Macroeconomic Challenges and Indonesian Economy during the Global Crisis

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Outline Presentation

* Summary of current economic development
* Policy Responses
* Challenges and Constraints
* Conclusion
The state of economy is still uncertain

**Current Trend**
- Y o Y growth sliding down
  - Q1 2008: 6.2%
  - Q2 2008: 6.4%
  - Q3 2008: 6.4%
  - Q4 2008: 5.4%
- Stock market index downed sharply in Dec 08 by 51% (compared to Dec 07) before recovered since March 09
- Export fell by more than 35% in Q1 09
- International Reserve fell from USD 61 b in July 08 to USD 50 b in Nov 08 before recovered back to USD 54 in March 08

**Good Signs**
- Growth is still positive in Q1 2009 – 4.6-4.8%
- Some indicators have shown a turning point in March 2009
  - Car and motor cycle sale
  - Electricity used by industries
  - Domestic Value Added Tax Revenues
- Unemployment is still down in Feb 09 survey
- Poverty continued to decline in July 08 and expected to decline in March 2009
## Crisis Control in the Financial Markets

### Supporting the Banking and Capital Market Systems

- Place *government funds with state-owned banks* to increase liquidity in the banking system
- Increase the amount of *deposits guaranteed* by the government in the banking system
- **Strengthen the government’s supervisory and enforcement capacity** over capital markets
- Prepare *crisis protocol* (implementation of the Financial System Stability Committee)

### Ensuring Foreign Exchange Stability

- **Manage state-owned enterprises’ foreign exchange** transactions to reduce speculation
- Maintain a *sufficient level of foreign exchange reserves* through trade financing facilities and prevention of illegal imports
- **Requiring greater disclosure on large-sized purchases of foreign currency against IDR** to curb speculative pressure on IDR
Stimulating Real Sector Growth

- Recognize the importance of monetary policy support, as deemed appropriate for domestic conditions
  - Bank Indonesia lowered the policy rate to 8.75% in Jan-09 when inflation pressure eased
  - Indonesian banks have started cutting their lending rates in response to the central banks’ rate cut to accelerate real sector growth

- Accelerate the disbursement of projects for government and state-owned enterprises

- Implement fiscal stimulus and provide additional fiscal stimulus for business and infrastructure projects

- Support for real sector and export promotion such as government guarantees for trade financing

- Reduce fuel prices, apply an automatic premium gasoline price adjustment and provide diesel price incentives to reduce manufacturing operational costs
Measures Are Taken to Ensure Sustainability of the 2009 Budget

Indonesia is moving from a defensive to offensive stance while maintaining fiscal sustainability

<table>
<thead>
<tr>
<th>Defensive Measures</th>
<th>Offensive (Counter-Cyclical) Measures</th>
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</thead>
<tbody>
<tr>
<td>▪ Earmark expenditure on lower priority projects and imports</td>
<td>▪ Additional expenditure on infrastructure projects which have greater impact on employment creation and poverty reduction</td>
</tr>
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<td>▪ Flexible allocation of provincial government expenditure</td>
<td>▪ Reduce costs of business through the implementation of the Income Tax Law</td>
</tr>
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<td>▪ Lower tax revenue growth target</td>
<td>▪ 2-7% reduction in income tax</td>
</tr>
<tr>
<td>▪ Redefine “emergency funding” in State Budget Law 2009 based on emergency conditions, government debt security funding costs and banking systemic risk</td>
<td>▪ Introduce tax incentives for selected sectors and regions</td>
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<tr>
<td>▪ Increase fiscal contingency fund to counteract deviations from current macroeconomic assumptions</td>
<td>▪ Relax tax tariffs for selected sectors e.g. crude palm oil</td>
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<td>▪ Shift financing sources from marketable securities to standby facilities</td>
<td>▪ Provide more direct subsidy for medium and low income households</td>
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<tr>
<td>▪ Prepare crisis protocol through the implementation of the “Financial System Stability Committee”</td>
<td>▪ Lower energy prices or provide a certain discount on electricity bill for industries</td>
</tr>
<tr>
<td></td>
<td>▪ Upsize financing from bilateral and multilateral organizations</td>
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## Fiscal Stimulus in Place for 2009

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
<th>Support from infrastructure and national programs, such as:</th>
</tr>
</thead>
</table>
| 1    | Accelerate job creation and foster growth of small scale businesses                              | - Additional peoples empowerment (PNPM) program to alleviate poverty  
- Expansion of credit program (KUR) to accelerate the development of the primary sectors  
- Additional infrastructure projects for job creation |
| 2    | Boosting the society’s purchasing power                                                            | - Subsidies on medicine, and cooking oil  
- Direct subsidies (cash transfer and conditional cash transfer) for low-income households  
- Provide more direct and indirect subsidies to education and health sector |
| 3    | Stimulate trade and promote entrepreneurship                                                       | - Import duty facility on selected capital goods and materials  
- Export financing and guarantee  
- Tax rate reduction on corporate income and individual income, and increase minimum threshold for employee tax  
- Discount on electricity peak-hour charge for industries and reduction of diesel fuel price |
Indonesia's Stimulus Package is Comparable to Other Economies

The fiscal stimulus package that Indonesia has put in place is in line with rest of the world.

<table>
<thead>
<tr>
<th>Country</th>
<th>2009 GDP Growth Projection (%)</th>
<th>2009 Fiscal Stimulus (% of Outlook GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Original</td>
<td>Outlook</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4.8</td>
<td>0.2</td>
</tr>
<tr>
<td>Thailand</td>
<td>4.5</td>
<td>2</td>
</tr>
<tr>
<td>Australia</td>
<td>2.2</td>
<td>1.7</td>
</tr>
<tr>
<td><strong>Indonesia</strong></td>
<td>6.0</td>
<td>4.0</td>
</tr>
<tr>
<td>USA</td>
<td>0.1</td>
<td>-0.8</td>
</tr>
<tr>
<td>UK</td>
<td>-0.1</td>
<td>-1.3</td>
</tr>
<tr>
<td>Singapore</td>
<td>3.5</td>
<td>-5</td>
</tr>
<tr>
<td>Japan</td>
<td>0.5</td>
<td>-0.2</td>
</tr>
<tr>
<td>South Korea</td>
<td>3.5</td>
<td>2.5</td>
</tr>
<tr>
<td>India</td>
<td>6.9</td>
<td>6</td>
</tr>
<tr>
<td>China</td>
<td>9.3</td>
<td>8</td>
</tr>
</tbody>
</table>

Source: CEIC, Bloomberg
Fiscal stimulus is not enough..

Figure 25. The size of stimulus packages falls short of output gaps */

(overall, in percent of GDP)

Table 5. Stimulus Impact on GDP

(In percent of GDP)

<table>
<thead>
<tr>
<th>Country</th>
<th>Range of impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>0.8 - 4.3</td>
</tr>
<tr>
<td>o/w: government</td>
<td>0.3 - 1.6</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.2 - 0.8</td>
</tr>
<tr>
<td>Korea</td>
<td>1.5 - 4.3</td>
</tr>
<tr>
<td>Malaysia</td>
<td>0.3 - 1.3</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.5 - 1.7</td>
</tr>
<tr>
<td>Singapore</td>
<td>0.8 - 3.2</td>
</tr>
</tbody>
</table>

Source: World Bank staff estimates. */ Government parts of packages only; for Malaysia, only the tax and spending measures.
Financing deficit is binding by access to market

Figure 26. Financing requirements are burdensome for some governments */
(in U.S. dollars, LHS; and in percent of GDP, RHS)

Figure 27. Domestic bond yields have risen
(Vertical axis: increase in 10-year govt bond spreads in bps; horizontal: gross financing requirements in percent of GDP)

Source: National authorities and World Bank staff calculations.

Source: Bloomberg and World Bank staff calculations.
CONSTRAINTS IN IMPLEMENTING POLICIES

- **Pre-1998:** under the New Order
  - Coordination in decision-making regarding policy formulation and implementation
    - Centralized decision-making
  - Accountability structures within government
    - Vertical and hierarchical structure, strong incentives
  - Capacity in terms of policy formulation, implementation, and service delivery
    - Good given centralized state and tasks at hand

- **Post-1998:** in a democratic and decentralized Indonesia
  - Difficult because of multiple stakeholders and multiple axes along which coordination needed
  - Dispersed and multiple vertical and horizontal lines of accountability, weak incentives
  - Weak in context of decentralized state and “second-generation” challenges