

Economic Analysis

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

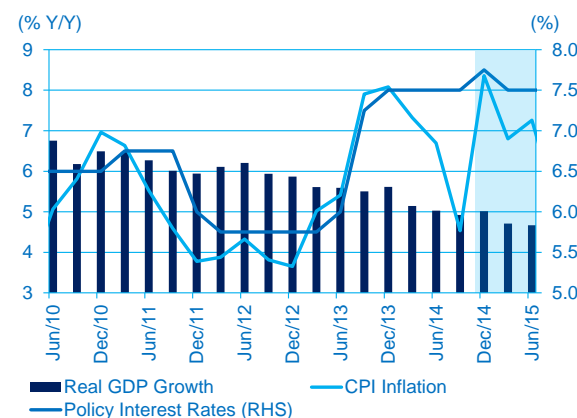
Sumedh Deorukhkar / Le Xia

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.

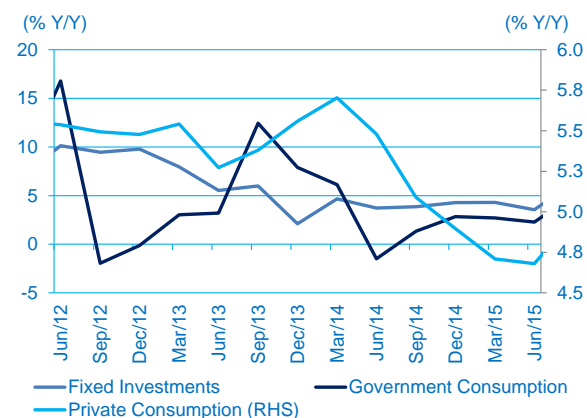
Boosting productive spending a key: A slow rate of budgeted fiscal disbursement, particularly for infrastructure projects, was a key drag on Indonesia's GDP growth in 1H15. Only 8% of \$21bn allocated for infrastructure spending in 2015 was spent in H1, in turn providing a muted fiscal stimulus to overall 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

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.