

Indonesia: Trade deficit widens to five-year high

The trade balance fell back into deficit in July, posting the widest gap in five years. This together with the weakness of the current account and Indonesian rupiah could argue for a non-consensus rate hike today



-\$2.03bn

July trade balance

Widest trade deficit in five years

Worse than expected

IDR fundamentals not as strong as trade deficit widens

Import growth rebounded in July with a 32% increase after moderating in June due to the effect of Ramadan. June's imports increased by a moderate 12.7%. The recovery in imports, powered by strong domestic demand, handily beat expectations of 14% and resumes the robust pace of import demand seen in April and May.

- Non-oil imports accelerated by 29.3% in July from June's modest 8.8% increase.

- Energy imports surged 47% from the previous month's 34% annual growth. Higher energy prices, as well as stronger demand due to higher energy subsidies, account for this vigorous import growth.

Exports in July rebounded, with a 19% gain year-on-year, which also beat the consensus forecast of 11.6%. But imports outpaced exports. As a result, the trade balance reverted to the recent trend of deficits. Catch-up from the holiday-related moderation in imports in June may partly explain the rebound. But strong domestic demand also underpinned the strength in imports while the challenging trade situation also played a role.

What it means for the central bank

The reversion to a trade deficit in July does not bode well for the current account in 3Q. The current account deficit in 2Q widened to -3% of GDP or to -\$8 billion from a 2Q 2017 deficit of -1% of GDP or almost -\$5 billion. Strong domestic demand could continue in the second half of the year and contribute to a further widening in the trade and current account deficits. We expect the current account deficit of -2.6% of GDP or a deficit of \$28 billion in 2018 from 2017's -1.4% of GDP or -\$14.5 billion. We believe that the underperformance of the Indonesian rupiah in the past week is as much related to the slide in the Turkish Lira as to the widening current account deficit. These developments could argue for a non-consensus Bank Indonesia policy rate hike at this afternoon's meeting.