

The liquidity consequences of the fiscal-fuelled growth

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Summary

- Fiscal expansions in Q4 2023 translated positively to the GDP growth number, as transfer payments managed to sustain the consumption growth in lower-income households while the business sector continued to show a strong appetite for expansion.
- The banking sector continues to face limited deposit growth despite the surge in government spending, as the limited trickle-up effect from following the disbursement of fiscal handouts fails to compensate for the decline in household income.
- Despite its positive impact on growth, continued spending by the public and business sectors may not help to strengthen the Rupiah.

- As noted in our previous reports, the market's interest rate expectation pendulum has been swinging left and right throughout the past week. In the midweek, the FOMC seems to be successful in pushing back the narrative for a QT taper and a March 2024 rate cut, but the renewed fears of a US banking crisis are in line with the dovish scenario of the overeager market. Moving closer to the weekend, the hot US non-farm payroll data (353,000 in January 2024 vs 180,000 forecasts) released on Friday calmed down the Fed pivot camp. But Fed Chairman Jerome Powell's dovish statement in a taped interview aired on Sunday swung the pendulum back to the side of monetary policy loosening again.
- Luckily, the Indonesian financial market continues to welcome more foreign investors

despite this fast-swinging pendulum of global interest rate expectations. The Rupiah regained some of its value in the past week, while the domestic stock market recorded around USD 276.41 Mn in foreign net buys. Meanwhile, foreign investors continue to find hard times getting back to the SBN market, but the benchmark 10Y yield is still languishing on the low 6.5-6.6% level thanks to the declining supply (*see Chart 1*).

- The question, then, is for how long the Indonesian financial market could strut along despite the uncertain global and domestic conditions. Indonesian corporates' low forward P/E (relative to the 2022-2023 average) may attract investors given the potential for a dividend play, while the still-high amount of liquidity in the public sector

(IDR 1106.12 Tn in November 2023) may help the government to maintain tight control over SBN supplies and thus suppress the yield on Indonesian sovereign bonds. However, recent news has shown that the government's

appetite for spending is going nowhere but northward, meaning that the government would eventually need to look into the SBN market to fund its spending programmes.

Limited refills amidst continued drawdowns

- The government's expanding fiscal spending amid the ongoing election period has been marked as the primary catalyst for the Indonesian economy in recent periods. This theme has been evident since the previous quarter, as indicated by government consumption's 0.27% contribution to the 5.04% YoY GDP growth in Q4 2023 (-0.29% YoY in the previous quarter, more on this in our separate report on the Q4 2023 GDP number).
- Given the close and positive correlation between the government's fiscal cycle and the private sector's liquidity condition, we also suspected that the expanded fiscal spending programmes would spark a recovery in banks' liquidity condition. Alas, despite the 26.27% MoM spurt in central government spending, banks continue to grapple with the limited 2.52% MoM deposit growth in December 2023 (*see Chart 2*).
- The transmission between the central government's fiscal cycle and banks' liquidity condition appears to be weakened by two channels. The first one is the consumption channel, as the government's social assistance spending translates more to household consumption rather than savings, which is not too surprising given that the principal aim of

such a transfer payment policy is to encourage aggregate demand growth.

- BCA big data shows that the increase in consumption in recent periods is concentrated in the lower-to-middle-income segment, which would benefit more from the expanded fiscal largesse. This condition, however, points to a rather ominous sign. Our big data also reveals a continued decline in savings, especially in higher-percentile depositors.
 - **While the decline in the savings balance could reflect a search for yields, this condition could also be explained by the decline in income** – meaning that these middle- and upper-income households continue to be forced to draw on their savings despite the limited growth in their consumption. It appears to be the case, then, that the fiscal-fuelled trickle-up effect from the lower-income households is not sufficient to compensate for the decline in upper-income households' incomes, explaining the hitherto uneven growth in household consumption and simultaneously the limited improvement in households' liquidity condition.
- Apart from the household-led consumption channel, the weakening transmission between the government's fiscal spending and banks' liquidity condition could also be explained by

“The connection between the fiscal cycle and the private sector's liquidity condition appears to be weakened in December 2023”

the business-led investment channel. As indicated by the recent GDP number, fixed-asset investments continue to grow robustly in Q4 2023, contributing 1.62% out of the 5.04% YoY Q4 2023 GDP growth number. Government spending, of course, has a lot to say about the robust FAI growth number, but the private sector also continues to play an important role in boosting investments.

- The business sector's still-strong appetite for investments could be attributed to the government's strategy in financing its spending programmes. As hinted above, **the government is yet to rely on debt to finance its fiscal expansion, which leads to lower yields in SBN and thus a limited increase in rates on Rupiah loans**. The government, in practice, is not competing with the private sector for financial resources, allowing businesses to borrow money and carry on with their expansions or other investments.
- The demand for productive loans, especially working capital loans, has indeed trended upwards since November 2023, which coincides with the spike in fiscal realisations. As such, the expanding fiscal realisation seems to have a limited crowding out effect on economic activities in the private sector, leading to a double expansion in government spending and investments that may eventually

heighten the burden on Indonesia's financial resources.

- What this shows, then, is that **the accelerating fiscal spending in Q4 2023 (especially in December 2023) appears to have succeeded in maintaining the growth momentum in the real sector, but failed to spark an improvement in the domestic liquidity condition**. It is important to note that the widening gap in the domestic financing needs, as depicted in our net bank balance indicator, often correlates strongly with the Rupiah's value (see Chart 3 – NBB). Hence, we note that further expansion in government spending, coupled with the private sector's still-robust demand for financing, may continue to undermine the Rupiah's foundation – a trend that would put the task of protecting the Rupiah's value almost exclusively on Bank Indonesia's shoulders, potentially throughout the first half of the year.

“Simultaneous expansions in government spending and private sector investments would not help to improve the domestic liquidity condition”

Chart 1

Controlling the supply

Mounting domestic and global uncertainties does not appear to significantly affect the yield on Indonesian sovereign bonds thanks to tighter control over SBN supplies

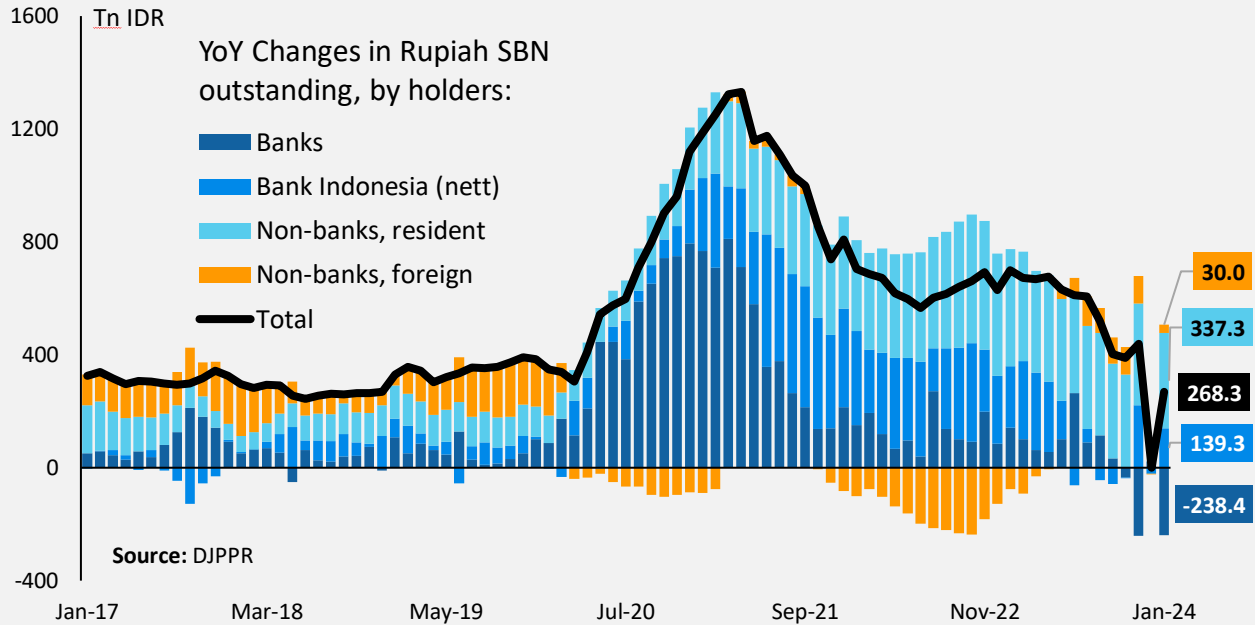


Chart 2

Lagging behind

Domestic banks continue to grapple with limited deposit growth despite accelerated fiscal spending in December 2023

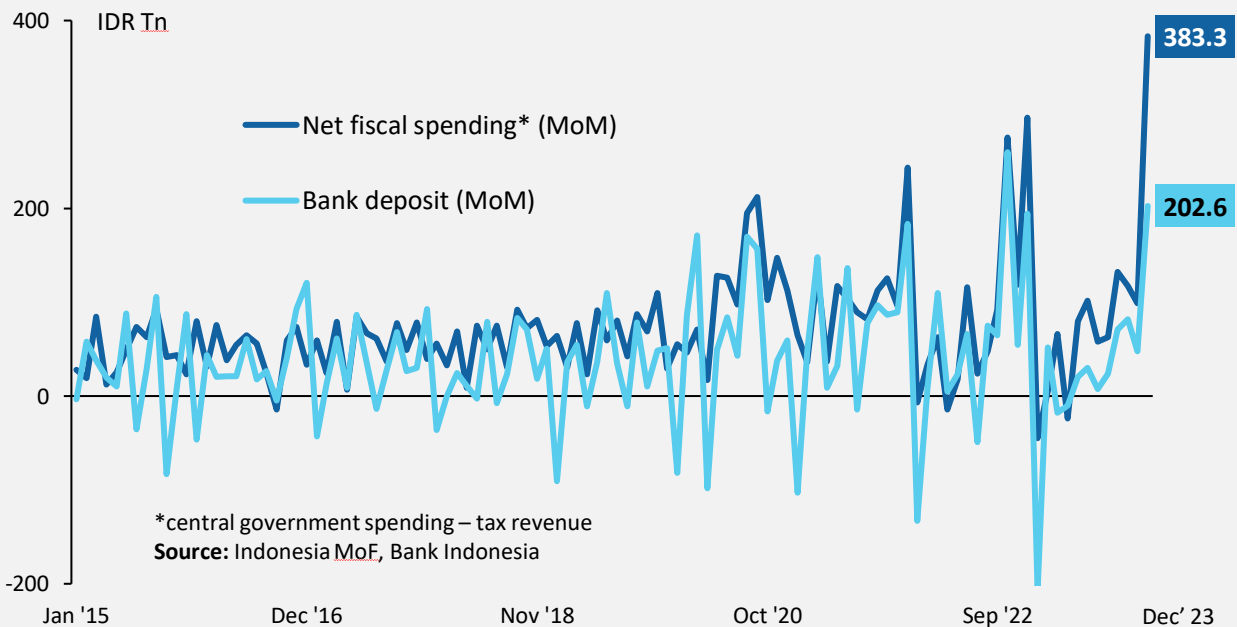
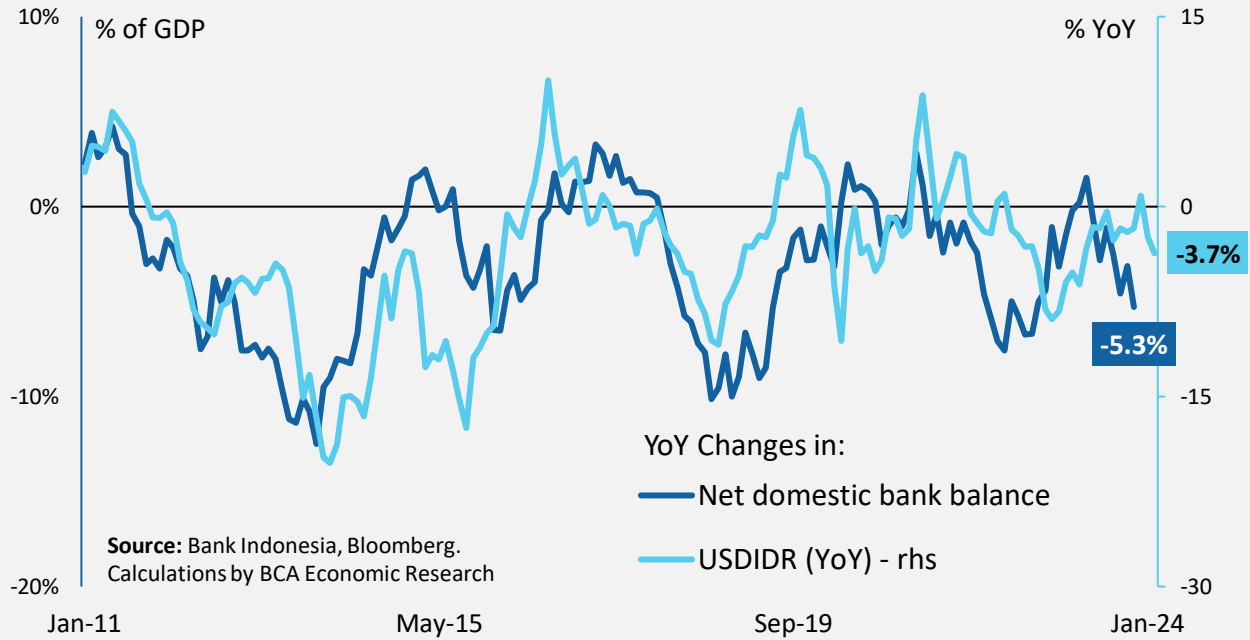


Chart 3

More spending, weaker Rupiah?

Continuous spending by both the public and private sectors would not help to improve the domestic liquidity condition, which may eventually put downward pressure on the Rupiah



Economic Calendar				
		Actual	Previous	Forecast*
1 February 2024				
ID	S&P Global Manufacturing PMI	52.9	52.2	52.1
CN	Caixin Manufacturing PMI	50.8	50.8	50.8
ID	Inflation rate YoY, %	2.57	2.61	2.42
US	Fed Interest Rate Decision, %	5.5	5.25-5.50	5.25-5.50
US	ISM Manufacturing PMI	49.1	47.4	47.6
2 February 2024				
US	Non-Farm Payrolls ('000)	353	333	175
5 February 2024				
ID	GDP Growth Rate YoY	5.04	4.94	4.96
7 February 2024				
ID	Foreign Exchange Reserves (USD Bn)	-	146.4	-
US	Balance of Trade (USD Bn)	-	-63.2	-63
8 February 2024				
CN	Inflation Rate YoY, %	-	-0.3	-
9 February 2024				
ID	Retail Sales YoY, %	-	2.1	-
13 February 2024				
US	Inflation Rate YoY, %	-	3.4	-
ID	Consumer Confident	-	123.8	123.9
ID	Motorbike Sales YoY, %	-	-11.6	-
ID	Car Sales YoY, %	-	-19.1	-
14 February 2024				
ID	2024 Presidential and General Election			
15 February 2024				
EU	Balance of Trade (EUR Bn)	-	20.3	15.4
ID	Balance of Trade (USD Bn)	-	3.3	-
20 February 2024				
ID	Balance of Payment	-	-	-
21 February 2024				
ID	BI Rate Announcement, %	-	6.00	-
ID	Loan Growth YoY, %	-	10.38	-

*Forecasts of some indicators are simply based on market consensus
 Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	2-Feb	-1 mth	Chg (%)
US	5.50	Dec-23	2.10	Baltic Dry Index	1,398.0	2,093.0	-33.2
UK	5.25	Dec-23	1.25	S&P GSCI Index	555.1	530.5	4.6
EU	4.50	Dec-23	1.70	Oil (Brent, \$/brl)	81.2	75.9	7.0
Japan	-0.10	Jan-16	-2.70	Coal (\$/MT)	118.1	124.9	-5.4
China (lending)	2.50	Dec-23	4.65	Gas (\$/MMBtu)	2.19	2.61	-16.2
Korea	3.50	Nov-23	0.30	Gold (\$/oz.)	2,035.1	2,059.0	-1.2
India	6.50	Dec-23	0.81	Copper (\$/MT)	8,500.5	8,440.5	0.7
Indonesia	6.00	Nov-23	3.43	Nickel (\$/MT)	16,013.0	16,337.0	-2.0
Money Mkt Rates	2-Feb	-1 mth	Chg (bps)				
SPN (1M)	5.88	5.80	7.6				
SUN (10Y)	6.54	6.49	4.4				
INDONIA (O/N, Rp)	5.81	5.82	-1.3				
JIBOR 1M (Rp)	6.63	6.64	-1.3				
Bank Rates (Rp)	Nov	Oct	Chg (bps)				
Lending (WC)	8.91	9.05	-13.89				
Deposit 1M	4.52	4.43	8.25				
Savings	0.67	0.67	0.34				
Currency/USD	2-Feb	-1 mth	Chg (%)				
UK Pound	0.791	0.793	0.19				
Euro	0.926	0.914	-1.33				
Japanese Yen	146.8	142.0	-3.26				
Chinese RMB	7.183	7.143	-0.55				
Indonesia Rupiah	15,658	15,470	-1.20				
Capital Mkt	2-Feb	-1 mth	Chg (%)				
JCI	7,201.7	7,323.6	-1.66				
DJIA	38,150.3	37,715.0	1.15				
FTSE	7,664.0	7,721.5	-0.75				
Nikkei 225	36,011.5	33,464.2	7.61				
Hang Seng	15,566.2	16,788.6	-7.28				
Foreign portfolio ownership (Rp Tn)	Jan	Dec	Chg (Rp Tn)				
Stock	3,115.8	3,226.3	-110.54				
Govt. Bond	841.9	842.1	-0.17				
Corp. Bond	10.4	10.6	-0.19				
External Sector	Dec	Nov	Chg (%)				
Export (\$ bn)	22.41	22.00	1.89				
Import (\$ bn)	19.11	19.59	-2.45				
Trade bal. (\$ bn)	3.31	2.41	37.13				
Central bank reserves (\$ bn)*	146.4	138.1	6.01				
Prompt Indicators	Dec	Nov	Oct				
Consumer confidence index (CCI)	123.8	123.6	124.3				
Car sales (%YoY)	-19.1	-7.5	-13.8				
Motorcycle sales (%YoY)	-11.6	-2.8	-4.0				
Manufacturing PMI	Jan	Dec	Chg (bps)				
USA	50.7	47.9	280				
Eurozone	46.6	44.4	220				
Japan	48.0	47.9	10				
China	50.8	50.8	0				
Korea	51.2	49.9	130				
Indonesia	52.9	52.2	70				

Source: Bloomberg, BI, BPS

Notes:

*Data from an earlier period

For changes in currency: **Black indicates appreciation against USD, **Red** otherwise

***For PMI, >50 indicates economic expansion, <50 otherwise

Indonesia – Economic Indicators Projection

	2019	2020	2021	2022	2023E	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0
GDP per Capita (US\$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	5.50
USD/IDR Exchange Rate (end of the year)**	13,866	14,050	14,262	15,568	15,397	16.037
Trade Balance (US\$ billion)	-3.2	21.7	35.3	54.5	37.0	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	0.1*	-0.5

*Actual number

** Estimation of the Rupiah's fundamental exchange rate

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