Indonesia Economic Quarterly
June 2017
Upgraded

Hans Anand Beck
Acting Lead Economist, Indonesia
June 15, 2017
Key Takeaways

S&P upgrade acknowledged strong economic fundamentals and management.
- S&P returned Indonesia to investment grade credit rating after 20 years, citing strong (fiscal) fundamentals
- Global growth and trade is firming but remains below pre-GFC levels.

2017 economic performance continues to be broadly positive, with some temporary help from commodities.
- Q1 2017 Quarterly GDP growth rose on a rebound in government consumption and surging manufacturing and commodity exports.
- Signs of a sustained turnaround in investment and credit growth.
- Revenues continued their strong start to the year supported by commodities, creating space for productive public spending.
- Risks remain tilted to the downside, including resistance to structural reform efforts.

Investing in the future is critical - to leverage the upgrade, reduce commodity dependence, and boost growth potential
- There is evidence that reducing Indonesia’s negative investment list will boost FDI
- Invest in early childhood development to address inequality and increase productivity
S&P recognized strong policy and fundamentals

2017 positive performance continues, with temporary help from commodities

Invest in the future to leverage the upgrade, reduce commodity dependence and boost growth potential
S&P recognized Indonesia’s strong economic fundamentals, returning it’s sovereign rating to Investment grade after 20 years.

“Indonesia has exhibited effective policymaking in recent years to promote sustainable public finances and balanced economic growth…”

“Indonesian authorities have taken effective expenditure and revenue measures to stabilize the country’s public finances despite the terms of trade shock…”

“…Indonesia's increased focus on realistic budgeting has reduced likelihood that shortfall in future revenue would widen general government deficit significantly.”

- Standard & Poor’s
While Indonesia’s fundamentals are strong, Indonesia will still need to compete….

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<tbody>
<tr>
<td>Real GDP (Annual percent change)</td>
<td>4.9</td>
<td>5</td>
<td>5.2</td>
<td>6.8</td>
<td>6.2</td>
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<tr>
<td>Consumer price index (Annual percent change)</td>
<td>6.4</td>
<td>3.5</td>
<td>4.3</td>
<td>1.8</td>
<td>2.7</td>
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<tr>
<td>Current account balance (Percent of GDP)</td>
<td>-2.0</td>
<td>-1.8</td>
<td>-1.8</td>
<td>0.2</td>
<td>3</td>
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<tr>
<td>Budget balance (Percent of GDP)</td>
<td>-2.6</td>
<td>-2.5</td>
<td>-2.6</td>
<td>-2.4</td>
<td>-6.5</td>
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<tr>
<td>Debt (Percent of GDP)</td>
<td>27.4</td>
<td>27.9*</td>
<td>29.0</td>
<td>42.1</td>
<td>62.1</td>
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<tr>
<td>S&amp;P Rating (2017)</td>
<td>BBB-</td>
<td>BBB</td>
<td>BB-</td>
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Source: BI: BPS; EAP Economic Update Report; MoF; World Bank staff calculations
Note: e stands for estimate; f stands for forecast; *estimated figure
.....as the global economy begins to pick up again.

*growth yoy, percent*

Source: World Bank Global Economic Prospects June 2017
S&P recognized strong policy and fundamentals

2017 positive performance continues, with temporary help from commodities

Invest in the future to leverage the upgrade, reduce commodity dependence and boost growth potential
Following the first increase in growth rates in 5 years in 2016, the trend continued in Q1 2017.

Contributions to real GDP growth yoy, percentage points

Private consumption
Investment
Net exports
Stat. discrepancy*
GDP

Source: BPS; World Bank staff calculations
There are signs of a more sustained pick up in investment

3mma growth yoy, percent, LHS; growth yoy, percent, RHS

Source: BI; BPS; World Bank staff calculations
Note: The nominal capital goods imports is measured in percent yoy terms. All other LHS variables are measured in 3mma percent yoy terms.
And signs of a pick up in broad credit growth
Industrial Production and manufacturing export growth is firming up, although commodities are also supporting exports.

Industrial Production Index and PMI

Exports growth

Source: BPS; Nikkei/Markit

Source: CEIC and BI; World Bank staff calculation
Commodities are also supporting a good start to the year for revenue collection…

- Total revenue collection increased by 17.8 percent yoy

**Contributions to growth yoy, percentage points**

![Graph showing contributions to growth yoy](image)

- **Revenue growth**
  - Excises and other taxes
  - VAT/LGST
  - Oil and gas related revenues
  - Non oil and gas income tax

Source: Ministry of Finance; World Bank staff calculations
…providing space to spend, especially in more productive areas such as capital.

January-May actual expenditure growth yoy, percent

Source: Ministry of Finance; World Bank staff calculations
Support from commodities is forecast to be transitory....

The Net Trade-weighted Price Index

growth yoy, percent

Source: BPS; World Bank; World Bank staff calculations
Note: Net trade-weighted price index is constructed over Indonesia’s six major export commodities.
...and risks to growth remain tilted to the downside.

### Upside
- Faster than expected pick up in global growth
- Better than expected lift in investor confidence

### Downside
- Uncertain global economic policy
- Faster than expected fall in commodity prices
- Resistance to structural reform

### External risks
- [Diagram showing external risks]

### Domestic risks
- [Diagram showing domestic risks]
S&P recognized strong policy and fundamentals

2017 positive performance continues, with temporary help from commodities

Invest in the future to leverage the upgrade, reduce commodity dependence and boost growth potential
Lifting FDI restrictions can boost physical capital and hence Indonesia’s growth potential

Inverse relationship between FDI investment policy restrictiveness and FDI inflows

*FDI stock measured in current USD and FDI regulatory index*

And Investment in early childhood development can create the human capital the economy needs to grow.

Association between child stunting (Height-for-age Z score) and fluid intelligence (W Z-score) in later life, Indonesia

Source: Giles, Satriawan, and Witoelar, 2017 (based on IFLS data)
Notes: “Fluid intelligence” assesses respondents’ general ability to think abstractly, reason, identify patterns, solve problems, and discern relationships. The Z-score is a standard measure that expresses each value by the number of standard deviations it is from the reference mean. The W-score is the score obtained from an adaptive number series test of fluid intelligence, which was normed and extensively pre-tested for the 2014 round of the IFLS. It was standardized into a Z-score for the purposes of this analysis.
...while reducing stunting also tackles a major source of inequality.

Stunting affects everyone, but is worse for the poor

In early childhood, stunting leads to increased risk of death and illness

In school-age, stunting leads to loss of IQ and poor learning outcomes

In adulthood, stunting leads to increased risk of NCDs and lower income levels

Stunting Incidence (percent of under-5 population)

Source: Riskesdas
Terima Kasih
As global trade has rebounded, so has Indonesia’s trade performance

Contributions to real growth yoy, percentage points

Source: BPS; World Bank staff calculation