High expectations

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Introduction

- Ambitious economic policy reforms initiated, setting high expectations for what these could achieve:
  - Fuel subsidies
  - Infrastructure spending
  - Business licensing

- But road from vision to reality is long:
  - Policy and admin. reforms needed to sustainably mobilize revenues
  - Overcoming execution constraints to absorb more and better capex
  - Implementation of complex reforms, and consistent follow-through

- Reforms are vital, especially with the economy facing headwinds:
  - Global growth is rising but commodity demand is not
  - US Dollars: globally, becoming scarcer
  - Possible revenue shortfall this year
Major recent developments

Near-term economic outlook: relatively subdued

Uncertainties
Recent developments: 1. China is not what it once was for Indonesia…

![Graph showing year-on-year growth, percent for China imports, Total China imports, China real GDP, and China imports from Indonesia.](chart)

**Note:** Imports in US Dollars.  
**Source:** CEIC; World Bank staff calculations
...and the commodity boom is over...

Source: World Bank
...Implication: deep reforms needed to sustain growth of more than ~5.5%

Source: BPS; World Bank staff estimates
Recent developments: 2. US Dollar strength (not Rupiah weakness)...

Cumulative change since June 2014, percent

Note: Rupiah against all currencies, and relative-priced, measures are based on daily proxy measure of nominal, and real effective exchange, rates.
Source: CEIC; BIS; World Bank staff calculations
...with more US Dollar strength potentially to come
Implications: possible shocks; working harder for scarcer dollars

✓ Relatively speaking, the Rupiah has done fine
  ▪ Comparing USD/IDR to past levels not meaningful
    – other currencies, relative prices, matter

✓ …but stronger USD environment does put a premium on more, and stable, net USD supply:
  ▪ More exports
  ▪ More foreign direct investment
  ▪ More domestic reinvestment
  ▪ More structural global investment portfolio allocations to Indonesia
Recent developments: 3. Revised 2015 Budget – dramatic spending reallocation…

Note: 2003-2014 – outturns; 2015: Revised Budget
Source: Ministry of Finance
...but revenue targets are over-ambitious; spending may have to be adjusted

Note: 20011-2014 – outturns; 2015: Revised Budget (compared with 2014 outturn).
O&G denotes oil and gas, N-O&G denotes non-oil and gas; LGST denotes luxury goods sales tax; NRR denotes natural resource revenues.
Source: Ministry of Finance; World Bank staff calculations
Implications: A long way to go to implement vision of the Budget

✓ New fuel pricing system is a banner reform:
  ▪ Sharply reduces wasteful, regressive spending
  ▪ Secures fiscal sustainability
  ▪ Cuts fiscal risks

✓ Capex surge - uncertain:
  ▪ Disbursement challenges – quality; timing
  ▪ Limited fiscal space: achieving even half of the budgeted 100% increase in capex from the 2014 outturn will be difficult

✓ Revenues:
  ▪ Receding commodity tide has exposed weaknesses
Major recent developments

Near-term economic outlook: relatively subdued

Uncertainties
Base case: no sharp upturn in growth

<table>
<thead>
<tr>
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<th>March 2015 IEQ</th>
<th>Revisions</th>
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<tr>
<td>(percentage change, unless otherwise indicated)</td>
<td></td>
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<tr>
<td>Real GDP</td>
<td>5.6</td>
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<td>Consumer prices</td>
<td>6.4</td>
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<tr>
<td>Current account balance (% of GDP)</td>
<td>-3.2</td>
<td>-3.0</td>
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<tr>
<td>Fiscal balance (% of GDP)</td>
<td>-2.2</td>
<td>-2.2</td>
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Note: Revisions are relative to December 2014 IEQ. 
Source: MoF; BPS; BI; World Bank projections
Major recent developments

Near-term economic outlook: relatively subdued

Uncertainties
Fiscal outlook: uncertain Rupiah-denominated fuel prices

**Year-on-year, percent**

- **Rupiah depreciation vs. USD**
- **ICP, USD price**
- **ICP, price in Rupiah**

- **Jan-11**
- **Aug-11**
- **Mar-12**
- **Oct-12**
- **May-13**
- **Dec-13**
- **Jul-14**
- **Feb-15**
Macro outlook: uncertain timing and scale of investment rebound

✓ Fixed investment has approximately halved since 2012
  ▪ Weaker commodity sector investment, reduced retained earnings growth, tighter credit
  ▪ Base case: some rebound, helped by infrastructure spending, but timing and size is key source of forecast risk

✓ SOEs:
  ▪ IDR 70.4 trillion capital injection
  ▪ Quality and quantity of increased infrastructure spending?

✓ Private sector – ready to come to the party?
  ▪ Business licensing reform push – one stop services
    ▪ Strong initial momentum
    ▪ Complex implementation challenge
Conclusion

March 2015 IEQ Contents

- Regular update on economic developments and the outlook
- Indonesia’s internationally high and volatile rice price
- Streamlining business licensing in Indonesia
- The sustainable pace of GDP growth in Indonesia: a closer look
- Harnessing natural resources for Indonesia’s development