

Infrastructure-driven budgetary twists and turns

17 September 2024

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Summary

- The government has agreed to increase the central budget for infrastructure spending. However, aside from the IKN project, central government expenditure on other infrastructure programs is still expected to decline substantially in 2025.
- Recent revisions to the central government's infrastructure budget may raise speculation that the 2025 budget deficit could be larger than previously announced.
- Although effective in increasing the share of capital expenditure budgets at the regional level, the government's strategy to delegate infrastructure spending to regional governments may not substantially improve the contribution of fixed-asset investments to GDP growth in the upcoming period.

- There are two burning questions now engulfing the Indonesian economy and its financial market. The first one is the upcoming Fed and BI policy meetings later this week, which seem odds-on to herald the start of a monetary policy easing cycle in the US, and possibly, in Indonesia.
- Meanwhile, the market continues to woo the Fed into taking a more aggressive rate-cut action. Despite the ongoing Fed blackout, the market has spent the past two days betting on a 50 bps FFR cut in the upcoming FOMC meeting, emboldened by the cooling US labour market and plummeting global oil prices. The FFR futures market is now pointing to a total of 125 bps in rate cuts for 2024, a demand that FOMC members may address by updating their quarterly summary of economic projections.
- This favourable global sentiment has translated positively to the Indonesian financial market. Foreign investors continue to cast their vote of confidence for the domestic financial market, especially the stock market which recorded USD 0.16 Bn worth of net foreign purchases throughout the past week. The Rupiah also comes increasingly closer to erasing its YTD losses (-0.02% YTD now, -6.84% YTD trough), thanks to the robust capital inflows and the 0.90% depreciation in the USD value (DXY index) throughout the past week.
- It is not surprising, then, that some analysts have begun calling for Bank Indonesia to start cutting the BI rate at this week's meeting. Despite the governor's earlier comment that the central bank may look to cut the policy rate by Q4-2024, the strengthening Rupiah and deflation (in MoM terms) in the last four

months have led the market to push BI to be more pragmatic and seize the chance to cut the policy rate faster and deeper. However,

uncertainty remains within the Indonesian economy, which leads us to the second burning question.

Infrastructure spending: Uncertainty in three acts

- The second question that now dominates the discussion on the Indonesian economy, of course, is the government’s programme and the state of their financing amid the transition period. As we noted in an earlier [report](#), the draft 2025 state budget announced last month may undergo some material changes before being passed into law next October, thus indicating that some in the market may currently be under-pricing the risk of a more expansive fiscal posture in 2025.

- Indeed, **several changes to the draft 2025 state budget have been reported**, including an additional IDR 40.59 Tn for the Ministry of Public Works and Public Housing (PUPR), of which IDR 9.11 Tn is earmarked for the IKN project. Meanwhile, the budget for the Nusantara Capital City Authority (OIKN) has also increased from IDR 505.5 Bn to IDR 27.8 Tn, bringing the total spending for the IKN project to an estimated IDR 35.8-39.9 Tn in 2025.

“Despite the increased IKN budget, government spending on other infrastructure programmes remains likely to suffer from a substantial decline”

- However, **despite recent adjustments, the upcoming central government’s overall willingness to spend on infrastructure may remain relatively modest compared to the incumbent (see Chart 1)**. Despite the seemingly minimal decline in the budget for the IKN project, government funding for other infrastructure programmes is expected to suffer double-digit reductions, even when

accounting for the remaining portion of the additional IDR 40.59 Tn PUPR budget not earmarked for the IKN project.

- **The uncertainties, then, are two-fold.** First, it remains uncertain whether the increase in the central government’s infrastructure budget comes from the reallocation of other budgets (such as the ballooning budget for other spending in 2025) or an increase in the budget deficit beyond the announced 2.53% of GDP. Second, despite the reported increase in the

PUPR and OIKN budgets, it remains uncertain whether government-sponsored infra-structure projects will continue to provide enough boost for the real GDP growth number through fixed-asset investments.

- The government has frequently relied on SOEs to invest in or secure financing for government-sponsored infrastructure projects. However, it remains to be seen whether this pattern will continue, given the minimal changes in the proposed 2025 SOE & public service agency (BLU) financing budget. **The uncertainty regarding the economic impact of fiscal-driven infrastructure spending is further compounded by the material decline in the budget for infrastructure projects with seemingly better ICOR or more substantial spillover effects**, such as spending on telecommunication infrastructure, water-works, or public housing.

- However, the 2025 infrastructure budget seems to be constructed by the assumption that regional governments may be more suitable to deliver on such an infrastructure programme (see Chart 2). Indeed, the wide gap between the announced infrastructure budget (IDR 400.3 Tn) and capital spending by the central government (IDR 190.6 Tn, as announced on 16 August 2024) suggests that much of the infrastructure spending will be delegated to regional governments, thus potentially allow regional governments to better identify and address their infrastructure gaps while also retaining more of the spillover effect within the investing region (assuming that more projects may be carried out by local suppliers and construction companies rather than SOEs).
- While recent data shows that this delegate-and-spend strategy appears to be effective in supporting infrastructure spending at the regional level (see Chart 3), it remains to be seen whether increased infrastructure spending by regional governments will be significant enough to make an impact on the national level. Except for a few provinces, **capital expenditure budgets in most provinces are too small to begin with**, meaning that regional governments may still require outside support (from private companies or the central government) to undertake large-scale infrastructure projects. Furthermore, multiple cases have also shown the risks of provincial governments embarking on projects that are too ambitious for their

“While higher transfers seem to be effective to boost capital spending by regional governments, such spending may be less effective compared to spending by the central government”

resources, illustrating the potential for stalled projects or overall low-impact vanity spending if the central government continues to empower provincial governments to spend their infrastructure budgets with minimal oversight.

- After the central and regional governments, the third avenue for fiscal-driven infrastructure spending is through the allocation of village funds. Although the budget for village funds has remained relatively unchanged (IDR 71.0 Tn proposed for 2025, +0.2% YoY), this does not imply that the allocation will have a negligible impact on the economy, especially at the local and provincial levels. Provinces receiving a larger share of these funds have experienced relatively muted construction cost inflation in recent periods (see Chart 4), indicating that the allocated village funds should be sufficient to maintain the pace of infrastructure development at the village level to the same level as in the previous fiscal year.
- Alas, the concern here is largely similar to that of infrastructure spending at the regional government level: infrastructure spending at the village level may not be significant enough to influence the real GDP growth number, while the quality of spending and lack of supervision is also a recurring issue.
- Our review of the three avenues for fiscal-driven infrastructure spending suggests a largely uniform conclusion. **Fixed-asset investments may not offer substantial support (above the current level) to GDP**

growth in the upcoming year, nor are spillover effects from infrastructure spending likely to significantly boost the economy. Furthermore, the sizable increase in the central government's infrastructure spending budget may lead investors to brace for a potential rise in the 2025 fiscal deficit beyond the current 2.53% projections. This concern is

compounded by the fact that the budgets for new governmental agencies (such as the National Nutrition Agency, the Climate Change Management and Carbon Trading Agency, and at least two others) are yet to be allocated. As before, the 2025 state budget is still in the casting mould, and uncertainties may remain until the hammer falls next October.

Chart 1

Lower number in between the lines

The IDR n Tn decrease in the headline infrastructure budget may not fully reflect the central government's lower commitment to infrastructure spending.

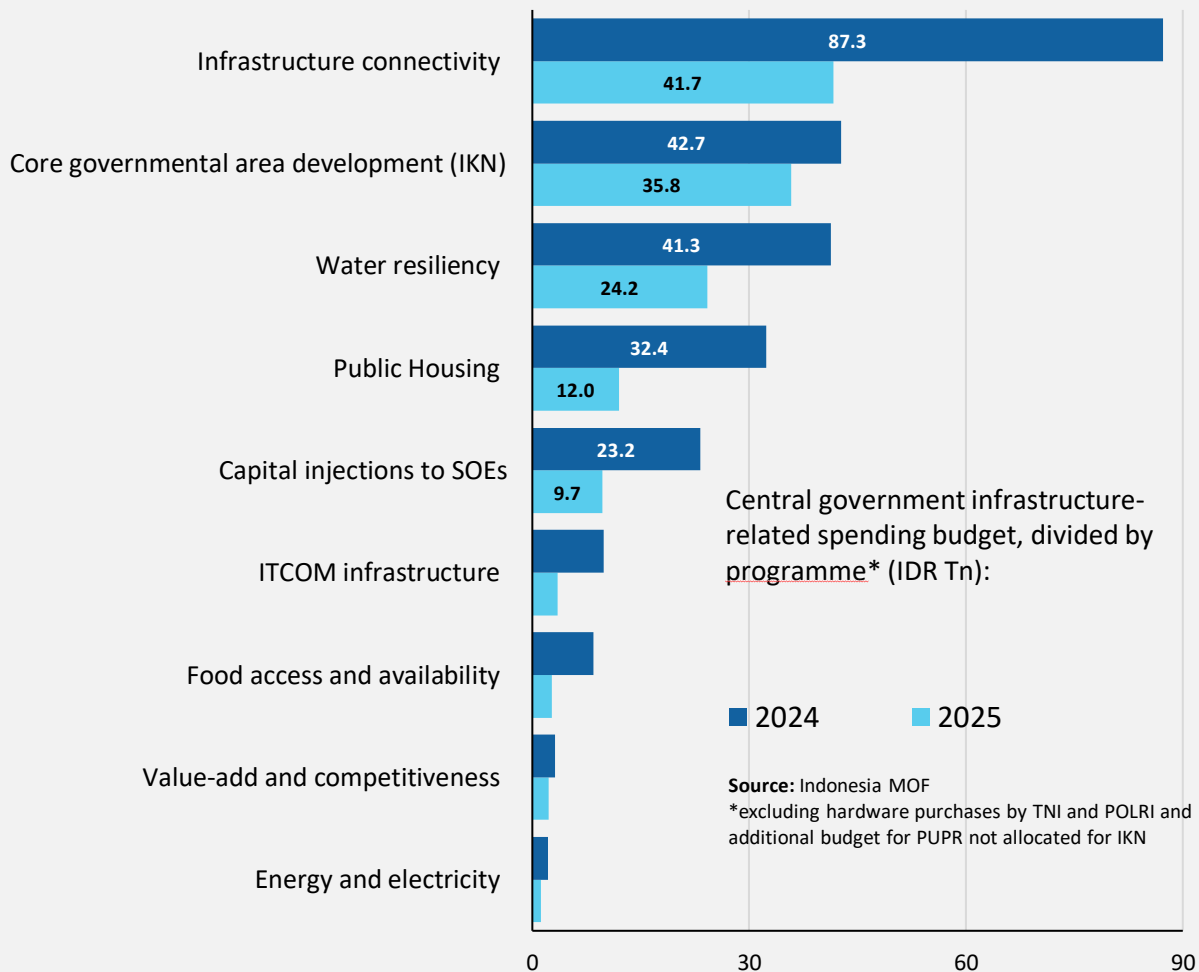


Chart 2

State rules

The wide gap between the total infrastructure budget and central government capital spending indicates that much of infrastructure investments will be carried out by regional governments.

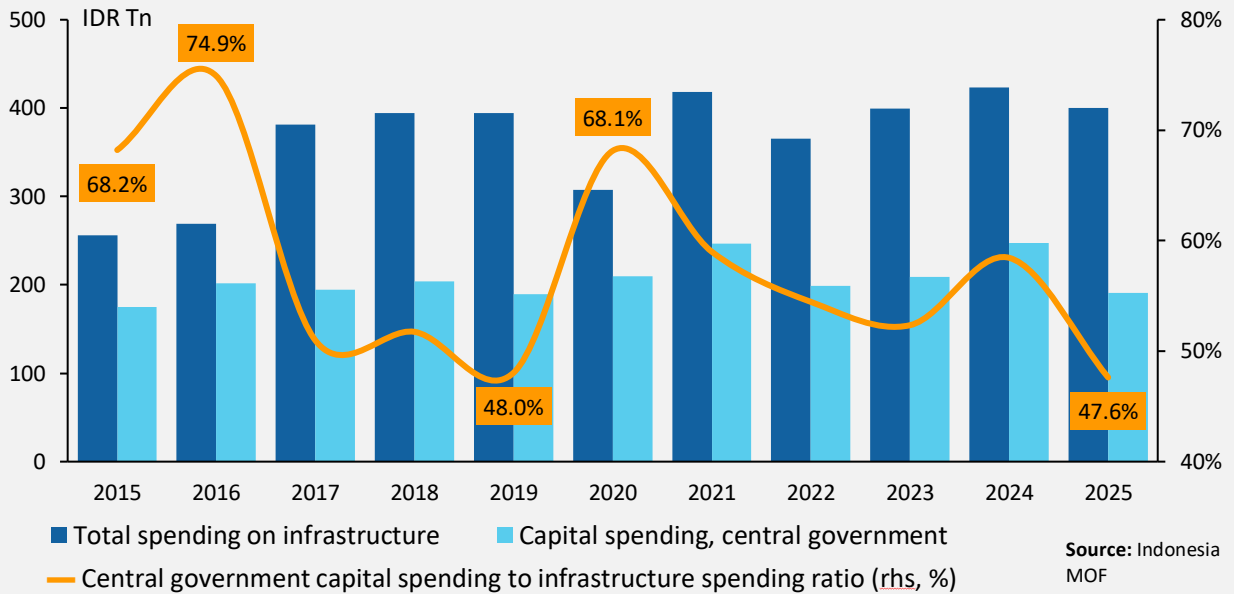
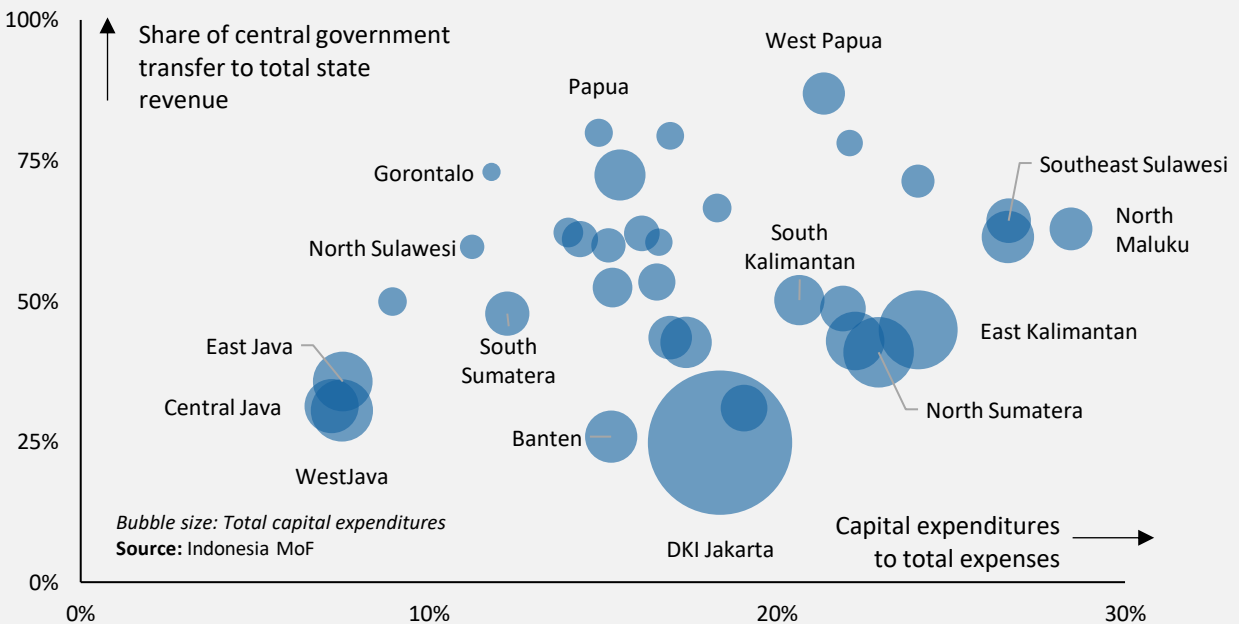


Chart 3

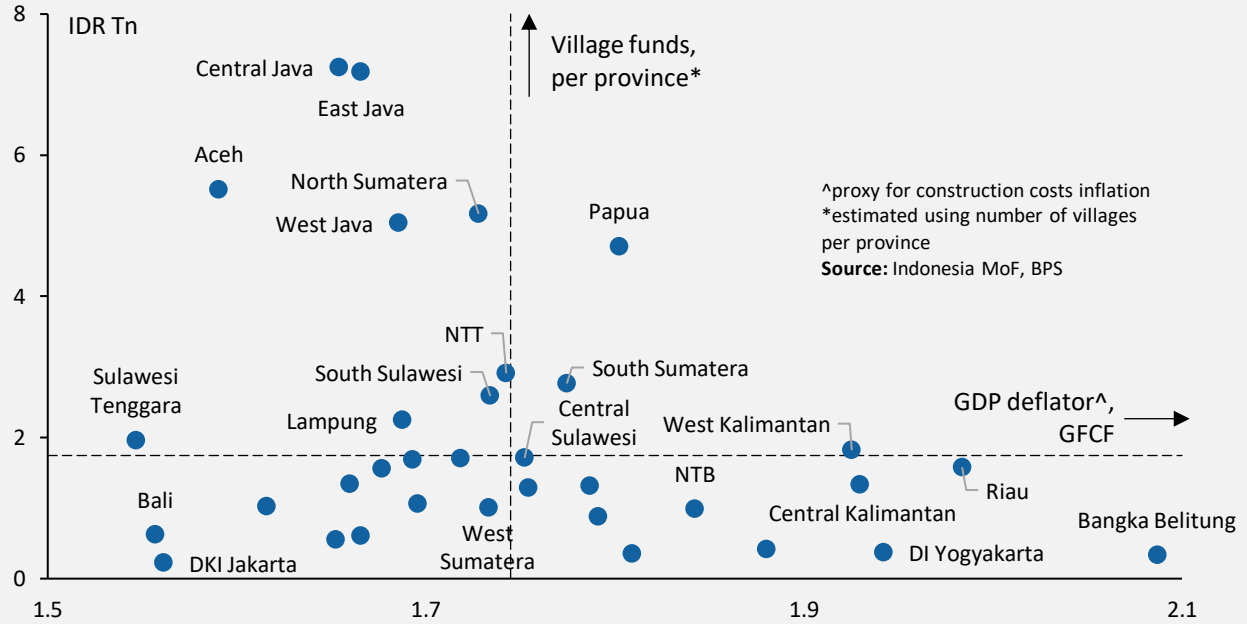
Following those who pays

Provinces that rely more on transfers from the central government seems to be more reliable in supporting the government’s infrastructure agenda



Business as usual

Despite its meagre increases, village funds may remain significant to boost basic infrastructure investments as construction costs in more populous regions remain muted



Economic Calendar				
		Actual	Previous	Forecast*
02 September 2024				
ID	CPI Inflation YoY, %	2.12	2.13	2.30
ID	S&P Global Manufacturing PMI	48.9	49.3	49
03 September 2024				
US	S&P Global Manufacturing PMI	47.9	49.6	4.8
04 September 2024				
US	Balance Of Trade, Bn	-78.8	-73	-78.5
US	Redbook YoY (%)	6.3	5	-
US	JOLTs Job Openings, Mn	7.673	7.91	8.09
US	JOLTs Job Quits, Mn	3.277	3.214	3.1
05 September 2024				
EU	Retail Sales YoY, %	-0.1	-0.4	-0.1
06 September 2024				
ID	Foreign Exchange Reserves, USD Bn	150.2	145.4	-
US	Non Farm Payrolls, K	142	89	120
09 September 2024				
CN	Inflation Rate YoY, %	0.6	0.5	0.5
ID	Motorbike Sales YoY, %	7.4	26	-
ID	Car Sales YoY, %	-14.2	-7.8	-
10 September 2024				
ID	Retail Sales YoY, %	4.5	2.7	3.0
11 September 2024				
US	Inflation Rate YoY, %	2.5	2.9	2.7
14 September 2024				
CN	Retail Sales YoY, %	2.1	2.7	2.5
17 September 2024				
ID	Balance of Trade, USD Bn	2.89	0.50	1.3
18 September 2024				
ID	Interest Rate Decision, %		6.25	6.25
19 September 2024				
US	Fed Interest Rate Decision, %		5.5	5.25
23 September 2024				
ID	M2 Money Supply YoY, %		7.4	

*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	13-Sep	-1 mth	Chg (%)
US	5.50	Jul-23	3.00	Baltic Dry Index	1,890.0	1,670.0	13.2
UK	5.00	Aug-23	2.80	S&P GSCI Index	519.1	544.4	-4.6
EU	3.65	Jul-23	1.45	Oil (Brent, \$/brl)	71.6	80.7	-11.3
Japan	-0.10	Jan-16	-2.90	Coal (\$/MT)	134.6	151.1	-10.9
China (lending)	2.30	Aug-23	3.75	Gas (\$/MMBtu)	2.25	2.16	4.2
Korea	3.50	Jan-23	1.50	Gold (\$/oz.)	2,577.7	2,465.2	4.6
India	6.50	Feb-23	2.85	Copper (\$/MT)	9,189.2	8,847.4	3.9
Indonesia	6.25	Jul-24	4.13	Nickel (\$/MT)	15,709.7	16,060.3	-2.2
				CPO (\$/MT)	928.8	869.5	6.8
				Rubber (\$/kg)	1.89	1.76	7.4
Money Mkt Rates	13-Sep	-1 mth	Chg (bps)	External Sector	Aug	Jul	Chg (%)
SPN (3M)	6.43	6.45	-1.9	Export (\$ bn)	23.56	22.24	5.97
SUN (10Y)	6.56	6.77	-20.7	Import (\$ bn)	20.67	21.74	-4.93
INDONIA (O/N, Rp)	6.34	6.30	3.6	Trade bal. (\$ bn)	2.90	0.50	478.90
JIBOR 1M (Rp)	6.90	6.90	0.5	Central bank reserves (\$ bn)*	150.2	145.4	3.32
Bank Rates (Rp)	Jun	May	Chg (bps)	Prompt Indicators	Aug	Jul	Jun
Lending (WC)	8.82	8.86	-3.79	Consumer confidence index (CCI)	124.4	123.4	123.3
Deposit 1M	4.70	4.68	2.60	Car sales (%YoY)	-14.2	-7.8	-9.7
Savings	0.67	0.67	0.02	Motorcycle sales (%YoY)	7.4	24.1	3.5
Currency/USD	13-Sep	-1 mth	Chg (%)	Manufacturing PMI	Aug	Jul	Chg (bps)
UK Pound	0.762	0.777	2.04	USA	47.9	49.6	-170
Euro	0.903	0.910	0.75	Eurozone	45.8	45.8	0
Japanese Yen	140.9	146.8	4.25	Japan	49.8	49.1	70
Chinese RMB	7.097	7.155	0.81	China	50.4	49.8	60
Indonesia Rupiah	15,400	15,833	2.81	Korea	51.9	51.4	50
				Indonesia	48.9	49.3	-40
Capital Mkt	13-Sep	-1 mth	Chg (%)				
JCI	7,812.1	7,356.6	6.19				
DJIA	41,393.8	39,765.6	4.09				
FTSE	8,273.1	8,235.2	0.46				
Nikkei 225	36,581.8	36,232.5	0.96				
Hang Seng	17,369.1	17,174.1	1.14				
Foreign portfolio ownership (Rp Tn)	Aug	Jul	Chg (Rp Tn)				
Stock	3,322.0	3,322.0	0.00				
Govt. Bond	852.3	813.1	39.24				
Corp. Bond	7.0	7.6	-0.62				

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	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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