Regional Snapshot

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Timely Uplift

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Indonesia's Q2 GDP upside surprise paves the way for rate hike

- The Indonesian economy managed to grow at a robust clip of 5.44% yoy in Q2, against expectation of around 5.2% yoy. At a time when global recession fears dominate, such upbeat growth print should be a reminder of how the relatively insular nature of the economy is a 'plus' at this part of the cycle.
- Nonetheless, even as domestic driver indeed proved to be strong, with private consumption at 5.51% yoy (vs. 4.34% before), the GDP print signalled a great uplift from global commodities demand, which helped to propel exports up by nearly 20% over the period, courtesy of coal demand, for one.
- Overall, the solid GDP print should give Bank Indonesia both the space to hike rate and a reminder nudge of the risk of not doing so, especially with inflation data on the uptick. We still see a good chance of a hike coming in the next MPC meeting on Aug 23rd.

Standing Out

For a while, Indonesia has stood out from the rest by having a monetary policy rate setting that stays unchanged while others are busy getting ratcheted up. Now, it has also stood out from others in terms of growth momentum, with the latest Q2 GDP print coming at 5.44% yoy, stronger than Q1's 5.01% and higher than the 5.2% or so that consensus had in mind.

We will circle back to discussing the monetary policy outlook shortly, but let's stay on the GDP print for now. Looking at the details, private consumption strength stood out clearly. Partly because the economic impact of Covid-19 cases has become more curtailed than before, with social restrictions largely loosened despite occasional case upticks for instance, household consumption grew at a commendable rate of 5.51% yoy in Q2, vs. 4.34% in the prior quarter. In terms of the contribution to headline growth, the segment added 2.92ppt, against 2.35ppt before.

Source: OCBC, Bloomberg.

Exports did well too, on the back of the boom in commodities shipment, especially that of coal over the period. As the GDP measure has it, exports grew by 19.7% yoy in Q2, compared to 16.2% in Q1. At a time when imports did grow but not as buoyantly (at 12.3% yoy vs. 15.0% before), the end effect was that net exports added a helpful 2.14ppt to headline growth, compared to 0.82ppt before.

The strengths in both private consumption and exports outweighed the slower outturn in investment activities and government spending. For one, investments grew at a more subdued rate of 3.07% yoy, vs. 4.09% before, adding less than 1 percentage point to headline growth, perhaps signalling greater apprehension for corporate expansion at a time of heightened global uncertainties. Meanwhile, government spending continued to pull back from its pandemic-era high, as the authorities focused more on fiscal rectitude with an eye on ballooning subsidy bills.

At the broad level, the GDP print signalled that there is considerable momentum in the post-pandemic recovery that the Indonesian economy can muster. The fact that the domestic consumption has shown signs of stronger pick-up should be comforting, given the multitude and potential intensity of some of the global headwinds that we are seeing in the second half of the year, as well.

Still, exports – which played an important role in supporting growth thus far – are likely to suffer some downdrafts due to such headwinds, nonetheless. Hence, the second half growth is likely to be more muted than what has transpired thus far. Indeed, even as we keep to our 5.0% growth forecast for the whole of this year, it is really taking into account the upside surprise in Q2, rather than projecting an all-weather, come-what-may second half growth trajectory.

Nevertheless, even as the outlook might be, relatively speaking, less rosy going forward, the good outturn thus far should give Bank Indonesia the comfort it needs in knowing that any rate hike now would not necessarily push the economy southward. Indeed, the strength should be seen as a reminder of the risk that inflation could feed on itself at a time that growth momentum is that strong.

Our baseline case is thus for BI to be on a tightening path from here, starting from a 25bps hike this month at the MPC meeting on Aug 23, for a total of 75bps tightening this year.

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