Recent economic developments and outlook

Decentralization that delivers
How did the Indonesian economy perform in Q3 2017?
GDP growth picked up

Contributions to growth yoy, percentage points

SOURCE: BPS; WORLD BANK STAFF CALCULATIONS
Investment at a multi-year high

Contributions to growth yoy, percentage points

SOURCE: BPS; WORLD BANK STAFF CALCULATIONS
Exports surged

Contributions to growth yoy, percentage points

- Source: BPS; World Bank Staff Calculations
How important was the recovery in commodity prices?
Prices for Indonesia’s key commodity exports generally increased

Index January 2016 = 100

SOURCE: WORLD BANK; CEIC; WORLD BANK STAFF CALCULATIONS
Commodity tailwinds did play a role in recent economic performance

- Higher commodity-related exports
- Machinery investments possibly linked to mining
- Destocking linked to high exports with low production in agriculture and mining
But encouraging signs outside commodities

- Export decomposition shows important role of non-commodity manufactures (shoes, auto parts)
- Strong FDI inflows in sectors including wholesale and retail trade and household goods
- Capital expenditure by central government up
Ada apa dengan Konsumsi 2 Rp?
Consumption weakened in H1, but shows signs of recovery in Q3

![Graph showing Qoq saar Growth and Yoy Growth from Q1 2015 to Q3 2017 with a peak in Q3 2017 at 5.5%]

Qoq saar Growth
Yoy Growth

Lebaran Quarters

Q1 2015: Qoq saar Growth 4.8%
Q3 2015: Qoq saar Growth 5.5%
Q1 2016: Qoq saar Growth 4.8%
Q3 2016: Qoq saar Growth 5.5%
Q1 2017: Qoq saar Growth 4.8%
Q3 2017: Qoq saar Growth 5.5%

CEIC, WORLD BANK STAFF CALCULATIONS
Weakness in the first half due to transitory factors

- Electricity tariff hikes for 19m 900VA households
- Increased tax enforcement following tax amnesty program
- Political uncertainty
Recovery reflects waning of transitory factors and strong fundamentals

- Low unemployment (5.5% Aug ‘17 vs. 5.6% Aug ‘16)
- Contained inflation, especially food
- Stable Rupiah
Why the divergence with retail sales?

- Some indicators show an improving trend (motorcycle sales up)
- Increasing shift from goods to services (37 percent of non-food cash consumption)
- E-commerce unlikely to be a significant driver – for now (still less than 2% of sales but growing fast)
Outlook and risks
**Favorable outlook**

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017f</th>
<th>2018f</th>
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</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>5.0</td>
<td>5.1</td>
<td>5.3</td>
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<tr>
<td>Annual percent change</td>
<td></td>
<td></td>
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<tr>
<td>Consumer price index</td>
<td>3.5</td>
<td>3.8</td>
<td>3.5</td>
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<tr>
<td>Annual percent change</td>
<td></td>
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<tr>
<td>Current account balance</td>
<td>-1.8</td>
<td>-1.6</td>
<td>-1.8</td>
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<tr>
<td>Percent of GDP</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Budget balance</td>
<td>-2.5</td>
<td>-2.7</td>
<td>-2.2</td>
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<tr>
<td>Percent of GDP</td>
<td></td>
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*Source: Bank Indonesia, Central Bureau of Statistics (BPS), Ministry of Finance, World Bank staff calculations*
...despite a number of downside risks

External
- G3 monetary policy normalization
- Growth in China
- Commodity prices
- Geopolitical risks

Domestic
- Political season
- Loss of reform momentum
- Energy prices
- Weak tax collection
Key messages

The Indonesian economy will accelerate modestly into Q4 2017 and 2018 supported by domestic and external engines.

Further acceleration in investment growth requires improvements in the business environment, infrastructure.

Ensuring that domestic energy prices are market-driven will protect the space for infrastructure spending.
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Key messages

The Indonesian economy will accelerate modestly into Q4 2017 and 2018 supported by domestic and external engines.

Further acceleration in investment growth requires improvements in the business environment, infrastructure.

Ensuring that domestic energy prices are market-driven and boosting tax collections will protect the space for higher infrastructure spending.
Recent economic developments and outlook

Decentralization that delivers
Over half of public spending in Indonesia is now conducted by subnational governments

SOURCE: APBN AND SIKD DATA; WORLD BANK STAFF CALCULATIONS
Access to basic services has improved in the years since decentralization...

Bantaeng, South Sulawesi

2001

- Improved sanitation 34%
- Improved water 38%

2015

- Improved sanitation 65%
- Improved water 87%

SOURCE: SUSenas and SIKD DATA, WORLD BANK STAFF CALCULATIONS
Access to basic services has improved in the years since decentralization...

2001
Enrolment rates
Junior High School: 43%
Senior High School: 19%

2015
Enrolment rates
Junior High School: 68%
Senior High School: 45%

SOURCE: SUSENAS AND SIKD DATA, WORLD BANK STAFF CALCULATIONS
...but quality varies widely

Timor Tengah Selatan: Stunting rate 70% (2013)

Wakatobi, Southeast Sulawesi: Stunting rate 11% (2013)

SOURCE: SUSENAS AND SIKD DATA, WORLD BANK STAFF CALCULATIONS
..but quality varies widely

Mahakam Ulu, East Kalimantan
Education score 33 (2014)

Langkat, North Sumatra:
Education score 76 (2014)

SOURCE: SUSenas AND SIKD DATA, WORLD BANK STAFF CALCULATIONS
By itself, more spending does not improve outcomes

SOURCE: SUSenas AND SIKD DATA, WORLD BANK STAFF CALCULATIONS
Governance challenges are associated with poor performance

Many high spending districts have poor audit results—and poor outcomes

About 43 percent of the top 5 percent of districts in terms of average spending per capita have average service access rates in the bottom 10 percent of districts (2008-2014)

*Only one of these districts received an unqualified opinion in both 2014 and 2015*

Higher inequality is correlated with poor performance

This is consistent with findings in the academic literature that inequality increases the risk of local elite capture, which in turn is associated with weak performance
The three i’s of improving local service delivery

- Incentives
- Information
- Interaction

Central Government

Local Government

Citizens & Businesses
The three I’s of improving local service delivery

Incentives for performance

Local government evaluation systems
- Align performance measurements with key bottlenecks
- Embed independent verification mechanisms
- Strengthen the pole and capacity of Provinces

Performance-based fiscal transfers
- Increase impact of DID through improved performance measures and allocations
- Increase impact of the DAK by instituting greater results orientation
The three I’s of improving local service delivery

Information for both the central government and citizens to assess performance

Improve availability of outcome indicators at the kabupaten, kota and desa levels
Make detailed and comparable data on local government spending easily available
Public availability of data creates a virtuous circle leading to better data quality
The three I’s of improving local service delivery

Interaction – between citizens and businesses, and local governments and service providers

Enhance transparency to foster citizen engagement
Provide local leaders, government agencies, citizens and firms with access to detailed information about performance and evaluation results

Develop local-level indices of service delivery and the business environment
This can help create a race-to-the-top in service provision and the business environment
TERIMA KASIH
THANK YOU