



INDONESIA ECONOMIC QUARTERLY 09|18 URBANIZATION FOR ALL

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Today's presentation



The economy scored some wins in Q2



But global volatility has hit hard



How has the government responded?



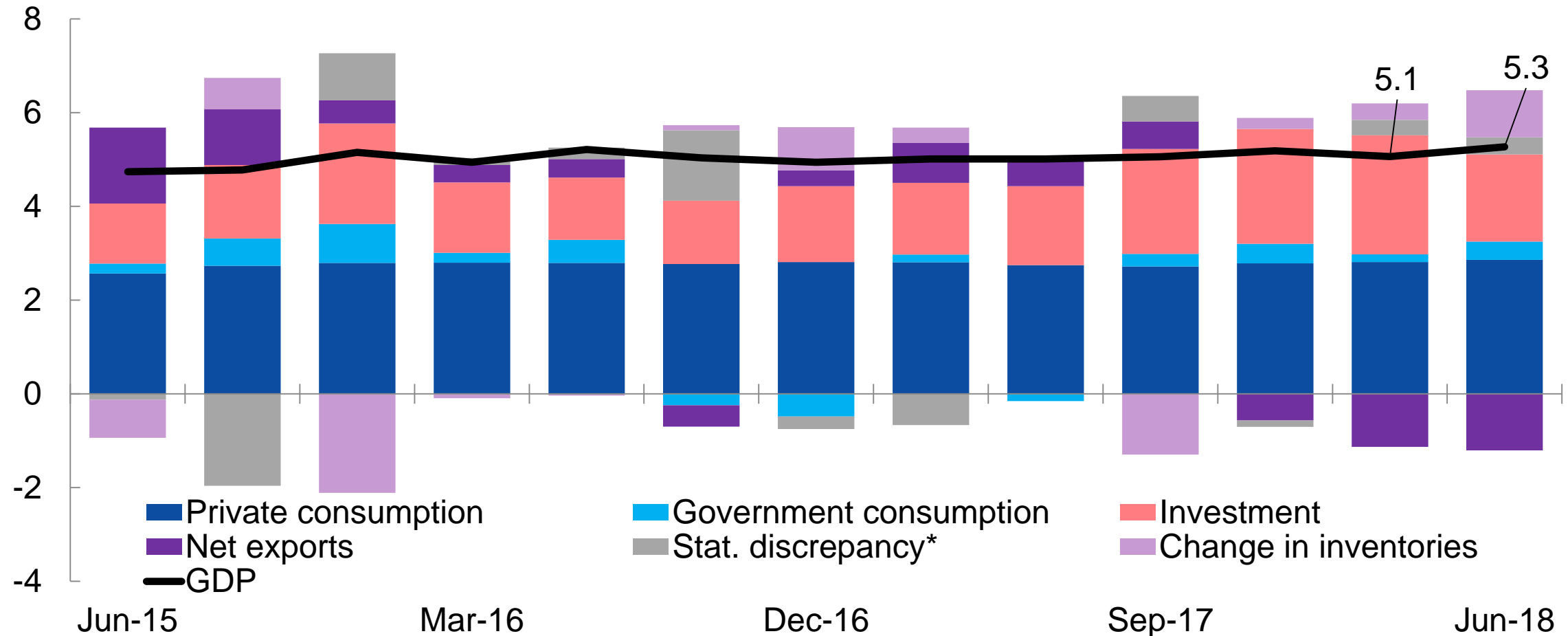
What next?



THE ECONOMY SCORED SOME WINS IN Q2

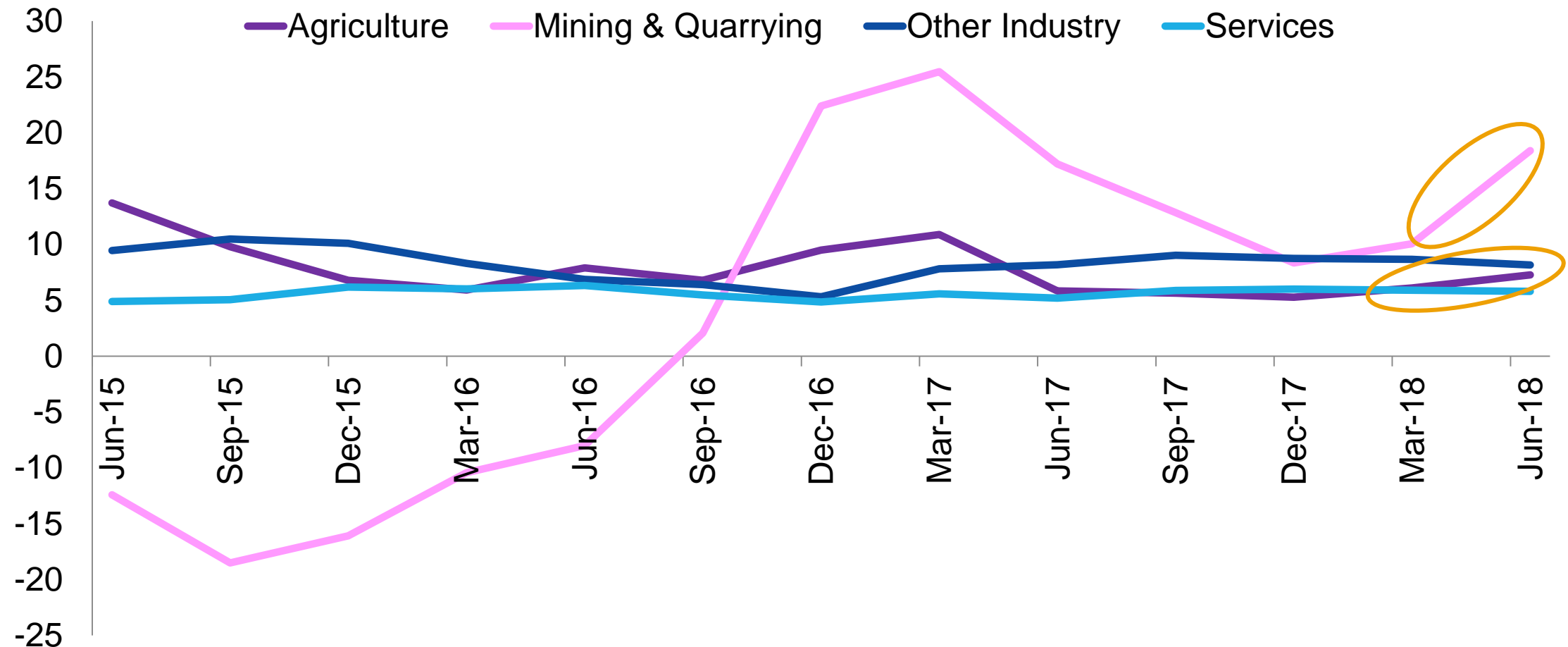
GDP growth accelerated to 5.3 percent in Q2, driven by stronger consumption

Gross Domestic Product (GDP) in constant prices, change from the previous year, percent; and contributions to real GDP growth, percentage points



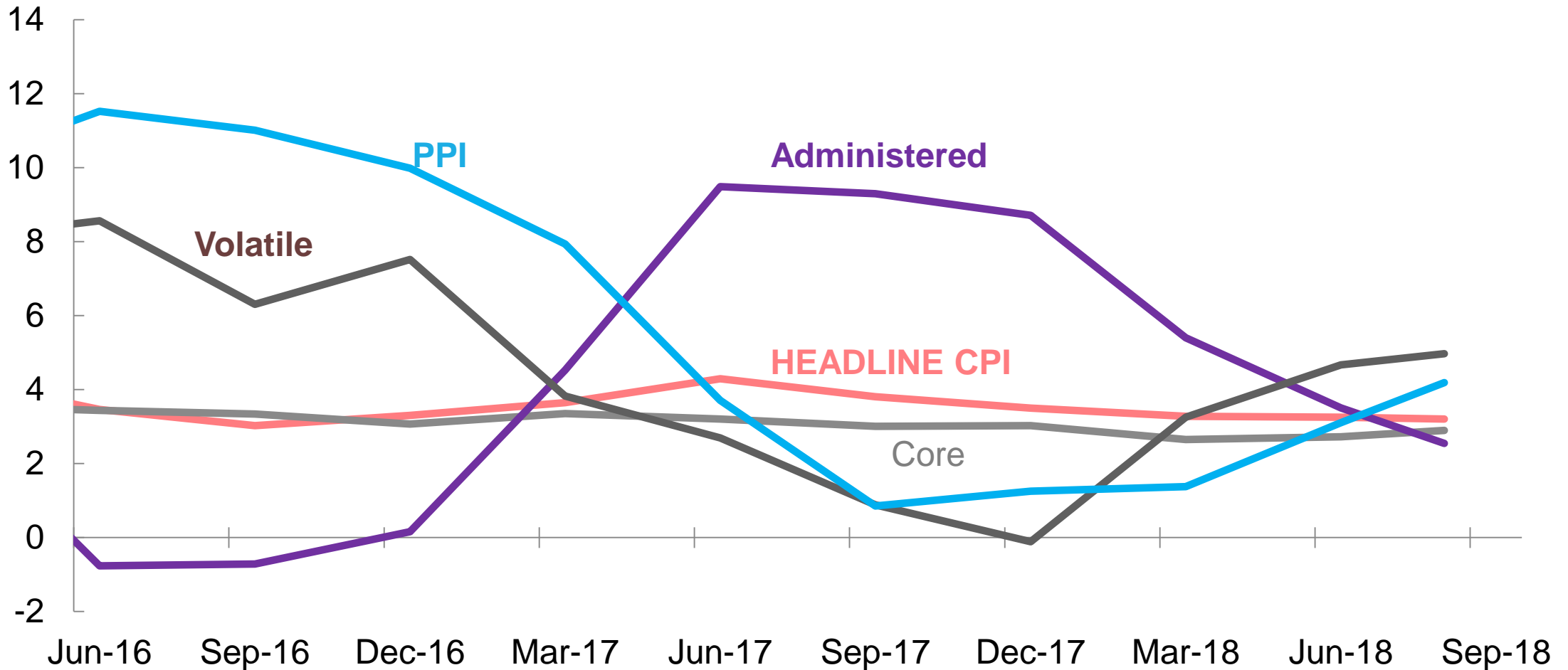
Income growth in mining and agriculture sectors accelerated...

Gross value added at current prices (nominal terms), change from the previous year, percent



...and headline CPI inflation remained low

Price indices, change from the previous year, percent



Note: PPI stands for Producer Price Index. Only the General Non-Oil & Gas category is used as measured by wholesale PPI

Source: BPS; World Bank staff calculations



BUT GLOBAL VOLATILITY HAS HIT HARD...

Three main sources of global volatility



U.S. Federal Reserve increased the policy interest rate, set to hike it again



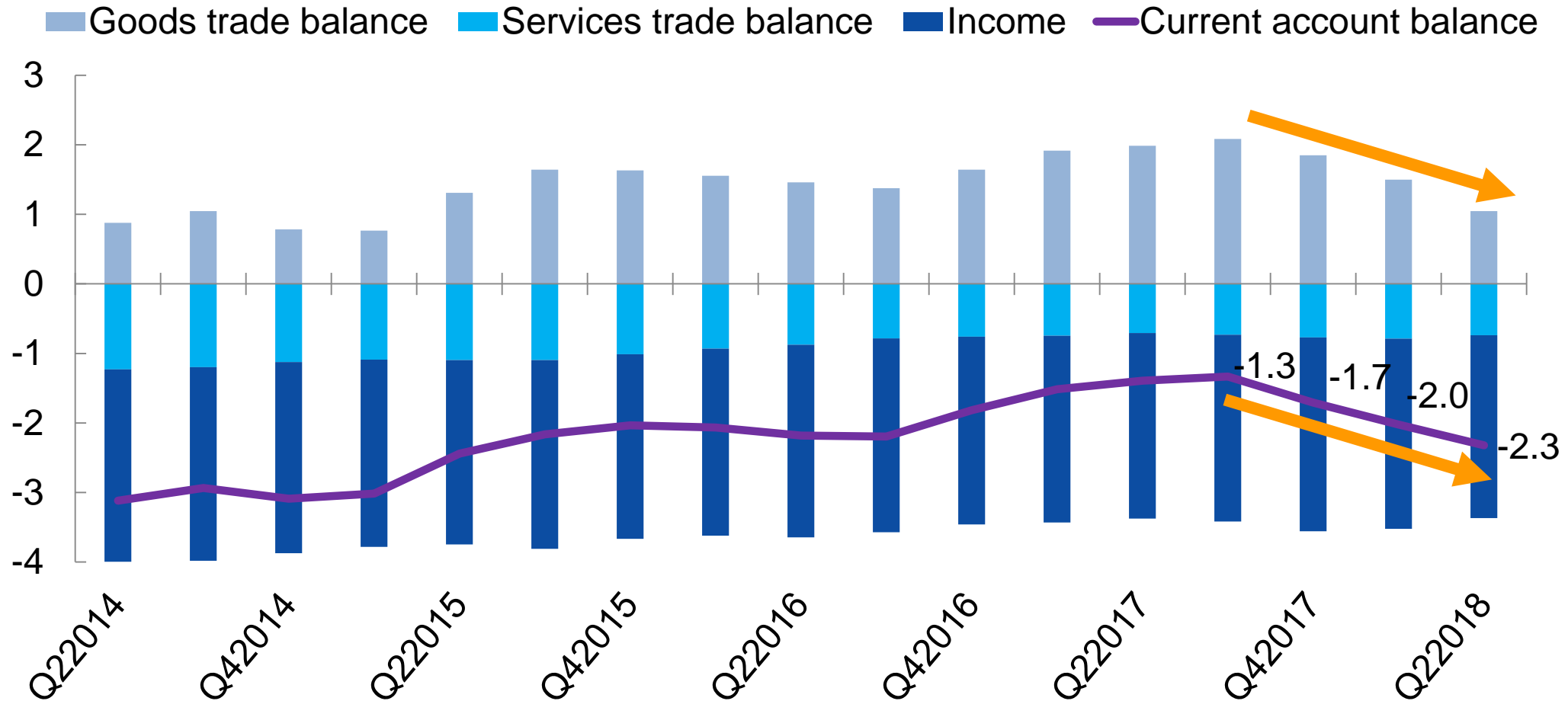
“Trade wars” heightened global uncertainty, particularly due to escalating tit-for-tat trade tariffs imposed by US and China



Contagion fears spread following stress in other emerging markets including Turkey

Indonesia has been under the microscope because of its current account deficit...

Four-quarter rolling sum, percent of GDP



Source: Bank Indonesia; World Bank staff calculations

...and the high share of government debt held by non-residents

Foreign holdings as a share of total, percent



Source: Ministry of Finance; World Bank staff calculations



HOW HAS THE GOVERNMENT RESPONDED?

Monetary policy has prioritized stability...

BI rate hikes

Bank Indonesia (BI) raised interest rates by 125 bps this year despite inflation remaining within the bank's target range

Managing Volatility

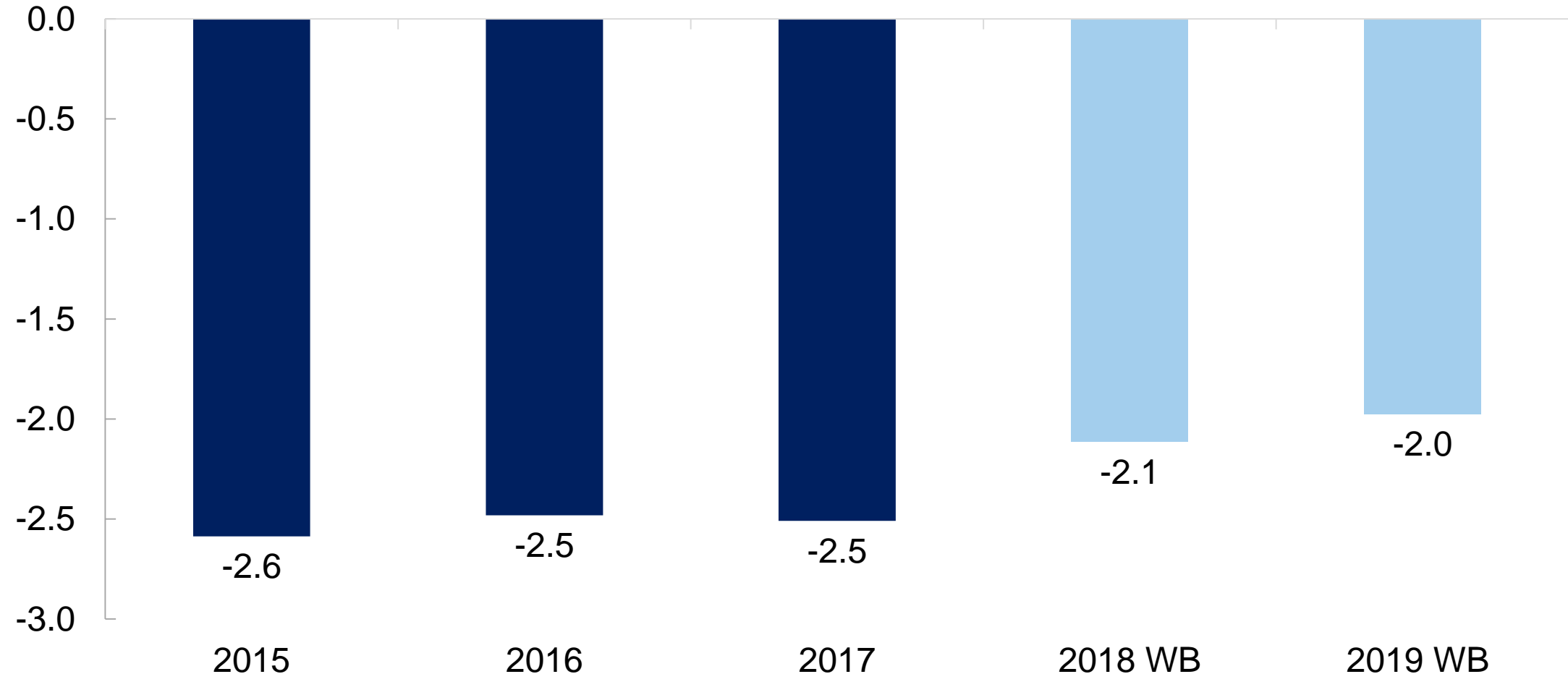
BI has not defended a specific exchange rate level and allowed market-driven depreciation, using record-high reserves accumulated in recent years to smooth volatility

Macro-Prudential Regulations

BI has required hedging of foreign currency corporate debt and has tried to lower cost of hedging

...as has fiscal policy, with deficits narrowing despite elections in 2018 and 2019

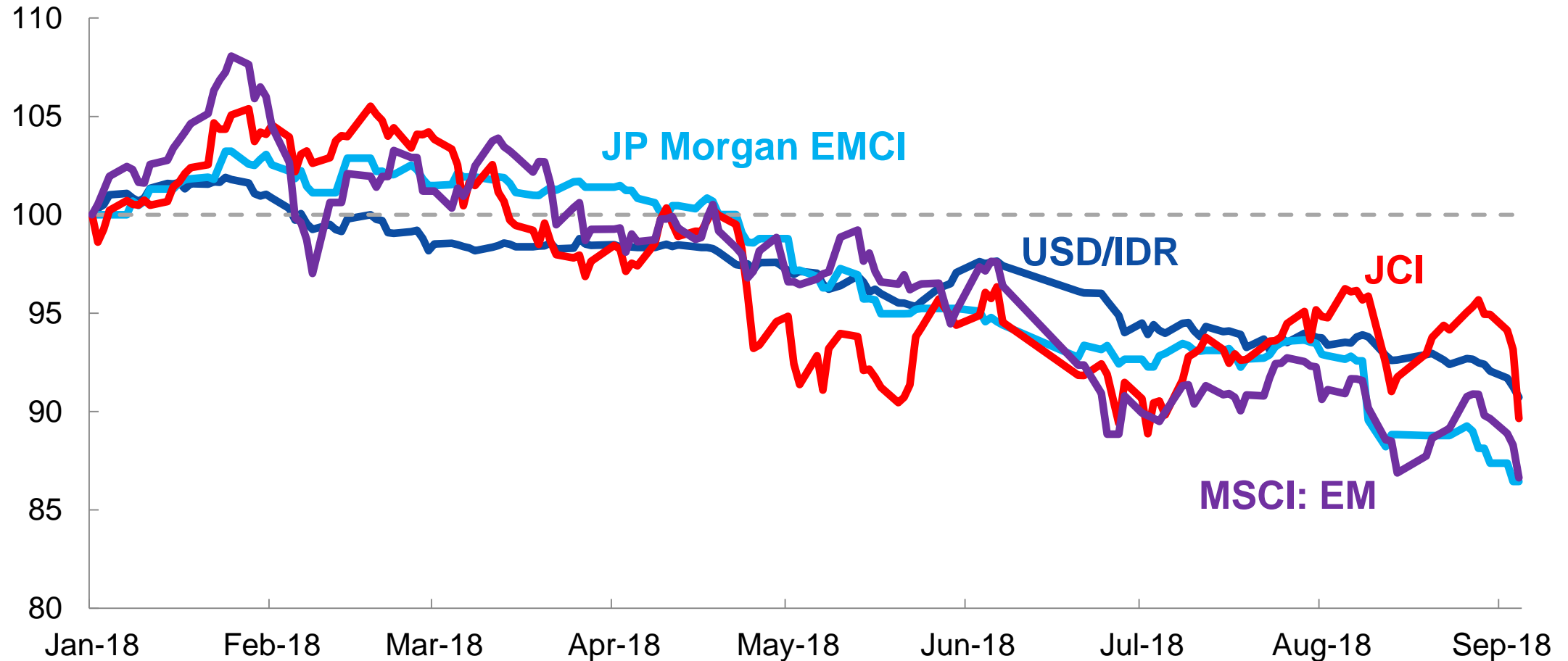
Fiscal Balance, percent of GDP



Source: Ministry of Finance; World Bank staff calculations

IDR depreciated with other EM currencies, and the stock market fell in-line with global equities

Index: January 2018=100



Source: Bloomberg; World Bank staff calculations



WHAT NEXT?



Capital outflows may
accelerate...

...leading to further
tightening as
Government committed
to stability...

...creating risks to
growth rather than of
a financial crisis

2018 is not 1999, or 2013: Indonesia is in a stronger position today

	Asian Financial Crisis (1998)	Taper Tantrum (2013)	September 2018
GDP growth (% yoy)	7.9	6.0	5.1
Credit growth (% yoy)	..	23.5	8.7
Current Account Deficit (% of GDP)	-2.7	-3.0	-2.3
Reserves (months of goods imports)	..	6.9	8.7
External Debt (% GDP)	62.1	32.9	33.0
Inflation (% yoy)	5.2	4.2	3.4

Note: Values refer to 12-month or 4-quarter average prior to the onset of the event

Source: BPS; Bank Indonesia; CEIC; IIF

Solid macroeconomic framework underpins steady outlook, although downside risks increased

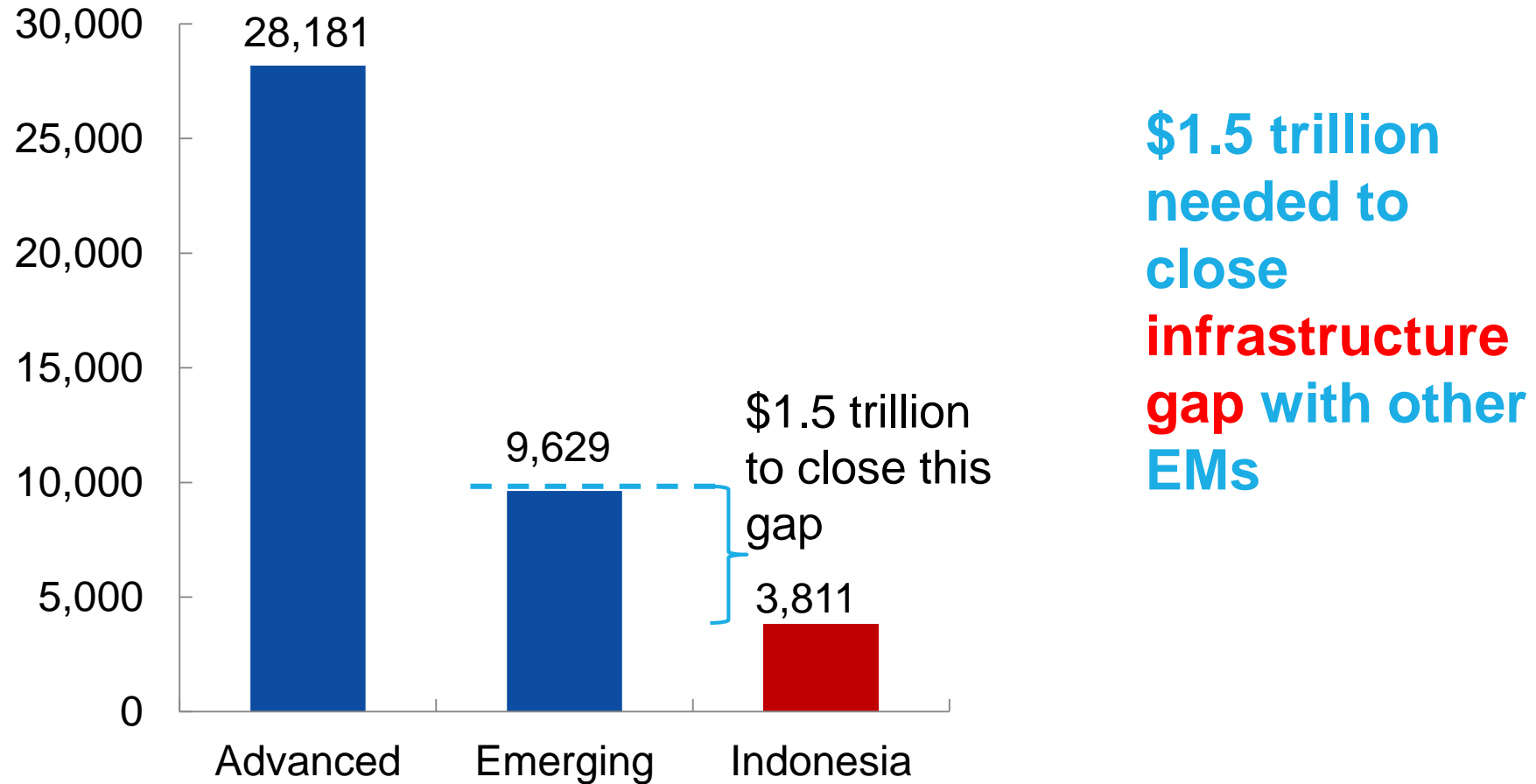
		2017	2018f*	2019f*
Real GDP	Annual percent change	5.1	5.2	5.2
-- Private Consumption	Annual percent change	5.0	5.1	5.1
-- Investment	Annual percent change	6.2	6.8	6.8
Current Account Balance	Percent of GDP	-1.7	-2.4	-2.3
Consumer Price Index	Annual percent change	3.8	3.4	3.7

Note: f: forecast

Source: Bank Indonesia, BPS, Ministry of Finance, World Bank staff projections and calculations

There are risks of unintended consequences of some short-term measures for potential growth

Average public capital stock per capita, 2015 USD

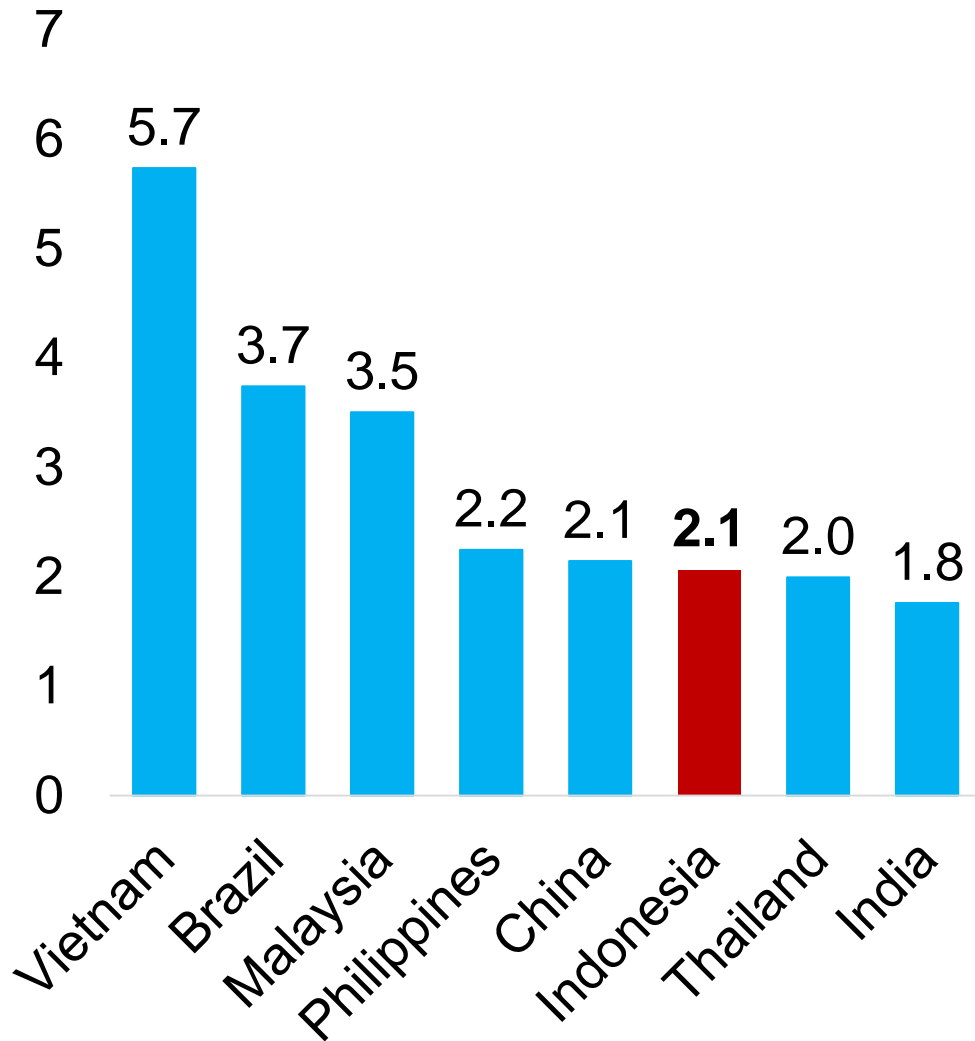


Note: 2015 estimates. Unweighted averages computed for 14 advanced economies and 21 EMs

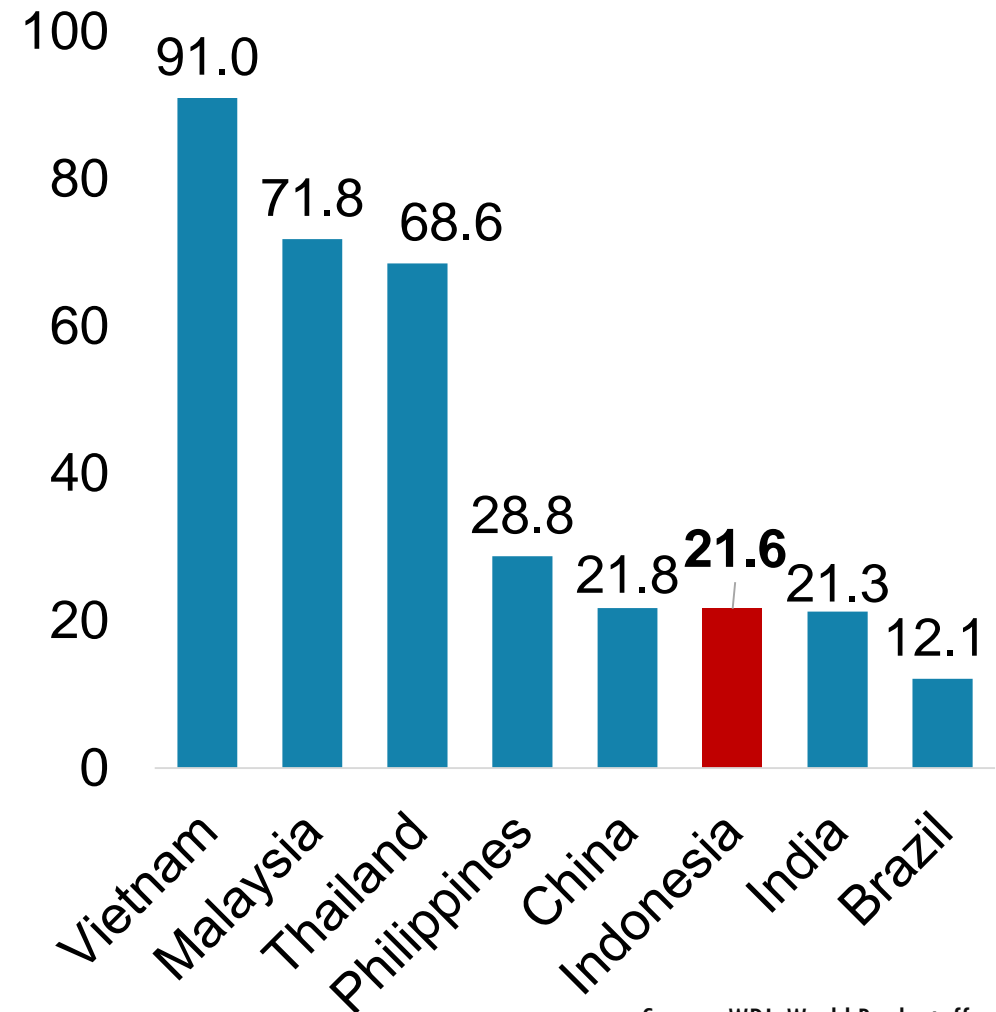
Source: World Bank staff calculations using IMF (2017) data

To reduce vulnerabilities and boost growth, addressing structural weaknesses is key

Percent of GDP, 2013-2017 average



Percent of GDP, 2013-2017 average



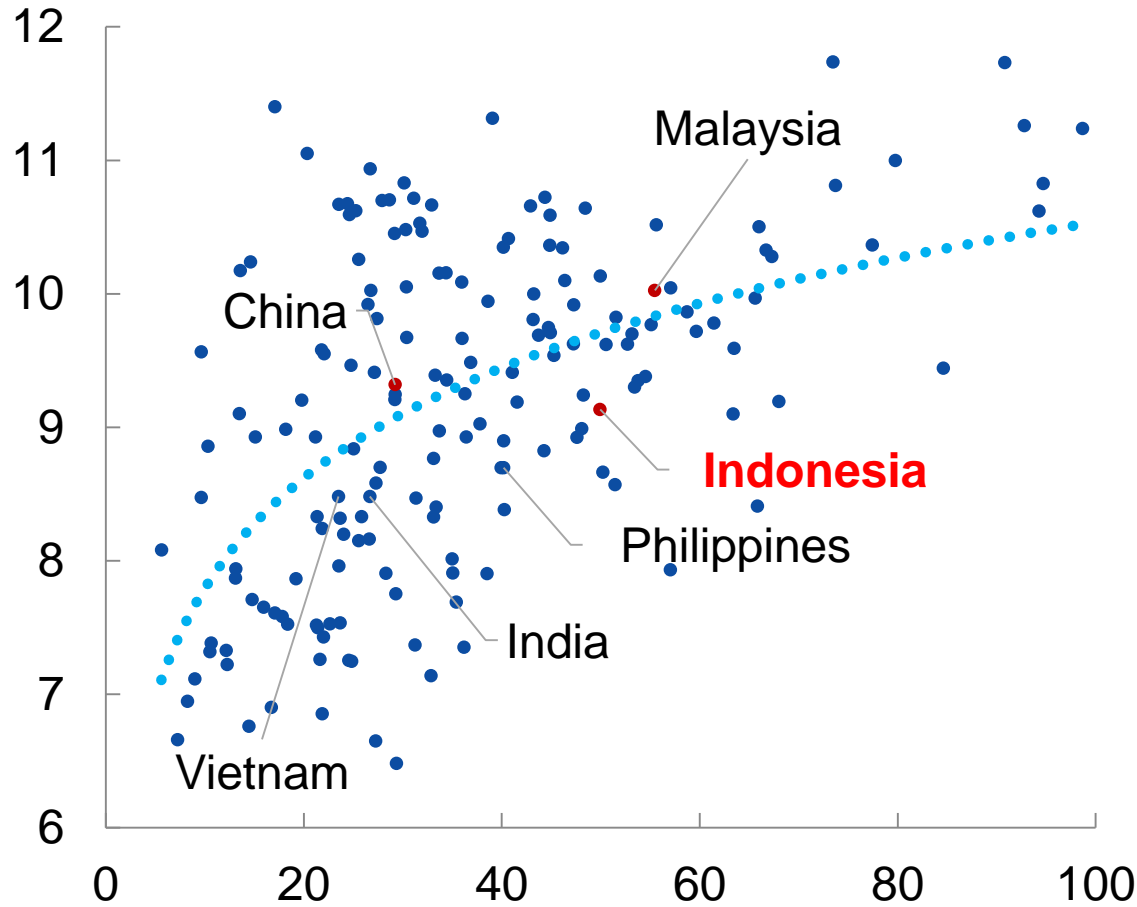
Source: WDI; World Bank staff calculations



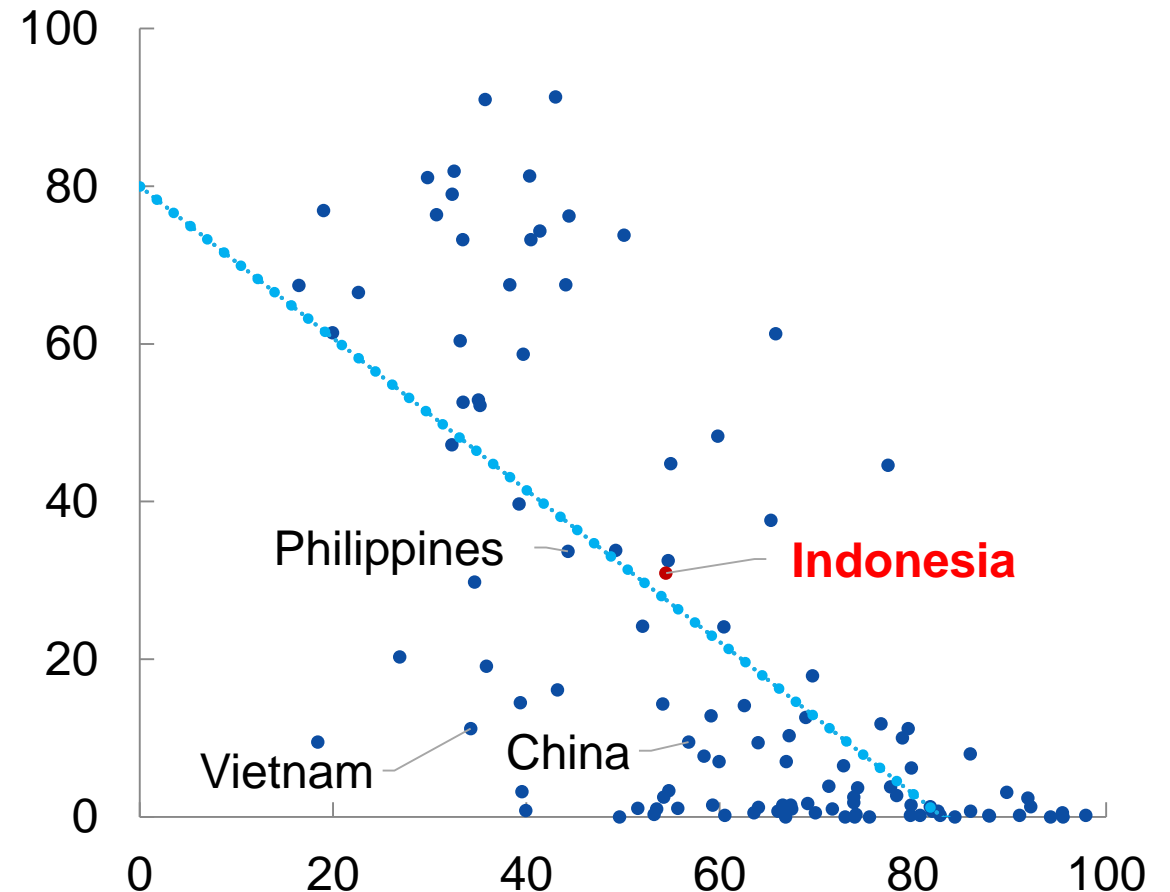
MAKING URBANIZATION WORK FOR ALL

Urbanization can be a powerful force for economic growth and poverty reduction for all

y-axis: log GDP per capita, 2016;
x-axis: urban population share, percent



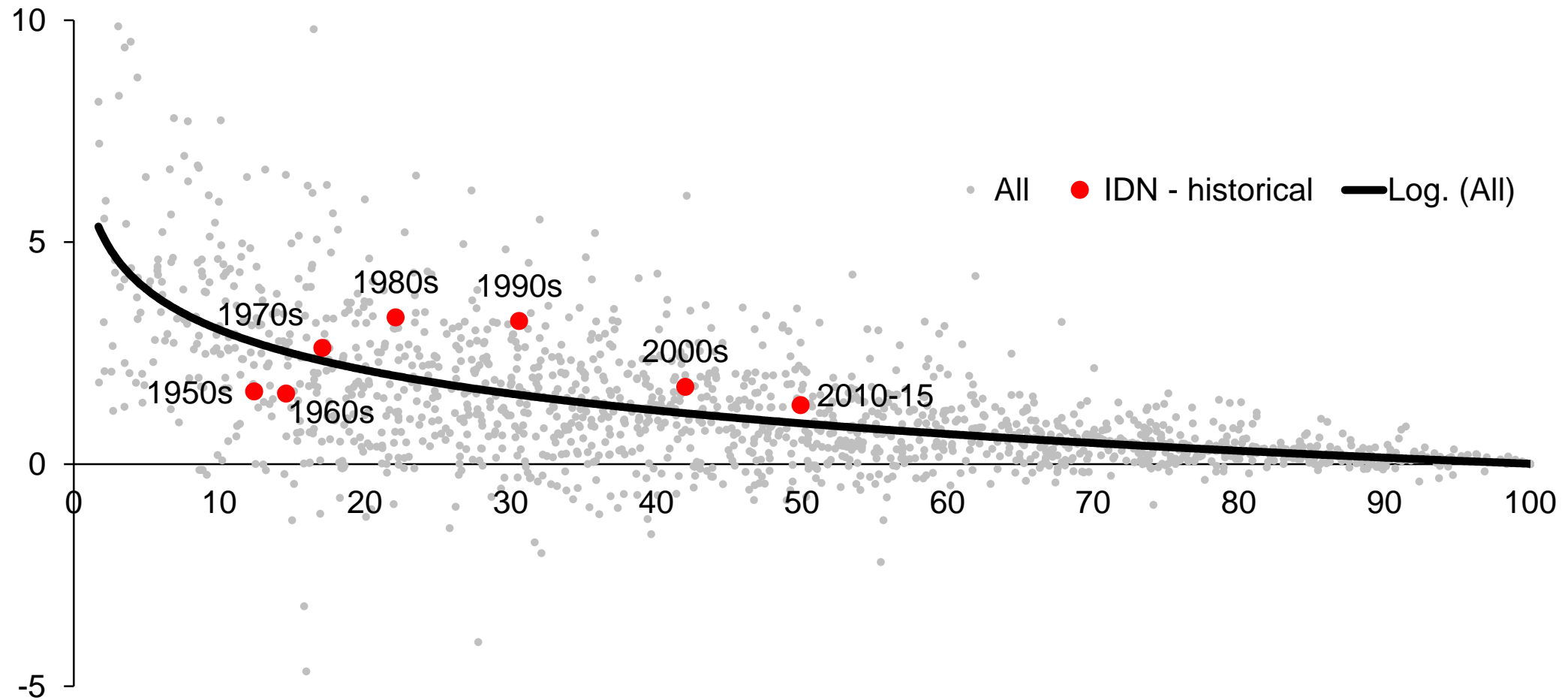
y-axis: poverty headcount ratio at USD 3.20 per day;
x-axis: urban population share, percent



Notes: GDP per capita in constant 2011 international dollars. Poverty rates for 2011-2016 (latest available). Urban population share calculated based on the Dijkstra and Poelman (2014) algorithm applied to Landsat-2012 gridded population data
Source: WDI, PovCalNet, World Bank staff calculations

Indonesia continues to urbanize, but the pace has normalized

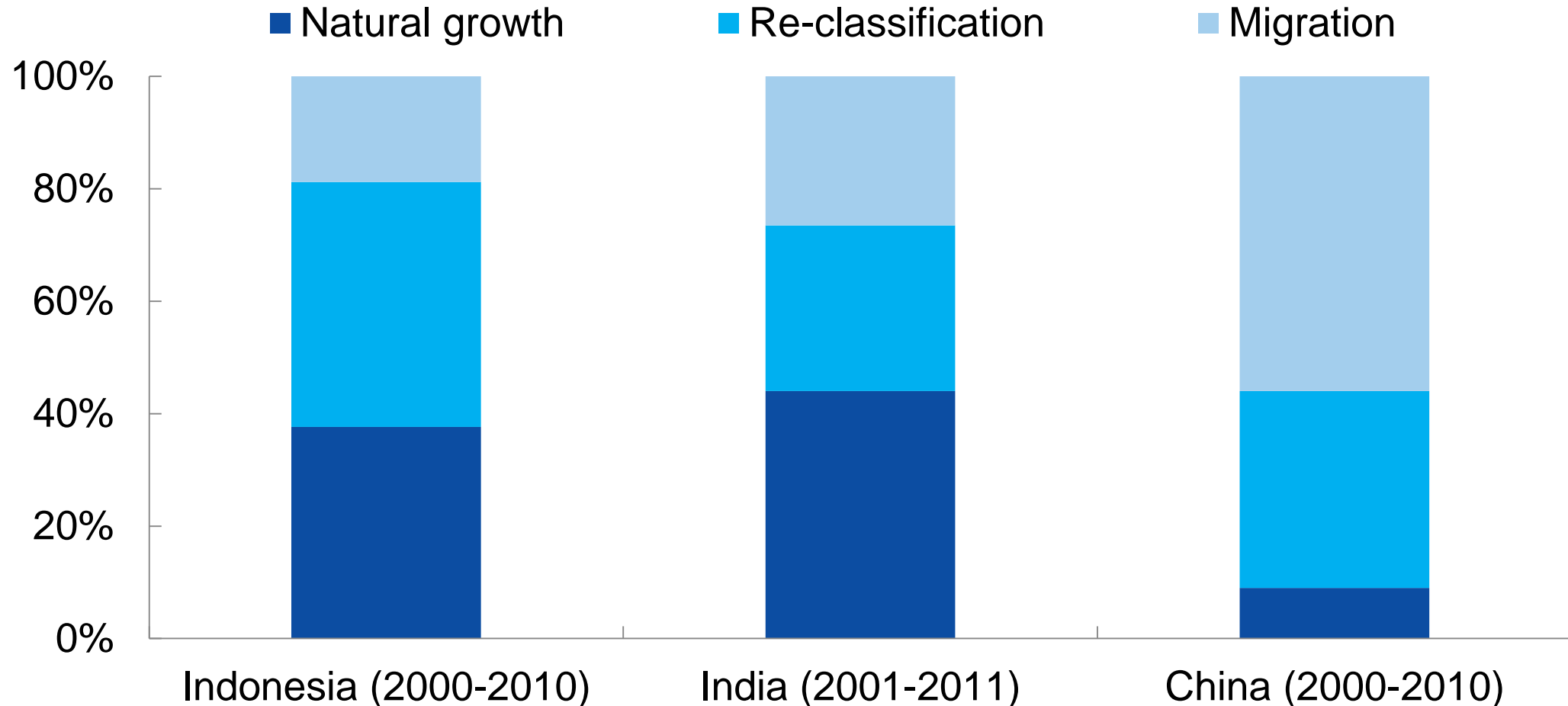
x-axis: initial urban share, percent; y-axis: average annual growth rate of urban share, percent



Source: World Bank staff calculations based on United Nations World Urbanization Prospects 2018 (<https://esa.un.org/unpd/wup/>)

Recent urbanization has occurred largely through conversion of rural areas into urban settlements

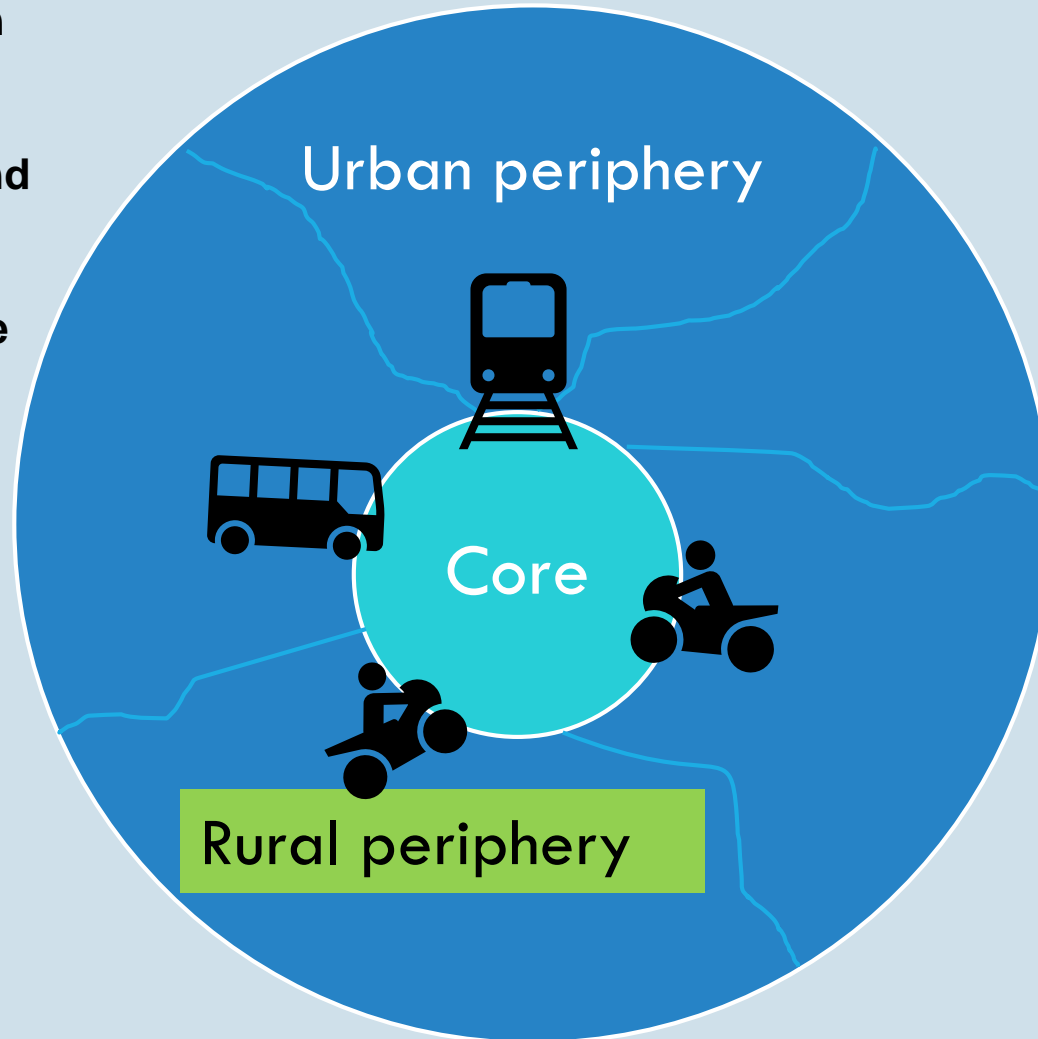
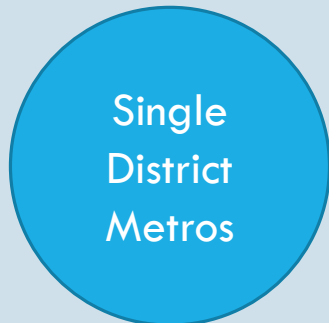
Share of changes in urban population accounted by each source, percent



Half of the urban population currently lives in metropolitan areas

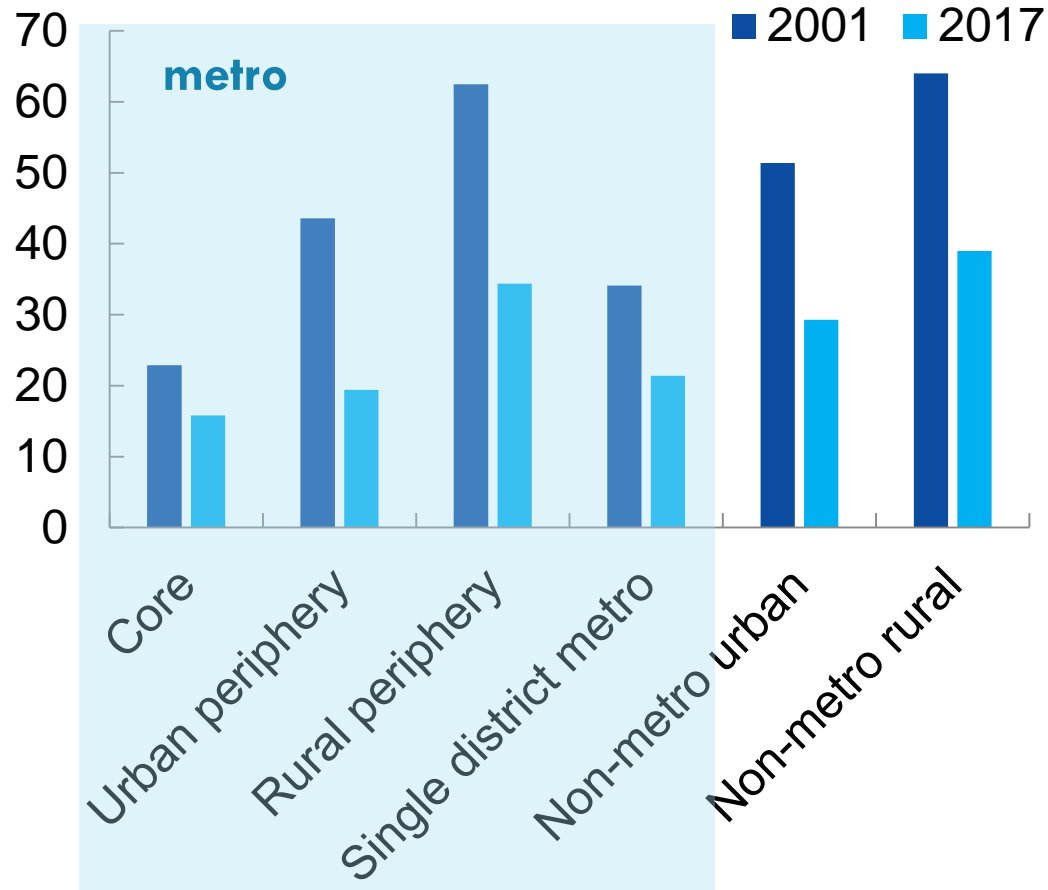
Metropolitan areas can span multiple districts ('multi-district' metro) composed of a core and periphery

...or consist of a single district ('single district metro')

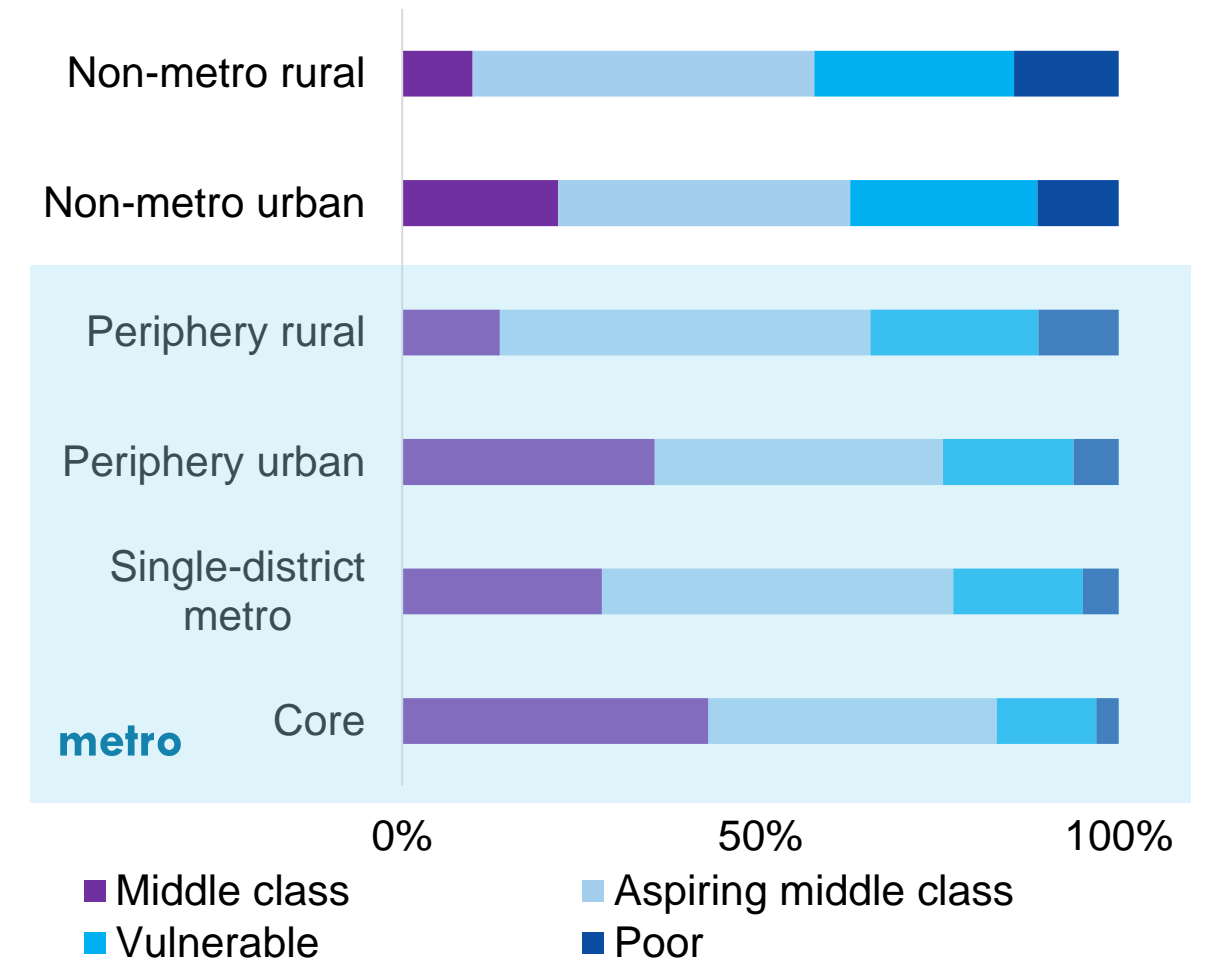


Better economic opportunities in metros helped many escape poverty and join the middle class...

Share of population that is poor or vulnerable, percent



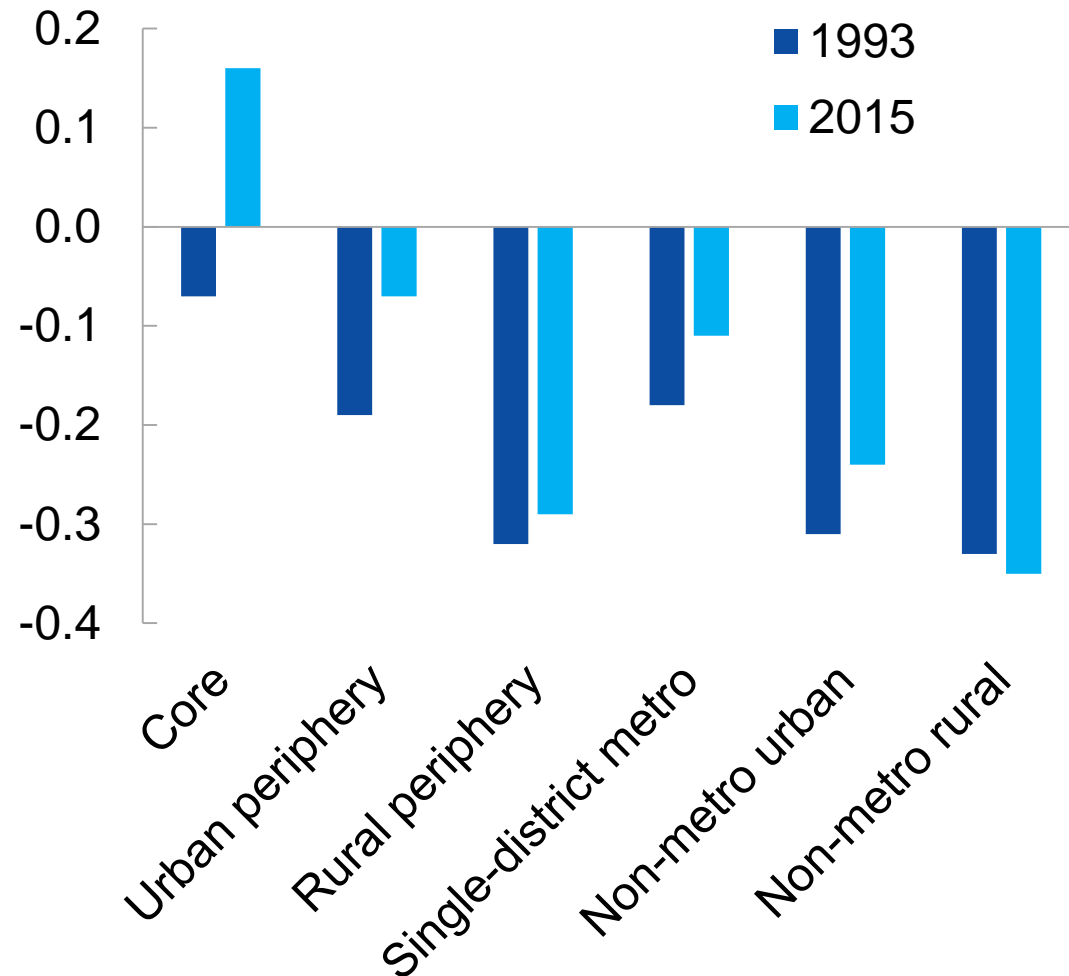
Breakdown of economic class by urban classification, percent



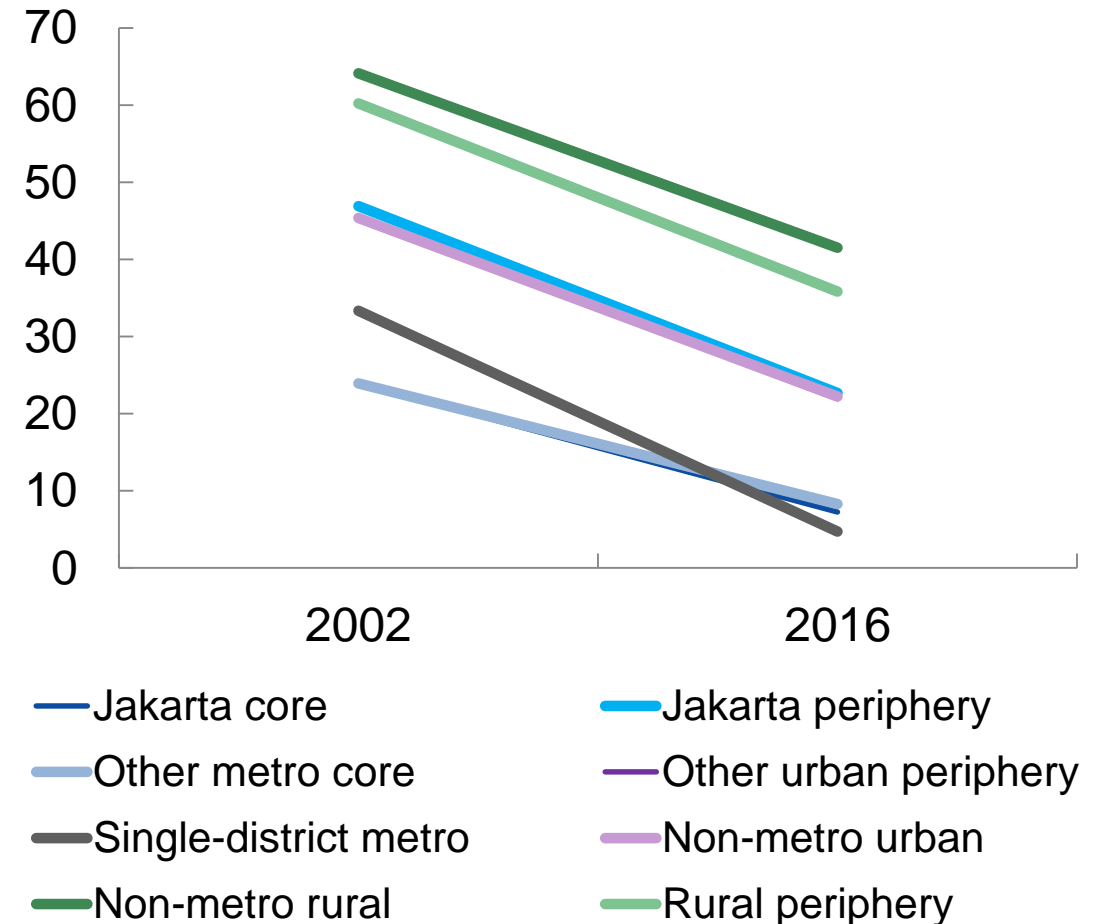
Source: Lain (2018) using Susenas data from March 2016

Inequality between places declined, but disparities remain large...

Consumption gap with DKI Jakarta, percent



Share of households deprived in access to safe drinking water, percent

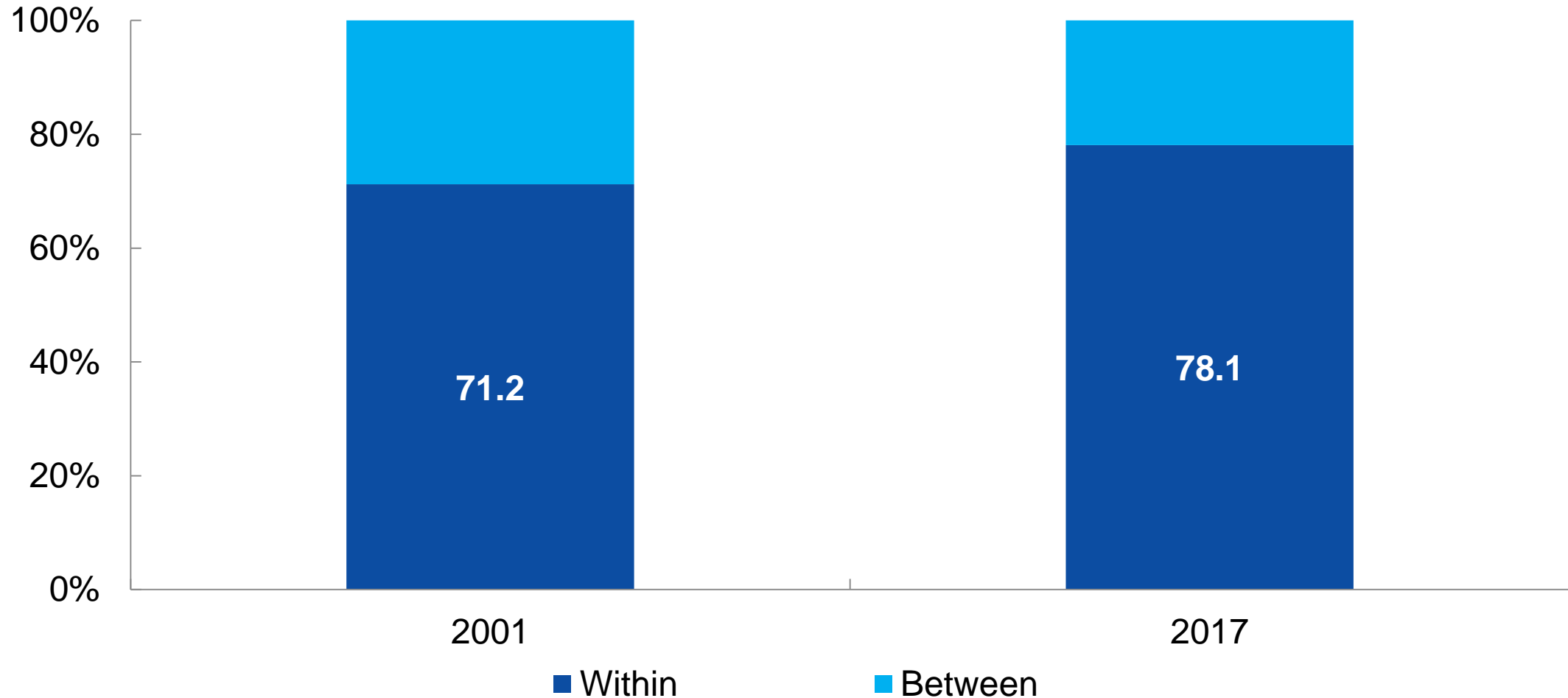


Source: Tiwari and Sadiq (2018); welfare gaps are calculated using differences in welfare ratios which represent the household's expenditure to the contemporaneous poverty line in the region of residence

Source: World Bank staff calculations using Susenas (2002, 2014, 2016) and PODES (2003, 2014) data, based on Lain (2018)

Inequality within places has increased, accounting for nearly 80 percent of all inequality

Total inequality, decomposed within and between districts, percent



Source: Tiwari and Sadiq (2018)

Urbanization can work for all Indonesians using the 3 Cs

Converge & Expand

- Expand services to ensure all Indonesians have equitable access to good quality basic services regardless of location

Connect & Integrate

- Facilitate mobility of goods, people, businesses and ideas so that gains of urbanization are spread

Customize & Target

- Help groups of people (e.g. those with disabilities, women, elderly) and places (e.g. remote areas and islands) that may lag behind

Implementing the 3 Cs require capacity, coordination and resources

Capacity	Coordination	Resources
<ul style="list-style-type: none">• Strengthen limited local government capacity to plan, develop and manage local investments in infrastructure	<ul style="list-style-type: none">• Coordination at the sectoral and inter-governmental levels is key• For example, multi-district metros require provinces to step-up their role	<ul style="list-style-type: none">• Revamp inter-governmental transfers• Boost own-source revenue collection of local governments• Create prudent but flexible framework for local government borrowing



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THANK YOU

Questions?
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