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Reforming amid uncertainty

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Introduction

Coming to the end of a challenging year,

- unfavorable external conditions persist...
- … and man-made fires and haze have contributed to moderating growth.

In this difficult environment

- considerably higher public capex disbursement has supported growth...
- … and seven policy packages are signaling strong reform intent.

Looking to next year, sustaining the reform momentum is the best strategy for Indonesia.
Major recent economic developments

Recent policy response

Outlook and risks
Fires and haze cost IDR 221 trillion (1.9% of GDP) in just five months…

Bubble size indicates total provincial disaster costs; cost in percent of provincial GDP (y-axis); area burned, thousand hectares (x-axis)

Note: Losses do not account for the economic benefit to those who set fires.
Source: Bogor Agricultural University; BPPT; BPS; CIFOR; media reports; Ministry of Health; regional governments; World Bank staff calculations
… which is more than twice the cost of rebuilding Aceh after the tsunami…

USD billion

<table>
<thead>
<tr>
<th></th>
<th>2004 Aceh tsunami</th>
<th>2015 fires and haze</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost (USD billion)</td>
<td>7</td>
<td>16.1</td>
</tr>
</tbody>
</table>

Source: World Bank staff estimates
...reducing growth materially in affected provinces...

*Real GDP growth year on year in 2015, percent*

Source: BPS; World Bank staff calculations
... having devastating social and environmental consequences...

- At least 19 deaths, 500,000 incidences of respiratory illness;
- IDR 2.1 trillion in immediate health costs; long-term cost likely much higher;
- ~4.7 million children stayed away from school (for up to 34 days in some regions)
- IDR 540 billion in costs due to school closures; difficult to quantify long-term impact of regular closures on graduation rates and productivity;
- IDR 59 trillion in biodiversity losses and loss of carbon storage
... and contributing to the growth moderation and rise in unemployment

_GDP growth, percent per year*_; _Number of net new jobs created_

Note: Q1-Q3 data for 2015.
Source: BPS; World Bank calculations

WORLD BANK GROUP
Major economic developments

Recent policy response

Outlook and risks
Higher public spending supported growth in Q3 2015

Real capital expenditure growth yoy, percent*

Note: * Real capital expenditure is calculated using the implicit total fixed investment deflator with 2010 base from the national accounts
Source: Ministry of Finance; World Bank staff calculations
Significant improvement of the composition of spending in the 2016 Budget

_IDR trillion_

- Fuel subsidy
- Infrastructure
- Social assistance
- Health

Source: Ministry of Finance; World Bank staff calculations
Direct transfers to villages will increase substantially over five years...

Source: Ministry of Finance; World Bank staff calculations
Reduction of regulatory burden and promotion of investment

Seven economic policy packages focusing on:

- Regulatory simplification;
- Support to SMEs;
- Minimum wage determination;
- Special economic zones;
- Tax relief.

Signal intention to join the Trans-Pacific Partnership (TPP)

*Source: Global Trade Alert (accessed 13/11/2015); World Bank staff calculations*
Major economic developments

Recent policy response

Outlook and risks
Baseline outlook is unchanged, with risks to the downside

<table>
<thead>
<tr>
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<th>December 2015 IEQ</th>
<th>Revisions</th>
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</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>5.0</td>
<td>4.7</td>
</tr>
<tr>
<td>Consumer prices</td>
<td>6.4</td>
<td>6.3</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>-3.1</td>
<td>-2.0</td>
</tr>
</tbody>
</table>

Note: Revisions are relative to October 2015 IEQ. Source: BI; BPS; World Bank staff projections.
Risk 1. Global growth may disappoint once again…

Real GDP growth in OECD countries, percent qoq-saar

Source: OECD; World Bank staff calculations
Risk 2. Weak revenues may constrain growth prospects

Source: Ministry of Finance; World Bank staff calculations
Risk 3. Impact of the village transfers

**Millions, LHS; IDR thousands, RHS**

- Number of poor and near poor (LHS)
- Median 90% DD per capita (RHS)

**Dana Desa disbursement, percent**

- National-to-District (tranche I)
- District-to-Village (tranche I)

Source: Village Potential Statistics (PODES) 2011; National Social Economic Survey (SUSENAS) 2013; World Bank staff calculations

Note: Sample includes 314 districts and 55,469 villages.
Source: Ministry of Finance; Coordinating Ministry of Human Development and Culture/World Bank Diagnostic Survey, November 2015; World Bank staff calculations