Indonesia Outlook

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Watch Out for a September Hike!

Monday, September 03, 2018

Highlights

- **As of today 3rd September 2018, the IDR has crossed the 14,800 mark against the USD, the lowest level it has been against that currency since the 1998 Asian Financial Crisis.** Back in 1998, it hit levels as low as 16,650 against the USD. At the moment, the currency is still a long way off from that level but Friday's finish at 14,730 was even weaker than lows during periods such as the taper tantrum in 2013 and the fall of commodity prices back in 2015. Upon Friday's close, the IDR had year to date up to that point lost 7.89% against the USD. However, compared to 2013 and 2015, the country's economic fundamentals can be said to be stronger. Inflation levels are more stable and moderate, the current account deficit is narrower whilst the fiscal deficit is projected to also be narrower at -2.1% of GDP for 2018 (compared to -2.6% and -2.2% of GDP respectively in 2015 and 2013). However, there are relatively more external risks that could weigh in on the currency this time around such as the trade tensions and other emerging market (EM) crisis (i.e. the Turkish Lira and Argentine Peso meltdown). Also, foreign ownership of Indonesian government securities is relatively high at 37.5% of the total securities as of August 2018. In such circumstances, the tough question is whether the country's fundamentals are strong enough to overcome the negative sentiments affecting EM currencies.

- **The country's economy has made some major progress since 2011 but on relative terms, compared to other Asian peers, the country still has some more room for improvement.** Compared to the three other emerging major ASEAN economies, namely Thailand, Malaysia and Philippines, the country remains the only economy that ran a current account deficit continuously from 2012 onwards (see chart 1). Also, during the same period, whilst the neighbouring economies have experienced bouts of stronger growth, Indonesia's growth has remained fairly consistent at around 5.0% - 6.0% (see chart 2) with limited pickup. However, Indonesia's economy may be less affected by a full blown trade war as net exports contribute less to growth compared to other components. Regardless, trade tensions appear to have still weighed in on the currency this year.

- **However, the government has already taken measures to structurally reform the economy although it will take time for these measures to kick in as the local economy needs a period to adapt.** The Ministry of Finance is already looking at applying tariffs to 500 consumer goods to reduce imports. The government is also working to expand the use of B20 (20% biodiesel blended into regular diesel) into more sectors and industries. The government additionally will look to ask PT Pertamina and PT Perusahaan Listrik Negara to review imports of capital goods and also require the two companies to postpone infrastructure projects that are yet to tie-up funds. To note, measures back in 2013 were in a

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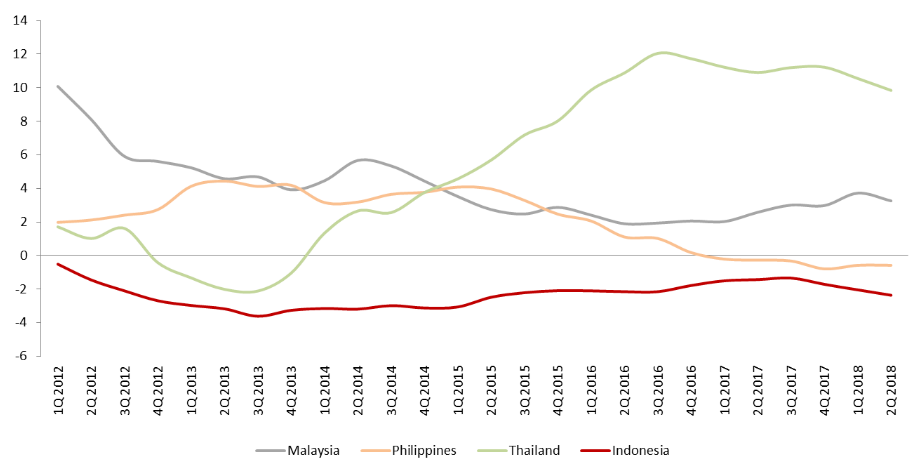
way more drastic as the government raised the price of highly subsidized fuel by 30-44% in an attempt to cut fiscal expenditure. In 2015, the government lowered tax rates on income earned for exporters' fixed deposits in local banks and lowered the holding period for the rupiah-denominated tradable BI securities from 1 month to 1 week. In 2013, 2015 and 2018, the central bank had obviously also utilized foreign reserves to intervene in the currency market to smoothen out volatility with reserves this year having decreased by US$13.7bn between January 2018 to July 2018. Going forward, the government may still have other tools available to address the issues at hand and this could potentially include requiring exporters to convert a certain amount of their export proceeds into the local currency. As a note, Malaysia had introduced a similar measure in December 2016 where exporters were required to convert 75% of their proceeds into the ringgit, and the currency was more stable after that.

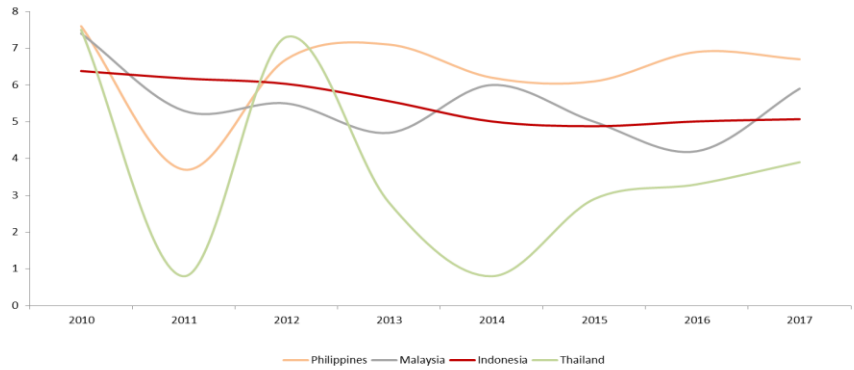
- **Going forward, a rate hike in September looks increasingly likely but the magnitude is not certain**. Rate hikes though don't appear to have stopped the selloff in the currency this year. Historically, it didn't seem to have had a consistent impact either in 2013 and 2015 (see chart 3). Regardless, Bank Indonesia (BI) and the government will probably still engage in a policy mix of interest rate hikes, market intervention as well as other measures as it goes all out to address the negative sentiments against the IDR. The magnitude of the hike though would depend really upon how the IDR behaves during the month.

Chart 1: Current Account Deficit/Surplus of Indonesia, Thailand, Philippines and Indonesia, % of GDP



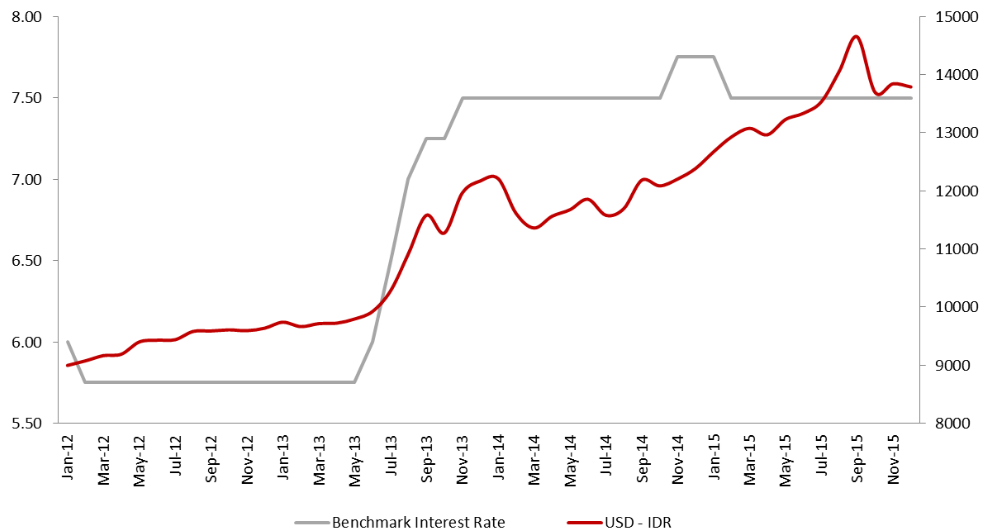
Source: Bloomberg and OCBC

Chart 2: GDP Growth of Indonesia, Thailand, Philippines and Indonesia, % of GDP



Source: Bloomberg and OCBC

Chart 3: Benchmark Rate, % (LHS) and USD – IDR value (RHS) between 2012 – 2015



Source: Bloomberg and OCBC

Table 1: Some measures undertaken by the government and BI in 2013, 2015 and 2018

	2013	2015	2018
Measures undertaken	• Forex intervention • Raising the prices of highly subsidized fuel by 30- 44%	• Forex intervention • Ban the dollar usage for local transactions • Lower tax rates on income earned for exporters' fixed deposits in local banks • Lower the holding period for the rupiah-denominated tradable BI securities from 1 month to 1 week	• Forex intervention • Expanding the use of B20 • Utilizing FX swaps • Looking to ask PT Pertamina and PT Perusahaan Listrik Negara to review imports of capital goods and require the two companies to postpone infrastructure projects that are yet to tie-up funds • Review capital goods imports for big government projects
Potential measures			• Introduce an import tax/tariffs on 500 consumer goods

Source: Various online news sources

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