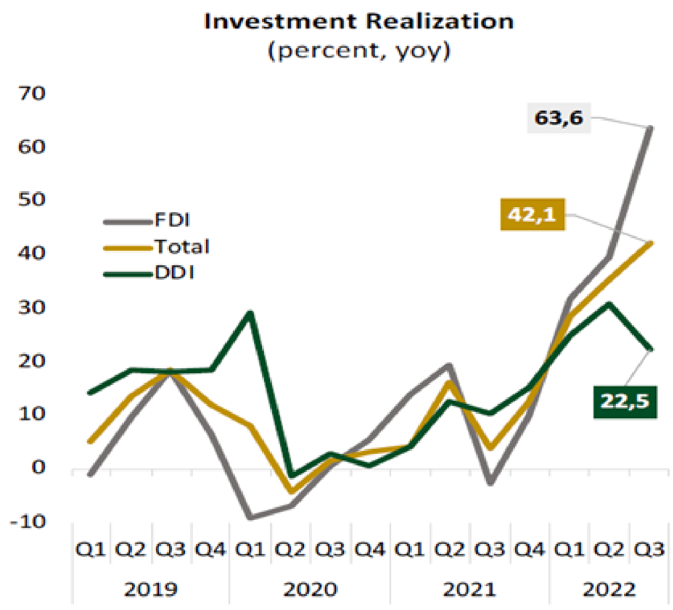
SCHRODERS INDONESIA 2023 OUTLOOK

2023 MACRO OUTLOOK: FLYING THROUGH A JETSTREAM

The year of 2022 has been a stellar year for Indonesia with solid economic growth recovery along with twin surplus on the fiscal and current account sides. Despite the 8.5% depreciation in the Rupiah, the currency remained among the most resilient ones compared to other currencies. Bank Indonesia YTD has increased its policy rate by 200bps to 5.50% which is expected in lieu of rising inflation and interest rate globally. The strong commodity price was among the major drivers of the strong Indonesia economy in 2022 along with private consumption and investment recoveries. Up until September, Indonesia was still recording budget surplus of 0.3% of GDP before turning into budget deficit of 0.9% of in October as a result of spending increase due to higher fuel price. Investment realization has also been very strong in 2022 as FDI grew by 63.6% YoY as of 3Q22 driven by basic metal industry.

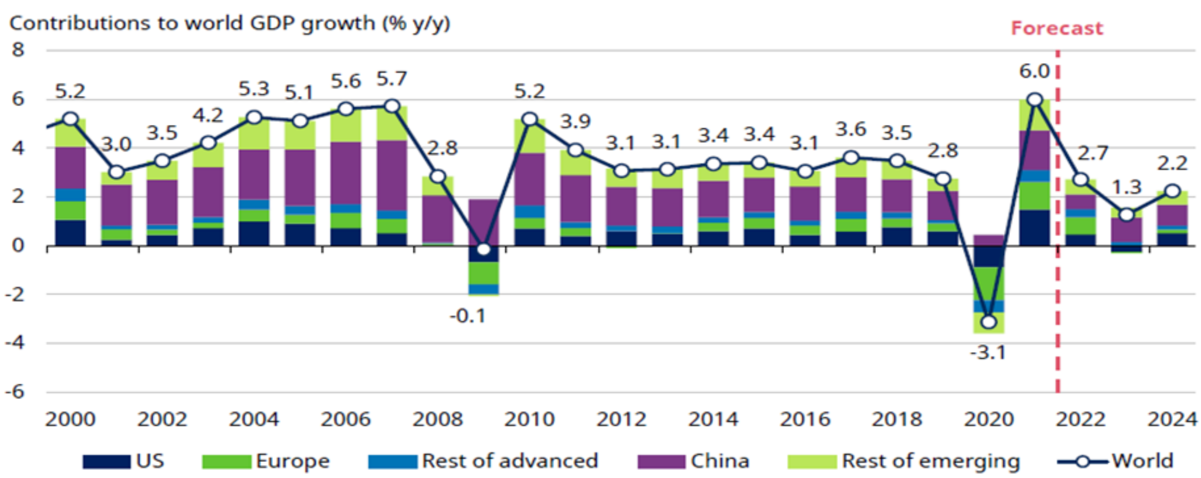
Figure 1. Indonesia Investment Realization



Source: Coordinating Ministry of Investment and Maritime Affairs , 29 Nov 2022

Our global economist team expects 2023 global GDP growth of 1.3% YoY after a series of downgrades as we expect major economies such as the US, Eurozone, as well as China to continue to face challenges in the new year. Though inflation seems to have subsided in the US, repercussion from the Fed's aggressive rate hikes has pressured the US economy. We have seen layoffs and jobless claims climbed up towards the end of 2022 while the overall impact from overall macro started to reflect in corporate earnings. Albeit a US recession remains questionable, we do think that the world's largest economy will face major economic slowdown in 1H23 before seeing the Fed starting to ease or at least maintain its policy rates towards the end of 2023. Our global economists is estimating Fed rate to peak at 4.50-4.75% in 1Q23 before easing to 3.50% by year end 2023.

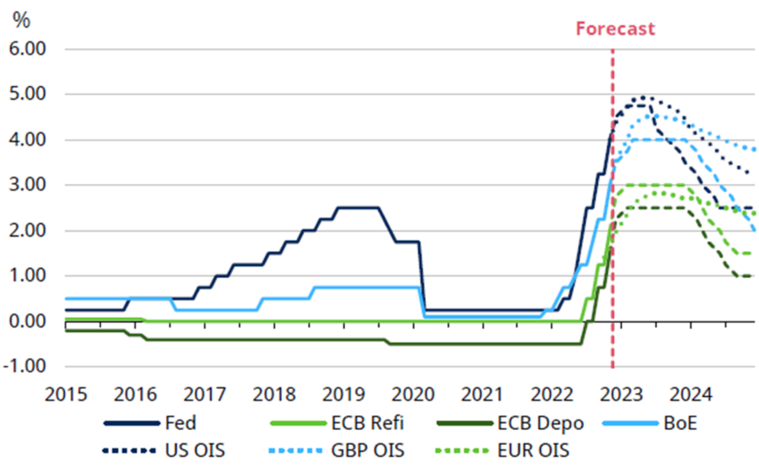
Figure 2. Schroders' global GDP growth forecast



Source: Schroders, 1 Dec 2022

Across the pond, Europe is likely to face the biggest pressure with risks of stagflation as a result to high energy price and ongoing geopolitical tension with Russia. The ever-dovish ECB has since reversed its stance and started hiking rates following the Fed and the BoE. Within EM, China remains as a wild card as policies remain as uncertain particularly surrounding the zero covid policy. However, we are starting to see the government's efforts to ease down its zero covid policy. Recent political shifts also caused economists to question China's economic growth in 2023. Though on the bright side, we are seeing policy easing especially on the monetary side in China. Hence, we expect some recovery in the Chinese economy in 2023. Meanwhile, the rest of EM will likely the main drivers of the global economy though some economies that are more domestic driven such as Indonesia and the Philippines are likely to be less impacted by the global economic slowdown.

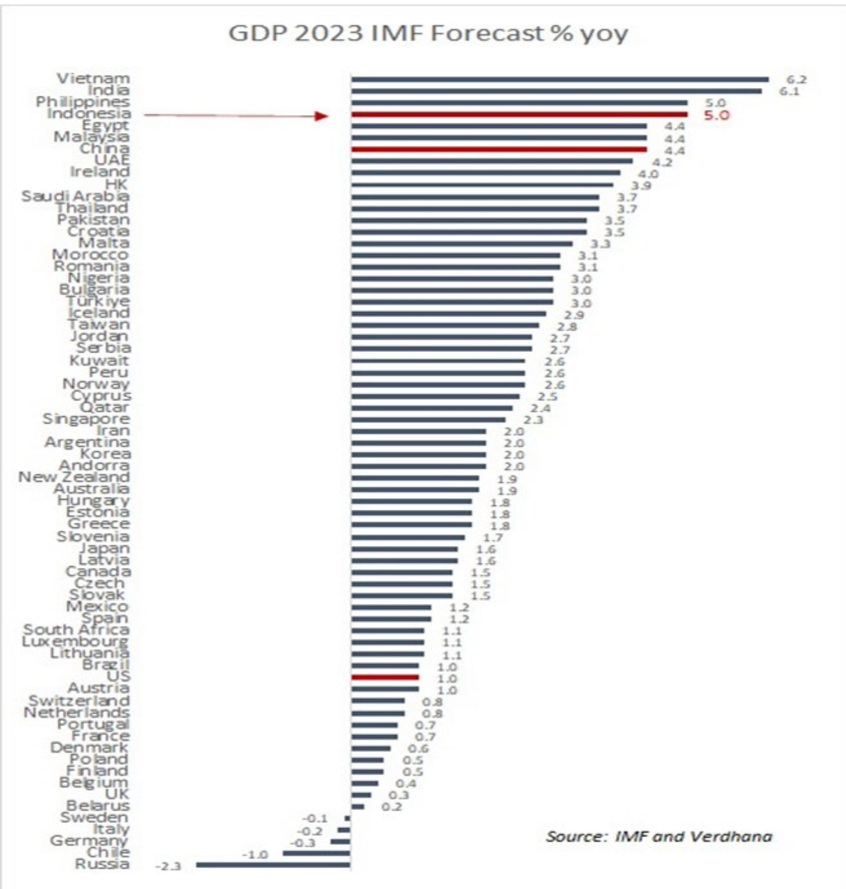
Figure 3. Policy rate dot plot for major central banks



Source: Schroders, Bloomberg, 1 Dec 2022

The information contained herein: (1) is proprietary to Bloomberg and/or its content providers; (2) may not be copied or distributed; (3) may not be accurate, complete or timely; and (4) has shown not been checked or verified by Schroders in any way. None of Bloomberg, its content providers or Schroders shall be responsible for any damages or losses arising from any use of the information in any way. The regions are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

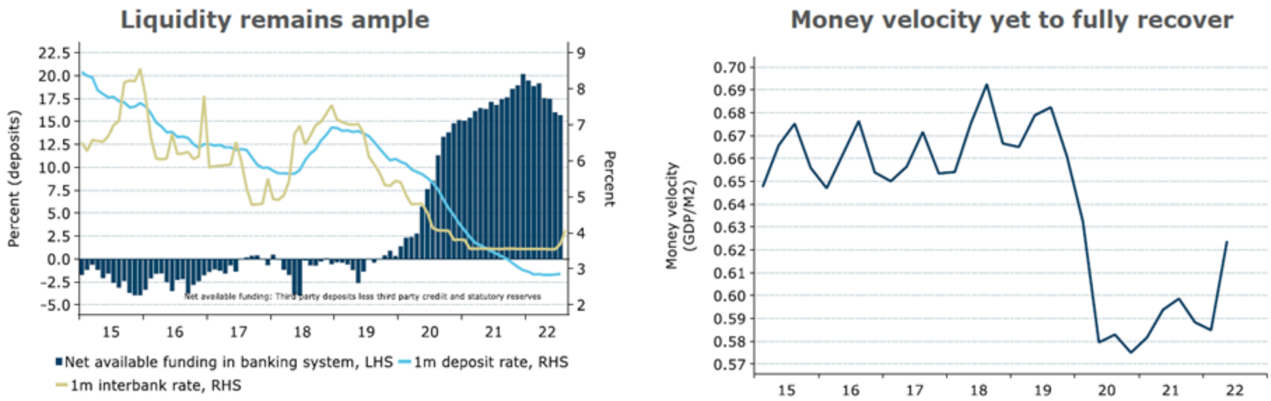
Figure 4. IMF 2023 GDP growth forecast



Source: IMF, Verdhana, 24 Oct 2022

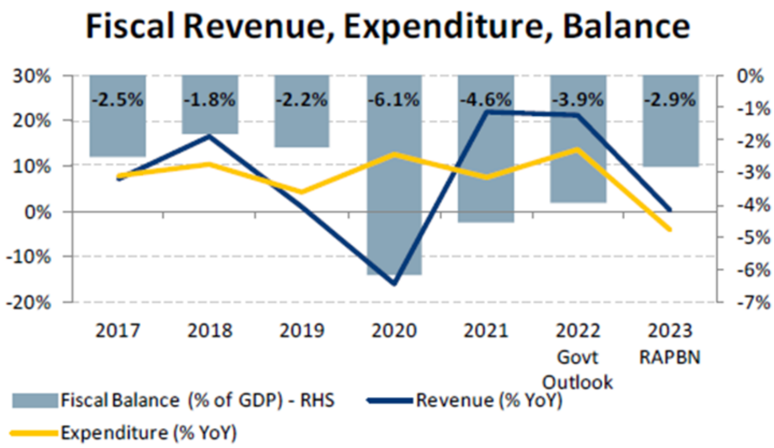
We expect Indonesia's GDP growth to remain solid next year albeit slightly slower compared to 2022. IMF is estimating Indonesia' 2023 GDP growth at 5.0% which still puts it within the strongest ones next year, only below India and Vietnam. The likeliest detractor of growth next year would be from net exports as we do expect commodity price to start normalizing in 2023. The Newcastle benchmark coal price has already came down below USD400/ton while the ICI selling price has been at a discount even since 2022. Thus, we do expect exports to come down. However, global economic slowdown may also slow down imports, hence, putting a cushion to downsides in net exports.

Figure 5. Consumption likely still need support as money velocity has not recovered to pre-covid while money supply still ample



Source: ANZ, 14 Sept 2022

Figure 6. Government aims to bring fiscal deficit back below 3% in 2023

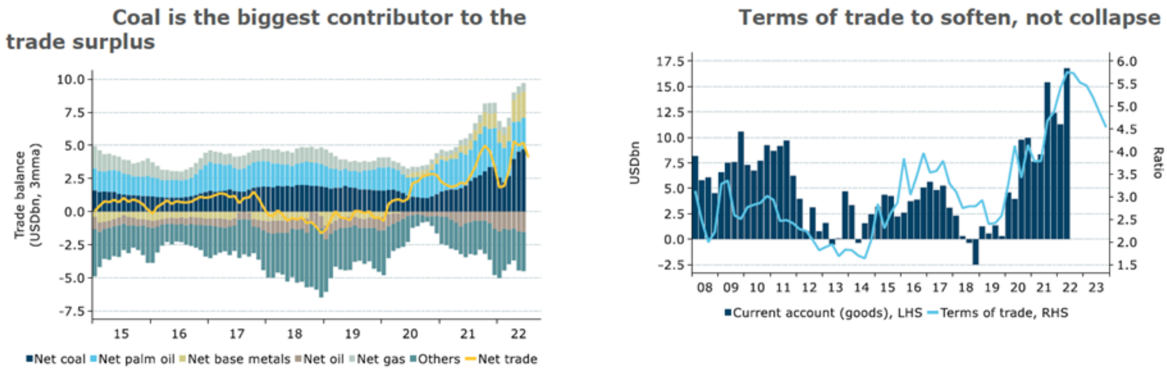


Source: Mandiri Sekuritas, Ministry of Finance, 18 Aug 2022

As the government is committed to bring down fiscal deficit below 3% of GDP in 2023, we think that government spending would also need to come down or flat at most. The government spending will likely be used to support both consumption and investments. Recent fuel price hike has shown impact to purchasing power and consumption though impact of inflation is not as bad as economists expected. However, due to political year, we think that social spending may be deployed if needed to support consumption. In the same time, the government also plans to push a number of projects before the presidential term ends in 2024. Though we think that social spending would be prioritized over infrastructure should the situation calls for it.

In terms of policies, consolidation will continue in Indonesia. According to the 2023 state budget, the government is aiming a budget deficit of 2.9% of GDP in 2023 with relatively flat yoy revenue growth and slight decline in spending. As tax revenue will have come from high base, the government expect a slower growth of 4.8% yoy in 2023. Meanwhile, non-tax revenue would decline by about 17% yoy in 2023 driven by lower commodity prices. On the spending side, we think that the government would focus more on social spending to support consumption as well as pushing last minute projects before the presidential term end in 2024. Healthcare related spending will continue to be cut as we are now in endemic stage of covid.

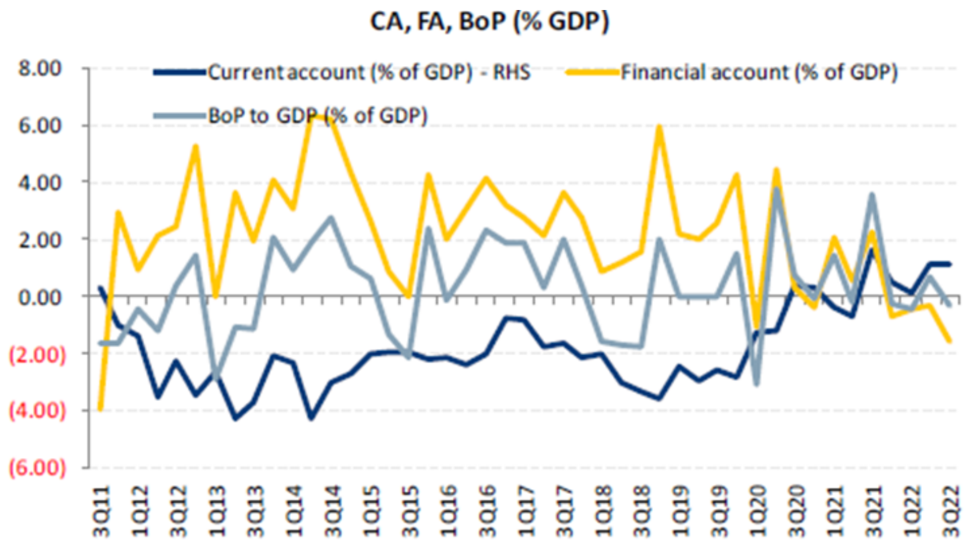
Figure 7. Easing commodity price may dampen trade balance but in a softer manner



Source: ANZ, 14 Sep 2022

On the current account side, we believe that the commodity price normalization would return the position back to deficit. Though we believe the deficit will not be as wide as pre-covid at about 2.5-3.0% as import will likely remain pressured by global economic slowdown while commodity price normalization will be more progressive. Nevertheless, the transition from twin surplus back to twin deficit may pose as risk on the Rupiah in 2023. Stronger USD and net capital account outflow, driven by the bond market, were the main causes of the Rupiah depreciation towards the end of 2022. Hence, we think that Bank Indonesia will remain vigilant and continue to increase its policy rate as needed. Though should the Fed start to ease down its rate hikes and Indonesia's inflation is not as bad as originally anticipated, we think that Bank Indonesia will adjust its policy accordingly.

Figure 8. Current account surplus as of 3Q22 while Balance of Payment pressured by capital account



Source: Mandiri Sekuritas, Ministry of Finance, 21 Nov 2022

2023 EQUITIES OUTLOOK: A DIAMOND IN THE ROUGH

Indonesia equities has been a darling among investors in 2022 as the JCI index posted return of 4.1%. The domestic driven economy, post covid corporate earnings and economic growth recovery, and high commodity price have been the many reasons foreign investors chased for Indonesian stocks throughout the year. The average valuation of about 15-16x PE was deemed attractive compared to global peers such as US and regional peers such as India at over 20x PE. GDP growth was also strong at 5.7% YoY as of 3Q22. Bloomberg consensus expects market earnings growth of over 20% YoY in 2022 which further fuel excitements on Indonesian equities.

Figure 1. Indonesia covid condition has significantly improved

Index Names	31-Dec-21	30-Dec-22	YTD Performance (%)	P/E Ratio FY23
NIFTY Index	17,354.1	18,105.3	4.3%	21.38
JCI Index	6,581.5	6,850.6	4.1%	14.18
STI Index	3,123.7	3,251.3	4.1%	12.01
UKX Index	7,384.5	7,451.7	0.9%	9.68
SET Index	1,657.6	1,668.7	0.7%	16.08
FBMKLCI Index	1,567.5	1,495.5	-4.6%	14.51
PCOMP Index	7,122.6	6,566.4	-7.8%	15.05
INDU Index	36,338.3	33,147.3	-8.8%	18.20
NKY Index	28,791.7	26,094.5	-9.4%	14.18
CAC Index	7,153.0	6,473.8	-9.5%	10.52
DAX Index	15,884.9	13,923.6	-12.3%	11.00
SHCOMP Index	3,639.8	3,089.3	-15.1%	11.49
HSI Index	23,397.7	19,781.4	-15.5%	10.88
SPX Index	4,766.2	3,839.5	-19.4%	17.52
KOSPI Index	2,977.7	2,236.4	-24.9%	10.55
CCMP Index	15,645.0	10,466.5	-33.1%	24.59

Source: Bloomberg, 31 Dec 2022

The information contained herein: (1) is proprietary to Bloomberg and/or its content providers; (2) may not be copied or distributed; (3) may not be accurate, complete or timely; and (4) has shown not been checked or verified by Schroders in any way. None of Bloomberg, its content providers or Schroders shall be responsible for any damages or losses arising from any use of the information in any way. The regions are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

We expect 2023 will still be a solid year for Indonesia though not as rosy as 2022. As a start, we do expect commodity prices to start normalize, particularly coal price. Hence, it will impact both GDP growth and corporate earnings growth. We expect 2023 GDP growth to slight ease to about 5.0% YoY as net export growth softens. However, consumption and investment shall be the drivers of growth. Pressure on purchasing power due to inflation may pose as risk, but inflation has been shown to be lower than street's expectations ever since the fuel price hike occurred.

Market earnings growth rate is expected to be low-single digit in 2023. However, if we strip out the commodity sector, earnings growth would still be double digit in the mid-teens. Banking and consumers should be among the top drivers of the earnings growth as loan growth picks up while consumer companies are seeing margin recovery from lower soft commodity prices. Tech sector will still remain under pressure as high interest rate environment is negative for the sector. However, any indications of the Fed pivoting or declining inflation and interest rate would be positive for the sector. Nevertheless, the earliest we expect monetary policy easing would only be towards the end of 2023.

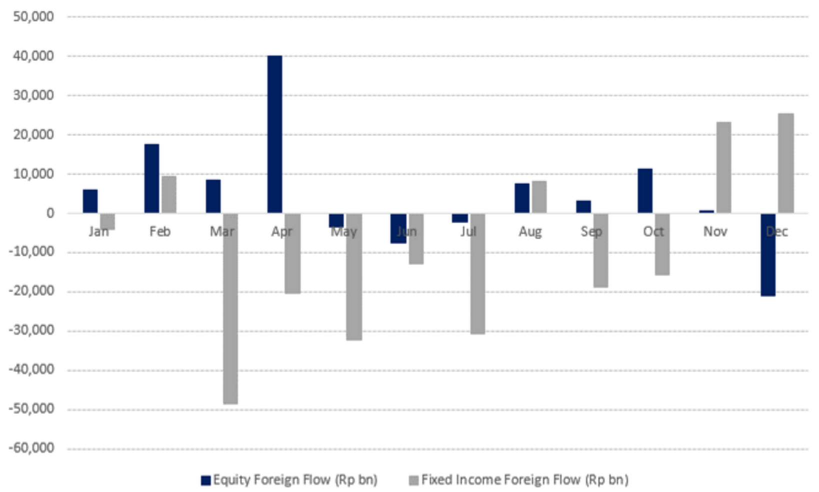
Figure 2. Excluding commodities, 2023 earnings growth still looks healthy

Sectors (Mansek Universe)	Sales Growth		EBIT Growth		Net Profit Growth	
	2022F	2023F	2022F	2023F	2022F	2023F
Banking	n/a	n/a	n/a	n/a	33.6	17.3
Construction & materials	13.2	19.4	12.5	32.5	15.7	37.1
Consumer staples	13.8	10.0	11.2	12.3	14.7	13.5
Healthcare	(5.7)	11.5	(35.1)	20.4	(33.0)	21.3
Consumer discretionary	19.7	5.1	43.8	(9.6)	39.0	0.2
Commodities	47.9	(17.4)	99.8	(39.3)	123.0	(29.4)
Property & Industrial Estate	(5.2)	6.6	(1.8)	13.5	29.8	39.2
Telecom	11.6	6.3	9.1	8.6	(7.4)	3.1
Transportation	63.5	29.8	(2,636.2)	62.5	3,879.2	51.8
Poultry	9.9	6.1	29.1	17.3	18.1	21.7
Oil and Gas	49.2	(12.7)	79.5	(12.5)	59.5	(13.2)
Internet	94.4	62.0	37.3	1.4	29.8	5.4
Conglomerates	(94.3)	75.9	(94.9)	84.9	(95.4)	102.6
Mandiri Universe	19.6	2.6	28.1	(11.2)	27.4	0.6
Mandiri Universe Ex SRTG	21.3	2.5	40.0	(11.5)	40.5	0.3
Mandiri Universe Ex SRTG Comdty	14.1	9.2	12.4	9.9	19.8	14.3

Source: Mandiri Sekuritas, 6 Dec 2022

Foreign investors well supported the Indonesian equity market in 2022 with total inflow of IDR61tn or USD3.9bn. Meanwhile, local investors have been sitting with ample of cash since 2H22 which gives them ample of ammunition to support the market in 2023. As we expect commodity prices to remain elevated, though slightly will have eased down, we think that it will keep Indonesia attractive in the eyes of foreigners. Moreover, Indonesia is on the path of recovery as well post covid, hence, corporate earnings and GDP growths would remain resilient. Valuation at 14.2x PE is also still at a discount compared to peers.

Figure 3. Foreign investors posted net inflow in equities in 2022



Source: Bloomberg, Ministry of Finance , 31 Dec 2022

The information contained herein: (1) is proprietary to Bloomberg and/or its content providers; (2) may not be copied or distributed; (3) may not be accurate, complete or timely; and (4) has shown not been checked or verified by Schroders in any way. None of Bloomberg, its content providers or Schroders shall be responsible for any damages or losses arising from any use of the information in any way. The regions are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

Nevertheless, there are a number of risks on the equity market going into 2023. First, if the higher inflation pressures purchasing power more than expected. However, we have seen inflation to have been more benign than expected even after the fuel price hike. Second, a sharp decline in commodity price would pose risk to Indonesian equities and currency though we think winter season and geopolitical tension would make the commodity price easing more gradual. Third, improvements in China's political and macro landscape including policy making which would attract foreign money back to China. At the moment, global investors seems to have mixed view on China due to recent developments in the country in the past year. Fourth, earlier recovery in the US market including policy reversal that would drive foreign money back to the US. Fifth, there may be noises coming from the political landscape going into the 2024 presidential election.

2023 FIXED INCOME OUTLOOK: RISING FROM THE ASHES

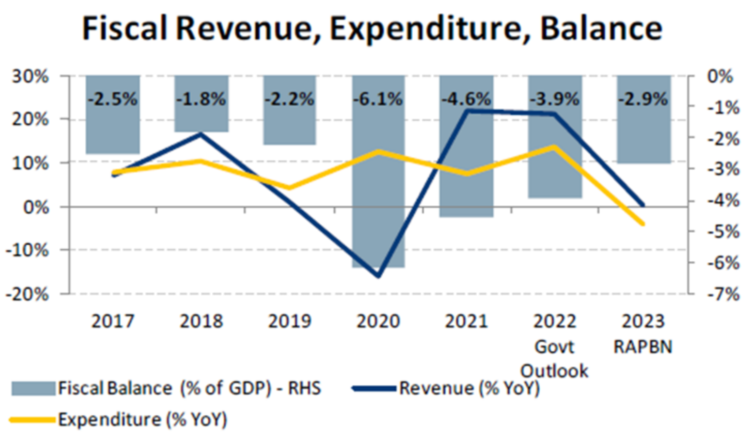
The year of 2022 has been a challenging year for fixed income with both inflation and interest rate on upward trajectory. Hence, we have seen foreign investors posted outflow of IDR129tn or USD8.3bn in 2022. During the year, Indobex government bond index posted a return of 2.61% though up until October the return was still at -0.71%. Recent indication of easing pace of rate hike by the Fed gave hope for bond investors going into 2023. At the moment the spread between the 10 year US treasury yield and 10 year IndoGB is at 350bps compared to historical level at 500bps.

Figure 1. Bond market showing recovery towards year end 2022

Source: Bloomberg, 31 Dec 2022

For illustrative purpose only and should not be viewed as a recommendation to buy or sell. The information contained herein: (1) is proprietary to Bloomberg and/or its content providers; (2) may not be copied or distributed; (3) may not be accurate, complete or timely; and (4) has shown not been checked or verified by Schroders in any way. None of Bloomberg, its content providers or Schroders shall be responsible for any damages or losses arising from any use of the information in any way.

Figure 2. Government plans to return fiscal deficit to below 3% in 2023



Source: Mandiri Sekuritas, Ministry of Finance, 18 Aug 2022

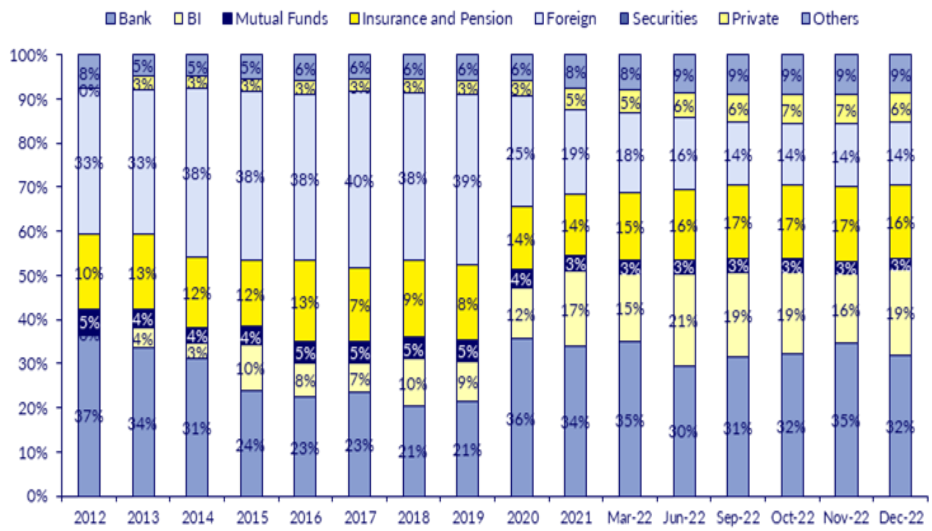
We are starting to see some recovery in the bond market towards the end of 2022 as the US inflation seems to have fallen below economists' expectations in October and, hence, prompting the Fed to start slowing down in its policy rate hike. Along with the peaking USD, sentiments seems to improve for IndoGB. However things remain to be seen entering 2023, as both the Fed and Bank Indonesia are expected to still increase rates in 1H23 while inflation is still higher than historical average.

Nevertheless, as we have seen inflation both in the US and Indonesia to be below expectations in the past months, we think that the pressure to the bond market would not be as bad as in 2022. Schroders' global economist team expects the Fed funds rate to peak at 4.75% by early 2023 before declining to 3.50% by the end of 2023 following the potential recession in the US in 1H23. Any further signs of central banks turning more dovish would become catalysts for the bond market.

Domestically, the government plans to bring fiscal deficit to below 3% by the end of 2023 as previously promised. Hence, we think that this will bring further positive sentiments for the bond market in 2023. Additionally, with the government's strong revenue growth last year, we do expect less bond supply needed in 2023 which would help support bond price. The government is expecting revenue growth to be relatively flat in 2023 while spending would slightly decline.

In 2022, foreign investors have posted large outflow from the Indonesian bond market due to inflationary pressures and monetary tightening. Along with the large new issuance in the past 2 years, foreign ownership in government bonds has fallen to 2010 level of 14%. Hence, we think that downside is rather limited at the moment for the bond market with potential flow reversal should central banks turn more dovish progressively. Despite the large outflow in 2022, the 10 year bond yield was relatively resilient ranging between 7.0-8.0% throughout the year. While ongoing uncertainties regarding inflation and monetary policies remain, we think that bond yield would remain relatively stable at current level for now. We believe monetary policy reversal would be the catalyst for the bond market to rally.

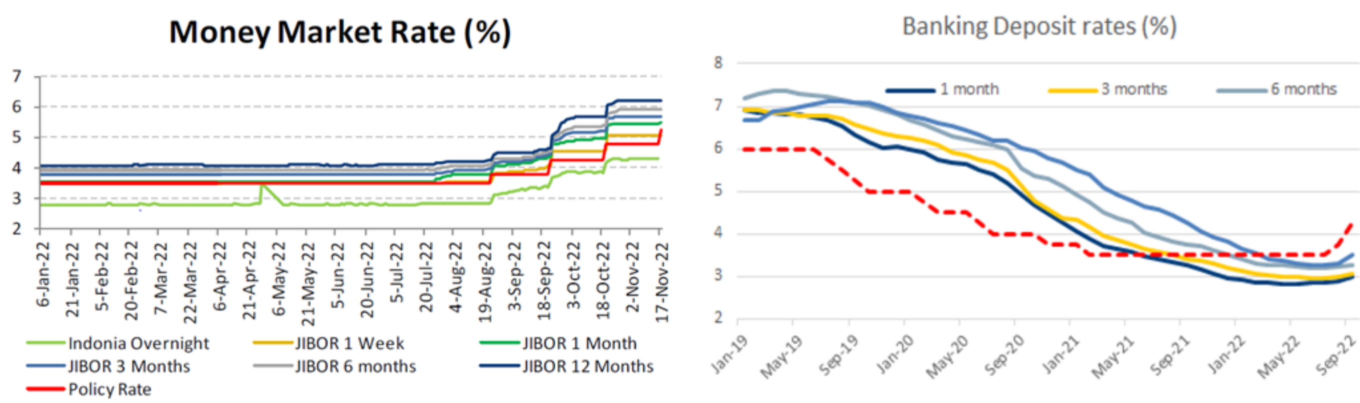
Figure 3. Foreign ownership in government bonds has fallen to 2010 level of 14%



Source: CLSA, 31 Dec 2022

Overall, we think that the bond market would remain benign in 1H23 as inflationary pressure and rate hike risks remains. However, we may see a transition towards 2H23 as inflation eases and central banks turn more dovish. We have started to see the long end series gaining support from foreign investors and Bank Indonesia towards the end of 2022 which we believe may continue. Short ends had already performed well and started to get hit by rising Bank Indonesia's policy rate. One potential risk is slowdown in demand from commercial banks as they are already sitting at high government bond position as well as rising bank deposit rates. Though we have seen banks are relatively slow in raising their deposit rates so far.

Figure 4. Bank deposit rates are lagging despite recent BI rate hikes



Source: CEIC, BI, Mandiri Sekuritas, 17 Nov 2022

DISCLAIMER

INVESTMENT IN MUTUAL FUND CONTAIN RISKS, PRIOR TO INVESTING IN MUTUAL FUND, INVESTOR MUST READ AND UNDERSTAND THE FUND PROSPECTUS. PAST PERFORMANCE DOES NOT INDICATE FUTURE PERFORMANCE.

The views and opinions contained herein are those of the author(s) on this page and may not necessarily represent views expressed or reflected in other Schroders communications, strategies or funds. This material is intended to be for information purposes only and is not intended as promotional material in any respect. The material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. It is not intended to provide and should not be relied on for accounting, legal or tax advice, or investment recommendations. Reliance should not be placed on the views and information in this document when taking individual investment and/or strategic decisions. Past performance is not a reliable indicator of future results. The value of an investment can goes down as well as up and is not guaranteed. All investments involve risks including the risk of possible loss of principal. Information herein is believed to be reliable, but Schroders does not warrant its completeness or accuracy. Some information quoted was obtained from external sources we consider to be reliable. No responsibility can be accepted for errors of fact obtained from third parties, and this data may change with market conditions. This does not exclude any duty or liability that Schroders has to its customers under any regulatory system. Any reference to sectors/countries/stocks/securities are for illustrative purposes only and not a recommendation to buy or sell any financial instrument/securities or adopt any investment strategy. The opinions in this material include some forecasted views. We believe we are basing our expectations and beliefs on reasonable assumptions within the bounds of what we currently know. However, there is no guarantee that any forecasts or opinions will be realized. These views and opinions may change.

PT Schroder Investment Management Indonesia, 30th Floor IDX Building Tower 1, Jl. Jend. Sudirman Kav 52-53, Jakarta 12190, Indonesia. PT Schroder Investment Management Indonesia is licensed and supervised by Indonesia Financial Services Authority (OJK).

PT Schroder Investment Management Indonesia
Indonesia Stock Exchange Building Tower 1, 30th Floor
Jl. Jend Sudirman Kav. 52-53 Jakarta Indonesia 12190

Website: www.schroders.co.id
Facebook page: Schroders Indonesia
YouTube: Schroders Indonesia
LinkedIn: Schroders