



WORLD BANK GROUP

Indonesia Economic Quarterly March 2015

High expectations

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Introduction

- **Ambitious economic policy reforms initiated, setting high expectations** for what these could achieve:
 - Fuel subsidies
 - Infrastructure spending
 - Business licensing
- **But road from vision to reality is long:**
 - Policy and admin. reforms needed to sustainably **mobilize revenues**
 - **Overcoming execution constraints** to absorb more and better capex
 - **Implementation** of complex reforms, and consistent follow-through
- **Reforms are vital, especially with the economy facing headwinds:**
 - Global growth is rising but commodity demand is not
 - US Dollars: globally, becoming scarcer
 - Possible revenue shortfall this year



Major recent developments

Near-term economic outlook: relatively subdued

Uncertainties

Recent developments: 1. China is not what it once was for Indonesia...

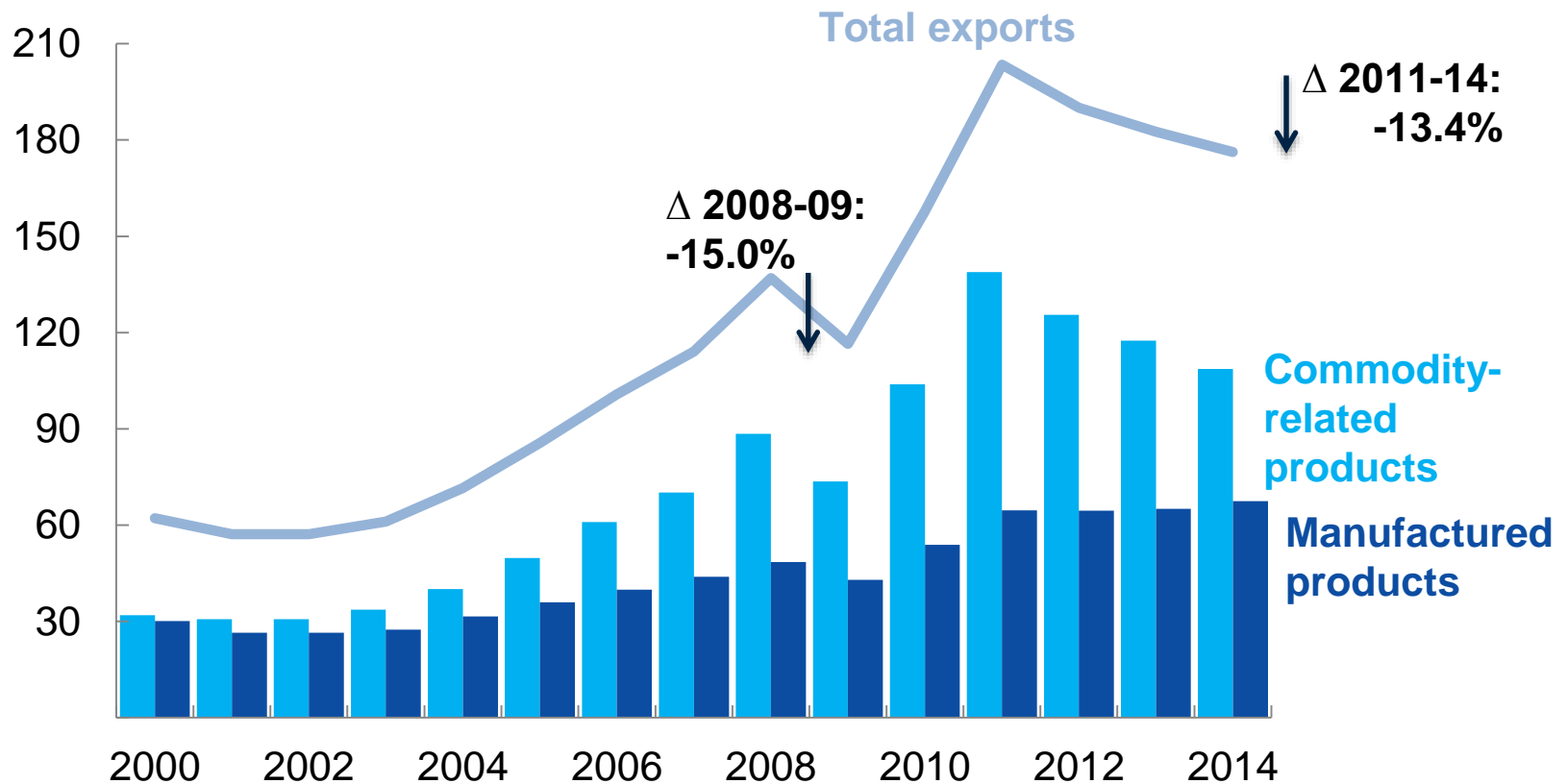
Year-on-year growth, percent



Note: Imports in US Dollars.
Source: CEIC; World Bank staff calculations

...and the commodity boom is over...

Exports, USD billion



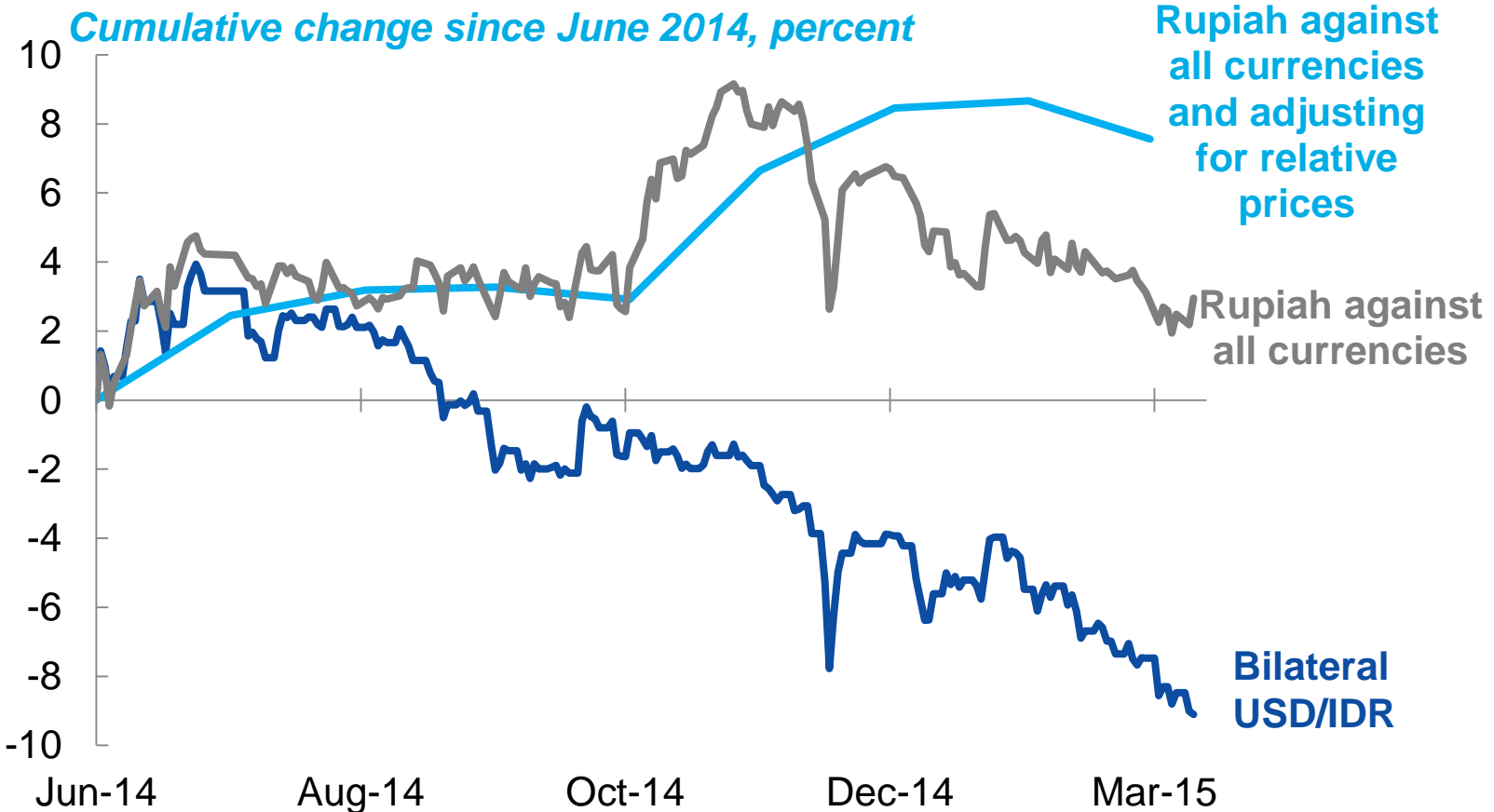
Source: World Bank

...Implication: deep reforms needed to sustain growth of more than ~5.5%



Source: BPS; World Bank staff estimates

Recent developments: 2. US Dollar strength (not Rupiah weakness)...



Note: Rupiah against all currencies, and relative-priced, measures are based on daily proxy measure of nominal, and real effective exchange, rates.

Source: CEIC; BIS; World Bank staff calculations

...with more US Dollar strength potentially to come

US Dollar against all currencies

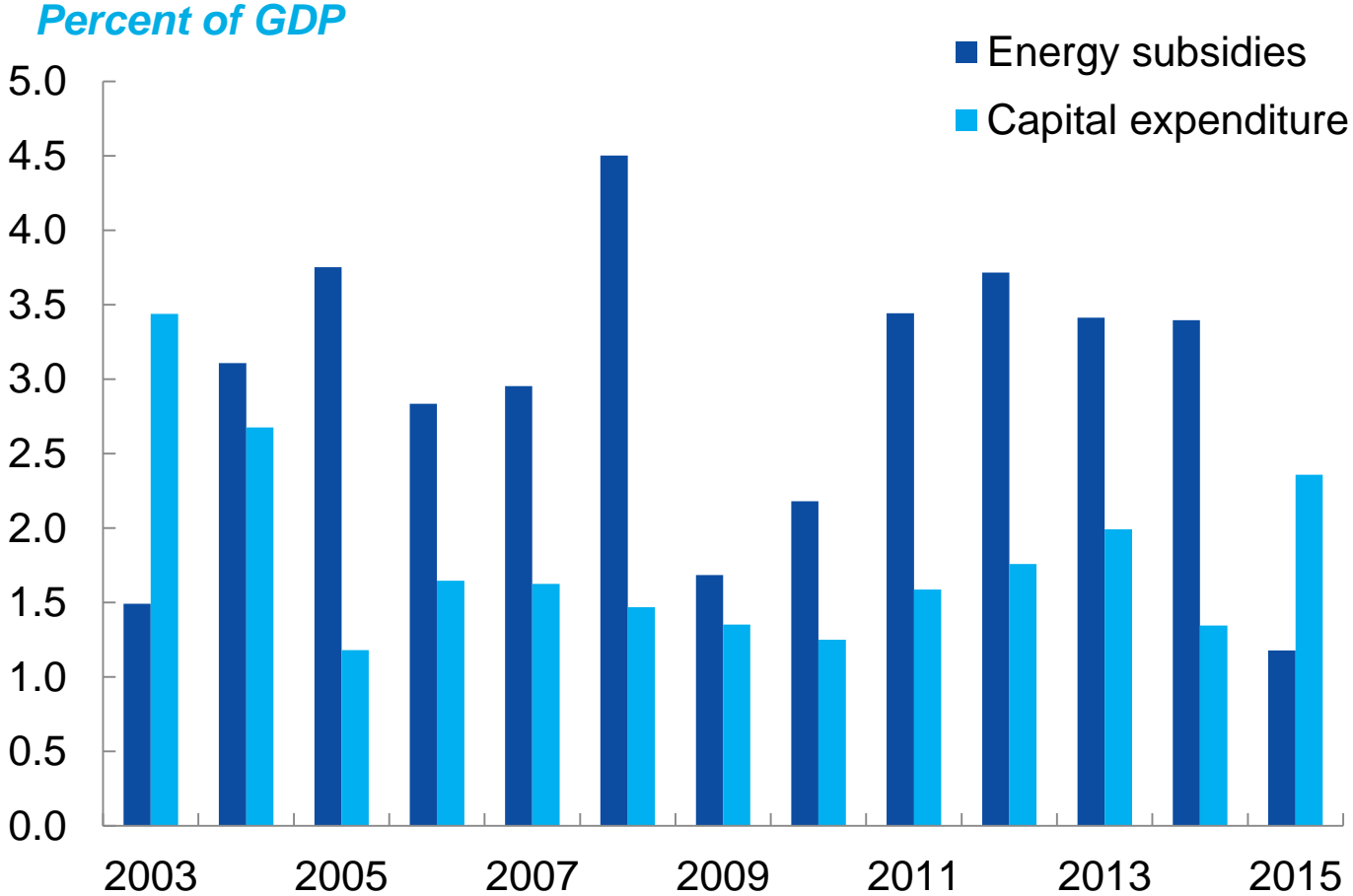


Source: BIS

Implications: possible shocks; working harder for scarcer dollars

- ✓ Relatively speaking, the Rupiah has done fine
 - Comparing USD/IDR to past levels not meaningful – other currencies, relative prices, matter
- ✓ ...but stronger USD environment does put a premium on more, and stable, net USD supply:
 - More exports
 - More foreign direct investment
 - More domestic reinvestment
 - More structural global investment portfolio allocations to Indonesia

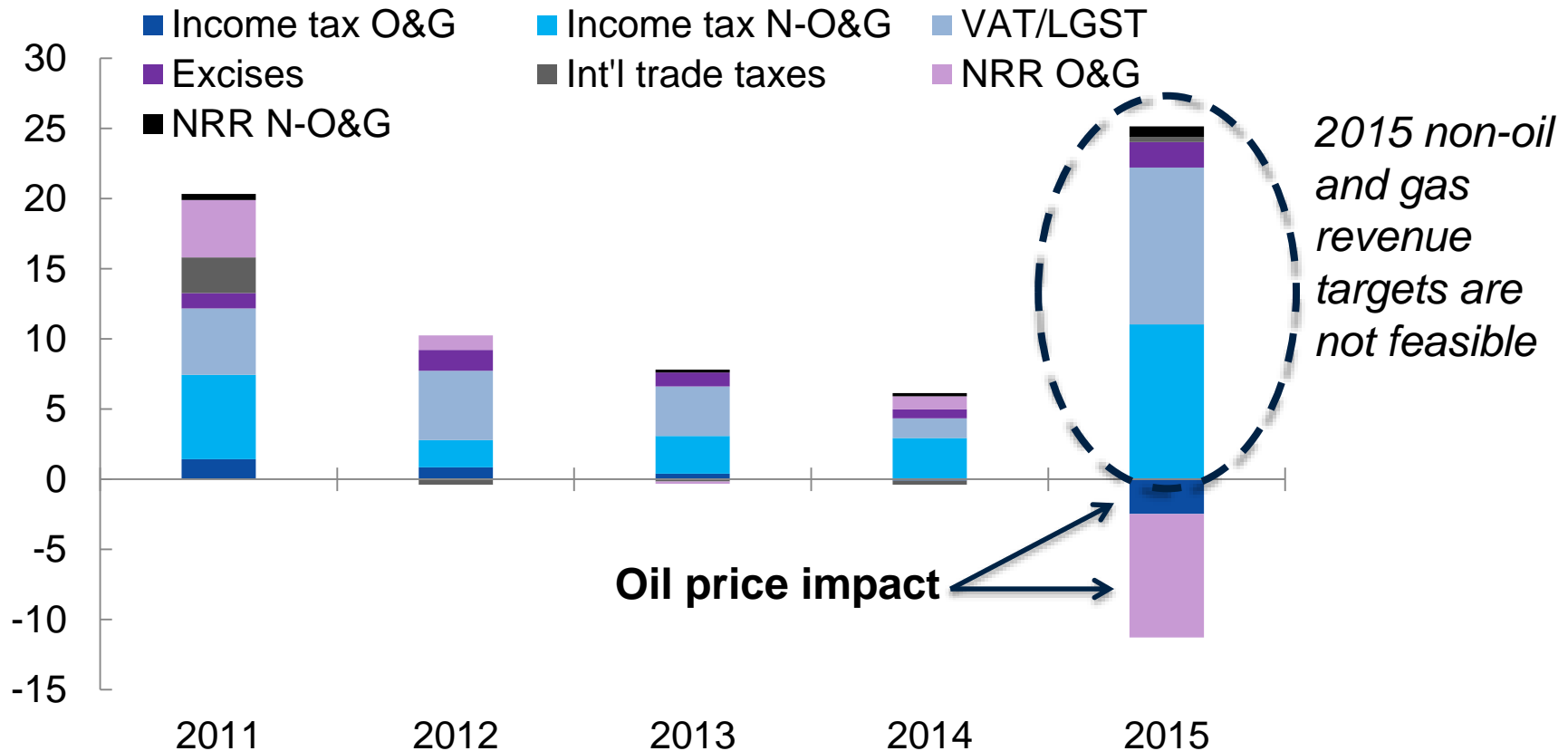
Recent developments: 3. Revised 2015 Budget – dramatic spending reallocation...



Note: 2003-2014 – outturns; 2015: Revised Budget
Source: Ministry of Finance

...but revenue targets are over-ambitious; spending may have to be adjusted

Contributions to nominal revenue growth, percentage points



Note: 2011-2014 – outturns; 2015: Revised Budget (compared with 2014 outturn).

O&G denotes oil and gas, N-O&G denotes non-oil and gas; LGST denotes luxury goods sales tax; NRR denotes natural resource revenues.

Source: Ministry of Finance; World Bank staff calculations

Implications: A long way to go to implement vision of the Budget

- ✓ New fuel pricing system is a banner reform:
 - Sharply reduces wasteful, regressive spending
 - Secures fiscal sustainability
 - Cuts fiscal risks
- ✓ Capex surge - uncertain:
 - Disbursement challenges – quality; timing
 - Limited fiscal space: achieving even half of the budgeted 100% increase in capex from the 2014 outturn will be difficult
- ✓ Revenues:
 - Receding commodity tide has exposed weaknesses

Major recent developments

Near-term economic outlook: relatively subdued

Uncertainties

Base case: no sharp upturn in growth

	March 2015 IEQ				Revisions	
<i>(percentage change, unless otherwise indicated)</i>	2013	2014	2015p	2016p	2015	2016
Real GDP	5.6	5.0	5.2	5.5	0.0	0.0
Consumer prices	6.4	6.4	6.5	5.1	-1.0	-0.1
Current account balance (% of GDP)	-3.2	-3.0	-3.0	-3.2	-0.2	-0.4
Fiscal balance (% of GDP)	-2.2	-2.2	-2.5	-	-0.5	-

Note: Revisions are relative to December 2014 IEQ.
Source: MoF; BPS; BI; World Bank projections

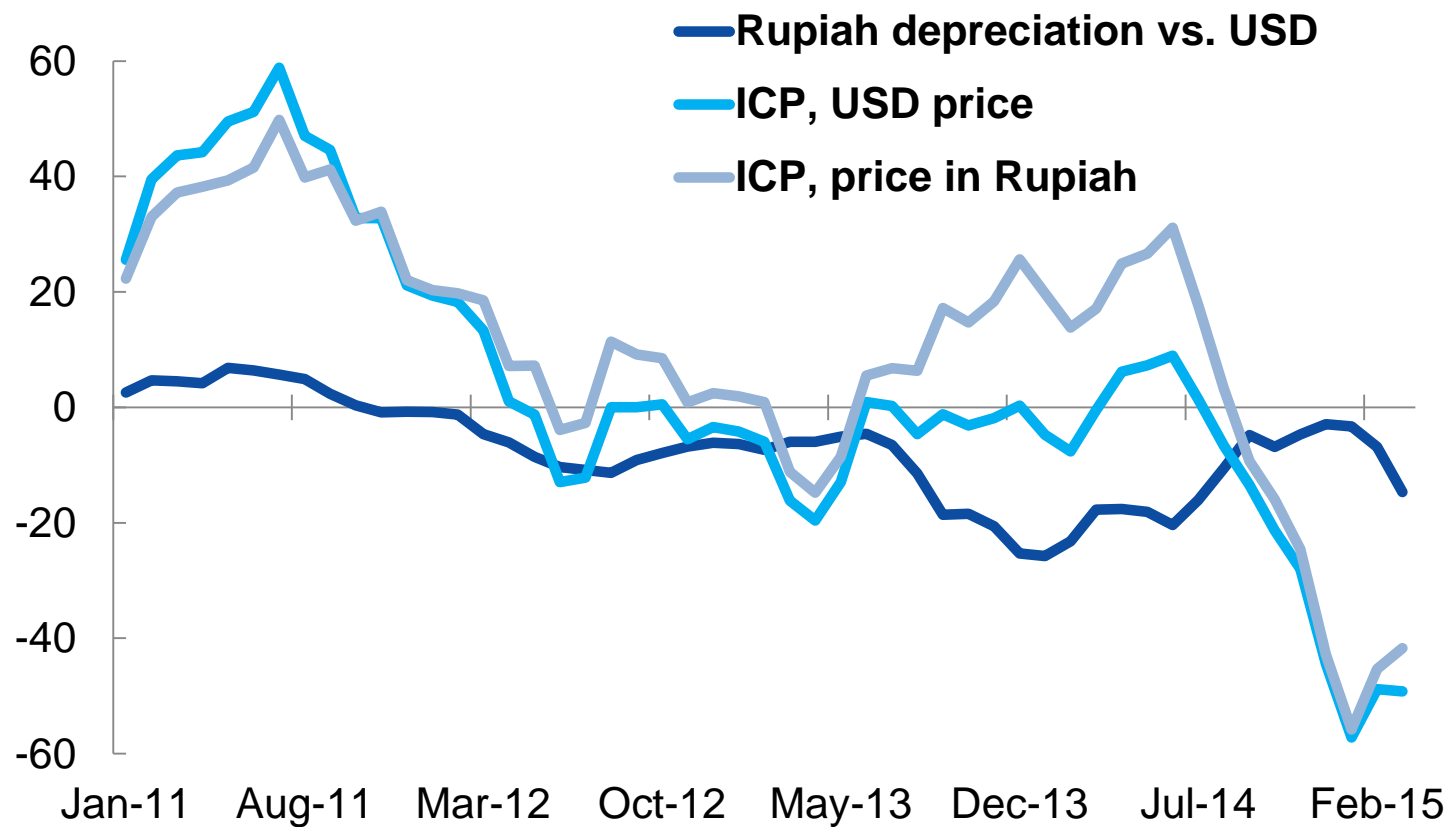
Major recent developments

Near-term economic outlook: relatively subdued

Uncertainties

Fiscal outlook: uncertain Rupiah-denominated fuel prices

Year-on-year, percent



Macro outlook: uncertain timing and scale of investment rebound

- ✓ **Fixed investment has approximately halved since 2012**
 - Weaker commodity sector investment, reduced retained earnings growth, tighter credit
 - Base case: some rebound, helped by infrastructure spending, but timing and size is key source of forecast risk
- ✓ **SOEs:**
 - IDR 70.4 trillion capital injection
 - Quality and quantity of increased infrastructure spending?
- ✓ **Private sector – ready to come to the party?**
 - Business licensing reform push – *one stop services*
 - Strong initial momentum
 - Complex implementation challenge

Conclusion

March 2015 IEQ Contents

- *Regular update on economic developments and the outlook*
- *Indonesia's internationally high and volatile **rice price***
- *Streamlining **business licensing** in Indonesia*
- *The **sustainable pace of GDP** growth in Indonesia: a closer look*
- ***Harnessing natural resources** for Indonesia's development*

