Maybank Kim Eng

STRATEGY

Indonesia

# Indonesia Strategy

# 2021 Outlook: higher gear

**Analysts**

Isnaputra Iskandar
(62) 21 8066 8680
isnaputra.iskandar@maybank-ke.co.id

## POSITIVE; JCI target 6,900

We maintain our POSITIVE view on the market as the overall macro situation should continue to gradually improve in 2021. Our end-2021 JCI target of 6,900 is based on 21.8x PER, 2SD above its 10-year mean. Higher valuations are justified given structural changes in the economy. Foreign fund inflows are likely due to 1) foreign investors' low exposure to Indonesia's equity market; and 2) potential hunt for yields by global investors. We like sectors with exposure to economic recovery, FDI and nickel. Our Top Picks are: AKRA, ASII, BJBR, BMRI, ICBP, INCO, KLBF, MAPI, PGAS, PWON, SMGR and UNTR .

## Low expectations for short-term recovery…

Given the wide range of market forecasts of 2021 GDP growth, this suggests expectations on both economic and earnings recovery are low. Successful distribution of vaccines will be the key variable. However, we think low interest rates, supported by low inflation and IDR appreciation, and rebound in commodity prices will also support the recovery.

## …and medium to long-term upside potential

The consensus 2022 GDP growth forecast of c. 5% also suggests the market is not factoring in potential upside to the economy in medium to long term from the Omnibus law and the value-added process in the mining sector. We think both can surprise not only in terms of increased investments but on the trade balance front as well.

## Persistently high retail participation

We think high participation from retail investors in the market will continue in 2021, supported by declining interest rates and improving risk appetite. This is positive to support liquidity in the market. Given retail investors' tendency to trade based on market momentum, we think market valuations could become stretched.

| Stock | Rating | Price*, IDR | TP, IDR | Upside**, % | PER***, x | PBV***, x | Yield***, % | ROAE***, % |
|---|---|---|---|---|---|---|---|---|
| AKRA | BUY | 3,280 | 3,800 | 17.9 | 17.5 | 1.4 | 2.0 | 8.4 |
| ASII | BUY | 5,950 | 7,800 | 34.2 | 12.9 | 1.4 | 3.1 | 11.4 |
| BJBR | BUY | 1,590 | 1,800 | 19.2 | 8.2 | 1.3 | 6.0 | 16.2 |
| BMRI | BUY | 6,700 | 7,600 | 16.4 | 13.8 | 1.5 | 2.9 | 11.5 |
| ICBP | BUY | 9,700 | 14,000 | 47.3 | 16.7 | 3.5 | 3.0 | 22.2 |
| INCO | BUY | 5,250 | 7,000 | 33.3 | 34.9 | 1.7 | 0.0 | 5.1 |
| KLBF | BUY | 1,485 | 2,000 | 36.4 | 23.7 | 3.8 | 1.7 | 16.4 |
| MAPI | BUY | 890 | 1,100 | 24.5 | 22.1 | 2.2 | 0.9 | 10.8 |
| PGAS | BUY | 1,790 | 2,200 | 24.7 | 22.1 | 1.1 | 1.8 | 5.2 |
| PWON | BUY | 525 | 650 | 24.8 | 12.5 | 1.4 | 1.0 | 12.0 |
| SMGR | BUY | 12,250 | 14,100 | 16.1 | 26.7 | 2.0 | 1.0 | 7.7 |
| UNTR | BUY | 26,575 | 30,000 | 16.5 | 10.9 | 1.4 | 3.6 | 14.1 |

* closing prices as of 15 Dec; ** including dividend, *** based on 2021 figures

Source: Bloomberg, Maybank KE

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# 1. Market outlook and positioning

## 1.1. Positive on JCI

We continue to be positive on the market due to gradual economic and earnings recovery. In 2021, we think the market will focus more on macro developments than corporate earnings. Our end-2021 Jakarta Composite Index (JCI) target of 6,900 is based on 21.8x 2021 PER. The target PER multiple is in line with 2SD above 5-year mean. We believe the JCI deserves to trade at a premium due to structural changes in the country. We prefer sectors related to economic recovery, FDI and nickel. Our Top Picks for 2021 are: AKRA, ASII, BJBR, BMRI, ICBP, INCO, KLBF, MAPI, PGAS, PWON, SMGR and UNTR.

Key risk factors to our call are lower-than-expected vaccine availability, uncertainty in state budget financing, court challenge on the Omnibus law, and potential changes in the roles of regulators in the financial sector.

Our positive stance on the market is based on the following arguments:

- **Short-term gradual recovery with low expectations**. We expect the economy to continue its gradual recovery and post positive growth for 1Q21. Overall, we forecast the economy to post 5.3% growth for 2021 (2020F: -1.8%). Vaccines will play a key part in the recovery, but low interest rates - driven by low inflation and IDR appreciation – will also help.

  On corporate earnings, we forecast an aggregate growth of 38% for 2021 after posting a YoY decline of 38% for 2020. We do not think our 2021 earnings forecast is aggressive because our forecasts suggest aggregate earnings are still lower than 2019 level. This implicitly says that we do not expect the economy to fully recover in 2021.

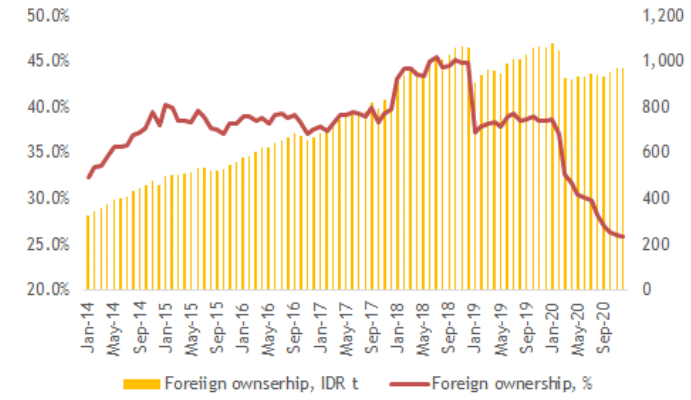
- **Underappreciated medium to long-term upside**. We believe the market has not factored in the potential upside from structural changes in the economy. This is shown by the market expectation of only c. 5.1% GDP growth for 2022. We expect the structural changes will be driven by the Omnibus law and the value-added process in the mining sector. Both will be positive for investments, which account for around one-third of the economy.

- **High retail participation**. We expect participation of retail investors to continue to be high in 2021, which could be positive in our view to support liquidity in the market. The high participation will be supported in our view by continued low interest rates, which make time deposits unattractive as an investment and support margin-based transactions.

- **Return of foreign investors.** Foreign investors' participation in both the domestic bond and equity markets has dropped quite substantially. Foreign ownership (in nominal value) in the bond market has increased as of late, but the percentage of ownership is still low at 25-26% vs 38% at the beginning of 2020. Meanwhile, in the equity market, foreign investors have posted total net outflows of IDR190-200t since the middle of 2017.

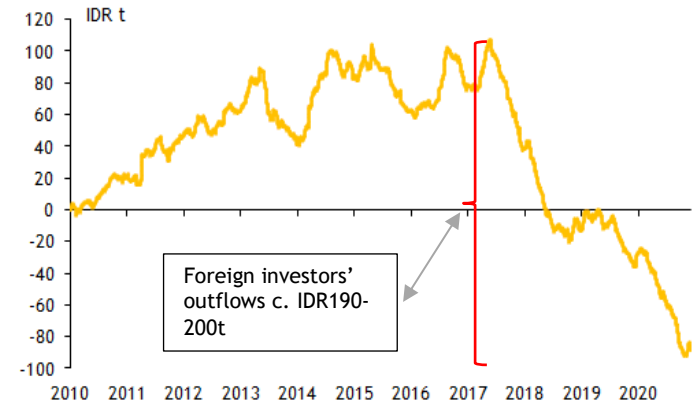
We expect the trend will reverse as we think global positive developments on vaccines, the potential change in the US fiscal policy and global investors' improving risk appetite could drive funds from developed to emerging markets, including Indonesia.

**Fig 1: Low foreign ownership in government bonds**




*Source: Bloomberg*

**Fig 2: Cumulative foreign investors' net buy/(sell) in IDX***




* excluding M&A deals

*Source: Bloomberg*

## 1.2. Technical view: positive

We are also positive on the JCI from a technical point of view. Our technical analyst, Satriawan (satriawan@maybank-ke.co.id), thinks the market will continue its upward trend in 2021. This can be seen from two technical tools: moving average (MA) and moving average convergence/divergence (MACD).

The MA analysis shows that the MA 50 (50 day moving average) line already crossed the MA 100 (100 day moving average) and MA 200 (200 day moving average) lines in November. This Golden Cross suggests the market will continue its bullish trend. Meanwhile, the MACD analysis shows that the MACD line already crossed above the signal line, also signalling a bullish market trend.

**Fig 3: Bullish on JCI from technical view as well**


*Source: Bloomberg*

## 1.3. JCI target and valuations

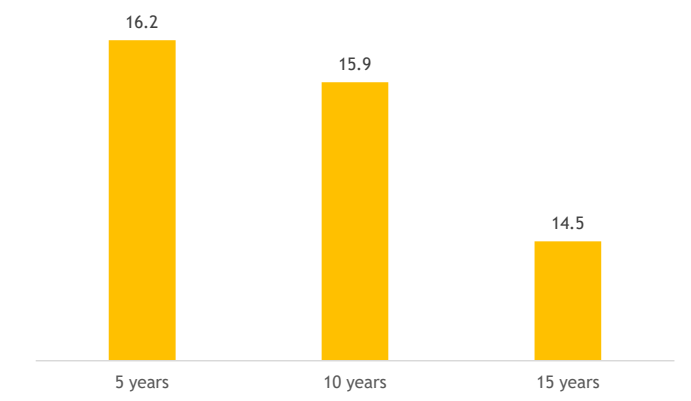
Our end-2021 JCI target of 6,900 is based on 21.8x 2021 PER. We assume market EPS growth of 38% YoY in 2021, which we believe is reasonable as it suggests aggregate corporate earnings have not gone back to 2019 levels.

The target PER is in line with 2SD above the 5-year mean. We think the JCI deserves higher trading multiples due to potential upside from structural changes in the economy post the issuance of the Omnibus law. Fig 4 suggests the valuation re-rating of the JCI is not something new. This can be shown by the increasing JCI PER average from 14.5x (15 years) to 15.9x (10 years) and 16.2x (5 years).

We think there is still upside from the current JCI level of c. 5,900. Our analysis suggests that the current index of 5,900 implies 7.2% 10-year government bond yield. This is higher than the current bond yield of 6.1-6.2%. Our analysis is based on the following assumptions: 1) risk premium of 5%; 2) EPS growth of 10% in 2022-26 and 6% from 2027 onwards; and 3) terminal value (TV) growth of 5%. We think our growth assumptions are not aggressive because we have not factored in the upside potential from the Omnibus law. Also, our TV growth assumption is still lower than the long-term nominal GDP growth of 8-9% (real growth: 5%; inflation: 3-4%).

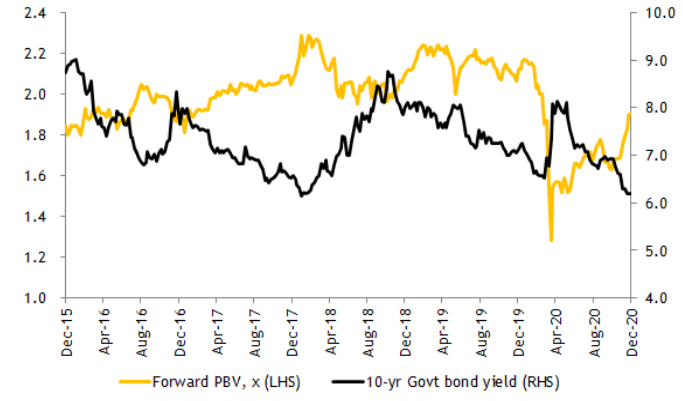
As we expect the 2021 average yield to be at least similar to the current one, the JCI looks undervalued in our view. This is despite c. 40% increase in the JCI since its low (c. 4,200) in April. Incorporating 6.2% into the calculation, the implied JCI is 6,900, which is in line with our JCI target.

**Fig 4: Re-rating of JCI PER (x) over time**




*Source: Bloomberg, Maybank Kim Eng*

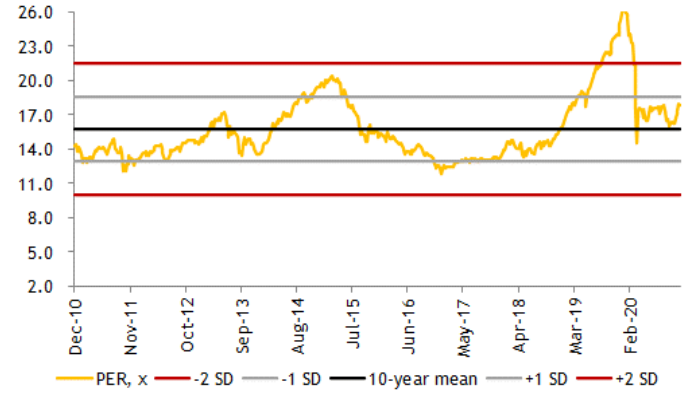
**Fig 5: JCI PBV vs 10-year government bond yield**




*Source: Bloomberg, Maybank Kim Eng*

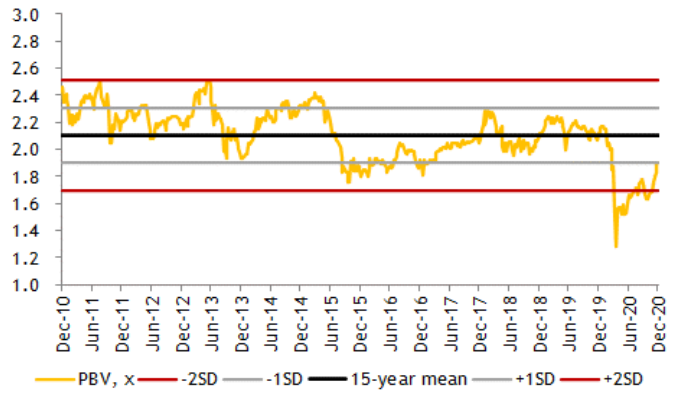
JCI's 2021 PER and PBV valuation do not look challenging in our view. The PER is still below 1SD above the 10-year mean. Meanwhile, the PBV is around 1SD below the 10-year mean. We believe the market should trade at a higher valuation due to low government bond yield and potential structural changes in the economy.

**Fig 6: JCI PER**




*Source: Bloomberg, Maybank Kim Eng*

**Fig 7: JCI PBV**

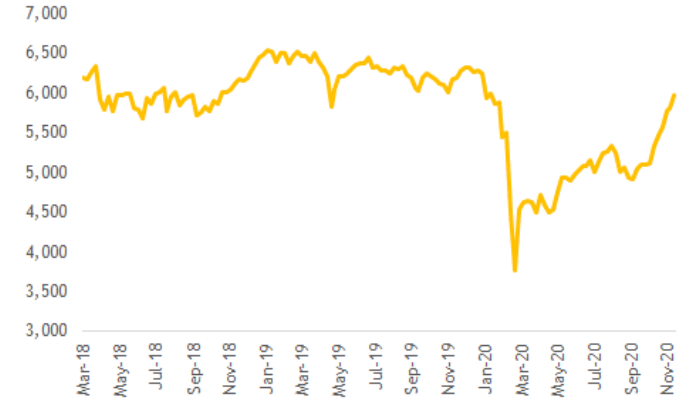



*Source: Bloomberg, Maybank Kim Eng*

## 1.4. Sector positioning: lack of choices?

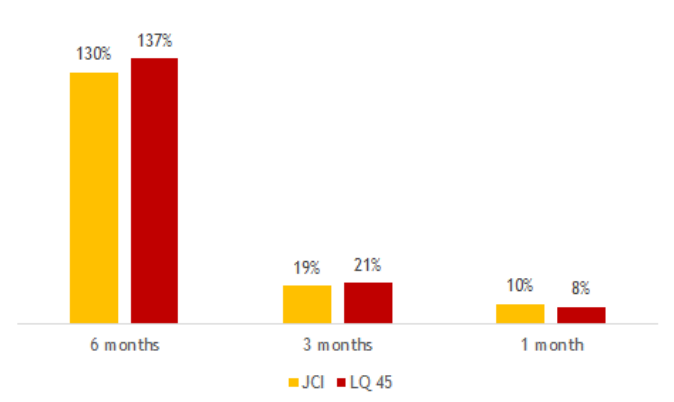
In the past month or two small caps outperformed the LQ-45 stocks, which we attribute to the lack of choice in the market during the bull market since most other stocks ran up already. We think the situation will continue due to 1) ESG issues that could prevent some institutional investors from buying certain sectors such as cigarette and coal; and 2) we do not expect many big IPOs over the next 12 months. That said, investors will continue their bargain hunting in tier-2 and tier-3 names to generate alpha or continue to buy liquid names, which could drive up valuations to new levels.

**Fig 8: JCI**




*Source: Bloomberg*

**Fig 9: Smaller stocks outperformed LQ45 last month**




*Source: Bloomberg, Maybank Kim Eng*

Given the potential lack of choices in the market and foreign inflows, it is possible that investors will also focus on high-beta stocks. Fig 10 lists the LQ-45 stocks ranked based on their betas. We use the 5-year betas to both capture market momentum and sector developments.

**Fig 10: Betas of LQ-45 stocks**

| No | Ticker | Beta | No | Ticker | Beta | No | Ticker | Beta | No | Ticker | Beta | No | Ticker | Beta |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | PTPP | 1.623 | 11 | PWON | 1.419 | 21 | ERAA | 1.265 | 31 | PTBA | 1.132 | 41 | ICBP | 0.871 |
| 2 | INKP | 1.602 | 12 | CTRA | 1.404 | 22 | ASII | 1.256 | 32 | HMSP | 1.073 | 42 | TBIG | 0.863 |
| 3 | TKIM | 1.573 | 13 | BSDE | 1.403 | 23 | AKRA | 1.248 | 33 | BBCA | 1.050 | 43 | TOWR | 0.764 |
| 4 | PGAS | 1.564 | 14 | ADRO | 1.385 | 24 | BTPS | 1.228 | 34 | KLBF | 1.032 | 44 | MDKA | 0.582 |
| 5 | ANTM | 1.519 | 15 | BMRI | 1.374 | 25 | JSMR | 1.211 | 35 | GGRM | 1.029 | 45 | MIKA | 0.449 |
| 6 | INCO | 1.519 | 16 | JPFA | 1.365 | 26 | SRIL | 1.178 | 36 | TLKM | 1.016 | | | |
| 7 | WIKA | 1.500 | 17 | BBRI | 1.344 | 27 | ITMG | 1.175 | 37 | INDF | 0.996 | | | |
| 8 | SMRA | 1.485 | 18 | INTP | 1.342 | 28 | SCMA | 1.161 | 38 | UNTR | 0.983 | | | |
| 9 | BBTN | 1.473 | 19 | CPIN | 1.286 | 29 | MNCN | 1.160 | 39 | ACES | 0.964 | | | |
| 10 | BBNI | 1.427 | 20 | SMGR | 1.268 | 30 | EXCL | 1.144 | 40 | UNVR | 0.927 | | | |

Note: betas, as of 6 December, are based on 5-year weekly data

*Source: Bloomberg*

Below is our sector positioning:

- We prefer sectors that will benefit from positive macro developments in the near, medium, and long terms. We like sectors with exposure to: 1) economic recovery (auto, cement, property, high-end retail and utilities); 2) FDI (industrial estate); and 3) nickel. Refer our latest reports on cement, property and retail sectors by our analysts: Aurellia Setiabudi (aurellia.setiabudi@maybank-ke.co.id) and Willy Goutama (willy.goutama@maybank-ke.co.id).

- We are neutral on the banking sector as banks will focus more on asset quality before extending loans aggressively. Our banking analyst, Rahmi Marina (rahmi.marina@maybank-ke.co.id) forecasts industry loan growth of only 1.1% in 2021. Refer to her banking sector outlook report dated 9 December titled Gradual recovery.

- We are neutral/selective on the consumer sector as we think economic recovery will not be broad based. It will benefit the medium to high-income earners more than the low-income earners.

- We are also neutral on the infrastructure sector, despite the government's strong commitment to the sector, due to persistent cash flow issues in the sector. Continued low inflation will also be negative for toll road companies as it can extend their payback periods.

- We are negative on cigarette and coal due to structural changes in these sectors, which are related to ESG issues and higher regulatory risks. We expect trading in both sectors to be more based on momentum.

**Fig 11: Top Picks**

| No | Stock | Rating | Price*, IDR | TP, IDR | Upside**, % | Investment Thesis | Risk factors |
|---|---|---|---|---|---|---|---|
| 1 | AKRA | BUY | 3,280 | 3,800 | 17.9 | 1) beneficiary from economic and commodity prices recoveries, 2) limited downside risk to petroleum margin, 3) beneficiary from increasing FDI flow. | 1) coal price collapse as 40% of volume is sold to coal sector, 2) margin downside from the competition with Pertamina (the largest petroleum player), 3) regulatory risk. |
| 2 | ASII | BUY | 5,950 | 7,800 | 34.2 | 1) strong recovery in automotive volumes, 2) low interest rate and IDR appreciation will improve puchasing power, 3) beneficiary from recovery in commodity prices. | 1) competition in the car segment, 2) collapses in commodity prices will reduce purchasing power, 3) prolonged economic recession will delay recovery in automotive volumes. |
| 3 | BJBR | BUY | 1,590 | 1,800 | 19.2 | 1) strong credit demand from civil servants and pensioners to continue in 2021, 2) outstanding loan quality, 3) most resilient earnings in the sector. | 1) slower than expected loan growth due to prolonged pandemic, 2) lower than expected success rate of loan restructuring that leads to NIM compression, 3) rapid new NPL formation that is faster than banks' ability to build provisioning buffer |
| 4 | BMRI | BUY | 6,700 | 7,600 | 16.4 | 1) competitive margin, 2) room for cost reduction from improving risk control, 3) higher ROE outlook. | 1) slower than expected loan growth due to prolonged pandemic, 2) lower than expected success rate of loan restructuring that leads to NIM compression, 3) rapid new NPL formation that is faster than banks' ability to build provisioning buffer |
| 5 | ICBP | BUY | 9,700 | 14,000 | 47.3 | 1) exposure to more than 1b population, 2) strong debt-servicing capability, 3) strong earnings growth post the acquisition of Pinehill | 1) prolonged economic recovery, 2) increasing wheat prices, 3) IDR depreciation |
| 6 | INCO | BUY | 5,250 | 7,000 | 33.3 | 1) main beneficiary of higher nickel prices, 2) lower regulatory risk post 20% divestment to Inalum, 3) potential surprise on dividend. | 1) nickel-price drop, 2) regulatory risk, 3) increasing oil and coal prices without being followed by higher nickel prices. |
| 7 | KLBF | BUY | 1,485 | 2,000 | 36.4 | 1) acceleration of earnings growth in the next three years from stronger consumer health and biosimilar segments, 2) proxy to Covid-19 vaccine and drugs in Indonesia, 3) dominant healthcare player in South East Asia. | 1) delay in new biosimilar products launching, 2) government strict regulations on vaccine and drug distribution, 3) intensifying competition for its consumer health products. |
| 8 | MAPI | BUY | 890 | 1,100 | 24.5 | 1) beneficiary from improving consumer mobility, 2) prudent inventory management, 3) high visibility of earnings recovery. | 1) slower-than-expected vaccine distribution, 2) prolonged weak purchasing power, 3) IDR depreciation. |
| 9 | PGAS | BUY | 1,790 | 2,200 | 24.7 | 1) beneficiary from economic recovery, 2) limited downside risk to pricing, 3) less likely for another asset impairment due to increasing oil prices. | 1) prolonged economic recession, 2) oil-price collapse, 3) government intervention. |
| 10 | PWON | BUY | 525 | 650 | 24.8 | 1) PWON will ride on the strongest revenue recovery from both its property development and its investment properties, 2) recently announced two new asset acquisitions will be earnings accretive, 3) strong balance sheet with low net debt position. | 1) another lockdown that forces closures of public places, 2) no appetite for mortgage lending, 3) delayed economic recovery. |
| 11 | SMGR | BUY | 12,250 | 14,100 | 16.1 | 1) SMGR's nation-wide presence will capture the cement demand recovery the most, 2) High room for improvement in profitability from easing cost pressure while it carries high floating-rate debt, 2) strong EPS growth in 2021-22. | 1) intensifying price war in SMGR's main markets, 2) government intervention in pricing, 3) infrastructure budget cuts. |
| 12 | UNTR | BUY | 26,575 | 30,000 | 16.5 | 1) beneficiary from higher coal prices, 2) limited downside risk to contact mining margins when coal prices are up, 3) beneficiary from economic recovery. | 1) declines in coal and gold prices, 2) margin pressure from coal companies, 3) competition in the contract mining market. |

* closing prices as of 15 Dec; ** including dividend

*Source: Bloomberg, Maybank Kim Eng*

# 2. Gradual improvements with low expectations

We expect GDP growth to continue its positive trend and post growth for 1Q21. Market expectations on both economic and earnings growth are low, which is positive in our view to lower market volatility. Key factors to support 2021 growth are successful distribution of vaccines and low interest rate, which is supported by low inflation and IDR appreciation.

## 2.1. Back to 5% level

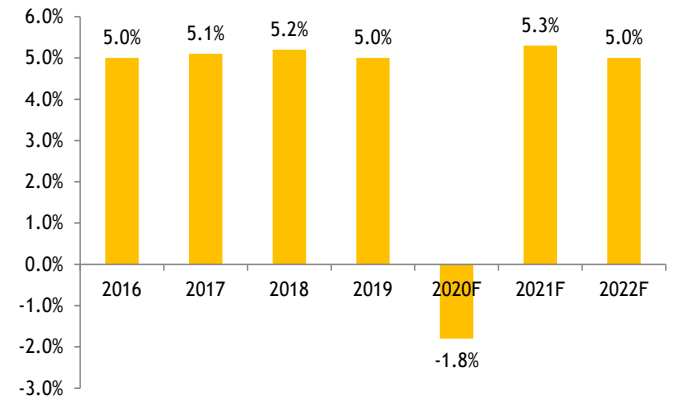
We forecast economic growth of 5.3% in 2021 from -1.8% in 2020. We forecast GDP growth to turn positive in 1Q21 (1.4%) after having posted declines of -5.32%, -3.49% and -1.3% for 2Q-4Q20. The GDP growth improvement is in line with gradual improvements in several domestic activities such as cement demand, gas distribution and automotive sales.

Our 2021 GDP growth forecast is based on the following growth assumptions: 1) private consumption (4.9%); 2) government spending (5.3%); 3) gross capital formation (5%); 4) exports (8.8%); and 5) imports (7.2%).

We think market expectation on 2021 GDP is low. We noticed that when BPS (Biro Pusat Statistik – Indonesia Statistical Agency) announced GDP growth for 2Q20 and 3Q20, which were below market expectations, the JCI did not collapse. We expect the same for 2021 as the uncertainty remains high. If we look at Bloomberg consensus, median estimate for 2021 growth is 5.1% YoY, lower than our forecast of 5.3%. However, the range of the growth is very wide, from 1.2% to 7.0%.

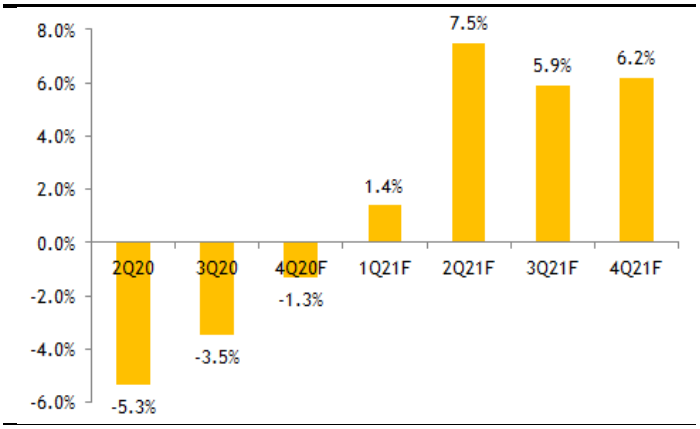
Our 2021 GDP growth forecast is primarily dependent on the successful distribution of the COVID-19 vaccines in Indonesia. This is because more than half of the economy (3Q20: 53%) is driven by domestic consumption. On top of the vaccines, other supporting variables for the growth are low inflation and IDR appreciation leading to decline in interest rate to 3.5% from 3.75% and government support. We think the upside to the growth could be from the positive impact of the Omnibus law, which was passed in October.

**Fig 12: GDP growth to rebound in 2021**



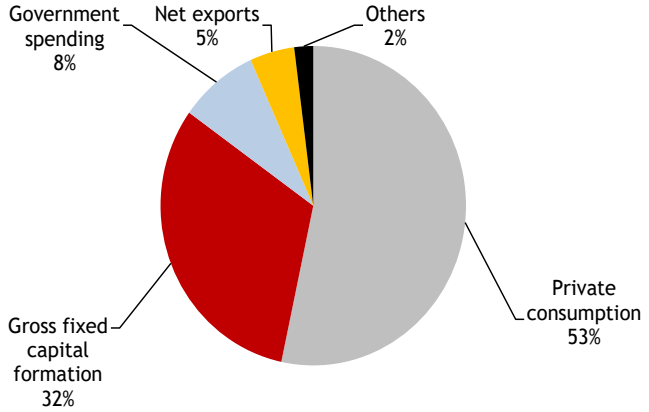

*Source: BPS, Maybank Kim Eng*

**Fig 13: Positive growth will be reached in 1Q21**



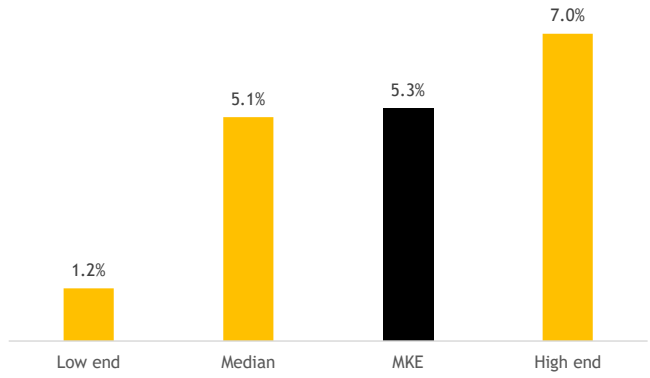

*Source: BPS, Maybank Kim Eng*

**Fig 14: 3Q20 GDP breakdown**



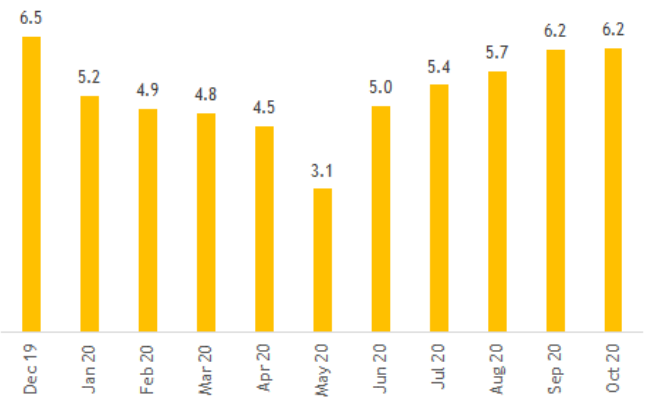

*Source: BPS*

**Fig 15: High range of GDP growth forecast for 2021**



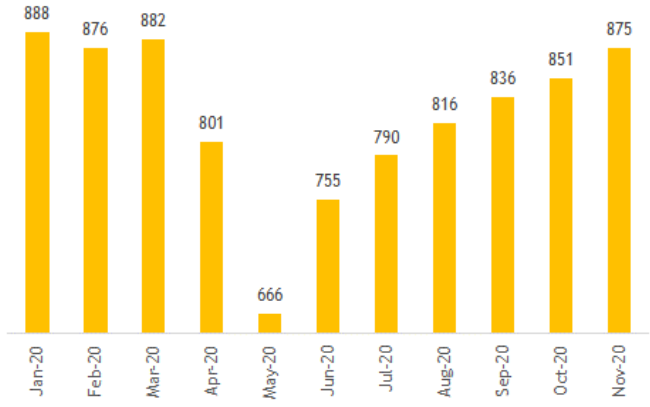

*Source: Bloomberg, Maybank Kim Eng*

**Fig 16: Improving domestic cement demand (m tonnes)…**



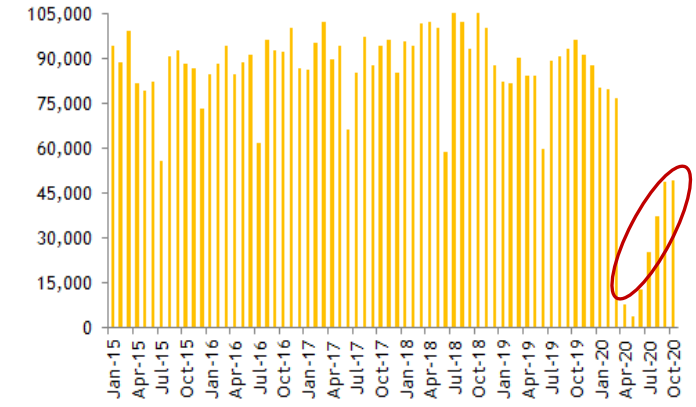

*Source: Company*

**Fig 17: …and gas distribution (bbtud) volumes**



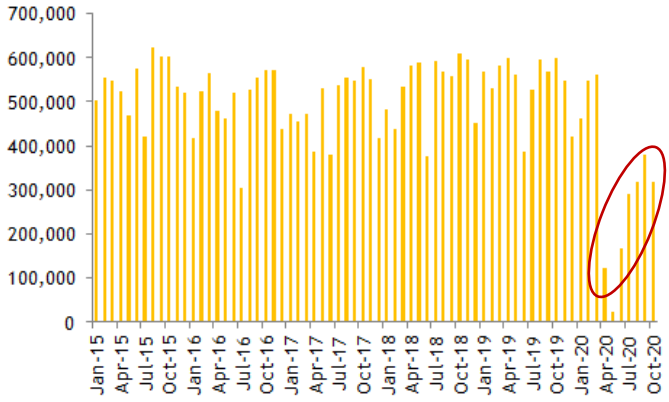

*Source: Company*

**Fig 18: Cars…**




*Source: Company*

**Fig 19: …and motorcycle volumes already reached bottom**

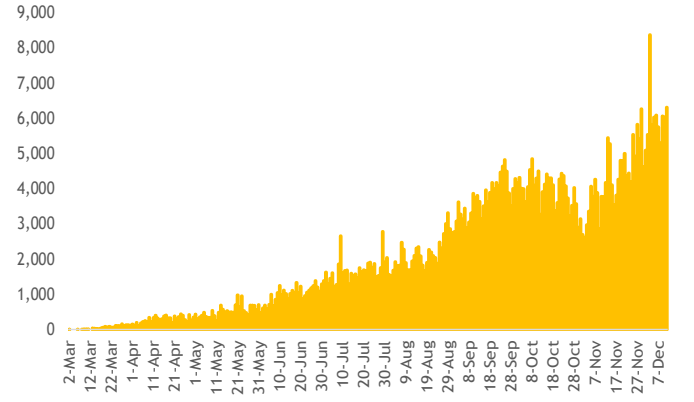



*Source: Company*

## 2.1.1. Vaccine dependent

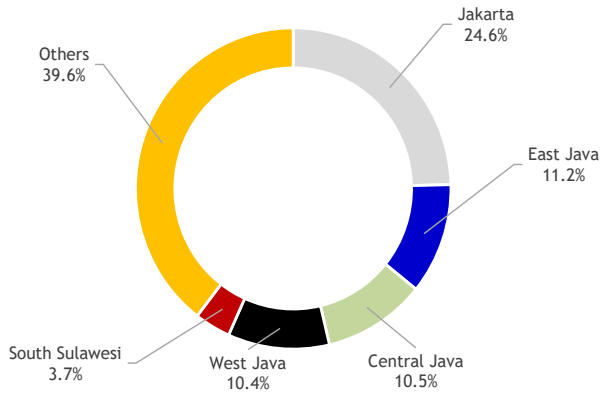
The COVID-19 situation looks far from over in Indonesia. The number of daily cases reached 6,310 as of 12 December. This is double the number of daily cases 3-4 months ago. The positivity rate is still high at 15-20%. Jakarta is the epicentre of the pandemic with 24.6% share, followed by East Java (11.2%), Central Java (10.5%), West Java (10.4%), South Sulawesi (3.7%) and other regions (39.6%).

**Fig 20: Increasing number of daily cases**



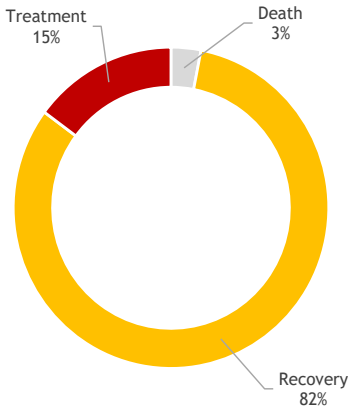

Note: data as of 12 December
*Source: Ministry of Health*

**Fig 21: Jakarta is still the Covid-19 epicentre in Indonesia**



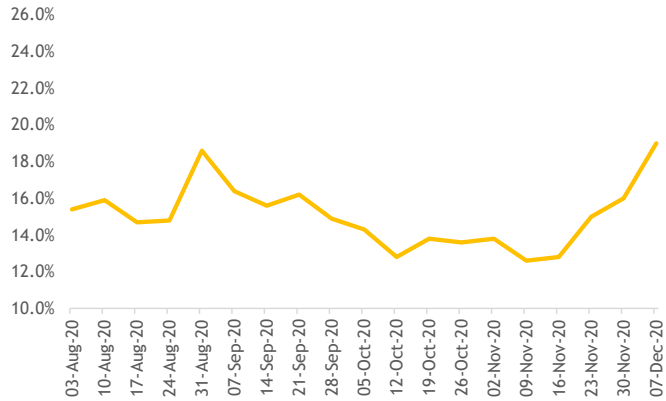

Note: data as of 12 December
*Source: BPS, Maybank Kim Eng*

**Fig 22: Breakdown on accumulative COVID-19 cases**




Note: data as of 12 December
*Source: Ministry of Health*

**Fig 23: Positive rate remains high**



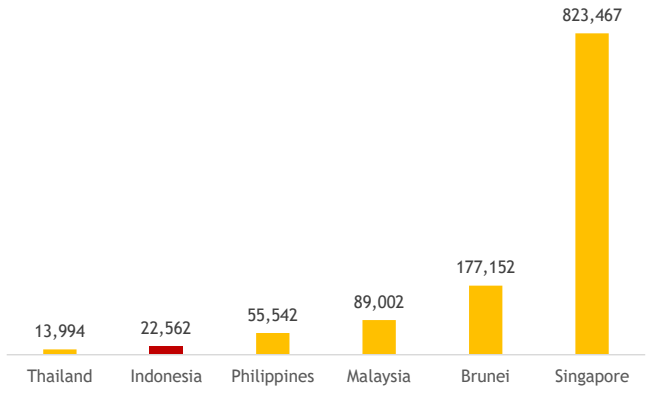

Note: data as of 15 December
*Source: Ministry of Health, kongkowcovid19*

The number of tests has increased to over 22,000 per 1m of the population, up from around 1,000 per 1m of the population four months ago. However, compared to other ASEAN-6 countries, this is the second lowest after Thailand (c.14,000 tests per 1m of the population. Singapore, Malaysia, Brunei, and the Philippines have done tests as follows: 823,000, 177,000, 89,000, and 55,000 per 1m of their population.

We think the education level of Indonesian people plays a key role in helping the government to effectively fight the pandemic. As 1) 57% of the population have education background of junior high school or below; and 2) only 13% have university education, it becomes an issue for the government to fully enforce the health protocols.

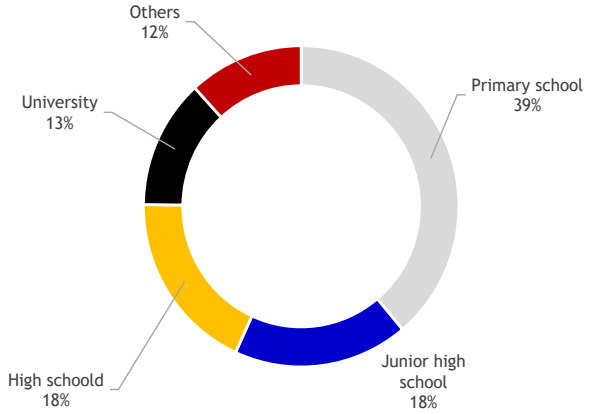
We think the low number of tests is also because the government is not confident with the hospital capacity. The number of beds per 1,000 population in Indonesia is 1.2, higher than the Philippines' 1.0 but lower than Malaysia's 1.9, Thailand's 2.1, Singapore's 2.4 and Vietnam's 2.6.

**Fig 24: Among ASEAN-6, Indonesia's # of tests per 1m population is one of the lowest**




Note: data as of 12 December
*Source: Worldodometer*

**Fig 25: Most of the workers (57%) in Indonesia are junior high school graduates and below**




*Source: BPS*

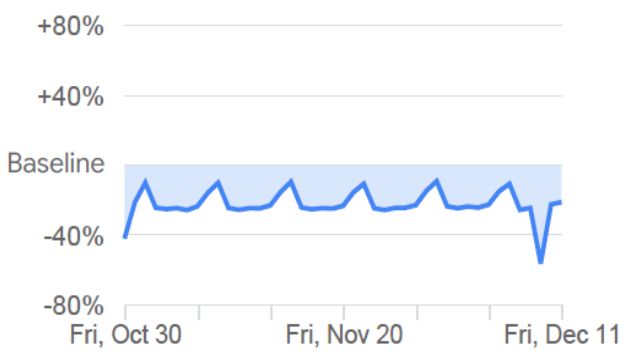
Having said that, it looks like to us vaccines are the only possible solution for Indonesia to balance between health and economic interests. We think vaccines could effectively help the country as more than 60% (3Q20: 61%) of the economy is driven by domestic activities (private consumption and government spending).

Based on the Google Mobility report dated 11 December, most of the domestic activities were still below the baselines. Activities related to retail & recreation, parks, transit station and workplaces were still -16%, -14%, -28% and -21% below the baselines, respectively. Meanwhile, activities related to residential and grocery & pharmacy were up +12% and +1% from the baselines.

**Fig 26: Google Mobility Index (retail & recreation): -16% from baseline**

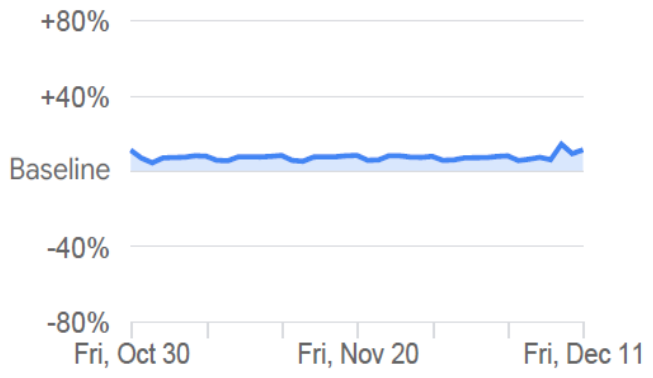

*Source: Google*

**Fig 27: Google Mobility Index (workplaces): -21% from baseline**



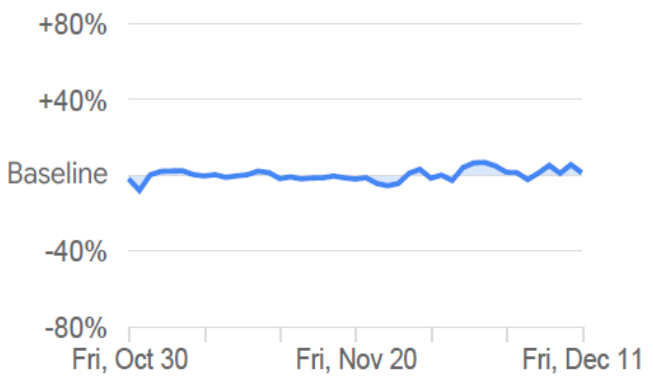

*Source: Google*

**Fig 28: Google Mobility Index (residential): +12% from baseline**




*Source: Google*

**Fig 29: Google Mobility Index (grocery & pharmacy): +1% from baseline**




*Source: Google*

The government targets to vaccinate 170m people, who are in the age group of 18-59. This suggests the government will need c.350m vaccines. So far, 61% of the requirement (213m vaccines) has been secured from China. The government is still working on the remaining 39% by securing from other vaccine companies or production of its own vaccine. The latter might be ready by the end of 2021 at the earliest.

Among the secured vaccines, 7.6% will be ready by the end of 2020, 0.8% in the beginning of 2021, and 91.6% in the remaining of 2021. All the secured vaccines are from China. Sinovac has the largest share (60%), followed by Sinopharm (31%) and Cansino (9%).

The Sinovac vaccine is being tested (phase three) on 1,620 people in Bandung, West Java. The injection process has been completed. All the volunteers are being monitored for side effects etc. The result of the test is expected to be announced in January 2021.

The recently issued decree of the Minister of Health suggests the approved vaccines are the ones already completed or in the phase three of the test. The list includes six vaccines produced by Bio Farma (pharmaceutical SOE), AstraZeneca, Sinopharm, Moderna, Pfizer and Sinovac. The list is not fixed and can change based on recommendation from the Indonesian Technical Advisory Group on Immunization.

The decree mentions that approval from BPOM (Badan Pengawas Obat dan Makankan – Indonesia's FDA) is required before the vaccine can be used. BPOM targets to issue Emergency Use Approval (EUA), subject to certain conditions in the third week of January. The target has been postponed from the initial one (third week of December 2020).

There are three aspects that BPOM is looking at: quality, security and efficacy of the vaccine. So far, according to BPOM, they are happy with the first two. BPOM is still waiting for the results of the trial test.

The secured vaccines are allocated to 107m people. Free vaccines will be allocated to 32m people (30%), which will be handled by the Ministry of Health. The remaining 75m people (70%) will have to pay for the vaccines, and this portion will be handled by the Ministry of State-owned Enterprises. The 32m people consist of medical officers (1%), public servants (4%) and low-income people (25%).

However, it is likely that the portion of the free vaccines will increase to be higher than 30%. The Coordinating Minister for Human

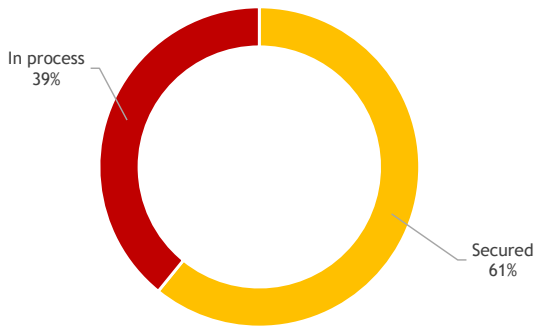
Developments and Culture mentioned that the portion of the free vaccines could tentatively increase to 50%. This is still lower than the demands from several parliamentary members that the portion of the free vaccines should be at least 70%, or even 100%, of total vaccines.

Assuming the 30% allocation of free vaccines, pricing will then become a major factor for the 75m people. According to the survey conducted by the Ministry of Health, WHO and UNICEF, although 65% of people support the vaccine programme, only 35% are willing to pay for the vaccines.

Judging from potential pricing set by KLBF (IDR1,485, BUY, TP IDR2,000), we think the government might price the vaccines at c. USD20 per person. Assuming two people are vaccinated in a family the vaccines cost will be IDR580,000. If the vaccines can last only 12 months, that implies monthly cost of IDR48,333. If one earns c. IDR2.7m per month, which is in line with national average minimum wage, the vaccine cost will be less than 2% of monthly income. That said, we think people can still afford the vaccine at USD20.

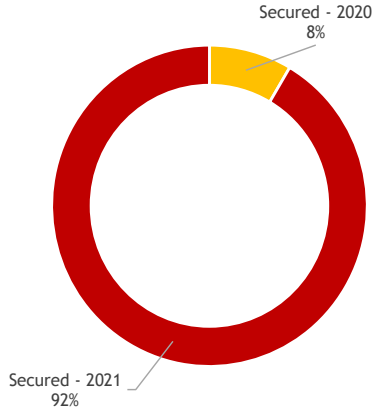
In terms of vaccine distribution, we do not think it will be a major issue in Indonesia. The government has the other vaccines, such as polio, BCG, hepatitis, and measles, in the country. Regional governments also look supportive of the vaccine programme in our view.

**Fig 30: 61% of vaccines have been secured by the government**



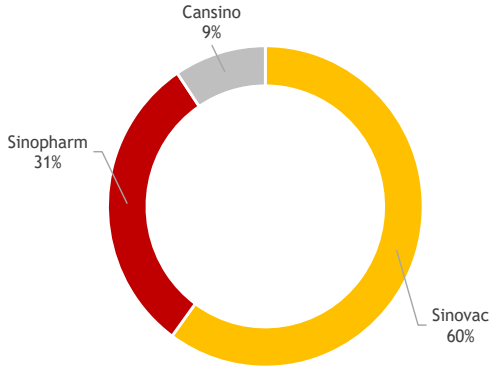

*Source: Coordinating Ministry for Marine and Investment Affairs, Gugus Tugas*

**Fig 31: Most vaccines will be distributed in 2021**



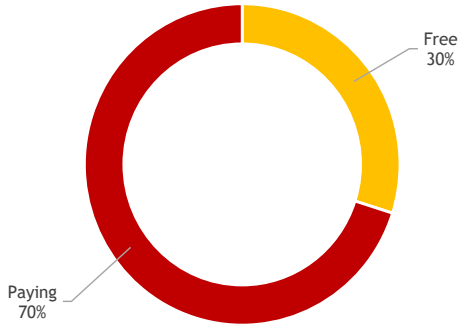

*Source: Coordinating Ministry for Marine and Investment Affairs, Gugus Tugas*

**Fig 32: All secured vaccines are from China**



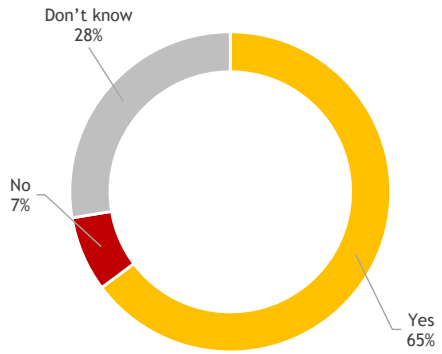

*Source: Coordinating Ministry for Marine and Investment Affairs*

**Fig 33: Government can only support a small fraction**



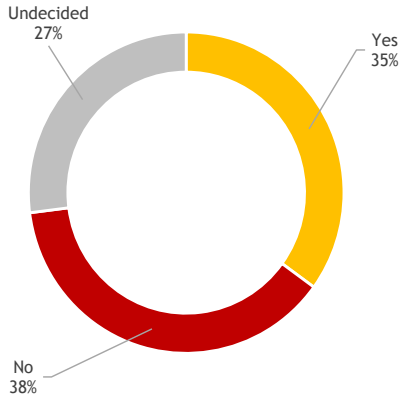

*Source: Ministry of Health*

**Fig 34: 65% of people support vaccine programme…**




*Source: Ministry of Health, WHO, UNICEF*

**Fig 35: …but only 35% are willing to pay**




*Source: Ministry of Health, WHO, UNICEF*

## 2.1.2. Declining interest rate

We think low interest rate environment will continue in 2021 thanks to low inflation and IDR appreciation. We forecast the BI will cut the benchmark interest rate by another 25bps to 3.5% by the end of 2021. As we forecast 2021 YoY inflation to be 2.4%, our forecast implies 1.1% real interest rate.

We think the implied real rate is reasonable because we think other central banks will continue their low-interest rate policy in 2021 to boost their economy. Also bear in mind that even though BI does not have specific real interest rate target, in 2017 the real interest rate was below 1%.

The low interest rate environment will benefit interest-sensitive companies such as automotive and real estate. Around 70-75% of ASII's automotive sales are funded by credit.

**Fig 36: We expect low interest rates to continue in 2021**

| | 2020F | 2021F | 2022F |
|---|---|---|---|
| Indonesia | 3.75% | 3.50% | 3.50% |
| Malaysia | 1.75% | 1.75% | 2.00% |
| Thailand | 0.50% | 0.50% | 0.50% |
| Philippines | 2.00% | 2.00% | 2.50% |

*Source: Maybank Kim Eng*

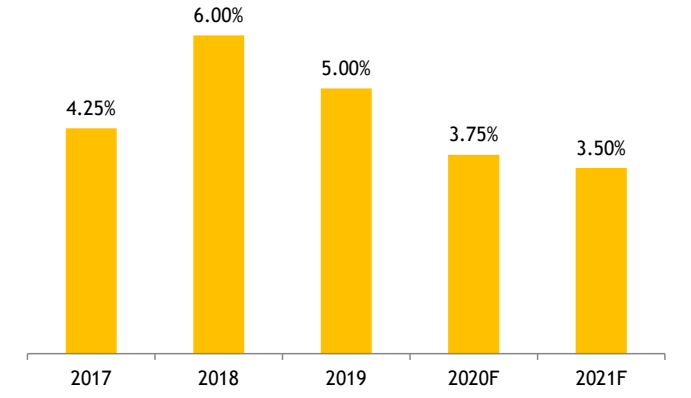
We forecast YoY inflation to increase to (but remain low) 2.4% in 2021 from 2% in 2020 due to improving economic activities. We are not concerned that prices of goods and services will increase significantly in 2021 as we do not think economic activities, despite the vaccines, will return to normal. This is because we think the vaccination process will be done in stages, and the government will still have to secure the remaining 39% of the vaccine requirement for Indonesia. Even if the vaccination is successful, we still need to rely on economic development in other countries, which are likely to undergo different stages than us.

We expect consumer confidence will improve but not recover to the 2019 level. The BI consumer confidence in October was 79, 21% lower than the threshold (100) and 37% lower than the 2019 average of 124.7. We expect consumer confidence will bottom and gradually recover in 2021 even though we do not expect it to reach the threshold or 2019 level.

One of the reasons is because the average minimum wage for 2021 will only increase marginally (+0.5% YoY). 29 out of 34 provinces (85%) will keep minimum wages at levels similar to 2020 as corporates' spending capacity will remain limited. However, five provinces will increase their minimum wage as follows: Jakarta (+3.3%), Central Java (+3.3%), Yogyakarta (+3.5%), East Java (+5.7%) and South Sulawesi (+2%).

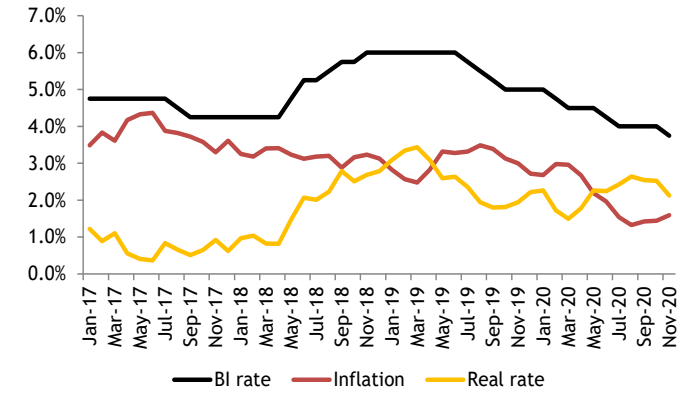
Another reason is low-income earners will still get financial support from the government but the amount will be lower. The government will reduce allocation for national economic recovery (Pemulihan Ekonomi Nasional / PEN) by 46% to IDR372.3t. Allocation for social protection will increase to 31% in 2021 from 29% in 2020. However, as the total allocation is 46% lower than 2020, the amount for social protection will drop by 44% YoY.

**Fig 37: Further rate cut in 2021**



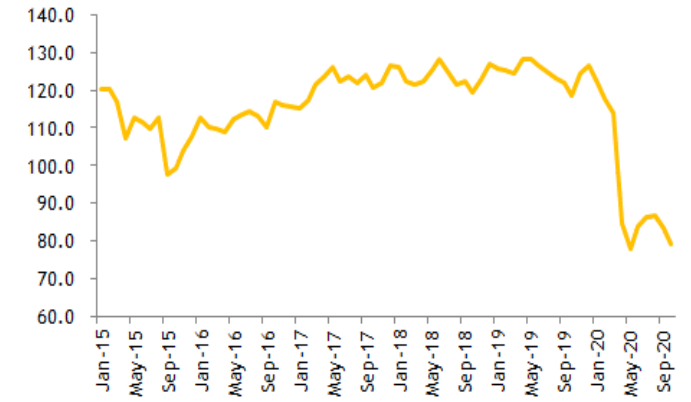

Note: end of period
*Source: BI, Maybank Kim Eng*

**Fig 38: Low inflation to support low interest rate**



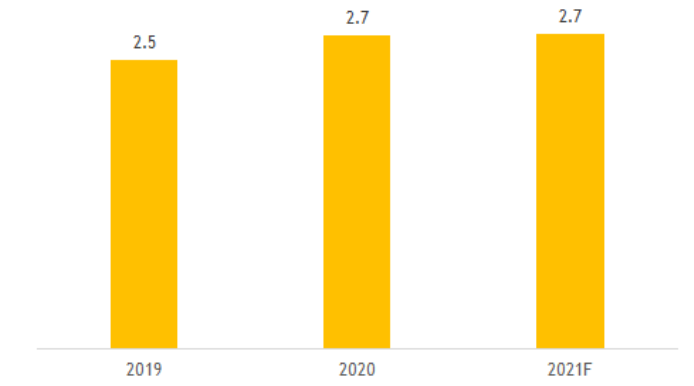

*Source: BPS, Maybank Kim Eng*

**Fig 39: It appears consumer confidence has bottomed already**



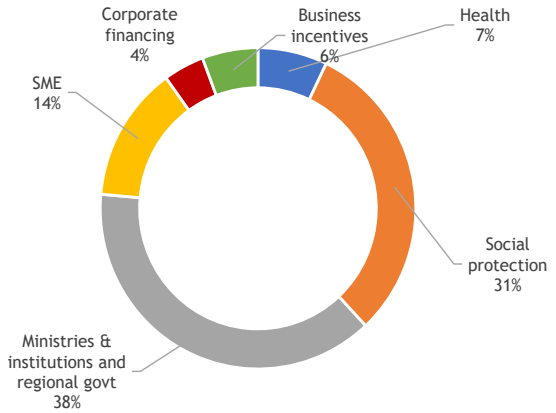

*Source: BI*

**Fig 40: Average minimum wage will increase slightly (+0.5% YoY) in 2021**



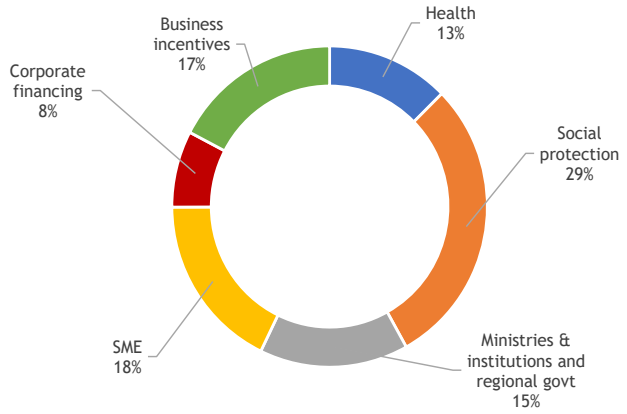

*Source: BPS, Maybank Kim Eng*

**Fig 41: 2021 social protection will be 44% lower in absolute value...**




*Source: MoF*

**Fig 42: ...despite having a higher allocation vs 2020**



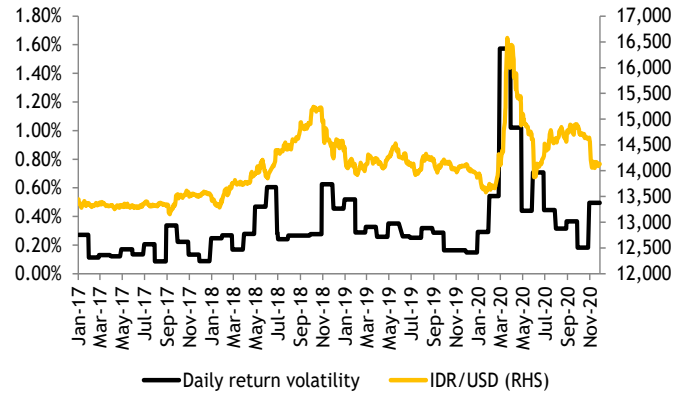

*Source: MoF*

Since the past two months IDR/USD has appreciated by c. 5% to IDR14,100 from its bottom (IDR14,900) on the back of the US election results and global vaccine developments. Both are positive factors that increase investors' risk appetite, which could lead to fund flows from developed to emerging markets.

Our FX Strategist, Saktiandi Supaat (saktiandi@maybank.com.sg), thinks that a vaccine is the game changer for global economies. He also thinks that in the current low interest rate environment with growth recovering from low bases and benign near-term inflation expectations, the hunt for yields can persist. Asia is home to some of the highest carry in the world. INR, IDR, MYR, CNH are some preferred proxy-FX for carry plays. That said, we forecast the IDR/USD will appreciate to IDR13,800 by the end of 2021.

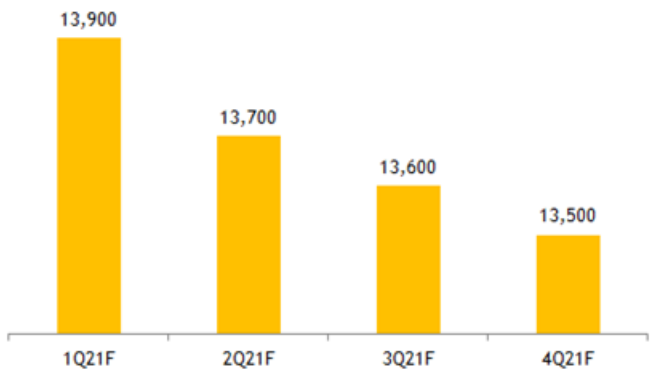
*Ceteris paribus*, the stronger IDR is negative for USD-earning companies such as coal, CPO, nickel and O&G. This is also negative for MYOR (IDR2,690, HOLD, TP IDR2,500) as 40% of its top line is from exports. On the flipside, this is positive for companies with USD input costs and/or USD debt, such as ACES (IDR1,810, BUY, TP IDR1,950), GIAA (IDR440, Not Rated), ICBP (IDR9,700, BUY, TP IDR14,000), KLBF (IDR1,485, BUY, TP IDR2,000), and MAPI (IDR890, BUY, TP IDR1,100).

**Fig 43: IDR/USD return volatility is back to normal**




*Source: Bloomberg, Maybank Kim Eng*

**Fig 44: We forecast IDR appreciation against USD in 2021**




Note: end of period
*Source: Maybank Kim Eng*

We think low inflation, IDR appreciation and gradual domestic economy improvement could support low government bond yield in 2021. The 10 year has dropped by c. 200bps since its peak in May to c.

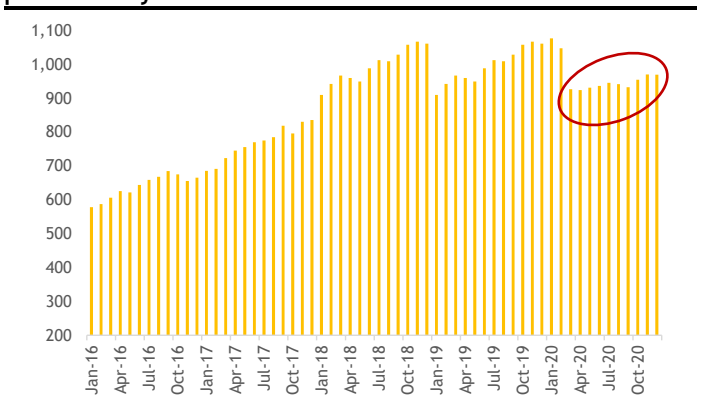
6.1-6.2%. Our fixed-income analyst, Winson Phoon (winsonphhon@maybank-ke.com.sg), expects the average 2021 yield to be around 6.25%, which is similar to the current level.

As of late there have been small flows from foreign investors to the bond market, which will keep the yield low. We think more clarity on the government's debt-funding programmes in 2021 will remove the overhang on the bond market, and as such it's likely bond yield will drop to below 6% by the end of 2021.

**Fig 45: Low government bond yield will continue in 2021**


*Source: Bloomberg*

**Fig 46: Improvements in foreign ownership in bond market positive for yield**




*Source: Bloomberg*

We think IDR/USD and government bond yield movements in 2021 will also be affected by how the government will finance the state budget. With a budget deficit/GDP target of 5.7%, the government estimates a total net issuance of IDR1,207t (+2.8% YoY).

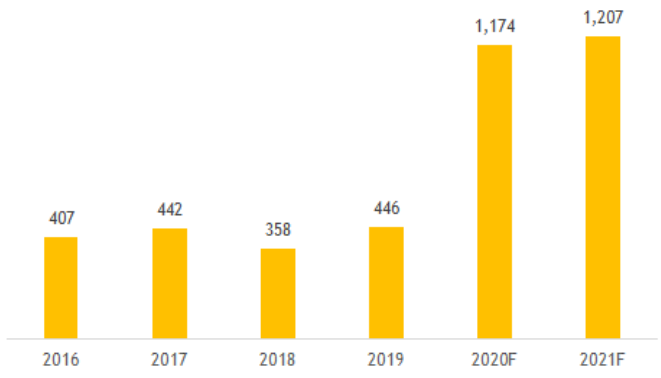
Although the government mentions that the burden sharing programme to finance the budget is only one-off for this year, given uncertainty in global economies in 2021, it is likely that the BI will participate again to support the budget. For the 2020 budget, as of 17 Nov, the BI had injected IDR457t, which consists of purchase of government bonds in primary market (16%), burden sharing for public goods (59%) and burden sharing for non-public goods (25%).

**Fig 47: State budget 2020 vs 2021**

| | 2020F | 2021F | YoY |
|---|---|---|---|
| **REVENUES (A)** | **1,700** | **1,744** | **2.6%** |
| I. Tax revenues | 1,405 | 1,445 | 2.8% |
| a. Taxes | 1,199 | 1,230 | 2.6% |
| b. Customs | 206 | 215 | 4.5% |
| II. Non-tax revenues | 294 | 298 | 1.4% |
| III. Grants | 1 | 1 | -30.8% |
| **B. EXPENDITURES** | **2,739** | **2,750** | **0.4%** |
| I. Central government | 1,975 | 1,955 | -1.0% |
| a. Ministries & institutions | 836 | 1,032 | 23.4% |
| b. Non ministries & institutions | 1,139 | 923 | -19.0% |
| II. Transfer to regions & village funds | 764 | 796 | |
| a. Transfer to regions | 693 | 724 | 4.4% |
| b. Village funds | 71 | 72 | 1.1% |
| **D. SURPLUS/DEFICIT** | **-1,039** | **-1,007** | **N/A** |
| Surplus/deficit to GDP ratio | 6.34% | 5.70% | |

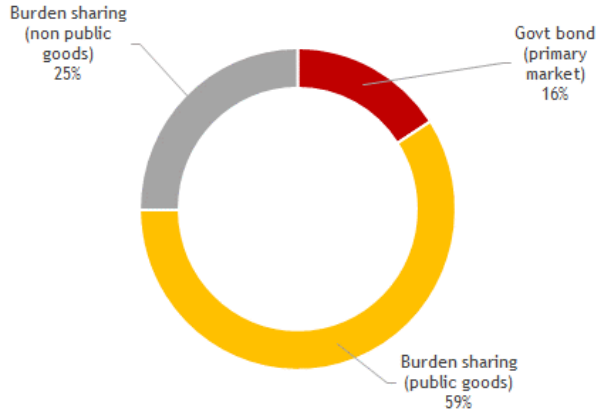
*Source: MoF*

**Fig 48: Government debt net issuance (IDR t)**




*Source: MoF*

**Fig 49: BI's participation to fund 2020 budget (as of 17 Nov)**




*Source: BI*

**Fig 50: Auctions of government conventional bonds**

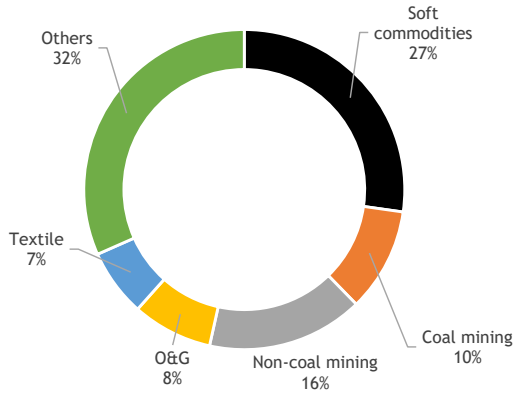
| Date | Target amount, IDR t | | Total bid, IDR t | Awarded amount, IDR t | Weighted average 10-year yield |
|---|---|---|---|---|---|
| | Min | Max | | | |
| 07-Jan-20 | 15.0 | 22.5 | 81.5 | 20.0 | 7.09% |
| 21-Jan-20 | 15.0 | 22.5 | 95.0 | 20.0 | 6.78% |
| 04-Feb-20 | 15.0 | 22.5 | 96.9 | 21.0 | 6.64% |
| 18-Feb-20 | 15.0 | 22.5 | 127.1 | 18.5 | 6.52% |
| 03-Mar-20 | 15.0 | 22.5 | 78.4 | 17.5 | 6.77% |
| 17-Mar-20 | 15.0 | 22.5 | 51.3 | 17.1 | 7.47% |
| 31-Mar-20 | 15.0 | 22.5 | 33.5 | 22.2 | 7.83% |
| 14-Apr-20 | 20.0 | 30.0 | 27.7 | 16.9 | 7.96% |
| 28-Apr-20 | 20.0 | 40.0 | 44.4 | 16.6 | 8.09% |
| 12-May-20 | 20.0 | 40.0 | 73.7 | 20.0 | 8.07% |
| 02-Jun-20 | 20.0 | 40.0 | 105.3 | 24.4 | 7.20% |
| 16-Jun-20 | 20.0 | 40.0 | 84.8 | 20.5 | 7.11% |
| 30-Jun-20 | 20.0 | 40.0 | 72.0 | 20.5 | 7.19% |
| 14-Jul-20 | 20.0 | 40.0 | 61.2 | 22.0 | 7.05% |
| 28-Jul-20 | 20.0 | 40.0 | 72.8 | 22.0 | 6.81% |
| 11-Aug-20 | 20.0 | 40.0 | 106.0 | 22.0 | 6.76% |
| 25-Aug-20 | 20.0 | 40.0 | 78.3 | 22.0 | 6.47% |
| 08-Sep-20 | 20.0 | 40.0 | 52.3 | 22.0 | 6.74% |
| 22-Sep-20 | 20.0 | 40.0 | 46.1 | 22.0 | 6.80% |
| 06-Oct-20 | 20.0 | 40.0 | 49.5 | 26.1 | 6.82% |
| 20-Oct-20 | 20.0 | 40.0 | 83.0 | 32.8 | 6.69% |
| 03-Nov-20 | 20.0 | 40.0 | 66.3 | 29.5 | 6.59% |
| 17-Nov-20 | 20.0 | 40.0 | 104.7 | 24.6 | 6.20% |
| 01-Dec-20 | 20.0 | 40.0 | 94.3 | 25.6 | 6.08% |

*Source: MoF*

## 2.1.3. Strong commodity prices to continue

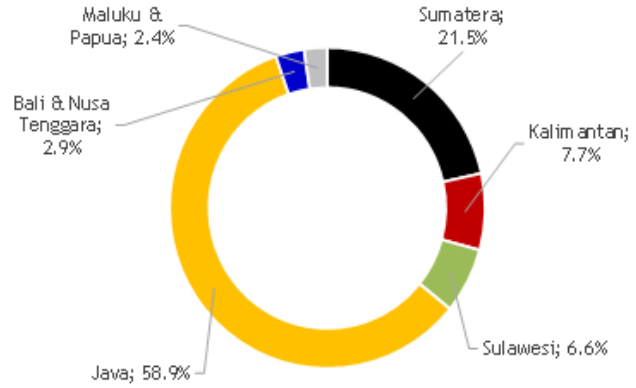
We expect strong commodity prices will continue due to improving global demand. This will be positive for the economy as: 1) more than 50% of exports are commodity based; and 2) c. 36% of Indonesia's GDP is contributed by commodity-producing regions (Sumatera, Kalimantan and Sulawesi islands).

**Fig 51: Most of Indonesia's exports are commodity driven (9M20)**



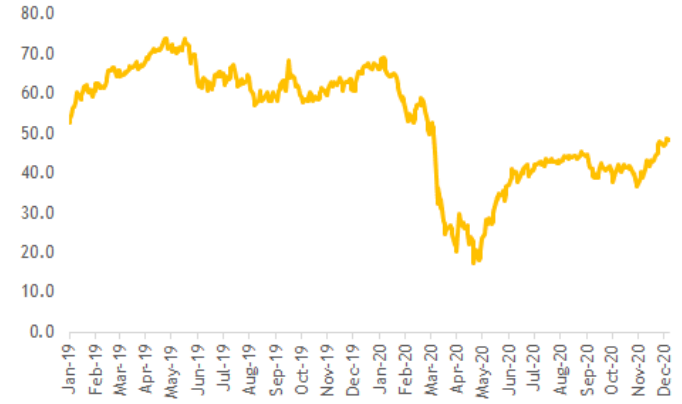

*Source: Bank Indonesia*

**Fig 52: Breakdown of 3Q20 GDP by province**



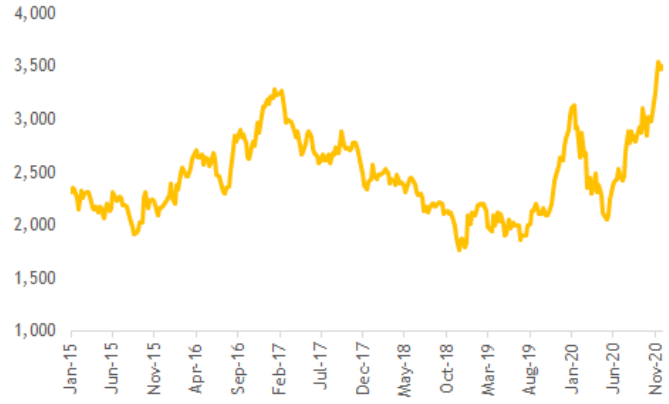

*Source: BPS*

**Fig 53: Brent oil price (USD/bbl)**



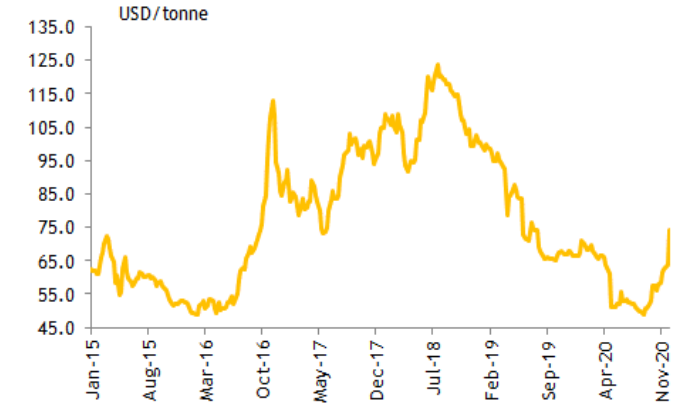

*Source: Bloomberg*

**Fig 54: CPO price (MYR/tonne)**



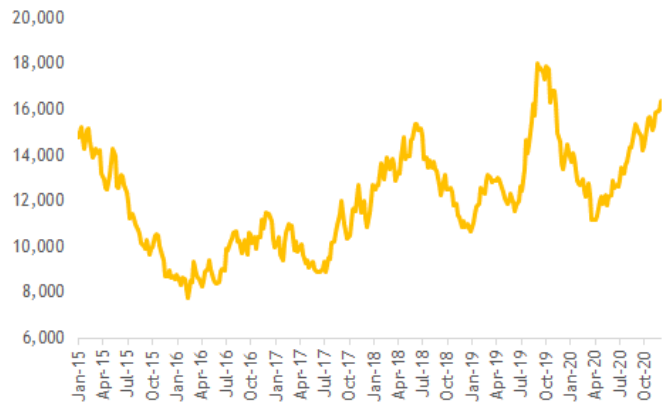

*Source: Bloomberg*

**Fig 55: Coal price**




*Source: Bloomberg*

**Fig 56: Nickel price (USD/tonne)**




*Source: Bloomberg*

## 2.2. Corporate earnings: still below 2019

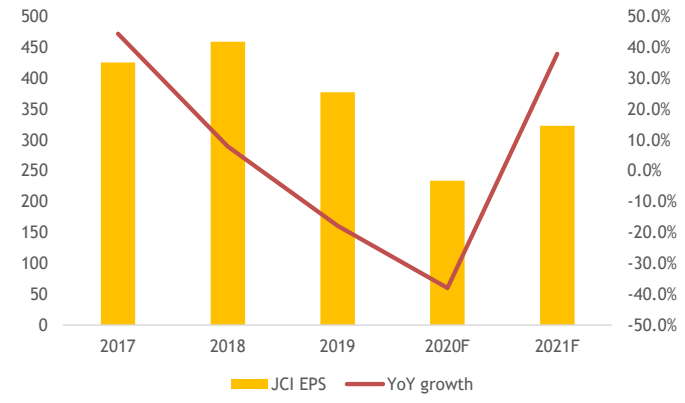
We forecast market EPS to drop 38% YoY in 2020 due to the pandemic. We forecast earnings to rebound (+38% YoY) in 2021 as we forecast all sectors to post growth on the back of gradual global and domestic recovery and low base effect in 2020.

The banking sector will be the main earnings growth contributor (c. 39% of 2021 growth). Although we forecast low growth of only 4.5%

YoY in 2021, we think earnings for the banking sector will be due to easing credit cost and extended loan restructuring.

Despite expected strong earnings growth in 2021, we do not think our forecasts are aggressive. Our analysis suggests 2021 aggregate earnings will still be 14% lower than 2019 levels. We forecast earnings to fully recover in 2022. This suggests we do not factor in a full recovery next year. This makes sense as we do not expect distribution of vaccines, which is the biggest driver for growth, to be smooth.

**Fig 57: Market EPS will rebound in 2021**




*Source: Bloomberg, Maybank Kim Eng*

**Fig 58: All sectors will post growth in 2021**

| | 2021 EPS growth |
|---|---|
| Auto | 6.2% |
| Banks | 36.9% |
| Mining | 37.9% |
| Consumer & retail | 15.1% |
| Cement | 26.5% |
| Infrastructure | 1038.6% |
| Utility | 37.6% |
| Property | 159.8% |
| Telco | 6.7% |

*Source: Bloomberg, Maybank Kim Eng*

# 3. Underappreciated medium to long-term potentials

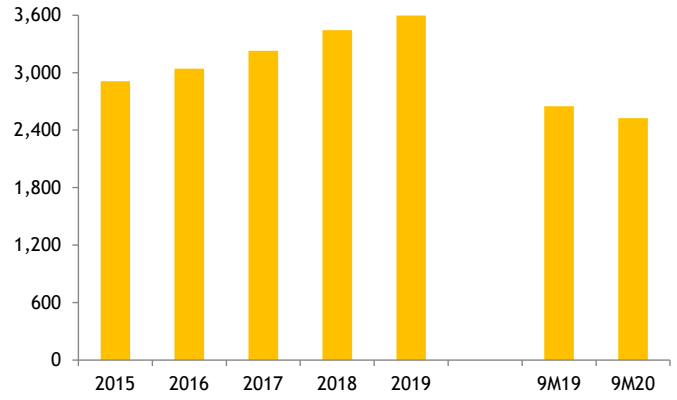
We believe the market has not factored in the potential upside from the structural changes in the economy in the medium to long term. This can be shown by the market expectation of 2022 GDP growth of 5.1%, which is more or less similar to our 2021 forecast of 5.3%. Two factors that can structurally change the economy, in our view, are the Omnibus law and the value-added process in the mining sector.

## 3.1. Surprise impact from the Omnibus law

As highlighted in our Indonesia Strategy report dated 6 October titled The Omnibus law finally passed, the main purpose of the law is to improve the investment climate in Indonesia. In 3Q20 gross capital formation accounted for c.30% of GDP, the second largest GDP component after consumption.

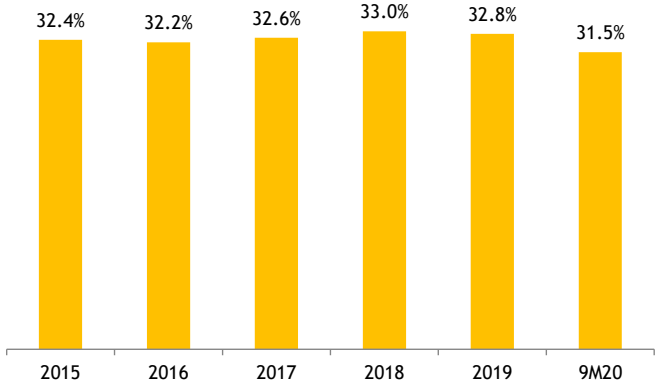
The proportion was relatively unchanged from time to time. We believe the main issues holding back investments are related to ease of doing business (licensing), labour and synchronisation of regulations between central and regional governments. Given the significant weight of the gross capital formation in the GDP calculation, improvements in this variable will have a significant impact on GDP. We estimate every 10% increase in the component, GDP value will increase by 0.3%.

**Fig 59: Gross capital formation (IDR b - in constant prices)**




*Source: BPS*

**Fig 60: Gross capital formation/GDP stable at c. 30%**




*Source: BPS*

According to the Omnibus law, the government has to prepare the supporting regulations for the law to make it enforceable. They will have to be ready within three months after the law becomes effective (beginning of February 2021). There are 44 supporting regulations the government will have to prepare. So far, it has completed 27 regulation drafts, and it's waiting for inputs from people. The 27 drafts consist of three presidential decrees and 27 government regulations.

If the government can complete all the supporting regulations as per schedule, and assuming prospective investors need six months to understand the regulation, we think it is likely FDI will start to flow in, due to the impact of the Omnibus law, by the end of 4Q21.

**Fig 61: Thirty regulation drafts are being prepared by the government**

| No | Regulation type | Subject |
|---|---|---|
| 1 | Presidential decree | Acceleration body for housing developments |
| 2 | Presidential decree | Cooperation between government and SOE in the management of basic geospacial information |
| 3 | Presidential decree | Financial rights and facilities for LPJK (body for developments of construction services) |
| 4 | Government regulation | Establishment of SOE in rural areas |
| 5 | Government regulation | Investment management body |
| 6 | Government regulation | Energy & mineral resources |
| 7 | Government regulation | Management and land rights |
| 8 | Government regulation | Special economic zone |
| 9 | Government regulation | Order of neglected land and areas |
| 10 | Government regulation | Land acquisition |
| 11 | Government regulation | Ease of national strategic projects |
| 12 | Government regulation | Agricultures |
| 13 | Government regulation | Marines and fisheries |
| 14 | Government regulation | Transportation |
| 15 | Government regulation | Cooperatives and small & medium enterprises |
| 16 | Government regulation | Regional business license |
| 17 | Government regulation | Public works and people's housing |
| 18 | Government regulation | Geospacial information |
| 19 | Government regulation | Synchronication of regulations |
| 20 | Government regulation | Land bank |
| 21 | Government regulation | Share capital |
| 22 | Government regulation | Post, telecommunication and broadcast |
| 23 | Government regulation | Dispute resolution between spatial plans and forestry area |
| 24 | Government regulation | Immigration |
| 25 | Government regulation | Regional tax and retribution |
| 26 | Government regulation | Environmental protection and management |
| 27 | Government regulation | Forestry |
| 28 | Government regulation | Health and hospital |
| 29 | Government regulation | Administration sanctions of state non-tax revenues |
| 30 | Government regulation | Administration of spatial planning |

*Source: Coordinating ministry for economy*

We think the positive impact of the Omnibus law is not only to increase investments, but also to diversify the investments. Data from Indonesia Investment Coordinating Board (BKPM / Badan Koordinasi Penanaman Modal), suggests that, based on 9M20 data, investments in the secondary sector had the largest share (46%), followed by tertiary (43%) and primary (11%) sectors.

However, breakdown of the secondary sector suggests that in the past two years, it was dominated by investments in the metal, machinery, and electronic sub sectors (2019: 37%, 9M20: 46%). We think the sub sector is related to the construction of nickel smelters in the eastern part of Indonesia.

**Fig 62: FDI (in USD m) by sector**

| Sector | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 9M20 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Primary | 3,034 | 4,883 | 5,933 | 6,472 | 6,991 | 6,236 | 4,502 | 6,076 | 4,827 | 3,294 | 2,322 |
| Secondary | 3,337 | 6,790 | 11,770 | 15,859 | 13,019 | 11,763 | 16,688 | 13,149 | 10,343 | 9,551 | 9,691 |
| Tertiary | 9,844 | 7,802 | 6,862 | 6,287 | 8,519 | 11,276 | 7,774 | 13,015 | 14,137 | 15,364 | 8,940 |
| **Total** | **16,215** | **19,475** | **24,565** | **28,618** | **28,530** | **29,276** | **28,964** | **32,240** | **29,308** | **28,209** | **20,953** |
| | | | | | | | | | | | |
| Primary | 19% | 25% | 24% | 23% | 25% | 21% | 16% | 19% | 16% | 12% | 11% |
| Secondary | 21% | 35% | 48% | 55% | 46% | 40% | 58% | 41% | 35% | 34% | 46% |
| Tertiary | 61% | 40% | 28% | 22% | 30% | 39% | 27% | 40% | 48% | 54% | 43% |
| **Total** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** |

*Source: BKPM, Maybank Kim Eng*

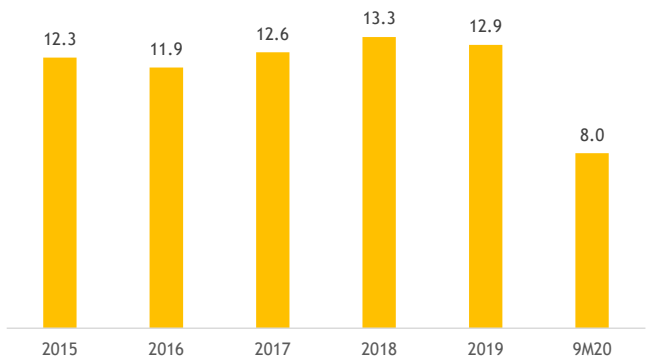
**Fig 63: Breakdown of FDI in the secondary sector (in USD m)**

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 9M20 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Food | 1,026 | 1,105 | 1,783 | 2,118 | 3,140 | 1,521 | 2,115 | 1,970 | 1,307 | 1,272 | 1,148 |
| Chemical & pharmaceutical | 793 | 1,467 | 2,770 | 3,142 | 2,323 | 1,956 | 2,889 | 2,578 | 1,938 | 1,486 | 1,511 |
| Metal, machinery & electronic | 590 | 1,773 | 2,453 | 3,327 | 2,472 | 3,092 | 3,897 | 2,418 | 3,249 | 3,559 | 4,482 |
| Others | 929 | 2,445 | 4,765 | 7,272 | 5,084 | 5,194 | 7,786 | 6,182 | 3,848 | 3,234 | 2,550 |
| **Total** | **3,337** | **6,790** | **11,770** | **15,859** | **13,019** | **11,763** | **16,688** | **13,149** | **10,343** | **9,551** | **9,691** |
| | | | | | | | | | | | |
| Food | 31% | 16% | 15% | 13% | 24% | 13% | 13% | 15% | 13% | 13% | 12% |
| Chemical & pharmaceutical | 24% | 22% | 24% | 20% | 18% | 17% | 17% | 20% | 19% | 16% | 16% |
| Metal, machinery & electronic | 18% | 26% | 21% | 21% | 19% | 26% | 23% | 18% | 31% | 37% | 46% |
| Others | 28% | 36% | 40% | 46% | 39% | 44% | 47% | 47% | 37% | 34% | 26% |
| Total | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

*Source: BKPM, Maybank Kim Eng*

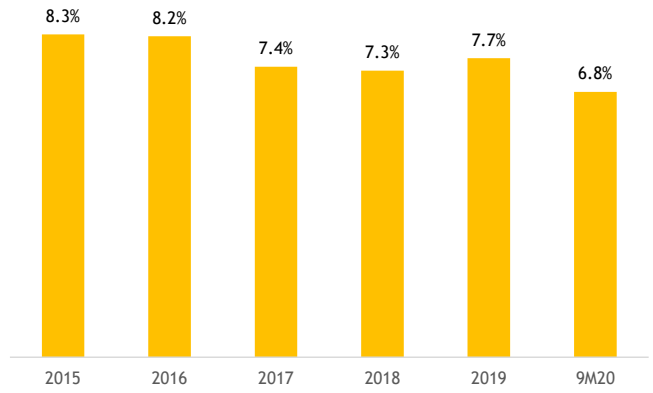
We think the Omnibus law will also benefit the textile sector and support export diversification. Most of Indonesia's exports are commodity based (9M20: 61%). Textile is the second largest export contributor with a stable market share of 7-8%. Being labour intensive, the sector will benefit from the labour reforms, facilitated by the Omnibus law. One of the reforms is the calculation of the minimum wages, starting 2022, which is based on either real GDP growth or inflation, and no longer based on nominal GDP growth.

**Fig 64: Value of textile exports (USD b)**




*Source: Bank Indonesia*

**Fig 65: Stable proportion of textile exports to total**



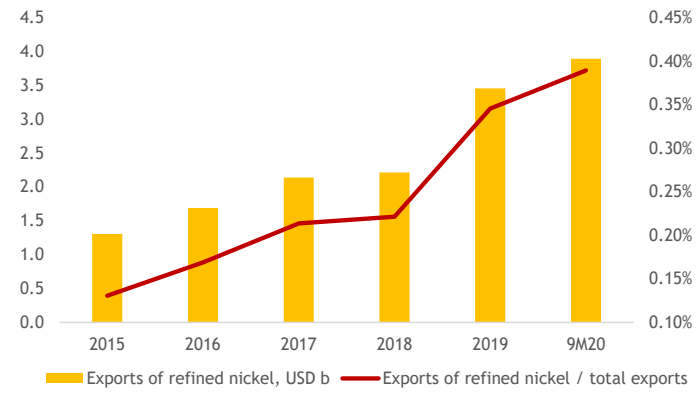

*Source: Bank Indonesia, Maybank Kim Eng*

## 3.2. Value-added projects: turning trade balance to a surplus

The government policy to ban exports of mineral ores has started to show some results. While the full economic impact is still difficult to measure at this stage, we see improvements on the export front. Exports of refined nickel in 9M20 was already 12.7% higher than 2019. Export contribution of refined nickel was still small (0.39% to GDP), but already more than double 2017's 0.17%.

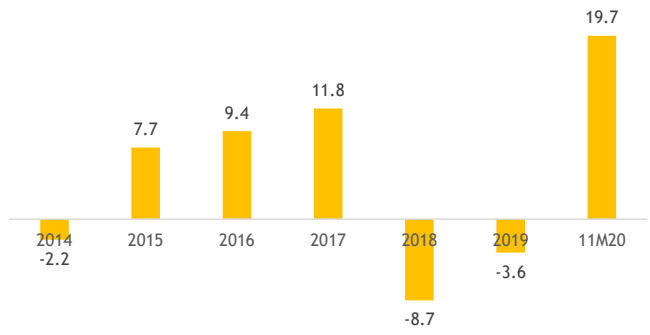
When the nickel smelters are up and running in the next 3-4 years, we estimate there will be an additional export of c. USD8-9b. Export contribution from refined nickel will also increase to 8% of GDP, in our estimate. *Ceteris paribus*, the additional exports will be able to turn the 2018-19 trade balance to a surplus.

**Fig 66: Increase in exports of refined nickel**




*Source: Bank Indonesia, BPS, Maybank Kim Eng*

**Fig 67: Trade balance (USD b)**

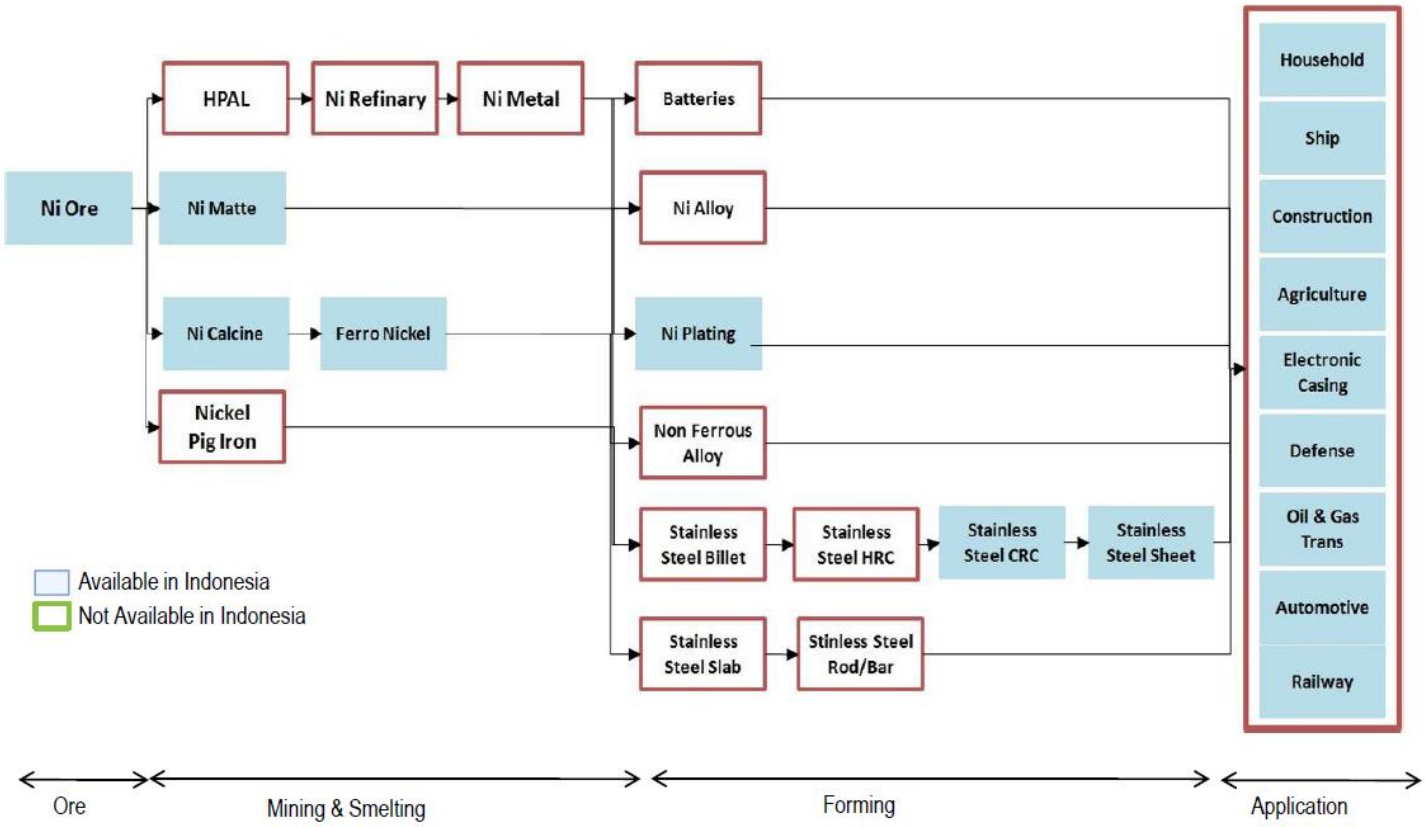



*Source: Bloomberg*

We think the upside to the nickel value-added process is very significant. Fig 68 below suggests that the country is still in the early stage of adding value as the current process still produces nickel pig iron and ferronickel.

According to the Ministry of Energy and Mineral Resources, now there are six HPAL smelter projects with total investments of USD13b, which will produce 246,774 tonnes of nickel. The six projects will be done by INCO (IDRxx, BUY, TP IDR7,000) and other unlisted companies: Adhikarya Cipta Mulia, Smelter Nikel Indonesia, Huayue and QMB New Energy Materials.

**Fig 68: Indonesia is at the early stage of the nickel value-added process**




*Source: Ministry of Industry*

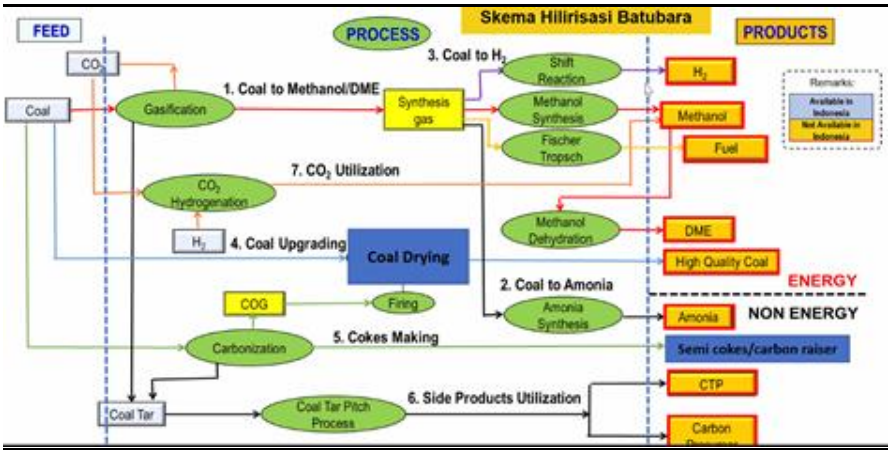
The government, through unlisted SOE (Inalum, Pertamina and PLN, has an ambitious plan to develop an integrated battery project from

upstream to downstream. The plan is still in the early stages. Some items are yet to be determined, including investment costs, timelines, structures of transaction and foreign partners.

Despite the positive developments in the nickel sector, we do not think this can be replicated in the coal sector. As highlighted in our Indonesia Mining report dated 23 November titled Still early, but a serious consideration, technology and economic aspects are not supportive of the government plan to create value added in the coal sector.

For most of the projects (see Fig 69), the technology is not ready and proven to support commercialization. If the technology is available, such as the one for coal-to-methanol project, the investment cost is high, which is hard to justify especially given the bleak outlook for coal prices. Realistically speaking, we think mine-mouth are perhaps the only project that can increase the value of low-CV coal without requiring too much investment.

**Fig 69: Many coal value-added projects are not feasible**




*Source: Ministry of Energy & Mineral Resources*

# 4. Retail participation

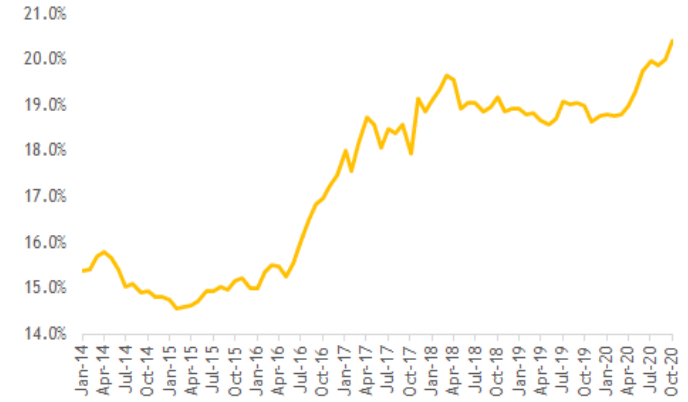
## 4.1. Will continue to be high

Participation of retail investors has increased over the past 2-3 years, but we noticed it has increased substantially during the pandemic. We expect their participation to remain high in 2021 as interest rate for 1-year time deposit, which has been on a declining trend since the end of 2019, will continue to be low, partly due to on-going low inflation. This will make term deposits and retail government bonds unattractive as an investment. The cost of borrowing will continue to be low, which is positive for margin-based transactions for retail investors.

There is no exact data showing retail investors' participation in daily trading on the stock exchange. However, several other data (insert source) support our argument of their increasing participation in the market as follows:

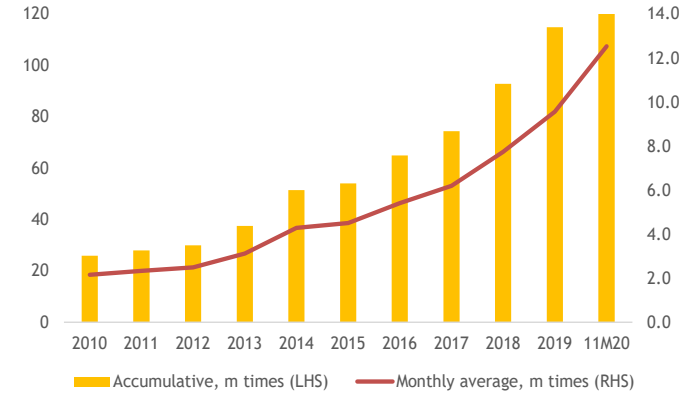
- As of end of November, ownership of retail investors in the market was 20%. This was higher than the end of December 2019 (18.7%) and five years ago (15.2%).
- The number of daily trading frequency is another indicator of retail investors' participation as retail investors normally trade in small number of shares. The number of daily trading frequency in 11M20 was 138m times, already 20.1% higher than 2019. In 2014-19 daily trading frequency posted a double-digit (17.1%) CAGR.
- The data on monthly average of daily trading frequency shows another strong indicator. In 11M20, it was 12.5m times, 31% higher than 2019 average of 9,6m times and more than double (231.6%) the 2016 average of 5.4m times.
- The number of securities accounts have increased substantially too. At the end of October, the number of accounts were 1.95m, 43% and 83% higher than those at the end of December 2019 and December 2018.

**Fig 70: Increasing ownership of retail investors**



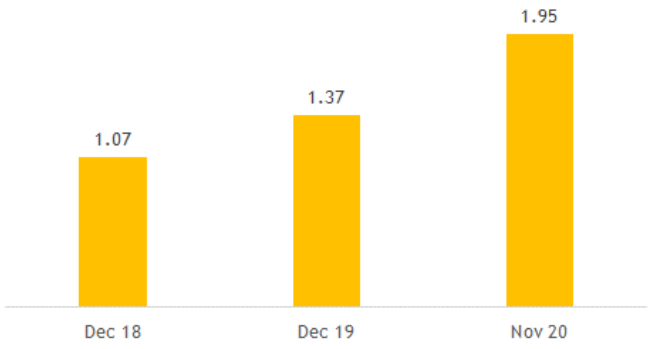

*Source: KSEI*

**Fig 71: Increasing IDX trading frequency**



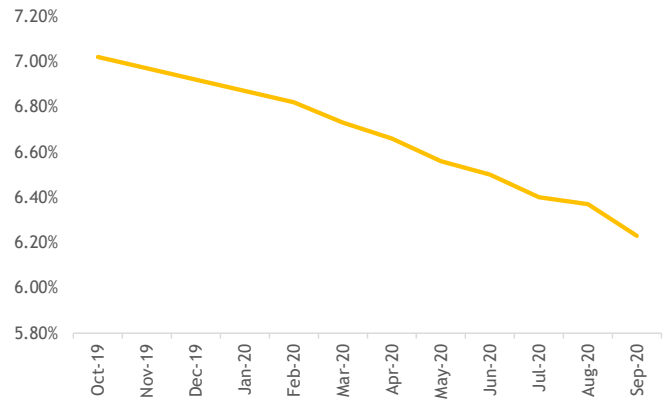

*Source: IDX*

**Fig 72: Increasing number of securities accounts (in m)**




Note: end of period data
*Source: KSEI*

**Fig 73: Declining 1-year IDR deposit rate could increase retail participation**




*Source: OJK*

## 4.2. Stock focus: not always speculative

As there is no market data on retail investors' trading patterns, our analysis is purely based on data on MKE Indonesia retail clients:

- We note that retail investors do not have sector preference; they can trade in all sectors. We think this is understood as most of their trading is based on market rumours and momentum, and not on fundamentals.

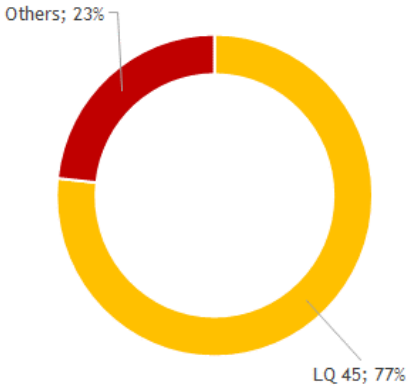
- Around 30% of the transactions are based on margin financing. We expect declining interest rate will support cheaper margin financing cost, and as such, be positive for margin-based transactions.

- We think the proportion of margin-based transactions to total transactions could be different from one securities house to another as the margin capacity is determined by its adjusted net working capital (Modal Kerja Bersih Disesuaikan/MKBD). Based on the IDX list of margin stocks issued at the end of November, a securities house with an MKBD of IDR250 and above can provide margin financing for 155 stocks. Meanwhile, a securities house with an MKBD of below IDR250b can provide financing for only LQ-45 stocks. The list can change from time to time based on the discretion of the IDX.

- The perception that retail investors only focus on small-cap and speculative stocks is not completely true. Our analysis of transactions by MKE Indonesia retail clients suggests that in 10M20, 77% of their transactions were for liquid (LQ-45) stocks, and the 23% for smaller and illiquid ones. The retail investors' proportion of LQ-45 trading is higher than its weight in the JCI (65%).

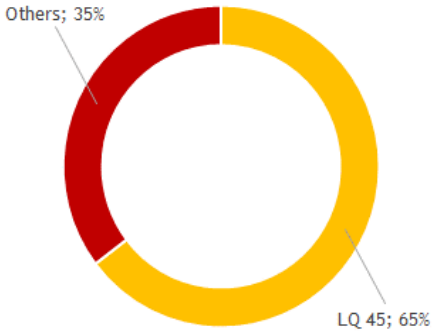
- We think the proportion of LQ-45 in the retail transactions for 2021 could diminish as we expect retail investors to be more aggressive by buying smaller names in the bull market. This is supported by expectedly lower cost of financing.

**Fig 74: Retail investors prefer LQ-45 stocks**




*Source: Maybank Kim Eng*

**Fig 75: JCI weighting of stocks**




*Source: Bloomberg*

# 5. Risk factors

- **Vaccine rollout**. Successful distribution of COVID-19 vaccines is the main assumption for our economic and earnings recovery story. This is because more than 50% of the economy is driven by domestic activities and it is likely that not 100% of the population will get the vaccines for free. The success depends on several factors, including pricing of the vaccines set by the government and people's participation in the vaccination programme.

- **Budget financing**. The 2021 state budget will remain in a deficit, suggesting the government will still need to secure external financing to support its expenditures. We think the government will continue to involve BI in the financing scheme due to uncertainties in the financial markets.

- **Court challenge**. Labour unions have decided to challenge the Omnibus law in the court. The risk is if they win the case, the government as per court order will have to revise the law. We think this could reduce the effectiveness of the law to attract investments to the country.

- **Change of roles of financial regulators**. There were market talks in the past that the government would change the roles of BI and OJK (Indonesia FSA) to be more active in supporting economic growth and stability. We think the market does not like the idea as that could compromise the credibility and independence of the central bank.

# Research Offices

## ECONOMICS

**Suhaimi ILIAS**
Chief Economist
Malaysia | Philippines | Global
(603) 2297 8682
suhaimi_ilias@maybank-ib.com

**CHUA Hak Bin**
Regional Thematic Macroeconomist
(65) 6231 5830
chuahb@maybank-ke.com.sg

**LEE Ju Ye**
Singapore | Thailand | Indonesia
(65) 6231 5844
leejuye@maybank-ke.com.sg

**Linda LIU**
Singapore | Vietnam |
Cambodia | Myanmar | Laos
(65) 6231 5847
lindaliu@maybank-ke.com.sg

**Dr Zamros DZULKAFLI**
(603) 2082 6818
zamros.d@maybank-ib.com

**Ramesh LANKANATHAN**
(603) 2297 8685
ramesh@maybank-ib.com

**William POH**
(603) 2297 8683
william.poh@maybank-ib.com

## FX

**Saktiandi SUPAAT**
Head of FX Research
(65) 6320 1379
saktiandi@maybank.com.sg

**Christopher WONG**
(65) 6320 1347
wongkl@maybank.com.sg

**TAN Yanxi**
(65) 6320 1378
tanyx@maybank.com.sg

**Fiona LIM**
(65) 6320 1374
fionalim@maybank.com.sg

## STRATEGY

**Anand PATHMAKANTHAN**
ASEAN
(603) 2297 8783
anand.pathmakanthan@maybank-ib.com

## FIXED INCOME

**Winson PHOON,** ACA
(65) 6812 8807
winsonphoon@maybank-ke.com.sg

**SE THO Mun Yi**
(603) 2074 7606
munyi.st@maybank-ib.com

## REGIONAL EQUITIES

**Anand PATHMAKANTHAN**
Head of Regional Equity Research
(603) 2297 8783
anand.pathmakanthan@maybank-ib.com

**WONG Chew Hann, CA**
Head of ASEAN Equity Research
(603) 2297 8686
wchewh@maybank-ib.com

**ONG Seng Yeow**
Research, Technology & Innovation
(65) 6231 5839
ongsengyeow@maybank-ke.com.sg

## MALAYSIA

**Anand PATHMAKANTHAN** *Head of Research*
(603) 2297 8783
anand.pathmakanthan@maybank-ib.com
• Strategy

**Desmond CH'NG, BFP, FCA**
(603) 2297 8680
desmond.chng@maybank-ib.com
• Banking & Finance

**LIAW Thong Jung**
(603) 2297 8688 tjliaw@maybank-ib.com
• Oil & Gas Services- Regional
• Automotive

**ONG Chee Ting, CA**
(603) 2297 8678 ct.ong@maybank-ib.com
• Plantations - Regional

**YIN Shao Yang, CPA**
(603) 2297 8916 samuel.y@maybank-ib.com
• Gaming – Regional
• Media • Aviation

**TAN Chi Wei, CFA**
(603) 2297 8690 chiwei.t@maybank-ib.com
• Power • Telcos

**WONG Wei Sum, CFA**
(603) 2297 8679 weisum@maybank-ib.com
• Property

**LEE Yen Ling**
(603) 2297 8691 lee.yl@maybank-ib.com
• Glove • Ports • Shipping • Healthcare
• Petrochemicals

**Kevin WONG**
(603) 2082 6824 kevin.wong@maybank-ib.com
• REITs • Technology

**Jade TAM**
(603) 2297 8687 jade.tam@maybank-ib.com
• Consumer Staples & Discretionary

**Fahmi FARID**
(603) 2297 8676 fahmi.farid@maybank-ib.com
• SMIDs

**TEE Sze Chiah** *Head of Retail Research*
(603) 2082 6858 szechiah.t@maybank-ib.com

**Nik Ihsan RAJA ABDULLAH,** MSTA, CFTe
(603) 2297 8694
nikmohdihsan.ra@maybank-ib.com
• Chartist

**Amirah AZMI**
(603) 2082 8769 amirah.azmi@maybank-ib.com
• Retail Research

## SINGAPORE

**Thilan WICKRAMASINGHE** *Head of Research*
(65) 6231 5840 thilanw@maybank-ke.com.sg
• Banking & Finance - Regional
• Consumer

**CHUA Su Tye**
(65) 6231 5842 chuasutye@maybank-ke.com.sg
• REITs - Regional

**LAI Gene Lih, CFA**
(65) 6231 5832 laigenelih@maybank-ke.com.sg
• Technology • Healthcare

**Kareen CHAN**
(65) 6231 5926 kareenchan@maybank-ke.com.sg
• Transport • Telcos

**TAN Chin Poh** *Head of Retail Research*
(65) 6231 5928 chinpoh@maybank-ke.com.sg

**Eric ONG**
(65) 6231 5924 ericong@maybank-ke.com.sg
• Retail Research

**Matthew SHIM**
(65) 6231 5929
matthewshim@maybank-ke.com.sg
• Retail Research

## INDIA

**Jigar SHAH** *Head of Research*
(91) 22 4223 2632 jigars@maybank.com
• Strategy • Oil & Gas • Automobile • Cement

**Neerav DALAL**
(91) 22 4223 2606 neerav@maybank.com
• Software Technology • Telcos

**Kshitiz PRASAD**
(91) 22 4223 2607
kshitiz@maybank.com
• Banks

**Vikram RAMALINGAM**
(91) 22 4223 2607
vikram@maybank.com
• Automobile • Media

## INDONESIA

**Isnaputra ISKANDAR** *Head of Research*
(62) 21 8066 8680
isnaputra.iskandar@maybank-ke.co.id
• Strategy • Metals & Mining • Cement
• Autos • Consumer • Utility

**Rahmi MARINA**
(62) 21 8066 8689
rahmi.marina@maybank-ke.co.id
• Banking & Finance

**Aurellia SETIABUDI**
(62) 21 8066 8691
aurellia.setiabudi@maybank-ke.co.id
• Property

**Willy GOUTAMA**
(62) 21 8066 8500
willy.goutama@maybank-ke.co.id
• Consumer

## PHILIPPINES

**Jacqui De JESUS**
(63) 2 8849 8844
jacquiannekelly.dejesus@maybank-atrke.com
• Strategy • Conglomerates

**Romel LIBO-ON**
(63) 2 8849 8844
romel_libo-on@maybank-atrke.com
• Property

**Fredrick De GUZMAN**
(63) 2 8849 8847
fredrickdaniel.deguzman@maybank.com
• Consumer

**Bernadine B BAUTISTA**
(63) 2 8849 8847
bernadine.bautista@maybank.com
• Utilities

**Rachelleen RODRIGUEZ**
(63) 2 8849 8843
rachelleen.rodriguez@maybank.com
• Banking & Finance

## THAILAND

**Maria LAPIZ** *Head of Institutional Research*
Dir (66) 2257 0250 | (66) 2658 6300 ext 1399
Maria.L@maybank-ke.co.th
• Strategy • Consumer • Materials • Services

**Jesada TECHAHUSDIN, CFA**
(66) 2658 6300 ext 1395
jesada.t@maybank-ke.co.th
• Banking & Finance

**Kaushal LADHA, CFA**
(66) 2658 6300 ext 1392
Kaushal.l@maybank-ke.co.th
• Oil & Gas – Regional
• Petrochemicals - Regional

**Vanida GEISLER, CPA**
(66) 2658 6300 ext 1394
Vanida.G@maybank-ke.co.th
• Property

**Yuwanee PROMMAPORN**
(66) 2658 6300 ext 1393
Yuwanee.P @maybank-ke.co.th
• Services

**Ekachai TARAPORNTIP** *Head of Retail Research*
(66) 2658 5000 ext 1530
Ekachai.t@maybank-ke.co.th

**Surachai PRAMUALCHAROENKIT**
(66) 2658 5000 ext 1470
Surachai.p@maybank-ke.co.th
• Auto • Conmat • Contractor • Steel

**Suttatip PEERASUB**
(66) 2658 5000 ext 1430
suttatip.p@maybank-ke.co.th
• Food & Beverage • Commerce

**Jaroonpan WATTANAWONG**
(66) 2658 5000 ext 1404
jaroonpan.w@maybank-ke.co.th
• Transportation • Small cap

**Thanatphat SUKSRICHAVALIT**
(66) 2658 5000 ext 1401
thanaphat.s@maybank-ke.co.th
• Media • Electronics

**Wijit ARAYAPISIT**
(66) 2658 5000 ext 1450
wijit.a@maybank-ke.co.th
• Strategist

**Theerasate PROMPONG**
(66) 2658 5000 ext 1400
theerasate.p@maybank-ke.co.th
• Equity Portfolio Strategist

**Apiwat TAVESIRIVATE**
(66) 2658 5000 ext 1310
apiwat.t@maybank-ke.co.th
• Chartist and TFEX

## VIETNAM

**Quan Trong Thanh**
(84 28) 44 555 888 ext 8184
thanh.quan@maybank-kimeng.com.vn
• Banks

**Hoang Huy, CFA**
(84 28) 44 555 888 ext 8181
hoanghuy@maybank-kimeng.com.vn
• Strategy

**Le Nguyen Nhat Chuyen**
(84 28) 44 555 888 ext 8082
chuyen.le@maybank-kimeng.com.vn
• Oil & Gas

**Nguyen Thi Sony Tra Mi**
(84 28) 44 555 888 ext 8084
mi.nguyen@maybank-kimeng.com.vn
• Consumer

**Tyler Manh Dung Nguyen**
(84 28) 44 555 888 ext 8180
dung.nguyen@maybank-kimeng.com.vn
• Utilities • Property

**Nguyen Thi Ngan Tuyen**
*Head of Retail Research*
(84 28) 44 555 888 ext 8081
tuyen.nguyen@maybank-kimeng.com.vn
• Food & Beverage • Oil & Gas • Banking

**Nguyen Thanh Lam**
(84 28) 44 555 888 ext 8086
thanhlam.nguyen@maybank-kimeng.com.vn
• Technical Analysis

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## Malaysia
**Maybank Investment Bank Berhad**
(A Participating Organisation of
Bursa Malaysia Securities Berhad)
33rd Floor, Menara Maybank,
100 Jalan Tun Perak,
50050 Kuala Lumpur
Tel: (603) 2059 1888;
Fax: (603) 2078 4194

Stockbroking Business:
Level 8, Tower C, Dataran Maybank,
No.1, Jalan Maarof
59000 Kuala Lumpur
Tel: (603) 2297 8888
Fax: (603) 2282 5136

## Singapore
**Maybank Kim Eng Securities Pte Ltd**
**Maybank Kim Eng Research Pte Ltd**
50 North Canal Road
Singapore 059304

Tel: (65) 6336 9090

## London
**Maybank Kim Eng Securities (London) Ltd**
PNB House
77 Queen Victoria Street
London EC4V 4AY, UK

Tel: (44) 20 7332 0221
Fax: (44) 20 7332 0302

## New York
**Maybank Kim Eng Securities USA Inc**
400 Park Avenue, 11th Floor
New York, New York 10022,
U.S.A.

Tel: (212) 688 8886
Fax: (212) 688 3500

## Hong Kong
**Kim Eng Securities (HK) Ltd**
28/F, Lee Garden Three,
1 Sunning Road, Causeway Bay,
Hong Kong

Tel: (852) 2268 0800
Fax: (852) 2877 0104

## Indonesia
**PT Maybank Kim Eng Securities**
Sentral Senayan III, 22nd Floor
Jl. Asia Afrika No. 8
Gelora Bung Karno, Senayan
Jakarta 10270, Indonesia

Tel: (62) 21 2557 1188
Fax: (62) 21 2557 1189

## India
**Kim Eng Securities India Pvt Ltd**
1101, 11th floor, A Wing, Kanakia
Wall Street, Chakala, Andheri -
Kurla Road, Andheri East,
Mumbai City - 400 093, India

Tel: (91) 22 6623 2600
Fax: (91) 22 6623 2604

## Philippines
**Maybank ATR Kim Eng Securities Inc.**
17/F, Tower One & Exchange Plaza
Ayala Triangle, Ayala Avenue
Makati City, Philippines 1200

Tel: (63) 2 8849 8888
Fax: (63) 2 8848 5738

## Thailand
**Maybank Kim Eng Securities (Thailand) Public Company Limited**
999/9 The Offices at Central World,
20th - 21st Floor,
Rama 1 Road Pathumwan,
Bangkok 10330, Thailand

Tel: (66) 2 658 6817 (sales)
Tel: (66) 2 658 6801 (research)

## Vietnam
**Maybank Kim Eng Securities Limited**
4A-15+16 Floor Vincom Center Dong
Khoi, 72 Le Thanh Ton St. District 1
Ho Chi Minh City, Vietnam

Tel : (84) 844 555 888
Fax : (84) 8 38 271 030

## Saudi Arabia
*In association with*
**Anfaal Capital**
Ground Floor, KANOO Building
No.1 - Al-Faisaliyah,Madina Road,
P.O.Box 126575 Jeddah 21352
Kingdom of Saudi Arabia

Tel: (966) 920023423

## South Asia Sales Trading
Kevin Foy
Regional Head Sales Trading
kevinfoy@maybank-ke.com.sg
Tel: (65) 6636-3620
US Toll Free: 1-866-406-7447

### Indonesia
Iwan Atmadjaja
iatmadjaja2@bloomberg.net
(62) 21 8066 8555

### New York
James Lynch
jlynch@maybank-keusa.com
Tel: (212) 688 8886

### Philippines
Keith Roy
keith_roy@maybank-atrke.com
Tel: (63) 2 848-5288

## North Asia Sales Trading
Andrew Lee
andrewlee@kimeng.com.hk
Tel: (852) 2268 0283
US Toll Free: 1 877 837 7635

### London
Greg Smith
gsmith@maybank-ke.co.uk
Tel: (44) 207-332-0221

### India
Sanjay Makhija
sanjaymakhija@maybank-ke.co.in
Tel: (91)-22-6623-2629


www.maybank-ke.com | www.maybank-keresearch.com