MCC
MATHIAS CORVINUS COLLEGIUM

CIE
Papers

cie.mcc.hu

Indonesian economy after elections

Csaba Moldicz

MCC CIE Papers

Publisher:

MCC Center for International Economy

Address:

1113 Budapest, Tas vezér utca 3-7.

https://cie.mcc.hu

Editor:

Csaba Moldicz

Budapest 2024.

ISSN 3004-2607

Indonesian economy after elections

Summary

The significance of the elections held on February 14, 2014 in Indonesia can be measured by the development of the economy, because not only has a stable political framework emerged over the last ten years, which is necessary for the rapid development of the economy, but under Joko Widodo’s presidency significant investments were made in the framework of an USD 500 billion mega infrastructure program. These investments were aimed to move up the economy's value chain and modernizing an economy that was characterized by infrastructural and logistical bottlenecks.

Despite the partial successes in modernizing the manufacturing sector, fluctuations in the commodity markets continue to have a major impact on the development of Indonesia’s economy, which is why a sustained boom on the commodity markets remains a factor of uncertainty for the forecasts for the Indonesian economy. Another factor of uncertainty is the development of China’s economy, as the country is Indonesia’s largest export and import partner. The predicted weakness of the Chinese economy will most likely have a negative impact on Indonesian growth.

At the same time, other factors predict long-term, rapid growth for Indonesia, while balance indicators and the currency exchange rate can remain stable. In addition to that it should be noted that the public budget deficit is projected at 2.29 percent, which along with an estimated GDP growth rate of 5.2 percent represents a sustainable growth path for Indonesia.

Other favorable factors for a long-term growth forecast are the young and growing population and improving employment indicators. Although young Indonesians are relatively well educated, the development of education and research hides enormous potential. In addition to the demographic advantages, the development of Indonesia's manufacturing sector should also be mentioned, of which the recent modernization of nickel processing is a good example. In addition to strong state intervention including the ban of nickel as a raw material and creating a favorable business environment, the country also needs to attract foreign investors. This task is not easy, as economic development suddenly turns into geopolitical disputes, as was also the case in Hungary.

Csaba Moldicz

Indonesian economy after elections

Csaba Moldicz

Abstract

With 276 million inhabitants, Indonesia is the fourth most populous country in the world, and if we measure its GDP in terms of purchasing power parity, it ranks sixth in the world. Its share of global GDP is just under 3 percent, and Indonesia falls into the category of middle-income countries. The country's population is growing rapidly, is young, and relatively well educated, which has a positive impact on economic growth potential. It is one of the fast- growing, emerging markets in which Hungarian economic players also have potential for collaboration to look for. The analysis looks at key economic indicators such as GDP, inflation, interest rates, trade balance and balance of payments, and also briefly examines labor market conditions.

Keywords: Indonesia, economy, economic development, infrastructure, nickel mining, processing

Rapid GDP growth amid geopolitical uncertainties

While the United States grew faster than expected, the market in the euro zone and China remained weak, putting pressure on the commodity market, which is central to Indonesia's growth. The aggressive tightening of monetary policy also puts pressure on portfolio flows and exchange rates, the cost of refinancing. Despite the unfriendly environmental conditions, Indonesia's GDP grew rapidly in 2023. GDP per capita was USD 12,939 in 2023 (PPP[1]), while the global average was USD 19,092. The country belongs to the upper middle-income countries. According to the Indonesian Bureau of Statistics, the Indonesian economy grew by 5 percent in 2023, not surpassing the 5.3 percent recorded in 2022. A look at the sectors shows robust growth in transportation and storage at almost 14 percent on an annualized basis. In the Indonesian archipelago, which comprises more than 17 thousand islands, transportation is a sector that requires significant resources and investment. For this reason, it should come as no surprise that the regional distribution of economic growth also varies greatly from province to province. While GDP growth in provinces such as Maluku and Papua, Sulawesi and Kalimantan ranged from 5.43 to 6.97 percent, with growth rates above the national average, provinces on the island of Java, which accounts for 57.05 percent of the national economy, grew at a slower rate of 4.96 percent. One of the reasons for the weaker than expected growth was the weak markets for Indonesia’s key commodities such as palm oil, coal and nickel. In the midst of global geopolitical unrest, global demand for these products weakened and the relatively high interest rates set by the US Federal Reserve also had an impact on the development of domestic demand through tighter policies.

[1] PPP stands for purchasing power parity

Regional distribution of GDP and GDP growth (2023, %)

Regions	Share in GDP in 2023 (%)	GDP growth in 2023 (%)
Java	57.05	4.96
Sumatra	22.01	4.69
Kalimantan	8.49	5.43
Sulawesi	7.10	6.37
Bali and Nusa Tenggara	2.77	4.00
Maluku and Papua	2.59	6.97

Source: https://www.bps.go.id/en/pressrelease/2024/02/05/2379/ekonomi-indonesia-triwulan-iv-2023-tumbuh-5-04-persen--y-on-y-.html

Although the Bank of Indonesia left the 7-day reverse repo rate unchanged at 6 percent in January, it continues to hit domestic demand hard. The interest rate level of 6 percent can be considered high when the inflation rate is 2.5 percent (January 2024). The reason for the significant difference and the positive real interest rate is the intention to secure stable external financing for the fast-growing emerging market. We must add that this scope for macroeconomic policy is opening up because the inflation rate was brought under control in 2023 after the energy price shock in the previous year. Headline inflation peaked at around 6 percent in early 2022. Forecasts for growth in 2024 range from 4.9 percent to 5.2 percent.

GDP estimates for 2024 (%)

OECD	5.2
Indonesian government	5.2
DBS Bank	5.0
World Bank	4.9
Bank Danamon	4.9

Source: own compilation

Balance in Indonesia's economy

Indonesia's largest export and import partner is China. In 2022, China accounted for 22.6 percent of exports and 28.5 percent of imports. The USA, Japan, India and Malaysia were also important export markets for Indonesian products, while Singapore, Japan, Malaysia and Korea were important importers in the same year. While Indonesia recorded a robust current account surplus in 2021 (0.48 percent of GDP) and 2022 (1.14 percent of GDP), the surplus turned into a deficit last year. This change could herald a new period for the Indonesian economy and the end of the commodity boom, as the change is taking place due to the declining trade surplus.

Indonesia's key trading partners' share in percent (2022)

Export		Import	
China	22.6%	**China**	28.5%
US	9.7%	**Singapore**	8.2%
Japan	8.5%	**Japan**	7.2%
India	8.0%	**Malaysia**	5.3%
Malaysia	5.3%	**Korea**	4.9%

Source: https://research.hktdc.com/en/article/MzU3OTQxMTQ2

The report of the Bank of Indonesia summarized balance conditions of the Indonesian economy thus: "Indonesia's Balance of Payments (BOP) is projected to record a surplus in 2023, thereby bolstering external resilience. Rupiah stability has been maintained in line with monetary policy consistency by Bank Indonesia. Inflation is falling and remains in the target corridor."

We should add that the situation is stable but not so rosy, as external pressures led to tight financing conditions globally and triggered capital outflows in Indonesia. Net portfolio outflows reached 0.3 percent of GDP in the third quarter of 2023, leading to a deficit in the capital account. At the same time, it is positive that the Bank of Indonesia's foreign exchange reserves, which amounted to USD 145 billion in January 2024, can finance 6.4 months of imports and debt service.

Despite the recovery after the global pandemic, the country's fiscal situation is stable and the macroeconomic outlook is positive, as described above. In September 2023, the country's parliament approved the budget for 2024, in which expenditure for 2024 is estimated at USD 216 billion. While the public budget deficit in 2023 was 2.30 percent of GDP, the figure for is almost the same at 2.29 percent of GDP. An important point for the development in 2024 will be the changes in crude oil prices. We should not forget that Indonesia has a complex system of energy subsidies. The subsidy target for 2024 is 13 percent higher than 2023. The total of USD 12 billion is mostly spent on fuel oil and LPG (60 percent) and the rest is for electricity subsidies. The Finance Minister pointed out destabilizing factors such as the upheaval in crude oil prices and the negative impact of El Nino on food prices. We can also add the uncertainties around China's growth in 2024 might also influence Indonesia's GDP growth this year.

At this point, it should be noted that Indonesia has reduced its subsidies for fuel and electricity over the last ten years. An analysis by the World Bank shows that before 2022, 46 percent of fuel subsidies benefited the richest 20 percent of the population, while only 18 percent of subsidies reached the poorest 40 percent. Nevertheless, energy remains an important expense for low-income households. The reduction in fuel subsidies meant that they accounted for 4 percent of market income for the poorest tenth of households, twice as much as for the richest 10 percent, who received only 2 percent of their market income.

Although VAT rates were raised two years ago, the VAT rate is still very low at 11 percent, which improves the living conditions of the poorest social strata of the Indonesian economy. Guild summarized the positive effects of the VAT increase as follows: "The results are pretty clear. Tax revenue increased from $99 billion in 2019, to a projected $ 136 billion in 2023 which is $6 billion more than budget planners had initially forecast. This extra revenue will help narrow the budget deficit from an anticipated 2.84 percent of GDP to just 2.3 percent." Broadening the tax base and improving the efficiency of tax collection is a long-term strategy for Indonesia as it can reduce the over-reliance on revenues from commodities, whose prices are highly dependent on supply and demand in the global market.

Infrastructure projects and the construction of a new capital

The country's geographical location, its vastness and the nature of the archipelago have always presented Indonesian decision-makers with challenges. This is why infrastructure development was accelerated under Joko Widowo – Indonesian President from 2014 to 2024. In his second and last term, launched a USD 500 billion mega infrastructure program. The program included the development of certain metropolitan regions, the construction of a new capital city, high-speed rail lines, the expansion of public transport and support for several industrial projects. (See the next table for details!)

Selected infrastructure projects in Indonesia between 2019 and 2024

Infrastructure projects	Sums
Development of metropolitan regions for Palembang, Banjarmasin, Makassar, Denpasar	USD 20 billion
Construction of a new capital	USD 33.7 billion
Jakarta-Semarang and Jakarta-Bandung high-speed rail lines	USD 7.3 billion
Development of local public transport in Jakarta, Surabaya, Bandung, Medan, Semarang, Makassar	USD 10.7 billion
Industry 4.0 projects in the food, textile, automotive, electronics and chemical sectors	USD 7.5 billion
Training for Industry 4.0	USD 24.3 billion
Construction of 31 ore smelters outside of Java	USD 10.9 billion
Total public funds	USD 77.5 billion
Total private,	USD 25.5 billion
PPP funds	USD 11.4 billion
Total investment	**USD 114.4 billion**

Source: based on https://indonesien.ahk.de/infothek/indonesia-launched-strategic-infrastructure-projects

The project to build a new capital city is gigantic and has attracted media attention. The main argument in favor of relocating the capital is practical, as Jakarta, the capital city, is sinking and air pollution is considerable. Critical voices often point out that Jakarta's problems cannot be solved in this way. We must add that the project is not only about environmental issues, but that it also serves the purpose of nation-building, as the island of Java is (too) dominant in both the political and economic life of Indonesia.

The concentration of wealth and power could be mitigated by the successful implementation of this project. Beech added further aspects and summarized the goals of the project: "Nusantara won't be just any planned city, the president asserts, but a green metropolis run on renewable energy …. The new capital … will be a paradigm for adapting to a warming planet. And it will be a high-tech city, … attracting digital nomads and millennials who will purchase stylish apartments with cryptocurrency."

Mega-infrastructure projects can certainly serve the goals of accelerated economic development. This is certainly true for a country that has always struggled with logistical bottlenecks. Since the start of the project, the original sum of USD 33 billion has been increased to USD 46 billion, 53 percent of which was to come from the government.

Industry development: from nickel to solar power

Another key project of the current government is the development of industry through the modernization of the economy and the transition to higher value-added manufacturing. The government intends to put more emphasis on the process industry.

The current leadership has banned the export of nickel ore in 2020, mainly to attract investments that generate higher added value in the economy. So far, this measure has triggered 14 billion dollars of investment, nickel-related exports have increased thirty-fold and there has been double-digit economic growth in the regions where the metal is mined in recent years. The irony is that many Chinese companies have invested in this industry as a result of the measure and today 90% of the nickel processing industry is controlled by Chinese companies, while the Americans have not followed suit.

We can raise the question of why Indonesia has not been able to improve its economy until recently and why the presidency of has focused so much on changing these circumstances. Indonesia's neglect of research and development and higher education in the past, influenced by political instability, has led to an economy that is overly dependent on commodity exports and low-quality manufacturing. In addition, an inconsistent approach to education, R&D and industrial policy have further exacerbated this situation. As a result, the workforce lacks advanced skills and innovation capacity, hindering the ability to effectively utilize the technological and knowledge-based advances that foreign direct investment brings.

In addition to nickel mining, Indonesia is focusing on other sectors such as renewable energy and semiconductors. Indonesia is also aiming to ratify the "New and Renewable Energy Bill" in 2024, which places a strong emphasis on the transition away from fossil fuels. At this point, it should be noted that Indonesia is rich in renewable energy sources. It is estimated that Indonesia has an energy potential of 400 gigawatts, of which 200 gigawatts could come from solar energy, while the rest would stem from hydropower and geothermal energy. With appropriate investment, this would cover Indonesia's future needs. We should add that Indonesia can not only meet its own needs, but also support the process of decarbonizing Southeast Asia.

Foreign Direct Investments

In 2022, the total inflow of foreign direct investment in Indonesia amounted to USD 22 billion, ranking the country 20th in the world. It is worth noting that the Covid-19 pandemic has had a negative impact on foreign direct investment in Indonesia, which fell by 22 percent between 2019 and 2021 to a total of USD 18.59 billion. This decline is due to a 58% drop in investments in the manufacturing industry.

In 2022, the total stock of foreign direct investment amounted to USD 262 billion. The main investors were Singapore (27.3 percent), the United States (11.7 percent), Japan (10.2 percent), the Netherlands (9.2 percent) and China including investments from Hong Kong (6.2 percent) in 2021. Indonesia has significantly liberalized the policy and legal framework for attracting direct investment by lowering the minimum capital requirement for foreign investors and abolishing the approval requirement for various business transactions with foreign investors.

The changing political landscape

Indonesian voters went to the polls on February 14 to decide on the next president and vice president- According to the results … The current president, Joko Widodo, was first elected in 2014 and his second term will end in early 2024. Widodo's presidency is notable not only because economic growth was relatively rapid between 2014 and 2023, but also because he was the first president to win the election without coming from the country's traditional political elite. His immense popularity was attributed to the pragmatism, business acumen, social sensitivity and attention to ordinary people that simultaneously characterized his governance.

The country's foreign policy dilemmas are currently characterized by the competition between the United States and China and Indonesia's role in this competition. On the one hand, the US has a significant political and cultural influence on the country, while on the other, China is investing dynamically and is Indonesia's largest trading partner. In terms of export markets, China is twice as important for Indonesia as the USA. Both in terms of the country's long-term development strategy and election campaign issues, the nickel issue appears to be of crucial importance for domestic and foreign policy actors.

It is therefore not surprising that the issue of nickel and China's growing economic role in Indonesia has been at the center of election debates. In the debate on January 21, Gibran Rakabuming, the PDI-P vice presidential candidate who is also the son of the current president, claimed that the other vice presidential candidate Muhaimin's team preferred Chinese- made batteries over Indonesian-made batteries. In the debate, the other vice presidential candidates strongly criticized the current president's nickel policy, which was defended by Gibran, the president's son.

The criticism was directed at the negative impact of the investments on the environment and, of course, the strengthening of Chinese growth, and from then on the debate was more about foreign policy than economic development. However, it is worth noting that it is also an issue that strongly moves voters, because in December 2023 an explosion in one of the nickel smelters in the Morowali industrial park claimed 21 lives, and this was not the first accident of its kind. It is worth remembering that in the last elections, opponents of the current president pursued the strategy of accusing the president of laying out the red carpet for the Chinese... This strategy did not work then, and it has not worked now. While it is obvious that the environmental problems caused by nickel processing need to be addressed and production needs to be made safe, the absence of American investment is a strategic mistake and does nothing to improve the confidence of the American side, while the framework is already in place - as the recently concluded (November 2023) comprehensive strategic agreement shows; it just needs to be fleshed out.

Summary

The Indonesian economy will grow by around 5 percent next year, although commodity markets will most likely experience a slowdown, domestic demand will support economic growth in the Southeast Asian economy. The labor market has also shown strength in recent months, as the unemployment rate has fallen below 5.3 percent and the labor force participation rate has also improved by 0.9 percentage points to 68.9 percent.

Last year, in the Indonesian economy a solid foundation were created in terms of growth potential, public finances and trade opportunities. However, moving up the value chain requires significant efforts from policy makers and steps still need to be taken in the areas of education, research and development and the labor market to further accelerate GDP growth in Indonesia.

Particular attention needs to be paid to the development of Indonesia’s manufacturing industry, as this goal cannot be achieved without a significant inflow of foreign capital, knowledge and technology. The modernization process of the economy therefore requires the next government to manage geopolitically sensitive issues, as the balance between the United States and China will be at the top of the agenda.