

**August 2016**

## BUSINESS SENTIMENT

**Down on sluggish economic conditions, but outlook remains bright**

- Business sentiment weakened in our latest survey, snapping its firm uptrend which had begun in August-September 2015. In our April-May 2016 survey, the Business Sentiment Index (BSI) dropped 8.5 percent to a level of 122.2.
- Nonetheless, the decline in the BSI does not yet constitute a break from its strong upward trend seen this year. Indeed, catalysts such as the government's groundbreaking tax amnesty ruling and expected recovery in domestic consumption in the second half of the year could quickly help restore the BSI's upward momentum.
- CEOs continued to claim that corporate performance remained fairly sluggish. Most notably, the index measuring sentiment toward sales growth dropped a further 6.3 percent to 94.8. And at the bottom line, profits growth was similarly anemic (this index sank 6.6 percent to 93.6), constricted by high operating costs.
- Looking forward, CEOs were less sanguine on Indonesia's economic outlook over the next six months. As a result, only 38.6 percent of CEOs are now upbeat on the economy, down from 47.6 percent in the previous survey.
- More encouragingly, business confidence toward the government improved further. In our survey, the Business Confidence in the Government Index (BCGI) eked out a small 1.9 percent gain to 141.0.

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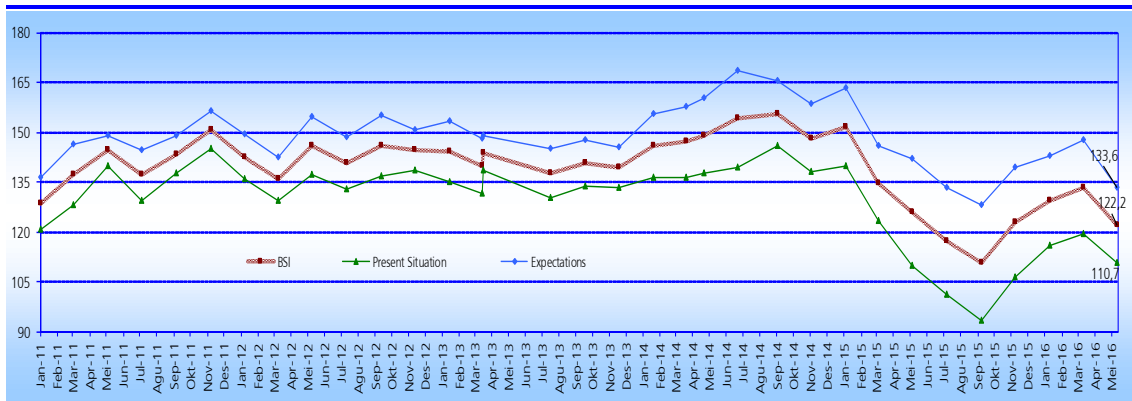
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**Business sentiment declined in the latest survey**



Source: Danareksa Research Institute

**Table 1. Appraisal of Present Situations**

	Jan-16	Mar-16	May-16	%Change
Business Sentiment Index	129.5	133.5	122.2	(8.5)
Present Situation	116.0	119.5	110.7	(7.3)
Expectations	143.1	147.6	133.6	(9.4)

Source: Danareksa Research Institute

**THE APRIL - MAY 2016 RESULTS:**

Business sentiment weakened in our latest survey, dragged down by concerns over sluggish economic conditions. This is the first time the Business Sentiment Index (BSI) has fallen since August-September last year, and whilst the BSI remains firmly in positive territory (at a level of 122.2), the deterioration in sentiment (the index slipped 8.5 percent) nonetheless indicates that the string of economic packages unveiled by the government have yet to set the economy onto a significantly faster growth trajectory.

The concerns of CEOs are borne out in the latest quarterly GDP data which shows that the Indonesian economy only expanded a modest 4.92 percent in the first quarter of 2016, down from 5.04 percent in the fourth quarter of 2015. Against this backdrop, the overall measure of sentiment toward current conditions - as measured by the Present Situations Index (or PSI) – dropped by 7.3 percent to 110.7, yet still remaining in positive territory above the 100 level.

Not only did CEOs perceive a deterioration in present situations, but they were also less sanguine on Indonesia’s outlook over the next six months, citing, in particular, concerns over how well their companies would perform in, what they see as, a more challenging environment. In our survey, the Expectations Index (or EI) dropped 9.4 percent to 133.6. Most notably, future sales growth and profits growth are both expected to slow – the respective indices slipped by 4.3 and 5.4 percent.

Worries over the economy’s prospects heightened – this index dipped 6.3 percent to 123.0 - on the back of the economic uncertainties which mainly centered on fiscal discipline issues exacerbated by poor tax collection. Overall, however, it is worth noting that CEOs are still broadly optimistic and, furthermore, that the decline in the BSI does not yet constitute a break from its strong upward trend seen this year. Indeed, catalysts such as the government’s groundbreaking tax amnesty ruling which was recently ratified by parliament coupled with an expected recovery in domestic consumption in the second half of the year could quickly help restore the BSI’s upward momentum.

**CEO ASSESSMENTS OF CURRENT BUSINESS CONDITIONS**

CEO assessments on the current state of the Indonesian economy are generally lukewarm but nonetheless improving – the index measuring sentiment toward economic conditions edged up another 1.5 percent to 91.0, yet still far below the neutral level of 100. In total, only 21.0 percent of CEOs believe the economy is performing well against 30.0 percent of CEOs who claimed it was performing badly. However, about half of CEOs believe the economy is performing normally.

Meanwhile, CEOs also observed a deterioration in business conditions (this index declined 10.2 percent to 122.3). In the domestic market, business conditions remained challenging in the face of relatively weak domestic demand, although on a more positive note, CEOs also reported greater ability to raise product prices (this index climbed 5.6 percent to 123.7), an indication that competitive pressures were easing somewhat. Exporters, meanwhile, continue to be hampered by persistently low commodity prices as global demand remains weak.

In this more challenging marketplace, CEOs, continued to claim, not surprisingly, that corporate performance remained fairly sluggish. Most notably, the index measuring sentiment toward sales growth dropped a further 6.3 percent to 94.8. And at the bottom line, profits growth was similarly anemic (this index sank 6.6 percent to 93.6), constricted by high operating costs (this index climbed 3.3 percent to 141.7). So far, capex does not appear to have picked up either: in our survey, the index measuring CEO sentiment toward capex spending dipped 2.6 percent to 98.3.

**Table 2. Appraisal of Present Situations**

	Jan-16	Mar-16	May-16	% Change
Economic Conditions	85.1	89.6	91.0	1.6
Business Conditions	133.0	136.2	122.3	(10.2)
Company's Conditions	130.0	132.7	119.0	(10.2)

Source: Danareksa Research Institute

**Table 3. Current Company Financial and Utilization Performance**

All Sectors	Jan-16	Mar-16	May-16	% Change
Capital Expenditure	108.1	100.9	98.3	(2.6)
Sales	103.0	101.2	94.8	(6.3)
Profits	101.4	100.2	93.6	(6.6)
Liquidity	100.5	101.6	91.5	(10.6)
Capacity/Equipment Utilization	101.1	102.1	99.8	(2.3)
Employment	110.5	109.0	100.7	(7.6)
Cost of Goods Sold	104.1	104.6	104.7	0.1
Operating cost	150.5	137.1	141.7	3.3
Interest expenses/cost	100.7	100.7	100.6	(0.1)
Foreign Exchange Loss	113.0	103.9	112.1	7.8
Average Price of Product/Service	122.2	117.2	123.7	5.6

Source: Danareksa Research Institute

**CEO APPRAISALS OF NEAR-TERM BUSINESS CONDITIONS**

Looking forward, CEOs were less sanguine on Indonesia’s economic outlook over the next six months as sentiment soured on the back of mounting concerns over fiscal discipline issues and poor tax collection. As a result, only 38.6 percent of CEOs are now upbeat on the economy, down from 47.6 percent in the previous survey. Yet the government has since moved promptly to address these concerns through its groundbreaking tax amnesty law. While it is difficult to ascertain how successful this move will be in persuading investors to repatriate funds to Indonesia, the early signs are said to be encouraging, with anecdotal reports claiming

that some taxpayers had already started to register for the program in Jakarta. All in all, the tax amnesty initiative coupled with an expected recovery in domestic consumption in the second half of the year could help get the economy back on track again.

Along with the less rosy economic outlook, CEOs were also less upbeat on the prospects for business conditions over the next six months. In our survey, only 50.5 percent of CEOs now expect good business conditions over the next six months, or down from 60.6 percent in the previous survey. At the corporate level, future sales growth and profits growth are both expected to slow – the respective indices slipped by 4.3 and 5.4 percent.

**Table 4. Expectations for the Six Months Ahead**

	Jan-16	Mar-16	May-16	% Change
Economic Prospects	124.9	131.3	123.0	(6.3)
Business Prospects	151.4	154.8	139.3	(10.0)
Company's Prospects	153.0	156.6	138.6	(11.5)

Source: Danareksa Research Institute

**Table 5. Prospects for Company Financial and Utilization Performance**

All Sectors	Jan-16	Mar-16	May-16	% Change
Capital Expenditure	137.6	137.6	135.1	(1.8)
Sales	145.1	142.7	136.5	(4.3)
Profits	140.8	142.0	134.4	(5.4)
Liquidity	128.9	126.9	123.7	(2.5)
Capacity/Equipment Utilization	104.1	103.5	104.3	0.8
Employment	121.4	123.9	114.7	(7.4)
Cost of Goods Sold	105.9	104.9	104.0	(0.8)
Operating cost	149.5	141.3	145.0	2.6
Interest expenses/cost	106.8	108.6	109.5	0.8
Foreign Exchange Loss	103.5	106.0	110.4	4.1
Average Price of Product/Service	134.6	126.2	129.1	2.3

Source: Danareksa Research Institute

**Table 6. Expectation Index on Key Economic Indicators**

Indicators	Jan-16	Mar-16	May-16	% Change
General Prices Expectation	111.1	119.7	120.9	0.9
Loan Rate Expectation	107.3	104.6	112.6	7.6
Exchange Rate Expectation	106.5	123.9	114.2	(7.8)
Stock Price Expectation	110.8	117.2	113.0	(3.5)

Source: Danareksa Research Institute

### EXPECTATIONS ON KEY ECONOMIC INDICATORS

Given the heightened concerns over the economy, CEO sentiment toward Indonesia's key economic indicators also weakened in the latest survey. In regard to prices, CEOs expected some heightening in inflationary pressures ahead of the Ramadan/Idul Fitri period when prices typically rise on the back of soaring demand for certain types of goods and services such as foodstuffs and transportation. The index measuring sentiment toward inflation edged up 0.9 percent to 120.9. The surge in inflation is typically short lived, however, and prices quickly return to normal levels. CEO sentiment toward the rupiah was also weaker. Despite the rupiah's strong recovery this year, sentiment on the prospects for the local currency unit may have deteriorated on growing concerns over fiscal discipline issues relating to the state budget. In our latest survey, the index measuring sentiment toward the rupiah fell 7.8 percent to 114.2.

Meanwhile, CEOs were less convinced than before that interest rates could be cut over the next six months: this index climbed 7.6 percent to 112.6. Nonetheless, this index had previously fallen on six straight occasions as benign inflation provided more room for the central bank to loosen its monetary policy and cut rates. A major development in this regard will take place in August when BI replaces the benchmark SBI interest rate with the seven-day reverse repurchase rate in a bid to better transmit monetary policy goals to the banking system, which, may in turn, encourage banks to reduce lending rates - a professed aim of the government in order to help promote economic growth. Lastly, CEOs were less upbeat on the outlook for stock prices - this index fell 3.5 percent to 113.0.

**Table 7. Business Confidence in the Government Index**

Indicators	Jan-16	Mar-16	May-16	% Change
Expand the Market Size	150.5	148.5	149.5	0.7
Create a Safe Environment	151.4	151.0	149.8	(0.9)
Stabilize prices	114.3	113.7	120.9	6.3
Provide Public Utilities	165.9	167.1	173.7	3.9
Enforce Law of Contracts	98.9	111.1	111.1	0.0
BCGI	136.2	138.3	141.0	1.9

Source: Danareksa Research Institute

**SENTIMENT TOWARD THE GOVERNMENT**

Despite the overall decline in business sentiment, Business confidence toward the government improved further. In our survey, the Business Confidence in the Government Index (BCGI) eked out a small 1.9 percent gain to 141.0 after climbing 1.5 percent in the previous survey.

On the economic front, CEOs are especially upbeat on the ability of the government to improve public infrastructure: this index climbed another 3.9 percent to a very high level of 173.7 – a firm endorsement of the government’s commitment to improve the nation’s creaky infrastructure. In regard to inflation, meanwhile, CEOs were less convinced that the government was doing a good job at stabilizing prices. Nonetheless, the 6.3 percent spike in this index may mostly be a reflection of seasonal factors related to Ramadan and Idul Fitri since long-term inflation remains under tight control. Also on the economic front, CEOs were encouragingly more confident in the government’s ability to expand the domestic marketplace. This index edged up 0.7 percent to 149.5, an indication that CEOs still believe that better economic conditions in the future will eventually translate into firmer markets to conduct business activities.

Finally, the index measuring sentiment toward the government’s ability to enforce the law of contracts was unchanged at 111.1, while the component measuring sentiment toward the government’s ability to create a safe and orderly environment slipped 0.9 percent to 149.8.

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