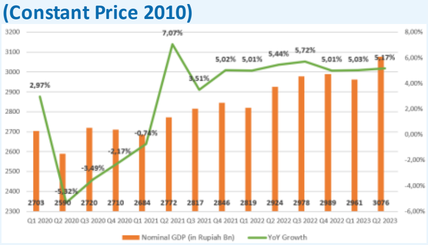
ECONOMIC REVIEW

Economic Performance | Indonesia | 15 December 2023

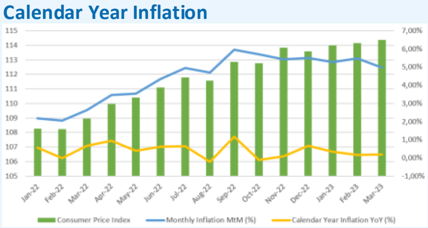
KEY INDEX

Graph 1: Indonesia's Gross Domestic Product (Constant Price 2010)



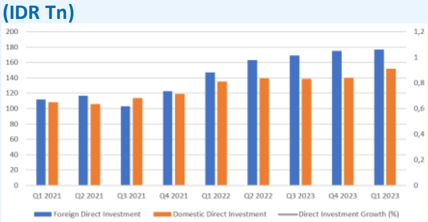
Source: Central Bureau of Statistics

Graph 2: Indonesia's CPI, Monthly Inflation, and Calendar Year Inflation



Source: Central Bureau of Statistics

Graph 3: Indonesia's Investment Realization (IDR Tn)



Source: Badan Koordinasi Penanaman Modal

KRI Analytical Team
PT Kredit Rating Indonesia
+62 21 3983 4411

Beyond the Numbers: Challenges and Opportunities for the Future

Indonesia's economic journey in 2023 has been a testament to its resilience and potential. By addressing the challenges head-on and capitalizing on the opportunities, the nation can steer towards a future of sustainable and inclusive economic growth, leaving a lasting legacy of prosperity for its people. While the economic indicators paint a picture of Indonesia's current state, the real story lies in addressing the challenges and capitalizing on the opportunities that lie ahead. Here are some key areas demanding attention:

- **Sustaining Growth**: Navigating global headwinds and inflationary pressures will require a multi-pronged approach, including fiscal and monetary policy adjustments, infrastructure development, and promoting domestic demand.

- **Taming Inflation**: Finding the sweet spot between controlling inflation and maintaining economic growth will be a delicate dance for BI. Targeted interventions and support for vulnerable segments of the population will be crucial to ensure equitable outcomes.

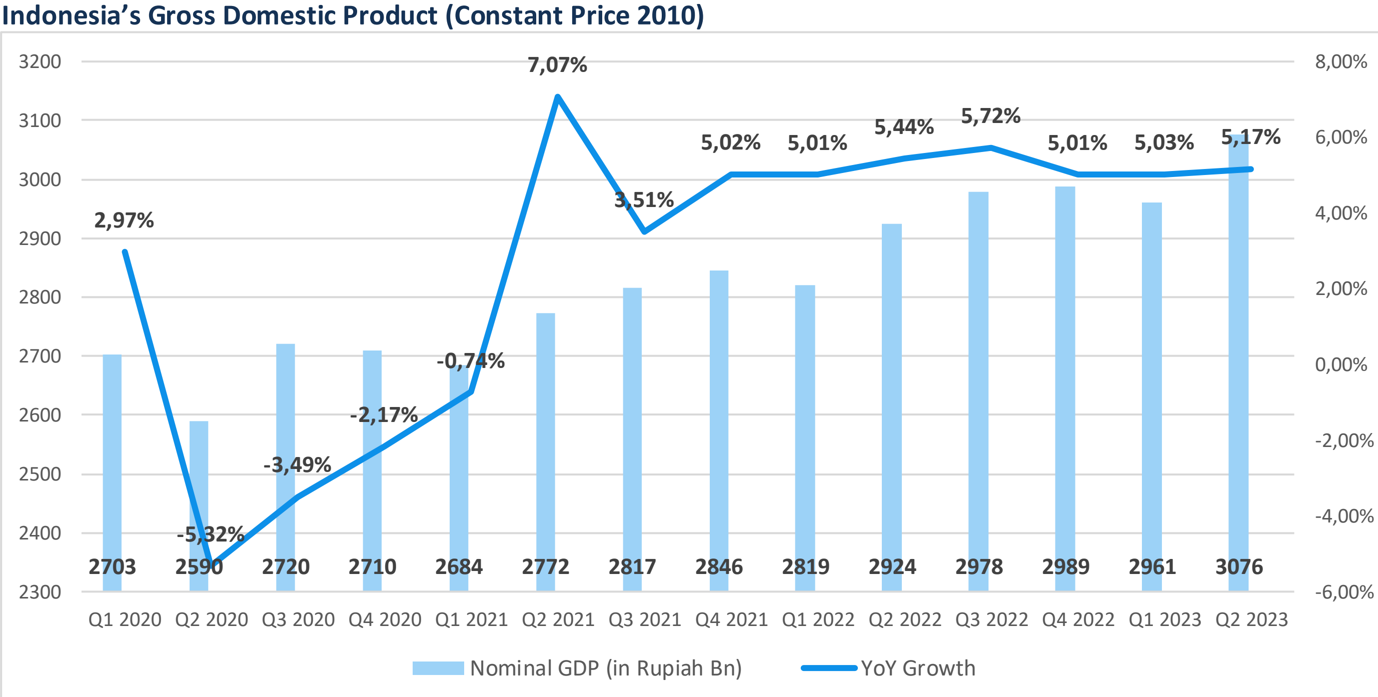
- **Enhancing Competitiveness**: To thrive in the global market, Indonesia needs to invest in improving its infrastructure, streamlining regulations, and upskilling its workforce. Embracing technological advancements and fostering innovation will also be key drivers of competitiveness.

- **Addressing Inequality**: Ensuring that the fruits of economic growth are shared by all requires addressing income inequality. Investing in education, healthcare, and social safety nets will be crucial to create a more inclusive and equitable society.

Indonesia Economic Recap 2023

Indonesia's economy maintains robust growth despite the global economic deceleration. This growth is primarily fueled by strengthening domestic demand and consistent positive export performance. The surge in exports was buoyed by strong demand from key trading partners. Household spending improved in tandem with increased mobility and purchasing power, accompanied by a decline in inflation. Amid the global slowdown, Indonesia is anticipated to be a significant driver of growth, particularly within the Southeast Asia region. The country has displayed impressive economic recovery, demonstrating stronger growth momentum compared to fellow ASEAN nations and G20 countries. In Q2 of 2023, Indonesia's economy expanded by 5.17% year-over-year, following a cumulative annual growth of 5.03% in Q1 2023 and 5.31% in 2022. This achievement positioned Indonesia among the fastest-growing economies worldwide, surpassing expectations during a period of global economic deceleration. Nonetheless, the projected annual economic growth for 2023 is expected to moderate to 4.8%, owing to the anticipated economic slowdown among Indonesia's major global trade and investment partners. This projection aligns with Bank Indonesia's estimated growth range of 4.5% to 5.3%. Contrarily, the Ministry of Finance initially forecasted a growth range between 5.3% to 5.7% for 2023, which was subsequently revised downwards to 5.1% to 5.7% in early June. This achievement means that Indonesia market has grown surpass the market expectations for more than six consecutive times.

Indonesia's Gross Domestic Product (Constant Price 2010)

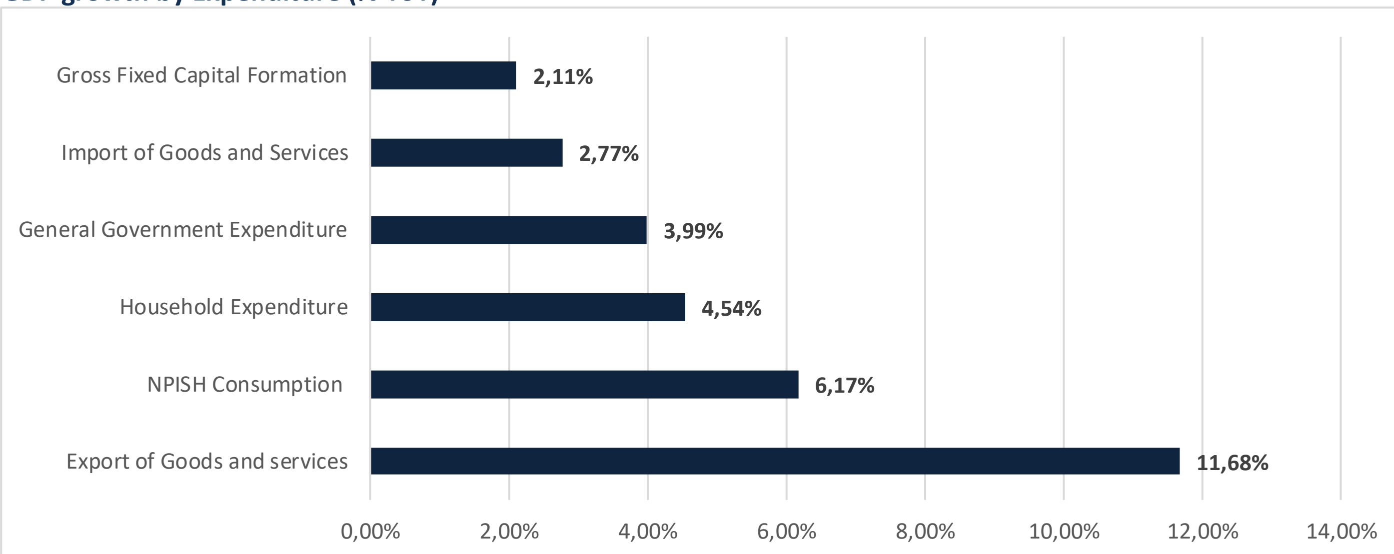


Source: Indonesia Central Bureau for Statistics (2023)

In Q1 2023, exports emerged as the most rapidly expanding element bolstering the GDP. The substantial 11.68% growth stemmed from heightened demand from key trade partners. Notably, exports surged to various destinations: Vietnam experienced a significant increase of 24.43% (Month-over-Month, March 2023), followed by notable rises to China (15.24%), India (13.25%), Singapore (9.15%), Taiwan (7.95%), and South Korea (7.84%). Moreover, exports from the oil and gas industry showed a robust growth of 12.79% Quarter-over-Quarter (QoQ). Simultaneously, exports from the non-oil and gas sector expanded by 9.71% QoQ. Examining its expenditure segments, all categories displayed positive growth, even government expenditure, which experienced four consecutive quarters of contraction in 2022.

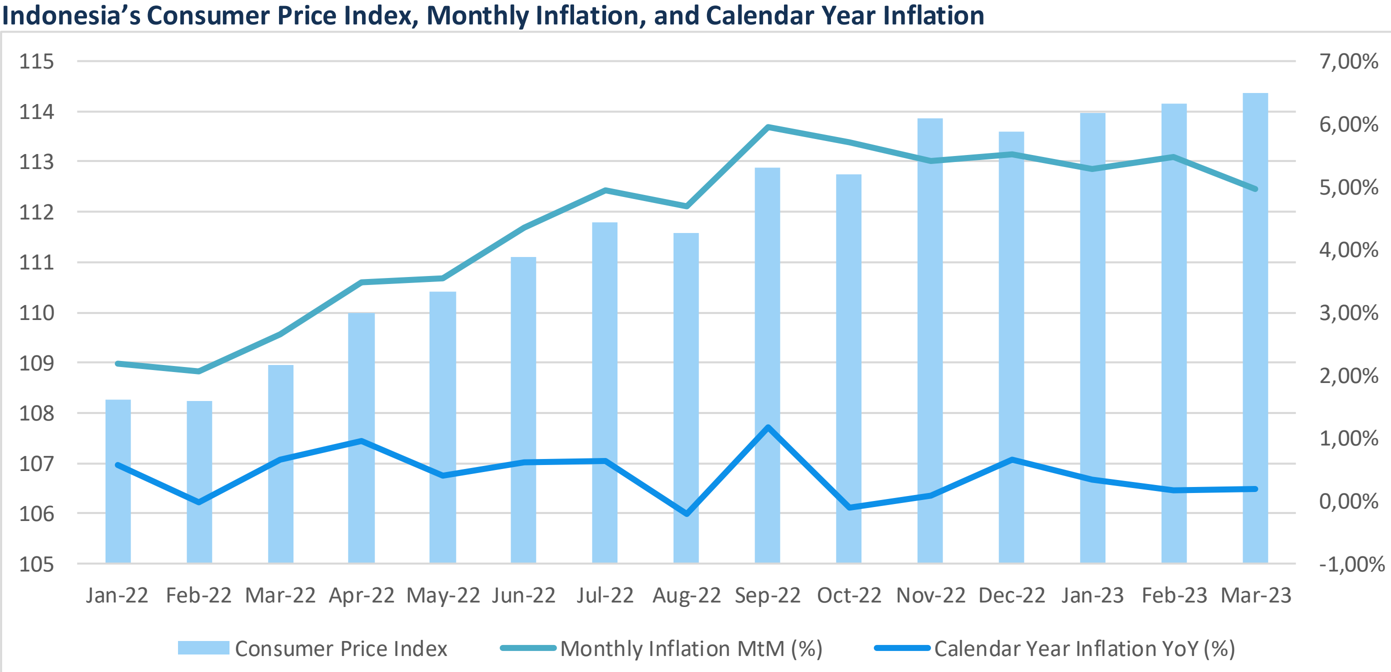
Household consumption, constituting over half of the economy, expanded by 4.54% year-over-year, surpassing the growth seen in the final quarter of 2022. Conversely, investment exhibited a slower pace in Q1-2023, with a 2.11% year-over-year growth rate, down from the 3.33% year-over-year growth observed in the preceding quarter. General government expenditure comes after Household expenditure with 3.99% of YoY growth. However, in Q2-2023 All expenditure components, except exports and imports, experienced a positive growth, including government spending that indicated a jump in growth to 10.62% (y.o.y) in Q2-2023.

GDP growth by Expenditure (% YoY)



Source: Indonesia Central Bureau for Statistics (2023)

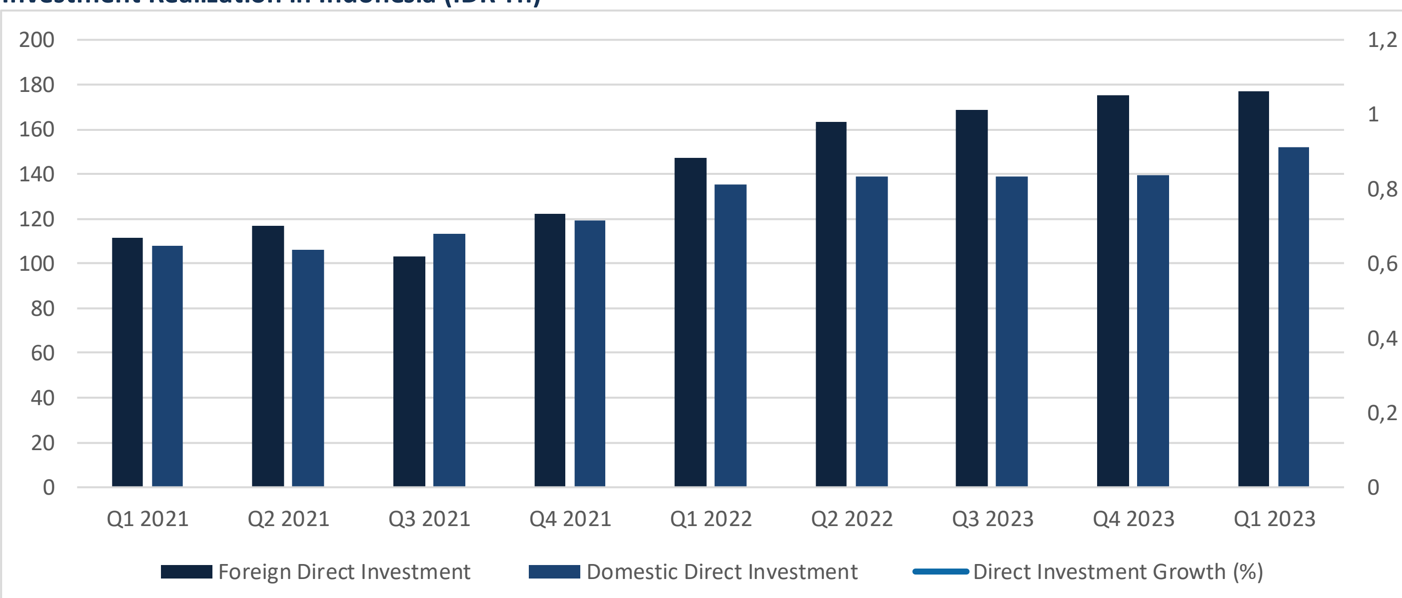
Indonesia's Consumer Price Index, Monthly Inflation, and Calendar Year Inflation



Source: Indonesia Central Bureau for Statistics (2023)

In Q1 2023, inflation displayed a consistent decline, although it persisted above the target range set by Bank Indonesia at 3.0 ± 1%. March 2023 saw an inflation rate of 4.97% (Year-over-Year), with the Consumer Price Index (CPI) registering at 114.36. Despite inflation remaining elevated compared to pre-pandemic levels, Indonesia's economic outlook remains promising due to robust domestic demand. Major contributors to inflation were the Food, Beverage, and Tobacco group at 6.05%, Transportation at 13.72%, Food and Beverage/Restaurant Supply at 4%, and Personal Care and Other Services at 4.74%. Conversely, the Information, Communication, and Financial Services group experienced deflation of 0.23%. In March 2023, the foodstuffs group observed a 5.72% Year-over-Year inflation rate. Rice, cayenne pepper, and garlic contributed to inflation, while staple foods like red chilis and shallots contributed to deflation. According to data from the National Strategic Market Price Information Center (PIHPSN), rice prices remained high at IDR 13,400-13,500/kg throughout February, reaching unprecedented levels in PIHPSN records. Looking ahead, Bank Indonesia anticipates that core inflation will remain controlled within the 3.0 ± 1% range in the first half of 2023. The CPI inflation is expected to return to the target range from September 2023 onward, following the gradual fading of the impact of fuel (BBM) price subsidy adjustments implemented last year.

Investment Realization in Indonesia (IDR Tn)



Source: Badan Koordinasi Penanaman Modal (2023)

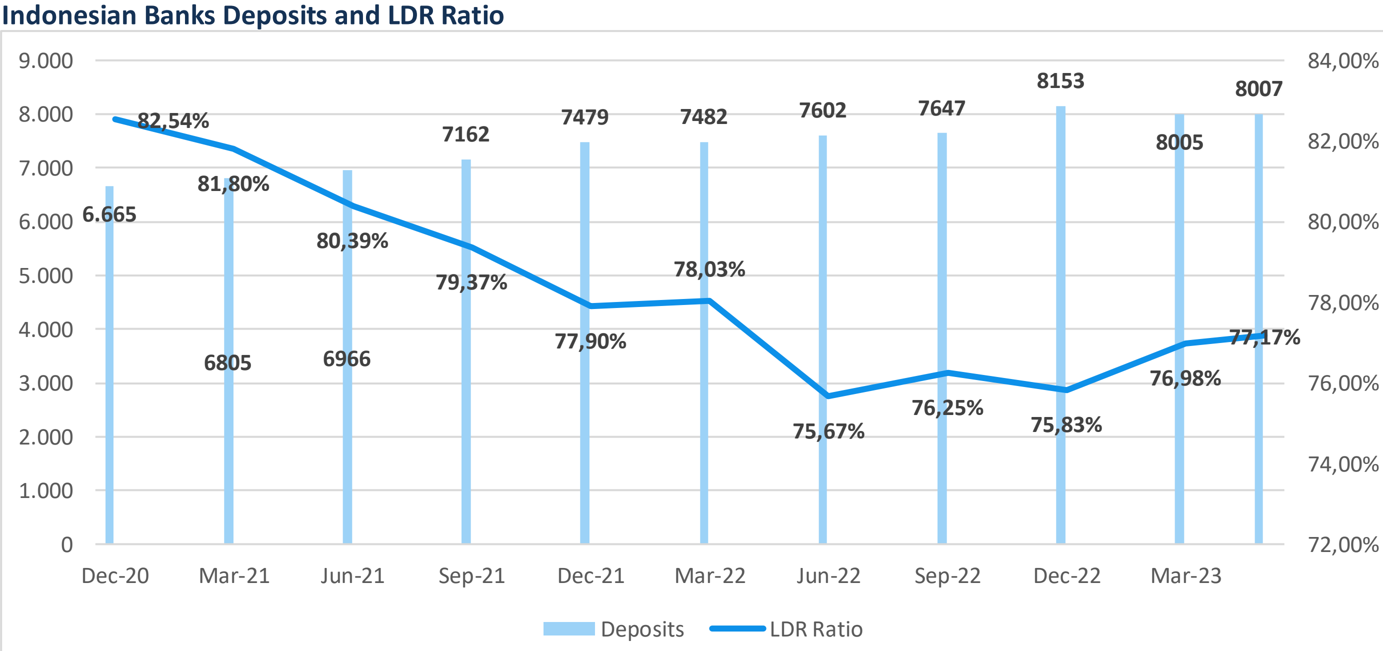
In the first quarter of 2023, Indonesia's total investment realization reached IDR 328.9 trillion, accounting for 23.5% of the annual investment target for 2023. Investment growth during this period saw a 16.5% year-on-year increase (4.5% quarter-on-quarter). This uptick in investment also led to a 15.24% quarter-on-quarter rise in employment, resulting in an additional 384,892 individuals finding employment opportunities. The Indonesian government remains optimistic about achieving the 2023 investment target of 1,400 trillion IDR. However, there are concerns about potential obstacles stemming from global economic downturns that could impede progress. Additionally, internal initiatives aimed at enhancing the ease of doing business and the current political landscape have prompted investors to adopt a 'wait and see' approach.

USD to IDR Exchange Rate

Source: Bank Indonesia (2023)

USD exchange rate relative to rupiah have undergone a massive fluctuation over the course of past couple of years. As we can see from data obtained from Bank Indonesia, there has been trend going on, where nearing the end of 2022, especially in Q4, there have been a surge in the value of USD relative to rupiah, where it increased to around 15.800 Rupiahs per USD. This increase also happens along the process of Indonesia's Economic recovery from Covid-19 Pandemic effect, that has haunted Indonesia's economy for the past three years. Another surge also happened approaching the end of 2023, where rupiah devaluated to all time lowest rate of Rp15,975 per USD. There are a couple of factors attributing to this, but the main cause of it is the increase of Interest Rate by The Federal Reserve, which increases the value and demand for US Dollar currency, driving many stakeholders to collect and reserve USD as much as possible. One of the strategies that then put up by Bank Indonesia (Indonesia's Central Bank) is to also increase its interest rate to further stabilize and maintain while decrease the impact of USD appreciation.

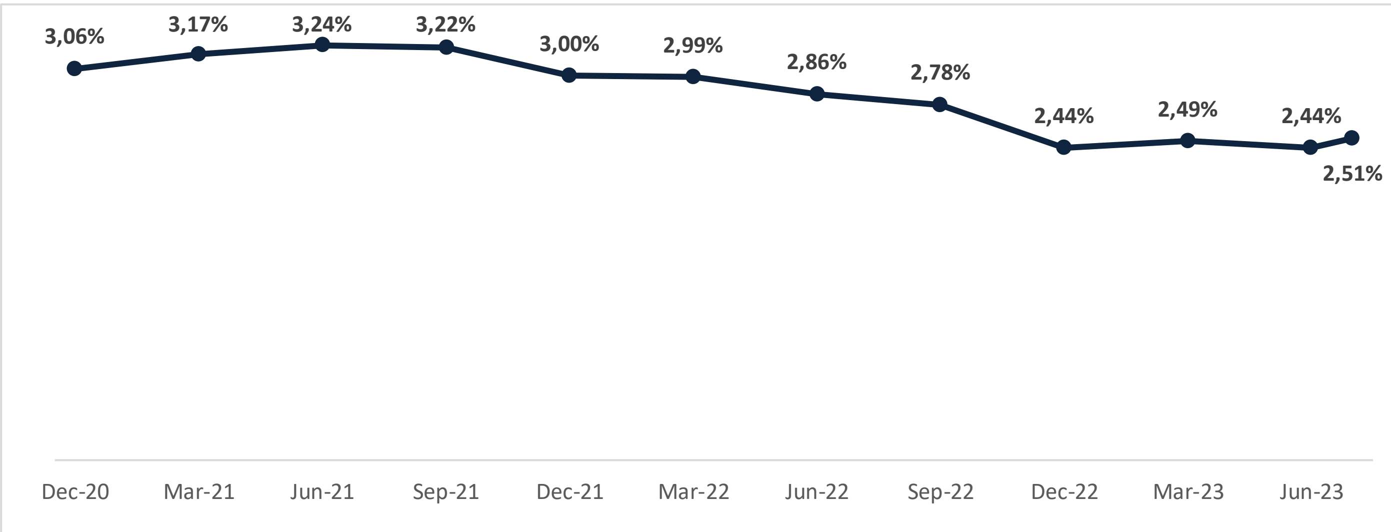
Indonesian Banks Deposits and LDR Ratio



Source: Otoritas Jasa Keuangan (2023)

Based on data from the OJK (Otoritas Jasa Keuangan), the Loan to Deposit Ratio (LDR) for conventional commercial banks was 77.17% in May 2023. This figure is slightly below the minimum LDR limit set by Bank Indonesia, which is 78%. The Loan to Deposit Ratio in May 2022 slightly increased from the previous month, which was 76.98% in March 2023. However, this level is still below the LDR during the pandemic, which was more than 80%. In May 2023, lending to third parties grew 9.3% (YoY) to IDR 6,577 Tn. Since January 2023, there has been a fairly rapid increase in lending to third parties, thus increasing the total credit disbursement as a whole, reaching IDR 6,644 Tn in May 2023 (growing 9.4% YoY).

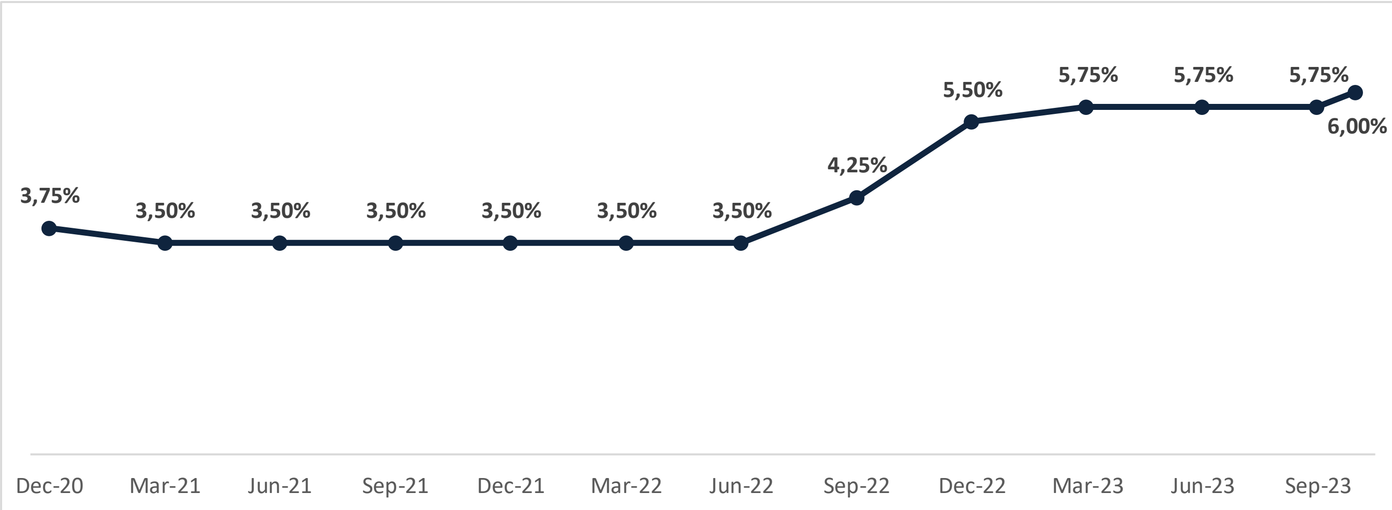
Indonesian Bank Industry Non-performing loan



Source: Otoritas Jasa Keuangan Indonesia (2023)

Domestic banks demonstrated relatively strong indicators underpinned by adequate liquidity and improved asset quality. Another indicator to analyze is the Non-Performing Loan of the overall Banking Industry of Indonesia. A non-performing loan (NPL) is a loan that has stopped generating income for a lender because the borrower has failed to make scheduled interest or principal payments for an extended period. As the main result of Covid-19 Pandemic, the decreased and restricted economic activities, the Non-Performing Loan Ratio increased significantly, to its peak at te Q2 of 2021, where it reached 3.24%. As Indonesia is able to control the spread of Covid-19 Pandemic, the Non-Performing Loan ratio drops significantly, especially through 2022. This positive trend continued in 2023 where the Non-Performing Loan Rate of Banking Industry in Indonesia reached 2.44% (June 2023) or decreased 14.7% (YoY).

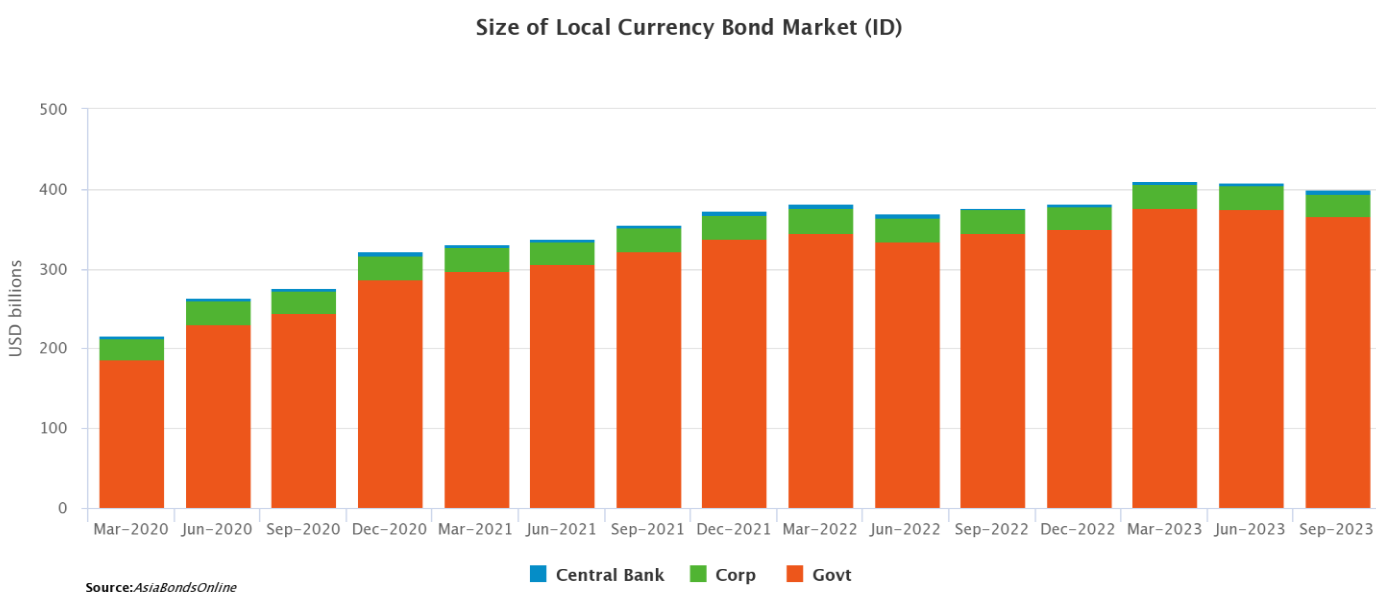
Bank Indonesia 7 Days Repo Rate



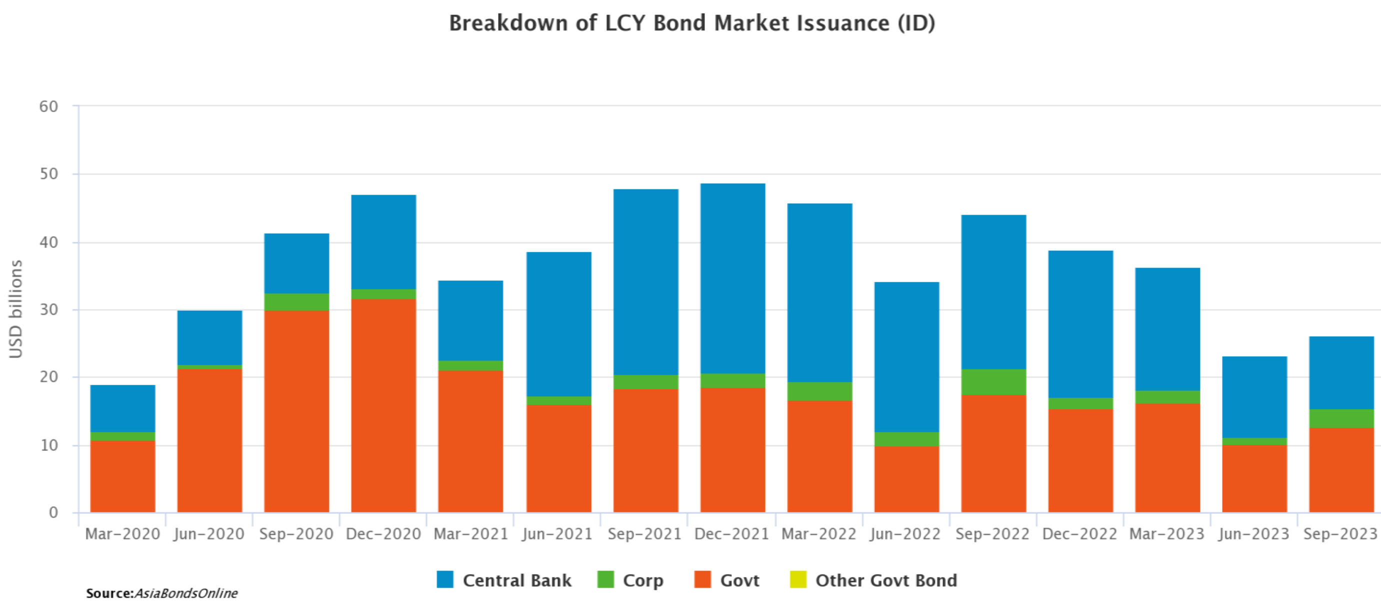
Source: Bank Indonesia (2023)

At the beginning of 2019, the benchmark interest rate was still 6%. Then, Bank Indonesia consistently lowered the interest rate from 5% to 3.75% in December 2020. The interest rate was lowered again to 3.50% from February 2021 to April 2022. However, based on the RDG (Rapat Dewan Gubernur) of Bank Indonesia on 22 -23 August 2022 decided to increase the BI 7-Day Reverse Repo Rate (BI7DRR) by 25 bps to 3.75%. Due to the depreciation of rupiah, and the strengthening of US Dollar, Bank Indonesia increase BI-7DRR by 0.25 bps to 6% in hopes of strengthening Rupiah during the global uncertainty. This was then proven by the continuing of increase of the BI7DRR, in which in the 3Q2022 – 2Q2023, there has been an increase of BI 7 Days Repo Rate, from 3.5% in Q22022, to 4.25% in 3Q2022, to 5.50% in 4Q2022, and to 5.75% in 1Q2023. The spread of interest rates with fees is still quite significant, and the bank has not responded to this increase in the benchmark interest rate yet.

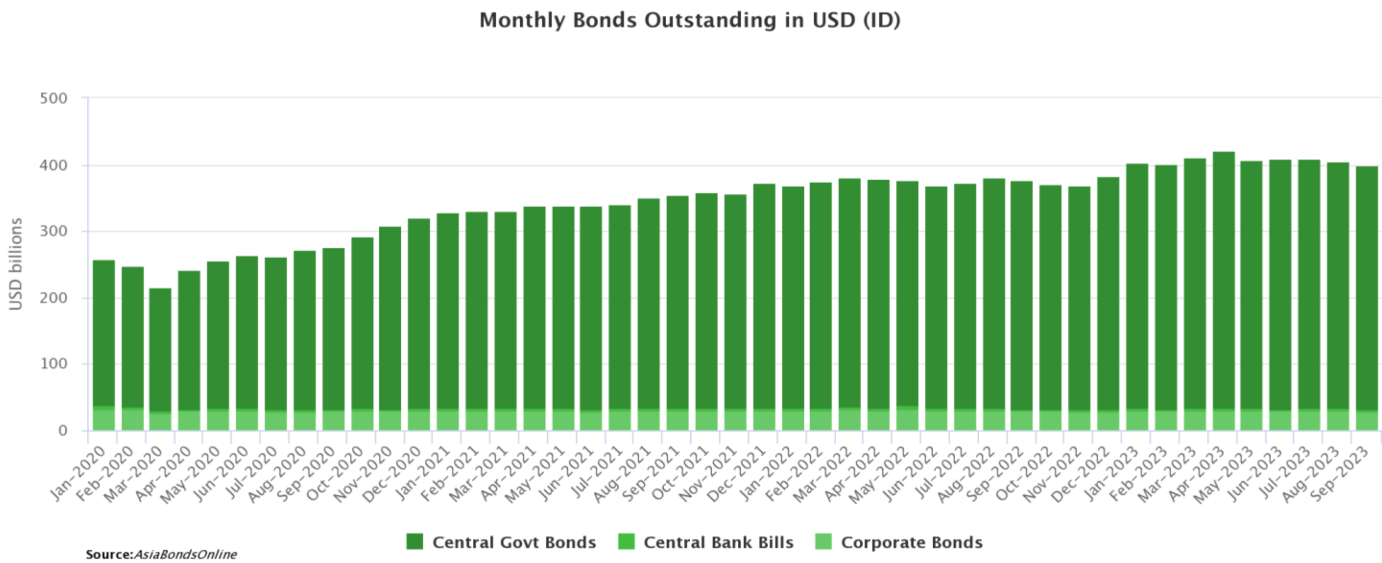
Indonesia's Bond Market Condition



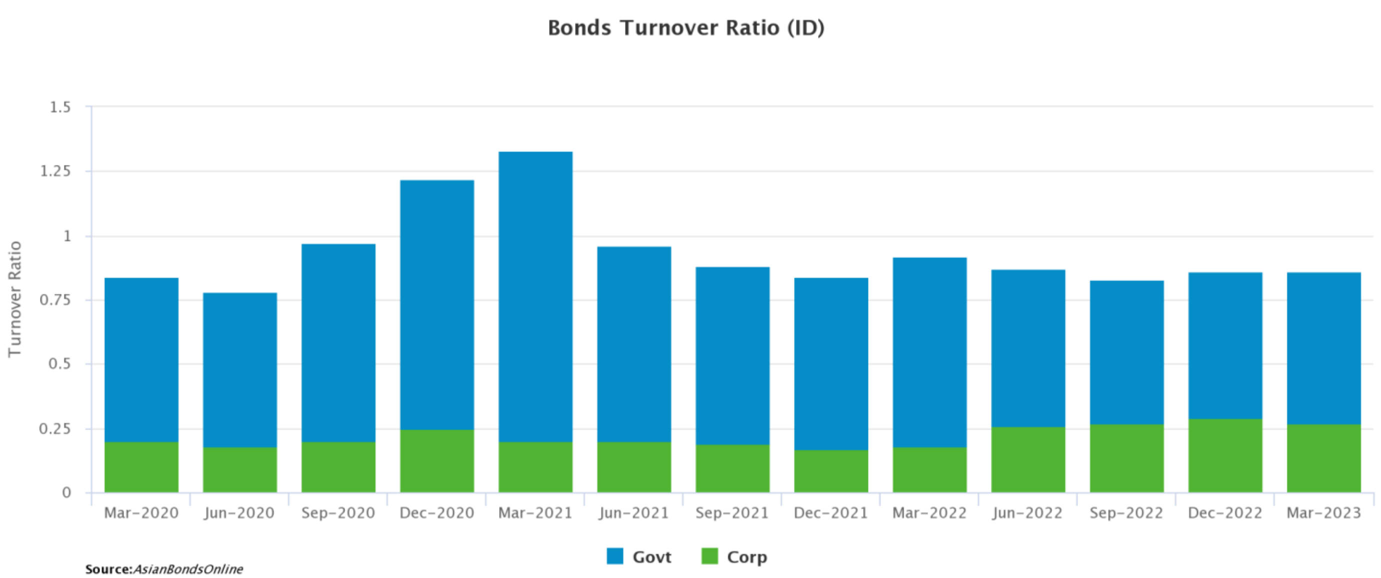
Along the way of economic recovery from Covid-19 impact, Indonesia's bond market has followed suit the recovery path of Indonesia Economy. During the Covid-19 pandemic, Bonds market rocketed due to the imminent demand for funding, especially from Indonesia's government, since it needed funds to help programs such as Social Safety Nets, Cash Transfers, and funding in health sectors, such as for infrastructure and vaccination efforts. During 2020 and 2021, we see a significant and massive increase in Bond Market Value, which is mainly happened due to the issuance of government bonds which the flooded the market. For corporation bonds, we didn't see much growth in this period. This growing trend the continued throughout 2022 and until 2023, where bond market size for both government and corporate remained stable throughout the year. The same can be seen from the perspective of bond issuance. During the early stages of Covid-19, the government bonds issued increased significantly. This can be seen from the government issued bonds that increased during the second, third and fourth quarter of 2020.

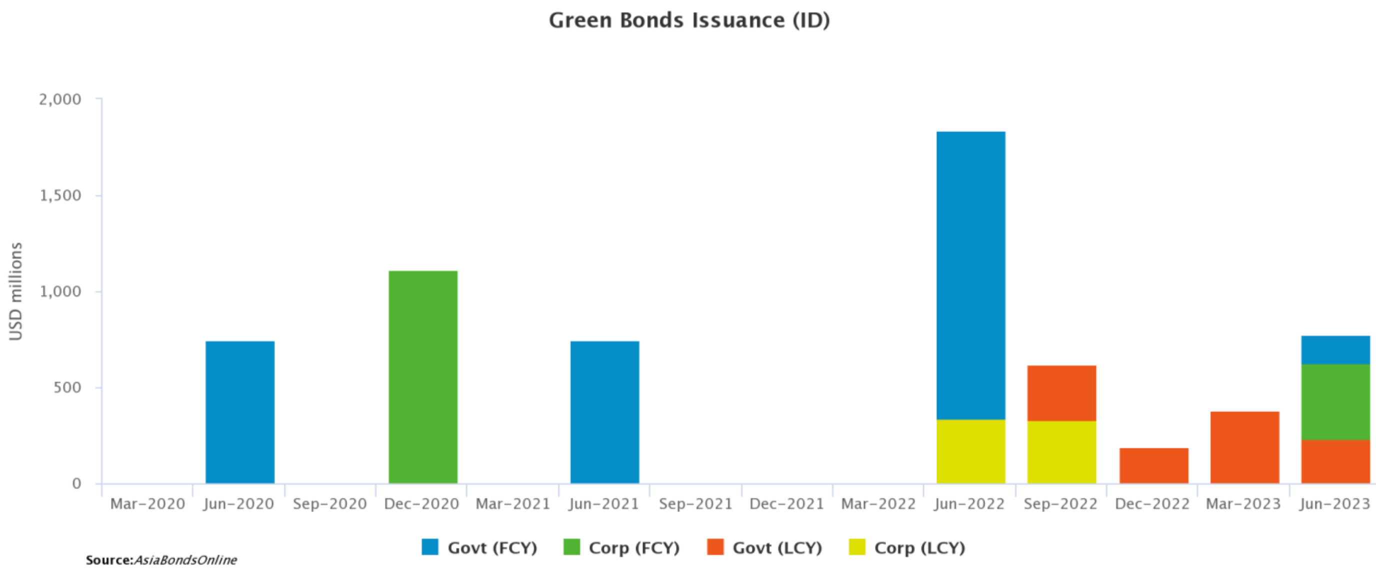


But then the trend switched in 2021. To further address the importance of burden sharing of government bonds, Indonesia Government through Ministry of Finance and Indonesian Central Bank initiate the burden sharing strategy, in which Indonesian Central Bank increased their portion of bond issuance in 2021. This then can be shown during 2021 and 2022, where Central Bank Bonds issuance portion increased significantly and outnumbered the government bonds issued. During the course of 2023, both government and central bank bonds issuance are remained stable and balanced. For the corporate bonds, there were a significant decrease of issuance in second quarter in every of the past three years. This can be seen in 2020Q2, 2021Q2, 2022Q2, and 2023Q2. Whereas in other quarter, corporate Bonds usually increased in issuance. Bonds outstanding in Indonesia is also growing significantly, especially in 2023 where it reached more than 400 USD Bn.

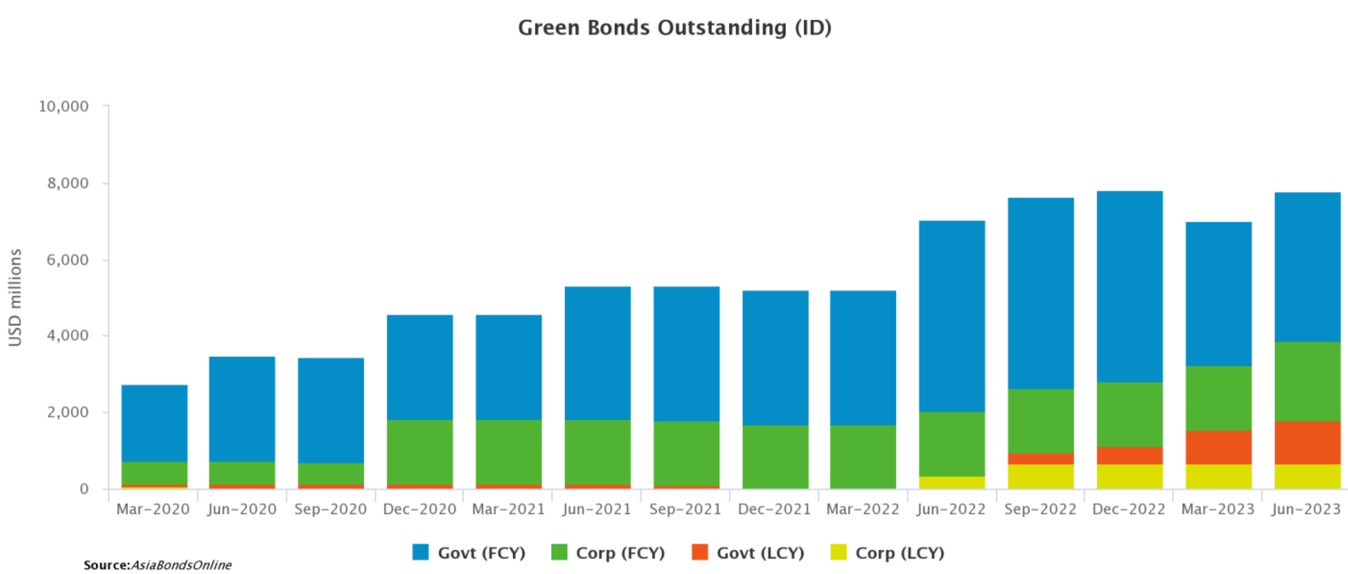


Another metric used to evaluate the performance of the bonds market is the Bonds Turnover Ratio. This ratio acts as a gauge for bond market liquidity, indicating the level of trading activity within the secondary market concerning the total available bonds. When calculated on a quarterly basis, it determines the average volume of bonds by considering the combined amount at the end of the previous quarter and the current one. In yearly computations, it calculates the average volume by averaging the bond values at the beginning and end of the year. The bond turnover ratio in 2023 indicates consistent figures, particularly when compared to 2022. There were no significant fluctuations in turnover throughout 2023, unlike the notable increase in turnover witnessed during the initial stages of the Covid-19 pandemic, especially concerning government bonds. However, for corporate bonds, there was a slight increase in turnover, particularly from the second quarter of 2022 to the first quarter of 2023.





Another interesting thing that currently happens in Indonesia's Bond market is the rise and increase of green bonds. Green bonds are a type of fixed-income financial instrument that are specifically earmarked to raise capital for projects or activities with environmental benefits. These bonds are used to finance projects that focus on environmental sustainability and climate change mitigation or adaptation efforts. The key characteristic of green bonds is that the proceeds generated from their issuance are exclusively allocated to finance or refinance green projects. They operate similarly to traditional bonds, where an issuer sells bonds to investors. However, the distinct feature of green bonds lies in their "green" designation, meaning the funds raised must be used for eco-friendly purposes, such as renewable energy projects, sustainable infrastructure development, clean transportation initiatives, energy efficiency improvements, or climate change adaptation measures.



Green bonds have been present in Indonesia's market for a considerable time and have progressively gained popularity over the years. This trend was particularly evident in 2022, notably in the second quarter, driven by increased issuance supported by both government entities and local businesses. In 2023, the government made the largest contributions to Green Bonds issuance in the local currency, followed by corporations issuing in foreign currency, and finally, the government issuing in foreign currency. This pattern is also reflected in the data on outstanding green bonds, showing a substantial increase in outstanding bonds during the second quarter of 2022, displaying a diverse range of bonds, notably a significant rise in both government and corporate green bonds issued in local currency. This trend persisted throughout 2023.