

A budget full of confidence

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Summary

- The government remains optimistic about the Indonesian economy in 2024, setting a GDP growth target of 5.3-5.7%. This target contrasts with the gloomy global economic outlook and the government's inflation target of 1.5-3.5%.
- The government's GDP and inflation targets reflect their belief that the global economy will experience significant challenges in 2024, while domestic factors such as household consumption and private investments will be sufficient to drive the economy towards another above 5% growth.
- The government is proposing a less-expansive fiscal budget despite the ambitious GDP growth target. This approach may provide room for Bank Indonesia to implement a more accommodative monetary policy, although any changes are not expected in the short term due to moderating expectations regarding the Fed's policy shift.

- Last week was relatively quiet in terms of economic data releases, as the data that emerged (such as Indonesia's trade balance, China's industrial output, and retail sales) simply reaffirmed previous indications. Nonetheless, it holds significant importance. Notably, several speeches delivered by FOMC members last week triggered a noticeable shift in expectations for Fed rates (**see Chart 1**), dampening the optimism surrounding the "Fed pivot" camp that may suppress the demand for risky assets. Indeed, this shift in Fed rate expectations coincided with outflows from Indonesia's financial market, particularly from the bond market as foreign investors sold USD 412.22 Mn worth of Indonesian government bonds.
- Last week also marked the start of the government's 2024 budget formulation

process, with the Finance minister outlining the current administration's last macro-economic framework (*Kerangka ekonomi makro, KEM*) and principles of fiscal policy (*Pokok pokok kebijakan fiskal, PPKF*). Similar to this year, the government continue to set high targets for 2024, aiming for 5.3-5.7% economic growth (5.3% YoY in 2023), which contrasts with the rather gloomy outlook for the global economy as outlined by the IMF.

- However, the economic growth target appears to be at odds with other macroeconomic assumptions for 2024. A notable example is the inflation target, set by the government in the range of 1.5-3.5%. While this target is only provisional, aiming for 5.3% economic growth while keeping inflation at 1.5% seems rather optimistic, given that the inflation target reflects a

scenario given that the inflation target reflects a scenario where global economic activity slows down (and hence, lower demand for commodities).

- Indeed, the government's other macroeconomic assumptions are consistent with the expectation of an incoming global recession. For example, the government expects oil prices to remain below USD 85/bl in 2024, reflecting prolonged weakness in demand. Additionally, assumptions regarding the USDIDR exchange rate (14,700-15,300) and 10Y government bond yield (6.49-6.91%) indicate expectations of substantial rate cuts by the Fed in 2024, which may occur if signs of US economic slowdown become more evident.

- The government, then, is aware that external demand will not provide a substantial boost to the economy. **This condition gives light to the second assumption, that domestic drivers such as household consumption and investments will shield the Indonesian economy from the global recession.** Thus, the government's stance appears to envision an economic El Dorado, where declining global demand keeps prices low, while the Indonesian economy continues to grow at an above 5% pace thanks solely to domestic demand.
- The government's optimism may also be derived from the strong economic performance observed in 2022. Despite the negative impact of reduced government spending, Indonesia achieved a growth rate

of 5.03% driven by resilient household consumption and strong external demand especially for commodities. However, these growth drivers are gradually weakening in 2023, prompting the government to utilise its resources and implement economic stimulus measures. Nevertheless, **the government is preparing for a more conservative fiscal approach in 2024, with a projected budget deficit of around 2.64% of GDP, compared to 2.84% of GDP in 2023.**

- It is important to note that a lower budget deficit for the coming year does not imply a contraction in government spending. On the contrary, the government will benefit from

expanding the tax base following last year's tax reform and amnesty program, which is predicted to increase government revenues to 12.38% of GDP in 2024 (11.71% of GDP in 2023). Whether the govern-

ment could achieve this revenue target is up for debate. Indeed, strong government revenues in 2022 (and hopefully 2023) are driven by soaring commodity prices, which is something that even the government does not expect to happen in 2024.

- The government's decision to adopt a more measured fiscal approach in 2024 becomes even more noteworthy when considering the outlook for the domestic bond market. It is important to emphasise that the Indonesian bond market has been benefiting from the Fed pivot sentiment, which has increased the demand for emerging market IOUs, including Indonesian government bonds. While the

"The government seems to expect that the domestic economy would significantly outperform its global peers"

likelihood of a Fed rate cut in 2023 is still a topic of debate, there is consensus regarding the possibility of rate cuts in 2024. This suggests an improved liquidity environment that should have a positive impact on the demand for Indonesian government bonds in the coming year. Ergo, concerns about unfavourable financing conditions do not adequately justify the government's less-expansive fiscal stance in 2024.

- It may be the case that the government simply does not see the need to spend to the bottom of its coffers to provide additional support for the economy. After all, **there is still-ample liquidity in the public sector, allowing the government to strategically allocate and spend funds to combat any potential impact of global economic slowdown.** It may also be the case that the government expects the impact of the global economic slowdown may primarily hit Indonesia somewhere in H2 2023 rather than in 2024, which fits Indonesia's profile as a commodity producer as the commodity cycle often precedes the actual global economic cycle.
- Despite the less-expansive fiscal posture and increasingly-optimistic growth target, **the government's assumption that private-driven domestic demand could fuel the Indonesian economy into another 5% growth is not necessarily flawed.** Indeed, the government's optimism is justifiable by two factors. The first one is the positive outlook for investments, driven by the improved legal status of the omnibus law on

job creation (UU Ciptaker), ongoing mineral downstreaming efforts, and Bank Indonesia's macroprudential inclusive financing ratio (RPIM).

- However, it is important to consider that this assumption may be exaggerated. While the ratification of the job creation law is a positive development, concerns have been raised regarding the sustainability of Indonesia's nickel industrial complex, especially given the potential over-supply of nickel in the face of a global economic downturn. Additionally, the extent to which the RPIM policy can stimulate investments remains uncertain, given the composition of Indonesia's MSME sector, which is predominantly comprised of businesses in the retail/wholesale sector rather than the more capital-intensive manufacturing sector.
- The relatively low capital requirement in the domestic MSME sector, combined with the increase in RPIM (from 25% to 30% in 2024), may lead to a widening gap between MSME loans and capital accumulation. Still, considering the importance of MSME in providing jobs for middle-income and low-income segments, the RPIM ratio may prove to be an important part of safeguarding consumption among these segments. Consequently, **the multiplier effect of BI's RPIM policy could reverberate into household consumption, which is a deviation from the intended purpose but nevertheless crucial for achieving the growth targets in 2023-2024.**

"The government may look to strategically spend its ample liquidity in 2023-2024"

- Another aspect that underscores the significance of household consumption is the government's commitment to maintaining the VAT tariff at its current level in 2024, demonstrating a cautious approach aimed at avoiding disruptions to consumer spending.
- Additionally, various alternatives to fiscal stimulus can be employed to boost household consumption. One such strategy is providing support through a more flexible monetary policy, which can serve as a counterbalance if the government chooses to be more conservative with fiscal measures. The recent ratification of the financial sector omnibus law (UU PPSK) underscores the importance of improved coordination between monetary and fiscal policies. Therefore, the government's intention to maintain a smaller budget deficit could indicate Bank Indonesia's shift toward a more growth-oriented stance in 2024, which is crucial considering the ambitious growth target and the potential stagnation in aggregate demand growth.
- In the short term, however, **we maintain our view that BI is likely to refrain from adjusting its policy rate in 2023.** The fluctuations in market expectations regarding the Fed's interest rates may expose the Rupiah to renewed depreciation pressures, particularly in light of the upcoming seasonal increase in external payments and the overall decline in commodity prices.
- While a slight depreciation of the IDR's value may be unavoidable, the risk of depreciation may not be significant due to the relatively limited capital outflow risks. **Despite the recent shift in Fed rate expectations, the deteriorating conditions in the US Main Street suggest that the Fed's ability to continue raising rates may be constrained.**
- Furthermore, the current lower valuations of Indonesian stocks could attract inflows to the country's financial market (*See Chart 2*), and the improving domestic FX liquidity conditions provide additional support for the Rupiah amid the decline in commodity prices. BI, of course, may look at data to chart its way forward. However, the current data indicate that BI may maintain its stance of a tighter monetary policy in the near term, with a potential for a more accommodative policy in the following year.

“Some depreciations may be unavoidable, but the Rupiah may continue to be stable in the coming periods”

Chart 1

A changing landscape?

The “Fed pivot” sentiment seems to have tapered off following multiple hawkish Fedspeaks last week.

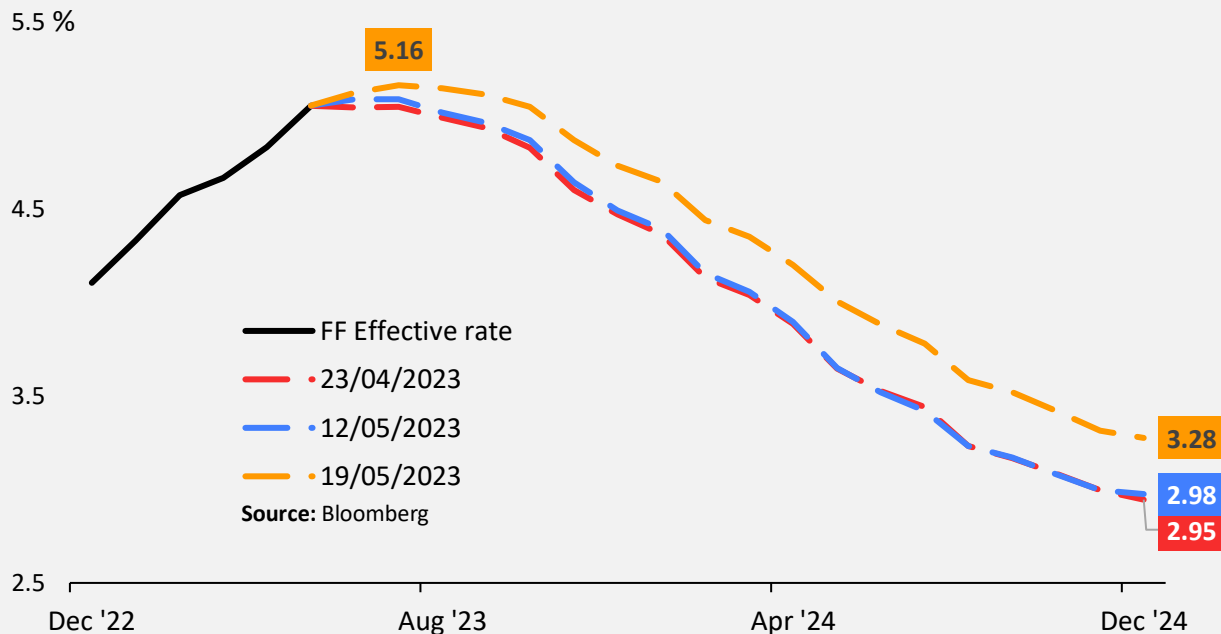
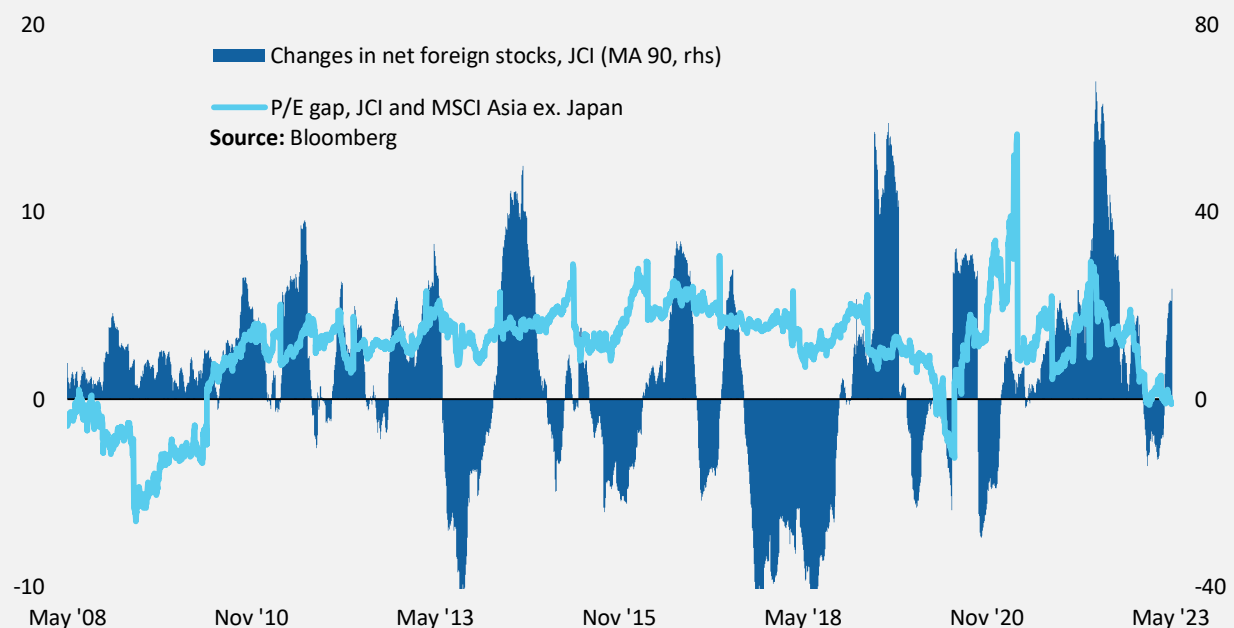


Chart 2

Lower price, higher demand?

Now-cheaper Indonesian stocks may help to encourage foreign inflows to the domestic financial market amidst the moderation in the Fed pivot sentiment.



Economic Calendar				
		Actual	Previous	Forecast*
1 May 2023				
US	ISM Manufacturing PMI	47.1	46.3	46.5
2 May 2023				
ID	S&P Global Manufacturing PMI	52.7	51.9	51.6
ID	Inflation Rate YoY	4.33%	4.97%	4.5%
EA	Inflation Rate YoY	7%	6.9%	6.9%
4 May 2023				
US	Fed Interest Rate Decision	5.25%	5%	5.25%
US	Balance of Trade (USD Bn)	-64.2	-70.5	-63.1
7 May 2023				
CN	Foreign Exchange Reserves (USD Bn)	3.205	3.184	3.19
8 May 2023				
ID	Motorbike Sales YoY	-19.4%	40.5%	-
ID	Foreign Exchange Reserves (USD Bn)	144.2	145.2	146.0
9 May 2023				
CN	Balance of Trade (USD Bn)	90.21	88.19	76.0
ID	Consumer Confidence	126.1	123.3	123
10 May 2023				
US	Inflation rate YoY	4.9	5%	4.9%
ID	Retail Sales	4.9%	0.6%	1.4%
11 May 2023				
CN	Inflation rate YoY	0.1%	0.7%	0.4%
15 May 2023				
ID	Balance of trade (USD Bn)	3.94	2.83	3.2
16 May 2023				
CN	Industrial Production YoY	5.6%	3.9%	9.8%
EA	Balance of Trade (EUR Bn)	25.6	4.6	-12.7
19 May 2023				
ID	Car Sales YoY	-28.8%	2.6%	-
25 May 2023				
ID	Property Price Index YoY	-	2.0%	2.2%
ID	Loan Growth YoY	-	9.93%	1.0%

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



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Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	19-May	- 1 mth	Chg (%)
US	5.25	May-23	0.35	Baltic Dry Index	1,384.0	1,368.0	1.2
UK	4.50	May-23	-5.60	S&P GSCI Index	543.4	593.2	-8.4
EU	3.75	May-23	-3.25	Oil (Brent, \$/bbl)	75.6	84.8	-10.8
Japan	-0.10	Jan-16	-3.60	Coal (\$/MT)	158.5	191.3	-17.1
China (lending)	4.35	May-23	4.25	Gas (\$/MMBtu)	2.37	2.23	6.3
Korea	3.50	Apr-23	-0.20	Gold (\$/oz.)	1,977.8	2,005.5	-1.4
India	6.50	Apr-23	1.80	Copper (\$/MT)	8,201.0	9,004.4	-8.9
Indonesia	5.75	Apr-23	1.42	Nickel (\$/MT)	21,171.0	25,593.0	-17.3
Money Mkt Rates	19-May	- 1 mth	Chg (bps)				
SPN (1M)	3.86	3.93	-6.4				
SUN (10Y)	6.42	6.65	-23.0				
INDONIA (O/N, Rp)	5.51	5.98	-46.4				
JIBOR 1M (Rp)	6.40	6.40	0.4				
Bank Rates (Rp)	Feb	Jan	Chg (bps)				
Lending (WC)	8.89	8.75	13.80				
Deposit 1M	4.18	4.00	17.94				
Savings	0.67	0.67	0.25				
Currency/USD	19-May	- 1 mth	Chg (%)				
UK Pound	0.804	0.805	0.16				
Euro	0.925	0.911	-1.52				
Japanese Yen	138.0	134.1	-2.80				
Chinese RMB	7.012	6.876	-1.94				
Indonesia Rupiah	14,925	14,845	-0.54				
Capital Mkt	19-May	- 1 mth	Chg (%)				
JCI	6,700.6	6,821.8	-1.78				
DJIA	33,426.6	33,976.6	-1.62				
FTSE	7,756.9	7,909.4	-1.93				
Nikkei 225	30,808.4	28,658.8	7.50				
Hang Seng	19,450.6	20,650.5	-5.81				
Foreign portfolio ownership (Rp Tn)	Apr	Mar	Chg (Rp Tn)				
Stock	2,789.1	2,726.8	62.33				
Govt. Bond	818.5	818.5	0.00				
Corp. Bond	11.8	12.0	-0.20				
				External Sector	Apr	Mar	Chg (%)
				Export (\$ bn)	19.29	23.42	-17.62
				Import (\$ bn)	15.35	20.59	-25.45
				Trade bal. (\$ bn)	3.94	2.83	39.43
				Central bank reserves (\$ bn)*	144.2	145.2	-0.68
				Prompt Indicators	Apr	Mar	Dec
				Consumer confidence index (CCI)	126.1	123.3	119.9
				Car sales (%YoY)	-28.8	2.7	9.0
				Motorcycle sales (%YoY)	-19.4	40.5	24.6
				Manufacturing PMI	Apr	Mar	Chg (bps)
				USA	47.1	46.3	80
				Eurozone	45.8	47.3	-150
				Japan	49.5	49.2	30
				China	49.5	50.0	-50
				Korea	48.1	47.6	50
				Indonesia	52.7	51.9	80

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	5.0
GDP per Capita (US\$)	3927	4175	3912	4350	4784	5011
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	3.4
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	28.4
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-1.02

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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