MONTHLY REPORT

∂Ri DANAREKSA RESEARCH INSTITUTE

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August 2014

TRADE OUTLOOK

June Review: High Imports due to the Holidays

- **In June, Indonesia's total exports reached US$ 15.4 bn, or up 4.0 percent MoM. On a YoY basis, they were up 4.5 percent. The higher exports stemmed from 5.6 percent YoY higher non oil and gas shipments. On a MoM basis, June's exports were 4.8 percent lower in volume terms although, by contrast, the average aggregate prices surged 9.3 percent.**

- **The exports of two major products - which accounted for 29.2 percent of non oil and gas exports - declined in June. Exports of animal and vegetable fats (HS 15) weakened 1.7 percent while exports of mineral fuels (HS 27) dropped 7.3 percent MoM. Despite this, the value of non oil and gas exports still rose, supported by stronger exports of other non oil and gas products such as electrical machinery, vehicle parts, and chemical products.**

- **By destination country, June's non oil and gas exports to Japan and the US remained firm. Shipments to Japan and the US strengthened by 4.5 percent and 9.3 percent, respectively, while, by contrast, non oil and gas exports to China dropped 7.9 percent MoM.**

- **Strong demand during Ramadan and Idul Fitri led to higher import volumes in June. Import volumes were 5.6 percent higher, and average aggregate prices were up 0.8 percent MoM. As such, the value of Indonesia's imports increased significantly by 6.4 percent MoM to US$ 15.7 bn. By product type, the imports of mechanical machinery and equipment (HS 84) surged 18.2 percent while imports of electrical machinery and equipment (HS 85) declined 0.5 percent.**

- **Non oil and gas imports from Indonesia's major trading partners strengthened. Indonesia's non oil and gas imports from Japan rose the most (+21.6 percent), followed by non oil and gas imports from China (+5.9 percent) and then Singapore (+2.3 percent).**

- **By classification, imports of all types of goods rebounded. Imports of consumer goods gained the most (+10.5 percent), followed by imports of capital goods (+9.6 percent), and imports of raw materials (+5.4 percent). In the first half of 2014, imports of raw materials accounted for 76.5 percent of Indonesia's total imports.**

- **In June, imports growth exceeded exports growth. This resulted in a trade deficit of US$ 305.1 mn. Cumulatively, in the first 6 months of the year, Indonesia's foreign trade still shows a deficit of US$ 1.1 bn, yet far lower than the deficit of US$ 3.3 bn recorded in the corresponding period of last year.**

Forecast for July 2014

Exports	US$ 13.9 bn
Imports	US$ 13.5 bn
Trade Surplus	US$ 450.1 mn

Forecast for 2014

Exports	US$ 196.4 bn
Imports	US$ 192.3 bn
Trade balance	US$ 4.1 bn

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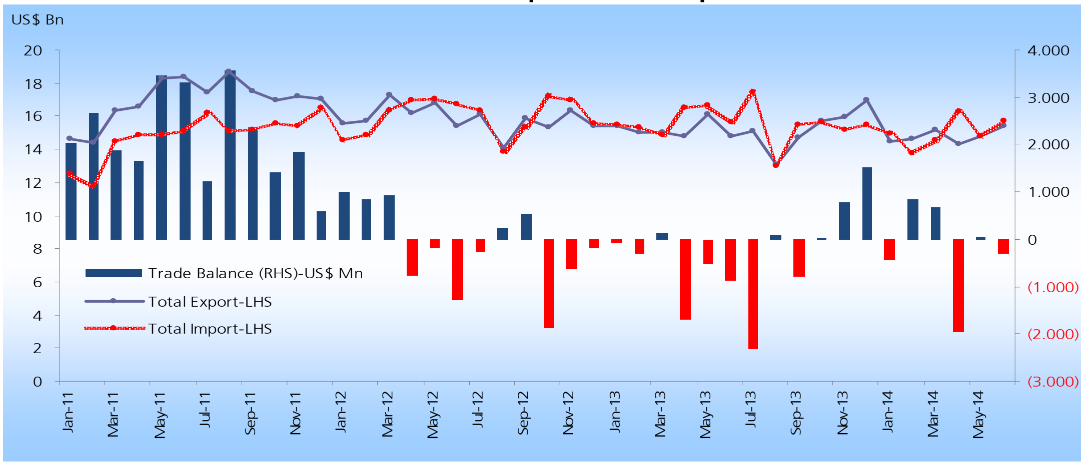
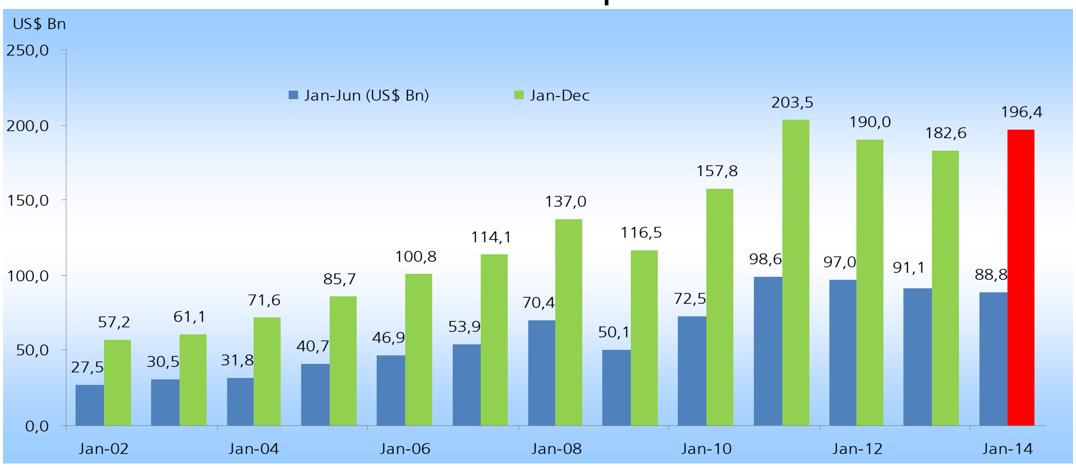
Indonesia's Exports and Imports



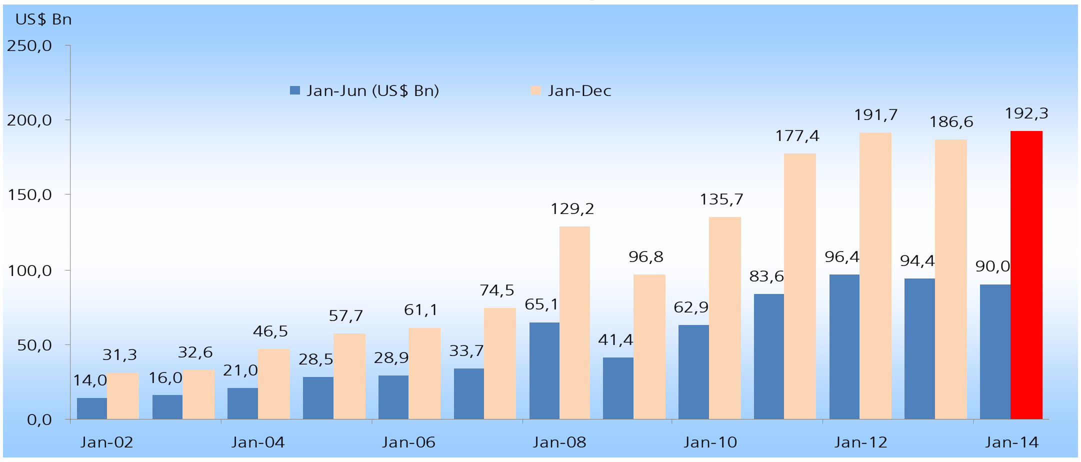
Source: BPS

2014F Full Year Exports



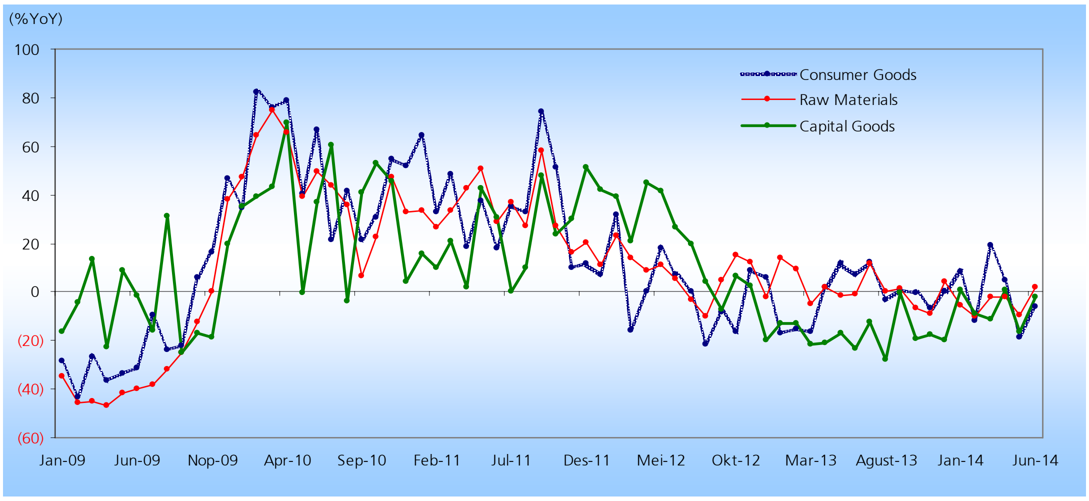
Source: BPS, Danareksa Research Institute

2014F Full Year Imports



Source: BPS, Danareksa Research Institute

YoY Change in Imports



Source: BPS

July Outlook: Stable

After recording a surplus of US$ 53.3 mn in May 2014, Indonesia's foreign trade was back in deficit in June. On the back of strong imports growth which exceeded exports growth, the deficit reached US$ 305.1 mn. The main contributor to June's trade deficit was the oil and gas trade deficit (-US$ 604.3 mn), since non oil and gas trade actually still managed to record a surplus of US$ 299.2 mn. In the following month of July, however, we foresee an improvement in Indonesia's exports performance, underpinned by the improving economic conditions of Indonesia's major trading partners.

China

- The Coincident Economic Index (CEI) for China, which measures current economic activity, increased by 0.9 percent in June to 262.1, following a 0.7 percent increase in May and a 0.7 percent increase in April. The China Leading Economic Index (LEI) rose 1.3 percent in June. The index stands at 294.0, after rising 0.7 percent in May and 1.1 percent in April.

- In July, China's retail sales slowed. The sales growth declined from 12.4 percent YoY in June to 12.2 percent in July. Easing demand growth helped keep general prices stable. In July, inflation rose 2.3 percent YoY, the same pace as in June.

- The official purchasing managers index (PMI) climbed to 51.7 in July from 51 in the previous month, marking further expansion of China's industrial sector. The PMI is now at its highest level in the past 27 months, lifted by higher new orders and stronger exports demand. A PMI reading above 50 indicates expansion in the manufacturing sector while a reading below 50 signals contraction.

- The stronger activity in the manufacturing sector is also reflected in firmer domestic supply and production. Industrial production grew by 9.0 percent YoY in July, after growing 9.2 percent in June.

- In view of the latest developments, we still expect Indonesia's exports to China to grow moderately over the near term.

Japan

- Japan's gross domestic product (GDP) shrank an annualized 6.8 percent in the second quarter of 2014, after growing 6.1 percent in the first quarter. The increase in the consumption tax explains the economic contraction. In April 2014, Japan raised its consumption tax to 8 percent from 5 percent in order to rein in its mounting public debt. Nonetheless, looking forward, the Japanese government still believes that the Japanese economy can show modest recovery as the effect of the April tax hike wanes in the following quarters.

- The gauge of current economic conditions - the CEI - decreased in June by 0.5 percent to 95.7, after posting a 0.3 percent increase in the previous month. However, the LEI indicator, which gauges economic prospects over the next 6-12 months fell for the fourth consecutive month. After dropping 1.1 percent in June, Japan's LEI fell 0.5 percent in July to 99.0.

- Japan's consumer confidence index rose 0.4 points to a seasonally adjusted 41.5 in July from 41.1 in June, its third-straight monthly increase. The improving optimism has been fuelled by a gradual improvement in the job market and wages.

- Japan's retail sales remained weak in July. Sales growth declined by 0.58 percent after contracting 0.4 percent a month before. Rising prices put a brake on consumer retail spending. In June, the headline inflation hit 3.6 percent YoY, after accelerating by 3.7 percent in the previous month.

- The Markit/JMMA Japanese Manufacturing Purchasing Managers Index (PMI) indicator edged down to 50.5 from 51.5 in June, signaling a weaker rate of improvement in overall manufacturing conditions. Muted domestic demand and falling industrial output meant that Japan's manufacturing sector only showed a slight improvement in July.

- However, after a record decline in the prior month, Japan's core machinery orders rose by 8.8 percent MoM in June, or contracting 3.0 percent yoy. The indicator is important as a leading indicator of capital spending over the 6-9 months ahead.

- Against this backdrop, Indonesia's exports to Japan are expected to remain stable going forward.

The U.S.

- The Conference Board Leading Economic Index (LEI) for the U.S. increased by 0.9 percent in July to 103.3, after climbing 0.6 percent in June and 0.6 percent in May. Furthermore, the Coincident Economic Index (CEI) for the U.S. rose by 0.2 percent in July to 109.6, following a 0.3 percent increase in June and a 0.2 percent increase in May. These developments suggest that the US economy is gaining traction and that growth should accelerate in the near future.

- The US Consumer Confidence Index (CCI) rose in July. The index now stands at 90.9, up from 86.4 in June. As US household assessments on current job conditions are more favorable, US consumers also foresee a brighter economic outlook and stronger jobs market in the near term.

- The headline inflation rate stayed at 2 percent in July, after gaining 2.1 percent in the prior month. Only a slight increase in food prices and falling energy costs helped keep general prices stable.

- Strong new orders and production in July fueled an increase in the ISM U.S. Manufacturing Purchasing Managers Index. The US PMI strengthened to 57.1 from 55.3 in June, indicating expansion of the manufacturing sector.

- At its latest meeting, the Fed made a further measured reduction in the pace of asset purchases. In early August, the Fed reduced its purchases of agency mortgage-backed securities to US$10 billion per month from US$15 billion per month, and longer-term Treasury securities to US$15 billion per month from US$20 billion per month. This policy reflects the further improvement in the US labor market coupled with the moderate pace of economic expansion. The US monetary authority also held the target range for the federal funds rate at 0 to 0.25 percent.

- Given these findings, Indonesia's exports to the US are expected to be steady in the future.

Indonesia

- Based on Danareksa's calculations, Indonesia's CEI climbed 0.37 percent MoM to 124.0 in June 2014, while the LEI strengthened 0.43 percent MoM to 135.8. Both indicators confirm that Indonesia's economy remains in expansionary mode.

- The second quarter GDP data shows that Indonesia's economy is slowing. In April-June 2014, GDP growth reached 5.12 percent YoY, or down from 5.22 percent in the first quarter of 2014. By expenditure, private consumption (+5.6 percent) and investment (+4.5 percent) were the main contributors of growth.

- Due to seasonal factors - Ramadan, Idul Fitri and the new school year - inflationary pressures heightened in July. The MoM headline inflation rate hit 0.93 percent, translating into a YoY inflation rate of 4.53 percent. All of the CPI components rose, with the foodstuffs component up the most.

- Bank Indonesia kept its benchmark SBI rate unchanged at its latest meeting at 7.5 percent, whilst also maintaining its Lending Facility rate and Deposit Facility rate at 7.50 percent and 5.75 percent, respectively. Given the prospect of stable inflation going forward and the need to keep the current account deficit in check, we believe that the BI rate will be maintained at its current level.

- After depreciating 3.01 percent MoM, the rupiah strengthened 2.02 percent MoM in July on average relative to the US dollar.

- The commodity price index – which is a measure of the prices of Indonesia's major commodity exports – fell further by 4.8 percent MoM in July, after posting a decline of 1.9 percent MoM in May. In the same period, the average global oil price dropped 6.62 percent MoM.

- Against this backdrop, we expect Indonesia's imports to grow by a moderate pace over the near term.

All in all, we expect Indonesia's exports to reach US$ 13.9 bn in July 2014, with imports reaching US$ 13.5 bn. As a result, we foresee a trade surplus of US$ 450.1 mn in July 2014.

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