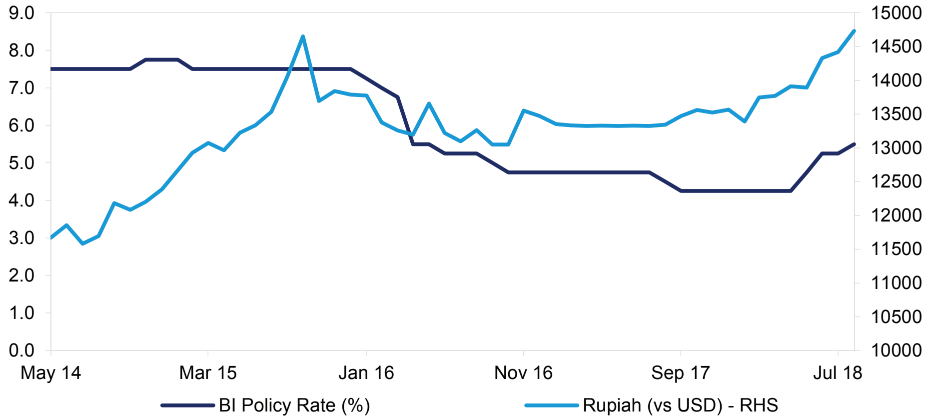
INDONESIA

FX & Rates	4Q18F	1Q19F	2Q19F	3Q19F
USD/IDR	15,000	15,200	15,400	15,400
IDR 7-Day Reverse Repo	6.25	6.50	6.75	7.00

Economic Indicators	2016	2017	2018F	2019F
GDP	5.0	5.1	5.3	5.4
CPI (average, y/y %)	3.5	3.8	3.5	3.9
Unemployment rate (%)	5.6	5.3	5.5	5.4
Current account (% of GDP)	-1.8	-1.7	-2.7	-2.5
Fiscal balance (% of GDP)	-2.5	-2.5	-2.4	-2.0

Rupiah And BI Policy Rate

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



Growth Beats Expectation In Q2, But Remains Cautiously Optimistic On External Front

Indonesia's second quarter GDP growth came in better than expected at 5.27% yoy (Consensus: 5.12%), and based on expenditures, growth was driven by all components. The highest growth was achieved by consumption expenditures for non-profit household, which grew by 8.71% yoy; followed by exports at 7.70% yoy and investment (Gross Fixed Capital Formation) for 5.87% yoy. Private consumption also grew more strongly at 5.05% yoy in Q2 2018 vs. 4.95% in Q1 2018. In general, consumers feel an improvement in economic conditions and more optimism in the second quarter of 2018. However, challenges going forward lie more on the uncertainty in the external front as the trade tensions continue to rise, led by the US, while the US Fed continue on its hiking trajectory for the rest of this year and going into 2019.

Nevertheless, our full year 2018 forecast of 5.3% remains on track for now as we continue to believe that growth momentum may be sustained in Q3 amidst notable one-off factors such as the highly successful Asian Games 2018 in Jakarta and Palembang and next month's annual IMF/WB meeting in Bali. We continue to hold a cautiously optimistic view of the Indonesian economy in 2018 even though the external uncertainty continues to run high and on the back of ongoing capital reversals towards the advanced economies. 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.

With External Pressures Mounting On The Rupiah, BI Is Likely To Continue Hiking Rates

Indonesia's inflation remained stable so far as no supply disruption was evident and as volatile prices component remain manageable. wihle higher food prices were offset by lower housing prices component and lower transport component. For now, 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 125bps to reach the current level of 5.50% since May 2018. The decision is 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 anchor financial stability and also in a bid to keep current account deficit (CAD) from widening further. BI's strategy to keep as minimal a currency volatility as possible is also complemented by its policy direction in providing FX swap rate at a better pricing in order to stimulate further transaction in its bid to deepen the financial market, especially the exchange rate market.

Going forward, with risks mounting due to rising trade tension, economic turmoil in Argentina and Turkey that are spreading to most emerging markets, and finally Fed's hiking cycle, may give additional reasons for BI to continue with further rate hikes. Given a more pressing external environment, we decided to bring forward our forecast for BI to hike sooner and by more at another 50bps in September and by another 25bps in Q4 to settle at 6.25% by the end of this year. For now, we keep our 25bps/quarter rate hike forecast, each in Q1 and Q2 2019 consecutively.

IDR Outlook: On-going BI Rate Hikes To Limit Excessive IDR Weakness

Previously, we had highlighted the risk of IDR weakness. Indonesia's twin current account and fiscal deficits make the IDR vulnerable alongside other Emerging Market currencies amidst rising US interest rates. Over the past quarter, together with the INR and PHP, the IDR was amongst the weakest trio of currencies in the Asia FX space. From Jun's level of around 14,000, the IDR fell to its early September low of about 14,900 against the USD, a correction of more than 6% across 3Q.

Indonesian authorities have been proactive in managing the IDR's weakness. So far in this cycle, Bank Indonesia (BI) has already raised its 7 day reverse repo rate by a cumulative 125 bps. Going forward, we expect BI to continue its rate hikes to try to stabilize the IDR against the risk of rising US interest rates. In addition, the finance ministry has started various efforts to control the pressure from the current account deficit by encouraging import substitution with local goods as well as delaying big ticket energy imports.

Overall, we expect the IDR to continue to weaken alongside other Asian currencies. Nonetheless, efforts by BI and Indonesian authorities will help limit excessive IDR weakness. We forecast USD/IDR at 15,000 in 4Q18, 15,200 in 1Q19 and 15,400 in 2Q and 3Q19.