MONTHLY REPORT

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September 2014

∂Ri DANAREKSA RESEARCH INSTITUTE

TRADE OUTLOOK

July Review: Slump In Imports Created A Surplus

- **Total exports in July dropped 8.0 percent MoM, or down 6.0 percent YoY to US$ 14.2 bn. Compared to a month earlier, the decline in exports stemmed from 8.6 percent lower oil and gas exports and 7.9 percent lower non oil and gas exports. Furthermore, 2.9 percent lower export volume and 5.2 percent lower average aggregate prices also contributed to the slump in July exports.**

- **The exports of two major products - which accounted for 29.5 percent of non oil and gas exports – rose slightly in July. Exports of animal and vegetable fats (HS 15) and mineral fuels (HS 27) rose by 1.7 percent and 0.8 percent, respectively. However, the exports value of other non oil and gas products, such as electrical machinery and rubber products tended to decline.**

- **On a monthly comparison, non oil and gas exports to Indonesia's major trading partners recorded a decline. Shipments to China and Japan weakened by 10.8 percent and 8.4 percent, respectively, while non oil and gas exports to the U.S. fell by 7.6 percent MoM.**

- **The volume of July's imports fell significantly by 10.2 percent, while the average aggregate prices slipped 0.3 percent. As result, the value of imports slumped 10.5 percent MoM, or 19.3 percent YoY to US$ 14.0 bn. Non oil and gas imports were down by 19.5 percent although oil and gas imports, by contrast, still grew 22.4 percent MoM. By product type, the imports of mechanical machinery and equipment (HS 84) sank 21.3 percent while imports of electrical machinery and equipment (HS 85) declined 13.3 percent.**

- **Non oil and gas imports from Japan and China declined 12.7 percent and 19.3 percent, respectively, while shipments from Singapore still increased (+2.8 percent).**

- **By classification, imports of all types of goods fell. Imports of consumer goods showed the largest decline (-27.3 percent), followed by imports of capital goods (-18.0 percent) and imports of raw materials (-7.2 percent). In the January-July period, imports of raw materials accounted for 76.8 percent of Indonesia's total imports.**

- **In contrast to June's deficit, Indonesia recorded a trade surplus of US$ 123.7 mn in July. The surplus owed to a larger drop in imports than exports. In the first 7 months of 2014, Indonesia's trade deficit reached US$ 1.0 bn, yet far lower than the deficit of US$ 5.7 bn recorded in the corresponding period of last year.**

Forecast for August 2014

Exports	US$ 14.1 bn
Imports	US$ 13.6 bn
Trade Surplus	US$ 461.8 mn

Forecast for 2014

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

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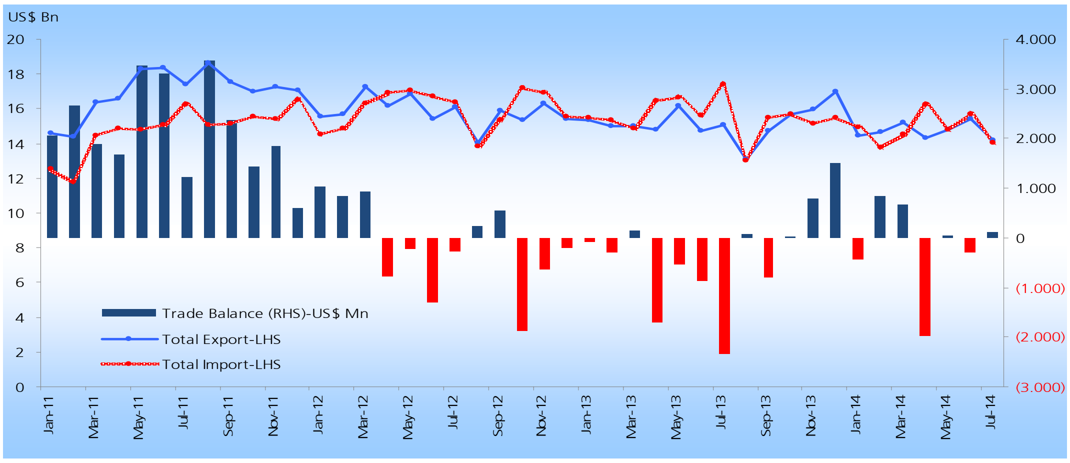
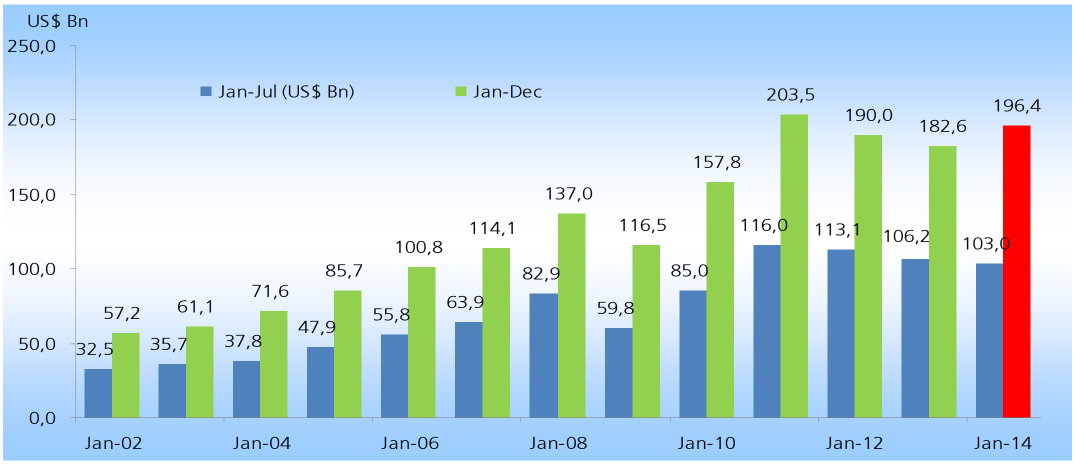
Indonesia's Exports and Imports



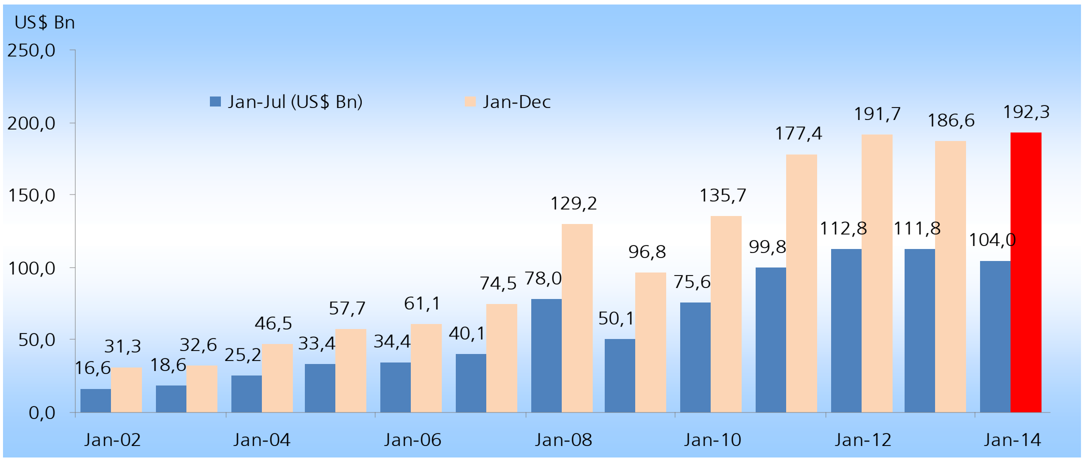
Source: BPS

2014F Full Year Exports



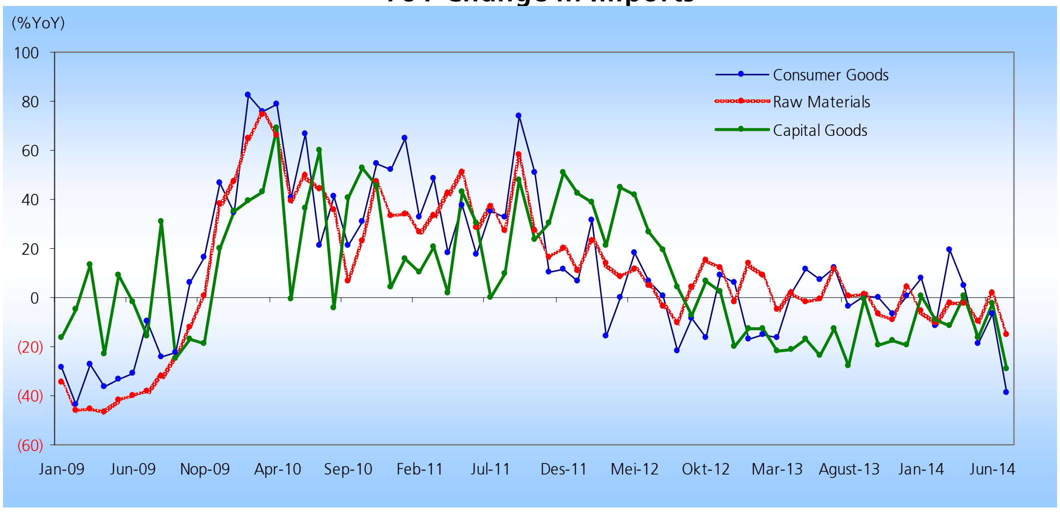
Source: BPS, Danareksa Research Institute

2014F Full Year Imports



Source: BPS, Danareksa Research Institute

YoY Change in Imports



Source: BPS

August Outlook: Trade Set to Show a Moderate Improvement

On a monthly basis, a larger decline in imports compared to exports helped to improve Indonesia's trade balance in July. Thus, after recording a US$ 288.3 mn deficit in June, Indonesia posted a surplus of US$ 123.7 mn in July. The non oil and gas trade balance still managed to record a surplus of US$ 1.73 bn, whereas oil and gas trade showed a US$ 1.60 bn deficit. Going forward, brisker economic activities in Indonesia's major trading partners should boost demand for Indonesian-made goods. As such, we expect Indonesia's trade performance to show a moderate improvement in August.

China

- The Coincident Economic Index (CEI) for China - which gauges recent economic activity -increased 1.2 percent in July to 265.1, following a 0.9 percent increase in June. The China Leading Economic Index (LEI) rose 1.3 percent in July to 297.7, after gaining 1.3 percent in June and 0.7 percent in May.

- China's retail sales slowed for the fourth consecutive month. The sales growth in August eased to 11.9 percent from 12.2 percent YoY in July. In the same month, headline inflation was stable. Prices climbed 2 percent YoY, or a faster rate than the 2.3 percent increase in July.

- The official purchasing managers index (PMI) fell from 51.7 in July (its highest level in the past 27 months) to 51.1 in August. A PMI reading above 50 indicates expansion in the manufacturing sector while a reading below 50 signals contraction.

- Weak demand affected industrial supply. The output growth of China's manufacturing sectors declined sharply to 6.9 percent, or far below the 9 percent growth pace in July. This is the weakest growth seen since exports demand from major markets started to fall in December 2008.

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

Japan

- The hike in consumption tax has had a significant impact on the Japanese economy. The latest data release shows that Japan's Q2 contraction was more severe than previously expected. Japan's gross domestic product (GDP) shrank an annualized 7.1 percent, or greater than the initial estimate of a 6.8 percent contraction. Nonetheless, looking forward, the Japanese government still believes that the Japanese economy can show a modest rebound in the next quarter.

- The gauge of current economic conditions - the CEI - declined in July by 0.1 percent to 95.0, after posting a 0.5 percent decline in the previous month. The LEI indicator - which gauges economic prospects over the next 6-12 months - also fell in the same month. After dropping 0.8 percent in June, Japan's LEI fell 0.8 percent in July to 97.4.

- The sentiment of Japanese households toward current economic conditions and economic prospects deteriorated. This is reflected in Japan's consumer confidence index (CCI) which dropped to 41.2 in August from 41.5 in the previous month as sentiment toward income growth and the job market weakened.

- Japan's retail sales, however, rebounded. After contracting 0.58 percent in June, retail sales climbed 0.5 percent in July as domestic demand improved. In the same month, headline inflation hit 3.4 percent, or slightly lower than June's 3.6 percent.

- The Markit/JMMA Japanese Manufacturing Purchasing Managers Index (PMI) indicator edged up from 50.5 in July to 52.4 in August. The improvement signals expansion in the manufacturing sector, as exports demand and new orders rose at a faster pace.

- Japan's core machinery orders rose 3.5 percent MoM in July, or up 1.1 percent YoY. The indicator is important as a leading indicator of capital spending over the 6-9 months ahead. Strong growth in business investment is seen as crucial to support the Japanese economy given weak consumption following the tax rate 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 by 0.2 percent in August to 103.8 after climbing 1.1 percent in July and 0.7 percent in June. Furthermore, the Coincident Economic Index (CEI) for the U.S. rose by 0.2 percent in August to 109.7, following a 0.1 percent increase in July and a 0.3 percent increase in June. This data suggests that the US economy is continuing to strengthen and that economic growth should accelerate in the near future.

- US households were more upbeat. The US Consumer Confidence Index (CCI) rose further in August to 92.4, after posting an increase in July. Consumers were more positive on the short-term outlook for the economy and the labor market.

- Headline inflation slowed to 1.7 percent in August from 2 percent in July. Falling energy prices and stable prices in other inflation components helped keep general prices low.

- An increase in new orders, stronger production, and higher exports demand in August helped push the ISM U.S. Manufacturing Purchasing Managers Index to its highest level since March 2011. The US PMI strengthened to 59.0 from 57.1 in July, indicating expansion of the manufacturing sector.

- At its latest meeting, the Fed continued to scale back its asset purchases. In early October, the Fed will reduce its purchases of agency mortgage-backed securities to US$5 billion per month from US$10 billion per month, and purchases of longer-term Treasury securities to US$10 billion per month from US$15 billion per month. This policy has been taken in view of the brisker pace of economic growth in the US, with improving labor market conditions and inflation moving towards its targeted level. Meanwhile, the US monetary authority has held the targeted 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 edged down by 0.01 percent MoM to 124.0 in July 2014, while the LEI strengthened 0.07 percent MoM to 135.8. Both indicators confirm that Indonesia's economy remains in expansionary mode.

- Inflationary pressures eased in August following the Idul Fitri holidays and the start of the new school year. The MoM headline inflation rate reached 0.47 percent, translating into a YoY inflation rate of 3.99 percent. Most of the CPI components rose, although prices in the transportation component fell.

- Bank Indonesia kept the BI 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 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 appreciating 2.02 percent MoM in July, the rupiah weakened 0.41 percent in August 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 2.1 percent MoM in August after falling 4.7 percent MoM in July. In the same month, the average global oil price sank 3.44 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$ 14.1 bn in August 2014, with imports reaching US$ 13.6 bn. As a result, we foresee a trade surplus of US$ 461.8 mn in August 2014.

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