

# Indonesia

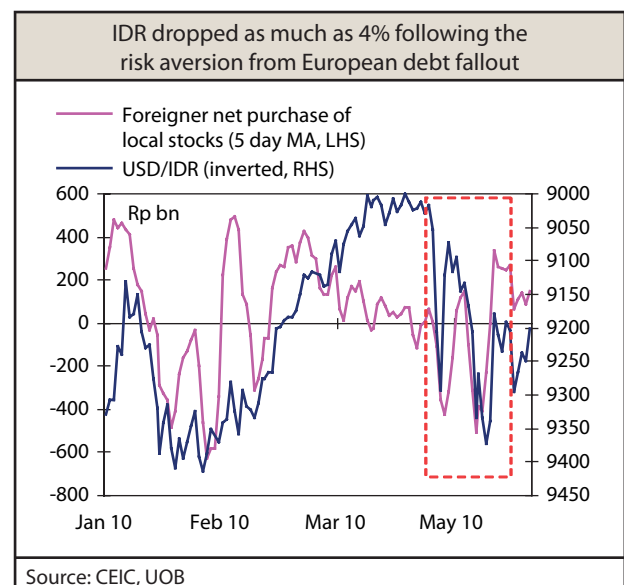
UOB Economic Projections	2008	2009	2010F	2011F
GDP	6.0	4.5	6.0	6.2
CPI (average, y/y)	9.8	4.8	4.7	6.7
Unemployment (end-4Q)	8.4	7.9	7.5	7.2
Current account (% of GDP)	0.0	2.0	1.3	1.0
Fiscal balance (FY, % of GDP)	-0.1	-1.6	-2.0	-1.5

- While we expect the current account surplus to narrow to 1.3% of GDP this year from 2.0% in 2009, investment inflows are likely to remain supportive, particularly as economic growth in the region is expected to stay firm. Under our assumption of a gradual RMB appreciation pace, USD/IDR is likely to consolidate lower at 9,000 by end-3Q10 before breaking the key support to end at around 8,950 by end-4Q10.
- The mild inflationary pressure in 1H10 has caused us to pare back our forecast for the overnight rate hike to 50bps for this year with the interest rate hike likely to begin in 4Q10.
- We are expecting relatively stable y/y growth in the remaining quarters this year to bring the full-year growth to around 6.0%.

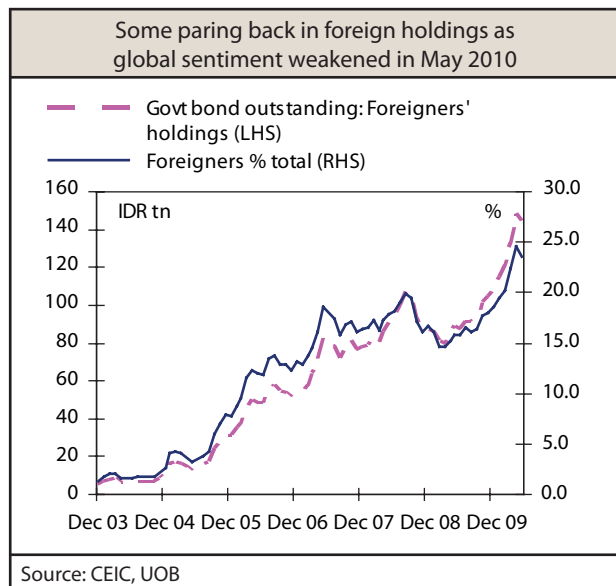
USD/IDR was choppy in 2Q10, easing off after a 4% rise from its low of around 9,000 as market stabilized following its initial reaction to the European debt and fiscal crisis. Subsequently, China's decision to return to its currency reforms led to a rally in Asian currencies, including the IDR in the later part of June.

Domestically, BI's measures to discourage further short-term capital inflows in mid-June were the focus. Given the volatile market conditions, there were concerns that the strong capital inflows into Indonesia post-global financial crisis would make the country more vulnerable to hot money reversals. This was particularly so for the bond market as foreigners hold around a quarter of the Indonesian government bonds. Against earlier expectations that the BI could restrict foreign buying of the SBIs, the central bank announced a set of more market-friendly measures. The BI would issue SBIs with longer tenors (9-month and 12-month SBIs to start in August and September respectively) as well as require the buyers in the primary market to hold the securities for at least one month. So far, the new policies have limited impact on the IDR but we do not expect the central bank to come up with more restrictions on capital flows in the near-term as this could potentially have a negative impact on investor sentiment.

While we expect the current account surplus to narrow to 1.3% of GDP this year from 2.0% in 2009, investment inflows are likely to remain supportive, particularly as economic growth in the region is expected to stay firm. Under our assumption of a gradual RMB appreciation pace, USD/IDR is likely to consolidate lower at 9,000 by end-3Q10 before breaking the key support to end at around 8,950 by end-4Q10.



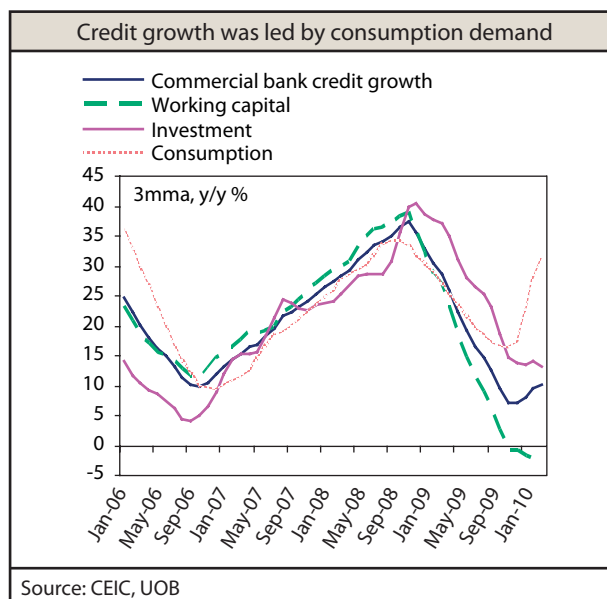
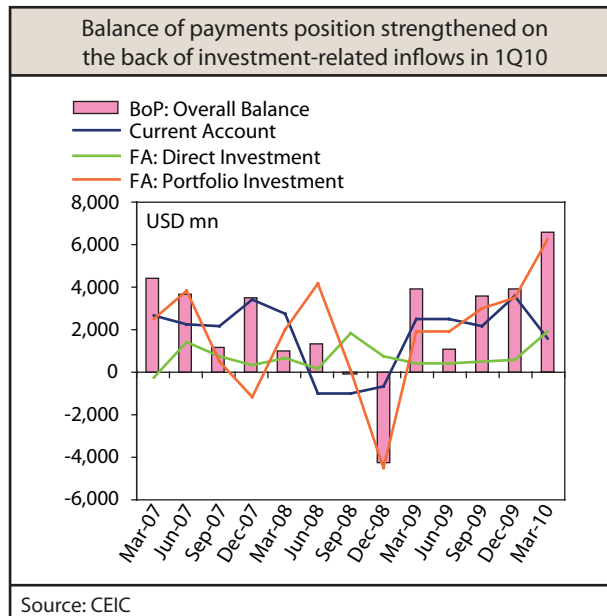
## Indonesia



### No change in official stance for steady interest rate this year

Since the beginning of the year, government officials have consistently signaled that the policy interest rate will remain unchanged for the whole of 2010 as a result of the mild domestic inflation. The BI has more recently provided a clearer direction for the benchmark rate which it said would rise by 50bps to 7.0% in 2011. The overnight rate has been at 6.5% since August 2009 and the latest BI measure to widen the spread between its overnight repurchase rate and the benchmark overnight rate to 100bps from 50 bps previously meant that the interbank overnight rate has more room to fluctuate without having to hike its policy rate.

So far, the headline and core CPI has risen by an average 3.8%/y/y and 3.9%/y/y respectively between Jan-May. This is below the official target of 4-6% range for 2010. Nonetheless, the planned 10% hike in electricity tariffs starting July 1 will probably lift the monthly headline inflation rate to above 6%/y/y by December although exemptions for the lower income household could lessen the impact on overall inflation. Therefore, we would expect the BI to begin normalising interest rate by 4Q10 instead of postponing the first rate increase to 2010 as the central bank has suggested. Even then, the mild inflationary pressure so far has caused us to pare back our forecast for the overnight rate hike to 50bps for 2010 with the bulk of the normalisation to take place next year.



### Stable economic environment

GDP growth rose to 5.7%/y/y in 1Q10, up slightly from 5.4% in the preceding quarter. With the exception of government spending, all the major components rose in 1Q10. Private consumption held up, contributing 2.3pt to headline growth and mitigated the contraction in government spending in the quarter. This trend is likely to continue as fiscal stimulus measures during the global financial crisis get withdrawn. GFCF saw growth rebounding to 7.9%/y/y, largest pace of increase in five quarters as sentiment recovered.

## Indonesia

Inventory correction and net exports boosted the GDP growth rate by around 1pt each in 1Q10. Exports growth surged in 1Q10, led by strong demand in the oil and gas sector which accounted for around 16% of total exports in 2009 (and palm oil accounted for a further 9%). Base effect will remain favourable for exports in 3Q10. But on the whole, private consumption is still expected to be the key driver in the quarters ahead. This will be supported by wage growth as well as the improvement in the jobs market with the official unemployment rate falling to 7.9% last year from 11.2% in 2005. The relative strength in consumption was reflected in commercial banks' credit growth which was geared towards consumption demand. Loans for consumption rose 27.8%/y/y in 1Q10 while that for investment purposes held up at around 13.1%/y/y.

The country's greater dependence on domestic consumption and manageable exposure to European exports demand will also make it more resilient to the debt crisis in Europe. EU-16 only accounted for 11% of Indonesia's exports vs as high as 20% for China and the Philippines. We are expecting relatively stable y/y growth in the remaining quarters this year to bring the full-year growth to around 6.0%.

Private consumption was the key growth driver in 1Q10							
	2009	1Q09	2Q09	3Q09	4Q09	1Q10	
	y/y % chge						Ppt Cont
GDP	4.5	4.5	4.1	4.2	5.4	5.7	5.7
Consumption	6.2	7.3	6.3	5.4	5.9	2.5	1.7
Public	15.7	19.2	17.0	10.3	17.0	-8.8	-0.6
Private	4.9	6.0	4.8	4.7	4.0	3.9	2.3
GFCF	3.3	3.5	2.4	3.2	4.2	7.9	1.8
Change in stocks (as % of GDP)	0.0	-0.3	0.3	0.6	-0.6	0.7	1.1
Net Exports	12.4	5.3	9.4	25.2	10.6	10.2	1.0
Exports	-9.7	-18.7	-15.5	-7.8	3.7	19.6	7.7
Imports	-15.0	-24.4	-21.0	-14.7	1.6	22.6	6.7

Source: CEIC, UOB