Macroeconomics Analysis Series

Indonesia Economic Outlook

Q3 - 2021

LPEM FEB UI
UNIVERSITAS INDONESIA

Key Figures

GDP Growth (Q1 '21)
-0.74%

Inflation (y.o.y. June '21)
1.33%

Credit Growth (y.o.y. Q1 '21)
-2.63%

BI Repo Rate (7-day, Jul '21)
3.50%

Current Account Balance (%GDP) (Q1 '21)
-0.36%

IDR/USD (June '21)
IDR14,339

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The Pandemic Strikes Back

Highlights

- *After suffering from recession for four consecutive quarters, Indonesia is expected to exit recession in Q2 2021.*
- *We predict GDP to grow substantially of 6.4% (estimate range from 6.2% to 6.7%) in Q2 2021 and around 3.2% to 3.9% for FY 2021.*
- *Despite the recent upsurge of Covid-19 cases, the economic activity in Q2 2021 was relatively robust due to the relaxation of social restriction measures, government stimulus, and Ramadan and Eid al-Fitr occurrence.*
- *GDP growth is predicted to decline substantially in the following quarter (Q3 2021) due to a prolonged social restriction measure.*
- *GoI needs to not compromise any effort to save the public health as the failure to do so would be catastrophic for both health and economic aspect.*
- *Despite the increasing pace of vaccination rate, the progress of vaccination is still not swift enough to achieve the theoretical state of herd immunity in the near future.*

Despite still being in negative territory, GDP growth of Indonesia is the closest it gets to the positive rate since the outbreak. Recorded at -0.74% (y.o.y), the Indonesian economy in Q1 2021 enjoyed a less severe contraction in almost all sectors than the previous three quarters. In addition, several sectors that enjoyed a rather positive growth during the pandemic were still recording an expansion in the first quarter of 2021. Diving deeper to its sectors, manufacturing industry as the biggest sector in the Indonesian economy with the contribution of more than a fifth, recorded a growth of -1.38% (y.o.y) in Q1 2021, a rather substantial increase from -3.13% (y.o.y) in the last quarter of 2020. Similarly, wholesale and retail trade as another major sector in the economy with the contribution of 13% to the national GDP, grew -1.23% (y.o.y) in Q1 2021 from -3.66% (y.o.y) in Q4 2020. As PPKM were in place during most of Q1 2021, it comes as no wonder, all expenditure components of GDP shrank, except for government consumption, exports, and imports. Beside disruption coming from Covid-19 pandemic, negative growth in most expenditure components is because we are comparing with Q1 2020 when the pandemic has not fully escalated domestically.

Observing the most recent development, it became apparent that one thing is highly uncertain and no economist could ever predict, which is the potential of Covid-19 virus mutation and the possibility of another wave. The possibility of a second wave is rarely taken into account by the governments (at least on the policy implementation level) until the wave arrived and it is already too late, as happened in South Korea mid-2020 and in

India early 2021. It is quite understandable, however, that the first wave of the pandemic has wreaked havoc the economy, where people lost their job and savings and the government desperately juggle their fiscal space and piling debts to provide adequate stimulus. Thus, the emergence of an early sign of recovery put the society eager to jumpstart the economic activity. This illustration is precisely what happened in Indonesia in Q1 2021. Despite the surge of Covid-19 cases in early 2021, Indonesia was experiencing a milder economic contraction after hitting its lowest growth in Q1 2020.

Table 1: LPEM FEB UI GDP Growth Forecast

Q2-2021	FY 2021
6.2% to 6.7%	3.4% to 3.9%

Entering Q2 2021, the economic activity in Indonesia was robust amid the resurgence of Covid-19 cases since mid-June. As an indication of significant progress in economic recovery, credit performance increases sharply throughout April and May 2021 due to a rise mainly in working capital credit and investment credit. Positive growth in consumption credit and accelerating core inflation suggesting purchasing power began to recover although consumers are still reluctant to spend. In June, Indonesia continued to record a monthly surplus in international trade of goods for 13 consecutive months since May last year. However, the current account surplus is expected to remain in negative territory similar to Q1 2021 figure due to the narrower trade surpluses of goods and persistent trade deficits in services. Unlike the last year's weak imports due to the pandemic, the imports of raw and capital goods have been reviving. The hike in imports was in line with the sign of industry's expansion to support the economic recovery as captured by the PMI figure above 50 throughout May-June 2021.

All in all, the economic activity in Q2 2021 was relatively robust due to the relaxation of social restriction measures, government stimulus, and Ramadan and Eid al-Fitr occurrence amid the recent upsurge of Covid-19 cases. We predict that Indonesia will exit recession with the economy to grow around 6.4% (y.o.y) (estimate range from 6.2% to 6.7%) in Q2 2021. However, the sharp jump in Covid-19 positive cases and prolonged social restriction measure since end of June are expected to pullback the progress of economic recovery in the remaining quarters of this year; making the predicted growth for FY2021 at around 3.2% to 3.9% (y.o.y).

Slow Dancing in A Burning Room

New Variant, Same Old Virus

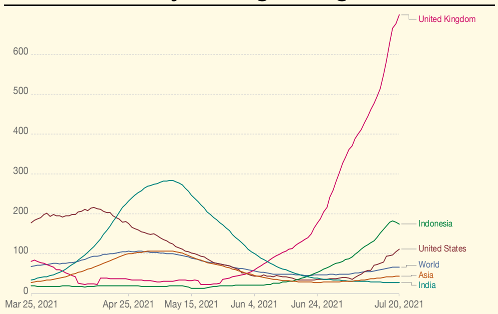
During the early stage of Covid-19 emergence in the first quarter of 2020, people were still uncertain of how many casualties the pandemic would have caused. On the economic aspect, almost everyone agreed that the pandemic would bring down economic activities; thus, causing a crisis across the world. Came into a realization, throughout 2020 more countries fell into an economic recession. One of the major discussions in 2020 was what kind of recovery we would have after the pandemic. Due to its nature of being unprecedented, Covid-19 recovery path are full of speculations. V-, L-, U-, K-, even W-shaped recovery are among those predictions. V-shaped recovery is the most favorable recovery path, suggesting a quick rebound from the economic downturn to the long-term growth path. This kind of recovery requires all the components of an economy to be agile and respond to the crisis in a timely and effective manner, despite all uncertainties. However, for other economies that could not respond well, they risk having U-shaped or even L-shaped recovery, suggesting an extended episode of contraction before the recovery, if the economy ever comes to that. K-shaped recovery is another unfavorable path of recovery in which a country might face an unequal recovery, with certain groups of people left behind on the recovery process. Another ominous scenario is W-shaped recovery, which suggests that a recovering economy might face another episode of economic downturn due to the second wave of Covid-19 pandemic.

Entering 2021, Indonesia was enjoying a period of a better economic state. Despite the surge of Covid-19 cases in early 2021, Indonesia was experiencing a milder economic contraction after hitting its lowest growth in Q2 2020. Similarly, production activities and household consumption were gradually rising as economic activities were gaining expansion momentum. The first half of 2021 is a period of 'pseudo-recovery' of Indonesian economy, putting almost all aspects of the society being complacent to any future potential health risk that could bring a second wave of the pandemic as the threat of Delta variant is imminent. The disastrous escalation of Delta variant is conspicuous. Even for other countries which had the pandemic situation under control, such as Vietnam, is not immune to the potential catastrophe brought by the Delta variant. Boasting as one of the earliest nations in the world who won the fight against Covid-19, Vietnam started to impose curfew on July 26th as the Delta variant spiked up the daily cases. Enjoying daily new cases of below 50 since February 2021 till early last May, Vietnam recorded a new high of 16,644 daily new cases on July 24th. The same story could also be found in Thailand, which recorded more than 15 thousand daily new cases on July 25th after enjoying a period of below 500 daily new cases in February till April 2021.

Despite a worrying rise in Covid-19 cases caused by the new Delta variant, Indonesia failed to seize the opportunity to bring its guard up. There were no adequate measures taken to anticipate the potential entrance of Delta variant to Indonesia. In addition, a suboptimal implementation of social restriction measures a few months before June also contribute to the occurrence of the pandemic second wave.

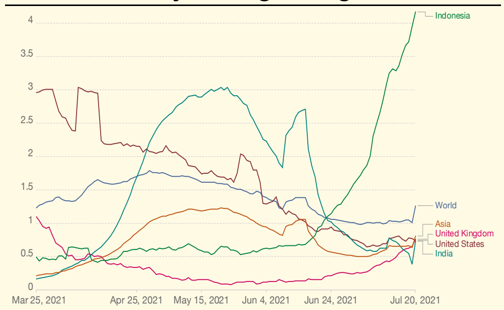
The latest development of Covid-19 cases in Indonesia is looking grim. Despite having been in the pandemic situation for more than a year, Indonesia seems to find itself back to square one, to say the least. In early July, the Government of Indonesia (GoI) imposed an emergency public activity restriction (Pemberlakuan Pembatasan Kegiatan Masyarakat Darurat/PPKM Darurat), which is a stricter version of the previous social restriction measures. The restriction recently imposed covers 44 regencies/municipalities in Java and Bali and only allows "essential" and "critical" sectors to operates from office. Such desperate measures are necessary to minimize the death counts, which are skyrocketing recently. As seen in Figure A and B, while the recent upsurge of daily Covid-19 cases in Indonesia is far below the number in the UK, the daily confirmed deaths are significantly higher, suggesting poor management of Covid-19 patients, which might be caused by inadequate health facilities, oxygen supply shortage, or delayed handling of the symptoms.

Figure A: Daily New Confirmed Covid-19 Cases per Million People (7-day moving average)



Source: John Hopkins University CSSE Covid-19 Data

Figure B: Daily New Confirmed Covid-19 Deaths per Million People (7-day moving average)



Source: John Hopkins University CSSE Covid-19 Data

Getting It Wrong from The Beginning

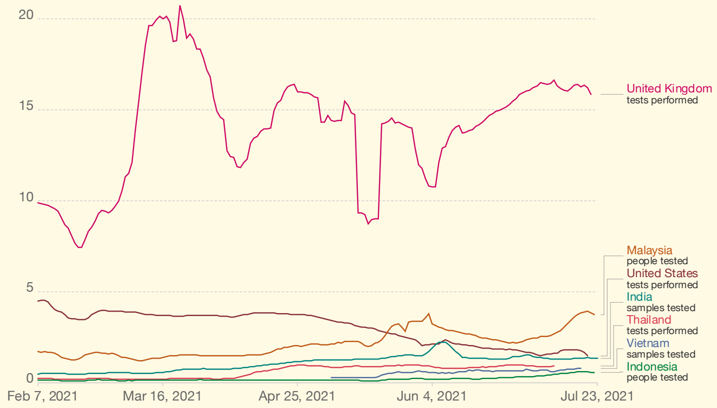
No country was ever ready for a pandemic. At the beginning of the outbreak, World Health Organization (WHO) has been conveying the same simple message: test, test, test. Massive testing combined with lockdown restriction has successfully helped both New Zealand and Taiwan free themselves from Covid-19 early. During the lockdown, both countries conducted extensive testing, contract tracing operation, and isolation measures, which make it possible for everyday life to return to normal quickly.

Talking about the death rate, Singapore is amongst countries with the lowest Covid-19 death rate throughout the pandemic. Up to 25 July 2021, Singapore reported only 37 Covid-19-related deaths among more than 64,000 people who have been infected with the virus. Their current number of 7-day daily average deaths per million people is at 0.02, significantly below the global average at 1.10. The highest death rate in Singapore was at 0.15 deaths per million people back in May 2020. Again, early detection using aggressive contract tracing and testing helped Singapore mitigate the spread of the virus. In Mid-July 2021, there were 12.14 samples tested per 1,000 people. People living in dormitories have been put on a testing schedule while mass testing was conducted in vulnerable areas, such as nursing homes, and people over the age of 13 who shows indications of an acute respiratory illness has been provided with a free test. People with Covid-19 above 45 years old or who have underlying health conditions making them vulnerable are treated in the hospital. The government also quickly set up bed space for Covid-19 patients in exhibition halls and other temporary facilities for those who had minimal or no symptoms. All of these helped prevent the healthcare system from being overwhelmed such that recourses and focuses can be concentrated on the most severe cases.

Another neighboring country, Vietnam, reported almost 3,000 confirmed cases and 35 deaths as of 30 April 2021. Vietnam was successful in keeping the infection low among its 97 million people thanks to their containment strategy, including comprehensive tracing and quarantining with a decisive central government. With proactive detection process, people who tested positive and had close contact with them were placed in quarantine centers run by the government. When the threat of Covid-19 dawned, the government swiftly impose strict border control: there was no departing aircraft from the nation and all arriving passengers, including returned residents and foreigners, were directed to quarantine facilities in military barracks. This reduced community transmission. In Vietnam, where social media is extensively utilized, it was used to promote public health messaging and debunk misconceptions. Realizing that it does not have extensive health care facilities and the resources for mass testing, preventive measures helped Vietnam to prevent outbreaks and nation shutdowns. The 7-day daily average tests per 1,000 people is only 0.79 at its peak on 18 July 2021. The world is currently watching Vietnam on how it would handle the new outbreak of Delta variant.

Chaos at the beginning, the UK focused on vaccine rollout to limit the impact of Covid-19 and reduce the risk of significant mortality. The government regularly met with the Joint Committee on Vaccination and Immunization (JCVI) from May 2020 to decide which groups would most benefit from early vaccination. Nine groups were placed as a priority structured by age, underlying health conditions, and type of works. The UK's vaccine program has been an enormous success. Experiencing the second wave of Covid-19 in January 2021, when almost 60,000 new cases were confirmed daily, the UK's case fatality rate was 3.48% at its peak on 8 February and has been showing a downward trend since then, proving that vaccine works.

Figure C: Progress of Daily Tests per 1,000 People (7-days moving average)



Source: Our World in Data

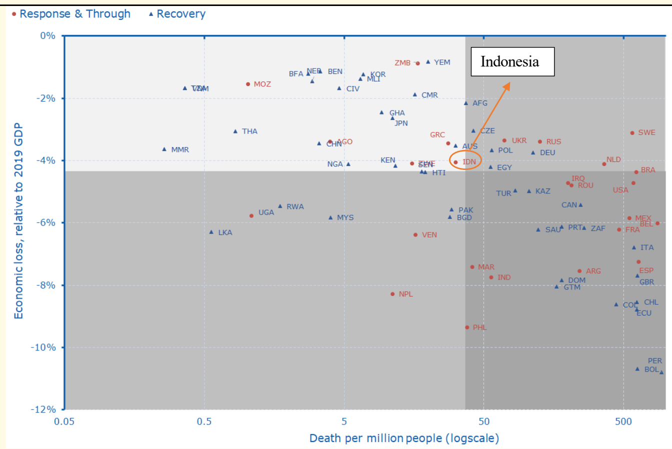
Indonesia was rather slow in controlling the pandemic. When neighboring countries reported a surge of cases, we did not follow what WHO recommended: testing was not performed on a massive scale. When we officially had our first confirmed cases, GoI only promoted rapid diagnostic testing, a far less accurate testing method. Only in July GoI formally advised provincial governments and others not to use rapid testing for diagnostic purposes in their updated Covid-19 prevention and control guidelines. Lockdown was also not in place. We had large-scale social restrictions, allowing regional governments to restrict the movement of people and goods in and out of their respective localities provided they had received permission from the Minister of Health. With no clear prevention and handling measures, we have never seen our daily cases below 1,000 since late March 2020. In terms of preparation for potential case surge, while other countries are increasing their health system capacity, we are relatively not doing much. In 2020, The Ministry of National Development Planning Indonesia (Bappenas) released the number of hospital beds per 1,000 people in Indonesia at 1.33, a slight increase from 1.04 beds per 1,000 people in 2017. This figure is relatively low compared to other countries, such as China, Japan, The UK, and Turkey, where the number of hospital beds per 1,000 people are reported at 4.79, 12.84, 2.88, and 2.45, respectively, in 2019. Even lately, as Indonesia embraces the second wave, the increase of testing has not been sufficient and still rank relatively low compared to other countries that were also hit severely by the Delta variant (Figure C). On 22 July 2021, Indonesia only has 0.57 7-day daily tests per 1,000 people, while Singapore, Malaysia, Thailand, and Vietnam have 12.14, 3.73, 0.92, and 0.79 7-day daily tests per 1,000 people, respectively.

A False Dichotomy

Since the early day of the pandemic hit, governments worldwide were to put their best effort to bring the situation under control. On one side, the most blatant aspect that needs to be protected is human lives. However, the policy discussion and formulation complication begin to take place when the government was calibrating the intensity of pandemic control measure. As Covid-19 spreads through human interaction, the most efficient way to restraint the virus transmission is through social restriction measure. However, the social restriction measure to limit person-to-person contact has a substantial impact on economic output and leads to an economic slowdown. Thus, numerous policymakers were stuck in the thinking of the "health vs economy" dichotomy, where the governments faced a tradeoff in prioritizing health or economic aspect. Arguably, this dichotomy has motivated several governments to not doing "whatever it takes" to manage the health crisis.

While compelling, the dichotomy is not entirely correct. The logic behind the "health vs economy" tradeoff is only plausible under one assumption, in which the economy is seen on a one-time period framework. This assumption cannot be any further from reality. More than 1.5 years since the first outbreak of Covid-19 and we are still fighting the same battle. During this arduous time, the health conditions and economic conditions have been through several phases, suggesting a multi-period crisis. In addition, a period of over a year has shown us the experiences of several countries, such as China, Singapore, and Vietnam, that could defy this dichotomy. Those countries have implemented a strict virus containment policy since the early days. Despite the ephemeral output decline due to such measure, the economy was quick to recover, and those countries are enjoying a pre-pandemic economic growth path.

Figure D: Life Loss vs. Economic Loss



Source: Luohan Academy

Looking at the bigger picture, the tradeoff also seems nowhere to be found. As shown by Figure D, an estimation by Luohan Academy indicates a positive correlation between life loss and economic loss by plotting the percentage of economic losses relative to 2019 GDP for these countries and regions and with their Covid-19 death rates. The estimation suggests that countries suffering greater losses of life incurred greater economic losses as well (bottom-right quadrant) and vice versa (top-left quadrant). The implication being of the "health vs economy" dichotomy proven to be false is not only unproductive but is potentially dangerous. Figure D reveals that the reality is the exact opposite of what the dichotomy suggests, meaning that any government taking action towards loosening pandemic control to protect the economy not only jeopardizing the health aspect but also worsening the economic condition eventually.

As Indonesia is experiencing the cataclysmic second wave of Covid-19, GoI is in no lack of case studies in handling the pandemic situations, unlike the beginning of the pandemic. As many countries have demonstrated (e.g., Singapore, New Zealand, Vietnam), doing all the necessary policy and steps to preserve human lives actually works, not only as a health policy but also as an economic policy. Looking within, Indonesia has also experienced several episodes of applying "emergency brake" (tightening the social restrictions measure in times of hospital being in overcapacity), followed by premature relaxation and low compliance of social distancing protocols by the people and low enforcement by the authority. As this is known too well by now that those are a recipe for disaster. Thus, GoI should put an enormous amount of focus and effort into ensuring that the ongoing emergency public activity restrictions are optimum in its implementation and. GoI should also put extra thinking when considering relaxation to not making the mistake of it being premature.

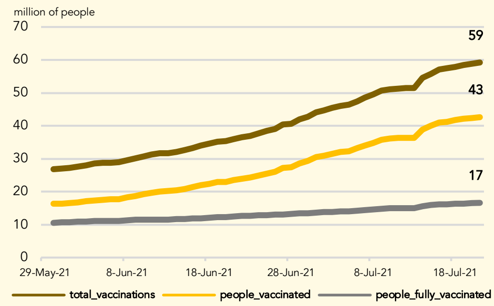
Long Way from Herd Immunity

Indonesia has been experiencing a massive increase both in the number of Covid-19 new daily cases and deaths since the first virus outbreak. The number of new confirmed cases increased by four times from the previous highest peak of 14,518 cases a day on January 30 to the new all-time high of 56,757 on July 9th. The recent acceleration of Covid-19 cases is believed to be the result of the Delta variant's presence during the Eid-ul-Fitr and holiday season two months ago. As the number of cases arose, so did the demand for hospital beds and medical equipment. Unfortunately, the existing figure of health facilities is still far from enough to contain the resurgence of the pandemic. The shortage of hospital beds, ventilators, and oxygen tanks during the rising cases of more infectious Delta variant has contributed to the high fatality rate where the new daily death number has increased by three times within a month in July.

To rescue the national health condition, Indonesia needs to work as fast as possible in providing an adequate number of health facilities and equipment, particularly the oxygen tanks. According to official data, the national daily need for oxygen has reached 1,928 tons a day, equivalent to 85% of the total available production capacity a day. The demand might outpace the supply as the infected cases continue to rise; thus, the supply of oxygen tanks and other health devices from other countries are critically needed to save people's lives. Further, we need to break the Covid-19 transmission path by accelerating the tracing test and limiting social interactions to the bare minimum. The test performed in Indonesia has seen 0.59 per 1.000 people, much lower than Malaysia (3.83), India (1.37), and South Africa (0.78). The acceleration of tracing tests will reduce the spread of the virus as the other countries that perform more tests appear to report lower new infection cases than those that do not.

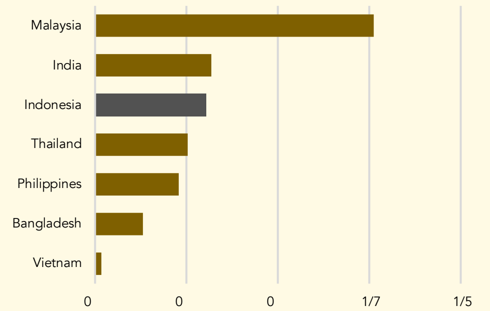
Along with the improvement in health facilities and test performance, the rollout of the vaccine is another critical key to manage the current health crisis. The government has been relying on mass vaccinations to tackle the virus, but only around 17 million (6.1% of the total population) have received the required two doses since January. The number of vaccinated populations is still far below the total 137 million vaccines that the government has received. The vaccination progress is plodding due to the distribution issues and massive misinformation regarding the vaccines that led some people to hesitate to receive jabs. The low vaccination rate is surprisingly also seen in other emerging countries (e.g., Thailand, Philippines, Bangladesh, and Vietnam), which currently also face the second wave of Covid-19.

Figure E: Number of Vaccinated Population in Indonesia (in millions of people)



Source: Our World in Data

Figure F: Shares of the Population Fully Vaccinated (% of total population)



Source: Our World in Data

The number of fully vaccinated people in Indonesia is still far from the early estimates for the herd immunity threshold at around 60-70%. Considering the threshold as the point estimate of herd immunity, Indonesia needs to ensure the vaccination covers another 174 million people. With the average of newly vaccinated people at around 620 thousand in a day, it is projected that 70% of the population will be fully vaccinated at the end of 2022. If the vaccinations number meets the government's target of 5 million people per day, 70% of Indonesia's population is estimated to achieve immunity two months from now. The target will only be accomplished as long as GoI can accelerate the distribution of vaccines and enhance the public trust in vaccination.

However, recent studies have found that even with full-scale vaccination efforts, the theoretical threshold for eradicating Covid-19 appears to be out of reach. The population's immunity is greatly dependent on how agile the vaccine is, and it is difficult to predict how long the immunity survives in a human body. Despite a high degree of immunity, some countries have faced the resurgence of Covid-19 cases, such as Malta. Even though 80% of Malta's population is fully vaccinated, the number of new daily positive cases has jumped around 200% in mid-July from the average of almost zero cases since June. Attaining the theoretical threshold of herd immunity seems improbable in the near future due to some causes, such as the presence of new highly infectious variants and the vaccine reluctance.

As the uncertainty of the low, peak, or recovery of the health condition continues to increase, the plan to put the society coexisting with Covid-19 seems highly possible as the pandemic exit plan. The Government of Singapore is the only country that has declared Singapore's 'living with Covid-19' plan, where people are set to live normally. They are now preparing the pandemic to endemic transmission by slowly escalating the social restrictions while accelerating the vaccination rate (13.5% of the population is fully vaccinated). In UK, the government has announced to remove any requirements of self-isolate as close contacts of Covid-19 pandemic case. The policy was driven by the research that finds no evidence of higher virus spread from the students with close contacts in schools, which perform daily testing than sending these students back home. The UK is slowly recovering the human activities by unlimiting the people's freedom to perform their day-to-day activities. Nevertheless, a similar headway might also be implemented by the GoI in the future as long as they can ensure a massive tracing and testing program, random testing, and adequate amount of health facilities to mitigate the increasing fatality rate. Also, the successful vaccination program is highly efficient at preventing the symptomatic disease of the infected person. It will, thus, lower the risk of fatality rate of the Covid-19 in Indonesia.

Building Preparedness Against Future Waves

The first wave of Covid-19 swept through the world unprepared. Authorities struggled to bring the situation under control and contain the spread of the virus. Indonesia had implemented a large-scale social restriction (PSBB) as the first response and finally lifted the restriction in June 2020. With reported cases decreasing, vaccines on the horizon, and social restrictions lifted, life slowly began returning to normal. However, Indonesia's health system is now overwhelmed with a higher death toll of Covid-19 compared to the first one, demonstrating the perils of failing to prepare when cases are relatively lower.

South Korea was among the first countries in the world to announce it had formally entered the second wave of Covid-19 pandemic, but it also appears to have brought cases under control. There are also some other countries that succeed in facing the second wave, such as Australia, Germany, and Spain. All because of the preparedness and prompt response of the country's government. On the other hand, there is India that stopped taking precautions after their initial restrictions were lifted and ended up having to face the harsh reality where cases and deaths spiked exponentially. Learning from India's experience, the GoI should have made the most of its resources to prepare for a possible resurgence. No one knows how many waves of the Covid-19 pandemic will be. Therefore, the GoI must ensure that they have active surveillance systems that are capable of monitoring the case numbers to enable rapid decision-making based on the up-to-date data. Moreover, it is also necessary to increase the capacity of health facilities to prevent collapse when the new wave comes and accelerate the vaccination program to reduce the potential for spread and the number of death cases. Scaling up the testing and tracing is also fundamental to contain the virus from spreading. Indonesia can learn from other countries in dealing with the second and third waves, starting from the implementation of partial lockdown, strict travel bans, and rigorous quarantine rules to keep imported cases of the disease from sparking new locally transmitted outbreaks.

In the long term, health infrastructure is an important factor that GoI should pay attention to. According to World Health Organization (WHO) standards, the ratio of hospital beds to 1,000 populations is one measure of the fulfillment of community needs for health services in an area. The WHO standard is one hospital bed for 1,000 inhabitants. Nationally, this ratio in 2019 has reached the WHO minimum standard, with a ratio of 1.18. This means that Indonesia has one hospital bed per 1,000 population. However, this figure is meager compared to other countries, for example, South Korea, which has about 11 hospital beds per 1,000 inhabitants. Not only the hospital bed ratio, but the disparity in health facilities across regions in Indonesia is also one of the severe problems right now, even before the Covid-19 pandemic occurred. This leads to a condition where many regions, especially in the eastern part of Indonesia, do not have adequate infrastructure to cope with the pandemic. This requires government intervention, especially in this Covid-19 situation. The improvement in terms of health facilities in Indonesia is urgently needed to take control of the outbreak. Transportation infrastructure is no less critical considering the current condition of Indonesia, where one of the obstacles is the distribution of vaccines to remote areas.

All in all, preparedness and assertive decision-making from the GoI is truly a vital lever to contain the pandemic, mitigate the economic effects, and facilitate a rapid recovery. Immediate concern should be focused on building buffers against the future waves of Covid-19 pandemic.

Fata Morgana of a Recovery

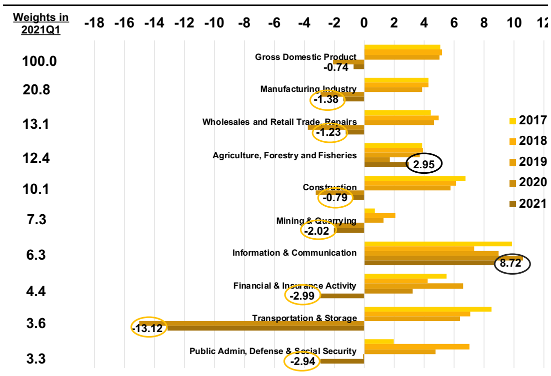
Global economy enters 2021 with a more optimistic view after a devastating year of the pandemic. With numerous promising aspects, such as vaccine rollout, better control of pandemic spread, and massive stimulus continue flowing to the economy, 2021 rolls with an encouraging outlook. However, managing the pandemic as voluminous as Covid-19 is a tricky matter, let alone trying to 'live with the virus'. As shown repeatedly since its emergence earlier last year, a country that tends to underestimate the health risks of Covid-19 and fail to put the necessary effort and policies to control the virus spread are doomed to fail in rescuing both the public health and the economy.

"Despite still being in negative territory, GDP growth of Indonesia is the closest it gets to the positive rate since the outbreak."

Observing the most recent development, it became apparent that one thing is highly uncertain and no economist could ever predict, which is the potential of Covid-19 virus mutation and the possibility of another wave. The possibility of a second wave is rarely taken into account by the governments (at least on the policy implementation level) until the wave arrived and it is already too late, as happened in South Korea mid-2020 and in India early 2021. It is quite understandable, however, that the first wave of the pandemic has wreaked havoc the economy, where people lost their job and savings and the government desperately juggle their fiscal space and piling debts to provide adequate stimulus. Thus, the emergence of an early sign of recovery put the society eager to jumpstart the economic activity. This illustration is precisely what happened in Indonesia in Q1 2021.

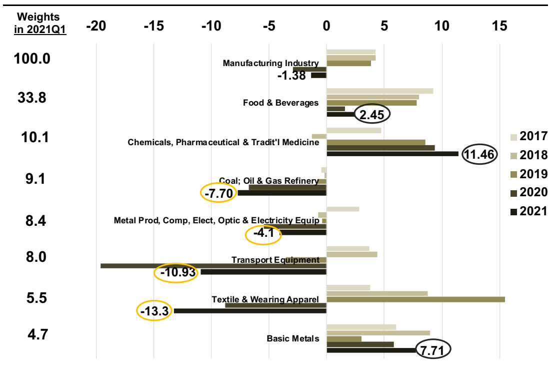
Despite still being in negative territory, GDP growth of Indonesia is the closest it gets to the positive rate since the outbreak. Recorded at -0.74% (y.o.y), the Indonesian economy in Q1 2021 enjoyed a less severe contraction in almost all sectors than the previous three quarters. In addition, several sectors that enjoyed a rather positive growth during the pandemic were still recording an expansion in the first quarter of 2021. Diving deeper to its sectors, manufacturing industry as the biggest sector in the Indonesian economy with the contribution of more than a fifth, recorded a growth of -1.38% (y.o.y) in Q1 2021, a rather substantial increase from -3.13% (y.o.y) in the last quarter of 2020. Similarly, wholesale and retail trade as another major sector in the economy with the contribution of 13% to the national GDP, grew -1.23% (y.o.y) in Q1 2021 from -3.66% (y.o.y) in Q4 2020. The relaxation of social restriction measures and some degree of pent-up demand burst drove the growth of the two biggest sectors, despite still being recorded negatively due to the base effect in which Indonesian economy was still enjoying positive growth in the same period of last year (Q1 2020). On the other hand, agriculture, ICT, and human health & social work sectors continue to record positive growth in early 2021. With its rather substantial contribution of 12.4% to the domestic economy, agriculture grew slightly to 2.95% (y.o.y) in Q1 2021 from 2.57% (y.o.y) in the previous quarter. While still enjoying a noticeable higher growth rate compared to others, ICT only grew 8.72% (y.o.y) in Q1 2021, making it the first single-digit growth during the pandemic after enjoying three quarters of double-digit growth rate. Similar story with human health & social work sector that only recorded a growth of 3.64% (y.o.y) in Q1 2021, substantially lower than 16.55% (y.o.y) in Q4 2020.

Figure 1: Growth of GDP and the Main Industries, 2017-2021Q1



Source: CEIC

Figure 2: Growth of Manufacturing Sector and Its Subsectors, 2017-2021Q1



Source: CEIC

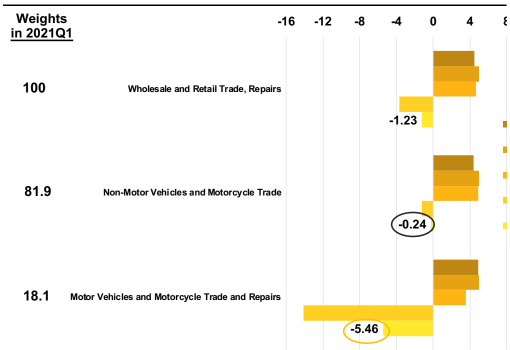
"…subsectors within manufacturing recorded a rather varied growth path."

Manufacturing sector shrank by 1.38% (y.o.y) in Q1 2021, quite an improvement from the growth in Q4 2020 of -3.14% (y.o.y). Accounted as the biggest sector with 20.8% of contribution to the domestic economy, subsectors within manufacturing recorded a rather varied growth path. For one, food & beverages subsector continues to hit a positive growth rate during the pandemic, recorded at 2.45% (y.o.y) in the first quarter of 2021, increasing from 1.66% (y.o.y) in Q4 2020. Despite being in positive territory of growth, food & beverages subsector growth is substantially below the pre-pandemic level of growth of around 7%-9%. Furthermore, the rapid growth of chemicals, pharmaceutical & traditional medicine subsector came as no surprise during the current health crisis. Accounted as the fourth biggest subsector in the manufacturing industry before with the contribution of around 8%, chemicals, pharmaceutical & traditional medicine subsector contributed to around 10.1% of manufacturing industry in Q1 2021. In addition, it is also the subsector with the highest growth within the sector, with a growth rate of 11.46% (y.o.y) in Q1 2021, substantially increase from 8.45% (y.o.y) from the last quarter of 2020. Transport equipment subsector, however, still taking the hardest hit in early 2021 as it still recorded a double-digit decline as the transport sector is still muted due to the decline in people's mobility. Recorded at -10.93% (y.o.y), transport equipment subsector gradually recovering from its lowest level of growth of -34.29% (y.o.y) in Q2 2020. Moreover, leather, leather products & footwear and furniture subsector grew positively in Q1 2021, breaking the pattern of being on the negative territory during the pandemic era. Leather, leather products & footwear subsector growth increase to 1.74% (y.o.y) in Q1 2021 from -6.07% (y.o.y) in Q4 2020, a rather massive growth spike. Similarly, furniture subsector grew substantially 8.04% (y.o.y) in Q1 2020 from -1.72% (y.o.y) in the previous quarter.

Considered as one of the most promising in Asia with higher household purchasing power and increasingly modern spending habit, which came from its large population and growing middle class, Indonesia's retail sector is not immune to the pandemic effect. Despite being in better shape recently compared to the beginning of Covid-19, wholesale and retail trade sector still shrank in 2021. Recorded at -1.23% (y.o.y) in the first quarter of 2021, this sector slowly bore less severe pressure. Thanks to non-motor vehicles sales, which contributed to more than 80% of wholesale and retail trade sector, contracted only -0.24% (y.o.y) in Q1 2021 from -2.19% (y.o.y) in the previous quarter as household's purchasing power gradually increase and economic activity started to gain its momentum in the early of 2021. Similarly, despite its larger hit during the pandemic, motor vehicles and repair subsector growth recorded quite an improvement. Despite still experiencing a growth decline of -5.46% (y.o.y) in Q1 2021, motor vehicles and repair subsector growth increase from -9.71% (y.o.y) in Q4 2020, also from a depressing decline of almost 30% in Q2 2020.

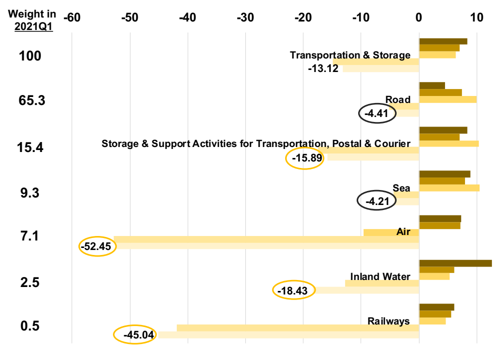
"Considered as one of the most promising in Asia with higher household purchasing power and increasingly modern spending habit, which came from its large population and growing middle class, Indonesia's retail sector is not immune to the pandemic effect."

Figure 3: Growth of Wholesale and Retail Trade and Its Subsectors, 2017-2021Q1



Source: CEIC

Figure 4: Growth of Transport and Its Major Subsectors, 2017-2021Q1



Source: CEIC

While some sectors are enjoying an improvement in their growth figure from the early momentum of increasing economic activity, transportation and storage sector is not one of those. The growth rate of transportation and storage sector has been painting a bleak picture during the pandemic. In Q1 2021, this sector still had a dismal growth rate of -13.12% (y.o.y), a rather insignificant increase from -13.42% (y.o.y) in Q4 2020. Observing deeper to its subsectors, further insights can be gained on how the economic recovery took place. The increasing economic and business activity has been seen in many places during the first quarter of 2021. However, the growth of such activities has been happening rather locally, as suggested by the growth rate of transport subsector. The abysmal growth of -45.04% (y.o.y) for railway transport subsector and -52.45% (y.o.y) in air transport subsector has suggested that people are still unwilling to travel long-distance. On the other hand, road transport recorded a growth decline of 'only' -4.41% (y.o.y) in Q1 2021. The asymmetric rate of decline suggesting while there was an increase in economic activity, it only took place on a local or regional basis.

Q1 2021 marked as the fourth quarter that the Indonesian economy has been living in the pandemic era. Since Q2 2020, we have seen several kinds of impacts on the economic sectors due to the pandemic as we have seen the growth dynamics of each sector from several scenarios of social restriction tightness. As Q1 2021 demonstrated with a certain degree of social restriction relaxation, the economic benefit has not been enjoyed equally by all sectors. Aside from sectors that have been experiencing tremendous growth during the pandemic (i.e., ICT and health & social work sectors), wholesale and retail trade sector were improving as the relaxation of social mobility restriction, while transportation and storage sector improvement is substantially slower. Thus, this trend suggested that the pandemic would create a rising inequality among sectors. Although this issue might not come as the first priority for now as GoI should have an undivided focus in getting the public health risks under control, the inequality problem should not be taken lightly once the pandemic storm is over. Going beyond the first quarter of 2021, saving people lives and protecting the most vulnerable group is an agenda that shall not be compromised to progress our economy forward from the "through" stage to the "recovery" stage.

"Beside disruption coming from Covid-19 pandemic, negative growth in most expenditure components is because we are comparing with Q1 2020 when the pandemic has not fully escalated domestically."

A Temporary Fresh Breath of Air

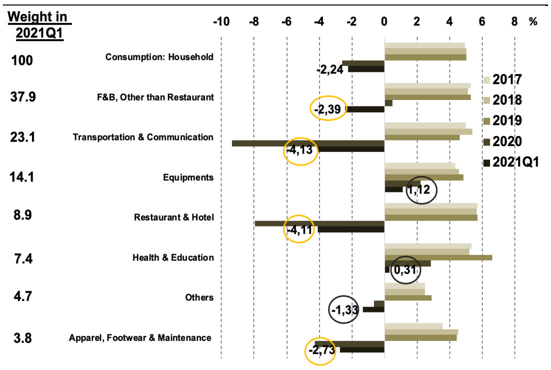
As a result of lenient policy regarding travelling during Christmas holiday and New Year of 2021, it comes as no wonder that daily Covid-19 confirmed cases in Indonesia increased steadily during the first month of 2021. In response to the rising cases, to prevent the spread of Covid-19, the government decided to place an entry ban for most foreigners and enforce a tightened travel requirements for domestic travel. Not only travel restrictions, the government also imposed restrictions on community activity (PPKM) in Java and Bali from 11 January to 8 February. The government decided to enforce micro-scale restrictions on community activity (PPKM Mikro) starting 9 February to curb the virus transmission. Originally applied only in Java and Bali, PPKM Mikro has been issued in 10 phases until the end of June 2021. Major differences between PPKM and PPKM Mikro are capacity limits for work-from-office arrangement, dine-in, and mall operating hours. As PPKM were in place during most of Q1 2021, it comes as no wonder, all expenditure components of GDP shrank, except for government consumption, exports, and imports. Government consumption grew by 2.96% (y.o.y) in Q1 2021, up from 1.84% (y.o.y) in the last quarter of 2020. This positive growth between January and March 2021 can be attributed to budget realisation, particularly social assistance at almost IDR55 billion compared to IDR47.2 billion in the same period last year. Beside disruption coming from Covid-19 pandemic, negative growth in most expenditure components is because we are comparing with Q1 2020 when the pandemic has not fully escalated domestically.

"After suffering from recession for four consecutive quarters, Indonesia is expected to exit recession in Q2 2021."

Observing household consumption, it shrank by 2.24% (y.o.y) during the first three months of 2021. Only consumption of equipment that grew by 1.12% (y.o.y) in Q1 2021 from 0.72% (y.o.y) in Q4 2020 and consumption of health and education that posted a positive growth of 0.31% (y.o.y) in Q1 2021 compared to 0.64% (y.o.y) in the previous quarter. On the contrary, other consumption components were hit hard by the pandemic. Consumption of food and beverage, transportation & communication, and restaurant & hotel, which accounts for almost 70% of total household consumptions, contracted by 2.39% (y.o.y), 4.13% (y.o.y), and 4.11 (y.o.y), respectively, during the first quarter of 2021.

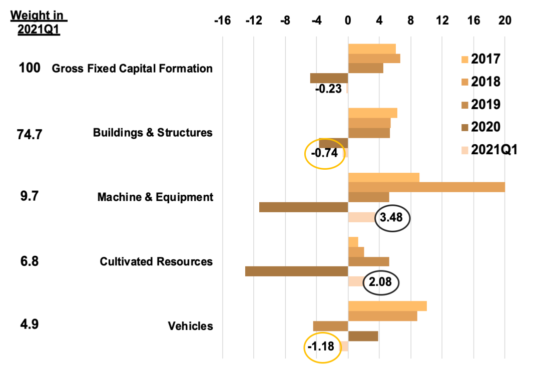
Moving on to investment component, it recorded negative growth of 0.23% (y.o.y) in Q1 2021 compared to 6.02% (y.o.y) contraction during the last quarter. With PPKM Mikro in place, investment in physical infrastructure, the highest contributor of investment, is expected to continue to decline, as indicated by a negative growth of 0.74% (y.o.y) in buildings & structures. Perhaps to meet international demand, investment in machinery & equipment grew by 3.48% (y.o.y) as opposed to 6.51% (y.o.y) contraction in Q4 2020. This would then translates to 6.74% (y.o.y) growth in exports during the first three months of 2021.

Figure 5: Growth of Household Consumption and its Components, 2017-2021Q1



Source: CEIC

Figure 6: Growth rate of Investment and its Main Components, 2017-2021Q1



Source: CEIC

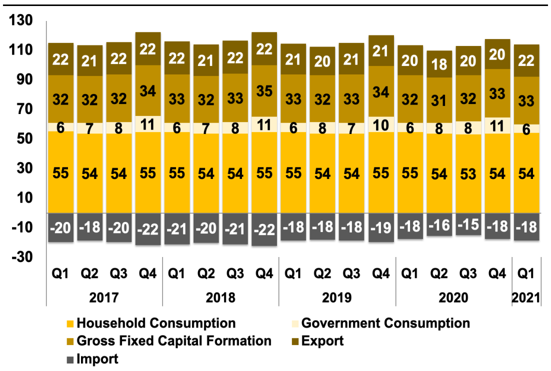
After suffering from recession for four consecutive quarters, Indonesia is expected to exit recession in Q2 2021. This is partly because of the low base effect as Indonesia hit rock bottom in the second quarter of 2020 when Covid-19 crisis occurred. Another critical factor for this anticipated positive growth is the disbursement of economic recovery program (PEN), which has a total budget of IDR699.43 trillion for 2021. During the first semester of 2021, PEN budget realisation reached IDR252.3 trillion, or 36.1% of the total budget. Health budget under PEN has been realised for IDR47.17 trillion, or 24.6% of the total health budget. For social protection, the budget has been realised for IDR66.3 trillion or 43.2% of the total budget. Disbursement of social protection budget through Family Hope Program (PKH), basic food cards, direct cash assistance (BLT), and pre-employment card helped improving purchasing power to support economic recovery. The remaining budget

"As an indication of significant progress in economic recovery, credit performance increases sharply throughout April and May 2021."

realisation was divided among MSMEs, business incentives, programs of ministries, institutions, and local governments, as well as programs to assist the finance of corporations during the pandemic. Moderating Covid-19 cases between April and June also contributed to the long-awaited positive growth. During the second quarter of 2021, the number of 7-day daily average confirmed new cases was ranging between 5,000 and 7,500, much lower compared to the first three months of 2021. Lastly, vaccination rollout also assist economic improvement.

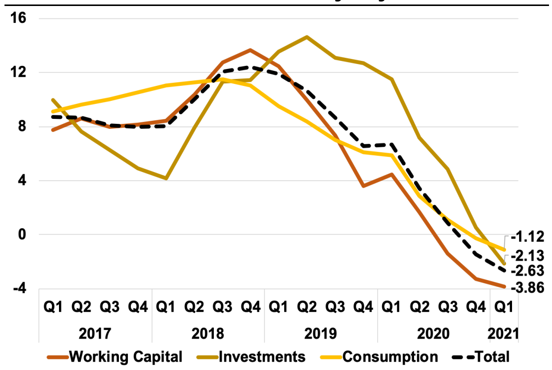
As an indication of significant progress in economic recovery, credit performance increases sharply throughout April and May 2021. The average credit during these two months increased by 35.03% compared to the average credit throughout April and June 2020, suggesting economic activity is slowly going back to pre-pandemic level. The double-digit growth was due to a rise in working capital credit, investment credit, and consumption credit by 56.70% (y.o.y), 31.44% (y.o.y), and 2.78% (y.o.y), respectively. Consumption credit reflected reluctancy among consumers to spend as the world is still full of uncertainty, as indicated by 11.10% (y.o.y) growth of third party funds in June 2021 and 10.77% (y.o.y.) growth of net asset value of mutual fund in May 2021.

Figure 7: Shares of GDP Components, 2017Q1-2021Q1 (%)



Source: CEIC

Figure 8: Credit Growth by Purposes, 2017Q1-2021Q1 (y.o.y, %)



Source: CEIC

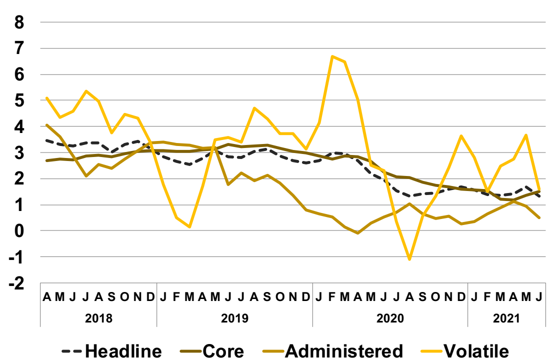
Post-Ramadan Price Normalization Drives Inflation Rate Lower

June's inflation rate is recorded at 1.33% (y.o.y), down significantly from 1.67% (y.o.y) in May 2021 as price pressures due to holidays finally eased. The weakening of inflation during this period was driven by a decrease in the administered prices and volatile goods prices component, although core inflation experienced a slight strengthening. On the contrary, deflation is recorded at -0.16% (m.t.m) on monthly basis, which is the lowest level since 2019. This was triggered by the weakening of the three components, particularly the volatile price component, which experienced quite high deflation. It comes as no surprise that volatile food inflation fell to 1.60% (y.o.y) in June compared to 3.66% (y.o.y) in the previous month, and -1.23% (m.t.m) from 0.39% (m.t.m) in May 2021 because of the food price normalization after the Eid-al Fitr celebration. For more than a year, the inflation rate is below BI's target

"The domestic investment is driven by infrastructure projects such as the electricity provision in Lampung and Maluku as well as the port development in Central Kalimantan, which is included in President Jokowi's agenda to improve the quality of infrastructure outside Java as an effort to equalize the economy."

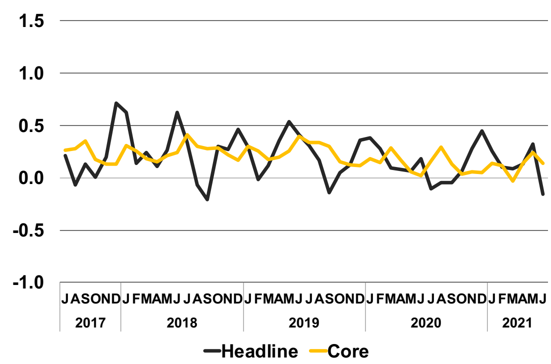
range of 3%±1 and we expect the price pressure to remain moderate in the months ahead.

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



Source: CEIC

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

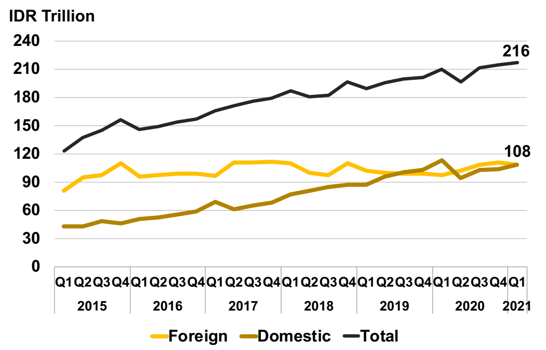


Source: CEIC

On the other hand, the annual core inflation started to accelerate since last month after experiencing a consecutive decline for 13 months, recorded at 1.49% (y.o.y) in June 2021. Although it is slowing down on a monthly basis, with 0.14% (m.t.m), down from 0.24% (m.t.m) in May 2021. The positive growth of core inflation is mainly influenced by movements in gold prices, house rentals, and car commodities. Although prices generally experienced deflation, the strengthening of core inflation was a signal that domestic demand was experiencing a slight growth.

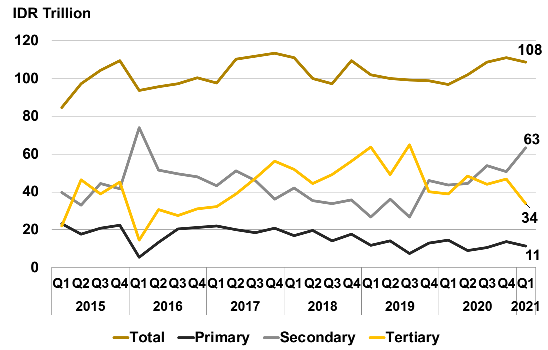
Indonesia's Investment Climate Begins to Improve

Figure 11: FDI and Domestic Investment (Nominal)



Source: CEIC

Figure 12: FDI Realization by Sectors (Nominal)



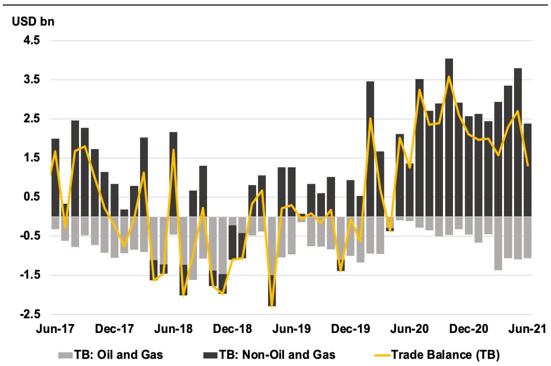
Source: CEIC

The Indonesian Investment Coordinating Board (BKPM) recorded an increase of 3.3% (y.o.y) in investment realization in Q1 2021 compared to Q1 2020 and 0.87% (m.t.m) compared to the previous quarter. This improvement was mainly contributed by an increasing domestic investment at 4.20% (y.o.y), while the realization of foreign investment actually decreased by 2.2%. The domestic investment is driven by infrastructure projects such as the electricity provision in Lampung and Maluku as well as the port development in Central Kalimantan, which is included in President Jokowi's agenda to improve the quality of infrastructure outside Java as an effort to equalize the economy. This improvement in investment realization indicates that the investment climate in Indonesia is getting better. However, the contribution of the primary sector needs to be increased. This is because the tertiary sector which is identical to capital intensive and minimal absorption of labor and the secondary sector has dominated foreign investment realization in the first quarter of 2021.

Trade Surplus Remains Amid the Second Waves of Covid-19

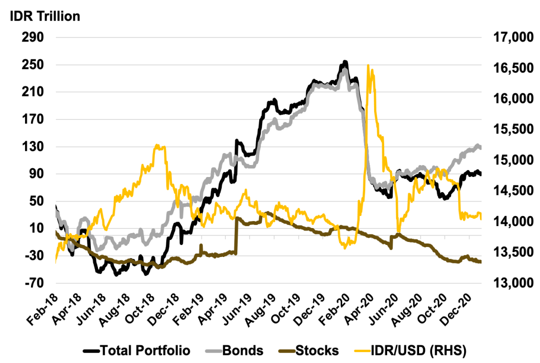
Indonesia continued to record a monthly surplus in international trade for 13 consecutive months since May last year amid the beginning of the second wave of Covid-19 pandemic last month. The foreign trade surplus in Q2-2021 has been widened by almost two times larger than its number in previous year. Besides the low base effect of the trade surplus in 2020, better performance of foreign trade is highly attributable to the rebound in global demand and hike in commodity prices as the surplus was also recorded higher than its figure in Q2 2019. The positive performance of trade balance in the second year of Covid-19 pandemic was driven by accelerating exports and imports, indicating the sign of economic recovery. As commodity exporter country, Indonesia is benefited by the robust increase in commodity prices. This is reflected by the 154% increase in the exports of non-oil and gas goods in Q2-2021 compared to the same period last year. While the imports of raw and capital goods have jumped three times higher than its figure last year due to the higher crude oil prices along with the recovery in global demand.

Figure 13: Monthly Trade Balance (Nominal) (June'17-June'21)



Source: CEIC

Figure 14: Exchange Rate and Accumulated Short-Term Capital Inflow (Jan'18-July'21)



Source: CEIC

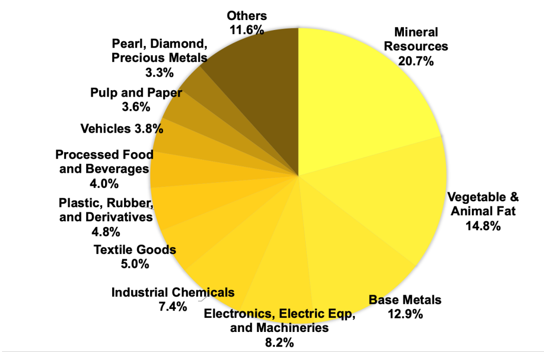
"Last year, the better-than-expected trade performance amidst the Covid-19 pandemic had released the pressures on Indonesia's current account balance..."

Last year, better-than-expected trade performance amidst the Covid-19 pandemic had released the pressures on Indonesia's current account balance as it was recorded the surpluses of 0.38% and 0.33% of GDP, respectively in Q3 and Q4 2020. However, Indonesia no longer enjoyed the surpluses since early 2021 with the resume of current account deficit at 0.36% of GDP in Q1 2021. Unlike the last year's weak imports due to the pandemic, the imports of raw and capital goods have been reviving to support the economic recovery. The trend of higher imports of goods that nearly outpaced the improvement in exports along with the persistent trade deficit in services, has brought the current account back to its deficit level. By looking at the foreign trade figure these past three months, the current account deficit will most likely persist in Q2 2021. While the current account balance for the 2H-2021 will highly depend on the development of Covid-19 pandemic cases in Indonesia. If the increasing number of Covid-19 positive cases remains, it is not impossible to see another round of current account surpluses as any mobility restrictions to contain the virus will likely dampen the domestic consumption, thus limiting the import demands.

Looking deeper into the composition of foreign trade, the details of exports and imports are relatively unchanged in Q2 2021. Exports are still dominated by raw commodities, which consist of mineral resources, vegetable fat, and precious metals. The proportion of these commodities to total exports was even higher at 39% compared to its figure in the similar period from the last two years. The significant jump in commodity prices due to the continuation of demand recovery from Covid-19 pandemic has contributed to a more significant share of Indonesia's commodity exports. On the other hand, imports of capital goods remained as the main contributor to total imports. Capital goods, which consist of machinery and electronics products, cover around 25% of total imports. Industrial chemicals products are also still the third-highest imported products by Indonesia from foreign countries because of high demand for medical supplies and equipment during the Covid-19 pandemic. The share of industrial chemical imports are expected to increase in the near future as Indonesia has been battling with the resurgence of Covid-19 pandemic cases.

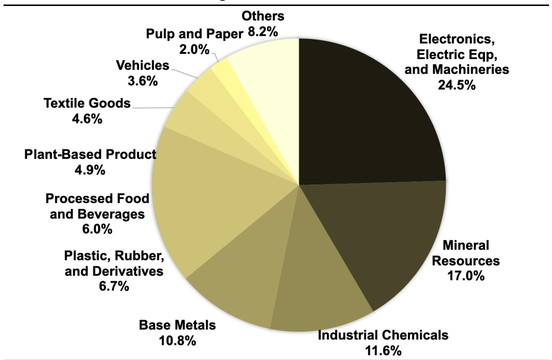
"The combination of steady exports and lower imports is expected to contribute on the trade surpluses in the remaining months of this year."

Figure 15: Indonesia Export Profile (May-June 2021)



Source: CEIC

Figure 16: Indonesia Import Profile (May-June 2021)



Source: CEIC

The second wave of Covid-19 pandemic has pulled back the demand in domestic consumption as the GoI needs to implement other social mobility restrictions. The lower demand has slashed the businesses' agenda to restart the production, thus plummet the import demands. While the imports are most likely to decrease in the near future, the trend of exports will highly depend on the global demand recovery. If the economic condition of Indonesia's main trading partners continues to improve, our exports demand will likely to stay in place. The combination of steady exports and lower imports is expected to contribute to the trade surpluses in the remaining months of this year.