

INDONESIA

FX & Rates	1Q19F	2Q19F	3Q19F	4Q19F
USD/IDR	14,600	14,700	14,800	14,800
IDR 7-Day Reverse Repo	6.25	6.50	6.75	6.75

Economic Indicators	2016	2017	2018F	2019F
GDP	5.0	5.1	5.3	5.2
CPI (average, y/y %)	3.5	3.8	3.5	3.8
Unemployment rate (%)	5.6	5.3	5.5	5.4
Current account (% of GDP)	-1.8	-1.7	-2.8	-2.5
Fiscal balance (% of GDP)	-2.5	-2.5	-2.1	-2.0

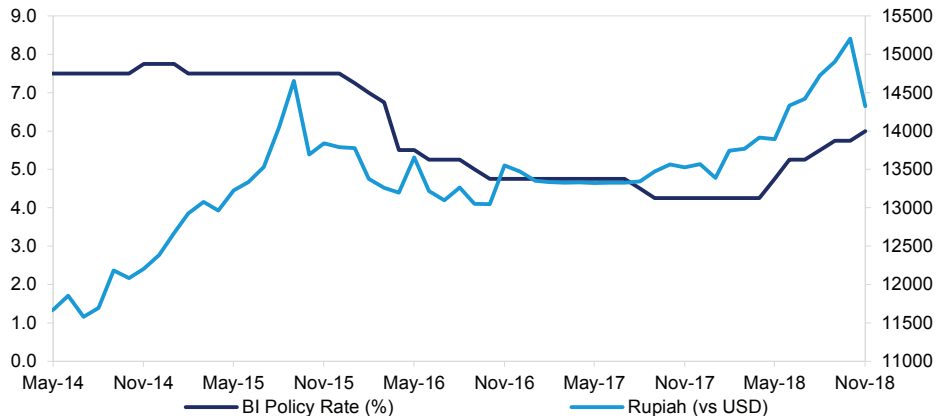
Growth Slowed In Q3 And May Extend Into 2019 Amidst Tighter Policies

Indonesian economy grew by 5.17% yoy in Q3 2018 versus 5.27% in the preceding quarter. Growth is driven by all components, where the highest growth is recorded by imports growth at 14.1% yoy, followed by exports at 7.5%. As for domestic demand, investment spending growth continue to be robust at close to 7% yoy growth, exceeding government spending at 6.3% and household consumption at 5.0% despite strong imports growth. We remain cautious on the uncertainty in the external front as the US-China trade tension continue and the US Fed continue on its hiking trajectory for the rest of this year and going into 2019, though recent rhetoric suggested less hawkish stance.

We kept our 2018 GDP growth forecast unchanged at 5.3% although now we may see growth momentum to be stalled in 2019 on the back of tighter monetary policy and lower fiscal deficit amidst consolidation in 2019. We continue to hold a cautiously optimistic view of the Indonesian economy in 2019 as domestic demand remains robust and stability in the external front and the rupiah are more entrenched. Even though the external uncertainty remains, policy mix introduced by the government, the central bank, and related policymakers have started to bear fruits as evident from the capital reversals into Indonesia in the past few weeks in November. Indonesia's large domestic markets and its high private consumption spending may continue to underpin the growth of the economy, coupled with steady investment growth, and a likely support from higher exports growth. Our growth forecast for 2019 is currently set at 5.2%.

Rupiah And BI Policy Rate

Source: BI, Bloomberg, UOB Global Economics & Markets Research



Where The Fed Goes, BI Will Likely Follow

Indonesia's inflation remained stable so far as no supply disruption was evident and as volatile prices component remain manageable even as we enter year-end festivities and holiday season. Our inflation forecast (year-average) of 3.5% remains unchanged and it is right in the middle of Bank Indonesia's (BI) inflation target of 2.5-4.5%. Bank Indonesia (BI) has thus far raised the BI 7-day Reverse Repo Rate by a cumulative 175bps to reach the current level of 6.00% since May 2018. The series of rate hikes decision remain consistent with BI's pre-emptive, front-loading, and ahead-of-the-curve strategy to anchor the stability of the domestic financial market against increased uncertainty in the global financial markets. In specific, BI's decision was made to keep current account deficit (CAD) from widening further and has resulted into more financial stability in terms of rupiah exchange rate. BI's strategy to keep as minimal a currency volatility as possible is also complemented by its policy direction in providing domestic NDF (DNDF) and FX swap rate at a more competitive pricing as part of its ongoing efforts to alleviate spillover from the external volatility unto the domestic financial market while at the same time deepen the financial market further.

Our expectation for the Fed Reserve remains at three 25bps rate hikes in 2019 but the Fed policy path is more uncertain next year as the Fed shifts emphasis to data dependence. So our 75bps cumulative rate hike in 2019 may

face some downside risks if US economic data weakens significantly or the US-China trade tension re-escalates. For now, we keep our 25bps/quarter rate hike forecast, each in Q1, Q2, and Q3 2019 consecutively to reach 6.75% by the end of 2019.

IDR Outlook: The Worst May Be Over But Still Expect Gradual Weakness Towards 14,800 In 2019

To a certain extent, BI's pre-emptive, front-loading, and ahead-of-the-curve strategy of managing IDR's weakness has paid off in 4Q18. Since early Nov, IDR has strengthened abruptly from 15,200 per USD to current levels of around 14,400.

Notwithstanding the near-term strength, the macro backdrop behind IDR remains challenging next year. Domestically, Indonesia's current account and fiscal account are expected to remain in deficit albeit some improvements, at -2.5% and -2.0% respectively. This makes the IDR vulnerable alongside other Emerging Market currencies as the Fed continues its gradual rate hikes. Externally, Indonesia is also not spared from trade headwinds due to the protracted trade dispute between US and China. That said, BI matching of the pace of Fed's tightening in 2019 may alleviate pressure on the IDR.

Overall, we expect the IDR to continue to weaken alongside other Asian currencies. We forecast USD/IDR at 14,600 in 1Q19, 14,700 in 2Q19 and 14,800 in 3Q and 4Q19. Prevailing spot of USD/IDR is 14,400.

Indonesia Election

Indonesia, world's third largest population, will come yet again to the ballot box in April 2019. This time, it will be for the first time that voters will vote for both House Representatives and President (and chosen VPs). The incumbent President Joko Widodo (Jokowi) will seek re-election and will face the same competitor in the 2014 presidential election, Prabowo Subianto - ex general of Indonesia National Military. Jokowi is seen as a proletarian while Prabowo is elite and that is likely to define each candidate's value proposition. The key parties under Jokowi's coalition include PDI-P, Golkar, National Democrat (Nasdem), and National Awakening Party (PKB) while Prabowo's coalition include Gerindra (Great Indonesia Movement), PAN (National Mandate Party), Democratic Party, and PKS (Justice Prosperous Party). For 2019 government and legislatures agreed to add 15 seat in addition to 560 existing seats on 2014 (see Table) to account for the under-represented provinces, such that now there are a total of 575 seats to be contested. Below subsequently are the campaign schedule and candidates' vision and mission, as well as survey results conducted thus far.

Key Difference With The 2014 General Election

The enactment of Law no 7 of 2017 render some differences and important things to note compared to the 2014 general elections. These are:

1. Simultaneous presidential and legislative elections (Article no 167, no 3, Chapter VIII)

Unlike previous general elections that legislative and presidential elections held at different dates, 2018 general elections both elections planned to be held at the same date.

2. Presidential Threshold 20% Base (Article 222, Chapter IV)

Competing party/parties that bring its presidential candidate must have at least 20% of total seat in parliament or 25% vote from total national vote. There is no change in threshold but the base of the threshold is different. In 2014 presidential election the base is from legislative elections in 2014 also because during that time, the legislative elections and presidential elections are held at different dates in the same year. For 2019, the base is using the last legislative election results (2014).

3. Parliamentary threshold is 4 % (Article 414, Chapter XI)

Competing parties in national legislative election should have minimum 4% vote from the last legislative vote held, which is now changed from the previous election's 3.5%. The consequence is there could be a fewer parties competing in national levels. However no threshold for competing in regional legislative board.

4. Open vote system (Article 168, Chapter I)

This addition is not drastic change compared to last election. The addition of open vote system is to include the party that supports the president and vice president candidate in the vote paper.

5. Vote Region Seat Magnitude 3 – 10 (Article 187, Chapter III)

In 2014 the seat are based on the proportion of population in each province. For 2019, the number of seats for every province in the legislatures will be a minimum of 3 and a maximum of 10. It means that even though a province is the smallest as a proportion, they will have a minimum of 3 representatives. At the same time, province with larger population cannot have more than 10 seats in the parliament.

Campaign Schedule

Key Dates	Event
17 July 2018	Legislative candidate registration
4-10 August 2018	Presidential candidate registration
23 September 2018 - 13 April 2019	Election campaign
14 - 16 April 2019	Quiet period
17 April 2019	Direct Election
9 May 2019	Political Parties for City DPRD election result announcement
12 May 2019	Political Parties for provincial DPRD election result announcement
15 May 2019	Political Parties for DPR and DPD election result announcement
6 October 2019	New President and Vice President Inauguration

Source: General Election Commission 2018

Survey Result Over Time

Candidates (In %)	12 – 19 August 2018	7-14 September	24 September – 5 October
	LSI Denny JA	Saiful Mujani R & C	Kompas Research
Joko Widodo – Ma'ruf Amin	52.2	60.4	52.6
Prabowo S – Sandiaga Uno	29.5	29.8	32.7
Undecided/Swing Voters	18.3	9.8	14.7

Source: Various Survey Institution and News 2018