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November 2014

TRADE OUTLOOK

September Review: Narrower Deficit

- **Indonesia's exports rose 5.5 percent MoM in September to US$ 15.3 bn, driven by both higher non oil and gas exports (+6.5 percent MoM) and oil and gas exports (+0.9 percent MoM). The average aggregate prices edged down 0.38 percent MoM, although on a YoY comparison, they are still 26.0 percent higher. Exports volume rose 5.9 percent MoM, although cumulatively in the first 9 months of the year, it is 18.8 percent lower compared to last year's exports volume.**

- **The exports of two major products rebounded in September. Exports of animal and vegetable fats (HS 15) and mineral fuels (HS 27) increased by 4.3 percent and 5.7 percent, respectively. The exports of other non oil and gas products, such as electrical machinery and rubber products, also posted increases.**

- **Shipments of non oil and gas export products to Indonesia's major trading partners posted increases. On a monthly basis, Indonesia's non oil and gas exports to China increased the most (up 13.9 percent), followed by a 9.1 percent increase to the U.S. and a 6.7 percent increase to Japan.**

- **Imports also rose in September. Total imports climbed 5.1 percent MoM to US$ 15.5 bn, driven by stronger oil and gas imports (+7.4 percent MoM) and non oil and gas imports (+4.4 percent MoM). September's imports volume was up 12.7 percent although the average aggregate prices contracted 6.7 percent MoM.**

- **By product type, imports of mechanical machinery and equipment (HS 84) dipped 0.7 percent, while imports of electrical machinery and equipment (HS 85) rose 1.4 percent. Shipments of non oil and gas products from China increased by 14.3 percent, while imports from Japan and Singapore declined by 3.8 percent and 6.8 percent, respectively.**

- **By classification, imports of all types of goods still posted increases. Imports of raw materials were up the most (+5.64 percent), followed by imports of capital goods (+4.90 percent) and imports of raw materials (+0.3 percent). In the January-September period, imports of raw materials accounted for 76.5 percent of Indonesia's total imports.**

- **After recording a trade deficit of US$ 311.5 mn in August, Indonesia recorded another trade deficit of US$ 270.3 mn in September. The deficit narrowed as exports growth was higher than imports growth. Also encouragingly, Indonesia's trade deficit in the first 9 months of 2014 stood at US$ 1.7 bn – or significantly lower than the deficit of US$ 6.4 bn recorded in the corresponding period of last year.**

Forecast for October 2014

Exports	US$ 16.4 bn
Imports	US$ 16.5 bn
Trade Deficit	(US$ 82.1 mn)

Forecast for 2014

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

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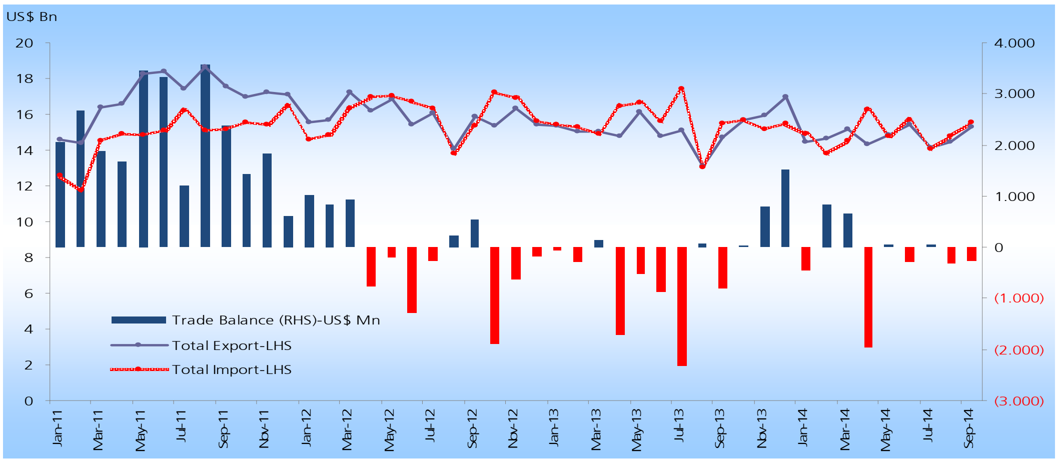
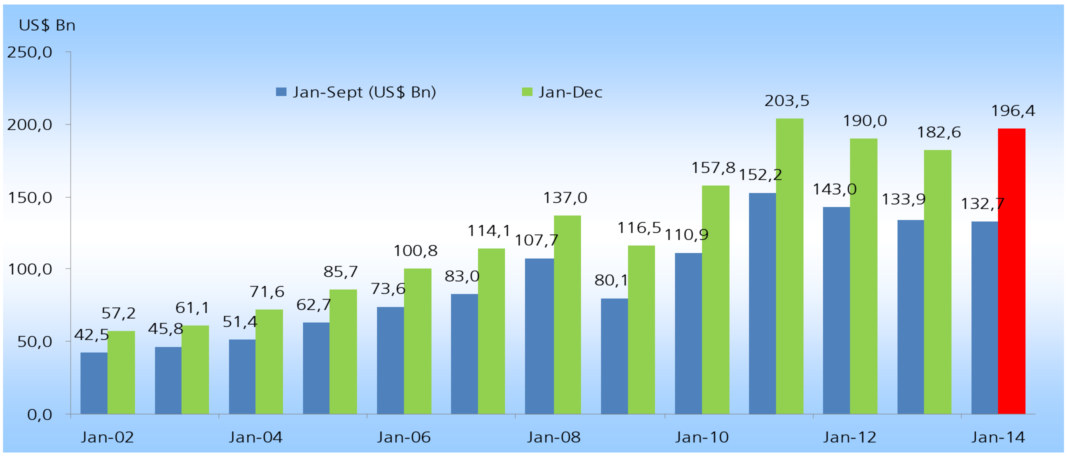
Indonesia's Exports and Imports



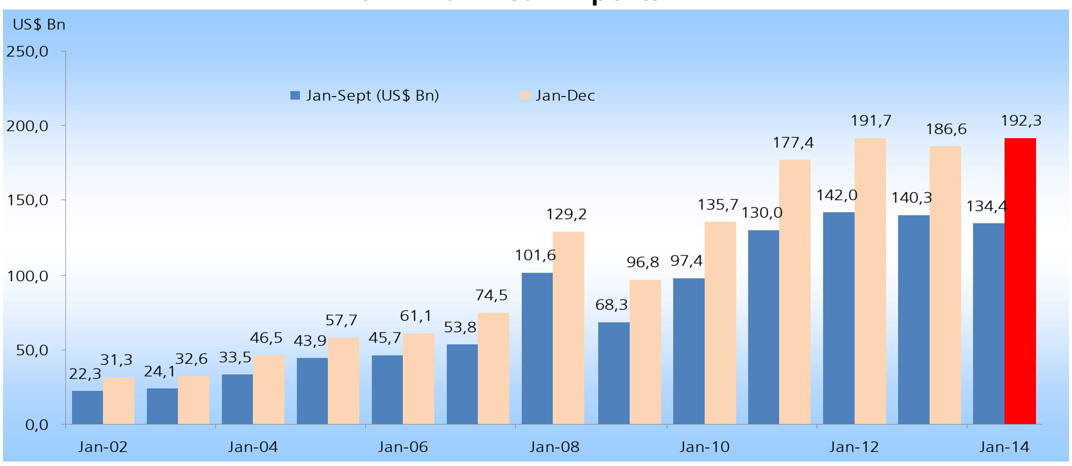
Source: BPS

2014F Full Year Exports

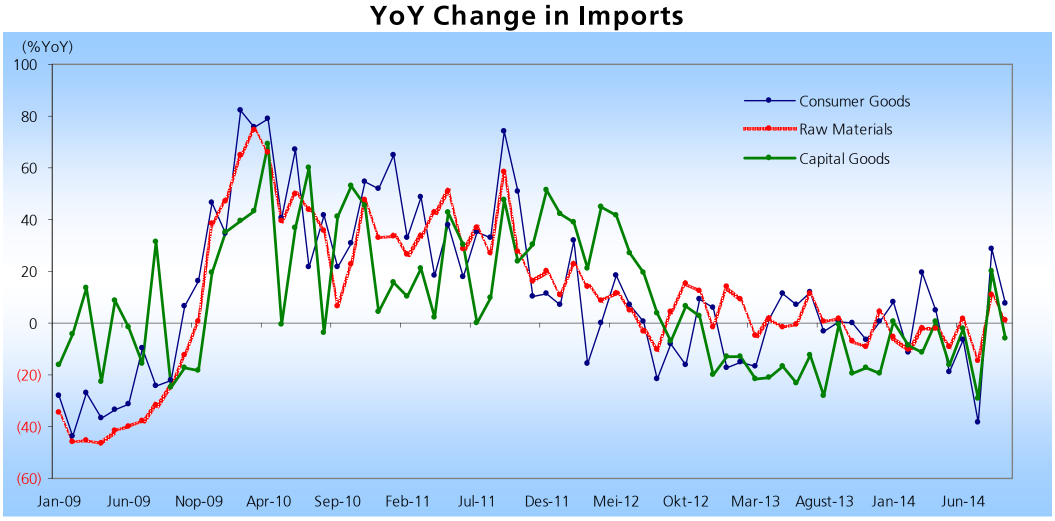


Source: BPS, Danareksa Research Institute

2014F Full Year Imports



Source: BPS, Danareksa Research Institute



Source: BPS

October Outlook: Still Steady

Indonesia's trade deficit narrowed in September. The non oil and gas trade recorded a surplus of US$758.7 mn, but still lower than the oil and gas trading deficit of US$1.03 bn. Based on the latest data releases, the economic conditions of Indonesia's trading partners were recovering at a slower-than-expected pace, suggesting that Indonesia's exports performance won't improve significantly any time soon. As such, we only expect a moderate improvement in Indonesia's trade performance in October.

China

- The Coincident Economic Index (CEI), which measures current economic activity, increased 0.5 percent to 266.1, following no change in August and a 1.1 percent increase in July. China's Leading Economic Index (LEI), meanwhile, increased 0.9 percent in September to 302.6, following a 0.7 percent increase in August and a 1.3 percent increase in July.

- The growth in China's retail sales slowed for the fifth consecutive month. In October, the YoY growth in retail sales eased to 11.5 percent from 11.6 percent in September. Also in October, headline inflation was steady at 1.6 percent.

- The key gauge of China's manufacturing sector continued to slow. The official purchasing managers index (PMI) declined to 50.8 in October from 51.1 in September. This marks a five-month low, as exports demand fell and new orders growth eased. A PMI reading above 50 indicates expansion in the manufacturing sector while a reading below 50 signals contraction.

- Growth in industrial output remains weak. Industrial production in China increased 7.7 percent in October, down from 8 percent in September.

- In a bid to bolster its slowing economy, China's central bank, the People's Bank of China (PBOC), cut its benchmark one-year loan rate by 0.4 percent to 5.6 percent. The PBOC also reduced the benchmark one-year deposit rate to 2.75 percent from 3 percent, and gave banks more flexibility to raise deposit rates above that benchmark. Falling loan rates provide businesses with lower financing costs when accessing funding to undertake expansion. The interest rate cuts are the first since July 2012.

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

Japan

- Japan's CEI rose by 0.4 percent to 95.3 in September after dropping 0.2 percent in the previous month. Meanwhile, the LEI rose 0.3 percent to 97.8, after edging up 0.1 percent in August.

- The Bank of Japan (BOJ) provided more monetary stimulus to support the domestic economy that has struggled with the nationwide sales tax hike. The BoJ will expand annual bond purchases to 80 trillion yen ($726 billion) per year, up from an annual increase of 60-70 trillion yen. The monetary authority also plans to increase its purchases of government debt by about 30 trillion yen, extending the average duration of JGB holdings to around 10 years and tripling its purchases of exchange-traded funds and Japanese real estate investment trusts.

- Consumer sentiment eased from the 39.9 points recorded in September to 38.9 points in October. The October number was the lowest reading in six months. Japanese household sentiment toward the job market continued to deteriorate, and the willingness of Japanese consumers to buy durable goods in the future also declined. A reading below 50 shows that pessimists outnumber optimists.

- Retail sales however, were up. After increasing 1.2 percent in August, retail sales climbed 2.3 percent YoY in September. Compared to the growth before the hike in sales tax, however, the improvement is still small, and more evidence is needed to conclude that consumer spending is recovering.

- Core consumer inflation slowed to 3 percent from 3.1 percent in the previous month. However, after adjusting for the impact of the sales tax hike, core consumer prices rose 1 percent on year, slower than the 1.1 percent rise in August. This is below the 2 percent target the Bank of Japan (BOJ) aims to achieve by April 2015.

- From the supply side, Japanese manufacturing activity expanded at the fastest pace in seven months in October as orders increased. The final Markit/JMMA Japanese Manufacturing Purchasing Managers Index (PMI) stood at a seasonally adjusted 52.4 in October compared to 51.7 in September. The weakening yen helps to boost exports.

- Japan's core machinery orders, a leading indicator of capital spending, rose for the fourth straight month in September. Core machinery orders rose 2.9 percent on month in September, yet slower than August's 4.7 percent MoM increase.

- 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 0.9 percent in October to 105.2, following a 0.7 percent increase in September, and no change in August. Furthermore, the Coincident Economic Index (CEI) for the U.S. edged up 0.1 percent in October to 110.2, following a 0.3 percent increase in September, and a 0.1 percent increase in August. This data indicates that U.S. economic expansion should be firm going forward.

- U.S. gross domestic product grew by a 3.9 percent annual rate in Q3 2014, but lower than Q2 2014's growth pace of 4.6 percent. Household spending, which accounts for more than two-thirds of U.S. economic activity, grew by 1.8 percent, or down from 2.5 percent in the previous quarter.

- As expected by the market, the Federal Reserve ended its bond-buying stimulus program commonly known as QE3. At the same time, the Fed also committed itself to maintain low interest rates for a "considerable time" after the asset purchases end. The policy has encouraged the markets since it suggests that the U.S. economy has been performing well, with better labor market conditions and a lower unemployment rate.

- The US Consumer Confidence Index (CCI) rebounded in October. It rose to 94.5 from 89.0 in September.

- The US inflation rate was flat at 1.7 percent YoY for the third consecutive month in October, as declines in energy prices were enough to offset higher food and shelter costs. Prices remained steady compared to the previous month.

- The October PMI was recorded at 59 percent, an increase of 2.4 percentage points from September's reading of 56.6 percent, indicating continued expansion in the U.S. manufacturing sector. Higher new orders and production fueled the industrial expansion.

- 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 rose by 0.43 percent MoM to 123.1 in September 2014, while the LEI increased another 0.39 percent MoM to 137.7. Both indicators suggest that Indonesia's economy remains in expansionary mode.

- Inflationary pressure increased in October. The MoM inflation rate reached 0.47 percent, translating into inflation of 4.83 percent YoY. The housing and medical care components posted the largest MoM increases, up 1.04 percent and 0.60 percent, respectively.

- Bank Indonesia hiked its benchmark BI rate to 7.75 percent, whilst also raising its Lending Facility rate to 8.00 percent and its Deposit Facility rate to 5.75 percent. This move was taken in response to the hikes in subsidized fuel prices which will lead to higher inflationary pressures.

- Negative sentiment still caused the rupiah to weaken by 1.98 percent in October, after depreciating 1.61 percent in August on an average basis relative to the US dollar.

- The commodity price index – which is a measure of the prices of Indonesia's major commodity exports – contracted 0.9 percent MoM in October after falling 3.5 percent MoM in September. Also in October, average global oil prices sank 11.0 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$ 16.4 bn in October 2014, with imports reaching US$ 16.5 bn. As a result, we foresee a trade deficit of US$ 82.1 mn in October 2014.

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