

Whipping a tired horse

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Summary

- The Indonesian financial market seems to respond positively to the improving short-term fiscal outlook, but uncertainties remain given the slowing growth momentum.
- The proposed continuation of the debt restructuring program may have a neutral impact on the demand for loans, especially MSME loans given that MSMEs are in no shape to assume more loans amidst the challenging domestic condition.
- Slowing demand for loans from the private sector in the short term may prove to be more beneficial, given the expected higher government debt issuance in the upcoming months.

- The global news stream seems to be dominated by the first US presidential debate held in the past week. However, this does not mean that the US and global financial markets have been left idle throughout the past week. The prospect of another round of unfunded tax cuts and President Trump strongarming the Fed to lower its policy rate adds uncertainty to the market, increasing concerns about the return of debt monetisation that may impair trust in the USD as the global reserve currency. The DXY index thus tracked lower following the debate, while the S&P 500 also snapped its three-week winning streak, as the downturn on Friday last week forced the index to close 0.4% lower than its position earlier in the week.
- The apparent uncertainty in the US seems to translate positively to the condition of the Indonesian financial market. Foreign investors purchased USD 1.20 Bn worth of Indonesian financial assets throughout the last trading week, with combined foreign inflows into the SBN (USD 0.51 Bn) and the domestic stock market (USD 0.14 Bn) surpassing the USD 0.56 Bn inflows to the SRBI market. The diminishing short-term fiscal concern explains the recent improvement in the Indonesian financial market, thanks to the announcement of the still conservative (2.29-2.82% deficits, including IDR 71 Tn for the nutritious meal programme) state budget in 2025.

Dangling a carrot everyone refuses

- The still-conservative fiscal posture (or in other words, less aggressive spending) highlights the challenge the government faces in simultaneously maintaining a stable domestic financial market (the government aims to keep the 10Y SBN yield between 6.9 – 7.3% in 2025 and the USDIDR exchange rate between 15,300-15,900) and accelerating domestic growth momentum (5.1 – 5.5% real GDP growth target in 2025) amidst the reality of a slowing economic growth trend in 2024-2025.
- This does not mean that Indonesian policymakers are abandoning the quest towards the sacrosanct 5% GDP growth. Bank Indonesia, as we observed, is reluctant to raise the BI rate amidst the slowing domestic aggregate demand growth, while a series of liquidity incentives (RPIM and the strengthened KLM) are put in place to maintain loan growth necessary to support business activities and investments. The government's recent recommendation for the OJK to again extend the pandemic-era credit restructuring programme could also be understood as part of the effort to shore up the domestic economic growth momentum, although the recommendation is made public on the grounds of the slowing loan growth in the MSME sector.
- It is no wonder that the slowing MSME loan growth sprung the government into action. The MSME sector plays an increasingly

“The challenging domestic condition and the already high indebtedness means that MSMEs are in no shape to assume more loans”

important role in the Indonesian economy, not just directly through its impact on generating business activities but also indirectly through the labour market as the limited employment opportunities in the formal sector continue to push workers into the MSME sector. However, **it is also hardly controversial that banks have chosen to limit their exposure to MSME loans in recent months, given the relaxed target/requirement on MSME loan growth and the seemingly worsening credit quality in the MSME sector (see Chart 1).**

- However, it might be wiser to review the recent situation facing the MSME sector before condemning them with such a verdict. The 103-bps increase in the NPL on agricultural MSME loans, for example, is amenable given the delayed

harvesting season due to the recent El Nino weather conditions. Hence, **the continuation (or more aptly, the reintroduction) of the credit restructuring programme is justifiable, given that a looser financing condition will help MSMEs (and other businesses) to ride out the short-term challenges** while banks' robust balance sheet will also help them to keep the seemingly worsening loans on the book for a while longer.

- However, **it is important to note that the MSME sector is indeed facing a structural problem.** MSMEs' limited exposure to the export market makes them especially

vulnerable to the slowdown in the domestic demand condition, while their heavy reliance on imports (especially for MSMEs in the wholesale and retail trade sector) further threatens their cash flow situation amidst the downward trend in the IDR's value.

- Ergo, the slowdown in MSME loans may not be entirely caused by the lower availability of bank financing for the MSME sector. **The MSME sector finds itself in no shape to take on more debt**, as the surge in MSME loans amidst the lacklustre domestic consumption growth since the pandemic has only worsened MSMEs' indebtedness (*see Chart 2*). Business owners, of course, are well aware of the challenging situation they now face, thus limiting the urgency to seek external financing as small businesses shift their focus towards efficiency rather than expansion. A recent study has also shown that around 52.42% of small business owners prefer to fund their operation out of pocket rather than looking for external financing, strengthening the argument that a looser financing condition may not significantly boost MSME loans due to the low demand for financing from MSME business owners.
- Despite its merits, then, the government's recent proposal to re-introduce the credit re-structurisation programme may fall short of its intended objectives. Neither banks (due to the relaxed requirement on MSME loans) nor MSMEs (due to the shift in its focus amidst the already high indebtedness) are

“Rather than an accelerated growth momentum, higher MSME loans may portend a higher demand for imported goods”

pushing for a more rapid loan growth, which explains the slow decline in MSMEs loan growth even before OJK called it a day on the original pandemic-era debt restructuring programme.

- Moreover, **counting on more aggressive MSME loans to boost the GDP growth momentum may not be a winning strategy in the first place**, given the peculiar feature of MSME loans. Nearly a half (46.83%) of the total MSME loans outstanding accounted for the import-intensive wholesale and retail trade sector (with most of the loan classified as working capital loans), meaning that accelerated MSME loans may portend higher consumer goods imports rather than a re-energised GDP growth momentum (*see Chart 3*). Indeed, higher goods import will not help to close the CA deficit gap that now burdens the Rupiah and Indonesia's macroeconomic fundamentals, especially considering the limited upswing in the global (Chinese) demand for commodities.
- Re-creating a loose financing condition to encourage MSME loans (and other loans) to accelerate may also translate negatively to the domestic liquidity condition. Unlike MSME loans, the typically more productive corporate loans are still on an upward trend (*see Chart 4*), meaning that the re-accelerated demand for financing from the MSME sector may reduce the pot of bank financing available for the corporate sector (and, hence, potentially disrupting the still-going CAPEX cycle in some capital-intensive

and export-led sectors). The prospect of increasing competition for liquidity is even more noticeable when we take into account the government’s expected higher debt issuance in H2 2024, creating a three-way race that may bid up the price of bank loans that may defeat the purpose of the proposed re-introduction of the debt restructuring programme.

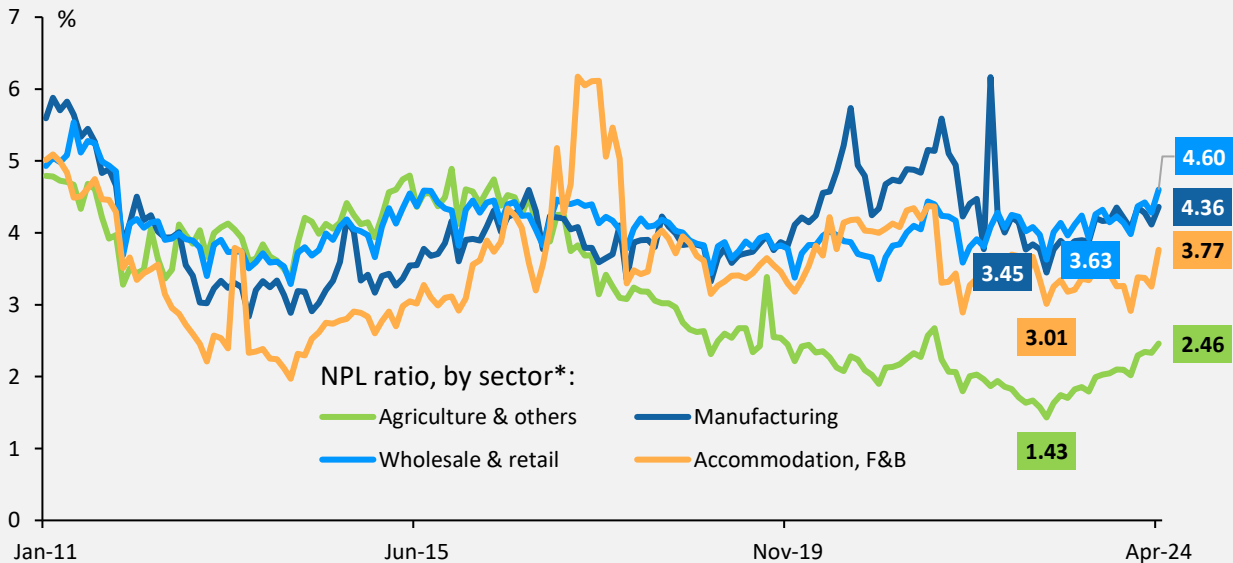
- **Given the prospect of the government’s higher demand for financing, the urgency to boost private loan growth may not be too pressing in the first place.** Allowing private loan growth to slow down (thereby, the domestic liquidity condition to improve) may be more beneficial for the MSME sector,

given a more balanced domestic liquidity condition may lower the exchange rate risk that now hits the MSME sector. Voting on the side of domestic market stability rather than continuously pushing for loan growth may also allow BI to maintain its policy posture, avoiding another hit to the outlook on domestic aggregate demand growth that shall translate positively to the MSME sector specifically and the domestic business sector more generally.

Chart 1

Bruised and battered

Apart from some special cases, higher costs due to the weakening Rupiah and the slowing revenue growth may suppress MSMEs’ cash flow condition, worsening their credit quality.



*Sectors displayed captures >75% of MSME loans outstanding.
Source: OJK

Chart 2

Wariness on both sides

The already high indebtedness amidst the uncertain domestic consumption trend may suppress MSMEs' demand for loans (and banks' appetite to extend more loans)

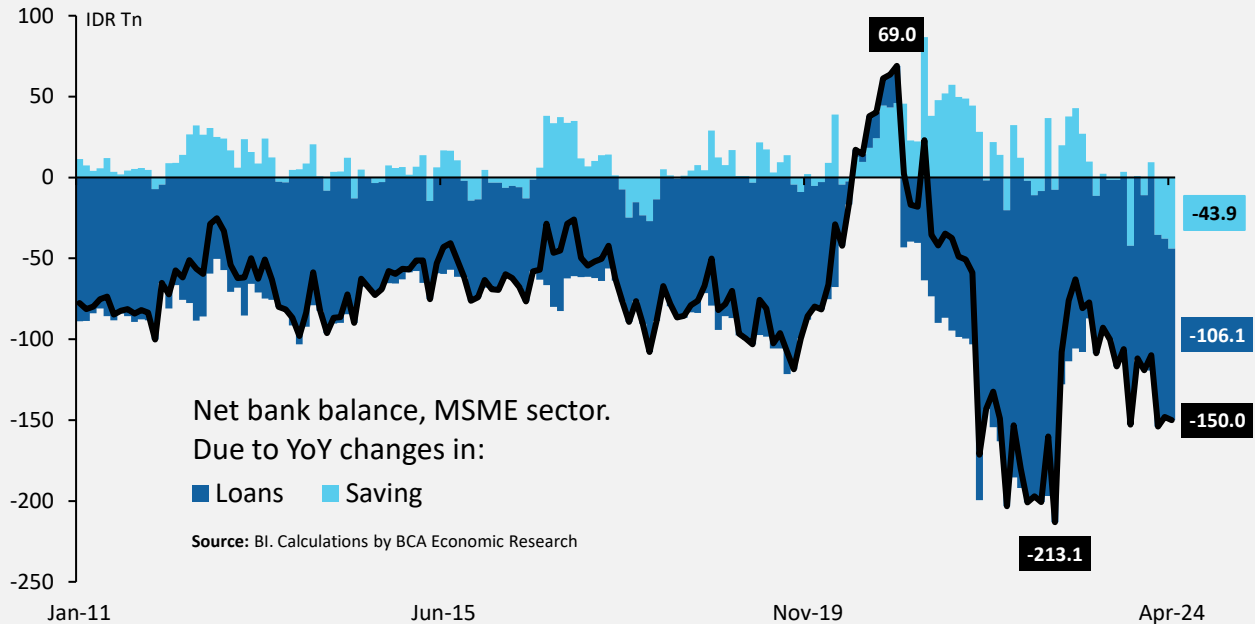


Chart 3

Money on importers' pockets

Looser financing conditions for the MSME sector may further suppress the outlook on Indonesia's current account balance condition.

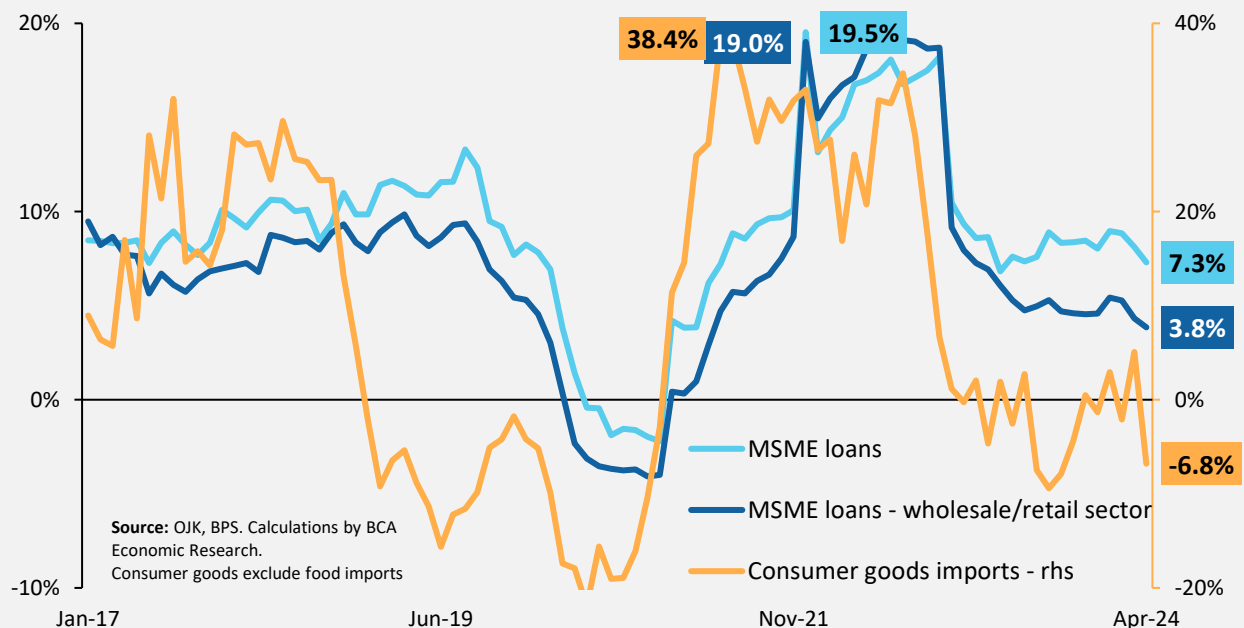
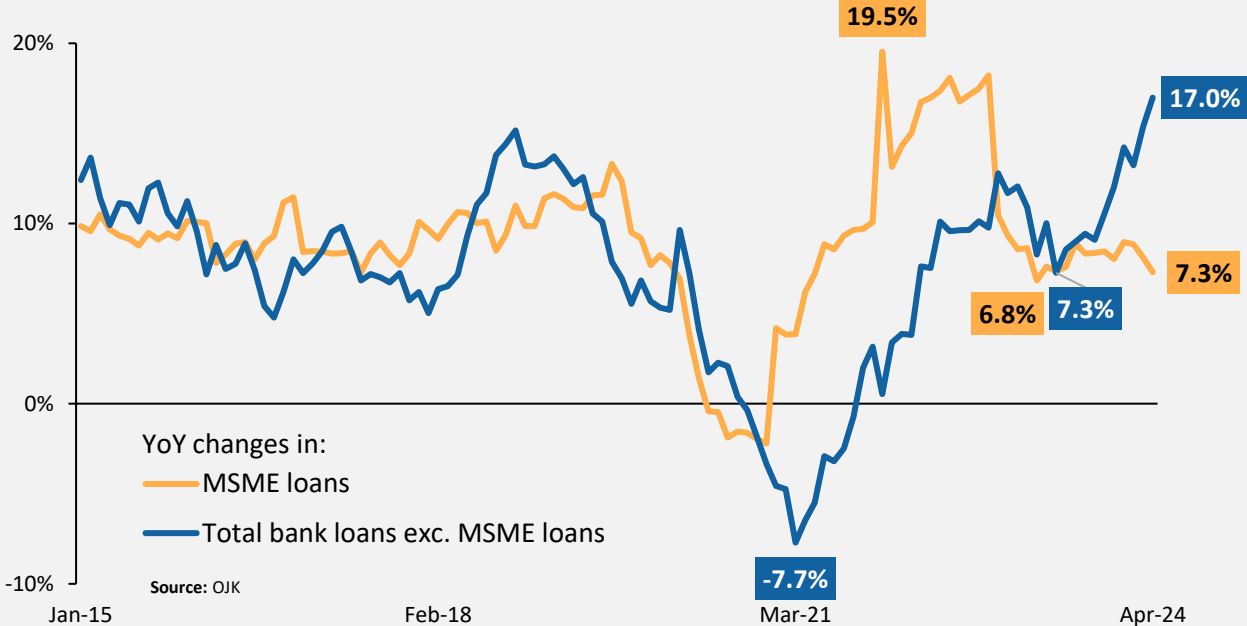


Chart 4

Competing for loans

Additional loosening to MSME loans means that more-established businesses may face competition for financing, which may translate negatively to their investments



Economic Calendar				
		Actual	Previous	Forecast*
11 June 2024				
ID	Retail Sales YoY, %	-2.7	9.3	11
ID	Car Sales YoY, %	-13.3	-17.5	-
12 June 2024				
CN	Inflation rate YoY, %	0.3	0.3	0.2
US	Inflation rate YoY, %	3.3	3.4	3.4
ID	Motorbike Sales YoY, %	-4.5	-2.5	-
13 June 2024				
US	Fed Interest Rate Decision, %	5.5	5.5	5.5
14 June 2024				
EU	Balance of Trade, (Bn)	15	23.7	16.0
17 June 2024				
CN	Retail Sales YoY, %	3.7	2.3	2.6
CN	Unemployment Rate, %	5	5	5
18 June 2024				
EU	Inflation rate YoY, %	2.6	2.4	2.6
US	Retail Sales YoY, %	2.3	3	2.8
19 June 2024				
ID	Balance of Trade, (Bn)	2.93	2.72	2.5
20 June 2024				
ID	Interest Rate Decision, %	6.25	6.25	6.25
01 July 2024				
ID	S&P Global Manufacturing PMI (Bn)	50.7	52.1	51
ID	Inflation rate YoY, %	2.51	2.84	2.96
02 July 2024				
US	JOLTs Job Openings, (Mn)		8.05	7.9
EU	Inflation rate YoY, %		2.6	2.4
EU	Unemployment Rate, %		6.4	6.5
3 July 2024				
US	Balance of Trade, (Bn)		-74.6	-76
05 July 2024				
ID	Foreign Exchange Reserves, (USD Bn)		139	148
US	Unemployment Rate, %		4	4
US	Non-Farm Payrolls, (Th)		272	160

*Forecasts of some indicators are simply based on market consensus

Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	28-Jun	-1 mth	Chg (%)
US	5.50	Jul-23	2.20	Baltic Dry Index	2,050.0	1,784.0	14.9
UK	5.25	Aug-23	3.25	S&P GSCI Index	578.4	592.4	-2.4
EU	4.25	Jul-23	1.65	Oil (Brent, \$/brl)	86.4	84.2	2.6
Japan	-0.10	Jan-16	-2.90	Coal (\$/MT)	133.2	142.0	-6.2
China (lending)	2.50	Aug-23	4.05	Gas (\$/MMBtu)	2.55	2.29	11.4
Korea	3.50	Jan-23	0.80	Gold (\$/oz.)	2,326.8	2,361.3	-1.5
India	6.50	Feb-23	1.75	Copper (\$/MT)	9,456.0	10,380.8	-8.9
Indonesia	6.25	Apr-24	3.74	Nickel (\$/MT)	17,040.2	20,217.7	-15.7
				CPO (\$/MT)	847.0	839.6	0.9
				Rubber (\$/kg)	1.66	1.77	-6.2
Money Mkt Rates	28-Jun	-1 mth	Chg (bps)	External Sector	May	Apr	Chg (%)
SPN (1M)	5.88	5.80	7.6	Export (\$ bn)	22.33	19.62	13.82
SUN (10Y)	7.05	6.86	18.7	Import (\$ bn)	19.40	16.90	14.82
INDONIA (O/N, Rp)	6.15	6.01	14.5	Trade bal. (\$ bn)	2.93	2.72	7.61
JIBOR 1M (Rp)	6.90	6.90	0.0	Central bank reserves (\$ bn)*	139.0	136.2	2.04
Bank Rates (Rp)	Apr	Mar	Chg (bps)	Prompt Indicators	May	Apr	Mar
Lending (WC)	8.85	8.83	2.01	Consumer confidence index (CCI)	125.2	127.7	123.8
Deposit 1M	4.65	4.62	3.47	Car sales (%YoY)	-13.3	-17.5	-26.2
Savings	0.68	0.68	0.22	Motorcycle sales (%YoY)	-4.5	18.3	-7.8
Currency/USD	28-Jun	-1 mth	Chg (%)	Manufacturing PMI	Jun	May	Chg (bps)
UK Pound	0.791	0.784	-0.92	USA	51.7	51.3	40
Euro	0.933	0.921	-1.33	Eurozone	45.6	47.3	-170
Japanese Yen	160.9	157.2	-2.31	Japan	50.0	50.4	-40
Chinese RMB	7.267	7.244	-0.32	China	51.8	51.7	10
Indonesia Rupiah	16,375	16,090	-1.74	Korea	52.0	51.6	40
				Indonesia	50.7	52.1	-140
Capital Mkt	28-Jun	-1 mth	Chg (%)				
JCI	7,063.6	7,253.6	-2.62				
DJIA	39,118.9	38,852.9	0.68				
FTSE	8,164.1	8,254.2	-1.09				
Nikkei 225	39,583.1	38,855.4	1.87				
Hang Seng	17,718.6	18,821.2	-5.86				
Foreign portfolio ownership (Rp Tn)	May	Apr	Chg (Rp Tn)				
Stock	3,115.0	3,294.9	-179.85				
Govt. Bond	807.0	789.9	17.11				
Corp. Bond	8.2	8.4	-0.20				

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	2023	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0
GDP per Capita (US\$)	4175	3912	4350	4784	4920	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	6.50
USD/IDR Exchange Rate (end of the year)*	13,866	14,050	14,262	15,568	15,397	16,304
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

*Estimation of the Rupiah's fundamental exchange rate

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