+357 96 030922
info@marketpublishers.com

Indonesia Business Forecast Report Q2 2014

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Abstracts

Core Views

While Indonesia's economy may have recorded consensus-beating growth in Q413, we believe that the economy is not yet out of the woods. We believe that the recent improvement in trade momentum is likely to reverse, and we expect investors to remain cautious towards further spending in light of the impending elections. Also, we believe that tighter credit conditions and the petrol fuel price hikes have yet to fully feed through the economy and this is likely to adversely affect the Indonesian consumer.

We believe that adverse macro implications from the mining ban introduced in January are definitely in order, given the importance of the mining sector to the economy. While we highlight that nationalist rhetoric or policies are likely to be ramped up in the coming year, such measures are unlikely to be too restrictive in light of mounting economic headwinds. We believe that Indonesia will be a more compelling growth story if policymakers put structural reforms ahead of near-term political and vested interests.

The Indonesian government's plan to push through greater subsidy reforms bodes well for its fiscal trajectory. The scaling back of subsidies, taken together with a realistic 2014 budget that has cut allocations to welfare spending, in spite of impending elections, helps the Indonesian government repair its policy credibility and points towards a healthier structural fiscal space. We consequently expect the country's fiscal deficit to remain manageable.

Key Risks To Outlook

Indonesia risks a crisis of confidence similar to past panics as hot money outflows continue to batter the country's asset markets. Should sentiment continue to worsen, the government and central bank will need to do more to address the weakening rupiah,

as well as the country's current account woes.

2014 elections also pose increasingly imminent risks, as potential candidates (and their prospective policies) remain largely unknown. As the elections approach towards the end of 2014, Indonesia could witness a retrenchment in foreign investor interest.

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Fiscal Policy

Reform Push To Put Fiscal Recovery On Sound Footing

The Indonesian government's plan to push through greater subsidy reforms bodes well for its fiscal trajectory. The scaling back of subsidies, taken together with a realistic 2014 budget that has cut allocations to welfare spending, in spite of impending elections, helps the Indonesian government repair its policy credibility and points towards a healthier structural fiscal space. We consequently expect the country's fiscal deficit to remain manageable going forward.

TABLE: FISCAL POLICY

Monetary Policy

BI Stands Pat Amid Strengthening Currency, Bonds

Bank Indonesia's (BI) decision to keep its benchmark interest rate on hold in mid-February was in line with our expectations towards the country's monetary policy. The decision also supports our bullish view on Indonesian fixed income, as well as the rupiah. We expect the central bank to maintain its hawkish stance through the first half of 2014 before adopting a more accommodative position towards the end of the year.

TABLE: MONETARY POLICY

Balance Of Payments

Mineral Export Ban A Fresh Headwind For Trade Recovery

Following three months in surplus, Indonesia's trade balance fell back into deficit in January as a conditional ban on the export of unprocessed mineral ores took a bite out of commodity shipments. While we continue to believe that Indonesia has avoided an external crisis, and that its overall macroeconomic position will continue to stabilise over the medium term, we nevertheless note that the ban will act as a fresh headwind against further improvement in the trade account.

TABLE: CURRENT ACCOUNT

CHAPTER 3: 10-YEAR FORECAST

The Indonesian Economy To 2023

A Bullish Long-Term Growth Story

Indonesia's large domestic demand base and exposure to commodities are two key factors driving our bullish growth outlook for the next decade. That said, government policy reform will be crucial in determining if the country can reach its real growth potential.

TABLE: Long-Term Macroeconomic Forecasts

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FORECASTS, %

Table: Emerging Markets, Real GDP Growth, %

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