

August 2017

BUSINESS SENTIMENT

Upbeat but risks remain**THE APRIL - MAY 2017 RESULTS:**

- In our latest survey, the overall measure of business sentiment, as reflected in the Business Sentiment Index (BSI), posted a modest decline of 2.1 percent to 140.2 after gaining 1.3 percent in the previous survey.
- Our survey reveals growing concerns on a number of issues, particularly related to higher inflation, rising cost pressures and weaker pricing power.
- On a more positive note, however, CEOs claimed slightly better profitability during the reporting months—this index added 2.7 percent to 110.4. Some relief appears to have been provided by lower COGS (this index was down 3.0 percent to 102.7) underpinned by a stable rupiah. For many companies, a stable currency is a boon since they are heavily dependent on imported raw materials.
- Although noting the pick-up in inflation, CEOs are, surprisingly, more dovish on domestic interest rates. Only 28.3 percent of CEOs now expect higher rates, down from 34.1 percent in the previous survey.
- With concerns surfacing over the health of the economy, CEOs were less satisfied with the performance of the government. In our survey, the overall measure of Business Confidence in the Government (BCGI) dropped 8.1 percent to 136.6.

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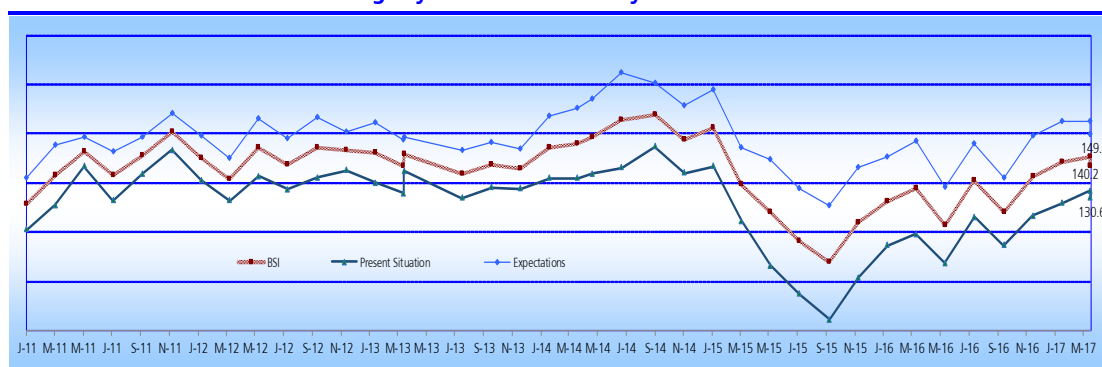
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Business sentiment weakened slightly in the latest survey



Source: Danareksa Research Institute

Table 1. Appraisal of Present Situations

	Jan-17	Mar-17	May-17	% Change
Business Sentiment Index	141.3	143.1	140.2	(2.1)
Present Situation	128.8	132.6	130.6	(1.5)
Expectations	153.8	153.7	149.7	(2.6)

Source: Danareksa Research Institute

THE APRIL - MAY 2017 RESULTS:

Although CEOs remain upbeat on Indonesia’s prospects going forward, our latest survey also reveals growing concerns on a number of issues, particularly related to higher inflation, rising cost pressures and weaker pricing power. As a consequence, overall sentiment toward the economy also deteriorated, although not significantly. As such, the overall measure of business sentiment, as reflected in the Business Sentiment Index (BSI), posted a modest decline of 2.1 percent to 140.2 after gaining 1.3 percent in the previous survey. Encouragingly, sentiment remains upbeat in many sectors of the economy, most notably agriculture (where the index stands at 166.7), finance (146.7), and manufacturing (145.1). A reading above 100 indicates that optimism outweighs pessimism.

On the economy, CEOs gave weaker assessments – the index measuring sentiment toward the state of the economy declined to 112.5 from 118.8 in the previous survey. In particular, CEOs noted heightened inflationary pressures. Whilst still under control, inflation has tended to head higher, largely driven by increases in administered prices such as electricity as well as higher food prices. At the corporate level, CEOs claimed a sharp increase in operating costs - this index jumped 6.0 percent to 149.2, its highest level since January 2016.

Compounding matters, CEOs also said that their companies were finding it more difficult to raise product prices - an indication of an increasingly challenging business environment. On a more positive note, however, CEOs claimed slightly better profitability during the reporting months – this index added 2.7 percent to 110.4 after it slumped 5.0 percent in the previous survey. Some relief appears to have been provided by lower COGS (this index was down 3.0 percent to 102.7) underpinned by a stable rupiah. For many companies, a stable currency is a boon since they are heavily dependent on imported raw materials. This is particularly true for companies operating in the pharmaceutical industry, for example, where as much as 90% to 95% of the raw materials are still imported.

With concerns surfacing over the health of the economy, CEOs were less satisfied with the performance of the government. In our survey, the overall measure of Business Confidence in the Government (BCGI) dropped 8.1 percent to 136.6. In particular, CEOs are less confident in the government’s ability to rein in inflationary pressures and create a healthier marketplace.

CEO ASSESSMENTS OF CURRENT BUSINESS CONDITIONS

CEOs gave less positive assessments on the current state of the Indonesian economy – the index measuring sentiment toward economic conditions dropped by a further 5.3 percent to 112.5 after slumping 16.2 percent in the previous survey. In total, 31.3 percent of CEOs believe the economy is performing well against only 18.9 percent of CEOs who claim it is performing badly. However, around half of the CEOs interviewed believe the economy is still performing normally.

Encouragingly, CEOs continue to believe that business conditions remain firm (this index added 0.7 percent to 142.2) despite their concerns over the state of the economy. In part, this may stem from the beneficial impact of currency stability, which particularly helps exporters to manage costs whilst bolstering their confidence in establishing credible business plans. In our survey, the index measuring sentiment toward COGS fell 3.0 percent to 102.7. As a result, CEOs also claimed better profitability – this index rose 2.7 percent to 110.4.

CEOs also claimed weaker sales growth, however, and greater difficulties in raising their product prices - an indication of an increasingly challenging business environment. Operating costs also rose, according to CEOs. This index jumped 6.0 percent to 149.2, its highest level since January 2016.

Table 2. Appraisal of Present Situations

	Jan-17	Mar-17	May-17	% Change
Economic Conditions	102.2	118.8	112.5	(5.3)
Business Conditions	143.7	141.2	142.2	0.7
Company's Conditions	140.3	137.8	137.2	(0.4)

Source: Danareksa Research Institute

Table 3. Current Company Financial and Utilization Performance

All Sectors	Jan-17	Mar-17	May-17	% Change
Capital Expenditure	118.5	110.0	111.8	1.6
Sales	111.8	111.5	110.4	(0.9)
Profits	113.2	107.6	110.4	2.7
Liquidity	105.9	100.5	95.2	(5.2)
Capacity/Equipment Utilization	103.1	103.7	98.9	(4.6)
Employment	108.7	102.0	99.1	(2.8)
Cost of Goods Sold	108.1	105.9	102.7	(3.0)
Operating cost	145.1	140.7	149.2	6.0
Interest expenses/cost	100.0	100.2	100.1	(0.2)
Foreign Exchange Loss	107.3	108.5	104.1	(4.1)
Average Price of Product/Service	128.6	126.1	120.6	(4.3)

Source: Danareksa Research Institute

CEO APPRAISALS OF NEAR-TERM BUSINESS CONDITIONS

Looking ahead over the next six months, CEOs are slightly less upbeat on Indonesia’s economic outlook. All in all, 45.1 percent of CEOs are upbeat on the economy, far outnumbering the 8.8 percent of CEOs who are downbeat. In addition, 46.0 percent of the CEOs interviewed expect the economy to perform normally over the next six months.

Along with the dimmer economic outlook, fewer CEOs expect conducive business conditions over the next six months. In our survey, 62.4 percent of CEOs now expect good business conditions over the next six months, or down from a reading of 65.1 percent in the previous survey.

At the corporate level, CEOs remain generally upbeat even though many of the indices did tend to weaken slightly. The main concern weighing on the minds of CEOs appears to be rising operating costs. This index climbed 6.3 percent to 148.5. To a large extent, this may stem from higher energy costs which are hitting companies operating in certain industries, such as mining and cement production. On a more encouraging note, however, CEOs expect both COGS and forex losses to decline. Sales growth is also expected to hold up strongly – this index was little changed at 137.0. Hence, against this backdrop, CEOs remain optimistic that their companies will continue to record solid profits growth over the medium term at least – although slipping 1.3 percent, this index remains at a relatively high level of 141.3.

Table 4. Expectations for the Six Months Ahead

	Jan-17	Mar-17	May-17	% Change
Economic Prospects	140.1	141.7	136.3	(3.8)
Business Prospects	162.5	160.2	157.8	(1.5)
Company’s Prospects	158.8	159.0	155.1	(2.5)

Source: Danareksa Research Institute

Table 5. Prospects for Company Financial and Utilization Performance

All Sectors	Jan-17	Mar-17	May-17	% Change
Capital Expenditure	139.2	130.2	127.4	(2.2)
Sales	144.3	137.1	137.0	(0.1)
Profits	150.1	143.2	141.3	(1.3)
Liquidity	128.3	121.5	113.4	(6.7)
Capacity/Equipment Utilization	104.8	104.1	103.6	(0.5)
Employment	120.2	112.7	109.5	(2.8)
Cost of Goods Sold	109.2	104.9	104.5	(0.3)
Operating cost	144.0	139.8	148.5	6.3
Interest expenses/cost	102.5	103.4	104.5	1.1
Foreign Exchange Loss	104.5	111.2	104.8	(5.8)
Average Price of Product/Service	137.8	134.1	128.8	(4.0)

Source: Danareksa Research Institute

Table 6. Expectation Index on Key Economic Indicators

Indicators	Jan-17	Mar-17	May-17	% Change
General Prices Expectation	123.0	112.0	121.1	8.2
Loan Rate Expectation	111.2	122.4	112.7	(8.0)
Exchange Rate Expectation	101.4	108.8	97.7	(10.2)
Stock Price Expectation	120.2	118.8	107.9	(9.1)

Source: Danareksa Research Institute

EXPECTATIONS ON KEY ECONOMIC INDICATORS

CEO sentiment toward Indonesia's key economic indicators was mixed in our latest survey. Of note, CEOs foresee much higher inflationary pressures going forward. This finding of our survey is consistent with the uptrend in Indonesia's consumer prices this year - even though inflation does remain at a relatively low level. The main culprit has been rising food and electricity costs. In June 2017, consumer prices were up by 4.37 percent from a year earlier.

Although noting the pick-up in inflation, CEOs are, surprisingly, more dovish on domestic interest rates. Only 28.3 percent of CEOs now expect higher rates, down from 34.1 percent in the previous survey. Indeed, Bank Indonesia's key policy rate, the 7-Day RR rate, was kept unchanged at its monetary policy meeting on 19 and 20 July, consistent with its efforts to maintain macroeconomic and financial system stability. The policy rate is unchanged since October 2016.

CEOs were also less upbeat on the rupiah. This index gave up all of its strong gain of 7.3 percent recorded in the previous survey to slump by 10.2 percent to 97.7. Finally, in regard to stock prices, the index sank a worrying 9.1 percent to 107.9. With stock prices at relatively high levels, CEOs might hold the view that stocks are susceptible to profit taking.

Table 7. Business Confidence in the Government Index

Indicators	Jan-17	Mar-17	May-17	% Change
Expand the Market Size	144.5	162.7	149.7	(8.0)
Create a Safe Environment	146.8	156.6	141.5	(9.6)
Stabilize prices	116.5	131.9	123.6	(6.3)
Provide Public Utilities	172.3	179.8	167.1	(7.0)
Enforce Law of Contracts	112.9	111.9	101.1	(9.7)
BCGI	138.6	148.6	136.6	(8.1)

Source: Danareksa Research Institute

SENTIMENT TOWARD THE GOVERNMENT

With concerns surfacing over the health of the economy, CEOs were less satisfied with the performance of the government. In our survey, the overall measure of Business Confidence in the Government (BCGI) dropped 8.1 percent to 136.6. All five components of the index posted declines.

In particular, CEOs had greater concerns in the government's ability to both control inflation and create a healthier marketplace (these indices were down by 6.3 percent and 8.0 percent, respectively). Also on the economic front, CEOs gave less positive assessments on the government's efforts to provide better infrastructure: this index dropped 7.0 percent to 167.1. Nonetheless, as the level of this index still remains at a very high level, or far above the neutral level of 100, it remains the case that CEOs are still broadly satisfied in the government's programs aimed at rejuvenating the nation's creaky infrastructure which creates costly bottlenecks and holds back the economy.

The component of the index measuring sentiment toward the government's ability to create a safe and orderly environment also fell. It dropped by 9.6 percent to 141.5. Finally, the component of the BCGI measuring sentiment toward the government's ability to enforce the law of contracts sank 9.7 percent to 101.1. The low level of this index reflects the poor perceptions toward law enforcement in the country, particularly in regard to tackling corruption. Efforts have been made by the country's Corruption Eradication Commission - otherwise known as KPK - but progress has been patchy.

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