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.
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.

Indonesia's Major Export Commodities

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

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

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

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

Source: World Bank and CEIC
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
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Labor market policies

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

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.
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