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DEFLATION IN INDONESIA: IMPACTS, CAUSES, AND ECONOMIC POLICY SOLUTION

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ABSTRACT

This study discusses the phenomenon of deflation in Indonesia from May 2024 to September 2024, including its impact on the economy, the causes, and solutions through relevant economic policies. Deflation, which is characterized by a general decline in prices, can have a negative impact on the Indonesian economy by decreasing people's purchasing power, increasing the rate of layoffs, slowing economic growth, and decreasing investment levels. The analysis in this study identifies several main causes of deflation in Indonesia, including decreasing people's purchasing power, disproportionate wage increases, and increasing Value Added Tax (VAT). Relying on empirical data and a qualitative approach, this study discusses economic policy solutions to overcome deflation in Indonesia, in terms of monetary policy, fiscal policy, and non-monetary policy.

Introduction

In the context of the global economy, deflation has emerged as a phenomenon that has attracted the attention of economists and policy makers. Deflation is a decline in the prices of goods and services in an economy in general (Salastia et al., 2024). Although often seen as the opposite of inflation which gets more attention, deflation can also have a significant impact on the economy both domestically and internationally. One of the main negative impacts of deflation is a decrease in aggregate demand. When prices of goods and services fall, consumers may postpone their consumption in the hope that prices will continue to fall further. This will reduce demand in the market, which in turn will have an impact on worsening the economic situation by slowing production and creating a cycle of higher unemployment (Budiyanti et al., 2024). In the long term, prolonged price declines can lead to stagflation.

Stagflation itself is a condition in which the economy experiences stagnant growth with high unemployment rates (Prawira et al., 2023). In addition, deflation can also worsen debt levels. In deflation, the real value of debt increases as the amount of money paid to pay off debt becomes more valuable (Ginting, 2016). This causes the debt burden for the household and corporate sectors to become heavier, which can create financial problems in these sectors. Internationally, many countries have faced deflation due to various causes, such as economic recession, declining aggregate demand and market instability. The causes and impacts of deflation can vary as indicated by the different economic structures of countries. Therefore, it is important to understand the specific context of each country, including Indonesia, which has unique economic and social characteristics.

Indonesia, as one of the countries with the largest economies in Southeast Asia, faces significant deflation challenges. Statistics Indonesia (BPS) reported that deflation in Indonesia had lasted for five consecutive months, from May to September 2024. In September 2024, deflation in Indonesia was recorded at 0.12% on a monthly basis, indicating a decrease in the Consumer Price Index (CPI) from 106.06 in August to 105.93. These price fluctuations are largely influenced by internal factors such as declining purchasing power of the community and external factors, such as economic recovery after the COVID-19 pandemic in Indonesia, and overshadowed by global challenges such as geopolitical uncertainty and climate change (Budiyanti et al., 2024). Specifically, the food sector is the main cause of deflation in Indonesia. Several groups are the largest contributors to deflation with significant contributions from various food commodities, namely food, beverages and tobacco. BPS noted that in July 2024, this group experienced deflation of 0.97% and contributed to deflation of 0.28%.

This study aims to examine deflation in Indonesia, the causes, impacts and solutions to economic policies in Indonesia during the period from May to September 2024. This study will explain the conditions of deflation in Indonesia. This study will also analyze how deflation affects people's purchasing power, employment and investment levels. In addition, the study will also identify economic policies that can be implemented to address this challenge, including monetary and fiscal policies. With a comprehensive analysis, it is hoped that this study can provide better insight into deflation in Indonesia and the steps needed to encourage sustainable economic growth.

Literature Review

Deflation is a term for an economic phenomenon where there is a general decline in the price of goods and services in the economy in a certain period (Fitri, 2024). In this context, deflation can be understood as a situation where the purchasing power of money increases, as the amount of money in circulation decreases or the demand for goods and services decreases. Although cheaper prices for goods can benefit consumers in the short term, deflation is often a sign of deeper economic problems and can have a negative impact on the economy as a whole.

This deflation is the opposite of inflation. If inflation describes an increase in the price of goods and services that causes a decrease in the purchasing power of money, deflation itself is a decrease in the price of goods and services that increases the purchasing power of money. Although inflation is often considered more dangerous since it can erode purchasing power and cause economic instability, deflation also has the potential to cause deeper damage to the economy by worsening the recession and creating a prolonged cycle of unemployment (Salastia et al., 2024).

With consecutive deflations recorded from May to September 2024, deflation in Indonesia has become an issue that is increasingly attracting attention. According to BPS, deflation in Indonesia occurred with percentages of 0.03% in May, 0.08% in June, 0.18% in July, and again 0.03% in August. This consecutive deflation is a bad signal for the economy, as it usually occurs in very difficult economic conditions. This deflation reflects a decline in household consumption, which is the main component of the Indonesian economy which is dominated by consumption (Aziizah, 2024).

Furthermore, the impact of this deflation is felt in people's purchasing power which is increasingly weakening. Data shows that household consumption growth only reached 4.90%

in the first and second quarters of 2024, a figure lower than during the pandemic (Aziizah, 2024). This decline in purchasing power has the potential to cause increased unemployment and decreased investment in important sectors such as consumption and property. In this case, Budiyanti et al., (2024) highlighted that deflation indicates a decline in aggregate demand, which can hamper economic growth in the long term. In addition, the history of deflation in Indonesia also recorded significant periods, including in 1999 and 2008-2009, where this condition was triggered by the financial crisis. In 2024, deflation occurred in the context of economic recovery after the COVID-19 pandemic, with a decrease in demand influenced by global uncertainty (Budiyanti et al., 2024). Furthermore, Budiyanti et al., (2024) also stated that appropriate monetary and fiscal policies are very important to overcome the negative impacts of deflation and encourage economic growth.

Method

This study applies a literature study method by utilizing various relevant sources to explore and analyze the topic discussed. The approach taken is qualitative descriptive, aiming to provide a detailed and in-depth picture of the phenomenon in focus, namely deflation in Indonesia. Deflation itself is a condition characterized by a general decline in the price of goods and services in a certain period, which can affect people's purchasing power and the stability of the country's economy.

In this study, the data used is qualitative and obtained from secondary sources, namely information that has been published by official institutions. The main sources used include: 1) Economic theories on deflation taken from various literature; and 2) Statistical data from BPS, which includes reports on deflation and other economic indicators relevant to this topic. The data collection technique is carried out using the literature study method where researchers access various existing written sources, such as scientific journals, as well as statistical data from government agencies and other related institutions. In this way, researchers can identify relevant information from a theoretical perspective and empirical data.

Furthermore, in analyzing the data obtained, this study uses qualitative descriptive analysis. This approach allows researchers to describe and explain the phenomenon of deflation in Indonesia comprehensively, and to explain the relationship between existing economic theories and the deflationary conditions that occur in Indonesia. Researchers will explain the various factors that cause deflation, the impact of deflation and policy solutions to this deflation. This study is expected to provide a clearer understanding of the impact, causes and solutions to deflation in Indonesia..

Results and Discussion

Deflation in Indonesia

In early June 2024, BPS announced the development of the CPI Index for May, which showed deflation of 0.03%. This deflation was influenced by several commodities, with rice being the main contributor at 0.15%, followed by broiler chicken, public transportation fares, fresh fish each contributing 0.03% and tomatoes at 0.02%. Entering June, deflation increased to 0.08%, with shallots being the main contributing commodity at 0.09%, followed by tomatoes (0.07%), broiler chicken (0.05%), broiler chicken eggs (0.02%) and garlic (0.01%).

In July 2024, deflation continued to increase, reaching 0.18%. This increase was triggered by the price of shallots contributing 0.11%, followed by red chilies (0.09%), tomatoes (0.07%), broiler chicken (0.04%), and garlic (0.02%). Furthermore, in August 2024, although deflation decreased slightly to 0.03%, shallots remained the main commodity contributing to deflation by 0.08%. Broiler chicken and tomatoes each contributed 0.03%, while broiler eggs (0.02%) and oranges (0.01%) also contributed.

In September 2024, BPS reported that deflation had increased to 0.12%. Several main commodities contributing to deflation this month were red chilies (0.09%), cayenne pepper (0.08%), gasoline (0.04%), broiler chicken eggs (0.02%), and broiler chicken (0.02%). This data shows price fluctuations in a number of commodities that had a significant impact on the CPI in Indonesia throughout the period.

Impact of Deflation in Indonesia

Deflation has occurred in Indonesia for five consecutive months, with a decline in the CPI of 0.12% in September 2024, showing a significant impact on people's purchasing power, employment, and investment levels. First, people's purchasing power has decreased quite clearly (Intan, 2024). Deflation often indicates a condition where people prefer to hold back spending due to economic uncertainty or decreased income, which is currently seen especially in the middle and lower classes. With individuals from these classes having difficulty shopping, which worsens the existing purchasing power crisis.

Second, employment is also affected. Deflation can have an impact on employment that faces declining demand due to low purchasing power will try to reduce production and costs, often involving layoffs. This creates uncertainty in the labor market, making workers worried about losing their jobs and causing them to reduce spending. As a result, this cycle of economic decline worsens the situation, as this decline in consumption worsens the situation, since decreased consumption can worsen deflation itself (Fitri, 2024).

Third, the level of investment has the potential to fall due to prolonged deflation, economic uncertainty and low demand encourage economic companies and low consumer demand encourage them to postpone or reduce new investments. If companies feel that demand for their products is low, they will be reluctant to invest in increasing production capacity or expansion. As a result, economic growth could be hampered, which also worsens labor market conditions (Budiyanti et al., 2024).

Causes of Deflation in Indonesia

Indonesia has experienced deflation for five consecutive months, caused by a decrease in demand for goods and services from the public. This deflation does not reflect success in controlling inflation, but rather shows that consumers are being more careful and tend to hold back their spending. This indicates a decrease in purchasing power among the public, who are trying to avoid unnecessary spending amid economic uncertainty (Puspapertiwi et al., 2024).

Several factors that have caused the decline in purchasing power of the Indonesian people include disproportionate wage increases, the impact of high interest rates, and limited job opportunities in the formal sector. In these conditions, many workers have difficulty earning a decent income, which has a direct impact on reducing consumption levels. In addition, the difficult economic situation has also forced many companies to carry out mass layoffs, which has further worsened the employment situation in Indonesia.

In addition to these internal factors, government economic policies such as the VAT rate of 11% also have a negative impact. The increase in VAT has caused the price of goods and services to increase, thus encouraging people to be more restrained in spending. For the middle class, this condition is very burdensome as of the difficulty in finding stable jobs, while the upper middle class tends to reduce their spending due to concerns.

Conclusion

Deflation in Indonesia can have a significant negative impact on the economy, although it sometimes benefits consumers through lower prices of goods and services. The main impact of deflation is a decrease in people's purchasing power, increased layoffs, and a decrease in investment levels. Some of the main causes of deflation in Indonesia include decreased purchasing power, increased layoffs, and an increase in VAT to 11%.

To overcome deflation, several economic policies that can be taken include monetary policy by increasing the amount of money in circulation, to fiscal policy with the government being able to increase public spending. In addition to monetary policy and fiscal policy, it is important to increase public awareness and encourage people's consumption behavior to be more active. With the implementation of the right policy, deflation can be managed effectively so as not to hinder Indonesia's economic progress.

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