LPEM FEB UI
UNIVERSITAS INDONESIA

Macroeconomics Analysis Series

Indonesia Economic Outlook

Q2-2022

Key Figures

GDP Growth (Q4 '21)
5.02%

Inflation (y.o.y. Mar '22)
2.64%

Credit Growth (y.o.y. Q4 '21)
4.40%

BI Repo Rate (7-day, Apr '22)
3.50%

Current Account Balance (%GDP) (Q4 '21)
0.4%

IDR/USD (Apr '22)
IDR14,357

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Global Crisis Prolonged by Geopolitical Tension

Highlights

- *Indonesia's GDP growth rate of Q1-2022 is estimated at around 4.75-4.95% (y.o.y). We see a potential for a rebound to pre-pandemic level GDP growth rate at 4.90-5.10% (y.o.y) in 2022.*
- *The escalated tensions between Russia-Ukraine accelerates the inflation in energy and food ingredient prices.*
- *Despite having low direct exposure of trade and financial channel towards Russia and Ukraine, the indirect impact through rising commodity prices and global uncertainty has affected Indonesia.*
- *The rise in commodity prices, especially energy, proven to be a windfall for Indonesia. As the main producers of CPO and coal, Indonesia is enjoying trade surplus of USD9.33 billion in Q1-2022.*
- *Rising prices also poses a threat of inflationary pressure on the domestic economy. Despite has not been fully materialized in CPI (stood at 2.64% (y.o.y)), latest PPI figure has reached 8.77% (y.o.y), indicating the rising inflationary pressures though the impact has not been passed through by producers.*
- *The increase in energy prices also poses a burden on the fiscal aspect. Our estimate suggest that rising energy price will increase subsidy spending from IDR207 trillion to IDR314.4 trillion in 2022.*
- *The increase in energy subsidy will reduce the room for discretionary spending from around 15.9% to 11.9%.*
- *With the potential additional fiscal burden and the mandate to reduce deficit below 3% next year, the need to reform energy subsidy scheme from product-based to targeted subsidy is even more pressing than ever.*
- *Mounting inflationary pressure throughout 2022 demands a more solid coordination between BI and MoF to manage inflation expectation such that it would not lead to overheating inflation.*

Contrary to what was expected in the early last year, Indonesia did not fully recovered in 2021 and did not reach its pre-pandemic level of growth. Ending 2021 with GDP growth of 5.02% (y.o.y) in Q4-2021, Overall economic growth in 2021 is recorded at 3.37% (y.o.y). Waves of several Covid-19 variants has served as the hiccups on the economic recovery progress trajectory throughout 2021. Moreover, sectoral performances indicate that the economic recovery got back to its upward track at the end of 2021 after took a hit in Q3-2021 due to the disruption of Delta variant. Several biggest sectors in the Indonesian economy, such as manufacturing, wholesale retail & trade, and agriculture grew robustly in Q4-2021, suggesting the spur in production activity, household demand, and purchasing power of the population. Furthermore, two sectors that has been hit the hardest during the

pandemic, namely transportation & storage and accomodation & FnB, enjoyed a significant growth in Q4-2021, thanks to the pandemic containment that enables people to travel and do leisure activities. From the expenditure components, All household consumption components recorded positive growth during the last three months of 2021. Accounted for more than half of the GDP, consumption grew by 3.55% (y.o.y) and government expenditure accelerated by 5.25% (y.o.y) in Q4 2021, which resulted from accelerating budget realization. As of 31 December 2021, government expenditure was recorded at 101.34% of 2021 budget or IDR2,786.76 trillion. At the same time the National Economic Recovery (PEN) budget realization was recorded at IDR658.6 trillion on 31 Desember 2021 or 88.4% of the total PEN budget of IDR744.77 trillion up from 53% on 17 September 2021.

On the invesment aspect, the investment realization recorded at IDR282.4 trillion during the first quarter of 2022 or grew by 28.5% (y.o.y), which is the highest amount in the last ten years. FDI grew by 31.8% to IDR147.2 trillion, driven mostly by investment in base metal, metal goods, and its equipment industry. On the other hand, DDI grew to IDR135.2 trillion or around 25.1% which is contributed by transportation, warehouse and telecommunications sectors. Even though the volume of global exports and imports was growing slower due to disrupted demand from Russia as they get several bans and sanctions from EU and US, the soaring commodity prices brought fruitful momentum for overall Indonesia's trade balance, which recorded another surplus at USD9.33 billion in Q1-2022. The amount of surplus was even 20% (y.o.y) higher compared to the same period in 2021. The surplus was the result of higher growth in exports than imports, which is mainly driven by the high commodity prices, particularly coal and palm oil. The robust trade balance coupled with slightly positive capital flows has led to maintained Rupiah stability.

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

Q1-2022	FY 2022
4.75% to 4.95%	4.90% to 5.10%

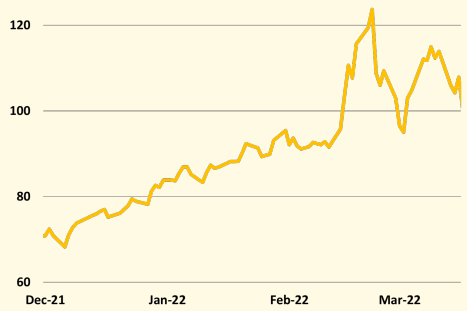
Entering 2022, Indonesia is facing various challenges both in domestic and international front. The combination of internal and external pressures is fuelling the risks of inflation amidst the recovery progress. The pulling factor of demand-side inflation increase the purchasing power that is building up due to increasing production activity, higher mobility, and the burst of pent-up demand. On the other hand, the pushing factor of supply-side inflationary pressure might threaten the purchasing power as the increase in input prices is taking its course. Regardless, the inflation risk has not been materialized yet, at least until the end of Q1-2022. Despite the disruption by Omicron variant in the early 2022, Q1-2022 is characterized by increasing economic activity and strong performance of trade balance. Thus, we view that the GDP growth of Q1 2022 will be around 4.85% (y.o.y) (estimate range from 4.75% to 4.95%). Despite all the challenges, we are still holding the view of economic growth in 2022 will reach its pre-pandemic level of around 5.0%.

The Impact of War on Fiscal Posture

Channel of War towards Domestic Economy

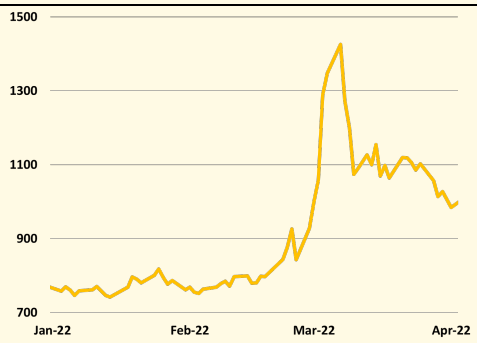
In the middle of recovery after the Covid-19 pandemic, the escalated tension between Russia and Ukraine has put an additional burden on the global market. The fragile condition, reflected by the extended impact of the war beyond the people of Russia and Ukraine, affects the well-being of people around the world. One of the most notorious impacts is the rise in global energy prices, especially oil and gas. Although the pre-war oil price has already risen, the recent invasion of Russia to Ukraine has put a substantial shock on the global oil market. The ongoing conflict between the two countries has extensively disrupted the global oil supply as Russia is the third-largest oil producer country after the US and Saudi Arabia. The event has become more complex after several countries administered sanctions by putting an embargo on Russian oil, which inevitably put another upward pressure on the already-high global oil price. On the other side, the rising trend in oil price has aggressively increased the demand for other sources of energy, such as coal and vegetable oils. As a result, a similar trend of price hikes also started to happen in the two commodities.

Figure A: WTI Crude Oil Price-Daily (USD/Barrel)



Source: Investing.com

Figure B: US Wheat Futures-Daily (USD/Bushel)



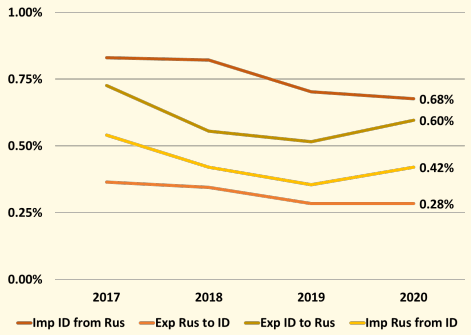
Source: Investing.com

Aside from oil prices, the war has also driven up the price of food commodities, such as wheat and barley. According to the Food and Agriculture Organization (FAO), Russia and Ukraine produced approximately 110 million tonnes of wheat in 2020, or equivalent to 30% of world wheat production. The current military invasion has forcefully interrupted the production process, leading to fewer supply. On top of that, the substitution effect has unintentionally put upward pressure on other agricultural commodities, including soybean and maize, making the overall price for food products on heat. Moreover, the hike in commodity prices will likely remain longer than others would expect, following that Russia is also one of the major fertilizer producers. The lower supply of fertilizer will then limit crop production not only in Russia but also in other fertilizer-importer countries.

As for Indonesia, the heightened global tension, especially in relation to the Russia and Ukraine war, has impacted some ways. The war exposed a relatively benign direct effect in the trade sector as the two countries had a relatively small contribution to Indonesia's foreign trade. The share of the two countries in Indonesia's trade was recorded at lower than 1% in 2021, both for export and import components. Unfortunately, the indirect effect of the higher trend of global commodity prices may still shadow the performance of Indonesia's trade in the near future. Until

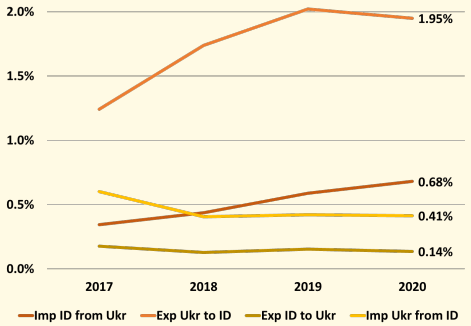
March 2022, Indonesia experienced a windfall in higher export due to higher energy prices, such as coal and CPO. However, if the global security issue persists, the incoming shock on Indonesia's trade should be well-anticipated.

Figure C: Indonesia-Russia Share of Trade (%)



Source: Trademap

Figure D: Indonesia-Ukraine Share of Trade (%)



Source: Trademap

Moving to other aspects, the military invasion of Russia to Ukraine has also impacted the domestic financial market. From the first day of the invasion on 24 February until the end of March 2022, Indonesia has recorded a massive amount of outflow accounting for IDR43 trillion from the bonds market. Aside from the rising uncertainty due to global geopolitical tension, the massive outflow was also contributed by the tight monetary policy deployed in several advanced economies such as the US and EU to counter the heating domestic inflation. Given the recent global uncertainty, many investors sought a safe shelter to land their money. As in the domestic market, the event was also reflected by the decline in yield difference of long and short-term tenors and the shifting preference of the market from short-term bonds to long-term bonds. The stock market, on the contrary, recorded an accelerated trend of capital inflow from the beginning of the year until April 2022, which accounted for IDR41 trillion. The favourable performance of the stock market was generally driven by the excellent performance of commodity-producer firms that dominated the domestic stock market.

All in all, the Russia-Ukraine war has exacerbated the current stairway to recovery. From higher energy prices to the looming risk of food crises, the impact of Russia's invasion of Ukraine has been felt far beyond the people of the respective countries. In Indonesia, although the impact was considerably less severe compared to other emerging markets, the persistence of the war may slowly crunch the domestic condition, especially from rising commodity prices that put pressure on inflation, which could hurt purchasing power and domestic economic recovery progress.

Domestic Policy Response towards Rising Commodity Prices

The outbreak of Russia-Ukraine has created dire ramifications in rising global commodity prices, most notably energy and food commodities. Consequently, it creates a supply shock on a global level that requires policy responses accordingly by the government. The types of policy response are varied, depending on the transmission of global supply shock towards each domestic economic condition. One main channel of global shock of commodity prices in Indonesia is transmitted through fuel prices. Considering several types of fuel in Indonesia, most fuel prices are subsidized by the GoI, both directly through a fuel subsidy scheme or compensation to Pertamina as a fuel producer state-owned enterprise.

Table I: Price Adjustment of Main Fuel Products

Fuel Type	Price per Litre (IDR)			Channel of Fiscal Burden
	March 2022	Mid-April 2022	Market Price*	
Pertamax Turbo (RON 98)	14,500 - 14,800	14,500 - 14,800	18,040	Compensation of price gap to Pertamina
Pertamax (RON 92)	9,000 - 9,400	12,500 - 12,750	16,500	Compensation of price gap to Pertamina
Pertalite (RON 90)	7,650	7,650	12,500	Direct Subsidy on Price

Source: Pertamina, CNBC
**Market price is proxied from the selling price of similar products by non-SOE fuel producers*

In general, even before the massive pressure on oil price due to the escalated geopolitical tension, the price-setting mechanism of Pertamina fuel price is burdening the state budget. Consumer of Pertalite, categorized as subsidized fuel, has been enjoying the price premium of around IDR4,000/L. On the other hand, despite being categorized as non-subsidized fuel, Pertamina sets its selling prices below-market prices, where the price difference is "subsidized" by the state budget through a compensation mechanism to Pertamina. With a relatively tight fiscal space, the current development of commodity prices certainly exposes fiscal conditions to an even heavier burden.

As shown in Table I, GoI has taken action to absorb the shock of rising global oil prices by adjusting the domestic fuel price. As of 1 April, GoI has adjusted the price of Pertamax from around IDR9,000/L to IDR12,500/L. However, as conceptualized by basic economic theory, the current adjustment of fuel price has the potential to create other problems. Summarized by Table I, currently, the GoI has only adjusted the fuel price of Pertamax and keeping Pertalite price unchanged. The new price-setting has changed the price difference between Pertamax and Pertalite, which would disrupt the previous equilibrium. Without maintaining the price difference, the new price has created an incentive for consumers to shift their demand of Pertamax to Pertalite and creates a shortage of Pertalite as it is faced with excess demand. Thus, in terms of fuel issues, GoI is facing a double-hit from the additional fiscal burden and shortage of subsidized fuel.

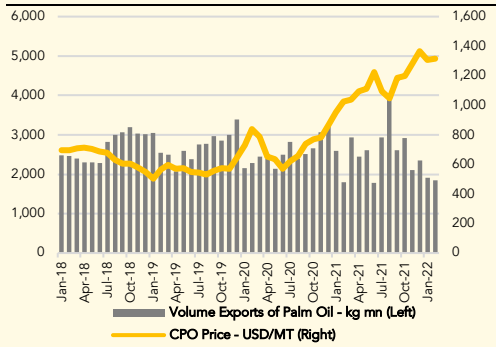
Aside from energy prices, food prices have risen, with the most significant jump in cooking oil prices. The soaring cooking oil prices are inevitable as their primary input comes from CPO. The global price of palm oil has been climbing since December 2021 due to the recovery in demand from the leading consumers, India and China. The conflict between Russia and Ukraine has also calibrated the rising palm oil prices, as it disrupted the sunflower oil supply and resulted in a high upsurge in palm oil demand. In turn, the domestic reference price of CPO, published regularly by the Ministry of Trade, reached an all-time high of USD1,788 per ton in April[1]. Higher cooking oil production costs due to rising CPO prices have put a strain on supply and resulted in high retail prices. In response to the inflationary pressures on cooking oil as an essential food ingredient, GoI has launched, implemented, and retracted several policies since January 2022.

In securing domestic supply of CPO for the cooking oil industry amid the high international demand, GoI previously imposed a permission requirement for palm oil exports, which could only

[1] https://www.kemendag.go.id/id/newsroom/press-release/periode-april-2022-harga-referensi-cpo-naik-tapi-biji-kakao-turun-bk-cpo-usd-200-mt-dan-biji-kakao-5-persen-1

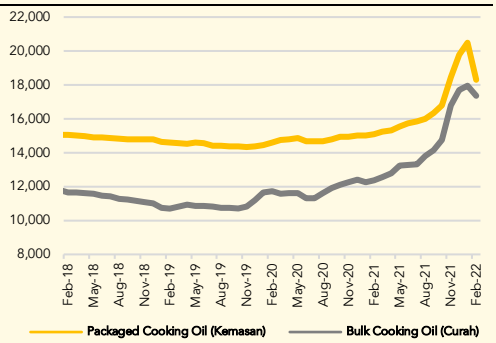
be acquired when palm oil producers had declared their six-month domestic distribution plan. The regulation has cut down the export volume of palm oil, which was reduced by 26% (y.o.y) in January compared to the same period last year. However, the market price of cooking oil was still high, reaching up to IDR20,488/L in January. Therefore, GoI launched other measures to ensure the low and stable cooking oil prices in early February, including the Domestic Mandatory Obligation (DMO) on palm oil. It requires palm oil producers to allocate at least 20% of their CPO for domestic sales, while the rest can be exported. Along with DMO, GoI has also imposed Domestic Price Obligation (DPO) for CPO used in cooking oil production. The domestic price of palm oil was capped at IDR10,300 per kg to ensure that the highest retail price (HET) for domestic cooking oil would be around IDR14,000/L for both packaged (*Minyak Goreng Kemasan*) and bulk versions (*Minyak Goreng Curah*).

Figure E: CPO Exports and Price



Source: CEIC, Ministry of Trade

Figure F: Domestic Cooking Oil Prices (IDR)



Source: Ministry of Trade

The regulated price has forced the producers to sell the cooking oil at about two-thirds of the market price, leading to severe shortages of cooking oil as companies held back their productions. Palm oil producers were also reluctant to sell at the GoI's HET price due to potential higher profit if they exported the CPO at the international price. Amid the mandatory domestic obligation, palm oil export was relatively unchanged in February 2022, with a slight increase of 2% (y.o.y) compared to the same period last year. At the same time, the average selling price of cooking oil was still recorded high at around IDR18,000/L, higher than the HET price. Since the previous policies were relatively inefficient in discouraging palm oil exports, GoI increased the DMO for palm oil by at least 30% for the domestic market in early March. GoI also elevates the levies of palm oil exports to hinder exports due to the scarcity of domestic cooking oil. The export levies are more than doubled to US$375 per ton of CPO when the international prices are above US$1,500 per ton, making the total cost of exporting palm oil maxed at around US$575 per ton of CPO given by the US$200 per ton export tax of palm oil. Because of such an all-time high cost, the exports are expected to decline. The higher revenue from export levies is intended to support subsidizing cooking oil prices at the HET price.

However, enforcing cap price and volume quota policy is challenging, particularly in terms of high price volatility and a wide price gap between regulated and market prices. The producers are unwilling to sell the cooking oil at such a low price; thus, the severe shortage of cooking oil is inescapable in mid-March. GoI even has to set the limitations policy for customers of maxed 2 litres of cooking oil per purchase. There is no fair solution here because cooking oil producers and retailers suffer losses. Since the producer's goal is to maximize profits while minimizing costs, the HET policy leads producers to incur losses because raw material costs are high while the selling price is low. Retailers and distributors have also been affected. They were buying at high prices a few periods ago, but cooking oil must be selling at a low price. As a result, producers cut

back on their production, and distributors postpone sales and hoard supply until prices return to normal. The scarcity of cooking oil in the market led to higher pressure on inflation.

Consequently, to stabilize the price and supply of cooking oil, GoI retracted the regulations of HET price for cooking oil and DMO policy for palm oil at the end of March. GoI lifted its price ceiling policy on packaged cooking oil while keeping the IDR14,000/L price cap on bulk cooking oil mainly consumed by lower-income households. As a result, the retail price of packaged cooking oil doubled to the market price at IDR25,000/L. The scarcity of cooking oil has indeed begun to lessen while the prices remain high.

To help lower-income households and street vendors facing the higher price of cooking oil, GoI has launched a direct cash transfer (BLT) scheme presenting transfers of IDR300,000 for three months, namely April, May, and June, which will be paid in advance in April. The cash transfer will be given to around 20.5 million households listed on the Non-Cash Food Assistance (BPNT) and Family Hope Program (PKH). GoI also allocated the transfers to 2.5 million street vendors selling fried food. The total budget for the cash transfer program is recorded at around IDR6.95 trillion, which GoI allocates from the PEN budget in 2022. The program is expected to dampen the burden on households purchasing the high price of cooking oil.

Along with the BLT program, GoI surprisingly took an aggressive action to ban the exports of CPO and its derivatives in a bid to dampen the soaring domestic prices of packaged cooking oil. The policy is effectively implemented starting from 28 April. Even though it is still too early to scrutinize the impact of the policy, the announcement of the export ban has sent a shock to the global palm oil market, where it has been facing an all-time high price recently. The export restrictions made by GoI will most likely disrupt the global supply and drive the prices even higher as Indonesia is the primary producer of palm oil, triggering another threat to the soaring global food prices. Further, the wide gap between global and domestic prices of palm oil might discourage producers from maintaining the domestic supply like the previous ineffective DMO policy. If there is no commitment from the palm oil and cooking oil companies to supply the cooking oil amidst the palm oil export restrictions, another severe shortage will be unavoidable. It is also noteworthy that applying an export ban is often difficult to implement without having a certain degree of leakage.

The palm oil export ban will also threaten Indonesia's revenue from export levies. The loss could jeopardize the GoI's subsidy program for cooking oil companies in selling bulk cooking oil at the capped price of IDR14,000/L. Considering the high costs of the export ban, we foresee that the policy will be only temporary. However, if the GoI keeps their decisions to implement the policy, they need to prepare the most effective strategy to enforce the industry in maintaining the domestic supply and the exit strategy to prevent the high jump in palm oil prices. In medium to long term, GoI needs to formulate a policy to stabilize the price of domestic cooking oil and maintain its supply. The program includes, first, strengthening the coordination between cooking oil and palm oil as most cooking oil producers do not produce their palm oil. Second, securing cooking oil stocks just like other staple commodities through the participation of Bulog. If prices rise at any time, the government has the authority to conduct market operations. Third, strictly determine the DMO that CPO producers must fulfil. Last, evaluate the palm oil industry thoroughly from upstream to downstream to find the most appropriate policy to prevent supply scarcity in times of high volatility of global prices.

Significant Fiscal Burden from Product-based Subsidy Scheme

The product subsidy policy for fuel can put more pressure on GoI's fiscal burden. The average Indonesian Crude Oil Price (ICP) in April 2022 reached USD113.5 per barrel, an increase of 80.2%

compared to the price on the macroeconomic assumptions in the 2022 State Budget, which is USD63 per barrel. Assuming the amount of GoI's energy subsidies in the 2022 State Budget will increase by an increase in the ICP price of 80.2%, the total mandatory expenditure will increase to IDR2,390.9 trillion or 88.1% of the total expenditure. This is expected to increase the energy subsidy spending from IDR134 trillion to IDR241.4 trillion and increase the total subsidy spending from IDR207 trillion to IDR314.4 trillion in 2022. With this estimate, the increase in oil price only, not including other hikes in commodity prices, has tightened the already narrow fiscal space. As shown in Table II, the increase in energy subsidy will reduce the room for discretionary spending from around 15.9% to 11.9%.

Table II. Additional Fiscal Burden from Subsidized Fuel Prices

	Before the Subsidy Increase		After the Subsidy Increase	
	Amount (IDR Tn)	% of Government Spending	Amount (IDR Tn)	% of Government Spending
Education	542.8	20.0	542.8	20.0
Health	256	9.4	256	9.4
Regional Transfer and Village Funds	385.1	14.2	385.1	14.2
Others				0.0
- Operational Spending	326.3	12.0	326.3	12.0
- Non-K/L Employee Spending	160.4	5.9	160.4	5.9
- Debt Interest Payment	405.9	15.0	405.9	15.0
- Subsidy	207	7.6	314.4	11.6
Energy Subsidy	134	4.9	241.4	8.9
Total of Mandatory Spending	**2,283.5**	**84.1**	**2,390.9**	**88.1**
Total Discretionary Spending	**430.7**	**15.9**	**323.29**	**11.9**
Total Spending	**2,714.2**	**100.0**	**2,714.2**	**100.0**

Source: LPEM FEB UI's calculation

**Using the macroeconomic assumption in the 2022 State Budget, where the oil price is USD63 per barrel*

***The increase in government subsidies is assumed to follow the ICP price increase to USD113.4 as of April 2022*

Facing this reality, one policy option that could resolve the current problems of fuel is to change the subsidy mechanism from product subsidy to agent-targeted subsidy. By setting the fuel price to follow the market rate, GoI could solve the shortage issue as the market price will ensure the clearing of supply demand. In addition, it would ease the fiscal burden as the expense of price hikes will be borne by the consumer who could afford the actual price of fuel. For the poor and vulnerable groups, GoI could provide a cushion against fuel price increases by directly subsidizing the household. For example, by implementing the same scheme as the one provided by the GoI to subsidize the price of cooking oil, which is by providing BLT.

Below are the potential outcomes of the budget needed under several scenarios for targeted subsidy. The budget needed to directly subsidize the poor and vulnerable groups will be significantly lower. With a maximum coverage of 50% of the population and a cash transfer of IDR500,000 per month for 8 months, the total required budget is IDR135 trillion, significantly lower than the current estimated amount of energy subsidy of IDR 241.4 trillion. With this scheme, energy subsidies for fuel, electricity, and LPG prices, can be removed and allowed to follow

market prices. This mechanism would increase the efficiency of subsidy as it is more targeted towards the population who needs it, contrary to the current fuel subsidy mechanism, which has a big potential of leaks and could be enjoyed by the middle-upper class of the population.

Table III. Scenario of Additional Spending from Targeted Subsidy (in IDR trillion)

Amount of Subsidy per Household	Total Subsidy If It Covers:		
	Bottom 30%	Bottom 40%	Bottom 50%
IDR300,000/month	48.6	64.8	81
IDR400,000/month	64.8	86.4	108
IDR500,000/month	81	108	135

Source: LPEM FEB UI's calculation

**Calculated using the assumptions that each household consists of 4 people, and the subsidy will be given for 8 months*

Anticipating Domestic Inflationary Threats

Recently, the run-up in commodity prices is casting a cloud over the global economic recovery, slamming vulnerable businesses and households, and fuelling fears that global inflation will become more persistent, with far-reaching consequences for all countries. Reflecting on the past two years, many commodity prices have surged from their lowest point in mid-2020, particularly on energy prices such as crude oil, coal, and natural gas. Marching towards mid-2022, commodity prices have jumped to record highs since the beginning of this year, tied to Russia's invasion of Ukraine added to sharp increases caused by the collision of strong demand and supply shortages. This burst in commodity prices raised concerns over domestic inflation, which had been running at its lowest rate in the last two years, would soon rise, as is currently happening in several countries. We have to face the reality that sooner or later, the rising pressure of global commodity prices will eventually affect domestic prices.

Table IV: Commodity Price Correlation on Inflation

Assumption: 10% Broad-based Price Increase

Commodity	Impact on Inflation (%)
Crude Oil	1.03
CPO	0.93
Coal	0.21
Natural Gas	0.36

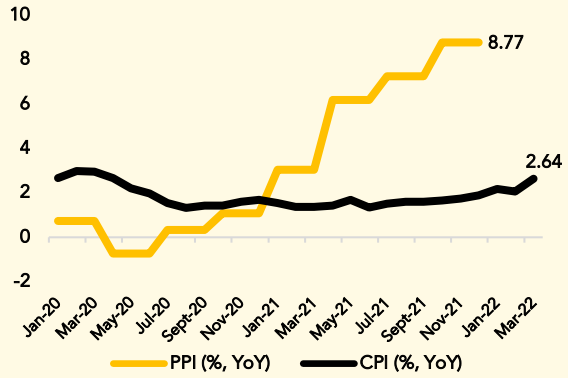
Source: LPEM FEB UI's calculation.

**Data of ICE Brent Oil, CPO FOB Malaysia, Newcastle Coal, and Natural Gas are retrieved from Thomson Reuters, Indonesia's headline inflation rate is retrieved from CEIC.*

A surge in commodity prices always coincides with higher inflation. The strongest case for commodity prices as indicators of future inflation is that they quickly respond to economy-wide shocks to demand. Countries with higher dependency on fossil fuel energy intensities, including Indonesia, will likely be more prone to experience higher aggregate prices and sustained inflationary effects from commodity price shocks. Accordingly, we perform a simple estimation between headline inflation and several key commodity prices to observe the commodity price elasticity and its impact on domestic inflation (Table IV). There are several takeaways. First, commodity prices and inflation are highly correlated. Second, there is a strong impact of higher oil and CPO prices toward inflation. Based on our estimation, every 10% increase in crude oil price corresponds to a 1.03 ppt increase in Indonesia's inflation rate. Meanwhile, a 10% increase in CPO price will associate with a 0.93 ppt increase in the inflation rate. Rising oil prices are usually quickly passed through to consumers in the form of higher

gasoline prices leading to higher distribution and logistics costs, which helps to explain this finding. Higher prices of CPO can also boost prices of food and beverages as it becomes the main raw material for cooking oil, which is a necessity for the food and beverage industry. Last, the impact of higher natural gas and coal prices is moderate. Our estimation showed that every 10% increase in natural gas and coal prices is related to a 0.36 ppt and 0.21 ppt increase in the inflation rate, respectively. Because of the GoI's DMO policy, the pass-through effect of higher coal prices will be relatively small, having little impact on the increase in domestic electricity prices as well as inflation.

Figure G: Indicator of Inflation (%, YoY)



Source: CEIC

Although the current inflation rate remains within BI's threshold range, the trend is expected to elevate gradually this year, eventually reaching above BI's upper target of 4% in overall 2022. At least four factors will put additional pressure on domestic inflation ahead. First, in terms of cost-push inflation, the pressure is intensifying as there has been a climbing trend of Producer Price Index (PPI) inflation since the beginning of last year, which is far exceeding the trend of Consumer Price Index (CPI) inflation that is relatively stagnant. The latest data showed that PPI inflation grew 8.77% (y.o.y) in Q4-2021, compared with 7.25% (y.o.y) in Q3-2021, and significantly higher than CPI inflation that is currently recorded at 2.64% in March 2022. Despite the fact that these two indexes are constructed from different baskets of goods and services, however, if producer prices go up sharply, it will be followed by a bump in the consumer inflation rate and vice versa. Broadly speaking, producers are currently confronted with rising input costs as a result of the sharp increase in global commodity prices, which will be passed on to consumers in the form of higher prices. Second, demand-pull inflation will persist as domestic demand rises in the face of easing Covid-19 curbs and the seasonal trend of Ramadan and Eid Fitr celebrations. Third, the removal of several price controls as a result of the ongoing surge in global commodity and energy prices, which has been exacerbated by Russia's invasion of Ukraine, will trigger the aggregate domestic price level to soar following market mechanisms. Last, a hike in Value-Added Tax (VAT) from 10% to 11% that came into effect in April, though we believe that the impact of an increase in the VAT tax rate on inflation will be limited. Considering the aforementioned factors, GoI must closely monitor all inflationary threats in the upcoming months as they will disrupt the recovery progress and erode people's purchasing power, particularly the vulnerable.

The Regulatory Path Ahead

Oil price shocks, the Russia-Ukraine war, and a spike in inflation have increased the odds of a slowdown in economic recovery. As a result of higher global oil prices, Pertamax price has been increased by IDR3,500 per litre since early April 2022. Two weeks after the price

adjustment, Pertamina recorded a 10% to 15% shift in gasoline consumption to Pertalite, government-subsidized fuel. While an increase in global oil price helps the GoI collect additional revenue, it would also add a significant amount of fuel subsidies. At this time, when the country is gradually recovering from the pandemic, blanket subsidies, which benefit not only the poor and vulnerable households but also the rich, would not be a viable solution anymore. This is also justified by the already widening fiscal deficit as the GoI currently has to achieve many recovery goals with limited resources. Instead of blanket subsidies, targeted subsidies for the vulnerable can help reduce the burden of rising oil prices on the poor while not putting too much pressure on the fiscal capacity. Targeted subsidies, for example, in the form of BLT, should be implemented using a method that properly identifies those who are most in need.

Today, Pertalite, which accounts for more than 70% of fuel consumption, is set at IDR7,650/L, while its economic price should be at least IDR12,000/L. Thanks to the relatively high fuel subsidies, Indonesia's inflation stayed relatively low at 2.64% (y.o.y) in March 2022 compared to other emerging countries, such as Brazil and India, at 11.3% (y.o.y) and 6.95% (y.o.y), respectively. With the increasing global oil price, GoI may want to consider setting the fuel prices at market rates while providing targeted subsidies for the vulnerable, creating more fiscal space for other allocations of government spending. However, setting fuel prices at their market rates would bring another issue: inflation.

To have benign inflation, it is crucial to anchor long-term inflation expectations, just like what BI does by anchoring inflation expectations on its inflation target. If long-term inflation expectation is well-anchored, long-run expectations should not react to short-term expectations since shocks affecting short-term expectations should not influence expectations over long horizons. Taking an example from the US, where inflation expectations are anchored at 2%, if everyone expects the Fed to achieve the 2% inflation target, consumers and businesses are less likely to respond when inflation rises above or falls below that level, for instance, due to global commodity price shocks. It will be simpler for the Fed to reach its objectives if inflation expectations stay steady despite brief rises or drops in inflation. What BI could do is continue communicating extensively on the policy framework to the public.

Considering the energy and commodity prices rally that does not seem to stop in the near future, BI may want to revise its inflation estimates for FY2022 and FY2023 upwards. This is so that the public uses it as a benchmark for their economic activities, such as businesses setting the right prices and households planning their spending better, preventing inflation from going spiral. How much the adjustment should need to be agreed upon using extensive policy coordination with the fiscal authorities. The amount of subsidies given, particularly fuel subsidies, has an implication on inflation; thus, regular dialogue on the right time for adjustments in administered pricing might reduce inflationary pressures and help BI forecast inflation.

To control inflation, major central banks have started to lift their benchmark rates. Thanks to subsidies and price controls, BI is currently under no pressure to raise its interest rate, even when other Asian central banks began to tighten their monetary policy amidst the Russia-Ukraine war that exacerbated supply chain disruptions. Going forward, BI should maintain a careful assessment of domestic conditions before deciding whether or not to increase interest rate; whether to start prioritizing inflation fight or maintain an accommodative stance to support growth. In terms of subsidies, GoI should really start to phase out fuel subsidies to reduce fiscal pressures as well as create more fiscal space for other priority expenditures. Should the Russian-Ukraine war continue and push inflation upward, BI may want to adopt an aggressive tight monetary policy to restrain inflation.

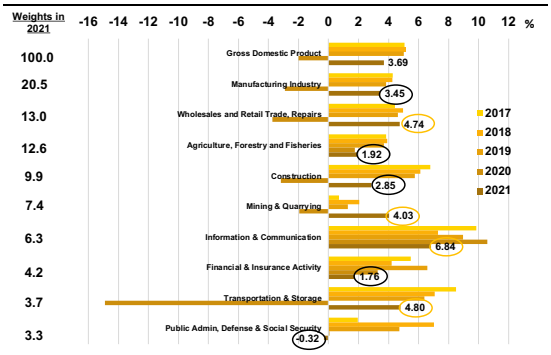
Recurrent Hiccups of Economic Recovery

Despite recovery has taken place across the world during 2021, the emergence of Omicron Variant in last November has disrupted the progress of economic rebound, both in developed and developing countries. The end-of-year disruption in health aspect has put global economies in a slump compared to the overall growth of 2021. Besides the emergence of Omicron Variant, the inflationary pressure due to rising input prices, the burst of pent-up demand, and labor shortage also posed a challenge for policymakers to maintain the recovery progress on track at the end of 2021. However, some countries were ahead of the curve in facing these issues; thus, the impact has been materialized in the late of 2021. For instance, developed economies have been grappling with inflation risk at least since the fourth quarter of last year. The peak of Omicron Variant also materialized around the same period. On the other hand, for majority of developing countries, including Indonesia, inflationary pressure has been beningn until now and the hit of Omicron Variant took place in early 2022. Despite being in a far better condition compared to 2020, contrary to what many have predicted in the beginning of the year, 2021 is not the year the global economy managed to get to the pre-pandemic level of growth.

"Marching towards the end of 2021, the repercussion of global inflationary pressure and the spread of Omicron Variant had not been fully materialized in the domestic economy."

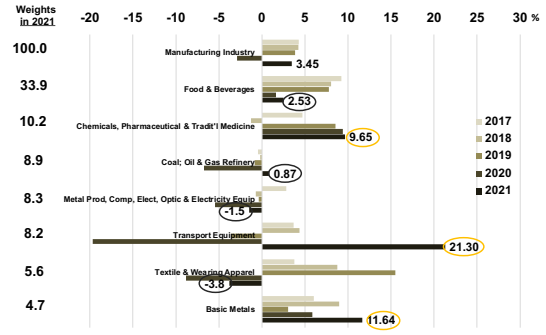
Marching towards the end of 2021, the repercussion of global inflationary pressure and the spread of Omicron Variant had not been fully materialized in the domestic economy. Thus, Indonesia rather recorded a growth rebound of GDP in Q4-2021 of 5.02% (y.o.y) after facing a dip in the previous quarter of 3.51% (y.o.y) due to the rising Delta Variant cases of Covid-19. However, the growth pickup in last quarter of 2021 was not enough to bring the overall 2021 growth figure to the the pre-pandemic trend of around 5% and only put the Indonesia's GDP growth to 3.69% (y.o.y) in 2021. Observing by its production components, sectoral performances indicate that the economic recovery got back to its upward track after took a hit in Q3-2021 due to the disruption of Delta variant. Manufacturing sector as the biggest sector with the contribution of more than 20% in the Indonesian economy grew robustly in Q4-2021 with the growth rate of 4.92% (y.o.y), a subtantial increase from 3.68% (y.o.y) in the previous quarter. The spur in production activity in Q4-2021 has put the overall growth of manufacturing sector in 2021 at 3.45% (y.o.y). Similarly, wholesale & retail trade which accounted as the second biggest sector experienced an increase in growth to 5.56% (y.o.y) in the last quarter of 2021 from 5.15% (y.o.y) in Q3-2021, suggesting a rising household demand and purchasing power of the population after the hit of Delta Variant. Overall, this sector reached 4.74% (y.o.y) in 2021, rose sharply from -3.74% (y.o.y) in 2020. Two sectors that has been hit the hardest during the pandemic, namely transportation & storage and accomodation & FnB, enjoyed a significant growth in Q4-2021, thanks to the pandemic containment that enables people to travel and do leisure activities. Recorded at 7.93% (y.o.y), transportation& storage experienced a massive growth increase in Q4-2021 from -0.72% (y.o.y) in the previous quarter. In addition, accomodation & FnB also shown a similar pattern, which grew from -0.14% (y.o.y) in Q3-2021 to 4.95% (y.o.y) in Q4-2021.

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



Source: CEIC

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

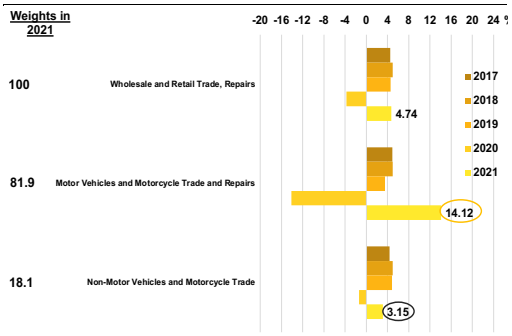


Source: CEIC

"Two sectors that has been hit the hardest during the pandemic, namely transportation & storage and accommodation & FnB, enjoyed a significant growth in Q4-2021, thanks to the pandemic containment that enables people to travel and do leisure activities."

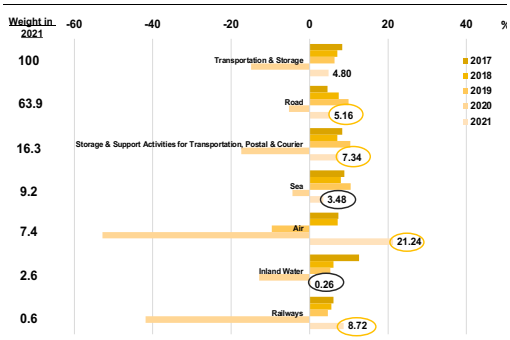
Observing deeper to subsector components of manufacturing, FnB as the biggest subsector with more than a third of contribution to the overall setor, experienced a growth dip in Q4-2021 to 1.23% (y.o.y) from 3.49% (y.o.y) in the previous quarter. The slower growth of FnB subsector might indicate the shifting in spending allocation towards travel and recreations of household as the social restriction was eased, while in Q3-2021 recorded a growth increase during the stricter social restriction from the preceding quarter. Furthermore, chemical, pharmaceutical & traditional medicine subsector growth also moderated from 9.71% (y.o.y) in Q3-2021 to 8.28% (y.o.y) in the last quarter of 2021 following the decline of Covid-19 cases after the wave of Delta Variant. Despite decreasing, transport equipment still recorded a double-digit growth rate of 22.61% (y.o.y) in Q4-2021, continuing the pattern of recovering transport sector and vehicle sales in the domestic economy. On the other hand, coal, oil & gas refinery subsector grew massively to 8.58% (y.o.y) after a contraction of 0.77% (y.o.y) in Q3-2021 as the energy prices surged due to global demand recovery. Despite indicating the economy recovery progress in almost all subsector compared to the previous year, several subsectors within manufacturing sector experienced a contraction at the end of 2021, namely rubber, metal productions, and other manufacturing with the growth rate of -7.51% (y.o.y), -0,49% (y.o.y) and -1.81% (y.o.y), accordingly.

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



Source: CEIC

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



Source: CEIC

Looking in detail at the wholesale and retail trade sector, a slight pickup was recorded in Q4-2021 with 5.56% (y.o.y) growth compared to 5.15% (y.o.y) for the previous quarter. Although the low-base effect was still shadowing, the value in Q4-2021 was successfully brought the annual growth of wholesale and retail trade sector with 4.74% (y.o.y) or almost-equivalent with the pre-pandemic level. Diving deeper to the sub-sector, motor vehicle trade marked a slower growth in Q4-2021 with 9.21% (y.o.y) compared to an immense value of 14.89% (y.o.y) in Q3-2021. Despite the sluggish pattern, the sub-sector of motor vehicle has marked a sky-rocketing annual growth of 14.12% (y.o.y) in 2021 compared to the negative value in 2020. Other than the low-base effect, several fiscal measures to support car and motorcycle industries have effectively boost the output of the subsector throughout 2021. On the other hand, non-motor vehicle trade as the major share to overall wholesale and retail sector accounted for 81.9%, accelerated to 4.75% (y.o.y) in Q4-2021 compared to 3.26% (y.o.y) in preceding quarter. Even though it has not fully recovered to its pre-pandemic level, at the annual basis, the sub-sector of non-motor vehicle trade has acquired a quite favourable amount of 3.15% (y.o.y) in 2021 relative to the bleak growth in previous year.

"Other than the low-base effect, several fiscal measures to support car and motorcycle industries have effectively boost the output of the subsector throughout 2021."

Moving to the other sector, transportation and storage has returned to the positive growth territory after a depressing negative growth in the previous quarter. The end of Delta variant outbreak period, accompanied by seasonal trend of Christmas and new year holiday have significantly contributed to the pleasing growth of 7.93% (y.o.y) in Q4-2021. Among all sub-sector, the railway and air transport achieved the highest growth of 20.68% (y.o.y) and 19.30% (y.o.y), respectively. Act as the main driver with 59.8% share of the overall transportation and storage sector, road transportation also marked a positive growth of 3.63% (y.o.y) in Q4-2021, a slight increase relative to 3.28% (y.o.y) in Q3-2021. Storage and support activity also rebounded in Q4-2021 with an immense growth of 20.20% (y.o.y) compared to prior growth in Q3-2021 which accounted at -8.56% (y.o.y). Looking at the annual level, despite the fluctuations throughout 2021, transportation and storage sector resumed its growth to the positive level compared to the negative amount in 2020. Among all sub-sector, air transportation achieved the highest annual growth of 21.24% (y.o.y) followed by railways transportation with 8.72% (y.o.y). Although the growth has not completely returned to the normal value as it was before the pandemic, the current level of growth has vividly presented the sign of recovery.

After an intense period marked by the beginning of Covid-19 in 2020, the society has gradually adapted to the pandemic situation in 2021. Thus, several sectors that can adjust with the situation were allowed to return to its usual business despite the strict health protocol measures. However, the threat of new variants marked by the outbreak of Delta in the middle of the year as well as the appearance of Omicron has aggressively delayed the recovery effort. As the result, several sectors namely transportation and storage activity as well as FnB marked an inconsistent growth pattern throughout 2021 due to the changing mechanism of health protocol such as mobility restriction to overcome the different waves of pandemic. From the external side, global supply disruptions which then led to the inflationary pressure also darken the situation although the impact has not been materialized completely, especially

in Indonesia. In spite of the fluctuations and uncertainties throughout 2021, yet, the overall growth has shown a rather promising movement of the economy. However, the additional note may be added that some sectors with a steep growth in 2021 were mainly supported by the low-base effect from the gloomy negative growth in 2020.

Strong Domestic Factors Keeping Growth on Track

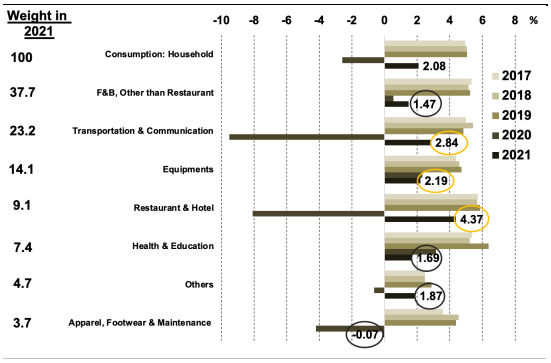
On the back of growing consumption following the easing of social mobility restriction on top of rising vaccinations as well as strong export performance due to stronger commodity prices, Indonesian economy grew by 5.02% (y.o.y) during the Q4-2021 compared to 3.51% (y.o.y) in the previous quarter. While this could be seen that the Indonesian economy returns to normal with around 5% growth, the prepandemic growth level, growth during Q4-2021 still comes from a low base with a negative growth of 3.61% (y.o.y) in Q4 2020. Government consumption accelerated by 5.25% (y.o.y) in Q4 2021, which resulted from accelerating budget realization. As of 31 December 2021, government expenditure was recorded at 101.34% of 2021 budget or IDR2,786.76 trillion. At the same time the PEN budget realization was recorded at IDR658.6 trillion on 31 Desember 2021 or 88.4% of the total PEN budget of IDR744.77 trillionm up from 53% on 17 September 2021. For the whole year of 2021, the economy expanded by 3.69% (y.o.y), suggesting economic recovery compared to 2.07% contraction in 2020. Although Omicron cases was surging, we expect the impact to be minimal as GoI imposed more lenient curbs considering high vaccination rates and the fact that Omicron variant is less severe compared to previous variants. Household consumption, investment, and imports are to continue their increasing trend, suggesting domestic recovery.

"After an intense period marked by the beginning of Covid-19 in 2020, the society has gradually adapted to the pandemic situation in 2021. Thus, several sectors that can adjust with the situation were allowed to return to its usual business despite the strict health protocol measures."

Zooming in on household consumption, which makes more than half of the GDP, it expanded by 3.55% (y.o.y) in Q4 2021, higher than the previous three months at 1.02% (y.o.y). All consumption components recorded positive growth during the last thre mothts of 2021 with consumption of food and beverage, transportation and communication, and equipments that account for 75% of total household consumption posted growth of 3.24% (y.o.y), 5.34% (y.o.y), and 3.09% (y.o.y), respectively,. The positive growth is thanks to eased mobility restrictions, rising vaccination rates, and year-end holiday. For overall 2021, household consumption grew by 2.02% (y.o.y), accelerating from 2.63% (y.o.y) contraction last year.

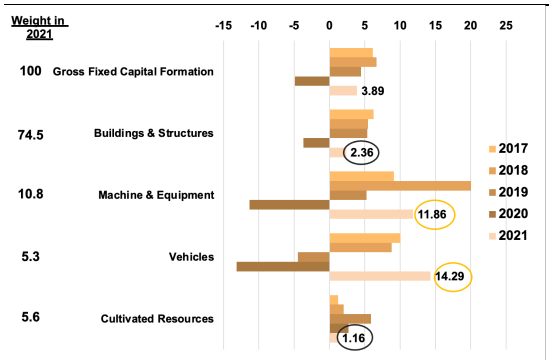
Moving on to investment, it posted an accelerating growth of 4.49% (y.o.y) in Q4 2021 compared to 3.76% (y.o.y) in the previous three months. Investment in buildings & structures that accounts for 74.5% of total investment recorded a positive growth of 2.48% (y.o.y) in Q4 2021, slightly lower than 2.26% (y.o.y) in Q3 2021.Investment in machine and equipment also experienced growth of 13.46% (y.o.y) during the Q4-2021, a slight increase from 11.49% (y.o.y) in Q3-2021. These suggests the resumption of investment after a short break during Q3-2021.

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



Source: CEIC

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

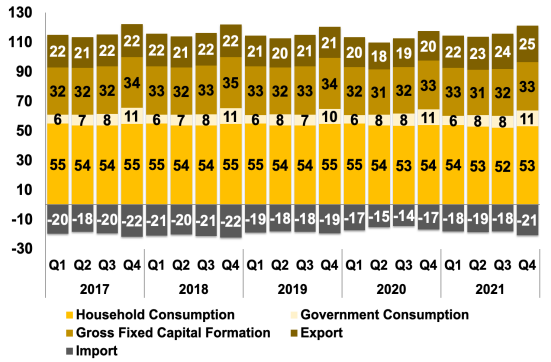


Source: CEIC

"In 2022, we expect a further improvement in credit performance although a sharp pick-up in lending still seems unlikely as the liquidity normalisation has been taken by BI since March 2022 and the current uncertain situation will force BI to tighten monetary policy in the near term."

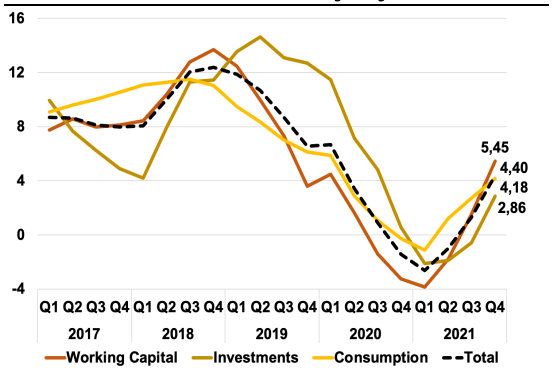
Furthermore, looking deeper into credit performance, total credit growth for overall 2021 has been continued to accelerate and gradually rebounded towards its normal growth trajectory. Total credit growth continued to accelerate to 4.40% (y.o.y) in Q4-2021, the highest in nearly two years since the beginning of the pandemic era. All types of credit have been shown notable performances, with the highest growth seen in working capital credit which sharply increased to 5.45% (y.o.y) from 1.51% in the previous quarter. Followed by consumption and investment credit which respectively accelerated to 4.18% and 2.86% (y.o.y) compared to 2.73% and -0.57% (y.o.y) in Q3 2021. In 2022, we expect a further improvement in credit performance although a sharp pick-up in lending still seems unlikely as the liquidity normalisation has been taken by BI since March 2022 and the current uncertain situation will force BI to tighten monetary policy in the near term. The latest detailed data in January 2022 showed that total credit grew by 5.79% (y.o.y), slightly higher than 5.24% (y.o.y) growth in December 2021. Working capital, investment, as well as consumption credit accelerated to 7.36%, 4.06%, and 4.98% (y.o.y) respectively in Jan 2022 compared to 6.32%, 4.01%, and 4.67% (y.o.y) in Dec 2021.

Figure 7: Shares of GDP Components, 2017Q1-2021Q4 (%)



Source: CEIC

Figure 8: Credit Growth by Purposes, 2017Q1-2021Q4 (y.o.y, %)



Source: CEIC

Banking industry has also shown a favorable performance with improved asset quality as NPL decreased to 3.08% in February 2022, down from 3.10% in Jan 2022.

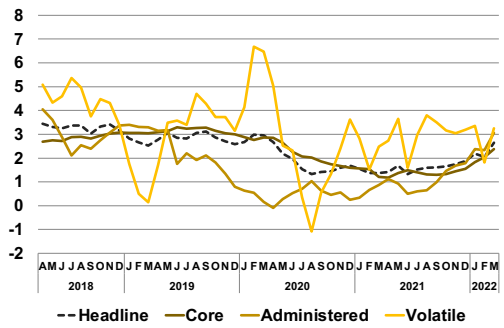
Deposit growth decelerate but remained solid at 11.1% (y.o.y) compared to 12.1% in Jan 2022. As monetary normalization through an increase in Rupiah reserve requirement ratio (RRR) for both conventional and sharia commercial banks has entered the second month and will continue until September this year, liquidity continued to decelerate, as proven by slower M2 growth to 12.5% (y.o.y) in February, fell from 13% (y.o.y) in January. If loan growth comes higher than expected, the banking sector should be wary of tightening liquidity. Overall, we expect demand for credit to strengthen this year as the economy continues to improve, particularly after a storm passed due to the Omicron variant marked by the total number of Covid-19 cases that has been relatively low.

Strengthening Domestic Demand is Starting to be Seen

The annual figure of inflation rate began to increase and was recorded at 2.64% in March 2022, following the soaring prices of various commodities due to global economic turmoil. Along with it, core inflation also edged up to an 14-month high of 2.37% (y.o.y) in March 2022, from 2.03% (y.o.y) in the previous month, suggesting recovering demand as public's purchasing power gradually improves. Volatile food component jumped to 3.25% (y.o.y), increased from the previous month which was recorded at 1.81% (y.o.y). Meanwhile, it comes as no surprise that administered prices grew by 3.06% (y.o.y), continuing its upward trend since June 2021, as public mobility increases. The price increase was driven by rising airfares during the Ramadhan and the upcoming Eid al-Fitr celebrations.

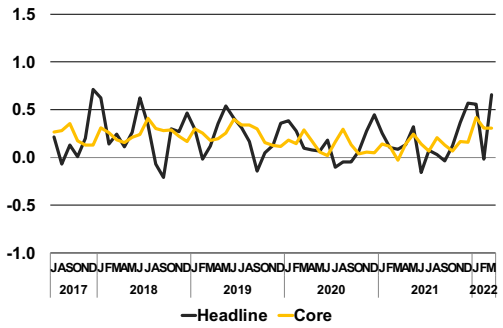
"We see that inflation rate is expected to accelerate this month like its usual seasonal trend during Ramadan and Eid al-Fitr celebrations."

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



Source: CEIC

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



Source: CEIC

On a monthly basis, March 2022 inflation rate was recorded at 0.66% (m.t.m), after experiencing deflation of 0.02% (m.t.m) in February 2022. This was influenced by rising inflation in the volatile food and administered prices component, amidst the relatively stable core inflation. The volatile food component experienced 1.99% (m.t.m) inflation in March 2022, an increase compared to the previous month's 1.50% (m.t.m) deflation. By commodity, these developments were mainly caused by the increase in the prices of red chili, cooking oil, and broiler eggs, along with weather constraints that disrupted production activities, the GoI's decision to revoke the one-price policy on cooking oil and release it according to the market price, as well as the increase in production costs for food products. We see that inflation rate is

expected to accelerate this month like its usual seasonal trend during Ramadan and Eid al-Fitr celebrations. Not to mention, the ongoing massive spikes in energy, agriculture, and gold prices resulting from the Russia-Ukraine conflict which will also have an impact on domestic inflation.

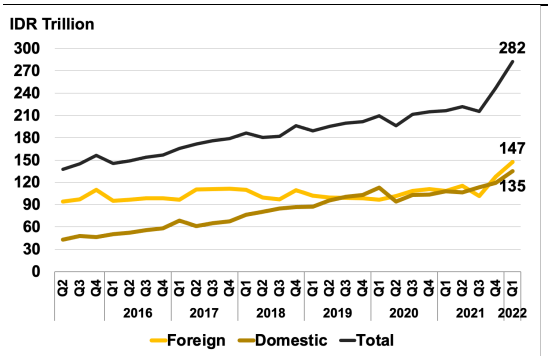
Highest Investment Realization in Past Decade

The Investment Coordinating Board (BKPM) recorded the investment realization of IDR282.4 trillion during Q1-2022 or grew by 28.5% (y.o.y), which is the highest amount in the last ten years. The investment realization in Q1-2022 is divided into two parts. First, the domestic investment which was recorded at IDR135.2 trillion or grew by 25.1% compared to the previous year. Second, the foreign investment (FDI) which was recorded at IDR147.2 trillion or grew by 31.8% compared to the 2021. The transportation, warehouse and telecommunications sectors are the main supporting sectors for the realization of domestic investment. As for the FDI realization, the largest contributory sector is the base metal, metal goods and its equipment industry.

From its distribution, the investment value in Java reached IDR133.7 trillion, while outside Java was recorded at IDR148.7 trillion. An increase of 16.6% from Q4-2021 which was recorded at IDR127.5 trillion shows that the realization of investment in Java and outside Java began to improve and stabilize at the beginning of this year. This can also be seen with the entry of Riau and Central Sulawesi into the top five investment locations for FDI and DDI.

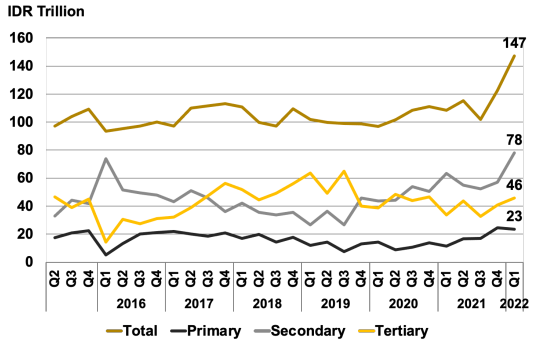
"This shows that despite being in the midst of global economic turmoil and the impact of the Covid-19 pandemic, investors' confidence, especially from the industrial sector, is still very high."

Figure 11: FDI and Domestic Investment (Nominal)



Source: CEIC

Figure 12: FDI Realization by Sectors (Nominal)



Source: CEIC

Based on the business sector, the three sectors experienced an increase except the primary sector. The main contributor to the increase in the FDI realization itself came from the secondary sector, with an increase of almost 37% compared to the previous quarter. This shows that despite being in the midst of global economic turmoil and the impact of the Covid-19 pandemic, investors' confidence, especially from the industrial sector, is still very high. In addition, this is also supported by better pandemic control compared to the previous year, as well as the positive effects of the relaxation of the mobility restrictions policy.

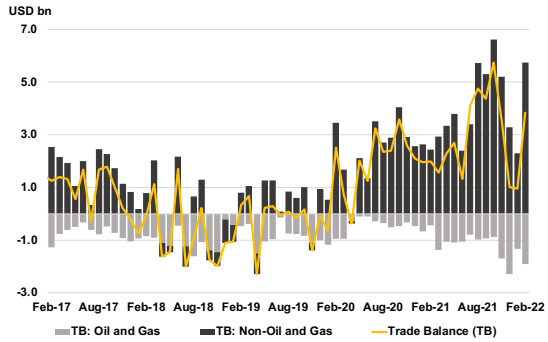
Soaring Commodity Prices Maintains the Trade Surplus

Indonesia's foreign trade continues to record relatively robust performance in early 2022, despite the external pressures stemming from the global recovery and the conflict between Russia and Ukraine. The external events have forced the commodity prices to rise, both oil and gas as well as non-oil and gas, as the result of higher demand from economic recovery after Covid-19 pandemic and supply chain disruption from the ongoing geopolitical tension. Even though the volume of global exports and imports was growing slower due to disrupted demand from Russia as they get several bans and sanctions from EU and US, the soaring commodity prices brought fruitful momentum for overall Indonesia's trade balance, which recorded another surplus at USD9.33 billion in Q1-2022. The amount of surplus was even 20% (y.o.y) higher compared to the same period in 2021. The surplus was the result of higher growth in exports than imports, which is mainly driven by the high commodity prices, particularly coal. The exports of non-oil and gas jumped 36% (y.o.y) in Q1-2022 from the figure in Q1-2021 as the coal prices was more than doubled to hit all-time high record at around USD423 per ton in mid-March. Moreover, the threat of exports contraction due to lower demand from Russia and Ukraine was unseen in the trade balance as these two countries had a relatively small portion to overall Indonesia's trade.

"The limited growth of non-oil and gas imports might be explained by the incomplete recovery from the pandemic and the indicatively businesses' gloomy sentiment on the Russia-Ukraine conflict."

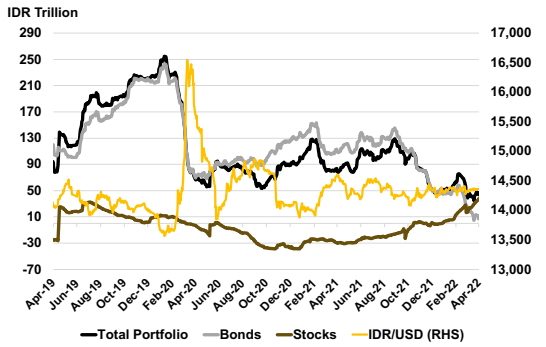
On the import side, overall imports only grew by 31% (y.o.y) from the figure in the same period in 2021. The major contributor to import figure in Q1-2022 was the higher prices of crude oil as the imports of oil and gas picked up by 68% (y.o.y) compared to Q1-2021. While the non-oil and gas imports only grew 26% (y.o.y). The limited growth of non-oil and gas imports might be explained by the incomplete recovery from the pandemic and the indicatively businesses' gloomy sentiment on the Russia-Ukraine conflict. Nevertheless, Indonesia's imports are still slower than exports which resulted in trade surplus in Q1-2022. Indonesia maintained to enjoy trade surpluses as the figure of Indonesia's exports are still mainly contributed by raw materials and commodity. Around 35% of the total exports were mineral resources, vegetable and animal fat, as well as pearl, diamond, and precious metals. Meanwhile, more than 80% of the total imports are the raw and capital goods used by the businesses. On monthly basis, the trade surplus in March was recorded as the 23rd consecutive surpluses since April 2020. The surpluses coupled with positive growth in imports indicate that the economy is improving, but the pace is likely to be gradual.

Figure 13: Monthly Trade Balance (Nominal) (Feb'17-Feb '22)



Source: CEIC

Figure 14: Exchange Rate and Accumulated Short-Term Capital Inflow (Apr'19-Apr'22)



Source: CEIC

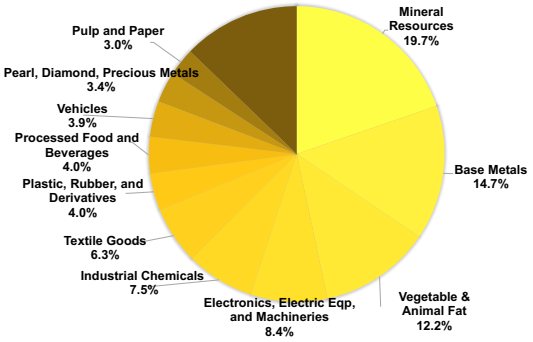
"The current account in Q1-2022 will most likely posted slight surplus or limited deficit as Indonesia maintained to gather higher capital inflows than outflows amid the ongoing geopolitical tensions and the acceleration of monetary tightening"

In 2021, Indonesia was recorded the first current account surplus of USD3.3 billion or equivalent to 0.3% of GDP since 2011, thanks to soaring commodity prices and gradual global demand recovery. However, the trend of current account surpluses have been narrowing in Q4-2021 with the surplus recorded only at USD1.42 billion. The figure was far lower than USD4.97 billion surplus in the previous quarter due to fast acceleration growth of imports. Continuing last year trend, the positive trade balance of goods in the first three months of 2022 is expected to help Indonesia to maintain the current account, net capital flows, and Rupiah. The current account in Q1-2022 will most likely posted slight surplus or limited deficit as Indonesia maintained to gather higher capital inflows than outflows amid the ongoing geopolitical tensions and the acceleration of monetary tightening. The inflows were partially triggered by the increase in exports due to soaring commodity prices, while the lower than expected outflows might be explained by the decline of foreign ownership in domestic assets during the pandemic. Nevertheless, the current account for overall 2022 might turn back into its negative territory as the signs of full recovering demand toughens.

"Nevertheless, the current account for overall 2022 might turn back into its negative territory as the signs of full recovering demand toughens."

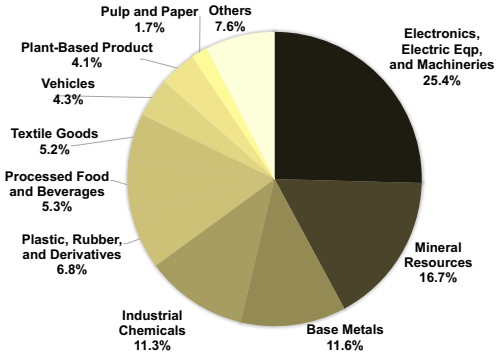
Further, the trade surpluses coupled with slightly positive capital flows has led to maintained Rupiah in Q1-2022. Rupiah is one of the best performers with the least depreciation rate amongst other developing country currencies in Asia. Rupiah is only depreciated by 0.66% (ytd), the lowest compared to Thai Bath, Malaysian Ringgit, Philippine Peso, and Indian Rupee. BI also managed to maintain the adequate level of foreign exchange reserves at USD139.1 billion in March 2022. The reserves are equal to finance 7.2 months of imports or 7 months of imports plus the government's foreign debt, which is significantly higher than the international adequacy threshold of only around three months of imports. Even though the amount is slightly decreased by USD5.8 billion from the reserve position of USD144.9 billion in end of 2021, BI sees that the current foreign reserves are capable of supporting external sector resilience and maintaining macroeconomic and financial system stability.

Figure 15: Indonesia Export Profile (January-February 2022)



Source: CEIC

Figure 16: Indonesia Import Profile (January-February 2022)



Source: CEIC

The favorable performance of Indonesia's exports due to rising commodity prices has helped maintain capital flows and stabilize the exchange rate as demand for Rupiah increased in Q1-2022. However, the potential risks to foreign trade and financial market remain for the rest of 2022 as the global prices are still fluctuating. Investors' confidence on Indonesia's market will be highly influenced by the process of monetary tightening and domestic economic performance amid the surging commodity prices. In the last four months, GoI has put efforts in maintaining the energy and food prices through fuel and bulk cooking oil subsidies. The BLT program compensating the higher prices of fuel and cooking oil was also given by GoI to dampen the impact of higher domestic prices on economic activities. The efforts contributed to the relatively manageable domestic inflation in Q1-2022. However, such policies might pose threat to fiscal balance if the fluctuation of global prices persists. GoI needs to formulate the most effective policies in responding the global prices volatility while sticking on the recovery plan to bring back the fiscal deficit under the threshold of 3% in 2023.

On monetary policy side, BI has managed to maintain its policy rate at 3.50% so far despite facing pressures from the ongoing monetary tightening. Unlike the other countries, such as South Korea, South Africa, and Canada, which already increase their benchmark rate, BI has room to hold the policy rate as Indonesia enjoyed stable Rupiah, trade surpluses, and robust domestic economic fundamentals. BI also had limited pressures from inflation amid the surging commodity prices as GoI persistently maintained the energy and food prices. Inflationary pressures, however, persists because BI need to put concern about the potential inflation driven by recovering demand and BI required to maintain the inflation at around their target of 2-4% (y.o.y). In the near future, BI should maintain its pro-stability monetary stance and pro-growth macroprudential policy during the current uncertain times. BI might also needs close coordination with GoI to carefully assess the domestic conditions, particularly domestic inflation, before deciding its next move on policy rates.