

QUARTERLY REVIEW

September 2012

ECONOMIC REPORT

A busy quarter for policy makers

Concerns over global slowdown continued to dominate the headline news during the third quarter of this year. While the Eurozone crisis remains the center of the problem, other data coming from different parts of the world suggests that global economy was losing momentum. In Europe, after a long period of ‘muddling-through’, the European Central Bank (ECB) made a bold move through the so called Outright Monetary Transaction (OMT), which outlines its intention to purchase unlimited bonds in the secondary market to bring down a country’s borrowing cost. In the US, the FED launched its third quantitative easing program with the objective to find a sustained improvement in the labor market. In Japan, the BoJ has decided to enlarge its asset purchase program in light of weaker economic growth outlook and deflation pressure. Weaker than expected economic data from China suggests that we now have to get used to Chinese GDP growth of 7-8%. In the domestic market, Indonesia’s current account deficit became the main topic of discussions, putting pressure in rupiah currency.

Global Economy

Investors’ optimism in the first quarter was overshadowed by disappointing economic data released during the second quarter and months thereafter. There is little to cheer in Europe before the ECB’s announcement on August 31st on unlimited bond purchase program. Europe’s weak economic fundamentals as well as structural problems including labor structure and pensions highlight some of the challenges that the region is facing. ECB’s OMT program seems to be a step in the right direction. However, this will not solve Europe’s underlying problems. One fundamental issue that Europe needs to urgently address is its labor structure. Since the creation of the single currency, Europe has witnessed a growing competitiveness imbalance, particularly in countries such as France and Spain. France manufacturing unit-labor costs have increased by 28% over the past 12 years, whereas Germany only 8%. Further, French companies on average pay much larger social charges relative to employees’ gross salaries. Without effective labor reforms, it will be difficult for Europe to restore competitiveness, and hence, its productivity.

GDP	2010	2011	Q1/12	Q2/12	2012E*
Developed Market	3.0%	1.6%	-	-	1.2%
Emerging Market	6.9%	6.2%	-	-	5.4%
World	4.9%	3.9%	-	-	3.3%
United States	2.9%	1.7%	2.4%	2.1%	2.2%
Euro Area	1.7%	1.5%	0.0%	-0.4%	-0.5%
<i>Germany</i>	3.6%	3.1%	1.2%	1.0%	0.9%
<i>France</i>	1.6%	1.7%	0.4%	0.3%	0.1%
<i>Italy</i>	1.0%	0.4%	-1.5%	-2.6%	-2.0%
<i>Spain</i>	-0.2%	0.7%	-0.6%	-1.3%	-1.6%
United Kingdom	1.7%	0.7%	-0.1%	-0.5%	-0.4%
Australia	2.7%	2.0%	4.4%	3.7%	3.6%
Japan	3.9%	-0.7%	2.9%	3.2%	2.3%
China	10.1%	9.2%	8.1%	7.6%	7.7%
India	7.4%	7.1%	5.3%	5.5%	5.5%
INDONESIA	6.0%	6.5%	6.3%	6.4%	6.0%

Data: World Bank, Bloomberg

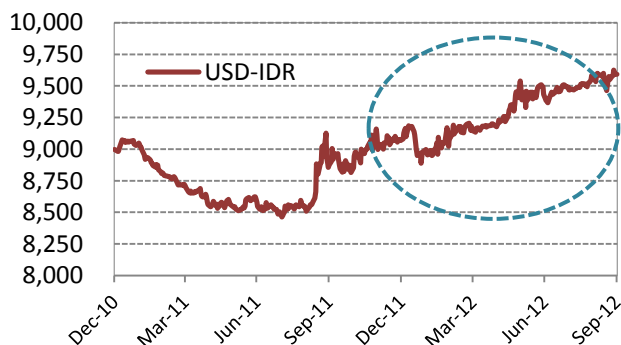
In China, Q2 GDP came in at 7.6%, the weakest since Q1/2009. The end of investments era in which the government injected billions of dollars on infrastructure projects to support the economy suggests that China is now moving from an investment led economy to consumption. This should create a better China in the longer term from our perspectives. Nevertheless, slowdown in Chinese infrastructure projects may dampen recovery in commodity prices in the short/medium term considering China has been the world’s largest commodity consumer in past the years.

Indonesia Economy

Back in Indonesia, robust GDP figure during the first half 2012 of 6.4% (Q1: 6.3%, Q2: 6.4%) was overshadowed by current account position, which has turned deficit since the end of 2011. Slowdown in exports driven by softer commodity prices coupled with surge in imports resulting from increase in capital goods as well as raw materials drove Indonesia's current account into the negative territory. Looking into the figures, Indonesia's trade deficit is not necessary a bad thing considering the uptake in imports was driven primarily by continued *strong investments* in the country, mostly in the private sector. As such, imports of capital goods should translate positively to the economy in the future.

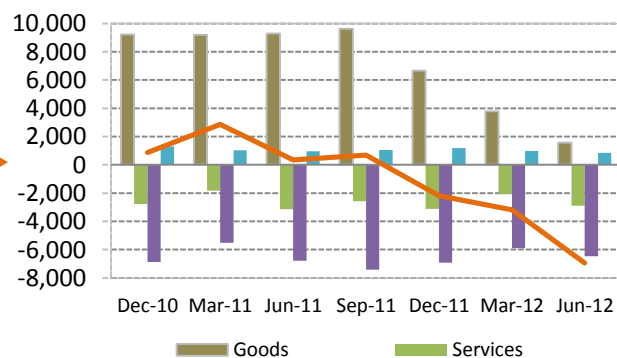
In the absence of a meaningful pick-up in commodity prices, particularly coal and palm oil, we do believe that Indonesia's exports in the coming months or quarters to remain relatively weak, and hence, leaving current account deficit to stay. Nevertheless, we argued that the size of the deficit should not jeopardize Indonesia's economy considering part of the deficit will continue to be offset by growth in FDI, as well as the potential upside from portfolio inflows to the country.

Chart 1: USD-IDR (2010 - present)



Source: Bloomberg, Panin Asset Management

Chart 2: Indonesia's Current Account Position



Source: CEIC, Panin Asset Management

Indonesian currency has depreciated by 5.8% versus the USD as of the September to IDR 9,591 (see Chart 1). Rupiah has been the weakest performer in the region despite Indonesia's robust GDP figure. Our observation suggests that the weakness in the currency can be attributed to Indonesia's current account deficit. As highlighted in Chart 2, we see a strong correlation between current account deficit and movement of Rupiah. We do not challenge the fact that Rupiah will continue to be vulnerable particularly to potential portfolio outflows to the country. Nevertheless, assuming that current account deficit will not widen further, we don't think that current account issue will put much more pressure on the currency.

In terms of outlook, we have not changed our view that Indonesia's long-term underlying fundamentals continue to look strong supported by a number of factors including strong domestic economy, good corporate earnings, improved inflation and public debt position. In the short-term however, we foresee a few external factors that could increase downside risks to Indonesia's economic growth. Slowdown in China, as well as Europe/US can have both direct and indirect impact to our economy through slowdown in exports, FDI, and portfolio inflows. We believe the former is significantly more concerning as China is not only Indonesia's largest trading partner, but also its influence in global commodity prices. As a result, we are cautiously optimistic on Indonesia's economic condition in the coming quarters.

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