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Allianz Research | 16 February 2024

What to watch: Indonesia's economy after the elections, a tale of two consumers in the US and UK and Türkiye's economic rebalancing

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In summary

This week, we look at three critical issues:

- **Indonesia after the elections: economic policy continuity is necessary but not sufficient.** Current defense minister Prabowo Subianto came out ahead in this week's election. Prabowo pledged continuity (and even selected Joko Widodo's eldest son as his running mate) to secure the tacit backing of the very popular outgoing president. While Jokowi's structural reforms supported productivity and attracted foreign investment, Prabowo will have to do even more to keep Indonesia in the economic champions league of a decoupling world. First, Indonesia's export market share in the US has increased much less than that of peers such as Vietnam, Thailand or India since 2019. Second, with the world's largest exploited nickel reserves, Indonesia has established itself as a player in global battery and electric vehicle supply chains. Yet, maintaining and expanding this sweet spot in the transition requires further push and reforms in infrastructure, foreign investment restrictiveness, the labor market, the rule of law and the control of corruption.

- **UK ants v. US grasshoppers?** Despite strong growth in real disposable incomes in 2023 (ca. +2-4%), and similar benefits from consumer credit (ca. 0.5-0.7pps of contribution to consumer spending growth) in both the US and the UK, US consumers are spending far more than their UK counterparts (+2.2% vs +0.3%). More generous fiscal policy and very positive net interest payments in the US explain part of this difference. More importantly, US household savings declined by -3pps of disposable income in 2023, while they increased by the same amount in the UK. In 2024, we expect around +2% for household consumption growth in the US and +1% in the UK on the back of positive wealth effects.

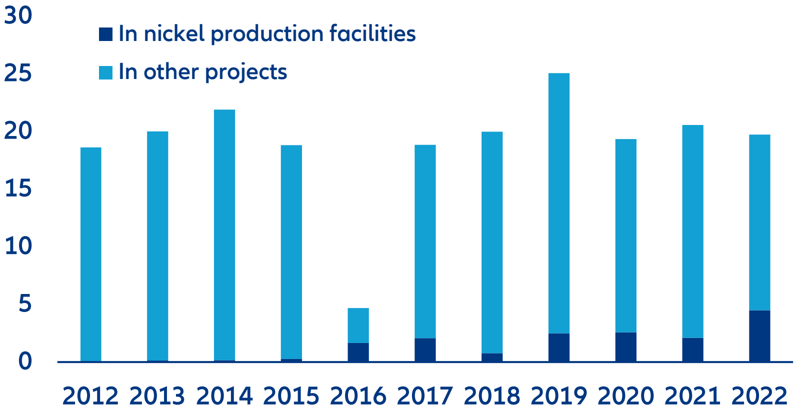
- **Türkiye: pushing through economic rebalancing.** We expect that the tight monetary policy stance will be maintained after the change of central bank governor in early February. As a result, gradual disinflation should set in in the second half of 2024 and the current account deficit should narrow to a more manageable -3% of GDP this year. We forecast real GDP growth to slow down to +3% this year, inflation to moderate to around 30% at end-2024 and the central bank to keep a tight stance with an end-year policy rate of 32.5%. That said, a key risk is that the growth slowdown could prompt policymakers to reverse course too soon and too much, thereby failing to reap the medium-term gains.

Indonesia after the elections: economic policy continuity is necessary but not sufficient

Pollsters suggest Prabowo Subianto came out ahead in the February 2024 presidential election and should be able to avoid a second round. Prabowo, the current defense minister, gathered about 58% of votes, according to unofficial figures from pollsters by the end of the day on 14 February (tallying about 88% to 98% of votes). This puts him well ahead of the other two contenders (Anies Baswedan with about 25% of votes and Ganjar Pranowo with about 17%). Official results will be announced in the coming month but most likely the criteria to win in the first round[1] have been met, meaning a second round (which would have been held on 26 June 2024) will not be necessary. Prabowo will take over from outgoing president Joko Widodo (known as Jokowi) on 20 October 2024.

Prabowo has committed to policy continuity: Jokowi's legacy includes structural reforms that have supported productivity and managed to attract foreign investment. Prabowo's vice-president candidate is Gibran Rakabuming Raka, Jokowi's eldest son. This along with his pledge of policy continuity has managed to secure the tacit backing of the very popular outgoing president. Over his two terms since 2014, Jokowi steered the country to a path of robust growth[2] and structural reforms, including the Omnibus Law on Job Creation, which came into effect in March 2023 and has made it easier for companies to hire and fire employees[3]. Infrastructure spending was also stepped up (e.g. in utilities, port capacity and transport) but the fiscal deficit was kept in check[4] and the public-debt-to-GDP ratio is among the lowest[5] across the main economies of Asia. This has led to several rounds of sovereign rating upgrades since 2014 (e.g. from BB+ to BBB by Standard & Poor's), reinforcing foreign investors' confidence in Indonesia's growth prospects and long-term fundamentals. The ensuing surge in foreign direct investment was also supported by an export ban on unprocessed nickel and bauxite ores. While this caused export losses and lower government revenues in the short-term, it has brought long-term benefits as processing is now conducted locally in Indonesia, leading to more than USD15bn of foreign investment in nickel processing since 2014 (Figure 1).

Figure 1: Foreign direct investment in Indonesia (USD bn)



Sources: Indonesia Investment Coordinating Board, World Bank, Allianz Research

However, the new president will have to do more to allow Indonesia to grab the opportunities created by the ongoing diversification in global supply chains. Indonesia's geographic and geopolitical position, as well as its rich natural resources endowment, dynamic labor market and solid public finances, put the country in a strong position amid the ongoing trend of supply-chain diversification. However, since 2019, Indonesia's export market share in the US increased much less than that of peers such as Vietnam, Thailand or India. This is likely related to the fact that Indonesia's exports currently remain very much dominated by commodities, such as coal (21% of exports in value

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[1] *A simple majority (50% of the votes) and at least 20% of the votes in more than half of all provinces.*

[2] *+4.2% on average over 2014-2023, or +5.1% on average if the pandemic years (2020-2021) are removed.*

[3] *Severance pay for redundancy dismissal for a worker with five years of tenure was cut from 60 to 24 weeks of salary.*

[4] *-2.9% of GDP on average over 2014-2023, or -2.3% of GDP on average if the pandemic years (2020-2021) are removed.*

[5] *Around 30% before the pandemic, up to c.40% now. This compares with c.60% in the Philippines and Thailand, c.65% in Malaysia and c.80% in China and India.*

terms in 2022), palm oil (12%) and natural gas (11%). In fact, our analysis of critical dependencies[6] shows that Indonesia is a critical supplier to the US and the EU when it comes to goods related to palm oil and wood charcoal or coal-like products. However, Indonesia is also a critical supplier to the EU for semi-finished products of stainless steel, likely denoting the success of measures put in place by the government in the past years. Indeed, the aim is to develop Indonesia's manufacturing base. With the world's largest exploited nickel reserves and the related export ban, Indonesia managed to establish itself as a player in global battery and electric vehicle (EV) supply chains. The next target is to climb up the value chain by developing full EV production chains (from cathodes to battery cells and EVs) locally. To that end, and to more broadly upgrade the country's manufacturing base and innovation potential, further structural reforms should be put in place in areas where Indonesia currently underperforms compared to peers, such as infrastructure, foreign investment restrictiveness and regulations, more broadly speaking related to the labor market, the rule of law and control of corruption (Figure 2). However, while we remain relatively confident in Indonesia's growth potential in the coming years, the end of the Jokowi era and the entry of a new president that has shown less interest in economic policies in the past mean that risks are probably skewed to the downside.

Figure 2: Indicators in Indonesia, main ASEAN peers, India and China

		Indonesia		Malaysia	Philippines	Thailand	Vietnam	India	China
		2014	Latest	Latest	Latest	Latest	Latest	Latest	Latest
Economic indicators	GDP growth, 10-year average	5.9%	4.2%	4.1%	4.8%	1.9%	6.0%	5.8%	6.0%
	GDP growth forecasts, 2025-2029	/	5.1%	4.0%	6.0%	2.9%	6.2%	6.3%	3.9%
	Fiscal balance (share of GDP)	-2.1%	-2.3%	-5.9%	-5.5%	-4.6%	0.3%	-9.2%	-7.5%
	Public debt (share of GDP)	25%	40%	66%	58%	61%	35%	81%	77%
	Labor force (million people)	124	137	17	47	40	56	524	782
	Labor force growth, 10-year CAGR	1.7%	1.2%	2.4%	1.6%	-0.2%	0.8%	1.0%	0.0%
Business environment	Logistics Performance Index, global rank	53	61	26	43	34	43	38	19
	FDI regulatory restrictiveness index*	0.4	0.3	0.3	0.4	0.3	0.1	0.2	0.2
	Severance pay (weeks of salary)**	60.7	24	16.7	21.7	30	21.7	10.7	21.7
	Regulatory quality (percentile rank***)	51.9	59.4	72.6	53.8	58.5	36.3	50.9	36.8
	Rule of law (percentile rank***)	44.7	45.3	68.4	33.5	54.7	47.6	55.2	52.8
	Control of corruption (percentile rank***)	32.2	37.7	62.3	33.5	35.8	45.8	44.3	55.2
	Global Innovation Index, global rank	87	61	36	56	43	46	40	12
Export competitiveness	Export market share in the US	0.8%	1.1%	1.7%	0.5%	1.9%	4.0%	2.7%	17.1%
	change since 2019 (pp)	/	0.3	0.1	0.0	0.5	1.3	0.4	-1.3
	Export market share in the EU****	0.9	0.8	1.1	0.5	1.0	1.9	2.4	21.6
	change since 2019 (pp)	/	0.0	-0.2	0.1	-0.2	-0.2	0.1	1.2
	Export market share in China	1.2	2.9	4.0	0.8	2.1	3.2	0.6	/
	change since 2019 (pp)	/	1.2	0.5	-0.2	-0.1	0.1	-0.3	/

** the lower the index, the fewer restrictions there are*
*** severance pay for redundancy dismissal for a worker with five years of tenure (weeks of salary)*
**** percentile rank indicates the country's rank among all countries covered by the aggregate indicator, with 0 corresponding to lowest rank and 100 to highest rank.*
***** EU27 and the UK*
Note: color scales refer to performances across countries for each indicator in the latest available year, red corresponding to a relatively lower performance and green to relatively better performance
Sources: national statistics, IMF, World Bank, ITC, Allianz Research

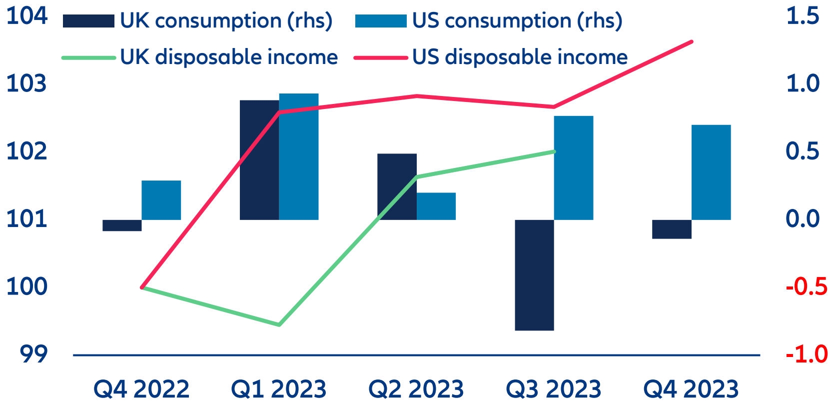
UK ants v. US grasshoppers?

Despite seeing similar growth in real disposable incomes in 2023, US consumers are spending far more than their UK counterparts, boosted by consumer credit, generous fiscal policy and positive net interest payments. In 2023, US consumer spending rose by +2.2%, compared to just +0.3% in the UK. Besides labor income (real wages + employment), consumer spending is typically influenced by consumer credit (though the share of consumer debt flows in aggregate consumption is generally low), the personal tax rate, the transfer rate, net interest payments (amount of interest households pay out on mortgages and other credits minus what they receive on their capital) and net worth (when it increases, households feel "wealthier" and typically spend more). While consumer credit

[6] *The methodology can be found in our report* China: keeping the dragon awake.

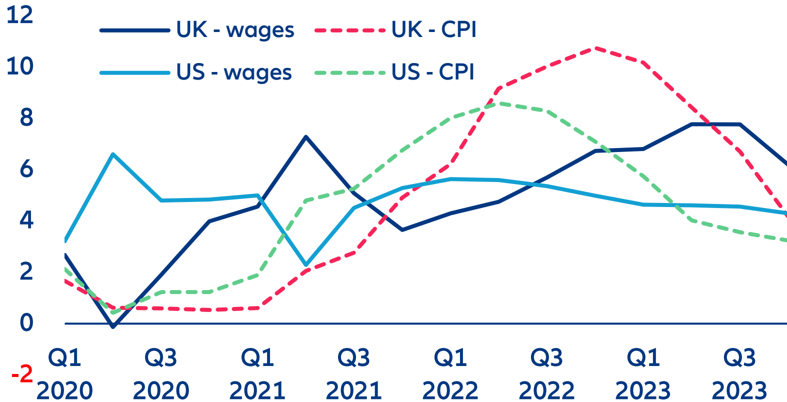
supported spending on both sides of the Atlantic, US households have benefited more from rising net interest payments as higher interest rates boosted interest received on savings, while interest payments on mortgages rose only modestly, owing to the prevalence of fixed-rate mortgages. In contrast, in the UK, interest payments to households have not varied much, given the larger share of mortgages with floating rates or renewed at higher interest rates. At the same time, their net worth has also dipped substantially owing to weak house prices: UK households faced a -7.6pps drop, while in the US the decline was much smaller at -4pps. They have also not seen any changes in personal tax rates or transfer rates resulting from fiscal policy, while US households have seen their effective personal tax rates drop by -2.4pps. In total, we estimate that, beyond the labor income effect, other drivers of consumption have in total boosted US numbers by over +2pps, while they depressed UK spending by around -3.8pps[7] (Figure 5).

Figure 3: US & UK real disposable income (Q4-2022 = 100) and consumption q/q growth (%, non-annualized)



Sources: LSGE Refinitiv, Allianz Research

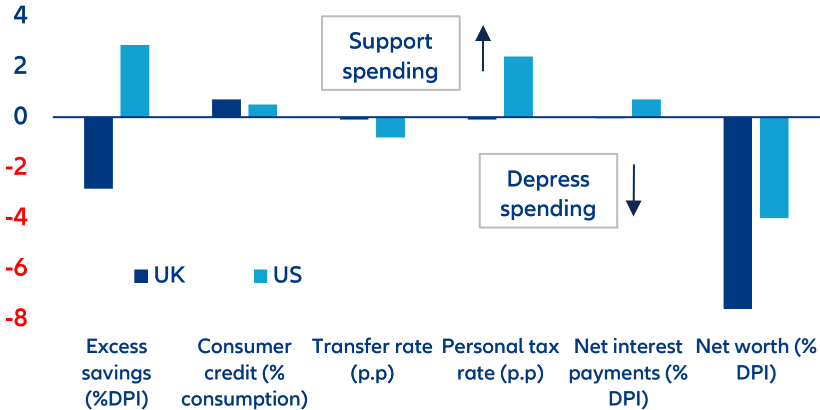
Figure 4: US & UK wage growth & CPI inflation (% y/y)



Sources: LSGE Refinitiv, Allianz Research

[7] *Precisely, we estimate a multiplier of 0.7 for transfers, 0.3 for taxes, 0.2 for interest income, 0.2 for net worth in the UK and 0.4 in the US.*

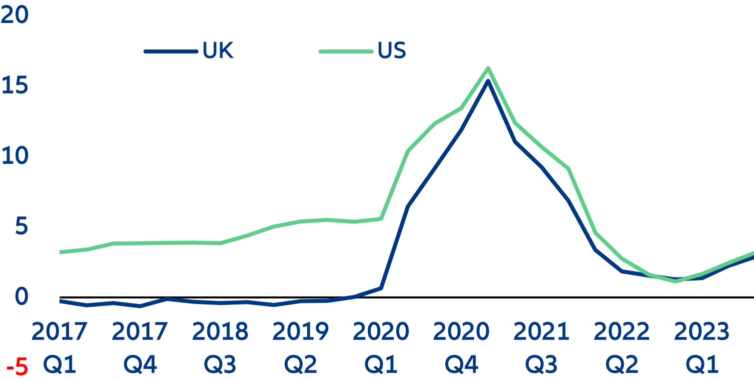
Figure 5: US & UK key determinants of consumer spending beyond labor income: change between Q4 2022 and Q3 2023



Sources: LSGE Refinitiv, Allianz Research. Note: DPI = Disposable personal income. A positive sign for excess savings means they have been reduced, a positive sign for the personal tax rate means it has been reduced.

Moreover, US households' excess savings declined by around -3pps of disposable income in 2023, while in the UK they *increased* by the same amount. The dip in the housing market and the cost-of-living crisis have hit consumer confidence hard in the UK. UK households are also clearly bracing for renegotiating their mortgages at a time of higher interest rates: Nearly 40% of households will need to renew their mortgages by 2025. However, looking at the net financial position, UK households have built some resilience, which should prevent them from being forced into aggressive deleveraging in case of a future downturn. Their net lending position[8] turned positive after the pandemic and has strengthened since, reaching GBP50bn in 2023, equivalent to 3% of disposable income (Figure 6). In comparison, while the net financial position of US households has declined since the pandemic, it remains at healthy 3% of disposable income (USD630bn).

Figure 6: Net lending, households' sector (four quarters sum, % disposable income)



Sources: LSGE Refinitiv, Allianz Research

But there should be light at the end of the tunnel in 2024: households are likely to become more optimistic as central banks progressively cut interest rates, reducing the accumulation of "excess" savings as net worth turns positive. In addition, the consumer credit cycle should remain dynamic and potential tax cuts could also support UK consumption in 2024. Meanwhile, in the US, the rapid rise in the stock market and ongoing recovery in house prices will continue to drive up net worth. US households also still have excess savings to spend (about 4% of their

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[8] *The net lending (or borrowing) position is defined as gross savings minus investment, which for households is essentially housing investment.*

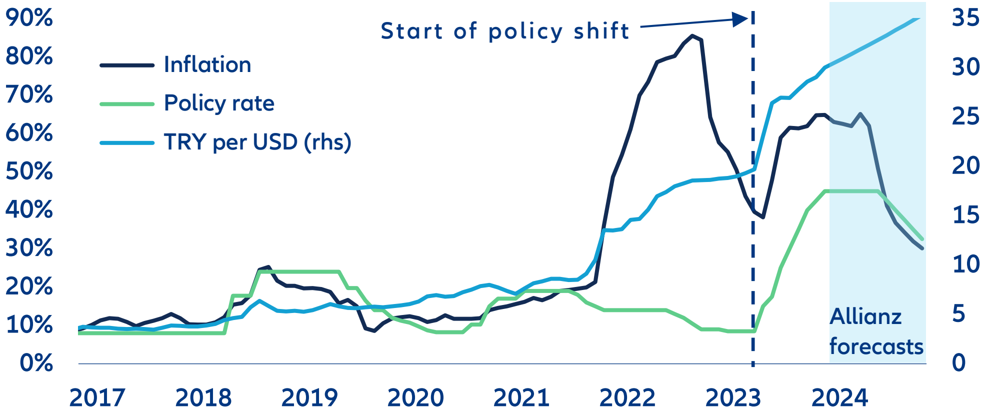
disposable income). All this sets the stage for healthy consumer spending growth in 2024, which could be supported even further by households' healthy financial positions.

Türkiye: pushing through economic rebalancing

This time will be different: Türkiye has another new central bank governor but monetary tightening is likely to continue. Earlier this month, former governor Hafize Gaye Erkan resigned suddenly, citing a press campaign against her. This briefly raised concerns that the transition to more orthodox monetary policies that began in June 2023 would be reversed, as in the past when the Turkish president fired a series of central bank governors for tightening monetary policy too much in his view. But policymakers, in particular Finance Minister Simsek, were quick to ensure that this time will be different. Erkan was replaced by Fatih Karahan, a former deputy in Erkan's team who is considered a hawk himself. He has reassured investors that the change will not lead to premature monetary easing and markets have remained calm for now. Karahan can build credibility at the next monetary policy meeting on 22 February, which will be closely watched. The key going forward will be to keep policy rates high enough for sufficiently long enough to ensure that inflation continues to fall later this year. We expect that the Monetary Policy Committee will stick to the intention communicated after its January meeting, when it indicated no further rate hikes but also no easing until inflation comes down significantly. We therefore forecast the current policy rate of 45.0% to be maintained until headline inflation falls below that rate (Figure 7).

Disinflation will be gradual and consumer price inflation is forecast to remain elevated at over 30% for the remainder of 2024. Inflation edged up slightly to 64.9% y/y in January on the back of a 49% minimum wage hike and continued strength in services inflation. Against this background, inflation is likely to remain close to 60% until mid-2024, before base effects, assuming continued restrictive monetary policies, will enable a disinflation process towards around 30% by the end of the year. Our forecast, which is more optimistic than the consensus and the forecast of the central bank of Türkiye (36%), would allow for a gradual monetary easing to begin in Q3 2024 (Figure 7).

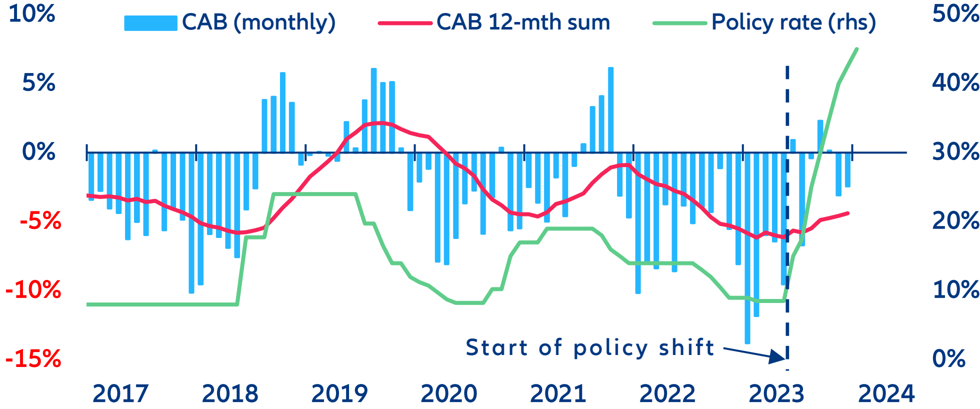
Figure 7: Inflation, policy interest and exchange rates



Sources: LSEG Datastream, Allianz Research

The rebalancing of Türkiye's large current account deficit will take time and will also depend on continued tight monetary policies. The transition to more orthodox monetary policies in June 2023 also included an end to the massive FX interventions by the central bank of Türkiye in defense of the TRY exchange rate. In combination with election uncertainty, the TRY depreciated sharply by 20% in June. Thereafter it has depreciated more gradually by 1-2% per month (Figure 7). But the weakened currency helped significantly reduce monthly current account shortfalls. On a 12-month moving average basis, the current account deficit narrowed from around -6% of GDP in May 2023 to an estimated -4.4% in December (Figure 8). Assuming continued orthodox policies, we forecast the annual shortfall to narrow further to a more comfortable -3% of GDP or so in 2024. A downside risk to this forecast would be an unexpected large increase in global energy prices because the energy trade balance combined with the non-monetary gold trade balance are the main contributors to Türkiye's overall current account deficit.

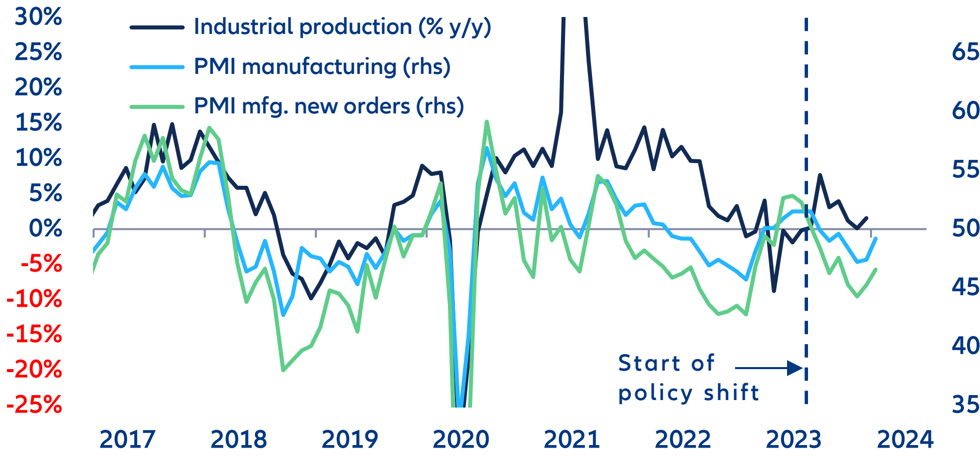
Figure 8: Current account balance (CAB, % of GDP) and policy interest rate (%)



Sources: LSEG Datastream, Allianz Research

However, the risk remains that the heavy short-term toll of tight monetary policy could prompt policymakers to abandon it too soon, thereby failing to reap the medium-term gains. Economic activity slowed down in the second half of 2023. Real retail sales growth decelerated from an average of +20.6% y/y in Q3 to +12.3% in Q4 and industrial production from +4.9% to +1%, respectively. Moreover, the manufacturing PMI and especially its new orders sub-component have been below 50 points since July 2023, indicating a contraction in the coming six months. Although monthly industrial production data and the PMIs suggest that output growth may have bottomed out (Figure 9), we expect economic performance to be soft in the first half of 2024 as continued tight monetary policies will curtail credit expansion and investment. On an annual basis, economic growth is forecast to ease from an estimated +4% in 2023 to around +3% in 2024. While such a rate appears reasonable for many others countries, it will only be half of the average growth that Türkiye recorded in 2010-2019. However, the short-term pain of an economic slowdown during the rebalancing period is inevitable in order to benefit from improving macroeconomic fundamentals in the medium term. Therefore, Turkish policymakers should resist any temptation to cut interest rates too early.

Figure 9: Industrial production growth and PMI manufacturing



Sources: LSEG Datastream, S&P Global, Allianz Research

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