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Regional Economic and Financial Review

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Foreword

The Nusantara Report describes the latest national economic conditions and outlook from a regional perspective. The spatial economic assessments presented in this publication are based on five regions: Sumatra, Java, Kalimantan, Bali-Nusa Tenggara (Balinusra) and Sulawesi-Maluku-Papua (Sulampua). The Nusantara Report is published on a quarterly basis by Bank Indonesia in January, April, July and October.

This edition of the Nusantara Report focuses on the strategic issue of "Financing Sectors with High Leverage for the Economy". This is an important issue to explore in line with structural efforts to bolster national economic resilience and revival against a backdrop of dynamic global economic changes. The report specifically discusses strategies to accelerate optimal financing towards strengthening growth of key regional economic sectors.

We sincerely hope the Nusantara Report brings valuable insights and benefits to all stakeholders and regional economists. The spirit of optimism is reflected in the Garuda Eagle architectural design of the Bank Indonesia Office Complex (KOPERBI) in the new Nusantara Capital City (IKN), representing the spirit of revival. We are also confident that Bank Indonesia can continue supporting sectoral recovery and development throughout the Indonesian archipelago, while remaining vigilant of the latest dynamics. We visualise this hope through the map of the archipelago, with a touch of the Tangkawang Ampiek batik motif, which symbolises good fortune and health towards national prosperity.

Jakarta, 19th July 2024

Economic and Monetary Policy Department

Firman Mochtar

Executive Director

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Executive Summary

Regional economic growth in the second quarter of 2024 remained solid, primarily underpinned by the regions of Java, Sumatra and Balinusra. Economic gains in the Java and Sumatra regions were driven by increasing household consumption during the holy month of Ramadan, coupled with investment relating to the development of national strategic projects (PSN) and manufacturing. In Balinusra, economic growth stemmed more from higher exports, particularly of copper concentrate. Conversely, economic moderation in the Kalimantan region was influenced by weaker investment as a corollary of the restrained outlook for coal exports. Economic moderation was also observed in the Sulampua region as investment performance declined given the delayed completion of several national strategic projects (PSN). Economic improvements in the second quarter of 2024 in various regions were also reflected in the performance of several economic sectors. Agricultural activity increased in all regions in line with the ongoing harvesting season. In addition, performance also improved in mobility-related sectors, particularly in the Java region in response to stronger household consumption. Meanwhile, high growth in the mining sector was supported by improving exports, particularly in the Balinusra region.

Overall, economic performance in most regions is projected to record limited gains in 2024. Private consumption is increasing in all regions, supported by the general and local elections held in 2024 and improving revenues. Meanwhile, increasing investment in several regions, including Java and Sulampua, is driving economic improvements. In the Java region, higher investment is supported by increasing government infrastructure development and industrial projects, coupled with government spending given the improving realisation of Local Own-source Revenue (PAD) and Transfer Fund Allocation to Regions (TKD). Notwithstanding, persistently restrained PSN development realisation is contributing to economic moderation in the Sumatra region. In terms of exports, stronger export performance for the major commodities is driving economic improvements in the Kalimantan region, while an influx of inbound international travellers is supporting strong economic performance in the Balinusra region. By sector, limited economic gains in several regions in 2024 were confirmed by the performance of major economic sectors, tertiary sector improvements and manufacturing industry performance, all of which are still restrained in most regions, except in Java. Mining sector performance is improving, particularly in Kalimantan and Balinusra. Meanwhile, moderating construction activity was observed in the Sumatra region. Such developments strengthen indications of restrained economic improvements in Indonesia in 2024. Policy support to stimulate regional economic growth, therefore, must be strengthened, including financing support, which is discussed specifically in Part III Strategic Issue: Financing Sectors with High Leverage for the Economy.

Lower Consumer Price Index (CPI) inflation was recorded in most provinces in the second quarter of 2024. Nationally, CPI inflation in the second quarter of 2024 retreated to 2.51% (yoy), which is still within the national headline inflation target corridor of 2.5%±1%. Milder inflationary pressures stemmed from volatile food (VF) in response to additional post-harvest supply of various food commodities, which continued in the second quarter of 2024. Meanwhile, core inflation and administered price (AP) inflation were observed to increase in most regions. Spatially, only 10 (ten) provinces recorded inflation above the target range, with the highest rate in Highland Papua (Papua Pegunungan) at 5.65% (yoy).

CPI inflation is expected to remain under control and within the 2.5%±1% target in 2024, supported by stronger policy synergy between Bank Indonesia and the Government. Spatially, CPI inflation in all regions is also forecast to remain manageable. This is supported by the Bank Indonesia policy mix, which will remain consistently oriented towards ~~consistently~~ maintaining rupiah stability, and as a pre-emptive and forward-looking measure to ensure inflation remains under control within the 2.5%±1% target corridor in 2024. In addition, Bank Indonesia will continue strengthening policy coordination with the (central and regional) Government within the Central and Regional Inflation Control Teams (TPIP and TPID) through the National Movement for Food Inflation Control (GNPIP) in various regions. Coordination will be strengthened to manage volatile food inflation against a backdrop of productivity issues and intertemporal supply imbalances, which remain an ongoing concern.

Moving forward, persistently high global uncertainty and geo-economic risks will continue to demand

attention. Strong economic growth in the United States (US) is supported by domestic demand and an accommodative fiscal policy stance. Similarly, economic expansion in India continues on the back of government stimuli and spending. On the other hand, the economic outlook for China remains sluggish. International commodity prices are seen to increase due to higher demand amid limited supply. Such factors could exacerbate global financial market uncertainty and the world economic growth outlook and, in turn, impact the economic outlook in various regions of Indonesia.

PART 1

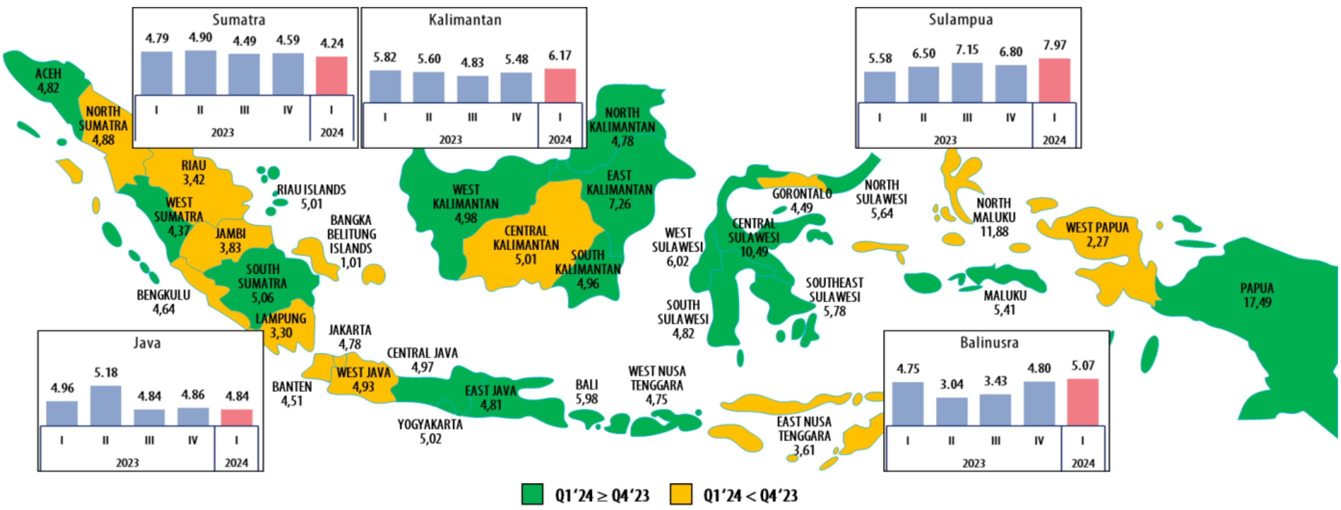
Overview of Recent Regional Economic Developments and Outlook

Regional Economic Growth

Regional economic growth remained solid in the second quarter of 2024. This was supported by household consumption in most regions, as reflected in solid retail sales in line with higher income due to disbursements of religious holiday allowances (THR). Private consumption also improved in most regions, excluding Kalimantan and Sulampua as spending normalised after the general election. Departing from other regions, economic improvements in Balinusra were driven by the strong contribution of high net exports in response to a surge of copper concentrate exports and inbound international travellers.

Persistently solid regional economic performance was confirmed by sectoral improvements in several regions. Improving private consumption in all regions boosted trade sector performance in most regions. Increasing consumption also improved manufacturing industry performance in all regions, except Java. Meanwhile, stronger net exports in the Balinusra region underpinned mining sector performance as well as accommodation and food service activities, which posted high growth in the second quarter of 2024.

Overall, economic performance in most regions is expected to post limited gains in 2024. Private consumption remains the main contributor to improvements in most regions in line with maintained income and supported by the general and local elections. Investment is expected to accelerate on the previous year, particularly in Java and Sulampua, boosted by additional national strategic projects (PSN) and the completion of other PSN, coupled with increasing industrial capacity in both regions. Meanwhile, a restrained export outlook is projected, particularly in Java and Sumatra, in line with softer demand for various manufacturing products in Indonesia's main trading partners.



Source: BPS-Statistics Indonesia, processed

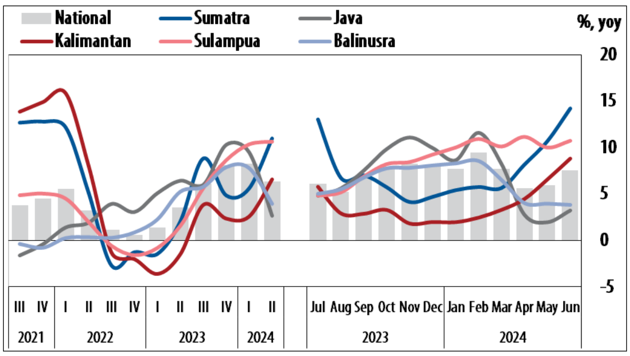
Figure I.1. Map of Regional Economic Growth in Q1/2024

Sectoral performance in various regions confirmed limited economic improvements in 2024. Improvements in the major economic sectors are mixed across the different regions. This is most notably reflected by restrained improvements in the tertiary sector and manufacturing industry in all regions, except Java, supported by greater mobility and increasing spending on the general election. Manufacturing industry gains in Java are supported by external demand, contrasting subdued growth of the export-based manufacturing industry in Kalimantan and Sulampua. Performance of the primary sector also improved on the back of mining sector gains, particularly in the Kalimantan and Balinusra regions. Meanwhile, agricultural moderation is taking place in the Java and

Sumatra regions. Sectoral performance in several regions has strengthened indications of restrained economic gains in Indonesia in 2024.

Private Consumption

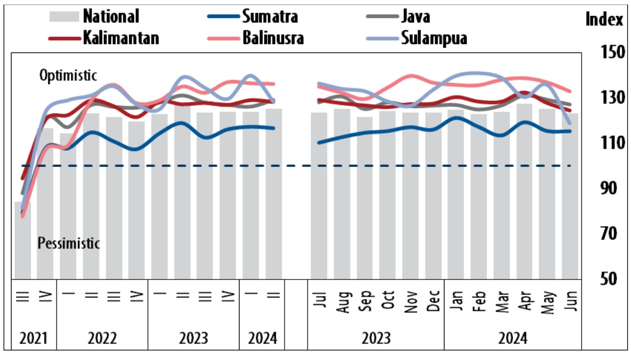
Private consumption is projected to remain solid in the second quarter of 2024. Eid-ul-Fitr celebrations will boost household consumption in the second quarter of 2024. This is consistent with a survey conducted by the Ministry of Transportation, which indicates a higher number of people embarking on the annual exodus (*mudik*) to their hometowns in 2024 compared with conditions in 2023, particularly in the Java region. In terms of income, disbursements of religious holiday allowances (THR) in April 2024 and 13th-month salaries in May 2024 are expected to have a positive impact on private consumption in all regions. Farm income, as reflected in the farmers' terms of trade (FTT), is also expected to be maintained, particularly in Sumatra and Kalimantan as regions producing fresh fruit bunches (FFB) (Graph I.1). In the Java, Balinusra and Sulampua regions, the FTT tracked incremental upward trends through to the end of the second quarter of 2024. Maintained private income also strengthened consumer confidence in the Java region and sustained high consumer confidence in the other regions in the second quarter of 2024 (Graph I.2). Such conditions preserved positive retail sales growth in most regions in the reporting period, while consumption by non-profit institutions serving households (NPISH) is expected to moderate given the completion of the general election in the first quarter of 2024.



Source: BPS-Statistics Indonesia, processed

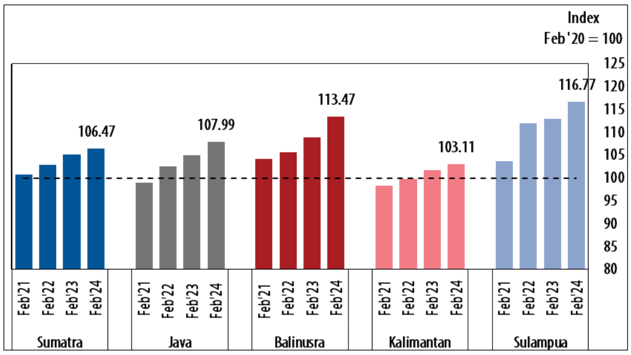
Graph I.1. Farmers' Terms of Trade (FTT) by Region

The outlook for private consumption overall in 2024 is still solid. The post-pandemic economic recovery remains intact, thereby increasing labour absorption in all regions. In February 2024, the workforce in all regions exceeded pre-pandemic levels, with the highest increases recorded in the Sulampua region, followed by Balinusra, Java, Sumatra and Kalimantan (Graph I.3). Greater labour absorption is also supported by higher minimum wages and civil servant salaries, thereby underpinning private income in various regions. Such developments have maintained solid private consumption. In addition, private consumption growth overall in 2024 will also be supported by controlled inflation within the target corridor, fiscal incentives and Bank Indonesia policy. Meanwhile, the upcoming local elections planned for the fourth quarter of 2024 will also have a favourable impact on private consumption.



Source: Bank Indonesia

Graph I.2. Consumer Confidence Index (CCI) by Region

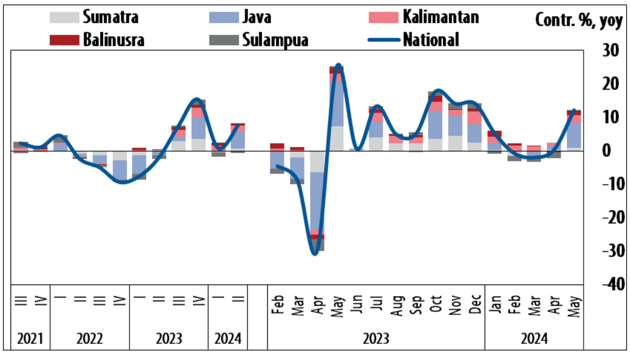


Source: BPS-Statistics Indonesia, processed

Graph I.3. Total Labour by Region

Investment

Investment in the second quarter of 2024 is projected to increase, particularly in the Java and Sumatra regions. Higher investment in Java and Sumatra is contributed by building and non-building investment. Building investment is supported by the ongoing development of several national strategic projects (PSN) by the Government, coupled with private projects. This was also confirmed by faster growth of cement sales in the second quarter of 2024 (Graph I.4). In addition, non-building investment also improved on the back of petrochemical industry development in the Java region as well as oil and gas and CPO development projects in Sumatra. Meanwhile, investment in Kalimantan, Balinusra and Sulampua was observed to moderate in the reporting period. In Kalimantan, investment moderated given a weaker coal mining outlook. Notwithstanding, deeper moderation investment was offset by various ongoing multi-year projects, including development of the new Nusantara Capital City (IKN), nickel smelters, paper mills, and RMDP RU V. In the Sulampua and Balinusra regions, investment moderated primarily due to limited government investment despite increasing private investment, particularly in downstream nickel projects in Sulampua and tourism projects in Balinusra.



Source: Indonesia Cement Association (ASI), processed

Graph I.4. Cement Sales by Region

Overall, investment in 2024 is expected to accelerate, particularly in Java and Sulampua. Investment in the Java region will improve due to the completion of national strategic projects (PSN) along with additional PSN, accompanied by higher capacity in the automotive and petrochemical industries. In Sulampua, investment will also improve due to increases in the PSN completion target and capacity of the basic metal industry. Meanwhile, investment is expected to moderate in other regions as IKN development projects normalise in Kalimantan, completion of the Trans-Sumatra Toll Road (JTTS) experiences delays and several other multi-year projects are completed. In addition, a lack of new additional strategic projects is hampering investment in the Balinusra region.

Regional Government Consumption

Regional fiscal stimuli in the second quarter of 2024 remain on target and above historical trends. The realisation of Regional Revenue and Expenditure Budget (APBD) spending as of May 2024 is higher than historical trends in all regions, except Kalimantan. APBD spending has accelerated most significantly in Sumatra, followed by Java. This was due to a higher realisation of Local Own-source Revenue (PAD) than historical trends, supported by the improving realisation of Transfer Fund Allocation to Regions (TKD) disbursements. Notwithstanding, spending realisation remains dominated by personnel expenditure, which is tracking an upward trend in all regions, except Kalimantan. In this region, spending also increased in terms of capital expenditures and the procurement of services to support IKN development.

The realisation of APBD expenditures was also supported by higher TKD disbursements in terms of the General Allocation Fund (DAU), Revenue Sharing Fund (DBH) and Village Fund. DAU disbursements increased in Balinusra, Java and Sumatra due to a larger block grant[1] portion. DBH disbursements increased in Kalimantan and Sumatra in line with the annual increase in the Mineral and Coal Mining Revenue Sharing Fund. The realisation of Village Funds also increased in all regions given the redesigned disbursement mechanism that separates earmarked village funds (for the eradication of extreme poverty through direct cash assistance - BLT) from non-earmarked and reward funds for independent villages. Meanwhile, Local Own-source Revenue (PAD) receipts accelerated due to a surge of levy receipts for public services, dividend payments on capital participation in municipally-owned enterprises (BUMD), and street lighting tax revenues, specifically in the Java and Sumatra regions.

Table I.1. Transfer Fund Allocation to Regions (TKD)

Transfer to Region (TKD) (IDR Trillion)	Allocation		Realization				
	2023	2024	up to May'23	up to May'24	%up to May'23	%up to May'24	up to May'24
1. Profit Sharing Fund (DBH)	136.26	143.10	40.74	45.12	29.9%	31.5%	10.8%
2. General Allocation Fund (DAU)	396.00	427.70	162.31	186.32	41.0%	43.6%	14.8%
3. Special Transfer Funds	185.80	188.10	53.65	51.83	28.9%	27.6%	-3.4%
a. Special Allocation Fund (DAK) Physical	53.42	53.82	2.56	1.17	4.8%	2.2%	-54.3%
b. Special Allocation Fund (DAK) Non Physical	130.30	133.76	50.53	50.55	38.8%	37.8%	0.0%
c. Grants to Regions	2.08	0.51	0.56	0.11	27.0%	21.7%	-80.1%
4. Special Autonomy Funds	17.24	18.27	4.20	2.84	24.3%	15.5%	-32.4%
5. DIY Special Funds	1.42	1.42	1.09	1.14	76.7%	80.0%	4.3%
6. Village Fund	70.00	71.00	27.31	32.91	39.0%	46.3%	20.5%
7. Fiscal Incentives	8.00	8.00	1.05	0.82	13.1%	10.3%	-21.4%
TKD Total	814.72	857.59	290.34	320.97	35.6%	37.4%	10.5%

Source: Ministry of Finance, processed

Overall, fiscal performance in 2024 is expected to improve compared with conditions in 2023. Realisation is expected to increase gradually, beginning in the second quarter of 2024. This will primarily be driven by the realisation of personnel expenditure in relation to disbursements of religious holiday allowances (THR) and 13th-month salaries, as well as grant expenditures to support local election preparations in

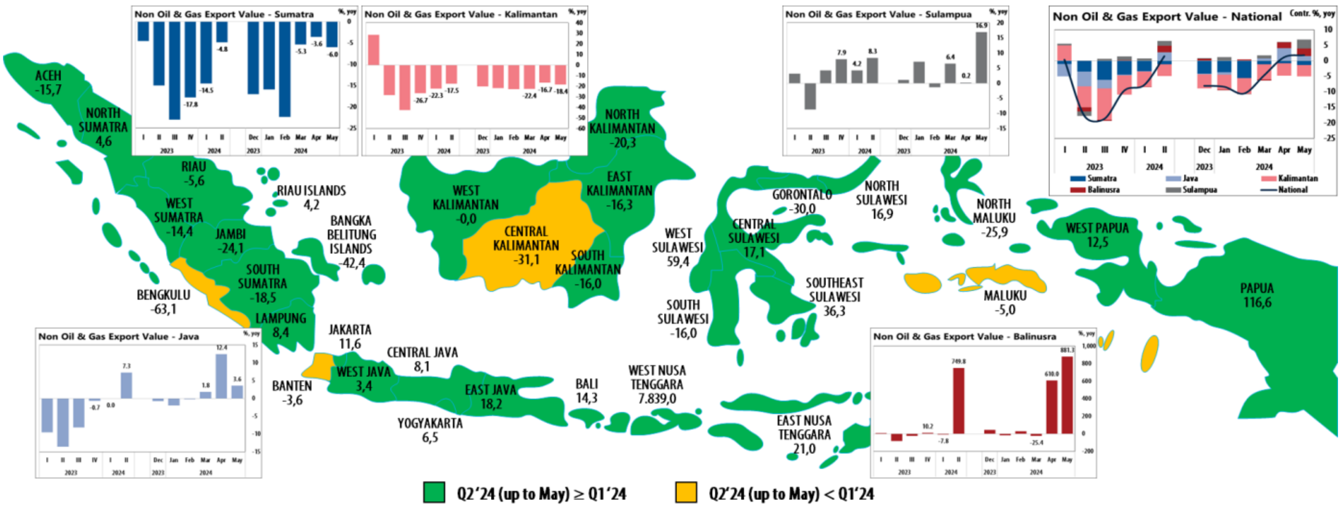
[1] The block grant is DAU received by regional governments on a monthly basis according to the respective allocation, which can be used by regional governments to provide public services as well as meet regional priorities and needs in accordance with decentralisation and regional autonomy authority.

November 2024. In addition, several regional government projects are also expected to boost the realisation of local government spending. This is linked to National Sports Week (PON) XXI and disaster rehabilitation in Sumatra, New Autonomous Region (DOB) spending in Sulampua, expansion of the irrigation network and improving roads in Balinusra as well as spending support for the new Nusantara Capital City (IKN) in Kalimantan. Accelerating the electronification program for local government transactions is also expected to have a positive impact on accelerating the realisation of regional government spending.

International Exports

Non-oil and gas export performance maintained positive growth in the second quarter of 2024 and increased in nearly all regions. As of May 2024, exports increased on the back of positive performance in the Java, Balinusra and Sulampua regions. In Java, higher exports were primarily driven by improving exports of jewellery and motor vehicles. In Balinusra, higher exports were supported by copper concentrate given favourable weather conditions for mining and the optimisation of export quota licences until the end of May 2024. Higher exports in Sulampua were driven by nickel pig iron (NPI) and processed nickel in line with the ongoing downstreaming program. Meanwhile, non-oil and gas exports in the Kalimantan and Sumatra regions indicated shallower contractions in line with lower contractions for coal and CPO exports as the main export commodities from both regions.

Overall, the outlook for non-oil and gas exports in 2024 is restrained in most regions, particularly in Java and Sumatra. This is a corollary of weak demand for various manufacturing products in the main trading partners of the Java and Sumatra regions. Notwithstanding, export prospects in Sumatra are still robust in line with exports of electronics and higher commodity prices. In Kalimantan, exports maintained positive growth on the back of coal and crude palm oil (CPO) exports. Meanwhile, the export outlook in Balinusra and Sulampua has improved for 2024, supported by the extension of copper concentrate export licences until the end of the year.



Source: Directorate General of Customs and Excise (DJBC), Q2/2024 data as of May 2024

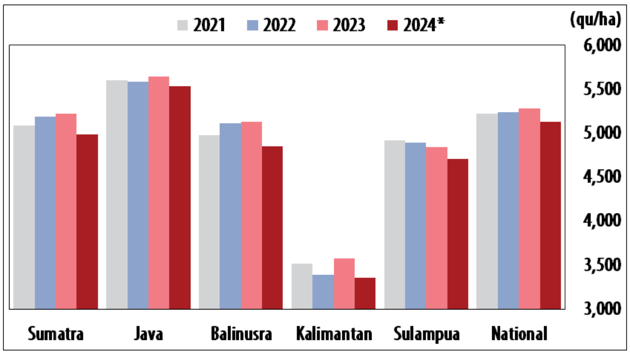
Figure I.2. Map of Regional Non-Oil and Gas Export Growth in Q2/2024 (% yoy)

Agriculture

Agricultural sector performance is projected to pick up in the second quarter of 2024. Stronger agricultural performance in the reporting period is primarily supported by higher rice and horticultural crop production given a shift in the main harvesting season to the second quarter of 2024 due to the impact of El Niño in 2023 in several production hubs located in the Java and Sumatra regions. In terms of plantation crops, the production of fresh fruit bunches (FFB), specifically in Sumatra and Kalimantan, is expected to increase given more conducive weather conditions in the second quarter of 2024. Spatially, agricultural sector performance is forecast to increase in all regions in the second quarter of 2024.

Overall, agricultural sector moderation is anticipated in 2024. Moderation is expected to stem from lower rice and horticultural production than previously projected. Rice productivity (Graph I.5) declined in all regions due to the prolonged El Niño weather phenomenon in 2023, which persisted into the first semester of 2024. Meanwhile, the subsequent La

Niña occurrence is expected to remain low, yet the increasing intensity of La Niña demands vigilance due to its potential impact on disrupting horticultural production in the second semester of 2024 (Graph I.6). In terms of plantation crops, FFB production is expected to post limited gains in Sumatra and Balinusra. Various efforts to increase productivity and anticipate climate risk by the (central and regional) Government and Bank Indonesia will persist to support price stability and manage food inflation. Meanwhile, agricultural sector performance in Kalimantan is expected to improve on the back of FFP production given greater arable land area to meet growing domestic needs to supply the B40 program. In addition, agricultural sector performance in the Java and Sulampua regions is projected to remain solid.



Source: BPS-Statistics Indonesia, processed

Graph I.5. Rice Productivity by Region

	West Java	Central Java	East Java	West Sumatra	North Sumatra	South Sulawesi	West Nusa Tenggara
Jan-23	595.12	706.96	540.51	376.28	596.68	113.90	576.58
Feb-23	403.47	782.39	714.03	435.90	679.70	113.29	577.05
Mar-23	866.61	774.46	446.17	694.14	775.22	189.67	488.07
Apr-23	977.14	483.26	314.02	385.70	577.65	151.68	547.09
May-23	664.79	392.99	332.91	417.19	683.18	250.34	55.49
Jun-23	437.87	211.40	103.72	302.98	402.33	208.89	36.65
Jul-23	265.78	175.77	161.52	364.39	319.31	188.30	74.33
Aug-23	59.19	81.10	56.98	983.37	1,207.09	58.74	24.40
Sep-23	57.14	73.79	48.50	458.26	1,188.97	22.03	11.57
Oct-23	119.82	104.42	25.22	484.38	779.99	46.42	10.04
Nov-23	621.45	426.80	240.86	375.20	781.38	178.74	132.33
Dec-23	776.47	298.61	557.69	1,352.40	1,452.95	110.52	245.63
Jan-24	1,051.42	729.26	459.53	722.09	506.17	132.46	125.95
Feb-24	353.50	385.54	288.74	249.79	142.13	298.45	216.67
Mar-24	344.57	388.96	318.73	309.94	177.03	310.86	280.86
Apr-24	249.98	246.73	182.97	375.28	231.52	342.17	135.83
May-24	71.77	52.62	32.11	316.61	254.27	239.54	28.30
Jun-24	79.99	60.15	35.98	168.31	120.36	210.87	23.49
Jul-24	36.36	18.84	10.90	163.13	164.15	136.28	13.54
Aug-24	34.80	16.79	7.58	214.85	250.37	70.12	9.61
Sep-24	74.39	41.22	19.43	249.21	270.13	84.89	24.91
Oct-24	216.58	183.10	93.09	303.16	294.69	148.82	88.24
Nov-24	374.82	365.39	238.47	381.27	310.69	267.51	230.53
Des-24	330.49	387.01	310.45	350.80	305.00	356.97	290.28

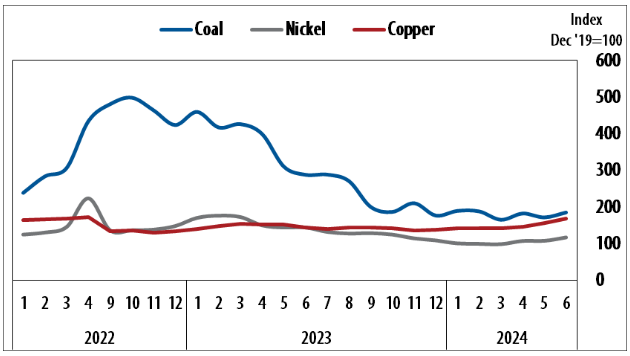
Low | Moderate | High | Very High

Source: Meteorological, Climatological and Geophysical Agency (BMKG), processed

Graph I.6. ENSO Index

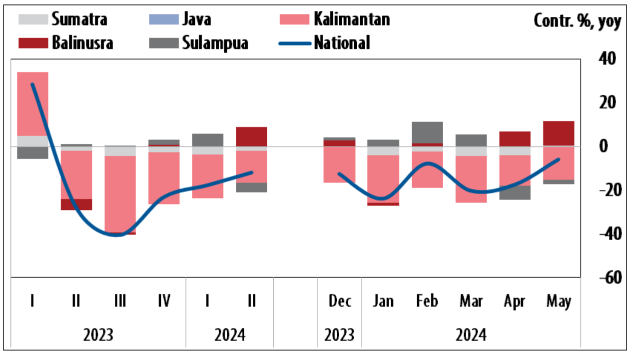
Mining

Mining industry performance is projected to moderate in the second quarter of 2024. This is a consequence of persistently low demand in trading partner countries, particularly for coal from Kalimantan. Restrained demand for coal is also reflected in the low coal price trend as of June 2024 (Graph I.7). Meanwhile, the prices of various other minerals, including copper and nickel, have gradually improved since the beginning of 2024. This is also reflected in the improving performance of mining exports in various regions (Graph I.8), particularly supported by Balinusra. Mining in Balinusra is expected to increase significantly due to maintained copper production after export licences were extended until the end of 2024. Mining performance in Sumatra is also expected to improve, underpinned by increasing oil and gas production to meet domestic demand. On the other hand, mining activity in the Sulampua region is forecast to moderate, albeit temporarily, due to the base effect of high copper production in the same period of the previous year.



Source: Ministry of Energy and Mineral Resources (ESDM), processed

Graph I.7. Reference Prices for National Mining Commodities



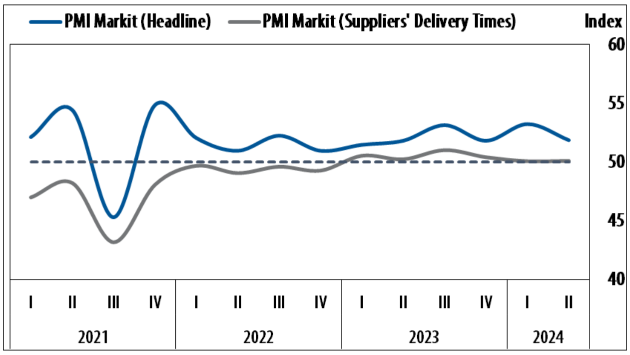
Source: Directorate General of Customs and Excise (DJBC), processed

Graph I.8. Value of Mining Exports by Region

The promising outlook for mineral production underpins solid mining sector performance in 2024. Maintained mining activity is anticipated in Balinusra and Sulampua throughout 2024 after the copper concentrate export licences were extended until December 2024. Export licences were granted given the sustainability of exports as well as adequate construction progress of copper smelters. Conversely, subdued coal production is forecast in Sumatra and Kalimantan in line with the prospect of sluggish demand.

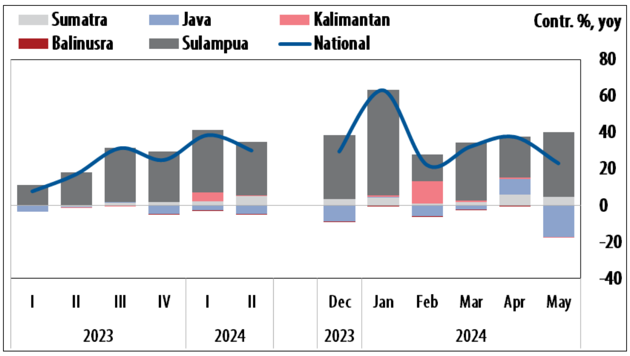
Manufacturing Industry

Manufacturing industry performance is projected to moderate in the second quarter of 2024. This is due to weaker domestic demand than initially projected as demand normalised after the Ramadan festive period and general election, despite strong support for exports. Such conditions were also confirmed by a Purchasing Managers Index (PMI) in expansionary territory (Graph I.9), and early signs of lower regional manufacturing exports (Graph I.10). Regionally, manufacturing activity moderation in Java was influenced by the food and beverages industry, petrochemical industry and automotive industry despite improving demand for footwear exports bound for the US and automotive exports to Vietnam. Deeper manufacturing industry moderation was offset, however, by persistently solid manufacturing industry performance outside the Java region. Improvements in Sumatra were supported by solid domestic demand for CPO for biodiesel blending, as part of the B35 and B40 programs, as well as cooking oil. Strong CPO industry gains also supported manufacturing industry performance in Kalimantan. In addition, high Chinese demand for downstream metal products, including iron and steel and nickel, boosted manufacturing industry performance in the Sulampua region in the second quarter of 2024.



Source: PMI Markit, processed

Graph I.9. Purchasing Managers Index (PMI)



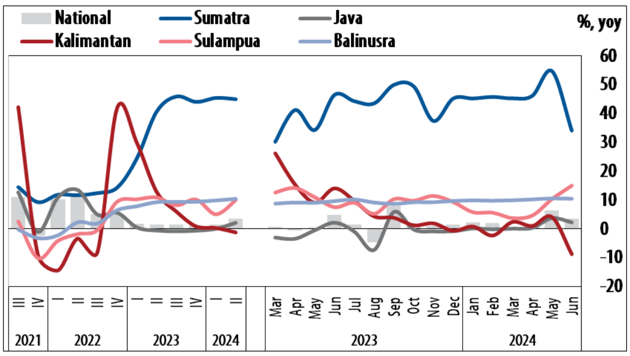
Source: Directorate General of Customs and Excise (DJBC), processed

Graph I.10. Volume of International Iron and Steel Exports by Region

Overall, manufacturing industry performance is projected to moderate in 2024. Limited improvements in domestic demand due to a weaker-than-expected income recovery is hampering manufacturing industry performance. In addition, the performance of commodity-based processing industries is also moderating, particularly in Sulampua and Kalimantan. The oversupply of processed nickel products to China could potentially impede manufacturing industry growth in the Sulampua region. The extension of policy to reduce import taxes on soybean oil and sunflower oil from 17.5% to 12.5% in India from March 2024 to March 2025 is also expected to impact manufacturing industry performance in Kalimantan in 2024. Notwithstanding, the hosting of various international sports events, coupled with general and local elections, will offset deeper manufacturing industry moderation in 2024.

Trade

Trade sector performance is projected to increase in the second quarter of 2024 in all regions, except Sulampua. Gains stem from increasing public mobility and higher income given disbursements of 13th-month salaries. In addition, the start of the school holidays and new academic year will also boost trade sector performance. Increasing tourism activity and agricultural production spurred trade in the Balinusra region. This was reflected in positive retail sales growth in most regions, coupled with a shallower contraction in Kalimantan (Graph I.11). Trade in Sulampua is expected to moderate as conditions normalise after Eid-ul-Fitr more quickly than in other regions.



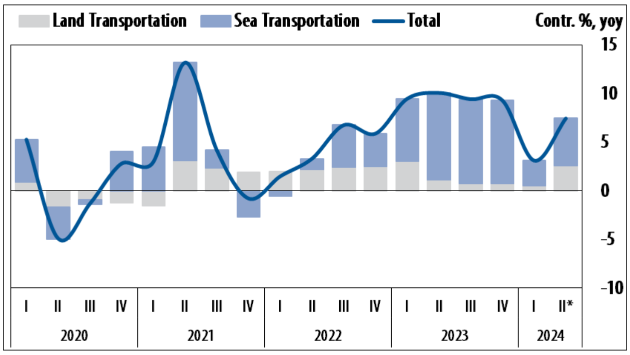
Source: Bank Indonesia, processed

Graph I.11. Real Retail Sales Index by Region

Regional trade sector performance is projected to moderate in 2024, except in Java and Sulampua. Trade is expected to post limited improvements in line with restrained international trade activity in Sumatra and manufacturing industry moderation in Kalimantan. Meanwhile, moderating trade in Balinusra will stem from lower-than-expected consumption. Nevertheless, increasing trade sector performance in Java and Sulampua will offset deeper moderation in 2024. Persistently high domestic demand due to the general and local elections as well as maintained private income are the main factors contributing to trade sector performance in both regions.

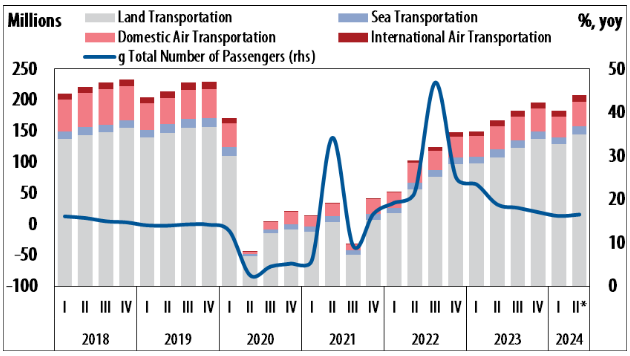
Transportation and Logistics

Transportation and logistics sector performance is expected to moderate in the second quarter of 2024, particularly in Sumatra and Sulampua. The sectoral slowdown was primarily influenced by lower international import activity. Notwithstanding, deeper moderation was offset by domestic freight growth, especially via sea routes (Graph I.12), as well as increasing mobility during the Ramadan festive period (Graph I.1). In the Sulampua region, mobility decelerated due to the closure of Sam Ratulangi Airport for 11 days in response to the Mount Ruang volcanic eruption. The impact of this natural disaster also disrupted transportation and logistics sector performance in the Sumatra region. On the other hand, transportation and logistics activity in Java and Balinusra remained solid due to the tourism high season coupled with the school holidays.



Source: BPS-Statistics Indonesia, processed

Graph I.12. Freight Growth by Transportation Mode as of May 2024



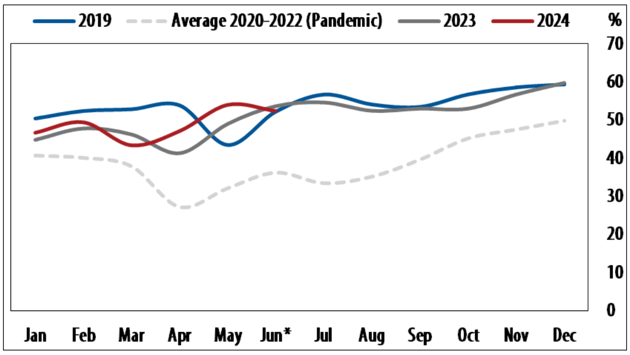
Source: BPS-Statistics Indonesia, processed

Graph I.13. Total Passengers by Transportation Mode as of May 2024

Overall, transportation and logistics sector performance in 2024 is projected to experience broad-based moderation in all regions. This is consistent with sluggish export performance, thereby undermining logistics activity, specifically freight. In Sumatra, the weaker sectoral outlook stems from the impact of natural disasters in several areas, particularly West Sumatra due to flooding, landslides and the eruption of Mount Marapi. Nonetheless, deeper moderation will be negated by solid public mobility given the general and local election activities in 2024. In addition, a surge of inbound international travellers to the Balinusra region, accompanied by new flight routes added throughout 2024, particularly in Kalimantan, Sumatra and Sulampua, will bolster transportation and logistics sector performance this year.

Accommodation and Food Service Activities

The performance of accommodation and food service activities in the second quarter of 2024 is projected to remain solid, particularly in Java, Kalimantan and Sulampua. The latest projection is based on higher demand during the Eid-ul-Fitr national religious holiday (HBKN) and additional collective leave days. Stronger sectoral performance was primarily felt in the Java, Kalimantan and Sulampua regions. Such conditions were confirmed by higher indications of domestic traveller mobility and hotel occupancy rates at the main travel destinations (Graph I.14). Nevertheless, stronger sectoral performance was undermined by the impact of natural disasters, particularly in Sumatra.

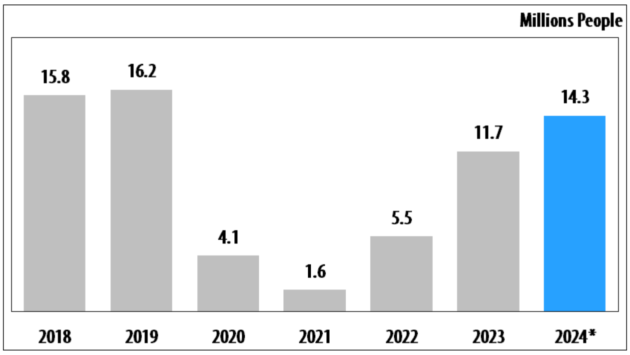


Source: BPS-Statistics Indonesia, processed

Notes:) June 2024 data is provisional data based on realised hotel occupancy rates in six regions (STR Global)*

Graph I.14. Hotel Occupancy Rate

In 2024, accommodation and food service activities are expected to increase, particularly in Balinusra and Kalimantan. Accommodation subsector performance is projected to increase in line with the upward trend of large-scale MICE activities along with the planned addition of new domestic and international flight routes and higher flight frequency, primarily in Balinusra. The expected increase in accommodation and food service activities in 2024 is also reflected in the upward mobility trend among domestic and inbound international travellers (Graph I.15). Nevertheless, further sectoral gains will be offset by limited flight capacity and persistently high jet fuel prices.



Source: BPS-Statistics Indonesia and Bank Indonesia, processed
*Notes: *) Projected value*

Graph I.15. Inbound International Travellers

Construction

Construction sector performance accelerated in the second quarter of 2024, primarily driven by Kalimantan. Faster development of the Central Government Core Area (KIPP) in the new Nusantara Capital City (IKN) ahead of the Independence Day celebrations on 17th August 2024 is expected to drive construction sector performance in Kalimantan beyond the previous period. In other regions, moderation is projected in line with relatively limited development of national strategic projects (PSN). In Sumatra, Sulampua and Balinusra, construction activity has subsided as most national strategic projects (PSN) enter the final completion stage. Meanwhile, construction in Java was restrained in the second quarter of 2024 due to land acquisition issues and technical constraints.

Construction sector performance in 2024 is projected to increase, particularly in Java and Sulampua. Ongoing development of national strategic projects (PSN) and private projects will boost construction activity. Furthermore, the development of government multi-year strategic projects and additional national strategic projects (PSN), accompanied by the ongoing completion of various private projects, will influence construction sector performance in the Java region. Construction activity in Sulampua is driven by the development of PSN, industrial zones and nickel smelters. Meanwhile, construction in Sumatra is expected to decline in 2024 given the completion of the Trans-Sumatra Toll Road (JTTS) national strategic project, yet deeper moderation will be offset by completion of the National Sports Week (PON) project in Aceh and North Sumatra, as well as post-disaster rehabilitation projects. Similar to Sumatra, development of the Central Government Core Area (KIPP) in the new Nusantara Capital City (IKN) will slow construction sector activity in Kalimantan. Construction activity in Balinusra is also expected to moderate despite ongoing private hospitality development projects.

PART 2

Recent Regional Inflation Developments and Outlook

Consumer Price Index (CPI) inflation in most regions fell in the second quarter of 2024. Nationally, CPI inflation in the second quarter of 2024 stood at 2.51% (yoy), lower than the rate recorded in the first quarter of 2024 and still within the national inflation target corridor. Milder CPI inflation primarily was stemmed from lower inflationary pressures in volatile food (VF) given additional post-harvest supply of various food commodities in the second quarter of 2024. Meanwhile, core inflation and administered price (AP) inflation both increased in most regions. Spatially, the highest rate of provincial inflation was recorded in Highland Papua at 5.65% (yoy) and the lowest was recorded in Bangka Belitung at 1.08% (yoy).

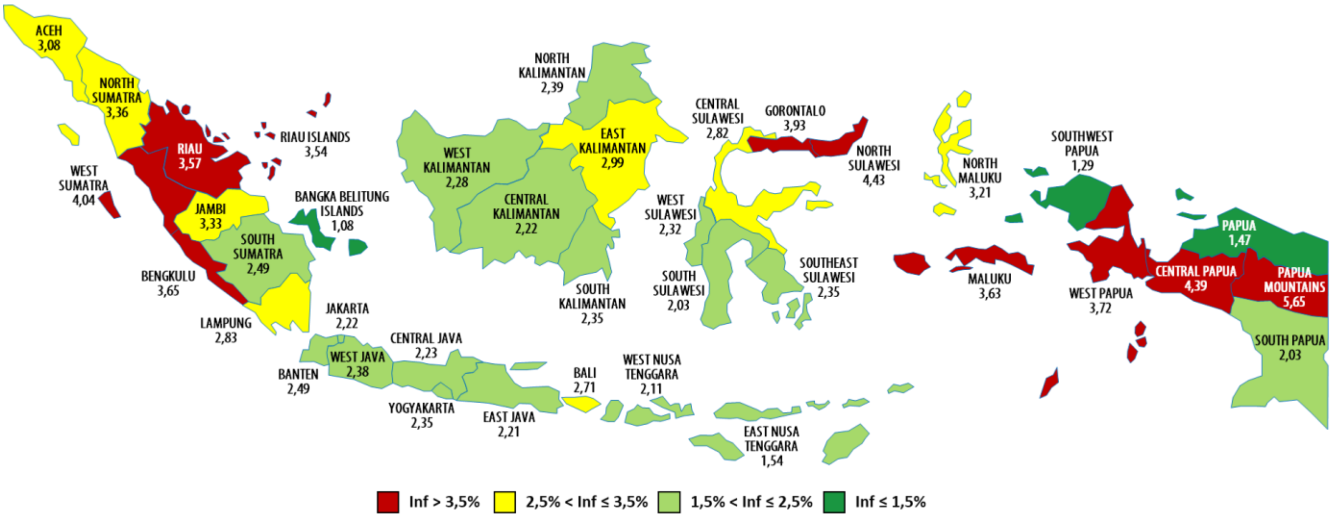
Core inflation increased in most regions. Nationally, core inflation in the second quarter of 2024 increased on the previous period, edged upwards by higher gold prices and increasing demand during the Eid-ul-Fitr national religious holiday (HBKN). Meanwhile, inflation expectations were well managed, supported by the Bank Indonesia policy mix. The main contributor to core inflation in the second quarter of 2024 was gold jewellery, with the highest price increases recorded in West Papua.

Volatile food (VF) inflation fell in most regions. Nationally, lower VF inflation was attributable to increasing supply during the ongoing harvesting seasons for rice, various chili varieties and shallots, as well as maintained feed prices. Several commodities contributed VF deflationary pressures in the second quarter of 2024, namely purebred chicken eggs and various fish products. Lower VF inflation was also supported by synergy to control inflation among the Central and Regional Government Inflation Control Teams (TPIP and TPID) through the National Movement for Food Inflation Control (GNPIP) in various regions. GNPIP implementation includes: (i) strengthening the resilience of strategic food commodities, (ii) strengthening independent food cultivation capacity, (iii) optimising interregional cooperation, (iv) supporting food distribution facilities, (v) optimising market operations/affordable markets/SPHP and GPM, (vi) strengthening food data and digitalisation, and (vii) strengthening coordination and communication.

Administered price (AP) inflation increased in most regions. Nationally, AP inflation in the second quarter of 2024 stemmed from inflationary pressures on machine rolled clove cigarettes and airfares. Higher cigarette prices are a knock-on effect of tobacco excise tax hikes at the beginning of the year. The prices of machine rolled clove cigarettes have increased the highest in Southeast Sulawesi. Meanwhile, higher airfares were driven by higher demand during the recent festive period and school holidays. Airfares increased the most in Bangka Belitung. In addition, the implementation of higher tariffs under the jurisdiction of regional governments in the second quarter of 2024 also contributed to the build-up of AP inflationary pressures. This is linked to higher parking charges in South Kalimantan, Bali and West Sulawesi, along with higher water supply charges in South Kalimantan.

Consequently, CPI inflation overall in 2024 is expected to remain under control and within the 2.5%±1% target corridor. The Bank Indonesia policy mix is consistently oriented towards maintaining rupiah stability as a pre-emptive and forward-looking measure to maintain inflation within the target range. Anchored inflation expectations are also contributing to manage core inflation in most regions. In addition, Bank Indonesia will continue strengthening policy coordination with the Central and Regional Government (TPIP and TPID) through the National Movement for Food Inflation Control (GNPIP) in various regions to manage food inflation.

Spatially, CPI inflation in several provinces located in the Sumatra region is expected to exceed other regions. High inflation in Sumatra is primarily attributable to the impact of natural disasters at local production hubs, which have reduced soil fertility and eroded harvest quality. Meanwhile, lower AP inflation is projected in line with central government policy to maintain energy prices, accompanied by relatively limited increases to regional tariffs. Nevertheless, the planned increase to regional tariffs and levies will demand vigilance moving forward. VF inflation is also expected to decrease as realised production surpasses expectations. This is supported by conducive weather conditions and various efforts to increase agricultural productivity in different regions. Notwithstanding, the impact of climate change and structural issues concerning productivity and intertemporal supply imbalances also demand attention. In addition, geopolitical uncertainty must also be monitored due to its potential impact on higher imported raw material prices for production. Consequently, the primary focus of efforts to control food inflation moving forward will be oriented towards ensuring intertemporal supply availability and maintaining seamless distribution from producing to non-producing regions, while also strengthening communication to manage inflation expectations.



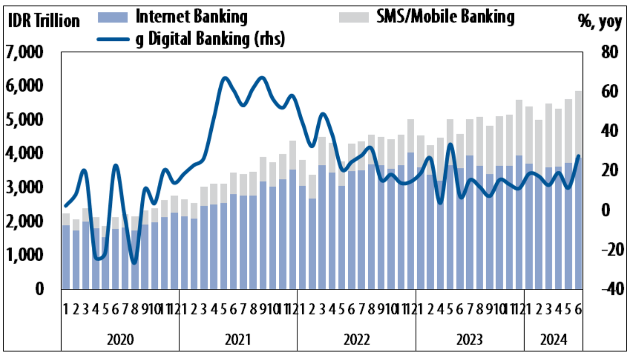
Source: BPS-Statistics Indonesia, processed

Figure II.1. Map of CPI Inflation by Province in Q2/2024 (% yoy)

PART 3

Recent Payment System and Rupiah Currency Management Developments

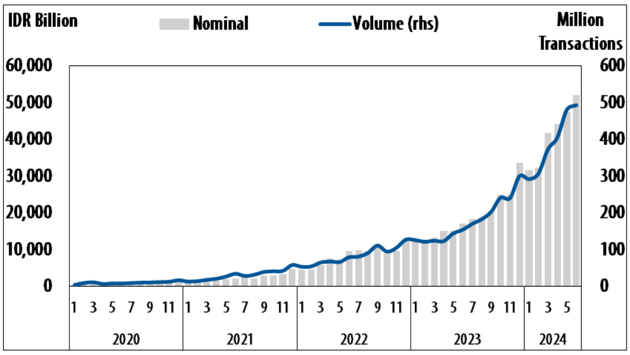
The digital economy and finance maintained solid growth in the second quarter of 2024. The value of digital banking transactions grew 27% (yoy) in the reporting period (Graph III.1). Similarly, the value of electronic money transactions in the second quarter of 2024 grew 39.5% (yoy), down slightly from 40.31% (yoy) in the previous period. On the other hand, transactions using card-based payment instruments, specifically ATM/debit cards, experienced a 4.4% (yoy) contraction. In contrast, retail transactions through the National Clearing System (SKNBI) in the second quarter of 2024 grew 1.29% in terms of value. Meanwhile, the value of wholesale transactions through the Bank Indonesia – Real Time Gross Settlement (BI-RTGS) system increased 12.42% (yoy) after contracting 1.2% (yoy) in the previous period. Finally, the value of BI-FAST transactions recorded 56.51% (yoy) growth in the reporting period.



Source: Bank Indonesia

Graph III.1. Digital Banking Transactions

In conjunction with relevant government ministries/agencies, Bank Indonesia continued payment system digitalisation and public education activities. This was achieved, among others, by promoting the use of Quick Response Code Indonesia Standard (QRIS) in all regions, particularly among micro, small and medium enterprises (MSME). As of June 2024, the number of QRIS merchants reached 32.7 million, dominated by MSMEs, and the number of QRIS users increased 36.54% (yoy) to reach 50.5 million. QRIS acceptance continues to accelerate, as reflected by increases in terms of QRIS transaction value and volume. In the second quarter of 2024, total QRIS transaction volume stood at 1.38 billion with a value of Rp141.51 trillion as of June 2024 (Graph III.2).



Source: Bank Indonesia

Graph III.2. QRIS Transactions

Bank Indonesia and the Bank for International Settlements (BIS) together with Bank Negara Malaysia (BNM), Bangko Sentral ng Pilipinas, Monetary Authority of Singapore (MAS) and Bank of Thailand (BoT) have completed the Blueprint for Phase 3 of Project Nexus. Project Nexus is an initiative of the BIS Innovation Hub that aims to increase cross-border payments by connecting various instant payment systems (IPS) globally. Nexus was designed to standardise connectivity methods, thus enabling domestic IPS to connect with one another. Nexus standardisation allows operators in one country to maintain only one connection to Nexus rather than having to make separate connections to each country. With just a single connection, therefore, the IPS of participating countries can be interconnected. As a result, participating countries can connect domestic instant payments seamlessly. Project Nexus will move to Phase 4, with a focus on creating a new entity, namely the Nexus Scheme Organisation (NSO), which will be responsible for managing the nexus scheme and continuing the mission of achieving instant cross-border payments. Bank Indonesia will continue its participation as an observer to monitor the progress of the project.

Bank Indonesia is committed to ensuring the availability of rupiah currency in sufficient quantities, of appropriate denominations, and of quality fit for circulation throughout all regions of the Republic of Indonesia. This is achieved through programs to circulate the rupiah in outermost, frontier and remote (3T) regions as well as mobile cash services, cash deposit services which was packaged in the

Sovereign Rupiah Expedition. In the second quarter of 2024, currency in circulation recorded 6.6% (yoy) growth, decelerating from 13.2% (yoy) in the previous period. In addition, Bank Indonesia has also expanded educational activities and the *Cinta Rupiah* campaign to educate the public on taking care of the rupiah and recognising the characteristics of authenticity through sight and touch (3D), while looking after the rupiah currency by not folding, defacing, crumpling, stapling or splashing (5J) the banknotes.

PART 4

Strategic Issue: Financing Sectors with High Leverage for the Economy

The global economy is still replete with uncertainty despite a comparatively more stable domestic economic outlook. Sluggish global GDP growth is projected at 3.2%, overshadowed by the risk of commodity price fragmentation and currency depreciation in most countries. Deepening geopolitical tensions, including the conflicts in Ukraine and the Middle East, could potentially disrupt the national economy, primarily through the threat of supply chain disruptions and higher imported inflation. In addition, there are also risks stemming from monetary policy divergence in several advanced economies, with the European Central Bank (ECB) lowering its policy rate while the US Federal reserve is maintaining a high Federal Funds Rate (FFR), which is expected to persist until the end of the year. At home, domestic economic growth in Indonesia remains solid despite global uncertainty, supported by the Bank Indonesia and Government policy mix. Such conditions are consistent with regional economic growth and inflation, which remain on target, with the opportunity to improve the performance of several key sectors.

Bank Indonesia institutes a policy mix to maintain stability and support sustainable economic growth. In this case, monetary policy is oriented towards maintaining stability, while macroprudential policy is directed towards supporting economic growth through optimal intermediation and maintaining the stability of the financial system. Seeking to strengthen intermediation, Bank Indonesia has formulated and implemented accommodative macroprudential policy instruments, including the introduction of Macroprudential Liquidity Incentive (MLI) Policy on 1st October 2023 for conventional and sharia commercial banks, as well as Islamic windows. Through MLI policy, the banking industry has more flexibility to disburse financing, thereby maintaining adequate liquidity and simultaneously maintaining low credit risk. On the demand side, MLI policy can support corporate growth and drive household consumption. Furthermore, targeted macroprudential incentives could potentially strengthen sectoral performance nationally and regionally.

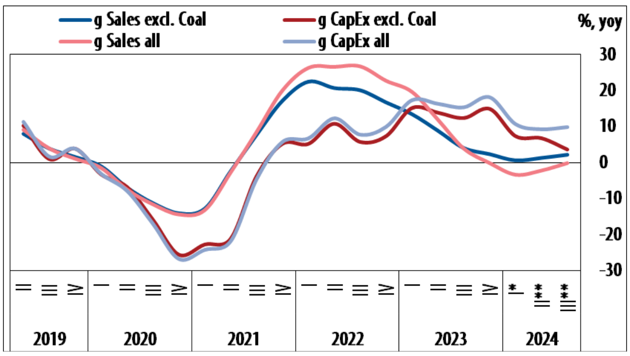
Accelerating financing optimally is necessary to precipitate faster growth of key regional economic sectors, while mitigating and managing systemic risk, supported by strong economic and financial inclusion. On the demand side, corporate performance continues to demonstrate positive overall developments ~~overall~~. Spatially, corporate performance is also tracking an upward trend in all economic sectors. On the other hand, however, several challenges continue to demand vigilance, such as broad-based corporate performance, particularly in sectors eligible for the MLI incentives, moderating MSME performance and widespread use of internal funds in business plans, corporate expansion and investment. On the supply side, credit extended to sectors eligible for the MLI incentives is increasing, underpinned by positive spatial conditions with compelling financing opportunities in all sectors. Several financing challenges require the support of policy and operational strategies, including balanced credit growth in MLI sectors in different regions, limited risk appetite in the banking industry and moderating MSME loan performance, accompanied by higher risk.

Financing can be accelerated through central and regional policy synergy and coordination, focused on refining the financing schemes, expanding access to finance and providing policy incentives, thereby maintaining a solid financing outlook. Policy innovation and transformation through synergy and coordination with financial authorities as well as government ministries/agencies in each region must be strengthened and implemented in a structured manner. Policy strengthening should focus on optimising the MLI incentives considering the key economic sectors in each region with high economic leverage as well as business models and financing potential. Through various strengthening and refining efforts, optimal and stable credit growth is projected in the 10-12% range in 2024 and 11-13% range in 2025, with an economic growth target of 4.7-5.5% in 2024 and 4.8-5.6% in 2025, while optimising the MLI incentives to achieve the 4% target.

Assessment of the Latest Demand-Side Developments

Overall, corporate performance is showing positive developments, accompanied by a potential increase

in the demand for credit. Corporate sales growth is projected to continue tracking an upward trend, supported by higher sales in most sectors, excluding the coal mining sector that is experiencing a contraction due to lower international coal prices. Sales growth optimism is also reflected in improving corporate performance in the MLI sectors. This is in line with the relatively strong corporate role in the mineral and coal mining (minerba) and non- mineral and coal mining ~~minerba~~ sectors in terms of increasing revenue through value chain strengthening in various industrial supply chains. The corporate sector is also more inclined to invest, as indicated by higher corporate capital expenditures (CapEx) compared to the previous period. This trend has occurred in most manufacturing, trade as well as mining and quarrying sectors. Overall, the largest corporate CapEx contribution is dominated by the tourism sector and creative economy, as well as downstream sectors, accounting for 44% and 33%, respectively. In general, higher CapEx are supported by improving investment support, such as early signs of stable policy assurance after the general election and business expansion needs relating to sales operations. Increasing investment needs and sales could potentially boost the demand for financing. In addition, early indications of declining corporate cash will expand the intermediation opportunity.



Source: Bloomberg 2024, processed

Graph IV.1. Corporate Performance

As an aggregate, resilience remains solid, as reflected by maintained corporate repayment capacity and leverage. The interest coverage ratio (ICR) in the third quarter of 2024 is projected well above the 1.0x threshold, demonstrating higher revenue than interest liabilities in the corporate sector overall, thus facilitating interest payments on outstanding loans. The state of corporate leverage also remains solid given ample liquidity. The debt-to-equity ratio (DER) is tracking a downward trend in the third quarter of 2024, indicating comparatively lower corporate debt than equity funding. This implies a more robust corporate sector against credit risk factors, such as high interest rates and lower internal funds for repayment obligations. The downward trend of corporate debt against equity may also reflect the preference for more balanced sources of corporate funding, particularly in terms of increasing efficiency and business expansion in the corporate sector. Adequate corporate liquidity is also reflected in the higher current ratio. This indicates that the corporate sector, in general, can maximise asset management to meet short-term liabilities, thereby remaining resilience in the face of downside risk. More specifically, corporations in MLI sectors have maintained a strong repayment capacity (ICR>1.0), which is also increasing. In addition, leverage is trending downwards, particularly when compared to the post-pandemic spike. The housing sector demands vigilance, however, despite maintaining a relatively high repayment capacity (ICR>10.0), which is nevertheless following a downward trend.

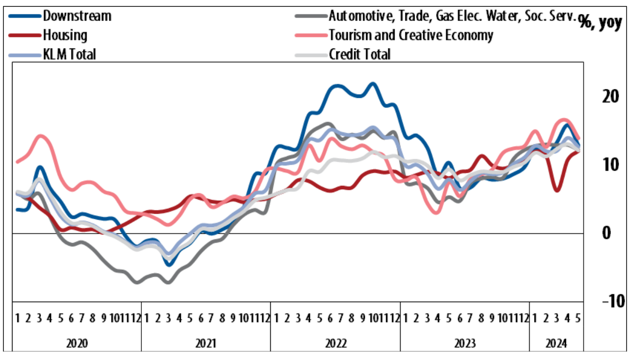
Spatially, corporate performance in all regions is recovering and stronger than in the previous period. Sales growth in all regions is accelerating, led by the Java region. Growth is also accelerating in terms of corporate CapEx, with the Java region posting the highest growth. On the other hand, the Balinusra region requires support to improve corporate performance considering that sales and CapEx are comparatively lower than in other regions. Corporate capacity to invest is also relatively large, as indicated by low ratios of CapEx to sales and CapEx to fixed assets compared with the pre-pandemic period in all regions. Indicators of corporate activity are also improving, as reflected in higher inventory turnover, accompanied by a stable working capital cycle.

The performance of corporations operating in MLI sectors is also improving in all regions. The impact of MLI implementation on sectoral recovery has also boosted demand-side performance, as reflected by increasing sales in almost all sectors after MLI implementation. The Java region is the largest contributor to higher sales in terms of the downstream sectors, trade, social services and education as well as the automotive sector. Meanwhile, corporations in the Balinusra region have the largest contribution to higher sales in the housing sector, electricity, gas and water supply as well as tourism and the creative economy. Meanwhile, sectoral growth remains divergent and requires further support, particularly the automotive sector, electricity, gas and water supply as well as the housing sector in order to increase their intermediation capabilities.

MSME performance is moderating in line with the downward sales trend. This is affecting the Sulampua, Balinusra and Java regions, contrasting stronger sales performance in Kalimantan and Sumatra. The main factors undermining MSME performance are demand, seasonal and operational factors. Production failures due to weather conditions, pests and disease, as well as consumer reluctance to buy are more specific determinants of lower performance in most regions.

Assessment of the Latest Supply-Side Developments

Recovery momentum on the demand side is also in line with improvements on the supply side. Financing disbursed by the banking industry has continued to improve, with credit growth in May 2024 accelerating to 12.15% (yoy) compared with 9.39% (yoy) in the same period one year earlier. Loans of all types to MLI sectors have also increased, led by the tourism sector and creative economy at 13.87% (yoy). In terms of growth deviation compared with the same period one year earlier, the electricity, gas and water supply subsector has accelerated the most. Faster credit growth is inextricably linked to the role of MLI implementation, which has incentivised the banking industry to increase new loan disbursements to all sectors. Based on the share of loan disbursements to MLI sectors, the Java region continues to dominate all sectors. On the other hand, the expansion of several MLI subsectors must be fostered to increase financing, namely social services and education, as well as the automotive sector, which have experienced moderating credit growth. Meanwhile, credit risk in all MLI sectors remains well mitigated, as demonstrated by stable non-performing loans (NPL) below the 5% threshold, coupled with lower LaR.



Source: Bank Indonesia

Graph IV.2. Aggregate Credit and MLI Developments

Spatially, credit growth also accelerated in most MLI sectors in all regions, supported by mitigated credit risk. All sectors in the Balinusra region recorded higher credit growth than in the same period one year earlier, yet NPL in the tourism and creative economy sector demands vigilance because it is above the threshold at 5.23%. The Java region also recorded higher credit growth in most MLI sectors, except social services and education as well as the automotive subsector, with all sectors maintaining credit risk below the NPL threshold. In the case of the Kalimantan region, a high LaR ratio was recorded in the electricity, gas and water supply subsector due to weaker electricity supply subsector performance, specifically in the provinces of East Kalimantan and Central Kalimantan, coupled with the ongoing recovery from the deleterious economic impact of the pandemic. Credit growth in the Sulampua and Sumatera regions accelerated in most economic sectors. On the other hand, several sectors in both regions continue to require intermediation support due to low credit growth, namely in the automotive and trade subsectors. In terms of resilience, the gross NPL ratio of the trade subsector in the Sumatra region was recorded slightly above the threshold at 5.05%.

Financing extended to the food crop and plantation crop subsector also demands attention given the important role of production in the sector, particularly in terms of managing inflation. Food and plantation loans recorded high growth, with credit growth also tracking an upward trend. Growth is supported by new loan disbursements in the Java region, particularly for palm oil and rice. Meanwhile, credit risk in the food crop and plantation crop subsector is comparatively low and well mitigated, with non-performing loans (NPL) recorded at 1.48% in May 2024. By commodity, the highest credit risk in the food crop subsector is associated with soybean, recorded at 4.34% in the reporting period with LaR of 12.91%.

Moving forward, regional financing potential remains high due to corporate operational needs, particularly in the accommodation subsector, manufacturing industry and trade. Based on the results of a financing survey conducted in June 2024, demand for financing in several regions tended to increase in the first quarter of 2024, with respondents expecting the trend to potentially continue increasing in subsequent periods. Higher demand for financing is primarily driven by operational needs, particularly in the accommodation subsector, manufacturing industry and trade, accompanied by relatively well mitigated credit risk. In addition, corporations prefer to source funding from the banking industry rather than using retained earnings, along with loans from affiliate companies or parent companies. Nevertheless, several regional financing challenges remain that demand a policy strategy and coordination to revive financing to sectors with high economic leverage.

Policy Recommendations and Coordination

Mapping key sectors in each region is crucial when formulating policy to strengthen bank financing. Bank Indonesia has already strengthened Macroprudential Liquidity Incentive (MLI) policy, effective from 1st June 2024. MLI policy aims to provide liquidity incentives by reducing the reserve requirement (RR) obligations for banks extending loans or financing to sectors with high economic leverage, inclusive sectors and green sectors. When strengthening MLI policy, Bank Indonesia redefined the sectors with high economic leverage eligible for the incentives, namely priority/key sectors consisting of downstream sectors (mineral and coal mining (minerba) and non-minerba), housing, tourism and the creative economy, the automotive sector, electricity, gas and water supply, as well as social services.

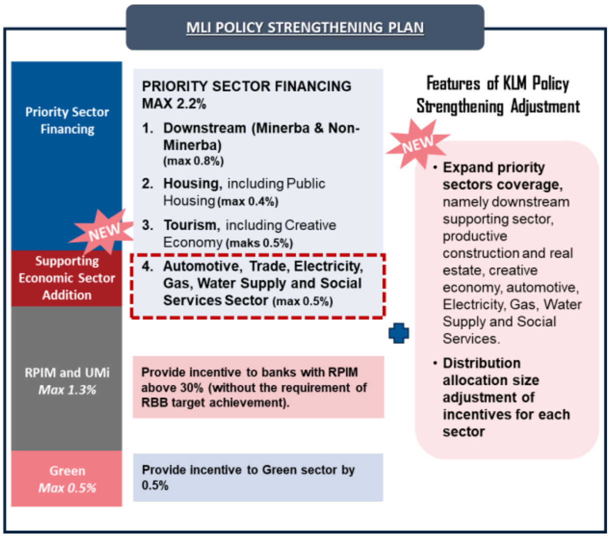


Figure IV.1. Scope of MLI Sectors

Through its domestic representative offices, Bank Indonesia has identified the MLI sectors (Table IV.1) as key sectors in each region along with success stories for their financing models. In general, key sectors in each region are also included in the scope of sectors eligible for the MLI incentives.

The development of optimal financing models to increase bank lending or financing to key regional MLI sectors could potentially boost regional economic leverage. Several financing models in line with the characteristics of key regional MLI sectors have the potential to be optimised and replicated in other regions with the same key sectors. First, in the downstream sectors, value chain financing, syndicated loans, two-step schemes and reimbursed loans from the banking industry to finance several projects in the Sumatra, Kalimantan and Sulampua regions are important success stories. Second, in the automotive and trade sectors in the Java region, value chain financing is used in the automotive supply chain, which can be replicated in the automotive industries of other regions, such as Sumatra and Kalimantan. Third, rent-to-own financing is used in the housing sector for low-income earners in several regions of Sumatra and Sulampua, which could be replicated to increase home ownership, particularly among low-income earners. Finally, Kredit Usaha Rakyat (KUR) channelling is used in the tourism and creative economy sector through village-owned enterprises (BUMDES) in the Balinusra region, which could be replicated as an example for implementation in Nusantara tourist destinations.

Table IV.1. Mapping Key Sectors by Region

Region	Key Sectors
Sumatra	i. Downstream : CPO, Rubber, Food (Rice & Red Chili), & Alumunium ii. Housing : *Real Estate* & Construction iii. Tourism & Creative Economy : Animation/Game Industry & Electronics iv. Automotive, Trade-Gas Electricity Water Supply-Social Services: Automotive and Wholesale/Retail Trade
Kalimantan	Downstream: · Minerba: Mining (Coal to Semi Cokes and Ammonia, Bauxite-Alumina) · Non-Minerba: Agriculture (Palm Oil and Derivatives)
Sulampua	i. Downstream : Fisheries, Basic Metal Industries ii. Housing : *Real Estate* & Construction iii. Tourism & Creative Economy : Accomodation and Food/Drink (Akmamin) iv. Automotive-Trade-Gas Electricity Water Supply-Social Services : Automotive
Java	i. Downstream : Manufacturing Industries ii. Automotive-Trade-Gas Electricity Water Supply-Social Services: Automotive & Gas Electricity Water Supply iii. Tourism & Creative Economy : Accomodation and Food/Drink (Akmamin) iv. Housing : Real Estate & Construction
Balinusra	i. Tourism & Creative Economy : Accomodation and Food/Drink, Handicraft and Fine Arts ii. Downstream : Fishery, Mining, and Copper iii. Automotive-Trade-Gas Electricity Water Supply-Social Services : Electricity and Automotive iv. Housing: Resindential Housing (Villas)

On the other hand, business activity in key regional MLI sectors continues to face a number of challenges that could impede financing growth. In downstream sectors, which are key sectors in the Sumatra, Kalimantan and Sulampua regions, the downstream sectors, including agricultural commodities (crude palm oil - CPO) and mining commodities, require the support of large capital to implement downstreaming to produce various derivative/downstream products. Nevertheless, downstream activities in several regions are not supported by optimal financing schemes given the potential risk of harvest failure and massive fluctuations in commodity prices. Consequently, lending appetite in the banking industry tends to be lower in such sectors. Value chain financing in the automotive sector, which is a key MLI sector in the Java region, continues to face the challenge of lower automotive demand compared with pre-pandemic conditions. Meanwhile, in the housing sector, including the construction and real estate subsectors, specifically in the regions of Sumatra, Sulampua and Balinusra, high backlog supply remains a significant challenge.

In key regional sectors dominated by MSME enterprises (non-formal), such as tourism and the creative economy in the Balinusra region, the most binding constraint is limited public access to finance. This is because non-formal businesses struggle to meet the credit requirements set by the banking industry. On the other hand, the tourism sector in several regions has not fully recovered from the pandemic, as reflected in low arrivals at several tourist destinations.

In general, it can be concluded that there are three major challenges to optimising financing growth in key regional MLI sectors, namely: (i) suboptimal financing models that are not appropriate to the specific characteristics of the sectors and regions, (ii) limited access to finance despite high demand for financing, and (iii) low lending appetite in the banking industry, which must be addressed in specific sectors.

Bank Indonesia will continue strengthening policy mix implementation to support sustainable economic growth and simultaneously maintain the stability of the financial system. Amid the various financing challenges and opportunities, stronger central and regional policy synergy is required, which aims to bridge the economic financing gaps in key regional MLI sectors. On the demand side, regional corporate performance has shown early signs of recovery, thus requiring financing support. Meanwhile, on the supply side, new loan disbursements by the banking industry remain uneven.

Central and regional government policy synergy can focus on three main strategies, namely: (i) strategies to develop appropriate and optimal financing models, (ii) strategies to increase access to finance for business players, and (iii) strategies to optimise the implementation of MLI policy to increase lending appetite in the banking industry to extend financing to key regional MLI sectors.

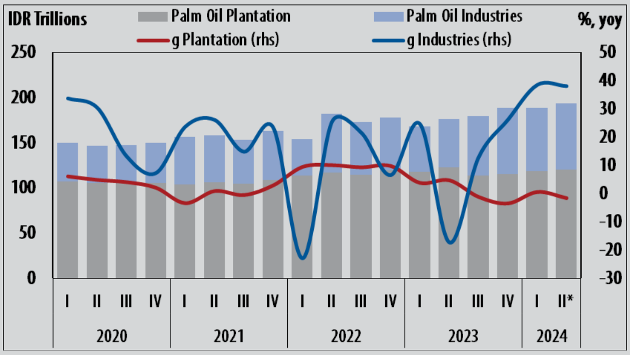
In terms of strategies to develop financing models, Bank Indonesia through its domestic regional offices will strengthen communication and coordination to develop and replicate financing business models in key sectors, which includes business matching activities at flagship events in each region.

In terms of strategies to increase access to finance for business players, Bank Indonesia through its domestic representative offices will strengthen strategic advisory activities with stakeholders and businesses in each region, strengthen market intelligence, as well as synergy to promote products and investment in key regional MLI sectors. Bank Indonesia will also work to increase financial literacy in synergy with programs to develop the MSME ecosystem and fostered clusters.

In terms of strategies to increase financing supply, Bank Indonesia will strengthen national and regional economic policy synergy as well as strengthen communication with the banking industry, particularly with bank lending policymakers at the central and regional levels.

Success Stories of Financing Business Models for Plasma and Independent Farmers to Accelerate Palm Oil Smallholdings

Based on the latest conditions, financing to the palm oil sector in the Sumatra region remains solid, particularly to the palm oil-based industry. New loan disbursements by the banking industry in Sumatra to the palm oil sector are directed primarily to the largest palm oil-producing regions, particularly in the provinces of North Sumatra and Riau. Disbursed loans to the palm oil processing industry are primarily used as working capital, while loans extended to oil palm plantations are predominantly used for investment, specifically replanting. Positive financing performance in the palm oil sector is due to the relatively low perception of risk in the sector, as reflected in the low NPL ratio and LaR. Meanwhile, the lending rates offered to oil palm plantations (upstream side) tend to be higher than in the palm oil processing industry (downstream side). This is consistent with the relatively higher perception of credit risk on the upstream side.



Source: Commercial Bank Reports, processed

Graph IV.3. Credit Growth in the Palm Oil Sector in Sumatra

The role of the domestic banking industry in supporting the rejuvenation of oil palm plantations can be realised through the KUR Program for Oil Palm Rejuvenation. A financing model has been applied by a palm oil corporation in Sumatra based on partnerships between plasma and independent farmers with parent companies. The form of partnership or cooperation is through farmer commitment to sell fresh fruit bunches (FFB) to the parent company. On the other hand, the parent company is committed to providing training and technical assistance to support farm production. In addition, the parent company also assists the farmers secure access to finance through guarantees to the banking industry linked to the production process. Farmers receive financing in the form of investment and interest capitalisation loans during the grace period.

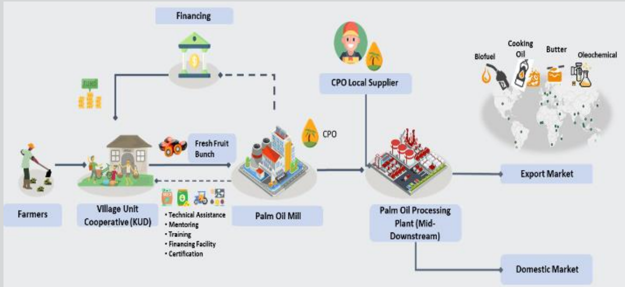


Figure IV.2. Partnership-based Oil Palm KUR Financing Scheme

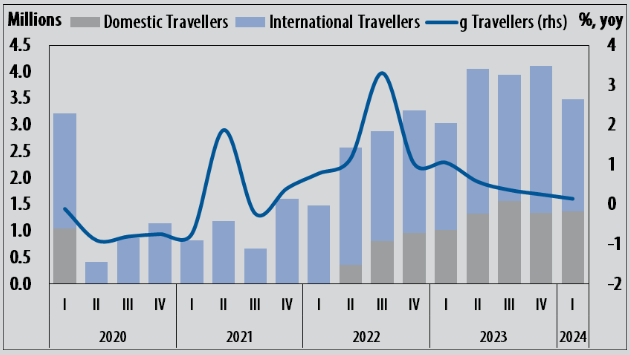
With optimal financing from the banking industry, the production of palm oil into crude palm oil (CPO) is targeted to increase to meet domestic and export demand. Notwithstanding, there are a number of implementation constraints, primarily concerned with the legality of land ownership along with limited data for credit scoring the farmers. This highlights the need for farm assistance and facilitation to secure access to finance, especially when meeting the requirements set by the banking industry.

Seeking to increase loan disbursements to the palm oil sector, there are several supply and demand side challenges. On the supply side, land productivity is declining, coupled with low replanting realisation, which could potentially reduce the supply of palm oil moving forward. In addition, profit margin in the downstream industries tends to be higher than on the upstream side, leading to comparatively lower investment in upstream industries. On the demand side, the main challenge is an underdeveloped special end-product market compared with conditions abroad. In terms of cost, downstream industry development is considered inefficient, particularly in terms of logistics given the lack of an integrated supply chain.

BOX 2

Role of Payment System Digitalisation in Transportation Sector

Tourism sector performance in the Balinusra region remains positive due to the influx of inbound domestic and international travellers. The total growth of travellers in the Balinusra region in the third quarter of 2024[2] was projected at 12.85% (yoy), up from 7.54% (yoy) expected in the second quarter of 2024 (Graph IV.4).

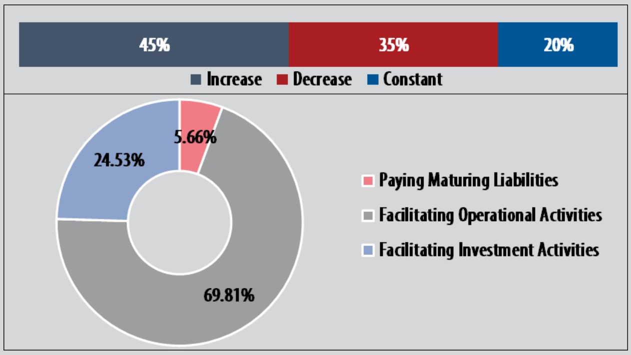


Source: Tourism Department throughout Balinusra region, processed

Graph IV.4. Growth of Travellers in Balinusra Region

Based on indicators of sectoral performance, the tourism and creative economy sector is the most prospective sector in the Balinusra region in terms of optimising financing, which is supported by the high contribution to regional fiscal performance (39%) and gross regional domestic product (GRDP) (17%). Loan disbursements to the tourism and creative economy sector in Balinusra in the second quarter of 2024 recorded solid 16.14% (yoy) growth. By subsector, credit growth was highest for loan disbursements to the tourism subsector at 101.46% (yoy) along with other manufacturing industries linked to the creative economy at 63.06% (yoy).

Despite the potential, risk still demands vigilance, particularly in terms of accommodation and food service activities due to a relatively high LaR (25.30%) given the lingering scarring effect of the Covid-19 pandemic. Nonetheless, LaR in the tourism and creative economy sector in the Balinusra region has tracked a downward trend from 53.10% in May 2023 to 29.36% in May 2024. Based on a comparative analysis of LaR and growth among subsectors, financing extended to the handicrafts industry has the potential for stronger growth given the relatively low LaR. Nevertheless, the challenge remains in terms of relatively limited demand for handicrafts. In response, support is required to create and unlock new markets, including through export championships. On the demand side, the tourism sector is also experiencing higher demand for financing. Based on a business financing survey[3], demand for financing in the tourism sector in the Balinusra region increased in the first quarter of 2024 to finance operational activities (Graph IV.5).



Source: Business Financing Survey, processed

Graph IV.5. Percentage of Respondents Based on Demand for Financing in Q1/2024 and Factors Increasing Financing Demand

One development potential for quality tourism in the Balinusra region is tourism villages. Through tourism villages, community-based tourism development can produce broad-based value added for the local economy and ensure cultural preservation in the local community. From a financing perspective, loans can be disbursed to tourism businesses in tourism villages through KUR channelling schemes in conjunction with village-owned enterprises (BUMDES). The role of BUMDES in channelling schemes is as an intermediary between the customer and banks. BUMDES can find potential borrowers and verify them based on specific criteria set by the banks and then provide recommendations to the banks. Furthermore, BUMDES can play a broader role in the credit channelling scheme by reducing credit risk on the bank side with stronger

[2] Q3/2024 projection by Tourism Department throughout Balinusra region.

[3] Bank Indonesia Survey, 2024

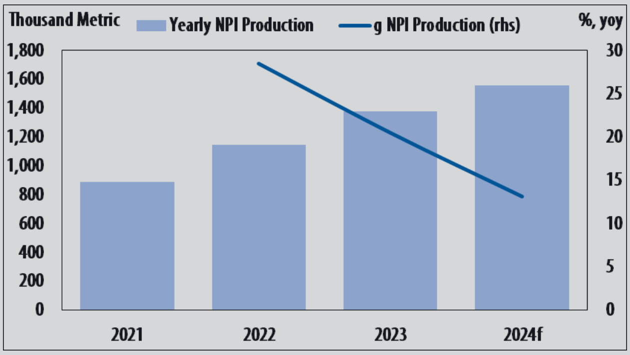
institutional support and capital guarantees. BUMDES can also play a role in increasing the financial literacy of micro, small and medium enterprises (MSME) in the tourism villages.

The creative economy sector has massive untapped potential in the economy of the Balinusra region. Strong growth in the number of workers engaged in the creative economy (13.16% yoy in 2021) and growth of new loan disbursements in the creative economy (15.69% yoy) are indicative of the large economic potential in the creative economy. One way of nurturing sustainable growth in the creative economy, particularly support to overcome limited financing, is by using Intellectual Property Rights (IPR) as loan collateral. The legality of using IPR as collateral for loan disbursements is stipulated in Government Regulation Number 24 of 2022, which regulates financing of the creative economy, including the use of IPR as loan collateral. The types of IPR that can be used as loan collateral include patents, copyrights and industrial designs. Nevertheless, several challenges remain that have prevented the use of IPR as collateral from being realised, including a lack of internal technical regulations in the banking industry as well as the availability of appraisers or assessors.

BOX 3

Development Potential of Financing Models for the Downstream Basic Metal Sector in the Sulampua Region

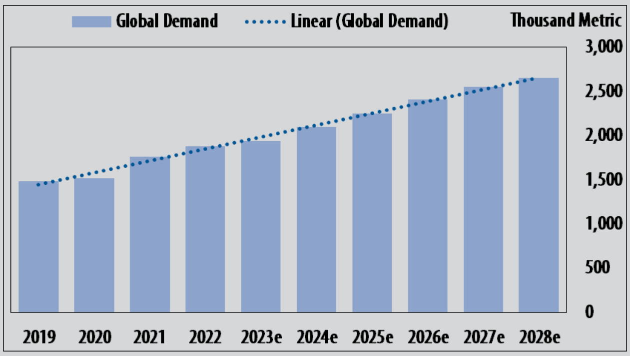
Performance of the basic metal subsector in the Sulampua region is expected to maintain an upward trend. In 2024, the production of nickel pig iron is forecast to reach 1.56 million metric tons, up 13.12% from the 1.38 million metric tons recorded one year earlier (Graph IV.6).



Source: SMM 2024, processed

Graph IV.6. Nickel Pig Iron Production in Sulampua

Production is increasing on the back of growing global demand. Global nickel demand is projected to grow from 1.48 million metric tons in 2019 to 2.65 million metric tons in 2028 (Graph IV.7). Output from the nickel industry is currently tracking an upward trend, dominated by mixed hydroxide precipitate produced from high-pressure acid leaching smelters as a raw material of electric vehicle batteries.



Source: SMM 2024, processed

Graph IV.7. Global Demand for Nickel Pig Iron

Labour absorption in the metal industry subsector is also relatively high. The nickel industry that is distributed in several industrial zones located in South Sulawesi, Central Sulawesi, Southeast Sulawesi and North Maluku absorbs approximately 218,000 workers, which is expected to continue increasing in line with higher global demand for nickel.

In May 2024, loans disbursed to the downstream basic metal sector recorded significant 21.89% growth (above the national average of 10-12%), despite moderating slightly compared with May 2023 at 28.30%.

The portion of domestic bank financing for project financing smelter development remains limited compared to the financing disbursed by holding companies and foreign banks. This is due to the nature of smelter development investment, which is dominated by foreign direct investment (FDI) rather than domestic investment. Limited domestic financing is also attributable to the spread margin, where the lending rates offered by foreign banks are more competitive than domestic banks.

In response, several domestic banks have undertaken financing penetration efforts to reach smelter companies through various financing models as follows: (i) syndicated loans, (ii) two-step loans, and (iii) reimbursement loans.

Syndicated Loan Model. The syndicated loan model involves two borrowers (foreign and domestic) with the respective portions of financing agreed. The advantage of this scheme allows creditors to share risk based on their respective capacity. In addition, supervision is more optimal because it involves all syndicate members.

Two-Step Loan Model. This model can be applied to FDI, domestic investment and joint venture projects based on a cooperation mechanism between a foreign bank and domestic bank. The source of financing from a foreign creditor is transmitted through credit channelling by the domestic bank, thus facilitating a more competitive spread margin. This option provides advantages to the foreign bank in terms of credit risk mitigation and a larger credit volume, considering the domestic bank has greater understanding considering the local social, political and economic risks.

Reimbursement Financing Model through the Refinancing of Completed Smelters. Demand for refinancing smelters is high, particularly among smelters funded by holding companies. This financing model can be used to mitigate operational risk during the construction period. Loan disbursements based on this method do not require a grace period because the refinancing is only disbursed once the smelter is operational.

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BANK INDONESIA

For further information please contacting:

BANK INDONESIA
Economic and Monetary Policy
Department Sectoral and Regional Group
Ph. +62 21 - 2981 8119, 2981 8868
Fax. +62 21 - 3452 489, 231 0553

BANK INDONESIA

JL. MH. Thamrin No. 2 Jakarta 10350
www.bi.go.id