INDONESIA

OUTLOOK IS STRONG BUT VULNERABLE TO EXTERNAL SHOCKS

GDP growth remained robust in 2024 and the outlook for 2025 is favourable. Consumer spending is expected to remain strong, but investment is expected to slow. Monetary easing by the central bank is expected to be constrained by pressures on the rupiah, while real interest rates - already high - have risen further. In fiscal terms, the government is expected to favour its social policy over capital expenditure. This will impact economic growth in the short and medium term. Exports are expected to suffer from the Chinese economic slowdown. In addition, although modest, the direct impact of a potential increase in US tariffs could also have a negative impact on the Indonesian economy.

GROWTH REMAINS STABLE

In 2024, real GDP growth remained stable at 5%. The contribution of net exports was negative despite sustained growth in exports. Domestic demand remained the primary growth driver. Consumer spending and investment reached 52.7% and 31% of GDP, respectively. Despite rising interest rates in real terms, investment has continued to grow (+4%), albeit at a slower pace, thanks in particular to the momentum of public investment in infrastructure. Investment in machinery and capital goods increased primarily in H2, but remained modest (4% of GDP).

Activity was very dynamic in the services sector and, in particular, in high value-added services (+6.2%). Activity was more modest in the manufacturing sector (+4.4%), which is however, presenting significant disparities between sectors. These discrepancies reflect the structural transformations that have been underway for several years. First, metals processing activities continued to post very dynamic growth (+13.3%), driven by the Widodo government strategy to ban exports of crude nickel, to strengthen domestic processing of commodities. Second, growth in labour-intensive industries (textiles, furniture) was much more contained (+4.2%). This should be put into perspective with the sharp increase in imports from China. In three years, the share of labour-intensive manufacturing sectors in GDP fell by 0.3 points to 1.8% of GDP at the end of 2024, as did the share of total employment (-1 pp), which stood at 13.8% in 2023. The indicators available for 2024 suggest that the decline has intensified, and explain the government's decision to extend safeguard duties on textile products in June 2024.

Economic prospects for the next three years are strong. Real GDP growth is expected to reach 5.1% on average, driven by the momentum of consumer spending and an increase in public investment. The main risks for 2025 concern changes in exports due to fragmentation of global trade, the economic slowdown in China (Indonesia's main trading partner) and a potential increase in US tariffs. Moreover, the anticipated rise in inflationary pressures and the strengthening of the US dollar against emerging currencies (in particular the rupiah) could constrain monetary easing and, as a result, impact private investment.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth (%)	5.3	5.0	5.0	5.0	5.1
Inflation (CPI, year average, %)	4.2	3.7	2.3	2.5	2.6
Gen. Gov. balance / GDP (%)	-2.4	-1.7	-2.3	-2.5	-2.7
Gen. Gov. debt / GDP (%)	39.7	39.2	38.8	38.7	38.6
Current account balance / GDP (%)	1.1	-0.2	-0.9	-1.4	-1.6
External debt / GDP (%)	30.1	29.8	31.3	31.5	31.3
Forex reserves (USD bn)	124	133	140	138	139
Forex reserves, in months of imports	5.5	6.0	6.1	6.1	6.1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDONESIA: ROBUST ECONOMIC GROWTH

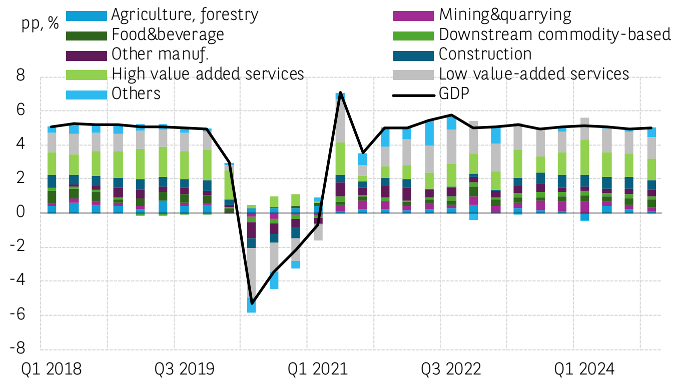

CHART 1 SOURCE: CEIC, BPS, BNP PARIBAS

INFLATION IS EXPECTED TO REBOUND IN 2025

In 2024, price increases slowed to 2.3% (vs. 3.7% in 2023). For 2025, a slight acceleration is expected due to the 1 percentage point (pp) increase in the VAT rate to 12% as of 1st January 2025. However, certain essential products are exempt. Consumer price inflation is expected to reach 2.8% by the end of 2025. It should remain within the target range set by the central bank (2.5% +/- 1 pp) over the entire year.

Despite moderate inflationary pressures, the central bank's scope for easing monetary policy is constrained by changes in the exchange rate. Its recent decision to lower its key rates by 25 basis points (bps) in January, to boost economic growth at a time when downward pressure on the rupiah is already strong, could weaken external accounts.

INVESTMENTS ARE STILL NOT HIGH ENOUGH

Prabowo Subianto's new government aims to increase the real GDP growth rate from 5% on average over the 2014-2024 period (excluding Covid) to 8% within 2-3 years. To do this, the government will boost consumption in the most disadvantaged households through an expansionary social policy. But this growth target of 8% seems unrealistic if not accompanied by a significant increase in investments. Despite the increase posted over the last two years, the country's investment rate remains below its pre-pandemic level. This would have to reach between 39% and 45% of GDP (vs. 30.7% of GDP today) for economic growth to stand at 7%, taking into account the incremental capital output ratio, slightly above 6 in Indonesia. However in 2025, the government plans to reduce its investment expenditure by 0.7 pp to 0.8% of GDP. Priority is being given to social spending, while the country's infrastructure needs remain very significant. The quality of infrastructure has not improved over the past five years, according to the country's latest logistics performance index published by the World Bank. In 2023, Indonesia was ranked 59th out of 139 countries, lagging behind China, Thailand and Vietnam. Deficiencies in infrastructure are weighing on its attractiveness and its industrial development. Private investment is also unlikely to rebound significantly. Production capacity utilisation rates remain below their long-term average and interest rates on investment loans have risen by 120 bps in real terms over the past twelve months.

INDONESIA: EXPORTS PER COUNTRY

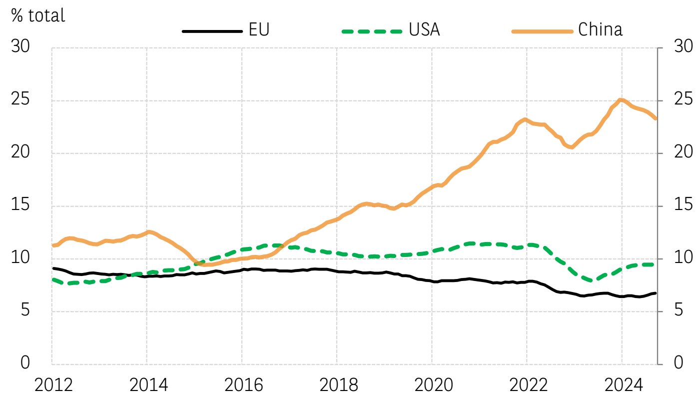

CHART 2 SOURCE: CEIC, BI, BNP PARIBAS

WHAT IS THE COUNTRY'S VULNERABILITY TO TRUMP 2.0?

Since the election of Donald Trump, US bond yields have risen, followed by Indonesian long-term interest rates, which rose 32 bps between December 2024 and mid-January. These developments need to be monitored. In fact, interest payments on debt continued to rise in 2024, to reach a high of 2.3% of GDP (equivalent to 17.6% of budget revenue), reducing budgetary leeway accordingly.

In addition, although its external accounts are relatively robust, Indonesia has already been weakened by significant capital outflows since Trump took power.

The current account deficit is structurally modest, Indonesia's external debt is moderate and its foreign exchange reserves are sufficient to cover all its short-term external financing needs. The main source of fragility is low net foreign direct investment (FDI), which have stood at just 1.3% of GDP on average over the past five years. This makes the country reliant on volatile portfolio investments to fund its current account deficit. Over the first three quarters of 2024, the current account deficit increased by 0.7 pp to 0.8% of GDP, mainly due to falling commodity prices. Over the whole year, this is not expected to have exceeded 1% of GDP and should therefore be fully covered by net FDI. By contrast, in 2025, the current account deficit is expected to be 1.4% of GDP and might no longer be covered by net FDI. This could then increase Indonesia's vulnerability to volatile capital outflows.

However, since the outcome of the US election, like other emerging Asian countries, Indonesia has posted significant capital outflows, the financial markets fearing that the US Federal Reserve will leave its interest rates unchanged. The rupiah has depreciated against the US dollar by almost 4% since November 2024. By comparison, the Indian rupee, the Malaysian ringgit and the Thai baht lost 2.1%, 3.3% and 2.5%, respectively. However, the risks generated by this depreciation remain contained. The country's total external debt was only 31.1% of GDP in Q3 2024 and corporate debt with no natural currency hedging was only 5.3% of GDP. In addition, the Central Bank (Bank Indonesia, BI) holds sufficient foreign exchange reserves to contain the rupiah's volatility (USD 140.1 billion, i.e., the equivalent of 6.1 months of imports of goods and services). In addition, it may choose to issue more SRBIs (Bank Indonesia Rupiah Securities), instruments denominated in rupiahs backed by government bonds owned by BI, offering attractive yields to attract foreign investors. In order to contain the pressure on its currency and protect its reserves, it has also required companies exporting commodities to deposit all of their foreign currency revenue with commercial banks for a minimum term of one year from 1st March.

In trade terms, the Trump administration might increase tariffs on products coming from Indonesia. Although the US trade deficit with Indonesia is modest ("only" USD 18.2 billion in 2024) and incommensurate with its trade deficits with China and Vietnam (USD 293 billion and USD 122 billion, respectively), it has increased significantly over the past five years (+32.9%). In addition, Indonesia enjoys a preferential tariff trade policy, in particular for electronics, chemicals, furniture and rubber products. But these products only account for 1.4% of its exports to the United States. More generally, all goods combined (intermediate goods and final goods), the value added of its goods exported to the United States was estimated at 2.3% of GDP in 2020 (according to the OECD TiVA indicators), equivalent to 2.5% of GDP today if the same trade structure was applied. Based on studies[1], which estimate that the elasticity of exports with respect to an increase in tariffs is 1.3, it can be inferred that the adoption of a 10% tariff on all Indonesian goods exported to the United States (directly or not) could generate a drop of 0.3 pp in its GDP.

Johanna Melka
johanna.melka@bnpparibas.com

1 Global Trade Patterns in the wake of the 2018-2019 US-China Tariff Hikes, Haberkorn, Hoang, Lewis, Mix, Moore (2024).