Looking at a positive primary balance

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Summary

- Despite the more aggressive social spending, the government continues to maintain a positive budget balance so far in 2023 as the realisation of spending on subsidies, personnel, and goods is slowing relative to the trend.
- By maintaining a healthy SAL balance and decreasing the need for the government to turn to the bond market for funding, more constrained fiscal spending in 2023 may help the economy maintain price stability and stability in the financial (bond) market in the upcoming periods.
- Despite its positive impact on price and financial market stability, lower fiscal spending may have some detrimental impacts on Indonesia's GDP growth prospects, given the increasingly vital contribution of government spending.

- Last week was a difficult time for the Indonesian financial market. Foreign investors in the domestic bond market sold a net total of USD 260.2 million, pushing the yield on the 10-year Indonesian sovereign bond by 56bps to just below 7%. This increase in the discount rate, quite naturally, did not bode well for foreign investors in the stock market. Foreign investors sold around USD 106.5 Mn worth of Indonesian stocks in the past week, while at the same time, the Rupiah is also breaching the IDR 15,500/USD level, a level not seen since mid-January 2023.
- Despite the turbulent weather in the financial market, the domestic real sector continues to sail without much interruption. As we noted in last week's report, surging rice prices in September 2023 did not translate much to the headline CPI number, as shown by the 2.28% YoY reading in the September 2023 CPI inflation (more on this on our upcoming report on today's CPI data).
- This relatively calm outlook appears to be mirrored by the government. Indeed, the government continue to maintain a positive budget balance by August 2023, amounting to 0.70% of GDP, which is higher than the 0.55% budget balance recorded last year. A positively higher budget balance this deep in 2023, of course, does not necessarily reflect the government's increasingly miserly attitude in 2023. For instance, the government has benefitted from supernormal revenues in 2023, while the realisation of the spending budget in 2023 only rarely deviates from the trend rather than declining relative to the previous year ***(see Chart 1)***.

- This trend, however, appears to have lost its steam in May 2023. Granted, government revenue in Q2-Q3 2023 still outperforms the historical trend, except for 2022. However, despite recent disbursements for personnel and social spending, the realisation of government spending in 2023 appears to be veering towards its most sluggish pace in the past five years.
- Examining the realisation of the 2023 state budget relative to the previous year, it is quite apparent that the government is inclined to restrain spending in at least three functions; subsidies, personnel expenses, and spending for goods ***(see Chart 2)***. Less aggressive subsidy spending in 2023 (relative to 2022) is understandable, given the decision to increase subsidised fuel prices in September last year.
- The slowing pace of spending for goods, however, may deserve further scrutinisation. Given goods spending's more discretionary nature and the current administration's recurring practice of diverting budgets from one less pressing programme to another more pressing one, the slowdown in goods spending may signal the government's need to preserve some amount of "tactical" funds to stabilise domestic prices amidst the potentially worsening commodity supply shocks lurking in the near future.
- The government has worked quite well in shielding the domestic economy from higher prices in the global commodity market while also balancing the budget. Indeed, the government was rather quick to build its rice inventory in 2023, having imported around 62.1% of the national rice import target between January-April 2023 before India shut its grain export market. Pertamina has insofar also appears to be quite tactical in exploiting the ebbs and flows in the global oil market, having restocked its inventory in months such as July 2023 when oil prices were relatively low.
- There is no guarantee, however, that these cost-inducing shocks in the global commodity market will be limited to 2023. Rather, reports are pointing towards a worsening supply imbalance in 2024, highlighting the impetus for the government to maintain these tactical funds in the next year. The government, then, may continue to restrain its spending budget in 2023, especially for more discretionary items such as spending on goods. Given the rise in interest payment bills to 2.05% of GDP in 2023, the government's strategy to allocate some budget for its rainy-day funds in the next year might lead to a surplus in the primary balance, with some estimates pointing at around 0.2-0.5% of primary balance surplus in 2023.

"The slowdown in goods spending may signal the government's need to preserve some amount of 'tactical' funds"

- Some positives may arrive from the government's potentially more conservative attitude in 2023. Firstly, a healthy excess budget balance (*sisa anggaran lebih*, *SAL*), may reduce the necessity for the government to seek funding from the bond market in the next year, which may result in

SBN issuance being lower than the projected IDR 666.4 Tn in 2024. This, in turn, may help to maintain the yield on Indonesian government bonds at a favourable level, with the yield on 10Y SBN targeted at around 6.7% in 2024 (6.93% currently). Additionally, such a strategy may aid the government in its effort to reduce its interest payment, which shall enhance the flexibility of future state budgets.

- Growing concerns over the steadily depreciating Rupiah highlight another benefit that could be derived from the potential surplus in the 2023 primary balance. Apart from household spending, the surging government spending in May-June 2023 partly explains Indonesia's CA deficit in 2023, hardly providing support for the Rupiah amidst the ongoing depreciation trend. More constrained government spending, then, may keep the net domestic liquidity condition (which we use as a proxy for CA) at a surplus, which should provide some support for the Rupiah against the all-conquering USD ***(see Chart 3)***.

- While more restrained fiscal spending in the rest of 2023 may help the Indonesian economy maintain price and financial market stability in the upcoming year, such a fiscal policy may jeopardise Indonesia's growth outlook in the present. Government spending, as we know, has played an increasingly vital role in driving Indonesia's GDP growth over the past two quarters. Ergo, lower fiscal spending may complicate the government's effort to achieve the 5.1% growth target in 2023, given Indonesia's diminishing terms of trade and the slowdown in private consumption growth.

- More discouraging is the decline in fiscal spending may worsen the outlook for private spending. As we noted in a previous report (Collideascope: Refill, please?), fiscal spending emerges as the most viable solution to improve the now-dwindling liquidity condition in the domestic private sector ***(see Chart 4)***, replenishing the resources available to Indonesian businesses and households to expand their consumption activities.

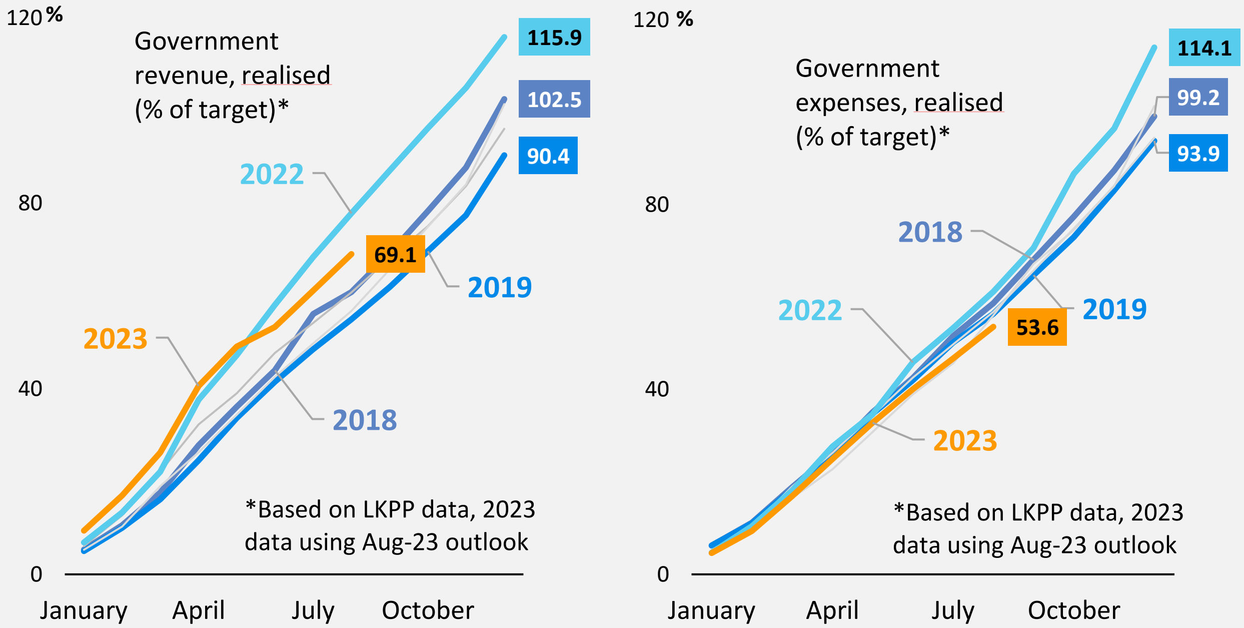
- We should note, however, that fiscal disbursements tend to speed up significantly by the end of the year, with 18.9% of goods spending and 35.7% of capital spending only released by December of last year. As illustrated in Chart 2, the government also appears to be more aggressive in realising its social spending budget relative to the previous year, signifying a shift towards more targeted fiscal spending in 2023. Therefore, while the factors mentioned above might be just enough to tilt Indonesia's primary balance to a surplus, a realm last witnessed in 2011, the question remains how much the government could disburse its spending budget to the private sector in this final quarter of 2023.

> ***"Apart from household spending, the surging government spending in May-June 2023 partly explains Indonesia's CA deficit in 2023"***

Chart 1

Slowest spending in the last five years

Realisation of government revenues has been quite significant in 2023 while state spending continue to lags behind relative to the trend in yesteryears.



Source: Indonesia MoF

Chart 2

More of this, less of that

Fiscal spending in 2023 is more targeted at lower-income population than households at large, as evident from the more-aggressive social spending relative to goods and subsidies

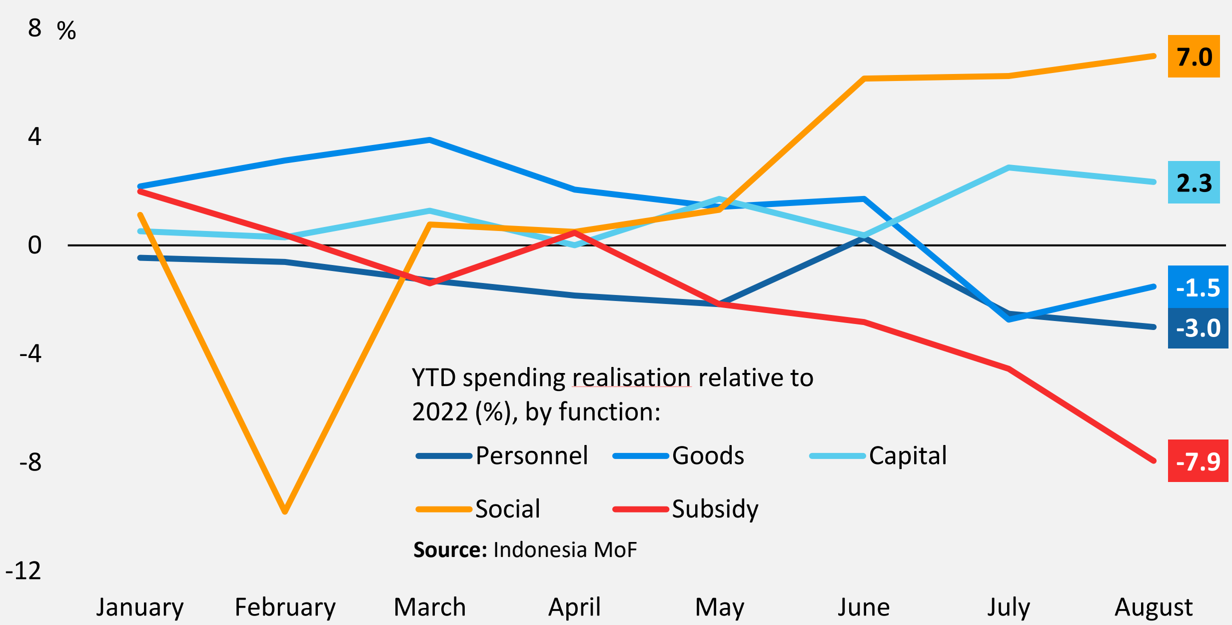
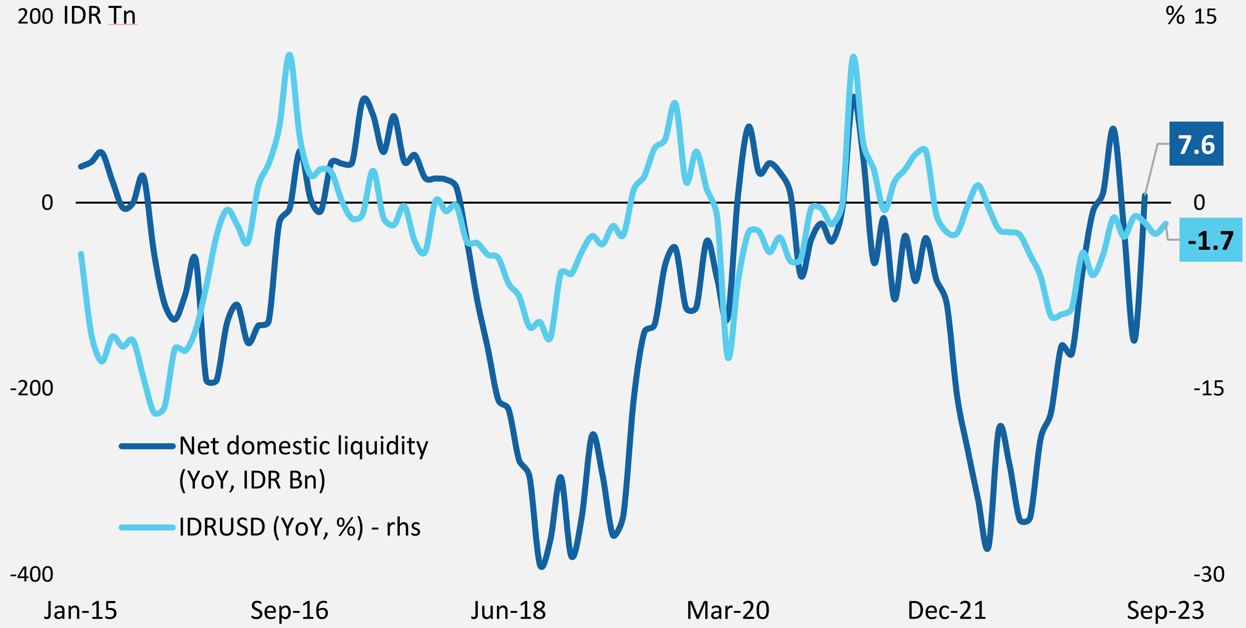


Chart 3

Saving for a stronger Rupiah

Lower public sector spending would keep the domestic liquidity condition on balance, which could translates positively to the IDR's exchange rate stability

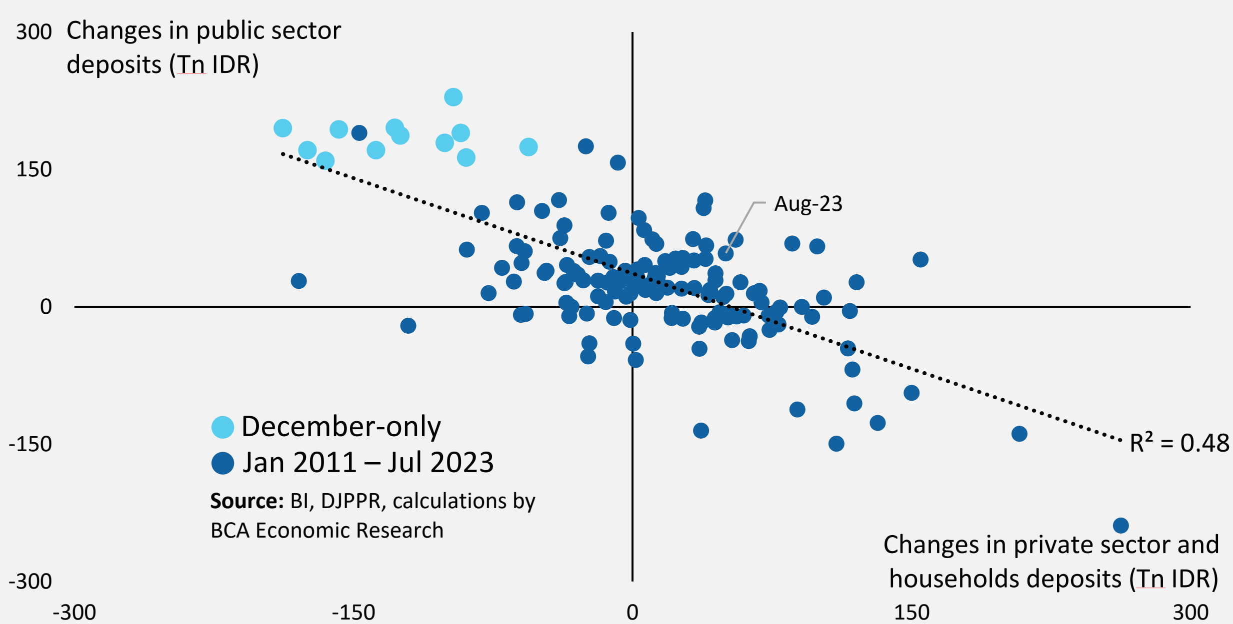


Source: Bloomberg, BI, DJPPR, calculations by BCA Economic Research

Chart 4

Waiting for the Fiscal Santa

Less-aggressive fiscal spending may translate negatively to the domestic private sector given the strong correlation between private sector liquidity and the government's fiscal cycle



Source: BI, DJPPR, calculations by BCA Economic Research

Economic Calendar

		Actual	Previous	Forecast*
1 October 2023				
CN	Caixin Manufacturing PMI	50.6	51.0	51.2
2 October 2023				
ID	S&P Global Manufacturing PMI	52.3	53.9	53
ID	**Inflation rate YoY**	**2.28%**	**3.27%**	**2.23%**
US	ISM Manufacturing PMI	-	47.6	48.1
3 October 2023				
US	JOLTs Job Openings (USD Mn)	-	8.8	8.6
5 October 2023				
US	Balance of Trade (USD Bn)	-	-65	-58.3
6 October 2023				
ID	**Foreign Exchange Reserves (USD Bn)**	**-**	**137.1**	**136.0**
US	Unemployment Rate	-	3.8%	3.8%
7 October 2023				
CN	Foreign Exchange Reserves (USD Tn)	-	3.16	3.15
9 October 2023				
ID	Consumer Confidence	-	125.2	125
11 October 2023				
ID	Retail Sales YoY	-	1.6%	1.3%
12 October 2023				
US	Inflation rate YoY	-	3.7%	3.8%
ID	Motorbike Sales YoY	-	1.8%	-
13 October 2023				
CN	Inflation Rate YoY	-	0.1%	0.2%
CN	Balance of Trade (USD Bn)	-	68.36	64.0
ID	Car Sales YoY	-	-8.3%	-
16 October 2023				
ID	**Balance of Trade (USD Bn)**	**-**	**3.12**	**4.6**
EA	Balance of Trade (EUR Bn)	-	6.5	-
19 October 2023				
ID	Loan Growth YoY	-	9.06%	-
ID	**Interest Rate Decision**	**-**	**5.75%**	**5.75%**
24 October 2023				
ID	Foreign Direct Investment YoY	-	14.2%	-

*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	Sep-23	1.80
UK	5.25	Sep-23	-1.45
EU	4.50	Sep-23	0.20
Japan	-0.10	Jan-16	-3.30
China (lending)	2.50	Sep-23	4.25
Korea	3.50	Aug-23	0.10
India	6.50	Aug-23	-0.33
Indonesia	5.75	Sep-23	3.47

Money Mkt Rates	29-Sep	-1 mth	Chg (bps)
SPN (1M)	5.33	5.58	-25.5
SUN (10Y)	6.89	6.36	53.1
INDONIA (O/N, Rp)	5.63	5.58	4.4
JIBOR 1M (Rp)	6.40	6.40	0.0

Bank Rates (Rp)	Jun	May	Chg (bps)
Lending (WC)	8.93	8.93	0.00
Deposit 1M	4.19	4.19	0.10
Savings	0.67	0.67	-0.20

Currency/USD	29-Sep	-1 mth	Chg (%)
UK Pound	0.820	0.791	-3.52
Euro	0.946	0.919	-2.82
Japanese Yen	149.4	145.9	-2.34
Chinese RMB	7.298	7.281	-0.24
Indonesia Rupiah	15,455	15,260	-1.26

Capital Mkt	29-Sep	-1 mth	Chg (%)
JCI	6,939.9	6,957.8	-0.26
DJIA	33,507.5	34,852.7	-3.86
FTSE	7,608.1	7,465.0	1.92
Nikkei 225	31,857.6	32,227.0	-1.15
Hang Seng	17,809.7	18,484.0	-3.65

Foreign portfolio ownership (Rp Tn)	Sep	Aug	Chg (Rp Tn)
Stock	2,833.3	2,869.7	-36.44
Govt. Bond	829.5	846.3	-16.83
Corp. Bond	10.8	11.1	-0.26

Trade & Commodities	29-Sep	-1 mth	Chg (%)
Baltic Dry Index	1,701.0	1,107.0	53.7
S&P GSCI Index	609.7	586.7	3.9
Oil (Brent, $/brl)	95.3	85.5	11.5
Coal ($/MT)	156.4	161.7	-3.3
Gas ($/MMBtu)	2.68	2.50	7.2
Gold ($/oz.)	1,848.6	1,937.5	-4.6
Copper ($/MT)	8,212.5	8,411.0	-2.4
Nickel ($/MT)	18,440.0	20,486.0	-10.0
CPO ($/MT)	779.6	803.0	-2.9
Rubber ($/kg)	1.39	1.33	4.5

External Sector	Aug	Jul	Chg (%)
Export ($ bn)	22.00	20.86	5.47
Import ($ bn)	18.88	19.57	-3.53
Trade bal. ($ bn)	3.12	1.29	141.85
Central bank reserves ($ bn)*	137.1	137.7	-0.42

Prompt Indicators	Aug	Jul	Jun
Consumer confidence index (CCI)	125.2	123.5	127.1
Car sales (%YoY)	-8.3	-6.7	4.7
Motorcycle sales (%YoY)	1.8	45.6	66.6

Manufacturing PMI	Sep	Aug	Chg (bps)
USA	N/A	47.6	0
Eurozone	43.4	43.5	-10
Japan	48.5	49.6	-110
China	50.6	51.0	-40
Korea	N/A	48.9	0
Indonesia	52.3	53.9	-160

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

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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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