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# HOW DOES THE MIDDLE EAST GEOPOLITICAL CONFLICT IMPACT INDONESIA'S TRADE BALANCE?

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ABSTRACT

The ongoing conflict between Israel and Palestine in the Middle East has escalated in October 2023 and continues, claiming thousands of lives and damaging infrastructure. This tension not only threatens regional stability but can also trigger global economic turmoil. This study analyzes the impact of the Middle East geopolitical conflict on Indonesia's trade balance using descriptive and comparative quantitative methods with secondary data. The results show that the geopolitical conflict in the Middle East has an impact on Indonesia's trade balance, especially from the decline in the surplus value and total trade during the conflict period. The conflict can cause an increase in energy commodity prices, hampered logistics movements, depreciation of the exchange rate, and global economic turmoil. Therefore, it is necessary for Indonesia to minimize the negative impact of the Middle East geopolitical conflict on Indonesia's trade balance, such as diversifying export and import markets, increasing supply chain resilience, strengthening economic diplomacy, and increasing economic competitiveness.

## Introduction

The prolonged geopolitical conflict in the Middle East between Israel and Palestine heated up again in October 2023 and continues to this day. This conflict, which has been going on since the 19th century, has claimed thousands of lives and destroyed various facilities and infrastructure. This conflict has been one of the main focuses in international geopolitics for decades and has implications for global political and economic stability. In addition, this conflict can also trigger a chain response from neighboring countries, worsen bilateral relations, and increase regional security risks. The involvement of neighboring countries such as Iran and Yemen, as well as allied countries such as the United States and Britain, has dragged global economic and political conditions into instability and uncertainty (Pratiwi, 2024).

There is an extraordinary tension in the Middle East, especially in the Red Sea, which is one of the vital international shipping lanes. The Red Sea, which connects Africa and Asia, has become an arena for conflict between Israel and the Houthi, a Yemeni militia group supported by Iran and on the Palestinian side. The roots of this conflict began with the blockade imposed by the Houthis on ships sailing to Israel. The restrictions imposed on the Houthis have not only disrupted shipping traffic to Israel but have also blocked global trade routes. As a result, global cargo shipping companies are choosing to change their shipping routes to avoid the Red Sea and choose to go around the Cape of Good Hope in South Africa despite the greater distance and increased costs (Rahman, 2023).

Previously conducted research shows that the conflict in the Middle East has resulted in instability in world oil prices, instability in the financial sector, disruption of international trade activities, reduced investor confidence in investing, and disruption of geopolitical security (Dewi, 2024). The conflict between Palestine and Israel has a significant impact on the global supply chain, especially for crude oil commodities, raw materials, and industrial auxiliary materials. One of the most important routes in this supply chain is the Strait of Hormuz, which is 39 kilometers long and is a vital maritime route for global oil movement. More than one-sixth of the world's oil production and one-third of the world's liquefied natural gas (LNG) pass through this strait (Sipayung, 2024). The security of the Strait of Hormuz is critical because armed conflict in the region could threaten the smooth flow of maritime trade and disrupt oil supplies from Gulf countries such as Saudi Arabia, Iraq, Kuwait, Bahrain, Qatar, and the United Arab Emirates. These supply disruptions could have significant impacts on global economic stability and energy prices (Li et al., 2021).

The Middle East region such as Saudi Arabia, UAE, and Oman are Indonesia's trading partners for crude oil and natural gas commodities. Indonesia as an oil importing country has a significant dependence on oil supplies from Middle Eastern countries (Badan Pusat Statistik, 2024). The Israeli-Palestinian conflict can affect oil availability and disrupt the global supply chain. Fluctuations in world oil prices can affect the trade balance and national fiscal balance. This chaos creates a domino effect on the Indonesian economy. Rising oil prices can increase the cost of industrial production in Indonesia, which can affect the price of domestic products. Rising oil prices are like a time bomb ready to explode the Indonesian economy. The burden of swelling energy subsidies, a weakening exchange rate, and soaring inflation can hamper economic growth and reduce people's purchasing power (Mubarok, 2023).

Over the past four years, Indonesia's trade balance performance has always been on a positive trend. Badan Kebijakan Fiskal (2024) or The Fiscal Policy Agency stated that until September 2024, Indonesia's trade balance recorded a surplus of USD3.26 billion. However, in the future, the economy will still face challenges that will hamper global trade activities in the form of geopolitical tensions and economic fragmentation that will affect the global supply chain, exchange rate pressures, and economic slowdowns in Indonesia's main trading partner countries such as China. The International Monetary Fund (2024) through the World Economic Outlook report published in April 2024 projected that global economic growth throughout 2024 and 2025 would grow by 3.2%.

The trade balance, also known as the balance of trade (BoT), is the difference in trade (both goods and services) between the value of a country's exports and the value of its imports during a certain time period (Sabry, 2024). It is an important component of a country's balance of payments and serves as an indicator of a country's trade. Exports are recorded as credits in the balance of trade because they generate money for the country, increase demand for the domestic currency, and drive economic growth. Conversely, imports are like taking out a loan. This creates an obligation to pay a party in another country, thus taking money out of the country. Import transactions are recorded as debit transactions (Laksono & Saudi, 2020).

The trade balance tends to fluctuate depending on where an economy is in its cycle. When an economy is growing due to rising exports, the trade balance will tilt toward exports. However, at the same point in the business cycle, the trade balance will shift toward imports if growth is driven by domestic demand. Sabry (2024) stated that the trade balance is influenced by several factors including production costs, raw material prices, intermediate product costs, input availability, changes in currency values, trade tariffs and quotas, foreign exchange availability, and the cost of domestically produced goods. Other sources state that the trade balance is influenced by factors such as foreign income levels, changes in global demand conditions, exchange rates, and changes in export and import prices. Although there are differences, both mention the exchange rate as one of the factors that influences the performance of the trade balance (Thong, 2023).

Geopolitics began to have a significant impact on global trade activities since 2018. It started with the tariff war between the United States and China, followed by Russia's invasion of Ukraine. Trade between countries involved in the same geopolitical interests will increase, while trade between competing countries will decrease (Bosone et al., 2024). Based on previous studies, the discussion of geopolitical conflicts mostly discusses the impact of the geopolitical conflict between the United States and China on global trade or how the geopolitical conflict between Russia and Ukraine impacts the European Union economy. Meanwhile, the purpose of this study is to analyze how geopolitical conflicts in the Middle East can impact Indonesia's trade balance. Presidential Regulation of the Republic of Indonesia No. 34 of 2024 states that Indonesia has inter-state trade relations with Palestine.

## Method

This research is quantitative research using descriptive and comparative methods. All data sources are secondary data. According to (Sugiyono, 2016) the descriptive quantitative research method is used to describe, depict, explain, explain, and answer in more detail the problems to be studied using data in the form of numbers, tables of numbers, or statistical data. The comparative method is carried out by comparing one data with another, in this study, namely trade data (exports and imports) between the periods before and after the conflict, as well as Indonesia's trade data with countries in conflict. This method focuses on providing an in-depth understanding of the observed phenomena, with the aim of describing and interpreting statistical data in detail. This study is intended to be able to analyze and clearly describe the impact of the geopolitical conflict in the Middle East on the stability of Indonesia's trade balance.

The data used in this study include annual export and import value data based on partner countries (Israel, Palestine, Iran, and UAE); total annual export and import value data; quarterly historical trade balance data for January 2022 – March 2024; and historical exchange rate data for 2022 – 2024. The data was obtained from the Central Statistics Agency, the Data and Information System Center of the Ministry of Trade, and the Directorate General of Customs and Excise. This data will be compared and analyzed to determine whether the Middle East conflict has an impact on trade, whether there has been a change in export and import trends, and how it impacts the overall trade balance.

## Results and Discussion

Geopolitical conflicts in the Middle East have been going on for more than a decade, but the dynamics are currently increasingly complex and the ongoing escalation has had a significant impact on the security sector, international relations, and the global economy. According to a study conducted by the Lembaga Ketahahan Nasional or National Resilience Institute of the Republic of Indonesia, the escalation in the Middle East has raised concerns about the stability of world oil prices which have a direct impact on global economic conditions, including Indonesia. This impact will directly increase the burden on the state budget and expenditure and has the potential to disrupt the flow of international trade and investment. Then indirectly, of course, it will have a negative impact on Indonesia's national economic growth (Lembaga Ketahanan Nasional, 2024).

Based on Figure 1, it can be seen that there is a weakening of the rupiah exchange rate during the geopolitical conflict period, this can be caused by several reasons. First, war can cause global political and economic uncertainty that can disrupt international financial markets. This uncertainty can make investors tend to stay away from risky assets, including the currencies of countries that are directly or indirectly affected by the conflict. Second, war can affect the supply and demand for certain commodities, which can then affect the price of these commodities. Indonesia as a country that imports many commodities, including oil and other raw materials, can feel the impact of the price increase. If the price of imported commodities increases, it can result in a larger trade deficit, which can then put additional pressure on the rupiah exchange rate (Góes et al., 2022).

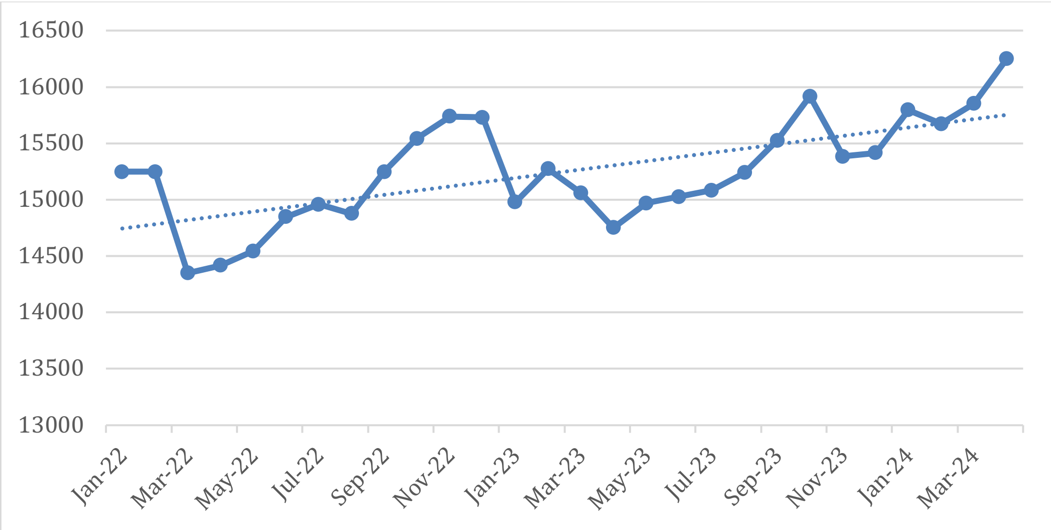


Figure 1. Changes in the Rupiah Exchange Rate Against the USD in 2022–2024

Source: Badan Pusat Statistik, 2024

Market sentiment also plays an important role in currency exchange rate changes. If the global financial market responds negatively to a war in another country, investors may sell currencies affected by the war, including the Rupiah, which can then cause its exchange rate to weaken. The escalating conflict in the Middle East has resulted in increased risk-off sentiment which has caused capital outflows including in Indonesia. During the risk-off phase, investors take a more cautious stance with a focus on protecting capital rather than seeking higher returns. This stance becomes dominant when there is economic uncertainty, rising geopolitical tensions, or a lack of confidence in the financial market (Olivier, 2024). At that time, investors tend to shift their portfolio allocation towards safer assets, which generally have lower volatility and higher stability. In this case, investors choose to withdraw their capital from developing countries such as Indonesia and invest it in assets in the form of US Dollars (USD) or gold, as a result the Rupiah exchange rate against the USD continues to weaken in the period from November 2023 to April 2024 (Figure 1). This weakening is likely to continue considering that the countries in conflict have not agreed to make peace.

Looking at the export-import data in the first quarter of 2024 (Table 1), the depreciation of the rupiah throughout 2024 did not immediately increase export performance. This is because the Middle East conflict also resulted in a global economic slowdown and geopolitical tensions. In addition, there is a gap between the theory of international trade and the facts and conditions that occur in Indonesia. Although the theory implies that the depreciation of the domestic currency should improve the trade balance through increased exports and decreased imports, in reality in Indonesia, the depreciation of the rupiah which was not followed by an increase in exports or a decrease in imports, caused the surplus value of the balance of trade to worsen (Mawardi, 2023). Research shows that in the long run, factors such as exchange rates, exports, imports and GDP affect the trade balance, but in the short run this relationship does not occur (Wahyudi & Sari, 2020). Nevertheless, commodity imports to Indonesia continue to increase because most industrial raw materials are still imported from abroad. In addition to macroeconomic variables, factors such as market sentiment towards socio-political developments also affect net exports.

Table 1 shows the value of exports-imports and the total value of trade between Indonesia and countries in conflict in the Middle East (Iran, Palestine, Israel) and Saudi Arabia as one of Indonesia's main trading partners before and during the period of escalating conflict. Indonesia has a fairly significant trade value with Saudi Arabia, especially in terms of oil and gas exports. Indonesia's trade relations with Saudi Arabia tend to be economic and strategic. Indonesia also has fairly strong diplomatic relations with Saudi Arabia. Total trade in the first quarter of 2024 increased by 24.9% (yoy), it can be seen that Indonesia's trade with Saudi Arabia was not directly affected by the geopolitical conflict in the Middle East. Likewise, total trade with Israel and Palestine tended to increase in the first quarter of 2024 compared to the same period in 2023 (before the escalation of the conflict). Despite not having diplomatic relations, there was a fairly sharp increase in import transactions during the conflict. The goods that drove this increase were mechanical machinery and equipment and their parts, tools and equipment made of base metals, and electrical machinery and equipment and their parts. Compared to Iran and Palestine, this value is quite high.

Table 1. Export and Import Values of Saudi Arabia, Israel, Iran, and Palestine in 2023–2024

| Description | 2023 | 2024 | Growth (%) |
|---|---|---|---|
| **Saudi Arabia** | | | |
| Export | 568,4 | 539,2 | -5,1 |
| Import | 824 | 1.199,4 | 45,6 |
| Total Trade | **1.392,4** | **1.738,6** | **24,9** |
| **Israel** | | | |
| Export | 39,2 | 37,5 | -4,3 |
| Import | 5,5 | 28,3 | 411,0 |
| Total Trade | **44,7** | **65,8** | **47,2** |
| **Iran** | | | |
| Export | 48 | 43,3 | -9,7 |
| Import | 6,2 | 4,8 | -22,8 |
| Total Trade | **54,2** | **48,1** | **-11,3** |
| **Palestine** | | | |
| Export | 0,6 | 1 | 66,7 |
| Import | 1,3 | 1,2 | -8,1 |
| Total Trade | **1,9** | **2,2** | **15,8** |

Source: Ministry of Trade of the Republic of Indonesia, 2024

According to data from the Central Statistics Agency (BPS), amid the escalating conflict in the Middle East, throughout 2023 the value of trade in goods to the region is estimated to reach USD19.20 billion. The main export products to the Middle East are vegetable and animal oils, rubber and rubber products, electronic and telecommunications equipment, and chemical fertilizers with a total of 3.50% of Indonesia's total export value or USD9.06 billion. Meanwhile, the main import commodities are petroleum, chemical products, equipment and machinery, jewelry and gems, and spare parts with an import value of USD10.13 billion or contributing 4.57% of Indonesia's total imports. Looking at this trend, it can be seen that Indonesia's economic relations with Middle Eastern countries are quite resilient to political turmoil in the region.

Figure 2 shows a downward trend in import value from the end of 2023 to March 2024 along with the weakening of the Rupiah exchange rate against the USD as a result of the escalating conflict in the Middle East. The weakening of the Rupiah exchange rate against the USD makes imported goods and services more expensive for business actors in Indonesia. With higher import prices, business actors will reduce import volumes to control costs. In addition, geopolitical tensions in the Middle East have also resulted in soaring logistics costs due to obstructed logistics routes which require additional time. This additional time has resulted in logistics costs increasing by up to 20%. One of the industries affected in Indonesia is the manufacturing industry, which still relies on imported raw materials and auxiliary materials. The impact of increasing raw material and auxiliary material costs will also increase the cost of producing a product. In addition, it will also put pressure on profitability and cause a decrease in productivity.

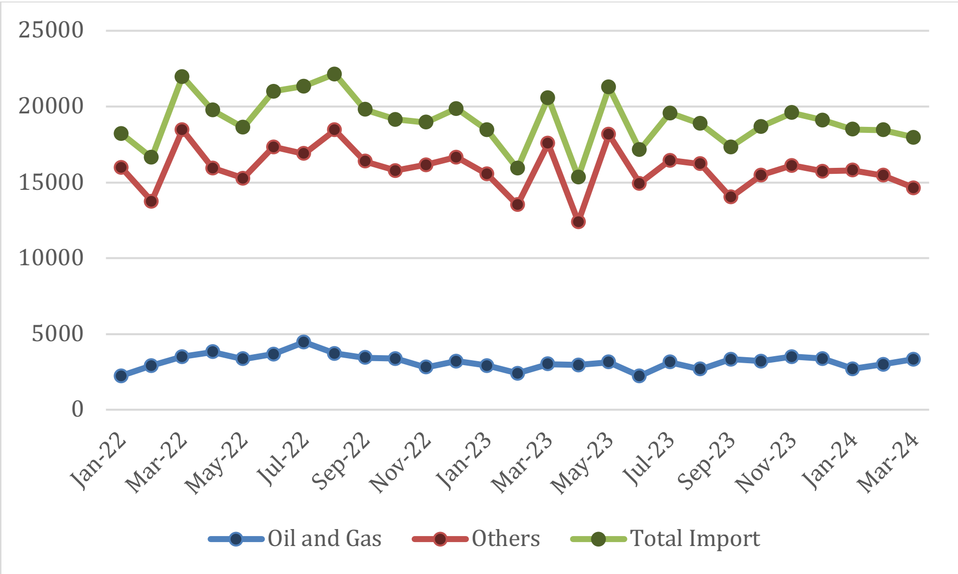


Figure 2. Import Values of Indoneisa in 2022–2024 (in Million USD)

Source: Badan Pusat Statistik, 2024

However, it should also be noted that this decline is not solely caused by the weakening of the Rupiah, several factors such as declining domestic demand, the global economic slowdown, or government policies that reduce imports to improve the trade balance. The combination of declining import value and the weakening of the Rupiah exchange rate can have complex economic impacts, such as declining investment, increasing inflation, or pressure on the trade balance (Yu & Wang, 2023). Therefore, it is important for governments and economic actors to pay attention to and manage these two factors carefully in their economic policies.

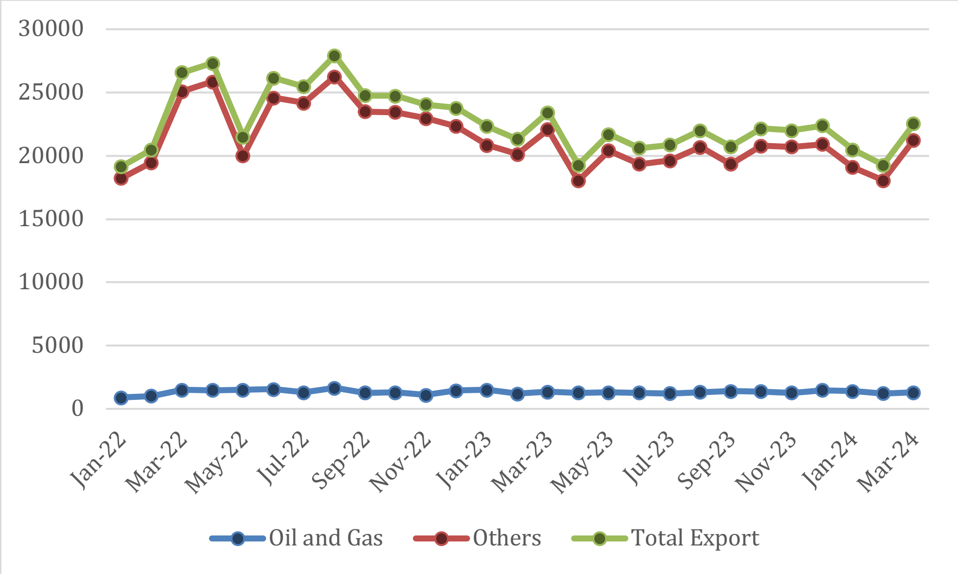


Figure 3. Export Value of Indonesia in 2022–2024 (in Million USD)

Source: Badan Pusat Statistik, 2024

The global economic slowdown has reduced export demand from destination countries, so that Indonesia's export value in the first quarter of 2024 decreased by 7.1% compared to the same period last year. Although there is a depreciation in the exchange rate, the value of export goods is lower, export transactions do not automatically increase. As long as demand for these goods does not increase, the value of export transactions will not increase. Indonesia's exports still depend on commodities that are vulnerable to economic turmoil, such as coal and palm oil. The prices of these commodities are easily affected by changes in supply and demand in the global market. In addition, obstacles to trade flows in the Middle East and Europe due to geopolitical conflicts in the Middle East have also caused export transactions to decline.

Table 2. Indonesia's Trade of Balance Value in 2022–2024

| Description | 2023 | 2024 | Growth (%) |
|---|---|---|---|
| **Total Trade** | **122.011,3** | **117.202,3** | **-3,9** |
| Oil and Gas | 12.340,0 | 12.904,1 | 4,6 |
| Others | 109.671,3 | 104.298,2 | -4,9 |
| **Export** | **67.061,1** | **62.306,5** | **-7,1** |
| Oil and Gas | 4.012,7 | 3.899,7 | -2,8 |
| Others | 63.048,4 | 58.406,8 | -7,4 |
| **Import** | **54.950,2** | **54.895,8** | **-0,1** |
| Oil and Gas | 8.327,3 | 9.004,4 | 8,1 |
| Others | 46.622,8 | 45.891,4 | -1,6 |
| **Balance of Trade** | **12.111,0** | **7.410,7** | **-38,8** |
| Oil and Gas | -4.314,6 | -5.104,7 | -18,3 |
| Others | 16.425,6 | 12.515,3 | -23,8 |

Source: Ministry of Trade of the Republic of Indonesia, 2024

Indonesia's foreign trade data in Table 2 shows that the conflict in Palestine and Israel has a negative impact on Indonesia's trade with both countries. The decline in oil and gas and non-oil and gas imports from Palestine and Israel can be attributed to various factors, including supply disruptions, declining domestic demand, weakening exchange rates, and government policies. The conflict in Palestine and Israel can also disrupt the global supply chain, increase the price of goods and services, and create economic uncertainty, thus hampering Indonesia's trade and investment with both countries (Dewi, 2024). Despite the positive trend, the surplus value and total trade value experienced a significant decline. Based on data obtained from the Ministry of Trade's Data and Information Center, it can be seen that Indonesia's trade experienced a significant decline in the first quarter of 2024 by 38.8% (yoy) which was influenced by an increase in the value of oil and gas imports and a sharp decline in the value of non-oil and gas exports. This decline may reflect the unstable global economic conditions, one of which was caused by the heating up of geopolitical conflicts in the Middle East.

The Central Statistics Agency observed that commodity prices in the international market experienced an increase, especially energy prices and precious metal prices. The increase in energy prices provides benefits to Indonesian commodity prices, such as CPO, coal, and nickel. The increase in commodity prices will contribute to revenues in Indonesia's trade balance, although from the side of the increase in energy prices it will put pressure, especially on Indonesia's fiscal. Geopolitical tensions in the Middle East have hampered the flow of goods and services to Europe and the Middle East. This is due to the escalation of the conflict between Iran and Israel, as well as changes in the direction of the United States monetary policy which increases the risk and uncertainty of global financial markets. However, it is important to understand that the trade balance is not a direct indicator of a country's economic health. It is often misunderstood that a trade surplus is a sign of a strong economy, while a trade deficit is a sign of a weak economy. The impact of the trade balance on the economy depends on various factors such as trade policies, the magnitude of the trade imbalance, and the duration of the positive or negative trade balance.

## Conclusion

Overall, the geopolitical conflict in the Middle East has had a negative impact on Indonesia's trade performance. Although the countries involved in the conflict are not Indonesia's main trading partners, its indirect effects should be watched out for because the potential for an increase in the price of energy commodities from the region could increase production costs, worsen inflation, and harm domestic competitiveness and purchasing power. The disruption of logistics movement, exchange rate depreciation, and global economic turmoil due to the conflict have also disrupted the supply of raw materials for the manufacturing industry in Indonesia and worsened the trade balance due to the depreciation of the rupiah which was not offset by a significant increase in exports or decrease in imports. Therefore, Indonesia needs to increase diplomacy and cooperation with countries in the region to maintain political and economic stability. Indonesia needs to diversify its export and import markets to reduce dependence on the Middle East by establishing trade cooperation with countries in other regions, such as Southeast Asia, East Asia, and Africa. In addition, increasing Indonesia's economic competitiveness by improving product quality, production efficiency, and investment attractiveness creates a good investment and business climate so that it can help improve Indonesia's trade balance performance.

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