

Indonesia

20 February 2025

At new crossroads

- Our recent trip to Jakarta¹ focused on the Indonesia Economic Summit and assimilating views from policymakers, new and former, to gauge the path for Indonesia's growth, fiscal, trade, monetary and financial policies.
- It has been close to a year since the Indonesia's watershed 2024 Presidential elections and the tide is turning for policy makers.
- The focus is now increasing social development expenditures, boosting tax revenues, raising investments via Danantara, and dealing with external risks.

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Government's vision on reaching 8% growth

President Prabowo's ambition is to bring Indonesia's growth rate to 8% of GDP during his term in office (2024-29) from the current 5%. Two key sources of growth are being touted as the main drivers of 8% growth.

First, the expansion of the 'free meal scheme'. The original budget for this scheme was pegged at IDR71trn (0.3% of GDP) for 2025, but the allocation was expanded by IDR100trn to IDR171trn (0.7% of GDP). Special Presidential Envoy Hashim Djojohadikusumo estimates the scheme could add 2 percentage points to GDP growth², inclusive of the multiplier effects from the local economy.

Meanwhile, Luhut Binsar Pandjaitan noted that the government needs to improve on their management of these programs. The funding is not as much of an issue, the management is a bigger bottleneck. He noted that the government is working with the Rockefeller foundation to engage them in a nutrition program, associated with the free meal scheme. The recognition of the lack of adequate management skills is a positive step, in our view, to address and ultimately better allocate and manage the free meal program.

Second, the focus is on the public housing program. The government wants to build 3mn housing units per year, of which 1mn will be apartment units and 2mn will be single family homes. There are 185 sub-sector linkages to the housing sector, which can contribute 2.0-2.5 percentage points to GDP growth on annual basis. Foreign investors – Qatar³ and UAE will build 3-5mn and 1mn homes, respectively, while Chinese property developers are also considering Indonesia.

¹ The trip reflects participation and views from the Indonesia Economic Summit on 18-19 February.

² Bigger meals budget to add 2 pct points to Indonesia's growth, president's adviser says, Reuters, 31 January 2025.

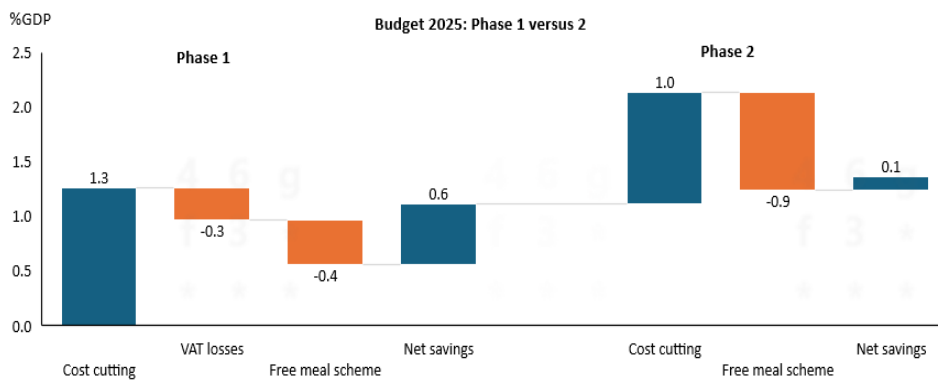
³ Indonesia signs deal with Qatar investor to build 1 million affordable homes, The Straits Times, 8 January 2025.

Near-term risks to growth

The incremental budget for the ‘free meal scheme’ will come from budget cuts that are currently being undertaken across various ministries. President Prabowo announced that there will be three phases of budget cuts, with the cumulative savings amounting to ID750trn.

In the first phase of the budget cuts, which has been completed, the total savings amounted to IDR306.69trn (1.3% of GDP)⁴. Of this, an additional IDR100trn (0.4% of GDP) has been reallocated for the free meal scheme, while IDR71.8trn (0.3% of GDP) is revenue foregone from the diluted VAT increase. The net savings for round 1 is likely to be IDR135trn (0.6% of GDP), by our estimates.

In the second phase of reducing costs, the government wants to save an additional IDR308trn, of which IDR58trn will be returned to ministries. The net savings is expected to IDR250trn (1.0% of GDP). If the distribution of the free meal scheme is increased to reach more children the target 83mn students within 2025 itself, the additional cost for this could be IDR219trn (0.9% of GDP). This implies net savings of IDR 31trn (0.1% of GDP) in phase 2.



Source: Gerindra 17th anniversary celebrations; OCBC.

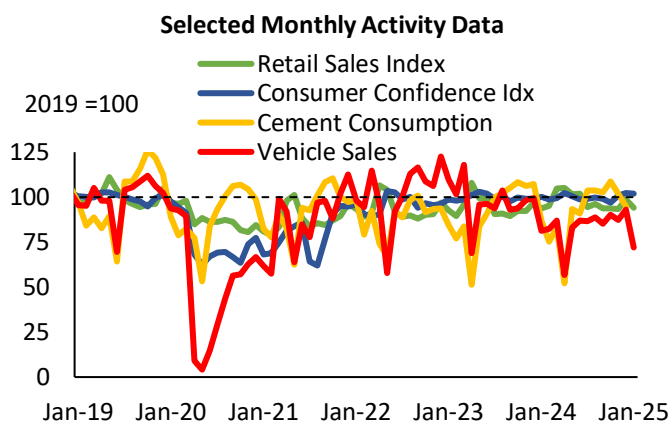
President Prabowo estimates that Phase 3 of the savings will come from additional SOE dividends worth IDR300trn, of which IDR200trn will be placed with Danantara and IDR100trn will be returned. This will have a limited impact on the math for the budget 2025 itself.

For 2025, the budget deficit is pegged at 2.5% of GDP versus 2.3% of GDP in 2024 (see *Indonesia: Fiscal Prudence as room for rate cuts opens up*, 22 August 2024). The combined net savings from phase 1 and phase 2 of the budget cuts could yield savings of IDR166trn, or 0.7% of GDP. But there are a lot of moving parts to these

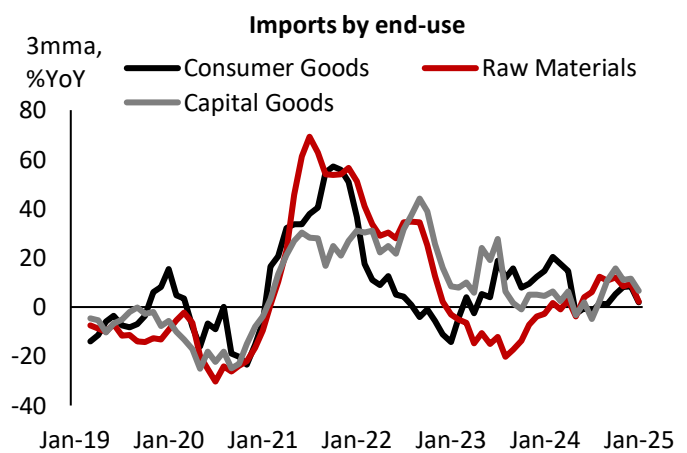
⁴ Govt slashes ministerial, regional spendings to finance welfare programs, The Jakarta Post, 25 January 2025.
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savings and expenditures reallocations, which warrant monitoring before considering a lower than budgeted 2025 fiscal deficit⁵.

The fiscal savings in the near-term implies reduced support for near-term economic growth. We see downside risks to our 1Q25 GDP growth forecast of 5.0%. The cracks in the near-term growth outlook are becoming more evident even based on incoming monthly activity data. Vehicle and cement sales have been falling, consistent with weaker import growth of consumer and capital goods. Export growth was also weaker in January and will under pressure from rising external headwinds.



Note: Cement sales data latest as of December 2024. Source: Bank Indonesia, GAIKINDO, Indonesia Cement Association, CEIC, OCBC.



Source: Statistics Indonesia (BPS), CEIC, OCBC.

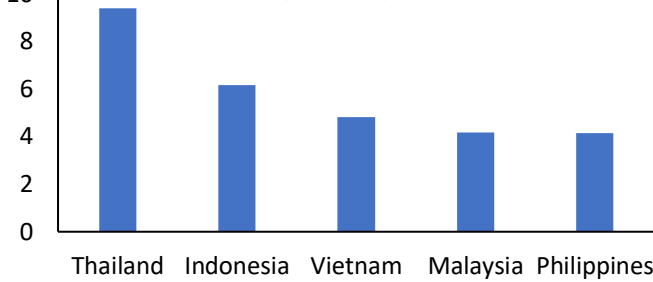
Some shifts in medium-term policy priorities

Notwithstanding the near-term risks, there are some crucial fundamental shifts in policy direction that hold water for better medium-term growth. Apart from the clear shift to social development expenditures, there is a bigger focus on improving expenditure efficiency and management of government programs. The expenditure reductions in Budget 2025 are expected to allow for more efficient allocation of expenditures from next year, even if there could be a drag to near-term growth.

In addition, the government is considering assigning the professional management to the bigger ports such as Tanjung Priok in North Jakarta and the Port of Soekarno-Hatta (Port Makassar). This will be in addition to the professional management of the free meal scheme. Reducing Indonesia's high Incremental Capital Output Ratio (ICOR) was also discussed to realise higher multipliers from investment spending.

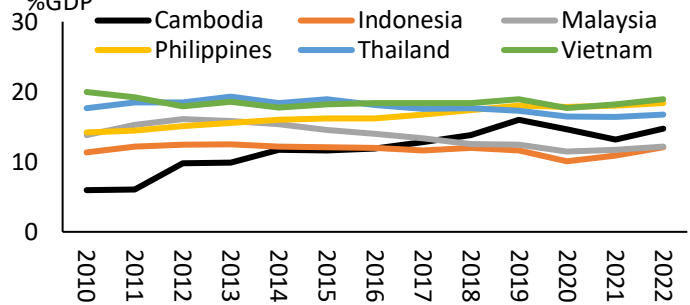
⁵ For instance, the Jakarta Post reported that Housing and Settlements Minister Maruarar Sirait proposed in November 2024 that the ministry's budget allocation for 2025 be increased from IDR5trn to over IDR53trn, citing insufficient funds for the flagship "3 million houses" program.

Incremental Capital Output Ratio (2024)



Source: CEIC; OCBC. The larger the value, the worse the efficiency of capital.

Total tax revenue



Source: OECD Compare your country; OCBC.

i. Emphasis on boosting tax revenues

Importantly, there is also a clear emphasis on boosting tax revenues, with the acknowledgment that Indonesia’s tax to GDP ratio at 12% is not sufficient to achieve its 2045 ambitions of becoming a high-income country. Special Presidential Envoy Hashim Djojohadikusumo noted that there will be an imminent announcement on measures to raise tax revenues. The intent to bring up Indonesia’s tax to GDP ratio to Cambodia’s and then ultimately to Vietnam’s.

The Coretax system, introduced in January 2025, was also discussed. Coretax is an online tax administration system aimed at integrating the process such as registration, reporting, audits to minimise manual inputs. The system has been plagued with issues from technical glitches to system crashes, but there is motivation to resolve these issues. Critical tax reforms and system upgrades are usually a work-in-progress for some time after they are introduced⁶.

Raising tax revenues will help keep the fiscal position in check and under the legal deficit limit of 3% of GDP and keep the public debt position well below the 60% of GDP legal limit. This was emphasized as a cornerstone of Indonesia’s macroeconomic stability.

ii. Where does infrastructure spending feature?

Admittedly, the priority assigned to infrastructure spending in terms of budget expenditures is less clear. The sense we get is that infrastructure, and broader investment spending, will be done more through investment vehicles such as Danantara, the newly established sovereign wealth fund, rather than directly from budget funds. The Indonesia Investment Authority (INA) in its 973 working days (as of 19 February 2025) had mobilised USD9bn in investments from 14 countries, according to Dr. Ridha DM Wirakusumah (INA’s CEO). This bodes well for the Danantara, which will likely subsume INA. Foreign direct investments will also play a bigger role in infrastructure development, with the public housing projects being a case in point.

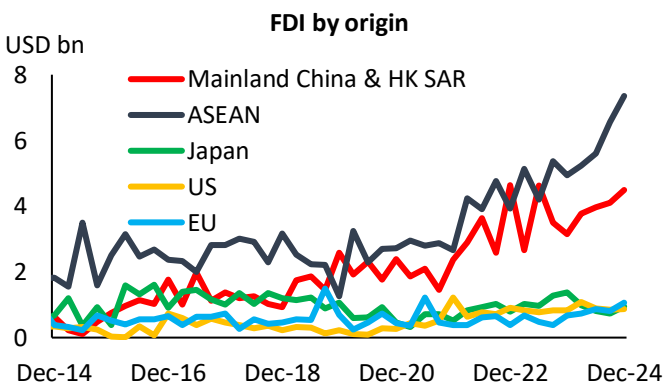
⁶ A case in point is the Goods and Services Tax network system in India.

The implications of this shift are mixed, in the near-term. On the positive side, there will likely be reduced pressure on SOEs to directly fund infrastructure projects⁷. The flipside is that progress on infrastructure projects in the near-term will likely be impacted given more restricted funding, weighing on growth.

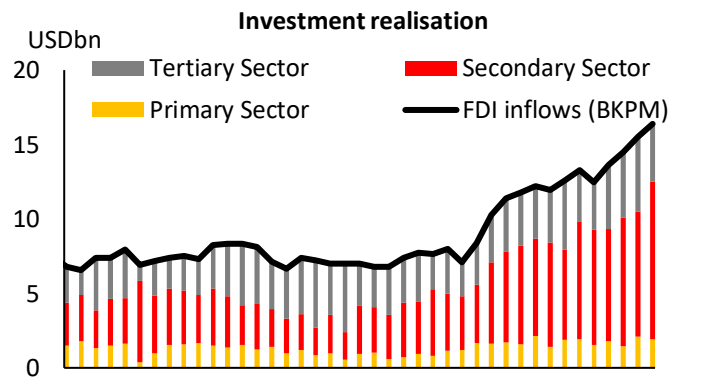
Beyond physical infrastructure, there is also an emphasis on investing in projects closely aligned to ESG principles. This is despite the US withdrawing from the Paris Agreement. There was a broader consensus that Indonesia’s authorities must forge ahead with adhering to ESG principles in order to better optimise its abundant natural resources. There was an emphasis placed on the importance of transition to renewable resources, with the specific mention of the potential for wind farms in the new capital city of Nusantara.

iii. Navigating external challenges

The importance of FDI as a source of investment spending and a more secure source of funding for the current account deficit was also emphasized. The risk with FDI, however, remains concentration in terms of source and sector, i.e., China and natural resources. About 27.1% of Indonesia’s FDI was sourced from Mainland China and HK SAR, with about one-third designated to the natural resources sector, in 2024.



Source: BKPM, CEIC, OCBC.



Source: BKPM, CEIC, OCBC.

There was a lot of discussion around how to diversify Indonesia’s export base. Much of the conversation was not new in terms of diversifying away from natural resources, building an ecosystem around the value chain for exports such as nickel (EVs, battery processing⁸), engaging MSMEs into the trade ecosystem and focussing on developing services exports. Five specific sectors were mentioned as potential sectors for diversification including shipping, railways, semiconductors, fisheries & seafood products and renewable energy. For its part, the authorities are

⁷ Infrastructure Development under the Jokowi Administration: progress, Challenges, and Policies, Wilmar Salim and Siwage Dharma Negara, December 2018.

⁸ Indonesian Investment Authority (INA) and Changzhou Liyuan New Energy Technology Co., Ltd. of China are building a lithium iron phosphate (LFP) factory. The operation will be run by the Chinese-Indonesian consortium PT LBM Energi Baru Indonesia in the Kendal Industrial Park (KIP).

negotiating agreements to improve economic cooperation globally. In the pipeline, there are: a Free-Trade Agreement with GCC countries, an Indonesia-Canada Comprehensive Economic Partnership Agreement (CEPA), accession to the OECD and the BRICS+ alliance.

iv. Indonesia and US tariffs

Specifically, for Indonesia dealing with US President Donald Trump's trade policies, a two-track approach was proposed. The first approach involved gauging the US response. Indonesia dealt with a similar circumstance under Trump 1.0, where the US focus with Indonesia related to the difficulties that US companies face in Indonesia⁹. There is also potential to buy more goods from the US, as some regional peers are considering such as Thailand. The US extended Indonesia's Generalized System of Preference (GSP) status in November 2020, after the need for the extension was questioned in 2018 under Trump 1.0. This may come into question again under Trump 2.0. The second approach is to deepen intra-ASEAN trade and focus on the domestic reform agenda.

Monetary policy direction

There were few discussions focussed on monetary policy per se. We believe the challenge for BI is navigating macroeconomic stability while balancing growth objectives. BI kept its policy rate unchanged at 5.75% at its 19 February meeting following a 25bp cut at its previous meeting. BI sees the room for monetary policy easing but the timing depends on external factors.

We expect another 25bp rate cut from BI sooner rather than later, considering the downside risks to near-term growth. Moreover, headline inflation remains benign and well within BI's 1.5-3.5% target range. The volatilities on the external front persist from uncertainties stemming from US monetary and trade policies. BI expects one 25bp rate from the US Federal Reserve in 2025.

Separately, BI is expanding the instruments available to retain and utilise foreign exchange proceeds in accordance with government policy, which will take effect on 1 March 2025. The term deposit tenor was extended to 12 months and placements can be done via SVBI and SUBVI with tenors up to 12 months¹⁰.

⁹ A recent case in point is Indonesia's dealings with Apple.

¹⁰ These funds can also be utilised for operational activities, payment in foreign currency tax obligations, non-tax state revenues, payments of dividends, payments for procurement.

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