Economic Analysis

Indonesia's Q1 GDP growth falters to 4.7% y/y – A wake up call for Jokowi?

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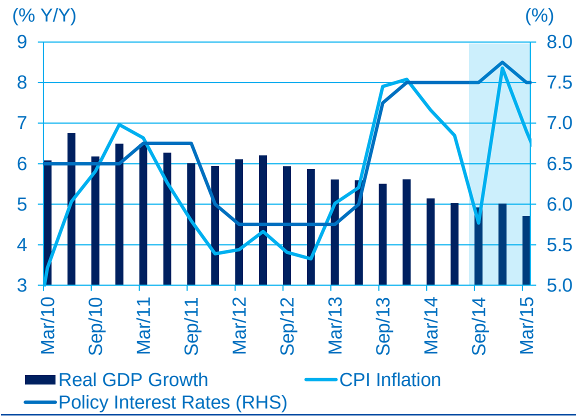
Indonesia's real GDP growth sputtered to a weaker than expected 4.7% y/y in Q1 2015 (Consensus: 4.9%; BBVA: 5.2%), its slowest pace since September 2009, compared to 5.0% in 4Q14 (Figure - 1). From the expenditure side, headline growth was dragged by weakening private and government consumption, which offset higher contribution from net exports and steady investment growth (Figure – 2). On a sectoral basis, negative mining growth and softer manufacturing and construction activity weighed on overall activity. The disappointing GDP outturn exacerbates Indonesia's already dim growth outlook for 2015 (BBVA est. 5.4% y/y); and puts pressure on Bank Indonesia (BI) to cut interest rates. However, risks to financial stability from a significantly weak rupiah, still high inflation and an imminent Fed lift-off, may likely keep BI on hold in 2015.

Risks to Indonesia's economic outlook remain on the downside. Looking ahead, while private investments are beset by slow progress on structural reforms, public spending is constrained by execution challenges and the de facto fiscal deficit limit of 2.5% of GDP. Furthermore, the high interest rate environment alongside significant currency depreciation has increased import costs, narrowed producer profit margins, and dampened domestic spending. Finally, restrictions on mineral exports, slowing Chinese demand, subdued commodity prices, a real trade weighted appreciation in the rupiah (Figure - 3) and an uncompetitive manufacturing sector suggests continued weakness in external demand going forward.

Will the real 'Jokowi' please stand up? Six months into his five year tenure, Indonesia's president, Mr. Joko Widodo, has seen his public popularity dwindle. Investors are fast losing patience on the government's ability to deliver on its election promise of structural reforms, clean governance, policy clarity and more openness to foreign investors. In contrast, recent months have been marked by delays in implementing much-anticipated structural reforms, a widening rift between Jokowi and his party leadership, an increase in protectionist policy measures and skepticism over the government's commitment to fight graft. Recent policy missteps have fueled legal uncertainties for domestic businesses and foreign investors, who fret about a lack of clear strategy and vision guiding economic policies in Indonesia.

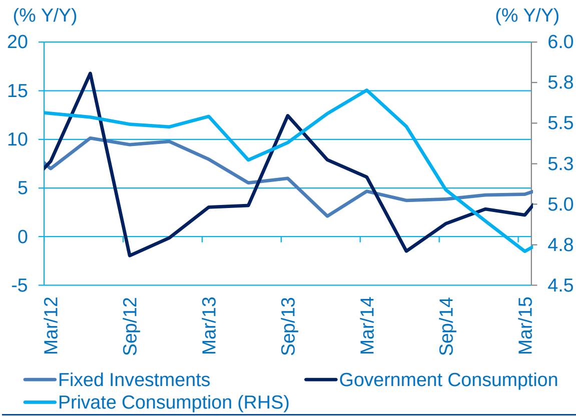
It's high time Jokowi shifts the pace of reforms into top gear. Notwithstanding Jokowi's policy stumbles, Indonesia's new government has made some progress on structural reforms (Table – 1) since its early success in tackling fuel subsidies. However, Indonesia needs to accelerate its pace of reform delivery. Jokowi's economic overhaul plans include strengthening social and physical infrastructure, addressing land acquisition issues, rooting out graft, and enhance manufacturing and refining capacity. Official estimates suggest Indonesia's infrastructure financing needs for 2015-19 to be roughly at USD 362 billion, or an average 8% of GDP per year. With private sector funding less forthcoming, the government aims to drive infrastructure by boosting public spending with a key role for major State Owned Enterprises (SOEs) in driving growth. Ongoing policy efforts to professionalize SOE operations and enhance their accountability through proposed bond issuances would be crucial for their role in Indonesia's development drive. Equally important would be the role of foreign direct investments from countries such as China, Japan and South Korea, who have recently committed to big ticket infrastructure investments in Indonesia as a part of Jokowi's capacity building efforts.

Figure 1
Indonesia's GDP growth slowed sharply in Q1…



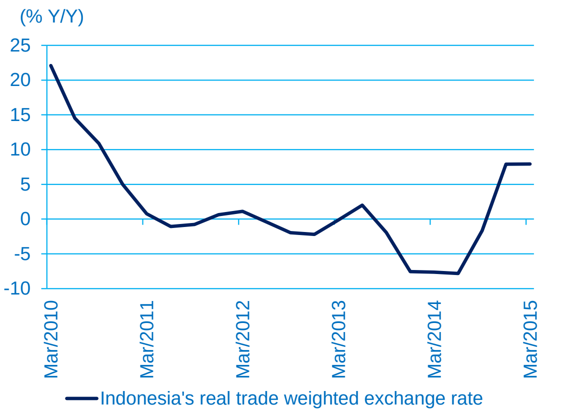
Source: BBVA Research, CEIC

Figure 2
… led by weakening consumption demand



Source: BBVA Research, CEIC

Figure 3
The rupiah has appreciated on a real trade weighted basis



Source: BBVA Research, CEIC

Table 1
President Jokowi's policy hits and misses

Hits	Misses
Five year infrastructure development plan to boost rail, road, port and power sector	Banning the use of foreign currencies for domestic transactions
Tax incentives to encourage foreign direct investments	Forcing banks and companies to place their data centers onshore
Establishment of one-stop service (PSPT) for project approval	Banning sale of beer in mini-markets
New land acquisition law to facilitate infrastructure development	Restricitons on foreigners to services Indonesian domestic sea lanes

Source: BBVA Research, Various News Sources

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