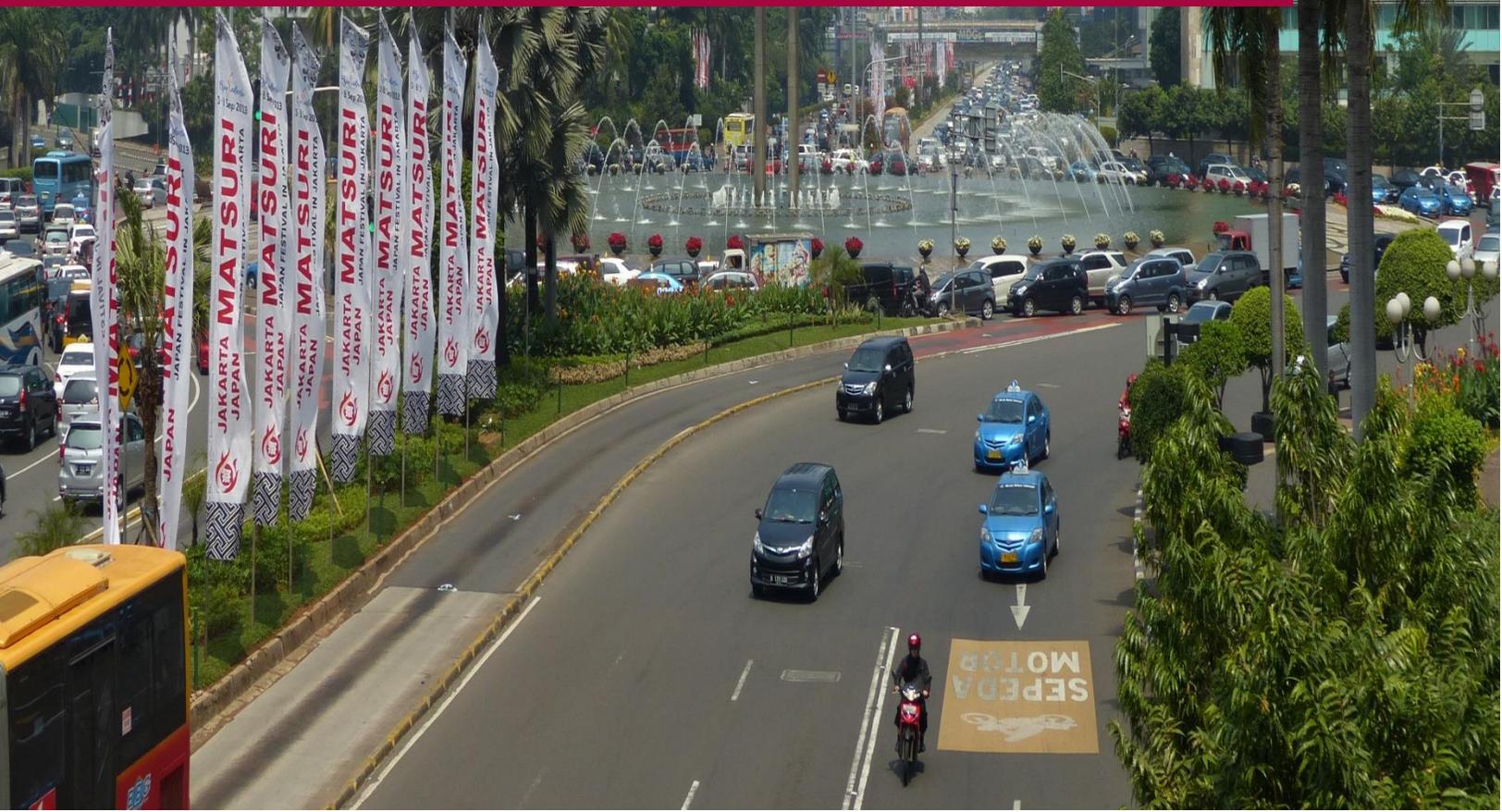


INDONESIA INVESTMENTS

Research Report July 2018

“Counterbalancing External Pressures”



Indonesia Investments Research Report

Counterbalancing External Pressures

July 2018



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Preface

Indonesia Investments' monthly research report is written and published by Van Der Schaar Investments B.V. - located in Delft, the Netherlands. The report aims to inform the reader of the latest political, economic and social developments in Indonesia as well as those key global developments that are impacting on the Indonesian economy or politics.

Our research reports are intended for a wide audience, including individual and corporate investors, financial market participants, policy makers, journalists, academics, and analysts.

The website Indonesia Investments is the reference and access point for gaining knowledge about Indonesian markets, economy and cultures. The website is owned by Van Der Schaar Investments B.V., a privately-held investment company (Ltd.) which was established in 2009 but stands in a tradition that stretches back to urban development in the Dutch capital city of Amsterdam in the early 20th century.

For further information about Indonesia Investments, please visit our official website at: www.indonesia-investments.com.

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Lastly, we want to emphasize that although we strive to present accurate, up-to-date, and objective information to the reader, Indonesia Investments cannot guarantee the accuracy of all data that is included in this report.



Introduction

While the external context has not changed much, we did detect stabilization in Indonesian markets in the month of July 2018. It is a sign that market participants have increasingly become used to the high degree of (persistent) uncertainties in global financial markets. Moreover, investors are aware that these uncertainties will remain part of the game in the foreseeable future.

For example, if we take a look at three important indicators that reflect investor confidence - namely the currency, stocks and bonds - then we saw an Indonesian rupiah that started and ended the month of July at around the same level (albeit the currency's volatility remained high in between both points, while it also required Bank Indonesia's recent aggressive monetary actions and words to ease investors' concerns and thereby smoothen the rupiah's performance).

We also saw a strengthening benchmark Jakarta Composite Index in July, rebounding from a 13-month low, supported by attractive valuations and the central bank's proven commitment to defend the rupiah. Meanwhile, hundreds of millions of US dollars were pumped into government bonds in July following months of outflows, showing appetite for riskier assets has somewhat returned.

The external pressures that plagued Indonesian markets in July 2018 were basically the same pressures that have been felt - across the world - in the preceding months. The strengthening US economy causes expectations of further monetary tightening in the USA (we will possibly see two more Fed rate hikes in the remainder of 2018), while trade tensions between the USA and China flare up regularly. In fact, China's Q2-2018 economic growth as well as July manufacturing activity in many countries reportedly slowed. This makes investors nervous especially because it is assumed the real impact of the trade war is yet to be felt.

Meanwhile, the US 10-year treasury yield is again hovering around the 3 percent level, thus also contributing to a strong US dollar.

In Indonesia the government and central bank are busy taking actions to counterbalance these external pressures. For example, Indonesian President Joko Widodo urged exporters to bring home their earnings in order to strengthen the country's foreign exchange reserves, thus making it easier to manage the rupiah. Widodo also decided to speed up the country's biodiesel program by making the use of biodiesel blended fuels compulsory for all vehicles and heavy machinery starting from 1 September 2018. This program should save Indonesia billions of US dollars in fuel imports, annually. However, speeding up the program also gives rise to concerns that various problems will arise. For example, the higher bio-content can

cause damage to engines and gasket materials. Therefore, the implementation of the program has to be closely coordinated with all stakeholders. However, time is very limited.

And ahead of the 2019 legislative and presidential elections - which are already being hotly debated in Indonesia's (social) media - it is important for the Widodo administration not to make any crucial mistakes and instead show good governance, while keeping the economy stable. Any mistakes will give ammunition to opposition. Even with smooth government performance in the remaining months, the presidential race is bound to become another tight battle between Widodo and Gerindra Chairman Prabowo Subianto (although opposition is still seeking the right formation). Moreover, chances are big that the race will become a dirty one as opposition is expected to create chaos and anxiety by spreading half-truths. The first examples of this have already surfaced.

Research Department

Indonesia Investments

Delft & Jakarta, 4 August 2018