Indonesia Economic Briefing

BI Rate: stay amid positive data

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BI Rate unchanged at 7.50%

- **Today, as expected, BI decided to keep the benchmark policy rate at 7.50% since Dec-13.** The deposit facility rate also unchanged at 5.75%, while the lending facility rate stayed at 7.5%.
- As the inflation trend is trending down, the trade balance returns to surplus, and the Rupiah strengthened back to the level of Rp11,293/USD (Apr 8). This means less pressure for BI to raise rate. We should see further whether this improving trade balance as a result of downfall on imports will last. BI is optimistic that the current account deficit in the first quarter could fall below 2% of GDP (1Q BoP data due in May). This highlights the lagging impact of the sharp policy rate hike last year on the economy.
- BI are less optimistic on the global economic recovery citing concern on the rebalancing China's economy. This led to a more moderate tone on the exports outlook as external demand has not recover and there could be some temporary impact of the ore exports partial ban. BI still expect the economic growth of 2014 to be in the range of 5.5-5.9% (from previously 5.8-6.2%).
- Despite the large capital inflows up to March, foreign exchange reserves decrease slightly to USD102.6bn in March or equal to 5.7 months of imports and foreign debt repayment, mainly due to matured by global bonds of USD1.3bn in March.
- Credit growth slowed further to 19.9%yoy in Feb-14 from previous level of 20.9%yoy in Jan-14.

Market and Policy Implications

- Expect further improvement on the CA deficit though we are slightly more pessimistic particularly on the slow recovery of the exports determinants (i.e. global commodity prices, and trading partner's economic performance esp. China). Meanwhile on the imports side, although we see some continued declines in the non oil and gas imports, but concern remained on the remaining high fuel imports. Therefore, we still expect CA deficit to narrow further to 2.9% of GDP this year.
- The burden of fuel imports particularly the subsidized one is also one of the factor that weighing on the fiscal performance. The government is expected to propose the revision of the state budget in May, as many of the macro assumptions has deviated (i.e. slower growth, weaker exchange rate and lower oil lifting). We expect the fiscal deficit could be bigger than previously assumed. The government may propose the fixed subsidy scheme on fuel or cut other spending.
- Another fuel price hike increase may also be an option, though we think it is less likely to happen this year as it is the election year. Raising subsidized fuel price would be best done in around March-April, when the inflation pressure is seasonally low. Therefore we think the inflation forecast is still on track (4.94%

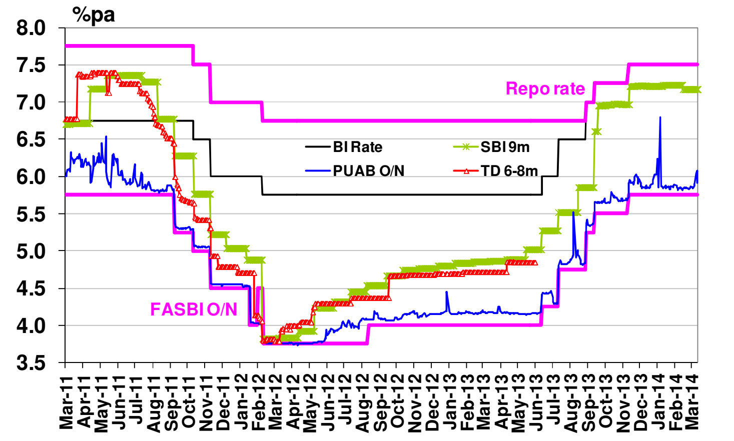
YE), though we are watching out for the El Nino effect on food prices and the passthrough impact of the electricity rate hike for the industrial users.

- Therefore this year's policy direction will still be tight, thus we have not rule out the chance of a rate hike, and still expect another 25bps rate hike, especially if external sentiments worsen and affect the rupiah. However the chances of rising pressure on the rupiah may be getting slimmer. From the external factor, most market participants are already able to price in the further tapering of the Fed. Nevertheless we still have to watch out for the seasonally high dollar demand in May-June for dividend payment. Though we think any pressure should be temporary as the fundamental economy remained on track. Furthermore a positive result on the election should help boost more confidence to the economy. We maintain our forecast that the rupiah could strengthen to around Rp11,058/USD by year end.

Chart 1. Rupiah (IDR) vs 10 Yr Bond Yield

Source: Bloomberg

Chart 2. Interest Rate



Source: Bloomberg

Indonesia: Selected Economic Indicators

	2010	2011	2012	2013	2014E	2015E
National Accounts						
Real GDP (% y-o-y)	6.2	6.5	6.2	5.8	5.7	6.2
Domestic demand ex. inventory (% y-o-y)	5.3	5.7	6.2	5.1	5.5	5.7
Real Consumption: Private (% y-o-y)	4.7	4.7	5.3	5.3	5.2	5.4
Real Gross Fixed Capital Formation (% y-o-y)	8.5	8.8	9.8	4.7	4.0	6.8
GDP (US$bn) — nominal	710	845	879	871	925	1,086
GDP per capita (US$) — nominal	2,986	3,509	3,596	3,490	3,640	4,215
Open Unemployment Rate (%)	7.1	6.6	6.1	6.3	6.1	6.1
External Sector						
Exports, fob (% y-o-y, US$ bn)	32.1	27.0	-6.1	-2.6	4.2	6.0
Imports, fob (% y-o-y, US$ bn)	43.7	30.3	8.4	-1.4	3.5	4.2
Trade balance (US$ bn)	30.6	34.8	8.6	6.1	3.3	6.8
Current account (% of GDP)	0.7	0.2	-2.7	-3.3	-2.9	-2.4
Central government debt (% of GDP)	26.1	24.6	23.1	22.0	21.2	22.2
International Reserves –IRFCL (US$ bn)	96.2	110.1	112.8	99.4	100.0	103.5
Reserve Cover (Months of imports & ext. debt)	7.1	6.3	6.1	5.4	5.6	5.8
Currency/US$ (Year-end)	8,991	9,068	9,670	12,189	11,058	10,754
Currency/US$ (Average)	9,085	8,779	9,380	10,428	11,605	10,770
Other						
BI policy rate (% year end)	6.50	6.00	5.75	7.50	7.75	8.00
Consumer prices (% year end)	6.96	3.79	4.30	8.38	4.94	4.61
Fiscal balance (% of GDP; FY)	-0.73	-1.14	-1.77	-2.24	-1.80	-2.00
S&P's Rating – FCY	BB	BB+	BB+	BB+	BB+	BB+

Source: CEIC, *Danamon Estimates

Economic and Market Research

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