

Industrial Sectors Affected by Current Macroeconomic Conditions in Indonesia

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In the second half of 2013, we expect companies engaged in the real sector in Indonesia to face challenges with the current macroeconomic conditions. These conditions include the depreciation of the rupiah (IDR) against US dollar (USD), a current account deficit, high inflation, and increasing interest rates. As of Sept. 30, 2013, PEFINDO has published the ratings of 65 companies in the real sector with the exception of financial institutions, most of which have issued debt instruments such as bonds and/or medium term notes (MTN).

Bank of Indonesia's (BI) middle exchange rate shows that as of Oct. 10, 2013, the rupiah had depreciated 19% to IDR11,542/USD1 from IDR9,670/USD1 at the end of 2012. This depreciation could have a positive or negative impact on several industrial sectors in Indonesia, such as those relying on imported materials and/or equipment and whose revenue is mostly generated in rupiah, such as pharmaceuticals, poultry feed, food and beverages, telecommunications, chemicals, and the automotive industry. The depreciation means increased production costs or capital expenditure for companies in those sectors, which would lower profitability margins if not directly passed on to the selling price of their products. Companies with a significant portion of unhedged USD debt with IDR revenue stream will also be adversely affected.

On the other hand, companies in the commodity-based sectors which generate most of their revenue from the export market could see a positive impact from the depreciation, such as those in the plantation and mining sectors. However, the positive impact might not be significant due to the weakening global demand for commodities, which has lowered prices. As of Sept. 30, 2013, PEFINDO has revised its rating outlook to negative and lowered the rating for four out of 10 companies in the plantation sector and one company in the mining sector, mostly due to their aggressive capital structure amid lower commodity prices, which could weaken their credit quality.

Predictions of further depreciation led Bank Indonesia to gradually increase its benchmark rate by 150 bps to 7.25% from 5.75% in the hope that this would help the rupiah against the dollar. This could also potentially lead banks to increase their lending rates, adversely affecting companies that aggressively rely on external borrowing with a higher share of variable interest rate in their capital structure, as they will bear higher interest expenses, which lead to lower profitability. Companies in the property and automotive sectors could also be adversely affected, particularly those who focus on the low-income segment where customers rely on loans to finance the purchases. An increase in interest rates could also force some companies to revise or postpone expansion plans in the near term, in turn delaying their bond issuance plans.

At the same time, the inflation rate was also high at 8.4% in September 2013, compared to 4.3% in September 2012, which could lead to weakening consumer purchasing power. High inflation could adversely affect the growth of the retail and consumer goods sectors. Although they could still show growth, it would not be as high as predicted earlier this year. The low-income segment tends to selectively choose or reduce consumption as prices rise. The demand of luxury goods could also be adversely affected after the government increased the tax of luxury goods as part of its economic policy to reduce imports to improve the current account.

The government has released a package of policies designed to improve the current account, maintain economic growth and manage inflation, as well as to accelerate investment. However, these measures take time and commitment to implement and see positive results.

In general, PEFINDO believes that the impact of current macroeconomic conditions in Indonesia will not be severe, which could drastically change our current rating distribution for the short term. Despite no major rating revisions expected, we will continuously monitor the performance of companies in our portfolio to anticipate any negative effects should macroeconomic conditions continue to weaken in the near to medium term.

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