Saying no to a Faustian bargain

15 January 2024

Lazuardin Thariq Hamzah
lazuardin_hamzah@bca.co.id

Barra Kukuh Mamia
barra_mamia@bca.co.id

Summary

- The government is expected to maintain its expansionary fiscal policies in H1 2024, which should have a positive effect on the private sector's liquidity condition.
- Despite the sizable fiscal expansion, its impact on household consumption remains uncertain given the household sector's low saving balance and the positive real interest rate.
- Anaemic demand growth from the household sector may tempt the central bank to start loosening its posture. However, such a strategy would be detrimental to the effort to improve the private sector's liquidity condition.

- Similar to the trend from the first two weeks of the New Year, the December 2023 US CPI data (3.4% YoY) released last week was hotter than the 3.2% YoY expected by the market. However, unlike the previous release of the December 2023 non-farm payroll (NFP) data, the recent release of US CPI numbers does not deflate the early and deep rate cuts expectations that continue to move the market. Some Fed officials may have publicly warned against the risk of slowing disinflation progress in 2024, but the FFR futures still point to a total of 150 bps rate cuts in 2024.
- The favourable global interest rate expectation means that the Indonesian financial market could continue to benefit from a healthy dose of foreign capital inflows. For instance, foreign investors in the domestic stock market recorded net-buy to the tune of USD 151.81 Mn in the last week, extending the foreign capital inflows trend since mid-December 2023. Indonesia's solid growth outlook, coupled with the hitherto improving sentiment on the commodity market, further highlights the attractiveness of the domestic stock market – although the Indonesian financial market's exposure to the risk of a sudden reverse in interest rate expectations cannot be understated yet.
- Despite the steady stream of foreign capital inflows into the Indonesian financial market, the improvement in the domestic liquidity condition remains considerably limited ***(see Chart 1)***. The demand for loans from the private sector, driven by the still-going investment cycle in the corporate sector, seems to be the sole positive factor behind Indonesia's restrained monetary expansion in 2023 (3.3% YoY in November 2023), which explains the economy's lower nominal GDP growth throughout 2023.
- Luckily, recent data shows that this challenging liquidity condition may start to

improve in the next couple of months. In line with its signal, the government managed to achieve its fiscal spending target in 2023, disbursing around IDR 611.4 Tn (IDR 310.6 Tn net) in December 2023 alone. Efforts to stabilise domestic prices and safeguard the household sector's purchasing power ahead of the month-long Ramadan festivities, along with election-related spending, may necessitate the government to keep pushing the fiscal pedal to the metal – a factor which should lead to an improvement in the private sector's liquidity condition ***(see Chart 2).***

- However, we remain sceptical that the expected fiscal spending bonanza in the upcoming months could boost Indonesia's GDP growth beyond the usual 5% velocity in 2024. First, the 2024 state budget indicates a 6.51% YoY growth in fiscal spending, which is below the expected 8.37% YoY nominal GDP growth for FY 2024. A spending budget growth below the expectation for nominal GDP growth suggests that the government is not looking to supplant the private sector as the primary driver of economic growth. Additionally, **the relatively restrained fiscal spending growth could also serve as an indication of the government's intention to front-load its spending realisation**, given the higher fiscal commitment in H1 2024.
- The household sector's already diminished savings balance accounts for the second aspect of our scepticism regarding the full impact of fiscal spending on Indonesia's GDP growth in 2024. While transfer payments may effectively stimulate aggregate demand, particularly in the lower segment, **the uncertain factor lies in whether households in the upper segment will choose to bolster their savings rate or increase nominal consumption.**
- It could be the case, then, that the upcoming expansion in the government's spending may mark the downturn in the household sector's aggregate demand. Indeed, the current trend shows that the household sector is unwilling to consume more on a nominal basis, thus relying solely on lower prices to expand their consumption basket (***see Chart 3)***.

"The Dec-2023 trade data indicates that the slowdown in aggregate demand is not limited to the household sector"

- Moreover, **the now-elevated real interest rates could further erode the incentive for households to prioritise consumption over saving**, which boldens our scepticism regarding the second coming (post-reopening consumption spree being the first one) of a supernormal aggregate demand in the upcoming period. The 2.45% MoM decline in the December 2023 import numbers strengthens this hypothesis, as the sharp drop in capital goods imports portends a weakening demand from the corporate sector (more on this in our December 2023 trade balance data)
- There is an argument to be made for Bank Indonesia to loosen its policy to boost the private sector's ailing aggregate demand. Making such a policy decision, however, is akin to a Faustian bargain. **Putting private**

demand in higher gear during a period of fiscal expansion would put the Indonesian economy in overdrive, but the strategy would not resolve the liquidity challenges now facing the economy and would possibly put downward pressure on the Rupiah's stability ***(see Chart 4).***

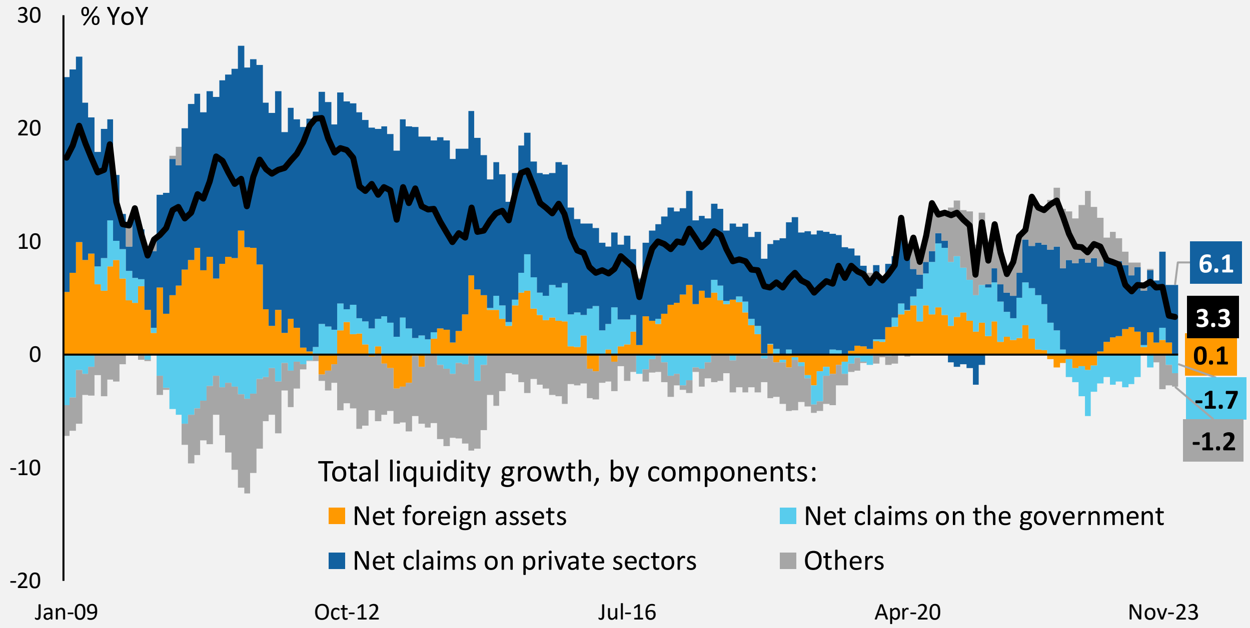
- Higher fiscal spending would also increase the government's financing needs, which will be difficult to finance should the private sector fail to improve its liquidity condition. Indeed, unfettered consumption may diminish domestic investors' capacity to absorb government debt, which could further expose the SBN market to the risk of a reversal in the global interest rate expectation.
- The government, of course, could try to time its debt issuances to follow developments in global interest rate expectations. After all, a sizable amount of liquidity remains unlocked in the public sector, which the government could use to fund its high fiscal commitments in H1 2024. The Fed's policy loosening signal does provide a strong argument for the Indonesian government to back-load its SBN issuance, although it is yet uncertain as to when and how far the Fed would cut the FFR in 2024.
- Given the still-uncertain global interest rate expectations, it would be more prudent for BI to keep a watchful eye over the variable it could manage; the domestic aggregate demand condition. Instead of stimulating the aggregate demand level, the central bank might better serve the economy by ensuring the stability of the Rupiah, considering the substantial pass-through effect from the Rupiah's exchange rate to the government's budget balance. Ergo, a sufficiently positive real interest rate seems to be a net positive for the Indonesian economy at the moment, which leads us to the expectation that BI will uphold its pro-stability messages in the upcoming policy meeting this week.

"Lowering the real interest rate may encourage the private sector to boost their consumption, at the price of exposing the Rupiah to global volatility"

Chart 1

A private pursuit

Demand for loans from the private sector dictates liquidity growth throughout 2023, while contributions from foreign investors and the government are relatively muted

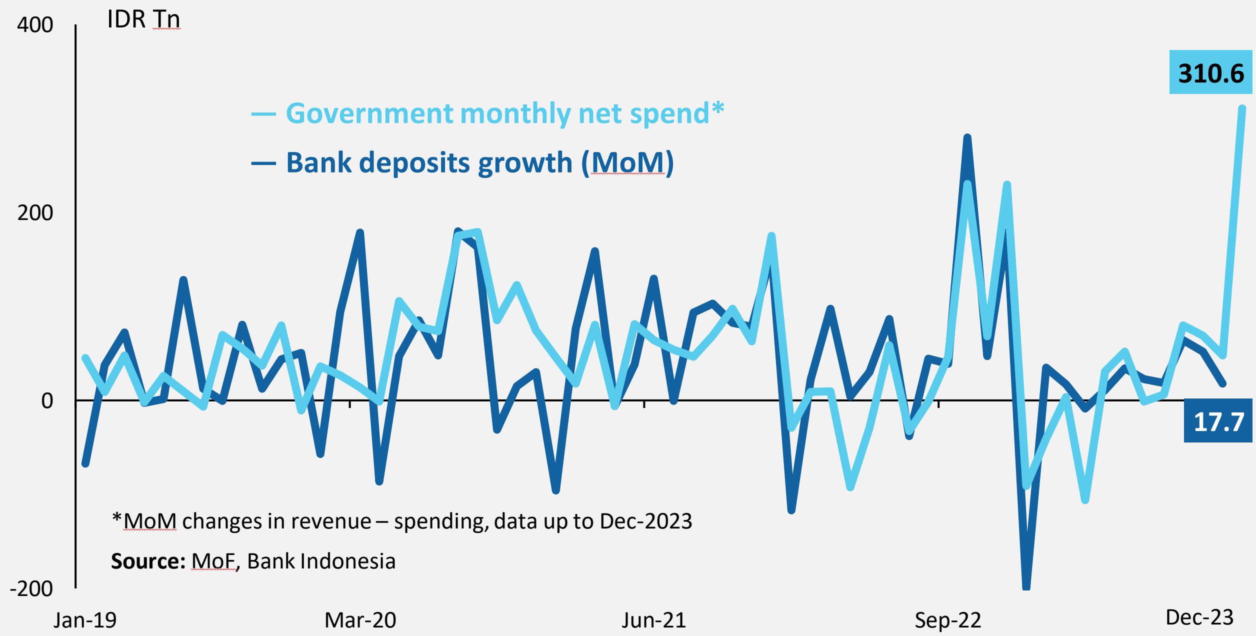


Source: Bank Indonesia

Chart 2

The government's getting into the picture

Higher fiscal expenses in late 2023 and the next few months would help to improve the domestic liquidity condition, which could translate positively to domestic consumption



*MoM changes in revenue – spending, data up to Dec-2023

Source: MoF, Bank Indonesia

Chart 3

Challenging customers

Transaction volume continues to show robust growth throughout 2023, but the sclerotic transaction value growth portends the low ceiling for household consumption growth

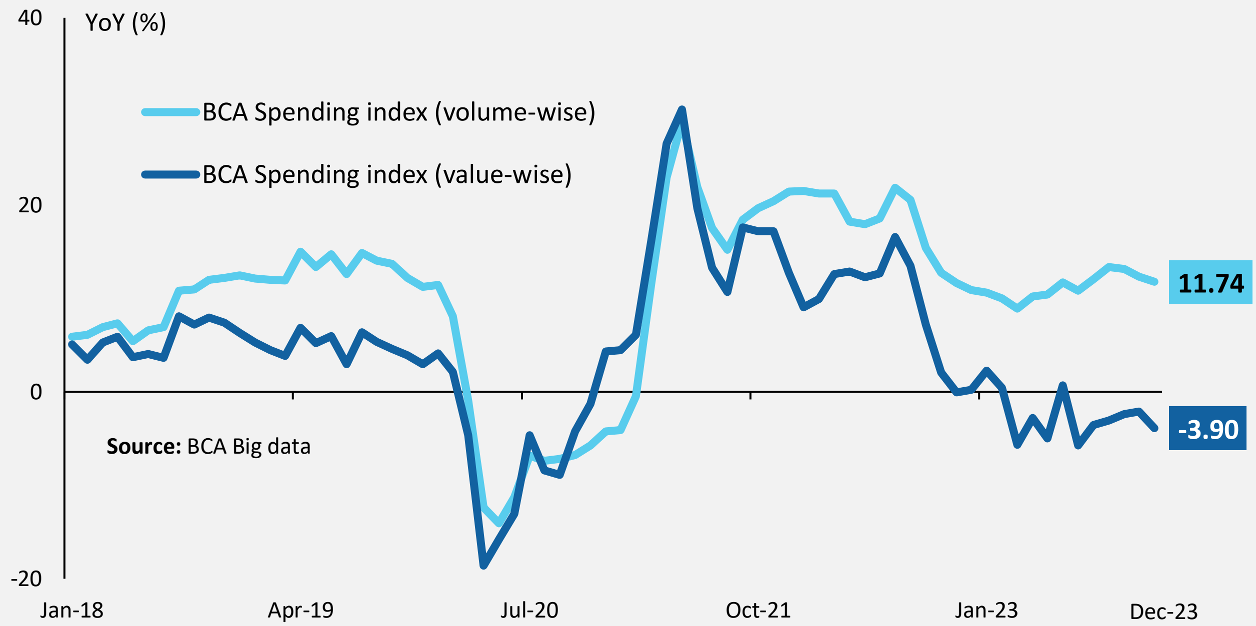
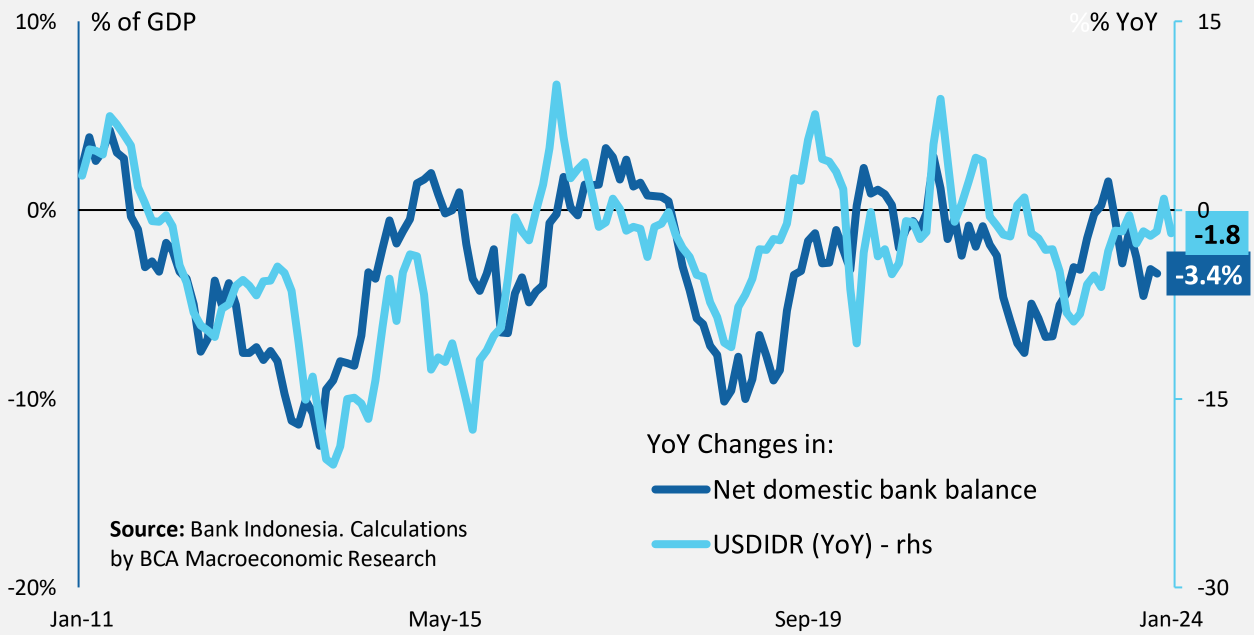


Chart 4

Higher the spending, heavier the burden?

Higher fiscal spending, coupled with stable private consumption, could boost the domestic financing needs that may exert a downward pressure on the Rupiah.



Economic Calendar

		Actual	Previous	Forecast*
2 January 2024				
ID	S&P Global Manufacturing PMI	52.2	51.7	51.9
CN	Caixin Manufacturing PMI	50.8	50.7	50.7
ID	**Inflation rate YoY**	**2.61%**	**2.86%**	**2.6%**
3 January 2024				
US	JOLTs Job Openings (USD Mn)	8.79	8.73	8.75
US	ISM Manufacturing PMI	47.4	46.7	47.3
5 January 2024				
US	Non-Farm Payroll ('000)	216	199	150
8 January 2024				
ID	**Foreign Exchange Reserves (USD Bn)**	**146.4**	**3.17**	**3.18**
ID	Motorbike Sales YoY	-11.6%	-2.8%	-
9 January 2024				
ID	Consumer Confidence	123.8	123.6	-
US	Balance of Trade (USD Bn)	-63.2	-64.3	-64.8
10 January 2024				
ID	Retail Sales YoY	2.1%	SS2.4%	-
11 January 2024				
US	Inflation Rate YoY	3.4%	3.1%	3.0%
12 January 2024				
CN	Inflation Rate YoY	-0.3%	-0.5	-0.7
CN	Balance of Trade (USD Bn)	75.34	68.3	46
15 January 2024				
EU	Balance of Trade (EUR Bn)	20.3	11.1	-
ID	**Balance of Trade (USD Bn)**	**3.31**	**2.41**	**1.57**
17 January 2024				
ID	**Interest Rate Decision**		**6.00%**	**6.00%**
19 January 2024				
ID	Loan Growth YoY	-	9.74%	-
24 January 2024				
ID	**Foreign Direct Investment (USD Bn)**	**-**	**13.26**	**-**

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

Scan for the link to our report depository or **click**: https://s.id/BCA_REI

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Dec-23	2.10
UK	5.25	Dec-23	1.35
EU	4.50	Dec-23	1.60
Japan	-0.10	Jan-16	-2.90
China (lending)	2.50	Dec-23	4.65
Korea	3.50	Nov-23	0.30
India	6.50	Dec-23	0.81
Indonesia	6.00	Nov-23	3.39
Money Mkt Rates	**12-Jan**	**-1 mth**	**Chg (bps)**
SPN (1M)	5.88	5.80	7.6
SUN (10Y)	6.65	6.67	-2.0
INDONIA (O/N, Rp)	5.75	5.90	-14.6
JIBOR 1M (Rp)	6.64	6.65	-0.8
Bank Rates (Rp)	**Oct**	**Sep**	**Chg (bps)**
Lending (WC)	9.05	9.02	2.79
Deposit 1M	4.43	4.33	10.10
Savings	0.67	0.66	0.19
Currency/USD	**12-Jan**	**-1 mth**	**Chg (%)**
UK Pound	0.784	0.796	1.51
Euro	0.913	0.926	1.45
Japanese Yen	144.9	145.5	0.39
Chinese RMB	7.168	7.177	0.14
Indonesia Rupiah	15,550	15,620	0.45
Capital Mkt	**12-Jan**	**-1 mth**	**Chg (%)**
JCI	7,241.1	7,125.3	1.63
DJIA	37,593.0	36,577.9	2.78
FTSE	7,624.9	7,542.8	1.09
Nikkei 225	35,577.1	32,843.7	8.32
Hang Seng	16,244.6	16,374.5	-0.79
Foreign portfolio ownership (Rp Tn)	**Dec**	**Nov**	**Chg (Rp Tn)**
Stock	3,226.3	3,136.1	90.27
Govt. Bond	841.0	833.9	7.17
Corp. Bond	10.6	11.2	-0.59

Trade & Commodities	12-Jan	-1 mth	Chg (%)
Baltic Dry Index	1,460.0	2,551.0	-42.8
S&P GSCI Index	538.3	520.3	3.5
Oil (Brent, $/brl)	78.3	73.2	6.9
Coal ($/MT)	127.3	140.0	-9.1
Gas ($/MMBtu)	13.20	2.38	454.6
Gold ($/oz.)	2,049.1	1,979.5	3.5
Copper ($/MT)	8,241.2	8,259.8	-0.2
Nickel ($/MT)	16,092.5	16,297.0	-1.3
CPO ($/MT)	820.1	780.1	5.1
Rubber ($/kg)	1.51	1.43	5.6
External Sector	**Dec**	**Nov**	**Chg (%)**
Export ($ bn)	22.41	22.00	1.89
Import ($ bn)	19.11	19.59	-2.45
Trade bal. ($ bn)	3.31	2.41	37.10
Central bank reserves ($ bn)*	146.4	138.1	6.01
Prompt Indicators	**Nov**	**Oct**	**Sep**
Consumer confidence index (CCI)	123.6	124.3	121.7
Car sales (%YoY)	-7.5	-13.8	-20.1
Motorcycle sales (%YoY)	-2.8	-4.0	-0.9
Manufacturing PMI	**Nov**	**Oct**	**Chg (bps)**
USA	46.7	46.7	0
Eurozone	44.2	43.1	110
Japan	48.3	48.7	-40
China	50.7	49.5	120
Korea	50.0	49.8	20
Indonesia	51.7	51.5	20

Source: Bloomberg, BI, BPS
Notes:
*Data from an earlier period
For changes in currency: **Black indicates appreciation against USD, **Red** otherwise
***For PMI, **>50** indicates economic expansion, **<50** otherwise

Indonesia – Economic Indicators Projection

	2019	2020	2021	2022	2023E	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.1	5.0
GDP per Capita (US$)	4175	3912	4350	4784	4982	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6*	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00*	5.50
USD/IDR Exchange Rate (end of the year)**	13,866	14,050	14,262	15,568	15,397*	16.037
Trade Balance (US$ billion)	-3.2	21.7	35.3	54.5	37.0*	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	0.1	-0.5

*Actual number

** Estimation of the Rupiah's fundamental exchange rate

Economic, Banking & Industry Research Team

David E.Sumual
Chief Economist
david_sumual@bca.co.id
+6221 2358 8000 Ext:1051352

Agus Salim Hardjodinoto
Head of Industry and Regional Research
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Barra Kukuh Mamia
Senior Economist
barra_mamia@bca.co.id
+6221 2358 8000 Ext: 1053819

Victor George Petrus Matindas
Senior Economist
victor_matindas@bca.co.id
+6221 2358 8000 Ext: 1058408

Gabriella Yolivia
Industry Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Lazuardin Thariq Hamzah
Economist / Analyst
lazuardin_hamzah@bca.co.id
+6221 2358 8000 Ext: 1071724

Keely Julia Hasim
Economist / Analyst
keely_hasim@bca.co.id
+6221 2358 8000 Ext: 1071535

Elbert Timothy Lasiman
Economist / Analyst
Elbert_lasiman@bca.co.id
+6221 2358 8000 Ext: 1007431

Thierris Nora Kusuma
Economist / Analyst
thierris_kusuma@bca.co.id
+6221 2358 8000 Ext: 1071930

Aldi Rizaldi
Research Assistant
aldi_yanto@bca.co.id
+6221 2358 8000 Ext: 1020451

Fikri Adam Zaqi
Research Assistant
fikri_zaqi@bca.co.id
+6221 2358 8000 Ext: -

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group

20th Grand Indonesia, Menara BCA

Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia

Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343