ICRA Indonesia

Monthly Economic Review
May/June 2014

Contacts:

Kreshna D. Armand
AVP Analyst
kreshna.armand@icraindonesia.com

Pradnya Desai
Manager-Rating Analyst
desai.pradnya@icraindonesia.com

Setyo Wijayanto
Manager-Rating Analyst
setyo.wijayanto@icraindonesia.com

+62 21 576 1516

www.icraindonesia.com

- **Inflation:** Year-on-year inflation rate slightly increased to 7.32% in May (vs. 7.25% a month earlier) as a benign ,inflation were recorded at 0.16%, contributed by an increase in processed food and utilities prices following electricity tariff elevation. Year to Date (YTD) inflation stood at 1.56% compared to 2.30% in the same period last year. The core inflation with administered and volatile prices excluded was at 4.82%. Inflation rates could further move up in coming months in anticipation of fasting month leading up to major festive event of Idul Fitri and further increase in electricity tariffs.

- **BI rate:** On June 12**,** the central bank (BI) decided to leave its benchmark interest rate unchanged at 7.5% for seven consecutive times. The decision was supported by current inflation rate which was still within BI's target for this year of 4.5±1%. It is also suggested that current level of interest rate benchmark was sufficient to keep inflation rate at bay while still giving a respite for economic growth. Previously, BI had concern on weakening GDP growth and revised it to 5.1%-5.5% from previously 5.5%-5.9%. In first quarter of 2014, the GDP growth was recorded at 5.2%.

- **Trade balance:** Trade balance dropped to a deficit of USD1.96bn in April after reporting a surplus of USD680 million in earlier month. The unprecedented deficit was reported in the non-oil and gas sector of USD901.5mn after consistently recording surplus for the last eight months. The dip was led by palm oil exports which fell almost 50% from March, nicking USD915mn off the exports, amid high inventory level in India and economic crunch in China. The trade deficit in oil and gas sector, on the other hand, paced down to USD1.06bn. Meanwhile, the imports increased due to seasonal factors (i.e. nearing fasting month). There was also an interesting uptick in capital expenditure in form of mechanical and electrical machinery which rose 18% month-on-month which could be a prelude to a pick-up in economic activities in the second quarter onwards. The imports were also supported by temporary strengthening in Rupiah around the month.

- **Foreign Reserves:** May's foreign reserves stood higher to USD107bn from USD105.6bn in April on account of a surplus in capital and financial transaction, supported by increased foreign inflow. During Jan-May 2014, the foreign fund inflow hovered around Rp130tn. That level of current reserve can now cover 6.2 months of imports (well above the international standard ratio of 3 months) or 6.0 months of imports and debt repayments.

- **Revised budget draft proposal:** Government has submitted the revised budget draft proposal to the parliament as summarized below:
  - The government predicted the fiscal deficit to reach 2.5% of GDP, higher than 1.7% stated previously, amid heightened energy subsidy and lower expected national income. The effect of heightened energy subsidy was partially compensated by budget cut in ministry and governmental institutions expenses in amount of Rp98.5tn – avoiding any significant inflationary hike as witnessed last year following the partial removal of fuel subsidy.
  - GDP growth was revised down to 5.5% from 6.0% amid global economic challenges marked by continued stimulus tapering in US, subdued growth in China's economy, and slow recovery in Euro zone. Domestically, uncertainty is borne by election period, compounded by lower tax revenue (decreasing by Rp48tn to Rp1,232tn) and lower non-tax revenue (in form of dividends which predicted to decrease by Rp22tn on account of lower contribution from mining companies due to exports ban).
  - Currency rate assumption was significantly revised, with Rupiah set at Rp11,700/USD after initially assumed at Rp10,500/USD.
  - Oil lifting was also revised lower at 818,000 barrel per day (bpd) from formerly 870,000bpd.
  - Inflation target as per government view was revised at a better level (the only positive revision) at 5.3% from 5.5% as economic growth is predicted to remain slow and inflation pressures mainly coming from supply scarcity issue still can be tamed.

- **Car & motorcycle sales:** The domestic car sales were down for two month in a row, to 98,198 units in May and 106,811 units in April from 113,079 units in March. The latter was mainly due to holidays that cut significant numbers of effective working days. On yearly performance, domestic car sales in May decreased by 1.5%, with April yoy increased 4.5%; leading to a year-to-date annual increase of 7.2%. In the opposite of car sales, domestic motorcycle sales grew to 743,030 units in May and 729,279 units in April from 725,629 units in March -- booking a year-to-date sales of 3.46 million units (year-on-year increase of 5.9%) with Honda (62% of market share) and Yamaha (32%) as the market leaders.

- **Jakarta Composite Index (JCI):** JCI was in speculative mood, at times boosted by several global economic indicators and domestic political sentiments leading up to ultimate presidential election. The market experienced a rather whirlwind period ended moderately positive, which opened at 4,840.15 at end of April and closed at 4,893.91 at the end of May, hitting as high as 5,031.57 in between. Despite the news of weakening economy, China's latest manufacturing index hit 50.8 – the fastest pace in 5 months. On the other end, US also showed improved job market, while Japan maintained its stimulus program and European Central Bank has cited to lower deposit rate which came into realisation just now, going into negative territory to spur lending. On June 12th, JCI closed at 4,934.41.

- **Rupiah:** The Rupiah continued its weakening trend against US Dollar in May, brushed off by continuing stimulus tapering in US for four consecutive months, leaving the level of monthly asset buying at USD45bn, with the uncertainty in the next government's leadership still lingers plus the seasonal factor of debt repayment period. The Rupiah closed at 11,611 per US Dollar at the end of May compared to 11,532/USD one month before. It continued to slip to 11,813/USD on June 12 based on those factors.

- **Bond Yield:** The 10-year government bond yield rose slightly to 8.21% at end of May from 8.09% at end of April, with trade balance performed worse than expected and rally in US Treasury amid the continued paring of asset purchases by The Fed. Continued benign inflation can act as the likely refuge of such yield escalation. On June 12, the yield retraced to 8.17%.

- **Commodities**

  - **Oil:** Crude oil prices gained in the month of May after declining in April. As on May 30, 2014, the Western Texas Intermediate /WTI prices stood at USD 103.00 per barrel, a recovery from the previous month's USD 99.27 per barrel. The prices rose in reaction to stronger growth signal given out through various positive economic data releases in the month of May, including US, China and Japan, which indicated upcoming increase in demand. These were partially countered by several world events such as continued deadlock within Ukraine, unrest in Libya etc, which create possibilities of supply disruptions. As on June 12, the WTI prices have risen further to USD 105.98 per barrel, on mounting supply disruption concerns over turmoil in Iraq.

- **Coal:** Coal prices on the other hand continued their downtrend. As on May 30, the coal closed at USD 73.15 per ton, down from USD 73.55 per ton towards the end of April. As on June 10, the price decreased further to USD 72.25 per ton. Coal cycle has overall entered a downturn, reaching its 4.5 year low in March 2014. The price by now is fast approaching the half of its 2011 peak of USD 136.3 per ton. Low coal prices have been driven by global recession and downturn cycles within its end user industries. While some economic data releases have indicated improvement in the main consumer geographies, the prices of coal have not replicated such improvement. On June 12, it got corrected further to 72.15%

- **CPO**: The price of CPO also continued their decline in May, closing at USD 754.05 per ton from April's USD 804.01 per ton. The decline towards the end of May was based on an expectation of oversupply – whereby the CPO stock levels are expected to reach between 2 to 2.5 million tons at the end of 2014, similar to the historical high in 2012. This is also supported by the expectation that Indonesia and Malaysia, the world's largest palm oil producers, would also end up producing higher in 2014. CPO prices declined further to USD 746.81 on June 12. However, the recent news on El Nino's impact to the palm oil production is expected to result in recovery of CPO prices.

- **Gold:** Gold too has continued its decline into month of May, closing at USD 1,254.1 per ounce as compared to USD 1,283.80 per ounce at the end of April. The gold outlook has been bearish in parallel to the US Federal Reserve's winding down of its bond buying program. While Ukraine crisis has so far not impacted this downtrend significantly, its continuance may lead to investors shifting to the established safe haven. Further, the recent announcement of India's easing the gold import may lead to surge in demand from the country, which may drive up the gold prices. Gold already recovered at USD 1,266.30 as on June 12.

- **Others:** The government and the parliament have agreed to raise the electricity tariff in July to November 2014 for 6 types of consumers with a raise by:
  - 11.57% every two month for non-listed industries type I-3
  - 5.7% every two month for households type R-2 (3500-5500VA)
  - 5.36% every two month for government institution type P-2 (200KVA)
  - 10.43% every two month for households type R-1 with 2200VA
  - 10.69% every two month for general public lightings type P-3
  - 11.63% every two month for households type R-1 with 1300VA.

© Copyright, 2014, ICRA Indonesia. All Rights Reserved.

All information contained herein has been obtained by ICRA Indonesia from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Indonesia in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Indonesia shall not be liable for any losses incurred by users from any use of this publication or its contents.