



Indonesia

Outlook

	Average 10-14	Forecasts							
		2015	2016	2017	2018	2019	2020	2021	2022
GDP growth (%)	5.8	4.9	5.0	5.1	5.2	5.0	-2.0	4.0	5.5
CPI inflation (%)*	5.5	6.4	3.5	3.8	3.3	2.8	2.0	2.5	3.3
Fiscal balance (% of GDP)	-1.6	-2.6	-2.5	-2.5	-1.8	-2.2	-6.5	-4.9	-4.0
Public debt (% of GDP)	24.0	27.0	28.0	29.4	30.1	30.5	38.5	41.8	43.2
Reference rate (%)*	6.6	7.5	5.6	4.6	5.1	5.6	4.3	3.7	3.9
Exchange rate (IDR/USD)*	11,439	13,458	13,330	13,398	14,267	14,131	14,627	16,100	15,000
Current account balance (% of GDP)	-1.6	-2.0	-1.8	-1.6	-2.9	-2.7	-1.3	-2.4	-2.3
External debt (% of GDP)	28.6	36.4	33.2	34.2	36.5	35.3	37.9	42.0	44.0

Note: * Annual average.

Source: BPI Research, based on data from national statistical agencies and IMF.

- Although the impact of COVID-19 has not been extraordinary, Indonesia's medium-term prospects are moderate.** After the fall in GDP of 2.0% in 2020 and the modest recovery expected in 2021 (+4.0%), due to the pandemic, the slow pace of the reforms will cause growth from 2022-2025 to be just above 5%, below its potential, which we estimate to be around 7%. Currency tensions and pressure on public finances will be a concern over the next two years. However, in the long term, Indonesia, which is the fourth most populous economy in the world, has favourable assets, such as strong demographics (young population), cheap labour and an abundance of cobalt and nickel. All this, in the context of the move towards the electric car, puts the archipelago in the sights of companies like Tesla, Hyundai and Toyota. Indonesia also expects to establish a sovereign wealth fund, like Temasek from Singapore, for which the investment promised from United Arab Emirates of 23 billion dollars in infrastructure is key.
- Real shock of COVID-19.** Deaths per million (62 in November 2020) exceed the average of ASEAN, but are less than those in southern Europe and Latin America. The virus will not be controlled until the second half of 2021 (the country has established ambitious agreements with pharmaceutical companies to have enough vaccines). It is estimated that for every two weeks of closure of the conurbation of the capital, Jakarta, between 2 and 3 tenths of a percentage of annual GDP growth are lost. A serious effect of the pandemic is the drop in tourism, which according to the World Travel & Tourism Council, represented 10.3% of GDP in 2019. There will, therefore, only be a modest recovery in 2021. According to the IMF, in 2022 Indonesia's real GDP level will be 5.5% below what was expected at the end of 2019 (Malaysia, -6.6% and Singapore, -3.3%).
- Financial vulnerabilities.** Indonesia's proportion of debt in foreign hands is higher than that of its ASEAN neighbours (39% of the 179 billion dollar bond market in June 2020, compared to Malaysia 24%; Thailand, 18%, and the Philippines, 8%). Indonesia receives 2% of its GDP in direct investment, significantly below other ASEAN countries (Vietnam, 6%, Malaysia and the Philippines, 3%, and Thailand, 2.7%). The predominance of portfolio investment over direct investment, which is more stable, is a source of financial instability. The dependence on commodities, even considering the upward outlook for nickel, palm oil and cobalt in the context of a future global recovery, is a risk given the high volatility of their price in international markets.

Outlook (continued)

• Economic policy response

- Health policy.** The demographics of Indonesia, with a population of 269 million, 141 of which are concentrated on the island of Java, with a population density of 1,121 inhabitants/km², makes it difficult to control the pandemic. Indonesia follows a moderate lockdown approach, restricted to outbreaks with the highest infection rates.
- Fiscal policy.** Public deficit may exceed the –6.5% of GDP forecast in 2020 and public debt, 38% of GDP. The pandemic has caused the postponement of the controversial 31 billion dollar (3% of GDP) project for a new capital in East Kalimantan, on the island of Borneo (the capital Jakarta has large areas below sea level that hinder the development of the metro and an excess population).
- Monetary policy.** The central bank made in 2020 four reductions of 25 bp in the reference rate and implemented quantitative easing (purchases of bonds of 27.6 billion dollars and non-marketable securities for 8.6 billion, a total of 3.3% of GDP). The latter is exceptional in nature and is not expected to be repeated. However, further rate cuts are expected at the beginning of 2021.

- Exchange rate trends.** The Indonesian rupiah (IDR) will depreciate 9% against the dollar in 2021, from an average of 14,600 IDR per dollar in 2020 to 16,000 IDR. The central bank, which is the guarantor of exchange rate stability, will be limited in its ability to defend the currency as the recovery of advanced economies coincides with the moderate recovery of Indonesia, with growth below the average in recent years. From 2022, with advances above 5%, the IDR should see a recovery (15,000 IDR per dollar).

Main risks

• Political risks

- The government of President Jokowi, characterised by balances of power, is a mix of reformist ministers such as Nadiem Makarim (Education) and Sri Mulyani (Economy) and traditionalists, such as the Defence Minister Prabowo Subianto. This makes it problematic to agree on the necessary reforms. Thus, the anti-corruption law approved by Parliament in 2019 led to the weakening of the anti-corruption commission. For its part, the vagueness of the Omnibus law, approved in October 2020 to deregulate the job market, intellectual property and reduce obstacles to foreign investment (with reductions in the tax rate on profits from 25% to 20% in 2023), could halt the necessary recovery of direct investment.
- The independence of the central bank, one of the most respected institutions in the country since the 1999 law, whose objective is the stability of the IDR and which prohibits the purchase of state debt outside the secondary market, may be compromised. The pandemic has increased political pressure for growth and job creation to be included in BI's objectives. The continued presence of the Economy Minister Sri Mulyani, however, acts as a curb on this pressure.
- President Jokowi, without his own party, cannot secure a reformist successor by the time he leaves office by law in 2025.

• Sovereign risk

- In 2021, the pressures on the public deficit, and consequently on public debt, will be significant, so the departure from the usual path of controlling budget imbalances may be more permanent than is desirable. Based on macro fundamentals, we estimate that there could be a decline of around one notch in 2021 in the sovereign credit rating and there may be additional downward pressure on the credit rating. In this context, if the rating agencies consider that the erosion of fundamentals is not temporary, the country could lose its investment grade rating.

	Rating	Last changed	Outlook	Last changed
STANDARD & POOR'S	BBB	21/05/17	Negative	21/05/17
MOODY'S	Baa3	08/02/17	Positive	08/02/17
FitchRatings	BBB	21/12/16	Negative	21/12/16

■ Indicates that the country has "investment grade".

□ Indicates that the country does not have "investment grade".