

Indonesia: 2Q08 GDP surprised on the upside

Indonesia's GDP grew a stronger-than-expected 6.4%/y/y in 2Q08 (mkt:6.2%), up from 6.3% in 1Q08. The resilience of the economy was reflected in the pick-up in the growth momentum as q/q growth strengthened to 2.4% in 2Q08 from 2.2% in 1Q08 even as the external environment continued to deteriorate and the government hiked fuel prices by an average of 28.7% on 24 May. Consumption and fixed investment strengthened while exports stayed firm as commodities demand remained buoyant in the quarter. Government consumption rose a sharp +21.2%q/q in 2Q08 as authorities disbursed cash to cushion the hike in domestic fuel prices. While private consumption turned in +1.1%q/q growth in 2Q08, this component could come under stress going forward as the fuel price hike and interest rate increases take their toll. However, the strong GDP growth in 1H08 could help the Indonesian economy achieve a 6% growth rate this year, which is in line with the government's target and higher than our forecast of 5.7%.

Implication on interest rate policy

The BI hiked its benchmark overnight rate by 25bps to 9.00% in August -- the fourth consecutive month of rate increase since May as the central bank stepped up its fight against inflation which surged to 11.9%/y/y in July. The accompanying statement showed that the BI has remained hawkish as it highlighted ongoing "risks of inflationary pressures from global oil and food prices, as well as from domestic demand". This is further reinforced by the strong GDP growth in 1H08.

However, as we expect the inflation rate to come in well-within the BI's 6.5%-7.5% target by the end of 2009, we do not think the BI will hike rates much more from here, especially with growing concerns over a sharper global economic slowdown. We were previously expecting the BI to stop at 9.00% but the hawkish statement and growth remaining buoyant in 2Q08, suggest probably another 25-50bps more.

The tight monetary policy stance and a resilient domestic economy are expected to support the IDR in the near-term but we expect USD/IDR to end slightly higher at 9,200 year-end compared to 9,176 currently as the impact of the monetary tightening could start to undermine the domestic unit in 4Q08.

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