The Indonesian Economy and Global Financial Crisis—Resilience of a Consumption-led, Balanced, and Open Economy

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Indonesia was hit by the global financial crisis in 2008. However unemployment and the decline in production did not seriously damage the Indonesian economy. This was because the increase of informal sector employment exceeded the unemployment created by the global financial crisis, and private consumption was strong.

Causality testing and calculation using a simultaneous-equation model based on the three-stage least squares (3SLS) method with data for 1978-2008 show that Indonesian growth was substantially brought about by private consumption. Private consumption led to increased investment, and investment led to increased exports. This export growth led to increase of consumption, which increased investment again. This is one of the macroeconomic linkages in Indonesia. The Indonesian characteristic of consumption-led growth and consumption-led investment was the main reason why Indonesia was not influenced seriously by the global financial crisis in 2008.

The Indonesian government's somewhat laissez-faire policy does not seem to be favorable to industrialization. Many of the industries that gained competitiveness are primary industries that have advantage of tropical environment. However, manufacturing industries are also found, such as transport equipment, road vehicles, and general industrial machinery which have advantage of domestic market,

Among the industries losing competitiveness, many are conventional labor-intensive industries that have a low level of investment after the Asian economic crisis in 1997. Weak bank lending is one of the reasons why there is little investment by these industries. Partly because of the low level of investment since 1997, savings are higher than investment in Indonesia. The level of investment is increasing recently, although bank lending remains low. This gap seems to be filled by informal financing including self-financing.

The recent trend for the Indonesian international account is of being open and balanced. Balanced positions are found both for the current account and the capital account. There is a lot of inflow of goods and capital, and also a lot of outflow of goods and capital, both for foreign direct investment and portfolio investment.

This open and balanced foreign account matches with the balance between saving and investment. This structure does not force the government to spend more, so the government budget deficit is quite low, and also this structure does not force a significant currency appreciation.