TOWARDS INCLUSIVE GROWTH

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Recent economic developments and outlook

Collecting more and spending better for inclusive growth
How is the health of the Indonesian economy?
The Indonesian economy grew slightly faster...

**GDP growth yoy and contributions, percentage points**

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

**Source:** BPS; World Bank staff calculations
...as investment remains on multi-year highs thanks to higher machinery purchases

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

Source: BPS; World Bank staff calculations
Headline inflation declined in the second half of 2017...

Source: BPS; World Bank staff calculations
...while labor markets remained robust

Net jobs created, by sector, thousands

Source: BPS; World Bank staff calculations
Ada apa dengan Konsumsi Rp 3?

What is the matter with consumption? – Part 3
Private consumption growth was slightly below its 10-year average but well above pre-2008 levels.

Private consumption growth, year-on-year, percent

- **2001-2007 average:** 4.05%
- **2008-2017 average:** 5.10%
- **2017:** 4.95%

Source: BPS; World bank staff calculations
The effects of inflation and the Rupiah, key drivers of consumption, often come with a lag

An increase in inflation has a negative effect on private consumption growth in the following quarter.

A depreciation in the exchange rate has a negative impact on private consumption after four quarters.

*Source: World Bank staff analysis*
Are debt levels too high?
In short – no

Indonesia’s debt levels are among the lowest in the world...

...thanks to prudent fiscal policies that led to a decline in debt levels...

...which are expected to remain stable even under certain shocks

Source: IMF Fiscal Monitor (October 2017), World Bank staff calculations
At the same time, maintaining a prudent fiscal stance is warranted

With Fed normalization, yield differentials are narrowing

Yields on 10-year bonds, US vs. Indonesia, percent

Foreigners hold nearly 40 percent of Indonesian Government bonds

Foreign holdings of local currency bonds, percent

Source: CEIC and World bank staff calculations

Source: ADB — Asian bonds online
Structural reforms will further enhance Indonesia’s borrowing capacity

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

**Higher revenue collections** can further enhance Indonesia’s credit strength

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

*Debt-to-revenues ratio, percent*

Source: BIS and World Bank staff calculations

Source: IMF Fiscal monitor and World Bank staff calculations

Note: Indonesia* simulates Indonesia’s debt/revenues ratio with a 1 percent increase in the revenue/GDP ratio
How much should we worry about Rupiah depreciation?
The Rupiah depreciated in 2018, but has significantly appreciated since the taper tantrum

Real effective exchange rate (increases denote appreciation)
Columns: percent change, December 2013 – December 2017
Dots: percent change, December 2017 – February 2018

Source: BIS; World Bank staff calculations
IDR moves partly reflect wider CA deficit linked to investment, and increasingly financed by FDI.

Imports, yoy growth, percent

Foreign Direct Investment, USD billion

Source: BPS; World Bank staff calculations
How much can growth accelerate in 2018 and 2019?
Growth is likely to remain steady over in the near-term, despite rising global risks

Global outlook favorable

Domestic conditions conducive

Risks of protectionism are rising; normalization of unconventional post-GFC monetary policy remains potential source of volatility

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<th>2016</th>
<th>2017</th>
<th>2018f</th>
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</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>Annual percent change</td>
<td>5.0</td>
<td>5.1</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>Annual percent change</td>
<td>4.3</td>
<td>3.8</td>
</tr>
<tr>
<td>Current account balance</td>
<td>Percent of GDP</td>
<td>-1.8</td>
<td>-1.7</td>
</tr>
<tr>
<td>Budget balance</td>
<td>Percent of GDP</td>
<td>-2.5</td>
<td>-2.4</td>
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Source: Bank Indonesia, BPS, Ministry of Finance, World Bank staff calculations
Accelerating growth beyond 5.5 percent in the near term will be challenging

Indonesia’s economy has capacity to grow between 5.0 – 5.5 percent based on current levels of infrastructure, skills, and productivity

$1.5 trillion needed to close infrastructure gap with other EMs

55 percent of 15-year-olds ‘functionally illiterate’

Low wages but high costs because of low productivity

Source: World Bank staff calculations using IMF (2017) data
Note: 2015 estimates. Unweighted averages computed for 14 advanced economies and 21 EMs

Source: OECD PISA

Source: UNIDO, WB staff calculations
Note: wages for finishing, weaving, and spinning of textiles
So what can be done to advance Indonesia’s development in 2018, 2019 and beyond?

Put forward a bold “policy sambal” to radically open the economy and bring in investments and jobs.

Invest in quality of life: improve people’s lives and build long-term foundations for inclusive growth.
Recent economic developments and outlook

Collecting more and spending better for inclusive growth
Collecting more and spending better are key drivers of inclusive economic growth

INCLUSIVE GROWTH

Spending Effectively

Spending More on Priority Sectors

Health, education, urban infrastructure, connectivity, social assistance

Spending Better

Spending Differently

Collecting more…

…and better
The quality of spending has improved as expenditures shifted towards priority areas for inclusive growth...

Percent of Central Government spending excluding transfers to subnational governments

Source: Ministry of Finance, World Bank staff calculations
Note: 2014-2015 refer to actual spending, 2016 and 2017 are budgeted. Infrastructure only includes line ministry spending and does not include below the line capital injections to SOEs.
...but Indonesia still needs to spend more in some areas...

<table>
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<tr>
<th>Percent of GDP</th>
<th>Health</th>
<th>Social assistance</th>
<th>Infrastructure, incl. housing</th>
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<tbody>
<tr>
<td>Current level of spending</td>
<td>1.4</td>
<td>0.6</td>
<td>2.4</td>
</tr>
<tr>
<td>Estimates of needed level of spending</td>
<td>2.3</td>
<td>1.1</td>
<td>4.9</td>
</tr>
</tbody>
</table>

Source: World Bank staff calculations
...by further reallocating expenditures away from poorly targeted subsidies...

Source: Ministry of Finance, World Bank staff calculations
...and increasing revenue collections

**Excises** – consider higher tobacco, vehicle, and environmental excises (such as taxes on plastic bags) to incentivize good behavior and raise revenues

**VAT** – lower threshold and reduce exemptions for greatest bang-for-the-buck

**Income tax** – lower threshold and simplify the tax code to get more individuals in the tax net

**Tax administration** – improve IT systems and HR to boost compliance

Revenues are well below what would be expected given Indonesia’s income level, constraining expenditures.

**General government revenue, percent of GDP, 2016**

Source: IMF Fiscal Monitor, World Bank staff calculations
In education, Indonesia can spend better to improve quality for all children

Dramatically reduce stunting through coordinated interventions

Invest in quality early childhood education for all Indonesian children

Launch a presidential initiative on education quality focusing on improving learning outcomes

Investments in education build a legacy for future growth – and parents care about their children today and will recognize the Government’s efforts
Spending better, but also spending more, is needed in the health sector

JKN is very popular with Indonesians, but faces a chronic deficit

→ Increase investments in primary health care, promotive and preventive interventions, particularly for vulnerable populations living in rural and remote locations

Spending on health is among the lowest in the world

General Government spending on health, percent of GDP

Indonesia, 1.08

Source: WDI
Emphasize quality over numbers in social assistance

The move of social assistance spending from subsidies to direct transfers has been positive...

...but after a large expansion in the PKH, focus should be on ensuring all eligible families are reached by the program and on increasing benefits

➢ IDR 1 of spending in higher benefits leads to more poverty reduction than the same IDR 1 spent on new beneficiaries

Despite improvements, many poor households do not receive PKH, while some richer households do

Share of beneficiaries by consumption decile, percent

Source: SUSENAS and World Bank staff calculations
Spending and revenue policies influence inclusive growth in the long-term, but also today’s distribution.

![Change in Gini coefficient from market to disposable income, points](image)

Source: Commitment to Equity, latest comparable data available.
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THANK YOU

Questions?
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