INDONESIA ECONOMIC QUARTERLY 09|18

URBANIZATION FOR ALL

Frederico Gil Sander, Lead Economist
September 20, 2018
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

Source: BPS; World Bank staff calculations
Income growth in mining and agriculture sectors accelerated...

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

Source: Bank Indonesia; BPS; World Bank staff calculations
...and headline CPI inflation remained low

**Prince 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

2015: -2.6
2016: -2.5
2017: -2.5
2018: -2.1
2019: -2.0

Source: Ministry of Finance; World Bank staff calculations
IDR depreciated with other EM currencies, and the stock market fell in-line with global equities.

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

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth (% yoy)</td>
<td>7.9</td>
<td>6.0</td>
<td>5.1</td>
</tr>
<tr>
<td>Credit growth (% yoy)</td>
<td>..</td>
<td>23.5</td>
<td>8.7</td>
</tr>
<tr>
<td>Current Account Deficit (% of GDP)</td>
<td>-2.7</td>
<td>-3.0</td>
<td>-2.3</td>
</tr>
<tr>
<td>Reserves (months of goods imports)</td>
<td>..</td>
<td>6.9</td>
<td>8.7</td>
</tr>
<tr>
<td>External Debt (% GDP)</td>
<td>62.1</td>
<td>32.9</td>
<td>33.0</td>
</tr>
<tr>
<td>Inflation (% yoy)</td>
<td>5.2</td>
<td>4.2</td>
<td>3.4</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018f*</th>
<th>2019f*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>5.1</td>
<td>5.2</td>
<td>5.2</td>
</tr>
<tr>
<td>-- Private Consumption</td>
<td>5.0</td>
<td>5.1</td>
<td>5.1</td>
</tr>
<tr>
<td>-- Investment</td>
<td>6.2</td>
<td>6.8</td>
<td>6.8</td>
</tr>
<tr>
<td>Current Account Balance</td>
<td>-1.7</td>
<td>-2.4</td>
<td>-2.3</td>
</tr>
<tr>
<td>Consumer Price Index</td>
<td>3.8</td>
<td>3.4</td>
<td>3.7</td>
</tr>
</tbody>
</table>

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

- **Advanced**: $28,181
- **Emerging**: $9,629
- **Indonesia**: $3,811

$1.5 trillion needed to close infrastructure gap with other EMs.

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

Percent of GDP, 2013-2017 average

Vietnam  |  Brazil  |  Malaysia  |  Philippines  |  China  |  Indonesia  |  Thailand  |  India
---|---|---|---|---|---|---|---
5.7  | 3.7  | 3.5  | 2.2  | 2.1  | 2.1  | 2.0  | 1.8

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*

*Philippines*  
*China*  
*Vietnam*  
*Indonesia*  
*Malaysia*  
*India*  
*Vietnam*  
*China*

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

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

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

- **Indonesia (2000-2010)**
  - Natural growth
  - Re-classification
  - Migration

- **India (2001-2011)**
  - Natural growth
  - Re-classification
  - Migration

- **China (2000-2010)**
  - Natural growth
  - Re-classification
  - Migration

Source: Derived from figures presented in Wai-Poi et al. (2018), World Bank — DRC (2014) and Pradhan (2013) for Indonesia, China and India respectively.
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’)

Source: World Bank
Better economic opportunities in metros helped many escape poverty and join the middle class...

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

**Consumption gap with DKI Jakarta, percent**

- 1993
- 2015

**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.
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

<table>
<thead>
<tr>
<th>Capacity</th>
<th>Coordination</th>
<th>Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Strengthen limited local</td>
<td>• Coordination at the sectoral and inter-governmental levels is key</td>
<td>• Revamp inter-governmental transfers</td>
</tr>
<tr>
<td>government capacity to plan,</td>
<td>• For example, multi-district metros require provinces to step-up their role</td>
<td>• Boost own-source revenue collection of local governments</td>
</tr>
<tr>
<td>develop and manage local</td>
<td></td>
<td>• Create prudent but flexible framework for local government borrowing</td>
</tr>
<tr>
<td>investments in infrastructure</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
TERIMA KASIH
THANK YOU

Questions?
fgilsander@Worldbank.org