Economic Analysis

Indonesia's Q2 GDP – Dismal outturn highlights need to fast-track productive spending

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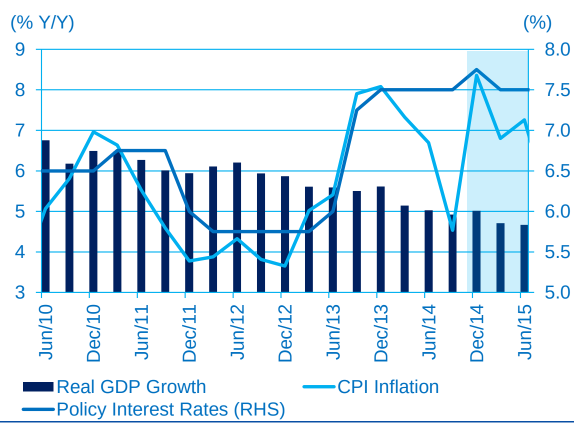
Indonesia's real GDP growth lingered near 6 year low levels in Q2 2015 at 4.7% y/y, a pace similar to the previous quarter although slightly above market expectations (Consensus: 4.6%; BBVA: 4.9%). The let up in growth was broad-based, undermined by a low rate of budgeted expenditure disbursement, weak private demand, sluggish investments and a protracted contraction in exports. The latest growth outturn underscores the need for Jokowi Government to fast-track productive spending. Doing so should help improve Indonesia's growth outlook in H2 2015, albeit only marginally given slower global growth, commodity price slump and weak domestic demand. We expect full year 2015 GDP growth for Indonesia to average a sub-par 5.0% y/y, which is lower than the government's recently downgraded annual growth target of 5.2%.

Limited room for interest rate cuts in 2015: Indonesia's July CPI inflation came in higher than expectations at 7.3% y/y, matching June's level, (Consensus: 7.1%) as a weak IDR and impact of the religious fasting month pushed up transportation and food prices. Looking ahead, we expect inflation to moderate as upside pressure from high administered prices and risk of possible El Nino weather effect are offset by weak demand and policy action to curb food supply shocks. Yet, inflation would stay above BI's 5.0% comfort level in 2015. High inflation and a weak external financing position - high current account deficit and elevated US dollar denominated debt – would prod Bank Indonesia to keep policy interest rate on hold at 7.5% ahead of imminent Fed rate normalization later this year.

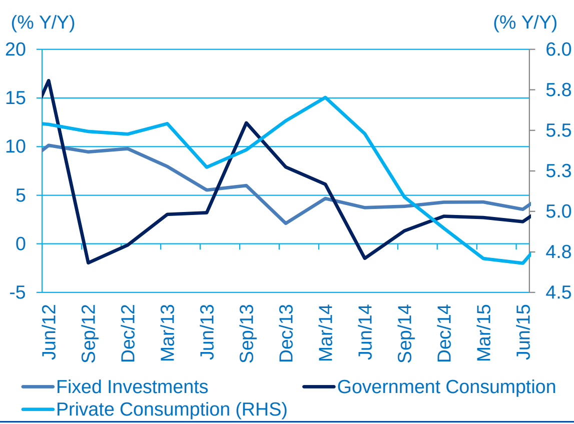
Boosting productive spending a key: A slow rate of budgeted fiscal disbursement, particularly for infrastructure projects, was a key drag on Indonesia's GDP growth in 1H15. Only 8% of $21bn allocated for infrastructure spending in 2015 was spent in H1, in turn providing a muted fiscal stimulus to overall GDP growth. Reassuringly, 2H15 looks promising with the government keen on ramping up the capital expenditure disbursement rate. The Ministry of Public Works and Public Housing, which accounts for the bulk (40%) of capex disbursements, is expected to achieve 90% of its allocated budget this year. If effectively executed, higher productive capital spending would help crowd in long term foreign investments in key sectors such as transport, mining, real estate, and agriculture sectors, in turn aiding 2H15 GDP growth.

Figure 1
Indonesia's GDP growth at 5 year low levels in Q2



Source: BBVA Research, CEIC

Figure 2
Growth slowdown has been broad-based



Source: BBVA Research, CEIC

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