LPEM FEB UI
UNIVERSITAS INDONESIA

Macroeconomics Analysis Series

Indonesia Economic Outlook

Q2-2023

Key Figures

GDP Growth (Q4 '22)
5.01%

Inflation (y.o.y. April '23)
4.33%

Credit Growth (y.o.y. March '23)
9.81%

BI Repo Rate (7-day, April '23)
5.75%

Current Account Balance (% GDP) (Q4 '22)
1.3%

IDR/USD (April '23)
IDR14,867

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Back to the Old Normal

Highlights

- *Despite the global inflationary pressures and economic uncertainty, Indonesia continued to grow higher than expected by 5.01% in Q4-2022, making the overall GDP growth rate at 5.31% for FY 2022.*
- *Growth in manufacturing sector in overall 2022 reached its highest annual growth since 2013 and remained the main contributor to GDP.*
- *Following the robust domestic activity, particularly due to the upcoming Ramadhan and Eid festive in the first half of 2023, we estimate GDP to continue growing positively at 4.92% (y.o.y) in Q1-2023 and 4.9-5.0% for FY2023.*
- *The largest contributor to GDP from the expenditure side, household consumption, grew substantially by 4.48% in Q4-2022 with persistent growth in all expenditure groups as the result of higher consumer confidence following the easing restrictions and manageable Covid-19 pandemic.*
- *Credit growth continued to accelerate to 11.52% (y.o.y) in Q4-2022, marked as the highest level since the pre-pandemic era.*
- *The annual inflation rate in April 2023 fell to 4.33% (y.o.y) in April with the only price increase recorded in the clothing and footwear group following the upcoming Eid festive.*
- *Investors' confidence in domestic economy is improving as captured by the continuation of higher FDI realisation in Q1-2023.*
- *Easing commodity prices lowered Indonesia's trade surpluses in Q1-2023 compared to the previous quarter. The trend will remain in 2023 since raw materials and commodities account for the majority of Indonesia's exports.*
- *As a result of the declining surplus in goods, the current account balance may be lowered in 2023.*

Indonesia has managed to get through episodes of inflationary pressure, high commodity prices, global monetary tightening, and value chain disruptions rather splendidly. Economy grew by 5.31% (y.o.y) for overall 2022 after recording higher-than-expected growth at 5.01% (y.o.y) in Q4-2022. The persistent notable performance of economic growth was supported mainly by the solid domestic demand following the manageable public health situation and robust production activity stemming from commodity windfall. It is reflected in the sectoral figure with the growth of the biggest sector contributor to GDP, manufacturing industry, which has reached 4.89% (y.o.y) in 2022 and marked as its highest annual growth rate since 2013. Looking into the subsector of manufacturing industry, the significant growth of manufacturing industry was driven by its major contributor, the manufacturing of FnB. The double-digit growth of manufacturing of machinery and equipment and basic metal has also accelerated the growth of manufacturing industry and reflected the solid production activities in Indonesia throughout 2022. On the spending side, solid household consumption annual growth rate of 4.93% (y.o.y) and investment growth of 3.87% (y.o.y) have both contributed significantly to robust GDP growth. All the expenditure components grew positively in Q4-2022, except for government spending with its negative growth of 4.77% (y.o.y) in Q4-2022 due to lower health and social spending for Covid-19-related stimulus.

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

Q1-2023	FY2023
4.89 – 4.95%	4.9% - 5.0%

While the majority of countries around the world were struggling to get back on their feet, Indonesia's impressive economic growth has boosted business and household optimism for 2023. Indonesia has also managed to bring down its state budget deficit below 3% of GDP in 2022 (actualized at 2.38% of GDP), a year ahead of the deadline mandated by Law No.2/2020. Moreover, the pressures of high inflation have gradually decreased, with inflation falling to 4.97% (y.o.y) in March 2023 from a peak of 5.95% (y.o.y) in September 2022, thanks to the BI and GoI's serious efforts to monitor inflation. Inflation is likely to return to BI's target of 3±1% in September of this year after the low base effect disappears. From the external side, the trade of goods continued to record positive balance in Q1-2023 following the continuation of higher export growth than imports. The yearly growth of trade balance is mainly attributable with the reopening of China's economy. The persistent trade balance of goods coupled with the improvement in capital inflows have bolstered the external sector and helped stabilize Rupiah in the first half of 2023.

However, Indonesia's trade balance has faced the end of commodity windfall. The easing commodity prices may lower Indonesia's trade surpluses in 2023 as exports are still mainly contributed by raw materials and commodities. The foreseeable downward trade surplus is partly reflected in the lower trade surplus in Q1-2023 compared to the figure in Q4-2022 as both exports and imports in the first quarter of this year were lower than a quarter earlier. Given the decelerating commodity prices and looming gloomy outlook of global economy, Indonesia may not grow at faster pace compared to the last quarter in 2022. However, the economy will still grow at a positive rate of 4.92% (y.o.y) in Q1-2023 (estimate range of 4.89% to 4.95%), putting FY2023 at 4.95% (estimate range of 4.90% - 5.00%).

A Series of Unfortunate Bank Collapses

Bank Failures Fueled by Bank Runs

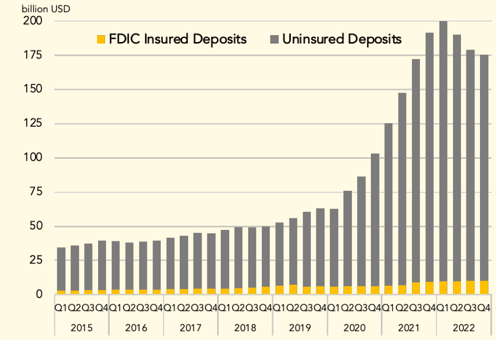
The recent failures of Silicon Valley Bank (SVB), Signature Bank, and Credit Suisse have raised attention on banking system soundness and who is to blame for this fiasco. Since March 2022, the Fed has been steadily hiking interest rates to combat soaring inflation. The higher-than-ever interest rate has driven up yields on US government bonds while the price of government bonds falls. As a result, the market value received by the bondholders plunged. While almost all banks worldwide face the implication of high-interest rate hikes, only certain banks have collapsed. It demonstrates that the interest rate hike is not the sole culprit of the recent bank failures.

In normal circumstances, a lower market value than the face value would not be a concern as long as the bondholders can hold onto it until maturity, at which time they can collect the face value without incurring any loss. However, if bondholders are compelled to sell their assets when the market value is less than face value, they will suffer a loss. The latter happened to SVB when they needed cash to meet the surge in withdrawals caused by the cash crunch from their depositors, which are mainly tech-based start-ups. Around 47% of total depositors were technology services companies that had suffered from funding winter and needed their deposits on hand after the Fed kept rising interest rates. Unfortunately, roughly 55% of SVB assets were invested in long-term assets, including government bonds whose market values are declining.

On March 7th, SVB planned to raise its capital to meet the deposits withdrawal demand, and Moody's notified SVB of their plan to lower SVB ratings. The next day, SVB made a public statement that they need to raise about USD2.25 billion in liquidity by selling their common and preferred stocks. This news concerned depositors and prompted higher demand for deposit withdrawal, causing SVB to liquidate around USD21 billion of its held-to-maturity portfolio with a loss of USD18 billion. In the evening of the day, Moody's downgraded SVB's long-term currency bank deposits and issuer ratings. The announcement of SVB's loss and downgraded rating have caused SVB stock to plummet, resulting in a run on the bank as more depositors requested large sums of money to be withdrawn on March 9th. The total amount of demanded withdrawal reached USD42 billion or around 25% of SVB's total deposits. Unfortunately, SVB failed to meet the demanded cash withdrawal due to limited liquidity. Thus, on March 10th, the California bank regulator decided to take over SVB to prevent the ripple effect of such failure and appointed the bank to Federal Deposit Insurance Corporation (FDIC). On the same day, FDIC announced that depositors' funds will be recovered on March 13th.

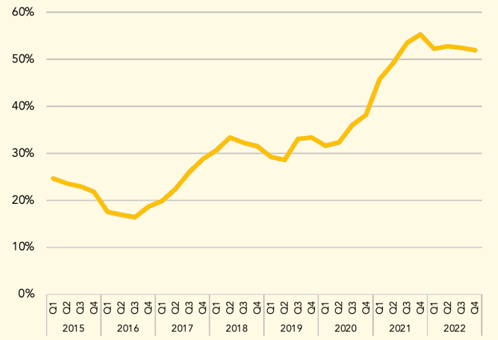
The collapse of SVB led to sudden panic among depositors and failed one more bank, Signature Bank, on March 12th. The SVB and Signature Bank failure is a textbook example of a bank run in which many depositors withdraw their funds from a bank at the same time due to panic. Banks are required by law to maintain a part of deposits in cash to meet depositors' withdrawal requests. However, if depositors withdraw large sums of money all at once, the bank may not have adequate cash reserves to meet their demands. This case can happen if depositors lose confidence in the ability of the bank to meet withdrawal demands, driving every depositor to want to be first in line. This bank run happened to SVB and Signature Bank, the second and third biggest US banking failures, respectively, in history following the bank crisis in 2008.

Figure A: SVB Insured vs. Uninsured Deposits (in billion USD)



Source: FDIC

Figure B: Share of SVB Long-term Assets to Total Assets (%)



Source: FDIC

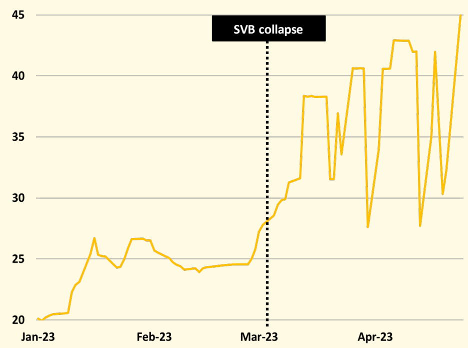
Looking deeper into the SVB case, the mismatch between assets and liabilities was the major driver of the bank failures on top of the interest rate hikes. SVB enjoyed a massive increase in deposits driven by the tech-based industry boom during the pandemic era. Therefore, they had confidence in storing the deposits into long-term maturity government bonds with higher yields in a low-interest rate period. Unfortunately, the yields moved inversely to the interest rate. SVB's assets on long-term maturity bonds began losing their value as the Fed persistently hiked the interest rate since March 2022. At the same time, SVB's depositors began to face funding winter, resulting in greater demand for deposit withdrawal, which peaked in January-February 2023. This combination exacerbated the insolvency of SVB. The bad circumstances faced by SVB caused depositors to lose their confidence, particularly those with uninsured deposits. SVB had a very low share of insured deposits as 88% of their deposits were uninsured. The domination of uninsured deposits helped to exacerbate bank runs as most depositors try to slide from potential loss. In comparison, the second largest investment bank, Goldman Sachs Bank, recorded only 33% of their total deposits uninsured. It demonstrates that the high number of uninsured deposits may amplify bank runs caused by the assets and liability mismatch issues. On the other hand, no bank would have failed if all banks had matched asset liability management and a high number of insured deposits.

The recent collapse of two US-based banks has, directly and indirectly, impacted the banking sector and financial market. The immediate consequence is the rippling effect on other banks as depositors demand more withdrawals from their accounts. Based on total deposits in the US banking sector, deposit outflows reached around USD968 billion at the end of March 2023, down from its all-time high in April 2022. The deposit outflow is unavoidable; in the most rational decisions, people will reduce the risks by shifting their deposits to safer assets. The banking sector turmoil in the US has further exacerbated the crisis in Credit Suisse, which has been wracked with financial losses over the last few years. Credit Suisse is finally taken over by its competitor, UBS, on March 19th. Moreover, the failure of the two US-based banks has also heightened financial market uncertainty. The efforts taken by US regulators to guarantee the funds of depositors and the takeover of Credit Suisse by UBS can, at the very least, soothe the market. But such interventions on SVB and Signature Banks would also encourage moral hazard in the long run, decreasing banks' incentives to protect against interest rate, liquidity, and systemic risks.

Potential Impacts of the US Banks Failure to Emerging Markets and Indonesia

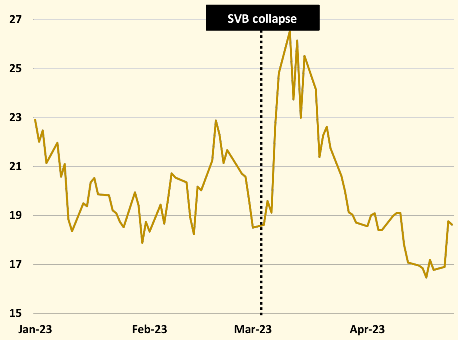
The collapse of SVB, followed by Signature Bank and Credit Suisse, has revealed their flaws in asset allocation resulting in the liquidity mismatch, which was relatively unseen before the current cycle of monetary tightening. Troubled banks have put a notable amount of third-party funds, which can be withdrawn at any moment, on a long-term asset of government bonds that has been losing its value due to the current cycle of interest rate hikes. Sensing the deteriorating banks' asset value, depositor of SVB and Signature bank was in the state of panic and swiftly withdraw their deposits. Once these banks declared bankruptcy, the first-round impact will hit the depositors. The case of banking turmoil in the US has put a big question mark among many countries on how regulators should respond to the current banking crisis as to limit its potential wider impacts. If not managed properly, this would have potential impact on emerging markets through several channels, namely financial and trade aspects.

Figure C: The United States 5-year Credit Default Swap



Source: Investing.com

Figure D: CBOE Volatility Index



Source: Investing.com

The recent banking turmoil may affect emerging markets in at least two ways. The first channel is through heightened risks and uncertainties in the global financial market that is primarily driven by the shock in the US banking sector. This is apparent in the rising of the US 5-year CDS and the volatility index (VIX) as proxies of heightened risks and uncertainties. As a result, investors shift their portfolio away from relatively risky assets towards the safe haven ones and emerging markets may expect either a weakening in capital inflow or potential outflow. However, several adjustments and measures that has been put in place by the US government to handle the banking sector turmoil eased the market, marked by steady decrease in the VIX figure. Thus, the impact of recent banking crisis toward emerging markets through the financial market channel is rather limited.

Should the Fed continue its monetary tightening cycle, the potential outflow from emerging markets, which causes currency depreciation, may come to realization as investors seek for higher return. Considering the low share of foreign ownership in government bonds that only accounts for less than 20% of total government bonds, the impact of rising FFR on Indonesia's financial market may be limited. Furthermore, many of EM's central banks, including Bank Indonesia, are forced to apply a similar scenario by increasing the domestic interest rate to maintain the spread. This procedure will potentially defer the domestic economic performance in the era of recovery after the pandemic. Regardless, BI considered the current spread is rather adequate and has been holding its policy rate steady since the SVB meltdown; thus, no subsequent domestic economic impact has been observed so far from this channel.

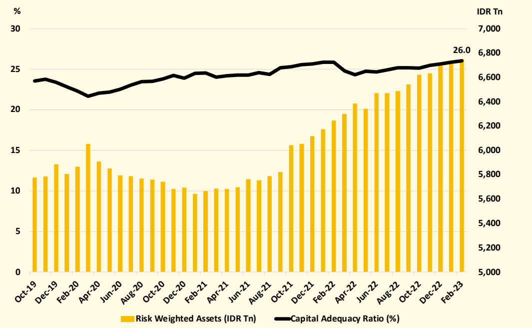
The continuation of rate hike by the Fed will likely cause US economic slowdown, which consequently will lower the Indonesian export demand by the US and affect the Indonesian import from the US. In 2022, the share of exports to the US was accounted for approximately 10% of the total exports, while share of imports was recorded at 4.9% of the total imports. Therefore, the recent dynamics in the US banking sector will possibly affect, though mildly, the overall Indonesia's trade performance. The other indirect impact is through the Rupiah's depreciation, which could make Indonesian import relatively more expensive and consequently lower current account surplus. However, given the overall low openness of Indonesia's trade, 46% of GDP, the burden from the collapse of SVB in this channel should be insignificant.

Current Condition of Indonesia's Financial Stability

The experience of Indonesian bank runs in the past has made the GoI continue to implement a range of reforms to strengthen the financial sector in Indonesia, especially the banking sector. One of the efforts made by the GoI is the implementation of the Financial Services Authority Regulation (POJK) concerning Consolidation of Commercial Banks which took effect on March 17, 2020. The POJK encourages the banking industry to undertake consolidation (merger/acquisition) efforts to strengthen the bank's capital side. In addition, POJK 12/2020 concerning bank consolidation also requires banks to have a minimum core capital of IDR 3 trillion by the end of 2022. Currently, there are only 4 banks classified as KBMI 4 or banks with jumbo core capital, which are Bank Mandiri, Bank Rakyat Indonesia (BRI), Bank Central Asia (BCA), and Bank Negara Indonesia (BNI).

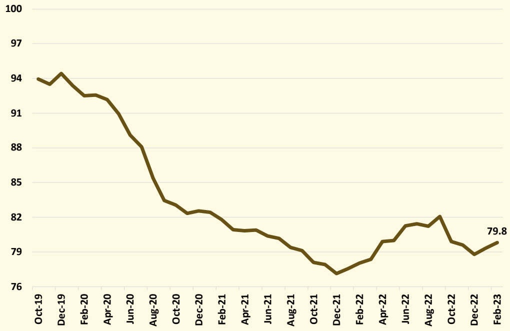
In terms of capital adequacy ratio (CAR), commercial banks' CAR in February 2023 was recorded at 26.02%, an increase of 0.52% compared to the previous month (m.t.m). The increase was triggered by an increase in commercial bank capital by 1.12% to IDR1.76 quadrillion from the previous month (m.t.m). Although at the same time, risk-weighted assets (RWA) also rose 0.59% to IDR6.75 quadrillion from the previous month (m.t.m). Compared to the previous year's position, the CAR ratio for commercial banks also increased by 0.65% (y.o.y). This increase was supported by an increase in bank capital of 8.77% (y.o.y). Meanwhile, banks' RWA also increased by 8.06% (y.o.y). This figure is higher than pre-pandemic which was at 22.33% and shows that the position of Indonesian banking capital is maintained at a good and adequate level. This also shows that in the midst of an increasingly uncertain world economic situation, the resilience of the national financial and banking system is still quite strong.

Figure E: Capital Adequacy Ratio & Risk Weighted Assets of Commercial Banks



Source: Indonesian Financial Services Authority, 2023

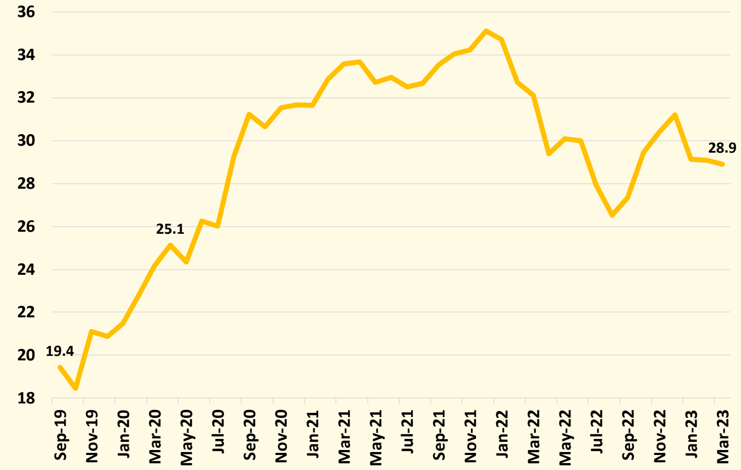
Figure F: Loan to Deposit Ratio of Commercial Banks (%)



Source: Indonesian Financial Services Authority, 2023

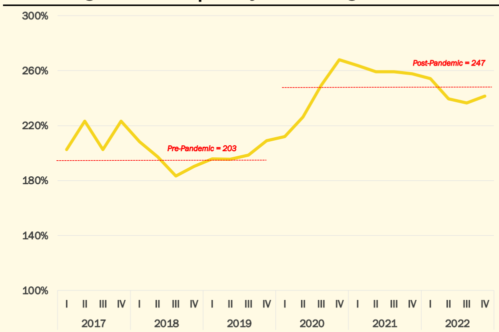
The loan to deposit ratio (LDR) was recorded at 79.80% in February 2023, getting closer to the pre-pandemic level which exceeded 80%. This indicates a slight growth in credit, but at the same time shows that these banks still have secure liquidity. In addition, the ratio of Liquid Assets to Third Party Funds (AL/DPK) was recorded as high at 28.91% in March 2023. Economic liquidity was also adequately reflected in the money supply in the narrow (M1) and broad (M2) terms in March 2023 which grew by 4.8% (y.o.y) and 6.2% (y.o.y), respectively. This also shows that Indonesia's banking liquidity can be said to be sufficient. Overall, the resilience of the financial system, especially the Indonesian banking system, is currently maintained, both in terms of capital and liquidity.

Figure G: Ratio of Liquid Assets to Third Party Funds



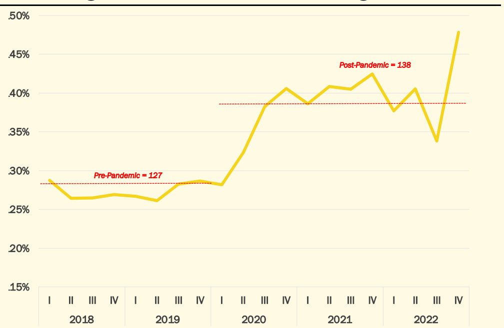
Source: Bank Indonesia

Figure H: Liquidity Coverage Ratio



Source: CEIC

Figure I: Net Stable Funding Ratio



Source: CEIC

Then, looking at the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) as the two key measures of liquidity risk management for banks, both are required by OJK to be reported by banks in Indonesia. If we compared the average LCR for banks in Indonesia during the pre- and post-pandemic periods, the LCR in the post-pandemic is stood at 247%, significantly higher than the pre-pandemic period which was 203%. This indicates that Indonesian banks have a higher buffer of liquid assets to meet their short-term liquidity needs. Furthermore, NSFR in the post-pandemic period is recorded at 138%, higher than 127% in the pre-pandemic period, which indicates that the banks have a higher and more stable funding base to support their longer-term activities. Overall, the LCR and NSFR measures suggest that banks in Indonesia have implemented sound liquidity risk management practices and have sufficient buffers to withstand short-term and longer-term liquidity stress scenarios. The stress tests conducted by Bank Indonesia[1] also show that the banking conditions in Indonesia are resilient to the impact of global banking turmoil.

Analysis of the Bank Run Risks in Indonesia

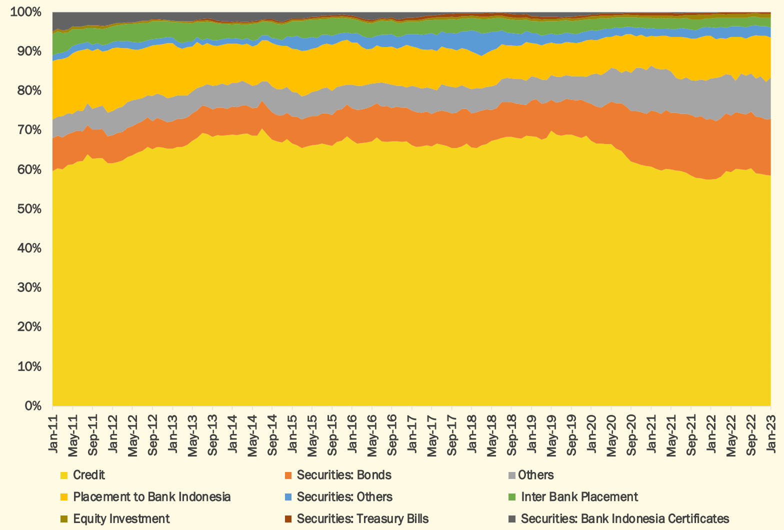
Bank runs occur when a large number of depositors suddenly withdraw their funds from a bank at the same time, often triggered by rumors or fear that the bank may become insolvent. Bank

[1] Siaran Pers BI: https://www.bi.go.id/id/publikasi/ruang-media/news-release/Pages/sp_256523.aspx

runs can lead to a vicious cycle of panic and further withdrawals, potentially causing the bank to collapse and triggering a broader financial crisis. Indonesia has experienced several banks runs in the past, including the 1998 Asian Financial Crisis and 2008 Global Financial Crisis, which led to the collapse of several banks and a severe economic recession. Since then, Indonesia has implemented a range of reforms aimed at strengthening its banking system and reducing the risk of future bank runs.

Compared to what happened in the past, the current state of the Indonesian banking system is resilient with adequate capitalization levels and high asset quality. The banking industry had also successfully maintained its liquidity levels during turbulent times, which helped to mitigate the impact of the pandemic on the banking sector. The use of funds by Indonesian banks is relatively well diversified. Unlike SVB whose assets are concentrated in long-term portfolios, the majority of Indonesian banks distribute their funds into loans with around 60%, followed by government bonds and corporate bonds that make up 14% portion of their portfolios (Figure J). Meanwhile, the placement to BI and equity is only around 10% and 1%, respectively. Moderate composition of long-term assets in Indonesian banks is currently perceived as safe. If banks invest too heavily in long-term assets, such as bonds, they could potentially face liquidity problems if they need to sell those assets quickly to meet short-term obligations. In addition, banks are subject to regulatory requirements that dictate the types of assets they can hold and the level of risk they can take on. The Basel III framework, a set of global banking regulations, imposes capital requirements on banks based on the riskiness of their assets, with riskier assets requiring higher levels of capital. Therefore, while long-term assets, such as bonds, can be an important part of a bank's investment portfolio, Indonesian banks need to balance their long-term investments with short-term liquidity needs and regulatory requirements.

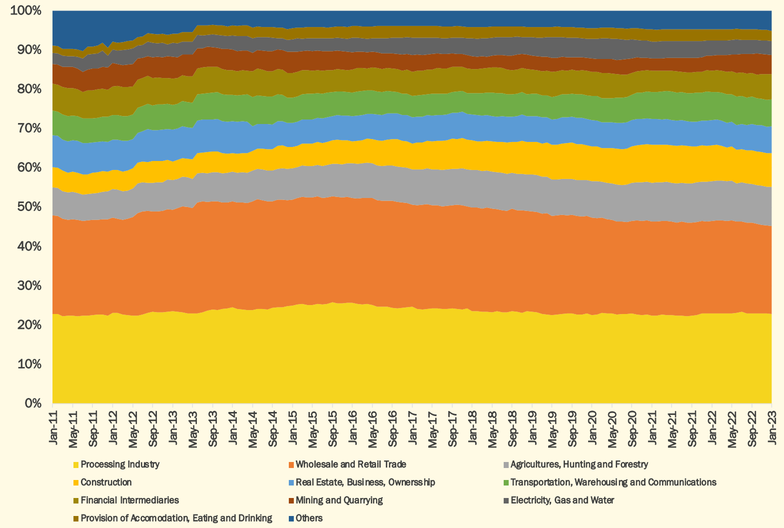
Figure J: Banks Distribution of Funding



Source: CEIC

However, the challenge that may lay ahead is the concentration of the banking sector itself, with a few large banks dominating the market, particularly large state-owned banks, such as Mandiri, BRI, and BNI. This concentration could lead to systemic risk if one or more of these large banks face difficulties. Nevertheless, if we oversee the structure of Indonesian banks' loans as the primary banks' use of funds, it has been dominated by three sectors for more than a decade, which are in line with the primary contributing sectors in the economy with loans to manufacturing industry (23%), wholesale and retail trade (22%), and agriculture, hunting, and forestry (10%) (Figure K). In contrast to SVB, which has 79% of its total loans concentrated in the wholesale sector (venture capital and startup companies), Indonesian banking credit concentration is far more well-diversified.

Figure K: Banks Loans by Sectors



Source: CEIC

Key lessons learned from SVB is that if banks have a high concentration in both source and use of funds in specific sector(s) or instrument(s), it will make banks vulnerable to any economic risks that affect those sector(s) or instrument(s). If the sector experiences a downturn, the bank's loan portfolio is more likely to be affected, leading to higher default rates, lower asset quality, and reduced profitability. Moreover, if multiple banks have high-concentration loans in the same sector or invest in certain instruments with high concentration, it can create systemic risk for the entire banking system. Thus, diversification of loan portfolios can also help banks to manage risk and reduce concentration risk.

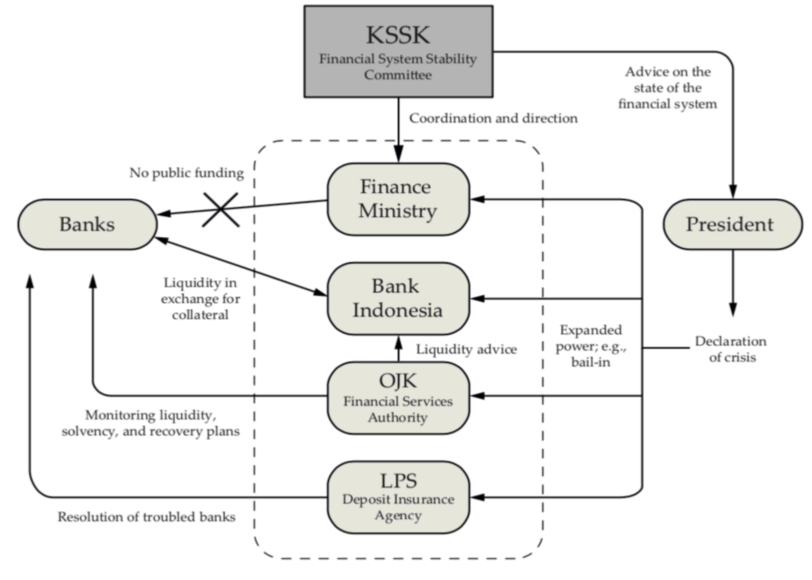
The failure of SVB in the US can provide important lessons for Indonesian banks on how to mitigate similar risks. Banks should be ready to encounter three types of risks: currency mismatch, maturity mismatch, and liquidity mismatch. Currency risks arise when a bank has assets or liabilities denominated in foreign currencies and any fluctuations in exchange rates can affect the bank's earnings and balance sheet. Meanwhile, maturity mismatch risks arise when a bank's assets and liabilities have different maturities. If a bank's liabilities are short-term but its assets are long-term, the bank may be exposed to liquidity risks if it is unable to meet its obligations when they become due. However, if a bank's liabilities are long-term but its assets are short-term, the bank may be exposed to interest rate risk.

Indonesia's Banking Crisis Management

The recent bank collapses in the US, including SVB served as a 'wake-up call' to policymakers and financial institutions all around the world. While the repercussion of this banking crisis is still unclear in terms of its potential scale and contagiousness, it certainly triggered the trauma of 2008/09 Global Financial Crisis. Fundamentally, banking system and industries are built upon confidence and trust, especially of depositors and the emergence of confidence crisis could trigger bank-run and bank collapse, as was the case with SVB and Signature Banks. Thus, policymakers have taken immediate actions to assure the soundness and safety of their banking sector, including in Indonesia. On March 13th, just three days after the SVB shutdown by US regulators, Financial Service Authority of Indonesia (OJK) released a press statement stating that the SVB shutdown has no direct impact towards Indonesian banking sector and "*OJK expects that people and industry players to not be affected by any speculations in the market*"[2]. While many indicators have suggested that the occurrence of banking crisis in Indonesia is relatively improbable, the recent banking crisis in the US created a perfect momentum to assess the banking crisis management protocol in Indonesia.

GoI has formulated its financial crisis framework and put in place the Law no.9/2016 on Financial System Crisis Prevention and Mitigation (PPKSK) in 2016 with the purpose of preventing and responding to financial crises through better preparation and cooperation between Indonesia's regulators and institutions. To understand the full context of PPKSK law, it is useful to revisit the event of the 2008 Bank Century bailout. Back in October 2008, Bank Century was the 13th largest bank in Indonesia and was facing severe liquidity problems. Within a month, Bank Century requested a USD108 million short-term loan from BI and has been put under special monitoring status by BI. However, things escalated quickly. On November 20th, 2008, Bank Century was reported having negative capital adequacy ratio and GoI decided that Bank Century was a systemic bank and emergency measures were necessary to be taken. The GoI took drastic measures by seizing the bank and gave itself five-year period to nurse it back to health and sell it. Few days after the seizure, however, Robert Tantular (one of the bank's cofounders) was arrested and later found guilty of issuing fake letters of credit (Wall Street Journal, 2010)[3].

Figure L: Summary of PPKSK Law



Source: Triggs, Kacaribu, Wang; 2019

The Bank Century bailout with the size of about USD737 million has provoked political turmoil in the form of riots outside the parliament building and instigated investigations towards numeruous government officials, including then (and current) Finance Minister, Sri Mulyani, and the then BI governor, Boediono. Moreover, the vote held by the Parliament to assess whether the bailout was warranted has resulted in the vote of 'no confidence' in the GoI. A major consequence of the Bank Century bailout has been nervous Indonesian officials and it is reported that senior officials in the four KSSK agencies would be less likely to act if another bank or financial institutions were to require support as the result of having faced a bombardment of investigations (Triggs, Kacaribu, Wang, 2019). This serves as a background for the drafting of PPKSK law as it

[2] Siaran Pers OJK: Penutupan Silicon Valley Bank Tidak Berdampak Langsung, SP 26/GKPB/OJK/III/2023
[3] https://www.wsj.com/articles/SB10001424052748703625304575115094084748472

deliberately absolves agencies and officials from independent responsibility for bailouts. Specifically, it ensures that all involved agencies to make collective decision; thus, provides them with political and institutional buffer shall a bailout is deemed necessary.

The PPKSK law specifies the responsibilities to be shared by seven key entities (Figure L). The first entity being at the center of responsibility is the Financial System Stability Committee (KSSK) with the role of coordinating and directing fours key crisis agencies (Finance Ministry, BI, OJK, and LPS) to prevent, prepare for, and respond to financial crises (von Allmen, Kang, 2018). These four agencies are mandated to meet formally every quarter to work together and identify which banks are systematically important, so they do not need to do this identification during the heat of the crisis. Furthermore, KSSK also serves as an information and data sharing platform among its members to improve their coordination. Beyond coordination body, KSSK is also responsible for formulating overall crisis resolution strategy and assigning its member agencies toward specific role in that agreed strategy (IMF, 2017).

The second entity is the Ministry of Finance that acts as the coordinator of KSSK. The PPKSK law also prevents the Ministry of Finance from utilizing public funding to bail out troubled banks (IMF, 2017). The third and fourth entities are BI and OJK. BI plays a role of providing liquidity assistance to a troubled bank and OJK to analyze the situation and advise BI whether the systemic banks need assistance. However, two conditions must be met to enable BI to provide emergency liquidity assistance: 1) bank in trouble needs to submit collateral of commensurate size and 2) Assessment by OJK suggest that the bank is in need of liquidity assistance. Furthermore, OJK is also mandated to monitors the financial sector and reports its health and soundness to the KSSK. To carry out this task, OJK undertakes supervisory stress tests to identify financial system's weakness and monitor banks' recovery plans to determine banks' capacity of supporting themselves in times of crisis and whether they are eligible for a bail-in.

The fifth entity is LPS. As a deposit insurer, LPS is prohibited by the PPKSK law to use public funds and instead use its own resources to resolve and bail-in troubled banks or financial institutions. However, the mechanism and bail-in powers of LPS is granted if the President (the sixth entity) declares a 'status of financial system crisis'. Once the declaration is made, resolution powers become available to relevant agencies under PPKSK law. To make such declaration, President has to be provided advise from KSSK whether a financial crisis is occurring. The last entity under the PPKSK law are the banks which are required to develop recovery plans that specify on how the banks' bail-in arrangement would operate during the crisis, including which asset to sell, which subsidiaries to be removed from holding groups, and their debt restructuring plan (IMF, 2017). In addition, the troubled banks are also mandated to issue debt to cover potential contractual bail-in. This requirement allows them to convert their debt into equity shall they run into a crisis.

Even though the PPKSK Law, which has been amended by the P2SK Law, provided a clearer framework and it represents a significant improvement over the prior arrangements for crisis management and resolution, there is room for improvement to ensure its effectiveness. First, the current process could create a risk of delays in decision-making. The Law regulates three approaches in decision-making process. The four members of KSSK need to reach a consensus on evaluating potential risks to financial stability. If consensus cannot be reached, voting will be used. In case there is no decision made by the voting, The Minister of Finance, the coordinator of KSSK, will decide for the members. The President will then determine whether Indonesia is experiencing crisis based on KSSK recommendation. There is currently no specific timeframe of each decision-making process. Another potential source of delay identified by the IMF (2017) is inadequate legal protection for agencies and personnel involved in crisis management. The current legal protection applies to actions made in near-crisis or crisis situations and is based on "misuse of authority", which may be interpreted as how an agency or a person contribute to achieve a set of results, rather than "good faith" that is an honest belief or purpose, faithful performance of duties, observance of fair dealing standards, or an absence of fraudulent intent.

The inadequate legal protection could add unnecessary delay in decision-making process as agencies or personnel may avoid taking necessary actions due to concerns over potential liability.

Second, agencies involved in KSSK have additional mandates, which is regulated in the PPKSK and P2SK Law. The new mandates have not been included in each agencies Law. OJK has now more authority to regulate and oversee cooperatives engaged in the financial sector, digital asset activities, financial sector technology innovation (*Inovasi Teknologi Sektor Keuangan* (ITSK)), strengthening the education function, consumer protection, and monitoring market behavior. LPS coverage has now been increased due to the new Law to also guarantee insurance policies managed by insurance companies. The Law has also extended BI's mandate to include supporting sustainable economic growth and formalize its debt monetization operations. The KSSK members have the ability to create a resolution plan and at the same time direct its members in implementing it. This may compromise independence and create a reduced accountability and responsibility of the four agencies.

Third, as the President will determine whether Indonesia's financial system is in crisis based on the recommendation by KSSK, his involvement could undermine the ability of KSSK to address the financial stability issues quickly and effectively. The President's involvement may also have a risk of politicizing resolution decisions.

To avoid unnecessary delays, there should be a definitive timeline for each approach in the decision-making process to make sure decision is made in a timely and informed manner to prevent a financial crisis. In addition, as suggested by the IMF (2017), the legal protection of agencies and personnel in KSSK should be expanded to follow Key Attributes of Effective Resolution Regimes for Financial Institutions prepared by Financial Stability Board, in which Article 2.6. states "*The resolution authority and its staff should be protected against liability for actions taken and omissions made while discharging their duties in the exercise of resolution powers in good faith, including actions in support of foreign resolution proceedings.*" The IMF (2017) also recommended to limit President's role in deciding whether Indonesia is experiencing a financial system crisis so that KSSK could deal with the issue swiftly and eliminate the risk of politicizing resolution decisions. Clear mandates for each agency should also be included in their respective Law. Additionally, limiting role of KSSK to only serve as a coordination body and remove its power to direct member agencies could keep the agencies independence. Lastly, rather than "misuse of authority", the Law for KSSK should provide its member agencies and personnel based on "good faith". This is to provide better legal protection for agencies and personnel and to avoid unnecessary delays as members may be reluctant to make a decision at the absence of legal protection. Finally, yet importantly, as LPS holds an important role in maintaining banking system stability, it should strengthen its capital base by having a higher share of insured deposits to prevent a bank run. As of March 2023, insured deposits contributed to 47.03% of total deposits of IDR 8,045 trillion. Additionally, LPS should ensure its reserve ratio, total assets as a percentage of insured deposits, to reach the target of 2.5% as mandated by the Law No. 24/ 2004 on Indonesia Deposit Insurance Corporation (The IDIC Law). As of 2022, LPS assets was recorded at IDR180.47 trillion (unaudited) or 2.20% of insured deposits of IDR8,203 trillion. Despite an increase of 0.86bps compared to 2021 figure, the reserve ratio is still below the required level regulated by The IDIC Law.

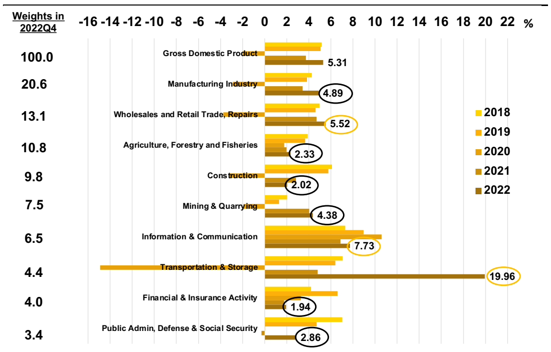
Highest Domestic Economic Growth since 2013

In the past three years, global economy has always started entering new year with a grim note. Though caused by different shocks (i.e., Covid-19 pandemic, war outbreak, overheated inflation, disrupted supply chain) that manifested in unforeseen ways, most policymakers and analysts at the beginning of each year has almost always characterized 2021 and 2022 with words such as 'uncertainty', 'slower recovery', and 'potential recession or downturn'. 2023 is almost no different. On the surface, the global economic performance in the last three years has always fallen short of the expectation to reach 'pre-pandemic' level of economic conditions. The recovery has been occuring in a rather gradual progression, often disrupted by series of negative shocks across the globe. In addition, the cumulative effects of the past three years of adverse shocks leaves the global economy being jittery. This is demonstrated by a relatively limited flows of investment growth and still below pre-pandemic level global trade volume. Fortunately, Indonesian economy seemed to gain some success to defy the odds during the past year. Throughout 2022, Indonesia was benefitted enormously by a combination of good policy and good luck, resulting in higher-than-expected economic growth in the last four quarter. Blessed by commodities windfall profit, solid domestic demand, and potent fiscal and monetary policy mix, Indonesia has managed to get through episodes of inflationary pressure, high commodity prices, global monetary tightening, and value chain disruptions rather splendidly. With the GDP growth of 5.31% (y.o.y) in 2022, Indonesia has recorded its highest annual economic growth rate in the last ten years while majority of the countries across the world was struggling to get back to their feet. Another noteworthy achievement is that Indonesia has managed to brought down its state budget deficit below 3% of GDP in 2022 (realized at 2.38% of GDP), a year earlier before the deadline mandated by the Law no.2/2020. The momentum of strong economic performance, optimistic sentiment by business and household, and excellent result of fiscal consolidation made Indonesia well-equipped to enter 2023.

"Throughout 2022, Indonesia was benefitted enormously by a combination of good policy and good luck, resulting in higher-than-expected economic growth in the last four quarter."

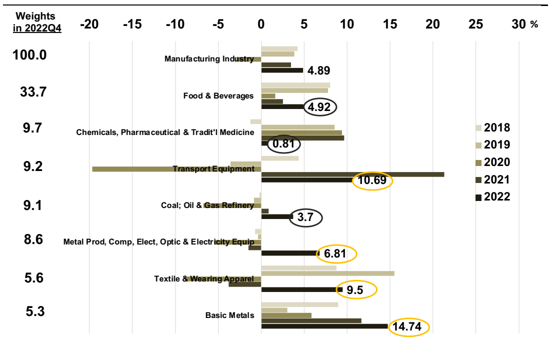
Considering the latest GDP data, the overall notable economic performance is also reflected on its sectoral figure. Manufacturing with a contribution of around one-fifth of Indonesian economy grew substantially to 5.64% (y.o.y) in the last quarter of 2022 from 4.83% (y.o.y) in the previous quarter, making the overall sectoral growth rate in 2022 at 4.89% (y.o.y) and reaching its highest annual growth rate since 2013. Similarly, wholesale and retail trade as the second biggest sector in the Indonesian economy also reached its highest growth rate in 2022 since 2012. In Q4-2022, wholesale and retail trade growth spiked to 6.55% (y.o.y) from 5.37% (y.o.y) in the previous quarter, thanks to positive domestic economic sentiment, robust household purchasing power, and end-of-year seasonal demand boost. With this performance, the overall 2022 growth of wholesale and retail trade was pulled up to 5.52% (y.o.y). One of the main catalyst for excellent domestic economic growth is the great progress in managing Covid-19 issue in 2022 which enable physical mobility and bolster economic activity. Evidently, sectors that relies on these aspects recorded a massive growth rate during last year. Transportation & storage recorded a remarkable growth of 19.96% (y.o.y) throughout 2022, making it the highest annual growth rate since 1977. In addition, the sector of accomodation and FnB activity reached its highest growth rate in the last 28 year as it grew by 12.01% (y.o.y) in 2022. With managable public health situation during last year, it is reflected in the economic activity of human health and social work activity as its growth decreased sharply to 2.95% (y.o.y) in 2022 after recorded a double-digit growth of 11.45% (y.o.y) in 2020 and 10.31% (y.o.y) in 2021.

Figure 1: Growth of GDP and the Main Industries, 2018-2022Q4



Source: CEIC

Figure 2: Growth of Manufacturing Sector and Its Subsectors, 2018-2022Q4

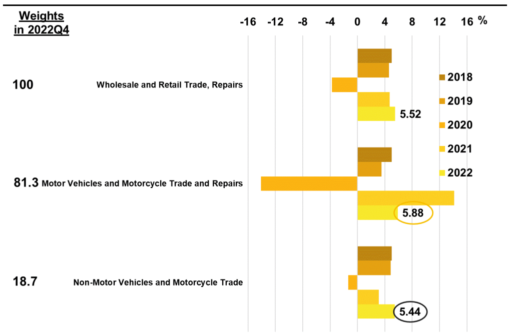


Source: CEIC

The significant growth of manufacturing industry in 2022 is mostly attributed to the performance of its subsector in the last quarter of last year. With the contribution of around one-third to the overall manufacturing industry, FnB subsector grew by 8.68% (y.o.y) in Q4-2022, a jump from 3.57% (y.o.y) in the previous quarter. A similar pattern is also demonstrated by coal, oil, and gas refinery subsector with a notable 2022 last quarter growth of 8.65% (y.o.y), compared to the average growth of 3.66% (y.o.y) in the first three quarters of 2022. Solid production activities of the Indonesian economy is reflected on the growth rate of manufacturing of machinery and equipment, and basic metal. In 2022, despite a slight deceleration from the previous year, machinery and equipment subsector recorded a double-digit growth of 11.44% (y.o.y) (vs. 11.72% (y.o.y) in 2021). Furthermore, basic metal also recorded a double-digit growth of 14.74% (y.o.y), increased from 11.64% (y.o.y) in the previous year and reached its highest growth rate at least since 2009. On the other hand, the significant improvement on public health aspect has resulted in the massive drop of demand for medicine-related products. Consequently, the manufacturing of chemical and pharmaceutical products only grew 0.81% (y.o.y) in 2022, a sharp decline from the growth of 9.41% (y.o.y) in 2020 and 9.65% (y.o.y) in 2021.

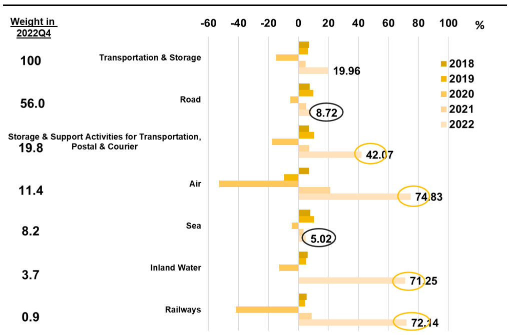
"Solid production activities of the Indonesian economy is reflected on the growth rate of manufacturing of machinery and equipment, and basic metal."

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



Source: CEIC

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



Source: CEIC

Similar to the manufacturing sector, the wholesale and retail sector also marked a notable increase in Q4-2022 to 6.55% relative to the value in the previous quarter of 5.37%. The value implies a strong pick-up for two consecutive periods after slower growth in Q2-2022, which was partly triggered by the higher-base effect from a solid hike in the same period last year. The growth in Q4-2022 concluded the annual growth of the wholesale and retail sector for 5.52% or increased strongly from 4.72% in 2021. Looking further to each component, the non-motor vehicles and motorcycle trade, as the main contributor to the sector with 81.3% share, grew 6.49% in Q4-2022 or relatively higher than 5.23% growth in Q3-2022. Likewise, the sub-sector of motor vehicles and motorcycle trade and repair also showed a fairly steep increase of 6.82% or rose substantially compared to 5.98% in Q3-2022. Diving deeper to the sub-sector of motor vehicles and motorcycle trade and repair, the higher growth was in-line with the data of motorcycle sales from AISI, which recorded a 12% rise to approximately 1.8 million units compared to 1.6 million units in Q3-2022. The increase in motorcycle sales was mainly driven by domestic sales, while on the other side, export presented an opposite pattern with a significantly lower trade during November-December 2022.

"Even though the sector paved a lower amount of growth, it was still considered as the highest among sectors in Q4-2022 GDP along with accommodation and F&B."

Moving to the other sector, transportation and storage continued its favorable positive growth in Q4-2022, although it was substantially slower than the previous quarter. The regarding sector grew 16.99% relative to 25.80% growth in Q3-2022. Even though the sector paved a lower amount of growth, it was still considered as the highest among sectors in Q4-2022 GDP along with accommodation and F&B. This is primarily supported by the relaxation of several public health measures, including the mandatory use of masks that have been implemented for approximately three years since the beginning of the pandemic era. The execution of such regulation has led to a higher frequency of social mobilization. Further to the performance of each sub-sectors, road transport as the primary contributor to the transportation and storage sector marked a higher growth of 9.52% compared to 8.72% in the previous quarter. On the other hand, the sub-sector of storage activities, as the second leading contributor after road transport, marked a relatively sluggish growth of 24.32% after a sky-rocketing growth of 57.00% in Q3-2022. Similarly, air and railways transport also loosened to 44.07% and 61.94%, respectively, after reaching its zenith of triple-digit growth in the last quarter. Overall, the whole sector of transportation and storage activities completely recovered after a depressing, negative growth in 2020. As a result, the transportation and storage sector recorded an immense growth of 19.96% annually or the highest level the sector has ever accomplished.

Indonesia economy in 2022 experienced a soft landing after most sectors, especially those with immense shares such as manufacturing, wholesale and retail, as well as agriculture, have concluded excellent performance in Q4, although slower compared to the growth in Q3. Especially for agriculture, the sector marked a massive escalation of growth of 4.51% in Q4-2022 compared to 1.95% in Q3-2022 and 2.33% in Q4-2021, which the higher Farmers Terms of Trade mainly attributed. Aside from the agriculture sector, the overall Indonesia economy in 2022 was supported by the relaxation of public health measures. This allows societies to mobilize freely, thus, increasing activities on related sectors such as transportation and storage as well as accommodation and F&B. After around two year under the bleak shadow of the pandemic, the considerably smooth circumstances in 2022 also support main activities such as production and consumption. However, despite the favourable internal condition, global dynamics such as prolonged geopolitical tension and banking issues may present reverse influences on the domestic state. In addition, as Indonesia is approaching a political year, prudent steps should be planned to maintain domestic economic stability.

Hitting a 9-Year High on the Back of Domestic Consumption and Resource Boom

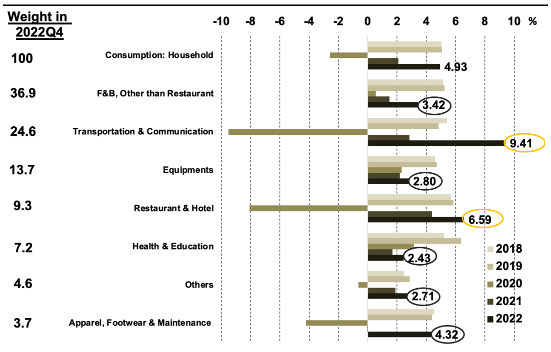
"Although it looked like the growth rate has returned to a pre-pandemic level, it should be noted that a low-base effect is still in place as full-year 2021 growth was recorded at 3.71% (y.o.y) due to harsher social restrictions."

With easing pandemic-related restrictions and enjoying soaring commodity prices, Indonesia posted a solid growth of 5.31% (y.o.y) in full year 2022. This figure is the highest full-year growth rate since 2013 beating market consensus supported by rising household consumption and export growth. Although it looked like the growth rate has returned to a pre-pandemic level, it should be noted that a low-base effect is still in place as full-year 2021 growth was recorded at 3.71% (y.o.y) due to harsher social restrictions. In the last quarter of 2022, the Indonesian economy grew by 5.01% (y.o.y), also higher than market's prediction but lower than previous quarter's growth of 5.72% (y.o.y). Looking at expenditure components, similar to Q3-2022, all components experienced a positive growth in the last quarter of 2022, except government expenditure that recorded a deeper negative growth of 4.77% (y.o.y) compared to a contraction of 2.55% (y.o.y) in Q3-2022. The negative growth is attributed to lower spending due to lower health and social spending for Covid-19-related stimulus. Compared to Q3-2022, government spending in Q4-2022 grew by 30.13% (q.o.q), indicating a seasonal spending pattern that occurs in the last quarter of every fiscal year when GoI often accelerates the disbursement of its budget.

Household consumption, which accounts for more than half of Indonesian GDP, expanded by 4.93% (y.o.y) in full year 2022, up from 2.02% (y.o.y) in 2021. The growth in household consumption was driven by the combination of pandemic-related restrictions removal in 2022 and GoI's effort to maintain the purchasing power through reallocation of the fuel subsidy to a more-targeted recipients. During the last quarter of 2022, household consumption grew by 4.48% (y.o.y), lower compared to 5.39% (y.o.y) growth in Q3-02022. Consumption of food & beverage, transportation & communication, and equipments, that make up for 75.2% of total consumption expanded by 3.38% (y.o.y), 8.05% (y.o.y), and 2.37% (y.o.y), respectively. Consistent high annual growth in transportation and communication group throughout 2022 suggested mobility continued to increase on the back of manageable Covid-19 pandemic and easing restrictions. Considering global uncertainty and lower commodity prices, this year's growth is expected to be driven by household consumption.

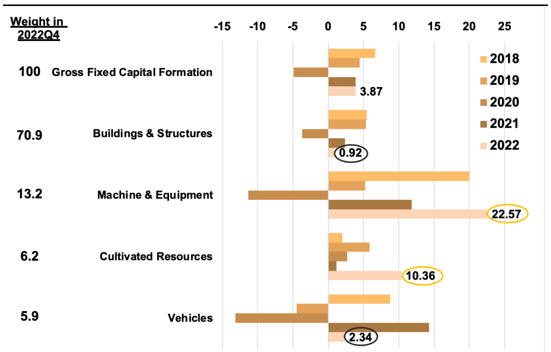
Looking at investment, it grew by 3.87% (y.o.y) in full-year 2022, slightly lower compared to full-year 2021 growth of 3.89% (y.o.y). Investment growth has not returned to its pre-pandemic level of an average of 5.35% (y.o.y between 2015 – 2019. In Q4-2022, investment growth were recorded at 3.3% (y.o.y), lower than previous quarter growth at 4.98% (y.o.y). Investment in buildings and structures, which account for 70.9% of total investment, recorded a positive growth of 0.11% (y.o.y) while investment in machine and equipment that contributes to 13.2% of total investment rose by18.36% (y.o.y) in the last quarter of 2022.

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



Source: CEIC

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



Source: CEIC

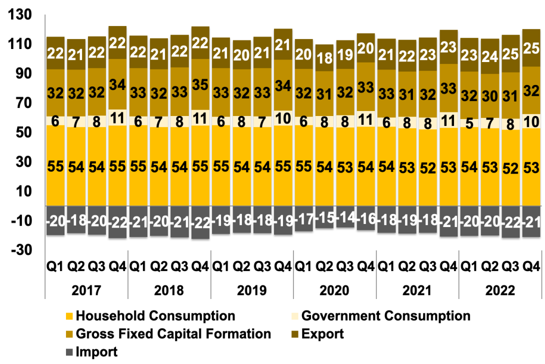
"Indonesian banking remains resilient amidst the current banking turmoil in the US and Europe. Banking performance is still growing positively, supported by strong capitalization, improving asset quality, and sufficient liquidity"

Observing into the banking credit performance, total credit growth continued to accelerate to 11.52% (y.o.y) in Q4-2022, marked as the highest level since the pre-pandemic era. All types of credit have performed outstandingly, with investment credit leading the way with a 13.56% (y.o.y) from 10.44% (y.o.y) in the preceding quarter. Following that, consumption credit accelerated to 9.12% (y.o.y), slightly jumped from 8.32% (y.o.y) in Q3-2022, owing to improved purchasing power and a controlled inflationary level. While a slight decrease seen in the working capital credit which grew by 11.82% (y.o.y) compared to 12.50% (y.o.y) in the previous quarter. In 2023, we expect a continuing improvement in credit performance as the most recent data in February 2023 showed that total credit grew by 10.64% (y.o.y), slightly higher than 10.52% growth seen in January 2023. Credit growth was primarily driven by investment and consumption. In line with the economic recovery, investment loans increased by 13.01% (y.o.y) and consumption loans grew by 9.66% (y.o.y).

According to the latest data from OJK in February 2023, the banking industry overall performed well, with improved asset quality, as the NPL ratio remained relatively stable at 2.58%. Third-party funds (DPK) increased by 8.18% (y.o.y), according to OJK data from the same period. The increase in DPK was driven by the growth of current account deposits which grew by 16.2% (y.o.y) followed by savings which grew by 5.2% and deposits by 4.9% (y.o.y). Therefore, banking liquidity remains solid as reflected in the Loan to Deposit Ratio (LDR) which was still maintained at 79.8% in February 2023.

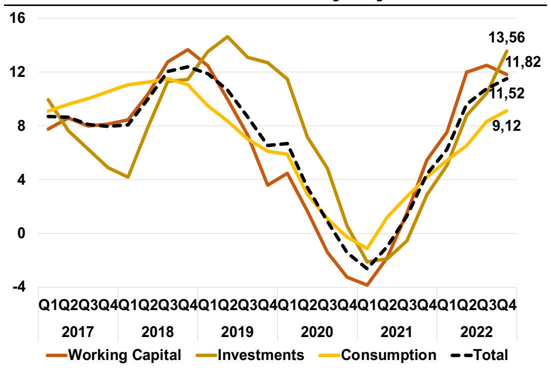
Overall, Indonesian banking remains resilient amidst the current banking turmoil in the US and Europe. Banking performance is still growing positively, supported by strong capitalization, improving asset quality, and sufficient liquidity. To deal with the increased risk of global uncertainty, banks must remain vigilant and implement appropriate risk management and mitigation measures. This includes conducting regular stress tests to assess the impact of potential scenarios on the bank's financial position. Currency risks, maturity mismatch risks, and interest rate risks are examples of potential risks that should be anticipated. The failure of SVB and several other banks globally provides some important lessons for Indonesian banks, particularly in terms of risk management, corporate governance, regulatory compliance, and growth strategies. Indonesian banks should take note of these lessons and take appropriate measures to mitigate the risks associated with their operations.

Figure 7: Shares of GDP Components, 2017Q1-2022Q4 (%)



Source: CEIC

Figure 8: Credit Growth by Purposes, 2017Q1-2022Q4 (y.o.y, %)



Source: CEIC

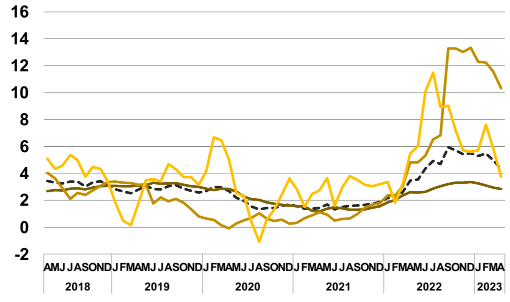
The Inflation Figure Moved in a Favorable Direction

"The annual inflation rate in April 2023 fell to 4.33% (y.o.y) from the previous month's figure of 4.97% (y.o.y). On the other hand, the monthly inflation trend actually showed an increase where the overall prices accelerated by 0.33% (m.t.m) compared to a month earlier."

The annual inflation rate in April 2023 fell to 4.33% (y.o.y) from the previous month's figure of 4.97% (y.o.y). This was driven by decline in all components of inflation, contributed by BI's monetary policy response in synergizing inflation control between BI and the GoI, regional governments, and other strategic partners in the Central and Regional Inflation Control Teams (TPIP and TPID) through the National Movement for Controlling Food Inflation (GNPIP) Program. The only expenditure group that experienced a price increase compared to the previous month's figure was clothing and footwear (1.80% (y.o.y)) following the Eid festive, while the other groups experienced slowdown in price hike.

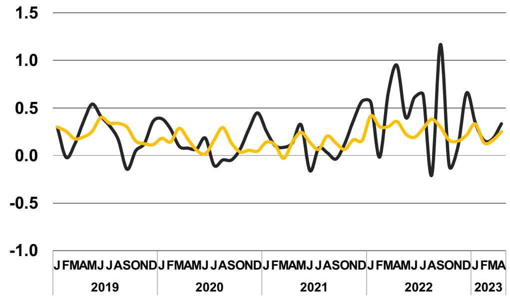
Core inflation was recorded at 2.83% (y.o.y) in April 2023, decreased from 2.94% (y.o.y) in the previous month. The slowdown in the annual inflation rate occurred after a massive increase at the end of the first quarter last year, following the increase in energy and food prices due to concerns over the impact of the Russian attack on Ukraine, which began at the end of February 2022. The administered prices inflation component has also decreased by 10.32% (y.o.y) in April 2023 compared to 11.56% (y.o.y) in February 2023. The volatile price component was also seen declining, with 3.74 % (y.o.y) in April 2023 or a decrease from 5.83% (y.o.y) in the previous month.

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



Source: CEIC

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



Source: CEIC

On the other hand, the monthly inflation trend actually showed an increase where the overall prices accelerated by 0.33% (m.t.m) compared to a month earlier. Observing its components, core inflation slightly increased to 0.25% (m.t.m) from 0.16% (m.t.m) in March 2023. This is in line with the gradual increase in demand partly due to declining global commodity prices. Inflation in the volatile foods category remained under control. The volatile foods category recorded inflation of 0.29% (m.t.m), a constant rate compared to the previous month. In addition, administered prices inflation was recorded at 0.69% (m.t.m), up from 0.12% (m.t.m) in the previous month. Overall, the inflation rate in April was driven by rising transportation prices in line with the Eid celebrations and the harvest season for horticultural and rice products in several areas on the island of Java.

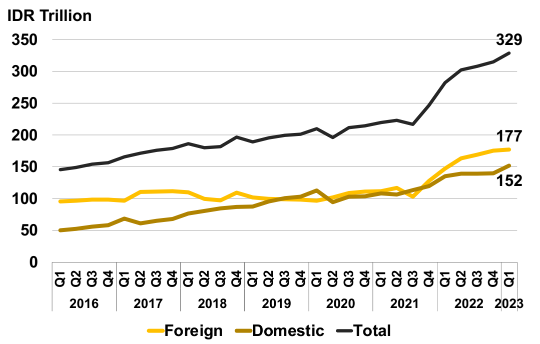
A Good Start for Investment Realization

"The Investment Coordinating Board (BKPM) recorded an investment realization of IDR328.9 trillion in Q1-2023. It was 23.5% of the 2023 investment realization target of IDR 1,400 trillion."

The Investment Coordinating Board (BKPM) recorded an investment realization of IDR328.9 trillion in Q1-2023. This number increased by 16.5% compared to the same period in 2022. The Q1-2023 achievement was 23.5% of the 2023 investment realization target of IDR 1,400 trillion. Around 46.2% or IDR 151.9 trillion of the total investment realization was from domestic investment (DDI) category. Then the remaining 53.8% or IDR 177.0 trillion is from foreign investment (FDI). The achievement of FDI that surpassed DDI shows that the level of trust in the international business community in Indonesia is good and even shows an increase of 20.2% compared to the same period in the previous year.

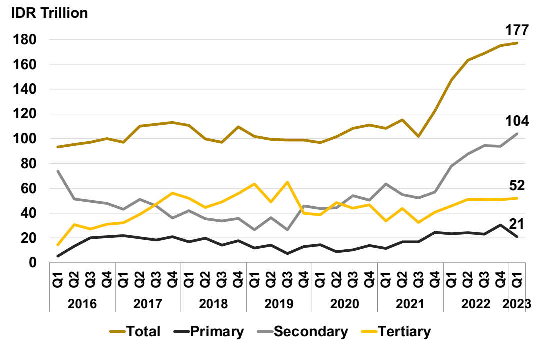
According to the sector, the basic metal, metal goods, non-machinery and equipment industries is the largest contributor to investment realization in Q1-2023, with an investment value of IDR46.7 trillion. Then the transportation, warehouses and telecommunications amounted to IDR36.1 trillion; mining IDR33.5 trillion; and industrial and office areas IDR27.9 trillion. Overall, the manufacturing industry contributed 42.5% of the total investment realization in Q1-2023. Throughout 2022 to the first quarter of 2023, the manufacturing industry sector, such as the basic metal, metal goods, non-machinery and equipment industries, consistently ranked at the top as the largest investment contributing sector in Indonesia.

Figure 11: FDI and Domestic Investment (Nominal)



Source: CEIC

Figure 12: FDI Realization by Sectors (Nominal)



Source: CEIC

Investment realization outside Java reached IDR172.9 trillion or 52.6% of the total realization in Q1-2023. Meanwhile, realization in Java was recorded at IDR 156.0 trillion or 47.4% of the total realization. The top three investment locations in Q4-2022 include West Java (IDR50.0 trillion), DKI Jakarta (IDR36.5 trillion), and East Java (IDR30.0 trillion). The top five main investor countries include Singapore (USD4.3 billion), Hong Kong (USD1.5 billion), China (USD1.2 billion), Japan (USD1.0 billion) and the United States (USD0.8 billion). This is a promising sign from investment and an opportunity for GoI to maintain economic growth in 2023.

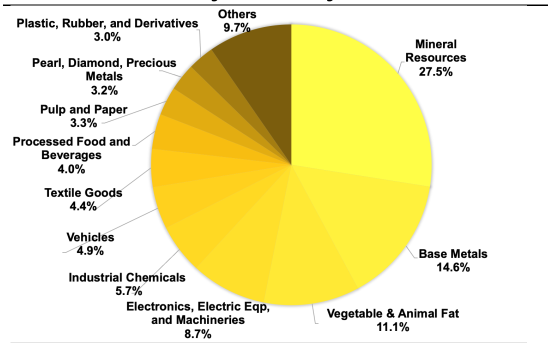
"Exports of non-oil and gas to China increased by 56% in Q1-2023 compared to the same period last year, making a total export growth of 37%. In addition, Indonesia's higher export to India and US have also contributed to the trade surplus in Q1-2023."

Persistent Growth of Exports, Albeit Smaller

Indonesia's trade balance continued to perform well and remained one of the fastest-growing contributors to Indonesia's external sector resilience, with the surplus recorded at USD54.5 billion throughout 2022, thanks to the surge in commodity prices. In the first half of 2023, Indonesia's trade balance remained positive at USD12.3 billion surplus even though the global prices for commodities have been gradually dropping since the last quarter of 2022. This surplus doubled from USD5.5 billion in the same period a year earlier. The stable performance of the trade surplus in Q1-2023 resulted from the continuation of higher export growth than imports, mainly due to the reopening of China's economy. Exports of non-oil and gas to China increased by 56% in Q1-2023 compared to the same period last year, making a total export growth of 37%. In addition, Indonesia's higher export to India and US have also contributed to the trade surplus in Q1-2023. By looking at the products, the fastest-growing export growth contributors were machine, electrical equipment, mechanical appliances, and their parts. At the same time, mineral resources and vegetable and animal fat remained the largest contributors to the surplus in the non-oil and gas sector.

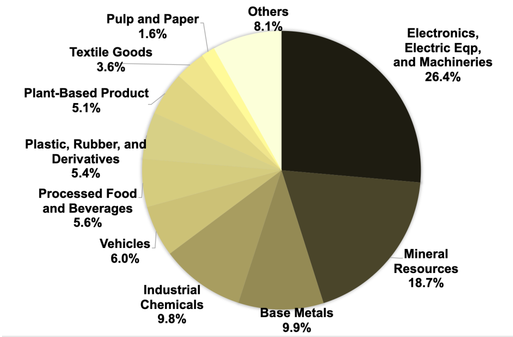
On the import side, overall imports only grew by 27% in Q1-2023 from the figure in the same period a year earlier. The higher imports were partly contributed by the surge in oil and gas imports in response to the higher demand for Ramadhan and Eid al-Fitr festive. At the same time, the non-oil and gas imports grew by 22% due to higher demand for capital goods and raw and auxiliary materials following the robust confidence in business activity. Nevertheless, Indonesia's imports were still slower than exports, resulting in a trade surplus in Q1-2023.

Figure 13: Indonesia Export Profile (January-February 2023)



Source: CEIC

Figure 14: Indonesia Import Profile (January-February 2023)



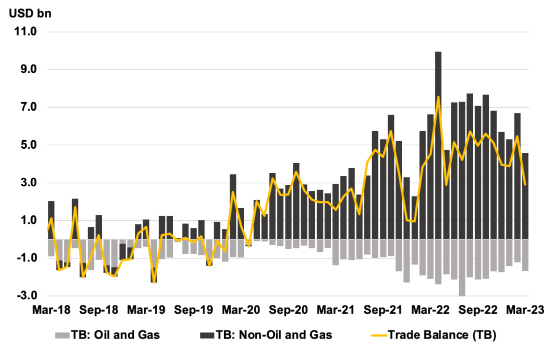
Source: CEIC

"As long as the commodity prices moderate, the faster economic recovery in Indonesia's main trading partner, China, may not be able to boost export growth to the 2022 level (30% (y.o.y))."

However, easing commodity prices may lower Indonesia's trade surpluses in 2023 as exports are still mainly contributed by raw materials and commodities. Around 42% of the total exports in January-February were mineral resources, vegetable and animal fat, and pearl, diamond and precious metals. Meanwhile, over 90% of the total imports are raw and capital goods businesses use. As long as the commodity prices moderate, the faster economic recovery in Indonesia's main trading partner, China, may not be able to boost export growth to the 2022 level (30% (y.o.y)). As a result, the GoI sees that the annual exports may only be able to grow around 13% in 2023. The trade surplus is also expected to be lower following the gloomy outlook for the global economy this year. The foreseeable downward trade surplus is partly reflected in the quarterly growth of Indonesia's trade balance. The trade surplus in Q1-2023 was slightly reduced by 17% compared to the surplus in Q4-2022. Both exports and imports in the first quarter of this year were lower than a quarter earlier. The lower trade surplus may drop or turn back the episode of current account surpluses, which stood at USD4.3 billion or 1.3% of GDP in Q4-2022.

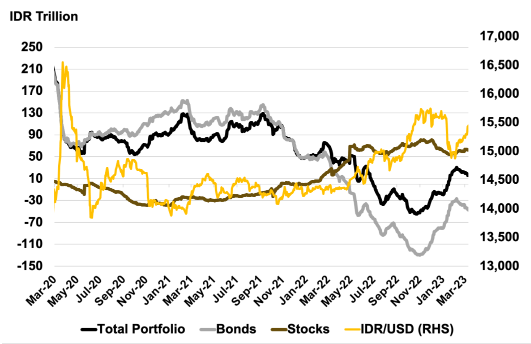
In the financial market, the capital flows have been gradually improving since the end of last year due to the less aggressive monetary stance taken by the Fed to fight inflation. The gradual drop in US inflation, combined with the unanticipated shock of bank failures, has left the Fed with no room to declare another aggressive interest rate in 2023. This event has picked up investor confidence in emerging markets, thus reducing the pressures on Indonesia's capital inflows. As a result, Indonesia has been seeing capital inflows since December 2022, with a notable increase beginning at the end of January 2023. Furthermore, Indonesia has seen an increase in direct investment as a result of the stable economic growth that has convinced investors of the promising economic outlook.

Figure 15: Monthly Trade Balance (Nominal)



Source: CEIC

Figure 16: Exchange Rate and Accumulated Short-Term Capital Inflow



Source: CEIC

"The gradual drop in US inflation, combined with the unanticipated shock of bank failures, has left the Fed with no room to declare another aggressive interest rate in 2023. This event has picked up investor confidence in emerging markets…"

8 DECENT WORK AND ECONOMIC GROWTH

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

10 REDUCED INEQUALITIES

17 PARTNERSHIPS FOR THE GOALS

The continuation of trade surpluses, albeit smaller than in the previous quarter, along with capital inflows in the first quarter of 2023, have helped stabilize the Rupiah. As of April 25, the Rupiah has appreciated by 4.63% (ytd) over the beginning of the year. Rupiah outperforms neighboring currencies, including Thailand Bath, Malaysian Ringgit, and Philippine Peso. As a result, BI was able to have adequate level of foreign exchange reserves at USD145.2 billion as of the end of March 2023. The reserves are sufficient to finance 6.4 months of imports or 6.2 months of imports and servicing government's foreign debt, which is far higher than the international adequacy standard of only roughly 3.0 months of imports. The reserve is ample to cushion any potential unfavourable shocks from the external sector and financial system in the future.

To fight inflation, BI has been monitoring inflation and tightening its monetary policy stance by raising interest rates by 225 bps from August 2022 to January 2023. As a result, inflation has progressively declined from its peak of 5.95% (y.o.y) in September 2022 to 4.97% (y.o.y) in March 2023. Inflation is likely to return to BI's target of 3±1% in September of this year after the low base effect disappears. Both monetary and macroprudential policy stance taken by BI were appropriate for maintaining external sector stability. Despite the fact that global monetary stance has been easing in response to the inflationary normalization, BI should always be prepared to respond any potential shocks resulting from heightened geopolitical tensions, which might create another round of supply chain disruption and high inflationary pressures. Continued prudent monetary and fiscal policy will provide substantial buffers to respond to unfavorable shocks. At the same time, to keep the economic growth on track, BI and GoI should also be closely in coordination to minimize and maintain the impact of increased interest rate on banks and real sector.