Marching Ahead Against External Hurdles

Photo credit: unsplash.com/@marcogiuseppetimelli

2024

INDONESIA MACROECONOMIC OUTLOOK

BCA Macroeconomic and Industry Research

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Executive Summary

GDP

Indonesia's economic growth momentum would increasingly rely on domestic factors as the global demand is expected to weaken in 2024. **Higher fiscal spending amid the election period may fuel the economy towards another 5% YoY GDP growth in 2024**, but concerns on whether the fiscal spree would last throughout the year means that *the GDP growth number in 2024 may be a touch slower than in the previous year.*

Rate

Relatively stable domestic inflation and the receding pressure on Indonesia's financial market may encourage Bank Indonesia to pursue a looser policy stance in 2024. However, *the still-volatile global interest rate expectation may continue to put the central bank on high alert*, as **BI is expected to lower the BI7dRR by 50-75 bps in 2024 depending on how the Fed would follow through on its dovish signals.**

CA

Indonesia may retain its trade surplus, given the prospect of still-elevated commodity prices in 2024. However, the relatively robust domestic aggregate demand growth and the continued strength of investment growth ***may* hold *Indonesia's current account balance at a narrow 0.5% GDP deficit in the upcoming year.***

#1: Introduction

"A surprisingly smooth sailing in 2023"

The global and domestic economy confounded gloomy expectations in 2023 – even the commodity headwinds are unlikely to push Indonesia's GDP growth below its usual 5%-plus pace. But despite still-strong domestic demand, the global situation is sufficiently unpredictable that the outlook for 2024 remains far from certain.

The global economy is not in its best shape in 2023, but things are better than first expected

FY 2023 Annual GDP forecast, median of private forecasters (%)

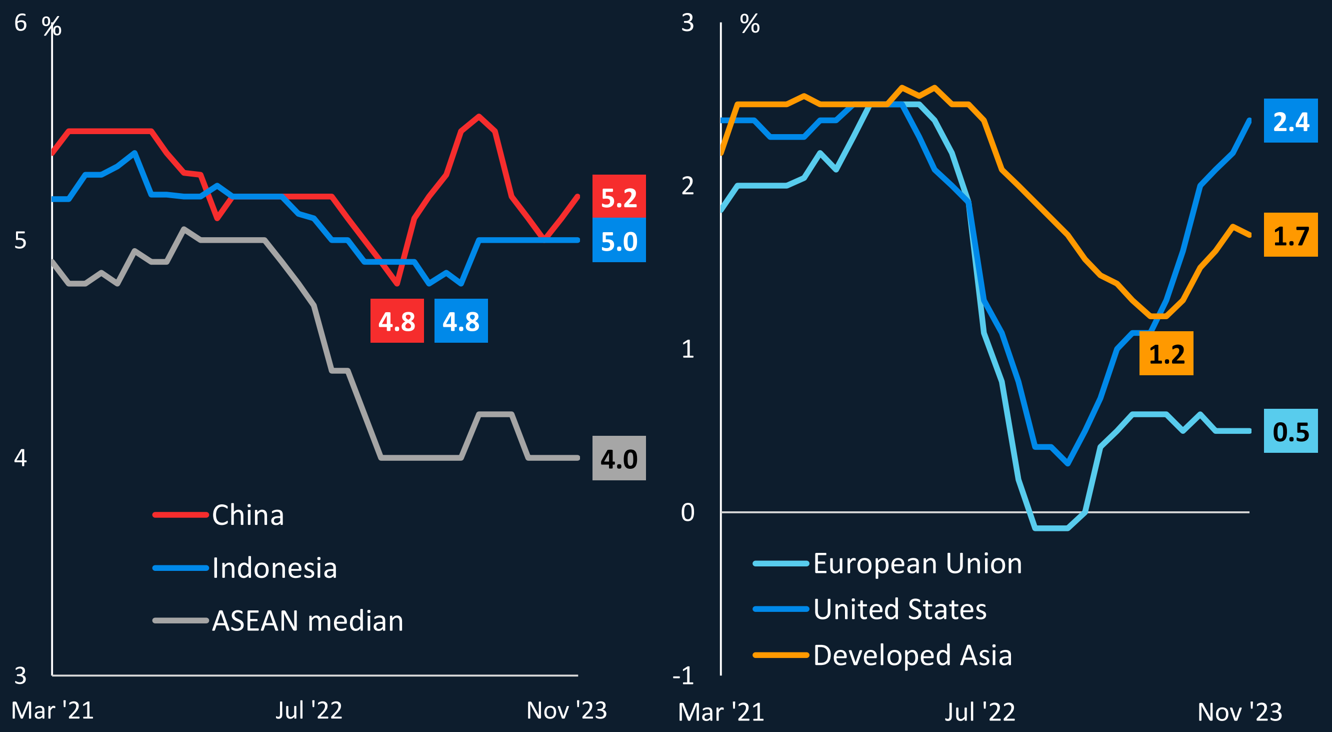


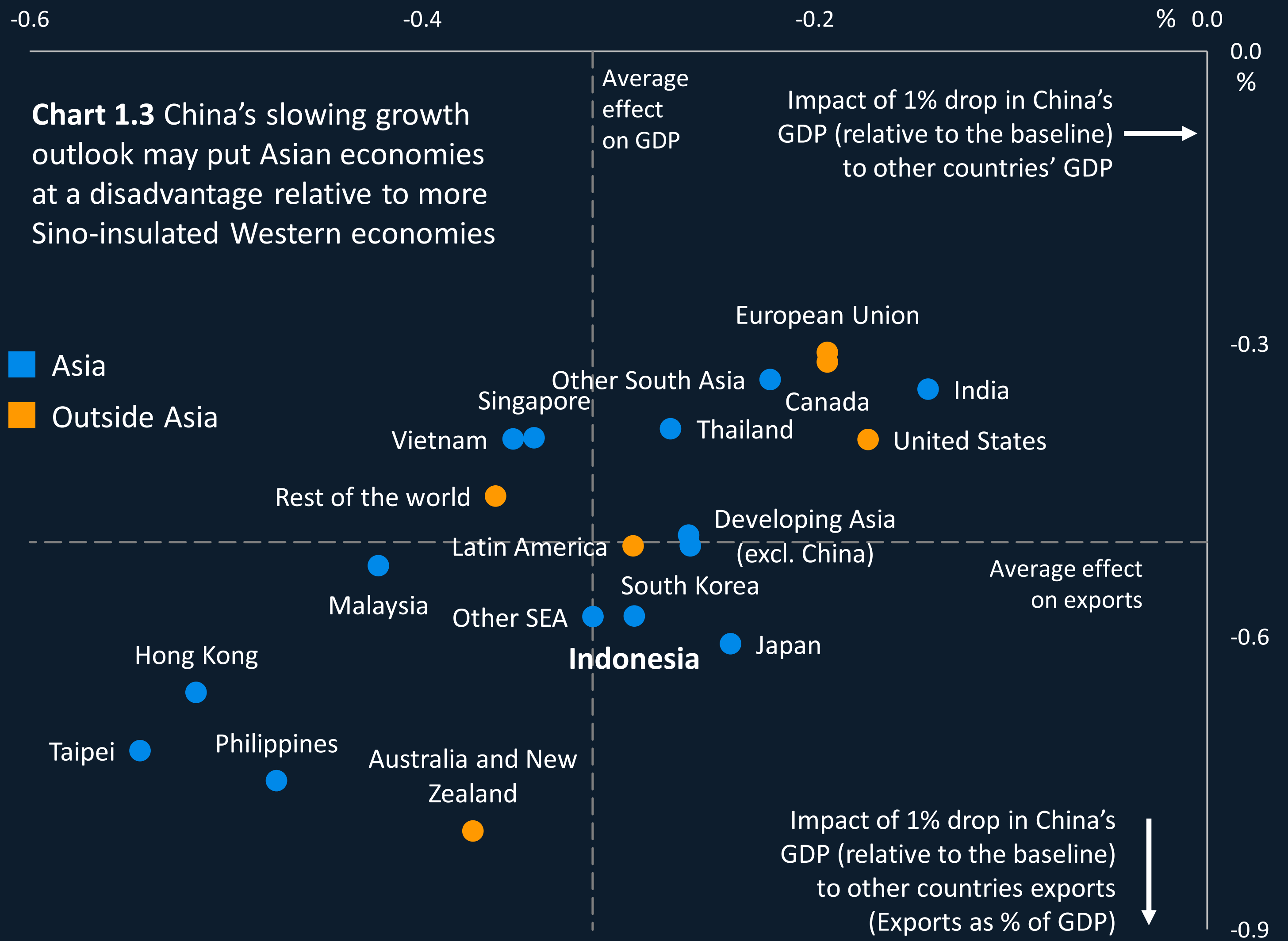
Chart 1.1-1.2 The dreaded "winter of discontent" never arrived for the global economy as supply conditions improved in 2023, but growth in China and especially Europe is set to plateau at lower levels than before

Source: Bloomberg

- To discuss the Indonesian economic outlook for 2024, it is necessary to first look at the global situation in 2023. The prevailing fear entering the year was either stagflation or – if inflation were to be overcome – that global demand would collapse. **But as it turned out, the situation was far better than expected: inflation decline, but without significant decline in global growth.**
- This cannot be separated from three main interventions: (i) rate hikes by the Fed and other central banks; (ii) release of oil from the US' strategic petroleum reserves (SPR); and (iii) the re-opening of China's economy.
- All these are themes that we explore more deeply in our ***Global Outlook***, but as far as Indonesia is concerned, the impact is rather mixed. For instance, the extra supply – particularly from China's excess industrial output – helps suppress inflation and thereby facilitate consumption.
- On the other hand, the Fed's tightening have had destabil-ising effect on the Rupiah's exchange rate, while China's reopening failed to incite a rally in the global commodity markets, with detrimental effect on our exports.

China's dimming light poses problems for some economies more than the others

Chart 1.3 China's slowing growth outlook may put Asian economies at a disadvantage relative to more Sino-insulated Western economies



Source: Zhai and Morgan, Impact of the People's Republic of China's Growth Slowdown on Emerging Asia: A General Equilibrium Analysis (March 25, 2016). ADBI Working Paper 560

- The risk of slowing growth in China spells trouble for the Indonesian economy in several inter-connected ways. First, **it worsens perception on Asian economies and thereby depresses Asian currencies**, accentuating the impact of the USD's recent rise.
- Secondly, China's excess output – coupled with weaker CNY – are toxic for domestic manu-facturers, which faces a 'race-to-the-bottom' dynamic against their Chinese competitors. Thirdly and finally, as mentioned, it also has negative effect on commodity prices, given China's outsized role as a global manufacturing hub.
- Fortunately for Indonesia, while the situation is clearly unfavourable for exporters, **the impact on GDP growth is cushioned by Indonesia's relatively limited dependence on exports**. As was often the case during prior global crises, it is Indonesia's huge internal market that comes to the rescue.

Indonesia increasingly relies on its internal market to keep the growth momentum alive

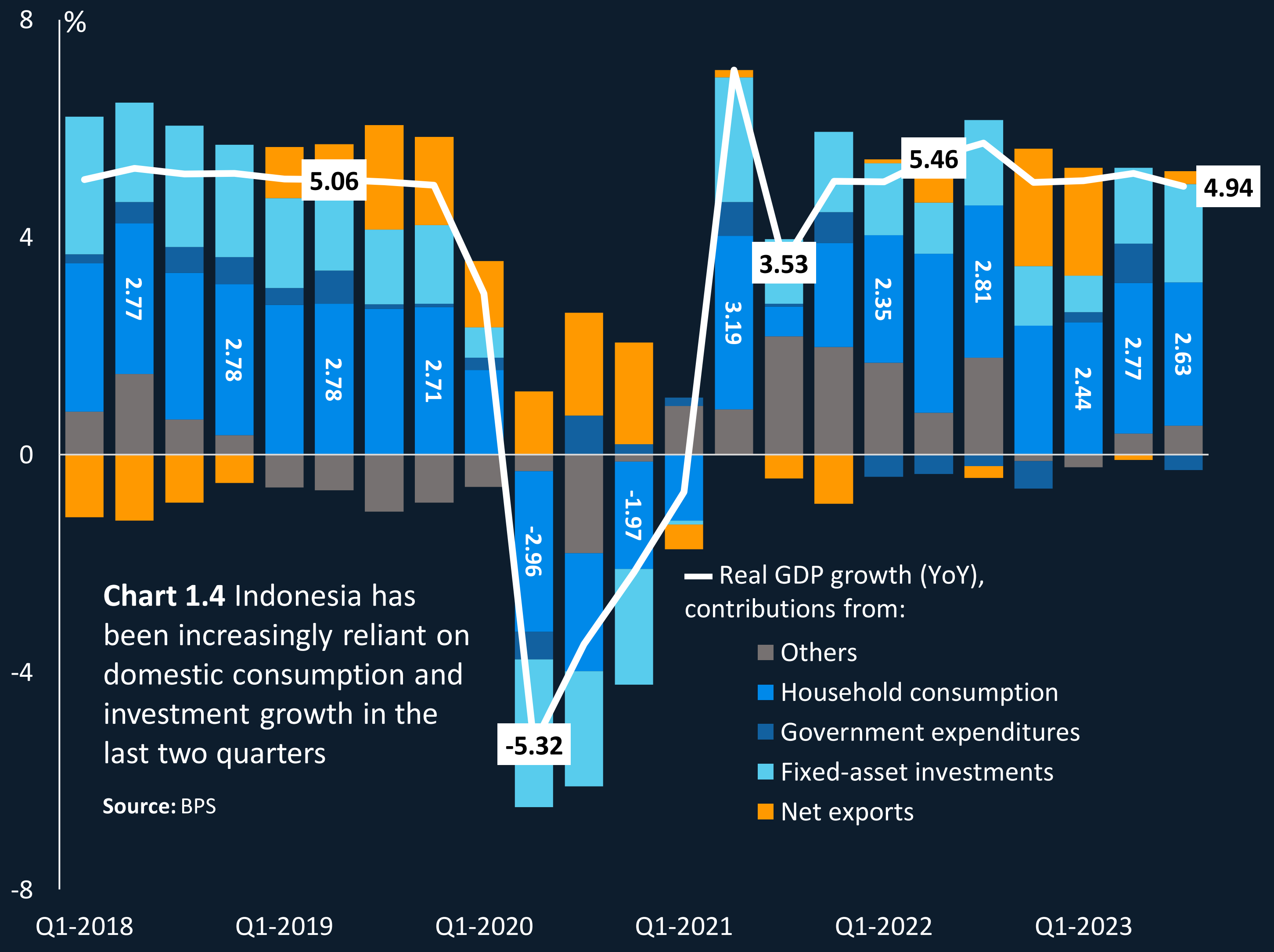
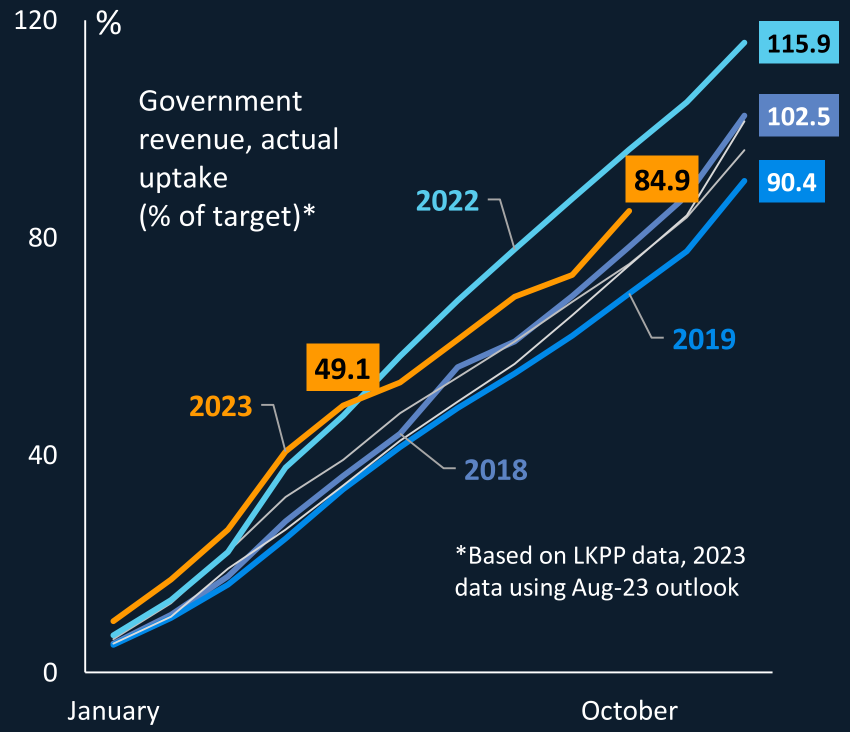


Chart 1.4 Indonesia has been increasingly reliant on domestic consumption and investment growth in the last two quarters

Source: BPS

- The general downturn in commodity prices has under-cut Indonesia's terms of trade – although its impact on real growth is much less dramatic as export volumes to China has remained quite robust. Still, it is quite evident that Indonesia can no longer rely on exports to propel its growth to the same extent as in 2021-22.
- Fortunately, **domestic demand is more than ready to take the baton.** While household consumption slowed in the wake of fuel price hike in Sep-22, it has picked up significantly by mid-23. This was greatly facilitated by stabilising prices, along with the global disinflation trend and in particular the influx of imported consumer goods from China.
- Fixed-asset investment have also seen notable revival, contributing to GDP growth at nearly the same extent as the "peak Jokowinomics" years in 2017-18. The export decline, it seems, had not dim the appetite to invest. And then, of course. there is the matter of government spending.

Fiscal policy has served as a brake for most of 2023, but things may be changing



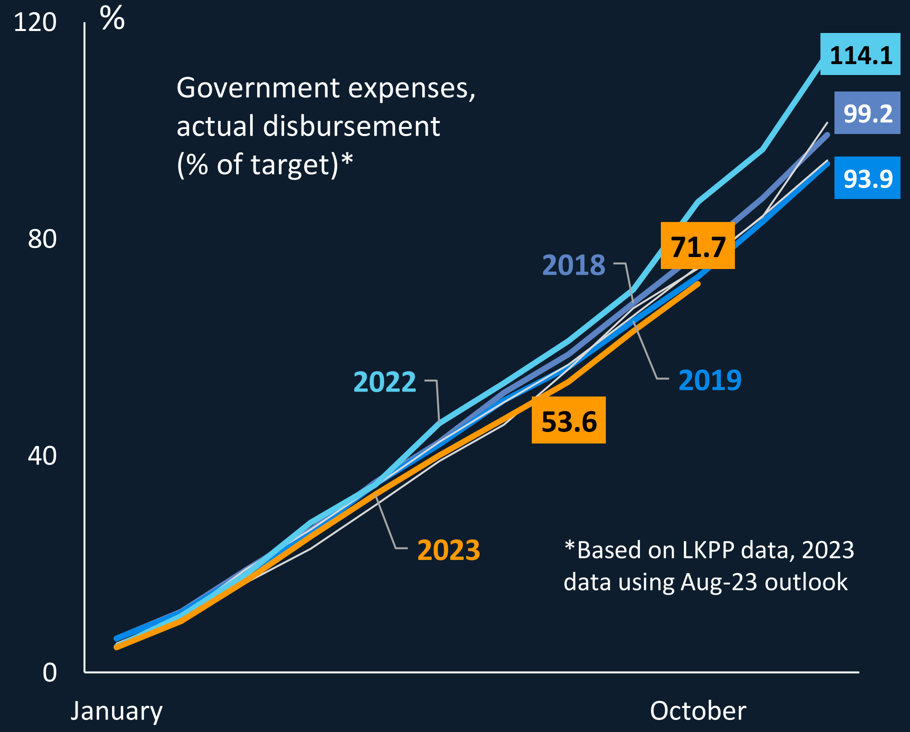


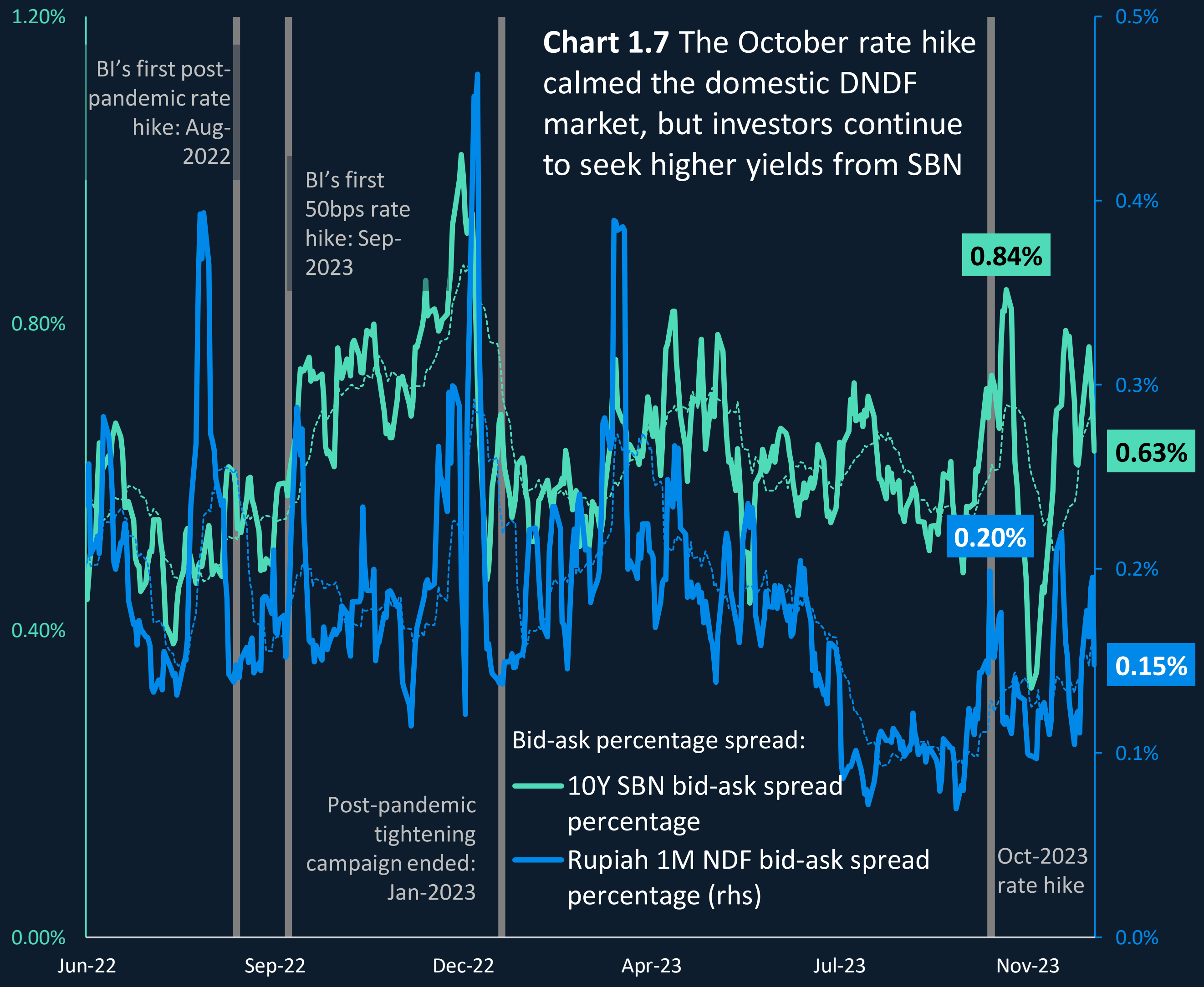
Chart 1.5-1.6 The government enjoyed strong revenue growth through 2022 and early 2023, but government spending was relatively lagging, except for the tail end of 2022

Source: Indonesia MoF

- Indonesia's relatively robust domestic demand is even more remarkable given the government's relatively restrictive fiscal posture thus far in 2023. **Supernormal profits due to high commodity prices in 2022 has lead to a windfall in tax revenues up until early 2023, while the same is not observable on the spending side.** This cautious stance is a continuation of 2022, when the government managed to exit the extraordinary pandemic-era deficit spending one year earlier than expected.
- **This situation, however, may soon change.** Despite its negative contribution to the Q3 2023 GDP growth number, the government has signalled its intention to attain its deficit target in 2023, which translates to massive fiscal disbursement to the tune of almost 1.6% of GDP in the last two months of the year. This spending is further spurred by the upcoming Elections and the spectre of rising food prices.

External pressures make it hard for BI to turn its focus away from stability

Chart 1.7 The October rate hike calmed the domestic DNDF market, but investors continue to seek higher yields from SBN



Source: Bloomberg. Data per 15 Dec 2023

- Just like the fiscal authorities, Bank Indonesia has maintained relatively short leash on the economy in 2023, but not for lack of trying. BI actually concluded its rate hike cycle earlier than other central banks, in Jan-23 – and the situation actually supported its decision at that time. In particular, Indonesia's wide real rate differentials vis-à-vis the US provided a strong incentive for foreign money to flow in.
- Alas, the vicissitude in investors' behaviour hit the domestic market hard during Q3-23, leading to continuous outflows and relentless pressure on the IDR. This prompted BI to react, first relying mostly on direct interventions in the FX market. But this strategy proved costly to BI's reserves, forcing it to make a somewhat-unexpected 25 bps hike in October.
- This did not quite quell market sentiment, but fate intervened in Indonesia's favour late in the year. Another dovish shift in the market's perception Fed's policy outlook calmed the IDR and Indonesian bond market, allowing BI to keep its policy rate at the current 6.00% level. We move our discussion, then, by pondering if this state of affairs would continue in 2024.

#2: Of Rates and Policies

"Waiting for the monsoon wind"

Despite its promising start, the still-volatile global expectations highlight the challenge facing the Indonesian financial market throughout 2023. As was the case at the beginning of 2023, the relatively calm domestic financial market conditions currently may prompt the central bank to start pondering a way to loosen the policy condition. The central bank's mandate to keep the Rupiah stable may continue to keep BI on high alert, given the still wide divergence in the global rate expectation.

Unfavourable regional situation compound the Rupiah's challenge in 2024

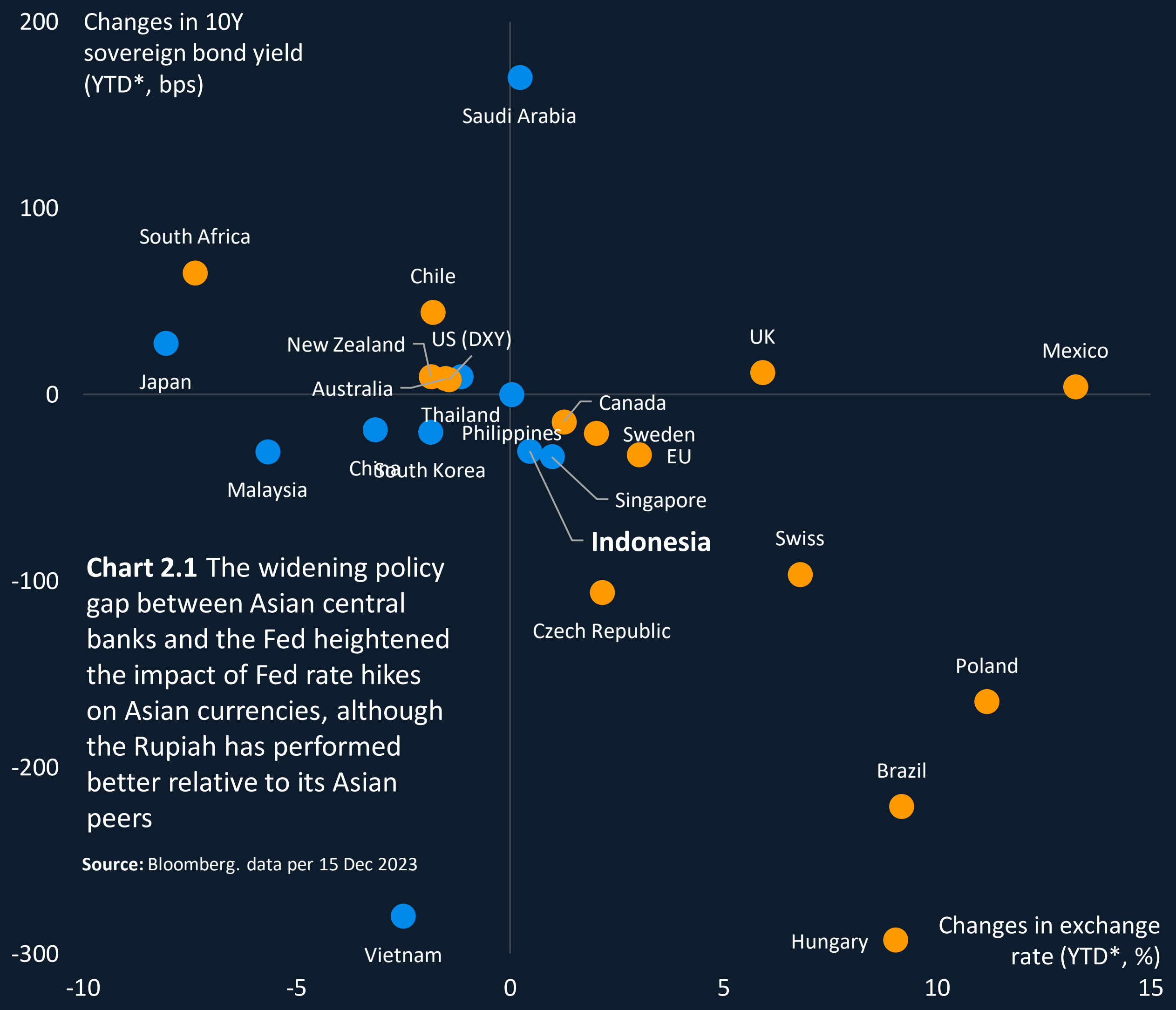


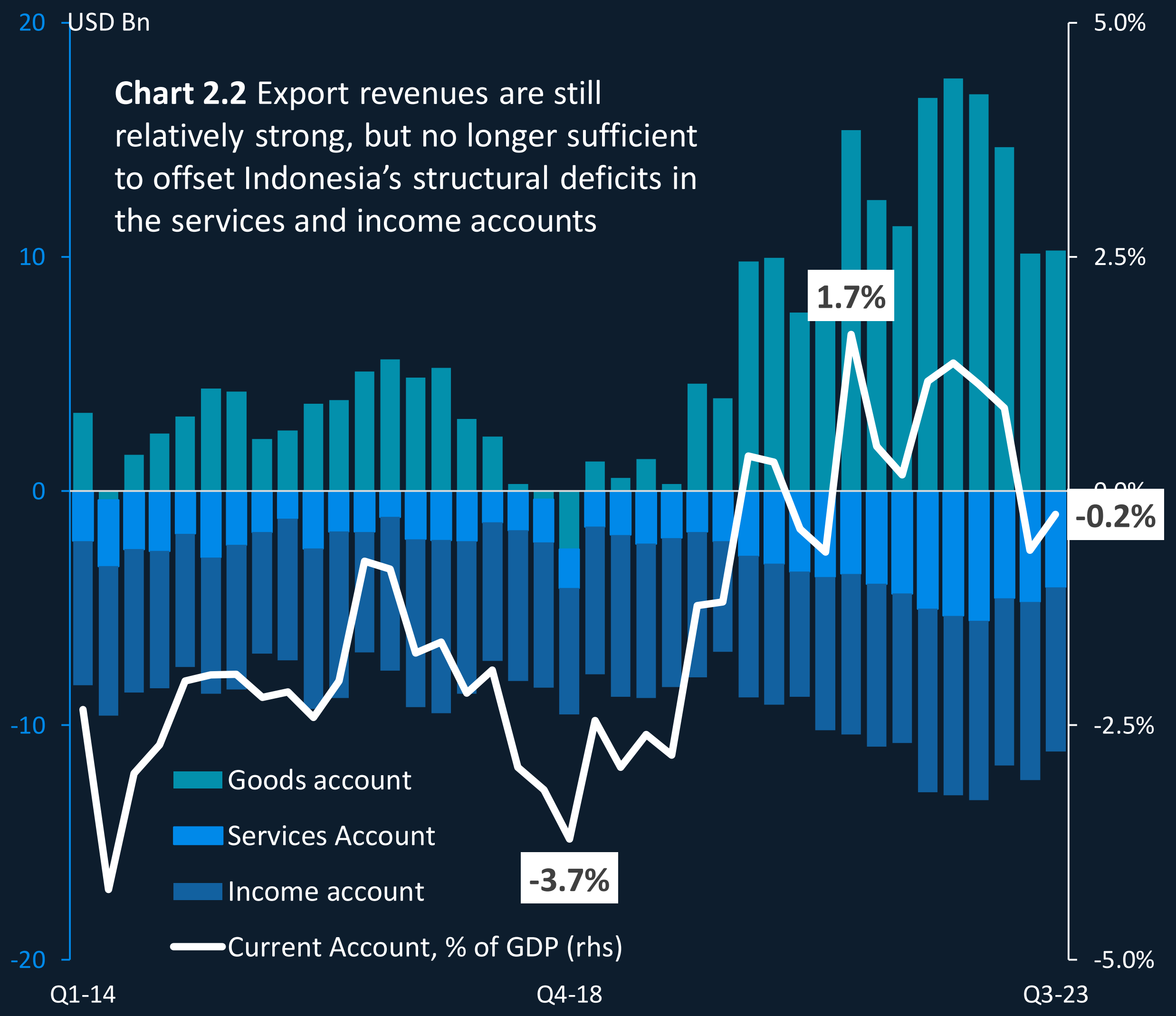
Chart 2.1 The widening policy gap between Asian central banks and the Fed heightened the impact of Fed rate hikes on Asian currencies, although the Rupiah has performed better relative to its Asian peers

Source: Bloomberg. data per 15 Dec 2023

- The high rates and volatile USD in 2023 seems to be the crux of every central banker's problem. For BI, however, the un-favourable state of its regional neighbours has added to the challenge of maintaining the Rupiah's stability.
- As we know, central bankers in Asia ended their tightening campaign sooner than their Western counterparts, and this divergence has put Asian currencies at a distinct disadvantage. This less hawkish posture by Asian central banks is explicable by the relatively manageable inflation, thanks in part to the supply overhang in China.
- But there are also **concerns over the economic health of Asian economic powerhouses, i.e. China and Japan,** which forces their central banks to adopt more dovish policies and triggers a run on their currencies as well as their neighbours'.
- Comparatively, then, **Indonesia is doing better than its Asian counterparts throughout 2023 in terms of both exchange rate and sovereign bond yields.** Indeed, it is possible to look at the Rupiah as being overly strong against its regional trade partners, which may take a toll on its current account (CA).

The Rupiah can no longer rely on CA surplus to protect itself from external pressures

Chart 2.2 Export revenues are still relatively strong, but no longer sufficient to offset Indonesia's structural deficits in the services and income accounts



Source: BPS

- High rates and strong USD was already a problem since 2022 – if anything, the Dollar index attained its post-GFC high (114.1) in Sep-22 rather than 2023 (106.9 in Oct-23). In 2022, however, the ongoing commodity supercycle offered support to the Rupiah, with the extra FX earnings bolstering BI's reserves.
- **But the supernormal commodity profits in 2022 softened to just normal profits, while the lasting vigour of Indonesia's domestic demand also continues to translate to robust imports.** The lower trade surplus means that Indonesia now suffers from CA deficit, as it usually did before the pandemic – this despite the government's strenuous efforts to extract more FX liquidity from exporters.
- The hangover from the commodity supercycle of yesteryear also added another dent to Indonesia's FX coffers. The commodity boom translated to supernormal dividend payments, which tipped Indonesia's CA balance to a deficit in Q2-23. The big dividend payments may well be a one-off seasonal impact – but still, **given the structural deficits in other accounts, the Indonesian economy may continue to live with a deficit CA (albeit rather narrow) for the foreseeable future.**

The volatile global rate expectations add to the challenge for the Rupiah

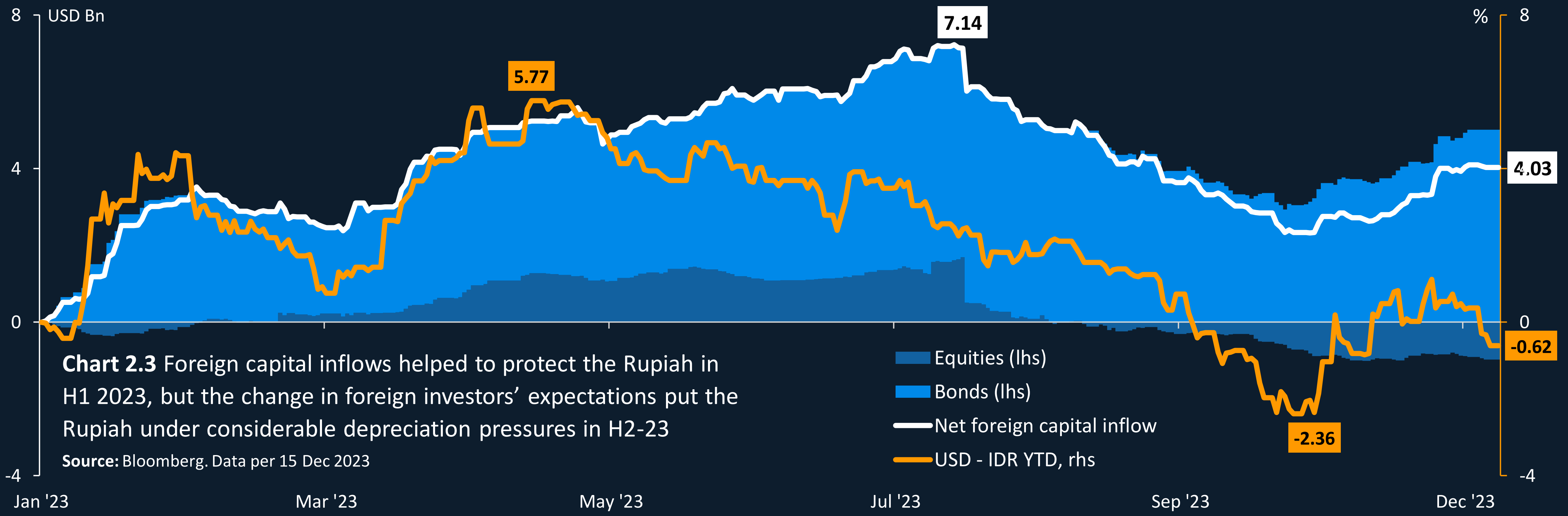


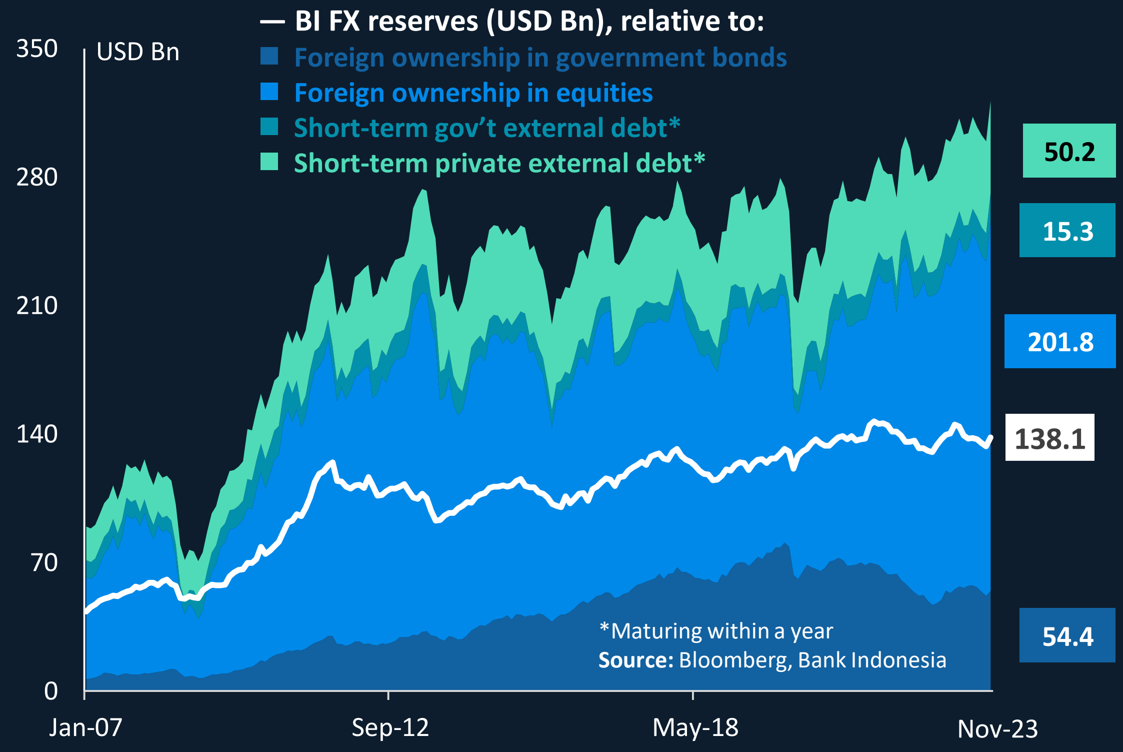
Chart 2.3 Foreign capital inflows helped to protect the Rupiah in H1 2023, but the change in foreign investors' expectations put the Rupiah under considerable depreciation pressures in H2-23

Source: Bloomberg. Data per 15 Dec 2023

- Despite the weakening protection from its CA, the still-divided outlook on the Fed's policy trajectory worked to the Rupiah's advantage in H1-23. The Fed pivot narrative ran supreme during that period, leading to the deluge of foreign capital inflows that shielded the Rupiah from global market volatility – until another shift in the global rate expectations rained down the pressure on the Rupiah in Q3-23.
- The subpar US jobs and inflation data in November, then, brought pivot back to the forefront and foreign capital back into Indonesia. The market, however, seems to be pricing in aggressive rate cuts by the Fed in 2024 (100 bps or more), meaning that there is a risk of negative policy surprise (the Fed cutting less than expected) that could spook the market again in the upcoming months.

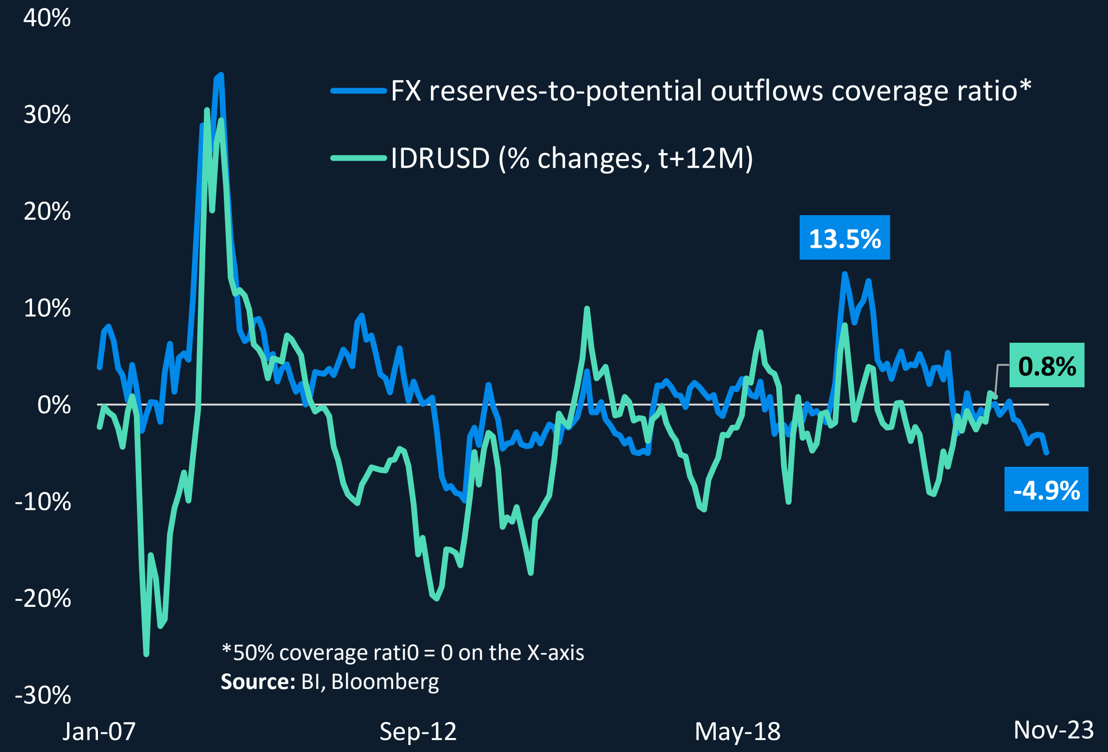
BI could not put market interventions on the shelf just yet

Chart 2.4 BI continues to rely on its FX reserves to guard against the risk of further capital outflows…



*Maturing within a year
Source: Bloomberg, Bank Indonesia

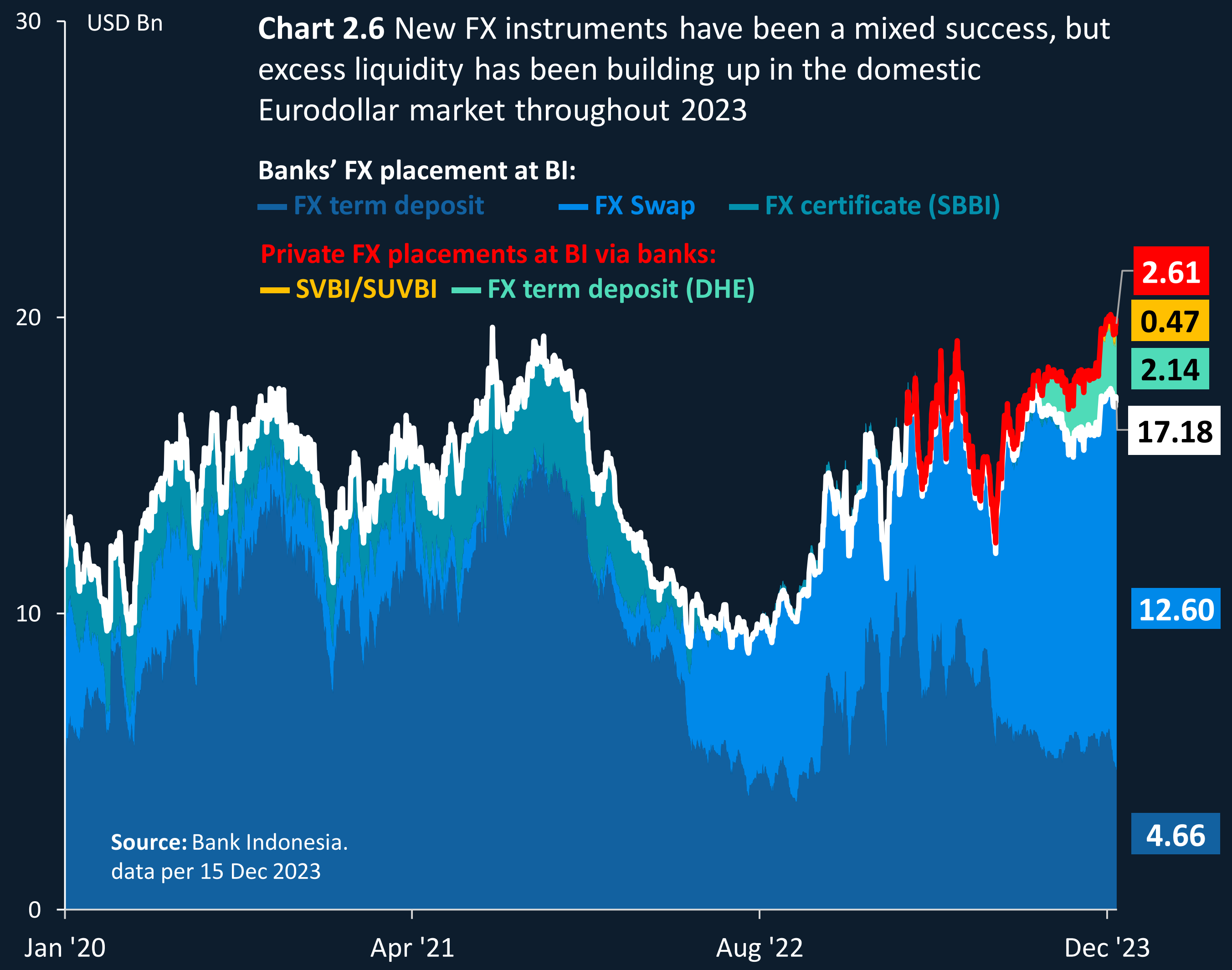
Chart 2.5 … but the declining reserves versus potential outflows means that intervention is mainly a tool of smoothing, not reversing, USD/IDR movements



*50% coverage rati0 = 0 on the X-axis
Source: BI, Bloomberg

- Unable to rely on the now negative CA balance or a constant stream of foreign capital inflows, BI has relied on market interventions to smooth out the Rupiah's movement in 2023. However, **prolonged market intervention campaign has proven to be costly, and – despite a massive FX reserves boost in November, cannot be relied upon in the long-run.**
- The purpose of FX reserves, after all, is not just intervention but also deterrence – and the deterrent effect seems to be at its weakest since 2016, which does not bode well for the currency's near-term stability. BI, then, still cannot afford the luxury of "pivoting" towards more accommodative policies, unless the Fed has already pivoted first.

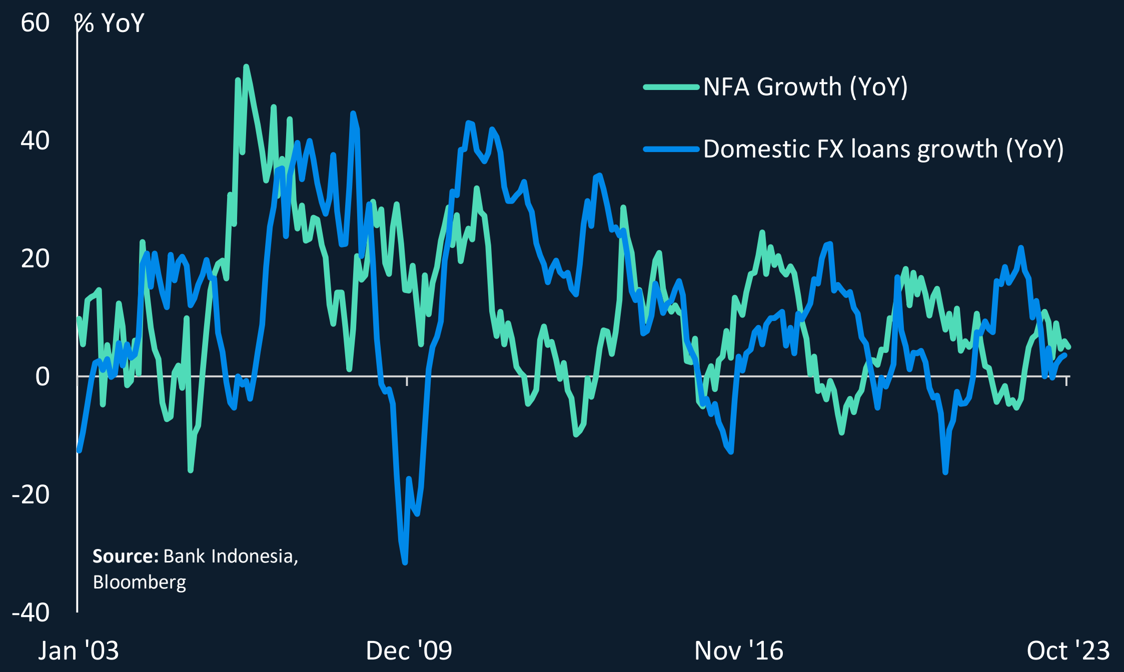
New instruments by BI are competing for a finite, albeit increasing, supply of FX liquidity …



- BI has tried, with some success, to bolster its FX reserves, mostly by issuing new instruments to sop up FX liquidity: SVBI, SUVBI, and the export receipts-linked term deposit facility (TD-DHE). The latter instrument was met with limited interest when first issued in Mar-23, but demand was boosted by a new regulation (PP 36/ 2023) which obliged commodity exporters to put their earnings domestically for a minimum of 3 months.
- All these have led to notable increase in FX liquidity within the system since Aug-23, even as capital outflows accelerated during that period. The more flexible nature of the new instruments – which is available to non-banks and even foreigners – have also attracted additional liquidity beyond what the traditional instruments usually provide.
- Still, **there is only so much FX liquidity to be absorbed by these new instruments before they start competing with each other** – or indeed with FX deposits in banks. Given this "crowding out" risk, BI may eventually have to reduce their issuance volumes to avoid disintermediation of FX loans …

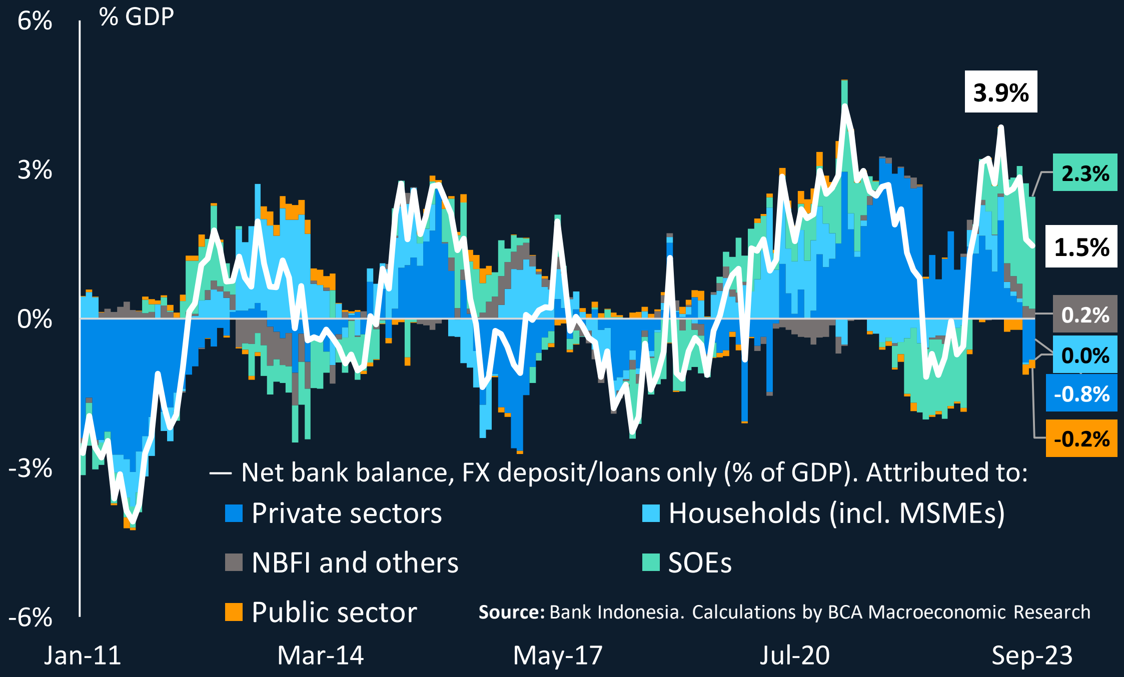
… although FX crowding out is not a concern in the short-term as SOE liquidity improves

Chart 2.7 Despite capital outflows since May-23, domestic FX liquidity conditions seems to be improving thanks to the declining demand for FX loans



Source: Bank Indonesia, Bloomberg

Chart 2.8 The improvement in SOEs' FX liquidity condition limit the demand for loans in the domestic Eurodollar market

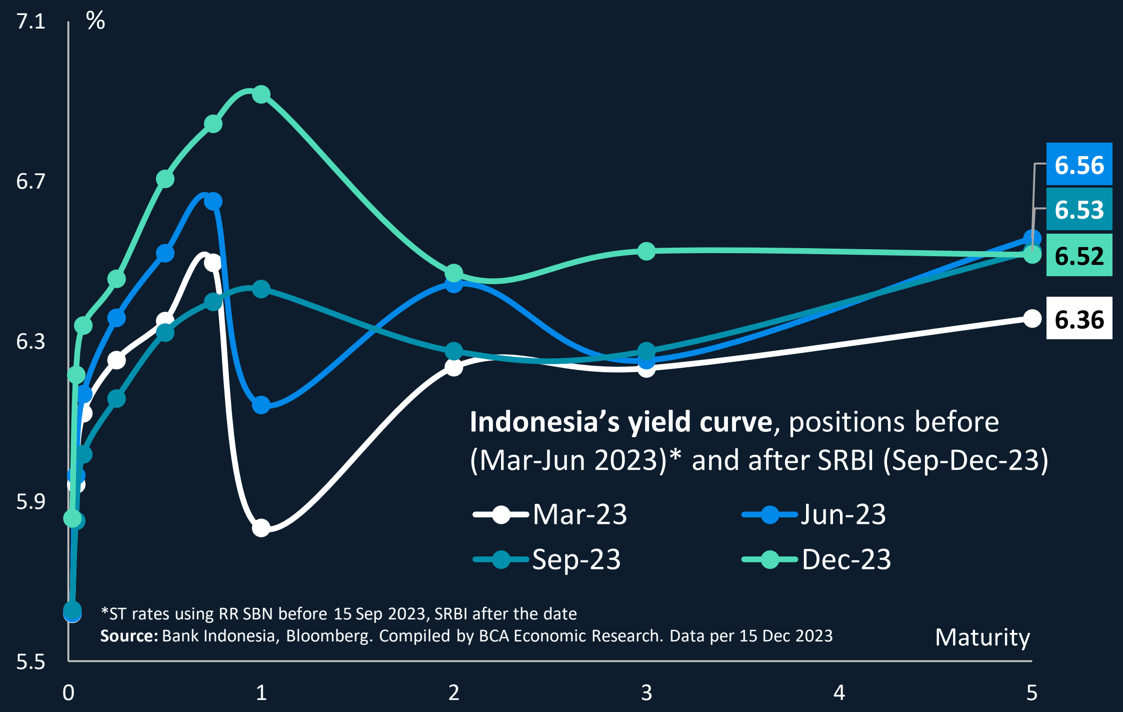


Source: Bank Indonesia. Calculations by BCA Macroeconomic Research

- … but that is a story for another time. At the moment, the risk of crowding out is limited by the fact that demand for FX has also been relatively weak. Declining import values due to global disinflation has been a factor, as has the high borrowing rates in USD – which seems to drive some corporates to borrow in IDR instead, taking advantage of the narrowing spread.
- The most important driver, however, is arguably the government's more regular reimbursement schedule for SOEs. Back in 2022, periodic shortages of FX liquidity on the part of large SOEs such as Pertamina had caused them to seek bridging loans from banks, which in turn leads to periodic drying-up of FX liquidity in the market. This is no longer an issue thanks to the improvement in SOEs' cash flow, including in FX.

BI's new Rupiah instrument points to high-for-longer domestic interest rates

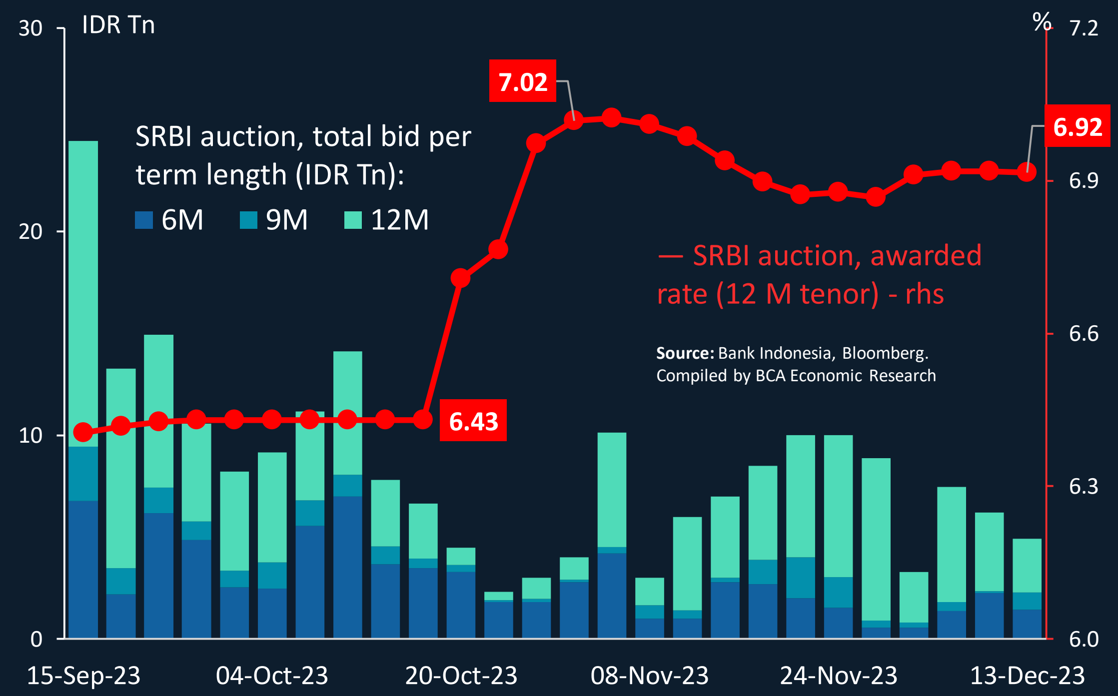
Chart 2.9 SRBI provides a more consistent pricing signal for Indonesia's short-term bond market



*ST rates using RR SBN before 15 Sep 2023, SRBI after the date

Source: Bank Indonesia, Bloomberg. Compiled by BCA Economic Research. Data per 15 Dec 2023

Chart 2.10 Continued increase in SRBI's yield indicates the market's preference for still-elevated rates in the coming months

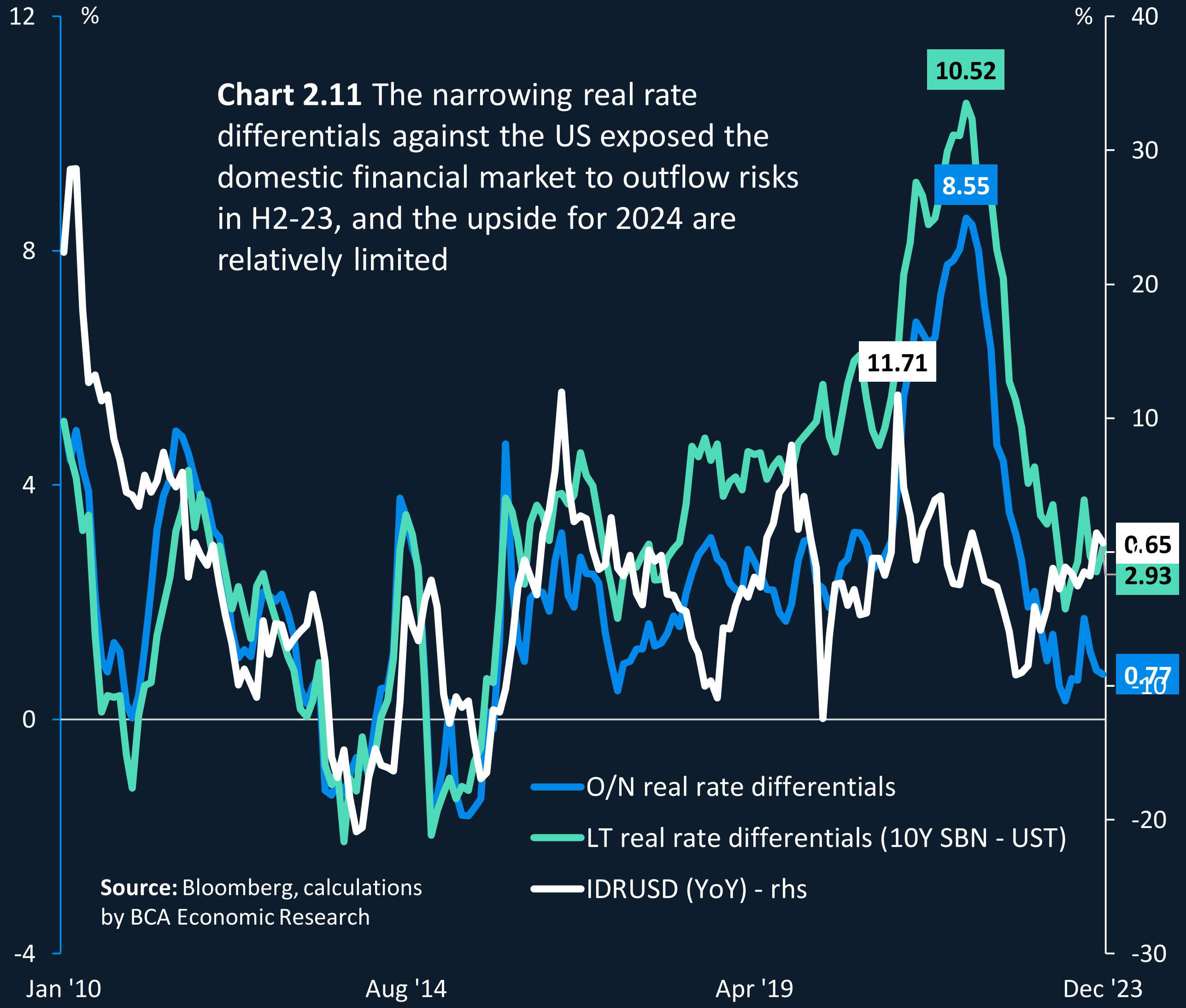


Source: Bank Indonesia, Bloomberg. Compiled by BCA Economic Research

- **BI also introduced a new IDR instrument, the SRBI, which likewise allows non-banks to participate and has provided a more consistent signal on the shorter-end of the yield curve** compared to previous benchmarks such as government bills (SPN) or BI instruments like SBI or reverse repo facility.
- As such, **the fact that SRBI's awarded rate is still relatively high – and that incoming bids have been declining – seems to indicate the market's preference for high BI policy rates for the foreseeable future.** This strengthens our conviction that BI has limited chance to lower the BI 7-day Repo Rate (BI-7dRR) without significant improvement in domestic (and ultimately global) liquidity.

Narrowing real rate differentials adds another challenge for the Rupiah

Chart 2.11 The narrowing real rate differentials against the US exposed the domestic financial market to outflow risks in H2-23, and the upside for 2024 are relatively limited



Source: Bloomberg, calculations by BCA Economic Research

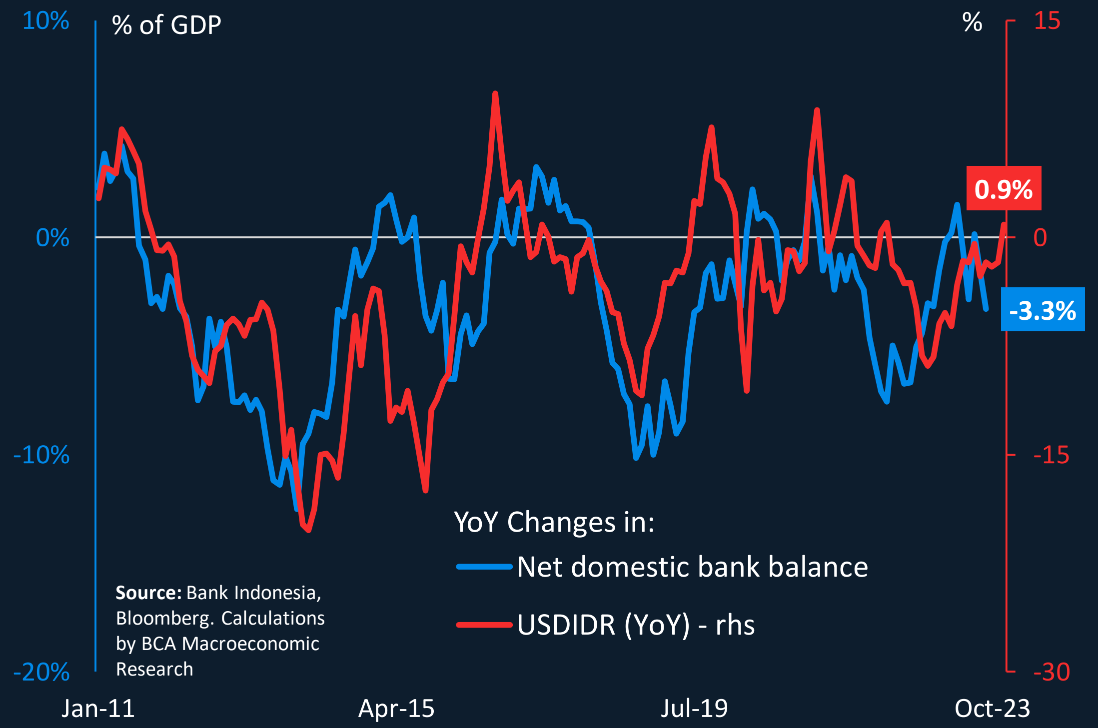
- While the easing pressures on the global financial market allow BI not to follow up on its surprise rate hike in Oct-23, then, **the elevated SRBI rate reveals the limited space for BI to ease the monetary policy.**
- **Another argument that supports this hypothesis is the continued need to maintain a healthy real rate differential** between IDR- and USD-denominated assets. This gap had been much wider in 2022, when the US was bedevilled by high inflation – and it may grow even narrower next year, as there is more downside to US inflation (esp. from rent) relative to Indonesian inflation.
- **The potential increase in UST issuance in 2024 could also dampen any potential decline in US rates,** a condition that could further drive global capital towards the UST and away from peripheral markets like Indonesia.
- One thing that we can take solace from may be the fact that in recent years, the USD/IDR exchange rate does not tracked real rate differentials as closely as before. This may be simply down to some anomaly in global financial flows during the pandemic, but it could also reflect Indonesia's lessening dependence on bond inflows to stabilize the IDR.

High real interest rates may be a necessity considering still-strong investment growth

Chart 2.12 Loan growth has remained uncharacteristically strong given the precipitous decline in core inflation

Source: Bank Indonesia, BPS. Calculations by BCA Macroeconomic Research

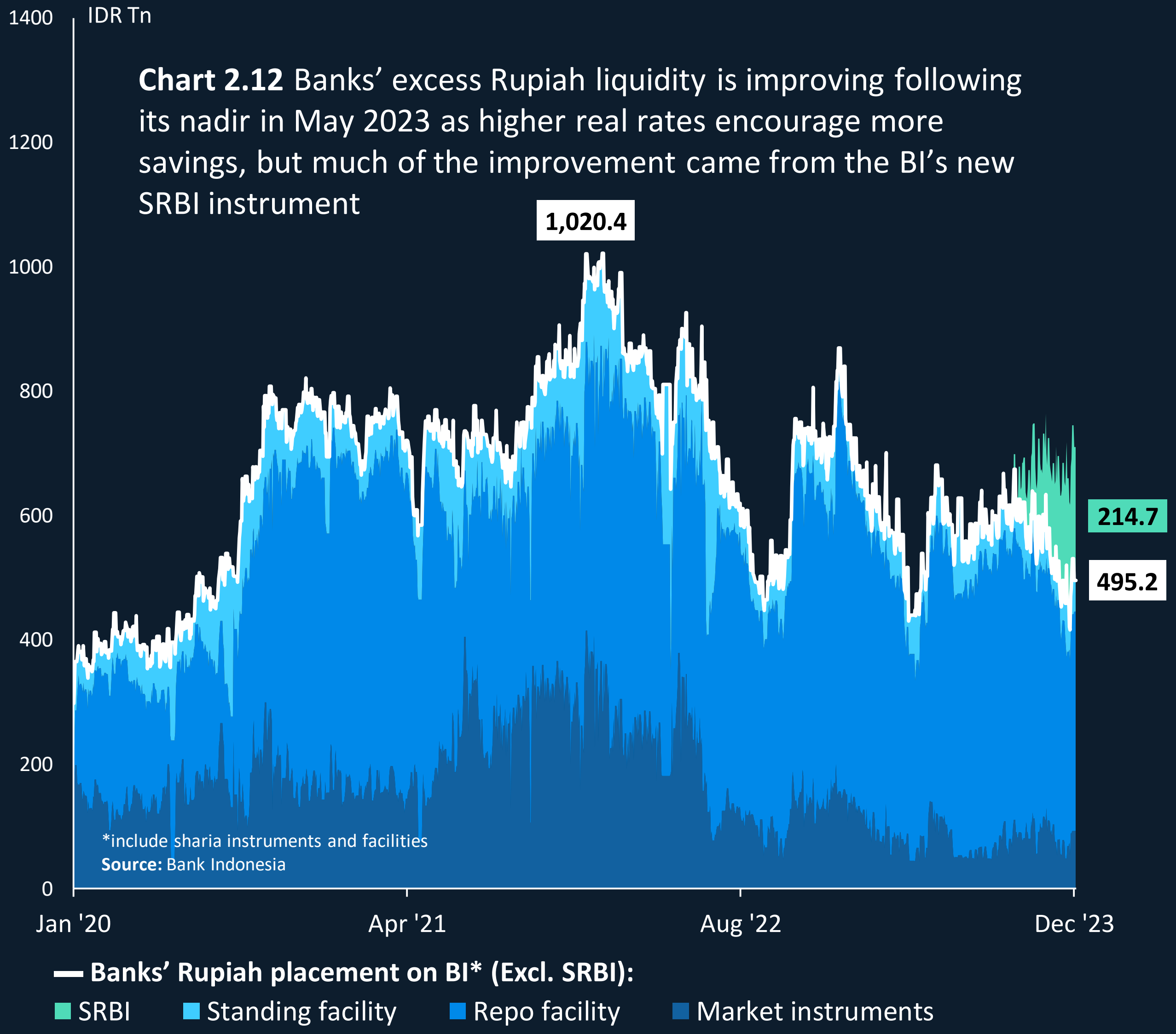
Chart 2.13 Excess investment (vis-à-vis savings) could remain a persistent source of pressure for the Rupiah



Source: Bank Indonesia, Bloomberg. Calculations by BCA Macroeconomic Research

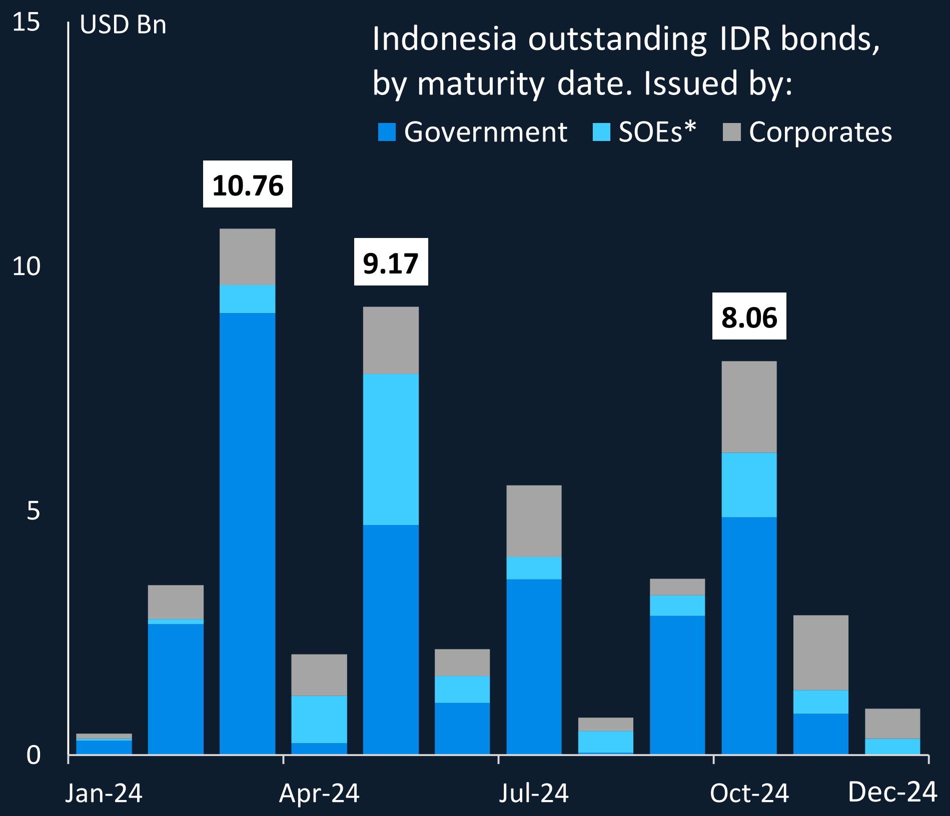
- Indonesia's real policy rates, of course, have risen on its own even prior to BI making its 25 bps hike in October – simply by virtue of declining inflation. As such, BI policy has gotten much tighter, which could be justified by the fact that loan growth has not declined as quickly as core inflation.
- This exceptionally strong investment appetite stands in contrast to savings (especially by households), which has been subpar since the economy fully reopened in mid-2022. The highly positive real rates, then, may be necessary to generate "forced savings" in order to finance that investment – without which, the financing may have to be "financed" by Rupiah depreciation.

IDR liquidity remains relatively abundant as “forced savings” begin to take effect



- The effect of these “forced savings” are quite apparent when we look at the amount of BI instruments bought by banks – which is a measure of excess liquidity that banks do not deploy towards loans or bonds. Excess liquidity seemed to decline rapidly upon reopening in mid-2022, but soon recovered in two phases: first suddenly (Nov-Dec ’22) and then gradually (Jun-23 onwards).
- The “sudden phase” was likely the product of a burst in government spending during the final two months of the year – something which we will discuss shortly. This burst, however, did not last and was quickly used up – especially during the Ramadan/Eid spending spree when IDR liquidity was at a premium.
- It is the “gradual phase”, then, that marks out the effect of the forced savings. Higher real yields, strengthened in recent months by the brand new SRBI, has allowed banks and BI to absorb liquidity from the real economy.
- As with the new FX instruments, the SRBI also opens up a new risk of crowding out and dis-intermediation. In the short-term, however, it is a key part of BI’s toolkit to re-duce the risk from the growing savings-investment gap.

The high amount of maturing bonds in Q1-24 adds to the government's substantial financing needs



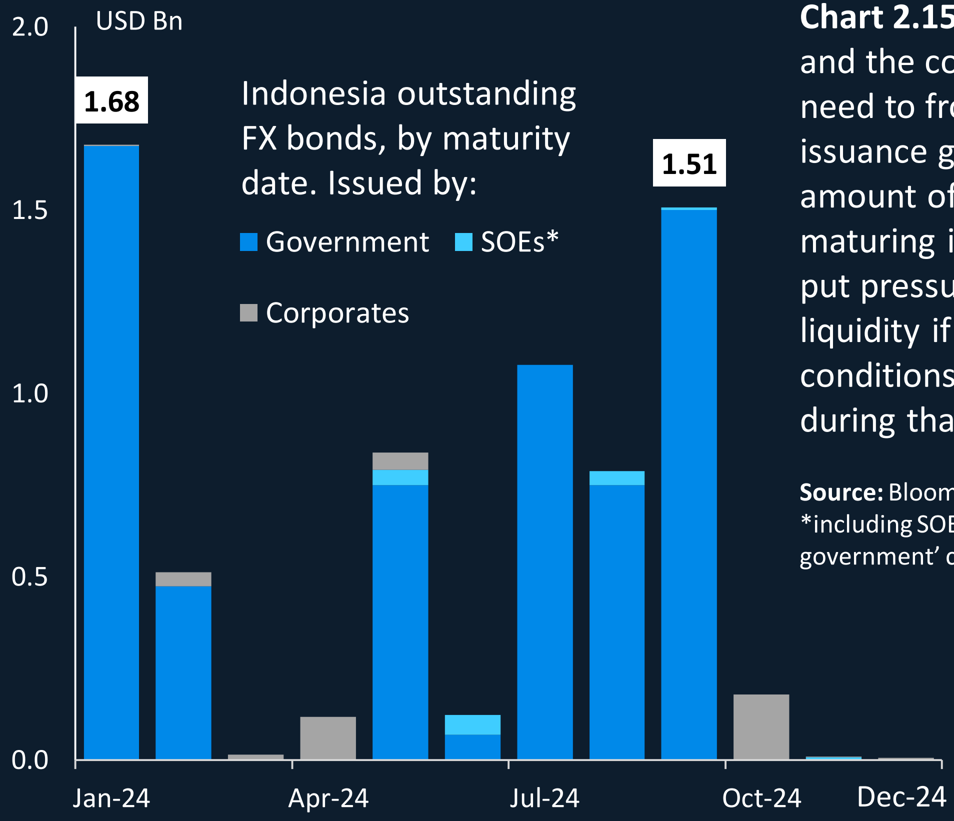


Chart 2.15-2.16 The government and the corporate sector may need to front-load their bond issuance given the significant amount of IDR and FX bonds maturing in Q1-24, which could put pressure on domestic liquidity if global market conditions turns unfavourable during that period

Source: Bloomberg
*including SOEs' subsidiaries and other government' controlled corporate entities

- We have laid out the argument for the need to stabilize the Rupiah by instilling more savings (and accordingly more discipline on loan creation) in the short-term. This is made more urgent by the financing needs from the public sector – **not just for the government's accelerated spending in the run up to the Elections, but also because of the amount of government bonds set to mature in early 2024.** The government itself has taken some precautionary measures here – among others, by reducing net bond issuance for 2024 and making more use of their accumulated savings (SAL) instead as lower oil prices throughout 2023 help the government to save the money earmarked for the spending on subsidy.

Demand from foreign investors will be crucial for government bond outlook …

Chart 2.17 Government bond yields have declined relative to equities earnings yield, which could suggest future reversal – either higher bond yields or higher stock valuations

Source: Bloomberg. Data per 15 Dec 2023

- Foreign investors have been a key source of demand for new government bonds (SBN) issuance in 2023, which in a way represents a return to normalcy after the anomalous pandemic years when foreign inflows mattered less. The strength of these inflows during the initial months was such that **yields fell below what we would expect from P/E ratios in the stock market.**
- This state of affairs did not last, but it underscores the two scenarios that we may be facing in 2024. **In the first one, Fed pivot drives down SBN yields but would have much bigger (positive) impact on stock valuations. If the pivot is delayed or not forthcoming, however, this could undercut bond valuations to much larger extents than equities.**
- All these suggest that much uncertainty remains with respect to bond market outlook in 2024 – and that the government is right to take the aforementioned precautions. The issue, of course, is that domestic capacity to absorb new SBN issuance has become more limited.

… given the much-diminished domestic capacity to absorb additional government bonds

Chart 2.18 Domestic investors play a crucial role in driving the demand for SBN throughout 2023…

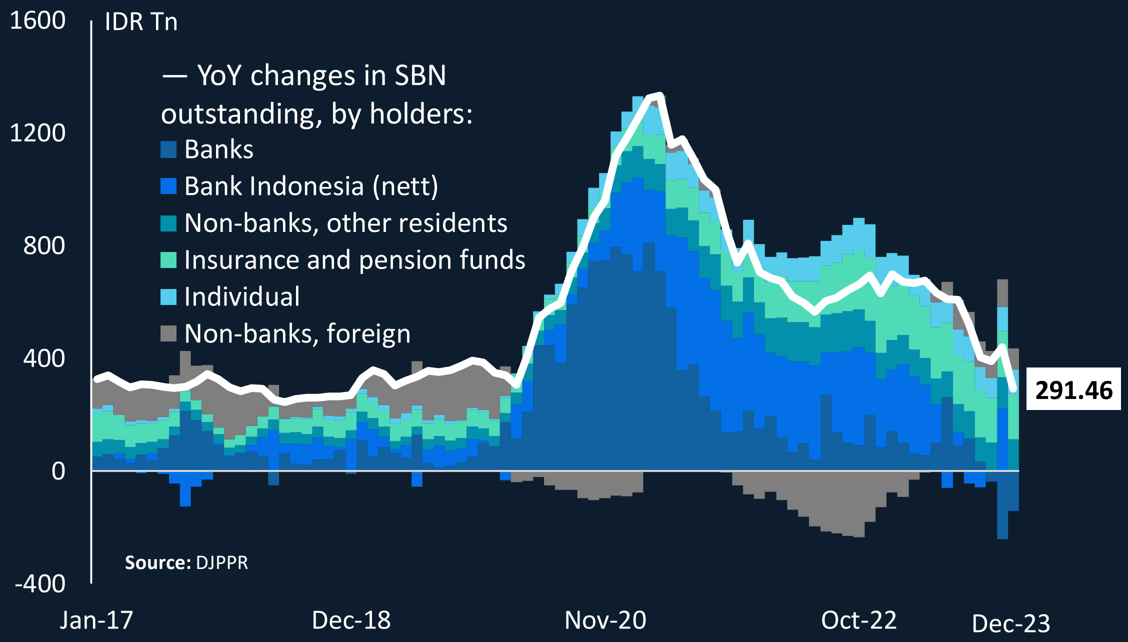
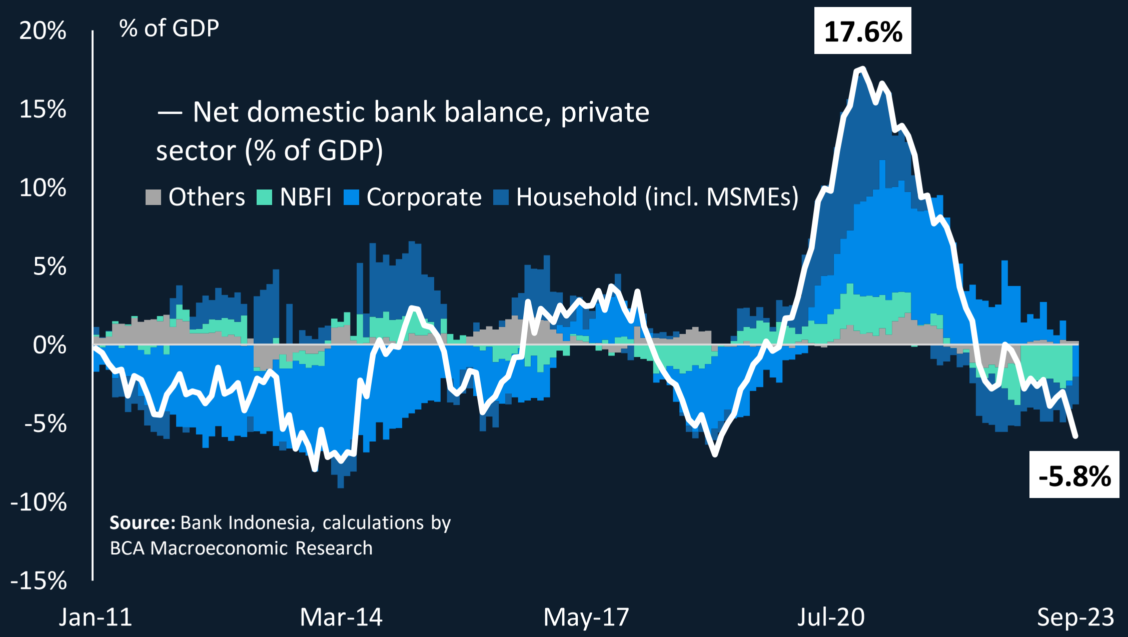
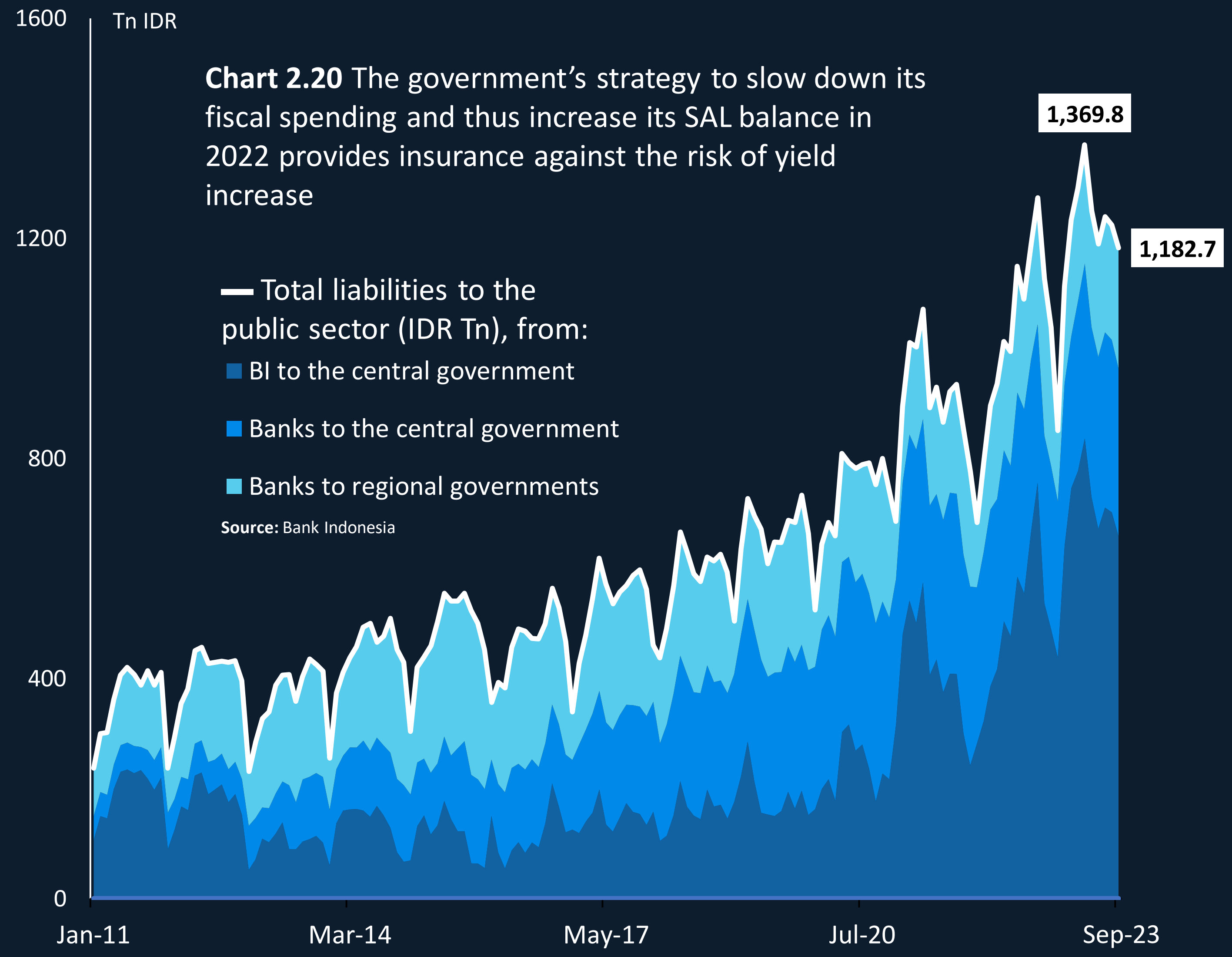


Chart 2.19 …but its already limited liquidity growth may restrict its ability to drive the demand for SBN



- Indeed, domestic demand had been key to SBN's stability during and after the pandemic. Banks played the lead role during the early phase (2020 to mid-2021), buy channelling their excess liquidity to SBN. This was followed in the middle phase by BI, courtesy of its "burden sharing" agreement with the Ministry of Finance. With the end of burden sharing in 2023, then, the task of buying new SBN fell on private individuals and corporates but – much more importantly – also on non-bank financial institutions (NBFI).
- Unfortunately, these sectors may have less room to acquire SBN at the moment, given their negative net savings in the past one-and-a-half year. There are exceptions – notably, government-affiliated NBFIs like BPJS – but the overall situation puts SBN yields increasingly at the mercy of the global market.

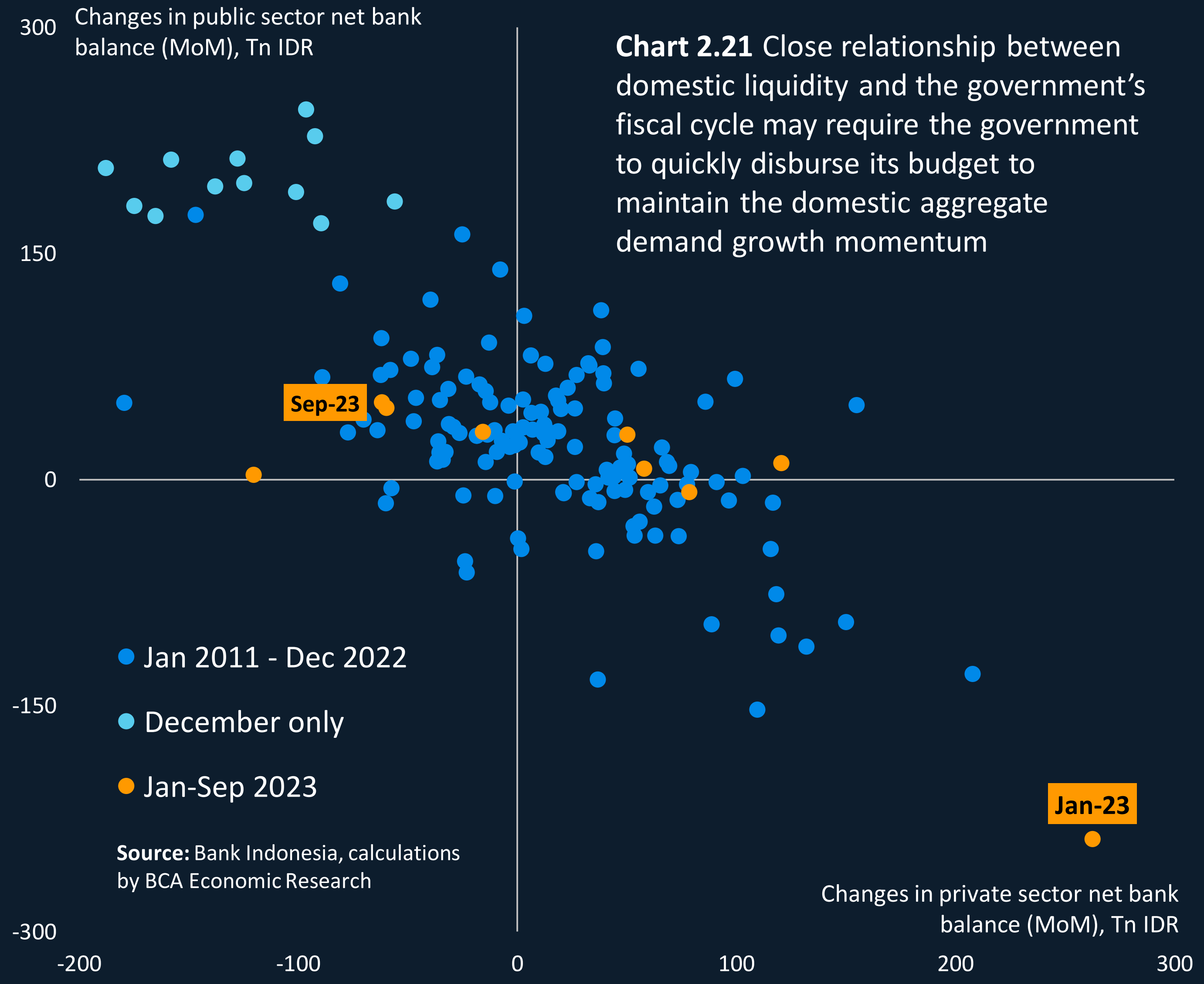
Still-high liquidity in the public sector may help the government to manage its lending rate…



- Despite early signs of accelerated fiscal spending, the still-substantial banking sector's liabilities to the public sector show that the government still sits atop a substantial pile of cash they could use to finance their fiscal commitments in Q4-23 to Q1-24. These accumulated savings (SAL), we argue, are at the crux of the government's precautionary strategy.
- Most importantly, **the government could use its substantial liquidity buffers to bridge the financing gap until a probable shift in the global monetary policy regime could allow the government to issue SBN at a lower lending rate.**
- However, as we mentioned earlier, despite the increasingly feasible signs of economic slowdown in the US, it remains unclear how quickly the Fed would loosen its policy stance in 2024. Such "tactical issuance" strategy, then, is not entirely riskless, and could even force an urgent "backloading" should the government's cash buffers allowed to fall to a much low level in mid- to late-2024.

... but Indonesia's real sector may benefit more from timely fiscal disbursement

Chart 2.21 Close relationship between domestic liquidity and the government's fiscal cycle may require the government to quickly disburse its budget to maintain the domestic aggregate demand growth momentum



Source: Bank Indonesia, calculations by BCA Economic Research

- Another possibility is that the government may opt to scale back its spending, similar to how it has spending realisation has been relatively slow in 2023. **Alas, this conservative posture is not entirely tenable given the risk of high food prices during an Election year, plus the desire to expedite strategic projects (including the new capital city/IKN) in the last year of Pres. Jokowi's term.**
- A further important point is the need to replenish private liquidity, for which the government had played a key role at the end of 2022 as we have seen earlier. Indeed, there is close correlation between the fiscal cycle and private liquidity, whereby government spending translates to private savings and vice versa.
- Without a quick and expansive fiscal spending, the forced savings that is required to balance out investment would have to come from deferred consumption. **Government spending, then, plays a crucial role in keeping the domestic aggregate demand growth alive** – a topic which we will discuss in the next chapter.

#3: Domestic consumption

"Refuel and reload after a long cruise"

Consumers have been living the high life in the past two years, buoyed by renewed optimism, excess savings, and a shot of global disinflation. Normalization beckons, but Election-related spending, consumption-oriented stimulus, and continued low inflation could help Indonesian households defy gravity for the third straight year.

Two years of consumer feast – is famine coming next?

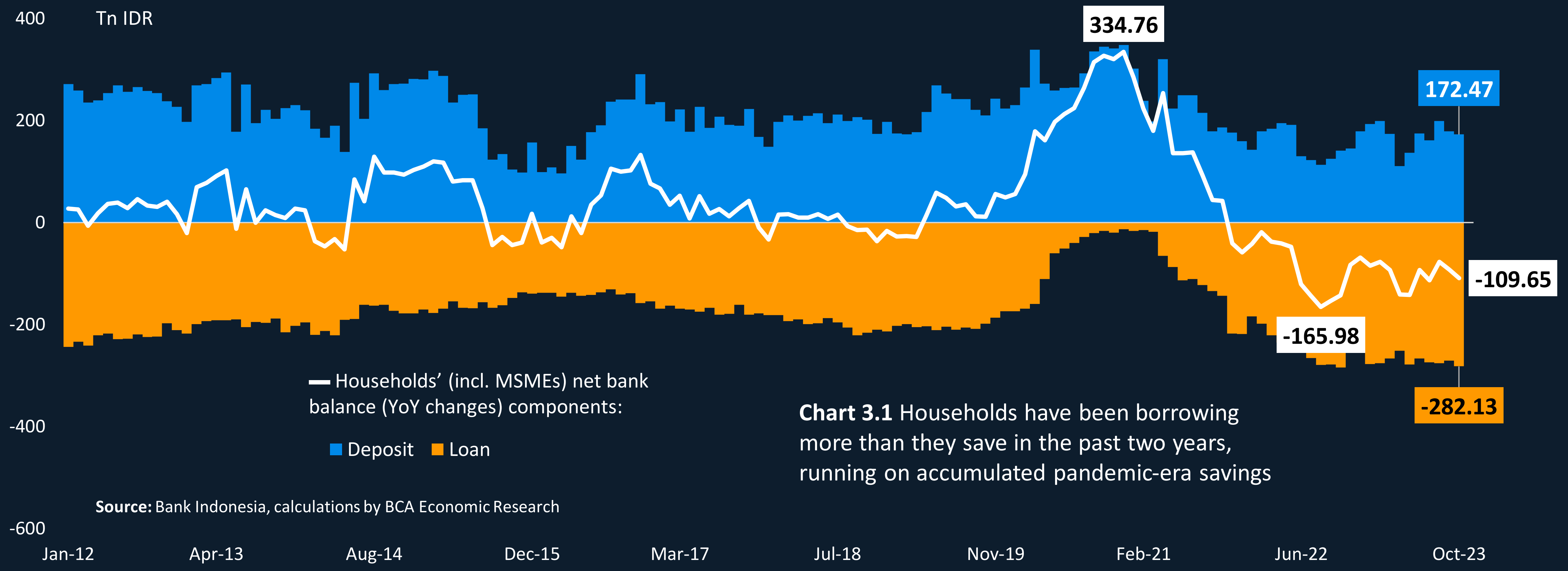


Chart 3.1 Households have been borrowing more than they save in the past two years, running on accumulated pandemic-era savings

Source: Bank Indonesia, calculations by BCA Economic Research

- As the old saying goes – no such thing as a free lunch – **the strong growth in the past two years have come at the expense of savings.** Post-pandemic pent-up demand turned into a spending spree fueled by the excess savings accrued during the pandemic. Even after this fuel had run out, households continued in spending mode, supported in part by consumer loans.
- A two years straight net spending for households is not normal, and may not be sustainable. On the one hand, this is positive news for economic growth, given that household spending constitutes more than half of Indonesia's economy. **On the other hand, it means that households now have limited net liquidity, translating to less money available for spending in the upcoming year.**

Aside from spending, consumers also move their money to time deposits

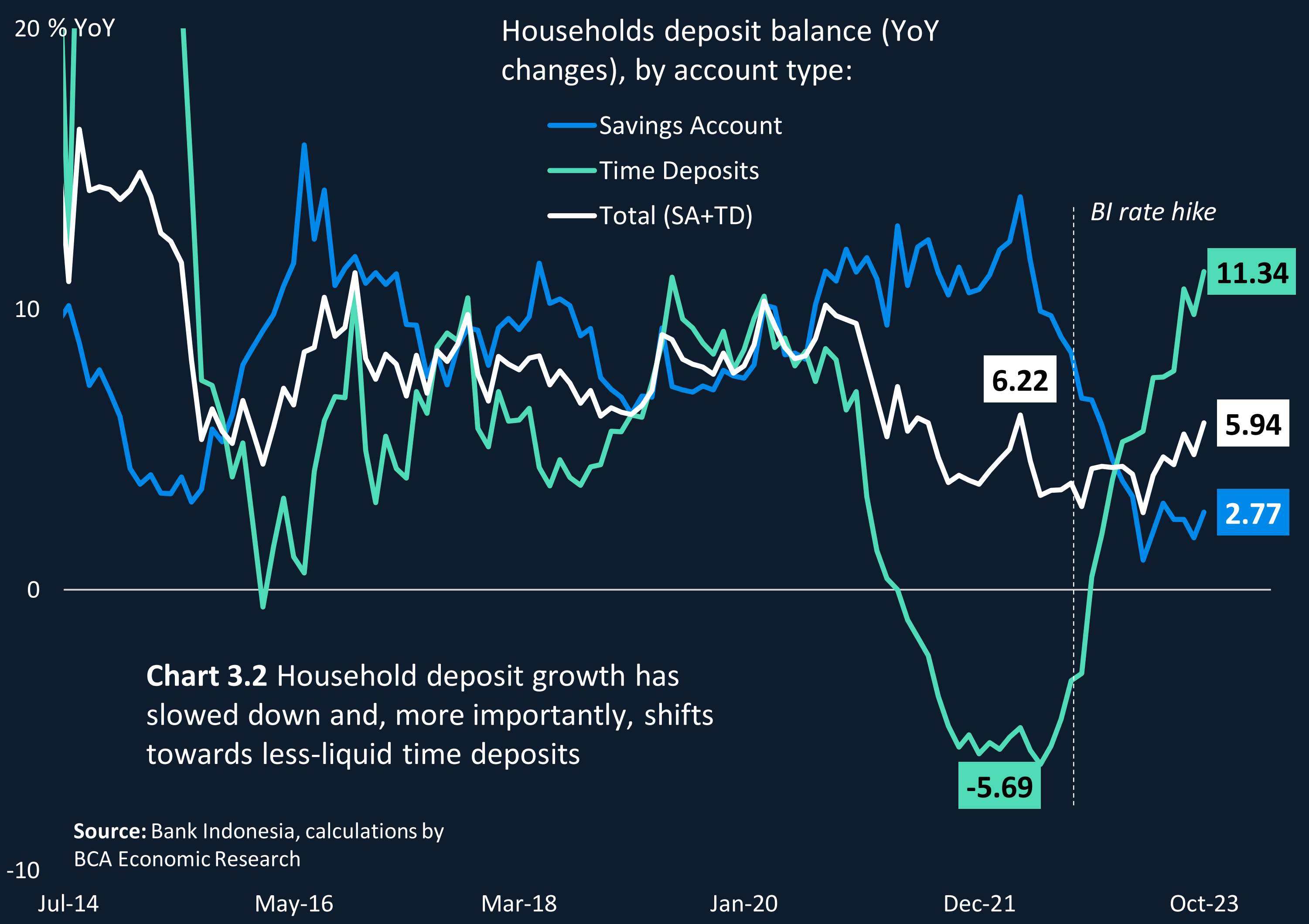


Chart 3.2 Household deposit growth has slowed down and, more importantly, shifts towards less-liquid time deposits

Source: Bank Indonesia, calculations by BCA Economic Research

- The slowing household deposit growth was evident since the economy reopened in mid-2022, and seems to have bottomed out in mid-2023. In fact, at 5.9% YoY by Oct-23, household deposits have grown faster than overall deposits (3.4%).
- This growth, however, does not necessarily translate to higher willingness to spend – but rather a more restrained stance. **High interest rates have induced households to shift their money away from savings account (SA) to the less-liquid time deposit (TD).**
- The vast majority of the extra savings that households have received in the past year, then, has been used to seek for yield rather than to add buffers to potential future spending. **This is probably not so detrimental for basic/staple consumption, but clearly a blow to discretionary spending**.

High-income households have retained optimism, but it has not fully translated to spending

Chart 3.3 Consumer confidence have plateaued at a high level following the reopening of the economy …

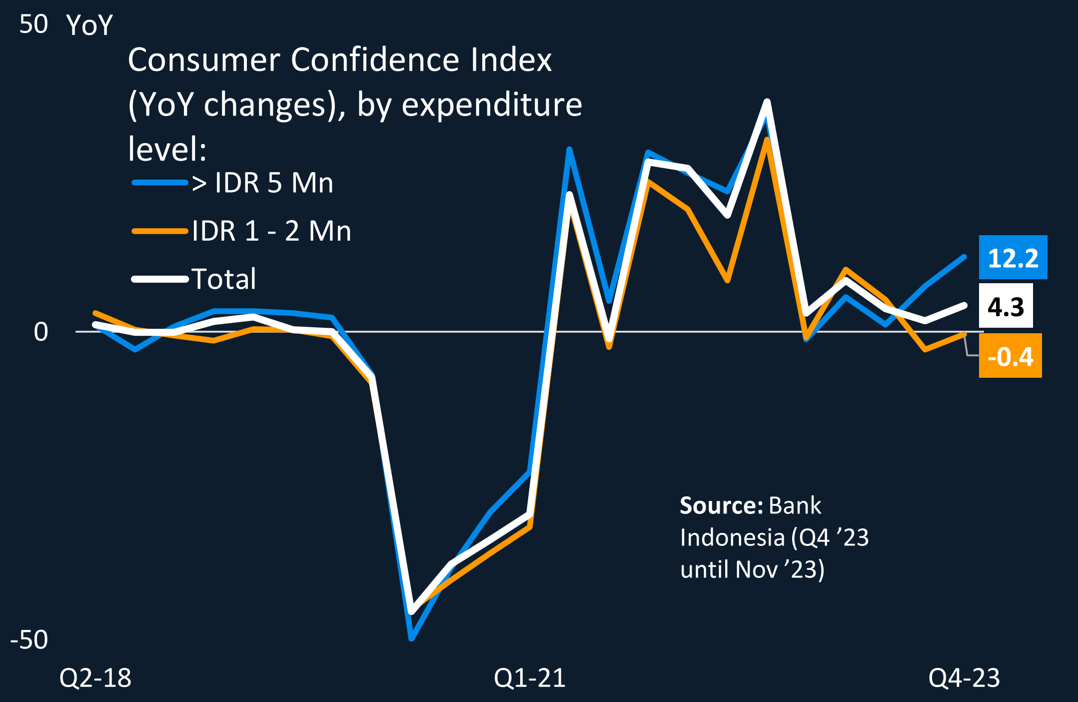
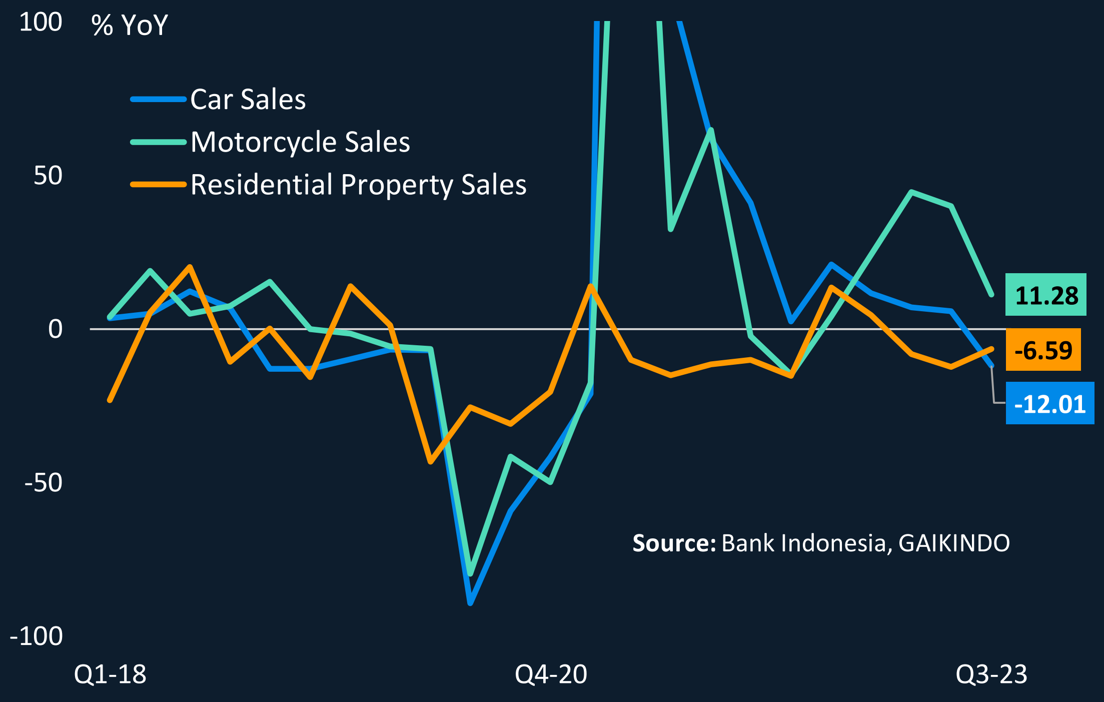


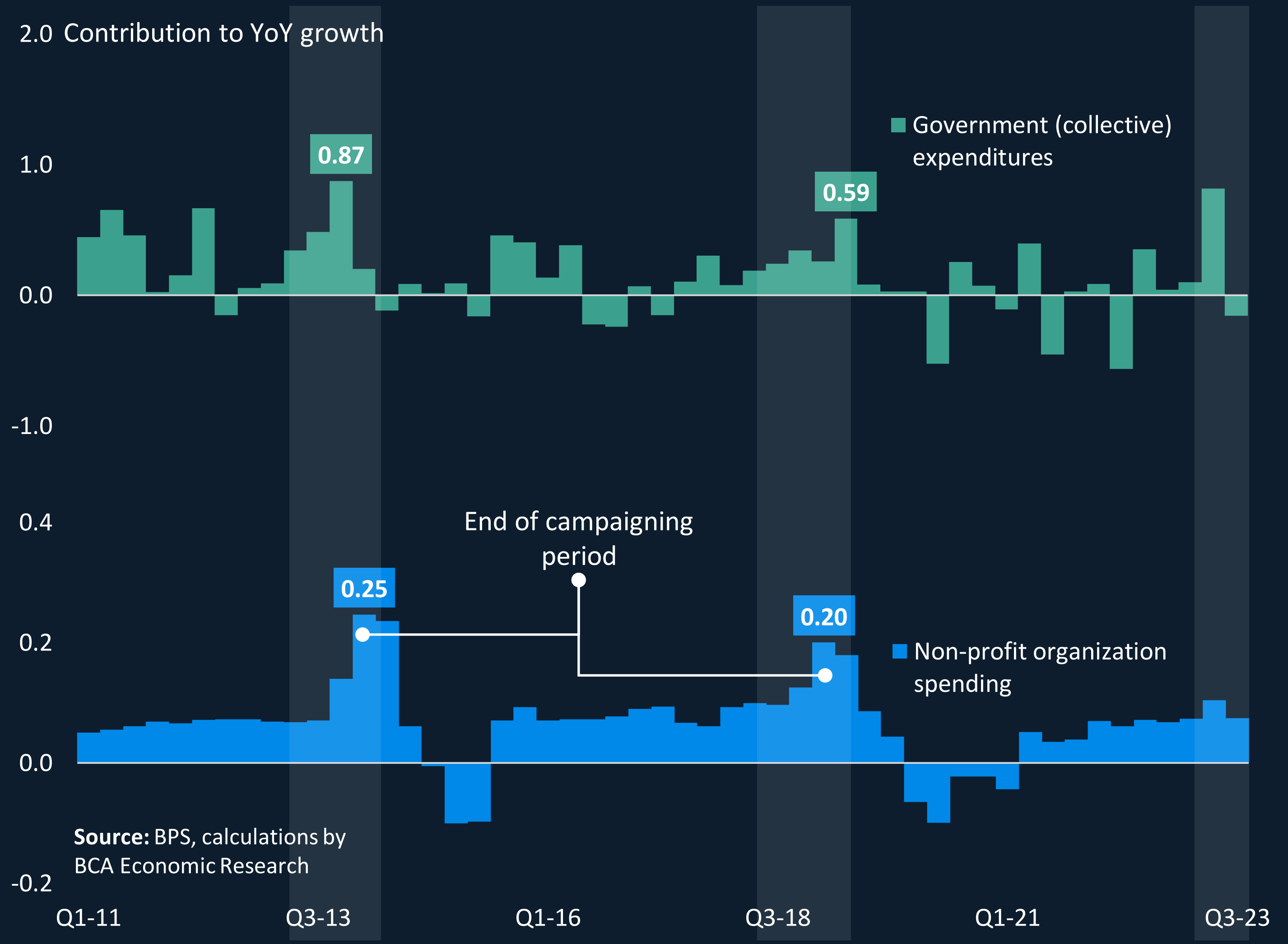
Chart 3.4 …and this has generally been followed by big-ticket items, with motorcycles briefly being an exception in 2023



- Strong confidence certainly plays a role in supporting consumption – especially for durable/big ticket items. The recovering confidence at the tail-end of the pandemic, then, had led to a massive jump in big ticket purchases. But consumer confidence could only rise so much, and the same is true for durable goods – except, interestingly, for motorcycles which might indicate stronger spending for lower-middle income households.
- **If we cannot boost optimism further, then, the only option is to boost their income. The Elections and the government's coffers looks to be the main drivers that would "refill" these households' net savings.**

The general election is an oasis for the dry liquidity beds

Chart 3.5-3.6 The general election period typically is a peak spending for the government and NPOs, lifting aggregate demand and increasing money velocity



Source: BPS, calculations by BCA Economic Research

- The case for stronger consumer purchasing power in the short-term is straightforward. Spending by the government (and non-profit institutions including political parties and related organisations) have always peaked before and during general elections.
- And indeed, the government has recently created new programs – on top of the usual line items – that could expedite these spending. These include tax incentives for real estate purchase, but most importantly several social assistance programs such as the El Nino cash transfer (BLT El Nino), in-kind food assistance (BLT BNPT), and 10 kg rice assistance.
- All these are likely to provide significant boost to consumption in Q4-23 and Q1-24. There is even some argument that the positive effects would last into Q2, if there is a presidential runoff, or even until Nov-24 when regional elections are slated to take place. Taken together, we expect the “Election effect” to probably add 0.1-0.2% towards consumption growth.

Beyond Election-related spending, government spending may not be a major growth contributor

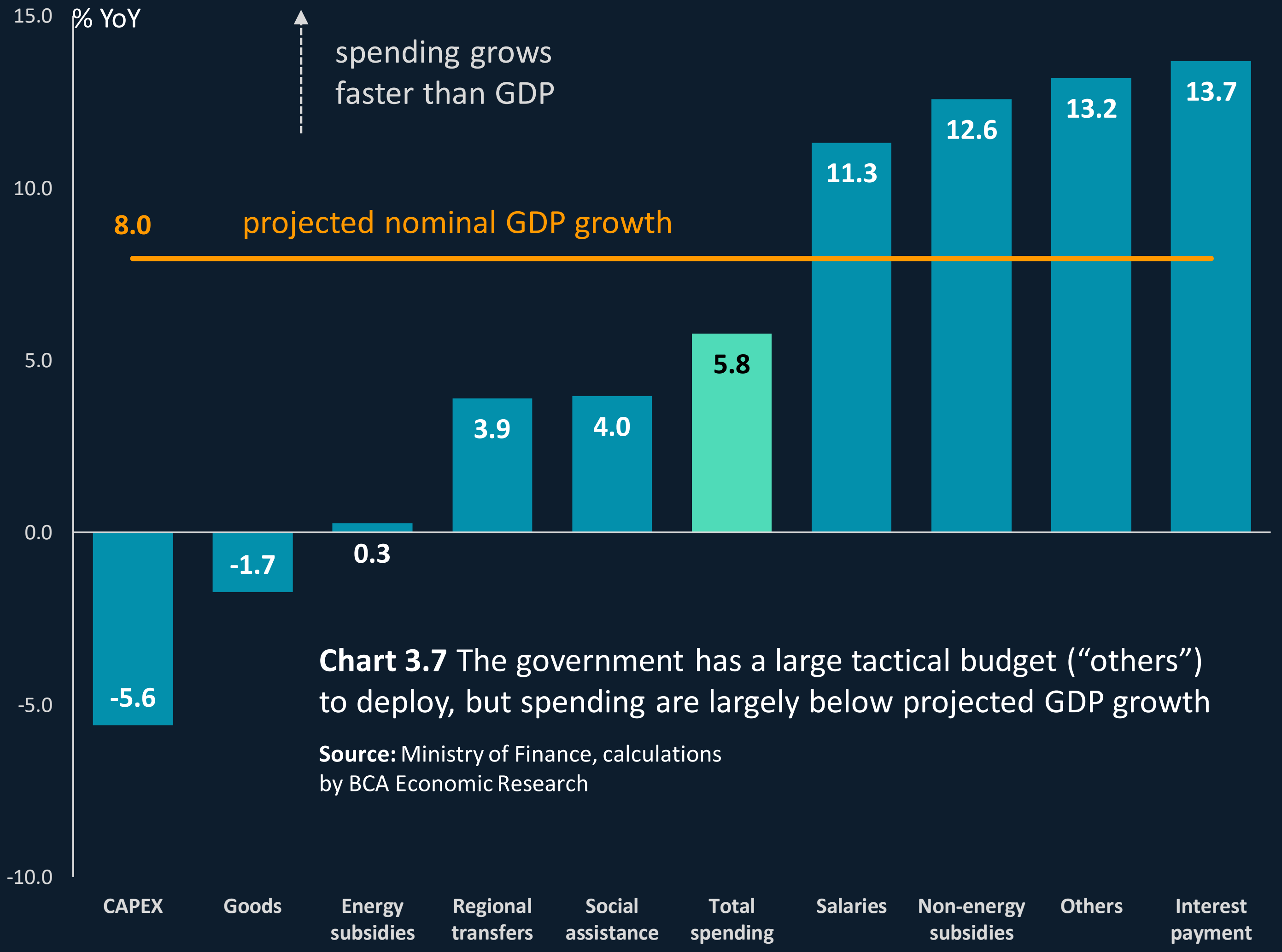


Chart 3.7 The government has a large tactical budget ("others") to deploy, but spending are largely below projected GDP growth

Source: Ministry of Finance, calculations by BCA Economic Research

- The nagging question, of course, is whether there is sufficient catalyst for consumption beyond the Elections. **In general, the plans for public sector spending in 2024 are none too aggressive, as we can see from the Budget and infer from the cautious stance of many SOEs in the past year.**
- There is a good argument – as we will also discuss in *Chapter 4* – that the pace of public investment will accelerate in the final year of Pres. Jokowi's term. Still, there is unlikely to be a vast array of new infrastructure projects beyond these existing ones, given the substantial decline in CAPEX budget.
- If anything, the largest growth in spending are in civil servant salaries (which is mostly mandatory), and for interest payment (which will not stimulate growth). Still, there is a pretty large growth in "other" budget, which is ostensibly aimed at potential compensation for Pertamina selling retail fuel at sub-market prices. **The recent decline in oil prices, then, could free up extra fiscal space should the need arise to add more fiscal stimulus.**

Disinflation helps Indonesian consumers amid limited nominal gains in their earnings

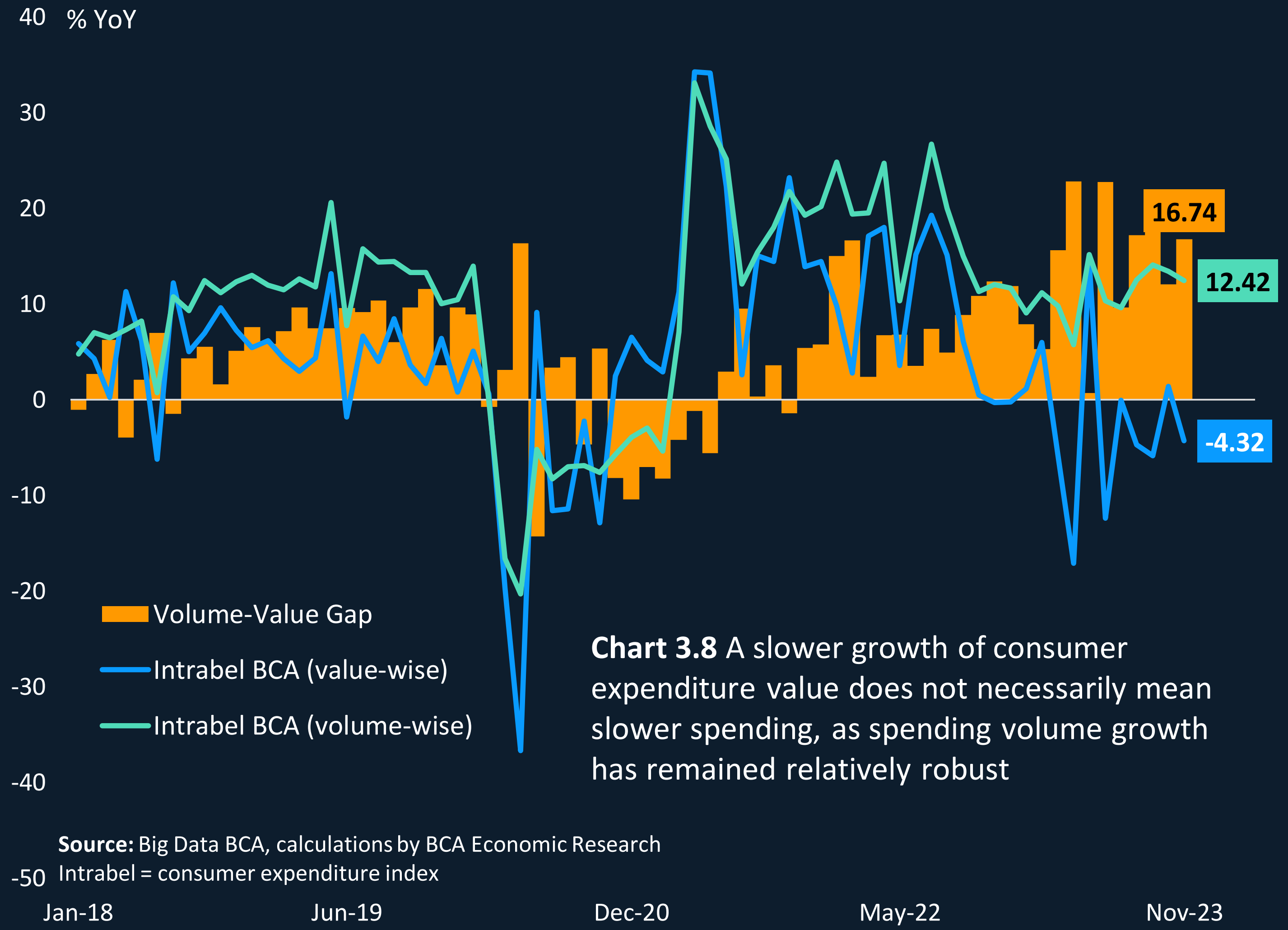
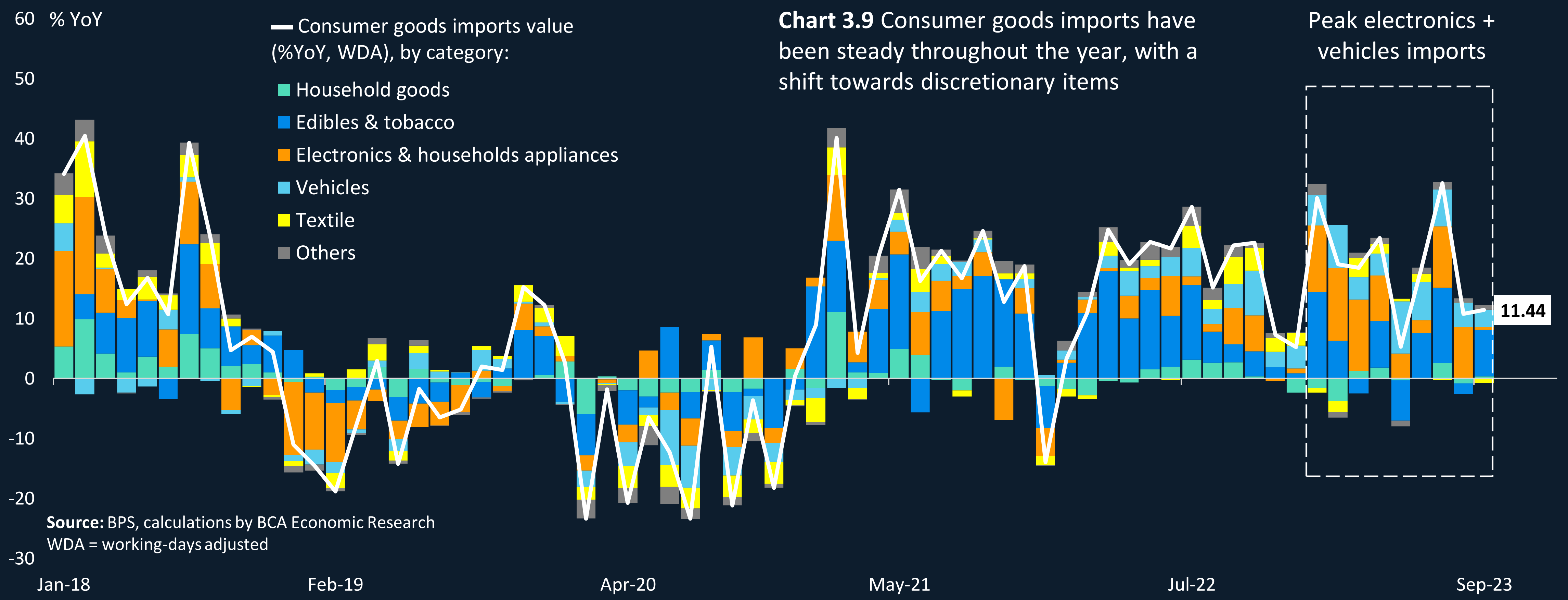


Chart 3.8 A slower growth of consumer expenditure value does not necessarily mean slower spending, as spending volume growth has remained relatively robust

Source: Big Data BCA, calculations by BCA Economic Research
Intrabel = consumer expenditure index

- The other potential tailwind for consumers is the continuing disinflation for much of consumer goods. This is something we have seen for much of 2023, thanks largely due to supply overhang in China – and therefore also in line with the disinflation trend else-where in the world.
- That disinflation has been a boon is plenty evident from our big data. We can calculate our "Intrabel" (*indeks transaksi belanja*/consumer spending index) in two ways: based on nominal transaction values, and based on transaction volumes or frequency.
- If we just focus on transaction value, it would seem as if we are seeing a consumer recession, as growth was (at times) negative. **Thanks to the fall in prices, however, consumption volumes have actually been robust – and is in fact starting to accelerate during H2-23.** The volume-value gap, in other words, is the main factor that "salvages" consumption despite the limited growth in the Rupiah value of their spending.

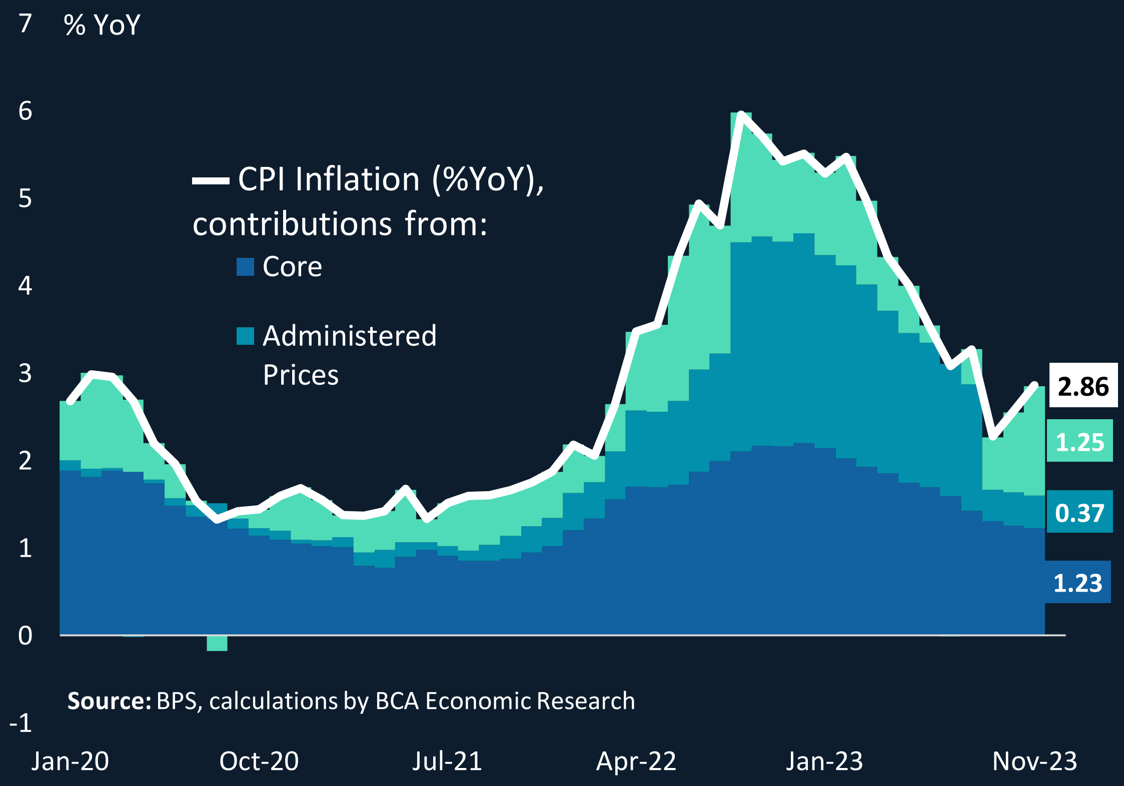
Demand for durable goods have been held aloft by disinflation



- The products that seem to benefit the most from this disinflation are electronics and vehicles – thanks partly to the easing of chip shortage and the global competition in electric vehicles (EV) production.
- In contrast, edible imports are not the major contributor to import growth like in the previous two years, which might be related to the climate-induced weakness in global food production. The combination of these two means that the benefit of disinflation is disproportionately enjoyed by the middle or even upper class, rather than the lower classes who would therefore continue to depend on fiscal support.

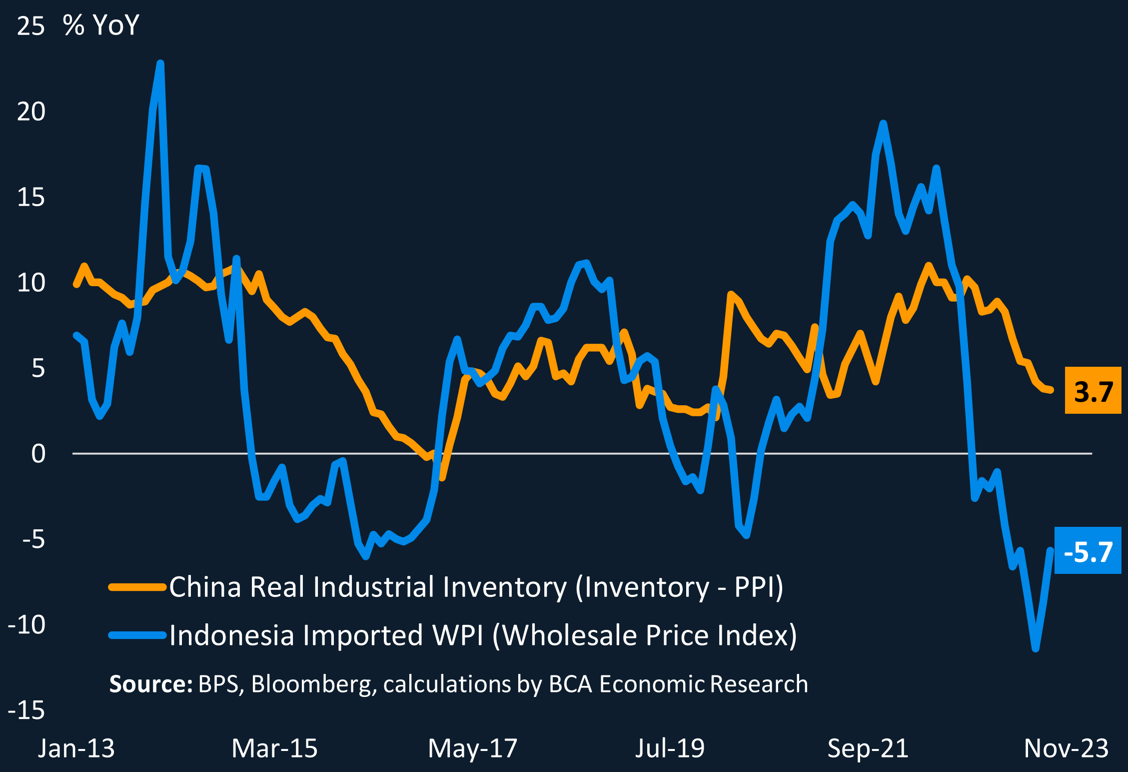
Inflation would remain moderate, but there is less room for further disinflation in 2024

Chart 3.10 As fuel hike effect subsided, food inflation has taken over as the main inflation driver



Source: BPS, calculations by BCA Economic Research

Chart 3.11 The gradual slowing of China's inventory growth could be a sign that disinflation momentum is beginning to moderate

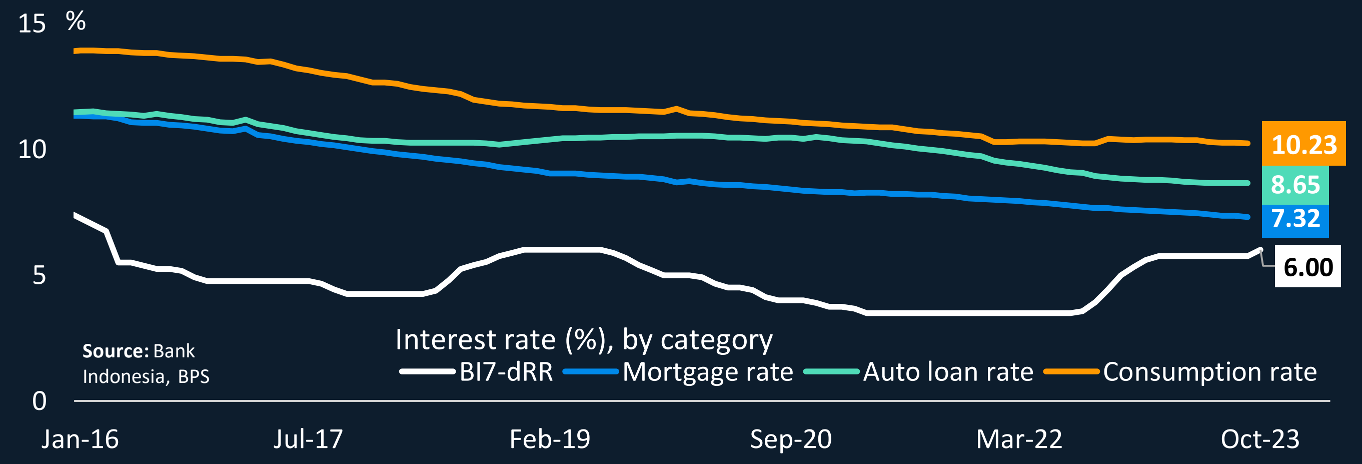


Source: BPS, Bloomberg, calculations by BCA Economic Research

- Unfortunately, whether for staple food or discretionary items, there are signs that the bulk of disinflation has already happened in 2023 – although high inflation is also unlikely to return in 2024. The most pressing issue is food inflation, which could persist into Q2-24 when the combination of potentially poor harvest due to residual El Nino effect and extra demand during Ramadan/Lebaran could collide. Still, the government's proactive moves in securing food imports should be able to cap annual inflation in 2024 slightly below BI's upper target of 3.5% YoY.

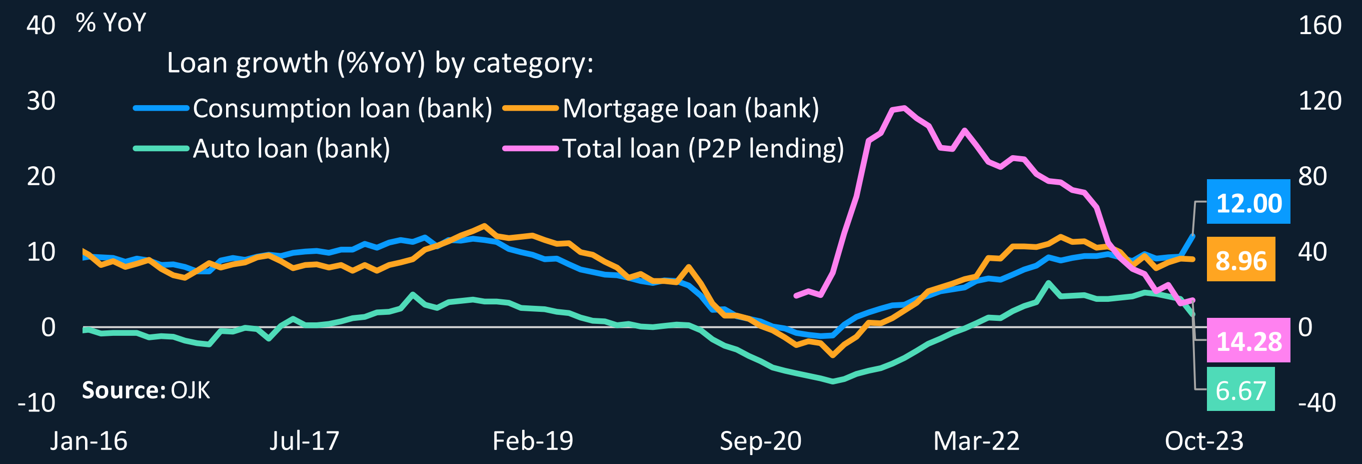
Can stimulus and competition in consumer loans cancel out the effect of rising real rates?

Chart 3.12 The latest rate hike cycle has had very little transmission towards consumer loan rates …



Source: Bank Indonesia, BPS

Chart 3.13 … although loan growth has slowed, partly on lower burn rate among P2P lenders



Source: OJK

- Given that consumers have been net borrowers – and that some "forced savings" might be induced by higher real rates – there are some argument that consumer loans could be the first driver of consumption to soften in the coming year.
- There are some early signs of such slowdown, such as in auto loans. The sharpest fall, however, is actually for P2P loans, whose decline from 2021-22 was nothing short of precipitous. But this is arguably driven by the lack of cheap global liquidity, which funded the entry of new (often foreign-owned) P2P lenders at the time.
- While this takes out a liquidity source for low-income households, it still leaves a substantial consumer loan market for domestic banks – and here the outlook is significantly less gloomy.
- The authorities maintain policies such as relaxed LTV rates and tax incentives on property sales that would support the housing and auto markets. At the same time, strong competition among banks meant that the increase in consumer loan rates have been *de minimis*, in spite of the 250 bps policy rate hike since mid-2022.

Catering to the domestic market is still a reasonably attractive proposition for businesses

Chart 3.14 Post-pandemic revenue for consumer-oriented corporates have been strong, albeit normalizing …

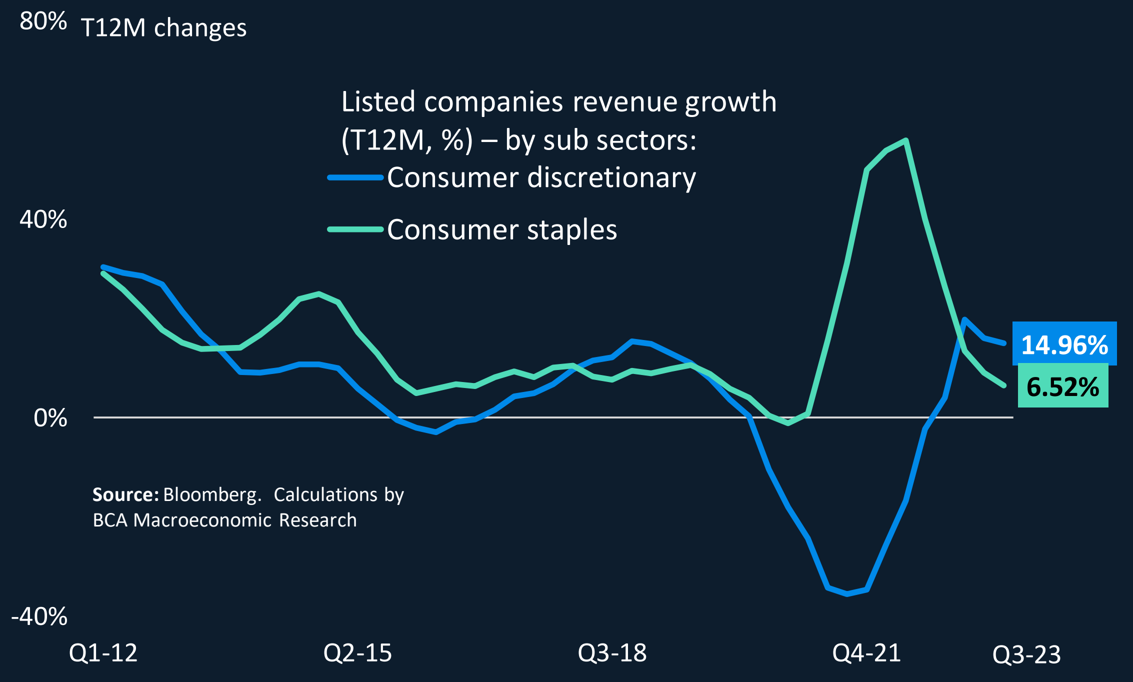
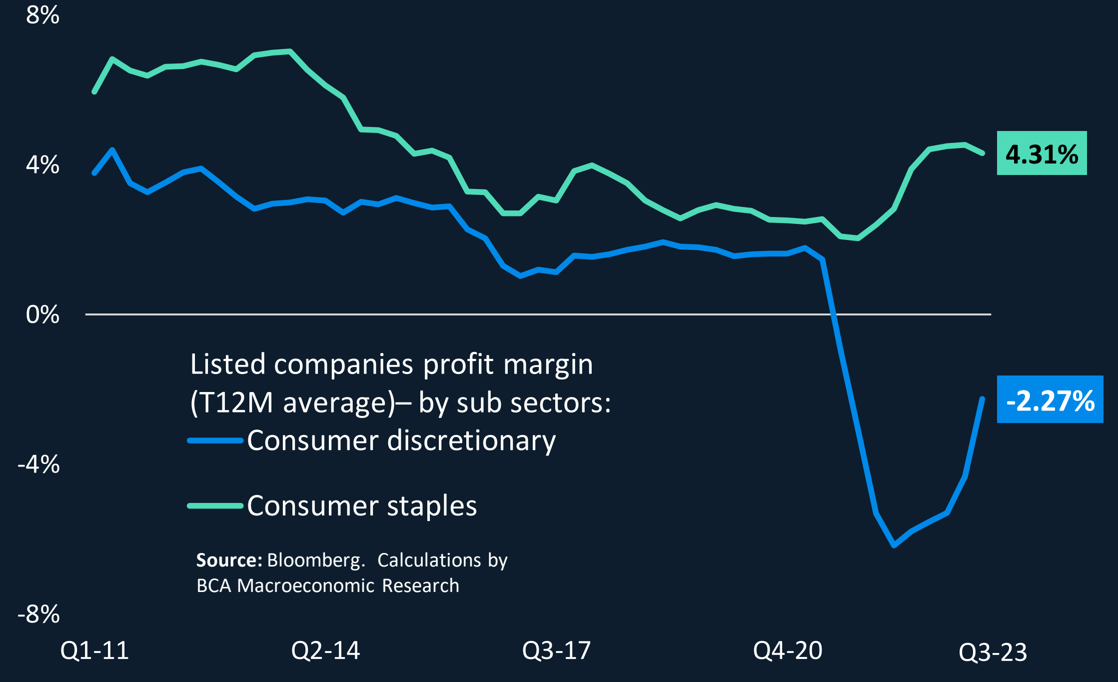


Chart 3.15 … while on the other hand, margin compression for discretionary products have begun to ease in recent quarters



- The robust consumption growth for the past two years has translated to businesses' revenues, especially for those that cater to discretionary consumer spending. In terms of profit margins, however, the staples and discretionary sides could not have been more divergent.
- The former saw soaring margins as food/energy inflation gives cover for an increase in the pricing of essential items. Meanwhile, local producers of discretionary goods have to contend with competition from cheap Chinese imports and rising costs of key intermediates (e.g. chips for electronics). Fortunately, there are signs that the margin compression is starting to ease, and that these companies could enjoy healthier profits in 2024 – albeit possibly on slightly normalised volume growth.

#4: Trade and Investment

"Going full speed amidst the doldrums"

With commodity boom in the rear-view mirror, Indonesia may be facing narrow, but persistent, CA deficit. This could be a problem given the still-strong appetite to invest among Indonesian corporates, plus the acceleration of public projects in 2024. The strong growth/shaky Rupiah conundrum may not be solved in the near-term, given the limited effect of investment to exports and of FDI to domestic FX liquidity.

China's continuing recovery could keep a decent floor on commodity prices…

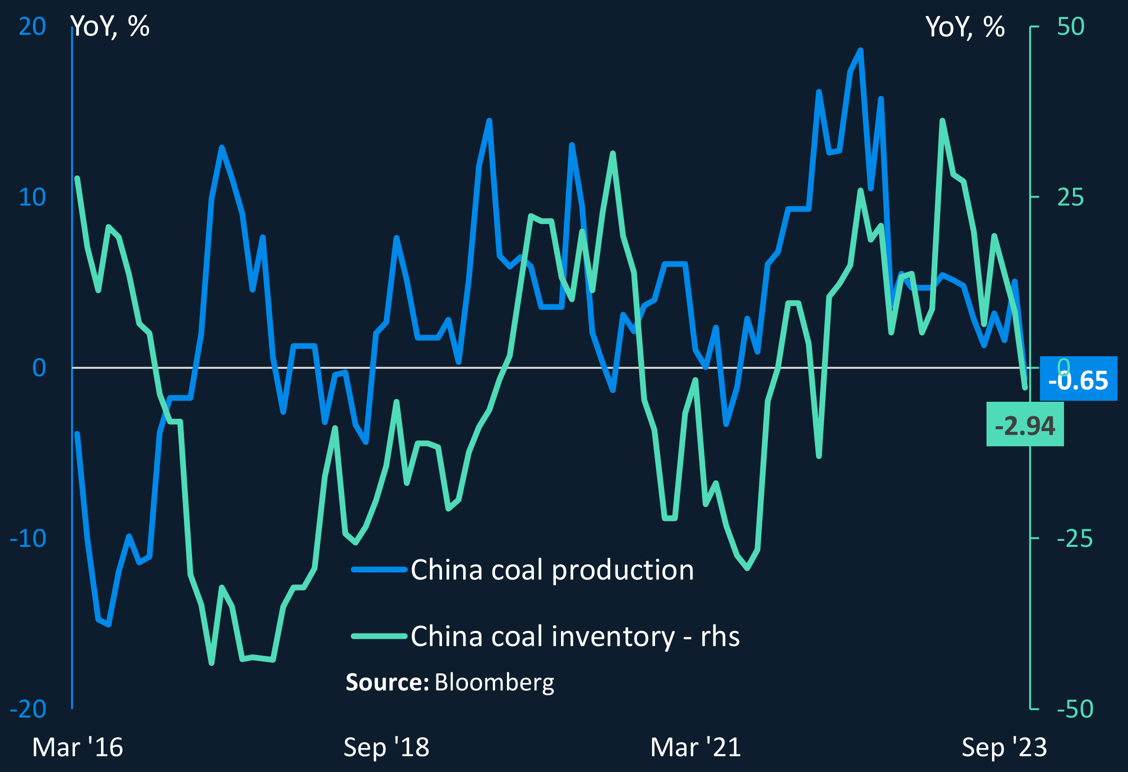
Chart 4.1 Commodity prices showed some upward movements in H2 2023 as China's manufacturing sector recovers from its nadir

Source: Bloomberg

- The Indonesian economy has been considerably lucky in the past three years. For instance, rather than hindering economic recovery, supply shocks in 2021-2023 allowed the economy to recover more quickly than its peers. However, the music in the global commodity market appears to have stopped playing, and net exports have netted negative contributions to the real GDP growth in the past two quarters. Could we continue to count on exports to boost our economy then?
- It is important to note that while prices are a long way down from their 2022 peak, **commodities continue to trade at higher prices relative to pre-pandemic levels**, as uncertainty over geopolitics and energy transition continue to breathe volatility into the commodity markets.
- The joker in all this is, of course, China. **Although its consumption remains anaemic, the Chinese authorities' efforts to stimulate its manufacturing sector has help put a floor on commodity demand.** It has also compensated Indonesia's worsening terms of trade with higher export volumes. Alas, the stimulus-dependent nature of this revival means that we cannot be too sure whether this trend will remain sustainable in 2024 – let alone in the long-run.

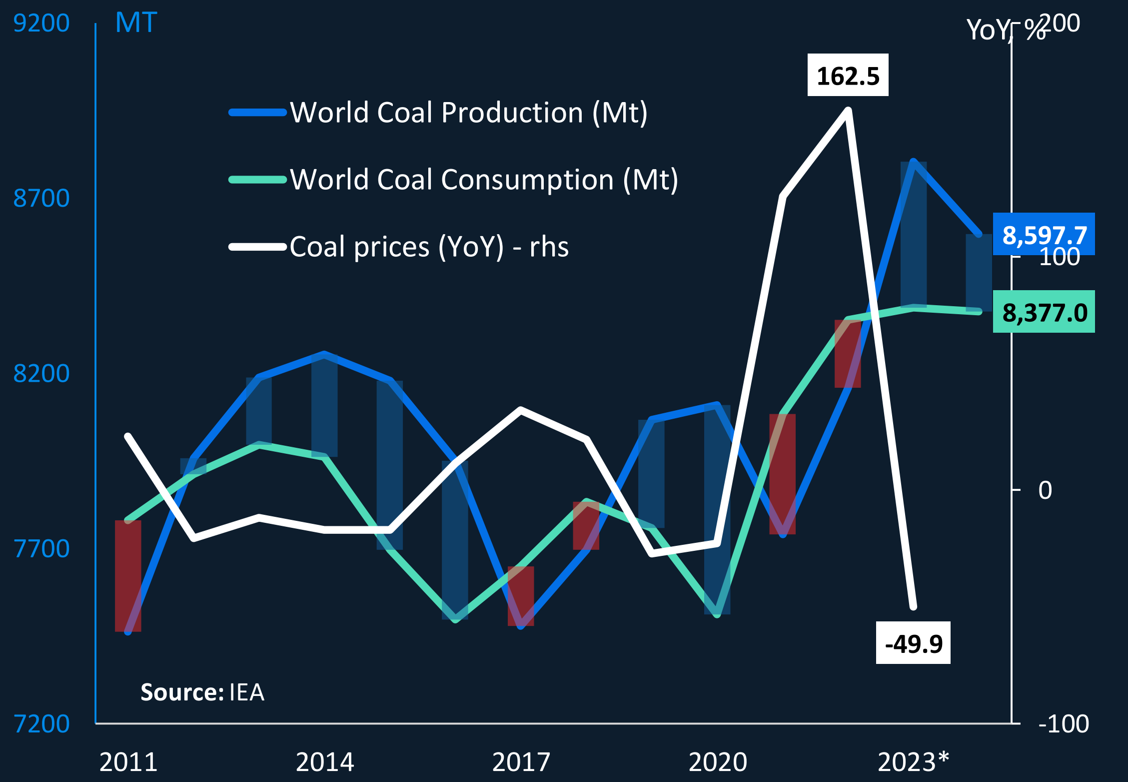
…but the ceiling on Indonesia's commodity exports may not be too high either

Chart 4.2 China's recovery economy may not translate to a spike in coal prices, given the increase in China's own domestic production



Source: Bloomberg

Chart 4.3 Global demand for coal have been greatly trailing production, in a similar manner to the mid-2010s



Source: IEA

- Unfortunately, China's recovery is not entirely beneficial for Indonesia, especially since the Chinese government has prioritised energy independence in its current five-year plan. This effort involves massive investment in renewable energy, but also a ramp-up in coal production – even as fossil fuels become a smaller part of the country's energy mix. **As a result, there is now a massive gap between coal production and consumption, not unlike the situation during the pandemic or the mid-2010s doldrums.**

The commodity terms of trade may not swing much in Indonesia's favour

- The softening global demand for goods also does not bode well for the sustainability of China's industrial recovery – and thus, by extension, the demand for raw materials as well. The fall in coal, gas, and metal prices have reflected this fear – but the fact that oil is now also affected should raise the alarm bells even more.
- Oil prices, of course, are supposed to be more resistant to demand shocks as it is upheld more strenuously by a cartel of producing countries (OPEC+). This is evident during Q3-23, when oil actually rallied after OPEC+ announced large output cuts. By Q4, however, signs of fracture begin to emerge within the group as Saudi seems unwilling to shoulder the lions' share of the output cut, while US shale producers take over the market that they vacated.
- Any hopes for an oil rebound, then, must rely on geopolitics. If a conflict arises that would put OPEC+ countries back on the same page (like the Russia-Ukraine War) then it may lead to renewed rally, but if it put them on opposite sides (as in the Israel-Palestine War) then the decline will likely be baked in.
- Given Indonesia's status as an oil importer, low prices are certainly more favourable. **Still, the fact that the upside in commodities lie mainly in something that we import indicates that there is very little upside to Indonesia's terms of trade.**

Cheaper imports are a boon for local manufacturers …

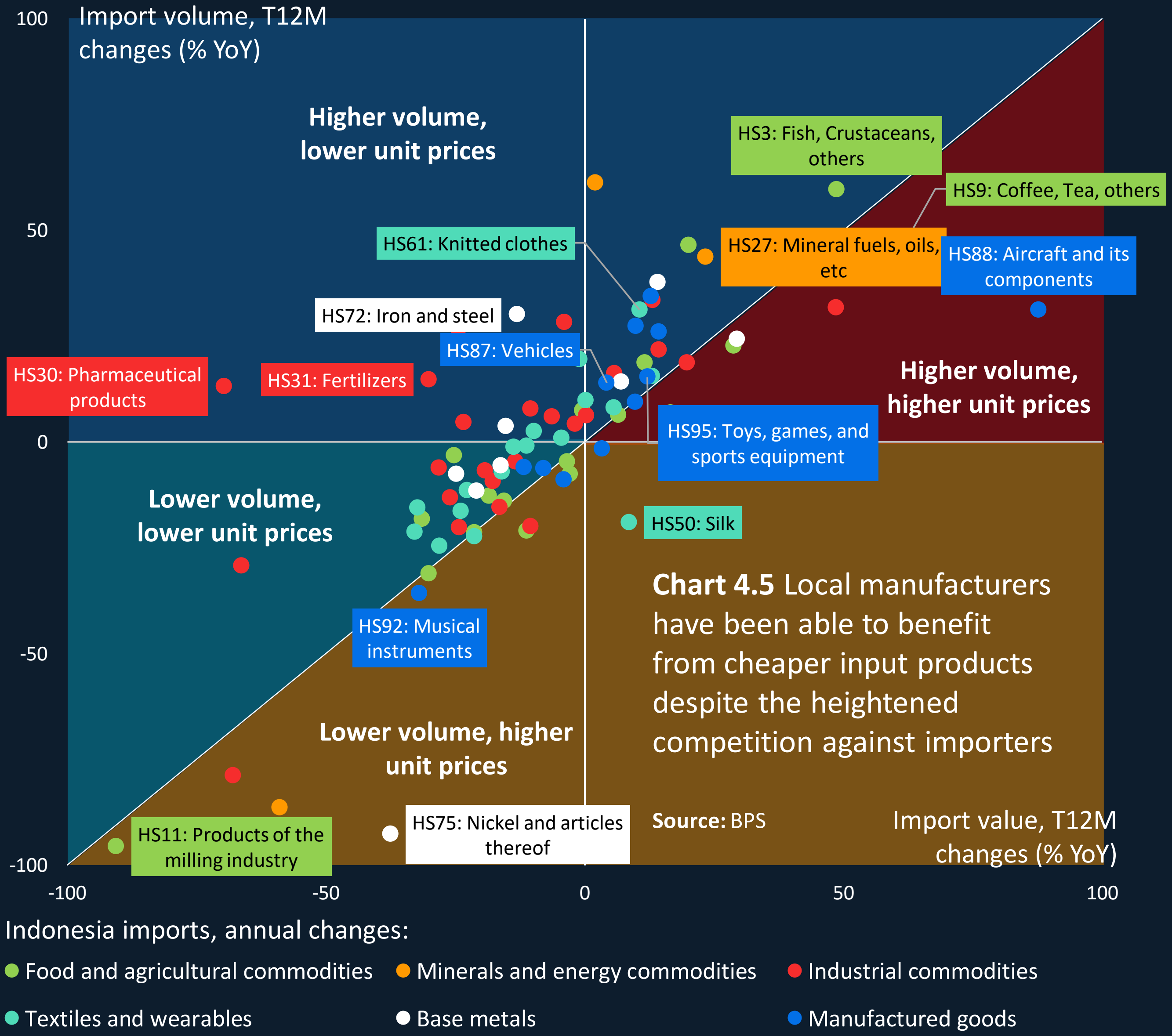


Chart 4.5 Local manufacturers have been able to benefit from cheaper input products despite the heightened competition against importers

Source: BPS

- **The same disinflationary trend extends beyond commodities and into intermediate and finished goods, given the excess supply in China.** This has been a boon for Indonesian consumers, as mentioned, but it actually works to the benefit of producers as well – as **they enjoy declining unit costs on raw materials and even capital goods.**
- This is coupled with the increased desire by Western companies to "de-risk" their supply chains away from China, which has led countries like Vietnam and Mexico to become a prime assembly centre for US-bound goods – even as the components are still largely imported from China. **Indonesia's positive manufacturing PMI indicates that we might be benefiting from some of these spill-overs, albeit not to the same degree as the others.**
- Unfortunately, all these positives for Indonesian manufacturers must be weighed against the downsides, most notably competition from cheaper imported finished goods. This is a problem particularly for certain industries such as steel, where there is a massive overcapacity in China, and textiles, where additionally the local industry has also been saddled by debt problems and structural loss in competitiveness.

…but it is only of marginal benefit given Indonesia's commodity-dependent export profile

Chart 4.6 Recent export volumes growth is almost exclusively driven by commodified goods such as base metals …

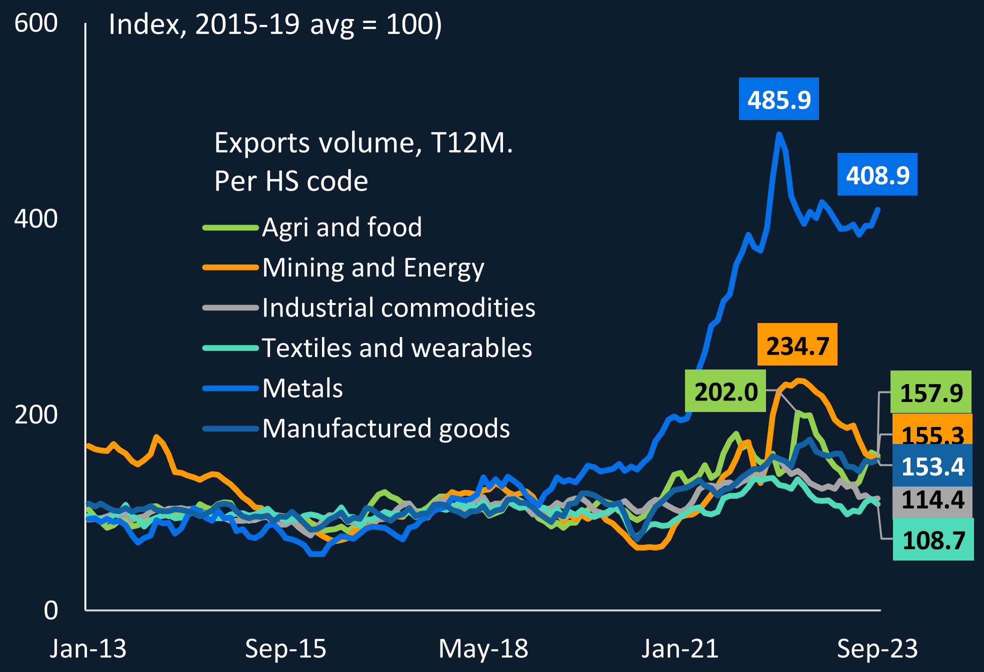
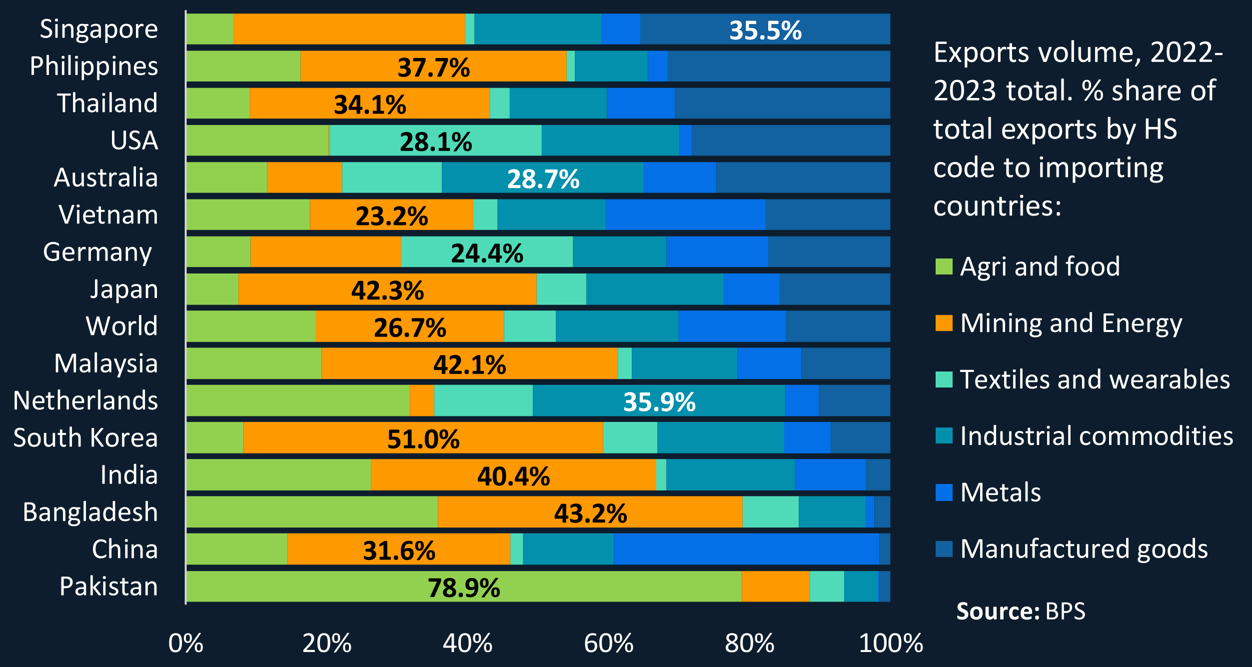


Chart 4.7 … while the prospect for growth in manufactured goods exports appears to be limited given the Western economy's weakening growth momentum

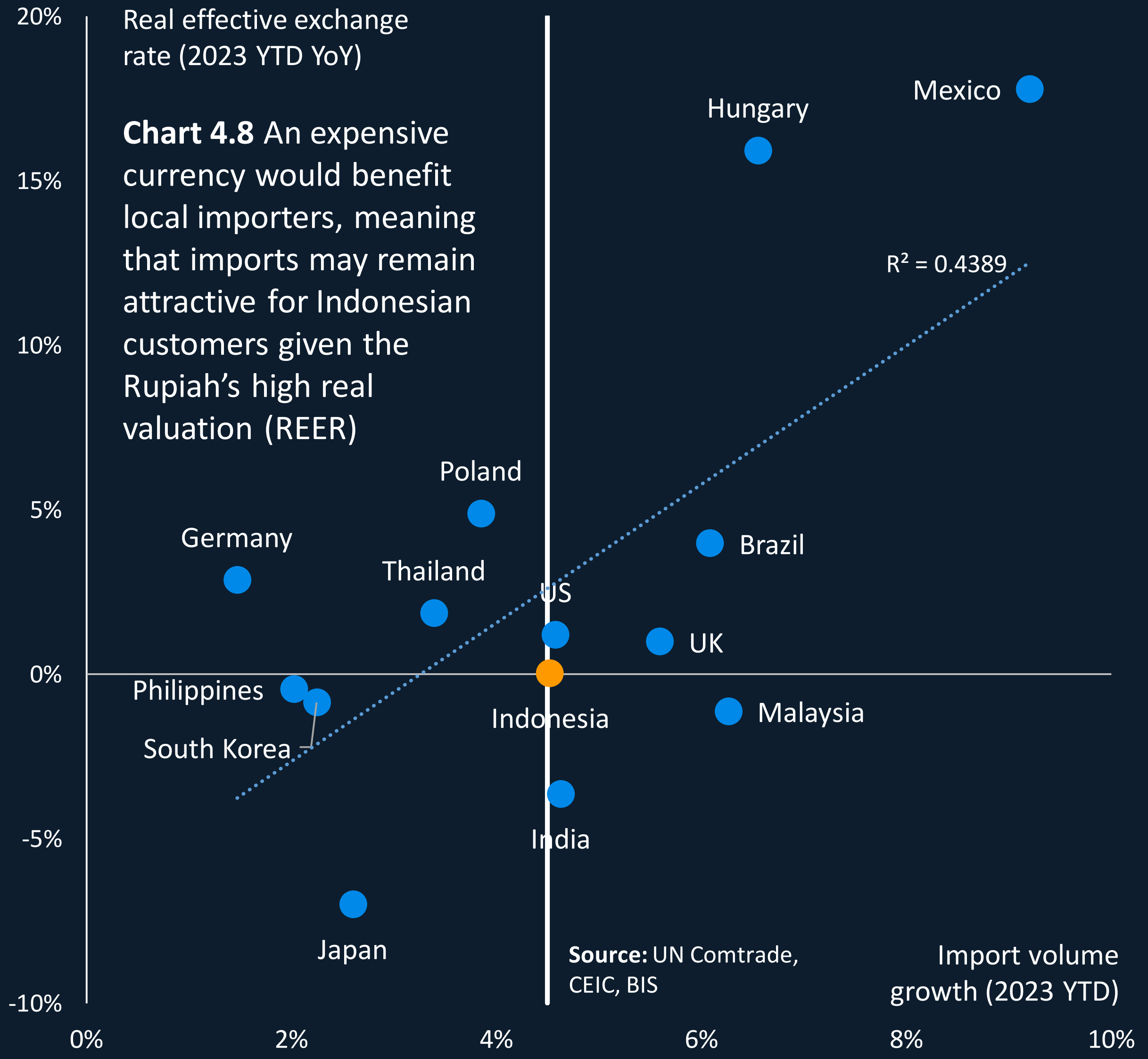


Source: BPS

- There is also a justifiable doubt on whether Indonesia is able to pounce on the opportunity, given the commodity-dominant nature of its exports. The main success story in the past few years (if we discount price effect and temporary boost) has been metals, especially nickel, the demand for which is strongly dependent on China. Steel oversupply, compounded by China's construction slowdown, suggests limited upside for export volumes here.
- On the flip side, Indonesia's exports to the West are dominated by manufactured goods, particularly textiles and other wearables – which creates an-other dilemma. On one hand, the Western economies (Europe in particular) are suffering from weakening demand. On the other, even if the demand remains robust, it is unclear if Indonesia's industries would be able to take advantage.

Relatively robust exchange rate may continue to work on importers' favour

Chart 4.8 An expensive currency would benefit local importers, meaning that imports may remain attractive for Indonesian customers given the Rupiah's high real valuation (REER)



Source: UN Comtrade, CEIC, BIS

- The Rupiah's relative strength versus other Asian currencies may also work to the disadvantage of Indonesian manufacturers. In fact, Indonesia's real effective exchange rate (REER) has become elevated (103.05 in 2023, compared to 101.03 pre-pandemic average). This, of course, restricts local manufacturers' cost-competitiveness in the global market, rendering them more reliant on the domestic market to absorb their products.
- Alas, **an overvalued currency also makes imports more attractive to consumers**, which is evident from the rather stable import volumes compared to most other Asian countries (bar Malaysia and India). China's inventory fire-sale further boosts this dynamic, a condition which may threaten the market share for local producers.
- **This, then, could be a side effect of BI's conservative policy as we discussed in *Chapter 2*.** A strong Rupiah might not be optimal if we wish to reorient Indonesia's industries towards manufacturing, but the short-term cost of weaker Rupiah might be difficult to bear – both psychologically and in terms of consumption growth. **It does seem that the growth model driven by "commodity-consumption combo" remains the path of least resistance for Indonesia for the foreseeable future.**

Price-stabilisation efforts further add to imports

Chart 4.9 Indonesian rice imports have increased significantly since H2-22 as the government prepares for potential disruptions in domestic rice supplies

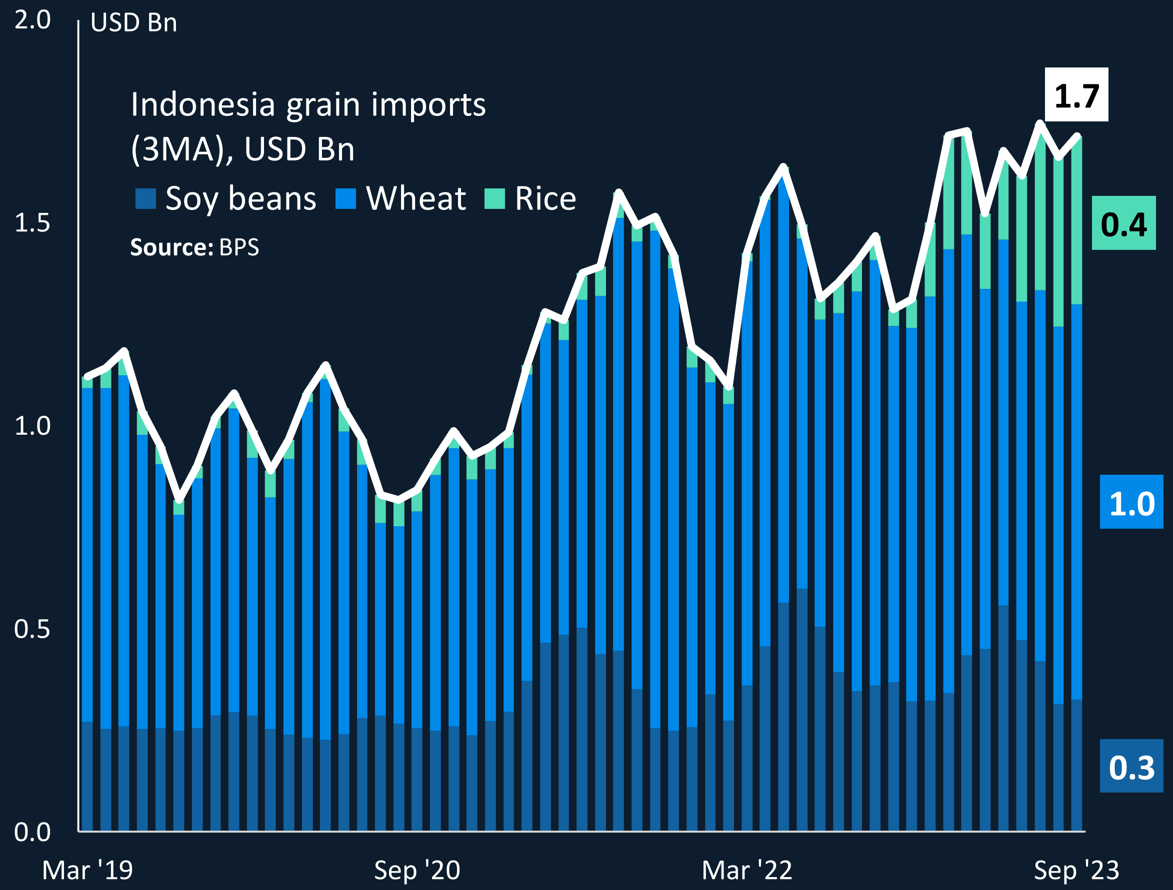
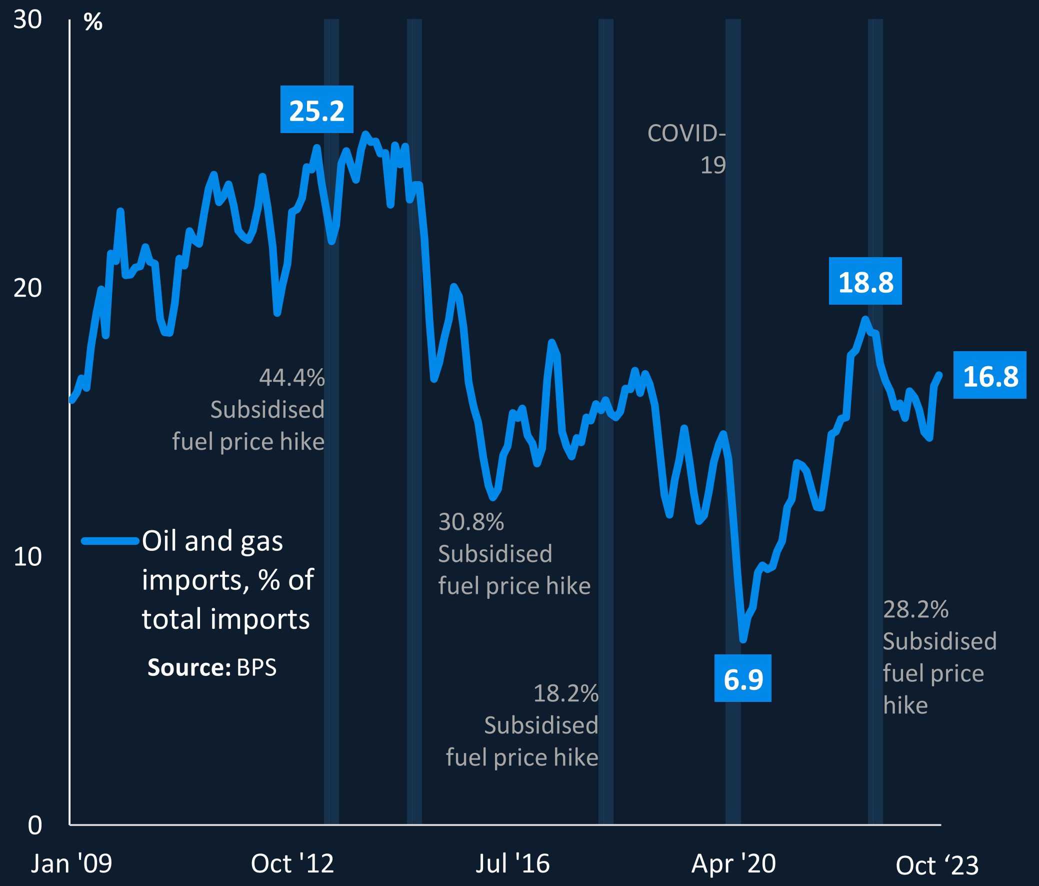


Chart 4.10 The share of fuel imports begins to rise again after it fell following the Sep-22 fuel hike



- One clear benefit from a strong and stable Rupiah lies in the cheaper cost of food and energy imports. Given the backdrop of El Nino plus the political context in 2024, the government has stepped up its efforts to import rice to calm down rising concerns over food inflation. For energy, mean-while, the cheaper price seems to have revived some consumption momentum that had been lost after the fuel price hike last year.

The commodity-consumption engine has been sputtering, which undercuts corporate Indonesia's revenues …

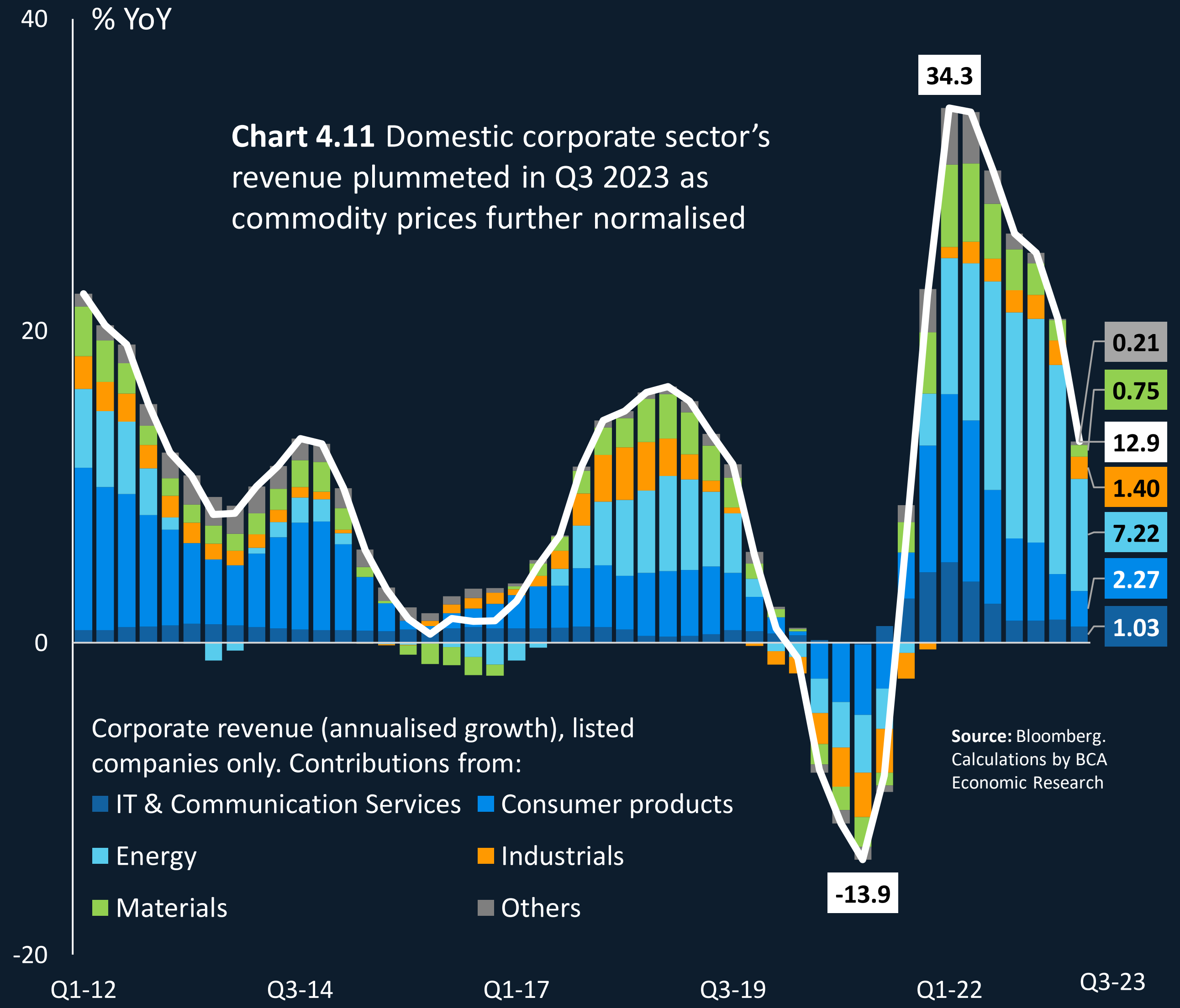


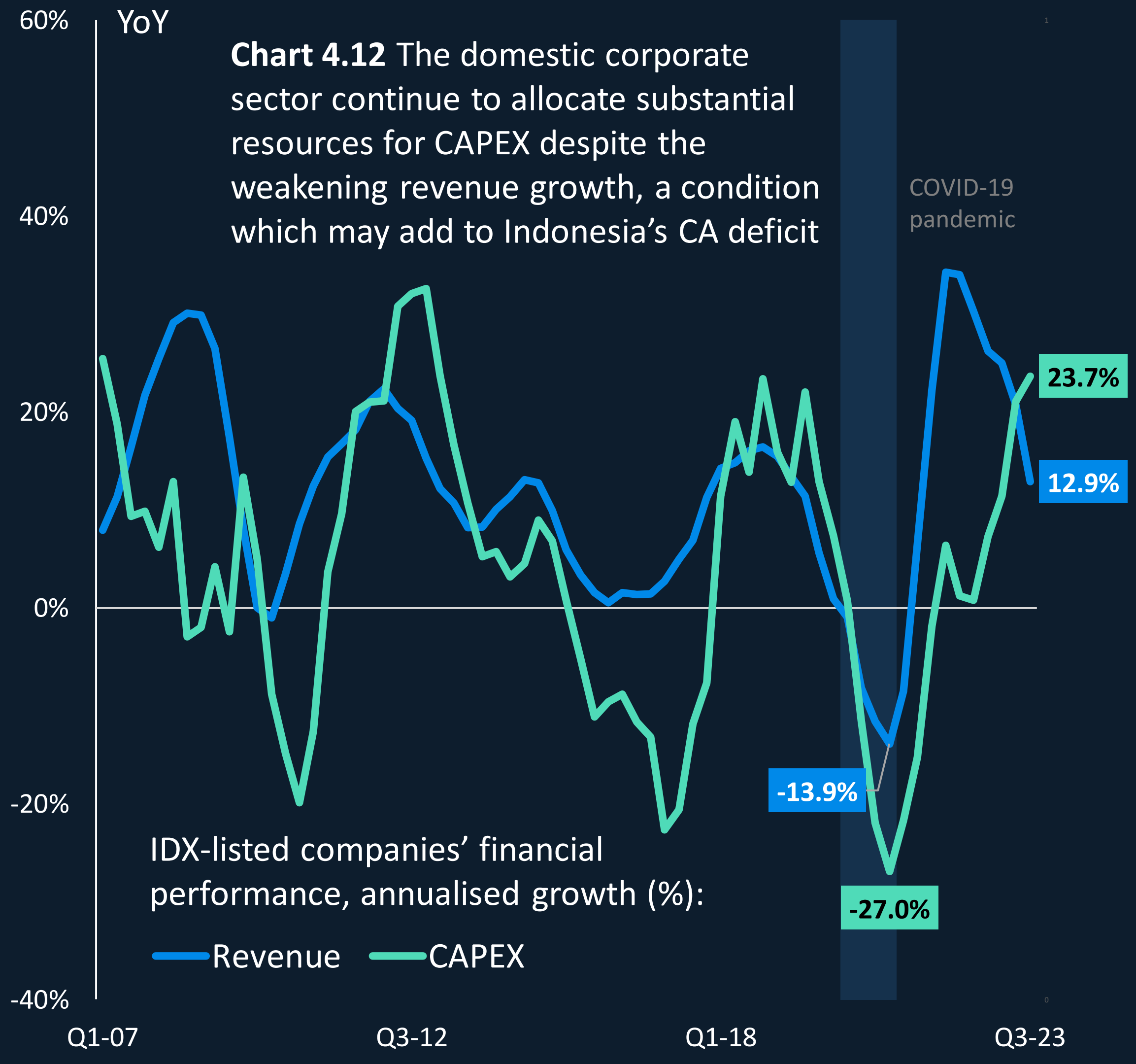
Chart 4.11 Domestic corporate sector's revenue plummeted in Q3 2023 as commodity prices further normalised

Source: Bloomberg. Calculations by BCA Economic Research

- All in all, a decline in commodity prices remains a net loss in corporate Indonesia's book. It also has negative impact on purchasing power, especially outside of Java where the economy largely revolves around commodity extraction. **The twin engines of the commodity-consumption combo, as such, has been under pressure as of late.**
- **Interestingly, the bigger drag on corporate profits seems to come from the consumers' side rather than commodities.** This is not entirely unsurprising. As mentioned previously, large parts of the recent consumption growth has been captured by foreign exporters rather than local producers. Given this competition, producers are also more reluctant to pass on their costs to their customers, which leads to margin compression – although this appears to be stabilizing in recent quarters.
- Finally, there is also a matter of the business cycle, whose ups-and-downs have been amplified by the pandemic. As mentioned in *Chapter 3*, the extraordinary recovery after the end of the lockdowns have sapped much of the house-hold savings – unless recharged by Election-driven public spending.

… but CAPEX remains uncharacteristically strong amidst the slowdown

Chart 4.12 The domestic corporate sector continue to allocate substantial resources for CAPEX despite the weakening revenue growth, a condition which may add to Indonesia's CA deficit



Source: Bloomberg, calculations by BCA Economic Research

- Accordingly, then, the strong capital expenditure (CAPEX) growth – which is quite unusual given the weakening revenue – has been driven mostly by the export-oriented commodity sector rather than domestically-oriented consumer goods (and services) sector.
- **Investors seem to view the cooling down of commodity prices as a temporary situation** due to a combination of high Fed rates and slowing demand, while the long-term outlook remains excellent given the tailwinds from geopolitics and energy transition.
- For many Indonesian commodity producers (and business conglo-merates that include such producers), there is also an additional urge to deploy the substantial cash piles they had amassed during the previous commodity boom. **The bonanza for commodities and "downstreaming" thereof, then, are still far from over.**
- Unfortunately, **CAPEX in excess of revenue probably translates to growing S-I gap, which naturally leads to CA deficit – and the robust imports of capital goods so far essentially confirms this.** And given the CAPEX increase is partly self-financed (and partly also financed from abroad/FDI), the recent increase in real rates is unlikely to dampen its momentum substantially.
- **On a whole, then, this is likely to be a resilient source of growth for Indonesia into 2024 – but one that has to be counterbalanced by internal savings in other areas.**

Investment growth are not entirely driven by commodities

Chart 4.13 Domestic investors dominate the service-heavy tertiary sectors, although interest in the “new economy” begins to pick up in Q3 2023

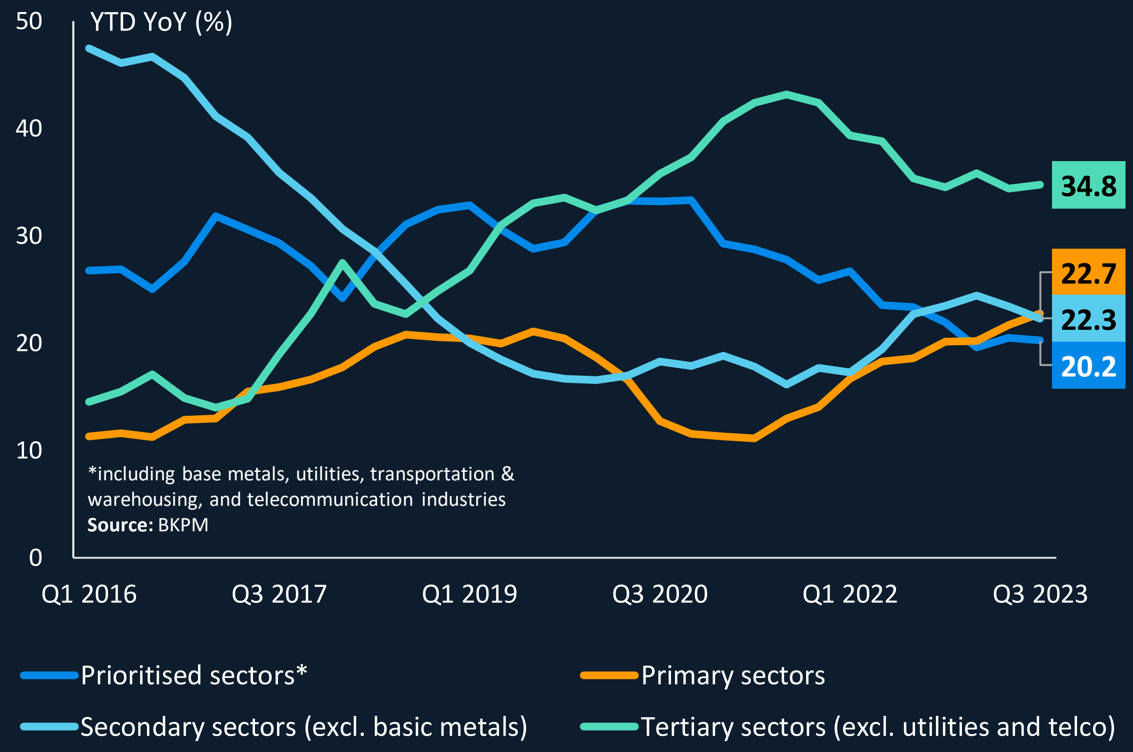
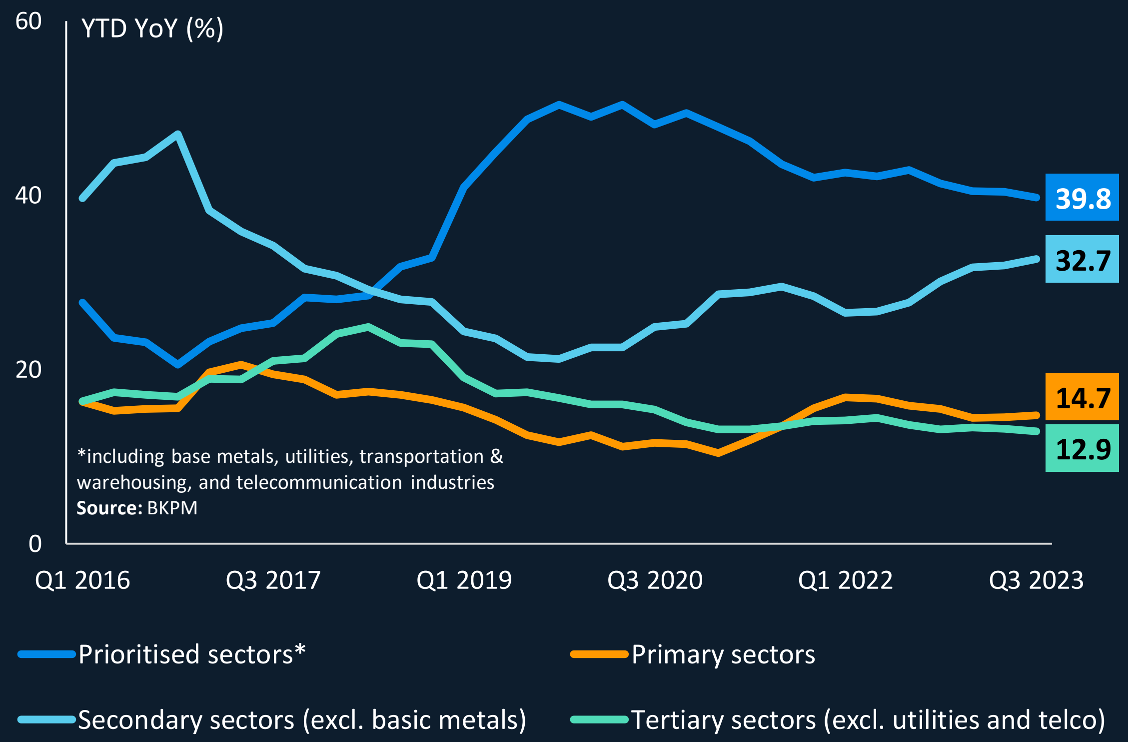


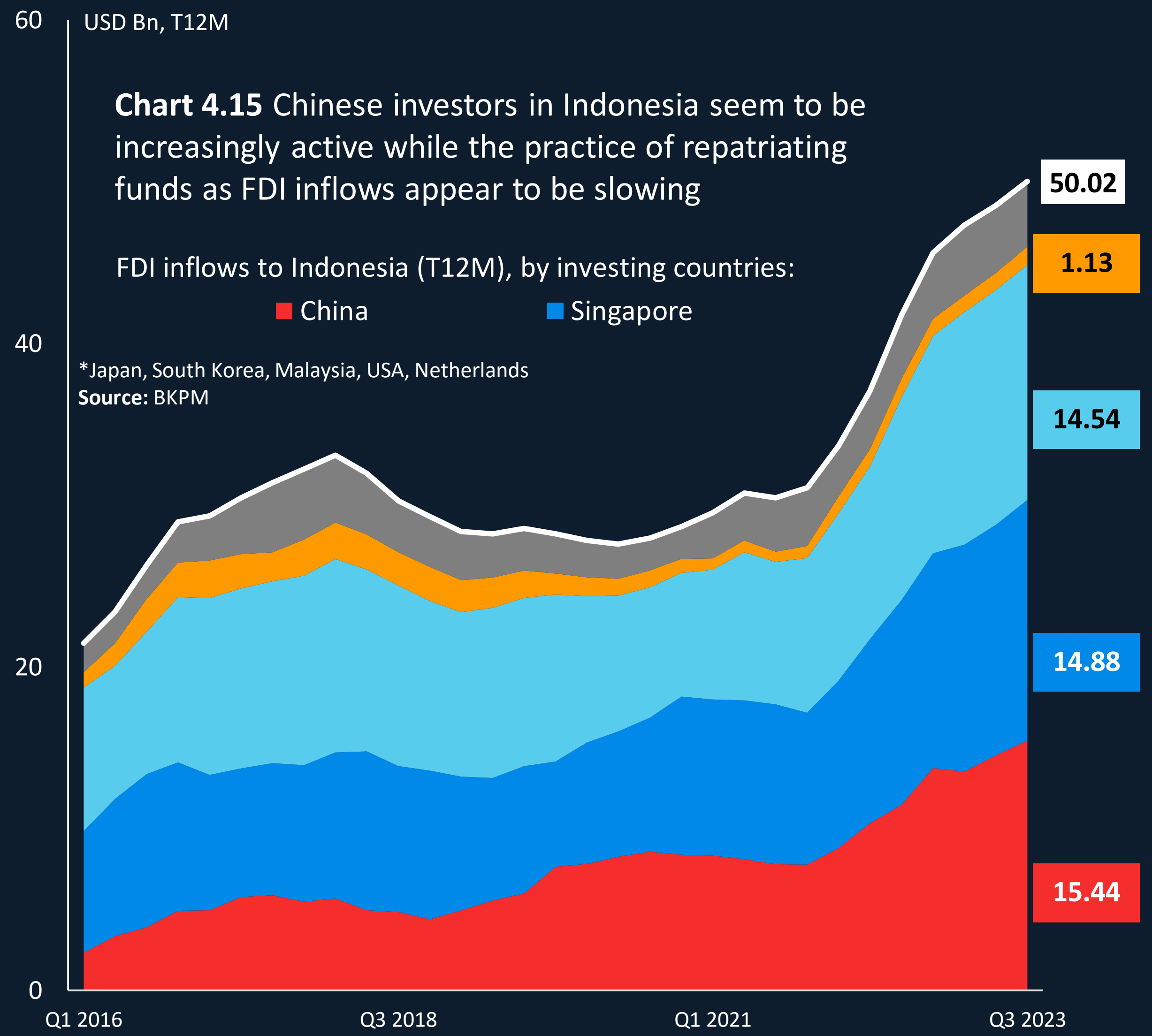
Chart 4.14 Indonesia’s resource nationalism has proven effective in attracting foreign investors into the capital-intensive "new economy" sectors



- **But while certain prioritised sectors (metals, energy, logistics, and IT-related sectors) is at the heart of this CAPEX boom, the investment boom is by no means limited to these industries.** Indeed, domestic investment remain rather evenly spread among other sectors, albeit now increasingly led by the tertiary sectors. The latter probably reflects public-sector investment, in particular the construction of prioritized national strategic projects (PSN) – including the new capital city (IKN) – which are expedited by the end of Pres. Jokowi’s term in office.
- Foreign investors, on the other hand, are more focused on these prioritized sectors, followed closely by other secondary (manufacturing) sectors. **This is a positive sign not just in the short-run, but also for the long-term goal of economic transformation – given Indonesia’s dependence on foreign know-how in many technical areas.**

China's share of the FDI pie has increased, but other countries have not lagged too far behind

Chart 4.15 Chinese investors in Indonesia seem to be increasingly active while the practice of repatriating funds as FDI inflows appear to be slowing



*Japan, South Korea, Malaysia, USA, Netherlands
Source: BKPM

- **The accelerating pace of FDI growth has been a constant theme in Indonesia's economy in the past years.** The allure of Indonesia's mine-to-market industrial complex explains this continued stream of foreign investments. At the same time, the heating geopolitical contest also seems to benefit Indonesia, given the global competition to secure nickel or other minerals deemed as the building blocks of the future economy.
- Among the myriad of investors looking for opportunities in Indonesia, none seem as aggressive as those from China, whose dominance in the EV and renewable energy supply chains increases its demand for minerals. This is a trend which may continue in the longer run as the country continues to build up its EV and other sectors' production capacity.
- **China's growing share, however, have not displaced other countries, whose FDI has also grown albeit not as rapidly.** Investments from the US, for instance, continue uninterrupted despite the US government's protectionist IRA programme. It is true, however, that FDI from many of the smaller countries – particularly tax haven countries – has been declining. This may be a positive trend, as it could indicate that liquidity is flowing to Indonesia from a more direct and transparent channel.

FDI inflows may continue to be a ”growth positive” but “liquidity neutral” event

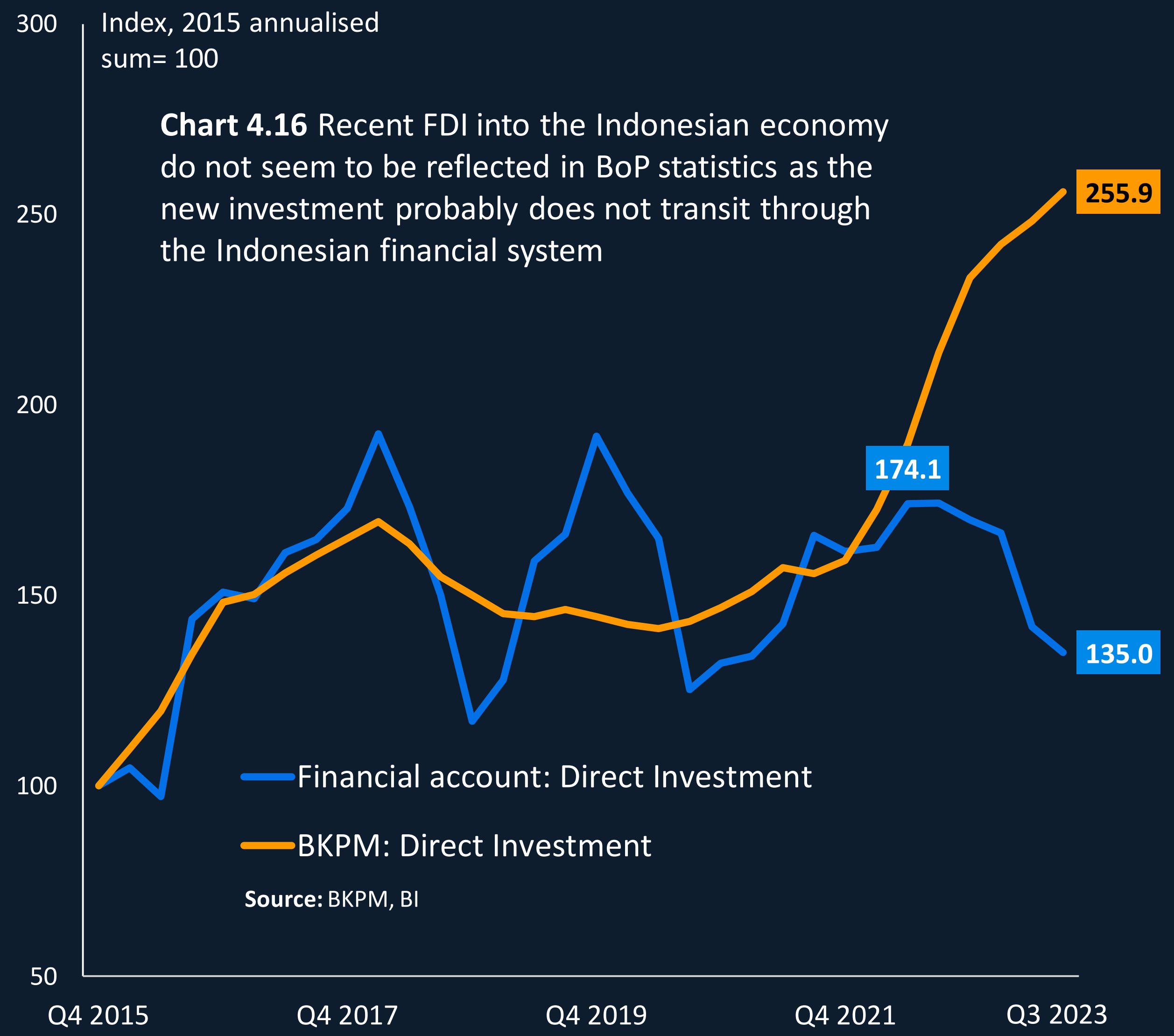


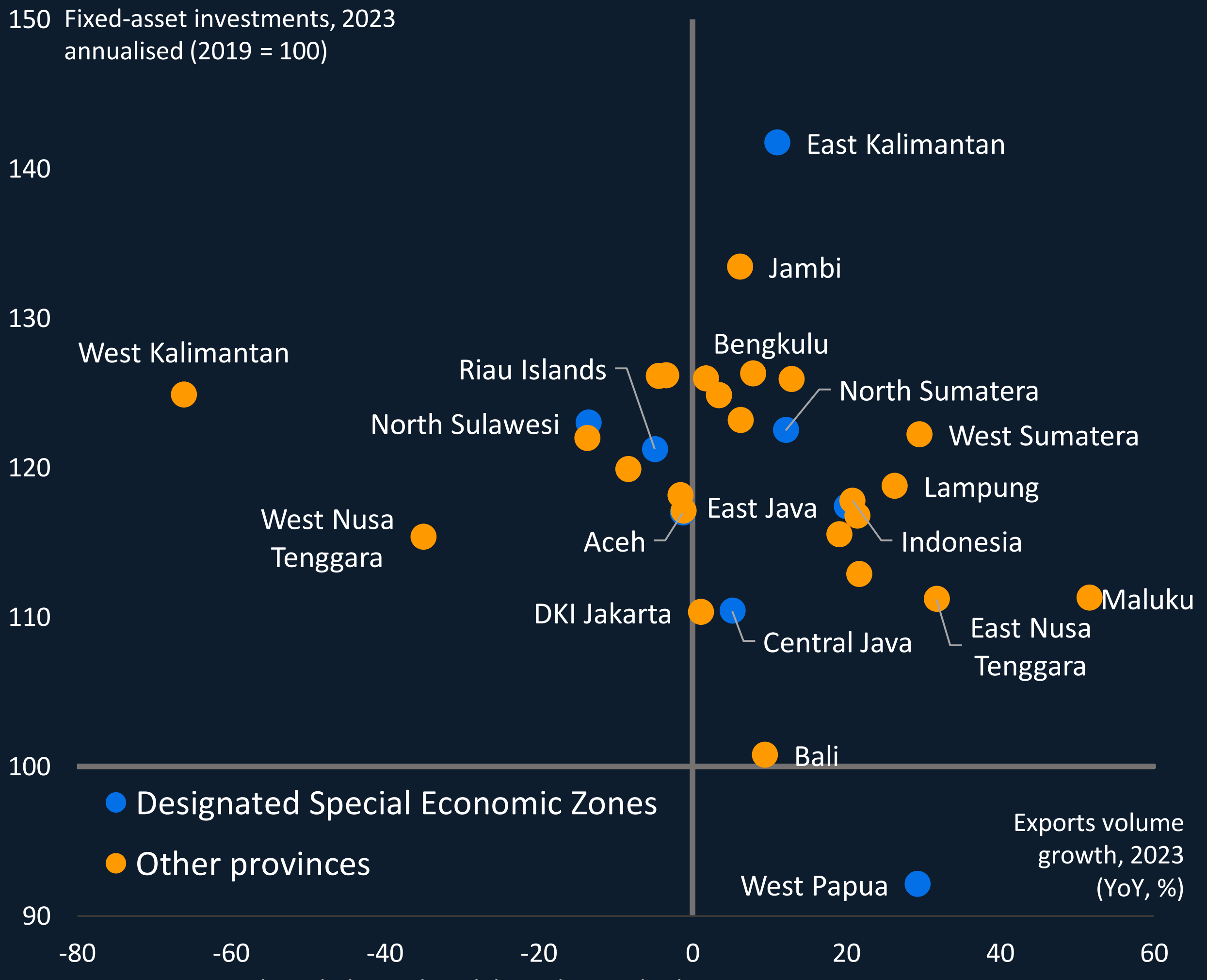
Chart 4.16 Recent FDI into the Indonesian economy do not seem to be reflected in BoP statistics as the new investment probably does not transit through the Indonesian financial system

Source: BKPM, BI

- While news of foreign-backed infrastructure projects and the fixed-asset investments component’s positive contribution to the GDP growth data is not hard to find, **the mark of FDI realisation in Indonesia is harder to find from the point-of-view of domestic banks.**
- Interestingly, our concerns about the widening gap between BKPM-issued and BI-issued FDI data seem to only intensify recently. We noted two possible explanations regarding this development. First, **the widening FDI data gap may reveal the increasingly ‘liquidity-neutral’ nature of foreign investments in Indonesia**, as the investors may realise their commitments by directly importing the resources necessary for their projects in Indonesia – capital goods and/or labour – which does not require routing their money via Indonesia’s banking system.
- **The widening FDI data gap could also serve as an indication that more foreign investors may be delaying their projects in Indonesia**. Such a case, then, may translate negatively to the investment prospect in the future, meaning that the fixed-asset investment (FAI) component’s contribution to growth may continue to rely on government projects.

Strong investment growth may not immediately translate to export growth

Chart 4.17 Some provinces find it difficult to improve their export competitiveness despite the considerable sum poured on SEZs and other infrastructure projects



Source: BPS. Sample exclude North Maluku and Central Sulawesi

- So we finally come full circle to the matter of exports. Given the still-aggressive FAI growth (whether foreign, private, or public), is it possible that the CA deficit due to these investments would generate sufficient exports to eventually close the gap?
- Our answer is probably, in the long-run – but probably not, in the short-term. If we break down recent FAI data by province, there is no obvious correlation with export growth. This holds true even for provinces that have designated Special Economic Zones (SEZ). **The trade-off between the strong investment growth and CA deficit (and accordingly IDR stability), then, remains a pesky problem for the foreseeable future.**
- Of course, things are far more complex than this surface analysis, and at some level – perhaps if we focus only on foreign investment, or those in certain sectors or after certain time lag – there is bound to be positive correlation.
- It is also true that investment, especially public ones, are not meant to reap immediate dividend, but to lay the groundwork for future competitiveness. In this respect, then, the strong FAI growth does not just juice up growth in the short-term, but may put Indonesia on the path towards continued strong growth in the future.

#5: Towards 2024

“A brisk walk in a dark alley”

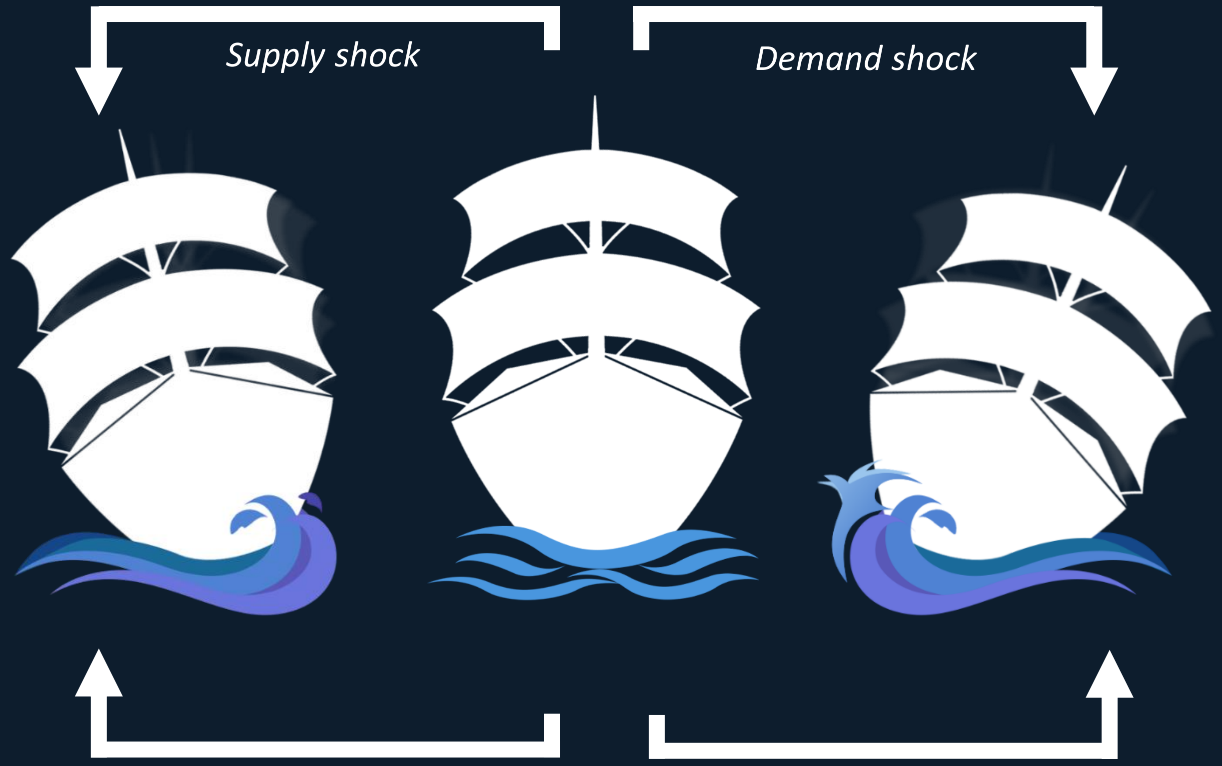
The big picture: Our scenario analysis in summary

	 SUPPLY SHOCK	 BASELINE	 DEMAND SHOCK
Commodity prices	Higher	Stable	Lower
Fed policy	High for longer	Slight moderation	Rapid cuts
Global demand	Limited slowdown	Limited slowdown	Deep slowdown
Current account	Neutral or slight surplus	Narrow deficit	Wider deficit
Rupiah exchange rate	Some pressure	Some pressure	Less pressure
Inflation	Slightly higher	Stable	Stable or slightly lower
BI policy rate	Flat or slight hikes	Flat or slight cuts	Rapid cuts
Domestic demand	Robust	Flat or slight slowdown	Moderate slowdown

The big picture: Our scenario analysis in summary

- Geopolitical escalation
- Energy/food crisis

- US recession
- China stimulus falters



- Widespread crop failures/ food crisis

- Weaker consumption in the post-Election period
- Slower CAPEX growth

- Indonesia's economic prospects in 2024 would remain buffeted by strong winds from the global economy – be it from the supply- or demand-side.
- The prospect of a global supply shock may seem much-reduced compared to 2022, but given the pre-existing geopolitical fissures and diminished capacity on the US' part to intervene in the energy market via SPR release, we cannot be so sure.
- Fears of a demand shock, meanwhile, has become the more dominant concern, as China is rocked by troubles in its property sector while the market is skeptical that the US will continue growing as well as it has in 2023.
- We continue to expect Indonesia to perform better vis-à-vis global, thus dampening the impact of these global shocks. One key reason is the Elections during H1-23, in which increased spending may ultimately carry the day despite what might happen abroad.
- Nonetheless, there are still certain pressures within the Indonesian economy – as we have discussed in the pre-vious four chapters – that might manifest itself in 2024, both in terms of consumption and also investment.

Baseline scenario (estimated probability: ~50%)

Ship-shape, despite some hitches

Main assumptions:

Global aggregate demand slows, but at measured pace – as does inflation. This soft landing enables the Fed to enact *some* policy easing: ending QT (surely), but also potentially cutting the Fed funds rate by 25-75 bps.

Meanwhile, global appetite for commodities remain quite robust as China's economy stabil-izes from its recent turmoil.

On the domestic front, the pattern we saw in 2023 (limited slowdown in consumption, still-robust investment growth) continues in 2024, with Election effect giving a nice "cherry on top" for Indonesian growth prospects.

Indicator	2024E
Oil Price	86.9
Fed Rate (eop)	5.00%
Real GDP YoY	5.03%
CPI Inflation YoY	3.21%
BI Rate (eop)	5.50%
USD/IDR (eop)	16,150
CA (% GDP)	-0.53%

- **Growth outlook:** Slowing global demand could drag on Indonesian growth somewhat, but Indonesia continues to over-perform thanks to its status as an attractive destination for FDI, plus strong investment on the part of the domestic private sector (especially in energy, metals, and some manufacturing) and the government (new capital city and other remaining projects). Some moderation of consumption after the Election is expected, but not enough to suppress real GDP growth below the customary 5% YoY pace.
- **Inflation outlook:** Some acceleration in inflation, especially from volatile food, is unavoidable, but will be balanced by relatively mild inflation globally.
- **CA outlook:** Indonesia's stronger growth vis-à-vis global ensures that some CA deficit remains, but China's stabilisation puts a relatively high "floor" on our terms of trade.
- **Rates and Rupiah outlook:** The CA deficit and robust financing demand ensures that BI stays cautious and only ease policy in line with the Fed. Some pressure on Rupiah will persist and may flare up from time to time, but the medium-term trajectory is still a gentle downslope rather than an abrupt cliff.

Demand-shock scenario (estimated probability: ~35%)

A gap year for growth

Main assumptions:

Global aggregate demand slows dramatically, causing a recession in the US and many other countries – including potentially China, whose current manufacturing-led growth strategy greatly depends on continued export strength.

Commodity prices languish further, but the resulting deflationary environment – on top of greater stresses in the financial market – enabled the Fed to ease policy more drastically.

For Indonesia, the global slump is paralleled by sharp declines in private sector spending, in large part due to loss of appetite for CAPEX. Fiscal support post-Elections are also limited by weak commodity revenue and a general pullback before the start of a new government.

Indicator	2024E
Oil Price	76.6
Fed Rate (eop)	3.75%
Real GDP YoY	4.71%
CPI Inflation YoY	2.72%
BI Rate (eop)	4.50%
USD/IDR (eop)	15,604
CA (% GDP)	-1.38%

- **Growth outlook:** Looking at previous crises, the growth impact of commodity shocks is generally bigger than that from financial shocks. In particular, we see the private sector's overall balance sheet – with negative NBB for the past year – as ripe for potential reversal, and further export weakness might serve as a signal that finally drive spending cuts. Nonetheless, the early-year Election effect, plus the easier monetary policy enabled by a more stable Rupiah, would allow for more import-driven consumption growth.
- **Inflation outlook:** Further global deflation is the most likely outcome of weak global demand, especially amid persistently excessive output from China.
- **CA outlook:** Low prices for Indonesia's export commodities plus a more stable Rupiah is generally a recipe for a wider CA deficit, although the success of the down-streaming programme probably moderates the worst-case CA deficit from 2-plus % to around 1-plus %.
- **Rates and Rupiah outlook:** More aggressive Fed rate cuts easing, probably telegraphed quite early in 2024, would weaken the USD and allow BI to also assume a much more dovish policy posture. And given the extent of tightening in 2022-23 (250 bps hike in BI-7dRR, on top of 550 bps hike in RRR), the room to ease is quite substantial indeed.

Supply-shock scenario (estimated probability: ~15%)

Higher highs and lower lows

Main assumptions

Global aggregate demand slows only marginally, and it is overtaken by shocks on the supply-side. Geopolitical flareups are the easy culprit *du jour*, but there are arguments for energy shocks – notably from OPEC+ production cut – and climate-induced food shocks.

The inflationary shock may preclude any easing (bar ending QT) on the Fed's part, and the US yield curve will probably experience bear steepening – causing stronger USD and weaker asset valuations across the globe.

Indonesia has seen its fair share of similar shocks in recent years, from coal to cooking oil (CPO) to rice, and they are almost entirely connected to a wider global story.

Indicator	2024E
Oil Price	123.6
Fed Rate (eop)	5.50%
Real GDP YoY	5.12%
CPI Inflation YoY	3.95%
BI Rate (eop)	6.00%
USD/IDR (eop)	18,260
CA (% GDP)	+0.32%

- **Growth outlook:** Commodity price increase is generally a boon for Indonesian growth, so long as the authorities are able to manage the multitude side effects that might appear. A 2022-level commodity boom, for instance, can drive up potential growth to 5.6 – 6.0% as per our estimates – but whether or not this potential is achieved is another issue entirely. The Election mood does mitigate against a potential fuel price hike that could kill the growth momentum, but potentially tight(er) BI policy could crimp borrowing outside of commodity-adjacent areas.
- **Inflation outlook:** If it persists long enough, high global prices would eventually translate to domestic inflation. But in the short-term, the government can prevent this via subsidies, price controls, or other mechanisms – which will likely be deployed amid an Election year.
- **CA outlook:** The situation in 2021-22 shows that Indonesia can still attain CA surplus, but only if the terms of trade is exceptionally favourable.
- **Rates and Rupiah outlook:** Like in 2022, CA surplus does not necessarily translate to stronger Rupiah if capital keeps leaking out, due to non-repatriation and inflows to safe havens. The more likely scenario here, then, involves BI holding still or even potentially tightening again.

Projections of macroeconomic indicators

	2019	2020	2021	2022	2023E	2024E
GDP growth (% YoY)	5.02	-2.07	3.69	5.3	**5.1**	**5.0**
GDP per capita (USD)	4,175	3,912	4,350	4,784	**4,982**	**5,149**
CPI inflation (% YoY)	2.59	1.68	1.87	5.5	**2.8**	**3.2**
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	**6.00**	**5.50**
10Y government debt yield (%)	7.04	5.86	6.36	6.17	**6.68**	**6.79**
USD/IDR exchange rate	13,866	14,050	14,262	15,568	**15,728**	**16,037**
Trade balance (USD Billion)	-3.2	+21.7	+35.3	+54.5	**+34.9**	**+32.6**
Current account balance (% of GDP)	-2.71	-0.42	+0.28	+1.00	**-0.4**	**-0.5**

Source : *BPS, Bloomberg, BCA Economist calculations*

Notes:
- BI 7-day Repo Rate, 10Y yield, and USD/IDR exchange rate all refers to end of year position
- 10Y yield and USD/IDR exchange rate projections refer to fundamental values; actual market values may vary depending on sentiment and technical factors

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