A preliminary update on corporate Indonesia

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Summary

- The Indonesian corporate sector appears to be hit with declining revenue growth in Q2-2023, a testament to the challenging competitive and demand conditions faced by the business sector throughout the quarter.
- The domestic business sector may face a more favourable competitive condition in the upcoming periods. However, fiscal interventions may still be necessary to stimulate the domestic aggregate demand condition.
- A robust short-to-medium demand outlook continues to encourage businesses to expand. However the strong CAPEX amidst the weakening revenue growth may lead to an increase in leverage.

- Last week's global macroeconomic developments were highlighted by significant policy announcements from two central banks. First, despite the identical move with ECB, the Fed's decision to raise the Fed funds rate by an additional 25bps amidst weakening inflationary pressures could mark a shift from outright rate hikes to a prolonged 'hawkish' hold. The other, arguably more surprising development is the hawkish policy shift from the Bank of Japan (BoJ). The BoJ announced that the 0.5% target under the yield curve control (YCC) policy would now serve as a reference point rather than a hard target, resulting in a 15bps increase in 10Y JGB yields after the meeting.
- The BoJ's decision to introduce greater flexibility to the YCC policy could encourage more Japanese money to come home, which may result in higher yields on US treasuries and other financial assets. Fortunately, the impact on the Indonesian financial market seems to be limited, as there has been little change in foreign investors' appetite for IDR-denominated assets.
- Indeed, the Indonesian financial market recorded capital inflows to the tune of USD 214.2 Mn last week, with USD 153.87 flowing into the domestic bond market. Foreign investors also continue to exhibit interest in the domestic stock market, as evidenced by the USD 60.3 Mn in net foreign buys throughout last week. The continuing capital inflow trend to the bond and stock market is encouraging, as it indicates foreign investors' optimistic outlook on the corporate sector and the Indonesian economy as a whole.

The Indonesian corporate sector: A glass half-full

- We took a look at 246 companies (excluding financial institutions) that have reported their Q2-2023 financial statements before the market opens on 31 July 2023 to examine whether the domestic corporate sector is doing as well as investors might be expected in Q2-2023.
- First, we observed an above-trend CAPEX growth in Q2-*2023* ***(see Chart 2 - CAPEX)***, continuing the trend in the past three quarters which indicates strong confidence in the business sector. CAPEX realisation is especially prevalent in a handful of sectors, namely healthcare service providers and commodity producers. The increase in CAPEX realisation by companies in the healthcare sector could be a function of the proposed law on healthcare (RUU Kesehatan), which, by limiting incentives for Indonesians to seek healthcare abroad, would help to boost hospital occupancy in tier-1 cities while also supporting hospital expansions to tier-2 and tier-3 cities throughout Indonesia.
- Meanwhile, two factors explain the ongoing CAPEX cycle in the commodity-producing sector. First, the widening geopolitical rift may sustain commodity prices at relatively high levels over a prolonged period. Additionally, despite the vociferous support to limit the use of dirty fuels (particularly those imported from Russia), the gap in renewable energy production capacity means that electrification and other ESG initiatives may lead to an increase in demand for carbon-emitting fuels. The still-favourable outlook for fuel demand in the short-to-medium term limits the risk for commodity producers, thus providing them with incentives to expand production.
- The second, and arguably the determining factor that explains the ongoing CAPEX cycle in the commodity-producing sector is the supernormal profit obtained by commodity producers in the past two years. The cash-rich business sector following the commodity boom explains the disconnect between CAPEX realisation and businesses' balance sheet conditions. Indeed, the domestic corporate sector appears to be in a de-leveraging mode through-out Q4 2021 – Q2 2023 ***(see Chart 3 – Balance sheet),*** opting to fund their investment projects with retained earnings as revealed in Bank Indonesia's monthly financing survey.

> ***"Supernormal profits obtained by the corporate sector in the past two years explain the still-strong CAPEX cycle "***

- This dynamic had resulted in situations of the past, where loans were growing slower than nominal GDP, and indeed until the middle of last year, they grew more slowly than deposits too. At present, however, the condition appears to have changed due to some overtakes ***(see Chart 4 – GDP vs Loan vs DPK).*** The first overtake was between loans and deposits, which was triggered by the decline in commodity prices halfway into the last year. The accelerating loan growth amidst downturns in the commodity market shows corporate Indonesia's ability to continue expanding despite the weakening market condition, as businesses could replace retained earnings to fund expansion projects by winding down their cash pile or taking more leverage.

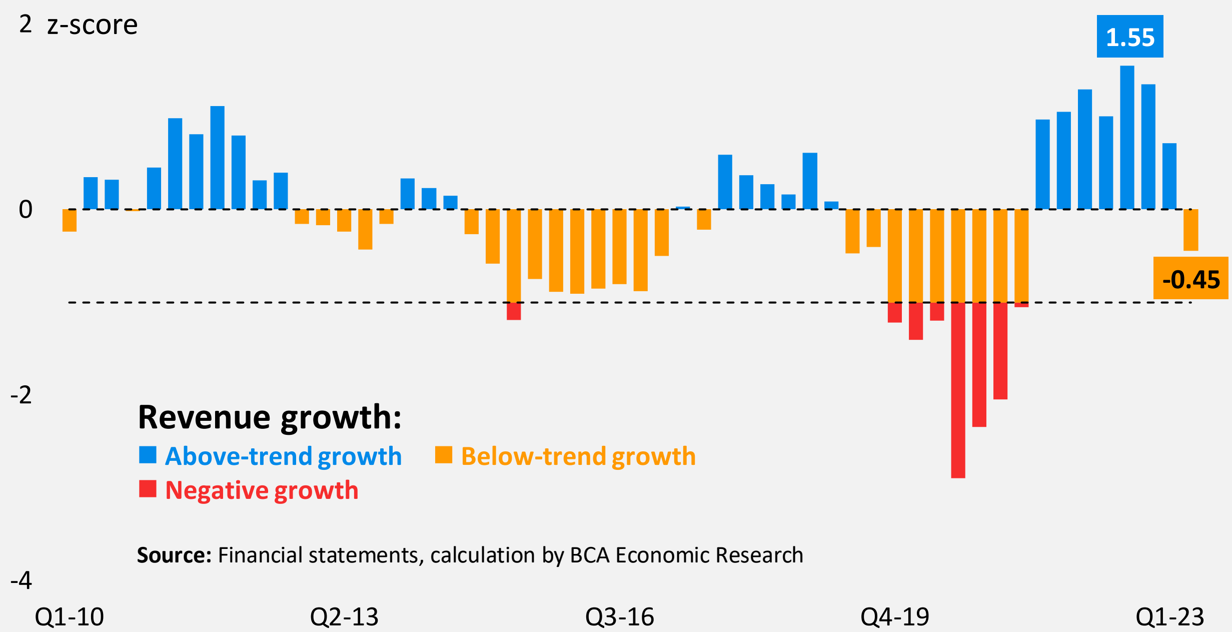
- But now we might be seeing another overtake, this one between loans and nominal GDP. This wheel-to-wheel action only comes to be as the latter slows down more significantly than the former, which is not a bullish signal. Nonetheless, given the corporate sector's overall lower indebtedness post-pandemic, the potential increase in leverage may not create undue credit risk in the future. Neither is the gap between loan and nominal GDP growth too wide, as was the case during the 2010-14 commodity boom, which probably limits the downsides should the expected revival of commodity prices not pan out.
- The slowing nominal GDP growth, of course, is paralleled by weakening revenue growth ***(see Chart 1 – revenue trend)***. Indeed, the landscape in Q2-2023 is a challenging one for the domestic corporate sector. The normalising commodity prices have hit exporters' earnings while slowing domestic consumption amidst increasing competition from imported goods highlighting the challenge for traders and manufacturers. The slowdown in business sector revenue in the previous quarter, as also reflected by our business transaction index, strengthens our conviction that the Indonesian economy may be running at a slower pace in Q2-2023 relative to the previous quarter, although some improvement may come in the second half of the year.
- Indeed, as also believed by those in the corporate sector by virtue of their strong CAPEX growth, this challenging situation in the domestic business sector may not drag on for too long. First, the weakening USD value may spark another rally in the commodity market. Moreover, China's declining goods inventory (-0.1% YoY in Jun-23) amidst the contraction in manufacturing activities in the past four months (NBS manufacturing PMI, 49.3 in Jul-23) would also tip the competitive balance in favour of domestic manufacturers.
- Alas, while reduced competition from importers would provide some help for domestic manufacturers, it does not explain how consumption would improve in subsequent months. Given the still-significant exchange rate risks, we maintain our view that fiscal expansions should take precedence in stimulating consumption in the near term, a policy the government shall find no complications to execute given the IDR 600 – 775 Tn still available in the budget for the government to spend.

"The improving competitive landscape means that the drag in corporate revenue may not last for long"

Chart 1

Short-term pain…

The slowing revenue growth highlights the challenge facing the business sector in Q2-2023, but the situation may soon pass given the government's anticipated fiscal expansion

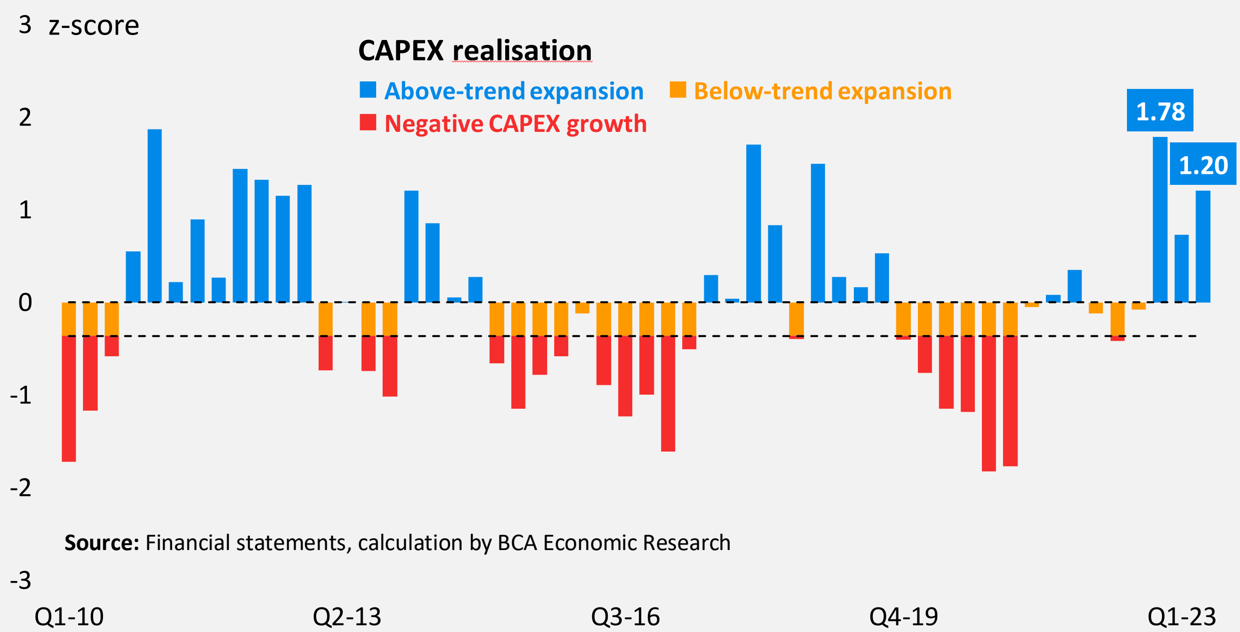


Source: Financial statements, calculation by BCA Economic Research

Chart 2

…Long-term gain?

Limited risk of demand uncertainty in the short-to-medium term encourage businesses to continue to expand despite the challenging situation in the short term

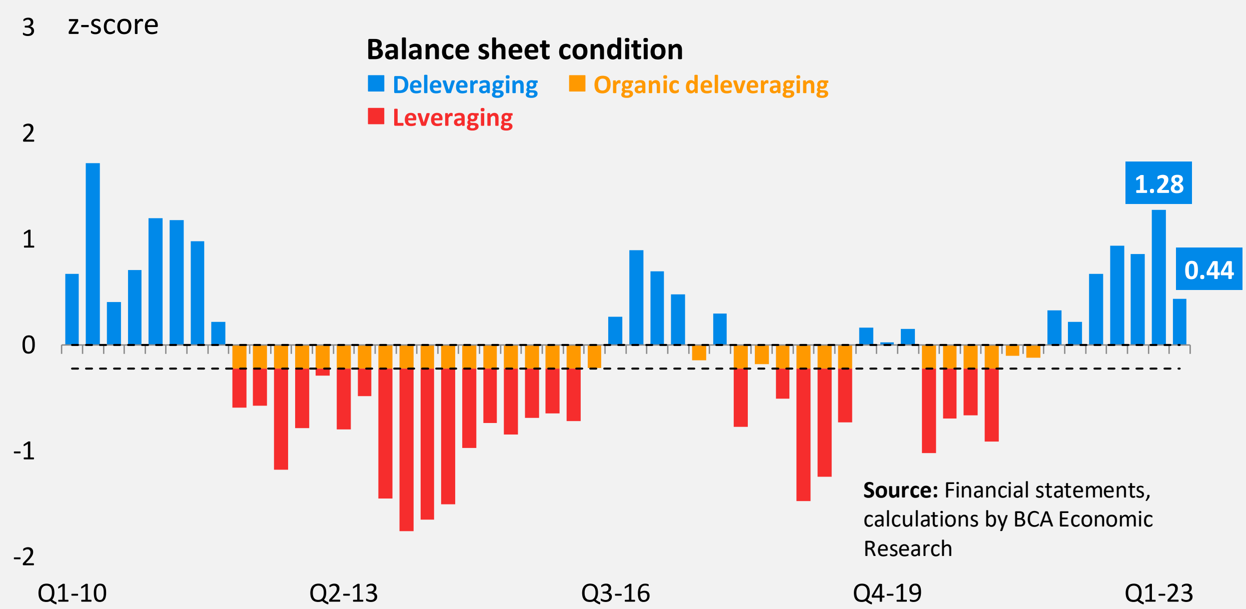


Source: Financial statements, calculation by BCA Economic Research

Chart 3

~~Save~~ Borrow to grow

Lower revenue led some businesses to increase their leverage rather than reduce their investments despite some increases in financing costs

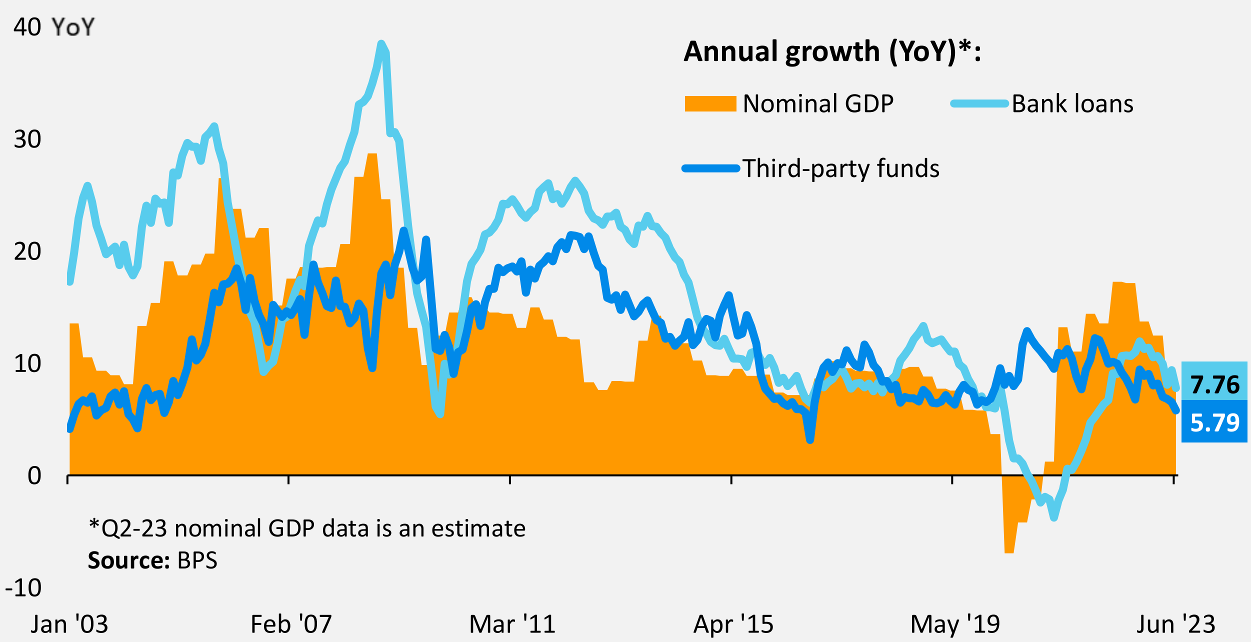


Source: Financial statements, calculations by BCA Economic Research

Chart 4

Expands at all costs?

The narrowing gap between nominal GDP and loan growth indicates businesses' increasing willingness to take more leverage to fund their investments



*Q2-23 nominal GDP data is an estimate

Source: BPS

Economic Calendar

		Actual	Previous	Forecast*
3 July 2023				
ID	S&P Global Manufacturing PMI	52.5	50.3	50.6
ID	**Inflation Rate YoY**	**3.52%**	**4.0%**	**3.6%**
US	ISM Manufacturing PMI	46	46.9	46.3
6 July 2023				
US	Balance of Trade (USD Bn)	-69.0	-74.6	-68.7
7 July 2023				
ID	**Foreign Exchange Reserves (USD Bn)**	**137.5**	**139.3**	**139.0**
CN	Foreign Exchange Reserves (USD Tn)	3.19	3.18	3.1
10 July 2023				
CN	Inflation rate YoY	0%	0.2%	0.1%
ID	Consumer Confidence	127.1	128.3	128
ID	Motorbike Sales YoY	66.6%	113.4%	-
12 July 2023				
US	Inflation rate YoY	3.0%	4.0%	3.6%
13 July 2023				
CN	Balance of Trade (USD Bn)	70.6	65.8	68.0
ID	Car Sales YoY	4.6%	65.2%	-
14 July 2023				
EU	Balance of Trade (USD Eur)	- 0.3	-11.7	-16.4
ID	Retail Sales YoY	-4.5%	1.5%	-
17 July 2023				
CN	GDP Growth Rate YoY	6.3%	4.5%	5.8%
ID	**Balance of Trade (USD Bn)**	**3.46**	**0.44**	**1.2**
21 July 2023				
ID	Foreign Direct Investment YoY	14.2%	20.2%	-
25 July 2023				
ID	Loan Growth YoY	7.76	9.39%	-
ID	**Bank Indonesia policy announcement**	**5.75%**	**5.75%**	**5.75%**
27 July 2023				
US	**Fed Interest Rate Decision**	**5.5%**	**5.25%**	**5.5%**
ID	M2 Money Supply YoY	6.1%	6.1%	-
EU	ECB rate (Main refinancing operation)	4.25%	4.00%	4.25%

*Forecasts of some indicators are simply based on market consensus
Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Jul-23	2.50
UK	5.00	Jul-23	-2.90
EU	4.25	Jul-23	-1.25
Japan	-0.10	Jan-16	-3.40
China (lending)	4.35	Jul-23	4.35
Korea	3.50	Jul-23	0.80
India	6.50	Jun-23	1.69
Indonesia	5.75	Jul-23	2.23

Money Mkt Rates	28-Jul	-1 mth	Chg (bps)
SPN (1M)	4.88	4.57	31.3
SUN (10Y)	6.26	6.24	2.0
INDONIA (O/N, Rp)	5.57	5.91	-34.5
JIBOR 1M (Rp)	6.40	6.40	0.5

Bank Rates (Rp)	May	Apr	Chg (bps)
Lending (WC)	8.93	8.92	0.35
Deposit 1M	4.19	4.18	1.37
Savings	0.67	0.67	0.00

Currency/USD	28-Jul	-1 mth	Chg (%)
UK Pound	0.778	0.784	0.80
Euro	0.908	0.912	0.50
Japanese Yen	141.2	144.1	2.06
Chinese RMB	7.149	7.224	1.06
Indonesia Rupiah	15,095	14,993	-0.68

Capital Mkt	28-Jul	-1 mth	Chg (%)
JCI	6,900.2	6,661.9	3.58
DJIA	35,459.3	33,926.7	4.52
FTSE	7,694.3	7,461.5	3.12
Nikkei 225	32,759.2	32,538.3	0.68
Hang Seng	19,916.6	19,148.1	4.01

Foreign portfolio ownership (Rp Tn)	Jun	May	Chg (Rp Tn)
Stock	2,755.0	2,738.1	16.95
Govt. Bond	846.9	829.4	17.53
Corp. Bond	11.3	11.8	-0.47

Trade & Commodities	28-Jul	-1 mth	Chg (%)
Baltic Dry Index	1,110.0	1,183.0	-6.2
S&P GSCI Index	590.9	533.7	10.7
Oil (Brent, $/brl)	85.0	72.3	17.6
Coal ($/MT)	148.0	151.2	-2.1
Gas ($/MMBtu)	2.53	2.67	-5.2
Gold ($/oz.)	1,959.5	1,913.7	2.4
Copper ($/MT)	8,625.5	8,382.0	2.9
Nickel ($/MT)	22,079.0	20,581.0	7.3
CPO ($/MT)	873.3	797.5	9.5
Rubber ($/kg)	1.29	1.29	0.0

External Sector	Jun	May	Chg (%)
Export ($ bn)	20.61	21.71	-5.08
Import ($ bn)	17.15	21.28	-19.40
Trade bal. ($ bn)	3.45	0.43	708.66
Central bank reserves ($ bn)*	137.5	139.3	-1.28

Prompt Indicators	Jun	May	Apr
Consumer confidence index (CCI)	127.1	128.3	126.1
Car sales (%YoY)	4.7	65.2	-28.8
Motorcycle sales (%YoY)	66.6	113.4	-19.4

Manufacturing PMI	Jun	May	Chg (bps)
USA	46.0	46.9	-90
Eurozone	43.4	44.8	-140
Japan	49.8	50.6	-80
China	50.5	50.9	-40
Korea	47.8	48.4	-60
Indonesia	52.5	50.3	220

Source: Bloomberg, BI, BPS
Notes:
Car and motorcycle sales data to be released on the third week of January 2022
^Data for January 2022
*Data from an earlier period
For changes in currency: **Black indicates appreciation against USD, **Red** otherwise
***For PMI, **>50** indicates economic expansion, **<50** otherwise

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Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3	5.0
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.3
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	35.3
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.7

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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