

Inheriting an inflexible pot

15 July 2024

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Summary

- The loosening US financing condition and the expectedly lower SBN issuance in 2024 may improve Indonesian sovereign bonds' attractiveness despite the pile of maturing bonds in the upcoming months.
- The current government's higher use of the excess budget balance (SAL) may leave the upcoming government with a smaller cash coffer, which could increase their dependency on the SBN market.
- High interest payments and shorter debt repayment schedules may reduce the wiggle room for future governments to decide their fiscal posture.

- The newsreel moved into a higher gear on the weekend, fuelled by the assassination attempt on former US president Donald Trump during a rally last Saturday. Finger-pointing and blame-shifting after the event added more uncertainty to the US political spectrum, which moved the USD index a tad higher as the market opens today (0.2% higher than the level on Friday).
- Amidst the currently elevated US political uncertainty, however, it might be best for us to keep our focus on the recent shift in the US macroeconomic condition, which has shown further evidence of cooling down following the -0.1% MoM CPI inflation in June 2024. The first negative MoM CPI inflation reading since May 2020 magnifies Fed Chairman Jerome Powell's recent comment that the US labour market is no

longer driving inflation, leading to the market pricing a 91% chance for a 25 bps FFR cut in September 2024 FOMC meeting as of today.

- The dovish shift in the FFR expectation pendulum translates positively to the domestic financial market. The domestic stock market recorded around USD 114.5 Mn in foreign net buys on the two trading days following the US CPI data release, while foreign investors showered the SBN market with USD 276.6 Mn of capital inflows on Thursday alone. Meanwhile, BI issued USD 1.11 Bn worth of SRBI in the latest auction (USD 0.14 Bn foreign inflows), down from the average of USD 1.71 Bn during the volatile May-June 2024 period which highlights the calmer water the Rupiah is sailing on at the moment.

Less issue with re-issuance

- The now-loosening US (and global) financial conditions seem to be in line with the Indonesian government's budget scenario in 2024. As we have argued in the 2024 Indonesian economic outlook issued in December 2023, the government is likely to 'frontload' their spending realisation, while the ample excess budget balance (SAL)¹ will allow the government to 'backload' their SBN issuance. An expedited FFR cut timeline (from December to September 2024 as the market expected) will allow the Indonesian government to return to the bond market as first planned, although the Ministry of Finance have signalled recently that the government will issue fewer amounts of SBN in 2024.
- Despite the news of lower SBN issuance, there is no denying that the current administration is still looking to spend more in 2024. Indeed, **the expected lower SBN issuance is due to a shift in the government's financing strategy**, which will rely more on foreign loans and SAL, while the 2024 fiscal deficit is expected to widen from 2.29% of GDP to 2.70% of GDP.
- The recent shift in the government's fiscal posture may help to tackle two problems the Indonesian economy currently facing. First, **the widened fiscal deficit signals the government's intention to unwind its 'frontload' fiscal spending strategy**, thus ensuring that government spending will contribute positively to the economy not only in H1 2024 but throughout the year.
- Second, **the shift towards more foreign loans and fewer SBN will help the government weather the upcoming high season of maturing bonds (see Chart 1)**, which may culminate in October 2024 when global economic and political uncertainty may reach its highest point ahead of the US presidential election. Hence, **we revised our expectation of the benchmark 10Y SBN yield to 6.78%**, in line with the 6.70% assumed by the government for the 2024 budget.

"More limited SBN issuance may calm the market despite the high amount of maturing bonds in upcoming months"

Escaping a narrowing maze

- Despite the short-term positive impacts mentioned above, **the current administration's decision to adjust its financing strategy may have some negative consequences for the fiscal situation the next administration will inherit**. The most straightforward impact, of course, is that the

continued use of SAL to finance the current administration's widening deficit will leave the upcoming administration with a smaller cash coffer, which according to one estimate (using BI's liabilities to the central government as a proxy) have shrunk by 15.30% YTD.

¹ Sisa anggaran lebih

- Given the more discretionary nature of its spending programme (especially the flagship free meals programme), it may also be hard for the upcoming administration to replicate the government's current strategy of relying more on external loans, which are often tied to specific projects, especially if the loans come from global development banks. **Inheriting a smaller SAL coffer and potentially limited opportunities to lend from abroad, the upcoming administration may need to rely on the bond market to finance its deficit**, which should not be a major problem should the market continue to vote in favour of the government's budget considerations.
- Alas, the upcoming government will be walking into a sharply different bond market to its predecessor when it first took office in late 2014. First, **despite the dovish shift in the Fed's rate expectation, the runaway US fiscal deficit may continue to keep the global interest rate relatively higher** (compared to the 2009-2021 era of ultra-low interest rate), meaning that the government may continue to carry a significant interest payment burden relative to its total revenue (*see Chart 2*). Indeed, the government's interest payment bills are expected to account for 21.53% of the government's total tax revenue in 2024, up from 9.47% in 2014 when the US fiscal deficit was nearing its post-GFC low (USD 40.6 Bn, USD 148.6 in 2023) and the Fed's liquidity intervention (QE) provided a backstop to the US and global bond market.
- The normalising global interest rate equilibrium (relative to the ultra-low interest rate during the post-GFC years) also appears to alter investors' behaviour, which highlights the second challenge facing the bond market. The US Treasury's effort to meet its funding needs while keeping the US growth momentum alive has led to a shorter duration in the UST market, which fits the demand profile in the US as excess savings are flowing to retail money market funds. Foreign investors' shift towards the SRBI market serves as a symptom that the combination of higher yield plus shorter duration in the UST market also affects the Indonesian bond market, as **the shifting investors' behaviour also forced the government to shorten the duration in the domestic sovereign bond market (see Chart 3)**.
 - A shorter bond duration is not necessarily bad for the market. For one, a **shorter duration may instil fiscal discipline, as the onus to repay the debt may fall on the government that issues the debt**. However, looking at it from the government's lenses, it is not hard to fathom that such a reading will lead to a complication. **A faster debt repayment schedule means that the government should ensure higher (and quicker) returns from its investment**, which could ensnare the government's investments and budget planning with more short-termism.
- **Efforts to loosen the fiscal cap amidst the already high-interest burden and a shorter**

"The depleted SAL balance, the substantial interest burden, and the shorter debt repayment flexible may reduce the upcoming government's budget flexibility".

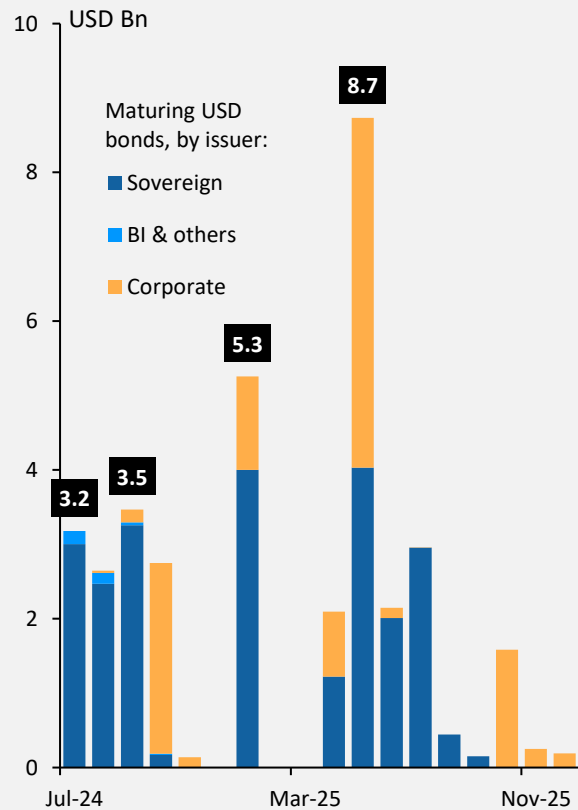
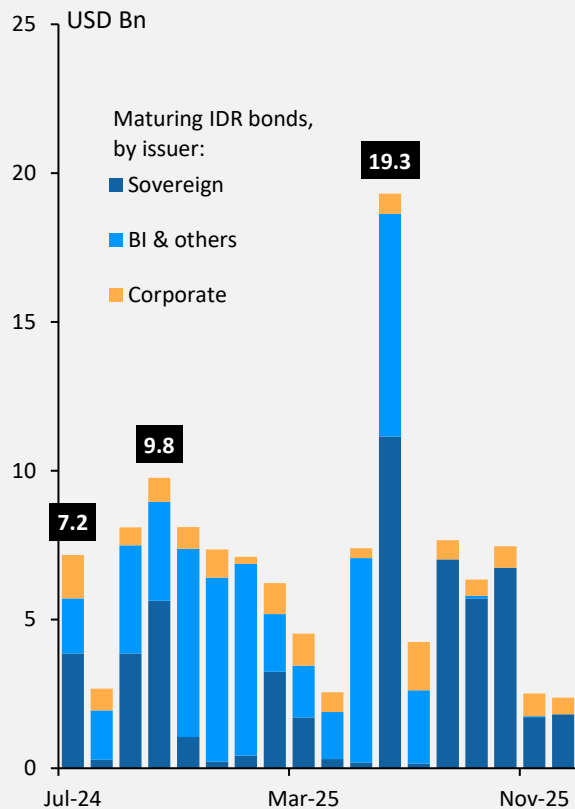
debt repayment schedule would be akin to forcing the economy (and the government that runs it) to sprint on a treadmill; each Rupiah of additional unfunded spending will need to be spent on projects that offer a high and quick return on investments, which neither fits the current government’s focus on infrastructure-driven investments nor the upcoming government’s apparent pref-

erence for more human-focused investments. The macro and market reality, then, is calling for the government to keep the budget requirement in place, despite continued speculation and debate that the upcoming government may lift the 3% cap on fiscal deficit.

Chart 1

Bonds mature as summer ends

The government’s signal to issue fewer SBNs helps to keep the benchmark yield stable despite the now-higher amount of maturing bonds.

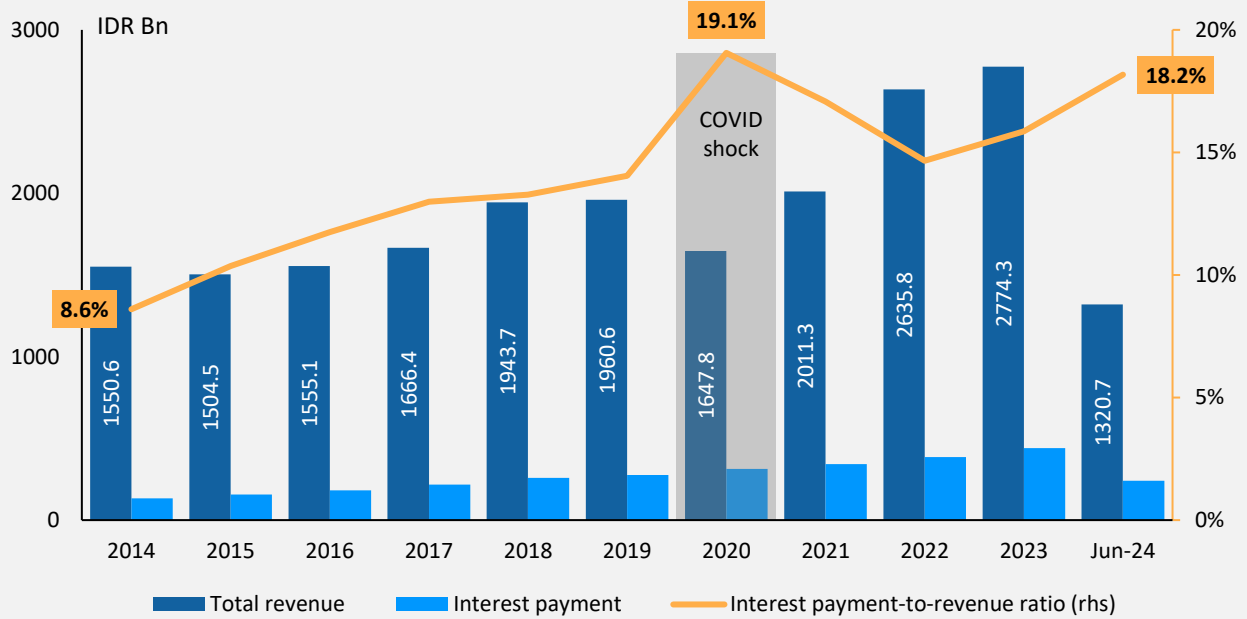


Source: Bloomberg

Chart 2

Low headspace

The Indonesian government may face an increasingly inflexible fiscal budget as the government already spent almost 1/5th of its total revenue on interest payments per June 2024

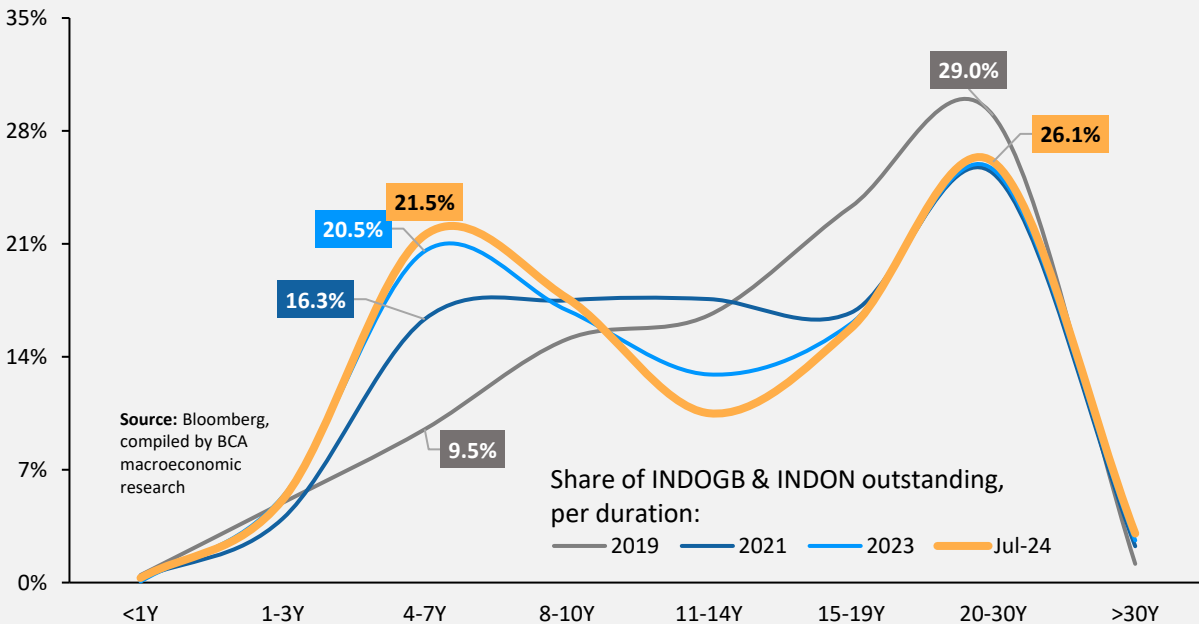


Source: CEIC

Chart 3

Sprinting on a treadmill

Indonesian government bonds' shorter duration means that a higher annual fiscal revenue growth will be instrumental should the government decide to issue more debt



Source: Bloomberg, compiled by BCA macroeconomic research

Share of INDOGB & INDON outstanding, per duration:

— 2019 — 2021 — 2023 — Jul-24

Economic Calendar				
		Actual	Previous	Forecast*
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)	18.14	8.05	7.9
EU	Inflation rate YoY, %	2.5	2.6	2.5
EU	Unemployment Rate, %	6.4	6.4	6.5
03 July 2024				
US	Balance of Trade, (Bn)	-75.1	-74.5	-76
05 July 2024				
ID	Foreign Exchange Reserves, (Bn)	140	139	148
US	Unemployment Rate, %	4.1	4	4
US	Non Farm Payrolls, (Th)	206	218	160
07 July 2024				
CN	Foreign Exchange Reserves, (Tn)	3.222	3.232	3.25
08 July 2024				
ID	Consumer Confidence	123.3	125.2	125.5
09 July 2024				
ID	Retail Sales YoY, %	2.1	-2.7	-0.5
10 July 2024				
CN	Inflation Rate YoY, %	0.2	0.3	0.3
ID	Motorbike Sales, %	3.5	-4.5	-
11 July 2024				
US	Inflation Rate YoY, %	3	3.3	3.1
12 July 2024				
CN	Balance Of Trade, (Bn)	99.05	82.62	85
ID	Car Sales YoY, %	-11.8	-13.3	-
15 July 2024				
ID	Balance Of Trade, (Bn)	2.39	2.93	2.49
CN	Retail Sales YoY, %	2	3.7	3.2
16 July 2024				
EA	Balance Of Trade, (Bn)		15	-

*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	12-Jul	-1 mth	Chg (%)
US	5.50	Jul-23	2.50	Baltic Dry Index	1,997.0	1,831.0	9.1
UK	5.25	Aug-23	3.25	S&P GSCI Index	572.4	573.0	-0.1
EU	4.25	Jul-23	1.75	Oil (Brent, \$/bbl)	85.0	81.9	3.8
Japan	-0.10	Jan-16	-2.90	Coal (\$/MT)	135.4	137.5	-1.5
China (lending)	2.50	Aug-23	4.15	Gas (\$/MMBtu)	2.17	2.71	-19.9
Korea	3.50	Jan-23	1.10	Gold (\$/oz.)	2,411.4	2,317.0	4.1
India	6.50	Feb-23	1.42	Copper (\$/MT)	9,726.9	9,630.4	1.0
Indonesia	6.25	Apr-24	3.74	Nickel (\$/MT)	16,577.9	17,563.9	-5.6
Money Mkt Rates	12-Jul	-1 mth	Chg (bps)	CPO (\$/MT)	859.0	835.8	2.8
				Rubber (\$/kg)	1.66	1.79	-7.3
Bank Rates (Rp)	Apr	Mar	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)	6.93	7.00	-7.3	Import (\$ bn)	19.40	16.90	14.82
INDONIA (O/N, Rp)	6.28	6.01	26.8	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	2.02
Currency/USD	12-Jul	-1 mth	Chg (%)	Prompt Indicators	Jun	May	Apr
UK Pound	0.770	0.785	1.95	Consumer confidence index (CCI)	123.3	125.2	127.7
Euro	0.917	0.931	1.55	Car sales (%YoY)	-11.8	-13.2	-17.4
Japanese Yen	157.8	157.1	-0.44	Motorcycle sales (%YoY)	3.5	-4.5	18.3
Chinese RMB	7.250	7.254	0.06	Manufacturing PMI	Jun	May	Chg (bps)
Indonesia Rupiah	16,138	16,290	0.94	USA	51.6	51.3	30
Capital Mkt	12-Jul	-1 mth	Chg (%)	Eurozone	45.8	47.3	-150
JCI	7,327.6	6,855.7	6.88	Japan	50.0	50.4	-40
DJIA	40,000.9	38,747.4	3.24	China	51.8	51.7	10
FTSE	8,252.9	8,147.8	1.29	Korea	52.0	51.6	40
Nikkei 225	41,190.7	39,134.8	5.25	Indonesia	50.7	52.1	-140
Hang Seng	18,293.4	18,176.3	0.64	Foreign portfolio ownership (Rp Tn)	Jun	May	Chg (Rp Tn)
				Stock	3,273.1	3,115.0	158.05
				Govt. Bond	805.6	807.0	-1.38
				Corp. Bond	8.2	8.2	-0.06

Source: Bloomberg, BI, BPS

Notes:

Car and motorcycle sales data to be released on the third week of January 2022

^Data for January 2022

*Data from an earlier period

For changes in currency: **Black indicates appreciation against USD, **Red** otherwise

***For PMI, >50 indicates economic expansion, <50 otherwise

Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3	5.0
GDP per Capita (US\$)	3927	4175	3912	4350	4784	5149
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	3.2
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.25
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	16,218
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	54.5	32.6
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.5

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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