**Key Figures**

- GDP Growth* (Q1 ‘19) 5.2%
- GDP Growth* (FY 2019) 5.2-5.3%
- Inflation (y.o.y. Mar ‘19) 2.48%
- Credit Growth (y.o.y. Feb ‘19) 12.13%
- Trade Balance (Q1 2019) USD -0.19 billion
- Current Account* (Q1 ’19) -2.24%

*) Forecast

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**Economic Growth is Stable**

**Highlights**

- GDP growth in Q1 2019 is estimated at 5.2%; overall 2019 forecast remains unchanged at 5.2-5.3%
- Fintech lending is growing rapidly. The role of regulators in facilitating financial education and ensuring consumer data protection is crucial
- Growth of the manufacturing sector reached around 4.3% for 2018
- Solid consumption growth rate stood at 5% for the whole 2018, supported by economic growth and government social spending; 2019 is expected to be as robust as 2018
- General elections result is to further increase credit growth in Q2 2019
- Unexpected current account improvement due to non-oil and gas trade surplus is projected in Q1 2019 and will still be uncertain for 2019 overall
- Rupiah will grow stronger as a result of clearer economic outlook due to completion of the general elections and economic slow down in the advanced economies

Growth momentum in the next quarter is likely to sustain, although some volatility is seen near term after the 2019 general elections. We maintain economic growth forecast for Q1 2019 at 5.2%, as we foresee stronger growth in household consumption. Household spending, which remains the primary driver of Indonesia’s economic growth, is projected to strengthen over the year due to several new policy measures, as long as there is no political dispute in the election result that could bring additional risk to the country.

<table>
<thead>
<tr>
<th>Table 1: LPEM FEB UI GDP Growth Forecast</th>
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<tbody>
<tr>
<td>Q1 2019</td>
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<tr>
<td>5.2%</td>
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In addition to robust domestic demand, government efforts to improve trade as well as FDI have started to bear fruit as the recorded trade balance surplus showed a better external balance in the last two consecutive months. If there is no further external pressure, the continuing net influx of portfolio capital flow and promising FDI improvement after the general elections on April 17 will also be key contributors to higher economic growth amidst global economic slowdown.
Fast Growth of Fintech P2P Lending: Opportunities with Some Risks

As the largest economy in Southeast Asia, Indonesia’s economy is predicted to become the seventh largest in the world in 2030. To achieve this, however, Indonesia has to take the full advantage of the digital economy to spur economic growth to the fullest, as it will create business opportunities with more new jobs and more consumer spending. The proliferation of digital economy in Indonesia is driven by three key digital services as follows.

1. A wide range of e-commerce platforms, including homegrown e-commerce, that sells everything, from general goods (Tokopedia and Bukalapak) to online travel (Traveloka, Tiket.com, etc).
2. Digitally-facilitated transportation services (Grab and GoJek), which operate in food delivery, ride-hailing and logistics.
3. Financial services technology or fintech, which includes services like lending, payment, insurance, investment, etc.

In the Indonesian digital economy ecosystem, fintech lending industry is growing fast. This is our focus in this short discussion.

Financial sector deepening plays an important role in economic growth by increasing public consumption and investments. The World Bank stated that the proportion of Indonesians holding bank accounts in 2018 remained low at 48.9 percent. These problems are due to the difficulty to access banking services in several regions and the lack of public knowledge in financial literacy. The emergence of fintech lending as a bridge between borrowers and lenders by pooling money from their retail lenders, namely Peer-to-Peer (P2P) Lending, provides several benefits in relation to financial inclusion and public financial independence.

First, it promotes the expansion of public access to financial loans, particularly in remote and unbanked communities and those who have no or limited credit history. Second, fintech lending can increase user convenience because it can be easily accessed 24 hours a day through any devices. Third, the disbursement of loans is faster, more accountable, and more efficient. Last, fintech lending offers much more competitive rates relative to those offered by the informal financial market like loan sharks; this is especially true for SMEs.

Figure B1: The Number of Indonesian Fintech P2P Lending Companies

Figure B2: Value of Loans in Fintech P2P Lending

The data from the Financial Services Authority (OJK) shows that there was a rapid growth of fintech P2P lending registered and licensed in Indonesia throughout the year, from 32 companies in early 2018 to 106 in April 2019 (Figure B1). The significant growth in the number of fintech lending players illustrates the
With 0.8 percent rate each day, the effective annual rate is calculated as \((1 + 0.8\%)^{360} - 1\).

Growing demand which was also reflected in loan disbursement growing by 1,006% to Rp 33.2 trillion at the end of March 2019 compared to the position at the beginning of 2018. The distribution of fintech lending is still focused on Java, with a total loan of Rp 28.5 trillion, compared to Rp 4.6 trillion outside Java.

P2P lending itself can be categorized into two segments based on the loan target, namely productive and consumptive lendings. While productive lending exists to fulfill the capital needs of companies, usually SMEs, consumptive lending is aimed more towards consumer consumption needs such as those related to health and education.

Consumptive lending platforms have dominated the P2P lending industry. Out of 106 registered and licensed platforms at OJK, we categorize 66 as firms that are more focus on consumptive lending products. The demand for the consumptive cash loans is very high indeed. The high potential rate of return has attracted many investors to lend in the platforms or even open their own fintech lending firms.

**Figure B3: P2P Lending Companies Based on The Type of Loan**

<table>
<thead>
<tr>
<th>Consumptive Lending</th>
<th>Productive Lending</th>
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<tbody>
<tr>
<td>Koinworks</td>
<td>Danamas</td>
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<tr>
<td>DanaCepat</td>
<td>Kredanas</td>
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<tr>
<td>AwanTunai</td>
<td>Amarthas</td>
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<tr>
<td>UangTeman</td>
<td>Investree</td>
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<tr>
<td>Dompet Khati</td>
<td>Modalku</td>
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<tr>
<td>Taralite</td>
<td>KlikACC</td>
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<tr>
<td>TunaKita</td>
<td>CROWDO</td>
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<tr>
<td>Cicil</td>
<td>Akseleman</td>
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<tr>
<td>PinjamanGo</td>
<td>Tokomodal</td>
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<tr>
<td>PinjamGampang</td>
<td>DanaMerdeka</td>
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<td>DanaN</td>
<td>PinjamDuit</td>
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<td>Avantee</td>
<td>Ternak.id</td>
</tr>
<tr>
<td>Rupiahcepat</td>
<td>Tanifund</td>
</tr>
<tr>
<td>Do-it</td>
<td>Indofund.id</td>
</tr>
<tr>
<td>Danarupiah</td>
<td>KreditPro</td>
</tr>
<tr>
<td>Kawancicil</td>
<td>KreditPro</td>
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<tr>
<td>Sanders One Stop</td>
<td>Danalaut</td>
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<tr>
<td>Solution</td>
<td>ModalUsaha</td>
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<td>Krediteрап</td>
<td>Asetku</td>
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<tr>
<td>Easy Cash</td>
<td>Lumpung Dana</td>
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<tr>
<td>Maucash</td>
<td>Lahansikam</td>
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</table>

Source: Fintech players registered and licensed at OJK as of April 2019, consumptive and productive lending categorized by author based on the type of loan

**Interest Rates in Fintech Lending**

The nature of the interest rate is different between consumptive and productive P2P lending. For consumptive lending, the interest rate is capped by OJK at 0.8 percent per day. This is equivalent to 1,661 percent\(^1\) annualized rate of return. While it looks staggeringly high, this rate is comparable to similar loan schemes from informal lenders found in the traditional markets in urban areas in Indonesia. On the other hand, the published rate of P2P productive lending ranges from 14 to around 20 percent per annum which is much lower compared to similar loan schemes typically happen in the informal settings.

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\(^1\) With 0.8 percent rate each day, the effective annual rate is calculated as \((1 + 0.8\%)^{360} - 1\).
Before the emergence of fintech lending, there are some other dominant non-bank lending facilities, such as MBK Ventura, Koperasi Mitra Dhuafa, government-operated Mekar, etc. that provide credit with interest rate ranging from 18 up to 35 percent per year. Similar to these products, with similar interest rates, there are now online platforms like Amartha that serves the same micro-lending segment. A few also provides sharia principles abiding financing products like the one offered by BTPN Syariah, namely Paket Masa Depan or PMD which provides credit facility with a ceiling of up to Rp50 million to support micro-business amongst females in rural areas.

Among all of these wide variety products and segments, the low interest rates given at P2P productive lending platforms such as Investree, Modalku, KoinWorks, and Akseleran deserves a special attention. These platforms usually require invoices as “collateral”, are utilizing sophisticated credit scoring system, and are supported by credit insurance products. They are clearly helping to improve the financial inclusion in the Indonesia, as they are tapping mostly the unbanked SMEs. Moreover, at the same time, these platforms are promoting the best practices of running a fintech lending industry.

Growing Risk of Asymmetric Information in Consumtive Lending

However, with the big potentials still to be captured ahead, fintech lending industry in Indonesia is still facing some big challenges. The most common issue in the P2P sector is the information asymmetry between players and platforms. This is especially true in the consumptive lending segment. Before giving a personal loan to a user, a P2P need to check whether the prospective user will be able to return the money, a process commonly known as credit scoring.

There is asymmetric information problem regarding the still-high interest rate of P2P lending. This issue might create drawbacks not only for the business segment but also the economy. We believe the concept of laissez-faire should then be applied here, letting players freely compete on the interest rate. As more players join the market, competitiveness will naturally follow and thus it will lead to lower interest rates.

On the other hand, credit scoring implementation in consumptive lending has faced new challenge recently. The credit scoring system is now generally ineffective due to the new limitation in accessing users’ smartphones since the release of such regulation by OJK in October 2018. The changes came as a result of unrest in some borrowers, feeling that their privacy is being violated by the “over-exploitation” of their
Indonesia’s reliance on commodities is susceptible to market price fluctuations. It is therefore critical to focus on the creation of value-added in the economy, particularly in the manufacturing sector.

Sluggish Manufacturing, Diverse Factors May Drive 2019 Growth

GDP growth realization in Q4 2018 was recorded at 5.18%, slightly increased compared to the achievement in the previous quarter of 5.17%. In line with our forecast, economic growth in Indonesia continued to accelerate in 2018. Overall economic growth in 2018 reached 5.17 percent (yoy), up from a growth rate of 5.07 percent in the previous year and was the highest achievement in the last five years. Information & communication, transportation & storage, and construction are sectors that lead the GDP growth rate in 2018, with the growth of these sectors reaching 7.31%, 7.07%, and 6.11%, respectively.

...
Meanwhile, the manufacturing industry as the most significant sector in GDP has been sluggish overall. The growth of the manufacturing industry slightly declined from the previous quarter, from 4.38% to 4.30% in Q3 2018, making the overall growth in 2018 4.26% (yoy). Production of food and beverages and textile & wearing apparel still dominates this sector with strong growth of demand. We project that the trend of these two subsectors will further contribute to the expansion of the manufacturing sector in Q2 2019, triggered by an increase in domestic demand ahead of Ramadhan and Eid Al-Fitr.

Another critical aspect that drives the growth of the manufacturing industry in the next quarter is the momentum of the 2019 general elections due to increased demand for these commodities during the campaign season. On the other hand, although the basic metals subsector only accounted for 4.3% of the total growth of the manufacturing industry, it increased markedly during Q4 2018 to 15.52% compared to 8.10% in the previous quarter, which resulted in an overall subsector growth of 8.98% (yoy) in 2018.

The manufacturing sector has been vital in boosting the potential growth of Indonesia’s GDP and, at least, in maintaining long-term growth. There is an urgency to revive the manufacturing industry to reduce the country’s dependence on exports based on raw commodities with relatively low complexity and linkages to other industries. Indonesia’s reliance on commodities is susceptible to market price fluctuations. It is therefore critical to focus on the creation of value-added in the economy, particularly in the manufacturing sector, so that the country can diversify their export products and participate more in the global value chain.

On the other hand, wholesale and retail trade grew at a modest pace during 2018, recorded at 4.99% in the full year of 2018, improving from a pace of 4.5% in the preceding year. This growth was supported by growth in the motor vehicles and motorcycle trade and repairs subsector by 5% and growth in the non-motor vehicles and motorcycle trade subsector by 4.99%.
“...In services, we also see a stimulus from fintech amid resilience in traditional financial, insurance and business services.”

Domestic demand powered the expansion of the wholesale and retail trade growth in 2018, aided by mild inflation, elevated consumer confidence, and a healthy labor market. Moreover, increasing sales or consumption in Indonesia among the lower class may also be attributed to retail sales growth. They were supported by social assistance programs and donations from candidates participating in the elections before the presidential and legislative elections in 2019. We forecast that the wholesale and retail trade industry will be strong in Q2 2019. This is underpinned by The Retail Sales Survey performed by Bank Indonesia, where faster sales growth will occur in the non-motor vehicles and motorcycle trade sub-sector, particularly in clothing, as the main engine of retail sales growth in the first quarter of 2019, with growth increasing to 34.1% (yoy) from 27.2% (yoy) last period. In addition, cultural and recreational goods also increased significantly from 11.0% (yoy) to 20.7% (yoy) due to Chinese Lunar New Year in February 2019.

Likewise, the growth of the transport and storage industry in Q4 2018 decreased slightly from 5.65% in Q3 2018 to 5.34%, while overall growth in the sector was rather high at 7.1% (yoy) in 2018. The biggest contributor to this sector came from the road subsector, with a growth of 7.2% in 2018. Likewise, storage & courier, sea, and railways had growth rates that are above the average growth in the transport and storage sector, with the growth of 8%, 7.4%, and 10.8% respectively. We assess that the rapid growth of the storage & courier subsector since 2016 reflected the high demand from society along with the ease of technology and information supporting the industry's development. Next, Indonesia has taken a good decision to improve the transportation and storage sector by facilitating logistics distribution. First, the government has accelerated the development of private investment in roads and railways, such as the construction of several toll roads both in Java and outside Java, and successfully managed to build both LRT and MRT in the capital and Palembang. Second, the development of sea tolls and the expansion and modernization of ports could offer attractive opportunities for investors in terms of infrastructure and port management while also becoming positive news for the sea transportation industry. With the various developments, we will continue to see an upward trend in the growth of the transportation and storage sector in 2019.

Based on our forecast for Q2 2019, manufacturing is expected to continue contributing to growth, just at a more moderate level. We see that various factors can drive growth in 2019. A possible cushion comes from continued improvement in the wholesale & retail and construction sectors, as well as a boost from the ICT and transportation & storage sectors. Greater contribution from retail and construction will offset an expected moderation in the
manufacturing industry. In services, we also see a fillip from fintech amid resilience in traditional financial, insurance and business services.

Q1 showed solid consumption growth, low-yet-stable inflation rate

Consumption growth in Q4 2018 was revealed to have recovered, making it slightly more favorable for overall growth in 2018 to reach the level of 5.01% (yoy). The composition of household consumption remained unchanged from the previous quarter, where more than half of consumption was spent on food and beverages, transportation and communication. Most of the components that constitute household consumption growth grew around 5% in 2018. Higher level of consumption growth in the last quarter was encouraged by a significant increase in spending transportation and communication (rising to 6.09% in Q4 from 5.34% in Q3 2018) and restaurant and hotel (rising to 5.79% in Q4 from 5.60% in Q3 2018) due to Christmas and New Year holiday.

Allocation of social assistance for lower-middle income contributed to this stable growth of consumption.

Allocation of social assistance for lower-middle income contributed to this stable growth of consumption. Implementation of this fiscal stimulus is expected to maintain the level of household consumption to achieve a sustainable economic growth in the first quarter of 2019. Consumer confidence in Q1 2019 was at 125 points, indicating a maintained and manageable consumer optimism. Up to the second month of this year, year-on-year credit growth rose higher than the previous quarter. It was attributable to a surge in loan disbursement from investment, working capital, as well as consumption. Nonetheless, election result is predicted to raise further credit growth in Q2 2019, especially for investment credit as policy for the next 5 years will be more straightforward and certain.

Headline and core inflation in the last month of Q1 2019, which respectively reached 2.48% and 3.03% (yoy), were relatively lower than 2018. The low level of headline inflation happened due to a drop in the price of food and commodities, include chickens, eggs, rice, and carrots. On the other hand, core inflation was stable at around 3 percent, slightly falling from 3.07 to around 3.04 in Q1. The price of airline ticket was one of the primary reasons for today’s inflation, which contributed around 0.03 percent. Altogether, inflation in the first three-months of 2019 has become the lowest since the year of 2016. Even worse, inflation in March was marked below the lower bound of BI’s inflation target, the lowest level in the past decade.
If inflation rate continually gets lower, it will likely raise policymakers’ concern about the economy. While there are still risks to domestic demand, expectations may heighten for Bank Indonesia to tighten monetary policy further. However, we still have to wait-and-see for inflationary pressure in the next three months, which is predicted to surge. Stronger demand for goods and services is projected to happen in line with Ramadhan and Eid al-Fitr momentum.

Higher Overall Investment Realization for 2018; to be Better in 2019

Amidst global uncertainty, released data show a 4% (yoy) growth in investment realization for domestic and foreign investment throughout 2018. After briefly declining in Q2-2018, higher realization in Q4 helped overall investment to grow from the previous year. The jump in Q4 realization from the previous year was mainly contributed by increasing FDI as well as stronger DDI realization throughout 2018. Based on the sector, domestic investment was still mainly contributed by construction, transportation, warehouse and telecommunications sectors with total contribution of industrial sectors amounting to 23.5% of the total DDI. On the other hand, foreign investment was mostly driven by electricity, gas, water supply, transportation, warehouse, and telecommunication, as well as mining sectors, with proportion of industrial sectors higher compared to domestic investment at 32.6% of the total FDI. However, the rise in industrial sector investment had yet to translate to manufacturing growth, given lower Q4 growth for this sector compared to the previous quarter. The need for most investment to be absorbed by the construction sector becomes clearer since this sector grew higher than overall GDP growth at 6.11% throughout 2018.
"the gap between the amount of FDI and DDI has been narrowing from the usual doubled amount of FDI in 2015 into a relatively slight gap. It reflects the growing confidence of domestic investors throughout last year."

Although investment realization has increased to around USD27 billion throughout 2018, it was still below the investment target and lower than the realization in the previous year, which amounted to USD31 billion. Based on its source, DDI realization showed a robust increase of 25% (yoy) while FDI realization was down at around 8% (yoy). Slowing investment inflows were mainly contributed by challenges from global uncertainty as well as lack of policy execution throughout 2018. Besides, foreign investors’ wait-and-see approach ahead of the 2019 general elections was also one of the key sources of the falling FDI. It should be noted, however, that the gap between the amount of FDI and DDI has been narrowing from the usual doubled amount of FDI in 2015 to a relatively slight gap. It reflects the growing confidence of domestic investors throughout last year. Our expectation remains that the declining trend of FDI will not continue in 2019 even though some of the implementation of 16th Economic Policy Package has been delayed due to the general elections on April 17th. Implementation of the Policy Package, coupled with government plans to relax restriction on foreign ownership in 49 business sectors, will further accelerate foreign investment realization.

Current Account will be Better as Trade Balance Improvement Continues Throughout 2019

After huge deficit in Indonesia’s trade balance throughout 2018, the first quarter of 2019 has given the country a larger-than-expected breathing space as the latest data showed a recovery signal, with trade surpluses of USD0.3 billion and USD0.5 billion in the two previous consecutive months, respectively. Trade balance improvement reduced the overall Q1 trade deficit down to USD0.19 billion from deficit of USD4.8 billion in Q4 2018. This was attributable to a sharp drop in imports driven by both oil and gas and non-oil and gas sectors. Government efforts to curb imports have started to bear fruits as data show a persistent decline in consumption goods imports since the end of 2018 with a 14.31% (yoy) drop in Q1 2019. Import growth of inputs and capital goods also flattened to 7.27% (yoy) and 4.17% (yoy), respectively. Looking further into the details, the reversal of non-oil and gas balance from deficit into surplus balance was mainly due to non-oil and gas imports decline outpacing the drop in non-oil and gas exports. The significant decline in non-oil and gas imports was dominated by machinery and electrical equipment (HS 85), which can be explained partly by the slowing down of export-oriented business expansion due to the downward trend in global commodity prices. Moreover, the completion of infrastructure projects this year is also expected to contribute to the decline of non-oil and gas imports.
In addition to the non-oil and gas improvement, the oil and gas trade deficit also narrowed in Q1 2019 on the back of lower volume of crude oil imports as oil and gas exports declined. The trend somehow reflects the implications of the B20 mandatory requirements as oil imports declined along with lower domestic production. Oil demand has partially shifted since the introduction of B20. Lower-than-expected trade deficit as contributed by both oil and gas and non-oil and gas balance improvement in Q1 are predicted to give positive signals of the current account performance, with the deficit standing around 2.24% of GDP, lower than 3.57% in Q4 2018 which was recorded as the worst deficit since 2014.

Based on the sector, there was no major changes in the structure of Indonesia’s exports and imports in February 2019. Exports were heavily dependent on the export of raw materials, particularly mineral resources, vegetable fat and precious metals with these three categories accounting for 39.6% of total export. On the other hand, electronics and machineries were still the highest import contributors with the proportion of 26.8% of total imports. Not only capital goods, our imports were also dominated by mineral resources, particularly oil, at least in these past five years. However, a gradual decline in oil imports since the end of 2018 has reduced the contribution of mineral resources imports in the beginning of the year as it only accounted for 13.4% of total imports, down from 19.7% in November 2018. Hence, the unexpected
Improvement of trade balance for overall Q1 should also be recorded in the changes of export and import structure in the upcoming March data.

The worsening current account position in Q4 2018 occurred as the implication of lower performance of exports due to uncertainty in global trade and falling commodity prices. Meanwhile, the upsurge in domestic demand particularly for infrastructure acceleration brought a high import growth. However, with the government playing an active role in managing current account deficit and unexpectedly lower external pressures, it could be assured that current account performance for the first quarter of 2019 have improved. It is projected to be around 2.2% of GDP. We also see that trade balance will remain unchanged or even get better for the upcoming quarters. This expectation is driven by the continuing implementation of B20 mandatory requirements as well as government efforts to further curb imports.

Rupiah has enjoyed a period of persistent strengthening since October 2018 until February 2019 before it slowly began to depreciate at the beginning of March 2019, with the currency briefly touching IDR14,300, the weakest point this year. Some global shocks such as higher oil price due to US sanctions against Venezuela, US-North Korea summit, and uncertainty towards Brexit have contributed to the temporary halt of the portfolio capital inflow. The pressure of Rupiah, thus, was caused by the profit-taking movement of traders in response to those global uncertainties. Moreover, the wait-and-see stance before the general elections has also slightly dampened the influx of portfolio capital. But we see that the trend is getting better as the general elections result on April 17th have caused the Rupiah to re-appreciate. If external stability is maintained with the US Fed’s continuing dovish monetary stance, the accumulation of portfolio capital inflow in emerging markets including Indonesia is projected to continue strongly throughout 2019.