

## Economic Analysis

## Jokowi keeps his pledge to cut fuel subsidies

Sumedh Deorukhkar

Indonesia's new Jokowi-led government kept its pledge to reduce the economy's fuel subsidy overhang and in turn free budgetary space to rev up investment spending by announcing the much awaited cut in fuel subsidies of IDR 2,000 per litre, effective today. The move translates into a 30% price hike in gasoline from IDR 6500 currently to IDR 8500 and a 36% price hike in diesel from IDR 5500 to IDR 7500.

The magnitude of fuel subsidy cut was cushioned by a sharp decline in global crude oil prices, which have fallen 20% since mid-June 2014. Looking ahead, a combination of benign international oil price scenario and a stable rupiah can lead to substantial reduction in Indonesia's fuel subsidy burden from a sizable nearly 3% of GDP. Such favorable commodity-currency interplay could create room for Jokowi to reallocate the savings to fund the government's priority program especially the infrastructure and the maritime sector development.

**Efforts to stem fuel subsidies underscores Jokowi's commitment to reforms:** While the timing and quantum of subsidy cuts was in line with consensus and our expectations, the move signals a strong intent by Indonesia's newly elected reform-minded President Joko Widodo to revive Indonesia's flagging growth prospects through hard reforms (**See our recent Economic Watch ['Taking stock of the challenges ahead for Indonesia's new President'](#)**). Last week, Fitch re-affirmed Indonesia's sovereign credit rating at BBB- with a stable outlook citing 'strong commitment of the new Government in continuing structural reforms and improving the investment climate' as one of the key factors.

**Bank Indonesia to look through temporary inflation spike:** We expect the fuel price hike to cause a temporary pickup in inflation in the near to medium term and weigh on private consumption. That said, the ongoing momentum in structural reforms presents a steadily improving growth outlook for Indonesia in 2015 (BBVA GDP Est. 5.5% y/y vs. 5.1% in 2014). Meanwhile Bank Indonesia is expected to look through temporary inflation spike (year end CPI at around 7.0% to 7.4% y/y) and keep interest rates unchanged this year at 7.5%.

**Given a hostile legislature, Jokowi faces tougher challenges ahead to push structural reforms:** While Jokowi's efforts towards fuel price rationalization are very encouraging, Indonesia's deep rooted challenges warrant much to be done on the reforms front. These include 1) measures to boost infrastructure development, 2) initiate labour reforms that make labour laws more flexible, 3) expedite land acquisition process, 4) ease process to secure business permits, 5) tackle corruption and other governance issues, 6) banking sector liberalization, 7) reap Indonesia's demographic dividend by improving education attainment levels, and 8) prop up alternative growth engines by enhancing the competitiveness of the manufacturing sector to compensate for an unwinding global commodity super cycle. In the wake of a hostile legislature that could hamper the efficacy of nationwide policymaking, we believe that the Jokowi government faces even bigger challenges in coming months.

**DISCLAIMER**

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.