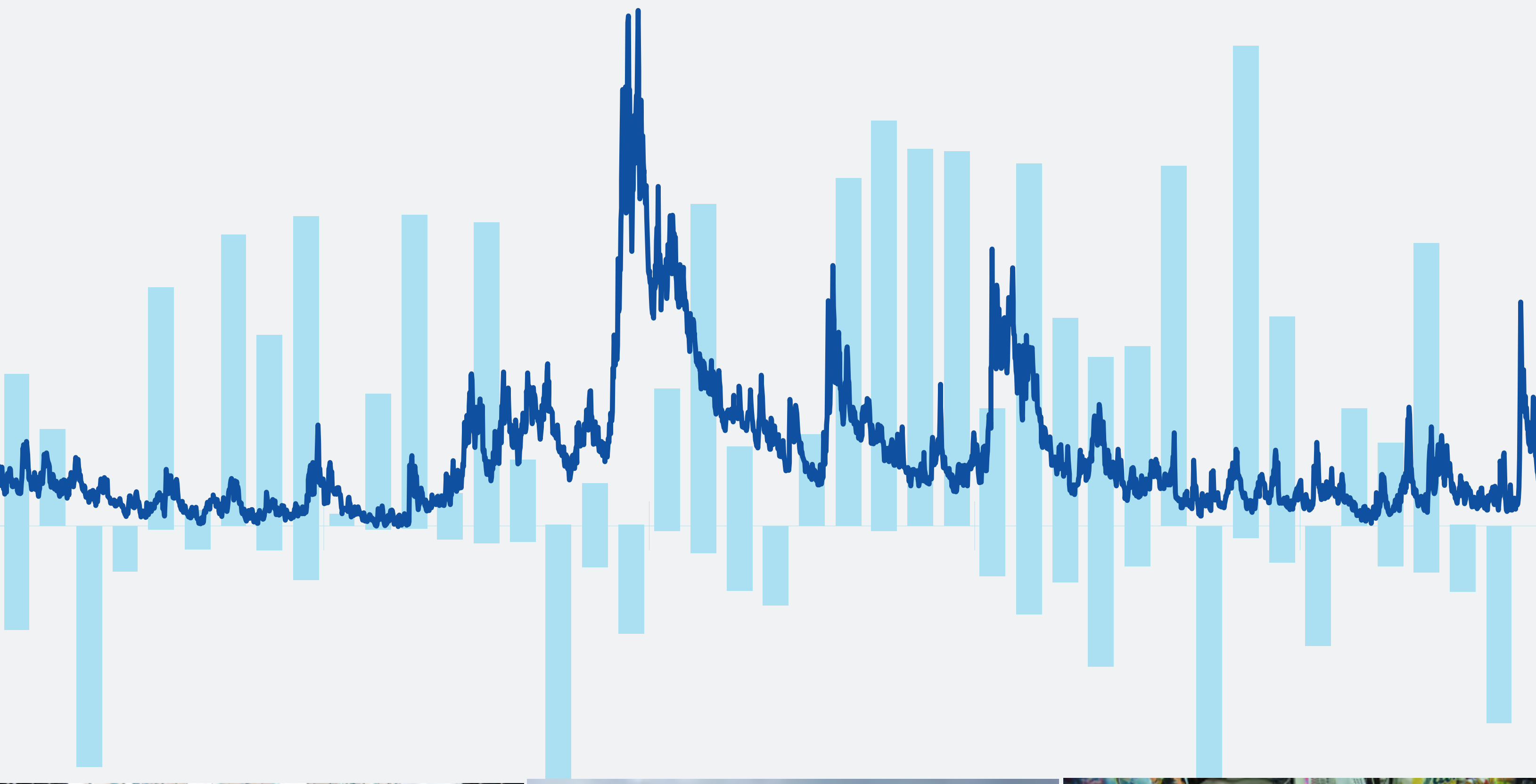
INDONESIA
ECONOMIC
QUARTERLY

October 2015

In times of global volatility



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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 policymakers, 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 Shubham Chaudhuri, Practice Manager, Ndiame Diop, Lead Economist and Hans Anand Beck, Senior Economist. Led by Elitza Mileva, Country Economist, and with responsibility for Part A, editing and production, the core project team comprises Arsianti, Magda Adriani, Masyita Crystallin, Fitria Fitrani, Ahya Ihsan, Yue Man Lee and Violeta Vulovic. Administrative support is provided by Titi Ananto. Dissemination is organized by Indra Irnawan, Jerry Kurniawan, Desy Mutialim and Nugroho Sunjoyo, under the guidance of Dini Djalal.

This edition of the IEQ also includes contributions from Taufik Indra Kusuma, Matthew Grant Wai-Poi and Maria Monica Wihardja (Part A.7, Poverty), Magda Adriani, Elitza Mileva and Maria Monica Wihardja (Part B.1, El Niño), Iene Muliati, Sapto Rahardjo, Budi Sumantoro and Mitchell Wiener (Part B.2, Health insurance), Raven Anderson, Taimur Samad and Tuo Shi (Part C.2, Housing). Key data and input were received from Frida Yanti Putri Nababan (Part A). The report also benefited from discussion with and in-depth comments from Vivi Alatas, Jamie Carter, Edgar Janz, Arvind Nair, Sudhir Shetty, Alex Sienaert, Nikola L. Spatafora, David Nellor (Australia Indonesia Partnership for Economic Governance), David Gottlieb (Australia Department of Foreign Affairs and Trade), Natalie Horvat and John Burch (both Australian Treasury, Australia-Indonesia Government Partnership Fund).

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Indonesia's growth moderation has continued and an uncertain external environment has further limited the room for both monetary and fiscal stimulus…

International financial and economic conditions have deteriorated in recent months, making macroeconomic management more challenging and the downside risks to the near-term outlook more pronounced. Global risk aversion has increased over concerns about China's growth slowdown and financial market volatility, as well as the near-term path of U.S. monetary policy. In addition, the outlook for emerging markets and for global trade has weakened further, with excess supply pushing commodity prices lower. In Indonesia, moderating growth and rising food prices have slowed the pace of poverty reduction. Persistent exchange rate pressures limit monetary policy options. At the same time, low global commodity prices and slower growth have affected revenue collection, reducing the space for fiscal stimulus due to the 3 percent of GDP fiscal deficit limit. Therefore, the government is deploying policy initiatives to strengthen investment and growth and make progress on development priorities.

… and has turned the government's focus to structural and fiscal reforms to raise investor confidence in Indonesia

The government recognizes the need to improve business confidence and the investment climate in order to enhance Indonesia's potential growth rate and has taken several important steps in this direction. Accelerating in the third quarter, public capital spending is estimated to have increased by 21.4 percent in real terms in the first nine months of 2015 compared to the same period in 2014, providing support to growth. Furthermore, in September and October the government announced a series of reform packages focused on reducing the regulatory burden and decreasing the costs of doing business, for example, through expediting investment and land use permits, faster firm registration, and lower energy prices for industrial consumers. In addition to the policy packages, the draft 2016 State Budget signals the objective of further improving the composition of public expenditures by strengthening social programs and by redirecting spending from energy subsidies to infrastructure development. Timely and effective implementation of these reforms will contribute to returning to a higher sustainable pace of growth.

Global headwinds pose significant risks to Indonesia's outlook

Concerns over China's growth prospects and the continuing uncertainty around the normalization of U.S. monetary policy have contributed to a new bout of global financial market volatility since August. These developments have driven emerging market currencies down and financing costs up: the JP Morgan Emerging Markets Currency Index (EMCI) fell by 5.8 percent between June 30 and October 15, while the Emerging Markets Bond Global Index (EMBIG) spread rose by 44 basis points. Between August 10 and September 30, 2015, the Rupiah depreciated by 8.3 percent against the US Dollar but has since recovered to its June 30 level. Indonesia's sovereign external borrowing costs (measured by the JPMorgan EMBIG spread) have increased by 69 basis points since June 30. At the same time, the slowdown in growth in developing countries and in global trade, and low commodity prices have weighed on Indonesian fiscal and export revenues.

GDP growth in Indonesia stabilized at 4.7 percent yoy in Q2 2015, while poverty reduction has stalled

Given the weak external environment, real GDP grew at the moderate pace of 4.7 percent year on year (yoy) in the second quarter, the same rate as in Q1 2015. Fixed investment remained the main driver of the economic slowdown, but private consumption expenditure grew at a moderate 4.7 percent yoy for a second quarter. Net exports contributed positively to growth but only on account of a significant contraction in imports outweighing a slight decline in exports in year-on-year terms. Since GDP growth fell to 5.0 percent and below in 2014 and the first half of 2015, the poverty rate in Indonesia has remained effectively flat.

Subdued domestic demand and low global oil prices continued to alleviate the current account deficit…

Domestic demand moderation and weak imports have reduced the current account deficit by half compared with its year-ago level. The trade deficit of USD 0.4 billion in Q2 2014 has turned into a surplus. Imports fell sharply in the second quarter, with around 40 percent of the decline from year-ago levels driven by lower oil prices. Merchandise export revenues also declined in year-on-year terms – for a sixth consecutive quarter – despite the temporary boost to copper exports from PT Freeport Indonesia's six-month export license granted by the government. In quarter-on-quarter terms, the current account deficit widened slightly to 2.1 percent of GDP in Q2 2015, from 1.9 percent in the previous quarter, owing to weaker services and income accounts, as is typical in the second quarter of every year.

…while the return of financial contagion has significantly reduced short-term capital inflows…

At the same time, the overall balance of payments turned to a deficit of USD 2.9 billion (1.3 percent of GDP) in Q2 2015. The financial account balance, at USD 2.5 billion, fell to its lowest level since Q1 2013 as the increase in direct investment did not fully offset the decline in more volatile capital flows. Strong government bond issuance supported portfolio flows in the first half of the year, but these flows reversed in August amid the tightening in financing conditions for all emerging markets. Foreign investors were net sellers of Rupiah-denominated government debt in July through September, resulting in USD 1 billion outflows. As of September 30, the stock market has experienced net foreign capital outflows of USD 983 million so far this year, with the trend worsening in August and September.

… and limited the scope for monetary stimulus

In response to the significant tightening in international financial conditions and continued exchange rate depreciation pressures, Bank Indonesia (BI) has maintained a relatively restrictive monetary stance and has intervened in currency markets to smooth nominal exchange rate volatility, helping to prevent disorderly depreciation. On the other hand, tighter monetary policy, coupled with lower external financing and weak domestic credit demand, has contributed to the continued weakness in credit growth. Given the current constraints on monetary policy to respond to slowing domestic demand, BI has eased macro-prudential regulation to support property and motor vehicle credit, with limited visible impact so far.

Inflation has remained high, with El Nino affecting moderately CPI inflation and more substantially the inflation experienced by the poor

Despite weak domestic demand-side pressures and tighter credit conditions, consumer price inflation remained above 7 percent yoy between May and August, falling to 6.8 percent yoy in September. The main reasons for the high inflation have been the November 2014 retail fuel price rise (a one-time shock to inflation) and persistently high food, especially rice, price increases. Domestic producer rice prices rose by an average of 16.6 percent yoy in June through September, at a time when international prices were decreasing. In addition to long-standing structural challenges in the agricultural sector (e.g. falling productivity and high labor intensity, poor infrastructure and connectivity, fragmented markets and transaction costs related to obtaining import licenses),[1] food (in particular rice) price pressures have risen in recent months in part because of El Niño related drought in some regions of Indonesia. World Bank estimates suggest that moderate to strong El Niño conditions could raise rice prices by up to 10 percent per year, CPI inflation by at least 0.3 to 0.6 percentage points, and the inflation rate experienced by poor households (which spend a larger share of their income on food) by around 1-2 percentage points. Agricultural households are also likely to have to cope with significantly lower incomes.

GDP growth is expected to bottom out at 4.7 percent in 2015, picking up to 5.3 percent in 2016…

The baseline World Bank projection for 2015 GDP growth remains at 4.7 percent, as in the July 2015 *IEQ*. In 2016, growth is expected to pick up somewhat to 5.3 percent, which is in line with the government's growth assumption in the 2016 draft Budget. Considerable increases in monthly public infrastructure spending since July and measures to improve public project planning and implementation are likely to provide a small boost to fixed investment towards the end of 2015, with most of the impact on GDP growth expected next year. The slight improvement in growth in 2016 is also based on economic activity strengthening in the Euro Area and Japan and global trade rising, albeit at a pace still significantly below the pre-2008 average. As a result, the demand for commodities is expected to increase somewhat and push export and investment growth higher, though still well below the average before the commodities downturn.

[1] For more on the structural characteristics of rice production in Indonesia see Part B.1 of the March 2015 *IEQ*.

… with risks to the outlook tilted to the downside

A faster-than-expected slowdown in China and lower-than-projected global commodity prices are a key downside risk to the outlook. Risks stemming from financial market volatility related to uncertainty about both the pace and magnitude of the normalization of U.S. monetary policy and the prospects for China have increased since August. The significant Rupiah depreciation, rising refinancing costs, insufficient hedging of foreign currency debt, and reduced profit margins have weakened corporate balance sheets, especially in the natural resources sector. Given significant external headwinds and constrained policy space, improvements to the baseline growth outlook will critically depend on effective implementation of the recently announced reform packages.

Table 1: In the base case, GDP growth is projected at 4.7 percent in 2015

		2014	2015p	2016p
Real GDP	(Annual percent change)	5.0	4.7	5.3
Consumer price index	(Annual percent change)	6.4	6.5	5.2
Current account balance	(Percent of GDP)	-3.1	-2.0	-2.6
Budget balance*	(Percent of GDP)	-2.2	-2.2	n.a.

Note: * 2015 estimate by the Ministry of Finance.
Source: BI; BPS; Ministry of Finance; World Bank staff calculations

Implementation of Indonesia's national health insurance program is proceeding, though more needs to be done to achieve universal access and to support broader social and economic goals

Indonesia's national health insurance program, launched on January 1, 2014, ensures portability of coverage regardless of one's place of employment and provides households with protection against financial shocks, such as illness of the primary wage earner. By aiming to provide universal access to healthcare, the program will help reduce poverty and vulnerability, increase income growth among the bottom 40 percent of the population, free up micro-capital for investment, and enhance human capital and productivity. However, as of end-2014, 82 percent of all members were covered by either central or local government budgets rather than user contributions. Furthermore, the healthcare services cost of non-salaried workers exceeded their contributions on a cash basis by a factor of 6, contributing to the negative net asset position of the Social Security Health Fund in 2015. To fulfill the broader developmental objectives, the intermediate goals of universal coverage and financial sustainability must be achieved too.

There is currently strong political momentum to increase the supply of affordable housing, but spending in the sector needs to be more equitable and effective

Delivering affordable housing is another developmental policy priority. Although estimates vary widely, Statistics Indonesia (*Badan Pusat Statistik*, BPS) puts Indonesia's housing backlog at 17.2 million units. The key constraint to significantly improving housing outcomes is affordability. Costly land acquisition and procedures to obtain permits, rising construction costs, and limited long-term bank funding have combined to make affordable housing development a risky and unattractive activity. On the demand side, limited financial inclusion, low incomes, and a lack of household savings limit access to formal housing. The government's plans include a mandatory savings-for-housing scheme and an ambitious initiative called One Million Homes (*Satu Juta Rumah*). The latter aims to produce one million housing units annually over the next five years. However, it would be important to reorient housing policy towards low income households, as public spending on housing has not always been equitable.

A. Economic and fiscal update

1. Recent developments in China triggered global financial market volatility

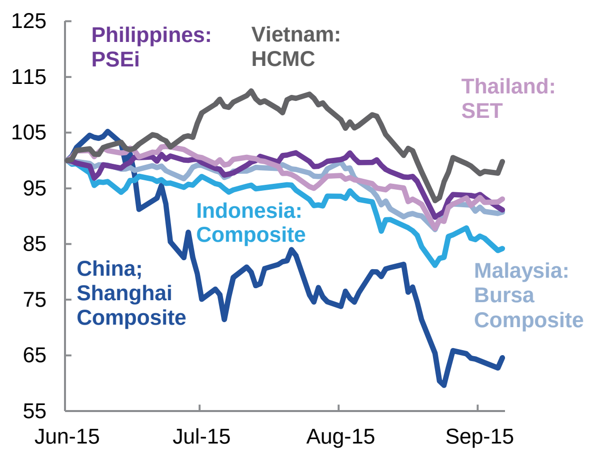
External risks, both financial and trade-related, have risen in recent months

The perceived possibility of a more significant than expected economic slowdown and higher stock market volatility in China have contributed to the rise in global investor risk aversion in recent months. These financial market developments come at a time of a broader weakening in the outlook for global growth and trade, further decline in commodity prices, and continuing uncertainty about the pace and magnitude of the normalization of U.S. monetary policy. Overall, the external environment has become more challenging in recent months, intensifying the downside risks to the near-term outlook for commodity exporting countries, including Indonesia.

Higher global investor risk aversion has pushed emerging market asset prices lower

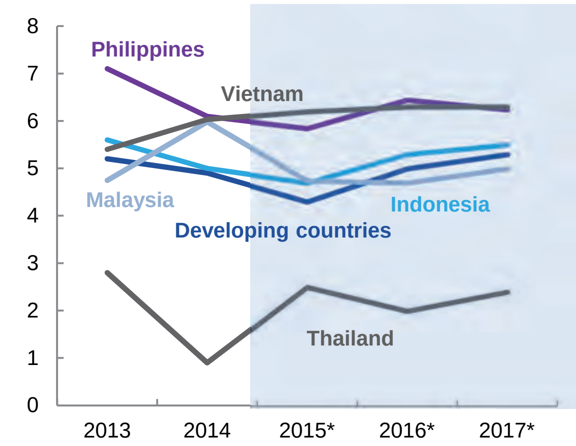
After a strong rally which began in November 2014, Chinese equity prices have experienced a sharp decline since June this year, falling by approximately 30 percent between June and August (Figure 1). In addition, a decision by the People's Bank of China to pursue a more flexible exchange rate regime resulted in the Renminbi depreciating by 1.9 percent against the U.S. dollar on August 11, 2015. However, many market analysts initially interpreted the move as a policy response to a weaker than expected economic outlook. These events triggered renewed global financial market volatility, with the MSCI emerging markets index falling by 11.1 percent and emerging market currencies, as measured by the JP Morgan EMCI index, by 5.8 percent between June 30 and October 15. Indonesian financial markets have also been severely affected, although their performance has not been exceptionally weak (see Section 5). The Jakarta Composite Index (JCI) fell by 8.2 percent between June 30 and October 15, leaving it down 13.7 percent over 2015 to date. The Rupiah weakened by 9.9 percent between end-June and September 30, but has since recovered, resulting in a 6.5 percent depreciation year to date.

Figure 1: Emerging market assets declined sharply as uncertainty about China's outlook increased
(stock market indices, June 3,2015=100)



Source: CEIC; World Bank staff calculations

Figure 2: The outlook for developing countries is subdued, though slightly better for Indonesia
(average annual GDP growth, percent)

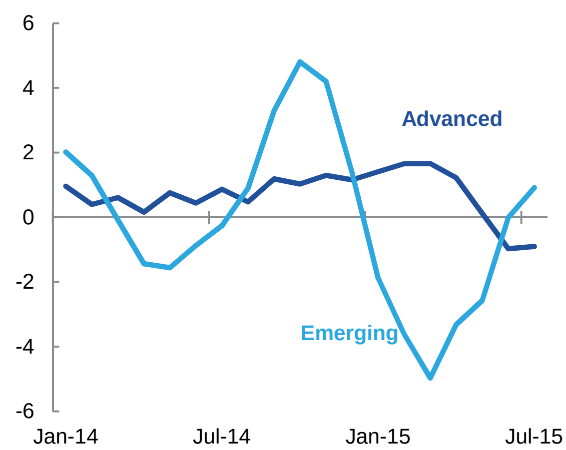


Note: * World Bank forecast
Source: World Bank staff projections

Subdued global economic activity and trade growth have put further downward pressure on commodity prices

The pickup in global growth projected by the World Bank earlier in the year has remained elusive. The recovery in high-income economies, with the exception of the U.S., remained subdued in the second quarter of 2015. The slowdown in developing countries intensified but slightly better-than-average growth is expected in Indonesia (Figure 2). Moreover, international trade momentum has weakened to levels last observed in the aftermath of the global financial crisis (Figure 2). Global trade volumes declined by 1.4 percent in three-month on three-month (3m/3m) terms in the first quarter of the year, and a further -0.3 percent 3m/3m in the second quarter.[2] Owing to slow global demand growth, and further weakened by recent concern over China's outlook, international oil prices have declined by an average of 45.9 percent yoy in the nine months to September, whereas non-energy prices have weakened by 14.6 percent yoy.[3]

Figure 3: Weak import demand also remains a challenge
(three-month on three-month growth of import volumes, percent)



Source: CPB Netherlands Bureau for Economic Policy Analysis; World Bank staff calculations

[2] Based on data until July 2015 from the CPB Netherlands Bureau for Economic Policy Analysis.
[3] Calculated using the World Bank Commodity Price Indices for Emerging Countries for petroleum and non-energy commodities.

2. Moderate consumption and subdued investment restrain growth

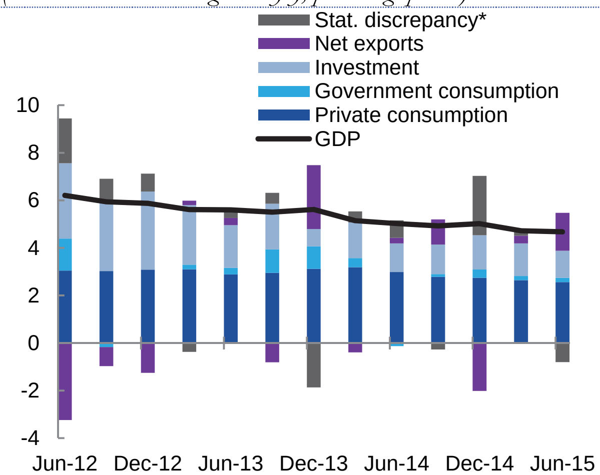
A broad-based slowdown in growth was recorded in Q2 2015, partly offset by declining imports, with the trend continuing in the near term

Following the trend among emerging economies, Indonesia's growth moderation continued into the second quarter. Private consumption expenditure and construction investment, both important drivers of growth, increased at a subdued pace. In line with weak domestic demand, imports contracted significantly, thus supporting growth. Exports continued to decline in year-on-year terms, albeit by less than in previous quarters. The economic stimulus from higher public infrastructure spending is expected only towards the end of 2015 with only a limited impact on growth this year. The growth outlook for 2015 remains unchanged at 4.7 percent yoy, picking up to 5.3 percent yoy in 2016 on the back of gradually improving external conditions and a small boost from government capital expenditure.

Real GDP grew by 4.7 percent yoy for a second quarter, as fixed investment decelerated further…

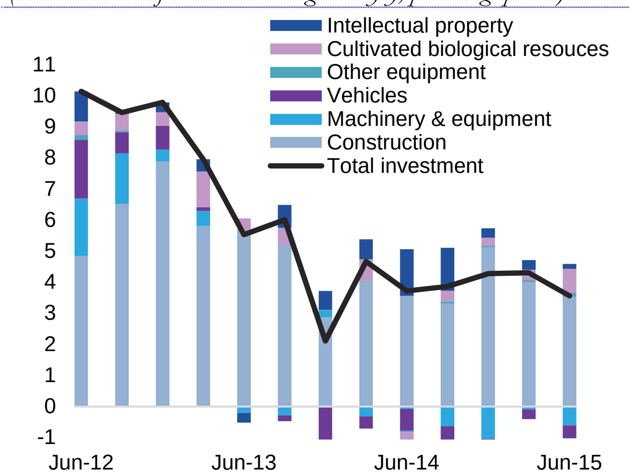
Real GDP grew at 4.7 percent yoy in Q2 2015, the same pace as in the previous quarter (Figure 4). The main reason for the Q2 weakness in economic activity remained fixed investment which increased by 3.2 percent yoy, down from 4.3 percent yoy in the previous quarter. Spending on machinery and equipment and vehicles contracted by 5.6 and 7.5 percent yoy, respectively, maintaining the negative growth contribution of these investment categories in most quarters since 2013. Construction growth, still the main driver of fixed investment, decelerated to 4.8 percent yoy, from 5.5 percent in Q1 2015.

Figure 4: The growth moderation continued in Q2 2015, with investment weakening further…
(contributions to GDP growth yoy, percentage points)



Note: * Statistical discrepancy includes changes in inventories.
Source: BPS; World Bank staff calculations

Figure 5: … on account of declining real spending on machinery, equipment and vehicles
(contributions to fixed investment growth yoy, percentage points)



Source: BPS; World Bank staff calculations

… and consumption expenditure growth remained relatively subdued…

Private consumption expenditure grew at the same moderate pace of 4.7 percent yoy recorded in the first quarter. This compares with an average growth rate of 5.4 percent yoy in 2012-2014 and corroborates the narrative that the GDP growth moderation and slower job creation since 2012 have translated into weaker consumer sentiment and lower household spending this year. Government consumption expenditure grew by 2.3 percent yoy, down from 2.7 percent yoy in the first quarter.

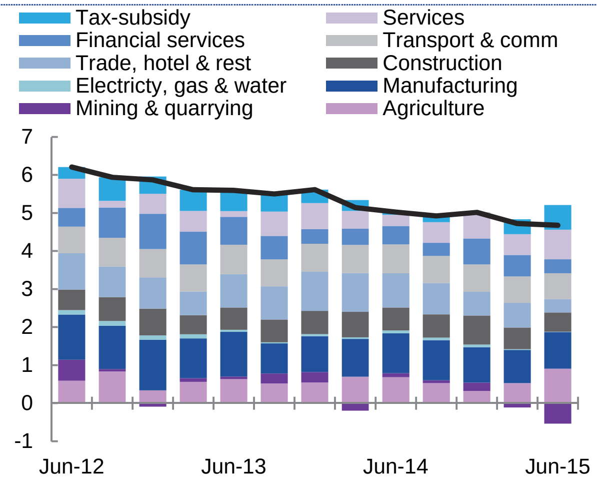
… while very weak import volumes supported growth

Net exports contributed 1.6 percentage points to growth in Q1 2015, but this was due entirely to a decline in imports, by 6.8 percent yoy, the weakest import data release since 2009. The decrease in import volumes was due to non-oil and gas goods and services, while oil and gas import volumes increased. According to monthly customs trade data, a decrease in (nominal) imports was observed across all three categories – consumer goods, capital goods and raw materials. On the other hand, exports were almost flat in year-on-year terms, recording a decline of 0.1 percent. In the second quarter, exports were supported only by the resumption of copper shipments by Freeport in May, after the company obtained an export license from the government.

On the production side, the mining sector continued to be a drag on growth

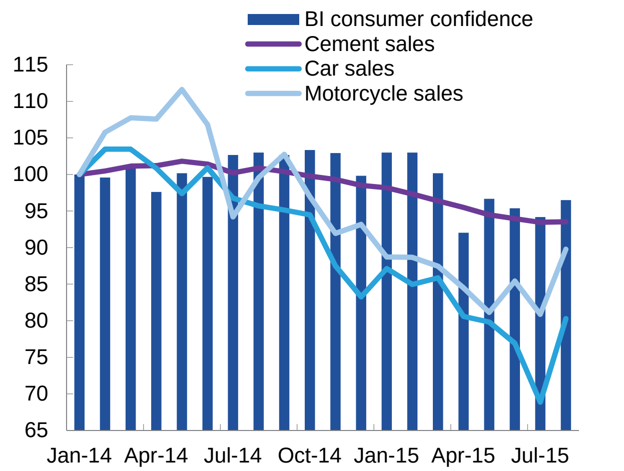
From the production perspective, mining and quarrying contributed negatively to GDP growth in the second quarter, while the contributions of construction and services declined. Mining and quarrying output contracted by 5.9 percent yoy, contributing -0.5 percentage points to GDP growth. Agriculture and manufacturing sector growth picked up slightly from Q1 2015, contributing 0.9 and 1.0 percentage points to GDP growth, respectively.

Figure 6: Mining contributed negatively to growth
(contributions to GDP growth yoy, percentage points)



Source: BPS; World Bank staff calculations

Figure 7: Monthly economic activity indicators recovered from their low July levels
(seasonally adjusted data, January 2014 = 100)



Source: CEIC; World Bank staff calculations

A pick-up in monthly August data has not yet signaled a recovery in year-on-year growth

A tentative improvement in monthly economic activity indicators was observed in August, after steep July declines (in seasonally adjusted terms) (Figure 7). Car and motorcycle sales in particular may have begun to reverse their second-quarter trend of contracting by 20 percent yoy or more. However, Nikkei/Markit's purchasing managers index (PMI) for manufacturing, at 47.4, continues to signal weaker activity. Despite some signs of output momentum picking up in the first two months of Q3 2015, economic activity, as proxied by monthly indicators, remains below year-ago levels.

In the base case, GDP growth, at 4.7 percent in 2015, remains unchanged from the rate

Looking ahead, the World Bank projects GDP growth of 4.7 percent for 2015 and an improvement to 5.3 percent in 2016. Most high-frequency indicators continue to signal economic weakness in the third quarter relative to 2014 and credit conditions remain relatively tight. In addition, there is limited scope for Bank Indonesia to loosen monetary policy, given sticky inflation (see Section 3), persistent external vulnerabilities, and highly volatile global financial markets, especially since August

projected in the July 2015 *IEQ*

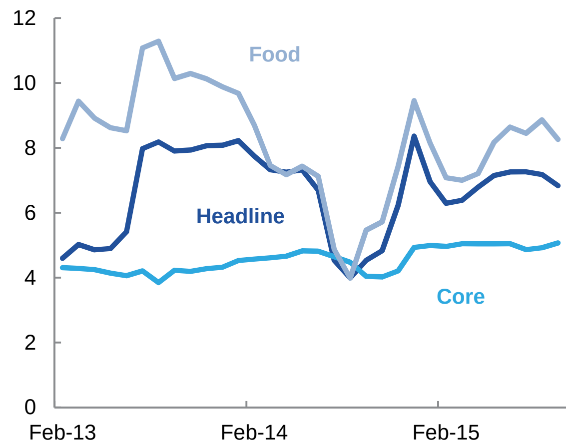
(see Section 5). Recent increases in monthly public infrastructure spending, as well as measures to improve project planning and implementation (see Section 6), point to a slight pick-up in fixed investment towards the end of this year, with most of the impact on GDP growth expected in 2016. In addition to the projected small infrastructure boost, the 2016 growth forecast is based on economic activity strengthening in the Euro Area and Japan and global trade rising, albeit at a pace still significantly below the average before the global financial crisis, and commodity prices increasing somewhat in the near term.[4]

3. Near-term inflation uncertainty has risen on account of so far moderate El Niño conditions

Headline inflation remains high on account of sustained increases in domestic food prices

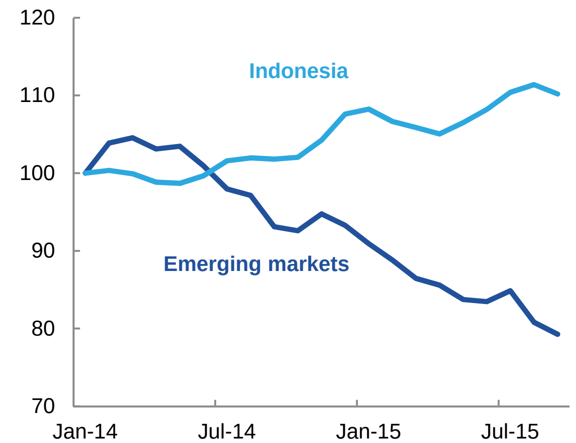
CPI inflation has remained above 7 percent yoy since May owing to persistently high food price increases of 8.5 percent yoy on average in May-August, compounding the base effect from the sharp increase in retail fuel prices in November 2014 (Figure 8). There was a small decline in headline inflation to 6.8 percent yoy in September. At the same time, core inflation, which excludes the more volatile food and energy prices, has stabilized at around 5.0 percent yoy. Headline inflation has stayed high despite unchanged retail gasoline and diesel prices since March and weaker domestic demand growth. Moreover, over the same period, international food prices, as measured by the World Bank food price index for emerging markets, have experienced a sustained decline since May last year as economic activity across countries has remained subdued (Figure 9). The diverging trajectory of domestic food price inflation is likely due to structural factors in the agricultural sector, such as falling productivity and high labor intensity, poor infrastructure and connectivity, fragmented markets, and transaction costs related to obtaining import licenses.

Figure 8: CPI inflation has remained high as domestic food price pressures persist…
(change yoy, percent; last observation September 2015)



Note: Food prices are a weighted average of the raw and processed food price components of CPI.
Source: BPS; World Bank staff calculations

Figure 9: … despite falling international food prices
(index, January 2014 = 100; last observation September 2015)



Note: World Bank food price index for emerging markets; CPI raw food component for Indonesia.
Source: BPS; World Bank; World Bank staff calculations

[4] See the latest World Bank projections in the East Asia Pacific Economic Update, October 2015: Staying the Course.

In the base case, a limited El Niño price effect is projected, with upside risks to inflation

The World Bank expects an annual average CPI inflation rate of 6.5 percent in 2015, declining to an average rate of 5.2 percent in 2016, only slightly above the upper limit of the BI target range. Apart from base effects due to the large November 2014 fuel price increase, the 2015 headline inflation forecast is based on continued Rupiah weakness and sticky domestic food prices, while demand-side pressures remain limited. The baseline inflation projections also account for the relatively limited effect of a moderate El Niño on prices (see Part B.1). According to an update by Indonesia's National Meteorology, Climatology and Geophysics Agency (*Badan Meteorologi, Klimatologi dan Geofisika*, BMKG), moderate El Niño conditions and below-average rainfall have been observed this year and the El Niño effect is expected to strengthen in August through December 2015.[5] If drought conditions deteriorate further than expected, there is a risk of higher food price rises in early 2016. Finally, implementation of the recently announced measures to remove unnecessary requirements for selected import and export licenses may relieve some of the food price pressure (see Section 8).

Table 2: In the base case, GDP growth is expected to be 4.7 percent in 2015, picking up to 5.3 percent in 2016
(percentage change, unless otherwise indicated)

	Annual			YoY in Fourth Quarter			Revision to Annual	
	2014	2015	2016	2014	2015	2016	2015	2016
1. Main economic indicators								
Total Consumption expenditure	4.8	4.4	4.9	4.5	4.4	5.3	-0.2	0.0
Private consumption expenditure	5.3	4.7	5.2	4.7	4.5	5.7	0.0	0.0
Government consumption	2.0	2.1	3.2	2.7	3.1	3.2	-1.6	-0.1
Gross fixed capital formation	4.1	3.7	5.0	4.3	3.6	5.8	-1.2	-1.1
Exports of goods and services	1.0	-0.2	4.7	-0.9	2.3	6.0	-2.4	-0.9
Imports of goods and services	2.2	-3.2	3.6	-2.3	-0.2	5.9	-4.2	-2.5
Gross Domestic Product	5.0	4.7	5.3	4.7	5.2	5.4	0.0	-0.2
2. External indicators								
Balance of payments (USD bn)	17.2	5.0	17.3	-	-	-	-5.9	0.2
Current account balance (USD bn)	-27.5	-17.8	-24.9	-	-	-	7.1	4.1
As share of GDP (percent)	*-3.1*	*-2.0*	*-2.6*	-	-	-	0.7	0.3
Trade balance (USD bn)	-3.0	5.9	1.2	-	-	-	5.5	1.4
Capital & financial acc. bal. (USD bn)	44.6	22.8	42.2	-	-	-	-13.0	-3.9
3. Other economic indicators								
Consumer price index	6.4	6.5	5.2	6.5	5.5	5.1	-0.3	-0.1
GDP Deflator	5.4	4.9	5.3	4.2	5.2	5.3	0.6	0.0
Nominal GDP	10.7	9.7	10.9	9.2	10.9	11.0	0.6	-0.1
4. Economic assumptions								
Exchange rate (IDR/USD)	11800	13400	14000	-	-	-	200	800
Indonesian crude price (USD/bbl)	98	58	61	-	-	-	-1	-3

Note: Exports and imports refer to volumes from the national accounts. All figures are based on revised and rebased GDP. Exchange rate and crude oil price assumptions are based on recent averages. Revisions are relative to projections in the July 2015 *IEQ*.
Source: BPS; BI; CEIC; World Bank staff projections

[5] BMKG, July 30, 2015, "The impact of El Niño: Indonesia will experience prolonged drought," http://www.bmkg.go.id/BMKG_Pusat/Sestama/Humas/IMBAS_EL-NINO,__INDONESIA_MENGALAMI_KEMARAU_PANJANG.bmkg

4. Capital inflows have remained generally resilient, though recent signs of strain have emerged

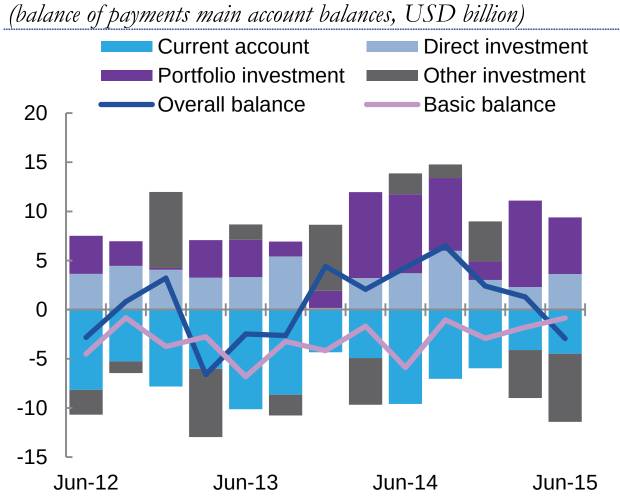
The current account deficit has halved compared with the level in Q2 2014…

The current account deficit narrowed markedly compared to the same period last year. Both exports and imports remained weak compared to last year. Although foreign capital inflows remained resilient in the first half of the year, portfolio flows reversed in August amid the tightening in financing conditions for all emerging markets. Looking forward, the current account deficit is expected to widen on account of rising imports, partly due to higher public infrastructure spending, while the ongoing global weakening in commodity prices and domestic structural challenges that impact Indonesia's international competitiveness restrict export expansion. The risks to financing the current account deficit have become more pronounced as global investor risk aversion has risen in recent months.

… as the oil and gas deficit narrowed significantly

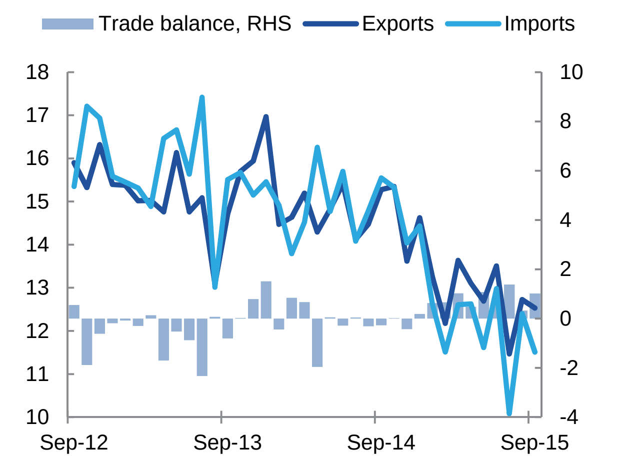
Compared with their year-ago levels the current account deficit has halved, to -2.1 percent of GDP (USD -4.5 billion), and the trade deficit of USD 0.4 billion in Q2 2014 has turned into a surplus of USD 4.1 billion, mainly because of lower imports. The oil and gas trade deficit declined by 33 percent yoy, to USD 2.1 billion in Q2 2015, supported by falling oil prices as volumes remained stable. This trend is expected to continue into the third quarter as July and August trade data show a positive balance of USD 1.8 billion, largely due to a further narrowing in the oil and gas deficit (Figure 11). The current account deficit widened by 0.2 percent of GDP in Q2 2015, from -1.9 percent of GDP (USD -4.1 billion) in Q1 2015, owing to a seasonal weakening of the services and income accounts that outweighed an improvement in the goods trade surplus. The income account balance typically deteriorates in the second quarter on account of outflows related to corporate debt servicing and profit repatriation.

Figure 10: The current account deficit widened slightly but portfolio and other investment flows were subdued
(balance of payments main account balances, USD billion)



Note: Basic balance = direct investment + current account balance.
Source: BI; World Bank staff calculations

Figure 11: Monthly trade data point to another quarterly surplus in the third quarter
(USD billion)



Source: BPS; World Bank staff calculations

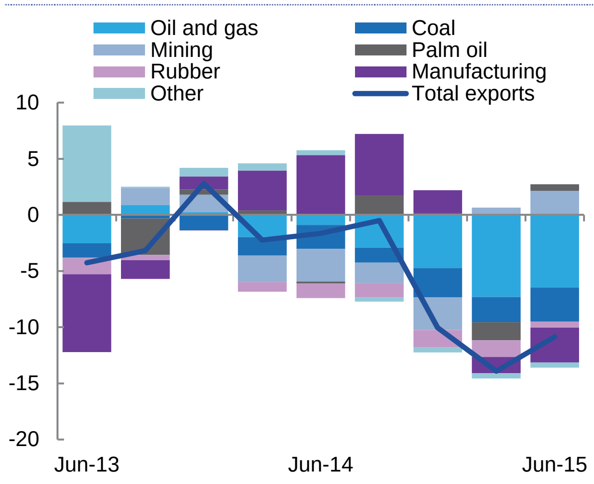
Imports contracted in year-on-year terms for a seventh consecutive quarter

Imports fell sharply, by 20.8 percent yoy in Q2 2015 and, according to monthly trade data, continued declining in July through September by 23.5 percent yoy (Figure 11). Although the Q2 2015 weakening in imports was broad-based (including in consumer and capital goods), fuel and other raw materials contributed more than three quarters of the total decrease in imports, or 8.6 percent yoy and 8.2 percent yoy, respectively. The fall in oil prices continued to drive the decline in imports. The price of Indonesian crude oil[6] decreased from an average of USD 107.1 in the second quarter of 2014 to USD 59.6 in the second quarter of this year, and further to USD 43.1 in September 2015.

Goods exports recorded another large and broad-based decline…

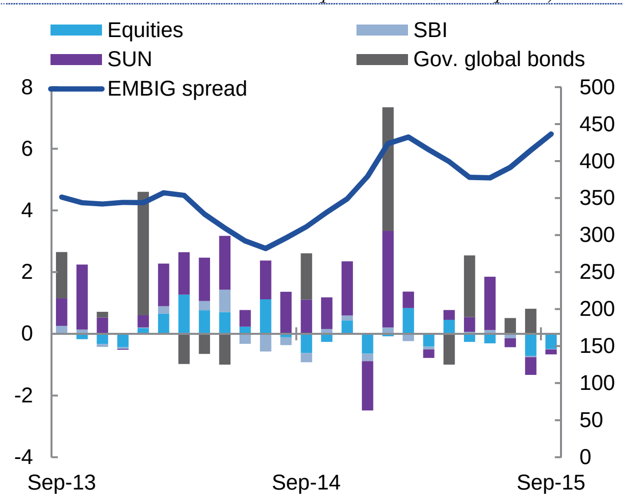
A significant decline in exports, of 10.9 percent yoy, was also observed the second quarter. Revenues from most categories of exports decreased in year-on-year terms, including from non-commodity related manufacturing which contributed -3.3 percentage points yoy to the fall in total exports. Only copper and palm oil exports contributed positively to total growth in Q2 2015, by 2.0 and 0.6 percentage points yoy, respectively (Figure 13). Stockpiling and the granting by the government of a six-month temporary permit to Freeport boosted copper exports in May and June to the level recorded before the partial mineral export ban became effective in January 2014. However, the increase was temporary and in July and August copper exports declined again (from USD 508 million in May to less than USD 383 million in August). Despite a continuing decline in the price of palm oil, exports increased owing to rising demand from India and Pakistan. In terms of volumes, palm oil, copper and rubber exports increased in the second quarter.

Figure 12: The boost to exports from the mining sector is likely to be temporary
(contributions to growth yoy, percent)



Source: BPS; World Bank staff calculations

Figure 13: Foreign ownership of Indonesian assets has declined, raising financing costs
(net foreign purchases, USD billion; net issuance of gov. global bonds, USD billion; Indonesia EMBIG spread, RHS, basis points)



Note: SUN – government bonds denominated in Rupiah; SBI – BI certificates.
Source: BI, JP Morgan; World Bank staff calculations

Capital inflows to Indonesia remained resilient in the second quarter…

Given the tightening in global financial market conditions in 2015, net capital inflows remained generally resilient in the first half of the year. Direct investment totaled USD 5.9 billion in H1 2015, down from USD 6.9 billion in H1 2014, and still well short of the USD 8.5 billion net external financing requirement coming from the H1 2015 current account deficit. Portfolio investment was solid, though short of the record levels of 2015, at USD 8.8 billion in Q1 and USD 5.8 billion in Q2, for a cumulative USD 14.6 billion over H1, down from USD 16.8 billion in H1

[6] The Indonesian crude price is determined by the national oil company, Pertamina, based on the moving average spot price of a basket of five internationally traded crudes: Minas (Indonesia), Tapis (Malaysia), Gippsland (Australia), Dubai (UAE) and Oman.

2014. Bond inflows, particularly into domestic government bonds and external issuance, were particularly resilient, against small net portfolio equity outflows.

… but have since turned into outflows, especially after global asset markets sold off in early August…

However, heightened global financial market volatility in the wake of the Renminbi depreciation and Chinese equity sell-off in August affected Indonesian assets severely (though not disproportionately more than peer emerging markets, see also Section 4). Foreign investors were net sellers of Rupiah-denominated government bonds (SUN) in July through September, resulting in USD 1 billion outflows (Figure 6). July portfolio inflows were supported by the government's global bond issuance (USD 500 million and EUR 1.25 billion), but there were net outflows in August despite the issuance of a JPY 100 billion government bond on August 4. The stock market recorded a net inflow of USD 9.9 million in July and a net outflows in August and September, bringing the year-to-September 30 total to a net outflow of USD 983 million.

…thus raising sovereign borrowing costs

Despite adequate bid-to-cover ratios (2.0 on average in July and August as well as in H1 2015) in government bond auctions, Indonesia's borrowing costs have risen more or less in line with the general emerging market trend. The JP Morgan EMBIG spread for Indonesia decreased by 29 basis points in the first half of the year but rose by 41 basis points between June 30 and October 15. In comparison, the emerging market average EMBIG spread declined by 13 basis points in H1 2015 and increased by 44 basis point between June 30 and October 15. The ten-year government bond yield rose by 47 basis points in the first half of the year and by an additional 40 basis points since then.

The projected current account balance is revised up due to weak imports in the first half of 2015 and further downward revision to commodity prices

The projected current account balance has been revised up by 0.7 percentage points, to -2.0 percent of GDP in 2015 (Table 3). The main reason for the revision was trade data in the first half of 2015, as the expected pickup in imports did not materialize. In addition, the fall in oil prices has caused a slight improvement in the net terms of trade of Indonesia (a net oil importer), despite persistently weak prices for the country's other key export commodities. Indonesia's net terms of trade improved by 3.2 percent between June and August because of a 25.5 percent decrease in the price of Indonesian crude oil against an average decrease of 10.1 percent in the prices of rubber, metals, coal, natural gas, and palm oil. The expected rise in government infrastructure investment has not affected imports yet. It is projected to slightly raise capital imports in the second half of 2015 and in 2016.

Table 3: In the base case, a current account deficit of 2.7 percent of GDP in 2015 is projected
(USD billion unless otherwise indicated)

	2014	2015	2016
Overall balance of payments	15.3	5.0	17.3
As percent of GDP	*1.7*	*0.6*	*1.8*
Current account	-27.5	-17.8	-24.9
As percent of GDP	*-3.1*	*-2.0*	*-2.6*
Goods trade balance	7.0	16.0	12.6
Services trade balance	-10	-10.1	-11.4
Income	-29.7	-29.5	-32.1
Transfers	5.2	5.8	6.0
Capital and financial accounts	44.6	22.8	42.2
As percent of GDP	*5.0*	*2.6*	*4.4*
Direct investment	16.0	11.9	13.8
Portfolio investment	26.1	20.8	24.9
Financial derivatives	-0.2	0.0	-0.1
Other investment	7.1	-0.6	3.4
Memo:			
Basic balance	-11.5	-5.9	-11.1
As percent of GDP	*-1.3*	*-0.7*	*-1.1*

Note: Basic balance = current account balance + net direct investment
Source: BI; World Bank staff calculations

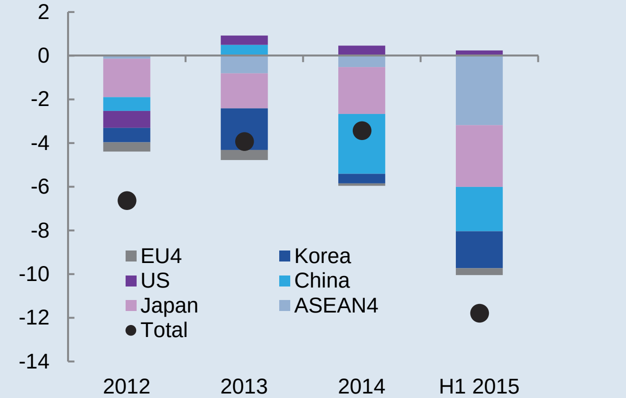
Box 1: How important are trade and direct investment links with China?

China's economic slowdown and move away from an investment-led growth model to one more driven by the services sector and consumer spending are affecting its trading partners. China has been a major export partner for Indonesia for more than two decades. In 2009-2014 China surpassed the U.S. to become Indonesia's second export destination after Japan, with an 11-percent average share in total exports. The rebalancing of China's economy has already had a significant impact on Indonesia's exports. Exports to China contributed -2.0 percentage points yoy to the decline in total exports in the first half of 2015, though ASEAN and Japan had a more significant negative effect (Figure 14). Last year, weak Chinese demand contributed -2.7 percentage points to the annual decline in Indonesian exports.

Indonesia's moderate dependence on trade with China is also confirmed by trade statistics based on value added. With the emergence of global production networks gross trade flow data (discussed in the previous paragraph) have become less accurate in describing trade linkages, as a single product may cross several borders before reaching consumers as a final good. For the same reason trade data may double-count export goods and inflate the total volume of trade. The OECD/WTO TiVA dataset overcomes the shortcomings of gross trade data by providing estimates of exports in value-added terms after accounting for the use of imported inputs to production.[1] In addition, TiVA data account for the fact that domestic value added has two ways of reaching foreign final consumers – directly through exports of final goods or services, and indirectly via exports of intermediates that reach foreign final consumers through other countries.

Figure 14: China's slowdown has already significantly reduced Indonesian exports…

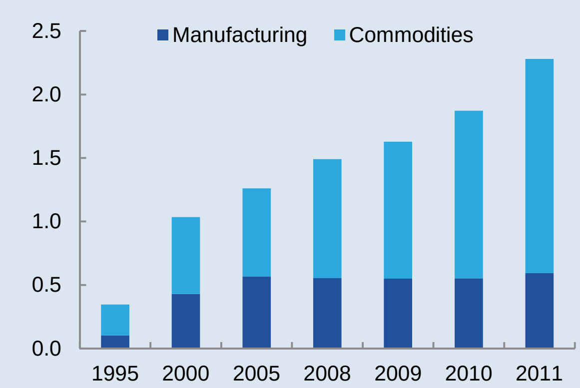
(contributions to overall export value growth yoy of exports to key trading partners, percentage points)



Note: ASEAN4 comprises Malaysia, Philippines, Thailand and Singapore
Source: BPS; World Bank staff calculations

Figure 15: … as Chinese consumers have become an increasingly important source of final demand…

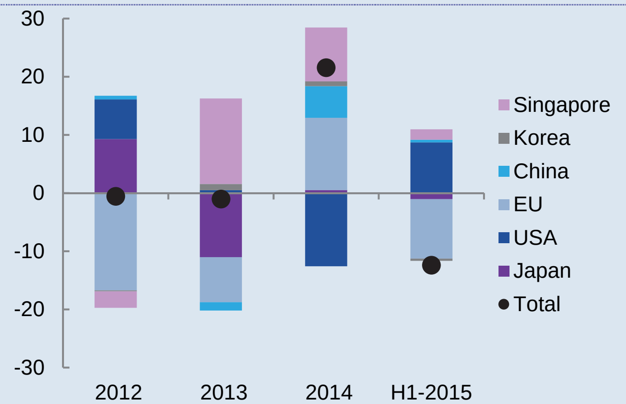
(domestic value added in exports accounted for by final demand from China, percent of GDP)



Source: OECD/WTO TiVA; World Bank staff calculations

Figure 16: … while the effect on FDI has been less pronounced

(contributions to total FDI growth yoy, percentage points)



Source: OECD/WTO TiVA; World Bank staff calculations

Based on trade in value added statistics, exports accounted for 24 percent of nominal GDP in 2011, the latest year for which TiVA data are available, down from 33 percent in 2000. During this period, the average value added gained from exports of ASEAN members also declined from 36 percent in 2000 to 31 percent in 2011, though the decrease was more significant for Indonesia. At the same time, China has become increasingly important as a source of final demand for the rest of the region.[2] In Indonesia's case, Chinese consumers accounted for 2.3 percent of nominal GDP in 2011, compared with 2.7 percent for Japan and 1.8 percent for the US. Indonesian value added embodied in Chinese final demand rose steadily from 0.3 percent of GDP in 1995 to 1.3 percent in 2005 and 2.3 percent in 2011 (Figure 15). However, commodity exports accounted for the full increase in value added between 2005 and 2011. Looking forward, services sector growth is expected to outstrip industrial growth as China reforms its growth model. To turn China's rebalancing into an opportunity, Indonesia would need to diversify its exports away from commodities into manufacturing and services.

With respect to FDI flows, recent economic developments in China are unlikely to have a significant direct impact on Indonesia (Figure 16). China's contribution to FDI growth has been relatively small, except for 2014. Total FDI flows to Indonesia contracted by 12.4 percent in the first half of this year compared with the first half of 2014 and a large part of the decline was due to the EU. The main drag on FDI in 2014 was the US. Although China's share in FDI to Indonesia, at 2 percent over the past five years, is relatively small, it is highly concentrated in mining: between 50 and 99 percent of China's annual FDI in 2010-2014). Reduced profitability of this sector in recent years is the likely reason for lower Chinese direct investment.

Note: 1 See Part B.2 of the March 2013 IEQ for more details on using the OECD-WTO TiVA dataset to analyze Indonesian trade flows. For more details on the TiVA database see http://www.oecd.org/sti/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm.
2 For more details on China's importance for East Asia's trade performance see Box I.B.3. in the East Asia Pacific Economic Update, October 2015: Staying the Course.

5. Higher global risk aversion has caused declines in Indonesian asset prices

The return of financial contagion has highlighted the constraint on monetary policy and limited credit growth

A shift in investor risk appetite in recent months has motivated portfolio reallocation away from emerging markets, which has driven down prices of financial assets in Indonesia. The significant Rupiah volatility has been symptomatic of these adverse trends and has constrained monetary policy. In addition to maintaining a relatively restrictive monetary stance, BI has intervened in currency markets to smooth exchange rate volatility, helping to prevent a disorderly depreciation. Given the limited policy space, BI has tried to support private consumption by introducing looser macro prudential measures. However, until now this has had little discernible effect on domestic credit growth, which has remained weak.

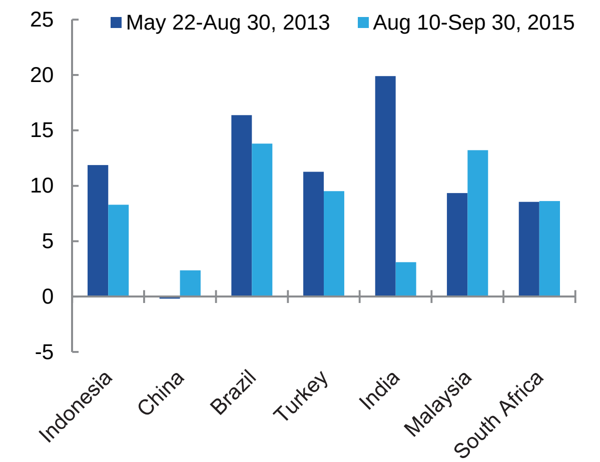
Indonesian stock prices have declined in proportion with other emerging markets

Indonesian equities as measured by the JCI have declined since April 2015, falling by 11.0 percent between the end of March and June 30 and by another 8.2 percent in the third quarter, leaving the index down 14.0 percent in the year to October 15. In sectoral terms, the decline has been driven by basic industry, mining, finance and consumer goods. The recent equity market sell-off in China also affected Indonesia, with the JCI dropping by 5.4 percent in the week through August 21. The equity loss over the week of China's 'black Monday' compares favorably with the performance of other major equity markets in the region, like China (-21.0 percent), Japan (-12.5 percent), Korea (-5.6 percent), and other major EME markets like Brazil (-6.6 percent). Indeed, all major emerging markets equity indices have been on a significant declining trend since June this year, and Indonesia's performance does not stand out as exceptionally weak over this period. In a regulatory response to the equity market pressures, the financial services authority (*Otoritas Jasa Keuangan*, OJK) eased share buy-back regulations on August 21, allowing companies to purchase their own shares without a general shareholders meeting.

Recent Rupiah depreciation pressures, albeit significant, have been limited by appropriate monetary and exchange rate policy

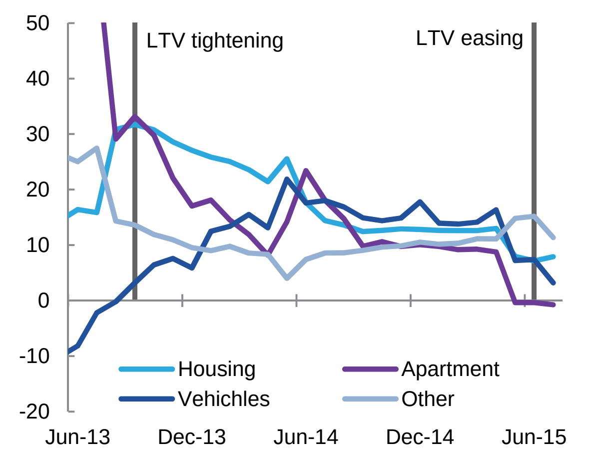
The Rupiah has continuously depreciated since mid-2014, following the strengthening in the US Dollar globally and compounded in August by spillovers from the Renminbi depreciation. The recent Rupiah depreciation does not stand out compared with peers and with the taper tantrum episode of mid-2013 (Figure 17). The Rupiah lost 8.3 percent of its value against the US Dollar between August 10 and September 30, 2015, versus 11.9 percent during the taper tantrum, while the corresponding depreciations of the Brazilian Real, for example, were 10.3 percent and 16.4 percent. As of October 15, the Rupiah recovered its June 30 level. Since mid-2013, Bank Indonesia's flexible exchange rate management and tight monetary policy in response to external imbalances have contributed to the relatively better performance of the Indonesian currency in recent weeks. Additional favorable factors in 2015 include a narrower current account deficit (2.0 percent of GDP in H1 2015 versus 3.4 percent in H1 2013) and better budget allocation away from exchange rate- (and oil price-) dependent fuel subsidies.

Figure 17: Recent Rupiah depreciation has been somewhat more limited compared with peers and with 2013 taper tantrum
(currency depreciation to USD, += depreciation, percent)



Source: CEIC; World Bank staff calculations

Figure 18: Macro-prudential easing has not yet had a visible impact on consumer credit
(percent)



Note: LTV stands for loan-to-value ratio.
Source: CEIC; World Bank staff calculations

There are no signs yet of an imminent improvement in domestic credit growth…

Turning to the domestic banking sector, credit growth has remained subdued due to both weak demand and supply. Credit growth declined from 10.4 percent yoy in April to 9.3 percent yoy in July, its lowest rate since January 2010, but increased to 10.9 percent yoy in August. The August improvement in credit growth was due to a rise in investment loan growth to 12.9 percent yoy, from 11.2 percent in April, while other lending growth continued to decline. Bank liquidity is ample, with commercial and state-owned bank loan-to-deposit ratios at 88.8 and 86.3 percent, respectively, compared with a regulatory maximum of 92 percent. On the supply side, deposit growth dropped to 12.6 percent in August, from 14.5 percent in April. Non-performing loan (NPLs) reached 2.8 percent in August, up from 2.4 percent in March. However, the increase in NPLs has been kept in check by banks' ability to restructure loans. As asset quality continues to deteriorate, credit supply may become more limited due to banks tightening their lending standards further.

… as macro-prudential easing has had a limited impact so far, mainly because of weak domestic demand

Given limited scope for monetary policy to address weak domestic demand, BI eased its macro-prudential regulation as of June 18 to support property and motor vehicle credit.[7] While there has been a marginal increase in the growth rate of housing loans in July, other types of consumer credit have not shown signs of improvement yet. Motor vehicle loan growth has been on a declining trend continuously since May 2014, reaching 3.2 percent yoy in July, down from 16.4 in April. In comparison, when BI tightened macro-prudential policy in September 2013,[8] property credit growth slowed, while motor vehicle lending did not respond as expected. Given weak domestic demand and heightened exchange rate uncertainty, the effect of the current easing in loan-to-value ratios may be limited.

6. Challenges in fiscal management in 2015

Nine months into the fiscal year, the

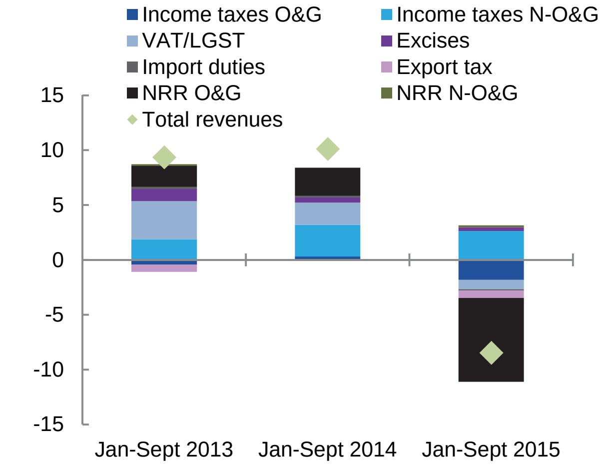
Official figures released by the Ministry of Finance indicate that revenues for the first nine months of the year declined by 8.5 percent yoy in nominal terms, in part

[7] http://www.bi.go.id/id/peraturan/ssk/Pages/pbi_171015.aspx
[8] See Part A.4 in the October 2013 *IEQ*.

implementation of the 2015 revised Budget continued to face challenges

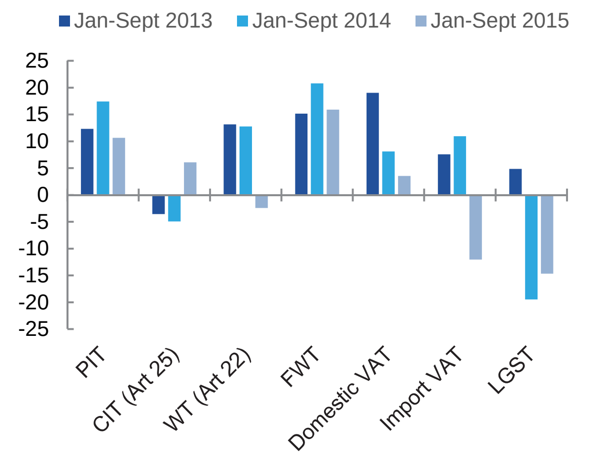
because of continuing headwinds in the global and domestic macroeconomic environment. The government has revised down its revenue target for 2015 by IDR 112 trillion.[9] On the expenditure side, disbursement has picked up in recent months from the levels observed earlier in the year, with capital spending rising 4.6 times between May and September. In the nine months this year, capital spending is estimated to have increased by 21.4 percent in real terms compared to the same period in 2014. According to the revised fiscal outlook, the Ministry of Finance expects the deficit to reach 2.2 percent of GDP, with room to go further within the legal limit of 3 percent. The government has proactively taken measures to manage fiscal risks, including by frontloading its market financing strategy and increasing foreign official borrowing. Nevertheless, if more emphasis is placed on higher expenditure execution to support growth, then a larger than projected fiscal deficit may be associated with higher financing costs, especially in the currently volatile financial market conditions.

Figure 19: Oil and gas revenues have driven the revenue decline in the first nine months of 2015 …
(contributions of selected revenue categories to nominal revenue growth yoy, percent)



Note: O&G stands for "oil and gas", N-O&G – "non-oil and gas"; LGST – "luxury goods sales tax"; NRR – "non-tax natural resource revenues".
Source: Ministry of Finance; World Bank staff calculations

Figure 20: … with most categories of income tax and VAT weakening too
(nominal revenue growth yoy, percent)



Note: PIT stands for personal income tax; CIT – corporate income tax under Article 25 of the Income Tax Law; WT – withholding tax under Article 22 of the Income Tax Law; FWT – final withholding tax of the Income Tax Law; LGST – luxury-goods sales tax
Source: Ministry of Finance; World Bank staff calculations

External headwinds and slower growth have weakened revenue collection…

The Ministry of Finance reports that overall revenue collection in the first nine months of 2015 reached IDR 989.7 trillion, a nominal decline of 8.5 percent yoy (Figure 19). Total tax revenues decreased by 0.8 percent yoy, supported only by non-oil and gas income taxes and excises, while all other tax categories contracted. However, the main reason behind this revenue performance was low oil and gas revenues, which contributed -7.6 percentage points yoy to the overall revenue decrease. The average Indonesian crude oil price in January – September 2015 was 50 percent lower than in the same period last year; the corresponding average Rupiah depreciation was 12.9 percent, only partly offsetting the decline in the oil (and gas) price.

[9] First Semester 2015 Government State Budget Implementation Report (*Laporan Pemerintah Tentang, Pelaksanaan Anggaran Pendapatan dan Belanja Negara, Semester Pertama Tahun Anggaran 2015*).

… with VAT receipts declining and income taxes moderating in year-on-year terms

In the year to September 30, value-added tax (VAT) decreased by 3.3 percent yoy, contributing -0.9 percentage points yoy to the total revenue decline. Domestic VAT, which accounts for 60 percent of total VAT, grew by 3.6 percent yoy, considerably below the five-year year-on-year average of 17.6 percent (Figure 20). Import VAT decreased by 12.0 percent yoy, on account of the significant decline in nominal imports (in Rupiah) of 6.2 percent (yoy) in the first half of this year. The collection of luxury-goods sales tax (LGST) also dropped, by 14.6 percent yoy. Looking more closely at income taxes, all components except the corporate income tax under Article 25 of the Income Tax Law moderated. Personal income tax and final withholding tax[10] receipts recorded positive growth of 10.6 and 15.9 percent yoy, respectively, which was lower than the growth rates in the corresponding period last year and is consistent with the moderation in nominal GDP growth in the first half of 2015 (9.4 percent yoy, down from 11.9 percent yoy in H1 2014).

The Ministry of Finance revised down its revenue outlook for 2015

Following the slower than budgeted revenue growth in the first semester of the fiscal year, the Ministry of Finance revised down its revenue outlook for 2015 by IDR 112 trillion, to IDR 1,650 trillion (Table 4).[11] VAT experienced the largest downward revision by IDR 78 trillion, followed by non-oil and gas income taxes by IDR 34 trillion. On the other hand, non-tax revenues, particularly those related to the oil and gas sector, were revised up by IDR 10 trillion on account of the revised assumption of a weaker Rupiah exchange rate against USD. According to the revised outlook, the Ministry of Finance expects a fiscal deficit of 2.2 percent of GDP in 2015, which raises the government's gross financing needs by IDR 38 trillion. Financing risks are mitigated by frontloading financing strategies, where around 76.7 percent of the above needs have already been met through securities issuance and about 7 percent are expected to be met through foreign official lending. Nevertheless, the rise in market volatility, which has driven Indonesian sovereign yields up by 146 basis points year to date for the 10-year government bond (to 9.3 percent on September 18), may increase financing risks.

The Government has introduced a number of tax measures with the intention to improve the investment climate and boost domestic consumption

In a move to improve the investment climate and attract more investments, on April 6, 2015, the Government issued a new regulation expanding the scope of tax allowances to 144 business sectors and streamlining the process for obtaining these tax incentives.[12] In addition, a tax holiday of up to 20 years was offered to investors in sectors defined as "pioneering" by the Ministry of Finance.[13] To improve consumer purchasing power, the Government recently removed certain items, such as household appliances, furniture, etc. from the list of items subject to the LGST,[14] and increased the non-taxable personal income tax threshold to IDR 36 million (from IDR 24.3 million previously).[15] At the same time, items which are no longer subject to the LGST but are imported became taxable at a ten-percent rate (versus 2.5 or 7.5 percent previously) according to Article 22 of the Income Tax Law.[16]

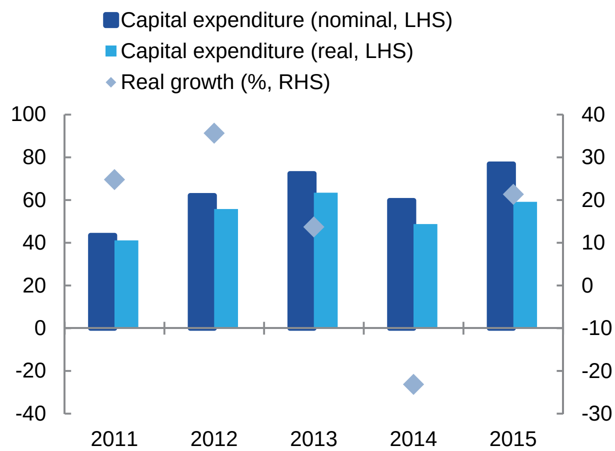
[10] Article 21, Article 25 (personal) and Article 4(2) of the Income Tax Law No. 7/1983. Final withholding tax is the full and final payment of income tax due from the recipient of the income.
[11] Ministry of Finance, Government Report on the Implementation of the State Budget Semester I Fiscal Year 2015. (http://www.anggaran.depkeu.go.id/dja/acontent/pelaksanaan%20APBN%20sem.1.pdf)
[12] Government regulation No. 18/2015 (PP-18/2015)
[13] Minister of Finance regulation No. 159/PMK.010/2015
[14] Minister of Finance regulation No. 106/PMK.010/2015
[15] Minister of Finance regulation No. 122/PMK.010/2015
[16] Minister of Finance regulation No. 107/PMK.010/2015. Certain imported goods are taxed under Article 22 of the Income Tax law because they are considered assets purchased with the intention to gain profit. Another tax change implemented by the Government in July was to raise the import duties on around 1000 consumer goods.

Budget disbursement picked up in recent months, but remained low compared to full year allocation

By September 30, IDR 1,249 trillion or 63 percent of total expenditure in the revised 2015 Budget were disbursed. Spending on personnel, interest payments, social assistance, and transfers to regions tracked their budget allocation closely. After a slow start at the beginning of the year, capital expenditure picked up in recent months, reaching IDR 77 trillion by end-September. This is IDR 17 trillion higher in nominal terms than the same period in 2014. Using the implicit total fixed investment deflator from the national accounts (a public investment one is not available), government capital spending is estimated to have increased by 21.4 percent in real terms compared to the same period in 2014. The significant pick-up in public investment is likely to have provided a boost to the economy in the third quarter of 2015.

Figure 21: Capital spending has picked up significantly in recent months

*(January – September cumulative realization in nominal and real terms (LHS), IDR trillion; real capital expenditure growth (RHS), percent)**



Note: * Real capital expenditure is calculated using the implicit total fixed investment deflator with 2010 base from the national accounts.
Source: Ministry of Finance; World Bank staff calculations

Capital expenditure disbursement rates differed by line ministry

According to TEPRA monitoring data (see next paragraph)[17], line ministries have made progress on capital spending at differing rates. As of September, project implementation at the Ministry of Public Works and Housing tracked its plan well, with 87 percent of strategic projects (accounting for 76 percent of the total ministry budget) already being implemented. However, progress at the Ministry of Transport and the Ministry of Energy and Mineral Resources (MEMR) has been slower than expected. 56 percent of the strategic projects at the former (representing 70 percent of the total ministry budget) have been started, while only 16 percent of the strategic projects (53 percent of the total ministry budget) at the latter are under implementation.

The government has introduced a number of new measures to accelerate budget execution

The government has recently introduced several measures to address long-standing budget execution challenges. At a Cabinet meeting on July 23, the President directed ministries to start procurement processes early (in November of the previous year), to complete the budget implementation document (*Daftar Isian Pelaksanaan Anggaran*, DIPA) by December of the previous year, and to begin disbursement in January. Through Presidential Decree No 20/2015, the Government recently established the Budget Realization Evaluation and Monitoring Team (*Tim Evaluasi dan Pemantauan Realisasi Anggaran*, TEPRA), led by the Minister of Finance, to closely monitor budget execution and facilitate the removal of implementation constraints both at the central and sub-national level. The team will report to the President every second week of the month. At the line ministry level, the Ministry of Public Works

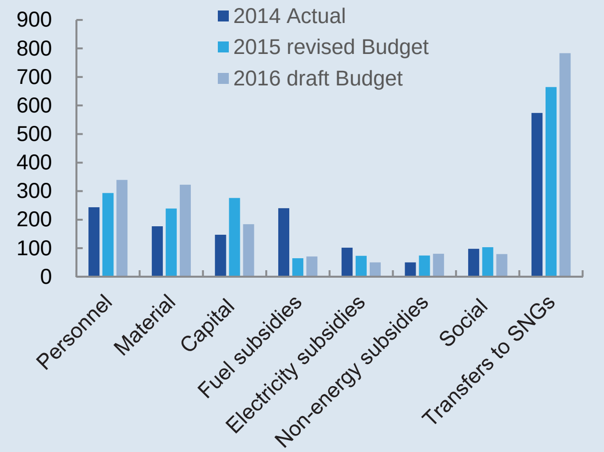
[17] http://monev.lkpp.go.id/monitor/monitorAdjustment

and Housing recently added resources to accelerate execution in 2015, start early procurement for 2016 (in September), and begin early preparation of multiyear contracts for 2016.[18] Finally, as part of the reform package announced on September 9, the Government will expedite the disbursement of the village fund to support rural development through the issuance of a joint decree between the Ministry of Rural Development of Disadvantaged Regions and Transmigration, the Ministry of Home Affairs, and the Ministry of Finance which simplifies and clarifies the fund disbursement procedures.[19]

Box 2: The draft 2016 Budget shows continued improvement in the composition of spending but will require significant revenue collection efforts

The Government submitted a draft 2016 Budget to Parliament on August 14, 2015. The budget is currently under discussion and is expected to be approved by the end of October 2015. The draft Budget macroeconomic assumptions, approved by Parliamentary Commission XI in charge of the State Budget, are broadly in line with the World Bank projections for 2016 (in Section 2): real GDP growth is projected at 5.3 percent; inflation at 4.7 percent; the Rupiah exchange rate against the U.S. Dollar at IDR 13,900; the Indonesian crude oil price at USD 50 per barrel; and oil production at 830,000 barrels per day. The revenue target for 2016 is set at IDR 1,848 trillion (14.5 percent of GDP), an increase of 12.0 percent compared with the Ministry of Finance's latest revenue outlook for 2015. The rise in revenues is expected to come almost entirely from higher tax receipts, up 14.5 percent relative to the latest 2015 revenue outlook. Given the challenging external macro environment and moderate growth affecting both the 2015 and 2016 revenue outlook, significant tax collection efforts will be required to reach the 2016 revenue target and to support budget execution.

Figure 22: Further improvement in the composition of spending is proposed for 2016
(expenditure, IDR trillion)



Note: SNGs – sub-national governments.
Source: Ministry of Finance

On the expenditure side, the proposed Budget shows continued improvement in the composition of spending, allocating funds away from energy subsidies to infrastructure development (through state-owned enterprises and larger transfers to sub-national governments) and to significantly higher health (for the first time meeting the 5 percent minimum health share target) and social assistance spending. Total expenditures are set at IDR 2,121 trillion (16.6 percent of GDP), 7 percent higher than in the 2015 revised Budget. The increase is largely driven by a significant rise in transfers to local governments, while central government spending is expected to rise only by 1.5 percent. Total line ministry expenditure is actually expected to contract by 15 percent relative to the 2015 revised Budget. The projected 2016 fiscal deficit is 2.1 percent of GDP (IDR 273.2 trillion), slightly below the Ministry of Finance's latest 2015 outlook of 2.2 percent of GDP.

[18] Ministerial Instruction, PUPR No.3/2015, http://www.pu.go.id/berita/10481/Ditjen-Bina-Marga-Launching-Lelang-Dini-TA-2016-Senilai-Rp-3,709-Triliun

[19] Villages are required to submit medium-term development plans and budget plans before obtaining budget funds from local governments. Prior to disbursement from the central government to local governments, the latter are required to issue regulations which will govern the process. (http://ekonomi.metrotvnews.com/read/2015/09/06/166442/realisasi-dana-desa-akan-dipercepat)

Table 4: The Ministry of Finance has revised the expected fiscal deficit to 2.2 percent of GDP in 2015
(IDR trillion, unless otherwise indicated)

	2014 Actual	2015 Revised Budget	2015 Ministry of Finance revised outlook	2015 January – September Budget realization
A. Revenues	**1,550**	**1,762**	**1,650**	**990**
1. Tax revenues	**1,147**	**1,489**	**1,367**	**801**
Income tax	546	679	678	397
Oil and gas	87	50	52	40
Non-oil and gas	459	630	596	358
VAT/LGST	409	577	498	272
International trade taxes	44	49	40	26
Import duties	32	37	35	23
Export taxes	11	12	5	3
2. Non-tax revenues*	**399**	**269**	**279**	**188**
B. Expenditures*	**1,777**	**1,984**	**1,910**	**1,249**
I. Central government	1,204	1,320	1,246	738
Personnel	244	293	n.a.	213
Material	177	239	n.a.	108
Capital	147	276	n.a.	77
Interest payments	133	156	157	123
Subsidies	392	212	214	149
Energy subsidies	342	138	140	105
Fuel	240	65	66	59
Electricity	102	73	75	45
Non-energy subsidies	50	74	74	44
Grants	1	5	n.a.	0
Social	98	104	n.a.	66
Other expenditures	12	36	n.a.	2
II. Transfers to regions	574	665	664	511
C. Primary balance	**-93**	**-67**	**-103**	**-136**
D. Overall balance	**-227**	**-223**	**-260**	**-259**
as percent of GDP	*-2.2*	*-1.9*	*-2.2*	
Key economic assumptions				
Real GDP growth (percent)	5.1	5.7	5.2	
CPI (yoy, percent)	8.4	5.0	4.2	
Exchange rate (IDR/USD)	11,878	12,500	13,100	
Crude-oil price (USD/barrel)	97	60	59	
Oil production ('000 barrels/ day)	794	825	825	

Note: * Unpublished Ministry of Finance data.
Source: Ministry of Finance

7. The pace of poverty reduction has slowed with the moderation in growth

The poverty rate has remained nearly flat in the year to March 2015…

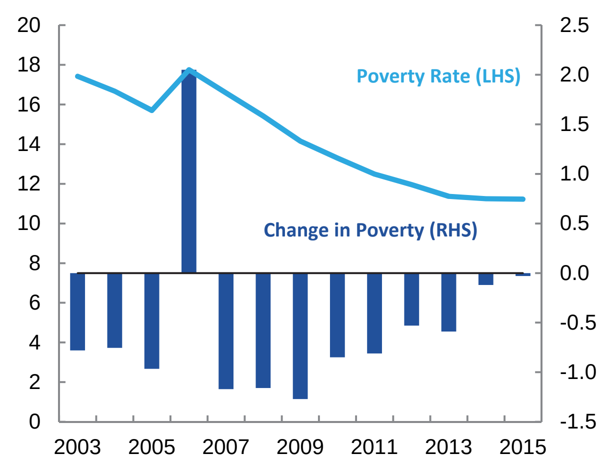
According to BPS estimates, the official poverty rate was 11.22 percent in March 2015, compared with 11.25 percent in March 2014. Although the rate is higher than the September 2014 rate of 10.96 percent, income seasonality makes comparisons between March and September poverty rates difficult. While the poverty rate has remained unchanged, the number of the poor has grown from 28.3 million people in March 2014 to 28.6 million in March 2015 due to population growth.

…continuing the trend of slower poverty reduction observed in recent years

2015 marks the second year in a row that the poverty rate has remained effectively flat, thus continuing the trend of limited poverty reduction. Since 2010, the poverty rate has decreased by an average of 0.5 percentage points per year, compared with the relatively large average declines of 1.2 percentage points between 2007 and 2009 (Figure 23). However, methodological changes applied in the March 2015 National Social Economic Survey (*Survei Sosial Ekonomi Nasional*, SUSENAS) has made the latest data not directly comparable to data from previous years (Box 3).

Figure 23: The pace of poverty reduction has slowed in recent years

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



Source: SUSENAS; World Bank staff calculations

Slowing economic growth and rising food prices hindered poverty reduction…

Slower poverty reduction as recorded in March 2015 has been driven primarily by moderating economic growth and rising food prices. The average monthly retail rice price rose by 6.0 percent between December 2014 and March 2015,[20] while food prices have increased at rates of 7.0 percent yoy or higher since November 2014.[21] With food making up two-thirds of the consumption of poor households, rising food prices have resulted in a 9.6 percent average increase in the national poverty line – from IDR 302,735 to IDR 330,776 per person per month.

… while recent fuel price fluctuations are unlikely to have significantly affected poverty

In contrast, the poverty rate was not particularly driven by fuel price changes. After the initial increase in fuel prices of IDR 2,000 in November 2014, fuel prices were lowered again in January 2015 in response to lower global oil prices. Previous experience suggests that the latest round of unconditional cash transfers (*Bantuan Langsung Sementara Masyarakat*, BLSM) would have helped to cushion the shock of rising fuel prices. However, due to the timing of the disbursements, the impact would not have been captured by the March 2015 data. The first round was distributed in December 2014 and the second in April and May 2015, the former too early and the latter too late to be picked up in March 2015 data.

Long term challenges of assisting hard-to-reach poor and highly vulnerable households persist

Finally, longer-term poverty reduction has slowed because the remaining poor are increasingly hard to reach, and also because there are still many Indonesians living just above the poverty line. As the poverty rate decreases, the remaining poor are further and further below the poverty line, requiring higher consumption growth to maintain the rate of poverty reduction. At the same time, in 2014 an additional 67.5 million Indonesians lived just above the poverty line but below 1.5 times the poverty line. This means that any major shock to the economy – for example, high food price increases – puts these people at risk of falling back into poverty.

[20] For a discussion of recent domestic rice price developments see Part B.1 in the March 2015 *IEQ*.
[21] See Part A.3 in the July 2013 *IEQ*.

Box 3: Methodological changes in the March 2015 SUSENAS make historical comparisons difficult

Two methodological changes were made to the 2015 SUSENAS, both of which can potentially affect measured poverty. First, respondents were asked to record household consumption of 100 broader food categories this year, compared with 260 narrow food categories used in previous years. Based on experiences in other countries, using fewer but broader categories in household surveys generally results in lower measured total consumption. As a consequence, for a fixed poverty line, the poverty rate appears higher than it would have been if the greater number of narrower categories were used. Although this implies that the 2015 poverty rate would have been lower if the old questionnaire had been used, it is unclear how much lower it would have been. BPS and the World Bank are conducting field tests later this year to better understand this effect.

Second, the method for selecting primary sampling units (PSUs, or *Blok Sensus*) for the survey was also changed. Previously, BPS used the Census to categorize PSUs by average education level. It then randomly selected PSUs to survey from within each education level. Beginning in 2015, BPS instead used the Census to categorize PSUs by wealth level. An estimate of household wealth can be estimated statistically from Census information, such as asset ownership, education levels, employment sector and type, housing conditions and demographic characteristics. PSUs were then randomly selected from each different wealth level. It is unknown what effect this would have on measured poverty. If more wealthy households and less poor households were surveyed than before, the measured poverty rate would be lower than it would have been under the old methodology. As with the first methodological change, the exact details of these changes, and their potential net impact on poverty measurement, still need to be better understood.

8. The risks to the outlook are skewed to the downside with the recent rise in uncertainty

Persistently low commodity prices remain a key downside risk to public and private sector balance sheets…

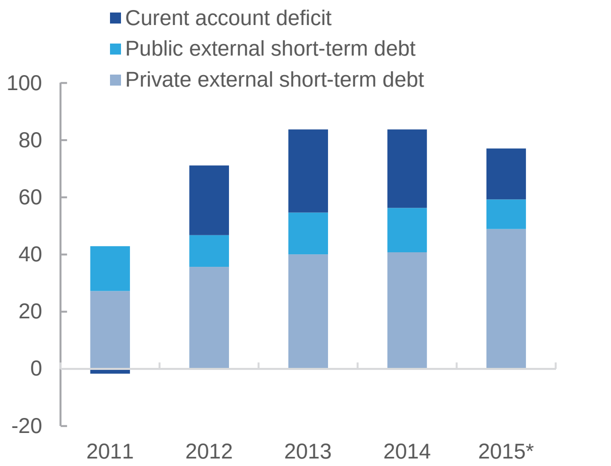
The balance of risks to the World Bank's economic outlook for Indonesia remains on the downside, as in the July 2015 *IEQ*. The subdued recovery in high-income economies and widespread slowdown in developing countries, in particular China, coupled with weak global trade growth, have pushed commodity prices lower. According to World Bank projections, oil prices are expected to remain well below their 2013 levels during the next decade,[22] benefitting overall economic activity in Indonesia (a net oil importer), but putting a significant strain on oil and gas-related fiscal revenues. Therefore, keeping in place the recently reformed system of fuel price adjustments based on economic costs is essential to reducing public balance sheet risks. The prices of most other commodities are also expected to remain low over the medium term, driving downside risks for the fiscal budget, as well as corporate profits and household incomes.

[22] World Bank, East Asia Pacific Economic Update, October 2015: Staying the Course.

… while risks stemming from financial market volatility and Rupiah depreciation have increased in recent months

Another key risk to Indonesia's outlook is the possibility of larger than expected real sector spillovers from volatile financial markets. Expected gross external financing needs in 2015 are lower compared with 2014 as the current account deficit has narrowed significantly and public external debt rollover requirements are lower (Figure 24). However, private sector external debt maturing within one year or less reached USD 49 billion at the end of 2014. Although gross international reserves, at USD 102 billion in September 2015, cover the estimated total 2015 gross financing needs of USD 77 billion, the rapid increase in the external leverage of the private sector, coupled with a significant Rupiah depreciation, rising refinancing costs, limited hedging of foreign currency debt, and reduced profit margins, poses a significant risk for the private sector.

Figure 24: The gross external financing needs of the private sector have gone up
(USD billion)



Note: Short-term debt is calculated on a remaining maturing basis; * 2015 projection.
Source: BI; World Bank staff calculations

As the room for expansionary policies is limited…

Policy space remains constrained, due in large part to the unfavorable external environment. BI's policy stance is expected to remain tight in the near term because of the possibility of further financial market volatility related to U.S. monetary policy normalization. With weak revenues the room for fiscal stimulus is also limited. Nevertheless, the draft 2016 State Budget, which proposes larger and better-targeted social programs and redirects spending away from energy subsidies to infrastructure development, could help increase the purchasing power of the most vulnerable and boost fixed investment and growth.

… supply-side reforms can support business and consumer confidence

In such a challenging macroeconomic environment supply-side reforms can play an important role in raising business and consumer confidence in the short term and raise the long-term rate of growth. The government started a significant effort of regulatory reform with four policy packages announced between September 9 and October 15, 2015, including ambitions to remove unnecessary requirements for selected import and export licenses, simplify investment licensing at the Capital Investment Coordinating Board's (*Badan Kordinasi Penanaman Modal*, BKPM) one-stop service system and in industrial zones, reduce fuel, gas and electricity prices for industry, introduce formula-based minimum wages, expedite the application process for land use permit, and expand export financing for SMEs and the People's Business Credit program (*Kredit Usaha Rakyat*, KUR). The effective implementation of these reforms will help return the economy to a higher rate of potential growth.

B. Some recent developments in Indonesia's economy

1. El Niño is expected to moderately raise domestic rice prices and inflation

The so far moderate El Niño conditions are expected to strengthen in H2 2015 and may exert pressure on prices

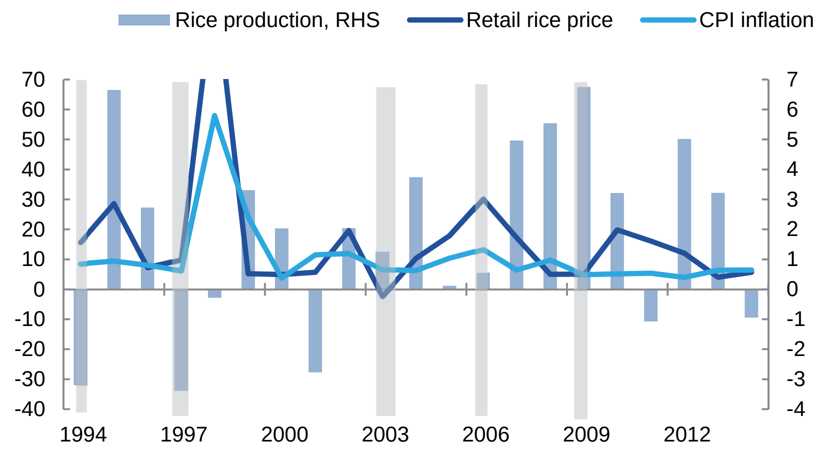
According to Indonesia's National Meteorology, Climatology and Geophysics Agency (*BMKG*), moderate El Niño conditions and below-average rainfall have been observed so far this year. The El Niño effect is expected to strengthen in August through December 2015.[23] Similar estimates have been obtained by the U.S. National Oceanic and Atmospheric Administration and the Australian Bureau of Meteorology, both of which expect the El Niño conditions to persist into early 2016. Global studies of the impact of large weather shocks like El Niño generally find significant macroeconomic consequences, such as lower GDP growth, higher domestic inflation, as well as upward pressure on global energy and non-fuel commodity prices.[24] This section provides some estimates of the potential effect of El Niño on rice prices and CPI inflation in Indonesia in the short term.

Historically, the effect of El Niño on rice production and prices has varied significantly…

The impact of El Niño on agricultural land, rice production and prices is not immediately obvious as these variables are affected by many factors in any time period. For example, in 1997, when El Niño was strong, the harvested area declined by over 400,000 hectares (-3.7 percent), but the increases in the retail rice price and CPI were moderate (Figure 25). In 2006, a weak El Niño did not lead to a decrease in paddy fields but rice and consumer prices increased considerably. According to Bank Indonesia (BI), the 1997 strong El Niño damaged around 161 thousand hectares of paddy land (or a decline of 1.4 percent relative to 1996), leading to a decrease in rice production of 715 thousand tons. The weak 2006 El Niño conditions resulted in less than half of the damage to land and rice output observed in 1997.[25]

[23] See footnote 4.
[24] See, for example, Cashin, P., K. Mohaddes and M. Raissi (2015). Fair weather or foul? The macroeconomic effects of El Niño. IMF Working Paper WP/15/89.
[25] Bank Indonesia *Laporan Nusantara* May 2014

Figure 25: The impact of El Niño on rice production and prices and the consumer price index has varied significantly across years
(annual change, percent)



Note: Gray areas indicate El Niño years.
Source: CEIC; World Bank staff calculations

… hence two scenarios are developed to gauge the potential impact in 2015

To estimate the potential impact of this year's El Niño on rice production and inflation, two scenarios are analyzed. In the moderate scenario the decline in harvested area of 200,000 hectares (or a decrease of 1.5 percent from 2014) is approximately equivalent to the one attributed to El Niño in 1997 in the BI report. In the severe scenario 400,000 hectares of paddy fields are assumed to be damaged. Using the 2014 productivity estimate by Statistics Indonesia (*BPS*) of 5.1 tons/hectare, the moderate scenario would lead to the loss of 1 million tons of rice output (Table 5). The severe scenario would result in a decline in rice production of 2.1 million tons.

Table 5: 2015 El Niño effect on overall inflation is expected to be moderate; more pronounced for the poor

	Estimated change for 2015					
Scenario	Harvested area	Rice production		Domestic retail rice price	CPI inflation	Poverty basket inflation
	(hectares)	(million tons)	(% change yoy)	(% change yoy)	(p.p.)	(p.p.)
Moderate	-200,000	-1.0	-1.5	5.1	0.3	1.1
Severe	-400,000	-2.1	-2.9	10.2	0.6	2.2

Source: CEIC; World Bank staff calculations

The estimated 2015 rice prices increase is between 5 and 10 percent…

The potential impact of El Niño on domestic rice prices and inflation is calculated using World Bank estimates from an instrumental variables regression of the change in rice prices on rice production and other determinants, including per capita rice consumption, rice import volumes, the international rice price and the length and quality of roads. The panel dataset covers the years 2005 through 2013 and 29 provinces in Indonesia. Since rice production depends also on the price of rice (i.e. causality may run from output to prices and vice versa), the former is instrumented by an exogenous dummy variable equal to one in each El Niño year. The regression results indicate that in the moderate scenario the domestic retail rice prices may increase by 5.1 percent, all else constant, whereas in the severe scenario, the rise in prices would be 10.2 percent.

… with a moderate effect on CPI inflation but a sizeable impact on the inflation experienced by the poor

Another set of World Bank estimates, based on a regression of CPI inflation on the change in the domestic rice price and a number of other variables[26], indicate that the above-mentioned rice price increases would be associated with a moderate rise in annual headline inflation between 0.3 and 0.6 percentage points. However, similar estimates for the price index of a basket of goods and services consumed by the poor suggest a more significant increase of 1.1 to 2.2 percentage points. The higher impact on the poor is due to the larger share of income the poor spend on rice relative to wealthier Indonesians.

El Niño may have additional effects on inflation and GDP growth…

The above-mentioned calculations could underestimate the inflationary impact of El Niño as the prices of agricultural commodities other than rice may also rise. In addition, higher temperatures and droughts could lead to higher demand for energy commodities as lower electricity output is generated from both thermal power plants and hydroelectric dams. According to an IMF study[27], inflation in Indonesia may rise by as much as 0.9 percentage points in the two quarters following an El Niño event. Furthermore, mining equipment in Indonesia relies heavily on hydropower; hence, mining output may also be affected. Given the significant share of agriculture and mining in Indonesian GDP (25 percent over 2004-2013), the authors estimate that GDP growth may fall by 0.9 percentage points in two quarters.

… and is likely to reduce significantly the incomes of agricultural households which are a large share of the population

In addition to lowering purchasing power, in particular of the poor, by raising prices, El Niño is likely to directly reduce the incomes of agricultural households, further exacerbating the adverse economic consequences. According to BPS's Agricultural Census 2013 (*Laporan Hasil Sensus Pertanian 2013*), there were 26.1 million agricultural households, of which 14.1 million were rice paddy farmers. Most of Indonesia's paddy farmers are located in East Java, the country's largest rice producing region and also one of the provinces that is likely to be most severely affected by El Niño in 2015. The agricultural sector is the main source of income for 9.7 million households. Furthermore, according to the 2013 National Socio-Economic Survey (SUSENAS), agricultural households accounted for 53.9 percent of poor households, with a 19.2 percent poverty incidence rate within the agricultural sector.[28]

Hence, early policy response is crucial to mitigate the impact, especially on the poor

The above analysis suggests that early policy responses (e.g. importing rice and other food commodities) may be called for, especially if El Niño intensifies. It also underscores the importance of social safety nets for households dependent on agricultural income. First, significant rice prices may be reasonably expected if production losses are large. Second, reduced agricultural incomes and higher prices could be devastating to poor households. Finally, moderate to strong El Niño conditions are also observed and expected to continue in the next few quarters in other parts of East and South Asia and the Pacific. This is likely to increase the international prices of commodities affected by the drought, raising Indonesia's import costs (on top of any further depreciation of the Rupiah (see Part A.5).

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[26] These variables are the output gap, three-month interest rate, exchange rate, fuel price, international energy and non-energy commodity price indices, and bank credit growth.

[27] See footnote 25.

[28] A study by the Ministry of Agriculture found that household incomes of paddy farmers may decline by around 52 percent, of corn farmers by 33 percent, and of soybean farmers by 24 percent, only on account of El Niño-related decreases in rice, corn and soybean production, lower quality of the harvest and higher production costs as a result of the drought Sumaryanto, S., 2015, The social economic impact of drought due to El Niño on food crop farmers and the solutions, Ministry of Agriculture unpublished manuscript.

2. Implementing Indonesia's national health insurance system

Indonesia established a national health insurance program to provide universal access to high-quality healthcare…

On January 1, 2014, the government launched a national health insurance program (*Jaminan Kesehatan Nasional*, JKN) with the objective to establish a well-designed, fiscally sustainable, high-quality national health insurance system covering all Indonesians by 2019.[29] JKN promises universal access to healthcare, assuring the portability of coverage regardless of one's place of employment. The program also provides households with protection against financial shocks, such as illness of the primary wage earner.

… and support social and economic transformation…

JKN plays an important role in reducing poverty and vulnerability, contributing to income growth among the bottom 40 percent of the population, and freeing up micro-capital for investment. Furthermore, JKN supports the government's medium- and long-term macroeconomic policies, as a healthy labor force significantly enhances human capital and economic productivity. Finally, the implementation of JKN contributes to the fulfilment of Indonesia's 1945 constitutional commitment to human rights and social justice.

More can be done to help achieve JKN's main objective of universal coverage and broader macro and development goals

Almost two years after JKN's introduction, more than half of Indonesians are members of the national health insurance program, which is a major milestone. However, to fulfill the broader macroeconomic and development objectives, the intermediate goal of universal coverage must be achieved. This would require the expansion of JKN membership to the private and informal sector, increasing contribution collection, improving JKN's financial and fiscal sustainability, and further enhancing its overall governance structure.

a. Where are we now with the national health insurance program implementation?

Health coverage is dominated by those insured by either central or local government budgets…

Indonesia's JKN is managed by BPJS Health (*BPJS Kesehatan*),[30] a not-for-profit public legal entity. As of December 31, 2014, BPJS Health had 133.4 million participants, making it the single largest health administrator in the world (Table 6). However, 82 percent of all members were covered by either central or local government budgets. Private sector salaried workers and non-salaried workers accounted for only 7.6 and 6.8 percent of the total BPJS Health membership, respectively, leaving ample room to increase participation from these categories of workers.[31]

… and most contributions come from subsidized premiums

Consequently, most contributions were collected from the government at both the central and local levels (Table 7). Premiums subsidized by the government, for the poor and disadvantaged people, accounted for 48.9 percent of total collected contributions. The share of contributions from the private sector and non-salaried workers were only 8.7 and 4.6 percent, respectively.

[29] JKN is part of the National Social Security System (*Sistem Jaminan Sosial Nasional*, SJSN). The legal bases for JKN implementation are Law No. 40/2004 regarding the SJSN and Law No. 24/2011 regarding the Social Security Agency (*Badan Penyelenggara Jaminan Sosial*, BPJS).

[30] BPJS *Kesehatan*, was established on January 1, 2014 through the transformation of the former for-profit, state-owned enterprise PT Askes (Persero) into a not-for-profit public legal entity.

[31] Non-salaried workers represent over 60 percent of the employed in Indonesia (National Labor Force Survey, SAKERNAS, February 2015), although some of these are poor and, therefore, covered by the government.

Table 6: As of December 2014, most JKN members were insured by the government

Segment	Number of participants (million)	Share (percent)
Poor and disadvantaged people – central gov. budget	86.4	64.8
Poor and disadvantaged people – local gov. budget	8.8	6.6
Salaried workers – government	14.2	10.6
Salaried workers – private sector	10.1	7.6
Non-salaried workers	9.1	6.8
Unemployed	4.9	3.6
Total	**133.4**	**100**

Source: BPJS Health's Audited Financial Report as of December 31, 2014; Indonesia's 2016 Financial Note and draft State Budget; World Bank staff calculations

Table 7: The government also pays most JKN contributions

Category	Contribution amount (IDR trillion)	Share (percent)
Poor and disadvantaged people – insured by gov.	19.9	48.9
Former PT Askes participants*	13.0	32.0
Former military and police officers	1.0	2.4
Companies/private sector salaried workers	3.5	8.7
Non-salaried workers	1.9	4.6
Jamkesda** and PJKMU Askes (transition)***	1.4	3.3
Total	40.7	100.0

Note: * See footnote 30; ** Regional health insurance program (*Program Jaminan Kesehatan Daerah*); *** The general public insurance program (*Program Jaminan Kesehatan Masyarakat Umum*) was managed by PT Askes (Persero) before its transformation into BPJS Health.
Source: BPJS Health's Audited Financial Report as of December 31, 2014; Indonesia's 2016 Financial Note and draft State Budget; World Bank staff calculations

For non-salaried workers, health costs exceed participants' contributions by a factor of six…

Furthermore, the claim ratio (i.e., the ratio of healthcare services cost to participants' contributions) on a cash basis of non-salaried workers was very high, at 617.4 percent as of December 31, 2014 (Table 8). By contrast, the claim ratio for the other categories of insured was 79.9 percent. As a result, total JKN healthcare services costs exceeded participants' contributions by IDR 1.9 trillion.

Table 8: Non-salaried workers' healthcare costs exceed their JKN contributions

Description	Non-salaried workers	All other	Total
Number of participants	9,052,859	124,370,794	133,423,653
Participants' contributions (IDR billion)	1,885.4	38,834.4	40,719.9
Healthcare services cost (IDR billion)	11,640.3	31,018.4	42,658.7
Claim ratio (percent)	617.4	79.9	104.8

Source: Indonesia's 2016 Financial Note and draft State Budget

… as these workers often pay JKN contributions when they become sick

The high claim ratio for non-salaried workers is due to the low number of the insured; these workers often join JKN when they become sick and may cease contributions after receiving treatment. This was in part due to Presidential Regulation No. 12/2013 as amended with Presidential Regulation No. 111/2013, which allowed non-salaried workers to maintain their coverage for up to six months without paying contributions. More data are needed to disaggregate the overall claim ratio and identify the factors driving the favorable or unfavorable outcomes for various sub-groups.

There is insufficient information to analyze the financial soundness of the

Premium insufficiency may have contributed to the negative net asset position of IDR 3.3 trillion of the Social Security Health Fund (Table 9). However, publicly available data are insufficient to determine whether the Fund has a cash flow (liquidity), insolvency and/or premium insufficiency problems, and whether

health insurance program

premium insufficiency exists only for certain groups, and if there are any unintended cross-subsidies between groups in the health system. In this respect, preparing financial statements on an accrual basis, including well determined claim reserves and an analysis of contributions receivable can help stakeholders monitor the financial soundness of the Fund. Disclosure of the investment asset mix is also important as assets have to be invested in accordance with the characteristics of JKN's liabilities to prevent an asset-liability mismatch.[32]

Table 9: The Social Security Health Fund ended 2014 with a negative net asset position
(IDR million)

	December 31, 2014	January 1, 2014
Assets		
Cash and bank deposits	494,118	367,595
Receivables-contributions	1,603,755	417,288
Receivables-investment	16,865	70,881
Receivables-BPJS Health	15,477	416
Other Receivables-net	11,478	-
Down payment	102,060	36
Investments	2,077,256	5,228,666
Total assets	**4,321,009**	**6,084,882**
Liabilities & net assets		
Liabilities		
Payables for health security	1,543,385	15,386
Prepaid income	570,464	
Technical reserves	5,297,239	5,953,643
Other liabilities	219,066	115,853
Total liabilities	7,630,154	6,084,882
Net assets	(3,309,145)	-
Total liabilities & net assets	**4,321,009**	**6,084,882**

Source: BPJS Health's Audited Financial Report as of December 31, 2014

BPJS Health's financial report indicates that operating costs are reasonable…

According to BPJS Health's financial performance report, on December 31, 2014 its operating budget was IDR 2,477 billion and its operating expenses IDR 2,468 billion, resulting in a net operating income of IDR 8.7 billion (Table 10). BPJS Health's operating budget is set by the government and comes from the Social Security Health Fund. As BPJS Health is a not-for-profit entity, the operating budget is set so as to produce only a small operating income. Although the ratio of operating expenses to total contributions received, at 6.1 percent, is reasonable according to international standards, more detailed data are needed to determine whether the operating budget is set at a proper level and whether the operating costs are reasonable.

… though high capital may pull resources away from service delivery into investment management

However, BPJS Health's comprehensive income of IDR 1.1 trillion in 2014 consisted almost entirely of investment income on own capital (IDR 1.3 trillion) (Table 10). This indicates that BPJS Health has far higher capital than it needs to manage its business risks. As a result, it may focus more on managing the return on its capital than effectively managing the health fund, as the former produces the bulk of its income.

[32] Public access to the full audited financial and program reports can also ensure public participation in supervising the implementation of the national health insurance program.

Table 10: BPJS Health – Financial Performance Report
(IDR million)

Description	December 31, 2014
JKN operating budget	2,476,992
JKN operating expenses	(2,468,277)
Net operating income	**8,715**
Non-operating income (expense)	
Investment income	1,331,078
Other income	103,300
Gain (loss) from investment disposal	(151,112)
Other expense	(225,256)
Net non-operating income	**1,058,010**
Income before tax (EBT)	**1,066,725**
Income tax benefit (expense)	4,346
Net income	**1,071,071**
Other income	41,295
Comprehensive income	**1,112,366**

Source: BPJS Health's Audited Financial Report as of December 31, 2014

b. Way forward: Making the system work better

Important next steps include expanding membership, and improving financial risk monitoring and overall system governance

As the previous section has highlighted, enhancing the long-term sustainability of Indonesia's national health insurance system is an ongoing process. Important next steps include: (i) addressing the low participation rates and contribution levels collected from private sector salaried workers and non-salaried workers; (ii) conducting appropriate monitoring and evaluations of JKN's financial soundness and related fiscal risks; and (iii) improving the overall governance of the system that, in turn, will help expand membership and increase financial sustainability.

Expanding JKN coverage to all Indonesians is necessary from both developmental and financial soundness perspectives

Universal coverage is a fundamental principle of the national health insurance program. If low health risk participants leave and self-insure, the national system will be left with those with higher health risk and, consequently, much higher premium rates. JKN's financial sustainability depends on expanding contribution collection among non-poor, non-salaried workers from both formal and informal sectors. It also requires contribution payment persistence, i.e., the ability to continue collecting contributions from participants every month. A "no evasion" policy with proper regulations and enforcement could help improve JKN's sustainability. In addition, integrated data management and IT plans between BPJS Health's headquarters and its regional offices, as well as health providers, can improve JKN participant data monitoring.

System sustainability also requires active program design and financial and fiscal risk management…

Along with expanding coverage, dynamically managing the programs and actively adjusting their design and financing parameters on a regular basis can help improve financial sustainability. Based on current regulations, the JKN's design will be re-evaluated every two years.[33] An important next step is establishing an office of actuary or risk management unit within the government institution responsible for managing fiscal risk. Furthermore, financial stress testing and an early warning system are standard practice in monitoring excessive expenditures and anticipating

[33] Article 16I of Presidential Regulation No. 12/2013 as amended by Presidential Regulation No. 111/2013.

increases in potential losses with a possible systemic effect on the government's fiscal position.

… as well as an effective overall governance structure

Coordination among line ministries and government agencies is the key to building the necessary ecosystem to support the short- and long-term sustainability of the SJSN system. This requires putting into place integrated policies, procedures, and processes that will serve four purposes: i) improve the overall governance structure to protect the system against changes that would be detrimental to the program's objectives and/or the fiscal sustainability of the programs, or would decrease system transparency; ii) guard the system against error, fraud and corruption; iii) put in place an effective monitoring and evaluation system that would carefully track the progress of the implementation against the stated benchmarks and performance indicators outlined in the health roadmap;[34] and iv) improve overall communication to all key stakeholders by developing and implementing an integrated socialization plan that increases system visibility and improves the understanding of the role and importance of the national social security system.

[34] The SJSN Law gives the responsibility for monitoring and evaluation of the implementation of the SJSN system to the National Social Security Council (*Dewan Jaminan Sosial Nasional*, DJSN). The government issued a Roadmap for National Health to guide JKN implementation activities and priorities.

C. Indonesia 2016 and beyond: a selective look

1. Improving housing outcomes in Indonesia

Indonesia faces a large housing deficit and an increasing need for affordable housing, particularly in urban areas

Indonesia currently has substantial demand for affordable housing. There are approximately 64.1 million housing units in Indonesia, around 20 percent of which are in poor condition. While estimates of the housing backlog vary widely, all indicate substantial unmet needs. Based on the 2013 National Census, BPS estimates a housing backlog of 17.2 million units. However, this estimate is likely to be significantly overstated as it is based on home ownership information and fails to take into account renters or lessees whose lifestyle preference may be not to own housing. Nevertheless, an estimated 820,000 to 920,000 new units are needed in urban areas each year to respond to annual demand from population growth and new household formation. The private sector only produces approximately 400,000 units per year. An additional 150,000 to 200,000 solutions are enabled by public sector programs, including incremental home improvement, rental housing, and social housing programs. This leaves a gap of an estimated 220,000 to 370,000 households that must resort to informal solutions or overcrowding in existing units each year.[35]

a. The availability of affordable housing is limited by high costs, low incomes and structural constraints

High housing costs, low and informal incomes, and limited access to housing finance constrain housing affordability

Affordability is a key constraint to significantly improving housing outcomes in Indonesia. On the supply side, costly land acquisition and permitting procedures, high construction costs (exacerbated by cumbersome regulations), and limited long-term bank funding have combined to make affordable housing development a risky and unattractive activity. On the demand side, limited financial inclusion, low incomes, and limited household saving restrict access to the formal housing sector.

[35] Housing statistics based on the most recent SUSENAS and MPWH administrative data.

As a result, only the richest 20 percent of households acquire housing in the formal commercial market. The middle 40 percent of households cannot afford formal housing without subsidy enhancements. The bottom 40 percent of Indonesians save little and cannot afford even a basic unit valued at IDR 15-30 million without expensive subsidies (Table 11).[36]

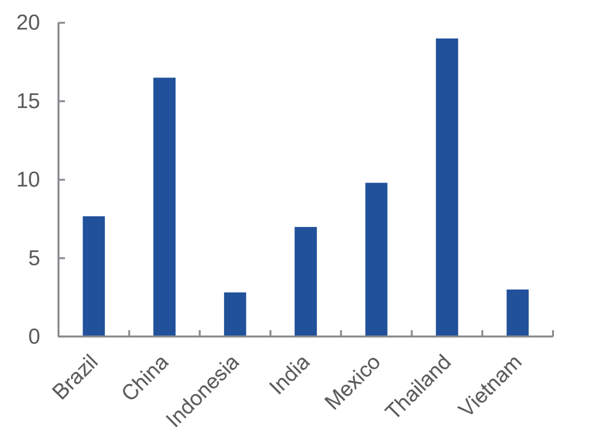
Table 11: Estimated housing affordability in Indonesia in market conditions
(IDR million)

	Household decile	Monthly income	Monthly payment capacity*	Estimated affordable home price with loan alone	Estimated affordable home price with down payment
 Can afford commercial unit	10	13.9	5.6	463	661
	9	7	2.6	216	309
	8	5.2	1.8	99	110
	7	4.2	1.4	74	82
	6	3.6	1.1	44	49
	5	3.1	0.9	38	43
 Cannot afford even basic unit	4	2.6	0.7	18	19
	3	2.1	0.5	13	14
	2	1.8	0.4	6.7	6.7
	1	1.2	0.1	2.3	2.3

Note: Calculations use rough assumptions with a gradated housing finance product mix: from 15-year commercial loans at 12 percent interest per year available to the top deciles to two-year housing microfinance products at 25 percent interest per year for the lowest decile. Saving capacity is also assumed to be gradated from 30 percent for the top decile to 0 percent for the lowest decile. * Equated monthly installments.
Source: Indonesia. A Roadmap for Housing Policy Reform (2015)

The mortgage market remains shallow…

Figure 26: Volume of residential mortgage finance as a share of GDP, 2012
(percent)



Source: hofinet.org; World Bank staff calculations

Given Indonesia's wealth and GDP, the penetration of mortgage finance is limited. Mortgage lending accounted for only 2.8 percent of GDP in 2012, compared with 7.0 percent in India and 19.0 percent in Thailand (Figure 26). Mortgage lending is constrained by a complex range of factors. First, most Indonesians simply cannot afford a mortgage without subsidy enhancements and government mortgage-linked subsidy programs have suffered from both inadequate funding and poor design. Second, over 60 percent of Indonesians are not part of the formal workforce and hence lack access to the financial system. Many of these households may be able to afford a mortgage but lack credit histories and are considered unbankable by the commercial banking sector. Unlike in countries like India or Mexico, the financial sector in Indonesia has not yet developed innovative

[36] While the definition of "basic unit" in Indonesia varies from region to region, in this instance we are using it to refer to a minimally socially acceptable dwelling. This generally entails some degree of tenure security, access to water and sanitation, adequate construction (e.g. sturdy materials and good construction of the roof, walls and floor), and sufficient space to avoid overcrowding (by regulation, more than 9 m^2 per occupant). Self-built construction can achieve these standards; no formally produced units are currently available at this price.

underwriting and credit risk management solutions to reach lower-income and non-salaried earners with housing products. Third, the banking sector lacks access to affordable, long-term funding from capital markets. Without the evolution of this secondary market, Indonesian banks will have limited ability to finance long-term mortgages from short-term deposits.

…and supply-side constraints limit the availability of low cost formal housing

Supply constraints prevent the private sector from participating in low-cost housing development. Land availability bottlenecks, including complex land acquisition, permitting and servicing processes, constraints on developer finance and the rising cost of construction, have limited formal housing development. This has kept annual production numbers low, particularly for low-margin affordable units. Developers have little incentive to build for the low-cost market, instead they prefer to maximize profits where strong demand from higher-income families or investors exists.

The lack of affordable housing has negative social, economic, and environmental effects, including slum proliferation

New affordable housing supply is often poorly located, pushing the urban poor to city peripheries. Lack of finance and the high cost of land in inner city areas mean that low-income households often resort to purchasing housing at the periphery of cities. As a result, these households end up paying premiums for transportation costs, which creates a broader negative impact in terms of congestion and spatial development patterns that are neither economically efficient, nor sustainable. Failures in the provision of affordable housing have contributed to the proliferation of slums. An estimated 12.2 percent of urban residents currently live in slums, which cover 38,430 hectares. If no action is taken, the area in cities attributable to slums is expected to continue to increase, along with the number of households. Many of these slum and squatter areas are not legally recognized and, therefore, lack basic services, becoming zones of exclusion, poverty and sub-standard living conditions.

The government has developed programs and institutions to support housing provision…

Indonesia has developed a broad set of policies and institutions to support housing provision, but these have not yet been effective in improving housing outcomes at the scale necessary. The government measures include, but are not limited to,: (i) a series of neighborhood community development programs (some of which, such as the National Program for Community Empowerment (*Program Nasional Pemberdayaan Mandiri*, PNPM) - Urban, supported by the World Bank); (ii) highly to fully subsidized public rental programs; (iii) Community Self Help Housing Subsidy (*Bantuan Stimulan Perumahan Swadaya*, BSPS) – an up-front subsidy for incremental home improvement; and (iv) a subsidized Mortgage Liquidity Facility (*Fasilitas Likuiditas Pembiayaan Perumahan*, FLPP) which aims to enhance mortgage affordability for middle-income households by subsidizing interest rates for fixed-rate mortgages (see Box 4). In addition, several state-owned enterprises, including PT Perumnas, Secondary Mortgage Facility (*Sarana Multigriya Finansial*, SMF), state insurance companies *(Jaminan Kredit Indonesia,* Jamkrindo*)* and public mortgage guarantee providers *(Asuransi Kredit Indonesia,* Askrindo*)*, are entrusted to play an active role in improving supply of and access to affordable housing through direct housing development, secondary mortgage market development and the extension of mortgage insurance. Finally, some local governments have pioneered programs that have achieved local results: e.g., a housing microfinance scheme in Palembang and a rental housing program administered by DKI Jakarta. However, these local initiatives often lack sustainable funding and the support to be scaled up.

…but these have had limited impact as government

In spite of these initiatives, government spending on housing has been historically too low to have a significant impact. For example, in 2013 the government committed only 0.3 percent of the total central government budget to spending on

spending on housing has historically been too low

housing. This accounted for only 0.05 percent of GDP, significantly less than housing budgets of international and regional peers like Thailand (2.15 percent of GDP) and the Philippines (0.3 percent of GDP).

Box 4: Summary of government housing programs

The government has focused recent housing policies on three primary initiatives – FLPP, BSPS, and public low-income rental housing (*Rumah Susun Sederhana Sewa, Rusunawa)*; a set of incentives for the private sector; and support to local governments. Introduced in 2011, FLPP provides concessional funds to primary lenders, which provide mortgages at a fixed interest rate of 7.25 percent per year for 20 years. Since 2011, FLPP has served an average of 68,000 households per year. FLPP 2.0 was introduced in early 2015, which recalibrated key product features to further enhance affordability and extend consumer and bank participation

Since 2006, the government has provided a subsidy (BSPS) to support incremental self-built housing, targeting rural and peri-urban areas. Households with income below IDR 1.5 million per month, which have legal title are eligible to receive a subsidy of either IDR 10 million for home improvement or IDR 30 million for new construction. From 2010 to 2013, 544,000 beneficiaries were reached with this program, with an average total housing project cost of around IDR 20 million.

The *Rusunawa* program supports multi-family public low-income rental housing, whereby the central government allocates a capital subsidy for construction and local governments are responsible for identifying and servicing project sites and managing units at completion. Tenants must earn below the provincial minimum wage, with nation-wide income limit of IDR 2.5 million per month. Rents are set at 30 percent of the minimum wage. In 2014, the Ministry of Public Works and Housing allocated IDR 2.4 trillion to the public rental program.

In addition, the government has allocated budget for capacity building and planning support to local governments and provides incentives to the private sector through a public low-income resident-owned housing initiatives (*Rumah Susun Sederhana Milik*, *Rusunami*) which include a reduction in the transfer tax rate from 5 to 1 percent to developers selling units below IDR 144 million. Meanwhile, buyers earning less than IDR 7 million per month are not required to pay VAT (typically 10 percent).

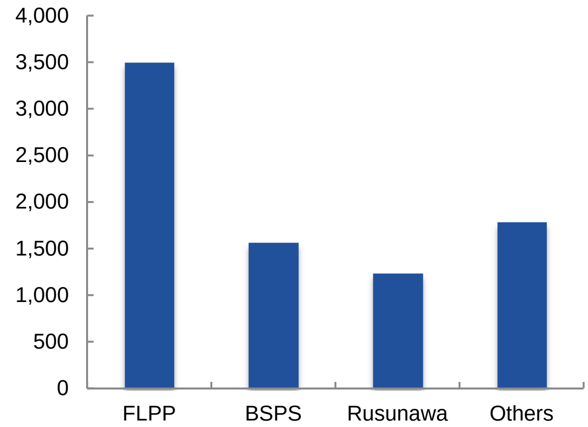
b. Better public spending can help address the affordable housing needs

There is currently strong political momentum to address the affordable housing shortage…

The government has recently made reducing the housing backlog and delivering affordable housing an explicit policy priority and has proposed to greatly increase housing spending. The plans include a mandatory savings-for-housing scheme (similar to a provident fund or social security policies such as BPJS), as well as an ambitious initiative called One Million Homes (*Satu Juta Rumah*). The latter aims to produce an average of one million housing units annually over the next five years. While ambitious, the target set by government is appropriate, given the need for affordable housing created by new annual household formation and the existing housing deficit.

… but increase in housing spending more equitable and effective

Figure 27: Average annual budget allocation for housing programs, 2011 - 2014
(IDR billion)



Source: Ministry of Public Works and Housing

Increasing public spending on housing has considerable potential to improve housing conditions. However, to accomplish this housing policy has to be re-oriented towards low income households, as public spending on housing has not always been equitable. First, the overall budget allocation for housing has historically favored programs targeted to middle- or upper-middle class households. In 2011- 2014, 43.3 percent of the Ministry of Housing budget was allocated to the FLPP program which targets borrowers with an income of up to IDR 4 million per month (and likely much higher as the income ceiling refers to base salary, does not factor in employment benefits, and is applied to individual borrowers rather than households (Figure 27).The remaining budget was divided among other programs, including BSPS (IDR6.3 trillion, 19.3 percent of budget), Rusunawa (IDR4.9 trillion, 15.3 percent of budget), and neighborhood upgrading and titling programs, all of which target lower-income households. Second, the absolute value of household subsidies across programs is significantly higher for programs that target relatively higher-income households. Higher-income households accessing FLPP can benefit from an effective government subsidy of IDR 126 million, or 43 percent of the maximum mortgage of IDR 300 million supported under the program. In contrast, the BSPS incremental housing improvement subsidy is only IDR 10-30 million. Finally, within individual programs, subsidies are not scaled progressively to income, thus enabling households that qualify for and can afford higher-value housing to capture an equal or greater subsidy.

No single approach can address Indonesia's needs for affordable housing…

There is no single approach providing affordable and adequate housing in Indonesia. Housing needs and demand are diverse across the country and require different policy responses. For example, a large number of currently substandard housing units can benefit from assisted home improvement or expansion. An estimated 3.9 million households live in slums which require upgrading, in-situ redevelopment, or relocation. A large number of poor households with extreme affordability constraints require highly subsidized housing. Indonesia's large and growing middle class (including many non-salaried workers) will require an efficiently and progressively designed subsidy policy to complement savings and mortgages to enable formal home acquisition.

…but there are some steps the government can take in the short and medium term to improve policy outcomes

In spite of complex and diverse needs, the government can take some short- and medium-term steps to raise access to affordable housing and create more equity and efficiency in the housing system. These are, in order of complexity: (i) increase the amount and proportion of government spending on programs that directly and effectively target the bottom 40 percent of the population; (ii) improve access to housing finance for low-income and informal-sector households; and (iii) mobilize urban land for affordable housing.

Strengthening the design and increasing the existing home improvement subsidy is a good first step…

In the short term, it could be useful to explore the potential to expand the incremental home improvement subsidy, BSPS, especially to urban areas where the housing needs are most acute. Since self-built housing constitutes over 70 percent of the housing stock in Indonesia, the method of incremental home improvement has proven to be an effective solution. Preliminary World Bank analysis suggests that the subsidy effectively reaches target groups, and that the program ensures appropriate use of funds and increases affordability through reductions in the cost of financing, engineering and labor. The BSPS program primarily targets rural areas but it is being expanded to peri-urban zones.

…as is exploring other cost-effective and equitable housing solutions, such as expandable core starter units, for very low-income households

In addition, the Ministry of Public Works and Housing is developing an expandable "core starter" home as a supply-side solution for low income households. These units allow governments to reach a significantly larger number of beneficiaries compared with other housing initiatives and to tailor the product to a variety of socio-cultural and political economy contexts. The proposed core starter home is move-in ready, getting poor households out of deprived housing conditions quickly and without burdening them with in-cash, in-kind or in-labor investment before habitation. This is particularly important for urban, cash-based economies where households cannot easily self-build (in contrast to rural areas with agricultural seasons).

Increasing access to housing finance, particularly for non-salaried households, is a good medium-term policy option

In the medium term, encouraging banks to offer housing finance to informal workers, which constitute about 60 percent of the workforce,[37] will help improve housing affordability. A three-pronged strategy could be used to this end. First, build capacity to assess credit risk linked to undocumented incomes. Second, promote savings-for-housing products that enable verification of saving capacity of would-be borrowers. Finally, assess the feasibility of a guarantee product specific to this category of borrowers, such as the People's Business Credit program (*Kredit Usaha Rakyat*, KUR) for small businesses, to draw best practice lessons for adoption.

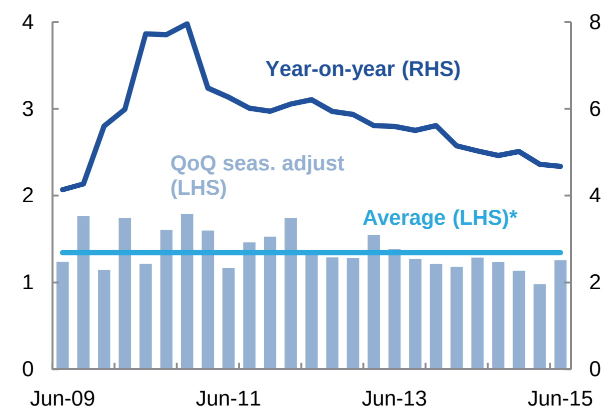
Land administration and acquisition reforms may help scale up affordable housing

Finally, the rapid growth of urban areas has increased pressure on land prices in urban and peri-urban zones. Private developers and investors have acquired large land banks for speculative purposes which, combined with the failure of formal sector supply to keep up with demand, has significantly pushed up prices of well-located land over the last three years. As a result, land is no longer affordable to the poor and even many middle-income groups throughout Indonesia. The lack of affordable and suitable land will ultimately limit efforts to increase housing affordability. While this issue is complex, there are some steps that government may consider in the short and medium term to mobilize land for housing and settlements. In the short run, the central government could build a detailed strategy to support local governments in recognizing and/or regularizing land tenure in the full range of informal settlements, including squatter areas. Second, the government may consider creating a framework to identify unused, or under-utilized state-owned and suitable *waqaf* land assets for new low-income housing projects. In the medium term, mobilizing sufficient land assets for housing may depend on strengthening local government capacity to improve land management systems (including land use zoning and spatial planning, permitting, valuation and taxation, cadaster, registration and regulatory enforcement) and introducing a range of methods to develop private sector land, such as land sharing, land readjustment and consolidation.

[37] 70 percent if the irregular workers in the formal sector are included, according to the International Labor Office's 2013 Women and Men in the Informal Economy: a Statistical Picture

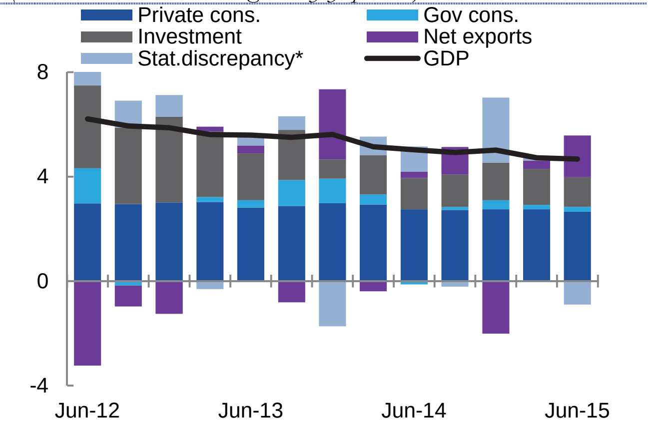
APPENDIX: A SNAPSHOT OF INDONESIAN ECONOMIC INDICATORS

Appendix Figure 1: Quarterly and annual GDP growth
(real GDP growth, percent)



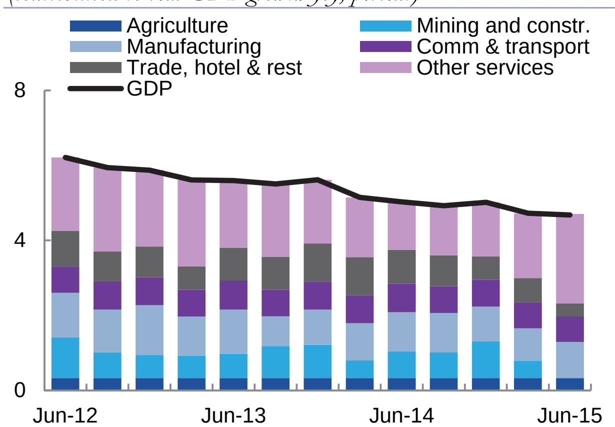
Note: *Average QoQ growth, Q2 2009–Q2 2015
Source: BPS; World Bank staff calculations

Appendix Figure 2: Contributions to GDP expenditures
(contribution to real GDP growth yoy, percent)



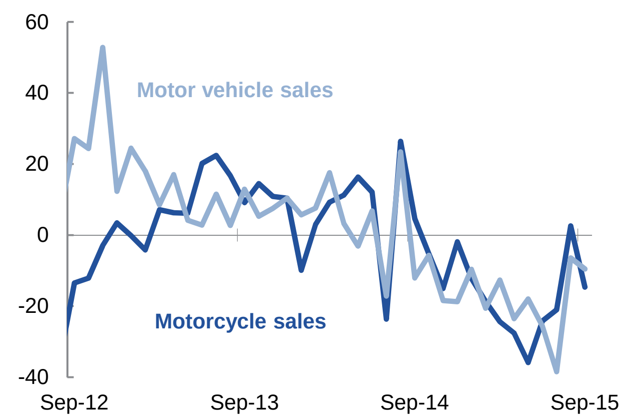
Note: * includes changes in stocks
Source: BPS; World Bank staff calculations

Appendix Figure 3: Contributions to GDP production
(contribution to real GDP growth yoy, percent)



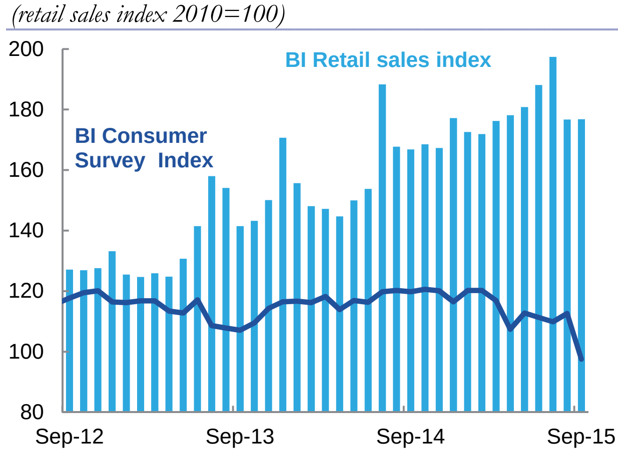
Source: BPS; World Bank staff calculations

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



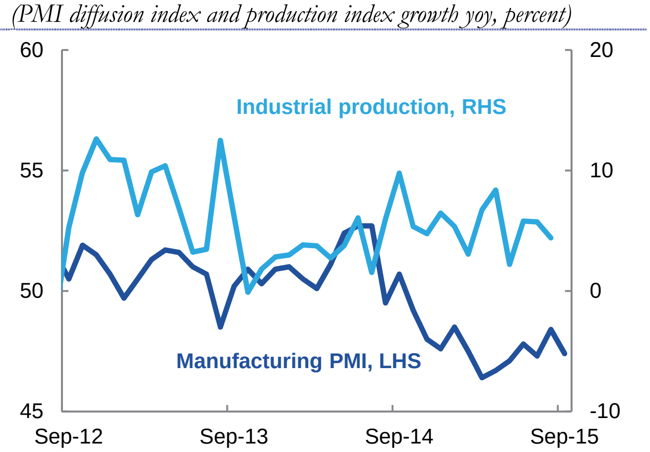
Source: CEIC; World Bank staff calculations

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



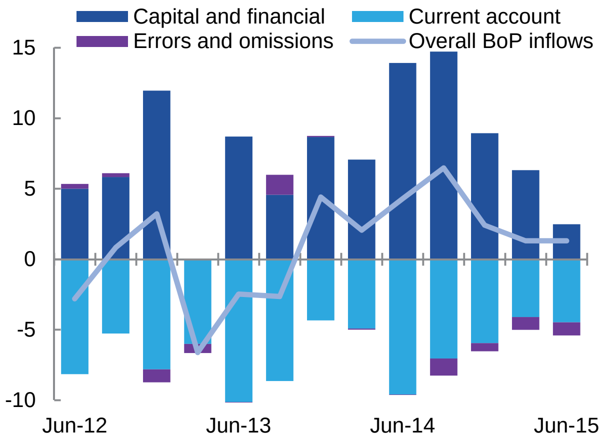
Source: BI

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



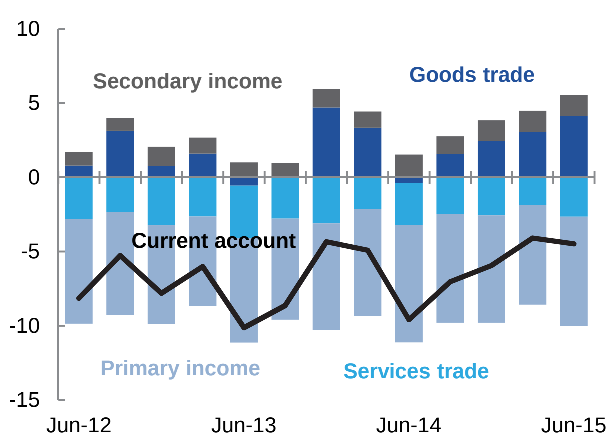
Source: BPS; Markit HSBC Purchasing Managers Index

Appendix Figure 7: Balance of payments
(USD billion)



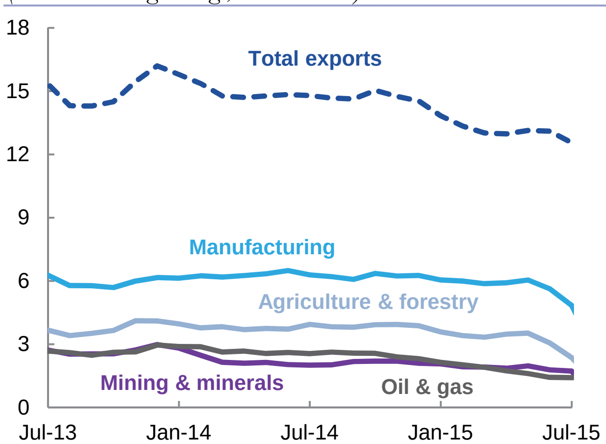
Source: BI

Appendix Figure 8: Current account components
(USD billion)



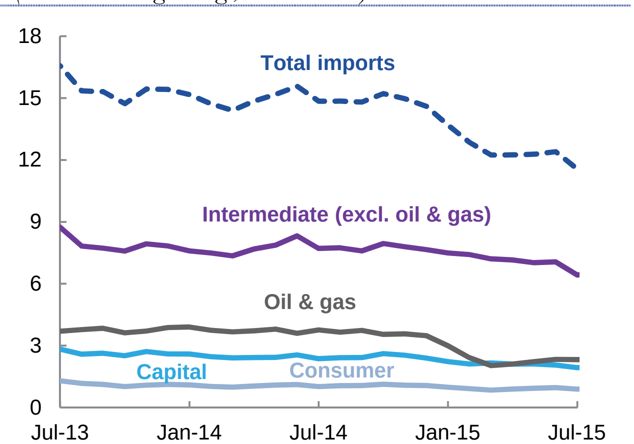
Source: BI; World Bank staff calculations

Appendix Figure 9: Exports of goods
(3-month moving average, USD billion)



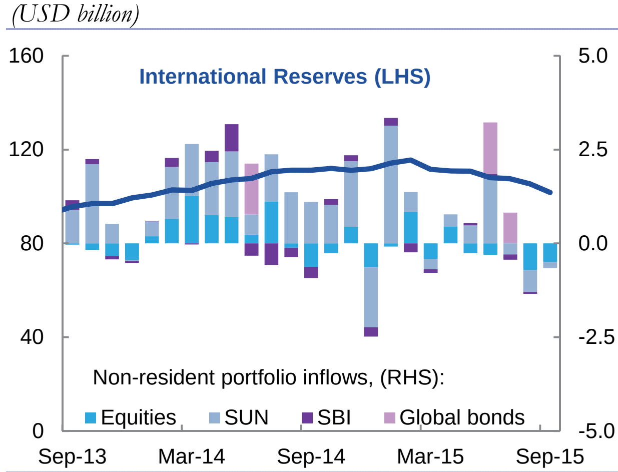
Source: BPS

Appendix Figure 10: Imports of goods
(3-month moving average, USD billion)



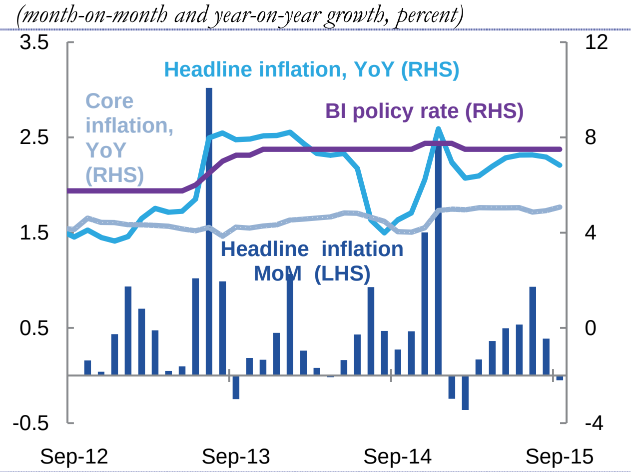
Source: BPS

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



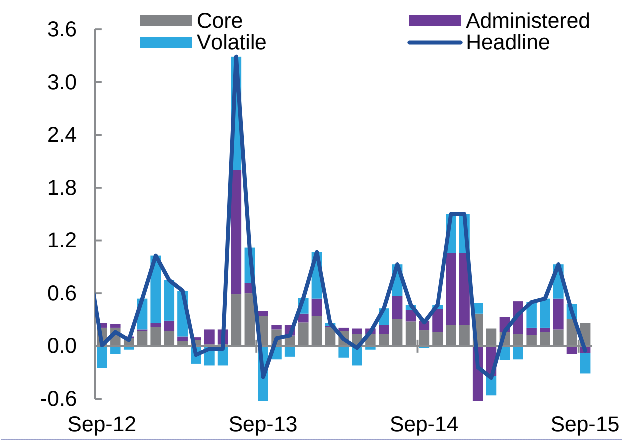
Source: BI; CEIC; World Bank staff calculations

Appendix Figure 12: Inflation and monetary policy
(month-on-month and year-on-year growth, percent)



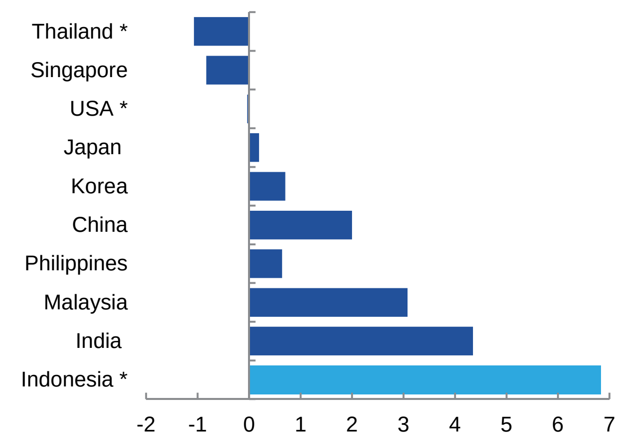
Source: BPS; World Bank staff calculations

Appendix Figure 13: Monthly breakdown of CPI
(percentage point contributions to monthly growth)



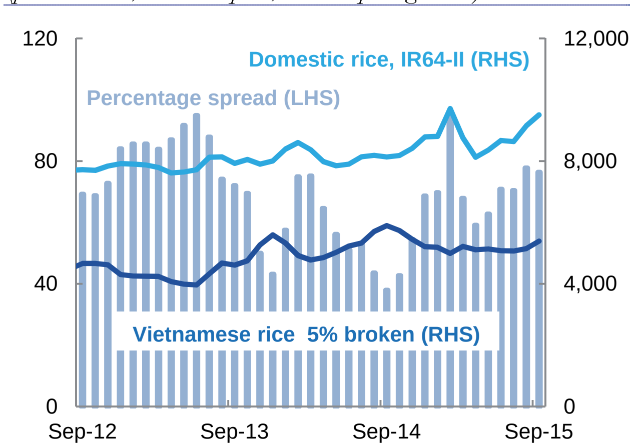
Source: BPS; World Bank staff calculations

Appendix Figure 14: Inflation comparison across countries
(year-on-year, September 2015)



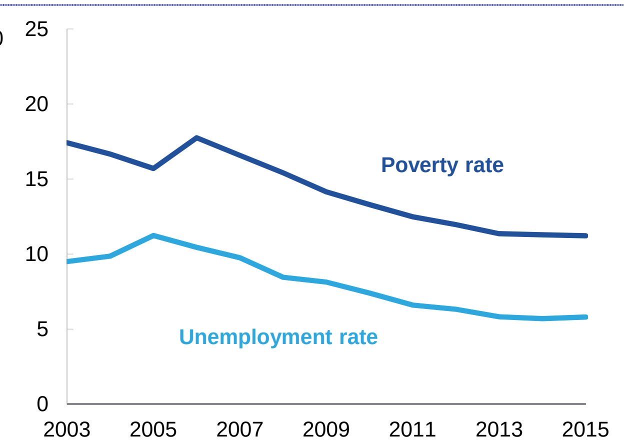
*September is the latest available month, others August
Source: National statistical agencies via CEIC; BPS

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



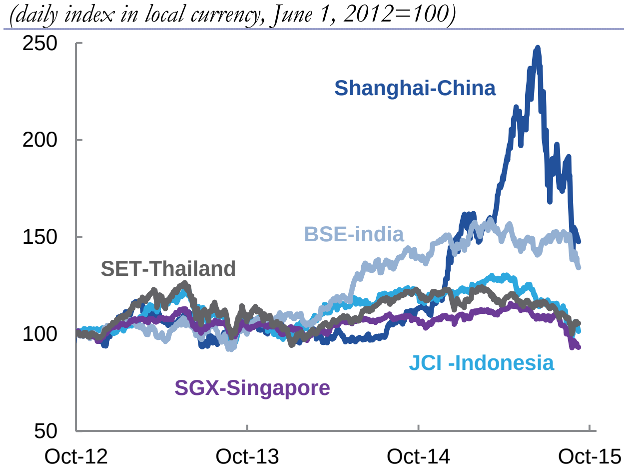
Source: Cipinang wholesale rice market; FAO; World Bank

Appendix Figure 16: Poverty and unemployment rate
(percent)



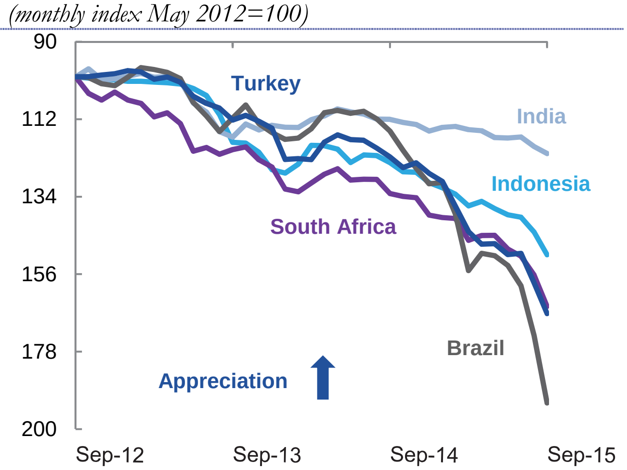
Source: BPS

Appendix Figure 17: Regional equity indices
(daily index in local currency, June 1, 2012=100)



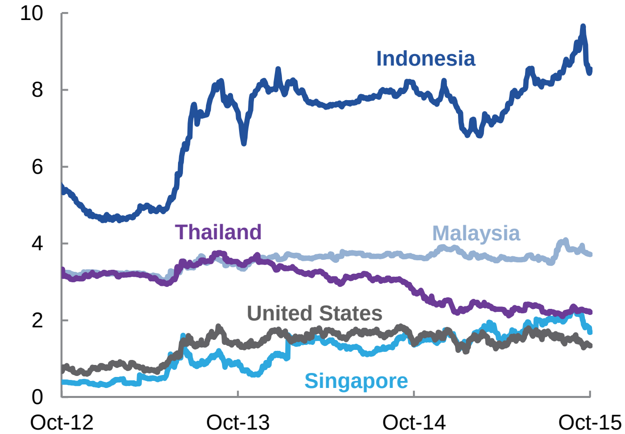
Source: CEIC; World Bank staff calculations

Appendix Figure 18: Selected currencies against USD
(monthly index May 2012=100)



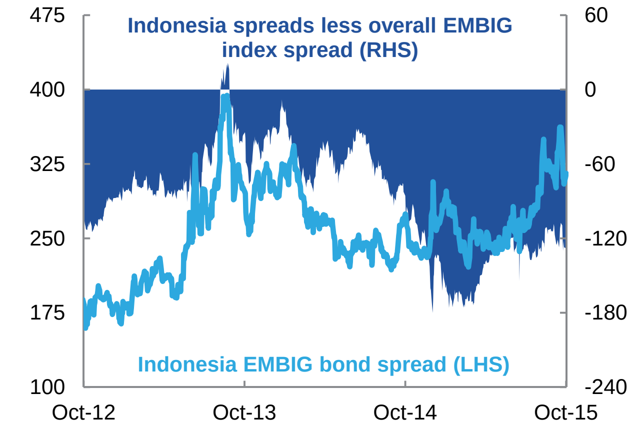
Source: CEIC; World Bank staff calculations

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



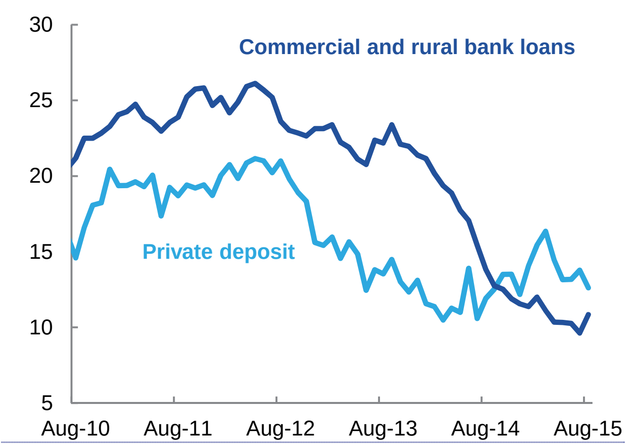
Source: CEIC

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



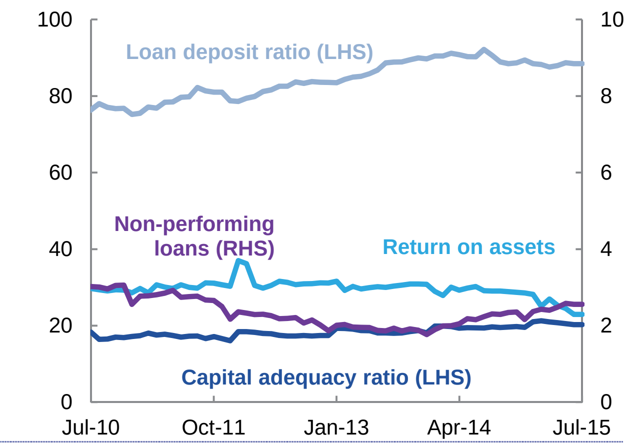
Source: JP Morgan; World Bank staff calculations

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



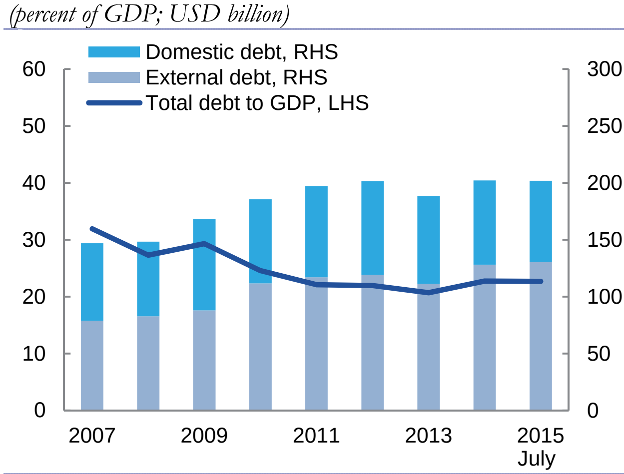
Source: BI; World Bank staff calculations

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



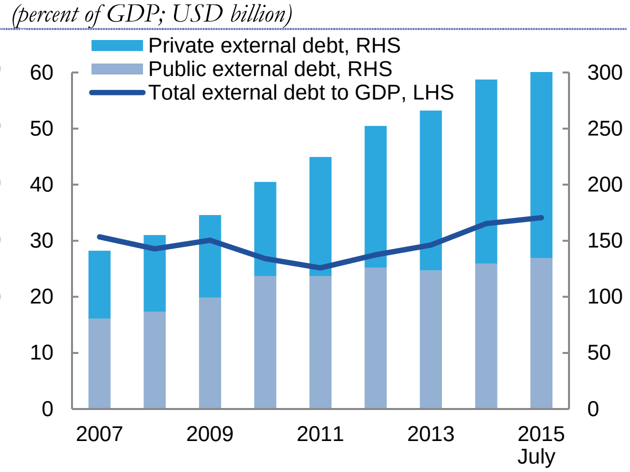
Source: BI

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



Source: MoF; BI; World Bank staff calculations

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



Source: BI; World Bank staff calculations

Appendix Table 1: Budget outcomes and projections

(IDR trillion)

	2010	2011	2012	2013	2014	2015	2015
	Actual	Actual	Actual	Actual	Actual	Revised Budget	MoF revised outlook
A. State revenue and grants	**995**	**1,211**	**1,338**	**1,439**	**1,550**	**1,762**	**1,650**
1. Tax revenue	723	874	981	1,077	1,147	1,489	1,367
2. Non-tax revenue	269	331	352	355	399	269	279
B. Expenditure	**1,042**	**1,295**	**1,491**	**1,651**	**1,777**	**1,984**	**1,910**
1. Central government	697	884	1,011	1,137	1,204	1,320	1,246
2. Transfers to the regions	345	411	481	513	574	665	664
C. Primary balance	**42**	**9**	**-53**	**-99**	**-93**	**-67**	**-103**
D. SURPLUS / DEFICIT	-47	-84	-153	-212	-227	-223	-260
(percent of GDP)	-0.7	-1.1	-1.8	-2.2	-2.2	-1.9	-2.2

Note: Budget balance as percentage of GDP is using revised and rebased GDP
Source: Ministry of Finance

Appendix Table 2: Balance of payments

(USD billion)

	2012	2013	2014	2013	2014				2015	
				Q4	Q1	Q2	Q3	Q4	Q1	Q2
Balance of payments	**0.2**	**-7.3**	**15.2**	**4.4**	**2.1**	**4.3**	**6.5**	**2.4**	**1.3**	**-2.9**
Percent of GDP	0.0	-0.8	1.7	2.1	1.0	1.9	2.8	1.1	0.6	-1.3
Current account	**-24.4**	**-29.1**	**-27.5**	**-4.3**	**-4.9**	**-9.6**	**-7.0**	**-6.0**	**-4.1**	**-4.1**
Percent of GDP	-2.7	-3.2	-3.1	-2.1	-2.3	-4.3	-3.0	-2.7	-1.9	-1.9
Trade balance	-1.9	-6.2	-3.0	1.6	1.2	-3.2	-0.9	-0.1	1.2	1.5
Net income & current transfers	-22.5	-22.9	13.6	-5.9	-6.1	-6.4	-6.1	-5.8	-5.3	-5.9
Capital & Financial Account	**24.9**	**22.0**	**44.4**	**8.7**	**7.1**	**13.7**	**14.7**	**8.9**	**6.3**	**2.5**
Percent of GDP	2.7	2.4	5.0	4.1	3.3	6.1	6.3	4.1	3.0	1.1
Direct investment	13.7	12.2	16.0	0.2	3.2	3.7	6.0	4.0	2.3	3.6
Portfolio investment	9.2	10.9	26.1	1.7	8.7	8.0	7.4	1.9	8.8	5.8
Other investment	1.9	-1.1	2.6	6.7	-4.9	2.2	1.3	4.0	-4.8	-6.9
Errors & omissions	**-0.3**	**-0.2**	**-1.9**	**0.1**	**-0.1**	**0.0**	**-1.2**	**-0.6**	**-0.9**	**-0.9**
Foreign reserves*	**112.8**	**99.4**	**112.0**	**99.4**	**102.6**	**107.7**	**111.2**	**111.9**	**111.6**	**108.0**

Note: * Reserves at end-period
Source: BI; BPS

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

	1995	2000	2005	2010	2011	2012	2013	2014
National Accounts (% change)[1]								
Real GDP	8.4	4.9	5.7	6.2	6.2	6.0	5.6	5.0
Real investment	22.6	11.4	10.9	8.5	8.9	9.1	5.3	4.1
Real consumption	21.7	4.6	64.0	4.1	5.1	5.4	5.6	4.8
Private	22.7	3.7	0.9	4.8	5.1	5.5	5.4	5.3
Government	14.7	14.2	6.6	0.3	5.5	4.5	6.9	2.0
Real exports, GNFS	18.0	30.6	16.6	15.3	14.8	1.6	4.2	1.0
Real imports, GNFS	29.6	26.6	17.8	17.3	15.0	8.0	1.9	2.2
Investment (% GDP)	28	20	24	31	31	33	32	33
Nominal GDP (USD billion)	202	165	286	755	893	918	910	889
GDP per capita (USD)	1102	857	1,396	3,178	3,690	3,740	3,659	3,524
Central Government Budget (% GDP)[2]								
Revenue and grants	15.2	20.8	16.8	14.5	15.5	15.5	15.1	14.7
Non-tax revenue	4.8	9.0	5.0	3.9	4.2	4.1	3.7	3.8
Tax revenue	10.3	11.7	11.7	10.5	11.2	11.4	11.3	10.9
Expenditure	13.9	22.4	17.3	15.2	16.5	17.3	17.3	16.9
Consumption	3.9	4.0	2.8	3.6	3.8	3.9	4.1	4.0
Capital	4.6	2.6	1.1	1.2	1.5	1.7	1.9	1.4
Interest	1.4	5.1	2.2	1.3	1.2	1.2	1.2	1.3
Subsidies	..	6.3	4.1	2.8	3.8	4.0	3.7	3.7
Budget balance	1.3	-1.6	-0.6	-0.7	-1.1	-1.8	-2.2	-2.2
Government debt	32.3	97.9	44.3	24.3	22.8	22.6	24.1	23.8
o/w external government debt	32.3	51.4	23.4	11.1	10.2	9.9	11.2	10.2
Total external debt (including private sector)	61.5	87.1	47.1	26.8	25.2	27.5	29.2	33.1
Balance of Payments (% GDP)[3]								
Overall balance of payments	..	..	0.2	4.0	1.3	0.0	-0.8	1.7
Current account balance	3.2	4.8	0.1	0.7	0.2	-2.7	-3.2	-3.1
Exports GNFS	26.2	42.8	35.0	22.0	23.8	23.0	22.4	22.4
Imports GNFS	26.9	33.9	32.0	19.2	21.2	23.2	23.1	22.7
Trade balance	-0.8	8.9	2.9	2.8	2.7	-0.2	-0.7	-0.3
Financial account balance	..	..	0.0	3.5	1.5	2.7	2.4	5.0
Net direct investment	2.2	-2.8	1.8	1.5	1.3	1.5	1.3	1.8
Gross official reserves (USD billion)	14.9	29.4	34.7	96.2	110.1	112.8	99.4	112.0
Monetary (% change)[3]								
GDP deflator[1]	9.9	20.4	14.3	8.3	7.5	3.8	4.7	5.4
Bank Indonesia interest key rate (%)	..	..	9.1	6.5	6.6	5.8	6.5	7.5
Domestic credit (annual average)	..	..	28.7	17.5	24.4	24.2	22.1	15.9
Nominal exchange rate (average, IDR/USD)[4]	2,249	8,422	9,705	9,090	8,770	9,387	10,461	11,865
Prices (% change)[1]								
Consumer price Index (eop)	9.0	9.4	17.1	7.0	3.8	3.7	8.1	8.4
Consumer price Index (average)	9.4	3.7	10.5	5.1	5.3	4.0	6.4	6.4
Indonesia crude oil price (USD per barrel, eop)[5]	17	28	53	79	112	113	107	60

Source: [1] BPS and World Bank staff calculations, using revised and 2010 rebased figures. [2] MoF and World Bank staff calculations (for 1995 is FY 1995/1996, for 2000 covers 9 months), [3] Bank Indonesia, [4] IMF, [5] CEIC.

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

	2000	2005	2010	2011	2012	2013	2014	2015
Demographics[1]								
Population (million)	213	227	242	245	248	251	254	..
Population growth rate (%)	1.3	1.2	1.3	1.3	1.3	1.3	1.3	..
Urban population (% of total)	42	46	50	51	51	52	53	..
Dependency ratio (% of working-age population)	55	54	51	51	50	50	49	..
Labor Force[2]								
Labor force, total (million)	98	106	117	117	120	120	122	128
Male	60	68	72	73	75	75	76	78
Female	38	38	45	44	46	45	46	50
Agriculture share of employment (%)	45	44	38	36	35	35	34	33
Industry share of employment (%)	17	19	19	21	22	20	21	21
Services share of employment (%)	37	37	42	43	43	45	45	45
Unemployment, total (% of labor force)	8.1	11.2	7.1	7.4	6.1	6.2	5.9	5.8
Poverty and Income Distribution[3]								
Median household consumption (IDR 000 per month)	104	211	374	421	446	487	548	..
National poverty line (IDR 000 per month)	73	129	212	234	249	272	303	331
Population below national poverty line (million)	38	35	31	30	29	28	28	29
Poverty (% of population below national poverty line)	19.1	16.0	13.3	12.5	12.0	11.4	11.3	11.2
Urban (% of population below urban poverty line)	14.6	11.7	9.9	9.2	8.8	8.4	8.3	8.3
Rural (% of population below rural poverty line)	22.4	20.0	16.6	15.7	15.1	14.3	14.2	14.2
Male-headed households	15.5	13.3	11.0	10.2	9.5	9.2	11.2	..
Female-headed households	12.6	12.8	9.5	9.7	8.8	8.6	11.9	..
Gini index	0.30	0.35	0.38	0.41	0.41	0.41	0.41	..
Percentage share of consumption: lowest 20%	9.6	8.7	7.9	7.4	7.5	7.4	7.5	..
Percentage share of consumption: highest 20%	38.6	41.4	40.6	46.5	46.7	47.3	46.8	..
Public expenditure on social security & welfare (% of GDP)[4]	..	0.4	0.4	0.4	0.4	0.6	0.5	..
Health and Nutrition[1]								
Physicians (per 1,000 people)	0.16	0.13	0.29	..	0.20	..	..	..
Under five mortality rate (per 1000 children under 5 years)	52	42	33	32	30	29	28	27
Neonatal mortality rate (per 1000 live births)	22	19	16	16	15	15	14	14
Infant mortality (per 1000 live births)	41	34	27	26	25	24	24	23
Maternal mortality ratio (estimate, per 100,000 live births)	340	270	210	..	..	190	..	..
Measles vaccination (% of children under 2 years)	74	77	78	80	85	84	77	..
Total health expenditure (% of GDP)	2.0	2.8	2.9	2.9	3.0	3.1	..	..
Public health expenditure (% of GDP)	0.7	0.8	1.1	1.1	1.2	1.2	..	..
Education[3]								
Primary net enrollment rate (%)	..	92	92	92	93	92	93	..
Female (% of total net enrollment)	..	48	48	49	49	50	48	..
Secondary net enrollment rate (%)	..	52	61	60	60	61	65	..
Female (% of total net enrollment)	..	50	50	50	49	50	50	..
Tertiary net enrollment rate (%)	..	9	16	14	15	16	18	..
Female (% of total net enrollment)	..	55	53	50	54	54	55	..
Adult literacy rate (%)	..	91	91	91	92	93	93	..
Public spending on education (% of GDP)[5]	..	2.7	3.5	3.6	3.8	3.8	3.6	..
Public spending on education (% of spending)[5]	..	14.5	20.0	20.2	20.1	20.0	19.9	..
Water and Sanitation[1]								
Access to an improved water source (% of population)	78	81	85	85	86	86	87	87
Urban (% of urban population)	91	92	93	93	94	94	94	94
Rural (% of rural population)	68	71	76	77	77	78	79	80
Access to improved sanitation facilities (% of population)	44	53	57	58	59	60	61	61
Urban (% of urban population)	64	70	70	71	71	72	72	72
Rural (% of rural population)	30	38	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	11	18	18	19	19	17	..

Source: [1] World Development Indicators; [2] BPS (Sakernas); [3] BPS (Susenas) and World Bank; [4] MoF, Bappenas and World Bank staff calculation, only includes spending on Raskin, Jamkesmas, BLT, BSM, PKH and actuals; [5] MoF; [6] Inter-Parliamentary Union

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