An update on corporate Indonesia:

Jousting for liquidity?

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Summary

- Recent global macroeconomic developments relieve the pressure on Indonesia's financial market, foreign inflows to the domestic stock market appear to be limited given the corporate sector's less-stellar revenue growth in Q3 2023.
- Despite the weakening revenue growth, the domestic corporate sector benefits from improved efficiency while maintaining a high appetite for CAPEX expansion.
- The persistent CAPEX trend amid weakening income growth may increase the private sector's demand for funding in the coming periods, unless the now-higher real interest rates start to induce forced savings in the private sector.

- Foreign investors have put the Indonesian market under siege in the past few months. Fortunately, the siege appears to be broken in the last week. Jolted by the Fed's decision not to hike its policy rate by another 25bps in the latest FOMC meeting (also, the weak labour market data in the US and the minimal tweak in Bank of Japan's YCC policy), foreign investors poured USD 419.88 Mn into the Indonesian bond market, lowering the 10Y SBN yield below the 7% mark. It is important to note, however, that the rally in the bond market last week was also observed in other markets ***(see Chart 1)*** – indicating that the recent appreciation in the value of Indonesian government bonds is more of a product of shifting global rate expectations rather than improving domestic conditions.
- Despite the watershed of foreign capital inflows into the domestic bond market, foreign investors continue to display a more measured attitude toward the Indonesian stock market, as evident from the USD 158.66 Mn in net capital outflows observed in the past week. First, we should recall that domestic conditions have not changed much in the domestic bond or capital markets.
- Unlike the Fed, Bank Indonesia's recent policy pivot is not expected to be a one-time hit, as indicated by the continuous increase in rates awarded on recent SRBI auctions (reaching 6.92% on 3 Nov 2023). The recent earnings season also suggests a decline in the rigour of the domestic corporate sector, essentially putting the domestic stock market between the Scylla of higher (for longer) discount rates and Charybdis of declining earnings yield. We move our discussion, then, to another update of our observation on Indonesia's corporate sector.

A case for a brake on private sector's spending

- Many analysts have pointed to the narrowing gap between bond yields and stock earnings yields as a source of volatility in the market throughout 2023. While this analysis might be more suitable to describe the current condition in the US stock market, investors may see some resemblance to this condition in the Indonesian stock market as well ***(see Chart 2)***. Despite major domestic banks reporting positive financial results, our study shows that the domestic non-financial corporate sector reported negative revenue growth in Q3 2023 ***(see Chart 3)***, confirming a trend that has been observed for some time in our BCA Business Transaction Index.
- The already negative revenue growth hid two still positive things behind it. First, companies in more domestically-oriented sectors enjoyed an increase in their aggregate revenue in the past quarter, a testament to the still-strong domestic demand in the past quarter. Second, domestic companies' limited ability to raise prices (and thus, their declining YoY revenue growth) does not seem to be a harbinger of a race-to-the-bottom dynamic. Companies in multiple sectors reported an improving operating margin in Q3 2023 ***(see Chart 4)***, including the commodity-producing sector. It could be said then, that despite the weakening revenue growth, the domestic corporate sector appears to benefit from a healthy level of profits in Q3 2023.

"Despite the weakening revenue growth, companies in some sectors appear to benefit from higher cost efficiency"

- It might be worthwhile to extend our discussion to likely factors behind corporate Indonesia's improving cost efficiency. The domestic corporate sector, it appears, continues to benefit from lower import prices, which in some parts is a product of China's strategy of 'exporting' itself out of the ongoing economic slump. The 24.01% YTD decline in shipping costs may also explain the corporate sector's improving cost efficiency, especially for companies in the goods-importing sector such as retailers in the consumer discretionary sector.
- The weakening Rupiah and spiking global food prices in the past quarter, however, may have a detrimental impact on some sectors unable to limit their exposure to the global supply chain, such as the food products and consumer staples sector which tends to be dependent on the global market for their raw materials. Under a normal situation, businesses may be able to shift the extra cost arising from turbulent external conditions toward their consumers. However, as mentioned earlier, the declining liquidity condition in the household sector may heighten their sensitivity to changes in the price level, hence forcing companies in the consumer staples sector to bear some of the extra cost.
- Another theme that continues to colour the domestic corporate sector is the still-ongoing CAPEX cycle. Corporate Indonesia's CAPEX growth trend appears to have strengthened in the past quarter ***(see Chart 5)***, driven by sectors such as coal and consumable fuels, diversified metals and mining, and integrated telecommunication services, which is congruent with the latest DDI figure and fixed-asset investments' higher contribution to

Indonesia's real GDP growth in Q3 2023 (1.81% out of 4.94% YoY from 1.39% out of 5.17% YoY in Q2 2023).

- Despite the already negative revenue growth, it is hardly surprising why corporate Indonesia remains keen to spend on CAPEX. The three sectors contributing the most to the YoY CAPEX growth in Q3 2023 are closely aligned with the government's emphasis on infrastructure development and industrialisation (through mineral down-streaming) programmes. Relative newcomers in the green-related sector also contributed to the spiking CAPEX growth in Q3 2023, although their financial data is yet to be included in our dynamic cohort study given the limited availability of their time series data.
- Despite its importance to Indonesia's long-term economic transformation, continued CAPEX amidst the slowing trend of revenue growth (especially in the commodity-producing sector) may pose some short-term risks to the other part of the economy. Higher demand for machinery and other capital goods may lead to higher imports at a time when anaemic commodity prices reduce Indonesia's revenue from exports. The still-strong CAPEX may contribute to keeping Indonesia's CA balance on the deficit territory; a condition that may add some downward pressure to the Rupiah given the strong inverse relationship between the currency's value and higher needs for domestic FX financing.
- Another factor that may explain corporate Indonesia's eagerness for more CAPEX spending is the still-ample liquidity buffer in the domestic private sector, which also explains domestic companies' continued willingness to limit their debt exposure in Q3 2023 ***(see Chart 6)***. The trend of deleveraging in domestic companies' balance sheets, however, seems to have passed its peak. While companies in some sectors could continue to tap into their liquidity coffers, weakening revenue growth may have limited some companies' ability to continue self-funding their operational and investment needs.
- Given Indonesia's bank-based financial systems model, the domestic corporate sector's higher demand for financing should provide some wind for the domestic banking sector. Indeed, the weakening corporate deleveraging trend in Q3 2023 coincides with the general shift in banks' focus towards more lending, while activities in the corporate bond market remain limited other than a seasonal spike in August 2023.
- As with our reading on the corporate sector's still-strong CAPEX realisation trend, the weakening corporate deleveraging trend may also pose a problem for BI's effort to maintain financial sector stability in the short term. The domestic private sector's recently increasing demand for financing may lead to competition for liquidity with the public sector, which is also in need of higher financing given the substantial fiscal commitments and the slew of maturing government bonds early in the next year. Thus, given the government's seemingly limited room to reduce their fiscal spending, a higher real rate environment might be needed to compel some measure of forced savings within the domestic private sector. Such a reading strengthens our conviction that it is more likely than not for BI to continue raising the policy rate in the upcoming meeting, despite the hitherto easing external pressure and the somewhat underwhelming GDP growth data in Q3 2023.

Chart 1

The one side of the coin

Rather than the strengthening domestic situation, euphoric attitudes toward the Fed's recent pause explain the rally in Indonesia (and other) bond markets

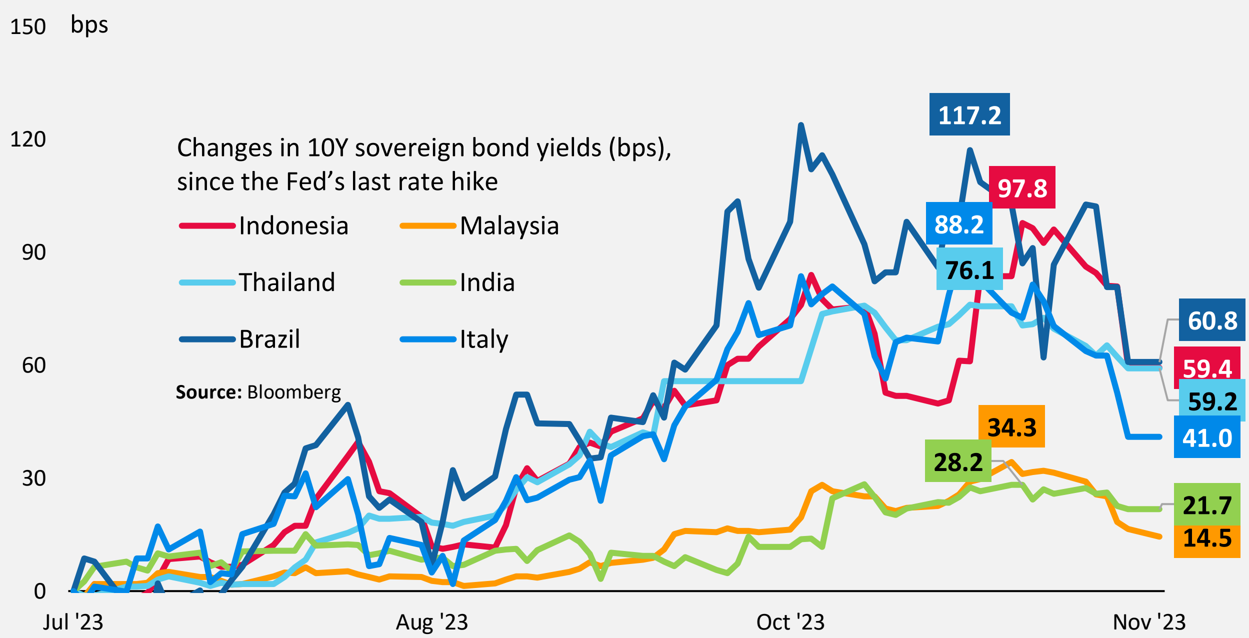


Chart 2

The other side of the coin

Foreign inflows to the domestic stock market remain limited relative to the bond market as the declining earnings yield may encourage foreign investors to look for other opportunities

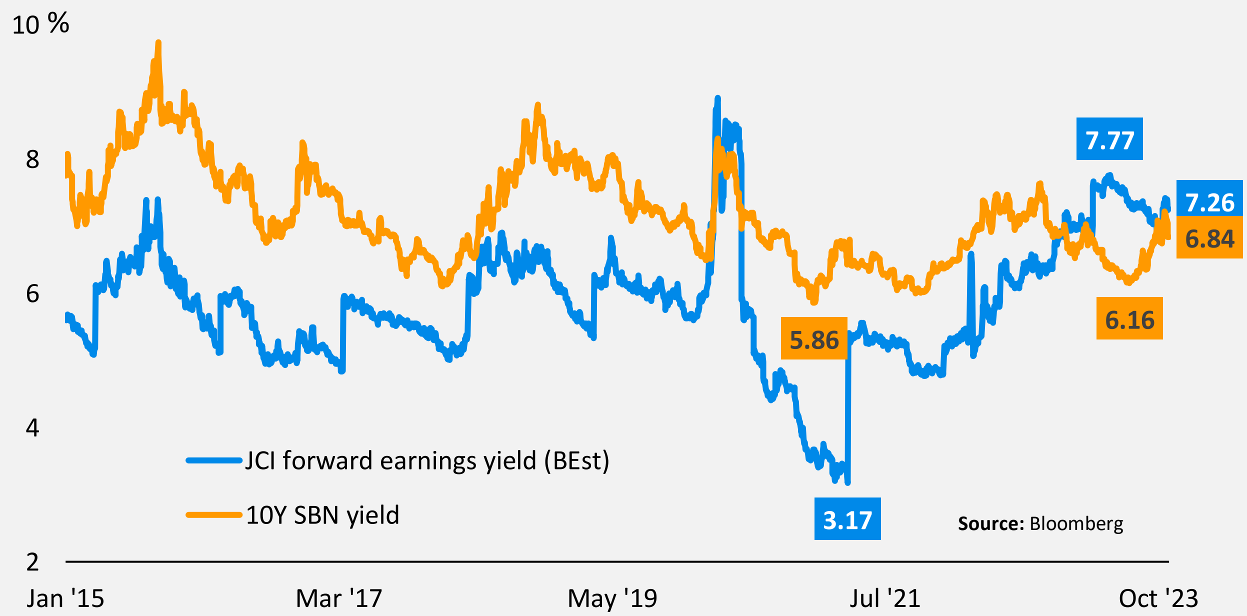
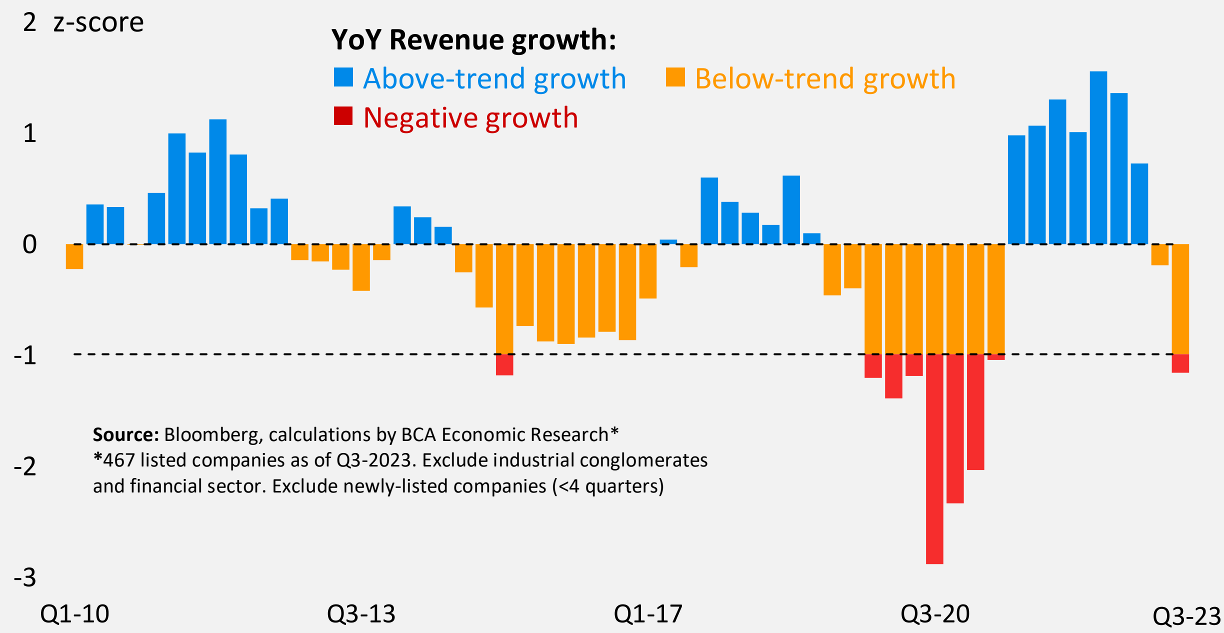


Chart 3

Business may be drying…

The falling commodity prices suppress corporate Indonesia's revenue growth, although companies in more domestic-oriented sectors still fare better

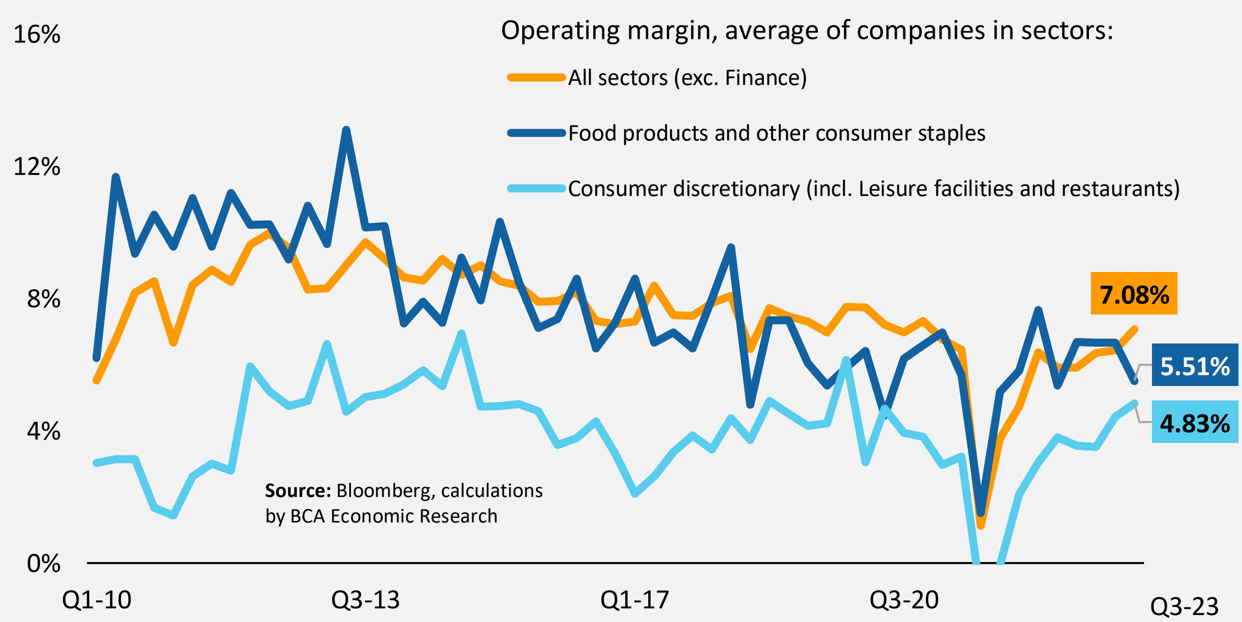


Source: Bloomberg, calculations by BCA Economic Research*
*467 listed companies as of Q3-2023. Exclude industrial conglomerates and financial sector. Exclude newly-listed companies (<4 quarters)

Chart 4

…but efficiency is the key

Despite the slowing revenue growth, Indonesia's corporate sector seems to benefit from higher profitability in Q3 2023 although higher food prices start to haunt companies in the consumer



Source: Bloomberg, calculations by BCA Economic Research

Chart 5

Full throttle

The corporate sector's continued CAPEX spending may lock Indonesia's CA in a deficit, especially given the decline in export-driven revenues

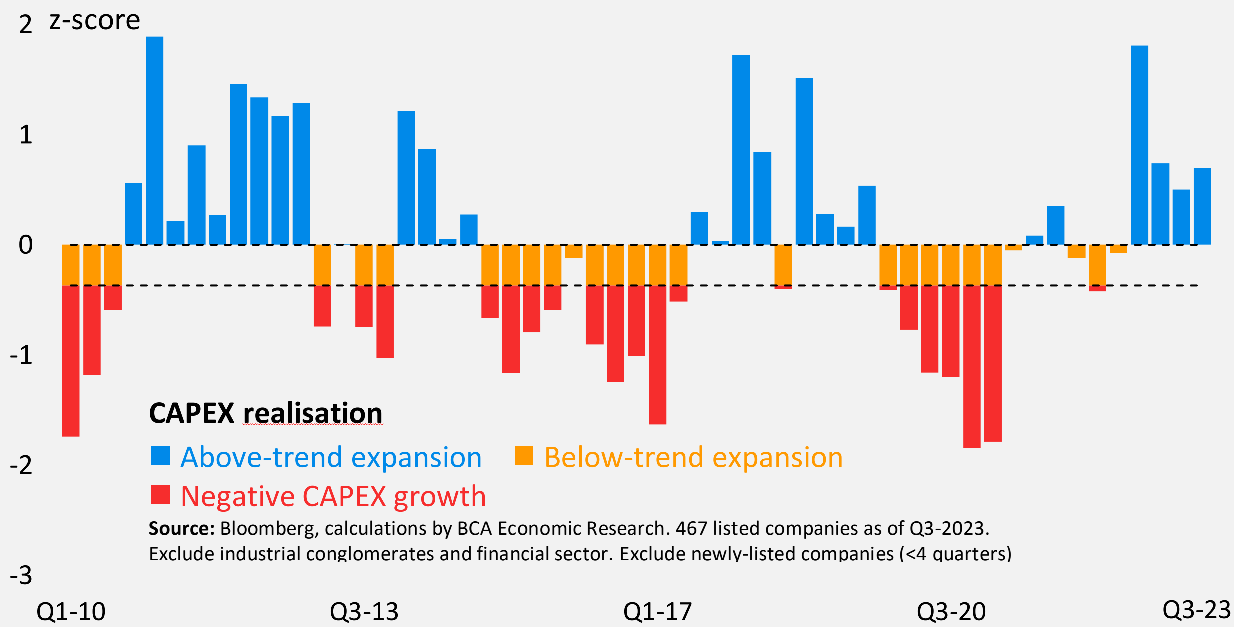
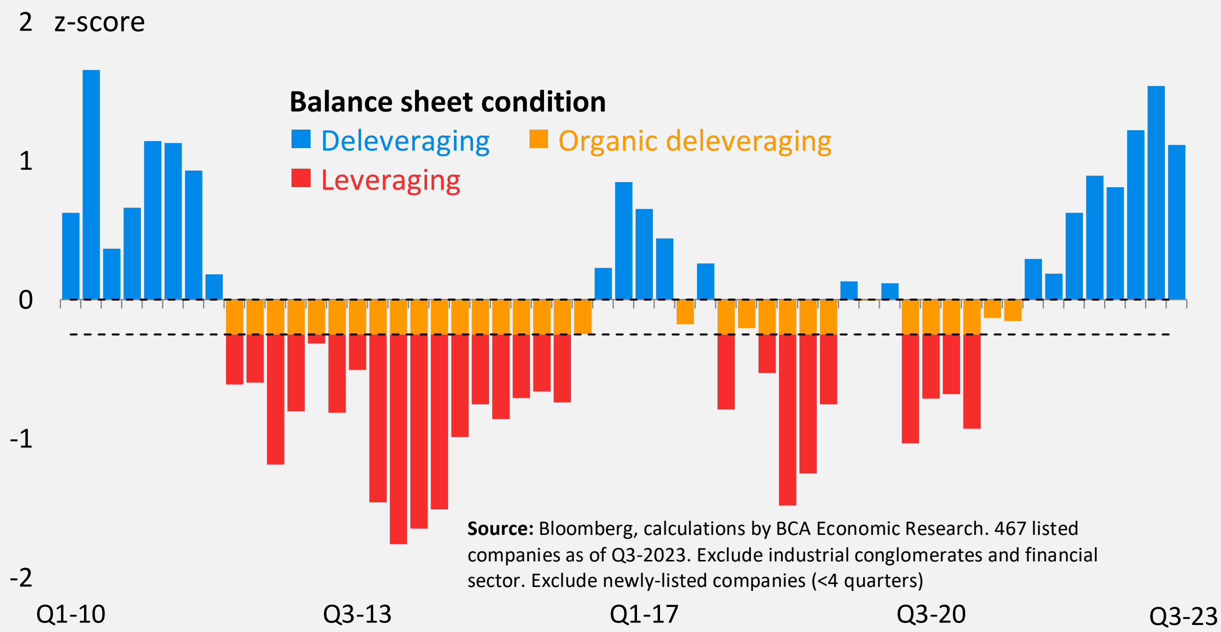


Chart 6

Banks' coming back in the picture

Ample liquidity conditions continue to fuel the deleveraging trend within the corporate sector, but the trend might continue to diminish in the upcoming periods



Economic Calendar

		Actual	Previous	Forecast*
1 November 2023				
ID	**Inflation rate YoY**	**2.56%**	**2.28%**	**2.4%**
ID	S&P Global Manufacturing PMI	51.5	52.3	52.0
US	ISM Manufacturing PMI	46.7	49	49.5
CN	Caixin Manufacturing PMI	49.5	50.6	50.8
3 November 2023				
US	Unemployment Rate	3.9%	3.8%	3.8%
US	Non-Farm Payroll (*thousand*)	150	336	190
6 November 2023				
ID	**GDP Growth Rate YoY**	**4.94%**	**5.17%**	**5.05%**
7 November 2023				
CN	Balance of Trade (USD Bn)	-	77.7	81.0
US	Balance of Trade (USD Bn)	-	-58.3	-59.5
ID	**Foreign Exchange Reserves (USD Bn)**	-	134.9	-
8 November 2023				
ID	Consumer Confidence	-	121.7	-
9 November 2023				
CN	Inflation Rate YoY	-	0.1%	0.2%
ID	Retail Sales YoY	-	1.1%	2.9%
14 November 2023				
US	Inflation Rate YoY	-	3.7%	3.8%
ID	Motorbike Sales YoY	-	-0.9%	-
ID	Car Sales YoY	-	-20.1%	-
15 November 2023				
EU	Balance of Trade (EUR Bn)	-	3.42	-
ID	**External Debt (USD Bn)**	-	395	
ID	**Balance of Trade (IDR Bn)**	-	6.7	22.3
ID	Export YoY	-	16.1%	-
ID	Import YoY	-	12.4%	-
17 November 2023				
ID	**Current Account (USD Bn)**	-	-1.9	-0.9
CN	Balance of Trade (USD Bn)	-	68.36	64.0
23 November 2023				
ID	Loan Growth YoY	-	8.9%	-
ID	**Interest Rate Decision**	-	6%	6%

*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	Nov-23	1.80
UK	5.25	Nov-23	-1.45
EU	4.50	Nov-23	1.60
Japan	-0.10	Jan-16	-3.10
China (lending)	2.50	Oct-23	4.35
Korea	3.50	Oct-23	-0.30
India	6.50	Oct-23	1.48
Indonesia	6.00	Oct-23	3.44

Money Mkt Rates	3-Nov	-1 mth	Chg (bps)
SPN (1M)	6.15	6.17	-2.0
SUN (10Y)	6.84	7.01	-16.3
INDONIA (O/N, Rp)	5.82	5.60	21.4
JIBOR 1M (Rp)	6.66	6.40	26.0

Bank Rates (Rp)	Jul	Jun	Chg (bps)
Lending (WC)	8.95	8.93	2.84
Deposit 1M	4.24	4.19	4.92
Savings	0.67	0.67	-0.41

Currency/USD	3-Nov	-1 mth	Chg (%)
UK Pound	0.808	0.828	2.51
Euro	0.932	0.955	2.52
Japanese Yen	149.4	149.0	-0.25
Chinese RMB	7.275	7.298	0.31
Indonesia Rupiah	15,728	15,580	-0.94

Capital Mkt	3-Nov	-1 mth	Chg (%)
JCI	6,788.9	6,940.9	-2.19
DJIA	34,061.3	33,002.4	3.21
FTSE	7,417.7	7,470.2	-0.70
Nikkei 225	31,949.9	31,237.9	2.28
Hang Seng	17,664.1	17,331.2	1.92

Foreign portfolio ownership (Rp Tn)	Oct	Sep	Chg (Rp Tn)
Stock	2,895.1	2,833.3	61.89
Govt. Bond	809.3	823.0	-13.66
Corp. Bond	11.3	10.8	0.52

Trade & Commodities	3-Nov	-1 mth	Chg (%)
Baltic Dry Index	1,462.0	1,780.0	-17.9
S&P GSCI Index	577.9	600.3	-3.7
Oil (Brent, $/brl)	84.9	90.9	-6.6
Coal ($/MT)	130.0	153.4	-15.3
Gas ($/MMBtu)	3.00	2.72	10.3
Gold ($/oz.)	1,992.7	1,823.0	9.3
Copper ($/MT)	8,095.7	7,929.0	2.1
Nickel ($/MT)	17,984.5	18,450.5	-2.5
CPO ($/MT)	775.5	777.4	-0.2
Rubber ($/kg)	1.47	1.39	5.8

External Sector	Sep	Aug	Chg (%)
Export ($ bn)	20.76	22.00	-5.63
Import ($ bn)	17.34	18.88	-8.15
Trade bal. ($ bn)	3.42	3.12	9.61
Central bank reserves ($ bn)*	134.9	137.1	-1.60

Prompt Indicators	Sep	Aug	Jul
Consumer confidence index (CCI)	121.7	125.2	123.5
Car sales (%YoY)	-20.1	-8.3	-6.7
Motorcycle sales (%YoY)	-0.9	1.8	45.6

Manufacturing PMI	Oct	Sep	Chg (bps)
USA	46.7	49.0	-230
Eurozone	43.1	43.4	-30
Japan	48.7	48.5	20
China	49.5	50.6	-110
Korea	49.8	49.9	-10
Indonesia	51.5	52.3	-80

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	5.1
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.6
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.25
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	16,114
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	32.8
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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