



DEMOCRATIZATION
MUST GO ON!

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The Habibie Center Quarterly on Indonesia's Economy and Political Review

by **Umar Juoro**

The Habibie Center Quarterly (THCQ)

The Habibie Center Quarterly (THCQ) is a journal that provides review from diverse perspectives on strategic changes, trends, and dynamics of Indonesia economy and politics along with their public policy implications. The Habibie Center Quarterly also provides current and quarterly reports on Indonesia economy and politics.

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Umar Juoro is a Chairman of Institute for Democracy, Economics, and Ecology at The Habibie Center

The economy has recovered

Indonesia's economy has recovered from the recession caused by Covid-19 pandemic. In the second quarter of 2021, the economic growth was 7,07 % supported mainly by consumption, grew by 5.9%, and investment grew by 7.5%. The relaxation of the large scale social limitations (PSBB) led the economy to resume its growth.

All sectors of the economy grew high, except agriculture that grew high in the previous quarter. Transportation, health, trade, finance, communication, and manufacturing grew high. Purchasing Manufacturing Index (PMI) in June was at an all time high, 53, which showed positive activities in the manufacturing sector. Consumer confidence was high at 104 in June.

However, credit growth still shows sluggish growth as in June credit growth was only 0.5% (y-o-y). Consumption credit showed positive growth 1.23%, but the corporate credit is still in contraction. In August the credit growth improved to 1.2%, with consumption credit grew 2.3%, while corporate credit was still in contraction. Credit is the main source of economic activities as shown by strong correlation between economic and credit growth. With low credit growth, but high economic growth in the second quarter, it shows that economic growth is back to the trajectory, not necessary in normality yet. The financial service authority (OJK) extends relaxation for the credit restructuring up to March 2023. This measure gives time for debtors to be able to manage their financial condition, but for banks discourage credit growth as restructuring means high loan at risk. Banks have plenty of liquidity and capital as shown by high growth of third party funds (around 10%) and Capital Adequacy Ratio (CAR) around 23%. However, with high perceived risk, credit growth cannot go high as expected.

Looking into the third quarter, economic growth likely to slow down as resurgence of Covid-19 forced the government to restrict stronger social mobility. PMI is down to 43

(below expansion level 50) in July and consumer confidence down to 77 (below optimist level 100). Nevertheless, economic recovery continued with economic growth expected around 3.5% in Q3.

Looking forward into the fourth quarter, there is expectation of economic improvement as social mobility restriction is eased along with sharp decline of Covid-19 infection. Economic growth in the fourth quarter would likely be higher at 4.2% and would be 3.7% at the end 2021. It is not bad and the economic recovery continues.

The capital market moves in a sideways at the level around 6100. While the 10 years bond yield is relatively stable at around 6.3%. The likely Fed tapering (lowering bond buying) can trigger capital outflow that gives pressure to capital and bond markets.

The likely increase of inflation as food and energy price increase, likely rupiah depreciation because of capital inflow triggered by the Fed tapering, likely to lead Bank of Indonesia (BI) to increase policy rate to 3.75% by the end of the year. BI sees that despite the fact that the Fed would taper at the end of the year, they keep the Fed rate not to increase up to 2023. For this, BI prepares for the impacts of tapering by strengthening forex reserve and macro prudential measures.

Unemployment and poverty are high

Unemployment is still high and many companies laid off their workers during the pandemic. Unemployment is still high at 6.3 % in August. During the pandemic, the government provide tax incentive for employees with salary below Rp 200 million annually to get free of income tax for six months.

Poverty level is also high at 10.2%, as the poor experience difficulties in getting income for survival during the pandemic. The social assistance program (Bansos) that is organized by the central and local government helps the poor to get through difficult times. Although there are cases of misusing of the fund by certain local bureaucrats, even the Minister of Social Affairs was arrested for a corruption case of embezzled social assistance fund, in general the program significantly assists the poor in difficult times.

Budget deficit and burden sharing

During the pandemic, the limitation for budget deficit 3% of GDP is lifted and without

limitation. It will get back to 3% in 2023. In 2020, the deficit was 6.1% and in 2021 is 5.8%. The planned deficit for 2022 is 4.8%. The deficit is mainly to finance health and economic recovery programs, covering all costs of hospitals for Covid-19 patients, free vaccination, higher remuneration for health workers needs a lot of budget allocation. Similarly for social assistance programs.

Financing deficit is also done by involving BI to do burden sharing. BI bought government bonds with interest the same as the BI repo rate, and paid by BI. In 2020, the burden sharing is Rp 397 trillion, in 2021 is Rp 215 trillion and in 2022 is Rp 224 trillion. BI also acts as stand by buyer for bond issuance by the government. Currently, around Rp 1000 trillion government bonds are on the BI balance sheet. There is worry that deficit financing would create inflation and depress rupiah currency value. However, this worry has not been materialized yet, so that BI and the Ministry of Finance continue the practice of burden sharing up into 2022.

Politics: strong ruling coalition and early bid for presidency

The ruling coalition at DPR (the parliament) is strong especially in supporting Jokowi's administration in passing the laws and policies. At the time of the pandemic, DPR passed the widely criticized omnibus law on employment creation. The omnibus law combined many different laws into one and revised many articles to be suitable with the effort to attract Foreign Direct Investment (FDI) and employment creation. The important articles on lowering severance payment, minimum wage, and loosening up the labor market intend to attract investment especially in labor intensive industries, despite strong resistance from the labor unions and students. In addition, the law on economic recovery, especially on lifting the limitation of public debt to 3% of GDP, allowing BI to finance the budget deficit, and stimulus programs, easily passed by DPR with strong support from the ruling coalition. Furthermore, DPR is likely to pass the revision of tax law that increases Value Added Tax (VAT), tax amnesty II, and higher tariff for income tax for the highest bracket.

Despite still a long way to Presidential Election 2024, serious early preparations have been made by several likely candidates for president. Various surveys, many of them are quite credible, have shown who the serious candidates for president are. From the survey Ministry of Defense, Chairman of Gerindra (the third largest party at DPR) Prabowo Subianto, and Central Java's Governor Ganjar Pranowo at the top of most surveys, followed by Jakarta's Governor Anies Baswedan. In the middle are West Java's Governor Ridwan Kamil, Minister of Tourism Sandiaga Uno, and Chairman of Partai Demokrat Agus Yudhoyono. Two likely presidential candidates that openly promote

themselves through billboards in most of the cities in the country are Puan Maharani (PDIP), Speaker of DPR, and Coordinating Minister and Chairman of Golkar Airlangga Hartarto. They are still at the bottom of the surveys. President Jokowi himself does not have any objections for his ministers to prepare for the presidential election.

The solidity of the ruling coalition will be tested further with the proposal of Jokowi to act on the new capital. Jokowi would like to move the capital city to East Kalimantan. The plan would be implemented in 2024. The cost for relocating the capital city is estimated at Rp 460 trillion. There is criticism that this is not a wise decision, especially at the time the economy is recovering from the recession during the pandemic.

There is a possibility that the PAN party is going to join the ruling coalition. If this happened, this just left just two opposition parties, namely Demokrat and PKS. In Indonesian politics, joining the winning side is a stronger preference than in the opposition, because of the access to power and financial power.

Appendix

Economic Outlook

	Q1.2021	Q2	Q3*	Q4*	2021	2022*
Growth (%)	-0.7	7.1	3.5	4.2	3.7	5.1
Inflation (%)	1.4	1.3	1.6	2	2	2.3
USD/IDR	14525	14485	14300	14400	14400	14300
Policy Rate (%)	3.5	3.5	3.5	3.75	3.75	4
Cap.Market Index	5985	6095	6200	6100	6100	6300
Unemployment (%)	6.3	6.2	6	6	5.5	5
Poverty (%)	10.1	10.1	10	9.8	9.8	8.8

About The Habibie Center

The Habibie Center was founded by Bacharuddin Jusuf Habibie and family in 1999 as an independent, non-government, non-profit organisation. The vision of The Habibie Center is to create a structurally democratic society founded on the morality and integrity of cultural and religious values. The mission of The Habibie Center are first, to establish a structurally and culturally democratic society that recognizes, respects, and promotes human rights by undertaking study and advocacy of issues related to democratization and human rights, and second, to increase the effectiveness of the management of human resources and the spread of technology.

The Habibie Center

Jl. Kemang Selatan No. 98, Jakarta - Indonesia 12560

Tel: 62 21 781 7211 | Fax: 62 21 781 7212

thc@habibiecenter.or.id | www.habibiecenter.or.id