Market update 21 January 2020

What happened last week and what to expect this week?

- **<u>IMF Meeting</u>**
  IMF on its meeting this week indicate that they are less optimistic about the prospects for global economic growth by lowering its projections again. They lower their estimate for global economic growth of 2.9% for FY19 and 3.3% for FY20, down from 3% for FY19 and 3.4% for FY20 in the October's forecast last year. The IMF sees that the global economy is still overshadow by several risks. Although one of the causes of global economic uncertainty such as the US-China trade war and Brexit has cooled down, several tariffs in the trade agreement are still in force. The IMF is also cautious of the possibility of escalating trade war between the US-Europe and the possibility of a re-escalation of the US-China trade war. The IMF also said that the policy of the central bank would remain accommodative to support economic growth.

- **<u>Indonesia's Banking</u>**
  Later in 1Q20, OJK plans to issue a regulation which will increase the **core capital requirement** for BUKU I **banks** from < IDR1tn to a minimum of IDR1tn by 2020 and further increase the requirement to reach IDR2tn and IDR3tn by 2021 and 2022 respectively. The regulation might trigger banks to consolidates and makes it easier for OJK to supervise and guard against external risks.

  Additionally, under regulation number 41/POJK.03/2019 concerning Merger, Consolidation, Acquisition, Integration and Conversion of Commercial Banks, OJK introduced new concepts regarding the integration and conversion of foreign banks' branch offices into Indonesian banks as follows:
  - Foreign banks' branch offices could convert their business licenses into banking business licenses; the new regulation requires a conversion approval in addition to an application for a new banking business license, which should be applied for based on existing regulations.
  - Writes off the 25% shareholding threshold set out in the BI Decrees, and introduces a new concept whereby a change of control will occur if the party acquiring shares in a bank becomes the shareholder with the largest shareholding, even though the new shareholder owns less than 25% of shares outstanding.

- **<u>Notable PSAKs that will be applicable in 2020</u>:**
  Starting 1 January 2020, Indonesian banks have adopted IFRS 9 (**PSAK 71**) and most of the banks have given guidance on additional provisions that would be made to retained earnings directly, instead of through the P&L. The PSAK requires banks to change their calculation and provisioning method, where initially under PSAK 55 provision is made based on past events and current condition of the debtors (reserve arise after an event occurs that results in the risk of default), under PSAK 71, banks will have to consider forecasts of future economic conditions in their provisioning and doing so for all loan categories. This new reserving method will eventually reduce banks' CAR. The **PSAK 71** discussed above will also be applicable to **non-banking** companies as such provisioning method are mandatory too for their receivables' provisioning.

  This year, companies will also need to adopt IFRS 15 (**PSAK 72**) about the Recognition of Revenues from Contracts with Customers. Some standards that were revoked by the issuance of PSAK 72 are PSAK 34 concerning Construction Contracts, PSAK 32 about Revenue, ISAK 10 about Customer Loyalty Programs, ISAK 21 about Real Estate Construction Agreements, and ISAK 27 about Transfer of Assets from Customers. In essence, PSAK 72 changes the way of recognizing contract revenue that was rigid (rule based) to principle based. Recognition of contract revenue, for example, now is not based on the amount of down payment received. PSAK 72 might have a major impact on property companies, contractors, airlines, retail, telco and many more.

Lastly, IFRS 16 (**PSAK 73**) that regulates leases will replace several standards; including PSAK 30 on Leases, ISAK 23 on Operating Leases, and ISAK 25 on Land Rights. The new standard will substantially change the accounting for lease transactions from the lessee side. In summary, based on PSAK 73, corporations must book almost all of their leased transactions as financial leases. Operating leases are only allowed for lease transactions that meet two conditions: short-term (under 12 months) and low value.

As a result, we think these new PSAKs will change how the company operates since it could impact their performance significantly. The notable sectors are Banks, Property and Construction.

- **Indonesia's Omnibus Law**
  The Indonesian government plans to hand over the omnibus law draft to the parliament this week to replace dozens of existing, overlapping laws to improve the investment climate. The new legislation is hoped to boost investment and create jobs through labour and tax incentives. The Ministry of Economy argues that the draft omnibus law that has been raising controversy publicly might be misleading as the actual draft is still under discussion and has not been made available publicly.

Indonesia economics index:

- **Indonesia's trade balance** in December 2019 was reported a deficit of USD 0.03bn (from USD 1.07bn in December 2018 and surplus USD 1.4bn in November 2019). The figure was much better than market consensus at USD 0.47bn deficit. Exports rose by 1.28% mainly triggered by rise in non-O&G export by 5.78% while those of O&G products dropped by 31.93%. Imports dropped by 5.62% with 7.28% triggered by non-O&G while O&G rose by 5.33%. Full year, the trade deficit narrowed sharply to USD 3.2bn from USD 8.70bn in 2018. Despite the current weakness, we believe that trade balance will likely to improve in the medium term, particularly when the imposition of the biodiesel mandate early next year, the recovery of several commodity prices and IDR stabilization.

- Indonesia **loan growth** in December only grew by 6.08%, slowing from 7.05% in November. The figure was the lowest growth rate since November 2009. We think the impact from lower benchmark interest rate are yet to be reflected namely due to Presidential Election and rising trade war tension at the second half of 2019. Going forward we think, lending growth will start to accelerate in 2020.

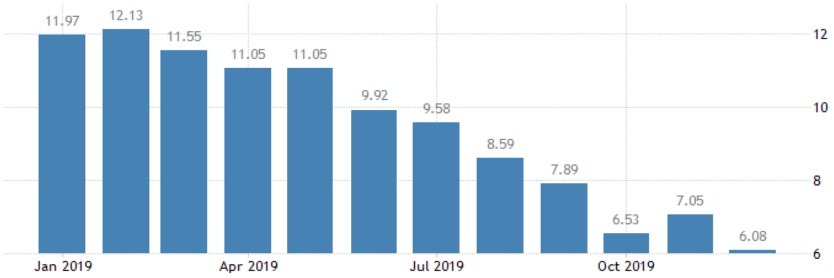

Figure 1. Indonesia Loan Growth up to December 2019 (Source: Trading Economics)

Economics data to be expected this week and next week:

- Bank Indonesia will conduct its monthly meeting next week. It is widely expected that the bank will keep the **7 Days Reverse Repo Rate** at the current level. Last year, the central bank has delivered 4 consecutive rate cut since July to October, bringing its benchmark rate to 5%. This rate cut means that BI has lowered the key interest rate by a cumulative 100bps. We believe that although the central bank still has room for an interest rate cut, the central bank will be more cautious on its decision to cut the rate further as it is unlikely that they will halt IDR appreciation by cutting rates.

- The **Federal Reserve** will conduct its monthly meeting on the 30th January. During their last month's meeting, they kept the target range for the federal funds rate at 1.5-1.75 percent. Thus, during 2019, the Fed has delivered three rate cut in July, September and October amid muted inflation pressure and concerns about the economic outlook. During their last meeting, the Fed considered the current rate to be appropriate and no further rate cuts is expected in the near future.

Market Indexes (13 January - 17 January 2020)

- During the period, JCI appreciated by 0.27% from 6,275 points on 10 January's closing to 6,292 points on 17 January's closing. YTD until today, JCI registered 0.13% loss after it closed at 6,300 points last year and closed at 6,238 today.
- During the period, in sectoral basis the index was dragged up by Miscellaneous Industry, Basic Industry and Finance sectors which were up by approximately 2% each. On the other hand, Agriculture sector, Infrastructure and Mining sectors each were down by approximately 3%. YTD until today, Consumer sector and Finance sector were the only sectors gained approximately 1% each. Agriculture sector booked the most decrease by approximately 8%, followed by property sector which booked 6% decrement.

Figure 2. JCI last YTD as of 21 January 2020 (Source: Yahoo Finance)

- MSCI Asia ex-Japan was up by 1.57% or 1.18 points from 10 January 2020 closing to 17 January 2020 closing (YTD +2.73 points or +3.71% from 73.50 points at December 2019 closing).
- IDR appreciated during the same period by 0.76%, and still appreciated YTD by 1.44% to IDR 13,658/USD today from IDR 13,866/USD on its closing in 30 December 2019.

External factors, specifically on geopolitical issues which is centered at the U.S. as well as worries on the recession issues surrounding the global economies and central banks' responses to it are still stood as some of the main catalysts to watch out for which may move our index and currencies. From internally perspective, we are keeping our focus on Rupiah, Indonesia CAD and trade balance which all in all is a crucial factor in our investment strategy.

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