Oil Prices, Global Uncertainty, and Macroeconomic Stability

Case of Indonesia and East Java

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Oil Prices and Its Impact to Macroeconomy

• Studies show that the impact of an oil price shock on GDP has a classic supply-side effect.
• The CPI-oil price relationship indicates an inflationary pressure stemming from increased oil prices, creating an inflationary shock.
• However, this occurs with varying degrees across countries with different economic characteristic.

Photos from telegraph.co.uk
Oil Prices and Its Impact to Macroeconomy

Studies:

• There is negative relationship between oil prices and macroeconomic indicators by demonstrating that almost all recessions in the US had been preceded by oil price increase (Hamilton, 1983).


• However, other arguments show that there are structural breaks in the data after 1986, indicated a changing, unstable oil price-macroeconomic relationship (Hooker, 1996).

• A country study on Singapore indicated a declining relationship, with oil price shock only having a marginal impact on macroeconomic indicator (Chang and Wong, 2003).
The pass through effect of a positive oil price shocks into inflation has been clearly observed in empirical data and research studies. Inflationary impact is usually followed by second-round effects.

Graph showing the trend of oil consumption (konsumsi) and production (produksi) from 1996 to 2010.

Indonesia Menjadi Net-importir Minyak

Source: BP Statistical Review of World Energy Market 2010 (diolah)
Case: Indonesia. Since 2003, Indonesia became oil net importer

**Indonesia: oil production & consumption**

**Oil production:** A mixture of hydrocarbons that exists in liquid phase in natural underground reservoirs and remains liquid at atmospheric pressure after passing through surface separating facilities.

**Oil consumption:** inland demand plus aviation and marine bunkers and refinery fuel and loss. Consumption of fuel ethanol and biodiesel is also included.

Source: United States Energy Information Administration, for oil production; and BP Statistical Review of World Energy, for oil consumption
Indonesia’s Total Revenue vs Oil Revenue

Graph showing the comparison between Indonesia’s total revenue and oil revenue from 1990 to 2010 in million rupiah.
The Global Economy
The global economy growth in 2013 is gloomier than predicted ...
Fundamental shift: US mild recovery, EM slowdown...
Financial market uncertainty increased…

Global Stock Market

Composite Equity Index Performance
(Rebased 1/1/2010 = 100)

Source: Bloomberg (diolah)
Global commodity prices tend to decline, unless oil price...

- Sluggish pace of global economy brought global commodity prices to a downward trend.
- While world oil prices rise due to the turmoil in the Middle East.
- Indonesia’s export commodity price index in 2013 is predicted to chart negative growth.

### Export Commodity Prices (IHEX)

<table>
<thead>
<tr>
<th>Growth IHX (yoy)</th>
<th>Jun-13</th>
<th>Jul-13</th>
<th>Aug-13*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>YoY</td>
<td>MtM</td>
<td>YoY</td>
</tr>
<tr>
<td>Non Oil and Gas</td>
<td>-6.6</td>
<td>-1.83</td>
<td>-9.1</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-13.8</td>
<td>-5.8</td>
<td>-15.3</td>
</tr>
<tr>
<td>Mining</td>
<td>-2.4</td>
<td>-2.1</td>
<td>-4.0</td>
</tr>
<tr>
<td>Industry</td>
<td>-7.0</td>
<td>-0.4</td>
<td>-10.2</td>
</tr>
<tr>
<td>Oil and Gas</td>
<td>-8.1</td>
<td>-0.5</td>
<td>-6.8</td>
</tr>
<tr>
<td>TOTAL</td>
<td>-7.2</td>
<td>-1.3</td>
<td>-8.1</td>
</tr>
</tbody>
</table>

*) Preliminary Data
Indonesia’s Economy
GLOBAL ECONOMY

- WORLD TRADE VOLUME
- COMMODITY PRICES EXCEPT OIL
- CURRENT ACCOUNT
- EXCHANGE RATE
- CAPITAL OUTFLOW
- EXPORT
- IMPORT
- GLOBAL FINANCIAL MARKET UNCERTAINTY

- The Fed Tappering Issue
- China Slowing Down

Structural

Short Term
The economic slowdown is projected to continue in Q3 2013...

### Economic Growth – Expenditure Side

<table>
<thead>
<tr>
<th>Component</th>
<th>2013</th>
<th>2013*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>I</td>
<td>II</td>
</tr>
<tr>
<td>Private Consumption Expenditures</td>
<td>5.17</td>
<td>5.06</td>
</tr>
<tr>
<td>Government Consumption</td>
<td>0.42</td>
<td>2.13</td>
</tr>
<tr>
<td>Gross Fixed Capital Formation</td>
<td>5.78</td>
<td>4.67</td>
</tr>
<tr>
<td>Export of Goods and Services</td>
<td>3.57</td>
<td>4.78</td>
</tr>
<tr>
<td>Import of Goods and Services</td>
<td>-0.06</td>
<td>0.62</td>
</tr>
<tr>
<td><strong>Gross Domestic Product</strong></td>
<td><strong>6.03</strong></td>
<td><strong>5.81</strong></td>
</tr>
</tbody>
</table>

Source: BPS-Statistics Indonesia

* Bank Indonesia's Projection
The less vigorous expansion in household consumption is closely linked to the declining of purchasing power......
Investment is expected to record more modest growth in Q3 2013, mainly in non-construction investment...

*Transportation Investment Indicators*

*Construction Investment Indicators*
Exports is expected to grow stable from previous quarter, while imports is projected to decline in line with economic activity deterioration...

**Real Exports Growth**

<table>
<thead>
<tr>
<th>% yoy</th>
<th>2012</th>
<th>2013</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Q1</td>
<td>Q2</td>
<td>Q3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Q1</td>
<td>Q2</td>
</tr>
</tbody>
</table>

**Real Imports Growth**

<table>
<thead>
<tr>
<th>% yoy</th>
<th>2012</th>
<th>2013</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Q1</td>
<td>Q2</td>
<td>Q3</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>May</td>
</tr>
</tbody>
</table>
Pressure on BoP remains high in Q3 2013 but with less intensity...
Rupiah remained under pressure in August 2013...
Inflationary pressure in August 2013 eased, decline to 1.12% (mtm) atau 8.79% (yoy) from July 2013 and lower than previously predicted by BI’s Price Monitoring Survey.
In line with BI Rate, banking interest rate increase...

- Deposit rate increased to 5.90%, from 5.60% in the previous month.
- On average, credit rate increased to 12.05%, from 11.93% in the previous month.
- Interest rate spread between credit and deposit declined to 6.15% from 6.33% in the previous month.
Credit growth increased

- Credit growth in Juli 2013 is recorded 22.3% (yoy), increase from 20.6% (yoy) in the previous month.
- Credit expansion is explained by all type of loan
- By sectoral, growth contribution of productive sector increased. Credit to manufacturing and trade sector increase by 26.3% (yoy) and 33.4% (yoy), respectively.
EAST JAVA’S ECONOMY
Economic growth based on province..
East Java Economy growth in 2\textsuperscript{nd} quarter 2013 is 6.97\% (yoy), higher than national (5.81\%).

The highest growth in sequence occurred in the Construction (10.53\%), Transportation & Communication (10.04\%) and Trade, Hotel & Restaurant (9.38%).
East Java Still Experienced Inflation in August 2013

- Annually (yoy), East Java inflation in August 2013 reached 8.06%, lower than national (8.79%).
- Monthly (mtm), East Java inflation is 0.97%, also lower than national (1.12%).

The weakening of Rupiah exchange and increasing price of gold risk inflation rate of this group.

Lower than previous period because the stable price of horticultural commodities (garlic, chili, apple, pear) along with the end of Ramadhan and Idul Fitri moments

Primary contributor of inflation, because the increasing price of fuel, transportation and electricity tariff
East Java Oil Reserves

The third biggest oil reserves in Indonesia. Cepu Blok has oil and gas reserves around 650 million barrel. Total oil reserves in East Java is around 583,475,5 million barrel.
Bank Indonesia’s Policy
Bank Indonesia instituted policy mix in Board of Governors’ meeting convened on September 2013...

- On 12th September 2013, Bank Indonesia decided to raise the BI Rate by 25 bps to 7.25%, the rate on the Lending Facility by 25 bps to 7.25% and the rate on the Deposit Facility by 25 bps to 5.50%.
- This action forms part of the follow-up measures taken to reinforce the policy mix instituted by Bank Indonesia, which focuses on controlling inflation, stabilizing the rupiah exchange rate and ensuring the current account deficit is managed to a sustainable level.
- Bank Indonesia is of the opinion that the aforementioned policies, accompanied by the array of policies implemented previously, will expedite reductions in the current account deficit and bring the rate of inflation down to its target corridor of 4.5±1% in 2014.
- Bank Indonesia will also redouble efforts to enhance coordination with the Government and the FKSSK in order to maintain macroeconomic and national financial system stability, particularly in terms of controlling inflation, stabilizing financial markets as well as reducing the current account deficit and ensuring a sound balance of payments.
Previously, on August 29, 2013, The Board of Governors strongly believes it is necessary to deliver an additional monthly Board of Governors’ meeting to reinforce the monetary and macro prudential policy mix to curb inflation, stabilize rupiah exchange rates, ease the current account deficit as well as strengthen macroeconomic resilience and financial system stability.

- The package of policy measures are as follows:
  1. raised BI rate by 50 basis points (bps) to 7.00%, the lending facility rate by 25 bps to 7.00% and the deposit facility rate by 50 bps to 5.25%
  2. Strengthening the rupiah exchange rate stabilization in accordance with economic fundamentals.
  3. Strengthening the liquidity management on the financial market and banks to maintain the stability of financial markets, the banking industries as well as the overall financial system.
  4. Strengthening the macro prudential policy to manage credits and risks
  5. Strengthening coordination among central banks in terms of monetary policy and financial system stability.