

# Indonesia Economic Quarterly: December 2012

*Policies in focus*

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## Outline

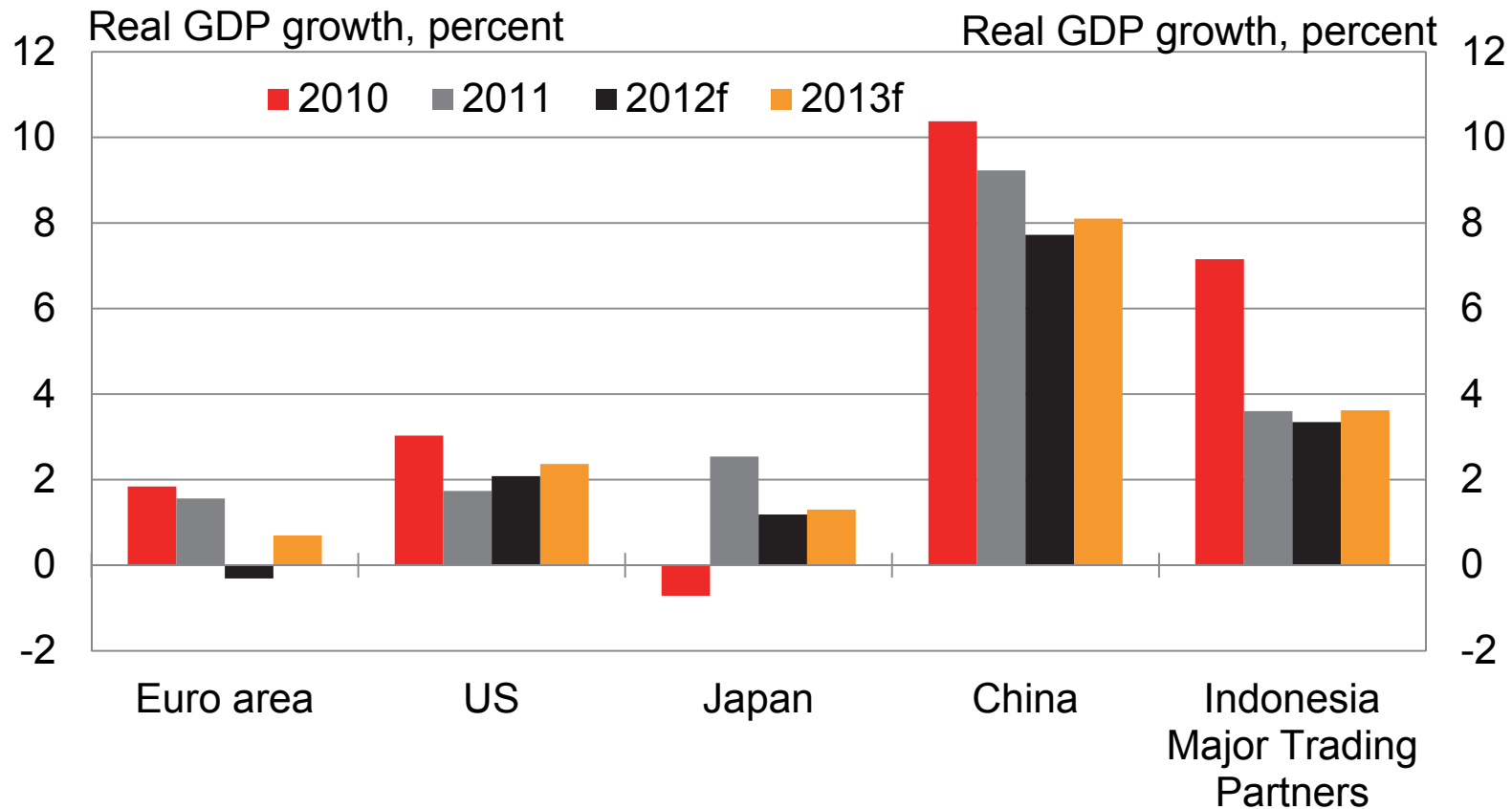
### *Policies in focus*

- **Global growth remains weak and the outlook is still uncertain**
- **Indonesia's economy has performed strongly so far, despite showing some strains**
- **Economic performance in 2013 should be solid but will depend on policies:**
  - **To respond quickly and effectively to any external shocks**
  - **To support domestic investment and growth**
  - **To ensure that the benefits of growth are shared**

**THE GLOBAL ECONOMY** remains weak

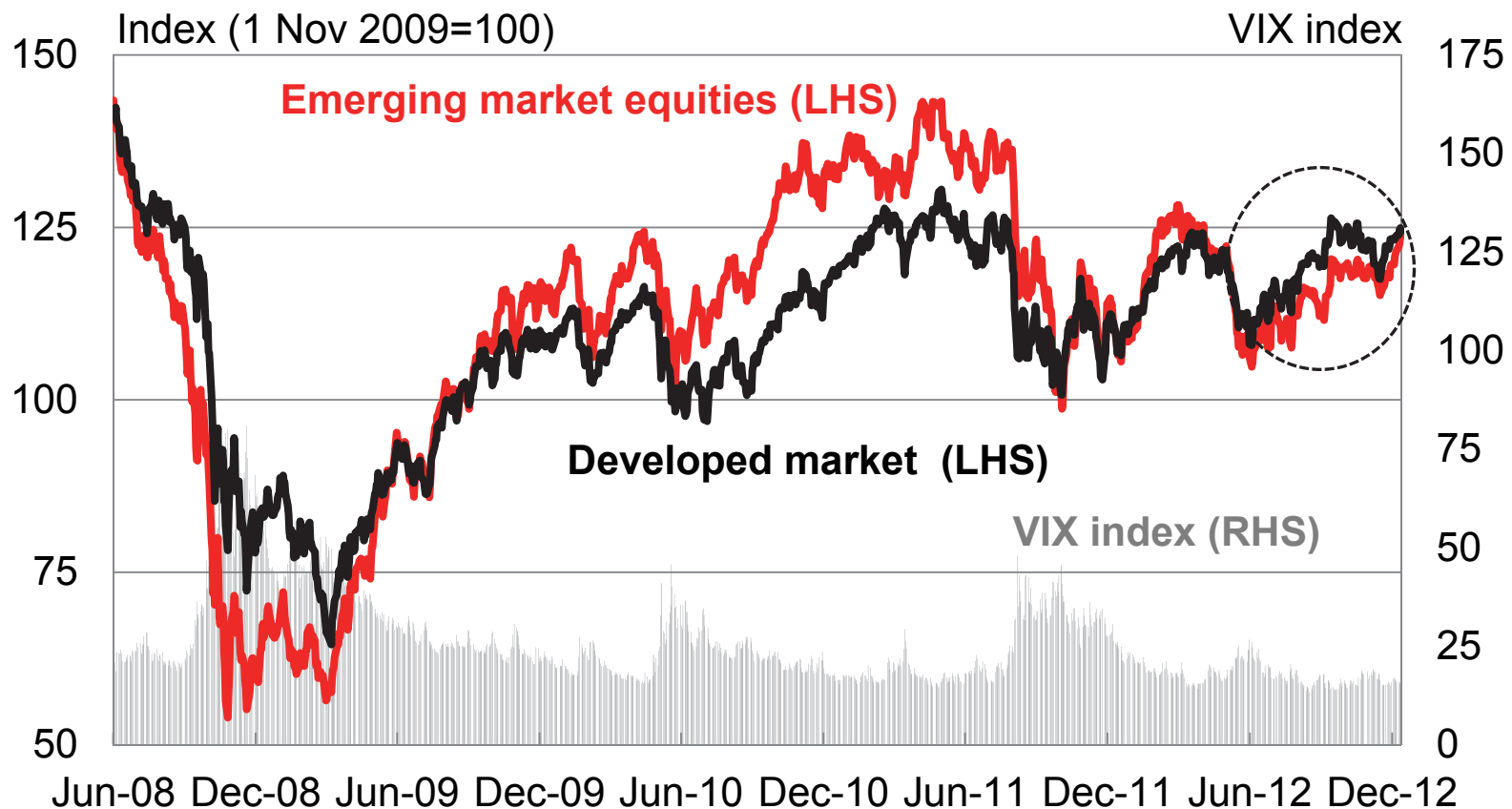
## Global economic conditions remain subdued...

*...growth in the US and China stabilized in Q3 but Japan and Europe contracted*



Source: CEIC and World Bank

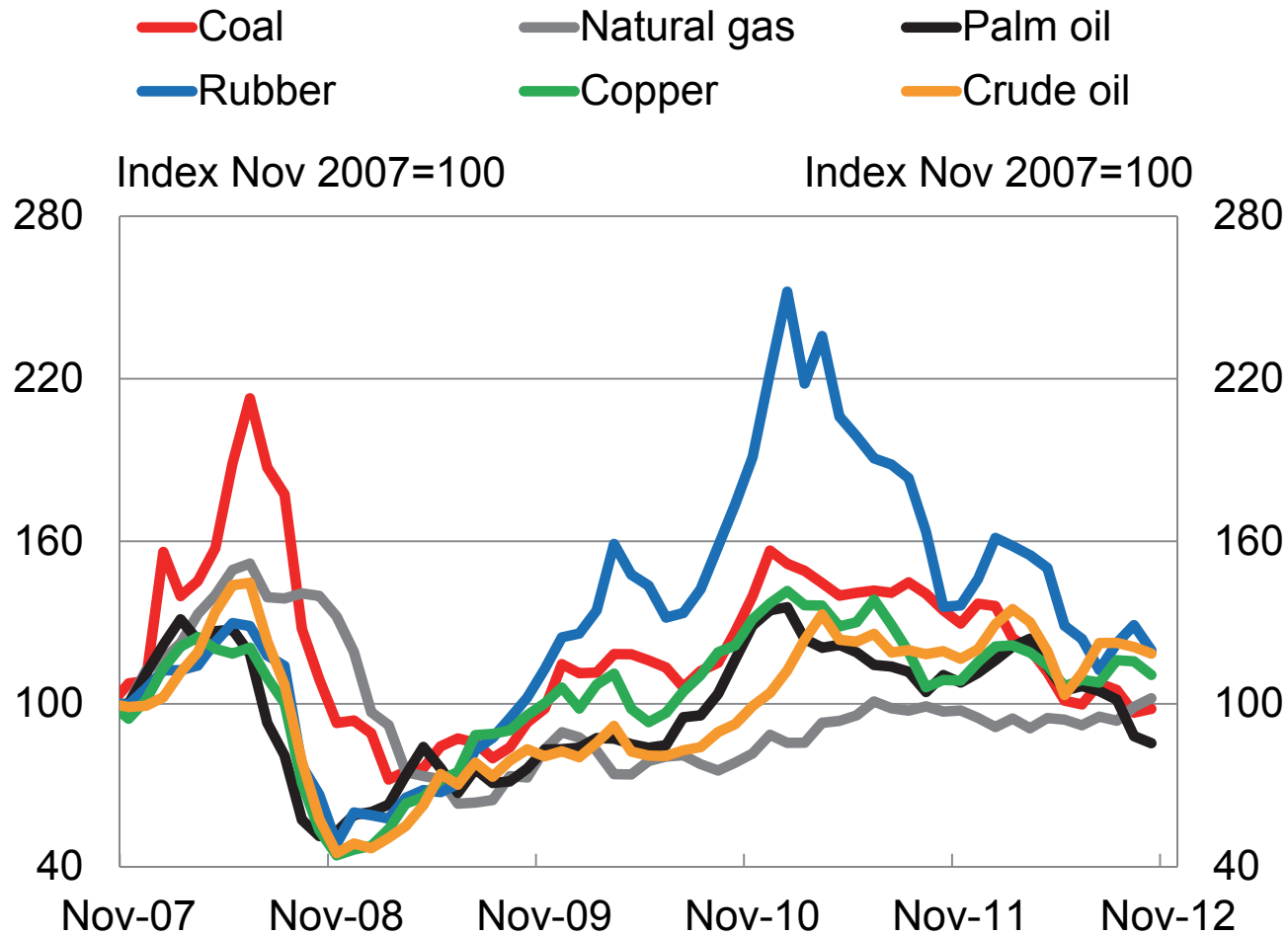
**International financial market conditions have improved since mid-year**  
*...helped by loose monetary policy in the US, Japan and Euro Area*



Source: CBOE, MSCI

## Commodity prices remain under pressure

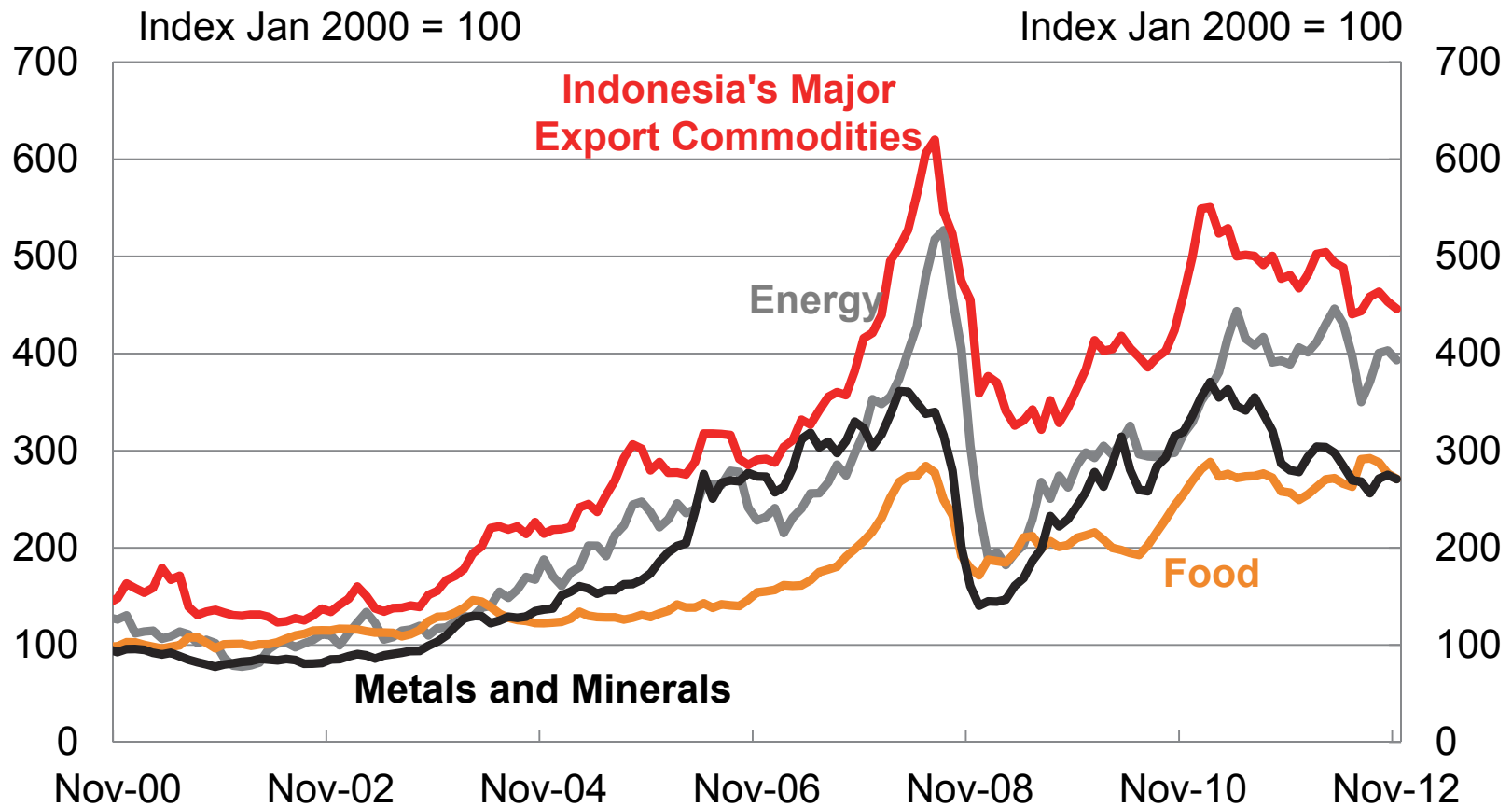
*Since mid-2011, with rubber, coal and palm oil seeing marked declines*



Note: Australian coal, World Bank global natural gas index, Malaysia palm oil, Singapore-traded rubber, London-traded copper, Brent crude; Source: World Bank and staff calculations

**Although commodity prices more broadly remain high**  
*Price levels in nominal USD terms are still elevated on a longer view*

International USD commodity prices



Note: Price index of Indonesia's Major Export Commodities is weighted by export shares of Coal, Gas, Palm Oil, Crude Oil, Copper and Rubber, which represent 42% of Indonesia's exports

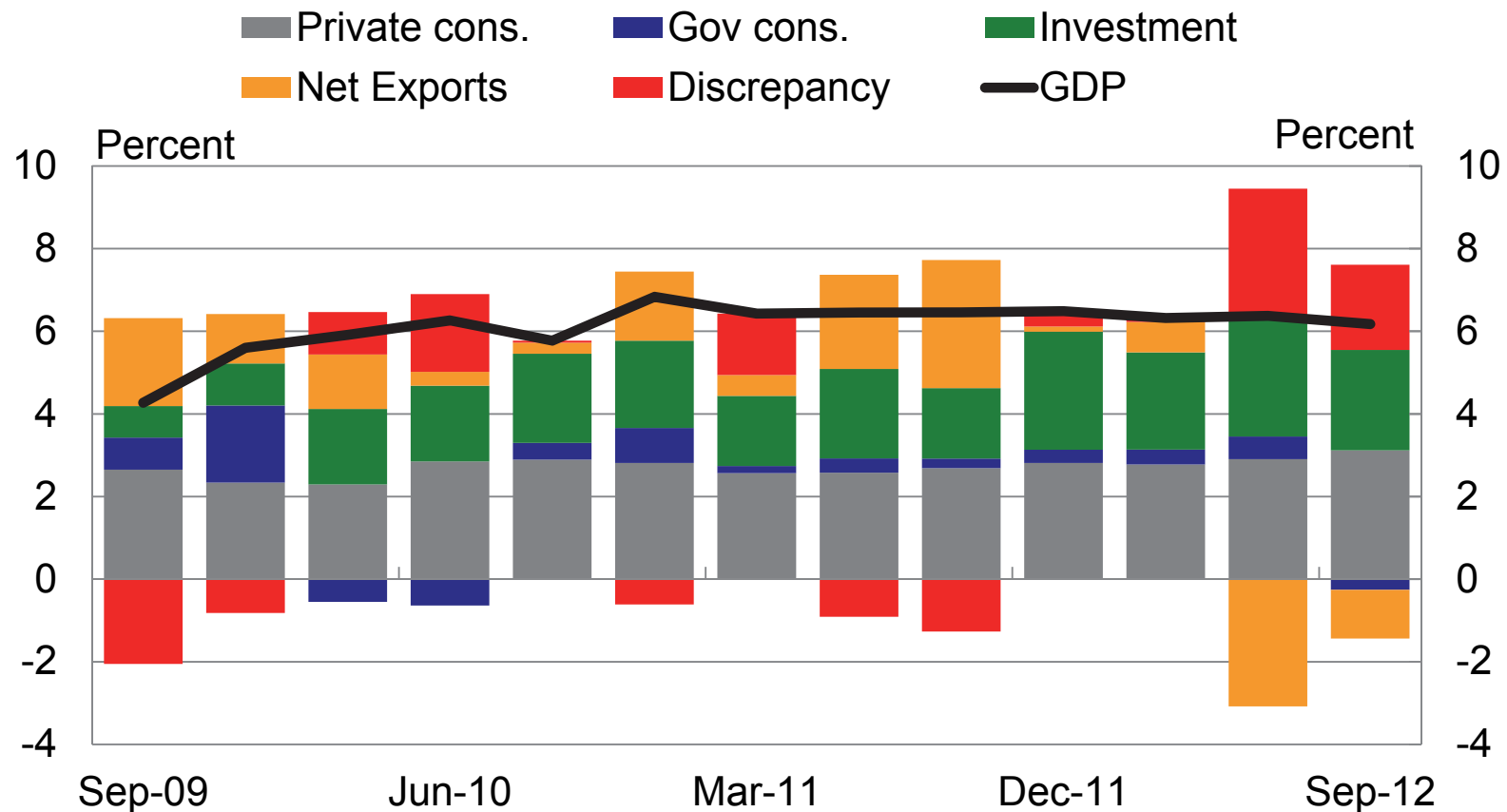
Source: World Bank and CEIC

**THE INDONESIAN ECONOMY** was a solid performer in 2012 but is showing some strains



**Economic growth has been supported by strong domestic demand**  
*...particularly private consumption and investment*

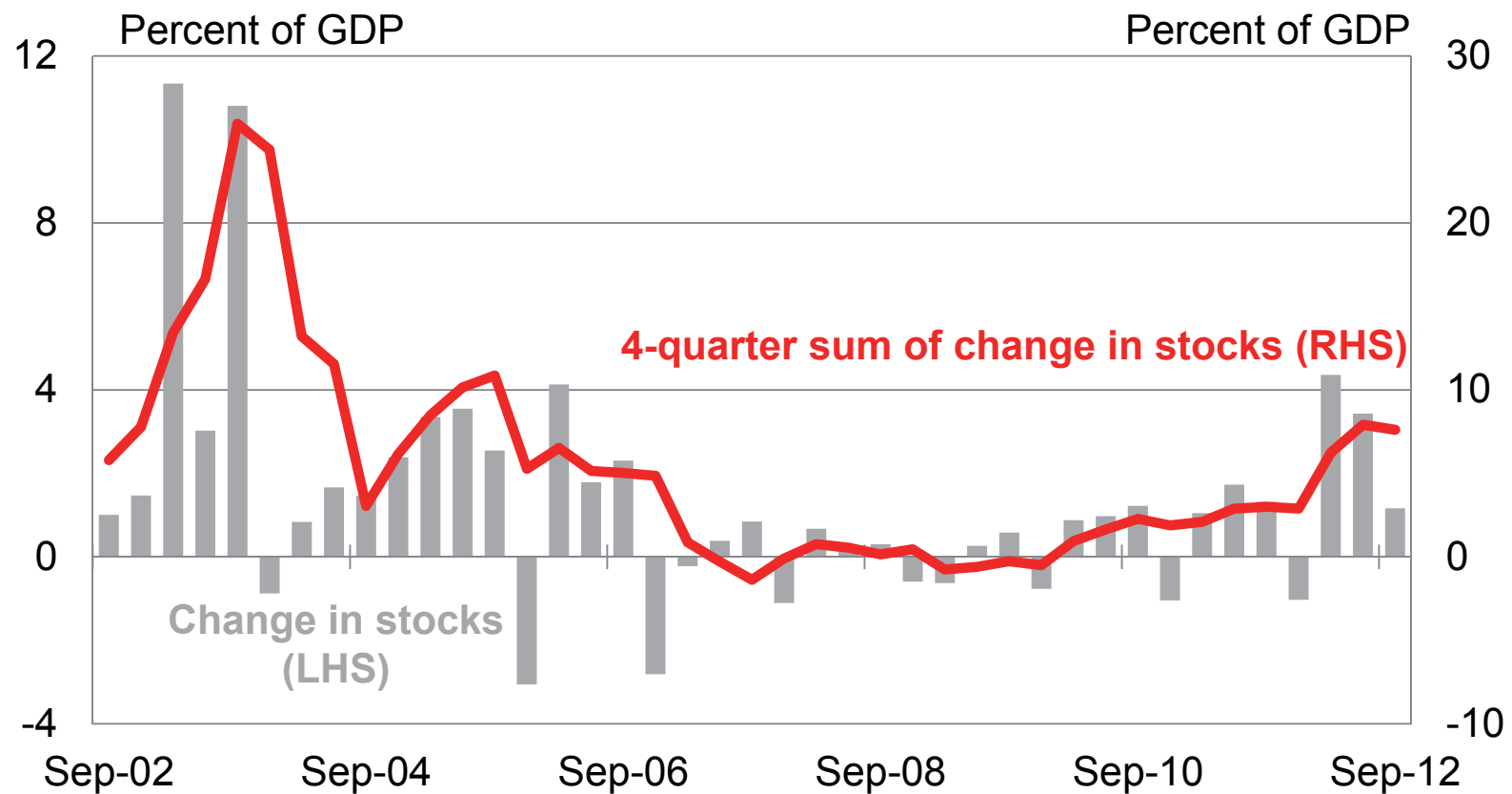
Year on year GDP contributions



Source: BPS via CEIC and World Bank

**However, stock levels appear to have been building**

*National accounts data show an unusual degree of inventory accumulation*

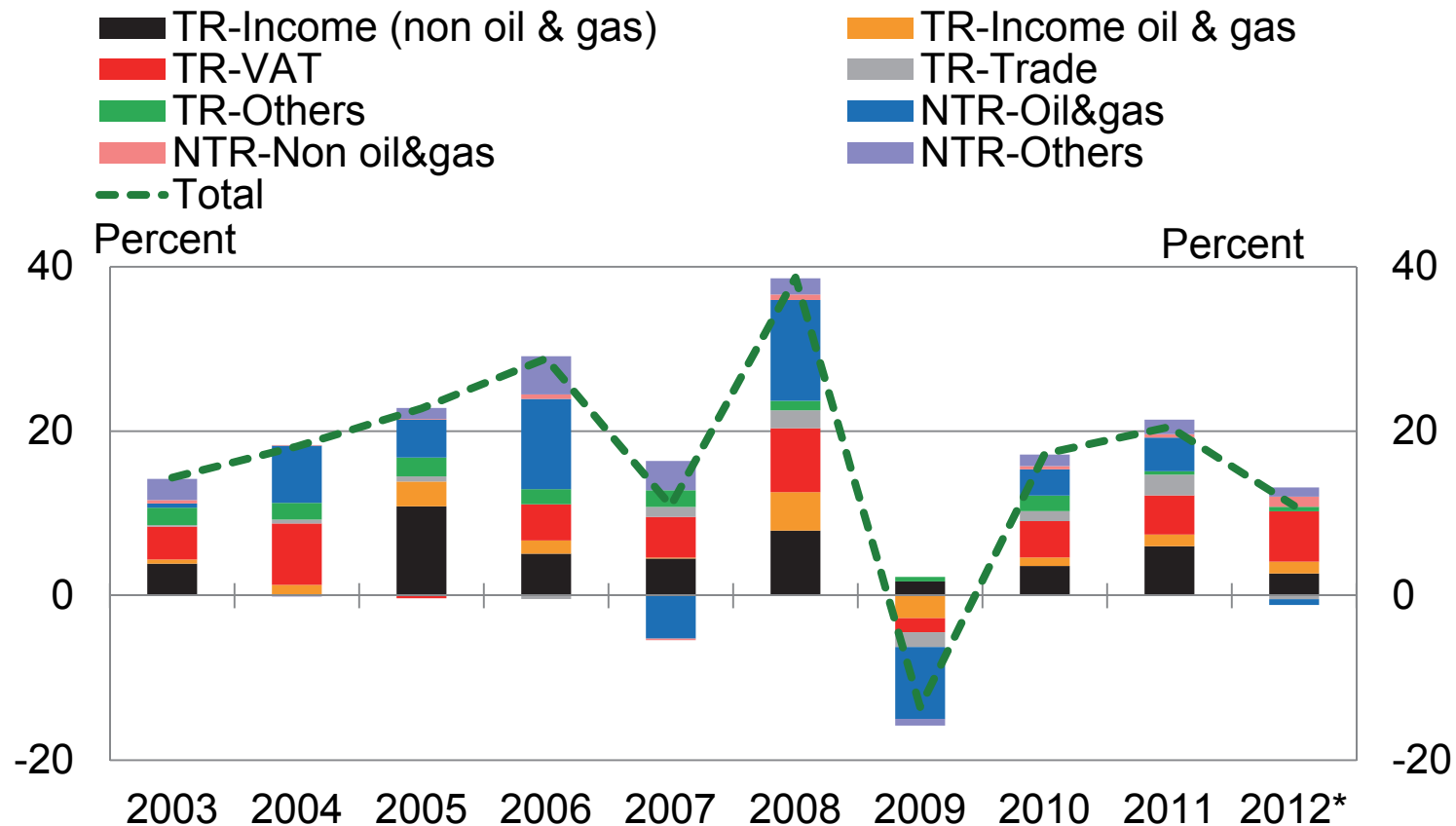


Source: BPS and World Bank staff calculations

## Nominal public revenue growth has slowed

*...with VAT revenue growth still robust but non-tax revenue growth declining*

Nominal growth in public revenues – Total, Tax Revenue (TR), and Non-Tax Revenue (NTR)

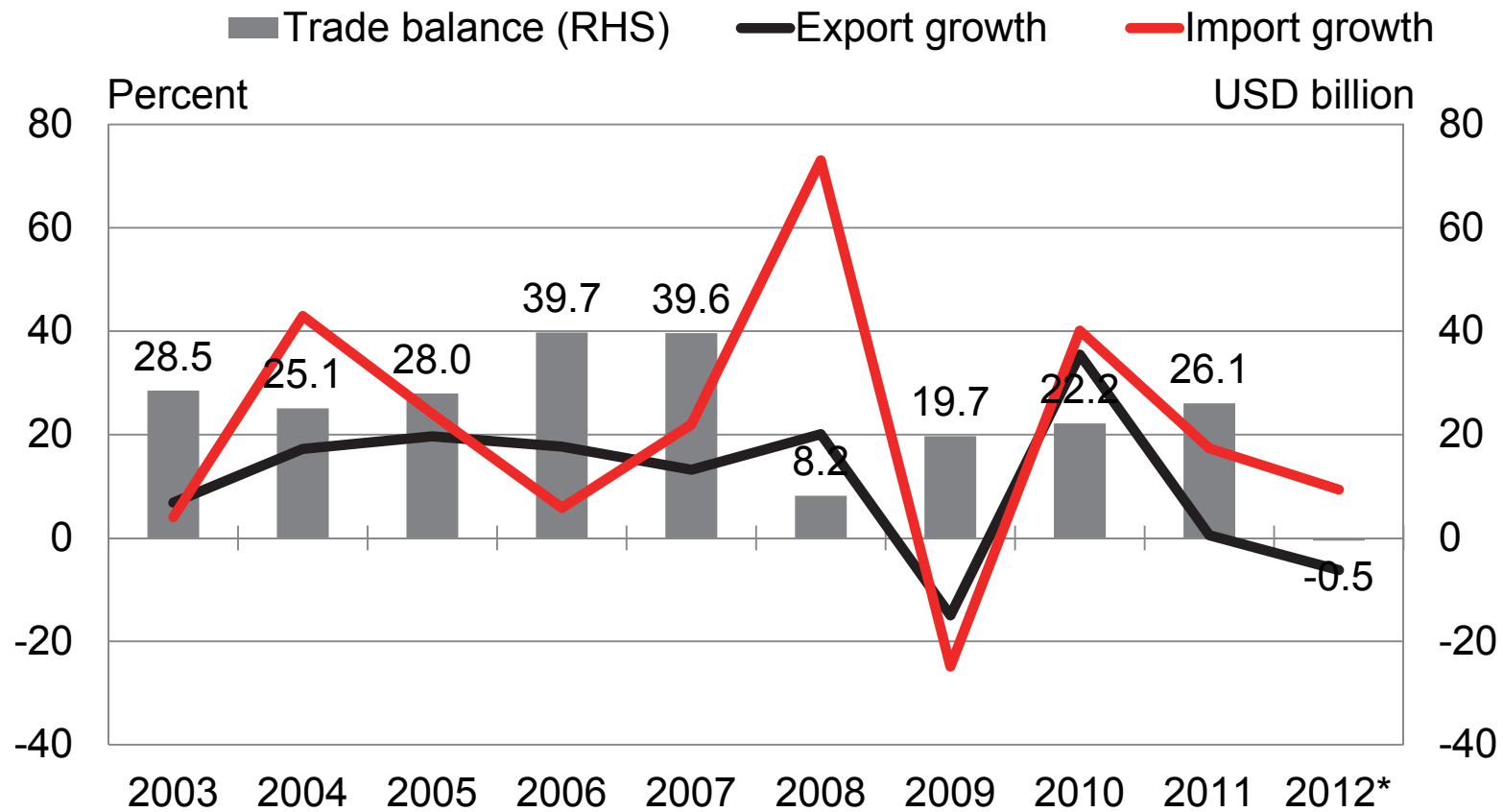


Note: \*2012 data are October to October.

Source: MoF and World Bank staff calculations

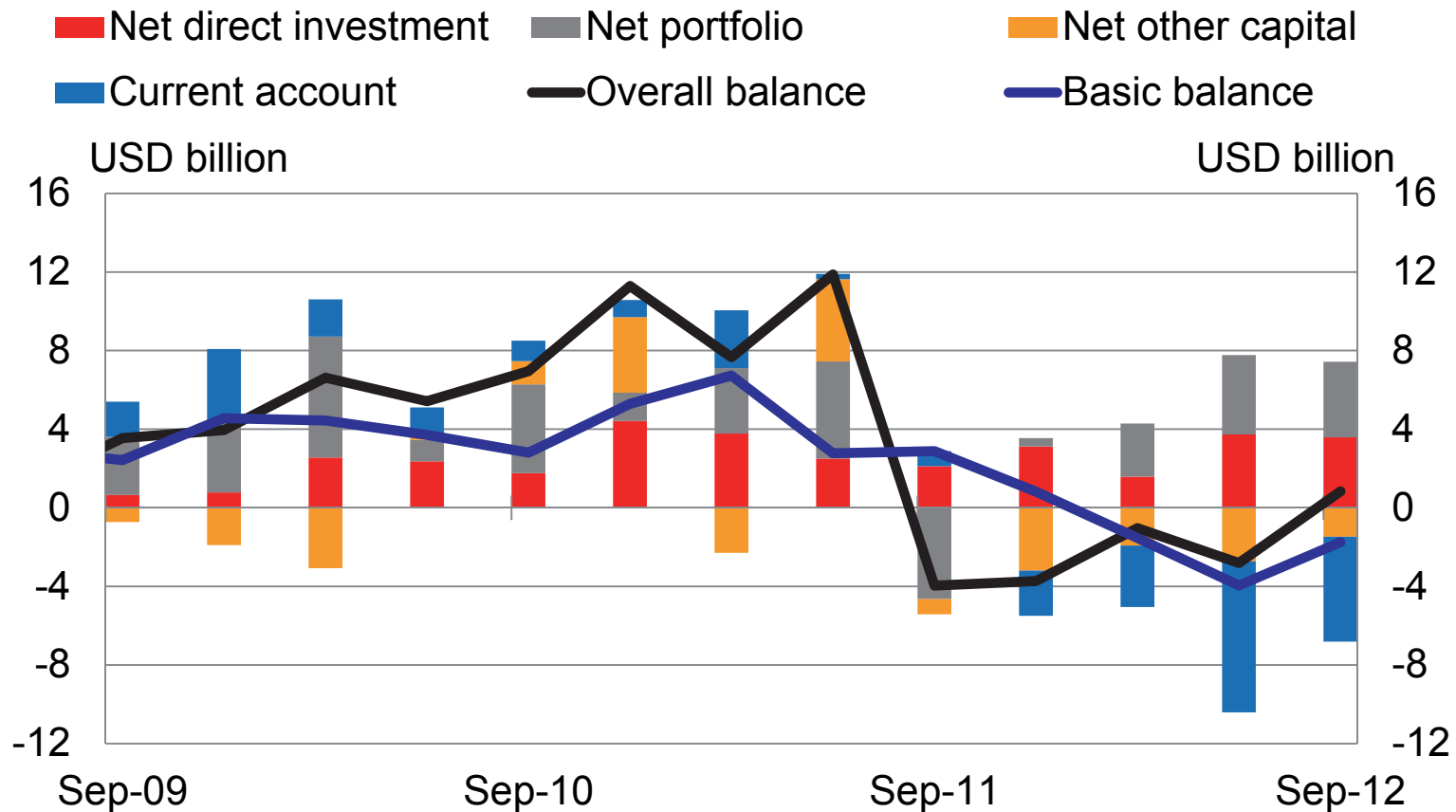
## A trade shock has erased the trade surplus

*Exports contracted in 2012 through October, while import growth continued*



Note: \* 2012 is comparison between January–October sum and the same period in 2011. Source: BPS

**Overall balance of payments flows returned to a small surplus in Q3**  
*...but the basic balance remains negative due to the current account deficit*



Source: BI

## Our baseline projection continues to be for solid growth in 2013

*Thanks to still-solid domestic demand and a slight external growth recovery*

	2010	2011	2012	2013
<b>Real GDP growth (percent)</b>	6.2	6.5	6.1	6.3
<b>CPI inflation (percent)*</b>	6.3	4.1	4.4	5.4
<b>Budget balance (percent of GDP)**</b>	-0.6	-1.1	-2.2	-1.7
<b>Major trading partner growth (percent)</b>	6.8	3.6	3.3	3.6

Notes: \* CPI inflation is Q4 on Q4. World Bank projections except for \*\*Budget balance, which is Government revised Budget (2012) and approved Budget (2013)

**But there are external risks to the outlook...**

*...and these are mostly to the downside*

➤ **Euro Area:**

- **ECB action has reduced financial crisis risk but not eliminated risk of renewed intensification of sovereign funding and banking sector challenges**

➤ **US “fiscal cliff”:**

- **World Bank assumes 1 percent fiscal drag for the US in 2013...**
- **...but “worst case” could shave 4 to 5 percent off US GDP in 2013**

➤ **China:**

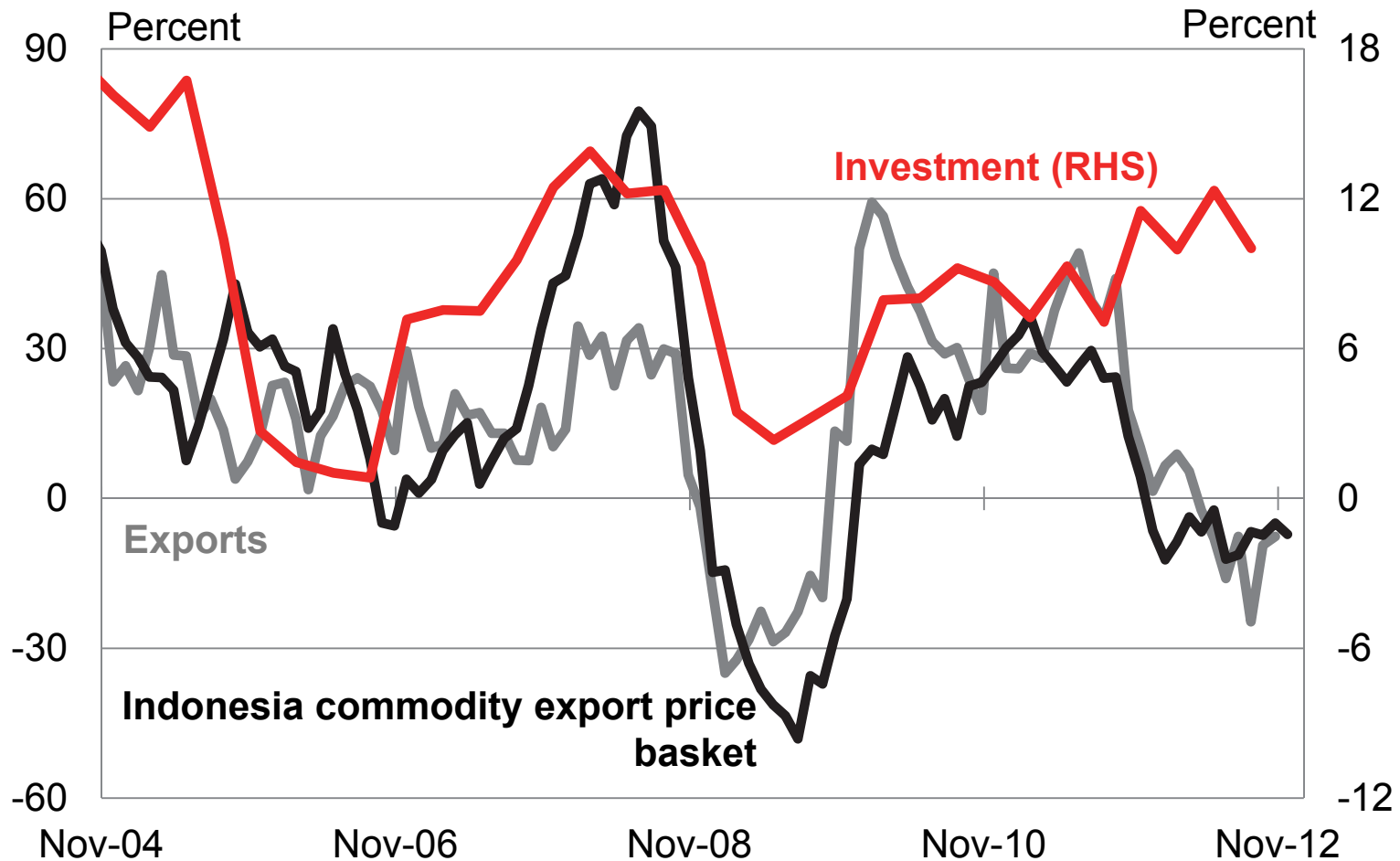
- **World Bank (October 2012) projects 7.7 percent growth in 2012 and 8.1 percent in 2013**
- **Risk of further slowdown**

➤ **Additional uncertainty:**

- **Impact of renewed global monetary easing on portfolio flows and commodity prices**

## Projections assume that strong investment growth will continue

*...but there is no room for complacency on this given commodity prices and exports*

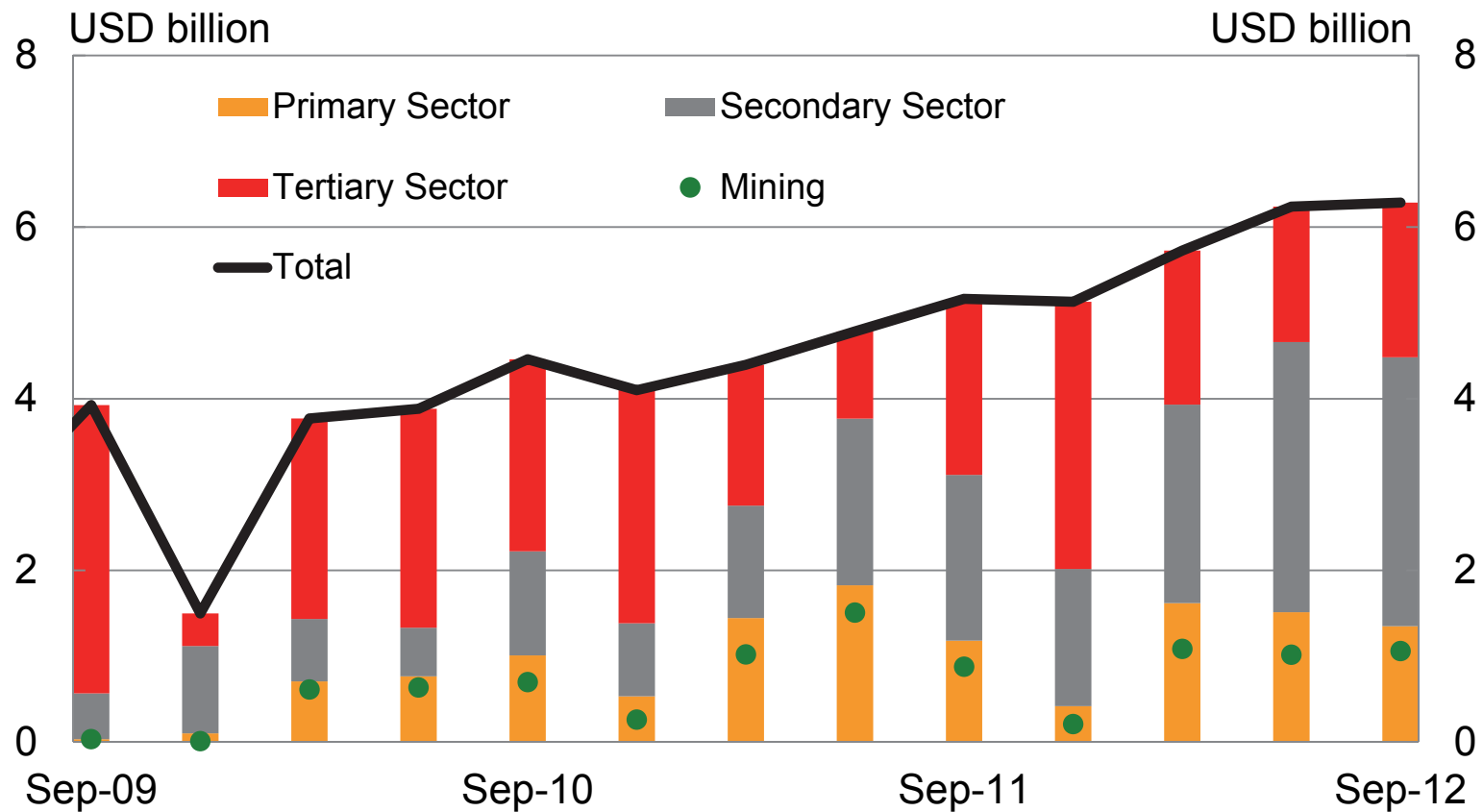


Note: Price index of Indonesia's Major Export Commodities is weighted by export shares of Coal, Gas, Palm Oil, Crude Oil, Copper and Rubber which represent 42% of Indonesia's exports

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**FDI has held up well and maintaining it will be crucial**  
*...for external financing and for investment growth*



Source: BKPM

**POLICIES WILL BE IN FOCUS** in 2013 and will need to guard against the multiple risks to growth



## Priority areas for policy to maintain growth in 2013

*...emphasizing clarity, inclusiveness and quality*

### ➤ Regulatory Policies:

- **Reducing further uncertainties in business and investment regulations will help investment and support growth**

### ➤ Labor Policies:

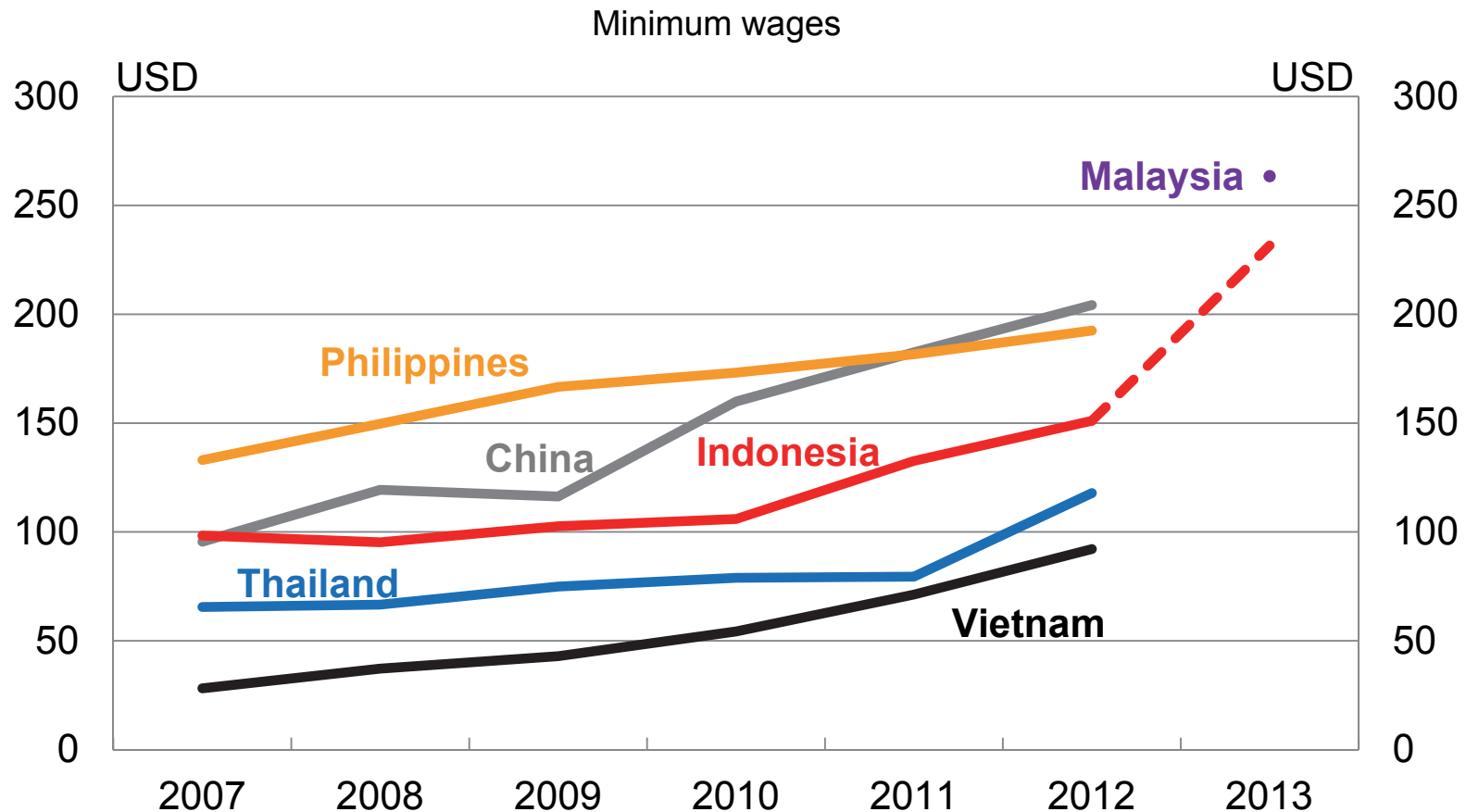
- **A more comprehensive approach to balancing the interests of all stakeholders in the labor market**

### ➤ Public Spending:

- **Improving the quality of spending across functional and geographical areas**

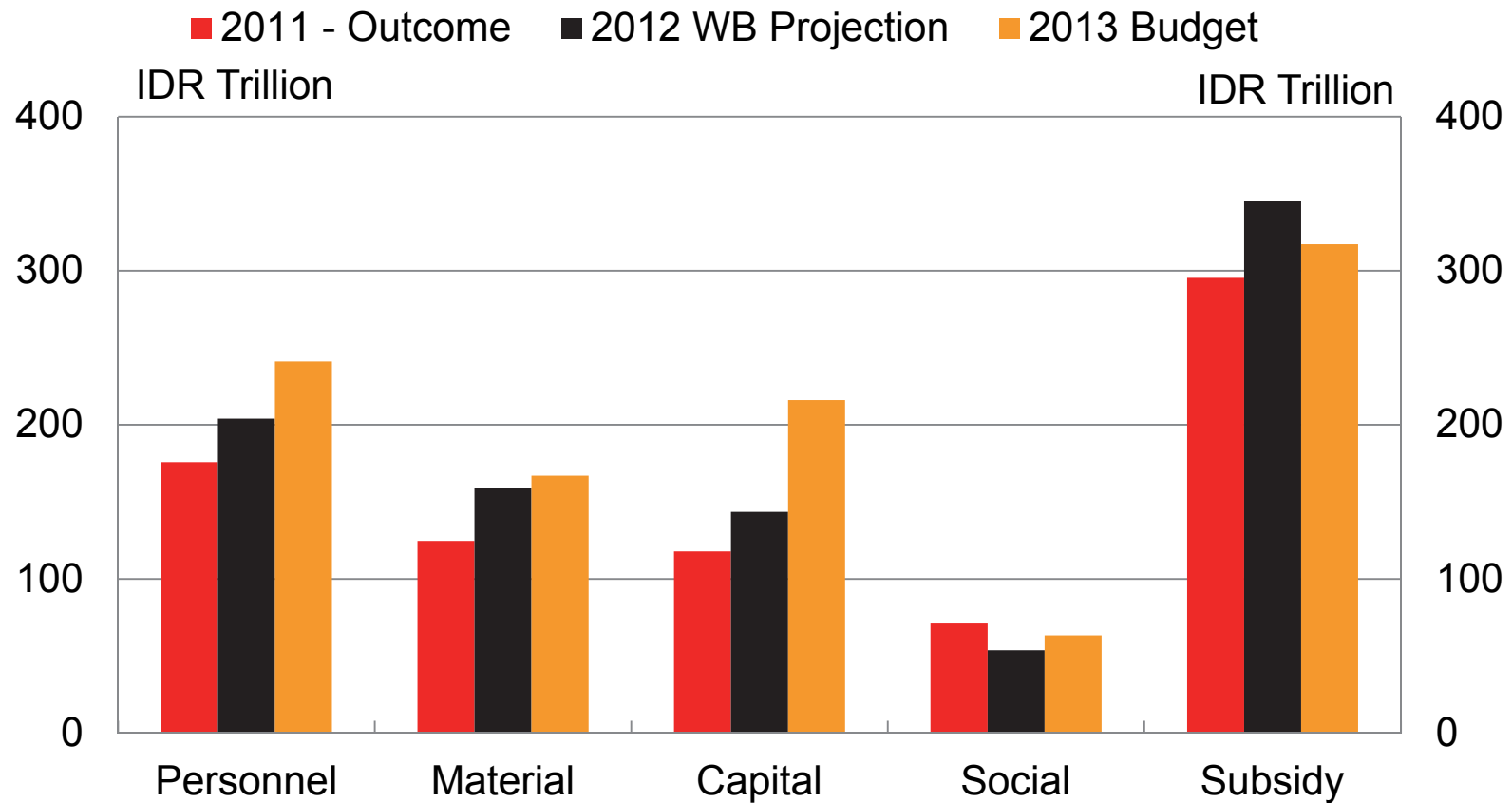
## Labor market policies

*Minimum wage levels in 2013 may be a concern and the process could be improved*



Source: World Bank Doing Business, 2013, and press and regulations for 2013 Note: Indonesia minimum wages based on DKI Jakarta (assuming USD exchange rate in 2013 is IDR 9,500); other countries based on the minimum wage in major cities or the capital region. These wages are not adjusted for productivity differences across countries

**Improving spending quality is a key policy priority, across functions...**  
*Strong increase in capital spending is positive but subsidy spending is a challenge*

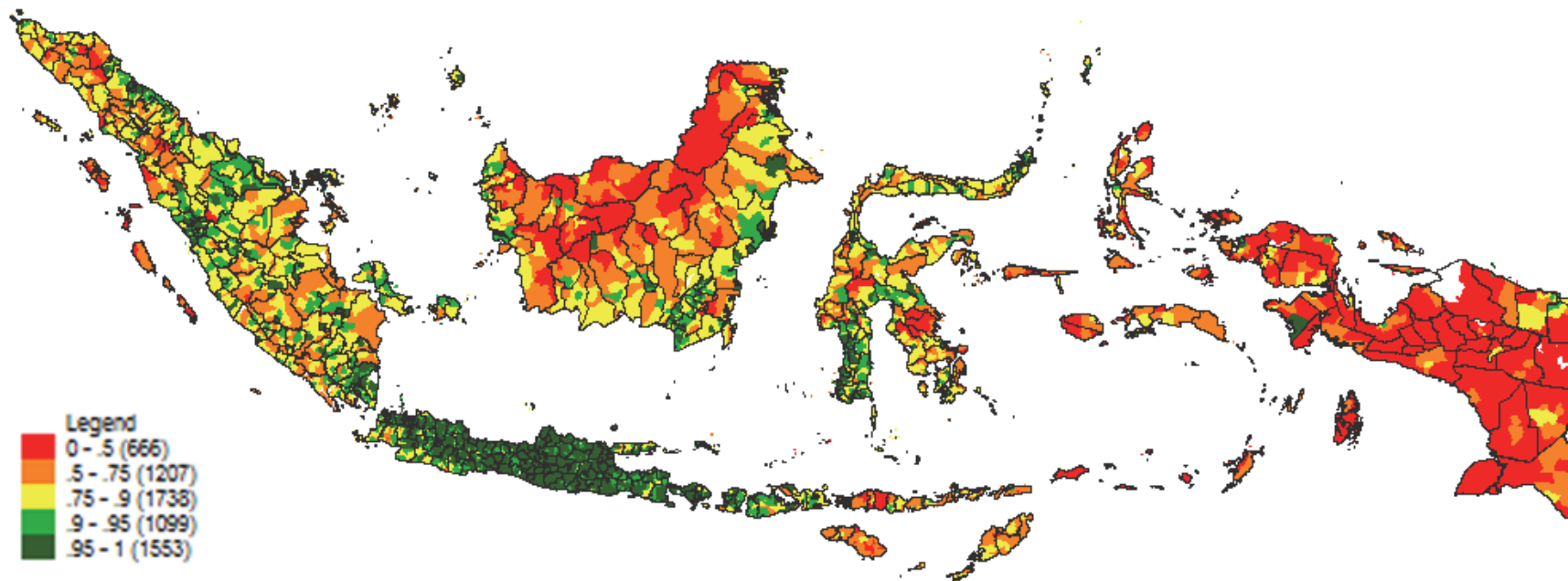


Source: MoF and World Bank staff calculations

...and improving spending results across space is also a challenge

*The geographical dimension (see VIC results on service delivery across Indonesia)*

### Composite Index of Education Supply Readiness



Notes: Index varies from 0 to 1 with higher value indicating higher supply readiness

Source: PODES (Potensi Desa) 2011 and the Village Infrastructure Census and Report

## Indonesia's policy choices are critical in maintaining economic progress

### *Summary*

- **To recap: Indonesia's policies will be in focus in 2013**
- **Indonesia has already equipped itself with sound crisis responses mechanisms but further efforts may be needed**
- **In light of the rapid transformation of the demand side of the economy, facilitating the supply response will be key**
- **Investment remains strong but the tailwinds are weakening**
- **Keeping investment growth going requires:**
  - **...further accelerating investments** by reducing regulatory uncertainties for business and enhancing the policy framework...
  - **...finding an inclusive and comprehensive approach** to labor market policies
  - **...and enhancing the quality of public spending** to boosting public investment in growth-enhancing areas and social protection.

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**Thank you**

- **Indonesia Economic Quarterly December 2012 *Policies in focus* also includes special topics on:**
  - **Minimum wages**
  - **Jakarta's flood risks and mitigation efforts**
  - **Indonesia's natural disaster reconstruction experience**
  - **Results of the recent Village Infrastructure Census**



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