Note to Journalists

Economic Exposure 2017: Waiting for the New Balance of Global Economy

This note contains the views of Sampoerna University on Indonesia's economic and financial sector outlook for 2017, as brought forward by **Dr. Wahyoe Soedarmono** at The Indonesian Economic and Financial Sector Outlook (IEFSO) 2017 on Monday, December 5, 2016. Dr Soedarmono is an economist and Chairman of the Management Studies Program at Sampoerna University's Faculty of Business.

A. Global Influence on Indonesia Economy

- **Following the election of Donald Trump as president of the United States, over Rp16 trillion worth of foreign capital pull out of Indonesia within a week in mid-November 2016.** Rupiah also depreciated. However, the impact of capital flight in Indonesia was relatively minor compared to that in Thailand, India, Taiwan, and South Korea. The pressure on Indonesia can be moderated by increased state revenues from a tax amnesty program which managed to bring in ransom fees amounting to Rp 98.7 trillion, and Rp 143 trillion worth of repatriated funds as of November 2016. In general, Indonesia is prepared to face short-term market volatility at least until 2017.

- **With regard to the planned interest rate increase by the Fed (taper tantrums) in late 2016 and throughout 2017, Indonesia's current account is quite robust**, with current account deficit (CAD) only reaching 1.8% of GDP in the third quarter of 2016, compared to 4.4% at the end of 2013. Thus, the risk of capital flight due to negative sentiment of foreign investors over Indonesia's condition can be minimized.

- **Sampoerna University (SU) sees that the policy implemented in 2013-2014 to anticipate taper tantrum needs to be adjusted to reflect current conditions.** While a cut in government spending (expenditure reducing policy) helped narrow CAD at the time of taper tantrum, SU has found that the strategy is no longer effective, if CAD increases at the end of 2016 due to taper tantrum. A study by Sampoerna University found that the following two policy options can lower CAD:

  (1) **Benchmark rate raising by Bank Indonesia**
  (2) **Expenditure switching policy through a strategy that allows the depreciation of rupiah exchange rate to reduce the consumption of imported goods, and increase exports** when the price of commodities such as coal, as well as non-mining commodities, is trending up in the international market. State income rose after Coal Price Reference (HBA) surged by 23% in one month, until November 2016, to USD 84.89 per ton. Coal export contributes significantly to Indonesia's total export value.

- **Should the policy rate be raised, Bank Indonesia needs to relax its macro-prudential policy to drive up lending growth**, after credit growth in the third quarter of 2016 only came in at around 6% year-on-year (yoy), much lower than the 20% growth (yoy) reported during the period of May 2013-June 2014 at the time of the previous taper tantrum taper.

- **On the other hand, the current position of CAD which is relatively low (1.8% of GDP), provides the government with enough space for fiscal expansion through spending increase**, amid increased tax revenue from tax amnesty program. Thus, keeping growth memontum alive, in order to achieve the economic growth target of 7% by 2019.

B. Indonesia Macroeconomy

- **In general, the Indonesian macroeconomic condition is improving.** Apart from the CAD which is forecast at 2.1% of GDP at the end of 2016, Indonesia's economic growth is also predicted to hit around 5.1% in 2016, which is higher than IMF's global economic growth projection of 3%. Furthermore, inflation is showing signs of easing (both in terms of headline CPI or core CPI). This positive macroeconomic performance reflects the effectiveness of economic programs. A series of policy packages introduced by the government in 2016 to stimulate business, exports and the productivity of the real sector, combined with BI's monetary policy to stabilize exchange rate and inflation, have started to make an impact.

- **However, economic growth in Indonesia is still much dependent on domestic consumption that contributed around of 56% of total GDP.** The structure needs to be changed in the long run, by encouraging domestic investment which made up around 32% of GDP in 2016.

- **If the government is to achieve an economic growth of 7% in 2019, then the macroeconomic policy adopted in 2017 needs to combine the following three elements:**

  (1) Boosting productivity. If investment to GDP ratio currently stands at 32%, and economic growth is around 5%, then investment needs to be pushed higher to 44% of GDP until 2019 if the economy is to expand by 7%. On the other hand, the ratio of national savings to GDP is only 33%, which is far from enough to jack up investment to 44% in oder for GDP to grow by 7%. High productivity will enable investment to be funded the limited amount of savings in order to lift the economy by 7%. In the end, the economic growth driven by increased investment will not result in rising current account deficit which may cause macroeconomic instability.

  (2) Increasing the proportion of national savings to GDP to 44% until 2019 from currently at around 33%. In this way, the investment requirement (44% of GDP) in order to achieve economic growth of 7% could be fully financed by national savings.

There are at least two ways by which the strategy can be executed. **First, a tax amnesty program that is well programmed**. **Secondly, financial inclusion programs to expand financial access to Indonesian people**, particularly to increase formal savings at banks and in other financial institutions, as well as other forms of savings in the financial system. **Improved financial inclusion is an important agenda at least over the next one decade, so that Indonesia can avoid the middle-income trap.**

(3) **In addition to increasing investment, the space for expansion through increased fiscal spending by the government remains available, thanks to the relatively low CAD**. However, the government needs to be selective in choosing strategic sectors to create sustainable economic growth. The sectors that need to be prioritized in government spending among include education, health, and infrastructure. In addition, efforts to improve business climate, both through deregulation and the strengthening of bureaucracy and governance aspects, are still needed.

C. ASEAN Economic Community (AEC)

In general, ASEAN needs to strengthen trade ties among its members, as well as with Japan, Korea, and China. Harmonization of trade regulations, including the standardization of the quality of Indonesian products, needs to be improved in order to gain acceptance in ASEAN. In addition to trade cooperation, the Indonesian government needs to take a strategic role/fiscal expansion to boost the competitiveness of its human resources. However, the strategies to capitalize on MEA are somewhat long-term in nature, and the impact of MEA itself on Indonesian economic development is likely to remain limited at least until to 2017.

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