# Mizuho Flash: Indonesia

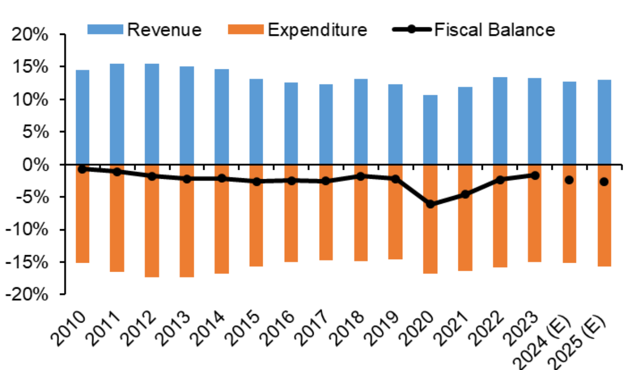
**Economics & Strategy | Asia ex-Japan**

**August 23 2024 | Tan Jing Yi | Market Economist**

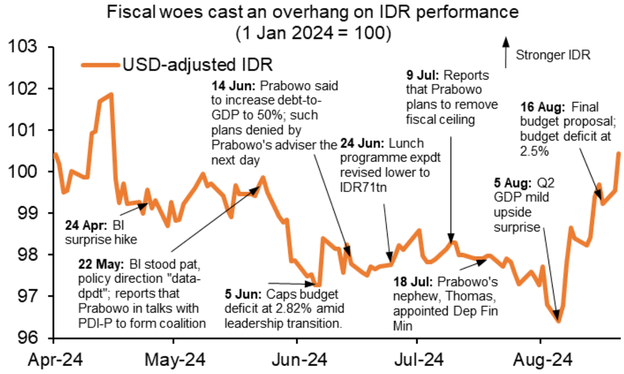
## Budget 2025: Fiscal Risks Not Absolved

In a Nutshell: There were no major policy surprises in Indonesia's 2025 Budget "Stability, Inclusivity and Sustainability", although it is worth mentioning that the proposed budget deficit was at the lower bound of the previously signalled range. This has arguably allayed some fiscal concerns, and provided further support to IDR's rally alongside piling Fed cut bets. Nonetheless, caution would be appreciated insofar as incoming administration needs to prove its commitment towards fiscal prudence, especially as past comments by president-elect Prabowo suggest ambitious spending plans and there exists the possibility of a mid-year budget adjustment. For now, while we view that risks for a wider deficit for 2025 to be moderate; the biggest question is arguably what lays ahead in terms of fiscal trajectory insofar as large spending required for long-term projects risks widening the revenue-expenditure gap.

- On 16 August 2024, President Joko Widodo (Jokowi) presented to the House of Representatives the last budget proposal of his two-term presidency.
- There were **no particular policy surprises**, as policies were aligned with the preliminary proposal. The budget signalled policy continuity of Jokowi's signature economic programmes, namely Nusantara (i.e. moving of Indonesia capital), as well as President-elect Prabowo's free meal programmes. Budget allocation for the latter was still earmarked at IDR71tn, in line with what was previously announced.
- One update was that the **proposed budget deficit (at 2.5% of GDP) is at the lower bound of the 2.45-2.82% range the government earlier signalled**, which could have provided relief for IDR bulls.
- It might be worthwhile to recall that preceding this budget, IDR was cast under the overhang of potentially significant fiscal slippages on President-elect Prabowo's ambitious spending plans, after years of fiscal prudence.
- In particular, comments on a material increase in debt (from 40% to 50%) as well as a possible scraping of the fiscal deficit ceiling sparked fears among investors and weighed on the IDR.
- The lower budget deficit estimate should have allayed some fiscal concerns fear and aided IDR's climb. IDR has climbed ~5.3% since August (as at Aug 20), outperforming regional currencies and has almost erased YTD losses against the USD. Nonetheless, caution against over-exuberance over Indonesia's fiscal prudence would appreciated insofar as the incoming administration has yet to prove itself and there is still possibility for a mid-year budget adjustment.




Source: CEIC; Mizuho

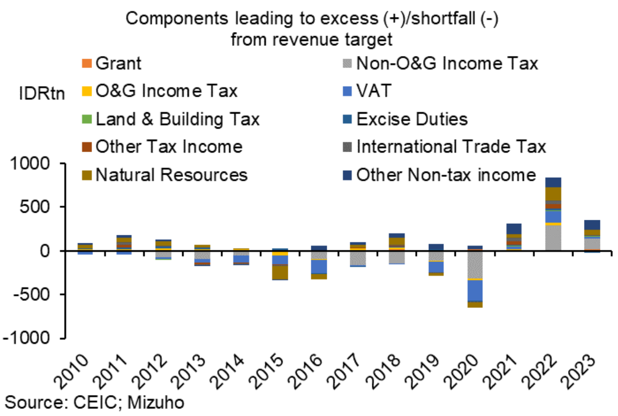



Source: Bloomberg; Mizuho

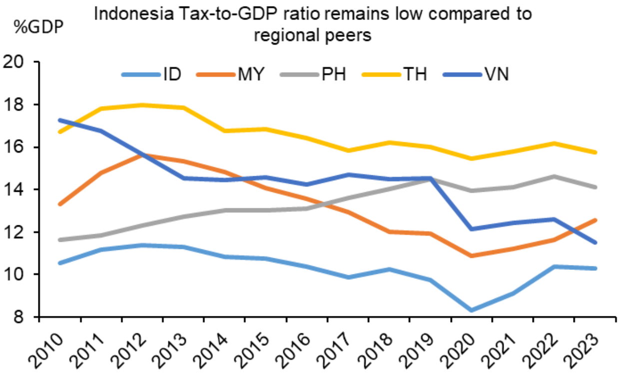
- Afterall, there still exists potential of fiscal slippages, given Prabowo's prior comments. Accordingly,

**credibility on fiscal prudence under the incoming administration may need time to be built**.

- But for now, at least, the **budget statement appears reasonable**, and **we only see some slight risk of fiscal slippages** on higher-than-expected expenditures while revenue target looks achievable.
- The revenue target to achieve IDR2,996tn should be achievable, supported by continued efforts to expand the tax base and another bump in VAT from 11% to 12% in January 2025[1]. This would represent a ~6.9% increase from 2024 revenue target, and is around the average realised revenue growth for 2016-2019.
- We do not see much potential for upside surprise to the 2025 revenue target. While revenue collection from 2021 through 2023 exceeded estimates, buoyed by higher non-oil & gas income tax, VAT and income from natural resources, we are more circumspect on such continued outperformance in 2024 going into 2025, given commodity headwinds, as well as lower-than-expected non-oil & gas tax income and VAT income realised in 1H'24, which could be an indication of consumers becoming more stretched.
- Meanwhile, downside revenue risk looks manageable as potential shortfall in oil & gas non-tax income should be offset by oil & gas tax income. Notably, oil & gas non-tax income looks fairly optimistic as we think the push for profit-sharing agreements and optimising production process may not be able to offset the contraction in oil and gas production by ~5.5% and ~2.7% respectively to justify the 10.5% and 7.9% increase in oil and gas non-tax income respectively. Nonetheless, on aggregate, we think that any shortfall in oil and gas non-tax income could be offset by excess oil and gas tax income, given rather pessimistic estimates (~18% lower compared to 2024 target)[2] even as the assumption for oil is unchanged (i.e. US$82/bbl for both 2024 and 2025).
- Barring a global recession and attendant slump in commodity prices, revenues from oil & gas (for both tax and non-tax sources) appear reasonable. In fact, these estimates have historically tilted towards the conservative side. From 2010 to 2023, realised oil & gas tax income did not meet target only in 2015, 2016, 2019 and 2020 – years when oil prices slumped; and as at 1H'2024, realised oil & gas tax income and oil and gas non-tax revenues is more than 50% 2024 target.




Source: CEIC; Mizuho




Source: CEIC; Mizuho

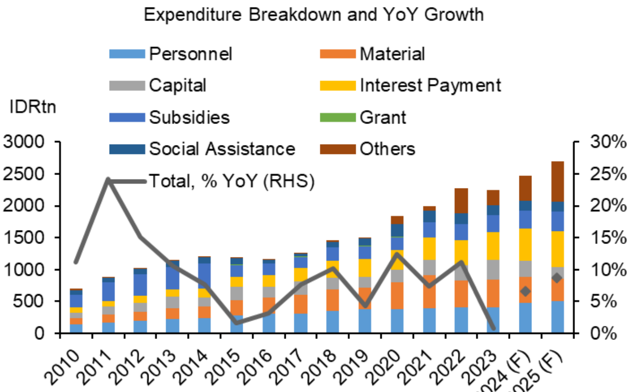
- On the expenditure side, budgeted total expenditures for 2025 of IDR3,613tn represents an increase a ~8.7% increase from 2024 budget. While this is similar in magnitude to the 8.6% YoY increase in budget estimate for 2024, this is a larger increase compared to 2016-2019 average realised expenditure growth of 6.4%. Most of the increase in budgeted expenditures is driven by **"others"** (which will grow by ~63% and contribute a 7.3ppt increase), offsetting contracting material (-15.8% YoY) and capital (-23.0% YoY) expenditures.
- We think that there could be higher-than-expected expenditures on the following fronts:
- Greater government investments could be required for Nusantara. 2025 budget had allocated

[1] Previous bump in VAT from 10% to 11% took place in April 2022.

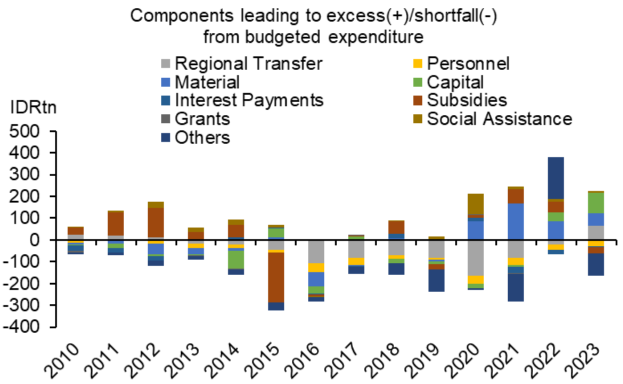
[2] The difference in direction of oil and gas tax and non-tax income growth is likely due to upstream and downstream considerations. Non-tax income is earned from production and could potentially be improved via more efficient production processes; while tax income would be earned from both downstream and upstream oil & gas production. As Indonesia is a net energy importer, tax income would be more subject to overall energy demand, whereas non-tax income would be more dependent on production capacity and efficiency, given that demand exceeds supply.

~IDR400tn for infrastructure (a 5.4% decrease compared to 2024 budget), part of it would be used to facilitate Nusantara. However, progress for the project have not been that great. Indonesia's Audit Board (BPK) noted in June that 5.8% of the earmarked area for the project faced land management rights issues, which construction conditions were suboptimal, including **the lack of materials, construction equipment and unprepared ports.** Meanwhile, investments into the project lagged behind. From 2023 to January 2024, investments that has entered the project stood at IDR47.5tn, barely half the target to hit IDR100tn by this year-end. Hence, risks are tilted to higher expenditures to resolve existing infrastructure issues to pull off a successful move of the capital. Notably, expenditure on material has been exceeding the budget since 2020 (Nusantara was announced in 2019) while expenditure on capital exceeded allocated budget in 2022 and 2023.

- Subsidy expenditure could be more than expected, although slippages may not be outsized. While the 2025 Macroeconomic Framework and Fiscal Policy Principles document has suggested that there would be subsidy rationalisation programmes for both fuel and electricity, a dearth of announcements from the government and (incoming) administration casts doubts on the political will to roll out such reforms. Nonetheless, we expect slippages (if any) to be moderate given relatively conservative macro assumptions – i.e. IDR averaging 16,100 per USD in 2025, and crude oil remaining at US$82/bbl (same as 2024), while allocation for energy subsidies (at IR204.5tn) for 2025 is an ~8% YoY increase despite these subsidy reforms plans.
- As for the free lunch programme, which may have led to the increase in **"others"** expenditure, fiscal risks appear rather contained for now. The programme is subsumed under "education" from a sectoral point of view and education expenditure at ~IDR722tn looks reasonable. After excluding the IDR71tn allocated for the free lunch programme, education expenditure would be ~12% increase from 2024 budget, which is slightly lower than the 13.2% YoY increase for 2024 budget, but much more than 2016-2019 budgeted increase of 4.4%. While the increase in allocated budget is due to plans to upgrade schools, we think that the increase in allocated budget ought to also buy some buffer in the event that the free lunch programme require more funds.




Source: CEIC; Mizuho




Source: CEIC; Mizuho

- All in, the 2025 Budget appears to incorporate Prabowo's campaign pledges of policy continuity and the free lunch programme, while staying committed to Indonesia's fiscal deficit ceiling.
- But fiscal risks are far from absolved, for previous comments on fiscal slippages may forewarn of possible shifts in the coming years, if not quarters. Point being, the move of a capital and social objectives arguably necessitate much more expenditures in coming years, while revenue collection (as percentage of GDP) has not improved that much despite continued efforts over the past years and remains lower relative to regional peers. Consequently, 2025 Budget may leave more questions, than answers, for years ahead.