

IFG Progress Digest

Indonesia's Growth Plateau: A Sectoral and Regional Diagnosis of Structural Stagnation

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- *Indonesia's 5% growth pattern increasingly reflects a structural ceiling rather than a temporary cyclical pause. Consumption, commodities, and low-productivity services continue to stabilize headline GDP, but weak productivity, limited manufacturing upgrading, and uneven investment spillovers prevent the economy from moving decisively toward higher value-added activities.*
- *The sectoral evidence shows stability in relative size but volatility in growth. Most sectors remain in the same size position throughout 2017-2025, while growth rates fluctuate around the COVID period. Manufacturing is the strongest structural candidate because it combines scale with above-average growth, whereas mining is more volatile and financial services remain subscale despite momentum.*
- *The regional diagnosis reveals a similar pattern: Java remains the dominant economic anchor but grows close to the average, while Kalimantan, Sumatra, and Eastern Indonesia show stronger growth variability without sustained scale gains. Policy should therefore prioritize targeted industrialization, stronger spatial-sectoral alignment, and incentives tied to productivity, exports, and technological upgrading.*

Indonesia's economic trajectory over the past decade reveals a growth model that is stable in headline terms but increasingly constrained beneath the surface. Real GDP has continued to expand around the 5% range, with recent outlooks suggesting limited deviation from 5.0-5.1% through 2025 (LPEM FEB UI, 2025; Coordinating Ministry for Economic Affairs, 2025). This stability should not be dismissed, particularly given repeated external shocks. Yet for a middle-income economy seeking structural upgrading, it increasingly looks more like a ceiling than a platform for acceleration.

The composition of growth reinforces this concern. Household consumption, which accounts for roughly 53% of GDP and grows at around 4.9% year on year, remains the largest stabilizer of demand (LPEM FEB UI, 2025). However, the World Bank (2025) points to softer middle-class consumption and declining savings among lower- and middle-income households, suggesting pressure on purchasing power and more precautionary behavior. Services have also supported growth, especially trade, hospitality, transport, and communication, but much of this momentum remains cyclical and consumption-serving rather than productivity-enhancing (Bank Indonesia, 2025; OECD, 2025).

Manufacturing remains the key missing engine of transformation. Although it contributes around one-fifth of GDP, its growth has often lagged the national average, reinforcing concerns over premature deindustrialization and weak integration into global value chains (Bank Indonesia, 2025; LPEM FEB UI, 2025). This matters because manufacturing competitiveness is closely linked to export upgrading, capital inflows, exchange-rate resilience, and participation in higher-value production networks (Verico, 2017). Without a stronger manufacturing base, Indonesia's ability to generate high-value exports remains constrained.

The economy also remains exposed to primary commodities such as coal, palm oil, and other resource-based exports. These sectors provide important foreign-exchange earnings, but they also leave growth vulnerable to global price cycles and external demand shocks. The World Bank (2025) notes the deterioration in Indonesia's terms of trade, while CIPS (2025) emphasizes the continued dominance of raw and semi-processed exports. Downstreaming can help, but only if it produces genuine value addition rather than merely extending commodity dependence.

Investment and labor-market dynamics further explain why headline stability has not translated into structural acceleration. FDI expanded by 18.6% year on year in Q3 2024, but domestic investment growth slowed sharply from 29.1% to 11.6%, while investment remains concentrated in selected sectors and regions (LPEM FEB UI, 2025; Coordinating Ministry for Economic Affairs, 2025). Employment also remains concentrated in agriculture and informal services, with skill mismatches limiting the transition into higher-productivity industries (World Bank, 2025; Bappenas, 2025).

Taken together, the evidence points to an economy that is stable but structurally constrained. Growth is still anchored by consumption, commodities, and low-productivity services, while manufacturing, investment efficiency, and labor reallocation have not yet generated sustained upgrading. This paper therefore moves beyond short-term macro commentary and maps Indonesia's sectoral and provincial performance dynamically to identify persistent growth drivers, structural rigidities, and areas where targeted policy could unlock higher productivity.

External and environmental risks reinforce the need for structural upgrading. Slower growth in major trading partners, trade protectionism, and global financial volatility can weaken exports, investment, and exchange-rate stability. Climate-related events also increase fiscal and economic costs, while the energy transition requires substantial financing. These pressures make the growth model more vulnerable when productivity gains are limited, because cyclical demand cannot fully offset external shocks or climate-related disruptions.

Across sectors, the horizontal distribution is broadly stable throughout 2017-2025. Log GDP mostly ranges between 10 and 15.5, with annual means around 12.5-13.5. Most sectors remain within about one log point of the mean, indicating limited re-ranking by size and only modest changes in the structure of production (Exhibit 1). In practical terms, large sectors remain large, while smaller sectors rarely gain enough scale to alter the aggregate economic hierarchy.

Growth dispersion is more cyclical than structural. Before COVID-19, sectoral growth generally ranged from 4% to 9%, with around five to seven sectors above the annual mean. During 2020-2021, dispersion compressed as most sectors clustered closer to the average. The post-pandemic period brought some re-widening, with growth ranging roughly from 2.5% to 8%, but the spread did not exceed the pre-COVID range. This points to recovery, not a decisive reallocation of growth.

Quadrant movement confirms the same pattern. Around 70-80% of sectors remain on the same side of the size mean, while 40-50% cross the growth mean at least once, particularly during 2020-2022. Sectoral movement is therefore mainly vertical: growth rates fluctuate around the average, but relative economic size changes little. This distinction matters because temporary growth acceleration does not necessarily imply structural transformation.

The sharpest adjustment occurred between 2019 and 2020, when several sectors shifted from above-average to below-average growth. Many moved back toward or above the mean during 2021-2023, but this rebound did not materially change their relative scale. The dominant numerical pattern is therefore stable sector size, temporary COVID-era compression, and modest post-pandemic re-dispersion. Indonesia's sectoral structure appears resilient to shocks, but not sufficiently dynamic to produce a new growth configuration.

The sectoral map therefore shows a useful distinction between resilience and transformation. Indonesia's economy can absorb shocks and recover toward its previous

configuration, but the recovery does not necessarily create new sectoral leaders. The repeated return to the same horizontal distribution suggests that the economy remains anchored in its existing structure. This is precisely why the 5% growth pattern has persisted despite improvements in infrastructure, macroeconomic management, and investment inflows.

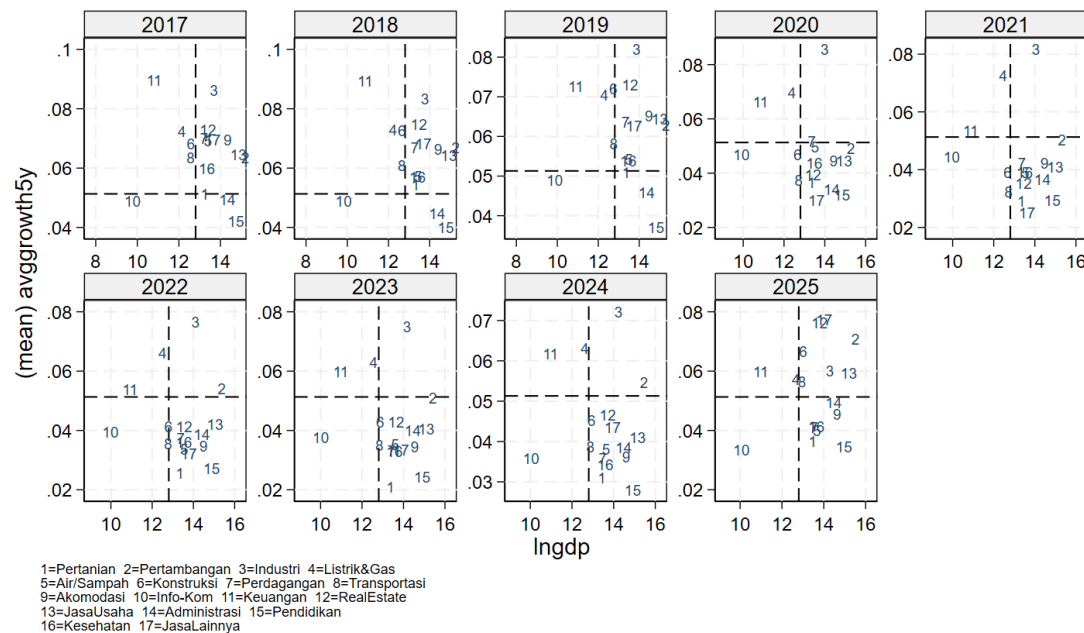
Sectoral Movement and Forward Potential

Sectoral switching is concentrated in a limited group of industries whose growth rates fluctuate around the mean while their relative size remains largely unchanged. Mining (2), financial services (11), and several smaller service sectors show the most visible quadrant transitions, particularly around the COVID period. These shifts should be interpreted carefully: they indicate changes in short-term growth positioning, not necessarily a fundamental change in sectoral importance or production capacity.

Mining is the clearest example. It remains relatively large, usually around log GDP 12.5-13.5, but alternates between the upper-right and lower-right quadrants as its growth moves above or below the mean. The most visible shifts occurred in 2019-2020, when growth weakened, and in 2021-2022, when it rebounded. This pattern highlights mining’s importance as a source of scale and episodic growth, while also exposing its sensitivity to commodity cycles and external demand (Exhibit 1).

Financial services follow a different pattern. It is generally below the mean in size but frequently above the mean in growth, placing it in the upper-left quadrant in several years. The sector therefore shows momentum without sufficient scale. Its strategic importance lies in whether sustained growth can shift it rightward over time through deeper intermediation, broader financial inclusion, stronger capital-market development, and greater support for productive investment across regions and firms.

Exhibit 1. Indonesia’s Sectoral Growth Dynamics, 2017 - 2025



Sources: BPS, IFGP Research

Several smaller service sectors also move across the growth mean, but their transitions are less economically significant because they tend to sit close to the threshold. Small changes in growth can shift their quadrant classification without materially changing their contribution to aggregate GDP. For this reason, repeated movement around the mean should be read as a signal of volatility rather than automatic evidence of structural upgrading or emerging sectoral leadership.

Manufacturing is the most consistently well-positioned sector. It is large, frequently grows above the mean, and repeatedly returns to the upper-right quadrant aftershocks. This combination matters because it links scale with above-average growth, making manufacturing the sector with the clearest structural potential. However, its inability to sustain high growth every year also points to unresolved bottlenecks, including weak innovation intensity, limited supplier depth, and insufficient integration into higher-value global production networks.

By contrast, trade, construction, and transport are already large but tend to grow around or below the mean. They remain essential to domestic activity, employment, and distribution networks, but the chart does not show a consistent move into higher-growth positioning. Property and real estate also remain close to the mean in both size and growth, suggesting a relatively stable but moderate trajectory. Overall, manufacturing offers the strongest structural potential, mining provides intermittent upside, and financial services have momentum but not yet sufficient scale.

This sectoral reading has an important policy implication. A large sector is not necessarily a growth engine, and a fast-growing sector is not necessarily large enough to transform the economy. The strongest candidates are sectors that can combine both scale and growth momentum. On this criterion, manufacturing remains central, financial services deserve strategic attention, and mining requires careful management because its growth potential is closely tied to external price cycles.

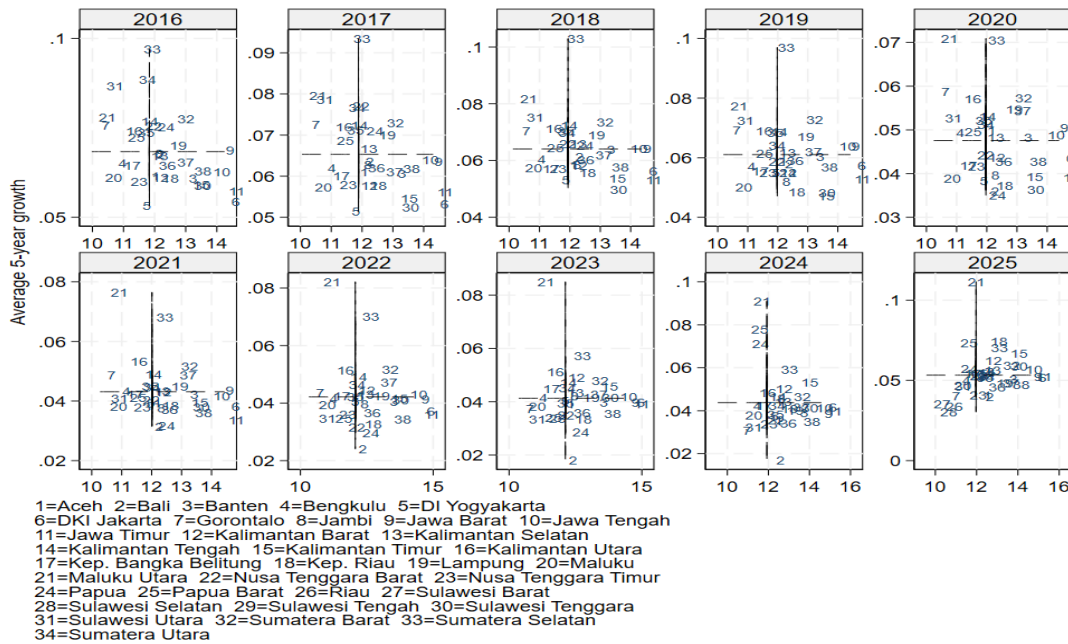
Regional Dynamics

At the provincial level, dispersion reflects not only sectoral dynamics but also regional inequality, resource endowment, and spatial concentration. Provincial log GDP is mostly concentrated between 10 and 14.5, with the mean around 11.5-12.5. DKI Jakarta (6), Jawa Barat (9), Jawa Timur (11), and Jawa Tengah (10) remain far to the right of the distribution. This indicates that relative regional size has changed little over time, despite repeated policy efforts to broaden growth geographically.

Growth dispersion is more pronounced across provinces than across sectors. Before COVID-19, provincial growth ranged roughly from 5% to 10%, with around eight to twelve provinces above the mean. Resource-based provinces in Kalimantan and parts of Sulawesi often recorded above-average growth, while Java remained dominant in size but more stable in growth. The regional picture is therefore

more uneven: some smaller or mid-sized provinces grow faster, but not consistently enough to change their national economic weight.

Exhibit 2. Indonesia’s Regional Growth Dynamics, 2017 - 2025



Sources: BPS, IFGP Research

COVID-19 compressed the provincial distribution more sharply than the sectoral distribution. In 2020-2021, growth narrowed to roughly 3-6%, and fewer provinces were clearly above the mean. From 2022 onward, dispersion widened again, with growth ranging from about 2% to 10%. However, this re-dispersion did not alter the spatial hierarchy. Large provinces remained large, and smaller provinces remained smaller, even when they temporarily recorded faster growth.

Java’s major provinces operate as stable anchors. They consistently record log GDP above 13.5-14.5, but their growth rates cluster close to the mean, usually within a narrow band of around 0.5-1.0 percentage point. This makes them mature but growth-constrained regions: economically dominant, yet not the main source of above-average acceleration. Additional investment in these regions may still be valuable, but its marginal growth impact is likely lower unless it raises productivity (Exhibit 2).

Resource-rich provinces in Kalimantan show the opposite profile. Their size is more mid-range, but their growth varies substantially, often moving 2-3 percentage points above or below the mean. Eastern Indonesia, including Papua, Papua Barat, Maluku, and NTT, also shows frequent movement between above- and below-average growth, reflecting high variability but limited scale. These regions contain potential, but their volatility suggests dependence on resource cycles, project timing, and uneven infrastructure and institutional capacity.

Sumatra, particularly Sumatera Selatan and Sumatera Utara, showed relatively high growth before COVID-19, then converged toward the mean during the shock before partially recovering. Across regions, around 40-60% of

provinces cross the growth mean at least once, while fewer than one-quarter cross the size threshold. Regional movement, like sectoral movement, is therefore mainly vertical rather than horizontal. Provinces grow faster or slower over time, but only rarely change their structural position.

Overall, provincial dispersion is driven by growth volatility among mid-sized and smaller provinces, while Java remains a stable but slower-growth anchor. Resource-dependent regions contribute much of the fluctuation, but their high-growth episodes have not yet translated into durable scale gains. The regional economy is therefore not stagnant in a narrow sense; it is mobile around the growth mean but rigid in its underlying spatial distribution.

The regional map also shows why national growth strategies cannot rely solely on aggregate investment targets. Where investment is placed, which sectors it supports, and whether it creates spillovers across provincial economies matter as much as the total amount invested. Without stronger regional linkages, high-growth episodes in smaller provinces may remain temporary, while large provinces continue to dominate output without delivering above-average growth acceleration.

Implications for Policy

Indonesia's sectoral and regional dispersion points to a clear policy message: the issue is not the absence of growth, but the weak reallocation of growth across sectors and regions. Around 70-80% of sectors and more than 75% of provinces do not materially change their relative size ranking, suggesting structural rigidity. Policy should therefore move beyond aggregate demand support and focus on reallocating labor and capital toward scalable, higher-productivity activities.

At the sectoral level, policy support should be more selective. Large sectors such as trade, construction, and traditional services remain important but tend to cluster around or below mean growth, implying lower marginal returns from broad-based incentives. Manufacturing and modern tradable services deserve stronger priority because they either combine scale with growth or show the potential to do so. Support should be conditional on productivity gains, export performance, innovation, and supply-chain upgrading.

Regional evidence adds spatial dimension. Java dominates economic size but appears mature and growth-constrained, while Kalimantan and parts of Eastern Indonesia show higher volatility and untapped growth potential. This calls for a shift from infrastructure equalization alone toward targeted regional industrialization. Resource-rich regions should be linked to downstream manufacturing, logistics networks, industrial estates, and export-oriented value chains rather than remaining isolated commodity-growth pockets.

The interaction between sectoral and regional patterns reveals a deeper misalignment: high-growth sectors are not always located in high-capacity regions, while large regions are often dominated by lower-productivity activities.

Indonesia therefore needs stronger spatial-industrial coordination, including skills policy, logistics integration, fiscal incentives, and financing instruments that connect emerging regions with national production networks. The objective is not only to disperse activity, but to disperse productive capability.

This also implies that regional policy should not treat all lagging regions in the same way. Resource-rich provinces require down-streaming strategies, logistics connectivity, and industrial ecosystems that reduce dependence on raw commodity cycles. Smaller eastern provinces require stronger basic infrastructure, human capital, and institutional capacity before high-growth episodes can become sustainable. Java, meanwhile, needs productivity upgrading and congestion management rather than simply more capital concentration.

The broader lesson is that Indonesia is cyclically flexible but structurally rigid. Many sectors and provinces cross the growth mean during shocks and recoveries, yet few move across the size threshold. Temporary acceleration must therefore be converted into permanent upgrading through industrial deepening, firm-level productivity improvement, technology adoption, and labor-market transition into higher-value occupations. Otherwise, recovery periods will continue to restore the old equilibrium rather than create a new one.

Without this shift, Indonesia's dispersion patterns will continue to show stability without transformation. The economy may keep expanding near 5%, but the composition of growth will remain too dependent on consumption, commodities, and low-value services to support a durable escape from middle-income stagnation. A more disciplined industrial and regional policy framework is needed to convert cyclical growth variation into sustained productivity, complexity, and income gains.

The policy framework should also build stronger discipline into incentives. Fiscal support, tax facilities, subsidized financing, and infrastructure prioritization should be linked to measurable outcomes such as productivity gains, export performance, local supplier development, formal employment creation, and technology adoption. This would reduce the risk that incentives merely preserve existing structures rather than encourage firms and regions to move into higher-value activities.

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