

Indonesia: Covid-19 to weigh on recovery

3Q GDP looks set to fall by 5.6%, with prospects for economic recovery weighed down by the pandemic



Source: Stenly Lam

Indonesia in recession as Covid-19 cases remain elevated

Indonesia's economy is in recession, with economic activity hampered by a recent spike in Covid-19 infections, forcing Jakarta and surrounding provinces to return to stricter lockdown measures in September. Indonesia currently has the highest number of Covid-19 cases in ASEAN, with new daily infections pushing north of 3,000. The return to stricter quarantine guidelines likely weighed on industrial activity in 3Q, with the latest PMI report reverting to contraction.

Prospects for the economic recovery rest on limiting the spread of the virus, with partial lockdown measures hobbling household consumption and weighing on overall sentiment. Consumer spending has slowed considerably, manifesting in below-target inflation and lacklustre retail sales while investments in durables such as road vehicles took a severe hit during the height of the lockdowns.

Fiscal support has been significant, with authorities allocating IDR 695 trillion (4.4% of GDP) to Covid-19 relief efforts, although bureaucratic delays have led to delays in disbursement. The budget deficit to GDP ratio rose to 4.2% as of September, prodding the authorities to enter in a "burden sharing" agreement with Bank Indonesia (BI). The agreement is for IDR575 trillion worth of deficit financing, with the central bank absorbing the financing costs to help limit the impact of increased spending on debt metrics.

Despite stimulus measures, GDP momentum remains subdued especially with Covid-19 cases hitting at least 3,000 daily, which will limit consumption momentum in the near term. One recent development that could offset the Covid-19 handicap is the recent passage of the Omnibus law,

which is designed to attract foreign investments by simplifying investment rules and regulations. An influx of foreign investors could help stabilize IDR and generate employment, which will be crucial in the recovery period. Should the implementing rules and regulation be drafted quickly, we could see growth prospects improve considerably, however a return to pre-pandemic GDP level will likely take at least 2 years with consumption, the main driver of the economy, still downbeat.

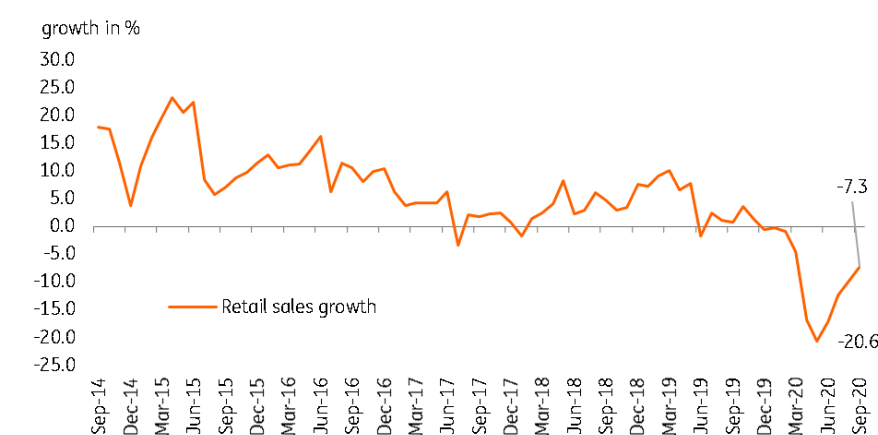
Covid-19 weighing on overall economic momentum

Indonesia's economy slipped into recession, with economic momentum still hampered by elevated daily infections from Covid-19. Several indicators point to subdued economic activity with anxiety over the virus weighing on overall consumer sentiment. Consumer sentiment hit a low of 77.8 in May, rebounding slightly in July and August before dipping again in September as Jakarta returned to more stringent lockdowns.

Poor sentiment has been reflected in anaemic household spending and a pullback in capital outlays for durable goods such as road vehicles. Retail sales have improved from the lows (reported in June) but weak consumer sentiment and uncertainty could be affecting consumption patterns with households likely setting aside more funds for savings in case things turn for the worse.

We can expect household spending, the main driver of overall economic activity, to remain downbeat until Covid-19 cases dissipate or when effective treatments and vaccines are readily available to the public. As a result, we expect consumer price inflation to dip below the central bank's inflation target of 2-4% for 2020.

Indonesia retail sales



Source: Bank Indonesia

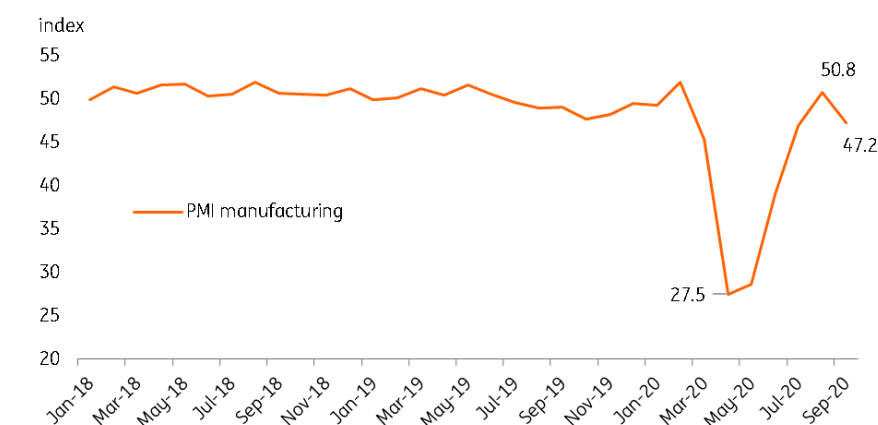
Restrictions matter

Suppressing the spread of Covid-19 is likely the most important factor in jumpstarting the economic engine as a virus under control translates into improved consumer sentiment and robust household consumption. Indonesia has refrained from implementing full lockdown measures to date, opting instead for partial lockdowns to help mitigate the spread of infection. Authorities had been gradually relaxing mobility curbs before a recent spike in cases forced government officials to reinstate more stringent lockdown measures in Jakarta and surrounding regions last September. The impact on manufacturing was significant enough to force PMI manufacturing activity back into

contraction after stringing together consecutive months of improvement since June.

Thus, effective control of Covid-19 should help to bolster the economic recovery, in terms of restoring household spending coupled with a recovery for manufacturing activity. However, given still elevated daily new infections, we expect growth momentum to struggle in the near term although we do note a recent modest deceleration in fresh cases as well as efforts by the authorities to prepare for eventual vaccine deployment.

Indonesia PMI manufacturing



Source: Markit

Omnibus law could offset Covid-19 impact somewhat

Despite the downbeat assessment for growth, one development that could offset the negative impact of Covid-19 on the economy could be the recent passage of the Omnibus law. President Jokowi hoped to pass the landmark bill at the beginning of his second term but the pandemic pushed back passage to last month. Investor optimism rebounded sharply with the new law expected to streamline the investment process and help attract foreign investors to Indonesia. The authorities are now drafting implementing rules and regulations with market players awaiting details on the said bill. The Omnibus law is reported to cover the following:

- a. Improves ease of doing business in Indonesia by amending more than 75 different laws to streamline and simplify opening a business in Indonesia
- b. Amendments to the power, mining, forestry, postal and healthcare sectors
- c. Simplifies environmental assessment requirements and licensing
- d. Amendments to the current labour law with regard to overtime, outsourcing, minimum wages, worker termination and social security to protect workers and employers
- e. Amendments to the tax code to increase ease of doing business and help attract foreign investors
- f. Inception of the Indonesian Sovereign wealth fund
- g. Incentives for micro and small enterprises and simplified application process

Should the Omnibus law deliver as promised, it could usher in an influx of investments that could bolster growth prospects and generate more employment to combat the recession.

Bank Indonesia focuses on IDR stability

Bank Indonesia (BI) paused at its last meeting with Governor Warjiyo focusing on currency stability while refraining from cutting policy rates to bolster growth. IDR has been under pressure in recent months as investors remain anxious over questions on central bank independence and more importantly growth prospects.

The currency has managed to find its footing of late, with investor sentiment improving somewhat with the Omnibus law. Unless IDR rallies sharply to close out the year, BI may be constrained from easing policy further, resorting to liquidity infusions to help keep borrowing costs pressured lower.

Constrained from cutting rates, [BI has opted to take the unconventional monetary policy route](#) to ensure market stability and even help finance the sizable fiscal response of the government. BI currently carries out quantitative easing to infuse liquidity into the financial system while conducting debt monetization with their “burden sharing” agreement with fiscal authorities.

Covid-19 to weigh on growth

Indonesia's growth momentum has been impaired by still elevated Covid-19 infections, weighing on domestic consumption, the main driver of economic growth. With retail sales and consumer confidence stalling, we forecast GDP growth to remain in negative y-o-y territory until 1Q 2021 as Indonesia hopes to curb the virus. Should authorities struggle to contain Covid-19, we would be inclined to downgrade our projections further. The authorities are banking on the Omnibus law for a boost but as long as daily Covid-19 infections remain elevated, growth momentum will remain subdued with inflation slipping below the 2-4% BI target, reflecting poor domestic demand. Meanwhile, BI will likely keep policy rates untouched for the rest of 2020, opting to undertake unconventional monetary policy to ensure financial market stability.

	3Q20	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F
Real GDP (% YoY)	-5.6F	-6.1	-4.5	2.7	2.9	3.0
CPI (% YoY)	1.4	1.9	3.3	3.5	3.6	3.5
BI policy rate (% eop)	4.00	4.00	3.75	3.75	3.50	3.50
3M rate (% eop)	4.30	4.40	4.28	4.35	4.34	4.46
10Y govt. bond yield (% eop)	6.93	6.78	6.69	6.49	6.52	6.59
Budget deficit to GDP (% eop)	4.20	6.10	6.2	5.8	6.0	5.60
Current account deficit to GDP (% eop)	2.0	1.6	1.7	1.9	2.3	2.4
IDR per USD (eop)	14880	14823	14841	14899	14910	14777

Source: ING estimates

Author

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial

instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.