

Indonesia Investments

Bracing for High Inflation

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- Indonesian Inflation Bound to Accelerate Sharply; GDP Growth to Be Curtailed?
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Van Der Schaar Investments B.V.
CV Indonesia Investments

Indonesia Investments

Monthly Report – August 2022

**‘Indonesia to Brace for High Inflation
After Subsidized Fuel Price Hike’**



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Preface

The monthly report of Indonesia Investments is written and published by business consultancy CV Indonesia Investments, headquartered in Yogyakarta (Indonesia), with the assistance of investment company Van Der Schaar Investments B.V. (based in Delft, the Netherlands). The report aims to inform the reader of the latest, most relevant, political, economic and social developments in Indonesia as well as those crucial international developments that impact on the economy of Indonesia or on its politics.

Our reports are intended for a diverse audience, including individual and corporate investors, financial market participants, diplomats, policymakers, decision-makers, academics, journalists, and analysts.



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Introduction – August 2022 Report

The month of August 2022 started on a good note for Indonesia as the nation's gross domestic product growth (GDP) reportedly expanded by 5.44 percent year-on-year (y/y) in the second quarter of 2022, beating the expectations and forecasts of most analysts (including ours). And so, with the better-than-expected performance in Q2-2022, which was particularly supported by household consumption and exports, we can also become more optimistic about economic activity in the remainder of 2022. Therefore, we decided to raise our outlook for Indonesia's economic growth in 2022 to the range of 5.0–5.5 percent (y/y), from the range of 4.0–5.0 percent previously.

The recovery is partly related to the removal of restrictions. For instance, in most shopping malls and supermarkets in Indonesia you can now enter without having to show your *PeduliLindungi* code (the code that proves that you are vaccinated). Why that is, we do not know. This could be because the majority of people are vaccinated, and so the code lost its meaning. However, another explanation could be that it is now widely known that all who are vaccinated are still going to be infected with COVID-19 (and can transmit it to others), which would also mean that the code is useless.

Meanwhile, during the Independence celebrations on 17 August (which I celebrated in Yogyakarta) no-one seemed to wear masks with the exception of those who wore the masks under their chins (also at gatherings held indoors).

It is a healthy return to normal, although elderly and people with underlying medical conditions obviously need to remain careful because an overdose of COVID-19 virus could be too much to handle for their immune systems. Similarly, young (healthy) people who are feeling sick (with signs like a fever, a runny nose, and a cough) need to stay home until they are recovered to protect others in society. While this was the sort of (unwritten) rule with influenza and common colds in the past, the COVID-19 crisis should have improved awareness among the younger generations that staying home in bed when sick aims at protecting the vulnerable in society (besides allowing the sick person to recover by resting). It is, in fact, the only way how society at large can protect vulnerable people in society from rapidly mutating respiratory viruses.



And considering COVID-19 has not been a threat anymore for Indonesia (as a whole) since late-July 2021 when the Delta wave eased, it is about time to go back to normal now (after all, ever since the Delta wave passed in Q3-2021, there have not been any significant pressures on the health system of Indonesia).

So, does the economic growth rate of 5.44 percent (y/y) in Q2-2022 mean that the Indonesian economy is back to normal again (back to pre-COVID-19-crisis times)? Well, unfortunately no. Household consumption (albeit showing a strong recovery), and foreign visitor arrivals (tourism) are yet to reach normal levels. Let's take a look.

In the case of household consumption it is interesting to take a look at the real sales index (retail sales) that is released by Bank Indonesia, each month. The table below shows that the average of 226.6 points in Q2-2022 is, indeed, a great improvement from Q2-2020 (194.2 points) and Q2-2021 (215.5 points) but is still not at the same level as in Q2-2019 (when the COVID-19 virus was yet to arrive). What this implies is that household consumption in Indonesia is still not as strong as it was prior to the COVID-19 crisis. In other words: people still spend less.

Bank Indonesia's Real Sales Index (RSI):

Period	Q2-2019	Q2-2020	Q2-2021	Q2-2022
April	229.3	190.7	220.4	239.2
May	249.8	198.3	227.5	234.1
June	233.6	193.6	198.5	206.6
Average Q2	237.6	194.2	215.5	226.6

Source: Bank Indonesia

A number of factors come to mind. For instance, millions of people were fired or saw their incomes decline amid the crisis. Their current incomes may still not be at the same level as it was in the past, hence they need to limit consumption. Another factor could be that media reports have been so alarming over the past couple of years that many people have become traumatized and are simply too afraid to visit crowded places, and thus consume less than before. Or, another factor could be that people feel uncomfortable wearing masks in shopping malls or participate in the nation's vaccination program. This would then also limit their opportunities to spend money.

It seems that it will require another year before the real sales index of Indonesia will be back at levels seen in Q2-2019, provided no new shocks occur.

Secondly, tourism is still at the early stages of recovery. While foreign visitor arrivals into Indonesia have started to recover in 2022 (after a very weak 2021), we are still miles away from normal levels, as can be seen in the table below.

Foreign Visitor Arrivals into Indonesia (Main Entry Gates; Air, Sea and Land):

	Jan. – Jul. 2019	Jan. – Jul. 2020	Jan. – Jul. 2021	Jan. – Jul. 2022
Foreign Visitors	9,183,685	3,281,542	79,522	1,220,180

Note: Starting from 2021 BPS started to separate main entry gates from border entry gates. This could imply that an accurate comparison between (1) the 2019-2020 period and (2) the 2021-2022 period is not possible. Still, we believe the overall trend remains the same.

Source: Badan Pusat Statistik (BPS)

For a country that collected nearly USD \$20.0 billion in foreign exchange earnings from the tourism sector (per year) prior to the COVID-19 crisis, the plunge in tourist arrivals does real damage, especially on an island like Bali that is highly dependent on tourism. In full-2019 foreign visitor arrivals into Indonesia were recorded at over 16 million, but in full-2022 it will probably be less than 2.5 million. Considering each tourist spends an average of around USD \$100 per day on hospitality, souvenirs, and other products and services, there is enormous missed income for those engaged in sectors that are related to tourism when foreigners are unwilling to visit Indonesia.

What might be a big obstacle is that Indonesia has tight entry requirements, with all people entering Indonesia required to show proof of vaccination. Based on reports in media, the Malaysian government [dropped most entry requirements](#) per 1 August 2022, implying all travellers entering Malaysia will no longer be required to provide proof of COVID-19 vaccination, pre-departure COVID-19 tests, or, on-arrival tests, as well as not being required to undergo quarantine. So, it will be interesting to follow whether Malaysia experiences a rebound in foreign visitors, and whether COVID-19 cases remain under control in Malaysia.

Hopefully, Indonesian authorities will soon start to accept that the COVID-19 threat exited Indonesia back in Q3-2021 already. While it is of course important to remain cautious, there comes a point when (excessive) caution (in the form of restrictions) does more damage to the Indonesian economy and society than good.

Lastly, jumping to a different subject, it seemed that Indonesia was subject to a hoax in late-August 2022. Approaching the end of the month almost all media institutions started to report that the government of Indonesia was likely to raise the prices of its subsidized fuels (Pertalite, Pertamax, and diesel fuel) per 1 September 2022 in an effort to improve the government's budget balance (as high global crude oil prices cause ballooning fuel subsidies for the state).

However, when the day arrived, there was no price increase. In fact, on 1 September 2022 Pertamina actually cut prices of its three unsubsidized fuel brands (Pertamax Turbo gasoline, Dexlite, and Pertamina Dex diesel) – for the first time this year – as global crude oil prices have declined somewhat compared to one or two months ago.

But then, on Saturday 3 September 2022, it was officially announced that subsidized fuel prices were to be raised across the country (a policy that took effect one hour after the announcement). As a direct consequence, Indonesia will now need to brace for accelerated inflation in the time ahead. Considering inflationary pressures were already on the rise amid high global food and energy prices, while Indonesia posted a budget surplus in the first seven months of the year, one could actually argue that this subsidized fuel price hike could have been delayed. However, there are various factors (including political ones) at play that make it a complex matter. These fuel subsidies remain a tough addiction for Indonesia, and therefore it is the first topic that we are going to delve into in this August 2022 report.

We in fact had to revise part of this August 2022 report due to the announcement on 3 September 2022 (when the content of the report had already been completed) as higher subsidized fuel prices will have a significant impact on inflation and economic growth. And so, various outlooks and analyses needed to be revised.

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Yogyakarta, Indonesia
4 September 2022



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Coronavirus Tips: How to Protect Yourself & Others

In case you have fragile health or a serious medical condition it is important to avoid being overly exposed to the COVID-19 virus. Unfortunately, all people are exposed to the COVID-19 virus (whether vaccinated or not, and whether wearing masks or not). But to reduce the risk of severe illness:

You can protect yourself and help prevent spreading the virus to others if you:



- **Cover your nose and mouth** with a (disposable) tissue or flexed elbow **when you cough or sneeze**. Wear a face mask when going outside (this won't stop aerosols unfortunately but should prevent larger droplets from spraying).

When not feeling well, stay home!

- **Strengthen your immune system**; people who are healthy (which are usually young people) may not even notice that they are infected with COVID-19. The trick here is that their immune system is stronger (generally). Therefore, now is the time to take some efforts to strengthen your immune system by eating healthy (fruits and vegetables each day), and get some sunshine in the morning for your vitamin D. Also do not forget to exercise! Taking enough time to sleep and avoiding stress are also crucial to improve the immune system. Lastly, it is highly recommended to quit bad habits, most notably: smoking!



- **Ventilation**; make sure that rooms inside houses, apartments, and buildings are properly ventilated as a COVID-19 infected person can spread aerosols so small that a facemask cannot prevent them from going into the air or from going into the lungs of someone who wears a facemask. Ventilation systems need to get a good supply of fresh air from outside and/or use a good filter. It is also advised to open windows or doors in closed spaces so there is a good supply of fresh air.

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