

Indonesia Business Forecast Report Q4 2014

<https://marketpublishers.com/r/I263D8221B2EN.html>

Date: July 2014

Pages: 44

Price: US\$ 1,195.00 (Single User License)

ID: I263D8221B2EN

Abstracts

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Core Views

The election results will ultimately depend on whether the electorate clamours for reform or stability. If the preference is for the former, current Governor of Jakarta Joko Widodo (Jokowi) from the PDI-P will likely emerge victorious. If the inclination is towards stability, hard-charging ex-general Prabowo Subianto, from the Gerindra, could yet achieve a come-from-behind victory. While we continue to view Jokowi as the favourite, the polling gap between the two candidates has closed markedly, suggesting that the race will be a close one.

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.

With inflation remaining well above Bank Indonesia's (BI) target range, we believe that the central bank will look to retain its tight monetary policy stance for the time being. However, we still envisage one interest rate cut before the end of Q414 as BI shifts towards a more growth supportive stance amid a slowing economy.

Major Forecast Changes

We have downgraded our end-2014 forecast on the Indonesian rupiah to IDR11,500/USD, from IDR11,000/USD previously, owing to the currency's recent weakness, as well as the heightened volatility that Indonesian assets have witnessed

ahead of presidential elections. Should Prabowo Subianto win the election, we believe that further downside risk may come to fruition as a fresh sell-off could take shape.

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Golkar-Gerindra Tie-Up Complicates Jokowi's Ascendance

Although we still consider the Democratic Party of Struggle's presidential candidate Joko Widodo to be the frontrunner in July's

upcoming election, we note that the decision by the second and third largest political parties (Golkar and Gerindra respectively) to align

presents a potential challenge to Jokowi's mandate. As such, political risk in Indonesia remains in a highly fluid state, with the upcoming presidential election and ensuing consolidation set to mark a potentially crucial turning point.

Table: Political Overview

Long-Term Political Outlook

Outlook Improved, But Uncertainty Lingers

Although Indonesia has returned to relative orderliness since the chaos of the late 1990s and early 2000s, the country faces multiple

challenges and threats to its stability that could flare up again if President Susilo Bambang Yudhoyono's successor proves incompetent or if improved governance fails to take hold.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Re-Acceleration Unlikely Before 2015

Economic growth in Indonesia has likely not yet found a bottom despite Q114's weak real GDP figure (5.2% year-on-year, as the recent imposition of the mineral ore export ban as well as relatively tight monetary policy

continue to act as drags on exports and investment.

However, we continue to believe that the investment outlook will improve somewhat beginning next year as investor confidence returns amid an easier monetary policy environment, and we therefore retain our real GDP growth forecast of 6.0% for 2015.

Table: Economic Activity

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Election Looms Large As Fiscal Troubles Resurface

Indonesia's fiscal position has once again come under pressure owing to the country's burdensome fuel subsidy programme, and the country's slowing economy (along with rising oil prices) will likely result in a deficit above 2.0% of GDP in 2014.

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Monetary Policy

Rate Cut Expectations Delayed As BI Fights Inflation, Trade Deficit

Despite slowing economic growth, Bank Indonesia will likely retain its tight monetary policy stance over the coming months as it looks to battle stubborn inflation as well as an ongoing external deficit. As such, we have pared back our expectations for interest rate cuts before the end of 2014, and now see the central bank pursuing just one cut equivalent to 25 basis points before the end of Q414.

Table: Monetary Policy

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Political Uncertainty Warrants Rupiah Downgrade

The Indonesian rupiah has been buffeted by rising volatility in the country's financial markets owing to political uncertainty ahead of July's presidential elections. Should the favourite Joko Widodo emerge victorious, we believe that the volatility should subside as political uncertainty recedes.

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