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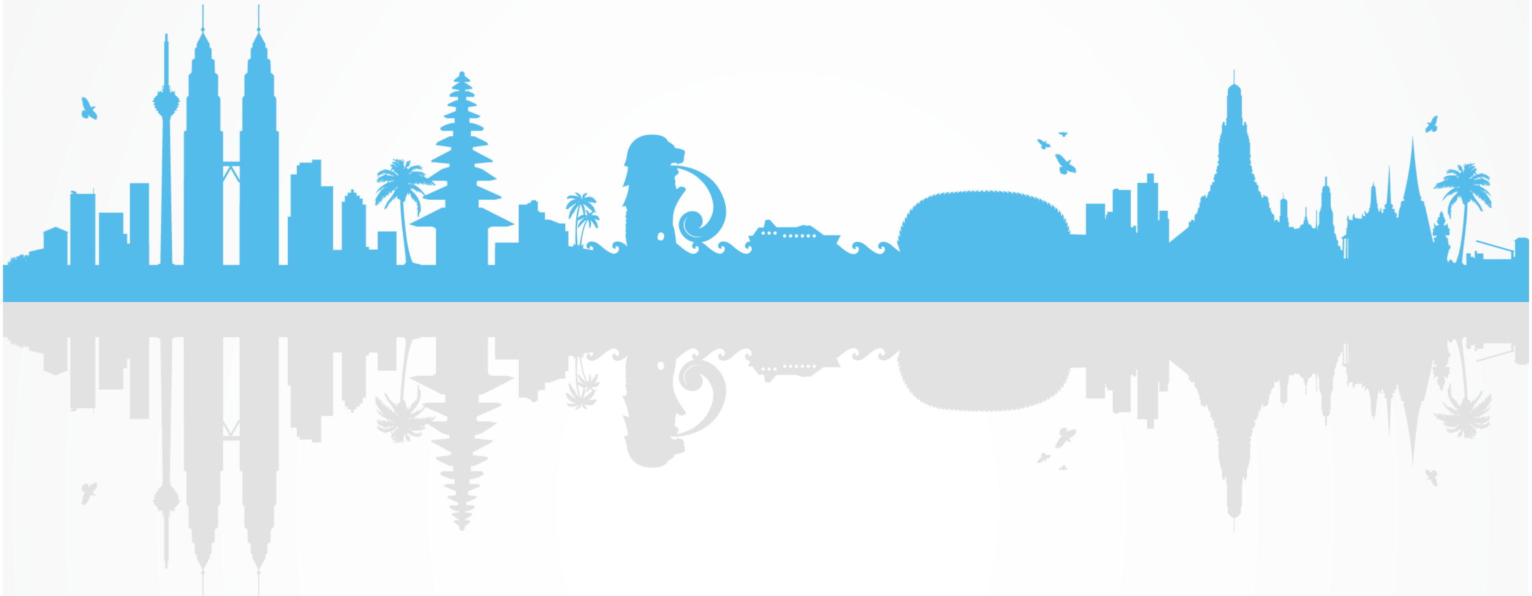

ECONOMICS SNAPSHOT
ASEAN FOCUS

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INDONESIA

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Indonesia, affected by external headwinds, has seen its pace of economic activity stabilize around 5% growth since 2014. By the end of 2016, the Indonesian economy will have grown by another 5%, driven by private consumption and supported by public consumption. Core inflation has trended down. October saw the lowest core inflation rate since 2000. Given the relative stability of the IDR, the monetary authority, Bank Indonesia (BI), cut rates 6 times in 2016, and the policy rate, the 7-days reverse repo rate, now stands at 4.75%. I believe the rupiah is still undervalued against the USD, and on the back of budgetary realignment and a pickup in growth momentum, I expect the IDR to gradually appreciate in 2H2017. The economy should grow by 5.1% in 2017 and the year-average inflation is seen at 3.9% yoy.

Private consumption – the main driver of Indonesia's growth

- In the first nine months of 2016 the economy had grown 5.04% yoy, driven by household consumption and supported by government expenditure that grew by 2% yoy. Household consumption, explaining more than half of this growth, remained as Indonesia's growth engine, thanks largely to a sizeable middle class population. The savings rate of the average Indonesian is slightly above 30%, and that has cushioned household spending during periods of economic weakness. The 2% yoy growth in government spending took place despite two rounds of budget cuts in the past 6 months, on the back of weak revenue collection.
- Gross fixed capital formation went up by 4.9% yoy in the first nine months of 2016, against 5.3% yoy in 1H2016. Private investment slowed as credit growth slid to 6.4% yoy in September 2016 from 9.6% yoy in January 2016. Global trade, soft through 2016, was reflected in export growth, which fell by 4.0% yoy in 9M2016.
- The economy is likely to have grown by 5.0% yoy in 2016; I expect a similar pace of 5.1% in 2017.

Trade surplus in 9M2016 on the back of slower global demand

- Amidst slower global and domestic demand, Indonesia's trade balance registered a USD2.1bn surplus in 3Q2016, a modest increase from the 2Q2016 figure of USD1.9bn. This brought Indonesia's trade surplus to USD5.7bn in the first nine months of 2016, against USD7.2bn surplus recorded during the same period in 2015.
- Given the current trend, I expect the trade balance to remain in surplus – about $7 billion -- at the end of 2016, alongside the upward momentum in the economy. While export revenues are likely to increase due to firmer commodity prices, a rise in import growth due to improvement in household consumption is likely to offset some of that gain in the trade balance.
- Foreign exchange reserves rose over most of 2016 to US$115.7bn in September. However, the two rounds of global uncertainty – first due to firmer UK growth numbers in October and then the US election results in November – and consequently higher yields abroad led to a decline in reserves in those months. Inflows picked up again in December and reserves ended the year at over US$116 billion. As the analysis (in the article "Currency Outlook" shows, reserves in Indonesia are more than adequate to

cover the various risk metrics devised by the IMF. As such it lowers the pressure on policy rates to deal with external shocks.

Room for monetary policy accommodation is still available

- In September 2016 headline inflation accelerated to 3.1% yoy or 0.2% mom, which brought ytd average inflation to 3.6% in the first nine months of 2016. Core inflation continued to head south, registering its lowest yoy growth in the past 15 years. Combined with the facts that: (i) manufacturing capacity is currently 30-35% below its potential, implying very little inflationary pressure in the pipeline and; (ii) interest rate differentials between Indonesia and its peers still provide space, albeit tight, for further monetary authority accommodation in the next 6 months. Our base case, however, does not have a cut factored in as external uncertainty, and consequently currency volatility, may not allow it.

Expectations are for a stable IDR

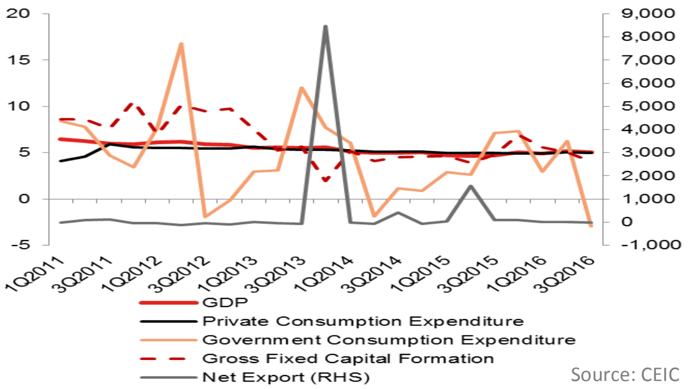
- In 2017, I expect the rupiah to average at IDR13,40 per USD with an year end value of 13,300. This relatively strong trend of the IDR is driven by productivity improvement, GDP growth, and capital inflows.
- Portfolio flows into Indonesia are expected to remain strong in 2017. A resilient economy with improving growth prospects and continued reforms make Indonesia's (already high) yield even more attractive. Further, firmer commodity prices provide another link between portfolio inflows, the prospect of realization of FDI, and the rupiah.

Risks and Other Issues

- The spike in yields that followed Mr. Trump's victory in US election exemplified the kind of external risks that still shadow the Indonesian economy. Mr. Trump's foreign policy posture, his economic agenda, and the new administration's appetite for globalization, will shape Indonesia's external risk profile going forward.
- Other risks would include: (i) China, continuing its economic reform agenda resulting in slower growth. Plus, China's high debt could affect regional risk premia; (ii) Brexit vs the Eurozone will have some impact on Indonesia via trade and exchange rate channels.
- The tax amnesty program has given significant boost to tax revenue with total redemption fee of IDR95 trillion up to end-November 2016. Redemption fees were derived from the declared and repatriated assets, which as of end-November 2016 amounted to around IDR3,950 trillion. To put these figures into perspectives, the total declared and repatriated assets are around 30% of Indonesia's estimated 2016 GDP. The total redemption fees are 0.8% of 2016 GDP, 2.8% of 2016 budget or 35% of 2016 fiscal deficit. By any standards Indonesia's achievement in its tax amnesty program is impressive. Participation rate of tax amnesty, however, is still low, with only 2% of total taxpayers participated in the program so far. In general, I believe tax amnesty bodes well for the improvement in tax administration. In the medium term, we believe serious reform in the areas of tax registration, collection, and enforcement are keys to bring about significantly higher tax to GDP ratio.

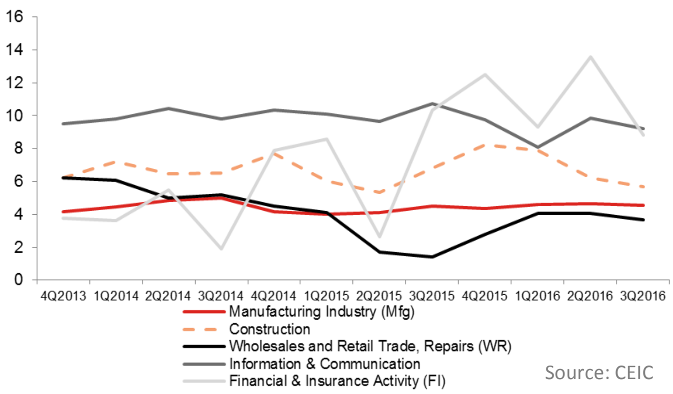
The economy is believed will have grown by 5.0% yoy in 2016, driven by private consumption and supported by government consumption. Five economic sectors – highlighted in the chart below -- contributed two-thirds of 2016 growth.

Figure 1: GDP Growth by demand components



Source: CEIC

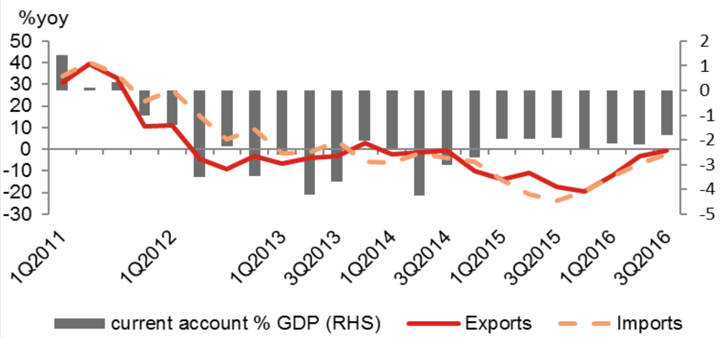
Figure 2: GDP growth by sectors



Source: CEIC

Current account deficit is expected to be lower than 2% of GDP helped by larger-than-anticipated trade surplus.

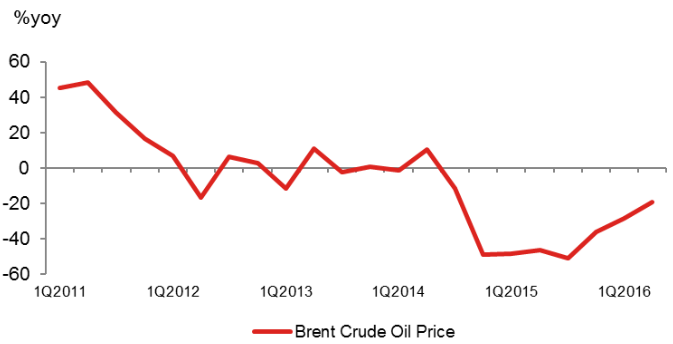
Figure : Trade Balance



Source: CEIC

Oil prices have provided some fiscal cushion

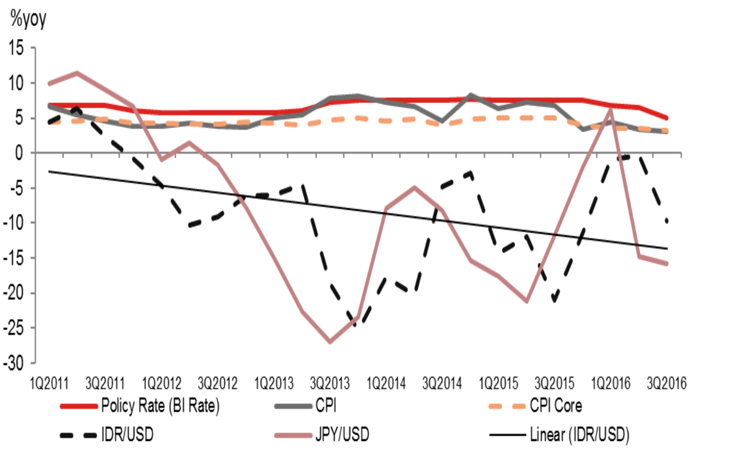
Figure 4: Oil price



Source: CEIC

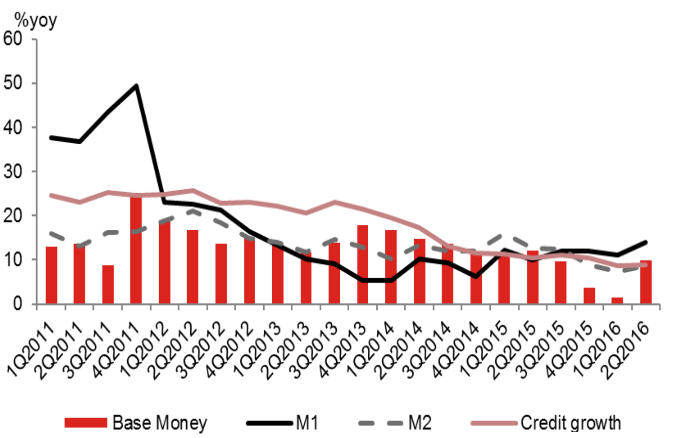
Rupiah had been on appreciating trend as inflationary pressure remained muted. Core inflation reached the lowest in the past 16 years. However, credit growth slowed amidst business uncertainties through 2016.

Figure 5: Inflation, policy rate, and exchange rate



Source: CEIC

Figure 6: Monetary Growth



Source: CEIC

INDONESIA

Annual Data

	2015
Nominal GDP (USD bn)	862
GDP per capita (USD)	3,374
Population (mn)	255.5

	2013	2014	2015	2016F	2017F	2018F
Real GDP growth (%yoy)	5.6	5.0	4.8	5.0	5.1	5.3
Real consumption growth (%yoy)	5.7	4.7	4.9	5.7	6.8	5.9
- Public consumption (%yoy)	6.7	1.2	5.4	5.4	7.0	5.8
- Private consumption (%yoy)	5.4	5.2	5.0	5.9	6.8	6.0
Real gross fixed capital formation (%yoy)	5.0	4.6	5.1	5.4	7.8	7.0
Real export growth (%yoy)	4.2	1.0	-2.0	-2.6	-0.5	-2.0
Real import growth (%yoy)	1.9	2.2	-5.8	-3.5	-3.5	-0.1
Export growth, balance of payments (%yoy)	-3.9	-3.6	-14.6	-7.2	-4.7	-4.1
Import growth, balance of payments (%yoy)	-2.6	-4.5	-19.9	-7.1	-6.4	-3.6
Trade balance (USD bn)	-4.1	-2.2	7.7	8.1	6.1	3.6
Current account balance (USD bn)	-29.1	-27.5	-17.7	-17.7	-17.5	-19.8
- % of GDP (%)	-3.2	-3.1	-2.0	-1.9	-2.1	-2.3
Reserves, end of period (USD bn)	99.4	111.9	105.9	115.0	120.0	122.0
- foreign reserves to months of imports	5.6	6.7	7.7	8.5	8.2	7.5
- short term debt (% of total reserves)	16.1	15.4	12.4	12.0	11.8	13.9
Fiscal balance (%GDP)	-1.90	-2.05	-2.51	-2.70	-2.40	-2.3
Retail Sales Index growth, average (%yoy)	28.2	3.8	11.4	8.0	10.0	12.5
Industrial production growth, average (%yoy)	2.8	6.5	1.5	5.9	6.0	6.0
Narrow money (M1) growth, average (%yoy)	5.4	6.2	12.0	8.5	9.0	10.0
Broad money (M2) growth, average (%yoy)	12.8	11.9	9.0	11.0	11.5	13.0
Domestic credit to private sector (%GDP)	21.6	11.6	10.4	8.0	9.5	11.5
Consumer Price Index (CPI), end of period (%yoy)	4.0	8.4	3.4	3.0	3.5	4.0
Consumer Price Index (CPI), average (%yoy)	6.4	6.4	6.4	3.5	3.9	3.8
Policy rates, end of period (%)	7.50	7.75	7.50	4.75	4.75	4.75
10Y government bond yield, yearly average (%)	6.97	8.29	8.25	7.72	7.70	7.00
Exchange rate vs. USD, end period	12,189	12,440	13,795	13,490	13,300	13,300

Quarterly data

	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16
GDP (%yoy)	4.7	4.7	5.0	4.9	5.2	5.0
CPI, average (%yoy)	7.1	7.1	4.8	4.3	3.5	2.9
Policy rates, end of period (%)	7.50	7.50	7.50	6.75	6.50	4.75
10Y government bond yield, quarterly average (%)	8.01	8.83	8.81	8.39	7.73	7.09
Exchange rate vs. USD, end period	13,339	14,653	13,788	13,239	13,180	13,050

SOURCE: CEIC, CIMB Niaga Bank Research (The Economist team)

Effective 19 August, the 7-day repo rate (currently 4.75%) replaced the BI policy rate (6.5%)