INDONESIA

Table 1	2021
Population, million	276.4
GDP, current US$ billion	1186.1
GDP per capita, current US$	4291.8
International poverty rate ($1.9)[a]	2.2
Lower middle-income poverty rate ($3.2)[a]	18.0
Upper middle-income poverty rate ($5.5)[a]	50.2
Gini index[a]	37.3
School enrollment, primary (% gross)[b]	106.4
Life expectancy at birth, years[b]	71.7
Total GHG Emissions (mtCO2e)	1755.8

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2011 PPPs.
b/ WDI for School enrollment (2018); Life expectancy (2019).

Indonesia's economy is recovering supported by growing commodities exports and accommodative fiscal policy. This helped reduce poverty closer to pre-pandemic levels. Medium term growth will be supported by rising private consumption and investment as aggregate demand picks up and structural reforms start paying off. Downside risks remain elevated and could derail recovery, including worsening global conditions and renewed COVID-19 outbreaks.

Key conditions and challenges

Sound macro fundamentals prior to the pandemic allowed Indonesia to build financial and fiscal buffers to respond to the crisis. However, the country faces several long-term structural challenges that can affect the recovery phase. Prudent macro management has been constrained by low tax effort, shallow financial markets and competitiveness challenges. Indonesia has responded well to the crisis, including in terms of addressing these challenges through structural reforms to boost taxation and investment.

Indonesia faces short-term cyclical challenges that can weigh on the recovery. As COVID-19 may become endemic, a strategy for accelerating the vaccination program over a protracted period is needed. Risks from US monetary tightening could also increase the cost of external financing, and rising tensions in Europe is worsening the external environment. Meanwhile, employment and incomes have not returned to pre-pandemic levels, especially among vulnerable households, and social assistance program coverage among targeted groups remains low.

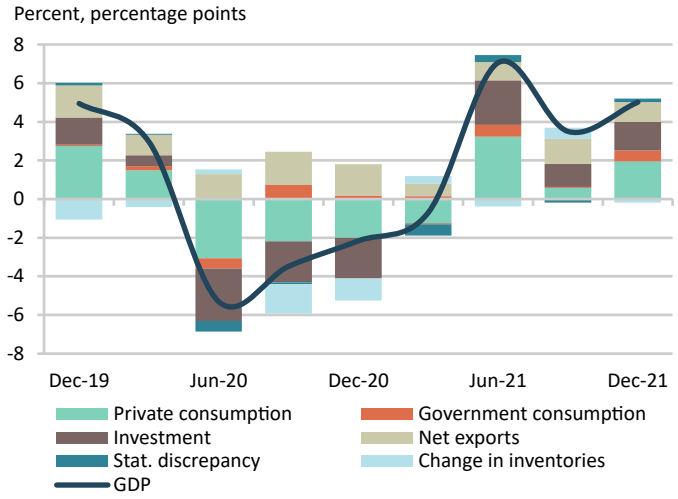
Recent developments

Growth rebounded from -2.1 percent in 2020 to 3.7 percent in 2021, supported by public consumption and exports. This came on the back of a counter-cyclical fiscal and monetary response to the pandemic, higher commodity prices, and a pick-up in external demand. On the supply side, more than 60 percent of the contribution to growth in 2021 came from the manufacturing, wholesale & trade, construction, and telecom sectors reflecting growing demand especially in sectors less affected by COVID-19 restrictions. Leading indicators in February also pointed to sustained recovery in domestic demand, with Purchasing Manager Index, consumer confidence and retail sales improving.

Price pressures remained low despite inflation reaching a 20-month high of 2.1 percent (yoy) in February. This reflects rising food prices due to restrained supply, higher commodity prices, and in line with the narrowing output gap. Higher tobacco duties and adjustment in non-subsidized LPG prices also raised administered prices. Nevertheless, the inflation rate remains within Bank of Indonesia's target range (2-4 percent).

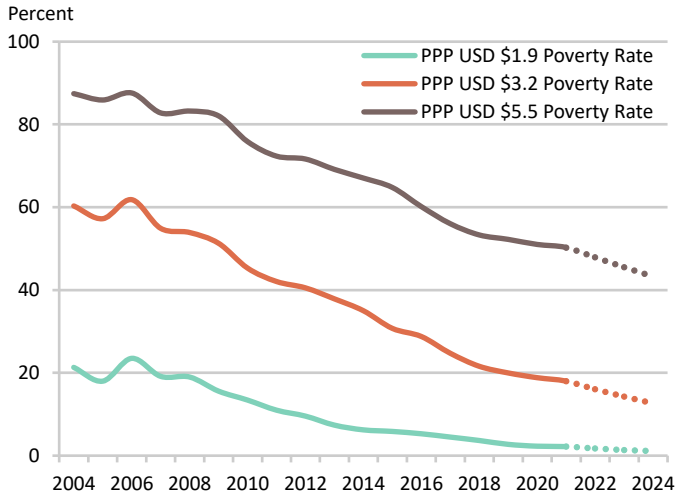
The external position remained sound despite tightening global monetary conditions. Indonesia ended the year with a small current account surplus of 0.3 percent of GDP, the first since 2011. This follows a solid performance by exports (up 46.1 percent) driven by commodities and manufactured goods. The position was supported by a stable Real Effective Exchange Rate (REER) and capital flows as well as improvement in the secondary income balance due to government grants for

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



Sources: National Statistics Agency and World Bank.

FIGURE 2 **Indonesia** / Poverty rate is declining albeit at a slower pace than pre-pandemic years



Sources: National Statistics Agency and World Bank. Note: Forecast is from 2021 onwards.

COVID-19 support. Foreign reserves are adequate covering 7.2 months of imports by end 2021.

Fiscal policy has been accommodative to offset the pandemic's fallout. The fiscal package has focused on health, social assistance, and firms support. This was made possible by commodity and oil price windfalls that boosted fiscal revenues to 11.8 percent. The fiscal deficit narrowed from 6.1 to 4.6 percent of GDP in 2020-2021. Monetary policy has also been accommodative thus far but may tighten going forward in line with tighter global financial conditions. The authorities announced a rise in the reserve requirements ratio starting in March 2022, although the policy rate has remained unchanged since February 2021. Private sector credit increased slightly in recent months but has remained weak throughout the pandemic.

Poverty continued to decline, getting closer to its pre-pandemic level. In September 2021, the poverty headcount rate, based on the national poverty line, fell to 9.7 percent after peaking at 10.2 percent in 2020. Progress was observed in both urban and rural areas, stemming from employment growth in manufacturing, wholesale & trade, as well as in the food and accommodation sectors.

Outlook

A recovery in private consumption and investment supported by structural reforms are expected to boost growth to 5.3 percent in the medium-term. Net exports will partially offset this as domestic demand boosts imports, while exports ease following moderation in external demand. As the output gap closes further, inflation is expected to increase over the medium term to 3.3 percent by 2024, slightly below the upper band target of the central bank. With improvements in domestic demand, the outlook projects a return to a current account deficit. However, external financing needs will remain moderate at 2.2 percent of GDP (average 2022-2024) aligned with an increase in FDI. As such, foreign reserves are expected to exceed 7.8 months of imports.

The fiscal stance is expected to tighten with the 2022 fiscal deficit projected at 3.7 percent of GDP. Consistent with its previous announcements, the government is committed to return to the legally mandated 3 percent of GDP deficit by 2023. The consolidation path will be anchored on scaling back the economic recovery program and on boosting domestic revenue mobilization. The recovery spending will ease from 4.0 percent of GDP in 2021 to 2.6 percent in 2022 in line with strengthening growth prospects. The recently approved Tax Harmonization Law will increase tax rates, broaden the tax base, facilitate tax compliance, and introduce a carbon tax.

Poverty is projected to continue falling as the recovery fuels private consumption. However, the pace of decline, based on lower-middle income countries poverty line of $3.2 per day in PPP terms, will be halved from -3.0 pp/year in pre-pandemic years 2014-2019 to -1.5 pp/year going forward (2019-2024). Whether this progress is achieved depends on the degree to which the recovery is inclusive of vulnerable groups. Meanwhile, strengthened efforts are needed to mitigate the pandemic's long-term scarring impacts on productivity and inequality through the human capital channel. Projections indicate large losses in lifetime earnings due to learning losses during widespread school closures in 2020-2021.

Downside risks to the outlook remain elevated. Risks are stemming from faster-than-expected global financial tightening and contagion effects from EMs that can render external financing more expensive, pandemic-related fiscal shocks that could derail pro-growth programs, further scarring with implications on productivity and competitiveness, and changing global demand and inflation related to the Russia-Ukraine war.

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

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices	5.0	-2.1	3.7	5.1	5.3	5.3
Private Consumption	5.2	-2.7	2.0	4.7	5.0	5.2
Government Consumption	3.3	2.0	4.2	1.4	1.5	4.4
Gross Fixed Capital Investment	4.5	-5.0	3.8	5.6	6.4	6.5
Exports, Goods and Services	-0.5	-8.1	24.0	14.7	10.3	8.3
Imports, Goods and Services	-7.1	-16.7	23.3	14.9	11.0	10.0
Real GDP growth, at constant factor prices	5.0	-1.6	3.3	5.2	5.3	5.3
Agriculture	3.6	1.8	1.8	3.8	3.9	3.9
Industry	3.8	-2.8	3.4	4.1	4.4	4.4
Services	6.4	-1.5	3.6	6.6	6.4	6.5
Inflation (Consumer Price Index)	2.8	2.0	1.6	2.7	3.1	3.3
Current Account Balance (% of GDP)	-2.7	-0.4	0.3	-0.9	-1.4	-1.9
Net Foreign Direct Investment (% of GDP)	1.8	1.3	1.4	1.6	1.8	1.9
Fiscal Balance (% of GDP)	-2.2	-6.1	-4.6	-3.7	-3.0	-3.0
Debt (% of GDP)	30.0	39.3	40.7	42.9	43.2	43.4
Primary Balance (% of GDP)	-0.5	-4.1	-2.6	-1.5	-0.6	-0.5
International poverty rate ($1.9 in 2011 PPP)[a,b]	2.7	2.3	2.2	1.7	1.4	1.1
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	19.9	18.8	18.0	16.0	14.2	12.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	52.2	51.0	50.3	47.9	45.5	43.2
GHG emissions growth (mtCO2e)	2.4	-0.8	1.4	1.9	1.9	1.8
Energy related GHG emissions (% of total)	34.5	34.0	34.7	35.7	36.7	37.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
a/ Calculations based on EAPPOV harmonization, using 2011-SUSENAS and 2021-SUSENAS.Actual data: 2021. Forecastss are from 2022 to 2024.
b/ Projection using annualized elasticity (2011-2021) with pass-through = 1 based on GDP per capita in constant LCU.