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FX Insight

IDR - Facing Some Near Term Downside Pressures

Key Thoughts

Our lack of short term enthusiasm for the IDR stem from the weak foreign portfolio inflows into Indonesia assets so far this year. The sell-off was likely triggered by a couple of factors, namely lackluster private consumption; narrowing real yield differentials; reduced likelihood of a S&P sovereign credit rating in the next 12-24 months; and the unwinding of carry trades. ***Despite the weakness in the IDR in the first three months of the year, there are still several key factors going in its favour in 2018, including its healthy economic fundamentals and government infrastructure spending***. Given these market developments, we now expect the USDIDR to end 2Q at 13500. On the back of its strong economic fundamentals and the possibility that IDR carry trade could return to favour as volatility stabilizes and the economy continues to outperform the rest of the world in 2H18, the USDIDR should ease to 13300 by end-3Q and then to 13200 to end 2018. In the run-up to the elections on 17 Apr 2019, we expect some political tensions to lift the USDIDR slightly higher to 13300 by end-1Q 2019.

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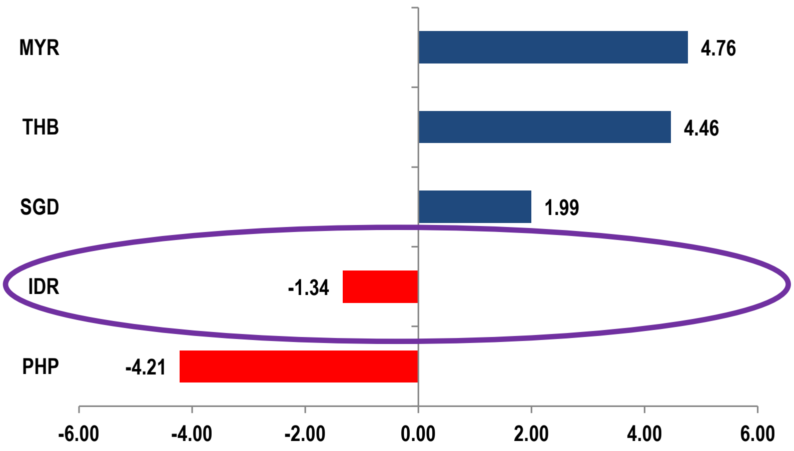
IDR Faces Some Near-Term Downside Pressures

The IDR continues to be among the worst performing currency in ASEAN. The IDR briefly hit a new 2018 low not seen since Nov 2016 at 13817 on 1 Mar. The main driving force of IDR weakness in Mar was the sell-off in equities, underpinned by lackluster domestic consumption. In addition, the unwinding of carry trade plays that begin in Feb, has extended into Mar though the pace of unwinding has eased. So far in Mar, the IDR has fallen by 0.15% against the USD as compared to the 1.65% lost in Feb.

Chart 1: IDR remains among the worst performing ASEAN currency



Source: Bloomberg, Maybank FX Research & Strategy

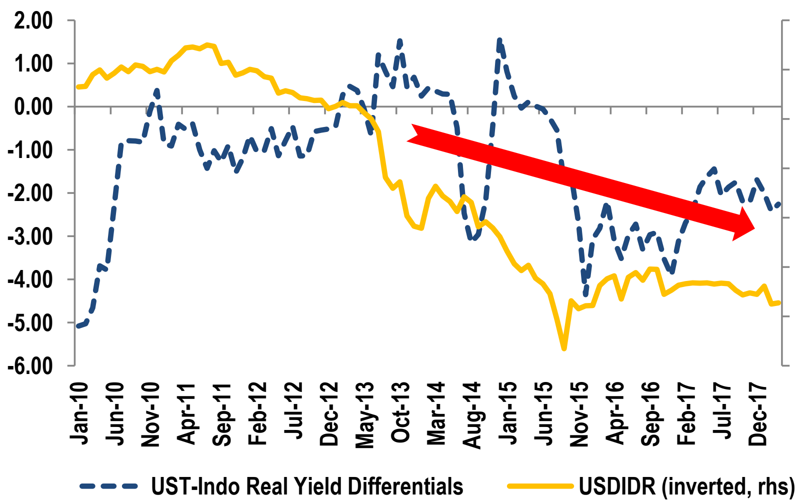
Year-to-date though the IDR has dipped by 1.43% against the USD. In the face of headwinds, we are no longer as optimistic about IDR prospects in 1H 2018. Note that in the event of a global equity correction and global rate increase, the IDR is among the most vulnerable currency given portfolio re-allocation globally and real yield weakness.

Our lack of short term enthusiasm for the IDR stem from the weak foreign portfolio inflows into Indonesia assets so far this year. The sell-off in Feb and the intermittent sell-off since was likely triggered by a couple of factors, namely lackluster private consumption; narrowing real yield differentials; reduced likelihood of a S&P sovereign credit rating in the next 12-24 months; and the unwinding of carry trades.

Lackluster private consumption spending so far has dimmed the earning prospects of domestically-dependent corporates, weighing on equities. This is even though the economy is expected to expand by a healthy 5.1-5.5% in 2018 but driven more by the synchronous global recovery and government spending on infrastructure than private consumption. Recall that private consumption makes up more than 50% of GDP. Thus, the inability to lift private consumption spending is likely to cool foreign appetite for equities.

As for debt, the unwinding of IDR carry trade plays, triggered by concerns of aggressive Fed rate hikes in 2018 as well as by the JPY losing its allure as the funding currency of choice amid rising volatility, had led to a sell-off in Indonesian debt. In addition, the narrowing real yield differentials between 10Y UST yields and the corresponding 10Y Indonesian government bond are making Indonesian debt less attractive, exacerbating the sell-off in Indonesian debt (Chart 2). This in turn weighs on the USDIDR.

Chart 2: Narrowing Real Yield Differentials Weighing on USDIDR

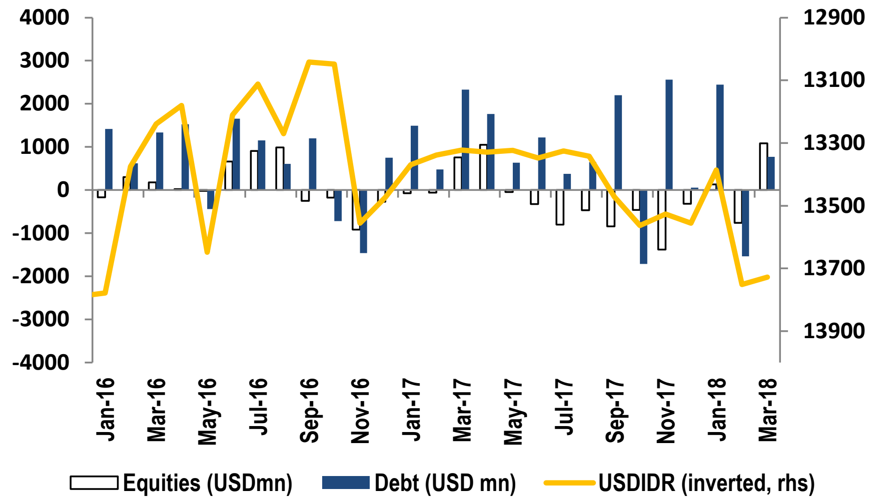


Source: Bloomberg, Maybank FX Research & Strategy

The low probability of another credit rating upgrade by S&P in the next 12-24 months should dampen sentiments and delay a repricing of Indonesia assets and moderate inflows. Consequently, the sell-off in Indonesian equities and debt has led to a reduction in short USD positions against the IDR, keeping the USDIDR elevated.

So far in Mar, foreign investors have sold off USD1.09bn and USD122.9mn in equities and debt. This brought the sell-off in equities by foreign investors to USD1.71bn year-to-date. In contrast, USD0.78bn in debt was purchased by foreign funds in the first three months of the year. Nevertheless, the dumping of equities and debt in Mar has led to a on the IDR, weighing on the IDR and keeping the USDIDR elevated above the 13700 levels.

Chart 3: Concerns of Further Unwinding of Carry Trades/Sell-off in Equities Weighed On IDR



Source: Bloomberg, Maybank FX Research & Strategy

Despite the weakness in the IDR in the first three months of the year, there are still several key factors going in its favour in 2018. Key among them is its healthy economic fundamentals. The economy continues to find strength from the cyclical global recovery that has lifted demand for commodities such as oil, CPO and coal, though this is likely to continue at a more gradual pace ahead. This in turn should benefit the IDR.

Also supportive is the government's USD400bn infrastructure programme that should not only bolster near term growth but potential growth as well. The push to accelerate infrastructure spending ahead of legislative and Presidential elections on 17 Apr 2019 should keep the growth momentum going. Spending in preparation for the Asian games slated to take place 18 Aug-2 Sep should also be supportive of growth ahead. In addition, the 15 reform/stimulus packages introduced so far that should help to cut red tape and liberalize rules that have been a drag on the economy.

At the same time, support for the IDR should also come from a tightening of monetary policy. We continue to look for BI to normalise policy and raise rate sometime in 2Q 2018. This is due to our expectations of a build-up in inflationary pressures as a result of improvement in economic growth. In the near term though, the central bank should keep its benchmark policy rate on hold to allow growth to gain further traction.

In light of the larger-than-expected outflows from Indonesian assets, we now expect the USDIDR to end 2Q at 13500 vs. 13000 previously. We remain positive on the IDR in 2H 2018 on the back of its strong economic fundamentals and the possibility that IDR carry trade could return to favour as volatility stabilizes and the economy continues to outperform the rest of the world. This should allow the USDIDR to ease to 13300 by end-3Q and then to 13200 to end 2018. In the run-up to the elections on 17 Apr 2019, we expect some political tensions to lift the USDIDR slightly higher to 13300 by end-1Q 2019.

Maybank USDIDR Forecast Changes

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDIDR	13500 (13000)	13300 (12900)	13200 (12800)	13300 (--)

Previous Forecasts in Parenthesis

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