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FX Flash

IDR - Headwinds From Trade Concerns

Firmer USDIDR Outlook

We have revised our USDIDR forecast higher as our expectations for a resurgence in Indonesian assets, particularly IndoGB, has hit a roadblock. Renewed Sino-US trade tensions have sparked another round of risk-off sentiments, weighing particularly on Indonesian assets. At the same time, trade tensions have worsened the country's trade deficit and hence, its current account deficit. The IDR has borne most of the brunt of this reversal of fortune compared to its ASEAN peers (since early May 2019). So far in May, the IDR has been the worst performing currency in ASEAN, falling 1.4% against the USD, while year-to-date, the IDR has slipped 0.5% against the USD (see chart 1). The absence of flows into Indonesian assets increases the likelihood that our forecast will not be achieved. We however maintain the IDR trajectory vs. the USD.

The ongoing trade tensions between China and US have led to weaker external demand for domestic goods so far. In Apr, exports sank by -13.3% y/y, sharper than the -9.4% recorded in Mar. This sharper drop in exports vis-à-vis imports resulted in the trade balance ballooning to a deficit of USD2.5bn in Apr compared to a surplus of US0.7bn in Mar. The trade deficit is likely to fade in for the rest of 2Q due to the Lebaran period and should translate to a wider current account deficit in 2Q 2019. This outlook has could pose risk to the BI's forecast for the current account deficit of 2.5% of GDP for 2019. This in turn has triggered a more cautious approach to Indonesian assets and the IDR than we had anticipated.

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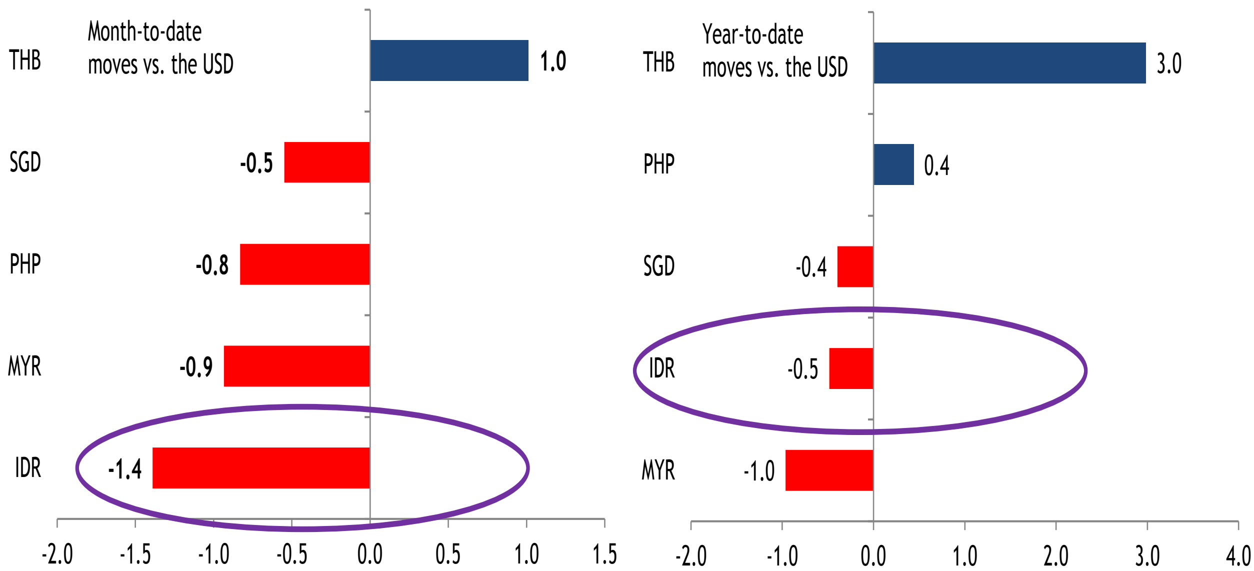
Chart 1: IDR Continues To Underperform



Source: Bloomberg, Maybank FX Research & Strategy

This is reflected in the lack of inflows into Indonesian assets that has been a drag on the IDR. Foreign investors have so far sold off both equities and government bonds in May. Foreign investors sold off USD0.02bn so far in May compared to the USD0.52bn sold off in the whole of Apr. Similarly, foreign investors sold off USD0.44bn of equities month-to-date in May, partially offsetting the inflows of US3.74bn in Apr. The foreign sell-off of Indonesian assets in May has weighed on the IDR and kept the USDIDR elevated still.

Nevertheless, we continue to expect the USDIDR to be anchored in the forecast horizon. As we have previously written, our optimism towards the USDIDR is premised on our expectations that Jokowi's win in the presidential elections in 17 Apr, reinforced by market anticipation that he will retain Sri Mulyani in a key economic portfolio, either at the Finance Ministry or in another portfolio with some oversight over the Finance Ministry. Her re-appointment would confirm that reforms will not only continue but could accelerate and intensify in Jokowi's second term in office. The expectations that Jokowi and his economic team will follow-through with further fiscal policies that will ensure not only economic growth but tame the twin deficits as well should be supportive of the IDR. We should continue to see the USDIDR move lower, albeit at a slower pace, in the quarters ahead.

We look for measures like tax reforms (of tax rule revision to support the property sector, removing value-added tax on some service exports, revising corporate taxes for coal miners, etc.) and changes to the "Negative Investment List" to open up previously partly closed sectors to foreign ownership to drive the economy forward. We also anticipate that there could be an extension and expansion of import tightening measures (including tariffs) and measures to encourage exports to curb the current account deficit. Other measures already announced included intensifying the use of biodiesel to reduce import of oil given its status as a net oil importer.

Support for the IDR should also come from BI's decision to maintain its current policy stance. Unlike its counterparts in Malaysia and the Philippines, the BI did not adjust its policy parameters, keeping its key policy rate unchanged at 6% amid global headwinds. BI governor Perry Warjiyo in his post-decision comments highlighted that the policy stance is "cautious neutral" and data dependent. Any moves to ease policy though will need to balance global risks and external stability of the economy with the need to push domestic economic growth amid a low inflation environment. This suggests that rate cuts are not imminent and should provide additional support for the IDR in the quarters ahead.

Given the recent market development, we take the opportunity to adjust our USDIDR outlook but retained its trajectory over the forecast horizon. We now expect the USDIDR to end-2Q and -3Q at 13900 and 13700 respectively from 12900 and 12700 previously. Thereafter, we expect the USDIDR to bounce mildly higher to 13900 in both 4Q 2019 and 1Q 2020 (vs. 12900 for both quarters previously) due to growth risks that could see the USD supported somewhat.

Maybank USDIDR Forecast

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDIDR	13900 (12900)	13700 (12700)	13900 (12900)	13900 (12900)

Previous Forecast in Parenthesis

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