GDP:
Disinflation distorts the view

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Executive Summary

- The Indonesian GDP grew by 5.17% YoY (3.86% QoQ) in Q2-23, higher than the predictions of most analysts.
- Robust GDP growth amid slowing nominal indicators (bank loans, deposits, and transactions) can be explained by the disinflationary trend, i.e. the fact that GDP deflator slowed even faster than CPI.
- Thus, there was a divide in our GDP: some activities declined nominally but got a bump in real terms (household consumption, net exports, goods-producing sectors), while others actually showed acceleration in nominal terms (FAI, government/non-profit spending, service sectors.
- We expect the latter category ("the nominal accelerators") to continue to perform well in the near-term. The former category ("disinflation-assisted activities"), meanwhile, remains at the mercy of global developments.
- The key to short-term growth would be fiscal transfers and Election-related spending, in order to shield consumers from the expected global headwinds.

- The Indonesian economy grew 5.17% YoY (3.86% QoQ) in Q2-23, slightly above analysts' consensus (5.00% YoY). This narrow miss nonetheless feels like a big shock to many, perhaps because it flies in the face of a slew of worsening nominal indicators.

- Bank loans, for instance, only grew 7.8% YoY per Jun-23, while bank deposits were at 5.8%. Our *Business Transaction Index (Intrabiz)* and *Consumer Spending Index (Intrabel)*, both of which tracks nominal transaction volumes, also showed similar slowdown (***see Chart 3***) – which is why we also, frankly, expected rather weak growth in Q2 (4.95%).

- **The key to this surprise, then, lies in the GDP deflator.** While CPI inflation declined from 5.0% YoY in Mar-23 to 3.5% in June, the rate of change for GDP deflator declined even faster – from 7.5% YoY in Q1 to only 1.5% in Q2. This sharp disinflation is precisely why such weak nominal growth (NGDP only grew 6.7% YoY in Q2-23) could coincide with relatively robust real growth.

- But why did the GDP deflator slow down more than the CPI? Remember that CPI reflects only inflation at the consumer (retail) level, while the GDP deflator is a broader measure that also accounts for inflation in other activities: manufacturing, wholesale trade, commodity exports, etc. Given that Q2 was the nadir for commodity prices, as well as the peak period of Chinese 'inventory dumping', it is understandable why prices at the wholesale or producers' levels could decline more sharply than the CPI.

- We can thus divide the Q2 GDP drivers into two categories (***see Table 1***): one where activities nominally slowed but got a bump in real terms due to disinflation (net exports, household consumption), and one where activities actually grew faster nominally (fixed-asset investment, government consumption, non-profit spending).

- Exports and imports were both adversely affected by global conditions, but there was a key asymmetry. Indonesian exports are dominated by raw materials such as coal and CPO, while imports – oil aside – largely comprise of manufactured goods. The downturn in commodity prices thus exerted a more pronounced nominal impact on exports as compared to imports.

"Some areas of the economy slowed nominally, but got a bump in real terms thanks to disinflation"

- Net exports, then, fell 57% YoY nominally, but only 1% in real terms. Had there been no asymmetric price declines, net exports would have bumped NGDP growth to 9.2% instead of 6.7%, which is quite a large difference. Looked at another way: without the fall in commodity prices, loans and deposits would have grown 2-3% higher – i.e. global disinflation is a major reason why banks are missing their business targets from last year.

- Household consumption was similarly not as bad in real terms as it looked nominally. Vehicle sales, especially motorcycles, remained strong while real retail sales seemed to regain some momentum at the tail end of Q2. Indeed, both BI retail sales index and our Intrabel (after CPI adjustment) appeared to have reached their low points prior to Q2-23, and Q2 thus marked a tentative recovery (***see Chart 4***).

- Of course, it remains true that consumer spending is still slowing down in nominal terms, as befits their dwindling excess savings. What helped real consumption was the (partly food-driven, partly China-driven) disinflation, which gave consumers – quite literally – more bang for their buck, just in time for the Lebaran (Eid-al-Fitr) festivities in late April.

- Fixed-asset investments (FAI) is a different story altogether, albeit still quite a surprising one. After a year when structures FAI barely contributed to GDP growth, it came back with a vengeance. This surge is presumably attributed to a slew of newly-finished projects, including public mega-projects such as the Greater Jakarta Light Rail Transit (LRT). We expect this to continue in the coming quarters, as the government and SOEs try to expedite their projects before the end of President Jokowi's final term.

- Non-structures FAI also contributed their fair share to growth, as corporations' appetite for CAPEX remains quite strong in the face of declining revenue growth. This holds true even – indeed, particularly so – for the commodity sectors, which has booked high earnings over the past two years and seems to hold on to the promise of brighter days ahead. To this, we can also add FDI growth into metal processing, which again is banking on the long-term growth story of global energy transition and electrification.

- Spending by the government and non-profits, meanwhile, seems to be a 'Christmas comes early' kind of story. Normally, we would expect government spending to pick up in the second half of the year, while the expected Election-related bonanza kicks off in the third quarter of the pre-Election year. The fact that both leapt 'prematurely' seems to reflect two things: (1) that the 2024 General Elections will take place earlier than usual in February rather than April, and (2) that the government is currently flush with cash, which prompted an early partial mobilization of social spending and larger Lebaran bonuses (THR) for government employees.

"Areas which grew faster nominally in Q2 (structures FAI, government spending, services sectors) are unlikely to slow significantly in the short-term"

- Industry-wise, there were certain sectors where the slowdown in nominal terms is offset by declining prices, resulting in positive real growth – the most marked example being, unsurprisingly, the mining sector. Both manufacturing and trade (wholesale plus retail) also showed similar pattern albeit less drastically, which bore the imprint of China's inventory dumping.

- The flip side to these are services sectors including telecommunication and media, which accelerated in both nominal and real terms. These sectors are of course also well-placed to reap further benefit from the electoral cycle, which could extend beyond February to June (Presidential 2nd round) and November (Regional Elections).

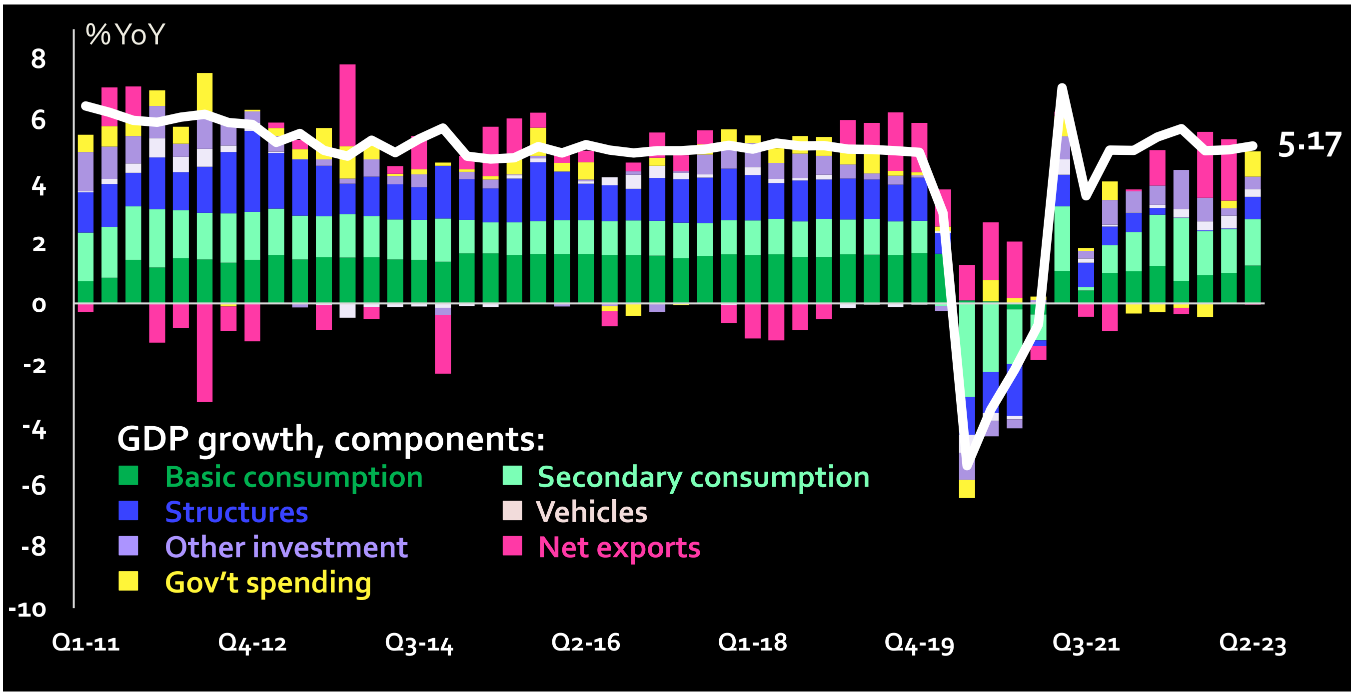
- These leaves us with a cautiously optimistic outlook for the near-term. There is little to suggest that the 'nominal accelerators' (structures FAI, government and non-profit spending, service sectors) would markedly slow in the short-term. On the other hand, the 'disinflation-assisted' activities (exports, trade, goods-producing sectors) remains at the mercy of global forces. Recent upward pressures on commodities and the decline in Chinese exports will once more widen the gap between nominal and real growth, although not necessarily to Indonesia's disadvantage.

- The decisive factor, as ever, is household consumption. The return of global inflation could weaken purchasing power, unless counteracted by higher incomes or – as has been the case in the past few quarters – carried over excess savings.

- As a commodity-exporting country, it is likely that global inflation would translate to higher domestic incomes, but there might be some time lag involved. In the meantime, fiscal transfers and the pre-Election boost in money circulation would have to provide a cushion for consumers, in order to shield Indonesia from the effects of a likely global slowdown in the next 4-6 quarters.

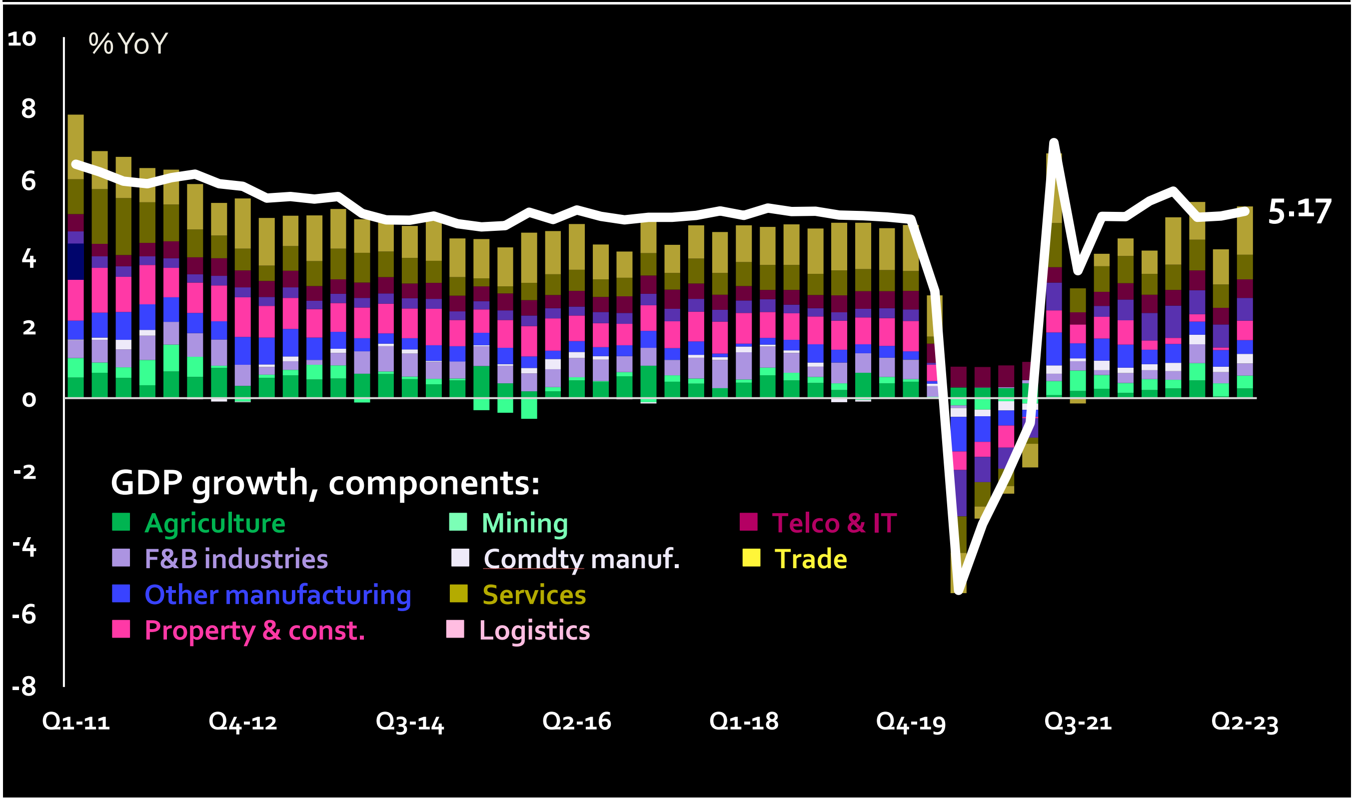
- Finally, do note (***see Chart 1***) that even if the global headwinds intensify, domestic factors alone was quite sufficient to achieve the robust outcome in Q2-23. **All these considerations convince us to upgrade Indonesia's growth outlook for 2023 (and perhaps into next year) to 5.2% YoY.**

Chart 1. The GDP in Q2-23 received boost from all domestic components, but particularly from gov't spending and structures fixed-asset investments (FAI)



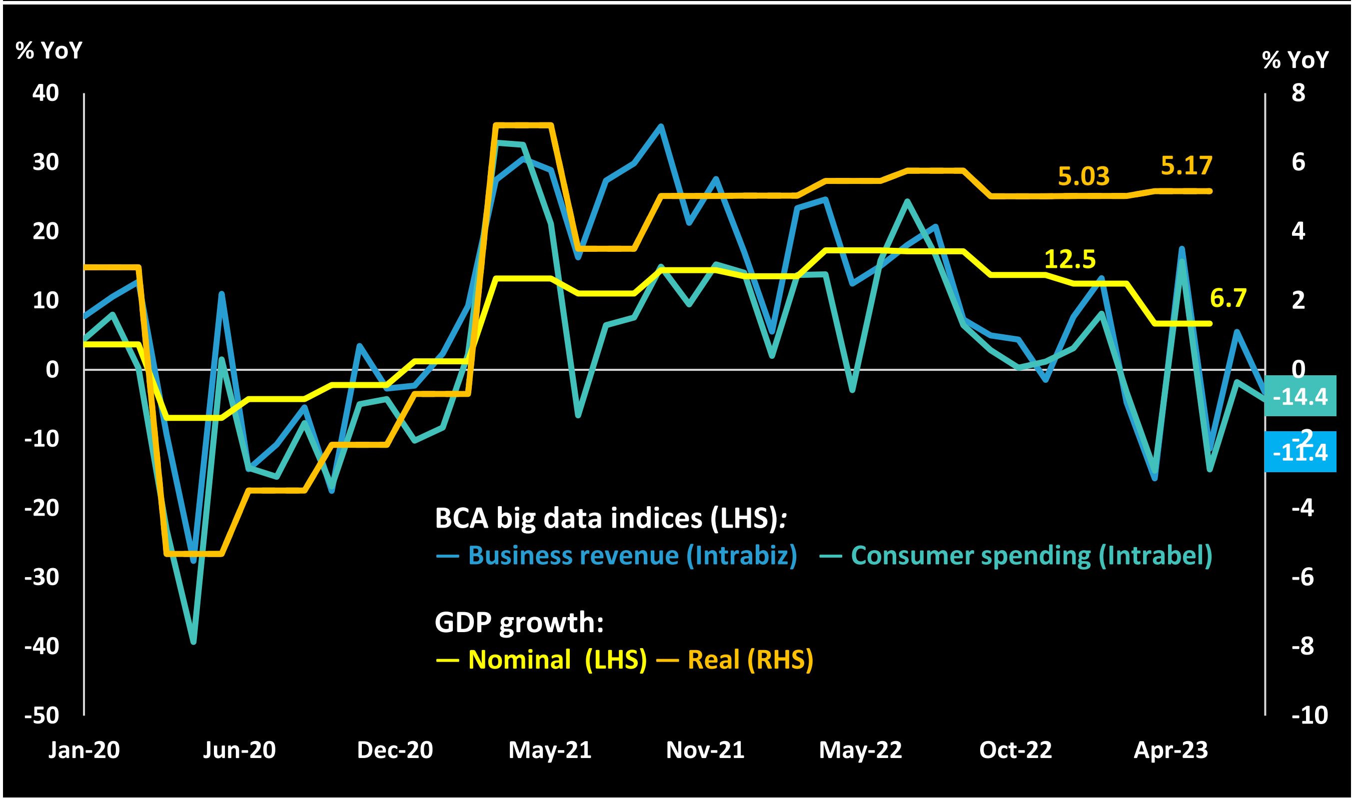
Source: BPS, BCA Economist

Chart 2. Certain sectors which slowed down nominally got a bump in real terms, with the most significant example being the mining sector



Source: BPS, BCA Economist

Chart 3. Our Big Data indices showed a definite slowdown in nominal growth, in line with the much lower NGDP growth figure for Q2-23 ...



Source: BCA Big Data, BCA Economist

Chart 4. ... but in real terms, domestic consumption appeared to have bottomed out earlier in the year, and Q2 might have marked a start of a slow and tentative recovery

Source: BI, BCA Big Data, BCA Economist

Table 1. Household consumption and net exports slowed in nominal terms but benefited from disinflation, while government/nonprofit spending as well as FAI have actually accelerated in nominal terms

	Nominal Growth (%YoY)		Real Growth (%YoY)		Gap (i.e. Deflator %YoY)	
	Q1-23	**Q2-23**	**Q1-23**	**Q2-23**	**Q1-23**	**Q2-23**
Household consumption	10.8	10.0 (▼)	4.5	5.2 (▲)	6.2	4.8 (▼)
Nonprofit org consumption	11.7	12.9 (▲)	6.2	8.6 (▲)	5.6	4.3 (▼)
Government consumption	5.8	12.4 (▲)	3.4	10.6 (▲)	2.4	1.8 (▼)
Fixed-asset investment	7.5	8.5 (▲)	2.1	4.6 (▲)	5.4	3.9 (▼)
Exports, G&S	12.8	-12.2 (▼)	12.2	-2.7 (▼)	0.6	-9.5 (▼)
Imports, G&S	9.1	-2.9 (▼)	3.8	-3.1 (▼)	5.3	0.2 (▼)
Net exports	43.9	-57.0 (▼)	74.2	-1.0 (▼)	-	-
GDP	12.5	6.7 (▼)	5.0	5.2 (▲)	7.5	1.5 (▼)

Table 2. Gross Domestic Products by Sector (nominal)

	2021		2022		Q2-22	Q3-22	Q4-22	Q1-23	Q2-23
	Rp Tn	Share	Rp Tn	Share	Rp Tn	Rp Tn	Rp Tn	Rp Tn	Rp Tn
Agriculture, livestock, forestry, and fishery	2,253.8	13.3	2,428.9	12.4	640.7	658.9	562.6	597.5	697.6
Mining and quarrying	1,523.7	9.0	2,393.4	12.2	619.0	660.0	647.0	600.9	547.9
Manufacturing industry	3,266.9	19.3	3,591.8	18.3	877.8	910.4	937.3	941.6	953.9
Electricity and gas	190.0	1.1	204.7	1.0	50.5	52.0	52.2	52.7	53.2
Water provisioning and waste recycling	12.0	0.1	12.5	0.1	3.2	3.2	3.2	3.2	3.3
Construction	1,771.7	10.4	1,913.0	9.8	449.5	480.9	512.2	501.2	492.8
Wholesale trade and repairs	2,200.5	13.0	2,516.6	12.8	624.8	648.1	653.0	657.0	671.6
Transportation and warehousing	719.6	4.2	983.5	5.0	235.9	254.9	284.3	281.8	306.7
Hotels, restaurant, and catering	412.3	2.4	472.1	2.4	116.2	118.3	127.5	124.9	129.6
Information and communication	748.8	4.4	812.8	4.1	201.6	203.8	211.3	212.3	220.0
Financial services and insurance	736.2	4.3	809.4	4.1	203.6	202.8	207.1	218.4	214.4
Real estate	468.2	2.8	488.3	2.5	121.4	122.6	123.9	124.9	125.6
Business services	301.1	1.8	341.4	1.7	84.5	85.9	90.0	90.7	96.3
Govt. administration , defence, and social security	584.4	3.4	605.1	3.1	156.1	148.0	161.4	144.9	172.5
Educational services	556.3	3.3	566.6	2.9	140.5	142.3	154.7	133.1	151.5
Healthcare and social services	227.0	1.3	236.2	1.2	56.4	60.9	66.4	56.4	62.6
Other services	312.2	1.8	354.2	1.8	87.2	87.2	95.0	96.9	101.3
GROSS DOMESTIC PRODUCT	**16,970.8**	100.0	**19,588.4**	100.0	**4,897.9**	**5,067.0**	**5,114.9**	**5,072.4**	**5,226.7**

***Numbers in recent quarters are subject to revision from BPS**

Table 3. Gross Domestic Products by Expenditure (nominal)

	2021		2022		Q2-22	Q3-22	Q4-22	Q1-23	Q2-23
	Rp Tn	Share	Rp Tn	Share	Rp Tn	Rp Tn	Rp Tn	Rp Tn	Rp Tn
Household consumption	9,236.0	54.4	10,160.4	51.9	2,532.4	2,564.7	2,641.9	2,682.0	2,786.1
Consumption by non-profit organizations	207.9	1.2	229.0	1.2	57.5	58.7	59.5	59.5	65.0
Government consumption	1,569.5	9.2	1,500.7	7.7	349.5	390.9	507.0	268.2	392.7
Fixed-asset investment	5,227.9	30.8	5,697.3	29.1	1,343.8	1,454.0	1,525.9	1,476.5	1,458.1
Exports of goods and services	3,634.4	21.4	4,797.7	24.5	1,205.3	1,295.6	1,264.2	1,164.8	1,058.2
Imports of goods and services	3,189.9	18.8	4,094.2	20.9	997.8	1,105.2	1,068.9	1,006.0	969.0
GROSS DOMESTIC PRODUCT	**16,976.7**	100.0	**19,588.4**	100.0	**4,897.9**	**5,067.0**	**5,114.9**	**5,072.4**	**5,226.7**

Source: BPS

Table 4. Gross Domestic Products by Sector (%YoY)

	Last 3 Years			Last 3 Quarters		
	2020	2021	2022	Q4-22	Q1-23	Q2-23
Agriculture, livestock, forestry, and fishery	1.77	1.87	2.31	4.57	0.43	2.02
Mining and quarrying	-1.95	4.00	4.38	6.46	4.92	5.01
Manufacturing industry	-2.93	3.39	4.89	5.64	4.43	4.88
Electricity and gas	-2.34	5.55	6.61	2.31	2.67	3.15
Water provisioning and waste recycling	4.94	4.97	3.23	2.84	5.69	4.78
Construction	-3.26	2.81	1.92	1.61	0.32	5.23
Wholesale trade and repairs	-3.79	4.63	5.55	6.53	4.92	5.25
Transportation and warehousing	-15.05	3.24	19.62	16.98	15.93	15.28
Hotels, restaurant, and catering	-10.26	3.89	11.97	13.84	11.55	9.89
Information and communication	10.61	6.82	7.74	8.78	7.13	8.02
Financial services and insurance	3.25	1.56	1.82	3.76	4.48	2.88
Real estate	2.32	2.78	1.72	0.39	0.37	0.96
Business services	-5.44	0.73	8.83	10.42	6.37	9.59
Govt. administration, defence, and social security	-0.03	-0.33	2.57	1.78	2.09	8.15
Educational services	2.61	0.11	0.59	0.43	1.02	5.43
Healthcare and social services	11.56	10.45	2.77	2.47	4.77	8.27
Other services	-4.10	2.12	9.47	11.14	8.90	11.89
GROSS DOMESTIC PRODUCT	**-2.07**	**3.70**	**5.31**	**5.05**	**5.04**	**5.17**

Table 5. Gross Domestic Products by Expenditure (%YoY)

	Last 3 Years			Last 3 Quarters		
	2020	2021	2022	Q4-22	Q1-23	Q2-23
Household consumption	-2.63	2.02	4.93	4.48	4.54	5.23
Consumption by non-profit organizations	-4.21	1.62	5.64	5.70	6.17	8.62
Government consumption	2.12	4.24	-4.51	-4.77	3.45	10.62
Fixed-asset investment	-4.96	3.80	3.87	3.33	2.11	4.63
Exports of goods and services	-8.42	17.95	16.28	14.93	12.17	-2.75
Imports of goods and services	-17.60	24.87	14.75	6.25	3.80	-3.08
GROSS DOMESTIC PRODUCT	**-2.07**	**3.70**	**5.31**	**5.01**	**5.04**	**5.17**

Source: BPS

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Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3	5.2
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.7
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	35.3
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.7

*Estimated number

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