LPEM FEB UI
UNIVERSITAS INDONESIA

Macroeconomics Analysis Series

# Indonesia Economic Outlook

2023

## Key Figures

GDP Growth (Q2 '22)
**5.44%**

Inflation (y.o.y. October '22)
**5.71%**

Credit Growth (y.o.y. Q2 '22)
**9.60%**

BI Repo Rate (7-day, October '22)
**4.75%**

Current Account Balance (%GDP) (Q2 '22)
**1.1%**

IDR/USD (October '22)
**IDR15,485**

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# Rising against the Odds

## Highlights

- *Solid domestic economic performance coupled with windfall from external sector has led to a higher-than-expected GDP growth of 5.44% (y.o.y) in Q2-2022.*
- *Driven by low-base effect, persistent trade surplus, and notable domestic consumption, we predict GDP to continue to grow at 5.81% (y.o.y) in Q3-2022 and 5.35% for FY2022.*
- *High GDP growth in Q2-2022 was contributed by robust domestic demand, seasonal events, commodities windfall, and delayed fuel price hike.*
- *The sectors of transportation & storage and accommodation and FnB were recorded as the best performers in Q2-2022, indicating that the demand for leisure activities and physical mobility of people was the engine of economic growth in the last quarter.*
- *Economic growth in Q2-2022 was strongly driven by household consumption, which posted solid growth of 5.51% (y.o.y) during April – June 2022.*
- *Remarkable credit performance in Q2-2022 indicates a strong rebound in economic activity.*
- *The annual inflation rate of 5.71% (y.o.y) in October 2022 was lower than the previous month as some food commodity prices began to decline.*
- *The investment realization in Q3-2022 recorded an all-time high in a decade, with IDR307.8 trillion or grew by 42.1% (y.o.y) compared to Q3-2021.*
- *Even though the exports have continued to rise over the year, the trade surplus has slightly corrected during Q3-2022 compared to Q2-2022 due to a faster acceleration in imports and a decline in export growth.*
- *The reduced trade surplus in Q3-2022 may twist the persistent current account surpluses for the remaining quarters in 2022.*
- *The risk of capital outflow and balance of payments deterioration will likely persist for the rest of 2022, as the Fed is expected to raise interest rates again in the remaining meetings this year.*

Indonesia's economy kept growing beyond expectations throughout 2022. In Q2-2022, the GDP figure grew substantially above consensus at 5.44% (y.o.y), making it the second-highest growth rate of Indonesia's economy since 2013 and being only lower to the growth rate of 7.07% (y.o.y) in Q2-2021. Several factors come into play in driving this high rate of growth in the second quarter of 2022. First, the momentum of domestic demand recovery is still prolonged due to lagging health recovery compared to other countries; thus, the low-base effect still prevails. Second, the seasonal event of Ramadhan and Eid Al-Fitr boosted consumption activity during Q2-2022. Contributed to 53% of GDP, household consumption grew by 5.51% (y.o.y) in Q2-2022, jumped from 4.34% (y.o.y) in the previous quarter. Third, the spike in commodity prices due to escalating geopolitical tension and global economic recovery has benefitted Indonesia as a net exporter of primary energy commodities, such as coal and CPO, in the form of export performance and tax revenues. Export grew by 19.74% (y.o.y) and taxes minus subsidies increased by 39.42% (y.o.y), the highest growth rate of net tax revenue since 2015. Lastly, the

decision of GoI to increase fuel subsidies and delay the fuel price hike in Q2-2022 amidst skyrocketing oil prices helped maintain a relatively low inflation level and purchasing power. Inflation during April-June period 'only' averaged at 3.79% and peaked in June with the inflation rate of 4.35% (y.o.y), well below the October inflation rate of 5.71% (y.o.y) and its peak during 2022 of 5.95% (y.o.y) in last September.

Table 1: LPEM FEB UI GDP Growth Forecast (y.o.y)

| Q3-2022 | FY2022 | FY2023 |
|---|---|---|
| 5.77% - 5.85% | 5.3% - 5.4% | 5.0% - 5.1% |

The second half of 2022 might pose various challenges that were not seen during the first half. The continuous aggressive monetary stance by major global central banks has driven capital flight from emerging markets, including Indonesia, causing substantial depreciation of their currency. Combined with rising commodity prices and fuel price hike policy implemented by GoI, depreciation of Rupiah has spurred domestic inflation to its highest level in the last seven years. Regardless, Indonesia's economy still has the potential to grow above 5% for the rest of 2022. Specifically for Q3-2022, the low-base effect could jack up the GDP growth as Indonesia's economy recorded its lowest positive growth rate during Covid-19 era in Q3-2021 (3.51%, y.o.y). In addition, solid domestic demand and excellent trade surplus would serve as additional support for Indonesia's growth in the rest of 2022. Thus, we predict GDP will continue to grow at around 5.81% (y.o.y) in Q3-2022 (estimate range from 5.73% to 5.81%) and 5.35% growth for FY2022.

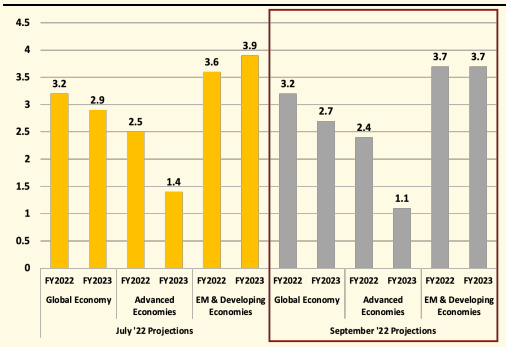
# Bumpy Road Ahead: Global Economic Turmoil and Risk of Debt Crisis

## The Cost of Aggressive and Uncoordinated Monetary Tightening

Two years after the pandemic-induced global recession in 2020, the world economy is currently facing a perfect storm of deepening stagflation with growing risks of financial crises. As growth slowed sharply, fears of an impending another round of global recession increased. Stagflationary pressures are also increasing as inflation hit new highs in decades in many countries. Moreover, geopolitical tension overshadows global growth prospects, with Russia's war against Ukraine has caused significant economic disruptions, amplifying pre-existing supply-side challenges and intensifying volatility in commodity markets. In addition, rising global borrowing costs increase the risk of financial distress among many countries which over the past decade have accumulated debt at the fastest rate in more than half a century, jeopardizing their debt sustainability. In addition, poorly timed policies and a lack of coordination among major countries have exacerbated these issues, pushing the global economy to the brink of collapse.

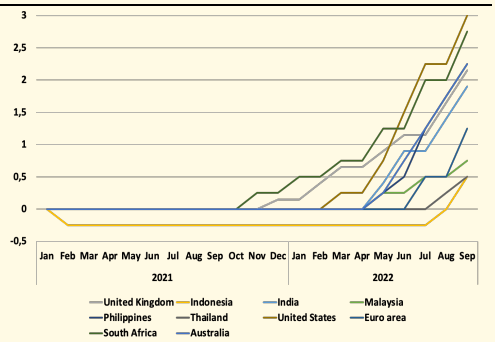
As a result, consensus for global growth in 2022 and 2023 has been downgraded significantly since the beginning of the year. Although this forecast does not suggest a global contraction for this or next year, there are patterns emerging from previous recessions, such as the fact that every global recession since 1970 has been preceded by a significant slowdown in global growth in the previous year. This condition is currently materializing—raising the prospect of a global recession in the near future. IMF forecasts global GDP growth to slow from 6.0% in 2021 to 3.2% in 2022 and 2.7% in 2023. These global growth forecasts have been corrected downward due to lower growth estimates for the two largest economies, the United States and China. This will be the weakest growth profile since 2001, except for the global financial crisis and the Covid-19 pandemic.

**Figure A: IMF Global Growth Projections (%)**




Source: World Economic Outlook October 2022

**Figure B: Cumulative Changes in Policy Rates (Percentage Points)**




Source: Bank for International Settlements (BIS)

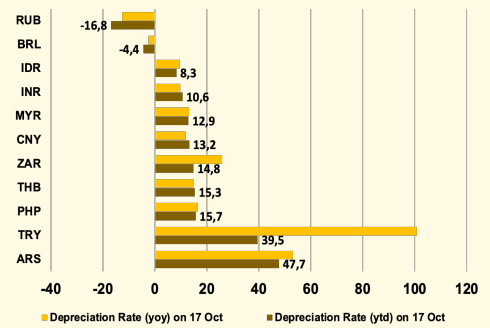
Meanwhile, the IMF also projected that global inflation to rise from 4.7% in 2021 to 8.8% in 2022 but decline to 6.5% in 2023 and 4.1% by 2024. Mounting inflationary pressures have been seen in the U.S. since early 2022, and are now also happening in the Euro area. With the global economic cycle turning and monetary tightening by most of the major central banks increasingly taking effect, headline inflation is projected to peak in the current quarter in most major economies and will remain well above central bank targets in most countries. However, it is expected to decline in the fourth quarter and throughout 2023.

Central banks around the world continue to tighten their monetary policy by hiking the interest rate in the spirit of tackling the ongoing global inflationary pressures, leading to vicious cycle that

triggers a global recession. Just in the last month, the Bank of England (BoE) and the Reserve Bank of Australia (RBA) raised their policy rate by 50 basis points. Meanwhile, in the same period, as the last major central bank to raise rates, the European Central Bank (ECB) continued its second tightening policy by raising its rate by 75 basis points, as inflation in the Eurozone reached 10% last month. Another large upward move was also taken by the US Federal Reserve, which has decided to raise its benchmark rate for the fifth consecutive time this year, with 75 basis points hike to the target range of 3.00%-3.25% in September 2022; making it the highest rate since 2008. In cumulative, the Fed has raised its policy rate by three percentage points since January 2021. Furthermore, many emerging market economies have extended tightening trends that they already began in mid-2021. Following the other EM countries, Bank Indonesia and Bank of Thailand have begun to raise their benchmark rates since August 2022, with a total hike of 125 and 50 basis points, respectively, this year, after being quite dovish for a long time.

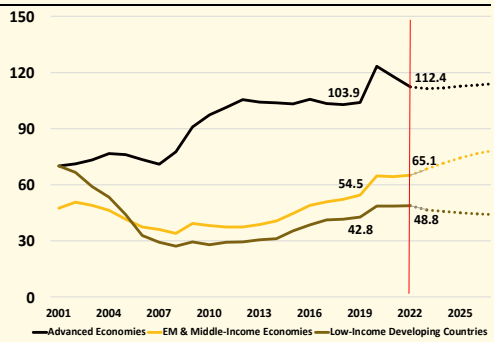
Among the policy failures that have aggravated the risk of stagflation, the Fed at first was slow to tighten monetary policy when inflation started to accelerate, focusing on current instead of prospective inflation performance. It then tightened more aggressively than expected, sending shock waves throughout the rest of the world. Those uncoordinated monetary policies have significantly undermined investors' confidence, triggering sharp declines, heightened volatility in financial markets, and depressed economic activity. The Fed's aggressive tightening has widened the interest rate differential between the US and other countries. As investors have become more risk-averse, higher US interest rates have resulted in net capital outflows from emerging markets. As a result, the US dollar appreciated to multi-decade highs while other major currencies depreciated further. The implications of a stronger dollar have exacerbated inflation problems in emerging markets, particularly in terms of imported inflation, forcing them to sacrifice foreign reserves and implement a tightening monetary stance to stabilize currency and tame inflationary pressures.

**Figure C: Depreciation Rate**




Source: Investing.com

**Figure D: Gross Debt Position (% of GDP)**




Source: International Monetary Fund

At the same time, the challenges that lie ahead are driven not only by a combination of high inflation and a bleak growth outlook but also by severe debt crises. As the aftermath of the Covid-19 crisis episode, which required all countries to deploy massive fiscal stimulus, the global economy has accumulated with debt. During the last three years, both developed and emerging countries' debt-to-GDP ratios increased significantly. Given the current circumstances, in which the global economy is slowing and the cost of living is rising, another round of fiscal stimulus may be required to maintain purchasing power and protect the poor and vulnerable groups. However, not all countries have the luxury of having adequate fiscal space to provide additional stimulus. This situation has put a number of countries at serious risk of facing sovereign debt crises.

Furthermore, the outcome of the Covid-19 crisis has resulted in an asymmetrical impact of debt burden among country groups, with middle-income countries in a rather unfavorable position.

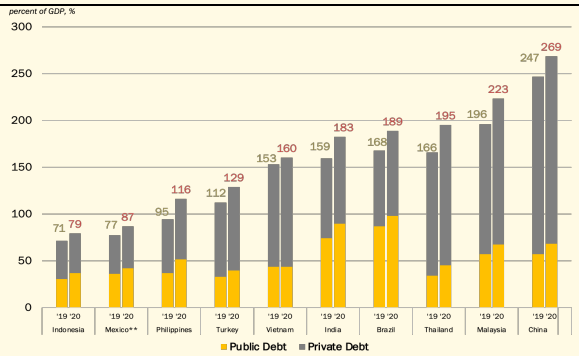
The group of advanced economies' debt to GDP ratio 'only' increased by 8.5% to 112.4% in 2022 from 103.9% in 2019, while the debt to GDP ratio of emerging market and middle-income economies increased by 10.5% (from 54.5% to 65.1%) during the same period. In general, emerging market and middle-income economies have a more limited fiscal space than advanced economies, and their debt issue has been exacerbated by higher relative debt accumulation during the Covid-19 era.

While all countries are facing the potential risk of debt sustainability issue down the road, countries other than advanced economies face greater pressure on their debt sustainability and a higher risk of debt crisis. Heavily indebted countries, such as Sri Lanka, are most likely to struggle with debt sustainability after the government announced a USD51 billion default on debt in April 2022. Overall, given this heightened uncertainty, many countries are at risk of sovereign debt default. Global monetary tightening has been broaching concerns regarding debt sustainability as interest rate hikes have added stress to countries grappling with mounting debt through higher borrowing costs.

## Indonesia's Debt Dynamics: Are We Susceptible To Global Debt Shock?

The pressure of monetary tightening on debt resilience is increasing since indebtedness has mounted following the extra spending needed to support economic activities during the unprecedented event of Covid-19 pandemic. The global public debt has soared to all-time high in 2020 compared to the pre-pandemic level. Similar to the climb in public debt, albeit not to the same extent, global private debt has also increased. In Indonesia, the private and public debt ratio to GDP has jumped to 79.3% in 2020 from 71.4% in 2019. The additional 7.9% public and private ratio was mainly driven by the higher general government public debt/GDP ratio of 6.1% since governments have boosted spending related to health aspects as well as household and business protection packages during the pandemic; making the total general government public debt/GDP ratio reached 36.6% in 2020. The higher debt in Indonesia was also contributed by the higher private debt ratio but with relatively benign escalation of only a 1.9% increase from 40.8% in 2019 to 42.7% of GDP in 2020. The rather steady private/GDP ratio can be explained by increased risk aversion among corporations during the health crisis following the muted demand, as more than half of gross private debt are the non-financial corporate debt (58%), while the rest is debt from household (42%).

**Figure E. Public and Private Debt Ratio in Developing Countries (% of GDP)**



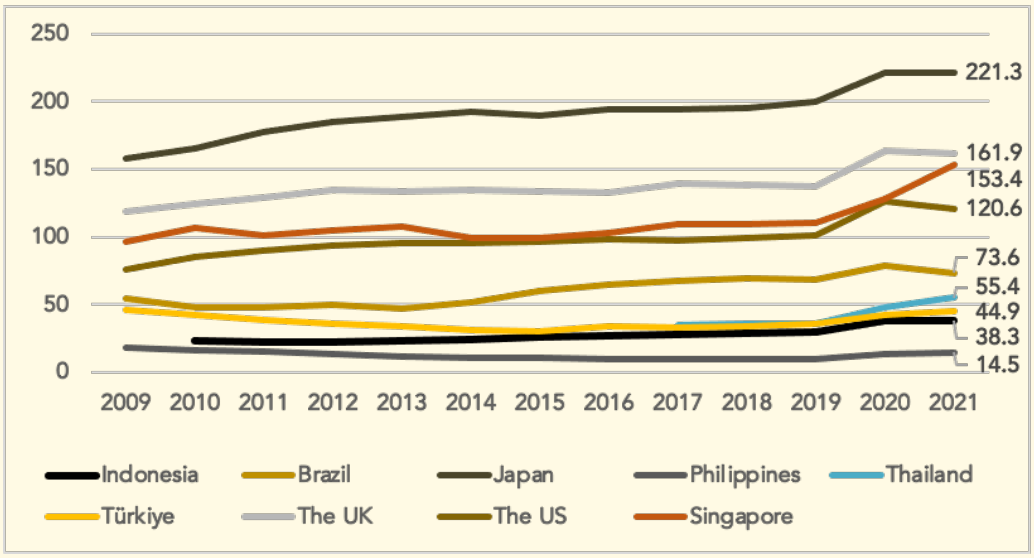

Source: IMF Global Debt Database

*Note: **Public sector debt** are general government debt (percent of GDP), **only central government data (percent of GDP); **Private sector debt** are loans and debt securities made by household and non-financial corporations (percent of GDP)*

Despite the higher debt during the pandemic, Indonesia's accumulation share of public and private debt to GDP was still relatively lower than other developing countries such as Thailand (195.3%), Malaysia (223.4%), and China (268.7%). Reviewing the government debt to GDP ratio, after reaching an all-time high of 41.6% in Q1-2021, Indonesia's government debt as a

percentage to nominal GDP has been decreasing since then and it was reported at 39% in Q2-2022, well below the maximum allowed ratio of 60%. Increase in commodity prices allowed state revenue to exceed its target in 2021 and the trend continues in 2022. The accumulated budget surplus may then be utilised as a fiscal cushion. While the current level is still higher compared to pre-pandemic level of around 30% of GDP, it is significantly lower than peers, such as Malaysia and Türkiye at 62.1% and 42.1%, respectively. The figure is also significantly lower compared to advanced economies, such as Japan, Singapore, and The U.S., which all have above 100% ratio. The relatively low debt to GDP ratio indicates that the higher debt burden of repaying the ballooned debt during the Covid-19 pandemic could be less risky in Indonesia relative to the size of the economies. Moreover, the risks of failing to meet the debt's interest and principal payments during the increasing trend of inflation and interest rate also depends on several factors, including the composition of creditors, currency, as well as maturity structure.

**Figure L: Central Government Debt (% of GDP), 2009 – 2021**

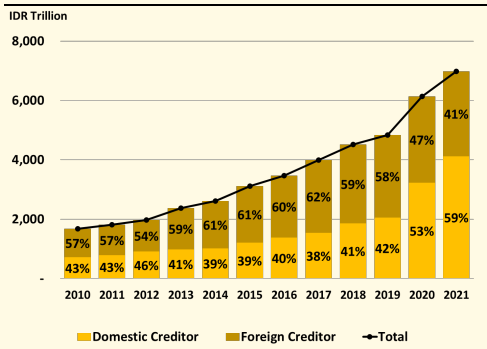



Source: CEIC

Looking carefully at central government debt, there has been an interesting shift on the composition of creditors. Share of central government debt from domestic creditors has been increasing at least since 2010 and has been dominating the total central government debt since 2020. By the end of 2021, central government debt was reported at IDR6,984 trillion with share of domestic creditors stood at 59% while central government debt from foreign creditors accounted for 41%. Increase in share of domestic creditors in 2020 was partly due to massive selloff by foreign investors and the agreement between Bank Indonesia and GoI, which the central bank purchased government bonds to provide cheaper financing for the government's Covid-19 relief measures, including health care and welfare bills. Bank Indonesia conducted direct purchase of government bonds of IDR397.6 trillion in 2020 and IDR439 trillion in 2021.

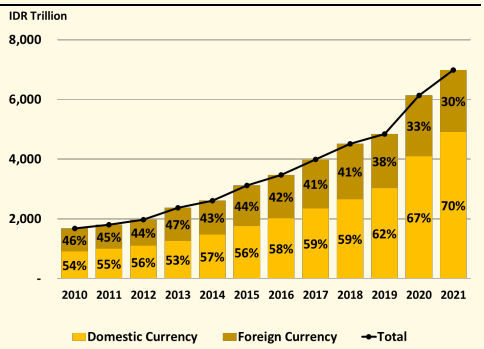
Examining central government debt by currency denomination, the share of domestic currency in central government debt has shown steady increase at least since 2010 at 54% to 70% in 2021. With higher debt denominated in domestic currency, there will be less exchange rate risk where exchange rate depreciation causes increased local currency payments over debt with a foreign currency value. Additionally, increase in interest rates triggered by the aggressive stance of most central banks raises the cost of borrowing, which would then translate into another burden in managing debt sustainability, especially for debt with foreign currencies-denominated.

Figure F: Gross Central Government Debt Composition by Creditors 2010-2021




Source: CEIC

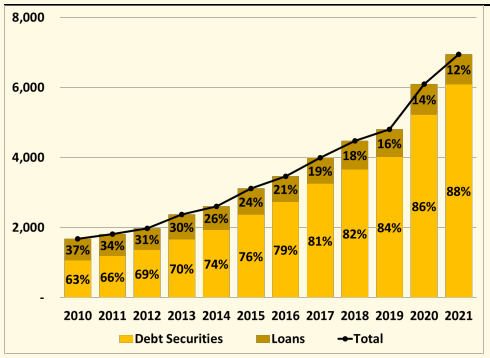
Figure G: Gross Central Government Debt Composition by Currency 2010-2021




Source: CEIC

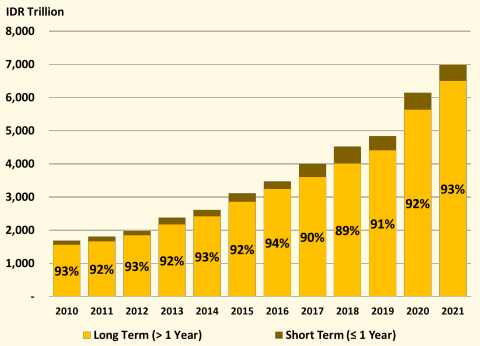
Exploring debt further, government debt mainly consists of debt securities rather than loans. In 2010, the proportion of government debt securities was 63% compared to 37% loans. The share of debt securities increases gradually and it reached 88%, or equivalent to IDR6,092 trillion, of total government debt of IDR 6,984 trillion while the share of loans was only 12% in 2021. There are at least two good reasons why the dominance of the securities over loans is actually a good thing. The first is that GoI will be forced to keep a high level of fiscal discipline every year. Any signs of mismanagement will be automatically punished by the market by higher yields; government bonds holders will tend to sell the bonds. Given the fact that GoI is still so eager to go up by one notch in the sovereign rating, fiscal discipline will be the main theme of GoI for the next several years. If successful, GoI will be rewarded with higher rating and lower yields, hence lower interest payment burden in the future. The second reason is that the government can use its bonds as the catalyst for financial market deepening to encourage more saving by providing a safe instrument.

Figure H: Government Debt by Type 2010-2021




Source: CEIC

Figure I: Government Debt by Remaining Maturity 2010-2021



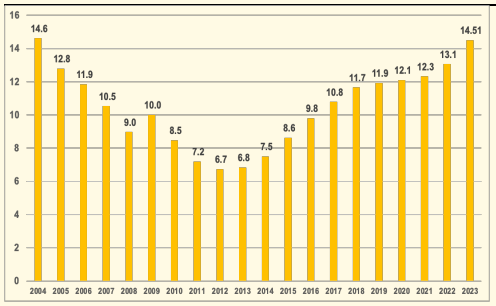

Source: CEIC

The government has also demonstrated a commitment to prudent debt management by extending the dominance of long-term maturity debt at least in the last five years. The latest data in 2021 shows that the government's cumulative debt is at IDR6,914.0 trillion, increasing gradually and substantially over the last five years, in line with financing needs for infrastructure development and other productive activities. More specifically, based on maturity, the debt was dominated by long-term debt, which stood at about IDR6,471.5 trillion or 93.6% of the total government debt and grew by 15.4% (y.o.y), while short-term debt stood at IDR442.5 trillion or 6.4% of the total and fell from previous year by 6.3% (y.o.y). This indicates that debt payments

will decline in the national budget together with an increase in the medium and long-term debt. Therefore, debt payments will burden the annual budget less in the future.

Looking at the expenditure component of the state budget, IDR405.87 trillion is allocated for interest payment in the 2022 Revised Budget or around 13.1% of total expenditure. The nominal value indicated an increase of 8.7% compared to the 2021 Revised Budget. The share of interest payment in total expenditure indicated a slow but steady increase since 2014, or since President Joko Widodo came into office. The accumulation of debt has mostly been channelled into productive use. The increase in debt is mostly for financing President Joko Widodo's infrastructure ambition and the goal of massive job creation. Massive spending has been channelled to large-scale projects, including airports, seaports, mass rapid transport systems, toll roads, as well as thermal and hydro-power plants. For 2023, the Ministry of Finance expected interest payment to be 14.5% of total expenditure or slightly above IDR441 trillion. This amount slightly increases compared to the 2022 Revised Budget figure. An increase in nominal interest payments mostly comes from accumulated debt in the last three years during the pandemic. The Ministry of Finance is said to follow several strategies in managing interest payment and debt in general for 2023; debt switch and prioritize debt in domestic currency to limit exchange rate risk.

**Figure J: Indonesia's Interest Payment (% of Expenditure)**




Source: CEIC
Note: Data for 2011 – 2021 are from realised budget, data for 2022 is from revised budget, data for 2023 is from budget forecast.

**Figure K: S&P Credit Rating of Selected Countries**

| Credit Rating | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Brazil | BB | BB | BB- | BB- | BB- | BB- |
| China, People's Republic of | AA- | A+ | A+ | A+ | A+ | A+ |
| India | BBB- | BBB- | BBB- | BBB- | BBB- | BBB- |
| Indonesia | BB+ | BBB- | BBB- | BBB | BBB | BBB |
| Malaysia | A- | A- | A- | A- | A- | A- |
| Mexico | BBB+ | BBB+ | BBB+ | BBB+ | BBB | BBB |
| Philippines | BBB | BBB | BBB | BBB+ | BBB+ | BBB+ |
| South Africa | BBB- | BB | BB | BB | BB | BB- |
| Thailand | BBB+ | BBB+ | BBB+ | BBB+ | BBB+ | BBB+ |
| Turkey | BB | BB | BB- | B+ | B+ | B+ |
| Vietnam | BB- | BB- | BB- | BB | BB | BB |

Source: World Government Bonds

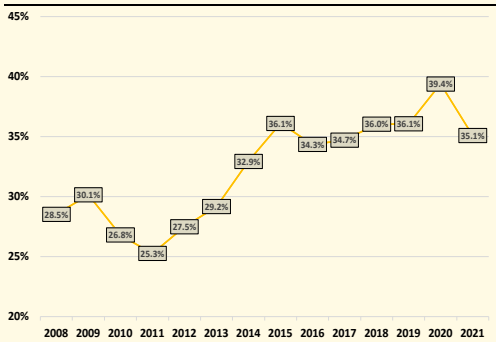
The favourable debt position combined with economic outlook brought three major credit rating agencies, namely Standard & Poor's, Moody's, and Fitch to rate Indonesia's government debt at BBB with stable outlook, Baa2 with stable outlook, and BBB with stable outlook, respectively. The better rating suggested that international investors have lower perceived risks towards Indonesia's sovereign creditworthiness, consequently reducing borrowing cost via lower expected yield. Compared to neighbouring countries, including Malaysia, Philippines, and Thailand, Indonesia still has lower credit rating, however, in the last six years, Indonesia's credit rating has been upgraded two times, indicating continuous improvement due to collective efforts in macroeconomic stability supported by monetary, fiscal, and structural changes to ensure strong economic growth as well as how investors increasingly put their trust in Indonesia's performance.

Observing into external debt, Indonesia's external debt position in 2021 is amounted to around USD416 billion, almost tripled from its postion back in 2007 and 30% larger than it was five years

ago. At first glance, the soaring trend of Indonesia's external debt, both from public and private sector, has risen the question about its sustainability and potential risks from its exposure, especially from the currency risks. Though it seems to be increasing fast, several measurements could be used to assess properly its risks. One measurement is to use external debt to GDP ratio. Indonesia's external debt to GDP ratio, historically, has steadily increased during the ending period of commodity boom from 2011 to 2015 and has been stable afterwards within the range of 35%-36% (except a slight jump to 39.4% in 2020 due to Covid-19 outbreak, declining the GDP figure), which currently stood at 35.1% in 2021. As a proportion to the size of economy, Indonesia's external debt is relatively low compared to its emerging peers, such as Brazil (35.3%), Thailand (37.9%), South Africa (38.3%), Vietnam (38.4%), Mexico (46.3%), Turkiye (54.2%), Argentina (56.6%), and Malaysia (69.3%).

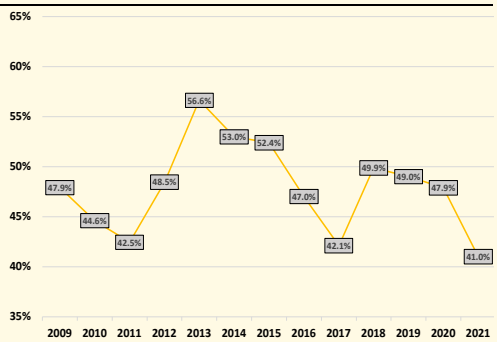
In addition, the maturity profile of the external debt serves as the proxy of the external debt sustainability. The smaller the proportion of short-term debt, the more sustainable is the debt. In the last ten years, the ratio of short term external debt by original maturity to total external debt has been decreasing from 17.54% in 2012 to 11.51% in 2021. Similarly, short-term external debt by remaining maturity to total external debt ratio over the same period also declined from 21.65% to 14.28%. This illustrates an improving external debt management over the years.

**Figure N: External Debt to GDP**




Source: CEIC

**Figure O: Short-Term Debt by Remaining Maturity to FX Reserve**




Source: Bank of Indonesia

In terms of payment capacity, another measure to consider whether Indonesia's external debt payment capacity is under control is the ratio of short-term debt to its forex reserves, as forex reserves plays a role as a proxy of the adequacy of foreign exchange currency. While fluctuating over the last 15 years, the ratio reached its lowest level last year since 2009 as it was recorded at 41% (Figure O). Furthermore, debt service ratio measures the ratio of repayments of external debt principal and interest to current account receipts. Tier 1 ratio that covers repayment of principal and interest on long term external debt and payment of interest on short term external debt in Q2-2022 was reported at 18.04%, a slight increase from three month earlier at 17.00% but considerably lower compared to the same period last year at 28.28%. Compared to its peers, Indonesia's debt service ratio in Q2-2022 is higher than India and Thailand at 5.20% and 5.68%, respectively, while lower than Brazil and Malaysia at 27.20% and 23.27%, respectively. While lower debt service ratio means that a country has more room to repay its loans, the current level is still well within a healthy range of 20% or below. Considering the condition of Indonesia's external debt based on 2021 data, Indonesia's external debt profile is relatively safe and stable. This puts Indonesia in relatively resilient circumstances and well-equipped to face current global financial volatility.

The second half of 2022 is a prolonged episode of aggressive global monetary tightening that triggers massive capital outflow from emerging markets, including Indonesia. Inevitably, the trend

of currency depreciation is taking place and countries with high exposure towards currency risk is facing serious issues of indebtness. High short-term debt denominated in foreign currency is a prolific recipe to a debt default, as happened to Sri Lanka earlier this year. Without proper debt management during normal times, countries could easily fall into the risks of default during turbulent times.

Thanks to prudent debt management in the pre-Covid-19 era and during turbulent times of Covid-19 era, Indonesia is not among the countries that are in serious risks of default in 2022 and 2023. As discussed above, Indonesia has been improving in almost all aspects of debt sustainability, such as ownership, debt-type, currency denomination, maturity profile, and creditor. Indonesian government debt is relatively low, mostly in the form of long-term debts and denominated in domestic currency. While interest payment burden has increased in the last several years, excellent fiscal discipline is in place to curb and potentially bring it down in the future. Splendid performance of fiscal prudence has resulted in improved credit ratings in the past couple of years. However, the upcoming challenges facing the debt sustainability issue might not be easy. Ongoing depreciation pressure and upcoming high interest-rate era could make the task of ensuring sustainability of external debt even rather challenging. Thus, debt management needs to be continually conducted in a vigilant manner that utterly requires strong coordination between GoI and BI.

## Keep Beating the Expectations

Indonesia's economic growth kept performing beyond expectations. The announcement of Indonesia's GDP data last July marked a second consecutive time the GDP figure grew well above consensus. Indonesia's economy grew by 5.44% (y.o.y) in the second quarter of 2022, making it the second-highest growth rate of Indonesia's economy since 2013 and being only lower to the growth rate of 7.07% (y.o.y) in Q2-2021. Several factors come into play in driving this high rate of growth. First, the momentum of domestic demand recovery is still prolonged. While many other countries has entered a normalization period of domestic demand after the economic slump during the Covid-19 pandemic, Indonesia was relatively lagging in its health recovery. This puts Indonesia in a position which still enjoyed the low-base effect and pent-up demand during Q2-2022.

*"Indonesia's economy grew by 5.44% (y.o.y) in the second quarter of 2022, making it the second-highest growth rate of Indonesia's economy since 2013 and being only lower to the growth rate of 7.07% (y.o.y) in Q2-2021."*

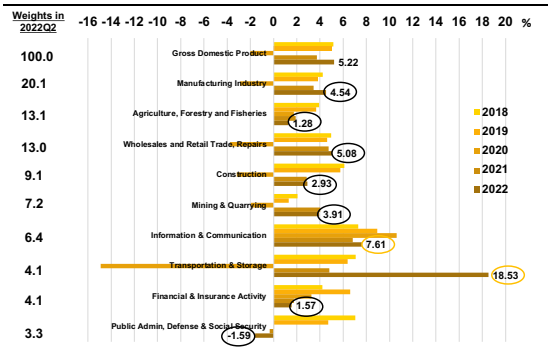
The second factor that supports the robust domestic economic performance is the seasonal event. The period of Ramadhan and Eid Al-Fitr that occured during Q2-2022 also contribute to the solid growth of economic and business activity. The escalating geopolitical tension and global economic recovery has pushed up main commodity prices, which plays the third factor. As a net exporter of main commodities, such as coal and CPO, Indonesia enjoyed a tremendous amount of windfall in terms of export and tax revenues which substantially contributed to the high growth of Indonesia's economic growth in the last quarter. However, the rising commodity and energy prices posed some risks to economic growth as it will subsequently rising price level, hurting production costs and consumers' purchasing power. Thankfully, this potential negative impact has been minimized by the fourth factor. The decision taken by GoI to increase fuel subsidy and maintain its price level during Q2-2022 amidst skyrocketing oil prices helped maintain a relatively low inflation level during that period. Regardless, GoI decided to reduce fuel subsidies and increase fuel price later on in Q3-2022. The result of policy action in delaying

the fuel price hike is that consumption grew steadily as the momentum of demand recovery during the second quarter of 2022 was not met by declining purchasing power as inflation was kept in check.

In terms of sectoral growth, the sectors of transportation & storage and accommodation and FnB recorded as the best performers in Q2-2022, indicating that the demand for leisure activities and physical mobility of people was the engine of economic growth in the last quarter. Transportation & storage sector experienced a growth increase and continuing its double-digit growth rate from 15.79% (y.o.y) in Q1-2022 to 21.27% (y.o.y) in Q2-2022. Furthermore, the growth of the accomodation and FnB industry increased to 9.76% (y.o.y) from 6.56% (y.o.y) during the same period. On the other hand, manufacturing, as the biggest sector in Indonesia's economy experienced a notable decline of growth as it grew only 4.01% (y.o.y) in Q2-2022 compared to 5.07% (y.o.y) in the previous quarter. The lower growth of manufacturing sector is partly contributed by the high-base effect as it grew substantially in the same period of last year.

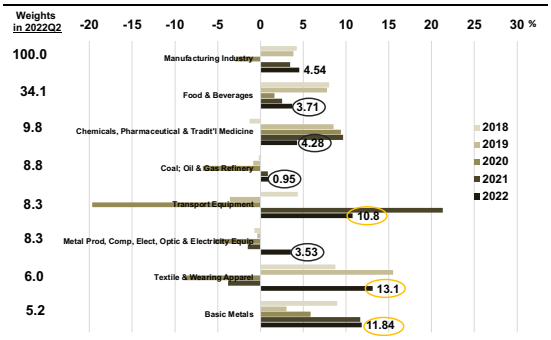
*"...the sectors of transportation & storage and accommodation and FnB recorded as the best performers in Q2-2022, indicating that the demand for leisure activities and physical mobility of people was the engine of economic growth in the last quarter."*

**Figure 1: Growth of GDP and the Main Industries, 2018-2022Q2**




Source: CEIC

**Figure 2: Growth of Manufacturing Sector and Its Subsectors, 2018-2022Q2**

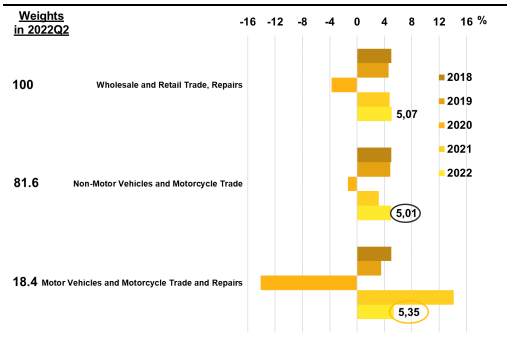



Source: CEIC

The slower growth of manufacturing industry in the last quarter is reflected on its main contributors. With the contribution of more than a third to manufacturing industry, the growth of FnB subsector slightly dipped from 3.75% (y.o.y) in the first quarter of 2022 to 3.68% (y.o.y) in Q2-2022. However, this growth rate is still relatively well above 2021 overall growth rate of 2.35% (y.o.y). Similarly, chemical, pharmacy & traditional medicine as the second biggest subsector within the industry grew substantially lower to 2.10% (y.o.y) in Q2-2022 from 6.47% (y.o.y) in the previous quarter. The massive growth decline of chemical, pharmacy & traditional medicine subsector might be contributed by rapid decrease of demand for pharmaceutical products following a rapid improvement of domestic health condition. On the other hand, several smaller subsectors recorded a notable double-digit growth rate in Q2-2022. Compared to the first quarter of 2022, in Q2-2022 textile & wearing apparel and leather & footwear subsectors grew 13.74% (y.o.y) from 12.45% (y.o.y) and 13.12% (y.o.y) from 8.25% (y.o.y), consecutively. Subsector of basic metal recorded the highest growth within the industry with the growth rate of 15.79% (y.o.y) in Q2-2022, a rapid increase from 7.90% (y.o.y) in the previous quarter. Similarly, the growth of machinery and equipment subsector increased from

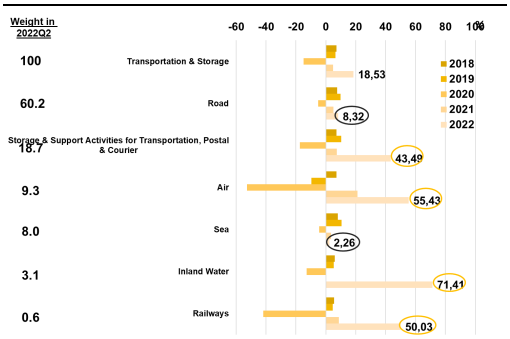
9.92% (y.o.y) in Q1-2022 to 11.22% (y.o.y) in Q2-2022. The substantial growth of these four subsectors signalled the rising demand of durable manufactured products following the increased economic activity and improved consumer optimism.

**Figure 3: Growth of Wholesale and Retail Trade and Its Subsectors, 2018-2022Q2**




Source: CEIC

**Figure 4: Growth of Transport and Its Major Subsectors, 2018-2022Q2**




Source: CEIC

*"The sluggish growth of sub-sector of motor vehicle and motorcycle trade was in parallel with the data from GAIKINDO which reported a notable amount of declining rate in motorcycle sales."*

Aside from manufacturing, higher-base effect also partly affected to the slower growth recorded by wholesale and retail trade sector. The regarding sector showed a solid growth in the similar period last year by 9.52% (y.o.y). In Q2-2022, the wholesale and retail trade grew 4.42% (y.o.y) or slightly down from the growth in previous quarter which accounted at 5.71% (y.o.y). Looking at each of its components, the sub-sector of non-motor vehicle and motorcycle trade, which grab the largest portion of the total wholesale and retail trade by 82.4%, experienced a substantial decline of growth to 4.67% (y.o.y) in Q2-2022 after a strong bound of 5.34% (y.o.y) in previous quarter. Likewise, the sub-sector of motor vehicle and motorcycle trade also noted a sizable growth dip from 7.14% (y.o.y) in Q1-2022 to 3.28% (y.o.y) in Q2-2022. The sluggish growth of sub-sector of motor vehicle and motorcycle trade was in parallel with the data from GAIKINDO which reported a notable amount of declining rate in motorcycle sales.

Contrary to the moderate growth recorded by wholesale and retail trade, transportation and storage continued its elevated growth pattern in three consecutive quarters after a bleak growth in Q3-2021. In Q2-2022 the transportation and storage sector recorded another double-digit growth of 21.27% (y.o.y) or substantially increased from the previous quarter growth of 15.79% (y.o.y). Looking at its components, road transportation as the primary contributor with 58.2% of share from the total transportation and storage sector grew to 9.77% (y.o.y) in Q2-2022 from 6.87% (y.o.y) in Q1-2022. Meanwhile, among all its components, sub-sector of inland water even experienced a triple-digit growth of 100.91% heavily elevated from 41.90% (y.o.y) in preceding quarter. Next to inland water, air transportation as well as railways transportation also succeeded in maintaining a strong pattern of growth of 53.20% (y.o.y) and 43.11% (y.o.y) in Q1-2022 to 57.67% (y.o.y) and 56.94% (y.o.y) in Q2-2022, respectively. The favourable performance shown by transportation and storage sector was strongly driven by the higher mobility during Ramadhan and Eid-al-Fitr festivities. As we march toward the pre-pandemic

situation, it is also expected that transportation and storage sector will easily maintain its positive pattern in several periods ahead.

The world is recovering after a depressing period of pandemic triggered by the spread of the Covid-19 period. In Indonesia, people are now allowed to make a long trip, visit public places, including school and offices, and conduct normal activities as before the pandemic. The robust growth by almost all sectors in economy in Q2-2022 signals a notable achievement in executing the recovery plans. However, despite the better circumstances that are currently happening in domestic, global threat should be anticipated by policymakers in a proper manner. From the burning level of inflation to the accelerating pattern of interest rate around the world, GoI should prepare a cushion that will prevent the impacts of those events from deteriorating Indonesia's growth in the near future.

*"The robust growth by almost all sectors in economy in Q2-2022 signals a notable achievement in executing the recovery plans. However, despite the better circumstances that is currently happening in domestic, global threat should be anticipated by policymakers in a proper manner."*

## Domestic Economy Remains Resilient

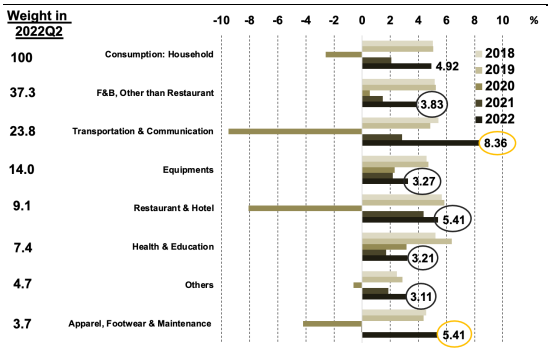
Exceeding consensus forecast, economic growth in Q2-2022 was strongly driven by household consumption and exports. Continuing the pattern from the first quarter in 2022, all expenditure components was recorded to have positive growth, except for government expenditure that continued to contract at 5.24% (y.o.y) following a negative growth of 7.74% (y.o.y) in Q1-2022. Due to its nature of being countercyclical, fiscal stimulus continued to be tapered off as the economy gradually getting back to its normal state, as reflected in the contraction of growth of government spending. Focusing on budget realization, as of end of June 2022, expenditure realization was at IDR1,243.6 trillion or 40.0% of the ceiling in the state budget. This figure is up 6.3% (y.o.y) compared to expenditure in the first semester of 2021. The government expenditures are directed towards the distribution of various social assistance & subsidies, funding for national strategic projects, as well as economic recovery programs, including transfers to regions. What was interesting is that during the first semester, government's budget balance indicated a surplus of IDR73.6 trillion or 0.39% to GDP on the back of increasing state revenue due to voluntary declaration program.

Zooming in on household consumption, the highest source of economic growth, it posted a solid growth of 5.51% (y.o.y) during April – June 2022, higher than the growth in the first three months of 2021 at 4.34% (y.o.y). The robust growth is due to easing social restrictions and Ramadan and Eid Al-Fitr celebration that took place in Q2-2022, which resulted in peaking consumption. Diving into its components, all consumption groups had a positive growth in the April – June 2022 period with consumption of food & beverage, transportation & communication, and equipments, which accounts for 75.3% of total consumption, having growth of 4.09% (y.o.y), 9.69% (y.o.y), and 3.31% (y.o.y), respectively. High growth of transportation & communication group suggested an easing concern over Covid-19 virus, which allows GoI to ease social restrictions and people to travel more freely.

Moving on to investment, a positive growth of 3.07% (y.o.y) was recorded in Q2-2022. lower than growth in previous quarter at 4.09% (y.o.y). Growth in buildings & structures that accounts for 73.8% of total investment was reported at 0.92% (y.o.y) while investment in machine & equipment that contributes 12.1% of total investment

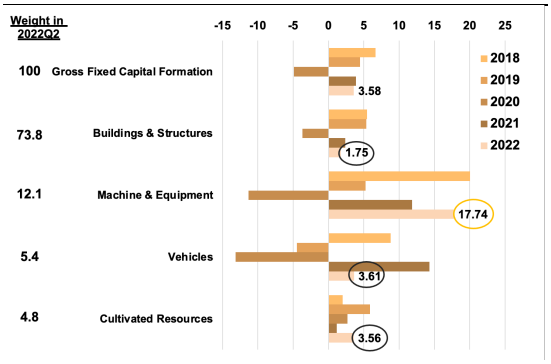
recorded a high growth of 16.30% (y.o.y) in Q2-2022. Although less than previous quarter, positive growth of all investment components indicated recovery remains intact.

Figure 5: Growth of Household Consumption and its Components, 2018-2022Q2




Source: CEIC

Figure 6: Growth rate of Investment and its Main Components, 2018-2022Q2




Source: CEIC

*"Although less than previous quarter, positive growth of all investment components indicated recovery remains intact."*

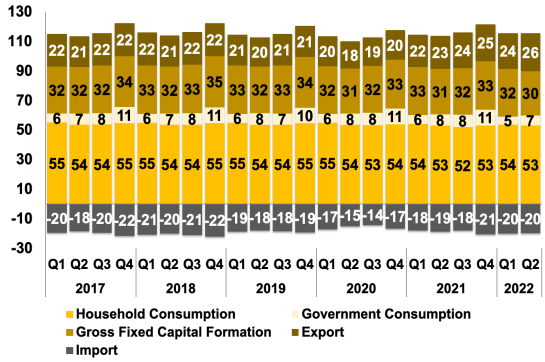
Moving on to the credit performance, total credit grew substantially high by 9.60% (y.o.y) in Q2-2022, jumped from 6.27% (y.o.y) a month earlier. This remarkable overall credit figure has slowly returned to its normal trajectory of the pre-pandemic level, indicating that recovery progress was on track as both production and consumption activities have gradually returned to normal. By purpose, the highest growth was seen in working capital credit with a double-digit growth, mounting from 7.54% (y.o.y) in Q1-2022 to 11.99% (y.o.y) in Q2-2022. Following that, investment and consumption credit also increased to 8.79% and 6.54% (y.o.y) from 5.05% and 5.43% (y.o.y), respectively, in the preceding quarter.

Meanwhile, according to the latest data in August 2022, the third-party fund grew at a slower pace by 7.77% (y.o.y) compared to the preceding month's figure at 8.60% (y.o.y) in July. It indicates a strong rebound in economic activities and public confidence remains optimistic toward the domestic economy. Along with higher credit disbursement, however, asset quality as reflected by NPL remained manageable at 2.88% in the latest data in August 2022. With the overall developments, banking liquidity remains generally stable as reflected in the Loan to Deposit Ratio (LDR) which was relatively flat at 81.2% in August 2022.

In the midst of high uncertainty as the threat of a global recession looms, Indonesia's banking sector is currently in excellent condition thanks to strong financing and improved implementation of risk management. In the current normalization policy taken by BI to tame inflationary pressures and stabilize Rupiah, we still expect credit disbursement to accelerate further in line with domestic economic recovery. Aside from Reserve Requirements hikes, BI has maintained its tightening stance by raising the policy rate by a total of 125bps in the last three months. Therefore, the era of low-interest rates has ended and banks will now face a higher interest rate environment going forward which potentially increasing the cost of funds. Nonetheless, the impact of interest rate hikes on the real sector will be limited this

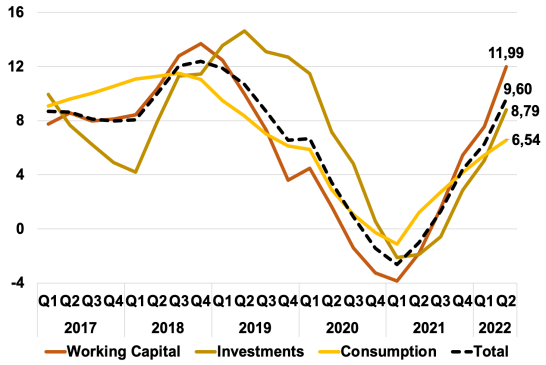
year and may be fully materialized next year, as confidence in domestic fundamentals remains high.

Figure 7: Shares of GDP Components, 2017Q1-2022Q2 (%)




Source: CEIC

Figure 8: Credit Growth by Purposes, 2017Q1-2022Q2 (y.o.y, %)




Source: CEIC

## October Inflation Pressure Begins to Slow Down

*"The annual inflation rate of 5.71% (y.o.y) in October 2022 was lower than the previous month as several food commodity prices began to decline."*

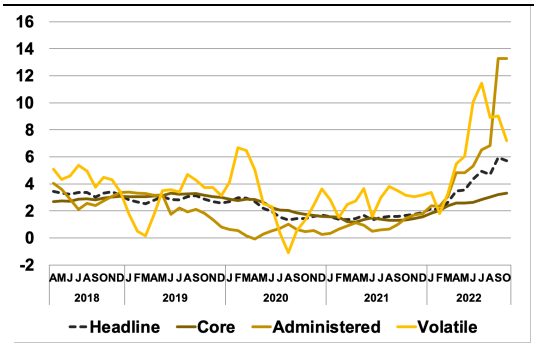
The headline inflation rate in October 2022 was recorded at 5.71% (y.o.y), starting to weaken after hitting a record high in the previous month at 5.95% (y.o.y). This was due to the downward trend in the prices of several food commodities, where the food ingredients inflation was recorded at 7.04% (yoy), lower than 8.69% in September. At the same time, volatile foods category also decreased and was recorded at 7.19% (y.o.y). However, the inflation rate for energy component is still soaring up to 16.88% (y.o.y) which was also reflected in transportation sector inflation with 16.03% (y.o.y) as a second-round effect of the adjustment of subsidized fuel prices by GoI.

Core inflation was recorded at 3.31% (y.o.y) in October 2022, slightly higher than inflation in the previous month which was recorded at 3.21% (yoy). This is the highest since September 2019 which was recorded at a level of 3.32% (y.o.y), although it is still considered relatively benign. The increase in core inflation was mainly due to the increase in fuel prices, which had a direct impact on inflation in the transportation sector. Core inflation is expected to continue as fuel price adjustments have an indirect impact on rising commodity or food prices.

On a monthly basis, inflation occurred in all sectors except the food ingredients sector (-1.49%), food, beverages, and tobacco (-0.96%), and information, communication, and financial services (-0.07%). Meanwhile, core inflation was maintained at a low level of 0.16% (m.t.m), down from 0.30% (m.t.m) in September 2022 in line with the lower propagation impact of the fuel price adjustment and the lack of strong inflationary pressure from the demand side. On the other hand, the volatile foods category in October 2022 recorded deflation of 1.62% (m.t.m), higher than the initial estimation and deflation in the previous month of 0.79% (m.t.m). This was mainly influenced by price reduction of various chili peppers as well as eggs and broiler meat which was supported by an increase in stock in line with the harvest

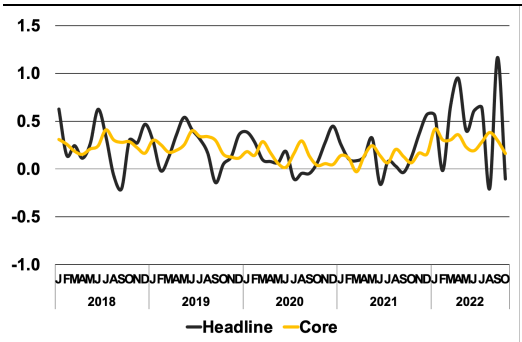
season of horticultural products, a more than adequate supply of eggs and broiler meat, as well as price controls efforts done by the GoI.

Figure 9: Inflation Rate (%, y.o.y)




Source: CEIC

Figure 10: Inflation Rate (%, m.t.m)




Source: CEIC

*"The investment realization in Q3-2022 recorded an all-time high in a decade, with IDR307.8 trillion or grew by 42.1% (y.o.y) compared to Q3-2021."*

All in all, BI needs to remain vigilant because the risks of further surges prevails, particularly from imported inflation as the currency depreciation might prolong in the near future. On the domestic side, the price for basic necessities goods has the potential to rise further following the higher energy price due to the adjustment of subsidized fuel prices. Both risks will strain headline Inflation to continue exceeding the upper band of 4% BI's inflation target for the rest of this year. For 2023, headline and core inflation is expected to be gradually lessened given the trend of global energy price normalization and continuation of BI's pre-emptive and forward looking measure to mollify the anticipated inflation.

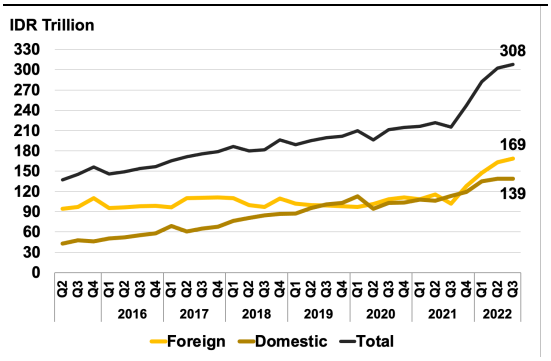
## Another Record of Investment Realization in a Decade

The investment realization in Q3-2022 set another new record in the last decade, with Rp307.8 trillion. This amount grew by 42.1% (y.o.y) or an increase of 1.9% (q.t.q) compared to the previous quarter. The investment realization consists of foreign direct investment (FDI), which was recorded at IDR168.9 trillion or grew by 63.6% (y.o.y), and domestic direct investment (DDI) which was recorded at IDR138.9 trillion or grew by 45.1% (y.o.y) compared to Q3-2021. In total, the investment realization from January to September 2022 has reached IDR892.4 trillion, an increase of 35.3% compared to last year (y.o.y). This figure has reached 74.4% of the 2022 investment target of IDR1,200 trillion. According to the sector, investment realization in Q3-2022 was mostly in the basic metal industry, metal goods, not machinery and equipment sector, with the amount of IDR44 trillion. Then, there is the transportation, warehouse, and telecommunications sector which are recorded at IDR32.5 trillion.

In terms of region, West Java absorbed the largest investment realization in Q3-2022, which was IDR44.9 trillion or 14.6% of the total investment. Followed by DKI Jakarta and Riau with IDR28.4 trillion and IDR27.5 trillion, respectively. As for the business sector, all three sectors of foreign investment except the primary one experienced an increase. The main contributor to the increase in the FDI realization itself came from the secondary sector, with an increase of almost 8% compared to the previous quarter. This shows that despite being in the midst of global economic

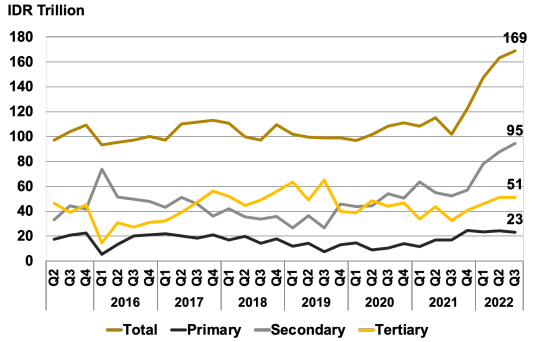
turbulence, investors' confidence, especially from the industrial sector, is still very high. The promising sign from investment is an opportunity for GoI to maintain economic growth amid the gloomy outlook of the global economy next year. In the short to medium term, GoI needs to maintain the attractiveness of FDI as a higher foreign investment can help ease the risks of further depreciation in the midst of financial market turmoil.

**Figure 11: FDI and Domestic Investment (Nominal)**




Source: CEIC

**Figure 12: FDI Realization by Sectors (Nominal)**




Source: CEIC

## Global Financial Turmoil Pressures the External Resilience

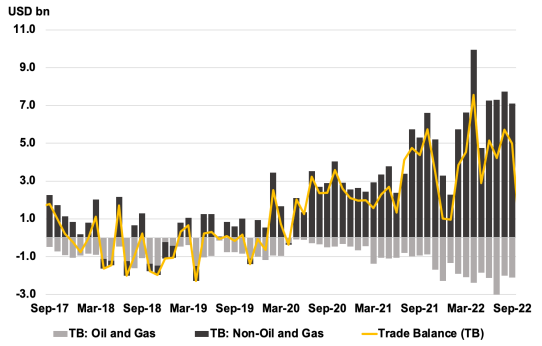
*"Even though the trade surplus has been consistent since May 2020, the primary factors affecting the surpluses have shifted from the heavy slowdown in imports during the muted activities in the beginning of Covid-19 pandemic to the faster acceleration in exports compared to imports due to commodity prices windfall in 2022."*

Almost three years into the pandemic, Indonesia's foreign trade balance in September 2022 continued to record a surplus for the 29th consecutive month. The overall trade surplus in Jan-Sept 2022 was recorded at USD39.9 billion, a jump from USD25.1 billion in the same period last year. Even though the trade surplus has been consistent since May 2020, the primary factors affecting the surpluses have shifted from the heavy slowdown in imports during the muted activities in the beginning of Covid-19 pandemic to the faster acceleration in exports compared to imports due to commodity prices windfall in 2022. Despite the pressures from global supply shortage and geopolitical tension between Russia and Ukraine, Indonesia managed to maintain a higher growth in exports than imports. As a result, the overall value of exports in Jan-Sept 2022 was recorded at USD219.4 billion, up from USD164.3 billion in the same period of 2021, resulting in the acceleration of exports of 34% (y.o.y). Export performance was bolstered mainly by higher commodity prices as the figure of Indonesia's exports remains largely contributed by raw materials and commodities. Based on its commodities, around 45% of the total exports in July-August 2022 were mineral resources, vegetable and animal fat, pearl, diamond, and precious metals.

At the same time, imports have also been growing by 29% (y.o.y), with the value of total imports increasing to USD179.5 billion in Jan-Sept 2022, up from USD139.2 billion in the same period in the previous year. Both imports of oil and gas as well as non-oil and gas have increased. Aside from the demand recovery for raw materials and capital goods needs for business activities, the growth in imports was mainly driven by the higher prices of oil and gas, as recorded by the 80% growth of imports in these commodities. Nevertheless, Indonesia's imports acceleration was still lower than exports, resulting in a favourable trade surplus.

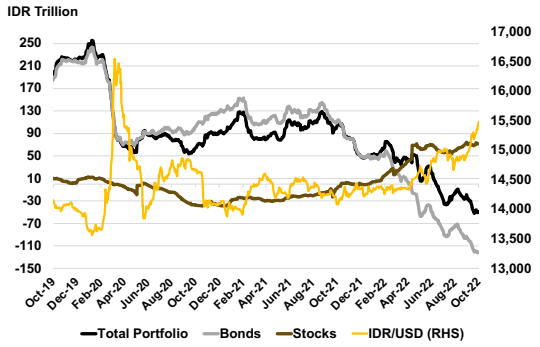
Even though the exports has continued to rise over the year, the trade surplus has slightly corrected during Q3-2022 compared to Q2-2022 due to a faster acceleration in imports and a decline in the growth of export. The higher value of imports in Q3-2022 compared to the same period in the previous year was contributed by the depreciation of the Rupiah, which also contributed to high imported inflation. The decline in exports, on the other hand, can be explained by the downward trend in the prices of Indonesia's primary export commodities, such as vegetable fats and animal oils, as well as iron and steel, since June 2022.

**Figure 13: Monthly Trade Balance (Nominal)**




Source: CEIC

**Figure 14: Exchange Rate and Accumulated Short-Term Capital Inflow**




Source: CEIC

*"The continuation of an interest rate hike by the Fed has significantly shifted the capital from emerging markets."*

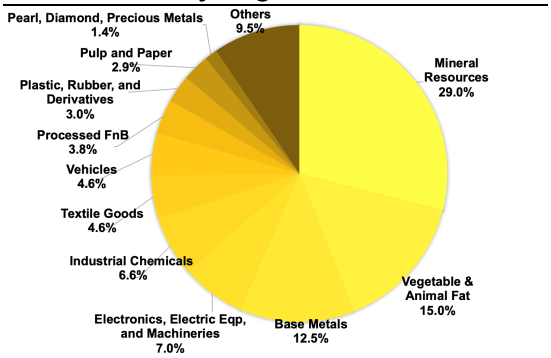
The reduced trade surplus in Q3-2022 may twist the persistent current account surpluses for the remaining quarters in 2022 as signs of commodity price normalization and recovering demand toughens. Nevertheless, the current account balance was still a recorded surplus in Q2-2022 at USD.3.9 billion, equivalent to 1.1% of GDP. The figure was even significantly higher than the surplus in one previous quarter at only USD1.5 billion or 0.5% of GDP. The commodity price windfall solely caused the improvement. However, global prices are moderating.

Moreover, capital and financial deficits in the balance of payment figure are widening as the global market deteriorates. The continuation of an interest rate hike by the Fed has significantly shifted the capital from emerging markets. In Indonesia, the capital outflow reached USD8.13 billion in mid-October compared to the first Fed rate hike in early March. The massive net sell-off in bond assets mainly contributed to the capital outflow while the stock market continued to record net buy. The tremendous bonds assets were lingering in Q3-2022, despite central banks of developing countries, including BI, having increased their benchmark ate. The risk of capital outflow will most likely persist until the end of 2022, as the Fed is expected to raise interest rates again in the remaining meeting this year.

Due to capital outflows, many emerging markets' currency, including Rupiah, are losing value against the US dollar. The value of the Rupiah has weakened to around IDR15,485 on October 17th, 2022, from around IDR14,300 in early 2022. The depreciation is expected to remain until the end of the year following the capital outflow. Nevertheless, the depreciation rate of the Rupiah will be relatively manageable as long as BI continues to perform measures to maintain Rupiah stability, which is foreign exchange market intervention through spot transactions,

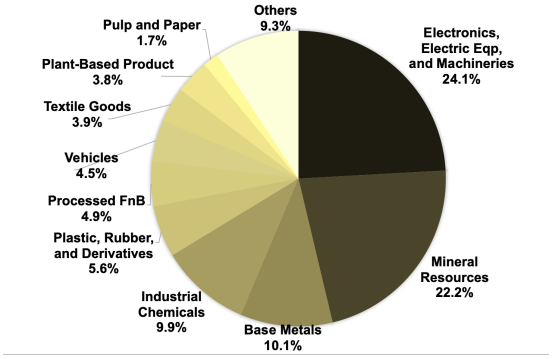
DNDF, and the purchase of SBN in the secondary market. Moreover, BI has ample foreign exchange reserves to cushion any turbulence in the near future, thanks to windfall energy prices. The reserves are still recorded at USD130.8 billion in September 2022, equivalent to financing 5.9 months of imports or 5.7 months of imports and servicing the government's external debt.

Figure 15: Indonesia Export Profile (July-August 2022)




Source: CEIC

Figure 16: Indonesia Import Profile (July-August 2022)




Source: CEIC

The capital market uncertainties, high domestic inflation, and trade surplus deterioration will continue to pressure Indonesia's external sector resilience until the end of 2022. The 125bps interest rate hike implemented by BI until October 2022 has helped to milden the potential massive capital outflow during the external vulnerability. To lessen the massive capital outflows in the last quarter of 2022, BI needs to maintain its Rupiah stability measures by following the ahead of the curve stance. The policy is expected to lessen the impact of external pressure on domestic financial and foreign exchange markets. Simultaneously, the GoI could prepare complementary measures to maintain macroeconomic conditions, particularly economic growth, amid the gloomy outlook for the global economy in 2023.

*"The 125bps interest rate hike implemented by BI until October 2022 has helped to milden the potential massive capital outflow during the external vulnerability."*