

# ■ Indonesia

UOB Economics Projections	2007	2008	2009F	2010F
GDP	6.3	6.1	4.0	5.2
CPI (average, y/y)	6.4	9.8	5.0	6.5
Unemployment Rate (%)	9.1	8.4	9.0	8.5
Current account (% of GDP)	2.4	0.1	1.9	0.6
Fiscal balance (% of GDP)	-1.3	-0.1	-2.5	-1.5

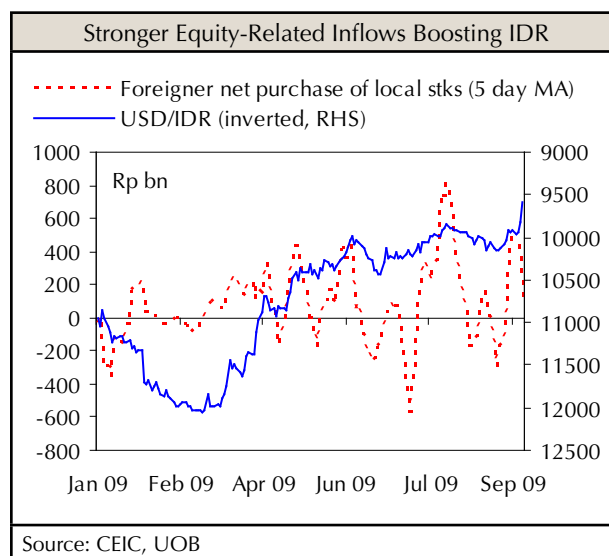
*The IDR has risen by more than 10% against USD YTD, making it the best performing Asian currency. Our year-end target for USD/IDR has shifted lower to 9,500, representing around 15% IDR appreciation for the year.*

*Taking into account the relatively resilient Indonesian economy and rising inflation by early part of next year, we expect the BI to be one of the first Asian central banks to begin hiking interest rate in 2Q10. We are expecting the central bank to raise the overnight rate by 125bps to 7.75% by end-2010.*

*We expect the growth momentum to continue strengthening in 3Q although the y/y growth rate probably eased slightly due to high base effect. We are maintaining our full-year growth forecast for the country at 4.0% this year but there is potential for some upside performance.*

Indication that the global economy is emerging from the economic slump and Moody's sovereign rating upgrade on the country are key factors for the IDR's rise to its YTD high of 9,580/USD in mid-September. The IDR has risen by more than 10% against USD YTD, making it the best performing Asian currency. More stable domestic politics, rebound in global risk appetite and the improvement in Indonesia's current account were also contributing to the currency's strength. In 1H09, the current account improved sharply to a surplus of around US\$6.0bn from a deficit of US\$1.6bn in 2H08 as non-oil goods imports contracted by a sharper pace compared with exports. Despite recent warnings from BI acting governor Nasution over the pace of IDR appreciation, we doubt the central bank wants to appear overly concerned given the currency's vulnerability to shifts in sentiment. The BI's record of interventions to support the IDR is also indication that it sees a stronger currency as an important tool to help anchor imported inflation in the country.

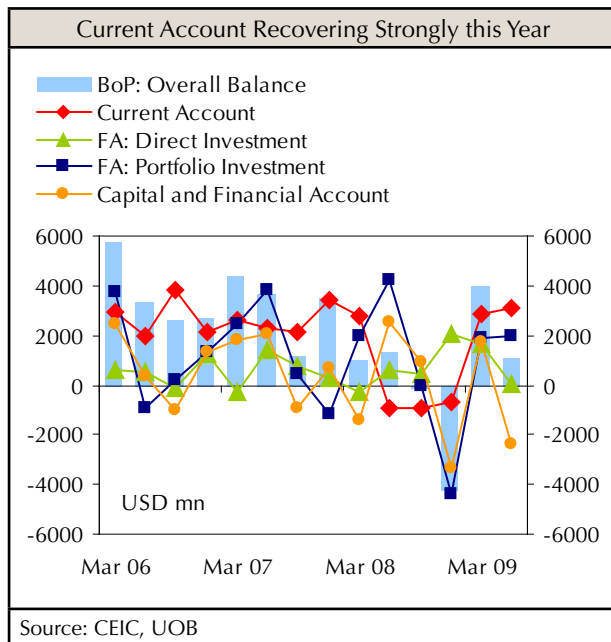
With USD/IDR on a bearish momentum, the downside for the pair could be stretched to around 9,400. However, lingering uncertainties over the pace of recovery in the global economy would likely cap further downside from there. Our year-end target for USD/IDR has also shifted lower to 9,500, representing around 15% IDR appreciation for the year.



## Monetary Policy Tightening to Start in First Half Next Year

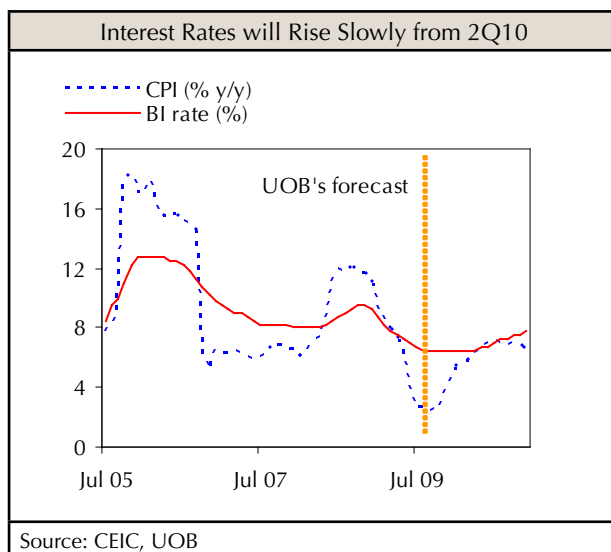
Headline inflation has dropped sharply to under 3.0%/y in 3Q09 from double-digit levels in 2H08, enabling the BI to cut its benchmark overnight rate aggressively from high of 9.5% in November last year to 6.5% in August. Since then, the BI has kept the interest rate steady in September and said that there is a tendency to maintain interest rates unless incoming data changes significantly. The BI views the current overnight rate of 6.5% consis-

## Indonesia



tent with its inflation target of 5% next year.

However, our calculation shows that the inflation rate is likely to rise above 5%/y by early part of 2010 and then rise towards 7% by 2H10. Recovery in domestic demand and rebound in commodity prices pose some upside risk to inflation next year although the strength in IDR is helping to cap imported inflation in the country. Taking into account the relatively resilient Indonesian economy and rising inflation by early part of next year, we expect the BI to be one of the first Asian central banks to begin hiking interest rate in 2Q10. We are expecting the central bank to raise the overnight rate by 125bps to 7.75% by end-2010.

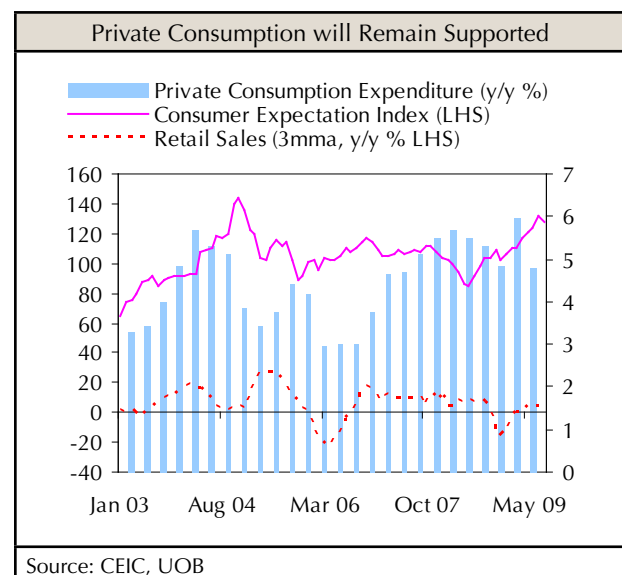


## Maintaining Moderately Loose Fiscal Policy

The Indonesian government is expecting its budget deficit to be reduced to 1.6% of GDP in 2010 from an estimated 2.5% deficit in 2009. This is moderately higher compared with an average budget deficit of 0.8% of GDP in the five preceding years. The government forecast was based on growth and inflation assumption of 5% in 2010 and an expected 4.5% increase in revenue while total expenditure will only see modest increase. The key will be the crude oil price which is assumed to average US\$60/bbl next year. An increase in average oil price by US\$10/bbl is likely to increase the budget deficit by around 0.4ppt of GDP given that the country is a net oil importer. Total subsidies spending on fuel oil, electricity, agricultural and food is projected to fall to 14.3% of the total expenditure in 2010 from an estimated 18.3% this year, but whether that could be attained is highly dependent on the movement of global energy prices. However, given the typical slow disbursement of the funding, Indonesia's actual budget deficit for 2010 could be lower-than-expected.

## 2Q09 GDP: Momentum Continues to Strengthen

Indonesia's 2Q09 GDP growth came in above expectation at 4.0%/y/y. The growth momentum also strengthened to 2.3%q/q from 1.7%q/q in 1Q09. Although the positive momentum in private consumption eased in the quarter, the segment remained one of the key contributors to the y/y growth rate. Government consumption kept up its stellar performance with double-digit y/y growth but this should taper off in the next two quarters following the completion of the presidential elections in July as well as the high base effect. Despite the weak-



## ■ Indonesia

er-than-expected rebound in the q/q fixed investment growth, we see some upside in this segment given the successful elections in the country and strong mandate for President Yudhoyono (SBY) and his Demokrat Party further reinforced positive investor sentiment. Foreign direct investment at US\$8.7bn in 2008 was less than 10% of the amount going to China and that should improve alongside the positive political developments and stabilisation in the global outlook. So far, Indonesia's export has remained weak in 2Q with a contraction of 15.7% y/y. Nonetheless, with imports falling by a sharper 23.9%y/y,

net exports' contribution to the y/y GDP growth rate rose to 2.0ppt from 1.2ppt in 1Q.

We expect the growth momentum to continue strengthening in 3Q although the y/y growth rate probably eased slightly due to high base effect. We are maintaining our full-year growth forecast for the country at 4.0% this year but there is potential for some upside performance. For 2010, the economy is likely to expand at a faster pace of 5.2% on the back of a more solid recovery in external demand.

2Q09 GDP: Private Consumption Remained Key to Growth							
	2008	2Q08	3Q08	4Q08	1Q09	2Q09	2Q09
	y/y % change						Ppt Cont
GDP	6.1	6.4	6.4	5.2	4.4	4.0	4.0
Consumption	5.9	5.5	6.3	6.4	7.2	6.3	4.0
Public	10.4	5.3	14.1	16.4	19.2	17.0	1.3
Private	5.3	5.5	5.3	4.8	6.0	4.8	2.7
GFCF	11.7	12.0	12.2	9.1	3.4	2.7	0.6
Change in stocks (as % of GDP)	0.2	0.2	0.3	-0.4	-0.3	0.2	0.0
Net Exports	7.3	-1.9	9.0	25.5	12.1	21.5	2.0
Exports	9.5	12.4	10.6	1.8	-18.7	-15.7	-8.0
Imports	10.0	16.1	11.0	-3.5	-26.0	-23.9	-9.9
Source: CEIC, UOB							