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Indonesia's economic plans

MARKET INTELLIGENCE REPORT

Report

President Prabowo Subianto has an ambitious economic goal for Indonesia, the largest economy in Southeast Asia, to hit 8% annual economic growth by 2029. To achieve this, the Indonesian Government is prioritising increased investment, expanded exports, and a continuation of the "downstreaming" policy implemented during the previous Jokowi Administration. The Government is confident it can reach its goals.

Indonesia faces structural headwinds

There are obstacles standing in the way, however, including the decrease in size of Indonesia's middle class - from just under 60 million people in 2019 to approximately 48 million in 2024. This decline is accompanied by sluggish real wage growth, which currently stands at only 1.46%. While the statistics for the proportion of people living in poverty and the "aspiring middle class" have improved somewhat, overall consumer confidence is weak.

The large informal sector in Indonesia remains a critical challenge to productivity. Approximately 60% of the workforce is employed in the informal economy, which often operates outside of regulatory frameworks and provides fewer opportunities for skills development and innovation, limiting the potential for improving labour productivity which remains well below that of regional peers Thailand and Malaysia.

Indonesia's low Human Development Index (HDI) highlights the gap in human capital development. The country sits behind other ASEAN nations and the global average in some key indicators such as education and healthcare. Indonesia's PISA scores, which measure the quality of education, show significant gaps in students' performance.

Meanwhile, Indonesia's Incremental Capital-Output Ratio (ICOR), which measures the efficiency of investment in generating economic output, is currently at 6.33 – significantly worse than the regional average. This inefficiency in capital utilisation means that investments are not translating into the desired economic growth at the same rate as in neighbouring countries.

There is also a continuing decline in the contribution of manufacturing to GDP, falling from 22% in 2010 to 17.2% in 2024, while the industrial sector's contribution to GDP peaked in 2001 at 29% and has steadily declined since then.

Indonesia remains heavily reliant on the export of commodities, with coal and palm oil accounting for around 25% of total export receipts. While the government is pushing for more downstream processing and value-added exports, this dependence on raw materials creates vulnerability to commodity price fluctuations.

Newly elected President Prabowo aims to address these challenges

President Prabowo has already made several large moves that his Government hopes will turbo charge Indonesia's economy.

The Government recognises that investment will be crucial to its economic future. To facilitate greater investment, President Prabowo has launched "Danantara", a state-owned superholding investment company that aims to pool all the 47 State-Owned Enterprises (SOEs) under one administrative system, and channel SOE dividends along with additional funding into investments. With an initial fund of US$20 billion, Danantara is touted as a transformative step, focused on high-impact, long-term projects.

Danantara plans to implement 10 to 15 major projects that will see an increase of 2-3% in GDP. Among these, the government is seeking investment to build three million houses annually over the next five years to address a significant shortfall in housing. The Indonesian Government has also announced a programme to widen access to the internet for all of Indonesia.

As part of the investment plan, Prabowo's Administration is going full steam ahead with the previous Jokowi Administration's "downstreaming" programme. This seeks to add value to Indonesia's natural resources rather than simply exporting raw materials. This approach has been particularly successful in nickel production where Indonesia is a global leader and holds the lion's share of the world's reserves. The government aims to expand this model to bauxite, copper, and other minerals.

Meanwhile, the Government's flagship, Free Nutritious Meals programme, is seen as a way to support the people, address stunting and improve nutrition, while also boosting economic growth. At full scale, this programme will see 82.9 million school children, as well as pregnant mothers, provided with free meals. President Prabowo also wants the programme to help boost Indonesian agricultural production and food security, including the dairy sector. It is, however, very costly.

More tax revenue may be needed

The World Bank has said Indonesia needs to significantly increase tax revenues in order to invest more in human and physical capital to achieve its high-income status ambitions. Indonesia's tax ratio currently sits at 10.2%, which the World Bank says is 6%

less than its comparative peers. The EIU expects the government's budget deficit to increase to 2.9% of GDP from 2.4% of GDP in 2025. Any mention of tax increases is met with strong public opposition. Meanwhile, large cuts to government agency budgets have been undertaken to fund Danantara and the Free Nutritious Meals programme.

The Indonesian economy is projected to fall short of the 8% target this year

The World Bank, International Monetary Fund, and Asian Development Bank all estimate that Indonesia's economy will continue to grow within the range of 5-5.1% in 2025.

A fragmenting international economy, economic decoupling, tariff barriers, and financial market volatility are other concerning factors for Indonesia.

Meanwhile, a recent report by the U.S. Chamber of Commerce highlighted local content requirements (which led to the well-publicised temporary ban on sales of Apple's IPhone 16 in Indonesia) as discouraging foreign companies from entering the market.

There are still opportunities for New Zealand companies

The path to 8% annual growth may present a number of challenges, but there continue to be significant opportunities for New Zealand. Indonesia is projected to have the world's seventh largest economy by 2030 and to be in the top five largest economies by 2050. For Kiwi businesses, a market of that size, potential and proximity to New Zealand, is a tantalising prospect.

There are also agreements in place to facilitate our trade. New Zealand and Indonesia are members of the AANZFTA agreement, which was upgraded in 2022 to further reduce trade barriers and boost trade within the region. Both countries are also members of the Regional Comprehensive Economic Partnership, which also reduced tariff barriers for New Zealand exporters.

As NZTE notes, Indonesia is a market particularly suited for exporters with international experience and who are able to take a long term view. While it might take time and patience, New Zealand brands with the right strategy and approach can succeed in this market and will reap the benefits as the very large number of Indonesian consumers continues to grow, and as Indonesia heads towards its vision of Golden Indonesia 2045.

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