

# Indonesia Investments

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## World Heading for Stagflation

- While the World Is Heading for Stagflation, Indonesia Is Unlikely to Follow Suit. Why?
- Our Projection for Indonesia's Q2-2022 Economic Growth Revised to 4.50% (y/y)
- Indonesian Inflation Nearly Touches 5.0% (y/y) in July 2022. Reason for Concern?
- Bank Indonesia Remains Unwilling to Join the Global Interest Rate Hike Wave
- Will Indonesia Impose Excise Duties on Plastic Products & Sweetened Beverages?
- The Key Role of MSMEs in the Economy

**JULY 2022**

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**Van Der Schaar Investments B.V.**  
**CV Indonesia Investments**

# Indonesia Investments

Monthly Report – July 2022

**‘World Heading for Stagflation’**



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## Preface

The monthly report of Indonesia Investments is written and published by Van Der Schaar Investments B.V., located 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.



The website [www.indonesia-investments.com](http://www.indonesia-investments.com) is the key reference and access point for gaining knowledge about the markets, economy, business sectors, politics, and cultures of Indonesia. This online platform is owned by Van Der Schaar Investments B.V., a privately-held investment company (Ltd.) that was established in 2009 but

stands in a tradition that stretches back to urban development in the Dutch capital city of Amsterdam in the early 20th century.

We offer two types of subscriptions (or individual purchases):

(1) **Weekly updates + monthly reports;** on average we send one or two analyses of relevant subjects per week (“weekly updates”) to make sure that our audience gets the latest and most relevant news quickly (and complete with an analysis). These updates also form the basis of the forthcoming monthly report (in which the topics are usually discussed in more depth as we have more time to make an analysis).

(2) **Monthly reports only;** usually between the 2<sup>nd</sup> and 5<sup>th</sup> of the month, we release our monthly report. As mentioned above, this report discusses the most relevant economic, political, and social developments that took place in Indonesia (or global developments that impact on Indonesia) in the preceding month.

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1 month	IDR 200,000	USD \$15	EUR €15
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We also offer a distributor subscription for those institutions that want to distribute our reports to (paying) members within their network. For example, a chamber of commerce that buys this subscription is allowed to distribute our monthly reports to those (paying) companies/institutions within its network. Just like the corporate subscription, a distributor subscription always includes both weekly updates and monthly reports.

**Price Overview Distributor Subscriptions:**

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## Introduction – July 2022 Report

Over the past couple of months there had been quite some speculation over whether the United States (US) – the world's biggest economy – would enter a new recession in the second quarter of 2022 (a development that would trigger concern over global economic growth, especially since China's economic growth has been under severe pressure as well). And, a few days ago, the official US gross domestic product (GDP) data were finally released. So, did the US indeed enter a new economic recession?

Well, yes and no. The US economy contracted by **0.9** percent year-on-year (y/y) in Q2-2022, after contracting **1.6** percent (y/y) in the preceding quarter. Typically, two consecutive quarters of negative growth is considered a recession. And so, we can indeed call it a recession. However, in the US it is the National Bureau of Economic Research (NBER) that actually officially determines whether the national economy entered a recession. And the NBER takes several other factors into calculation too.

One of the factors is job growth. And as US nonfarm payrolls rose by 372,000 in June 2022 (topping the 250,000 estimate), while the US unemployment rate remained at a comfortable 3.6 percent, we are not seeing the typical 'recession circumstances'.

From our viewpoint we are currently simply seeing a correction in economic growth due to the high base that was set in 2021 (when the US economy rebounded strongly

from the COVID-19 crisis that peaked in 2020). For example, US retailers had a glut of inventories to work through, and so spent less in the first half of 2022. Therefore, we are currently not overly concerned seeing this 'US recession' so far in 2022.

However, the road ahead is filled with uncertainty since US inflation remains near a 40-year high level, prompting the US Federal Reserve to enact its second consecutive 0.75 percentage point interest rate hike in July 2022 (thereby taking the benchmark overnight borrowing rate up to a range of 2.25 - 2.50 percent).

#### United States Inflation Rate (annual % change):



Sources: [www.tradingeconomics.com](http://www.tradingeconomics.com) and US Bureau of Labor Statistics

While one could argue that a Fed Funds Rate at 2.50 percent is still manageable for the US economy (provided jobs growth remains solid, albeit high inflation certainly

undermines purchasing power, while also denting business activity), many expect to see more Fed rate hikes in the next couple of months that will push US borrowing costs higher (thus putting the brakes on US economic growth).

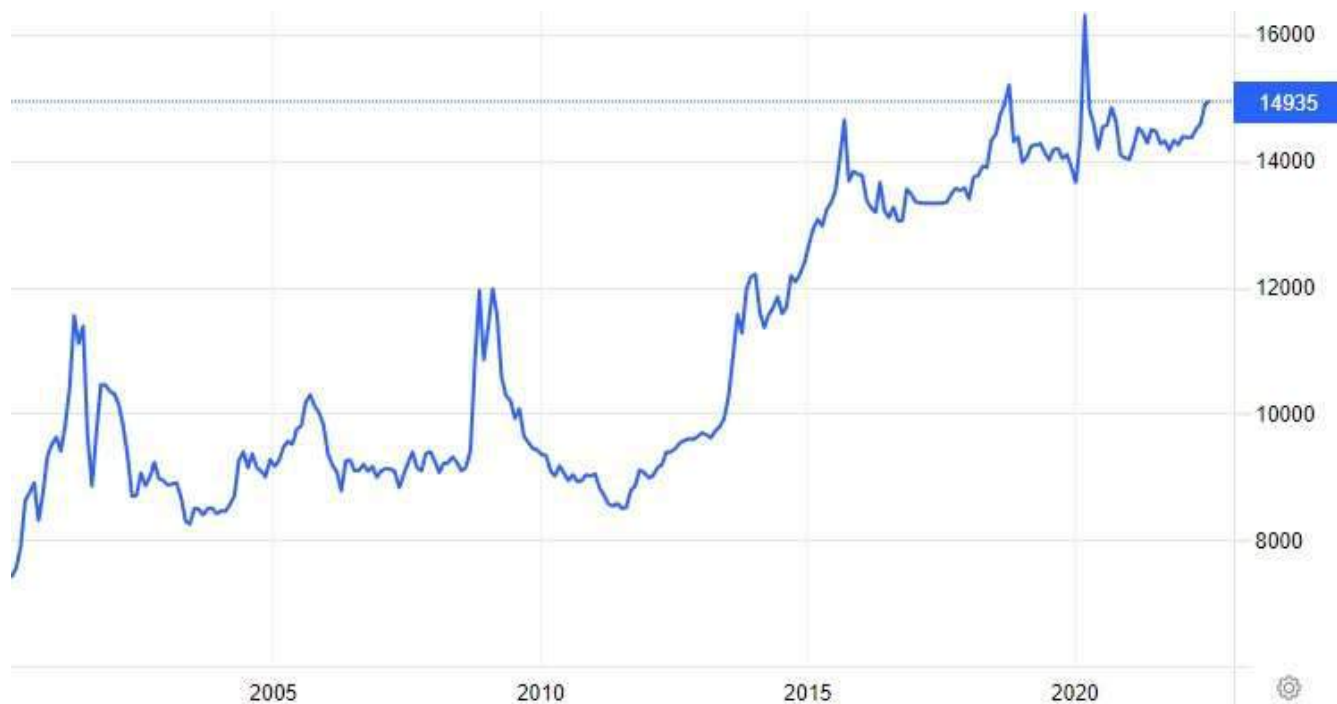
It is a complex situation for the Federal Reserve. Waiting too long before raising its benchmark rate (with some people arguing that the Federal Reserve responded too slowly already) threatens to cause an inflation-driven recession. However, raising the rate too aggressively and/or too quickly would also risk a job market slowdown and recession in the US.

Obviously monetary tightening in the US has a direct impact on the world, including Indonesia (and besides raising the Fed Funds Rate, the Fed also started quantitative tightening by reducing the size of asset holdings on its nearly USD \$9 trillion balance sheet; an effort to decrease the amount of liquidity, or money supply, in the national economy, hence curb economic activity and push inflation lower).

Among the biggest impacts is the strengthening US dollar as investors shift money to the US in order to enjoy higher returns (that are perceived risk-free). Essentially, all other currencies around the world, including the Indonesian rupiah, are therefore showing a depreciating trend. And when the US dollar is strong it means that imports become more expensive for Indonesia (including key commodities, such as energy and food, which are typically traded in US dollars).

It is interesting that US dollar strength is not a recent phenomenon. If we take a look at the chart below we can see that the rupiah has been weakening quite significantly against the greenback for the past decade or so (with peaks in the chart being related to international crises – mostly stemming from abroad – or Federal Reserve policy adjustments).

### Indonesian Rupiah versus US Dollar (January 2000 – July 2022):



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com)

This makes it quite understandable that Indonesia wants to cut oil and fuel imports into Indonesia (and seeks national food sovereignty) as inbound shipments become increasingly expensive (if not, Indonesia simply continues to absorb external shocks that occur through essentially no fault of its own). Meanwhile, it also explains why

Indonesia is involved in bilateral currency swaps to promote the use of regional currencies in trade and investment in the (Southeast) Asian region. This is a strategy that makes the involved Asian nations less vulnerable to external shocks.

And another consequence of monetary tightening in the US is that the central bank of Indonesia (Bank Indonesia) cannot wait too long before raising its own interest rate since a higher Fed Funds Rate incites capital outflows from Indonesian assets. With a higher benchmark rate in Indonesia it would then become more expensive to borrow, hence economic activity becomes a bit disrupted too in Indonesia. This is unfortunate because after 17 months of having Indonesia's benchmark interest rate at a historic low of 3.50 percent, lending rates in the banking industry of Indonesia finally reached more attractive levels (typically Indonesian lending rates are quite high). Once Bank Indonesia raises its benchmark rate we assume that lending rates will quickly rise accordingly because we always see this pattern: commercial banks are hesitant to follow the central bank's example when the benchmark interest rate is cut, but tend to rapidly adapt their lending rates (upwards) when the central bank raises its benchmark rate.

### **Stagflation to Spread to Indonesia?**

Over the past year or so many have warned that stagflation is a serious risk for the world (stagflation referring to a situation in which there is low economic growth but

high inflation). This scenario is now finally becoming acknowledged as a number of global institutions have recently started warning about stagflation after cutting their outlooks for global economic growth in 2022 (and 2023 is even expected to become a worse year in terms of economic expansion in the West), while inflation has been on the rise, rather sharply.

The threat is that accelerating (or stubbornly high) inflation cuts purchasing power, thus limits demand, implying less needs to be produced, hence businesses may need to cut employment, which would mean purchasing power drops further (which, in fact, is a vicious cycle). Right now, it seems that the US and the European Union (EU) will be trapped in this stagflation situation for the next couple of years. Not only the World Bank, but also other major institutions – like Goldman Sachs and BlackRock – have recently been warning about the stagflation risk.



The question then becomes: will Indonesia also experience a period of stagflation? Well, we highly doubt it. Of course, Indonesia will be negatively affected by subdued global economic growth (particularly in case the US and EU will enter a prolonged period of stagflation as well as ongoing economic turmoil in China). This will show in the form of weaker export earnings and weaker direct investment in Indonesia. Similarly, imported inflation will cause price pressures in Indonesia.

However, such external matters should not impact too significantly on Indonesia's domestic consumption. Indonesia's massive consumer force is the key locomotive of national economic growth. And while it may decelerate a bit amid external shocks, it will still go forward in a strong manner. Moreover, something we have emphasized on many occasions before, Indonesia is not properly integrated into the global value and logistics chains, which implies that in times of global economic turmoil, it is not overly affected (which actually turns into a disadvantage in times of global economic prosperity because Indonesia will miss out on a bigger slice of the cake).

Meanwhile, Indonesian inflation should not run out of hand provided the central government continues to spend generously on the energy subsidies. While generous state spending on energy subsidies has always been a controversial matter (and we have often criticized the program), it seems to be productive in the current uncertain environment (considering high inflation can push millions of Indonesians into full-blown poverty).



Moreover, the windfall gain from coal and palm oil exports allow this more generous attitude towards energy subsidies (without causing major pressures on the central government's budget balance). What is also an advantage for Indonesia is that high international oil prices (implying the energy subsidy bill grows for the government) encourage higher prices of other commodities such as coal and palm oil (implying windfall gains for Indonesia). It means that it is more-or-less a (fiscally) sustainable situation for Indonesia (as it is unlikely to see low palm oil and coal export earnings at a time when crude oil prices skyrocket).

In national media we read in late July 2022 that Indonesian President Joko Widodo said subsidized energy prices will definitely not increase before the end of this year. It is an interesting message because: (1) it implies that inflation should not run out of hand in Indonesia this year (skyrocketing energy prices being the main driver of high inflation in the West) and (2) it leaves room for higher subsidized energy prices in 2023 (when the government's budget deficit needs to be back below 3 percent of the country's GDP) if global oil prices do not ease next year (although we do doubt to see such unpopular policymaking shortly ahead of Indonesia's 2024 elections, but – who knows – the cabinet still sees a window of opportunity in 2023).

What is also interesting is that Indonesian Finance Minister Sri Mulyani Indrawati stated in national media (also in late-July 2022) that she expects Bank Indonesia to have raised its key rate by 100 bps before the end of 2022. Although the central bank

is independent from the cabinet in terms of policymaking, there does exist intense cooperation and coordination between both institutions. So, possibly, Indrawati's projection is quite insightful. It would also mean that Bank Indonesia needs to start raising its benchmark rate soon as it is likely to use a gradual approach (raising the rate by 25 basis points at a time, instead of going for a more aggressive approach).

Considering Bank Indonesia has repeatedly emphasized that it particularly focuses on (core) inflation as a reason to substantiate an interest rate hike in Indonesia, it will be particularly interesting to follow the latest developments related to inflation.

Richard van der Schaar, MA Indonesian Studies

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Yogyakarta, Indonesia

1 August 2022

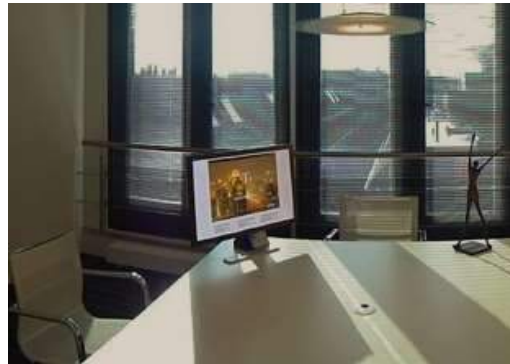


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# Coronavirus Tips: How to Protect Yourself & Others

Immunization programs are ongoing but in case you have fragile health or a medical condition it's important to remain careful to avoid becoming infected with COVID-19 or infect others who have fragile health.

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 at 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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