Inside Indonesia

OCBC Bank

Not Sheepish At All

Indonesia's GDP surprised on the upside

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- **It may be the last working day of the Lunar Year of the Sheep today, but there is nothing sheepish about Indonesia's Q4 GDP figure that was just released.**
- **At 5.04%yoy, the print was better than 4.8% expected and proved to be the best expansion rate since early 2014. A steady private consumption helps, but it was ultimately the government spending that offered the big pull.**
- **The pick-up in growth momentum validates the government's renewed reform spurt late last year. The testy global environment leaves little room for monkeying around, however. Focus on infrastructure, red tape cuts, and overall macro stability will remain crucial this year.**

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Keynesian Kicker

For much of 2015, we have waited, and waited, for the pick-up in government spending in Indonesia. Although it makes up just around 9% of total GDP on average, its importance has grown recently. How government spending fares has played a crucial role in how the overall economy does, for a number of reasons.

For one, the traditional growth engine of private consumption has been sputtering of late. Hit structurally by commodities slowdown and cyclically by tighter monetary policy conditions since mid-2013, Indonesian consumers have pulled back. To be sure, it still commands the lion's share of Indonesia's economy – at over 54% of GDP – and its movement thus has huge bearing on how the overall growth rate pans out. This time round, it grew by 4.92% yoy in Q4 2015, compared to 4.96% of the prior quarter – stable enough to not drag growth down, but obviously not roaring enough to pull overall GDP up by much.

The uninspiring growth rate of private consumption thus puts government spending in focus. This is especially so given that one of the central planks of Jokowi government's agenda has been infrastructure spending. Its failure to push things through in the first half of last year was the big factor contributing not just to the relatively dismal growth rate at that time, but also to the sense of market disappointment. In contrast, the pick-up in government spending starting in Q3 – and accelerating further in Q4 as we learn today – would thus be doubly useful.

Not only has the 44.3%qoq and 7.3%yoy growth in government spending in Q4 helped to contribute to the overall better-than-expected overall GDP print today, it would also become a signal to investors that the government might just have gotten its acts together. That can be a much more powerful multiplier effect beyond just the immediate pick-up in demand for extra jobs, goods and services from the projects.

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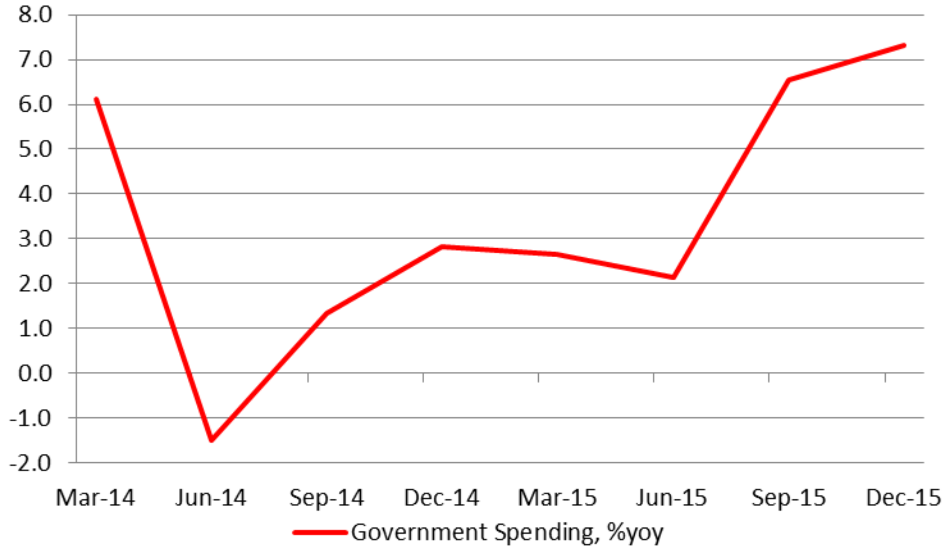
Monkey Year's Momentum

Overall, the numbers from today's GDP data suggest that there is a significant momentum for Indonesia's economy as 2016 plays out. Our expectation is for growth to clock 5.1% growth. This is lower than the 5.2-5.6% pencilled in by the government, not so much because of domestic factors but due to global ones.

Figure 1. Government spending's picking up



Source: CEIC, OCBC.

On the domestic front, we believe that a few things are going in the right direction. To begin with, the infrastructure pick-up that has been talked about for so long does indeed look like it is coming more forcefully, as smaller scale projects go on quietly even as big ones are not proceeding as smoothly as hoped – with the slow start of the high-speed Jakarta-to-Bandung train project being a visible example. Elsewhere, the rate cut cycle that Bank Indonesia has already started will help bolster private consumption, especially if the relative global stability holds enough for it cut rate further. On top of that, we do have some other potential positive catalysts on the horizon. The tax amnesty law, that we wrote about in "*Home Sweet Home*" report of Feb 2, may shape up to be an important factor this year as well.

As we highlighted in the report, even if the program achieves just a partial success, it can act as a stabilizing force for the country's currency and broader asset markets – and that can make all the difference in what might be shaping up to be a rather mischievous Monkey Year on the global front. All the commodities slump, Fed uncertainty and China turmoil of last year have already dealt Indonesia's export sector a significant blow. Exports shrunk by more than 6.4%yoy in Q4 going by today's GDP data, for instance. The ongoing sense of global unease is unlikely to generate a turnaround in exports that will be huge enough to be a dependable source of growth this year.

Thus, overall, it is great that Indonesia's Q4 growth surprised on the upside thanks to domestic factors such as the much-awaited pick up in government spending. For it to enjoy a strong momentum this year, Indonesia will continue to have to do some spring-cleaning of its policy framework that will make its economy not only comfortable for its domestic households but also warmly inviting to foreign investors.