

## Weakening consumption: a cautionary tale for the Indonesian economy

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### Summary

- Domestic consumption appears to be weakening, courtesy of feeble consumer confidence amidst dwindling household liquidity. The weakening in consumption may not be too visible in the short term given the upcoming wage adjustments and high-spending season.
- Still-ample liquidity may allow the government to intervene but substantial fiscal commitment for legacy projects may force the government to opt for more cost-efficient solution
- The weakening consumption and more manageable monetary condition may put off BI's subsequent rate hikes.

- Some commentators expected the first FOMC meeting of the year to dent the presently buoyant market optimism. However, the market rallied even before Chairman Powell left the podium. It seems that support for the "Fed pivot" sentiment still dominates the air around Wall Street for now, with reports of some US blockbuster companies' less-than-stellar Q4 2022 earnings strengthening the conviction that the end is nigh for the Fed's ongoing tightening campaign. However, with the US economy continuing to show resiliency, as indicated by the non-farm payroll data which brings the unemployment rate to 3.4%, many in the market now seem to delay their expectation of a Fed pivot (**see Chart 1**), leaving us to ponder when the USD will start marching on again.
- The Indonesian financial market is benefiting from the risk-off sentiment as the Rupiah hovers near its 2023 peak and net foreign

inflows reached a significant USD 71.34 million last week. However, it is the real economy that delivered a rather pleasant surprise last week. The January 2023 CPI inflation figure, at 5.28% YoY, was lower than expected, despite a substantial increase in food prices. Adding to the news is the decline in the core inflation number, the first occurrence since September 2021. **The lower-than-expected inflation figure is a positive development, but the softer core inflation number may suggest other factors at play.**

- One hypothesis is that Indonesian consumer demand remains stable, but the influx of imported goods from China and the significant strengthening of the Rupiah over the last month may have allowed domestic retailers to reduce prices, leading to a lower core inflation figure. Our internal consumer spending and business transaction indices supports this hypothesis for now, as

domestic transactions continue to grow, albeit at a slower pace compared to Q2 – Q3 2022 (see **Chart 2**).

- However, the second hypothesis presents a cautionary tale. Domestic consumption may already be trending downwards or at least stagnating. **While we see that the Indonesian economy may continue to enjoy more robust domestic demand than its global peers in 2023, it is important to note that the upside potential may not be as positive as one might expect.** The high inflation rate, which remains above Bank Indonesia's target range, the limited improvement in house-hold liquidity, and a series of layoffs (despite being concentrated in the export-oriented and internet-based industries) are factors that could weaken consumer confidence, a hindrance to the prospects of domestic aggregate demand.
- The threat of a slowdown in consumption is hardly good news for the government, especially in such a politically-sensitive year. The government, of course, should aim to meet its 5.3% YoY growth target, especially in such a politically-sensitive year. One suggestion to give the economy a boost has been to cut subsidised energy prices, which would lower the headline CPI number through deflation in the administered prices component which contributed 2.17% out of the 5.28% YoY headline CPI inflation in Jan-23.
- The argument for reducing subsidised fuel prices may have its merits. Energy prices are

now lower than when the government decided to increase subsidised fuel prices, with oil prices oscillating between 77 – 88 USD/bl in 2023 compared to 92 – 113 USD/bl around the end of Q2-2022. The presently stronger Rupiah will also help Pertamina (and PLN, of course) to refill their inventories at cheaper prices. To put it simply, by reducing subsidised fuel prices, consumers' purchasing power will be directly improved,

corporate margins will increase and investments may be stimulated. Lower subsidised fuel prices could also boost the popularity of those who succeed in pushing forward the motion (see

***"Lower fuel prices may be too much to ask but the government could still support the consumption of those in dire need"***

**Chart 3**). However, there are reasons why this speculative policy is more appealing to politicians than to economists.

- The first reason for scepticism about reducing subsidised fuel prices is the uncertainty of oil prices itself. Although oil prices have been trending downward for some time, the global demand for oil remains unpredictable. This is especially true given the improving economic outlook in China and the continued resilience (despite weakening consumption) of the US and European economies. **The current price level hardly resembles OPEC's expectation of increasing oil demand in 2023**, and with industrial commodity prices already on the rise, it may be premature to conclude that oil prices will not follow suit (see **Chart 4**).
- The second reason, budgetary in nature, stems from the first reason. The now-lower

oil prices have allowed the government not to impose greater control over the distribution of subsidised fuel, but asking the government to cut fuel prices may be unrealistic. At USD 90/bl, the government's assumption of oil prices in 2023 may leave a comfortable buffer, but their exchange rate expectations may be too optimistic (*see Chart 5*), particularly in light of the rapidly declining coal prices and the narrowing spread if the Fed follows through on their "higher-for-longer" outlook. Subsidies in 2023 Budget may not have covered the potential "compensation" for Pertamina or PLN. Additionally, with mobility and consumption continuing to grow, although at a slower pace, it may be best for the government to resist the temptation to cut subsidised oil prices.

*"The upcoming wage increases would help to restore purchasing power all the way to the high-spending season of Ramadan by the end of Q1 2023"*

- We venture into the classical ground of practical political economy for reason number three. The government does have the liquidity to compensate energy SOEs' losses (*see Chart 6*), and the political urgency in 2023 undoubtedly favours more popular policies. But funding needs for other projects, including legacy projects such as the new capital city, are also significant. Clearly, the government is whipsawed between political and economic urgency to avoid slumping consumption and the obligation to adopt a conservative budget. Fortunately, the still-ample liquidity provides a middle ground solution for the government. The government may use its leftover cash to

support the consumption of those in dire need (probably through transfer payments), addressing the political pressure to achieve their 5.3% growth target without overextending the budget.

- **Another policy option that the government may consider is to set fiscal contributions for oil subsidies at a fixed price.** This policy has its precedent from Dec 2014 – mid-2016 when the government fixed the subsidy for diesel fuel (Solar) at IDR 1000/litre (although the government never explicitly set fiscal contributions on gasoline/Premium at a fixed price). This policy would introduce fiscal

discipline in the spending for subsidised fuel subsidies, allowing the government to safely pursue other big-ticket projects.

- However, while this mechanism may lock spending for oil subsidies in a more predictable posture, such a policy may contribute to price instability, which may be unproductive in stimulating domestic consumption. The government was also quick to abandon this policy in Q2-2018 (while in practice this mechanism has been steered to bed in mid-2016), opting for the "variable" fuel subsidy once global oil prices surged above USD 70/bl. Indeed, fiscal discipline is the main allure behind the "fixed" fuel subsidy policy, but such a feature may not be the best way to counter the early symptoms of weakening consumption that has emerged lately.
- Finally, we must note that **the slowdown in consumption may not be too visible in the short term.** The upcoming yearly wage

adjustments will help to restore purchasing power, especially for those in the professional class, while the seasonal spike in demand during Ramadan and Eid will spread throughout H1 2023 GDP data, picking up from the robust 5.01% YoY growth in Q4 2022. Election spending may also provide some boosts to domestic economic growth in subsequent quarters. But despite this slew of recent positive economic data, we should keep in mind that fundamentally, with the global economy continuing to weaken (as indicated by weakening retail sales growth in the US and Europe) and China's reopening failing to translate into higher coal prices, a moderation to the prospect of Indonesia's

economic growth in 2023 may be hard to avoid.

- The slowdown in aggregate demand and the more manageable monetary situation may put off BI's subsequent rate hikes (although we still expect a 25 bps rate hike to be delivered in Q1 2023). However, considering the cap on deficit spending, the government may not throw fiscal stimulus anytime the economy shows symptoms of weakness. **We thus expect the annual GDP growth for 2023 to be around 4.74% YoY (vs 5.31% YoY in 2022), which is still a respectable number with domestic consumption holding firm (despite on a flatter trend) while exports contribution moving downward compared to the 2022 number.**

Chart 1

### Expectations, moderated

Markets agree that the FFR would reach above 5%, delaying expectations of a Fed pivot as the US job market continue to show resilience

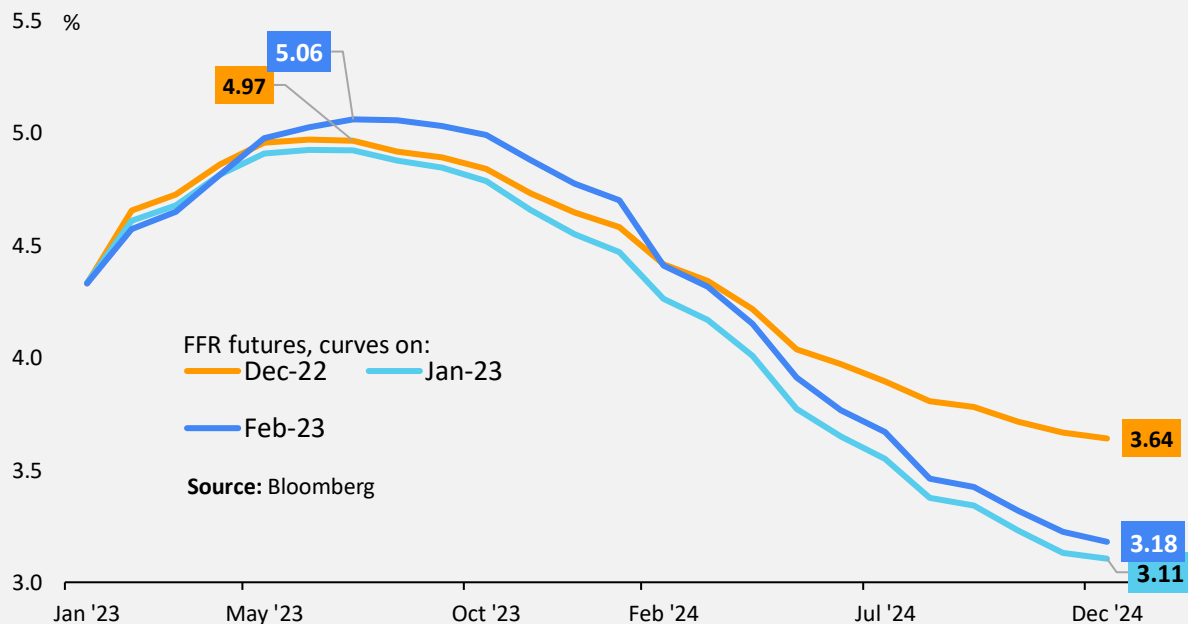


Chart 2

### Flat-footed, for now (?)

Consumer spending remains positive but the growth trend tends to be flat entering 2023. Seasonal effect and wage adjustments may lift consumption in the short term but lack of clear driver may limit its growth in subsequent quarters.

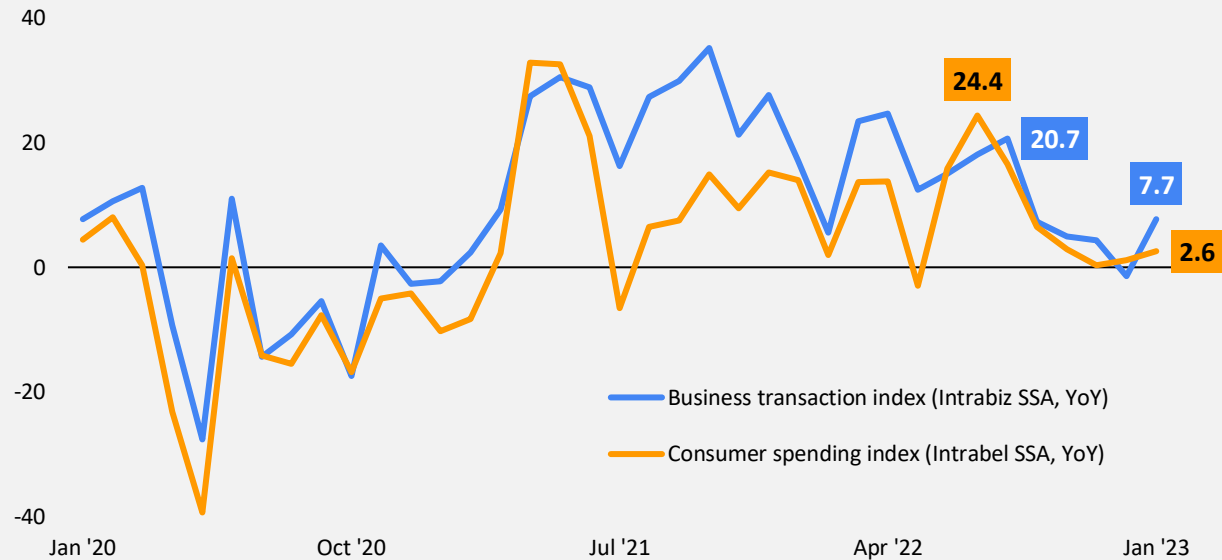


Chart 3

### Mind the gap

Improving economic outlook may translate to global demand growth outpacing supply growth, which may translate to an upward price momentum such as in 2021

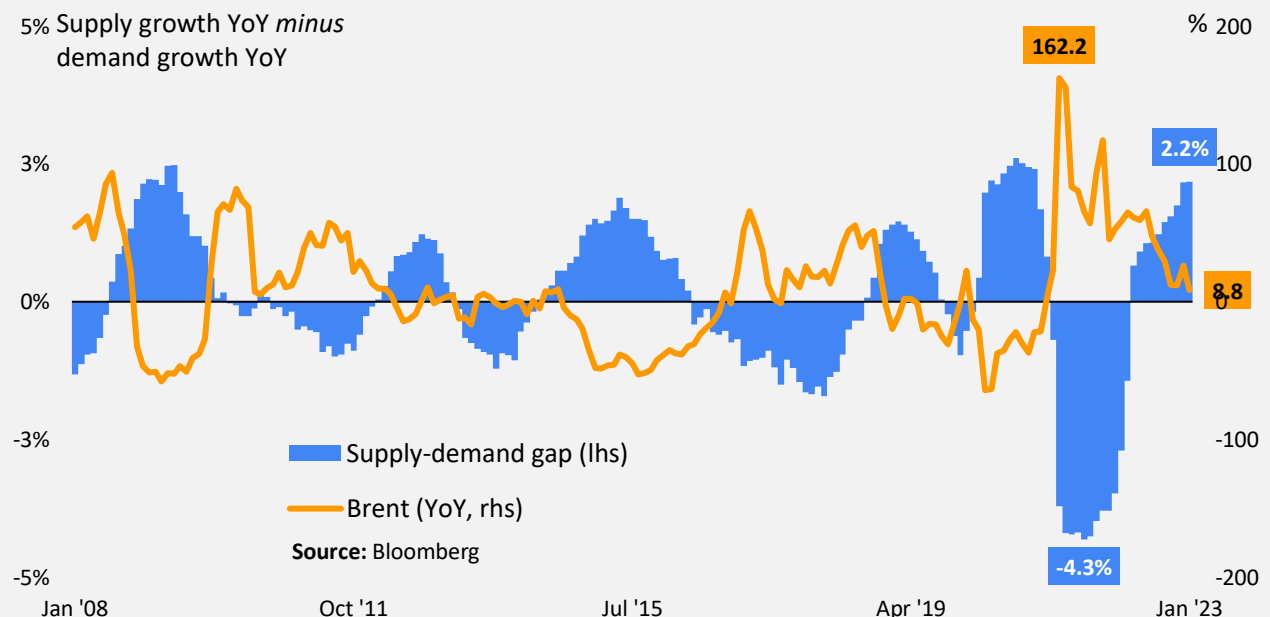


Chart 4

### Popularity contest

People tend to look at price stability to measure the government's success, giving an incentive for the government to launch popular policies, especially in such a politically-sensitive year

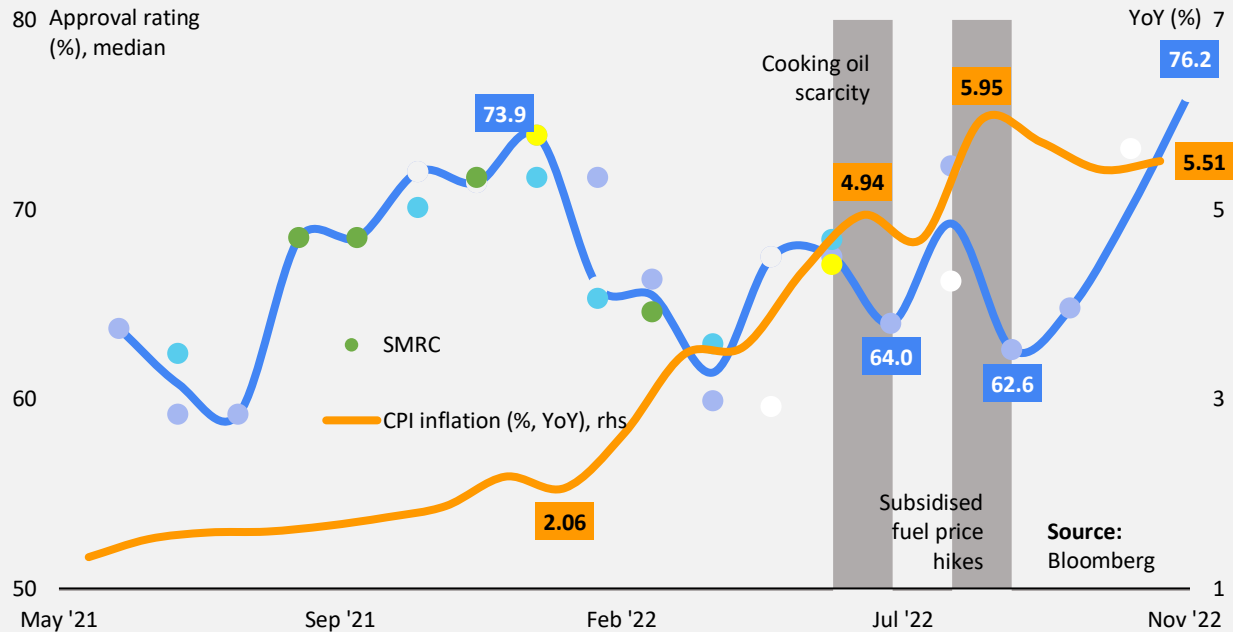
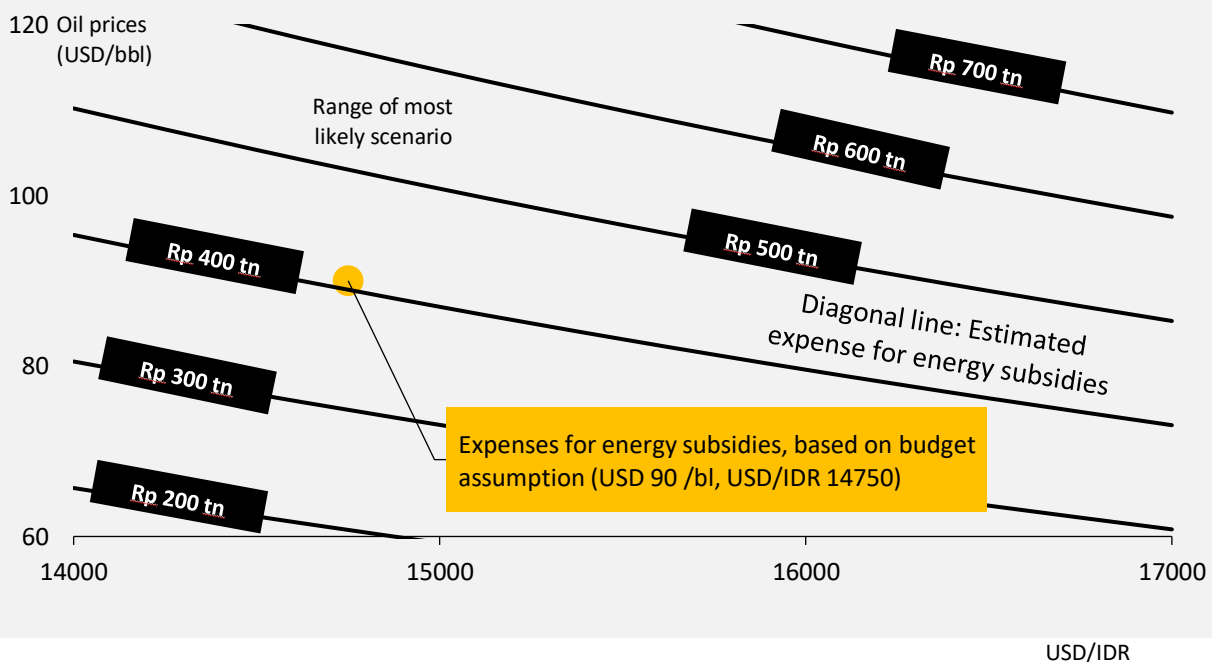


Chart 5

### Popularity is expensive

The government is likely to compensate energy SOEs' losses even if oil prices and the IDR's exchange rate hover around the 2023 budget assumption

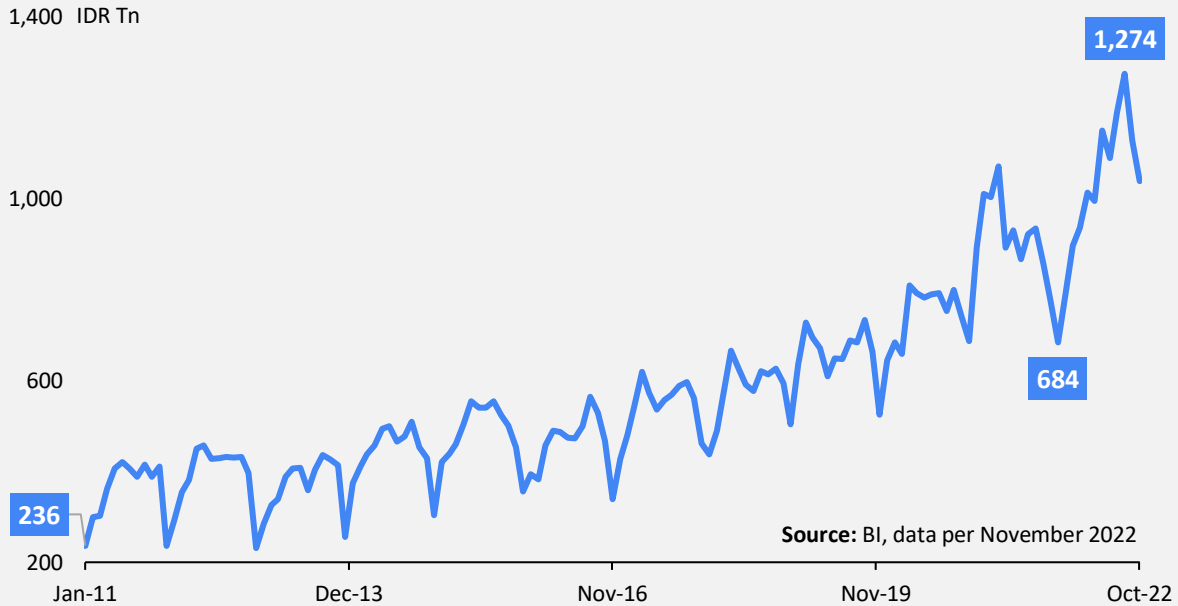


Source: MoF, Pertamina, PLN, Bloomberg. Calculation by BCA Economist

Chart 6

### Much cash, many expenses

The government still have ample liquidity to backstop domestic consumption, but funding needs for some legacy projects means that the government should opt for a cost-efficient policy option



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Economic Calendar				
		Actual	Previous	Forecast*
1 February 2023				
ID	Manufacturing PMI	51.3	50.9	50.8
ID	CPI Inflation YoY	5.28%	5.51%	5.43%
2 February 2023				
US	Fed rate decision	4.75%	4.50%	4.75%
EU	ECB deposit rate decision	2.50%	2.00%	2.50%
3 February 2023				
US	Non-farm payrolls (thousands)	517	260	185
US	Unemployment rate	3.4%	3.5%	3.6%
6 February 2023				
ID	GDP Growth Q4 2022 (YoY)	5.01%	5.72%	4.8%
7 February 2023				
ID	Foreign exchange reserve (USD Bn)	-	137.2	138.0
US	Balance of trade	-	-61.5	-68.8
8 February 2023				
ID	Consumer confidence index	-	119.9	120
9 February 2023				
ID	Retail sales (YoY)	-	1.3%	3.0%
US	Initial jobless claims	-	183K	189.0K
10 February 2023				
CN	Inflation rate YoY	-	1.8	2
14 February 2023				
US	CPI Inflation YoY	-	6.5%	6.3%
15 February				
ID	Balance of trade (USD Bn)	-	3.89	3.1
US	Retail sales YoY	-	6%	4.5%
16 February				
CN	House price index YoY	-	-1.5%	-1.3
US	PPI YoY	-	6.2%	6.0%
ID	BI 7DRR decision	-	5.75%	6.00%
20 February				
ID	Current account Q4 2022 (USD Bn)	-	4.4	3.5
23 February				
EU	Inflation rate YoY	-	9.2	8.5
ID	Property price index Q4 2022 (YoY)	-	1.94%	

\*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	3-Feb	-1 mth	Chg (%)
US	4.75	Feb-23	-1.75	Baltic Dry Index	621.0	1,250.0	-50.3
UK	4.00	Feb-23	-6.50	S&P GSCI Index	574.5	590.6	-2.7
EU	3.00	Feb-23	-5.50	Oil (Brent, \$/bbl)	79.9	82.1	-2.6
Japan	-0.10	Jan-16	-4.10	Coal (\$/MT)	220.7	317.9	-30.6
China (lending)	4.35	Feb-23	2.55	Gas (\$/MMBtu)	2.40	3.74	-35.8
Korea	3.50	Jan-23	-1.70	Gold (\$/oz.)	1,865.0	1,839.5	1.4
India	6.25	Dec-22	0.53	Copper (\$/MT)	8,951.3	8,307.0	7.8
Indonesia	5.75	Jan-23	0.47	Nickel (\$/MT)	28,427.0	30,958.0	-8.2
Money Mkt Rates	3-Feb	-1 mth	Chg (bps)	CPO (\$/MT)	870.3	947.6	-8.2
SPN (1M)	3.68	4.65	-96.9	Rubber (\$/kg)	1.39	1.31	6.1
SUN (10Y)	6.53	7.02	-49.6	External Sector	Dec	Nov	Chg (%)
INDONIA (O/N, Rp)	5.39	4.98	41.1	Export (\$ bn)	23.83	24.09	-1.1
JIBOR 1M (Rp)	6.41	6.20	21.1	Import (\$ bn)	19.94	18.96	5.2
Bank Rates (Rp)	Sep	Aug	Chg (bps)	Trade bal. (\$ bn)	3.89	5.13	-24.2
Lending (WC)	8.46	8.42	3.71	Central bank reserves (\$ bn)*	137.2	134.0	2.39
Deposit 1M	2.97	2.87	10.38	Prompt Indicators	Dec	Nov	Oct
Savings	0.66	0.65	0.76	Consumer confidence index (CCI)	119.9	119.1	120.3
Currency/USD	3-Feb	-1 mth	Chg (%)	Car sales (%YoY)	9.0	4.4	23.3
UK Pound	0.829	0.836	0.74	Motorcycle sales (%YoY)	24.6	26.9	20.9
Euro	0.926	0.948	2.34	Manufacturing PMI	Jan	Dec	Chg (bps)
Japanese Yen	131.2	131.0	-0.13	USA	47.4	48.4	-100
Chinese RMB	6.798	6.915	1.72	Eurozone	48.8	47.8	100
Indonesia Rupiah	14,893	15,598	4.73	Japan	48.9	48.9	0
Capital Mkt	3-Feb	-1 mth	Chg (%)	China	49.2	49.0	20
JCI	6,911.7	6,888.8	0.33	Korea	48.5	48.2	30
DJIA	33,926.0	33,136.4	2.38	Indonesia	51.3	50.9	40
FTSE	7,901.8	7,554.1	4.60				
Nikkei 225	27,509.5	26,094.5	5.42				
Hang Seng	21,660.5	20,145.3	7.52				
Foreign portfolio ownership (Rp Tn)	Jan	Dec	Chg (Rp Tn)				
Stock	2,700.6	2,699.4	1.22				
Govt. Bond	811.9	762.2	49.70				
Corp. Bond	12.4	12.5	-0.02				

Source: Bloomberg, BI, BPS

Notes:

^Data for January 2022

\*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

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3*	4.7
GDP per Capita (US\$)	3927	4175	3912	4350	4564*	5011
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.3
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.00
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,647
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	55.8*	43.2
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	0.9*	-0.2

\*Estimated number

\*\* Estimation of the Rupiah's fundamental exchange rate

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