Key takeaways

Indonesia showed resilience as volatility returned to global financial markets

- Thanks to strong fundamentals and macro-fiscal management, Indonesia weathered recent volatility better than many peers:
  - Efficiencies in the 2016 budget and a more credible 2017 budget
  - Low inflation; a pause in accommodative monetary policy
  - Policy packages have made it easier to do business

However, risks have intensified and remain tilted to the downside

- External, as well as domestic risks remain
  - Global policy uncertainty, trade deals and revenue collection

This emphasizes the importance of sustaining reform momentum to mitigate risk and foster inclusive growth

- Fiscal reforms to spend with greater impact, and stem the decline in revenues
- Investment climate reforms to accelerate private investment
- Investing in human capital through education
Indonesia remains resilient to sluggish global growth

Economic growth (Annual percentage change)

Gloomy Global Economic Growth – below 3% in current forecast period

Source: World Bank Global Economic Prospects; WDI
Gloomy global trade

*Global import demand*, fixed base 2010=100

Source: World Bank Global Economic Prospects; WDI
Indonesia remains resilient to global financial volatility

*Exchange rates against USD (index, April 1=100)*

- **Malaysia**
- **Philippines**
- **Thailand**
- **Singapore**
- **Indonesia**
- **EMCI**

Source: CEIC; WB Staff Calculation

Brexit

US election
Exports in the region Depend On Global Growth Outlook

But in Indonesia, Private consumption has supported growth while private investment remains subdued.

*Contributions to yoy GDP growth (percentage points)*

Source: CEIC; WB Staff Calculation
The baseline expectation is that Indonesia’s economy will remain resilient and stable

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017p</th>
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<tbody>
<tr>
<td>Real GDP growth</td>
<td>4.8</td>
<td>5.1¹</td>
<td>5.3</td>
</tr>
<tr>
<td>Inflation</td>
<td>6.4</td>
<td>3.5</td>
<td>4.4</td>
</tr>
<tr>
<td>Current account balance (% GDP)</td>
<td>-2.1</td>
<td>-2.1¹</td>
<td>-2.3</td>
</tr>
<tr>
<td>Budget balance (% GDP)</td>
<td>-2.6</td>
<td>-2.5²</td>
<td>-2.6</td>
</tr>
<tr>
<td>Government Debt (%GDP)</td>
<td>27.4</td>
<td>28.3¹</td>
<td>28.7</td>
</tr>
<tr>
<td>Unemployment (%)</td>
<td>6.2³</td>
<td>5.6³</td>
<td>-</td>
</tr>
<tr>
<td>Underemployment (%)³</td>
<td>29.9³</td>
<td>27.2³</td>
<td>-</td>
</tr>
</tbody>
</table>

¹ Estimate; ² Preliminary realization data; ³ Data is for August; ⁴ Defined as workers who works less than 35 hours/week, as a % of total workers

Source: MoF; BI; CEIC; BPS; World Bank projections
Indonesia remains resilient

But downside risks have intensified

Sustaining reform momentum is essential to withstand risks and promote inclusive growth
Downside risks still dominate upside risks

Upside
- Commodity price uptick
- Faster investment climate reform

Downside
- Sluggish global growth and trade
- Uncertain global economic policy
- Lower than expected revenue

External risks
- Domestic risks
Headwind 1 (for commodity exporters):
Commodity Prices will remain low
Headwind 2: Global Financial Tightening Will Matter…..

(US$ denominated debt, percent of total public external debt) (Short-term debt, percent of gross external debt)

... as debt remains a key source of vulnerability in several countries

(Debt service as a percent of income)  (Return on assets, listed firms, percent)

Sustaining reform momentum is essential to withstand risks and promote inclusive growth.

Indonesia remains resilient.

But downside risks have intensified.
The tax amnesty boosted revenue in 2016...

- Total tax amnesty revenue was IDR 103 trillion (62% of the target) by the end of Phase 2

- Repatriated offshore foreign assets remained low at 14% of the target
...but all other major revenue sources fell in 2016...

Excluding the Tax Amnesty, revenue decreased by 3.7 percent in 2016.

Source: Ministry of Finance; World Bank staff calculations
...emphasizing the need to accelerate revenue reform

**Implemented**
- VAT e-filing and e-invoicing
- Formation of *Tim Reformasi Perpajakan* (Tax Reform Team)

**Ongoing**
- Use new Tax Amnesty data to improve compliance and expand tax base
- **Reform VAT law** (reduce exemptions, lower VAT threshold)
- **Income tax law**
- Strengthen measures to reduce base erosion and profit shifting (BEPS)
- Reform tax administration (*KUP law*, business processes and IT)

Source: Ministry of Finance; World Bank staff calculations
Fiscal credibility introduced in the 2016 revised budget has been sustained in 2017...

- More achievable revenue forecasts for 2017
- Expenditure for 2017 is in line with the 2016 Revised Budget
- 2017 fiscal financing needs pre-financed in December 2016

*Source: Ministry of Finance; World Bank staff calculations*
...with room for improvements to the quality of spending, particularly capital spending...

- Capital expenditure fell by 23% in 2016:
  - Base effect
  - Several projects deferred
- The government maintained lower subsidy spending in 2016 and in the 2017 Budget, along with other improvements to the quality of spending
  - improved targeting of energy subsidies
  - mandated higher infrastructure spending at the sub-national level

Source: Ministry of Finance; World Bank staff calculations
...and in other priority sectors

Government expenditure (% GDP)

- Personnel (CG)
- Subsidies
- Social assistance
- Health
- Infrastructure

2016 Revised Budget, 2017 approved Budget, World Bank target (2020)

Note: Infrastructure and social assistance data use World Bank sectoral definitions. Source: Ministry of Finance; World Bank staff calculations.
Sustain investment climate reform momentum

- The investment climate is improving - Indonesia was a top 10 reformer in the 2017 Doing Business Report
- But more needs to be done, especially to meet the government’s target Doing Business rank of 30 in 2019
- Need to move beyond “quick win” reforms and implement medium-term structural reforms

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<thead>
<tr>
<th></th>
<th>DB 2016</th>
<th>DB 2017</th>
<th>Target 2019</th>
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<tbody>
<tr>
<td>Overall ranking</td>
<td>106</td>
<td>91</td>
<td>30</td>
</tr>
<tr>
<td>Starting a business (days)</td>
<td>48</td>
<td>25</td>
<td></td>
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<tr>
<td>Getting electricity (days)</td>
<td>76</td>
<td>56</td>
<td></td>
</tr>
<tr>
<td>Compliance for exporting (cost, $)</td>
<td>170</td>
<td>139</td>
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Source: World Bank
...and sustain education reforms

Increased education spending—mostly on teacher salaries—has improved access:

• Student teacher ratios are now some of the lowest in the world – further improvement is unlikely to improve learning outcomes

The challenge now is to improve the quality of education:

• While PISA scores have slightly improved overall, Indonesia remains behind its peers

A video study provides useful evidence for reforms

• The national curriculum emphasizes student-centered learning (involving less teacher lecturing and more interactive learning), but most teachers have not picked-up this approach

• Teachers that do use student-centered approaches achieve better learning outcomes

Key reforms

Improve teacher deployment and allocation
Enhanced teacher performance evaluation and training
Increased spending on areas with the highest returns like early childhood development
Terima Kasih