

Indonesia Economic Outlook Q1-2024

“The Year of Transition”

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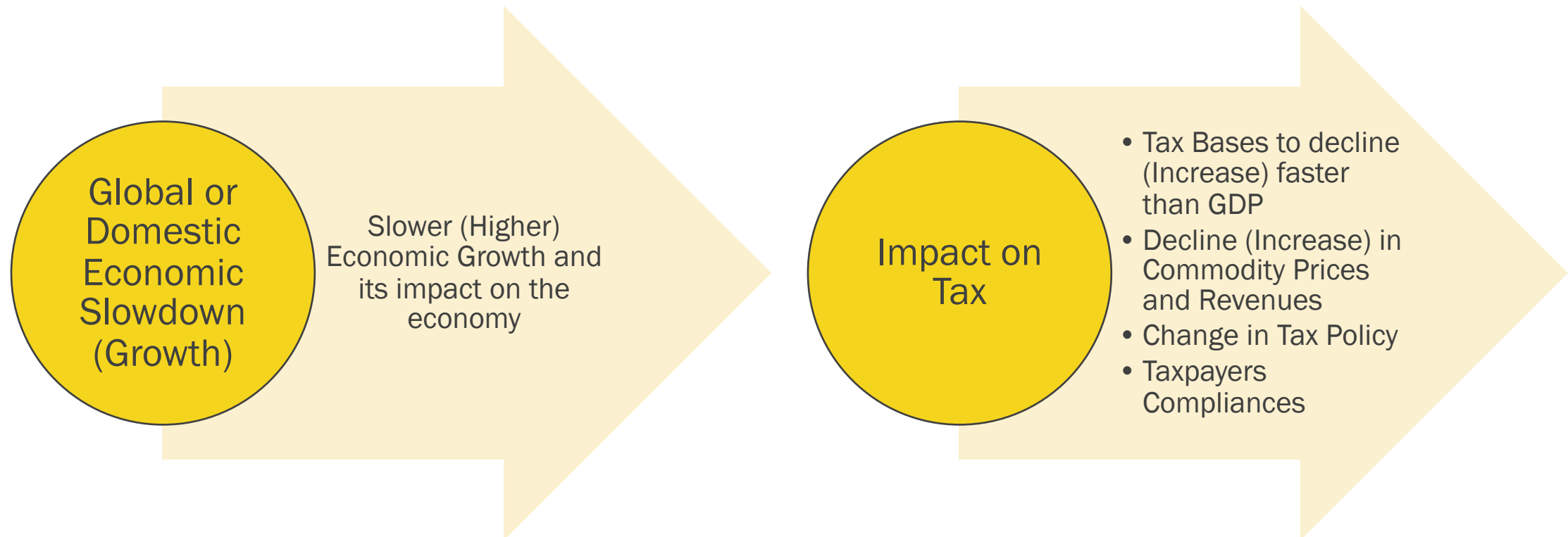
February 2024

Macroeconomic Highlights

- In line with market expectations, the Indonesian economy expanded by 5.04% (y.o.y) in the last quarter of 2023, making the overall economy grow by 5.05% (y.o.y) in 2023.
- The GDP growth in 2023 was lower compared to 5.31% (y.o.y) growth in 2022 as Indonesia still enjoyed a fair bit of low-base effect in 2022.
- However, considering China's economic slowdown, rising geopolitical tension, declining commodity prices, and global monetary tightening, the growth level in 2023 is an achievement for Indonesia.
- By expenditure, growth in Q4-2023 was supported by positive growth in all expenditure components, except imports, which recorded a negative annual growth in Q4-2023.
- Domestic consumption, the main contributor to Indonesian GDP, grew by 4.47% (y.o.y) in Q4-2023 or 4.82% (y.o.y) in FY2023.
- Maintaining a trade surplus in 2024 will be a challenge amidst global weakening demand, global rate cuts uncertainty, and in the wake of the election.

Economy and Tax

Economic Condition and Its Implications for Tax Administration



The Impact of Economic uncertainty on taxpayer compliance

- Noncompliance takes different forms.
 - Engage in taxable transactions without having registered with the tax authorities,
 - Fail to file their tax returns by the statutory filing deadline,
 - Underreport their tax liabilities illicitly claim tax refunds, or
 - Underpay the amount of taxes due (tax arrears)
- When credit is tight or unavailable, credit-constrained taxpayers may be tempted to use tax evasion as an alternative source of finance for their operations.
- Taxpayers who face severe economic stress—such as the risk of bankruptcy—may perceive the downside risks of tax evasion (penalties) to be minimal compared with the potential upside gains (avoiding bankruptcy)
- If an economic crisis leads to a shift in economic activity from the formal to the informal sector, compliance is likely to decline, since it is widely recognized (virtually by definition) that the rate of noncompliance is much higher in the informal sector.

Indonesia's Economic Conditions

Global Economic Outlook

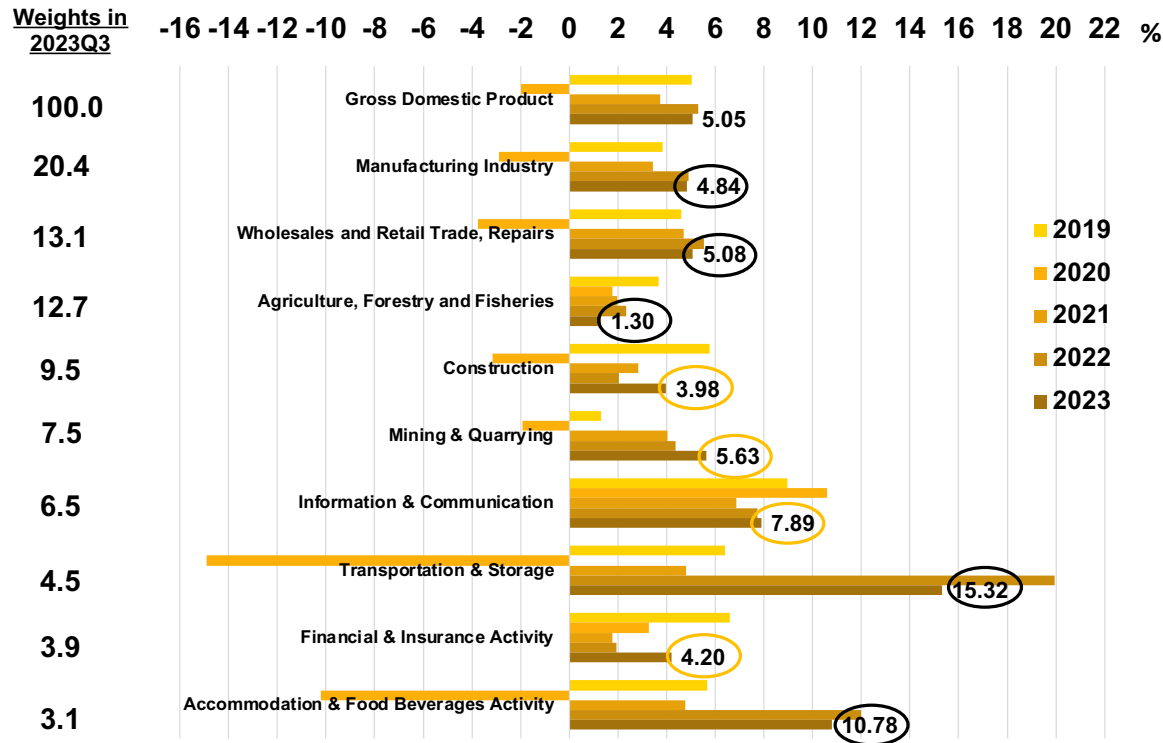
Most countries are expected to grow at a slower pace

Countries/Area	2019	2020	2021	2022	IMF		World Bank		Bloomberg		OECD	
					2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F
World	2,8	-2,8	6,3	3,4	3,0	3,0	2,1	2,4	2,6	2,7	2,7	2,9
US	2,3	-2,8	5,9	2,1	1,8	1,0	1,1	0,8	1,5	0,6	1,6	1,0
Euro Zone	1,6	-6,1	5,3	3,5	0,9	1,5	0,4	1,3	0,5	1,0	0,9	1,5
Indonesia	5,0	-2,1	3,7	5,3	5,0	5,0	4,9	4,9	4,9	5,0	4,7	5,1
Japan	-0,4	-4,3	2,3	1,1	1,4	1,0	0,8	0,7	1,3	1,0	1,3	1,1
China	6,0	2,2	8,4	3,0	5,2	4,5	5,6	4,6	5,2	4,7	5,4	5,1
India	6,5	3,9	-5,8	9,1	6,1	6,3	6,3	6,4	7,0	6,1	6,0	7,0
Russia	2,2	-2,7	5,6	-2,1	1,5	1,3	-0,2	1,2	0,5	1,2	-1,5	-0,4
Brazil	1,2	-3,3	5,2	2,9	2,1	1,2	1,2	1,4	2,1	1,5	1,7	1,2
ASEAN-5	4,9	-3,4	3,4		4,6	4,5	-	-	-	-	-	-

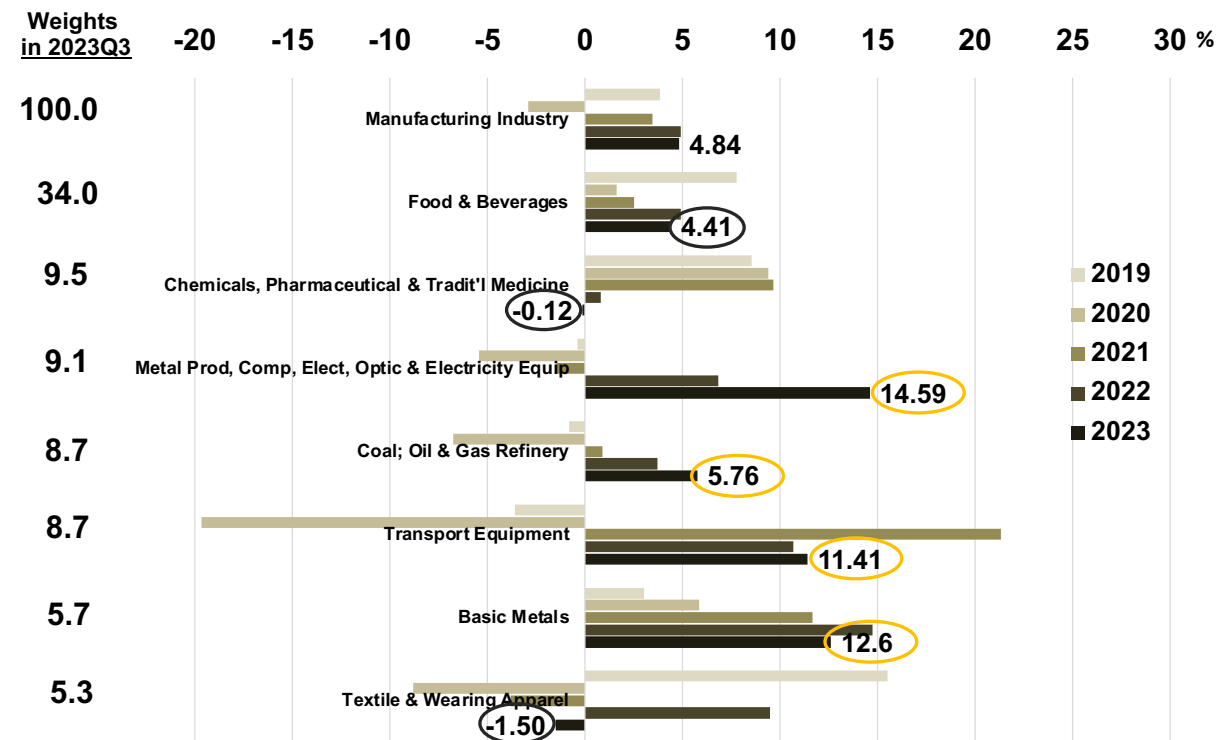
Source : IMF, Jul-23 World Economic Outlook; World Bank, Jun-23 Global Economic Prospect; OECD, Jun-23 Economic Outlook; Bloomberg as of 27-Jul-23

In the Need of New Source of Growth

Growth of GDP and the Main Industries, 2019-2023Q3



Growth of Manufacturing Sector and Its Subsectors, 2019-2023Q3

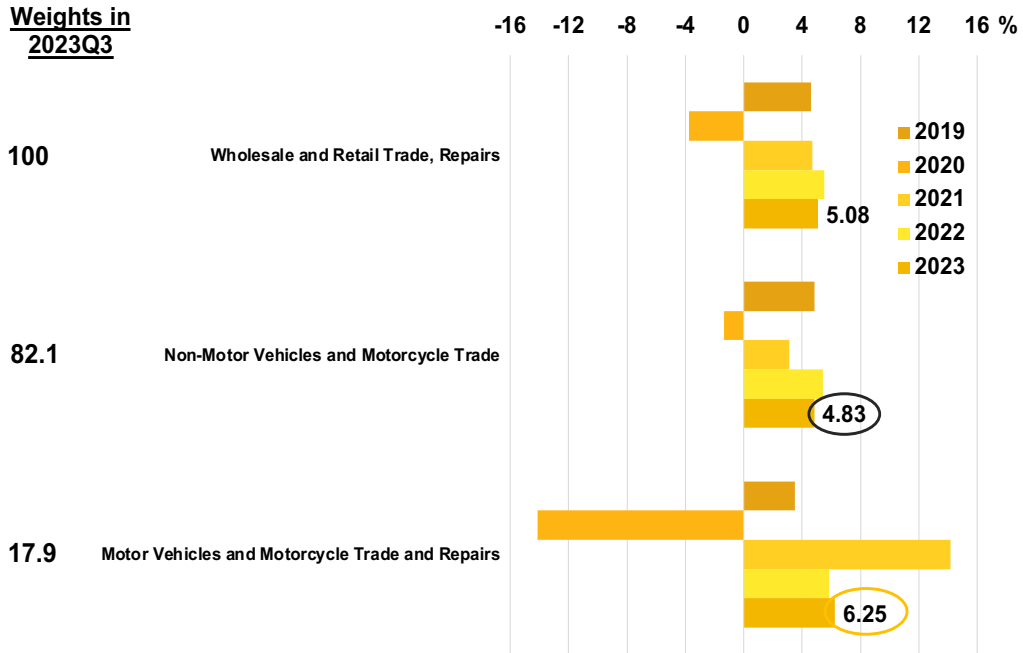


Source: CEIC

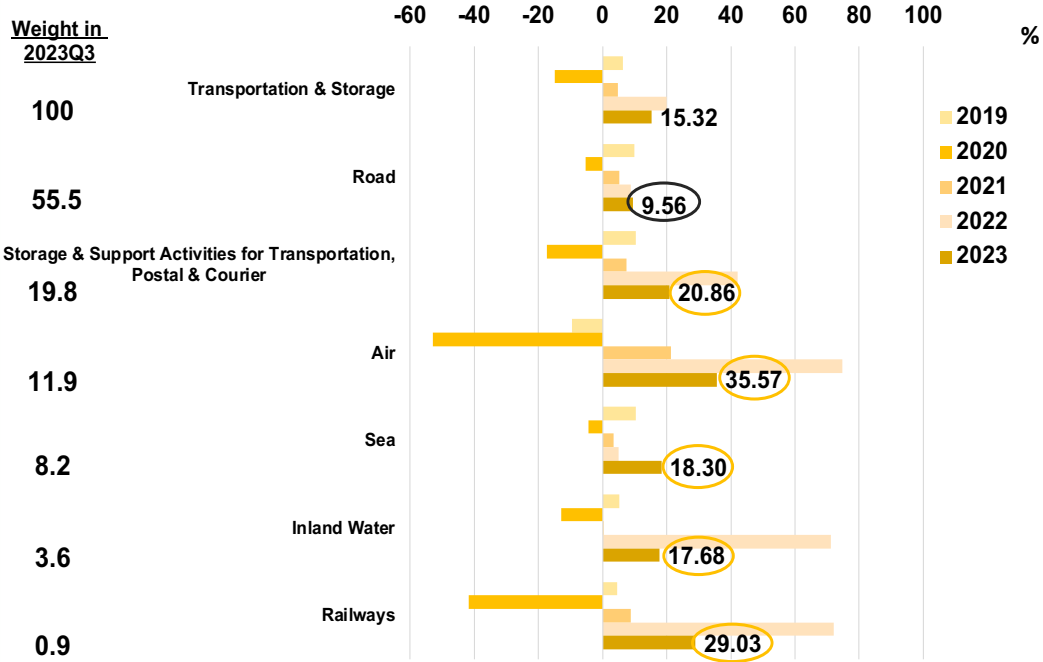
- In Q3-2023, GDP growth of Indonesia broke its upward trajectory pattern and decreased to 4.94% (y.o.y) from 5.17% (y.o.y) in the previous quarter, registered as the lowest quarterly growth since Q4-2016 (excluding Covid-19 period of 2020 and 2021).
- State budget still showed a surplus in September 2023 due to a contraction in several spending channels, such as personnel and material spending. As a consequence, public administration sector recorded a massive contraction during Q3-2023.
- El-Nino has caused deterioration in agricultural production, consequently disrupted supply of agricultural products and substantially decreased the growth of agriculture, forestry, and fisheries sector.
- Deviating from the overall GDP growth figure, manufacturing industry grew by 5.20% (y.o.y) in Q3-2023, increased considerably from 4.88% (y.o.y) in the previous quarter

Normalization of Trade and Transport Activity

Growth of Wholesale and Retail Trade Subsector and Its Subsectors, 2019-2023Q3



Growth of Transportation and Storage Sector and Its Subsectors, 2019-2023Q3



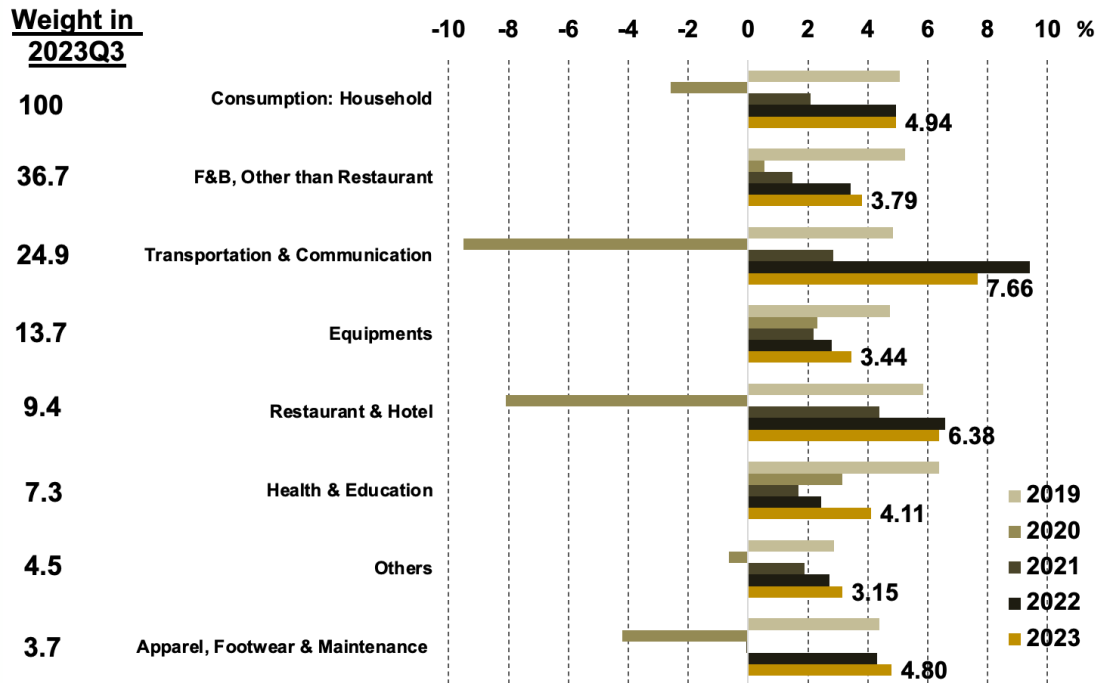
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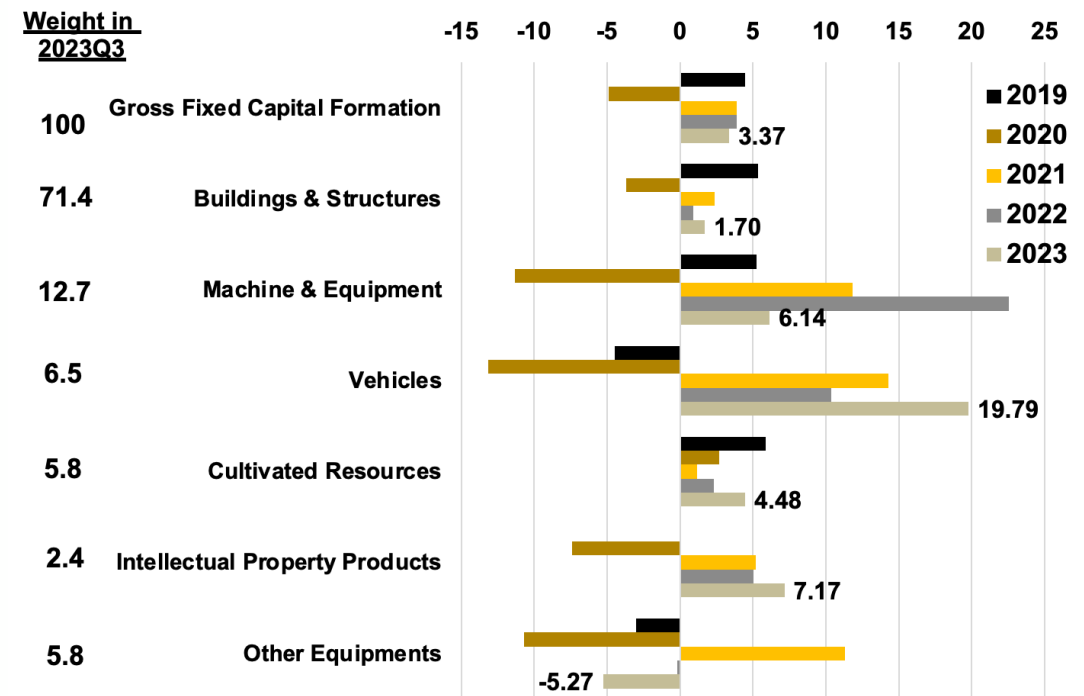
- Wholesale and retail trade sector experienced a lower growth of 5.08% (y.o.y) in Q3-2023 from 5.26% (y.o.y) in Q2-2023.
- The slowdown in the trade of motor vehicle caused by high-base effect of automotive sales as the pent-up demand from Covid-19 materialized in 2022. As a consequence, the automotive sales dropped by 11.95% (y.o.y) in Q3-2023, recording the first negative quarterly sales growth since the pandemic era.
- With growth rate of 14.74% (y.o.y), transportation and storage sector managed to record double-digit growth for seven consecutive quarters.
- Despite decelerating, transportation and storage sector maintained its status as the sector with the fastest growth among all sectors in Q3-2023.

Contraction of Government Expenditure

Growth of Household Consumption and its Components, 2019-2023Q3



Growth Rate of Investment and its Main Components, 2019-2023Q3

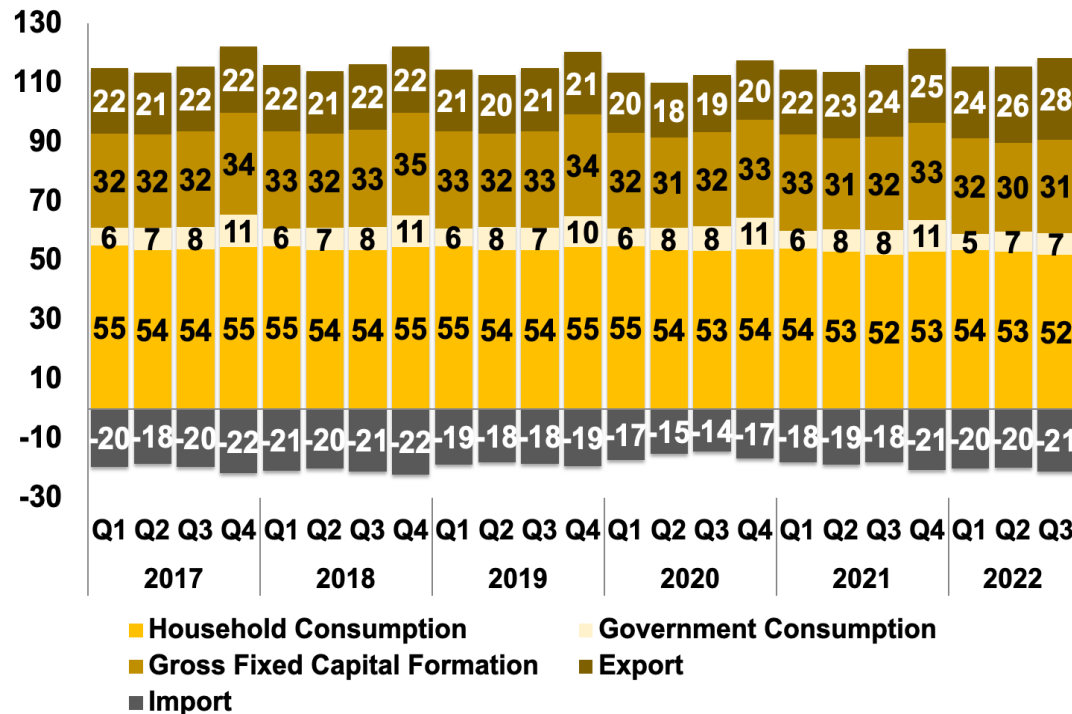


Source: CEIC

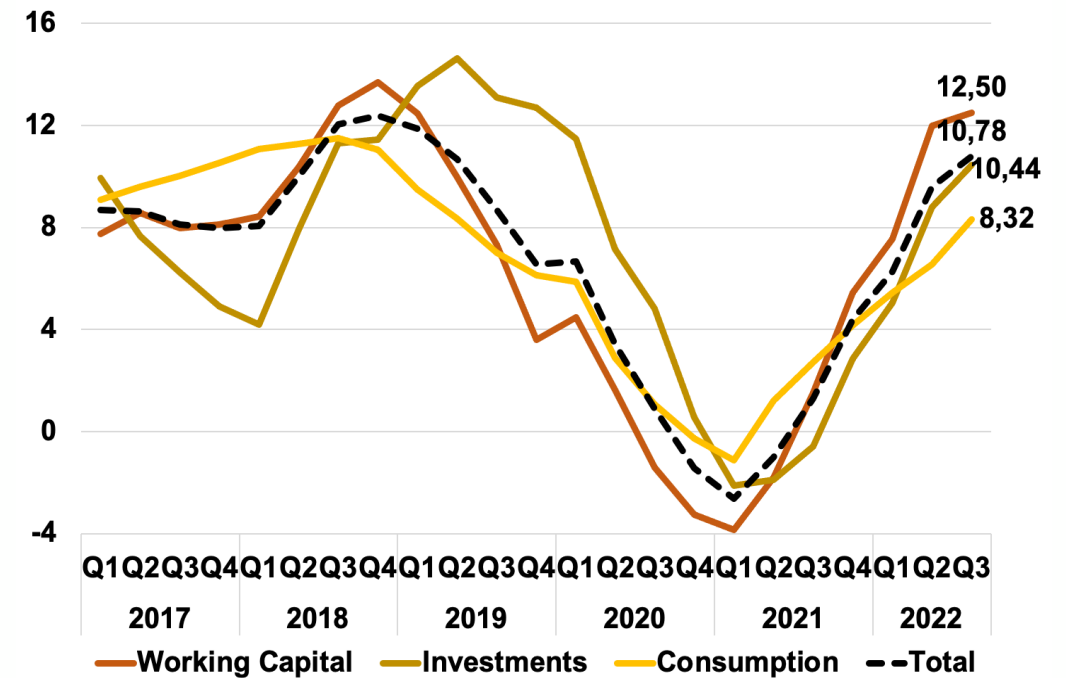
- Looking at expenditure components, the dip in the economic growth was attributed to a softer household consumption and contraction on government consumption and exports.
- Government consumption contracted by 3.76% (y.o.y) in Q3-2023 after experiencing a high growth of 10.62% (y.o.y) in the previous quarter. This is due to lower personnel spending, capital spending, and social assistance disbursement in Q3-2023.
- Household consumption that makes up more than half of Indonesian GDP posted a 5.06% (y.o.y) growth in Q3-2023, slower compared to 5.23% (y.o.y) growth in the second quarter 2023, due to passing of Ramadan, Eid Al-Fitr, and school holiday season.
- Investment expanded by 5.77% (y.o.y) in Q3-2023, supported by building and structure components. Expedited infrastructure investment as President Joko Widodo will end his second term soon attributed to the increasing growth.

Favourable Credit Performance

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



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

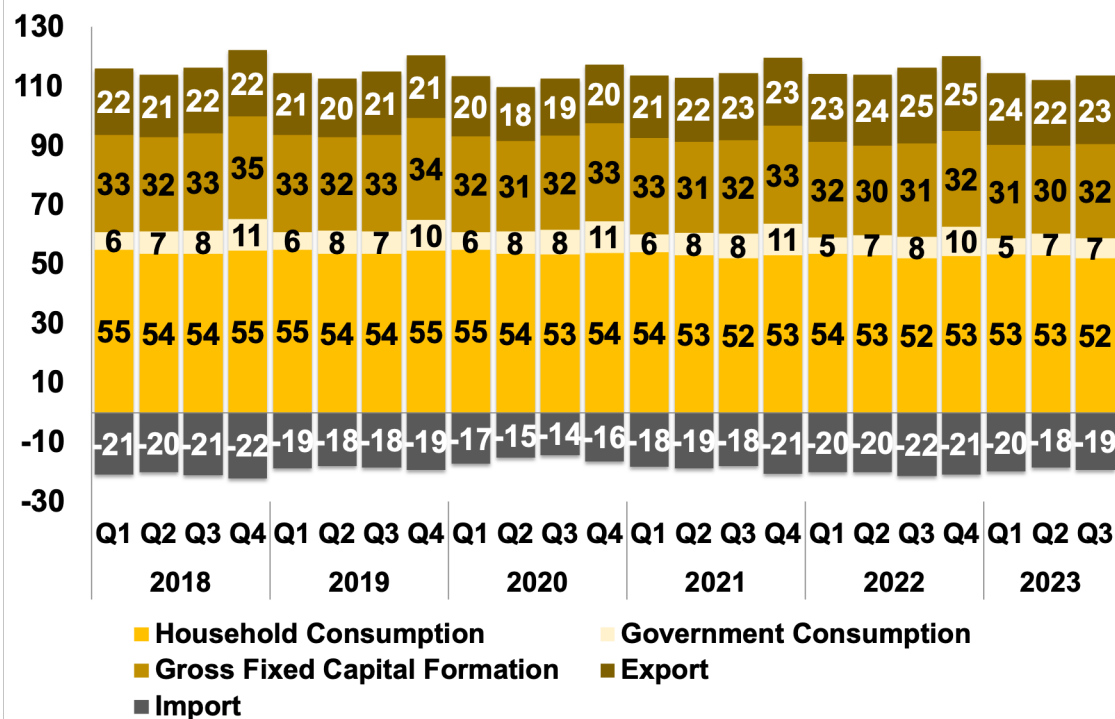


Source: CEIC

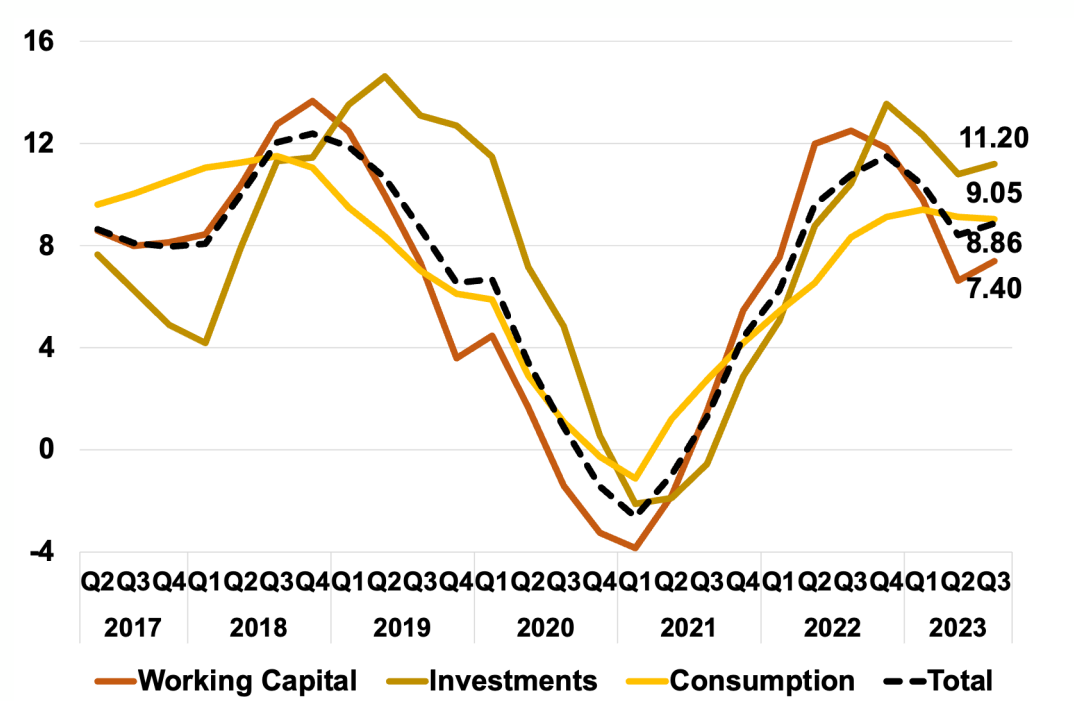
- Total credit has fully recovered to the pre-pandemic levels. Total credit growth has accelerated to 10.78% (y.o.y) in Q3-2022, higher than 9.6% (y.o.y) in the previous quarter. The pleasing figure indicates that economic activities have returned back to its normal conditions as Covid-19 cases remained restrained.
- Meanwhile, according to the latest data in November 2022, the third-party fund 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.
- 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.

Favourable Credit Performance Indicates a Strong Rebound in Economic Activities

Shares of GDP Components, 2018Q1-2023Q3 (%)



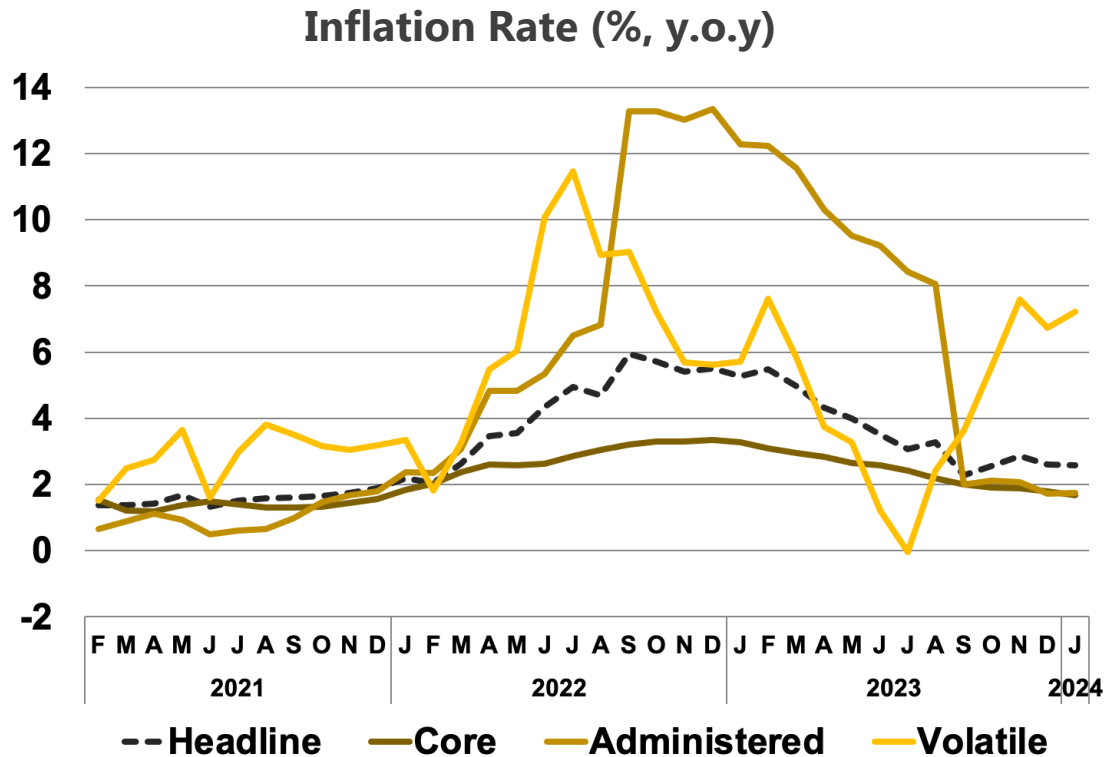
Credit Growth by Purposes, 2017Q1-2022Q3 (y.o.y, %)



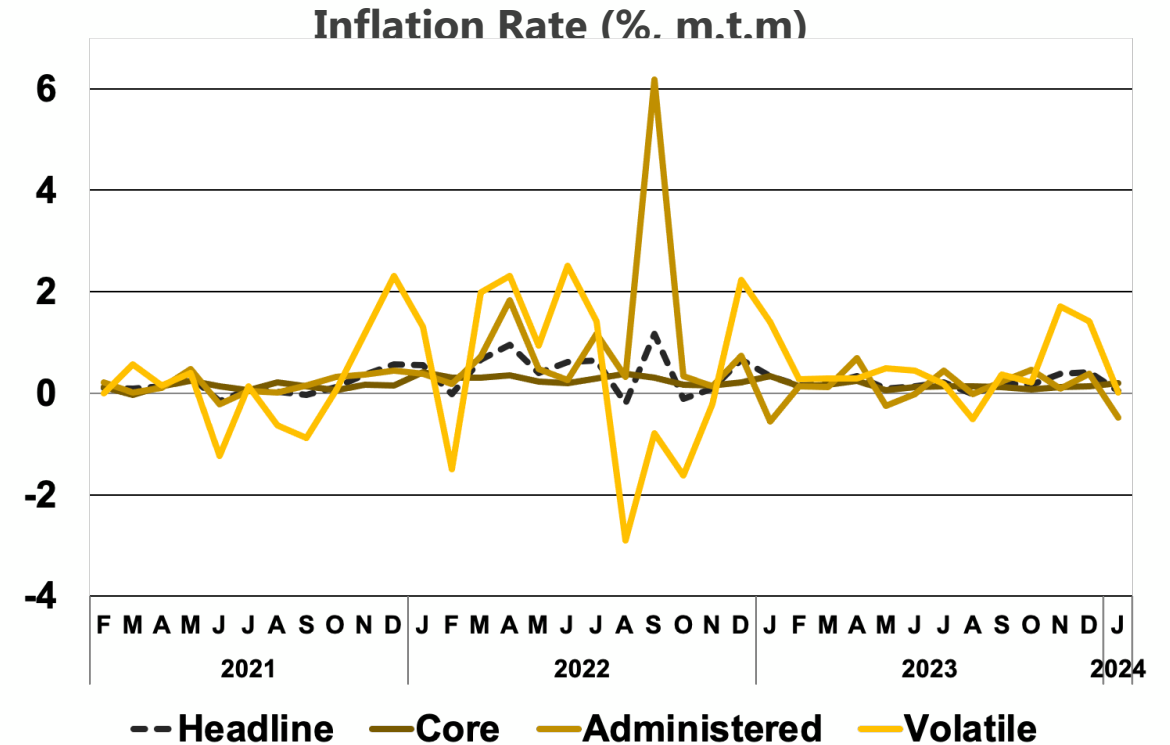
Source: CEIC

- Credit growth accelerated to 8.86% (y.o.y) in Q3-2023 from 8.40% (y.o.y) in the previous quarter.
- This is driven by a growth increase in investment and working capital components.
- On the other hand, consumption credit growth decline slightly from 9.11% (y.o.y) to 9.05% (y.o.y) as the consumption seasonal peak has ended.
- The increase in working capital and investment credit might be driven by the acceleration of government projects as it is approaching the end of current administrative period.

Bigger Role of Food Inflation



Source: CEIC

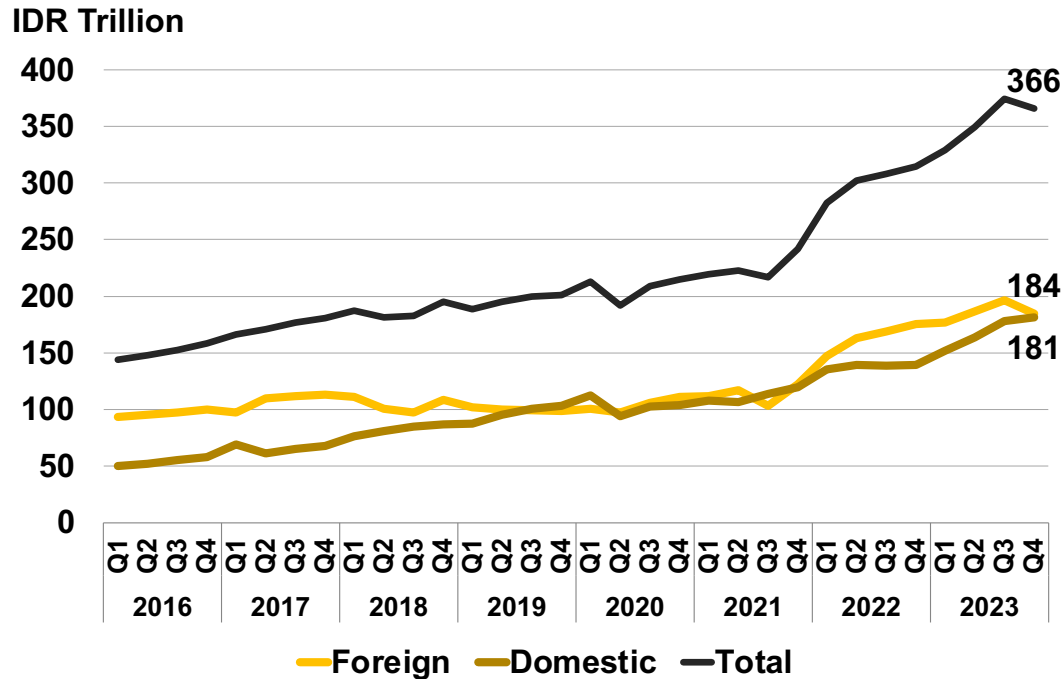


Source: CEIC

- In January 2024, headline inflation eased to 2.57% (y.o.y), lower compared to 2.61% (y.o.y) at the end of 2023 and continuing its downward trend since November 2023.
- As Indonesia renewed its inflation calculation in 2024 using new CPI series which rely on 2022 Cost of Living Survey, the composition of food commodities increased substantially to 38.0% (previously 33.7%).
- Consequently, controlling food inflation becomes more vital to keep domestic inflation in check and within BI's target range.

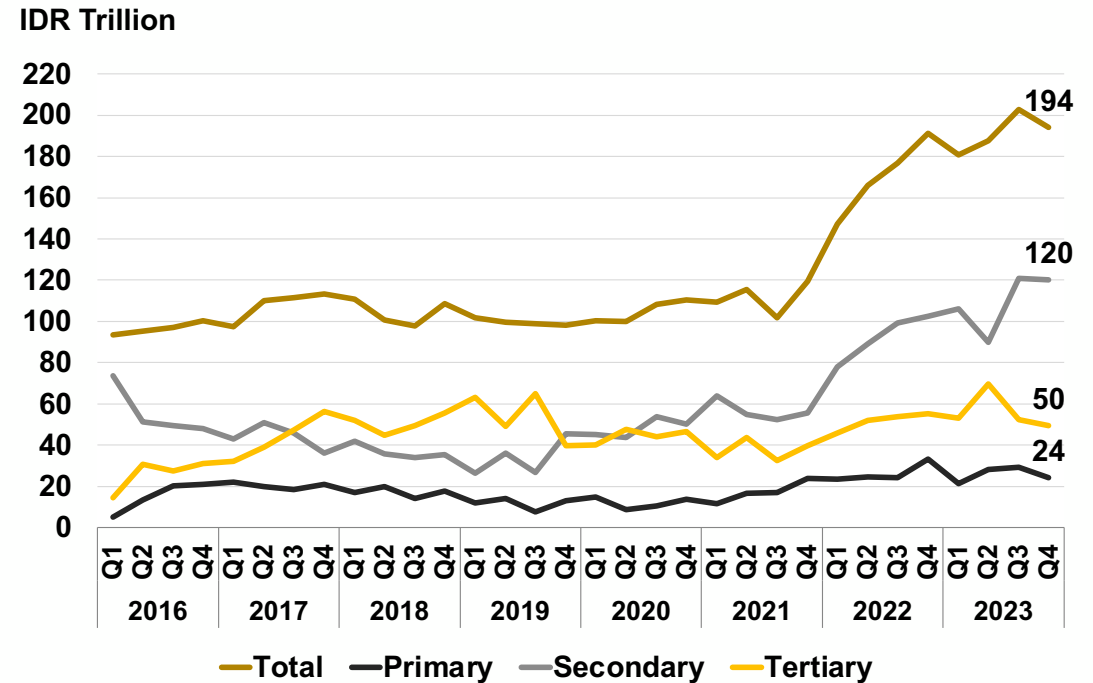
Investment Are Still Concentrated

FDI and Domestic Investment (Nominal)



Source: CEIC

FDI Realization by Sectors (Nominal)

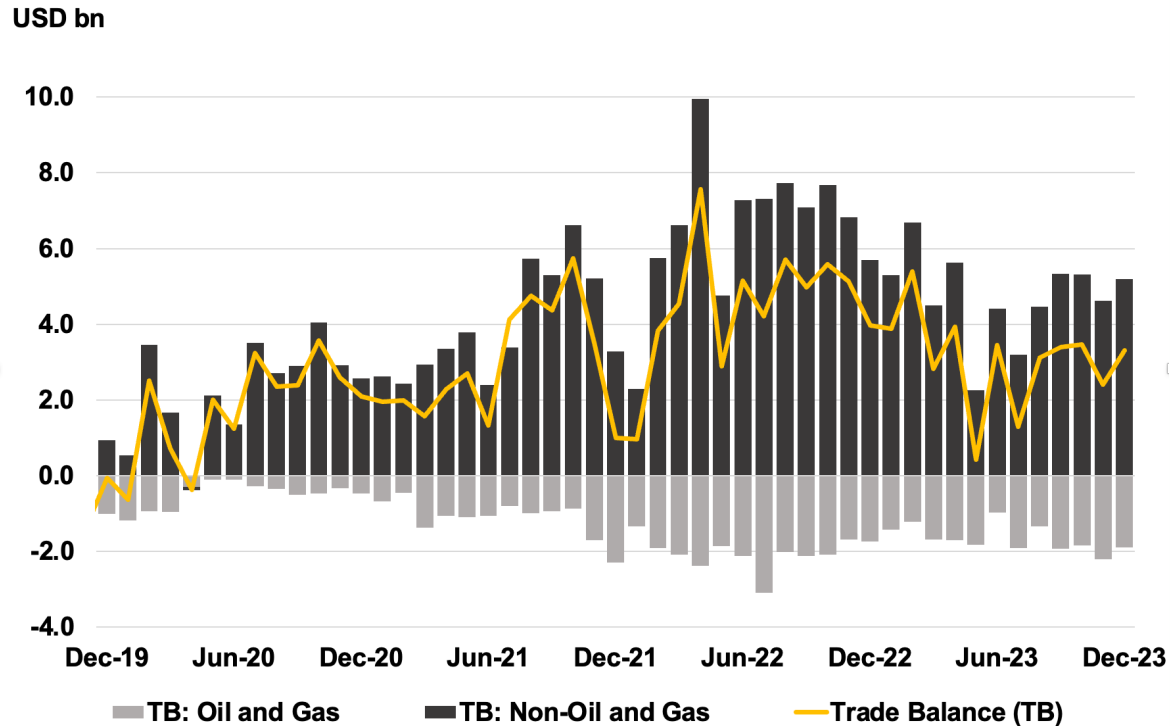


Source: CEIC

- The Investment Coordinating Board (BKPM) reported that the total direct investment realization reached IDR365.8 trillion in Q4-2023. In comparison to Q3-2023, investment realization in Q4-2023 is 2.27% lower.
- Investment realization is still dominated by downstreaming-policy-related industries. With the combined realization of FDI and DDI at IDR56.77 trillion in Q4-2023, basic metal industry became the largest contributor of investment realization in Indonesia.
- Based on the investment location, realization of investment is still heavily concentrated in Java.
- The biggest FDI source to Indonesia came from Singapore with total realization of USD3.21 billion followed by China (USD1.85 billion), Malaysia (USD1.65 billion), Japan (USD1.38 billion) and Hong Kong (USD1.29 billion). This could be a worrying sign on the road as Indonesia is heavily relying on its Asian peers in direct investment flow.

Maintained Growth Amidst Turmoil

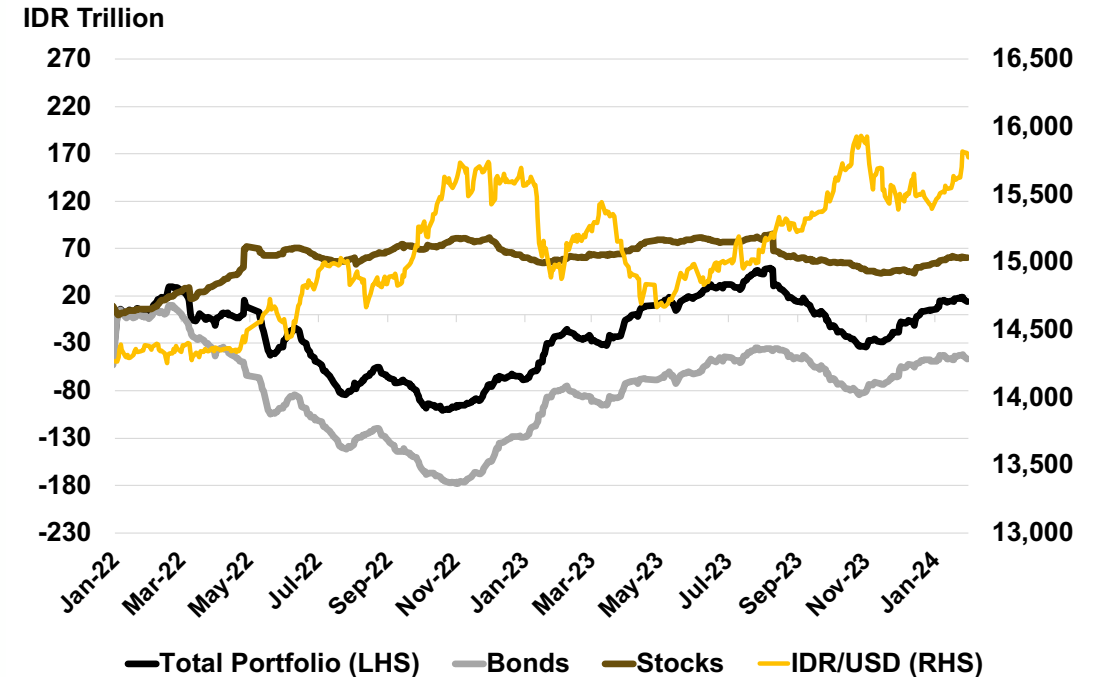
Monthly Trade Balance (Nominal)



Source: CEIC

- Cumulatively, Indonesia recorded a trade surplus of 36.93 billion in 2023 and prolonged trade surpluses for 44 consecutive months since May 2020.
- Global weakening demand, moderation of commodity prices, and rising geopolitical tension throughout 2023 has caused considerable decline both in exports and imports figure, although on a different magnitude.
- During the past year, Indonesia's exports dropped by 11.36% (y.o.y) while imports shrank by 6.55% (y.o.y) compared to 2022.
- On year-to-date basis, Indonesia attracted net capital inflow of around USD4.71 billion throughout 2023 and significantly improved compared to net outflow of USD4.64 billion in 2022.

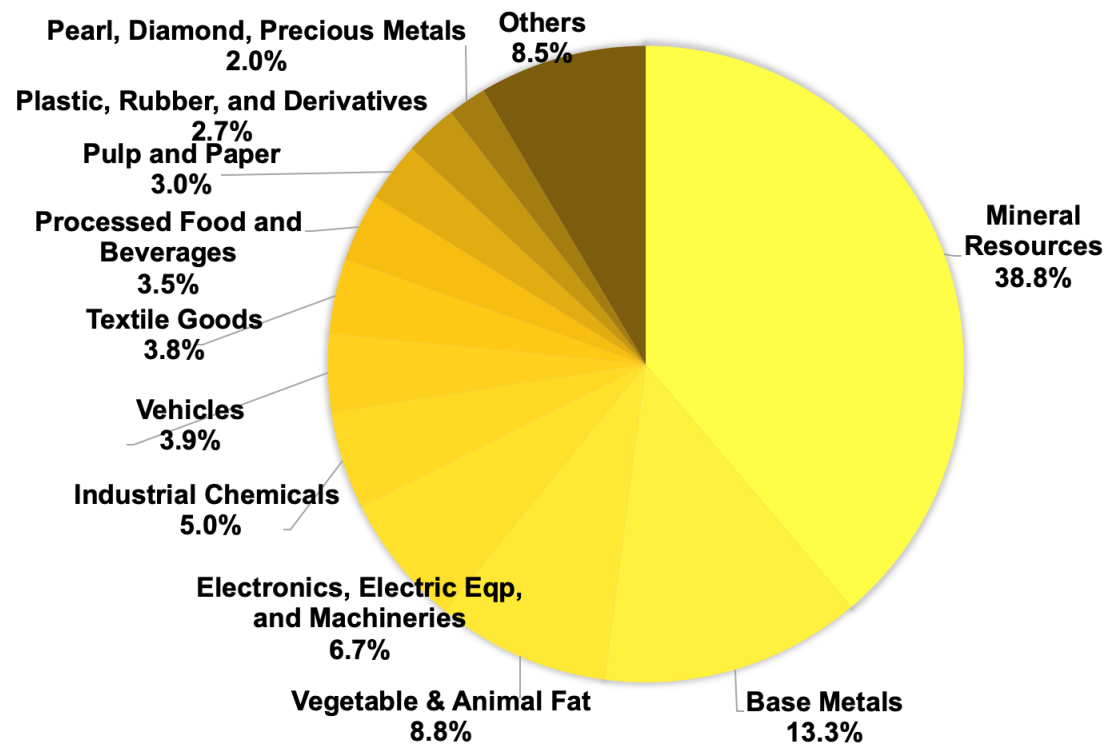
Exchange Rate and Accumulated Short-Term Capital Inflow



Source: CEIC

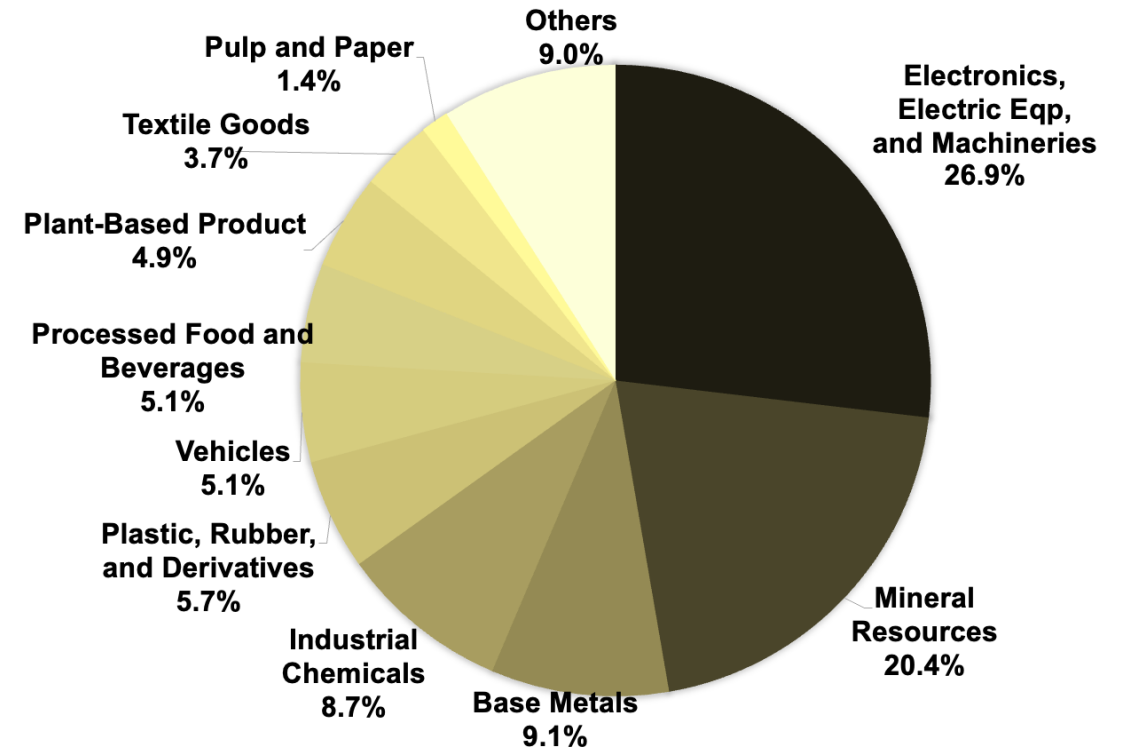
Composition of Exports and Imports Remains

Indonesia Export Profile (October-November 2023)



Source: CEIC

Indonesia Import Profile (October-November 2023)



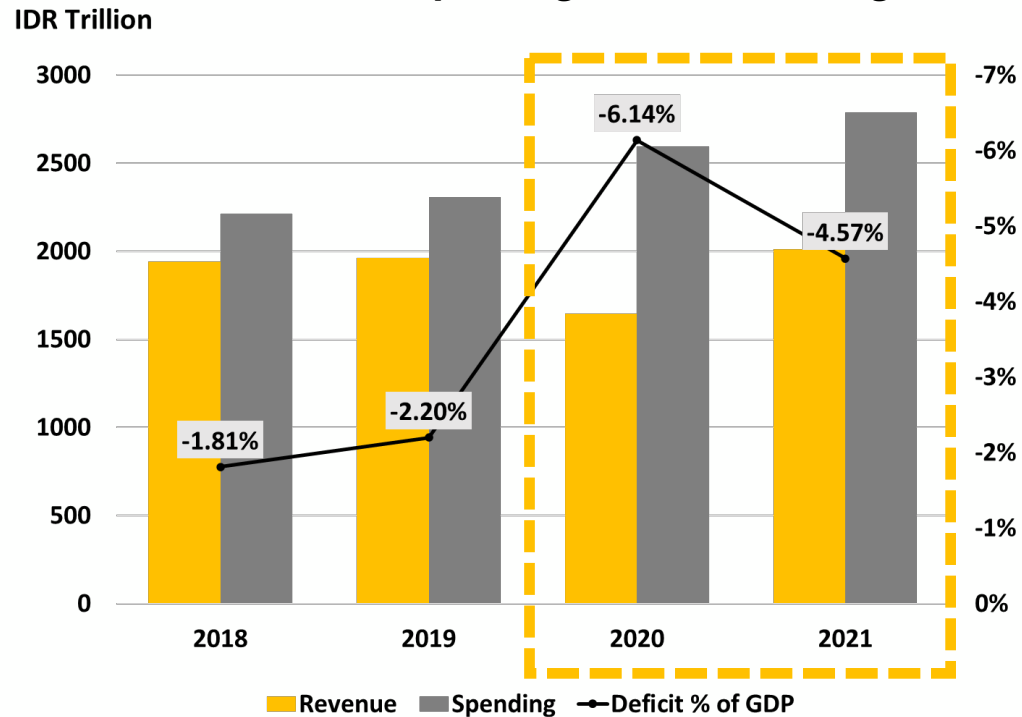
Source: CEIC

- Indonesia's exports dropped by 8.38% (y.o.y) in Q4-2023, moderating from a contraction of 18.66% (y.o.y) in the previous quarter and prolonged the high-base effect of soaring commodity prices in 2022.
- The increase in non-oil and gas exports was dominated by commodity goods, accounting for 62.9% of the increase. These commodity goods included mineral resources (38.8%), base metals (13.3%), vegetable and animal fats (8.8%), pearls, diamonds, and precious metals (2%).
- Imports of oil products shrank by 12.71% (y.o.y) and gas by 24.81% (y.o.y) due to price freefall in comparison to 2022. In addition, China as Indonesia's main trading partner is in an economic slowdown.

Indonesia's Fiscal Discipline

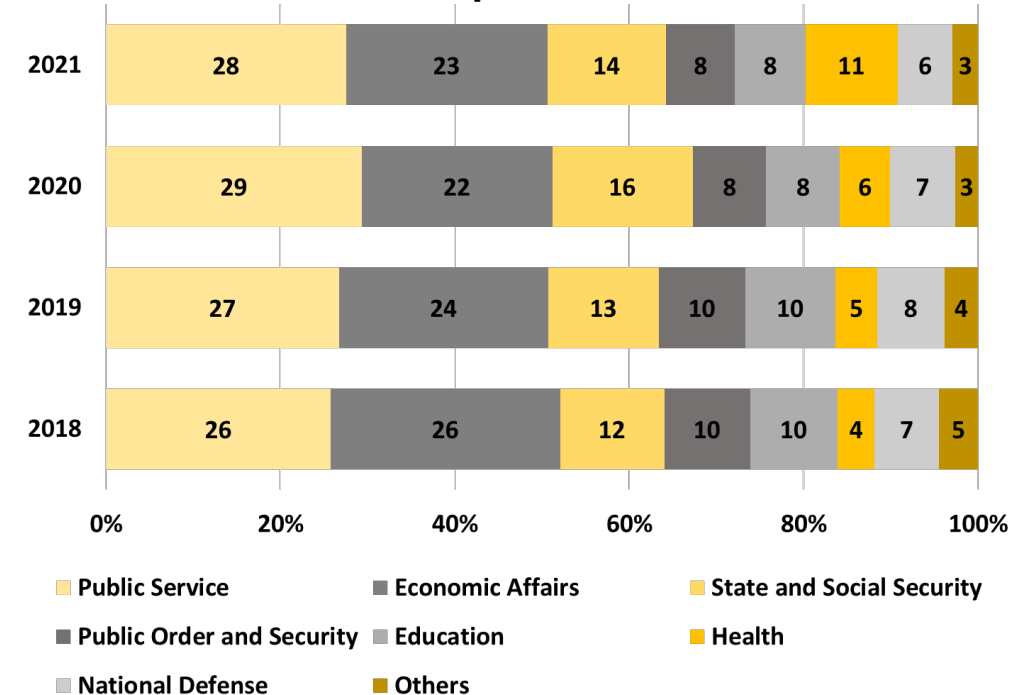
Fiscal Impact of Covid-19

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



Source: Ministry of Finance

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



Source: Ministry of Finance

- 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 main expenditure is for National Economic Recovery (PEN program which accounted at IDR695.20 trillion in 2020. 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 PEN program amounted to no less than 27%, both in 2020 and 2021, suggesting **its significance in the state budget**.
- In general, the allocation pattern for the PEN program was aligned with the growing trend in government spending. Overall, the total spending side of the government budget experienced a **notable increase of 22% from the previous year**.

2024 State Budget Summary

	2023 Outlook	2024 Proposed Budget	Delta (%)
A. State Revenue and Grant	2,637.2	2,802.3	6.3%
I. Domestic Revenue	2,634.1	2,801.0	6.3%
1. Tax Revenue	2,118.3	2,309.0	9.0%
2. Non-Tax Revenue	335.6	492.0	46.6%
II. Grant	0.6	0.4	-33.3%
B. State Expenditure	3,123.7	3,325.1	6.4%
I. Central Government Expenditure	2,298.2	2,467.5	7.4%
1. Personnel spending	432.5	481.4	11.3%
2. Material spending	418.2	410.9	-1.7%
3. Capital spending	258.9	244.4	-5.6%
4. Interest payment	437.4	497.3	13.7%
5. Subsidy	271.4	282.7	4.2%
6. Grants spending	-	-	0.0%
7. Social assistance	146.5	152.3	4.0%
8. Other expenditure	333.4	377.4	13.2%
II. Regional Transfer	769.6	814.7	5.9%
C. Primary Balance	(49.1)	(25.5)	-48.1%
D. Surplus/Deficit	(486.5)	(522.8)	7.5%
% Surplus/Deficit to GDP	(2.30)	(2.29)	-0.4%

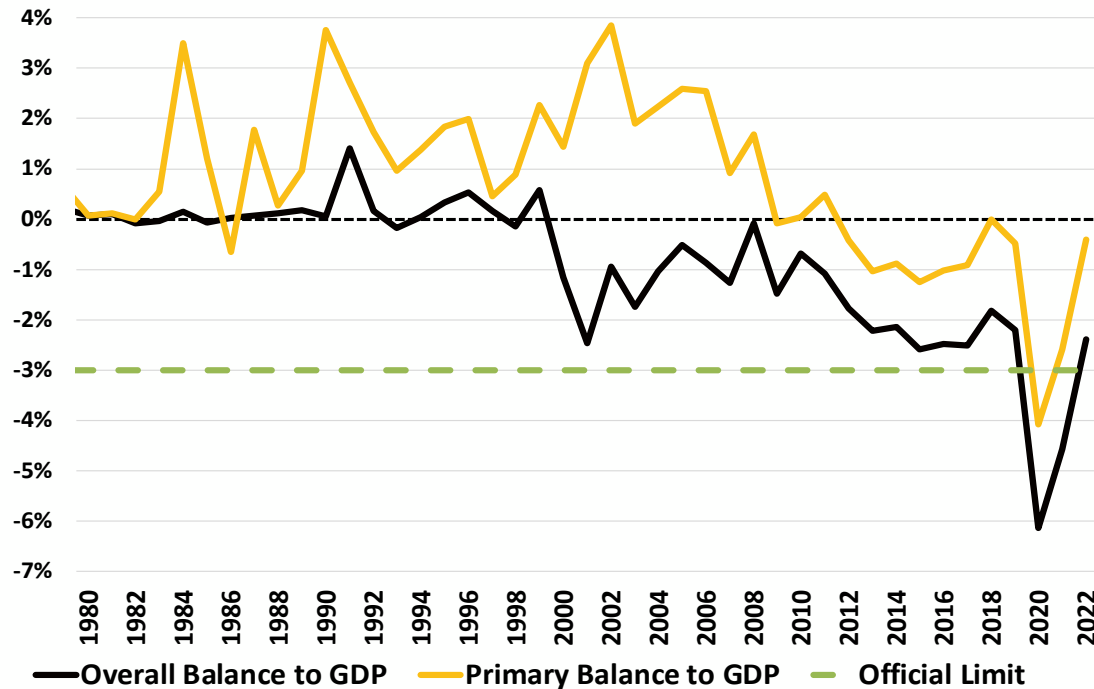
Source: Ministry of Finance

- 2024 state budget reflects a slight increase in fiscal space, thanks to last-year fuel price reform.
- As expected, social assistance and subsidy will increase during the election cycle.

	2023 State Budget		2024 State Budget	
	Amount (IDR Tn)	% of Government Spending	Amount (IDR Tn)	% of Government Spending
Education	233.9	8%	237.3	7%
Health	169.8	6%	186.4	6%
Regional Transfer and Village Funds	814.8	27%	857.6	26%
Others				
- Personnel Spending	442.5	14%	481.4	14%
- Debt Interest Payment	441.4	14%	497.3	15%
- Energy Subsidy and Compensation	352.2	12%	329.9	10%
- Other Subsidy	86.1	3%	96.9	3%
Total of Mandatory Spending	2540.7	83%	2686.8	81%
Total Discretionary Spending (Fiscal Space)	520.5	17%	638.3	19%
Total Spending	3061.2	100%	3325.1	100%

History of Indonesia's Fiscal Management

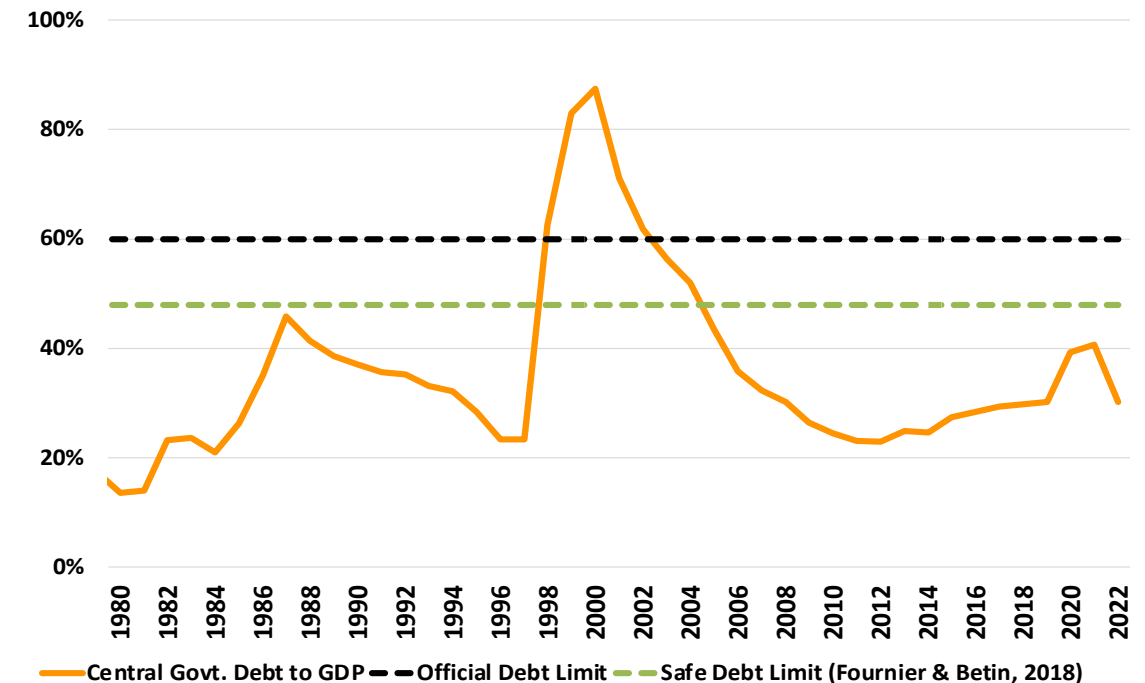
Government Revenue and Expenditure (IDR Trillion)



Source: CEIC

- The Indonesian budgeting system was transformed following the 1997/1998 economic crisis, one notable remark is that Indonesia introduced a **fiscal rule** as specified in the 2003 State Financial Law which caps **annual deficits at 3% of GDP** and **accumulated debt at 60% of GDP**.
- 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).
- Thanks to aggressive fiscal discipline in the previous years, Indonesia could afford an episode of spending expansion (2011 onwards) while still being **fiscally prudent** and below the threshold set by the fiscal rule.
- In the last couple of years, Indonesia has experienced an **improvement in its sovereign credit rating**. 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.

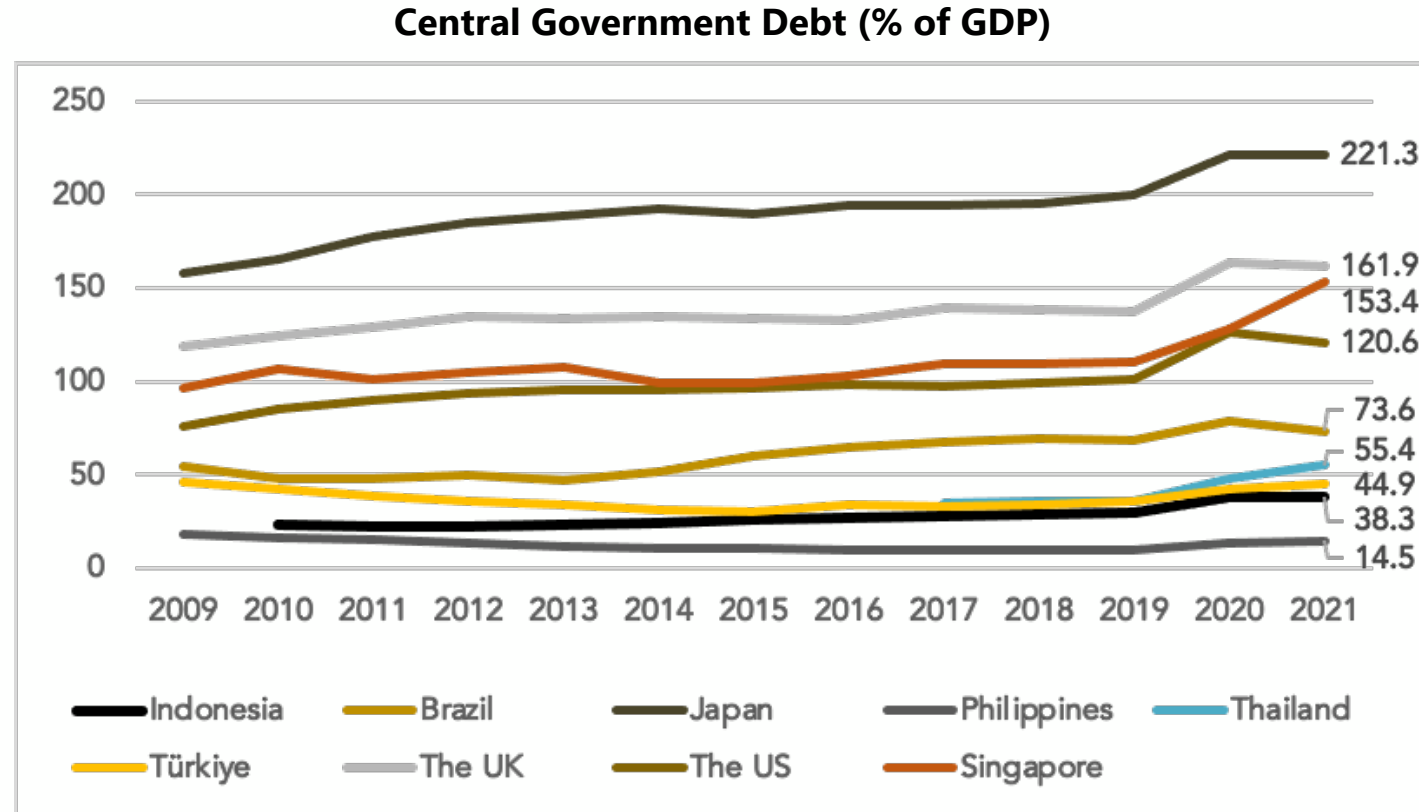
Government Debt to GDP (%)



Source: IMF, OECD

Relatively Low Central Government Debt Ratio

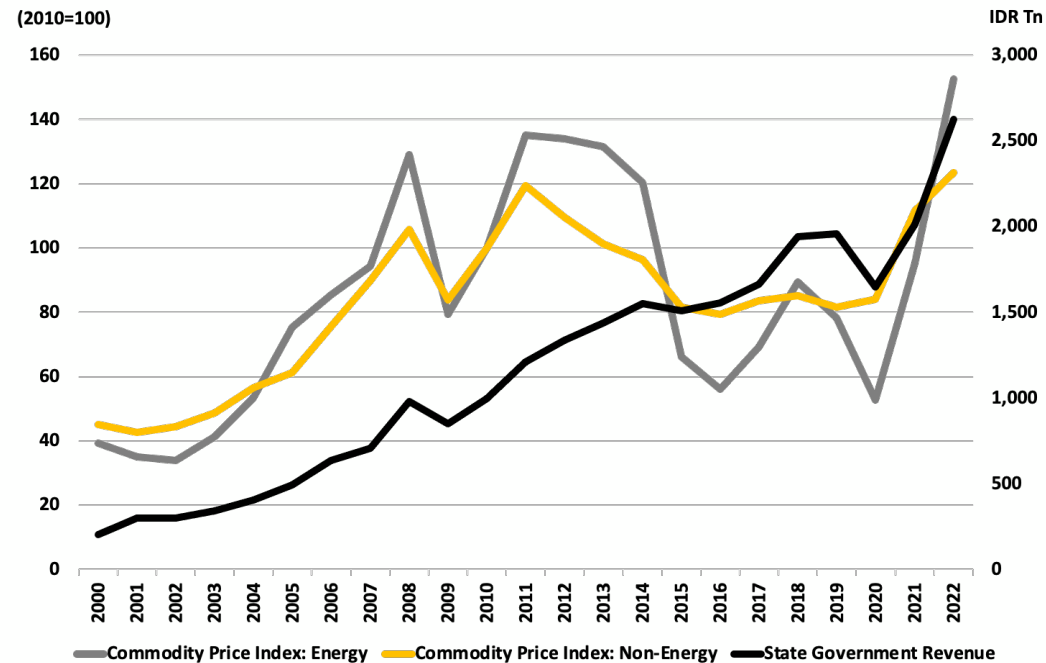
- **Indonesia's government debt ratio has been decreasing to 39% in Q2-2022** after reaching an all-time high of 41.6% in Q1-2021, well below the maximum allowed ratio of 60%.
- Increase in commodity prices allowed state revenue to exceed its target in 2021 and the trend continues in 2022. The accumulated budget surplus may then be utilised as a fiscal cushion.
- **Indonesia's government debt to GDP ratio is significantly lower than peers**, such as Malaysia and Türkiye at 62.1% and 42.1%, respectively.
- The relatively low debt to GDP ratio indicates that the **higher debt burden** of repaying the ballooned debt during the Covid-19 pandemic **could be less risky in Indonesia** relative to the size of the economies.



Source: CEIC

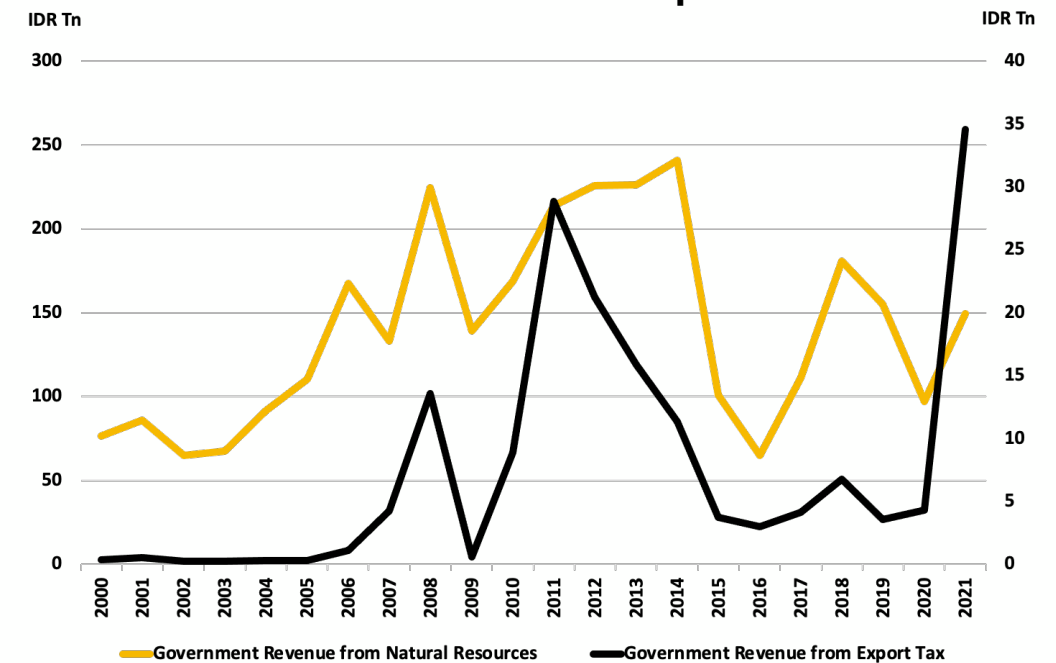
Commodity Windfall and Economic Resiliency

Commodity Prices Index and Indonesia's Government Revenue



Source: CEIC

Indonesia's Government Revenue from Natural Resources and Export Tax

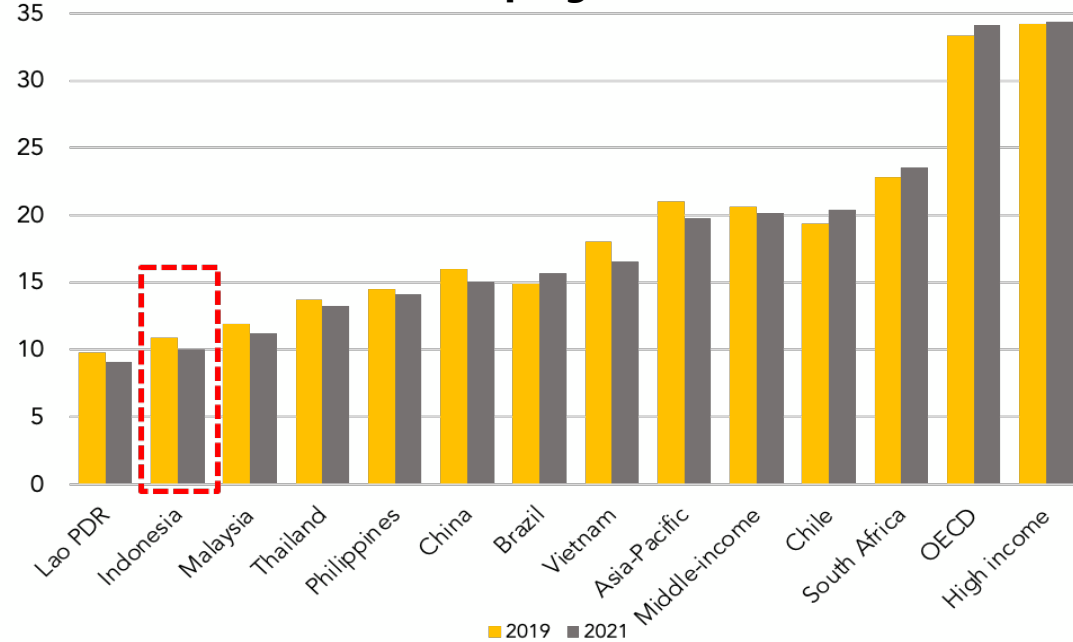


Source: IMF, OECD

- Indonesia is considered resilient with its manageable economic growth, which can be partly attributed to high commodity prices that have supported economic growth and contributed to fiscal revenues.
- There is 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.

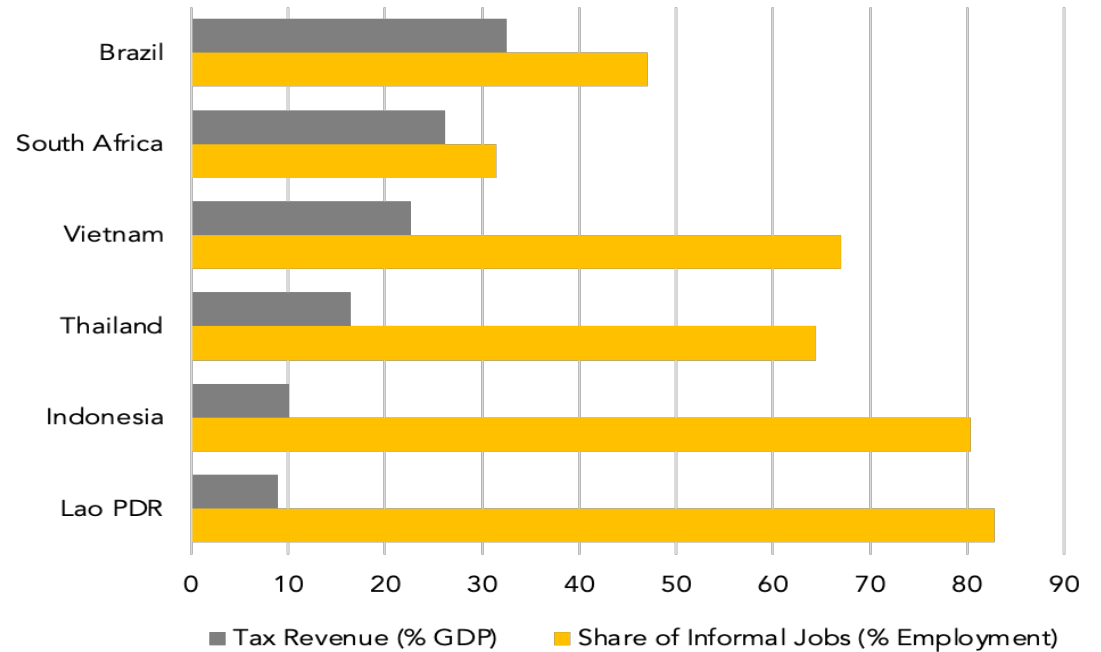
Indonesia's Stubbornly Low Tax-to-GDP Ratio

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



Source: CEIC

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



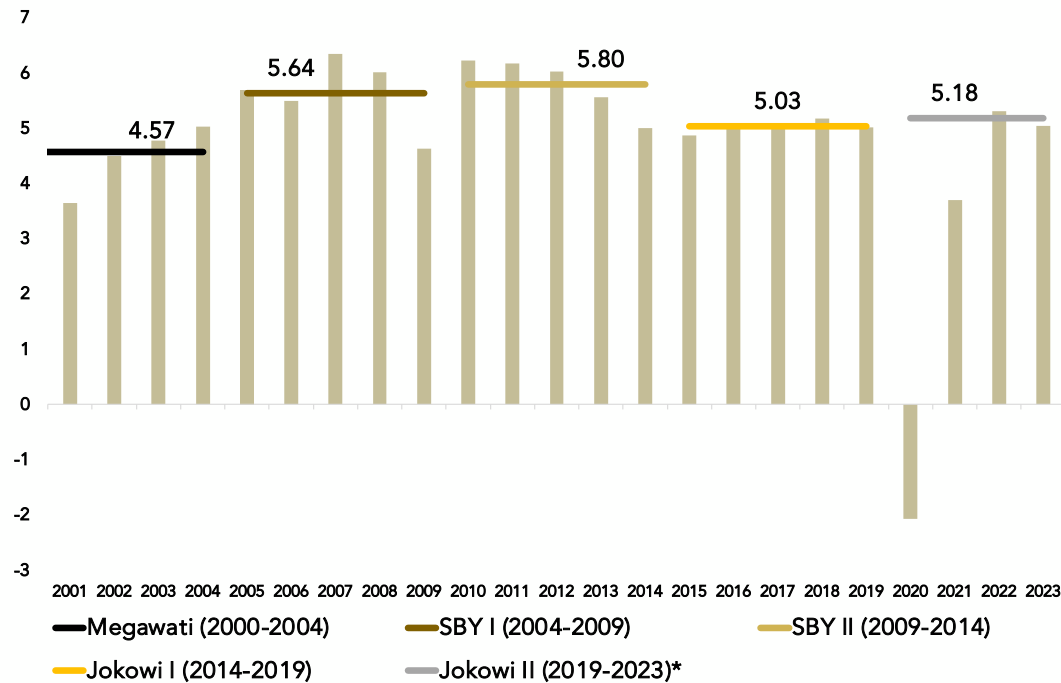
Source: IMF, OECD

- Indonesia is one of the countries with the lowest tax-to-GDP ratio compared to most other developing countries.
- The stubbornly low tax ratio can be partially explained by the higher degree of informality compared to other countries. 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.
- GoI also needs to reform tax administration, such as shifting the top potential business from KPP Pratama to KPP Madya in order to boost the tax revenue (Basri et al, 2020).
- 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.

Assessing A Decade of Jokowinomics

Economic Growth and Productivity (1)

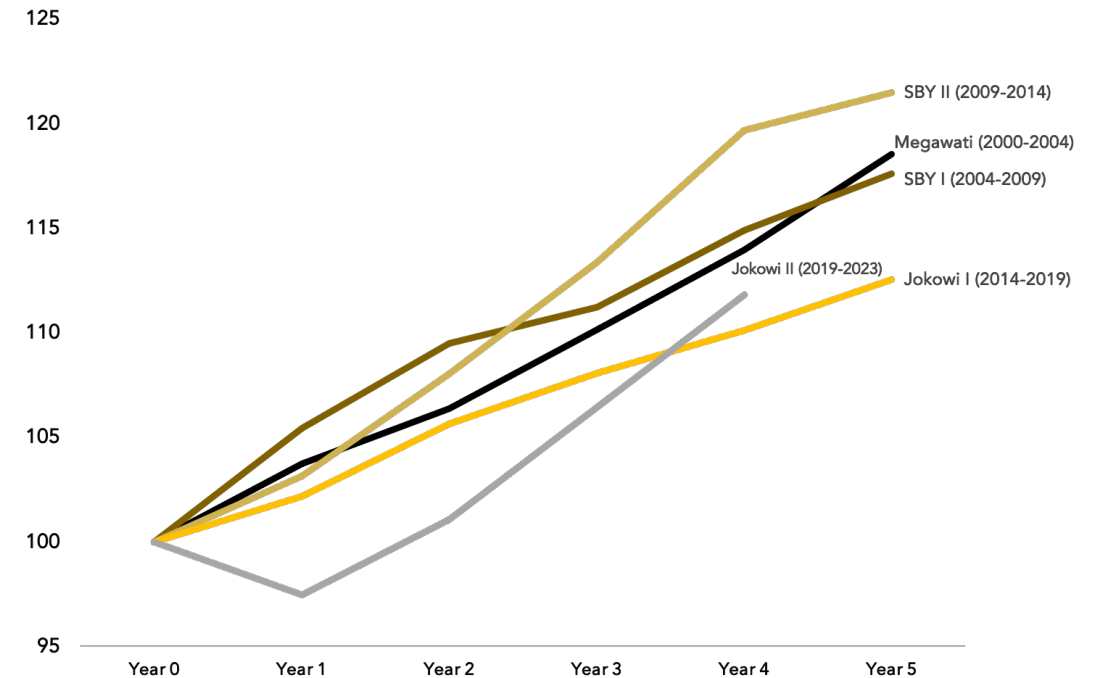
GDP Growth (%)



Source: CEIC

* Excluding Covid-19 period (2020-2021)

Labor Productivity**



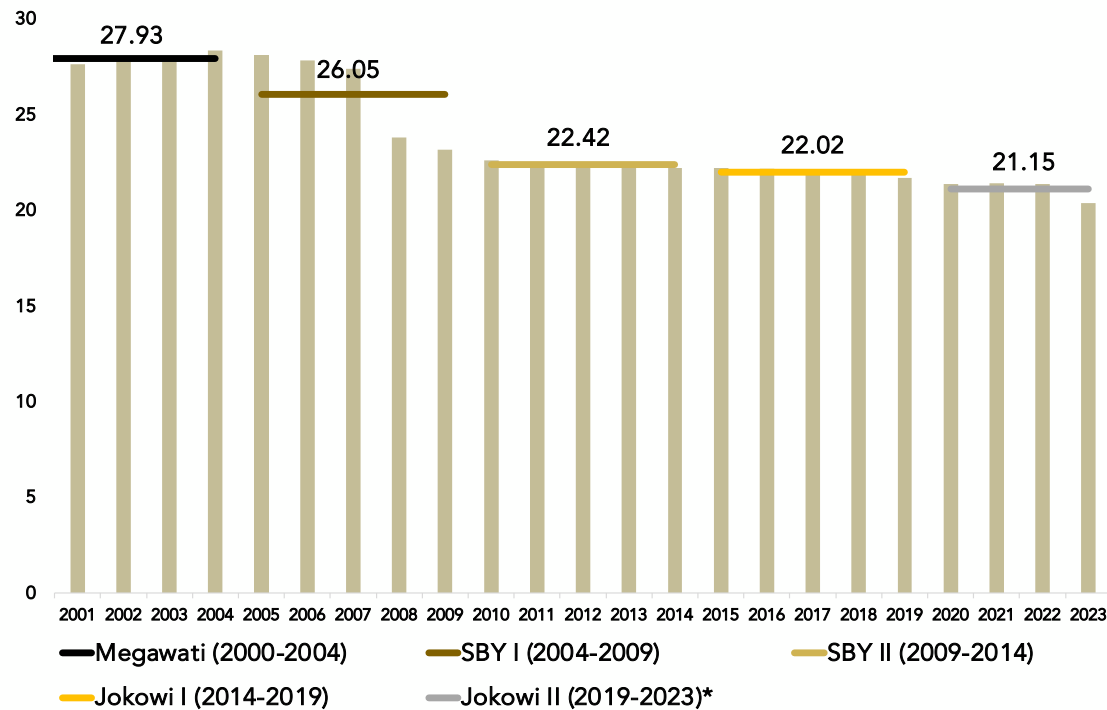
Source: CEIC

* *Indexed to the start of the administrative period (Year 0 is indexed to 100)

- While Indonesian economy grew faster compared to President Megawati's time in the office, GDP grew relatively lower compared to President SBY's administration in both terms. Average GDP growth during President Jokowi's first term is around 5.03% (y.o.y) and 5.18% (y.o.y) in its second term (excluding Covid-19 period).
- It is worth to note that SBY's presidency coincided with the period of commodity boom, which have spurred economic growth as Indonesia is main commodities exporter.
- Since the beginning of administration term, there has been higher labour productivity improvement during President Megawati's and President SBY's term. First-term of President Jokowi administration marked the slowest labour productivity increase compared to the other four presidency term since 2000.

Economic Growth and Productivity (2)

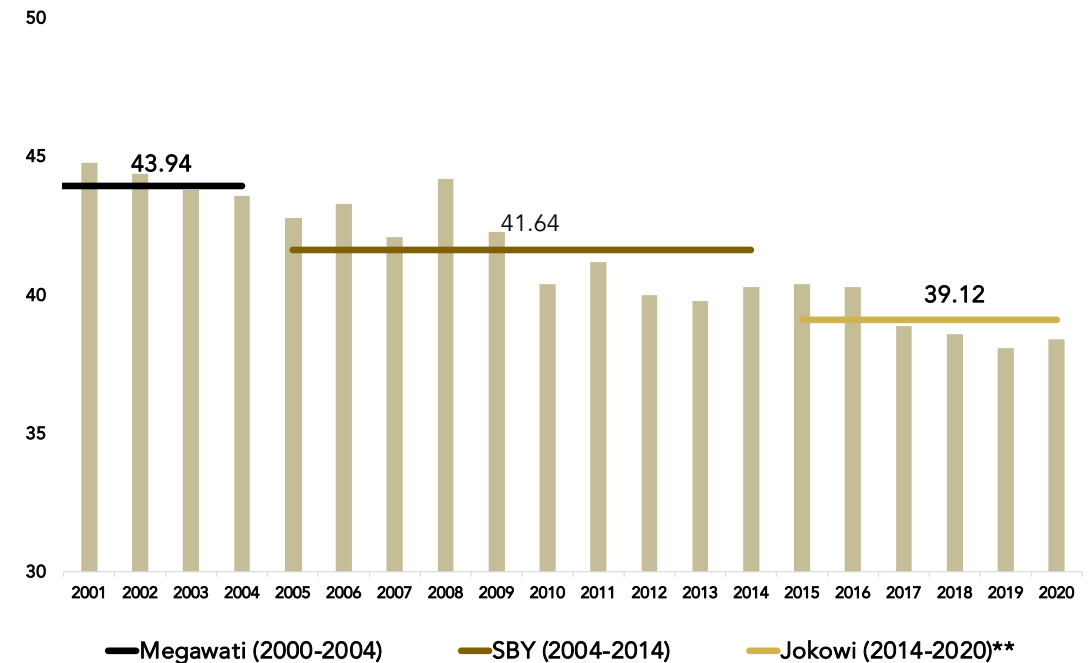
Share of Manufacturing Sector (% GDP)



Source: CEIC

* Excluding Covid-19 period (2020-2021)

Manufacturing Value-Added (% of Production)



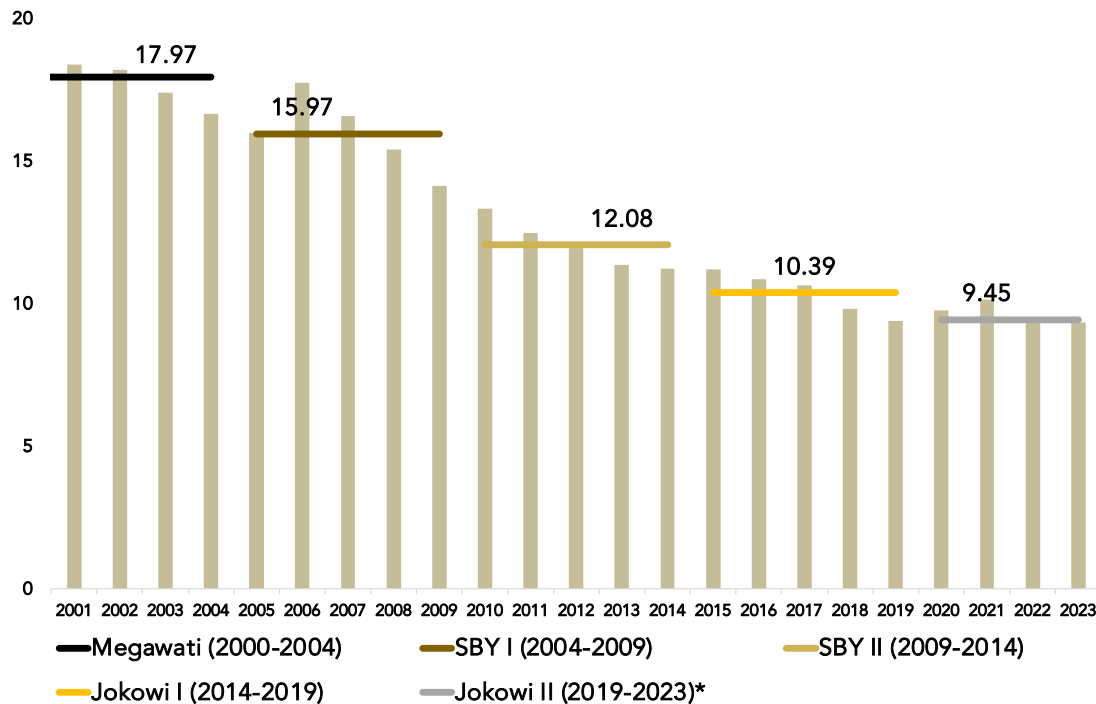
Source: OECD

* **The latest data available is in 2020

- Indonesia has been consistently showing the sign of premature deindustrialization. Throughout President Megawati's era to President Jokowi's, manufacturing sector in Indonesia has been consistently shrinking and grew below national GDP growth rate.
- Consequently, second-term President Jokowi's administration marked the lowest average of manufacturing share to GDP.
- OECD's data on manufacturing value-added as a share of production also show a downward trend for Indonesia in the last two decades.
- Since President Jokowi took office in 2014, the average manufacturing value-added is around 39.12% until 2020 (due to limited availability of the data), considerably lower than the average during President Megawati's (43.94%) and President SBY's (41.64%).

Poverty and Inequality (1)

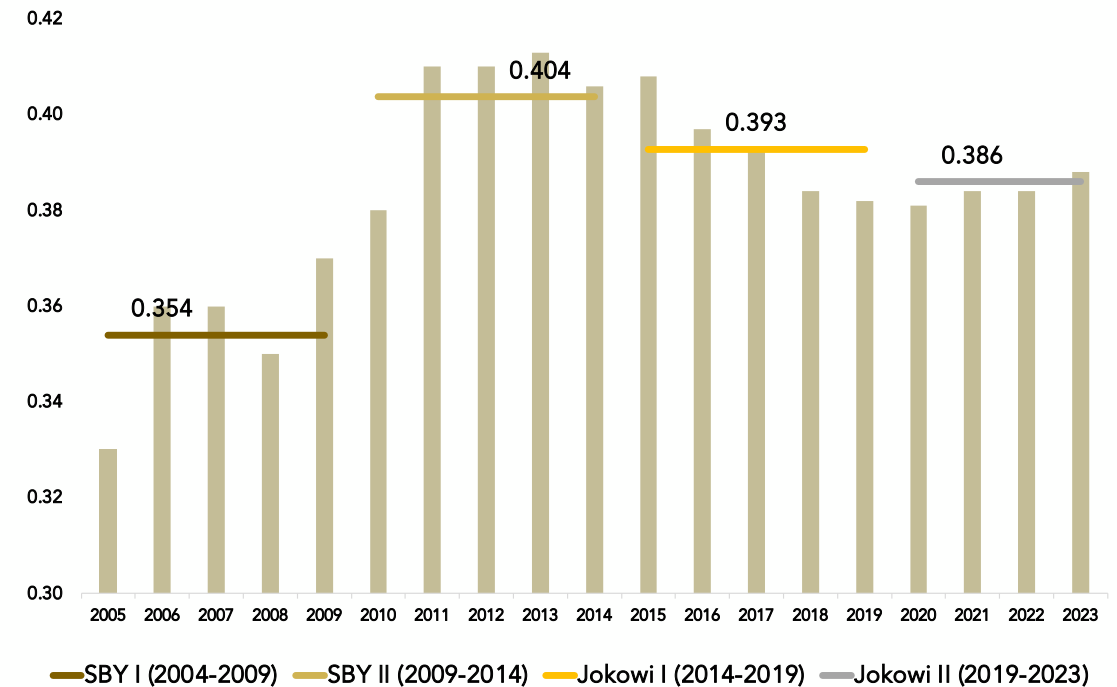
Percentage of Poor People



Source: CEIC

* Excluding Covid-19 period (2020-2021)

Gini Coefficient**



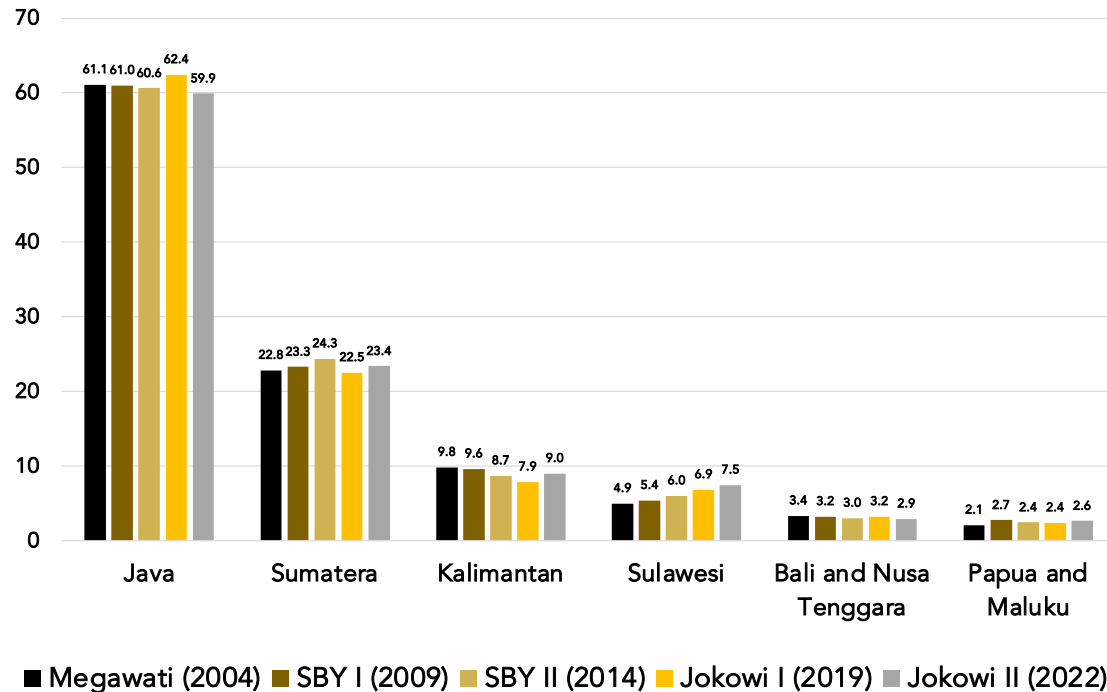
Source: CEIC

**Gini Coefficient data available since 2005

- On poverty aspect, President Jokowi's administration has reached single-digit poverty rate, the first in Reformation era. In 2018, percentage of poor people in Indonesia reached 9.82% and continued to decrease until Covid-19 hit the economy.
- Regardless of Covid-19, both President Jokowi's administration has managed to continue the consistent trend of poverty eradication in Indonesia since President Megawati's era.
- Gini coefficient in Indonesia worsened rather substantially during the second term of President SBY's administration, on average jumped to 0.404 from 0.354 in his first administration term.
- This has been improved to 0.393 in President Jokowi's first term and even further to 0.386 in the second term of President Jokowi's administration.

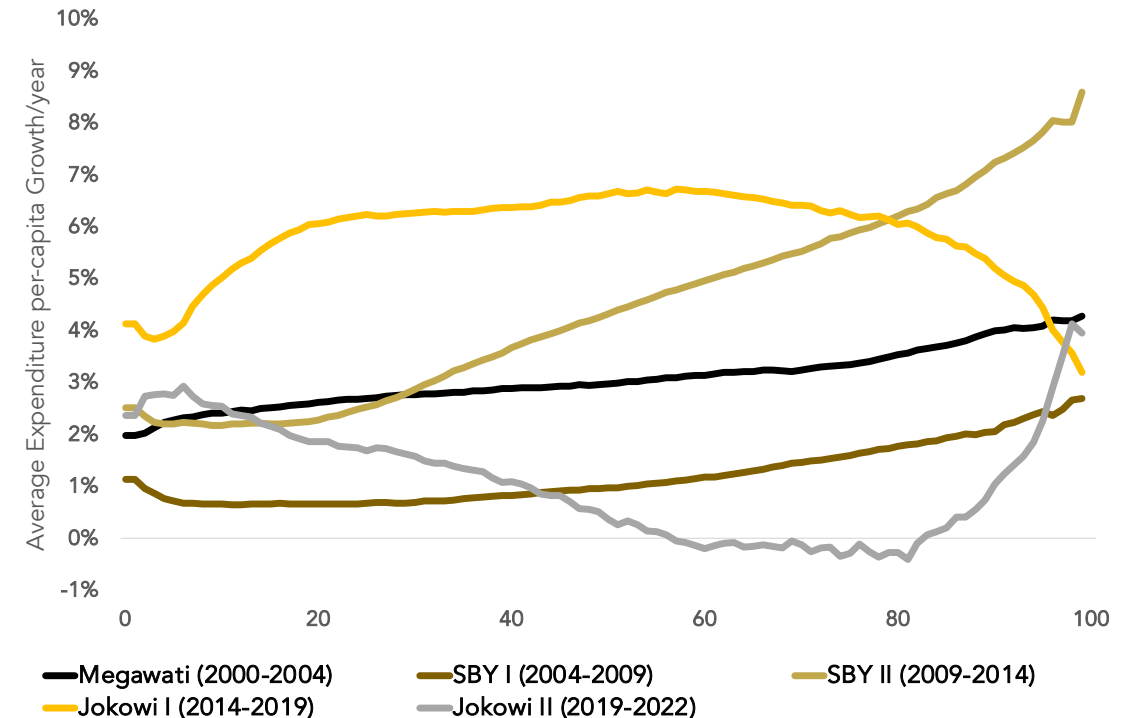
Poverty and Inequality (2)

Share of GDRP to National GDP



Source: CEIC

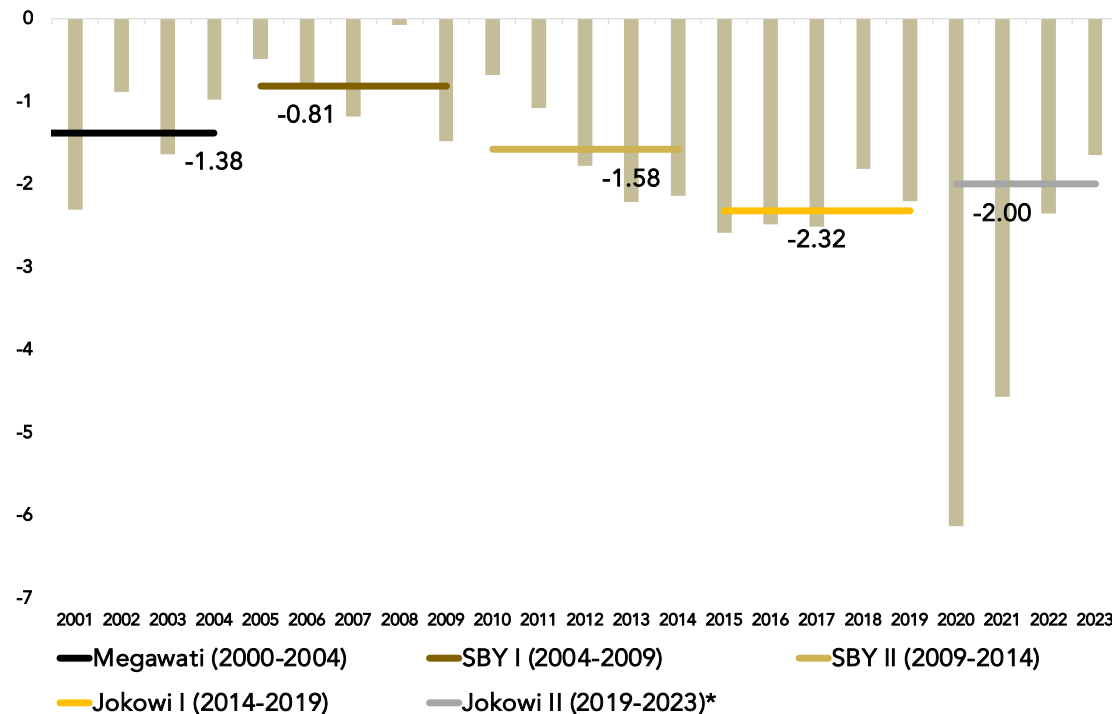
Growth Incidence Curve



Source: Dartanto & Can (2023)

- An inverted U-shape of GIC in the first-term of President Jokowi's administration suggests that economic growth is more inclusive and equally distributed as the middle-class population enjoy a higher welfare improvement in comparison to the poorest and richest. Thus, Gini coefficient could reach 0.38 in 2019.
- On the other hand, U-shaped GIC during President Jokowi's second term indicates welfare improvement occurred for the poorest 20% and richest 10% of population. Moreover, middle-class population with income percentile of 60%-80% experienced a negative welfare growth.
- From regional distribution, there is not much of a progress during President Jokowi's era. Share of economic activity in Java and Sumatera (western part of Indonesia) has not been improved much in 2022 compared to 2004.
- The concentration of economic activity even reached its peak at the end of President Jokowi's first term, with Java and Sumatera accounted for 85% of economic activity in Indonesia.

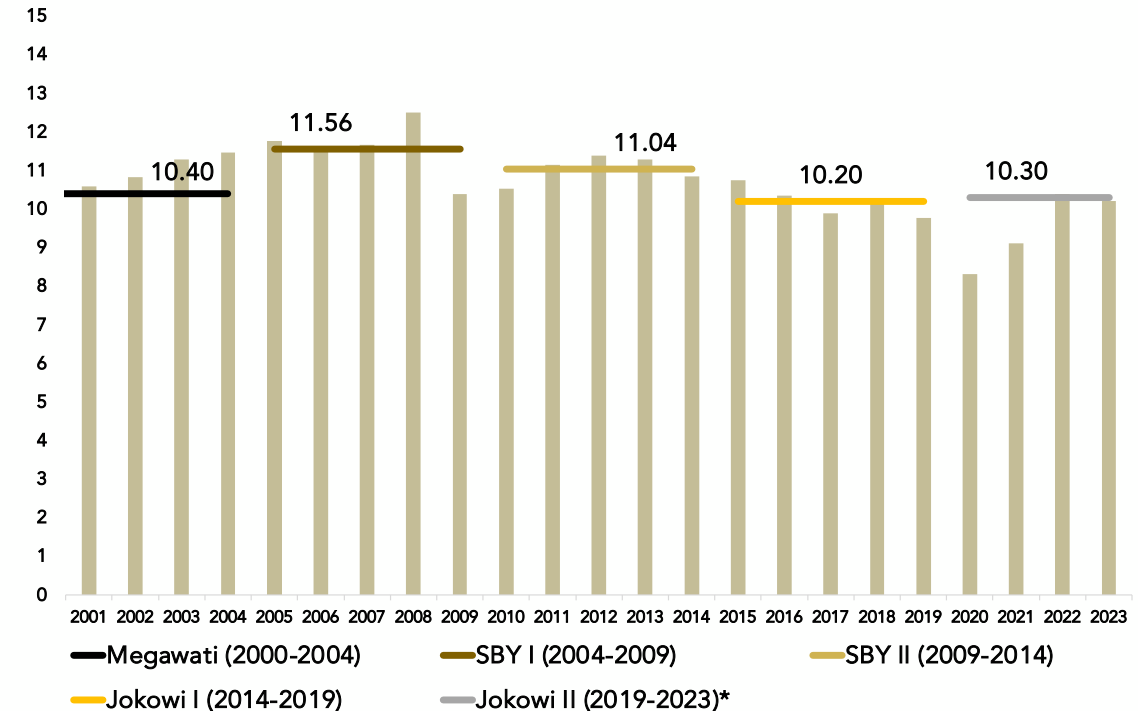
Fiscal Balance (% of GDP)



Source: CEIC

* Excluding Covid-19 period (2020-2021)

Tax Ratio (% of GDP)



Source: CEIC

- In 2014, President Jokowi started his administration not long after the end of commodity boom and shortly after President Jokowi won 2019 election the economy were hit severely by the Covid-19 pandemic.
- Although Indonesia's tax revenue was rather stagnant during the first term of President Jokowi's administration, it gradually increased in President Jokowi's second term, albeit slowly, after a massive decline due to Covid-19.
- Despite the low revenue, fiscal discipline has been maintained throughout two terms of President Jokowi's administration. However, the deficit is understandably widened as the tax revenue is lower compared to President SBY's time.
- Various effort to reform fiscal posture and expand fiscal capacity has been undertaken during President Jokowi's era especially during Covid-19, including fuel subsidy reform, the passing of tax reform law, and Omnibus law on job creation and financial sector.

Reshaping the Expenditure

- 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**.
- 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
- Subsidy reform could be the first step towards a more balanced fiscal as fiscal imbalance will be difficult to sustain if revenue continues to rise more slowly than spending (Ikhsan & Virananda (2021)).
- Two types of social assistance:
 - 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.
 - **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.