# Wiggle Room

**Wellian Wiranto**
*+65 6530 6818*
*WellianWiranto@ocbc.com*

**Indonesia suspends fiscal rules to support the economy**

- Facing a relentless uptick in Covid-19 cases and an unavoidable downtick in economic momentum, Indonesia is injecting IDR405tn (USD24bn) of stimulus. For its embattled healthcare workers, this could not have come any sooner. Crucial lifelines are given to many low-income households too.
- With the sharp pick-up in expenditure, deficit is slated to balloon to 5.07% of GDP, requiring a suspension of fiscal rule, which has served as a bedrock of credibility since 2003. To help finance the deficit, Bank Indonesia will now be allowed to buy government bonds directly in the primary market, if needed.
- Quite a lot to take in for ratings agencies and investors alike, especially given that the moves may last for three years. While having maximum wiggle room at a time of urgent humanitarian situation is crucial, a firmer path towards longer-term consolidation would be helpful to anchor market buy-in.

**Five for Fighting**

As Indonesian authorities try to step up more forcefully to fight against Covid-19 outbreak and the resultant economic challenges, they have found their hands to be tied. The fiscal rule legislation adopted back in 2003 – which limits deficit to 3% and debt to 60% of GDP a la Eurozone's Maastricht Treaty criterion – had been useful in serving as a bedrock of fiscal credibility, when the country was rebuilding post-Asian Financial Crisis. In more recent months, however, the scale and speed at which global and domestic events transpired have exposed the constraint of having very little fiscal room, right when a lot is needed – and needed quickly.

Bolstered by the sense that extraordinary times call for extraordinary measures, the Indonesian government under President Jokowi has decided to suspend the fiscal rule to allow for immediate spending on March 31st. Instead of being straitjacketed by the 3% deficit rule, the deficit for 2020 is expected to exceed 5% of GDP, after accounting for the IDR450tn (USD24bn, 2.4% of GDP) of extra spending.

The money will be used for a multi-front fight.

To begin with, for the country's healthcare sector – where many workers have been infected by the virus and died due to an unconscionable lack of protective gears – the stimulus package promises an extra IDR75tn (USD4.6bn) funding. For good measure, this would include a provision of life insurance coverage for the doctors and nurses. Part of the sum will go into equipping the 132 hospitals that are dedicated for the treatment of Covid-19 patients across the country, as well.

Next on the list is IDR110tn (USD6.8bn) to mend the social safety net at a time of a sudden slump in economic activities that threaten the livelihood of many Indonesians, especially those in the lower-income groups and those working in the large informal sector. Up to 10mn households are to be given 25% additional cash transfers. Aid to qualifying pregnant mothers would now be at IDR3mn (USD185) per year each, for example. Up to 20mn people will be given IDR200k (USD12) food assistance cash cards, for 9 months. Electricity tariffs will be free for the 24mn households with lower electrical capacity of 450VA for the next 3 months. For the next 7mn households who enjoy higher capacity of 900 VA will see their bills halved over the same period.

Meanwhile, an IDR70tn chunk of stimulus is to help businesses tide through tough times. For one, the much-awaited corporate tax cut, from 25% now to 22% in 2020-21, and to 20% thereafter, that was part of the taxation omnibus law that has been in parliamentary discussion for the past few months, has been brought forward. Elsewhere, import taxes for 19 sectors are reduced and income tax for workers in manufacturing sector will be absorbed fully.

Finally, a so-called recovery program worth IDR150tn would form another key plank of the stimulus. Although details are yet to be finalized, according to the Vice Finance Minister, this program is likely to include measures to help credit restructuring as well as to serve as guarantee fund for working capital loans for SMEs and corporations.

**Deficit Distancing**

All the measures announced are sensible, timely, and necessary in cushioning the economic blows that are bound to continue coming furiously.

Tellingly, even with the package, Finance Minister Sri Mulyani said that the government has downgraded its growth expectation to 2.3% from 5.3%. For good measure, under worst-case scenario, growth might dip to as low as -0.4%. Taken together, this might mean that larger fiscal stimulus might well be needed if the situation worsens. Indeed, at an aggregate 2.4% of GDP, purely from headline numbers alone, the package may seem rather measured compared to those announced by neighbouring Singapore and Malaysia recently.

However, even at the relatively restrained level, Indonesia's latest stimulus has necessitated a considerable change in the rulebook that might take some time for market players to chew and swallow. It might be especially so because the suspension of the fiscal rule is slated for not only the current year, but all the way to 2021 and 2022.

To be sure, purely from the fact that no one really has any good sense of how long the Covid-19 crisis will continue globally, the flexibility in having fiscal bandwidth for as long as 3 years can be understandable. There is also the justifiable worry that if the government were to revert to the 3% rule too quickly from more than 5% this year, it would require such a large degree of fiscal tightening that growth momentum might be hurt considerably.

However, given how much of a departure from the norm this rule suspension is, a clearer path towards medium-term consolidation over the course of the next few years would have helped investors and ratings agencies digest it better.

For one, a hypothetical stipulation that, if growth were to pick up and exceeds a certain threshold of “X” percent in 2021 or 2022, the government would commit to an automatic marginal reduction in deficit of “Y” percentage points of GDP could be instrumental in leaving investors something to hang their hats on. In short, rather than an outright suspension of fiscal rule, having such stipulations would allow the market to see it as a relatively more palatable temporary amendment.

There is, of course, no magic formula of X’s and Y’s especially in the current situation. However, without an interim rule of sorts, the fiscal rule suspension might feel too much like a blank cheque for some corners of the market, even as – we cannot stress enough – the motivation to deliver as much fiscal help to a country enmeshed in fighting the good fight against Covid-19’s clutches is a noble one.

**Primary Purchase**

Another key aspect of the stimulus package was the announcement that Bank Indonesia will now be allowed to purchase government debt in the primary market – i.e. at issuance stage.

This is another major departure from the norm, since BI is currently only allowed by law to go about the roundabout way of purchasing government bonds through the secondary market, i.e. banks and foreign investors, etc. Indeed, that’s something that BI has been doing in earnest, building up its holding of government bonds to 15% of total outstanding from barely 10% at the start of 2020, even as foreign holdings drop to below 33% from more than 39% before.

From our understanding, BI and the MOF are working out the circumstances and mechanism through which the primary purchase will take place. The priority will still be for the MOF to finance its deficit through market mechanism, but with BI as a backstop buyer, in case of low investor demand. While the details are still relatively vague at this stage, our best guess is that there may be thresholds in the form of bond yield levels (beyond which BI would step in) or bid-to-cover ratios (below which BI comes in).

While the extraordinary nature of the ongoing challenges would widen the acceptance level by investors of such an unprecedented move, it would, again, be helpful if there is some medium-term framework in place to bolster market confidence. This could take the shape of a clearer definition in both the entry and the exit points. In terms of entry, some definition of when BI would step in to purchase, and potentially a cap in terms of size of purchase per issuance, could be helpful. In terms of exit, as the situation stabilizes down the road, perhaps some guidance of when BI might unwind their holdings could be communicated, as well.

**Abnormally Normal**

All in all, the fact that the Indonesian authorities – alongside their peers across the world – have to seemingly pull whatever rabbits they can out of their hats, to find ways to cushion the blow speaks to the scale of challenges facing the global economy, if not humanity.

From not touching your face subconsciously to and washing your hands obsessively at the personal level, to protecting your loved ones and colleagues by distancing yourself actively, we are all dealing with a new set of abnormal behaviours.

The same suspension of “normal” rules has been applied by authorities everywhere and Indonesia’s case is no exception. However, with the ultimate hope that this too shall pass, any kind of temporary rules and frameworks would offer a good sanity check or just a plain sense of normality for investors.

# Treasury Research & Strategy

## Macro Research

**Selena Ling**
*Head of Research & Strategy*
LingSSSelena@ocbc.com

**Tommy Xie Dongming**
*Head of Greater China Research*
XieD@ocbc.com

**Wellian Wiranto**
*Malaysia & Indonesia*
WellianWiranto@ocbc.com

**Terence Wu**
*FX Strategist*
TerenceWu@ocbc.com

**Howie Lee**
*Thailand, Korea & Commodities*
HowieLee@ocbc.com

**Carie Li**
*Hong Kong & Macau*
carierli@ocbcwh.com

**Dick Yu**
*Hong Kong & Macau*
dicksnyu@ocbcwh.com

## Credit Research

**Andrew Wong**
*Credit Research Analyst*
WongVKAM@ocbc.com

**Ezien Hoo**
*Credit Research Analyst*
EzienHoo@ocbc.com

**Wong Hong Wei**
*Credit Research Analyst*
WongHongWei@ocbc.com

**Seow Zhi Qi**
*Credit Research Analyst*
ZhiQiSeow@ocbc.com

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC Bank, its related companies, their respective directors and/or employees (collectively "Related Persons") may or might have in the future interests in the investment products or the issuers mentioned herein. Such interests include effecting transactions in such investment products, and providing broking, investment banking and other financial services to such issuers. OCBC Bank and its Related Persons may also be related to, and receive fees from, providers of such investment products.

This report is intended for your sole use and information. By accepting this report, you agree that you shall not share, communicate, distribute, deliver a copy of or otherwise disclose in any way all or any part of this report or any information contained herein (such report, part thereof and information, "Relevant Materials") to any person or entity (including, without limitation, any overseas office, affiliate, parent entity, subsidiary entity or related entity) (any such person or entity, a "Relevant Entity") in breach of any law, rule, regulation, guidance or similar. In particular, you agree not to share, communicate, distribute, deliver or otherwise disclose any Relevant Materials to any Relevant Entity that is subject to the Markets in Financial Instruments Directive (2014/65/EU) ("MiFID") and the EU's Markets in Financial Instruments Regulation (600/2014) ("MiFIR") (together referred to as "MiFID II"), or any part thereof, as implemented in any jurisdiction. No member of the OCBC Group shall be liable or responsible for the compliance by you or any Relevant Entity with any law, rule, regulation, guidance or similar (including, without limitation, MiFID II, as implemented in any jurisdiction).

Co.Reg.no.:193200032W