

INDONESIA
ECONOMIC
QUARTERLY

December 2018

Strengthening competitiveness



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Preface

The Indonesia Economic Quarterly (IEQ) has two main aims. First, it reports on the key developments in Indonesia's economy over the past three months, and places these in a longer-term and global context. Based on these developments and on policy changes over the period, the IEQ regularly updates the outlook for Indonesia's economy and social welfare. Second, the IEQ provides a more in-depth examination of selected economic and policy issues and an analysis of Indonesia's medium-term development challenges. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged in Indonesia's evolving economy.

The IEQ is a product of the World Bank's Jakarta office and receives editorial and strategic guidance from an editorial board chaired by Rodrigo A. Chaves, Country Director for Indonesia. The report is prepared by the Macroeconomics, Trade and Investment (MTI) Global Practice team, under the guidance of Ndiame Diop (Practice Manager) and Frederico Gil Sander (Lead Economist). Led by Derek H. C. Chen (Senior Economist and lead author), the core project team comprises Abigail, Arsianti, Dwi Endah Abriningrum, Yus Medina, Alief Aulia Rezza, Ratih Dwi Rahmadanti and Dhruv Sharma. Administrative support is provided by Deviana Djalil. Dissemination is organized by Nugroho Sunjoyo, Jerry Kurniawan, and GB Surya Ningnagara under the guidance of Lestari Boediono Qureshi.

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Abbreviations

APBN	Anggaran Pendapatan dan Belanja Negara (State budgets)	NRP	Nominal Rate of Protection
BI	Bank Indonesia	N-O&G	Non-Oil & Gas
BITs	Bilateral Investment Treaties	NPL	Non-Performing Loans
BKPM	Badan Koordinasi Penanaman Modal (Indonesia Investment Coordinating Board)	NTI	Net Trade Index
BLU	Off Budget Fund	NTM	Non-Tariff Measures
BOP	Balance of Payments	O&G	Oil and Gas
BPNT	Non-Cash Food Assistance	OECD	Organization for Economic Co-operation and Development
BPS	Badan Pusat Statistik (Bureau of Statistics)	OPEC	Organization of the Petroleum Exporting Countries
CAD	Current Account Deficit	PBI-JKN	Penerima Bantuan Iuran-Jaminan Kesehatan Nasional (National Health Insurance Beneficiaries)
CAR	Capital Adequacy Ratio	PHT	Penjualan Hasil Tambang (mining sales)
CG	Central Government	PKH	Program Keluarga Harapan (Family Hope Program)
COMTRADE	Commodity Trade Statistics Database	PMI	Purchasing Managers' Index
CPB	Central Planning Bureau	PNBP	Other Non-Tax Revenues
CPI	Consumer Price Index	PPP	Public-Private Partnership
CPO	Crude Palm Oil	qoq	quarter-on-quarter
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership	RCEP	Regional Comprehensive Economic Partnership
DAK	Dana Alokasi Khusus (Special Allocation Fund)	RHS	Right Hand Side
DAU	Dana Alokasi Umum (General Allocation Fund)	RON	Research Octane Number
DECPG	Development Economics Prospects Group	sa	Seasonally adjusted
DFAT	Department of Foreign Affairs and Trade	SBI	Sertifikat Bank Indonesia (Bank Indonesia Certificate)
DKI	Daerah Khusus Ibukota (special capital region)	SBN	Surat Berharga Negara (State securities)
DNDF	Domestic Non-Deliverable Forward	SEMEFPA	Support for Enhanced Macroeconomic and Fiscal Policy Analysis
DNI	Daftar Negatif Investasi (Negative Investment List)	SKKMIGAS	Satuan Kerja Khusus Pelaksanaan Kegiatan Usaha Hulu Minyak dan Gas Bumi (The Special Taskforce for Upstream Oil and Gas Business Activities)
EAP(CE)	EAP Chief Economist	SNI	Indonesia National Standard
EFTA	European Free Trade Association	SOEs	State of Enterprises
EMBI (G)	Emerging Market Bond Index Global	STRI	Service Trade Restrictiveness Index
EMCI	Emerging Market Currency Index	SUN	Surat Utang Negara (Government Bonds)
EU	European Union	TA	Tax Amnesty
FAOSTATS	Database of Food and Agriculture Statistics	ToT	Terms-of-Trade
FDI	Foreign Direct Investment	TPP	Trans-Pacific Partnership
FSAP	Financial Sector Assessment Program	UNIDO	United Nations Industrial Development Organization
FTA	Free Trade Agreement	UNCTAD	United Nations Conference on Trade and Development
GDP	Gross Domestic Product	USTR	United States Trade Representative
GoI	Government of Indonesia	VAT	Value Added Tax
ICTs	Information and Communication Technologies	VIX	Volatility Index
IDR	Indonesia Rupiah	WDI	World Development Indicators
IEQ	Indonesia Economic Quarterly	yoy	year-on-year
IHS	Institute Human Studies		
IMF	International Monetary Fund		
KAPET	Integrated Economic Development Zones		
KBLI	Klasifikasi Baku Lapangan Usaha Indonesia (Indonesia Standard Industrial Classification)		
kbpd	Kilo Barrels per Day		
KPPU	Komisi Pengawas Persaingan Usaha		
LGST	Luxury Goods Sales Tax		
LHS	Left Hand Side		
LNG	Liquefied Natural Gas		
LPG	Liquid Petroleum Gas		
MoF	Ministry of Finance		
MSMEs	Micro, Small, Medium Enterprises		
MTI	Macroeconomics, Trade and Investment		

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Executive Summary: Strengthening Competitiveness

After a challenging 10 months of capital outflows, currency depreciation, higher government bond yields and mounting pressures from fuel prices, November brought respite to Indonesia: global oil prices fell, and capital flows returned, leading to currency appreciation and lower bond yields. Nevertheless, the global and domestic dynamics that prevailed for the initial 10 months of 2018 remain mostly in place, and this edition of the *Indonesian Economic Quarterly* highlights the importance of structural reforms to increase exports and FDI, which will strengthen Indonesia's external position.

Indonesia's economic growth over the past five quarters has been driven by investment, especially in the mining and infrastructure sectors. In the third quarter of 2018, GDP growth remained broadly steady at 5.2 percent yoy¹, driven by domestic demand. Gross fixed capital formation accelerated on the back of a rebound in construction investment. While private consumption eased slightly, a surge in government consumption kept total consumption growth on an even keel (Figure ES.1). As equipment investment remained robust, import growth was nearly double that of exports. As such, net exports continued to weigh on growth, despite exports expanding for the eighth consecutive quarter. On the production side, growth picked up in most sectors, except for agriculture and utilities. As a result, growth of gross value-added accelerated slightly to 5.1 percent yoy from 5 percent in Q2 (Figure ES.2).

High crude oil prices through October and continued robust growth in equipment investment more than offset a small improvement in the income balance due to currency depreciation and led to a widening of the current account deficit to 2.7 percent of GDP in Q3 from 2.3 percent in Q2² (Figure ES.3). Net foreign direct investment reached USD 3.9 billion in Q3, but this was still less than half the current account deficit. Overall, with a narrower financial and capital account surplus, the balance of payments deficit rose to USD 4.4 billion³, bringing reserves down to USD 114.8 billion at the end of Q3. Reserves are sufficient to finance government external debt repayments and imports for 6.3 months⁴.

Scarce capital inflows due to tighter monetary policy in advanced economies and greater uncertainty around

global trade policy (bond inflows were tracking the lowest levels in seven years), added to the widening current account deficit, led the Rupiah depreciated through October, with the currency reaching a trough of IDR 15,237 per USD on October 30. Year-to-September, the currency depreciated 8.2 percent in nominal terms and 7.6 percent in real effective terms (Figure ES.4).

Despite high oil prices in Q3, headline consumer price inflation fell from an average of 3.3 percent yoy in Q2 to an average of 3.1 percent in Q3 (Figure ES.5). The lower headline reading was largely driven by low administered price inflation on the back of a high base-effect due to the electricity tariff hikes last year.

Despite inflation being at a two-year low, Bank Indonesia (BI) raised its benchmark policy rate twice in Q3 and once in November, by 25 basis points each time. The sustained policy tightening was in response to external conditions and reflected the Government's focus on maintaining stability. Notwithstanding turbulent global financial markets, overall macroeconomic resilience has been maintained, largely due to sound macroeconomic fundamentals and a coordinated policy framework.

The Government's fiscal position has also reflected the priority of stability. Both total Government revenues and expenditures showed strong growth through October, but the net result has been a smaller budget deficit compared to the same period in 2017 (Figure ES.6), reducing financing needs and pressures on bond markets. Higher revenue collection was mainly driven by income taxes from non-oil & gas, oil & gas related revenues and value added tax (VAT)/luxury goods sales tax (LGST), while expenditure growth was mainly due to higher personnel, material and energy subsidy spending. The 2019 Budget signals projects a lower budget deficit of 1.8 percent of GDP in 2019, underpinned by substantial increases in revenues. The projected fiscal consolidation in 2019 will further reduce financing needs.

Real GDP growth is projected at 5.2 percent yoy this year and in 2019, a notch higher than in 2017 (Table ES.1), as stronger domestic demand is expected to more than offset the drag from the external sector. Despite projected consumer price inflation edging up next year, private

¹ Consensus forecast for real GDP growth in Q3 2018 was 5.1 percent.

² Expressed as a four-quarter rolling sum. As a share of GDP, the current account deficit was 3.4 percent of GDP in Q3.

³ As a share of GDP, the balance of payments deficit was 1.7 percent of GDP in Q3.

⁴ Bank Indonesia (August 15, 2018).

consumption is forecast to strengthen due to increased social spending and a strong labor market. Gross fixed capital formation is also expected to remain robust, as firms who had remained on the sidelines due to the elections make new commitments. Likewise, Government consumption is forecast to remain robust as continued reform and revenue growth create space for both fiscal consolidation and additional spending.

Table ES.1: Real GDP growth is expected to rise to 5.2 percent in 2018 with stronger domestic demand

		2017	2018f	2019f
Real GDP	(Annual percent change)	5.1	5.2	5.2
Consumer price index	(Annual percent change)	3.8	3.2	3.5
Current account balance	(Percent of GDP)	-1.7	-2.9	-2.5
Government budget balance	(Percent of GDP)	-2.5	-2.1	-1.8

Source: BI; Central Bureau of Statistics (BPS); Ministry of Finance; World Bank staff calculations

Note: 2017 actual outcome; f stands for World Bank forecast

With the current uncertainty in global trade policy, slower projected growth of major trading partners, weaker terms-of-trade (ToT), and robust domestic investments continuing to drive strong import needs, the current account deficit is projected to widen to 2.9 percent of GDP in 2018, despite the dampening impact of currency depreciation on imports and especially the income balance. These effects are expected to be felt more intensely in 2019, when the current account deficit is expected to moderate to 2.5 percent of GDP⁵.

Downside risks to Indonesia's growth outlook remain substantial. Global trade tensions, in particular between the United States and China, appear to have subsided, but could return if ongoing negotiations are not successful. The possible further escalation of such disputes continue to pose significant risks to Indonesia through a weaker external sector and dampened commodity prices. At the same time, the current tightening cycle of the U.S. Federal Reserve continues to heighten the risk of capital outflows and financial volatility among emerging market economies, including Indonesia.

To date, Indonesia has emerged relatively unscathed from the recent volatility plaguing emerging market economies, largely because of its sound macroeconomic fundamentals and adequate buffers that allowed for a coordinated monetary, fiscal and exchange rate policy framework. It is

important for Indonesia to seize the current opportunity to rebuild foreign reserves to maintain sizable buffers.

More fundamentally, this edition of the Indonesia Economic Quarterly highlights the importance of boosting exports and foreign direct investment to reduce Indonesia's structural current account deficit, and further enhance external resilience, in addition to increasing productivity and economic growth.

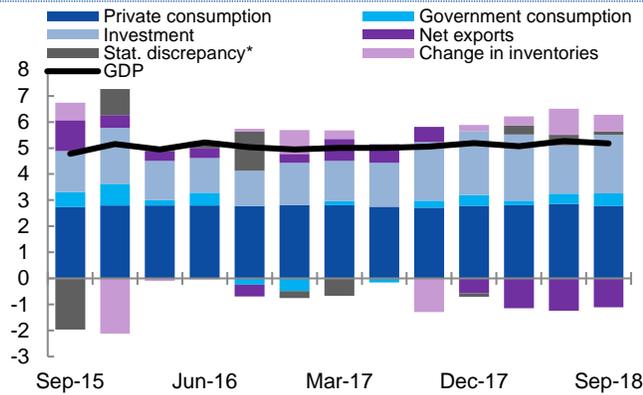
Indonesia's current account position in 2018 has all the hallmarks of a 'healthy' current account deficit: it is of limited size compared to previous periods and other countries, and it is driven by investment rather than consumption. However, Indonesia's reliance on volatile portfolio capital flows to finance its current account deficit have amplified the effects of the recent global turmoil on Indonesia's financial markets. When portfolio flows ebbed due to no fault of Indonesia, the Rupiah depreciated, and bond yields rose. The reliance on portfolio flows are in large part due to the slow growth in exports and limited foreign direct investment, which have contracted over the last quarters. These developments are underscored by declining shares in global manufacturing and commercial service exports, low levels of FDI in GDP compared to neighbors, and low labor productivity.

Indonesia can grow faster, create more and better jobs and boost the structural current account position and its financing by accelerating export growth and attracting more of the global savings pool. Countries such as Thailand, Vietnam and Malaysia have successfully integrated into global value chains and are attracting production investments that are relocating away from China.

A policy agenda to boost exports and investments – and which would make Indonesia more competitive globally – entails opening more to trade, global investment and talent. These include: (i) reversing the increase in import barriers, including tariff and (certain) non-tariff barriers, which raise prices to consumers and firms, making them less competitive; (ii) implementing ambitious free trade agreements, which can catalyze policy reforms and enhance market access for Indonesian products overseas; (iii) reducing the significant restrictions to foreign investors, which limit investment and competition harming the competitiveness of the protected sectors; (iv) easing the requirements to bring in critically scarce skills from abroad to temporarily fill the domestic skills gap, in line with the experience of other countries in the region. These measures, along with closing the infrastructure and human capital gaps, will not only strengthen its external position, but will boost Indonesia's competitiveness and support an acceleration of growth in the coming decade.

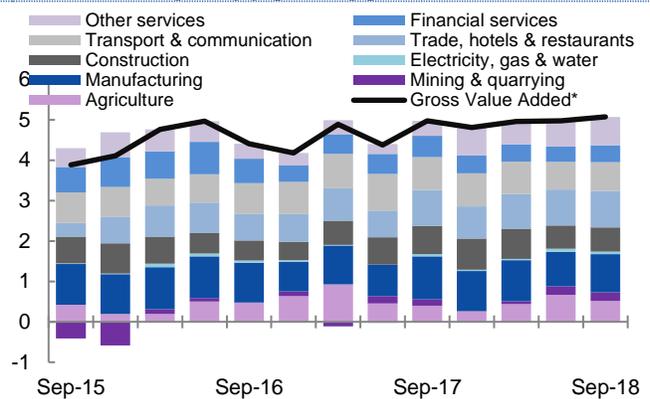
⁵ Despite the recent appreciation, the Rupiah is still 3.9 percent weaker for the year as of November 30 (see Section A.5).

Figure ES.1: GDP growth eased a little in Q3
(contribution to growth yoy, percentage points)



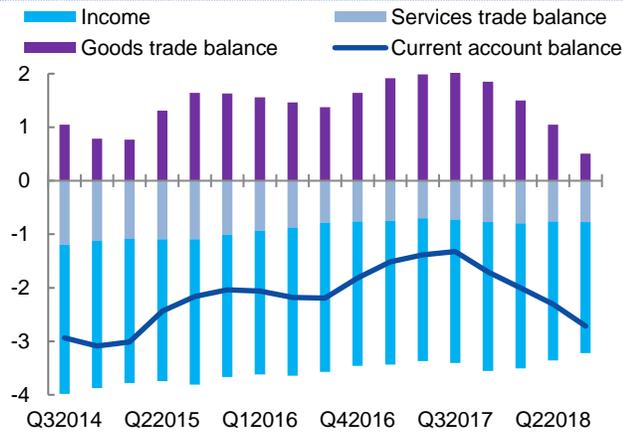
Source: BPS; World Bank staff calculations

Figure ES.2: Manufacturing sector growth more than offset the moderation in the agriculture sector growth
(contributions to growth yoy, percentage points)



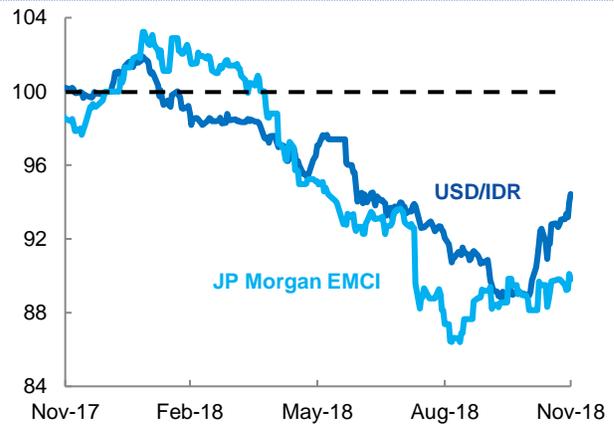
Source: CEIC; World Bank staff calculations
Note: See Figure A.9

Figure ES.3: The deficit in the goods trade balances led the deterioration of the current account balance
(four-quarter rolling sum, percent of GDP)



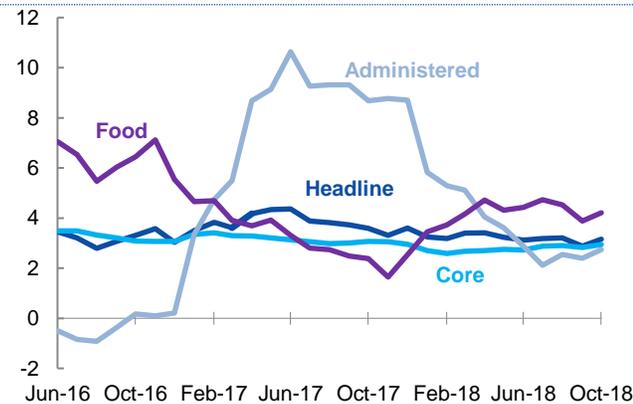
Source: CIEC, World Bank staff calculation

Figure ES.4: The Rupiah continued depreciating against the U.S. dollar in Q3, before recovering in Q4
(index, Jan 1 2018 = 100)



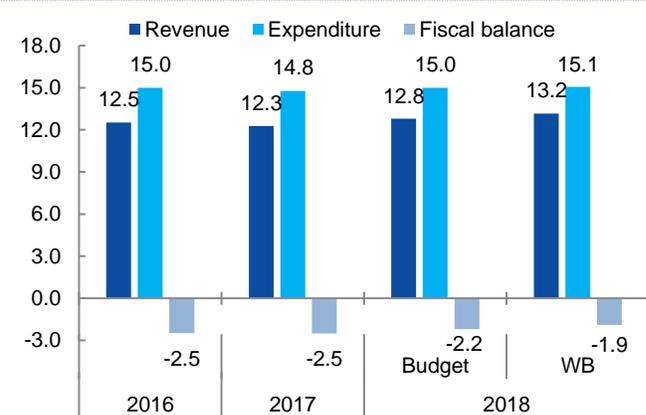
Source: JP Morgan, BPS and World Bank staff calculations

Figure ES.5: Headline inflation eased in Q3 despite higher oil prices
(change yoy, percent)



Source: BPS; World Bank staff calculations
Note: See Figure A.19

Figure ES.6: Stronger revenues and expenditures with a net result of lower Government budget deficit are projected for 2018
(percent of GDP)



Source: Ministry of Finance; World Bank staff calculations
Note: See Figure A.35

A. Economic and Fiscal Update

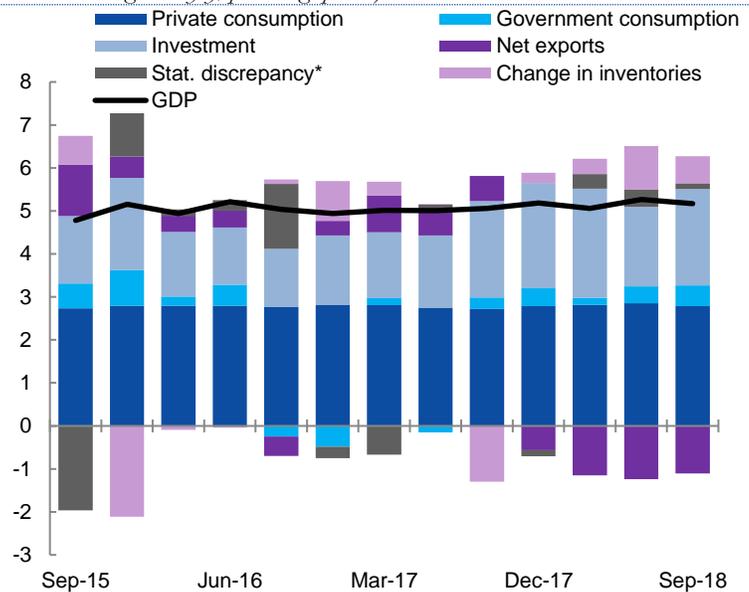


1. Indonesian economic growth eased slightly in Q3 2018

Real GDP growth was 5.2 percent in Q3 2018, marginally lower than the 5.3 percent recorded in Q2

The Indonesian economy grew 5.2 percent year-on-year (yoy) in Q3 2018, marginally slower than the 5.3 percent in Q2 2018, but a little above consensus forecasts of 5.1 percent. The slight moderation in GDP growth was in part due to a slower accumulation of inventories as well as easing private consumption growth (Figure A.1). Government consumption extended its rapid growth seen in Q2 and accelerated further in Q3. As in Q2, imports growth nearly doubled that of exports growth, partly reflecting the rebound in investment growth after the one-off slowing in Q2. As was the case in the previous three quarters, net exports continue to weigh on growth, despite robust domestic demand. On the production side, Q3 growth outpaced Q2 growth for most sectors, except for agriculture and utilities.

Figure A.1: GDP growth eased a little in Q3
(contribution to growth yoy, percentage points)

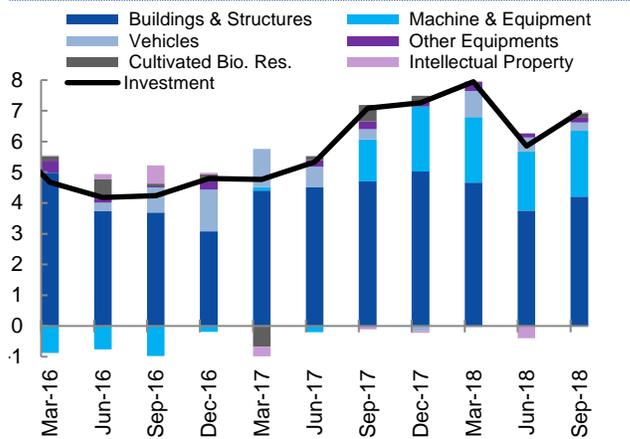


Source: BPS; World Bank staff calculations

Fixed investment growth rebounded in Q3

Growth in gross fixed capital formation rebounded to 7.0 percent in Q3, from a one-off slowing of 5.9 percent in Q2 (Figure A.2). The transitory deceleration in the previous quarter was because of the fewer working days this year, as the Muslim festive period in fell entirely in Q2, compared to 2017, when it was spread between Q2 and Q3. The rebound also coincided with robust Q3 nominal capital goods imports growth of 22.5 percent yoy, as well as a steep pick up in investment credit growth (see Section 5).

Figure A.2: Investment growth rebounded as growth in buildings and structures investment picked up
(contribution to growth yoy, percentage points)

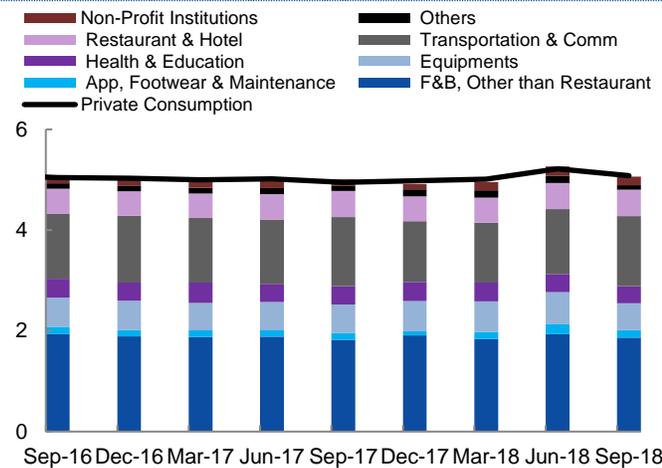


A pick-up in activity in buildings and structures contributed to the acceleration in investment growth. In terms of contribution to growth, buildings and structures investment contribution increased from 3.8 percentage points (pp) in Q2 to 4.2 pp in Q3. The contribution from vehicles investment eased for the second consecutive quarter from 0.5 pp to 0.3 pp.

Source: BPS; World Bank staff calculations

Figure A.3: Private consumption growth eased on the back of reduced consumption of equipment as well as health and education

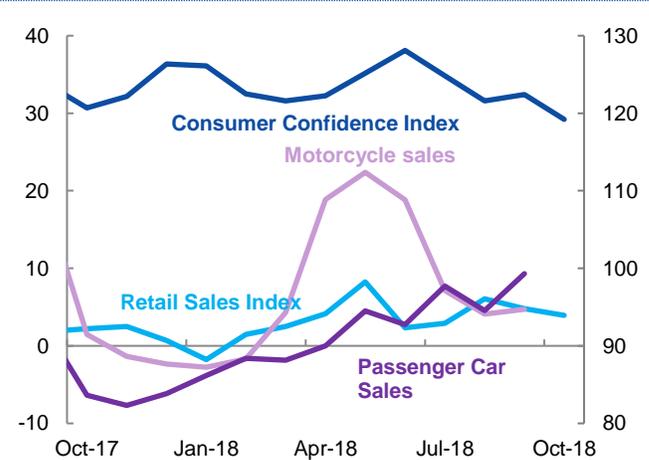
(contribution to growth yoy, percentage points)



Source: CEIC; World Bank staff calculations

Figure A.4: Most high-frequency indicators linked to private consumption eased in Q3

(yoy, percent/ 3mma yoy, percent, LHS; consumer confidence index; RHS)



Source: Bank Indonesia, CEIC; World Bank staff calculations
Note: Retail sales index in yoy percent terms; vehicle sales in 3-month moving average (mma) percent yoy terms.

Private consumption growth eased to 5.1 percent as the fillip provided by the Q2 festive period dissipated

Despite some easing in headline inflation (see Section A.4), private consumption growth eased to 5.1 percent in Q3 from 5.2 percent on the back of a slight moderation in both household consumption and non-profit institutions' consumption growth. Household consumption growth eased to 4.9 percent (from 5.0 percent in Q2) as the support from the Q2 festive season spending dissipated. Within the household category (Figure A.3), the contribution to growth from the consumption of equipment as well as health and education, eased. Meanwhile, consumption of food and beverages, and transport and communication contributed the most to growth. Restaurant and hotel consumption as well as transport and communication grew the fastest. In line with the slight moderation in consumption growth, high-frequency indicators for

consumption, such as the consumer confidence index, motorcycle sales and retail sales were soft in Q3 (Figure A.4). Given concerns about consumption over the past couple of years, it is worth noting that despite the moderation in private consumption growth, it remains a tick above its average growth rate over the past four years.

Box A.1: Global economic conditions softened in Q3

Global economic conditions softened in Q3. This was led by slower growth in the Eurozone and China. Eurozone GDP growth eased to 1.7 percent yoy from 2.2 percent in Q2, partly on weak economic growth in Italy, while an uptick in inflation contributed to the tempering of consumption growth. In line with expectations, China's economy continues its growth moderation at a measured pace, with GDP growth at 6.5 percent in Q3, down from 6.7 percent in Q2. This easing was due to moderating investment and industrial production, as well as the ongoing financial deleveraging as the Chinese Government attempts to improve the quality of its domestic debt.¹ In contrast, the U.S. economy, bolstered by fiscal stimulus, roared ahead and expanded 3 percent in Q3.

Figure A.5: Global trade growth eased...

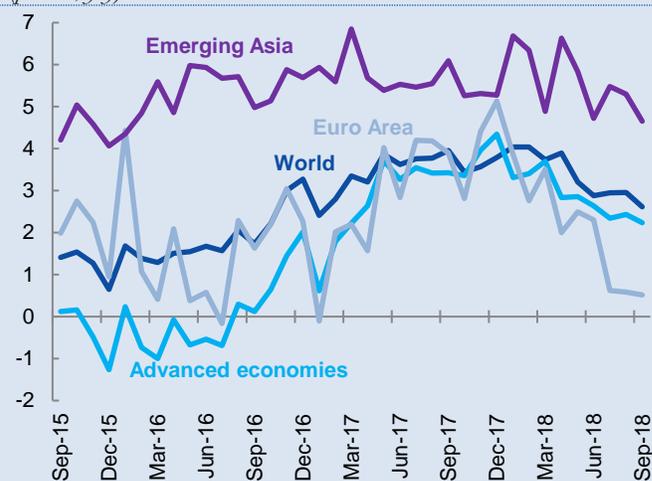
(percent, yoy)



Source: CBP World Trade Monitor, World Bank staff calculations

Figure A.6: ...as did industrial production

(percent, yoy)



Source: CBP World Trade Monitor, World Bank staff calculations

Higher frequency indicators of global economic activity painted a mixed picture at the start of Q3, with global trade growth remaining robust at 3.5 percent, despite trade restrictions associated with increasing rising protectionism beginning to take effect (Figure A.5). However, trade growth among emerging economies were substantially stronger than among advanced economies in Q3². The Eurozone economies were the main cause of the drag on advanced economy trade growth as U.S. tariffs on steel and aluminum began to take effect. Eurozone exports and import growth eased to a five and six-quarter low, respectively.

Meanwhile, global industrial production growth eased to 2.8 percent in Q3, its slowest since Q1 2017, compared to an average of 3.3 percent in Q2 (Figure A.6). Despite industrial production growth in United States recording its strongest outcome since 2011, industrial production in advanced economies also weakened. Industrial production growth in emerging economies moderated to 3.3 percent in Q3, compared to 3.8 percent in Q2, largely due to contractions in Latin America on the back of economic troubles in Argentina.

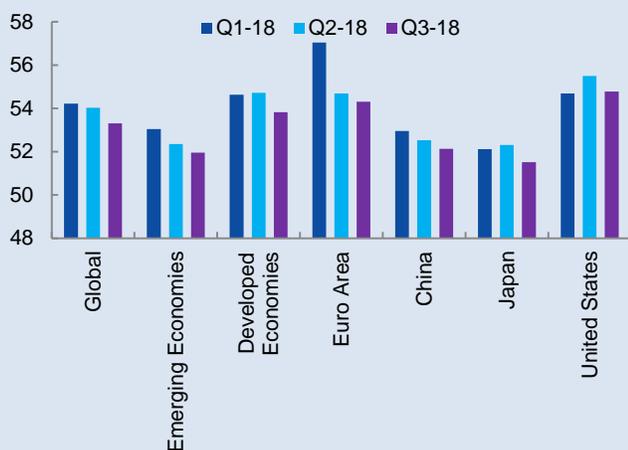
Another indicator of economic activity, Markit's Composite PMI recorded broad based decreases in Q3 that reflected a moderation in economic activity in line with easing global trade growth and softening industrial production (Figure A.7). The composite global PMI, while remaining in expansionary territory (an average of 53.3 in Q3) fell to its lowest point since the end of 2016.

In contrast to the trade outcomes where emerging market economies outperformed advanced economies, the advanced economies Composite PM, despite easing to an average reading of 53.8 in Q3, from an average of 54.7 in Q2 was higher than the Composite PMI for emerging economies which eased to an average of 52 compared to 52.4 in Q2 and 53 in Q1.

Against a backdrop of softening global economic growth outcomes and mixed signals with regards to higher frequency indicators policy makers around the world have reacted with varying degrees of urgency. As has already noted, the rapid pickup in GDP growth in the United States has been driven by expansionary fiscal policy. In anticipation of slowing export growth amid trade tensions, Chinese authorities have introduced a raft of measures aimed at stimulating economic activity ranging from cutting reserve requirement ratios (akin to loosening credit conditions), easing restrictions on emissions (as a means of boosting production and investment) and

introducing tax cuts. Thus far, these policies have appeared to have been effective in achieving their stated objectives (See World Bank, 2019).

Figure A.7: PMI outcomes around the world eased
(growth yoy, percent)



Source: Markit Economics, Haver, World Bank staff calculations
Note: Readings above 50 represent expansions and readings below 50 represent contractions

Figure A.8: Global financial market volatility did not dissipate completely in Q3
(index, January 1, 2018 =100)



Source: Bloomberg; World Bank staff calculations

On the monetary policy front, the U.S. Federal Reserve continues to reiterate its commitment to normalizing interest rates while central banks in many emerging economies have also tightened their monetary policy stances in an attempt to manage capital flow volatility as well as currency volatility. In the Eurozone, the European Central Bank has reaffirmed its commitment to end quantitative easing, despite the tepid economic activity outcomes in recent months. Alongside Indonesia, many central banks in emerging Asian countries have also raised interest rates to mitigate the adverse impact caused by significant bouts of exchange rate volatility coupled with depreciation and compounded by capital outflows³. Managing macrofinancial conditions remained a challenge for policy makers as equity market volatility (as represented by the VIX index) and bond market volatility (as represented by the MOVE index) did not completely dissipate in Q3 after the jitters seen in Q2. The beginning of Q4 saw significant volatility in the VIX index due to weaker than expected corporate earnings by major tech companies such as Google and Amazon (Figure A.8).

The upward trend in oil prices continued in Q3 despite easing global demand due to moderating economic activity. The World Bank’s crude oil price index rose to its highest level since December 2014. More broadly, the World Bank’s energy price index also rose 41.4 yoy to reach its highest level since Q4 2014. The renewed set of U.S. sanctions⁴ on Iran, effective from November 4, may place further pressure on energy prices⁵. In contrast, non-energy prices (as measured by the World Bank’s non-energy price index) fell 0.8 percent in Q3 against the 8.7 percent increase in Q2.

¹ World Bank (2019).

² A dichotomy appears to be emerging with advanced economy trade growth which, in Q3, was significantly slower than trade growth in emerging economies. Imports growth in advanced economies averaged 1.1 percent yoy and exports growth averaged 2.4 percent yoy. In contrast, emerging economies trade outcomes were more positive with imports growth surging to an average of 7.6 percent in Q3, and exports growth accelerating to an average of 4.4 percent in Q3.

³ The Reserve Bank of India has raised interest rates twice since June 2018 (for a total increase of 50 basis points), the Philippines central bank by a total of 100 basis points, and Bank Indonesia by a total of 75 basis points (see Section A.5).

⁴ <https://www.businesstimes.com.sg/energy-commodities/oil-prices-fall-on-signs-of-rising-global-supply>

⁵ Global oil prices plunged in November, with Brent going from a peak of USD 86 per barrel on October 4 to USD 58 on November 23 (See Section A.2).

Growth of Government consumption surged in Q3 as nominal material spending spiked

Real Government consumption growth accelerated to 6.3 percent yoy from 5.2 percent in Q2. The Q3 outcome was in part due to nominal material spending growth surging 26.3 percent yoy compared to 8.8 percent in Q2. This was the fastest pace of growth in material spending since Q1 2017 and was largely driven by spending associated with the Asian games. Nominal personnel spending also picked up to 16.7 percent yoy from 12.6 percent in Q2. Social spending growth decelerated significantly to 4.3 percent yoy compared to 67.6 percent in Q2. This was expected given that the outcomes in Q1 and Q2 were driven mainly by the advance roll out of

the Government's subsidized social assistance program (PBI) as well as the widening of the coverage of the Family Hope program (PKH).

Net exports once again subtracted from growth

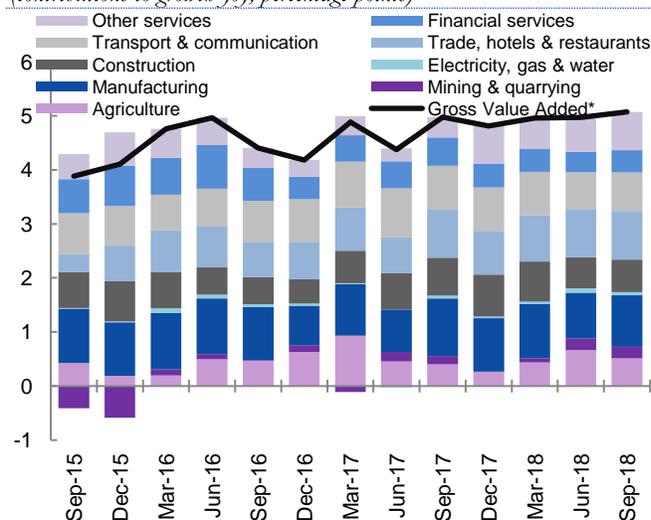
In line with slower global trade, both exports and imports growth eased marginally in Q3, however, imports still grew nearly twice as fast as exports, which led to an overall drag on GDP growth from net export growth. Exports growth eased slightly to 7.5 percent in Q3 from 7.6 percent in Q2, while imports grew 14.1 percent, down from 15.3 percent in Q2. The exports growth outcome was driven by plunging oil and gas (O&G) exports that were partially offset by stronger exports of non-O&G products. Due to spending associated with the Asian Games, services exports growth almost doubled to also record its fastest pace of growth since Q4 2017. Imports growth continued to be driven by non-O&G imports, while imports of O&G products imports weakened to the slowest growth since Q3 2017, partly due to the biofuel mandate that began on September 1⁶.

On the production side, most sectors grew faster than in Q2, except for the agriculture and utility sectors

In gross value-added terms, growth picked up slightly from 5.0 percent in Q2 to 5.1 percent in Q3 (Figure A.9). Most sectors saw stronger growth compared to Q2, except for the agriculture and utility sectors (Figure A.9). Agriculture sector growth moderated to 3.6 percent, partly due to a base effect from a bumper harvest season last year and lower production of food crops and commodities, such palm oil and rubber this year. The manufacturing sector recorded an uptick in activity (4.3 percent yoy compared to 3.8 percent in Q2). The mining and quarrying sector also continued to pick up with growth rising from 2.6 percent in Q2 to 2.7 percent in Q3, on the back of strength in global commodity prices. Despite the strength in investment activity, particularly in building and structures, the construction sector accelerated only modestly to 5.8 percent in Q3 from 5.7 percent in Q2.

Figure A.9: Manufacturing sector growth offset the moderation in the agriculture sector

(contributions to growth yoy, percentage points)



Source: CEIC; World Bank staff calculations

Note: Gross Value Added is derived as the sum of the value added in the agriculture, industry and services sectors. If the value added of these sectors is calculated at purchaser values, gross value added is derived by subtracting net indirect taxes from GDP.

2. Prices of energy-related commodities maintained their upward trajectories

Prices of key commodities follow the trend exhibited in the last quarters

The prices of Indonesia's key export commodities in Q3 followed trends observed in previous quarters. Prices for coal, crude oil, and liquefied natural gas (LNG) rose, booking an average yoy growth of 31.0 percent, nearly equal to that in Q2. On the other hand, prices of rubber and crude palm oil (CPO) eased further by 17.0 percent, continuing the downward trend seen since the beginning of the year. Prices of base metals were relatively stable, documenting a mere 2 percent decline (See Box A.2).

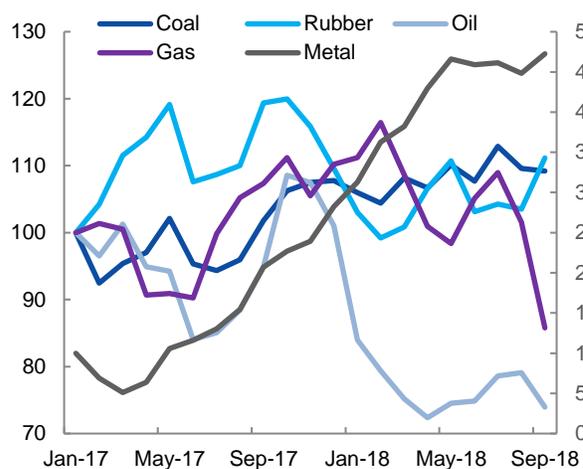
⁶ <https://www.reuters.com/article/us-singapore-siew-indonesia/indonesia-imposes-mandatory-use-of-b20-biodiesel-in-drive-to-cut-fuel-bill-deputy-minister-idUSKCN1N5160>

Partly due to the 100 million ton increase in the coal export quota beginning in September this year, coal exports rose to 7.3 percent yoy in Q3, slower than the 12.9 percent in Q2⁷. Export of base metals also recorded an increase of 128.3 percent in Q3, lower than the growth of nearly 300 percent booked in the second quarter. The surge in mineral exports was largely due to the Government partially lifting the export ban on unprocessed minerals in 2017, in place since 2014⁸.

Exports of the country's other key commodities, on the other hand, was weaker. The volume of O&G exports recorded a yoy contraction of 22.2 percent as swaps of ownerships of several oil blocks resulted in sharp changes in the amount earmarked for export⁹. In terms of volumes, export of oil (including refined products) and gas declined from 35.4 million barrels (mbbls) and around 300 million British thermal unit (mmbtu) respectively in Q3 2017, to 28.7 mbbls and around 267 mmbtu in Q3 2018. The volumes of exported rubber contracted yoy by nearly 7 percent, partly caused by the bearish demand for the commodity following the trade war between China and the United States (Figure A.10).

Figure A.10: Three month moving average of Indonesia's main commodity exports

(export volume index, January 2016 = 100; index for metal in RHS)



Source: CEIC; World Bank staff calculations

Note: Data for CPO is not available. Export volumes of base metals are not presented due to significant jump observed in 2018.

⁷ In its attempt to narrow the current account deficit, the Government has increased the export quota of coal by 100 million tons with effect from September 2018. While the industries were only able to meet around 25 percent of the additional quota, the total increase in export volume is nevertheless less than 25 million tons because a portion of the additional coal production is being used to meet the Domestic Market Obligation (see <http://pubdocs.worldbank.org/en/823461540394173663/CMO-October-2018-Forecasts.pdf>). In addition, industries could be responding to the higher quota cautiously in an effort to avoid oversupplying the market and adversely affect the prices (see <https://www.montelnews.com/de/story/indonesia-cuts-november-coal-price-by-3/950238>)

⁸ Indonesia partially lifted the non-processed mineral export ban at the beginning of 2017. Accordingly, the country has since been steadily increasing its volume of mineral export. Before that, since January 2014, miners needed to at least process their ore and concentrate before permissions to export are granted.

⁹ The government recently granted Pertamina permission to operate 12 oil blocks that were previously operated partly by foreign oil companies. As a result, the output from those fields are now processed (and later consumed) domestically, hence reducing the total export of oil.

Box A.2: A tale of two groups of commodities

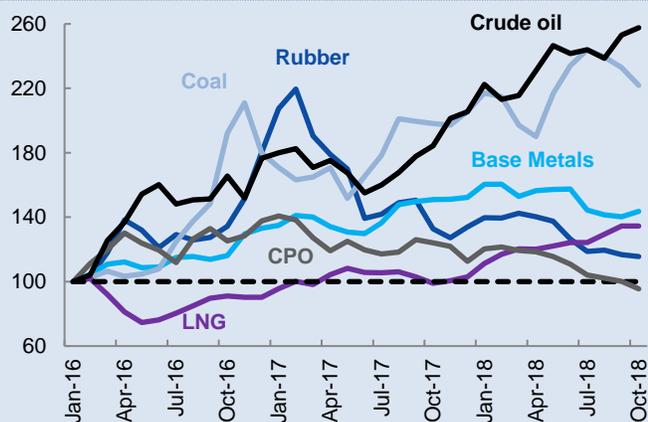
In line with the trend that began at the end of Q1 2018, prices for Indonesia’s key export commodities continued to move in different trajectories. Prices of non-agricultural commodities such as coal, crude oil, and LNG maintained their upward trend. (Figure A.11). In contrast, ample availability and weak demand continued to weigh on rubber and CPO prices.

Coal prices rose an average of 23.7 percent yoy in Q3, after a jump of 31.3 percent in Q2, driven by a surge in demand from China and India in preparation for the high demand for electricity during winter. Relatedly, in September 2018, China's Ministry of Ecology and Environment trimmed its pollution reduction target to 3 percent from 5 percent for the period October 2018 through to March 2019, opening the door for a substantial increase in the use of coal for power production in the country's northern provinces. Meanwhile, the bullish mood for crude oil continued as prices reached a four-year high at the end of Q3, translating into 45.5 percent yoy growth, which partly reflected supply fears as sanctions were imposed on Iran. However, the upward path in crude oil prices reversed in the middle of Q4 with oil prices plunging. Brent oil prices fell from a peak of USD 86 per barrel on October 4 to USD 58 on November 23. One of the main reasons for the reversal was that the U.S. allowed exemptions for major importers of oil (such as India) to continue buying oil from Iran. Furthermore, global economic activity moderated in Q3 and eased demand pressures that led to additional downward pressure on prices. Meanwhile, LNG prices also enjoyed a new multi-month high in Q3, surging 23.5 percent, due to massive growth demand in China and demand revival in South Korea.

On the agricultural commodities, rubber prices continued to be in the bearish territory as global trade policy uncertainty dampened sentiment. Prices in Q3 declined further yoy by 19.5 percent after a 17.2 percent fall in Q2, and are likely to fall further due to ample supply, as tapping in key growing areas has started. On the other hand, the price of CPO slipped further by 15.2 percent, following the fall of other vegetable oils, such as soybean, rapeseed, and sunflower oil.

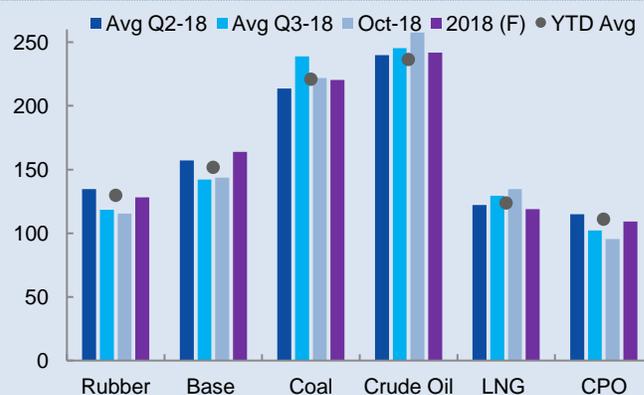
Moving forward, the World Bank (2018) expects the prices of rubber and CPO to remain under pressure. Coal prices are projected to be stable, while base metal and prices are expected to make slight gains. The average price of oil in 2018 is still expected to be higher than it was year ago, despite significant declines seen in November 2018. (Figure A.12).

Figure A.11: Non-agricultural commodity prices continued to rally, while agricultural ones remained under pressure
(index: January 2016 = 100)



Source: World Bank Pink Sheet; World Bank staff calculations
Note: LNG stands for Liquefied Natural Gas; CPO stands for Crude Palm Oil

Figure A.12: Base metal prices are expected to end 2018 higher than the YTD average
(index: January 2016 = 100)



Source: CEIC, BPS; World Bank staff calculations

3. Pressured by higher crude prices, the current account deficit widened further

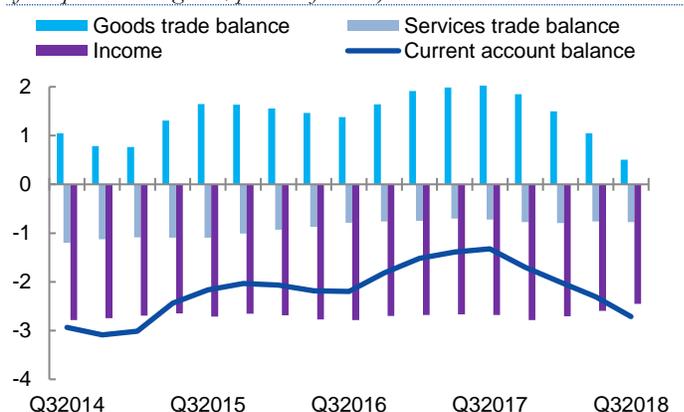
The current account deficit widened as the goods trade balance went into deficit, while the services deficit increased

Amid high crude oil prices in Q3 and continued robust growth in equipment investment¹⁰, Indonesia's current account deficit widened to 2.7 percent in Q3, wider than Q2's 2.3 percent¹¹ (Figure A.13). On a quarterly basis, the current account deficit was 3.4 percent of GDP in Q3, larger than the deficit of 1.8 percent seen in Q3 2017 (Table A.1).

The current account deficit widened on the goods trade balance turning to a deficit and a larger service trade deficit.

Overall, as the surplus at the financial and capital account was not sufficient to offset the deficit recorded in the current account, the balance of payments booked a deficit of USD 4.4 billion. After three consecutive quarters of BOP deficits, BI's international reserves fell to USD 114.8 billion at the end of Q3, but are still sufficient to finance Government external debt repayments and imports for 6.3 months¹².

Figure A.13: The deficit in the goods trade balances led the deterioration of the current account balance
(four quarter rolling-sum, percent of GDP)



Source: CIEC, World Bank staff calculation

Table A.1: Indonesia's Balance of Payments (BOP)

(USD billion unless otherwise indicated)

	Q3-2017	Q4-2017	Q1-2018	Q2-2018	Q3-2018
Nominal GDP	262.9	257.9	258.2	263.9	262.5
Overall Balance of Payments	5.4	1.0	(3.9)	(4.3)	(4.4)
As percent of GDP	2.0	0.4	(1.5)	(1.6)	(1.7)
As percent of GDP, four-quarter rolling sum	1.5	1.1	0.3	(0.2)	(1.1)
Current Account	(4.6)	(6.0)	(5.5)	(8.0)	(8.9)
As percent of GDP	(1.8)	(2.3)	(2.1)	(3.0)	(3.4)
As percent of GDP, four-quarter rolling sum	(1.3)	(1.7)	(2.0)	(2.3)	(2.7)
Goods trade balance	5.3	3.1	2.3	0.3	(0.4)
Services trade balance	(2.1)	(2.3)	(1.7)	(1.9)	(2.2)
Income	(7.8)	(6.6)	(6.3)	(6.4)	(6.2)
Capital and Financial Accounts	10.2	(6.8)	2.3	4.5	4.2
As percent of GDP	3.9	2.7	0.7	1.7	1.6
As percent of GDP, four-quarter rolling sum	3.0	2.9	2.4	2.3	1.7
Direct Investment	7.6	4.3	3.1	2.7	3.9
Portfolio Investment	4.0	2.0	(1.2)	0.1	(0.1)
Other Investment	(1.4)	0.7	(0.2)	1.7	0.2

Source: Bank Indonesia; World Bank staff calculations

Total imports continued to outpace total exports...

Nominal growth in total imports of goods and services continued to outpace that of total exports for the fourth consecutive quarter. Total exports grew by 10.7 percent yoy in Q3, slower than the 22.6 percent growth booked in the same quarter last year, driven slightly more by

¹⁰ Equipment investment has a high import content, which drives up imports of capital and intermediate goods.

¹¹ Expressed as a four-quarter rolling sum.

¹² Bank Indonesia (August 15, 2018).

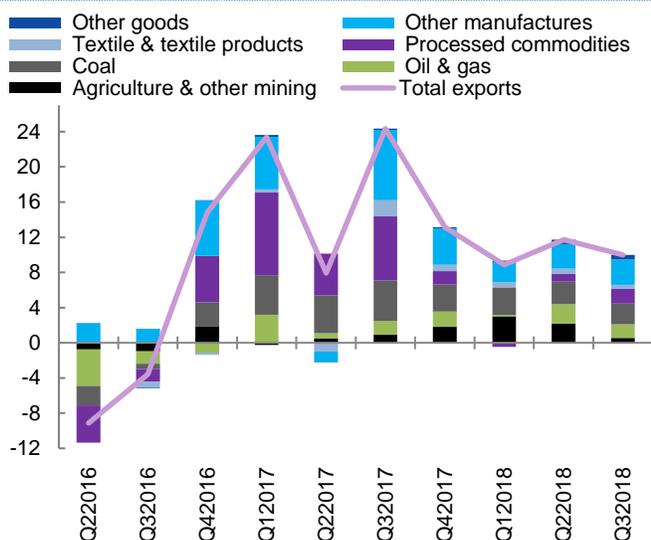
exports of services. Total imports, on the other hand, accelerated to 23.8 percent in Q3 from 21.3 percent in Q3 last year

... driven by the strong growth of goods imports.

Growth of goods imports more than doubled that of exports in Q3. Goods imports growth upped 25.5 percent in Q3, from 22.4 percent Q3 2017, driven by strong consumption and investment¹³. Meanwhile, goods exports growth eased substantially to 10.0 percent in Q3 from 24.3 percent in Q3 2017. The moderation in the goods exports growth was partly due to a high base effect observed in Q3 2017, as well as slower global growth and global trade. Accordingly, the goods trade balances went into deficit for the first time since Q2 2014¹⁴.

Figure A.14: Softer goods exports growth seen in every category

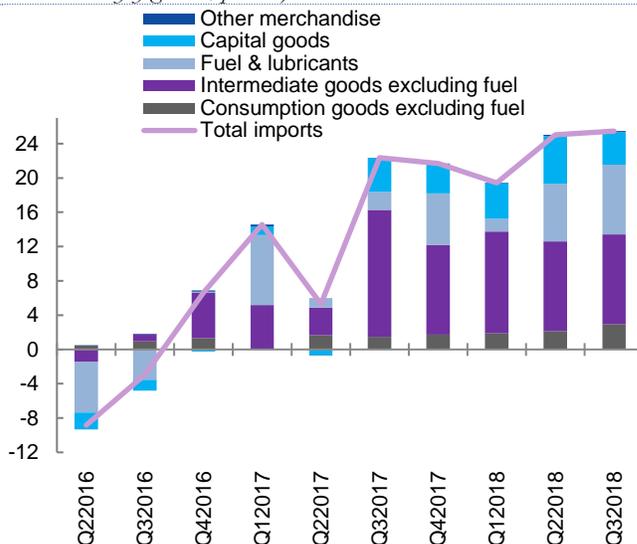
(contributions yoy growth, percent)



Source: CEIC and Bank Indonesia; World Bank staff calculations
 Notes: The “other manufacturing” category includes paper, paper materials, furniture, plastics, processed foods, chemicals, and “other” goods

Figure A.15: Growth of goods imports continued to outpace exports, driven by fuel and consumption goods.

(contributions yoy growth, percent)



Source: CEIC and Bank Indonesia; World Bank staff calculations

The slowing of goods exports growth in Q3 was broad-based...

Compared to both Q2 2018 and Q3 2017, the yoy growth of goods exports in Q3 2018 slowed across nearly all categories. Exports of coal¹⁵, other manufacturing products (including paper and paper products and processed foods), textiles and motor vehicles, in particular, saw softer growth (Figure A.14). The continued contraction of palm oil and processed rubber exports contributed to the negative contribution of the processed commodities category. On the O&G front, despite slightly lower production¹⁶, growth of exports was relatively stable at 18 percent,

¹³ Goods imports grew 25.0 percent in Q2 2018, while that of exports grew 11.7 percent.
¹⁴ Back in Q2 2014, growth of goods imports was relatively high, driven by higher demand for consumption goods for both fasting month and Lebaran festivities. On the other hand, growth of goods exports was hampered by sluggish demand for main Indonesia commodities, especially coal and palm oil, as well as the decision by the government of Indonesia to ban the export of unprocessed mineral.
¹⁵ Shipments of coal is reportedly down in particular for China as the country started to limit the coal imports while also give more preference to high-calorific coal (which is not the trait of Indonesian coal). The value of coal exports has been also by the relatively lower price of coal at the end of Q3, as the Government of Indonesia increased its export quota by 100 million tons.
¹⁶ The special task force overseeing upstream oil and gas activities in Indonesia (SKK Migas) announced that the lifting oil and gas in Q3 slowed by 1.5 percent qoq (quarter to quarter) from 791 kbpd (kilo barrels per day) to 780 kbpd partly because of unplanned shutdown in two important fields at Plaju and Dumai. Vice Minister of Energy and Mineral Resources also revealed that the swap of Mahakam oil fields that was previously owned by Total to Pertamina has partly affected the export figures. Gas production, on the other hand, improved both qoq (6.8 percent) and yoy (21.2 percent).

similar to that in Q3 2017. Apart from exports to the United States¹⁷, India¹⁸, South Korea¹⁹, and Vietnam²⁰, those to the other ten top destinations recorded slower growth than in Q2 2018.

... while higher oil prices supported goods imports growth

Goods imports has been persistently growing more than 20 percent yoy over the last five quarters (Figure A.15). Its main drivers, imports of fuel and consumption goods, grew firmly yoy at 56.7 percent and 36.0 percent, respectively. The surge in prices were partly behind the escalation²¹ in fuel imports. Similarly, imports of consumption goods accelerated further to the highest yoy growth in at least the past six years. This is despite the steady depreciation of the Rupiah, in both nominal and real terms and the Government policies to increase the consumption goods import tax²². Meanwhile, the growth of capital goods imports moderated to 22.7 percent, slightly lower than 24.1 percent of growth in Q3 2017.

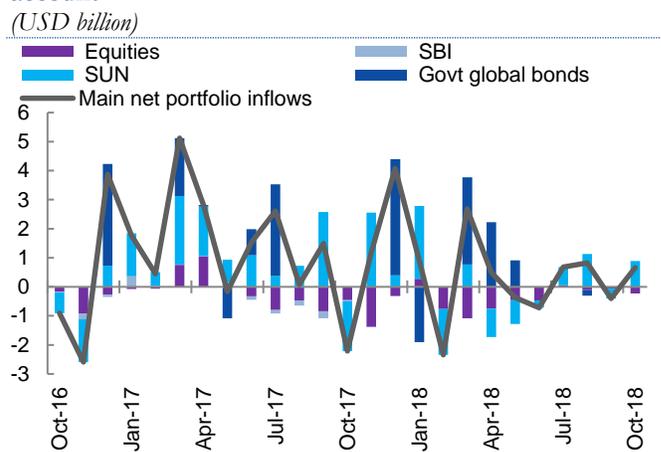
Deficit in the services account slightly widened

The services account deficit widened to USD 2.2 billion in Q3 2018, slightly higher than the deficit of USD 1.9 billion reported in the previous quarter. Growth of services imports accelerated by 13.3 percent in Q3, in line with higher imports of goods and the uptick of the demand of services due to hajj pilgrimage activities. An even larger services trade deficit was restrained by higher services exports as the number of foreign travelers to Indonesia increased during the Asian Games events held in Jakarta and Palembang.

The financial account surplus remained relatively stable

Despite the volatile external backdrop, the financial and capital account posted a relatively stable surplus of USD 4.2 billion (1.6 percent of GDP) in Q3 from USD 4.5 billion (1.7 percent of GDP) in Q2, but far less than USD 10.3 billion (3.9 percent of GDP) documented in Q3 last year. The figure reflects a pickup in net foreign direct investment (FDI) inflows to USD 3.9 billion from USD 2.7 billion in the previous quarter, leaving the basic balance (which is the sum of current account balance and total of net FDI) relatively unchanged, albeit still negative.

Figure A.16: Stable surplus seen in financial and capital account



Net portfolio inflows in Q3 totaled USD 1.1 billion, more than reversing the USD 0.6 billion outflow in Q2, but, significantly lower than the USD 4.2 billion that entered Indonesia in Q3 last year (Figure A.16). The resurgence was driven by a reversal in flows from the purchase of Rupiah denominated sovereign bonds (SUN) and this provides some evidence that investor confidence in Indonesia had begun to return in Q3. Pressures on the equities side also eased with outflows from the equity markets falling to USD 0.1 billion in Q3 2018 from USD 1.7 billion in the previous quarter. Private sector outflows from debt securities reached about USD 1 billion versus net inflows of USD 0.8 billion in Q2, consistent with a reduction in non-resident

¹⁷ Driven mainly by exports of textiles and footwears.

¹⁸ Driven by exports of coals, rubber and palm oil.

¹⁹ The main driver is exports of non-precious metals and copper.

²⁰ Exports of vehicles parts and parts of electrical equipment drove the growth.

²¹ Prices of oil and the refined products increased 56.0 percent and 45.2 percent yoy, respectively. Meanwhile, the volume of the imported oil and refined products grew 3.2 percent and 9.6 percent, respectively.

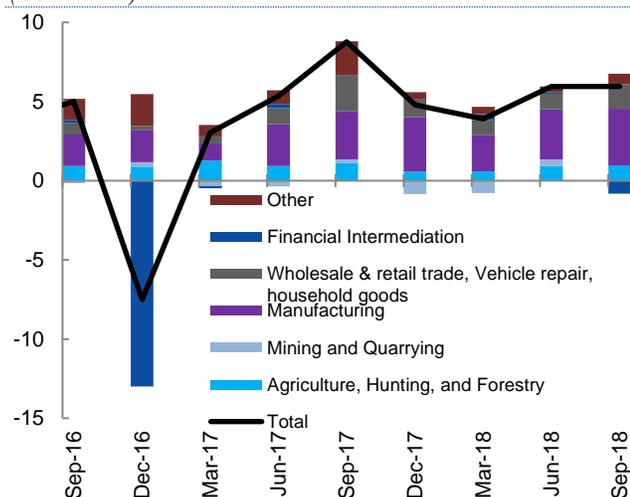
²² <https://finance.detik.com/berita-ekonomi-bisnis/d-4199347/pajak-impor-barang-konsumsi-naik-hingga-10-kapan-berlaku>

holdings of Government bonds particularly in September, when the situation in Turkey deteriorated. This has since stabilized and started to rise more meaningfully in recent weeks, partly reflecting attractive valuations amid some stability in the external backdrop (See Section A.5).

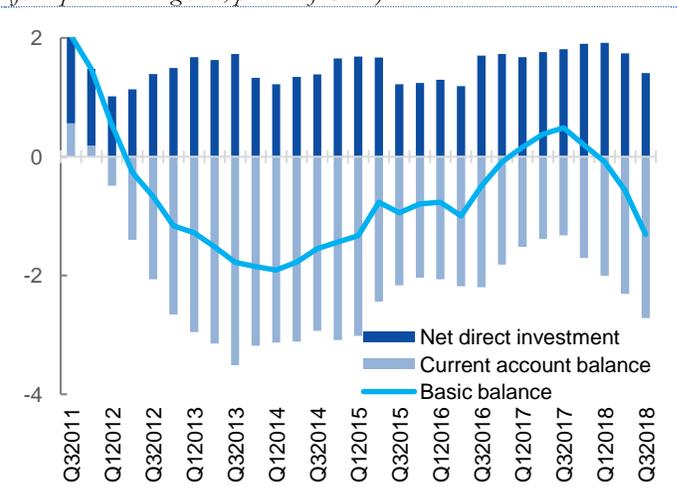
Net foreign direct investment rose from Q2

Net FDI totaled USD 3.9 billion in Q3, upped from USD 2.7 billion in Q2 (Figure A.17). The figure was nevertheless lower than the USD 7.4 billion recorded in Q3 2017²³. Manufacturing, wholesale trade, agriculture, fisheries, as well as the financial intermediation sectors were the main recipients of the direct investment in Q3²⁴. Despite the increase in value, albeit very slow²⁵, net direct investment (direct investment in Indonesia less Indonesian direct investment abroad) in Q3 has not been sufficient to finance the current account deficit since Q1 2018 (Figure A.18).

Figure A.17: Net foreign direct investment (FDI) increased, mostly in the manufacturing sector... (USD billion) **Figure A.18: ... but net direct investment was insufficient to cover the current account deficit** (four quarter rolling-sum, percent of GDP)



Source: CEIC and Bank Indonesia; World Bank staff calculations



Source: CEIC and Bank Indonesia; World Bank staff calculations

²³ Significant direct investment in Q3 last year was seen going into few Indonesian ‘unicorn’ startups that are believed to be valued more than USD 1 billion.

²⁴ Direct investment outflows in Q3 2018 was valued at USD 1.9 billion, higher than in Q2 2018 (USD 1.2 billion) and Q3 2017 (USD 1 billion) as an Indonesian company reportedly acquired a coal mining company in Australia.

²⁵ Indonesia attracts relatively little FDI compared to peers. Over 2013-2017, FDI into Indonesia averaged 2.1 percent of GDP. This is significantly lower than, for instance, Malaysia (3.5 percent), Brazil (3.7 percent) and Vietnam (5.7 percent). See Part B for a more detailed discussion.

4. Headline inflation continued to ease

Inflationary pressures eased in Q3 largely on the back of lower administered price inflation

Headline consumer price inflation eased to an average of 3.1 percent yoy in Q3, from an average of 3.3 percent in Q2 (Figure A.19). The lower headline reading was largely driven by low administered price inflation on the back of a high base-effect due to last year's electricity tariff hikes.

Administered price inflation dropped from an average of 3.5 percent in Q2 to 2.4 percent yoy in Q3, as pressures from last's year electricity tariff hikes dissipated further, offsetting the increase in non-subsidized fuel prices²⁶. Moreover, administrated prices related to transportation, communication, and finance services recorded lower price hikes compared to Q2, thus containing the upward pressures in Q3.

Core inflation ticked up, as tuition fees in 2018 were increased more than in the past

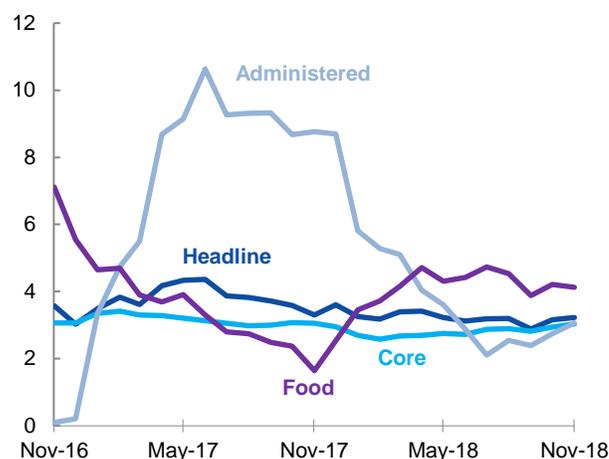
Core inflation, which excludes inflation from volatile goods and administered prices, edged up in Q3 to 2.9 percent yoy from 2.7 percent in Q2, partly due to larger increases in college fees and services prices this year. Bank of Indonesia reported higher increases in tuition fees at all education levels, including universities, for the new school year that began in Q3 2018²⁷. Education, recreation, and sport prices rose 3.5 percent yoy in Q3 from 3.4 percent in Q2. This partly contributed to the moderation in consumption of education and health related categories (see Section A.1).

Headline inflation moved higher in November, but remains well within with the target range

On a monthly basis, headline inflation moved notably higher, to 3.2 percent yoy in November from 2.9 percent in September, led by higher core, administered price, and volatile good inflation. Core inflation rose to 3.0 percent yoy in November compared to 2.8 percent in September. Upward adjustment of various non-subsidized fuels led to higher administered price inflation in November. Volatile good inflation rose due to price increases in unsubsidized fuels and higher food prices. The latter was driven by a small hike in raw food prices such as red chili, onion, and rice, as well as prepared food prices. Headline inflation continued to be well within the BI target range of 2.5 percent to 4.5 percent despite these upward adjustments.

Figure A.19: Headline inflation eased in Q3, but has been creeping up in Q4

(change yoy, percent)



Source: BPS; World Bank staff calculations

Note: Food prices are a weighted average of the raw and processed food price components of CPI.

²⁶ The price of Pertamina (RON 92) was raised twice in Q3 2018, from IDR 8,900 per liter to IDR 9,500 per liter in July and further to IDR 10,400 per liter in October. The Government also hiked the RON 94 price (to IDR 12,250 from IDR 10,700), Pertadex (to IDR 11,850 from IDR 10,500); Dextrite (to IDR 10,500 from IDR 9,000), non-subsidized solar (to IDR 9,800 from IDR 7,700), and non-subsidized kerosene (to IDR 12,870 from IDR 11,550) <https://www.pertamina.com/id/news-room/announcement/daftar-harga-bbk-tmt-10-oktober-2018>.

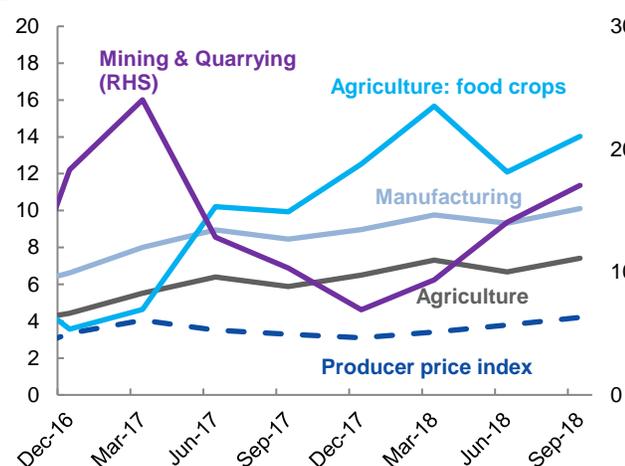
²⁷ <https://www.bi.go.id/id/moneter/koordinasi-pengendalian-inflasi/highlight-news/Pages/Analisis-Inflasi-TPIP-Juli-2018.aspx>

Table A.2: Key components of the consumer price index
(average change yoy, percent)

Categories	Q1-17	Q2-17	Q3-17	Q4-17	Q1-18	Q2-18	Q3-18	Oct-18	Nov-18
Headline	3.7	4.3	3.8	3.5	3.3	3.3	3.1	3.2	3.2
Core	3.4	3.2	3.0	3.0	2.7	2.7	2.9	2.9	3.0
Clothing	2.9	2.8	2.4	3.5	4.0	3.8	3.5	3.5	3.6
Health	4.0	3.8	3.4	3.1	2.8	2.9	3.0	3.0	3.1
Education, recreation and sports	2.7	2.8	2.9	3.3	3.4	3.4	3.5	3.2	3.1
Administered	4.5	9.5	9.3	8.7	5.4	3.5	2.4	2.7	3.1
Housing, utilities, fuel	3.4	5.7	5.7	5.2	3.8	2.4	2.1	2.4	2.5
Transport, communication and finance	3.0	5.4	4.7	4.5	1.6	1.8	1.6	2.1	2.6
Volatile	3.8	2.7	0.9	-0.1	3.3	4.7	4.7	4.5	4.3
Raw food	3.9	2.9	1.4	1.0	3.5	4.8	4.7	4.4	4.3
Processed food, beverages, tobacco	5.1	4.6	4.3	4.2	4.1	4.1	4.1	4.0	4.0

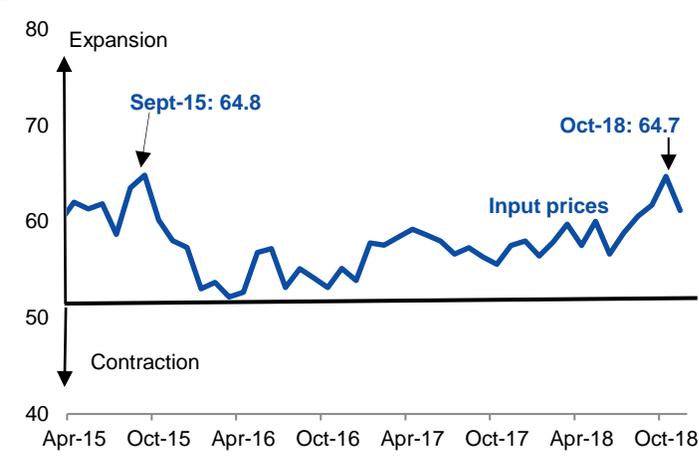
Source: BPS; World Bank staff calculations

Figure A.20: A broad-based increase in producer prices contributed to the upward trajectory of the producer price index
(change yoy, percent)



Source: CEIC; World Bank staff calculations

Figure A.21: Producers faced greater cost pressures as input prices rose the fastest in over three years
(50 = no changes from previous month, monthly)



Source: IHS Markit, Nikkei

Producer prices continued to trend upwards in Q3

The producer price index climbed 4.2 percent in Q3 compared to an increase of 3.8 percent yoy in Q2, continuing an upward trend observed since the beginning of 2018. The Q3 outcome was due to broad-based price increases in the food, manufacturing, agriculture food crops, and mining and quarrying sectors (Figure A.20). This was the fastest growth since Q3 2014. Rupiah depreciation and rising raw material prices contributed to the fastest input price growth in over three years in October (Figure A.21).

5. Macrofinancial conditions remained soft in Q3

Macrofinancial conditions deteriorated in Q3 before demonstrating signs of a recovery in early Q4

Indonesia’s macrofinancial conditions continued to deteriorate in Q3 with the Rupiah further weakening and bond yields rising, broadly in line with the sustained volatility in global financial markets, despite some moderation compared to Q2 (see Box A.1). Consequently, Bank Indonesia (BI) raised its benchmark policy rate twice in Q3, by 25 basis points each time. Partly due to sound economic fundamentals and the resilience of the financial sector, two broad measures of financial system soundness – the non-performing loan (NPL) ratio and the capital adequacy ratio (CAR) – remained broadly stable.

The Rupiah depreciated in both real and nominal terms in Q3

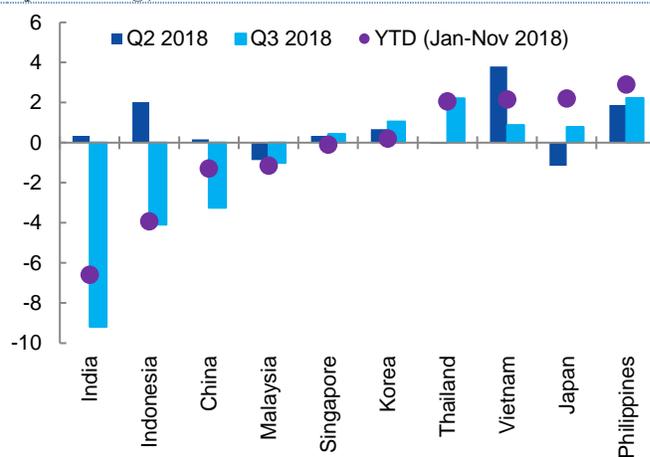
Partly reflecting the ongoing global financial market volatility (see Box A.1), the weakening of the Rupiah carried over from Q2 into Q3 (Figure A.22), depreciating 4.2 percent against the U.S. dollar – less than Q2’s 4.8 percent drop. When compared to other emerging market economies, as represented by JP Morgan’s Emerging Market Currency Index (EMCI), the depreciation in the Rupiah was broadly similar until the end of Q3 when the EMCI recovered more than the Rupiah to post an overall Q3 loss of 3.7 percent (compared to the 8.6 percent rout in Q2). In year-to-date terms²⁸, the Rupiah has depreciated 5.6 percent in nominal terms, while emerging market currencies have depreciated 10.2 percent.

Figure A.22: The Rupiah depreciated against the U.S. dollar in Q3 before recovering somewhat at the start of Q4
(index, Jan 1 2018 = 100)



Source: JP Morgan, BPS and World Bank staff calculations

Figure A.23: In real effective terms, the Rupiah depreciated more than most of its regional peers
(percent change)



Source: JP Morgan Real Effective Exchange Rate, CPI based (2010=100), and World Bank staff calculations
Note: Downward movement represents depreciation

The Rupiah continued depreciating in Q4 with the currency crossing the IDR 15,000 threshold on October 3, the first time since the height of the Asian financial crisis in June 1998. However, the downward trend appears to have reversed since then, with the currency paring back losses in the lead up to the U.S. mid-term elections on November 6. The gains were more attributable to weakness in the U.S. dollar, associated with the Democrats successfully claiming a majority in the U.S. congressional lower house and the potential challenge it might create for the current administration’s stimulatory fiscal policy stance²⁹. BI’s announcement that it would allow domestic non-deliverable forward (DNDF) transactions as a means of maintaining Rupiah stability (effective from 1 November)³⁰ also potentially underpinned some of the currency’s recovery. In real effective terms³¹, only the Indian Rupee fell more than the Rupiah’s 4.1 percent depreciation in Q3 (Figure A.23). In year-to-date and real effective terms, it has depreciated 3.9 percent.

In Q3, bond yields rose but at a

As in H1 2018, bond yields continued increasing in Q3, however, at a significantly gentler pace than in Q2 (Figure A.24). In Q3, 10-year bond yields rose 19 basis points compared to 122 basis points in Q2. This smaller rise in bond yields was also seen with that of other emerging markets,

²⁸ As of November 30, 2018

²⁹ <https://www.cnn.com/2018/11/07/forex-markets-dollar-us-midterm-elections-in-focus.html>

³⁰ DNDF is an exchange rate hedging instrument for banks and corporations to mitigate the risk of exchange rate fluctuations. Unlike other forward transactions, DNDF transactions will use the Rupiah, rather than USD; encouraging business people and investors to buy more Rupiah. See https://www.bi.go.id/en/ruang-media/siaran-pers/Pages/sp_207318.aspx for more information.

³¹ Real effective exchange rates are based on trade weighted averages of bilateral exchange rates and adjusted by consumer prices.

shallower trajectory than they did in Q2

with the Emerging Markets Bond Index Plus (EMBI+) ending Q3 in neutral territory in terms of losses and gains, compared to a rise of 73 basis points in Q2. The more moderate upward pressure on EM bond yields in general was due to dissipating uncertainty and volatility associated with particular emerging markets – Turkey and Argentina – especially towards the end of Q3.

Figure A.24: Investor confidence returned in Q3 with bond yields rising much less than in Q2

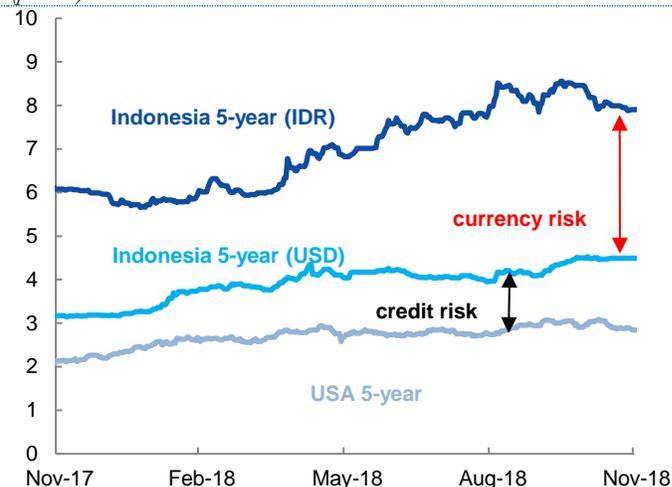
(percent)



Source: JP Morgan, CEIC, World Bank staff calculations
 Note: EMBI+ is a JP Morgan emerging market bond index yield to maturity

Figure A.25: Spread between Rupiah denominated bonds and USD denominated bonds peaked in Q3 but began to narrow in early Q4

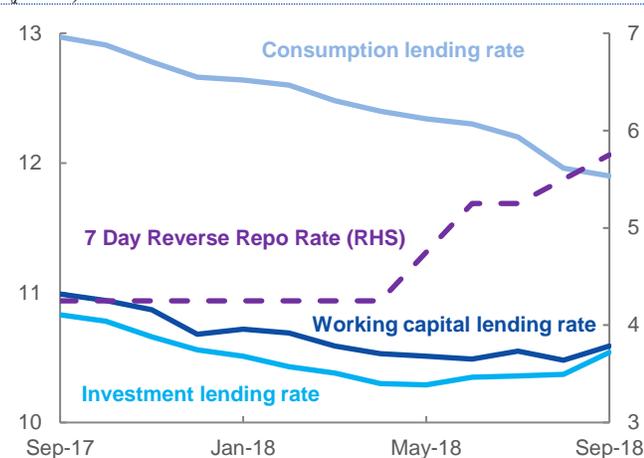
(percent)



Source: Bloomberg, CEIC, World Bank staff calculations

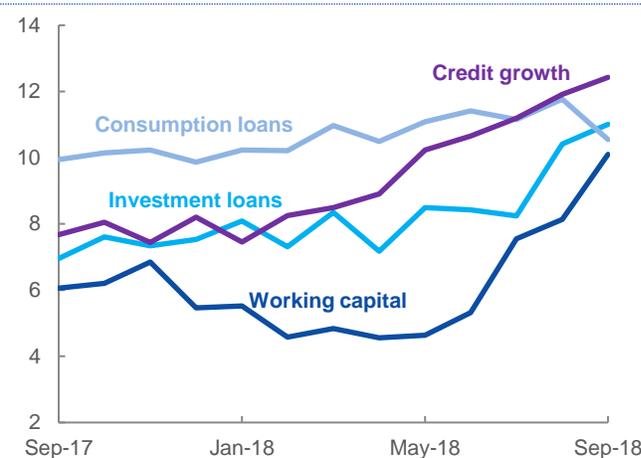
In a sign hinting of a possible recovery in investor confidence in Indonesian assets (and particularly the currency), the spread between the Rupiah- and USD-denominated bonds peaked (compared to the spread throughout 2018) in early September before narrowing in Q4. Decomposing the spread in order to apportion risk stemming from currency movements and credit-related risk reveals that, as was the case in Q2, the main risk is currency related due to exchange rate volatility (Figure A.25). The spread between USD-denominated Indonesian bond yields and U.S. bond yields remained stable, while the spread between Rupiah denominated Indonesian bond yields and USD denominated Indonesian bond yields widened in Q3 before beginning to narrow. Furthermore, a Government bond auction on 6 November was oversubscribed by three times which confirms the hypothesis about the recent, gradual return in confidence. On average, Government bond auctions in Q4 (until the end of November) were oversubscribed by an average of 2.5 times, higher than in Q3 (2.2) and Q2 (2.1).

Figure A.26: The rise in benchmark policy rate has not been fully transmitted into higher lending rates ...
(percent)



Source: CEIC, Bank Indonesia, and World Bank staff calculations

Figure A.27: ... and credit growth continued to pick up
(yoy growth, percent)

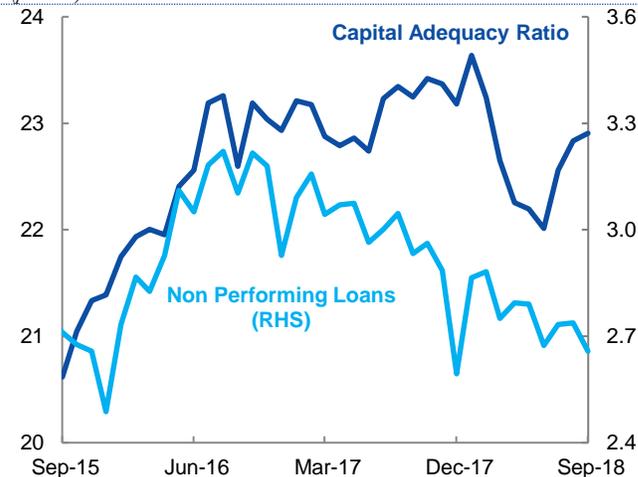


Source: CEIC, Bank Indonesia, and World Bank staff calculations

Monetary policy tightening continued in Q3

Monetary policy tightening continued in Q3 with BI raising its policy rate twice, by 25 basis points each time (Figure A.26). However, in contrast to the Q2 focus on Rupiah stability, in Q3, BI explicitly highlighted an additional objective of narrowing the current account deficit³². In contrast to the policy rate, lending rates have been still trending downwards, benefitting from the previous easing cycle, with the average lending rate³³ falling to 11.0 percent in Q3 compared to 11.1. in Q2. Consequently, credit growth has strengthened, reaching an average of 11.8 percent yoy in Q3 (Figure A.27), the highest in nearly 4 years, with credit extended for working capital loans and investment loans picking up sharply – 13.6 percent yoy and 11.4 percent yoy. In a sign of the banking system’s resilience, the depreciating currency and monetary policy tightening do not appear to have had an adverse impact on non-performing loans, which hovered around the 2.7 percent mark in Q3 (broadly similar to the outcomes in Q2). The CAR also pointed to a resilient banking system and averaged 22 percent in Q3 – similar to where it was in Q2 and well above the benchmark 8 percent threshold (Figure A.28).

Figure A.28: Banking sector demonstrated continued resilience in the face of monetary policy tightening
(percent)



Source: CEIC and Bank Indonesia

³² As seen in the press releases accompanying the Board decisions in August and September 2018. The August press release: https://www.bi.go.id/en/ruang-media/siaran-pers/Pages/sp_206618.aspx, and the September: https://www.bi.go.id/en/ruang-media/siaran-pers/Pages/sp_207318.aspx.

³³ The average includes consumption lending rates, lending rates for working capital, and lending rates for investment loans.

6. Solid revenue collections support strong expenditure growth, but challenges with spending quality remains

Better revenue collection leads to lower deficit despite higher spending

Both total Government revenues and expenditures continue to show strong growth in the year-to-October this year. Revenue collection was mainly driven by income taxes from non-O&G and O&G-related revenues, and VAT/LGST, while the robust total Government expenditure growth was mainly due to higher personnel, material, and energy subsidy spending. The net result is a significantly smaller budget deficit, compared to the deficit over the same period in 2017. The 2019 budget signals the Government's priorities to boost revenue collection to support higher spending. As a result, the budget deficit is projected to be lower at 1.8 percent of GDP in 2019, compared to the expected deficit of 2.1 percent according to the 2018 outlook.

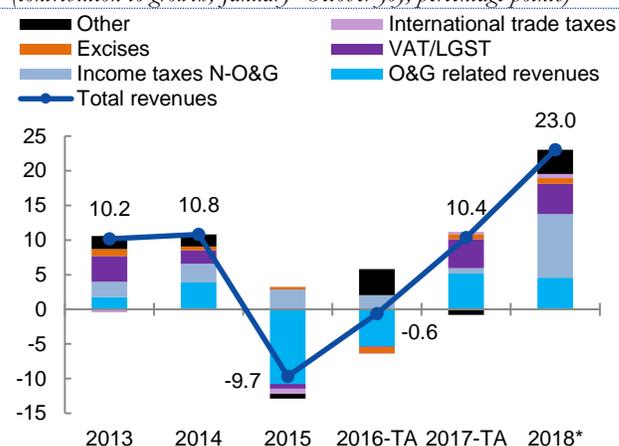
Total revenues continue to grow strongly as seen earlier this year

The year-to-October 2018 Central Government revenue continued to grow strongly: 23 percent this year yoy compared to the 10.4 percent over the same period in 2017, excluding revenue from the Tax Amnesty Program³⁵ (see Figure A.29).

All revenue components contributed positively to total revenue growth. Revenue from non-O&G income tax³⁶ and from VAT³⁷ continued to show significant contribution, of 9.2 and 4.4 percentage points, respectively. In addition, O&G-related revenue (income tax, dividends, and royalties) also showed a positive contribution to total revenue of 4.6 percentage points, though less than in 2017. The increase in O&G revenue was partly due to higher global commodities prices, particularly that of oil and coal. As of end-October 2018, revenue from excises recorded double-digit growth – 10.4 percent yoy compared to 9.4 percent in 2017 for the same period, the fastest growth since 2013. This is driven by both higher effective tobacco excise tariffs and production.³⁸

Figure A.29: Non-O&G income tax, O&G related revenues and VAT were the main contributors to the high total revenue growth

(contribution to growth, January–October yoy, percentage points)



Source: Ministry of Finance; World Bank staff calculations

Note: O&G related revenues refer to oil and gas income tax, dividends and royalties (non-tax revenues), N-O&G stands for non-oil and gas income tax; VAT/LGST stands for Value added tax/luxury goods sales tax; "Other" includes: land/property taxes, other tax revenues; non-oil and gas non-tax revenues; other non-tax revenues (profits of public enterprises, revenues from Public Service Agency [BLU], and other non-tax revenues [PNBP]³⁴); and grants. 2017-TA means that total revenues exclude redemption fees collected under the Tax Amnesty Program. 2018* is a yoy comparison against 2017-TA.

³⁴ Other non-tax revenue (PNBP) includes revenue sharing from the sales of coal (Penjualan Hasil Tambang/PHT) and Oil and Gas upstream activities. The big contribution of "other" component to the total revenue growth in 2018 was partly due to increase of those commodities price while in 2016 it was partly due to the higher O&G lifting.

³⁵ The Tax Amnesty Program was a one-off Central Government income tax revenue program that ran from Q3 2016 until Q1 2017.

³⁶ This is mainly driven by robust collections of corporate income taxes as improvement in compliance. In the year to October, income taxes from imports (Article 22 Import) and corporates (Article 25/29) grew by 28 percent and 25 percent yoy in nominal terms, respectively. Article 22 Import is a payment made by companies related to their certain import transactions, which can be seen to be part of corporate income taxes for Indonesia.

³⁷ VAT grew by 15 percent yoy as of end-Oct due to higher commodity prices. Meanwhile, gearing domestic demand drove the notable growth of import VAT which seen an increase of 28.1 percent yoy in nominal terms compared to the same period last year.

³⁸ The effective tobacco excise tariff increased more than normative tariff at 10.04 percent in the year to October. Meanwhile, the tobacco production also increased by 2.6 percent yoy partly due to some improvement in enforcement in Program Penertiban Cukai Berisiko Tinggi starting in Q3 2017). Furthermore, excises on vaping liquid used in electronic cigarettes came into effect starting October 1, 2018.

Growth in total Government spending doubled, driven by energy subsidy spending...

Total Government expenditure in the year-to-October 2018, including transfers to sub-national Governments, rose by 12 percent yoy, doubling the 6 percent increase seen over the same period in 2017 (Figure A.30). Energy subsidies, excluding arrears, increased partly due to higher global commodity prices. Spending on interest payments also grew, mainly driven by the Rupiah depreciation and higher Government bond yields. Similarly, social spending expanded following the expansion of the PKH and early disbursement of subsidized health premium (PBI-JKN), particularly in the first seven months of 2018. Personnel and material spending rose on payments of allowances for pensioners and additional performance allowances to active civil servants during the Eid festivities. Meanwhile, material spending grew partly due to several major events such as the regional elections, the 2018 Asian Games and the World Bank-IMF Annual Meetings in Bali. However, as of end-October 2018, capital spending only grew at 1 percent yoy, slower than the 8 percent in the same period last year, due to a lower budget allocation³⁹.

Spending disbursement rate continues to increase but quality issues remain

As of October 2018, the Government has disbursed 77 percent of the budget (see Figure A.31), which is the highest in at least the last eight years, but there are still challenges relating to the quality of spending. The high disbursements were broad based, but particularly strong for energy subsidies and social and personnel spending. In contrast, the execution of capital spending stood at only half of the budget (53 percent) for 10 months this year, although this is a slight improvement from 2017.

Figure A.30: Energy subsidies, interest payment, and personnel and material spending were the main contributors to total expenditure growth
(January-October expenditure contribution to growth, percentage points)

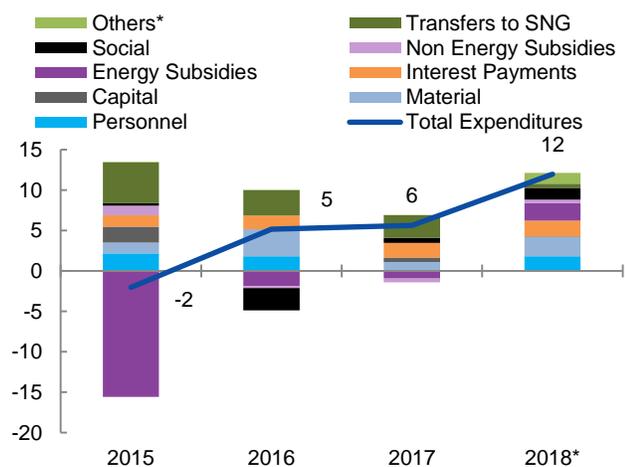
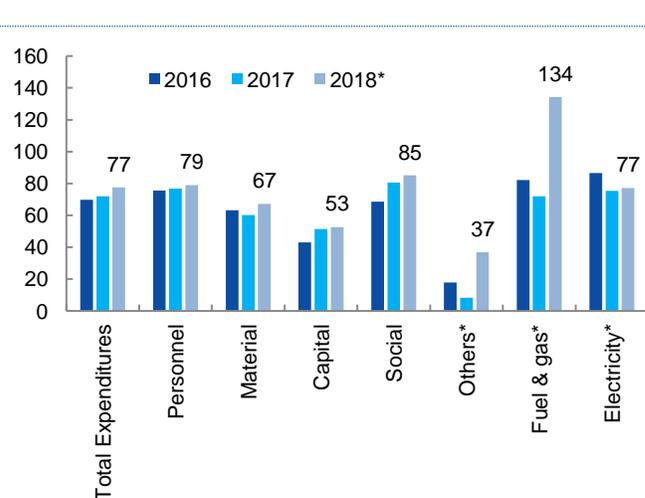


Figure A.31: Higher disbursements are broad based with fuel and gas subsidies higher than planned
(January-October expenditure as percent of budget, percent)



Source: Ministry of Finance, World Bank staff calculations

Notes: *Fuel and gas for 2018 is not the figure published by the Government's APBN Kita, as it excludes arrears payments which are added back to "Others" spending category as per the budget classification. *Others from 2017 onwards includes arrears payments from previous energy subsidies

Better revenue collection leads to a lower deficit

By end-October 2018, the total Government budget deficit reached IDR 237 trillion, or 73 percent of the targeted budget shortfall, lower both in level and the targeted rate of 75 percent for the same period in 2017, when it was IDR 299 trillion, thanks to improved revenue collection. Similarly, the total net financing as of October 2018 was at IDR 320 trillion or 98 percent of the target, which was lower in nominal terms by 16 percent yoy compared to the same period last year.

³⁹APBN Kita November 2018

Total Central Government debt stock reached IDR 4,479 trillion or 31 percent of GDP by the end of October 2018, and still around half of the 60 percent legal threshold. The debt stock remains mainly denominated in domestic currency at 57 percent and only 10.1 percent has a short-term maturity⁴⁰, reducing the exposure to exchange-rate and refinancing risks.

The 2019 budget highlights the importance of boosting revenue collection

In 2019, the Government is aiming for double-digit growth both for revenue and expenditure with a lower primary and fiscal deficit. Total revenues and grants are projected at IDR 2,165 trillion (13.5 percent of GDP), an increase of 13.8 percent (nominal terms) compared to the 2018 outlook. This is slightly lower than the expected increase of 14.2 percent this year, but much higher than the average increase of 3.8 percent from 2014 to 2017. Furthermore, total expenditures are proposed at IDR 2,461 trillion (15.3 percent of GDP) an 11 percent increase relative to the 2018 outlook. This is the largest projected year-on-year increase⁴¹ since President Joko Widodo took office in 2014, highlighting the importance of boosting revenue collections to spend more while maintaining a conservative fiscal deficit.

Optimistic target of tax ratio at 11.1 percent of GDP in 2019

Tax revenues are expected to increase by 11.4 percent in real terms vis-à-vis the 2018 outlook (or 15.4 percent in nominal terms), bringing the tax ratio to 11.1 percent of GDP. This is an optimistic target but not unprecedented, given that real growth in tax revenues has exceeded 10 percent five times in the past 15 years. Non-O&G income taxes, followed by VAT collections, are expected to be the main drivers of revenue growth, as efforts to improve tax compliance continue. Excises are also expected to increase by 6.4 percent in nominal terms from the 2018 outlook, mostly through stronger enforcement⁴².

Faster total expenditure growth expected in 2019, due to higher energy subsidies, social programs, and regional transfers but slower infrastructure spending growth

The Central Government expenditure in the 2019 budget is still expected to have double digit growth at 12.4 percent (nominal terms) from the 2018 outlook, lower than the average 14.5 percent increase in 2017-18. It shows broadly higher allocation for energy subsidies and an increase in benefits from the PKH and higher premium and number of beneficiaries for the PBI-JKN. Consistent with expectations of a weaker Rupiah and persistently high crude oil prices next year, the Government will allocate IDR 160 trillion for energy subsidies, about 69 percent higher than the 2018 Budget, but still a much lower amount (and share of the budget) than pre-reform levels⁴³. The 2019 allocation is slightly lower than the 2018 outlook, due to the one-time payment of subsidy arrears to Pertamina and PLN in 2018 for subsidy spending in 2016 and 2017. On social spending, the Government intends to almost double the amount received by each beneficiary household – currently averaging IDR 1.7 million (USD 118) per year – to IDR 3.1 million (USD 215) in 2019. Accordingly, the PKH allocation will double to IDR 34.4 trillion, while maintaining the number of beneficiaries at 10 million poor households.

Furthermore, the Government also intends to increase the amount of regional and village fund transfers by 8.3 percent from the 2018 outlook, which is larger than the average 5.5 percent increase in 2017-18. This is mostly due to the increase in Special Allocation Funds (*Dana Alokasi Khusus*, or DAK) and consistent with the projected overall increase in total expenditures as well as the additional transfer to urban village (*Kelurahan*) as part of block grant (*Dana Alokasi Umum* or DAU).

Infrastructure is still a priority, but the growth is slower than the annual average of the last four years. The Government plans to spend IDR 415 trillion for infrastructure in the 2019 budget

⁴⁰As of December 2017, the government projected 10.1, 25.4, and 39.8 percent of total public debt will be due in 1, 3, and 5-years, respectively. <http://www.dippr.kemenkeu.go.id/page/load/24>

⁴¹ Comparing approved budget (APBN) allocations across the years

⁴² A recent announcement from the Government stated that there will be no increase in tobacco tariffs in the 2019 budget. However, the DG of Customs mentioned that they are optimistic that they can meet the 2019 Budget target. <http://ekonomi.metrotynews.com/makro/gNQMYBvN-target-penerimaan-cukai-masih-sesuai-apbn-2019>

⁴³ Pre-reform period refers to a period when the Government still provided subsidies for RON 88 gasoline or before 2015.

coming from the Central Government expenditure, transfers to regional and Government financing, or an increase of 1.1 percent from the 2018 outlook but less than the 18 percent average year-on-year increase between budgets in 2016-18. However, that amount still represents nearly a fifth of total expenditures, much higher than a tenth in 2013-14.

7. Economic growth outlook and risks

The outlook continues to be moderately positive, with downside risks remaining substantial

Indonesia's growth outlook remains moderately positive and stable due to sound macroeconomic fundamentals and stronger domestic demand being projected over the forecasting horizon. However, downside risks remain substantial despite some recent easing in financial volatility.

Growth projected to reach 5.2 percent in 2018 and 2019 as stronger domestic demand is expected to more than offset the drag from the external sector

Real GDP growth is projected at 5.2 percent yoy this year and in 2019, a notch higher than in 2017 (Table A.3), as stronger domestic demand is expected to more than offset the drag from the external sector. Despite consumer price inflation forecast to edge up next year, private consumption is projected to strengthen on increased social spending. Gross fixed capital formation is also expected to take off as investors continue take advantage of the still-easy domestic financing conditions, particularly in the second half of the year when political uncertainties are reduced. Likewise, Government consumption is forecast to remain robust as continued reform and revenue growth create space for both fiscal consolidation and additional spending.

Table A.3: Key economic indicators

(growth yoy, percent, unless otherwise indicated)

	Annual			Revision from previous IEQ
	2017	2018f	2019f	2018
1. Main economic indicators				
Gross Domestic Product (GDP)	5.1	5.2	5.2	0.0
Private consumption expenditure	5.0	5.1	5.2	0.0
Government consumption	2.1	5.0	5.3	1.0
Gross fixed capital formation	6.2	7.0	7.5	0.2
Exports of goods and services	9.1	7.3	7.2	0.8
Imports of goods and services	8.1	13.8	10.7	4.3
2. Other economic indicators				
Consumer price index	3.8	3.2	3.5	-0.2
3. Economic Assumptions				
Exchange rate (IDR/USD)	13381	14200	14250	100
Indonesian crude price (USD/bbl)	51.2	67.7	66.7	4.8

Source: BPS; Bank Indonesia; CEIC; World Bank staff projections

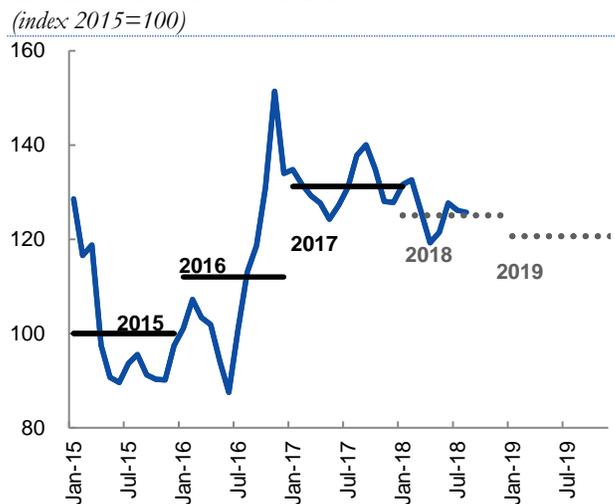
Note: 2017 figures are actual outcomes. f stands for forecast. Statistical discrepancies and change in inventories are not presented in this table. All GDP components are based on the latest GDP data. Exchange rate and crude oil price assumptions are average annual data. Revisions are relative to projections in the September 2018 IEQ

The terms-of-trade are projected to deteriorate

Indonesia’s terms-of-trade in 2018 is likely to be weaker than in 2017

Barring significant movements in the prices of Indonesia’s key commodities export in Q4 2018, the Indonesia’s terms-of-trade (ToT)⁴⁴ in 2018 is expected to be lower than it was in 2017 (Figure A.32). Beyond 2018, the expected movements of the prices of coal, crude oil, and palm oil – the three commodities with the largest weight in the export basket – imply a further downward correction in 2019 for Indonesia’s net trade-commodity price index⁴⁵ is expected⁴⁶.

Figure A.32: The net trade-weighted price index – historical and forecast until 2019



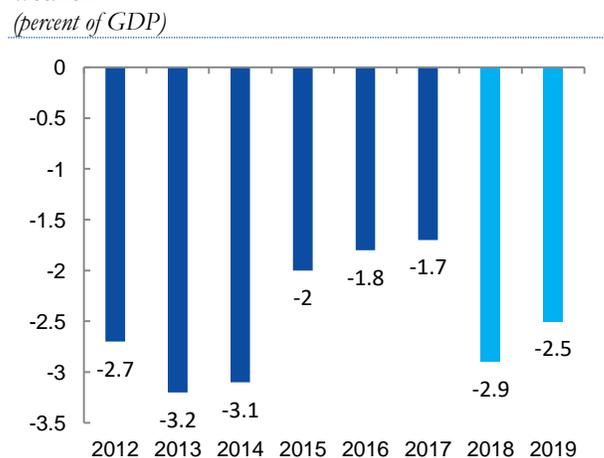
Source: BPS; World Bank; World Bank staff calculations
 Note: Net trade-weighted price index is constructed over Indonesia’s six major export commodities (rubber, base metals, coal, oil, LNG, and palm oil)

The current account deficit is expected to widen in 2018

The current account deficit is expected to widen in 2018

With the current global trade policy uncertainty, slower projected growth of major trading partners, weaker ToT, and domestic investments continuing to drive strong import needs, the current account deficit is projected to widen to 2.9 percent of GDP in 2018, despite recent policy measures to support exports and to restrict imports. However, with dampening impact of currency depreciation weighing on imports and the income balance, the current account deficit is expected to moderate to 2.5 percent of GDP in 2019 (Figure A.33).

Figure A.33: The current account deficit is expected to widen in 2018 and 2019 as import-intensive investment remains strong and terms-of-trade weaken



Source: CEIC and Bank Indonesia; World Bank Staff Calculations
 Note: 2018 and 2019 are forecasts

⁴⁴ Terms of trade (TOI) refers to the relative price of imports in terms of exports and is defined as the ratio of export prices to import prices. It can be interpreted as the amount of import goods an economy can purchase per unit of export good.

⁴⁵ The Net Trade-Commodity Price Index (NTI) is defined as: $NTI_t = \frac{Weight_{i,p} \times Price_{i,t}}{Price_{i,t}}$ where $Weight_{i,p} = \frac{(E_{i,t}) - (I_{i,t})}{\sum (E_{N,t}) - \sum (I_{N,t})}$ and i= commodity type; t= month; p=period cycle (ex. 5 year average); N = number of commodities; T= base year; E=value of export; I=value of import

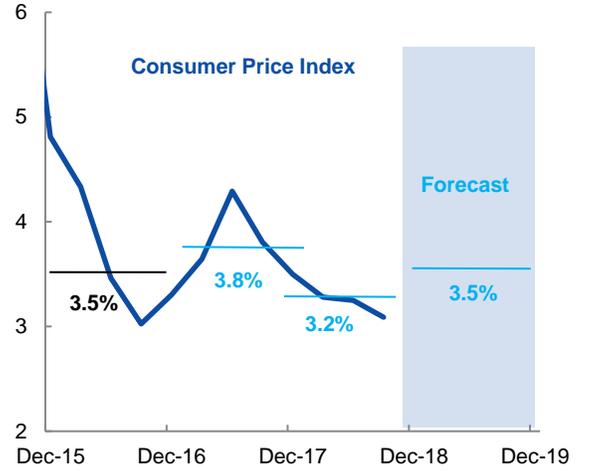
⁴⁶ If future prices are assumed instead of the World Bank forecasts for coal, crude oil and palm oil, the projected ToT for 2018 and 2019 (not presented in the chart) will be marginally weaker. The alternative NTI was calculated using average futures prices of coal (ICE, Newcastle), the average of the three benchmarks of oil, namely Brent, WTI and Dubai (ICE) and palm oil (Malaysian). The prices for the other key commodities were taken from World Bank (2018).

Consumer price inflation is expected to increase modestly in 2019, but within BI's target range

Projected headline inflation revised down marginally, but remains within the target range

Headline inflation is expected to remain well within the Government target range averaging at 3.2 percent in 2018, lower than that the 3.8 percent of 2017 (Figure A.34). Strong social spending along with stronger administrative price inflation as the high base effects of 2017 dissipate, are expected to exert some upward pressures in 2019, leading to a forecast of 3.5 percent.

Figure A.34: Headline inflation levels are projected to remain well within the target range
(annual average change yoy, percent)



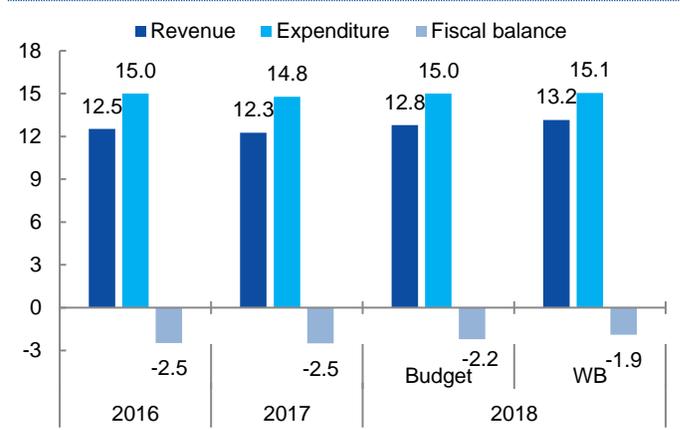
Source: BPS; World Bank staff calculations

Government budget deficit is set to narrow in 2018

Fiscal management improved; the World Bank projects a fiscal deficit of 1.9 percent of GDP in 2018

Fiscal management in the first nine months of 2018 improved due to realistic revenue forecasts, and as a consequence, a revised budget was not necessary in 2018, despite it being an election year. This is a significant departure from previous years, such as in 2016 when mid-year budget cuts were necessary. Based on revenue realization up to October, total central Government revenues are projected to reach IDR 1,876 trillion, a 12.6 percent increase compared to 2017, driven largely by projected increases in collections from income taxes (Table A.4). Meanwhile, total Government expenditures are projected to reach IDR 2,145 trillion, a 6.9 percent increase compared to 2017, driven by increases in social spending. Overall, the World Bank projects a fiscal deficit of 1.9 percent of GDP, 0.3 percentage point lower than the 2018 budget target deficit of 2.2 percent of GDP (Figure A.35).

Figure A.35: Stronger revenues and expenditures with a net result of lower Government budget deficit are projected for 2018
(percent of GDP)



Source: Ministry of Finance; World Bank staff calculations

Table A.4: Ministry of Finance and World Bank budget projections
(IDR trillion, unless otherwise indicated)

	2017	2018	2018	2018	2019	MoF Outlook 2018 vs Budget 2018 (% deviation)	Budget 2019 vs Budget 2018 (% change)
	Actual	Budget	MoF Outlook	World Bank	Budget		
A. Revenues	1,666	1,895	1,903	1,876	2,165	0.44	14.3
1. Tax revenues	1,344	1,618	1,548	1,469	1,786	-4.30	10.4
Oil & Gas Income taxes	50	38	55	66	66	45.3	73.6
Non-Oil & Gas taxes, o/w:	1,101	1,386	1,296	1,207	1,511	-6.5	9.1
Non-Oil & Gas Income taxes	596	817	706	663	828	-13.6	1.4
VAT/LGST	481	542	565	517	655	4.2	21.0
Land and building tax	17	17	17	19	19	0.4	10.0
Other taxes	7	10	8	8	9	-21.4	-11.3
Excises	153	155	156	149	166	0.1	6.5
International trade taxes	39	39	42	47	43	8.7	11.9
2. Non-tax revenues	311	275	349	398	378	26.8	37.4
Natural resources revenues	111	104	169	181	191	63.2	84.0
Oil & Gas	82	80	144	145	160	79.6	98.9
Non-Oil & Gas	29	23	25	37	31	6.6	32.9
Other non-tax revenues	200	172	180	216	188	4.8	9.2
3. Grants	12	1	5	9	0	349.8	-66.6
B. Expenditures	2,007	2,221	2,217	2,145	2,461	-0.2	10.8
1. Central government	1,265	1,454	1,454	1,377	1,634	-0.1	12.4
Personnel	313	366	342	345	382	-6.3	4.3
Material	291	340	320	307	345	-6.0	1.5
Capital	209	204	194	163	189	-5.0	-7.1
Interest payments	217	239	249	253	276	4.5	15.6
Subsidies, o/w:	166	156	228	214	224	46.0	43.6
Energy	98	95	163	151	160	73.0	69.3
Fuel	47	47	109	95	101	131.3	114.7
Electricity	51	48	55	56	59	15.3	24.3
Non-energy	69	62	65	62	64	4.8	4.2
Grants	5	1	1	0	2	0.0	32.9
Social	55	81	80	84	102	-1.2	25.6
Other	9	67	39	11	114	-42.5	69.6
2. Transfers to regions	742	766	764	768	827	-0.3	7.9
C. Overall Balance	(341)	(326)	(314)	(269)	(296)		
D. Financing	367	326	314	269	296		
1. Debt financing	429	399	387	-	359		
2. Investment financing	(60)	(66)	(66)	-	(76)		
3. Lending	(2)	(7)	(6)	-	(2)		
4. Guarantee obligation	(1)	(1)	(1)	-	-		
5. Other financing	0	0	0	-	15		
<i>Memo items (as % of GDP)</i>							
Total Revenues	12.3	12.8	12.8	13.2	13.5		
Tax Revenues	9.9	10.9	10.4	10.3	11.1		
Non-Tax Revenues	2.3	1.9	2.4	2.8	2.4		
Total Expenditure	14.8	15.0	15.0	15.1	15.3		
CG Expenditure	9.3	9.8	9.8	9.7	10.2		
Transfer to regions and Village Fund	5.5	5.2	5.2	5.4	5.1		
Overall Balance	-2.5	-2.2	-2.1	-1.9	-1.8		
Assumptions:							
Real GDP growth rate (%)	5.1	5.4	5.2	5.2	5.3		
CPI (%)	3.6	3.5	3.5	3.2	3.5		
Exchange rate (IDR/USD)	13,384	13,400	14,294	14,200	15,000		
Crude-oil price (USD/barrel)	51.2	48.0	70.0	69.5	70.0		

Source: Ministry of Finance and WB Staff calculations.

While the outlook for economic growth remains positive, downside risks have increased

External risks to the outlook include protracted and escalating trade disputes, volatility in the financial and capital markets, tightening financial conditions, and inadequate buffers for policy stabilization

While there recently has been some reprieve from capital outflows from emerging market economies and further weakening of the Rupiah, downside risks to Indonesia's growth outlook, nevertheless, remain substantial.

Uncertainties surrounding global trade policy continue to pose risks to the growth outlook of large regional economies, such as China. Other regional economies, such as Vietnam and Malaysia, which participate in regional supply chains, could also experience negative spillover effects from China's potential slowing. The persistence or escalation of such disputes therefore continue to pose significant risks to the Indonesian economy through weaker exports and dampened commodity prices.

At the same time, the potential continuation of monetary policy tightening of the U.S. Federal Reserve may lead to more capital outflows and financial volatility among emerging market economies, including Indonesia. Higher bond yields and the consequent higher borrowing costs could dampen the nascent credit recovery and hence private investment.

Indonesia should take the opportunity to rebuild and strengthen policy buffers

To date, Indonesia has emerged relatively unscathed from the recent volatility plaguing emerging market economies, largely because of its sound macroeconomic fundamentals, and adequate buffers that allowed for a coordinated monetary, fiscal, and exchange rate policy framework. Inflation has been stable and low, permitting monetary policy to focus on exchange rate stabilization. Recent fiscal reforms have enhanced compliance and enforcement, leading fiscal revenue growth to reach multi-year highs, thereby allowing the Government to both increase growth-inducing expenditures and undergo fiscal consolidation. Lastly, record-high reserves contributed to the cushioning of the Rupiah's depreciation, during the protracted period of exchange rate volatility.

Given the recent return of capital inflows and appreciating pressures on the Rupiah, it is timely for Indonesia to rebuild foreign reserves maintain sizable buffers to enable further management of exchange rate volatility, should it return in the near future. In similar light, other critical reforms such as those relating to enhancing fiscal revenues and improving the quality of spending must continue to further strengthen fiscal policy.

B. Boosting export and investments in Indonesia: An agenda for reform



Indonesia has enjoyed robust economic growth in recent years, underpinned by healthy macroeconomic fundamentals and relatively favorable commodity markets and demographic structure. However, the recent global turmoil has exposed Indonesia's vulnerabilities, in particular the country's reliance on volatile portfolio capital flows to finance its current account deficit. These vulnerabilities are partly due to the slow growth in exports and foreign direct investment, which are in turn a reflection of the mounting competitiveness challenges faced by the country. Indonesia's vulnerabilities are further underscored by declining shares in global manufacturing exports, low foreign investments in GDP, and low labor productivity, which are largely the result of an extensive list of policies that increase the costs and reduce the quality and availability of physical, services and labor inputs to production. These distortions include regulatory bottlenecks, such as trade and investment restrictions; inefficiencies in labor and capital markets, which increase the costs of skilled labor and financing for firms; and infrastructure deficiencies, including energy and transport.

A policy agenda to boost exports and investments would need to address these distortions through a series of short- and medium-term reforms (Box B.1). These reforms would also increase the effectiveness of costly tax incentives, which the Indonesian government has been using to attract investments, as the impact of these tax incentives is likely to remain limited in the absence of structural reforms.

Box B.1: A policy reform agenda to boost exports and foreign investments

A policy reform agenda to boost exports and investments would need to address distortions in key markets through a series of six short-term and four main medium-term reforms.

The short-term reforms would include:

- reducing import tariffs and (certain) non-tariff measures;
- implementing ambitious free trade agreements;
- relaxing restrictions on investments
- allowing a larger number of critically scarce talent from abroad,
- reducing the fuel subsidy, and
- increasing the ability of the competition commission to deter businesses' anti-competitive practices.

The medium-term reforms would include:

- embedding competition considerations into Indonesia's policy-making and strengthening the competition authority;

- strengthening the primary, secondary, and post-secondary education systems;
- strengthening energy and transport infrastructure by leveraging private investments in these sectors—including by lowering subsidies to State-Owned Enterprises (SOEs), increasing open tenders by simplifying legal frameworks for public-private partnerships (PPP), and by deepening the local banking and capital markets.

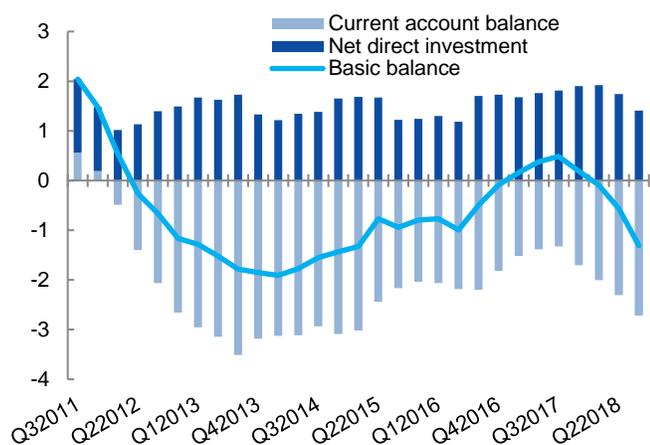
1. Indonesia needs to boost its global competitiveness to increase resilience to shocks and to reap the opportunities of the current global environment

Indonesia has been enjoying robust economic growth with healthy macroeconomic fundamentals

Indonesia has enjoyed a robust economic growth of around 5 percent per annum in real terms since 2012, underpinned by healthy macroeconomic fundamentals, including low levels of fiscal deficits, public debt, and inflation. While commodity prices have declined from their peak in 2011, they have remained favorable and are still a key driver of economic expansion. In addition, Indonesia is still reaping the dividends of a demographic structure that allows millions of individuals to join the labor force every year.

Figure B.1: The current account deficit has widened along with the basic balance

(4-quarter rolling average, percent of GDP)



Source: World Bank staff calculations based on Bank Indonesia data

Figure B.2: The Indonesian Rupiah has depreciated more than other regional currencies

(USD/Local currency – 1 Sep 2017 = 100)



Source: World Bank staff calculations based on Bank Indonesia data

However, the slow growth of exports and FDI have increased Indonesia’s reliance on volatile short-term portfolios, substantial portions of which have exited the country during the recent global turmoil

In spite of this positive macroeconomic performance, the recent global turmoil has exposed Indonesia’s vulnerabilities. Indonesia’s current account deficit has expanded through 2018, reaching 3.4 percent of GDP in the third quarter of the year (Figure B.1).⁴⁷ The widening deficit is partly due to sluggish exports growth and a sustained growth in imports, particularly capital goods. The latter are linked to renewed investments in the mining sector following strong commodity prices, and to the Government’s promotion of infrastructure over the past three years. Given Indonesia’s large infrastructure gap and potential for future mining exports, the high growth of imports is not alarming. The concern is rather with the low growth of exports and with the decline in foreign direct investment (FDI), which in the past quarters have been unable to cover the current account deficit. As a result, Indonesia has increased its reliance on short-term portfolio flows to finance the current account deficit.⁴⁸ These flows are more volatile than FDI, and tend to move out of emerging economies for safe haven destinations during periods of global uncertainty. That was the case over past months due to trade tensions and volatility associated with other specific large emerging economies. This led to the Rupiah

⁴⁷ This figure is based on a 4-quarter rolling average.

⁴⁸ This is reflected in the expanding deficit in the basic balance – i.e. FDI - current account deficit – which has reached 1.3 percent of GDP in Q3 2018.

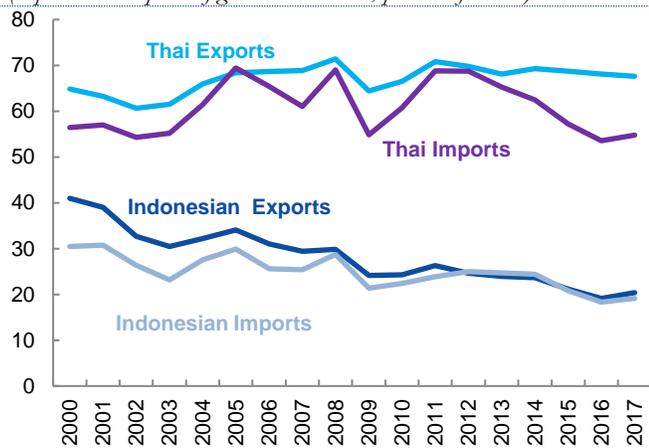
depreciating more against the USD than other regional currencies between March and October 2018 (Figure B.2), despite healthy macroeconomic fundamentals and the tightening of domestic monetary and fiscal policies (see Section A5).

Indonesia has great potential to increase its exports to a level close to that of its regional peers

Indonesia has great potential to increase its exports to a level close to that of its regional peers. Exports of goods and services comprise around 20 percent of Indonesia’s GDP, half of the 40 percent in 2000 (Figure B.3). This share is considerably lower than Thailand’s, a country that has shown little signs of external vulnerability to the recent global turmoil (Figure B.2), as its exports have grown robustly over the past two decades. Like most countries in the region, exports are a major part of the Thai economy, constituting almost 70 percent of GDP, a share that has remained stable over time. In both Indonesia and Thailand, imports also closely track exports in level and growth, consistent with the need of to import in order to export. Similarly, Indonesia’s export performance in global markets has been lackluster. It has been declining since 2000, except during the commodity boom period (2007–11) (Figure B.4). In 2016—the last year for which comparable global trade data is available—Indonesia’s share in global goods and services exports was 0.81 percent, down from the 2011 share of 0.95 percent and even from the 0.91 percent on the eve of the Asian crisis. This trend contrasts with that of Vietnam and Thailand, whose global market shares have been constantly increasing since 2000. The other main commodity exporter in the region, Malaysia, has seen its global market share gradually reduced, but this is still higher than Indonesia’s, despite the size of its economy being a third of Indonesia’s.

Figure B.3: A tale of two countries: Trade openness in Indonesia vs Thailand

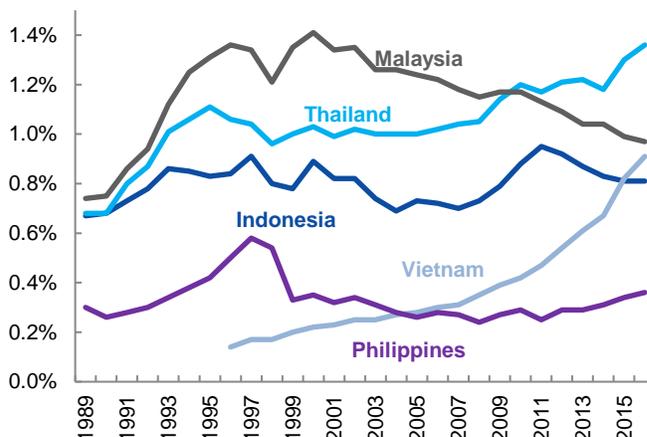
(exports and imports of goods and services, percent of GDP)



Source: World Bank staff calculations based on World Development Indicators and Bank of Thailand

Figure B.4: Indonesia’s total exports have lost market share over the past decades

(share in world’s exports of goods and services)



Source: World Bank staff calculations based on World Development Indicators

The export potential spans across a wide range of sectors as illustrated for example by the cases of horticulture, electronics and maritime transport

The potential for the country’s export growth spans across a wide range of sectors as illustrated for example by the cases of horticulture, electronics and maritime transport. Indonesia’s horticulture and electronics exports are much lower and less dynamic than regional peers (see Box B.2) despite its endowments of fertile land and abundant labor would bode well to tap into these rapidly growing global markets. Similarly, while Indonesia stretches over the world’s largest archipelago, none of its liner shipping companies feature among the world’s top 30 by market share, compared to a country like Singapore which features two in the top 20 (UNCTAD, 2017).⁴⁹ This potential applies also to port services exports: Indonesian port operators are not active internationally, unlike other regional operators such as Port of Singapore

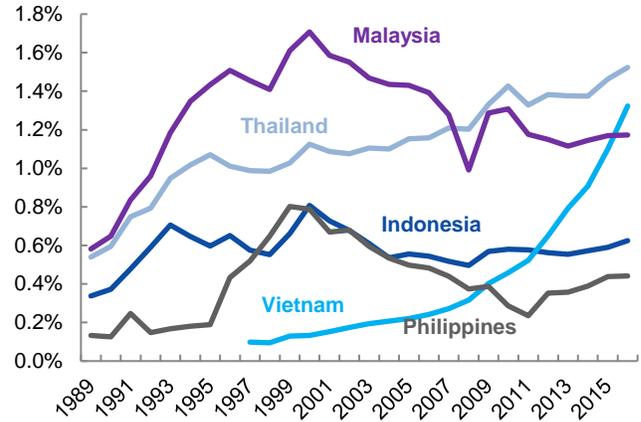
⁴⁹ Systematic data on maritime transport exports and imports are not available.

and Philippines' ICTS, which are the world's second and seventh largest ports respectively, in terms of investments, spanning dozen of projects around the globe (UNCTAD, 2017).

In manufacturing, Indonesia's share in global exports and domestic GDP has declined unlike other economies in the region

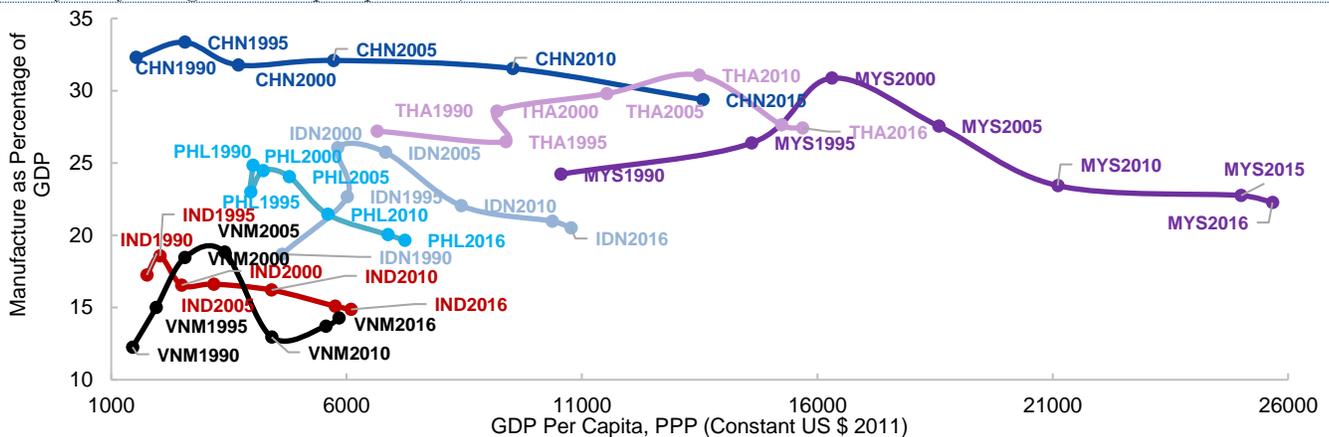
Much of Indonesia's decline in global export markets is due to its manufacturing exports, whose share has declined unlike those of other export-oriented economies in the region. Indonesia's market share in global manufacturing exports was 0.6 percent in 2016, considerably lower than the peak of 0.8 percent in 2000 and even lower than the 0.7 percent share in 1993 (Figure B.5).⁵⁰ The current figure appears to fall short of Indonesia's potential as it is lower than those of almost all other large economies in the region, despite Indonesia being the largest.⁵¹ Over the same period, Vietnam and Thailand increased their global manufacturing shares; the former has grown by a factor of 10 since 2000 and has become one of the world's fastest-growing manufacturing exporters. Indonesia's stagnation in global manufacturing competitiveness has also been reflected in the reduction of manufacturing share in the GDP. This reduction is typical of countries shifting from middle- to high-income status. However, de-industrialization has predated this shift in Indonesia and manufacturing has begun to shrink at a fraction of the income level at which countries like Malaysia and Thailand started to de-industrialize (Figure B.6). This "premature de-industrialization" (Rodrik 2016) is not good news for Indonesia, as it risks undermining the quality of jobs as well as economy-wide productivity growth, which is typically higher in manufacturing than in other sectors (Rodrik 2012).

Figure B.5: The rise and fall of Indonesian manufacturing competitiveness
(share in global manufacturing exports)



Source: World Bank staff calculations based on World Development Indicators

Figure B.6: Pre-mature de-industrialization in Indonesia?
(share of manufacturing in GDP vs. per capita GDP)



Source: World Bank staff calculations based on World Development Indicators and Diop (2016)

⁵⁰ During the same period, Indonesia's share in global commodity exports hovered constantly at around 1.7 percent except for a spike in 2007–11.

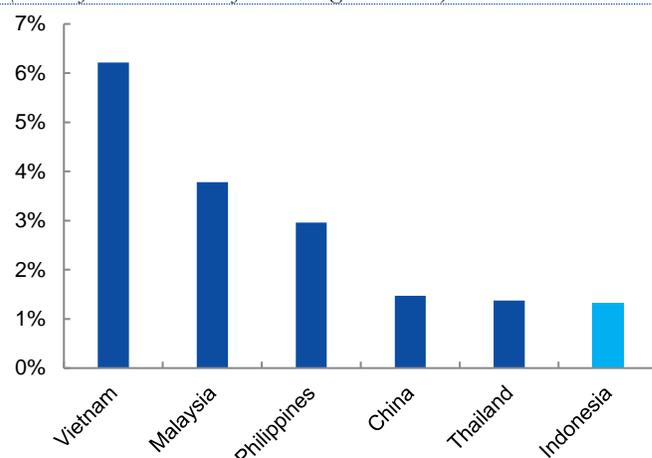
⁵¹ The only exception is the Philippines. However, in relative terms, Indonesian manufacturing exports punch below the country's weight even vis-à-vis the Philippines, as the latter's global share is 70 percent that of Indonesia while its economy's size is less than a third of Indonesia's.

Indonesia could also do more to attract and retain FDI, which is low relative to the size of the economy – especially much needed export-oriented FDI

At the same time, Indonesia could also do more to attract FDI—especially export-oriented ones—to secure a much-needed source of stable external financing and export growth. While the share of FDI inflows relative to GDP, which is low by regional standards (Figure B.7), had been growing over the past two decades, it has been receding over the past 3 years.⁵² Most of the FDI to Indonesia are driven by the desire to extract and/or process natural resources or to serve the large domestic market. On the other hand, in recent years, the country has struggled to attract efficiency-seeking FDI, which typically search for efficient production bases for exports. Attracting these investments is important as they generate a significant number of high-paying jobs and are often a source of new products and production technologies for the host economy. Figure B.8 shows that within manufacturing, export-oriented FDI outperformed domestic market oriented FDI, in terms of growth of labor productivity, average wages, number of new products, and investment rate over the period 2008-15. At the same time, export-oriented FDI are also more likely to leave Indonesia as they tend to be more sensitive to a deterioration in the business climate than other manufacturing FDI, which are more dependent on the large domestic market. Manufacturing FDI in Indonesia are increasingly oriented to serve the domestic rather than the global markets, which signals that Indonesia has lost competitiveness in the sector. In 2014, only 35 percent of new foreign manufacturing plants in Indonesia were export oriented, a significant drop from the 58 percent in 1996 (Figure B.9).⁵³ This drop is even more marked when considering a historically export-oriented sector like electronics, where the share of export-oriented plants of total new foreign plants fell from 67 percent to 17 percent. The decline in export-oriented FDI reduces both overall FDI and exports, and hence foreign exchange earnings, increasing the Indonesia's vulnerability to external shocks.

Figure B.7: Indonesia punches below its weight in terms of FDI inflows

(FDI inflows as a share of GDP, avg. 2016–17)

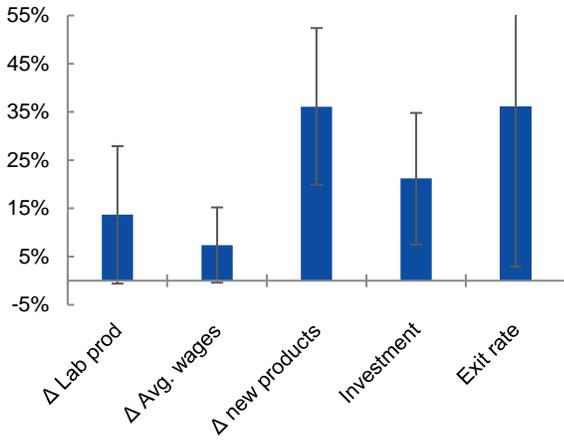


Source: World Bank staff calculations based on World Development Indicators

⁵² According to data from the Indonesian investment promotion board (BKPM), FDI declined from 3.3 percent of GDP in 2014–15 to 3.1 percent in 2016–17; while according to Bank Indonesia data for the same period, FDI dropped from 2.2 percent to 1.3 percent of GDP.

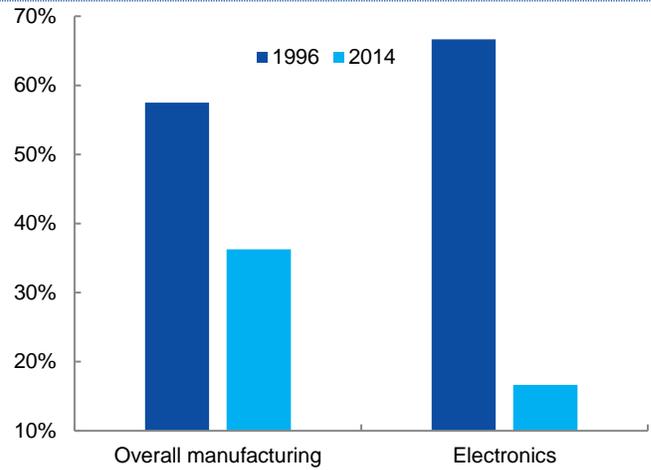
⁵³ In addition, data from the medium and large manufacturing plant survey (Statistik Industri) show that export-oriented foreign plants also have a 36 percent higher probability of leaving Indonesia than other domestic-oriented foreign plants over the 2008–15 period.

Figure B.8: Export-oriented FDI outperforms domestic-market oriented FDI in manufacturing but are more likely to leave Indonesia
(percentage change relative to domestic market seeking foreign plants, 2008-2015)



Source: World Bank staff calculations based on Statistik Industri data. Note: The bars depict the point estimates along with the 95 percent confidence interval of plant-level regressions of the outcome variables in the graphs (computed over 2008-15 period) on a dummy for export-oriented plants (defined as exports>50 percent of sales) in the sample of foreign plants included in the data, controlling for 2-digit KBLI sector dummies.

Figure B.9: The declining share of new export-oriented foreign investment in manufacturing and electronics
(share of export-oriented plants in total foreign plants, new and old)

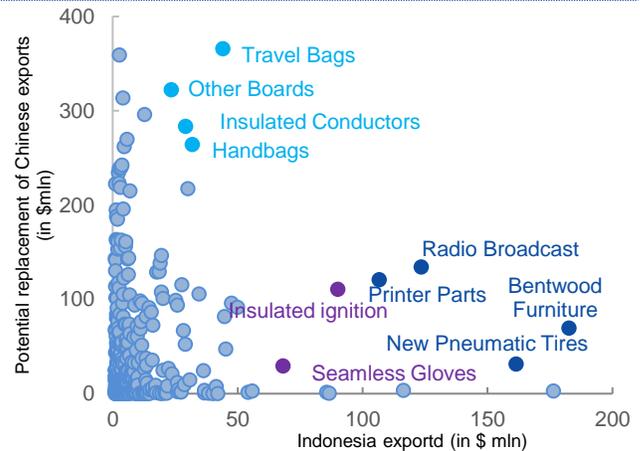


Source: World Bank staff calculations based on Statistik Industri data. Note: New plants are 3 years old and younger; old plants are older than 3 years. Foreign plants are defined as having more than 50 percent foreign ownership. Export-oriented plants are defined as exporting more than 50 percent of their sale value.

If sustained, the trade tensions between the United States and China offer a unique opportunity of boosting exports and foreign investments as Chinese exports to the United States fall and investors seek to bypass tariffs by moving production to Southeast Asia

Not only are the current global conditions a reminder to Indonesia of the importance of boosting exports and foreign investments, but they also offer an unique opportunity for doing so. In particular, the ongoing trade tensions between the United States and China have led to the reciprocal increase in import tariffs in both countries on a large share of bilateral imports.⁵⁴ While these increases in import tariffs have created uncertainties in global trade and financial markets, they are also generating opportunities for countries to replace exports in the two world's largest markets. The largest potential for Southeast Asian economies, including Indonesia, is to replace China's exports to the United States given their similarity in export baskets. World Bank calculations suggest that U.S. imports from China in the products subject to tariff measures may decline by almost USD 70 billion (Cali 2018). This drop would include products which are already exported

Figure B.10: Indonesia has the potential to replace Chinese exports to the US in various products
(Expected drop in Chinese exports to the United States vs. Indonesian exports to the United States in 2017, US\$ millions)



Source: World Bank estimates on the basis of USTR, US census bureau and Kee et al. (2008) Note: Products in the top-right area have most replacement potential.

⁵⁴ Specifically, between July and September this year, the United States has levied import tariffs of 10 percent and 25 percent on imports from China worth USD 235 billion (the 10 percent rate will be raised to 25 percent as of January 2019). In retaliation, China has raised 25 percent tariffs on the majority of the USD 130 billion worth of imports from the United States.

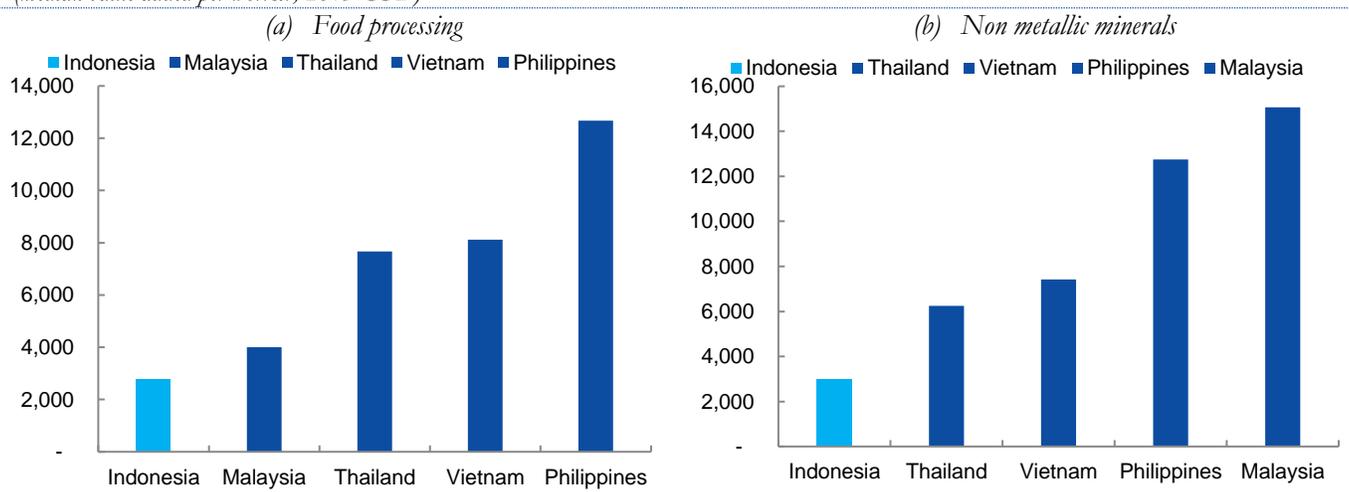
to the United States by Indonesia and therefore presents a substantial opportunity for Indonesia to replace China. Chinese exports to the United States in these products equal to 1 percent of Indonesian GDP in domestic value-added terms and span a range of goods from travel bags to printer parts and pneumatic tires (Figure B.10). In addition, the trade tensions are also leading to a diversion of investments away from China and the United States, as investors seek to bypass the import tariff hikes. A recent survey suggests that two-thirds of the companies in South China are planning to relocate some portion of their production out of China and half of them are planning to relocate the entire production, as a result of the escalating trade tensions⁵⁵. Most plan to relocate to Southeast Asia and early evidence suggests that Vietnam and Thailand in particular, are already benefiting from increased investments in response to the trade tensions.⁵⁶

2. Distortions in the main markets for production factors weigh down export competitiveness and investment flows

Taking advantage of these opportunities would require Indonesia to strengthen its competitiveness

Taking advantage of these opportunities would require Indonesia to increase the competitiveness of its economy and to fulfill its potential as a world-class investment and production destination. The relatively weak performance of exports and foreign investments can be both cause and consequence of the low productivity of Indonesian firms. Even diverse industries, such as labor-intensive food processing and capital-intensive non-metallic minerals, in Indonesia suffer a competitiveness gap vis-à-vis regional comparators (Figure B.11). Low productivity puts Indonesian firms at a competitive disadvantage vis-à-vis their peers in global markets. In turn, low exports and FDI further reduce firms’ productivity growth by reducing their exposure to global technologies, markets and skills.

Figure B.11: Indonesia’s productivity needs to catch up vis-à-vis comparators
(median value added per worker, 2015 USD)



Source: World Bank staff estimates on World Bank Enterprise data

Note: Data for Indonesia, Vietnam, Malaysia and the Philippines is from 2015. Data for Thailand is from 2016.

In spite of a series of economic reforms over the past years,

While the Government of Indonesia has undertaken a series of economic policy reforms over the past years, key distortions in factor markets still weigh on the country’s competitiveness. The government has carried out 16 economic policy packages since September 2015, aiming to

⁵⁵ American Chamber of Commerce in South China (2018).

⁵⁶ For example, China’s GoerTek is shifting production of its wireless earphones AirPods to Vietnam, and Cheng Uei, which supplies chargers and connectors for iPhones and Android smartphones, is evaluating new facilities in Thailand, Vietnam, and the Philippines (Ting-Fan and Li 2018). This shift involved other sectors as well, including auto parts with Japanese companies Yukowo shifting its car antenna components production to Vietnam, and Panasonic moving its car electronics production to Thailand, Malaysia, and Mexico, similar to Daikin Industries moving its compressors production to Thailand and Malaysia (Nikkei Asian Review 2018).

key distortions in factor markets still weigh down the country's competitiveness

reduce the costs of doing business. The reforms spanned from simplifying import and export processes to reducing barriers to entry in specific sectors to revising the minimum wage formula. While a number of these reforms were steps in the right direction, an extensive list of distortions still harms the competitiveness of Indonesian industries by increasing the costs and reducing the quality and availability of key factors of production. These include regulatory bottlenecks, such as trade and investment restrictions, inefficiencies in labor and capital markets, and infrastructure deficiency. Many of these distortions are likely to matter more with growing demands for customization and reduced time-to-market transitions, the increasing role of services inputs in manufacturing production (“servicification”) and the increased use of automation. These factors have put more emphasis on access and connectedness to input and output markets and on the capabilities of workers, firms and countries to adopt new technologies.⁵⁷

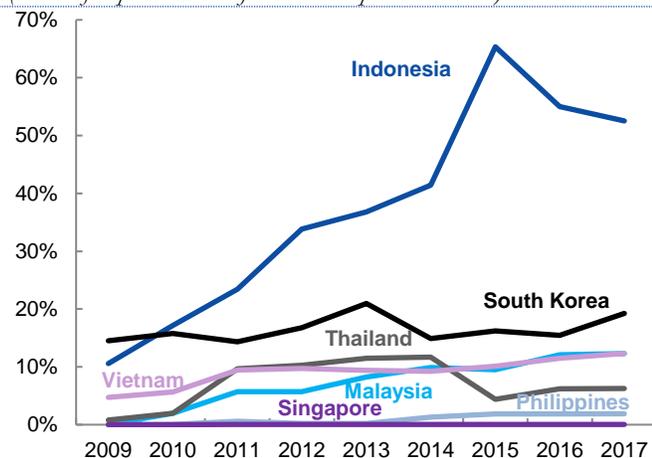
Trade and investment restrictions

Indonesia has increased barriers to goods imports, including tariffs and non-tariff measures more than its peers

In the past decade, Indonesia has gradually increased barriers to goods imports, including tariffs and non-tariff measures (NTMs), which raise the costs and reduce the availability of inputs. Between 2009 and 2017, Indonesia introduced new import barriers on a far greater share of its imports than other countries in the region (Figure B.12). These have contributed to the increase in the nominal rate of protection (NRP) of the economy (Figure B.13).⁵⁸ Domestic food prices in 2015 were on average 33 percent higher than would have been the case in the absence of trade restrictions, more than double the NRP in 2008 (Marks 2017). Similar increases in NRP were observed in other major sectors, including those used as intermediates in production, such as crops, livestock, capital equipment and metals. As a result, trade policies impose a rising cost on domestic producers, in addition to that on households.

Figure B.12: Indonesia has increased its trade barriers significantly more than its peers since 2009

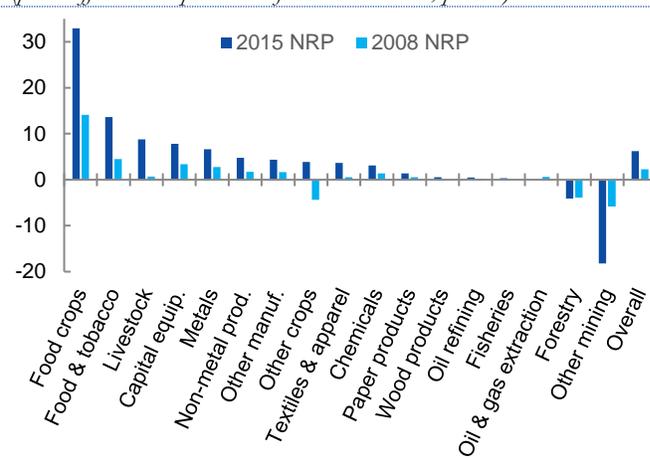
(shares of import value subject to new import restrictions)



Source: Global Trade Alert https://www.globaltradealert.org/data_extraction (accessed 1 November 2018)

Figure B.13: As trade barriers increased, so did the nominal rate of protection

(price difference compared to a free trade scenario, percent)



Source: Marks (2017)
Note: negative NRP indicates production and/or export subsidy.

⁵⁷ Hallward-Driemeier and Nayyar (2017).

⁵⁸ The NRP is computed as the difference between the observed domestic price and that which would prevail in the free trade regime, thus providing an estimate of the impact of all trade distorting measures (tariff and non-tariff) on domestic prices.

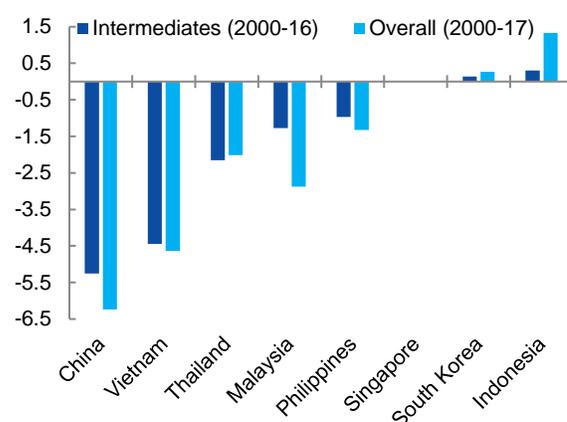
Indonesia has increased import tariff rates, thereby increasing the cost and/or reducing the quality of production inputs

In the past years, Indonesia has hiked import tariff rates, which increases the cost of production inputs and consumption goods, in contrast to the region's tendency towards tariff reduction. Between 2000 and 2017, Indonesia has increased its average import tariff rate by 1.3 percentage points and its tariff rate on intermediates by 0.3 percentage points (Figure B.14). While the country started from relatively low import tariff rates, Indonesia's trend over time contrasts with that of most other countries in East Asia, which have substantially reduced their tariff rates. The use of import tariffs has also included the imposition of anti-dumping measures on a number of products—including steel and yarn—to protect domestic producers from alleged unfair import competition. Empirical evidence has shown that tariff hikes reduce the productivity and output of firms in the protected sectors, as lower import competition reduces incentives to invest and increase efficiency.⁵⁹ This evidence applies also to Indonesia, where tariff increases harm the competitiveness of the downstream sectors as well by increasing the costs and/or reducing the quality of production inputs.⁶⁰

Indonesia has also increased the application of NTMs on goods imports, which are often justified by health, safety, and environmental concerns, but which can also significantly increase importing costs

Indonesia has also increased the application of NTMs on goods imports, which are often justified by health, safety, and environmental concerns, but which can also significantly increase the costs of importing. The increase in the NTM application has been widespread across categories of imports, in particular capital goods and intermediates (Figure B.15). These measures consist of import licenses and checks aiming to ensure that imported goods are safe for consumers and do not harm public health or the environment, such as diseases carried by plant and animal imports, or safety hazards from goods handled by children. While some of these are legitimate concerns, other measures appear to unnecessarily increase the costs of importing. Recent World Bank analysis suggests that a policy measure like the import monopoly of a state-owned enterprise (SOE) significantly increases the costs of imports without clear benefits to the economy (Figure B.16). Similarly, the large import costs of product quality conformity requirements suggest the need to review both this requirement across products and the certification system.⁶¹ The potential for rationalizing NTMs to reduce the cost of trading is illustrated by the elimination of import licenses in eight large manufacturing product categories

Figure B.14: Indonesia has increased its average applied import tariff rates more than its peers (percentage change in average import tariff rate, overall (2000–17) and intermediates (2000–16))



Source: World Bank estimates on the basis of TRAINS data
 Note: The graph reports applied Most Favored Nation import tariff, which is the most widely used tariff rate vis-à-vis trading partners. Due to data availability for overall tariffs the starting year for China and Vietnam is 2001; and the end year for Malaysia and Thailand is 2016 and 2015 respectively. For intermediates tariffs the end year for Thailand is 2015.

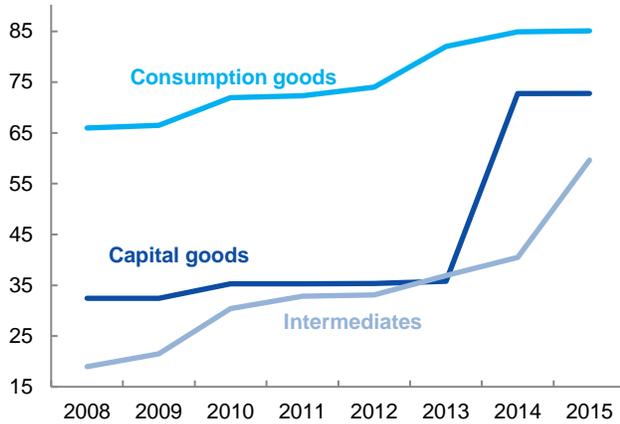
⁵⁹ Pavnick (2002); Amiti and Khandewal (2013).

⁶⁰ Amiti and Konings (2007); Narjoko, Anas and Herdiyanto (2018); Rahardja and Varela (2014).

⁶¹ An illustration of the costs induced by certain NTMs is last March's dispute over high-grade salt, a key input for various manufacturing industries. This was subject to an import quota controlled by the Ministry of Maritime Affairs and Fisheries aimed at protecting domestic producers. The recommended yearly quota of 2.2 million ton was not sufficient to fulfill domestic demand this year in the face of reduced domestic production. The resulting scarcity of salt severely constrained the production of various industries, including food processing and pharmaceuticals, which came close to stopping their production. This led to the issuance of an emergency presidential decree to shift the responsibility for the import quota to the Ministry of Industry (see Reuters (2018) "Indonesia's salt spat gives industry a shake", April 6).

at the end of 2015, which World Bank analysis suggests has led to a significant reduction in import costs.⁶²

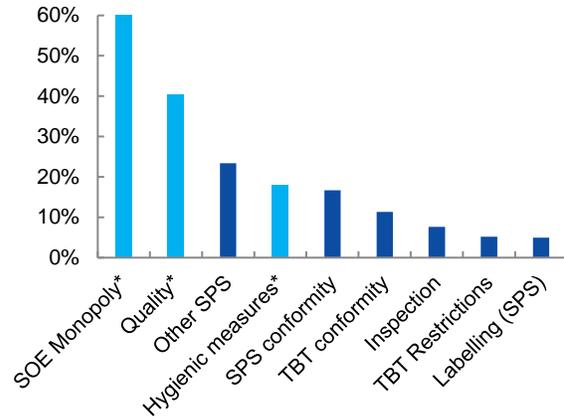
Figure B.15: Indonesia has increased its application of Non-Tariff Measures across import categories
(percentage of imports covered by at least one NTM)



Source: Cali and Puzello (2018)

Note: * indicates estimate is statistically significant at least at the 10 percent level. SPS stands for Sanitary and Phytosanitary standards (applied to food products and other agri goods) and TBT is Technical barriers to trade (applied to manufactured goods)

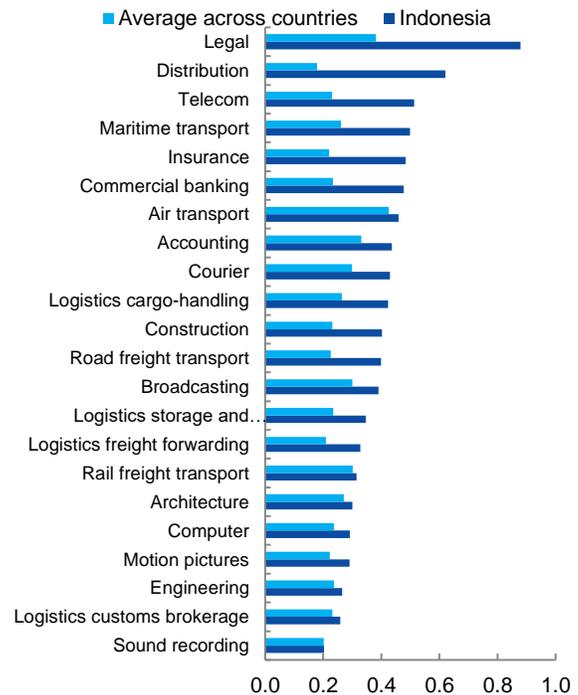
Figure B.16: Some Non-Tariff Measures considerably increase the cost of imports in Indonesia
(effect of NTMs on import prices in ad valorem equivalent terms)



Service imports are also subject to substantial barriers, which negatively affect competitiveness by reducing the quality and increasing the costs of domestic services, many of which are key inputs to production

Imports of services are also subject to substantial barriers, which negatively affect competitiveness by reducing the quality and increasing the costs of domestic services, many of which are key inputs to production. For example, barriers to legal service imports include prohibiting foreign lawyers to set up a commercial presence or practice law in Indonesia; in distribution services - foreign investments are not allowed in a large part of retail distribution, including supermarkets and minimarkets; in maritime transport - foreign companies cannot transport goods between Indonesian ports hence severely restricting competition in a key transport sector. Recent evidence shows that higher barriers in services stifle competitiveness in Indonesian manufacturing industries that use these services more intensively in production⁶³. This result is in line with the international evidence⁶⁴ and

Figure B.17: Indonesia restricts the import of services more than other countries
(degree of restrictiveness to services imports; 0 = lowest; 1 = highest)



Source: OECD

⁶² Cali (2017) estimates that the elimination of importer as well as producer import licenses reduced import prices by 6.7 percent.

⁶³ Duggan, Rahardja and Varela (2013).

⁶⁴ Arnold, Javorcik, and Mattoo (2011); Arnold et al. (2016).

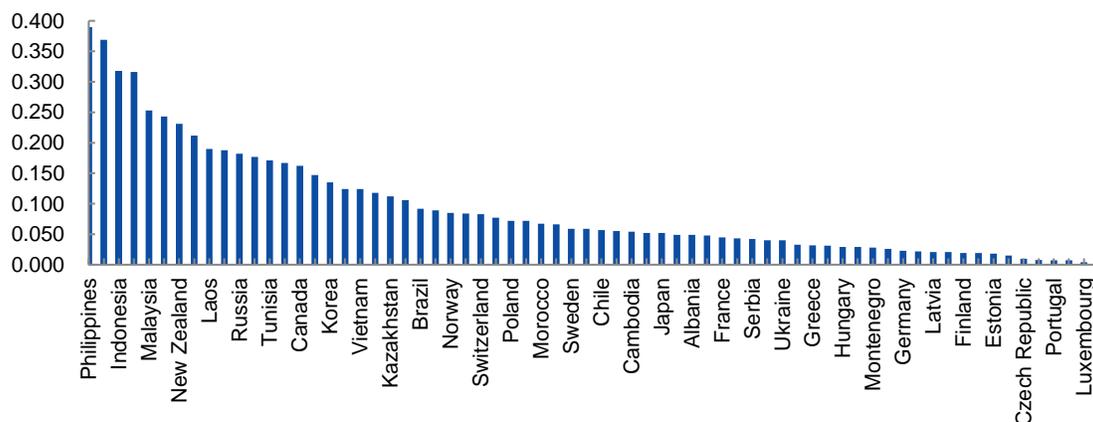
suggests that these barriers worsen the quality and/or increase the price of domestic services. According to the OECD Services Trade Restrictiveness Index (STRI), Indonesia has a higher-than-average level of barriers to trade in all 22 services sectors among the 44 high- and middle-income countries surveyed (Figure B.17). Among others, these barriers include restrictions on intra-corporate transferees, limitations to foreign entry such as a foreign equity limit, and barriers to competition such as high minimum capital requirements.⁶⁵ Indonesia has the most restrictive barriers among all countries surveyed in sectors that provide key inputs to producers, such as telecom, distribution, road freight transport, maritime transport, and construction.

A host of policy barriers—many included in the Negative Investment List—raise the costs of investing in Indonesia, particularly for foreign investors, who are banned altogether in some sectors

Besides international trade, a host of policy barriers also raises the costs of investing in Indonesia, particularly for foreign investors. Indonesia has one of the highest degrees of regulatory restrictiveness towards FDI among the 68 middle- and lower-middle income countries surveyed by the OECD (Figure B.18). Key examples of such restrictions are included in Indonesia’s negative investment list (Daftar Negatif Investasi, or DNI), in the form of foreign equity limits, sectoral reservations to micro, small, and medium enterprises (MSMEs), special licenses, and minimum local content requirements. For example, the DNI limits foreign equity participation to 15 percent of all sectors, in some cases prohibiting foreign investment altogether, such as for onshore oil and gas upstream production installation, power plants below 1 MW, retail business of car, motorcycle, and commercial vehicles and supermarkets below 1,200 sqm. In addition, dozens of sectors across agriculture, industry, and services are reserved exclusively for MSMEs, which effectively rules out foreign investors, as they cannot operate as MSMEs in Indonesia.⁶⁶

Figure B.18: Regulatory restrictiveness towards FDI is high in Indonesia

(FDI regulatory restrictiveness index, 0 = lowest; 1 = highest)



Source: OECD

These restrictions significantly reduce both foreign and domestic investments, reduce entry and performance, and

These restrictions significantly reduce both foreign and domestic investments, reduce entry and performance and increase prices in the sectors to which they are applied. Matching restrictions with investments over time across sectors, World Bank (2017a) finds that raising the maximum foreign equity limits allowed in a sector substantially increases the number of both FDI and domestic investment projects.⁶⁷ The results also suggest that reserving a sector only for MSMEs reduces the number of FDI projects, and requiring minimum levels of local content in production—recently introduced by Indonesia on some electronics, IT equipment, mobile

⁶⁵ The STRI is a composite indicator of restrictions across five standard policy categories, which include restrictions on foreign entry, restrictions to movement of people, barriers to competition, regulatory transparency, and other discriminatory measures.

⁶⁶ Other sectors are open, but in partnership with MSMEs, a much less biting restriction than reserving a sector to MSMEs.

⁶⁷ The analysis is undertaken with data coded according to the 4-digit KBLI classification, which includes 514 sectors.

increase prices in the protected sectors

phones, and agri-business—negatively affect both foreign and domestic investments.⁶⁸ These restrictions to investments also worsen the competitiveness of the manufacturing sector. By matching the DNI investment restrictions across sectors over time with manufacturing plant-level data, new World Bank analysis shows that these restrictions reduce the competition in the sector. Following the introduction of a DNI restriction (foreign equity limit, SME reservation, or special license), the entry of new foreign manufacturing plants declines, particularly those which are export-oriented, and so does the exit of domestic plants that are less exposed to competition (Figure B.19). This reduced competition benefits incumbent businesses, which increase profits and prices at the expense of the users and consumers of the products (Figure B.20). As competition declines, so does the average plants’ performance, as measured by the reduction in the probability of investing, the labor productivity, the average wages paid, and the quantities produced by the plants. These effects are also consistent with the restrictions reducing the adoption of new production technologies that is typically brought about by foreign plants. The analysis finds that these restrictions also increase the costs of key inputs to production, particularly intermediates and services, thus reducing the profitability of downstream industries as well.

Figure B.19: DNI restrictions reduce the entry of foreign plants – particularly exporters - and the exit of domestic plants...

(percent change associated with introduction DNI restriction with the related 95 percent confidence interval)

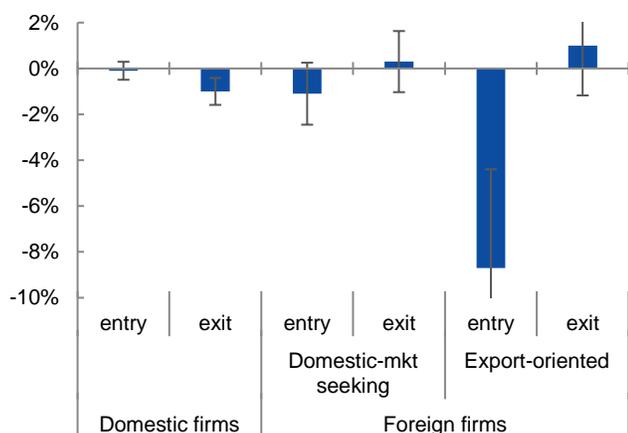
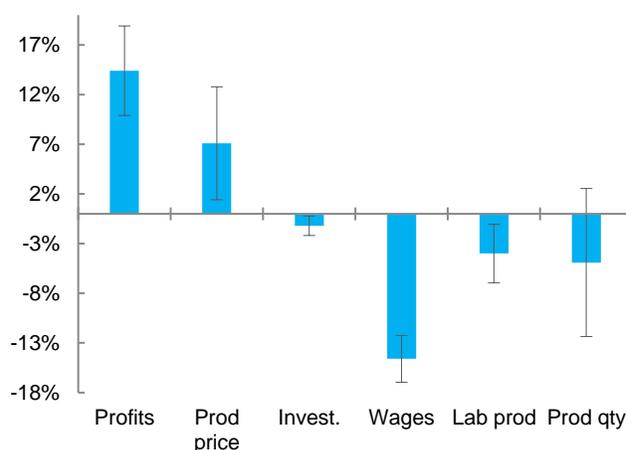


Figure B.20: ...and the lower competition reduces performance and wages, and increase prices

(percent change associated with introduction DNI restriction with the related 95 percent confidence interval)



Source: World Bank staff estimates on the basis of DNI PerPres and Statistik Industri data.

Note: The figures depict the point estimates along with the 95 percent confidence interval of yearly plant-level regressions of the outcome variables in the graphs on a time-varying DNI restriction dummy defined at the KBLI 5-digit level during the period 2008–14 (121,068 observations for domestic plants and 12,314 for foreign plants).

These trade and investment restrictions have increased the isolation of industries and reduced their incentives to compete globally

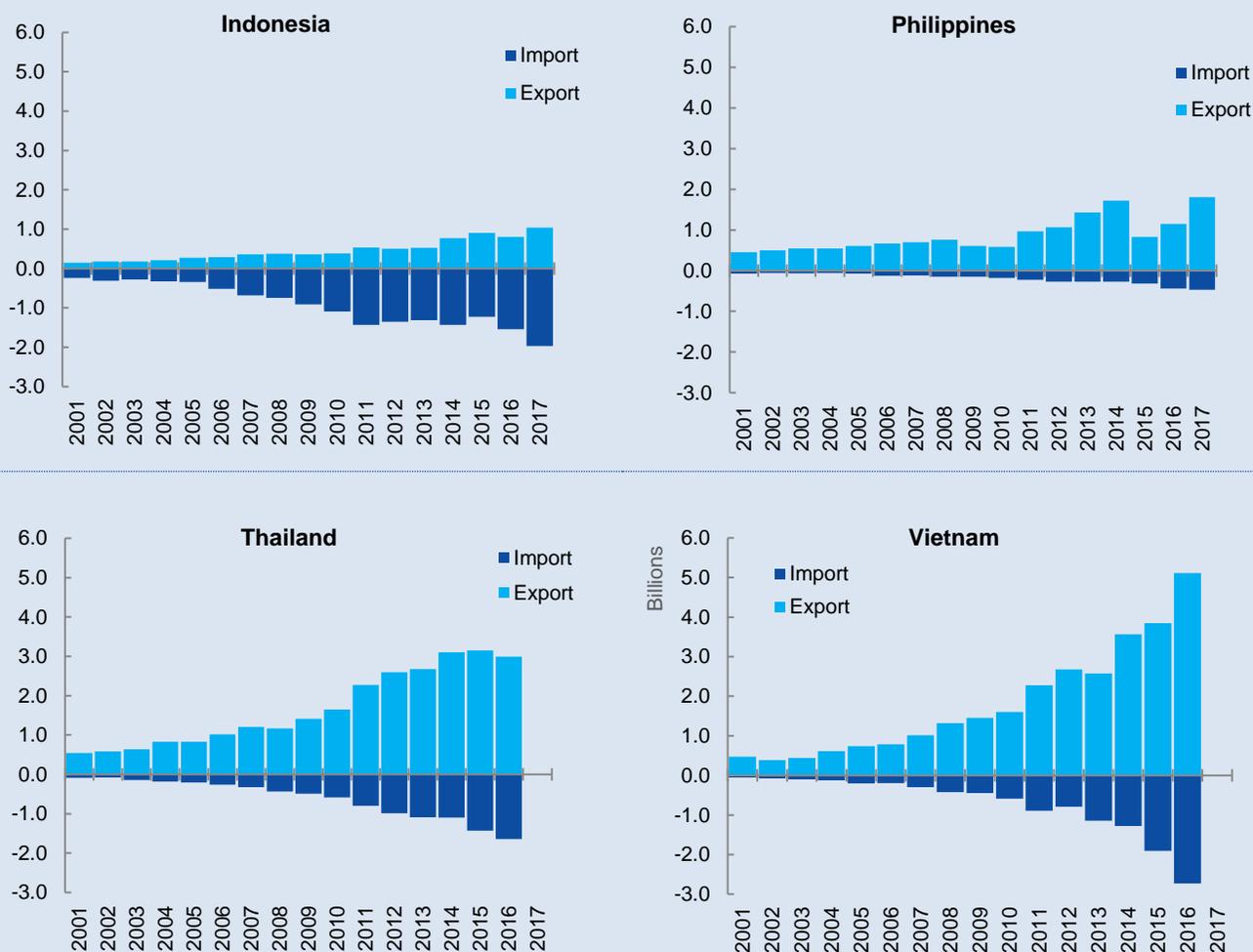
Rather than nurturing Indonesian industries for the global markets, these trade and investment restrictions appear to have increased their isolation and reduced their incentives to compete globally. Two cases in point are horticulture and electronics, two export-oriented sectors with large growth in global demand, which Southeast Asia has been successfully tapping into. In recent years, Indonesia has tried to promote the development of both sectors through restrictive investment and trade measures, such as limiting foreign equity participation in horticulture firms and requiring a minimum local content in electronics production for domestic sale. These restrictive policy measures have been associated with stagnating exports, in contrast to the high and growing level of exports and imports of regional peers that have maintained more open trade and investment regimes (Box B.2).

⁶⁸ In the case of foreign investments, the analysis finds that local content requirements reduce only the number of approved (but not yet realized) investments while it does not significantly affect that of realized investments. These requirements appear more pinching for domestic investments, as both approved and realized investments decline as a result of local content requirements.

Box B.2: Why trade and investment restrictions have not helped the development of Indonesian horticultural and electronics industries

With the 2010 Horticultural Law (no. 13), Indonesia sought to develop the sector through a combination of restrictions to foreign investors (in the form of 30 percent maximum foreign equity)¹ and import barriers with the introduction of licensing requirements and restricted ports of entry. The investment restrictions have reduced the participation of foreign seed companies, which can provide invaluable sources of knowledge in a technologically intensive sector, such as horticulture. Similarly, the trade restrictions have stifled horticulture import growth in recent years (and have increased domestic prices of fruits and vegetables)², but have not spurred any significant increase in exports (Figure B.21). On the other hand, by keeping open trade and investment regimes, Vietnam, Thailand and, to some extent, the Philippines have expanded both horticultural exports and imports over the same period. Vietnamese exports in particular, have grown five-fold in the last ten years to USD 5 billion, and imports have grown more than 10-fold to close to USD 3 billion. Trade and investments have played a key role in the development of the sector: foreign companies control 80 percent of the domestic purchases of seed, and 80 percent of domestic supply of fruit and vegetable seeds is imported. The government has established production areas for the top 8 fruits for exports, in which the farmers are provided long-term land ownership and intensive extension services to adopt the planting techniques needed to meet overseas customer demand. In addition, private investment is invited to improve post-harvest and export handling capacity.

Figure B.21: The difficult transition of Indonesia’s horticulture sector
(exports and imports of horticulture products in USD billions)



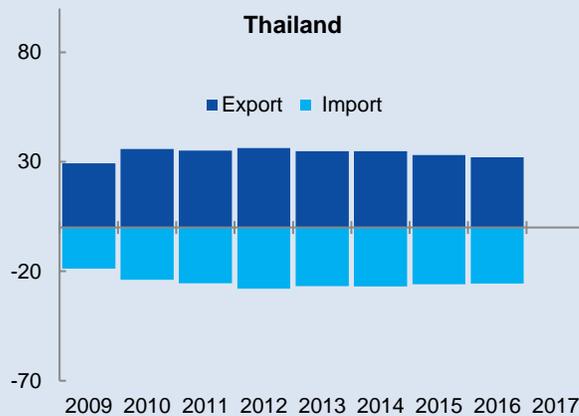
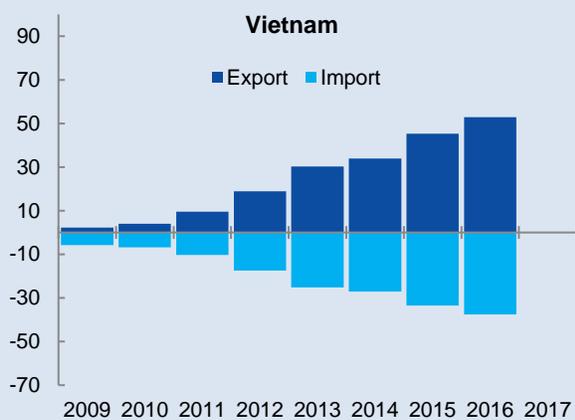
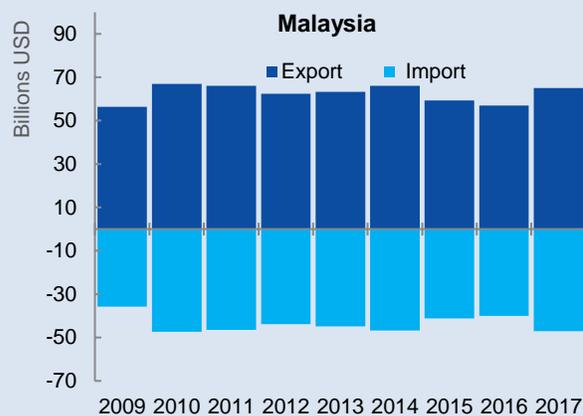
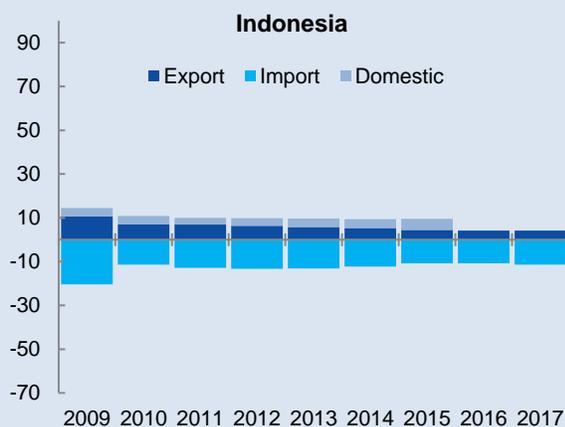
World Bank staff calculations based on FAOSTATS.

Indonesia has also used investment and sale restriction measures to promote the development of the electronics industry. Since 2013, the government has introduced local content requirements of between 20 percent and 40 percent of the value of the products to market various pieces of electronic equipment domestically.³ These measures aimed to spur the domestic industry by incentivizing domestic value addition. However, these restrictions make it difficult for domestic producers to source the best inputs globally, which

is particularly problematic in an industry whose production is highly fragmented across countries. Rather than addressing the competitiveness factors that have reduced investors' willingness to use Indonesia as a production basis for their electronics exports (Figure B.9 above), these measures have contributed to turn Indonesia's electronics industry increasingly domestic oriented. In the past decade both imports and exports have shrunk, and domestic sales have overtaken exports as the largest source of revenues for domestic producers (Figure B.22). While Indonesia has the largest domestic market in the region, it is still small in global terms.⁴ Thus, it does not present as sufficiently attractive for producers who want to serve global markets by sourcing the best inputs globally. In fact, the value of Indonesia's domestic sales is considerably smaller than that of the electronics exports of other countries in the region, such as Vietnam, Thailand, and Malaysia, which have more export-oriented electronics industries, with much larger imports and exports than Indonesia. These figures suggest that it is worthwhile for Indonesia to re-consider this inward-looking strategy to promote the industry.

Figure B.22: Indonesia's domestic-oriented electronics sector

(exports and imports of electronics products in USD billions)



Source: World Bank staff calculations on COMTRADE for trade data and Statistik Industri and the survey of micro and small manufacturers for Indonesian domestic sale.

Note: Data for domestic sale is only for Indonesia and is not available for 2016–17.

¹ The Horticultural Law works retroactively, implying that foreign companies needed to divest their majority ownership by 2015 at the latest. While the government has indicated some flexibility with the divestment deadline, foreign companies continue facing regulatory uncertainty.

² The World Bank estimated that fruit and vegetables prices have been more than 20 percent higher than they would have been in the absence of trade restrictions.

³ These requirements have been introduced through two Ministry of Information regulations (No. 26/2013 and No. 27/2015).

⁴ For example, the Indonesian market represents just 2 percent of a USD 479-billion global smartphones market in 2017.

By restricting competition, these regulatory measures can help generate dominant positions for incumbent businesses or facilitate collusion among them, thus harming productivity, calling for the strengthening of the currently weak competition framework and its enforcer, KPPU

By restricting competition, these regulatory measures can also help generate dominant positions for incumbent businesses or facilitate collusion among them, which further stifles competition. The lack of competition harms productivity growth by reducing the firms' incentives for product and process innovation. These anti-competitive practices are often in intermediate sectors⁶⁹, thus further dragging down competitiveness by raising the cost of inputs to production. There is therefore a critical need for strong competition policy and its enforcement. In many countries, national competition

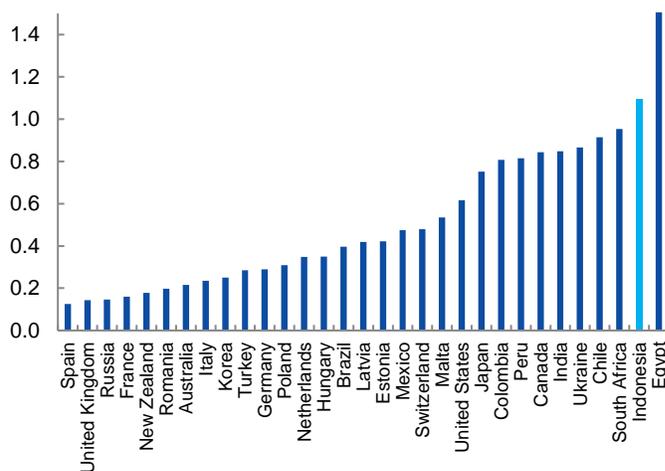
authorities help ensure that policymaking takes into account pro-competition concerns and prevent or discourage the anti-competitive conduct of business incumbents. In Indonesia, the effectiveness of competition policy framework and its implementation needs to be strengthened. Indonesia's Competition Law dates back to 1999—the first law ever developed by the Parliament's initiative in the post-Suharto era—when it also established a Business Competition Commission (KPPU) mandated to enforce the competition policy. However, both the competition framework and the KPPU still suffer from a number of limitations that make Indonesia's competition regime one of the least effective of the 49 surveyed by the OECD (Figure B.23). For example, the KPPU is the only competition agency which cannot perform unannounced inspections of the premises of firms investigated for antitrust infringement aimed at gathering evidence. Similarly, the KPPU cannot act against firms located abroad, even if their behavior directly affects competition and/or consumers in domestic markets. As a result, the number of cartels detected by the KPPU has been very limited compared to even smaller economies.⁷⁰ In addition, the KPPU has limited deterrence powers: at less than USD 2 million, the maximum penalty that the KPPU can levy is significantly lower than most other jurisdictions. Finally, while the majority of KPPU's advisory opinion activity has focused on anti-competition practices facilitated by government regulations, the impact of such opinions on policy-making remains elusive in the absence of formal feedback mechanisms from the government.

Inefficiencies in other factor markets

The relatively low quality of labor, particularly high-skilled labor, is another key constraint on the competitiveness of Indonesian firms

The increased automation and sophistication of production technology has raised the importance of skills quality for firms, hence amplifying the need to improve the quality of labor in Indonesia, particularly high-skilled labor. The labor force's quality of skills, particularly that of high-skilled professionals and managers, is a key concern. The share of firms in Indonesia that report adequacy of skills as the top constraint when hiring managers and professionals is the highest in the region (Figure B.24). On the other hand, firms searching for unskilled production workers, appear to complain less than their regional comparators about the inadequacy of available skills. In addition, 80 percent of Indonesian firms complain specifically

Figure B.23: Indonesia lags behind in the strength and scope of its competition regime (2013)
(0 to 6 from most to least conducive to competition)



Source: World Bank elaboration based on Alemani et al. (2016)

⁶⁹ Ivaldi, Jenny and Khimich (2016).

⁷⁰ In Indonesia, in the 2000–17 period, the KPPU investigated only 11 cartel cases, excluding collusion with government officials in public procurement tenders (source: KPPU decisions published online). In comparison, in South Africa, whose economy is three times smaller than Indonesia's, some 76 cartels were detected and sanctioned between 2005 and 2015, excluding construction projects (World Bank 2016).

about language and managerial skills, a much higher proportion than in peer countries. According to a recent joint Government of Indonesia-World Bank assessment, Indonesia suffers critical shortages of skills in dozens of positions, such as Head of Chemical Manufacturing Control, Biochemistry Supervisor; Microbiology Supervisor, Food Technologist, Chemical Engineer, Cloud Solution Architect and UI/UX Designer.⁷¹ This skills' shortage translates into lower productivity and employment growth⁷². Indeed, poor management quality is typically associated with low innovation⁷³, which may help explain the low share of firms that generate product or process innovation in Indonesia.

The labor skills problem is consistent with the need to improve the quality of the domestic education system and is compounded by the limited formal on-the-job training undertaken by Indonesian firms, especially for skilled employees

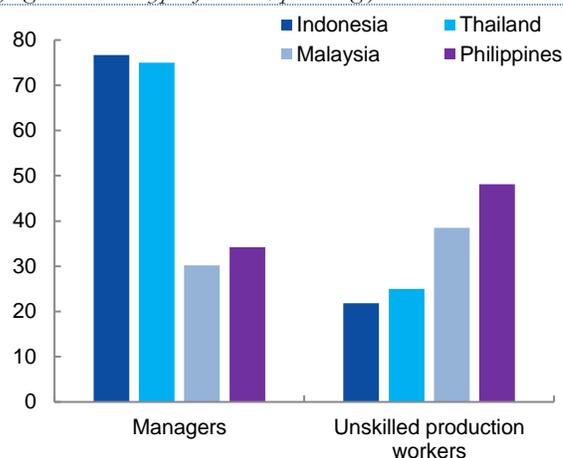
The problem of labor skills is consistent with the need to improve the quality of the domestic education system and is compounded by the limited formal on-the-job training undertaken by Indonesian firms, especially for skilled employees. The recent rapid expansion in access to education (with the number of schools more than doubling in 2003–16) has translated into a massive increase in the labor force with tertiary and secondary education levels. However, this has not been reflected in a commensurate improvement in the quality of education since 2000⁷⁴. According to international tests, more than 55 percent of Indonesians who finish their education are functionally illiterate, a much larger share than registered in Vietnam (14 percent) and the OECD countries (20 percent). Despite these skill shortages, the share of Indonesian firms that employ on-the-job training is one of the lowest among middle-income countries.⁷⁵

The energy market subsidization policy has provided perverse incentives for producers to use old fuel-powered machines instead of providing firms what they really need: more reliable electricity provision

The subsidization policy for energy markets has reduced domestic energy prices, instead of providing firms what they really need, i.e., more reliable electricity provision. The Government has adopted a long-standing policy of subsidized energy prices, particularly fuels, whose price in Indonesia is among the lowest in the world. While the subsidy was largely removed from the national budget in 2015, around 27 percent of it has been reinstated by this year on the government budget⁷⁶. However, such policies have provided perverse incentives for firms to use inefficient and low productivity fuel-powered machines, rather than more modern electricity-powered ones. In fact, Cali et al. (2018) estimate from a panel of Indonesian manufacturing plants that a 10 percent increase in fuel price raises plant productivity by 1.4 percent. This result is driven by the switch to more productive and energy-efficient equipment, induced by the fuel price increase. At the same time, the reliability of electricity provision

Figure B.24: Lack of the right skills bites, particularly for managers

(share of firms that cited inadequate skills as the key barrier in trying to hire each type of worker, percentage)



Source: Gomez-Mera and Hollweg (2018) based on WBES data

⁷¹ Government of Indonesia and World Bank (2018).

⁷² Firms that report difficulties in hiring managers and high-level employees experience 50 percent lower employment growth; difficulties in finding employees with foreign language, technical, leadership, and management skills are correlated with weaker firm performance and lower productivity among Indonesian firms, see Gomez Mera and Hollweg (2018).

⁷³ Cirera and Maloney (2017).

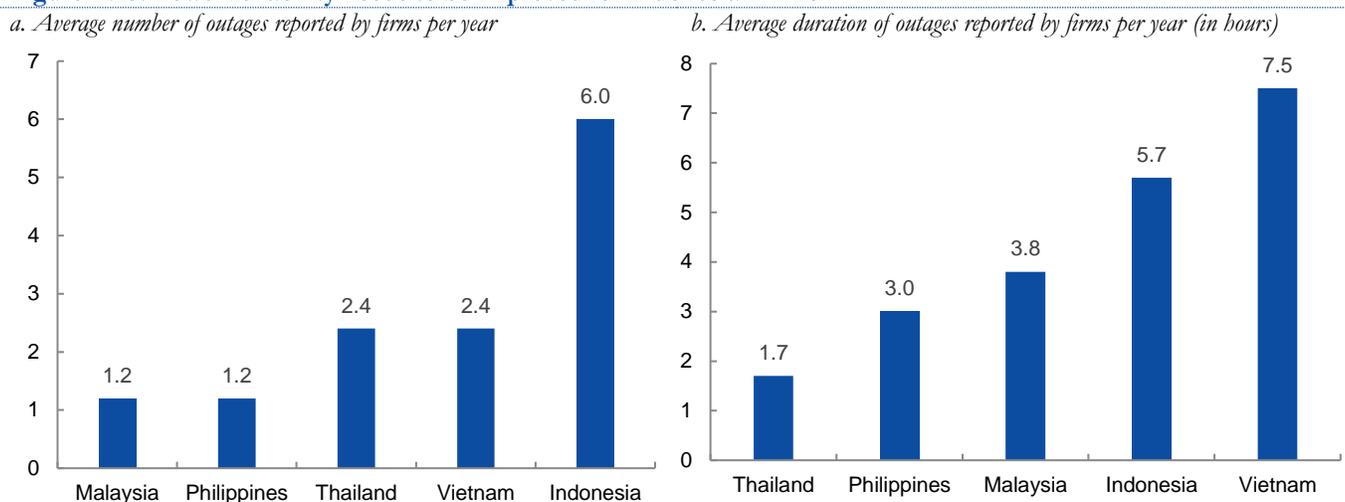
⁷⁴ World Bank (2018a).

⁷⁵ Gomez-Mera and Hollweg (2018).

⁷⁶ This excludes off-budget subsidies, which are mainly absorbed by Pertamina.

remains an issue. While firms' connection to the grid is widespread, at least on the main islands, Indonesian firms experience significantly longer and more frequent power outages, especially in Central Java, than their counterparts in the region (Figure B.25). This disrupts production and increases energy costs, for example by forcing firms to use generators to secure reliable power supply, which in turn translates into lower productivity, particularly for smaller firms.⁷⁷

Figure B.25: Power reliability needs to be improved for Indonesian firms



Source: World Bank staff estimation on the basis of WBES data (data for 2015 for all countries except Thailand (2016))

The competitiveness of Indonesian firms is negatively affected by high transport costs, mainly due to congestion and a lack of adequate investment in infrastructure

Finally, the competitiveness of Indonesian firms is negatively affected by high transport costs, mainly due to congestion and a lack of adequate investment in infrastructure. New data gathered by the World Bank (2018b) show that the largest share of logistics costs for Indonesian manufacturers is due to transport, mainly road and sea transport, and its share in manufacturing sales is higher in Indonesia than in Vietnam and Thailand. Incentives to use road transport as opposed to sea transport, including the diesel subsidy and the limited enforcement of road safety rules contribute to the road congestion problem. In addition, large infrastructure gaps exist in ports, particularly in secondary ports, which slow down port operation and/or make ports ill-equipped for the demand expected in the immediate future.⁷⁸ These high costs reduce the ability of firms to fully exploit economies of scale, even within the large island economies of Java and Sumatra. The connectivity penalty is larger in peripheral regions,⁷⁹ where the Government's attempt to subsidize private sector development without a broader integration of these regions with the core of the country has largely failed (Rothenberg et al. 2017).⁸⁰

3. What Indonesia can do to boost exports and investments?

Addressing these constraints would require a mix of short- and medium-term reforms

Addressing the constraints that weigh on Indonesian competitiveness would accelerate investments, exports, and growth, fulfilling the country's potential as one of the world's fastest growing economies. The good news is that several of these constraints could be addressed through six specific short-term policy reforms, including reducing import barriers, implementing ambitious Free Trade Agreements (FTAs), revising the DNI, allowing more

⁷⁷ Poczter (2017).

⁷⁸ This is based on detailed work on 18 ports carried out by the World Bank – see World Bank (2015a).

⁷⁹ World Bank (2015a)

⁸⁰ A case in point is the Integrated Economic Development Zones (KAPET) which aimed to develop lagging regions in Eastern Indonesia. The scheme includes tax breaks on all production factors, in addition to subsidized facilities, infrastructure, and services (Temenggung 2013). While these subsidies are fiscally costly, there is no evidence of any significant impact on investment or performance (Rothenberg et al. 2017), as these are likely to still be constrained by a lack of connectivity in these regions to markets as well as by a lack of adequate factors of production.

international recruitment of critical skills not readily available in Indonesia at the moment, eliminating the fuel subsidy and revising the Competition Law. Other human capital and infrastructure related bottlenecks would require a medium-term reform agenda.

Short-term policies

A key measure to boost exports and investments is substantially reducing import barriers, both tariff and non-tariff ones

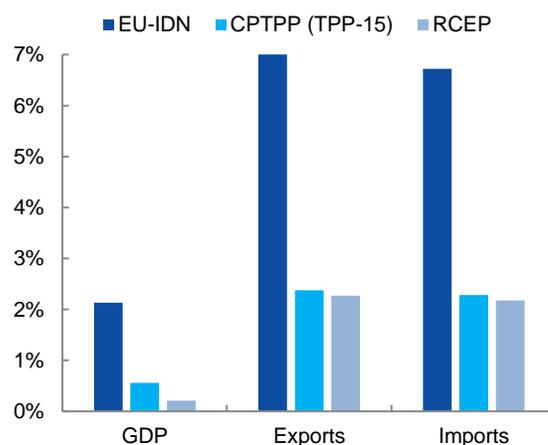
One of the key measures for Indonesia to boost exports and investments is to substantially reduce import barriers, both tariff and unnecessarily burdensome non-tariff ones. As exporters use imported inputs intensely, this measure would reduce the cost and increase the availability of key production inputs for exports. It would be important to begin by reversing the increase in the import tariffs of recent years, particularly on intermediates, including a proper review of whether the conditions justifying anti-dumping tariffs are still in place. In reforming NTMs, it would help to first focus on the most burdensome measures for imports. The objective would be to assess the opportunity of reducing their coverage across goods and the cost of applying them. For example, a review of the SNI certification would help identify the costs and benefits of the certification for various types of goods and possibly to find ways to reduce the cost of the certification itself. In addition, the Indonesian government could increase the transparency of its agencies in the administration of these measures. This could include, for instance, the issuance of recommendation letters for imports of specific goods by line ministries, which can often exert a large degree of discretion in releasing such letters.

Indonesia could also accelerate the conclusion of ongoing Free Trade Agreements and consider joining others with high degree of ambition, which could help accelerate domestic reforms and enhance access to key markets

Indonesia could also accelerate the conclusion of ongoing Free Trade Agreements (FTAs) negotiations and consider joining others with a high degree of ambition. FTAs are no substitute for unilateral trade and investment reforms, but they do provide an external mechanism to accelerate domestic reforms as well as a good opportunity to increase access to key markets. While Indonesia is close to signing a renewed economic partnership agreement with Japan and FTAs with Australia and with the European Trade Association (EFTA) block, other important agreements are still being negotiated, notably one with the EU and the Regional Comprehensive Economic Partnership (RCEP), which is being negotiated among 16 Asian economies. Recent work based on dynamic general equilibrium modeling suggests the positive impact of both agreements, particularly the EU one, as this would significantly reduce bilateral tariff and non-tariff barriers (Figure B.26). The study suggests that Indonesia could also benefit from joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which has replaced the original TPP. The inclusion of ambitious investment chapters in these “new generation” agreements could also help Indonesia attract foreign investments in the absence of Bilateral Investment Treaties (BITs) that the government has not been renewing upon expiration. In fact, renegotiating BITs appear to be a more effective strategy than terminating them as they provide an important protection to foreign investors against possible changes to the rights agreed upon at the time of investment. To that end, the government could consider introducing additional safeguards in BITs that limit the possible recourse to state-investor dispute settlement.

Figure B.26: FTAs are a possible boon for the Indonesian economy

(percentage point change in Indonesia’s economic variables associated with various FTAs, by 2030)



Source: Maliszewska et al. (forthcoming)

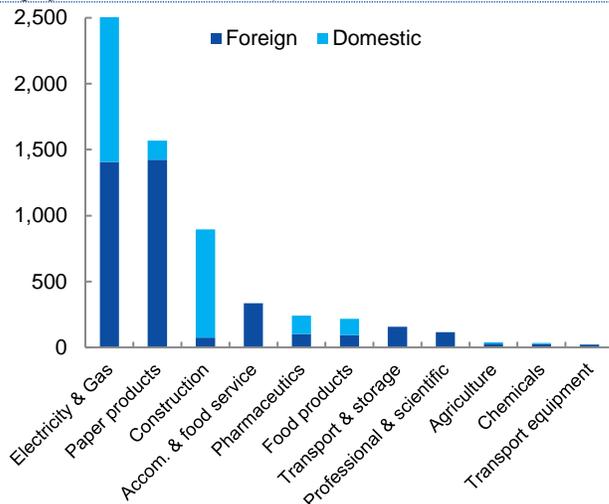
The revision of the DNI is a key step to relaxing restrictions to investments, and the elimination of foreign equity limits alone could generate additional foreign and domestic investments of USD 6 billion

Relaxing restrictions to investments is another key reform area to boost FDI and exports. Many such restrictions in a wide range of sectors could be revised through the issuance of a new DNI, including foreign equity limits, SME reservations and partnerships, and minimum local content requirements.⁸¹ For instance, the World Bank estimates that removing foreign equity limits in all sectors not closed to investments would generate an additional USD 4 billion and USD 2 billion in foreign and domestic investments, respectively.⁸² Sectors such as electricity and gas supply, paper products, construction, and tourism and food services would be the largest beneficiaries of these additional investments (Figure B.27). Other restrictions not covered in the DNI would need to be addressed through revisions of laws (e.g., Horticultural Law and Education Law) and sectoral regulations (e.g., local content requirements for electronics goods). In addition, as part of a longer-term agenda, it would be opportune to review a host of local government regulations—mainly at the district level—that often deter investments.

In the short run, Indonesia could improve the availability of critically scarce skills by allowing a larger number of high-skilled professionals from abroad, deepening the reform initiated by the recent presidential regulation on workers' permits

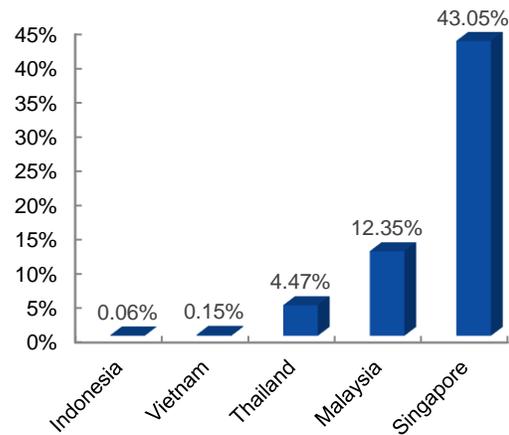
In the short run, Indonesia could improve the availability of critically scarce skills—a key constraint to firms' competitiveness—by allowing a larger number of high-skilled professionals from abroad. This could be done by deepening the reform initiated by the recent Presidential Regulation on workers' permits (No. 28/2018), which has not been fully implemented yet. More importantly, several of the restrictive requirements on hiring foreign professionals still remain in place, including the need for approval of the foreign workers' plan and the stringent foreign-to-domestic worker ratios. Indonesia should consider relaxing these requirements, which help explain why only 0.06 percent of the Indonesian labor force is foreign, a fraction of the shares among regional peers (Figure B.28).

Figure B.27: Eliminating foreign equity limits can boost investments across sectors
(expected additional investments from the elimination of foreign equity limits, in million USD)



Source: World Bank staff estimates on the basis of DNI PerPres and BKPM investment data

Figure B.28: Indonesia does not yet tap into foreign skills to fill domestic gap
(share of foreign workers in labor force, 2016)



Source: Immigration statistics in each country (for number of foreign visa) and World Development Indicators (for labor force). Note: 2016 data for all countries except Vietnam (2015).

⁸¹ As this issue went to press the Government was debating the opportunity of issuing a revised DNI, which may be forthcoming.

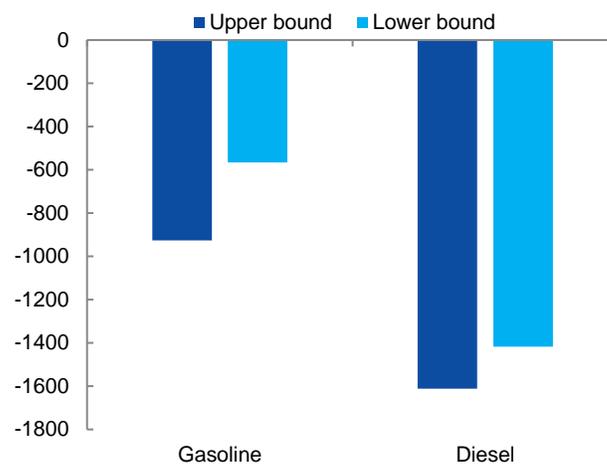
⁸² This computation is based on the estimated response of investments to foreign equity limits from the empirical model mentioned above and described in World Bank (2017).

Eliminating the fuel subsidy is another important short-term reform, which could have positive effects on both manufacturing competitiveness and external stability

Another important reform that could be achieved in the short-term is the elimination of the fuel subsidy, which could have multiple positive effects on Indonesian competitiveness and external stability. On the one hand, it would considerably free up fiscal resources for more effective expenditures. In 2018, the subsidy is estimated by the government at around 5 percent of central government expenditures in the budget and 0.7 per cent of 2018 GDP. On the other hand, the increase in fuel price from the elimination of the subsidy could spur efficiency gains in the industrial sector as suggested by the empirical evidence above. While the elimination of the subsidy would generate some inflationary pressures, the domestic fuel prices increase would also reduce the demand and hence the imports of diesel, gasoline and LPG, thus improving the country’s external balance. The World Bank estimates that the removal of the subsidy would generate a drop of USD 2–2.5 billion in imports of diesel and gasoline alone (Figure B.29).

Figure B.29: Reducing fuel subsidy could improve the current account deficit

(estimated change in annual imports from eliminating fuel subsidy, by product, in USD mln)



Source: World Bank staff estimates on the basis of Citi Research (estimates of economical price), BPS (import data), Agustina et al. (2008) (price elasticities of demand) and Pertamina (fuel consumption split)

Revising the existing Competition Law is a key step to making the Indonesian competition framework more effective at identifying and sanctioning anti-competitive behavior

Revising the existing Competition Law (no. 5/1999) is a key step to make the Indonesian competition framework more effective at identifying and sanctioning anti-competitive behavior. The Indonesian Parliament is discussing the revision of the Law, which is a unique opportunity to strengthen the system’s ability to identify and deter firms’ anti-competitive behavior. Specifically, the tools to detect and deter cartels should be enhanced, including granting the KPPU the power to conduct unannounced searches to gather evidence of anticompetitive practices; increasing the maximum level of fines; strengthening the ability of the KPPU to execute them; and introducing the possibility of using leniency for businesses which share information to detect and sanction cartels. In addition, the revision could clarify the application of administrative and criminal sanctions to firms and individuals; specify the definition of “business actor” so that it comprises all legal entities operating as a single economic unit in the market; and introduce the concept of settlement to improve the efficiency of the enforcement process. Finally, the system should strengthen KPPU’s ability to prevent anti-competitive mergers by moving from the current post-merger to a mandatory pre-merger notification regime, clarifying the standard of theory of harm and the definition of merger as combining two or more previously independent economic units through a lasting change in control.

Medium-term

In the medium run, it will be important to embed competition considerations into Indonesia’s policy-making and to strengthen the

In the medium run, it will be important to embed competition considerations into Indonesia’s policy-making and to strengthen the technical capacity of KPPU to enforce the competition law and advocate for pro-competition reforms. The former is important as government regulations often deter entry and restrict import competition, thus helping to create dominant positions and facilitate cartel formation. This would require a more effective regulatory governance system. This could include, for instance, the implementation of Presidential Instruction no. 7/2017, which mandates coordinating ministries to vet new regulations, and responsible ministries to conduct impact analysis and hold wide public consultations for the proposed reforms, and the

capacity of the KPPU to enforce the competition law and advocate for pro-competition reforms

revision of the Law of Making Laws (2011). Including the KPPU in the consultation process would help ensure a more systematic consideration of regulatory impacts on barriers to entry, expansion, and competition. Furthermore, the KPPU and sector regulators could strengthen their assessment of Indonesian markets to identify current regulations and government interventions that hinder competition, and recommend alternative measure that minimize market distortions. In addition, strengthening the KPPU's analytical and investigative capacity would also be important to ensure better enforcement of competition rules, especially if the competition law revision entrusts it with more effective investigative and deterrence powers. This would also entail streamlining the KPPU's procedures for case handling, decision making, and monitoring.

Improving the availability and quality of skilled Indonesian workers would require strengthening the quality of the education system at all levels

Improving the availability and quality of skilled Indonesian workers is a complex long-term agenda which should be at the core of the government's strategy to boost exports and investments. This would require improving the education system at all levels. While Indonesia has managed to strengthen schooling attainment since the early 2000s, student learning remains below the levels of peer countries. World Bank (2018a) provides key recommendations to increase the quality of primary and secondary education. These include better defining and enforcing the mandatory qualification criteria for teachers, complementing the existing financing mechanisms for education with a targeted, performance-based transfer for lagging schools and districts, and launching a national education quality campaign to generate public pressure for effective actions to improve student learning. In addition, post-secondary education may benefit from the entry of foreign universities as signaled by the Government's stated intention earlier this year to open up universities to foreign investment.⁸³ Such reforms along with relaxing restrictions on the hiring of foreign lecturers could improve the higher education system by extending its knowledge frontiers and increasing competition in the supply of higher education services.

Improving energy and transport infrastructure would entail reducing SOE market dominance, simplifying legal frameworks for PPP, and deepening local banking and capital markets

Strengthening energy and transport infrastructure are other key policy agenda elements to increase reliability and reduce the cost of power and transport. To that end, the government should continue expanding infrastructure investments as in previous years—possibly at an even greater pace. In addition, leveraging private sector investment can help Indonesia meet its large infrastructure needs more effectively. As identified by World Bank (2017b), mobilizing the private sector for infrastructure development will require improvements in: (i) the complex legal and regulatory environment for public-private partnerships, (ii) project planning, appraisal, and selection processes, (iii) transparency and efficiency of SOEs that dominate the infrastructure sector, including reducing subsidies to SOEs and using open competitive tenders for infrastructure projects, and (iv) the depth of local banking and capital markets.

These reforms would also increase the effectiveness of costly tax incentives, which the government seems increasingly interested in employing to attract investments, but with limited evidence of success

These reforms would also increase the effectiveness of tax incentives, a tool the Indonesian government seems increasingly interested in employing to attract investments. The Government estimates that in 2017, tax incentives through VAT, income tax, and import tariffs alone amounted to foregone fiscal revenues of over USD 10 billion (Government of Indonesia 2018). While the impact of these specific incentives in attracting investments has not been assessed yet, international evidence suggests that they are far less important than other factors, such as the costs of raw material and intermediates, the transparency of the legal system, the quality of infrastructure, and the availability of skilled labor (UNIDO 2011; World Bank 2018c). In fact, the data show that tax incentives are not useful in attracting investments in countries where these factors are not developed (Van Parys and James 2009). In these cases, tax incentives then become a fiscal cost for the country, which benefit only the investors who pay lower taxes. That was the case also for Indonesia's Integrated Economic Development Zone (KAPET) program,

⁸³ See, for instance, The Strait Times (April 4, 2018).

which provides tax breaks to firms in certain districts in Indonesia's outer islands. In an evaluation of the program, Rothenberg et al. (2017) find that firms in KAPET districts paid lower taxes, but these tax incentives neither encouraged greater firm entry, nor raised local measures of output or welfare.

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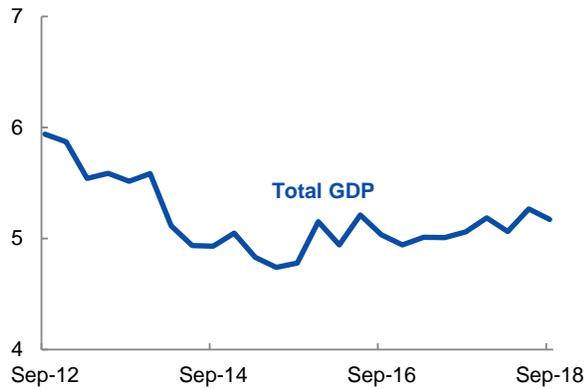
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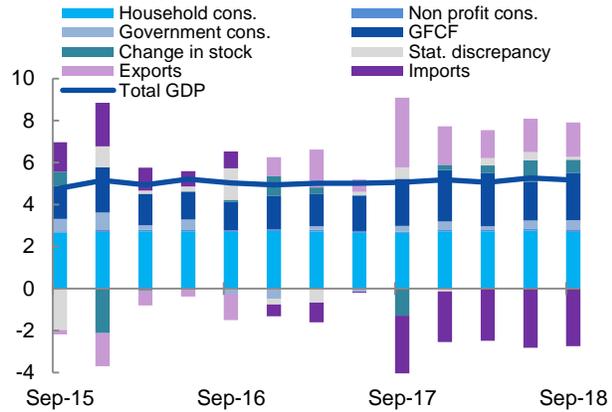
APPENDIX: A SNAPSHOT OF INDONESIAN ECONOMIC INDICATORS

Appendix Figure 1: Real GDP growth
(growth quarterly yoy, percent)



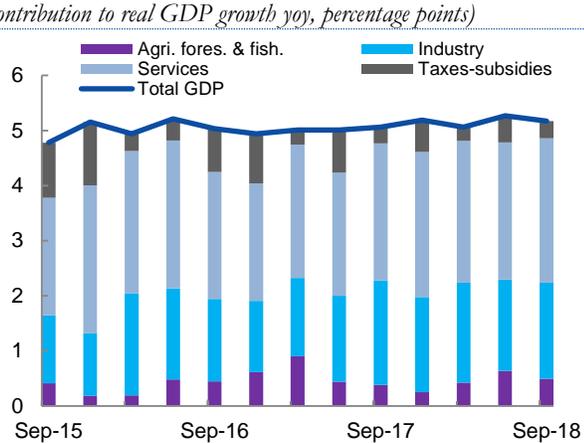
Source: BPS; World Bank staff calculations

Appendix Figure 2: Contribution to GDP growth (expenditure)
(contribution to real GDP growth yoy, percentage points)



Source: BPS; World Bank staff calculations

Appendix Figure 3: Contribution to GDP growth (production)
(contribution to real GDP growth yoy, percentage points)



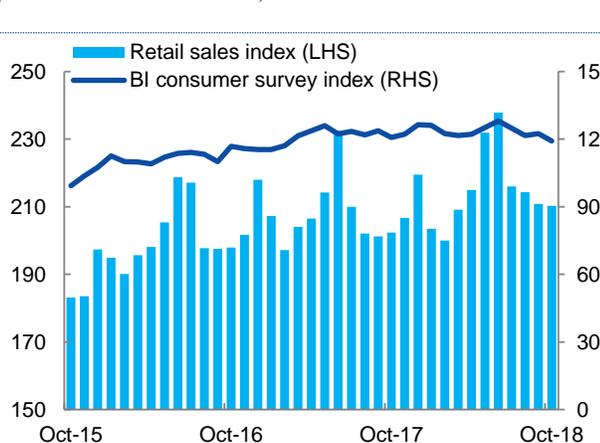
Source: BPS; World Bank staff calculations

Appendix Figure 4: Motor cycle and motor vehicle sales
(growth yoy, percent)



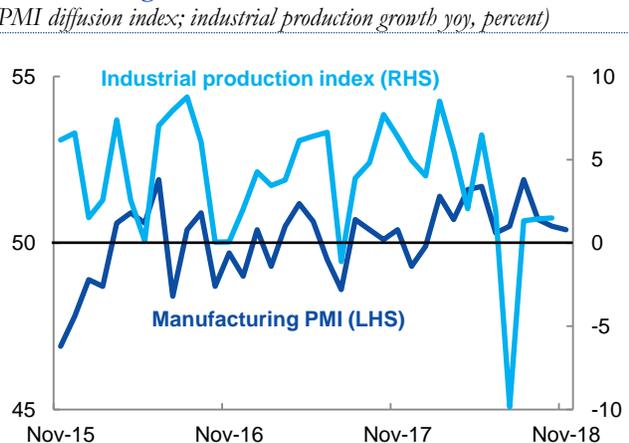
Source: BPS; World Bank staff calculations

Appendix Figure 5: Consumer indicators
(retail sales index 2010=100)



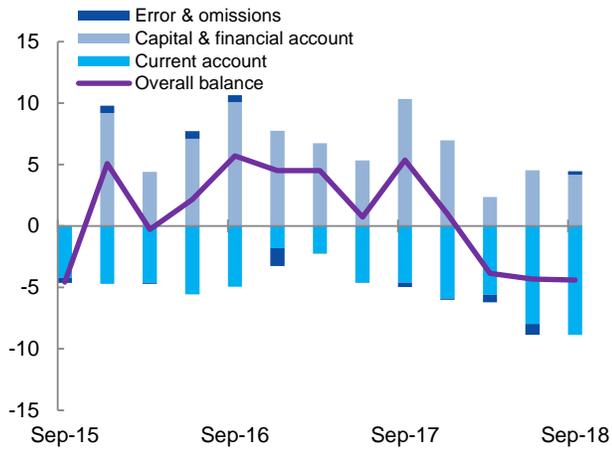
Source: BI

Appendix Figure 6: Industrial production indicators and manufacturing PMI
(PMI diffusion index; industrial production growth yoy, percent)



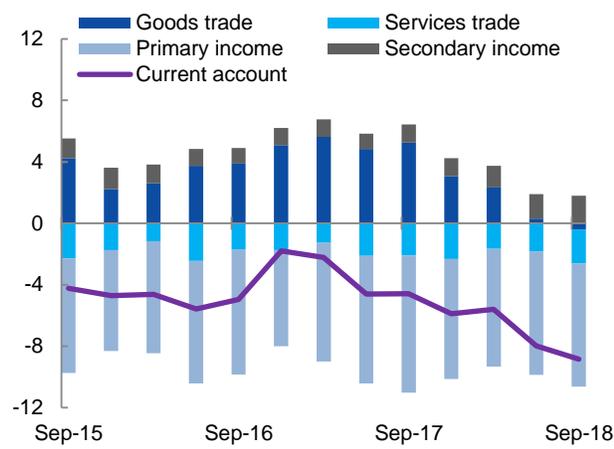
Source: BPS; Nikkei/Markit; World Bank staff calculations
Note: Manufacturing PMI above 50 indicates expansion

Appendix Figure 7: Balance of payments
(USD billion)



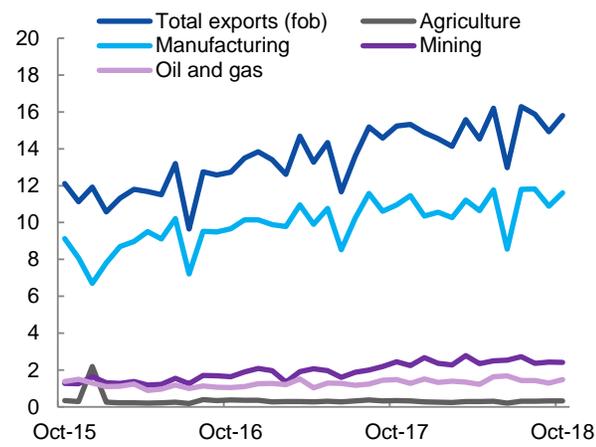
Source: BI

Appendix Figure 8: BOP: Current account
(USD billion)



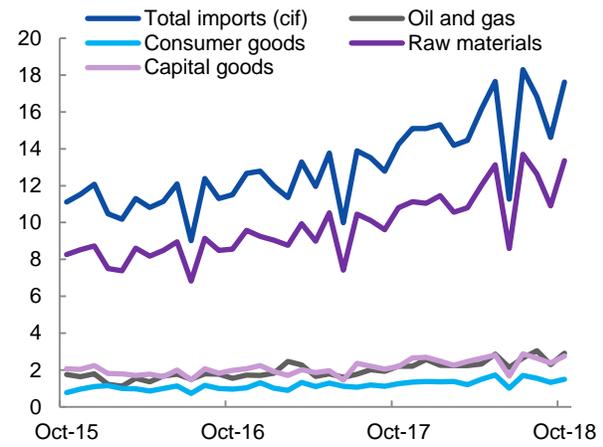
Source: BI

Appendix Figure 9: Exports of goods
(USD billion)



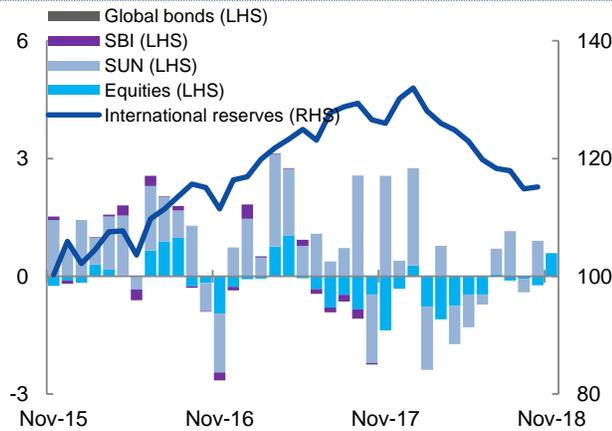
Source: BPS

Appendix Figure 10: Imports of goods
(USD billion)



Source: BPS

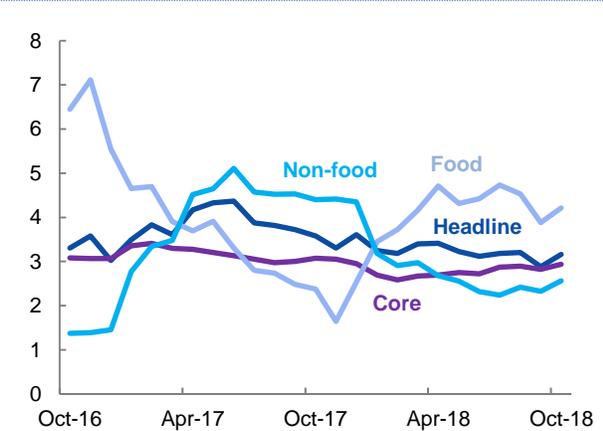
Appendix Figure 11: Reserves and capital flows
(USD billion)



Source: BI; Ministry of Finance (MoF)

Note: SUN is government securities, SBI is BI certificates

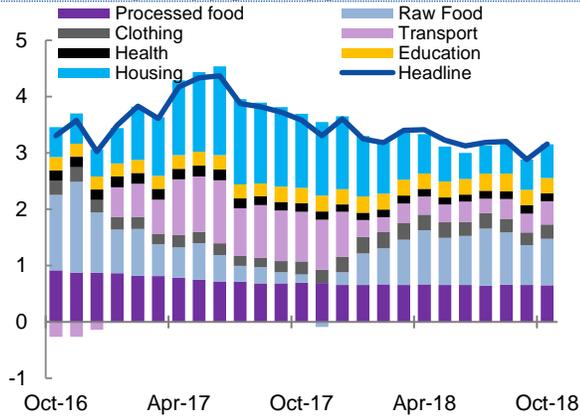
Appendix Figure 12: CPI inflation
(growth yoy, percent)



Source: BPS; BI; World Bank staff calculations

Appendix Figure 13: Monthly breakdown of CPI inflation

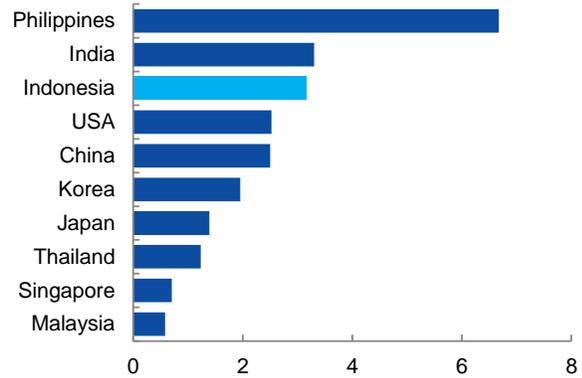
(contribution to growth yoy, percentage points)



Source: BPS; World Bank staff calculations

Appendix Figure 14: CPI inflation comparison across countries

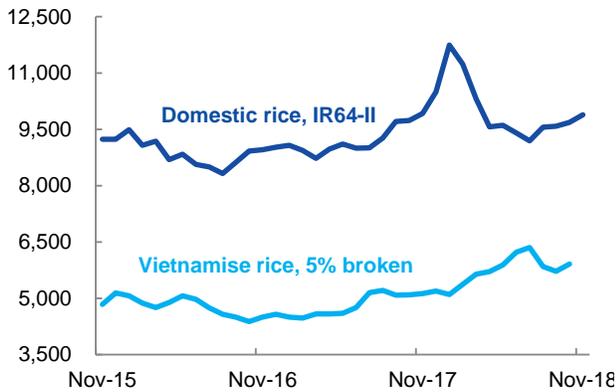
(growth yoy, percent)



Source: BPS; CEIC; World Bank staff calculations
Note: October 2018 data.

Appendix Figure 15: Domestic and international rice prices

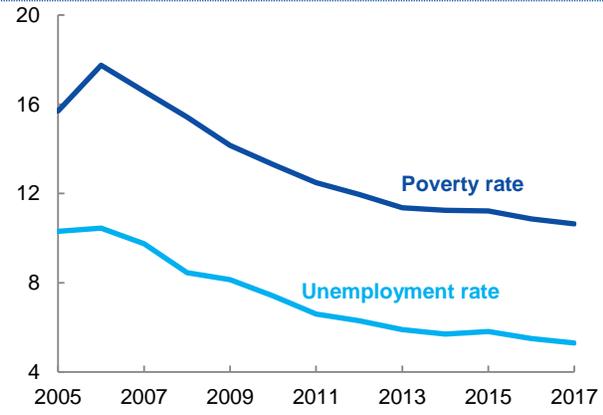
(wholesale price, in IDR per kg)



Source: Cipinang wholesale rice market; FAO
Note: "5% broken" refers to the quality of milled rice. 5 percent being the proportion of grains broken during the processing stage.

Appendix Figure 16: Poverty and unemployment rates

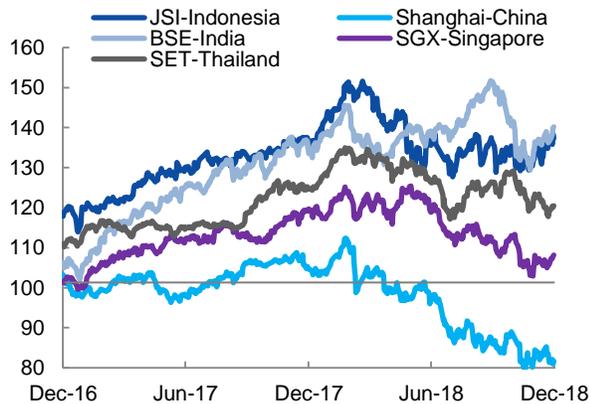
(percent)



Source: BPS
Note: Poverty line based on national poverty line

Appendix Figure 17: Regional equity indices

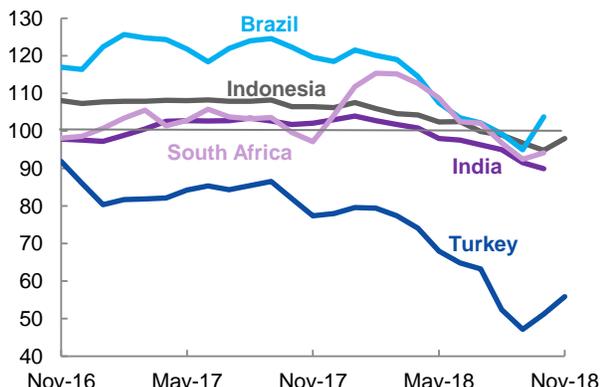
(daily index, September 1, 2015=100)



Source: CEIC; World Bank staff calculations

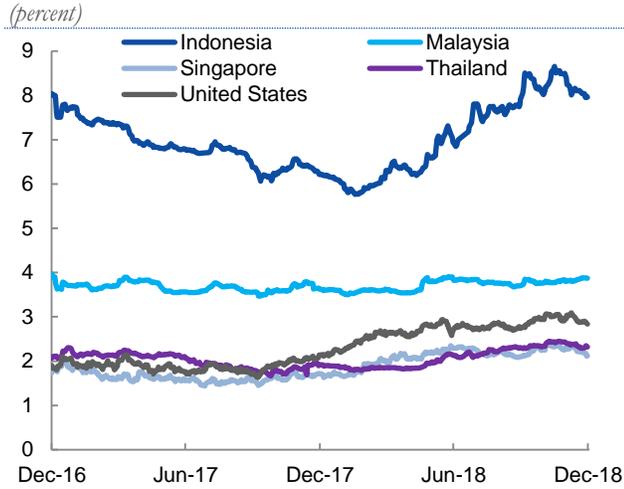
Appendix Figure 18: Spot exchange rates of selected currencies against USD

(monthly index, August 2015=100)



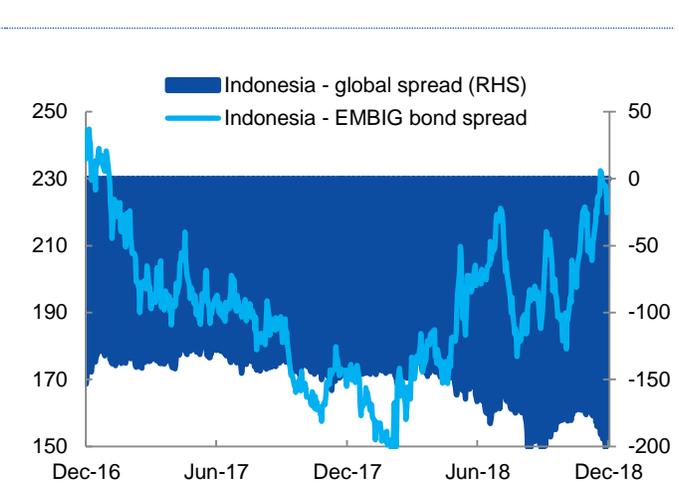
Source: CEIC; World Bank staff calculations

Appendix Figure 19: 5-year local currency government bond yields
(percent)



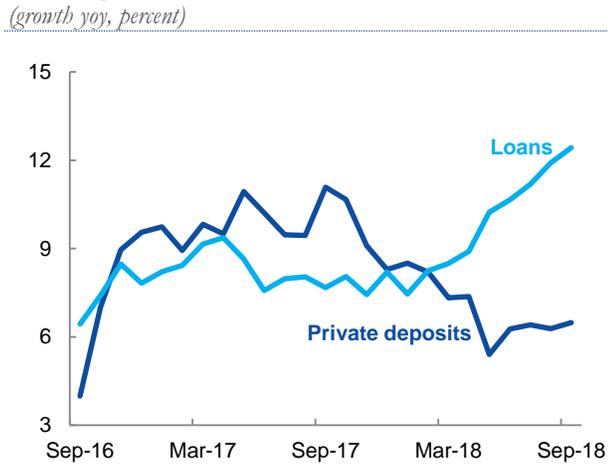
Source: CEIC

Appendix Figure 20: Sovereign USD bond EMBIG spread
(basis points)



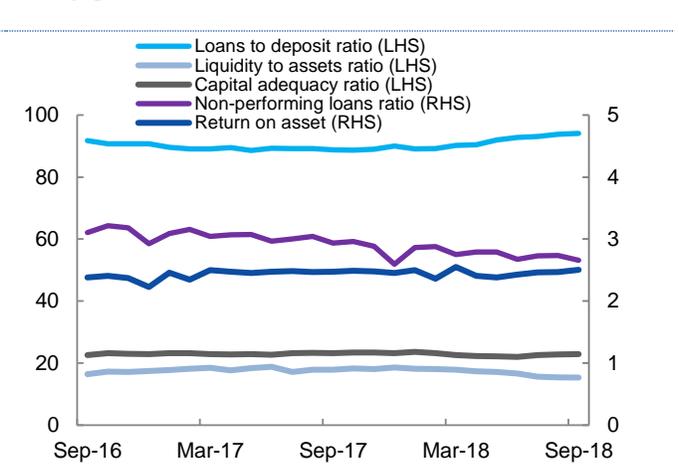
Source: JP Morgan

Appendix Figure 21: Commercial and rural credit and deposit growth
(growth yoy, percent)



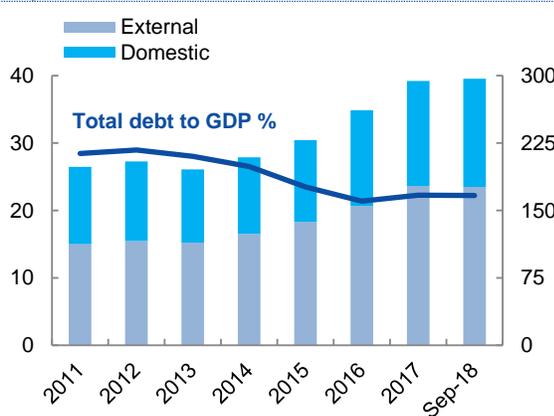
Source: BI; World Bank staff calculations

Appendix Figure 22: Banking sector indicators
(monthly, percent)



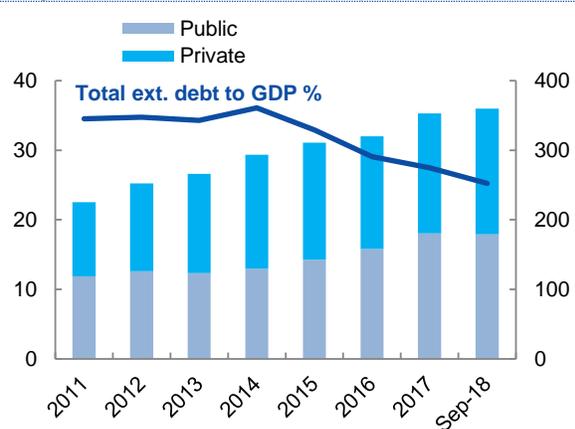
Source: BI; World Bank staff calculations

Appendix Figure 23: Government debt
(percent of GDP, LHS; USD billion, RHS)



Source: BI; MoF; World Bank staff calculations

Appendix Figure 24: External debt
(percent of GDP, LHS; USD billion, RHS)



Source: BI; World Bank staff calculations

Appendix Table 1: Budget outcomes

(IDR trillion)

	2011	2012	2013	2014	2015	2016	2017
	Actual						
A. State revenue and grants	1,211	1,338	1,439	1,550	1,508	1,556	1,666
1. Tax revenue	874	981	1,077	1,147	1,240	1,285	1,344
2. Non-tax revenue	331	352	355	399	256	262	311
B. Expenditure	1,295	1,491	1,651	1,777	1,807	1,864	2,007
1. Central government	884	1,011	1,137	1,204	1,183	1,154	1,265
2. Transfers to the regions	411	481	513	574	623	710	742
C. Primary balance	9	-53	-99	-93	-142	-126	-124
D. Surplus / Deficit	-84	-153	-212	-227	-298	-308	-341
(percent of GDP)	-1.1	-1.9	-2.3	-2.2	-2.6	-2.5	-2.5

Source: MoF; World Bank staff calculations

Note: Budget balance as percentage of GDP uses the revised and rebased GDP

Appendix Table 2: Balance of payments

(USD billion)

	2014	2015	2016	2017				2018		
				Q1	Q2	Q3	Q4	Q1	Q2	Q3
Balance of payments	15.2	-1.1	12.1	4.5	0.7	5.4	1.0	-3.9	-4.3	-4.4
<i>Percent of GDP</i>	1.7	-0.1	1.3	1.9	0.3	2.0	0.4	-1.5	-1.6	-1.7
Current account	-27.5	-17.5	-17.0	-2.2	-4.6	-4.6	-5.9	-5.6	-8.0	-8.8
<i>Percent of GDP</i>	-3.1	-2.0	-1.8	-0.9	-1.8	-1.7	-2.3	-2.2	-3.0	-3.4
Trade balance	-3.0	5.4	8.2	4.4	2.7	3.2	0.7	0.7	-1.6	-2.6
Net income & current transfers	-24.5	-22.9	-25.2	-6.6	-7.3	-7.8	-6.6	-6.3	-6.4	-6.2
Capital & Financial Account	44.9	16.9	29.3	6.7	5.3	10.3	7.0	2.4	4.5	4.2
<i>Percent of GDP</i>	5.0	2.0	3.1	2.8	2.1	3.9	2.7	0.9	1.7	1.6
Direct investment	14.7	10.7	16.1	2.8	4.4	7.4	4.7	3.3	2.7	3.9
Portfolio investment	26.1	16.2	19.0	6.5	8.1	4.0	2.2	-1.3	0.1	-0.1
Other investment	4.3	-10.1	-5.8	-2.5	-7.2	-1.1	0.1	0.3	1.7	0.2
Errors & omissions	-2.2	-0.4	-0.3	0.0	0.0	-0.4	-0.1	-0.6	-0.9	0.3
Foreign reserves*	111.9	105.9	116.4	121.8	123.1	129.4	130.2	126.0	119.8	114.8

Source: BI; BPS; World Bank staff calculations

Note: * Reserves at end-period

Appendix Table 3: Indonesia's historical macroeconomic indicators at a glance

	2000	2010	2011	2012	2013	2014	2015	2016	2017
National Accounts (% change)¹									
Real GDP	4.9	6.2	6.2	6.0	5.6	5.0	4.9	5.0	5.1
Real investment	11.4	8.5	8.9	9.1	5.0	4.4	5.0	4.5	6.2
Real consumption	4.6	4.1	5.1	5.4	5.7	4.7	4.9	4.3	4.6
Private	3.7	4.8	5.1	5.5	5.5	5.3	4.8	5.0	5.0
Government	14.2	0.3	5.5	4.5	6.7	1.2	5.3	-0.1	2.1
Real exports, GNFS	30.6	15.3	14.8	1.6	4.2	1.1	-2.1	-1.6	9.1
Real imports, GNFS	26.6	17.3	15.0	8.0	1.9	2.1	-6.2	-2.4	8.1
Investment (% GDP)	20	31	32	33	32.5	32.4	32.4	32.2	32.6
Nominal GDP (USD billion)	165	755	893	918	915	891	861	933	1,015
GDP per capita (USD)	857	3,167	3,688	3,741	3,668	3,532	3,370	3,603	3,878
Central Government Budget (% GDP)²									
Revenue and grants	20.8	14.5	15.5	15.5	15.1	14.7	13.1	12.5	12.3
Non-tax revenue	9.0	3.9	4.2	4.1	3.7	3.8	2.2	2.1	2.3
Tax revenue	11.7	10.5	11.2	11.4	11.3	10.9	10.8	10.4	9.9
Expenditure	22.4	15.2	16.5	17.3	17.3	16.8	15.7	15.0	14.8
Consumption	4.0	3.6	3.8	3.9	4.1	4.0	4.5	4.6	4.4
Capital	2.6	1.2	1.5	1.7	1.9	1.4	1.9	1.4	1.5
Interest	5.1	1.3	1.2	1.2	1.2	1.3	1.4	1.5	1.6
Subsidies	6.3	2.8	3.8	4.0	3.7	3.7	1.6	1.4	1.2
Budget balance	-1.6	-0.7	-1.1	-1.8	-2.2	-2.1	-2.6	-2.5	-2.5
Government debt	97.9	24.5	23.1	23.0	24.9	24.7	27.4	28.3	30.8
o/w external government debt	51.4	11.1	10.2	9.9	11.2	10.2	12.7	12.3	12.8
Total external debt (including private sector)	87.1	26.8	25.2	27.5	29.1	32.9	36.1	34.3	34.8
Balance of Payments (% GDP)³									
Overall balance of payments	..	4.0	1.3	0.0	-0.8	1.7	-0.1	1.3	1.1
Current account balance	4.8	0.7	0.2	-2.7	-3.2	-3.1	-2.0	-1.8	-1.7
Exports GNFS	42.8	22.0	23.9	23.0	22.4	22.3	19.9	18.0	19.1
Imports GNFS	33.9	19.2	21.2	23.2	23.1	22.7	19.3	17.1	18.0
Trade balance	8.9	2.8	2.7	-0.2	-0.7	-0.3	0.6	0.9	1.1
Financial account balance	..	3.5	1.5	2.7	2.4	5.0	2.0	3.1	2.9
Direct investment	-2.8	1.5	1.3	1.5	1.3	1.7	1.2	1.7	2.0
Gross official reserves (USD billion)	29.4	96	110	113	99	112	106	116	130
Monetary (% change)³									
GDP deflator ¹	20.4	8.3	7.5	3.8	5.0	5.4	4.0	2.5	4.3
Bank Indonesia interest key rate (%)	..	..	..	..	..	..	6.3	4.8	4.3
Domestic credit (eop)	..	23.3	24.7	23.1	21.4	11.6	10.1	7.8	8.2
Nominal exchange rate (average, IDR/USD)	8,392	9,087	8,776	9,384	10,460	11,879	13,392	13,307	13,384
Prices (% change)¹									
Consumer price Index (eop)	9.4	7.0	3.8	3.7	8.1	8.4	3.4	3.0	3.6
Consumer price Index (average)	3.7	5.1	5.3	4.0	6.4	6.4	6.4	3.5	3.8
Indonesia crude oil price (USD per barrel, eop) ⁴	28	79	112	113	107	60	36	51	61

Source: ¹ BPS and World Bank staff calculations, using revised and 2010 rebased figures. ² MoF and World Bank staff calculations, ³ BI, ⁴ CEIC

Appendix Table 4: Indonesia's development indicators at a glance

	2000	2010	2011	2012	2013	2014	2015	2016	2017
Demographics¹									
Population (million)	212	243	246	249	252	255	258	261	264
Population growth rate (%)	1.4	1.3	1.3	1.3	1.3	1.2	1.2	1.1	1.1
Urban population (% of total)	42	50	51	51	52	53	53	54	55
Dependency ratio (% of working-age population)	55	51	51	50	50	50	49	49	49
Labor Force²									
Labor force, total (million)	98	117	117	120	120	122	122	125	128
Male	60	72	73	75	75	76	77	77	79
Female	38	45	44	46	45	46	46	48	49
Agriculture share of employment (%)	45	38	36	35	35	34	33	32	30
Industry share of employment (%)	17	19	21	22	20	21	22	21	22
Services share of employment (%)	37	42	43	43	45	45	45	47	48
Unemployment, total (% of labor force)	8.1	7.1	7.4	6.1	6.2	5.9	6.2	5.6	5.5
Poverty and Income Distribution³									
Median household consumption (IDR 000 per month)	104	374	421	446	487	548	623	697	765
National poverty line (IDR 000 per month)	73	212	234	249	272	303	331	354	375
Population below national poverty line (million)	38	31	30	29	28	28	29	28	28
Poverty (% of population below national poverty line)	19.1	13.3	12.5	12.0	11.4	11.3	11.2	10.9	10.6
Urban (% of population below urban poverty line)	14.6	9.9	9.2	8.8	8.4	8.3	8.3	7.8	7.7
Rural (% of population below rural poverty line)	22.4	16.6	15.7	15.1	14.3	14.2	14.2	14.1	13.9
Male-headed households	15.5	11.0	10.2	9.5	9.2	9.0	9.3	9.0	8.7
Female-headed households	12.6	9.5	9.7	8.8	8.6	8.6	11.1	9.8	9.3
Gini index	0.30	0.38	0.41	0.41	0.41	0.41	0.41	0.40	0.39
Percentage share of consumption: lowest 20%	9.6	7.9	7.4	7.5	7.4	7.5	7.2	7.1	7.0
Percentage share of consumption: highest 20%	38.6	40.6	46.5	46.7	47.3	46.8	47.3	46.2	45.7
Public expenditure on social security & welfare (% of GDP) ⁴	..	0.4	0.4	0.4	0.5	0.5	0.6	0.5	0.5
Health and Nutrition¹									
Physicians (per 1,000 people)	0.16	0.14	..	0.20	..	..	..	..	..
Under five mortality rate (per 1000 children under 5 years)	52	33	32	31	29	28	27	26	25
Neonatal mortality rate (per 1000 live births)	22	16	16	15	14	14	13	13	12
Infant mortality (per 1000 live births)	41	28	26	25	25	24	23	22	21
Maternal mortality ratio (modeled est., per 100,000 live births)	265	165	156	148	140	133	126	..	..
Measles immunization (% of children ages 12-23 months)	76	78	80	82	81	75	75	76	75
Current health expenditure (% of GDP)	2.0	3.5	3.3	3.4	3.4	3.4	3.3	..	..
Domestic general government health expenditure (% of GDP)	0.6	1.1	1.0	1.2	1.3	1.3	1.3	..	..
Education³									
Primary net enrollment rate (%)	..	92	92	93	92	93	97	97	97
Female (% of total net enrollment)	..	48	49	49	50	48	49	49	49
Secondary net enrollment rate (%)	..	61	60	60	61	65	66	66	79
Female (% of total net enrollment)	..	50	50	49	50	50	51	51	49
Tertiary net enrollment rate (%)	..	16	14	15	16	18	20	21	19
Female (% of total net enrollment)	..	53	50	54	54	55	56	55	53
Adult literacy rate (%)	..	91	91	92	93	93	95	95	96
Public spending on education (% of GDP) ⁵	..	3.5	3.6	3.8	3.8	3.6	3.5	3.3	3.0
Public spending on education (% of spending) ⁵	..	20.0	20.2	20.1	20.0	19.9	20.6	20.0	20.0
Water and Sanitation¹									
People using at least basic drinking water (% of population)	75	85	86	87	88	89	90	..	..
Urban (% of urban population)	89	94	94	95	96	96	97	..	..
Rural (% of rural population)	64	76	77	78	79	80	81	..	..
People using at least basic sanitation (% of population)	44	60	62	64	65	66	68	..	..
Urban (% of urban population)	66	74	74	75	76	77	77	..	..
Rural (% of rural population)	28	47	49	51	53	55	57	..	..
Others¹									
Disaster risk reduction progress score (1-5 scale; 5=best)	..	..	3.3	..	..	..	..	..	..
Proportion of seats held by women in national parliament (%) ⁶	8	18	18	19	19	17	17	17	20

Source: ¹ World Development Indicators; ² BPS (Sakernas); ³ BPS (Susenas) and World Bank; ⁴ MoF, Bappenas, and World Bank staff calculations, only includes spending on rice distribution for the poor (Raskin), health insurance for the poor, scholarships for the poor, and Family Hope Program (PKH) and actuals; ⁵ MoF; ⁶ Inter-Parliamentary Union



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