Economic Analysis

Indonesia | Q3 GDP growth stays broadly flat

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Indonesia's Q3 2015 GDP growth was broadly flat at 4.73% y/y from 4.67% y/y in the previous quarter (Consensus Est.: 4.8%; BBVA Est.: 4.9%), driven mainly by a pick-up in productive public spending and higher investment demand (See Figures 1 & 2). However negative exports growth continued to impinge, while private consumption growth was just a tad higher, reflecting weaker household purchasing power amid high interest rates, elevated inflation and a downbeat consumer and business sentiment. September consumer confidence index fell to its lowest reading since February 2009. Meanwhile, policy room for Bank Indonesia to exercise growth simulative interest rate cuts is limited going forward. While weak final demand and a favorable base effect are expected to ease inflation levels ahead, BI would be cognizant of upside risks to food price inflation as authorities cope with the devastating El Nino weather effect. Against the backdrop of weaker than expected Q3 GDP outturn, slower global growth, real economic and financial market headwinds in China, and domestic macro headwinds, we reduce our full year 2015 GDP growth estimate for Indonesia to 4.8% y/y (from 5.0% previously) and for 2016 to 5.3% y/y from 6.0% previously. From a medium to longer term perspective, we continue to expect a steady improvement in Indonesia's growth prospects led by higher productive capital spending by the public works department and the lagged impact of recent policy stimulus measures (See Table – 1).

Will Jokowi's latest economic stimulus package be effective? Since early September 2015, Indonesia's Jokowi administration in coordination with Bank Indonesia and the Financial Services Authority (OJK) has announced a spate of policy measures aimed at reversing the ongoing erosion in consumer purchasing power, rekindling a flagging investment cycle, boosting industrial competitiveness, and improving governance standards (See our previous flash). The latest economic package from Jokowi is incremental but progressive and wide ranging. The package lacks bold and hard legislative reforms aimed at making rigid labor laws more flexible, directly tackling red tape, and narrowing the large negative investment list that restricts foreign investments across key sectors. Also, the success of these measures would depend on the government's ability to ensure regulatory certainty and effective coordination amongst authorities to make land acquisition easier and enforce the new legal framework that supports public private partnerships. So far, the pace of investment reforms during Jokowi's first year as President have disappointed and policy uncertainty has increased as investors are stymied by sudden and unfavorable shifts in regulations (See Figure – 3). That said, on a positive note, the newly announced measures, if implemented effectively, should help release the economy's animal-spirits.

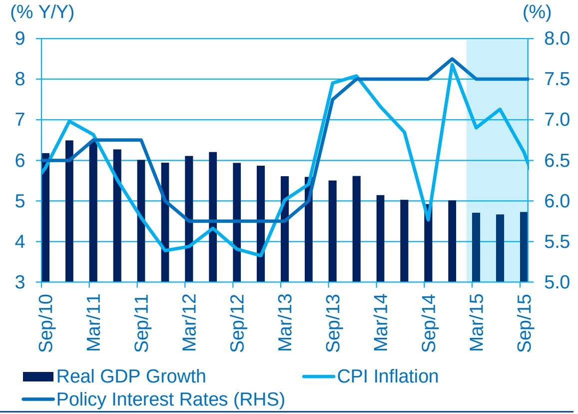
The Rupiah has strengthened off-late but remains vulnerable: The Indonesian Rupiah has recovered sharply since mid-September 2015 when it had hit multi-year lows as financial market uncertain spiked amid concerns over slower global growth, the imminent Fed rate hike and emergence of financial fragilities in China alongside loss of growth momentum (See Figure – 4). The September crash in asset prices across emerging Asia reviewed grim memories of the 1997 Asian crisis. However, stronger foreign exchange reserve buffers, improving current account balances, flexible exchange rate regimes, political stability and healthier banking fundamentals (See Figure – 5) place economies such as Indonesia at a stronger footing currently to weather external headwinds (See our recent Economic Watch). That said, given Indonesia's significant foreign ownership of local currency government bonds - highest in the region at 38% - , the rupiah would continue to remain vulnerable to episodes of foreign capital flight, especially as the implicit probabilities of a Fed lift-off in December rise from 30% to 50%.

Table 1
Key measures outlined in Indonesia's latest economic stimulus package

	Measure	Details	Impact
•	**Measures to enhance consumer purchasing power**		
1	Rice subsidy scheme	• Expand existing rice subsidy scheme	• Ease consumer budget constraint
2	Aid to fisherman	• LPG to fuel convertor kits given to fishermen	• Make fishing more energy efficient
3	Stabilize food prices and anchor inflation	• In coordination with Bank Indonesia, food prices and overall inflation will be anchored through credible monetary policy and supply response	• Aid real income levels of consumers
4	Reduce beef import prices	• Indonesia to consider more countries to find competitive prices for beef imports	• Ease the price of beef in domestic markets
5	Wage setting regulations	• Periodic inflation linked revision of wages	• Upkeep real income levels
6	Raise threshold tax level to buy luxury apartment	• Cheaper luxury apartments will no longer be subject to luxury tax	• Boost domestic housing sector
7	Protect small rice farmers	• Insure small farmers against crop failure, government to pay 80% of the premium	• Protect the livelihood of farmers
8	Subsidised loans to salaried workers	• Salaried workers to get subsidised loans for opening small businesses – Widen eligibility list	• Encourage entrepreneurship and increase home based economic activity
•	**Measures to boost investment activity and industrial competitiveness**		
10	Low interest rate loans for micro, small, mid-sized firm	• Loan rates cut from 23% to 12% for labor-intensive small businesses, given by Exim bank • Provide working capital for export oriented SMEs	• Help sustain small businesses and avoid layoffs
11	Special Economic Zones	• New regulations to promote Special Economic Zones and two bonded logistic zones	• Boost industrialization & higher FX revenue
12	Easier import regulations	• Import regulations are eased for select agri products, textiles, cosmetics, tires and pearls	• Boost producer margins by reducing cost of imports
13	Simplifying and speeding up investment, land acquisition and business permit procedures	• Processing time for permits cut from 8 days to just three hours for specific companies, won't need to obtain environmental permits and location permits. • Fast-track permit allocation for mining sectors from up to 4 years to 15 days • Reduced time for investors to obtain land use certificates, provide greater legal certainty.	• Boost industrial activity and domestic private investments
14	Lower energy and electricity prices	• 30% discount to industries for electricity usage between 11pm and 8pm. • Allow delayed electricity bill payment for specific distressed industries • Lower price/subsidy for diesel & gas for industry	• Enhance operational efficiency by reducing costs, lower transportation costs, avoid distressed companies from going bankrupt and prevent layoffs
15	Tax sops and others	• Doubled the maximum length of tax holidays to 20 years while expanding eligibility of sectors • Corporate tax rate will be reduced next year from 25% currently to 18%-20%. • Scrapped VAT for imports of aviation products • Remove value added tax in transportation sector • Interest rate tax cuts for exporters • Greater devolution of central government funds to local governments	• Increase industry profitability, enhance competitiveness, Offer efficient industrial facilities for investors
16	Easier operating norms for foreign workers in Indonesia	• 10-locals-per-1 expat requirement revoked. • Work permits not needed for non-resident directors. Easier laws on work permits.	• Boost confidence of foreign workers in Indonesia • Encourages foreign manufacturers to invest in Indonesia

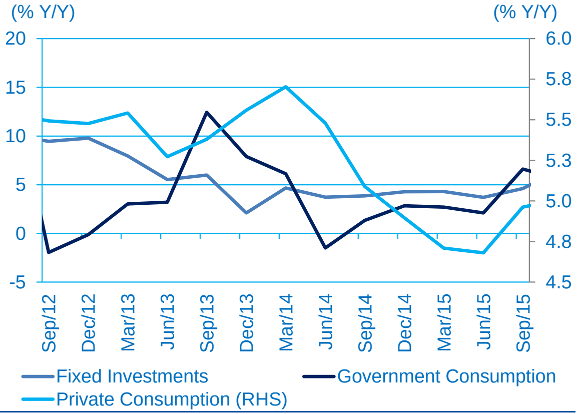
Source: BBVA Research, Indonesian Government official sources

Figure 1
Indonesia's Q3 GDP growth remains broadly flat



Source: BBVA Research, CEIC

Figure 2
Q3 Growth was largely driven by Govt spending



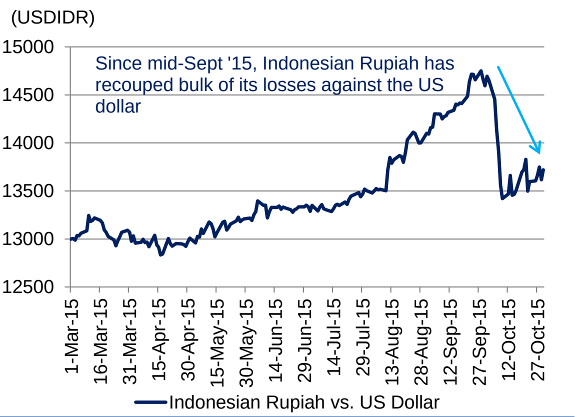
Source: BBVA Research, CEIC

Figure 3
Past policy hits and misses by the Jokowi administration

Past reforms actions by Jokowi administration	Policy measures by Jokowi that have upset foreign investors
Scrapping low octane gasoline subsidies and cap on diesel subsidy	Banning the use of foreign currencies for domestic transactions
Five year infrastructure development plan to boost rail, road, port and power sector	Forcing banks and companies to place their data centers onshore
Tax incentives to encourage foreign direct investments	Banning sale of beer in mini-markets
Establishment of one-stop service (PSPT) for project approval (Pelayanan Terpadu Satu Pintu)	Restricitons on foreigners to services Indonesian domestic sea lanes
New land acquisition law to facilitate infrastructure development	Limits to FDI in ports, warehousing and freight forwarding.
National broadband plan to make internet more accessible	Restrictions on export of minerals such as nickel and copper

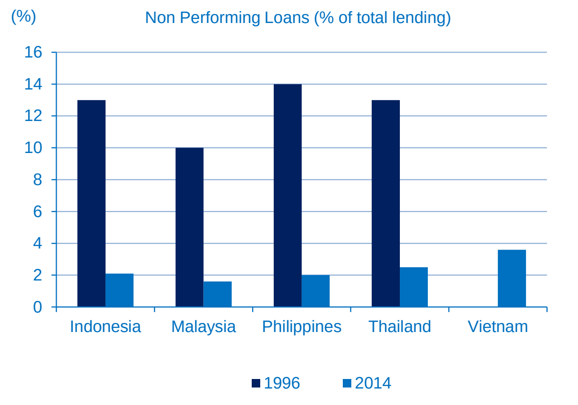
Source: BBVA Research, CEIC

Figure 4
The Indonesian rupiah has recovered but remains vulnerable to global financial uncertainty



Source: BBVA Research, CEIC

Figure 5
Indonesia's bank asset quality has improved meaningfully since the 1997 Asian crisis



Source: BBVA Research, CEIC