

Indonesia Business Forecast Report Q1 2015

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Abstracts

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Core Views

Despite the fact that Joko 'Jokowi' Widodo emerged victorious in July's presidential elections, significant political uncertainty remains. In particular, Prabowo Subianto's Red and White coalition has shown signs that it will be a particularly obstructionist opposition in parliament, creating additional risk to the implementation of Jokowi's policy agenda. While we remain generally positive on the incoming administration, this is a key risk to our view.

While his policy platform has not yet been fully elaborated, Jokowi's ability to streamline bureaucratic inefficiencies, improve public finances, strike a balance between pro-business and pro-welfare policies, as well as willingness to take politically unpopular but necessary measures to right economic imbalances could provide some upside potential for the infrastructure, mining and oil and gas sectors.

Economic growth will likely accelerate in 2015 as policy-making stabilises along with improving investor sentiment. Indonesia's macroeconomic outlook has stabilised considerably since 2013, including an improvement in the trade account as well as significantly lower inflation. This should allow Bank Indonesia (BI) room to ease policy in H115.

Major Forecast Changes

We have downgraded our end-2014 forecast on the Indonesian rupiah to IDR12,200/USD from IDR11,500/USD previously owing to broad US dollar strength. That said, we remain positive on the currency's fundamental outlook, and expect it to

recover somewhat in 2015 to average IDR11,850 next year.

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Jokowi Faces Obstructionist Opposition
Despite Prabowo Subianto's defeat in July's presidential election, the former general continues to wield a significant amount of political leverage. Following his Red and White coalition's success in scrapping direct elections for local political leaders, we note that risks of a highly obstructionist opposition against Joko Widodo's policy agenda are on the rise.

Table: Political Overview

Long-Term Political Outlook

Outlook Improved, Uncertainty Lingers

Although Indonesia has returned to relative orderliness since the post-Suharto chaos of the late 1990s and early 2000s, the country faces multiple challenges and threats to its stability that could flare up again if the opposition to incoming president Joko 'Jokowi' Widodo successor proves excessively obstructionist. As such, investors will continue to view Indonesia as one of Asia's riskier destinations.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Index

Economic Activity

Risks To 2015 GDP Forecast

Indonesia's trade account continues to improve, and along with the increase in policy continuity that should follow Joko Widodo's accession to the presidency, we believe that Indonesia's economic growth outlook will be brighter in 2015. That said, an obstructionist opposition in parliament, as well as a decreasing likelihood of interest rate cuts in H115,

underscore increasing downside risks to our sanguine real GDP growth forecast of 6.0% next year.

Table: Economic Activity

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Fiscal Position Sound, But Spending Mix Still A Concern

Indonesia's fiscal deficit remains in manageable territory by historical standards, and the country's government debt-to-GDP ratio is an admirable 24.9%. However, improving the government spending mix remains a significant challenge, with total subsidy spending hovering near 20.0% of overall expenditures. While incoming president Joko Widodo is focused on reducing fuel subsidies in an effort to tackle this problem, strong parliamentary opposition could be a barrier to progress in this area.

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Monetary Policy

AEC: Financial Services Liberalisation Will Be Drawn Out

The AE C will prove fortuitous for the larger banks in the region, allowing them to provide cross-border financial services at a lower cost.

We also see greater ASEA N integration helping Malaysia cement its position as a leading Islamic finance player. Furthermore, the deregulation of regional insurance markets will attract multinational insurers from slower growing markets, such as Japan and Korea, into ASEA N. That said, political risks, particularly in Indonesia, remain a salient threat towards the liberalisation of the region's financial services environment.

Exchange Rate Policy

Shifting To Neutral On IDR As US Dollar Takes Off

We have shifted our near-term outlook for the Indonesian rupiah to neutral in light of ongoing US dollar strength, and now see the currency ending 2014 near its current level of IDR12,200/USD. However, we maintain our expectations for moderate strength over the medium term owing to a solid fundamental outlook, and expect the currency to appreciate to IDR11,800/USD in 2015.

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