LEARNING MORE, GROWING FASTER

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June 6, 2018
Rencana untuk presentasi ini

1. Apakah saat ini perekonomian Indonesia sehat?

2. *Tidak* tayang di Bioskop Lebaran ini:
   - ★ *Kejarlah Rupiah... Kau ku Tangkap*
   - ★ *Pengabdi Konsumsi*
1. Apakah saat ini perekonomian Indonesia sehat?
The Indonesian economy continued to expand at a steady pace in Q1...

*GDP growth yoy and contributions, percentage points*

- Private consumption
- Investment
- Government consumption
- Net exports
- Stat. discrepancy *
- Change in inventories
- GDP

Source: BPS; World Bank staff calculations
…lifted by further acceleration of investment growth

Growth in gross fixed capital formation yoy and contributions to growth, percent

- Buildings & Structures
- Machine & Equipment
- Vehicles
- Other Equipments
- Intellectual Property

Source: BPS; World Bank staff calculations
Investment-led growth is high quality growth... but is Indonesia still too tied to commodities?

Higher commodity prices drives up cash flows of mining companies and investment...

LHS: Commodity price index and nominal mining VA, yoy change

RHS: contribution of investment to GDP growth (pp)

Av 2003-12, 2.1%
Av 2013-17, 1.6%

Source: World Bank staff; BPS
Mixed evidence of diversification into high-value added goods and services

Source: World Bank staff; BPS. Note: High-tech manufacturing includes electronics, transport equipment and machinery; traditional services include wholesale & retail sales, transport & storage (except air); Modern services are financial services, information & communication, business services, real estate, air transport, health and education; Low-tech manufacturing is mostly food processing.
Growth expected to be firm despite rising global risks

Risks to the global outlook are increasing: financial volatility has been on the rise; terms of trade deterioration; widening current account deficit; geopolitical risks, protectionism

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<tr>
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<th>2017</th>
<th>2018f</th>
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<tbody>
<tr>
<td>Real GDP</td>
<td>Annual percent change</td>
<td>5.1</td>
<td>5.2</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>Annual percent change</td>
<td>3.8</td>
<td>3.5</td>
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<tr>
<td>Current account balance</td>
<td>Percent of GDP</td>
<td>-1.7</td>
<td>-2.0</td>
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<tr>
<td>Budget balance</td>
<td>Percent of GDP</td>
<td>-2.5</td>
<td>-2.1</td>
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Source: Bank Indonesia, BPS, Ministry of Finance, World Bank staff projections and calculations
2. (Tidak) mask di dekat Anda

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Kejarlah Rupiah...
Kau ku Tangkap
Higher global volatility in 2018...

Index

VIX Index

MOVE Index (RHS)

Source: BPS; World Bank staff calculations
...has led to currency depreciation and higher yields in many emerging economies

**Exchange rates, year-to-date and year-on-year percentage change**

- **YTD**
- **YoY**

**10-year bond yields, basis points change from January 1 2018**

- **Vietnam**
- **Thailand**
- **Malaysia**
- **India**
- **USA**
- **Philippines**
- **Indonesia**

Source: JP Morgan Real Effective Exchange Rate, CPI based 2010 = 100; World Bank staff calculations

Source: www.investing.com; World Bank staff calculations
A sound macroeconomic policy framework provides a substantial buffer against volatility

Credible monetary policy has kept real interest rates positive, anchored inflation expectations.

BI has accumulated reserves and signed bilateral swap agreements.

Macroprudential measures mitigate risk of dollar-denominated corporate debt.

Conservative fiscal policy limits supply of rupiah assets, CA pressure.

Recent policy actions signal commitment to stability.
The Rupiah recovered some ground in recent days

Index, January 2017 = 100

Source: CEIC, World Bank staff calculations
Deepening the financial sector will provide further resilience against external volatility

**Foreigners hold nearly 40 percent of Indonesian Government bonds**

*Foreign holdings of local currency gov’t bonds, percent*

- Indonesia
- Korea
- Malaysia
- Thailand

**A deeper financial sector would support growth and provide greater domestic liquidity**

*Credit-to-GDP ratios as of Q3 2017, percent*

- Indonesia: 39.1
- India: 56.8
- Brazil: 63.0
- Turkey: 84.7
- Thailand: 115.6
- Malaysia: 134.1
- China: 210.5

Source: ADB — Asian bonds online

Source: BIS and World Bank staff calculations
PENGABDI KONSUMSI
Perception colored by slump in retail sales, which provide a partial view of private consumption

Retail sales and private consumption in the national accounts decoupled

Retail sales growth, yoy, LHS; private consumption growth, yoy, RHS

Consumption has been shifting to services and foods prepared outside the home

Percent of household expenditure

- Goods (except prepared foods)
- Services
- Prepared foods, incl. food outside home

Source: Bank Indonesia, BPS; World bank staff calculations

Source: CEIC; World bank staff calculations
Private consumption growth has generally followed potential GDP growth... 

...especially in recent years, consistent with sound monetary, exchange rate and fiscal policies.
Consumption responds to fiscal and monetary policies, but effect is small and imbalances could emerge

Response of CONSUMPTION to INFLATION

Response of CONSUMPTION to REAL_INTEREST

Vertical axis: Change in private consumption growth, percentage points
Horizontal axis: Number of quarters
Sample period: 2000Q4 2018Q1
To accelerate consumption growth sustainably, the focus needs to be on unlocking supply-side constraints.

Fiscal/monetary stimulus + Flat potential GDP growth → possibly higher GDP and consumption growth in the short-term... 
...but macroeconomic imbalances (↑inflation, ↑CA deficit)

Higher potential GDP growth through structural reforms → higher long-term GDP growth → higher consumption growth

Policy implications
➢ Continue to avoid short-term measures that could build imbalances and undermine macroeconomic stability
➢ Focus on policies to alleviate supply-side bottlenecks: closing the infrastructure, human capital and productivity gaps
Learning more, growing faster
Indonesia has made great progress in closing ‘quantity’ gaps in education...

Enrollment rates and years of schooling are up...          ...especially for poorer Indonesians

Source: Barro and Lee (2013, SUSENAS)

Source: SUSENAS, various years
Modest improvements in quality have also been made...

Y-axis: change in enrollment, percentage points

Change in Math Test points


Harmonized learning outcome index

Source: Altinok et al (2018)
Note: The HLO is constructed for 163 countries, it has a mean of 500 and a standard deviation of 30.
...but large gaps remain: 55% of Indonesians are functionally illiterate...

Source: World Bank estimates based on data from PISA 2015 (OECD, 2016)
Note: Students with achievement level below 2 in PISA achievement scale are considered functionally illiterate
...and progress has been faster among higher-income students


Note: Index of socioeconomic conditions measure family economic background including family assets, education levels, among others
Closing the learning gap with OECD countries will take much longer for poor students

Number of years to catch up to OECD average PISA scores based on current growth rate in Indonesian PISA scores

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<tr>
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<th>Mathematics</th>
<th>Reading</th>
<th>Science</th>
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</thead>
<tbody>
<tr>
<td>Richest quintile</td>
<td>20</td>
<td>33</td>
<td>62</td>
</tr>
<tr>
<td>Average</td>
<td>50</td>
<td>69</td>
<td>134</td>
</tr>
<tr>
<td>Poorest quintile</td>
<td>136</td>
<td>190</td>
<td>484</td>
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Source: World Bank staff calculations
How can Indonesia reform education to close the human capital gap?
Improve delivery at the local level, where most of the growing education budget goes

LHS: IDR Trillion; RHS: percent of GDP and spending

Source: World Bank COFIS database using MOF data and Presidential Regulation on budget details of respective years
Notes: Realized spending data is available until 2014. 2016 and 2017 are revised budget data, 2018 is budget data. Realized spending data might not capture some SNG (Sub-National Government) education spending if coded under the General Administration function
Take advantage of large number of upcoming retirements to boost teacher quality.

Source: Teacher census (2006) and DAPODIK (2016)

Note: PNS refers to civil servant teachers

Source: SAKERNAS 2005 and 2015
Initiatives to improve quality require more and better **information** on learning outcomes.

*Score in National Exam by integrity index in 2016*

Source: Rahmawati, 2018
Key reform areas to boost the quality of Human Capital in Indonesia

Start right by investing in early childhood education and stunting eradication

Take action to improve service quality at the district level

➢ low-performing districts need qualified human resources and technical support

➢ opening of new schools and madrasahs needs to be limited to those where there is both demand and institutional capacity to deliver high-quality services

➢ resource transfer mechanisms should use performance-based criteria

New teachers being hired need to be adequately qualified, with higher standards than in the past

A National Education Quality Initiative should be launched...

...but this will first require better information on learning outcomes
There are large payoffs to successful education reforms

*Annual percentage point addition to economic growth rates*

Note: Points denote possible improvements to current PISA score.
TERIMA KASIH

THANK YOU

Questions?
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