2025 Macro Letter

1. Indonesia 2025: Fragile Growth, Rising Risks

Indonesia's economic outlook for 2025 hinges on coordinated policy efforts to address weak consumption, external trade risks, and Rupiah stability. While government spending, FDI inflows, and fiscal reforms provide a foundation for growth, external uncertainties and structural challenges underscore the need for a cautious yet proactive policymaking.

We remain cautious over Indonesia's consumer growth story due to weakening demand particularly for low-end consumer goods, increasing risks in asset quality from online lending and rural banking, and the prevalent rise of online gambling in Indonesia which has impacted income levels for Indonesia's middle-income segment.

The move to cut rates increases risk of capital outflows and Rupiah depreciation, driven by a weakening Indonesian economy. As BI maintains to stimulate the economy while maintaining Rupiah stability through its Benchmark Rate and open market operations (typically impacting short-term yields), we expect Government Spending to drive longer-term yields through a larger supply of Government Bonds.

Rising imports signal that domestic investment activity remains robust. However, this adds vulnerability to import-driven inflation (especially on a weak Rupiah). Furthermore, **we do not see any significant upside in a Trade Surplus**.

We expect the domestic manufacturing sector to struggle due to weak consumer demand, a lack of economies of scale to compete globally against China and India, higher imported input costs impacting margins, and China's economic slowdown leading to dumping measures.

2. Foreign Flows Drive Investment Decisions

With U.S. Treasury yields elevated, the Indonesian Bond market is dependent on Central Bank liquidity support and Non-Bank flows. We suspect that the recent flattening of the yield curve is driven by Banks' ownership outflows of short-term bonds.

Bank Indonesia's decision for a rate cut in January 2025 underlined its pivot from stability to economic growth. While we expect a steepening of the Indonesian Sovereign Yield Curve, short-term yields will remain elevated given the dynamic movements of U.S. Treasuries, and long-term yields are expected to trend upwards due to Indonesia's fiscal policies.

Corporate Bonds (A/AA/AAA) Spreads have been trending lower, particularly with the AAA and AA-rated companies. Given the current environment of low domestic inflation, taking on additional risk in a volatile market appears unwarranted. We remain selective on specific corporate bond issuance and investments.

Interestingly, **Earnings Yields are at levels similar to Bond Yields, where Equity Inflows are currently at a downtrend**, indicating some undervaluation. We think it makes sense to remain invested in Indonesian Equities given that reversals can be sharp. That said, security selection is critical across Blue-Chip and Momentum-Driven Equities to drive outperformance.

3. Trump Policies Fuel Growth, But Pose Risks for Indonesia

The U.S. economy is poised for robust growth, driven by a strong labor market and the Trump administration's policies. Deregulation, tax reforms, and trade restrictions—including higher tariffs on China—are fueling expectations of sustained economic expansion and persistent inflation.

However, Trump's pro-industrial agenda, which prioritizes fossil fuel production and rolls back green initiatives, may introduce deflationary pressures by boosting energy supply and industrial productivity. **This could prompt earlier Fed rate cuts while supporting near-term growth in household income and commodity exports.**

For Indonesia, reduced global commodity demand stemming from U.S. protectionism and increased domestic energy production may shrink its trade surplus, exerting downward pressure on the Rupiah.

4. USD Private Credit Continue to Outperform

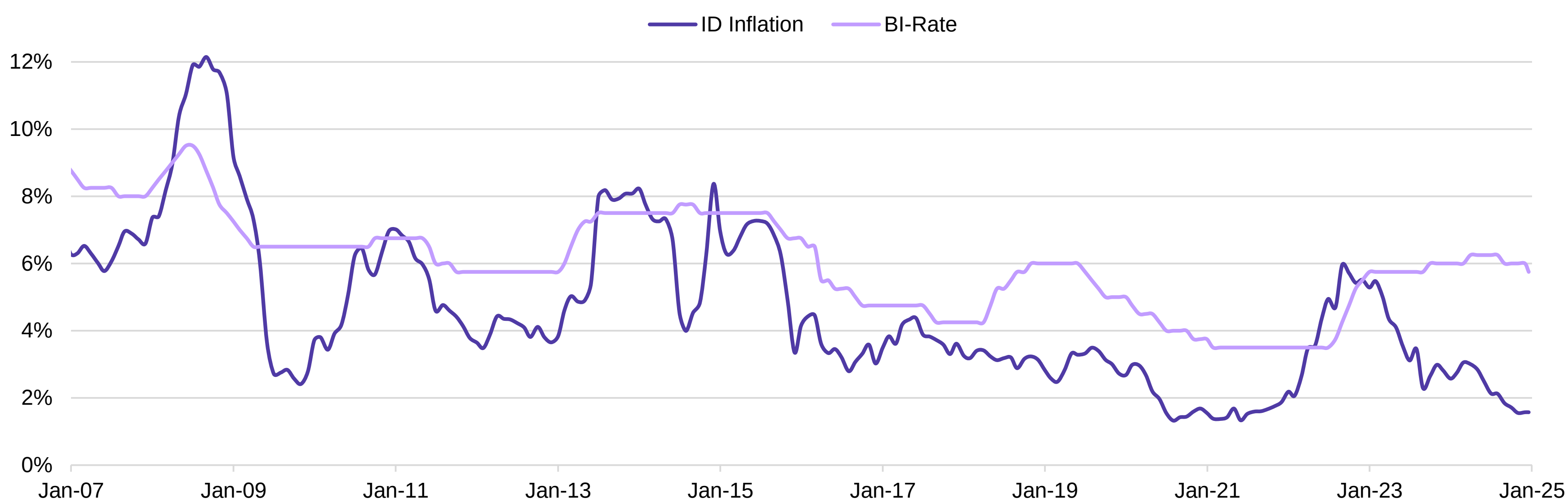
USD Indonesian Sovereign Bonds offer yields comparable to investment-grade USD bonds and a premium over U.S. Treasuries. We think holding these bonds offer the bare minimum buffer to hedge against a depreciating Rupiah, given Indonesia's sovereign credit rating.

While anticipated rate cuts may generate short-term capital gains, **we think holding Bonds risk eroding annualized returns over the medium term as yield advantages diminish.** In contrast, **USD Private Credit is positioned to deliver more durable, structurally higher returns amid prolonged easing cycles compared to USD Bonds.**

1. Indonesia 2025: Fragile Growth, Rising Risks

Heading into 2025, we expect Indonesia's domestic economy to remain weak highlighted by a diminishing middle-income segment and a low inflationary environment in 2024. Consumption, contributing 54% to Indonesia's GDP, faces ongoing challenges driven by weak demand in discretionary spending and overall purchasing power. Despite government fiscal interventions such as the social assistance program and the 6.5% provincial wage increase, we expect the overall impact on broader Consumption remains limited. **We remain cautious over Indonesia's consumer growth story due to weakening demand, particularly for low-end consumer goods, increasing risks in asset quality from online lending and rural banking, and the prevalent rise of online gambling in Indonesia which has impacted income levels for Indonesia's middle-income segment.**

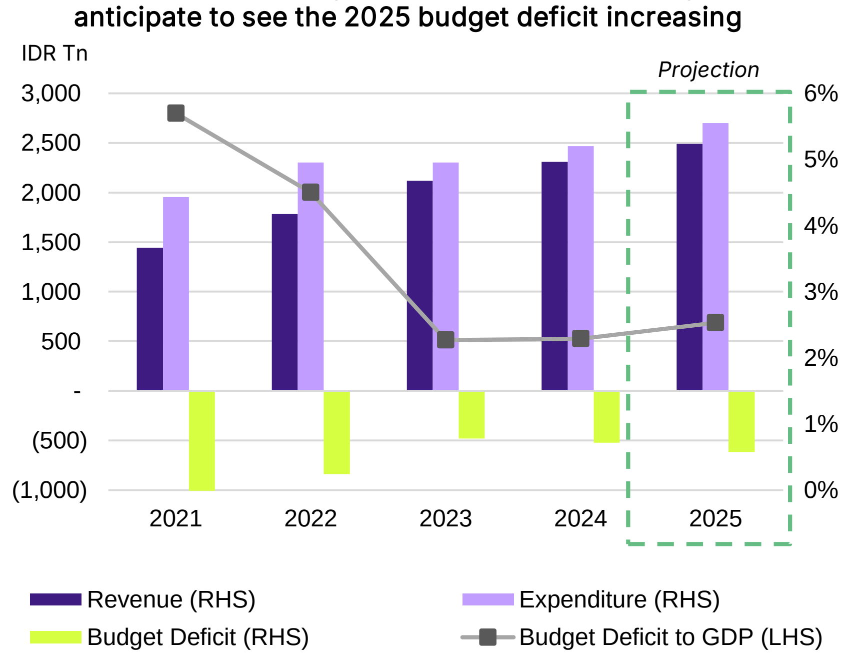
Declining inflation and a higher borrowing costs are impetus for BI to cut rates



A weakening Indonesian economy prompted Bank Indonesia (BI) to adopt a pro-growth stance and reduce the BI-Rate by 0.25% to 5.75%. In the past 2 years, BI's policy decisions focused on controlling inflationary pressures (primarily driven by pressures abroad) and Rupiah stability. Given that Indonesia's inflation in 2024 remained weak, BI has moved to a pro-growth stance to stimulate the economy while attempting to maintain Rupiah stability through open market operations.

Despite this, the Rupiah remains at risk given the narrow interest rate spread between the U.S. Federal Reserve's Benchmark and BI's Benchmark Rate. **The move to cut rates increased the risk of capital outflows and Rupiah depreciation, driven by a weakening Indonesian economy.**

With the increase in government social spending, we anticipate to see the 2025 budget deficit increasing



While we were not opposed to a rate cut in January 2025 and were expecting a rate cut towards the end of 2024 and allow the Rupiah to depreciate, we highlight Indonesia's policy dilemma across monetary and fiscal policies and the impact on the yield curve.

We expect Government Spending to be critical in sustaining economic growth for 2025. Key Government Programs include the Free Nutritious Meal, Affordable Housing Program, Inflation Subsidy Program, Nusantara Capital Project, and Downstream Investment for the Renewable Energy & Electric Vehicle (EV) Manufacturing Sector.

In all Government Programs, increases in subsidies and investment typically result in larger Budget Deficits (typically from Government Borrowing) and a Crowding Out effect on yields.

Studies suggest that the impact of Government Borrowing/Budget Deficits on yields is driven by the flow of Government Borrowing across Supply and demand.

As BI maintains to stimulate the economy while maintaining Rupiah stability through its Benchmark Rate and open market operations (typically impacting short-term yields), we expect Government Spending to drive longer-term yields through a larger supply of Government Bonds. Higher bond yields are driven by higher-than-expected Government Spending. If the Indonesian Government extends its Deficit, then we would see a steepening yield curve whereby the long-term bond yields are expected to drift upwards. **At the same time, BI has a delicate balance to maintain Rupiah stability as U.S. inflation remains sticky and persistent, which suggests elevated short-term yields.**

In addition, we see Fiscal Revenue growth to be limited due to a weak economy (despite VAT increases), moderating commodity prices, and a weakening Rupiah impacting Trade Balances.

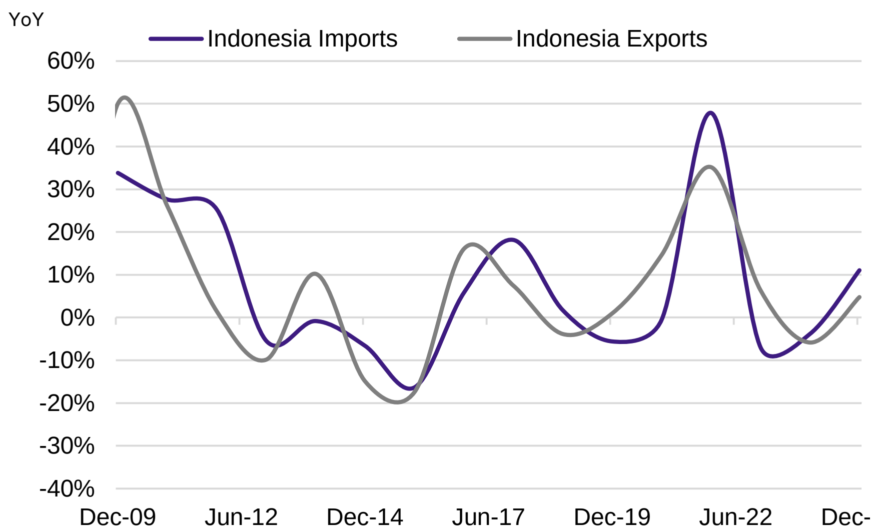
Source: Simpan Asset Management, Central Agency of Statistics Indonesia (BPS), Bank Indonesia (BI), Ministry of Finance (MoF), Bloomberg, Bridgewater Associates.

1. Indonesia 2025: Fragile Growth, Rising Risks

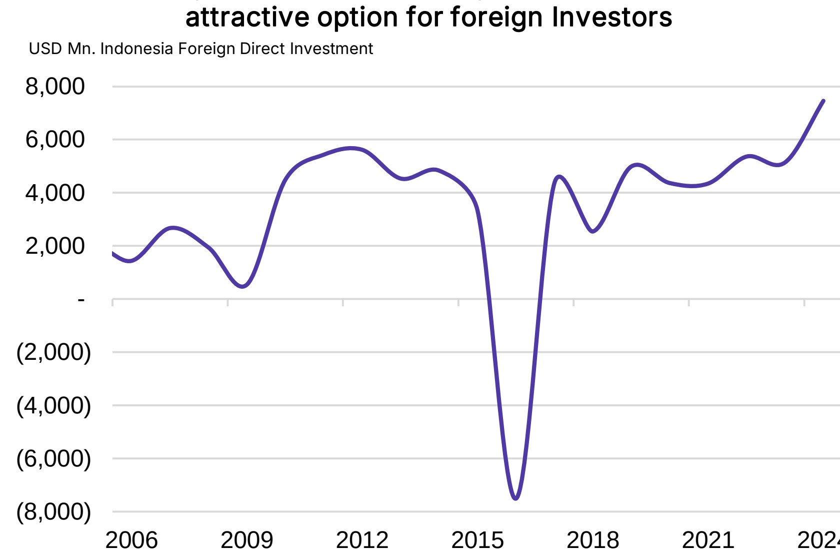
While Indonesia's Trade Balance continues to record a Surplus, the trade outlook presents uncertainty. **Rising imports signal that domestic investment activity remains robust. However, this adds vulnerability to import-driven inflation (especially on a weak Rupiah).** Furthermore, a diminishing surplus may be driven by a weakening Rupiah and the impact on the U.S.'s newly proposed tariff schemes, which can dampen Indonesia's economic growth.

We do not see any significant upside in the Trade Balance due to 1) U.S.-China trade conflicts disrupting Chinese demand as China remains Indonesia's largest trading partner; 2) a normalization in commodity prices and mild demand limiting growth; and 3) redirected Chinese goods from U.S. tariffs create competition in domestic markets and further impact net exports.

Imports are expected to increase while Exports growth remain moderate

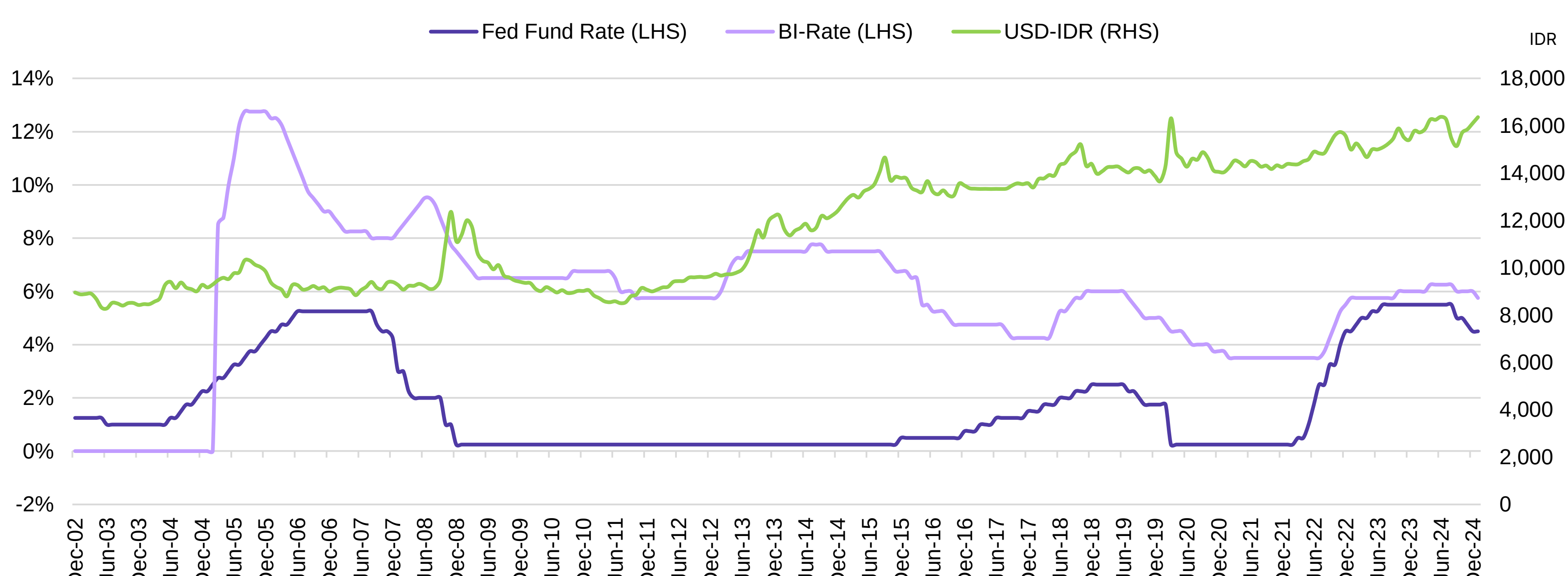


Anticipating FDI to continue rising as Indonesia remains an attractive option for foreign Investors



From our sources, we expect the domestic manufacturing sector to struggle due to weak consumer demand, a lack of economies of scale to compete globally against China and India, higher imported input costs impacting margins, and China's economic slowdown leading to dumping measures. However, on a positive note, Foreign Direct Investment (FDI) is anticipated to strengthen in the second half of 2025 from infrastructure projects and downstream manufacturing initiatives.

Widening interest rate spread between Indonesia and the US creates volatility in the IDR



A stronger U.S. Dollar, a weakening Rupiah, and uncertainties surrounding U.S. monetary policy are expected to keep Indonesian interest rates elevated for the foreseeable future despite the rate cut. This puts the Rupiah in a vulnerable position and is projected to face continued volatility driven by uncertainties surrounding U.S. trade policies and limited prospects for interest rate cuts by the Federal Reserve (Fed). **Higher-for-longer interest rates raise concerns about domestic liquidity and portfolio flows.**

Foreign investors have increasingly withdrawn funds from emerging markets, including Indonesian assets, in favor of opportunities in developed markets. An elevated U.S. Treasury Yield adds downside risks for the Rupiah, which can trigger investment outflow from Indonesia's equity and bond marks. Following geopolitical shifts with the new U.S. administration, the trend is expected to gain momentum and continue to weigh the Rupiah and Indonesian markets.

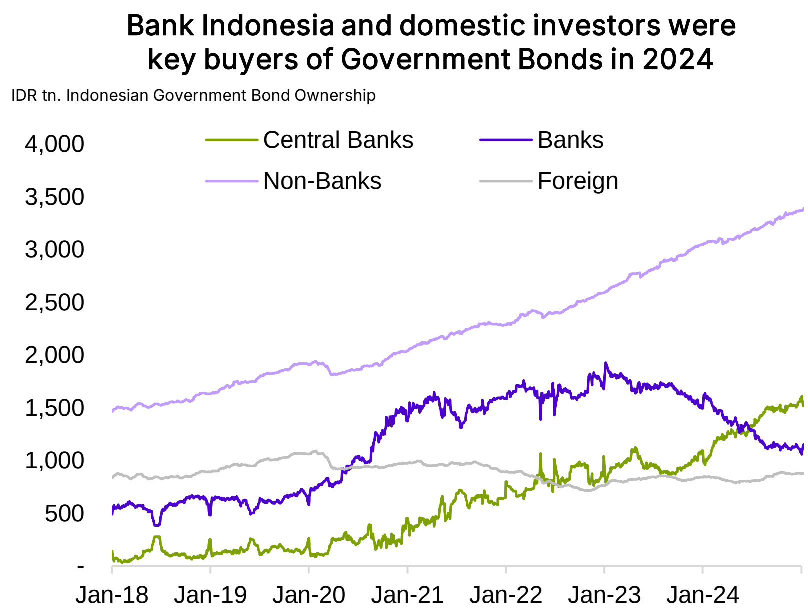
Source: Simpan Asset Management, Central Agency of Statistics Indonesia (BPS), Bank Indonesia (BI), Bloomberg.

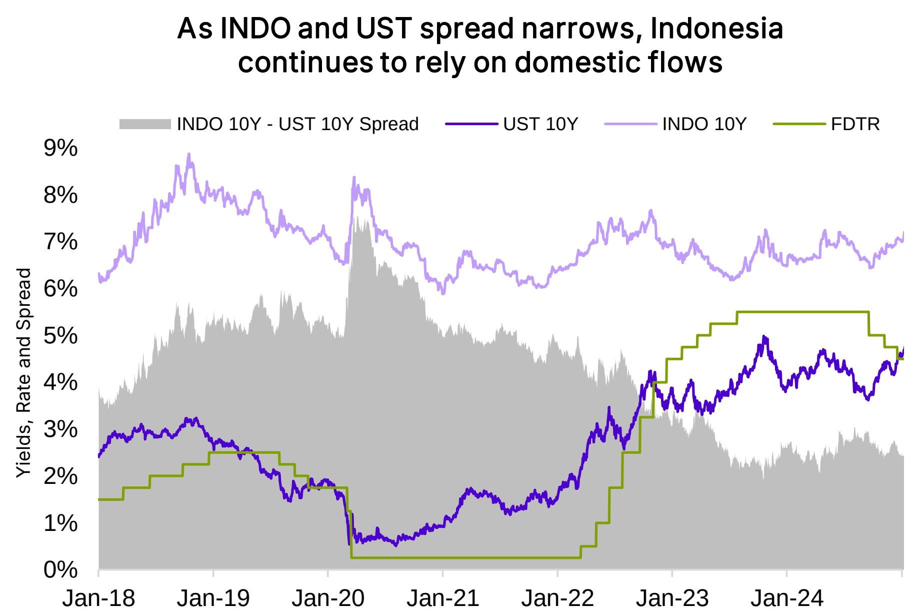
2. Foreign Flows Drive Investment Decisions

Indonesia's capital markets are heavily dependent on capital flows which have a direct impact on price movements. The Indonesian Bond market saw significant support and liquidity from Non-Banks and Central Banks with the latter focused on improving overall market liquidity. Notably, Banks reduced their bond ownership in 2024 given the tight banking liquidity to support their lending operations. Foreign ownership remains well below pre-pandemic levels and relatively muted.

With U.S. Treasury yields elevated, the Indonesian Bond market depends on Central Bank liquidity support and Non-Bank flows. We think there is continued outflow from Banks (given tighter bank liquidity to fund their lending operations) and Foreign capital (given thin yield spreads between U.S. Treasuries and Indonesian Government Bonds).

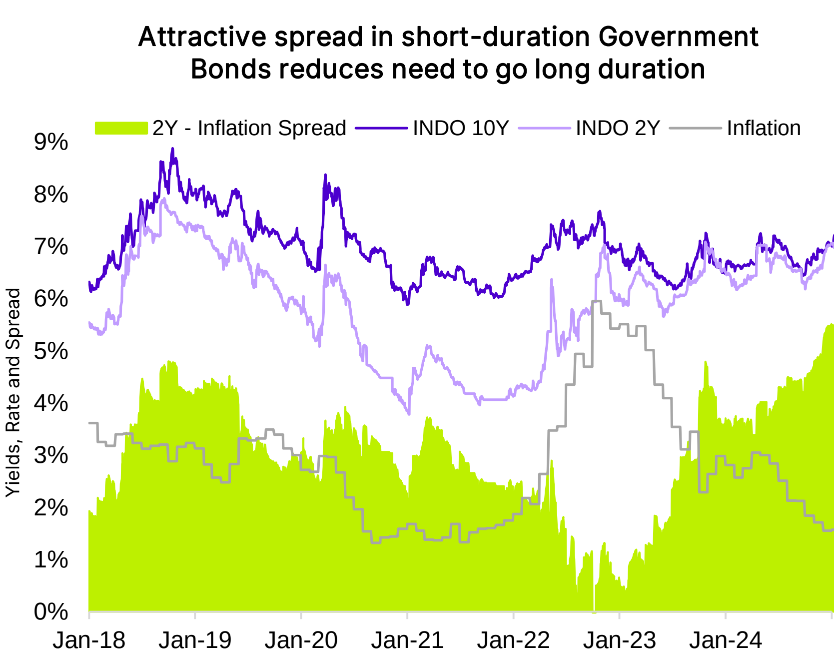
Expected upside on the Indonesian Government Bond Prices could be driven by the following: 1) Tax cuts by the new U.S. Administration widening the U.S. fiscal deficits and weakening the Dollar, 2) lower than expected tariffs, and 3) wider Indonesian Trade Deficit leading to a weaker economy and prompting further BI rate cuts. Furthermore, Trump stated that he prefers a weaker Dollar to boost US manufacturing and export competitiveness which may provide some upside. **However, at this point, we expect Indonesian Government Bond Yields to be elevated given the global and domestic macro environment.**

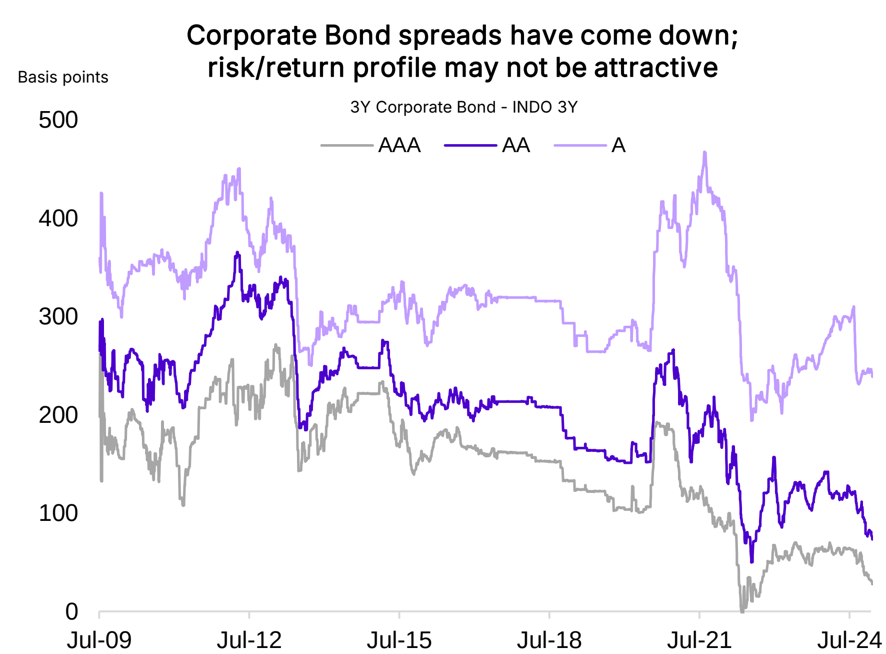




In 2024, we found that INDOGB 10Y and INDOGB 2Y spreads have remained historically tight, while INDOGB 2Y and Indonesia's Inflation Rate remained historically wide. **We suspect that the recent flattening of the yield curve is driven by Banks' ownership outflows of short-term bonds.**

Corporate Bonds (A/AA/AAA) Spreads have been trending lower, particularly with the AAA and AA-rated companies. Given the current environment of low domestic inflation, taking on additional risk in a volatile market appears unwarranted. The subdued inflationary pressures provide a stable backdrop, reducing the urgency to chase higher yields through corporate bonds. Instead, we believe current conditions call for a more cautious selection approach. **Given the dynamic movement in the yield curve across the Indonesian Government Bond space and the lack of liquidity across corporate bonds, we remain selective on specific corporate bond issuance and investments.**





Source: Simpan Asset Management, Central Agency of Statistics Indonesia (BPS), Bank Indonesia (BI), Bloomberg.

2. Foreign Flows Drive Investment Decisions

Bank Indonesia's decision for a rate cut in January 2025 underlined its pivot from stability to economic growth. While we expect a steepening of the Indonesian Sovereign Yield Curve, short-term yields will remain elevated given the dynamic movements of U.S. Treasuries, and long-term yields are expected to trend upwards due to Indonesia's fiscal policies.

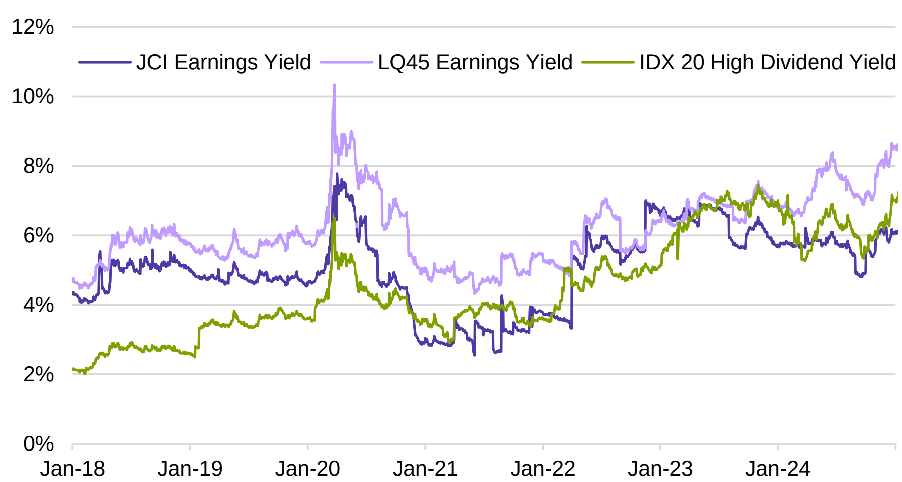
Dovish market expectations of 200 bps Fed cuts by 3Q25 were changed to 50 bps by end of 2025. We expect a "higher-for-longer" interest rate path which would elevate short-term interest rates.

Across Equities, we saw record highs for JCI in 4Q25 followed by a steep correction due to Trump's presidential election victory and the Fed's hawkish 2025 outlook. Blue-Chip Equities particularly the Big Banks were the main drivers for both the rally and slump. **In 1H25, we expect a challenging market environment with a "wait-and-see" approach and heightened volatility within domestic equity markets given Trump's return as U.S. President and Prabowo's policies to materialize.**

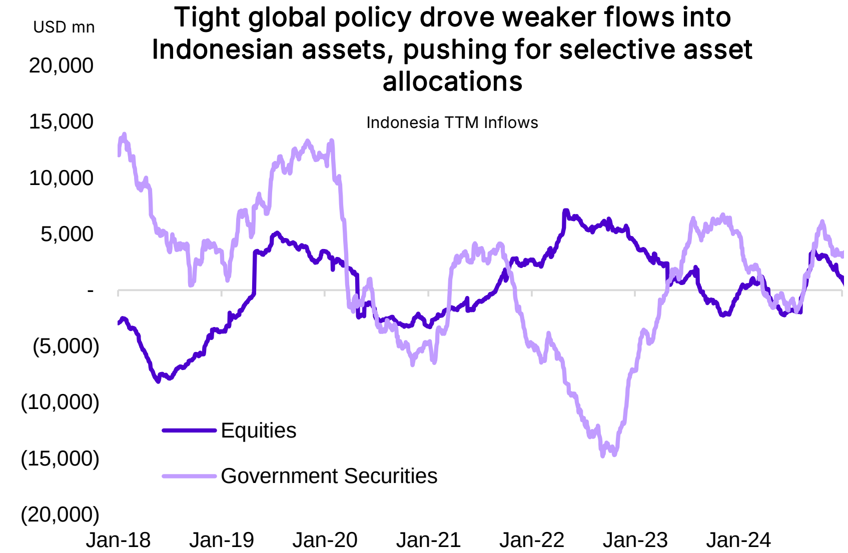
Earnings Yield across Indonesian Equities are elevated due to lower share price and EPS revisions. **Interestingly, Earnings Yields are at levels similar to Bond Yields and Equity Inflows are currently at a downtrend, indicating some undervaluation. We think that there is warrant remaining invested in Indonesian Equities given that reversals can be sharp. We think securities selection has become more important across Blue-Chip and Momentum-Driven Equities to drive returns.**

More specifically, we are complementing long-term core holdings with a more tactical approach across momentum-driven stocks and securing trading profits given an equity market with heightened volatility.

Equity earnings yields are elevated, comparable to Bond yields



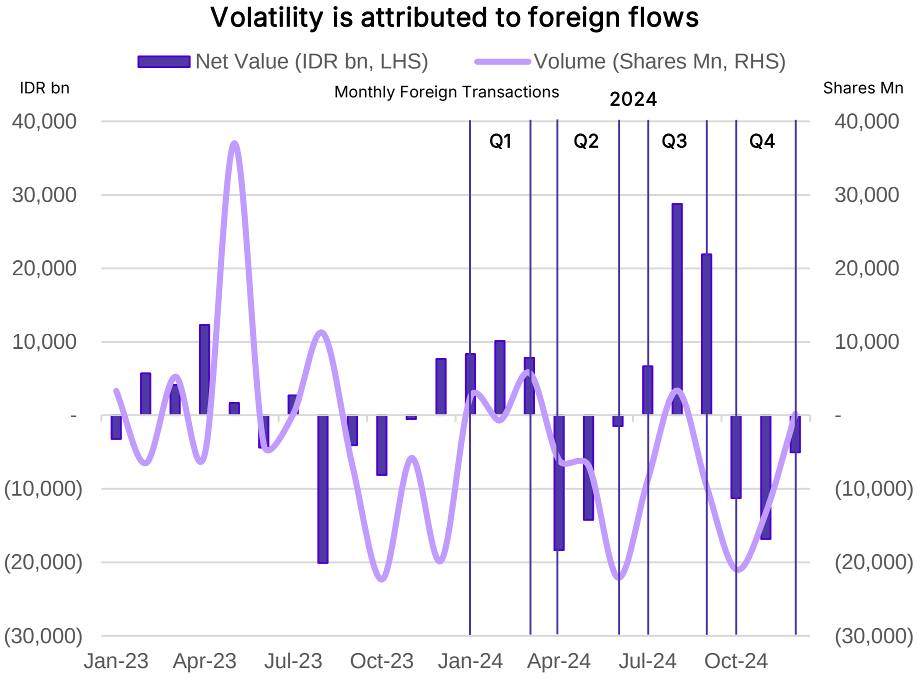
Tight global policy drove weaker flows into Indonesian assets, pushing for selective asset allocations



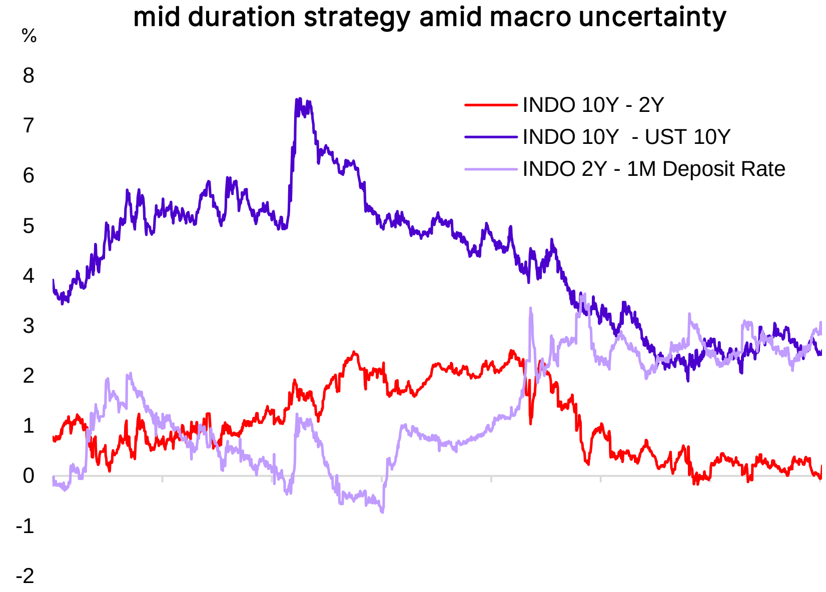
As previously mentioned, INDOGB 2Y and 10Y continue to be historically tight while INDOGB 2Y and 1M deposit spreads remain wide. **The Yield Differential between INDOGB and U.S. Treasuries highlights preference over USD assets. We think that while the Fed is expected to cut rates, INDOGB Yields will remain elevated given the narrow yield spreads.**

As a result, we are adopting a more defensive stance in fixed income by shortening portfolio duration and increasing exposure to short- and mid-term Indonesian government bonds, which provide greater stability amid market uncertainty. To enhance performance, we continue to prefer high-coupon bonds offering attractive accrued interest.

Volatility is attributed to foreign flows



Narrow INDO 10Y – 2Y bond spread calls for a short-mid duration strategy amid macro uncertainty

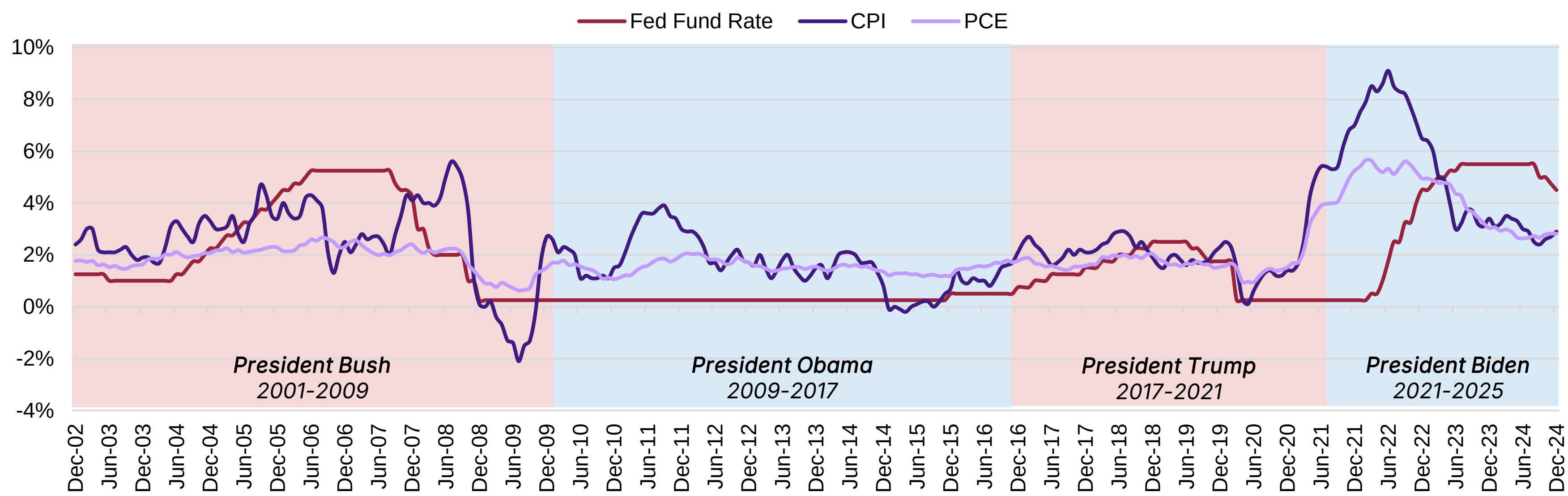


Source: Simpan Asset Management, Indonesia Stock Exchange, Bank Indonesia, Bloomberg.

3. Trump Policies Fuel Growth, But Pose Risks for Indonesia

The U.S. economy is expected to maintain robust growth supported by a strong labor market and the new U.S. administration. Trump's policies on deregulation, immigration, tariffs, and taxes have prompted markets to expect further economic growth and sustained levels of inflation. **Trump's continuation of restrictive trade policies, particularly increasing tariffs on China, is expected to intensify inflationary pressures within the U.S. economy.** These tariffs are expected to increase production costs and consumer prices due to disruption in production and supply chains and exacerbate food inflation risks.

While the Fed has begun reducing rates, Inflation remains sticky, above the Fed's 2% target

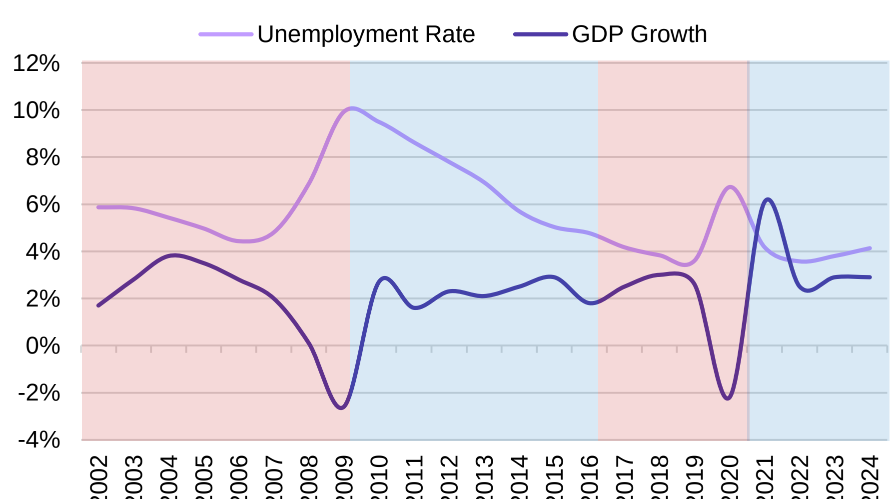


Despite historically wide Real Rates (Fed Fund Rate less Inflation), the Fed has readjusted its rate cut expectations primarily due to a strong economy, a robust labor market, and the transition to a new U.S. administration. **Markets are pricing in a "higher for longer" rate cycle, with only two rate cuts expected in 2025. The Fed's January decision has confirmed this as rates were maintained. This trajectory strongly influences Indonesia's monetary policy.**

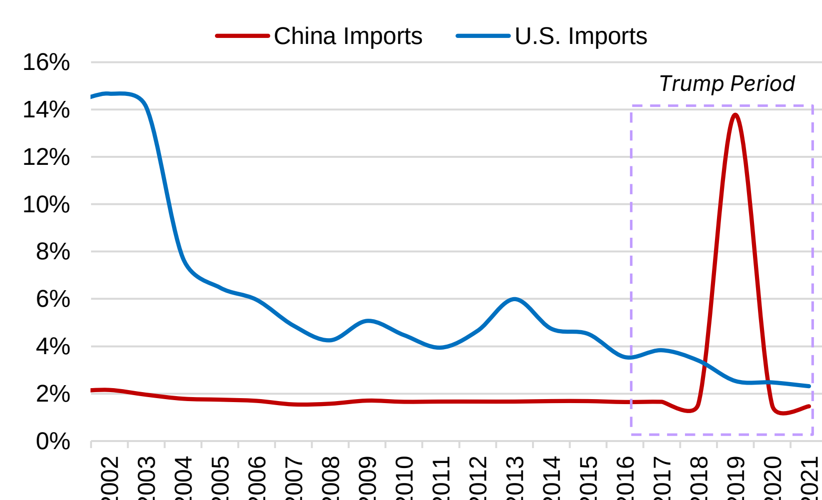
Additionally, Trump will take a pro-industrial approach, implementing energy policies prioritizing fossil fuel production, deregulation, and a rollback of green initiatives. **While these changes may be deflationary and prompt earlier Fed rate cuts, they will likely boost U.S. industrial productivity, household income, commodity exports, and near-term economic growth.** The increased supply of fossil fuels could limit price upside, creating a mixed outlook for global energy markets.

For Indonesia, this presents a double-edged sword. On one hand, lower global energy prices could reduce costs for energy-importing industries. At the same time, export opportunities in fossil fuels and critical minerals, such as nickel, may grow as Indonesia strengthens its position as a key energy supplier in Asia. On the other hand, heightened global competition and potential oversupply in fossil fuels could weigh on commodity prices, impacting Indonesia's economic gains and trade surplus. **We view this as neutral. While U.S. inflation may moderate due to lower energy input prices despite tariff increases, it may, however, impact Indonesia's commodity trade surplus and put pressure on the Rupiah.**

U.S. Economy remains robust due to solid growth and resilient labor market



Average tariff rates against were the highest during Trump's first period



Trump's "America-first" policies are poised to support U.S. economic growth stability in 2025, supported by tax cuts and domestic investments.

The downside risk towards the end of 2025 and in 2026 would be a slower-than-expected U.S. economy. This could be driven by the large-scale implementation of restrictive immigration and tariff policies introducing supply-side shocks, slower U.S. long-term economic expansion, and higher inflation. Although job growth is expected to hold steady, immigration restrictions could tighten the labor supply, pushing the unemployment rate to an estimated 3.9% by the end of 2025.

Source: Simpan Asset Management, Bureau of Labor Statistics, Federal Reserve System, World Bank, Bloomberg.

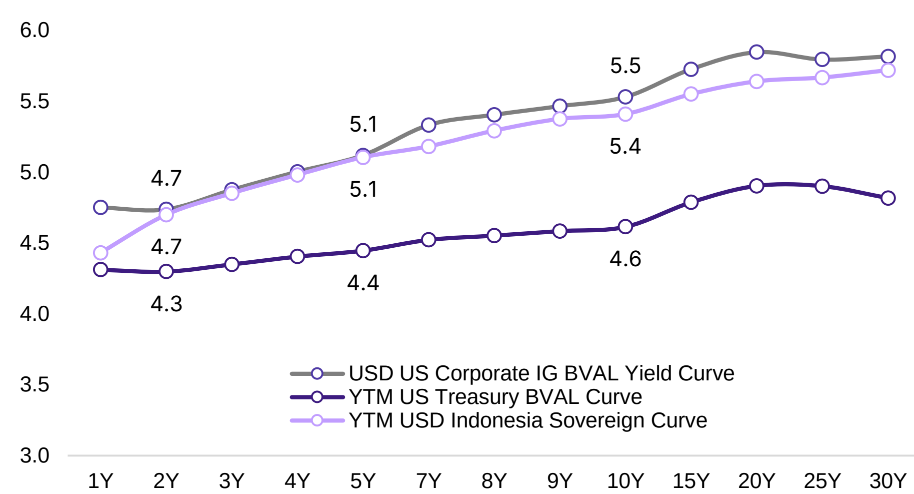
4. USD Private Credit Continue to Outperform

In 2024, Simpan Asset Management offers USD Onshore and Offshore Investment Solutions to our Discretionary Mandate clients. In light of a weakening Rupiah, we see a need for Indonesian investors to invest across USD asset classes to diversify against Rupiah-denominated assets.

The U.S. economy is expected to remain strong and interest rates elevated in a "higher-for-longer" environment, resulting in a stronger Dollar and disruption in flow across Indonesia's capital markets.

Across the Bond Yield Curve against U.S. Treasuries, USD Indonesia Sovereign Bonds, and USD IG Bond Yields; **USD Indonesia Sovereign Bonds provide significant premium to U.S. Treasuries and fair similar to USD IG Bond Yields.** Exposure to USD Indonesia Sovereign Bonds provide the bare minimum buffer to hedge against the Rupiah given its credit rating.

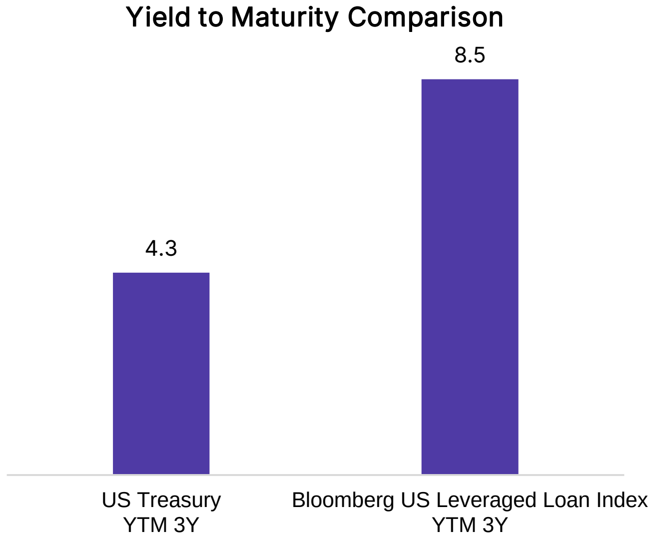
USD Indonesian Sovereign Bonds Provide Significant Premium to US Treasuries



However, in expectation of further rate cuts, we do not expect Bonds to provide sustained returns over the medium term. Rate cut sentiments offer one-off capital gains that depreciate annual returns over a longer period. Rather, we think that Private Credit – Alternatives offer a longer period of returns above USD Bonds.

The Yield to Maturity equivalent of 3Y between U.S. Treasuries and Bloomberg U.S. Leveraged Loan Index offers spread of approximately 420 – 430 bps. From our observation, Lower Middle Market typically is priced at LIBOR + 600 bps and the Upper Middle Market segment typically is priced at LIBOR + 200 bps.

Yield to Maturity Comparison



Leveraged Loan Default Rate
(The Morningstar/LSTA US LLI had 1,129 Rated Issuers as of September 2024)

Periods	Default Rates	Scenarios
October 2024	1.30%	-
September 2025 – Pessimistic Case	2.50%	Higher-than-expected inflation due to policy shifts, resulting in slower pace of rate cuts. Steeper-than-expected economic slowdown would be negative for credit
September 2025 – Base Case	1.00%	Supportive financing and macro conditions over the next 12 months. Amid strong issuance, borrowers have refinanced much of the speculative-grade debt maturing in2 025. Funding costs are expected to decline following recent rate cuts
September 2025 – Optimistic Case	0.75%	Growth surprises to the upside, without a slowdown in the expected pace of rate cuts. Borrowers see a boost to sales and revenue from a strengthening economy, while funding costs continue to come down.

Data as of 30 September 2024. Sources: PitchBook; S&P Global Ratings Credit Research & Insights; and S&P Global Ratings Private Market Analytics

Based on a study by S&P Global Ratings Private Markets Analytics and S&P Global Ratings Credit Research & Insights, the U.S. leveraged loan default rate is expected to fall to 1% by September 2025, from 1.26% in September 2024. Lower Fed rates will mean lower funding costs, and this will benefit issuers' coverage ratios and free operating cash flows.

Supportive financing and macro conditions have contributed to this year's decline in the leveraged loan default rate while also positioning borrowers for further improvement over the next 12 months.

We expect that Private Credit – Alternatives can generate significant return premium over USD Public Bonds given the appropriate yield spreads and manageable expected default rates.

Source: Simpan Asset Management, Bureau of Labor Statistics, Federal Reserve System, Bloomberg. Data as of 23 January 2025

Appendix: Macro Dashboard

Indicators (as of 31 January 2025)	Indication	Scorecard
Global Indicators		
Dollar Currency Index	Strong	1%
US GDP Growth (Y/Y)	Strong	34%
US CPI (Y/Y)	Strong	33%
UST 10Y vs. UST 2Y	Narrow Spread	70%
UST 2Y vs. UST 3M	Narrow Spread	74%
UST 10Y - US CPI	Wide Spread	22%
MSCI World P/E	Expensive	11%
MSCI World Earnings Yield	Expensive	89%
MSCI World Earnings Yield vs UST 10Y	Narrow Spread	97%
Indonesia Macro Indicators		
Indonesia GDP (Y/Y)	Weak	70%
Indonesia CPI (Y/Y)	Weak	100%
Current Account as a % of GDP	Neutral	49%
Trade Balance as a % of GDP	Weak	61%
M2 Supply (Y/Y)	Weak	98%
Retail Sales	Weak	80%
Unemployment Rate	Strong	96%
Government Expenditure as a % of GDP	Neutral	47%
Government Revenue as a % of GDP	Weak	68%
Government Debt as a % of GDP	Strong	23%
Consumer Credit as a % of GDP	Strong	27%
Growth Indicators		
BI Consumer Confidence Index	Strong	2%
Indonesia Industrial / Manufacturing Index	Strong	32%

Indicators	Indication	Scorecard
Real Returns		
Indonesia GDP - CPI (Y/Y)	Wide Spread	1%
IDR 10Y Bond Yield - Indonesia CPI (Y/Y)	Wide Spread	5%
IDR 2Y Bond Yield - Indonesia CPI (Y/Y)	Wide Spread	1%
IDR 1M Deposit Rates - Indonesia CPI (Y/Y)	Wide Spread	8%
Bond Prices		
Central Bank' Government Bonds Ownership	Strong	1%
Banks' Government Bonds Ownership	Weak	99%
Non-Banks' Government Bonds Ownership	Strong	0%
Foreign' Government Bonds Ownership	Weak	81%
Bonds Inflow 12M (USD, Million)	Weak	67%
Bond Spreads		
IDR 10Y - IDR 2Y Bond Yield	Narrow Spread	94%
IDR 10Y - UST 10Y	Narrow Spread	97%
IDR 2Y - IDR 1M Deposit	Wide Spread	13%
Stock Valuation		
JCI P/E	Cheap	92%
JCI Earnings Yield	Cheap	29%
LQ45 Earnings Yield	Cheap	17%
IDX 20 High Dividend, Dividends Yield	Cheap	10%
IDR 10Y - JCI Earnings Yield	Narrow Spread	83%
MSCI Indonesia Earnings Yield	Cheap	25%
Stock Inflow 12M (USD, Million)	Weak	69%
Banking Sector		
Loan Growth (Y/Y)	Weak	68%
Loan to Deposit Ratio	High	32%
Net Interest Margins	Neutral	47%
Return on Asset	High	45%
Non-Performing Loan	Good	89%

Source: Simpan Asset Management, BLS, Morgan Stanley Capital International (MSCI), Central Agency of Statistics Indonesia, Ministry of Finance Indonesia, Bank Indonesia, Federal Reserve System, Bloomberg.

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