Indonesia Economic Briefing

BI Rate: unchanged at 7.5%

Dian Ayu Yustina
Economist/Bond Analyst
dian.yustina@danamon.co.id

BI Rate stays as economic growth slows down

- **Today, as expected, BI maintained the benchmark policy rate at 7.50%.** The deposit facility rate also unchanged at 5.75%, while the lending facility rate stayed at 7.5%.
- The decision came amid weak data on economic growth despite the slight improvement in the Balance of Payment, with the CA deficit remains relatively unchanged from the previous quarter.
- **First quarter GDP this year slowed down significantly at 5.2%yoy**, below the central bank's expectation. The real exports contraction was the main cause as exports of copper and mineral was down, negatively affected by slowing global demand and low global prices. The government's regulation on partially banning the raw mineral exports also give some temporary impact to the downfall. Meanwhile domestic demand is still relatively strong, driven by election related consumption and a slight pick up in the investment growth. With the recent development, BI revised down growth target to 5.1-5.5%yoy.
- **The slowdown in exports led to a less favorable improvement in the current account deficit.** CAD in 1Q was at 2.06% of GDP, only slightly improving than the previous quarter (2.12% of GDP). The improvement owed to contraction in non oil and gas imports and also the narrowing deficit of the services balance. The overall balance of payment is still in surplus due as capital inflows remained positive. This led to a higher accumulation of forex reserves which rose by USD3bn to USD 105.6bn, equal to 5.9 months of imports and debt repayment. However, BI expects, in the next two quarters, CAD may still widen as in line with the seasonal factor (i.e. seasonally high imports during the upcoming Moslem's fasting and Lebaran festivities, dividend repatriation and interest payment). For the overall year, BI expects deficit could still fall below 3% of GDP.
- BI's inflation target remained in the range of 3.5-5.5%, though expects the YE inflation to fall at around 5% after factoring in the segmented electricity rate hike and El Nino effect.
- Credit growth slowed further although still in a moderate pace from 19.9%yoy in Feb-14 to 19.1%yoy in March. On the conference call BI reiterate that overall liquidity condition on the economy is in line with the monetary tightening. The problem remains in the distribution of liquidity among banks. However interbank repo transaction volume keep rising (helped by the enacment of the mini MRA), which eventually helped the overall banking liquidity.

Market and Policy Implications

- We are more pessimistic on the inflation after the electricity rate hike. **We see the inflation rate by YE could reach around 5.4%yoy, though still within the BI's inflation target range.** Thus, if all else equal (assuming no fuel price hike), BI may still keep the BI rate unchanged until end of the year. However, if the slow improvement in the current account deficit negatively affect the rupiah, we may still expect another 25bps hike on the policy rate.

- However the fuel subsidy reform has been the main talk lately, thus we should see further the picture of the 2014 state budget revision that will be proposed to the parliament possibly in May 20th. On the conference call, the MoF reiterate that it will propose to decrease the revenue target, increase subsidy spending (due to deviations in the macro assumptions) which will result in a wider deficit, though it is implied that the government would still able to keep it below 3% of GDP.

- Few months ahead will be an interesting period. The government will propose the 2015 state budget and 2014 state budget revision in May, while we are also preparing for the July's presidential election. We may see some pressure on the rupiah in the next two months, particularly due to the seasonally high dollar demand for dividend payment and interest payment. But we see some positive sentiments coming back once the new government is elected. We maintain our forecast that the rupiah could strengthen to around Rp11,058/USD by year end.

Indonesia: Selected Economic Indicators

	2010	2011	2012	2013	2014E
National Accounts					
Real GDP (% y-o-y)	6.2	6.5	6.3	5.8	5.3
Domestic demand ex. inventory (% y-o-y)	5.3	5.7	6.1	5.1	5.4
Real Consumption: Private (% y-o-y)	4.7	4.7	5.3	5.3	5.4
Real Gross Fixed Capital Formation (% y-o-y)	8.5	8.8	9.7	4.7	4.0
GDP (US$bn) — nominal	710	845	879	871	897
GDP per capita (US$) — nominal	2,986	3,509	3,596	3478	3,538
Open Unemployment Rate (%)	7.1	6.6	6.1	6.3	6.1
External Sector					
Exports, fob (% y-o-y, US$ bn)	32.1	27.0	-6.1	-2.6	2.2
Imports, fob (% y-o-y, US$ bn)	43.7	30.3	8.4	-1.4	3.7
Trade balance (US$ bn)	30.6	34.8	8.6	6.1	3.6
Current account (% of GDP)	0.7	0.2	-2.7	-3.3	-2.9
Central government debt (% of GDP)	26.1	24.6	23.1	22.0	21.2
International Reserves –IRFCL (US$ bn)	96.2	110.1	112.8	99.4	100.8
Reserve Cover (Months of imports & ext. debt)	7.1	6.3	6.1	5.4	5.6
Currency/US$ (Year-end)	8,991	9,068	9,670	12,189	11,058
Currency/US$ (Average)	9,085	8,779	9,380	10,428	11,605
Other					
BI policy rate (% year end)	6.50	6.00	5.75	7.50	7.75
Consumer prices (% year end)	6.96	3.78	3.65	8.08	5.37
Fiscal balance (% of GDP; FY)	-0.73	-1.14	-1.77	-2.24	-2.20
S&P's Rating – FCY	BB	BB+	BB+	BB+	BB+

Source: CEIC, *Danamon Estimates

Economic and Market Research

Anton Hendranata anton.hendranata@danamon.co.id	**Economist / Econometrician**	**+62 21 5799-1563**
Dian Ayu Yustina dian.yustina@danamon.co.id	**Economist / Bond Analyst**	**+62 21 5799-1563**

PT Bank Danamon Indonesia, Tbk.
Menara Bank Danamon
Jalan Prof. Dr. Satrio Kav. E IV #6
Mega Kuningan, Jakarta 12950
INDONESIA
***
Facs: +62 21 5799-1048

ANALYST CERTIFICATION

We hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views in this report.