



2019 Indonesia elections

As Indonesian polls point to incumbent Joko Widodo (Jokowi) winning the election, we assume this to be accurate, although official results will only be released in May 2019. With this key uncertainty lifted, investors will shift their attention to fundamentals and the expectation of policy continuity.

Challenges ahead

Two key issues remain for Southeast Asia's biggest economy, namely to reduce external vulnerabilities and to boost gross domestic product (GDP) growth. Since Jokowi took power, GDP has averaged 5% a year, missing the 7% target. One barrier to growth is a rigid labour market which compares to the hiring flexibility for labour-intensive industries in other ASEAN economies in the region.

Indonesia's vulnerability also stems from its current account deficit which makes its currency, the Rupiah, less resilient during risk-off periods. The government has taken steps to address this issue, but more will need to be done to see a sustained improvement in the current account.

Equities outlook

So far for 2019, Indonesia has the second highest corporate earnings growth of 9.9% in the ASEAN region. Indonesia equities are trading at 10-year historical mean on a price-to-earnings ratio and below one standard deviation on a 10-year historical price-to-book ratio basis.

In terms of sectors, we are overweight on banks that will deliver strong loan growth and better net interest margins with interest rates that have peaked. Since Jokowi is likely to expand budgets for infrastructure projects, we would be adding weights to the infrastructure sector. We advocate reducing exposure to the consumer sector as government subsidies are likely to decline in 2020 because handouts had already been distributed this year to sweeten Jokowi's election prospects.

A dovish US Federal Reserve (Fed) outlook is positive for Indonesian equities as this means foreign investors are likely to keep their allocation within the country.

Fixed income outlook

Bond spreads are expected to continue to narrow as markets had previously priced in a Jokowi win. Under a risk-on environment such as now, quasi-sovereign bonds will perform better with their wider spreads, compared to sovereign bonds. Even so, foreign investors will view Indonesian government bonds as a more attractive emerging market (EM) asset with the 10-year yield spread over equivalent US Treasury bonds at over 500 basis points (bps) on an unhedged basis, alongside high real rates and a stable Rupiah.

For hard-currency sovereign bonds, longer tenors look more compelling. Bank Indonesia has also sounded dovish lately, but any move from them should be contingent on a stable current account.

House view

Any interest rate cut from Bank Indonesia will be positive for both equity and fixed income assets, so the Rupiah should have room for appreciation given the country's relative openness of the capital markets to foreign investors.

The risks would be a further deterioration in the current account deficit which was the main reason for the currency depreciation in 2018, owing to a further weakening of the current account from persistently strong imports. The attention has been turned to exports, and improvements to US-China trade talks should boost outbound shipments for the country.

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