Schroders

For professional investors and advisors only

Indonesia Market Commentary

October 2020

Macroeconomics

BKPM has released the 3Q20 investment realization where it showed growth of 1.6% YoY compared to -4.3% in 2Q20. FDI finally showed positive growth of 5.3% YoY in 3Q20, first time since 3Q19, driven by FDI from Asian countries such as China, South Korea, and Singapore. FDI in base metal industry was among the strongest in terms of growth while backlog investments realization also supported the growth. Meanwhile, DDI grew by 2.1% YoY in 3Q20 driven by ex-Java investments. BKPM noted that there are still additional backlogs, mostly DDI, to be realized in 4Q20, hence, should give support to overall investments in FY2020.

Indonesia reported monthly inflation of 0.07% MoM or 1.44% YoY in October. Food and healthcare related inflation were the main drivers for inflation in October. Within food and beverages, red chili and red onion contributed the most to the inflation. Meanwhile, transportation continued its deflationary trend during the month which is suspected due to discounts and promotion ahead the long weekend towards the end of October. Core inflation slipped from 1.86% YoY in September to 1.74% YoY in October.

Indonesia recorded another trade surplus in September at USD2.4bn, compared to USD2.3bn in August, as import decline remains deep compared to the decline in exports. Hence 3Q20 trade surplus was recorded at USD8.0bn compared to USD2.9bn surplus in 2Q20. Export contraction continued to narrow in September at -0.5% YoY compared to -8.4% YoY in August. Improvements in exports was driven by higher CPO price and stronger iron and steel exports to China. Import contractions also narrowed, though remained high, at -18.9% YoY in September compared to -24.2% YoY in August. Higher oil imports and increasing mechanical and machinery equipment imports from healthcare equipment were the drivers. Bank Indonesia mentioned that it expects Indonesia to book current account surplus in 3Q20, first time since 2011, due to stronger exports.

As of September, Indonesia recorded budget deficit of 4.16% of GDP, widened from 3.05% as of August. Revenue fell by 13.7% YoY as of September with tax revenue and non-tax revenue dropped by 14.5% YoY and 13.5% YoY respectively due to weak domestic demand and second Jakarta PSBB. Meanwhile, expenditure has grown by 15.5% YoY as of September driven by central government spending as a result of social spending and the national economic recovery program. As of mid-October, realization for the fiscal stimulus program has reach 49.5% of FY2020 target.

In September, Indonesia's forex reserve fell from USD137bn to USD135.2bn due to Rupiah stabilization efforts and foreign debt payments. Meanwhile, Bank Indonesia maintained its policy rate at 4.00% in the meeting in October. USD/IDR closed at IDR14,625/USD which appreciated by 1.7% MoM due to positive inflow into the bond market after the passing of the Omnibus Law.

Equity

Local Market

JCI index made a rebound in October as the index made a positive return of 5.3% MoM following the early passing of the Omnibus Law. However, foreign investors still booked fund outflow of USD252mn (IDR3.7tn) from the equity market. The Omnibus Law was passed on 5 October, ahead of market's expectations, after months of debates within parliament. The law covers over 1,000 articles on topics such as business licensing, taxation, foreign investment and sovereign wealth fund, and labor reform. Overall, the law should be positive for growth and equity market. However, investors, particularly foreign, were still waiting for the final version to come out at that time as the law was only signed by President Jokowi on 2 November. Hence, local investors have been more reactive to the law compared to the foreign investors, who still prefer to wait-and-see. There were some concerns on protests that sparked due to the Omnibus Law, but market still managed to pull through them. Market was also excited with the government's plans in partnering with foreign in battery projects, which is considered as part of the new economy, as Indonesia has the largest reserve of Nickel in the world. Meanwhile, the Jakarta Governor has returned the capital city's PSBB back to transition mode as daily new cases has eased down and hospital ICU capacity came down from 80% back to about 67%. The PSBB transition is more relaxed compared to the previous one with shopping mall operating hours extended by one hour and cinemas and gyms are allowed to reopen with 25% capacity. The government mentioned that it is ready to distribute vaccine for COVID-19 starting in November for front line workers using the 9mn doses imported from China. The vaccine roll-out for the public is estimated to start in January 2021 until March 2022. During the month, Bank Indonesia maintained the policy rate but mentioned that it is expecting 3Q20 current account to book a surplus, first time since 2011, due to stronger exports and weak imports. Globally, cases of COVID-19 continues to rise with a new wave happening in Europe which caused global investors to jitter as a number of countries such as France and the UK already announced second lockdown. In the US, the presidential candidate debates have started with Biden seems to be taking the lead. As the election is fast approaching, discussion on the fiscal stimulus continued which pressured the market as it has been on-and-off for months.

The Jakarta Miscellaneous Industries Index was the winner in October with a +16.8% MoM gain driven by ASII after posting stronger than expected 3Q20 result supported by its Auto business. The stock garnered large inflow from foreign investors during the month which supported the stock price performance. Top 5 index drivers were: BRAM (+28.2%), ASII (+21.6%), MASA (+19.4%), SMSM (+16.7%), and UCID (+6.5%).

The Global Market

The US market posted another monthly loss in October as market was under pressure due to rapid increase in COVID-19 cases, stimulus uncertainties, and macro backdrop all while investors nervously wait for the US election in November. DJIA 26,501.6 (-4.6%); S&P 500 3,270.0 (-2.8%); NASDAQ 10,911.6 (-2.3%). Former Vice President Biden has been on the lead with market now expecting a Democratic Sweep. A Biden win would mean ramp up in government stimulus and increase in taxes. Should the congress remain split, the US market would be put in a gridlock once again as policies may face hurdles in congress to get passed. Meanwhile, the US reported 3Q20 GDP growth of 33.1% QoQ, a rebound from the dip in 2Q20, but weaknesses in macro data may linger.

The Asian posted mixed performance in October as investors are assessing 3Q20 corporate earnings and minimizing risks ahead of the US election. NIKKEI 22,977.1 (-0.9%); Hang Seng 24,107.4 (+2.8%); Shanghai Comp 3,224.5 (+0.2%); Straits Times 2,423.8 (-1.7%); FTSE Malay KLCI 1,466.9 (-2.5%); KOSPI 2,267.1 (-2.6%). Meanwhile, the Japanese market is starting to flatten after the rebound since late May as stimulus funds started to dwindle while exports normalize. China's manufacturing PMI continued to improve at 53.6 compared to 53.0 in the previous month. However, tension with the US and low credit allocation efficiency on manufacturing investment may require the Chinese government to come up with policies to smooth out its economic growth.

The European market plunged in October as COVID-19 cases rapidly increase and led to lockdowns in France, Germany, and the UK as healthcare providers started to reach their capacities. FTSE 100 5,577.3 (-4.9%); CAC 40 4,594.2 (-4.4%); DAX 11,556.5 (-9.4%). Meanwhile, 3Q20 corporate earnings also disappointed investors while uncertainties on US election added volatility to the market. The ECB pre-committed on further easing monetary policy in December due to the escalating pandemic in the region.

Outlook & Strategy

Though the Omnibus Law has been passed by Parliament in October, domestic investors were the main supporter of the market so far with foreign investors still posting net sell. The US election is another factor that needs to be monitored in November as it will likely move the global market.

Property sector would be benefitted by lower taxes and foreign ownership of property. Infrastructure sector would be benefitted by the Sovereign wealth Fund as it would help construction companies to grow and reduce pressure to their balance sheet. Recently, investments into electronic vehicles and batteries, dubbed the new economy, put Indonesia back to the commodity map due to its high nickel reserve. Hence, it would help sway the country's commodity exposures from coal and CPO to nickel.

Fixed Income

October was a strong month for the bond market as the 10-year government bond yield fell from 6.967% to 6.609%. Foreign investors recorded net inflow of USD1.5bn into the bond market in October. The strong performance was mainly driven due to investors confidence after the passing of the Omnibus Law. The US Treasury yield rose from 0.69% to 0.88% while the USD denominated Indonesian 10-year yield (INDON30) closed at 2.18% at the end of October, indicating further narrowing.

After being under pressure due to Jakarta PSBB and noises on Bank Indonesia's independence, the bond market made a comeback in October as the Omnibus Law was passed. The law is hoped to attract FDI into Indonesia and hence would reduce the incoming bond supply risk as the government would be able to use the FDI to help on its spending. As a result, we saw foreign posting inflows into the bond market on most days during the month which also supported the Rupiah. Meanwhile, the central bank also mentioned that it is expecting a current account surplus in 3Q20 for the first time since 2011.

Investors' confidence was also helped by news on vaccine development as the government mentioned that it is planning to deploy the first round of imported COVID-19 vaccine in November. Meanwhile, full rollout of the vaccine would start in January 2021 until March 2022. Bank Indonesia maintained its policy rate at 4.00% in October. Bond investors are now paying close attention to the US election coming in November.

In terms of issuance, the government still managed to gain some demand from local investors with bids showing some recovery. As of October, the government managed to issue about IDR1,267.8tn of bonds YTD. The amount includes IDR252.6tn of issuance through the private placement scheme with Bank Indonesia as part of the burden sharing arrangement between the central bank and the government. All-in-all, YTD bond issuance has reached 82.8% of the government's FY2020 issuance target. As of end of October, foreign ownership of IDR government bond has reached IDR955.8tn, or 26.5% of total outstanding amount.

Outlook & Strategy

The bond market performed well in October and, hence, has limited upside at this juncture. At this moment, noises on the US election, COVID-19, and policies such as the Omnibus Law and financial authority supervision are limiting the upside in the bond market.

The Omnibus Law has given much support to the bond market in October with foreign investors posting net inflow into the bond market. The Sovereign Wealth Fund, which is part of the Omnibus Law, would be able to help financing for government's infrastructure and SOE projects with the help from foreign institutions. Hence, it may reduce the government's needs for bond issuance and reduce the incoming bond supply risks. Thus, implementation of the Omnibus Law would be among bond investors' key interests in the next few months.