REVIEW OF ECONOMIC DEVELOPMENT

Economic Growth, Inflationary Pressure and Post-Pandemic Normalization Efforts

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Overview

In the second quarter of 2022, Indonesia's economic growth reached 5.44% year on year (y-o-y). At the same time, inflation rate has increased since the beginning of 2022 to reach its highest level since 2015 of 4.35%. Then, the Rupiah (IDR) exchange rate against the USD also weakened compared to the previous quarter. However, Bank Indonesia keeps the benchmark interest rate constant at 3.50%.

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Table 1. Summary of Indonesian Macroeconomic Indicators

Indicator	2021				2022	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP growth (% y-o-y)	-0.70	7.07	3.51	5.02	5.01	5.44
Inflation rate (% y-o-y)	1.37	1.33	1.60	1.87	2.64	4.35
Exchange rate (IDR/USD Spot: Mid)	14,572.00	14,496.00	14,307.01	14,269.01	14,349.01	14,848.00
BI-7 Day RR	3.50	3.50	3.50	3.50	3.50	3.50
Current account (% of nominal GDP)	-0.39	-0.66	1.65	0.48	0.13	1.14

Source: CEIC

Economic Growth

Until the second quarter of 2022, Indonesia's economic growth showed a trend of improving economic recovery. GDP growth in the second quarter of 2022 was recorded at 5.44%, higher than the first quarter of 2022. Compared to the second quarter of 2021, this figure is lower (7.07% in the first quarter of 2021). But considering that last year's growth rate was measured from a very low basis in 2020, the figure of 5.44% has been a great achievement. The return of normal (pre-pandemic) economic activity compared to 2020 and 2021 has driven this recovery.

Similar to the end of 2021, household consumption has contributed the biggest push to Indonesia's GDP growth in the second quarter of 2022. Household consumption grew 5.51 percent y-o-y, higher than the first quarter of 2022. Although household consumption growth is not the component of GDP expenditure with the highest growth, its impact is very large in driving economic growth in the second quarter of 2022, which is 2.92% (from the 5.44% growth in the second quarter of 2022) because the proportion of household consumption is more than 50% of the total GDP (51.47%).

On the other hand, government spending decreased by 5.24% (y-o-y). Nonetheless, the figure was 2.50 percentage points higher than the previous quarter. The government expenditure component is the only component of GDP based on expenditure that has decreased. Furthermore, other components such as gross fixed capital formation grew by 3.07%, lower than the previous quarter (4.09%). Breaking down the Gross Fixed Capital Formation components, investment in machinery and equipment had the highest growth rate, while the lowest one is in construction investment.

Reviewing Indonesia's international trade in Q2/2022, exports of goods and services continued to strengthen and achieved growth of 19.74% (y-o-y), higher than the previous quarter but lower than the same quarter in the previous year. On the other hand, imports of goods and services decreased from quarter to quarter. In Q2/2022, imports of goods and services recorded a growth of 12.34% (y-o-y), 2.69 percentage points lower than the previous quarter.

Table 2. Economic Growth (%, y-o-y)

GDP Growth (% y-o-y)	2021				2022	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP	-0.70	7.07	3.51	5.02	5.01	5.44
By Expenditure						
Household consumption	-2.21	5.96	1.02	3.55	4.34	5.51
Government consumption	2.55	8.06	0.62	5.25	-7.74	-5.24
Gross fixed capital formation	-0.21	7.52	3.76	4.49	4.09	3.07
- Construction	-0.79	4.42	3.84	3.91	4.83	1.02
- Machinery and equipment	3.48	19.00	11.49	13.46	19.17	16,30
- Transportation	-4.23	10.47	-0.21	5.34	7.04	9.68
Export of goods and services	6.94	31.50	29.16	29.83	16.22	19.74
Import of goods and services	4.41	31.84	29.95	29.60	15.03	12.34
By Sector						
Tradable						
Agriculture, livestock, forestry, fisheries	3.44	0.53	1.43	2.28	1.16	1.37
Mining and quarrying	-2.02	5.22	7.78	5.15	3.82	4.01
Manufacturing	-1.38	6.58	3.68	4.92	5.07	4.01
- Oil and gas	-7.70	3.37	-0.77	8.58	1.15	0.75
- Excluding oil and gas	-0.71	6.91	4.12	4.58	5.47	4.33
Non-tradable						
Electricity, gas, and water supply	1.68	9.09	3.85	7.81	7.04	9.33
Construction	-0.79	4.42	3.84	3.91	4.83	1.02
Wholesale, retail, and trade & repairs	-1.26	9.52	5.15	5.56	5.71	4.42
Transportation & storage	-13.09	25.10	-0.72	7.93	15.79	21.27

Accommodation & food and beverage activity	-7.27	21.58	-0.14	4.95	6.56	9.76
Information & communication	8.72	6.90	5.54	6.21	7.14	8.05
Financial & insurance activity	-2.97	8.33	4.29	-2.59	1.64	1.50
Human health & social work activity	3.39	11.69	14.06	12.16	4.38	6.45
Other services	-5.15	11.97	-0.30	3.35	8.24	9.25

Source: CEIC

On the GDP Supply side, the highest sectoral growth in the second quarter of 2022 came from transportation and warehousing activities, which amounted to 21.27%. Manufacturing sector growth was recorded at 4.01% (y-o-y) with the oil and gas manufacturing sector only grew by 0.75%, while the non-oil and gas manufacturing sector recorded higher growth, at 4.33%. Overall, there was no contraction in the sectoral components of GDP (sector-based/supply side) in the second quarter of 2022. It should be noted that the largest contribution to the total growth in the second quarter of 2022 (by 5.44%) came from the manufacturing sector (0.82%), the transportation and warehousing sector (0.76%), the trade sector (0.58%) and the informatics-communication sector (0.50%). The remaining 2.78% came from the growth of 8 other sectors, including the service sector.

Balance of Payment

Indonesia's balance of payments in the second quarter of 2022 recorded a surplus of USD 2.4 billion, after previously recording a deficit of USD 1.8 billion in the first quarter of 2022. Improvement in the Balance of Payments in the second quarter of 2022 was due to the relatively large current account surplus accompanied by a decrease in the capital and financial account deficit. The surplus in Indonesia's trade balance increased the total foreign exchange reserves at the end of the second quarter of 2022 (June 2022) to USD136.4 billion, equivalent to 6.4 months of import financing and interest payments on government foreign debt.

Surplus in the current account balance in the second quarter of 2022 came from the surplus in the non-oil and gas trade balance, which was driven primarily by high commodity prices on the international market. The relatively large non-oil and gas trade balance surplus compensated for the deficit in the oil and gas sector trade balance and the services trade balance. On the other hand, the capital and financial account balances improved significantly compared to the previous quarter since its deficit decreased from USD2.1 billion in the first quarter of 2022 to USD1.1 billion, with the source of deficit improvement coming from net direct investment inflows of USD3.1 billion. Meanwhile, portfolio investment is still in deficit although it is relatively small compared to previous quarter (USD2.94 billion in Q1/2022 to USD 0.4 billion at the end of June 2022). Other Investments suffered larger deficit due to the increase in corporate debt payments which generally occurs in companies with the end of the fiscal year in March each year.

Foreign exchange reserves at the end of June 2022 decreased compared to the end of the first quarter of 2022, from USD139.1 billion to USD 136.4 billion. Since April 2022, the Indonesian government has used foreign exchange reserves for the purpose of paying off foreign debt and managing the exchange rate, which has experienced high uncertainty after the US Central Bank raised interest rates since mid-March 2022. Foreign exchange reserves in April 2022 stood at USD 135.7 billion, declined by USD3.4 billion. In May 2022, foreign reserves was recorded relatively the same as April 2022 (USD135.6 billion). At the end of June 2022, foreign exchange reserves were recorded at USD136.4 billion or equivalent to 6.4 months of import financing and interest payments on government debt.

Table 3. Summary of Balance of Payment

Balance of Payment (in Billion USD)	**2021**				**2022**	
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Current Account	-1.09	-1.93	4.95	1.52	0.41	3.85
Exports	49.38	54.32	61.65	67.49	66.77	75.17
- Excluding oil and gas	45.88	50.53	58.11	63.61	62.65	70.07
- Oil and gas	3.02	3.34	3.18	3.66	3.81	4.85
Imports	-41.75	-45.98	-46.24	-55.05	-55.47	-58.36
- Excluding oil and gas	-35.90	-38.95	-39.99	-45.48	-45.44	-45.62
- Oil and gas	-5.29	-6.48	-5.69	-8.71	-9.51	-12.03
Services	-3.39	-3.71	-3.60	-3.96	-4.38	-4.97
Income	-6.75	-8.02	-8.27	-8.91	-8.01	-9.51
Current transfers	1.43	1.46	1.42	1.95	1.49	1.52

Current account (% of nominal GDP)	-0.39	-0.66	1.65	0.48	0.13	1.14
Capital and Financial Account	5.77	1.66	6.90	-2.10	-2.13	-1.08
Capital account	0.002	0.005	0.010	0.063	0.001	0.003
Financial account	5.77	1.65	6.89	-2.16	-2.13	-1.08
- Direct investment	4.49	5.40	3.38	3.84	4.37	3.06
- Portfolio investment	4.90	3.99	1.20	-5.02	-3.19	-0.42
- Other investment	-3.73	-7.76	2.14	-1.01	-3.45	-3.64
Net error and omissions	-0.62	-0.18	-1.16	-0.26	-0.10	-0.38
Overall balance	4.06	-0.45	10.69	-0.84	-1.82	2.39
Foreign reserves	137.10	137.09	146.87	144.91	139.13	136.38

Source: CEIC

Foreign Direct Investment

In the second quarter of 2022, foreign direct investment (FDI) was recorded at USD11.37 billion. FDI increased from year to year, with an increase of USD1.11 billion from the previous quarter and 3.37 billion US dollars from the same quarter in the previous year. The largest direct contributor to FDI came from the secondary sector of USD6.11 billion, followed by the tertiary and primary sectors.

Data from the Balance of Payments drew similar picture where the manufacturing sector (secondary sector) is the largest contributor to direct FDI amounting to USD1.76 billion. Please note that FDI data in the Balance of Payments only includes capital flows received by foreign companies from their direct investors and from one group company abroad during a certain period. Balance of Payments data show that in the secondary sector, the metal processing industry and the petrochemical industry received the largest foreign capital inflows in the second quarter of 2022 from Taiwan and South Korea.

Table 4. Foreign Direct Investment in Indonesia by Sector

Investment (in Billion USD)	2021				2022	
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Primary Sector	0.81	1.16	1.18	1.68	1.64	1.70
Mining	0.51	0.94	0.89	1.47	1.17	1.26
Food crops & plantation	0.28	0.21	0.27	0.19	0.47	0.44
Secondary Sector	4.47	3.80	3.63	3.90	5.43	6.11
Food industry	0.97	0.53	0.52	0.32	0.69	0.55
Chemical & pharmaceutical	0.49	0.32	0.48	0.36	0.85	0.90
Textile industry	0.10	0.07	0.08	0.07	0.13	0.11
Motor vehicles & other transport	0.60	0.36	0.27	0.27	0.54	0.24
Tertiary Sector	2.37	3.03	2.27	2.80	3.19	3.56
Transport, storage, & communication	0.84	0.92	0.62	0.78	0.87	0.88
Construction	0.01	0.01	0.05	0.02	0.02	0.03
Real estate, ind. estate, & business act	0.54	0.74	0.51	0.40	0.52	1.00
Trade & repair	0.08	0.20	0.07	0.11	0.18	0.24
Total Foreign Direct Investment	7.65	8.00	7.07	8.37	10.26	11.37

Source: CEIC

International Trade

Indonesia's exports and imports experienced an increasing trend in line with improving domestic and global economic conditions. In the second quarter of 2022, Indonesia exported USD26.15 billion, with non-oil and gas commodities as the largest contributor. This achievement was 0.35 billion US dollars lower than the previous quarter but increased by USD7.6 billion compared to the second quarter of 2021. In terms of imports, in the second quarter of 2022 Indonesia imported as much as USD21 billion with non-oil and gas imports being the largest contributor. This figure is USD0.96 billion lower than the previous quarter, but higher than the same quarter last year. Thus, in the second quarter of 2022, Indonesia experienced a trade balance surplus of USD5.09 billion.

Table 5. Export and Import

Component (in Billion USD)	2021				2022	
	Q1	Q2	Q3	Q4	Q1	Q2
Export	18.40	18.55	20.62	22.36	26.50	26.15
- Excluding oil and gas	17.45	17.31	19.68	21.29	25.09	24.60
- Oil and gas	0.95	1.24	0.93	1.07	1.41	1.55
Import	16.79	17.22	16.23	21.35	21.96	21.00
- Excluding oil and gas	14.51	14.92	14.37	17.97	18.47	17.33
- Oil and gas	2.28	2.30	1.87	3.38	3.49	3.67

Source: Statistics Indonesia

In terms of commodities, the highest non-oil and gas exports were mineral fuels in the amount of USD5.1 billion, or equivalent to 20.7% of Indonesia's non-oil and gas exports. Indonesia's five highest export commodities in the second quarter of 2022 were mineral fuels, animal fats and oils, iron and steel, vehicles and their parts, followed by footwear. Meanwhile, the largest non-oil and gas imports were machinery/mechanical equipment, in the amount of USD2.8 billion or 16.2% of non-oil and gas imports. The top five Indonesian imported commodities include machinery/mechanical equipment, electrical machinery/equipment, iron and steel, vehicles and their parts, as well as dregs and food industry waste.

Figure 1. The Highest Non-Oil and Gas Export (in Billion USD)

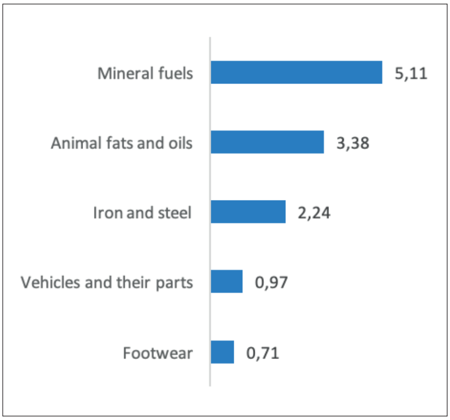
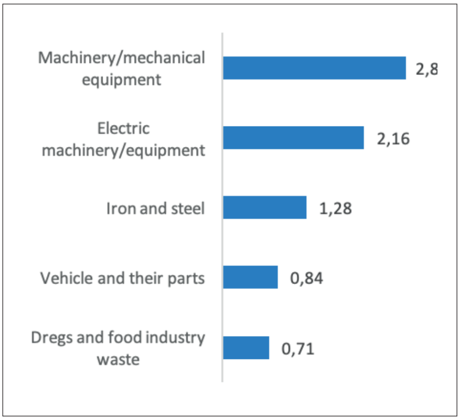


Figure 2. The Highest Non-Oil and Gas Import (in Billion USD)

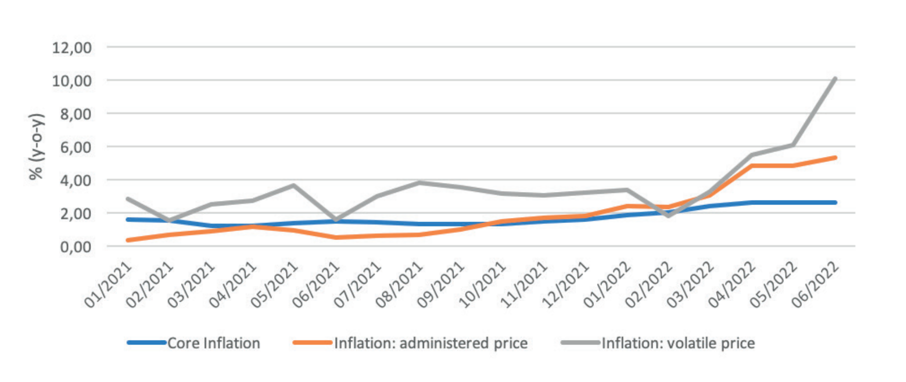


Source: Ministry of Trade

Inflation

At the end of the second quarter of 2022, inflation rate had already reached its highest point for the past 5 years. After withstanding below Bank Indonesia's inflation target since the beginning of the pandemic, the inflation rate started to display an upward trend since January 2022 and in June 2022 it reached 4.35%, which is 0.85% percentage points above the target. Similar to the first quarter of 2022, the processed food, beverage and tobacco group had the highest inflation rate of 8.26%. Meanwhile, there was deflation for the information, communication, and financial services group of 0.23%. When compared to the end of the same quarter in 2021, there is a decrease of 0.24 percentage points.

Figure 3. Inflation Rate based on Consumer Price Index



Source: CEIC

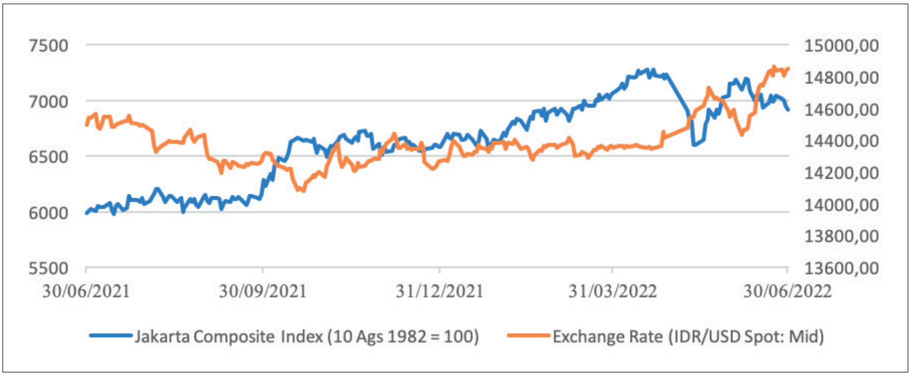
If we disaggregate the CPI inflation rate, there is an increase in all inflation components. At the end of Q2, the core inflation rate was 2.63 percent, higher than the same quarter in 2021, which was 1.49%. For government-regulated price component (administered price), there was an increase of 5.33% (y-o-y), much higher than the previous year, which was 0.49%. Then, the inflation rate of the volatile component (volatile price) was 10.07%, higher than the same quarter in 2021 (1.60%).

Exchange Rate and Stock Exchange Index

In the midst of Indonesia's economic recovery, the IDR (Rupiah) exchange rate against the US dollar (USD) tends to weaken in the second quarter of 2022. This was allegedly a side effect of the increase in the

Fed's interest rate, which resulted in the outflow of foreign capital from Indonesia. At the end of July 2022, it was noted that the US dollar-rupiah middle exchange rate had depreciated by 2.42% compared to the end of July 2021 and 3.48% compared to the end of the previous quarter. On the other hand, the Composite Stock Price Index (JCI) in the second quarter of 2022 showed higher volatility than the previous period.

Figure 4. Jakarta Composite Index and Exchange Rate



Source: CEIC

Development and Spending Budget Plan/RAPBN 2023

At the Plenary Session of the DPR RI for the 2022-2023 Session, the President delivered an introductory speech to the Law on the State Budget for Fiscal Year and the Financial Note 2023. In line with the previous State Speech, in this speech it was conveyed that the policy of the 2023 RAPBN is aimed at supporting increased productivity while optimizing the function of the shock absorber in maintaining the momentum of economic recovery and anticipating the risk of uncertainty. This time the RAPBN is focused on supporting strengthening the quality of human resources, increasing productivity and competitiveness, as well as strengthening bureaucratic reform and developing a green economy.

In the 2023 RAPBN, the government's reiterated commitment and efforts to return the deficit to below 3% of GDP, which is 2.85% of GDP, could be taken as a positive thing, as it seeks to re-establish fiscal discipline and avoid the occurrence of "moral hazard" in fiscal policy management. This deficit reduction is important as an effort to consolidate the government's fiscal and control the rate of increase in government debt which until July 2022 has reached IDR7,163 trillion with a debt to GDP ratio of 37.9%.

Table 6. Development and Spending Budget Plan 2023

A. State Revenue	2,443,592.2
I. Domestic Revenue	2,443,182.7
Tax Revenue .1	2,016,923.7
a. Domestic Tax Revenue	1,960,582.7
b. International Trade Tax Revenue	56,341.1
Non-Tax Revenue .2	426,259.1
II. Grant Revenue	409.4
B. State Expenditure	3,041,743.6
I. Central Government Expenditure	2,230,025.1
a. Personnel Expenditure	442,575.1
b. Goods & Service Procurement/Expenditure	379,298.1
c. Capital Expenditure	199,114.6
d. Debt Service Payment	441,400.0
i. Domestic	426,800.0
ii. Foreign	14,600.0
e. Subsidy	297,186.4
i. Energy Subsidy	210,665.4
ii. Non-Energy Subsidy	86,521.0
f. Grant Expenditure	10.1
g. Social Expenditure	148,565.2
h. Other Expenditure	321,875.7
II. Regional Transfer	811,718.5
C. Primary Balance	-156,751.4
(D. Surplus (Deficit	-598,151.4
Surplus (Deficit) to GDP %	-2.85
E. Budget Financing	598,151.4
I. Debt Financing	696,317.6
II. Investment Financing	-175,955.3
III. Loans	5,284.7
IV. Government Guarantee	-330.5
V. Other Financing	72,834.9

Source: Fiscal Policy Agency, Ministry of Finance 2022

This effort to control government debt is important, because although the figure is still better than other countries, the burden of debt interest payments in the APBN has increased very significantly to approximately 180% in the 2014-2021 period and the share has increased from 11% to 20% in the same period. In addition, although currently most of the funding sources have come from within the country, the large portion of ownership of state securities (SBN) in national banks and Bank Indonesia indicates a restraint in real sector funding (crowding out effect) and the circulation of money which is dominated only by the financial sector.

The large burden of paying interest on this debt—together with the obligation to keep the deficit below 3% of GDP at the same time —makes the flexibility of fiscal management more limited and challenging. On the revenue side, the increasing risk of a weakening global economy and weakening international commodity prices resulted in state revenues being estimated to be relatively stagnant in 2023, which was only IDR2,443 trillion, slightly up from for the forecasted 2022 State Budget which was IDR2,436 trillion.

Apart from unfavorable global and domestic environmental factors, the sluggish growth of state revenues also shows that the government's ability and efforts to expand and intensify sources of state revenue, particularly those from taxes have not improved much. The tax ratio, the percentage of tax revenue to GDP, in the 2023 RAPBN is estimated to be still very low, at only 9.61%, down compared to 9.99% in the 2022 APBN outlook. Improvements in the estimated state revenues in 2022 are driven more by windfall profits from rising global commodity prices. and the second period of tax amnesty.

Meanwhile, the potential decline in state revenues and the state budget deficit has resulted in a reduction in the state spending plan and therefore it is necessary to improve the quality of spending (better spending). In 2023, state spending is projected to be IDR3,041.7 trillion, down 4.0% from the 2022 outlook. Compared to the 2022 forecast, central government spending and transfers to the regions both experienced a decline of 5.9% and 1.6%, respectively.

Furthermore, capital expenditures decreased significantly by -14.5%, with the share also decreasing to less than 9% of total central government spending. In contrast, personnel expenditures, interest payments and subsidies increased by 6.2%, 9.3%, and 4.4%, respectively. Furthermore, in the 2023 RAPBN, interest payments on debt and energy subsidies still account for a large portion of total central government spending, namely

20% and 13%. As a result, the focus of the RAPBN for increasing national productivity is questioned.

Finally, the government's attention to priority sectors, such as education, health, infrastructure and food security in the 2023 RAPBN is indeed positive and needed to support increased productivity for an inclusive and sustainable transformation. However, the use of funds is often not directed at the right intervention policy, its management is not efficient and effective, or even not well targeted. This happens because of the lack of attention to the expected results (outcomes) with funding (inputs) from state expenditures that have been disbursed.