LPEM FEB UI
UNIVERSITAS INDONESIA

Macroeconomics Analysis Series

Indonesia Economic Outlook

Q3-2024

Key Figures

GDP Growth (Q1 '24)
5.11%

Inflation (y.o.y, June '24)
2.51%

Credit Growth (y.o.y, Q1 '24)
11.84%

BI Rate (July '24)
6.25%

Current Account Balance (% GDP) (Q1 '23)
-0.6%

IDR/USD (July '24)
IDR16,135

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Precarious Growth Drivers

Highlights

- *GDP to grow 4.97%-5.01% in Q2-2024 and 5.0%-5.1% for FY2024, driven by lack of seasonal factors, and domestic and global uncertainties.*
- *Growthin Q1-2024 was driven by seasonal factors with key sectors like manufacturing and wholesale trade underperforming, while smaller sectors such as transportation and public administration saw robust increases.*
- *Household consumption grew by 4.91% (y.o.y) in Q1-2024, up from 4.83% (y.o.y) in Q4-2023, driven by Ramadan festivities, increased social assistance, and higher civil servant salaries.*
- *Government consumption surged by 19.90% (y.o.y) in Q1-2024, the highest in two decades, due to increased spending on elections, social assistance, and employee allowances.*
- *Despite a robust trade surplus, external risks, such as weak global demand could impact Indonesia's export growth and trade balance moving forward.*
- *Rupiah showed signs of stabilization in early July 2024 after depreciating 6.33% (y.t.d) by June, influenced by global financial uncertainties and market expectations of the Fed policy shifts.*

The first quarter of 2024 was rather eventful for Indonesia. The occurrence of the General Election, the Ramadhan period, the acceleration of infrastructure project completion nearing the end of the current administration's term and several long holidays have bolstered domestic economic activities. Consequently, Indonesia's GDP grew by 5.11% (y.o.y) in the first quarter of 2024, increased from 5.04% (y.o.y) compared to Q4-2023 and higher than the overall growth of 2023, which stood at 5.05% (y.o.y). The combination of various seasonal factors managed to uplift household consumption, GoI's spending, and infrastructure investment. In addition, sectors that are driven by physical mobility, such as accommodation and food and beverages, transportation and storage, and health and social work also enjoyed a high growth rate stemming from seasonal events. ICT, public administration, and construction also grew immensely to the general election and rising GoI's spending.

Despite experiencing an acceleration, Indonesia's economy indicated ongoing structural problems, with a growth mostly supported by seasonal factors. Around 45% of Indonesia's economy was attributed to only three sectors, namely manufacturing, wholesale and retail trade, and agriculture. These three biggest sectors in the economy continued to grow below overall economic growth. Persistent stagnation of manufacturing sector growth substantiates any indication of premature deindustralization in Indonesia. Furthermore, below-5% growth of wholesale and retail trade sector suggests that another worrying potential of weakening purchasing power of general population, especially the middle class group. In addition, this could also be contributed by the potential of premature deindustrialization that limits welfare improvement of labour due to limited productivity of production activity in Indonesia. On the other hand, agriculture sector growth performance was rather depressing, driven by low productivity issue due to various factors, ranging from low skills of labour, low quality of input materials, to lack of insurance scheme for farmers. This situation was worsened by seasonal factor of El-Nino phenomenon.

From external perspective, the current account deficit in Q1-2024 increased to USD 2.2 billion (0.6% of GDP), widened from USD 1.1 billion (0.3% of GDP) in the last quarter of 2023 due to contraction of goods trade balance, despite being cushioned by higher tourism receipts. However, in Q2-2024 external trade performance improved. the trade surplus reached USD8.04 billion due to increased global demand for various commodities and higher prices, representing a 2.82% (y.o.y) increase from the same period last year or an 8.42% (q.o.q) increase from Q1-2024. Indonesia was also on track to achieve its target in terms of investment realization, supported by high growth of FDI in Q2-2024. In contrast, global uncertainty due to the Fed's evolving stance and domestic policy uncertainty following the administration's transition has spurred capital outflows in Q2-2024. This exerted massive pressure on Rupiah and has depreciated by 6.33% (y.t.d) by the end of June 2024.

Table 1: Growth Forecast (y.o.y)

Q2-2024	FY2024
4.97% - 5.01%	**5.0% - 5.1%**

Indonesia was relatively in a worse shape during Q2-2024, compared to the first quarter of this year. Lack of any seasonal factors pushing economic activities, high global uncertainty and ongoing structural problems might manifest negatively in the GDP growth figure. In addition, uncertainties regarding future policy directions by the new administration also triggered consumers to hold their consumption and investors to adopt a *wait-and-see* approach. Thus, GDP growth might decelerate in Q2-2024. We see GDP to grow by 4.99% (y.o.y) (estimate range from 4.97% to 5.01%) for Q2-2024, and 5.1% (y.o.y) for FY2024 (estimate range from 5.0% to 5.1%).

Squeezed in the Middle

Who are the Middle Class?

The middle class plays a central role in a country's economic development. Easterly (2001) concludes that countries with a larger middle class tend to grow faster. Birdsall, Graham, and Pettinato (2000) argue that the middle class is the backbone of both the market economy and democracy in advanced societies. There are at least three traditional arguments supporting the importance of the middle class in society. First, the middle class is a source of entrepreneurship with the capacity and tolerance for delayed gratification, which can create employment and productivity growth for the rest of society (Acemoglu & Zilibotti, 1997). Second, the middle class provides necessary human capital and savings to accelerate capital accumulation and wealth creation in the economy (Doepke & Zilibotti, 2005). Third, middle class consumers are willing to pay more for quality goods. This encourages product differentiation, investment, and innovation in production activities, consequently raising income levels for everyone (Murphy et al., 1989). Indonesia aspires to become a high-income country by 2045 and achieving this ambitious goal requires a large middle class population. The Ministry of National Development Planning (Badan Perencanaan Pembangunan Nasional/Bappenas) has stated that reaching high-income status will necessitate increasing the middle class to 70% of Indonesia’s population by 2045.

While identifying the middle class is as much a social designation as an economic classification, most economists choose to measure it in terms of income or consumption levels. Easterly (2000) takes a relative approach and defines the middle class as those between the 20th and 80th percentile of consumption distribution. Similarly, Birdsall, Graham and Pettinato (2000) define the middle class as the population between 0.75 and 1.25 times the median per capita income. Using an absolute approach, Bhalla (2010) defines the middle class as those with annual income beyond USD3,900 in purchasing power parity terms. Kharas and Gertz (2010) take a measurement of those with daily expenditures between USD10 and USD100 in purchasing power parity terms to define middle class.

In this report, we adopt the definition of the middle class from the World Bank (2019). World Bank (2016) defines the middle class as those who enjoy economic security, who are free from worry about monetary poverty, and, as a consequence, are turning their disposable income toward discretionary consumption rather than subsistence. The definition by the World Bank (2019) is based on economic vulnerability, wherein the middle class comprises those with less than a 10% chance of being poor or vulnerable in the future, given their current consumption. The class definition is detailed below.

Table A: Class Definition*

Class	Poor	Vulnerable	Aspiring Middle Class	Middle Class	Upper Class
Household Status	Below poverty line (PL)	>10% chance of being poor next year (1.0-1.5xPL)	<10% chance of being vulnerable (1.5-3.5xPL)	<10% chance of being poor or vulnerable (3.5-17 PL)	>17xPL

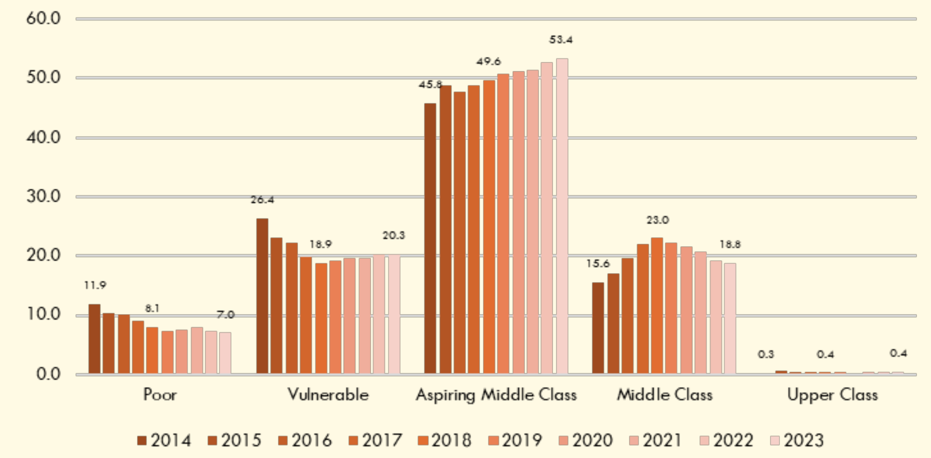
Source: World Bank (2016)

* LPEM FEB UI calculated class defition by classifying per-capita consumption according to city/regency level poverty line on each year

As of 2023, Indonesia's middle class includes approximately 52 million people, representing 18.8% of the total population. However, this segment has been shrinking recently. Between 2014 and 2018, the middle class expanded by over 21 million, rising from 39 million to 60 million people. During this period, the middle class's population share increased from 15.6% to 23.0%.

Since then, the middle class has contracted by more than 8.5 million, bringing its current size to around 52 million and its share back to approximately 18.8%. On the other hand, the aspiring middle class, defined as those with less than a 10% chance of falling into vulnerability, has shown a relatively consistent increase over the years. In 2014, this group represented approximately 45.8% of the population or around 115 million people. By 2023, their numbers had risen to 53.4%, equivalent to about 144 million people, meaning that over half of Indonesia's population now falls into this category. The expansion of both the aspiring middle class and the middle class from 2014 to 2018 indicated a positive trend of upward social mobility. During this period, the share of the poor and vulnerable decreased while the aspiring and middle classes grew. However, from 2018 to 2023, the expansion of the aspiring middle class suggests a reversal of this progress. The share of the vulnerable population has increased and the middle class has contracted, indicating a shift from previously middle class individuals to the aspiring middle class or even the vulnerable category.

Figure A: Population by Class (%), 2014-2023



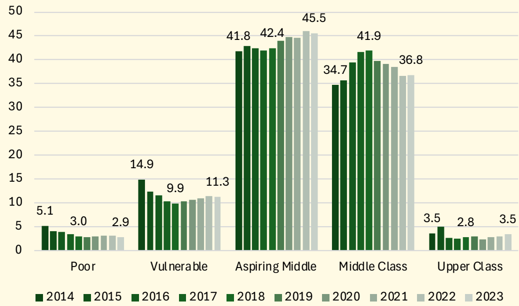
Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

The Erosion of Middle Class Purchasing Power

In 2023, the combined consumption of the aspiring middle class and middle class groups accounted for a substantial 82.3% of total household consumption in Indonesia, with the aspiring middle class contributing 45.5% and the middle class 36.8%. This marks an increase from 2014, when these groups accounted for 41.8% and 34.7% of consumption, respectively. However, their trends have diverged over the past five years. The consumption share of the aspiring middle class has improved, rising from 42.4% in 2018. In contrast, the middle class's share of consumption has decreased from 41.9% during the same period. This decline indicates a reduction in the middle class's consumption, reflecting a potential decrease in their purchasing power.

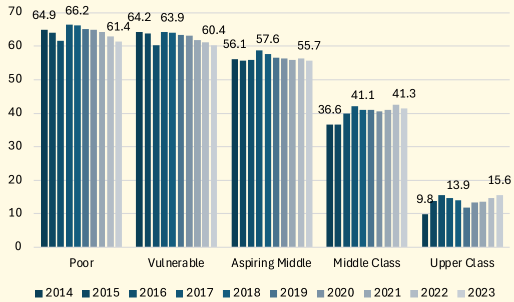
To better understand these trends, consider the share of food expenditure relative to total expenditure. Engel's Law posits that as income decreases, the proportion of spending allocated to food increases. This is because food is a basic necessity, and people tend to maintain their food consumption levels even with lower incomes. Thus, a decrease in purchasing power generally results in a higher percentage of total expenditure going toward food. As of 2023, the majority of Indonesians still allocate a significant portion of their spending to food, with the middle class and upper class being exceptions. The middle class allocates 41.3% of their expenditure to food, while the upper class spends 15.6%. For the aspiring middle class, the share of food expenditure has slightly decreased from 56.1% in 2014 to 55.7% in 2023. In contrast, the middle class has seen an increase in food expenditure, rising from 36.6% to 41.3% over the same period. An increasing share of food expenditure, or a decrease in non-food consumption, can be a concerning indicator. Non-food expenditures, such as for durables, health, education, and entertainment, are more indicative of purchasing power and economic well-being. These expenditures tend to rise with disposable income and are key drivers of economic growth. A rising food expenditure share, therefore, suggests a decline in the purchasing power of the middle class. This erosion of purchasing power is worrisome as it impacts aggregate consumption, a crucial driver of Indonesia's recent economic growth.

Figure B: Share of Consumption by Income Groups (%)



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

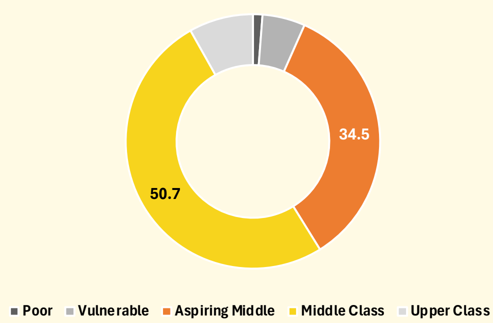
Figure C: Share of Food Expenditure to Total Expenditure (%)



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

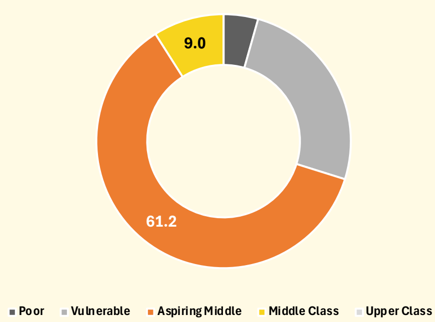
The middle class is pivotal to Indonesia's state revenue, contributing 50.7% of tax receipts[1], while the aspiring middle class adds 34.5%. These contributions are crucial for financing public development programs, including infrastructure and human capital investments. To support these investments, it is essential to preserve the purchasing power of both the middle and aspiring middle classes. As of 2022, Indonesia's tax-to-GDP ratio stands at 9.1%, which is relatively low compared to neighbouring countries. This underscores the importance of robust tax contributions from these groups to strengthen public finances. If their purchasing power declines, their tax contributions may decrease, potentially worsening the already low tax-to-GDP ratio and impairing the GoI's ability to provide critical services and finance development projects.

Figure D: Share of Tax Receipt (%)



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

Figure E: Share of Subsidy Receipt (%)



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

Regarding subsidies[2], the aspiring middle class is the largest recipient, while the upper class receives none, and the middle class receives a smaller share relative to its tax contributions. This distribution highlights the importance of supporting the middle class for fiscal balance. If the middle class's purchasing power declines, this may force them to shift into the aspiring middle class or vulnerable categories, diminishing their role as tax contributors and increasing their

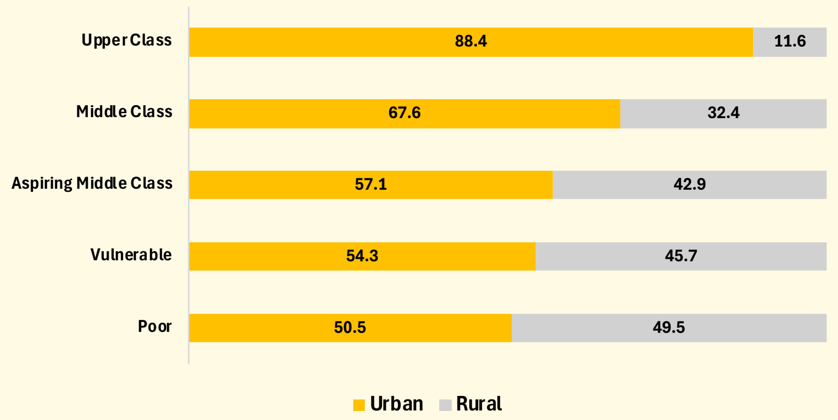
[1] The taxes included are income tax, property tax, and motor vehicle tax, as reported by the National Socioeconomic Survey (Susenas).
[2] The subsidies included are restricted to local government assistance and food aid, as reported by the National Socioeconomic Survey (Susenas).

dependence on fiscal support. Consequently, the GoI would face greater financial strain and may need to increase public expenditure on subsidies, further impacting the tax-to-GDP ratio and complicating efforts to achieve fiscal sustainability and sustain economic growth.

Social Aspect Dynamics of the Middle Class

Across income groups in Indonesia, most of its population lives in urban areas, though the proportions vary. Among the aspiring middle class, 57% reside in urban areas, while this figure rises to 67.6% for the middle class. The distribution of these classes also varies by island. Kalimantan has the highest proportion of aspiring middle class residents at nearly 60%, whereas Bali and Nusa Tenggara region has the smallest share of aspiring middle class (48.0%). For the middle class, Sulawesi has the highest share of 22.2%, while Sumatra has the lowest at 13.8%. Despite these variations, Java and Sumatra have the largest populations of both aspiring middle class and middle class individuals, owing to their larger total populations. Specifically, 54.6% of the aspiring middle class lives in Java, 24.3% in Sumatra, and 21.1% on other islands. The concentration of the middle class is even higher in Java as 62.1% of the middle class population resides in Java, 16.2% in Sumatra, and the remaining 21.7% across other regions.

Figure F: Consumption Classes Breakdown by Urban and Rural Areas (%)



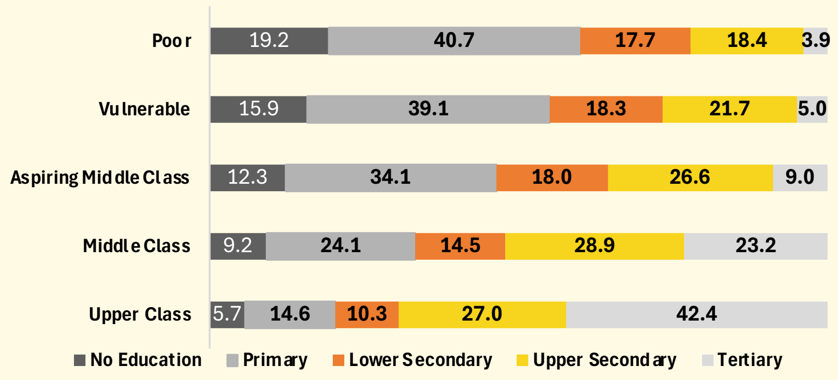
Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

In terms of education level[3], a distinct trend is observed across income groups: as income levels rise, the proportion of individuals with no education or only primary education declines, while those with upper secondary and tertiary education increase. For example, in 2023, 34.1% of the aspiring middle class had only a primary education, compared to just 14.1% of the middle class. Conversely, 26.6% of the aspiring middle class had attained an upper secondary education, whereas 28.9% of the middle class had achieved this level. This trend underscores the link between higher income levels and improved access to advanced education, creating a virtuous cycle of upward social mobility. Increased financial resources enable more significant investment in education, allowing individuals to pursue upper secondary and tertiary qualifications. Access to higher education also provides an opportunity for individuals to get higher earnings prospects in the future. Transitioning populations into higher income classes and expanding access to higher education are therefore essential not only for personal economic advancement but also

[3] Education level in this report is classified as follows: Does not complete primary education and no schooling, primary education (elementary (SD) and its equivalent), lower secondary education (junior high school (SMP) and its equivalent), higher secondary education (senior high school (SMA/SMK) and its equivalent), tertiary education (diploma and university level education).

for broader societal benefits. As individuals progress to higher income levels, their enhanced educational attainment contributes to a more skilled and educated workforce.

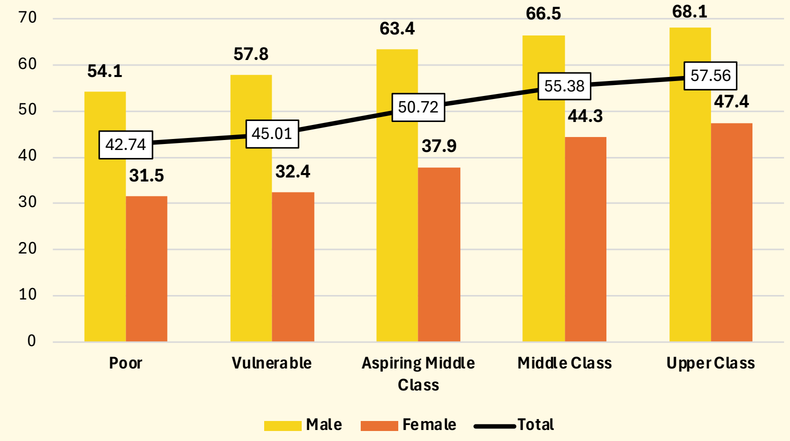
Figure G: Share of Educational Attainment (%)



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

Furthermore, there is a discernible jump in terms of attainment of tertiary education level beyond aspiring middle class groups. While the incremental share of the population attaining tertiary education is gradual from poor to aspiring middle class groups, the share increase between aspiring middle class to the middle class and upper class are substantial. Relative to aspiring middle class, share of middle class that attained tertiary education is 14.2% higher. Moreover, the share of the upper class who attained tertiary education is 19.1% higher than those of the middle class. This signals a potential for exponential benefit in terms of education attainment to advance the population beyond the aspiring middle class level.

Figure H: Labour Force Participation (%)

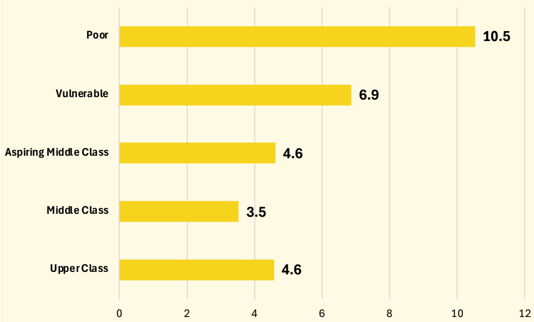


Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

Examining labour force participation reveals an intriguing trend: as income levels rise, participation rates also increase. Currently, the national labour force participation rate is 49.9%. The aspiring middle class and the middle class exhibit higher rates of 50.7% and 55.4%, respectively, indicating that higher income groups are more engaged in the labour market. This increased engagement likely results from better access to education, training, and job opportunities provided by higher income. As individuals climb the income ladder, they are more likely to actively participate in the labour market, benefiting from improved job security and higher wages. However, a concerning trend emerges when breaking down labour force participation by gender. Across all income groups, female labour force participation rates are consistently lower than the national average and significantly lag behind male participation rates. This disparity suggests that women, regardless of income level, face systemic barriers to workforce participation.

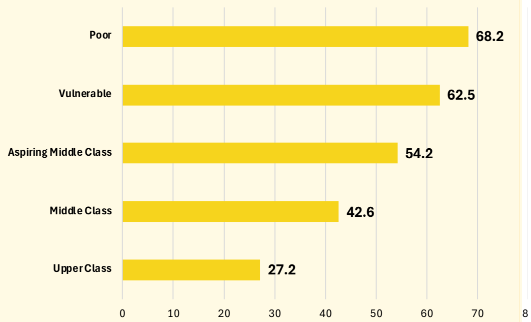
Indonesia's unemployment rate stands at 5.2%. Examining employment data by income group, both the aspiring middle class and the middle class have unemployment rates below the national average, at 4.6% and 3.5%, respectively. The middle class, in particular, has the lowest unemployment rate, even lower than the upper class rate of 4.6%. This suggests that higher income brackets, especially the middle class, enjoy greater job stability, likely due to access to more stable and higher-quality job opportunities. A similar pattern emerges when analysing employment by job formality. As income increases, the share of individuals with informal jobs decreases. In 2023, 54.2% of the aspiring middle class held informal jobs, compared to only 42.6% of the established middle class. This indicates that higher income groups not only face lower unemployment rates but also have greater access to formal employment, reflecting enhanced job security and stability. However, it is concerning that the informal employment rate remains high. More than half of aspiring middle class workers and over 40% of middle class workers lack formal job security.

Figure I: Unemployment Rate (%)



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

Figure J: Share of Labor with Informal Jobs (%)



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

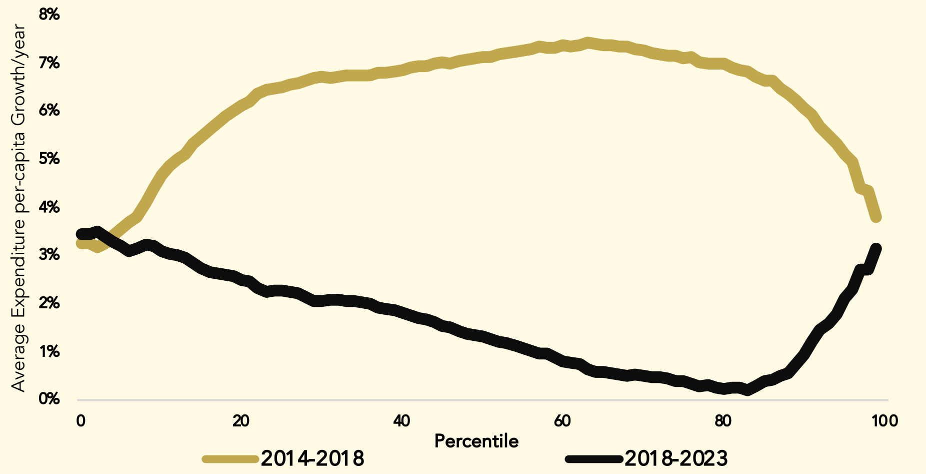
Declining Welfare of the Middle Class

In the first half of the last ten years, the share of poor and vulnerable groups were shrinking while the aspiring middle class and middle class were expanding. During 2014-2018, many Indonesians achieved upward social mobility by escaping poverty and gaining economic security, indicating a narrowing of economic inequality. However, this progress was short-lived, and the trend began to reverse afterward. While the share of poor people has consistently decreased, so has the middle class share. Since 2018, the middle class population has been declining while the vulnerable and aspiring middle class groups have been expanding. This suggests that a portion of the previous middle class has been getting poorer, falling into the aspiring middle class or even vulnerable categories.

The reversal of progress towards economic equality is evident when observing the aspiring middle class. Although the share of the aspiring middle class has steadily expanded since 2014, the driving factors have changed. During 2014-2018, this expansion was due to the vulnerable population successfully moving up into the aspiring middle class category. In contrast, during 2018-2023, the growing share of the aspiring middle class was primarily driven by the middle class population becoming poorer and now being categorized as aspiring middle class. This phenomenon is illustrated by Figure K. Based on income distribution, on average, the bottom

20% enjoyed an increase in expenditure per capita of around 4.63% annually during 2014-2018. Meanwhile, the 20%-80% percentile experienced a 7.01% increase, and the top 20% saw a 5.84% increase in expenditure per capita during the same period. Subsequently, although expenditure per capita growth uniformly decreased, the decline was most severe for the aspiring middle class and middle class populations. From 2018-2023, expenditure per capita growth for the bottom 20% was 3.01%, for the top 20% it was 1.25%, and for the 20%-80% percentile it was 1.29%. While some of the growth decline could be attributed to the occurrence of COVID-19, the weakening purchasing power of the aspiring middle class and middle class started in 2018. This indicates that more structural factors play a role in the dwindling welfare of those in the middle of the income distribution.

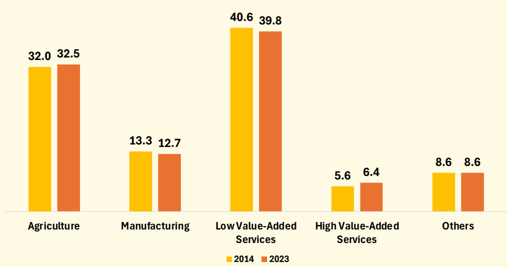
Figure K: Growth Incidence Curve by Income Percentile



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

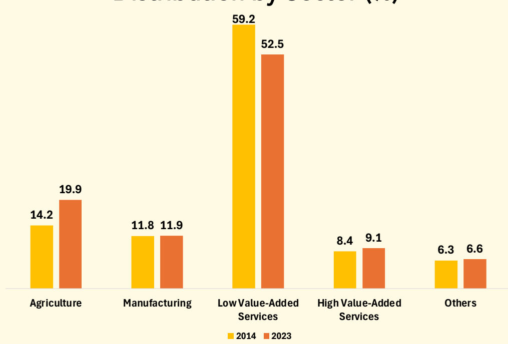
Despite accounting for more than 75% of Indonesia's working population, most aspiring middle class and middle class groups are employed in low-productivity sectors, such as agriculture and low value-added services. In 2023, 72.3% of the aspiring middle class worked in these sectors, compared to 72.6% in 2014, indicating no substantial improvement in labour mobility toward more productive sectors. While there is a slight increase in aspiring middle class workers in high value-added services, many have also entered the agriculture sector. Additionally, the share of aspiring middle class workers in the manufacturing sector has decreased over the past decade.

Figure L: Aspiring Middle Class Employment Distribution by Sector (%)



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

Figure M: Middle Class Employment Distribution by Sector (%)

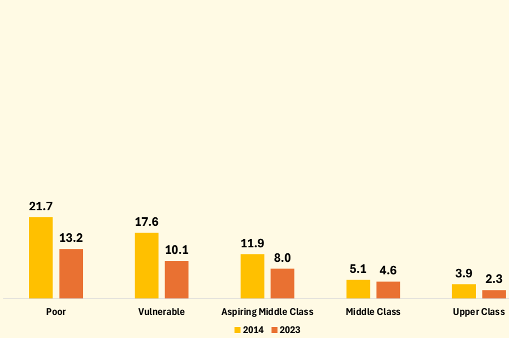


Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

The sectoral distribution of middle class workers reveals a similar pattern. In 2014, 73.4% of middle class workers were in low-productivity sectors, slightly improving to 72.4% in 2023. Currently, more than half of middle class workers are in low value-added services. Despite a considerable decrease over the past ten years, most middle class workers who left low value-added services moved to agriculture, another low productivity sector. Although a small share of middle class workers has entered high value-added services, the labour share in the manufacturing sector has remained relatively stagnant. This trend is concerning for both aspiring middle class and middle class workers, as they are concentrated in low-productivity sectors. These sectors tend to pay less and are often informal, lacking job security and basic safety nets. This suggests inadequate job creation for these groups or structural barriers preventing them from entering higher-productivity sectors. If left unresolved, the aspiring middle class and middle class could face serious risks of lower wages and poorer job quality in the future.

To assess the quality of life for aspiring middle class and middle class groups comprehensively, non-monetary aspects should also be considered. The World Bank (2019) classified non-monetary aspects of welfare into three dimensions: water poverty, sanitation poverty, and housing poverty. For the aspiring middle class, there have been improvements in the water and sanitation dimensions. A decade ago, 11.9% of the aspiring middle class lacked access to clean drinking water, which decreased to 8.0% in 2023. Additionally, the share of the aspiring middle class without access to a toilet with a septic tank dropped significantly from 31.6% in 2014 to 17.9% in 2023. The middle class has also seen improvements, though less pronounced. In 2014, 5.1% of the middle class did not have access to clean drinking water, which decreased to 4.6% in 2023. Similarly, the share of the middle class with poor sanitation decreased from 16.1% in 2014 to 13.7% in 2023.

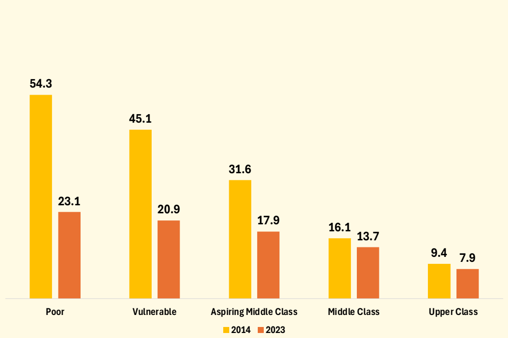
Figure N: Water Poverty (%)*



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

**does not have access to clean drinking water*

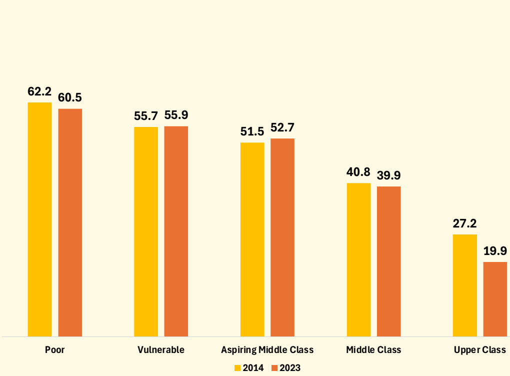
Figure O: Sanitation Poverty (%)**



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

***does not have access to a toilet with septic tank*

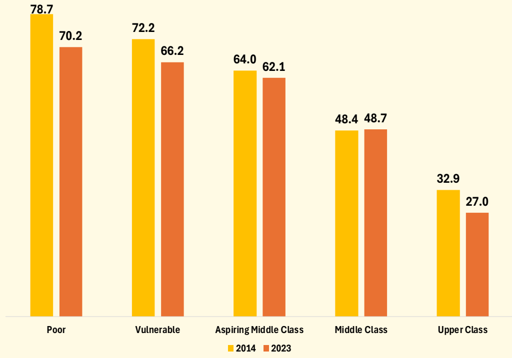
Figure P: Housing Poverty (%)***



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

****Live in a house with low quality of roof, floor, or walls*

Figure Q: Poor on at least One Dimension (%)****



Source: National Socioeconomic Survey (Susenas); LPEM FEB UI staff calculations

*****Poor at least in one dimension (water, sanitation, housing)*

Despite these improvements in water and sanitation, both groups still face serious issues regarding housing quality. The share of the middle class living in poor housing conditions only decreased slightly, from 40.8% in 2014 to 39.9% in 2023. Even worse, more than half of the aspiring middle class lived in poor housing conditions, with the share increasing from 51.5% in 2014 to 52.7% in 2023. Taken together, the aspiring middle class and middle class have not experienced significant improvement in non-monetary aspects of welfare. Currently, around 48.7% of the middle class are deprived of at least one non-monetary dimension, a slight increase from 48.4% a decade earlier. For the aspiring middle class, more than 60% of its population is currently poor in either water, sanitation, or housing aspects.

Being not classified as poor or vulnerable, aspiring middle class and middle class groups live beyond subsistence. However, this does not mean they are free from other dimensions of welfare deprivation. These deprivations could have significant ramifications, especially for children. Poor living conditions combined with inadequate feeding practices, common in the aspiring middle class, could lead to a higher risk of stunting.

Transformative Policies for Middle Class

Given that the aspiring middle class and the middle class together constitute 72.2% of the population and contribute to 82.3% of national household consumption, it is clear that these groups dominate household consumption growth in GDP. To reach the ambitious goal of becoming a high income country by 2045, policies must focus on helping aspiring middle class individuals transition to middle class status and sustaining the purchasing power of the current middle class.

Investing in education and vocational training is necessary for this transition. By equipping individuals with necessary skillsets to access higher productivity jobs (i.e., high value-added services and manufacturing), their earning potential is enhanced, which in turn boosts overall economic welfare. Creating more job opportunities in high productivity sectors is also essential. For example, the manufacturing sector can absorb a large workforce and offer higher wages. Promoting industrial growth and innovation will generate better-paying jobs and improve working conditions, thereby strengthening the middle class and the economy.

Ensuring economic security for both aspiring middle class and middle class during challenging times is vital to safeguard their purchasing power, particularly during periods of unemployment or job transitions. To address this need, GoI should expand social assistance programs, including unemployment benefits, paid leave, and parental leave. Comprehensive parental leave, which includes both paternal leave and maternal leave, is essential not only for supporting gender equality but also for increasing women's labour force participation. Moreover, to further enhance women's labour force participation, GoI should implement policies that support flexible work arrangements, such as remote work and adjustable hours. Investing in affordable childcare services and addressing workplace discrimination are also another measure to support women's participation in the labour force. All these strategies align with findings from a 2019 World Bank survey, which found that the middle class viewed job creation and social assistance are among the most critical policies for addressing inequality.

Tackling informal employment is also paramount. Over half of aspiring middle class and middle class workers are in informal jobs. Encouraging formal employment through tax breaks, subsidies, and other financial incentives can help businesses formalize their workforce. Simplifying business registration and compliance with labour regulations will also make formal operations more appealing. In addition, strengthening state capacity to enforce laws and regulations are also necessary to reduce informality.

Addressing housing poverty is also imperative, as the issue has worsened for both aspiring middle class and middle class individuals. Policies should focus on increasing access to affordable housing through subsidies, low-interest loans, and developing affordable housing projects. Moreover, other life quality aspects, such as access to clean water and sanitation should go hand-in-hand with the improvement of housing condition. Provision of clean water and sanitation will not only increase the life quality of current aspiring middle class and middle class groups, but also to ensure health quality of their offsprings and could influence the life quality of next generation of middle class.

These policy measures are not only crucial for economic growth but also for political stability. Ignoring the aspiring middle class and middle class groups come with significant political risks. These groups represent a substantial portion of voters, and their dissatisfaction can lead to major electoral shifts, as seen in the 2020 US Presidential election when many middle class voters, unhappy with economic and pandemic policies, switched their support from Trump to Biden (GU Politics, 2020). Furthermore, failure to address inequality in the context of economic growth and development could lead to social unrest, particularly if the middle class, who are numerous and educated, face economic disadvantages. Unlike poorer and more vulnerable groups, the middle class is more likely to voice their concerns when their economic situation deteriorates. Rising inequality and middle class frustration over stagnation have already led to demands for systemic reforms in Chile. Similar unrest has been observed in France, where the "Yellow Vests" movement emerged in response to perceived economic inequality and dissatisfaction with government policies (Jetten, J., et al. (2020)). In Brazil, the 2013 protests were largely driven by the middle class, demanding better public services and protesting against government corruption and economic mismanagement (Saad-Filho, A. (2013)).

To effectively implement these policies, strong institutional practices are crucial. According to a 2019 World Bank survey, the aspiring and existing middle class in Indonesia view eradicating corruption as one of the most important issues to be resolved. Robust institutions ensure transparency, accountability, and efficiency in policy execution and help combat corruption, which can undermine policy effectiveness. These practices foster trust between the government and the public, which is essential for the successful adoption of policies supporting the middle class. Well-functioning institutions are better equipped to manage resources, monitor progress, and make necessary adjustments to address emerging challenges, ensuring that policies achieve their intended outcomes. Ultimately, a robust middle class supported by sound policies and strong institutions will drive sustainable economic growth and social stability.

High Reliance of Growth on Seasonal Factors

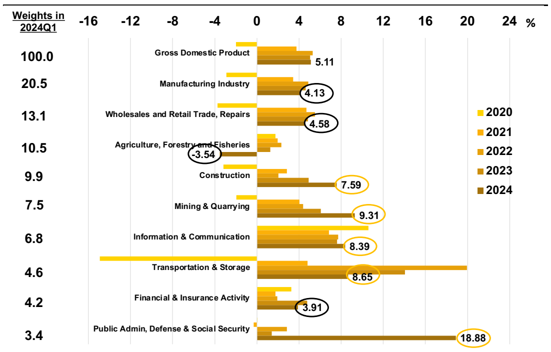
"Despite experiencing an acceleration, Indonesia's economy indicated ongoing structural problems, with a growth mostly supported by seasonal factors."

Indonesia's GDP grew by 5.11% (y.o.y) in the first quarter of 2024, increased from 5.04% (y.o.y) compared to Q4-2023 and higher than the overall growth of 2023, which stood at 5.05% (y.o.y). Overall, the driver of economic growth in Q1-2024 was rather similar to the last quarter of 2023. Despite experiencing an acceleration, Indonesia's economy indicated ongoing structural problems, with a growth mostly supported by seasonal factors. Around 45% of Indonesia's economy was attributed to only three sectors, namely manufacturing, wholesale and retail trade, and agriculture. These three biggest sectors in the economy continued to grow below overall economic growth. Persistent stagnation of manufacturing sector growth substantiates any indication of premature deindustrialization in Indonesia. Furthermore, below-5% growth of wholesale and retail trade sector suggests that another worrying potential of weakening purchasing power of general population, especially the middle class group. In addition, this could also be contributed by the potential of premature deindustrialization that limits welfare improvement of labour due to limited productivity of production activity in Indonesia. On the other hand, bleak performance of agriculture sector tells a slightly different story than the previous two main sectors. While the depressing growth rate of agriculture sector was also driven by structural problem, there are some seasonal factors that played a role in its growth rate in Q1-2024. Agriculture sector in Indonesia is facing a low productivity issue due to various factors, ranging from low skills of labour, low quality of input materials, to lack of insurance scheme for farmers. However, El-Nino phenomenon has been occurring during the first quarter of 2024 and has been affecting the production level of agriculture in Indonesia. These combinations of structural and seasonal phenomena resulted in a negative growth for agriculture sector in Q1-2024.

"Sectors with significantly small shares experienced a substantial growth rate in the first quarter of 2024 beyond the national average. They managed to push Indonesia's GDP growth even higher than the previous quarter."

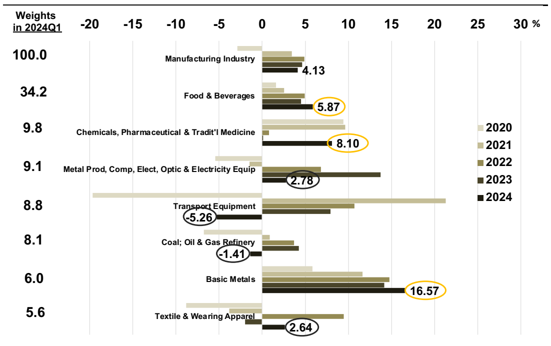
Sectors with significantly small shares experienced a substantial growth rate in the first quarter of 2024 beyond the national average. They managed to push Indonesia's GDP growth even higher than the previous quarter. Unlike the main sectors, seasonal factors played a more dominant role as growth driver of smaller sectors. The occurrence of Ramadan period (and the following homecoming activity for Eid Al-Fitr) in Q1-2024 contributed to high growth of transportation and storage sector, and accomodation and food and beverages activity. Religious holiday allowance and 13th salary payment for Eid Al-Fitr also drove the growth of public administration sector as personnel spending increased. In addition, higher personnel spending for public health institution also increased the growth of health sector. Another seasonal event that took place in Q1-2024 was general election. The event of general election boosted the growth of business services and ICT as it created demand for various services, such as event organizer and communication services. Moreover, the acceleration of infrastructure project completion before the ending of the current administration term served as a catalyst for construction sector growth and also played a role in higher public administration sector growth due to an increase in GoI's capital spending. Also, mining and quarrying also gained higher growth by another seasonal factor following higher domestic and global demand various metal and coal commodities.

Figure 1: Growth of GDP and the Main Industries, 2020-2024Q1



Source: CEIC

Figure 2: Growth of Manufacturing Sector and Its Subsectors, 2020-2024Q1



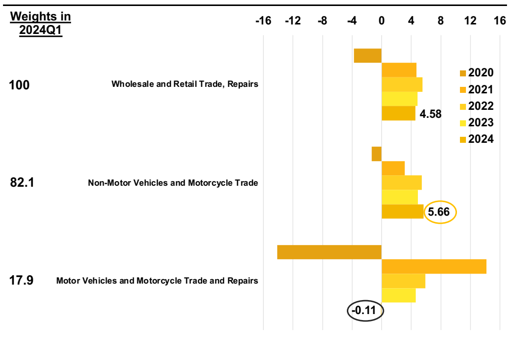
Source: CEIC

Manufacturing sector growth slightly increased from 4.07% (y.o.y) in Q4-2023 to 4.13% (y.o.y) in Q1-2024. However, looking at its components, subsectors within manufacturing industry had high variation of growth performance in the first quarter of 2024. Being the biggest subsector within manufacturing industry with the share of more than a third, food and beverages subsector growth increased considerably to 5.87% (y.o.y) in Q1-2024 from 4.71% (y.o.y) in Q4-2023. This is mostly supported by higher domestic demand amidst the Ramadhan and Eid Al-Fitr period. Furthermore, despite decelerating, basic metal subsector growth remains immensely high due to the ongoing high demand from global market. Recorded a double-digit growth for eight consecutive quarters, basic metal grew slower to 16.57% (y.o.y) in Q1-2024 from 18.82% (y.o.y) in the previous quarter. Another main subsector that had a stellar growth performance was chemical, pharmaceutical, and medicine subsector. Barely grew by 0.85% (y.o.y) in the last quarter of 2023, growth of chemical, pharmaceutical, and medicine subsector skyrocketed to 8.10% (y.o.y) in Q1-2024. This is driven by higher domestic and global demand for chemical, pharmaceutical, and traditional medicine products. On the other hand, poor performance of other subsectors dragged down the overall manufacturing growth. Being the third largest subsector within manufacturing industry, metal and electronic products growth took a nosedive from 11.12% (y.o.y) in Q4-2023 to 2.78% (y.o.y), ending its double-digit growth trend in the past four quarters. The plunge in the subsector growth might be caused by its relatively low competitiveness, especially on the price aspect compared to similar products from other countries. In Q1-2024, export value of machinery and electronic equipment grew by -3.74% (y.o.y) despite having its quantity to grow by 5.69% (y.o.y). Similarly, domestic manufacturing might also faced some pressure from imported products as imports quantity for those products increased by 9.28% (y.o.y) during the same period, facing although the imports value only rose by 3.14% (y.o.y). Further, prolonging issues surrounding rubber industry from EU's anti-deforestation law and shortage of input materials has extended the subsector's growth decline period. For the fourth time in a row, rubber subsector shrunk as it grew by -5.24% (y.o.y) in Q1-2024 from -4.49% (y.o.y) in Q4-2023. Similarly, transport equipment subsector performance growth continued to deteriorated from -2.56% (y.o.y) to -5.26% (y.o.y) as vehicle sales dropped significantly. In Q1-2024, wholesale and retail vehicle sales grew by -23.90% (y.o.y) and -14.98% (y.o.y), marking the worst sales performance since 2009 for wholesale sales and since 2015 for retail sales. Moreover, textile subsector growth rebounded after negatively affected by rise in illegal textile imports and the lower competitiveness of domestic textile products compared to imports. As the demand for textile products increase due to General Election event and Ramadan and Eid Al-Fitr period, textile subsector recorded its first positive growth rate since 2022 as it grew by 2.64% (y.o.y) in Q1-2024, an increase from -3.42% (y.o.y) in the previous quarter. Those two events also drove up demand for paper and leather products. Consequently, paper subsector and leather subsector growth increased from 5.83% (y.o.y) to 6.13% (y.o.y) and from 4.91% (y.o.y) to 5.90% (y.o.y), consecutively, during the same period.

"Manufacturing sector growth slightly increased from 4.07% (y.o.y) in Q4-2023 to 4.13% (y.o.y) in Q1-2024, with high variation of growth performance within its subsectors."

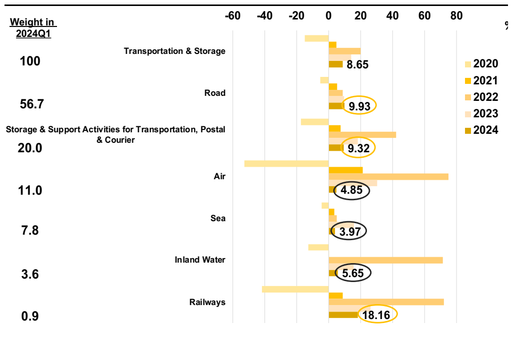
"...wholesale and retail sector grew considerably to 4.58% (y.o.y) in Q1-2024 from 4.09% (y.o.y) in the previous quarter, driven by motor vehicle trade which accounted for more than 80% of domestic trade activities."

Figure 3: Growth of Wholesale and Retail Trade and Its Subsectors, 2020-2024Q1



Source: CEIC

Figure 4: Growth of Transport and Its Major Subsectors, 2020-2024Q1



Source: CEIC

Q1-2024 in Indonesia was an eventful period and greatly benefitted wholesale and retail sector. The combination of General Election, Ramadan and Eid Al-Fitr, and several long holiday occurrence drove up aggregate demand by consumers. As a consequence, wholesale and retail sector performed rather excellently and grew considerably to 4.58% (y.o.y) in Q1-2024 from 4.09% (y.o.y) in the previous quarter. Accounted for more than 80% of domestic trade activities, non-motor vehicle trade became the main growth engine of the overall sectoral growth. This subsector enjoyed an increase of growth from 5.15% (y.o.y) in the last quarter of 2023 to 5.66% (y.o.y) in Q1-2024. While an outstanding growth occurred in non-motor vehicle trade subsector, a rather contrasting picture was seen in motor vehicle trade subsector. Although improving, the growth of motor vehicle trade remains contracted in the first quarter of 2024. Motor vehicle trade subsector grew by -0.11% (y.o.y) in Q1-2024 from -0.52% (y.o.y) in Q4-2023. The rise of cost of funds following higher policy rates and increasing vehicle prices were unmatched by the rise in general population's income. In general, the massive drop in motor vehicle sales might indicates a secular trend of declining purchasing power by the population. Thus, the overall performance of wholesale and retail trade sector was mostly contributed by seasonal events this is a rather sustainable engine of growth for the industry. Thus, to ensure the viable growth rate of wholesale and retail trade sector, GoI should resolve its structural issue and address the weakening purchasing power problem.

After eight consecutive quarters of double-digit growth, the transportation and storage sector grew by 8.65% (y.o.y) in Q1-2024, down from 10.33% (y.o.y) in Q4-2023. This lower growth rate indicates an ongoing trend of mobility activity normalization after Covid-19, as the sector's growth rate has been on a downward trajectory since Q2-2022. Lower growth rate occurred almost uniformly across its subsectors, expect for road and railways transports. The tradition of *mudik* (homecoming activity) to celebrate Eid Al-Fitr pushed upward the growth fo road transport subsector from 9.89% (y.o.y) in Q4-2023 to 9.93% (y.o.y) in Q1-2024 and railways transport subsector from 16.95% (y.o.y) to 18.16% (y.o.y) during the same period. In addition, increased mobility stemming from election-related activities could also play a part in a slight increase of road transport activities. Overall, transportation and storage sector still managed to grow substantially and way above pre Covid-19 growth rate average. The ongoing slowdown of the sector growth rate does not indicate any weakening in the activity, but rather a normalization after a period of 'supernormal' growth in the past two years.

While Indonesia's economy entered 2024 with a rather positive note on growth, it should not be construed as a sign of fundamental improvement of the economy. In fact, relatively high growth in Q1-2024 was mostly driven by seasonal factors. Enormous growth of public administration sector to 18.16% (y.o.y) in Q1-2024 from 1.61% (y.o.y) in the previous quarter was mostly due to disbursement of social assistance program, acceleration of infrastructure project completion which increase GoI's capital spending, and religious holiday allowance and 13th salary payment. Furthermore, the occurrence of General Election boosted growth of ICT (from 6.74% to 8.39%, y.o.y), business services (from 7.62% to 9.63%, y.o.y), and accomodation and food and beverages activity (from 7.89% to 9.39%, y.o.y) during the same period. However, underlying issue of gradual decline in productivity remains. For the rest of 2024 and beyond, Indonesia's economy might not always be able to rely on seasonal events to bolster its growth. Therefore, addressing the issue of general productivity of economic sectors and creating quality high value-added jobs is of utmost importance.

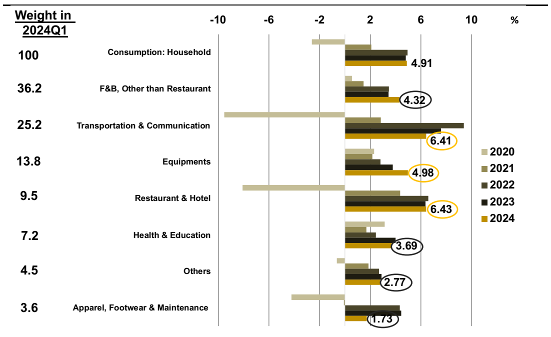
"Household consumption, accounting for 53.32% of Indonesia's GDP, grew by 4.91% (y.o.y) in Q1-2024, up from 4.83% in Q4-2023. This acceleration was driven by the momentum of Ramadan, several national holidays and collective leave periods, which boosted public mobility."

Holiday Season Fuels Economic Growth

Household consumption, accounting for 53.32% of Indonesia's GDP, grew by 4.91% (y.o.y) in Q1-2024, up from 4.83% in Q4-2023. This acceleration was driven by the momentum of Ramadan, several national holidays and collective leave periods, which boosted public mobility. This momentum was further supported by sustained purchasing power through increased social assistance distribution and increases in civil servants' (ASN) salaries in accordance with Government Regulation No. 5 of 2024 and the provision of holiday allowance for Eid al-Fitr (THR). Ramadan festivities, in particular, successfully spurred consumer spending, especially in the food and beverage sector. As the largest component of household consumption, accounting for over one-third, the food and beverage sector grew by 4.32% (y.o.y) in Q1-2024, up from 2.56% (y.o.y) in the previous quarter. Growth acceleration was also observed in most components of household consumption, except for transportation & communication and apparel, footwear & maintenance. In addition, the consumption growth of non-profit institutions serving households surged to 24.29% (y.o.y) in Q1-2024, building on the previous quarter's strong growth of 18.11% (y.o.y), driven by the general election cycle. This double-digit growth for two consecutive quarters marks the first occurrence since the 2019 election cycle.

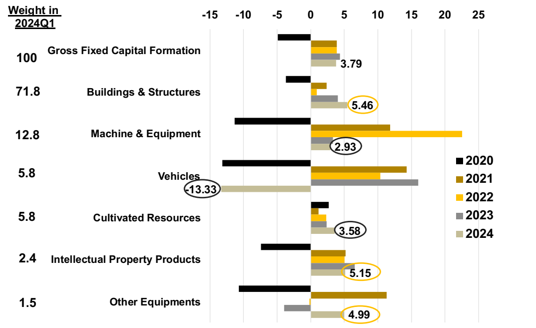
From the government side, consumption grew significantly by 19.90% (y.o.y) in Q1-2024, the highest in the last 20 years. This acceleration was driven by increased expenditures on goods, particularly for the 2024 elections, social assistance spending, and a rise in employee expenses due to the distribution of holiday allowances, which included a 100% performance allowance.

Figure 5: Growth of Household Consumption and its Components, 2020-2024Q1



Source: CEIC

Figure 6: Growth rate of Investment and Its Main Components, 2020-2024Q1

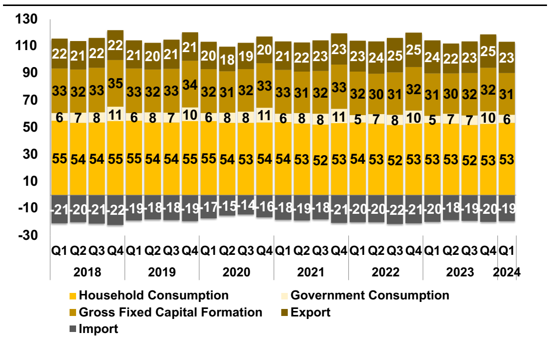


Source: CEIC

"Credit growth in Q1-2024 returned to a double-digit level, reaching 11.84% (y.o.y) from 9.71% (y.o.y) in the previous quarter. All credit by purposes indicated growth in the same period."

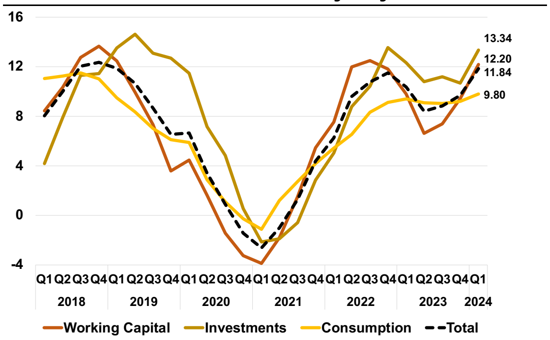
Investment growth moderated to 3.79% (y.o.y) in Q1-2024 from 5.02% (y.o.y) in the previous quarter. This moderation was driven by the vehicle category, which experienced a negative growth of 13.33% (y.o.y) as opposed to positive growth of a positive growth of 3.20% (y.o.y) in Q4-2023. This can be partially explained by the declining sales of all types of commercial (wholesale) vehicles. A decelerating growth was also observed in building investment, which contributed 71.8% to the investment component. Despite growing robustly at 5.46% (y.o.y) in Q1-2024 due to ongoing infrastructure development, this was a decline from 6.42% (y.o.y) in the previous quarter. Meanwhile, growth acceleration was observed in all other components of GFCF compared to the previous quarter.

Figure 7: Shares of GDP Components, 2018Q1-2024Q1 (%)



Source: CEIC

Figure 8: Credit Growth by Purposes, 2018Q1-2024Q1 (y.o.y, %)



Source: CEIC

Credit growth in Q1-2024 returned to a double-digit level, reaching 11.84% (y.o.y) from 9.71% (y.o.y) in the previous quarter. All credit by purposes indicated growth in the same period. Investment credit saw the highest growth at 13.34% (y.o.y) in the first three months of 2024, up from 10.68% (y.o.y) in the previous quarter. Working capital credit growth increased to 12.20% (y.o.y) from 9.43% (y.o.y) in Q4-2023, while consumer credit grew by 9.80% (y.o.y) from 9.22% (y.o.y) in the previous quarter. This growth acceleration can be explained from both the supply and demand sides.

On the supply side, high credit growth was driven by a strong banking appetite supported by robust capital and sufficient liquidity, which was partly driven by the Macroprudential Liquidity Incentive Policy (*Kebijakan Insentif Likuiditas Makroprudensial*/KLM). On the demand side, credit growth was propelled by improved sales and corporate investment performance, which is expected to continue improving as policy uncertainty decreases post-election.

On the other hand, deposit growth returned to above 5%, reaching 6.30% (y.o.y) in Q1-2024 after growing "only" 3.36% (y.o.y) in the previous quarter due to the high-base effect post-Covid-19 pandemic. Several factors might have played a role in the rise of deposit growth. From January to March 2024, interest rates on saving deposits increased, especially in state banks, regional government banks, and foreign and joint banks. This adjustment occurred because bank deposit rates typically lag changes in the BI rate. In addition, higher household income due to increased economic activity and holiday allowance could have also spurred deposit growth. Demand deposits saw the highest growth at 8.50% (y.o.y) in Q1-2024, up from 3.09% (y.o.y) in Q4-2023. Saving deposits grew by 4.93% (y.o.y), while time deposits by 5.68% (y.o.y) in Q1-2024, up from 2.41% (y.o.y) and 4.45% (y.o.y), respectively, in the previous quarter.

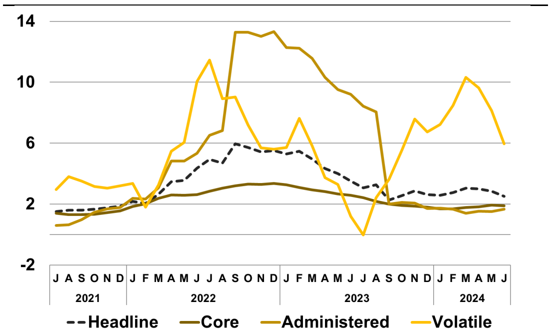
Inflation Trends Show a Decline Amid Mixed Indicators

Headline inflation reached 2.51% (y.o.y) in June 2024, slightly down from 2.84% (y.o.y) in the previous month. The inflation rate has been decreasing for three consecutive months as the impact of El Niño subsided and the period of heightened demand during Ramadan and Eid al-Fitr in March-April 2024 ended. Decrease in inflation was also driven by consistent monetary policy and strong synergy between Bank Indonesia and the Government, within the Central and Regional Inflation Control Teams (TPIP and TPID). It was carried through the strengthening of the National Food Inflation Control Movement (GNPIP) by securing production and increasing the food supply chain efficiencies.

"Across all components, the increase in inflation is only evident in administered price, as core inflation and volatile price experienced a decrease from the previous month."

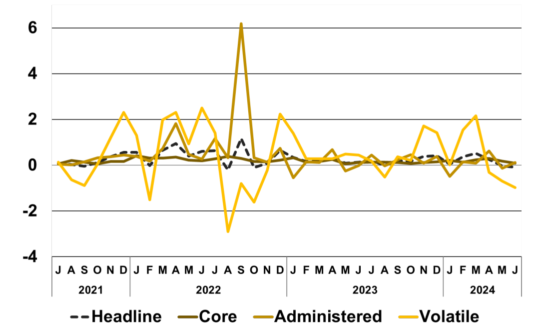
Across all components, the increase in inflation is only evident in administered price, as core inflation and volatile price experienced a decrease from the previous month. Administered price recorded a 1.68% (y.o.y) inflation rate in June 2024 which increased from 1.52% (y.o.y) in previous month, contributing only 0.33% to June 2024's inflation. This was influenced by the increase in airfares during the Eid al-Adha holiday and price increase in machine-rolled clove cigarettes as producers passed higher excise duties on tobacco products to consumers. Core Inflation slightly decreased to 1.90% (y.o.y) in June 2024 from 1.93% (y.o.y) in previous month. This decline was driven by well-anchored inflation expectation as there is no discernible risks of commodity shortages during the heightened demand period of Eid al-Adha. Volatile price inflation saw a 5.96% (y.o.y) in June 2024, decreased quite significantly from 8.14% (y.o.y) in May 2024. The decrease in volatile price inflation was supported by an increase in supply, along with the continuation of the harvest season and a reduction in feed prices for purebred chicken. In terms of expenditure groups, the rise in June 2024 inflation was primarily driven by price increases in the food, beverage, and tobacco group, which recorded a 4.95% (y.o.y) inflation rate, contributing 1.40% to the annual headline inflation.

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



Source: CEIC

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



Source: CEIC

"… certain risks could lead to inflationary pressures. Firstly, BPS projects a 40-50% decrease in rice production from June to October 2024 compared to the April-May 2024 harvest period, which could trigger a rise in rice prices. Additionally, a weakening Rupiah may contribute to imported inflation…"

On a monthly basis, headline inflation stood at -0.08% (m.t.m) in June 2024, a decrease from -0.03% (m.t.m) in May 2024. Reflecting the annual inflation trend across all components, inflation increased only in administered prices, while core inflation and volatile prices experienced decreases. Administered price inflation reached 0.12% (m.t.m) in June 2024, up from -0.13% (m.t.m) in May 2024. This increase was driven primarily by higher prices for machine-made kretek cigarettes and air transportation fares, due to continued transmission of increased tobacco tariffs and greater mobility during the Eid al-Adha holiday. However, the rise in administered prices was offset by decreases in core inflation and volatile prices. The most significant monthly decrease was observed in the volatile goods component, which recorded -0.98% (m.t.m) inflation in June 2024, down from -0.69% (m.t.m) in May 2024. This deflation was driven by price drops in shallots, tomatoes, and purebred chicken. Core inflation recorded a 0.10% (m.t.m) rate in June 2024, down from 0.17% (m.t.m) in the previous month. The lower core inflation was influenced by anchored inflation expectations, including during the Eid al-Adha holiday, as well as economic capacity to respond to domestic demand. The core inflation was mainly attributed to price hikes in gold jewelry and ground coffee.

Looking ahead, inflation is expected to experience moderate fluctuations but will remain within BI's target range of 1.5% to 3.5% throughout 2024. However, certain risks could lead to inflationary pressures. Firstly, BPS projects a 40-50% decrease in rice production from June to October 2024 compared to the April-May 2024 harvest period, which could trigger a rise in rice prices. Additionally, a weakening Rupiah may contribute to imported inflation, as a depreciating currency tends to make imported goods more expensive domestically. These factors underscore the multifaceted nature of inflationary pressures, requiring vigilant monitoring and appropriate policy responses. Continued synergy between the Central and Regional

Inflation Control Teams (TPIP and TPID) and the National Food Inflation Control Movement (GNPIP), in collaboration with Bank Indonesia, is anticipated.

Post-Election Surge: Indonesia's Q2-2024 Investment on the Rise

Total investment realization in the second quarter of 2024 reached IDR428.4 trillion, which is 26% of the 2024 investment target of IDR1,650 trillion. The latest total investment realization rose by 22.5% (y.o.y) from the same period in 2023 and was 6.7% (q.o.q) higher compared to the previous quarter. By source of investment, total investment in Q2-2024 was slightly dominated by foreign direct investment (FDI), totalling IDR217.3 trillion, contributing 50.7% to the total investment realization. Domestic direct investment (DDI) totalled IDR211.1 trillion, making up 49.3% of the total investment realization. Both FDI and DDI showed growth in Q2-2024. FDI grew by 16.6% (y.o.y) and 6.3% (q.o.q), suggesting foreign investors' confidence in Indonesia as a favorable investment destination despite global economic uncertainty. The growth of DDI reached 29.1% (y.o.y) and 7.1% (q.o.q). This highlighted a robust domestic economy of local businesses and entrepreneurs, with respect to investment realization growth of micro and small businesses.

"The Ministry of Investment/BKPM highlighted the important role of a conducive presidential transition to investment climate along with Micro and Small Enterprises (MSEs) contribution to investment realization."

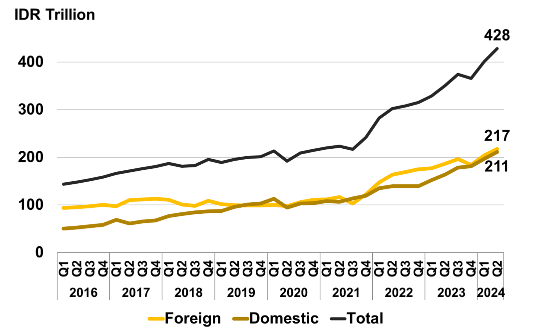
Moreover, investment realization in the first half of 2024 is recorded to reach IDR829.9 trillion, achieving 50.3% of the 2024 investment target. The number showed an increase of 22.3% (y.o.y) from the same period in the previous year. The Ministry of Investment/BKPM highlighted the important role of a conducive presidential transition to investment climate along with Micro and Small Enterprises (MSEs) contribution to investment realization. In the first half of 2024, investment realization from MSEs amounting IDR127.0 trillion with approximately 2.4 million projects, representing 15.3% of total investment realization.

In terms of industry, the basic metal industry, metal goods, non-machinery, and related equipment continued to lead total investment realization, with a total of IDR79.24 trillion, representing 17.78% of Q2-2024's investment. Compared to previous period in Q1-2024, the share of basic metal industry, metal goods, non-machinery, and related equipment sector to total investment increased by approximately 5% which indicated its notable contribution. The mining sector followed as the second-largest investment sector, with investments totaling IDR46.64 trillion, accounting for 10.47% of the total. The mining sector had pushed transport, storage, and communication sector into the third position with investment amounting IDR42.17 trillion and representing 9.46% of total investment in April-June 2024 period.

Regarding investment locations, the total investment realization in Java reached IDR208.54 trillion, accounting for 48.68% of the total investment realization. This indicated that while investment remains heavily concentrated in Java, the proportion is slightly lower than total investment in outside of Java. Central Sulawesi experienced significant investment, with IDR35.30 trillion for the April-June 2024 period. This investment in Central Sulawesi remained driven by downstream activities, notably in smelter development.

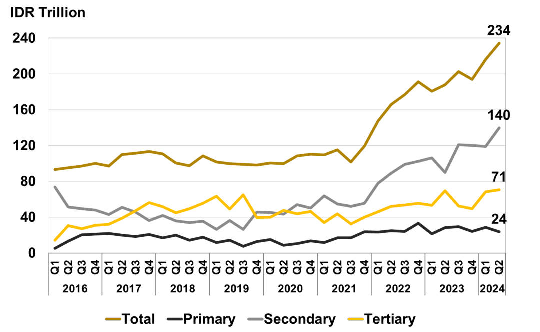
Examining FDI by country, Asia continued to be the primary source in the second quarter of 2024, accounting for 77.94% of total FDI. Singapore led the list with USD4.6 billion, followed by China at USD2.0 billion, and Hong Kong at USD1.9 billion. Although Asia's strong presence demonstrates robust regional economic ties, this concentration might raise concerns. It suggests that Indonesia's investment inflows are less diversified, which could increase the risk of economic shocks if the Asian markets face downturns or disruptions.

Figure 11: FDI and DDI (Nominal)



Source: CEIC

Figure 12: FDI Realization by Sectors (Nominal)



Source: CEIC

"In Q2-2024, the trade surplus reached USD8.04 billion, representing a 2.82% (y.o.y) increase from the same period last year or an 8.42% (q.o.q) increase from Q1-2024."

Sustained Trade Surplus; The Fed's Decision Weigh on Rupiah

A trade surplus was recorded during the April to June quarter of 2024, marking the eighteenth consecutive quarter of surplus. In Q2-2024, the trade surplus reached USD8.04 billion, representing a 2.82% (y.o.y) increase from the same period last year or an 8.42% (q.o.q) increase from Q1-2024. This growth is attributed to a rise in both exports and imports, with exports outpacing imports. In Q2-2024, exports were valued at USD62.78 billion, a 1.93% (y.o.y) increase or a 0.76% (q.o.q) increase. Imports were recorded at USD58.78 billion, showing a 1.76% (y.o.y) increase or a 0.64% (q.o.q) increase. The boost in exports was driven by rising global commodity prices, benefiting major export commodities from Indonesia. For instance, the average price of crude palm oil, one of Indonesia's key export commodities, rose by 4.93% (y.o.y) or 1.32% (q.o.q) in Q2-2024. Additionally, increased demand from Indonesia's main trading partners contributed to the trade surplus. In Q2-2024, China's imports grew by 1.76% (y.o.y) or 3.95% (q.o.q). This surge in demand, coupled with favourable commodity prices, boosted Indonesia's export performance.

Breaking down exports, the increase in performance was driven by both oil and gas and non-oil and gas exports. Oil and gas exports rose to USD4.00 billion in Q2-2024, up from USD3.83 billion in Q2-2023, representing a 4.53% (y.o.y) increase. Similarly, non-oil and gas exports grew by 1.76% (y.o.y), rising from USD57.77 billion in Q2-2023 to USD58.78 billion in Q2-2024.By commodity, the export performance showed a mix of annual increases and decreases during Q2-2024. Notably, mineral resources, the top contributor to Indonesia's non-oil and gas exports, experienced a 10.09% (y.o.y) contraction, dropping from USD19.76 billion in Q2-2023 to USD17.76

billion in Q2-2024. However, this decline was offset by increases in other commodities. For instance, exports of base metals surged by 15.05% (y.o.y), increasing from USD6.50 billion in Q2-2023 to USD7.49 billion in Q2-2024.

Imports also tell a similar story. In Q2-2024, imports grew by 1.80% (y.o.y), rising from USD53.78 billion in Q2-2023 to USD54.75 billion in Q2-2024. The increase in imports was driven by both oil and gas and non-oil and gas imports. Oil and gas imports increased by 8.31% (y.o.y), from USD8.31 billion in Q2-2023 to USD9.00 billion in Q2-2024. Non-oil and gas imports ticked up by 0.61% (y.o.y), from USD45.47 billion in Q2-2023 to USD45.74 billion in Q2-2024. By commodity, the rise in non-oil and gas imports was driven by increasing imports of electronics, electrical equipment, and machinery, which grew by 2.32% (y.o.y), and industrial chemicals, which increased by 4.90% (y.o.y).

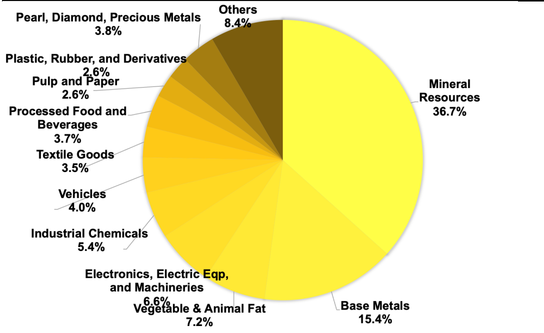
"Since Indonesia's imports primarily consist of raw materials and capital goods, the recent decrease in the PMI suggests that import growth may face challenges in the near term."

Looking ahead, two factors are expected to heavily influence Indonesia's export performance. First, increasing commodity prices are anticipated to support export growth. For instance, oil prices are expected to rise in the second half of 2024 due to persistent withdrawals from global oil inventories driven by OPEC+ production cuts. This trend is likely to boost Indonesia's oil and gas exports. Second, weak global demand, particularly from Indonesia's main trading partners, could negatively impact export growth. Economic slowdowns or reduced purchasing power in these regions might lead to decreased demand for Indonesian goods, offsetting some of the gains from higher commodity prices. Regarding imports, the latest Manufacturing Purchasing Managers' Index (PMI) stood at 50.70, the lowest level in thirteen months. Although this figure remains in expansionary territory, the decline is attributed to reduced growth in new orders and a slower pace of purchasing activity. Since Indonesia's imports primarily consist of raw materials and capital goods, the recent decrease in the PMI suggests that import growth may face challenges in the near term.

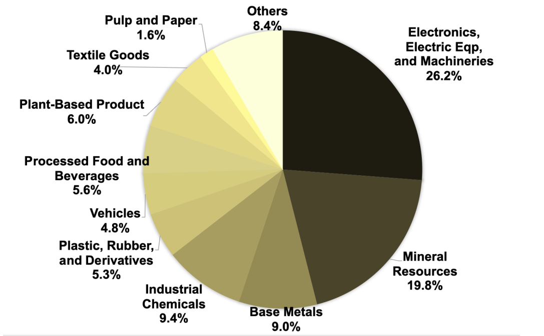
In the first quarter of 2024, the current account deficit increased to USD 2.2 billion (0.6% of GDP), widened from USD 1.1 billion (0.3% of GDP) in the last quarter of 2023. This deeper deficit was primarily due to a 14.14% (q.o.q) contraction in the goods trade balance. In contrast, the service trade balance showed improvement, with a reduced negative balance of -USD 4.42 billion in Q1-2024, compared to -USD 4.98 billion in Q4-2023, driven by high tourism receipts. Looking ahead, the current account is expected to remain in negative territory in the second quarter of 2024, but with a smaller deficit. This anticipated improvement is driven by a higher trade surplus in Q2-2024, driven by rising commodity prices and increasing demand from Indonesia's trading partners.

Figure 13: Indonesia Exports Profile (Q1-2024)

Figure 14: Indonesia Imports Profile (Q1-2024)



Source: CEIC



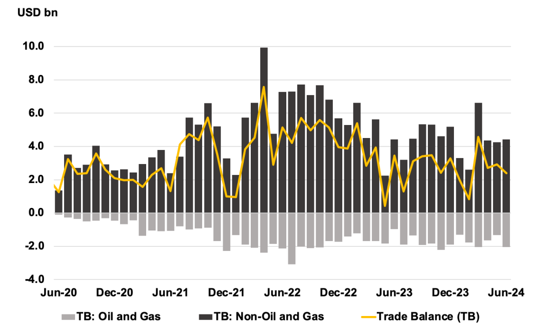
Source: CEIC

"While depreciation might appear alarming, the Rupiah was not alone in this trend."

The Fed has consistently held its policy rate between 5.25% and 5.75% over its last seven meetings, including those in the April to June quarter. This stance is driven by the Fed's strategy to maintain high interest rates until inflation decreases to its 2% target, aiming to preempt any resurgence in inflationary pressures. As of May 2024, U.S. inflation was reported at 3.3% (y.o.y), slightly down from 3.4% (y.o.y) in April, but still above the desired level. During the June meeting, the Fed hinted at the possibility of one rate cut before the end of December 2024. The Fed's firm stance has influenced the Indonesian financial market, mostly through stock instruments, resulting in net outflows of USD2.24 billion from April to June 2024. Apart from fueled by both external factors, capital outflows from domestic market are also triggered by domestic concerns, such as rumors about the fiscal policies of the upcoming administration. Rumors surrounding fiscal policies spurred further capital withdrawals in June. On 14 June, a Bloomberg article reported that the Prabowo administration plans to increase the debt-to-GDP ratio by two percentage points annually over the next five years. On the same day, net capital outflows from the stock market reached USD700 million, and the Rupiah weakened by 0.80% compared to its value on 13 June. Additionally, between April and May 2024, net foreign sales of large-cap banking stocks occurred as foreign investors engaged in profit-taking after these banks paid dividends. This activity was also influenced by the OJK's announcement of the end of the Covid-19 credit restructuring stimulus policy. Conversely, the bond market demonstrated stability, showing no changes in net foreign buying or selling during the same period. However, there was a noticeable increase in bond yields for both 1-year and 10-year government bonds in Q2-2024. The yield on the 1-year government bond increased from 6.10% at the end of March 2024 to 6.55% at the end of June 2024. Similarly, the yield on the 10-year government bond rose from 6.72% to 7.06% over the same period.

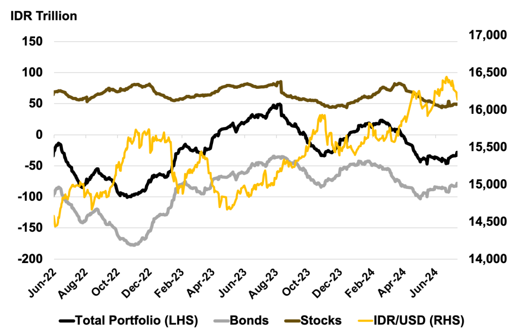
Amid persistent capital outflows, primarily from the stock market since March 2024, the Rupiah depreciated by 6.33% (y.t.d) by the end of June 2024. While this depreciation might appear alarming, the Rupiah was not alone in this trend. The Thai Baht, Philippine Peso, and Malaysian Ringgit, among other Asian and emerging market currencies, also depreciated against the US dollar, reflecting market expectations of the Fed's commitment to its hawkish stance. Consequently, Indonesia's foreign exchange reserves decreased by USD0.21 billion, from USD140.39 billion in March 2024 to USD140.18 billion in June 2024. Despite this reduction, the reserve assets at the end of June 2024 still represented 6.3 months of imports or 6.1 months of imports and government external debt servicing. This is well above the international standard for reserve adequacy, which is about three months of imports.

Figure 15: Monthly Trade Balance (Nominal)



Source: CEIC

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



Source: CEIC

"The uncertainty surrounding the Fed's policy moves will continue to be a major risk factor for the Rupiah in the coming months."

As of early July 2024, following the release of the June jobs report, the US Dollar Index (DXY) declined to a three-week low. The report highlighted slower job growth and a rising unemployment rate, which fueled expectations of a potential Federal Reserve rate cut in September. This development weakened the US dollar against several major currencies, including the Euro, British Pound Sterling, and Japanese Yen. Similarly, the Indonesian Rupiah began to show signs of strengthening; starting on 2 July 2024, it appreciated to IDR 16,135 per US dollar by 12 July 2024. This implies that the fluctuations in the Rupiah's value are significantly influenced by market expectations concerning Federal Reserve decisions. The uncertainty surrounding the Fed's policy moves will continue to be a major risk factor for the Rupiah in the coming months. Domestically, inflation remains well-controlled within the targets set by Bank Indonesia, aided by stable food prices. Additionally, Bank Indonesia's proactive triple intervention strategy, which includes market operations, stabilization of currency and bond markets, and liquidity management, continues to play a crucial role in maintaining currency stability. These measures collectively help mitigate the impact of external shocks and support the Rupiah in a volatile global economic landscape.