

Indonesia

Market Commentary

June 2018

Macroeconomics

June 2018 inflation was 0.59% month-on-month (mom), in line with consensus expectation. It translates to annual inflation of 3.12% year-on-year (yoy) compared to 3.23% yoy in May). Manageable food inflation and high-base effect from last year's electricity tariff adjustment were major factors. We still see upside risk in the second half of the year, with oil price fluctuations and currency pressure as the main factors.

May trade balance recorded a deficit of USD 1.52bn, much higher than consensus expectation of around

USD 600mn. Year-to-date (YTD), the deficit reached USD 2.8bn, compared to USD 6bn of surplus in the same period last year. Imports and exports grew by 28.2% YoY and 12.4% YoY, respectively. Imports growth was driven by prices, especially due to rising oil price. Exports did not increase as strong, as the increase in export volume was cushioned by the weak aggregate price (especially rubber).

Bank Indonesia (BI) took another aggressive monetary policy by raising the 7-Days Reverse Repo Rate

(7DRRR) by 50bps in June. BI is sticking to its statement of being pre-emptive, front-loading and ahead of the curve in order to maintain stability over growth. Current account deficit (CAD) has also been a concern lately for the Central Bank as the Country's continual trade deficit may impact the Balance of Payment. During the meeting, BI has also introduced a new macro-prudential relaxation for loan-to-value (LTV) rule related to property ownership, while at the same time amending the stages applicable to liquidate fund.

Equity

Market Update

JCI index dropped 3.1% in June 2018, the fifth consecutive months in the red, the first occurrence since the 2008 global financial crisis. Indonesian equities were impacted by the negative sentiment from the trade war between US and China that rocked equity markets globally. Global factor however, is not the only one that caused the selling pressure, as nationally Indonesia is being faced by the concerns over the higher-than-expected current account deficit (CAD). Hence, despite US 10-Yr Treasury traded below 3% level during June, Indonesian bond yield saw a sharp 80bps increase. Investors' confidence was also being pressured by the sharp depreciation of the local currency in, the worst monthly drop since November 2016. All in all, June recorded USD 647mn of foreign outflow, which brought the

YTD outflow to USD 3.6bn (IDR 49.4tn). Sector-wise, infrastructure was the best performer in the month, posting 2.8% gain as the top 3 telco players have signalled that they are ready for an increasing average selling price environment. Mining was second best with 1.5% gain. On the other hand, Construction, Property and Real Estate was the worst performer with 7.1% loss in June, contractors were the main culprits as concern on higher financing cost and changes in land clearing regulation might hamper new contract growth. The second worst performer was Agriculture with 6.4% loss on the back of weakening crude palm oil price.

June has been another eventful month for Indonesian macro with all the actions packed toward the end of month with Bank Indonesia raising the benchmark rate by 50bps.

Inflation remains under control, but the looming trade deficit might give pressure to the CAD. In June, Indonesia held the simultaneous regional elections in 17 Provinces which was conducted smoothly and peacefully.

Investment strategy

Global market turned cautious in June and corrections have reversed most of the major markets' gains this year. Deep correction happened in China as the trade war concerns heightened. This exacerbates sell-off in emerging markets, including Indonesia. The YTD outflow from Indonesia market reached USD 3.6bn, which brought the foreign outflow from 2015 until June 2018 to USD 6.8b.

Positive signal for the Indonesian economy was seen in consumer goods consumption recovery; same-

store-growth of retailers showed an improving trend especially in modern market, motorcycle sales up 13% yoy in the first 5 months of 2018, while 4-wheelers posted 6% yoy growth during the same period. The consumer goods manufacturers also mentioned that this year's Lebaran

spending was better than last year. However, we also need to see whether the recovery will sustain post Lebaran period.

Market valuation now has become more attractive at 13.6x PER 2018. However, the movement in JCI will heavily dependent on global

backdrop like the USD exchange rate movements, the Fed rate decision, USD 10-year yield, RMB depreciation and interest rate decisions in Europe. The confidence on Rupiah will also have a big role on the market sentiment.

Fixed Income

Market Update

Correction in the bond market continued in June 2018, in the midst of low trading volume during long Lebaran holiday. The 10-year benchmark yield (FR64) increased from 6.96% to 7.83%, before going back to 7.70% by the end of the month. Pressures in emerging market remained, which was affected by continuing trade tension between US and its trade partners. This led to foreign outflow, as shown in the IDR 3.64tn decrease of foreign ownership in government bond, representing 37.79% of total bond outstanding down from to 38.15% in May. Rupiah also continued to be under pressure, and depreciated by 3.1% to 14,330 during the month.

The pressure on the currency, combined with trade deficit trend,

might be a factor for the central bank to raise policy rate by 50 bps, and brought the 7-Day Reverse Repo rate to 5.25%. On its statement, BI said that the decision was pre-emptive and ahead of the curve in order to maintain domestic financial market competitiveness, in the midst of global monetary policy changes and volatility in the global financial market. At the same time, BI relaxed the loan-to-value (LTV) regulation in the property sector, to be effective in August 2018.

Domestic macro situation still led to mix sentiments. There was less supply side pressure, combined with high base effect from last year's electricity tariff increase. However, May 2018 trade balance posted wider deficit of USD 1.52bn, mostly driven by oil and gas deficit. Imports and

exports grew by 28.2% and 12.4% yoy, respectively. Such trend has also put pressure on the currency.

By the end of June, the government has issued IDR 454tn of bonds or around 54% of gross issuance target in 2018, assuming budget deficit at 2.19% of GDP. Despite slightly lower total bids, foreign participation increased to 23.1% of total bids, compared to 20.5% in previous auction. Corporate bond issuances were still limited due to bond market volatility.

Outlook and Strategy

We still expect sentiments in emerging market and concern on EM currencies to continue driving the bond market.

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