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MacroInsight

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Macroeconomics Indicator

	2019	2020F
GDP growth (%YoY)	5.04	2.45
Inflation (%YoY)	2.72	1.80
BI rate (% Year-end)	5.00	4.00
Rp/US$ (Year-end)	14,155	15,500
CA balance (% of GDP)	2.82	2.51
Fiscal balance (% of GDP)	2.21	5.07

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Details on the burden sharing scheme

- BI and MoF have come to an agreement on the burden sharing scheme for state budget 2020. BI will bear 54.8% of total cost of financing.
- The special rate bond will be a one-off exception. Both parties emphasize the importance of guarding the market mechanism.
- The agreed scheme shall bring positive sentiment to economic activity without creating unnecessary disturbance in both inflation and currency.

Newly agreed financing scheme

The newly agreed financing scheme for the increased fiscal deficit to 6.34% of GDP will consist of two major categories, which are: (i) public goods and (ii) non-public goods totalling at Rp903.46tr. The 0% interest bonds will be designated for the public goods spending financing (Rp397tr), while in the non-public goods (Rp505tr) the financing rate (for MoF side) will be either BI policy rate minus 1% (3.25% - burden sharing) or the market rate (for Rp329tr other spending which shall be fully borne by the government). Without the special rate bonds, the cost of fund for fighting the pandemic is roughly at Rp66.5tr, while with the agreed scheme the cost of fund will be at roughly Rp30.6tr or around 46% lower.

Exit policy and the importance of guarding the market mechanism

Bank Indonesia (BI) and Ministry of Finance (MoF) were emphasising on the importance of guarding the global community trust on Indonesia'. Thus, the issuance of the so-called special rate bond will only happen this year and it will be a one time-off issuance. On the exit policy, the official medium-term state budget plan already addresses the gradual decline of fiscal deficit starting from FY 2021 at 3.21% - 4.17% of GDP, until FY 2024 at below 3% of GDP.

Positive impact to economic activity

The share of financing cost between BI and MoF is constructive and will have positive impact to the economic activity. In terms of money supply, the additional Rp903.45tr is equal to 13.8% of M2, while the Rp397.6tr public goods (the part that is fully borne by BI) spending is equal to 6.1% of M2 which shall be manageable to both inflation and exchange rate. In terms of debt servicing, the burden sharing will save MoF interest expense allocation to roughly 17% of total spending from around 20% without the sharing. With the assumption of 90% realization of the plan, our internal simulation suggests an addition of 0.5% to the yearly inflation number and a depreciation of Rp143 – Rp179 per US$, *ceteris paribus*.

Fig. 1: Summary of state financing sharing scheme

Additional financing needs	Rp903.46tr	Interest rate	Cost share
Public Goods	**Rp397.60tr**		
Health	Rp87.55tr	BI 7d RRR	BI 100%. MoF 0%
Social Aid	Rp203.90tr		
Sector, Gov't agencies, Municipals	Rp106.11tr		
Non-Public Goods	**Rp505.86tr**		
MSME	Rp123.46tr	Market rate	**BI 4.06%** (market rate - BI 7d RRR - 1%), **MoF 3.3%** (BI 7d RRR -1%)
Non-MSME Corporation	Rp 53.37tr	Market rate	
Other	Rp329.03tr	Market rate	100% government

Assumption: BI 7d RRR : 4.30%, Market rate: 7.36%

Source: MoF, BI, Various, Indo Premier

Exit policy in the medium-term

The global nation trust is imperative for Indonesia's source of financing development. Thus, the exit policy from the extraordinary financing measures during pandemic is essential to guard the trust. Over the medium term, the current government's stance is to bring the fiscal deficit to be below 3% over the next 2-3 years. This will hopefully help to preserve fiscal sustainability and eventually global nation's trusts.

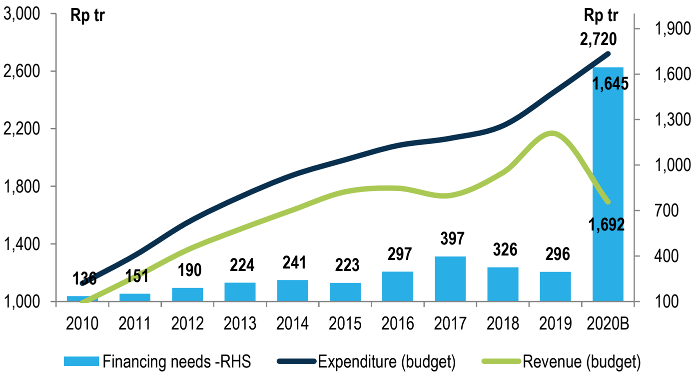
Fig. 2: Fiscal deficit will be below 3% over the next 2 – 3 years

Item	2021 figure	Medium Framework		
		2022	2023	2024
Revenue and Grant	9.90 - 11.00	10.32 - 11.30	10.53 - 11.69	10.84 - 12.15
Tax Revenue	8.25 - 8.63	8.27 - 8.70	8.38 - 9.09	8.59 - 9.55
Tax Ratio	9.30 - 9.68	9.32 - 9.75	9.43 - 10.14	9.64 - 10.60
Expenditure	13.11 - 15.17	13.11 - 14.85	12.88 - 14.41	13.03 - 14.66
Primary Balance	(1.24) - (2.07)	(0.94) - (1.70)	(0.49) - (0.87)	(0.34) - (0.66)
Surplus/(Deficit)	(3.21) - (4.17)	(2.79) - (3.55)	(2.35) - (2.72)	(2.19) - (2.51)
Debt Ratio	36.67 - 37.97	36.65 - 37.39	36.45 - 37.36	36.08 - 37.18

Source: MoF, Indo Premier

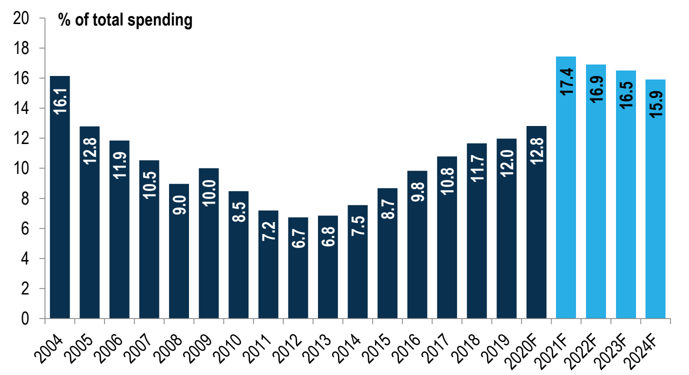
Under the new scheme, the budget allocation for debt servicing may increase at a quite steep rate from around 13% of total spending currently to around 17.4% of total spending next year. However, this is quite manageable in our view as alternatively without the sharing scheme, it could hover to around 25% of total spending. Higher allocation for debt servicing could eliminate the fiscal space to other development agendas.

Fig. 3: Financing needs under the 6.34% of GDP fiscal deficit



Source: MoF, Indo Premier

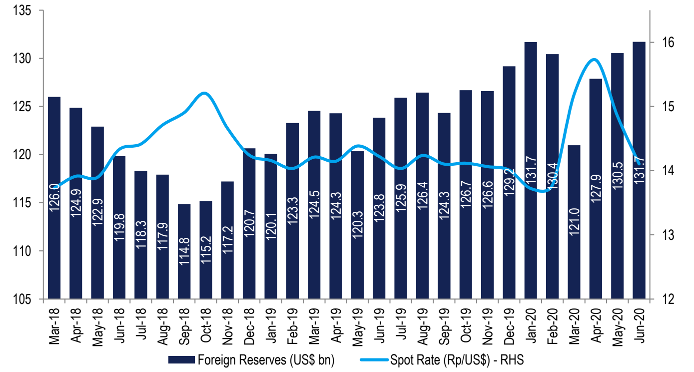
Fig. 4: Debt servicing will increase over the next 4 – 5 years



Source: MoF, Indo Premier

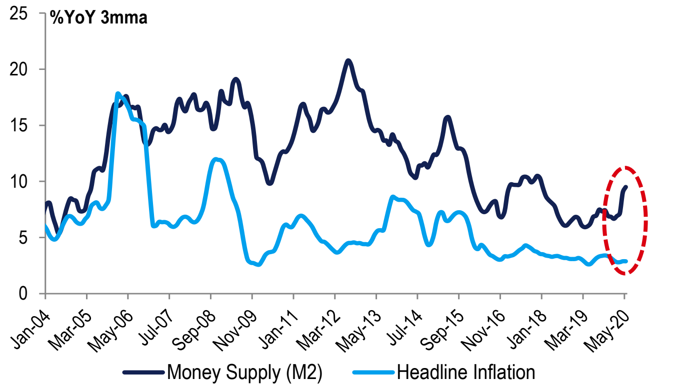
With the assumption of 90% realization of the additional financing plan, our internal simulation suggests an addition of 0.5% to the yearly inflation number and a depreciation of Rp143 – Rp179 per US$, *ceteris paribus*. On the inflation number, the increase in money supply may impact fresh demand from private sector towards housing, transportation, energy, etc. whilst from the currency point of view, the increase in money supply may impact to higher Rupiah availability that could cause lower rupiah value (depreciation).

Fig. 5: Impact to exchange rate at around Rp143 – Rp179 per US$



Sources: BI, Bloomberg, Indo Premier

Fig. 6: Impact to yearly headline inflation additional of around 0.5%



Source: BI, BPS, Indo Premier

We are on the view that it would be very premature to have clear sight on what is going to happen in 2021, since the outlook in 2020 may still swing to an uncharted territory. However, we see that the government macroeconomic framework is broadly reasonable. We also look forward to the creative financing execution, as it will be crucial to bring back the development agendas. Over the medium-term, we must underline that the high fiscal deficit is only a temporary solution. Soon, there should be a tighter measure for the fiscal deficit or else a solvency problem may arise, as tax revenue will mathematically be lower under the new omnibus law.

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