CHAPTER 2

Economic Growth

Indonesia maintained its economic recovery momentum in 2018, despite global economic slowdown and increasing global uncertainty. Economic growth accelerated on the back of solid domestic demand, helped to alleviate unemployment, poverty and inequality.

Chapter 2
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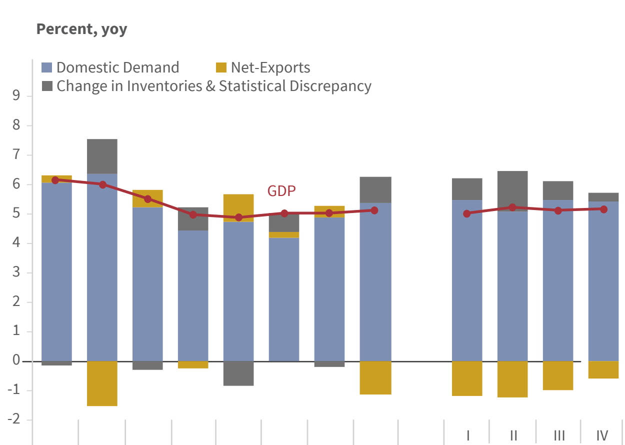
Indonesia's economic recovery momentum continued in 2018. Growth accelerated to 5.17% in 2018 from 5.07% in 2017 (Chart 2.1), with the 2018 level the highest number on record since 2013. In general, Indonesia's domestic economic performance was indicative of a solid national economy, particularly considering the simultaneous downward trend tracked by the international economy as global uncertainty continued to increase.

The faster economic growth in 2018 originated from the policy mix instituted by Bank Indonesia and the Government in response to the global uncertainty. The preemptive, front-loading and ahead-of-the-curve monetary policy response, and the government commitment to sustain the fiscal balance outlook, provided businesses with the economic assurance that they needed in order to expand. This monetary policy response was taken to preserve economic stability, exchange rate stability in particular. Further, Indonesia's accommodative fiscal policy catalyzed economic activity. This policy direction, pursued by both central and regional governments, included strong infrastructure spending, financial market deepening, macroprudential, payment system and structural policies. Policy implementation stimulated business activity and accelerated economic growth.

Chart 2.1. Indonesia's Economic Growth



Source: BPS-Statistics Indonesia, calculated

Indonesia's economic growth sped up in 2018 on domestic demand. Consumption and investment growth accelerated as incomes grew, while infrastructure projects continued and public purchasing power was maintained due to low and stable headline inflation. Several other activities also influenced spending in 2018, including local elections, international events such as the Asian Games and IMF–World Bank Annual Meetings, and preparations for the general election. Meanwhile, net exports declined because export growth slowed in line with slowing global economic growth, but at the same time Indonesia's imports remained high to meet domestic demand.

The secondary and tertiary sectors were the key drivers of economic expansion during 2018. Wholesale and retail trade grew robustly, congruent with solid consumption and import activities. Government expenditure, including the education budget, stimulated growth of government administration services and education services. The construction sector posted strong gains as the Government accelerated completion of several infrastructure projects. Meanwhile, as the main contributor to gross domestic product (GDP), the manufacturing sector continued to grow steadily in 2018.

Economic growth quickened in nearly all regions of the Indonesian archipelago. Growth in Java and Sumatra rose in moderation, while Maluku-Papua (Mapua) posted higher gains. Strong domestic demand was the main driver of economic growth in Java and Sumatra. Solid growth in Java was also propped up by exports as the manufacturing sector gained traction. Meanwhile, higher growth in Mapua stemmed from a significant spike in copper exports. Contrasting the export gains achieved in Mapua, mining exports from Kalimantan and Bali-Nusa Tenggara (Bali-Nusra) declined, which trimmed economic growth in both regions. Flagging economic growth in Sulawesi was attributable to weaker investment.

As Indonesia's economic recovery continued, the country also experienced a better quality of growth. Several prosperity indicators, including unemployment, poverty and inequality, improved in 2018. Positive labor market developments included a decline in open unemployment, accompanied by incremental increase in the participation rate. Poverty decreased in 2018 to its lowest rate since the economic crisis in 1998. Inequality also declined following various government initiatives to maintain public purchasing power and expenditure among low-income earners, as spending by the top 20% of the population decreased.

2.1. Increasing Domestic Demand

Strong domestic demand was the main driver of national economic expansion in 2018. Domestic demand grew 5.62% in 2018, the fastest rate since 2012, driven by household consumption, non-profit institutions serving households (NPISH) and the Government Consumption. In addition, robust growth of gross fixed capital formation (GFCF), supported by both non-construction and construction investment, also contributed to the increasing domestic demand. In turn, strong domestic demand helped offset the external sector's net negative contribution in 2018 – the result of declining exports and high imports (Table 2.1).

Household consumption expanded beyond 5% due to rising incomes. And household income growth remained strong due to low inflation and the positive impact of fiscal stimulus and various large events organized in 2018. The Government boosted fiscal stimulus by increasing the number of beneficiaries under the social assistance program (*bantuan sosial* or *bansos*), and also by increasing the amount that beneficiaries received.[1] At the same time, the Government adjusted energy subsidies to maintain purchasing power among low-income earners. Meanwhile, several large events also contributed to household consumption, including the local elections, Asian Games, IMF–World Bank Annual Meetings and preparations for the general election. Income growth was also maintained, as reflected by increases in the farmers' terms of trade (ToT), real farmworker wages and wages in the informal services sector, which all surpassed 2017 figures (Chart 2.2).

Growing consumer confidence was reflected in solid household consumption. Bank Indonesia's Consumer Confidence Index rose across all spending brackets during the first half of the year (Chart 2.3). Consumer optimism was felt in both components: confidence in both current and in future economic dynamics for the next six months. Consumers were upbeat on current economic conditions due to rising incomes and improving conditions for buying durable goods, coupled with a stable job market. However, consumer confidence retreated modestly in the latter half of 2018 as exchange rate pressures grew.

Table 2.1. Gross Domestic Product by Expenditure

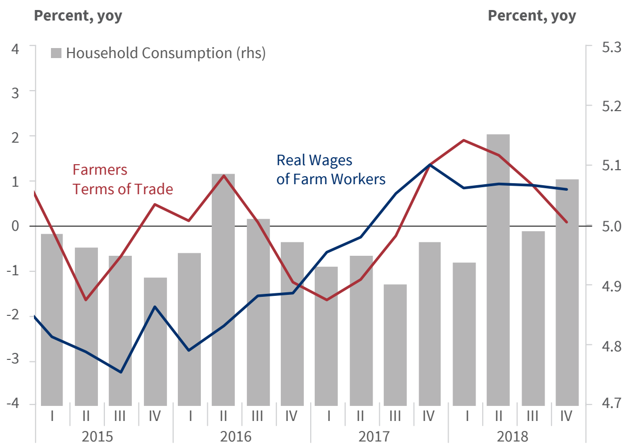
Percent, yoy

Component of GDP	2014	2015	2016	2017	2018				
					I	II	III	IV	TOTAL
Domestic Demand[1)]	**4.62**	**4.94**	**4.39**	**5.13**	**5.86**	**5.44**	**5.81**	**5.41**	**5.62**
Private Consumption	5.28	4.84	5.04	4.98	5.01	5.23	5.07	5.20	5.13
Household Consumption	5.15	4.96	5.01	4.94	4.94	5.16	5.00	5.08	5.05
Non-Profit Institutions Serving Households (NPISH) Consumption	12.19	-0.62	6.64	6.93	8.10	8.75	8.59	10.79	9.08
Government Consumption	1.16	5.31	-0.14	2.13	2.71	5.20	6.27	4.56	4.80
Investment[2)]	**5.66**	**3.00**	**4.99**	**5.69**	**8.38**	**8.35**	**6.53**	**10.93**	**8.52**
Gross Fixed Capital Formation (GFCF)	4.45	5.01	4.47	6.15	7.94	5.85	6.96	6.01	6.67
Construction	5.52	6.11	5.18	6.24	6.16	5.02	5.66	5.02	5.45
Non-Construction	1.58	1.93	2.43	5.90	13.56	8.33	10.73	8.96	10.31
Change in Inventories	0.48	-0.59	0.23	-0.07	0.35	0.98	-0.02	1.53	0.71
Net Exports*	**-0.24**	**0.94**	**0.13**	**0.31**	**-1.16**	**-1.22**	**-0.98**	**-0.58**	**-0.98**
Exports	1.07	-2.12	-1.66	8.91	5.94	7.65	8.08	4.33	6.48
Imports	2.12	-6.25	-2.41	8.06	12.64	15.17	14.02	7.10	12.04
Gross Domestic Product	**5.01**	**4.88**	**5.03**	**5.07**	**5.06**	**5.27**	**5.17**	**5.18**	**5.17**

[1)] Domestic Demand is equal to Consumption Expenditures (Private + Government) and Gross Fixed Capital Formation
[2)] Investment is equal to Gross Fixed Capital Formation and Change in Inventories
*Contribution to GDP
Source: BPS-Statistics Indonesia. calculated

1 For more information on social assistance disbursements (bantuan sosial or bansos) refer to Box 9.1 Social Protection and Regional Transfers for Equitable Economic Growth.

Chart 2.2. Wages of Workers and Farmers Terms of Trade



Source: BPS-Statistics Indonesia, calculated

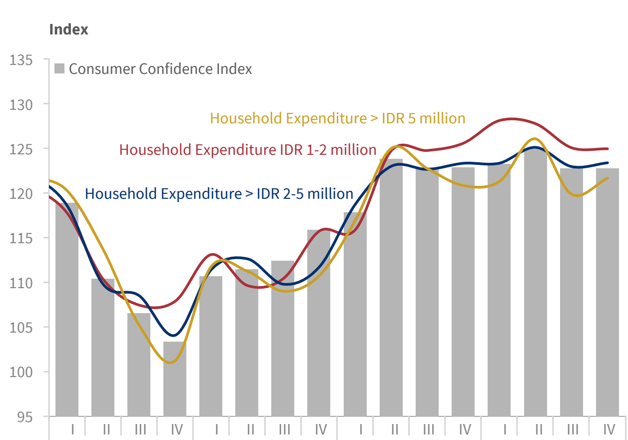
In general, rising incomes and maintained consumer confidence supported non-food consumption gains, with the exception of medical care and education. Incomes rose, supporting the ongoing shift in consumer preferences towards leisure and lifestyle, as reflected by spending related to transport and communication, and restaurants and hotels. This spending accelerated to 5.54% in 2018 from 5.40% in 2017 (Chart 2.4). Several other factors also contributed to the gain, including a nascent middle class, growing access to technology and the demographic bonus of a dominant productive-age population.

Increasing private consumption also stemmed from NPISH. The increase was driven by local elections that were contested simultaneously in 171 constituencies in the first half of the year. At the same time, preparation for the 2019 general election since the beginning of 2018, has also boosted consumption. Therefore, NPISH consumption, which accounts for 2.12% of total private consumption, accelerated significantly to 9.08% in 2018 from 6.93% in 2017.

Government consumption also contributed to increasing domestic demand. Government consumption in 2018 grew by 4.8%, up significantly from 2.13% in the previous year. Expansive government consumption originated from increases in and refinements to employee benefits, and increasing procurement linked to international events and to local elections. Furthermore, current government expenditure policy focuses on maintaining public purchasing power and prioritized short-term stimulus in the form of social assistance disbursements (bansos). Fiscal stimulus from local government – as reflected in the high budget absorption – also shored up economic performance in the reporting period.

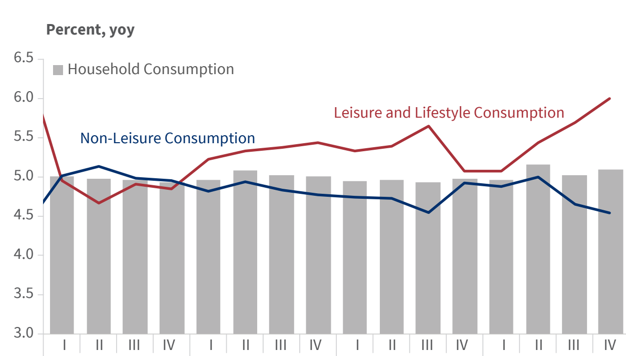
Gross fixed capital formation was another source of economic expansion in 2018, backed by significant growth in non-construction investment. Non-construction investment grew 10.31% in 2018, the fastest pace recorded since 2012, on substantial investment in machinery and equipment (Chart 2.5). Such developments were explained by the government move to accelerate several projects: the electrification infrastructure projects under the massive 35,000MW project, and construction of the national fiber optic broadband telecommunications network. Investment in vehicles also grew strongly, due to expansion in the mining sector. Meanwhile, construction investment grew solidly by 5.45% in 2018, supported by private residential

Chart 2.3. Consumer Confidence Index



Source: Bank Indonesia

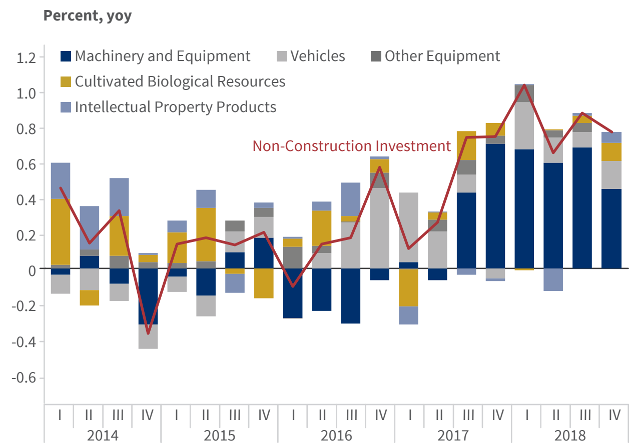
Chart 2.4. Leisure and Non-Leisure Consumption



Note:
Leisure & Lifestyle : transport & communication + restaurant & hotel
Non-Leisure: non-restaurant food & beverages, education & health, clothes, housing & household equipment, others

Source: BPS-Statistics Indonesia, calculated

Chart 2.5. Contribution of Non-Construction Investment Growth to GDP

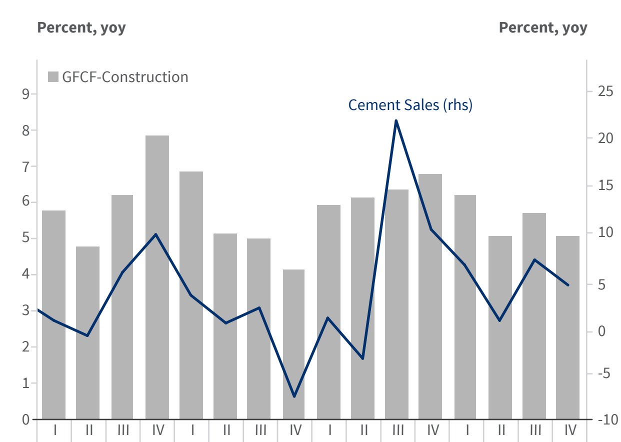


Source: BPS-Statistics Indonesia

projects as reflected by increase in cement consumption (Chart 2.6).

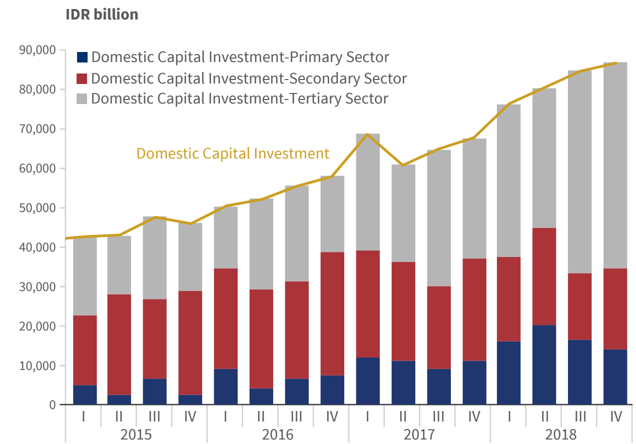
Investment by the corporate sector also increased, as reflected by growth of domestic capital investment. In 2018, domestic capital investment soared 25.25% on gains in the primary and tertiary sectors (Chart 2.7). Domestic capital investment in the primary sector originated from the mining industry, and was triggered by high international prices for mined commodities and a surge in mining exports. In addition, investment in infrastructure also increased in line with the proliferation of technology and the digital economy. Further, ongoing infrastructure project development, including electrification projects, boosted domestic capital investment in the construction and utilities (electricity, gas and water supply) sectors.

Chart 2.6. Cement Sales and Construction Investment



Source: BPS-Statistics Indonesia, Indonesian Cement Association, calculated

Chart 2.7. Domestic Capital Investment Realization



Source: Indonesia Investment Coordinating Board, calculated

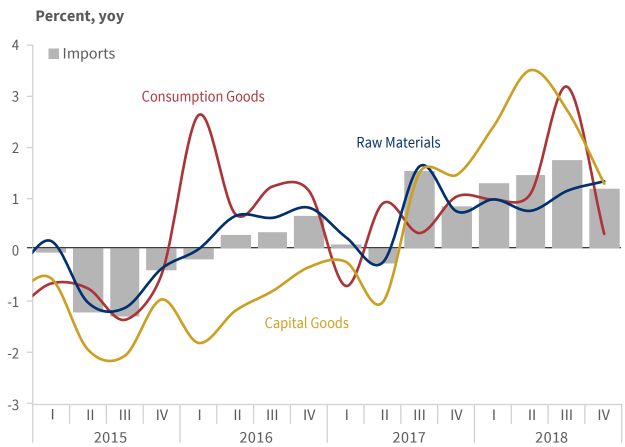
Private investment increased as business confidence strengthened. This was due to Indonesia's ongoing macroeconomic stability and the greater ease of doing business in Indonesia. The business climate continued to improve in 2018, and five rating agencies reaffirmed Indonesia's sovereign rating at investment grade.[2] The World Bank's Ease of Doing Business survey also highlighted improvements in Indonesia including: (i) a reduction in notary costs when starting a business; (ii) a reduction in the time taken to settle a land dispute case in court, thus aiding those needing to register property; and (iii) improved access to credit information by loan-givers, thereby smoothing the process for obtaining loans. Overall, Indonesia's ranking in the Ease of Doing Business survey for 2019 did drop slightly to 72 from 73. In comparison, however, Indonesia ranks higher than India (77) and the Philippines (124), but remains below Malaysia (15), Thailand (27) and Vietnam (69).

Solid growth of domestic demand, in turn, pushed up imports in 2018. Import growth hit 12.04% in 2018, up from 8.06% in 2017. Import growth quickened to meet increasing domestic demand for infrastructure projects, which will enhance economic productivity moving forward.

All categories of goods imports, namely raw materials, capital goods and consumer goods, increased in 2018 (Chart 2.8). Accounting for more than 80% of total non-oil and gas imports, imports of raw materials, such as iron and steel, organic chemicals, animal feed and

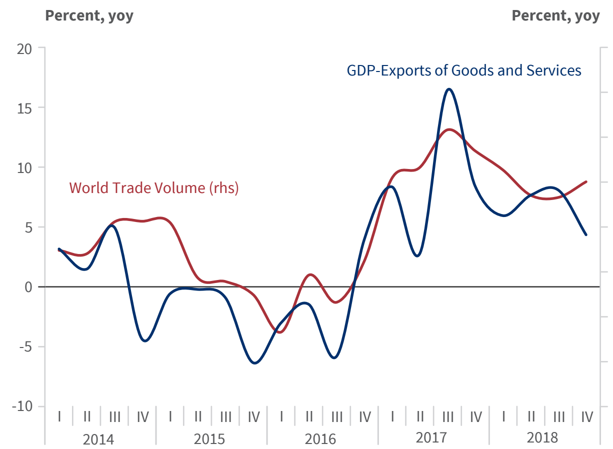
2 The five rating agencies are the Japan Credit Rating Agency, Rating Investment Information, Moody's Investors Service, Standard & Poor's and Fitch Ratings.

Chart 2.8. Non-Oil and Gas Real Imports



Source: Bank Indonesia, calculated

Chart 2.9. Real Exports and World Trade Volume



Source: BPS-Statistics Indonesia, Bloomberg, calculated

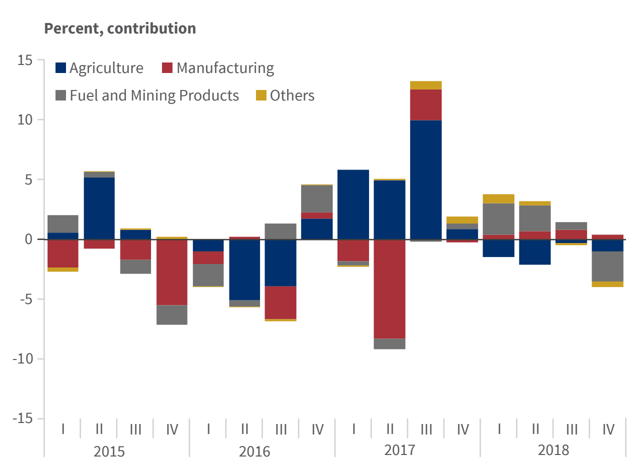
gold, increased to support production activity. These imports of raw materials were also in high demand to meet requirements for spare parts and equipment for capital goods associated with electrification and telecommunications projects. And solid non-construction investment also pushed up imports of capital goods, particularly of machinery and equipment. Similarly, consumer goods imports increased in line with household consumption gains.

On a quarterly basis, rapid import growth tapered off in the fourth quarter of 2018. Imports grew 7.1% in the fourth quarter, halving from 14% in the previous period. The significant decline was attributable to the positive impact of the policy mix instituted by the Government and Bank Indonesia, including a government program to control imports, and to stabilize rupiah exchange rate.

Indonesia's export performance deteriorated in 2018, with global trade sluggish and international commodity prices falling. Exports in 2018 grew lower at 6.48% compared with 8.91% in 2017. Global economic slowdown, coupled with the impact of restrained world trade volume and lower international commodity prices, ultimately undermined Indonesia's exports (Chart 2.9). Breaking it down by destination, exports were hampered by weaker demand from Indonesia's main trading partners, including China, Japan and South Korea. But Indonesian exports to the United States accelerated in line with US economic gains in 2018.

The slump in export growth was primarily due to weaker non-oil and gas exports, particularly crude palm oil (CPO) (Chart 2.10). CPO exports contracted during the first half of 2018 but regained momentum in the latter half of the year as international prices rose, and on India's decision to lower import duties. Stronger manufacturing exports were the key driver of the export growth in 2018. Export growth was also supported by exports of chemicals, iron and steel, which contain a high import content thus diminishing the positive impact on net exports. Mining exports also rebounded; coal and metal ore exports increased, despite the ongoing export contraction affecting refined oil and gas products. The export surge of metal ore was possibly due to increasing production and a higher export quota for concentrates. Likewise, coal exports increased as prices rose during the first three quarters of 2018.

Chart 2.10. Non-Oil and Gas Real Exports

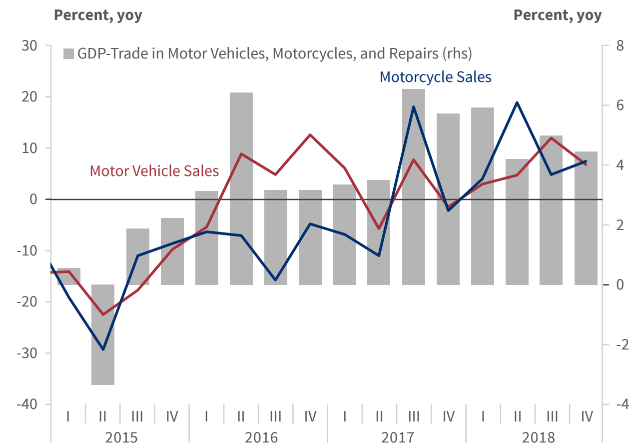


Source: Bank Indonesia

2.2. Secondary and Tertiary Sectors Drive Growth

By sector, economic expansion in 2018 was primarily driven by the secondary and tertiary sectors. Congruent with solid domestic demand, wholesale and retail trade accelerated to 4.97% in 2018 from 4.46% in 2017 (Table 2.2). Furthermore, increasing domestic demand stimulated intermediation activity among wholesalers, and enabled them to create value added in the trade sector. International events, such as the Asian Games and IMF–World Bank Annual Meetings also boosted trade. Consequently, the Retail Sales Index rose, with growth accelerating to 3.74% in 2018 from 2.89% in 2017. Automotive sales also rallied, which fed through to wholesale and retail trade of motor vehicles, motorcycles, and repairs (Chart 2.11).

Chart 2.11. Motor Vehicle and Motorcycle Sales



Source: BPS-Statistics Indonesia, Gaikindo, AISI

Proliferation of the digital economy has been a boon to wholesale and retail trade, information and communications, and transport and storage. Rapid expansion of the digital economy in Indonesia was reflected in the online sales growth of three marketplaces which have recorded growth in excess of 100% (Chart 2.12). The nascent digital economy has not only stimulated business activities, including online businesses, but has also absorbed informal workers. Furthermore, the rapid growth of online businesses has also increased internet data usage. The transport and communications sector has also benefited from the development of online businesses in terms of advertising spending, courier services and ride hailing, and logistics and warehousing services.

As the dominant contributor to GDP, manufacturing industry performance has remained stable due to improvements achieved in several subsectors. Manufacturing sector growth stood at 4.27% in 2018, relatively stable compared with 4.29% in 2017. By

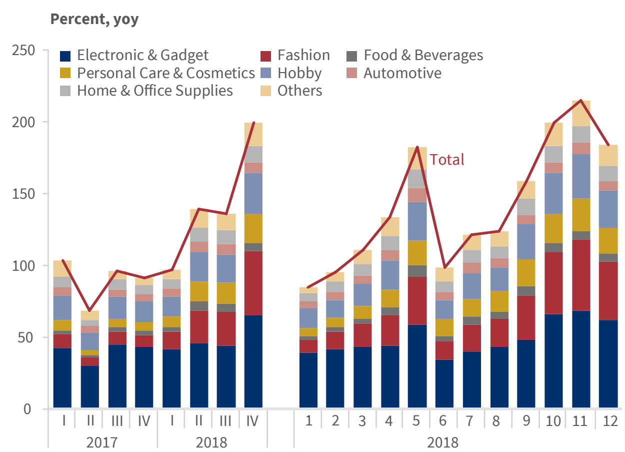
Table 2.2. Gross Domestic Product by Industrial Origin

Percent, yoy

Component of GDP	2014	2015	2016	2017	2018				
					I	II	III	IV	TOTAL
Agriculture, Forestry, and Fishery	4.24	3.75	3.36	3.87	3.34	4.72	3.66	3.87	3.91
Mining and Quarrying	0.43	-3.42	0.95	0.66	1.06	2.65	2.67	2.25	2.16
Manufacturing	4.64	4.33	4.26	4.29	4.60	3.88	4.35	4.25	4.27
Electricity	5.90	0.90	5.39	1.54	3.31	7.56	5.58	5.46	5.47
Water Supply, Sewerage, Waste Management and Remediation Activities	5.24	7.07	3.60	4.60	3.65	3.94	6.20	7.92	5.46
Construction	6.97	6.36	5.22	6.80	7.35	5.73	5.79	5.58	6.09
Wholesale and Retail Trade, Repair of Motor Vehicles and Motorcycles	5.18	2.54	4.03	4.46	4.99	5.22	5.28	4.39	4.97
Transport and Storage	7.36	6.71	7.45	8.49	8.56	8.70	5.65	5.34	7.01
Accommodation and Food Services	5.77	4.31	5.17	5.39	5.17	5.60	5.91	5.95	5.66
Information and Communication	10.12	9.70	8.88	9.63	7.76	5.11	8.14	7.17	7.04
Financial Services	4.68	8.58	8.90	5.47	4.23	3.06	3.14	6.27	4.17
Real Estate	5.00	4.11	4.69	3.66	3.19	3.07	3.82	4.24	3.58
Business Services	9.81	7.69	7.36	8.44	8.04	8.89	8.67	8.94	8.64
Public Administration, Defense and Compulsory Social Security	2.38	4.63	3.19	2.06	5.79	7.20	7.93	7.13	7.02
Education Services	5.47	7.33	3.80	3.70	4.84	5.04	6.60	4.97	5.36
Health Services and Other Activities	7.96	6.69	5.15	6.84	6.06	7.07	7.54	7.80	7.13
Other Services	8.93	8.08	8.02	8.73	8.43	9.22	9.19	9.08	8.99
Taxes Less Subsidies on Products	5.08	32.55	19.20	13.33	9.13	13.90	8.40	10.83	10.58
Gross Domestic Product	**5.01**	**4.88**	**5.03**	**5.07**	**5.06**	**5.27**	**5.17**	**5.18**	**5.17**

Source: BPS-Statistics Indonesia

Chart 2.12. Online Sales



Source: Bank Indonesia

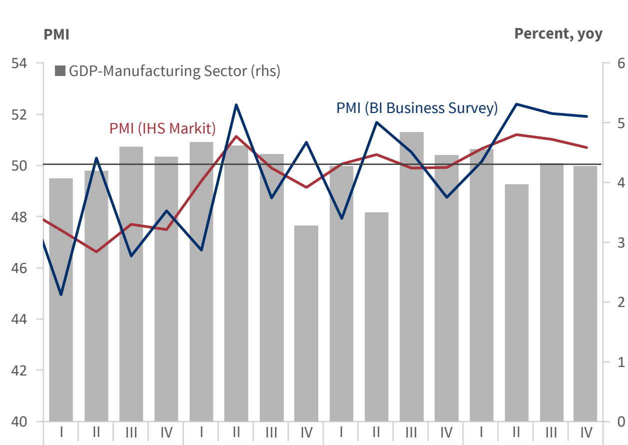
subsector, the main drivers of growth were the textiles and clothing industries, rubber, plastics and plastic items, and tobacco. Exports of clothing and rubber also rose. A number of subsectors grew only moderately, including the food and beverages industry, CPO, and the furniture industry. In contrast, two subsectors experienced contractions: the chemical, pharmaceutical and traditional medicaments industry, and fabricated metal products, computers, electronics, optical products and electrical equipment. The performance of such subsectors demands attention in order to maintain and expand the role of the manufacturing industry (Box 2.1 Stimulating Export-Oriented Manufacturing).

Stable manufacturing growth was confirmed by the Purchasing Managers Index (PMI) and by corporate financial indicators. The PMI remained in an expansionary phase throughout 2018 (Chart 2.13), and corporates posted rising profitability and productivity. Increases in the return on assets and return on equity substantiate the corporate profitability gains (Chart 2.14). Furthermore, the increases in profitability were accompanied by improving productivity, as evidenced by asset turnover and inventory turnover (Chart 2.15). By sector, the profitability gains were led by manufacturing, mining and trade (Table 2.3).

The construction sector maintained solid growth due to infrastructure projects, which largely moved into the completion phase of development in 2018. The construction sector posted strong 6.09% growth in 2018, albeit down slightly from 6.8% in 2017. In 2018, a total of 32 national strategic projects (PSN) were completed worth approximately USD23.7 billion. In addition to the completed projects, another 32 projects were partially operating or had moved into the completion phase. This includes the 35,000MW electrification program and programs to develop economic equity. The acceleration of infrastructure projects will increase activity in the property sector, residential property in particular.

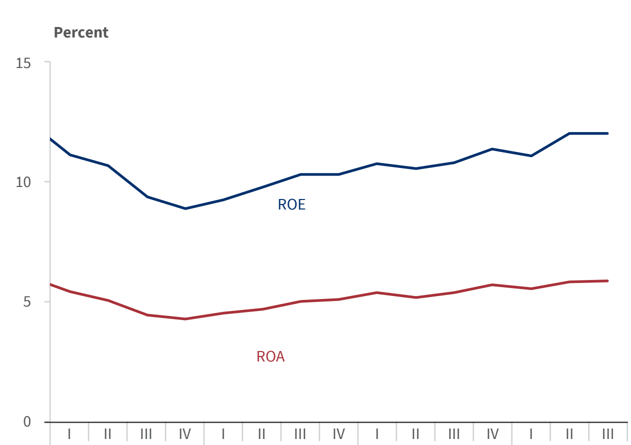
Improvements in the services sector – government administration, education services and financial services – also contributed to domestic economic gains. In 2018, income in the government administration subsector grew 7.02%, up significantly from 2.06% in 2017 in line with aggressive government expenditure in the second and third quarters. Education services income posted 5.36% growth in 2018, quickening from 3.70% in 2017, due to an increasing number of students, annual bonus allowances, teacher allowances and disbursements under the School

Chart 2.13. Purchasing Managers Index and Manufacturing Sector Growth



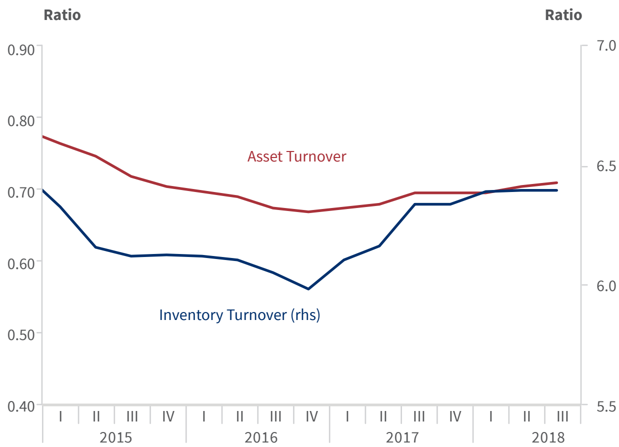
Source: BPS-Statistics Indonesia, IHS Markit, Bank Indonesia

Chart 2.14. Nonfinancial Corporate Profitability



Source: Financial Reports of Corporates in the Indonesia Stock Exchange, Bloomberg, calculated

Chart 2.15. Nonfinancial Corporate Productivity

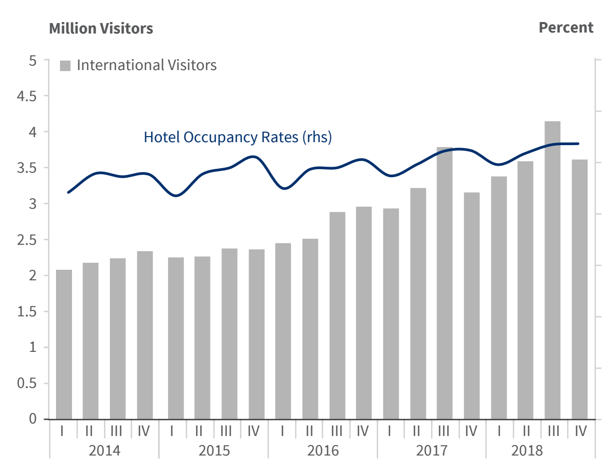


Source: Financial Reports of Corporates in the Indonesia Stock Exchange, Bloomberg, calculated

Operational Assistance (Bantuan Operasional Sekolah or BOS) program, a system of direct grants for schools.

The role of tourism is expanding, and Indonesia has experienced growth in accommodation and food services (restaurants, catering, deliveries), as the preferences of upper-middle class consumers shift towards leisure and lifestyle. This shift has stimulated domestic tourism and increased consumption at restaurants, reflected in growth of food service activities. In addition, international events such as the Asian Games and IMF–World Bank Annual Meetings, hosted by Indonesia in the second half of 2018, also boosted the sector. The expansion of tourism can also be seen in an increase in the number of international visitors to Indonesia, and higher occupancy rates at star-rated hotels (Chart 2.16).

Chart 2.16. International Visitors and Hotel Occupancy Rates



Source: BPS-Statistics Indonesia

The primary sector also contributed to economic expansion in 2018. The mining and quarrying sector grew 2.16% in 2018, up significantly from 0.66% in 2017. The gains were attributed to increasing production of metal ore – metal prices rose in the first half of the year – and a larger export quota for concentrates. Meanwhile, agriculture, forestry and fishing – the third largest contributor to GDP with a 12.54% share of the total – grew 3.91% in 2018, up modestly from 3.87% in 2017.

2.3. Growth Accelerated in Most Regions

Java, Sumatra and Mapua were the main drivers of higher national economic growth. In 2018, the economies of Java and Sumatra posted stronger economic growth: Java's growth accelerated to 5.72% and Sumatra's to 4.54% (Figure 2.1). Domestic demand was the key driver in both regions. Java's economy was also buoyed by manufacturing exports that increased as the manufacturing industry gained traction. Meanwhile, economic growth in Mapua hit 6.99% in 2018, due to a surge in mining exports.

Defying the upward trend, however, national economic growth was restrained by economic moderation in Sulawesi, Bali and Nusa Tenggara (Bali-Nusra) and Kalimantan. In 2018, the Sumatra's economy decelerated to 6.65% and Bali-Nusra to 2.68%. The slowdown in Sumatra was attributable to weaker investment

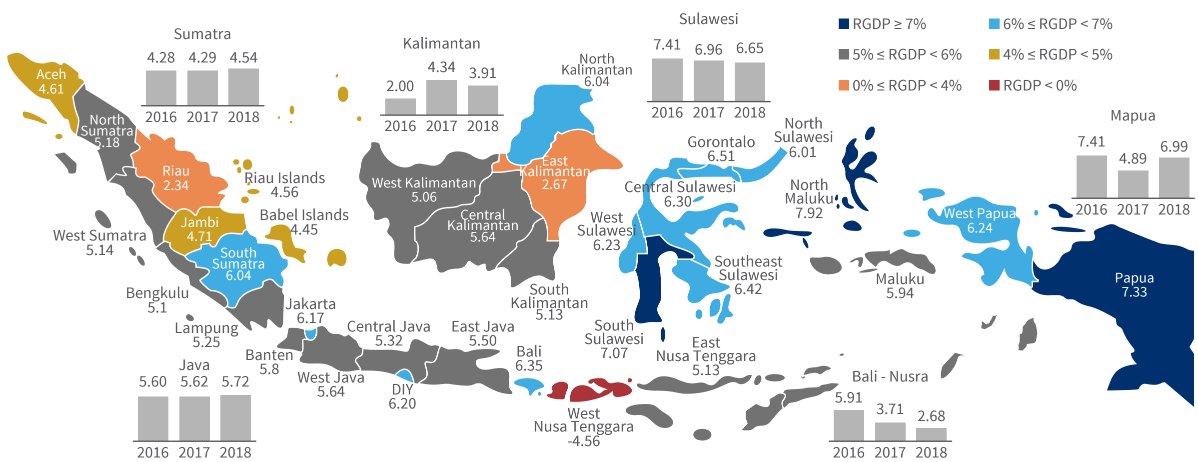
Table 2.3. Corporate Financial Performance

Sectors	ROA (percent)		ROE (percent)		Asset Turnover		Inventory Turnover	
	2017	2018	2017	2018	2017	2018	2017	2018
Agriculture	5.19	3.01	10.09	5.89	0.65	0.61	7.73	6.52
Basic and Chemical Industry	3.29	5.36	6.45	10.87	0.69	0.68	5.36	5.54
Consumer Goods Industry	12.66	12.98	21.44	22.05	1.29	1.30	5.07	5.26
Infrastructure, Utilities and Transport	4.26	3.66	10.02	8.88	0.55	0.54	63.00	54.34
Basic Industry	5.20	5.70	11.28	12.58	0.76	0.76	8.23	7.52
Mining	5.74	8.81	10.73	16.71	0.54	0.73	16.37	18.26
Property and Real Estate	4.59	4.21	9.55	9.25	0.34	0.33	1.99	2.12
Trade, Services and Investment	4.70	5.18	8.58	9.72	0.97	1.01	7.90	7.50
Aggregate	**5.40**	**5.85**	**10.80**	**12.04**	**0.70**	**0.71**	**6.40**	**6.46**

Data as of Q3-2017 and Q3-2018 (332 Corporates)

Source: Financial Reports of Corporates in the Indonesia Stock Exchange, Bloomberg, calculated

Figure 2.1. Regional Economic Growth in 2018



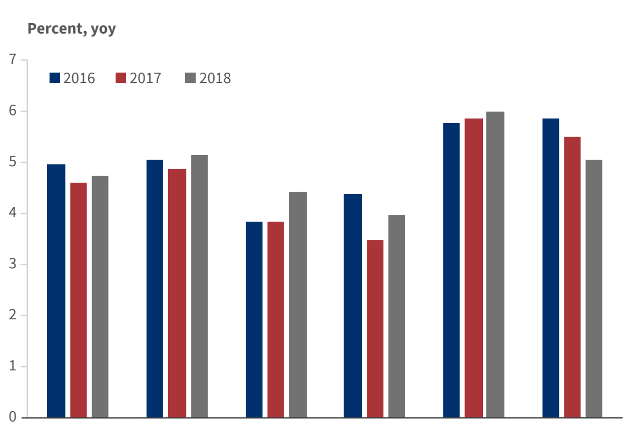
Source: BPS-Statistics Indonesia, calculated

after several large-scale infrastructure projects were completed. And a 4.56% economic contraction recorded in West Nusa Tenggara held back growth in the Bali-Nusra region. The contraction was caused by declining mining exports and the devastating impact of a large earthquake in the latter half of the year. Furthermore, sluggish mining exports also precipitated an economic downturn in Kalimantan: growth fell to 3.91% in 2018.

Solid household consumption triggered economic gains in some regions. Increase in household consumption attributed to incomes rose, low inflation, and low-income earners targeted fiscal stimulus (Chart 2.17). The Asian Games, which took place in the third quarter of 2018, also catalyzed household consumption in Java and propped up household consumption in Sumatra. In addition, consumption in Bali-Nusra was boosted by the IMF–World Bank Annual Meetings held in Bali. Finally, local elections contested simultaneously in 17 provinces, 115 regencies and 39 cities in the first semester of 2018 helped drive consumption by NPISH in nearly all regions (Chart 2.18).

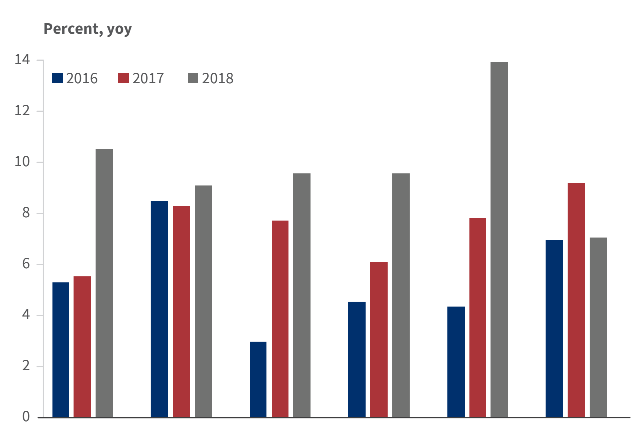
Government consumption further stimulated regional economic growth, as government expenditure increased in most regions, excluding Bali-Nusra and Mapua (Chart 2.19). Government consumption in 2018 was boosted by local elections and government commitments to provide short-term stimulus in order to maintain public purchasing power. To this end, the Government achieved optimal and equitable distribution of regional transfers and Village Fund disbursements. Furthermore, the Asian Games and IMF–World Bank Annual Meetings also buoyed

Chart 2.17. Household Consumption by Region



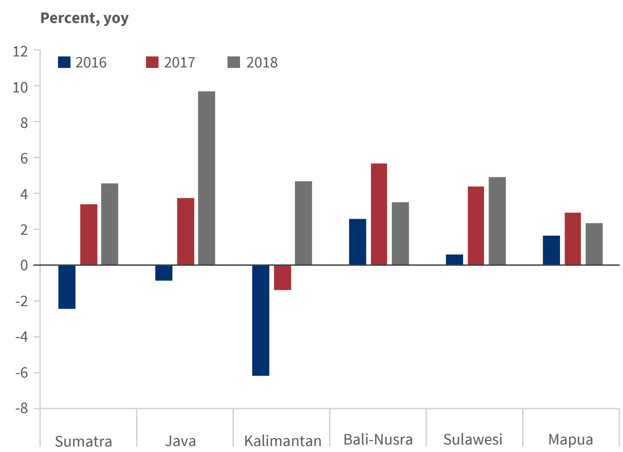
Source: BPS-Statistics Indonesia, calculated

Chart 2.18. NPISH Consumption by Region



Source: BPS-Statistics Indonesia, calculated

Chart 2.19. Government Consumption by Region

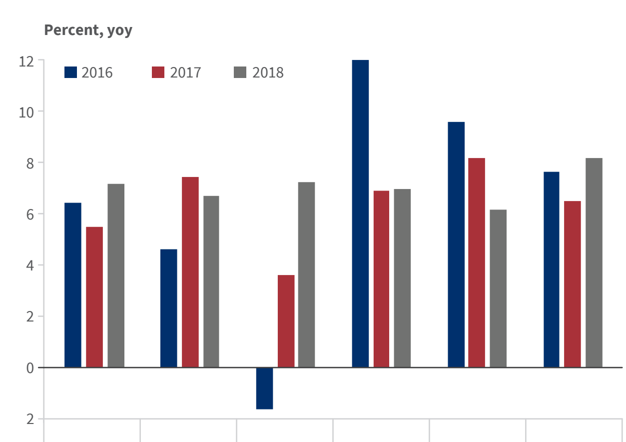


Source: BPS-Statistics Indonesia, calculated

local government consumption, particularly in Sumatra and Java.

Faster investment growth in most regions was another driver of regional economic growth (Chart 2.20). Investment growth was driven by non-construction investment, which accelerated in all regions. Non-construction investment growth in Sumatra stemmed from the expedited completion of projects linked to the Asian Games, which were held in South Sumatra. In Eastern Indonesia, investment in the mining sector and in construction equipment to support strategic infrastructure development by the Government also boosted non-construction investment. In Java, non-construction investment originated from greater investment in machinery and equipment to increase

Chart 2.20. GFCF by Region



Source: BPS-Statistics Indonesia, calculated

production of transport equipment industry, among other items.

The implementation of NSP by the Government, regional connectivity and energy projects in particular, spurred investment in nearly all regions. In Java, for example, the Government continued work on a light rail train network in Jakarta, on Patimban Port in West Java and the New Yogyakarta International Airport in Yogyakarta. In Sumatra, various sections of the trans-Sumatra toll road were built on schedule, and the Government sped up construction of supporting infrastructure for the Asian Games, which were held in South Sumatra. In Eastern Indonesia, construction of the trans-Sulawesi and trans-Papua highways, and supporting infrastructure for the sea tollway, remained on target. In Java and Sulawesi, however, the completion of several infrastructure projects in 2018 led to slightly slower investment growth in the region. These projects are: five toll road sections in Java – totaling 331km earmarked for operation in 2018 – plus a mass rapid transit (MRT) network in Jakarta, a dam in Gorontalo and renewable energy infrastructure in South Sulawesi.

Increasing domestic demand pushed up import growth in all regions. This import growth was driven by consumer goods, particularly in Java. But shipments of raw materials and capital goods for the construction of new factories in industrial regions also contributed to Java's higher imports. Furthermore, imports of raw materials and capital goods into Eastern Indonesia also accelerated, as demand from industry rose for inputs into exported products.

In Sumatra, import growth was pushed up by demand for capital goods used to expedite infrastructure projects, including Asian Games venues and toll road construction.

Slower national export growth was due primarily to export contractions from Kalimantan and Bali-Nusra, and weaker exports from Sumatra. The fall in exports from Kalimantan was due to declining exports of CPO, which were hit by sliding international commodity prices, and coal, after demand from China dwindled. In Bali-Nusra, exports were dragged down by reduced exports of copper concentrate from West Nusa Tenggara. Meanwhile, lower global CPO prices pushed down export volumes from Sumatra, but further declines were offset by increasing exports of coal and chemical products.

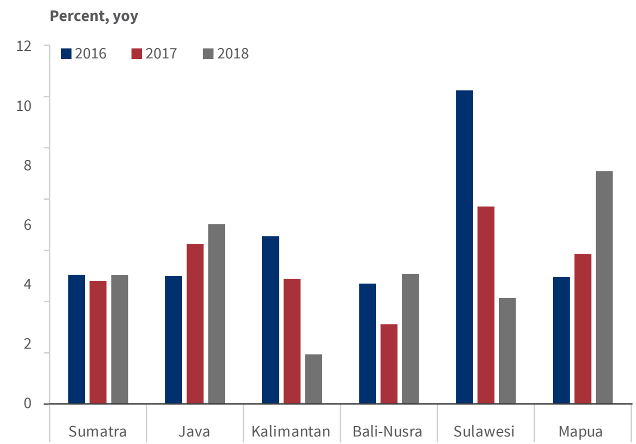
Solid export performance in Java, Sulawesi and Mapua prevented deeper national export declines. Export growth from Java was led by consignments of textiles and textile products, cement, machinery and transport equipment. Exports of transport equipment continued to grow strongly as Vietnam reopened access to its automotive market. Indonesia also diversified variants of exported cars, and exports of trains to Bangladesh and the Philippines increased. Meanwhile, Mapua's exports were pushed up by copper concentrate exports from Papua, and exports of liquefied natural gas (LNG) from West Papua. And Central Sulawesi began exporting iron and steel in 2018, which lifted Sulawesi's overall exports.

By sector, increasing trade bolstered the economy in most regions; this increase was due to solid domestic demand and import growth. Wholesale and retail trade in nearly all regions, except Bali-Nusra, was boosted, attributed to Indonesia's hosting of international events and by rising incomes. International events such as the Asian Games in Jakarta, Bandung and Palembang generated additional wholesale and retail trade in Java and Sumatra. And while the IMF–World Bank Annual Meetings sparked wholesale and retail trade in the province of Bali, a deadly earthquake undermined consumption in West Nusa Tenggara. This cut wholesale and retail trade for Bali-Nusra as a whole.

Ongoing government infrastructure projects played a significant role in maintaining a solid construction sector in all regions. In Sumatra, for example, construction sector performance was supported by the completion of toll roads in North and South Sumatra, by ongoing construction of Kuala Tanjung Port, and supporting infrastructure for the Asian Games. Similarly, construction in Java was buoyed by the completion of several toll roads and other connectivity infrastructure. In Eastern Indonesia, construction sector performance primarily improved in Sulawesi, driven by the accelerated development of PSN, including a dam in Gorontalo and a wind farm in South Sulawesi.

Manufacturing industry performance picked up in Java, Sumatra and parts of Eastern Indonesia (Chart 2.21). In Java, increasing demand nurtured manufacturing industry performance, and resulted in an increase in production capacity. This capacity increase was achieved in the textiles, clothing, plastics and automotive industries through the construction of new factories and via additional production machinery. Manufacturing in Sumatra also improved on implementation of the policy

Chart 2.21. Manufacturing Sector by Region

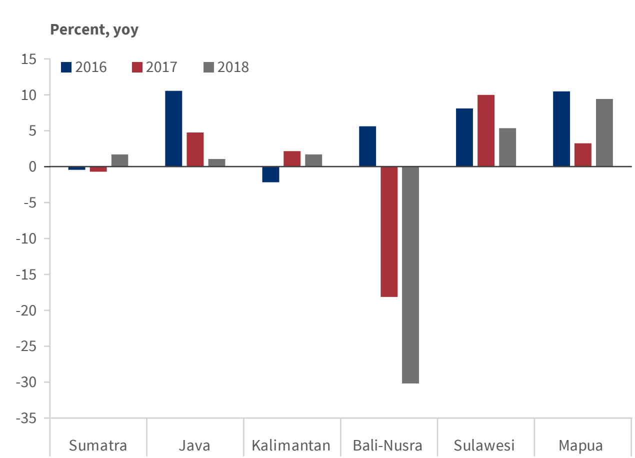


Source: BPS-Statistics Indonesia, calculated

on B20 biodiesel – a fuel containing 20% biofuel, in this case CPO, which is produced intensively in Sumatra. Meanwhile, the manufacturing industry in Mapua posted significant gains, led by gas refining (LNG), processed foods (fish products) and cement in West Papua.

Mining and quarrying performance flourished in Mapua and Sumatra, which boosted the performance of the national mining and quarrying sector (Chart 2.22). Faster mining and quarrying sector growth in Mapua stemmed from extensions to special mining permits (IUPK) and larger export quotas for major mining firms in Papua. Higher international copper prices also helped to elevate sectoral performance, during the first half of 2018 in particular. Production from Sumatra's mining and quarrying sector also rose on domestic demand for coal

Chart 2.22. Mining and Quarrying Sector by Region



Source: BPS-Statistics Indonesia, calculated

to fuel steam power plants. However, coal production declined in Kalimantan as demand waned from key trading partners.

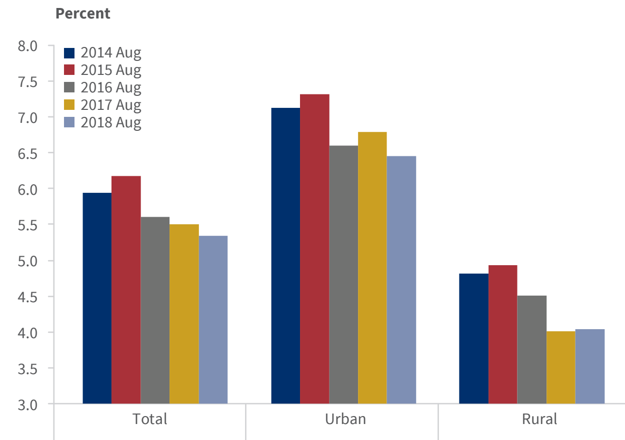
The national oil and gas subsector contracted in 2018, as oil production in Sumatra and Kalimantan decreased, outweighing increasing gas production in Mapua. A natural decline of reserves at some fields in Riau and East Kalimantan, the main oil-producing provinces of Indonesia, pushed lower the total oil lifting volume. Such decline subdued overall economic performance in both provinces; Riau grew 2.34% and East Kalimantan 2.67% in 2018. On the other hand, gas prices have risen since the beginning of 2018 and this, coupled with the return to production of West Papua plants following maintenance in 2017, effectively increased LNG lifting in West Papua. LNG production was also pushed up by growing demand from Japan and South Korea, which offset lower demand from China. The sectoral gains helped push West Papua's economic growth to 6.24%.

Growth in the agricultural, forestry and fishing sector moderated in nearly all regions, except Kalimantan. In Java, food crops were ravaged by drought in some regions, and this hit East Java the hardest. In Sumatra, the plantation crops sector declined – lower production and lower prices – due to falling agricultural commodity prices for CPO, rubber and coffee. And in the case of palm oil, production was reined in by Permen LHK No. 7/2017, a regulation issued by the Ministry of Environment and Forestry to protect peatlands. In Sulawesi, plantation crop performance declined due to lower cacao production as a result of a natural decline as plants age. And fishing in Mapua moderated in 2018 as a corollary of a moratorium on new fishing vessels and a deficient existing fishing fleet. In contrast, agriculture thrived in Kalimantan due to plantation crops, as the amount of land devoted to palm oil increased, as did productivity.

2.4. Growth Quality Improved

Faster economic growth in 2018 supported incremental decrease in unemployment, poverty and inequality. In August 2018, open unemployment fell to its lowest level in ten years. It came in at 5.34% in August 2018, down from 5.5% in August 2017 (Chart 2.23). Furthermore, the number of labor force increased due to the demographic bonus – a dominant working-age population – currently enjoyed by Indonesia. The participation rate increased

Chart 2.23. Open Unemployment Rate

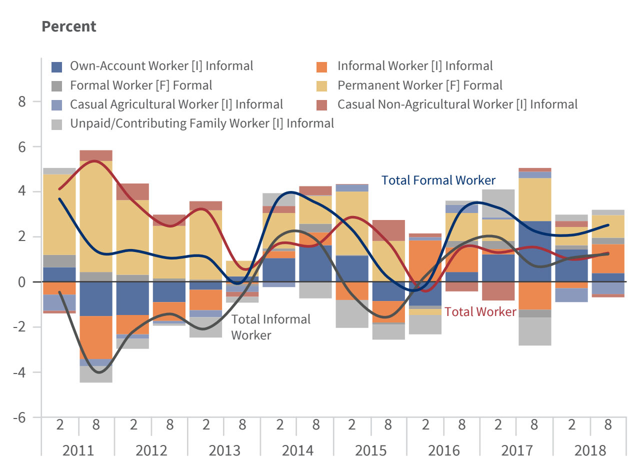


Source: BPS-Statistics Indonesia, calculated

to 67.26% in August 2018 from 66.67% in August 2017, as more homemakers and school-leavers entered the labor force.

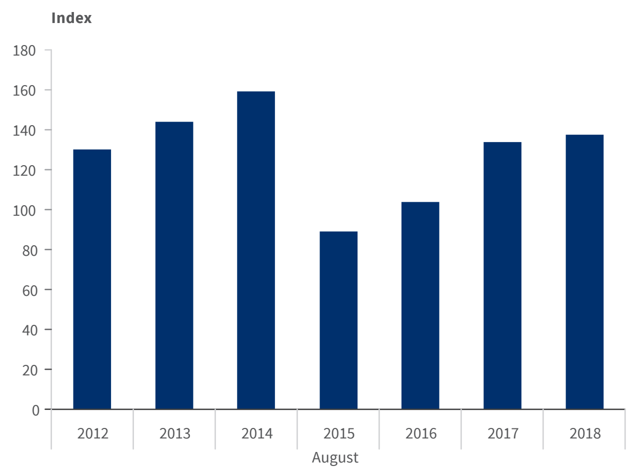
The absorption of labor into the formal sector increased in 2018. Greater uptake of formal workers stemmed from an increase in employer assisted by permanent worker/paid worker, which grew at a faster rate than increases in other formal workers categories (Chart 2.24). Indeed, data published in August 2018 showed that the number of permanent employees had increased. Increasing absorption of formal workers was also highlighted by other indicators, including job vacancies online and in print media. Indonesia's job vacancy index climbed to 137.8 in August 2018 from 134.1 in August 2017 (Chart 2.25). Additionally, the number of workers in informal

Chart 2.24. Contribution of Labor Growth by Employment Status



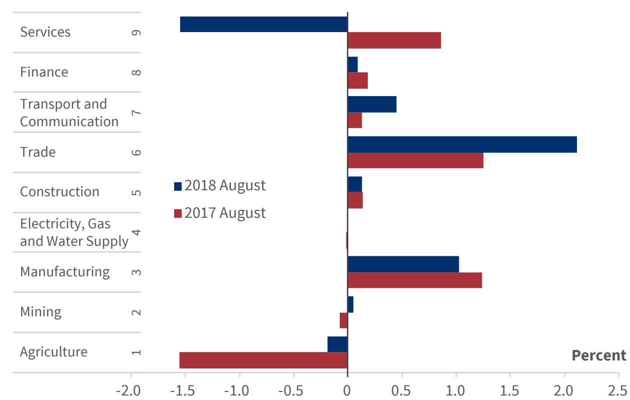
Source: BPS-Statistics Indonesia, calculated

Chart 2.25. Online Job Vacancy Indicator



Source: Bank Indonesia

Chart 2.26. Contribution of Labor Growth by Sector



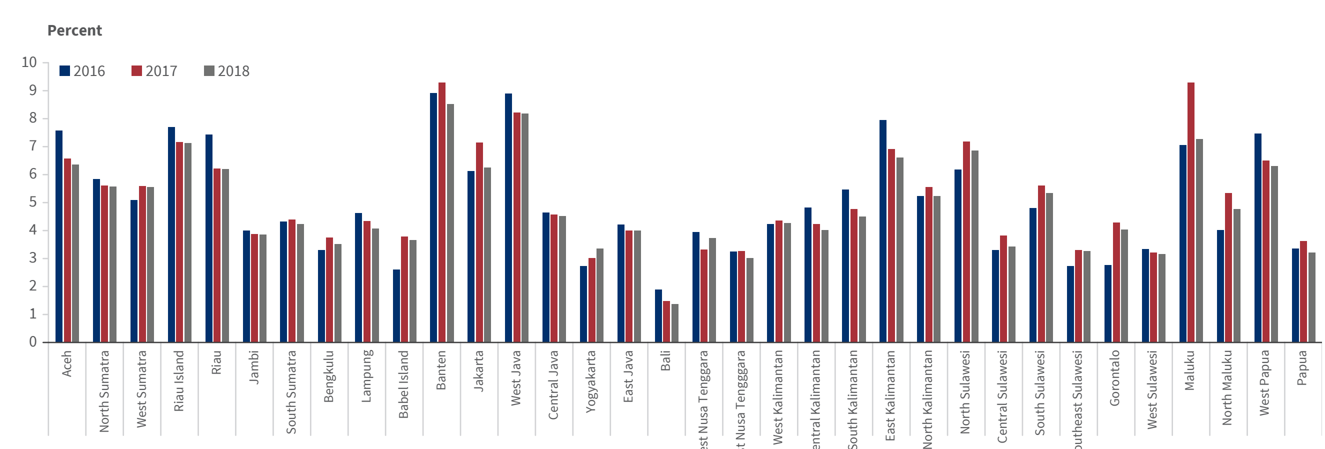
Source: BPS-Statistics Indonesia, calculated

sector has continued to decline, although still dominated the labor force with 56.84% share.

By sector, the trade, accommodation and food services sector, and transport and communications absorbed more labor in 2018, as did the labor-intensive manufacturing sector. Labor absorption in trade, accommodation and food services grew 9.09% in August 2018 versus August 2017, meaning the sector remained the main contributor to labor market expansion (Chart 2.26). Such developments followed the improving trade performance. Labor absorption into the transport and communications sector also posted strong growth of 9.38% in August 2018, and was a major contributor after trade, accommodation and food service activities, and manufacturing. Labor absorption in manufacturing remained high as the sector expanded; in August 2018, Indonesia posted 7.29% year-on-year growth of total manpower employed in manufacturing. Aggregating the sectors, the labor market was still dominated by the non-tradeable sector, with an increasing gap between labor in the non-tradeable and tradeable sectors.

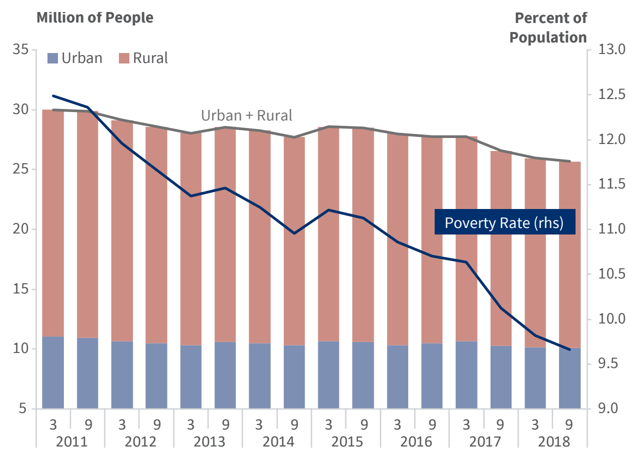
Broad-based labor market improvements were achieved in various regions. In total, 32 provinces recorded lower open unemployment in August 2018, compared with just 16 provinces in August 2017 (Chart 2.27). All provinces in Sumatra, Kalimantan, Sulawesi and Mapua recorded declines in open unemployment, most significantly in Maluku where the rate fell to 7.27% in August 2018 from 9.29% in August 2017. Strong declines in open unemployment were confirmed in Jakarta and Banten,

Chart 2.27. Open Unemployment Rate by Province



Note: Data as of August on each period
Source: BPS-Statistics Indonesia, calculated

Chart 2.28. Poverty Rate



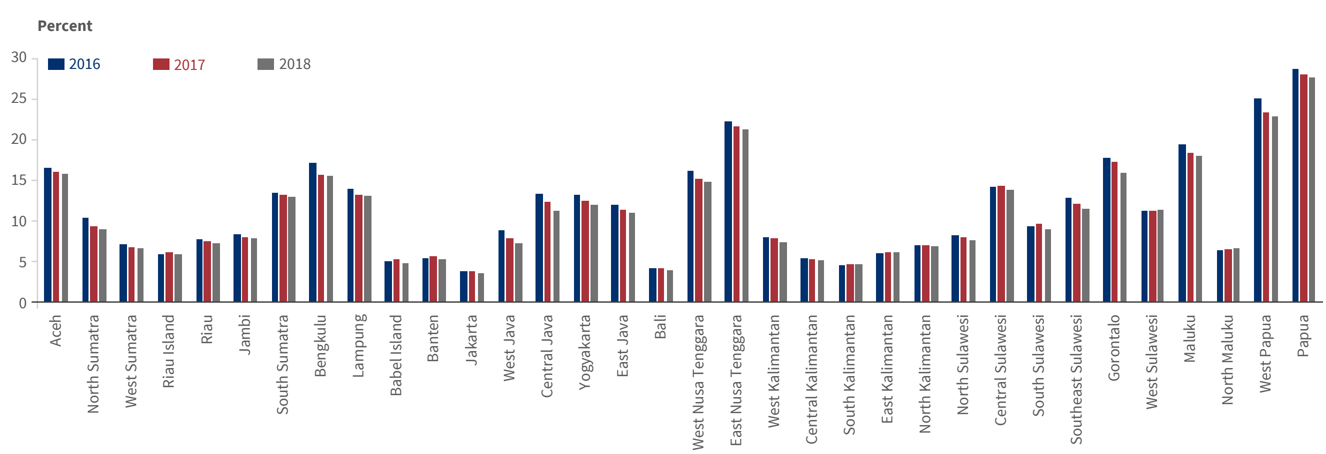
Source: BPS-Statistics Indonesia

as the primary industrial base. Jakarta decelerated to 6.24% in 2018 from 7.15% in 2017, and Banten to 8.52% from 9.28%. In Java, all provinces posted lower open unemployment, except Yogyakarta. Labor market dynamics improved in line with an increase of secondary and tertiary sector activities in some regions in response to solid domestic demand. In contrast, West Nusa Tenggara experienced an increase in open unemployment – to 3.72% in 2018 from 3.32% in 2017 – as the local economy contracted.

Poverty also decreased significantly in 2018. Indonesia's relative poverty figure stood at 9.82% in March 2018 and 9.66% in September 2018, the lowest reading since the economic crisis in 1998 (Chart 2.28).[3] Fundamentally, declining poverty since 2015 has been attributable to increasing domestic economic growth momentum, accompanied by lower unemployment and controlled inflation. Indonesia's significant poverty improvements have also been supported by an expansion of government social protection programs. Urban and rural poverty rates have declined, with a faster pace of decline recorded in rural areas. Such developments were consistent with improvements in real farmworker wages and farmers' ToT in September 2018, when compared with September 2017. Furthermore, rural prosperity has also been built by the Village Fund program, which was designed to finance labor-intensive development.

Lower poverty rates were achieved in nearly all of Indonesia's provinces in 2018; 32 out of a total of 34 achieved a lower poverty rate in 2018 versus 2017, while in 2017 just 25 provinces achieved a lower poverty rate compared with 2016 (Chart 2.29). In addition, the five provinces with the highest poverty levels in 2017 – Papua, West Papua, East Nusa Tenggara, Maluku and Gorontalo – posted improvements. Moreover, all provinces in Sumatra, Java, Kalimantan and Bali-Nusra recorded lower poverty rates. Such accomplishments were inextricably linked to the Government's commitment to stimulate balanced and equitable local economic development by improving connectivity and expanding the social assistance programs (bansos).

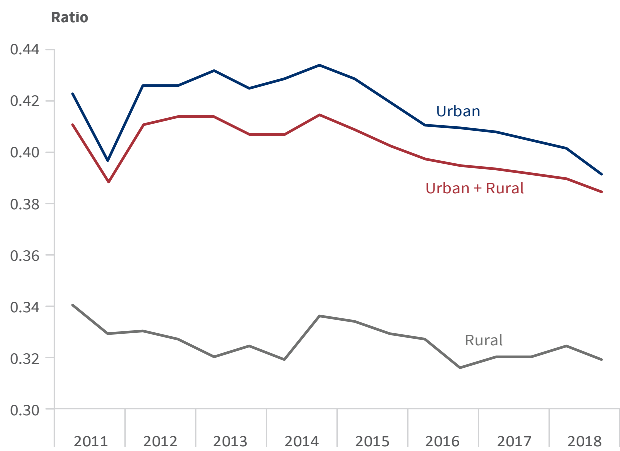
Chart 2.29. Poverty Rate by Province



Source: BPS-Statistics Indonesia, calculated

3 In absolute terms, 25.67 million Indonesians were categorized as poor in September 2018 (9.66%), down 910,000 compared with September 2017.

Chart 2.30. Gini Ratio



Source: BPS-Statistics Indonesia, calculated

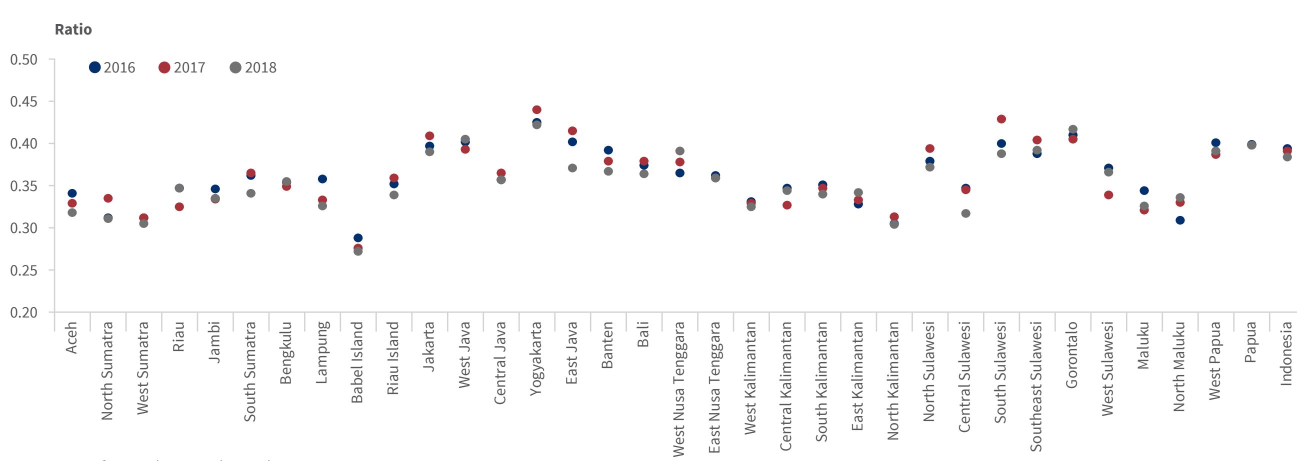
Indonesia's poverty gap index and poverty severity index both improved in 2018. The poverty gap index stood at 1.63 in September 2018 (versus 1.79 in September 2017) and 1.71 in March 2018 (1.83 in March 2017), with September being the lowest level recorded in the last five years. Similarly, the poverty severity index declined to 0.41 in September 2018 from 0.46 in September 2017.[4] The improvements stemmed from lower spending by the top 20% of the population and increasing spending by the middle 40% and bottom 40%. The increase in spending per capita among the middle 40% of the population was congruent with greater prosperity among the nascent and flourishing middle class.

The poverty gap index and poverty severity index declined in several regions, particularly in Eastern Indonesia. In September 2018, the poverty gap index decreased in 25 provinces, while the poverty severity index decreased in 23 provinces. Such conditions mark a significant improvement on the previous year, when the poverty gap index improved in just 15 provinces, and 13 provinces improved their poverty severity index. The largest gains were recorded in areas with a poverty index gap above the national average, predominantly in Eastern Indonesia, such as Papua, Gorontalo, and West Papua.

Income inequality, or economic inequality, has also declined, as shown by a declining Gini ratio. A lower Gini ratio points to less inequality in both rural and urban areas. Indonesia's Gini ratio was 0.384 in September 2018 and 0.389 in March 2018, improving from 0.391 in September 2017 and 0.393 in March 2017 (Chart 2.30). Nevertheless, urban areas have tended to consistently dominate the improvements since March 2015. In addition, lower inequality was also reflected in the growth of spending per capita among the lowest 40% of the population, which outpaced spending growth by the middle 40% and top 20%, in line with rising incomes among low-income earners, boosted by social assistance disbursements (bansos).

Improving inequality was also corroborated by declines in the Gini ratio in some dominant urban regions. A total of 20 provinces achieved a lower Gini ratio in September

Chart 2.31. Gini Ratio by Province



Note: Data as of September on each period
Source: BPS-Statistics Indonesia, calculated

4 The poverty severity index is a measure of the spending disparity of the poor. The poverty gap index is a measure of the depth of poverty: the poverty gap index (P1) measures the average extent to which poor individuals fall below the poverty line. A higher index indicates more severe poverty.

2018 compared with 18 provinces one year earlier. The deepest declines were reported in the provinces of East Java, South Sulawesi, Central Sulawesi, North Sumatra, and South Sumatra, each with significant urban areas (Chart 2.31). Furthermore, nearly all of Java's provinces recorded a lower Gini ratio, with declines ranging from 0.008 to 0.044 basis points. The Gini ratio in West Java, however, increased slightly. And in Mapua nearly all provinces recorded a higher Gini ratio, albeit by a moderate increment of between 0.004 and 0.006 basis points.

Box 2.1.

Stimulating Export-Oriented Manufacturing

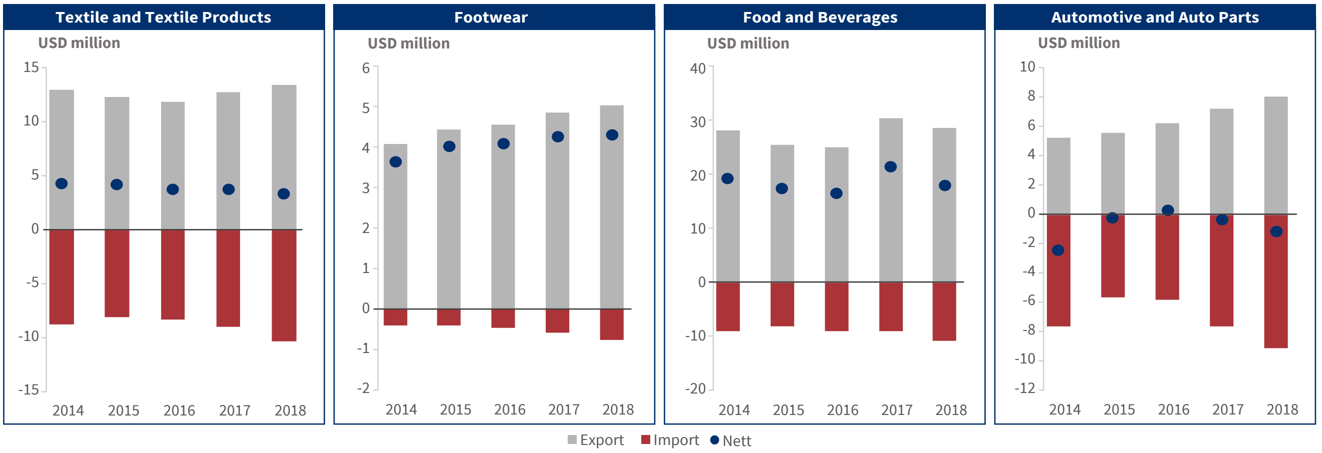
Indonesia's manufacturing industry is a key driver of national economic growth momentum. Manufacturing contributes greatly to GDP, to exports, to labor absorption, and to Indonesia's competitiveness.[1] In addition, the manufacturing industry plays a critical role in strengthening Indonesia's trade balance, which is dominated by natural-resource-based commodities. Consequently, the manufacturing industry should refocus on export-oriented industries in order to help improve current account performance.

Indonesia could increase manufacturing exports from the textile, footwear, and food and beverage sectors, and from automotive industries (Chart 1).[2] These four industries are targeted by the Government in its National Industrial Development Master Plan for 2015 to 2035. But efforts to accelerate industrial development must also be accompanied by efforts to overcome challenges. Further rigorous analysis using trade competitiveness diagnostics revealed that these four strategic industries face production, institutional and market access challenges.[3]

In the textiles and textile products sector, the overarching challenges are production factors, namely a high dependence on imported raw materials, limited availability of skilled staff, and weak investment. In footwear, the main challenge is restricted access to diverse markets. The food and beverages industry suffers from low productivity, because it is slow to adopt technology and is highly dependent on imported raw materials. The automotive sector faces a different challenge: a domestic production incentive scheme that is not aligned with prevailing global demand.

Efforts to expand the role of the manufacturing industry require a focused policy strategy. An integrated strategy should focus on three interrelated aspects both centrally and regionally (Figure 1). First, improve the obstacles to production to overcome productivity gaps. This relates closely to efforts to boost domestic industrial capacity to ensure that it is on par with other countries in the region. To this end, Indonesia must provide adequate supporting infrastructure for industry development, and needs to provide sufficient numbers of appropriately educated and trained staff to meet industry demand. In addition, upstream industries should be developed to strengthen links among domestic industries in the local value chain.

Chart 1. Export-Oriented Manufacturing Industry Priority Sector



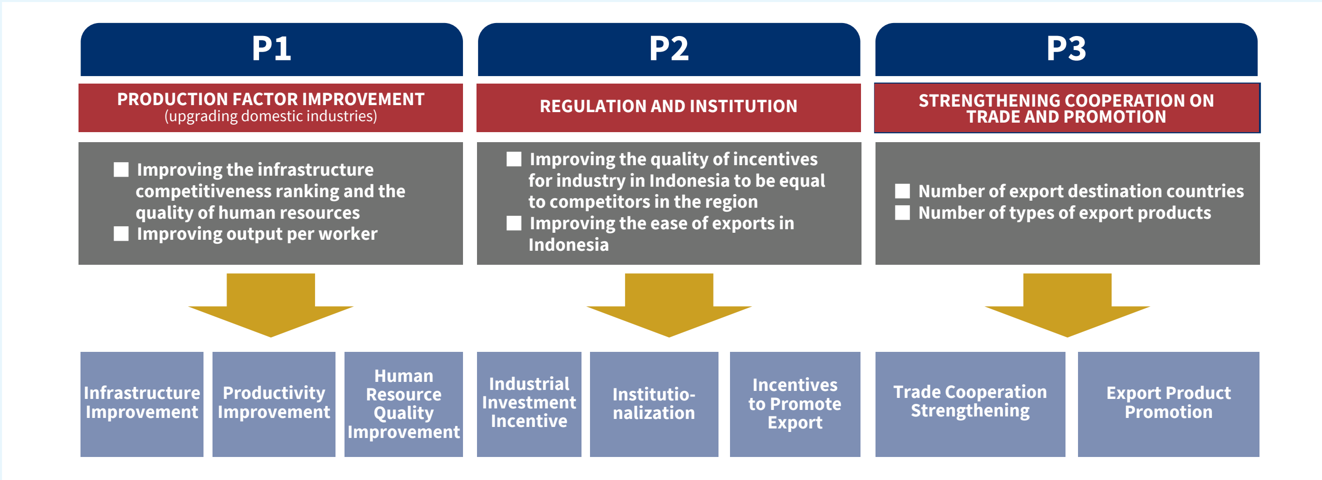
Source: Bank Indonesia

1 In 2018, the manufacturing industry accounted for 21% of GDP and 48% of exports, while absorbing 14.7% of total labor (August 2018).

2 According to the results of the Growth Strategy review (Bank Indonesia, 2018).

3 Trade competitiveness diagnostics is an analysis tool used to measure export constraints, among other things. Reis, J. G. and Farole, T., Trade competitiveness diagnostic toolkit, (World Bank, 2012).

Figure 1. Industrial Development Strategy



Second, regulatory and institutional factors should be reviewed in order to overcome regulatory deficiency, including related to export incentives. Deregulation, and incentives to attract investors to export-oriented industries, will improve the business climate. This strategy also aims to ensure institutional and regulatory backing for industry development, with the aim of becoming competitive globally.

Third, trade cooperation, promotion and marketing should be strengthened in order to expand and diversify market access. To this end, Indonesia will expand its free trade agreements and bilateral cooperation. Furthermore, Indonesia will also try to diversify its export products. To do this, and to strengthen the sector, Indonesia must develop its market analysis and intelligence; this will enhance understanding of global demand trends.

The competitiveness of the manufacturing industry will also be increased if Indonesia is able to optimize the opportunities afforded by Industry 4.0, which include increased connectivity and interaction, primarily through information technology and communications. Industry 4.0 comprises five technological elements: the Internet of things, artificial intelligence, human-machine interface, robotic and sensor technology, and 3D printing. Optimizing the opportunities will increase economic productivity and competitiveness in Indonesia. To that end, the Government launched its roadmap Making Indonesia 4.0 on 4 April 2018. The roadmap lays out an expanded role for manufacturing in catalyzing national economic growth, and targets Indonesia moving into the top ten largest and strongest global economies by 2030. The Government is incrementally revitalizing the manufacturing industry in order to expand the role of exports. It is achieving this through technological and innovative change to increase productivity and competitiveness. A solid contribution from exports would strengthen the economy and improve the labor absorption.