MARCH 2014 IEQ: “INVESTMENT IN FLUX”

- Fixed investment: subdued, and risks
- FDI: solid, but has plateaued recently
- Risks to fiscal space needed for public investment
- Portfolio investment: currently strong, but volatile
OUTLINE

Recent economic developments and outlook

Investment in flux, amid policy uncertainties, fiscal pressures

Priorities for the longer-term, and selected issues
GDP: WEAK INVESTMENT, STRONG NET EXPORTS

Contribution to GDP growth yoy, percent

Source: BPS; World Bank calculations
IMPORT DEMAND HAS SOFTENED

Contribution to yoy growth

Source: BPS; World Bank staff calculations
RAW MINERAL EXPORTS BAN BUMP IN Q4

Source: BPS; World Bank staff calculations
OVERALL BOP: NARROWER C/A DEFICIT...

Balance of payments, USD billion

Overall balance
Net other capital
Net portfolio
Net direct investment
Current account

Dec-10  Dec-11  Dec-12  Dec-13

Note: Basic balance = Current account balance + net FDI
Source: BI; World Bank staff calculations
...SUPPORTING THE RUPIAH OVER Q1 2014

Nominal currency index, 2011 average = 100

USD

IDN

Selected EM majors

Note: Selected EM majors is a simple average of BRL, IDN, TRY and ZAR vs. USD; USD is broad NEER index
Source: JP Morgan; World Bank staff calculations
GLOBAL ECONOMY: LIKELY TO STRENGTHEN

Major trading partner GDP growth, percent

Source: World Bank staff calculations
INDONESIA: MIXED HIGH FREQ. DATA; MORE HEADWINDS

Economic activity indicators - mixed
Growth in 3-month moving avg. yoy, percent

- Motor vehicles
- Cement sales

Credit growth - falling
Growth yoy, percent

- Nominal (LHS)
- Real (LHS)

Monthly nominal lending growth (RHS)

Source: CEIC; World Bank staff calculations

THE WORLD BANK I BANK DUNIA
Sharing Development Solutions for an Emerging Indonesia
INDONESIA OUTLOOK: SOME MORE GROWTH MODERATION TO COME...

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2014p</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real GDP</strong> (% change)</td>
<td>6.2</td>
<td>5.8</td>
<td>5.3</td>
<td>5.6</td>
<td>5.3</td>
</tr>
<tr>
<td><strong>Consumer price index</strong> (% change)</td>
<td>4.3</td>
<td>6.9</td>
<td>6.2</td>
<td>5.2</td>
<td>6.7</td>
</tr>
<tr>
<td><strong>Current account balance</strong> (USD billion)</td>
<td>-24.4</td>
<td>-28.5</td>
<td>-24.4</td>
<td>-20.2</td>
<td>-22.8</td>
</tr>
<tr>
<td><strong>Current account balance</strong> (% GDP)</td>
<td>-2.8</td>
<td>-3.3</td>
<td>-2.9</td>
<td>-2.1</td>
<td>-2.6</td>
</tr>
<tr>
<td><strong>Budget balance</strong> (% of GDP)</td>
<td>-1.9</td>
<td>-2.2</td>
<td>-2.6</td>
<td>n.a.</td>
<td>-2.1</td>
</tr>
</tbody>
</table>

Source: BI; BPS; Ministry of Finance; World Bank staff projections
## AMIDST SIGNIFICANT RISKS

<table>
<thead>
<tr>
<th>Domestic</th>
<th>External</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Positive</strong></td>
<td></td>
</tr>
<tr>
<td>• Elections lead to a stronger than expected</td>
<td>• Commodity prices rise</td>
</tr>
<tr>
<td>boost to consumption, investment</td>
<td>• Global risk appetite is stronger than expected,</td>
</tr>
<tr>
<td></td>
<td>boosting portfolio inflows to EMEs inc. Indonesia</td>
</tr>
<tr>
<td><strong>Negative</strong></td>
<td></td>
</tr>
<tr>
<td>• Investment weakens as downturn extends to</td>
<td>• External financing conditions tighten again</td>
</tr>
<tr>
<td>building investment</td>
<td>• Global commodity prices fall, e.g. due to slower</td>
</tr>
<tr>
<td>• Consumption growth disappoints as income</td>
<td>than expected growth in China</td>
</tr>
<tr>
<td>and credit effects take their toll</td>
<td></td>
</tr>
</tbody>
</table>
Recent economic developments and outlook

Investment in flux, amid policy uncertainties, fiscal pressures

Priorities for the longer-term, and selected issues
INVESTMENT IN FLUX...

Foreign direct investment
Inbound FDI, rolling 4-quarter average

Fixed investment
Contributions to real growth yoy, percent

Source: BI; World Bank staff calculations
FISCAL SECTOR: REVENUES SOFT; NEW POLICY PRESSURES

Note: 2013 deficit is World Bank staff projection
Source: Ministry of Finance; World Bank staff calculations
Achieving a deficit of <2.5% in 2014 looks difficult without more fuel subsidy reform.
EXAMINING THE MINERAL EXPORT BAN

Rationale

- Unprocessed export ban + Export duty and tax
- Increased domestic mineral processing
- Higher value-added mineral exports
- GDP growth Trade Balance Fiscal Revenues Job Creation

Underlying assumptions

- Significant processing investment is stimulated, i.e., that smelters are financially viable
- Processing adds a lot of value to mineral exports
- Higher processed exports will offset lower ore exports
- Higher value exports will increase non-tax revenues
- Processing will create more and better jobs in the sector
BUT IS THE MINERAL EXPORT BAN SOUND?

Note: Data for 2013
Source: WITS database; World Bank staff calculations
TRADE IMPACTS

Estimated impact on net trade balance

USD billion

-5.3  -3.3  -3.0  -0.9
2014  2015  2016  2017

Source: World Bank
REVENUE IMPACTS

Estimated impact on fiscal revenues (export duties and taxes, royalties and CIT)

USD billion

Source: World Bank
OUTLINE

Recent economic developments and outlook

Investment in flux, amid policy uncertainties, fiscal pressures

Priorities for the longer-term, and selected issues
AVOIDING THE TRAP

THE CHALLENGE – harnessing Indonesia’s potential to generate shared prosperity, through fast productivity-driven economic growth with inclusiveness

- **Structural policies to boost prosperity:**
  - Closing the infrastructure gap
  - Closing the skills gap
  - Enhancing the functioning of markets

- **Complementary areas:**
  - Service delivery for all
  - Social protection
  - Natural disaster risk management

- **Foundational pre-requisites:**
  - Macro-fiscal management and managing shocks
  - Implementation
Thank you

March 2014 IEQ contents:

- Regular update on economic developments and the outlook
- Examining the mineral exports ban
- Urban disaster risks planning
- A taster of the forthcoming World Bank report, Avoiding the Trap

On the web: