LPEM FEB UI
UNIVERSITAS INDONESIA

Macroeconomics Analysis Series

Indonesia Economic Outlook

Q1-2023

Key Figures

GDP Growth (Q3 '22)
5.72%

Inflation (y.o.y. December '22)
5.51%

Credit Growth (y.o.y. Q3 '22)
10.78%

BI Repo Rate (7-day, January '23)
5.75%

Current Account Balance (% GDP) (Q3 '22)
1.3%

IDR/USD (January '23)
IDR14,880

Macroeconomic and Political Economy Research Group

Jahen F. Rezki, Ph.D.
jahen@lpem-feui.org

Syahda Sabrina
syahda.sabrina@lpem-feui.org

Nauli A. Desdiani
nauli.desdiani@lpem-feui.org

Teuku Riefky
teuku.riefky@lpem-feui.org

Amalia Cesarina
amalia.cesarina@lpem-feui.org

Meila Husna
meila.husna@lpem-feui.org

Faradina Alifia Maizar
faradina@lpem-feui.org

No Time for Complacency

Highlights

- *Commodity windfall and robust economic performance have supported Indonesia in managing the GDP growth of 5.72% (y.o.y) in Q3-2022.*
- *Following the lesser low-base effect and the deterioration of commodity prices, we predict GDP to grow lower at 4.56% (y.o.y) in Q4-2022 and 5.19% for FY2022.*
- *High GDP growth in Q3-2022 was contributed by solid demand and production activity, commodities windfall, and delayed fuel price hikes.*
- *Household consumption continues to grow above 5% at 5.39% (y.o.y) in Q3-2022 with impressive growth in transportation & communication group suggesting mobility keeps increasing considering Covid-19 is relatively under control.*
- *Total credit has accelerated to 10.78% (y.o.y) in Q3-2022, higher than 9.6% (y.o.y) in the previous quarter.*
- *The annual inflation rate of 5.51% (y.o.y) in December 2022 was higher than the previous month, in line with the year-end seasonal pattern.*
- *Investment recorded a new high in the last quarter of 2022, showing that investors' confidence is still very high despite being in the midst of global economic turbulence.*
- *Trade balance is still persistently in positive territory in Q4-2022, albeit lower than the previous quarter due to a gradual decreasing trend of commodity prices.*
- *The current account balance may be reduced further at the end of 2022 and at the beginning of 2023 as the lower performance of trade surplus in goods and larger deficit in services.*

Despite the economic bleakness in the global economy following serious disruptions of prolonged Covid-19 spread, geopolitical tension, rising food and energy prices, and overheating inflation throughout 2022, Indonesia has managed to persistently grow at 5.72% (y.o.y) in Q3-2022. The figure is the highest level in the last ten years and marks its third consecutive quarter having a growth rate higher than expectations. The growth was mainly supported by the solid demand and production activity as Indonesia managed to channel the commodity windfall profit to increase the budget and delay the fuel price hike. Moreover, the relatively low growth in the same period previous year has also contributed to the higher-than-expected growth in Q3-2022. Manufacturing industry as the biggest sector to contribute to GDP recorded a significant growth increase from 4.01% (y.o.y) in Q2-2022 to 4.83% (y.o.y) in Q3-2022. From expenditure side, the robust household consumption of 5.39% (y.o.y) and investment growth of 4.96% (y.o.y) has played an important role in boosting economic growth.

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

Q4-2022	FY2022	FY2023
4.51 - 4.61%	5.18% - 5.20%	4.9% - 5.0%

Indonesia is also facing the threat of high prices with headline inflation continues pose higher than BI's target range of 3.0±1% due to the high commodity prices that have led to fuel price adjustments. However, the inflationary pressure in 2022 was lower than initially forecasted and was still considered relatively benign, thanks to delayed fuel prices and a well-coordinated inflation normalization policy by BI and GoI. Moreover, the period of persistent trade surpluses may end soon due to the gradual decreasing trend of commodity prices. All things considered, Indonesia might not grow above 5% in Q4-2022 as the deterioration of the low-base effect and lower commodity prices at the end of 2022 compared to the second and third quarters of 2022. However, the economy will still grow at positive territory at 4.56% (y.o.y) in Q4-2022 (estimate range from 4.51% to 4.61%); making the estimation of FY2022 at 5.19% (estimate range of 5.18% - 5.20%).

Back to Fiscal Discipline

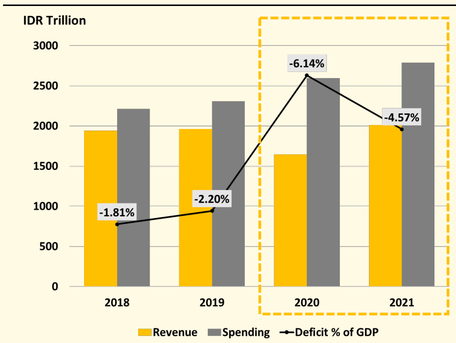
Fiscal Impact of Covid-19

Following the Covid-19 outbreak, GoI responded by stretching its budget to control the pandemic and revive the economy. Expenditures were up caused by massive health and social spending to minimize the health and economic impact of Covid-19, while revenues were down following the economic slowdown. The rapid spending expansion in response to Covid-19 was packaged as the National Economic Recovery program (Program Pemulihan Ekonomi Nasional/PEN). In 2020, GoI spent IDR695.20 trillion, equivalent to approximately USD51.3 billion, for the National Economic Recovery program. The budget for the PEN program was also increased to IDR744.77 trillion in 2021. Looking at the composition of the state budget, the share of the National Economic Recovery program amounted to no less than 27%, both in 2020 and 2021, suggesting its significance in the state budget.

The PEN program was designed to focus on maintaining the welfare of the people, minimizing the worsening unemployment and poverty, and especially managing the health aspect. In 2020, GoI allocated IDR203.9 trillion for the social safety net scheme, which was proportionate closely to 29% of the total of the National Economic Recovery program. In 2021 the allocation for such a scheme was increased to IDR214.96 trillion. Moreover, the program also focuses on businesses and SMEs that were highly exposed to any movement during the pandemic, mainly reflected by IDR244.07 trillion in the budget distribution in 2020 and IDR225.23 trillion in 2021.

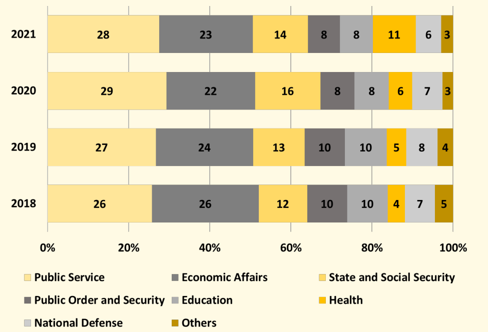
The program also allocated a substantial amount to the health sector. In 2021, the budget for the health sector accounted for IDR214.96 trillion or heavily increased from IDR87.55 trillion in 2020. Several major purchases under the health sector scheme include spending for patient treatment, vaccination, and tax incentives. In general, the overall allocation pattern for the National Economic Recovery program was aligned with the growing trend in government spending. Looking at the 2020 state budget, the realization for health spending grew 48% and reached its peak in 2021 with an increase of approximately 101%. Rising spending was also recorded in the realization of the state and social security budget, with a 55% growth from 2020. Moreover, public service spending presented further substantial growth of 34%. Overall, the total spending side of the government budget experienced a notable increase of 22% from the previous year.

Figure A: Realization of Revenue and Spending in the State Budget 2018-2021



Source: Ministry of Finance

Figure B: Spending by Sector as % of Total Central Government Expenditure 2018-2021



Source: Ministry of Finance

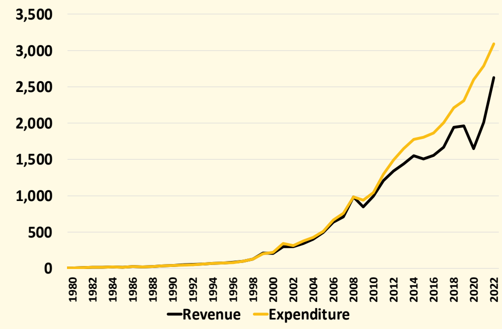
Unfortunately, the challenge has been far more complicated as those circumstances, which required an immense amount of financing, happened when the government experienced a significant shrink in the revenue side. In 2020, the realization of government revenue marked a 17% decrease from its amount in 2019. This was mainly driven by the tax-imposed activities that have become more subtle since the beginning of Covid-19, such as VAT and personal income tax that decreased by 15% and 23%, respectively. Moreover, tax supports that consist of tax holidays and exemptions for SMEs and other scales of businesses that could not withstand the liquidity risks also added pressure to the government's limited revenues.

The higher spending and lower revenue have forced the fiscal stance to go beyond its average level. As a result, in 2020, the fiscal deficit declined substantially to 6.1% of GDP. Regarding the official rule of law No.17/2003, the deficit level in the state budget should be maintained at 3% of GDP at most to ensure fiscal prudence. However, during the unprecedented time of Covid-19, achieving this mandate was nearly impossible as fiscal policy urgently needed to play its role of shock absorber and behave in a countercyclical manner. To provide a legal basis for fiscal policymakers to take necessary actions during that time, GoI declared the Government Regulation in lieu of Law (Perppu) No.1/2020 as permission to execute countercyclical fiscal measures during the pandemic and allow the fiscal deficit to go beyond 3% until the end of Fiscal Year 2022 and revert to 3% as of Fiscal Year 2023. Later, the regulation was constituted under Law No.2/2020 on National Budget Policy and Financial System Stability Under Pandemic Circumstances. The law also allows GoI to take necessary actions to minimize the damage to Indonesia's economic and health aspects and explore alternative sources of funds to finance the massive spending, such as issuing government bonds and taking a loan from domestic and international sources. Consequently, it is no longer surprising to see the rise in central government debt by approximately 40% compared to its usual level.

History of Indonesia's Fiscal Management

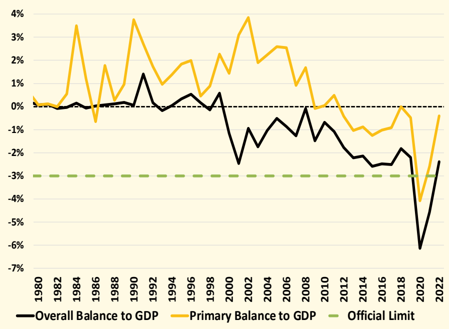
Historically, Indonesia has maintained a responsible and conservative fiscal policy that sustains aggregate fiscal discipline. In the years prior to the Asian Financial Crisis, the GoI's budget experienced a moderate surplus of almost 2% of GDP, and public debt was relatively low at around 25% of GDP. In addition, despite a regressive political situation with increasing state control over society, Indonesia enjoyed a high economic growth rate; thus, expanding public resources and development policies were at the forefront. However, Asian Financial Crisis has brought a calamitous shock and affected Indonesia's economy profoundly. The economy shrank by over 13% of GDP in 1998. Government debt also rose dramatically in only a few years, from 23.4% of GDP in 1996 to 87.4% in 2000. This crisis triggered political upheaval in Indonesia, marked by the resignation of long-serving President Soeharto and entered a new political era of democracy called the Reform Era.

Figure C: Government Revenue and Expenditure (IDR Trillion)



Source: CEIC

Figure D: Government's Overall and Primary Balance to GDP (%)



Source: CEIC

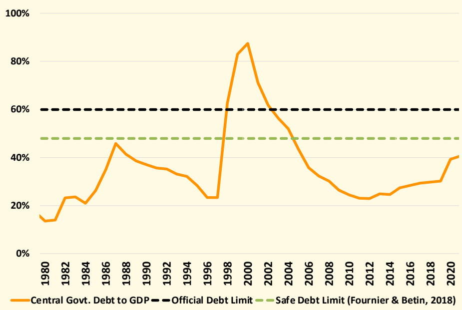
The Indonesian budgeting system was transformed following the 1997/1998 economic crisis, which involved a new legal framework for budgeting, a unified and more comprehensive budget, massive fiscal decentralization and the empowerment of local government, and a refined role of the Parliament in the budget process. This is followed by a series of successive laws adopted in the early 2000s and extensive consultations involving a multitude of stakeholders. Among these laws, one notable remark is that Indonesia introduced a fiscal rule as specified in the 2003 State Financial Law. The law stated that Indonesia adopts a fiscal rule which caps annual deficits at 3% of GDP and accumulated debt at 60% of GDP, which is inspired by the Maastricht Treaty criteria for the Economic and Monetary Union in Europe.

As a developing country with limited fiscal space and fiscal prudence being unwarranted and prone to political influence, imposing fiscal rule serves as a protection against the political risk that could potentially jeopardize long-term debt sustainability. The fiscal rule aimed to solidify the economic recovery and to promote future fiscal discipline by enacting these fiscal responsibility criteria into law and forcing any ruling administration to be fiscally prudent, essentially institutionalizing the fiscal discipline.

The impact of the fiscal rule is immediately materialized. In 2003, the government's overall deficit was 1.74% of GDP, and the debt level was at 56.3% of GDP. Since the passing of State Financial Law in 2003, the debt ratio has reserved its course and consistently stayed well below the threshold of 60%, though it has been argued that Indonesia's safe debt limit should be lower (Fournier and Betin, 2008). Between 2003 and 2011, Indonesia successfully managed the budget deficit below the threshold with the average deficit-to-GDP of around 0.97% and consistently recorded a primary surplus (except in 2009), which transpired into a significant drop in debt-to-GDP ratio to 23.1% in 2011.

From 2011 onwards, GoI shifted its spending policy towards a more expansionary stance. This resulted in a persistent primary deficit in the following years due to greater spending despite the struggle to improve Indonesia's comparatively low tax ratio. With the average budget deficit increased to 2.22% during 2011-2019, Indonesia's debt-to-GDP ratio climbed up and reached 30.2% in 2019. Thanks to aggressive fiscal discipline in the previous years, Indonesia could afford an episode of spending expansion while still being fiscally prudent and below the threshold set by the fiscal rule.

Figure E: Government Debt to GDP (%)



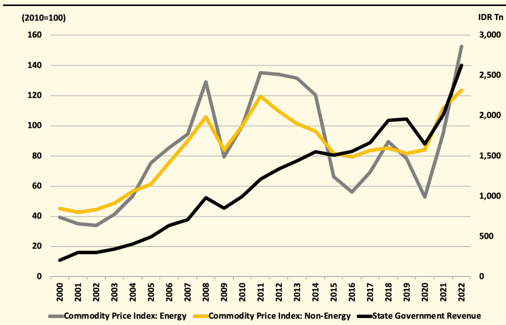
Source: IMF, OECD

The improvement in fiscal management has strengthened Indonesia's public debt sustainability. In the last couple of years, Indonesia has experienced an improvement in its sovereign credit rating. For instance, Indonesia's credit rating by S&P has been upgraded seven times since 2003 from B- to BBB, making it into the "investment grade" bracket. Consequently, Indonesia is able to issue debt at a lower rate which also eases the future fiscal burden and enhances debt sustainability. Thanks to the implementation of the fiscal rule, the virtuous cycle of public debt management have been set in motion. For a developing country with numerous long-term development agendas, it has been shown historically that fiscal rule plays a crucial role in widening the fiscal space and enhancing fiscal capacity to absorb potential shock.

Consolidation Efforts to Continue in 2023

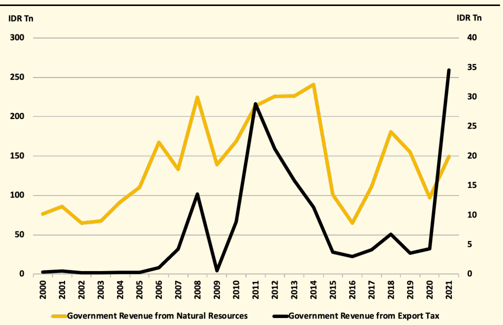
Despite pressures from the Covid-19 pandemic coupled with a looming global economic slowdown and geopolitical uncertainties that continue to threaten the economy, Indonesia is considered resilient with its manageable economic growth. This can be partly attributed to high commodity prices, which have supported economic growth and contributed to fiscal revenues, considering that most of Indonesia's merchandise exports were commodities. Figure F shows a positive correlation between the commodity prices index, especially for the energy component, and Indonesia's state government revenue. One of the impacts of this windfall can be seen from the increase in GoI revenue from natural resources and export taxes in 2022, where the majority of the export taxes also come from natural resources exports.

Figure F: Commodity Prices Index and Indonesia's Government Revenue



Source: CEIC and The World Bank

Figure G: Indonesia's Government Revenue from Natural Resources and Export Tax



Source: CEIC

On the other hand, the central government expenditure realization in 2033 was recorded at IDR2,274.52 trillion (98.82% of the budget ceiling), recording a growth of 13.69% (y.o.y) compared to 2021. The increase in the realization of central government expenditure was mainly influenced by the rise in subsidy spending, which grew 4.43% (y.o.y) to maintain the availability of affordable subsidized goods amidst rising commodity prices. GoI set the state revenue and expenditure target to IDR2,266.2 trillion and IDR3,106.4 trillion, respectively, in the state budget for 2022 (Perpres 98/2022). Budget realization in 2022 exceeded the total revenue target of 15.9%, especially on income tax and commodity-related revenue components. Meanwhile, the expenditure realization was lower by around 0.5% than the target set by the GoI. The commodity windfall has also helped GoI reverse a high pandemic-level fiscal deficit and slowly return to the statutory mandated level of under 3%. It is predicted that in 2022, the fiscal deficit will decrease to IDR 840 trillion or 4.5% of GDP (Perpres 98/2022) from 6.14% in 2020. However, the realization as of December 2022 shows that it has managed to reach IDR 464 trillion or 2.4% of GDP in 2022.

In the 2023 state budget posture, state revenue is targeted to reach IDR 2,463 trillion, while the need for state expenditure is estimated at IDR 3,041.7 trillion, resulting in a budget deficit of IDR

598.2 trillion, or 2.85% of GDP. On the revenue side, the targeted revenue is projected to be lower by 7% compared to the revenue realization in 2022 due to the normalization of commodity prices, suggesting state revenue dependence towards commodity price performance. Thus, non-tax revenue (PNBP) is estimated to reach IDR 441.4 trillion or a decline of 8.3% from last year's figure due to projected movements in commodity prices, which are expected to moderate ahead. This transpires into the need to reform state budget revenue through various strategies to be more stable and less reliant on commodities. This year, tax revenue optimization must be pursued under economic recovery and supported by the effectiveness of tax reform. Various tax policies and reforms, including the Tax Harmonization Law (UU HPP), are expected to support the optimization of tax revenues in 2023. With this strategy in place, tax revenues in the 2023 state budget are targeted to reach around IDR 2,021.2 trillion or grow 5% (y.o.y).

Tabel H. State Budget (APBN) 2022-2023 (IDR Trillion)

	2022			2023	
	APBN	**Realization***	**Delta**	**APBN**	**Delta to 2022 Realization**
A. State Revenue	1,846.1	2,626.4	780.3	2,463.0	(163.4)
Highlighted Revenue Components					
1. Income Tax	680.9	998.2	317.3	935.0	(63.2)
2. VAT	554.4	687.6	133.2	743.0	55.4
3. Commodity-Related Revenue	127.9	308.5	180.6	206.2	(102.3)
B. State Expenditure	2,714.2	3,090.8	376.6	3,061.2	(29.6)
Highlighted Expenditure Components					
1. Education	542.8	541.7	(1.1)	612.2	70.5
2. Social Security	429.9	461.6	31.7	476.0	14.4
3. Infrastructure	367.8	373.1	5.3	391.7	18.6
4. Subsidy	206.9	252.8	45.9	298.5	45.7
5. Health	256.0	176.7	(79.3)	178.7	2.0
6. Food Security	92.2	36.1	(56.1)	104.2	68.1
C. Primary Balance	(462.2)	(78.0)	384.2	(156.8)	(78.8)
D. Surplus/Deficit	(868.0)	(464.3)	403.7	(598.2)	(133.9)
% Surplus/Deficit to GDP	(4.9)	(2.4)	2.5	(2.8)	(0.5)
E. Financing	868.0	583.5	(284.5)	598.2	14.7

**unaudited realization as of December 2022*
Source: Nota Keuangan APBN 2023 dan APBNKita, Ministry of Finance

On the spending side, the effort taken by the GoI is to strengthen quality spending or to promote "spending better", focusing on cost-effectiveness and priority spending (i.e., human capital, physical capital, and institutional reform). State expenditure is allocated at IDR 3,061.2 trillion, covering the central government's spending at IDR 2,246.5 trillion and regional transfer at IDR 814.7 trillion. Observing the allocation of expenditure components, government outlays in health and social security reduced substantially, contracting by 16% and 5%, respectively, compared to last year's allocation. In terms of the health aspect, the decline occurred because the Covid-19 particular health budget no longer existed this year, in line with the PEN program that ends in 2022 since the pandemic is under control. However, the GoI is currently implementing health reforms by increasing routine health spending in 2023, primarily to transform the national health system and accelerate stunting reduction. Accordingly, whereas spending on social security has decreased in value due to the absence of a PEN program in 2023, the amount of budget allocated is substantial compared to pre-pandemic conditions, with policy directions directed at improving the recipient database by developing the Social Economic Registration (Regsosek), improving adaptive social protection, providing on-target subsidies based on beneficiary targets as well as accelerating extreme poverty eradication. Meanwhile, food security and education spending have seen the highest growth rates of 11% and 6%, respectively. The increased allocation on food security aims to increase agricultural and fisheries productivity to overcome the production deficit that exists in several major food commodities. While an increase in education spending in 2023 is intended to enhance the quality and competitiveness of human capital in order to adapt to the post-pandemic era. GoI also increased budget allocation for infrastructure spending and subsidies by 5%. Infrastructure development this year is intended to promote economic transformation by improving ICT-based infrastructure and accelerating the development of national priority projects, including the development of the new capital city (IKN). Subsidy spending is directed at price stabilization, maintaining purchasing power, as well as supporting MSMEs.

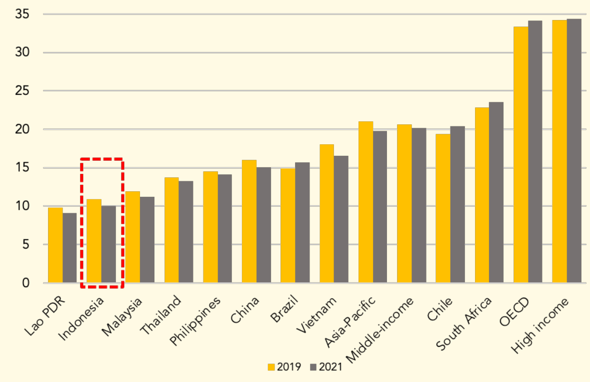
The road ahead will be bumpy, and the challenge will be to maintain the state budget's role as a shock absorber in the face of current escalating global risks. Due to the combination of good policy and good luck, GoI has been able to reach a deficit below 3% in 2022. With continuing fiscal consolidation efforts, maintaining the deficit below 3% of GDP in 2023 may be challenging but still attainable. State revenue may not be as high as in 2022 since commodity prices are expected to fall due to declining global demand. The prospect of a worldwide recession may further correct commodity prices, thus limiting the government's windfall in 2023. Therefore, to maintain a deficit level below 3%, GoI must focus on optimizing revenues by implementing effective tax reforms and looking for other stable sources of revenues in the long term. In addition, spending must be directed toward bolstering economic recovery and structural reforms by promoting spending better.

Sustaining Progress Towards Budget Reshaping

The commodity windfall has undeniably brought advantages to Indonesia's fiscal position in 2022, with government revenue growing by 18% from a year earlier. The total government revenue collected from the taxes and excises recorded at IDR2,035 trillion, or equal to 10.4% of the projected 2022 GDP. Yet, Indonesia is one of the countries with the lowest tax-to-GDP ratio compared to most other developing countries. Indonesia's tax ratio in 2019 pre-pandemic was 11.6%, below the Asia Pacific average of 20.3%. It was also one of the lowest among ASEAN peers, such as Vietnam (24.2%), the Philippines (18.1%), Thailand (17.2%), and Malaysia (12.4%). Looking into the components of tax revenue, Indonesia has limited revenue from income and profit compared to other countries. The revenue generated from income and profit tax was only recorded at 4.9% of GDP in 2019, much lower than Malaysia (8.5%) and the Philippines (6.4%). The stubbornly low tax-to-GDP ratio in Indonesia can be partially explained by the higher degree of informality compared to other countries, except Lao PDR (Figure I). The high ratio of people in the informal sector means less income is being reported and taxed by the tax authority. To increase the tax revenue, the GoI needs to migrate businesses from the informal to the formal sector. Reducing regulatory costs and improving enforcement is most likely the optimum policy combination for reducing informality and raising tax collections (Ulyssea, 2021)[1].

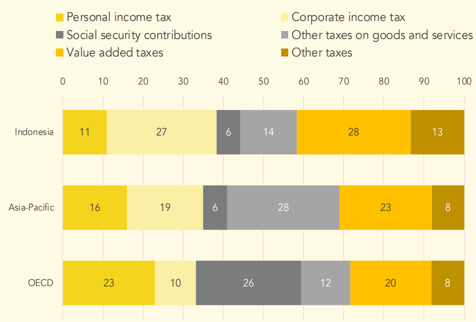
Moreover, the GoI should continue to determine other new sources of income with less reliance on commodities in order to anticipate the impact of commodity price volatility on tax revenue. The GoI has implemented several measures to broaden the tax base as well as increase tax collection; one of them is urging taxpayers to participate in the voluntary disclosure program. The GoI successfully collected around IDR22.3 trillion in additional taxes throughout 2022 from 308 thousand participating taxpayers in the voluntary disclosure program who have not disclosed possession obtained since 2016. The tax authority has also made significant changes through the Tax Regulations Harmonization Law (HPP Law no.7/2021), which allowed the government to increase the tax base with several measures, such as the new Value-Added Tax (VAT) Trading Through Electronic System (PPN PMSE). The PPN PMSE gave an additional IDR10.11 trillion in revenue throughout 2022. At the same time, the tax authority has imposed tax for the income generated from the P2P lending (Fintech tax), and Crypto tax with additional revenues collected are IDR210.04 billion and IDR246.45 billion, respectively.

Figure I: Tax-to-GDP Ratio in Developing Countries 2019 vs. 2020 (%)



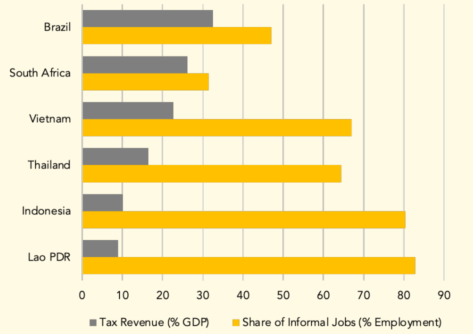
Source: OECD

Figure J: The Tax Revenue Ratio Based on Tax Components (%)



Source: OECD

Figure K: Tax Ratio and Share of Informal Jobs in 2020 (%)



Source: OECD, ILOSTAT (latest data on 19 July 2021)

[1] Ulyssea, G. (2021). Informality and Taxation in Developing Asia. Asian Development Bank.

Furthermore, GoI collects higher revenue of IDR60.76 trillion from the VAT rate adjustment under HPP Law, with the VAT rate up from 10% to 11% as of April 2022. The HPP Law will continue to generate promising additional revenue from the higher progressive individual income tax and broader VAT tax base as the GoI eliminated several previously exempted goods and services from the VAT. Other new tax measures, such as carbon tax, are also expected to increase the government revenue and partly substitute the drop in the revenue related to commodity prices in 2023. The carbon tax implementation taken by the GoI was also in line with the government's plan in the Philippines. Moreover, the government of Malaysia and Vietnam has prepared to apply higher corporate income tax (CIT) to increase their tax revenue. It reflects that most developing countries are currently planning to gather more revenue from domestic sources in order to meet higher spending needs on public infrastructure, health, and education services.

However, the GoI also needs to focus on improving tax administration in order to boost the tax revenue. Basri, et al. (2020)[2] found a possibility of larger tax avoidance as the business grows since the relatively lower staff-to-taxpayers ratio in the Small Taxpayers Offices (KPP Pratama) compared to Medium-sized Taxpayer Offices (KPP Madya) has made businesses with high-income potential feels like being "targeted". One of the comprehensive tax administration reforms is to shift the top businesses from KPP Pratama to KPP Madya to make them treated equally. The benefit of additional tax revenue from such reform is equivalent to raising the CIT rate by eight percentage points. Moreover, the GoI should reevaluate the tax incentives as the ratio of tax incentives to GDP reached 1.52% in 2020. The competition in giving tax incentives to attract investment has been increasing among developing countries. However, it is costly to the government. To keep the attractiveness of investment and maintain the tax incentives, GoI may scrutinize the ineffective tax incentives by amending and discontinuing them while preparing alternative non-tax incentives for investors.

Apart from administrational reform, the GoI also needs to prepare the implementation of international tax rules of Two-Pillar Solutions initiated by the OECD to address the challenges of taxing the digital economy and reducing the tax avoidance practice. While the substance and specific model rules to implement the Two-Pillar Solutions are still being assessed, the implementation is a global commitment that must be taken into effect in 2023. The reform is expected to increase the global income tax revenue and fairer tax allocation between countries. Indonesia needs to play an active role in meeting the worldwide consensus and complying together. Nevertheless, institutional resources are necessary to perform the reform in tax system. In times of commodity price volatility, the GoI requires the capacity to smooth the volatile revenue by allocating and managing the revenue to cushion the fiscal posture from any potential shocks.

On the spending side, GoI could implement two strategies to improve the allocation and efficiency of public spending: cutting fossil fuel subsidies and having well-targeted social assistance. On 3 September 2022, President Joko Widodo decided to adjust the price of subsidized fuel, reducing the costly fuel subsidies after carefully considering the ballooning energy subsidy triggered by rising global oil and gas prices. Before the subsidy cut, fuel subsidies increased from IDR152.5 trillion to IDR 502.4 trillion triggered by higher global oil and gas prices. Without the price hikes, the Minister of Finance expected that consumption of subsidized fuel would increase the subsidy need by IDR198 trillion making the total fuel subsidy close to IDR700 trillion.

[2] Basri, M. Chatib, Mayara Felix, Rema Hanna, and Benjamin A. Olken. 2021. "Tax Administration versus Tax Rates: Evidence from Corporate Taxation in Indonesia." *American Economic Review*, 111 (12): 3827-71.

After hiking the subsidized fuel prices, the GoI reallocated the fuel subsidy budget into social assistance in the form of fuel cash assistance to cushion the blow of higher fuel prices. The cash assistance worth IDR12.4 trillion was distributed to 20.65 million beneficiary families, who will receive IDR150,000 per month starting from September 2022 to December 2022. In addition, the GoI also prepared a budget of Rp9.6 trillion for 16 million workers who earn a maximum salary of IDR3.5 million per month, in which every beneficiary will receive IDR600,000. President Jokowi also ordered regional governments to use two percent of the General Transfer Fund (DTU) of IDR2.17 trillion for public transportation assistance, online bike taxi assistance, and fishermen.

From fiscal perspective, cutting back on fuel subsidies is a desirable reform for long-term fiscal sustainability and phasing out fuel subsidies as today's blanket subsidy, in which anyone who uses Solar and Pertalite benefits from the subsidy despite their income level, are inefficient. In addition, subsidy reform could be the first step towards a more balanced fiscal as fiscal imbalance will be difficult to sustain as long as revenue continues to rise more slowly than spending (Ikhsan & Virananda (2021))[3]. Instead of broad subsidies, it would be better for the GoI to spend more on target assistance specifically directed at lower-income groups. This way, in the midst of surging prices due to fuel subsidy cuts, people's purchasing power, especially the lower-income groups, is maintained while not putting too much pressure on the fiscal capacity.

While the decision to cut fuel subsidies is critical to reinstate the 3% budget deficit ceiling by 2023, the social assistance provided by the GoI is a crucial instrument for protection responses to shocks, such as the fuel subsidy cuts. A flexible and robust unconditional cash transfer system is essential as it can be adjusted quickly to cover more people or to have more money transferred to targeted beneficiaries. Apart from unconditional cash transfer, the GoI could also have conditional cash transfer that combines a protection goal of maintaining people's purchasing power and a promotion goal of, for example, improving people's welfare by facilitating investments in human capital through education or meeting a particular health requirement. The conditionality, transfer size, number of users, and kind of transfer, whether in-kind or monetary, should all be considered while adjusting the conditional cash transfer programs. On top of the strategies above, the current GoI plans of health reform, subsidy reform, and better databases are expected to result in better quality spending. Once the Regsosek database has been completed, it could be utilized to make sure social programs, whether it is fuel cash assistance or health assistance, correctly reach the individuals they are designed for.

On longer-run goals, fossil fuel subsidies should be phased out as fossil fuels are limited, meaning their supply is limited, and they will eventually run out. Apart from targeted social assistance, the GoI could reallocate fuel subsidies to finance infrastructure projects, including the construction of Indonesia's new capital city as well as financing for renewable energy alternatives. As renewable energy alternatives are gaining momentum and the estimated total amount of financing needed is enormous (around IDR500 Trillion), the GoI could reallocate fossil fuel subsidies to subsidizing renewable energy sources in order to meet the target of 23% clean and renewable energy by 2025 as stipulated in Indonesia's Nationally Determined Contribution (NDC) under the United Nations Framework Convention on Climate Change (UNFCCC).

Contrasting View of Global and Domestic Economic Condition

2022 was not a pleasant year for the global economy as a series of major disruptions kept erupting across the world. Prolonged Covid-19 spread, heating geopolitical tension due to war outbreak in Ukraine, rising food and energy prices, rapid

[3] Ikhsan, M., & Virananda, I. (2021). Fiscal Sustainability in Indonesia with Asymmetry. Economics and Finance in Indonesia, 67(1), 19-33.

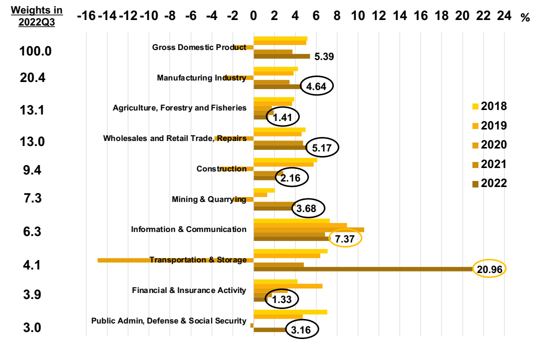
emergence of protectionism practices, overheating inflation, and sovereign debt defaults or in serious risk of debt distress are among the major issues surrounding global economy last year. The bleakness of 2022 was summarized neatly by the predictions published by major institutions, such as IMF and World Bank, that persistently revised down its growth projections throughout last year. However, Indonesia somehow managed to paint a rather contrasting picture of its economic condition. Compared to global economic growth, Indonesia's GDP growth realized at 5.72% (y.o.y) in Q3-2022, reaching its highest level in the last ten years and marking its third consecutive quarter having growth rate higher than expectations. At that time, global economy was facing serious challenge of overheating inflation that stemmed from skyrocketing energy and commodity prices. Consequently, tightening stance by central banks across the globe were in order to combat inflation; thus, squeezing domestic demand and slowing down economic activity. In contrast, blessed by its commodities, Indonesia managed to channel the windfall profit to increase subsidies budget and delayed the fuel price hike until late in Q3-2022. Due to a relatively managable domestic inflation during that period, BI was relatively behind-the-curve and has not reached its aggresive tightening period yet. Therefore, demand and production activity remained solid. Another important factor that took part in Q3-2022 notable growth data is the low-base effect. In Q3 of the previous year, Indonesia's economy recorded a dissapointing growth rate of only 3.51% (y.o.y), substantially lower than a long-term growth trend of 5%. Thus, the rebound momentum due to low-base-effect was materialized in Q3-2022 economic growth figure.

"...Indonesia's GDP growth realized at 5.72% (y.o.y) in Q3-2022, reaching its highest level in the last ten years and marking its third consecutive quarter having growth rate higher than expectations."

Manufacturing industry as the biggest sector to contribute to GDP recorded a relatively significant growth increase from 4.01% (y.o.y) in Q2-2022 to 4.83% (y.o.y) in Q3-2022. In addition, the growth rate of transportation & storage sector and accomodation & FnB has been persistently increasing since in the last five quarters, signalling the continuous momentum of rising people's mobility and physical economic activity. Accomodation & FnB almost doubled its growth rate from 9.76% (y.o.y) in the second quarter of last year to 17.83% (y.o.y) in Q3-2022. Similarly, transportation & storage sector grew by 25.81% (y.o.y) in Q3-2022, a jump from 21.27% (y.o.y) in the previous quarter. Other sectors that experienced a notable double-digit growth rate in Q3-2022 were business services and public administration. Recorded at 10.79% (y.o.y), business service grew in-line with increased economic activity while public administration grew by 12.42% (y.o.y) in Q3-2022 due to the expansion of social protection program by the GoI following the risk of heating inflation.

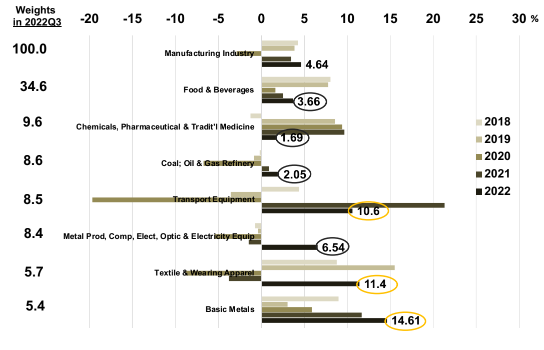
"The steep decrease of chemical and pharmaceutical subsector is attributed to the drop in demand for medicine-related products as the Covid-19 has been far less threatening than before."

Figure 1: Growth of GDP and the Main Industries, 2018-2022Q3



Source: CEIC

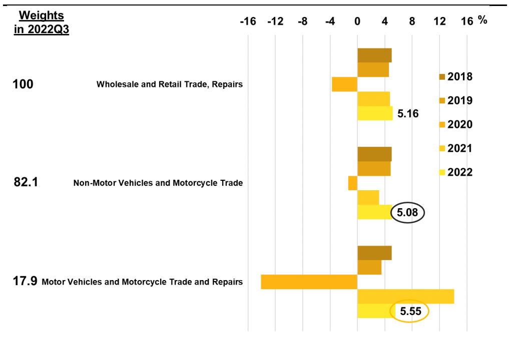
Figure 2: Growth of Manufacturing Sector and Its Subsectors, 2018-2022Q3



Source: CEIC

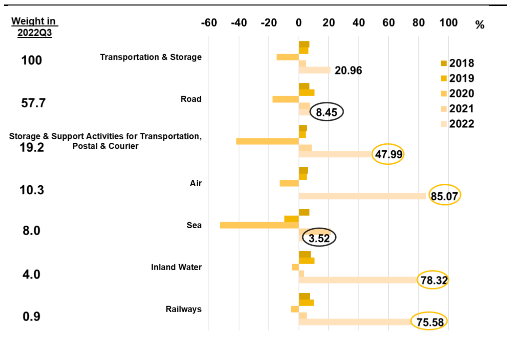
Despite the increasing growth of overall manufacturing industry, FnB subsector as the main contributor in the manufacturing industry experienced a slight deceleration of growth from 3.68% (y.o.y) in Q2-2022 to 3.57% (y.o.y) in the next quarter as it has passed the high season period of domestic consumption. A surprising growth performance has been shown by chemical and pharmaceutical subsector. The second biggest subsector within manufacturing industry recorded the first growth contraction in the last four years, declined significantly to -3.50% (y.o.y) in Q3-2022 from 2.10% (y.o.y) in the previous quarter. The steep decrease of chemical and pharmaceutical subsector is attributed to the drop in demand for medicine-related products as the Covid-19 has been far less threatening than before. On the other hand, numerous subsectors managed to record a grew positively and reached double-digit growth rate in the third quarter last year. Those subsectors are leather products (13.44%, y.o.y), basic metals (20.16%, y.o.y), metal products and electronics (17.67%, y.o.y), and transport equipment (10.26%, y.o.y). The growth of these subsectors confirmed the domestic trend of growing economic and production activity.

Figure 3: Growth of Wholesale and Retail Trade and Its Subsectors, 2018-2022Q3



Source: CEIC

Figure 4: Growth of Transport and Its Major Subsectors, 2018-2022Q3



Source: CEIC

After a slower pace in Q2-2022, the wholesale and retail sector recorded favorable growth in Q3-2022. The sector marked substantial growth, which accounted for

5.35% (y.o.y) relative to the growth in the prior period, which stood at 4.42% (y.o.y). As the pandemic remains manageable, the overall demand from the society also gradually crawls back to its usual pattern, which mainly supports the growth of wholesale and retail sectors. Looking at its components, the sub-sector of the motor vehicle and motorcycle trade recorded solid growth of 5.69% (y.o.y) or increased substantially relative to the previous quarter of 3.28% (y.o.y). Similarly, the sub-sector of the non-motor vehicle and motorcycle trade which was the leading supporter of the sector with 82.1% of the share, also marked a pleasing growth of 5.22% (y.o.y). The number rose significantly compared to previous growth in Q2-2022 and Q3-2021 of 4.67% (y.o.y) and 3.26% (y.o.y), respectively. The significant growth was in line with the Association of Motorcycle Industries (AISI) data, which reported a substantial trade of motorcycle product of 524,821 units in August 2022, or grew approximately 61% from its number in July 2022.

"The ease of social restriction policy coupled with higher confidence of the society toward the condition after the pandemic has affected the sector (transportation and storage) positively."

The transportation and storage sector was still persistent with its good performance by showing solid growth for four consecutive periods after negative growth in Q3-2021. The ease of social restriction policy coupled with higher confidence of the society toward the condition after the pandemic has affected the sector positively. In Q3-2022, the transportation and storage sector showed a subtle increase to 25.81% (y.o.y) from 21.27% (y.o.y) in Q2-2022. Looking deeper, among all sub-sectors, air and railways transport elevated firmly to the respective growth of 144.35% (y.o.y) and 126.68% (y.o.y) in Q3-2022. The primary support for the skyrocketing growth was the higher intensity of mobility as well as the increasing number of foreigners visiting Indonesia due to some major events such as G20. The storage sector also displayed a similar pattern with 57.00% (y.o.y) growth, which grew considerably higher compared to 46.04% (y.o.y) In Q2-2022. On the other hand, the sub-sector of road transport, as the main contributor to the transportation and storage sector with 57.7% share, dipped to 8.72% (y.o.y) or slightly slower relative to 9.77% (y.o.y) of growth in the previous quarter. Short after the Q3-2022 period, we may expect to see another favorable performance from the transportation sector, with several big occasions, such as Christmas and New Year holidays, coming ahead.

As we continue to march toward the normal level after a stressful period caused by the pandemic, several vital sectors, such as manufacturing and trade, have been consistently approaching its normalcy. Moreover, the transportation and storage, as well as accommodation & FnB known to be the main losers during the pandemic period, have also secured their place under the normal growth pattern. The good performances shown by those sectors, on the other hand, reflected a strong bound of domestic demand, as the majority of societies felt less anxious to spend their income. Despite the unfriendly situation from the global perspective, Indonesia has somehow managed not only to survive but also display a relatively good performance. Soon after, we may assume relatively better circumstances as the GoI has removed any form of social restriction policies.

Solid Domestic Growth, Shrugging Off Global Recession Fears

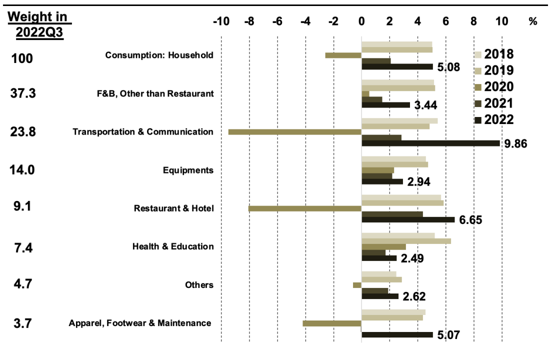
While the world is currently clouded by uncertainty coming from Russia-Ukraine war, looming global recession, and global monetary tightening, Indonesia posted another solid economic growth in Q3-2022, beating market consensus thanks to robust domestic consumption, investment growth, and impressive export performance. The annual growth rate of 5.72% (y.o.y) in Q3-2022 even beat the Q2-2022 figure of 5.45% (y.o.y), the quarter when increase in consumption is usually seen during Ramadan month and the Eid Al Fitr. Looking at its component, all expenditure components indicated a positive growth, except government expenditure that continued its negative growth at 2.88%% (y.o.y) in Q3-2022 after experiencing a contraction of 4.86% (y.o.y) in the previous quarter. On a quarterly basis, government spending reported a high growth of 11.22% (q.t.q), suggesting government accelerated spending, particularly to absorb global economic shocks and as a cushion blow of subsidized fuel price adjustment. As of end of September 2022, expenditure realization was at IDR1,913.9 trillion of 61.6% of the state budget ceiling, an increase of 5.9% (y.o.y) compared to last year's figure. During the first nine months of 2022, government's budget balance displayed a surplus of IDR60.9 trillion or 0.33% to GDP on the back of higher state revenue. Tax, excise duty, and nontax revenues all displayed growth of 54.2% (y.o.y), 26.9% (y.o.y), and 2.1% (y.o.y), respectively.

"...the subsidized fuel price hike in early September 2022 did not alter overall household consumption in a significant manner as GoI shifted the fuel subsidy to a more targeted assistance..."

Looking at household consumption, the main source of economic growth, it posted another above 5% growth of 5.39% (y.o.y) during July – September 2022, slightly lower compared to April – June 2022 growth of 5.51% (y.o.y). This would imply that the subsidized fuel price hike in early September 2022 did not alter overall household consumption in a significant manner as GoI shifted the fuel subsidy to a more targeted assistance, particularly to support low-income population. Zooming in on its component, all consumption groups indicated a positive growth during July – September 2022 period. Consumption of food & beverage, transportation & communication, and equipments, which accounts for 75.1% of total consumption grew by 2.65% (y.o.y), 12.87% (y.o.y), and 2.30% (y.o.y) in Q3-2022. Impressive growth in transportation & communication group suggested mobility keeps increasing considering Covid-19 is relatively under control.

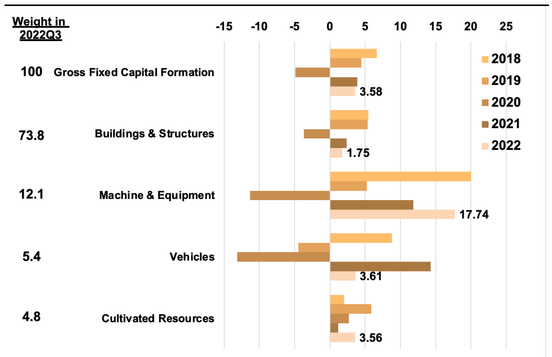
As for investment, it grew by 4.96% (y.o.y) in Q3-2022, higher compared to growth in previous quarter at 3.07% (y.o.y). Buildings and structures group, which account for 71% of total investment, recorded a positive growth of 0.07% (y.o.y) while investment in machine and equipment that contributes to 13.5% of total investment rose by 36.46% (y.o.y), the highest growth of all investment groups.

Figure 5: Growth of Household Consumption and its Components, 2018-2022Q3



Source: CEIC

Figure 6: Growth rate of Investment and its Main Components, 2018-2022Q3



Source: CEIC

"The pleasing figure in banking credit indicates that economic activities have returned back to its normal conditions as Covid-19 cases remained restrained."

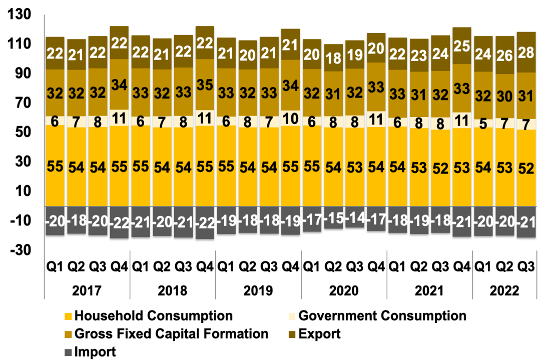
Focusing on the performance of credit, it has fully recovered to the pre-pandemic levels. Total credit has accelerated to 10.78% (y.o.y) in Q3-2022, higher than 9.6% (y.o.y) in the previous quarter. The pleasing figure in banking credit indicates that economic activities have returned back to its normal conditions as Covid-19 cases remained restrained. In terms of its purpose, working capital credit and investment credit were both seen to have the highest growth with a double-digit growth to 12.50% (y.o.y) and 10.44% (y.o.y) in Q3-2022 from 11.99% (y.o.y) and 8.79% (y.o.y), respectively. Next is investment credit which also increased to 8.32% (y.o.y), slightly jumped from 6.54% (y.o.y) in Q2-2022.

Meanwhile, according to the latest data in November 2022, the deposit (third-party fund) growth declined further to 9.4% (y.o.y) from as high as 12% (y.o.y) in the preceding month as economic confidence improved and economic activities increased. Better public confidence has prompted large depositors to use their funds for consumption and investment. In addition to higher credit disbursement, asset quality however remained manageable at 2.65% based on the latest data from OJK in November 2022. This is partially due to the restructured loans also decreasing along with sectoral recovery. OJK plan to extend the credit restructuring period from the end of March 2023 until March 2024 to support certain sectors or industries that require additional credit/financing period. Therefore, banking liquidity has been declining compared to the beginning of the pandemic period but remains generally sufficient as reflected in the Loan to Deposit Ratio (LDR) which remains healthy at 79.6% in November 2022.

Overall, the credit will be expected to continue to accelerate further in line with domestic economic recovery. However, the third-party fund is predicted to slowing down making the liquidity in the banking system expected to gradually tighten, especially in the current BI's normalization policy to curb inflation and stabilize Rupiah. In 2022, BI has risen its policy rate with a total of 200 bps and is expected to be less aggressive ahead and reach its terminal rate in the first semester of 2023 which may support economic recovery this year. In 2023, the banking sector will face a higher interest rate which potentially impact on the higher cost of funds.

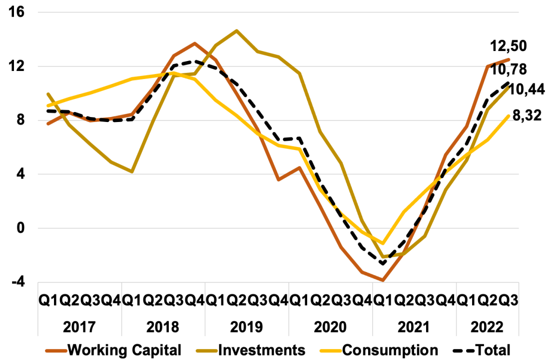
Nevertheless, the impact of the higher rate on the real sector may be limited in the near term as confidence towards the domestic economy is still high. Once the global situation heats up, the impact of the higher rate may gradually materialize in the domestic economy.

Figure 7: Shares of GDP Components, 2017Q1-2022Q3 (%)



Source: CEIC

Figure 8: Credit Growth by Purposes, 2017Q1-2022Q3 (y.o.y, %)



Source: CEIC

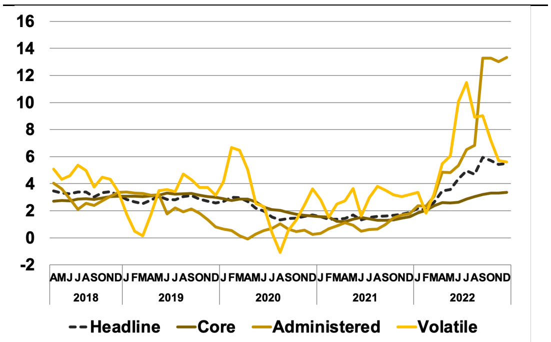
A Road to 2023's Inflation Prospects Within BI's Target Range

"The annual inflation rate of 5.51% (y.o.y) in December 2022 was higher than the previous month, in line with the year-end seasonal pattern."

The inflation rate increased slightly in December 2022, reaching 5.51% (y.o.y), up from November's figure of 5.42%. This increase was driven by rising pressure in core inflation and administered prices. Meanwhile, in terms of volatile food prices, it continues its downward trend. The full headline inflation of 2022 increased compared to 2021 which was recorded at 1.87% (y.o.y) and was higher than the target of 3.0±1%, mainly influenced by the impact of subsidized fuel price adjustments in September 2022.

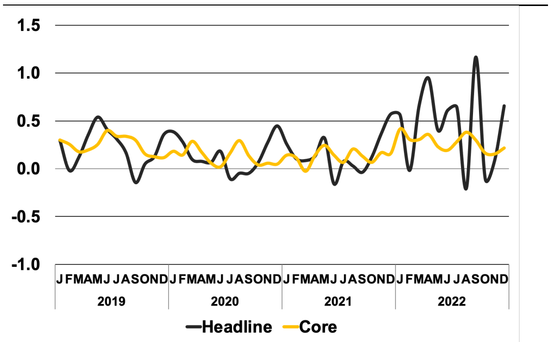
The energy component grew by 16.88% (y.o.y) in December 2022, a slight increase 16.85% (y.o.y) in the previous month. At the same time, the administered prices inflation also recorded an increase from 13.01% (y.o.y) to 13.34% (y.o.y) in December 2022. However, the inflation rate for volatile and foods ingredients were experiencing a decrease and recorded at 5.61% (y.o.y) and 5.59% (y.o.y), respectively. Core inflation was recorded at 3.36% (y.o.y) in December 2022, slightly higher than inflation in the previous month which was recorded at 3.30% (y.o.y). This is the highest since 2017 which was recorded at a level of 3.41% (y.o.y), although it is still considered relatively benign. This is in line with the lower propagation impact of fuel price adjustments and the subdued inflationary pressure from the demand side.

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



Source: CEIC

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



Source: CEIC

On a monthly basis, inflation occurred in all sectors except the information, communication, and financial service (-0.06%). Meanwhile, core inflation was maintained at a low level of 0.22% (m.t.m), up from 0.15% (m.t.m) in November 2022. The volatile foods category in December 2022 recorded inflation of 2.24% (m.t.m), higher than the previous month's deflation of 0.22% (m.t.m), in line with the year-end seasonal pattern. The administered prices group recorded inflation of 0.73% (m.t.m), an increase from the previous month's inflation of 0.14% (m.t.m) due to the increase in tariffs for drinking water companies, and in line with the seasonal pattern of increasing demand for air transport at Christmas and New Year, and inflation of filter cigarettes. The inflationary pressure in 2022, which was lower than initially forecasted, had a positive impact on the prospect of inflation in 2023, which is predicted to return to the BI's target range of 3.0±1%.

All Time High Investment Realization

The Investment Coordinating Board (BKPM) recorded an investment realization of IDR314.8 trillion in Q4-2022. It was another new record in the last decade that has brought Indonesia's annual investment realization in 2022 to IDR1,207.2 trillion. This amount has exceeded its target of IDR1,200 trillion. The investment realization in 2022 also rose 33.98% compared to the previous year which was recorded at IDR901.02 trillion. Around 44.4% or IDR 139.6 trillion of the total investment realization in Q4-2022 was from domestic investment (DDI) category. Then the remaining 55.6% or IDR 175.2 trillion is from foreign investment (FDI).

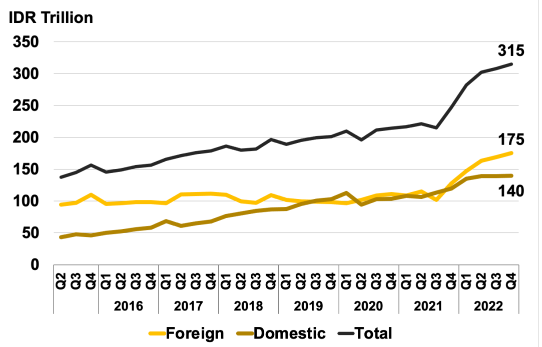
"On an annual basis, the largest investment realization came from the basic metal, metal goods, non-machinery and equipment industry sector reaching IDR171.2 trillion."

According to the sector, mining is the largest contributor to investment realization in Q4-2022, with an investment value of IDR39.8 trillion. Then the basic metal, metal goods, non-machinery and equipment industries were recorded at IDR39.4 trillion, transportation, warehouses and telecommunications amounted to IDR36.8 trillion, chemical and pharmaceutical industries IDR33.5 trillion, and industrial and office areas IDR28.9 trillion. On an annual basis, the largest investment realization came from the basic metal, metal goods, non-machinery and equipment industry sector reaching IDR171.2 trillion.

Investment realization outside Java reached IDR 164.2 trillion or 52.2% of the total realization in Q4-2022. Meanwhile, realization in Java was recorded at IDR 150.6

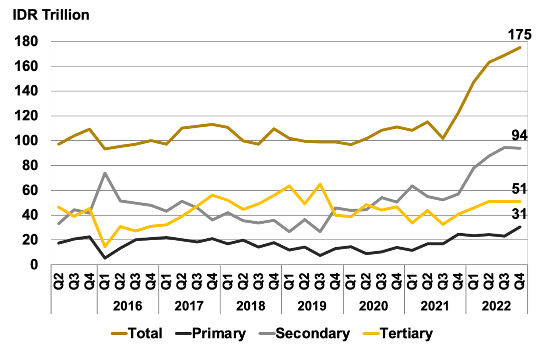
trillion or 47.8% of the total realization. The top three investment locations in Q4-2022 include West Java (IDR46.2 trillion), Central Sulawesi (IDR34.7 trillion), and DKI Jakarta (IDR34 trillion). The top five main investor countries include China (USD3.0 billion), Singapore (USD2.7 billion), Hong Kong (USD1.6 billion), Malaysia (USD1.1 billion) and the United States (USD0.9 billion). This shows that despite being in the midst of global economic turbulence, investors' confidence is still very high during 2022. This is also a promising sign from investment and an opportunity for GoI to maintain economic growth in 2023.

Figure 11: FDI and Domestic Investment (Nominal)



Source: CEIC

Figure 12: FDI Realization by Sectors (Nominal)



Source: CEIC

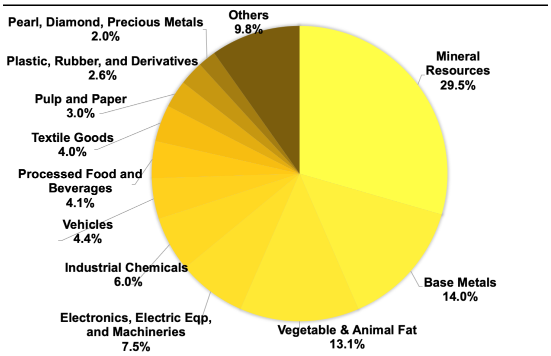
Downward Trend of Trade Surplus

"The acceleration in exports were mainly contributed by the commodities as around 59% of the Indonesia's exports in October-November 2022 were mineral resources, base metal, vegetable and animal fat, pearl, diamond, and precious metals"

Following the economic recovery in most of domestic indicators at the global level, the international trade transactions continues to increase. The rising demand and period of surging commodity prices throughout 2022 has generated positive effects on the commodity exporter countries, including Indonesia. Indonesia maintained trade surpluses for 32 consecutive months since May 2020 mainly due to higher prices of coal and palm oil. Exports in Q4-2022 grew by 8.06% compared to the same period in previous year, making annual export growth for overall 2022 at 26.11%. The acceleration in exports were mainly contributed by the commodities as around 59% of the Indonesia's exports in October-November 2022 were mineral resources, base metal, vegetable and animal fat, pearl, diamond, and precious metals. However, other non-oil and gas, such as processing industry exports as well as agriculture, forestry, and fisheries products, also recorded the positive trend, albeit limited compared to the increase in export of commodities. Non-oil and gas exports to China, the United States, and India continued to be the largest contributors to overall Indonesian exports throughout 2022.

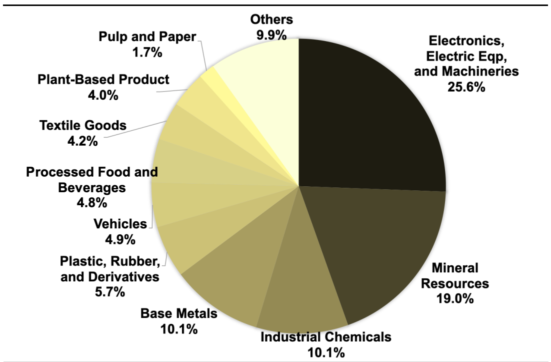
In Q4-2022, imports also increased by 1.87% compared to same period in 2021, while the growth of import for overall 2022 was recorded at 21.07%. The oil and gas imports, as well as non-oil and gas imports, rose in Q4-2022 compared to the same period previous year, owing to increasing demand of input materials and capital goods from the economic rebound. Indonesia is still reliant on productive goods imports, with electronics, electric equipment, and machineries (25.6%), mineral resources (19.0%), and industrial chemicals (10.1%) accounting for the majority of imports in October-November 2022 figure. Even though the imports have been accelerating due to higher demand of domestic production activities, the growth was still lower than exports, resulting in the persistent trade surpluses. The trade balance in Q4-2022 was recorded at USD14.6 billion; making the overall trade surplus of USD54.5 billion for overall 2022. The surplus in the last quarter of 2022 was even higher than last year, albeit 1.91% decrease compared to the previous quarter. The trade surpluses are being slightly propped by the lower prices of commodities compared to the second and third quarters of 2022. Looking at the price trend, although the trade balance is still persistently in positive territories, the amount of trade surpluses may be deteriorates further in 2023 due to the gradual decreasing trend of commodity prices.

Figure 13: Indonesia Export Profile (October-November 2022)



Source: CEIC

Figure 14: Indonesia Import Profile (October-November 2022)



Source: CEIC

Moreover, the favourable trade balance has helped to maintain current account balance, with the latest data reports that the current account surplus reached USD4.38 billion or equal to 1.3% of GDP in Q3-2022. However, the amount was lower compared to the USD4.96 billion surplus in the same period previous year due to the widening deficit of trade in services as the people mobility accelerated. The current account balance may be reduced further at the end of 2022 and at the beginning of 2023 as the lower performance of trade surplus in goods and larger deficit in services. Nevertheless, the positive current account balance has brought impactful contribution to the Rupiah stabilisation amid the global financial market uncertainty. In the second and third quarters of 2022, Rupiah was the best performing currency among other developing countries with lesser depreciation rate. The sound trade surpluses throughout the year have cushioned the effect of monetary tightening on depreciation as higher exports than imports indicate more foreign exchange liquidity in the market. Yet, the persistent trade surplus at the end of 2022 continues to help improving the performance of Rupiah with the appreciation of Rupiah to IDR15,040 in mid-January 2023 from IDR15,595 in mid-December 2022. The appreciation of Rupiah against dollar was even better than most emerging economy peers.

"The current account balance may be reduced further at the end of 2022 and at the beginning of 2023 as the lower performance of trade surplus in goods and larger deficit in services."

8 DECENT WORK AND ECONOMIC GROWTH

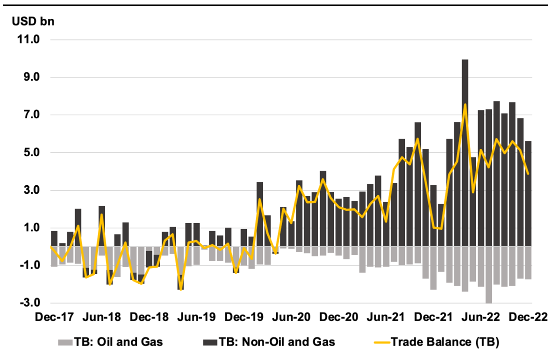
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

10 REDUCED INEQUALITIES

17 PARTNERSHIPS FOR THE GOALS

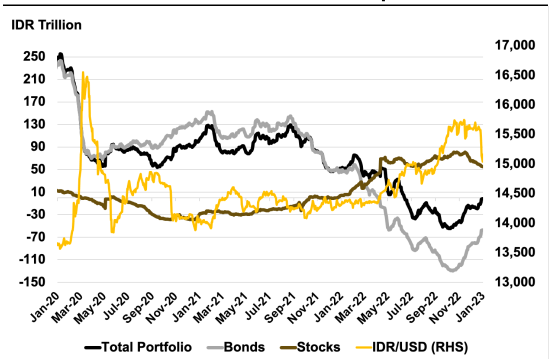
Aside from robust trade surpluses, the financial market in most of emerging economies performed better than in prior quarters during the end of 2022 and beginning of 2023. The amount of capital inflows into Indonesia has climbed swiftly to USD1.07 billion in mid-January from mid-December following the downward trend of inflationary pressures and less aggressive stance by most central banks. Capital inflows, along with the Rupiah stability policy of foreign exchange monetary operations, such as the deployment of foreign currency term deposit (TD) instruments using the foreign exchange proceeds of exports (DHE), have bolstered the Rupiah performance at the start of 2023. In addition, the GoI's plan to expand the government regulation on export earnings to exporters of manufactured goods boosts the positive sentiment to Indonesia's financial market and Rupiah.

Figure 15: Monthly Trade Balance (Nominal)



Source: CEIC

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



Source: CEIC

The high commodity prices sustained Indonesia's persistent trade surpluses throughout 2022 which also help BI to maintain adequate monetary capacity. However, the fruitful momentum from the soaring commodity prices on current account and Rupiah may be end in the near future following the downward trend of commodity prices and global economic slowdown. BI needs to anticipate the impact of trade surplus reversal by strengthening all the policies related to Rupiah stabilisation. BI's efforts to lower the imported inflation from the foreign exchange monetary operation are also expected to help Rupiah in the near future. The monetary stance implemented by BI should keep the yield differential between Indonesian Government Bond and Treasury Bonds attractive to anticipate capital outflow and Rupiah volatility. In the medium to long term, GoI needs to focus on structural reforms that support growth in non-commodity exports and downstream processing industries as reliance on commodity exports is more susceptible to the effects of price volatility.