bond market as commodity prices normalize and imports start to grow stronger.

Figure 29. Government financing needs and issuance estimates

Government Securities	APBN 2020	APBN 2021	Govt APBN2021 Target - SKB3 (Aug 2021)	Government Bond Issuances Realization YTD (2-Nov-2021)	RAPBN 2022F	RAPBN 2023F
Budget Deficit	**(956.3)**	**(1,006.5)**	**(961.5)**		**(868.0)**	**(581.6)**
% of GDP	(6.09)	(5.07)	(5.82)		(4.85)	(3.00)
Gross Bond Supply	**1531.7**	**1565.1**	**1427**	**1080.5**	**1329.6**	**1113.9**
Gross Local Currency Bonds	**1372.8**	**1375.3**	**1270.1**	**923.6**	**1179.3**	**980.2**
Auction Program (Inc. Sukuk)	760.8	1,269.1	925.1	796.6	842.9	661
Retail Bonds (ORI & Sukuk)	76.8	86.0	95.2	92.2	95.2	95.2
Private Placement	535.3	20.3	249.8	34.8	241.2	224
Gross Foreign Currency Bonds	**158.9**	**189.8**	**156.9**	**156.9**	**150.3**	**133.7**
3 Conventional						
3 Sukuk						
Total	**31.7**	**52.9**	**30.9**	**44.4**	**35.1**	**27.5**
Source: DMO and Mandiri Sekuritas						
Source of Financing	**1,193.3**	**1,006.4**	**961.5**		**868.0**	**581.6**
Debt Financing	**1,229.6**	**1,177.4**	**1,027.0**		**973.6**	**733.4**
Government bonds - nett	**1,177.2**	**1,207.3**	**1,029.2**		**955.1**	**714.9**
Loan Program - nett	52.5	(29.9)	(2.2)		18.6	18.6
Investment Financing	(104.7)	(184.5)	(204.7)		(182.3)	(182.3)
Loan Financing	1.0	0.4	1.8		0.6	0.6
Liability Financing	(3.6)	(2.7)	(2.7)		(1.1)	(1.1)
Others	70.9	15.8	140.0		77.3	31.0

Source: DMO, Mandiri Sekuritas

We view the government's commitment to bring down the budget deficit below 3% by 2023 to be positive for the bond market. The government's efforts would help alleviate risks of sovereign rating downgrade from credit rating agencies who continued to re-iterate the importance of fiscal discipline for Indonesia to maintain its rating. Moreover, as the government has excess budget for financing, not only does it lower risks of upcoming bond supplies, but it also allows the government to use some cash of about IDR120tn to buyback some of the bonds it issued. The buyback would also keep liquidity ample in the banking system and give support to bond demand. Bank Indonesia is also still committed to support financing through the burden sharing program.

Key risks to the fixed income market include:

- **Resurgence of covid cases and lockdowns.** Just like the equity market, resurgence of covid cases would be negative for the bond market as it raises uncertainties while also potentially require more stimulus from the government and, thus, bond financing.
- **Inflationary pressure.** The rise of inflation is generally negative for bond valuation and hence would pressure the bond market.
- **Faster than expected monetary tightening.** At the moment, we expect Bank Indonesia to only start raising policy rates at the end of 2022 by 25-50bps. However, should inflation spike higher than expected or the Rupiah faces pressure, a faster than expected rate hike may cause pressure to the bond market.
- **Wider than expected budget deficit.** The government is committed to bring down the budget deficit below 3% by 2023. However, should there be an issue that slow down or reverse the narrowing deficit, bond investors may turn jittery. The same issue may also pose risk of sovereign rating downgrade by credit rating agencies should the government unable to meet its 3% deficit target by 2023.
- **Bank Indonesia independence noises**. The government plans to continue the burden sharing scheme with Bank Indonesia and has been raising questions among investors in the past regarding the central bank's independence. Any noises regarding the central bank independence may cause volatility to the bond market.
- **Currency volatility**. Potential CAD widening towards the end of 2022 may put some pressure to the Rupiah which could also add some volatility to the bond market. The movement of the USD is also something that needs to be monitored going into 2022.

DISCLAIMER

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PT Schroder Investment Management Indonesia, 30th Floor IDX Building Tower 1, Jl. Jend. Sudirman Kav 52-53, Jakarta 12190, Indonesia. PT Schroder Investment Management Indonesia is authorized as Investment Manager and supervised by Indonesia Financial Services Authority (OJK).

PT Schroder Investment Management Indonesia
Indonesia Stock Exchange Building Tower 1, 30th Floor
Jl. Jend Sudirman Kav. 52-53 Jakarta Indonesia 12190

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