External debt:
Downward trend, upward pressure

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Executive Summary

- Indonesia's external debt declined to USD 403 Bn (-3.4% YoY) in Q2-2022. Private sector debt forms most of the outstanding debt, as the government moves quite aggressively to deleverage from its external debt position.
- The government looks poised to continue to deleverage its external debt position. Still, the government is projected to raise around USD 40.6 Bn in deficit spending, which could be costlier next year as an uncertain global economy and tighter liquidity may deter foreign investors from picking up where BI left off.
- Liquidity need is still high for SOEs and the private sector, which translates to greater demand for FX loans. Increasing demand for FX loans at home could lead to an uptick in the domestic financial sector's external borrowing and complicate BI's effort to stabilise the IDR's value in the medium-term.

- Indonesia's external debt was recorded at USD 403 Bn at the end of Q2-2022, a decline of 3.4% YoY (-2.3% QoQ) which continues a recent downward trend. The public sector appears to be more aggressive in reducing its external debt, with the government's external debt position falling to USD 195.9 Bn (-5.7% YoY), while the business sector debt declining more slowly to USD 207.1 Bn (-1.1% YoY).

- The Indonesian government is of course a beneficiary of the current commodity boom, which has boosted state revenues and reduced the need for external funding. Uncertainties over global energy supplies is continuing to lift the demand for coal, sustaining the price of one of Indonesia's mainstay export products. As such, the government's recent move to hike coal royalties is a positive move both to reduce fiscal deficit and also to redistribute the coal windfall to the broader economy – rather than relying on the coal companies' own limited CAPEX. The relatively conservative budget for 2023 would also cut deficits by 18.3% compared to the previous budget, reducing the need for external financing.

- Still, the government is projected to raise around USD 40.6 Bn in deficit funding next year, which will partly be met by external sources. This funding, however, should prove to be costlier next year. Bank Indonesia's scheduled departure as a 'buyer-of-last-resort' in the domestic debt market would translate to upward pressure on the Indonesian government bonds' yield. Meanwhile continued monetary tightening in the US, coupled with risk-off sentiments owing to uncertain global prospects, may yet push yields higher – hence the assumption of 80-90 bps increase in 10Y yields for next year.

- However, liquidity needs, especially for FX, are still a pressing concern in many parts of the economy. For one, ambitious infrastructure targets amid narrowing fiscal space may lead to higher financing needs among infrastructure SOEs. There is also a concern with the government's energy subsidies, which causes (temporary) shortfalls in liquidity for energy SOEs (Pertamina & PLN). These force them to take a series of bridging loans from the domestic financial sector before being properly relieved by the government's payouts. Liquidity needs for energy SOEs are further escalated by older bonds that would mature in the short-term (Chart 2), while Pertamina's renewed interest in refineries and PLN's planned energy transition further highlight liquidity demand coming from SOEs.

> ***"The case remains strong for SOEs and broader domestic private sector to look outward for borrowing opportunities"***

- Meanwhile, the urgency to scale up activities to meet the reviving domestic demand underlines liquidity needs in the private sector. Getting liquidity from domestic lenders, however, is not a straightforward business. As we explained in previous reports, some chunks of liquidity in the private sector sit idly in the commodity-exporting sector, which faces little incentives to expand or to keep its windfall profits at home. As such, rebounding industries such as manufacturing (+7.6% YoY), retail & wholesale (+9.8% YoY), and accommodation (+13.9% YoY) have been raking up external debts over the last couple of months.

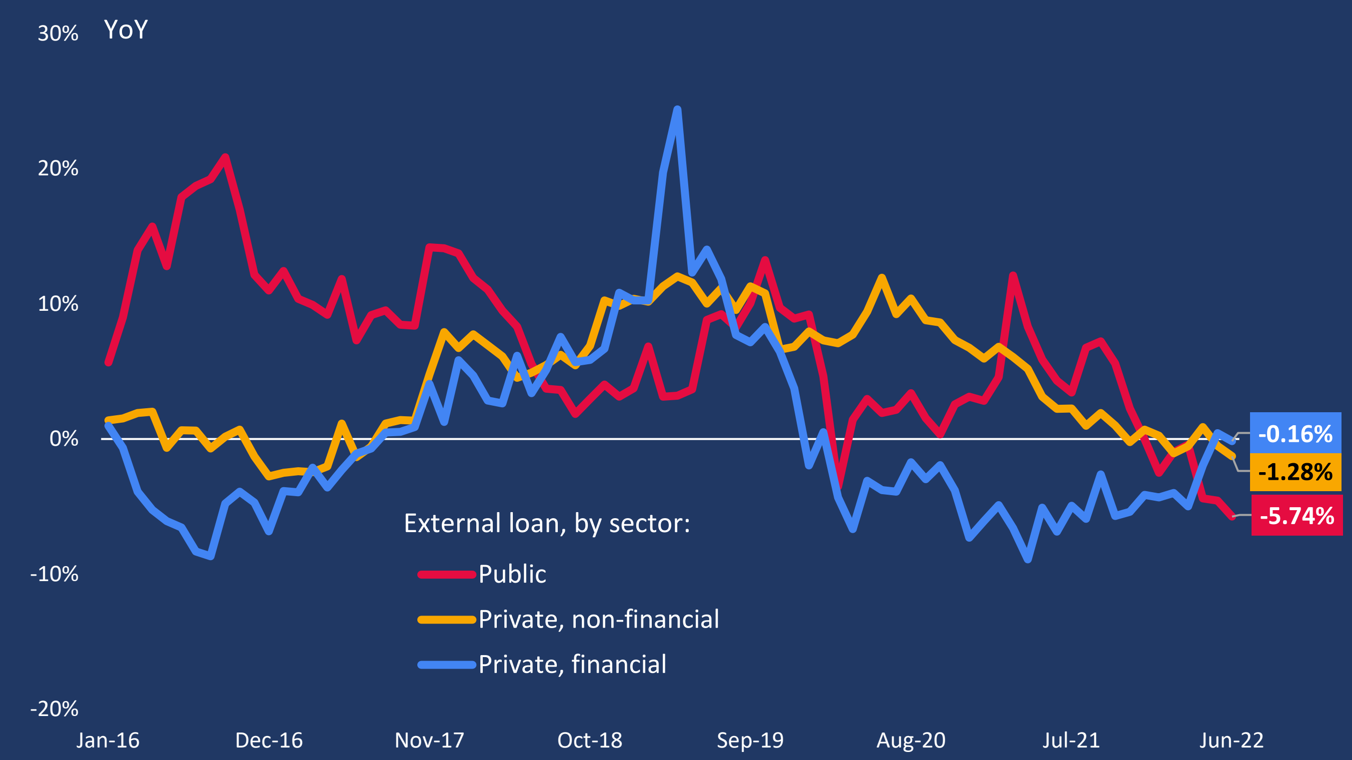
- The case thus remains strong for the private sector to look outward for borrowing opportunities. Alas, the increasingly stronger USD would make the loans more expensive, especially if – as we expect – the Fed fails to deliver on the supposed "dovish pivot" in its upcoming Jackson Hole and FOMC meetings. There is also the question of financing supply, as such environment do not play well with investors' willingness to look for opportunities in emerging markets.

- The task to distribute foreign exchange liquidity, then, may rest on the domestic financial sector. FX loans have grown quite positively throughout Q4 2021 – Q2 2022, in line with intensifying import activities. This is why we are seeing an upward trajectory in banks' external debt uptake as they borrow FX abroad to be lent at home, whereas external borrowing by non-financial corporates are actually on a declining trend.

- The situation could, in the long run, undermine BI's effort to maintain the IDR's stability. For now, banks are able to stretch the limited supply of USD by creating liabilities in Eurodollars (overseas USD). However, this would eventually have to be settled by influx of USD into the domestic economy. This is why higher demand for FX loans from domestic banks, and correspondingly higher demand for external debt by those banks, often precede the decline in the IDR's value (***Chart 3***).

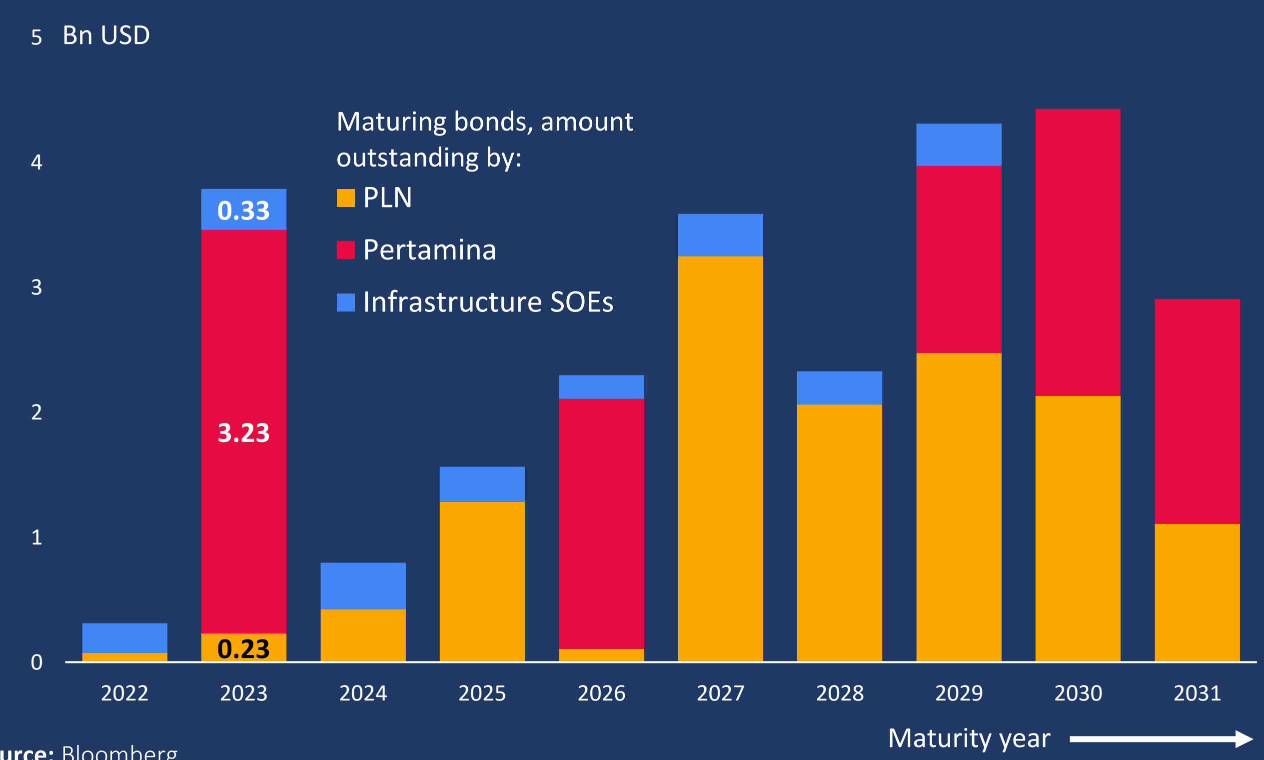
- Overall, however, the situation remains stable for the moment and external debt repayment is not a cause of concern. High coal prices would continue to fill Indonesia's hard-currencies spigot, and the government's ability to extract windfall profits appears to be improving following the recent upward adjustments to coal and nickel royalties' tariffs. BI's FX reserves are still on a solid footing, and the 31.8% debt-to-GDP ratio in Q2 2022 (33.7% in Q1 2022) further highlights Indonesia's resiliency against external debts. This basic calculus points to a robust domestic economy amidst gloomy global prospects. Indonesia, in every definition, is miles off from the risk that betides economies such as Sri Lanka and other net fuel- and food-importers this year.

Chart 1. The public sector may afford to deleverage its external debt position as high commodity prices leads to a surge in state non-tax revenues



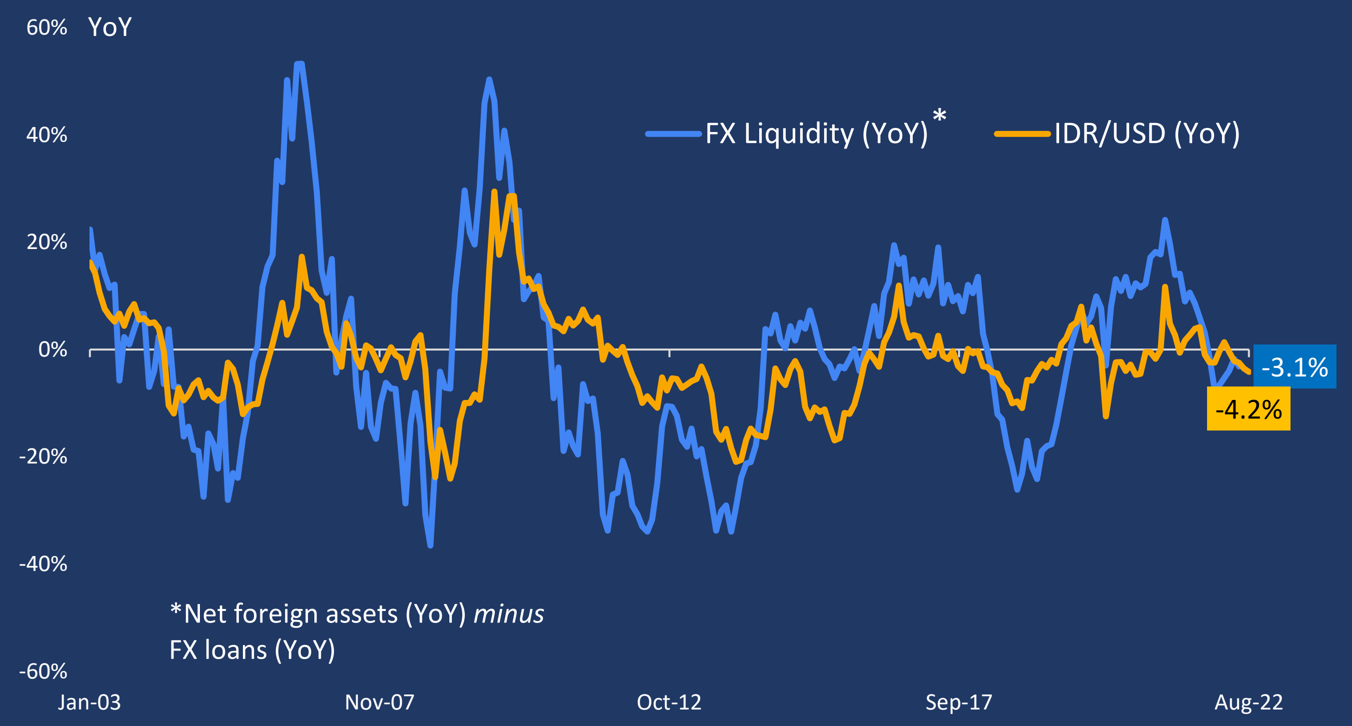
Source: Bank Indonesia

Chart 2. Aside from subsidies and expansion projects, bonds maturing in short-term highlights liquidity needs among energy SOEs.



Source: Bloomberg
As of 26 August 2022

Chart 3. Increasing demand for FX coupled with tightening supply in the domestic economy may add pressure for the IDR to depreciate



Source: Bank Indonesia

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Table 1. External Debt Position of Indonesia (USD Million)

		2018	2019	2020	2021	Jun-21	Jun-22
Short Term External Debt ≤ 1 year	***Government and Central Bank***	1,045	918	136	130	163	623
	Government	722	661	118	107	153	613
	Central Bank	324	258	18	23	11	10
	Private	45,784	44,066	43,209	47,799	46,917	52,798
	Total	**46,830**	**44,984**	**43,345**	**47,930**	**47,080**	**53,421**
Long Term External Debt > 1 year	***Government and Central Bank***	185,230	201,954	209,109	209,075	207,702	195,315
	Government	182,475	199,216	206,257	200,067	204,876	186,737
	Central Bank	2,754	2,739	2,852	9,007	2,826	8,578
	Private	143,371	157,377	164,481	159,237	162,387	154,307
	Total	**328,600**	**359,331**	**373,590**	**368,311**	**370,089**	**349,622**
Foreign Exchange Reserves		**120,654**	**129,183**	**135,897**	**144,905**	**137,093**	**136,379**
Foreign Exchange Reserves/Short-Term External Debt		**2.6**	**2.9**	**3.1**	**3.0**	**2.9**	**2.6**

Source: Bank Indonesia

Indonesia – Economic Projections Table

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	5.1
GDP per Capita (US$)	3877	3927	4175	3912	4350	4564
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	5.2
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.50
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	15,070
Trade Balance (US$ billion)	11.8	-8.5	-3.2	21.7	35.3	36.9
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.3	0.5

** Estimation of Rupiah's fundamental exchange rate

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