2025 State budget:

A sound yet provisional budget

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Summary

- The government appears committed to maintaining a moderate fiscal budget in 2025, aiming to keep the fiscal deficit at 2.53% of GDP as spending growth (5.89% YoY) is expected to lag revenue growth (6.94% YoY).
- Despite the anticipated increase in revenue and external loans, the higher assumption for SBN yields in 2025 suggests that the government faces a pressing need to increase its bond supply in the market.
- The current ambiguity in policy signals and the moderate deficit target provide the government with both the time and flexibility to refine and bring the provisional budget into its final form.

- President Joko Widodo unveiled the draft 2025 state budget last Friday, which will be the first under the incoming Prabowo-Gibran administration, pending parliamentary approval. On the surface, the draft largely aligns with the administration's stated goals of increasing social spending while continuing current infrastructure projects. However, **the budget turned out to be less expensive than expected**, with the primary balance deficit targeted at IDR 63.3 Tn (down from IDR 110.8 Tn in the 2024 outlook) while the 2025 fiscal deficit is set at 2.53% of GDP (down from 2.70% according to the latest 2024 budget outlook).
- The government's balanced fiscal stance seems to have improved the sentiment on Indonesia's financial market. The proposed lower fiscal deficit for 2025 seems to have especially reassured foreign investors in the domestic bond market, as indicated by the USD 0.47 Bn inflows to the SBN market that pushed the benchmark 10Y SBN yield to 6.69% as the market closed last week.

Financing and revenue: Unblinded by the light

- Recent positive trends in the global financial market have also played a role in bringing the Indonesian financial market to a stronger position today. However, the favourable development in the global financial market condition does not appear to spur the government from adopting more aggressive macroeconomic assumptions in its 2025 state budget. The Rupiah, for instance, is expected to trade at IDR 16,100/USD in 2025, a 2.61%

depreciation compared to the current level, despite the prevailing market consensus on a weaker USD in the next year.

- The government's more realistic assumption is also reflected in its borrowing rate expectations for next year. Despite the FFR futures market predicting 100 bps of cuts in 2025, the government has set its lending rate (10Y SBN yield) assumption at 7.1%, higher than the 6.9% expected in the latest 2024 budget outlook. However, **it might be more accurate to refrain from labelling these yield and exchange rate assumptions as pessimistic, given the distortive effect that the SRBI instrument currently has on the domestic financial market**, leading to overshooting exchange rate and bond yield levels at present.
- **The realistic benchmark yield expectation also seems to suggest fewer financing options for the government next year.** Indeed, the incumbent administration could be more creative with its financing strategy at present, tapping into its excess budget balance (SAL) and utilising loan facilities from international creditors to reduce SBN issuance as the bond market turns volatile.
- Some parts of this mixed financing strategy are expected to continue next year, with the government planning to increase lending from international creditors by 27.05% to IDR 128.1 Tn. However, the sizable drop in its liquidity coffers (indicated by the 13.13% YTD drop in Bank Indonesia's liabilities to the public sector) and the IDR 151.7 Tn decline in the "other financing" account suggest **the upcoming administration may have limited choice but to return to the SBN market next year *(see Chart 1)***.
- Beyond international lenders, the incoming government's financing strategy will also hinge on expectations of higher tax revenue in 2025. **Total fiscal revenue is projected to rise by 6.94% to IDR 2,996.6 Tn, driven largely by a 12.28% increase in tax revenue.** Changes in the tax code, such as the VAT rate increase from 11% to 12% and the introduction of a new excise tax on sugary drinks, are expected to help push tax revenue closer to the government's target. However, mixed signals on cigarette excise—especially with the government recognizing the threat posed by down-trading and the increased circulation of illegal cigarettes—suggest that the strategy of bringing higher tariffs may not be relied upon to meet the tax revenue target.

"The draft 2025 state budget appears to fail to address three things. First, how the government will hit its tax ratio target is yet to be specified… "

- Indeed, the incoming administration has repeatedly emphasised its objective to expand the tax base to generate sufficient tax revenue to fund its ambitious fiscal targets, rather than relying on higher tariffs or introducing new taxes. However, this mission to push Indonesia's tax ratio upwards seems to have taken a more gradual (if not a slow) start. The tax ratio is expected to increase from 9.82% in 2024 to the targeted 10.23% in 2025, meaning that tax revenue will need to grow logarithmically if the Prabowo-Gibran administration is still looking to hit its target of boosting the tax ratio to 23% by 2029. Fortunately, **the tail effect from the improving nominal GDP growth this year *(see Chart 2)***, as the higher nominal growth in 2024 (8.08% YoY projected in 2024, vs. 6.66% YoY in

2023) may translate to a higher tax revenue in 2025.

- Alas, it does not seem that the government's financing situation will drastically improve beyond 2025. **The incoming government has not yet unveiled its tax reform plan, and the reduced budget for the Ministry of Finance does not suggest any additional support for the ministry to develop further reforms.** Consequently, the lower Ministry of Finance budget also provides limited indications of the rumoured establishment of a separate state revenue institution, further casting a question mark on the incoming administration's plan to further optimise Indonesia's tax revenue potential.

Spending: A tighter grip on the purse

- On the other hand, the incoming government has given clearer signs regarding its fiscal spending plans. **A potpourri of purchasing power-enhancing programmes appears to be in the hearts of the incoming government's growth strategy**, leading to them seeking a quick and early implementation of the new programmes to hit its 5.2% YoY real GDP growth target ***(see Chart 3)***.

- These programmes are spread over multiple posts/ functions of the spending budget. For instance, expenses for public services are set to increase by 8.21% in 2025, signalling an increase in civil servant salaries that may translate positively to household consumption. The incoming government is also set to spend more on social protection (4.04% YoY), healthcare (5.44% YoY), and education expenses (24.33% YoY), with the latter containing the budget for the incoming administration's flagship free nutritious meals (MBG) programme.

- Various market commentators have pointed to the MBG program as the crux of their concerns, fearing a bloated budget required to accommodate what was initially seen as an inefficient programme. Whether the advertised 0.1% growth contribution from the program materialises will ultimately depend on how effectively the incoming administration executes it, but at the very least, the IDR 71 Tn allocated for the programme has reassured economic observers in Indonesia that the government is determined to launch the programme without breaking the budget.

"… second, the budget has not provided a clear signal of its commitment to support the IKN project…"

- Rumours had been spreading that the incoming government is looking to spend less on subsidies to give room to its other spending programmes. However, a quick review of the draft 2025 state budget should be enough to invalidate these rumours. For instance, spending on energy subsidies is set to increase by 6.07% YoY to IDR 204.5 Tn in 2025. IDR 2.0 Tn of the IDR 11.7 Tn increase in the spending on energy subsidies is earmarked to subsidised 3 kg LPG, dispelling widespread rumours about an ongoing deliberation to remove the subsidy. **While the subsidy budget is indeed declining in 2025, the IDR 4.7 Tn decrease in the subsidy budget is primarily driven by lower spending to subside the interest rate on the microlending programme**, which is to be expected given the projected lower demand for such loans in 2025.

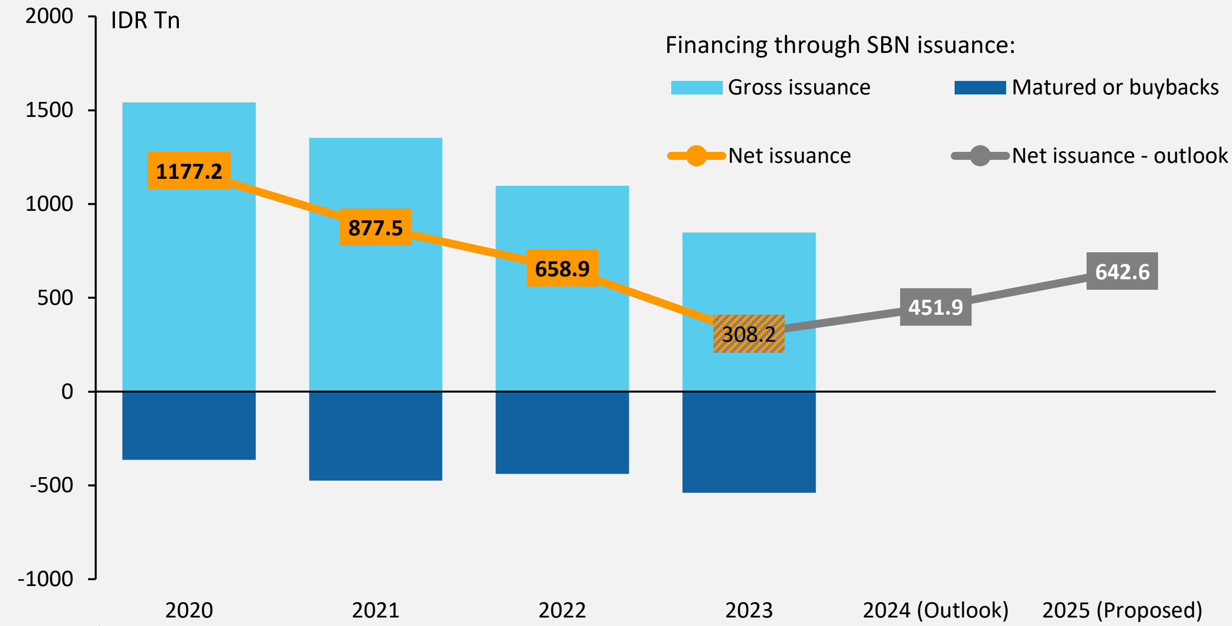
- **The incoming government, of course, are looking to keep inflation at around 2.50% YoY in 2025 (2.70% in 2024), making it imperative for them not to tamper with the subsidy budget.** With that being said, the draft 2025 energy subsidy budget does not leave substantial room to shield the government's finances from the vicissitudes of the global energy market, particularly against the increasingly volatile oil prices. **The spiking education spending (which is the biggest part of the mandatory spending) also leaves less space for the "other spending" account *(see Chart 4)***, which the current administration uses to compensate energy SOEs amidst flaring global energy prices.
- Adding to the concern of a budget overrun is the assumed oil price of USD 81/barrel in the draft 2025 state budget, which is only slightly above the current price range of USD 79-80/barrel. Fortunately, the weakening global growth prospects seem to downplay this fiscal risk. OPEC has recently revised its 2025 forecast for global oil demand downward, while record-high oil production in the US, combined with below-average production in Saudi Arabia and the UAE aimed at arresting prices from sliding down further, may keep oil prices relatively stable in the coming months.
- The incoming administration has pledged to continue its predecessor's infrastructure-building legacy, with the future of the Nusantara (new capital city/IKN) project remaining a key focus. However, the draft 2025 state budget, in its current form, does not clearly reflect this commitment. **Although infrastructure spending only faces a marginal drop of 5.45% YoY, the 43.73% YoY decline in the capital spending budget (-IDR 148.3 Tn) suggests a different narrative.** This significant reduction indicates that much of the so-called infrastructure budget may be allocated for other purposes, such as capital injections to infrastructure SOEs and transfers to regional governments. Adding to the problem is that the incoming government has not made it clear how much their commitment to the IKN project will weigh in Rupiah terms, which shall be communicated more clearly in the final form of the 2025 state budget.
- Another point to consider is the 18.52% reduction in the budget allocation for ministries and state institutions (K&L) in the upcoming fiscal year. **The incoming administration appears to be pushing for greater efficiency in K&L spending by imposing these cuts, while simultaneously trying to maintain flexibility and adaptability in its spending decisions *(see Chart 5)***. Indeed, it will be intriguing to observe how this fiscal strategy will measure against the "big tent" spirit of the new administration. The decision to maintain the fiscal deficit at a moderate 2.53% of GDP suggests that the draft 2025 state budget still has some room for expansion, thus, leaving the government both the time and space to go back to the negotiation table to hammer the provisional budget to its final form.

"…third, the lower K&L budget may go against the incoming government's big-tent spirit"

Chart 1

Back to the bond market, we go

The declining excess budget balance and higher use of international lending facilities in 2024 means that the upcoming government will need to issue more SBN despite the lower deficit.

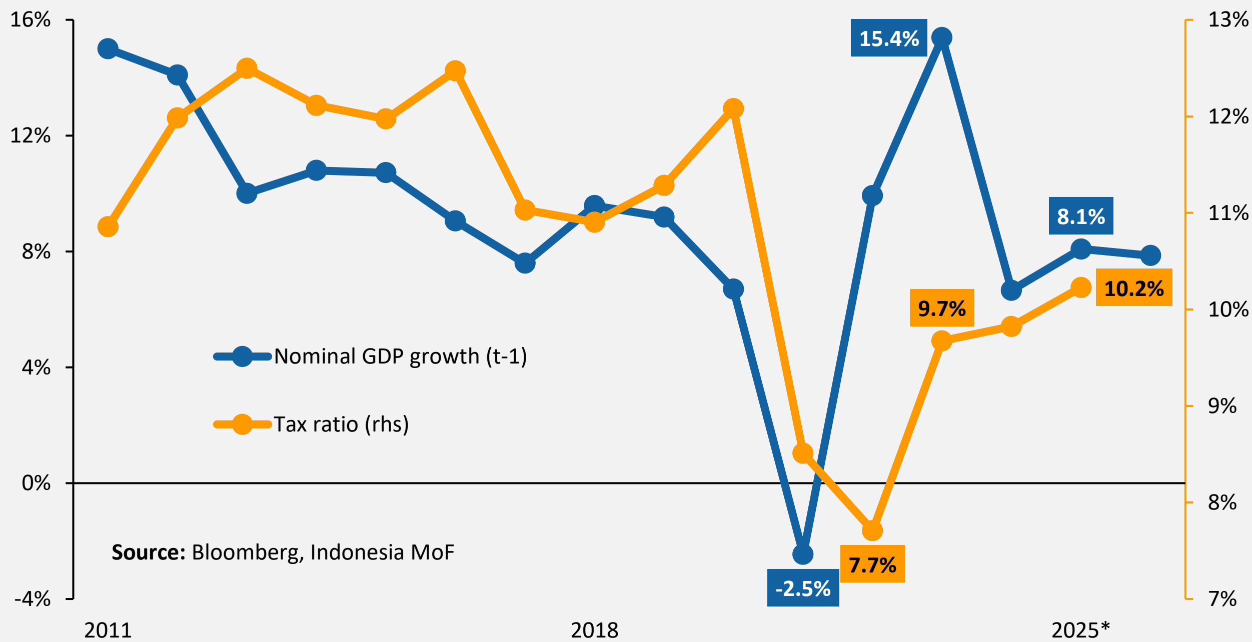


Source: Indonesia MoF

Chart 2

Some help from the past

The government's expectation of a sizable increase in its tax revenue in 2025 is not unreasonable, given the expected higher nominal GDP growth this year

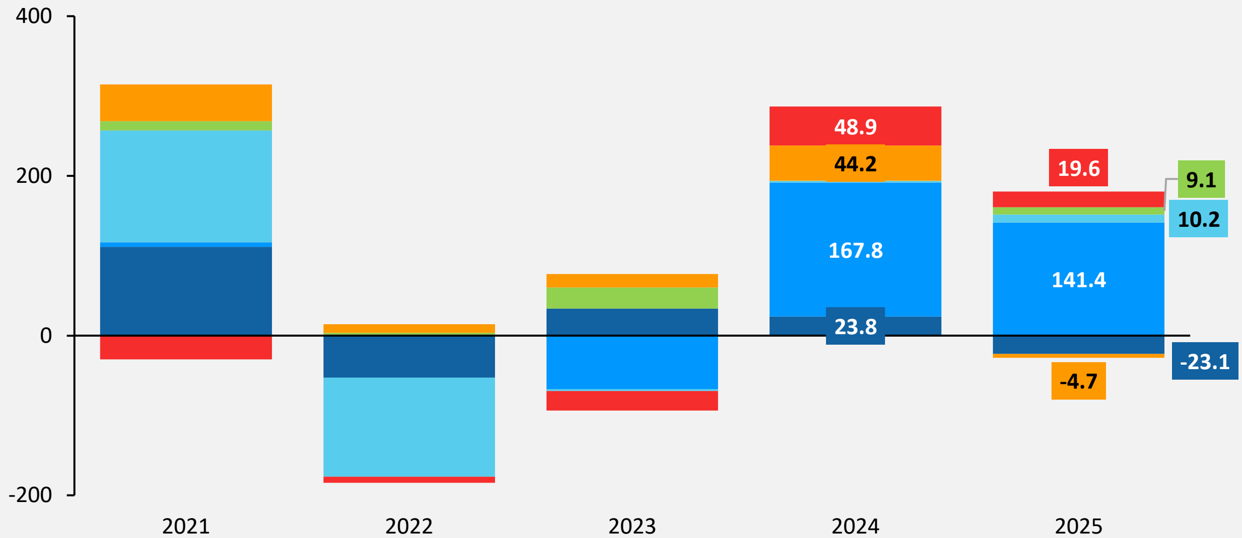


Source: Bloomberg, Indonesia MoF

Chart 3

Changing tactics

The upcoming government looks to hit its 5.2% growth target by spending more on high-multiplier social spending programmes, opting to scale back spending on infrastructures.



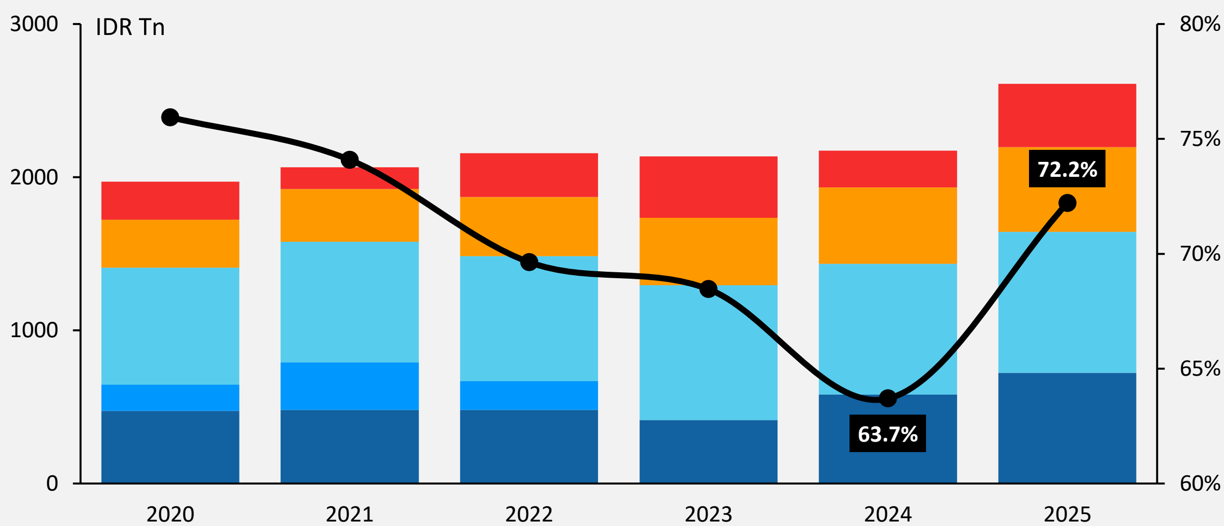
Annual changes in the spending budget on:

Source: Indonesia MoF

Chart 4

It is okay to be less flexible sometimes

The subdued demand condition in the global energy market in the upcoming periods may allow the forthcoming government to make do with a less flexible budget.



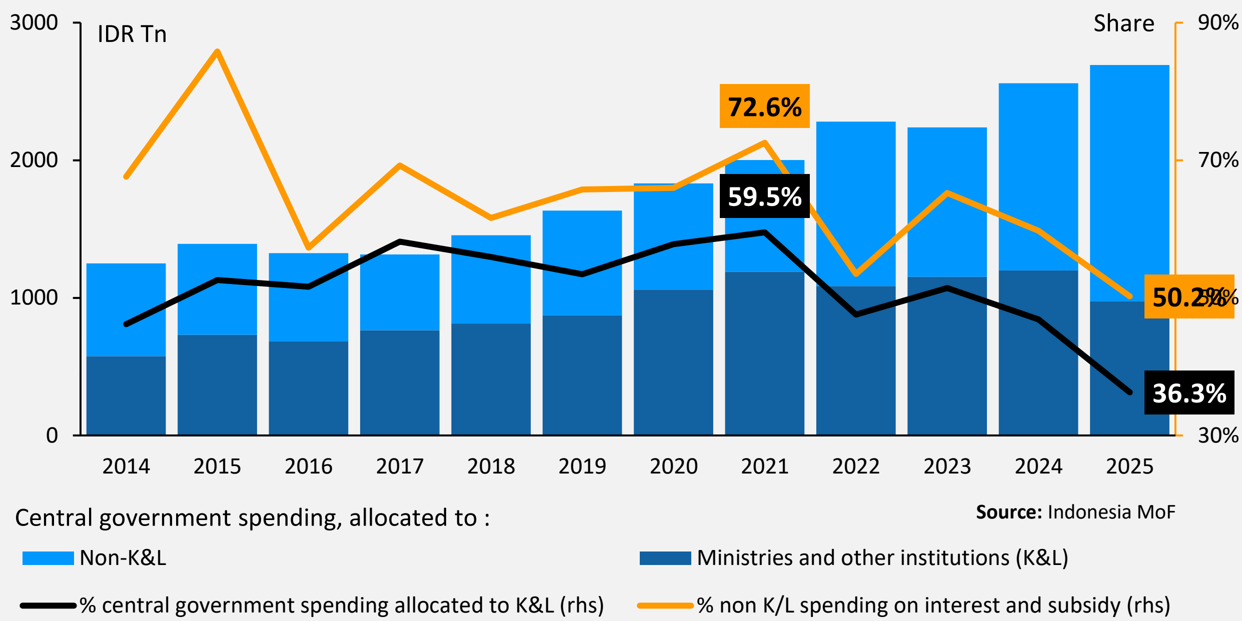
Mandatory spending, per component:

Source: Indonesia MoF

Chart 5

Tighter grip on the purse

Despite the generally inflexible budget, the executive branch of the government may still afford to be more tactical with its spending budget compared to other public institutions.



Source: Indonesia MoF

Macroeconomic assumptions

Budget Assumptions	2022		2023		2024	2025
	Budget	Realisation	Budget	Realisation	Outlook	Proposed
Growth (%, YoY)	5.2	5.3	5.1	5.05	5.1	5.2
Inflation (%, YoY)	3	5.5	3.1	2.61	2.7	2.5
Exchange Rate (IDR/USD)	14,350	14,871	15,100	14,800	16,000	16,100
10Y SBN Yield (%)	6.8	7	6.8	7.9	6.9	7.1
Indonesian Crude Price (USD/bl)	63	97	78	90	82	82
Crude oil lifting (Th bl/day)	703	612	614	660	592	600
Natural gas lifting (Th BoE/day)	1,036	954	985	1,100	990	1,005

State budget summary

Category (IDR Tn)	2022		2023		2024	2025
	Budget	Realisation	Budget	Realisation	Outlook	Proposed
Total Revenue	1,864.1	2,635.8	2,637.3	2,783.9	2,802.5	2,996.9
Tax revenue	1,510.0	2,034.6	2,118.4	2,154.2	2,218.4	2,490.9
Non-tax revenue	335.6	595.6	515.8	612.5	549.1	505.4
Total spending	2,714.2	3,096.3	3,123.7	3,121.2	3,412.2	3,613.1
Budget deficit (% GDP)	-4.85	-2.35	-2.30	-1.65	-2.70	-2.53

Economic Calendar

		Actual	Previous	Forecast*
1 August 2024				
ID	**CPI Inflation YoY, %**	**2.13**	**2.51**	**2.17**
US	**FOMC meeting, %**	**5.5**	**5.5**	**5.5**
UK	BoE meeting, %	5.00	5.25	5.00
02 August 2024				
US	Non Farm Payrolls	114	179	4.1
US	Unemployment Rate, %	4.3	4.1	4.1
05 August 2024				
ID	**GDP Growth Rate, %**	**5.05**	**5.11**	**4.5**
06 August 2024				
US	Balance of Trade, USD Bn	-73.1	-75.1	-72
07 August 2024				
ID	**Foreign Exchange Reserves, Bn**	**145.4**	**140.2**	**-**
08 August 2024				
ID	Consumer Confidence	123.4	123.3	122
09 August 2024				
CN	Inflation Rate YoY, %	0.5	0.2	0.3
ID	Retail Sales YoY, %	2.7	2.1	1.7
15 August 2024				
ID	**Balance of Trade, Bn**	**0.47**	**2.39**	**2.2**
CN	Retail Sales YoY, %	2.7	2.0	3.0
16 August 2024				
ID	**2025 RAPBN announcement**			
21 August 2024				
ID	**Interest Rate Decision, %**		**6.25**	**6.25**
22 August 2024				
US	FOMC Minutes			
ID	**Q2-2024 Balance of Payment, USD Bn**		**-2.2**	**-0.97**
27 August 2024				
US	S&P/Case-Shiller Home Price, YoY %		6.8	6.5
30 August 2024				
US	PCE Price Index, YoY %		2.5	2.5

*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 (%)
US	5.50	Jul-23	2.60
UK	5.00	Aug-23	2.80
EU	4.25	Jul-23	1.65
Japan	-0.10	Jan-16	-2.90
China (lending)	2.30	Aug-23	3.85
Korea	3.50	Jan-23	0.90
India	6.50	Feb-23	2.96
Indonesia	6.25	Apr-24	4.12

Money Mkt Rates	16-Aug	-1 mth	Chg (bps)
SPN (3M)	6.47	6.56	-8.2
SUN (10Y)	6.71	6.94	-23.7
INDONIA (O/N, Rp)	6.15	6.15	-0.8
JIBOR 1M (Rp)	6.90	6.90	-0.1

Bank Rates (Rp)	May	Apr	Chg (bps)
Lending (WC)	8.86	8.85	1.37
Deposit 1M	4.68	4.65	2.54
Savings	0.67	0.68	-1.07

Currency/USD	16-Aug	-1 mth	Chg (%)
UK Pound	0.773	0.771	-0.23
Euro	0.907	0.918	1.17
Japanese Yen	147.6	158.4	7.26
Chinese RMB	7.159	7.269	1.53
Indonesia Rupiah	15,690	16,180	3.12

Capital Mkt	16-Aug	-1 mth	Chg (%)
JCI	7,432.1	7,224.3	2.88
DJIA	40,659.8	40,954.5	-0.72
FTSE	8,311.4	8,164.9	1.79
Nikkei 225	38,062.7	41,275.1	-7.78
Hang Seng	17,430.2	17,728.0	-1.68

Foreign portfolio ownership (Rp Tn)	Jul	Jun	Chg (Rp Tn)
Stock	3,322.0	3,273.1	48.98
Govt. Bond	813.1	808.1	4.97
Corp. Bond	7.6	8.2	-0.60

Trade & Commodities	16-Aug	-1 mth	Chg (%)
Baltic Dry Index	1,691.0	1,942.0	-12.9
S&P GSCI Index	540.1	564.2	-4.3
Oil (Brent, $/brl)	79.7	83.7	-4.8
Coal ($/MT)	150.5	140.7	7.0
Gas ($/MMBtu)	2.12	2.10	1.1
Gold ($/oz.)	2,508.0	2,469.1	1.6
Copper ($/MT)	9,006.3	9,505.3	-5.3
Nickel ($/MT)	16,130.2	16,304.4	-1.1
CPO ($/MT)	874.6	852.3	2.6
Rubber ($/kg)	1.76	1.64	7.3

External Sector	Jul	Jun	Chg (%)
Export ($ bn)	22.21	20.85	6.55
Import ($ bn)	21.74	18.45	17.82
Trade bal. ($ bn)	0.47	2.39	-80.29
Central bank reserves ($ bn)*	145.4	140.2	3.74

Prompt Indicators	Jul	Jun	Apr
Consumer confidence index (CCI)	123.4	123.3	127.7
Car sales (%YoY)	-7.9	-11.8	-17.4
Motorcycle sales (%YoY)	26.0	3.5	18.3

Manufacturing PMI	Jul	Jun	Chg (bps)
USA	49.6	51.6	-200
Eurozone	45.8	45.8	0
Japan	49.1	50.0	-90
China	49.8	51.8	-200
Korea	51.4	52.0	-60
Indonesia	49.3	50.7	-140

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

	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$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	2.87
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00
USD/IDR Exchange Rate (end of the year)**	13,866	14,050	14,262	15,568	15,397	16,172
Trade Balance (US$ 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

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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