MONETARY POLICY REPORT
Economy, Monetary, and Finance
QUARTER IV 2018
Bank Indonesia has a single overarching mandate, namely to achieve and maintain rupiah stability. Nevertheless, rupiah stability encompasses two aspects, namely price stability of goods and services, as reflected in stable inflation, as well as rupiah exchange rate stability to currencies in other countries. The Government has set the inflation target for 2018 at 3.5±1%. To that end, Bank Indonesia implements sustainable, consistent and transparent monetary policy that also pays due regard to the prevailing economic policies of the Government. In pursuance of its mandate, Bank Indonesia institutes an optimal mix of monetary, macroprudential, payment system and rupiah currency management policies.

Bank Indonesia regularly publishes the Monetary Policy Report each quarter after the Board of Governors Meeting has been convened in February, May, August and November. The Report has two primary functions, namely: (i) to provide economic data, analysis and projections to help form and anchor rational expectations as part of the anticipative monetary policymaking framework; and (ii) as a medium for the Board of Governors to publicly explain and clarify the various considerations underlying monetary policy decision-making at Bank Indonesia.
# Table of contents

1. Executive Summary 03

2. Global Economic Developments 06
   - Global Economy 06
   - Global Financial Markets 10
     - Global Policy Response 11
   - Global Commodity Markets 12
   - Box: Balance Sheet Reductions by the US Federal Reserve 13

3. Domestic Economy and Financial Market Developments 15
   - Economic Growth 15
   - Welfare 23
   - Balance of Payment 26
   - Rupiah Exchange Rate 30
   - Inflation 32
   - Financial Market 36

4. Economic Outlook and Risks 44
   - Global Economic Outlook 44
   - World Trade Volume and International Commodity Price Outlook 47
   - Domestic Economic Outlook and Risks 48
Executive Summary

The BI Board of Governors agreed on 20th and 21st February 2019 to hold the BI 7-Day (Reverse) Repo Rate at 6.00%, while also maintaining the Deposit Facility (DF) and Lending Facility (LF) rates at 5.25% and 6.75%, respectively. The decision is consistent with efforts to strengthen external stability, especially to control the current account deficit within a manageable threshold and maintain the attractiveness of domestic financial assets. Furthermore, Bank Indonesia also institutes a monetary operations strategy to increase liquidity, to boost financing in the banking sector. Moving forward, Bank Indonesia will undergo accommodative macroprudential policy and strengthen payment system policy to expand economic financing. Coordination with the Government and other relevant authorities are increased in order to maintain economic stability, to maintain economic growth momentum.

The global economy continues to slow down, with less uncertainty in the global financial market. US economic growth slowed down, due to limited fiscal stimuli, structural labour market issues, and reduced market confidence. Europe’s economic growth slowed down, amongst others due to the ongoing economic and financial structural issues, sluggish exports and uncertainty plaguing the Brexit. In China, economic growth is hampered in line with downcast exports due to the trade tension with the US and lower domestic demand due to the ongoing deleveraging process. Congruent with the uncertain global economic outlook, international commodity prices are sliding, including the global oil price and monetary policy normalisation in advanced economies that has relatively moderated, with less uncertainty in the global financial market. Accordingly, the US Federal Reserve is now expected to ease the pace of gradual Federal Funds Rate (FFR) hikes and pare back planned balance sheet reductions. The recent updates in the global economy and finances has generated challenges to export, yet also increased foreign capital flows to developing economies, including Indonesia.

National economic growth momentum has been maintained on the back of domestic demand. Solid economic growth in Indonesia reached 5.18% (yoy) in fourth quarter of 2018, up from 5.17% (yoy) in the previous period. The economy continues to expand on resilient domestic demand in line with increasing household consumption and consumption by non-profit institutions serving households (NPISH). Investors remain upbeat on the domestic economic outlook, which has fed through to strong investment performance. Meanwhile, net exports are negative, weighed down by global economic softness and falling commodity prices. Regionally, economic growth has accelerated in Java and Kalimantan in line with vibrant agricultural, services and mining activities. Consequently, economic growth in Indonesia accelerated from 5.07% (yoy) in 2017 to 5.17% (yoy) in 2018, representing the fastest rate recorded in the past five years. Moving forward, Bank Indonesia projects solid economic growth for 2019 in the 5.0-5.4% range, bolstered by household and NPISH consumption as well as strong investment.
Indonesia’s balance of payments (BOP) is improving, thus supporting external sector resilience. In the final quarter of 2018, the BOP amassed a USD5.4 billion surplus on a significant gain in the capital and financial account in line with non-resident investors’ favourable perception of the national economic outlook and dissipating global uncertainty. Meanwhile, the current account deficit stood at USD9.1 billion in the fourth quarter of 2018, equivalent to 3.57% of GDP. For the year, however, the current account deficit has remained within a manageable threshold at 2.98% of GDP. In January 2019, Indonesia’s trade balance experienced a USD1.16 billion deficit as a corollary of dwindling global demand against a backdrop of persistently strong domestic demand. Foreign capital inflows were maintained in January 2019, recorded at USD2.2 billion, which continued into February 2019. Consequently, the position of reserve assets was solid at USD120.1 billion at the end of January 2019, equivalent to 6.7 months of imports or 6.5 months of imports and servicing government external debt, which is well above the international standard of three months. Bank Indonesia expects the balance of payments to regain momentum looking ahead, backed by a manageable current account deficit and maintained foreign capital inflows, which will continue to reinforce external sector resilience. Furthermore, Bank Indonesia will continue to enhance coordination with the Government in order to strengthen external sector resilience by reducing the current account deficit to around 2.5% of GDP in 2019, amongst others.

The Rupiah appreciated, thus supporting economic stability. Point to point, the Rupiah gained 3.63% (ptp) in the fourth quarter of 2018 compared with conditions at the end of the previous period, boosted by a positive balance of payments. The strong Rupiah persisted into January 2019, appreciating another 2.92%, with the trend continuing into February 2019 on the back of non-resident capital inflows to domestic financial markets, drawn by solid economic fundamentals as well as attractive on domestic financial assets and less global economic uncertainty. Bank Indonesia believes that the Rupiah will remain stable, in line with market mechanisms.

Inflation is low and stable within the target corridor for 2019 at 3.5±1%. CPI inflation in January 2019 was recorded at 0.32% (mtm) or 2.82% (yoy), down from 0.62% (mtm) or 3.13% (yoy) the month earlier. Midler price pressures on volatile foods (VF) and deflation of administered prices (AP) have contributed to lower headline inflation. VF inflation declined beyond its historical average on corrections to food prices, while administered prices were dragged down by lower non-subsidised fuel prices and cheaper train fares. Core inflation was kept under control despite a moderate uptick in line with seasonal trends, edged up by house rental prices and higher wages. Looking ahead, Bank Indonesia will consistently maintain price stability and strengthen policy coordination with the Central and Regional Government to maintain low and stable inflation, which is projected within the inflation target of 3.5±1% in 2019.

Financial system stability has been maintained as the bank intermediation function improves and the banking industry effectively contains credit risk. The Capital Adequacy Ratio (CAR) of the banking industry remained high at 22.9% and the Liquidity Ratio at 19.3% in December 2018. In addition, the banking sector maintained a low level of Non-Performing Loans (NPL), namely at 2.4% (gross) or 1.0% (net). In terms of the intermediation function, the banking industry reported faster credit growth from 8.2% (yoy) in 2017 to 11.75% (yoy) in 2018, while deposit growth decreased from 9.4% (yoy) in 2017 to 6.5% (yoy) in 2018. On the other hand, economic financing through the financial markets, such as initial public offerings
(IPO) and rights issues, corporate bonds, medium-term notes (MTN) and negotiable certificates of deposit (NCD), totalled Rp207.8 trillion (gross) in 2018, down from Rp299.4 trillion (gross) in 2017. Bank Indonesia projects credit growth in 2019 at 10-12% (yoy), while predicting deposit growth in the 8-10% (yoy) range. Moving forward, Bank Indonesia will undergo accommodative macroprudential policy to boost economic financing to maintain financial system stability, while in coordination with the relevant authorities.

The payment systems, both cash and noncash are uninterrupted. In terms of cash payments, the position of currency in circulation increased 7.8% (yoy) in the fourth quarter of 2018 compared with 10.7% (yoy) in the previous period. Large value noncash payments, settled through the Bank Indonesia – real time gross settlement (BI-RTGS), and small value payments, settled through the national clearing system (SKNBI), runs smoothly. Meanwhile, retail transactions through ATM/debit cards, credit cards and e-money accelerated from 12.1% (yoy) to 13.8% (yoy) in the final quarter of 2018. E-money transactions maintained solid growth at 218.9% (yoy) in the reporting period, albeit moderating from 300.4% (yoy) previously. Online transactions via digital banking achieved a faster pace of growth, however, climbing from 41.1% (yoy) to 44.4% (yoy). The impressive performance of e-money and digital banking is associated with growing consumer propensity towards Fintech platforms and e-commerce as well as uptake of e-money in the transportation sector. Bank Indonesia will continue to strengthen financial systems policy in order to broaden economic financing while continue to prioritise consumer protection and maintain macroeconomic stability.
Global Economic Developments

GLOBAL ECONOMY

The global economy continues to moderate, yet with reduced uncertainty in the global financial markets (Graph 2.1). US economic growth has slowed due to limited fiscal stimuli, structural labour market issues and retreating market confidence. Economic growth has also decelerated in Europe, amongst others as a result of the ongoing economic and financial structural issues, sluggish exports and uncertainty plaguing the Brexit. In China, economic growth has been hampered by downcast exports due to trade tensions with the US and lower domestic demand stemming from the ongoing deleveraging process. Congruent with the uncertain global economic outlook, international commodity prices are sliding, including the global oil price, while monetary policy normalisation in advanced economies has eased relatively with less uncertainty in the global financial markets. Accordingly, the US Federal Reserve is now expected to reduce the pace of gradual Fed Funds Rate (FFR) hikes and pare back planned balance sheet reductions. Recent developments in the global economy and finance have created challenges for exports yet also increased foreign capital flows to developing economies, including Indonesia.

The economy of the United States is projected to slow compared with previous expectations. The US economy is forecasted to expand 3.0% (yoy) in the fourth quarter of 2018, down slightly from 3.1% (yoy) in the previous period and relatively stable compared with conditions in the same period one year earlier. Based on projected growth in the fourth quarter of the year, the US economy is expected to moderate in 2018 compared with the economic achievements of 2017, primarily...
due to weaker consumption and investment activities. On the other hand, labour market conditions have continued to improve in 2018. Fourth-quarter unemployment stood at 3.8%, stable on the previous period but falling consistently throughout 2018. For the year, the unemployment rate averaged 3.9% in 2018, far below the Non-Accelerating Inflation Rate of Unemployment (NAIRU) of 4.6%.

Milder inflationary pressures were reported towards the end of 2018 in the United States. Price pressures eased as consumption slowed. Consequently, CPI inflation was recorded at 1.9% (yoy) in the fourth quarter of 2018, down from 2.3% (yoy) in the previous period. Meanwhile, core inflation remained stable at 2.2% (yoy) in the fourth quarter of 2018 (Graph 2.3). Weaker price pressures on energy, medical care and recreation contributed to lower headline inflation. Moving forward, inflation expectations are predicted to ease and remain within the target range as the economy is closing the gap despite limited wage growth due to a comparatively low participation rate and stagnant productivity gains.

Economic growth is decelerating in Europe as a result of declining export performance, slower consumption and investment growth as well as ongoing fiscal consolidation. The euro area expanded 1.2% (yoy) in the fourth quarter of 2018, with growth slowing from 1.6% (yoy) in the previous period (Graph 2.4). The downturn was caused by slower growth of net exports, consumption and investment. Export performance declined in line with global economic moderation and inward-looking trade policies instituted by several countries. Consumption and investment were restrained by political uncertainty in the region, escalating trade tensions and production factor constraints (labour and equipment shortages). The labour shortages persist despite unemployment falling to 8.1%, which is below the NAIRU of 8.4%.
Inflationary pressures in Europe remain mild, accompanied by lower inflation expectations. CPI inflation was recorded at 1.6% (yoy) in the fourth quarter of 2018, down from 2.1% (yoy) in the previous period and below the ECB’s 2.0% target (Graph 2.5). Core inflation was also relatively low in the fourth quarter of 2018, namely 1.1% (yoy), which is in line with economic moderation and falling oil prices.

Japan’s economy has continued to moderate beyond previous expectations. Stagnant economic growth was recorded at 0.0% in the fourth quarter of 2018, which is below the previous expectation of 0.8% (yoy) and the 0.1% (yoy) posted in the previous period. Declining net exports and consumption have contributed to economic moderation in Japan. Externally, the net export position is predicted to deteriorate in line with restrained demand in Japan’s trading partners along with simmering US-China trade tensions. Furthermore, consumption remains subdued, as indicated by declining retail sales, department and convenience store sales as well as machinery and equipment sales.

Headline inflation continues to decline in Japan, held back by economic moderation and corrections to energy prices. CPI inflation was recorded at 0.3% (yoy) in the fourth quarter of 2018, down from 0.5% (yoy) in the previous period. Core inflation has also tracked a downward trend (Graph 2.7). Consequently, inflation realisation in Japan is well below the 2% target published by the Bank of Japan (BOJ). Lower inflation is attributable to caution as households and the corporate sector wait and see what transpires in terms of rising prices and salaries, together with increasing competition emerging in the corporate sector.
China’s economy continues to moderate as a consequence of financial deleveraging and weaker external demand, which has been exacerbated by trade tensions with the United States. Economic growth in China decelerated to 6.4% (yoy) in the fourth quarter of 2018, representing the lowest rate on record since 2009 (Graph 2.8). Economic moderation was induced by consumption and net exports. Declining automotive and retail sales were indicative of slower consumption, primarily triggered by financial deleveraging. Net exports experienced a deep correction due to strained trade relations with the United States as well as the global economic downturn. Chinese exports bound for the United States contracted 4.4% (yoy) in December 2018. Furthermore, imports also contracted on weak domestic demand and sliding energy prices.

Inflation in China decreased in line with food and non-food inflation. In the fourth quarter of 2018, CPI inflation in China was recorded at 1.9% (yoy), down from 2.5% (yoy) in the previous period (Graph 2.9). Lower food prices were the main drag on headline inflation. Congruently, non-food inflation was also observed to decline in line with milder price pressures on transportation, housing, recreation and medical care. On the other hand, relatively stable core inflation was maintained.

Economic growth in India is projected to decelerate in the fourth quarter of 2018, accompanied by higher unemployment. India’s economy is expected to expand at 7.0% (yoy) in the final quarter of 2018, down slightly from 7.1% (yoy) in the previous period (Graph 2.10). Less investment is the main contributor to economic moderation in India, as confirmed by a dip in the Manufacturing Purchasing Managers Index (PMI) during the reporting period. Correspondingly, the unemployment rate is ticking upwards as wage growth remains restrained.
CPI inflation in India has declined yet remains within the target corridor, namely $4.0 \pm 2\%$. CPI inflation in India was recorded in the fourth quarter of 2018 at 2.2\% (yoy), down significantly from 3.8\% (yoy) in the previous period (Graph 2.11). The main contributors to lower headline inflation were energy and food prices, which experienced deflation in December 2018.

GLOBAL FINANCIAL MARKETS

Global financial uncertainty has subsided in line with the slight thawing of trade tensions between the United States and China. The EPU of the United States’ trade policy declined in the fourth quarter of 2018, indicating an easing of US-China trade tensions (Graph 2.12). Uncertainty in the US was shown to decrease by a correction in the financial condition index after spiking significantly in the fourth quarter of 2018. Moreover, a lower VIX at the beginning of 2019 also pointed to a reduced financial market uncertainty (Graph 2.13). Less rigidity in the US financial markets triggered capital inflows to developing economies (Graph 2.14). Nonetheless, financial market uncertainty due to sentiment stemming from US-China trade tensions and the dynamic political climate in the United States continues to demand vigilance.

GLOBAL POLICY RESPONSE

Advanced economies are becoming more reluctant to normalise monetary policy. The Fed is expected to pursue a more measured approach to further Federal Funds Rate (FFR) hikes (Graph 2.15) and balance sheet reductions (refer to Box: Balance Sheet Reductions by the US Federal Reserve). The Fed is only expected to raise the FFR once in 2019 and then hold the policy rate in 2020. Meanwhile, balance sheet reductions should be completed by the end of 2019. In Europe, the European Central
Bank (ECB) is not expected to raise the ECB Rate until the beginning of 2020 and has again extended its Targeted Longer-Term Refinancing Operations (TLTROs). Similar to conditions in Europe, the Bank of Japan (BoJ) has decided to hold its monetary policy stance. The BoJ is expected to maintain a low policy rate for an extended period of time, while expanding liquidity by purchasing Japanese Government Bonds through stealth baby steps. Meanwhile, the People’s Bank of China (PBoC) is predicted to sustain expansive monetary policy in order to ensure adequate liquidity.

GLOBAL COMMODITY MARKETS

World trade and international commodity prices continue to decline on the back of global economic moderation together with US tariffs imposed on Chinese imports. The projection for world trade volume growth has been downgraded (Graph 2.16). As of November 2018, the realisation data for world trade volume points to an ongoing slowdown in the fourth quarter of 2018. Export and import growth were expected to slump in the reporting period, primarily in non-US advanced economies as a result of inward-looking trade policies in the form of import tariffs imposed by the United States as well as uncertainty regarding a potential no-deal Brexit that has eroded domestic demand and imports (Brexit sentiment). In contrast, trade volume in developing economies has actually picked up, driven by China’s import frontloading policy prior to the full imposition of import tariffs by the United States. Imports in developing economies have also increased in line with India’s recent economic gains. Nevertheless, further increases have been offset by weaker import growth in China.
International commodity prices are falling, including oil. Oil prices retreated further in the fourth quarter of 2018 (Graph 2.17), suppressed by less optimism in the global economy and increasing production in Saudi Arabia, Russia and the United States. The recent ramping up of production has compelled members of the Organisation of the Petroleum Exporting Countries (OPEC) to agree oil production cuts. In addition, the partial lifting of US sanctions against Iran also precipitated a lower oil price in the fourth quarter of 2018.

The prices of Indonesia’s main export commodities are trending down, held back by coal, CPO and metal prices (Table 2.1). In the fourth quarter of 2018, coal prices fell on high coal production and inventory in China as well as an increase of coal exports from the United States. CPO prices also declined in line with increasing production and inventory amidst weaker demand. Base metals such as copper, nickel and aluminium experienced price corrections triggered by global economic moderation. In contrast, tin prices increased on higher demand for fine tuning in China.
The economic outlook for the United States and a recent statement relayed by the US Federal Reserve have indicated a potential change in the framework of balance sheet reductions. The US economy in 2019 and 2020 is projected to moderate in line with weaker economic performance and deteriorating financial markets. In accordance with the US economic slowdown, milder inflationary pressures are also expected in 2019-2020. In response, the Federal Reserve has indicated through policy communication that more measured monetary policy normalisation will be pursued. Detailed in the FOMC press release in January 2019, the Fed stated that it will be patient regarding the next FFR hike. Similarly, at a FOMC press conference in January 2019, Jeremy Powell indicated that the Fed is prepared to change the framework of balance sheet reductions based on the latest economic and financial market developments.

A lower realisation of balance sheet reductions below the planned monthly caps officially announced by the Fed also suggests the need to review the framework of balance sheet reductions. Since October 2017, the Fed has been implementing balance sheet reductions, with the program initially predicted to last 3-4 years. At the end of 2018, however, holdings of US Treasury (UST) securities and mortgage-backed securities (MBS) decreased USD374 billion or 9.2% from the level recorded during the balance sheet reduction program. Consequently, only 83% of the monthly caps for UST and MBS totalling USD450 billion were realised during the period from Q1/2017 – Q4/2018 (Table 1). Moving forward, the lower realisation of balance sheet reductions below the monthly caps is expected to persist. The New York Fed (July 2018) has estimated smaller balance sheet reductions than the official monthly caps announced by the Fed at 72% of the maximum.

The results of a recent assessment showed that balance sheet reductions are expected to culminate more quickly and with smaller reductions. The balance sheet reductions are predicted to end in the fourth quarter of 2019 in line with the higher balance sheet target. Using a liability approach, the balance sheet reductions are expected to reach the corresponding target at the end of 2019 before increasing in the subsequent year, as required economically (Graph 1 and Graph 2). An assessment has been conducted on the liability side through: (i) a higher natural requirement in line with increasing economic momentum; and (ii) excess reserves or buffer (Table 2). The natural requirement consists of currency in circulation, which is predicted to expand in line with forward-looking economic growth expectations, as well as Required Reserves and other liabilities (US Government Account, Foreign Account and Reverse Repo Purchases), which are expected to grow in line with historical trends. Notwithstanding, the Fed is expected to maintain excess reserves/buffer of USD1 trillion above the natural requirement level of liabilities.

### Table 1 Plans and Realization of Reduction Balance Sheet

<table>
<thead>
<tr>
<th>Balance Sheet Reduction October 2017 - December 2018</th>
<th>UST</th>
<th>MBS</th>
<th>Total (Billion USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum Plan for Reduction Balance Sheet (The Fed monthly caps)</td>
<td>270</td>
<td>180</td>
<td>450</td>
</tr>
<tr>
<td>Reduction Balance Sheet Realization</td>
<td>243</td>
<td>131</td>
<td>374</td>
</tr>
</tbody>
</table>

Source: the Fed and FRED
The smaller balance sheet is in line with less tightening by the Fed than previously predicted. The balance sheet target on the liability side will be achieved through smaller asset reductions. Consistent with signals from the Fed of more measured monetary policy normalisation and a lower realisation of balance sheet reductions than planned, the Fed is expected to release UST and MBS holdings more gradually. Simulations that take into account a smaller total of maturing UST and MBS and larger amount reinvested than the monthly caps have shown that the balance sheet reductions are predicted to finish at the end of 2019.

Global liquidity is predicted to increase in line with the expected completion of balance sheet reductions earlier than previously anticipated. The additional liquidity originating from faster balance sheet reductions should ease the tightening of global liquidity, as reflected by improvements in the Financial Condition Index. Only moderate increases in US yields are expected, accompanied by more restrained US stock index declines. In addition, outflow from developing economies is predicted to be lower than previously thought.

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1 In line with the Fed’s requirements to maintain an interest rate corridor, expected placements of High-Quality Liquid Assets (HQLA) in Excess Reserves, and backed by a survey conducted by the New York Fed (December 2018) and the research by Bernanke (2017).
ECONOMIC GROWTH

Despite in auspicious global economic dynamics, the domestic economy has performed well with stability maintained as growth momentum endures on the back of domestic demand. Solid economic growth was achieved in the fourth quarter of 2018 at 5.18% (yoy), increasing from 5.17% (yoy) in the previous period (Table 3.1 and Graph 3.1). The domestic economic gains come amidst strong domestic demand in line with increasing consumption amongst households and non-profit institutions serving households (NPISH). Robust investment was also maintained in line with upbeat investor optimism in the national economic outlook. Meanwhile, the global economic downturn prompted lower world trade volume and international commodity prices, which in turn undermined net exports. Spatially, most regions contributed to faster economic growth nationally, led by Java and Sumatra, boosted by agricultural, services and mining gains. Consequently, economic growth in 2018 accelerated to 5.17% (yoy) compared with the 5.07% (yoy) realised in 2017, which represents the fastest growth rate recorded in the past five years. Moving forward, the
national economic outlook for 2019 in solid in the 5.0-5.4% range, supported by domestic demand, primarily in the form of increasing household and NPISH consumption as well as persistently strong investment growth.

**Increasing household consumption has induced domestic demand.** Household consumption grew 5.08% (yoy) in the fourth quarter of 2018, up from 5.00% (yoy) in the previous period (Graph 3.2). Household consumption has increased on rising wages and improving household confidence together with maintained public purchasing power in line with low and stable inflation. Household income has increased, especially amongst low-middle income families, as indicated by gains in real farmworker wages (Graph 3.3). Such developments were also confirmed by increments in the Consumer Confidence Index (CCI) for low-middle income households, influenced by improving incomes and more job openings along with social assistance disbursements (bansos) that are closer to the target allocation. Furthermore, consumer confidence amongst middle-upper households is also increasing as a result of higher salaries and a stronger rupiah (Graph 3.4). Faster household consumption growth was also in line with seasonal factors towards yearned when the holiday season tends to elevate consumption and retail sales. Positive yearend developments supported stronger household consumption growth in 2018 overall, increasing therefore to 5.05% from 4.94% in the previous year.

**Consumption by non-profit institutions serving households (NPISH) bolstered domestic demand.** Increased spending on preparations for the legislative and presidential elections boosted NPISH consumption in the fourth quarter of 2018, accelerating to 10.79% (yoy) from 8.59% (yoy) in the previous period. In addition, NPISH consumption also benefitted from increasing activity at non-governmental organisations and other social organisations relating to the disbursement of assistance
payments and monitoring of reconstruction and rehabilitation efforts in various regions stricken by natural disasters in 2018. Preparations for the legislative and presidential elections as well as post-disaster recovery efforts have increased NPISH consumption growth to 9.08% in 2018, up from 6.93% in 2017.

**Government spending has continued to stimulate economic growth despite declining in the fourth quarter of 2018.** Government consumption in the final quarter of 2018 recorded 4.56% (yoy) growth, down from 6.27% (yoy) in the previous period. The downturn was in line with slower growth of personnel expenditure, procurement and government services, contrasting high growth of social assistance spending (Graph 3.5). Annually, government expenditure expanded 4.80% in 2018, more than doubling the 2.13% posted in 2017. The increase primarily stemmed from personnel expenditure, procurement and social assistance disbursements (bansos). The Government accelerated its social assistance program through efforts to expand the number of beneficiaries and disburse the payments per the targets set. Expansive personnel expenditure was driven by the realisation of 13th-month salaries in the middle of 2018, which were not only disbursed to active civil servants but also to eligible retirees. Meanwhile, the increases recorded in terms of procurement and services were induced by government spending to host the Asian Games as well as IMF-World Bank Annual Meetings.

**Solid investment growth was maintained by building and non-building investment (Graph 3.6).** Investment expanded in the fourth quarter of 2018 by 6.01% (yoy) despite decelerating from 6.96% (yoy) in the previous period. Investment growth was buoyed by building investment, which posted 5.02% (yoy) growth in the reporting period, down from 5.66% (yoy) in the third quarter of 2018 as a number of government infrastructure projects entered the completion stage or were...
Cement sales were postponed in an effort to reduce imports and, therefore, the current account deficit. Such dynamics were confirmed by declining cement sales towards the end of the year (Graph 3.7).

**Non-building investment continued to perform well in line with the improving domestic economic outlook.** Non-building investment growth remained high at 8.96% (yoy) in the fourth quarter of 2018 despite moderating from 10.73% (yoy) in the previous period. Non-building investment growth stemmed primarily from machinery and mechanical appliances to strengthen the manufacturing industry in the face of a promising domestic economic outlook. Nevertheless, investment in machinery and mechanical appliances was restrained, as indicated by declining imports of capital goods (Graph 3.8). In addition, global economic dynamics that have triggered lower international commodity prices also influenced mining and agricultural activities, which in turn undermined investment in transportation equipment and heavy equipment (Graph 3.9).

**Annually, investment posted stronger growth in 2018 and supported domestic economic performance.** For the year, investment grew 6.67% in 2018, up from 6.15% in 2017. The gains were backed by non-building investment to meet solid domestic demand throughout 2018. Meanwhile, building investment moderated due to the completion or postponement of several government infrastructure projects in the first half of 2018.

**Concerning the external sector, net exports have remained negative due to a deeper decline of exports than imports.** Exports in the fourth quarter of 2018 recorded 4.33% (yoy) growth, down from 8.08% (yoy) in the previous period (Graph 3.10). Exports were held back by lower commodity prices and world trade volume as a consequence of the global economic downturn (Graph 3.11). On the non-oil and gas side, mining exports declined on the
back of copper ore and concentrate because of lower demand from Indonesia’s main trading partners, including the Philippines, Japan, India and China. Agricultural exports have also been affected, especially rubber and pulp, due to weaker demand from China. In terms of oil and gas commodities, exports of refined products and crude oil decreased as a result of lower export volume and oil prices. In contrast, services exports increased during the reporting period in line with government policy to promote the tourism sector.

Imports also decelerated in line with a policy mix implemented to reduce the current account deficit. Slower import growth, which began in the third quarter of 2018, persisted in the three months to December 2018. Import growth stood at 7.10% (yoy) in the fourth quarter of 2018, halving from 14.02% (yoy) in the previous period due to declining non-oil and gas imports in the form of consumer and capital goods (Graph 3.12 and Graph 3.13). As part of its efforts to deter imports, the Government postponed a number of infrastructure projects that required capital goods with a high import content, including electrification projects. The impact of such policy manifested in declining capital goods imports, particularly of machinery and equipment. In addition, implementation of the B-20 program has increased utilisation of crude palm oil (CPO) in the form of fatty acid methyl ester (FAME) for the production of biodiesel, which has reduced diesel imports. With import growth outpacing that of exports, net exports have remained negative in 2018.

By sector, the primary and tertiary sectors were the main drivers of economic growth in the fourth quarter of 2018 (Graph 3.14). Primary sector performance improved, led by expansion of the Agricultural, Livestock, Forestry and Fishing sector. Furthermore, the tertiary sector also posted solid gains, accompanied by a larger contribution to growth, primarily the Financial Services sector as well as the
Electricity, Gas and Water Supply sector. In contrast, the secondary sector moderated slightly as the Manufacturing Industry pared back activity (Table 3.2).

In the primary sector, Agriculture, Livestock, Forestry and Fishing recorded a faster pace of growth due primarily to increasing production to meet strong domestic demand. Agriculture, Livestock, Forestry and Fishing posted 3.87% (yoy) in the fourth quarter of 2018, up from 3.66% (yoy) in the previous period. The gains come amidst increasing CPO production in line with positive export growth in the face of lower international commodity prices. Higher CPO production was also induced by increasing domestic absorption triggered by the Government’s B-20 biodiesel program. Agricultural performance was also elevated by the onset of harvesting seasons in several food production hubs. The Fishing subsector achieved positive growth in line with improving production and exports compared with conditions in the previous period. Conversely, Mining and Quarrying continued to experience slower growth due to lower mining commodity prices on the international market coupled with a production contraction in terms of mined metal ore.

Table 3.2 Economic Growth by Sector

<table>
<thead>
<tr>
<th>Components</th>
<th>2016</th>
<th>2017</th>
<th>2017</th>
<th>2018</th>
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<td></td>
<td>I</td>
<td>II</td>
<td>III</td>
<td>IV</td>
<td>I</td>
</tr>
<tr>
<td>Agriculture, Livestock, Forestry and Fisheries</td>
<td>3.37</td>
<td>7.11</td>
<td>3.32</td>
<td>2.83</td>
<td>2.39</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>0.95</td>
<td>-1.30</td>
<td>2.11</td>
<td>1.83</td>
<td>0.04</td>
</tr>
<tr>
<td>Manufacturing Industry</td>
<td>4.26</td>
<td>4.28</td>
<td>3.50</td>
<td>4.88</td>
<td>4.51</td>
</tr>
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<td>Utilities (Electricity, Gas and Water Supply)</td>
<td>5.26</td>
<td>1.80</td>
<td>-2.09</td>
<td>4.88</td>
<td>2.50</td>
</tr>
<tr>
<td>Construction</td>
<td>5.22</td>
<td>5.96</td>
<td>6.95</td>
<td>6.98</td>
<td>7.24</td>
</tr>
<tr>
<td>Trade, Hotel, and Restaurant**</td>
<td>4.23</td>
<td>4.75</td>
<td>3.86</td>
<td>5.27</td>
<td>4.64</td>
</tr>
<tr>
<td>Transportation, Warehousing, Information and Communication***</td>
<td>8.23</td>
<td>9.39</td>
<td>10.05</td>
<td>8.85</td>
<td>8.24</td>
</tr>
<tr>
<td>Financial Services, Real Estate and Corporate Services****</td>
<td>7.14</td>
<td>5.36</td>
<td>5.62</td>
<td>5.90</td>
<td>4.84</td>
</tr>
<tr>
<td>Other Services*****</td>
<td>4.48</td>
<td>3.72</td>
<td>2.59</td>
<td>4.08</td>
<td>6.88</td>
</tr>
<tr>
<td>GDP</td>
<td>5.03</td>
<td>5.01</td>
<td>5.01</td>
<td>5.06</td>
<td>5.19</td>
</tr>
</tbody>
</table>

---

1 The primary sector includes: (i) Agriculture, Livestock, Forestry and Fishing; and (ii) Mining and Quarrying.
Secondary sector performance moderated in line with restrained Manufacturing Industry growth. The Manufacturing Industry recorded 4.25% (yoy) growth in the fourth quarter of 2018, down from 4.35% (yoy) in the previous period. The downswing was caused by weaker external demand and rising production input prices from imports. The food and beverage sub sector grew 2.74% (yoy) in the fourth quarter of 2018, down significantly from 8.10% (yoy) in the previous period. In addition, the transportation equipment industry also experienced slower growth after the government postponed several infrastructure projects and mining activities decreased. Notwithstanding, further Manufacturing Industry declines were offset by faster growth of the automotive industry and textiles industry to meet persistently strong domestic demand.

The contribution of the tertiary sector to economic growth continues to increase. The gains posted in the fourth quarter of 2018 were led by Financial Services, Real Estate and Corporate Services as well as Electricity, Gas and Water Supply, which accelerated respectively to 6.13% (yoy) and 5.64% (yoy) from 4.47% (yoy) and 5.62% (yoy) in the previous period. Meanwhile, Construction maintained solid growth of 5.58% (yoy) in the reporting period despite slipping from 5.58% (yoy) in the third quarter of 2018. Slower Construction sector growth was caused by the Government postponing several infrastructure projects. The Transportation, Storage, Information and Communications sector also recorded solid growth of 6.35% (yoy) in the fourth quarter of 2018, albeit down from 7.01% (yoy) in the previous period due to less activity in the transportation and storage subsector, amongst others.

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2 The secondary sector is the manufacturing industry.
3 The tertiary sector includes: (i) Trade, Accommodation and F Service Activities; (ii) Transportation, Storage, Information and Communications; (iii) Financial Services, Real Estate and Corporate Services; (iv) Other Services; (v) Electricity, Gas and Water Supply; and (vi) Construction.
Spatially, national economic momentum was supported by faster growth in most regions, particularly Java and Kalimantan (Figure 3.1). In the fourth quarter of 2018, the main engines of economic growth in Java were Agriculture, Livestock, Forestry and Fishing, which accelerated with the onset of the harvesting seasons for rice and horticultural produce, as well as Financial Services, Real Estate and Corporate Services. Economic gains in Kalimantan were prompted by improvements in the Mining and Quarrying sector as coal production was ramped up in response to an increase in the export quota coupled with increasing demand from China during the winter months. In contrast, economic growth in Sumatra, Sulawesi as well as Maluku-Papua moderated in the fourth quarter of 2018 due to less agricultural and mining activity caused by declining exports of natural resources and lower international commodity prices. Economic growth in Bali and Nusa Tenggara improved yet remains fragile considering the ongoing post-disaster reconstruction and rehabilitation efforts in West Nusa Tenggara.

For the year, Java, Sumatra and Maluku-Papua achieved faster economic growth in 2018 compared with 2017. Trade and Manufacturing were the main drivers of economic growth on the island of Java in 2018 in line with solid domestic demand and government backing to strengthen national industrial competitiveness. Similarly, the main locomotives of economic growth in Sumatra in 2018 were also Trade and Manufacturing, CPO processing for the domestic market in particular. In Maluku-Papua, the economic improvements achieved in 2018 were led by a strong Mining sector in the first half of the year prior to the phasing out of open-cast mining and expiration of the Special Mining Permit afforded to Papua.
WELFARE

The relative poverty figure has continued to fall, accompanied by less inequality in Indonesia. The poverty rate stood at 9.66% in September 2018, decreasing from 10.12% one year earlier (Graph 3.15), representing the lowest rate recorded since the peak of the economic crisis in 1997/98 at 24.2%. The fundamental decline in the poverty rate since 2015 has been supported by solid economic growth and lower unemployment. The falling poverty rate is also in line with low and stable inflation, thereby limiting further increases in the poverty line. Furthermore, rising wages amongst middle-low income earners through social medical care and expansion of the social assistance program (bansos) have also alleviated the poverty rate. Poverty has fallen evenly across rural and urban areas, accompanied by less income distribution inequality, as reflected by an improvement in the Gini ratio.
The poverty rate has fallen in rural and urban areas, with a more significant decline recorded in rural areas. The number of rural decreased by 770,000 in September 2018 to 15.54 million Indonesians compared with the same period one year earlier (Graph 3.15). In comparison, the number of urban poor fell by 140,000 to a total of 10.13 million over the same period. Rural poverty has been alleviated through higher real farmworker wages and improvements in the farmers’ terms of trade (ToT). Labour-intensive government programs, including social assistance (bansos) and the Village Fund, have raised incomes and expanded job opportunities in rural areas.

Low and stable inflation has helped to control poverty. The poverty line increased 6.07% (yoy) to Rp410,670 per capita/month in September 2018 (Graph 3.16), compared to 7.14% (yoy) in March 2018 and Rp401,220 per capita/month. Despite a higher poverty line, absolute poverty has continued to fall in line with maintained public purchasing power, especially amongst lower-income households, congruent with controlled inflationary pressures on foodstuffs, rising incomes and government backing in the form of expansive and targeted social assistance disbursements (bansos).

Spatially, broad-based poverty alleviation has been observed in all regions. In September 2018, more provinces experienced lower poverty rates than higher poverty rates. The most significant declines were recorded in Bangka Belitung, where relative poverty fell by 10% (yoy). In contrast, the provinces of West Sulawesi and North Maluku recorded higher levels of relative poverty, increasing 0.36% (yoy) and 2.8% (yoy) respectively, due to flagging agricultural activities that undermined the farmers’ terms of trade (ToT).
Consistent with a lower incidence of relative poverty, the Poverty Gap Index and Poverty Severity Index also improved. The Poverty Gap Index improved further to 1.63 in September 2018 after recording the lowest rate of the past five years in March 2018 (Table 3.3). The decline indicates that the average shortfall in income of the population from the poverty line has continued to decrease/improve. Meanwhile, the Poverty Severity Index also experienced a decline from 0.46 in September 2017 to 0.41 in September 2018 (Table 3.4), indicating that the spending disparity of the poor has narrowed.

Economic inequality has also improved in rural and urban areas. The Gini ratio stood at 0.384 in September 2018, improving from 0.389 in March 2018 and from 0.391 in September 2017 (Graph 3.18). Urban economic inequality has consistently declined since March 2015. In contrast, rural inequality increased from 0.324 in March 2018 before decreasing to 0.319 in September 2018. The Government has actively expanded and intensified its social assistance program (bansos) in 2018, which induced greater spending amongst the most disadvantaged households, thus narrowing the spending gap between lower and middle to upper income earners.

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4 The Poverty Gap Index is a measure of the intensity of poverty, namely the average poverty gap in the population as a proportion of the poverty line. A higher index indicates a higher average shortfall in income of the population from the poverty line. A lower index is desirable.

5 The Poverty Severity Index is a measure of the spending disparity of the poor. A higher index indicates a larger gap between the poor.

---

### Table 3.3 Poverty Depth Index

<table>
<thead>
<tr>
<th>Years</th>
<th>Urban</th>
<th>Rural</th>
<th>Urban+Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar 2015</td>
<td>1.40</td>
<td>2.55</td>
<td>1.97</td>
</tr>
<tr>
<td>Sep 2015</td>
<td>1.30</td>
<td>2.40</td>
<td>1.74</td>
</tr>
<tr>
<td>Mar 2016</td>
<td>1.19</td>
<td>2.74</td>
<td>1.94</td>
</tr>
<tr>
<td>Sep 2016</td>
<td>1.21</td>
<td>2.32</td>
<td>1.74</td>
</tr>
<tr>
<td>Mar 2017</td>
<td>1.24</td>
<td>2.49</td>
<td>1.83</td>
</tr>
<tr>
<td>Sep 2017</td>
<td>1.24</td>
<td>2.43</td>
<td>1.79</td>
</tr>
<tr>
<td>Mar 2018</td>
<td>1.17</td>
<td>2.37</td>
<td>1.71</td>
</tr>
<tr>
<td>Sep 2018</td>
<td>1.08</td>
<td>2.32</td>
<td>1.63</td>
</tr>
</tbody>
</table>

Source: BPS, calculated

### Table 3.4 Poverty Severity Index

<table>
<thead>
<tr>
<th>Years</th>
<th>Urban</th>
<th>Rural</th>
<th>Urban+Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar 2015</td>
<td>0.36</td>
<td>0.71</td>
<td>0.54</td>
</tr>
<tr>
<td>Sep 2015</td>
<td>0.35</td>
<td>0.67</td>
<td>0.51</td>
</tr>
<tr>
<td>Mar 2016</td>
<td>0.27</td>
<td>0.79</td>
<td>0.52</td>
</tr>
<tr>
<td>Sep 2016</td>
<td>0.29</td>
<td>0.59</td>
<td>0.44</td>
</tr>
<tr>
<td>Mar 2017</td>
<td>0.31</td>
<td>0.67</td>
<td>0.48</td>
</tr>
<tr>
<td>Sep 2017</td>
<td>0.30</td>
<td>0.65</td>
<td>0.46</td>
</tr>
<tr>
<td>Mar 2018</td>
<td>0.29</td>
<td>0.63</td>
<td>0.44</td>
</tr>
<tr>
<td>Sep 2018</td>
<td>0.25</td>
<td>0.62</td>
<td>0.41</td>
</tr>
</tbody>
</table>

Source: BPS, calculated
INDONESIA BALANCE OF PAYMENTS

Indonesia’s balance of payments (BOP) recorded a surplus in the fourth quarter of 2018, which bolstered external sector resilience. The BOP surplus stood at USD5.4 billion in the reporting period, upending the USD4.4 billion deficit experienced in the previous period. The BOP surplus stemmed from an increment in the capital and financial account that exceeded the corresponding increase in the current account deficit (Graph 3.19).

The capital and financial account posted a significantly larger surplus in line with upbeat domestic and foreign investor confidence in the domestic economic outlook (Graph 3.20). In the fourth quarter of 2018, the capital and financial account recorded a USD15.7 billion surplus, up significantly from USD3.9 billion in the third quarter of 2018 on the back of portfolio investment gains as foreign capital flowed back to domestic financial assets along with large issuances of global bonds by the Government and corporate sector. Furthermore, domestic firms demonstrated their optimism in the domestic economic outlook by withdrawing offshore deposits to fund their business requirements, as reflected by a surplus of other investment.

The current account deficit increased in the fourth quarter of 2018 in line with strong domestic demand despite unfavourable global economic dynamics (Graph 3.21). The current account deficit stood at USD9.1 billion (3.57% of GDP) in the fourth quarter of 2018, up from USD8.6 billion (3.28% of GDP) in the previous period. A decline in the non-oil and gas goods trade balance precipitated a larger current account deficit. Nevertheless, prevailing policy to reduce the current account deficit has begun to curtail imports despite growth remaining comparatively high in order to meet strong domestic demand. Simultaneously, exports are declining as a corollary of global economic moderation. Notwithstanding,
improvements in the primary income account effectively negated further increments in the current account deficit, primarily in relation to lower interest payments on government debt securities coupled with a larger travel services trade surplus that was made possible by hosting the Asian Para Games in Jakarta and the IMF-World Bank Annual Meetings in Bali.

For the year, Indonesia’s BOP deficit recorded in 2018 was caused by a current account deficit despite the significant capital and financial account surplus achieved. The BOP deficit stood at USD7.1 billion in 2018, reversing the USD11.6 billion surplus recorded in 2017. Furthermore, the current account posted a USD31.1 billion deficit in 2018, equivalent to 2.98% of GDP, increasing from a USD16.2 billion deficit, or 1.6% of GDP, in 2017. Notwithstanding the increase, the current account deficit remained within a manageable threshold in 2018. The current account deficit was primarily attributable to rapid growth of non-oil and gas imports, particularly raw materials and capital goods, to fuel productive domestic economic activity, against a backdrop of restrained non-oil and gas export growth. A growth surge of oil imports in line with the higher global oil price and increasing domestic fuel consumption also contributed to the larger current account deficit. On the other hand, the capital and financial account recorded a significant surplus totalling USD25.2 billion, underpinned by long-term capital inflows. Furthermore, the capital and financial account maintained a surplus despite highly uncertain global financial markets, thus evidencing solid external sector resilience in Indonesia.

Entering the first month of 2019, the trade balance recorded a deficit, influenced by global dynamics. Indonesia’s trade deficit was USD1.16 billion in January 2019, up from USD1.03 billion the month earlier (Graph 3.22). The deficit stemmed from a larger oil and gas trade deficit caused by a greater decline of oil
and gas exports than the decrease of oil and gas imports. On the other hand, the non-oil and gas trade deficit remained relatively stable compared with conditions the month earlier, supported by an increase of non-oil and gas exports to help offset strong non-oil and gas import growth.

The oil and gas trade deficit stood at USD0.45 billion in January 2019, increasing from USD0.28 billion the month earlier. The deficit comes amidst an oil and gas export decline from USD1.75 billion in December 2018 to USD1.23 billion in January 2019, weighed down by refined products and crude oil in line with lower export volume and oil prices. Falling exports exceeded the corresponding oil and gas import decline, which slumped USD0.34 billion (mtm) to USD1.69 billion in January 2019 compared with conditions the month earlier, affecting refined products and crude oil in line with lower import volume and prices.

The non-oil and gas trade deficit was recorded at USD0.70 billion in January 2019, relatively unchanged compared with the USD0.75 billion deficit in the previous period. Such developments were explained by an uptick of non-oil and gas exports combined with stable non-oil and gas imports. In the reporting period, non-oil and gas exports stood at USD1263 billion, increasing USD0.05 billion (mtm) on the position in December 2018 and dominated by motor vehicles and parts, electrical machinery and equipment as well as iron and steel. On the other hand, oil and gas imports were recorded at USD13.34 billion in January 2019, with the gains driven by organic chemicals, plastics and plastic products as well as iron and steel.

The deluge of foreign capital inflow was maintained in February 2019. The inflow of non-resident capital stood at USD2.2 billion in January 2019 (Graph 3.23), drawn to the public and private sector alike. In the public sector, foreign capital flowed to rupiah SUN instruments, while capital inflows to the private...
sector were dominated by stock instruments. Foreign capital inflows to rupiah SUN were maintained in February 2019. Consequently, total foreign capital inflows as of 15th February 2019 stood at USD1.4 billion.

Despite decreasing slightly in January 2019, the position of reserve assets remained solid. International reserves were recorded at USD120.7 billion in December 2018, equivalent to 6.7 months of imports or 6.5 months of imports and servicing government external debt, which is well above the international adequacy standard of three months. The position of reserve assets fell to USD120.1 billion in January 2019 (Graph 3.24) as the Government opted to service more external debt. Nevertheless, the level of reserve assets in January 2019 was also equivalent to 6.7 months of imports or 6.5 months of imports and servicing government external debt, namely above the international adequacy standard of three months. Bank Indonesia considers the current position of reserve assets adequate to build confidence in the domestic economic outlook and stability, along with positive export performance.

Moving ahead, Indonesia’s balance of payments (BOP) is projected to improve and continue reinforcing external sector resilience. Solid coordination and concrete measures taken by the Government in conjunction with Bank Indonesia to stimulate exports and reduce imports are expected to control the current account deficit within a manageable threshold in 2019, namely 2.5% of GDP. Simultaneously, Bank Indonesia will continue to monitor global developments that could influence the BOP outlook, especially in terms of world trade volume (WTV) and international commodity prices, which are decreasing. Furthermore, Bank Indonesia will continue to strengthen its policy mix in order to sustain economic stability, while strengthening coordination with the Government to pursue structural reforms, in particular to support the external balance.
RUPIAH EXCHANGE RATE

The rupiah appreciated, thus supporting economic stability. Point to point, the rupiah gained 3.63% (ptp) in the fourth quarter of 2018 compared with conditions at the end of the previous period, boosted by a positive balance of payments. The strong rupiah persisted into January 2019, appreciating another 2.92%, with the trend continuing into February 2019 (Graph 3.25) on the back of non-resident capital inflows to domestic financial markets, drawn by solid economic fundamentals as well as attractive domestic financial assets and reduced global economic uncertainty.

In the fourth quarter of 2018, the rupiah strengthened in line with the majority of other currencies in the region due to broad-based US dollar depreciation. The US dollar weakened against other global currencies in response to expectations of a less hawkish policy direction adopted by the US Federal Reserve together with optimism surrounding the slight thawing of trade tensions between the US and China after another round of trade negotiations between the two countries, as well as political dynamics in the US that subsequently prompted US dollar depreciation in global financial markets. At home, solid economic fundamentals along with maintained macroeconomic and financial system stability have helped strengthen the rupiah. National economic conduciveness was evidenced by low and stable headline inflation coupled with a strong position of reserve assets maintained towards the end of 2018.

The strong rupiah persisted throughout January and into February 2019 as foreign capital kept flowing into domestic financial markets. Such dynamics are consistent with the majority of regional currencies (Graph 3.26). The strong rupiah was a consequence of foreign capital inflows throughout January and into February 2019 (Graph 3.27), driven
by domestic and global factors. Domestically, solid economic fundamentals, coupled with maintained macroeconomic and financial system stability attracted non-resident capital to the national economy. In addition, competitive domestic financial asset yields remained attractive to non-resident investors. Promising national economic dynamics were portrayed by the data released in the fourth quarter of 2018 that pointed to 5.18% (yoy) GDP growth, the highest on record in the past five years, thus beating market expectations of 5.10% (yoy) and GDP growth in the previous period of 5.17% (yoy). Globally, positive sentiment stemmed from less uncertainty in the global financial markets in line with the less hawkish policy stance adopted by the US Federal Reserve, together with optimism surrounding the trade relationship between the United States and China despite ongoing Brexit uncertainty, which edged up the rupiah.

The stronger rupiah was accompanied by contained exchange rate volatility. Rupiah volatility increased on the previous period, however. In the fourth quarter of 2018, average quarterly rupiah volatility increased to 11.56%, which was nevertheless lower than the regional average of 15.07% (Graph 3.28). Thus far in 2019 (ytd), rupiah volatility has tracked an upward trend, reaching 11.63%, which is still lower than the regional average of 12.62% (Graph 3.29). Moreover, rupiah volatility was also lower than that recorded in other emerging market economies (EMEs), including the South African rand, Brazilian real and Turkish lira. On a monthly basis, rupiah volatility spiked in January 2019 compared with conditions the month earlier before decreasing again in February 2019. As of January 2019, rupiah volatility averaged 13.05%, increasing from 9.98% the month earlier. Consequently, rupiah volatility posted a monthly average of 9.23% in February 2019 (as of 20th February).
Moving forward, Bank Indonesia projects rupiah stability in line with market mechanisms. At the beginning of February 2019, global financial market uncertainty tended to subside as advanced economies opted for a more gradual pace of monetary policy normalisation and trade tensions between the United States and China began to thaw. More gradual Federal Funds Rate (FFR) hikes are now expected along with smaller balance sheet reductions than initially proposed. In addition, maintained macroeconomic and financial system stability along with the promising domestic economic outlook are expected to bolster future exchange rate movements.

INFLATION

Consumer Price Index (CPI) inflation was kept under control within the corresponding target corridor. On a quarterly basis, price pressures on volatile foods (VF) and administered prices (AP) pushed up headline inflation in the fourth quarter of 2018 in line with cyclical trends during the Christmas and New year holiday season. For the year, therefore, inflation in 2018 trended down to 3.13% compared with the 3.61% realised in 2017. Furthermore, inflation in 2018 was controlled within the target range, namely 3.5±1%, for the fourth consecutive year. Low and stable inflation has also been maintained at the beginning of 2019, supported by low inflation of volatile foods and stable core inflation.

Inflationary pressures intensified towards yearend in line with the seasonal spike in demand experienced during the Christmas and New Year holiday period. Inflation reached 1.17% (qtq) in the fourth quarter of 2018, up from 0.04% (qtq) in the previous
period. Escalating inflationary pressures on volatile foods and administered prices contributed to higher inflation. Price pressures on volatile foods were amplified by rising demand for foodstuffs during Christmas and New Year, including chicken meat and eggs. In addition, more expensive animal feed also raised food prices along with restrained rice supply in the current planting season. On the other hand, the onset of the monsoon season affected the supply of certain other food commodities. Meanwhile, administered prices (AP) increased on higher airfares, railway fares and intercity fares. Nevertheless, inflationary pressures were controlled on the back of declining core inflation despite increasing demand. Such developments were inextricably linked to policy consistency by Bank Indonesia to anchor rational inflation expectations and manage rupiah movements in line with the currency’s fundamental value.

CPI inflation at the beginning of the first quarter of 2019 remained under control, thus supporting attainment of the 2019 inflation target, namely 3.5±1%. CPI inflation in January 2019 was recorded at 0.32% (mtm) or 2.82% (yoy), down from 0.62% (mtm) or 3.13% (yoy) the month earlier (Graph 3.30). Lower inflation stemmed from milder price pressures on volatile foods (VF) and deflation of administered prices (AP). VF inflation was supressed by deflation of foodstuffs to a rate below the historical average. Furthermore, administered prices experienced deflation as non-subsidised fuel prices decreased along with cheaper railway fares. Meanwhile, core inflation remained under control despite increasing in line with seasonal trends, edged up by rising house rentals and higher wages.

Volatile foods experienced milder inflationary pressures in January 2019 as the supply of foodstuffs increased. VF inflation decreased to 0.97% (mtm) in the reporting period, which is lower than in the
previous period as well as the historical average in January for the past four years at 1.55% (mtm) (Graph 3.31). The harvesting season for various foodstuffs, including red chillies and shallots, boosted supply. In addition, price pressures on purebred chicken and eggs eased in line with increasing corn imports to control feed prices. On the other hand, further VF inflation declines were negated by higher rice prices during the current planting season coupled with rising international food commodity prices, primarily crude palm oil (CPO) and garlic (Table 3.5).

Administered prices (AP) recorded deflation in January 2019, dragged down by cheaper fuel and a correction to transportation tariffs. AP deflation reached 0.12% (mtm) in the reporting period, down from 1.20% (mtm) the month earlier. The main contributor to AP deflation was fuel in line with lower special fuel prices, which fell by an average of Rp200/litre on 5th January 2019 (Table 3.6). Furthermore, a correction to railway fares after the busy Christmas and New Year period also contributed to AP deflation. Nonetheless, deeper AP deflation was neutralised by rising airfares and filtered clove cigarette prices. Intense inflationary pressures on airfares since the end of 2018 have stemmed from increasing costs, primarily aviation fuel, against stable demand.

Core inflation increased on rising house rental rates and wages in January 2019. Core inflation increased from 0.17% (mtm) in December 2018 to 0.30% (mtm) in January 2019 in line with seasonal trends. House rental rates, non-supervisory wages, bottled water, gold jewellery and domestic workers’ wages were the main drivers of core inflation in the reporting period. Nevertheless, non-traded core inflation decreased, while traded core inflation increased (Graph 3.33).

Controlled core inflation is also closely linked to anchored inflation expectations. Inflation expectations have effectively been

---

**Table 3.5 Contributors to Volatile Food Inflation/Deflation**

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Inflation/Deflation (% mtm)</th>
<th>Contribution (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rice</td>
<td>1.06</td>
<td>0.04</td>
</tr>
<tr>
<td>Tomato</td>
<td>14.68</td>
<td>0.03</td>
</tr>
<tr>
<td>Purebred Chicken Meat</td>
<td>1.98</td>
<td>0.02</td>
</tr>
<tr>
<td>Shallot</td>
<td>4.37</td>
<td>0.02</td>
</tr>
<tr>
<td>Mujair Fish</td>
<td>6.64</td>
<td>0.01</td>
</tr>
<tr>
<td>Purebred Chicken Egg</td>
<td>1.32</td>
<td>0.01</td>
</tr>
<tr>
<td>Carrot</td>
<td>7.43</td>
<td>0.01</td>
</tr>
<tr>
<td>Tomato</td>
<td>11.94</td>
<td>0.01</td>
</tr>
<tr>
<td>Watermelon</td>
<td>6.40</td>
<td>0.01</td>
</tr>
<tr>
<td>Red Chili</td>
<td>-7.0</td>
<td>-0.04</td>
</tr>
</tbody>
</table>

**Table 3.6 Contributors to Administered Price Inflation/Deflation**

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Inflation/Deflation (% mtm)</th>
<th>Contribution (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air Transport Fares</td>
<td>0.91</td>
<td>0.01</td>
</tr>
<tr>
<td>Clover Filter Cigarettes</td>
<td>0.49</td>
<td>0.01</td>
</tr>
<tr>
<td>Fuel</td>
<td>-1.1</td>
<td>-0.04</td>
</tr>
<tr>
<td>Train Fares</td>
<td>-9.6</td>
<td>-0.02</td>
</tr>
</tbody>
</table>

**Graph 3.32 Administered Prices Inflation**

**Graph 3.33 Core Traded vs Non-traded (yoy)**
anchored to the target corridor in 2019, as reflected by January’s edition of the Consensus Forecast, namely decreasing to 3.50% (average yoy) from 3.70% (average yoy) the month earlier (Graph 3.34). In the real sector, retailers’ inflation expectations have decreased for the upcoming 3 and 6 months.

**Spatially, controlled CPI inflation within the national target is supported by measured inflation developments in various regions.** Most areas recorded low monthly inflation in the reporting period, namely Eastern Indonesia (0.56% mtm), Java (0.30% mtm) and Sumatra (0.17% mtm). Annually, however, intense inflationary pressures were felt in Papua (7.20%), Central Sulawesi (5.96%), North Kalimantan (5.49%) and West Papua (5.19%).

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**Graph 3.34 Consensus Forecast Inflation Expectations**

**Table: Consensus Forecast Inflation Expectations**

<table>
<thead>
<tr>
<th>Year</th>
<th>2017 Inflation Expectation</th>
<th>2018 Inflation Expectation</th>
<th>2019 Inflation Expectation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Inflation Expectation</td>
<td>Inflation Expectation</td>
<td>Inflation Expectation</td>
</tr>
<tr>
<td></td>
<td>2.00</td>
<td>2.50</td>
<td>3.00</td>
</tr>
</tbody>
</table>

---

**Figure 3.2 Regional Inflation Map, January 2019 (%yoy)**

Source: BPS, calculated
due to rising airfares and fresh fish prices (Graph 3.35).

FINANCIAL MARKETS

In the fourth quarter of 2018, Bank Indonesia’s monetary policy stance was successfully transmitted against a backdrop of financial system stability, increasing intermediation and adequate liquidity for productive economic purposes. Monetary policy transmission through the interest rate channel remains effective, as reflected by the O/N interbank rate which has converged on the BI 7-Day (Reverse) Repo Rate. The banking industry is currently raising deposit rates, while lowering lending rates. Meanwhile, liquidity in the economy remains adequate, as evidenced by money supply growth in line with GDP growth. Fundamentally, financial system stability has been maintained and the bank intermediation function is improving, while the banking industry has contained the credit risk. Nonetheless, economic financing through the financial markets has slowed due to a rising cost of funds as interest rates increase.

The O/N interbank rate continues to converge on the BI 7-Day (Reverse) Repo Rate. The average daily O/N interbank rate increased to 5.71% in the fourth quarter of 2018 from 5.15% in the previous period in response to the cumulative 175bps hike in the BI 7-Day (Reverse) Repo Rate from May-November 2018 to 6.00%. In general, money market stability has been maintained despite seasonal liquidity pressures towards yearend as a result of large-scale currency withdrawals and tax deposits. Such developments were reflected in the spread between the O/N interbank rate and the BI 7-Day (Reverse) Repo Rate in the fourth quarter of 2018, which narrowed to just 16bps from 23bps in the previous period. In 2019, the O/N interbank
rate has remained stable at 3-23bps below the BI 7-Day (Reverse) Repo Rate, with the O/N interbank rate recorded at 5.86% in January 2019 (Graph 3.35).

**Adequate liquidity has effectively controlled O/N interbank rate volatility.** Low volatility was reflected in the relatively stable min-max spread of the O/N interbank rate in the fourth quarter of 2018 at 31bps compared with 25bps in the previous period. Low volatility despite a seasonal spike in demand for liquidity and banks adjusting their pricing in response to the higher policy rate is indicative of adequate liquidity supply. In addition, average daily interbank money market transaction volume remained high in the fourth quarter of 2018 to meet banking industry demand for liquidity, reaching Rp19.0 trillion (Graph 3.36). Low money market volatility was maintained in January 2019, as indicted by a stable average daily min-max spread coupled with high transaction volume at 25bps and Rp20.6 trillion respectively.

**Deposit rates in the banking industry are tracking an upward trend.** The weighted average deposit rate at the end of the fourth quarter of 2018 increased to 6.88% from 6.31% in the previous period. According to monthly dynamics, interest rates were raised in the second until fourth quarter of 2018 in line with the higher cost of funds affecting the banking industry (Graph 3.37). The banks raised interest rates on all tenors, 1-month tenors in particular. Furthermore, all BUKU bank groups raised deposit rates in the reporting period, led by BUKU 3 banks. Since the end of 2017, therefore, the weighted average deposit rate has increased by a total of 81bps.

**In contrast, the banks have been inclined to lower lending rates.** The weighted average lending rate stood at 10.81% at the end of the fourth quarter of 2018 (Graph 3.38). The main contributors to the lower weighted average lending rate were working capital loans and

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*Graph 3.36 O/N Interbank Volume*

*Graph 3.37 Spread of Banking Rates*

*Graph 3.38 Lending Rates*
investment loans, which tracked downward trends as lending rates on consumer loans increased. By group, BUKU 1, 2 and 4 banks were most inclined to lower lending rates. Lower lending rates in the fourth quarter of 2018 represented an extension of lower lending rates at the end of the first, second and third quarters, recorded at 11.20%, 11.07% and 11.03% respectively. Consequently, the weighted average lending rate has decreased cumulatively since the end of 2017 by a total of 51bps.

Financial system stability has been maintained, accompanied by contained credit risk. Financial system stability is supported by a high Capital Adequacy Ratio (CAR), reaching 22.9% in the fourth quarter of 2018 (Graph 3.39). On the other hand, the liquidity ratio stood at 19.3% in December 2018, down from 19.6% in September 2018 (Graph 3.40). In addition, the banking sector maintained a low level of Non-Performing Loans (NPL), namely at 2.4% (gross) or 1.0% (net).

Financial system stability has been maintained as the bank intermediation function improved in the fourth quarter of 2018. Outstanding loans disbursed by the banking industry maintained high growth at 11.75% (yoy) in the fourth quarter of 2018, albeit down slightly on the 12.69% (yoy) recorded in the previous period. Working capital loans, investment loans and consumer loans continued to grow solidly in the fourth quarter of 2018 at 13.0% (yoy), 10.9% (yoy) and 10.4% (yoy) respectively despite moderating from 13.8% (yoy), 11.8% (yoy) and 11.7% (yoy) in the previous period (Graph 3.41). By economic sector, loans allocated to Construction and Corporate Services accelerated in line with faster tertiary sector growth. In contrast, other dominant sectors recorded slower loan growth, including the
Trade sector and Others Sector (household consumption). Meanwhile, loans extended to the Manufacturing Industry declined slightly in line with manufacturing sector performance (Graph 3.42).

**Annually, the bank intermediation function improved in 2018.** Credit growth in 2018 increased to 11.75% from 8.2% in 2017, driven primarily by working capital loans and investment loans that accelerated respectively to 13.03% and 10.94% from 8.5% and 4.8% in the previous year. On the other hand, consumer loans moderated to 10.35% from 11.0% in the reporting period. By sector, the others sector (household consumption) was the key driver of loan growth in 2018, along with trade and the manufacturing industry in line with increasing economic momentum, primarily in the form of domestic demand.

**The banking industry has confirmed flatter deposit growth.** Deposit growth decelerated to 6.5% (yoy) in the fourth quarter of 2018 from 6.6% (yoy) in the previous period (Graph 3.43), held back by slower growth of demand deposits and savings deposits, which declined to 6.6% (yoy) and 7.3% (yoy) from 9.6% (yoy) and 9.5% (yoy) respectively in the third quarter of 2018. For the year, deposit growth in 2018 stood at 6.5%, down from 9.4% (yoy) in 2017.

**Credit and deposit growth are expected to improve in 2019 as domestic economic momentum continues to build and financial system stability is maintained.** Credit growth in 2019 is projected in the 10-12% (yoy) range and deposit growth at 8-10% (yoy) based on solid national economic growth in the 5.0-5.4% range, supported by strong domestic demand, household and NPISH consumption in particular. Bank Indonesia will maintain an accommodative monetary policy stance in order to stimulate economic financing and maintain financial system stability in coordination with other relevant authorities.
Broad money, as a measure of liquidity in the economy, moderated in the reporting period. M2 was recorded at Rp5,758.3 trillion in the fourth quarter of 2018 as growth slowed to 6.3% (yoy) from 6.7% (yoy) in the previous period (Graph 3.44). The main drag on M2 growth was weaker M1 growth, with narrow money decelerating to 4.8% (yoy) from 8.2% (yoy) due to Currency Outside Banks (COB) and rupiah demand deposits. In contrast, quasi-money accelerated in the reporting period to 6.7% (yoy) from 6.3% (yoy) in the third quarter of 2018, induced by rupiah and foreign currency term deposits, primarily held by private corporate customers.

Based on the affecting factors, a deeper NFA contraction and slower credit growth contributed to softer M2 growth in the reporting period. Net Foreign Assets (NFA) contracted by -6.4% (yoy) in the fourth quarter of 2018, deteriorating from -3.9% (yoy) in the previous period. The deeper contraction stemmed primarily from declining growth of foreign securities. Furthermore, flatter credit growth in the fourth quarter of 2018 also undermined M2 growth. Conversely, Net Domestic Assets (NDA) accelerated to 11.3% (yoy) from 11.1% (yoy) in the third quarter of 2018 (Graph 3.45).

Economic financing from the nonbank financial industry experienced a decline. Economic financing through the capital market, IPOs and rights issues, corporate bonds, medium-term notes (MTN) and Negotiable Certificates of Deposit (NCD) was recorded at Rp207.8 trillion (gross) in 2018, down from Rp299.4 trillion in 2017. A rising cost of funds due to higher interest rates in response to increasing SBN yields and policy rate hikes undermined economic financing through the nonbank financial industry. The corporate sector has become more prudent when seeking financing through bonds as a result of a larger interest expense due to the rising cost of funds. Based on quarterly dynamics, economic financing experienced a deeper contraction

![Graph 3.45 Growth of M2 and Its Affecting Factors](source: Bank Indonesia)
in the fourth quarter of 2018 compared with conditions in the previous period. The decline primarily stemmed from fewer corporate bond issuances as the dominant instrument, accounting for 55% of all financing through the financial markets.

**Domestic stock market performance improved in the fourth quarter of 2018 in line with milder external pressures.** The Jakarta Composite Index (JCI) traded up 3.65% (qtoq) in the fourth quarter of 2018 to close at a level of 6194.50 from 5976.55 in the previous period. The gains were supported by less intense global financial uncertainty in line with a slight thawing of trade tensions between the United States and China. In addition, financial market rigidity in the United States also eased, which triggered foreign capital inflows to developing economies, including Indonesia. In the fourth quarter of 2018, non-resident investors booked a net buy totalling USD0.43 trillion, representing the first such inflow recorded since the third quarter of 2017 (Graph 3.46).

**Milder global pressures maintained non-resident capital inflows in January 2019.** Non-resident investors booked another net buy in January 2019 to the tune of Rp13.82 trillion, the highest inflow recorded since May 2017 (Graph 3.46). The inflow was maintained in line with less external risk and supported by positive domestic sentiment and a stronger rupiah. Foreign capital inflows were also drawn by solid domestic economic fundamentals and attractive domestic financial assets. In addition, the JCI rally also drew foreign capital. Consequently, the portion of non-resident funds increased in January 2019 (Graph 3.46).

**Domestic stock market performance surpassed global stock market performance in the fourth quarter of 2018.** On a quarterly basis, the Jakarta Composite Index (JCI) rallied 3.6% (qtoq) in the fourth quarter of 2018, contrasting global bourses...
that experienced corrections. Furthermore, the JCI also outperformed the 2.6% (qtq) gain recorded in the Philippines. Stock markets in other ASEAN countries, including Singapore, Malaysia, Thailand and Vietnam, experienced corrections (Graph 3.48). Similarly, all stock markets in emerging market economies (EMEs) and advanced economies recorded contractions (qtq) compared with dynamics in September 2018. Upon entering 2019, the JCI traded up a further 5.46% (mtm) to close at a level of 6532.97. The recent gains are in line with global stock market performance, which generally improved at the beginning of 2019 (Graph 3.49).

**Nearly all sectors performed better in the fourth quarter of 2018.** Miscellaneous industry, the financial sector, property sector and basic industry led the JCI gains in the fourth quarter of 2018, recording growth of 11.3% (qtq), 9.2% (qtq), 5.9% (qtq) and 4.3% (yoy) respectively (Graph 3.50). The increments in the miscellaneous and basic industries were achieved due to solid demand for manufacturing products in line with increasing domestic demand. Meanwhile, the JCI rally observed in the financial sector was attributed to positive banking industry performance, denoted by faster credit growth accompanied by contained credit risk. The property sector benefitted from persistently strong building investment growth in the final quarter of the year. In January 2019, the JCI continued to rally on the back of positive sectoral performance (Graph 3.51).

**SBN market performance improved on lower yields in the fourth quarter of 2018.** SBN yields declined for all tenors in the reporting period, led by short tenors that fell 40bps to a level of 7.35%. The benchmark 10-year SBN yield declined 10bps to 8.02% at the end of the fourth quarter of 2018 from 8.12% in the previous period (Graph 3.52). Overall, SBN yield fell by an average of 18bps to 7.96%. The improvements come amidst less...
global uncertainty together with solid domestic economic fundamentals and a strong rupiah. In addition, the policy mix instituted by Bank Indonesia to maintain the attractiveness of domestic financial markets in the eyes of non-resident investors has been proven effective by the net buy booked by foreign investors in the SBN market totalling Rp42.4 trillion during the fourth quarter of 2018, even exceeding the Rp20.68 trillion inflow booked in the previous period. Cumulatively in 2018, therefore, non-resident investors booked a net buy worth Rp57.10 trillion, while the portion of foreign SBN holdings was maintained at 36.88% (Graph 3.53).
GLOBAL ECONOMIC OUTLOOK

A softening of global economic growth is projected for 2019 and 2020. The economies of the United States, Europe, Japan and China are projected to moderate in line with restrained consumption and investment growth coupled with dwindling external sector support (Table 4.1). Advanced economies will continue to confront structural labour market and productivity issues, thereby prompting economic moderation. In contrast, India’s economy is predicted to accelerate on the back of structural reforms and strong fiscal backing. The expected global economic slowdown and simmering trade tensions between the United States and China will be accompanied by declining world trade volume and lower international commodity prices.

Economic consolidation is projected in the United States for 2019 and 2020. Economic growth in the United States is predicted to slow in 2019 compared with dynamics in 2018 as the effect of tax cuts begins to fade, labour participation and productivity remain low and concerns arise over the fiscal sustainability of propping up the economy.

Table 4.1 Global Economic Outlook

<table>
<thead>
<tr>
<th>GDP</th>
<th>WEO (IMF)</th>
<th>Consensus Forecast (CF)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>October 2018</td>
<td>January 2019</td>
</tr>
<tr>
<td>World</td>
<td>2.7</td>
<td>2.7</td>
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<td>Advanced Economies</td>
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<td>2.1</td>
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<td>US</td>
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<td>2.5</td>
</tr>
<tr>
<td>Europe</td>
<td>2.0</td>
<td>1.9</td>
</tr>
<tr>
<td>Japan</td>
<td>1.1</td>
<td>0.9</td>
</tr>
<tr>
<td>Emerging Market</td>
<td>4.7</td>
<td>4.7</td>
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<tr>
<td>China</td>
<td>6.6</td>
<td>6.2</td>
</tr>
<tr>
<td>India</td>
<td>7.3</td>
<td>7.4</td>
</tr>
<tr>
<td>World Trade Volume</td>
<td>4.2</td>
<td>4.0</td>
</tr>
</tbody>
</table>

Source: WEO IMF, Consensus Forecast; *Preliminary
GDP growth in 2019 is expected to enter a consolidatory phase, converging on potential output. Furthermore, flagging consumption is predicted in the United States as the effect of personal income stimuli wanes more quickly than initially expected. Flatter investment growth is also predicted, affecting residential and non-residential investment alike, due to corporate tax reductions that are considered suboptimal to stimulate investment activity, coupled with declining temporary tax reform funds.

**Economic growth in Europe is projected to moderate in 2019 and 2020.** Economic growth in Europe in 2019 is not expected to reach the level achieved in 2018 and the growth projection has been revised down. The economic downswing in Europe stems from ongoing structural economic and financial issues, weak exports and uncertainty plaguing the Brexit. The latest short-medium term indicators and leading indicators have confirmed that economic moderation will persist in Europe despite the economy exceeding potential output in 2018.

**Restrained economic performance is projected in Japan for 2019 with economic moderation expected to follow in 2020.** Business and consumer confidence are continuing to retreat. PMI indicators for Manufacturing and Services will continue to track downward trends during the first semester of 2019. Meanwhile, the consumer tax hike planned for October 2019 is expected to undermine consumption further. On the other hand, the Japanese Government has set other fiscal policies to overcome the adverse impact of higher consumer tax, including social programs for low-income earners (lower motor vehicle tax, rebates on cashless purchases, shopping vouchers and subsidised day care), tax incentives for corporations willing to invest and raise salaries, as well as structural labour market reforms.
China’s economic slowdown is predicted to persist in 2019 and 2020 yet remain within the government’s long-term target. The downturn primarily stems from weaker export performance due to the ongoing trade spat with the United States together with weaker domestic demand spurred by the ongoing deleveraging process. Proactive fiscal stimuli through large-scale reductions to taxes and fees will offset further economic decline. In addition, China’s Government will increase stimuli through infrastructure development with off-budget funding (LG special bonds). Moving forward, the United States and China will continue to negotiate in pursuit of agreement to reduce trade tensions in 2019.

The faster pace of economic growth reported in India is predicted to endure in 2019 and 2020. Economic momentum in India is not merely supported by strong fiscal backing yet also increasing infrastructure development, goods and services tax (GST) implementation and ongoing structural reforms. GST implementation is expected to contribute significantly in terms of raising productivity and potential growth. The structural reforms implemented in India, including labour market and land reforms, could induce higher economic growth. Furthermore, the recent gain in India’s competitiveness ranking could improve the business and investment climate.

The Indonesia Export Price Index (IHKEI) outlook is bleak, with the downward trend expected to persist in 2019 and 2020. Falling coal and metal prices are the main drag on the Indonesia Export Price Index. Coal prices are decreasing due to increasing production in China, global economic moderation and environmental issues. The determining factors of lower coal production in China, amongst others, are anticipated to persist as a result of the coal mining efficiency program started two years ago. Increasing coal production in China is reflected in the trend of lower local coal prices in China. Prices are
also sliding due to less coal consumption in the United States and Europe as a consequence of environmental concerns, replaced by cleaner renewable energy sources. In addition, metal prices, primarily nickel and aluminium, are projected to decline on rising production and lower consumption. Nickel production in Indonesia and aluminium production in China are expected to increase further. On the other hand, Chinese demand for metals is relatively subdued in line with restrained investment in electricity infrastructure and the automotive sector.

The downward oil price trend is projected to continue (Graph 4.3). A net-supply situation is expected to persist in 2019 and 2020 because the supply cuts agreed by OPEC will be negated by increasing output in the United States combined with lower demand. Increasing oil production in the United States will offset the OPEC+ supply reductions, particularly after completion of the pipeline project in the middle of 2019 along with several offshore projects. Meanwhile, global demand for oil is expected to dwindle in line with global economic moderation in 2019 and 2020. Furthermore, oil prices could begin to rise in 2020 upon implementation of the new International Marine Organisation (IMO) rules due to infrastructure uncertainty in anticipation of the new regulations. The new environmentally friendly IMO rules require the shipping industry to use fuels with a sulphur content of 0.5-3.5% from 1st January 2020.

WORLD TRADE VOLUME AND INTERNATIONAL COMMODITY PRICE OUTLOOK

The projections of world trade volume (WTV) have been downgraded for 2019 and 2020 in line with global economic moderation and the imposition of tariffs on Chinese imports by the United States. The global economic slowdown, particularly in
advanced economies, will erode demand for imports and, in turn, undermine world trade volume. The economic downturn in advanced economies (excluding the United States) is reflected by declines in the composite PMI. Meanwhile, China’s economy is also predicted to moderate, which will reduce import demand for several commodities, such as coal and manufacturing goods from iron and steel. In addition, inward-looking policies, including the imposition of import tariffs by the United States and China, will also suppress trade activity.

**DOMESTIC ECONOMIC OUTLOOK AND RISKS**

Despite a backdrop of global economic moderation, national economic momentum in Indonesia is expected to build. Economic growth in Indonesia is projected in the 5.0-5.4% and 5.1-5.5% ranges for 2019 and 2020 respectively (Table 4.2). Those projections are based on solid domestic demand in the form of increasing household consumption on the back of maintained public purchasing power, rising incomes, low and stable inflation as well as increasing NPISH consumption due to election spending in 2019. Strong, albeit more moderate, investment growth is expected in line with investor optimism surrounding the promising post-election domestic economic outlook along with various ongoing government infrastructure development projects that are nearing completion. Imports are predicted to slow, held back by capital goods as non-building investment growth flattens as well as the current policy mix instituted to reduce the current account deficit. Exports are also expected to decelerate, weighed down by the global economic downswing, yet not to the extent of the import decline. A deeper decline of imports than exports will improve the net export position, however.
Private consumption is projected to accelerate on increasing household and NPISH consumption. Private consumption is predicted to expand in the 5.2-5.6% range, backed by higher incomes, positive consumer confidence and maintained public purchasing power in line with controlled inflation. The impact of investments in the previous period will trickle down to incomes, boosted further by a minimum wage hike and the government’s social assistance program (bansos). In addition, a spike in consumption by non-profit institutions serving households (NPISH) to meet logistics cost during the run up to the legislative and presidential elections in 2019 will stimulate private consumption and, ultimately, induce household consumption. The trend of increasing household consumption is expected to persist in 2020 and contribute to 5.0-5.4% private consumption growth.

Government consumption in 2019 is predicted to expand in the 3.7-4.1% range, thereby underpinning economic growth momentum. Government consumption growth in 2019 will be driven by policy to frontload social assistance disbursements (bansos) in the first semester, coupled with increasing procurement for logistical support in relation to the legislative and presidential elections to be contested in 2019. The Government has increased the social assistance (bansos) allocation in the 2019 state budget with a focus of poverty eradication, reducing inequality and creating job opportunities. Increasing the bansos budget also represents

Table 4.2  Projected Economic Growth by Expenditure

<table>
<thead>
<tr>
<th>Components</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2018</th>
<th>2019*</th>
<th>2020*</th>
</tr>
</thead>
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<tr>
<td></td>
<td>I</td>
<td>II</td>
<td>III</td>
<td>IV</td>
<td>I</td>
<td>II</td>
</tr>
<tr>
<td>Private Consumption</td>
<td>5.04</td>
<td>4.98</td>
<td>5.01</td>
<td>5.23</td>
<td>5.07</td>
<td>5.20</td>
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<td>Government Consumption</td>
<td>-0.14</td>
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<td>2.71</td>
<td>5.20</td>
<td>6.27</td>
<td>4.56</td>
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<td>Investment</td>
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<td>6.15</td>
<td>7.94</td>
<td>5.85</td>
<td>6.96</td>
<td>6.01</td>
</tr>
<tr>
<td>Export</td>
<td>-1.66</td>
<td>8.91</td>
<td>5.94</td>
<td>7.65</td>
<td>8.08</td>
<td>4.33</td>
</tr>
<tr>
<td>Import</td>
<td>-2.41</td>
<td>8.06</td>
<td>12.64</td>
<td>15.17</td>
<td>14.02</td>
<td>7.10</td>
</tr>
<tr>
<td>GDP</td>
<td>5.03</td>
<td>5.07</td>
<td>5.06</td>
<td>5.27</td>
<td>5.17</td>
<td>5.18</td>
</tr>
</tbody>
</table>

Source: BPS; *Bank Indonesia Projection; ^Consisting of household consumption and consumption of NPISH
part of the efforts to expand the scope of the Family Hope Program (PKH) and the beneficiaries of the Noncash Food Assistance Program (BPNT) in line with the targets set. Government consumption in 2020 is projected to continue expanding in the 3.9-4.3% range.

**Solid investment growth is predicted for 2019 despite moderating in the 6.4-6.8% range.** Building investment will continue to perform well yet restrained by the completion of several government infrastructure development projects in 2019, with only a few infrastructure projects remaining an ongoing concern thereafter. After the legislative and presidential elections, however, investment is expected to regain momentum in the latter half of the year in line with improvements in the investment climate. Meanwhile, robust non-building investment growth will persist in 2019 due to outstanding electrification projects. Nevertheless, falling international commodity prices and dwindling global demand will impede further non-building investment growth in 2019, in particular affecting economic activities based on exports of natural resources. In 2020, business sentiment in terms of investment is anticipated to improve after the legislative and presidential elections have been contested in 2019. Furthermore, government infrastructure projects are expected to continue. Consequently, Bank Indonesia projects investment growth in 2020 in the 6.6-7.0% range.

**Exports are projected to decelerate in line with the overcast global economic outlook.** Exports in 2019 are projected to expand in the 4.4-4.8% range. The prospect of global economic moderation will curb world trade volume and lower international commodity prices, including oil, which will ultimately present a challenge in terms of stimulating Indonesian exports. The economic slowdown expected in China will be affected by simmering trade tensions with the United States along with weaker domestic demand.
as a corollary of the ongoing financial deleveraging process, which will also influence Indonesian exports bound for China, such as coal and manufacturing goods from iron and steel. In general, manufacturing exports will experience a decline in line with the global economy, contrasting the predicted export gains for iron and steel as well as textiles and textile products. In 2020, exports are expected to bounce back and grow in the 5.1-5.5% range, supported by a number of opportunities to boost CPO and coal exports. The factors that could increase CPO exports include: (i) the ongoing trade war between the United States and China will affect soybean products and therefore stimulate demand for viable substitutes, namely CPO; (ii) export market diversification through the initiation of Preferential Trade Agreements (PTA), such as between Pakistan and Indonesia; and (iii) reductions to import tariffs on Indonesian CPO in India. Furthermore, the outlook for mining exports is improving due to increasing coal demand combined with metal mineral export gains.

Imports are projected to slow on the back of moderate investment growth and weaker export performance. Bank Indonesia predicts a decline of import growth in 2019 to 7.1-7.5% due to weaker export performance and moderate non-building investment growth. Furthermore, sliding international commodity prices will affect the expansion plans of export-oriented mining businesses, thus paring back demand for imports of capital goods such as heavy equipment as well as machinery and equipment. In addition, imports of consumer goods are also expected to decline due to the strong rupiah as well as government efforts to promote the use of domestic products. The policy mix instituted to reduce the current account deficit will also begin to rein in the pace of import growth, oil and gas imports in particular, due to B-20 policy and the application of domestic content
requirements (TKDN) targeting government infrastructure projects. Consequently, Bank Indonesia projects import growth to slow to 6.7-7.1% in 2020.

**Economic growth momentum in 2019 and 2020 will continue to build on the secondary and tertiary sectors.** The promising sectoral growth outlook will be driven by resilient domestic demand despite the global economic uncertainty. The secondary sector, namely manufacturing, is expected to maintain solid growth to meet domestic demand, supported by investor optimism in the domestic economic outlook. In the tertiary sector, construction is projected to sustain positive growth in line with ongoing government infrastructure projects. Trade, accommodation and food service activities are also projected to maintain strong growth together with increasing retail sales projections and government efforts to stimulate the tourism sector. Gains are also expected in the communications and transportation sector as the scope of the broadband network is expanded and the digital economy continues to flourish. In contrast, primary sector performance will remain subdued by lower world trade volume and international commodity prices.

**The primary sector is projected to maintain positive yet restrained growth in 2019 and 2020**. Growth of agriculture, livestock, forestry and fishing as well as mining and quarrying will be suppressed by lower international commodity prices. Meanwhile, agriculture, livestock, forestry and fishing performance will also be influenced by weaker export growth for natural resources. Nonetheless, the expected declines may be offset by increasing domestic absorption of CPO production to fuel the government’s B-20 biodiesel program. Sluggish mining and quarrying sector expansion is predicted in line with the results of the latest Consumer Expectation Survey conducted by

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1 The primary sector includes: (i) Agriculture, Livestock, Forestry and Fishing; (ii) Mining and Quarrying.
Bank Indonesia that showed how investors remain twitchy concerning the mining and quarrying sector gains amidst decreasing international commodity prices.

The secondary sector\(^2\), namely the manufacturing industry, is forecasted to regain momentum in 2019 and 2020. Manufacturing industry gains will manifest as investors remain upbeat on the manufacturing outlook together with solid domestic demand. The automotive industry is expected to maintain strong gains in order to meet domestic demand for motor vehicles. In addition, the textiles industry is predicted to accelerate to meet domestic and export demand. On the other hand, industries engaged in processing natural resources will be impaired by weaker demand for exports and sliding international commodity prices. Notwithstanding, solid domestic demand, including refined CPO products for biodiesel production, will sustain manufacturing industry improvements.

Table 4.3  Projected Economic Growth by Sector

<table>
<thead>
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</thead>
<tbody>
<tr>
<td>Agriculture, Livestock, Forestry and Fisheries</td>
<td>3.37</td>
<td>3.87</td>
<td>3.34</td>
<td>4.72</td>
<td>3.66</td>
<td>3.87</td>
<td>3.91</td>
<td>3.8-4.2</td>
<td>3.6-4.0</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>0.95</td>
<td>0.66</td>
<td>1.06</td>
<td>2.65</td>
<td>2.67</td>
<td>2.25</td>
<td>2.16</td>
<td>1.4-1.8</td>
<td>1.7-2.1</td>
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<tr>
<td>Manufacturing Industry;</td>
<td>4.26</td>
<td>4.29</td>
<td>4.60</td>
<td>3.88</td>
<td>4.35</td>
<td>4.25</td>
<td>4.27</td>
<td>4.3-4.7</td>
<td>4.4-4.8</td>
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<tr>
<td>Utilities (Electricity, Gas and Water Supply)*</td>
<td>5.26</td>
<td>1.76</td>
<td>3.33</td>
<td>7.29</td>
<td>5.62</td>
<td>5.64</td>
<td>5.47</td>
<td>5.1-5.5</td>
<td>5.2-5.6</td>
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<td>Construction</td>
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<td>6.80</td>
<td>7.35</td>
<td>5.73</td>
<td>5.79</td>
<td>5.58</td>
<td>6.09</td>
<td>6.1-6.5</td>
<td>6.2-6.6</td>
</tr>
<tr>
<td>Trade, Hotel, and Restaurant**</td>
<td>4.23</td>
<td>4.63</td>
<td>5.02</td>
<td>5.29</td>
<td>5.39</td>
<td>4.68</td>
<td>5.10</td>
<td>5.0-5.4</td>
<td>5.1-5.5</td>
</tr>
<tr>
<td>Transportation, Warehousing, Information and Communication***</td>
<td>8.23</td>
<td>9.12</td>
<td>8.12</td>
<td>6.70</td>
<td>7.01</td>
<td>6.35</td>
<td>7.03</td>
<td>7.1-7.5</td>
<td>7.2-7.6</td>
</tr>
<tr>
<td>Financial Services, Real Estate and Corporate Services****</td>
<td>7.14</td>
<td>5.43</td>
<td>4.63</td>
<td>4.22</td>
<td>4.47</td>
<td>6.13</td>
<td>4.87</td>
<td>4.9-5.3</td>
<td>5.0-5.4</td>
</tr>
<tr>
<td>Other Services*****</td>
<td>4.48</td>
<td>4.37</td>
<td>6.01</td>
<td>6.85</td>
<td>7.68</td>
<td>6.82</td>
<td>6.85</td>
<td>6.6-6.0</td>
<td>6.6-6.0</td>
</tr>
<tr>
<td>GDP</td>
<td>5.03</td>
<td>5.07</td>
<td>5.06</td>
<td>5.27</td>
<td>5.17</td>
<td>5.18</td>
<td>5.17</td>
<td>5.0-5.4</td>
<td>5.1-5.5</td>
</tr>
</tbody>
</table>

*Amalgamation of two economic sectors: (i) Electricity and Gas Procurement; and (ii) Water Supply;
**Amalgamation of two economic sectors: (i) Wholesale and Retail, Car and Motorcycle Repairs; and (ii) Provision of Accommodation, Food and Beverages;
***Amalgamation of two economic sectors: (i) Transportation and Warehousing; and (ii) Information and Communication;
****Amalgamation of three economic sectors: (i) Financial Services; (ii) Real Estate; and (iii) Corporate Services;
*****Amalgamation of four economic sectors: (i) Government Administration, Defence and Compulsory Social Security; (ii) Education Services; (iii) Health Services and Other Activities; and (iv) Other Services;
Source: BPS; ^ Bank Indonesia Projection

2 The secondary sector is the manufacturing industry.
The tertiary sector is projected to expand and become the main locomotive of domestic economic growth momentum in 2019 and 2020. The tertiary sector gains will be driven by the transportation and communications sector, which is predicted to accelerate in line with development of the digital economy and finance, along with government efforts to expand the scope of the broadband network in various regions. Expanding and strengthening the scope of the broadband network will also induce improvements in terms of trade, accommodation and food service activities, namely through retail trade and courier services to support e-commerce. Furthermore, the performance of trade, accommodation and food service activities as well as transportation and communications will also benefit from government programs to develop tourism as part of the policies taken to reduce the current account deficit. Meanwhile, the construction sector will maintain solid growth on the back of ongoing government infrastructure development projects.

In general, the domestic economic outlook is set to improve in 2019 and 2020 despite the ongoing global economic risks dynamics. The salient external challenge faced is the prospect of global economic moderation. Economic growth in Indonesia’s leading trade partners, including the United States and countries in Europe, is expected to flag. Likewise, Indonesia’s trading partners in the developing world, such as China, are predicted to moderate in response to the trade war unfolding with the United States coupled with dwindling domestic demand due to the ongoing financial deleveraging process underway in China. Congruent with global economic moderation, international commodity prices are also projected to decline, including oil. Meanwhile, monetary policy

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3 The tertiary sector includes: (i) Trade, Accommodation and Food Service Activities; (ii) Transportation, Storage, Information and Communications; (iii) Financial Services, Real Estate and Corporate Services; (iv) Other Services; (v) Electricity, Gas and Water Supply; and (vi) Construction.
normalisation in advanced economies will continue at a more gradual pace, which will undermine export growth through the trade channel, while simultaneously triggering a deluge of foreign capital inflows to developing economies, Indonesia included. The main domestic challenge currently facing Indonesia’s economy is how to reduce the current account deficit to a manageable threshold. Existing efforts to accelerate infrastructure development projects along with a range of structural reforms, including deregulation to bolster the investment climate, are expected to strengthen productivity gains moving forward.

**In terms of prices, Bank Indonesia expects to control the Consumer Price Index (CPI) with the target corridor in 2019, namely 3.5%±1%.** The prospect of low and stable inflation will be achieved through controlled core inflation and price pressures on volatile foods (VF) as well as low administered prices (AP) inflation. Furthermore, the inflation outlook is also reinforced by rational inflation expectations anchored to the target range, minimal demand-side pressures and stable rupiah exchange rates. Bank Indonesia has effectively controlled inflationary pressures through policy consistency to achieve the inflation target. In addition, close policy coordination with the Central Government and Regional Administrations through the National Inflation Task Force (TPI) and Regional Inflation Task Forces (TPID) has also alleviated inflationary pressures on volatile foods (VF) and administered prices (AP) in particular, with a focus on four seminal (4K) policies, namely supply availability, price affordability, smooth distribution and effective communication.

Bank Indonesia projects controlled core inflation in 2019 in line with anchored inflation expectations, adequate production capacity in response to public demand and minimal external price pressures. Moderate inflationary pressures
on non-oil and gas import commodities are expected, which will translate into minimal pressures on headline inflation. Domestic demand is predicted to maintain solid growth yet adequate production capacity will alleviate inflationary pressures on core inflation. Furthermore, rational inflation expectations anchored to the target corridor will also help to control core inflation. Inflation over the past few years has tracked a downward trend in line with policy consistency to by Bank Indonesia steer inflation in the target range, which have contributed to anchor inflation expectations to the inflation target.

**Moderate inflationary pressures on volatile foods (VF) are expected in line with intensive government measures to maintain food price stability.** Price pressures on VF inflation will primarily originate from rising international food prices as projected by the World Bank (Commodity Markets Outlook, October 2018). Seeking to control inflationary pressures, however, coordination with the National Inflation Task Force (TPI) and Regional Inflation Task Forces (TPID) will constantly be strengthened with a focus oriented towards the 4K policies, Food Availability and Smooth Distribution in particular, backed by a conducive ecosystem and access to accurate data. Furthermore, various government efforts over the past few years to strengthen connectivity infrastructure, supporting infrastructure for agricultural production as well as food stock management are playing a significant role in terms of the low and stable VF inflation outlook.

**Milder inflationary pressures on administered prices (AP) are predicted in 2019 compared with conditions in the previous year due to government reluctance to adjust strategic tariffs and commodity prices prior to the general election.** Low AP inflation is expected due to the lower global oil price that has alleviated price pressures on special fuels. Consequently,
AP inflation is expected to remain under control considering the comparatively large weight attributed to special fuels and energy prices in the AP inflation basket.
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