ASIA PERSPECTIVE

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Indonesia Economic Update Report

This Issue:

Indonesia’s Economic Performance in Q3

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Indonesia witnessed a drop in GDP growth to 3.51% (YoY) in Quarter 3, 2021

As harsh lockdowns to contain COVID-19 spikes outweighed the effect of higher commodity prices and trade, Indonesia's GDP only recorded a 3.51% growth (YoY) in Quarter 3 of 2021, showing a significant slowdown from Quarter 2's growth of 7.07% (YoY).

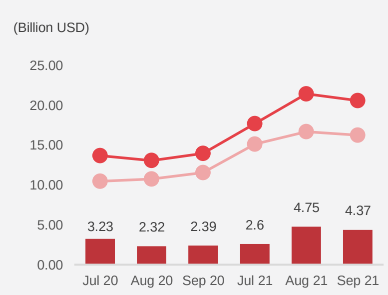
Despite a boost from the low base effect from last years' economic slump, GDP growth is weaker than the forecasted 4.5% (YoY) growth previously done by the finance ministry. Private consumption, the largest contributor to the total GDP, only rose by 1.03% (YoY) this quarter. Although commodity prices recently surged, which boosted export performance, the consumer demand was still dim. On the production side, the manufacturing output increased by 3.68% (YoY), less than Quarter 2's growth of 6.58% (YoY). Public activity as well as domestic tourism declined compared to both the previous quarter and the previous year.

Meanwhile, Indonesia's economy has continued to bounce back from the economic slowdown caused by severe spikes in new COVID cases. As of now, the country has succeeded in flattening the curve. In Jakarta, over 75% of the population has been fully vaccinated, which has acted as a booster for the entire nation's economy. A strong rebound in Quarter 4 with improved manufacturing activity and retail sales is expected as movement restrictions have been further relaxed.

Outbound shipments hit an all-time high in August

Indonesia's exports climbed up by 51% from last year's Q3 (a YoY growth of 3.51%), while imports rose by 47%. Accordingly, the trade surplus surged to 11.74 billion USD during the same period. In the first 9 months, exports and imports both grew by 40.38% and 34.27%, respectively, compared to one year earlier.

In August 2021, Indonesia announced its largest-ever monthly trade surplus, largely thanks to an all-time high export performance of 21.42 billion USD. The export momentum will probably be further boosted during the upcoming quarter due to improving manufacturing output and more relaxed movement restrictions. Alongside restored consumption, a strong export performance should result in a strong finish for the year.



Source: Statistics Indonesia, 2021

Indonesia’s path to carbon neutrality by 2060 has just started

Indonesia pledged to cut emissions by 29% by 2030 as part of Indonesia’s upgraded Nationally Determined Contribution (NDC) to mitigate climate change. Subsequently, the country set an ambitious goal to reach carbon neutrality by 2060.

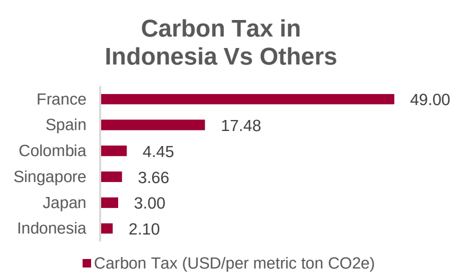
As the world’s top exporter of thermal coal by weight, Indonesia has planned for gradual cuts until all of the country’s power comes from clean sources. According to the International Energy Agency, 60% of the nation’s energy currently comes from coal, while solar and wind account for less than 1%. By 2060, solar and wind sources are expected to cover around 53% of Indonesia’s energy supply. In addition, nuclear power is also likely to become a substantial part of the energy mix. Indonesia’s first nuclear power is expected to start operating in 2045.

This shift, if done properly, would help to reduce the nation’s reliance on fossil fuels while attracting foreign investments in the renewable energy industry. In the meantime, it is worth highlighting the consequences that Indonesia would face if they do not shift to cleaner energy sources, such as international pressure to curb emissions, or unstable supply chains as many entities shift away from fossil fuels.

Skeptics have questioned the feasibility of this agenda. Indonesia’s government recently announced the halt the approval of new coal-fired power plants, following with the introduction of a carbon tax. According to the bill's final draft, firms purchasing goods or services that emits carbon in their production would have to pay the carbon tax. Such levy would significantly affect carbon-intensive industries such as pulp, paper, cement, power generation, and petrochemicals. Therefore, the policy has faced resistance from some of the country’s largest industries, claiming that the implementation would result in economic trade-offs.

A recent government study indicated the need of massive financing for Indonesia to be able to implement the net-zero carbon emissions plan. Specifically, an estimated budget of 200 billion USD per year until 2030, and over 1 trillion USD in the following decades must be reserved for this governmental agenda. As a result, the government has considered different options to boost funds, including cutting fuel subsidies and selling carbon units. The recent controversial Omnibus Law also intended to encourage private sector investment in nuclear energy, paving the way for Indonesia’s nuclear power ambitions.

Another major challenge is weak law enforcement, as laws and regulations do not effectively respond to the environmental problems. There concern as the newly announced carbon tax is among the world’s lowest, at only 2.11 USD per metric ton of carbon dioxide. The tax was perceived as too low to be able to encourage reductions in greenhouse gas emissions and actions against climate change.



Source: Jakarta Globe

As the timeframe is long, strong commitments from all related stakeholders and concrete actions are essential to ensure the phasing out of coal power plants. Moving forward, Indonesia’s net-zero-future includes a nuclear power plant establishment and ban on fossil-fuel vehicles, signaling momentous changes in the economy and business performance. Therefore, the classic question awaiting to be answered would be how to find the sweet spot between the country’s sustainable development and short-term economic growth.

Indonesia Pushed Tax Reform Law

Amid the continued coronavirus outbreak, Indonesia’s fiscal strategy centers around improving the budget deficit and increasing the tax ratio. The country seeks to bring its budget deficit within a limit of 3% of GDP by 2023.

Indonesia’s parliament commission recently approved next year’s state budget and tax reform proposal. To cut debt and slash the budget deficit to 4.85% of GDP in 2022, the reform overhauled the value-added tax system, expanded income tax brackets, introduced a tax on carbon-intensive activities and another round of tax amnesty programs.

From its current rate of 10%, the value-added tax would first increate to 11% starting from April 2022, and increase to 12% in 2025. However, VAT exemption of basic goods and services would remain. Indonesia also delayed reducing the corporate income from its current rate of 22%. A new 35% income tax bracket for individuals earning more than 349,000 USD per year was added, and the cap of the lowest tax bracket increased from 3,500 to 4,200 USD of annual revenue.

In line with the national carbon neutrality plan, the carbon tax was introduced. Coal plants would be the first target to be subject to the tax starting April 2022, followed by other carbon-intensive industries.

The bill also informed about a tax amnesty scheme, which will run from January to June 2022, allowing taxpayers to pay past obligations without penalties. Moreover, those who invest in renewable energy or government securities for at least five years would benefit from a lower rate.

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