

Solid growth facing a downside risks for stability



Key Takeaways

- Indonesia's GDP grew +5.44% YoY in 2Q22, above consensus/MNCS estimate at +5.17%/+5.22% YoY.
- Such impressive growth was driven by raising HH consumption and exports amidst : 1) improving mobility; 2) favorable macro condition; 3) holiday & festive momentum as well as 4) the windfall effect from commodity boom.
- Challenge remains on higher than expected inflation with : 1) higher mobility coupled with high oil price; 2) extreme weather to cause supply shock; and 3) pass on higher input cost as domestic economy continue to strengthen.
- Pressure on IDR has caused domestic CB to intervene reflected by the drops in FX reserves (-USD4.2bn MoM) with imports coverage declined to 6.2 months in Jul-22 (vs 6.6 months in Jun-22).
- We expect BI to raise benchmark policy rate by +25 bps thus Aug-22 to stabilize the IDR and managing inflation.
- Expecting a more normalized growth in 2H22 on the back of rising inflation and potentially lower trade surplus due to commodity prices moderation.

2Q22 GDP grew impressively

Indonesia's GDP grew +3.72% QoQ/+5.44% YoY in 2Q22. The actual figure was higher than consensus & MNCS estimate at 5.17% YoY and 5.22% YoY respectively. Such impressive performance was driven by : 1) solid consumption (+5.51% YoY) and 2) solid exports (+19.74% YoY). Household consumption continued to show an improvement on the back of : 1) increase in mobility; 2) favorable macro policy including low interest rate environment to cause an increase in loan & M2; 3) holiday and festive momentum. Interestingly, consumers are not only spending but also deleveraging. Meanwhile exports jump was largely driven by the windfall effect from commodity boom. Cumulatively, Indonesia's trade balance recorded a surplus of USD81.92bn since the beginning of pandemic. However, government spending declined by -5.24% YoY. Worth noting that government budget recorded a surplus of 0.39% GDP in Jun-22 on the back of increasing revenue (+48.5% YoY) while state expenditure only reached 40% of the target. Domestic economy remained strengthening in 2Q22 amidst unfavorable global macro : 1) war; 2) high inflation and 3) aggressive monetary tightening.

Inflation still above the upper target

Albeit, the recovery to remain intact, domestic economy faces another challenge from rising consumer prices. Headline inflation was reported to increase by +4.94% YoY in Jul-22, the highest since Oct-15. Such figure also indicated that the actual inflation has overshot BI's upper target of 4% twice since Jun-22. So far, domestic inflation was largely driven by volatile prices such as food and administered prices as government adjusted non-subsidized fuel price and electricity prices. Food prices volatility to remain concern on the back of extreme weather that negatively affect production in some horticulture producing area. On the other hand, core inflation also rose by +2.86% YoY.

Despite the figure looks manageable, we expect inflation is still skewed towards the upside, considering : 1) increasing mobility coupled with high oil prices; 2) prolonged IDR depreciation that may cause core inflation to increase further as well as 3) the pass on effect from producers to consumers as economic strengthen to add more inflationary pressure given PPI increase has outperformed the pace of both headline & core inflation. With such condition headline-7 day reverse repo spread turned to -144 bps while spread between core-7 day reverse repo rate narrowed to -64 bps. Furthermore, based on recent BI survey, CPI for Aug-22 is expected to record a deflation of -0.08% MoM. Albeit the possibility of deflation, headline CPI would still recorded an annual increase of +4.82% YoY (+82 bps above upper BI's target).

Pressure on IDR

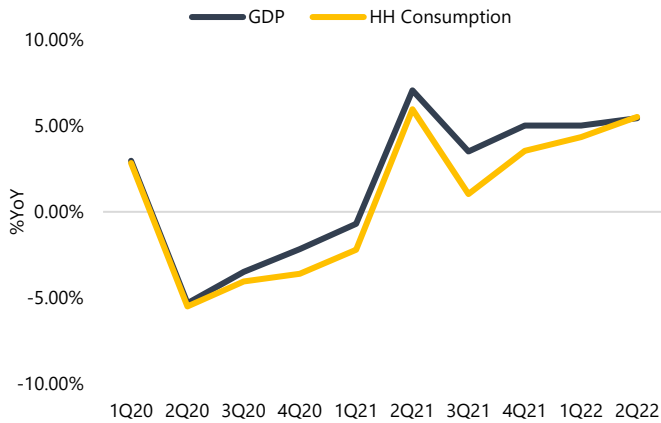
The IDR has depreciated by against USD (-4.74% YTD). The domestic currency hit 15,000/USD several times in Jul-22. Pressure on IDR slowing in the last day of Jul-22, however, we see that BI took an intervention to stabilize IDR reflected by the drop in FX reserves (-USD4.2bn MoM) bringing the position of FX reserves to cover 6.2 months of imports. This also marked a decline in imports coverage from Jun-22 FX reserves position adequate to cover 6.6 months of imports. In addition, we also noted that IDR movement in NDF market has reached above 14,930/USD for 1M contract. With such circumstance, we expect BI to raise 7-day reverse repo rate by +25 bps in Aug-22.

Downside risks ahead

We expect global risk to remain linger in 2H22. Geopolitical risks include 1) unresolved conflicts between Russia & Ukraine as well as 2) another deteriorating US-China tie over Taiwan recently. Despite inflation is expected to normalize in 2H22, we still see that major AE CBs particularly the Fed to further raise the borrowing cost causing global liquidity to further tightening. With global growth & trade volume is expected to slow, we see a downside risks for commodity price that may result lower trade surplus for Indonesia. Under the scenario of higher inflation that could affect consumption and lower trade balance, we expect a more normalized growth for domestic economy in 2H22.

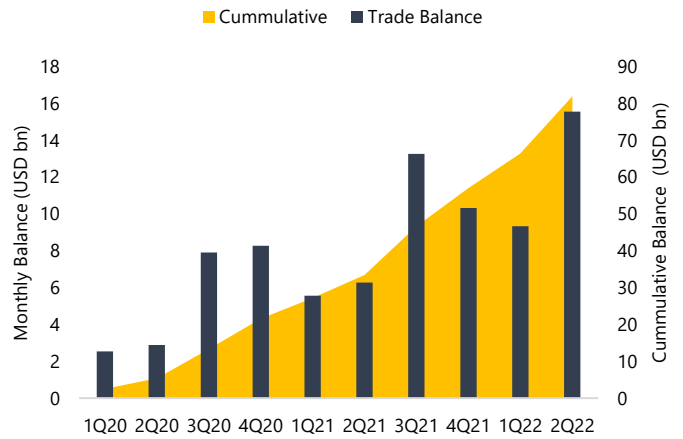
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Exhibit 1. GDP grew impressively driven by raising consumption



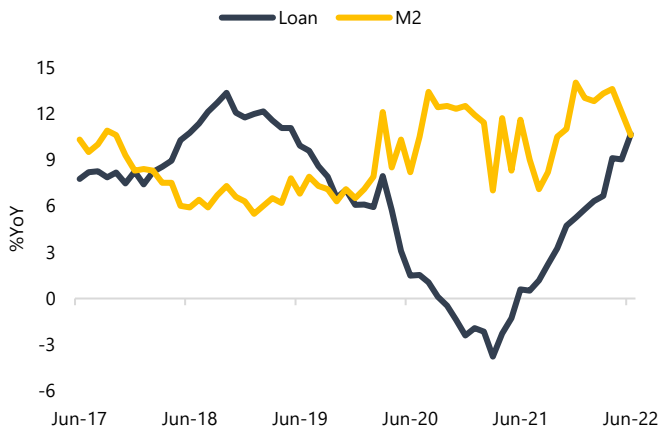
Sources : Statistics Indonesia, MNCS Research

Exhibit 2. Trade balance surplus favoring output growth



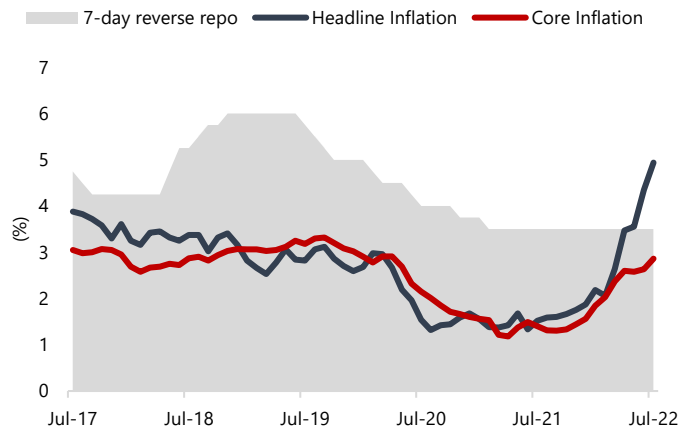
Sources : Statistics Indonesia, MNCS Research

Exhibit 3. Adequate liquidity also support growth momentum



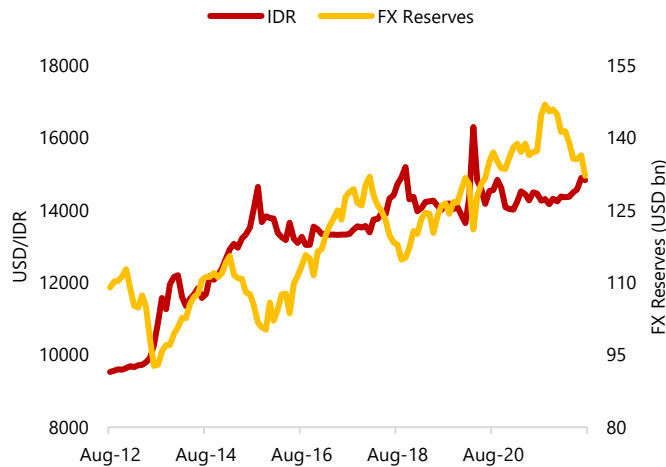
Sources : Bank Indonesia, MNCS Research

Exhibit 4. Challenge on inflation overshooting BI target



Sources : Bank Indonesia, Statistics Indonesia, MNCS Research

Exhibit 5. Weakening IDR took BI to intervene



Sources : Bank Indonesia, Bloomberg, MNCS Research

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