More subdued growth outlook, resulting from two major shocks to the economy and ongoing adjustments.

Developments in Q3 show adjustments are well underway but highlight Indonesia’s macro vulnerabilities.

The role of good policies in this time of continuing adjustment.
FIRST SHOCK: TRADE SHOCK, SINCE 2011...

Quarterly merchandise trade balance, USD billion

Source: BI
...AS TERMS OF TRADE HAVE WEAKENED

US Dollar price index, 2000 average = 100

Source: World Bank
PRESSURING THE OVERALL CURRENT ACCOUNT

USD billion

Goods trade balance
Income balance
Current account balance
Services trade balance
Current transfers

Source: BI
SECOND SHOCK: FINANCING COSTS

Source: JP Morgan
More subdued growth outlook, resulting from two major shocks to the economy and ongoing adjustments.

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MONETARY CONDITIONS: TIGHTENING

BI Overnight deposit facility rate

Percent, year-on-year

New loan approvals (RHS)

FASBI rate

Source: BI
DOMESTIC DEMAND: SOFTENING

Growth yoy, percent

Jun-05  Oct-06  Feb-08  Jul-09  Nov-10  Apr-12

Source: BPS; World Bank staff calculations
INVESTMENT SLOWING DOWN

Real fixed investment growth, percent

- Building
- Foreign machinery & equip
- Foreign transportation
- Other
- Total

Source: World Bank
Average of analysts’ real GDP growth forecasts

Source: Consensus Economics
## OUTLOOK: MORE ADJUSTMENT TO COME...

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<tr>
<td><strong>Real GDP</strong></td>
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<tr>
<td>(% change)</td>
<td>6.5</td>
<td>6.2</td>
<td>5.6</td>
<td>5.3</td>
<td>5.9</td>
<td>6.2</td>
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<tr>
<td><strong>Consumer price index</strong></td>
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<tr>
<td>(% change)</td>
<td>5.4</td>
<td>4.3</td>
<td>7.3</td>
<td>6.7</td>
<td>7.2</td>
<td>6.7</td>
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<td><strong>Current account deficit</strong></td>
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<tr>
<td>(% GDP)</td>
<td>0.2</td>
<td>-2.8</td>
<td>-3.4</td>
<td>-2.6</td>
<td>-2.7</td>
<td>-2.1</td>
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<td><strong>Major trading partner GDP</strong></td>
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<tr>
<td>(% change)</td>
<td>3.6</td>
<td>3.4</td>
<td>3.4</td>
<td>3.9</td>
<td>3.4</td>
<td>4.0</td>
</tr>
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Source: BI; BPS; Ministry of Finance; World Bank staff projections
...BUT PERSPECTIVE, PLEASE

Real GDP growth, percent

Source: World Bank
More subdued growth outlook, resulting from two major shocks to the economy and ongoing adjustments

Developments in Q3 show adjustments are well underway but highlight Indonesia’s macro vulnerabilities

The role of good policies in this time of continuing adjustment
THREE R’S FOR POLICY

- **Responding, to facilitate more near-term adjustment:**
  - Monetary and fiscal policy coordination
  - Exchange rate flexibility

- **Reducing uncertainty:**
  - Contingency planning
  - Communication

- **Refocusing policies to lift sustainable growth rate:**
  - August package: follow through
  - “Quick wins” for competitiveness
  - Fiscal sector: energy subsidies, infrastructure spending, social protection
AUGUST PACKAGE: IMPLEMENTATION IS KEY

Relieve external balance pressures
- Exports: tax relief for labor-intensive exporters
- Investment: DNI; “de-bottlenecking”

Reduce inflation pressures
- Food imports: move to price-based restrictions

Support employment
- Bounded zones
- Tax relief for qualifying firms in labor-intensive sectors
- Minimum wages
MORE MEASURES TO LIFT COMPETITIVENESS

- Boost from weaker Rupiah provides an opportunity...
- ...but will be wasted without a supply response
- “Quick wins” in trade facilitation can help

Average container dwell time at Tanjung Priok, days

Source: Jakarta International Container Terminal (JICT)
Energy subsidy costs – baseline and with 10 percent IDR depreciation/oil price increase

Note: *World Bank projections
Source: World Bank staff calculations
REDIRECTING SPENDING: THE OPPORTUNITY

Spending on fuel subsidies and infrastructure, percent of GDP

- Fuel subsidy cost
- Total infrastructure spending (government, SOE and private)

*World Bank projections
Source: Ministry of Finance; World Bank
MORE INFRASTRUCTURE STOCK, HIGHER INCOME

2011 per capita income – actual, and following higher annual infrastructure growth rate increases (USD)

- Actual: 3,471
- 5 percent: 180
- 10 percent: 648

Source: World Bank staff calculations
BREAKING INTO INFRASTRUCTURE CYCLE

ADDRESS THE PERSISTENT INFRASTRUCTURE GAP

SUPPORT EXTERNAL BALANCES OVER THE MEDIUM-TERM
- Improve domestic and external competitiveness
- Potential to re-orientate import-intensity of spending
- Enhance FDI potential (and provide more stable financing)

REALLOCATE SPENDING TOWARDS INFRASTRUCTURE
- Offset the rise in financing costs
- Enhance sustainable growth
MAIN MESSAGES

- Indonesia faces greater constraints: trade shock, global liquidity
- The economy and policy settings are adjusting:
  - Base case outlook for growth moderation and gradually narrowing current account deficit
  - But external uncertainties still elevated and adjustment phase carries risks
- Critical continued role for policy – 3 R’s:
  - Responding, to facilitate more near-term adjustment
  - Reducing uncertainty: contingency planning and communication to support confidence
  - Refocusing policy efforts on lifting competitiveness and the sustainable growth rate
    - August policy package implementation
    - Additional “quick wins”, e.g. trade facilitation
    - Continuing progress on fiscal sector reforms