INDONESIA

Table 1	2019
Population, million	270.6
GDP, current US$ billion	1119.2
GDP per capita, current US$	4135.6
International poverty rate ($1.9)[a]	3.6
Lower middle-income poverty rate ($3.2)[a]	21.5
Upper middle-income poverty rate ($5.5)[a]	53.2
Gini index[a]	39.0
School enrollment, primary (% gross)[b]	106.4
Life expectancy at birth, years[b]	71.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2018), 2011 PPPs.
(b) Most recent WDI value (2018).

The COVID-19 pandemic has pushed the Indonesian economy into negative growth for the first time in two decades. Fiscal and monetary authorities responded to provide relief to households and firms and to stabilize the economy. High frequency indicators in Q3 pointed to an incipient but protracted recovery. However, mobility restrictions were reintroduced in Jakarta in mid-September due to rising number of cases. The Government intends to accelerate the implementation of relief measures and deploy substantial resources to support the recovery.

Recent developments

Indonesia's economy contracted by 5.3 percent yoy in Q2 2020 (GDP per capita growth is -6.4 percent in Q2) following a 3.0 percent expansion in Q1, as the COVID-19 shock buffeted the economy. Mobility restrictions, individual precautionary behavior, and labor income losses led to a sharp contraction in private consumption (-5.6 percent yoy). Substantial fiscal relief measures partly cushioned the shock to consumption. Low commodity prices, high uncertainty and weak demand depressed investment (-8.6 percent yoy).

Exports also suffered (-11.7 percent yoy) as global demand plummeted. Nevertheless, with the slump in domestic demand, imports contracted more than exports (-17 percent yoy), leading net exports to contribute positively to growth (+0.7 pp) (Figure 1).

On the supply side, sectors exposed to external shocks and mobility restrictions contracted sharply. These sectors (manufacturing, trade and hospitality) employ a large proportion of Indonesians in the bottom 40 percent. High frequency indicators suggest that the economy was recovering slowly with the gradual lifting of mobility restrictions in mid-June. But these restrictions were reintroduced in the capital city Jakarta due to rising COVID-19 cases, and high hospital bed and ventilator occupancy rates.

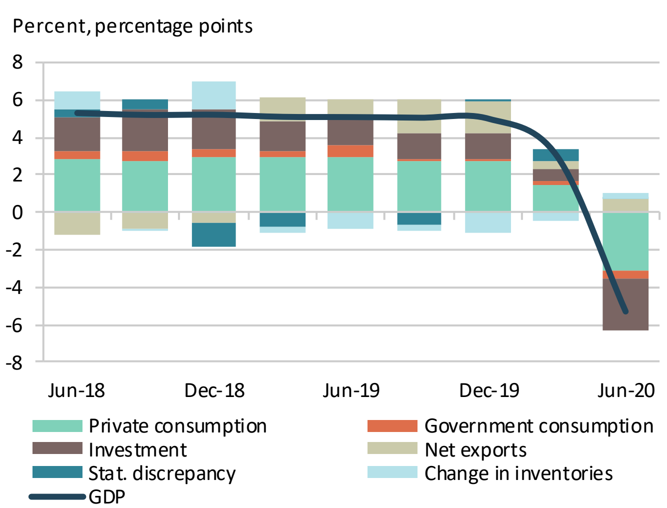
The economic slowdown and muted domestic demand have opened a substantial output gap. With negative output gap, low commodity prices and stable food supplies, inflation fell to 2.4 percent yoy in H1 2020.

With these developments, the goods trade balance remained in surplus. However, the collapse in tourist arrivals widened the service trade deficit. The income account deficit narrowed as dividend payments to foreign investors fell due to the sluggish business activity. Consequently, the current account deficit (CAD) dropped to 1.2 percent of GDP in Q2 (1.4 percent of GDP in Q1).

Capital inflows stabilized in Q2 as global financial volatility eased due to substantial interventions of central banks. These developments, together with low inflation, enabled Bank of Indonesia (BI) to cut its benchmark interest rate four times by 100 basis points to 4.0 percent. Capital inflows were supported by large issuance of global bonds by the Government and corporations. Consequently, international reserves soared, the Rupiah stabilized, and bond yields fell. In the banking sector, loan growth slowed to 1.5 percent yoy in June. NPLs remain low (3 percent of outstanding loans in Q2) but have risen from 2.7 percent in Q1, while the capital adequacy ratio stood at 22.5 percent.

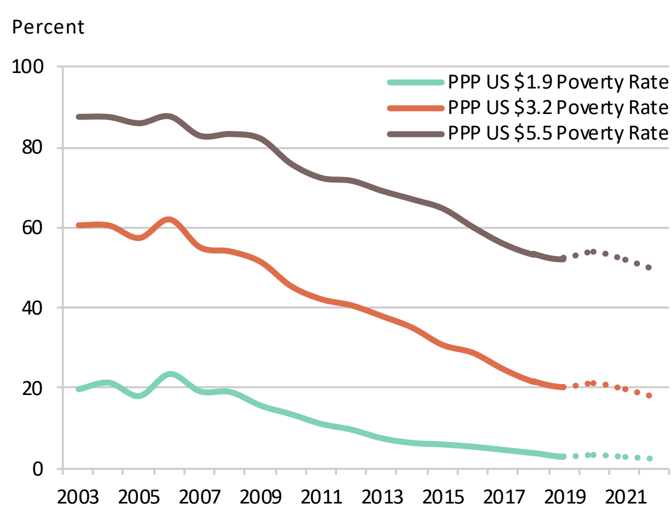
The COVID-19 shock on income and employment could potentially increase poverty. Official statistics show that the poverty incidence increased to 9.8 percent in March (+0.4 pp yoy). A high-frequency representative household survey suggests that nearly a quarter of the population had stopped working by early May. These disruptions are higher in traditional services sector, manufacturing and

FIGURE 1 Indonesia / Real GDP growth and contributions to real GDP growth



Sources: National Statistics Agency; World Bank.

FIGURE 2 Indonesia / Poverty rates, actual and projected



Sources: National Statistics Agency; World Bank.
Note: Forecast is from 2020 onwards and based on the scenario of absence in mitigation.

other industries. Moreover, 64 percent of those who remained at work reported lower income, particularly in sectors that employ many of the bottom- and middle-40.

Fiscal authorities responded through assistance to households and firms with a package of IDR 695.2 trillion (4.3 percent of GDP). The package includes allocations to the health sector (0.5 percent of GDP), social assistance (0.9 percent of GDP), tax incentives, working capital loans and capital injections for SOEs, credit programs for MSMEs and additional spending. Owing primarily to lower fiscal revenues due to the crisis, the fiscal deficit is projected to widen to 6.3 percent of GDP in 2020. The Government has temporarily lifted the fiscal deficit ceiling of 3 percent of GDP through 2022. Given the large financing needs, BI agreed to buy a large share of Government new bond issuances in 2020.

Outlook

Growth is projected to contract by 1.6 percent in 2020 as mobility restrictions, health risks and weak global economic activity depress private consumption and investment. Lower domestic demand will help keep the CAD at 1.3 percent of GDP despite wider services trade deficit as tourism contracts. With weak demand and a negative output gap, inflation will ease to 2.1 percent.

The forecast in 2021-2022 reflects lower potential growth relative to pre-COVID trend (-0.6pp), due to lower investment and productivity, and slow and protracted recovery. Under these assumptions, growth will reach 4.4. percent in 2021 due to a base effect and to 5.1 percent in 2022. Inflation will increase moderately as domestic demand picks up. The current account deficit will widen slightly as imports recover and the services trade deficit persists due to depressed tourism.

The fiscal deficit is projected to remain above 3 percent through 2022. The Government projects a fiscal deficit of 5.5 percent of GDP in 2021, driven by some recovery in revenues and moderate expenditure growth as exceptional fiscal support measures are extended but scaled down. Accordingly, public debt is projected to increase from 30 percent of GDP in 2019 to 37 percent in 2020 and could stabilize around 42 percent of GDP in 2023-2025, assuming revenue-enhancing reforms are implemented.

Extreme poverty (based on US$1.9 per day poverty line) is projected to increase for the first time since 2006, from 2.7 to 3.0 percent between 2019-20. The Government social assistance package could mitigate the impact on poverty if targeted well and delivered in a timely manner (Figure 2). As of early May, 78 percent of the bottom 40 households reported receiving at least one of the social assistance programs, or loan deferment and electricity subsidy programs. But the implementation of certain programs remains slow and coverage is insufficient to compensate all affected households.

Risks and challenges

Risks to the outlook are unprecedently high and largely tilted to the downside. Mobility restrictions were reintroduced in Jakarta on September 14 and could be expanded to other provinces. In such scenario growth could drop further to -2.0 percent in 2020. Slower global demand, lower commodity prices and renewed waves of capital outflows would further dampen Indonesia's growth prospects.

The economic relief program is comprehensive, but effectiveness will depend on the speed and performance of the targeting and delivery systems. The coverage and length of social assistance package – some of which were phased out in September - would also need to be re-assessed in light of mobility restrictions and the evolution of the crisis.

TABLE 2 Indonesia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2017	2018	2019	2020 e	2021 f	2022 f
Real GDP growth, at constant market prices	5.1	5.2	5.0	-1.6	4.4	5.1
Private Consumption	5.0	5.1	5.2	-1.1	4.0	4.5
Government Consumption	2.1	4.8	3.2	1.0	6.0	4.5
Gross Fixed Capital Investment	6.2	6.6	4.4	-5.0	4.0	5.0
Exports, Goods and Services	8.9	6.5	-0.9	-7.9	1.0	12.0
Imports, Goods and Services	8.1	11.9	-7.7	-12.3	-1.5	10.3
Real GDP growth, at constant factor prices	4.8	5.0	5.0	-1.8	4.4	5.1
Agriculture	3.9	3.9	3.6	2.0	3.6	2.8
Industry	4.1	4.3	3.8	-0.5	4.2	5.1
Services	5.7	5.8	6.4	-3.9	4.8	5.8
Inflation (Consumer Price Index)	3.8	3.3	2.8	2.1	2.6	3.0
Current Account Balance (% of GDP)	-1.6	-2.9	-2.7	-1.3	-1.5	-1.6
Net Foreign Direct Investment (% of GDP)	1.8	1.2	1.8	1.6	1.7	1.8
Fiscal Balance (% of GDP)	-2.5	-1.8	-2.2	-6.3	-5.6	-4.3
Debt (% of GDP)	29.4	30.4	30.0	37.0	40.1	42.0
Primary Balance (% of GDP)	-0.9	-0.1	-0.5	-4.5	-3.7	-2.0
International poverty rate ($1.9 in 2011 PPP)[a,b]	4.5	3.6	2.7	3.0	2.6	2.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	24.7	21.6	20.0	21.2	19.6	17.8
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	56.0	53.3	52.2	53.7	51.8	49.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.

(a) Calculations based on EAPPOV harmonization, using 2011-SUSENAS, 2018-SUSENAS, and 2019-SUSENAS data. Actual data: 2019. Forecast is from 2020 to 2022 and based on unmitigated circumstances.

(b) Projection using annualized elasticity (2011-2018) with pass-through = 1 based on GDP per capita in constant LCU.