LPEM
Quarterly Economic Outlook
2015 Q4

Highlights

- **Foreign investment led Q4 2015 GDP, projected to continue in 2016**
- **Consumption still dominates but fading**
- **Q4 2015 GDP to grow at around 4.9% (y-o-y), 2015 GDP to grow at around 4.8% (y-o-y), and 2016 GDP to grow at 5.2-5.4%**
- **2016 inflation to be within BI's target, higher than 2015**

Since we published our previous quarterly outlook, we have continued to witness how things that are statistically supposed to happen very rarely become normal shocks in the global economy. The oil price dropped by about 50% in the last 6 months. Within the same period, Shanghai SE Composite Index fell by about the same magnitude. Last, but not least, a surprise comes from Bank of Japan last week when it introduced the new regime of monetary policy – the negative interest rate. These shocks and potential new shocks will make global economy this year as unpredictable as the previous one, if not more. Indonesian economy, which showed a relatively high resiliency in 2015, once again will be tested in 2016.

Despite the volatile global economy, we continue to believe that the underlying Indonesian economy is fundamentally stronger than currently perceived by market participants. Considerable external risks will continue to negatively affect domestic growth. Exports, which are still dominated by raw commodities, will continue to shrink along with significant decline in commodity prices. Reduced risk appetite among global investors will also negatively affect investments growth, both portfolio and FDI. Growth, however, will still be much supported by consumer spending, return of much-needed capital spending following credit easing by commercial banks in recent months, and BI's decision to cut interest rate earlier this month.

Is the worst over yet?

At **4.9%** and **4.8%**, respectively, our estimate of Q4 GDP and FY2015 growth reflects the end of difficult market adjustment for the last several quarters. The evidence that the economy has reached the bottom of the slowing down trend is also shown by relatively resilient Rupiah from the Q4 2015 until today, despite the flurry of negative developments from global economy.

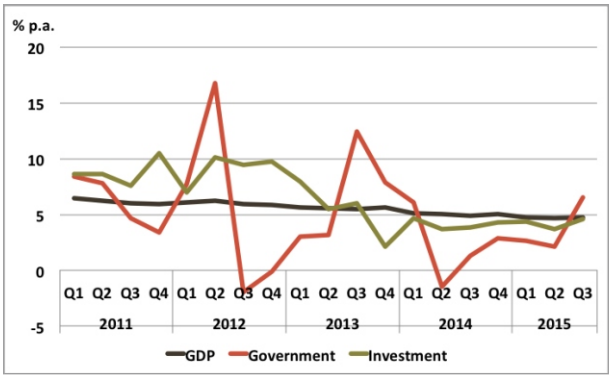
The decision of Bank Indonesia and the government to let Rupiah and the economy find its equilibrium through market self-adjustment proved to increase resilience of the general economy.

- Investments

Despite rather disappointing realization of government expenditure, improvement in the growth figure in Q3-Q4 2015 was and will continue to be sustained by growth in consumer spending and gross capital formation (investments).

Investments, which trailed GDP growth during much of 2013-2014, have been showing signs of recovery in the last few quarters. Investments have converged to GDP growth in Q3 2015, and we expect it to grow above the GDP growth for the Q4 2015 and going forward. A more stable Rupiah in the near- and medium-term may significantly regain confidence of investors, particularly among export-oriented manufacturers.

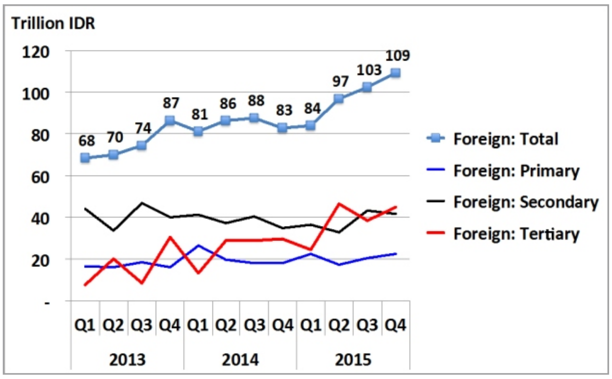
Figure 1: GDP Growth



Source: CEIC

The shifting trend in direct investments is also particularly noteworthy. Steady decreases are reported on FDI realization in manufacturing industries, particularly food, textile, vehicle, chemical, and pharmaceutical products, which can be attributed to slowdown in exports market. On the other hand, tertiary sector, particularly transportation services, construction, and real estates, shows steady and significant increases as infrastructures spending rapidly increase. Shift to domestic-oriented investments may present challenges to the government, which aims to tackle the persistent current-account deficit.

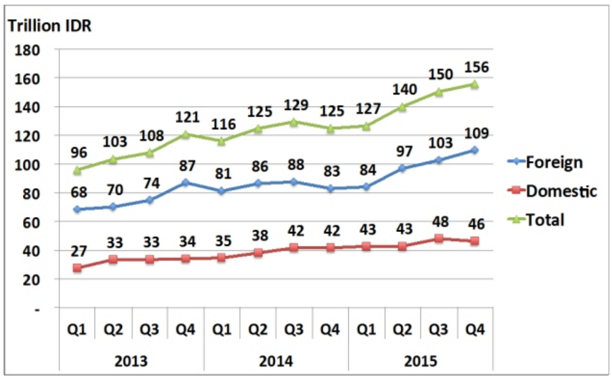
Figure 2: FDI Realization (Nominal)



Source: CEIC

Foreign investment in October – December 2015 amounted USD 7.9 billion, increased by USD 0.5 billion from Q3 2015. Increase in FDI indicates that series of economic stimulus package launched by President Joko Widodo is effective to improve investor sentiment. On the other hand, domestic investment in Q4 slightly decreased to IDR 46 trillion from IDR 48 trillion in Q3.

Figure 3: Foreign and Domestic Investment (Nominal)



Source: CEIC

- **Government expenditure**

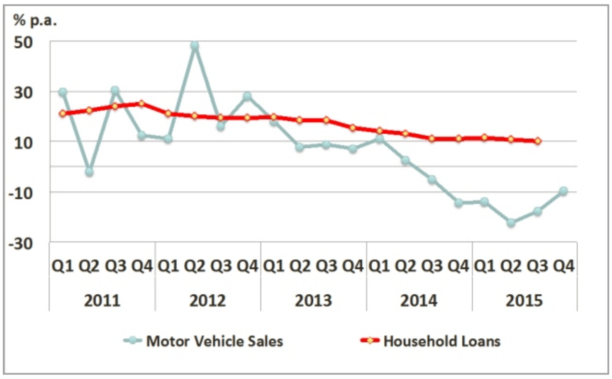
In FY2015, the realization of government spending grew only by 1.9% (y-o-y) as opposed to 8% and 11% in 2014 and 2013, respectively. Tax and nontax revenue also displayed disappointing growth in 2015 of -4% as opposed to 8% in both 2013 and 2014. Adopting the maximum target of 2% deficit to GDP ratio, with a good reason, has tied the government hands from helping the GDP avoiding its slowing down trend.

This target has been relaxed slightly to 2.1% for the 2016 budget. The problem is whether the economy can really grow faster in 2016 to significantly increase the tax revenue. 2015 tax collection was significantly below target. Even with a forecasted 5.3% GDP growth rate, IDR 1,565 trillion target for tax collection in 2016 seems too optimistic.

- **Consumption**

Amid stagnant economy, household consumption is predicted to still dominate GDP movement. The quarterly average of Consumer Confidence Index decreased from 106.7 in Q3 to 103.5 in Q4 despite a the pick up in the last 2 months of 2015. We predict that household consumption will still grow at around 4.9% for Q4. Motor vehicle sales growth displayed increase in Q4, although still in negative territory, at -9.7% (y-o-y), which is better than growth in the first nine months of 2015 of -18.1% (y-o-y). Bank Indonesia's decision to cut its interest rate in January 2016 is expected to help consumption and loans growth in the next quarter

Figure 4: Growth Rates of Household Consumption, Household Loans, and Motor Vehicle Sales

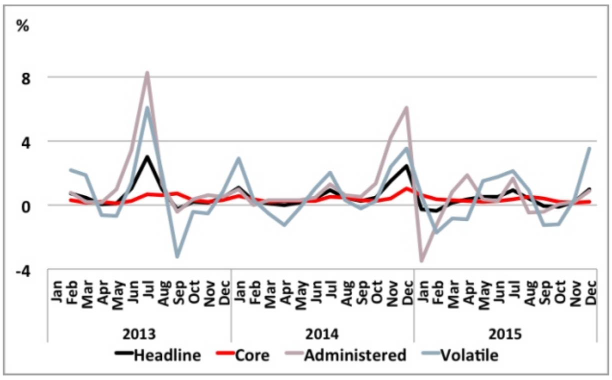


Source: CEIC

Inflation in 2015 was 3.35% (y-o-y), while within Bank Indonesia's target, is at the lowest level for the last five years. Core inflation in 2015 was reported at 3.93% (y-o-y), down from 4.93% in 2014, which reflected the overall weaker demand in 2015.

Going forward, we expect headline inflation to return to above 4% (y-o-y) level in near-and medium-term, especially in light of increased extreme weather risks, which affect food prices, and signals from BI on looser monetary policy in 2016.

Figure 5: Inflation Rate (m-t-m)



Source: CEIC

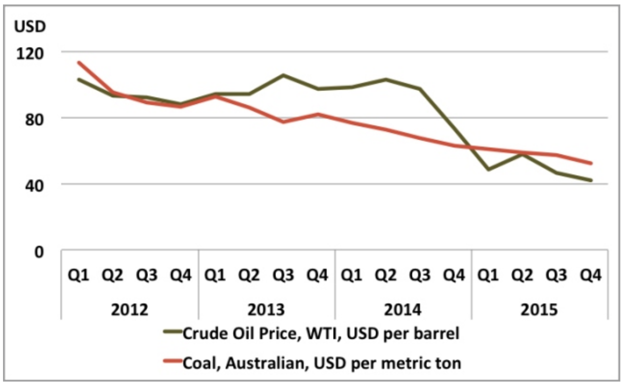
External Factors: (More) Challenges Ahead

Even as we are being cautiously optimistic about the FY2015 figures and near- and medium-term outlook, we need to add an important caveat that such outlook is very contingent on the global economic performance, as stated earlier. China and United States are particular source of concerns for the outlook of Indonesian economy, as the risks of slowdown in both countries can further depress the commodity prices (which run contrary to our expectation of stagnant or modest increase throughout this year), reverse the trend of capital inflow to emerging markets that was started following major EM selloff last October, and further reduce the demand for major non-commodities export goods.

China, in particular, poses the biggest risk to global economy and deserves special attention. Increasingly negative perceptions toward reliability of official Chinese economic figures and ability of Chinese government to maintain control of the economy have caused more investors to assume hard-landing scenario and thus precipitating commodity sell-off and negatively hurt commodities exporters. While still a remote probability, commodity sell-off, along with increasing oil supply glut amid increase in Iranian production, may further reduce the demand for Chinese products from emerging market and turn the negative perceptions into self-fulfilling prophecy of Chinese hard-landing, which will further hinder the return of growth to >7% level.

Further deterioration of trade performance in Q4 due to global economic slowdown and persistent commodity price decline perfectly illustrate how external risks may affect the path to achieve >7% growth target in 2016. Exports value dropped 19.5% (y-o-y) for October-December period, supported by decline in both oil and gas exports value and non-oil and gas exports value of 41.3% and 15.7% respectively.

Figure 6: Selected Commodity Prices (quarterly average)



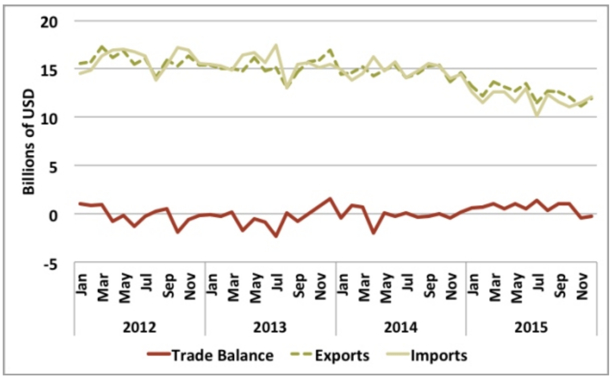
Source: World Bank

Commodity prices will continue to be key challenges for export performance in the near- and medium-term. With oil prices currently in $25-$35 per barrel range, further reduction in government revenue from oil extraction will restrict any potential increase in government expenditure. News about mine closure and downsizing in many commodities companies throughout 2015, particularly smaller coal miners, may continue in 2016 and further depress the overall economy. Provinces that are dependent on commodities, such as East Kalimantan and Riau, will also face further stagnation if commodity prices are still depressed.

Being a net oil importer, the effect of low oil price to Indonesian economy will be rather mixed in the medium term. We expect that oil price decline will bring marginal increase to GDP growth through higher saving and increased consumer demand and help the inflation to stay below 5% level. The impact, however, is rather limited, as gasoline price is still regulated and current trend does not show significant price decrease following steep decline in international oil price.

Despite trade deficit in November and December, Indonesia posted an overall trade surplus in Q4. As in previous quarter, weak exports performance is compensated by bigger decline in imports. In Q4, oil and gas imports value dropped by 50% (y-o-y) while non oil and gas imports value dropped by 11% (y-o-y), which led to Indonesia's first annual trade surplus in 2015 after three years of trade deficit. With the current trend of decline in exports and imports, we predict current account deficit in Q4 to be around 2% of GDP and post a modest improvement in 2016.

Figure 7: Trade Balance



Source: BPS

Researcher
Febrio Kacaribu (febrio.kacaribu@gmail.com)
Research Assistants
Alvin Ulido Lumbanraja
Faradina Alifia Maizar