THE INDONESIAN ECONOMY AFTER THE GLOBAL FINANCIAL CRISIS

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The effects of the Global Financial Crisis on the Southeast Asian economies

- Collapse of Lehman Brothers, an American investment bank, on 15 September 2008 sparked massive sell-offs on stock exchanges and foreign exchange markets around the world (flight to safety)
- After fall of Lehman Brothers, East Asian economies all confronted by acceleration in financial turbulence that had started in mid-2007.
- Fortunately, Indonesia, like the other Southeast Asian countries (Malaysia, Thailand, and the Philippines) withstood the financial turbulence well, because they were better prepared for this shock after their experience with the Asian Financial Crisis (AFC) of 1997/98
- Over past 15 years these Southeast Asian countries, including Indonesia, have strengthened their external balances, reduced government debt to ensure fiscal sustainability, reduced government debt, and improved banking supervision

The effects of the Global Financial Crisis on the Indonesian economy, 1

- In fourth quarter of 2008 disruption in the global economy hit Indonesian economy through the trade channel as export-oriented industries contracted sharply, with adverse effects on employment
- Strong growth of non-oil and gas exports ended abruptly in fourth quarter of 2008, as did imports
- Drop in exports most evident in Indonesia’s exports to China, which recorded largest contraction: 22.1 per cent
- Exports to Japan, US, EU, and the other ASEAN countries also declined
- Because Indonesia’s merchandise exports are still dominated by primary exports, Indonesia’s agricultural sector also adversely affected

The effects of the Global Financial Crisis on the Indonesian economy, 2

- In general, Indonesia only suffered relatively mild effects from the GFC.
- Together with China and India, Indonesia was one of only three Asian countries recording positive growth after GFC, thus ensuring steady decline in the incidence of absolute poverty
- Indonesia’s economy grew at 4 per cent in the year to June 2009, displaying more resilience than some of its neighbours
- Although there was mild decline in economic growth compared with preceding seven years, this decline was lower than global average, and that of Indonesia’s neighbours, including Malaysia, Singapore, and Thailand, which are much more export-oriented than Indonesia, because Indonesia’s exports to GDP ratio is only 17 per cent
- Indonesia’s economic performance during GFC also much better than Asian Financial Crisis

The effects of the Global Financial Crisis on the Indonesian economy, 3

- Three reasons why Indonesia's vulnerability to effects of GFC was less than that of its East Asian neighbours:
- 1. Indonesia's relatively low share of manufactures in its total exports;
- 2. Relatively low share of inter-regional trade in total trade;
- 3. Relatively low degree of export-led growth

The effects of the Global Financial Crisis on the Indonesian economy, 4

- Compared with its Southeast Asian neighbours, share of Indonesia's manufactured share was relatively low in 2005-2006, only 12.5 per cent of its GDP, compared with Singapore's 156.8 per cent; Malaysia's 75.4 per cent, the Philippines's 34.7 per cent; and Thailand's 47.7 per cent.
- On the other hand, Indonesia's share of primary exports in its total merchandise exports was the highest at 43.7 per cent, compared with Malaysia's 17.8 per cent; the Philippines' 7.3 per cent; and Thailand's 11.7 per cent.

The effects of the Global Financial Crisis on the Indonesian economy, 5

- First **reason why Indonesia's relatively low dependence on manufactured exports made it less vulnerable to the GFC was that manufactured exports have much higher income elasticities than primary exports. Hence, demand for manufactured exports falls sharply during recessions in the major export markets, as was the case with Indonesia's**
- **Second reason why Indonesia was not hit hard by the GFC, compared to the other Southeast Asian countries, was that it had (and still has not) participated in a major way in the regional product fragmentation trade, that is the cross-border dispersion of parts and components production within vertically integrated production processes. The reason for this was its ambiguous attitude towards FDI.**
- **Third reason why Indonesia was not as vulnerable to the transmission of the GFC was that Indonesia's economic growth was not as export-led as its Southeast Asian neighbours.**
- **Fourth reason why Indonesia was less vulnerable to transmission of the GFC was that it was not largely exposed (relative to its GDP) to banks in the US, the EU, and Japan, and had avoided large credit exposures to sub-prime loans and securities in the US**
- **Hence, Indonesia's relatively better performance was to some extent more by default than by design**

Tackling the adverse effects of the Global Financial Crisis

- **Fiscal stimulus measures, including tax cuts, skillful monetary policy, and direct cash transfers to the poor, significantly contributed to softening the adverse effects of the crisis.**
- **The parliamentary elections in April 2009 and the presidential elections in July 2009 provided further economic stimulus. Election-related spending by parliamentary candidates on potential voters also contributed to household incomes, particularly of the poor. These stimulus measures helped maintain employment in the formal sector and the proportion of casual workers in the labour force**
- **Indonesia's relatively slow economic growth (although now slightly faster than that of India)), may last a little longer than people expect, because of the slowdown in the advanced countries, the US, the EU, and Japan, which used to be the main drivers of world economic growth.**
- **Even China, which because of its rapid economic growth has recently emerged as the world' s main driver of world economic growth, is slowing down (recording only 7.4 per cent during the second quarter of 2012) because of the slowdown of its exports to the US and the EU.**

Sustaining stable economic growth

- With the global economy growing more slowly, global trade and capital have grown slower, but FDI to Indonesia, including to its manufacturing sector, has recently increased in response to Indonesia’s resilience to the weakness in the global economy.
- Amidst a still certain outlook, Indonesia will have to prepare itself for the adverse effects of potential consequences of China’s slowdown and the declines in prices of its major export commodities (palm oil, coal, a.o.), and the possibility of renewed turbulence in in financial and commodity markets
- The Indonesian economy is estimated to grow at 6.1 per cent in 2012 according to the World Bank, and to grow at 6.3 per cent in 2013, while the OECD report of 2012 on the Indonesian economy estimates that Indonesia’s GDP will grow at 6.0 per cent in 2012 and at 6.2 per cent in 2013.
- The Indonesian government’s projections are more optimistic with GDP estimated to grow at 6.5 per cent in 2012, and at 6.8 per cent in 2013.
- The World Bank and OECD estimates appears the most plausible.

Prospects for rapid and sustainable growth, 1

- Worrisome feature of vIndonesia’s economic growth after Asian Financial Crisis (AFC) of 1997/98 is that non-tradable sectors have been growing much faster than tradable sectors, incl. manufacturing sector. While during Suharto era manufacturing sector was growing at double digits, after AFC manufacturing sector has only been growing at low single digit, although recently it has been growing at higher single digit.
- Resumption of rapid manufacturing growth is crucial, as it was major source of export revenues and major engine of growth after end of oil boom era in 1982. Rapid manufacturing growth also very important for generating employment and reducing poverty, as China’s recent experience has indicated. However, primary exports, particularly CPO (crude palm oil) and coal, are important sources of export revenues, as in the Dutch colonial era.
- Relying too much on primary exports deflects attention from building internationally competitive manufacturing sector (‘natural resource curse’?)
- Resource exploitation, which generates resource rents, has led to rent-seeking activities and corruption if resource rents not adequately captured by resource rent taxes (RRTs)

Prospects for rapid and sustainable growth, 2

- **Inadequate capture of resource rents has led to over-exploitation of Indonesia's precious tropical hardwood forests (part. the diptero carpa species) because of weak governance**
- **Deforestation, peatland degradation, and forest fires (adversely affecting health of population in Sumatra, Kalimantan, Malaysia, and Singapore, have made Indonesia third largest emitter of greenhouse gases in the world after China and the US Indonesia will experience significant losses because of climate change, incl. increased frequency in extreme weather events; heavy rains leading to big floods (because of deforestation); harmful effects on agriculture, fishery, and forestry**
- **Development of internationally competitive manufacturing sector requires strengthening and upgrading labour-intensive industries; developing skill-intensive industries in line with broader and more skilled human reasource base; developing efficient supporting industries (missing middle), and efficient resource-processing industries, if necessary with foreign investors. Tackling dilapidated physical infrastructure crucial to attracting more FDI and DDI**

Selected economic and social indicators for Indonesia, 2000– 2011 (OECD report, September 2012)

	2000	2005	2008	2009	2011
Population (total million)	206.3	220.9	227.6	234.4	241.0
Absolute poverty (%)	19.1	16.0	15.4	14.2	12.5
Gini coefficient	-	0.36	0.35	0.37	0.41
Informal employment (% of employment)		69.5	69.6	69.3	62.2
GDP growth rate (real, per cent)	4.9	5.7	6.0	4.6	6.5
Supply (% of nominal GDP):					
Agriculture	15.6	13.1	14.5	15.3	14.7
Mining	12.1	11.1	10.9	10.6	11.9
Manufacturing	27.7	27.4	27.8	26.4	24.3
Services	44.6 6	48.3	46.8	47.8	49.1
Public finance: Nomional balance	-1.2	- 0.5	-- 0.1	- 1.6	- 1.1
Current account balance((% of GDP)	4.9	0.1	0.0	1.9	0.2