

INDONESIA

- The fiscal constraint will remain a stumbling block to any significant pick up in public spending.
- While household consumption is expected to remain the mainstay of the economy, recent high frequency indicators are pointing to some moderation in consumption growth.
- Interest rates and the exchange rate are expected to remain stable in the near-term

The Indonesian economy is expected to grow around 5% y-o-y in 2017, with risks tilted to the downside, after having come in at 5.0% y-o-y in 2016. The growth rate in 2016 fell short of the target of 5.3% y-o-y. The fiscal constraint will remain a stumbling block to any significant pick up in public spending. The tax amnesty scheme contributed around 0.8% of GDP in revenue terms and was a one-time effort. Going forward, there are unlikely to be any additional meaningful benefits to the economy from this scheme, either in terms of investments or revenues as the amount of external funds repatriated were low. While household consumption is expected to remain the mainstay of the economy, recent high frequency indicators are pointing to some moderation in consumption growth. Gross fixed capital formation is unlikely to see any significant increase either from the government or the private sector. We expect Bank Indonesia (BI) to keep the interest rate unchanged at 4.75% for some time to come. With respect to the currency, the central bank has been intervening on both sides to keep the currency stable.

Recent high frequency indicators for household consumption are pointing to a moderation in growth, despite improving consumer sentiment. Retail sales growth has slowed on a 3-month moving average (trend) basis to 4.2% y-o-y in March 2017 compared to 11% y-o-y growth seen in 2016. Motor cycle sales too have seen a sharp decline of 6.8% y-o-y on a trend basis compared to a 8.5% y-o-y fall in 2016. There is some evidence of ongoing investment activity judging by the gradual pickup in cement consumption as well as the turnaround in capital goods imports that has been observed since the start of 2017.

Government consumption detracted from overall GDP growth in 2H2016 as the government cut spending plans to curtail the fiscal deficit. Tax revenue as a share of GDP has been lacklustre at around 12%, and would have been hurt by earlier declines in commodity prices. The Federal system of government requires a significant chunk of revenue to be shared between the central government and the provinces. The implementation of infrastructure programmes at the provincial government level remains weak. Unless structural reforms are implemented and capacity building activities are undertaken in the provinces, the central government will continue to face constraints with respect to the productive fiscal spending, thereby hurting GDP growth prospects.

With respect to the tax amnesty scheme, around Rp 4800 trillion in asset value was declared, with a large share of it being domestically declared. The scheme fell short in terms of the amount that was repatriated – Rp 147 trillion. There was a revenue shortfall as well, with total revenue collected from the scheme coming in at around Rp 115 trillion below the target of Rp 165 trillion.

Credit growth in the economy has eased in recent years and currently stands at around 8.2% y-o-y (as of March 2017) on a trend basis compared to around 8.0% y-o-y in 2016. Banking sector concerns could increase in the coming months as non-performing loans (NPLs) continue to rise.

Both exports and imports, especially the import of raw materials have seen strong growth in recent months on the back of higher commodity prices. The outlook for commodity prices going forward is uncertain and net exports will possibly weigh on overall GDP growth.

CPI inflation, which has eased since 2015, came in at an average of 3.6% y-o-y in March 2017 compared to a 3.8% y-o-y rise in February while core CPI remained stable within the range of 3% to 3.5% over the last 12 months. Inflation will likely see an uptick going ahead on the back of the government's plans to cut electricity subsidies as

well as higher oil prices compared to a year ago. Overall, inflation is expected to stay within the BI's target inflation range of 3% to 5%. The Indonesian Rupiah has strengthened on a real effective exchange rate (REER) basis and for now remains supported by strong capital inflows.

Table 1: Select Economic Indicators

	Mar-17	Feb-17	Mar-17	Mar-17	2016	2015
	Actual	Actual	3mma	YTD	Average	Average
Real Sector	% change, y-o-y					
Industrial Production	--	3.3	3.8*	3.6*	4.0	4.8
Retail Sales	2.6	3.7	4.2	4.2	11.0	13.3
Motorcycle Sales	-15.9	-13.5	-6.8	-6.8	-8.5	-17.6
Motor Vehicle Production	8.3	7.5	5.8	5.8	4.9	-16.1
Cement Consumption	3.6	0.5	0.5	0.5	-0.4	3.9
CPI Inflation	3.6	3.8	3.6	3.6	3.5	6.4
Core CPI Inflation	3.3	3.4	3.4	3.6	3.4	4.9
Real Sector	Actual Values					
Consumer Confidence Index	121.5	117.1	118.0	118.0	112.7	109.9
External Sector	% change, y-o-y					
Exports	23.6	11.5	20.8	20.8	-3.9	-14.6
Non-Oil Exports	24.0	11.9	21.6	21.6	-0.3	-9.7
Imports	18.2	11.6	14.8	14.8	-4.9	-19.9
Non-Oil Imports	13.8	-1.9	7.4	7.4	-1.0	-12.3
Capital Goods Imports	19.0	-5.1	6.4	6.4	-9.6	-15.6
External Sector	Actual Values					
Trade Balance (USD bn)	1.2	1.3	1.3	3.9	8.8	7.7
Forex Rate: USD/IDR	13321.0	13347.0	13337.0	13337.0	13329.8	13457.6
Nominal Effective Exchange Rate Index	--	77.7	78.2*	78.1*	76.4	75.1
Official Reserve Assets (USD bn)	121.8	119.9	119.5	119.5	109.9	107.7
Monetary Sector	% change, y-o-y					
Money Supply	--	9.30	9.69*	9.52*	7.82	12.80
Commercial Banks Credit Growth	--	8.57	8.24*	8.43*	8.03	10.69
Consumption Credit Growth	--	8.87	8.92*	9.00*	8.50	10.34
Working Capital Credit Growth	--	7.61	7.19*	7.33*	6.15	9.91
Investments Credit Growth	--	9.97	9.39*	9.76*	11.06	12.59
Monetary Sector	Actual Values					
Bank Indonesia Policy Rate	4.75	4.75	4.75	4.75	NA	NA
Short-term (3-month) Interbank Offer Rate	6.87	6.84	6.85	6.85	7.17	7.56
Government Securities: 10 year yield	7.26	7.79	7.63	7.63	7.76	8.30

A y-o-y change in 3mma March 2017 is the percentage change in the average of January, February, and March 2017 data over the average of January, February, and March 2016 data. A y-o-y change in actual number for a month, say March 2017, is the percent change in the March 2017 value over the March 2016 value.

Note: * represents year-to-date (ytd) number and 3-month moving average (3mma) ending February 2017

Source: CEIC, Marketnomix

Figure 1. Bank Credit Growth Slowing

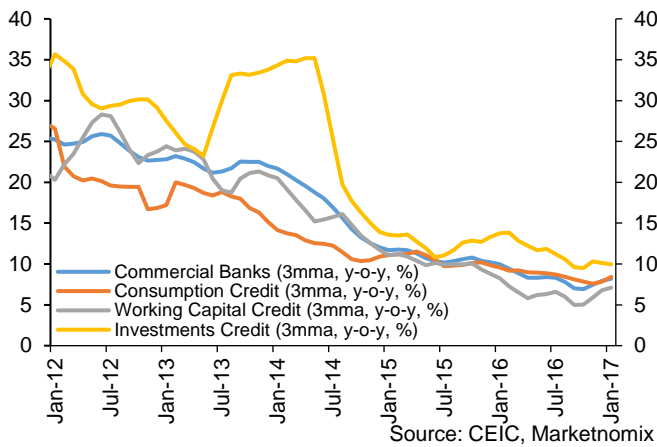


Figure 2. Exports and imports have improved, partly with rising commodity prices

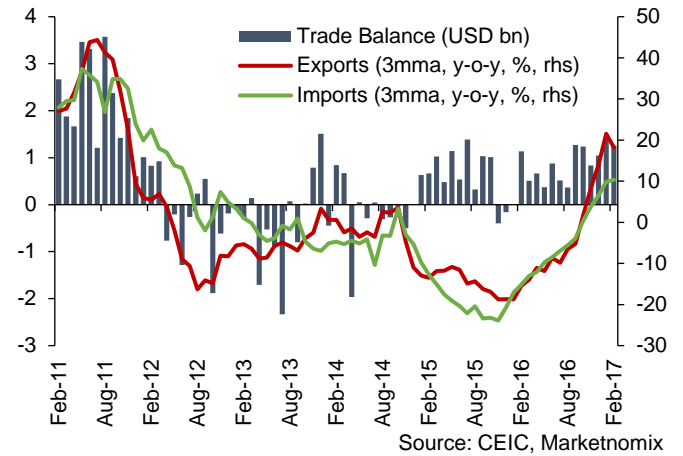


Figure 3. Bank Indonesia to keep policy rate on hold

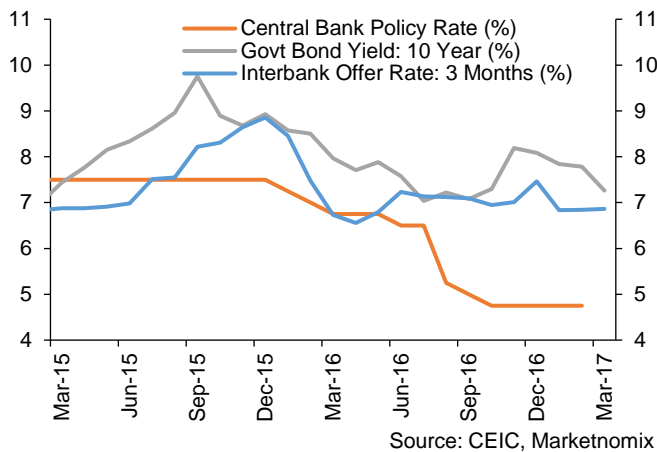
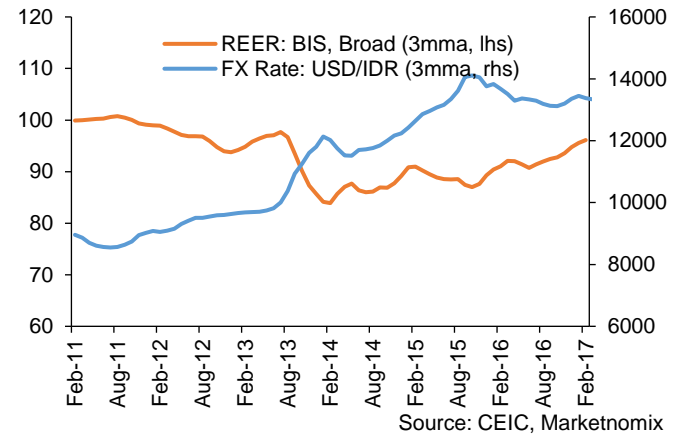


Figure 4. Capital inflows have kept rupiah stable



Index of Industrial Production

Growth in industrial production came in at 3.3% y-o-y in February 2017 compared to a rise of 3.9% y-o-y in January 2017 on a 3-month moving average basis and grew 4% y-o-y for the whole of 2016. The uncertain outlook for commodity prices coupled with lack of meaningful investment activity could weigh on overall industrial production going forward.

Within the manufacturing segment, data is available only until December 2016. Food products that account for around 30% of total manufacturing output slowed marginally to 6.4% y-o-y in 2016 compared to a growth of 6.7% y-o-y in 2015. Healthy private consumption expenditure would have been supportive for the food products segment.

Chemicals and chemical products, and pharmaceuticals continued to be a drag on overall industrial production, with the former having declined by 0.9% y-o-y in 2016 compared to a rise of 0.9% y-o-y in 2015 and the latter slowing to a growth of 8% y-o-y in 2016 from a 12.7% y-o-y increase in 2015. Further, textile production continued to decline through 2016, falling 4.8% y-o-y in 2016 compared to a decline of 1.2% y-o-y in 2015. The decline in tobacco production accelerated in the latter half of 2016 and resulted in a decline of 2.7% y-o-y for the whole year compared to a rise of 4.8% in 2015.

Production of computer, electronics & optical products continued to slow on a trend basis and rose 2% y-o-y in 2016 compared a 3% y-o-y increase in 2015. On the other hand, the pace of decline in motor vehicles, trailers & semitrailers slowed on a trend basis towards the end of 2016 and came in at 0.8% y-o-y for the whole of 2016. This was significantly lower than the annual growth of 5.2% y-o-y recorded in 2015.

Table 2: Index of Industrial Production

	Dec-16	Nov-16	Dec-16	Dec-16	2015	2014
	Actual	Actual	3mma	YTD	Average	Average
Industrial Production Manufacturing	% change,y-o-y					
Basic Metals	0.1	-6.8	-1.9	-0.3	6.1	6.2
Non-Metallic Mineral Products	7.3	4.2	3.2	5.8	7.0	3.6
Fabricated Metal Prod except Machinery and Equip	-6.9	-2.9	-3.4	-0.1	9.4	3.2
Chemicals and Chemical Products	5.5	7.4	7.1	-0.9	0.9	6.0
Pharmaceuticals, Medicinal Chemical & Botanical Products	2.2	12.4	3.1	8.0	12.7	9.9
Rubber and Plastics Products	-6.0	-7.3	-5.5	-8.4	4.6	0.7
Wood and Prod of Woods and Cork except Furniture	-10.7	-1.6	-4.1	2.0	0.2	9.1
Paper and Paper Products	11.0	-16.2	-2.1	-3.2	-3.6	2.9
Printing and Reproduction of Rec Media	4.4	-1.8	0.5	-1.2	4.6	-0.8
Computers, Electronics and Optical Products	-2.1	-0.8	-0.3	2.0	3.0	-3.9
Electrical Equipment	0.3	2.4	-3.4	-7.5	-0.5	9.8
Machinery and Equipments	-4.8	-3.0	-3.4	3.5	2.3	8.0
Repair and Installation of Machinery and Equipment	-5.4	-5.3	-5.4	-3.6	4.5	-5.8
Motor Vehicles, Trailers and Semitrailers	6.6	4.6	-1.9	0.8	5.2	4.2
Other Transport Equipment	0.3	5.8	-0.1	0.7	-6.5	-4.1
Textiles	-11.3	-5.5	-7.9	-4.8	-1.2	-5.5
Wearing Apparel	-5.9	-4.8	-2.4	-7.2	-10.9	3.6
Leather and Related Products and Footwear	5.8	2.2	5.6	7.6	3.6	6.2
Food Products	8.5	8.6	8.3	6.4	6.7	10.5
Beverages	-1.0	-1.7	-0.9	-0.1	-0.7	2.9
Tobacco	-5.5	-6.3	-4.3	-2.7	4.8	8.0
Furniture	0.1	6.8	0.4	0.6	4.3	1.8
Other Manufacturing	-1.1	-8.2	-6.5	-6.5	5.5	5.4

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Source: CEIC, Marketnomix

Table 3: Annual Forecasts

Real GDP (% change)				Consumer Prices (% change)				Current Account (% of GDP)			
Country	2016	2017	2018	Country	2016	2017	2018	Country	2016	2017	2018
China	6.7	6.6	6.2	China	2.0	2.4	2.3	China	1.8	1.3	1.2
India*	6.8	6.6	6.4	India*	4.9	4.8	5.1	India*	-0.9	-1.5	-1.5
Indonesia	5.0	5.1	5.3	Indonesia	3.5	4.5	4.5	Indonesia	-1.8	-1.9	-2.0
Japan	1.0	1.2	0.6	Japan	-0.1	1.0	0.6	Japan	4.6	4.6	4.5
Malaysia	4.2	4.3	4.5	Malaysia	2.1	2.7	2.9	Malaysia	2.0	1.8	1.8
Myanmar	6.3	7.5	7.6	Myanmar	7.0	6.9	6.7	Myanmar	-6.5	-6.6	-6.7
Philippines	6.8	6.8	6.9	Philippines	1.8	3.6	3.3	Philippines	0.2	-0.1	-0.3
Singapore	2.0	2.2	2.6	Singapore	-0.5	1.1	1.8	Singapore	19.0	20.1	19.2
Thailand	3.2	3.0	3.3	Thailand	0.2	1.4	1.5	Thailand	11.4	9.7	7.8
United States	1.6	2.0	2.2	United States	1.3	2.7	2.4	United States	-2.6	-2.7	-3.2
Euro Zone	1.7	1.7	1.6	Euro Zone	0.2	1.7	1.5	Euro Zone	3.4	3.0	3.0
Vietnam	6.2	6.5	6.3	Vietnam	2.7	4.9	5.0	Vietnam	4.7	4.1	3.4

Fiscal balance (% of GDP)				Official Policy Rate***				Currency per US Dollar***			
Country	2016	2017	2018	Country	2016	2017	2018	Country	2016	2017	2018
China	-3.7	-3.7	-3.4	China**	4.35	4.60	4.85	China	6.95	7.05	7.13
India*	-6.6	-6.4	-6.3	India*	6.25	6.00	6.00	India*	67.92	67.00	69.00
Indonesia	-2.5	-2.4	-2.5	Indonesia	6.5	4.75	5.00	Indonesia	13473	13800	14400
Japan	-4.2	-4.0	-3.3	Japan	-0.1	-0.1	-0.1	Japan	116.96	120.00	125.00
Malaysia	-3.0	-3.0	-2.7	Malaysia	3.00	3.25	3.50	Malaysia	4.49	4.70	4.90
Myanmar	-4.6	-4.5	-4.5	Myanmar	--	--	--	Myanmar	--	--	--
Philippines	-0.4	-1.0	-1.2	Philippines	3.00	3.25	3.50	Philippines	49.60	51.00	53.00
Singapore	3.3	1.7	1.5	Singapore	--	--	--	Singapore	1.45	1.45	1.48
Thailand	-0.5	-1.6	-1.8	Thailand	1.50	1.50	1.75	Thailand	35.83	36.50	37.50
United States	-4.6	-4.4	-4.5	United States	0.75	1.5	2.0	United States	--	--	--
Euro Zone	-1.7	-1.5	-1.2	Euro Zone	0.00	0.00	0.00	Euro Zone	1.05	1.05	1.00
Vietnam	-5.6	-5.7	-5.7	Vietnam	--	--	--	Vietnam	22761	23000	24000

* Data for India are for fiscal years - 2016 corresponds to the period April 2016 to March 2017

**One Year Best Lending Rate (%)

*** Policy Rates and Exchange rates are as of 31 December

Source: CEIC, IMF, Marketnomix estimates.

About Us

Marketnomix comprises a team of professional economists providing sound macroeconomic inputs that capture developments in the global economy. Marketnomix aims to positively impact the strategic decisions of individuals and firms.

Rajan Govil and Janak Nabar are co-founders of Marketnomix. Between them, they have close to 40 years of experience covering a number of economies. Their research experience spans the sell-side as well as the buy-side, including as global asset allocators. They have provided guidance to institutional clients, corporate treasuries, family offices and high net worth individuals with businesses and investments across the world.

Rajan has worked as an economist with the International Monetary Fund (IMF) and as economist/investment strategist with the private financial sector. He presently consults for the IMF and other multilateral agencies. Rajan has worked as Chief Economist-India and later Regional Economist for Asia-Pacific at HSBC Bank, and as the Head of Investment Strategy, Asia at BSI Bank. Rajan has taught at Delhi University, Indian Institute of Management Bangalore and Vanderbilt University. He has a PhD in Economics from Vanderbilt University.

Janak was until the end of 2014, a Senior Investment Strategist at BSI Bank Ltd, Singapore, having assumed responsibility for the Bank's macroeconomic and asset price outlook for Asia in December 2013. He has worked as an Economist focusing on the Asia-Pacific region with IDEAglobal Ltd. His work experience includes two years with the United Nations High Commissioner for Refugees in Belgrade, Serbia. Janak holds an MSc (Econometrics and Mathematical Economics) from the London School of Economics and Political Science, MA (Mathematics) from Balliol College, University of Oxford (as a Radhakrishnan Scholar), and BA (Mathematics) from the University of Pune, India (ranked first in the University). He currently also heads the Centre for Technology, Innovation and Economic Research (CTIER), an independent think tank based in Pune focusing on innovation and technology policy in India.

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