PRESSURES MOUNTING

Jim Brumby, PREM Sector Manager & Lead Economist
Paramadina Public Policy Institute, March 2013
Steady recent economic growth, but pressures mounting

Strong performance can continue but will require policy progress in key areas

More evidence on the need and scope for progress in these areas
INDONESIA’S ECONOMY CONTINUES TO PERFORM WELL

Real GDP growth, year-on-year

Source: CEIC; World Bank Global Economic Prospects, January 2013, and East Asia Update, December 2012
MOUNTING PRESSURES

1. Investment growth cooling; public infrastructure lagging

2. Real sales and nominal GDP growth: moderating

3. External balances: no relief

4. Fiscal sector: burdened by energy subsidies

5. Poor and vulnerable households: slower pace of improvement
INVESTMENT GROWTH: MODERATING

Source: CEIC; World Bank staff calculations

[Graph showing year-on-year growth for Real fixed investment and Capital goods imports (3-month moving average) from March 2009 to January 2013.]
EXTERNAL BALANCES: STILL UNDER PRESSURE, RECENTLY DUE ESPECIALLY TO OIL & GAS TRADE DEFICIT

Source: CEIC; World Bank staff calculations
**EXTERNAL BALANCES: KEEPING THE NEED TO SUPPORT FDI AND PORTFOLIO FLOWS IN FOCUS**

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Direct Investment</th>
<th>Net Portfolio</th>
<th>Net Other Capital</th>
<th>Current Account</th>
<th>Overall Balance</th>
<th>Basic Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec-09</td>
<td>6</td>
<td>12</td>
<td>-6</td>
<td>6</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Dec-10</td>
<td>12</td>
<td>12</td>
<td>-12</td>
<td>12</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>Dec-11</td>
<td>-12</td>
<td>-12</td>
<td>-12</td>
<td>-12</td>
<td>-12</td>
<td>-12</td>
</tr>
<tr>
<td>Dec-12</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: CEIC; World Bank staff calculations
GROWTH OUTLOOK: MEASURED REAL FINAL SALES
GROWTH DECLINING

Year-on-year growth

Real final sales
Real final domestic sales
Real GDP

Note: Real final (domestic) sales = Measured private consumption + government consumption + fixed investment + net exports (-net exports)
Source: CEIC; World Bank staff calculations
GROWTH OUTLOOK: NOMINAL GDP GROWTH MODERATING

Source: CEIC; World Bank staff calculations
NOMINAL INCOME GROWTH: SLOWER IN 2012

Source: CEIC; World Bank staff calculations
INFLATION: FOOD PRICE PRESSURES

Source: CEIC; World Bank staff calculations

Change in CPI from Dec 2012 to Feb 2013 (LHS)
Change in CPI from Dec 2012 to Feb 2013 (RHS)

Percent Percent

Green Chili Red Chili Garlic Onion Food inflation excl items* Food inflation

0 20 40 60 80

Source: CEIC; World Bank staff calculations
ACHIEVING OFFICIAL POVERTY REDUCTION TARGETS WILL BE A STRETCH
## Fiscal Sector: Burdened by Inefficient Spending

The diagram above illustrates the spending in various sectors for the years 2011, 2012, and 2013. The sectors include Personnel, Material, Capital, Int. Payments, Energy subsidy, and Social. The data is sourced from MoF; World Bank staff calculations.

<table>
<thead>
<tr>
<th>Sector</th>
<th>2011 Actual Audited</th>
<th>2012 Preliminary Actual</th>
<th>2013 Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personnel</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
</tr>
<tr>
<td>Material</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
</tr>
<tr>
<td>Capital</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
</tr>
<tr>
<td>Int. Payments</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
</tr>
<tr>
<td>Energy subsidy</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
</tr>
<tr>
<td>Social</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
<td>IDR trillion</td>
</tr>
</tbody>
</table>
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NOTWITHSTANDING THE PRESSURES, STRONG PERFORMANCE AND PROGRESS CAN CONTINUE...

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross domestic product</td>
<td>6.5</td>
<td>6.2</td>
<td>6.2</td>
<td>6.5</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>5.2</td>
<td>4.3</td>
<td>5.5</td>
<td>5.2</td>
</tr>
<tr>
<td>Budget balance</td>
<td>-1.2</td>
<td>-1.8</td>
<td>-1.7</td>
<td>-1.4</td>
</tr>
<tr>
<td>Major trading partner growth</td>
<td>3.6</td>
<td>3.4</td>
<td>3.7</td>
<td>4.0</td>
</tr>
</tbody>
</table>

Note: CPI is annual average. Government figures for Budget deficit: 2012 is preliminary outturn, 2013 is approved Budget and 2014 is from the 2013 Draft Budget Financial Note
Source: Ministry of Finance, BPS, Consensus Forecasts Inc., World Bank staff calculations
...BUT THIS REQUIRES THAT POLICY ADDRESSES MOUNTING PRESSURES

- **Investment:**
  - Sustain private investment by providing policy certainty; making ongoing improvements in regulatory framework
  - Work to meet the public infrastructure investment challenge

- **Trade and external balances:**
  - Focus on competitiveness rather than import restrictions

- **Fiscal sector:**
  - Fuel subsidy reform

- **Households:**
  - Food: focus on availability; redirect subsidies

Timely responses tend to yield results
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SUCCESSFUL MANUFACTURES RELY ON IMPORTS

Value-added in manufactured goods exports

Source: OECD and WTO Trade in Value-Added (TiVA) statistics
FDI HAS ROOM TO INCREASE

Source: CEIC; World Bank staff calculations
PUBLIC INFRASTRUCTURE NEEDS A FURTHER BOOST

Note: Real value calculated using investment GDP deflator
Source: Infrastructure investment data as detailed in Box 5 of March 2013 IEQ and World Bank staff calculations
TAP INTO THE POTENTIAL OF FAST URBANIZATION


Per capita GDP against urbanization rates

Agglomeration areas in Indonesia

SUMMARY: MARCH 2013 IEQ
PRESSURES MOUNTING

- This edition of the IEQ contains analysis on:
  - Fiscal policy – analysis of the 2012 Budget outturn
  - Trade dynamics – insights from new trade in value-added data for Indonesia
  - Urbanization – harnessing the potential of agglomeration areas
  - Infrastructure investment spending – trends and the need for more

- Key messages:
  - Steady recent economic performance with base case for this to continue
  - But there are some mounting pressures and the risks to the economy are to the downside
  - Timely policy responses tend to yield good results