Economic and Industry
Research of BCA Group

Embracing the journey into unchartered challenges

2024 Banking Outlook

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Executive Summary

- The banking sector outlook is highly dependent on the Fed’s policy decision in 2024: maintain high rates throughout 2024 or pivot in H2-24. For the banking industry, these two scenarios pose different risks. Prolonged high interest rates imply threats to liquidity and asset quality, while a rate decrease signals potential disruptions on the profitability front.
- Slowing commodity prices and tightening global liquidity mean that external liquidity sources for banks cannot be relied upon in the coming year. Meanwhile, money creation through credit may still be limited, and the main hope lies in an “outflow” of liquidity from the public sector to other sectors.
- Bank profitability will be affected by the possibility of declining interest rates, which could impact interest income. Our concern is focused on two trends in banking statistics (Sep'23): (1) the growth of interest expense surpassing interest income, and (2) a moderate rise in operating expenses (OPEX) in H2-23. In a scenario where these trends continue into 2024, fee-based income becomes a crucial component for maintaining profit levels. Unfortunately, the outlook for fee-based income is not without challenges. Shifting towards the broader use of cheaper integrated payment channels may (1) enhance financial inclusion, benefiting the banking sector, but it also (2) imposes a ceiling on fees per transaction for banks. Additionally, with digital platforms potentially minimizing their burn rate next year, we anticipate transaction growth to be somewhat subdued compared to the past two years.
- All in all, credit growth may still be supported due to several factors: (1) Real sector activities are quite robust until the end of 2023, and the upcoming election could provide an additional boost to the domestic economy; (2) Inflation and nominal GDP’s potential acceleration; (3) Continued strong appetite for CAPEX can spur demand for imports. Meanwhile, the prospects for deposit growth are much more limited due to pressure on domestic liquidity. Our forecast for credit in 2024 is a 10 - 11% YoY growth, and deposits are expected to grow by 8 - 9% YoY.

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CHAPTER ONE

Liquidity: A Challenging Environment

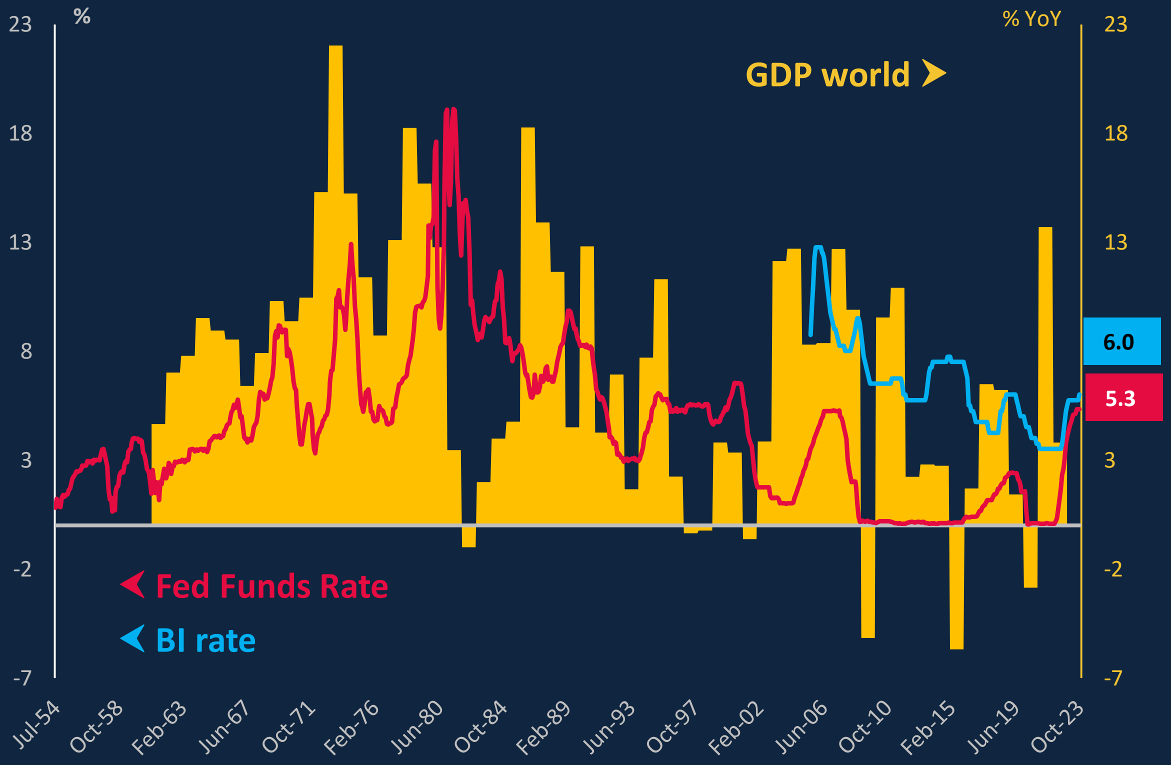
The Fed's tightening measures aimed at combating unusually high inflation since 2022 are not anticipated to be permanent. However, predicting when and how rapidly the Fed will ease its policies is a complex task. Two possible scenarios for 2024: either interest rates will remain high throughout the year, or a pivot will start in the second half of 2024. The trajectory of Fed policy in 2024 holds significant implications for the banking sector outlook.

The projected economic downturn in 2024 is expected to have a pronounced impact on EMs, given their perceived higher risk compared to developed countries. For Indonesia, declining commodity prices would exert additional pressure on liquidity, including that of the financial sector. The tightening liquidity in the financial sector is evident in the increasing LDR of banks, driven primarily by a slowdown in deposits rather than accelerated loan growth.

Nevertheless, FX liquidity within the banking system remains ample, attributed to SOEs and BI's Export Proceeds Time Deposit (TD). In the current environment of excess FX liquidity, it is expected that SVBI will not have a crowding-out effect. Despite the abundant FX liquidity, interest rates for US loans have risen more sharply than IDR loans, indicating an increase in lending standards for US loans, likely in response to the anticipated risk of further IDR depreciation.

The abundant liquidity in the public sector could flow out to other sectors in the next 3 to 6 months due to government spending approaching the elections.

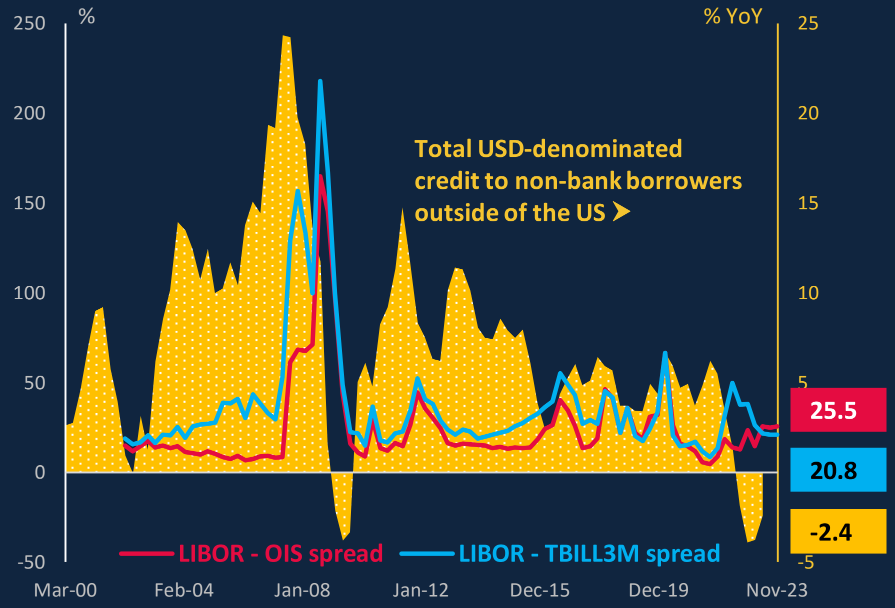
All eyes on the Fed's next move



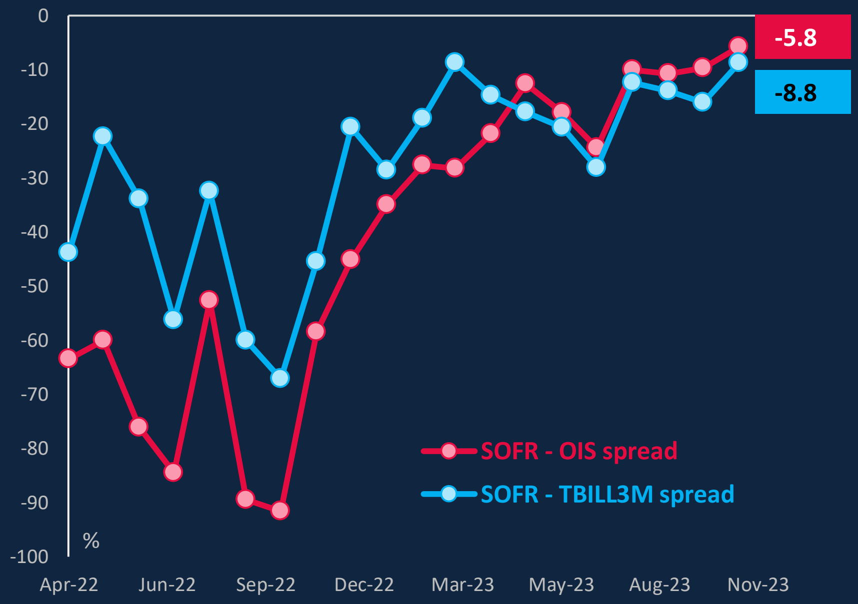
Source: Bloomberg, Fed St. Louis, BI

- Since 1960, 71% of the Fed's tightening campaign has ended in a global economic downturn. The Fed's battle with inflation since 2022 has also led to a global slowdown in 2023, though more moderate than what was predicted initially.
- The current period of high interest rates is not expected to be permanent, and the Fed is anticipated to pivot eventually. But the challenge lies in pinning down when and how swiftly this transition will occur.
- There are two possible scenarios that could unfold next year. The first involves a scenario where rates remain high for longer, which could further slow economic growth and exacerbate challenges in bank liquidity and asset quality. The second involves a Fed pivot around H2-24, which could exert significant pressure on bank margins.
- Apart from the Fed, various other variables could influence the banking outlook for 2024, including the general election, government policies, and commodity prices.

Global liquidity is continuing to dry up



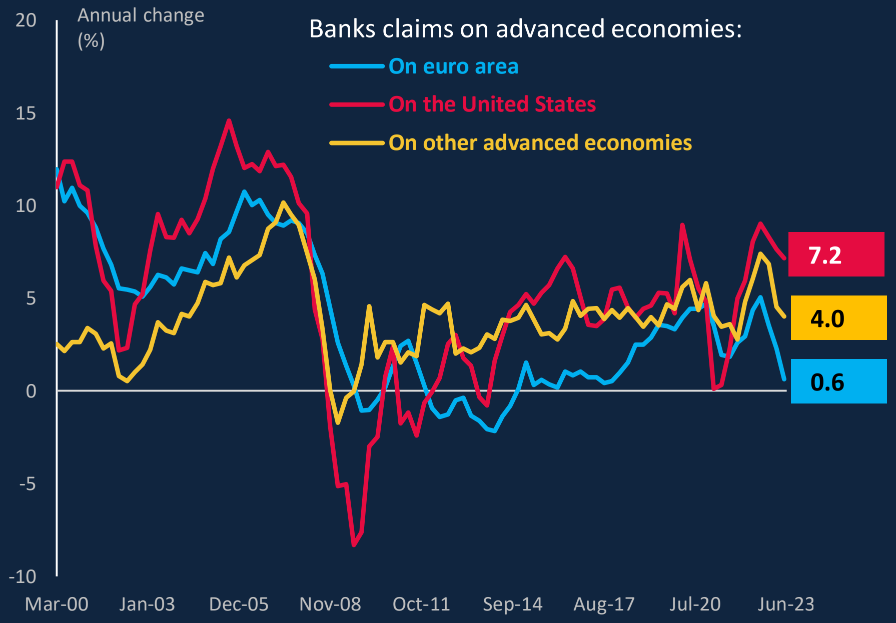
Source: Bloomberg, BIS



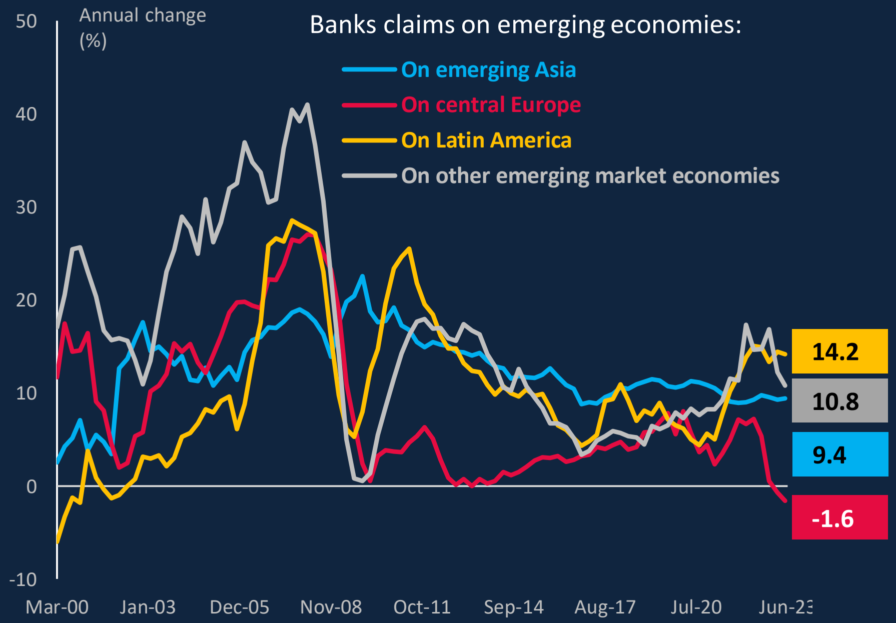
Source: Bloomberg

- As of the writing of this report, the global liquidity indicator, which signifies the disparity between riskier and less risky assets (specifically, Eurodollar vs. US dollar within the Fed's jurisdiction), maintains its upward trajectory. This persists despite the anticipation of a less hawkish stance from the Fed.
- This implies two potential scenarios: (1) There is an expectation that the elevated interest rates will endure for a somewhat extended period and/or (2) asset deterioration has already occurred, prompting a rise in lending standards.

Downturn in 2024 may put greater pressure for EMs



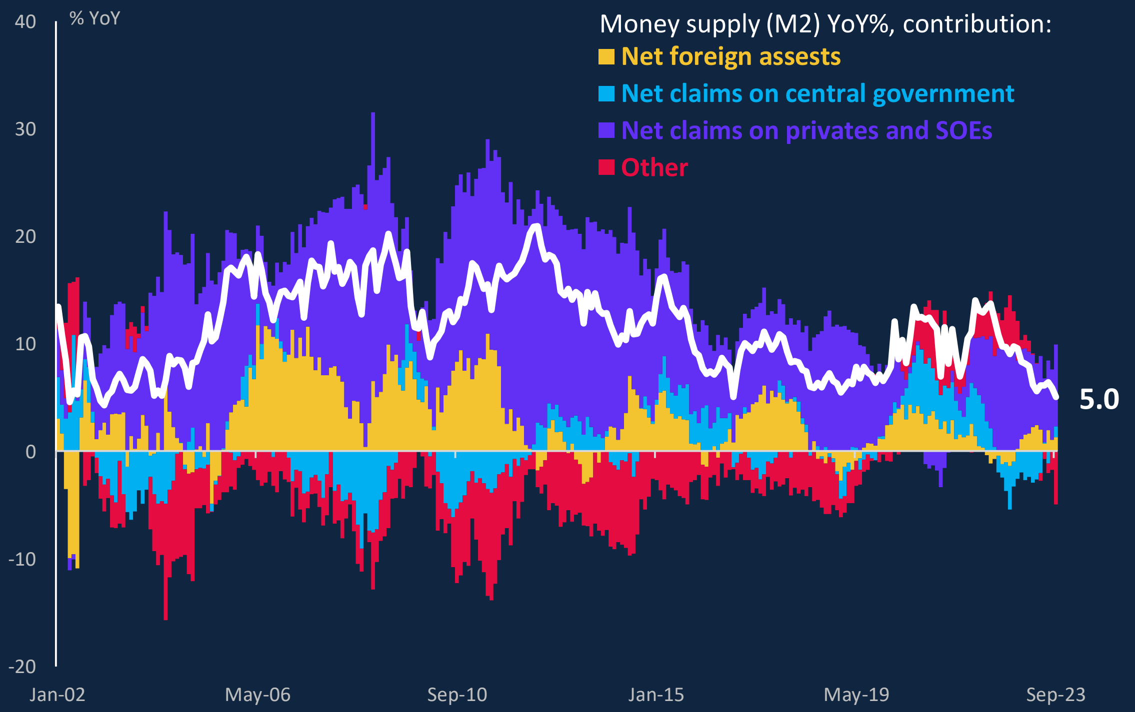
Source: BIS



Source: BIS

- Learning from the events of the past two decades, a liquidity slowdown in advanced economies has consistently been followed by tightening liquidity in emerging markets (EMs). However, the reverse does not necessarily hold true. During taper tantrum (2013 – 14), yuan devaluation (2015), Fed tightening and trade war (2016 -19), EMs' liquidity growth decelerated while advanced economies' liquidity grew relatively faster.
- This is understandable considering that everything ultimately boils down to the level of country risk. While assets in advanced economies are perceived as safe havens, EMs are overshadowed by the risk of contagion effects, capital outflows, slowing exports, and domestic instability (political, security).

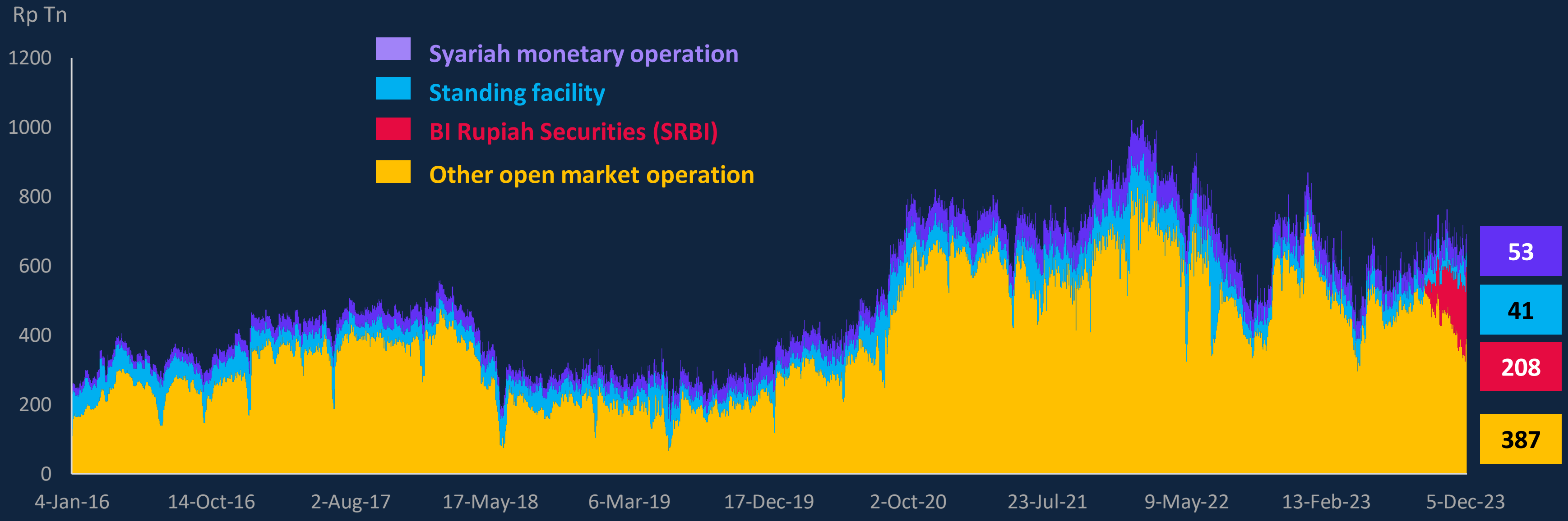
Domestic liquidity: A decline in commodity prices next year means less contribution from net foreign assets …



Source: SEKI

- Further tightening, especially if prolonged, will likely strengthen the dollar index, leading to a decline in commodity prices (given the negative correlation with the USD). However, this relationship is not always precise due to geopolitical and other external factors affecting specific commodities (e.g., OPEC+ production cuts and the US SPR release for crude oil).
- In 2021–22, there was a significant increase in domestic liquidity due to the commodity boom and the government's COVID-era stimulus. However, liquidity growth in 2023 decelerated across all sources: credit, export revenue, and government spending. Among these variables, lower export revenue is expected to persist until 2024. Therefore, the other two components must play a role in supporting domestic liquidity.

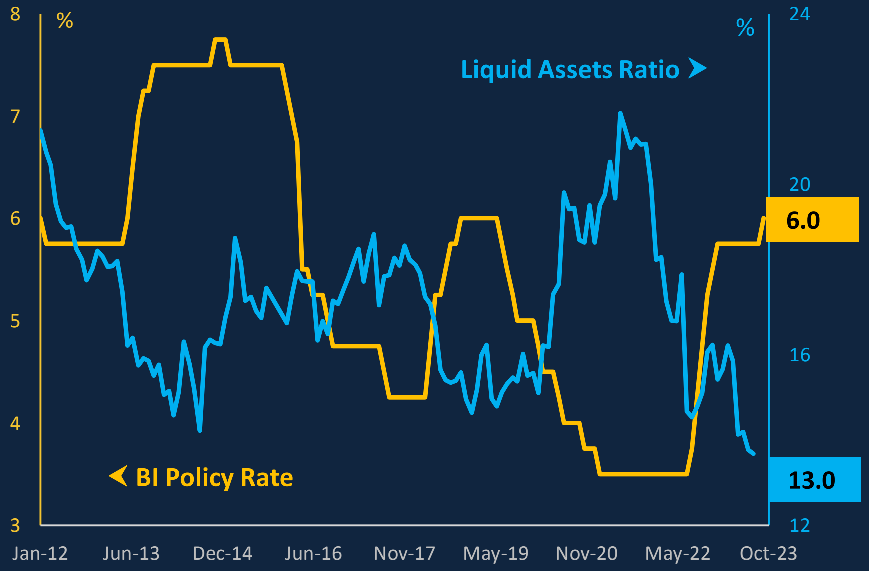
... meanwhile new BI instrument absorbs IDR liquidity from the market ...



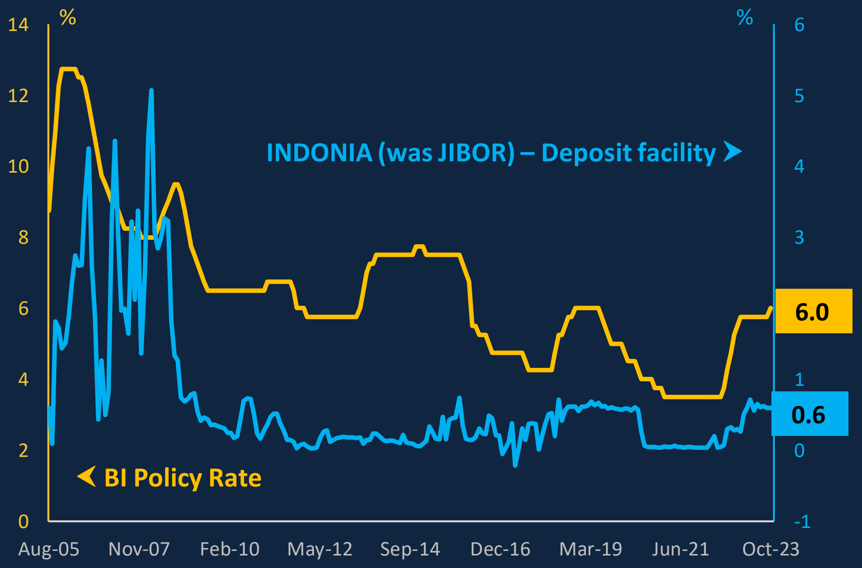
Source: BI

- Roughly speaking, SRBI offers a higher yield (6.7 – 6.9% as of 8 Dec 2023) compared to the NIM of banks (5.0% as per Sep-23) and is exactly in par with opportunity cost of lending (weighted average lending rate: 9.3% minus NPL 2.4% ~ 6.9%). We could also say that SRBI yield reflects banks' expectation of what would be the rate of return from credit next year (combination of lending rate and NPL). The limited volume of SRBI provided by BI is a constraint preventing banks from placing more funds into the instrument.

... while the banking sector has more limited liquidity for intermediation



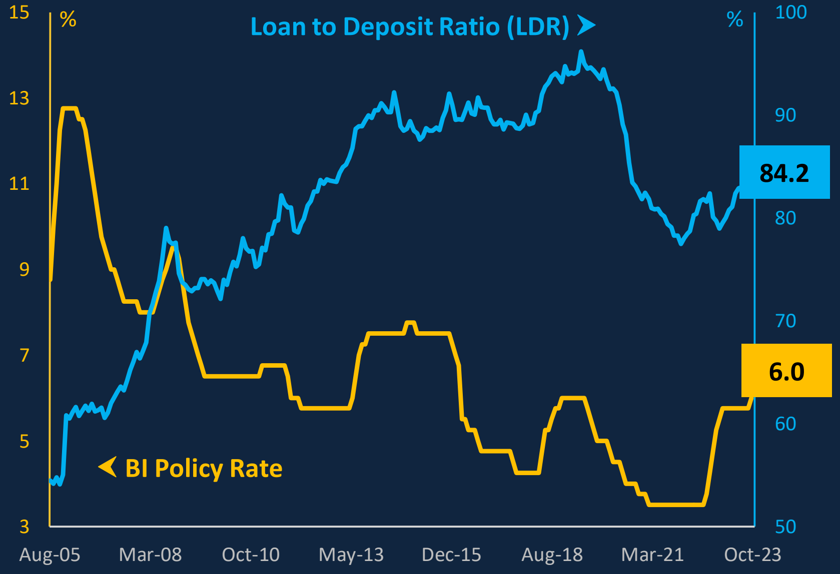
Source: BI, OJK



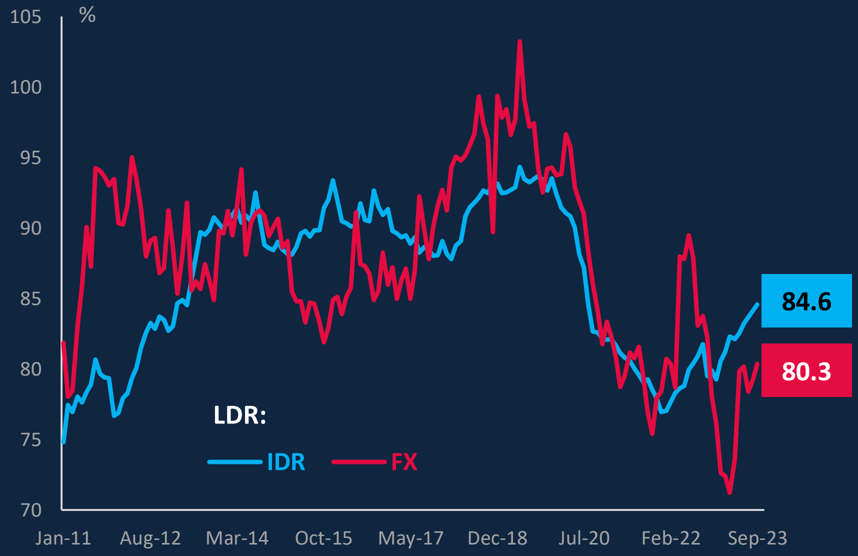
Source: BI, OJK

- Tightening liquidity in the banking sector is reflected in the declining liquid assets ratio and the rising interbank rates. Over the past decade, the liquid assets ratio typically reaches its lowest point when the BI rate hits a local maximum and rebounds when BI begins to decrease interest rates, showing a robust correlation of approximately -70%. Meanwhile, the interbank rates also tend to rise when BI hikes interest rates, with a substantial correlation of 62%.
- If this relationship persists, the recovery of banking liquidity hinges on whether BI will start cutting rates next year, a decision significantly influenced by the Fed's policy.

... potentially bringing LDR closer to pre-pandemic levels



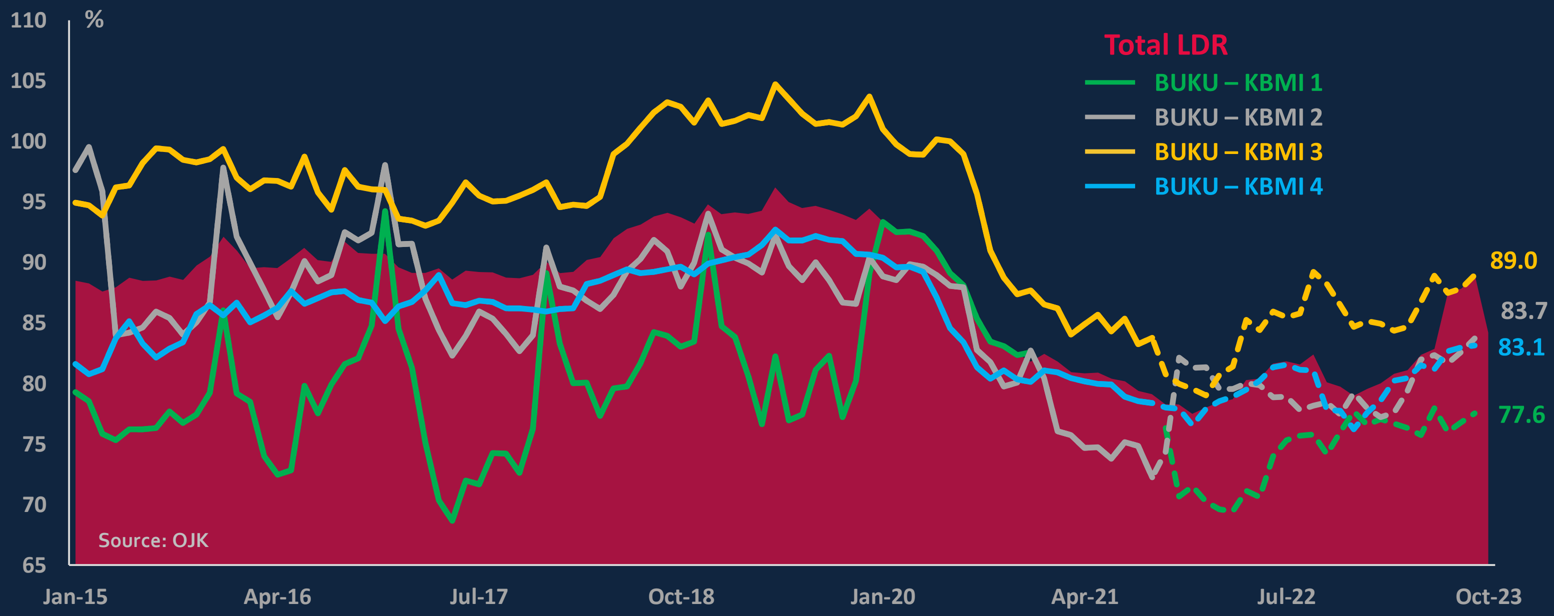
Source: BI, OJK



Source: OJK

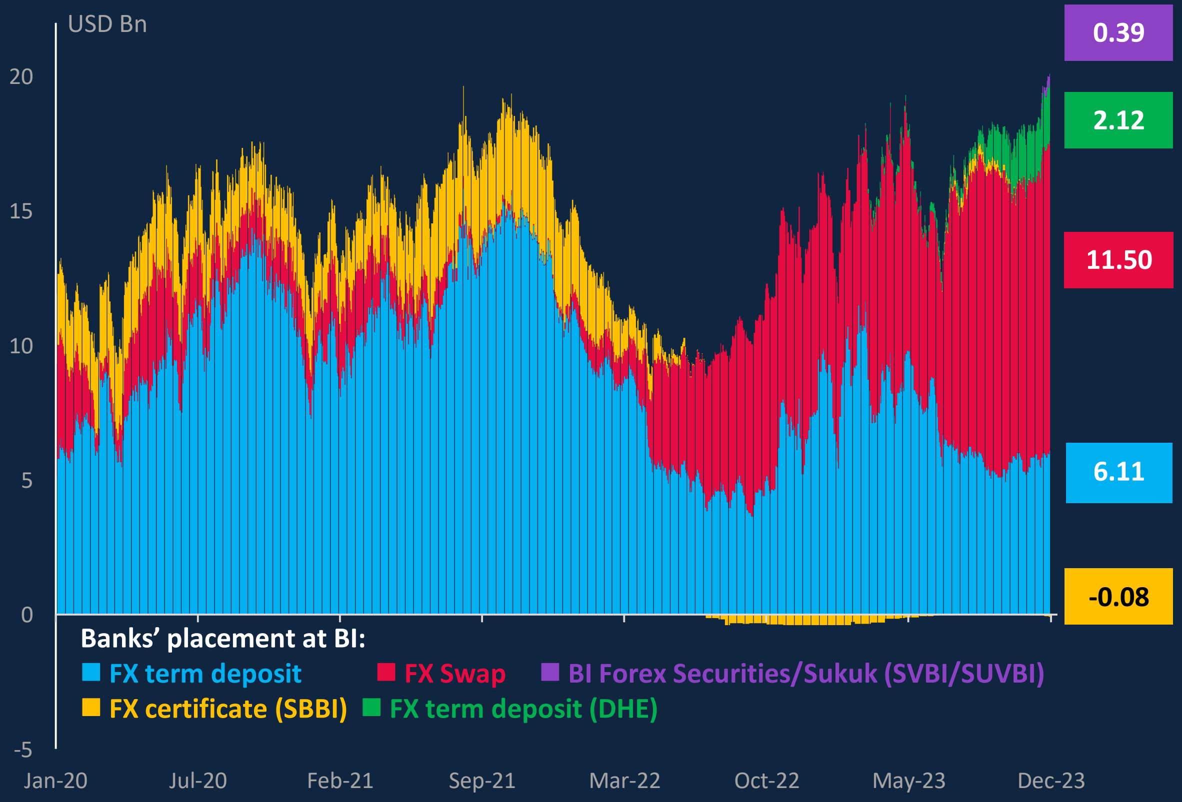
- In theory, a high-rate environment is expected to slow down the LDR. This was evident during the taper tantrum period (2013 – 14), where elevated interest rates led to a deceleration in the demand for bank loans, causing the LDR to move sideways. However, the LDR may deviate from our theoretical expectations in 2024, potentially increasing even when the interest rates are still high. Unfortunately, the primary reason for this divergence is not stronger loan growth, but rather the deceleration in deposit growth (further details are available in a separate chapter).
- In 2023, FX LDR is relatively lower level compared to the IDR LDR. This is likely attributed to some temporary reluctance in securing FX loans due to (1) the depreciation of the Rupiah, making FX loans comparatively more expensive, and (2) global disinflation diminishing the demand for FX (in nominal terms) for import purposes.

LDR is surging across all bank segments, esp. KBMI 3



- Medium - large banks typically exhibit a higher LDR than smaller banks, attributed to their capacity for driving increased loan growth. However, there have been occurrences where the LDR of smaller banks (KBMI 1 – 2) surpassed that of larger banks (KBMI 4), as observed at the onset of the pandemic (with the exception of KBMI 3). This phenomenon could be attributed to a redirection of funds towards larger banks, perceived as a more secure option during uncertain times.

New instrument has successfully attracted more FX liquidity ...

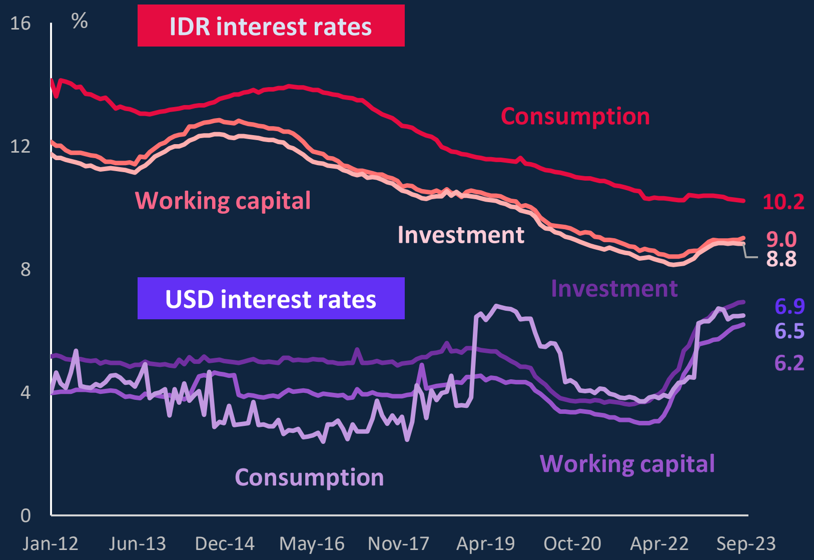


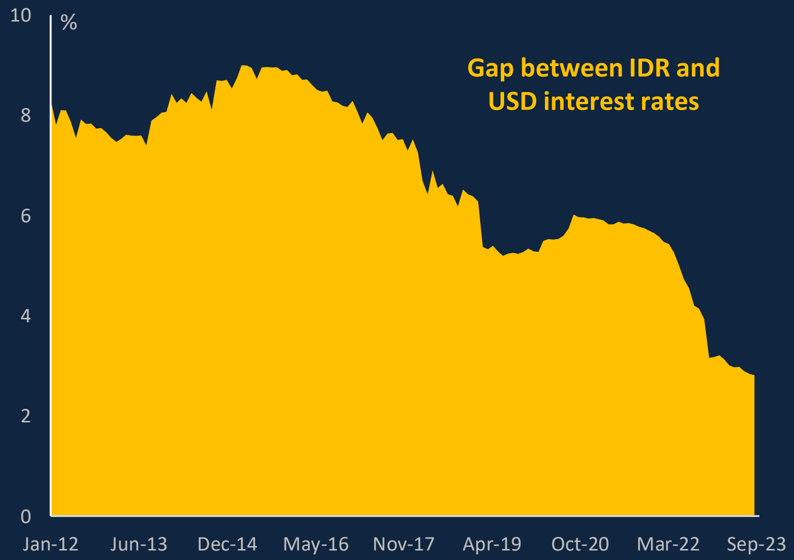
Source: BI

- The ample FX liquidity is attributable to time deposits from export proceeds (TD-DHE) and SVBI, each contributing around 9% and 2% to banks' excess FX liquidity. Inflow into these instruments is driven by the higher rates offered: TD-DHE (5.35-5.50%) and SVBI (5.7%) as of 5 Dec 2023.
- So far, with this magnitude, both SVBI and TD-DHE appear to have not crowded out banking FX liquidity. It is FX swap outstanding that spike up while FX term deposits remains relatively flat.
- In the current state of excess FX liquidity, banks might actually benefit from the higher rates offered by SVBI. But when FX liquidity tightens, SVBI issuance holds the risk of crowding out liquidity that would otherwise be available for banks' FX loans.

... but rates for USD loans have increased more sharply

Interest rates for credit denominated in IDR has risen more slowly compared to those denominated in USD.



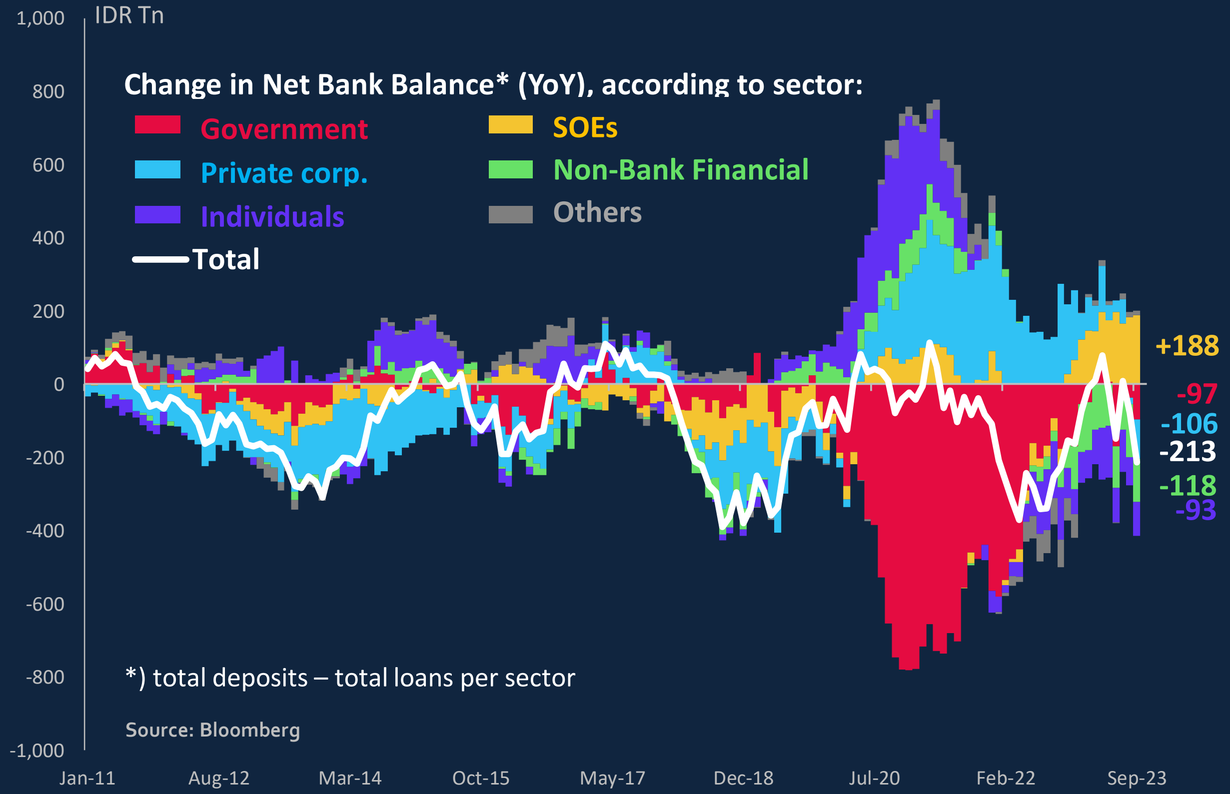


Source: OJK

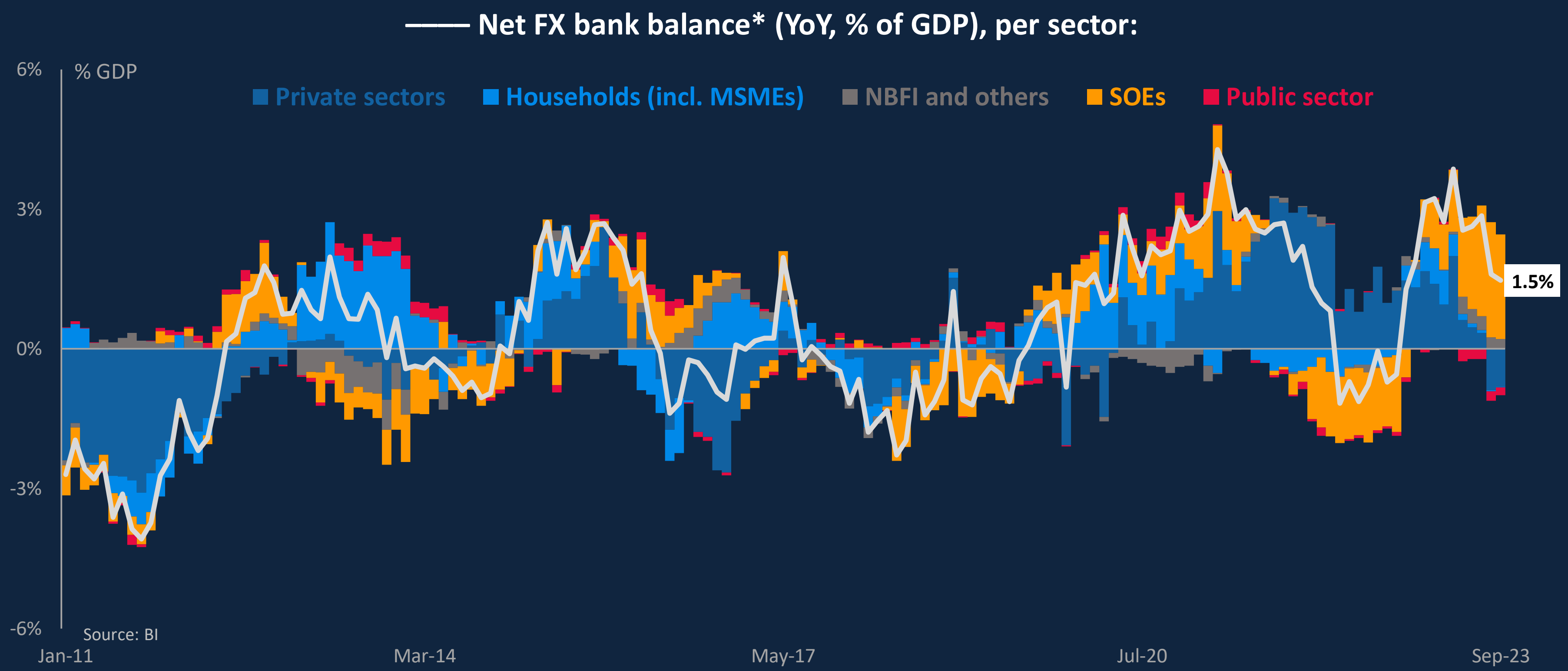
- Interest rates on USD loans have surged by over 300 bps since the Fed started hiking rates in Mar-22 (cumulative Fed increase: 525 bps). In contrast, IDR loan rates have only risen by approximately 50 bps, despite BI raising rates by 250 bps since the previous year.
- This shows that ample FX liquidity within the banking sector is not necessarily accompanied by lower lending standards for USD loans, or in other words, this might be the market's expectation to longer hawkish Fed stance and also IDR deprecation next year. It is unclear whether TD-DHE has contributed to the sharp increase in USD lending rates (as its portion is still small at ~3% compared to banks' outstanding FX loans ~USD 63 Bn).

Private sector lacks "ammunition" to boost liquidity

- The COVID pandemic prompted individuals and private corporations to adopt a more conservative approach, resulting in a substantial surge in savings. Meanwhile, the government had to increase spending to stimulate the economy.
- Individuals and the private sector began deploying their excess savings in 2021, but by the beginning of 2022 a significant portion of these savings have been depleted.
- Since most of the excess savings is presently held by SOEs and the government, the primary catalyst for enhancing domestic liquidity in the next 3 – 6 months would likely be the public sector (especially approaching the elections).



While FX liquidity is not evenly distributed



- Starting this year, the net FX bank balance is primarily held in SOEs. This is a result of more consistent government payments and the buildup of liquidity that has not yet been distributed to other sectors.

CHAPTER TWO

Profitability: A New Playbook Needed

In 2023, banking industry enjoyed high profit from higher rates, but it is unlikely to happen again in 2024.

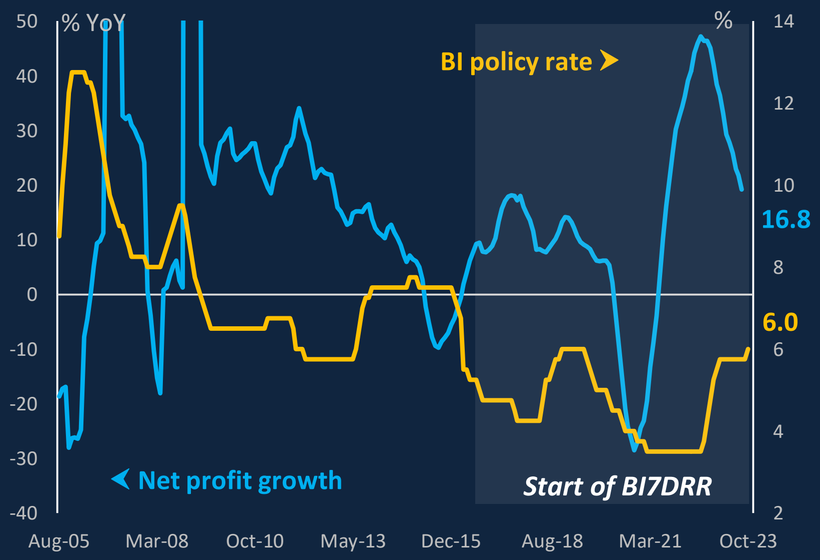
A significant risk to net profit stems from the possibility of BI rate cuts in the latter half of 2024, which could lead to slowing interest income.

- Additional pressure on profit comes from rising non-interest cost, which have started to rise in line with pricing in general (including: salary, rent, and other inputs).
- In the long-term, the banking sector's fee-based income is going to face challenges from: (1) Rising competition (2) A shift towards the broader use of cheaper integrated payment channels. Meanwhile, a potential deceleration in digital transactions could occur as promotions taper amid slowing investment into tech and/or ecommerce companies.

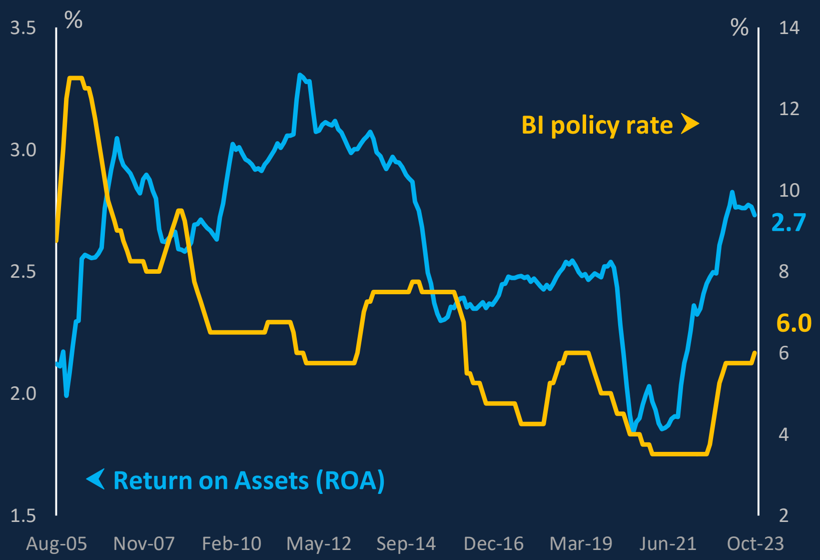
Slowdown in profit will likely have a minimal impact on banks' capital, which currently remain higher than pre-pandemic levels, in part thanks to OJK's regulation that raises the minimum capital requirement for banks.

Asset quality will likely worsen due to lower commodity prices in 2024, evident from the rising special mention loans (a leading indicator of NPL). But the progress tends to be slow and gradual.

There might be brief slowdown in profit growth …



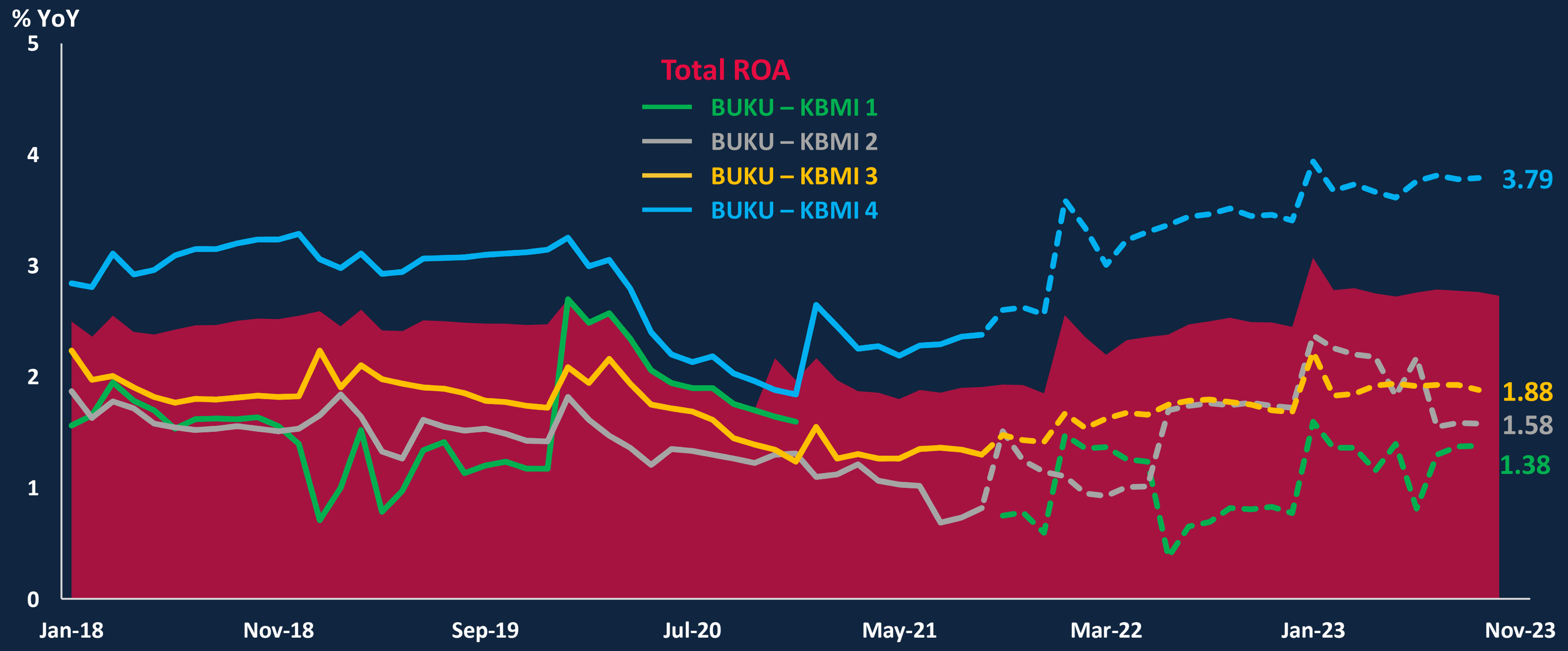
Source: OJK, BI



Source: OJK, BI

- A significant risk to net profit stems from the possibility of BI rate cuts in the latter half of 2024, assuming the Fed pivot scenario. A rate cut scenario can lead to slowing interest income, both from banks' placements in BI instruments and loans to the private sector.
- Not to mention that rate cuts usually happens when the economy faces a roadblock, in other words, when there is a slowdown in loan demand. However, as illustrated in the charts above, the pressures on profitability tend to endure for a maximum of one year, or the time required for low borrowing costs to finally recover loan demand. Overall, we expect ROA to normalize to pre-pandemic levels (around 2.5%).

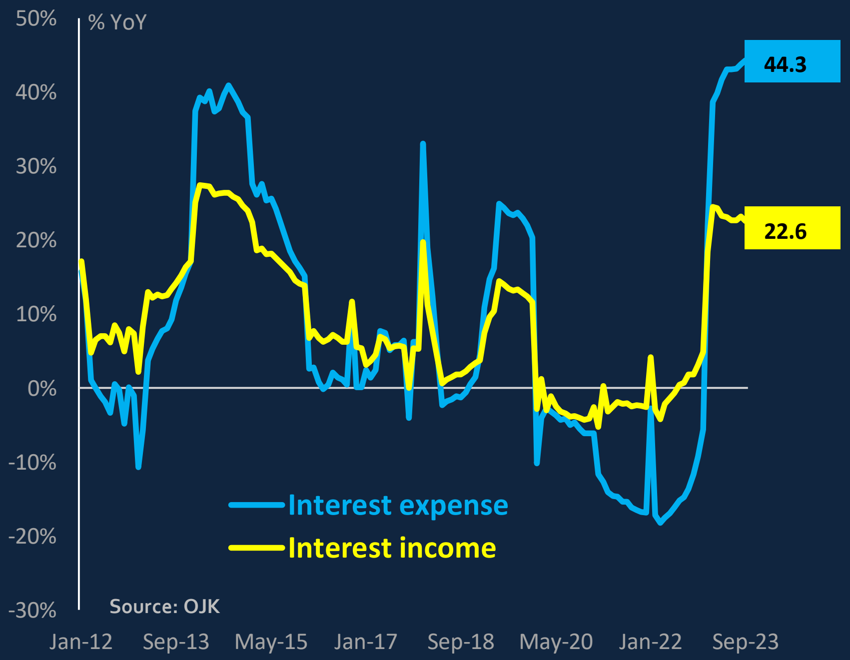
... with smaller banks starting to experience a decline, but big banks are starting the year with a strong ROA

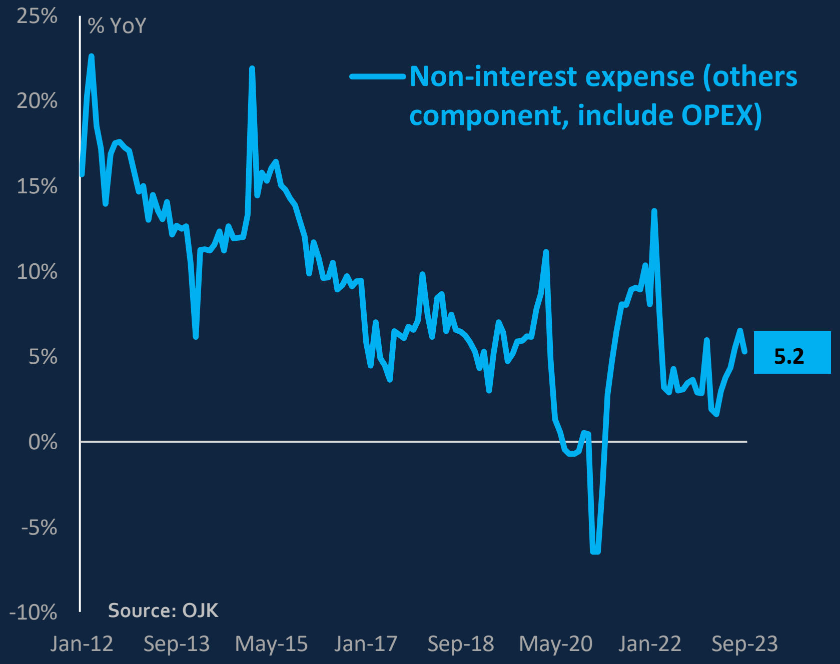


Source: OJK

- It is worth noting that the profitability of large banks is even higher than pre-pandemic levels.

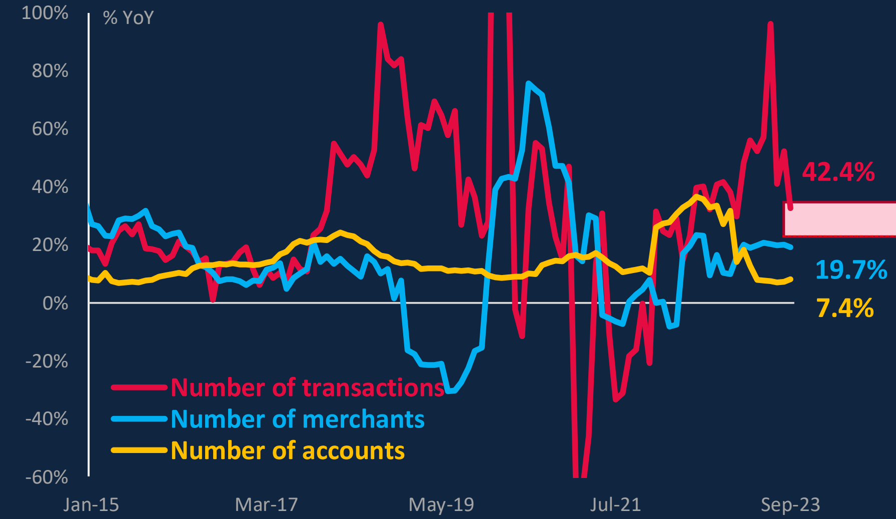
As interest income loses battle to interest expense, OPEX starts to creep up



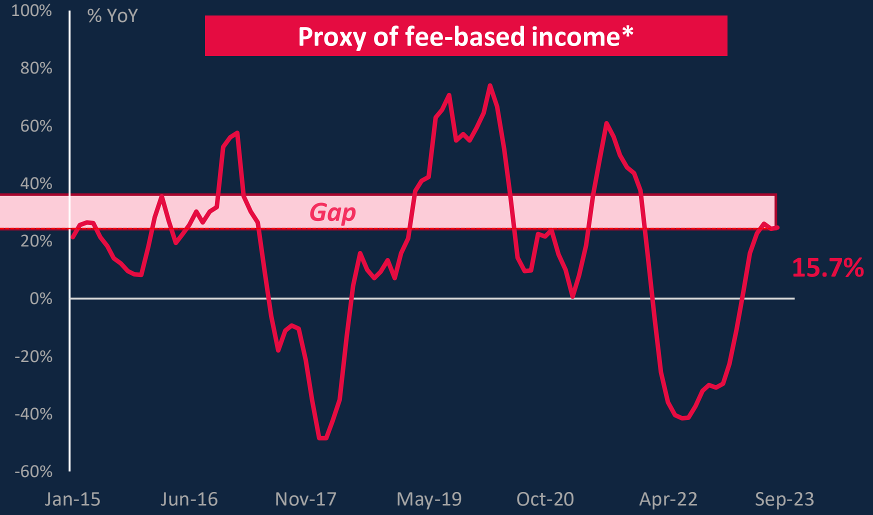


- The “others” component of non-interest cost is moving higher in line with pricing in general (salary, rent, and other inputs) in H2-23, also seen during the 2014-15 tightening period. In the case of a longer high rate period, pressure from a higher OPEX can be more significant.

Banks need a different playbook for fee-based income



Source: LPS, BI

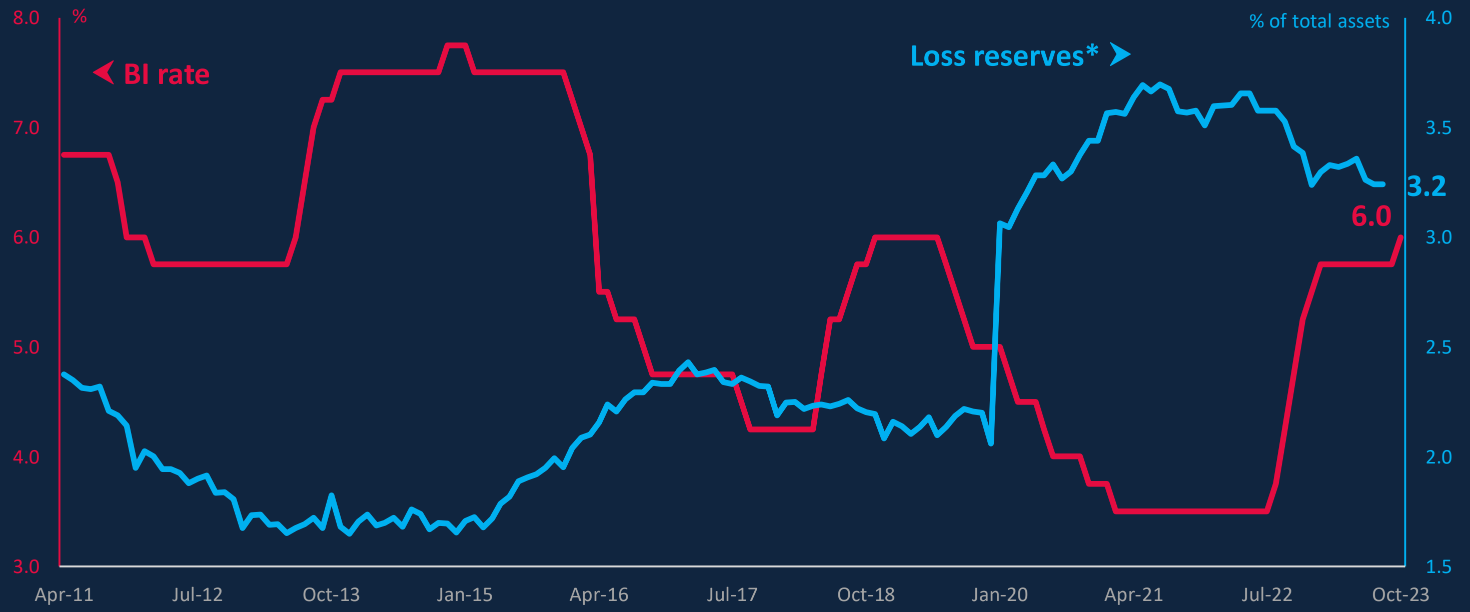


Source: OJK

*) Non-interest income, spec. "others" component

- Transaction volumes have surged since 2022, leading to increased non-interest costs for banks. However, this uptick in transaction volume has not been matched by a proportional rise in fee-based income.
- Several possible causes could be: (1) Intense competition drive demand for lower prices and/or (2) a shift towards the broader use of cheaper integrated payment channels that may impose a ceiling on fees per transaction for banks. Additionally, a potential deceleration in digital transactions may occur as e-commerce and digital financial institutions reduce promotions and other incentives due to rising borrowing costs.
- If the pressure on profit intensifies, banks might have to implement one of the two strategies: either rising lending rates in certain credit sectors to bolster interest income, or reduce deposit interest rates to trim the cost of funds.

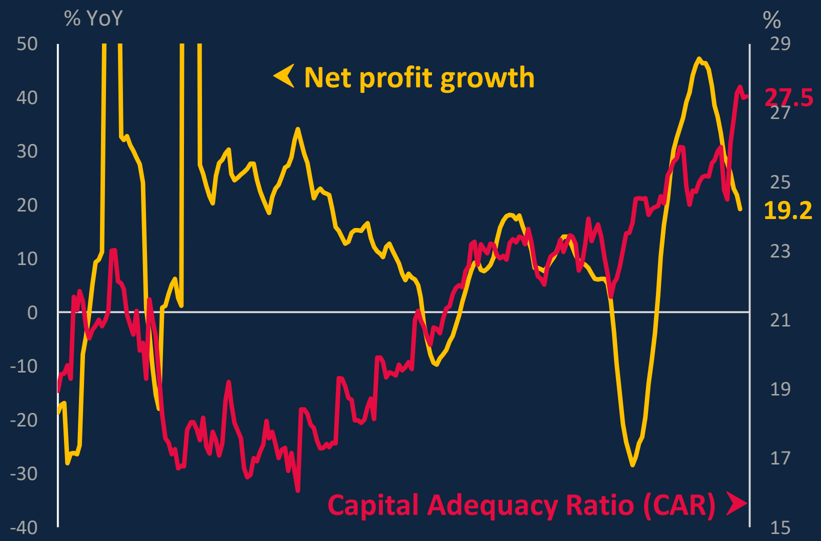
Provisioning might slightly increase



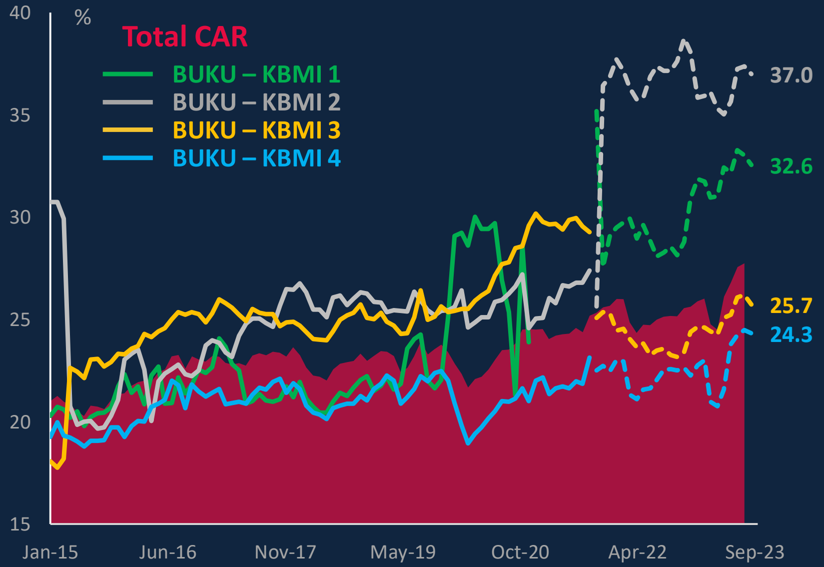
Source: OJK, BI
*) Cadangan Kerugian Penurunan Nilai aset keuangan (CKPN)

- Loss reserves will rise during economic slowdowns (which typically coincide with when BI starts cutting interest rates).
- However, the current level of provisioning is still much higher than pre-pandemic levels. This suggests that any potential increase in loss reserves would probably be moderate, around 3.2 – 3.5%.

But slowdown in profits likely to have a minimal impact on capital



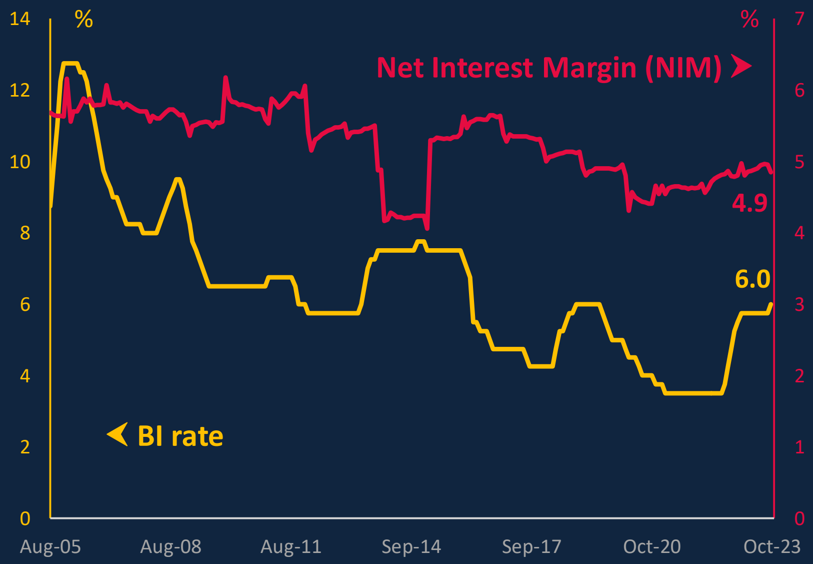
Source: OJK



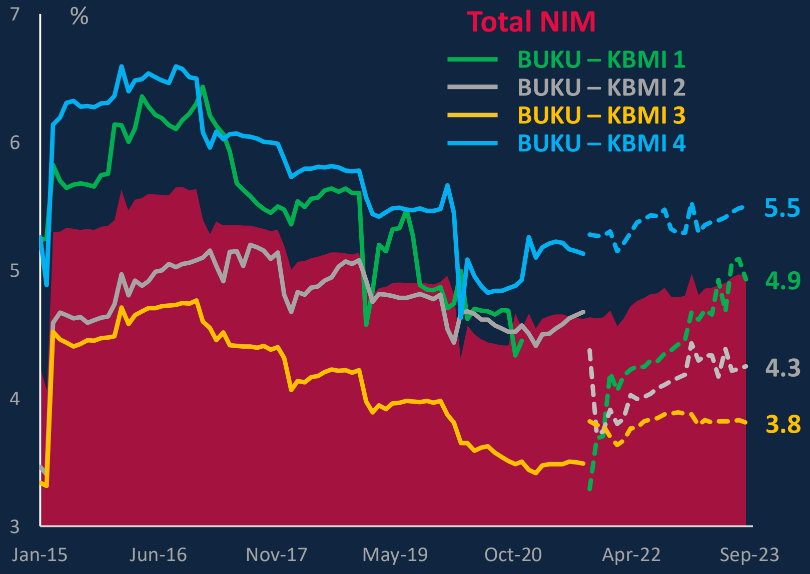
Source: OJK

- Even during the sharpest fall in net profit growth in 2020, the overall CAR level in the banking system never fell below 20%. This trend suggests that the expected slowdown in net profit in 2024 would only bring CAR to a slightly lower level of around 25 – 26%.
- The elevated CAR is attributed not to a smaller denominator (ATMR) but rather to a heighted level of capital, essential for expansions and the development of digital channels. OJK's regulation that raised the core capital requirement to a minimum of Rp 3 Tn in 2022 also had a role to play in the banking sector's strong CAR. However, the limited outlook for capital growth implies that there might be less progress next year in the development of "hype" banking technologies, such as the metaverse, blockchain, and others.

NIM likely to decline after the end of the tightening cycle



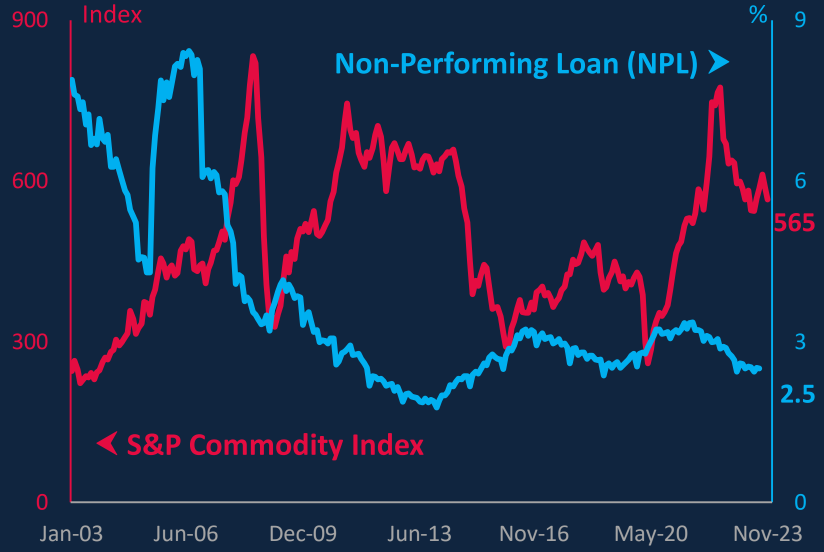
Source: OJK



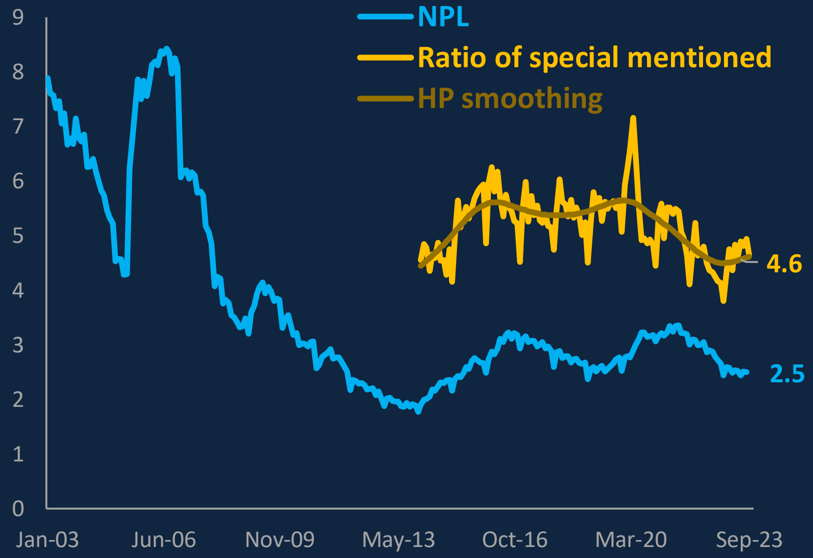
Source: OJK

- NIM in the banking industry closely aligns with the long-term trajectory of interest rates, given the asymmetric impact of interest rate fluctuations on the cost of funds vs lending income.
- Medium-sized banks have recently witnessed a decline in NIM due to slowing liquidity, necessitating an increase in their funding costs. In contrast, larger banks have demonstrated greater resilience in their NIM, possibly attributed to the growing dominance of their digital ecosystems, which contributes to the expansion of their CASA franchise.

Asset quality to slightly worsen due to lower commodity prices



Source: OJK, Bloomberg



Source: OJK

- Given Indonesia's heavy reliance on commodity exports, constituting ~11% of the total GDP, fluctuations in commodity prices wield significant influence over economic conditions. Consequently, there exists a negative correlation between commodity prices and NPL levels. Banks heavily exposed to sectors susceptible to commodity price shifts, such as mining and energy, encounter heightened risks.
- The special mention category, a key leading indicator for NPL, has demonstrated an upward trend over the past year, leading us to anticipate a corresponding increase in NPL levels.

CHAPTER THREE

Outlook on credit and deposits

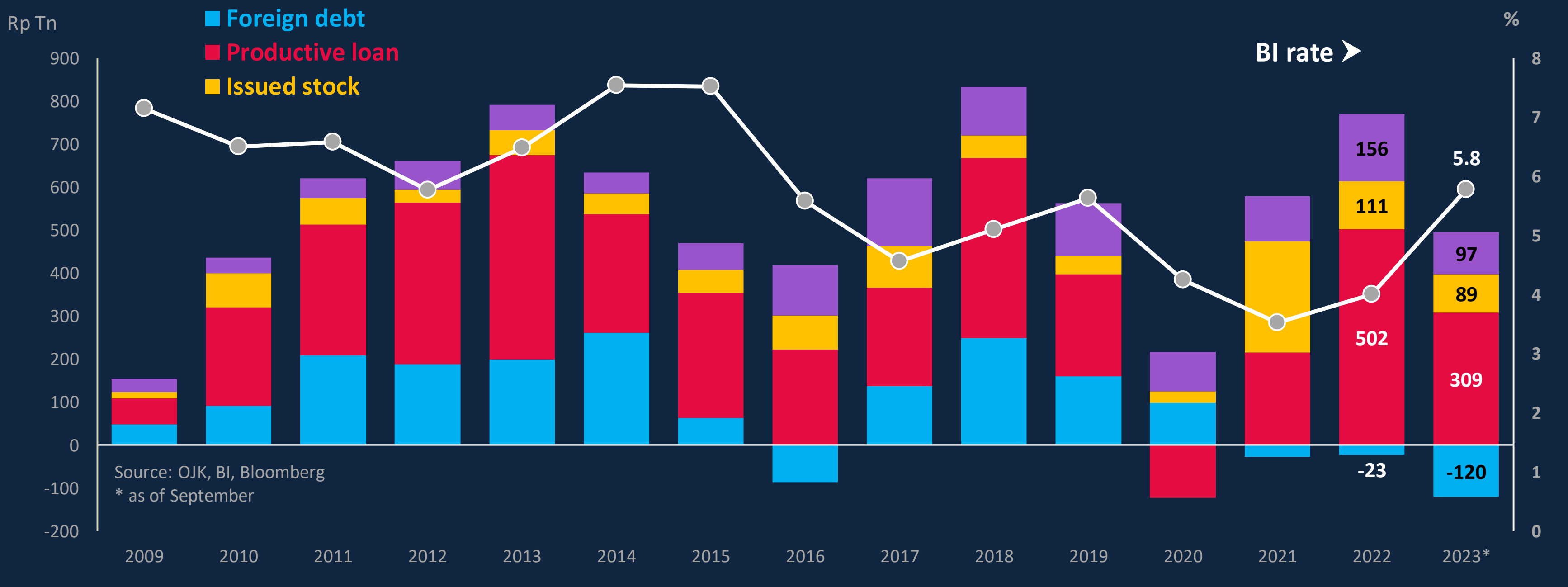
Despite the ongoing economic challenges, both businesses and individuals exhibit resilience. The gradual transmission of BI rates to lending rates has widened the gap between profit margins and lending rates, which maintains the appeal of bank loans. However, this gap might narrow due to potential increases in lending rates and reduced margins.

Nevertheless, credit demand could receive support from a potentially lower real interest rates (higher inflation) and increasing imports. However, we should not discount the possibility that higher real rates could continue in 2024, which could put a limit on credit growth. Investment credit demand, particularly from sectors with promising long-term prospects, tends to fluctuate less compared to other loan types.

In the short term, we might see a continued shift from CASA to TD due to the higher yield environment. Meanwhile, overall deposit growth is anticipated to be more limited, in line with our outlook on domestic liquidity. Despite this, various factors, including government spending, could still contribute to a boost in deposits.

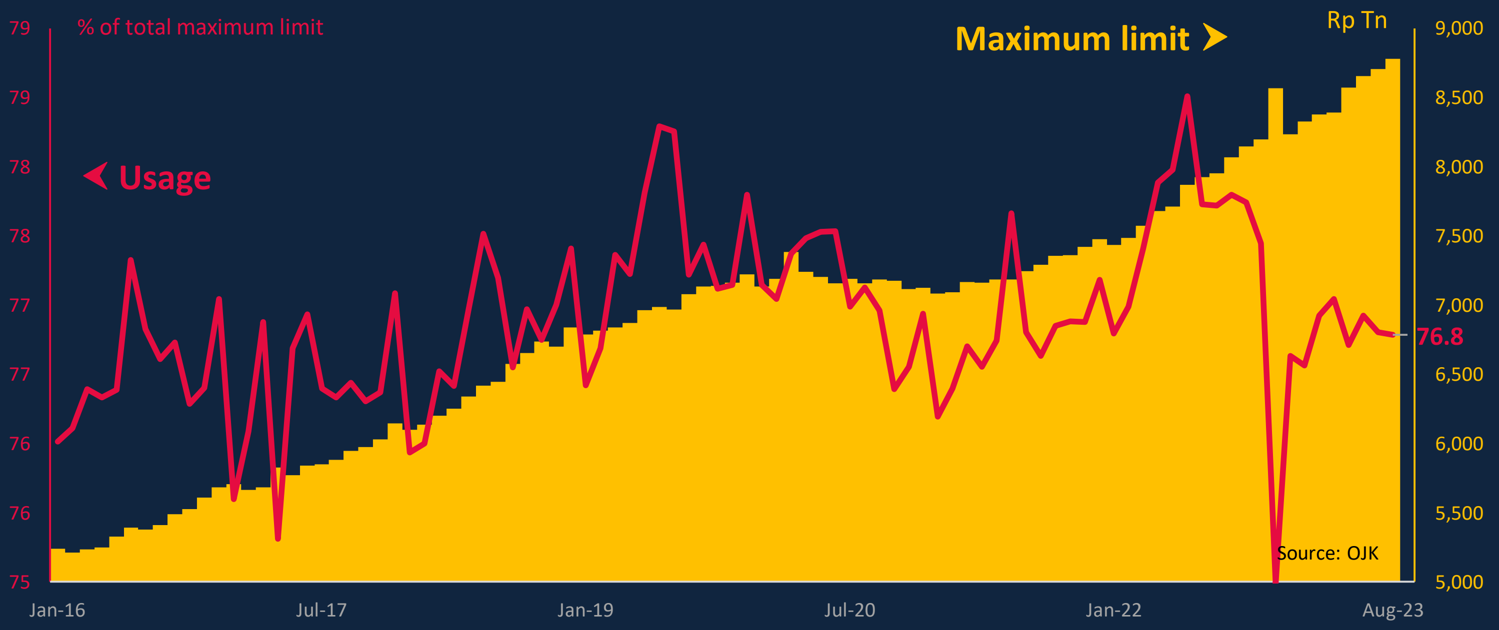
Demand for financing across all channels declined, but we expect a moderate rebound in 2024

BCA



- In 2022, the demand for financing grew sharply in part due to the low-base effect from COVID. Meanwhile, in the first part of 2023, the demand of financing declined since companies have decided to use retained earnings (which experienced heightened growth during commodity boom in 2021-22) to fund their expansion.

Undisbursed loans still on the rise, no supply-side problems (yet)?



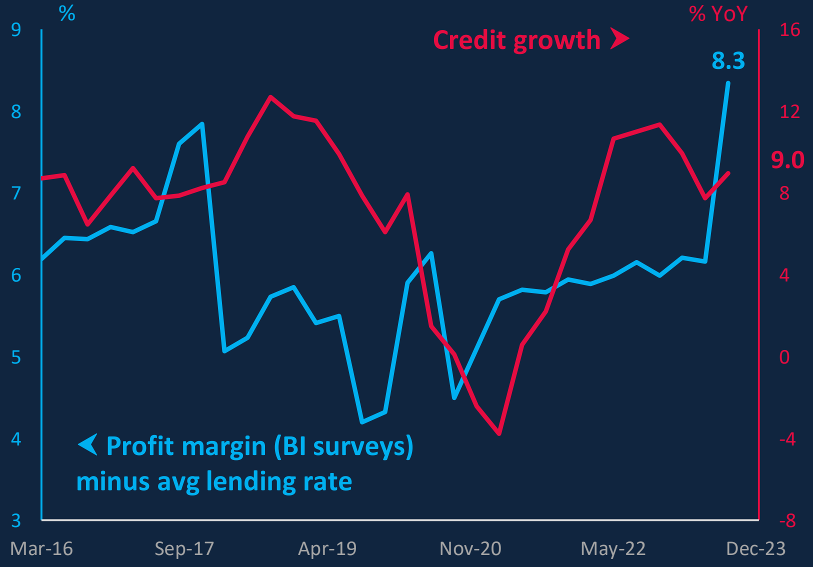
- The slowing credit growth is not entirely the result of supply side challenges, such as limited liquidity, but also arises from diminishing demand as businesses adopt a more conservative, wait and see approach in the face of the uncertain economic landscape.

Fortunately, the real sector still relatively resilient, from both the retail and business side …

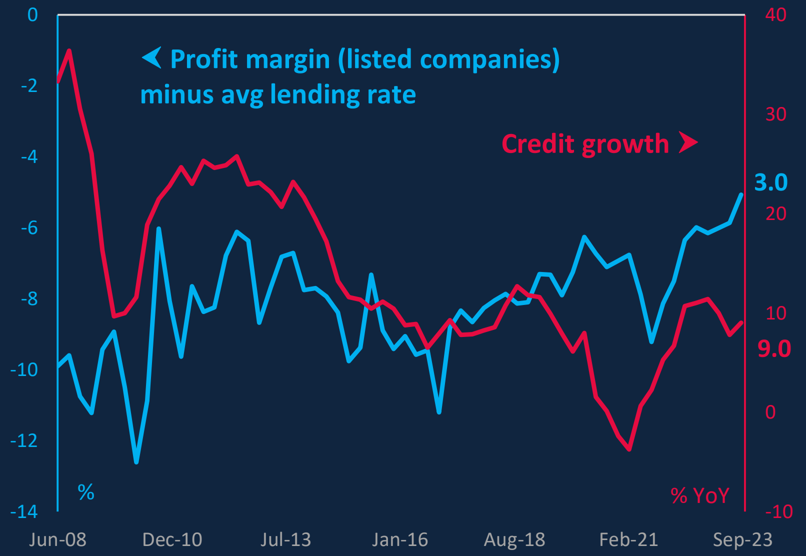
		Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23
Retail spending indicators (real)	Intrabel volume-wise YoY MA 3m													
	Passenger car YoY													
	Motorcycle – YoY													
	Retail sales index YoY													
	Passenger movement (all) YoY													
Retail spending indicators (nominal)	Intrabel value-wise YoY MA 3m													
	Consumer goods imports YoY													
	Consumer credit YoY													
Consumer sentiment	Consumer confidence index													
Business indicators (real)	Commercial cars YoY													
	Cement consumption YoY													
	Manufacturing PMI													
	Cargo loaded - domestic ports YoY MA													
Business indicators (nominal)	Intrabiz value-wise YoY MA 3m													
	Raw materials imports YoY													
	Capital goods imports YoY													
	Government capital expenditure YoY													
	Working capital credit YoY													
	Investment credit YoY													
Business sentiment	News sentiment index (BCA)													

Source: Big Data BCA, OJK, BI, BPS, Bloomberg

… and businesses' profit margin still in a rising trend (compared to borrowing costs)



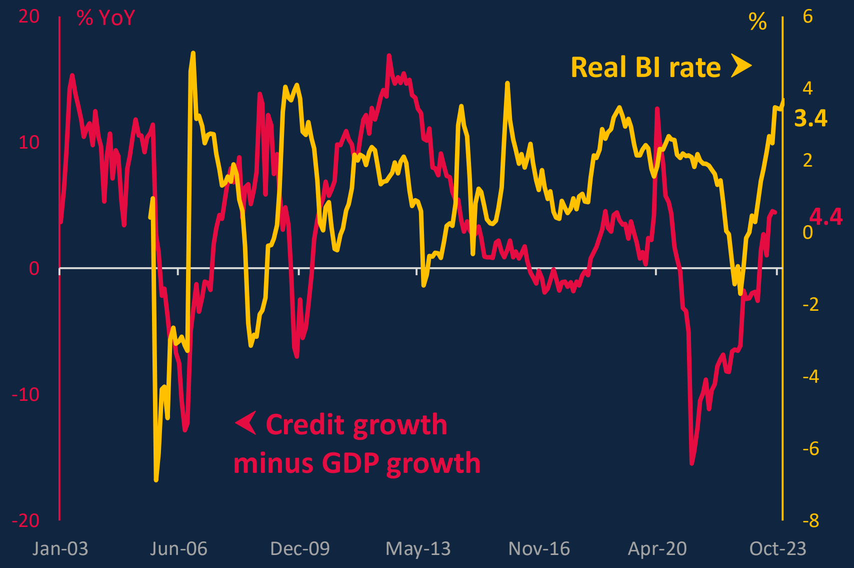
Source: BI, OJK



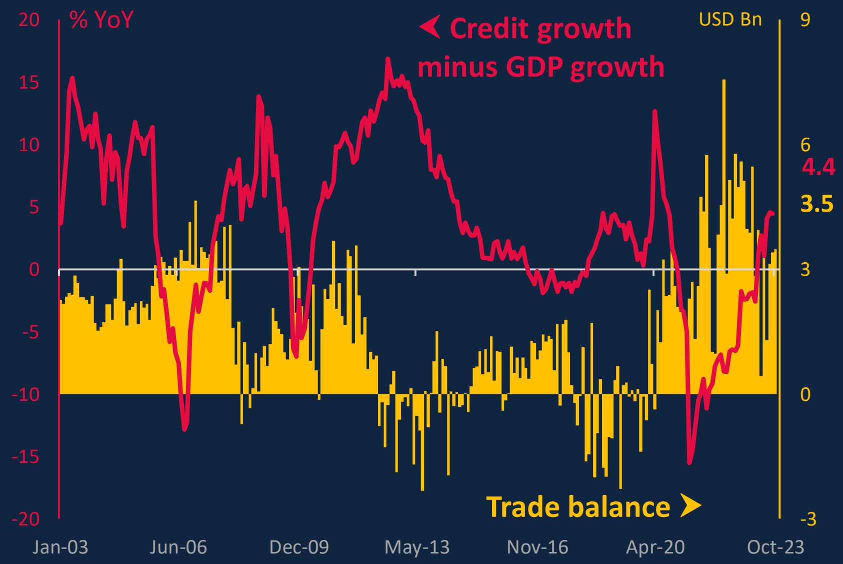
Source: Bloomberg, OJK

- Banks have not completely passed on the increased interest rates to lending rates, resulting in a widened gap between businesses' profit margins and lending rates. This situation makes bank credit still comparatively attractive.
- However, as discussed in the profitability section, this gap is expected to narrow in the medium term due to a potential increase in lending rates, while businesses may face stagnant or declining revenue growth due to the economic slowdown.

Inflation and trade deficit can boost credit growth



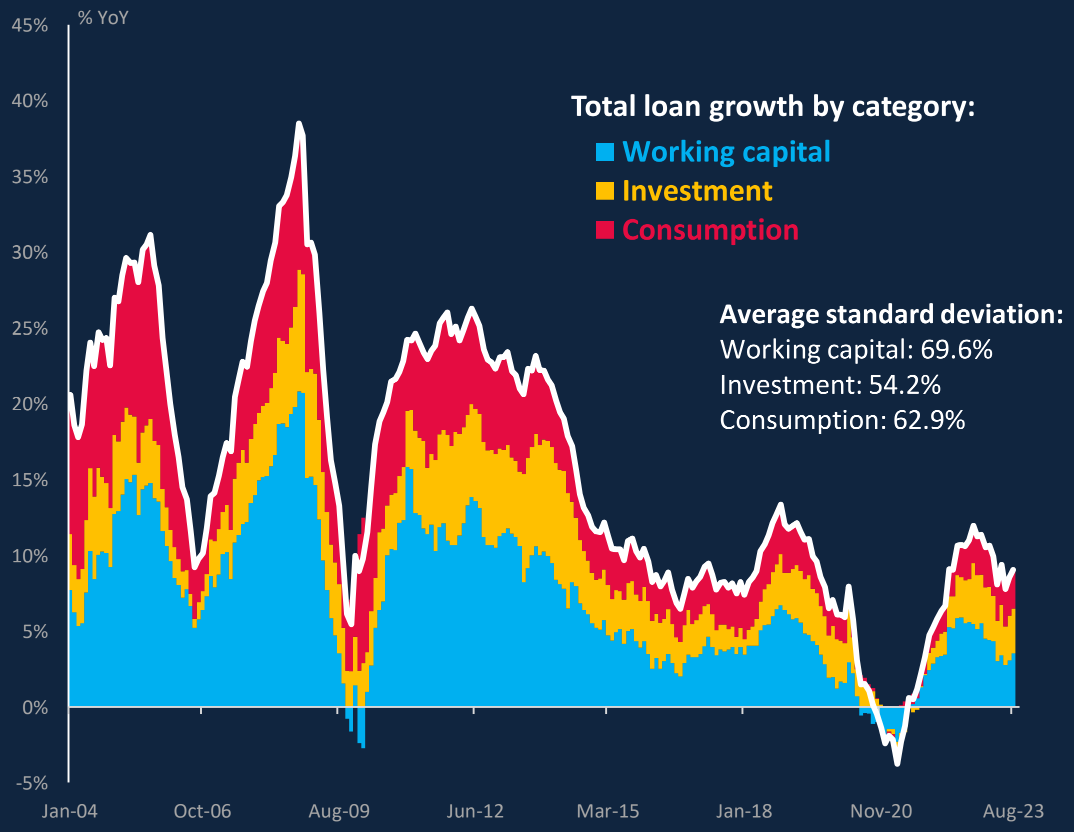
Source: OJK, BPS, BI



Source: OJK, BPS

- In the scenario of accelerating inflation and a minimal increase in bank rates, then lower real interest rates could help boost loan growth in 2024. However, the inflation outlook remains in the wildcard. At the time of the report's writing, there is a rising expectation for global disinflation and weakening oil prices due to OPEC+'s decision. However, we still should not discount the possibility of inflation rising higher in 2024.
- Additionally, a potential increase in imports (due to strong CAPEX appetite and Rupiah depreciation) can spur businesses' demand for credit.

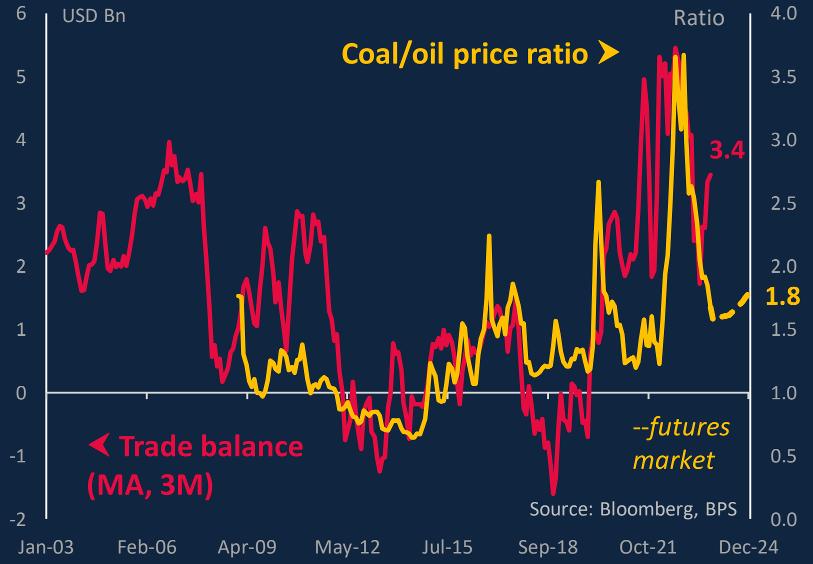
Investment credit remains resilient amid downturn

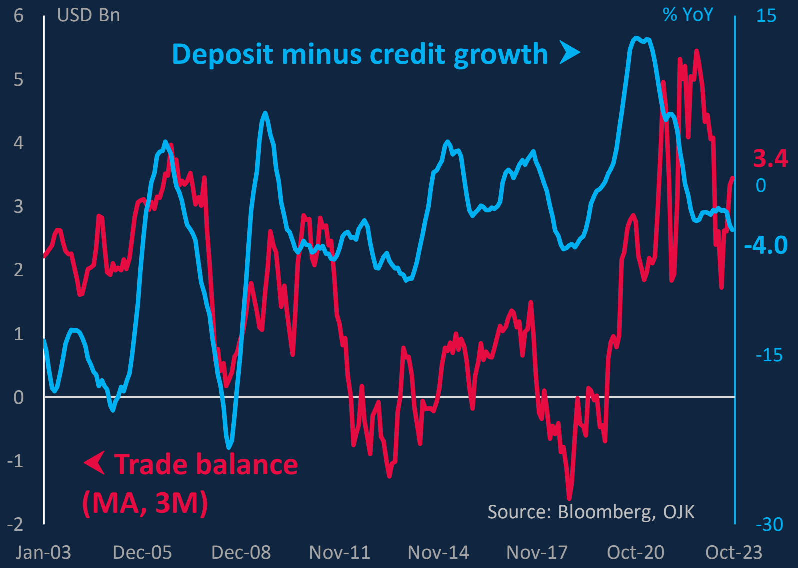


Source: OJK

- While the demand for credit usually decreases during an economic slowdown, the extent of this decline varies across loan categories. Our analysis indicates that investment loans demonstrate the least fluctuation, suggesting that the growth in investment loans may experience a relatively smaller drop in 2024.
- This tendency may be attributed to the nature of investment credit, often utilized in projects with a long-term outcome such as expanding production capacity, improving operational efficiency, and diversifying business lines. These needs persist for sectors with bright long-term prospects (despite short-term or even medium-term slowdowns). More details regarding domestic CAPEX growth can be found in our domestic outlook 2024 report.

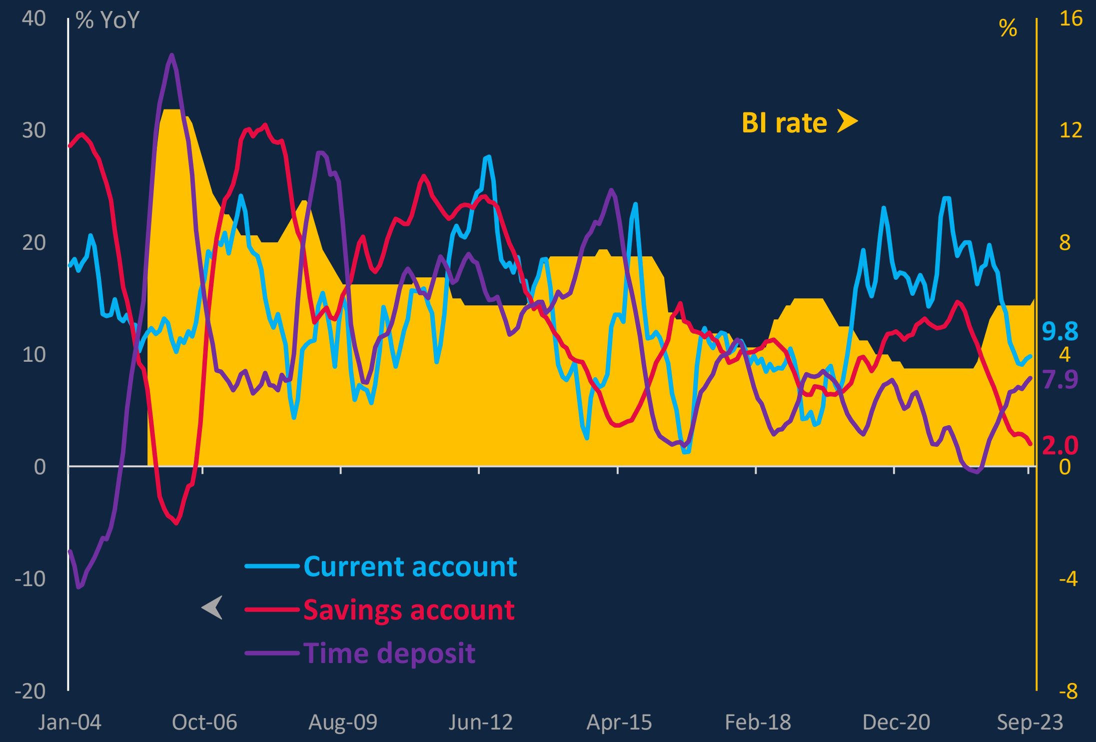
Prospect of deposit growth will be limited?





- There is a strong correlation between trade surplus and the gap between deposit and loan growth. Forecasting this surplus can be achieved through the coal-to-oil price ratio. The medium-term trajectory of the trade balance indicates a decline, thus limiting deposit growth. However, other sources of liquidity, such as government spending (with a more detailed exploration of the impact of general elections in the next slide), can also exert influence to deposit growth.
- But the slight increase in the coal-to-oil price ratio in 2024 (based on futures market) suggests that the decline in the trade balance is likely to be more moderate, presenting a positive signal for savings.

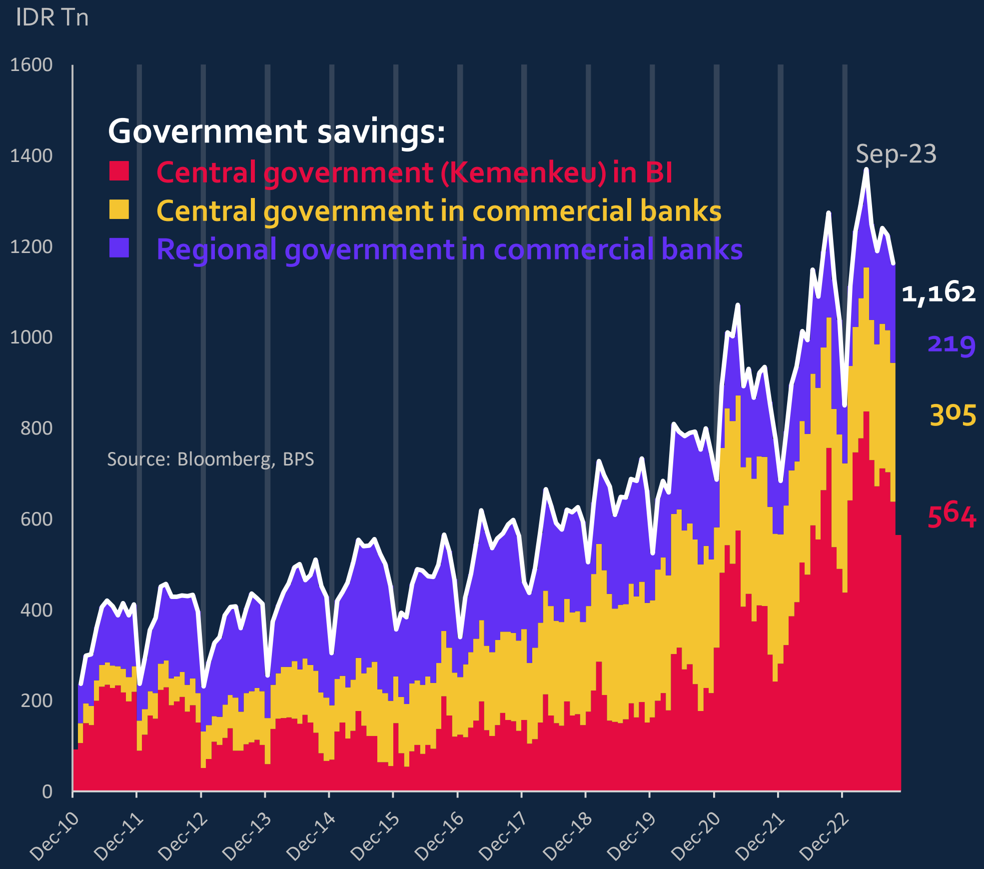
In the short-term, TDs can accelerate to 9 – 12 % YoY



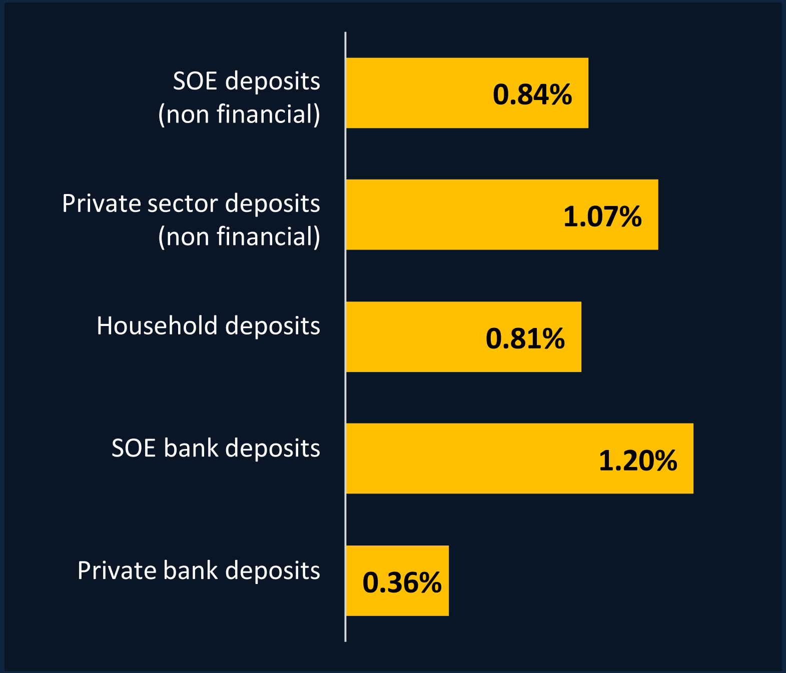
Source: OJK, BI

- The tightening liquidity situation is compelling banks to increase time deposit interest rates, resulting in a shift from CASA as customers pursue higher yields. Additional funds might also enter time deposits due to spillover effects from increased government spending.
- However, when BI cuts interest rates, time deposit growth tends to decline, indicating a shift back to CASA.

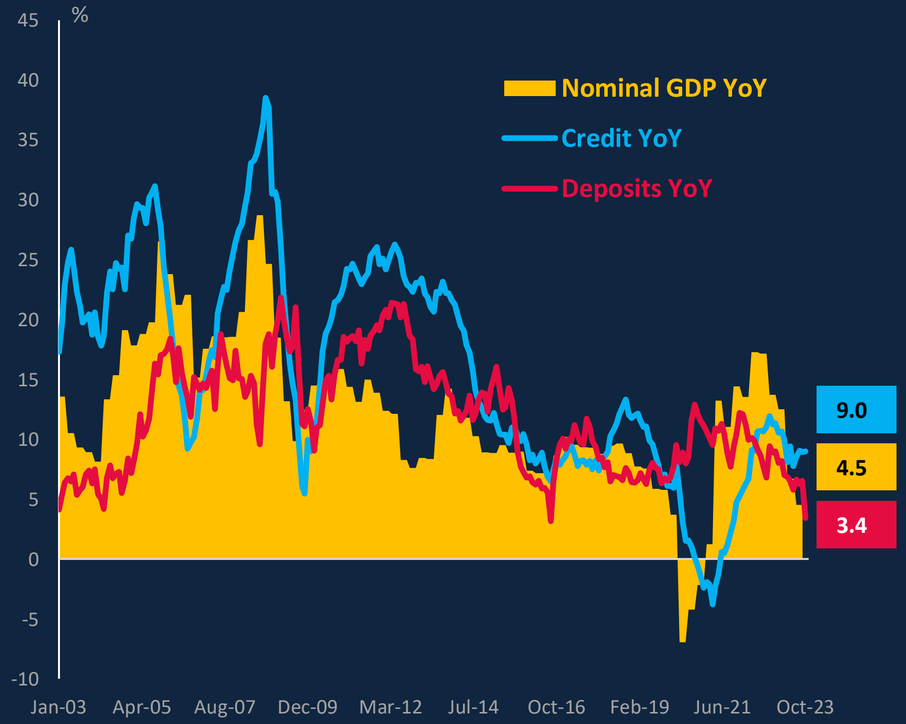
Disbursement of gov't spending will boost deposits



For every 10% decline of government savings in the banking system from its usual trend, the following components experience an increase (% relative to the trend):



All in all, growth of credit and deposits is expected to be limited in 2024



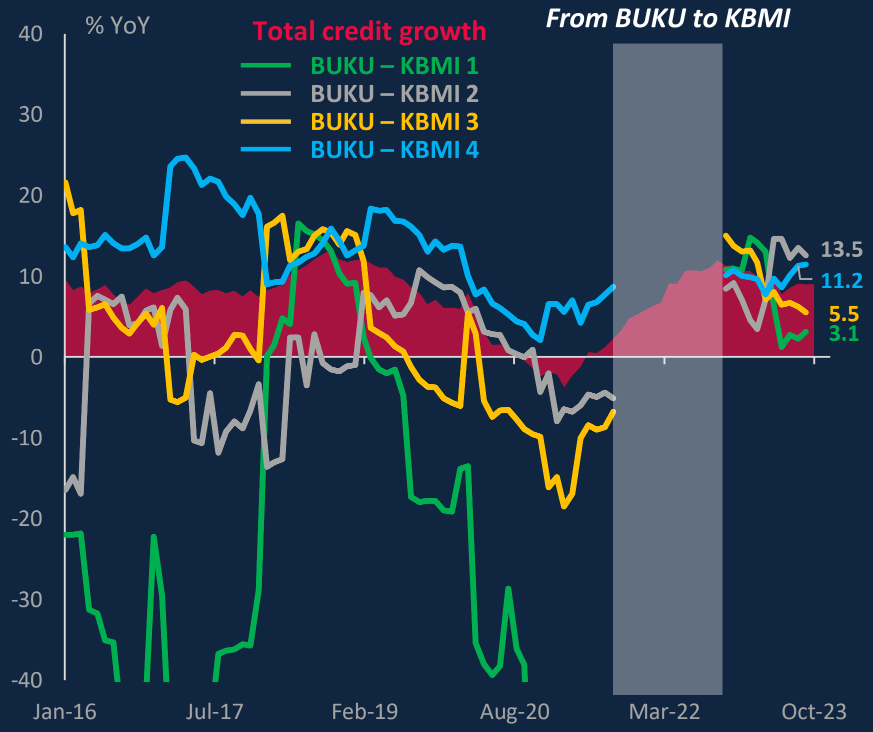
Source: OJK, BPS

	Mar-24	Jun-24	Sep-24	Dec-24
Credit YoY	9.49	10.14	10.51	10.61
Deposits YoY	4.56	5.35	6.59	8.14
Nominal GDP YoY	7.06	8.11	8.46	9.04

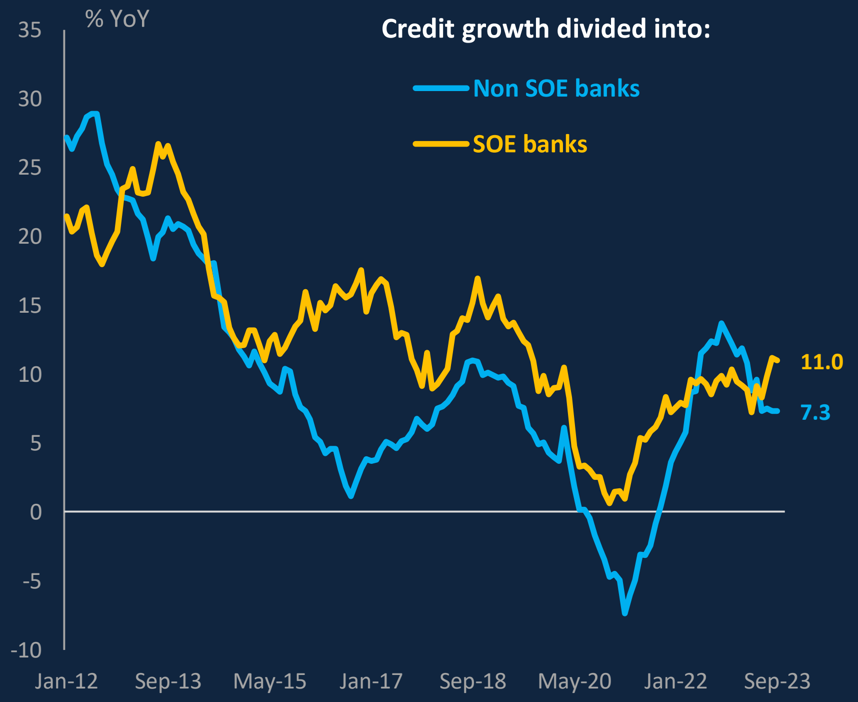
We project credit growth in 2024 to be within the range of 10 - 11% YoY, while deposit growth is anticipated to be within the range of 8 - 9% YoY (not ruling out the possibility of a slower pace of deposits, given the recent modest growth of 3.4% YoY in Oct'23). These projections are based on several assumptions for the upcoming year:

- Improving nominal GDP
- Declining real interest rates
- Moderate decline in trade surplus
- Government spending

Credit growth higher for certain segments: KBMI 2, KBMI 4, and SOE banks

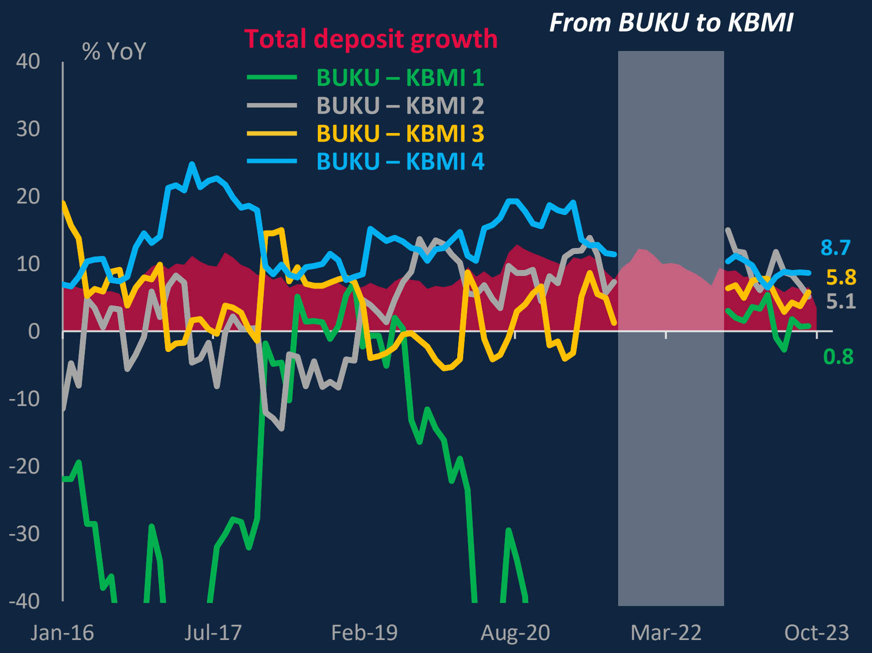


Source: OJK

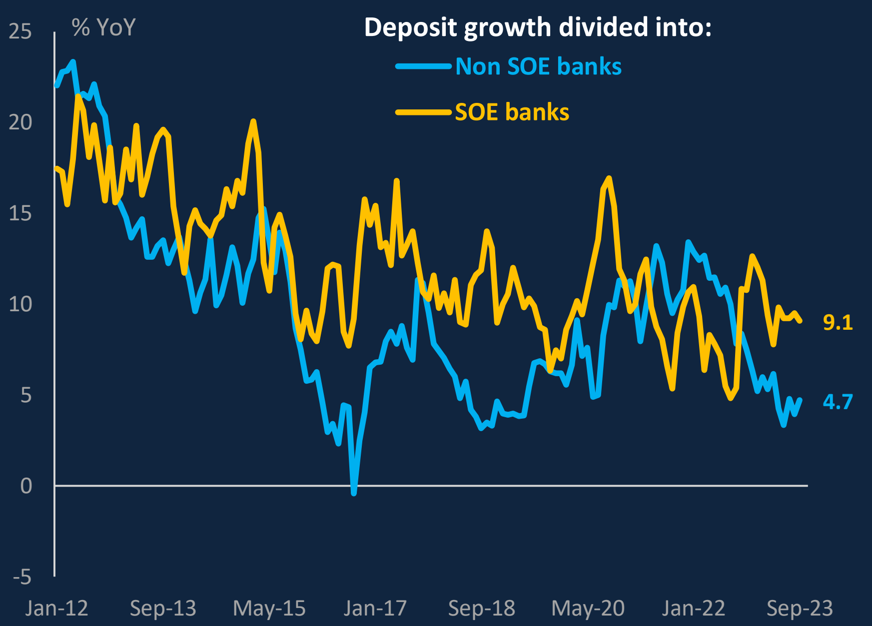


Source: OJK

Large banks (KBMI 4) and SOE banks experience the highest increase in deposits



Source: OJK

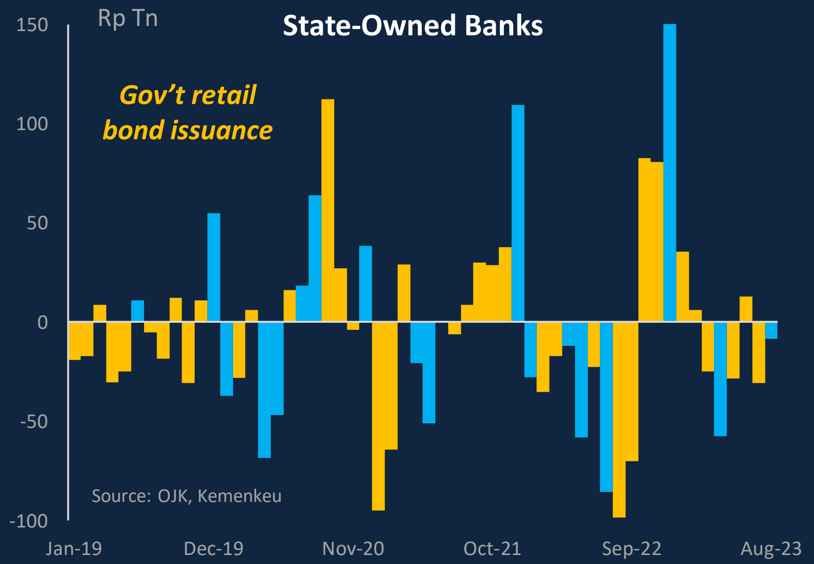


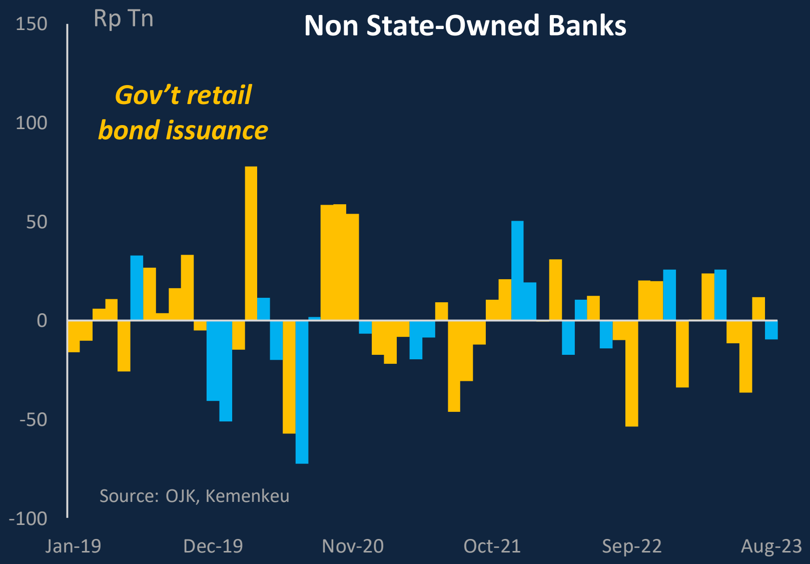
Source: OJK

- The increase in deposits of SOE banks is driven by the disbursement of the government budget and an improvement in revenue of (non-financial) SOEs. Meanwhile, the increase in deposits for large banks (KBMI 4) is likely related to their digitalization efforts (as discussed before).

Gov't retail bond issuance has a neutral impact on deposits

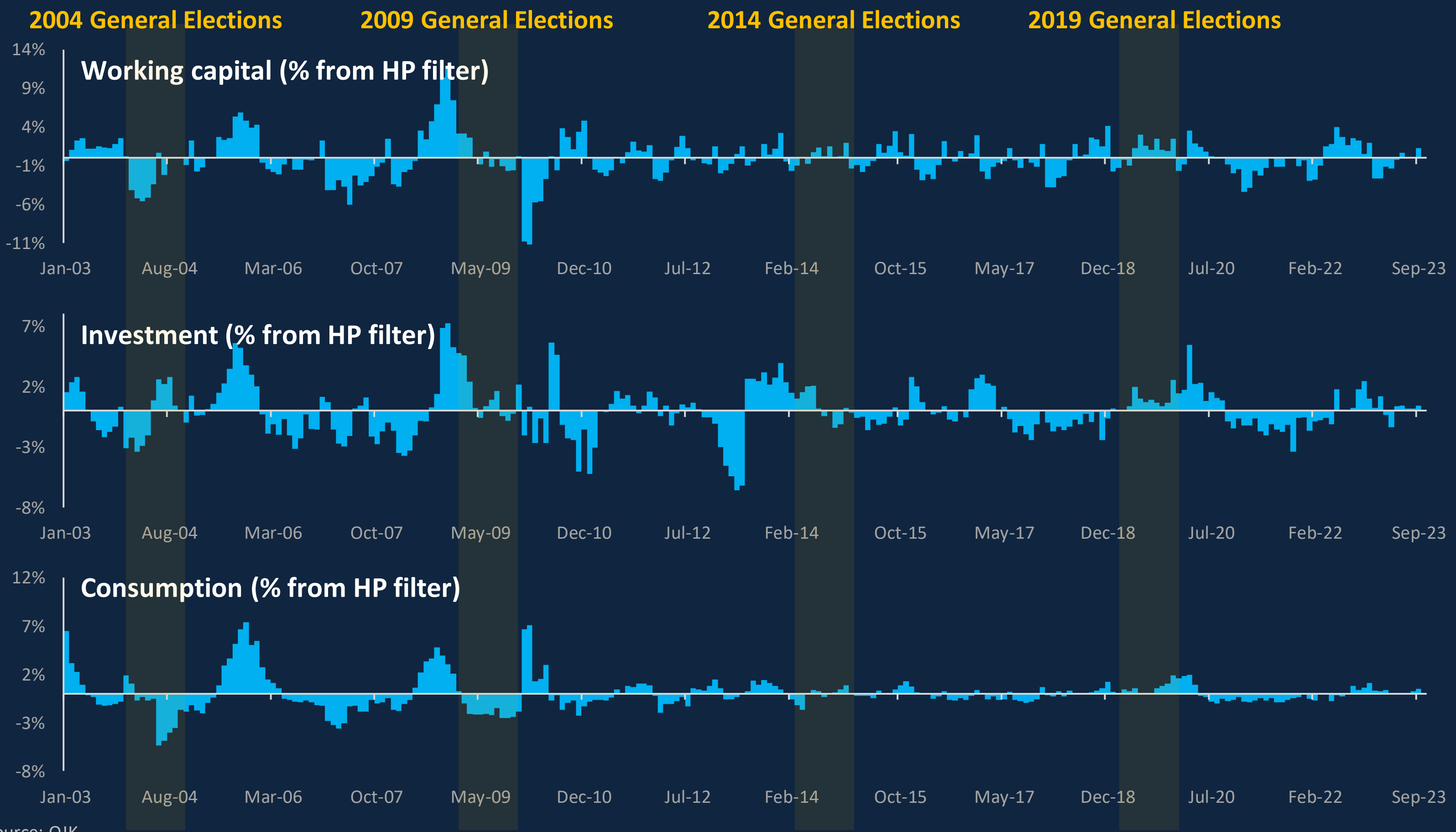
Deviation of deposits from H-P filter





- Bank deposits have a 40-50% likelihood of growing lower than its normal trend during periods that coincide with the government's retail bond (SBN) issuance.
- The government is looking to increase its SBN issuance by 59.5% to Rp 648.1 Tn in 2024. But the total amount of SBN issued could fall lower than planned if the government decides to tap into its excess budget balance (*SAL: Saldo Anggaran Lebih*) to reduce its interest burden.

Credit demand tend to rise before and after elections



Descriptive statistics during election periods

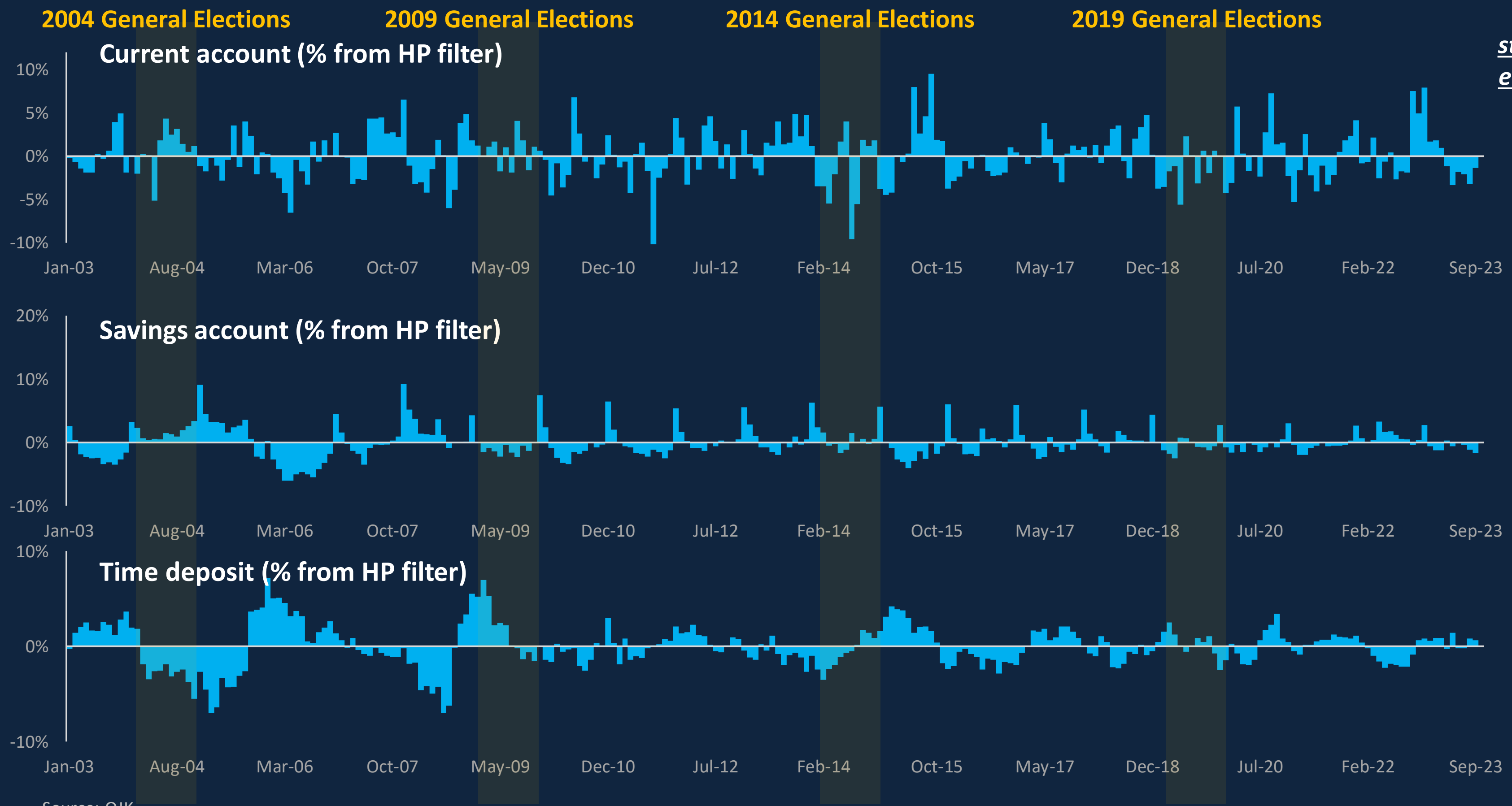
Min: -5.6%
Max: 3.1%
Avg: -0.2%

Min: -3.4%
Max: 4.7%
Avg: 0.6%

Min: -5.4%
Max: 1.8%
Avg: -0.9%

Source: OJK

Elections have the most positive impact on savings



<u>Descriptive statistics during election periods</u>

Min: -9.6%
Max: 4.3%
Avg: -0.5%

Min: -2.4%
Max: 9.1%
Avg: 0.5%

Min: -5.5%
Max: 6.9%
Avg: -0.2%

Source: OJK

CHAPTER FOUR

Opportunities ahead

Growth of consumer credit, which tend to be highly sensitive to interest rates, is still sustained by slow transmission of BI rates to interest on consumer loans. Consequently, a potential upturn in lending rates could negatively impact consumer credit growth in 2024. However, improvements in nominal GDP growth in 2024 and government incentives could partially mitigate these adverse effects.

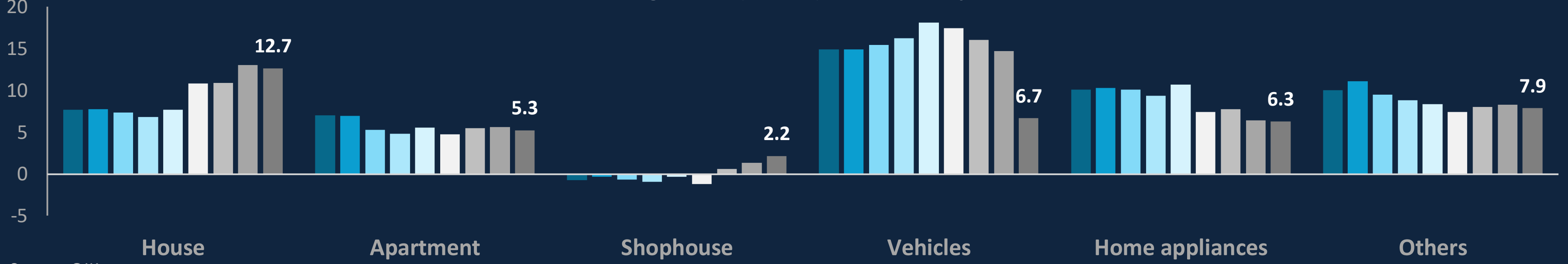
Sectors with high leverage face an increased risk of deteriorating asset quality during an economic slowdown. Conversely, sectors exhibiting relative conservatism in credit usage could potentially experience heightened credit growth in 2024, especially those poised to benefit from increased demand during the election season.

The impact of commodity prices tends to be more pronounced in certain provinces, particularly concerning credit growth. The commodity boom in 2012 contributed to a seeming decline in bank activities in major CPO and coal-producing regions of Indonesia compared to the present.

Meanwhile, Java (excluding Jakarta) has witnessed a rapid surge in banking activities, driven by the widespread adoption of e-commerce and digital payment systems (QRIS and VA). This trend is anticipated to extend to regions outside of Java.

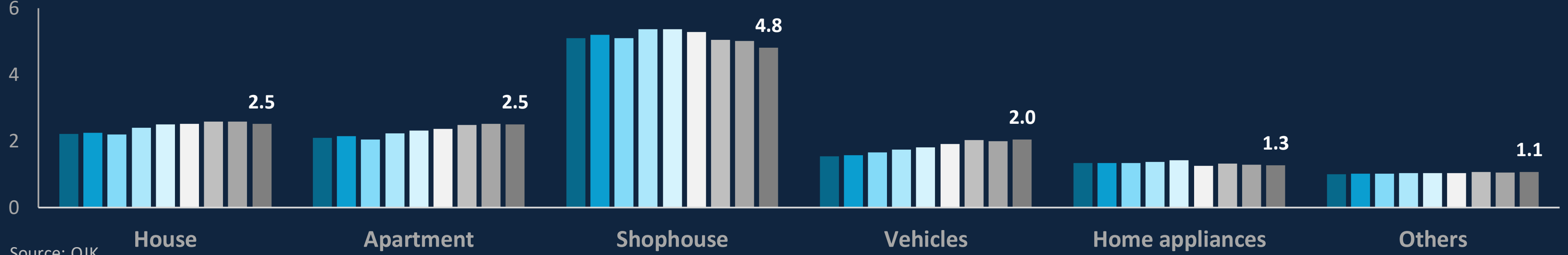
Consumer credit likely to grow on limited basis in 2024

Credit growth (% YoY) Jan'23 – Sep'23



Source: OJK

NPL (%) Jan'23 – Sep'23

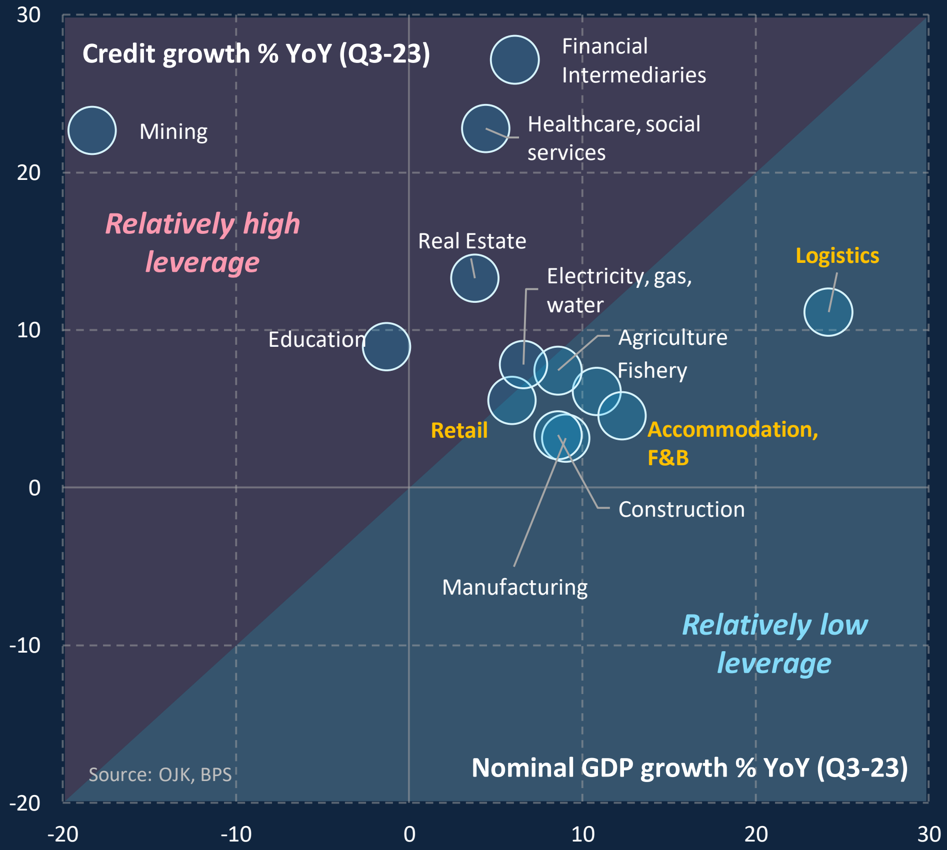


Source: OJK

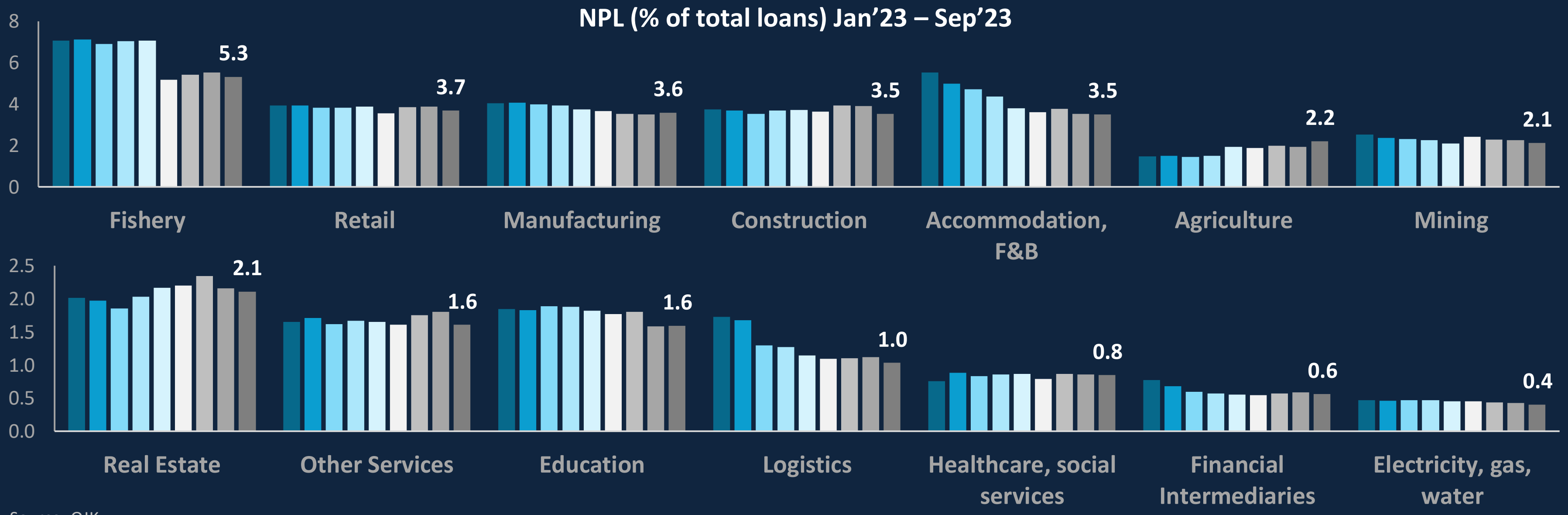
- The growth of consumer credit, which tends to be highly sensitive to interest rates (with a correlation of around 40–50%), is still sustained by the relatively slow transmission of BI rates to interest on consumer loans. However, as mentioned earlier, banks may need to start increasing rates more aggressively next year to sustain profitability.
- Nonetheless, the potential improvement in nominal GDP growth in the second half of 2024, along with government regulations (details mentioned later in the chapter) could help minimize the negative influence from the potential increase in lending rates.

Sectors with relatively low leverage have potential for credit growth in 2024

- In the chart on the right, sectors with higher credit growth in Q3-23 compared to nominal GDP growth are labeled as high leverage, while those with lower credit growth are considered low leverage.
- Highly leveraged sectors face increased risk of declining asset quality during economic slowdowns. However, the current position of the mining sector, in particular, might be distorted by the high nominal GDP in 2022 (high base effect).
- On the other hand, sectors in the blue area are relatively more conservative in their credit usage. These sectors could potentially see increased credit growth in 2024, especially those (logistics, retail, accommodation, and F&B) that stand to benefit from heightened demand during the election season.



Certain sectors have additional risks of worsening NPL



Source: OJK

- 2023 has been a year of continued recovery for most sectors, with notable improvements in NPL for fishery, accommodation and F&B, and logistics. The notable progress in sectors like accommodation and F&B is particularly positive, considering that BI's COVID restructuring scheme for special sectors is set to conclude in Mar-24. Export-oriented manufacturing sectors, especially those heavily reliant on imported inputs, are likely the most susceptible to the challenges of slowing global demand and currency depreciation.
- Real estate is likely under pressure due to higher rates. Meanwhile, the worsening NPL of the agriculture sector, might be related to unfavorable climate conditions.

... and the influence of commodity prices tend to be greater for some provinces

Which provinces* are significantly affected (p value < 0.05) by an increase in commodity prices?

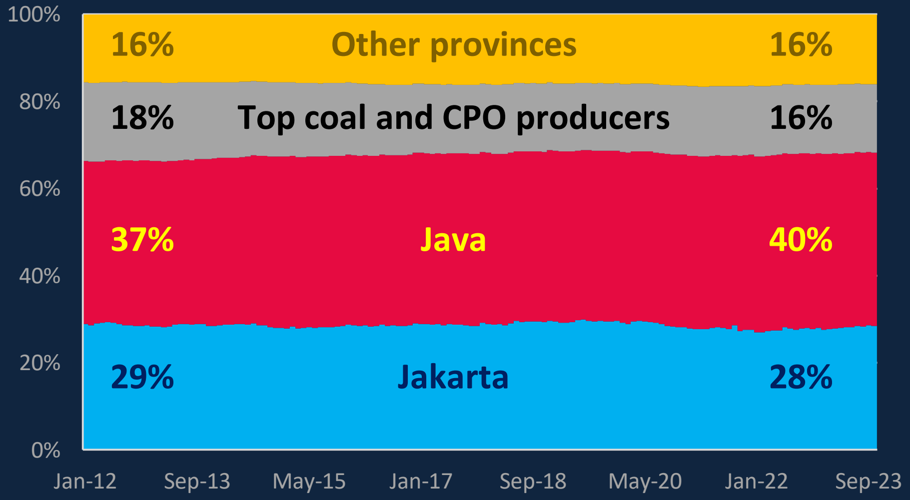
Impact of 10% YoY price increase	To deposit growth	To credit growth
CPO	• North Sumatra • Bengkulu • Riau	• Jambi • South Kalimantan • South Sumatra
Coal	-	• South Kalimantan • East Kalimantan • South Sulawesi
Rubber	• Riau	• Jambi • South Sumatra • Bengkulu
Nickel	-	• Central Sulawesi

Source: Bloomberg, OJK, BPS, BCA Economist calculations
*) holding nominal regional GDP, real BI rate constant

The direction of commodity price coefficients to deposits and loans tend to be varied. In certain historical periods and at specific commodity price levels, we observe a negative coefficient towards credit growth. This may indicate an effect where an increase in export revenue discourages credit uptake (favoring retained earnings) or differences in the outlook of each commodity influencing expansion interest.

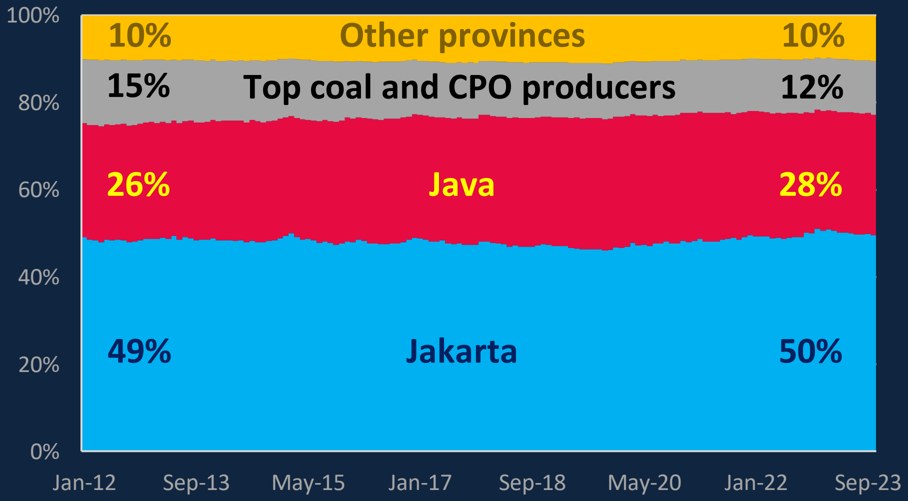
Financial inclusion has progressed rapidly in Java (outside of Jakarta)

Portion of total credit by provinces (%)



Source: OJK

Portion of total savings by provinces (%)



Source: OJK

- Bank activities have surged in Java (excluding Jakarta), whereas in Jakarta, they have largely remained stagnant. Beyond Java, there has been an apparent decline in banking activities, possibly influenced by the commodity boom in 2012, leading to greater liquidity in commodity-producing regions (Riau, Kalteng, Sumut, Kaltim, Sumsel, Papua, Papua Barat, Kalsel, Aceh, Sumbar) compared to the present.
- The upward trajectory of banking activities in Java (outside Jakarta) can be attributed to the growing financial inclusion driven by the increased adoption of e-commerce and digital payment channels (QRIS, VA). This pattern is anticipated to extend to other provinces, encompassing regions outside of Java.

Authorities focus on improving domestic liquidity and maintaining consumer credit growth …

Regulation	Impact
BI extended its 0% down payment policy for both automotive and mortgage loans until Dec 31, 2024	Encourage consumer credit growth
Gov't exempts 100% value-added taxes (VAT) for new houses under Rp 2 billion until Jun-24, and 50% from Jun-24 to Dec-24	
BI extended its relaxed minimum credit card payment (5% from total outstanding) rule until Jun-24	
Commodity exporters are required to park at least 30% of their export proceeds (DHE) in Indonesia's financial system for at least 3 months starting in Aug 1, 2023	Maintain ample FX liquidity in the banking industry
BI issued BI Foreign Currency Securities (SVBI) and BI Foreign Currency Sukuk (SUVBI), with the first auction on Nov 21, 2023	Limited "crowding out effect" due to high minimum investment required and ample FX liquidity in the banking system (presently)
BI lowered the Macroprudential Liquidity Buffer (PLM) ratio from 6% to 5% and the PLM Syariah ratio from 4.5% to 3.5% effective from Dec 1, 2023	Banks could minimize the ratio of reserves and potentially increase operating income

… while the P2SK law aims to increase the effectiveness of the financial services sector

A few highlights from the P2SK law

Category	Regulation
Banking	Launch of roadmap to develop and strengthen Indonesia's Shariah Banking
Capital market and carbon exchange	• Launch of Indonesian capital market roadmap for 2023 – 27 in early 2023 and carbon exchange on Sep 26, 2023 • Expand the scope of sustainable finance products beyond green bonds • Preparation of Exit Strategy for public companies that are delisted or face business continuity issues
Financing institution, venture capital (VC)	Preparation of several roadmaps to develop financing institutions, VCs, microfinance institutions, and bullion businesses
Technological innovation in the financial sector	Preparation of POJK related to innovation of financial technology and digital assets (including crypto)

Source: OJK

The derivative and cryptocurrency markets would likely take flight once the Fed initiates its pivot. This new comprehensive law appears to be a preemptive measure aimed at minimizing the same reckless market practices observed in 2020-21, characterized by numerous instances of illicit trading and gambling.

Projections of macroeconomic indicators

	2019	2020	2021	2022	2023E	2024E
GDP growth (% YoY)	5.0	-2.1	3.7	5.3	5.1	5.0
GDP per capita (USD)	4175	3912	4350	4784	4982	5149
CPI inflation (% YoY)	2.7	1.7	1.9	5.5	2.8	3.2
BI 7-day repo rate (%)	5.00	3.75	3.50	5.50	6.00	5.50
USD/IDR exchange rate (end of year)**	13,866	14,050	14,262	15,568	15,728	16,037
Trade balance (USD Bn)	-3.2	21.7	35.3	54.5	34.9	32.6
Current account balance (% of GDP)	-2.7	-0.4	0.3	1.0	-0.4	-0.5

Source: BPS, Bloomberg, BCA Economist calculations

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