Indonesia considers mid- to long-term growth as commodities demand provides a tailwind

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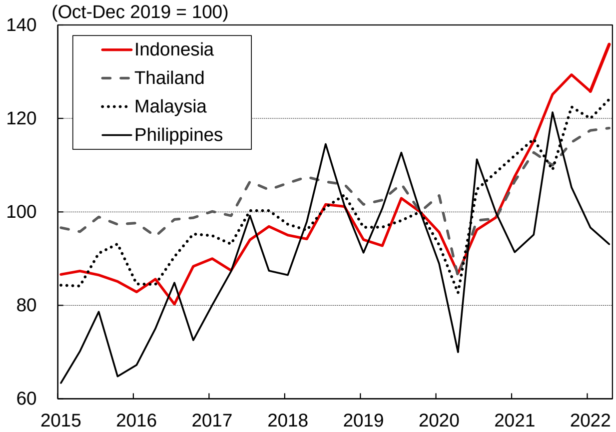
Indonesia's economy continues to recover at a robust pace: the real GDP growth rate for the April-June quarter was 5.4% YoY, which exceeds its rate of expansion before the pandemic (around 5% YoY). Private consumption has picked up as economic activities normalise and, as ASEAN's most commodity-rich country, Indonesia has experienced a considerable tailwind from the increase in global demand for commodities. Its real exports have increased significantly on compared with other ASEAN countries' and the rise in commodity prices appears to have led to an improvement in corporate earnings and a rise in household income (Charts 1 and 2).

Despite many downside risks to the economy, such as high inflation and the resulting rate hikes, Indonesia's economy is forecast to expand at a robust pace, as long as the commodity sector remains strong. Nevertheless, Indonesia's economy can be heavily affected by commodities demand and prices, and the government is considering its stability in the medium and long term. Indonesia is moving away from an industrial structure that depends on the export of raw materials by fostering and strengthening its manufacturing industry. For example, the government enacted its Job Creation Act ("Omnibus Law") which unified complex laws related to employment and investment in an effort to improve the investment environment. Furthermore, the government also enacted somewhat forceful policies, such as its ban on exports of nickel ore in order to encourage a shift in the location of higher-value-added processes, such as refining, from other countries to Indonesia. It intends to make Indonesia an EV production hub in ASEAN by using nickel – an important material in EV production – to cultivate downstream industries. At this point in time, the manufacturing sector has yet to reach the government's target of over 25% of GDP; however, inward direct investment shows investment in the secondary sector has gathered momentum, particularly related to metals, and it appears policies are slowly starting to have an effect (Chart 3).

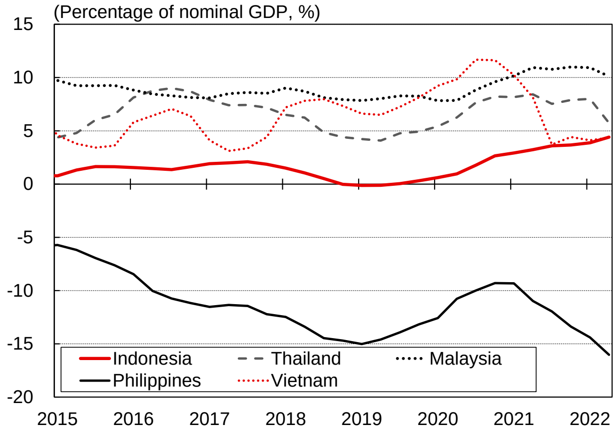
Many ASEAN countries are setting new development strategies for the post-COVID-19 era, but most of those lack specific focuses. Indonesia has forged ahead with a tightening of its restrictions on raw commodity exports, which has resulted in opposition from other countries who say this is resource nationalism. Nevertheless, it is worth noting that policies which take advantage of Indonesia's own abundant natural resources are making concrete progress. The economy is expected to be stable for the time being thanks to the commodities boom, and there is a good opportunity now to accelerate these medium and long-term measures.

Chart 1: ASEAN Real Exports



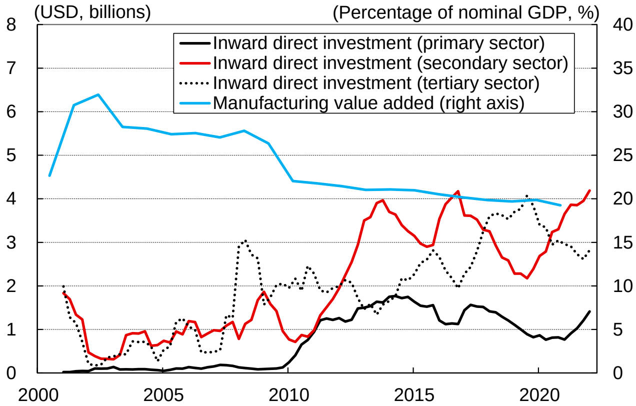
Source: Each country's national statistics,
MUFG Bank Economic Research Office

Chart 2: ASEAN Trade Balance



Source: Each county's national statistics,
MUFG Bank Economic Research Office

Chart 3: Indonesia's Inward Direct Investment and Manufacturing Value Added



Note: Inward direct investment is a quarterly average
Source: World Bank, MUFG Bank Economic Research Office

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