



INDONESIA ECONOMIC QUARTERLY CLOSING THE GAP

Frederico Gil Sander
Lead Economist
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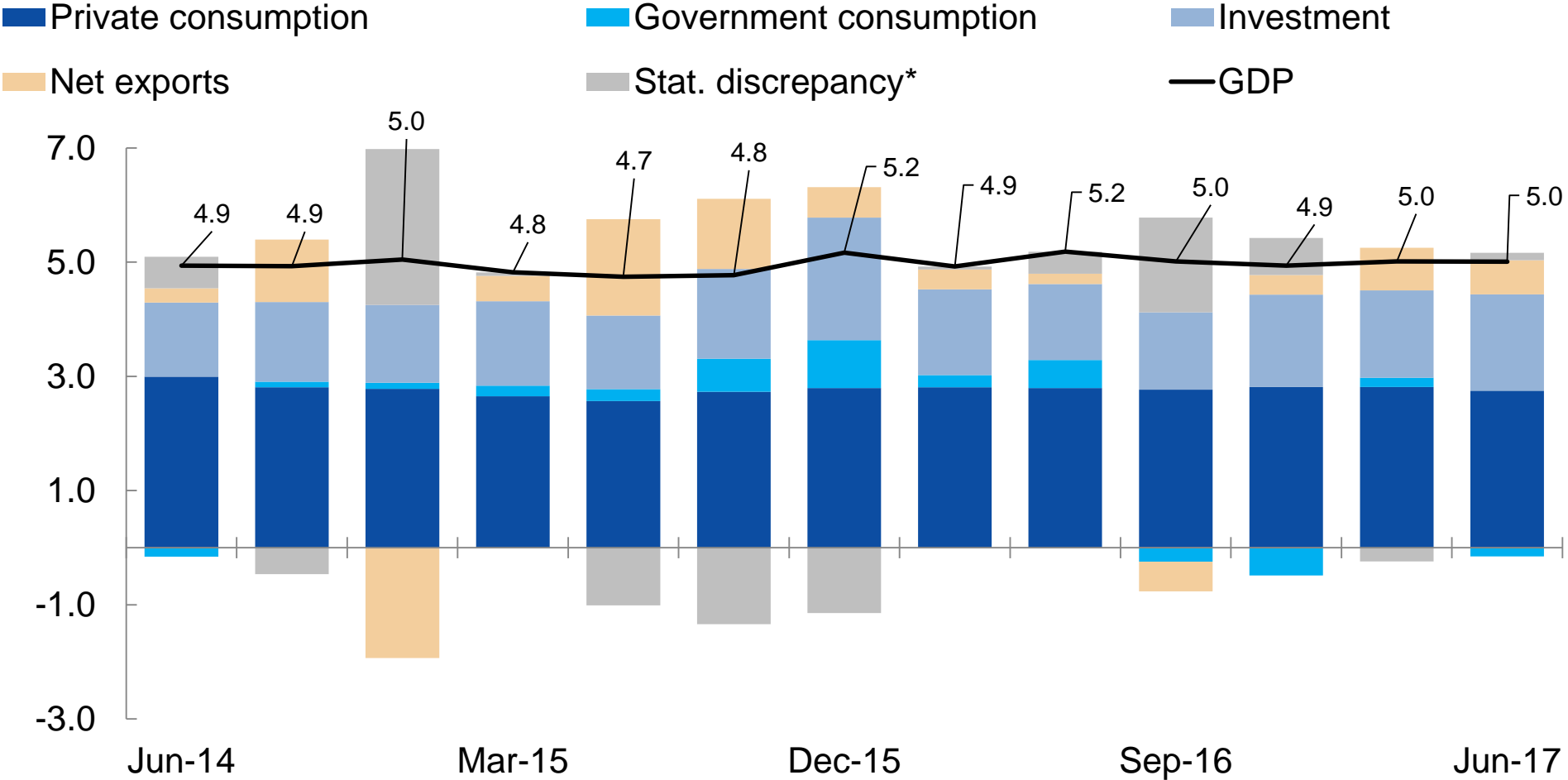
How is the economy doing?

What to expect in 2018?

Closing the gap

Growth steady amid mostly favorable conditions

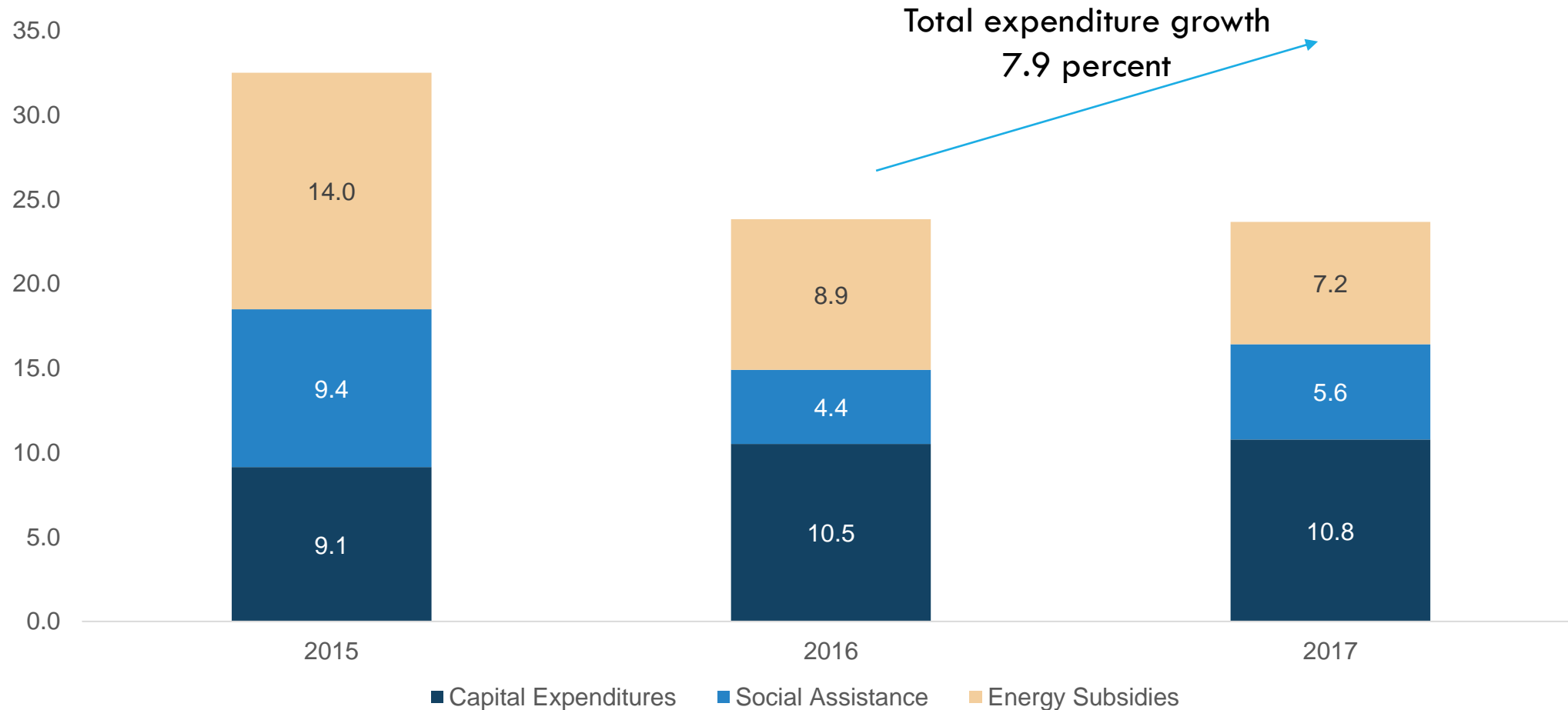
GDP, change from the previous year, percent (line) and contributions to year-on-year growth, percentage points (bars)



Source: BPS; World Bank staff calculations.
 Note: * Stat. discrepancy includes changes in inventories.

Quality of spending improved, contributing to higher investment growth

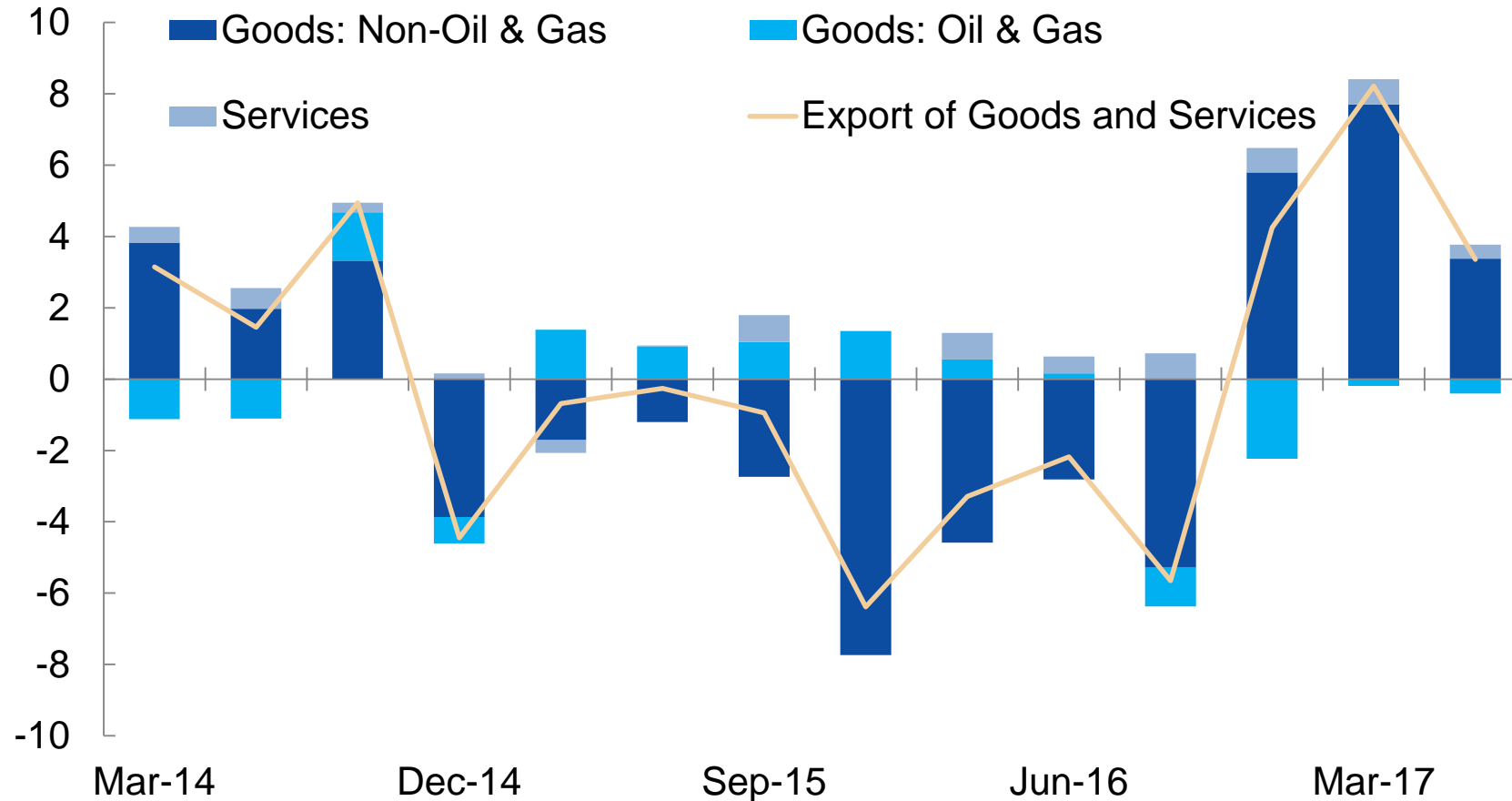
January-August expenditure realizations, shares of total expenditure



Source: Ministry of Finance; World Bank staff calculations.

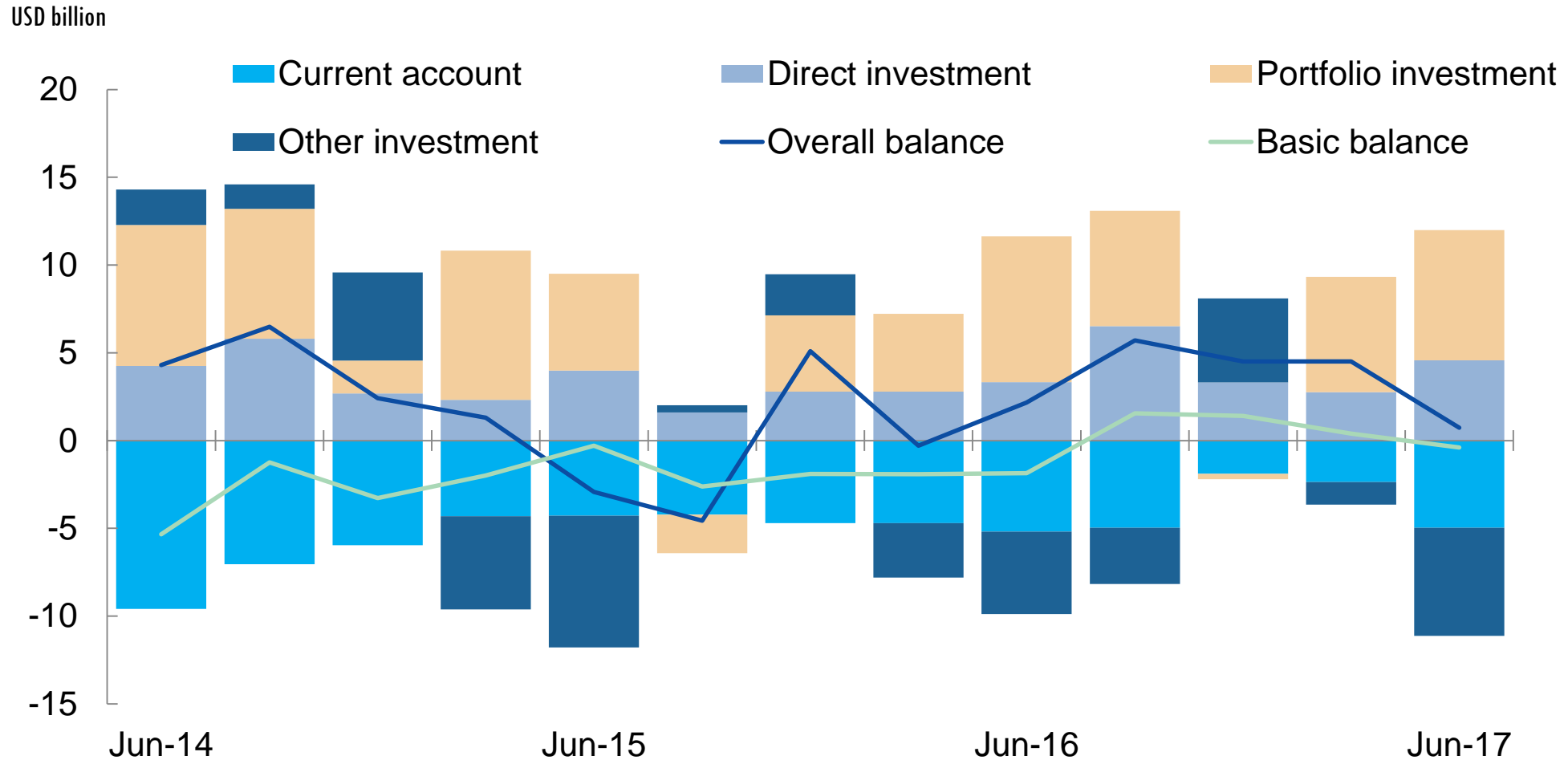
Commodity prices retreated following earlier gains, but export growth remained positive

Exports of goods and services at constant prices, change from the previous year, percent (line), and contributions to year-on-year growth, percentage points (bars)



Source: BPS; World Bank staff calculations.

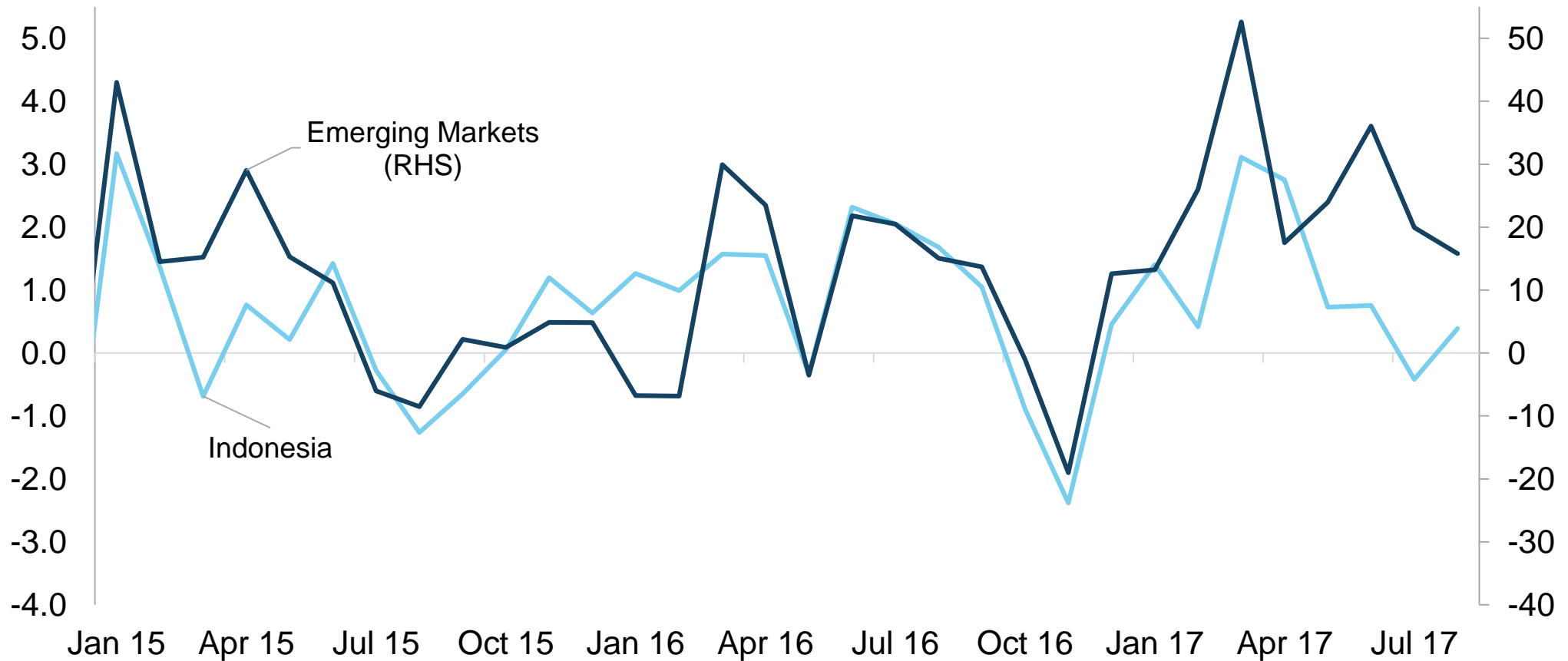
A wider current account deficit was mostly financed by higher FDI...



Source: CEIC and BI; World Bank staff calculations.

... while financial flows were robust, reflecting a benign external environment and strong demand for EM assets

Portfolio flows (debt and equity), USD billion



Source: IIF; World Bank staff calculations.



Ada apa dengan
Konsumsi?

Many reasons why private consumption should have accelerated...

- Festive season of Idul Fitri, which moved to Q2 this year, usually sees a pick-up in consumption
- 4 million jobs created, double-digit wage growth
- Stable rupiah and subdued food inflation
- BI's consumer confidence index relatively high

... so why did consumption remain flat? No clear answer – some hypotheses, but need more data to discern among them

1. Short-term adjustments to constructive reforms

- Shift in expenditures from subsidies to capital expenditures and more targeted transfers
- Increased efforts to boost tax-to-GDP ratio to resource the state to deliver more and better services

2. Industrial investment and productivity growth remain sluggish

- Most jobs created were informal and recent wage growth concentrated among top earners
- Implementation of business-environment and pro-competitive reforms has been challenging, dampening creation of high-quality jobs

3. Commodity prices lost steam in Q2

- Despite substantive progress in diversifying the economy, commodity prices still matter for Indonesia
- Lower prices in Q2 vs Q1, but recovered in Q3

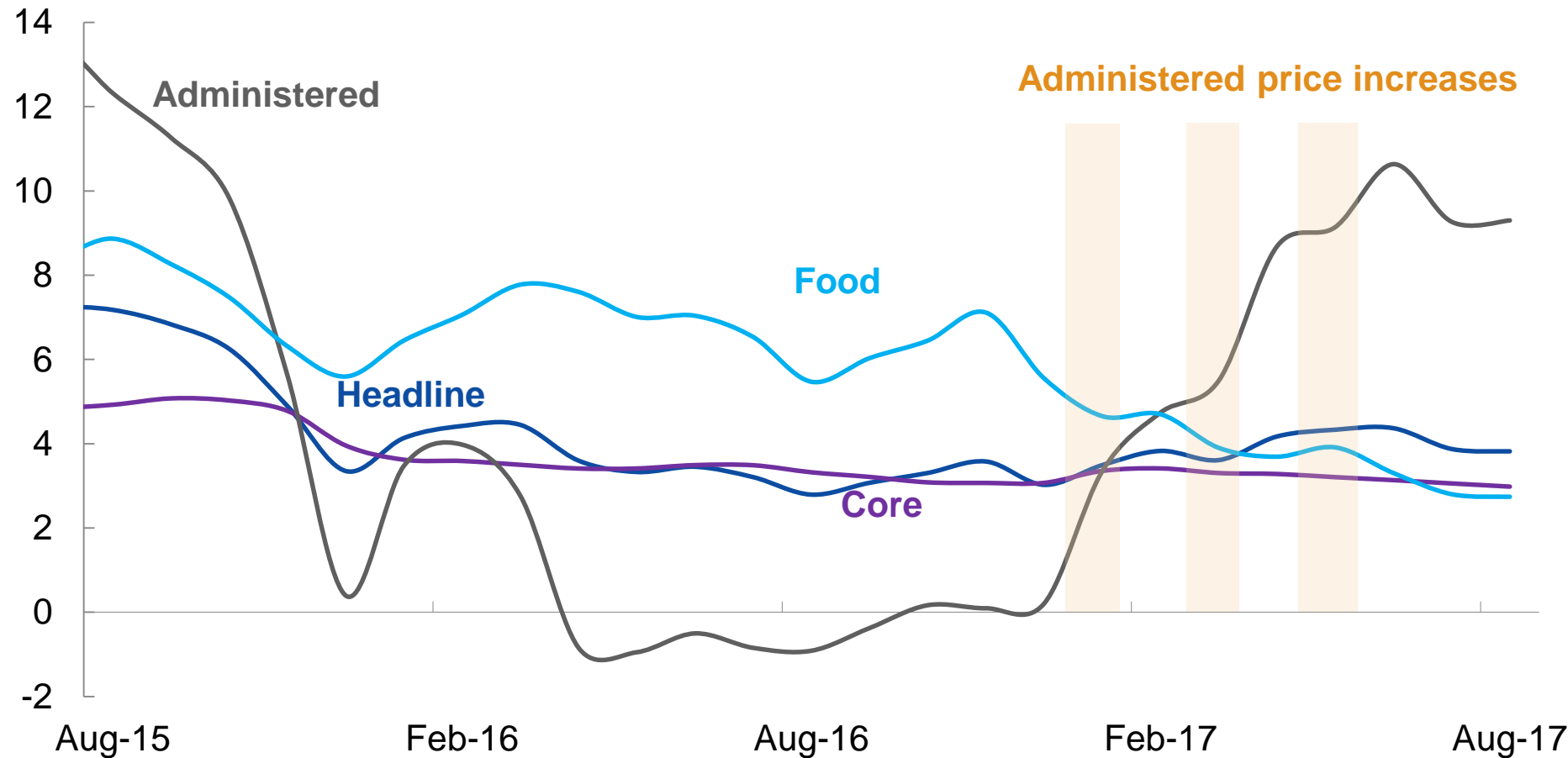
4. Noisy data

- The shift in the Idul Fitri holiday reduced the number of working days and may have introduced unusually large noise to the national accounts data

With some exceptions, most possible explanations point to temporary causes

Short-term pain for long-term gain: Administered price hikes are the mirror image of better expenditure composition

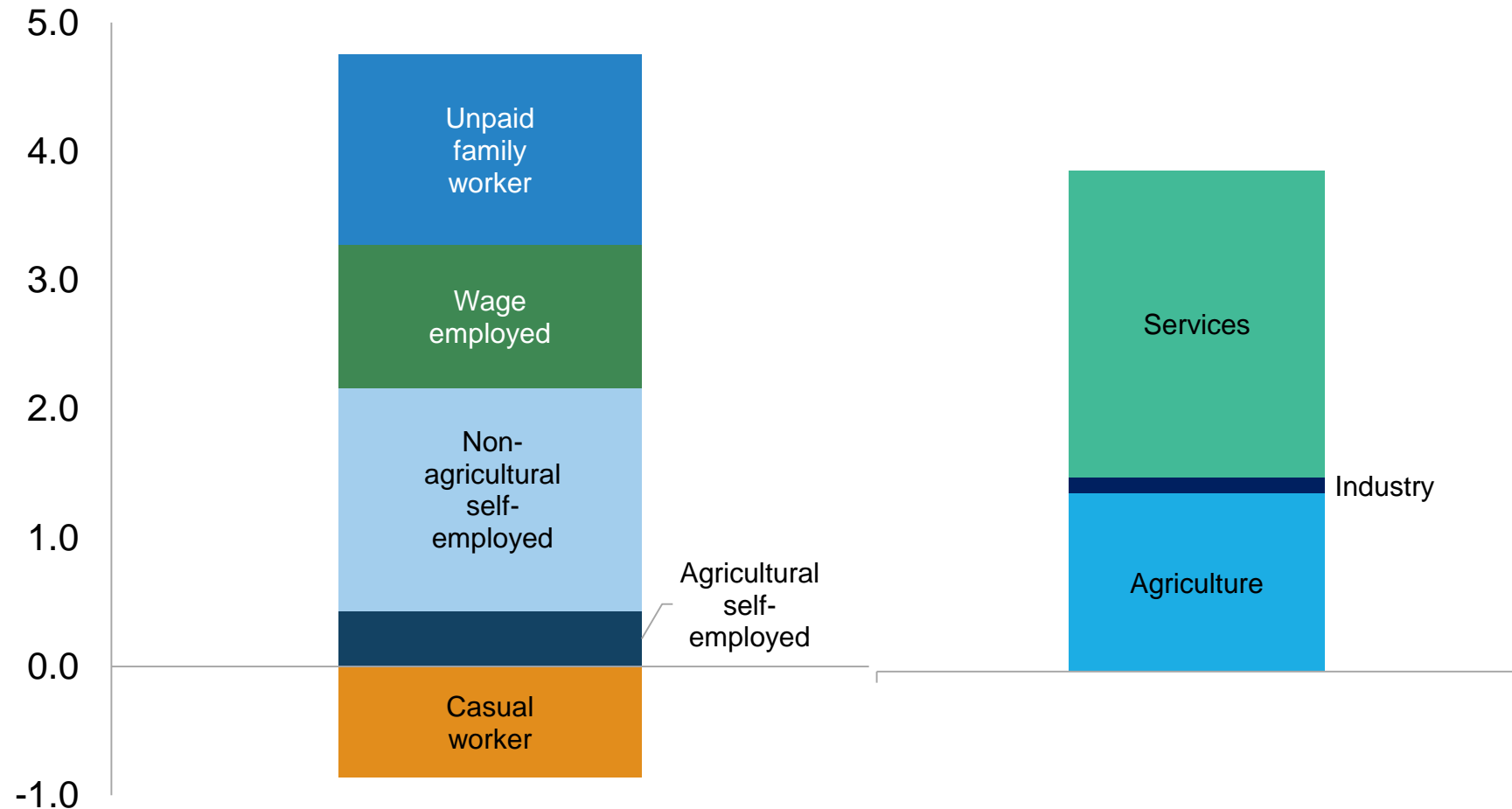
Change from the previous year, percent



Source: CEIC; World Bank staff calculations.

Bigger concern: Boosting private investments to create good jobs in industry and services

Change in the number of employed workers (millions), February 2016 — February 2017, by type of job and sector of employment



Source: Sakernas; World Bank staff calculations.

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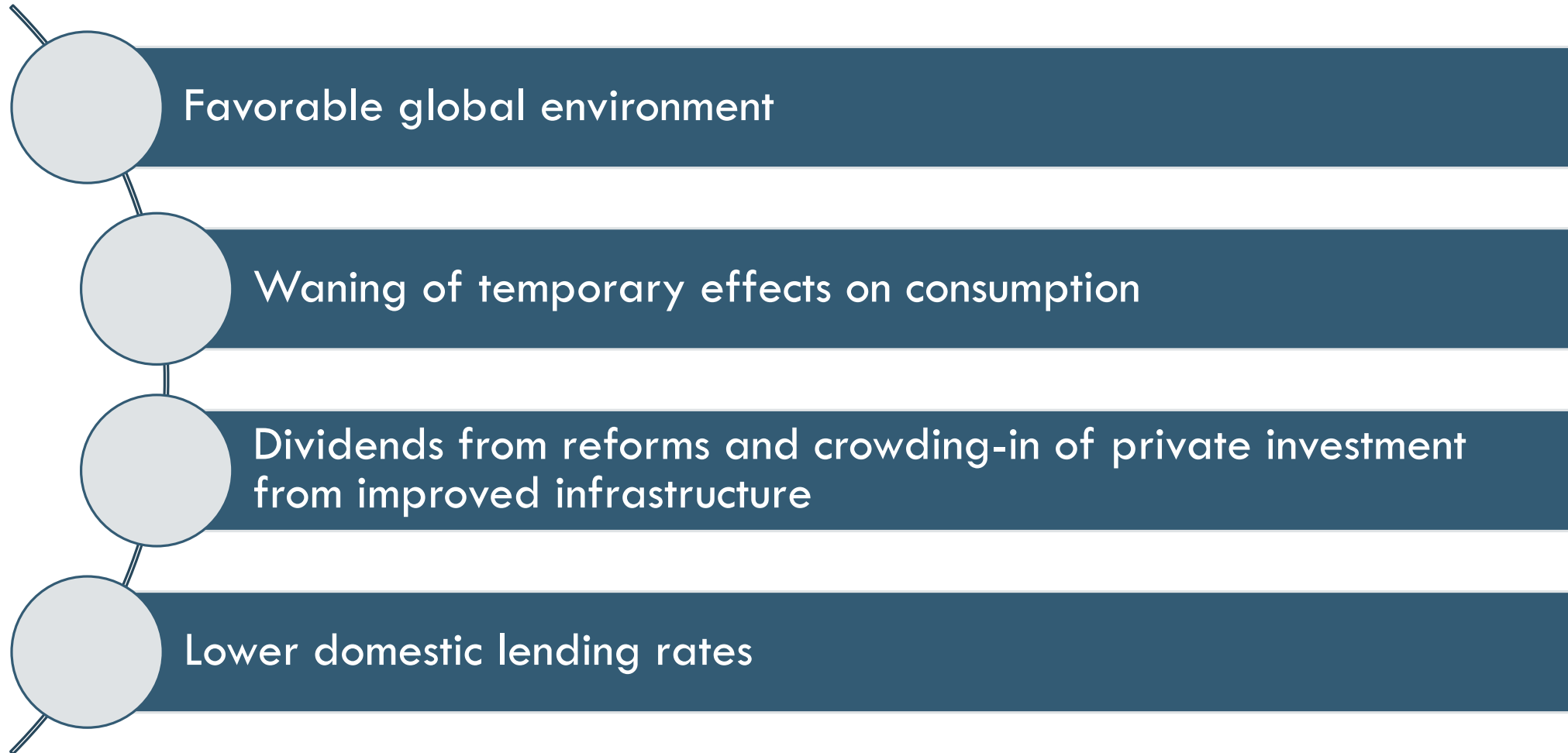
Smooth sailing or rough seas?

Real GDP growth is expected to gradually accelerate in H2 2017 and into 2018

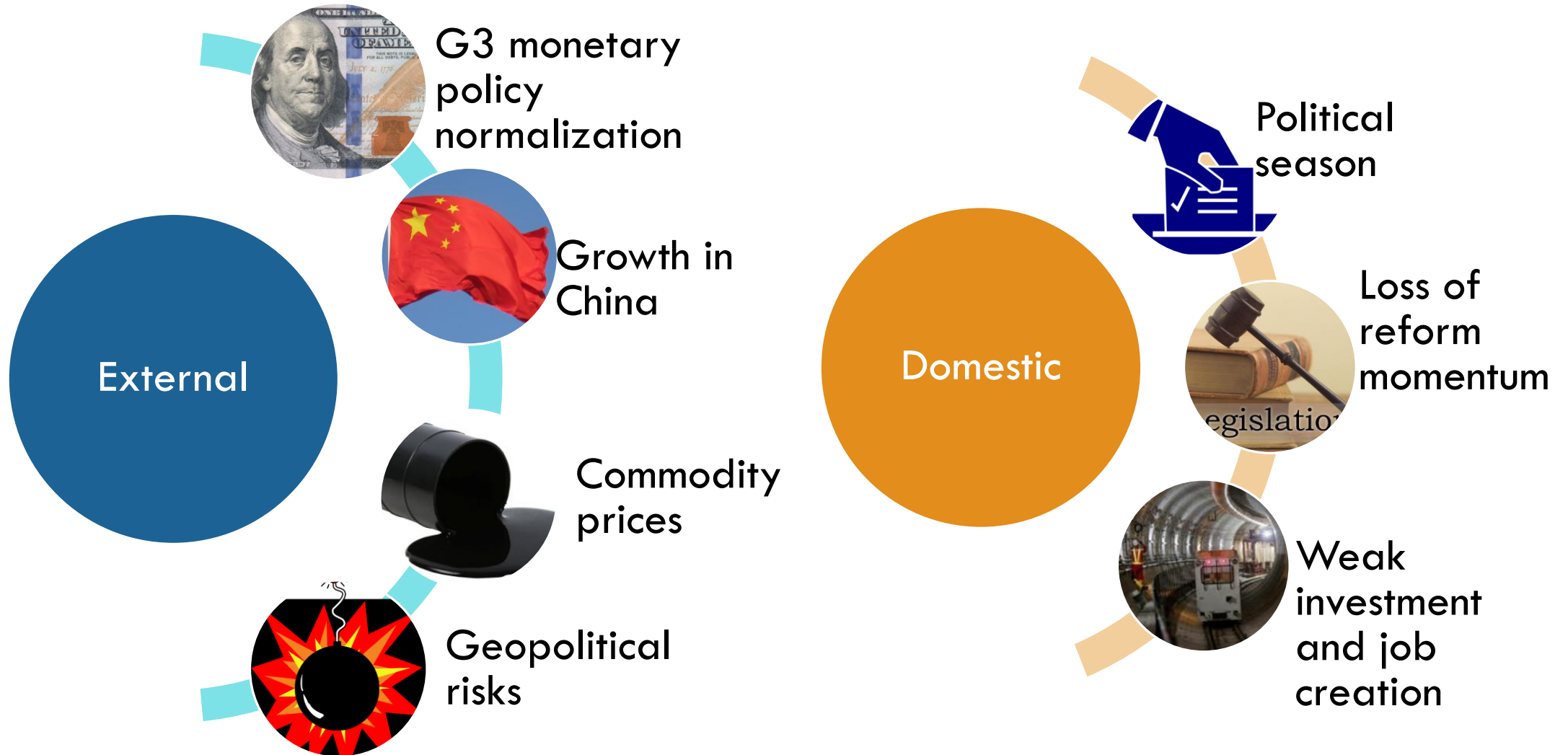
		2016	2017f	2018f
Real GDP	(Annual percent change)	5.0	5.1	5.3
Consumer price index	(Annual percent change)	3.5	4.0	3.5
Current account balance	(Percent of GDP)	-1.8	-1.7	-1.8

Source: CEIC, BPS, World Bank staff projections.

More drivers of growth in the near-term...



... despite a number of downside risks



What will it take to accelerate growth in the long term?

INCREASE COMPETITIVENESS

REDUCE INEQUALITY



Build human capital, especially through investment in the early years

Make it easier and more predictable for the private sector to invest

Close the infrastructure gap

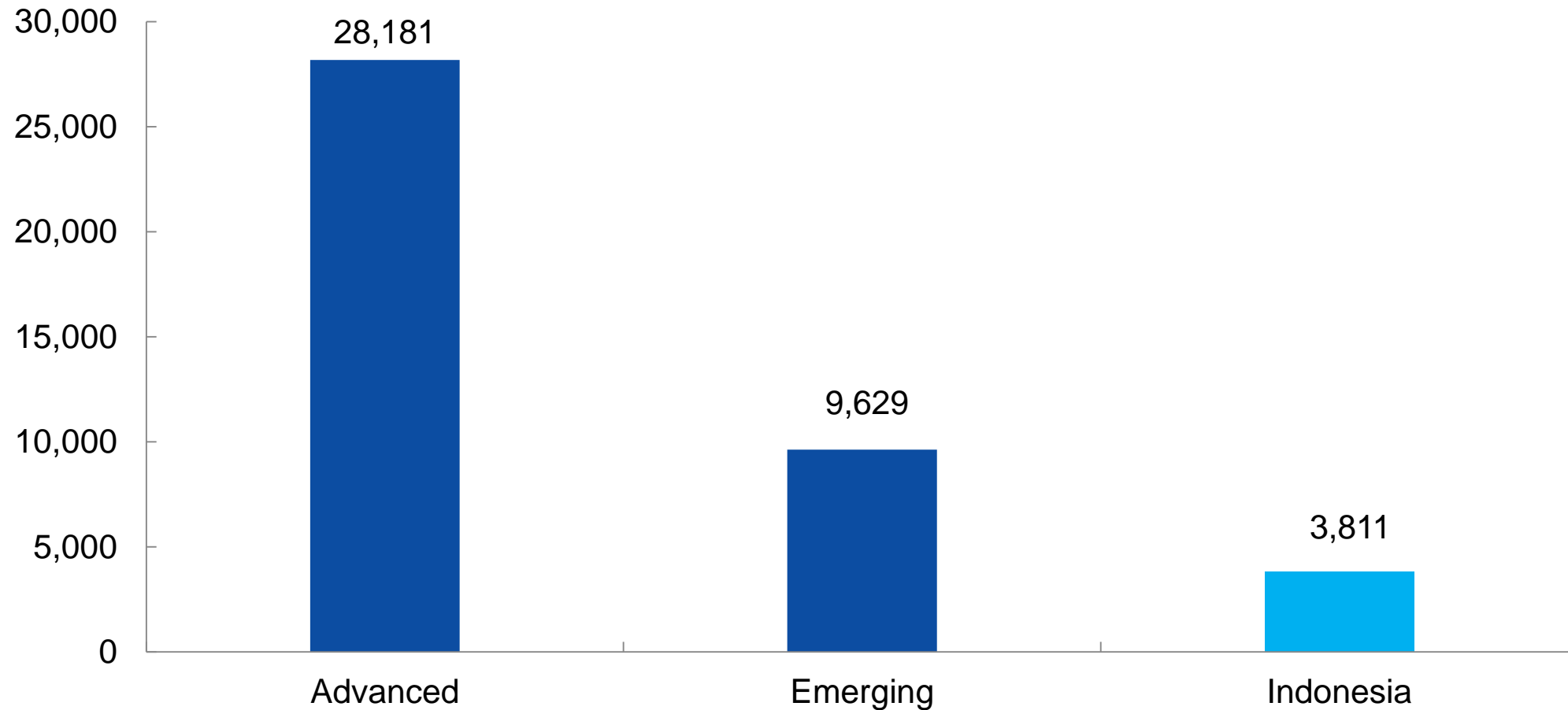
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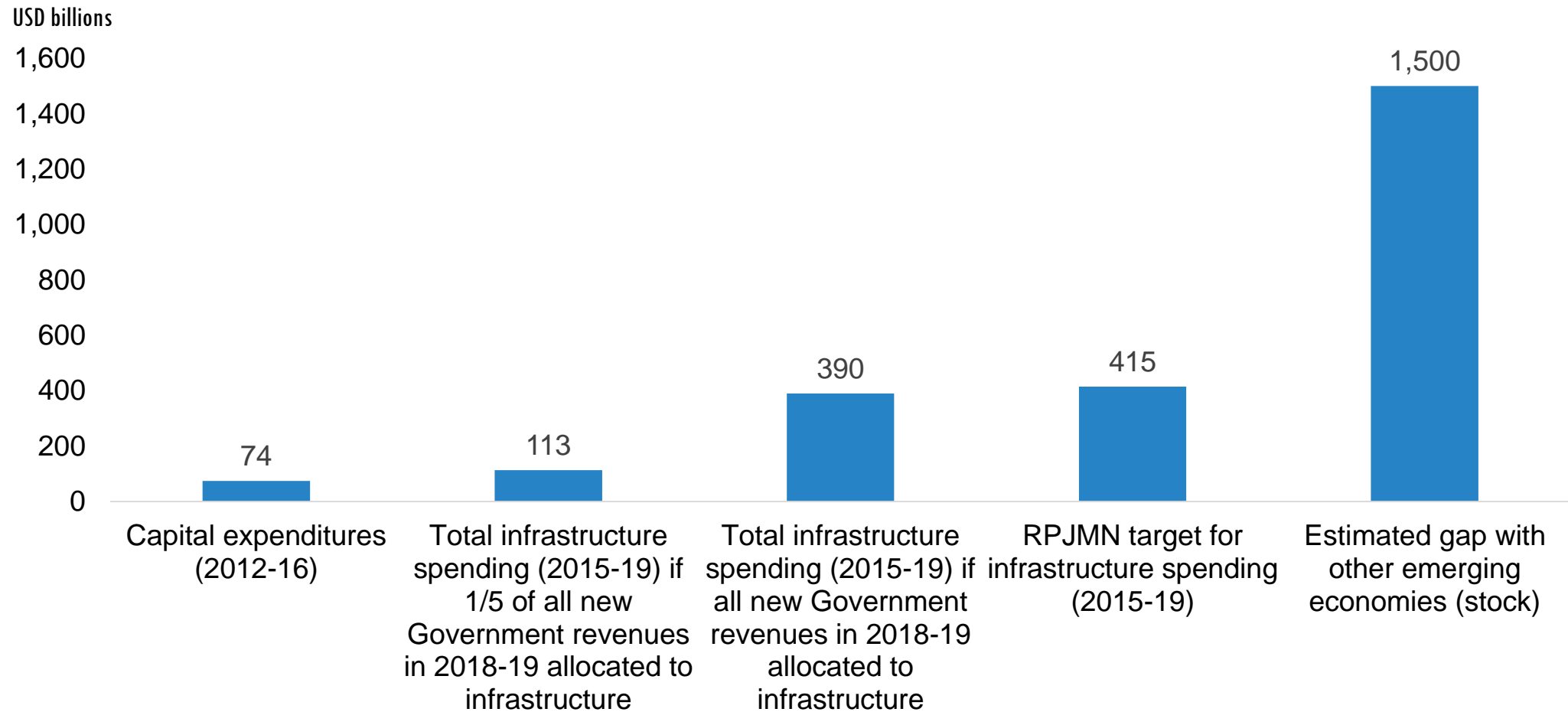
Indonesia's current public capital stock per person is low compared to both emerging and advanced economies...

Capital stock per person, constant 2010 USD



Source: World Bank staff calculations using IMF (2017) data.
Note: 2015 estimates. Unweighted averages were computed for 14 advanced economies and 21 emerging economies.

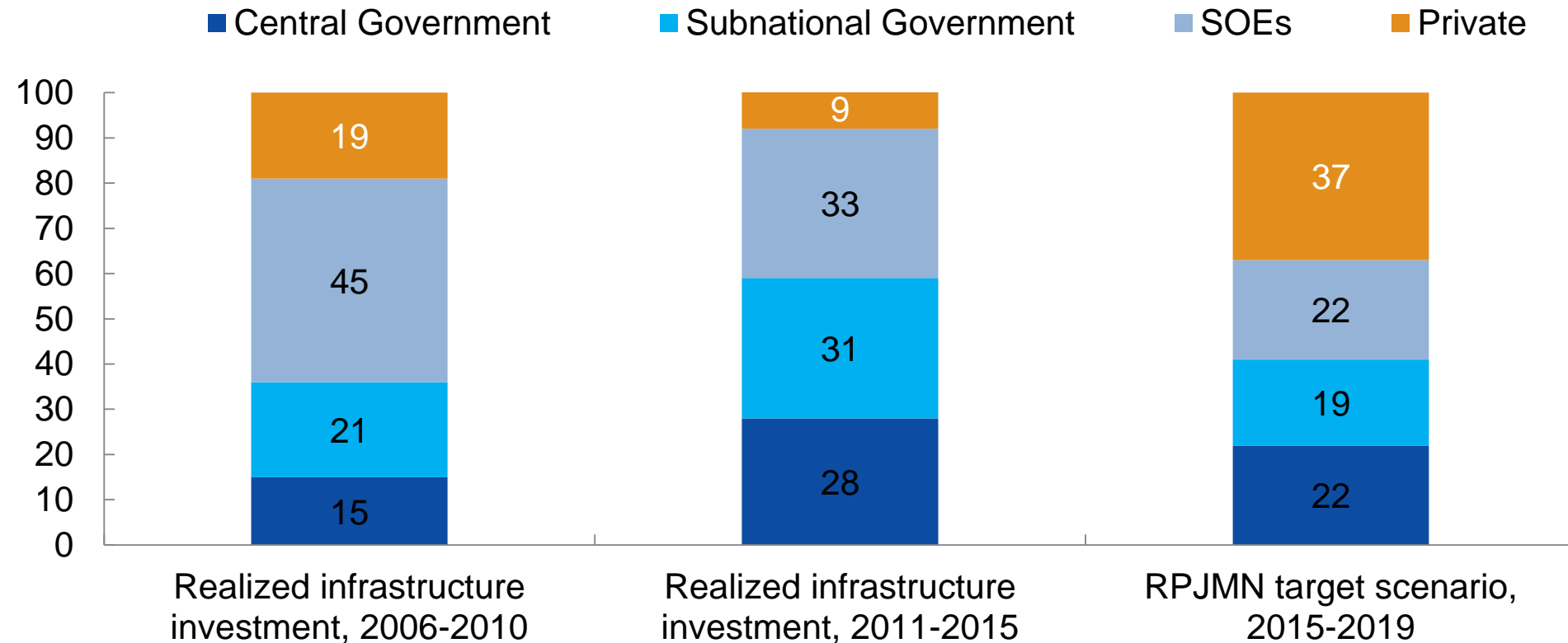
... and even if Government manages to collect more, public resources are not sufficient to meet infrastructure needs



Source: World Bank staff estimates using Central Government audited accounts and projections; World Bank staff calculations using IMF (2017) data.

To close the gap, private investment in infrastructure will need to ramp up significantly

Share of total investment in core infrastructure, percent



Source: Audited accounts of Central and Subnational Governments, SOE balance sheets, World Bank Private Participation in Infrastructure (PPI) database.

Notes: Uses methodology from World Bank (2015) and AIPEG (2017) for 2013-2016 SOE estimates. For subnational government, 2015-2016 data refers to budgeted amounts.

What will it take to close the gap?



Mobilizing the private sector for infrastructure development requires addressing four major challenges

More certainty for laws and regulations

Difficulties in identifying, selecting and preparing viable projects

SOE dominance hinders private sector interest

Limited long-term domestic currency financing for infrastructure

1. More certainty in laws and regulations → fewer delays and cancellations

Mispricing of tariffs, uncertainty regarding tariff setting and revisions

E.g. In the water sector, average tariffs paid by consumers is USD 0.28 per m³ – partly explains insufficient interest of private sector operators

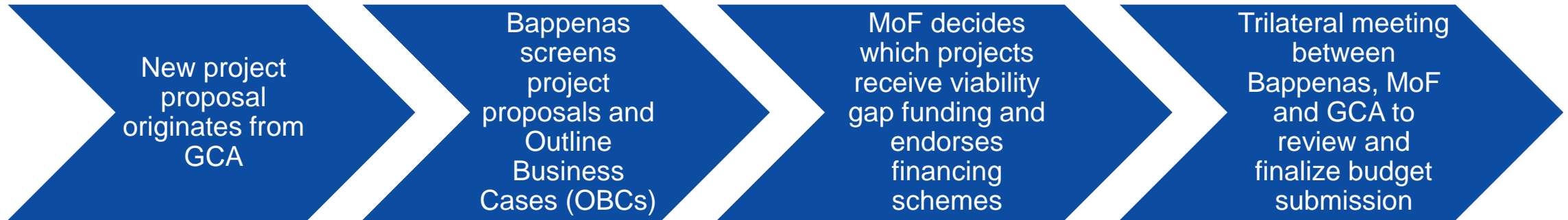
Overlapping, often inconsistent regulations (~158 laws and regulations related to PPP)

E.g. in February 2015 the Constitutional Court invoked Law 07/2004 on Water Resources due to a broad reading of Article 33 → Implication: Private sector not allowed to operate water distribution networks

Delays in obtaining permits and approvals

Interviews with investors indicate that the permits regime is still cumbersome despite efforts to establish a one-stop integrated services center and a fast-track online system

2. Challenges in identifying, selecting and preparing viable projects → lack of 'bankable' projects for the market



Ability for GCA to conduct rigorous assessment could be improved

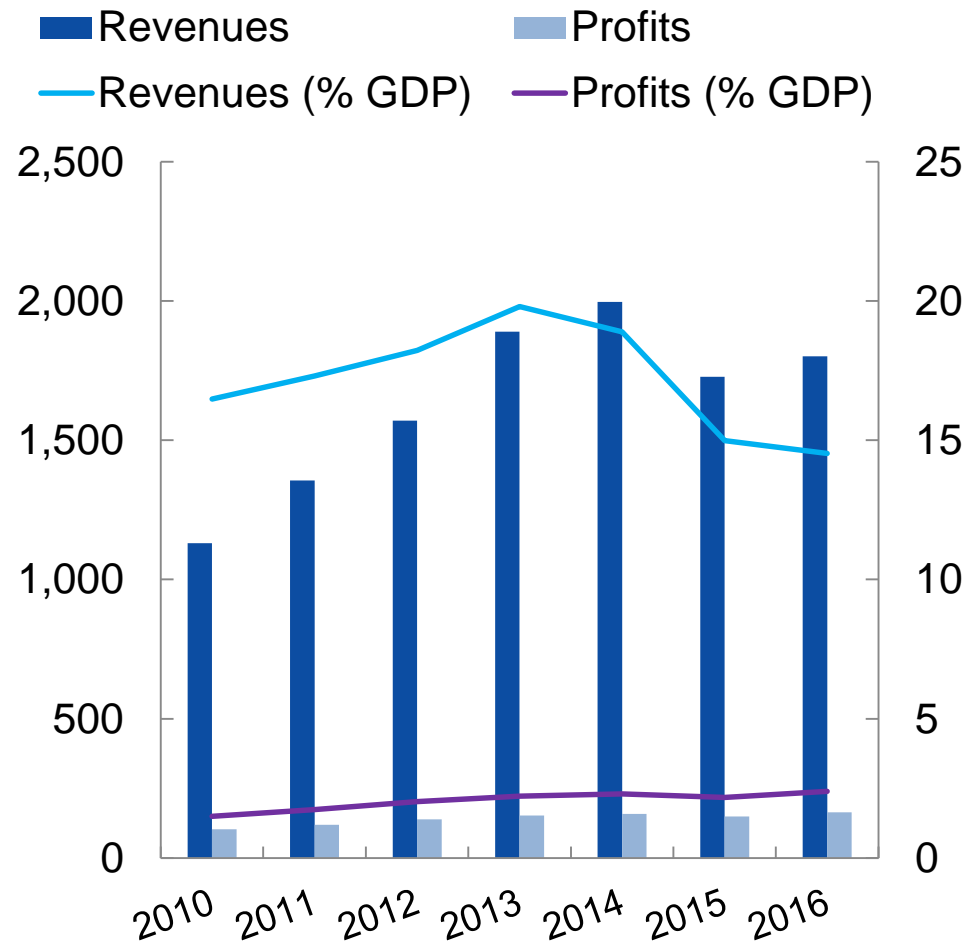
Procurement regulations and remuneration caps prevent GCAs from hiring qualified external consultants

Due to staffing and budget constraints, Bappenas cannot make up for relative lack of project preparation by GCAs

Coordination could be enhanced among mechanisms to allocate projects to different Government support instruments (viability gap, availability payments etc.)

3. SOEs play an important role in boosting infrastructure stock, but their dominance also crowds out private sector investment

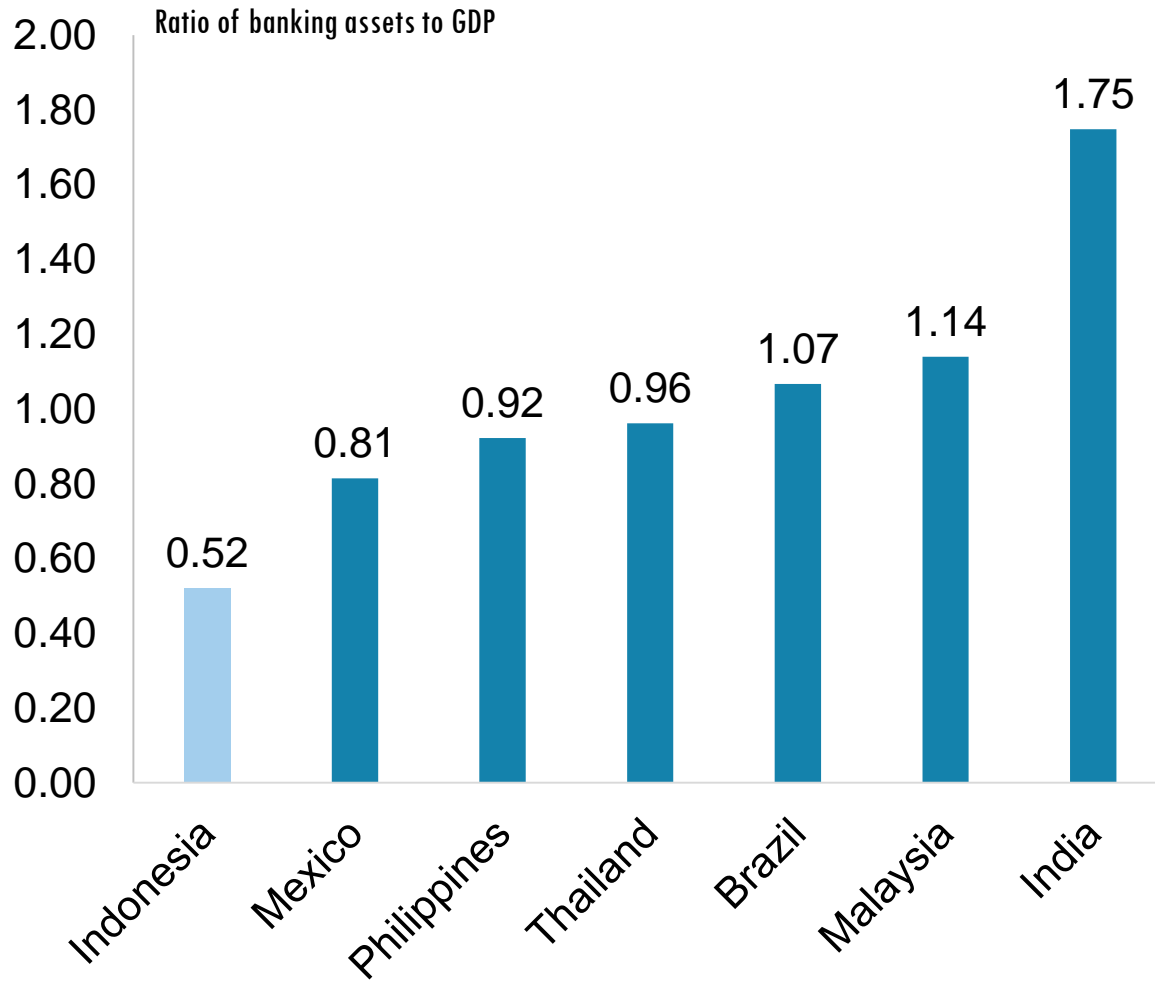
IDR trillions, LHS; Percent of GDP, RHS



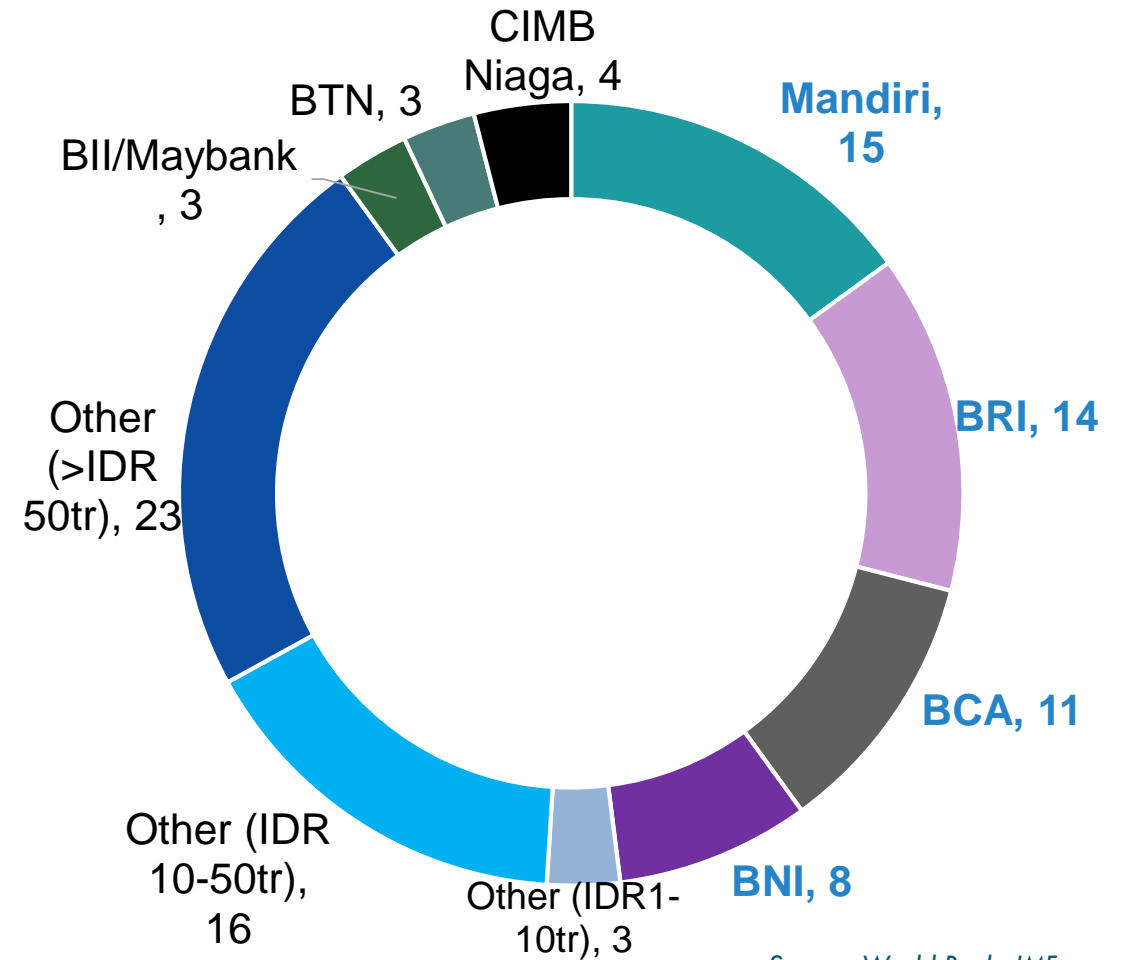
Source: Ministry of SOEs and press reports, World Bank staff calculations.

- SOEs account for about a third of core infrastructure spending, but have not always delivered infrastructure efficiently: declining revenues and flat profits as percent of GDP
- Crowding out:
 - Electricity – Only 9 percent of installed generation capacity by private power utilities and captive generation
 - Transport – Private sector only accounts for 33 percent in total length of completed roads, less than 15 percent of roads under construction/awarded/assigned
- SOEs benefit from direct assignment and access to cheaper sources of financing

4. Small, concentrated banking sector limits availability of infrastructure financing...



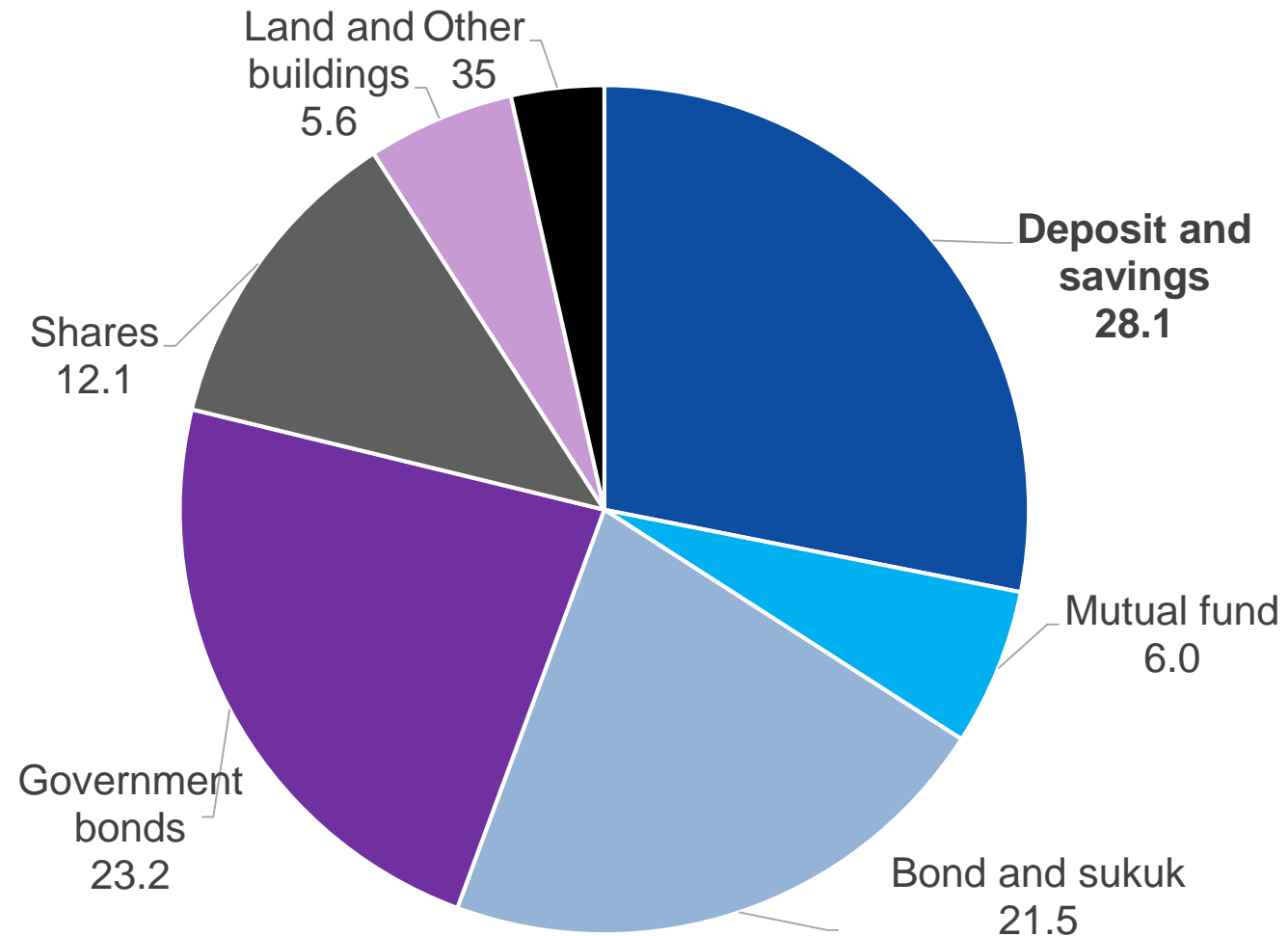
Share of total banking assets, %



Source: World Bank, IMF.

4. ...and domestic institutional investors are mostly focused on short-term gains

Share of pension fund investments, percent



Source: OJK (July 2017), World Bank staff calculations.

Now is the time to act to attract more private investments in infrastructure



One-belt-one road: USD275 billion in South and SE Asia

Global interest rates going up as monetary policy is finally heading towards normalization

Low levels of indebtedness create space for prudent expansion of PPP guarantees

INDONESIA
ECONOMIC
QUARTERLY

October 2017

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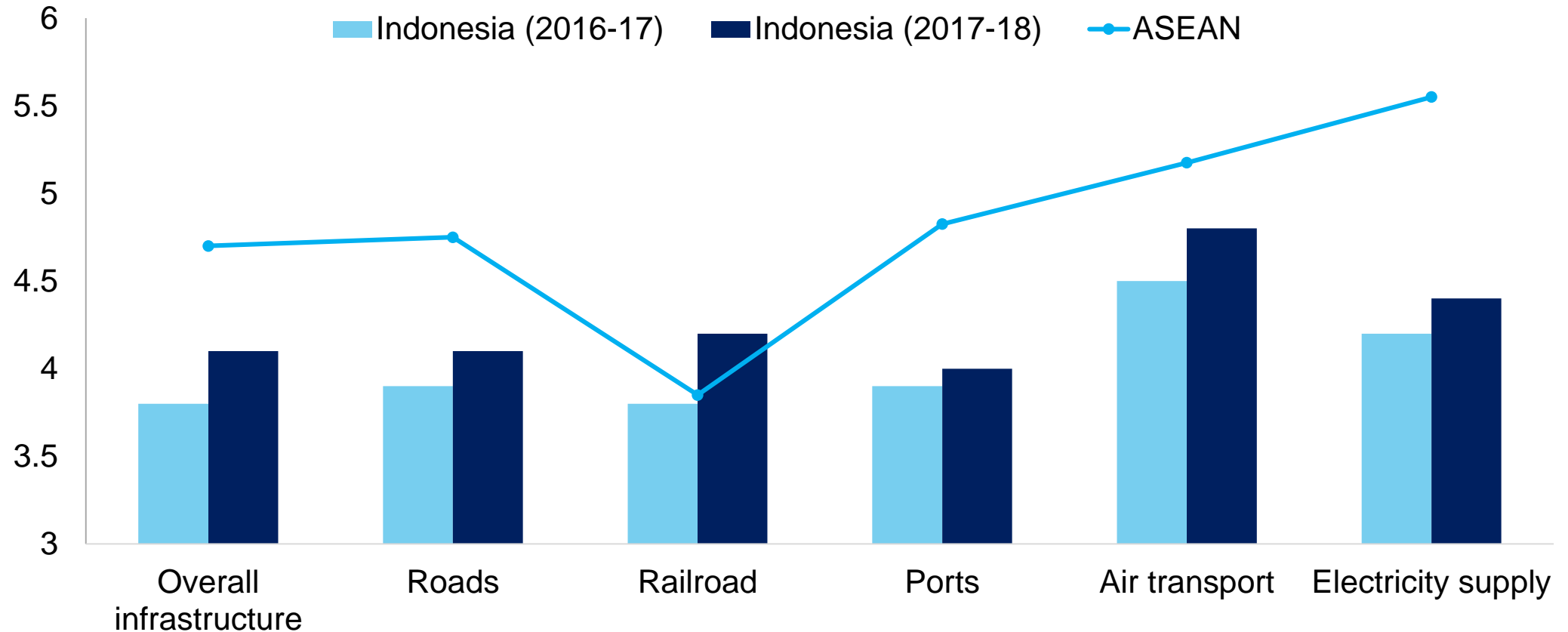
TERIMA
KASIH

THANK YOU



While improving recently, quality of infrastructure is perceived to be lower than in ASEAN peers

(indices of infrastructure quality; 1(worst) to 7(best) points)



Source: World Bank staff calculations using World Economic Forum Global Competitiveness Report data
Note: ASEAN is the unweighted average of Malaysia, Singapore, Thailand and Philippines; BRICS is the unweighted average of Brazil, Russia, India, China, South Africa