



WORLD BANK GROUP

Indonesia Economic Quarterly March 2017

Staying the Course

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March 22, 2017

Key Takeaways

2016 stronger economic fundamentals despite global uncertainty

- Growth was higher than previous year for first time in five years

Prospects for a pick up are subject to risks and challenges

- Early signs of pickup including on consumer spending, employment, revenue collection and infrastructure spending.

Staying the course crucial for realizing prospects

- Maintain vigilance, continue strong macro-economic management, sustain reform momentum.
 - Opportunity to raise competitiveness by reducing restrictiveness of service sector
 - Review subsidy programs (KUR)



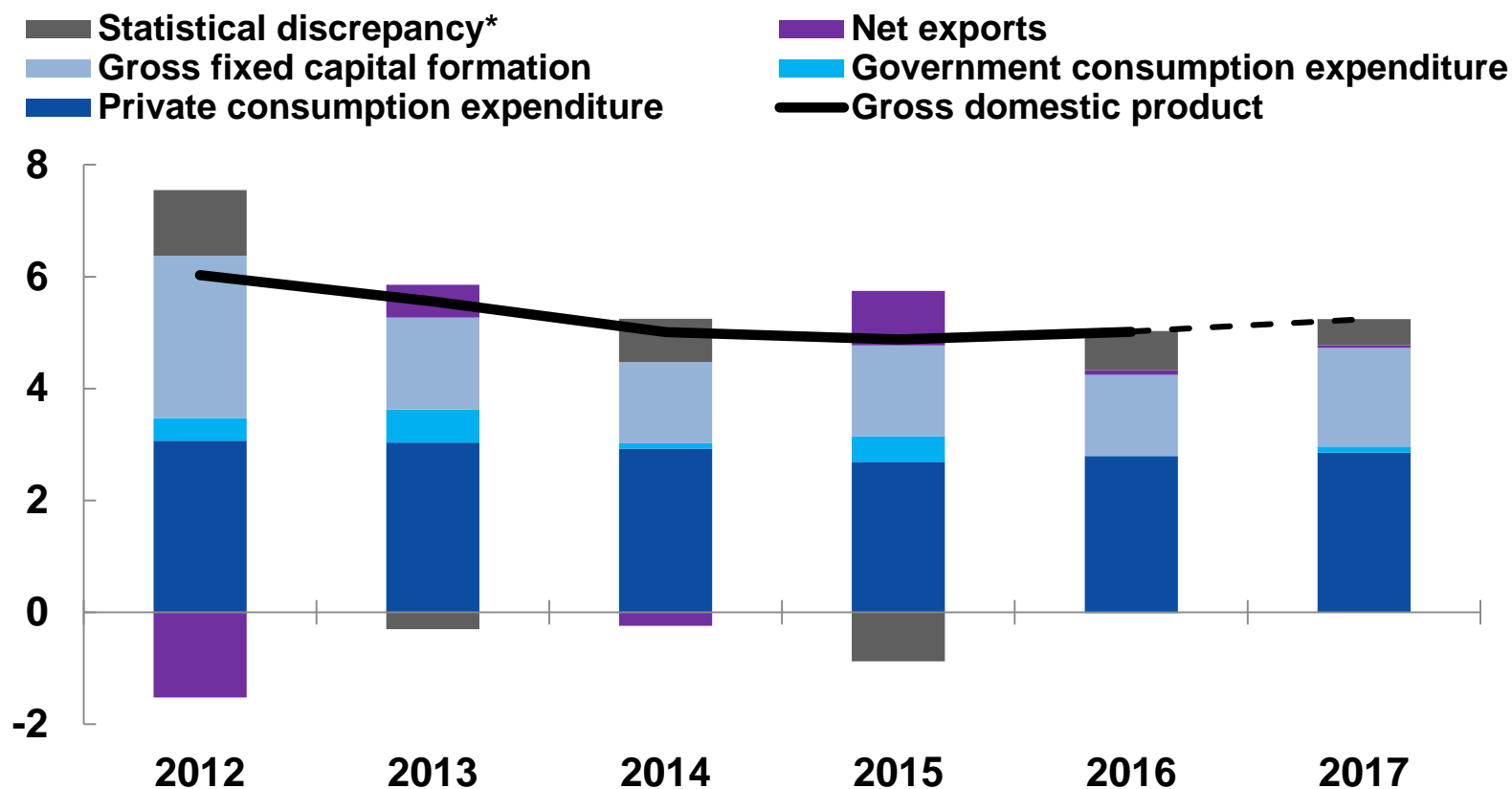
2016 stronger fundamentals despite global uncertainty

Prospects for a pick up, but subject to risks and challenges

Staying the course is crucial for realizing prospects

Despite global headwinds, annual real growth increased in 2016, for the first time in 5 years...

Contributions to GDP growth, percentage points



....as part of a broader strengthening of economic fundamentals

| | | 2015 | 2016 |
|--------------------------------|-------------------------|------|------|
| Real GDP | (Annual percent change) | 4.9 | 5 |
| Consumer price index | (Annual percent change) | 6.4 | 3.5 |
| Current account balance | (Percent of GDP) | -2.0 | -1.8 |
| Budget balance | (Percent of GDP) | -2.6 | -2.5 |

Source: BI: BPS; MoF; World Bank staff calculations

Note: 2016 actual outcome; f stands for forecast

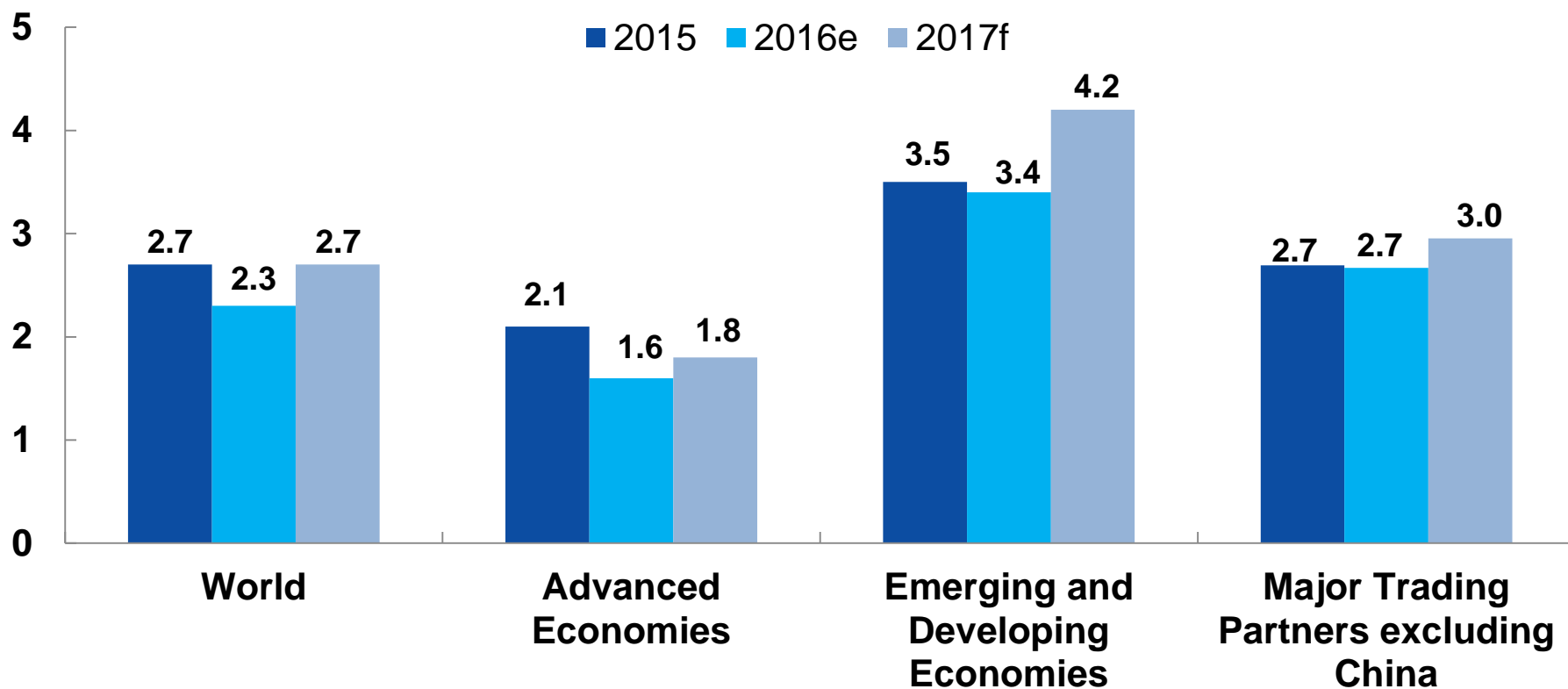
Robust growth in the face of global uncertainty

Prospects for a pick up, but subject to risks and challenges

Staying the course crucial for realizing prospects

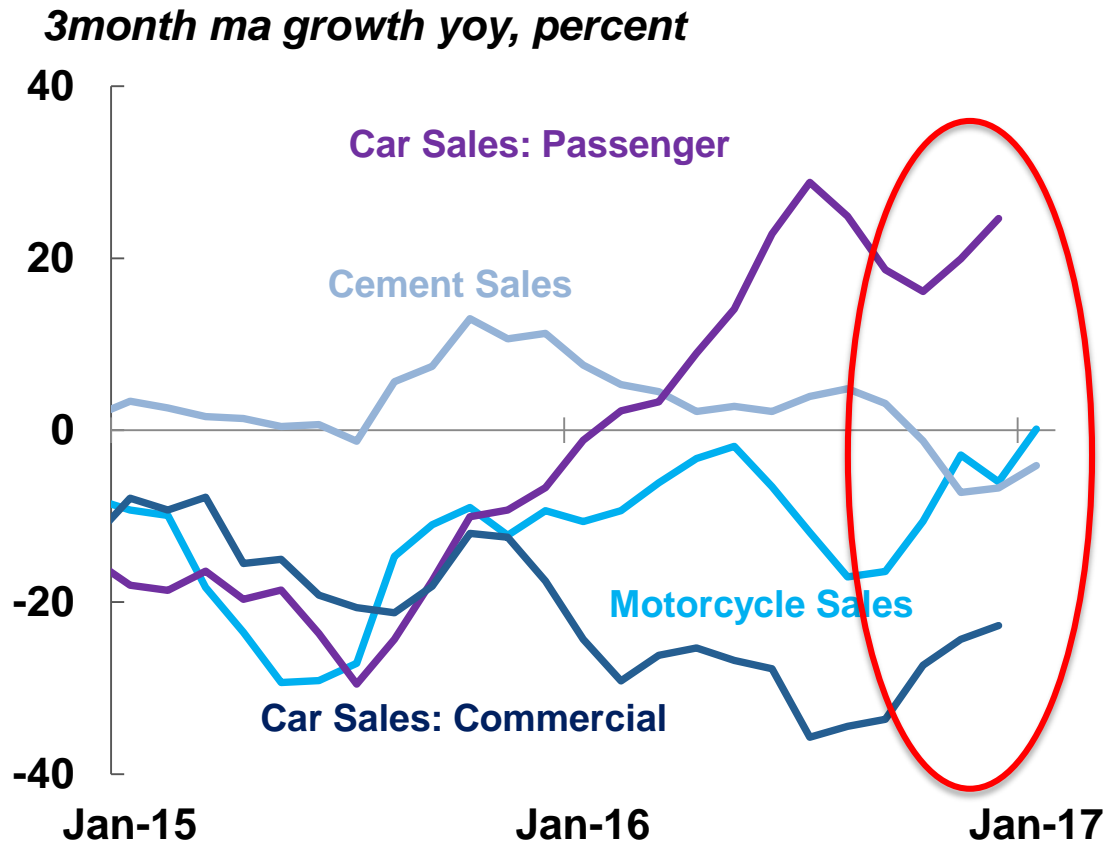
External conditions are forecast to firm up.

Percent, growth



Early shoots of consumer confidence emerging...

Consumer durables leading indicators

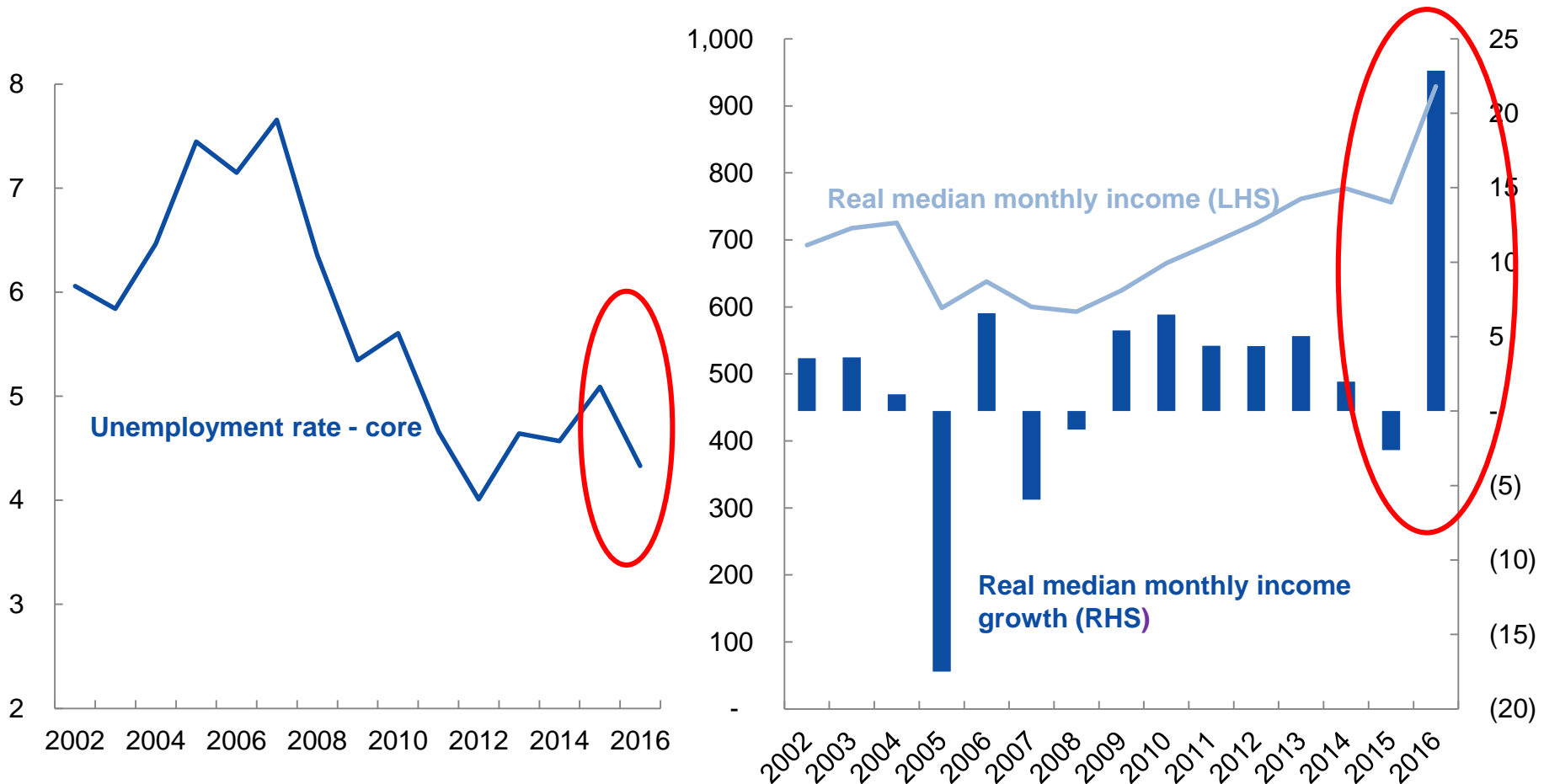


Source: BPS; Nikkei/Markit

Source: ASI; GAI; World Bank staff calculations

...supported by an employment rebound and real wages.

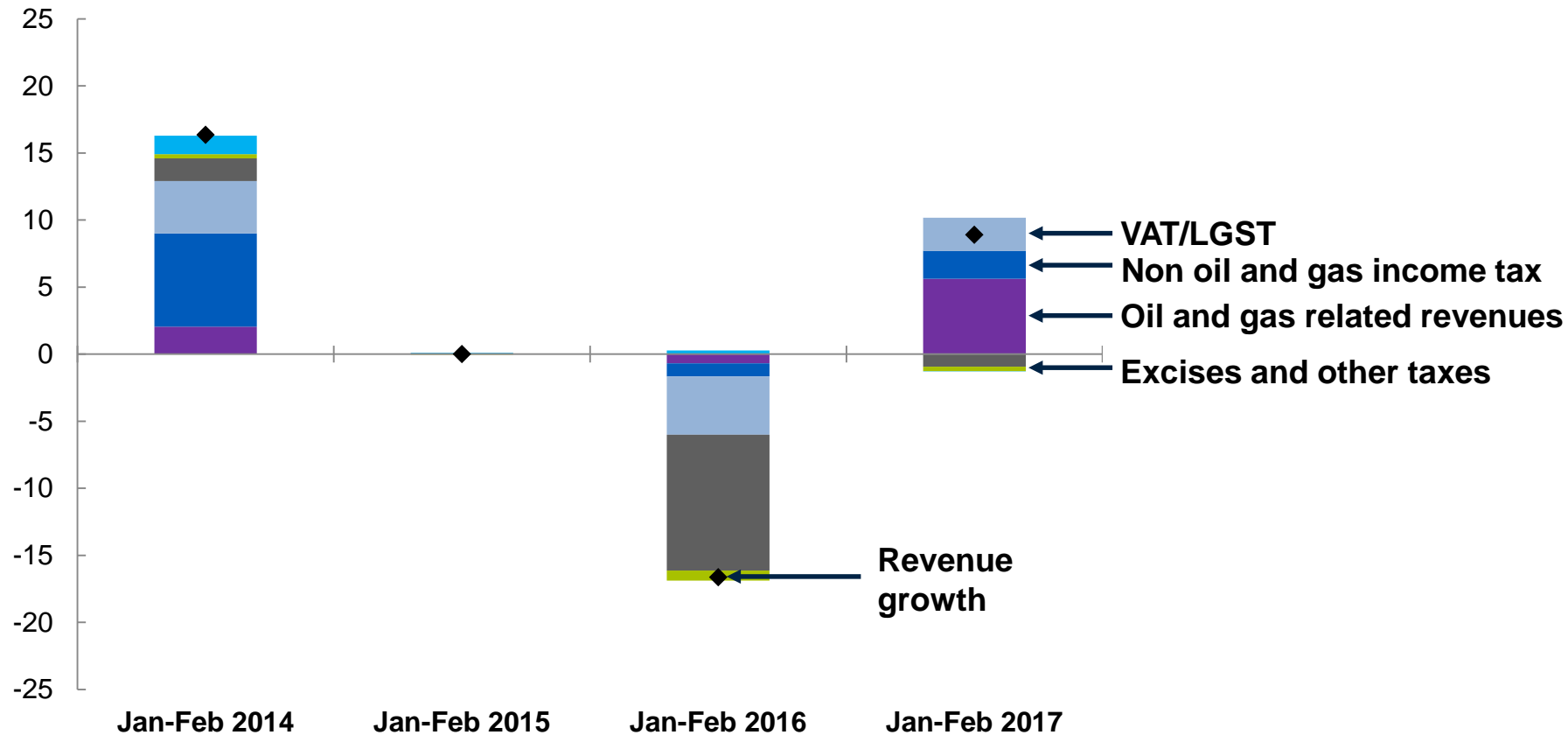
- Core unemployment fell to its lowest rate since 2012 and real earnings growth appeared to strengthen significantly in 2016



Tax collection is picking up again (Jan-Feb)...

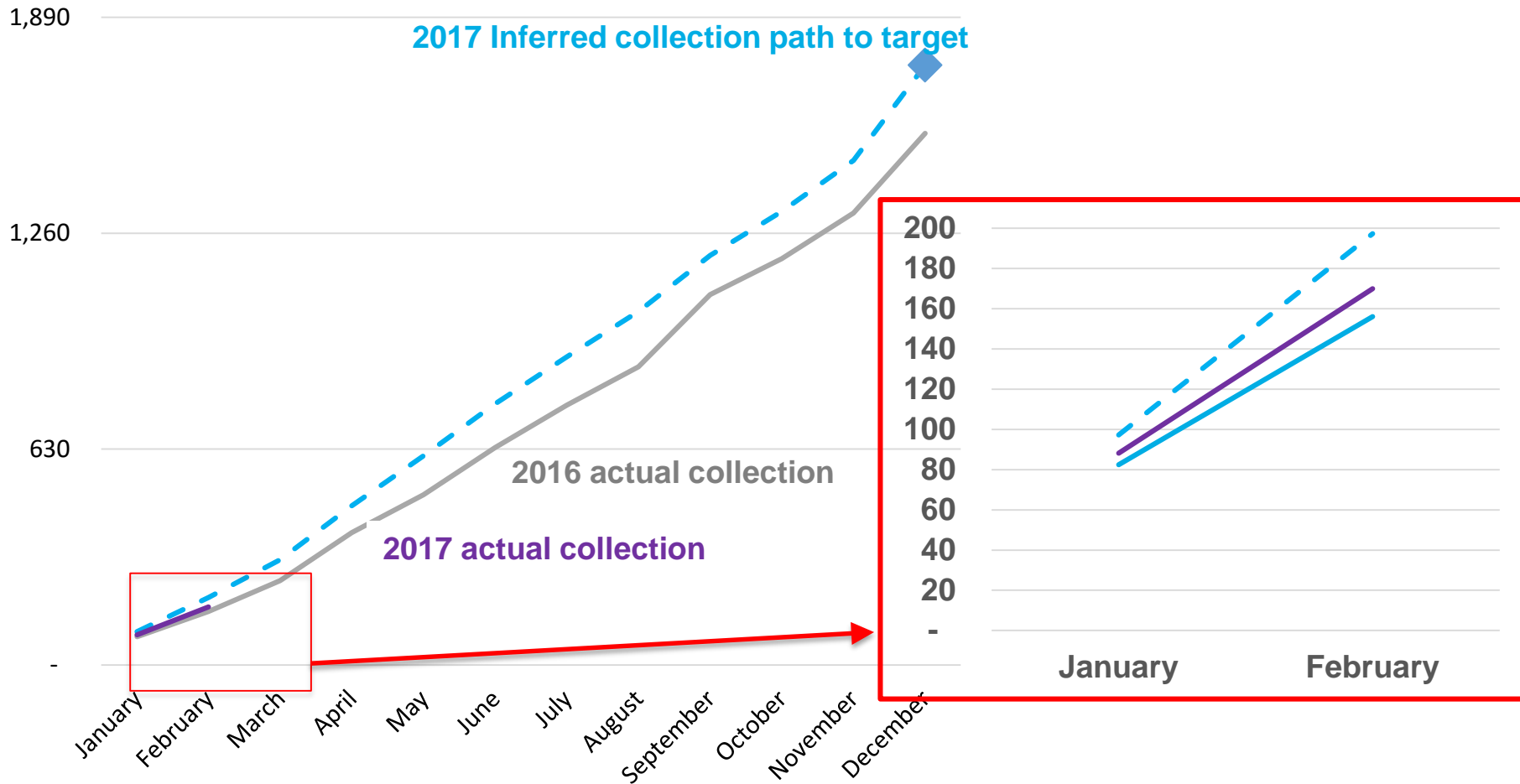
- Total revenue collection increased by 8.9 percent yoy, but levels are still lower than 2014 and 2015

Contributions to annual revenue growth,
Percentage Points



...but there is a long way to go to meet 2017 targets.

IDR Trillion

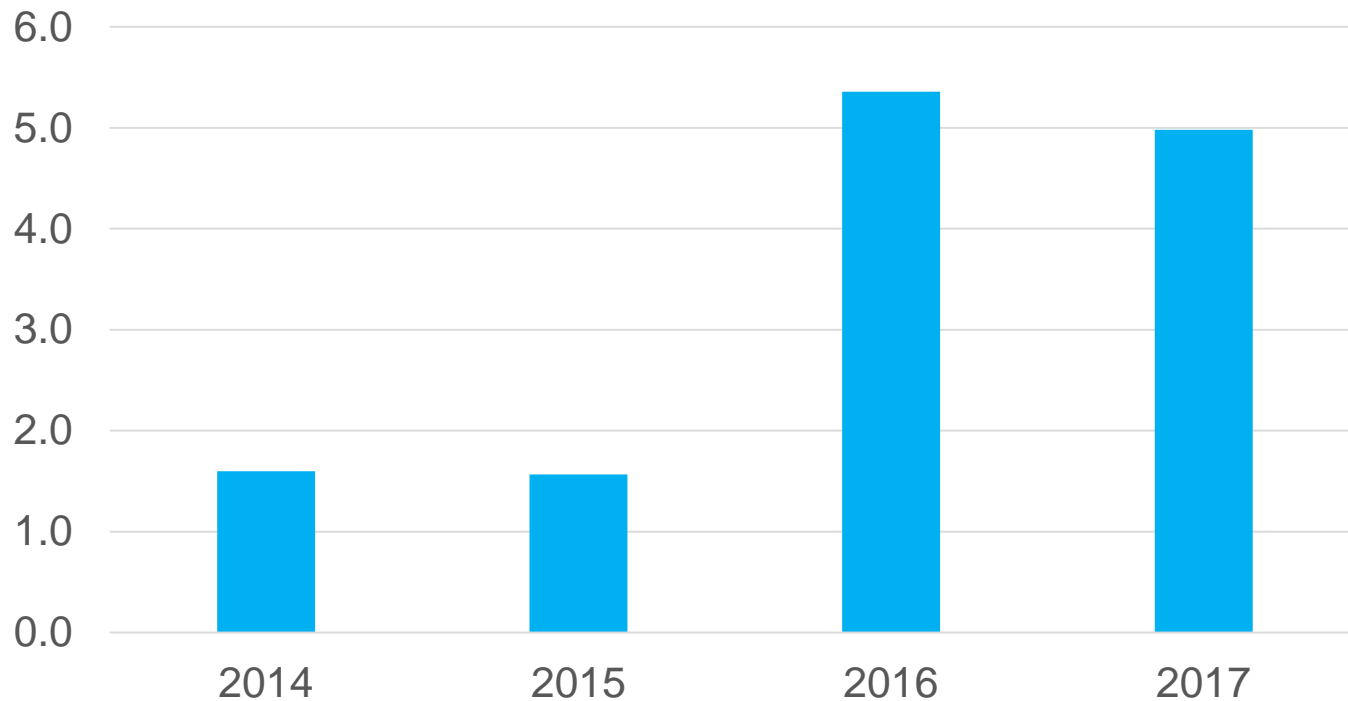


- Source: Ministry of Finance Data; World Bank staff calculations
- Note: Target revenue path is calculated by using the average percentage monthly contributions to total revenues (2010-16) and the Budget 2017 Total Revenues target

Government capital spending began 2017 well.

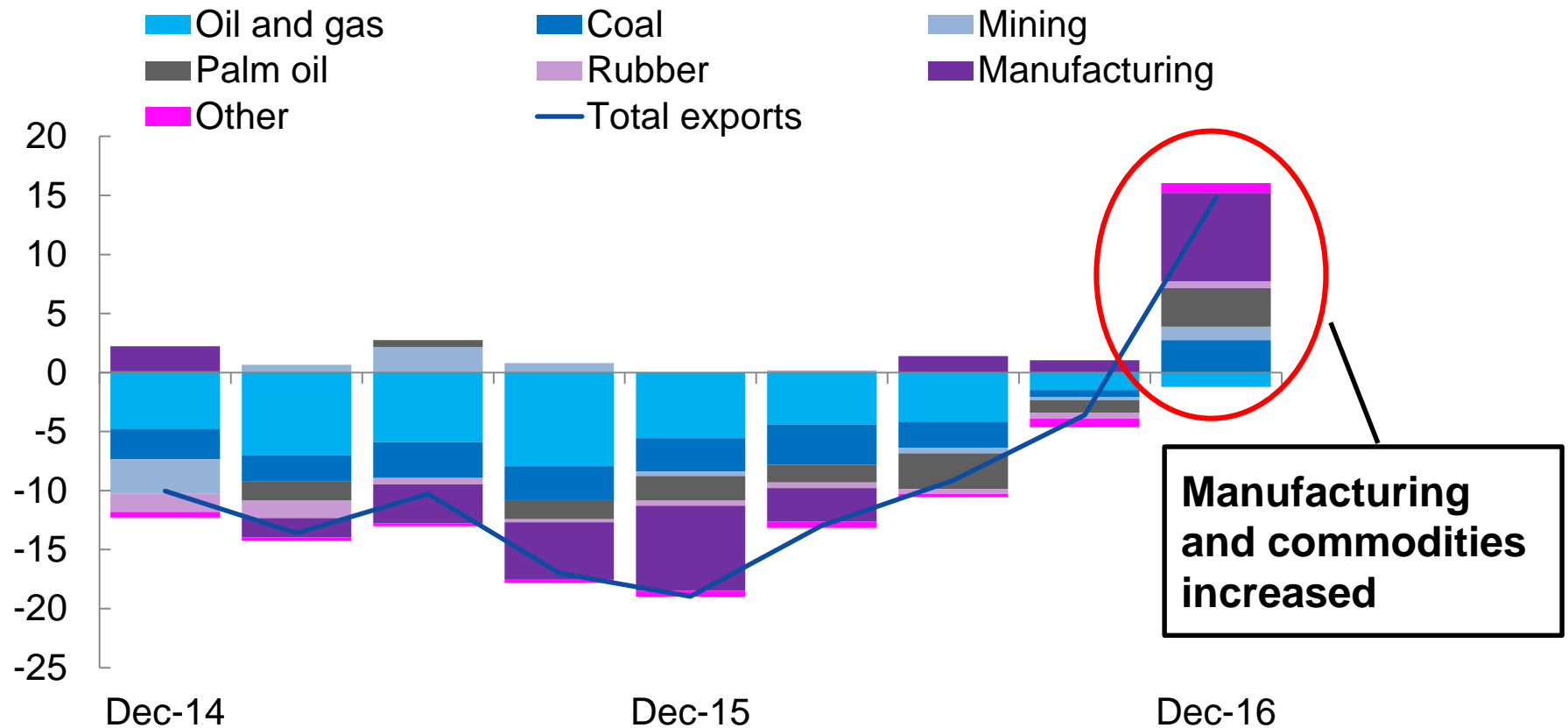
- January-February capital expenditure sustains high level achieved in 2016;
- Early procurement policy continued: by mid February, a third of Ministry of Public Works budget had been contracted

Jan-Feb capital expenditure outturns
(IDR Trillion)



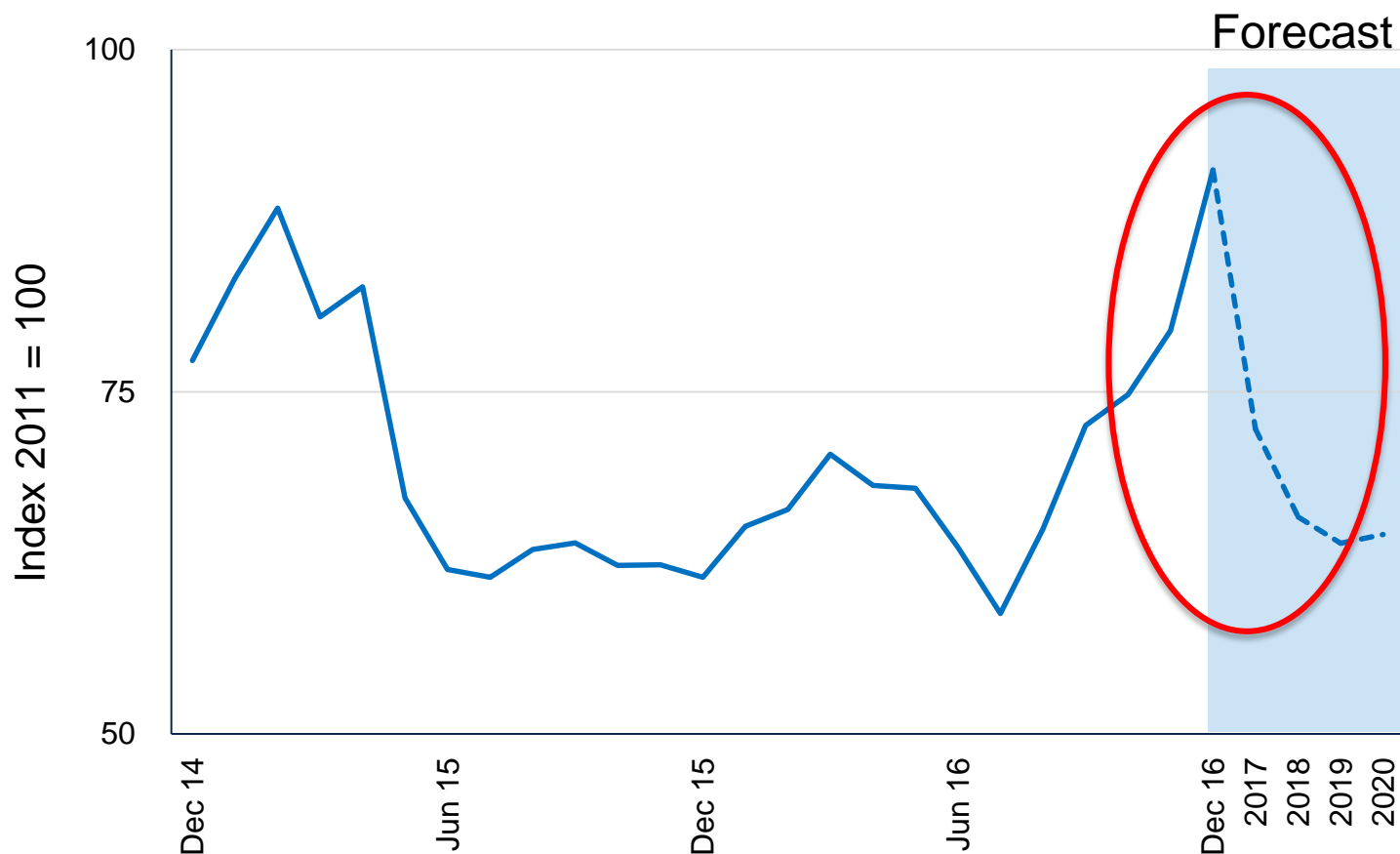
Exports are growing for the first time since 2013, carried by manufacturing, and commodities....

Contributions to goods exports values growth, percentage points



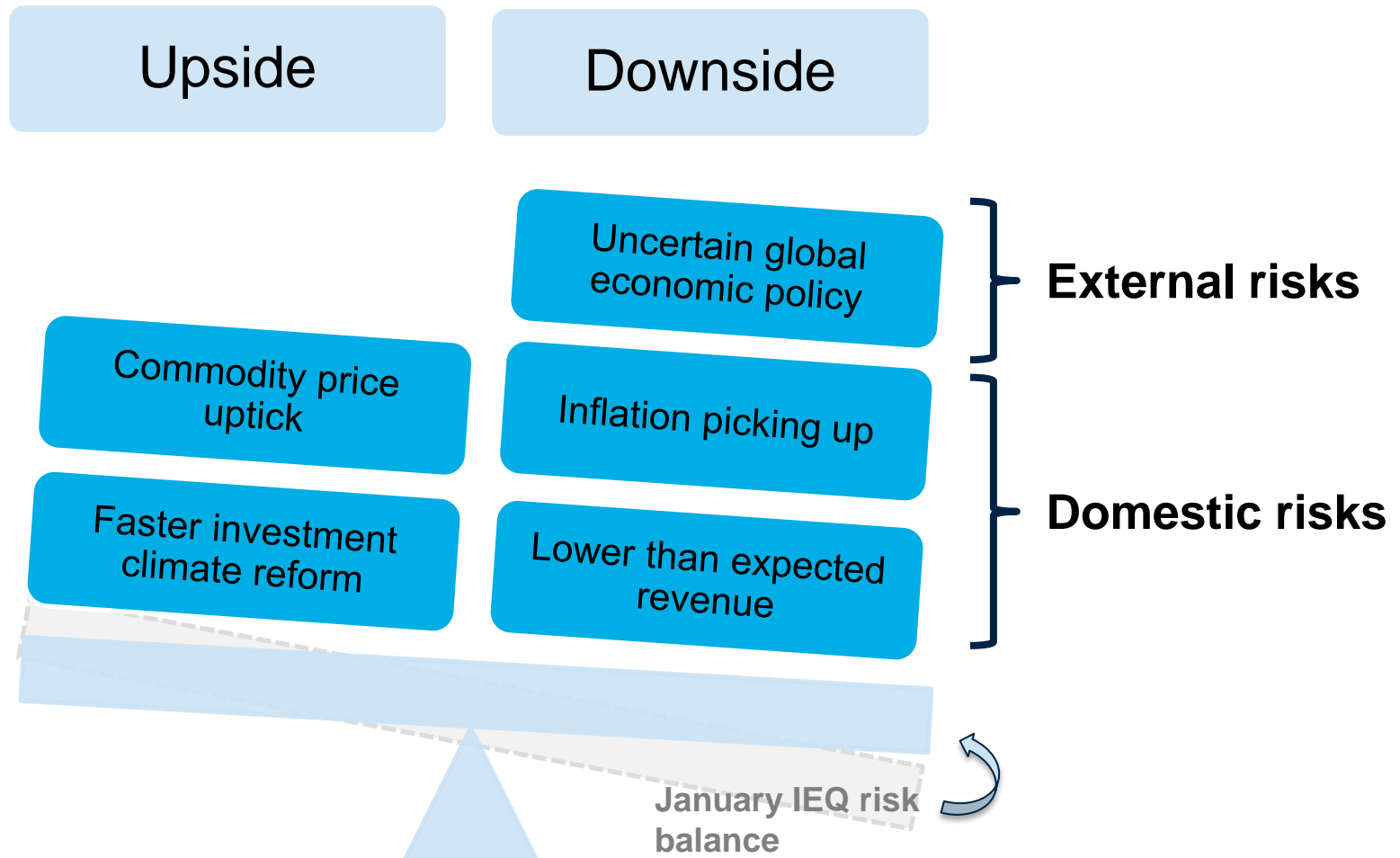
...supported by a positive commodities terms of trade shock, which forecasts suggest will be temporary

- Energy prices forecast to surge 26 percent this year



Source: World Bank Pink Sheet; CEIC; World Bank (2017); World Bank Staff Calculation

Downside risks easing but still dominate upside



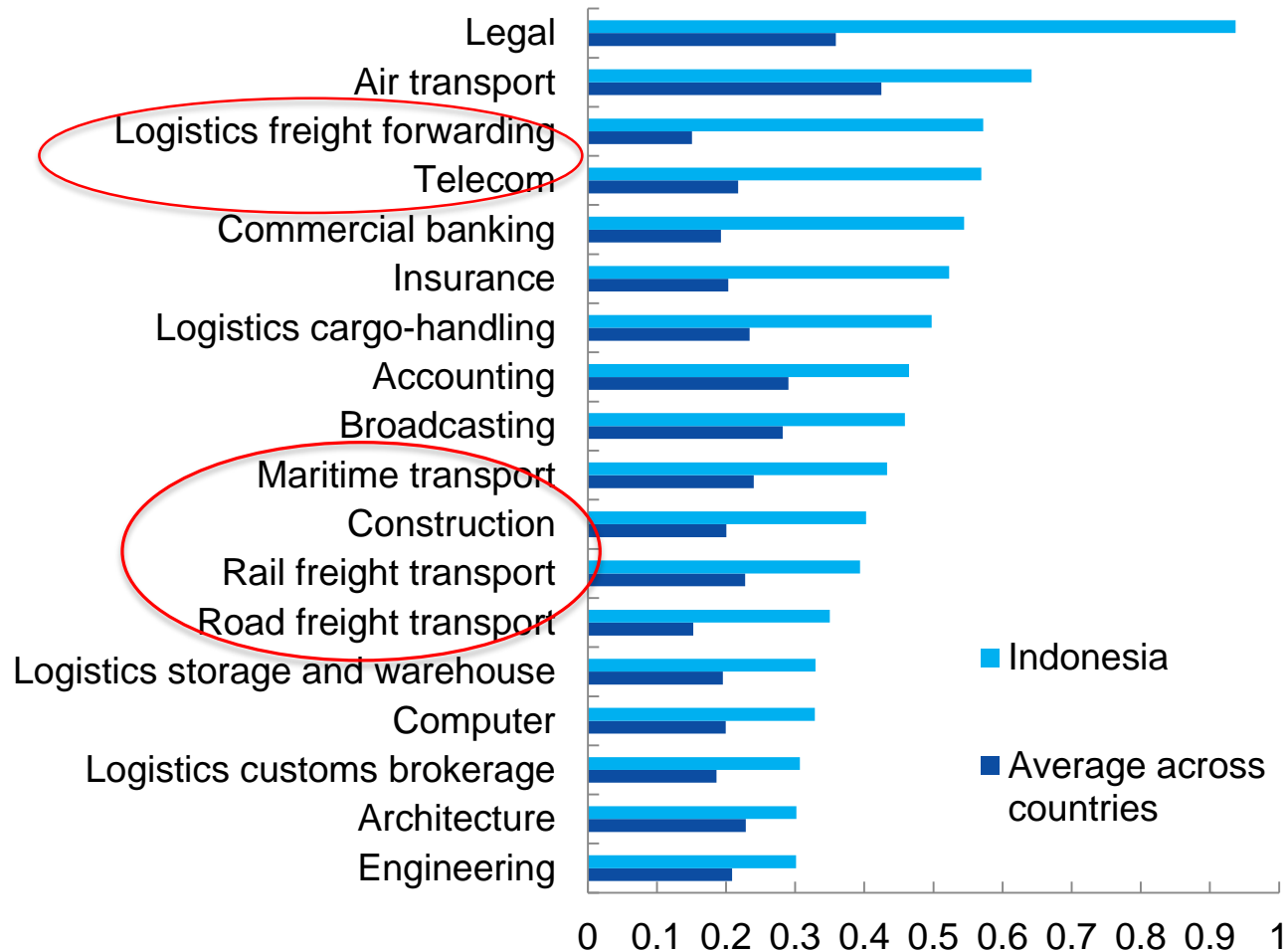
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Staying the course by, for example, reforming services sector...

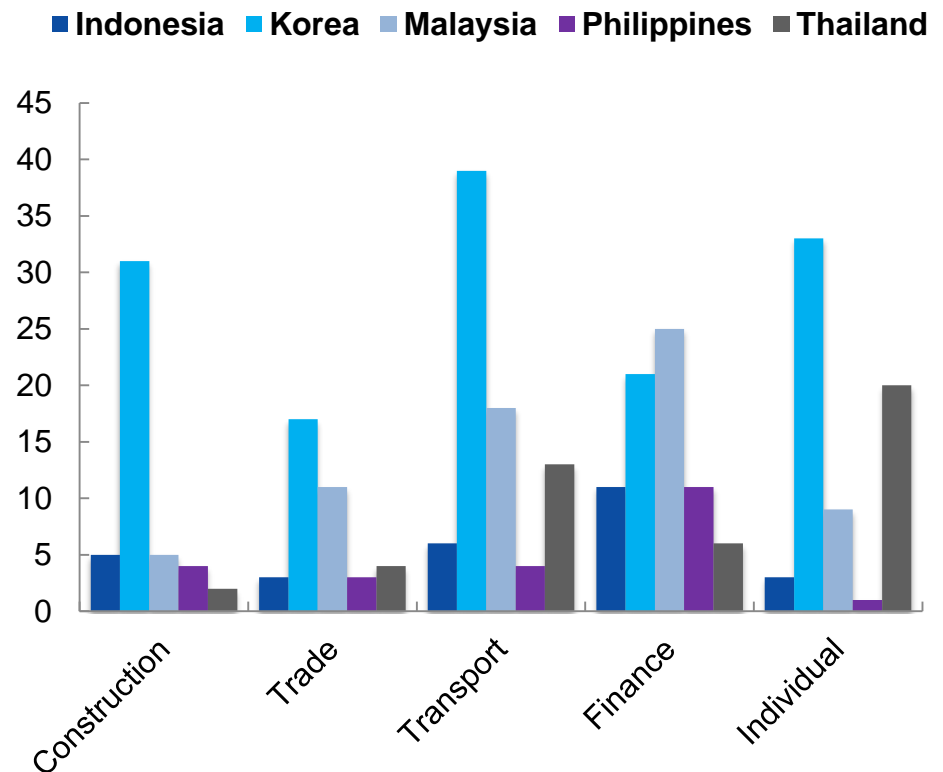
- Indonesia is in the top decile of countries in terms of restrictions



...to improve service sector productivity and competitiveness.

- By removing barriers to services trade, increased openness would likely:
 - ✓ Improve quality
 - ✓ Reduce price for some sectors
 - ✓ Help facilitate introduction of new services
 - ✓ Expose domestic market to new knowledge

Indonesia has relatively low productivity in a number of areas



Review costly, regressive and untargeted subsidies like the KUR program.

5 reasons to re-consider the new KUR program's effectiveness*

| Principle | Reason new KUR program is not optimal |
|---------------------------|---|
| Relevance | X Sustainable loans access more important for MSMEs than lower interest rates |
| Costs | X Expansive coverage of KUR means higher costs |
| Competitive environment | X High risk market for MSME loans impeded as subsidies crowd out commercial lending |
| Equity among participants | X Regressive, as total subsidy Government pays increases linearly with loans size |
| Sustainability | X Current KUR interest rate deviates significantly from market rates and is not financially sustainable |

* Original KUR program introduced 2007; new design introduced 2015

Terima Kasih