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Indonesia Economic Briefing

Rising Energy Prices: The Implications

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- **Lately, attentions shifted to the global oil price that has steadily climbed and reached three year high at USD70.4 per barrel (Jan 24).** The upward trend even lasted longer after the extreme weather in the western hemisphere where demand is seasonally high. The push factors may lie more on the extension of OPEC's production cut. The rate of compliance of OPEC member countries were at its strongest level in Nov 17. At the Vienna meeting, OPEC, Russia and nine other global producers agreed to cut oil output by 1.8 million barrels a day until end of 2018, though window is still open for another review in June.

- **The prospect of future oil price remains clouded with uncertainties.** Things are looking quite upbeat on the demand side as expectation of better global economy grows. IMF's forecast (on its bi-yearly release WEO) on global growth this year was slightly higher by 0.2% point, to 3.9%. As demand side looks firming up, supply condition will depend on a number of factors i.e. OPEC's commitment on the curb, the performance of US shale industry and/or geopolitical disturbances on the producing countries i.e. Iran, Iraq, Libya, Nigeria and Venezuela.

- **The upward pressure on oil price will have its consequences to the Indonesian economy, as the spread between market price and the oil price assumption in the state budget widened.** The market price for the subsidized RON-88 gasoline is currently underpriced by 30-36%, assuming the Brent oil price is moving in the current range of USD65-70 per barrel. The condition may continue up to the first quarter as the government already pledged not to raise any of the administered prices in the first quarter.

- **The cost of differences between the market price and the subsidized price has been born by the energy-SoE, Pertamina and to some extent, PLN.** Assuming the average oil price this year falls in the range of USD60-65 per barrel, the cost will be in the range of Rp65-85 trillion, a quite significant number that could have impact on the financial performance of Pertamina. The additional weight may disturb the capacity of the company to do investment as it seeks to expand in the upstream sector.

- **Impact is not limited to Pertamina only.** Electricity-producing SoE, PLN may also bear the cost with the oil price being one of the components in the procurement of electricity. Rising oil price were closely followed by coal prices that has climbed even steeper than oil. Coal price in January has surpassed USD100 per tonne, highest since December 2016, and well above this year's PLN's assumption at the range of USD60-63 per tonne. Coal makes up about 57% of the fuel needed for power plant. This has led the PLN to propose new plan to include coal price in the formulation of electricity tariff.

- **From the recent state budget posture, rising oil price up to USD65 per barrel would actually bring a net positive effect of Rp4-14.4trillion to the budget balance as revenue from oil will also increase,** assuming the energy subsidy is maintained and the energy-SoEs bears the difference.

- **Raising the administered energy price seems an unlikely option for its widespread impact on inflation and purchasing power** (a Rp500 rise in the subsidized fuel price could add 0.7% to the headline inflation). If it comes to that though, the government needs to really push the social transfer program to reach the urban poor to give them buffer from rising living cost. However, excess impact may span to the middle/upper class withholding or even reducing spending thus could further hurt the already structurally pressured consumption.

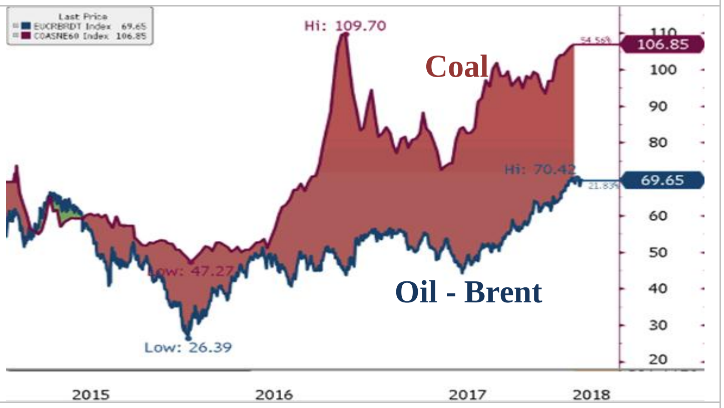
- **Other options may include the government raising the amount of energy subsidy in the budget or increasing the amount of capital injection (below the line) to the related-SoEs.** If the energy subsidy is raised, say by Rp15tn, we may be looking at a higher deficit by around 0.1% of GDP. Both options would mean a significant increase in the budget financing, thus may need additional bonds issuance which will be challenging in the current global environment. Or, another way is by letting the energy-SoEs to issue bonds to reduce/cover the cost as well as to add more capacity to help the company expand. Either way, the movement of global factors (energy prices, interest rate) will be quite a challenge this year to the economy.

Chart 1. Impact on Subsidy and Budget

In IDR tn	2016	Annualized 2017	2018F
Assumption			
Avg Oil Price (USD/barrel)	44	55	65
Avg IDR/USD	13,308	13,383	13,520
Subsidized Fuel Consumption (mn KL)	43.2	42.7	43.2
Effective Subsidy	**45**	**45***	**90**
Net Impact to State Budget* (Rp Trillion)			4 to 14.4

Source: MoF, CEIC, Danamon Calculation

Chart 2. Oil and Coal Prices



Source: Bloomberg

Danamon

Indonesia: Selected Economic Indicators

	2014	2015	2016	2017E	2018E
National Accounts					
Real GDP (% y-o-y)	5.0	4.9	5.0	5.0	5.3
Domestic demand ex. inventory (% y-o-y)	5.3	3.9	5.0	4.6	5.4
Real Consumption: Private (% y-o-y)	5.1	5.0	5.0	4.9	5.0
Real Gross Fixed Capital Formation (% y-o-y)	4.4	5.0	4.5	5.7	6.0
GDP (USD bn) — nominal	890	861	932	1,005	1,115
GDP per capita (USD) — nominal	3,529	3,371	3,604	3,838	4,198
Open Unemployment Rate (%)	5.9	6.2	5.6	5.5	5.5
External Sector					
Exports (% y-o-y, BoP Basis)	-3.7	-14.9	-3.1	16.8	6.0
Imports (% y-o-y, BoP Basis)	-4.5	-19.7	-4.5	16.8	11.8
Trade balance (USD bn, BoP Basis)	6.9	14.1	15.4	18.1	17.6
Current account (% of GDP)	-3.2	-2.1	-1.8	-1.8	-2.0
Central government debt (% of GDP)	24.7	27.4	27.8	28.6	28.7
International Reserves –IRFCL (USD bn)	111.9	105.9	116.4	130.2	136.8
Reserve Cover (Months of imports & ext. debt)	6.5	7.4	8.4	8.3	8.5
Currency/US$ (Year-end)	12,440	13,795	13,436	13,548	13,575
Currency/US$ (Average)	11,878	13,392	13.308	13,383	13,520
Other					
BI policy rate (% year end)	7.75	7.50	6.50*	N/A	N/A
BI 7-Day Reverse Repo rate (% year end)	N/A	6.25	4.75	4.25	4.25
Consumer prices (% year end)	8.36	3.35	3.02	3.61	3.64
Fiscal balance (% of GDP; FY)	-2.26	-2.70	-2.46	-2.60	-2.52
S&P's Rating – FCY	BB+	BB+	BB+	BBB-	BBB-

Source: CEIC, E = Danamon Estimates, *) Up to August 2016

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