Towards the final lap with a tested plan in hand

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Summary

- The government adopted a conservative stance in formulating the proposed 2024 state budget, setting the GDP growth target at 5.2% YoY while suppressing the deficits to its lowest level since the pandemic.
- The proposed state budget seems to have been designed with the assumption that the global disinflation trend would continue. Nonetheless, the enhanced flexibility of the budget should offer some protection if supply shocks result in a renewed inflationary pressures in 2024.
- Despite the noticeable increase in the infrastructure budget, the government may increase its reliant on domestic consumption to fuel economic expansion in the coming year.

Prudent targets, but with some caveats

- President Joko Widodo unveiled what would be his final state budget on 16 August 2023. Throughout the announcement, the president reiterated the necessity for maintaining a 'healthy' fiscal posture in the upcoming year. The projected state revenue is set to rise by 5.5% to IDR 2,781.3 Tn, while expenditures are expected to grow by 5.8% to reach IDR 3,304.1 Tn in 2024. Consequently, this posture is expected to keep the deficit to 2.29% by the end of 2024, a stone throw away from 2.30% expected this year.
- Moreover, the primary balance is also set at -IDR 25.5 Tn (-0.11% of GDP), its lowest level since 2018 ***(see Chart 1)***. Given many statements by government officials emphasising the importance of maintaining a stable budget, the conservative approach adopted in the proposed budget may be a product of necessity. This is unsurprising considering the continued rise in interest ***payments (see Chart 2)***, which is up from 2.05% in 2023 to 2.18% in the next year. The government, then, might continue to embrace a conservative fiscal stance for the foreseeable future, given the prospect of a further increase in bond yields amid the expectation of a higher-for-longer global rate environment.
- On a more positive note, the budget could also be seen as a confirmation that the government no longer needs to heavily leverage itself to finance domestic economic expansion. In contrast to reported instances of fiscal over-stimulation (or under-stimulation) in other economies, the Indonesian government acts swiftly to curtail

spending and deficits once it becomes apparent that the private sector has sufficiently recovered. This frictionless exit from COVID-era financing explains the improvement in Indonesia's risk profile, which in turn stabilises the domestic bond market despite the mounting global volatility.

- The government expects the domestic financial market to remain stable in 2024, with the yield on the 10Y government bond to decrease by a slight 10bps to 6.7%. As we highlighted in a prior report, the gradual transition towards "old normal" monetary policies may eliminate the artificial demand stemming from central banks' asset purchase programmes, leading to an upturn in global bond yields. Given the indication from the Fed that the central bank would continue its QT campaign for a longer period, the Indonesian government's inclination towards a more disciplined fiscal posture in 2024 is not unexpected. Such an approach would help to restrict the supply of the government's IOUs in the market, contributing to the maintenance of stability that hitherto characterises the domestic bond market.
- Meanwhile, the Rupiah is also expected to slightly strengthen by 100 points to IDR 15,000. This exchange rate assumption reflects the government's support of the "Fed pivot" scenario. However, given the expected stability in the bond market, it is rather surprising that the government did not foresee a more aggressive exchange rate scenario. The answer sits on Indonesia's unique circumstances as an Asian economy. Monetary policy easing amidst the economic slowdown in China may counteract the appreciation pressure stemming from the projected decrease in the USD's value, leading to a tug-of-war between appreciation and depreciation forces that throw many Asian currencies into inertia, including the Rupiah.
- **The demand shock expectation stemming from the slowdown in China's economy continues to colour Indonesia's 2024 state budget** and its embedded macroeconomic assumptions. For instance, plummeting demand from China explains the assumption of USD 80/bl oil prices, which is not far removed from the current price level. Consequently, this expectation of relatively low (compared to the last year) and stable oil prices influences the assessment of domestic inflation for the next year, with the government projecting it to decline to 2.80% in 2024.

> ***"The proposed budget continue the tradition where the current government leaves a conservative budget for its successor"***

- The inflation target is again consistent with the budget's emphasis on stability. While the government is not anticipating a significant decrease in prices, it appears to be planning under the assumption that consumers will continue to benefit from lower prices given the slowdown in global economic powerhouses. It is worth noting, though, that the future trajectory of the global economy is still highly uncertain, and whether it will be shaped more by demand or supply shocks remains to be seen.

- Despite the dominance of the demand shock argument in recent days, discussions on the supply shock scenario have not become irrelevant. For one, economists are still not too convinced that the ongoing deflationary episode in China would lead to Japan-style deflation. Commodity analysts have also been calling for a renewed rally in the global energy market, especially for oil given the growing "soft landing" sentiment in the US (which is not appear to be the government's baseline scenario), the anticipated SPR refiling, and OPEC+'s decision to extend production cuts in 2024. However, the risk of rising global oil seems to be a secondary concern for the government, as evidenced by the limited attention given to fuel prices during the budget announcement. Nevertheless**, supply shocks in the global oil market appear to be the Achilles heel for the proposed state budget**, considering that each dollar increase in oil prices would contribute an additional IDR 6.5 Tn to the budget deficit.
- Another supply-side risk more deeply embedded in the government's macro-economic scenario for 2024 is the potential for upward volatility in food prices, which is particularly relevant given the heightened political sensitivity of food prices and the government's focus on combatting child malnutrition. Fortunately, the proposed 2024 state budget will equip the present administration (and its successor) with the necessary tools to manage domestic food prices. Spending on food security is tipped to increase by 14.5% to IDR 108.8 Tn, reaching the highest level since 2018. The enhanced flexibility of the proposed budget ***(see Chart 3)***, engineered through the exclusion of healthcare spending from mandatory expenses, will also assist the government in deploying resources necessary to mitigate food and other supply shock-related inflation. These enhanced tools underscore the government's confidence in maintaining stable domestic prices throughout the new year, which is instrumental in the effort to achieve the realistic 5.2% YoY GDP growth target.

"Expectations of demand shock stemming from the global economic slowdown seem to influence significant portions of the budget"

Growth drivers: Mobilising the "old reliable"

- We previously posited that the growth pace of 5.3-5.7% projected in the government's May 2023 macroeconomic framework (*Kerangka Ekonomi Makro*) is somewhat overly optimistic, considering the global macroeconomic trajectory, which is laden with uncertainties. Hence, we appreciate the government for adopting a more realistic but solid target of 5.2% YoY GDP growth in 2024, which is only a slight change from the anticipated 5.1% YoY in the economic growth outlook for the current year.

- The question, then, is which sector the government would look to contribute more to hit this achievable target? A slight gaze on the spending posture may lead to the conclusion that the government would continue to rely on infrastructure to spearhead Indonesia's economic expansion, as indicated by the 7.83% growth that would push the infrastructure budget to IDR 422.7 Tn in 2024.

- However, the intricate technicalities involved in formulating the budget may distort the view that consequently leads to this infrastructure-driven growth argument. Official statements from the budget announcement consistently emphasise the necessity of maintaining the financial soundness of Indonesia's many infrastructure SOEs, suggesting that a portion of the infrastructure spending in 2024 might be allocated as capital injections into these SOEs – rather than a direct investment in infrastructure projects. This argument gains further credibility from the notable 5.59% contraction in the capital spending budget, which signals the current administration's more relaxed stance toward infrastructure and another capital spending as their term draws to a close.

"The increase in the infrastructure budget might take the form of capital injections into struggling infrastructure SOEs"

- The government's watered-down rhetoric regarding infrastructure spending does not arise from political pressure against the current administration's legacy projects. Instead, it emanates from the confidence that the successive government will continue these projects, thus alleviating the pressure on the current administration to burden the cost of these legacy infrastructure projects. In addition to the law on the new capital city, which should see the completion of the Nusantara city project, the proposed law on the 2024 state budget also delineates the current administration's vision for Indonesia's medium-to-long term development. This not only secures President Joko Widodo's legacy but also ensures successive governments' commitments to infrastruc-ture spending.

- In the meantime, then, **the government seems to be adopting a strategy that has been pivotal in propelling the recovery and sub-sequent expansions of the Indonesian economy since the ebb in 2020: the private-driven growth model**. Indeed, the 5.8% growth in the spending budget is shy of the anticipated 8.0% YoY in nominal GDP growth, highlighting the government's preference to play a secondary role in funding the economy's growth.

- The government's continued reliance on domestic consumption to drive economic growth appears to be built on the assumption of lower yet stable inflation in 2024. Lower prices would enable customers to buy more goods, allowing the economy to replicate the situation that led to the surprising 5.17% GDP growth in Q2-2023.

However, as mentioned earlier, the Indonesian economy remains vulnerable to supply-shock risks. Apart from its adverse effect on affordability, renewed inflationary pressures could also exacerbate the reduction in Indonesian customers' pandemic-era excess savings, thereby limiting the potential for sustained growth in aggregate demand.

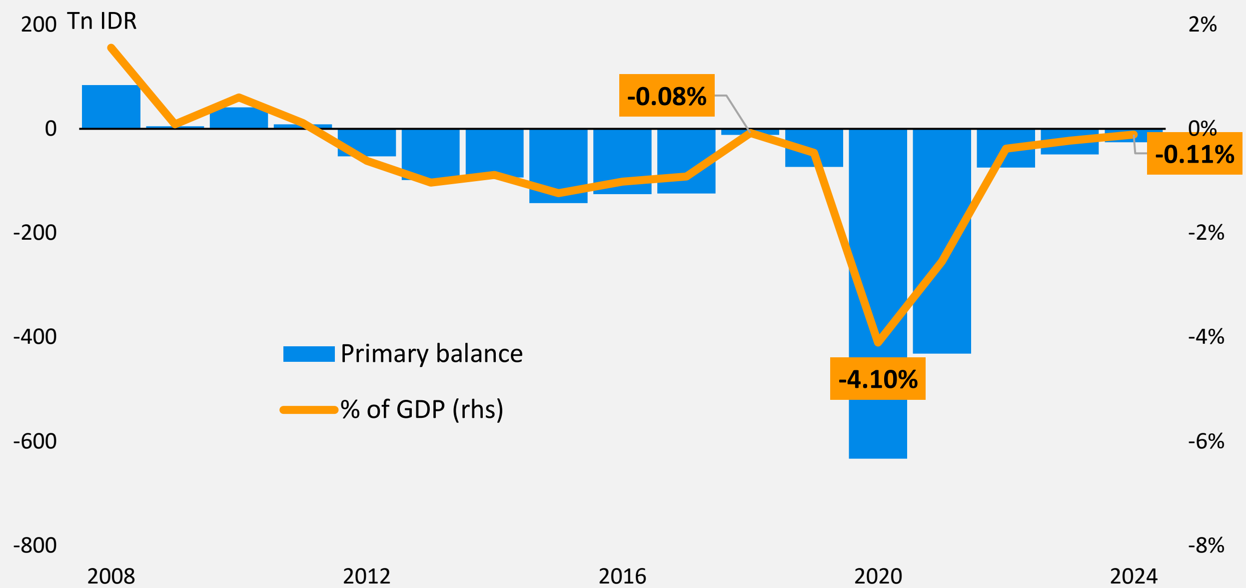
- **Government interventions, then, will still be necessary to bolster domestic consumption levels, particularly among groups that are more susceptible to volatile shifts in food and fuel prices.** This rationale is deeply in-grained in the government's strategy, wherein capital spending is sacrificed for other initiatives that would directly impact these economically vulnerable groups, such as food price stabilisation and other social safety net programmes ***(see Chart 4)***. The proposed 8% salary increase for government employees (compared to 2.8% in inflation expectations) would also allow middle-income individuals (and higher up) to boost their consumption, which is important given the declining excess savings.
- In addition to its outsized influence on economic growth, continuous expansions of domestic aggregate demand also hold a pivotal role in balancing the budget. Notably, out of the anticipated 5.5% increase in state revenues, nearly all will be derived from domestic tax revenues, which is expected to increase by 9.2% in 2024. The increase in domestic tax revenue would compensate for the decline in non-tax revenue following the expected downturn in the commodity market, ultimately pushing the tax ratio to 10.1% ***(see Chart 5).***
- The targeted increase in the tax ratio to 10.1% from 9.9% in 2023 demonstrates the government's optimism regarding the prospect of domestic consumption. However, it is important to note that the budgetary provisions intended to stimulate consumption are primarily directed towards individuals in economically vulnerable groups or limited to government employees, while the tax levy itself could check the expansion in consumption levels for other economic groups.
- Although the impact of these measures would ripple through various sectors of the economy, it might still be prudent for the government to consider some form of broader intervention to ensure comprehensive growth in consumption levels across the economy. Given the moderately optimistic exchange rate forecast, it is plausible that the government is encouraging Bank Indonesia to adopt a more growth-friendly stance in 2024 – offering additional support that would clear the path for the government to achieve the 5.2% GDP growth target.

> ***"The modest exchange rate assumption could be an open invitation for BI to pursue more growth-friendly policies in 2024"***

Chart 1

Conservatism as a deliberate policy?...

The domestic bond market may remain stable in the next year despite the increasingly mercurial global bond market thanks to the government's disciplined budget

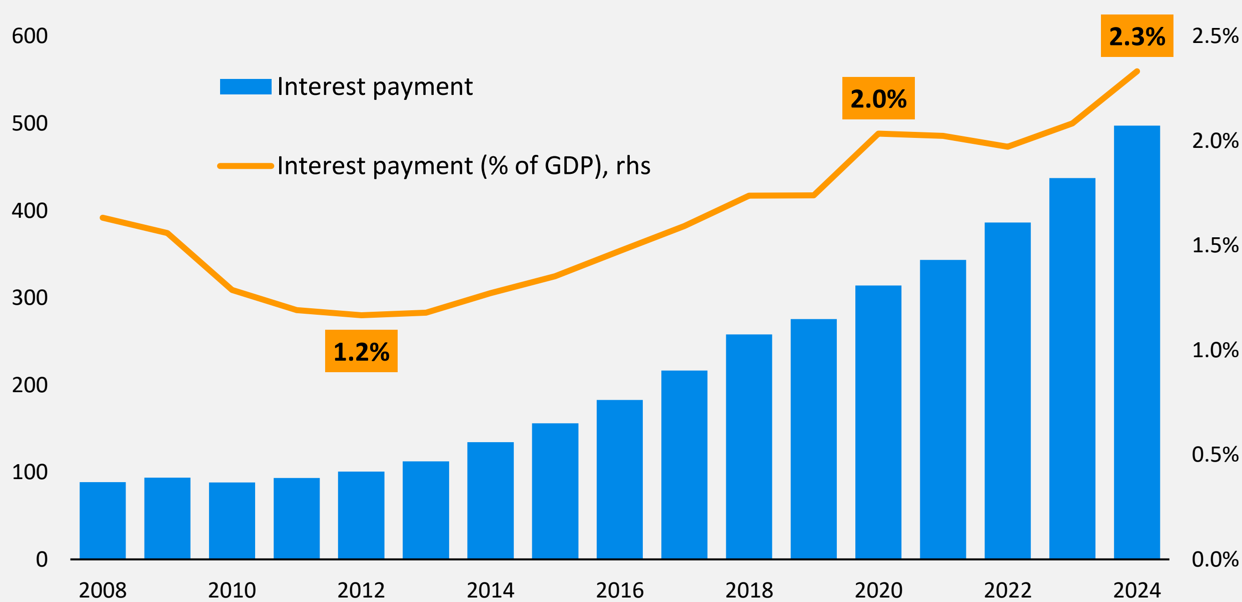


Source: MoF, Bloomberg. Compiled and calculated by BCA Economic Research.

Chart 2

...or turning conservative out of necessity?

The continued increase in interest payment and the decline in worldwide bond value may force the government to embrace a conservative fiscal budget for a foreseeable future

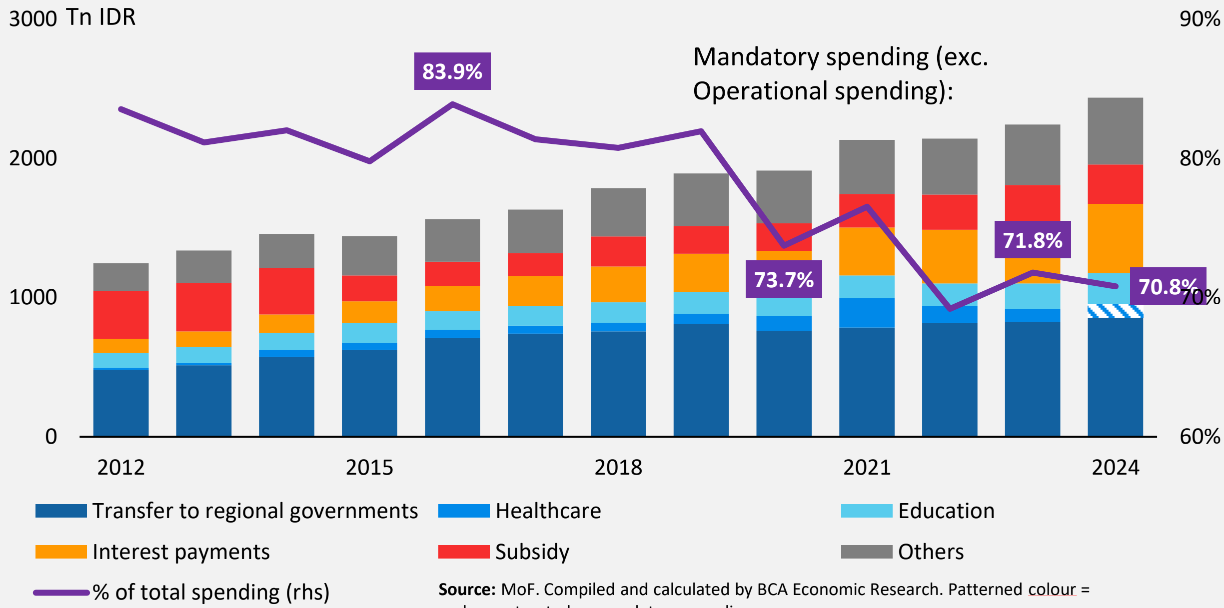


Source: MoF, Bloomberg. Compiled and calculated by BCA Economic Research.

Chart 3

Flexibility is the key

The 2024 budget appears to be built on the demand shock expectation, but the budget's improved flexibility would also help the government to counter supply shocks

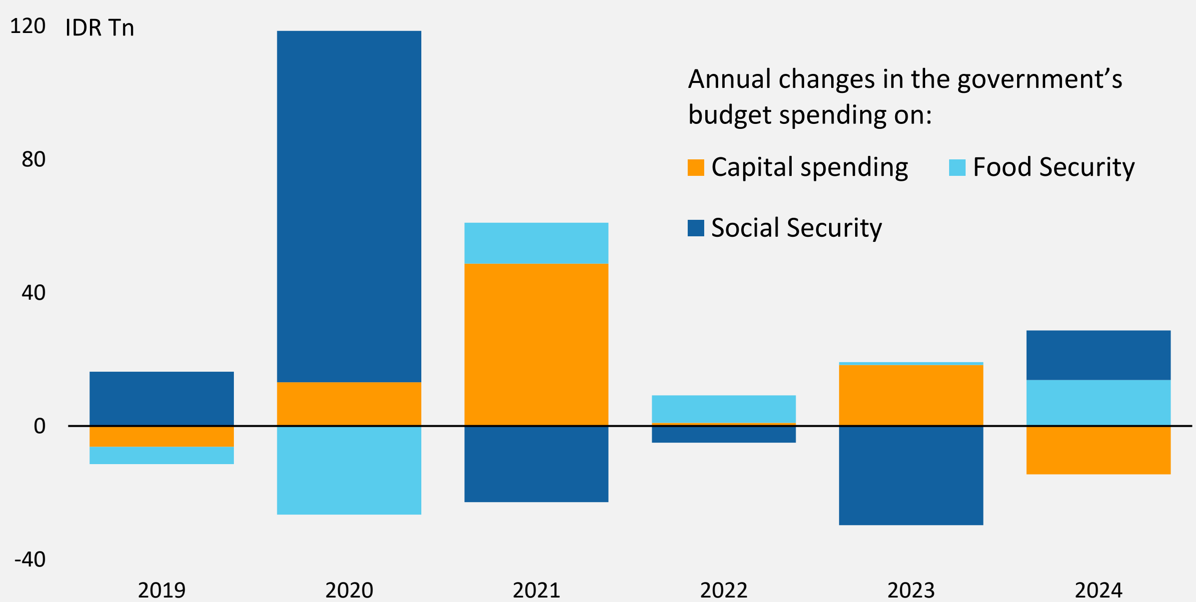


Source: MoF. Compiled and calculated by BCA Economic Research. Patterned colour = no longer treated as mandatory spending

Chart 4

Keeping Nino out of the kitchen

The government looks to prioritise spending on high-multiplier and more-direct fiscal programmes in 2024 given the necessity to mitigate against El Niño risks.

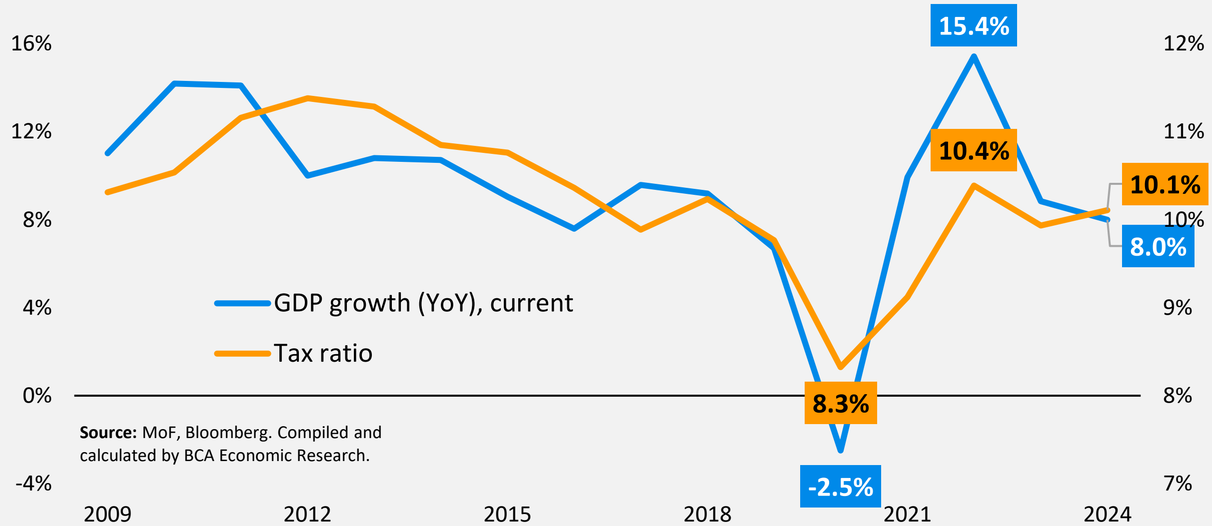


Source: MoF. Compiled and calculated by BCA Economic Research.

Chart 5

Distributional effects

Continuous increase in consumptions by middle-to-high income individuals is expected to lift Indonesia's tax ratio, although the slowdown in nominal GDP growth may pose a challenge.



Source: MoF, Bloomberg. Compiled and calculated by BCA Economic Research.

Macroeconomic assumptions

Budget assumptions	2021		2022		2023	2024
	Budget	Realisation	Budget	Realisation	Outlook	Budget
Growth (% YoY)	5.0	3.7	5.2	5.3	5.1	5.2
Inflation (% YoY)	3.0	1.9	3.00	5.5	3.1	2.8
Exchange rate (IDR/USD)	14,600	14,312	14,350	14,871	15,100	15,500
10Y SBN yield (%)	7.3	6.4	6.8	7.0	6.8	6.7
Indonesian Crude Price (USD/bl)	45	68	63	97	78	80
Crude oil production ('000 bl/day)	705	660	703	612	614	625
Gas production ('000 boe/day)	1,007	995	1,036	954	985	1,033

Source: MoF

Budget summary

Category (Tn IDR)	2021		2022		2023	2024
	Budget	Realisation	Budget	Realisation	Outlook	Budget
Total revenue	1,743.65	2,011.35	1,846.14	2,635.84	2,637.25	2,781.31
Tax revenue	1,444.54	1,547.84	1,510.00	2,034.55	2,118.35	2,307.86
Non-tax revenue	298.20	458.49	335.56	595.59	515.80	473.02
Total spending	2,750.03	2,786.41	2,714.16	3,096.26	3,123.68	3,304.14
Budget deficit (% GDP)	-5.70	-4.57	-4.85	-2.35	-2.3	-2.29

Source: MoF

Economic Calendar

		Actual	Previous	Forecast*
1 August 2023				
ID	S&P Manufacturing PMI	53.3	52.5	52
ID	**Inflation Rate YoY**	**3.08%**	**3.52%**	**3.2%**
CN	Caixin Manufacturing PMI	49.2	50.5	50.3
US	S&P Manufacturing PMI	49	46.3	49
US	JOLTs Job Opening	9.582	9.616	9.6
3 August 2023				
UK	BoE Bank Rate Decision	5.25%	5.00%	5.00%
4 August 2023				
US	Unemployment Rate	3.5%	3.6%	3.6%
US	Non-Farm Payroll ('000)	187	185	200
7 August 2023				
ID	**Foreign Exchange Reserves (USD (Bn)**	**137.7**	**137.5**	**140.0**
ID	**GDP Growth Rate YoY**	**5.17%**	**5.03%**	**5.1%**
CN	Foreign Exchange Reserves (USD Tn)	3.20	3.19	3.19
8 August 2023				
ID	Consumer Confidence	123.5	127.1	127.5
CN	Balance of Trade (USD Bn)	80.6	70.6	69
US	Balance of Trade (USD Bn)	-65.5	-69	-65.1
9 August 2023				
CN	Inflation rate YoY	-0.3%	0%	-0.3%
ID	Motorbike Sales YoY	45.6%	66.6%	-
ID	Retail Sales YoY	7.9%	-4.5%	3.1
10 August 2023				
US	Inflation rate YoY	3.2%	3%	3.1%
ID	Car Sales YoY	-6.7%	4.6%	-
15 August 2023				
ID	**Balance of Trade (USD Bn)**	**1.31**	**3.46**	**2.7**
CN	Retail Sales YoY	2.5%	3.1%	4.6%
US	Retail Sales YoY	3.2%	1.6%	1.0%
22 August 2023				
ID	Current Account (USD Bn)	-	3.0	1.5
24 August 2023				
ID	**Interest Rate Decision**	**-**	**5.75%**	**5.75%**

*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 (%)
US	5.50	Aug-23	2.30
UK	5.25	Aug-23	-1.55
EU	4.25	Aug-23	-1.05
Japan	-0.10	Jan-16	-3.40
China (lending)	4.35	Aug-23	4.65
Korea	3.50	Jul-23	1.20
India	6.50	Aug-23	-0.94
Indonesia	5.75	Jul-23	2.67

Money Mkt Rates	16-Aug	-1 mth	Chg (bps)
SPN (1M)	5.06	4.73	33.0
SUN (10Y)	6.42	6.16	25.8
INDONIA (O/N, Rp)	5.64	5.63	1.2
JIBOR 1M (Rp)	6.40	6.40	0.5

Bank Rates (Rp)	May	Apr	Chg (bps)
Lending (WC)	8.93	8.92	0.35
Deposit 1M	4.19	4.18	1.37
Savings	0.67	0.67	0.00

Currency/USD	16-Aug	-1 mth	Chg (%)
UK Pound	0.785	0.764	-2.76
Euro	0.919	0.891	-3.11
Japanese Yen	146.4	138.8	-5.16
Chinese RMB	7.299	7.142	-2.14
Indonesia Rupiah	15,283	14,958	-2.13

Capital Mkt	16-Aug	-1 mth	Chg (%)
JCI	6,900.5	6,869.6	0.45
DJIA	34,765.7	34,509.0	0.74
FTSE	7,356.9	7,434.6	-1.04
Nikkei 225	31,766.8	32,391.3	-1.93
Hang Seng	18,329.3	19,413.8	-5.59

Foreign portfolio ownership (Rp Tn)	Jul	Jun	Chg (Rp Tn)
Stock	2,892.9	2,755.0	137.88
Govt. Bond	846.9	846.9	0.00
Corp. Bond	11.3	11.3	-0.03

Trade & Commodities	16-Aug	-1 mth	Chg (%)
Baltic Dry Index	1,233.0	1,090.0	13.1
S&P GSCI Index	573.6	562.5	2.0
Oil (Brent, $/brl)	83.5	79.9	4.5
Coal ($/MT)	155.1	133.7	16.0
Gas ($/MMBtu)	2.55	2.50	1.9
Gold ($/oz.)	1,891.8	1,955.2	-3.2
Copper ($/MT)	8,115.3	8,661.8	-6.3
Nickel ($/MT)	19,530.0	21,400.5	-8.7
CPO ($/MT)	820.6	848.5	-3.3
Rubber ($/kg)	1.26	1.32	-4.5

External Sector	Jul	Jun	Chg (%)
Export ($ bn)	20.88	20.60	1.36
Import ($ bn)	19.57	17.15	14.10
Trade bal. ($ bn)	1.31	3.45	-61.96
Central bank reserves ($ bn)*	137.7	137.5	0.12

Prompt Indicators	Jul	Jun	May
Consumer confidence index (CCI)	123.5	127.1	128.3
Car sales (%YoY)	-6.8	4.7	65.2
Motorcycle sales (%YoY)	45.6	66.6	113.4

Manufacturing PMI	Jul	Jun	Chg (bps)
USA	46.4	46.0	40
Eurozone	42.7	43.4	-70
Japan	49.6	49.8	-20
China	49.2	50.5	-130
Korea	49.4	47.8	160
Indonesia	53.3	52.5	80

Source: Bloomberg, BI, BPS
Notes:
Car and motorcycle sales data to be released on the third week of January 2022
^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

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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

** Estimation of the Rupiah's fundamental exchange rate

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