

Indonesia Economic Briefing

Restoring Confidence to Fiscal Policy



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Please see the important disclaimer and information on the back of this report.

Macroeconomic Assumption	2015 Actual	2016 Revised Budget	2017 Budget
Economic growth (%)	4.79	5.20	5.10
Exchange Rate (IDR/USD)	13,392	13,500	13,300
Inflation (%)	3.35	4.00	4.00
3-Month T-Bills (%)	6.00	5.50	5.30
ICP (USD/barel)	49	40	45
Oil Lifting (Thousand bpd)	778	820	815
Gas Lifting (Thousand bpd)	1,195	1,150	1,150

Economic Highlights

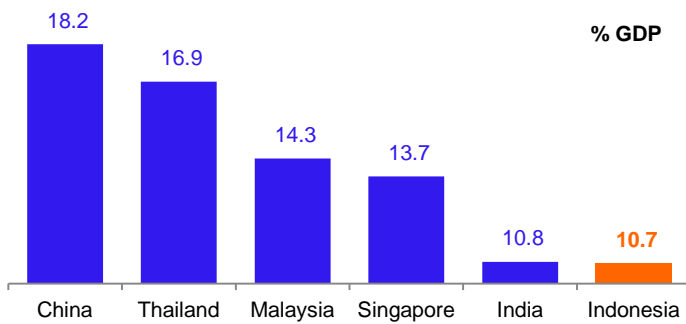
- Mid last week, the 2017 government budget has been approved by parliament. Revenue and spending figures are higher than what the MoF initially proposed but lower compared to 2016 target. It appears to reflect a more **conservative stance in navigating through longer than expected global uncertainty as they aim to restore confidence towards fiscal policy**.
- **Key points that have shown several shifts in budget management** include: 1) a notion of “spend on what we have” as the posture hinges on revenue. This is opposed to previous budgets where expenditure needs would drive how much revenue to collect and how much financing to raise, 2) diverging infrastructure commitments from State Owned Enterprises (SOEs) to regional governments, and 3) tighter financing strategy with a focus on primary deficit.
- On tax revenue, the government is targeting 13.5% yoy growth. If we calculate the natural growth rate of tax at around 9.0% (from the sum of 2017 GDP and inflation), then extra effort programs are expected to contribute by merely 4.5%. This is much lower than the last 2 budgets, whereby extra effort portion accounted for an average of 18.0% (e.g. from tax amnesty proceeds). **Our calculation also indicates that the aim is for 10.8% tax ratio vs 10.7% in 2015**, mostly by means of optimizing third party data.
- Infrastructure spending through SOEs was written off as **the MoF opted to enhance regional participation**, stating that “regencies must be given trust first, so that they are encouraged to boost competencies”. Part of the ongoing decentralization program, rural fund has been given a total of IDR 60tn in 2017, up by IDR 13tn compared to a year earlier. We believe this would help to minimize inequality in the Eastern region of Indonesia –i.e. Sulawesi, Maluku, and Papua-, as the growth of rural areas have outpaced the western region this past decade.
- Furthermore, an earmark program for regional transfer next year is the **25% requirement of general allocation fund to be utilized for infrastructure**. We think it would help to increase cross-governmental check on spending quality. But the central government is also aware that each region has its own timing and pace when it comes to infrastructure needs, thus restraining from an over excessive push.
- **Managing primary deficit**. Since 2012, Indonesia has been on a primary deficit, which means it has raised fund to cover its principal debt payment. In GDP term, primary deficit has doubled from 0.6% in 2012 to 1.2% in 2015, yet the target in 2017 is 0.8%. To the extent that tax revenue falls below their target, we think non-priority spending cut strategy will come into effect.

Table 1. Government Budget (IDR tn)

	2015 Actual	2016 Revised	2017 Budget
Government Revenue and Grant	1,505	1,786	1,750
Tax	1,240	1,539	1,499
Non Tax	254	245	250
Government Expenditures	1,796	2,083	2,081
Central Government Expenditures (CGE)	1,174	1,307	1,316
CGE: Equity	209	202	204
CGE: Subsidies: Energy	119	94	77
CGE: Subsidies: Non Energy	67	83	83
Regional Transfer and Rural Funds	623	776	765
Government Budget Surplus (Deficit)	(292)	(297)	(330)
<i>Government Budget Surplus (Deficit): %GDP</i>	<i>-2.53%</i>	<i>-2.35%</i>	<i>-2.41%</i>

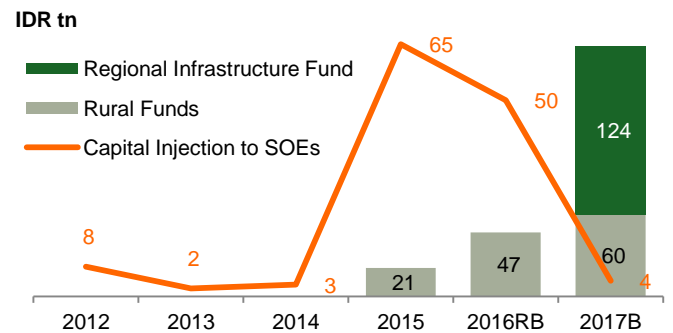
Source: MoF

Chart 1. Tax Ratio - Regional Comparison 2015



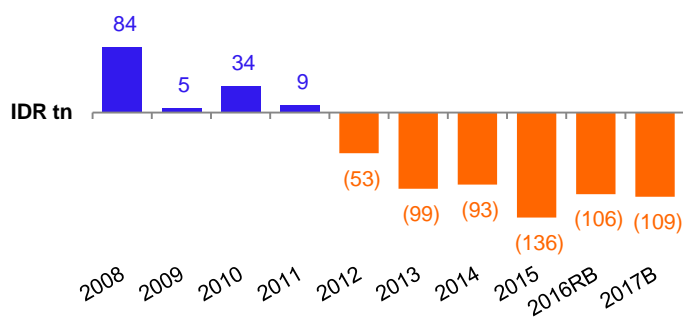
Source: MoF, CEIC, Danamon Calculations

Chart 2. Infrastructure Required through Regional Gov't



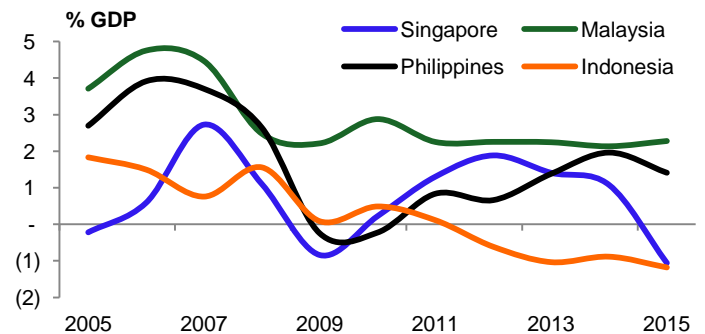
Source: MoF

Chart 3. Indonesia's Primary Balance



Source: MoF

Chart 4. Regional Comparison of Primary Balance



Source: MoF, CEIC, Danamon Calculations

Indonesia: Selected Economic Indicators

	2011	2012	2013	2014	2015	2016E
National Accounts						
Real GDP (% y-o-y)	6.2	6.0	5.6	5.0	4.8	5.0
Domestic demand ex. inventory (% y-o-y)	6.1	7.7	5.0	5.4	3.9	5.0
Real Consumption: Private (% y-o-y)	5.1	5.5	5.4	5.2	5.0	5.1
Real Gross Fixed Capital Formation (% y-o-y)	8.9	9.1	5.0	4.6	5.1	4.8
GDP (US\$bn) — nominal	893	918	915	890	862	893
GDP per capita (US\$) — nominal	3,688	3,741	3,668	3,530	3,374	3,453
Open Unemployment Rate (%)	6.6	6.1	6.3	5.9	6.2	6.0
External Sector						
Exports, fob (% y-o-y, US\$ bn)	29.0	-6.6	-3.9	-3.4	-14.8	-7.5
Imports, fob (% y-o-y, US\$ bn)	30.8	8.0	-2.6	-4.5	-19.9	-6.9
Trade balance (US\$ bn)	26.1	-1.7	-4.1	-1.9	7.6	6.1
Current account (% of GDP)	0.2	-2.7	-3.7	-3.2	-2.1	-2.3
Central government debt (% of GDP)	22.3	22.3	21.3	23.6	25.0	24.6
International Reserves –IRFCL (US\$ bn)	110.1	112.8	99.4	111.9	105.9	103.0
Reserve Cover (Months of imports & ext. debt)	6.3	6.1	5.4	6.5	7.4	7.0
Currency/US\$ (Year-end)	9,068	9,670	12,189	12,440	13,795	13,400
Currency/US\$ (Average)	8,779	9,380	10,428	11,900	13,392	13,360
Other						
BI policy rate (% year end)	6.00	5.75	7.50	7.75	7.50	6.50*
BI 7-Day Reverse Repo rate (% year end)	N/A	N/A	N/A	N/A	6.25	4.75
Consumer prices (% year end)	3.78	3.65	8.08	8.36	3.35	3.20
Fiscal balance (% of GDP; FY)	-1.14	-1.77	-2.24	-2.26	-2.70	-2.50
S&P's Rating – FCY	BB+	BB+	BB+	BB+	BB+	BB+

Source: CEIC, E = Danamon Estimates, *) Up to August 2016

Economic and Market Research

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