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The Global Economic Outlook and the State of Indonesia

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Key Messages:

- The recent global economic situation reflects a perfect storm – a combination of a slowdown in growth, prolonged geopolitical tensions, soaring inflation, and tightening monetary policy – which is haunting the global economy.
- The coronavirus disease (COVID-19) pandemic created a tremendous global impact and left widespread scarring effects, particularly on vulnerable groups. There is rising concern about unemployment, poverty, and inequality as an impact of several crises, particularly in the developing world.
- The Indonesian economy faces the implications of global economic uncertainties and challenges through trade and financial channels. Nevertheless, given the limited share of links to the global economy, Indonesia is unlikely to experience a contraction in 2023.
- On the fiscal side, the government is trying to get back on track with the fiscal deficit, estimated to be 2.84%, denoting low fiscal space.

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The global economy is facing a perfect storm as a result of the coronavirus disease (COVID-19) pandemic, prolonged geopolitical tensions, soaring inflation, and tightening monetary policy. A darkening future has been projected and the worst is yet to come. Amid global uncertainty, governments have become less aggressive in their budget spending, while high inflation has led many central banks to tighten their monetary policy. Furthermore, the pandemic has left widespread scarring effects, such as unemployment, poverty, and inequality, particularly on vulnerable groups. Global challenges and lower economic growth of the major economies will also affect Indonesia's economic conditions, as the country may experience slower growth as a spillover from its major trading partners. It is important for the world and Indonesia to address these challenges, particularly the scarring effects, through multilateral solidarity and better maintenance of prudent fiscal policy.

The Perfect Storm in the Global Economic Outlook

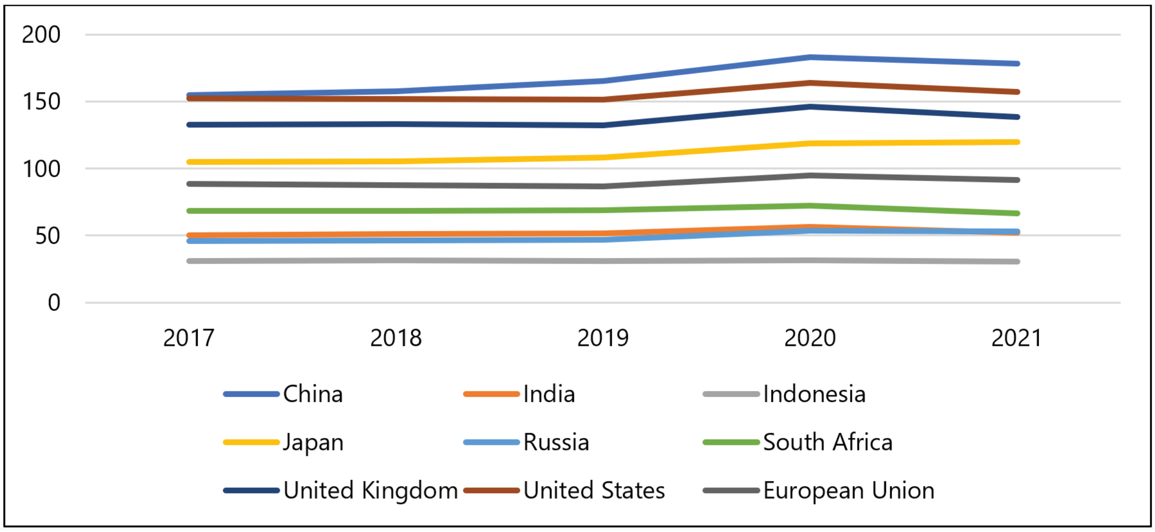
Global economic growth has slowed since the second quarter of 2022 and has worsened because of the current geopolitical tensions. The world is facing a perfect storm from the coronavirus disease (COVID-19) pandemic, prolonged geopolitical tensions, soaring inflation, and tightening monetary policy. The International Monetary Fund (IMF, 2022b) has projected low growth at 3.2% in 2022 and slower growth at 2.7% in 2023. A darkening future has been projected and the worst is yet to come, as inflation haunts global economic growth and may hamper the recovery process from COVID-19. Inflation is expected to remain elevated at 8.8% in 2022 and normalise to 6.5% in 2023 and 4.1% in 2024 (IMF, 2022a).

On the fiscal side, governments have provided large stimulus packages to society and business – through tax breaks, subsidies, targeted support, and cash assistance. The debt to gross domestic product (GDP) ratio started to increase in several countries in 2020 (Figure 1) when the pandemic hit the world and shut down almost all economic activities, resulting in a large contraction in the global economy. The government provided support, particularly for health and the economic recovery, to help offset the negative impacts of the pandemic.

However, amid global uncertainty, governments have become less aggressive in their budget spending. In the United States (US), the Congressional Budget Office projects that the US budget deficit will shrink to $1.0 trillion in 2022 from $2.8 trillion in 2021 (CBO, 2022). The lower budget deficit is due to lower government spending related to the COVID-19 pandemic. In China, local governments are facing debt issues. Debts are piling up, primarily due to the slump in the housing market and the financial burden of the central government's zero-COVID-19 policy (Kawate, 2022). In 2021, China recorded debt to GDP of 178.13%.

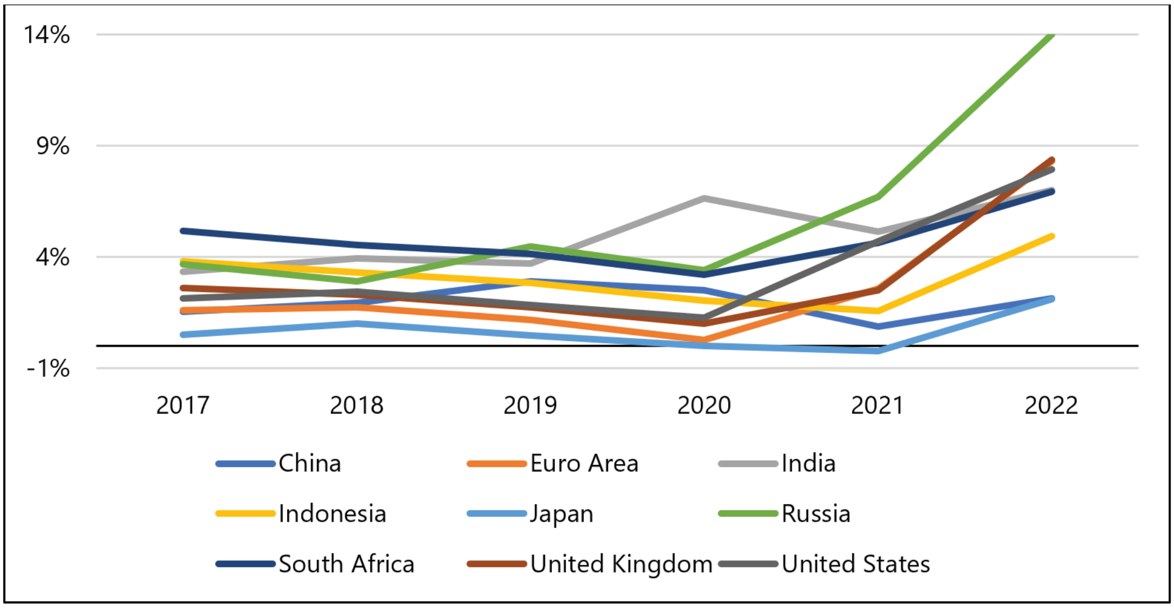
On the monetary side, even before Russia's invasion of Ukraine, countries across the globe were

Figure 1: Debt-to-GDP Ratio in Selected Economies, 2017–2021 (% of GDP)



GDP = gross domestic product.
Source: CEIC Data (2022), https://www.ceicdata.com/en (accessed 3 October 2022).

Figure 2: Inflation Rate in Selected Economies, 2017–2022



Source: Economist Intelligence Unit (2022), https://viewpoint.eiu.com/ (accessed 14 October 2022).

experiencing substantial hardships because of high inflation, mainly resulting from the large stimulus packages, reopened economies after the pandemic, and supply chain disruptions. The war in Ukraine has exacerbated inflation rates, as it has caused price pressures on food prices (wheat and corn) and energy prices (oil, gas, coal, and industrial metals) (OECD, 2022). High inflation led many central banks to tighten their monetary policy in early 2022 to maintain the greater-than-expected overshoot of inflation targets (Figure 2). The US Federal Reserve raised the funds rate in March 2022 and signalled that the rate would continue to rise until 2023. The increase in interest rates in major economies is likely to hurt developing countries, as it will induce capital outflows. From January to July 2022, investors in developing countries withdrew $50 billion in funds because of tightening monetary policy in major economies as well as the war in Ukraine (Asgari, 2022). This is the most severe capital outflow since 2005.

The Scarring Effects of the Pandemic

The pandemic, combined with other global phenomena, caused a tremendous impact across the globe and left widespread scarring effects, particularly on vulnerable groups.

Unemployment

The global labour market is struggling to recover. The International Labour Organization (ILO, 2022) predicted global unemployment to reach 207 million in 2022, significantly higher than the 2019 level (186 million). The outlook is notably severe in Latin America and the Caribbean and Southeast Asia. In 2023, the labour market recovery will remain weak, with vulnerable groups, such as women, youth, older persons, and migrant workers, having a higher probability of employment losses than other groups. ILO projected the global unemployment rate to reach 5.9% in 2022, normalising to 5.7% in 2023.

Poverty

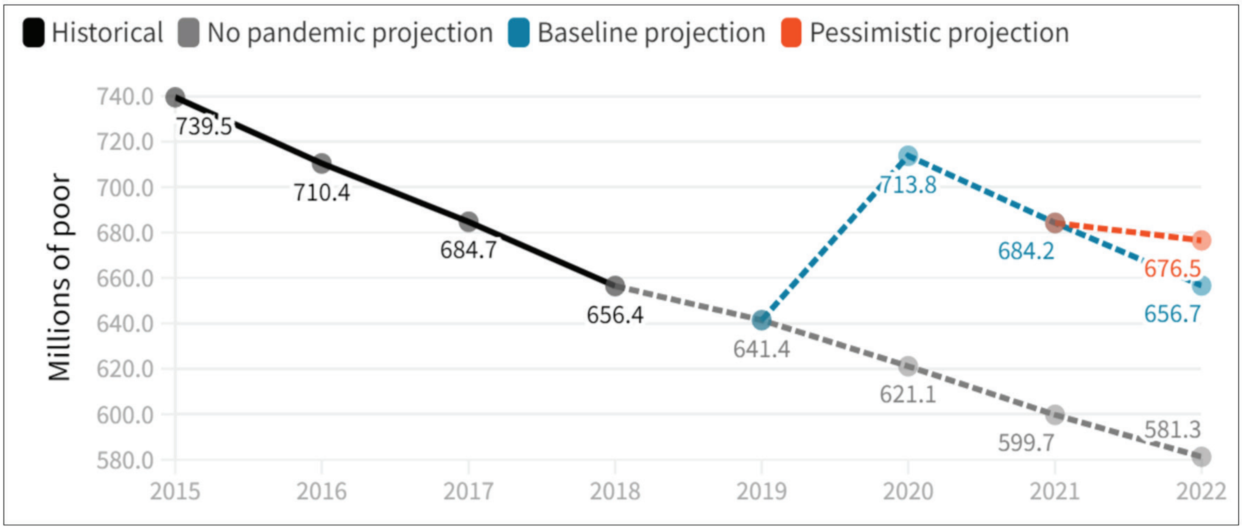
The number of people living in extreme poverty had steadily declined for almost 25 years, but the pandemic disturbed this trend. By the end of 2022, the World Bank (Mahler et al., 2022) predicts an additional 75 million–95 million people living in extreme poverty, compared with pre-pandemic projections (Figure 3). The rising food prices have hit poor families hardest, particularly in low-income countries where a typical person spends about two-thirds of their resources on food. This requires government intervention to assist poor families through social protection policies.

Inequality

During the COVID-19 pandemic, billionaire wealth and corporate profits soared to record levels, while more than a quarter of a billion more people could crash to extreme levels of poverty (Oxfam, 2022). Billionaires' fortunes, especially in the food and energy sector, increased as much in 24 months as they did in 23 years. Meanwhile, the pandemic has pushed as many as 263 million people into extreme poverty in 2022. In India, GDP growth is concentrated in the top income group (top 10%) while the rest of the population is more fragile and in a vulnerable condition.

On gender inequality, the pandemic pushed women out of employment more than men, especially in the

Figure 3: Extreme Poverty, 2015–2022



Source: World Bank (2022), Poverty. https://www.worldbank.org/en/topic/poverty (accessed 15 October 2022).

service sectors: tourism, hospitality, and care work. The gender pay gap also widened, and it will take 136 years to close the gap compared with the pre-pandemic projection of 100 years (Oxfam, 2022).

Indonesia Amid the Global Uncertainty

In 2021, Indonesia showed accelerated growth and ended the year with 3.7% economic growth. The spike in food and energy prices caused Indonesia's inflation to rise but provided momentum for government revenue. The IMF (2022b) revised Indonesia's economic growth forecast to 3.2% in 2023, down from an earlier projection of 3.6%. However, as major economies are facing lower economic growth, Indonesia may experience slower growth as a spillover from its major trading partners, such as China and the US.

The implications of global economic uncertainties and challenges to Indonesia come from two main channels:

First, the **trade channel**. Despite the slowdown in economic growth, the situation in China, one of Indonesia's most important trading partners, is not as bad as commonly thought. Therefore, the deterrent effect on trade channels will not be severe. Indonesia has a lower share of exports to GDP than other countries, so the global shock might not significantly impact the country. Other issues stem from geopolitical tensions and Europe's winter energy crunch, with high demand for energy increasing coal prices. However, this creates a windfall for Indonesia as a coal exporter.

Second, the **financial channel**. This channel appears to be more concerning for Indonesia, as a strong US dollar reflects the difference in growth between Indonesia and the US. The rupiah is likely to depreciate as the US becomes a net exporter, and inflation is set to increase further as producers transfer higher costs to consumers.

Despite the global uncertainties and huge challenges Indonesia is facing, its fiscal prudence is an asset. During the pandemic, Indonesia relaxed its fiscal policy from a 3% legal requirement to a 6% fiscal deficit as a response to the pandemic – serving as a buffer, particularly for socio-economic assistance. Next year, according to Indonesia's State Revenue and Expenditure Plan for 2023, Indonesia targets returning the deficit to only 2.8% of GDP. A lower budget deficit target means that Indonesia would not have much fiscal space next year. Therefore, it is important for the government to ensure the quality of government spending and to prioritise the allocation to sectors that have higher multipliers. In terms of tax revenue, the government must improve the fiscal space through tax and subsidy reallocation.

Policy Recommendations

The world needs to focus on addressing the challenges stemming from the dire economic projections in the coming years and provide support to the most impacted and vulnerable groups.

First, governments should implement effective measures to tackle the scarring effects of the pandemic, particularly in employment, poverty, inequality, and education. This calls for multilateral solidarity to work together and seek global solutions that benefit countries around the world. The G20 could play an important role in leading initiatives to mitigate the challenges and facilitate multilateralism.

Second, maintaining macroeconomic stability serves as the foundation for countries' resilience amid global uncertainties. Tightening monetary conditions could trigger debt distress, particularly in emerging markets and developing countries; borrowing costs will put pressure on international reserves and cause depreciation of exchange rates. Governments must be careful in managing debt and keep it under control. Through global leadership, we need to provide liquidity to countries that may benefit from it, not only to those that need it desperately. In China, the local government debt issue needs to be reformed in terms of financial regulations to allow for bonds issuance when necessary.

Third, the darkening economic outlook must be considered by business players, particularly under the conditions of the ongoing COVID-19 pandemic and rising geopolitical tensions. As winter is here and several countries return to dealing with outbreaks of COVID-19 variants, businesses need to seek strategies to improve resilience during supply chain disruptions.

Finally, for the Indonesian economy, the government should maintain fiscal prudence and improve its tax revenue by (i) increasing export levies on sectors that have been advantaged by the windfall in energy and commodity prices (palm oil and coal); (ii) reforming the tax administration rather than tax rates (if any, it should be for sin tax and luxury goods) to increase fiscal space; and (iii) ensuring better quality spending, particularly on sectors with higher multipliers to the economy, while guaranteeing social assistance for the most vulnerable groups.

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