The recent epidemic of Coronavirus has a ripple effect that might disrupt the global growth recovery, including Indonesia. The outbreak could potentially bring some indirect impacts on Indonesia economy through three channels: financial market, real sector, and the government sector. Headwinds from the outbreak has shocked the financial market due to fears by global investors which trigger capital outflows from emerging economies in the short run, threatening the market liquidity and FX stability. In the real sector, the impacts of the outbreak could take place in terms of the decrease in tourism & trade activities and a potential delay in real investment. In the government sector, lower tax revenue and higher government bonds yield could be expected.

We simulate the outbreak to contribute a potential 10-30 bps correction to Indonesia GDP growth rate in 2020. The magnitude of the impact would depend on the length of the outbreak and the economic policy responses. Some spending strategy changes would be helpful, such as front-loading social spending and regional transfers, to boost aggregate demand in the short run. The risks of further slowing down of GDP, given the ongoing trend of improved CAD and declining inflation rate, should suggest Bank Indonesia to cut the policy rate by 25-bps to 4.75% this month.

Subdued Inflation Reflects Sluggish Demand

Entering 2020, there are two main highlights related to the new formula for CPI calculation. First, BPS updated the new base year for the CPI calculation to 2018. Second, BPS modified several new classifications of expenditure groups such as by adding price components in the ride-hailing sector and excluding items that were no longer relevant. January headline inflation was stable, recorded at 2.68% (yoy), remained safe within the new BI’s target corridor of 3.0%±1. On a monthly basis, inflation reached 0.39% (mtm), accompanied by controlled core inflation and deflation in administered prices despite a modest increase in inflationary pressures on volatile foods.

Volatile foods grew at 4.13% (yoy) or 1.93% (mtm), attributed to the devastating floods in various regions which hampered the production and distribution of several volatile foods. Consequently, various foodstuff prices such as chili, fish, rice, and tomatoes fetched higher prices. On the other hand, overall subdued inflation was also influenced by lower inflationary pressure from government policy to reduce prices of fuels and normalize airfares after the year-end festive period. The administered prices inflation only grew by 0.64% (yoy), with deflation of 0.28% (mtm) recorded on a monthly basis. Meanwhile, relatively stagnant annual and monthly core inflation...
At 2.88% (yoy) and 0.18% (mtm) reflects the continued weakening of the aggregate demand. Going forward, we see that low-maintained inflation will be able to support BI policy of continuing its accommodative monetary policy stance.

**Will the Coronavirus Disrupt Indonesia Economy?**

China economy is showing some signs of correction caused by the deadly recent epidemic of Coronavirus, with the number of confirmed cases is still rising rapidly. Given China’s big contribution to the global economy, the ripple effect of the outbreak could disrupt the global growth recovery, including Indonesia. We outline how the coronavirus epidemic could potentially bring further impacts on Indonesia economy through three possible channels: financial market, real sector, and the government sector.

Headwinds from the outbreak have shocked the financial market due to fears by foreign investors which trigger capital outflows from emerging economies in the short run. Indonesia’s portfolio market has recorded an outflow of USD2.2 billion (from USD19.1 billion in 27th Jan 2020 to USD16.9 billion in 10th Feb 2020), as there is a “flight-to-safety” market reaction; when investors shift their portfolio by selling off their assets to purchase safer investments like the US treasury. Investors tend to set a “wait and see” investment behavior and strongly react to the speculation about this unexpected event. As a consequence, after a robust performance of Rupiah during last year, the recent sudden outflow could have an impact on the exchange rate stability. The effect of the outbreak on the foreign exchange rate has appeared in emerging Asia countries currency, where almost all currencies depreciated, except Rupiah and Philippines Peso. IDR appreciated by 1.5% (Figure 6) driven by stable macroeconomic conditions. Amid the threat of drying up banking liquidity, Bank Indonesia has intervened the financial markets through several injections on bonds, forex, and DNDF markets to ensure sufficient liquidity in the market.

In the real sector, the repercussions from the coronavirus outbreak take place in the form of the decrease in tourism & trade activities and a potential delay in real investment. Tourist arrival from China contributes 13.5% of total tourist arrival in Indonesia. However, since Indonesia’s economy is relatively less open compared to its peers in terms of tourism, with the revenue <2% of GDP, the impact of the coronavirus outbreak might affect less severely. On trade exposure, China and Hongkong are one of Indonesia’s top export destinations (accounted for around 18% of total export Indonesia, particularly on lignite and coal). Indonesia is also a big buyer of China’s industrial machinery as intermediate inputs (with China’s import share accounted at 30% of total
import particularly on electronics and mobile telephone components). China production on machinery is currently operating below its capacity, disturbing the supply lines for machinery outputs. As a result, there might be a potential slump of Indonesia’s domestic production as the import of intermediate goods declines. Such relatively high trade-linkage will generate a pass-through slowdown in trade performance during the outbreak hit; the impact would come into realization in the short to medium-term. Similar to trade, the slowdown of China economy due to coronavirus might lead to a potential delay in China’s FDI to Indonesia. However, the impacts on FDI are expected to materialize in 2021. Although the share of China’s FDI to total inward investment in Indonesia is only 2%, much of FDI is also channelled through Singapore.

The last possible channel of the outbreak to Indonesia economy comes from the government sector. The contraction of global trade activities will directly and indirectly curtail tax revenue. Meanwhile, our projection on continuing capital outflow will push the current 10-Year and 1-Year government bonds yield from 6.6% and 4.6% respectively (Figure 4) to hike by 20-50 bps, adding more burden on the cost of government debt. Therefore, fiscal policy should be implemented in a prudent manner while maintaining fiscal deficit at around 2.5% but lower than 3.0% to weather the unfavorable risks from the coronavirus outbreak which could pose additional pressure on domestic growth.

We estimate the outbreak to potentially cause a 10-30 bps correction to Indonesia GDP growth rate in 2020. The magnitude of the impact would depend on the length of the outbreak and the economic policy responses. Some spending strategy changes would be helpful, such as front-loading social spending and regional transfers, to boost aggregate demand in the short run.

2019 Indonesia GDP figures confirmed that deteriorating external demand was the main culprit for the slowdown in Indonesia economic growth, with growth in Q4-2019 down to 4.97%, making FY2019 economy eased to 5.02%, the slowest pace since the last three years. The weak external demand has been spilled-over to domestic demand, with private consumption slowed-down to 5.04%. Investment also remained sluggish, slowed-down to 4.45%. The faster decline in import by -9.5% than the fall in export by -6.9% indicates that improving economic activity would not be seen in the near future. The risks of further slowing down of GDP, given the ongoing trend of improved CAD and declining inflation rate, should suggest Bank Indonesia to cut the policy rate by 25-bps to 4.75% this month.