INDONESIA

Table 1	2020
Population, million	273.5
GDP, current US$ billion	1058.4
GDP per capita, current US$	3869.8
International poverty rate ($1.9)[a]	2.7
Lower middle-income poverty rate ($3.2)[a]	19.9
Upper middle-income poverty rate ($5.5)[a]	52.2
Gini index[a]	38.2
School enrollment, primary (% gross)[b]	106.4
Life expectancy at birth, years[b]	71.7

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2019), 2011 PPPs.
(b) WDI for School enrollment (2018); Life expectancy (2019).

A surge in COVID cases in July-August has slowed a nascent economic rebound during Q2 2021. Although the COVID situation and vaccination are improving gradually, pandemic risks remain high. The authorities are maintaining a countercyclical fiscal and monetary policy stance to support the economy. Growth is projected to rebound to 3.7 percent in 2021 and 5.2 percent in 2022. International poverty rates are expected to decline, but at a slower pace. Risks to the outlook are tilted to the downside.

Key conditions and challenges

Indonesia's economy has diversified in past decades but suffers from weak competition, limited economic integration, human capital gaps, and under-developed financial markets.

Strong employment growth in the past decade was mostly in low productivity services. These sectors have been severely impacted by the COVID-19 crisis. They also host many informal workers that fall outside of the social assistance net. The impact of the pandemic on labor income is reversing some of the poverty reduction gains in the past decade.

The COVID-19 crisis heightens Indonesia's long-standing challenges of financing its development needs. Tax revenues, for instance, are low compared to peers at less than 11 percent of GDP over the past decade. Indonesia remains relatively dependent on portfolio and debt creating external flows.

Recent developments

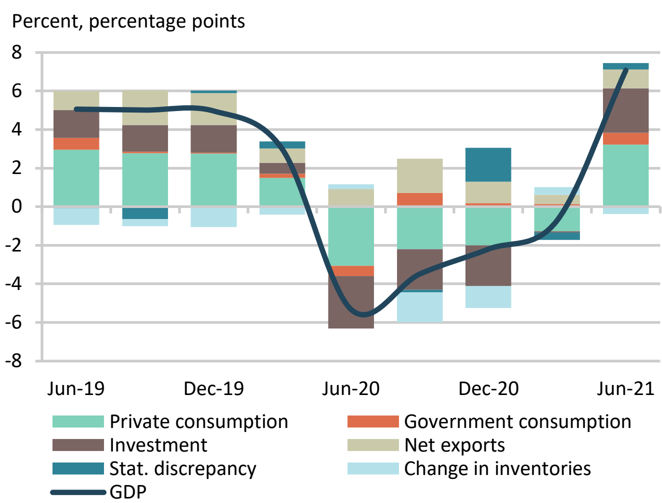
A surge in COVID cases in July-August driven by the Delta variant has slowed a nascent economic rebound. The economy expanded by 7.1 percent yoy during Q2 2021 after four quarters of recession. The expansion was driven by base effects and a pickup in domestic demand. With higher COVID cases and uncertainty in July-August, consumer sentiment and retail sales fell to some of their lowest levels during the pandemic. Manufacturing also contracted but appears less disrupted than in previous waves due to stronger external demand, commodity prices, and firm-level adjustments to health protocols.

The COVID situation is improving but pandemic risks remain high. Tighter mobility restrictions, improved patient treatment and accelerated vaccine rollout are helping flatten the curve. But the national vaccination rate is only 17 percent as of August 2021. Notwithstanding the national average, between 68 and 51 percent of the target population are fully vaccinated in the capital city Jakarta and tourism hub Bali.

The disruption in growth risks slowing improvements in the labor market and poverty. The unemployment rate dropped from 7.1 to 6.3 percent in August 2020-February 2021 as the labor force participation increased slightly. The poverty rate based on the national poverty line declined slightly to 10.1 percent in March 2021, after increasing from 9.2 to 10.2 percent in September 2019-2020.

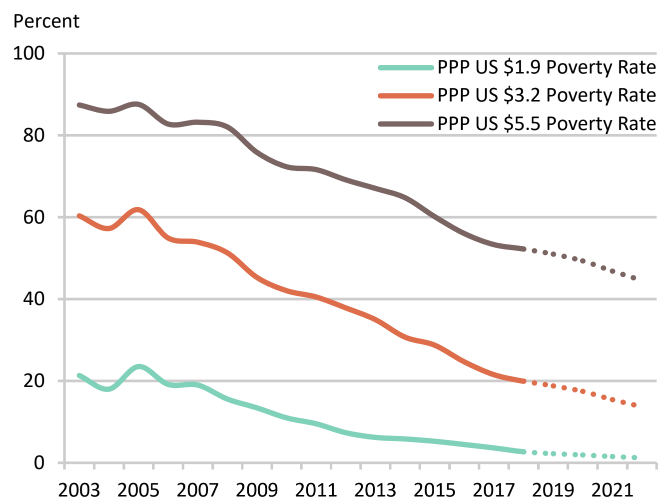
Fiscal and monetary authorities took several measures to support the economy. Bank Indonesia cut its benchmark interest rate by 150 basis points in February 2020-March 2021 to 3.5 percent, loosened macroprudential regulations, and helped finance the fiscal deficit. This policy stance was underpinned by large negative output gaps, low inflation (1.5 percent in H12021), and overall favorable external conditions. But credit growth has remained weak.

FIGURE 1 Indonesia / Real GDP growth and contributions to real GDP growth



Sources: National Statistics Agency and World Bank.

FIGURE 2 Indonesia / International poverty rates expected to decline, but at much lower pace than pre-pandemic



Sources: National Statistics Agency and World Bank.
Note: Forecast is from 2021 onwards.

In July, the government increased the 2021 COVID fiscal package from 4.2 to 4.5 percent of GDP through budget reallocations. The additional spending is to improve patient treatment, and expand food assistance, cash transfers, and wage subsidies.

Tax revenue growth is limited by weak corporate and personal incomes while public spending remains strong. Government revenues reached 6.2 percent of GDP in January-July, higher than last year but still below pre-pandemic levels. With continued strong spending, the fiscal deficit narrowed slightly from 2.1 to 2.0 percent of GDP in 2020-2021. BI government bond purchases stood at 0.8 percent of GDP in January-July 2021.

Outlook

The economy is projected to rebound by 3.7 percent in 2021 driven by low base effects, improvements in consumer spending and investment, and stronger global growth and export commodity prices. Growth would slightly exceed 5 percent per year in 2022-23 assuming at least 70 percent of the targeted population in the economically largest regions is fully vaccinated by March 2022. Growth in contact-intensive services sectors is expected to remain muted while a stronger global economy would support growth in commodity and export-oriented manufacturing sectors.

Successful implementation of structural reforms is critical to mitigate potential COVID scars and improve medium-term prospects. The government is advancing structural reforms through the Omnibus Law on Job Creation, aimed at attracting more investment, and the draft General Tax Law, recently submitted to Parliament, which seeks to improve fiscal revenues by broadening the tax base.

External conditions are expected to improve in the near term with a narrowing current account deficit, improving FDI, and stable capital flows. The outlook assumes low inflation due to the large negative output gap. But external pressures could build up with monetary policy normalization in advanced economies.

The fiscal deficit is projected to narrow gradually to 3.0 percent of GDP in 2023 in line with government commitments. The BI budget financing has been extended until 2022 to meet the higher financing needs. Public debt is increasing but remains low relative to peers and the legal debt ceiling (60 percent of GDP). Higher interest payments could put pressure on fiscal space in the medium term absent revenue reforms.

The international poverty rate (based on US$3.2 per day threshold for lower-middle income countries) is projected to fall from 17.4 to 13.7 percent in 2021-2023. The pace of poverty reduction, according to the international poverty line, is expected to nearly halve between 2021-23 compared to the pre-COVID period whereby international poverty rate declined by 3 p.p. between 2015-19. Long-term efforts are crucial to reverse potential setbacks from lower human capital accumulation, asset depletion, and uneven economic recovery.

Risks to the outlook are tilted to the downside. Growth could reach only 2.0-3.3 percent in 2021-2022 in a downside scenario where the pandemic is not contained, and external conditions worsen. This could result from a slower than expected vaccine rollout and new COVID waves as well as sudden stops or reversals in capital flows.

TABLE 2 Indonesia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	5.2	5.0	-2.1	3.7	5.2	5.1
Private Consumption	5.1	5.2	-2.7	3.7	5.2	5.1
Government Consumption	4.8	3.3	1.9	3.1	2.9	2.8
Gross Fixed Capital Investment	6.7	4.5	-4.9	4.0	5.5	5.4
Exports, Goods and Services	6.5	-0.9	-7.7	9.1	7.9	7.3
Imports, Goods and Services	12.1	-7.4	-14.7	9.0	8.0	7.6
Real GDP growth, at constant factor prices	4.9	5.0	-1.6	3.4	5.2	5.1
Agriculture	3.9	3.6	1.8	3.6	3.8	3.9
Industry	4.3	3.8	-2.8	5.2	4.3	4.4
Services	5.8	6.4	-1.4	1.8	6.4	6.0
Inflation (Consumer Price Index)	3.3	2.8	2.0	1.8	2.2	2.5
Current Account Balance (% of GDP)	-2.9	-2.7	-0.4	-0.8	-1.4	-1.6
Net Foreign Direct Investment (% of GDP)	1.2	1.8	1.3	1.4	1.5	1.7
Fiscal Balance (% of GDP)	-1.8	-2.2	-6.1	-5.6	-4.2	-3.0
Debt (% of GDP)	30.4	30.0	39.4	42.4	44.5	45.0
Primary Balance (% of GDP)	-0.1	-0.5	-4.1	-3.4	-2.1	-0.5
International poverty rate ($1.9 in 2011 PPP)[a,b]	3.6	2.7	2.3	1.9	1.5	1.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	21.6	19.9	18.8	17.4	15.5	13.7
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	53.3	52.2	51.0	49.3	46.8	44.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.
(a) Calculations based on EAPPOV harmonization, using SUSENAS 2011-2020. Latest actual data: 2020. Forecast are from 2021 to 2023.
(b) Projection using annualized elasticity (2011-2020) with pass-through = 1 based on GDP per capita in constant LCU.