INDONESIA ECONOMIC QUARTERLY

March 2017

Staying the course

THE WORLD BANK
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Preface

The Indonesia Economic Quarterly (IEQ) has two main aims. First, it reports on the key developments over the past three months in Indonesia's economy, 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 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 Chaves, Country Director for Indonesia. The report is compiled by the Macroeconomics and Fiscal Management Global Practice team, under the guidance of Ndiame Diop, Practice Manager, and Hans Anand Beck, Acting Lead Economist. Led by Derek H. C. Chen, Senior Economist and lead author, the core project team comprises Magda Adriani, Arsianti, Dwi Endah Abriningrum, Indira Maulani Hapsari, Ahya Ihsan, Taufik Ramadhan Indrakesuma, Jonathan William Lain, Yus Medina, Alief Aulia Rezza, Jaffar Al Rikabi, Dhruv Sharma, and Kelly Wyett. Administrative support is provided by Titi Ananto and Sylvia Njotomihardjo. Dissemination is organized by Jerry Kurniawan, GB Surya Ningnagara, Kurniasih Suditomo, Nugroho Sunjoyo, and Suryo Utomo Tomi. Thanks to Leela Raina, Taufik Ramadhan Indrakesuma, Edgar Janz, and Nathaniel Adams for proof-reading the report.

This edition of the IEQ also includes contributions from Irfan Mujahid, Massimiliano Cali, Titik Anas and Robertus Herdiyanto (Part B.1, Services trade policies); Michael Steidl based on a policy note written by Wolfram Hiemann, with the support from Cynthia Clarita Kusharto (Part B.2, KUR), Hamidah Alatas, Ratih Dwi Rahmadanti, Daim Syukriyah, Bagus Arya Wirapati for their data contribution (Appendix: social indicators). The report also benefited from discussions with, and in-depth comments from Tatiana Nenova (Program Leader, EACIF), Nikola L. Spatafora (Lead Economist, EAPCE), Ekaterine T. Vashakmadze (Senior Country Economist, DECPG), Christopher Juan Costain (Lead Financial Sector Specialist), Amanda Robbins and David Nellor (Australia Indonesia Partnership for Economic Governance).

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For more World Bank analysis of Indonesia's economy:

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Acronyms

Askrindo	Asuransi Kredit Indonesia (Indonesia's credit insurance)
BI	Bank Indonesia
BOP	Balance of Payments
BPS	Badan Pusat Statistik (Central Bureau of Statistics)
BRI	Bank Rakyat Indonesia
CAR	Capital Adequacy Ratio
CEIC	Census and Economic Information Center
CGC	Credit Guarantee Companies
CMEA	Coordinating Ministry for Economic Affairs
CPI	Consumer Price Index
CPO	Crude Palm Oil
DAU	Dana Alokasi Umum (General Allocation Fund)
EMCI	Emerging Market Currency Index
EMDE	Emergency and Developing Economies
DGT	Directorate General of Tax
FDI	Foreign Direct Inflow
GDP	Gross Domestic Per capita
GGDC	Groningen Growth Development Center
GoI	Government of Indonesia
IEQ	Indonesia Economic Quarterly
IO	Input output
Jamkrindo	Jaminan Kredit Indonesia
JCI	Jakarta Composite Index
KBLI	Klasifikasi Baku Lapangan Usaha Indonesia
KUR	Kredit Usaha Rakyat (Credit for businesses program)
LFPR	Labor Force Participation Rate
LHS	Left hand side
LNG	Liquefied natural gas
MoF	Ministry of Finance
MSME	Micro, Small and Medium Sized Enterprises
NPL	Non-Performing Loan
OECD	Organization for Economic Cooperation and Development
OJK	Otoritas Jasa Keuangan (Financial Services Authority)
OPEC	Organization of the Petroleum Exporting Countries
PINA	Pembiayaan Investasi Non Anggaran
PMI	Purchasing Manager's Index
PMN	Penyertaan Modal Negara
PPP	Public Private Partnership
PT	Perusahaan Terbatas (Limited Co)
RHS	Right hand side
RPJM-N	Rencana Pembangunan Jangka Menengah Nasional (National Medium Term Development Plan)
SAKERNAS	Survey Angkatan Kerja Nasional
SBI	Sertifikat Bank Indonesia
SME	Small Medium Enterprises
SOE	State Owned Enterprises
SPV	Special Purpose Vehicles
STRI	Services Trade Restrictiveness Index
SUN	Surat Utang Negara (Conventional Government Securities)
Susenas	Survey Sosial Ekonomi Nasional
Taspen	Tabungan dan Asuransi Pensiun
TKI	Tenaga Kerja Indonesia (Indonesian Labor)
TOT	Term-of-Trade

VAT	Value Added Tax
VIX	Volatility Index
yoy	Year-on-year

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Executive summary: Staying the course

The fundamentals of the Indonesian economy continue to be strong

With a robust rate of economic growth, low current account deficit, a conservative fiscal deficit and inflation at a record low, the fundamentals of the Indonesian economy continue to be strong. Despite global policy uncertainty, economic growth strengthened in 2016 on the back of higher private consumption growth. The economic outlook remains positive, supported by a projected pick-up in the global economy and recovering commodity prices, carrying both investment and exports. Major shifts in trade policies among advanced economies, unexpected changes in U.S. monetary policy, political uncertainty in Europe, a protracted period of elevated domestic inflation, and weak fiscal revenues pose significant downside risks.

Quarterly GDP growth eased as government expenditure declined…

Real GDP growth in Q4 2016 eased to 4.9 percent yoy from 5.0 percent in Q3, as government expenditure continued contracting and import growth rebounded. The 4.0 percent decline in government expenditure was the largest since Q1 2010, due in part to base effects of strong expenditure growth in Q4 2015. Meanwhile investment growth rose and export growth turned positive after eight quarters of contraction, in line with stronger commodity prices.

…but annual GDP growth rose despite global uncertainty

After five years of adjusting to lower commodity prices, economic growth edged up to 5.0 percent in 2016 as a whole, from a revised 4.9 percent in 2015, despite heightened global policy uncertainty. A stable Rupiah, record low inflation, declining unemployment and soaring real wages lifted consumer confidence and private consumption. In contrast, falling government expenditure and weaker investment growth weighed on overall economic growth for the year.

Enhanced fiscal credibility will

While revenues from the tax amnesty program increased overall revenue collections, non-tax amnesty revenue collection weakened in 2016. Fiscal policy credibility was enhanced by cuts in government expenditure, along with the more achievable

support investor confidence

revenue targets in the 2017 Budget, which bolstered investor confidence. The Budget also features growth-enhancing improvements in the composition of spending, including sustained higher allocations for infrastructure, health and social assistance, and improved targeting for energy subsidies and social programs. The fiscal deficit was 2.5 percent of GDP in 2016, lower than expected and down from 2.6 percent in 2015.

The current account deficit narrowed to a five-year low

The external sector also strengthened with the current account deficit narrowing to a five-year low of 0.8 percent of GDP in Q4 2016, from 1.9 percent in Q3 2016, largely due to an improvement in manufacturing exports. For 2016 as a whole, the current account balance as a share of GDP narrowed to 1.8 percent from 2.0 percent in 2015, also a five-year low.

Robust economic growth and contained inflation helped reduce poverty in 2016

The official poverty rate fell by 0.4 percentage points between September 2015 and September 2016 to 10.7 percent. This suggests that the slight uptick in the pace of poverty reduction seen between March 2015 and March 2016 has continued, on the back of stronger GDP growth, contained inflation, and the lowest core unemployment rate since 2012. However, this decline is still lower than the rates of poverty reduction achieved between 2007 and 2011, which averaged 1.1 percentage points annually.

Growth is expected to pick up in the medium term, but will be significantly lower than growth rates seen after the 2008 global financial crisis

Table 1: GDP growth is projected to increase to 5.2 percent in 2017

		2016	2017f
Real GDP	(Annual percent change)	5.0	5.2
Consumer price index	(Annual percent change)	3.5	4.3
Current account balance	(Percent of GDP)	-1.8	-1.8
Budget balance	(Percent of GDP)	-2.5	-2.6

Source: BI; BPS; MoF; World Bank staff calculations
Note: 2016 actual outcome; f stands for forecast

With all expenditure components expected to firm up, real GDP growth is projected to rise to 5.2 percent in 2017, an d reach 5.3 percent in 2018. Household consumption growth is projected to gain as a stable Rupiah buoys consumer confidence, while higher real wages and continued low unemployment support consumer purchasing power. Private investment growth is also poised to increase as commodity prices recover, and the effects of monetary easing in 2016 and recent economic reforms gain traction. At the same time, higher commodity prices will also ease fiscal constraints and lift government spending, while stronger global growth carries exports. Both government spending and exports are therefore likely to rebound from their contractions in 2016. While GDP growth rates in the medium-term are projected to surpass those of recent years, they are significantly lower than those seen immediately following the 2008 financial crisis, as the economy rebounded from the global downturn. Staying the course on continued structural reforms is therefore necessary to further enhance the economy's potential growth.

Inflation is expected to be temporarily elevated in 2017

Consumer price inflation is expected to jump from 3.5 percent in 2016 to 4.3 percent in 2017, due to hikes in electricity tariffs and vehicle registration fees. However, inflation is projected to slow in 2018 as the effects of the price hikes dissipate.

The fiscal deficit is projected to widen on stronger public

The projected central government fiscal balance of 2.6 percent of GDP in 2017, is wider than the 2.4 percent deficit in the Government's approved 2017 Budget. Higher public expenditures, partly due to renewed efforts to boost public

infrastructure investment

infrastructure investment, are expected to be partially offset by revenue growth, in turn carried by stronger GDP growth and dividends from administrative and tax policy reforms.

Unexpected changes in U.S. monetary policy pose a downside risk…

Risks to the outlook are tilted to the downside. Surprise outcomes from the series of upcoming elections in Europe, could further add to heightened policy uncertainty in major advanced economies, amid a climate of increasing protectionist sentiments. In addition, the U.S. Federal Reserve is expected to proceed with monetary normalization and gradually raise the Fed Funds Rate in the coming years. Should the Fed hike interest rates more rapidly than expected, taper-tantrum like capital outflows from emerging markets could occur as investors rapidly reevaluate and rebalance portfolios to maximize expected gain. Volatility in financial and capital markets could weigh on growth of the Indonesian economy in the medium-term.

…as do an elevated period of higher-than-expected inflation and weak fiscal revenues

A protracted period of elevated inflation, due to recent hikes in administrative prices, poses a key downside risk to consumption growth. Apart from volatility of the exchange rate, consumers are generally sensitive to price increases, especially those of food, and household consumption constitutes the dominant portion of the Indonesian economy. Should inflation remain higher and longer than expected, consumer spending may be dampened, resulting in lower output growth. In addition, Bank Indonesia may be compelled to act by tightening monetary policy, which would also cool investment growth. At the same time, fiscal revenues continue to pose a downside risk, as lower revenue collection constrains fiscal spending and much needed infrastructure investment.

This edition also includes two focus topics. The first looks at how services trade in Indonesia can benefit from the removal of trade restrictions. The second presents a review of Indonesia's redesigned KUR program, along with policy insights and recommendations

Indonesia should re-evaluate restrictions to services trade so as to reduce costs, enhance competitiveness and improve productivity

The services sector appears to be one of the most promising engines of growth. It represents increasingly higher shares of the Indonesian economy and trade, although the proportions are still below those of many other middle-income economies. The importance of the services sector for economic growth is underscored by its strong forward linkages to the rest of the economy (i.e. any policies applied to the services sector would have implications to the other sectors in the economy). Indonesia is a net services importer as demand exceeds supply in most service sectors. Despite this, Indonesia has some of the most restrictive barriers to services trade. This restrictiveness is likely to have contributed to the relatively low productivity of the Indonesian services sector vis-à-vis comparator countries. It also penalizes manufacturing productivity, as services are key inputs for manufacturing production. Hence, it is important to re-evaluate restrictions to services trade, in light of their importance to the overall economy.

In view of the ten-fold increase in costs for the redesigned KUR program, there is a strong need to reconsider the use of subsidized loans to support MSMEs

Originally established by the Government of Indonesia in 2007, the *Kredit Usaha Rakyat* (KUR) program is one of the largest subsidized loan programs for micro, small and medium sized enterprises (MSMEs) in emerging markets. During a major redesign in 2015, the focus of KUR changed from facilitating access to loans for first time MSME borrowers through the provision of partial credit guarantees, to the provision of loans at subsidized interest rates to MSMEs regardless of their previous access to finance. This redesign has led to a ten-fold increase in the cost of the program to the Government, in terms of both direct and indirect subsidies. Unless significant benefits from the KUR program can be properly documented, there is a strong need to reconsider the use of subsidized loans to support MSMEs, in view of the costs. In particular, the Government should consider whether the additional benefits of the new KUR program justify the large increase in cost, or whether a focus on other tested and less expensive instruments—such as partial credit guarantees together with a strengthening of the financial infrastructure—could support the MSME sector at a much lower cost. Government spending on interest rate subsidies comes at the expense of spending on other priority interventions, given scarce fiscal resources.

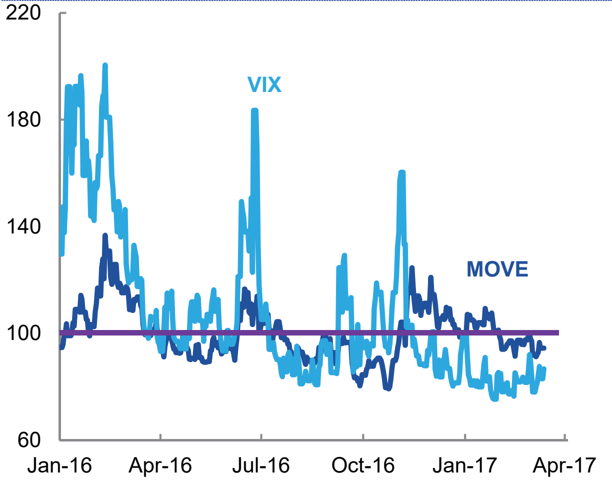
A. Economic and fiscal update

1. Global economy on a strong footing for 2017

The global economy made a calm entrance into 2017

After a turbulent year in 2016, the global economy made a relatively calm entrance into 2017. The outcomes of the UK referendum in June and the US presidential elections in November led to sudden bouts of financial volatility, but were largely localized to around the occurrence of those events (Figure 1).[1] Since then, despite continued policy uncertainty amid a climate of increasing protectionist sentiments, the global financial market has been surprisingly calm, and supportive of global economic activity.

Figure 1: Global financial market makes a relatively calm entrance into 2017
(index January=100)



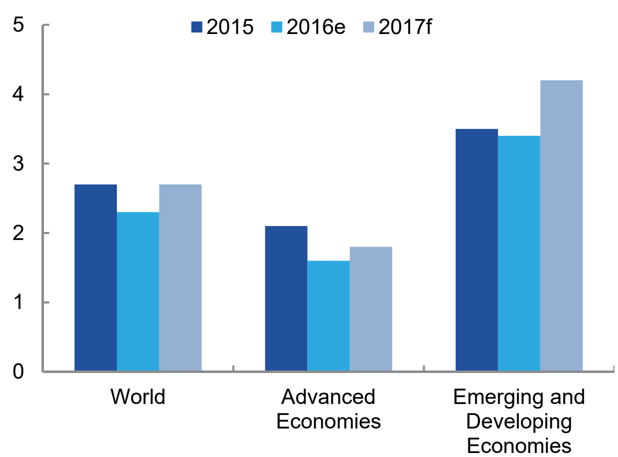
Source: Bloomberg; World Bank staff calculations

[1] The VIX index, which measures volatility in equity markets, jumped 49 percent after the U.K referendum before quickly settling to a pre-referendum level after only a week. The MOVE index, a gauge of bond market volatility, jumped around 10 percent over the week following the referendum, before also stabilizing at a lower, pre-referendum level. The movements in these indices were similarly sharp and transitory, following the results of the U.S elections in November. The VIX index jumped 32 percent during the week of the U.S. elections in November, before receding and stabilizing below its pre-election 2016 average level. The MOVE index also surged in November and then settled at an elevated level broadly in line with its pre UK referendum level.

Global economic growth is expected to pick up in 2017, led by EMDEs

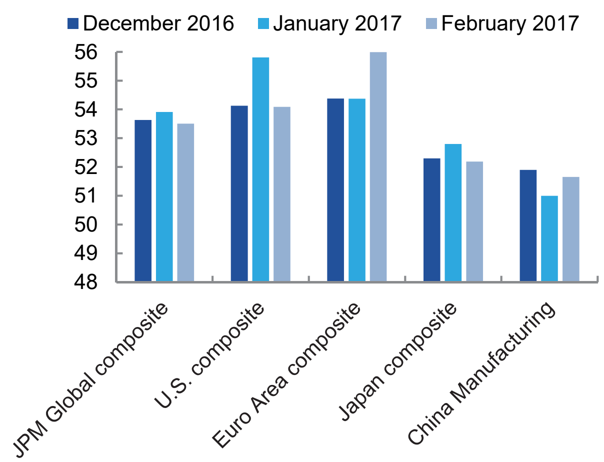
Global economic growth is expected to pick-up this year, with real GDP for the world expanding 2.7 percent, up from a post-crisis low of 2.3 percent in 2016 (Figure 2). As commodity prices continue to recover and domestic challenges recede in several large commodity exporters, emerging and developing economies (EMDEs) will lead the rebound in global growth, with output climbing 4.2 percent in 2017. Economic activity in advanced economies are also expected to grow faster this year reaching 1.8 percent, led by significantly stronger U.S. growth. January and February readings of Purchasing Manager's Index (PMIs) support the upbeat global growth forecast, with those for the world and the largest economies hovering around multi-year highs (Figure 3).

Figure 2: Global GDP growth is projected to pick up in 2017, despite overwhelming global policy uncertainty
(growth yoy, percent)



Source: World Bank 2017a
Note: 2016e is for estimate and 2017f is forecast

Figure 3: Purchasing Manager's Index (PMI): Largest economies begins 2017 on a strong footing
(index)



Source: Markit Economics, Haver Analytics
Note: Outcome above 50 represents an expansion and a outcome below represents a contraction

Commodity prices are projected to continue recovering, supporting commodity exporters

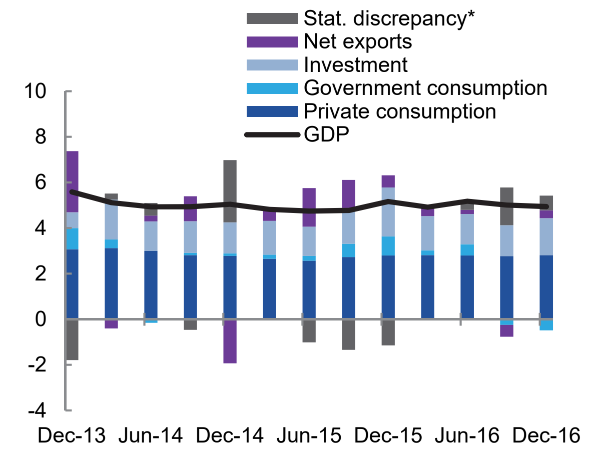
In line with gradual recoveries seen in 2016, commodity prices are projected to continue rising in 2017. Energy prices are forecast to surge 26 percent this year, while metal prices are on average predicted to jump 11 percent. Higher commodity prices provide a substantial tailwind to commodity exporters including Indonesia, lifting their fiscal revenues, improving terms-of-trade and having positive effects on trade and current account balances, and stimulating economic growth.

2. GDP growth strengthened in 2016

GDP growth eased in Q4 on the back of a contraction in Government consumption and rebound in imports

Real GDP growth eased slightly to 4.9 percent year-on-year (yoy) in Q4 from 5.0 percent in Q3, driven again mainly by a contraction in Government consumption and a rebound in imports (Figure 4). The contraction in fiscal expenditures, the largest since Q1 2010, broadly reflects the Government's prudent fiscal stance, but also compares to higher than average Government consumption in Q4 2015, which was driven by regional elections.

Figure 4: Real GDP Growth: Government spending continued to contract in Q4
(contributions to yoy growth, percentage points)



Source: CEIC and BPS Indonesia
Note: *Statistical discrepancy includes changes in inventories

Supported by low inflation and a relatively stable Rupiah, private consumption growth remained stable in Q4.

Investment growth picked up in Q4…

Meanwhile, investment growth strengthened in Q4 after easing or being flat for three consecutive quarters. To some extent the pickup reflected the usual pattern in Indonesia which typically sees investment picking up at the end of the year. However, there are signs that this uptick could be the beginning of a sustained upward trajectory in 2017. Lending rates for working capital and investment loans declined by around 100 basis points on the back of 150 basis points of monetary policy easing in 2016, credit growth reversed its downward trajectory late last year and commodity prices picked up in the second half of 2016. Moreover, investor confidence is likely to have been bolstered by enhanced fiscal credibility and the positive reform momentum for improving investment climate in Indonesia[2].

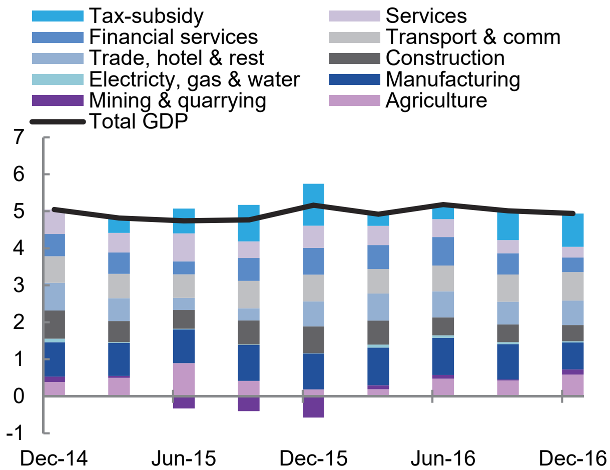
…and exports and imports grew for the first time in two years

Q4 saw a reversal in the negative growth of exports and imports for the first time in almost two years. The pickup in investment in Q4, alongside robust private consumption, supported import demand. After detracting from growth in Q3, net exports contributed positively in Q4 due to a strong expansion in exports, which was driven by rising commodity prices. As a leading indicator for manufacturing exports, the new export orders component of the Markit manufacturing PMI recorded an increase in February – providing tentative positive signs of a sustained turn around in export growth in 2017.

In terms of sectoral performance, agriculture and mining picked up in Q4, but they were the only bright spots as growth in most other sectors remained broadly stable or eased compared to Q3 (Figure 5).

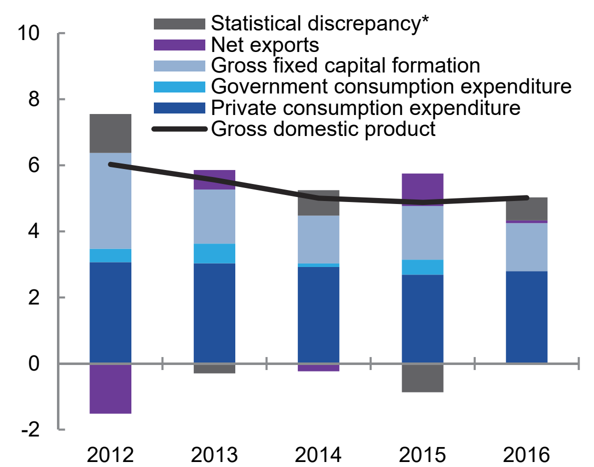
[2] Indonesia moved up in the 2017 Doing Business rankings from 106 in 2016 to 91 in 2017 – making Indonesia one of the top reformers both regionally and globally (World Bank, 2017d)

Figure 5: As a share of GDP, the agriculture sector expanded in Q4
(contributions to GDP growth yoy, percentage points)



Source: CEIC and BPS Indonesia

Figure 6: GDP growth outpaced previous year's growth for the first time in five years
(contributions to GDP growth yoy, percentage points)



Source: CEIC and BPS Indonesia
Note: *Statistical discrepancy includes changes in inventories

Annual GDP growth outpaced the previous year's growth rate for the first time in five years

Despite increased global policy uncertainty, annual real GDP growth in 2016 came in at 5.0 percent, compared to a marginally upward revised 2015 growth outcome of 4.9 percent (Figure 6). This is the first time in five years that annual GDP growth has outpaced the previous year's outcome and it could be a sign that Indonesia's growth cycle has finally bottomed out. In 2016, real GDP growth was led by private consumption, which rose on the back of a stable Rupiah, low inflation and lower unemployment[3]. In contrast, falling Government expenditure and weaker investment growth weighed on overall economic growth for the year.

3. Increases in administered prices have been the main driver of higher inflation in 2017

Headline CPI inflation picked up at the beginning of 2017, mainly due to electricity tariff hikes

After easing to the second lowest reading since 2009 in December, annual consumer price inflation has been rising during the first two months of 2017, picking up to 3.5 percent in January and 3.8 percent in February. This is mainly due to hikes in electricity tariffs and vehicles registration fees, which led administered prices (set by the Government) to rise by 3.4 percent yoy in January and 4.7 percent in February, from 0.2 percent in December 2016 (Figure 7). Following Government reforms to reduce electricity subsidies, 18.7 million customers in the 900VA electricity category, will experience a gradual electricity tariff hike every two months starting in January to May this year. By July 2017, those 18.7 million customers, who represent 29 percent of total electricity customers, will be paying the standard auto-adjusted tariff scheme[4].

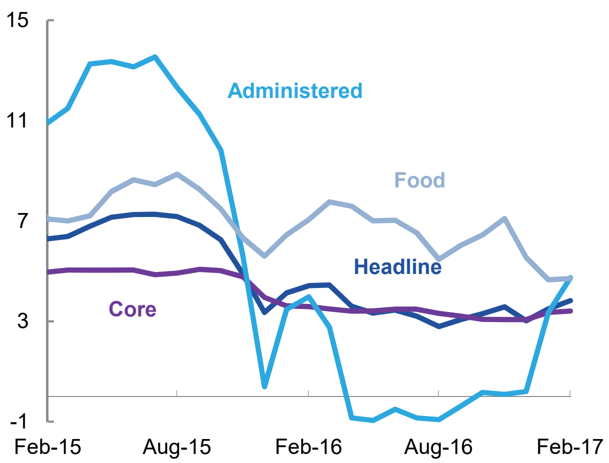
Core inflation, which excludes more volatile prices such as food and fuel, has also been rising, edging up to 3.4 percent in January and February from 3.1 percent in December. Meanwhile, food inflation continued to ease from 5.7 percent in

[3] See Badan Kebijakan Fiskal (2017).

[4] As stated in Ministerial decree for energy and natural resources no 28/2016, electricity tariffs will be adjusted every month according to changes in the Rupiah against the USD, oil prices, and monthly inflation.

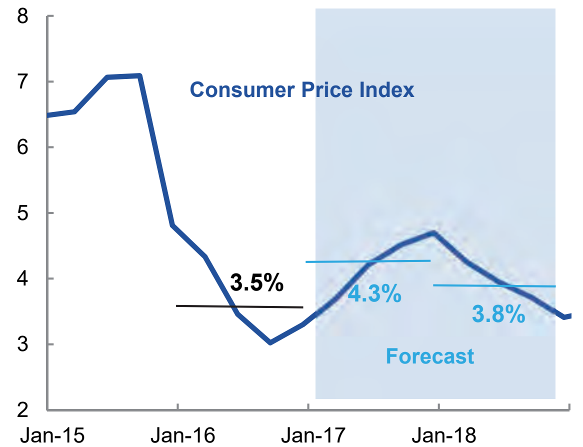
December to 4.4 percent in February, mainly due to lower unprocessed food inflation, which includes rice prices that have been relatively stable in light of good harvests on favorable weather conditions in 2016.

Figure 7: CPI inflation picked up in early 2017, mainly driven by the electricity tariff hike
(growth yoy, percent)



Source: BPS; World Bank staff calculations

Figure 8: Increases in administered prices will likely lead to higher inflation in 2017, but tapering down in 2018
(growth yoy, percent)



Source: BPS; World Bank staff calculations

Headline inflation is projected to temporarily rise in 2017, but will taper down in 2018

Inflationary effects from the final electricity tariff hike in May and Muslim festivities in June are expected to peak in Q4 2017. Rising global oil prices are also expected to contribute to higher production and transportation costs. However, these inflationary effects will be partially offset by further reductions in food inflation, resulting from an expected peak rice harvest in the first half of 2017. The World Bank expects the annual average CPI inflation rate to increase 4.3 percent in 2017, before moderating to 3.8 percent in 2018, and remaining within Bank Indonesia's 3 to 5 percent inflation target band (Figure 8).

There are upside and downside risks to the inflation forecast. Actual inflation rates may be higher should the Government decide to increase retail gasoline prices closer to global prices. In contrast, if the Government postpones the implementation of electricity tariff hike scheduled for May, actual inflation rates are likely to be lower.

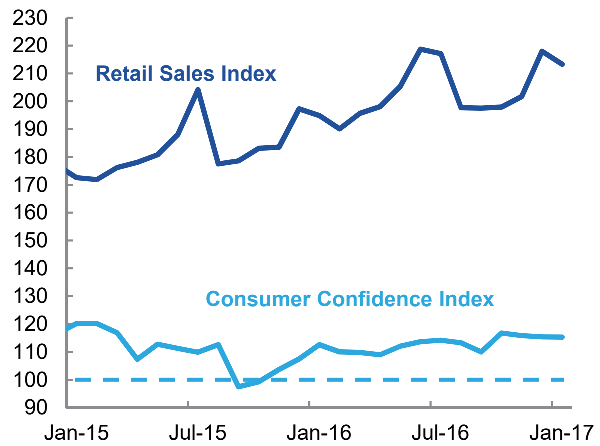
High-frequency data for consumption stay robust despite inflationary pressures…

Monthly leading indicators for consumption and investment signaled continued stability in economic sentiment. Despite expectations of modest inflationary pressures this year, consumer confidence in January was strong, with the index only marginally lower than the Q4 2016 average of 116, which was the highest in seven quarters (Figure 9). Likewise, the retail sales index rose 9.4 percent in January, broadly unchanged from the average monthly growth of 9.5 percent for Q4 2016.

…while indicators for investment and consumer durables showed signs of recovery

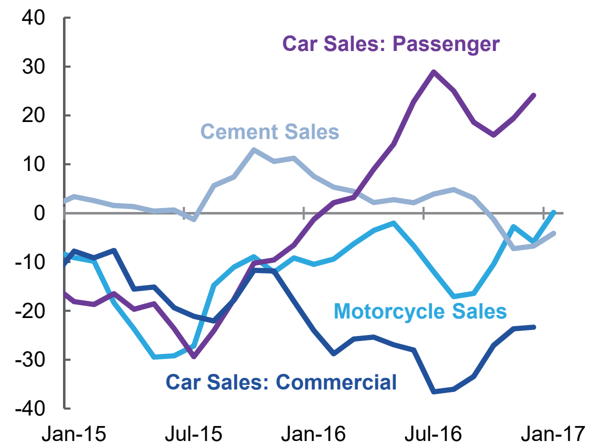
Meanwhile, indicators for investment and consumer durables picked up and signaled a recovery. Vehicle sales across all categories reversed their declining trends and rebounded in Q4 2016, and is expected to persist into 2017[5] (Figure 10). Capacity utilization rose to a six-quarter high of 76.3 percent in Q4 2016, while the Nikkei/Markit manufacturing PMI improved to a four-month high in January, before easing to 49.3 in February.

Figure 9: Leading indicators for consumption remain stable…
(index)



Source: BI

Figure 10: …while indicators for investment and consumer durables are showing a rebound
(3 month moving average growth yoy, percent)



Source: ASI; GAI; World Bank staff calculations

4. Commodity prices and the external sector

Prices for Indonesia's key export commodities continued to improve in Q1 2017

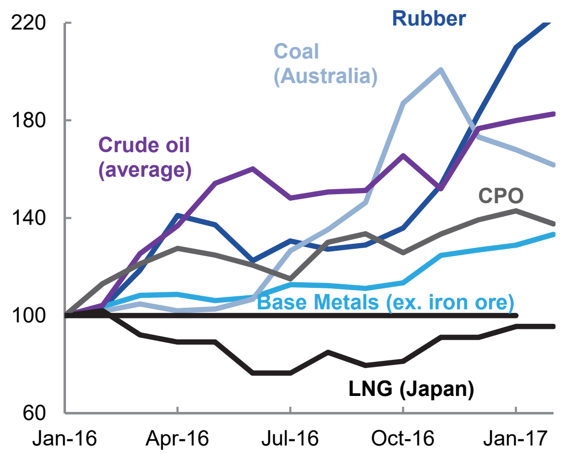
Commodities comprise a significant share of exports in Indonesia – amounting to around 30 percent of total exports in 2016. Prices for Indonesia's key export commodities, which include oil and gas, Crude Palm Oil (CPO), rubber and base metals, continued to improve in Q1 2017 (Figure 11). Apart from crude oil and LNG, the prices of key commodities already exceed World Bank projected prices for this year (Figure 12).

OPEC and China's policy will dictate oil, gas and coal prices' development

The decision of OPEC and other oil producing countries to limit production after a long period of unrestrained output, provides support for the prices of oil and gas. The World Bank projects an average oil price of USD 55 for 2017[6]. After surging for most of 2016 on China's policy limiting coal mine operation to 276 days annually, global coal prices began to ease after the Chinese Government relaxed regulations, allowing for higher coal production, especially in the provinces with coal shortages.[7]

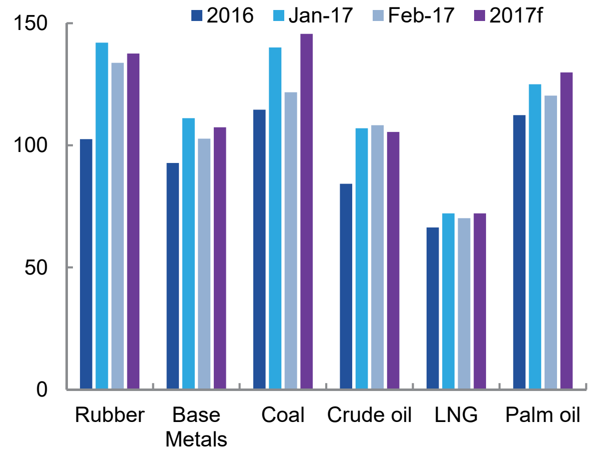
[5] Indonesia 2017 car sales seen to increase by 3-4 percent according to top car distributor Astra (Reuters, Feb 24, 2017)
[6] Market analysts expect that prices at $50-$60/bbl will be sufficient to increase shale oil production, given cost reductions and productivity improvements in the U.S. shale oil industry. This limits the upside risk for oil prices in the near term (see World Bank 2017b).
[7] Macquarie Research (January 2017)

Figure 11: Global prices for Indonesia's six key export commodities mostly rose in 2016
(index January 2016 = 100)



Source: World Bank Pink Sheet; CEIC; World Bank staff calculations

Figure 12: Aside from crude oil and LNG, global prices for Indonesia's major export commodities already exceed World Bank forecasts
(index 2015=100)

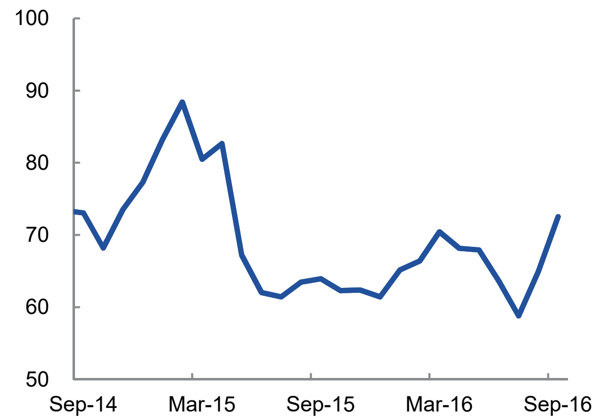


Source: World Bank (2017); World Bank staff calculations
Note: f stands for forecast

Rubber and CPO prices improved on the back of tight supply and robust demand

Rubber prices maintained their rising trajectories, driven by the recovery in the crude oil market[8], supply concerns triggered by floods in South Thailand and peninsular Malaysia[9], and a renewed expectation of a faster US-led global economic recovery and the resultant improved outlook for rubber demand. Accordingly, fundamentals are in line to support rubber prices, at least in the short term. On CPO, prices strengthened strongly in Q4 2016, caused by lower palm oil inventory in Malaysia (the lowest for December since 2010) due to weak production and robust export demand[10], as well as Indonesia's commitment to its biodiesel plan[11]. Moving into 2017, the CPO's supply and demand balance will remain

Figure 13: The net trade-weighted price index indicates a positive commodities terms-of-trade shock for Indonesia since July 2016
(index 2011=100)



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, gas, and palm oil)

[8] Synthetic rubber, a substitute of natural rubber, is an artificial elastomer made from petrochemical feedstocks. The price of rubber therefore follows the price of oil and its feedstocks.
[9] See Reuters (January 9, 2017).
[10] Malaysia Crude Palm Oil Council: http://www.mpoc.org.my
[11] Since early 2016, the Indonesian government launched the B20 biodiesel program. It stipulates a mandatory 20 percent of fatty acid methyl ester (derived from palm oil) to be blended with 80 percent of diesel.

tight, as lower starting inventory and robust demand growth should more than offset a recovery in production.

Indonesia's terms-of-trade rose

Taking into account the relative import and export quantities of these six major commodities, Indonesia has been experiencing a positive terms-of-trade (ToT) shock since July 2016, as a result of the higher global prices of these commodities (Figure 13).[12]

The annual current account deficit fell to its lowest level in five years

On the external sector, the annual current account deficit shrank to 1.8 percent of GDP in 2016—the smallest deficit since 2011 (Figure 14). This was driven by an improvement in both the goods and the services trade balances. The goods trade balance improved because import values fell by more than export values, particularly in the oil sectors where Indonesia is a net importer and prices fell sharply in 2016[13]. In contrast, the services trade balance improved because export values increased by more than import values. The largest contributors to this improvement were a USD 1 billion increase in tourism exports and a USD 550 million decrease in freight transport imports (which tend to move in line with goods exports).[14]

The financial account surplus expanded in 2016 as Indonesians reduced their holdings of foreign assets (resulting in net inflows). For example, Indonesians reduced their purchases of and sold existing FDI and foreign portfolio investments. Indonesians also moved funds from abroad into Indonesian currency and deposits. On the other hand, FDI and portfolio investment by foreign residents in Indonesia was slightly lower than in 2015 (but still resulted in net inflows). This was in line with modest foreign investment in other emerging markets.[15] Overall, the balance of payments (BOP) recorded a large surplus of 1.4 percent of GDP in 2016, from a deficit of 0.1 percent in 2015.

The BOP remained in surplus in Q4 2016, while the current account deficit narrowed to 0.8 percent of GDP in Q4, the lowest in more than five years

On a quarterly basis, the BOP remained in surplus, driven by large inflows into private currency and deposit assets (a component of other investment), and a sharp reduction in the current account deficit to 0.8 percent of GDP, its lowest level since 2011 (Figure 15).

The fall in the current account deficit was driven by a significant improvement in the trade balance, as export values increased by more than import values. In yoy terms, growth in export values was positive for the first time since 2013 (Figure 16). While higher commodity prices helped boost export growth, growth in manufacturing exports was also strong (13.2 percent yoy), potentially indicating a more enduring turn-around in export values. The value of coal and palm oil exports were particularly strong commodity contributors, supported by an 86 percent increase in the price of coal and a 20 percent increase in the price of palm oil over the year. Growth in goods imports was also positive for the first time since 2013.

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

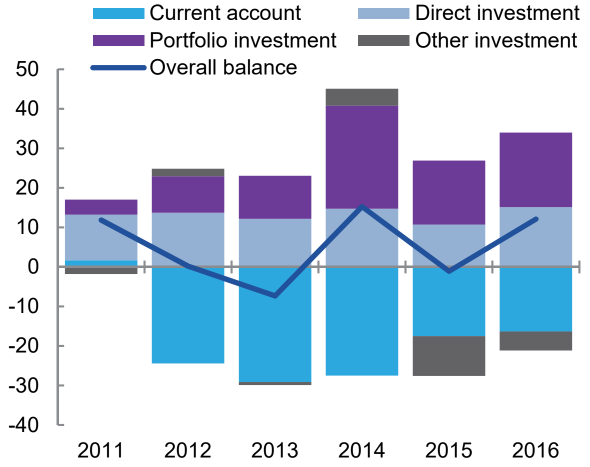
[13] Prices for crude oil and LNG fell by 15.6 and 32.9 percent respectively in 2016 relative to 2015. In contrast, prices for Indonesia's other major export commodities (like coal and palm oil) increased over the same period.

[14] For a detailed discussion of services trade, see Part B.1.

[15] See IIF (2017).

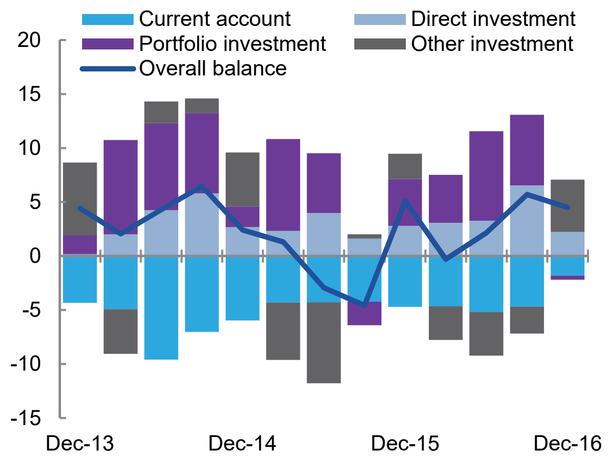
All major categories of imports contributed to this growth, except capital imports which were only marginally lower over the year. Raw material imports made the largest contribution (Figure 17). Both service exports and imports also increased over the year, with export growth outpacing import growth.

Figure 14: The BOP recorded a surplus in 2016, driven by strong capital inflows and the current account deficit falling to a 5-year low
(USD billion)



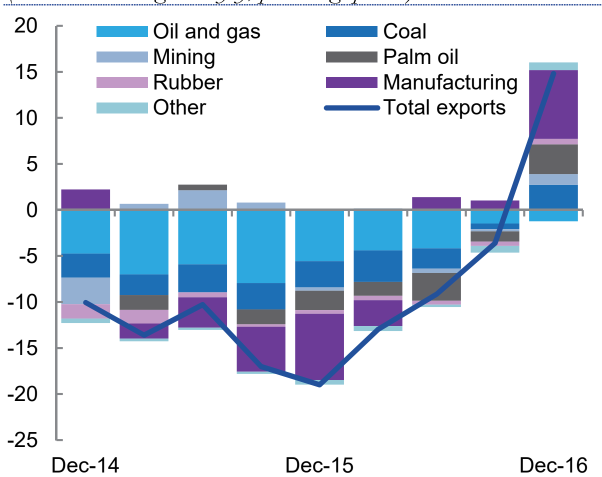
Source: BI; World Bank staff calculations

Figure 15: The BOP remained in surplus in Q4 driven by a sharp fall in the current account deficit
(USD billion)



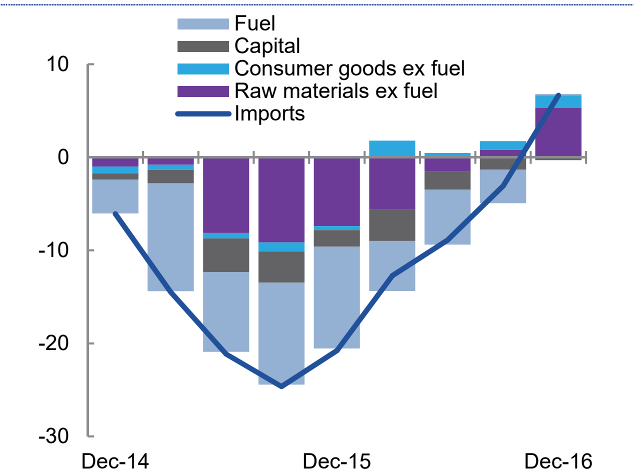
Source: BI; World Bank staff calculations

Figure 16: The value of goods exports increased for the first time since 2011…
(contributions to growth yoy, percentage points)



Source: BI; World Bank staff calculations

Figure 17: …as did the value of goods imports
(contributions to growth yoy, percentage points)



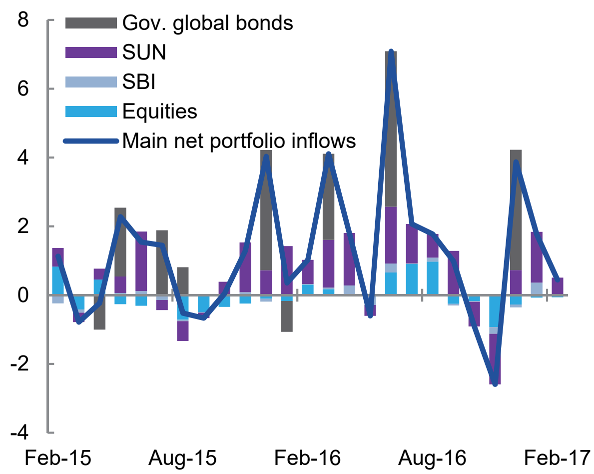
Source: BI; World Bank staff calculations

Weak FDI and negative portfolio investment drove a narrowing of the financial account surplus in Q4

The capital and financial account surplus narrowed in Q4 due to weak FDI and negative portfolio investment. FDI inflows and outflows were dominated by the unravelling of "round-tripped" FDI in the banking sector,[16] potentially due to a change in tax incentives following the tax amnesty program[17]. Overall, net FDI was soft in Q4.

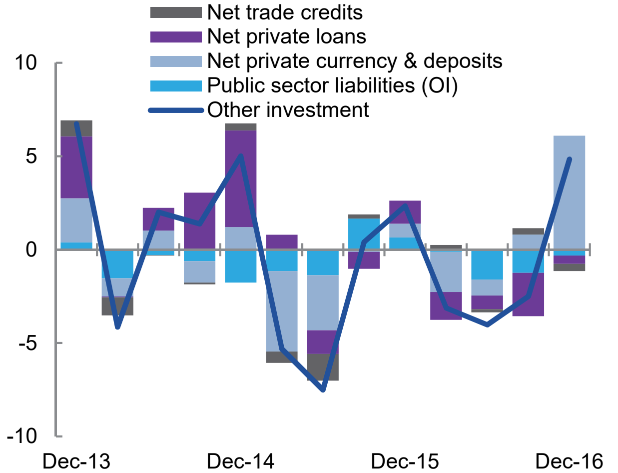
Portfolio investment was negative in Q4, which has only occurred two other times in the past five years.[18] This was driven by a sell-off of Indonesian bonds and equities following the US election in November (Figure 18). Other investment was large and positive in Q4, keeping with its seasonal pattern. On top of this seasonal pattern, there were especially large inflows into private currency and deposit assets (the largest inflows since at least 2004) (Figure 19), which reflect the repatriation of assets as part of the tax amnesty.[19]

Figure 18: International investors sold Indonesian equities and bonds in November 2016
(USD billion)



Source: BI; World Bank staff calculations
Note: SUN: Surat Utang Negara (Conventional Government Securities), SBI: Sertifikat Bank Indonesia

Figure 19: Inflows into private currency and deposit assets were particularly high in Q4
(USD billion)



Source: BI; World Bank staff calculations

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16 Bank Indonesia (2017)
17 FDI round-tripping is the channeling of local funds to special purpose vehicles (SPVs) abroad (typically set up in offshore financial centers or tax haven economies) and the subsequent return of the funds to the local economy in the form of FDI. When this investment is unwound it generates two equal and offsetting transactions in the balance of payments. First, it registers as a reduction in FDI in Indonesia (outflow) as funds are returned to the SPV. Second, it registers as a reduction in FDI abroad (inflow) as funds are returned to Indonesia from the SPV. As such, the net impact on FDI is zero.
18 These previous instances occurred during periods of global financial volatility. The first, in Q3 2011, was related to the Eurozone debt crisis, and the second, in Q3 2015, was related to uncertainty around US monetary policy.
19 Bank Indonesia (2016)

The current account deficit is expected to remain constant at 1.8 percent of GDP in 2017

Looking forward, the current account deficit is expected to remain stable in 2017 at 1.8 percent of GDP (Table 2). Both export and import values are expected to pick up in 2017, with exports marginally outpacing imports, resulting in an improvement in the trade balance. Commodity prices continued to rise through Q1 2017, and this positive commodity terms-of-trade shock is expected to last through the rest of the year, supporting the trade balance. Leading indicators suggest that growth may pick up slightly in some of Indonesia's major trading partners and further carry exports growth. However, there are a number of risks to this outlook, one of which is the ongoing economic deceleration in China (Indonesia's largest trading partner). For imports, raw material and capital imports in particular are projected to strengthen, in line with an expected pick up in investment. FDI is expected to pick up in 2017 in line with stronger global growth and growth in Indonesia. Risks to capital inflows remain, given the continuation of heightened global policy uncertainty, particularly regarding the pace of interest rate normalization in the United States (see Box 1 for further discussion on Indonesia's exposure to the United States).

Table 2: The current account deficit is expected to remain constant in 2017

(USD billion unless otherwise indicated)

	2016	2017f
Overall Balance of Payments	12.9	14.1
As percent of GDP	*1.4*	*1.3*
Current Account	-16.3	-18.4
As percent of GDP	*-1.8*	*-1.8*
Goods trade balance	15.4	17.7
Services trade balance	-6.5	-7.4
Income	-29.7	-33.3
Transfers	4.4	4.6
Capital and Financial Accounts	29.2	32.4
As percent of GDP	*3.1*	*3.1*
Direct Investment	15.1	18.4
Portfolio Investment	18.9	16.4
Other Investment	-4.8	-2.4

Source: BI; World Bank staff calculations

Box 1: Indonesia's exposure to the United States and United Kingdom economies

In the current era of global policy uncertainty amid a backdrop of heightened protectionist sentiment, this box briefly examines Indonesia's exposure to the United States and United Kingdom via various channels.

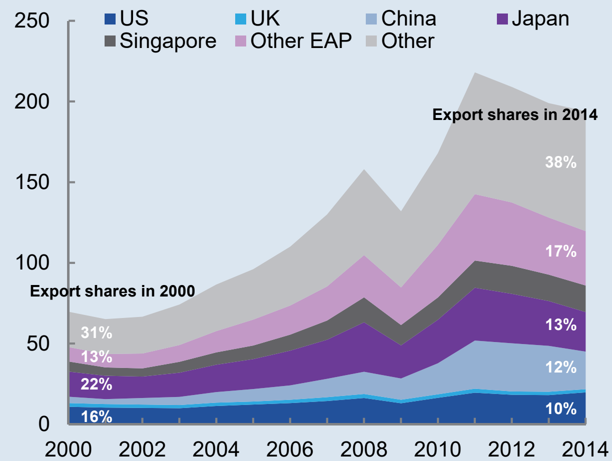
The United States is the world's largest economy, accounting for approximately one quarter of world GDP and about one tenth of global trade.[1] It is also a dominant player in global financial markets. The United Kingdom, while not as large as the United States, is still the fifth largest economy in the world and accounts for 3.5 percent of total trade.[2] Furthermore, London is the world largest financial center, intermediary to a large amount of global financial flows.[3] Given the size of these economies and their ties with the global economy, economic shocks to or emanating from the United States or United Kingdom can have implications not only for their closest economic partners, but also for the global economy. Such shocks are transmitted through a variety of channels, including trade, investment, and finance. Overall, Indonesia's exports to the United States, investment inflows from the United Kingdom, and both countries' influence over global financial markets, present the strongest channels through which policies in the United States and the United Kingdom can affect the Indonesian economy.

Trade linkages

The United States is Indonesia's third largest export destination, accounting for 10.4 percent of total goods exports over 2013-2015, but this share has been declining over time, from 15.5 percent in 2000 (although exports to the United States are still growing in level terms) (Figure 20). The United Kingdom is a significantly smaller export destination, accounting for only 1.0 percent of Indonesia's goods exports in 2013-2015, making it Indonesia's 18th largest export destination. Similarly, exports to the United Kingdom have declined are a share of total exports, from 2.7 percent in 2000. Indonesia's largest export destinations are China (13.2 percent of total exports) and Japan (13.0 percent) (Figure 21)[4]. While primary commodities such as fuel, minerals and metals constitute the lion's share of Indonesian exports to China and Japan, manufactured products are the dominant portion of exports to the United States, as well as to the

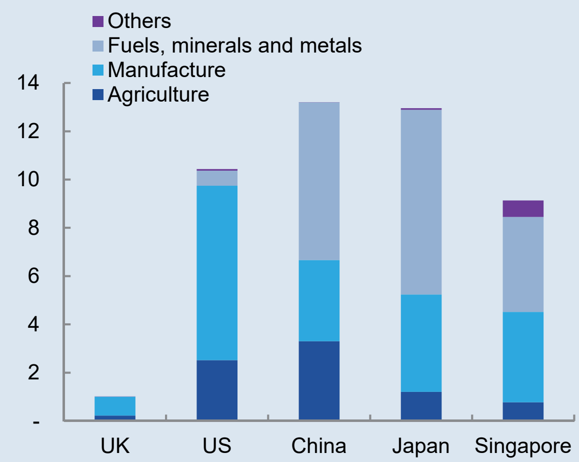
United Kingdom. As such, interruptions in trade flows with either the United States or the United Kingdom could have a disproportionate effect on Indonesian's manufacturing sector.[5]

Figure 20: Indonesia's exports to the United States and United Kingdom are declining as a share of total exports
(exports by destination, USD billions)



Source: UN Comtrade
Note: EAP stands for East Asia and the Pacific

Figure 21: The United States is Indonesia's third largest export destination
(share of total exports, percent)



Source: UN Comtrade
Note: Values are averages for 2013-2015

While not the largest destination for Indonesian exports, the United States is a very significant export destination for Indonesia's largest trading partners, China and Japan, as well as other economies in the region like Vietnam, accounting for more than 20 percent of their exports over 2013-2015. Therefore, trade disruptions between the United States and the East Asia and Pacific (EAP) region could have negative secondary effects on Indonesia via declining demand in China and Japan. Indeed, World Bank (2016a) finds that a one-off, one-percentage point decline in China's economic growth could reduce Indonesia's economic growth by 0.4 percentage point after two years.

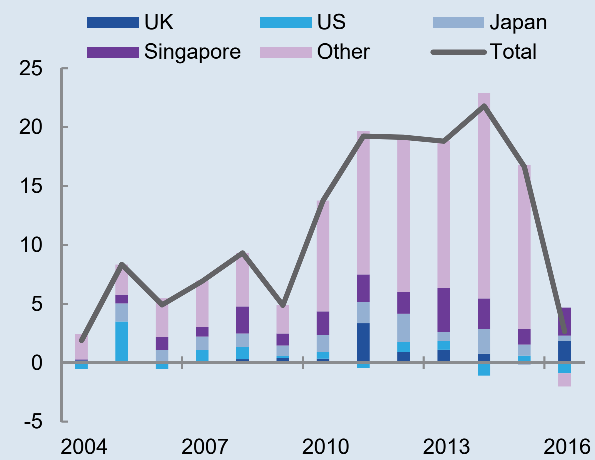
In terms of services exports, Indonesia's exports of services to the United States and the United Kingdom are currently small, relative to that of goods exports[6]. However, globally, services trade has been relatively more stable than goods trade, which has seen a significant slowdown.[7] Section B1 of this report therefore examines the channels via which Indonesia's services trade can be enhanced.

The United States, and to a lesser extent the United Kingdom, are important players in the global community market. The United States alone is the world's largest consumer of natural gas and oil, accounting for more than one-fifth of global consumption. It is also a significant consumer of other commodities exported by Indonesia including coal and copper. Large shifts in US demand for these commodities are likely to impact global prices, which would affect Indonesia's terms-of-trade, and consequently trade and current account balances. Variations in global commodity prices will also impact fiscal revenues, fiscal spending, investment expenditure, and hence economic growth.

Investment linkages

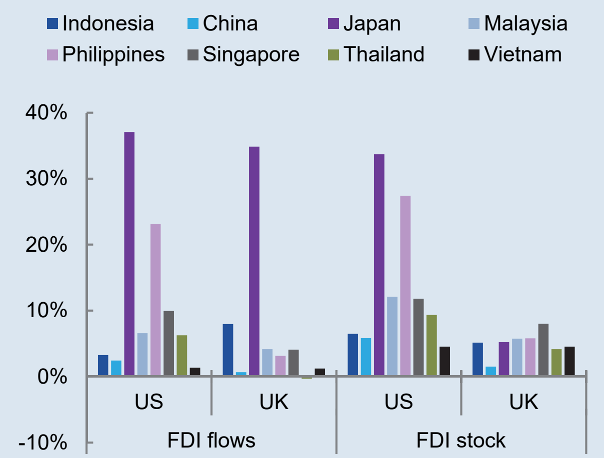
Foreign direct investment (FDI) is a major source of investment in Indonesia. Data from Indonesia's Investment Coordinating Board shows that foreign investment accounted for 68 percent of total investment realization over the last five years. While the United States is the world's largest source and recipient of FDI, it is not a major source for Indonesia (Figure 22). Over 2004-2016 (the time period for which data is available), net FDI flows from the United States accounted for 3.3 percent of the cumulative total. An investment of USD 3.0 billion in the manufacturing sector in 2005 accounted for the vast majority of these flows. The United Kingdom is a slightly larger source of FDI for Indonesia, accounting for 6.1 percent of net FDI flows over the same period, making it the third largest source after Singapore (15.0 percent) and Japan (10.5 percent).

Figure 22: The United Kingdom is an important source of FDI in Indonesia
(USD billions)



Source: BI

Figure 23: Indonesia is less dependent on FDI from the United States and United Kingdom compared to other countries in the region
(share of total FDI flows and total FDI stock, percent)



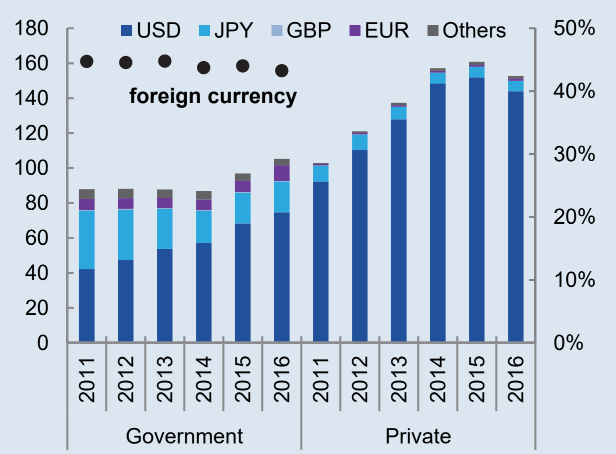
Source: UNCTAD
Note: Data is averaged over the latest 5 year period available for all countries (2008-2012), except for FDI flows into Vietnam which are for 2011-2012 only.

The stock of FDI is equal to the total accumulated value net FDI flows over time. It shows the total value of foreign-owned direct investment assets. Indonesia is not particularly exposed to the United States or United Kingdom in terms of its stock of FDI. Around only 6 percent of its FDI stock comes from the United States and only 5 percent from the United Kingdom. This is relatively low compared to other countries in the region, particularly Japan and the Philippines (Figure 23), which receive a much larger share of their FDI from the United States.

Financial linkages
Developments in the United States can impact global financial markets, and in turn Indonesia's financing conditions, through a number of channels including exchange rates, interest rates, and investor confidence. Developments in the United Kingdom tend to have similar but more muted impacts.

Exchange rates
The US dollar is the most widely used currency in international trade and financial markets and is the world's de-facto reserve currency. As such, US dollar exchange rate movements have global implications. For example, an appreciation of the US dollar against the Rupiah would increase Indonesia's debt servicing costs of the US dollar denominated debt, which has grown in recent years (Figure 24). The majority of both public (70 percent) and private (94 percent) foreign debt is denominated in US dollars; the private sector being especially exposed. Further, a much higher proportion of private foreign debt is short-term (29 percent) than public foreign debt (5 percent).

Figure 24: The majority of Indonesia's foreign debt is denominated in USD
(USD billion, LHS; percent of total debt, RHS)

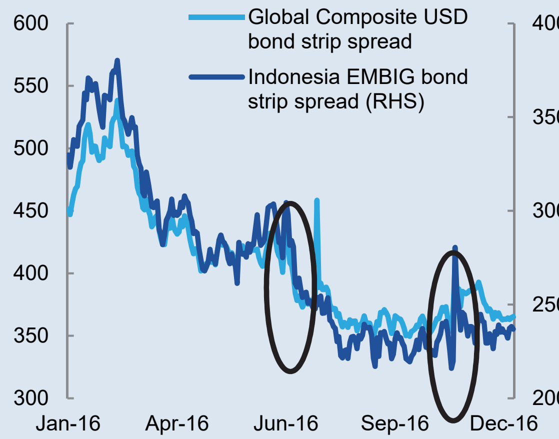


Source: CEIC; World Bank staff calculations

Interest rates
Actual or expected changes in US monetary policy impact global interest rates. For example, since the global financial crisis, highly accommodative monetary policies in advanced countries—including the United States and United Kingdom —made the higher interest rates for emerging market and developing economy (EMDE) debt relatively more attractive, resulting in an uptick in capital inflows for such countries, including Indonesia. In turn, higher US interest

rates could reduce or reverse such flows and push up global interest rates, raising the cost of Indonesia's borrowing costs. Recent analysis shows that a 100 basis point increase in long-term US bond yields could reduce capital flows to EMDEs by 20-45 percent, with the upper bound of this range reflecting simultaneous interest rate increases by other major central banks and the lower bound reflecting unchanged monetary policy elsewhere.[8]

Figure 25: Bond spreads rose in Indonesia immediately following the UK referendum and the US election, but quickly recovered
(bonds strip spread, basis points)



Source: JP Morgan; World Bank staff calculations

Figure 26: Equity prices also fell, before recovering most of their losses
(stock prices, index, 4 January = 100)

Source: Bloomberg; CEIC; World Bank staff calculations

Investor confidence

Independent of economic or financial market developments, increased financial market volatility or uncertainty about changes in US or UK policies can reduce incentives to invest—both domestically and abroad. This in turn could adversely affect long-term global growth prospects. Recent analysis estimates the impact of financial volatility and policy uncertainty on output and growth in EMDEs. Financial market volatility was measured by the VIX index—the implied volatility of the US stock market. A 10 percent increase in the VIX index was shown to reduce average EMDE output growth by about 0.2 percentage point and EMDE investment growth by about 0.6 percentage point after one year. Policy uncertainty was measured by the Economic Policy Uncertainty Index (EPU), a news-based measure of policy uncertainty. A sustained 10 percent increase in the US EPU index was shown to reduce EMDE output growth by 0.2 percentage point, and EMDE investment growth by 0.6 percentage point after one year.[9] Such impacts were realized to a limited extent following the UK referendum and the recent US presidential election. Investors withdrew from emerging markets assets, including in Indonesia (Figure 25 and Figure 26). However, in Indonesia, much of these declines were reversed in subsequent weeks and markets remained resilient.

[1] Data is for 2015
[2] ibid
[3] See Long Finance (2016).
[4] See World Bank (2015b) for an analysis of the importance of Indonesia's trade and investment links with China.
[5] Changes to economic growth in the United States or the United Kingdom can influence growth in its trading partners either directly, through changes in import demand, or indirectly, through the productivity spillovers embedded in trade, or through any impact on the price of traded goods.
[6] Bilateral services trade data is difficult to collect due to the intangible nature of services but also the high capacity needed to record such data. Available data suggests that Indonesia's service exports are small compared to goods exports, and that of these service exports, the US and UK are not major destinations. See World Bank trade in services database: http://data.worldbank.org/data-catalog/trade-in-services
[7] See Constatntinescu, C., A. Mattoo, and M. Ruta, (2016)
[8] World Bank (2016a)
[9] ibid

5. Robust domestic macro financial conditions

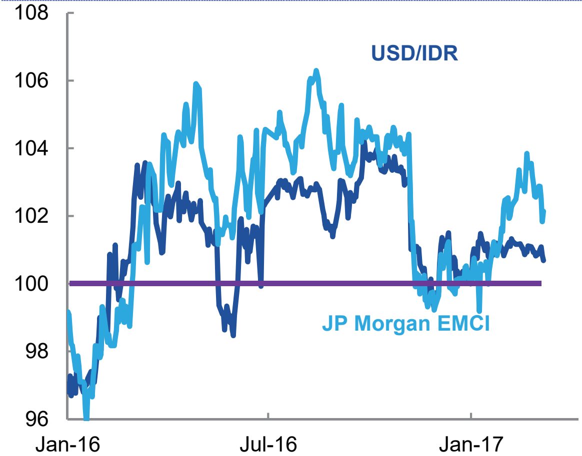
After going from strength to strength in 2016, domestic financial conditions were stable in Q1

Domestic macro financial conditions remained stable during Q1 2017. Relative to the significant gains made in 2016, the Jakarta Composite Index (JCI) made a steady start to the year, while bond yields trended downwards. This suggests that Indonesia remains an attractive investment destination. Monetary policy remains accommodative after six policy rate cuts in 2016, although Bank Indonesia (BI) indicates that room for further easing may have narrowed. The banking sector continues to be well capitalized, despite an increase in non-performing loans observed last year.

The Rupiah made a steady start to the year…

The Rupiah demonstrated resilience throughout 2016, in part due to BI intervention in currency markets particularly around the US presidential elections when there were signs of increased volatility. Since the beginning of 2017, the Rupiah has appreciated 0.8 percent, while other emerging market currencies have appreciated around 2 percent on average (Figure 27). While it is possible that the Rupiah could experience some pressure this year given the likelihood of continued US monetary normalization[20], it is widely expected that such pressures will be minimal as investors have already priced in changes in the US Federal funds rate.

Figure 27: Rupiah made a steady start to 2017
(index, January 3 2017 = 100)



Source: CEIC; Bloomberg
Note: Staff calculations

…as did the Jakarta Composite Index

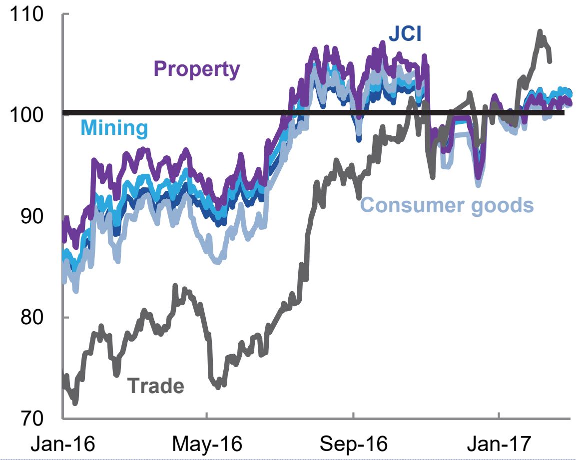
The JCI has made a steady start to 2017, but has been outperformed by regional peers. The strong performance in 2016 was largely due to a reversal of the losses incurred in 2015. The recovery remained robust through the course of 2016, despite significant global financial disruptions. The mining sub-index led the strong performance in 2016, and was stable in Q1 2017. Rising commodity prices are expected to continue to support the mining sector again this year. Growth in the trade sector sub-index has also been robust, with a- year-to-date increase of almost 5 percent.

Bond yield movements indicated renewed investor confidence in Indonesia

Bond yields stabilized following the losses incurred in the aftermath of the US presidential elections. Yields across all tenors tracked downwards to be, on average, 40 basis points lower than at the start of 2017. January bond auctions were oversubscribed[21], once again reflecting the strong investor confidence in the Indonesian economy.

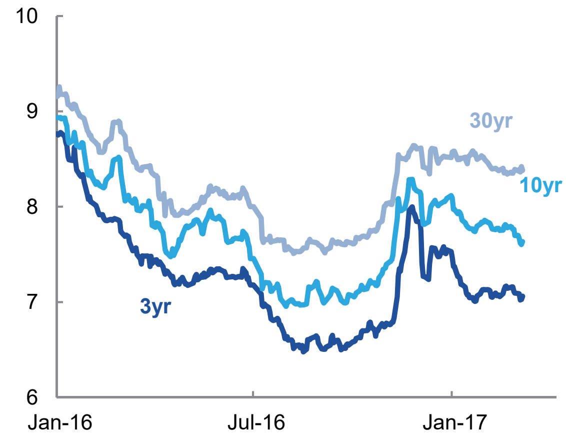
[20] The US Federal Reserve raised interest rates on March 15, 2017 – the first of the three increases that are widely expected in 2017.
[21] See DJPPR (2017a).

Figure 28: JCI made a steady start to 2017
(index January 2017 = 100)



Source: CEIC
Note: Staff calculations

Figure 29: Bond yields declined in 2017 reflecting investor confidence in Indonesia
(percent)

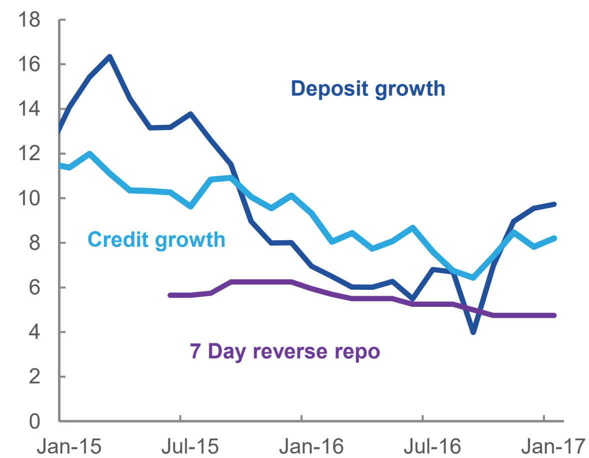


Source: CEIC

Monetary policy remained accommodative and appears to have transmitted through to key investment lending rates

Recent statements by BI indicate that the monetary policy easing cycle is likely to be on hold. Notwithstanding this apparent policy position, current policy remains accommodative. BI's interest rate cuts in the first half of 2016 appear to have finally begun transmitting to the relevant channels with interest rates on working capital loans and investment loans falling by 110 and 76 basis points, respectively, since the start of 2016. Interest rates on consumption loans remain sticky and fell only 33 basis points over the same period. However, this does not seem to have affected consumption growth which remains healthy.

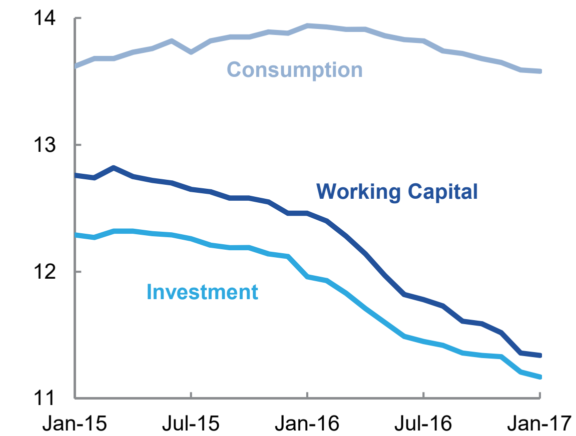
Figure 30: Deposit growth continued to increased
(growth yoy, percent)



Source: CEIC; Bank Indonesia

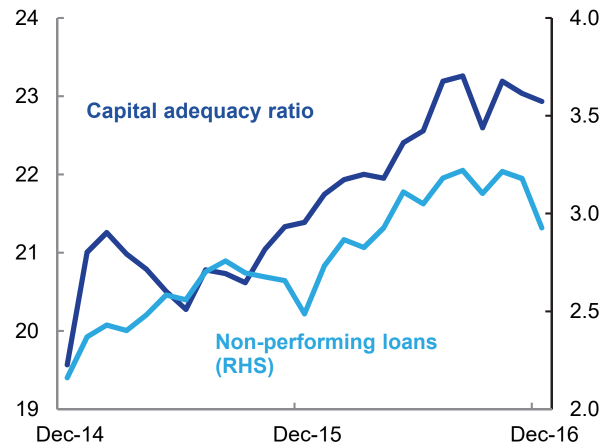
The increase in credit growth seen early in Q4 does not appear, at this stage, to be sustained. The stickiness in credit growth can, in part, be attributed to the steady increase in non-performing loans (NPLs) in 2016. The upward trajectory in NPLs appears to have reversed over the past few months which could have positive flow-on effects to credit growth. Another measure of the health of the domestic macro-financial conditions is the capital adequacy ratio (CAR), which provides one indication (amongst several) of whether a financial system is meeting international benchmarks (Figure 32). Indonesia's CAR rose to a healthy 23 percent late 2016 – well above the Basel III stipulated requirements. This suggests that the banking sector is healthy despite the increase in NPLs. Deposit growth rose steeply at the end of 2016. This is in line with anecdotal evidence suggesting that most of the inflows from the Government's Tax Amnesty program may have been simply deposited in banks (the remainder appears to have made its way to equity and bond markets).

Figure 31: Interest rates on consumption loans remain sticky while the cost of working capital has fallen
(percent)



Source: CEIC

Figure 32: The Indonesian banking system remains healthy despite the increase in non-performing loans
(percent)



Source: CEIC

6. Fiscal policy looks promising in 2017, reforms are anticipated to continue

Fiscal pressures eased, progress to date appears promising

In the second half of 2016, the Government undertook several measures that resulted in fiscal consolidation and improved credibility, including: downward revision of revenue targets; expenditure cuts; and encouraging high participation in the first phase of the tax amnesty program. As a result, the central Government fiscal deficit for 2016 was at 2.5 percent of GDP, lower than the Government outlook of 2.6 percent of GDP, and remained substantially below the 3 percent of GDP fiscal rule limit. 2017 results to date appear promising on the whole. On the revenue side, the Government has set more realistic revenue targets in the 2017 Budget (Figure 33) than in 2016, and end of February nominal revenue realizations grew yoy overall, rebounding from a decline in Q4 2016. On the expenditure side, the 2017 Budget implementation thus far sustains the momentum over the same period in 2016. End of February budget outturns show a lower fiscal deficit relative to the same period last year, due to muted expenditure disbursement and stronger revenues. Government financing tracks well against its targets. By February 21, the Government had raised financing of IDR 149 trillion or 45 percent of the 2017 expected budget deficit[22].

Non-tax amnesty revenues are rebounding, particularly commodity-related and VAT revenues

Revenue realization in the first two months of 2017 grew by 8.9 percent yoy in nominal terms, or by 7.6 percent if revenues collected from the tax amnesty program are excluded (Figure 34). Growth is being driven mainly by commodity-related revenues, but promisingly, also from other tax sources including VAT, which is growing again after a disappointing nominal decline in 2016. Comparison against previous years, however, put this in perspective. The current growth in monthly tax revenue realizations is not yet able to lift nominal revenue collection to 2015 or

[22] See Direktorat Jenderal Pengelolaan Pembiayaan dan Risiko Kementerian Keuangan (2017b)

2014 levels, at a time when tax collection needs to be rising in relation to those years on the back of tax reforms to meet this year's revenue collection targets.

The final phase of tax amnesty program will conclude in Q1 2017 with slow phase three progress to date

Indonesia's tax amnesty program will reach its conclusion March 31st with the end of the third phase. Collection in this final phase to-date has been small, although in line with modest Government expectations[23]: an additional IDR 2 trillion of redemption fees have been collected on top of the IDR 103 trillion collected in 2016 in phases one and two, taking the overall total to IDR 105 trillion, or 63.6 percent of the Government's IDR 165 trillion target. Repatriated foreign assets remain very low relative to the Government's target, reaching IDR 145 trillion, or 14.5 percent of the Government's IDR 1000 trillion target. Moreover, according to Indonesia's Financial Services Authority (OJK), only approximately IDR 89.6 trillion, 63.5 percent of the committed repatriated assets in phases one and two had actually been repatriated by December 31st, 2016.[24]

Figure 33: The Government's approved 2017 Budget includes more realistic revenue targets
(IDR trillion)

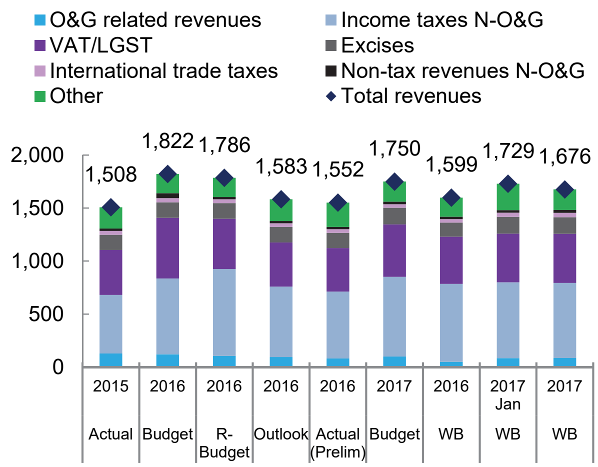
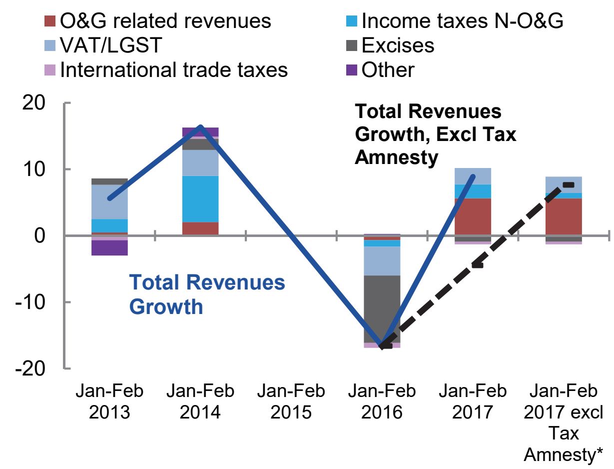


Figure 34: Year-to-date revenue collection growth is higher in 2017 than in 2016, but still lower than 2015 and 2014
(contributions to revenue growth yoy, percentage points)



Source: MoF; World Bank staff calculations
Note: O&G stands for oil and gas, N-O&G stands for non-oil and gas; LGST stands for luxury goods sales tax; "Other" includes: 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). In Figure 34, Jan-Feb 2015 saw zero growth yoy compared to Jan-Feb 2014, which is why the chart does not show any revenue streams contributing to growth for that year.

Expenditure disbursement remained low, but is expected to improve in Q2

By February, budget disbursement remained low reaching only 11 percent of total expenditure compared to 12 percent over the same period in 2016. With the exception of social and material spending, total expenditure, capital expenditure, and transfers to subnational Government all recorded a nominal decline relative to the same period in 2016 (Figure 35). This is partly due to the base effect of strong outturns over the same period in 2016. However, budget execution is expected to improve in Q2 supported by the continuation of early procurement initiatives implemented in a number of line ministries. For example, by January 2017, the Ministry of Public Works and Housing, the key line ministry in implementing

[23] See Direktorat Jenderal Pajak Kementerian Keuangan (2017) for updated numbers from the tax amnesty program. Numbers cited here are as reported by DGT on March 6, 2017.
[24] Data reported by DGT during presentation entitled "What's next after the tax amnesty?" UBS Indonesia Conference 2017, March 6, 2017

infrastructure projects, had already procured projects amounting to IDR 33 trillion, or about one third of its budget allocation.[25]

Figure 35: Expenditure outturn remains weak
(Jan-Feb actual expenditure growth yoy, percent)

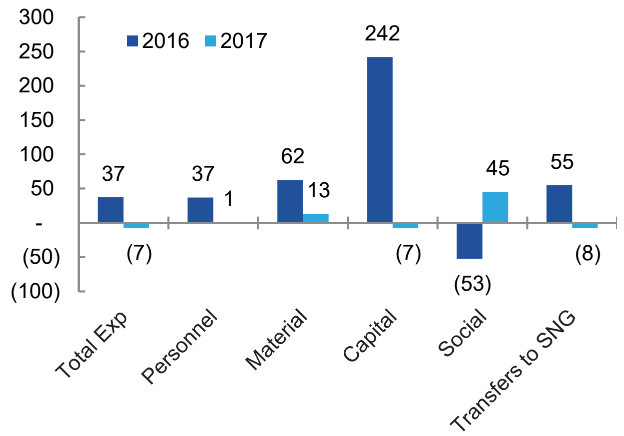
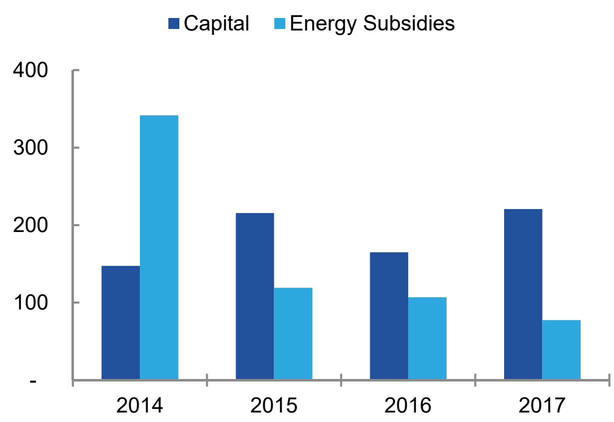


Figure 36: Capital expenditure is projected to increase in 2017, while expenditures on energy subsidies are slated to decline
(IDR trillion)



Source: MoF; World Bank staff calculations
Note: Realization numbers in February 2016 include an additional day of spending as month ended February 29, while in 2017, month ended February 28

Fiscal spending in 2017 will focus on infrastructure, health, and social assistance through central and sub-national spending

As discussed in the January 2017 IEQ, the 2017 Budget sustained a higher allocation on infrastructure, health, social assistance (in addition to 20 percent of total budget mandatory allocation for education) and a further reduction in energy subsidy spending (Figure 36). In particular, infrastructure development remains a top priority for the Government in 2017[26]. Beginning 2017, sub-national Governments are required to allocate a minimum 25 percent of general transfers (general block grant and revenue sharing) for infrastructure. Capital injections to a number of infrastructure-related State Owned Enterprises (SOEs) provided in 2015 and 2016 (IDR 29 trillion and IDR 36 trillion) are expected to provide additional leverage for SOE capital expenditures in 2017.[27]

In addition, transfers to sub-national Governments and village funds (Dana Desa) are set to increase in 2017 by 8 percent yoy, approximately equivalent to the total amount allocated for line ministries. This reflects the Government's commitment to further the implementation of fiscal decentralization and develop Indonesia's outer regions. However, continuous improvements in budget planning and execution at central and sub-national levels are needed to ensure that increases in budget allocations for key sectors translate into improved outcomes.

[25] See Detik.com (January 12, 2017)
[26] The Government's infrastructure development targets for 2017 includes 815 km national roads, 550 km railways, 13 airports, and 55 seaports (Kementerian Koordinator Bidang Perekonomian Republik Indonesia, 2016)
[27] For 2017 Budget, the Government allocated capital injections for asset management general services agency (BLU) and for infrastructure financing state owned enterprises (SOEs). There are no allocations provided directly to infrastructure SOEs.

Fiscal deficit is projected to be 2.6 percent of GDP in 2017

In line with the macroeconomic outlook for 2017 and ongoing tax policy and administration reforms, the World Bank projects total revenues to reach IDR 1,676 trillion in 2017, an eight percent increase in nominal revenues yoy. The growth in revenues is expected to be broad-based, with projected increases in revenue collection across income tax, VAT, excises and non-tax revenues. Total expenditure is projected to reach IDR 2,034 trillion in 2017, a nominal increase of 9.4 percent yoy, largely driven by projected improvements in capital expenditure. Overall, the World Bank projects a fiscal deficit of 2.6 percent of GDP (unchanged from January 2017 IEQ), higher than the 2017 Budget of 2.4 percent of GDP (Table 3). This higher projected fiscal deficit assumes a slightly lower revenue projection than the target in the budget (a difference of IDR 75 trillion), largely due to lower projections for non-oil and gas income tax and for VAT.[28] It also assumes that the Government's priority is to maintain nominal increases in fiscal expenditure, in particular, capital expenditure to boost infrastructure development.

There are both downside and upside risks to revenue projections

A slowdown in tax administration and policy reforms represents one downside risk to revenue collection. If this risk materializes, the 2017 expenditure outlook will be impacted, with a risk of a budget cut similar to what took place in 2016. On the other hand, the 2017 Budget adopts a conservative assumption of USD 45 for crude oil price and similarly conservative assumptions for other commodities. Thus, natural resources related revenues could provide an upside risk that may offset any impacts from a reform slowdown should it indeed materialize. In the most optimistic scenario, commodity prices continue to grow and the Government accelerates its tax administration and policy reforms. If this scenario plays out, then Government revenues may well see a bigger-than-anticipated rebound and assuming expenditure is not revised up, the fiscal deficit will likely fall below 2.6 percent. Close monitoring of fiscal developments in the coming quarter will provide clarity on which of these scenarios are more likely to play out by end of the year.

The Government introduced further measures to accelerate infrastructure development

To help mobilize investment for infrastructure development, the Government recently launched the Non- Government Budget Investment Financing or Pembiayaan Investasi Non Anggaran Pemerintah (PINA).[29] This is an alternative funding scheme for infrastructure projects that complements existing initiatives to promote public private partnership (PPPs). The launch was also marked by the financial closing of a toll road project implemented by PT Waskita Karya (state owned construction company) as the first project to adopt the PINA scheme. PT SMI (Indonesia's state owned infrastructure financing company) and PT Taspen (civil servant pension fund company) jointly provided investment financing in the form of equity to PT Waskita Toll Road, which currently has 15 segments of toll road concessions. Such transactions can make an important contribution to addressing Indonesia's infrastructure challenge. Nevertheless, a continued focus on increasing the role of private sector participants to ensure market-based pricing remains important.

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[28] The WB projection on revenues from oil and gas assumes lower production levels, though higher prices.

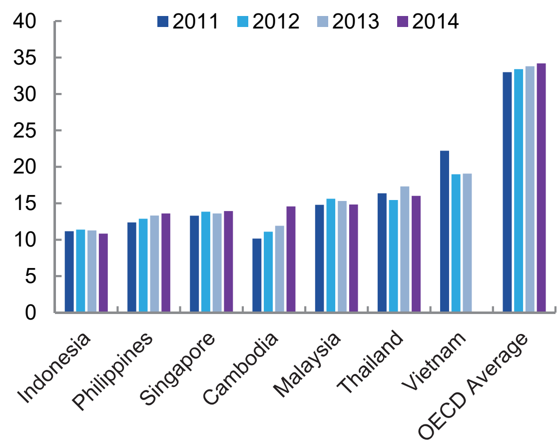
[29] For more, see Sekretariat Kabinet Republik Indonesia (February 12, 2017)

Tim Reformasi is overseeing an ambitious reform agenda that, if implemented, will significantly increase the tax-to-GDP ratio

The Ministry of Finance's new *Tim Reformasi* is working fast to outline a detailed roadmap for its four-year tax reform agenda.[30] The reforms will be centered on three administrative pillars and one policy pillar: organizational structure and business processes; human resources; the IT system; and tax laws and regulations. The new strategy includes a "quick-wins" list of reforms the Government intends to implement immediately in 2017, but more importantly, it sets out work on fundamental multi-year reforms, including investing in a new IT system. Additionally, on tax administration, the end of the tax amnesty program shifts attention to the question of what Government will be able to do using the newly collected data.

If the Directorate General of Taxes (DGT) is able to successfully use data collected to improve compliance and broaden the tax base, then there may be longer term benefits of the tax amnesty program. On the policy-side, reforms of the VAT and of the tax regime governing medium, small and micro enterprises (PP46) may be prioritized, as may be the income tax law. These proposed reforms broadly seek to expand the taxable base, reduce exemptions, and reduce compliance costs. If the Government is able to successfully pass through the legislative hurdles and implement positive reforms on these areas, then 2017 will prove to be a big year for meaningful, structural reforms. With Indonesia amongst the countries in the region with one of the lowest tax-to-GDP ratios, this will be a positive development (Figure 37).

Figure 37: Indonesia's tax-to-GDP ratio is low compared to peers
(percent of GDP)



Source: IMF; World Bank calculations

[30] In addition to Tim Reformasi Perpajakan, the Ministry of Finance also established Tim Penguatan Reformasi Kepabeanan dan Cukai (Custom and Excise Strengthening Reform Team). The work of this team is focused on one administrative and one policy pillar: organizational structure and human resources; and custom and excise laws and regulations. Tim Penguatan Reformasi Kepabeanan dan Cukai aims to improve custom and excise revenues and address long-standing challenges in the custom and excise reform area. (BKF, 2017)

Table 3: The World Bank projects lower revenue and expenditure than in the 2017 Budget
(IDR trillion, unless otherwise indicated)

	2015 Actual audited	2016 Budget	2016 Actual (Prelim)	2017 Budget	2017 World Bank
A. Revenues	**1,508**	**1,822**	**1,552**	**1,750**	**1,676**
(% of GDP)	*13.1*	*14.6*	12.5	*12.8*	*12.4*
1. Tax revenues	**1,240**	**1,547**	**1284**	**1,499**	**1,435**
(% of GDP)	*10.7*	*12.4*	10.3	*10.9*	*10.6*
Income taxes	602	757	667	788	744
Oil & Gas	50	41	36	36	36
Non-Oil & Gas	553	716	631	752	708
VAT/LGST	424	572	411	494	463
Property taxes	29	19	19	17	21
Excises	145	146	143	157	157
International trade taxes	35	40	35	34	41
Import duties	31	37	32	34	38
Export duties	4	3	3	0	3
Other taxes	6	12	8	9	9
2. Non-tax revenues	**256**	**274**	**262**	**250**	**237**
(% of GDP)	*2.2*	*2.2*	2.1	*1.8*	1.8
Natural resources revenues	101	125	66	87	76
Oil & Gas	78	79	45	64	49
Non-Oil & Gas	23	46	21	23	26
Other non-tax revenues	155	149	197	163	162
3. Grants	**12**	**2**	**6**	**1**	**3**
B. Expenditures	**1,806**	**2,096**	**1,860**	**2,080**	**2,034**
(% of GDP)	*15.6*	*16.8*	14.9	*15.2*	15.0
1. Central Government	**1,183**	**1,326**	**1149**	**1,316**	**1,280**
(% of GDP)	*10.3*	*10.6*	9.2	*9.6*	9.4
Personnel	281	348	305	345	329
Material	233	325	258	270	261
Capital	215	202	165	221	210
Interest payments	156	185	183	221	222
Subsidies	186	183	175	160	159
Energy	119	102	107	77	82
Fuel	61	64	44	32	33
Electricity	58	38	63	45	49
Non-energy	67	81	68	83	77
Grants	4	4	7	2	8
Social	97	55	50	56	54
Other	10	25	7	41	39
2. Transfers to regions	**623**	**770**	**711**	**760**	**753**
(% of GDP)	*5.4*	*6.2*	5.7	*5.5*	5.6
Overall Balance	**-298**	**-274**	**-308**	**-330**	**-357**
(% of GDP)	**-2.6**	**-2.2**	**-2.5**	**-2.4**	**-2.6**
Assumptions					
Real GDP growth rate (%)	4.8	5.3	5.0	5.1	5.2
CPI (%)	6.4	4.7	3.5	4.0	4.3
Exchange rate (IDR/USD)	13,458	13,900	13,309	13,300	13,359
Crude-oil price (USD/barrel)	51	50	39	45	55

Source: MoF
Note: The World Bank projection does not include potential revenues from the tax amnesty

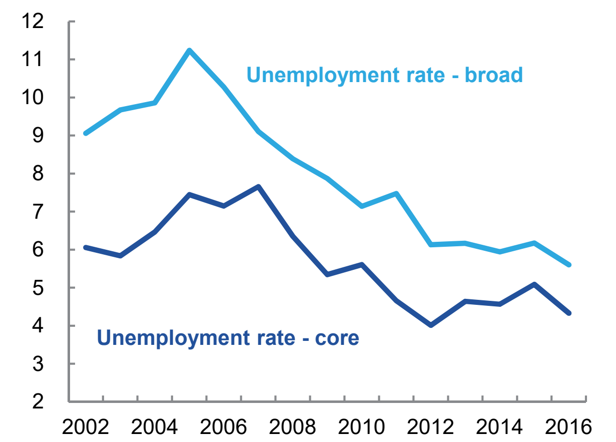
7. Low unemployment and strengthening real wage growth herald a period of labor market tightness, but the pace of formalization has slowed

Unemployment has fallen as employment growth has outstripped labor force growth

The slight increase in unemployment seen in 2015 was more than reversed in 2016. Data from BPS show that the rate of core unemployment fell to 4.6 percent in August 2016, the lowest since 2012, from 5.1 percent in August 2015 (Figure 38).[31] This reflects employment growth outstripping the expansion of the labor force. Between August 2015 and August 2016, the labor force grew by 2.3 percent to 123.8 million, while the number of employed workers grew by 3.1 percent to 118.4 million. This leaves the proportion of the working age population that is employed at 62.6 percent, up from 61.7 percent in August 2015, and the labor force participation rate (LFPR) at 65.5 percent, rising slightly from 65.0 percent in August 2015.[32] However, large gender differences remain: for women the LFPR is 49.9 percent compared to a LFPR of 81.0 percent for men.

Figure 38: Core unemployment fell to its lowest rate since 2012

(unemployment rate, percent)



Source: Sakernas

Real wage growth appears to have strengthened significantly, as the labor market has tightened…

The tightening of the Indonesian labor market also appears to have had a profound effect on wage growth. After a decline of 2.6 percent yoy in 2015, BPS data suggest that between August 2015 and August 2016 median real monthly earnings grew by a staggering 22.9 percent (Figure 39).[33] This increase was matched by a large jump in median nominal monthly earnings, which grew by 21.0 percent over the same period. In part, this may be due to an adjustment of wage growth back to the pre-2014 trend: over the period 2014-2015 real wages declined by an average of 0.3 percent per year at the median whereas over the period 2012-2013, median real wages grew 4.7 percent per year on average.

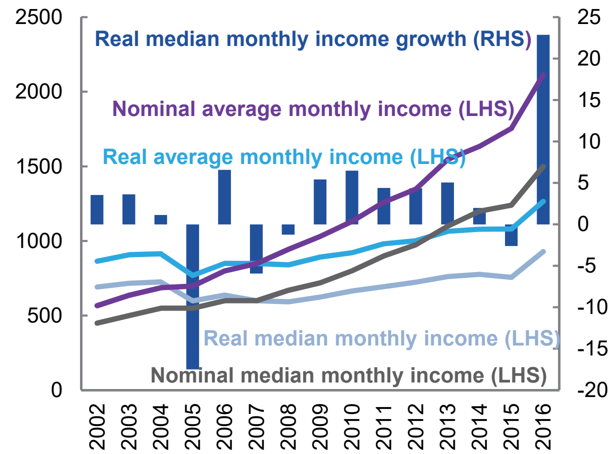
[31] 'Core unemployment' is defined as the proportion of those individuals who are not employed but are actively searching for work. It should be distinguished from 'broad unemployment', which also includes discouraged workers, those who are establishing a new business, and those who have a future job arranged.
[32] The working age population includes all individuals aged 15 years or above.
[33] Although there were changes to this Sakernas questionnaire between August 2015 and August 2016, and the sample size was reduced, this should not affect the data's representativeness at the national level.

…but this wage growth has not been shared evenly across the Indonesian economy

Although all sectors enjoyed strong real earnings growth in the year to August 2016, some industries grew more quickly than others. The service sector outperformed agriculture and other primary industries. Between August 2015 and August 2016, median real earnings grew by 37.2 percent in financial services and by 24.3 percent in community and, social, and personal services. Meanwhile, the analogous increase in mining and quarrying – where median real earnings had collapsed by an average of 7.4 percent per year over 2014 and 2015 – was just 14.4 percent. Therefore, some sectors have not fully regained the wage losses experienced during the two years before 2016.

Figure 39: Real earnings growth appeared to strengthen significantly in 2016

(earnings, thousand IDR, LHS; yoy growth in real median monthly earnings, percent, RHS)



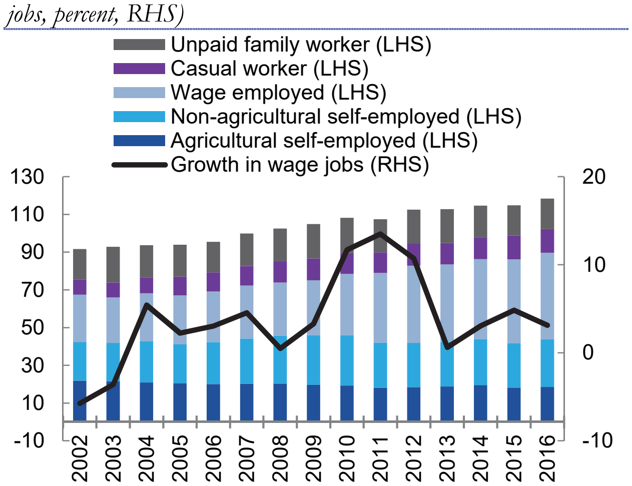
Source: Sakernas

Indonesia has continued to formalize, driven by an expanding base of wage sector jobs…

Indonesia's drive towards formality has continued in recent years, with the economy reaching a turning point in 2016. According to the official BPS definition, the formal sector – which comprised 58.3 million workers in August 2016 – is close to overtaking the informal sector – at 60.1 million workers.[34] This appears to be due to growth in wage employment, which comprised 38.7 percent of the workforce in August 2016 (Figure 40). By contrast, the proportion of non-agricultural self-employed workers – around half of whom are also classified as formal and who comprise almost all of the remainder of the formal sector – has remained relatively flat.

Figure 40: Total employment: The proportion of employed workers with wage jobs continues to rise, but at a slowing rate

(number of workers, millions, LHS; yoy growth in number of wage jobs, percent, RHS)



Source: Sakernas

[34] The official BPS definition of formality uses information on employment status – including whether an individual is wage- or self-employed – and on their sector or industry of work. Some BPS publications use a simplified definition, which classifies only wage employees and self-employed employers assisted by one or more permanent workers as formal. According to this simplified definition, there were 50.2 million formal workers and 68.2 informal workers in Indonesia in August 2016.

…but the pace of formalization has slowed in recent years

Nevertheless, even though the expansion of the formal sector has continued into 2016, recent growth in the number of wage jobs has been relatively slow. The number of wage-employed workers grew by just 2.9 percent per year on average over the period 2013-2016, compared to 9.8 percent in the four years beforehand. This slowdown in the creation of wage jobs presents a potential future pitfall for efforts to reduce poverty and create shared prosperity, as providing gainful employment remains a crucial part of sharing the gains from economic growth.

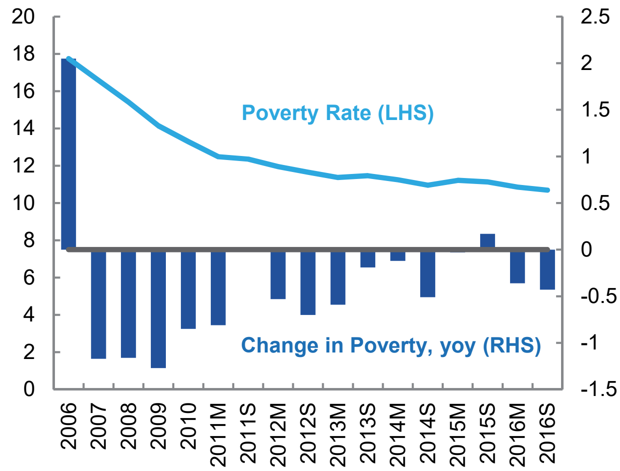
8. Poverty and inequality continue to fall

The poverty rate continued to decline in 2016

The official poverty rate was 10.7 percent in September 2016, 0.4 percentage points lower than in September 2015. The recent fall continues from the decline first seen in March 2016, when the poverty rate dropped by 0.4 percentage points yoy. At the same time, the poverty headcount fell by 0.7 percentage points over the year to 27.8 million people in September 2016. Though these declines improve on the stagnation in the poverty rate between 2013 and 2015 (Figure 41), they remain lower than the rates of poverty reduction achieved between 2007 and 2011, which averaged 1.1 percentage points annually[35].

Figure 41: The decline in poverty between September 2015 and September 2016 is greater than in recent years, but remains less than the rate of decline before 2011

(poverty rate, percent, LHS; change in poverty, percentage points, RHS)



Source: Susenas
Note: M is March and S for September

The poverty line only saw a slight increase in September 2016, owing to stable food prices

The trend of moderating inflation and stable food prices have persisted since the last poverty update[36], and continued to contribute to poverty reduction. This is demonstrated by the relatively small increase in the poverty line. The September 2016 poverty line only climbed 5.0 percent yoy to IDR 361,990, less than the September ascent between 2014-2015 (10.4 percent) and 2013-2014 (6.6 percent).

The Gini coefficient, a measure of inequality, also fell

The Gini coefficient for September 2016 was 39.4, 0.8 points lower than in September 2015 (Figure 42). After a remaining mostly flat between 2011 and 2015, the Gini coefficient has now fallen for three consecutive survey periods in a row.

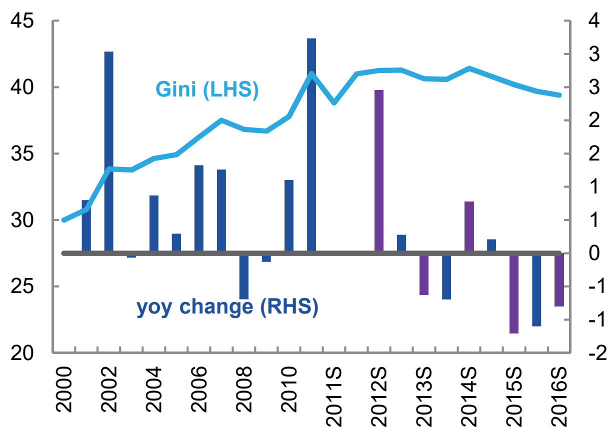
Though the Gini is falling, the Bottom 40 are still lagging behind

The major driver of the falling Gini between September 2015-2016 is strong consumption growth of the Middle 40 (consumption Quintiles 3 and 4) (Table 4). In a repeat of the March 2015-2016 change in share of total national consumption, the September 2016 data show that the share of the Middle 40 increased by 1.63 percentage points, mainly at the expense of the Top 20 (Quintile 5), whose

[35] It is important to note that September poverty figures are not directly comparable to March poverty figures, as the seasonality of poverty is not yet well-understood.
[36] see World Bank (2016b). Part A, Section 7.

consumption share decreased by 1.29 percentage points. However, the Bottom 40 percent of households also experienced a decline of 0.34 percentage points in their consumption share. This indicates that although the Middle 40 are starting to catch up to the Top 20, the Bottom 40 are still lagging behind.

Figure 42: After a long period of increase, the Gini coefficient has fallen yoy for three consecutive survey periods
(Gini coefficient, points; change in Gini coefficient, points)



Source: Susenas
Note: S in x axis is for September. Yoy change for September data, which has only been available since 2011, is highlighted purple.

Table 4: Inequality continues to fall due to increasing Middle 40 consumption, but the Bottom 40 still lag behind
(distribution of national consumption in Indonesia, September 2015 - 2016)

Period	Bottom 40	Middle 40	Top 20
Sept 2015	17.45	34.70	47.85
Sept 2016	17.11	36.33	46.56
Δ 2015-2016	-0.34	+1.63	-1.29

Source: Berita Resmi Statistik No.15/02/Th.xx (BPS 2017)

However, much work is still needed to reduce inequality and meet the Government's target

Despite the recent drop in the Gini coefficient, inequality remains much higher than in 2000, just after Indonesia recovered from the Asian financial crisis. Between 2000 and 2011, the Gini coefficient increased from 30 to 41, making it one of the fastest rising inequality in the region. The GoI has made inequality reduction a priority, and has set a target in the National Medium Term Development Plan (RPJM-N) to reduce the Gini coefficient to 36 by 2019. In order to achieve this goal, a concerted effort is required to address the key drivers of inequality: providing equal opportunities for all Indonesians, enabling access to more and better jobs for all, building resilience to shocks, and making fiscal policy more inclusive.[37]

9. Economic growth outlook and risks

The fundamentals of the Indonesian economy continue to be strong

Overall, the fundamentals of the Indonesian economy continue to be strong, with a robust rate of economic growth, low current account deficit and a conservative fiscal deficit. The economic outlook continues to be positive, supported by higher private consumption growth, while a projected pick-up in the global economy and recovering commodity prices, lift both investment and exports.

GDP growth is expected to rise to 5.2 percent this year

2016 was the first time in five years that annual economic growth outpaced the previous year's outcome, and could be indicative that Indonesia's growth cycle has finally bottomed out. Moreover, with all expenditure components expected to firm up, real GDP growth is projected to increase to 5.2 percent in 2017[38], and climb further to 5.3 percent in 2018 (Table 5).

[37] See World Bank (2015) for a detailed analysis on the drivers of Indonesia's rising inequality.
[38] This represents a 0.1 percentage point downward revision from the January 2017 edition of the IEQ.

Private consumption, investment, Government spending and exports are all projected to strengthen

Household consumption growth is projected to gain as a stable Rupiah buoys consumer confidence, while the double-digit jump in real wages and the low unemployment rate boost consumer purchasing power. Private investment growth is also poised to increase as the effects of monetary easing in 2016 and recent economic reforms gain traction. The continued recovery in commodity prices, along with the recent increases in credit growth and enhanced fiscal credibility, are also likely to be supportive of investment expenditures. Meanwhile, public investment is expected to increase this year, as the Government is firmly committed to boosting infrastructure investment. As commodity prices and the global economy continue to firm up, and life fiscal revenues and external demand, Government spending and exports are likely to rebound from their contractions in 2016.

Structural reforms need to persist to enhance potential growth

While a pick-up in commodity prices provide some respite, and GDP growth rates in the medium-term are projected to surpass those of recent years, they are significantly lower than those seen immediately following the financial crisis, as the economy rebounded from the global downturn. As such, more policy effort and staying the course on continued structural reforms, is necessary to further enhance the economy's potential growth, and to avoid having the current relatively slower growth rates as the new normal.

Unexpected changes in US monetary policy and possible financial volatility poses downside risks

Risks to the growth outlook are tilted to the downside. The U.S. Federal Reserve is expected to gradually raise the Fed Funds Rate in the coming years[39]. Should the Fed hike interest rates more rapidly than expected, taper-tantrum like capital outflows from emerging markets could occur as investors rapidly reevaluate and rebalance portfolios to reduce risk.[40] Such volatility in global financial and capital markets could weigh on Indonesia's growth in the medium-term.

Further political surprises in the EU could add to global policy uncertainty

After the UK referendum rattled the European Union in 2016, surprise outcomes from the series of upcoming high-stakes elections in France, Germany, the Netherlands, and possibly Italy, could further heighten global policy uncertainty among advanced economies. Such uncertainty, amid increasing protectionist sentiment, could have a severe dampening effect on global trade and financial flows.

Domestic risks include a protracted period of higher-than-expected inflation …

Due to the increases in administrative prices this year, a protracted period of elevated inflation poses a key downside risk to consumption growth. Consumers are generally sensitive to price increases, especially those of food, and private consumption constitutes the largest share of GDP. Should inflation remain elevated longer than expected, consumer spending may be dampened, resulting in lower output growth. In addition, Bank Indonesia may be compelled to tighten monetary policy, which would also cool investment growth.

…and weak revenue collection

At the same time, weak fiscal revenues continue to pose a downside risk to lower economic growth. Lower revenue collection could constrain fiscal spending and much needed infrastructure investment[41].

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[39] The first increase in 2017 of 25 basis points took place on March 15, in line with expectations.

[40] Taper tantrum is the term used to refer to the surge in U.S. Treasury yields that occurred in 2013, due to the announcement of the Federal Reserve's intention to reduce its Quantitative Easing (QE) asset purchasing program, or more simply put, the amount of money it was feeding into the economy. The taper tantrum ensued when investors panicked in reaction to news of this tapering and drew their money rapidly out of the bond market, which drastically increased bond yields. Substantial capital outflows from a few major emerging market economies also occurred, leading to their respective exchange rates to plunge.

[41] ADB (2017) estimates that Indonesia's infrastructure gap is between 4.7 to 5.1 percent of GDP.

Table 5: Key economic indicators
(percent, unless otherwise indicated)

	Annual			Revision from previous IEQ
	2016	2017f	2018f	2017
1. Main economic indicators				
Private consumption expenditure	5.0	5.1	5.2	-0.2
Government consumption	-0.1	2.8	3.8	0.6
Gross fixed capital formation	4.5	5.7	6.0	-0.5
Exports of goods and services	-1.7	2.0	2.4	0.5
Imports of goods and services	-2.3	1.0	2.0	-0.6
Gross Domestic Product	**5.0**	**5.2**	**5.3**	**-0.1**
2. Other economic indicators				
Consumer price index	3.5	4.3	3.8	-0.1
GDP Deflator	2.5	3.5	3.2	-0.8
Nominal GDP	7.6	8.8	8.7	-1.0
3. Economic Assumptions				
Exchange rate (IDR/USD)	13300	13359	13450	59
Indonesian crude price (USD/bl)	51	54	59	3

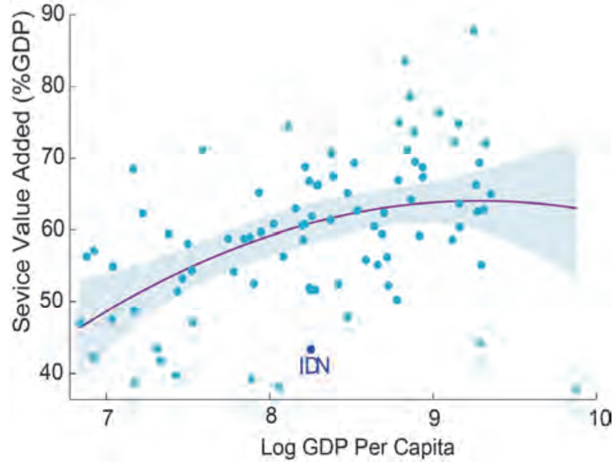
Source: BPS; BI; CEIC; World Bank staff projections
Note: 2016 figures are actual outcome. F stands for forecast. Statistical discrepancies and change in inventories are not presented in this table. All GDP components are based on the latest GDP data. Exchange rate and crude oil price assumptions are average annual data. Revisions are relative to projections in the January 2017 IEQ.

B. Focus Topics

1. Getting services trade policies right for Indonesia's development

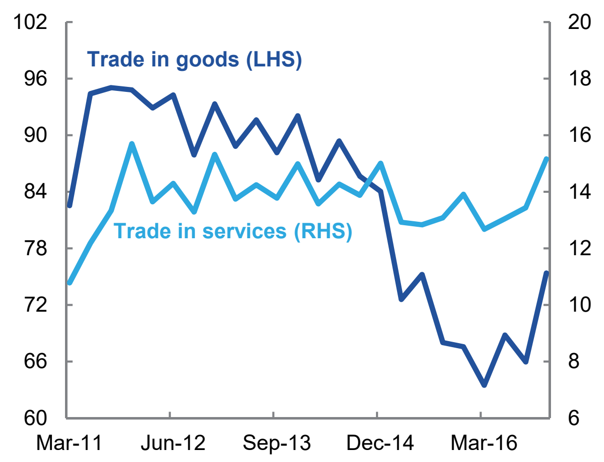
Services are becoming increasingly important for Indonesia's economy and trade. However, the share of services in GDP is still below that of many other middle-income economies. This is partly due to Indonesia's barriers to services trade, which are highly restrictive compared to other countries. This article discusses the likely impact of trade restrictiveness on the development of the services sector in Indonesia. It emphasizes the importance of re-evaluating such restrictions and improving competition to help unleash the potential of the service sector for the benefit of the whole economy.

Figure 43: Indonesia's services share in GDP is below the average for middle-income economies
(USD billion)



Source: World Development Indicators

Figure 44: Trade in services has been more resilient than in goods
(USD billion)



Source: CEIC; World Bank staff calculations

The services sector is a promising engine of growth in Indonesia, although its shares in GDP is still lower than many other middle-income economies

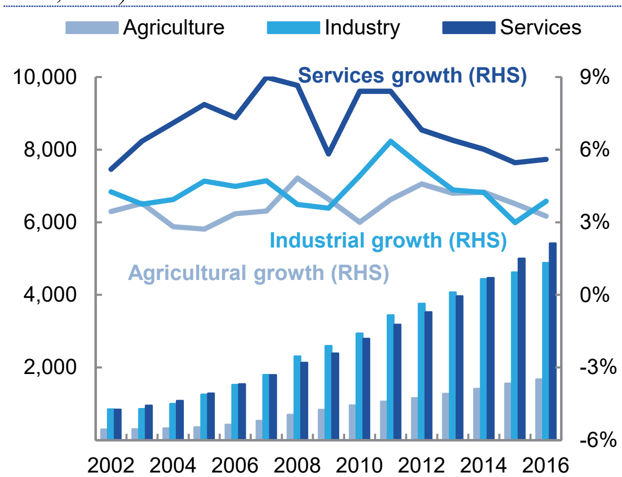
Over the course of economic development, key engines of growth in economies typically shift from primary (agriculture) to secondary (industry), and then to tertiary (service) sectors. As a result the share of services in the economy tends to expand significantly. Indonesia is no exception, even though the share of services is lower than in many other middle-income countries (Figure 43). Technological progress has made services more tradable across borders, such as through the outsourcing of back office operations, the temporary movement of service providers, and online sales. Indeed, global trade in services has expanded faster than trade in goods. This is also the case in Indonesia, where trade in services has been more resilient than trade in goods, which has been slowing down in recent years (Figure 44). With appropriate policies, services trade has the potential to emerge as another engine of growth. Just like two legs walking together, the benefits from both trade in goods and services should be mutually reinforcing.

a. Indonesia's services trade outlook

Services represent an increasing share in Indonesia's economy and trade

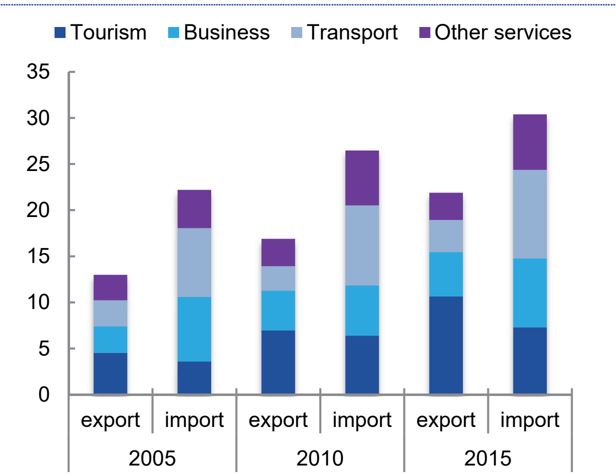
Services account for around 45 percent of Indonesian GDP. The sector has been growing at an average rate of 6.8 percent per annum since 2001, faster than the industrial and agricultural sectors (Figure 45). By early 2016, 53.6 percent of employed Indonesians – or 64.7m workers – were working in the services sector. More than 2m new jobs were added in services in 2015 alone.[42] Growth in the services sector has been broad-based. The transportation and communication sector exhibited the strongest average growth rate at 12.1 percent per annum since 2001, followed by the construction sector at 6.9 percent per annum. Trade in services has grown at an annual average rate of around 6 percent for exports and 4 percent for imports since 2005. This growth has been mainly driven by transport and communication, and travel services, which dominate services trade and have shown substantial growth rates (Figure 46).

Figure 45: Services constitute the highest share in the economy and is the fastest growing sector
(GDP in IDR trillion, LHS; growth in percentage; constant price 2000, RHS)



Source: BPS; World Bank staff calculations

Figure 46: Exports and imports of services have been growing rapidly in the past decade
(USD billion)



Source: Trademap; World Bank staff calculations

[42] Data on population above 15 years of age by main employment status from SAKERNAS.

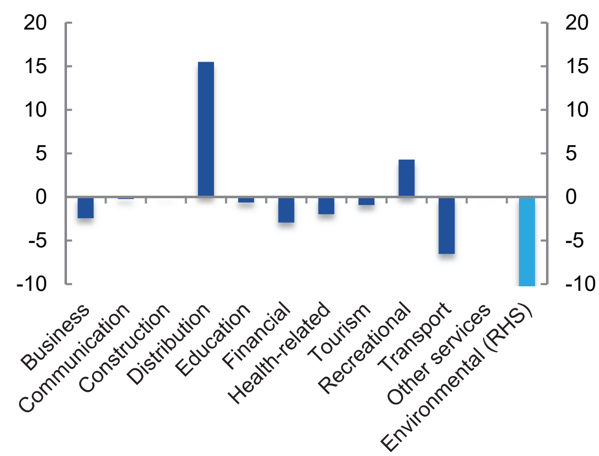
The importance of services for Indonesia's growth is underscored by their strong forward linkages to the rest of the economy

Services are key inputs of production in many sectors of the Indonesian economy.[43] Services contribute around 44 percent of the value of intermediate inputs for the mining sector, 32 percent for the agriculture sector, and 21 percent for the manufacturing sector. Eight out of the twelve main service sectors have higher forward linkage scores than the average of all sectors in the economy. For instance, 21 percent of the environmental services output are used by crude oil industries and 20 percent are used by pharmaceutical industries. Therefore, any policies applied to the service sectors would also have substantial implications for the competitiveness of other sectors.

Indonesia is a net services importer as demand exceeds supply in most service sectors

As in other sectors of the economy, trade can play a key role to fill eventual gaps in demand or supply. To evaluate such gaps across service sectors, we use Input-Output tables comparing for each services sector the domestic demand and the domestic output, after the international demand (export) is taken out from the total demand component. Estimates show that 10 out of the 12 service sectors have excess demand (Figure 47). This means that most of the service sectors' domestic demand cannot be satisfied by domestic production and must be fulfilled by imports instead. Environmental services have the largest excess demand, with domestic demand exceeding domestic production by 27 times, even though this sector is small overall. One of the reasons for this large excess demand is the specialized technologies used by the sector that the domestic providers are often unable to provide, such as waste management in the crude oil sub-sector.[44] Transport services also have a domestic supply gap, with 6.5 percent of total demand having to be provided by international transport providers. Such services are key for exporters and importers of goods and the ability to tap into foreign transport providers is key in maintaining their competitiveness. The two sectors that have excess supply are distribution and recreational services, and the international market absorbs around 15.5 percent and 4.3 percent of their supplies, respectively.

Figure 47: Ten out of the twelve service sectors have excess demand, the other two have excess supply
(excess supply, percent, LHS; 100 percent, RHS)



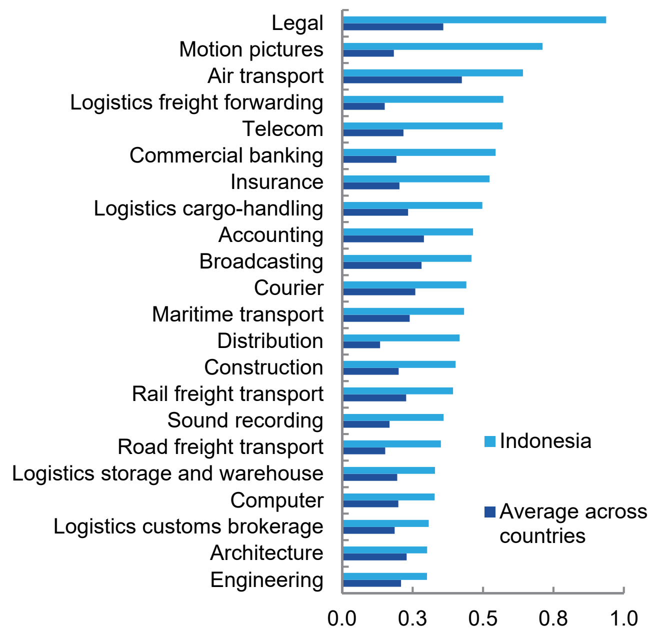
Source: World Bank staff calculations based on Indonesian I-O table 2010, BPS (2015)

43 According to the Indonesian 2010 Input-Output tables published by Statistics Indonesia (BPS) in 2015.
44 This sub-sector is the largest user, which consumes or uses 21 percent of the total environmental services.

b. Indonesia's services trade restrictiveness and productivity

Indonesia has some of the most restrictive barriers to services trade among 42 comparator countries

Figure 48: Indonesia's services trade restrictiveness index
(index)*



Source: OECD
Note: * the indices take values between zero and one, with one being the most restrictive

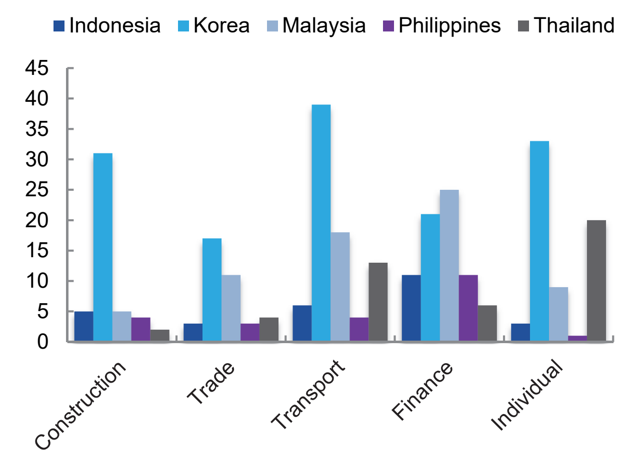
In spite of the importance of efficient services provision for the economy and the existing supply deficit, Indonesia maintains substantial restrictions to services trade. Data from the OECD show that Indonesia has a higher level of restrictions, as measured by the Services Trade Restrictiveness Index (STRI) in all of the 22 sectors surveyed across 42 high- and middle-income countries for which data is available (Figure 48, Table 6). For all sectors, Indonesia is in the top decile of countries in terms of restrictions, except for architecture, engineering and courier services. Indonesia has also the highest STRI score among all countries for which data available in logistics freight forwarding, motion pictures, sound recording, telecom, distribution and commercial banking. And a sector like legal services has a score close to the maximum possible score of 1, suggesting a pervasive level of restrictions to trade. For all sectors, Indonesia is in the top decile of countries in terms of restrictions, except for architecture, engineering and courier services. Indonesia has also the highest STRI score among all countries in logistics freight forwarding, motion pictures, sound recording, telecom, distribution and commercial banking. Legal services has a score close to the maximum possible score of 1, suggesting a pervasive level of restrictions to trade. Restrictions in this sector in Indonesia include the prohibition of foreign lawyers to set up a commercial presence or practice law in the country, something that many other countries in the sample allow for. The only possibility to tap into foreign legal expertise is for Indonesian advocates to hire foreign lawyers to provide advice on foreign law.

Box 2: Services Trade Restrictiveness Index

The OECD Services Trade Restrictiveness Index (STRI) is an evidence-based tool that helps to identify which policy measures restrict trade. It is calculated on the basis of the regulatory database that contains information on regulation across 22 service sectors collected from 34 OECD members, in addition to Brazil, China, Colombia, India, Indonesia, Latvia, Russia, and South Africa. The 22 service sectors are: computer services, construction, legal services, accounting services, architecture services, engineering services, telecommunication, distribution services, broadcasting, motion pictures, sound recording, commercial banking, insurance, air transport, maritime transport, road freight transport, rail freight transport, courier services, logistics cargo-handling, logistics storage and warehouse, logistics freight forwarding, and logistics customs brokerage. The regulatory information from these sectors is mostly taken from national legislation available on public websites. Based on the qualitative information in the database, composite indices are used to quantify the identified 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. Most measures in the STRI regulatory database have binary (yes/no) answers and binary scores are applied directly. Measures that have numerical answers are broken down on thresholds to which binary scores are applied. The scores take values between zero and one. Complete openness to trade and investment gives a score of zero, while being completely closed to foreign services providers yields a score of one. The indices are currently available for the year 2014 and 2015, and 2016 for some countries.

This high restrictiveness is likely to have contributed to the relatively low productivity of Indonesian services vis-à-vis comparator countries

Figure 49: Indonesia has relatively low productivity in a number of service sectors
(USD thousand)



Source: GGDC database
Note: data is for 2010, constant price 2005

The international evidence suggests that by stifling competition, barriers to services trade reduce services' efficiency.[45] This is consistent with the Indonesia's case, where relatively high services restrictiveness is associated with low labor productivity of services vis-à-vis comparator countries. The productivity of services is measured as the total value added of each sector over the total labor of the particular sector, drawing from the Groningen Growth Development Center (GGDC) database. According to this data the productivity of the Indonesian service sectors is generally lower than most of its peers in the region (Figure 49). Among the sectors for which data is available,[46] Indonesia shows levels of productivity comparable to its key regional peers only in construction services. Productivity in this sector increased from USD 3,600 per worker in 2000 to around USD 5,000 per worker in 2010-11. In contrast, Indonesian productivity is among the lowest of the comparator countries for trade, hotel and restaurant services; transport and communication services; finance, insurance, real estate and business services; and individual, and social and

[45] See for instance European Central Bank (2006) and New Zealand Productivity Commission (2014).
[46] The sectors analyzed are: construction services; trade, hotel and restaurant services; transport and communication services; finance, insurance, real estate and business services; individual, social and community services.

community services. For instance, the productivity of trade, hotel and restaurant services was USD 2,700 per worker in 2011, which is lower than that of Malaysia, Thailand, and Philippines.

Restrictiveness also penalizes manufacturing productivity as services are key inputs for manufacturing production and exports

Given the importance of services as inputs to production, trade restrictiveness among service sectors also raises the costs of production and weighs on the productivity of firms in other sectors of the economy. Duggan, Rahardja and Varela (2013) found that relaxing policies toward FDI in the services sector over the 2000s was associated with improvements in perceived performance of the services sector,[47] and with an increase of about 8 percent in manufacturers' total factor productivity. This increase was driven mainly by lower restrictions in transport, distribution and electricity services, in line with the importance of these services in Indonesia's manufacturing production. This result is also consistent with much empirical evidence emerging from other developing countries.[48]

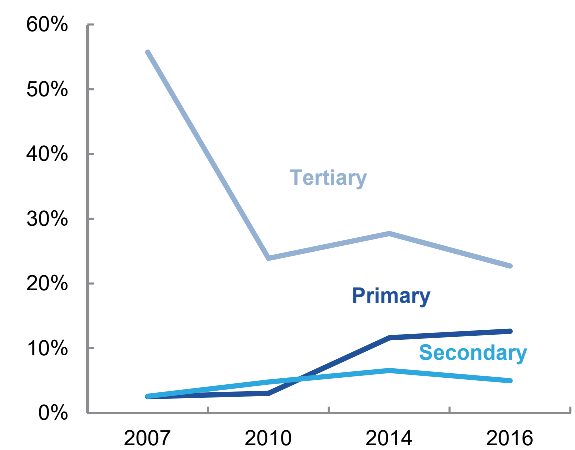
c. Reducing barriers to services trade for the benefit of the economy

It is important to re-evaluate restrictions to services trade in light of their impact on the overall economy…

These findings suggest the importance of reviewing the existing policy restrictions on services trade to secure the availability of quality services and support the competitiveness of the economy. A large part of these restrictions are due to general regulations that apply to all sectors in the economy. For instance, certain management positions in Indonesian corporations are reserved for Indonesian nationals. While this may protect certain Indonesian skilled workers, it is also likely to reduce the quality and increase the price of providing these services, thus harming downstream industries.

Figure 50: Foreign equity restrictions in the services sector have decreased but are still higher than other sectors

(share of sectors with at least one foreign equity limit restrictions in the DNI)



Source: World Bank staff estimates on the basis of Negative Investment List (DNI) decrees
Note: shares computed out of 1,456 KBLI-5 digit sectors

Similarly, foreign equity limitations are also applied across a broad range of service sectors, preventing foreign presence to provide services in Indonesia, which may be

[47] Perception based performance is measured using perceptions-based indicator of services performance that are constructed from a combined data on perceptions from the World Bank enterprise survey and on input-output data from BPS.

[48] Arnold, J., B. Javorcik, M. Lipscomb and A. Mattoo (2016) suggest that banking, telecommunication, insurance and transport reforms in India have significant positive effect on the productivity of its manufacturing sector; Arnold, J., B. Javorcik, and A. Mattoo (2006) found a positive relationship between services sector reform and the performance of domestic firms in downstream manufacturing sectors in Czech Republic. They suggest that allowing foreign entry into services industries is likely to be the key channel through which services liberalization contributes to improved performance of manufacturing sectors.

particularly harmful for those services for which a demand-supply gap exists. Such restrictions may also stifle the introduction of new technology of services production introduced by foreign firms. According to newly collected data by the World Bank, services have the highest incidence of foreign equity restrictions among broad sectors (Figure 50). While the share of (5-digit KBLI) service sectors with at least one foreign equity restriction in a sub-sector has decreased since 2007, a quarter of them was still subject to at least one restriction in 2016 and that share has remained stable since 2010. Such restrictions apply also to sectors such as finance and transport, which have large domestic supply-demand gaps.

There are also regulations that apply to specific sectors that may result in high potential loss for the economy. For instance, as medical services are limited to domestic providers, many Indonesian nationals go abroad to access to higher quality medical services. Around 50 percent of international patients in Singapore are Indonesian nationals and around 12,000 Indonesian citizens travel to Malaysia annually for medical services[49]. Thus, re-evaluating such restrictions in light of their overall impact would not only benefit services' users in Indonesia, but also the whole economy.

…and to reduce other barriers to competition in services, so as to help unleash the untapped potential of this sector

Increased openness to services should not only imply an increase in the flows of the services out and into the country, but also an increase in foreign presence by lowering barriers to entry. This would help increase competition between domestic and foreign services providers. International evidence suggests this would lead to the provision of higher quality services, the introduction to new services and/or price reduction of the services.[50] With appropriate supportive policies, pro-competitive effects of liberalizing trade in services would enable domestic services providers to enhance their productivity to better compete with foreign services providers. In addition, openness to services trade could also expose domestic producers to new knowledge and technologies that are important drivers of productivity growth in services, and the economy.

[49] See Ministry of Health, retrieved on Jan 9, 2017

[50] See Trapani and Oslon (1982); Goolsbee and Syverson (2008); Besker and Noel (2009).

Table 6: Examples of Restrictions in the Construction Services Sector

STRI Measures	Outcome for Indonesia
Foreign equity restrictions: maximum foreign equity share allowed (percent)	67
There are limits to the proportion of shares that can be acquired by foreign investors in publicly-controlled firms	Yes
Restrictions on cross-border mergers and acquisitions (M&A)	No
Performance requirements	Yes
Discriminatory qualification requirements for building permits to undertake construction work	No
Commercial presence is required in order to provide cross-border services	Yes
Legal form: only joint ventures are allowed	No
Legal form: foreign branches are prohibited	Yes
Legal form: other restrictions	No
Memo: Cross-border data flows: free transfer of personal data or application of the accountability principle	No
Memo: Cross-border data flows: transfer is possible only when certain private sector safeguards are in place	Yes
Cross-border data flows: transfer is possible only to countries with substantially similar privacy protection laws or consent by Government authority	No
Cross-border data flows: fulfilling a combination of conditions is required before transfer is possible	No
Cross-border data flows: transfer of personal data is prohibited	No
Board of directors: majority must be nationals	No
Board of directors: majority must be residents	No
Board of directors: at least one must be national	No
Board of directors: at least one must be resident	No
Managers must be national	Yes
Managers must be resident	No
Screening explicitly considers economic interests	No
Screening exists without exclusion of economic interests	Yes
Memo: thresholds for screening projects	Yes
Other restrictions on foreign entry	Yes
Acquisition and use of land and real estate by foreigners is restricted	Yes
Restrictions on the type of shares or bonds held by foreign investors	No
Conditions on subsequent transfer of capital and investments	No
Quotas: intra-corporate transferees	No
Quotas: contractual services suppliers	No
Quotas: independent services suppliers	No
Labour market tests: intra-corporate transferees	Yes
Labour market tests: contractual services suppliers	Yes
Labour market tests: independent services suppliers	Yes
Limitation on duration of stay for intra-corporate transferees (months)	24
Limitation on duration of stay for contractual services suppliers (months)	24
Limitation on duration of stay for independent services suppliers (months)	24
Other restrictions to movement of people	No
Foreign suppliers are treated less favourably regarding taxes and eligibility to subsidies	No
Public procurement: Explicit preferences for local suppliers	Yes
Public procurement: Procurement regulation explicitly prohibits discrimination of foreign suppliers	No
Memo: thresholds above which tender is mandated	Yes
Public procurement: Technical specifications affect the conditions of competition in favour of local providers	No
Public procurement: Discriminatory qualification processes and procedures	No
Public procurement: Contract award on the basis of non-objective/discriminatory criteria	No
Public procurement: Procurement laws, regulations and procedures are transparent	Yes
Public procurement: Foreign suppliers are provided the opportunity to challenge the consistency of the conduct of procurement with the laws and regulations.	Yes
Laws or regulations impose national standards that deviate from international standards: building design code standards	No
Laws or regulations impose national standards that deviate from international standards: construction product standards	No

Other restrictions in other discriminatory measures	No
Decisions by the regulatory body can be appealed	Yes
Firms have redress when business practices restrict competition in a given market	Yes
National, state or provincial Government control at least one major firm in the sector	Yes
Publicly-controlled firms are exempted from the application of the general competition law	Yes
Prices or fees are regulated	No
Other restrictions in barriers to competition	No
Minimum capital requirements	Yes
Restrictions on advertising	No
There is a legal obligation to communicate regulations to the public within a reasonable time prior to entry into force	No
There is an adequate public comment procedure open to interested persons, including foreign suppliers	Yes
Range of visa processing time (days)	4
Multiple entry visa for business visitors	Yes
Cost to obtain a business visa (USD)	45
Number of documents needed to obtain a business visa	6
Time required to obtain a construction permit (in calendar days)	210.2
Total cost required to obtain a construction permit (% of warehouse value)	3.8
Other restrictions in regulatory transparency	No
Number of procedures required to obtain a construction permit (number)	17

Source: OECD STRI database

2. The new Kredit Usaha Rakyat (KUR) program[51]

This article reviews the "People's Business Loan" (Kredit Usaha Rakyat, KUR) program, which supports loans to micro-, small- and medium-sized businesses (MSMEs) with partial credit guarantees and, since the program was redesigned in 2014, offers interest rate subsidies. The article focuses on a comparison between the scheme that was implemented between 2009 and 2014, and the new scheme, which is currently under implementation, along with policy insights and recommendations.

a. The KUR program has become the Government's flagship policy to support small businesses

MSMEs are a cornerstone of the Indonesian economy

Micro-, small- and medium-sized enterprises (MSMEs) play an important role in Indonesia's economic development and poverty reduction. According to data from the Ministry of Cooperatives and SME, there were 57.9 million MSMEs throughout Indonesia in 2013. They accounted for more than 99 percent of all firms, employed over 114 million people (over 97 percent of total employment in the private sector), and contributed to about 60 percent of GDP.[52]

Access to finance continues to be a challenge for them

Indonesian MSMEs face significant challenges in accessing financing, mainly due to the stringent operational, reporting and collateral requirements of commercial banks. This hinders their growth and development. For example, a recent survey of 200 small and medium sized enterprises (SMEs) in six areas in Java concluded that access to finance, together with intense competition from large-scale enterprises and other SMEs, as well as high energy prices, are the main barriers to SME development in Indonesia.[53] Access to finance was mentioned as the fourth most important obstacle by Indonesian SMEs in the 2016-2017 World Competitiveness Report by the World Economic Forum, behind corruption, excessive Government bureaucracy, and the supply of infrastructure.

The GoI has supported MSME credit since 2007 through a partial credit guarantee program, KUR

In order to facilitate access to finance for small businesses, the Government of Indonesia established the KUR program in 2007 in order to enhance MSMEs' access to bank loans through the provision of subsidized, partial credit guarantees. KUR guarantees were provided through Askrindo and Jamkrindo – the two dominant state-owned Credit Guarantee Companies (CGCs) – to participating banks for their eligible MSME loans. The Government paid the guarantee premiums and provided capital to the two CGCs annually, and set the policies and requirements applied under the KUR program. The CGCs covered 70 to 80 percent of the risk of loan loss for bank's MSME loan portfolios.

In 2014, KUR was the largest partial credit guarantee program in emerging markets

KUR quickly grew to become a sizeable program. By the end of 2014, the value of total outstanding loans supported by KUR was IDR 49.5 trillion, accounting for approximately 14 percent of all outstanding loans to micro and small businesses. The Non-Performing Loan (NPL) ratio of these supported loans was 3.3 percent. Between 2009 and 2014, the 34 participating banks concluded around 12.5 million loan contracts with MSMEs and disbursed IDR 179 trillion in KUR-supported

[51] The article is based on a forthcoming policy note that was prepared by the World Bank's Finance and Market Global Practice in Indonesia. The note is based mainly on data provided by the KUR Policy Committee and in-depth interviews with various program stakeholders and experts in the field of microfinance, MSME, and economic development.

[52] The GoI categorizes MSMEs as follows: (i) micro enterprises with net assets of up to IDR 50 million or annual revenues of up to IDR 300 million; (ii) small enterprises with net assets between IDR 50 to 500 million or annual revenues between IDR 300 to 2,500 million; and (iii) medium enterprises with net assets between IDR 500 to 10,000 million or annual revenues between IDR 2.5 to 50 billion.

[53] See Maya Irjayantia, Maya/Azisb, Anton Mulyono (2012)

loans. The majority of the program—85 percent of total KUR-backed disbursements—was channeled through three state-owned commercial banks: BRI, Mandiri, and BNI. BRI alone disbursed IDR 117 trillion between 2009 and 2014, or 65 percent of the whole KUR program.

b. The KUR program has changed from partial credit guarantee program to an interest rate subsidy program

In 2015, the Government redesigned KUR with a stronger focus on interest rate subsidies

While the KUR program was originally intended to run until the end of 2014, the Government decided to extend the program, but introduce major reforms. At a time of economic slowdown, the then newly appointed administration stipulated that the new KUR program be aimed at: (i) increasing the disbursement of loans to productive businesses; (ii) increasing the competitiveness of MSMEs; and (iii) supporting economic growth and employment. The new KUR program featured prominently in the Government's economic reform packages announced in late 2015. Under the new KUR program, the Government provides interest subsidies to participating banks allowing them to lend to MSMEs at capped interest rates. The interest rate subsidy also covered the guarantee fees paid by banks to the CGCs.

The program dominates a sizeable portion of the market for MSME loans

In 2016, the total loan amount disbursed through the KUR program was IDR 94.4 trillion. Government targets for 2017 are set even higher, coming close to IDR 110 trillion, according to the Coordinating Ministry of Economic Affairs. When compared to the total outstanding stock of loans to micro (IDR 182 trillion by end 2016) and small (IDR 241 trillion) businesses, it is clear that the KUR program is of central importance for the entire market segment.

Substantial adjustments have changed the character of the program

The new KUR program entails a major shift in paradigm, from enhancing MSMEs' financial access to providing inexpensive loans to MSMEs. The KUR program has shifted from a partial credit guarantee program intended to create credit records for first-time borrowers and thus make them more bankable, towards a program with a predominant focus on interest-rate subsidies intended to create better loan conditions for borrowers, including first-time and repeat borrowers (Table 7 summarizes the main design aspects of the old and new KUR programs). The previous KUR program had an explicit requirement on additionality – that is, first time bank borrowing or at least additional borrowing – in order to target the MSMEs without credit histories and therefore the greatest constraints in accessing capital. However, this requirement no longer applies in the new KUR. Non-first time borrowers, and even former KUR borrowers and former commercial borrowers, can now also apply. The number of eligible sectors has also increased, such that the new KUR program is available to almost all sectors where MSMEs operate. The sectors with the highest number of eligible MSMEs include wholesale and retail trade, and agriculture.

Table 7: Key design aspects of the old and new KUR programs

Aspect	KUR 2007-2014	KUR 2015 onwards
Loan Size	Micro: up to IDR 20 million Retail: above IDR 20 to 500 million Linkage*: up to IDR 2,000 million	Micro: up to IDR 25 million Retail: IDR 25 to 500 million
Maximum Effective Interest Rate p.a.	Micro: 22% Retail: 14%	Micro and Retail: 12% (2015); 9% (2016 onwards)
Maximum Tenor	Investment Capital: 5 years Working Capital: 3 years	Investment Capital: 5 years[54] Working Capital: 4 years
Partial Risk Guarantee (Wholesale Credit Guarantee)	Pari-passu 70% (in general) or and 80% (for priority sectors[55]) (e.g. agriculture, fishery, industry) on the outstanding amount and accrued interest for banks with NPL below 5 percent; no portfolio cap; claim trigger: loan classified non-performing ("doubtful");	Negotiated and agreed between banks and CGCs (Permenko 8/2015, Art. 9 (2))
CGCs Fees	Stipulated by GoI Government and paid to CGCs 2007-2009: 1.50% 2010-2014: 3.25% of guaranteed part of the loan[56]	Negotiated and agreed between banks and CGCs, reportedly facilitated by KUR Committee, upfront 1.5% of loan amount
Interest Rate Subsidy	None	Micro: 10% of loan amount paid as subsidy Retail: 4.5% of loan amount paid as subsidy Interest rate subsidy calculated based on monthly outstanding amount and paid directly to the bank, includes credit guarantee fee

Note: *) Loans to Rural Banks (BPR) and other Microfinance Institutions (MFI) that implemented KUR Micro loans
Source: Kementerian Koordinator Perekonomian (Coordinating Ministry for Economic Affairs, CMEA)

Stakeholders hold different views of the program's priorities and objectives

Structured interviews undertaken by the World Bank with stakeholders in the Government and the financial sector showed different, and at times contradicting, views of the strategic priorities and objectives of the new KUR program. This creates a certain amount of confusion about the policy goals between different stakeholders and about how to measure the effectiveness of the policy.

Under the old KUR program, direct and indirect subsidies amounted to 4.7 percent of the total loan portfolio…

Over 2008-2014, the Government covered credit guarantee fees of IDR 5 trillion—a direct subsidy. In addition, the Government provided the CGCs capital injections throughout the previous KUR period. The difference between the opportunity cost of this capital and the income CGCs derived from this capital amounts to an estimated IDR 638 billion over a seven-year period and can be considered an indirect subsidy to the KUR program. Furthermore, participating banks extended KUR loans at interest rates below market rates, potentially resulting in lower bank incomes and therefore lower tax revenues for the Government—another indirect subsidy. This effect is estimated to be in the vicinity of IDR 3 trillion.[57] The total direct and indirect subsidies borne by the Government under the previous KUR program until 2014 can thus be estimated at IDR 8.6 trillion, an average of IDR 1.2

[54] KUR investment loans can be up to seven years if the loan is prolonged, the nominal amount is increased or restructured.
[55] Priority sectors include agriculture, fishery, small industries, TKI.
[56] These ratios are not entirely comparable due to different calculation methods, e.g. based on the loan amount or only the guaranteed part of the loan amount.
[57] This figure should be understood as an approximation given that several factors are difficult to measure. First, the value of the guarantee was considered only as a rough approximation when comparing the market interest rates with the actual interest rates charged by participating banks. Secondly, the potential value of KUR clients who generate a credit record and subsequently become commercial clients of the bank has not been measured.

trillion per year. This is equivalent to an annual average interest subsidy of 4.4 percent of the outstanding KUR loan balance.

…while under the new KUR program, this number has risen to 8.6 percent

Under the new KUR program, the Ministry of Finance sets the maximum effective interest rate participating banks can charge as well as the interest rate subsidy, in line with the Government's fiscal capacity. The 2016 Approved Budget allocated IDR 12.6 trillion in interest subsidies for the new KUR program, and the 2017 Approved Budget allocates IDR 9.5 trillion. However, some participating banks have noted that the interest rate subsidy does not sufficiently cover the differential between what they perceive as the market interest rate and the maximum effective interest rate set under the KUR program.[58] Even so, in an effort to meet the Government's ambitious KUR disbursement targets, some banks have shifted collateralized commercial loans to KUR loans. Consistent with the methodology to estimate the indirect costs of the old KUR program, this foregone income is estimated to reduce tax revenues by an estimated IDR 2.2 trillion over 2016-2017. A further IDR 0.2 trillion over 2016-2017 can be seen as an indirect subsidy due to reduced returns on capital of the CGCs. Overall, the projected direct and indirect subsidies for the new KUR program sum up to IDR 12.3 trillion per year – ten times the annual subsidy under the old KUR program. In terms of percent of KUR loans outstanding, the average annual subsidy increased substantially, from 4.4 percent under the old KUR program to 14.8 percent under the new KUR program. (Table 8 summarizes the costs of the old and new KUR programs.)

Table 8: Summary of KUR costs and comparison of the old and new KUR
(IDR trillion)

Subsidy Items	Old KUR 2008-2014	New KUR 2016-2017
Direct Subsidy: Credit Guarantee Fees to CGCs and interest rate subsidy	5.0	22.1
Indirect Subsidy: Implicit Interest on PMN Capital for CGCs minus KUR Investment Income	0.6	0.2
Indirect Subsidy: Reduced Government Tax Income from Lower Bank Profits	3.0	2.2
Subsidy (Direct and Indirect)	**8.6**	**24.5**
Subsidy (Direct and Indirect), annual average	**1.2**	**12.3**
Subsidy (Direct and Indirect), % outstanding loan balance, annual average	**4.4**	**14.8**
Subsidy (*Direct only*), % central Government spending, annual average	**0.05**	**0.5**

Note: Budget data for 2008-2014 refer to realized spending; budget data for 2016-2017 refer to Approved Budgets. The outstanding loan balance is actual for 2008-2014 and estimated for 2016-2017.
Sources: MoF; KUR Policy Committee, World Bank calculations

c. The new credit guarantee fee arrangement reflects a more market-oriented approach

The new credit guarantee fee arrangement reflects a more market-oriented approach

One of the major reforms introduced under the new KUR program, is the negotiation and agreement between CGCs and participating banks on the guarantee fee. This new arrangement reflects a more market-oriented approach, wherein the terms of the guarantee fee are no longer decided by the Government, but by CGC and bank managers, who are responsible and accountable for the results of their respective companies. Moreover, in theory, CGCs and banks should be better able to estimate and mitigate the risks inherent in the credit guarantees.

[58] The weighted average market interest rate of 21.4 percent can be broken down into 7.9 percent Government subsidy (plus 0.5 percent for CGC administration), 4.5 percent bank concession, and the 9 percent effective interest rate paid by borrowers.

The CGCs follow some good practices, but could improve on others

Both of the large nationwide CGCs, Askrindo and Jamkrindo, follow some of the best practice principles identified by the World Bank for credit guarantee schemes.[59] For example, both CGCs maintain a separate recording system for KUR that allows for transparency. Annual reports are produced and disclosed publicly, and include: calculation methods for estimated reinsurance claims, a code of conduct, and a whistle blowing system. On the other hand, the annual reports do not yet analyze and present facts on the "additionality" of the KUR program – a key argument for credit guarantees. Other best practices not yet adopted include the independent and effective supervision of the CGCs or the CGS adopting a transparent and consistent risk-based pricing policy.

d. Interest rate subsidies are not considered best practice in MSME finance

The new KUR program makes interest rate subsidies an important policy instrument

While the new KUR program has introduced improvements in the guarantee fee arrangement, it has increased the use of interest rate subsidies. Interest rate subsidies are not a new measure in the Indonesian policy mix. In fact, over the period 2007-2014, the Government spent IDR 1.7 trillion subsidizing agricultural loans (interest subsidies in the agriculture sector are common in many other countries). The sheer scale of the new KUR program takes this policy instrument to a much higher level of importance.

However, the effectiveness of interest rate subsidies to promote MSME finance is doubtful

There are four key reasons to doubt the effectiveness of interest rate subsidies in promoting MSME's access to finance and thus ultimately their growth opportunities.

Subsidies crowd out commercial lending, particularly in the micro segment. Given that the KUR interest rates are substantially below the prevailing market rates, and that one single bank (BRI) is dominant in the micro segment, financial institutions that do not participate in the KUR program will find it hard to compete. According to market participants, KUR loans are not only offered to genuinely unserved demand, but in large proportions to repeat clients and borrowers that have previously accessed unsubsidized loans – which raises doubt about the additionality that the KUR program generates in the market. There is a risk that banks will direct subsidized KUR loans to those MSMEs that can provide the most information on their creditworthiness (generally MSMEs who have already received a bank loan), while the financial institutions without access to KUR attend to higher risk MSMEs with less information. In the long run, commercial offerings will find it hard to compete in the microloan market (commercial market interest rates are usually between 20 to 26 percent), and probably abandon the market.

For MSMEs, sustainable access to loans is usually more important than lower interest rates. Interviews with bank representatives and MSMEs, and micro loan assessments, confirm that subsidized KUR loans have the potential to increase MSMEs' income by only 3 percent or less; whereas the increase in income from the mere access to loans and the diligent investment is often more than 20 percent.

The current KUR interest rates are not financially self-sufficient, and will not be in the near future. In the microfinance sector, financial self-sufficiency measures the extent to which an institution's business revenue (interest payments) covers its adjusted costs, with the three main adjustments being made for subsidized cost of funds, in-kind subsidy, and inflation.[60] The subsidized KUR interest rate of 9 percent only allows

[59] See The World Bank and FIRST Initiative (2015)
[60] See Rosenberg, Richard (2009)

banks to meet a small share of their costs in the microfinance segment, both currently and for the coming year. Thus, the offerings at that rate will not be commercially viable in the medium-term, and the Government would have to pay subsidies on a recurring basis, if it seeks to maintain the rate.

Interest rate subsidies are a regressive form of assistance. The total subsidy paid by the Government increases linearly with loan size. If larger loans tend to be associated with larger and more successful businesses, this means that Government assistance is regressive (i.e., a larger percentage of Government assistance is directed to larger businesses compared to smaller businesses). The new KUR program mitigates this issue somewhat by providing a higher subsidy to micro firms as opposed to small or medium firms, and by capping the loan size.

e. Conclusions and recommendations

KUR is a major intervention with significant fiscal costs…

The KUR program has grown to be the Government's dominant mechanism to support MSMEs in Indonesia. During a major redesign in 2015, the focus of KUR changed from facilitating access to loans for first time MSME borrowers through the provision of partial credit guarantees, to the provision of loans at subsidized interest rates to MSMEs, regardless of their previous access to finance. This redesign has led to a ten-fold increase in the cost of the program to the Government, in terms of both direct and indirect subsidies, which sum up to roughly IDR 12.3 trillion per year over 2016-2017. While it is notable that the Government dedicates substantial resources to the MSME finance sector, there are many reasons to doubt that interest rate subsidies are the most appropriate and fiscally sustainable instruments for creating a conducive business environment for this market segment.

…but interest rate subsidies are not an efficient mechanism for supporting MSMEs…

First, interviews with stakeholders in Indonesia and global experience show that sustainable access to loans is typically more important for MSMEs than lower interest rates. Second, there is a wealth of international evidence[61] indicating that the costs of subsidized financing typically outweigh the benefits. Third, there is a substantial risk that the competitive environment for MSME loans gets crippled, while the long-term ability of the financial sector to offer commercial loans to such borrowers is severely hampered. Fourth, the current KUR interest rate deviates significantly from market interest rates, and is not financially sustainable. Given the large uptake of the program, the drain on the fiscal budget is, and will continue to be, substantial.

…as such, the Government should consider whether the additional benefits of the new KUR program justify the substantial increase in cost…

Unless significant benefits from the KUR program can be properly documented, there is a strong need to reconsider the use of subsidized loans to support MSMEs, in view of the costs. In particular, the Government should consider whether the additional benefits of the new KUR program justify the large increase in cost, or whether a focus on other tested and fiscally viable instruments—such as partial credit guarantees together with a strengthening of the financial infrastructure (credit information systems, collateral registry, etc.)—could support the MSME sector at a much lower cost. More focused targeting of interest subsidies and credit guarantees to MSMEs with severely restricted access to finance (such as first time borrowers, MSMEs in remote areas, or MSMEs in underserved priority sectors) could also improve the program's efficiency.

[61] See for example: ADB (2009) and World Bank (2008)

…especially given the current fiscally-constrained environment

Government spending on interest rate subsidies comes at the expense of spending on other priority interventions, particularly given constraints to raising government revenues and the budget deficit, at least in the medium term. World Bank (2017c) notes that underfunded priority sectors in Indonesia (those where additional public spending can have the greatest impact on poverty and growth) include infrastructure, health, and social assistance.

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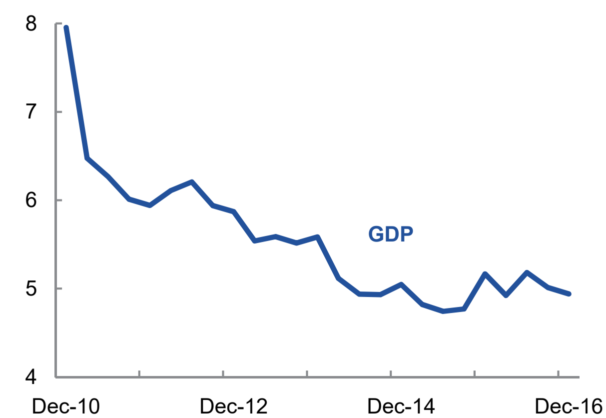
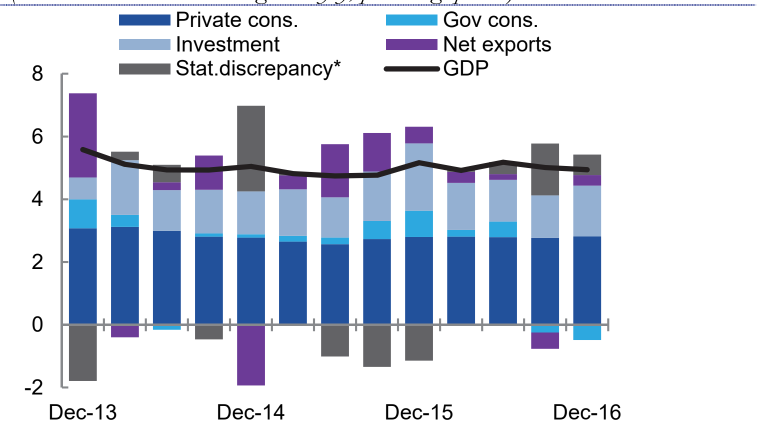
APPENDIX: A SNAPSHOT OF INDONESIAN ECONOMIC INDICATORS

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



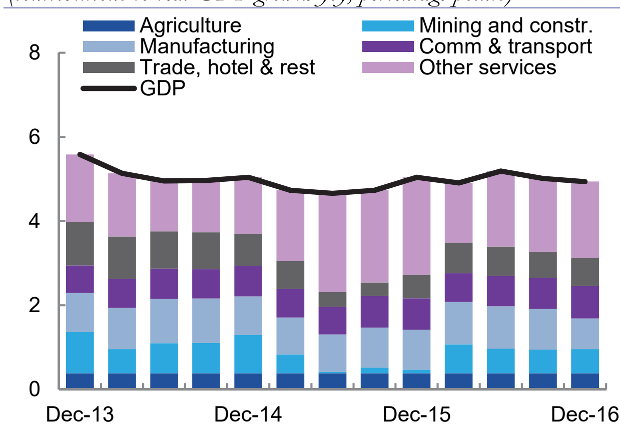
Source: BPS; World Bank staff calculations

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



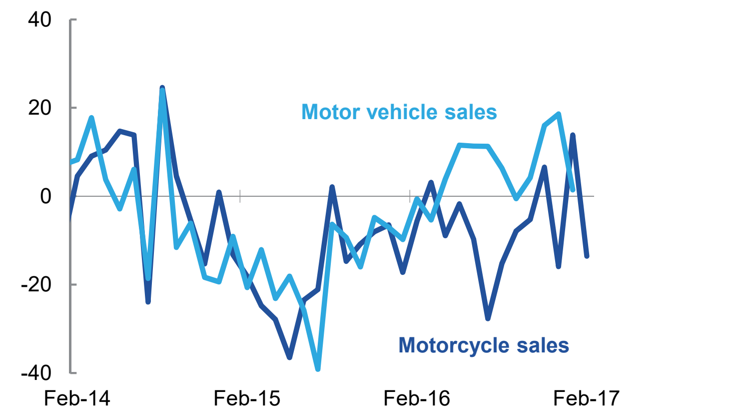
Source: BPS; World Bank staff calculations
Note: * includes changes in stocks.

Appendix Figure 3: Contributions to GDP growth (production)
(contributions to real GDP growth yoy, percentage points)



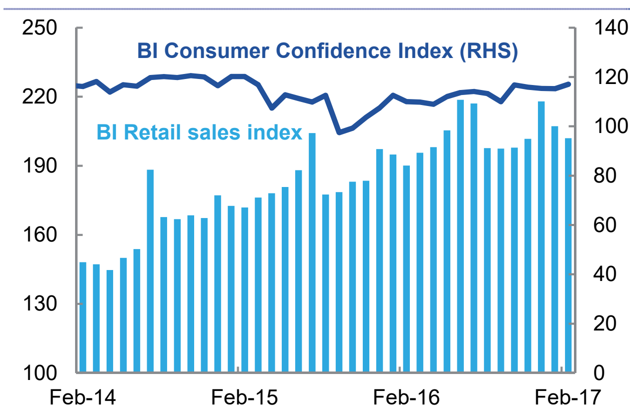
Source: BPS; World Bank staff calculations

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



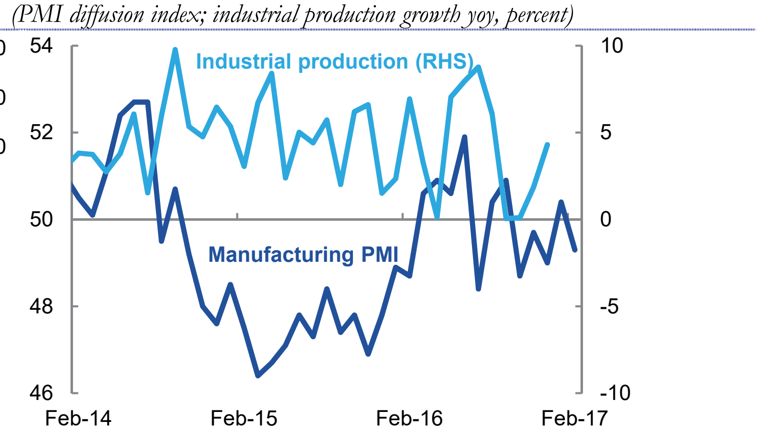
Source: CEIC; World Bank staff calculations

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



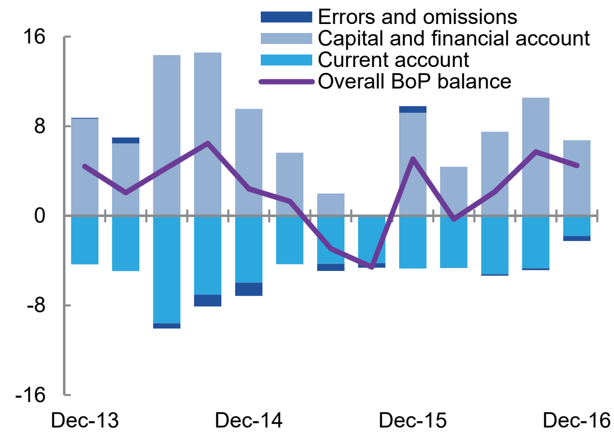
Source: BI

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



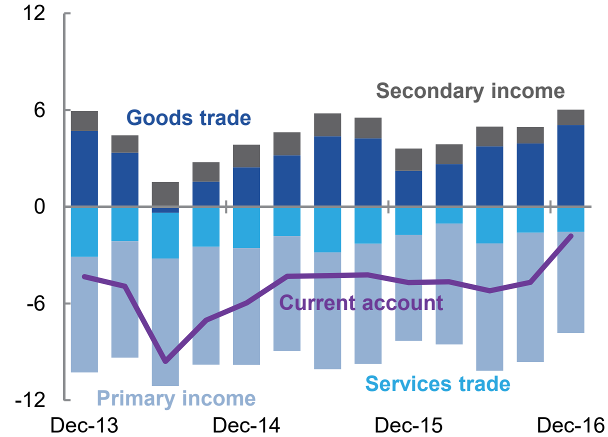
Source: BPS; Nikkei/Markit; World Bank staff calculations

Appendix Figure 7: Balance of payments
(USD billion)



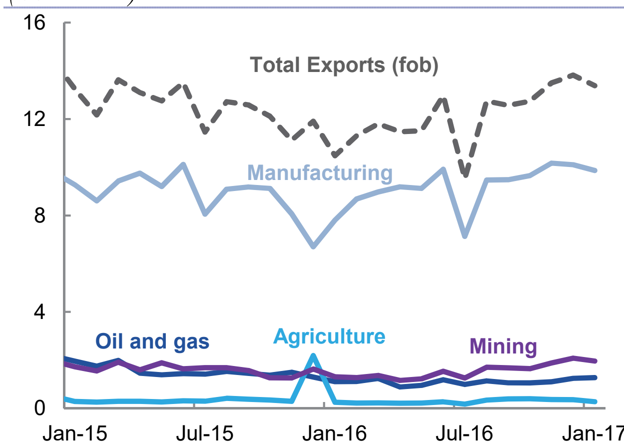
Source: BI

Appendix Figure 8: Current account components
(USD billion)



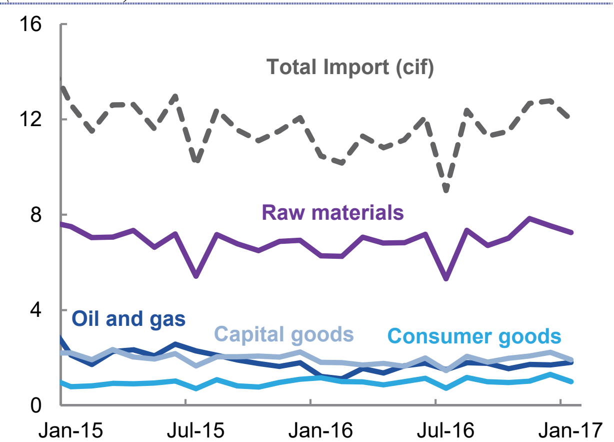
Source: BI

Appendix Figure 9: Exports of goods
(USD billion)



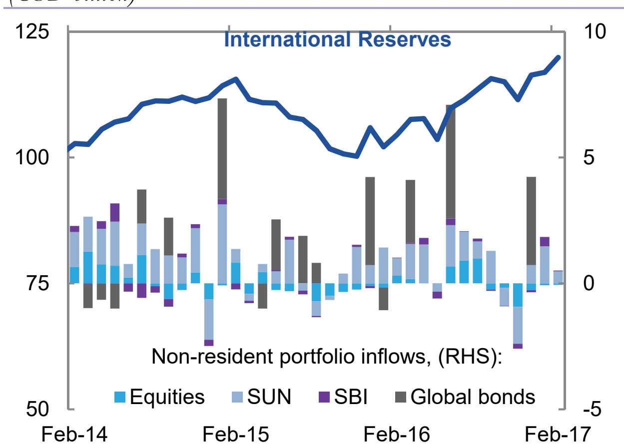
Source: BPS

Appendix Figure 10: Imports of goods
(USD billion)



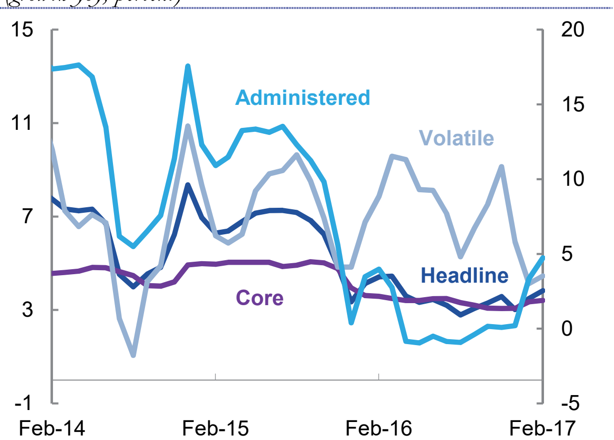
Source: BPS

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



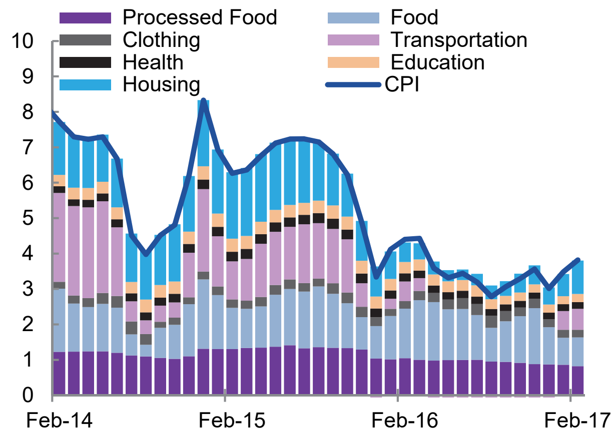
Source: BI; Ministry of Finance (MoF)
Note: SUN is Government securities, SBI is BI certificates

Appendix Figure 12: Inflation
(growth yoy, percent)



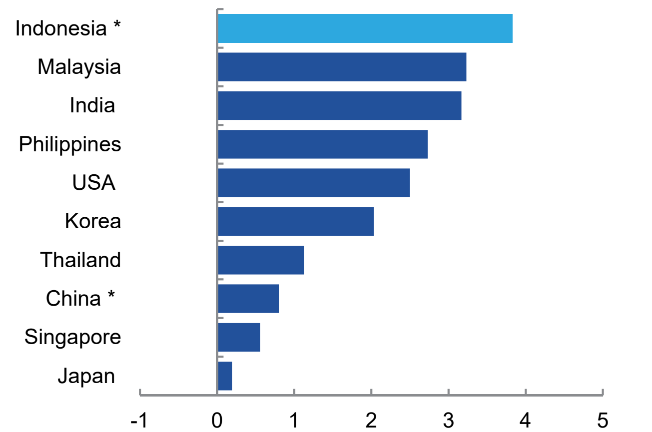
Source: BPS; BI; World Bank staff calculations

Appendix Figure 13: Monthly breakdown of CPI
(contribution to growth yoy, percentage points)



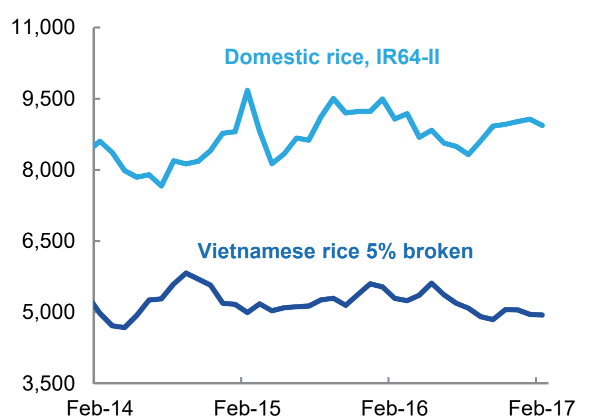
Source: BPS; World Bank staff calculations

Appendix Figure 14: Inflation comparison across countries
(growth yoy, percent)



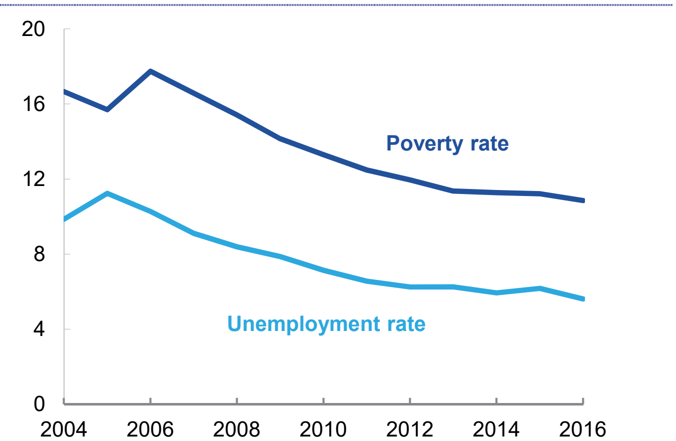
Source: BPS; CEIC; World Bank staff calculations
Note: * February 2017 data; others January.

Appendix Figure 15: Domestic and international rice prices
(wholesale price, IDR per kg)



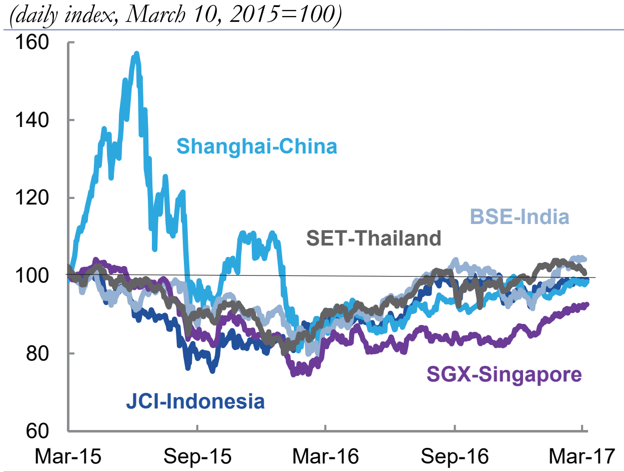
Source: Cipinang wholesale rice market; FAO
Note: "5% broken" refers to the quality of milled rice. 5 percent being the proportion of grains fragmented during the processing stage.

Appendix Figure 16: Poverty and unemployment rate
(percent)



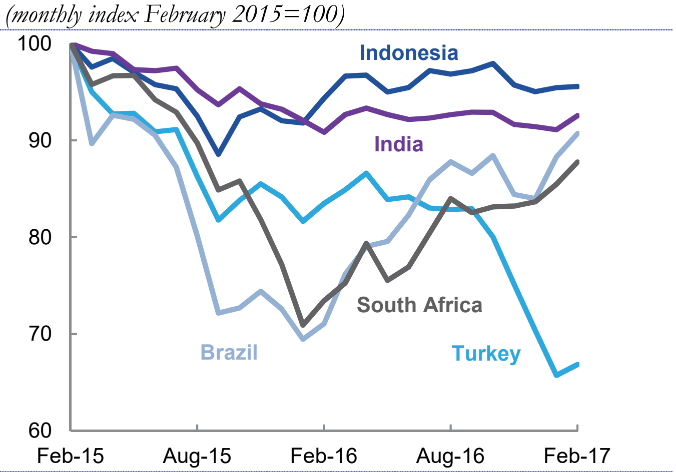
Source: BPS
Note: Povety line based on national poverty line

Appendix Figure 17: Regional equity indices
(daily index, March 10, 2015=100)



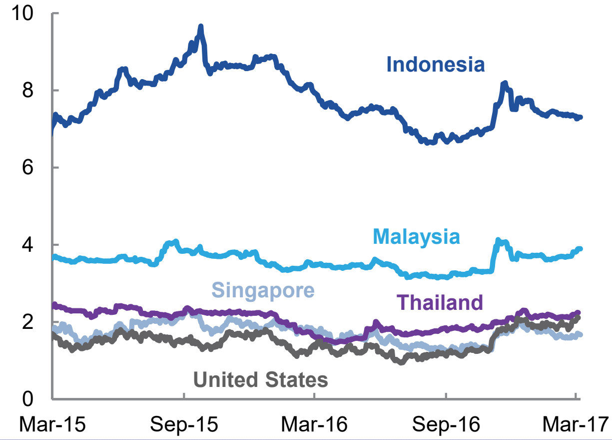
Source: CEIC; World Bank staff calculations

Appendix Figure 18: Selected currencies against USD
(monthly index February 2015=100)



Source: CEIC; World Bank staff calculations

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

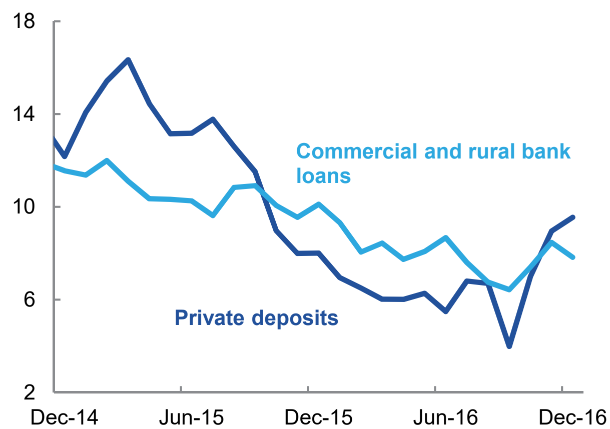


Source: CEIC

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

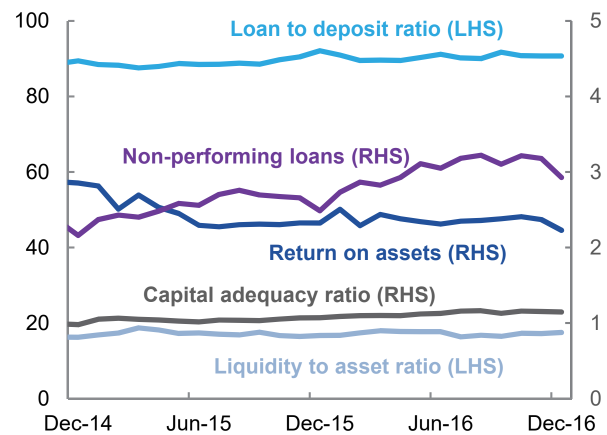
Source: JP Morgan

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



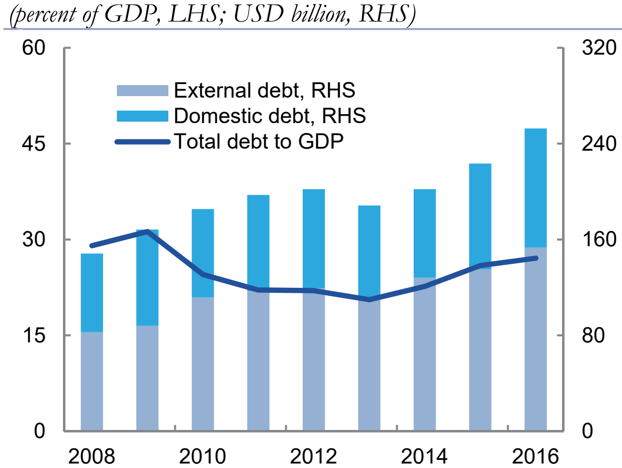
Source: BI; World Bank staff calculations

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



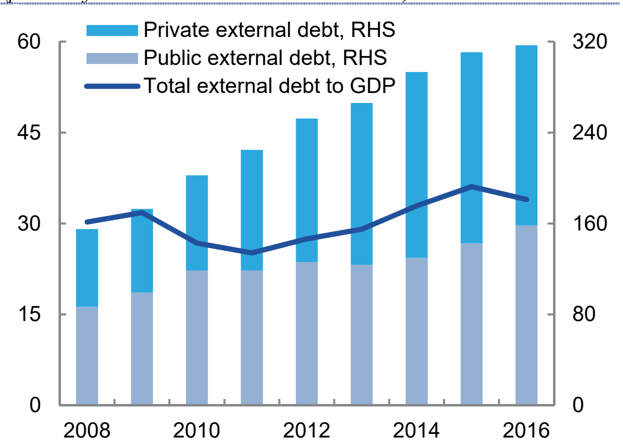
Source: BI; World Bank staff calculations

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 and projections

(IDR trillion)

	2012 Actual	2013 Actual	2014 Actual	2015 Actual	2016 Preliminary Actual	2017 Budget
A. State revenue and grants	**1,338**	**1,439**	**1,550**	**1,508**	**1,552**	**1,750**
1. Tax revenue	981	1,077	1,147	1,240	1,284	1,499
2. Non-tax revenue	352	355	399	256	262	250
B. Expenditure	**1,491**	**1,651**	**1,777**	**1,807**	**1,860**	**2,080**
1. Central Government	1,011	1,137	1,204	1,183	1,149	1,316
2. Transfers to the regions	481	513	574	623	711	765
C. Primary balance	**-53**	**-99**	**-93**	**-142**	**-125**	**-109**
D. SURPLUS / DEFICIT	-153	-212	-227	-298	-308	-330
(percent of GDP)	-1.8	-2.2	-2.1	-2.6	-2.5	-2.4

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	2015		2016			
				Q3	Q4	Q1	Q2	Q3	Q4
Balance of payments	**15.2**	**-1.1**	**12.1**	**-4.6**	**5.1**	**-0.3**	**2.2**	**5.7**	**4.5**
Percent of GDP	1.7	-0.1	1.3	-2.1	2.4	-0.1	0.9	2.3	1.9
Current account	**-27.5**	**-17.5**	**-16.3**	**-4.2**	**-4.7**	**-4.7**	**-5.2**	**-4.7**	**-1.8**
Percent of GDP	-3.1	-2.0	-1.8	-2.0	-2.2	-2.1	-2.3	-1.9	-0.8
Trade balance	-3.0	5.4	8.9	2.0	0.5	1.6	1.5	2.3	3.5
Net income & current transfers	-24.5	-22.9	-25.3	-6.2	-5.2	-6.3	-6.7	-7.0	-5.3
Capital & Financial Account	**44.9**	**16.9**	**29.2**	**0.1**	**9.2**	**4.4**	**7.5**	**10.6**	**6.8**
Percent of GDP	5.0	2.0	3.1	0.0	4.3	2.0	3.3	4.3	2.8
Direct investment	14.7	10.7	15.1	1.6	2.8	3.1	3.3	6.5	2.2
Portfolio investment	26.1	16.2	18.9	-2.2	4.3	4.4	8.3	6.5	-0.4
Other investment	4.3	-10.1	-4.8	0.4	2.3	-3.1	-4.0	-2.5	4.8
Errors & omissions	**-2.2**	**-0.4**	**-0.8**	**-0.4**	**0.6**	**0.0**	**-0.1**	**-0.2**	**-0.4**
Foreign reserves*	**111.9**	**105.9**	**116.4**	**101.7**	**105.9**	**107.5**	**109.8**	**115.7**	**116.4**

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
National Accounts (% change)[1]								
Real GDP	4.9	6.2	6.2	6.0	5.6	5.0	4.9	5.0
Real investment	11.4	8.5	8.9	9.1	5.0	4.4	5.0	4.5
Real consumption	4.6	4.1	5.1	5.4	5.7	4.7	4.9	4.3
Private	3.7	4.8	5.1	5.5	5.5	5.3	4.8	5.0
Government	14.2	0.3	5.5	4.5	6.7	1.2	5.3	-0.1
Real exports, GNFS	30.6	15.3	14.8	1.6	4.2	1.1	-2.1	-1.7
Real imports, GNFS	26.6	17.3	15.0	8.0	1.9	2.1	-6.4	-2.3
Investment (% GDP)	20	31	31	33	5.0	4.4	5.0	4.5
Nominal GDP (USD billion)	165	755	893	918	915	891	861	933
GDP per capita (USD)	857	3,167	3,688	3,741	3,528	3,442	3,329	3,603
Central Government Budget (% GDP)[2]								
Revenue and grants	20.8	14.5	15.5	15.5	15.1	14.7	13.1	..
Non-tax revenue	9.0	3.9	4.2	4.1	3.7	3.8	2.2	..
Tax revenue	11.7	10.5	11.2	11.4	11.3	10.9	10.7	..
Expenditure	22.4	15.2	16.5	17.3	17.3	16.8	15.7	..
Consumption	4.0	3.6	3.8	3.9	4.1	4.0	4.5	..
Capital	2.6	1.2	1.5	1.7	1.9	1.4	1.9	..
Interest	5.1	1.3	1.2	1.2	1.2	1.3	1.4	..
Subsidies	6.3	2.8	3.8	4.0	3.7	3.7	1.6	..
Budget balance	-1.6	-0.7	-1.1	-1.8	-2.2	-2.1	-2.6	..
Government debt	97.9	24.5	23.1	23.0	24.9	24.7	26.8	..
o/w external Government debt	51.4	11.1	10.2	9.9	11.2	10.2	11.9	..
Total external debt (including private sector)	87.1	26.8	25.2	27.5	29.1	32.9	36.0	..
Balance of Payments (% GDP)[3]								
Overall balance of payments	..	4.0	1.3	0.0	-0.8	1.7	-0.1	1.3
Current account balance	4.8	0.7	0.2	-2.7	-3.2	-3.1	-2.0	-1.8
Exports GNFS	42.8	22.0	23.8	23.0	22.5	22.3	19.9	18.1
Imports GNFS	33.9	19.2	21.2	23.2	23.2	22.7	19.3	17.1
Trade balance	8.9	2.8	2.7	-0.2	-0.7	-0.3	0.6	1.0
Financial account balance	..	3.5	1.5	2.7	2.4	5.0	2.0	3.1
Direct investment	-2.8	1.5	1.3	1.5	1.3	1.7	1.2	1.6
Gross official reserves (USD billion)	29.4	96.2	110.1	112.8	99.4	111.9	105.9	116.4
Monetary (% change)[3]								
GDP deflator[1]	20.4	8.3	7.5	3.8	5.0	5.4	4.0	2.5
Bank Indonesia interest key rate (%)	..	6.9	6.5	4.7	6.0	7.9	7.6	7.2
Domestic credit (eop)	..	22.8	24.6	23.1	21.6	11.6	10.4	..
Nominal exchange rate (average, IDR/USD)	8,392	9,087	8,776	9,384	10,460	11,869	13,389	13,300
Prices (% change)[1]								
Consumer price Index (eop)	9.4	7.0	3.8	3.7	8.1	8.4	3.4	3.0
Consumer price Index (average)	3.7	5.1	5.3	4.0	6.4	6.4	6.4	3.5
Indonesia crude oil price (USD per barrel, eop)[4]	28	79	112	113	107	60	36	51

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
Demographics[1]								
Population (million)	213	242	245	248	251	254	258	..
Population growth rate (%)	1.3	1.3	1.3	1.3	1.3	1.3	1.2	..
Urban population (% of total)	42	50	51	51	52	53	53.7	..
Dependency ratio (% of working-age population)	55	51	51	50	50	49	49.0	..
Labor Force[2]								
Labor force, total (million)	98	117	117	120	120	122	122	125
Male	60	72	73	75	75	76	77	77
Female	38	45	44	46	45	46	46	48
Agriculture share of employment (%)	45	38	36	35	35	34	33	32
Industry share of employment (%)	17	19	21	22	20	21	22	21
Services share of employment (%)	37	42	43	43	45	45	45	47
Unemployment, total (% of labor force)	8.1	7.1	7.4	6.1	6.2	5.9	6.2	5.6
Poverty and Income Distribution[3]								
Median household consumption (IDR 000 per month)	104	374	421	446	487	548	623	697
National poverty line (IDR 000 per month)	73	212	234	249	272	303	331	354
Population below national poverty line (million)	38	31	30	29	28	28	29	28
Poverty (% of population below national poverty line)	19.1	13.3	12.5	12.0	11.4	11.3	11.2	10.9
Urban (% of population below urban poverty line)	14.6	9.9	9.2	8.8	8.4	8.3	8.3	7.8
Rural (% of population below rural poverty line)	22.4	16.6	15.7	15.1	14.3	14.2	14.2	14.1
Male-headed households	15.5	11.0	10.2	9.5	9.2	9.0	9.3	9.0
Female-headed households	12.6	9.5	9.7	8.8	8.6	8.6	11.1	9.8
Gini index	0.30	0.38	0.41	0.41	0.41	0.41	0.41	0.40
Percentage share of consumption: lowest 20%	9.6	7.9	7.4	7.5	7.4	7.5	7.2	7.1
Percentage share of consumption: highest 20%	38.6	40.6	46.5	46.7	47.3	46.8	47.3	46.2
Public expenditure on social security & welfare (% of GDP)[4]	..	0.40	0.40	0.39	0.59	0.53	0.59	0.60
Health and Nutrition[1]								
Physicians (per 1,000 people)	0.16	0.29	..	0.20	..	..		..
Under five mortality rate (per 1000 children under 5 years)	52	33	32	30	29	28	27	..
Neonatal mortality rate (per 1000 live births)	22	16	16	15	15	14	14	..
Infant mortality (per 1000 live births)	41	27	26	25	24	24	23	..
Maternal mortality ratio (modeled est., per 100,000 live births)	265	165	156	148	140	133	126	..
Measles vaccination (% of children under 2 years)	74	78	80	85	84	77	69	..
Total health expenditure (% of GDP)	2.0	2.9	2.7	2.9	2.9	2.8	..	..
Public health expenditure (% of GDP)	0.7	1.1	1.1	1.2	1.2	1.1	..	..
Education[3]								
Primary net enrollment rate (%)	..	92	92	93	92	93	97	97
Female (% of total net enrollment)	..	48	49	49	50	48	49	49
Secondary net enrollment rate (%)	..	61	60	60	61	65	66	66
Female (% of total net enrollment)	..	50	50	49	50	50	51	51
Tertiary net enrollment rate (%)	..	16	14	15	16	18	20	21
Female (% of total net enrollment)	..	53	50	54	54	55	56	55
Adult literacy rate (%)	..	91	91	92	93	93	95	95
Public spending on education (% of GDP)[5]	..	3.5	3.6	3.8	3.8	3.6	3.5	3.0
Public spending on education (% of spending)[5]	..	20.0	20.2	20.1	20.0	19.9	20.6	20.0
Water and Sanitation[1]								
Access to an improved water source (% of population)	78	85	85	86	86	87	87	..
Urban (% of urban population)	91	93	93	94	94	94	94	..
Rural (% of rural population)	68	76	77	77	78	79	80	..
Access to improved sanitation facilities (% of population)	44	57	58	59	60	61	61	..
Urban (% of urban population)	64	70	71	71	72	72	72	..
Rural (% of rural population)	30	44	45	46	47	48	48	..
Others[1]								
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	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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