Energy issues bubbling up again

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Summary

- Global oil prices are rising again, but the government allocated much less generous subsidies and compensation outlays for 2024.
- Pertamina's proposal to abolish Pertalite and replace it with (bioethanol-blended) Pertamax Green can help deal with the situation with relatively smaller inflationary impact.
- Pertamax Green simply substitutes (partially) imports of oil with ethanol in the short-term, but there is a conceivable route to scale up ethanol production at home.
- The ratio of coal/oil prices are still on a downtrend amid China's economic malaise, and the current account deficit may thus prove to be more persistent.

- The past week had not been the best week for Indonesian assets, with net outflows from both bonds and equities, but the arrival of September seems to rekindle some hope for the global market. Manufacturing PMI across the globe mostly marched in the right direction, even though they remain below par (50) for US and China alike. And while the debt issues in China's real estate sector are far from resolved, expectations that Beijing could soon launch a bigger stimulus has revived Asian equities coming into this week.
- Even better – for the market that is – were the jobs data coming from the US. Unemployment rate increased to 3.8%, job openings fell by 338 thousand, but nonfarm payrolls still ticked up by 187 thousand. Altogether, these gave a picture of a labor market that is cooling, but still some ways off from a recession – a perfect excuse for the Fed to stay put in September. The market is now pricing in only 7% chance of FFR hike in September, and 33% chance for November (they stood at 23% and 46%, respectively, in the immediate aftermath of Jackson Hole).
- But amid these silver linings, there is still an ominous cloud in the form of a US Dollar that actually strengthened despite all these developments which should, in theory, correlate with weaker USD. The greenback's gain also occurred despite a bullish week for oil, which at USD 88/barrel is now standing at its highest level since January. While strong Dollar and rising oil price do not often mix, when they do – as in 2022 – the result could be devastating for oil-importing emerging economies, including Indonesia.

Alcohol as an escape – from declining fuel compensation

- Recall that, when these twin pressures hit last year, the government was at first reluctant to adjust retail fuel prices, for fear of jeopardizing an economy that had only just recovered from two years of lockdowns. As a result, Pertamina (the state's oil company) had to bear the brunt of rising oil prices, which it covered by borrowing from state banks. The liquidity situation for Pertamina (and other SOEs) only started to improve in Sep-22, as the government hiked fuel prices and began to repay overdue subsidies and compensations.
- *Technical note: Subsidies technically is only given for the lowest-grade diesel fuel ("Solar") in addition to household LPG and electricity, but in practice the price of the lowest-grade gasoline ("Pertalite") is also subsidized albeit labelled as "compensation".*
- Since then, things have gotten pretty hunky-dory with regards to energy. SOEs have now become a large net creditor to the whole economy (**see Chart 1**), and the fuel price hike did not result in as big an inflation spike as many had feared – and consequently was not as detrimental to consumption. Indeed, given the large base effect still contained within the YoY headline inflation figure (currently at 3.27%), we can safely expect a big decline as we go past Sep-23, perhaps towards 2.0% or thereabouts (see Chart 2).
- But things might be about to shift once more. As mentioned, the global oil price is rebounding as OPEC+ squeezes output ever more tightly, counteracting the gravitational force of weaker global demand. Despite this pressure – which some analysts think could bring the Brent crude within USD 90-100/bbl towards the end of the year – the Indonesian government seems to have taken the opposite tack in its State Budget for 2024. It assumes an oil price of USD 80/bbl, while estimating a decline in total energy subsidies and compensation – mostly coming from Pertalite compensation (**see Chart 3**).
- The lower compensation but potentially higher energy cost presents a conundrum for Pertamina. And it is through this lens that we need to examine its recent proposal to abolish Pertalite in 2024, to be replaced by two "greener", higher-octane fuel products. One, Pertamax Green 95, is made by blending the non-subsidized RON 92 gasoline (the same as regular Pertamax) with 5% ethanol, and is already available commercially at limited volumes. The other, Pertamax Green 92, is made by blending the compensated-for RON 90 gasoline (same as Pertalite) with 7% ethanol. It is this latter product that should be regarded as the true Pertalite replacement, given its lower octane number and price point (see Table 1).
- The proposal, as such, can be seen as a compromise that would not inflict too much pain on the consumers. As a fuel, ethanol is not cheaper than gasoline per se (**see Chart**

> ***"Pertamax Green is a less-inflationary option to deal with the decline of fuel compensation"***

4), but a forced shift from Pertalite to Pertamax Green 92 might have less of an inflationary impact compared to an across-the-board price hike like what we saw last year. Assuming that Pertamax Green 92 is sold at about IDR 10,500 – 11,000 per liter, it would probably add only 0.3-0.6% to the annual inflation. As this does not affect subsidized Solar, which is the main cost component for logistics, we can assume that this shift would result in less spillover ("second-round effects") on other goods' prices.

- But Pertamax Green is far from a panacea. In theory, it would reduce RON 90 consumption by 7%, but this does not take into account any potential demand growth next year. The compensation budget, in contrast, is reduced by 16.6% (**see Chart 3**). This still leaves a significant gap, of IDR 15-20 Tn, which could grow larger if next year's oil price overshoots the government's expectations.
- This gap would still have to be "allocated" as such among consumers, Pertamina, and the government. Rationing (e.g. by limiting the volumes of Pertamax Green 92 and thus forcing consumers to pick other options) would put the burden on the consumers' lap, but may affect GDP growth at the margins by cutting into consumer surplus. Given that next year is both an election year (domestically) and potentially a recessionary year (globally), policymakers may want to avoid such a scenario – which means that the gap would probably be internalized either by the government's or Pertamina's balance sheet.

Alcohol as an escape – from import-dependence?

- So far we have been focusing on short-term considerations, but the Pertamax Green proposal may well be made with an eye on the longer-term. After all, the Indonesian government already has a similar scheme with palm oil-derived biodiesel, which is now a required component (35%) of diesel fuel blend. This can be understood as a ploy to reduce dependence on imported oil, while creating a captive market for domestic CPO.
- The problem, of course, is that unlike CPO, Indonesia does not produce sufficient bioethanol at the moment. As a rough estimate, we would need around 2.0-2.5 Bn liters of ethanol to be blended into Pertamax Green – but so far only two local companies have declared its willingness to supply ethanol to Pertamina, both with a combined capacity of only 50 Mn liters!
- In the short-term, then, we would simply shift some oil imports into ethanol imports instead. Given ethanol's higher prices, this may even increase import values – although given the imperfect correlation between oil and ethanol prices (**see Chart 4**), such fuel diversification could mitigate against the risk of oil price shocks to some extent.
- The way forward, then, is to develop the production capacity at home, all the way to the sugarcane plantations. This would be a tough slog, but may well be doable given the experience of Brazil which is now the world's second-largest ethanol producer. Brazil's experience with its Cerrado region, in

particular, might be instructive given the similarities – tropical climate, acidic and waterlogged soils – with some of the regions in Kalimantan and Papua that the government have been trying to develop as "food estate", with limited success.

- But if this is indeed the government's masterplan, there is still the question if this is the most efficient way forward – we defer to others on the environmental issues here. The US and Brazil accounts for more than 80% of the global bioethanol production, and in both countries the industry has continued to benefit from government subsidies to this day in order to remain competitive with petroleum products. This is understandable given that bioethanol (and biofuels more generally) tend to have much lower energy return on investment (EROI) overall – physics, at the end of the day, is the limit.
- The bottom line, then: in an age of global warming and energy insecurity, diversifying and "onshoring" our energy sources is a must, but picking winners remains a tricky business.

Coal/oil ratio – Indonesia's most basic terms-of-trade indicator

- Speaking of oil and imports, we have often (in many previous reports) shown the correlation between Indonesia's trade balance and the commodity terms-of-trade index, which we construct based on the composition of Indonesia's export and import baskets. If that sounds too elaborate, that's because it is – and as with many complicated things in life, there are simpler "life hacks" that can do the job almost as well.
- In this case, our hack is the ratio between coal and oil prices, which – as it turns out – explains almost 80% of the variations in our commodity terms-of-trade index. Unsurprising, given the still-dominant role of fossil fuels in most supply chains (including other commodities), but worrying given the divergent trend lines between these two commodities, with oil now on an uptrend while coal is at best clawing up 5-10% of its recent decline.
- Of course, the fundamental difference between these two is the market structure. Oil has diversified customer base, but only a small handful of countries that control the export market (mostly consolidated under OPEC+). Meanwhile, China remains the dominant coal importer, making it hard for coal to escape its economic troubles.
- This is why we are skeptical that the current account deficit in Q2-23 was a one-off. Recall that China suffered from an extended economic slowdown (albeit not as well-publicized) in the early-to-mid 2010's, during which Indonesia's CA flipped from an average surplus of 0.9% of GDP (2009-11) to minus 2.6% of GDP (2012-16). China's current issues seem more intractable than back then, compounded by its declining demographics, high corporate debt levels, and heightening rivalry with the US. For Indonesia, this may well mean the return of the old and tricky tradeoff between CA and growth.

Chart 1

Flush with cash

State-owned entities were massive net borrowers of forex last year, but fuel hikes, disbursement of compensations, and capital injections have greatly improved their liquidity

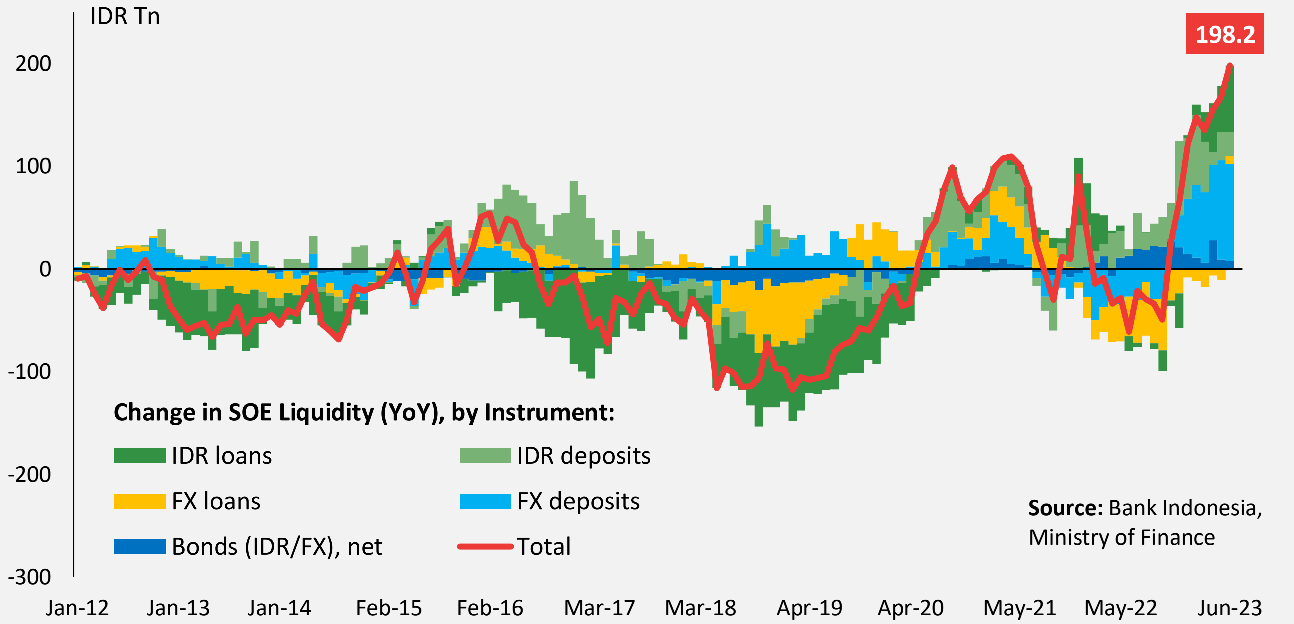

Chart 2

In the rear-view mirror

A large part of the current headline inflation figure was the result of the fuel price hike in Sep-22, which will surely normalize soon

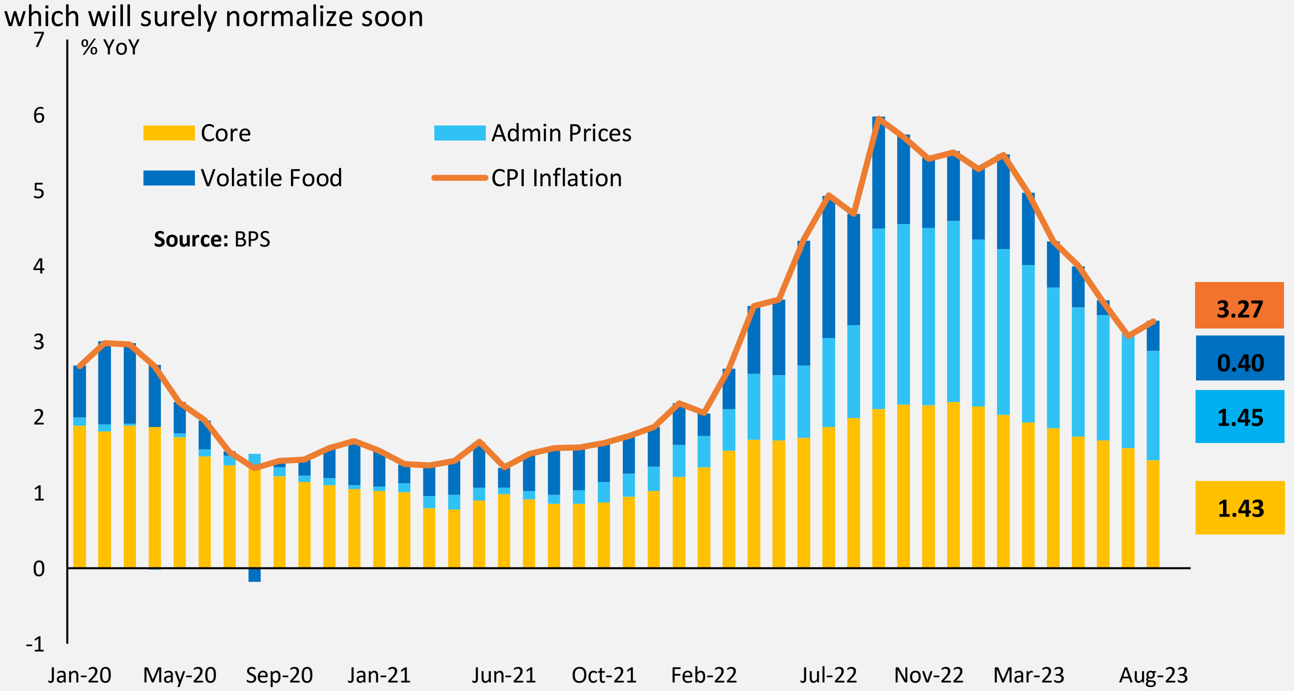

Chart 3

Normalizing the abnormal

The government is gradually winding down the extra-large energy subsidies and compensation budget from 2022

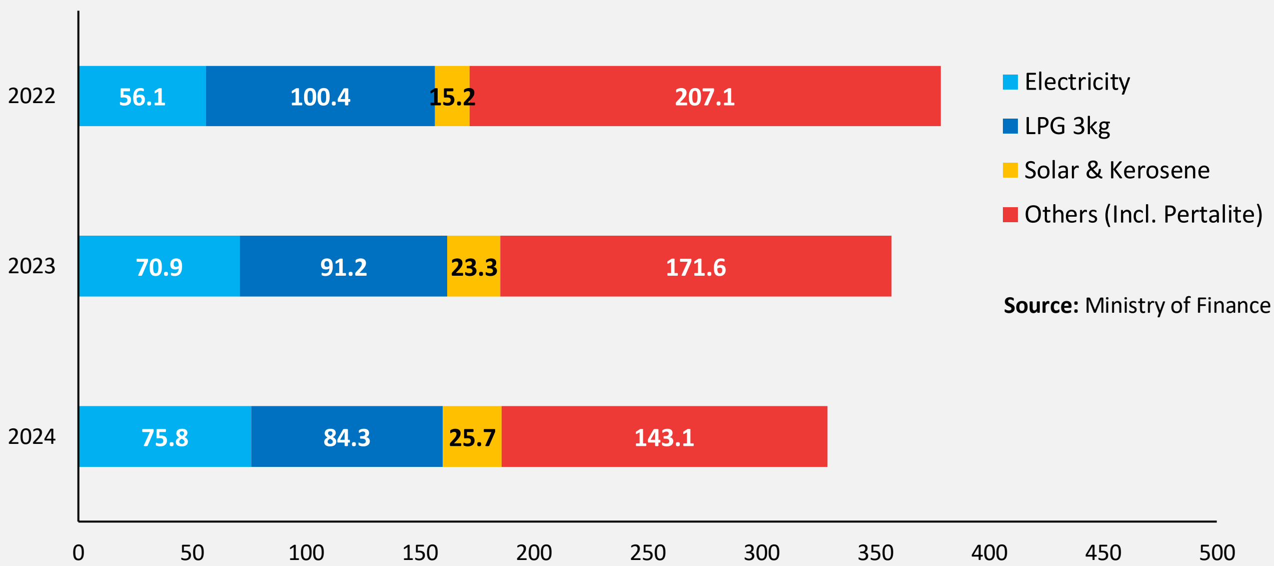

Chart 4

Not quite a cheaper alternative

Ethanol tends to be more expensive than oil, but the price gap has narrowed down considerably after last year's price shock

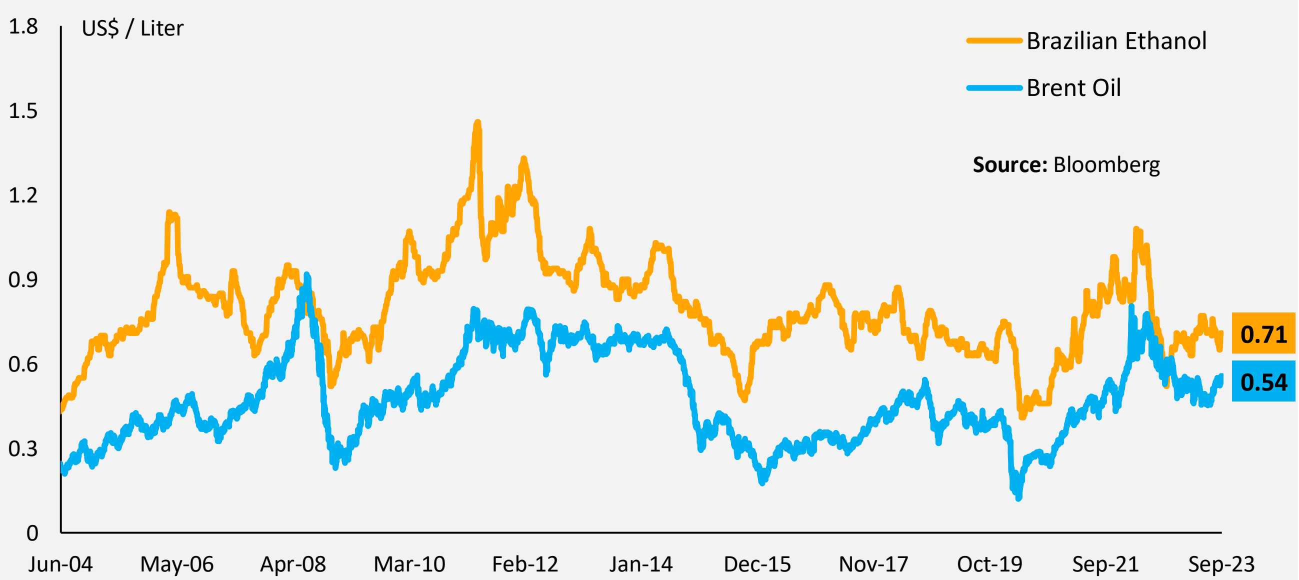

Chart 5

The gist of it

The coal/oil ratio lies at the heart of our commodity terms of trade index, and both point towards potential persistence of the current account deficit

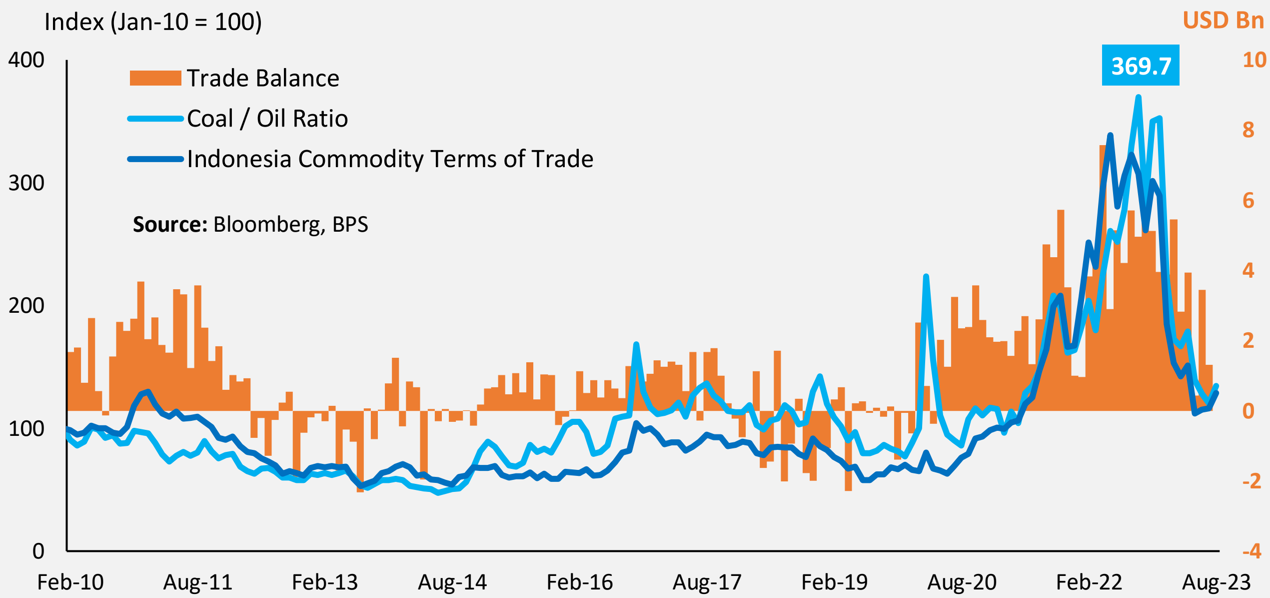

Table 1

	Pertalite	Pertamax Green 92	Pertamax	Pertamax Green 95
Blend	RON 90 gasoline	93% RON 90, 7% ethanol	RON 92 gasoline	95% RON 92, 5% ethanol
Octane number	90	92	92	95
Retail price (current, Rp/liter)	10,000	10,500 – 11,000 (estimated)		13,300 13,500

Source: Pertamina, News

Economic Calendar

		Actual	Previous	Forecast*
1 September 2023				
ID	S&P Manufacturing PMI	53.9	53.3	53.0
ID	**Inflation Rate YoY**	**3.27%**	**3.08%**	**3.0%**
CN	Caixin Manufacturing PMI	51	49.2	49.3
US	S&P Manufacturing PMI	47.9	49.0	47.0
US	Non-Farm Payroll ('000)	187	157	180
6 September 2023				
US	Balance of Trade (USD Bn)	-	-65.5	-68.1
7 September 2023				
CN	Balance of Trade (USD Bn)	-	80.6	81
ID	**Foreign Exchange Reserves (USD Bn)**	-	**137.7**	**134.0**
CN	Foreign Exchange Reserves (USD Tn)	-	3.20	3.20
8 September 2023				
ID	Consumer Confidence	-	123.5	121
9 September 2023				
CN	Inflation rate YoY	-	-0.3%	-0.4%
12 September 2023				
ID	Motorbike Sales YoY	-	45.6%	-
13 September 2023				
US	Inflation rate YoY	-	3.2%	3.4%
ID	Car Sales YoY	-	-6.7%	-
15 September 2023				
ID	**Balance of Trade (USD Bn)**	-	**1.31**	**1.1**
CN	Retail Sales YoY	-	2.5%	2.2%
18 September 2023				
ID	Retail Sales YoY	-	7.9%	-
21 September 2023				
US	**Fed Interest Rate Decision**	**-**	**5.5%**	**5.5%**
ID	**Interest Rate Decision**	-	**5.75%**	**5.75%**
22 September 2023				
ID	M2 Money Supply YoY	-	6.4%	-

*Forecasts of some indicators are simply based on market consensus
Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Sep-23	2.30
UK	5.25	Sep-23	-1.55
EU	4.25	Sep-23	-1.05
Japan	-0.10	Jan-16	-3.40
China (lending)	2.50	Aug-23	4.65
Korea	3.50	Aug-23	1.20
India	6.50	Aug-23	-0.94
Indonesia	5.75	Aug-23	2.48

Money Mkt Rates	1-Sep	-1 mth	Chg (bps)
SPN (1M)	5.92	4.82	110.5
SUN (10Y)	6.37	6.22	14.4
INDONIA (O/N, Rp)	5.53	5.60	-7.0
JIBOR 1M (Rp)	6.40	6.40	0.0

Bank Rates (Rp)	May	Apr	Chg (bps)
Lending (WC)	8.93	8.92	0.35
Deposit 1M	4.19	4.18	1.37
Savings	0.67	0.67	0.00

Currency/USD	1-Sep	-1 mth	Chg (%)
UK Pound	0.794	0.783	-1.46
Euro	0.928	0.910	-1.86
Japanese Yen	146.2	143.3	-1.97
Chinese RMB	7.266	7.178	-1.22
Indonesia Rupiah	15,240	15,115	-0.82

Capital Mkt	1-Sep	-1 mth	Chg (%)
JCI	6,977.7	6,886.5	1.32
DJIA	34,837.7	35,630.7	-2.23
FTSE	7,464.5	7,666.3	-2.63
Nikkei 225	32,710.6	33,476.6	-2.29
Hang Seng	18,382.1	20,011.1	-8.14

Foreign portfolio ownership (Rp Tn)	Aug	Jul	Chg (Rp Tn)
Stock	2,869.7	2,892.9	-23.21
Govt. Bond	845.3	855.2	-9.90
Corp. Bond	11.1	11.3	-0.20

Trade & Commodities	1-Sep	-1 mth	Chg (%)
Baltic Dry Index	1,065.0	1,150.0	-7.4
S&P GSCI Index	599.0	591.7	1.2
Oil (Brent, $/brl)	88.6	84.9	4.3
Coal ($/MT)	159.0	142.9	11.3
Gas ($/MMBtu)	2.57	2.49	3.2
Gold ($/oz.)	1,940.1	1,944.3	-0.2
Copper ($/MT)	8,479.3	8,594.3	-1.3
Nickel ($/MT)	20,891.0	22,143.0	-5.7
CPO ($/MT)	840.0	844.4	-0.5
Rubber ($/kg)	1.36	1.28	6.3

External Sector	Jul	Jun	Chg (%)
Export ($ bn)	20.88	20.60	1.36
Import ($ bn)	19.57	17.15	14.10
Trade bal. ($ bn)	1.31	3.45	-61.96
Central bank reserves ($ bn)*	137.7	137.5	0.12

Prompt Indicators	Jul	Jun	May
Consumer confidence index (CCI)	123.5	127.1	128.3
Car sales (%YoY)	-6.8	4.7	65.2
Motorcycle sales (%YoY)	45.6	66.6	113.4

Manufacturing PMI	Aug	Jul	Chg (bps)
USA	47.6	46.4	120
Eurozone	43.5	42.7	80
Japan	49.6	49.6	0
China	51.0	49.2	180
Korea	48.9	49.4	-50
Indonesia	53.9	53.3	60

Source: Bloomberg, BI, BPS
Notes:
^Data for January 2022
*Data from an earlier period
For changes in currency: **Black indicates appreciation against USD, **Red** otherwise
***For PMI, **>50** indicates economic expansion, **<50** otherwise

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Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3	5.2
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.7
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	35.3
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.7

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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