Mizuho Flash: Indonesia & Malaysia

Economics & Strategy | Asia ex-Japan

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December Trade Data Portends a Growth Slowdown

In a nutshell: December trade data for commodity exporters Indonesia and Malaysia showed incipient signs of weakness, in both export and import growth. For Indonesia, the trade surplus in 2022 was supported by commodities such as coal and palm oil while for Malaysia, the support was more broad based from electrical & electronics products as well as commodities.

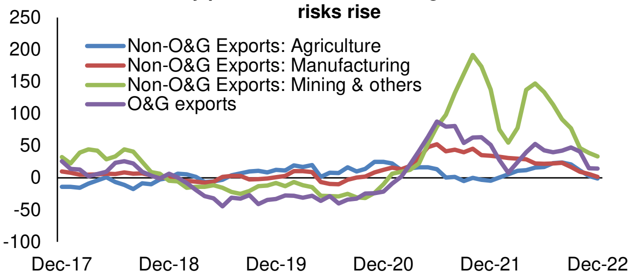
Fading commodity tailwinds and rising recession risks will lead to slower export growth in both economies, which will more than offset weakening import growth, engineered by tighter monetary and fiscal policies to rein in inflationary pressures. As such, we expect the current account surpluses in both countries to narrow in 2023.

The narrowing of the current account surplus and sticky inflationary pressures will necessitate that BI and BNM remain hawkish at their 19 January meetings - we expect both BI and BNM to deliver 25bp in rate hikes - even with rising expectations for the US Federal Reserve to dial back its pace of rate hikes.

Indonesia: Fault Lines Emerging

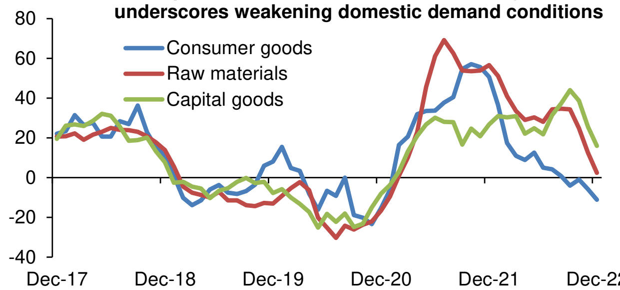
Despite the pick-up in Indonesia's export growth to 6.6% YoY in December from 5.5% in November (Consensus: 7.5%), **the details betray an underlying weakness**. The pick-up was largely due to volatile oil & gas exports (+38.2% YoY from -16.8% in November), which more than offset a slowdown in non-O&G exports (5.0% from 6.9%). Within non-O&G exports, the weakness in agriculture and manufacturing exports more than offset higher mining exports. **But underlying momentum slowed markedly across all major non-O&G and O&G drivers** (Figure 1).

Export drivers: Underlying momentum has clearly slowed into end-22 and will likely persist into 2023 as commodity price tailwinds fade and global recession risks rise



Source: CEIC; Mizuho Bank

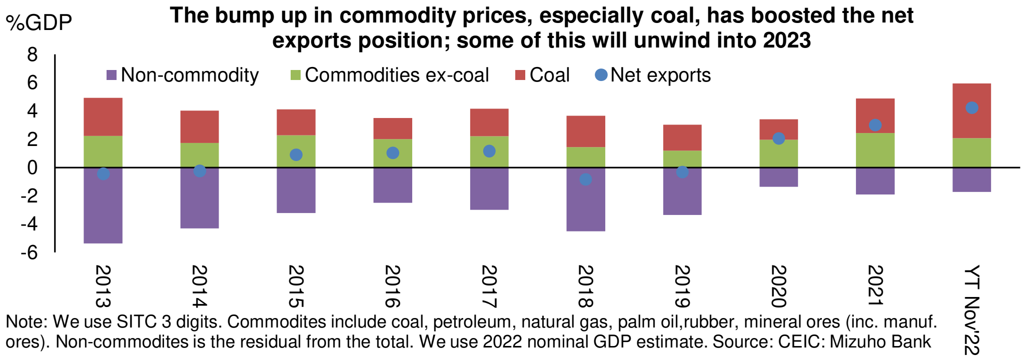
Imports by end-use: The collapse in consumer goods imports and weakness in the other categories underscores weakening domestic demand conditions



Source: CEIC; Mizuho Bank

To that end, **the weakness in import growth was more obvious**, slowing to -6.6% YoY in December from -1.9% in November (Consensus: -8.0%). The **drivers were broad based across O&G and non-O&G imports**. By end-use, **consumer goods imports contracted sharply** (-27.5% YoY in December from -16.2% in November) as did raw material imports (-7.2% YoY from -1.8%) while growth in capital goods import picked up slightly (12.2% YoY from 7.3%). Similar to exports, **the underlying momentum in end-use imports weakened significantly** (Figure 2), underscoring weaker domestic demand conditions.

As a result, the **December trade surplus narrowed to USD3.9bn from USD5.1bn in November**, led by a narrower non-O&G trade surplus with the O&G deficit remaining stable. **This data seems prescient of the weakness we expect in 2023. Reflecting on 2022, Indonesia's trade position clearly benefitted from commodity price tailwinds** (i.e. favourable price effects) even as export volumes slowed[1]. **Coal prices** (and to a smaller extent coal export volumes) **alone boosted Indonesia's net trade surplus position in 2022[2] from 2021, even as the net surplus for non-coal commodities narrowed and the non-commodities trade remained in a deficit** (Figure 3).

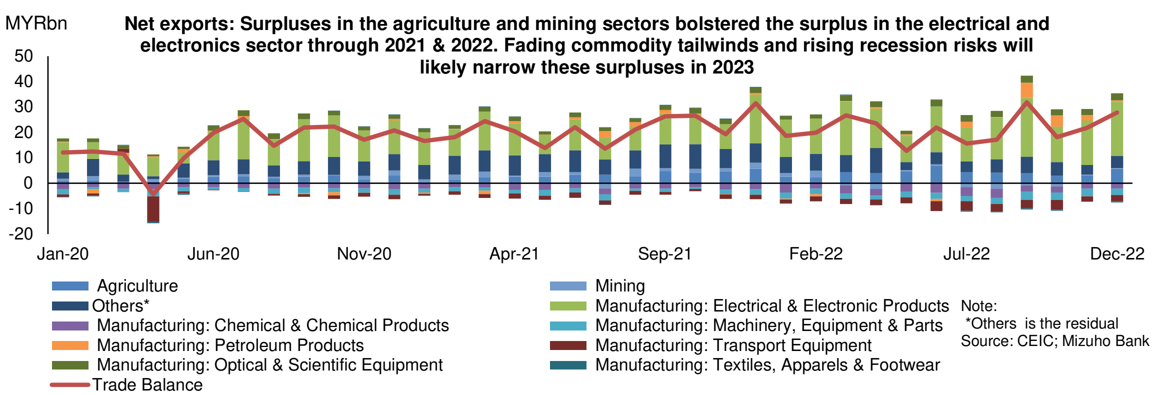


Note: We use SITC 3 digits. Commodites include coal, petroleum, natural gas, palm oil,rubber, mineral ores (inc. manuf. ores). Non-commodites is the residual from the total. We use 2022 nominal GDP estimate. Source: CEIC: Mizuho Bank

Malaysia: Devil is in the Details

Meanwhile in Malaysia, the widening of the trade surplus to MYR27.8bn in December from MYR21.8bn (Consensus: MYR27.8bn) **is headline positive but details are less so**. The devil in the details paints a picture of slowing growth momentum. **Both export and import growth slowed**; export growth slowed to 6.0% YoY in December from 15.1% in November while import growth eased to 12.0% YoY from 15.6% in November.

For Malaysia, unlike Indonesia, the widening of the trade surplus in 2022 was broad based, *supported not only by commodities such as petroleum and palm oil but also manufactured goods,* specifically electrical and electronic products and optical and scientific equipment (Figure 4).



Note:
*Others is the residual
Source: CEIC; Mizuho Bank

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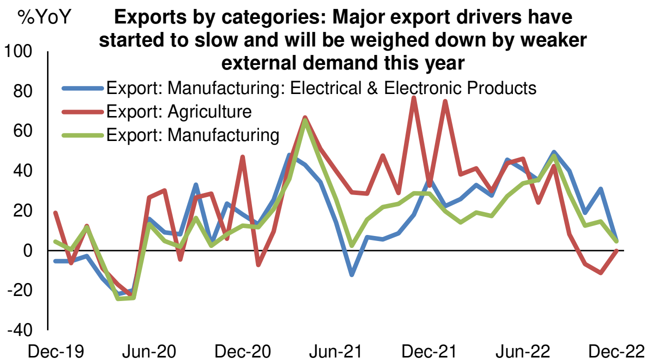
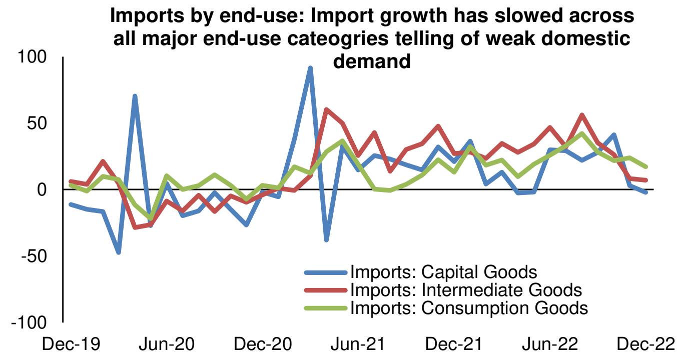
[1] Export and import volume data is available only through November 2022. It lags trade value data by one-month. Export volume growth slowed to 3.5% YoY from January-November '22 from 9.5% in the same period in 2021. Within this, O&G export volumes (-12.1% from 4.2%YoY) slowed more than non-O&G export volumes (4.3% from 9.8%).

[2] Similar to volume data, the trade data breakdown by HS code lags the headline release by a month.

But the signs of a slowdown are becoming increasingly more apparent – **manufacturing export growth slowed for a fourth consecutive month** to 4.6% YoY in December from 14.5% in November led by electrical and electronics products while **agriculture exports continued to contract**, albeit to a lesser extent -0.2% YoY in December from -11.2% in November. **By destination, exports to China, Japan and the US slowed in December**. The **same is true for imports, wherein the weakness is increasingly becoming more broad based.** By end-use, imports of capital, consumer and intermediate goods weakened in December versus November while imports of volatile dual use goods picked further.



Source: CEIC; Mizuho Bank



Source: CEIC; Mizuho Bank

Trade Under Pressure This Year

With commodity prices already coming off their recent highs, the supportive price effects from 2022 will fade into 2023. This **will hurt Indonesia more so than Malaysia** as higher commodity exports in the past two have helped offset weaker non-commodity exports[3]. **For Malaysia, the rising likelihood of a global recession in H2 2023 will hurt its manufactured goods exports,** especially since growth in major trading partners such as the US and China are set to slow.

The slowdown in import growth mirroring weakening domestic demand has, for the most part, **been engineered by tighter financial conditions brought on rates hikes by Bank Indonesia (BI) and Bank Negara Malaysia (BNM).** Even so, the slowdown in imports for both Indonesia and Malaysia will not be able to offset weaker exports. As such, **we expect the current account surpluses in both countries to narrow in 2023** (for Indonesia to 0.5% of GDP from 1% in 2022; for Malaysia to 1.5% of GDP from 3.8% in 2022).

The narrowing of the current account surplus and sticky inflationary pressures will necessitate that BI and BNM remain hawkish at their 19 January meetings, even with rising expectations for the US Federal Reserve to dial back its pace of rate hikes. *More so for BI, a hawkish bias will help buffer against IDR volatility, which persists as underscored by the quick reversal of IDR (vs USD) gains early this week.*

For BNM, backstopping portfolio outflows given the deeply negative interest rate differential to the US will remain a priority but the easing of the political premium attached to MYR from last year has likely bought BNM some room to manoeuvre.

As such, **we expect both BI and BNM to deliver 25bp in rate hikes.**

[3] Furthermore, a thawing of political relations between Australia and China at the start of this year will have negative implications for Indonesia's coal exports, which benefitted from China substituting Australian coal for Indonesian coal in 2021 and 2022.

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