Indonesia Outlook

OCBC Bank

Concerns on rising trade tensions as country reports widest trade deficit on record

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Highlights

- **Rising trade tensions between the US and China would likely have a more limited effect on Indonesia's domestic economy compared to other ASEAN peers given the country's growth is more domestically driven.**
- **However, the impact of the trade spat will probably be felt in the monthly trade data as the country reported the widest trade deficit on record in April at US$2.5bn.**
- **It would also weigh in on the IDR although multiple pressure points that affected the currency in 2018 are absent this time around.**
- **The tensions is unlikely to be an immediate concern to Jokowi's plans to develop export oriented industries given that would be a long – term goal and that trade negotiations remain fluid in nature.**
- **For tomorrow, we expect that Bank Indonesia (BI) would remain on hold as it adopts a "wait and see" approach to continue to monitor the uncertain trade tensions and the impact it would have on the market.**

The recent rise in trade tensions between China and the USA would most likely have a more limited effect on Indonesia's domestic economy compared to other ASEAN peers. The country is not a big trading nation and exports as a part of GDP is much lower compared to other key ASEAN peers (see chart 1). Growth instead is more heavily driven by domestic household consumption (see chart 2). Over the next year or so, even if the trade war escalates into 2020, the country's growth in the short-run could receive a boost from Jokowi's strong drive to further his infrastructure agenda (when he is confirmed as the winner of the presidential race). Jokowi himself also recently stressed for a stimulative 2020 state budget although we cautiously await confirmation of the government's spending plans when the budget is tabled later this year.

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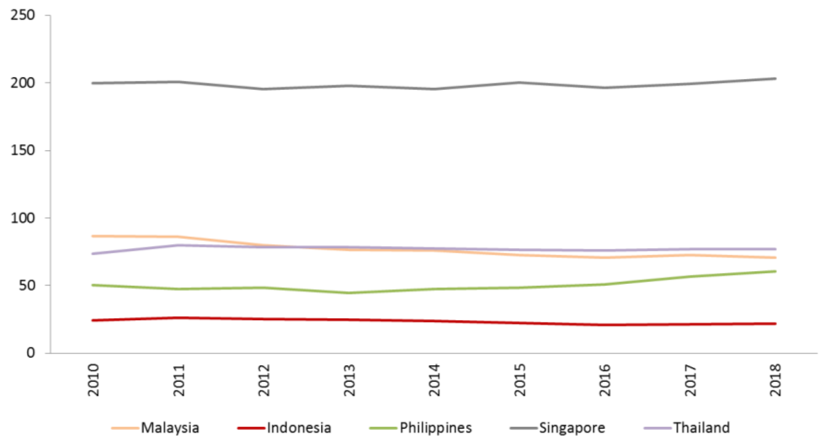
However, the rising trade tensions could impact the country's trade deficit, which was the widest on record for April at US$2.5bn as exports fell by 13.0% yoy. In particular, oil and gas related exports declined by 37.1% yoy, which may be driven by domestic needs. Non-oil & gas manufacturing exports though did fall by 11.5%, which is possibly a reflection of the weaker global environment that can risk being exacerbated by the trade spat. On the import side, the decline in April was slower at 6.6% yoy but it remains to be seen if a fall can continue as the country gradually exhausts its stocks of goods. For the near term, a deficit is likely to continue into May especially given the country is entering the festive season.

We don't view that the trade tensions to be an immediate concern to any Jokowi drive to develop export orientated industries. Our reasoning is that such a goal would be very long-term in nature and that the trade tensions situation remains very fluid. Any such plan would likely just focus on building the foundations during the next five years, which could include developing the requisite infrastructure or upskilling human capital. After all, The World Bank's (WB) Ease of Doing Business rankings place Indonesia at 73rd, behind Malaysia (15th), China (46th), Thailand (27th) and Vietnam (69th). Meanwhile, the WB's Human Capital Index puts the country at the third quartile of all countries globally whilst its score at 0.53 is well below the East Asia and Pacific average at 0.61. Jokowi would also require time to gradually make changes to the negative investment list as he takes into account the views of various stakeholders.

Rising trade tensions maybe weighing on the IDR but multiple pressure points that the currency faced in 2018 are also absent currently. Last year, the IDR faced the pressure of a global tightening, being led by the Fed's normalization policy. However, this year, the Fed's dot plots have changed to indicate the policy rate staying on hold. Trade tensions this year though appear at this point to be more elevated than it was in 2018 as Trump sets a one month deadline for China to agree to a deal or face tariffs on the remainder of Chinese goods. The tariffs imposed as discussed may have a negative effect on the trade surplus/deficit, which could be an added pressure on the IDR. That said, the IDR may face the additional pressure of the risk of outflows of the repatriated tax amnesty funds (reported exposure at Rp147tn) once the lock up period expires in 2H 2019. The trade tensions itself can reduce appetite for EM assets, making the country a less attractive option to keep the tax amnesty funds in.

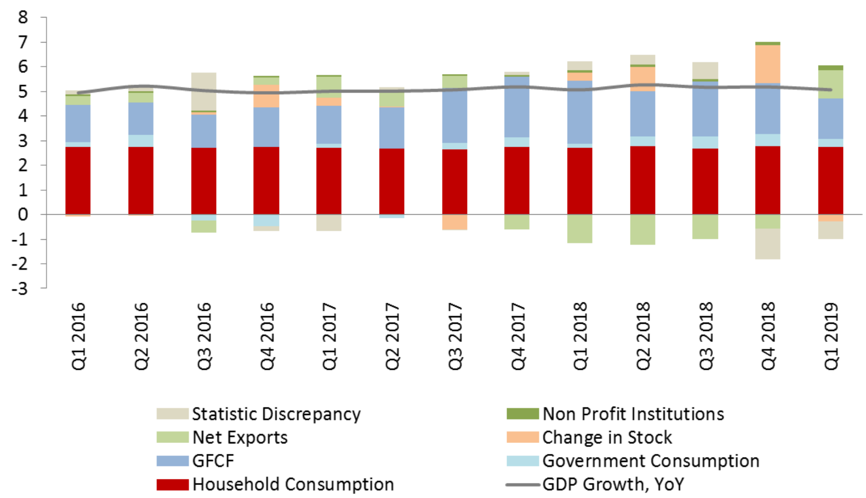
In the immediate short term, the focus would be on Bank Indonesia's (BI) rate decision tomorrow, of which we expect them to stay on hold and adopt a "wait and see" approach. The situation regarding the trade talks at this point still appears very uncertain and the central bank may choose to continue to see how it evolves as they focus on market stability given growth is stable at this juncture.

Chart 1: Exports as % of GDP of ASEAN – 5



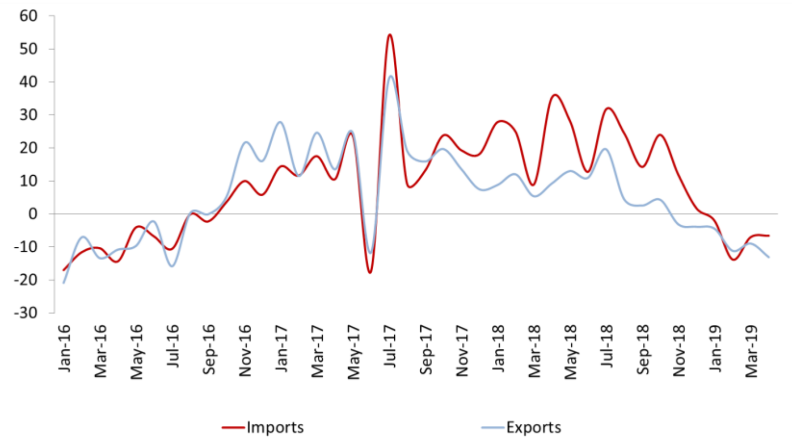
Source: CEIC, Bloomberg and OCBC

Chart 2: Contributors to GDP Growth, % yoy



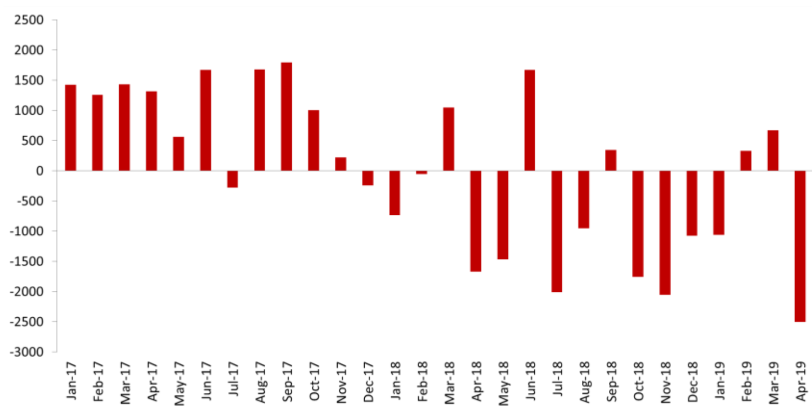
Source: CEIC, Bloomberg and OCBC

Chart 3: Growth of Imports and Exports, % yoy



Source: CEIC, Bloomberg and OCBC

Chart 4: Monthly Trade Surplus/Deficit, US$bn



Source: CEIC, Bloomberg and OCBC