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Tough Road Ahead

Indonesia's Q1 GDP data does not bode well for the rest of 2020

- Gone are the days when we could just assume Indonesia would clock growth of close to 5%, come what may. Even as expectation for Q1 GDP was already relatively subdued at 4%, the outturn was quite a shock at just 2.97% yoy.
- That such a poor print occurred even before Indonesia started to feel the full brunt of the Covid-19 impact only adds salt to the wound. It can only mean that a negative year-on-year GDP print is now a distinct possibility in Q2.
- Facing the tough prospect of a deeper slowdown, the pressure for both fiscal and monetary authorities to pursue more stimulus will no doubt increase. To us, the focus should remain on implementing the current measures, however. Hard-won macro stability cannot be the next Covid-19's victim.

Where are the consumers?

The world has changed so much so fast of late that the first quarter of this year might as well be a decade ago. Still, for the purpose of deciphering what kind of impact the various economies would suffer in the current quarter and for the rest of the year, it can nonetheless be telling.

In Indonesia's case, unfortunately, it is not telling an encouraging story.

Even though the impact from global slowdown would have been evident especially for the exports prints even back then, the natural assumption has always been that domestic consumption would stay relatively protected, given the apparent lack of Covid-19 cases for much of the quarter.

Hence, the Q1 GDP data is especially concerning on a few fronts. First, there is the headline figure of 2.97% to contend with. It came well below relatively subdued expectation of 4.0% and Q4 2019's 4.97%. It also marks the lowest year-on-year quarterly growth that Indonesia has seen since 2005.

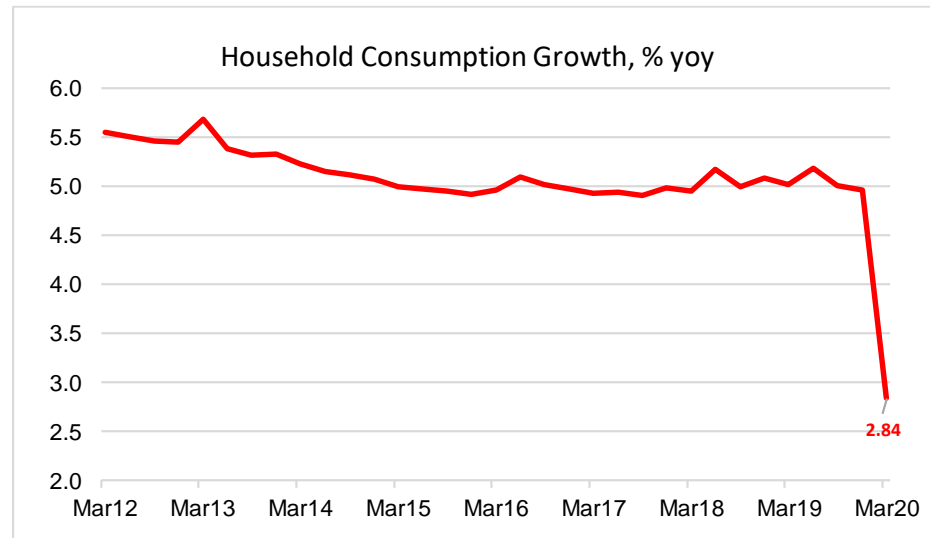


Source: OCBC, Bloomberg, CEIC.

Indonesia

5 May 2020

Moreover, the private consumption portion of the economy – typically the pillar of support that holds the Indonesian economy up during periods of global quakes – may itself be on shaky grounds this time round.



Source: OCBC, Bloomberg, CEIC.

In year-on-year terms, private consumption came in at just 2.84% growth in Q1, compared to 5.1% it averaged over the last two years. In terms of net contribution to headline growth, household consumption only added 1.56 percentage points, compared to over 2.7ppts on average over the same period, as well.

Looking deeper into the details, it appears that Indonesian consumers may have taken precautions against the coronavirus well before they were told to by the government.

Purchases of clothes and shoes dipped sharply, registering a quarter-on-quarter contraction of 6.28% and year-on-year drop of 3.3%. Despite a typical craze with technology – as highlighted by a preponderance of multiple cell phones that Indonesians always seem to carry with them – it appears that purchases of IT equipment in general had also dipped sharply, contracting by 6.8% qoq. Economic activities associated with “going out” or anything to do with “nongkrong” in Bahasa parlance showed tell-tale signs of suffering too, with restaurants posting around 4.8% qoq drop in consumption.

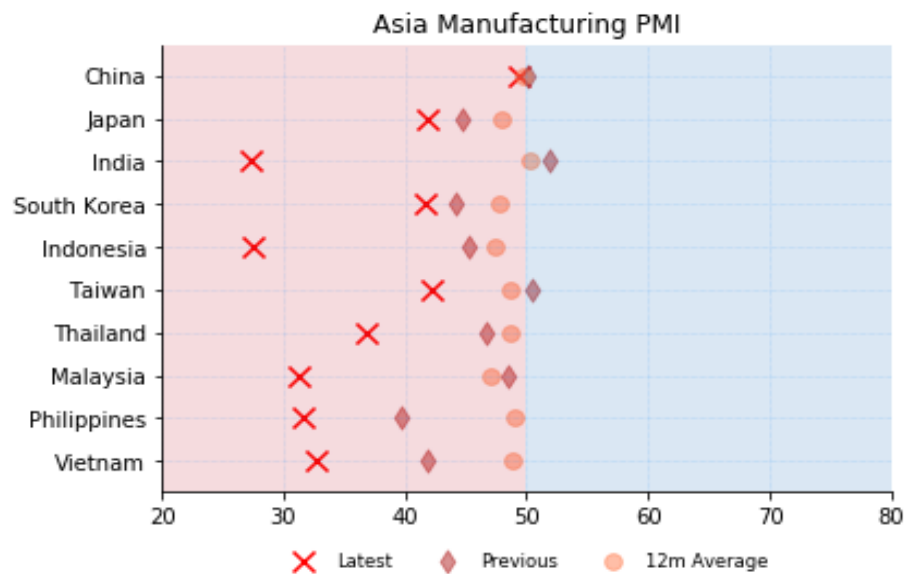
Given that such pullback in consumption activities is likely to have gotten worse in Q2 thus far as the country formally adopts lockdown measures of varying intensity and euphemistic reference, it does not bode well for what the GDP outlook will be.

This may be especially so as other segments of the economy are hardly in better stead. Take the exports sector, for instance. While it did eke out a positive year-on-year growth, it is at a rather minuscule rate of 0.24%. Even

Indonesia

5 May 2020

with a still-considerable shrinkage of imports (which grew by -2.2%yoy), net exports contributed just 0.45ppt to headline growth in Q1, compared to 1.4ppt quarterly average of 2019. Given the challenging global outlook crimping end-demand, that is further exacerbated by low commodity prices, Indonesia's exports are unlikely to be a source of growth support anytime soon. Already, April's manufacturing PMI for Indonesia printed just 27.5, the lowest since the series started. Compared to its regional peers, the level also marks the second worst, just behind India.



Source: OCBC, Bloomberg, CEIC.

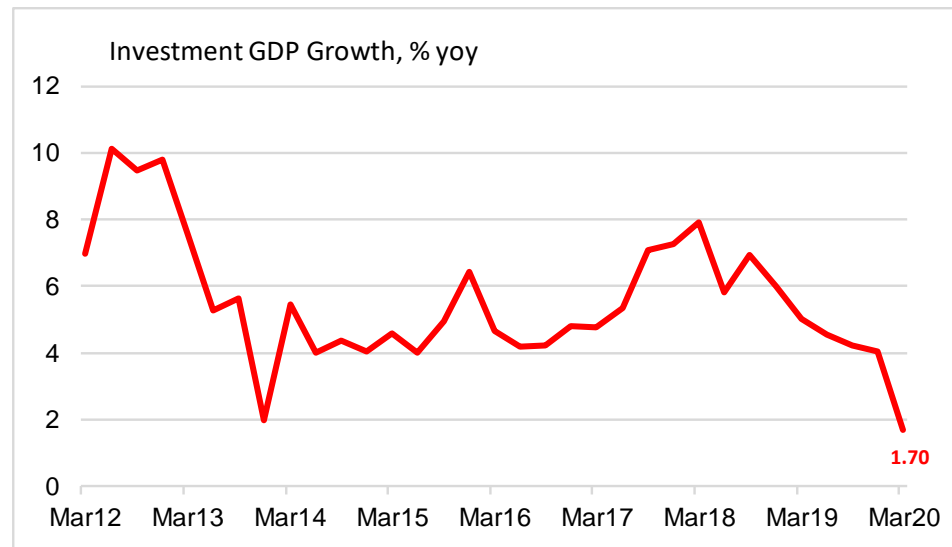
Elsewhere, investment activities show further signs of virus impact that might stay for a while more. At just 1.7%, investment activities saw their slowest growth rate since at least 2012. Similar conclusion can be drawn in terms of its net contribution to headline growth too, at just 0.56ppt, compared to the already-subpar 1.5ppt per quarter in 2019. With domestic business sentiment likely to remain poor and FDI flows crimped, such investment activities would probably stay curtailed too.

The prospect for any marked FDI pickup over the medium term may be dim as well. In particular, any hope of forceful labour reforms that arose when President Jokowi submitted the investment omnibus laws early this year is now dead on arrival, given the immediate need to preserve jobs and placate labour unions amid the outbreak.

If consumption, investment, exports are all sputtering, that leaves us with government spending in terms of growth accounting. While government consumption has picked up pace somewhat in Q1 – registering 3.74% yoy growth compared to less than 0.5% the quarter before – the fact of the matter is that its contribution to overall growth is still minuscule given that it comprises less than 8% of the economy on average.

Indonesia

5 May 2020



Source: OCBC, Bloomberg, CEIC.

Hence, while we fully agree that fiscal stimulus measures would help – and necessary as the spender of last resort when no one else in the economy is equipped or inclined to do so – we remain cautious of the degree of uplift it can bring. Moreover, there remains the nagging issue of how much financial capacity Indonesia's government does have in boosting spending even more from the IDR405tn fiscal package it previously announced, as well. As we detailed in our [April 24th report](#), even though there is technically no more 3%-of-GDP fiscal deficit cap for 3 years, Indonesia still has to bear in mind global investors' risk appetite, given the current account deficit status that leaves it dependent on external funding.

While allowing Bank Indonesia to purchase government bonds in primary auction may appear to be a *deus ex machina* that resolves all issues at hand, it should be treated with caution as well, given that the effects of balance sheet expansion on inflation in emerging markets remain a big unknown. Even though in the near term, the lack of end-demand by consumers and businesses would curb price pressures, there remains the potential supply side shock to contend with. Already, President Jokowi has warned of the risk of food supply shortages, in part due to supply chain concerns but also especially because this year's dry season is expected to be more intense than usual.

The room for monetary policy accommodation may be limited, as well, given the need to preserve currency stability. While Rupiah has strengthened considerably in April due to improvement in global risk sentiment, so much so that it went beyond the 15000 against USD that BI touted as its year-end expectations, the downshift in sentiment has resulted in some weakening of the currency again. Even if there is enough of a sense of currency stability for BI to cut rate in the next meeting on May 19th, BI can only adopt a gingerly

Indonesia

5 May 2020

approach when it comes to rate cuts and may be reluctant to bring it below 4.0% from the current 4.5% anytime soon.

In short, as much as Indonesia's longer-term potentials in terms of young demographics and abundant natural resources remain plain to see, it will be an especially tough road ahead in 2020. We see a possibility that growth in Q2 may dip to as low as -1.5% yoy given the weak momentum especially on the private consumption front and the limited space for fiscal and monetary accommodation. For the whole of 2020, we now see growth at 1.0% yoy compared to 1.5% before.

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