OCBC Bank

Indonesia

5 August 2020

The Hero in a Zero

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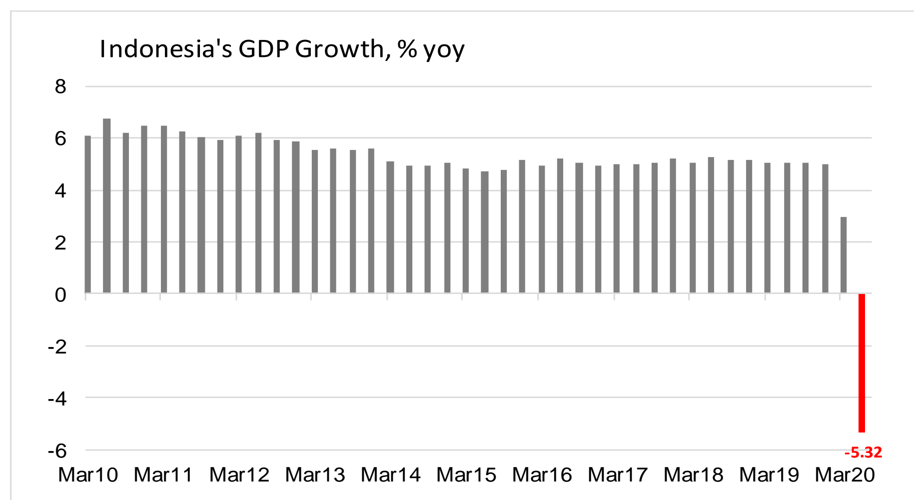
Can Indonesia escape a full year GDP contraction?

- Indonesia reported its Q2 GDP. At -5.32%yoy, the contraction came worse than expected and marked the worst outturn since the Asian Financial Crisis. Multiple wounds can be seen in the economy body, with sharp pullback in consumption and even deeper hits in investment and export activities.
- With two consecutive quarters of contraction now, many would describe Indonesia as having entered a technical recession. To us, the more important question now is whether Indonesia can get out of it. Specifically, even to achieve a 0% growth for 2020 and escape a full-year contraction, Indonesia would have its work cut out for it.
- Specifically, with stimulus disbursement still proceeding at a subdued pace, more needs to be done to quicken the injection and provide some uplift. Elsewhere, BI may come under new compulsion to cut rate further, but we see a good chance of it resisting the urge to do so, with yield differential remaining a key factor in preserving fund inflows momentum.

Ouch all around

In some respect, it feels a bit like watching a slow-motion clip of a boxing match. You know the blow from this heavyweight fighter called Vicious Virus is coming, and you can see the would-be recipient hunkering down in a desperate attempt to limit the impact – and yet, when it ultimately landed, the punch still felt so awfully sharp that it wrenched your gut.

Pardon the drama. We just saw the sharpest contraction in the Indonesian economy in over two decades. At -5.32% yoy, the 'growth' rate was also weaker than the -4.0% we expected and the -4.7% that consensus pencilled in.



Source: OCBC, Bloomberg, CEIC.

What is the big deal, you might say, given that pretty much every economy in the world would have seen an outright contraction in Q2 amid the unprecedented time that we had all witnessed?

For one, the sharp contraction came in the context of an economy that – not so long ago – had been growing so steadily, with growth rates not meandering far away from 5% on average, that it invited questions about its data efficacy. Moreover, looking back at the last global crisis of 2008-09, Indonesia stood out as being one of the few economies which could still eke out a respectable, positive, growth rate back then.

Looking into the details, the broadness of the contraction is another marker of just how painful things were.

The all-important private consumption saw -5.51% yoy growth, translating to a net -2.96ppt contribution to headline GDP growth. Given that we already saw some pullback in this segment in Q1 even before the worst of the virus impact was felt, the fact that we see a sharp pullback is in itself not a surprise.

Still, the magnitude of the consumption slowdown signals that, even though the Indonesian authorities tried their best not to engender a widescale lockdown for fear of crimping growth, the reality is that consumers might have shied away from going out in general on their own accord irrespective of official guidelines.

The next economic segment which suffered the most was investment activities, which shrank by 8.61% yoy in Q2, compared to the already anaemic +1.7% yoy in Q1. The decline reflected the freezing of any production capacity increase over the period given the uncertainties – shaving off headline growth by 2.73ppt.

Meanwhile, exports slumped, with growth rate of -11.7% yoy. It bore the imprints of the triple hits of production shutdown, demand slowdown and commodity price slump over the period. In net terms, however, trade did provide a rare net positive contribution to headline growth, at 0.74ppt. This is due to the even-sharper pullback in import activities, which contracted by nearly 17% yoy, as consumers and businesses slowed down their purchase of consumer and intermediate goods alike.

What about government spending? One would have thought, amid the focus on stimulus packages – which resulted in suspension of fiscal cap and pushed the boundary of market acceptability because of debt monetization – government spending should have helped growth.

Alas, it was not the case. Government consumption actually declined by 6.9%yoy, making it a negative contributor. Indeed, it pulled down headline growth by 0.53ppt over the period. The curious outturn is due to the fact that, even though the government has allocated as much as IDR695tn for stimulus,

the pace of disbursement has been snail-like. Indeed, going by press reports, even by now, the government has disbursed just 20% of the sum.

While it is fairly normal to expect the government's spending to fall short of budget allocations for the year and for it to only pick up speed in the second half of the year, the economy does not have the luxury of things proceeding at a normal speed now.

Indeed, the president has repeatedly berated his officials for not having any sense of crisis in carrying out their duties. If today's GDP data release does something to instil that additional jolt in the urgency to inject the stimulus money into the system, perhaps it could be seen as a small sliver of positive amid the dire numbers.

Overall, given the weak momentum from the Q2 print, it is hard to envision a strong and robust recovery in second half, particularly when Indonesia has yet to bring its virus situation under control. The ongoing worry about another dip in global growth would not help as well.

Still, arithmetically speaking, if Indonesia can eke out a 0.5% and 2% yoy growth in the two remaining quarters of the year respectively, it can still have a chance of printing 0% full-year growth, instead of facing an outright economic contraction for 2020 as a whole. Indeed, that is our baseline expectation for the economy this year. It is a sign of how badly the economy has been that even if Indonesia can achieve just a flat zero percent growth, it should still be deemed as a heroic achievement.

In terms of policy reaction, we doubt that the GDP data itself would prompt any talk of new stimulus from the government in the near-term. In large part, this is because of the poor execution of the current package to begin with. Moreover, there are also concerns about how even wider deficits might tip the balance for a market which has been stomaching unconventional policy measures with a remarkable degree of forbearance so far.

On the monetary policy side, today's poor data would inadvertently increased the compulsion for the central bank to cut its policy rate further. On balance, however, we believe that it can resist the urge still, by highlighting the scale of policy rate easing that it has done so far and its now-integral role in fiscal financing through debt monetization.

On balance, unless growth momentum weakens substantially again, BI should be able to hold out and leave its policy rate unchanged at 4.0% for the rest of the year. This would form an important plank in anchoring macroeconomic stability, by securing fund inflows through interest rate differential.

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