INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/32

INDONESIA

February 2018

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR INDONESIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Indonesia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 10, 2018 consideration of the staff report that concluded the Article IV consultation with Indonesia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 10, 2018, following discussions that ended on November 14, 2017, with the officials of Indonesia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 21, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Indonesia.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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FOR IMMEDIATE RELEASE
February 6, 2018

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation with Indonesia

On January 10, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Indonesia.

The Indonesian economy has continued to perform well. Real GDP growth accelerated slightly to 5.1 percent in Q3:2017 from 5 percent in 2016 and H1:2017, led by robust exports and fixed investment. The output gap is estimated at –0.5 percent of GDP. Inflation fell to 3.3 percent in November, at the lower half of the official target band (4±1 percent), due to the slightly negative output gap and stable food prices, which more than offset the increase in electricity prices earlier in the year due to improved targeting of subsidies. Core inflation has remained stable at around 3 percent. The current account deficit declined to 1.5 percent of GDP in Q1-Q3:2017 due to higher exports. However, credit growth remains slow reflecting both weak demand and banks' tight lending standards.

The economic outlook is positive. Real GDP growth is projected at 5.1 percent in 2017, rising gradually to 5.6 percent over the medium term, led by robust domestic demand. Inflation is projected to remain around 3.5 percent, within the official target range, due to stable food and administered prices, and well anchored inflation expectations. The current account deficit is expected to remain contained at near 2 percent of GDP due to firm commodity prices and robust exports. Risks to the outlook remain tilted to the downside, including spikes in global financial volatility, uncertainty around U.S. economic policies, lower growth in China, and geopolitical tensions. Global growth and commodity prices could surprise on the upside. Domestic risks include tax revenue shortfalls and larger fiscal financing needs due to higher interest rates.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors commended the authorities for the sound economic performance, including stable economic growth, moderate inflation, and a modest current account deficit, which have contained systemic risks. They noted that the economic outlook is favorable, but encouraged the authorities to stay vigilant against risks, including from volatile capital flows. Directors stressed that achieving higher potential growth would help create jobs for the young and growing labor force. The priority should be on a self-reinforcing and well-sequenced fiscal-structural reform package that mobilizes revenues to finance development spending and supports structural reforms in the product, labor, and financial markets.

Directors welcomed the focus of the near-term policy mix on supporting growth while preserving stability. They noted that fiscal adjustment in 2018 should be gradual to protect growth while rebuilding fiscal buffers. They agreed that the current stance of monetary policy is appropriate for targeting price stability and supporting growth, and recommended further enhancing monetary transmission. Directors welcomed the authorities' commitment to maintain exchange rate flexibility and to limit foreign exchange intervention to preventing disorderly market conditions.

Directors commended the authorities' efforts to rebalance public expenditure toward priority sectors. They encouraged early implementation of a medium-term revenue strategy to finance growth-enhancing priority spending and structural reforms, as well as reduce the heavy reliance on external financing. This strategy should include frontloaded tax policy and administration reforms. Short-term measures to arrest the fall in the tax ratio should also be considered.

Directors welcomed the progress achieved in boosting infrastructure investment. They stressed that the pace of infrastructure development should be aligned with available financing and the economy's absorptive capacity. Priority should be given to financing infrastructure with domestic revenue, as well as greater private sector participation, including foreign direct investment. This would limit the buildup of corporate external debt and contingent liabilities from state-owned enterprises (SOEs). Financial deepening through developing a national strategy for capital market development would also support infrastructure investment.

Directors commended the authorities' efforts to streamline regulations. They noted that future efforts should target areas with the largest potential gains for the economy, such as reducing state control, rationalizing the role of SOEs, and greater coordination of regulations among ministries and regional governments.

Directors emphasized that improving education and easing labor market regulations would support employment. They underscored the need to raise the level and quality of education spending, streamline job protection regulations, and improve vocational training and job placement services. Enhancing female labor participation would also be important.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors took positive note of the authorities' efforts to strengthen financial oversight and crisis management. Going forward, they encouraged greater focus on the areas identified by the FSAP where further improvement is needed, including clarification of institutional mandates, improving supervision of financial institutions and financial conglomerates, adopting a more rigorous approach to credit risk, and continuing to strengthen the crisis management framework. Continuing to monitor foreign exchange and external debt vulnerabilities of corporates will also be important.

Indonesia: Selected Economic Indicators

	2013	2014	2015	2016	2017 Prel.	2017 Latest outturn		2018 Proj.
Real GDP (percent change)	5.6	5.0	4.9	5.0	5.1	5.0	Q1-Q3	5.3
Domestic demand	4.7	5.0	4.2	4.6	4.7	4.5	Q1-Q3	5.1
Of which:								
Private consumption 1/	5.5	5.3	4.8	5.0	5.0	5.0	Q1-Q3	5.0
Government consumption	6.7	1.2	5.3	-0.1	2.1	1.3	Q1-Q3	2.0
Gross fixed investment	5.0	4.4	5.0	4.5	6.0	5.8	Q1-Q3	6.2
Change in stocks 2/	-0.6	0.5	-0.6	0.3	-0.2	-0.3	Q1-Q3	0.0
Net exports 2/	0.6	-0.2	1.0	0.1	0.7	0.8	Q1-Q3	0.3
Saving and investment (in percent of GDP)								
Gross investment 3/	33.8	34.6	34.2	34.3	34.0	...	...	34.1
Gross national saving	30.7	31.5	32.1	32.5	32.4	...	...	32.3
Prices (12-month percent change)								
Consumer prices (end period)	8.1	8.4	3.4	3.0	3.3	3.3	Nov.	3.6
Consumer prices (period average)	6.4	6.4	6.4	3.5	3.8	3.8	Jan.-Nov.	3.4
Public finances (in percent of GDP)								
Central government revenue	15.1	14.7	13.1	12.5	12.0	8.1	Jan.-Sept.	12.2
Central government expenditure	17.3	16.8	15.7	15.0	14.7	10.1	Jan.-Sept.	14.7
Of which: Energy subsidies	3.2	3.2	1.0	0.9	0.7	0.4	Jan.-Sept.	0.7
Central government balance	-2.2	-2.1	-2.6	-2.5	-2.7	-2.0	Jan.-Sept.	-2.5
Primary balance	-1.0	-0.9	-1.2	-1.0	-1.0	-0.8	Jan.-Sept.	-0.9
Central government debt	24.8	24.7	27.4	28.3	29.0	...	...	29.5
Money and credit (12-month percent change; end of period)								
Rupiah M2	9.4	13.5	9.0	11.7	12.0	9.8	Jul.	...
Base money	16.7	11.6	3.0	4.6	9.8	7.2	Jul.	...
Private Sector Credit	20.0	11.8	10.3	7.7	8.6	7.5	Sept.	10.3
One-month interbank rate (period average)	5.8	7.5	7.2	6.9	...			...
Balance of payments (US$ billions, unless otherwise indicated)								
Current account balance	-29.1	-27.5	-17.5	-16.8	-16.9	-11.5	Q1-Q3	-20.4
In percent of GDP	-3.2	-3.1	-2.0	-1.8	-1.7	-1.5	Q1-Q3	-1.9
Trade balance	5.8	7.0	14.0	15.4	18.4	15.8	Q1-Q3	14.8
Of which: Oil and gas (net)	-9.7	-11.8	-5.7	-4.8	-6.9	-5.0	Q1-Q3	-7.6
Inward direct investment	18.8	21.8	16.6	3.8	23.8	16.8	Q1-Q3	26.6
Overall balance	-7.3	15.2	-1.1	12.1	11.3	10.6	Q1-Q3	7.3
Terms of trade, percent change (excluding oil)	-2.5	-3.3	-14.6	-0.2	6.5	...	...	2.7
Gross reserves								
In billions of U.S. dollars (end period)	99.4	111.9	105.9	116.4	127.6	126.5	Oct.	135.0
In months of prospective imports of goods and services	5.9	8.1	8.0	7.9	8.0	7.9	Oct.	7.9
As a percent of short-term debt 4/	177	189	191	213	226	224	Oct.	234
Total external debt 5/								
In billions of U.S. dollars	266.1	293.3	310.7	318.8	345.4	335.4	Q2	359.3
In percent of GDP	29.0	32.9	36.1	34.2	34.0	33.0	Q2	32.8
Exchange rate								
Rupiah per U.S. dollar (period average)	10,414	11,862	13,391	13,306	...	13,382	Jan.- Dec.	...
Rupiah per U.S. dollar (end of period)	12,171	12,435	13,788	13,473	...	13,579	Dec. 18	...
Memorandum items:								
Jakarta Stock Exchange (12-month percentage change, composite index)	-1.0	22.3	-12.1	15.3	...	15.5	Dec. 18 (ytd)	...
Oil production (thousands of barrels per day)	830	794	800	820	815			800
Nominal GDP (in trillions of rupiah)	9,546	10,570	11,532	12,407	13,604			14,852

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes NPISH consumption.
2/ Contribution to GDP growth (percentage points).
3/ Includes changes in stocks.
4/ Short-term debt on a remaining maturity basis.
5/ Public and private external debt.

INTERNATIONAL MONETARY FUND

INDONESIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

December 21, 2017

KEY ISSUES

Context. The Indonesian economy continues to perform well. Economic growth has stabilized at near 5 percent, inflation has moderated, the current account deficit is manageable, and systemic risks are contained. Indonesia is in a good position to address its socio-economic challenges. Creating sufficient jobs for its young and growing population and reaping the benefits of the demographic dividend requires higher sustainable and inclusive growth and economic diversification.

Outlook. Growth is projected at 5.1 percent in 2017 and 5.6 percent over the medium term, led by robust domestic demand. Inflation is expected to remain within the target band due to stable administered prices and well-anchored inflation expectations. The current account deficit is expected to remain contained due to robust exports. Risks, however, remain tilted to the downside and are mainly external.

Main policy recommendations:

- Boosting potential growth requires a comprehensive, self-reinforcing, and properly sequenced fiscal-structural reform package. The near-term priority should be on structural reforms with low fiscal costs. Gains in growth from these reforms and additional revenue from a medium-term revenue strategy would allow for higher spending on infrastructure, education, health, and further structural reforms. Meanwhile, the increase in infrastructure spending should be paced in line with available financing and the economy's absorptive capacity.
- Given the slightly negative output gap, slow credit growth, and downside risks, the near-term policy mix should support growth while preserving stability. Monetary policy should continue focusing on price stability and supporting growth, while exchange rate flexibility should be maintained. Fiscal adjustment should be gradual in 2018 to protect growth, while rebuilding fiscal buffers.
- Efforts should continue to enhance financial oversight and crisis management. The enforcement of prudential regulations should be strengthened, while restructured and special mention loans should continue to be closely monitored, while properly enforcing loan classification to avoid evergreening. Legal protection of supervisors should be enhanced to ensure timely actions.

Approved By
Kenneth H. Kang and Petya Koeva Brooks

Mission dates: November 1–14, 2017
Mission team: L. Breuer (Head), J. Guajardo, T. Kinda, J. Shin (all APD), H. Jin (FAD), H. Kang (MCM), Y. Lu (SPR), supported by J. Nelmes (senior resident representative), K. Manasseh, T. Yan (both COM), and T. Feridhanusetyawan (APD). U. Eriksson von Allmen (Head of the FSAP team, MCM) discussed the findings of the FSAP. J. Agung, Executive Director, and A. Machmud, Senior Advisor, joined some meetings. A. Isnawangsih and N. Jotikasthira (both APD) worked in the preparation of this report.

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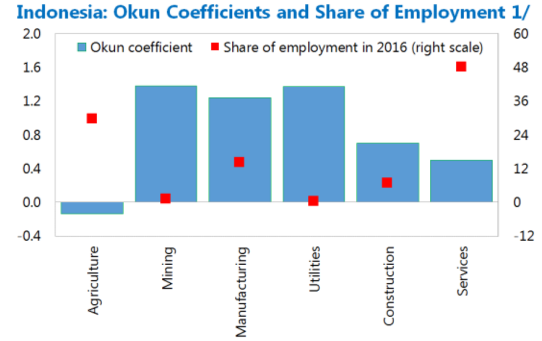
CONTEXT

1. **The Indonesian economy continues to perform well**. Economic growth has stabilized at near 5 percent, inflation has moderated, the current account deficit is manageable, and systemic risks are contained.[1] The current favorable external environment, characterized by a pickup in global growth, supportive financial conditions, and a partial recovery of commodity prices, provides a window of opportunity to push forward the government's reform agenda, while addressing vulnerabilities and risks, including the reliance on external financing.

2. **Against this backdrop, the country is in a favorable position to address its socio-economic challenges**. The government's objective to achieve higher sustainable and inclusive growth will help create jobs for the young and growing population. Indonesia's working age population is growing rapidly, at 1.6 percent or 2.5 million people per year (Box 1), which could increase further youth unemployment (19.4 percent in 2016).[2] In addition to faster economic growth, reaping the benefits of the demographic dividend requires diversifying the economy away from agriculture and towards industry and services, which have larger elasticities of employment growth to output growth.

Indonesia: Okun Coefficients and Share of Employment 1/



Sources: Indonesian authorities; and IMF staff estimates.
1/ The Okun coefficient is the elasticity of employment growth to Real GDP growth.

3. **Discussions focused on policies to boost potential growth in the medium term as well as on the appropriate policy mix in the near term**. Increasing potential growth requires a self-reinforcing fiscal-structural reform package that mobilizes revenues to finance development spending (infrastructure, education, health, and targeted transfers), and supports structural reforms to the product, labor, and financial markets. The near-term policy mix, given the slightly negative output gap, slow credit growth, and downside risks, should protect growth while preserving stability.

4. **The authorities' policies have been broadly in line with past policy advice**. Monetary policy easing in 2017 was appropriate given cyclical considerations and moderate inflation, and there has been further progress with monetary operations reforms. The authorities are taking steps to implement the 2017 FSAP recommendations and progress has already been made in some areas. On the fiscal front, there have been efforts to rebalance the budget away from untargeted subsidies towards social and infrastructure spending. However, the progress in implementing a medium-term revenue strategy has been slow, and the authorities are focusing on tax administration reforms using the information gathered from the tax amnesty implemented in 2016–17.

[1] S&P upgraded Indonesia to investment grade in May 2017, which was the last of the major rating agencies to do it.

[2] Working age population is defined as 15–64 years old and youth as 15–24 years old. See Chapter 1 in the forthcoming selected issues.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

A. Recent Developments

5. Real GDP growth picked up slightly to 5.1 percent (y/y) in Q3:2017 from 5 percent in 2016 and H1:2017, led by stronger export and fixed investment growth. Private consumption growth remained stable at 5 percent, while government consumption and public investment growth increased. The output gap is estimated at around –0.5 percent of GDP.

6. The credit cycle downturn has continued, with credit growth slowing to 7.7 percent (y/y) in September 2017 and a negative credit-to-GDP gap, reflecting both weaker demand and banks' tighter lending standards.

7. Inflation fell to 3.3 percent (y/y) in November, or to the lower half of the official target band (4±1 percent), due to the slightly negative output gap, stable food prices, and well-anchored inflation expectations, which more than offset the increase in electricity prices earlier in the year due to improved targeting of subsidies. Core inflation has remained stable at around 3 percent.

8. The fiscal deficit is projected to increase in 2017 to near the statutory ceiling of 3 percent of GDP due to modest tax revenue growth. Despite robust oil and gas revenue, total revenue grew by 4.4 percent (y/y) through October, less than envisaged in the original budget (16.7 percent, y/y). A revised budget was submitted in July 2017, with higher spending on subsidies and investment, and a larger fiscal deficit of 2.9 percent of GDP (2.4 percent in the original budget). However, expenditure restraint in H2:2017 has helped contain the fiscal deficit to around 2.7 percent of GDP, despite revenue shortages of 0.8 percent of GDP. The fiscal stance is projected to be neutral in 2017, with the cyclically adjusted primary balance remaining broadly unchanged.

9. The current account (CA) deficit fell to 1.5 percent of GDP in Q1-Q3:2017 from 1.8 percent in 2016 due to higher exports, led by coal and palm oil. Portfolio inflows, mainly into local currency government bonds, have been robust. The balance of payments (BOP) has remained in surplus, and international reserves reached US$126 billion (8 months of imports) in November 2017. The rupiah has depreciated by 0.1 percent in nominal effective terms in the first 10 months of 2017, but it has appreciated by 2.1 percent in real effective terms due to the inflation differential.

B. Outlook and Risks

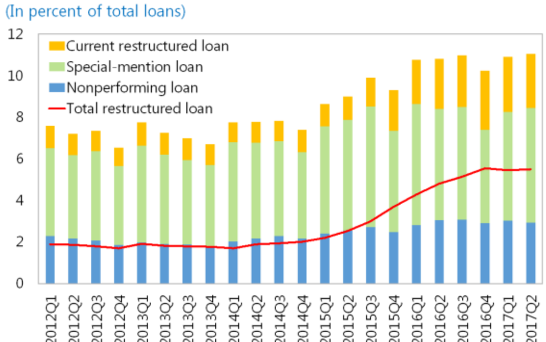
10. The economy is expected to improve in the near term. Real GDP growth is projected at 5.1 percent in 2017 and 5.3 percent in 2018, led by a pickup in investment and credit, and higher commodity prices. Infrastructure investment is also expected to increase, although less than planned by the authorities. Inflation is projected at 3.3 percent in 2017 and 3.6 percent in 2018, within the official target range (4±1 percent in 2017 and 3.5±1 percent in 2018), due to stable food and administered prices, and a slightly negative output gap. The CA deficit is projected to remain contained at 1.7 percent of GDP in 2017 and 1.9 percent in 2018 due to firmer commodity prices and robust exports, with the BOP remaining in surplus.

11. The medium-term outlook is favorable. Real GDP growth is projected at 5.6 percent over the medium term due to robust domestic demand, with the output gap closing in 2020. These projections include smaller increases in infrastructure investment than planned by the authorities and do not include major tax reforms. Inflation is expected to remain within the target band. Improved bank balance sheets and sustained economic growth would lead to a gradual pickup in credit growth to 12 percent by 2020, with the credit gap also closing in 2020.

12. Risks to the outlook remain tilted to the downside (Appendix I). The main risks are external, including a reversal in capital inflows (triggered by global financial volatility or uncertainty around U.S. monetary and fiscal policies), lower growth in China, and geopolitical tensions. The impact of these shocks could be amplified by the fiscal and corporate sectors' heavy reliance on nonresident financing (61 percent and 33 percent of total debt, respectively). On the upside, global growth and commodity prices could be stronger than expected. Domestic risks include tax revenue shortfalls, larger fiscal financing needs due to higher interest rates, political uncertainty in the run-up to the 2019 presidential elections, and natural disasters.

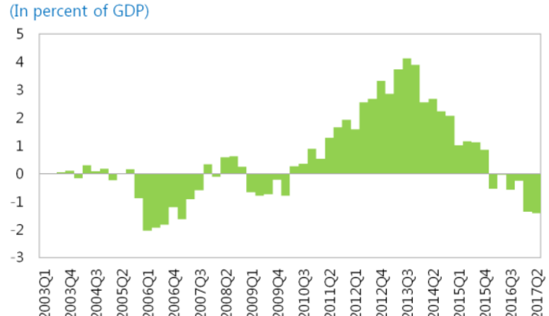
13. Systemic financial risks are contained, but some critical vulnerabilities remain. FSAP stress tests find that banks are broadly resilient to severe external shocks. The banking system remains sound with high capital, ample liquidity, and strong profitability. Banks have been repairing their balance sheets, but problem loans, including NPLs, special mention and restructured loans, remain elevated at over 10 percent of total loans due to legacy effects from the fall in commodity prices and the slight economic slack. Banks are also exposed to potential systemic financial risk given their exposure to the corporate sector, which is vulnerable to FX and external rollover risks.

Problem Loans
(In percent of total loans)



Sources: Financial Services Authority (OJK); and IMF staff estimates.

Loan-to-GDP Gap[1/]
(In percent of GDP)



Sources: Bank Indonesia; CEIC Data Co., Ltd.; and IMF staff estimates.
1/ The gap is the difference between the loan-to-GDP ratio and its long-run trend which is estimated from an one-sided HP filter with 400,000 as a smoothing parameter.

C. External Sector Assessment

14. Indonesia's external position is assessed as broadly consistent with fundamentals and desirable policies, while external debt remains sustainable. Preliminary estimates indicate that the CA deficit remains close to the estimated CA norm (Appendix II).[3] The level and composition of the net international investment position indicate that Indonesia's external position is sustainable. External debt remained moderate at 34.4 percent of GDP in September 2017. External financing appears sustainable, although it could be affected by domestic and external volatility (Appendix III). International reserves, projected at US$127.6 billion or 134 percent of the IMF's reserve adequacy metric at end-2017, would be sufficient to address most shocks.

Authorities' Views

15. The authorities broadly agreed with the macroeconomic outlook and risks. They remain committed to maintaining macrofinancial stability. Growth is projected to strengthen in 2018 led by strong investment growth and higher commodity prices. Private investment would pick up as banks clean their balance sheets and some infrastructure projects are completed. Private consumption growth is expected to remain stable due to robust consumer confidence and higher non-cash transfers to low income households. Inflation is expected to remain contained on stable food and administered prices, while core inflation continues to be under control. The external position would remain resilient, with low CA deficits and high reserve buffers. Structural reforms would accelerate medium-term growth above 5.5 percent.

16. The authorities broadly concurred with the external sector assessment, but expressed some concerns with the level of the CA norm. They agreed with the assessment that the external position remains broadly consistent with fundamentals and desired policies, but expressed doubts about the IMF EBA methodology to estimate the CA norm (–1.3 percent of GDP in 2017). They disagree with some indicators used in the EBA model to measure country risk (those of the *International Country Risk Guide*). Therefore, the CA norm resulting from the EBA model does not reflect Indonesia's needs of higher CA deficits to finance investment on infrastructure and critical structural reforms. They encourage the IMF to always consider country specific factors when estimating the CA norm, noting that the EBA model is based in a multilaterally consistent approach.

POLICIES TO BOOST POTENTIAL GROWTH AND SAFEGUARD MACROFINANCIAL STABILITY

17. Boosting potential growth requires a comprehensive, self-reinforcing, and properly sequenced fiscal-structural reform package. As fiscal space is constrained, the near-term priority should be on structural reforms with low fiscal costs, such as reforming product markets to promote entry and reduce state control, easing complex regulations, and fostering financial deepening and inclusion. Gains in growth from these reforms, along with a medium-term revenue strategy (MTRS), would create additional fiscal space for further structural reforms and development spending on

[3] The CA gap for 2017 (difference between the CA balance and its norm) is estimated between −1.1 percent and 0.9 percent of GDP, consistent with a REER gap between –4.5 percent and 5.5 percent.

infrastructure, education and health, where policy gaps remain large. Complementarities between reforms should also be exploited.

A. Fiscal and Other Structural Policies to Boost Potential Growth

Fiscal Policy to Create Space for Investment and Structural Reforms

18. In the context of declining tax revenues in recent years, the authorities have improved the quality of public spending.

a. Following the decline in oil and gas revenue amounting to 2 percent of GDP since 2014, the government has aimed to mobilize revenues by strengthening tax administration. It implemented a tax amnesty in July 2016–March 2017 with mixed results. Amnesty revenues, at 1.1 percent of GDP, exceeded market expectations, but other non-oil and gas revenue fell, likely impacted by the suspension of audits for amnesty participants. Despite these efforts, non-oil and gas tax revenues have declined by 0.5 percent of GDP since 2014.

b. In response, the government has rebalanced spending to priority sectors and improved efficiency. While total public spending has fallen by 2 percent of GDP since 2014, capital spending has risen by 1 percent of GDP. The targeting of electricity subsidies to low-income households has been improved, and performance criteria for transfers to local governments have been adopted. Efficiency savings on education spending are to be channeled to a trust fund to finance future education needs. However, some reforms have been delayed, such as the application of fully automatic formula-based fuel and electricity pricing mechanisms. The prices of low octane gasoline and electricity have not been adjusted since H1:2017.

19. The authorities are also aiming to strengthen tax administration with the data from the tax amnesty. Although asset repatriation during the amnesty was modest at 1.2 percent of GDP, assets declared totaled 40 percent of GDP. The authorities plan to use this data to improve tax compliance, assisted by the International Automatic Exchange of Information initiative. To help these efforts, the authorities passed a law that will give tax officials direct access to bank accounts owned by both Indonesian citizens and foreigners starting in 2018. The authorities are also developing a proposal for a MTRS to raise additional revenue, which they expect to finalize by March 2018.

Staff Position

20. Indonesia has some fiscal space. Despite small gross financing needs and low debt, fiscal space is constrained by weak revenues, a fiscal deficit near the statutory ceiling, and the large reliance on external financing. Shallow domestic financial markets and an open capital account render the economy vulnerable to capital flow volatility. Adhering to the statutory 3 percent of GDP deficit ceiling is critical to maintain fiscal discipline and protect investor confidence.

21. Early implementation of a MTRS to finance growth-enhancing priority spending and structural reforms is critical. The MTRS should aim to raise revenue by at least 3 percentage points of GDP in the medium term, which would allow the government to expand spending on infrastructure, health, and education, and support critical structural reforms. This can be achieved by frontloading tax policy reforms, improving tax administration, removing exemptions in VAT, CIT, and PIT, introducing excise taxes on vehicles and fuel, and raising the VAT rate to 12 percent from 10 percent. The MTRS should also aim to lower poverty and inequality. Although some tax measures included in the MTRS could be regressive, their impact on poverty and inequality is expected to be modest.[4] Much of the incidence of poverty and inequality in Indonesia is associated with unequal access to social services and infrastructure. Thus, the potential adverse effects from taxes could be more than offset by the increased provision of social services and infrastructure, and higher targeted social spending in education, health, and social programs.

Indonesia: Policy Options in the Reform Scenario

(In percent of GDP)

Policy Options	Estimated Fiscal Impact by 2022	Details of the Policy
Total revenue measures 1/	3.0	
Value-added tax	1.0	Remove exemptions, lower VAT registration threshold, and increase rate from 10 percent to 12 percent.
Excise taxes	1.0	Introduce fuel excise tax and convert the current luxury goods sales tax on vehicles to a vehicle excise tax.
Corporate income tax	0.5	Remove exemptions and unify tax rates, impose alternative minimum tax to fight profit shifting
Personal income tax	0.3	Lower threshold for the top rate.
Property tax	0.2	Increase rate and gradually replace transaction tax with recurrent property tax.
Total expenditure measures 2/	2.7	
Infrastructure	1.3	Increase investment expenditure toward 5 percent of GDP while improving efficiency.
Education	0.8	Increase education expenditure toward EM average (4.8 percent of GDP) while improving efficiency.
Health	0.6	Implement universal health coverage while improving efficiency.
Social Assistance	0.1	Consolidate poorly-targeted programs.
Other expenditure	-0.1	Cut nonpriority expenditure.

1/ Positive sign means more revenue. This includes both tax policy and administration reforms.
2/ Positive sign means more expenditure. This includes both expenditure policy and public financial management reforms.

22. As adopting a MTRS will take time, the authorities should focus on implementing its short-term action items to arrest the fall in the tax-to-GDP ratio. As a subset of the MTRS, the government could introduce excises on fuel, vehicles, sugary drinks, and plastic bags, reduce the VAT threshold, streamline tax administration, and lower compliance costs. These actions would protect the environment, improve the business climate, level the playing field, and encourage innovation, e.g., by shifting tax incentives to new rather than existing firms. They would also pave the way for future reforms such as raising the VAT rate, which can be used to support costlier structural reforms and expand priority spending, including social programs to lower poverty and inequality.

Authorities' Views

23. The authorities agreed with the need to implement a comprehensive MTRS to create fiscal space for priority spending. They concurred that fiscal space is constrained due to the lower

[4] See Chapter 2 in the forthcoming selected issues.

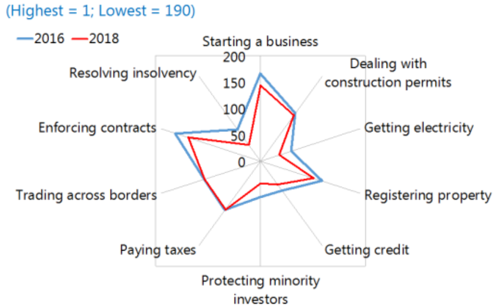
oil and gas revenues and a fiscal deficit near the statutory ceiling. The authorities are working on a proposal for a MTRS with the objective of raising tax revenue by at least 3 percent of GDP in five years based on both tax policy and tax administration reforms, which is expected to be finalized by March 2018. Higher excises on sugary drinks and plastic bags are currently under examination, as part of comprehensive tax reform efforts to optimize revenue. The extra revenue would be used to finance spending on infrastructure, health, education, and structural reforms.

Structural Reforms to Promote Investment and Employment

24. Public infrastructure investment has grown (Box 2). The authorities have increased public infrastructure spending by 1 percent of GDP between 2014 and 2017, and improved the institutional framework by establishing the Committee for Acceleration of Priority Infrastructure Delivery (KPPIP) and expediting land acquisition procedures. However, the narrow fiscal space has constrained public investment, and the authorities are aiming to raise infrastructure investment through SOEs and PPPs. They have selected 247 priority projects, with a total cost of US$323 billion (32 percent of GDP), to be implemented between 2015 and 2022. Most of the cost is expected to be borne by the private sector (18 percent of GDP) and SOEs (10 percent of GDP). The government is piloting various forms of financing, including banks loans to and bond issuances by SOEs and project securitization.[5]

25. The authorities have been implementing reforms to improve the business environment. They have adopted 16 economic packages since 2015 to streamline regulations and strengthen productivity and competitiveness (Appendix IV). The FDI regime was partially liberalized, including on logistics, tourism, and agriculture, and the setting of the minimum wage was made clearer. A single submission system is being introduced to simplify business registration, covering the licenses of both central and local governments. A national single window system to automate export and import permits has been introduced in more than 21 ports. The authorities are also planning to streamline non-tariff measures (NTMs), gradually shifting control from border to post border, and open to trade through bilateral and regional trade agreements. These efforts have led to a notable rise in Indonesia's World Bank's *Doing Business* ranking from the 106th position in 2016 to the 72nd position in 2018, with gains in most areas.

Indonesia: Ease of Doing Business Rank 1/
(Highest = 1; Lowest = 190)



Source: World Bank, *Doing Business Report*.
1/ These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints and information availability.

26. The authorities have articulated a financial development strategy. A high-level joint forum for financial deepening and the National Council for financial inclusion were created to promote interagency coordination. The authorities are preparing an ambitious national strategy for financial market development, including detailed multi-year strategic initiatives. BI has implemented measures to develop the money and FX markets to enhance monetary policy transmission (e.g., the

[5] See Chapter 3 in the forthcoming selected issues.

reserve requirement averaging and the adoption of the Global Master Repurchase Agreement). The introduction of a credit registry and the recent licensing of private credit bureaus are positive steps to strengthen the credit culture. The increasing use of digital financial services (DFS) can help overcome geographical barriers to financial inclusion.[6]

27. Notwithstanding these efforts, challenges remain. Growth remains constrained by a large infrastructure gap, low institutional quality, inadequate human capital, and shallow financial markets. Coordination among line ministries has improved, which has helped avoid conflicting regulations, but challenges remain in the coordination between central and local governments. Large state control through SOEs and entry barriers have discouraged private investment and undermined competition. Trade barriers and FDI restrictions have contributed to low integration with global value chains compared to ASEAN peers.[7] The weak credit culture has hampered financial deepening.

Staff Position

28. Infrastructure development should continue, but vulnerabilities and risks need to be carefully managed to protect macrofinancial stability:

- *The increase in infrastructure spending should be paced in line with available financing and the economy's absorptive capacity*. Given shallow domestic financial markets and constrained fiscal space, the level of infrastructure investment planned would require a significant rise in corporate external debt, including by SOEs, with potential spillovers to the financial system. A more measured pace of infrastructure development would help preserve stability, while sound risk management would help mitigate fiscal risks from contingent liabilities.

- *Priority should be given to financing infrastructure development with additional revenues from the MTRS.* This would allow for steady funding for infrastructure investment, while protecting stability and limiting the buildup of corporate external debt.

- *Private sector participation, including FDI, should be encouraged.* This would accelerate infrastructure investment, lower contingent liabilities from SOE debt, improve efficiency, and allow transfers of knowhow. Achieving this goal requires ensuring transparent, competitive bidding processes, expediting concessions for brownfield projects, and regulatory certainty. Financing through asset backed securities can be further explored, including in the areas of toll roads and power plants, where successful operations have been completed. Government guarantees for infrastructure development (credit, business viability, and PPP guarantees), which remained small at 2.8 percent of GDP in March 2017 (Box 2), need to be carefully designed and monitored to avoid a potential increase in future contingent liabilities.

[6] See Chapter 4 in the forthcoming selected issues.

[7] See Chapter 5 in the forthcoming selected issues.

29. Rationalizing the role of SOEs would reduce fiscal risks and foster competition. Indonesia has 118 SOEs spread across 13 sectors. In 2016, total SOE assets amounted to 51 percent of GDP and total SOE liabilities to 33 percent of GDP. Limiting the role of SOEs to strategically relevant and commercially viable areas would lower fiscal support needs, strengthen financial oversight, and attract private investment, including FDI. This could begin in the energy sector, where two SOEs dominate and large investment is needed. The authorities should also ensure cost recovery in Pertamina and PLN by adjusting regulated fuel and electricity prices with an automatic formula. Reducing barriers to entry could foster market-based incentives and improve SOE governance and efficiency. The plan to create holding companies of SOEs should be carefully reviewed. While it may enhance efficiency, it may also increase the monopolistic power of SOEs.

Framework for Reviewing the Status of Public Enterprises

		Policy or Strategic Relevance	
		Low	High
Commercial Viability	Low	Close down	Convert into a noncommercial government entity
	High	Privatize	Retain as a public corporation, monitor closely operations and finances

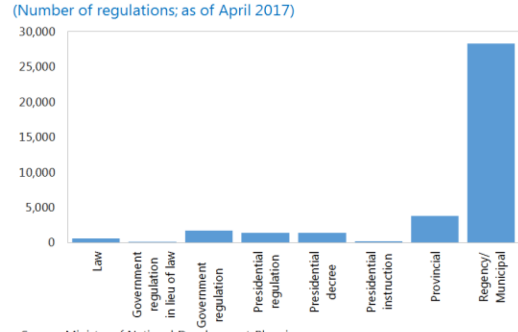
Source: IMF, Fiscal Affairs Department, 2016, *How to Improve the Financial Oversight of Public Corporations*, Fiscal Policy Paper.

30. Deregulation efforts should be targeted to areas with the greatest economic gains:

- Easing regulations on state control, antitrust exemptions, and barriers in the network sector (electricity and transport) would foster competition. Streamlining NTMs and easing FDI restrictions would strengthen links with global value chains and competitiveness. Greater ministerial coordination would avoid conflicting regulations. The recent presidential decree to strengthen the coordination of economic policies through all coordinating ministries is a welcome first step.

- *A regional government coordination forum, anchored by a national policy direction, would help improve coordination.* Introducing merits and competition factors into fiscal transfers to local governments and capacity building would enhance accountability and coordination.

Enacted Regulations During 1998–2017
(Number of regulations; as of April 2017)



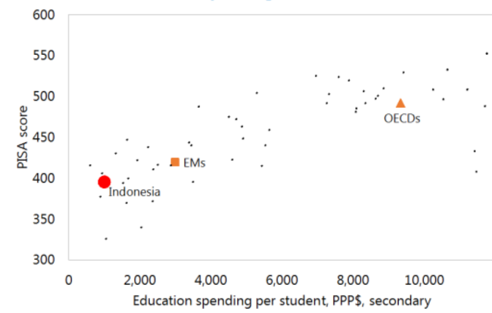
Source: Ministry of National Development Planning.

31. Improving education and easing labor market regulations would support employment. The labor market has underperformed, with high youth unemployment (30 percent); high informal employment (58 percent); and low female labor participation (55 percent).

- *Labor markets*. Streamlining stringent job protection, including administrative dismissal procedures and severance payments, while improving vocational training and job placement services, would promote youth employment and reduce the use of short-term contracts. Active labor market policies, including job placement services and vocational training, would help labor mobility. However, these programs should tackle well identified labor market failures and be subject to careful ex-post evaluations. Adopting a more open immigration policy for skilled labor, and improving the quality of domestic education, can lower skill mismatches, especially in professional services. Female labor force participation can be enhanced by providing flexible work arrangements and subsidizing childcare subject to careful cost-benefit analysis.

- *Education*. Strengthening the link between compensation and performance in the education sector would improve the efficiency of spending and the quality of education. Savings from these measures and additional resources could be directed to ensure more equitable access to quality education, especially in rural areas. Improved access to student loans would increase enrollment in higher education. The monitoring framework on the local government's budget spending and schools' performance should also be improved.

Government Education Spending and Outcome 1/



Sources: World Bank; and IMF staff estimates.
1/ Latest data available.

32. Stronger regulatory and supervisory frameworks would promote financial deepening and inclusion, and support infrastructure development. Progress developing a strategy for capital market development is commendable, and reflects high-level political support and enhanced inter-agency coordination. Continued efforts are needed to build a liquid yield curve and introduce new interest rate and FX hedging instruments. The supervisory and regulatory framework should evolve in line with financial market development. Portfolio exposure targets, including minimum MSME exposure targets and the minimum investment requirement on government bonds and infrastructure-related SOE bonds on nonbank financial institutions, should be reviewed. Improving the insolvency and creditor rights regimes would raise participation in the corporate bond market and financial access for MSMEs. The authorities should review the effectiveness of the People's Business Loan (KUR) program, including its fiscal costs and whether it has achieved its objective.[8]

33. An illustrative scenario that includes fiscal and other structural reforms shows that potential growth could rise to 6.5 percent in the medium term (Appendix V). Staff's reform scenario includes a MTRS that raises additional revenue by 3 percent of GDP, which is used to expand public spending in infrastructure, education, and health. It also includes structural reforms to the product and labor markets, reduced trade and FDI restrictions, and lower state control in the economy. Initially, potential growth rises due to a pickup in infrastructure investment and lower trade and FDI restrictions, which catalyzes private investment and employment growth. Over the medium term, structural reforms to the product and labor markets lead to gains in total factor productivity, which combined with additional investment in infrastructure and private investment, raise potential growth to 6.5 percent by 2022. Inflation increases in the near term due to the demand stimulus and higher taxes, but moderates after due to a tighter monetary stance, stronger

[8] The KUR program aims to enhance MSMEs' access to bank loans by providing subsidized, partial credit guarantees covering 70 percent of the loss.

domestic competition and expanded production capacity. The CA deficit widens due to higher investment-related imports, partly offset by higher exports due to enhanced competitiveness.

Indonesia: Illustrative Effects of Fiscal and Other Structural Reforms 1/

				Baseline					Reform Scenario				
	2015	2016	2017	2018	2019	2020	2021	2022	2018	2019	2020	2021	2022
General government revenue	**14.9**	**14.3**	**13.8**	**14.0**	**13.9**	**13.9**	**13.9**	**13.9**	**14.5**	**15.1**	**15.6**	**16.2**	**16.9**
Central government revenues and grants	**13.1**	**12.5**	**12.0**	**12.2**	**12.1**	**12.1**	**12.1**	**12.1**	**12.7**	**13.2**	**13.7**	**14.3**	**14.9**
Of which: tax revenues	10.8	10.4	9.8	10.0	10.0	10.0	10.0	10.0	10.5	11.0	11.6	12.2	12.8
Oil and gas revenues	1.1	0.7	0.9	0.9	0.8	0.7	0.7	0.6	0.9	0.8	0.7	0.7	0.6
Non-oil and gas revenues	11.9	11.8	11.2	11.3	11.3	11.4	11.4	11.4	11.8	12.4	13.0	13.6	14.2
Tax revenues	10.3	10.1	9.5	9.6	9.7	9.7	9.7	9.8	10.1	10.7	11.3	12.0	12.6
Income tax	4.8	5.1	4.4	4.4	4.4	4.5	4.5	4.6	4.6	4.8	5.0	5.2	5.4
VAT	3.7	3.3	3.4	3.6	3.5	3.5	3.5	3.5	3.7	3.9	4.1	4.3	4.5
Excise	1.3	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.5	1.7	1.9	2.1	2.3
Other	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Nontax revenues	1.5	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Local government revenue net of transfer	**1.8**	**1.8**	**1.8**	**1.8**	**1.8**	**1.8**	**1.8**	**1.8**	**1.8**	**1.9**	**1.9**	**2.0**	**2.0**
General government expenditure	**17.5**	**16.8**	**16.5**	**16.5**	**16.4**	**16.4**	**16.4**	**16.4**	**17.0**	**17.5**	**18.0**	**18.5**	**19.1**
Health	1.3	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.6	1.7	1.9	2.0	2.1
Education	3.5	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.5	3.6	3.8	3.9	4.1
Social assistance	1.5	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.8	1.8
Infrastructure	2.2	2.2	2.7	2.8	2.6	2.5	2.5	2.5	2.9	3.2	3.4	3.6	3.8
Other expenditure	8.9	8.1	7.3	7.3	7.3	7.4	7.3	7.3	7.3	7.2	7.2	7.2	7.2
General government deficit	**-2.6**	**-2.5**	**-2.7**	**-2.5**	**-2.5**	**-2.5**	**-2.5**	**-2.5**	**-2.5**	**-2.4**	**-2.3**	**-2.2**	**-2.2**
General government debt	**26.8**	**28.3**	**29.1**	**29.6**	**30.2**	**30.2**	**30.4**	**30.5**	**29.6**	**30.1**	**30.0**	**29.9**	**29.7**
Real GDP growth	**4.8**	**5.0**	**5.1**	**5.3**	**5.5**	**5.6**	**5.6**	**5.6**	**5.4**	**5.7**	**5.9**	**6.2**	**6.5**
Inflation	**3.4**	**3.0**	**3.3**	**3.6**	**3.8**	**3.7**	**3.5**	**3.6**	**3.8**	**4.1**	**4.0**	**3.7**	**3.8**
Current account deficit/GDP	**-2.0**	**-1.8**	**-1.7**	**-1.9**	**-1.8**	**-1.9**	**-2.0**	**-2.0**	**-2.0**	**-2.0**	**-2.2**	**-2.3**	**-2.3**

Source: World Bank; Indonesian authorities; and IMF staff estimates.

1/ The estimated impact of the reforms included in the staff's active scenario are based on Nozaki and Shin, 2015, "Infrastructure Development in Indonesia," IMF Country Report No. 16/82; Dabla-Norris and others, 2015, "Structural Reforms and Productivity Growth in Emerging Market and Developoing Economies," IMF Working Paper No. 16/15); Bouis, Duval and Eugster, 2016, "Producer Market Deregulation and Growth: New Country-Industry-Level Evidence," IMF Working Paper No. 16/114; Gal and Hijzen, 2016, "The short-term impact of produt market reforms: A cross-country firm-level analysis."; Chapter 3, Time for a supply-side boost? Macroeconomic effects of labor and product market reforms in advanced economies, IMF World Economic Outlook, April 2016.

Authorities' Views

34. The authorities broadly agreed that the macroeconomic implications and fiscal risks of the infrastructure plan should be closely monitored. They noted the progress made in upgrading infrastructure, with SOEs playing a key role on advancing projects that had been stalled for years. Going forward, they have an ambitious infrastructure development plan, and are seeking private sector and SOE participation. They agree that infrastructure development should be paced in line with available financing and the economy's absorptive capacity, and are exploring alternative financing instruments that could mitigate risks, including by enhancing equity instead of debt financing. They also conveyed that the financial deepening program has progressed to support the need of infrastructure financing, and concurred with the need to closely monitor SOEs and PPPs to mitigate fiscal risks from contingent liabilities.

35. The authorities have been implementing growth-enhancing structural reforms. They highlighted their past efforts to streamline regulations, reform education and health, and open to FDI, which have led to a significant improvement in the World Bank's *Doing Business* ranking. On trade policy, they want to harmonize NTMs with their ASEAN neighbors to reinvigorate trade. They are also considering labor market reforms to increase flexibility and align wage growth with productivity growth. Understanding the importance of these reforms, the authorities will continue to strive for the agenda to be achieved by taking concrete and prudent necessary steps.

B. Near-Term Policy Mix—Supporting Growth While Preserving Stability

36. The near-term policy mix should support growth while preserving stability given the slight economic slack, slow credit growth and downside risks. Fiscal adjustment should be more gradual than planned in the 2018 budget, monetary policy should continue focusing on price stability and supporting growth, and financial policies should safeguard financial stability.

Fiscal Policy

37. The 2018 budget targets a reduction in the fiscal deficit to 2.2 percent of GDP. Total revenues are projected at 12.8 percent of GDP, 0.8 percentage points above the projected outturn in 2017. The increase in revenue would be fully driven by a rise in income tax revenue of more than 1 percent of GDP as tax compliance improves with the data from the tax amnesty, which could prove optimistic. Total budgeted expenditure is projected to be 0.3 percent of GDP higher than the projected outturn in 2017, led by higher current and capital spending, partly offset by lower transfers to local governments.

38. The public sector's reliance on nonresident financing stabilized in 2017, although at a high level. Public debt is moderate at 29 percent of GDP, but the share of public debt held by nonresidents remained high at 61 percent in September 2017, broadly unchanged from 2016. The high reliance on nonresident financing makes public debt vulnerable to exchange rate and capital flow volatility. However, government bond yields have been relatively resilient in recent episodes of high global financial volatility. For example, 10-year bond yields increased only from 7.2 percent to 7.9 percent between October and December 2016 when global financial volatility spiked following the U.S. presidential elections, and have since declined to 6.5 percent in November 2017.

Staff Position

39. The authorities should aim for a gradual adjustment in 2018 to balance stability and cyclical considerations. Indonesia has some fiscal space, allowing for a slower than planned pace of adjustment. If revenues continue to surprise on the downside, adhering to the fiscal deficit target of 2.2 percent of GDP would require cutting expenditure, which would weaken domestic demand and limit resources for investment in infrastructure and critical structural reforms. Given the slightly negative output gap, a more gradual fiscal adjustment (a deficit target of up to 2.5 percent of GDP) would be more appropriate to protect growth while gradually lowering the primary deficit and rebuilding fiscal buffers. The resulting fiscal stance would be less contractionary than in the budget plan, with the cyclically adjusted primary balance rising by 0.2 percent of GDP. The deficit should not exceed 2.5 percent of GDP to preserve market confidence in the fiscal rule. Within the budget envelope, there is still scope to continue rebalancing away from untargeted subsidies towards more support for social spending, public investment, and structural reforms. Limiting the issuance of FX denominated government bonds and lowering the primary deficit as revenues increase with a MTRS would help moderate the reliance on nonresident financing.

Authorities' Views

40. The authorities broadly agreed that fiscal adjustment should be gradual in 2018. Fiscal policy will continue supporting growth through spending on infrastructure, health, education, and social transfers as envisaged in the budget. But it will not be used to stimulate aggregate demand beyond the budget plan. The authorities recognized a potential risk of revenue shortfalls in 2017, but they have already anticipated them to keep the budget deficit at a level well below the deficit ceiling. They believe that revenue and expenditure will be less volatile going forward, as the one-off shocks to revenue since 2014 will taper off, including those from the 2014-15 fall in commodity prices, the 2015-16 special tax on SOE asset reevaluation, and the 2016-17 tax amnesty. They also indicated that with the spirit of a better targeted mechanism for energy subsidies, they will keep monitoring energy prices and ensure the protection of the poor from hikes in energy prices.

Monetary and Exchange Rate Policies

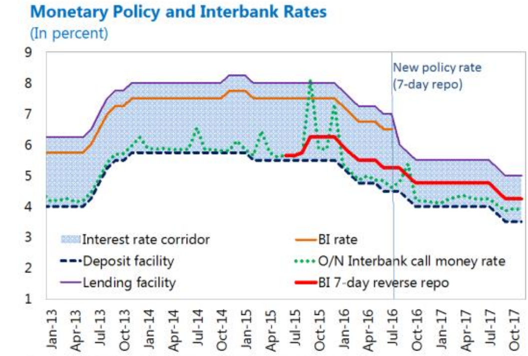
41. Bank Indonesia (BI) recently eased monetary policy. BI cut the policy rate by 50 basis points to 4.25 percent in August-September 2017, after cutting it by 150 basis points in 2016 and then holding it unchanged for 10 months. These actions were motivated by the moderate inflation outlook, the slightly negative output gap, slow credit growth, and lower external pressures. The rupiah has depreciated by 0.3 percent against the U.S. dollar in the first 11 months of 2017, and international reserves have risen by US$9.6 billion, due to higher foreign currency proceeds from international bond issuances, tax revenues, and oil and gas export receipts, and BI's FX intervention aimed at stabilizing the rupiah in line with its fundamental value.

42. There has been further progress with the reform of monetary operations. The interbank rate has moved closer to the policy rate since August 2016, when the policy rate was changed to the 7-day reverse repo rate and the interest rate corridor was narrowed. In July 2017, BI launched a partial reserve requirement (RR) averaging of 1.5 percent, out of the 6.5 percent current primary RR ratio, over a two-week period, allowing the floor of the RR ratio to be at 5 percent on any given day. This reform has benefited small banks with potential shortage of liquidity. BI has also moved to a variable-rate auction for its securities to encourage price discovery in the money markets. Issuance of T-bills has risen, providing more instruments at the short end of the yield curve.

Staff Position

43. The current stance of monetary policy is broadly appropriate. Recent monetary policy easing is adequate, given moderate inflation, the slightly negative output gap, and lower external pressures. With the real policy rate (1 percent) below the estimated neutral real rate (1¾ percent), monetary policy is sufficiently accommodative to support growth while maintaining price stability. Given external uncertainty, monetary policy should stay on hold in the immediate future, while BI assesses the pass-through of its recent actions.

44. There is room to further strengthen monetary transmission. Although the interbank rate has moved closer to the policy rate, market interest rates have been slow to adapt, particularly lending rates. Structural factors affecting the transmission include limited bank competition; distortionary interest rate caps; a weak credit culture; and low efficiency in the banking sector. Policy priorities include eliminating interest rate caps; limiting issuances of BI securities at the short end and minimizing overlap with MOF instruments; and improving banks' asset quality through faster restructuring.



Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

45. Exchange rate flexibility is critical to adjust to shocks. BI should allow the exchange rate to move freely in line with market forces, with FX intervention limited to preventing disorderly market conditions.

Authorities' Views

46. The authorities broadly concurred with the assessment of the monetary stance and reform priorities. The current monetary policy stance is appropriate given the moderate inflation outlook and slightly negative output gap. Going forward, BI will continue to remain vigilant and formulate monetary policy in line with economic developments. The implementation of the RR averaging has been smooth and has helped small banks with potential shortage of liquidity. Large banks with ample liquidity have not made use of the extra degree of flexibility. BI plans to gradually increase the RR averaging from 1.5 percent to the total RR by 2021, based on review of the liquidity conditions and progress in financial market deepening. The authorities broadly agreed with the reform priorities to further strengthen monetary transmission.

47. The authorities reiterated their commitment to exchange rate flexibility. BI continues to maintain a flexible exchange rate policy and to ensure the rupiah is in line with its fundamental value. BI will not shy away to intervene in the FX market in the case of excessive volatility of the rupiah exchange rate and misalignment of the rupiah exchange rate that may induce risks to the attainment of the inflation target.

Financial and Corporate Sector Issues—Enhancing the Supervisory Framework

48. Financial soundness indicators point to a sound, liquid, and profitable banking sector. The banking system is well capitalized with a capital adequacy ratio of 23.2 percent. Profitability is strong, and system-wide liquidity remains ample. However, banks are exposed to corporate sector vulnerabilities and financial soundness varies across banks. The FSAP's stress tests show that, under the most severe stress scenario, banks experience credit losses, particularly from corporate exposures, but high capital buffers and strong profitability help to absorb most of these losses, and many but mostly smaller banks are vulnerable to liquidity shocks, including FX liquidity shortfalls, due to their reliance on short-term deposits and limited access to the money market. NPLs have stabilized at slightly below 3 percent due to improved corporate performance and household debt service capacity, but special-mention loans and restructured loans remain elevated. BI's simulations suggest that the impact of the recent expiration of the Financial Services Authority's (OJK's) relaxation on loan restructuring criteria would be limited: the system-wide capital adequacy ratio would fall by less than ½ percentage points under the worst-case scenario.[9]

49. The authorities have been strengthening financial oversight and crisis management. Basel III standards and a new insurance law have been adopted, and supervisory practices are improving. The authorities have made active use of macroprudential tools and introduced a countercyclical capital buffer, currently set at zero in line with credit developments. Most implementing regulations for the crisis management law have also been issued, including those regarding recovery plans for domestic systemically important banks, resolution framework for both systemic and non-systemic banks, and rules for write-off and haircut of remaining assets from the Bank Restructuring Program. However, the implementing regulation regarding a levy for the Bank Restructuring Program is still under discussion.

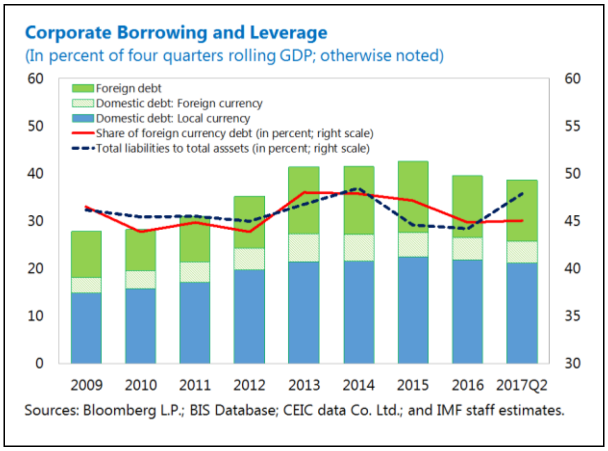
50. The authorities are taking early actions in response to the findings of the 2017 FSAP. They broadly agree with the key recommendations of the FSAP and are considering how to take them forward, recognizing that some recommendations are for the medium term (Box 3). That said, the draft bill amendment of the BI law that is being prepared and will be included in the 2015-2019 National Legislation Program includes a financial stability and macroprudential mandate. An amendment to the OJK law is also included in that Program. BI and OJK have been improving their stress test framework and established a framework for a joint stress test and data sharing. To advance on the recommendation to reduce silos in financial oversight, which ultimately requires changes to the OJK law, OJK brought internal coordination directly under the authority of the Chairman. The authorities conducted several joint crisis simulation exercises. BI and OJK also issued regulations to implement risk-based AML/CFT supervision.

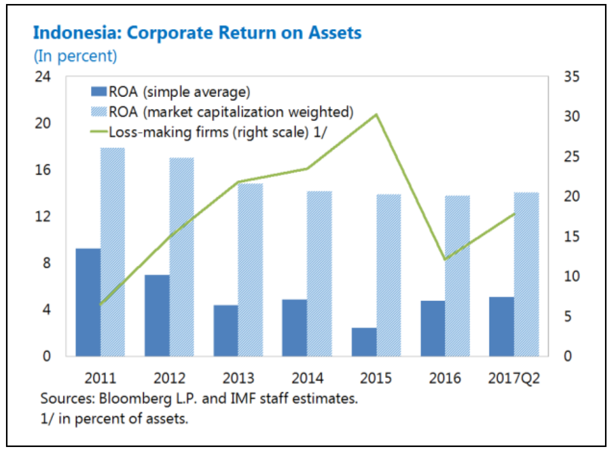
51. The corporate sector has reduced leverage but some sectors remain vulnerable to FX and external rollover risks. Profitability has improved on cost-cutting efforts, and external debt has moderated. However, NPLs in commodity-related corporates are high (e.g. 8 percent in the mining sector), due to legacy effects from low commodity prices and banks' risk management, as well as the weak credit culture. With FX debt accounting for 45 percent of total corporate debt, corporates are exposed to exchange rate volatility while facing larger rollover needs next year. These could have spillovers to the banking sector, as 71 percent of bank loans are extended to the corporate sector.

52. The corporate prudential FX regulation has helped moderate risks from corporate external debt. This regulation requires hedging at least 25 percent of net FX liabilities of corporates with external debt maturing within six months, maintaining the short-term liquidity ratio (FX assets

[9] OJK's relaxation on asset classification for loans up to IDR 5 billion expired in August 2017. For the past two years, banks had to fulfill only one criterion for loan restructuring—repayment capacity of borrowers. From September 2017, banks need to apply two additional criteria—financial strength and industry prospects for the borrower.

to FX liabilities maturing within three months) above 70 percent, and having a credit rating of no less than BB- or equivalent to borrow externally. The regulation was adopted in 2015 in response to the rapid increase in corporate external debt as well as regulatory and supervisory gaps, which has the potential to disrupt the financial system through spillovers to the banking sector. Since the introduction of this measure, corporate foreign debt has stabilized.





Staff Position

53. Efforts should continue to strengthen financial oversight and crisis management in line with the FSAP recommendations (Table 11). OJK should tackle its silo structure in its law amendment and strengthen the enforcement of prudential regulations, including on credit risk management and supervision on financial conglomerates. The authorities should continue to monitor closely restructured and special mention loans, and enforce proper loan classification to avoid evergreening. Restructuring of commodity-related legacy NPLs should be accelerated, taking advantage of the improved credit information. Legal protection of supervisors and officials of all agencies involved in financial oversight and crisis management should be enhanced to ensure timely actions. Consideration should to be given to the emergency liquidity assistance (ELA) eligibility criteria to allow extending emergency lending to banks that are assessed by OJK as viable even if its capital is temporary below minimum requirements. The ELA framework should also enable BI, in situations where it is not satisfied with a bank's solvency and viability, or with collaterals, to request an indemnity from the government subject to appropriate safeguards. The authorities need to consider allowing for the use of public funding in limited circumstances justified by systemic preconditions for use and processes for recovery from the banking industry. A liquidity coverage ratio requirement by significant currencies could be adopted to contain FX liquidity risks.

54. The corporate prudential FX regulation can be further improved by extending its coverage to all corporate FX liabilities. This regulation is assessed as a residency-based capital flow management measure (CFM) by the IMF's Institutional View and as a macroprudential measure (MPM) because it applies only to FX liabilities of corporates with external debt, while it is intended to mitigate a buildup of systemic risk. Going forward, this regulation should be periodically reviewed and could be revisited as steps are taken to strengthen regulation and supervision to address systemic financial risks.

Authorities' Views

55. The authorities broadly agreed with the reform priorities on supervision and risk management. They are committed to take further steps to strengthen the financial sector. These include strengthening and clarifying the roles and objectives of statutory authorities by amending the laws of BI, OJK, and Indonesian Deposit Insurance Corporation (LPS) as well as efforts to advance financial market deepening and promote further financial inclusion. Several changes are already underway to strengthen the legal and supervisory framework.

56. The authorities are of the view that the corporate prudential FX regulation should not be seen as a CFM nor a CFM/MPM, but plan to do a cost-benefit analysis of extending its coverage. The regulation is aimed to ensure macrofinancial stability through the adoption of prudential principles on corporate foreign borrowing. This regulation is not targeted to limit capital flows, and therefore it should be categorized as "other policies." The authorities encouraged staff to continue deepening understanding on this policy area by exhaustively drawing on country experiences, including Indonesia's experience, in mitigating corporate sector risks.

STAFF APPRAISAL

57. The Indonesian economy continues to perform well. Economic growth has stabilized at near 5 percent, inflation has moderated, the CA deficit remains manageable, and systemic risks are contained. The economic outlook is positive, with a continuation of recent trends and a gradual pickup in growth over the medium term. Risks remain tilted to the downside and are mainly external. The public and corporate sectors continue to rely heavily to external financing, leaving Indonesia vulnerable to a reversal in capital inflows. Indonesia's external position in 2017 continues to be assessed as broadly consistent with fundamentals and desirable policies.

58. Achieving higher potential growth would help create jobs for the young and growing labor force. The policy priority should be a self-reinforcing fiscal-structural reform package that mobilizes revenues to finance development spending (infrastructure, education, health, and targeted transfers), and supports structural reforms to the product, labor, and financial markets.

59. The government has rebalanced public spending to priority sectors and improved efficiency. The targeting of fuel and electricity subsidies to low-income households has been improved, and performance criteria for transfers to local governments have been adopted. However, the implementation of a fully automatic pricing mechanism for fuel and electricity has been delayed.

60. Early implementation of a MTRS to finance growth-enhancing priority spending and structural reforms is critical. The MTRS should also aim to lower poverty and inequality, and should include frontloaded tax policy reforms and gradual gains from tax administration reform by removing exemptions in VAT, CIT, and PIT; introducing excise taxes on vehicles and fuel, raising the

VAT rate, improving compliance, and streamlining the VAT refund process. As adopting a MTRS will take time, the short-term action items should be implemented to arrest the fall in revenue.

61. Infrastructure development should be paced in line with available financing and the economy's absorptive capacity. Priority should be given to financing infrastructure development with revenue from the MTRS and encouraging private sector participation, including FDI. This would limit the buildup of corporate external debt, including by SOEs, and the potential adverse spillovers to the domestic financial system. Infrastructure development should also be accompanied by sound risk management to mitigate fiscal risks from contingent liabilities from SOE debt and PPPs.

62. Efforts to streamline regulations should target areas with the largest potential gains for the economy, such as reducing state control, antitrust exemptions, and barriers in the network sector. Avoiding conflicting regulations requires greater coordination among ministries and regional governments under a national policy direction. Rationalizing non-tariff measures and FDI restrictions would support linkages with global value chains and competitiveness.

63. Improving education and easing labor market regulations would support employment. Ensuring more equitable access to quality education requires improving the efficiency of education spending and the quality of education. Promoting employment and reducing the use of short-term contracts requires streamlining stringent job protection, while improving vocational training and job placement services. Enhancing productivity and female labor participation requires a more open immigration policy for skilled labor, flexible work arrangements, and affordable childcare.

64. Financial deepening with appropriate prudential standards would support infrastructure development. The recent progress developing a national strategy for capital market development reflects high-level political support and enhanced inter-agency coordination. Improving the insolvency and creditor rights regimes would raise participation in the corporate bond market and financial access for MSMEs. The corporate prudential FX regulation can be further improved by extending its coverage to all corporate FX liabilities.

65. The near-term policy mix should support growth while preserving stability. Monetary policy should continue focusing on price stability and supporting growth. The current monetary stance is appropriate; BI should stay on hold in the immediate future and assess the pass-through of its recent actions. BI should also allow the exchange rate to move freely in line with market forces, with FX intervention limited to preventing disorderly market conditions. Fiscal adjustment should be gradual in 2018 to protect growth and rebuild fiscal buffers.

66. Efforts should continue to strengthen financial oversight and crisis management, and implement the FSAP recommendations. The authorities have made progress in strengthening the frameworks for financial oversight and crisis management and resolution in recent years. The FSAP identified several areas where further improvement is needed, including clarification of institutional mandates, improving supervision of financial institutions and financial conglomerates, adopting a more rigorous approach to credit risk, and reconsidering some elements of the new crisis management framework, including the ELA framework.

67. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Box 1. Demographic Dividend: Opportunities and Challenges

Indonesia has the fourth largest population in the world (260 million), with a median age of 28 years. Population growth averaged 1.3 percent per year in 2000-16, but it fell to 1.1 percent in 2016 due to a lower fertility rate. At the same time, the working age population (15-64 years old) grew by 1.6 percent or 2.5 million people per year in 2000-16, reaching 67 percent of total population in 2016. Urbanization has also been rapid.

The share of working age population is projected to peak at 70 percent in 2030, providing a sizable demographic dividend to the economy. Working age population is projected to continue growing faster than overall population until 2030, and slightly slower than that after, with the share of working age population remaining above current levels until 2050.[1/] Thus, Indonesia has a window of opportunity to take advantage of its demographic dividend and try to get rich before getting old.

The demographic dividend also poses challenges. The economy will need to accelerate job creation to absorb the new labor force entrants and lower youth unemployment (15-29 years old), which remains significantly higher than in other age groups likely due to stringent labor regulations, low education quality, and skill mismatches. Addressing youth unemployment and reaping the benefits of the demographic dividend will require implementing structural reforms to accelerate growth and diversify the economy away from agriculture and towards industry and services, which have higher elasticities of employment growth to output growth.

Indonesia: Demographic Indicators

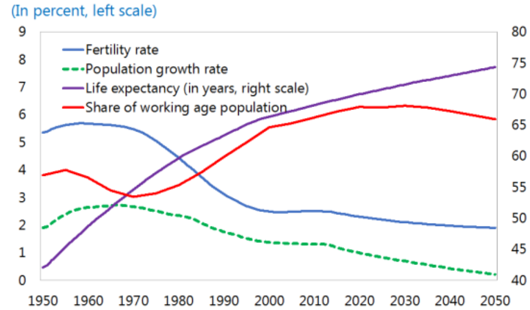
	2000	2005	2010	2016 1/
Population growth (percent)	1.4	1.4	1.3	1.1
Working age (15-64 years old)	2.1	1.6	1.4	1.2
Rural	-0.7	-0.1	-0.3	-0.4
Urban	4.3	3.1	2.9	2.5
In percent of total				
Working age (15-64 years old)	64.6	65.3	66.2	67.2
Rural	58.0	54.1	50.1	45.5
Urban	42.0	45.9	49.9	54.5
Population <30 years old	58.0	55.7	53.7	51.9
Total population (million)	211.5	226.7	242.5	261.1
Life expectancy at birth, total (years)	66.2	67.2	68.1	69.1
Fertility rate, total (births per woman)	2.5	2.5	2.5	2.4

Source: World Bank, Health Nutrition and Population Statistics; and BPS.

1/ or latest available data.

Fertility, Population Growth and Life Expectancy

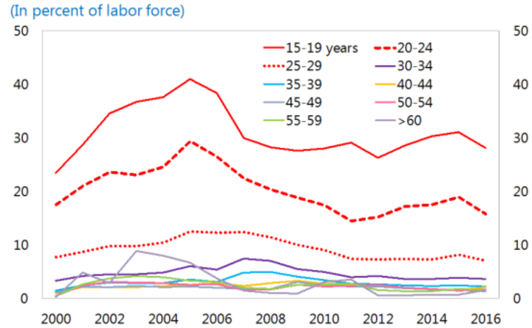
(In percent, left scale)



Source: IMF staff estimates based on United Nations 2015 (medium-fertility scenario)

Unemployment Rates by Age Group

(In percent of labor force)



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

1/ Arslanalp and Lee (2017) project that Indonesia's demographic classification will change to late dividend by 2030 (a shrinking working age population share over the subsequent 15 years) from early dividend in 2015 (an increasing working-age population share over the subsequent 15 years).

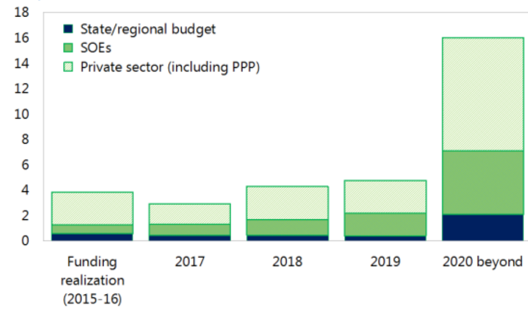
Box 2. Strengthening Institutions and Funding for Infrastructure

The authorities have made infrastructure development a priority. They have increased public capital spending, recapitalized SOEs to boost infrastructure investment, and improved the institutional framework by creating the Committee for Acceleration of Priority Infrastructure Delivery (KPPIP) and accelerating land acquisition procedures. The authorities have selected 247 National Strategic Projects with a cost of 32 percent of GDP to be implemented during 2015-22. KPPIP coordinates 37 of these projects, including 12 oil refineries, one electricity program, 74 roads, and 23 rail roads.

Progress has already been made on infrastructure development:

- *Government and SOE infrastructure spending has increased*. Central government capital spending and transfers to local governments for infrastructure rose by 1 percent of GDP between 2014 and 2017. The government also injected capital to SOEs by 0.6 percent of GDP in 2015-16 to support their infrastructure investment. SOEs are slowly leveraging to finance infrastructure projects, including by issuing domestic and external bonds. The government has also committed guarantees for infrastructure investment (credit, business viability, and PPP guarantees), which reached 2.8 percent of GDP in March 2017, below the maximum limit of 6 percent of GDP for 2017-20.

Funding Allocation Plan for 247 Projects
(In percent of GDP)



Sources: The Committee for Acceleration of Priority Infrastructure Delivery (KPPIP); and IMF staff estimates.

- *The institutional framework has improved*. KPPIP was created to accelerate and coordinate the priority projects. The land acquisition process has been streamlined, with the maximum time needed to acquire land shortened to 400 days from 518 days. The State Asset Management Agency has made this process more flexible by unifying land acquisitions for the National Strategic Projects under one agency.
- *The authorities are making efforts to attract private sector participation.* The government is providing guarantees to ensure acceptable market returns for the private sector to finance infrastructure projects, including through the Viability Gap Fund (covering up to 49 percent of the construction cost) and Availability Payment (annuity payment scheme during the concession period). The authorities are also aiming to mobilize debt and equity financing and develop the regulatory framework for new financing instruments, including structured products (e.g. asset backed securities) and infrastructure bonds.
- *The Negative Investment List* has been revised to attract FDI to infrastructure development. For instance, the foreign ownership limit for toll road operators, telecommunications, and testing companies has been increased to 100 percent from 95 percent; and the foreign ownership limit for distribution and warehousing has been raised to 87 percent from 33 percent.
- Out of 247 National Strategic Projects, four have been completed; 131 are under construction; and 112 are under preparation. The construction of the light rail transit in Jakarta has been fast-tracked, and land acquisition has been accelerated. For instance, land acquisition for the Java North Line Double Track Rail project took less than 2 years to complete.
- Several PPP projects are under way: Umbulan Water (US$0.3 million) supported by the Viability Funding Gap; Palapa fiber-optic supported by the Availability Payment scheme (US$0.6 million); Central Java Power Plant (US$3.0 billion); and three toll roads (US$2.2 billion).

Box 3. Implementation of the 2017 FSAP Key Recommendations

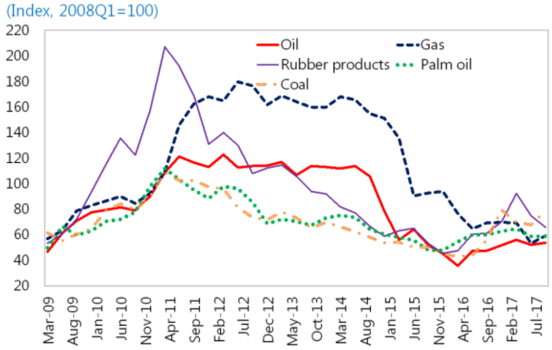
The authorities are taking early steps to implement some of the key FSAP recommendations, although others, such as changes to laws, will take time to implement. Progress has been achieved in the following areas:

- A draft bill amending the BI law is now under preparation and is included in the 2015-19 National Legislation Program. It will set out a financial stability and macroprudential mandate for BI. The legislation program also includes an initiative to amend the OJK law, regarding the primacy of objectives and authority over non-operating financial holding companies. Also, the authorities acknowledge the importance of insurance policyholder protection and plan to propose, after consultations with Parliament, an amendment of the Insurance Law to specify policyholder protection as principal objective of OJK.
- BI and OJK are improving their stress test frameworks and have established a framework for a joint stress test and data sharing.
- To advance on the recommendation to reduce silos in financial oversight, which ultimately requires changes to the OJK law, OJK has established a new Integrated Supervisory and Regulatory Department which brings internal coordination directly under the authority of the Chairman as an interim solution.
- OJK has started an initiative to strengthen its banking supervision by re-evaluating data quality, methodology, and business process used in on-site and off-site supervision, and optimize the IT system to support the integrated supervision.
- OJK has issued a new regulation in 2017 related to the imposition of administrative sanctions in the form of revocation of business licenses to insurance companies in specific circumstances, such as drastic deterioration of financial condition.
- In the area of crisis management and resolution, the authorities have focused on the promulgation of several regulations under the PPKSK Law, including regulations regarding recovery planning for domestic systemically important banks, resolution framework for both systemic and non-systemic banks, and write-off and haircut of remaining assets from the Bank Restructuring Program. The authorities have also conducted a series of join crisis simulation exercises.
- BI and OJK have issued regulations to implement risk-based AML/CFT supervision.

Figure 1. Indonesia: Macro-Financial Developments

Commodity prices recovered somewhat in 2017, after bottoming out in early-2016, except for gas…

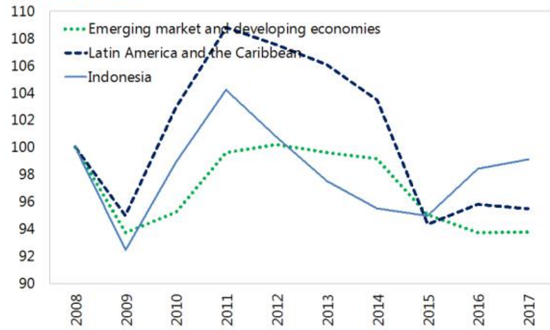
Key Commodity Prices
(Index, 2008Q1=100)



Sources: IMF, Commodity Price System database; and staff estimates.

…leading to a modest improvement in Indonesia's terms of trade and export prices, especially of coal and palm oil.

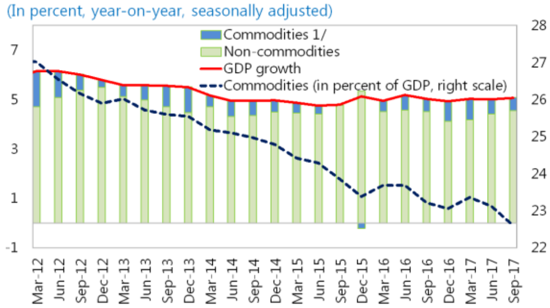
Terms of Trade
(Index, 2008=100)



Sources: IMF, *World Economic Outlook;* and IMF staff estimates.

Growth has stabilized at near 5 percent since 2014, with the share of the commodity sector still declining.

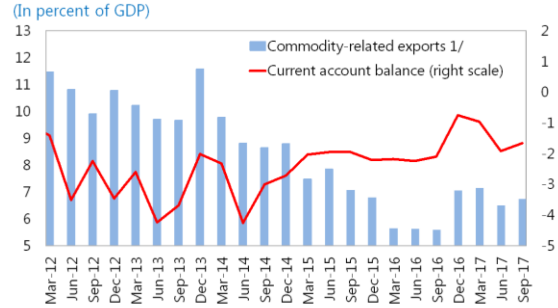
Contribution to Real GDP Growth
(In percent, year-on-year, seasonally adjusted)



Sources: Haver Analytics; and IMF staff estimates.
1/ Includes agriculture, mining and quarrying, manufacturing coal, petroleum and gas.

The current account deficit has remained contained in 2017 due stronger exports, led by commodities.

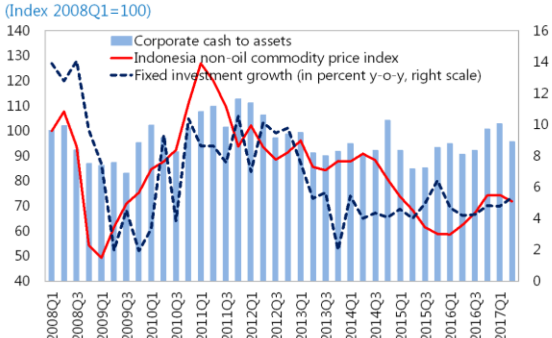
Current Account Balance and Commodity Exports
(In percent of GDP)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.
1/ Includes agriculture products, palm oils, processed rubber, oil products, and mining products.

The corporate sector has not yet fully recovered from the commodity down cycle, with still low investment growth.

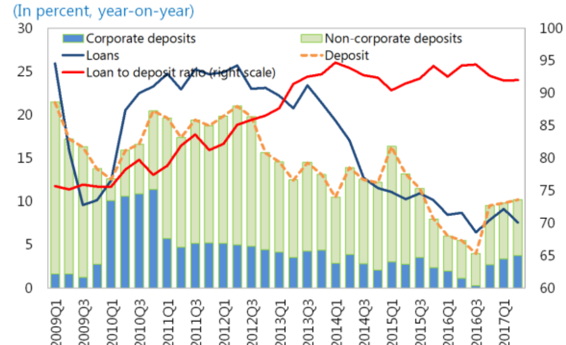
Commodity Prices, Corporate Cash and Fixed Investment
(Index 2008Q1=100)



Sources: CEIC Data Co. Ltd; Bloomberg L.P.; and IMF staff estimates.

The growth rate of loans and deposits remain subdued, although the latter has recovered somewhat recently.

Loan and Deposit Growth
(In percent, year-on-year)

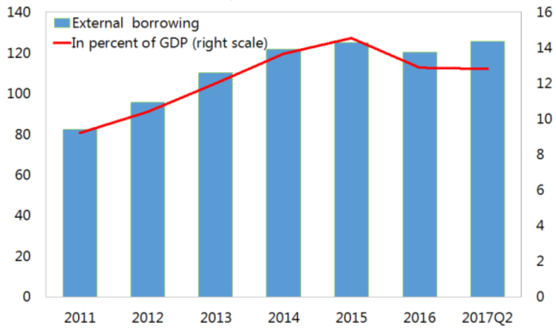


Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

Figure 1. Indonesia: Macro-Financial Developments (Concluded)

Corporate external debt stabilized in 2016-17, after rising rapidly in previous years…

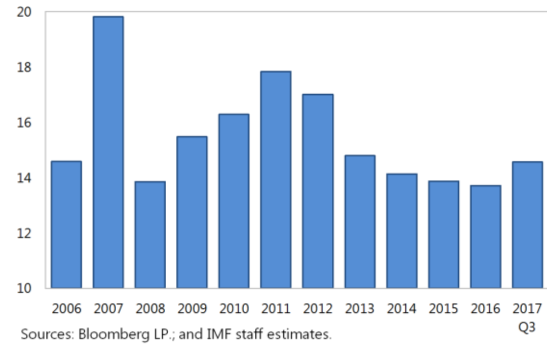
Corporate External Debt
(In billions of U.S. dollar and in percent of GDP)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

…and corporate profitability improved slightly in 2017, in line with the gradual recovery in commodity prices.

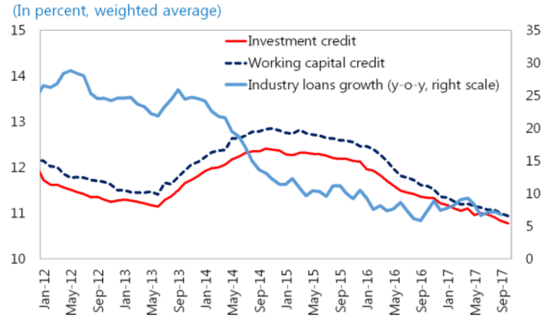
Profitability – Return on Assets of Listed Companies
(In percent)



Sources: Bloomberg LP.; and IMF staff estimates.

Monetary easing in 2016 and August-September 2017 has been partially transmitted to lending rates.

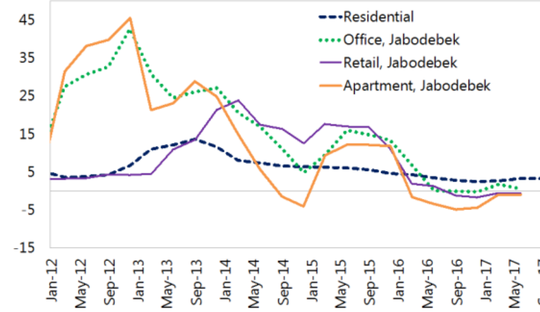
Commercial Banks' Lending Rates and Credit Growth
(In percent, weighted average)



Source: CEIC Data Co. Ltd.

Property prices have remained stable in 2017.

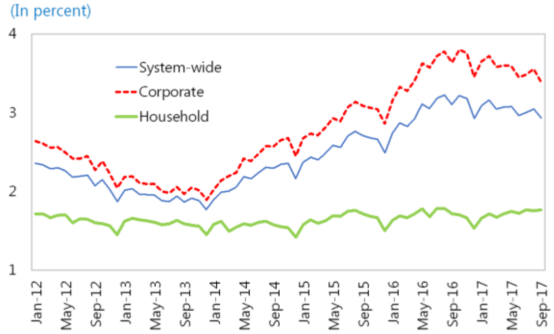
Property Prices
(Year-on-year percent change)



Source: Bank Indonesia, *Commercial Property Survey*.

NPLs in the banking system have stabilized in 2017 after rising sharply during 2014-16.

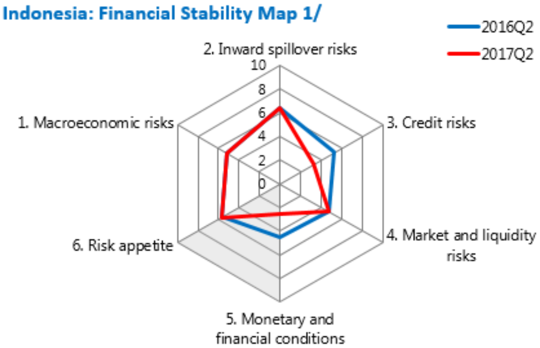
Nonperforming Loan Ratio
(In percent)



Sources: Indonesia Financial Services Authority (OJK); CEIC Data Co. Ltd; and IMF staff estimates.

Macro-financial risks have abated somewhat from a year ago, especially for credit risk and monetary/financial conditions.

Indonesia: Financial Stability Map 1/

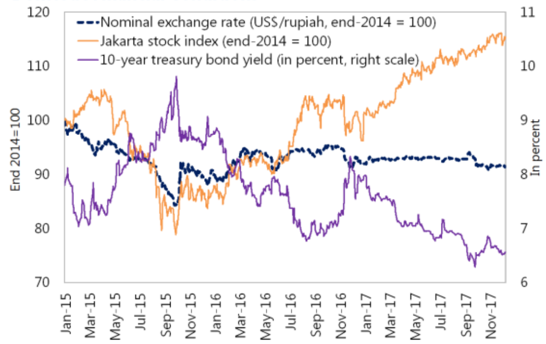


1/ Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

Figure 2. Indonesia: Recent Market Developments

Equity prices have risen and treasury bond yields have fallen in 2017, reflecting favorable financial conditions…

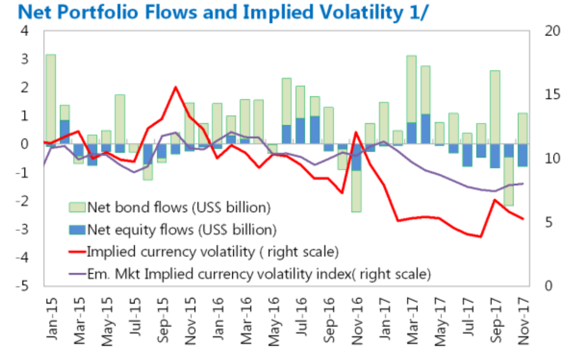
Domestic Financial Conditions



Source: Bloomberg LP; and IMF staff estimates.

…while portfolio inflows have increased and currency volatility has declined.

Net Portfolio Flows and Implied Volatility 1/

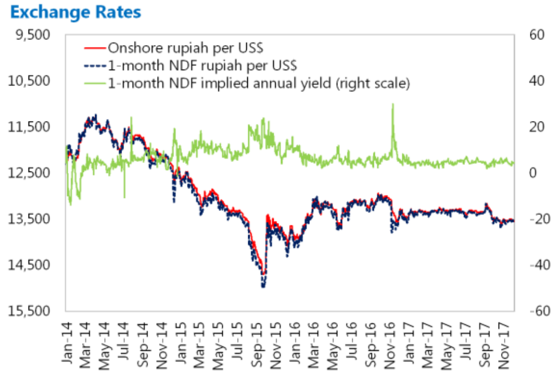


Sources: Bloomberg L.P.; and IMF staff calculations.

1/ High implied volatility indicates potential for large price swings in either direction.

The rupiah has remained stable against the US$ despite higher capital inflows and lower current account deficits…

Exchange Rates

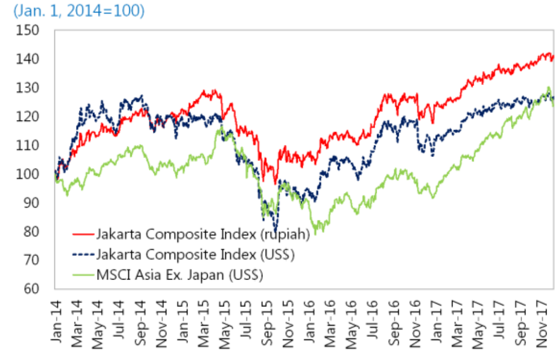


Source: Bloomberg L.P.

…while equity prices have rallied this year.

Equity Market Indices

(Jan. 1, 2014=100)

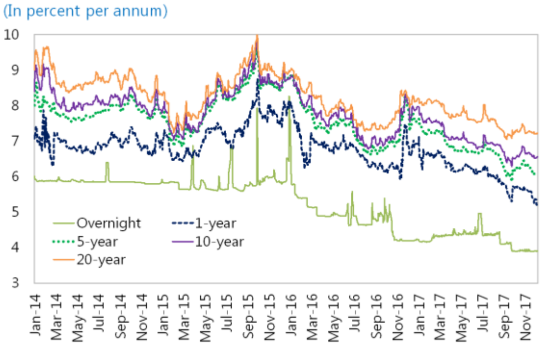


Sources: Bloomberg L.P.; and IMF staff estimates.

Domestic bond yields have declined significantly in 2017 on supportive portfolio inflows.

Domestic Government Bond Yields

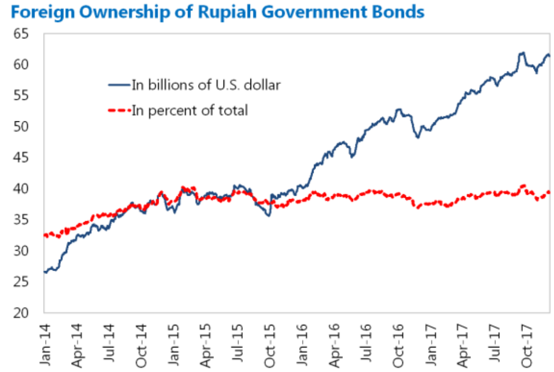
(In percent per annum)



Source: Bloomberg L.P.

Foreign investors participation in rupiah government bonds has remained stable at around 40 percent.

Foreign Ownership of Rupiah Government Bonds



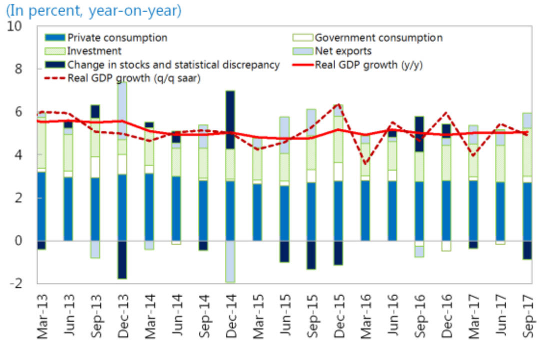
Sources: Bloomberg L.P.; CEIC Data Co., Ltd.; and IMF staff estimates.

Figure 3. Indonesia: Real Sector

Real GDP growth has been stable at near 5 percent in 2017, supported by robust export and investment growth.

Contribution to Real GDP Growth

(In percent, year-on-year)

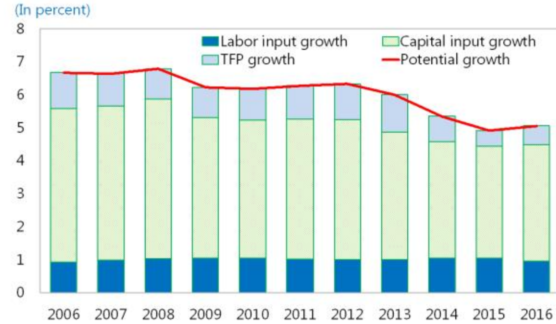


Sources: CEIC Data Company Ltd.; and IMF staff estimates.

Potential growth has declined to around 5½ percent, reflecting lower contributions from capital and TFP growth.

Contribution to Potential GDP Growth

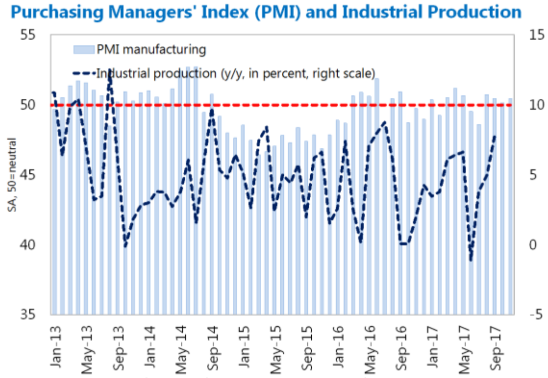
(In percent)



Source: IMF staff estimates.

Industrial production growth has remained moderate in 2017, with the PMI staying near neutral levels.

Purchasing Managers' Index (PMI) and Industrial Production

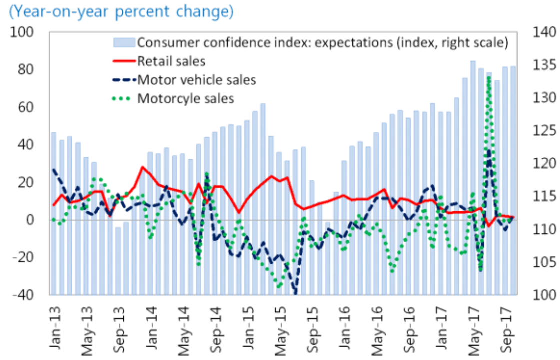


Sources: Haver Analytics; and CEIC Data Company Ltd.

While consumer confidence has picked up, retail and vehicle sales have slowed, giving mixed signals for consumption.

Indicators of Private Consumption Activity

(Year-on-year percent change)

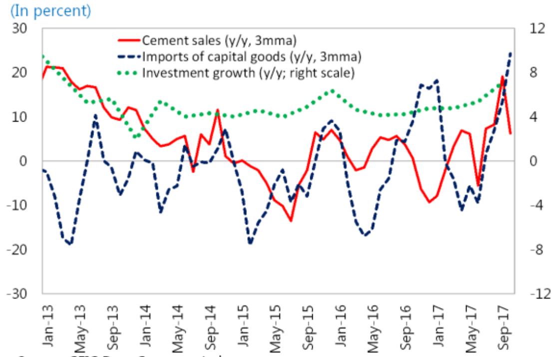


Sources: CEIC Data Company Ltd.; IMF staff estimates.

Cement sales and capital goods imports have gradually risen, mirroring the recovery in investment in Q3:2017.

Indicators of Investment Activity

(In percent)

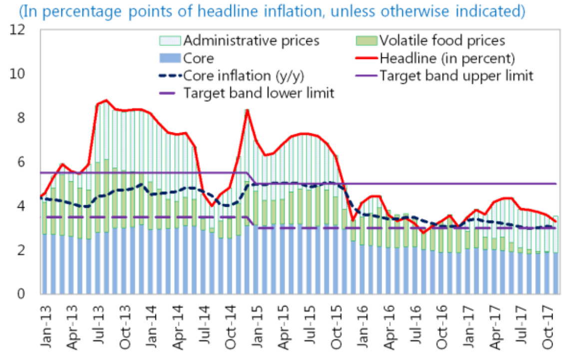


Source: CEIC Data Company Ltd.

Inflation remains near the center of the target band due to lower food and core inflation, and stable administered prices.

Inflation Developments

(In percentage points of headline inflation, unless otherwise indicated)



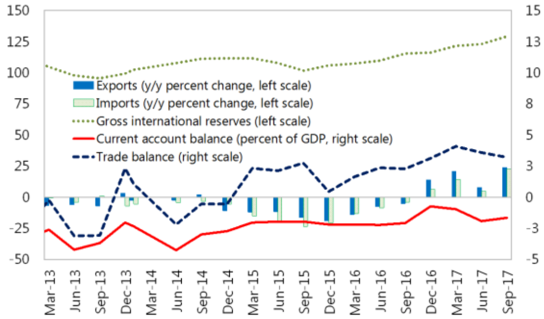
Sources: CEIC Data Company Ltd; and IMF staff estimates.

Figure 4. Indonesia: External Sector

The current account deficit fell in 2017 due to an increase in exports that more than offsets the rise in imports…

Current Account Balance and International Reserves

(In billions of U.S. dollar, unless otherwise indicated)

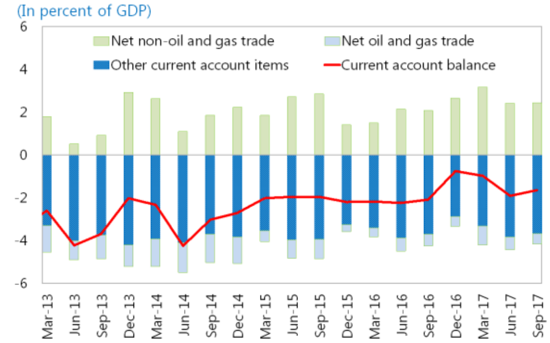


Sources: CEIC Data Company Ltd; and IMF staff estimates.

…as reflected in the improvement in the non-oil and gas trade balance.

Current Account Balance

(In percent of GDP)

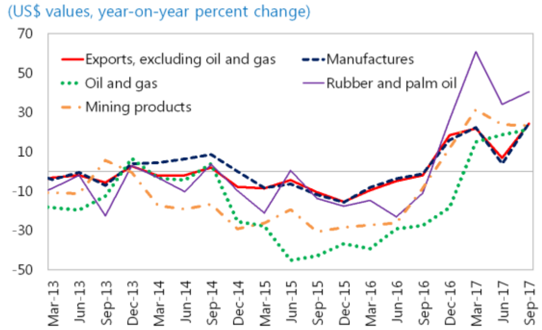


Sources: CEIC Data Company Ltd.; and IMF staff estimates.

The pickup in export growth in 2017 has been broad based, although stronger for rubber and palm oil.

Exports of Goods

(US$ values, year-on-year percent change)

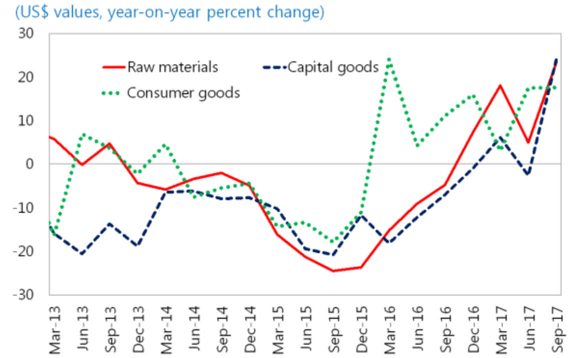


Sources: CEIC Data Company Ltd.; and IMF staff estimates.

The rise in imports has been led by consumer goods and raw materials. Imports of capital goods have recovered recently.

Imports of Goods

(US$ values, year-on-year percent change)

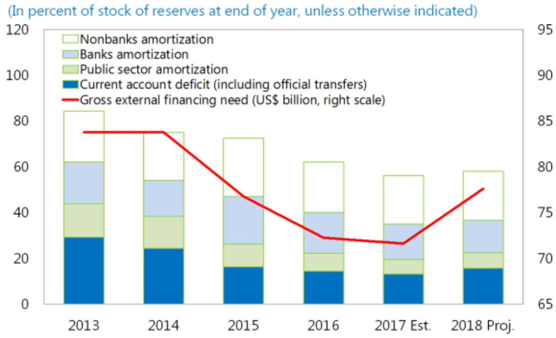


Source: CEIC Data Company Ltd.

External financing needs would remain limited in 2018 due to low current account deficits and public debt amortization.

Gross External Financing Needs

(In percent of stock of reserves at end of year, unless otherwise indicated)

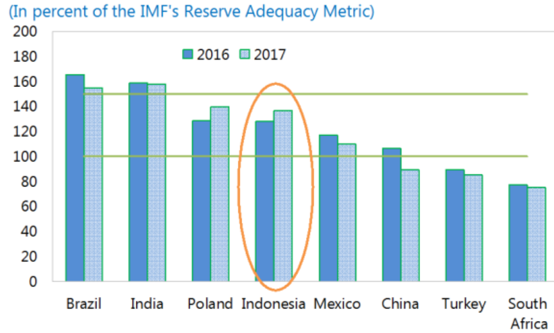


Source: IMF staff estimates.

Indonesia's foreign reserves have increased to US$126.5 billion in 2017.

Gross International Reserves

(In percent of the IMF's Reserve Adequacy Metric)



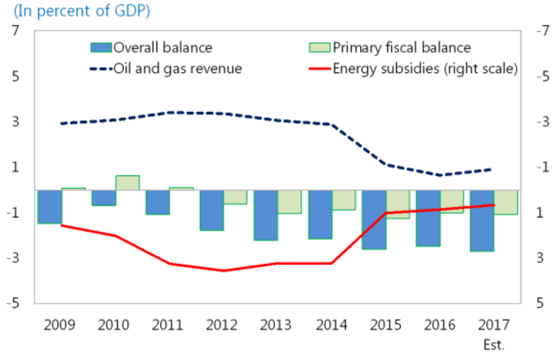
Sources: IMF, *International Financial Statistics*; and IMF staff estimates.

Figure 5. Indonesia: Fiscal Sector

The fiscal deficit remains close to the statutory ceiling, due to lower revenues, despite reductions in energy subsidies…

Central Government Indicators

(In percent of GDP)

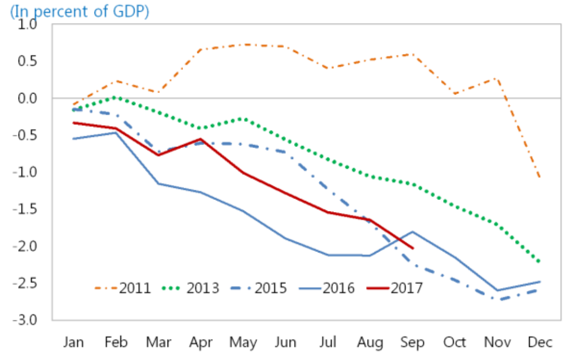


Sources: Indonesian authorities; and IMF staff estimates and projections.

…with budgetary pressures, due to weak revenue performance.

Central Government Deficit Path, 2011-2017

(In percent of GDP)

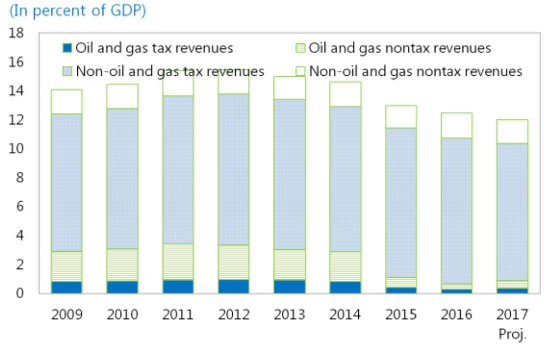


Sources: Indonesian authorities; and IMF staff estimates.

Overall revenue declined due to both lower oil and gas revenues and non-oil and gas revenues…

Central Government Revenue

(In percent of GDP)

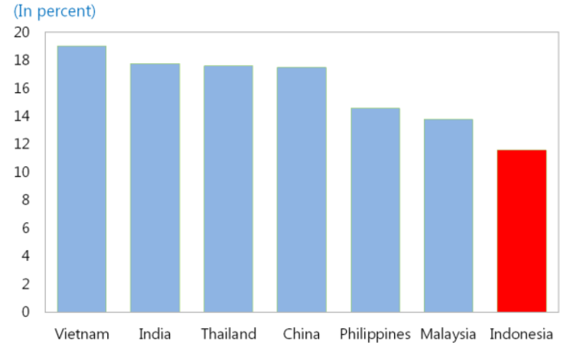


Sources: Indonesian authorities; and IMF staff estimates and projections.

…with Indonesia's tax-to-GDP ratio ranking the lowest among EM peers in Asia.

General Government Tax-to-GDP Ratio, 2016

(In percent)

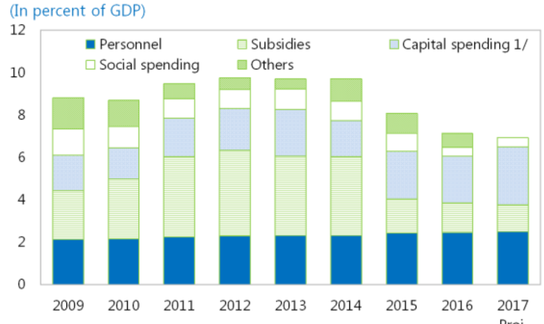


Sources: IMF, *WEO Database*; and Authority data.

Government capital spending has increased despite the fall in total government expenditure.

Central Government Expenditure

(In percent of GDP)



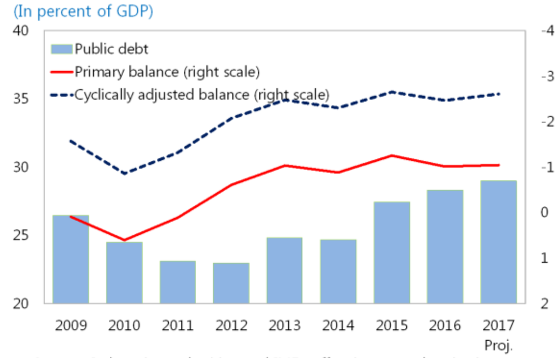
Sources: Indonesian authorities; and IMF staff estimates and projections.

1/ Includes transfers to local governments for infrastructure.

Public debt has increased due to higher fiscal deficits and rupiah depreciation, but remains moderate.

Public Debt, Primary, and Cyclically Adjusted Balance

(In percent of GDP)



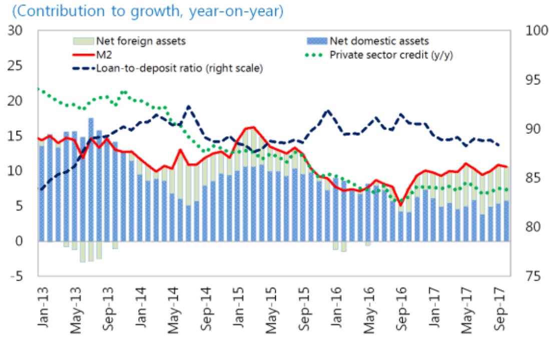
Sources: Indonesian authorities; and IMF staff estimates and projections.

Figure 6. Indonesia: Monetary Sector and Bank Liquidity Developments

Credit growth remains subdued due to weak credit demand and tighter lending standards.

Monetary Aggregates and Loan-to-Deposit Ratios

(Contribution to growth, year-on-year)

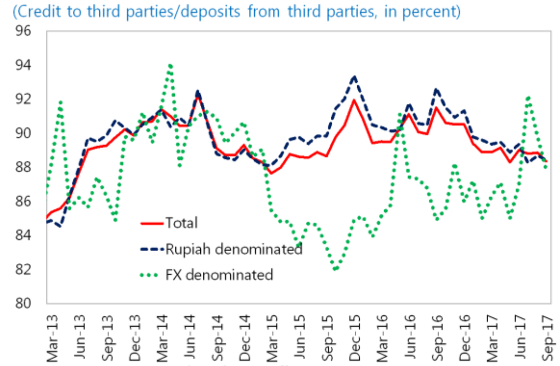


Sources: CEIC Data Company Ltd; and IMF staff estimates.

The loan-to-deposit ratio (LDR) has moderated in 2017, while the one in FX has recently picked up.

Commercial Bank Loan to Deposit Ratios

(Credit to third parties/deposits from third parties, in percent)

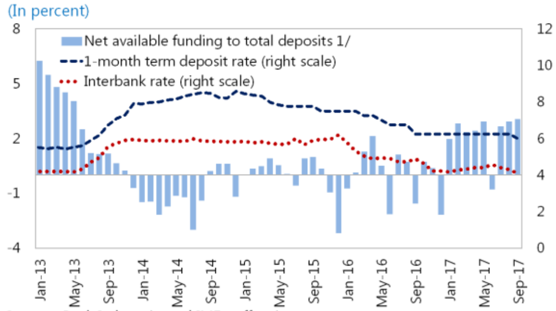


Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

Net available funding has increased in 2017 due to a rebound in deposits and higher capital inflows…

Funding Pressure

(In percent)



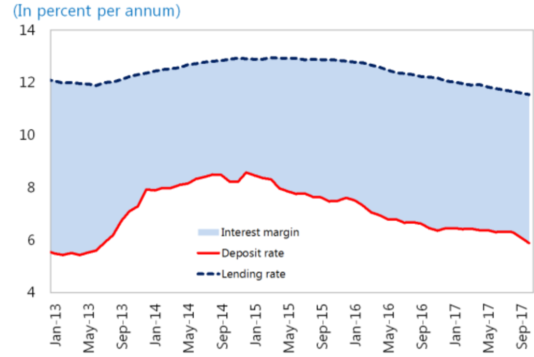
Sources: Bank Indonesia; and IMF staff estimates.

1/ Net available funding is defined as third-party funding less third-party credit and statutory reserves.

…although banks' interest margins remain wide, as deposit rates have declined more than lending rates.

Banking System Interest Margin

(In percent per annum)

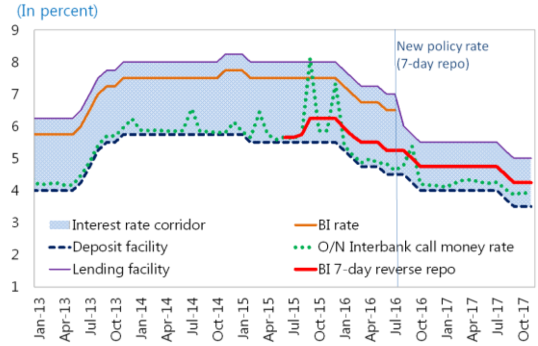


Source: Bank Indonesia.

BI reduced its policy rate by 50 bps in August-September 2017 due to lower inflation and reduced external pressures.

Monetary Policy and Interbank Rates

(In percent)

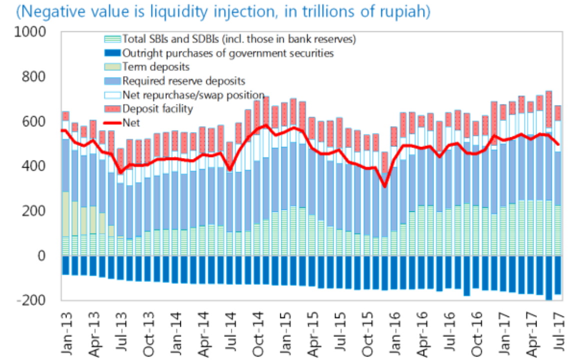


Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

BI has increased its liquidity absorption since the shift in policy rates, to firm up the short end of the yield curve.

Bank Indonesia's Liquidity Absorption by Instrument

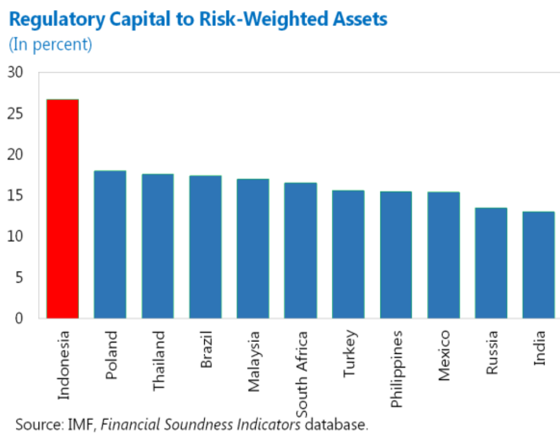
(Negative value is liquidity injection, in trillions of rupiah)



Sources: Bank Indonesia; CEIC Data Co. Ltd; Bloomberg LP; and IMF staff estimates.

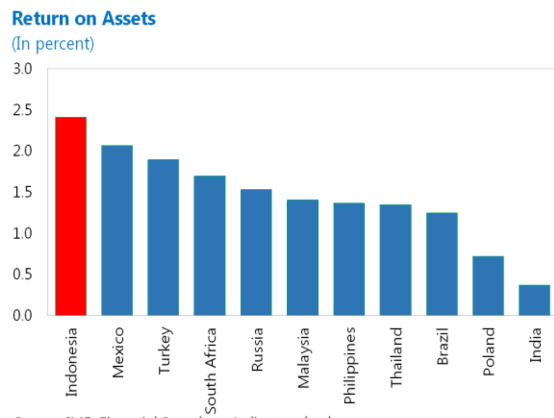
Figure 7. Selected Emerging Market Economies: Financial Soundness Indicators, 2017:Q2 1/

Indonesia's banking system is well capitalized compared to other emerging market economies…



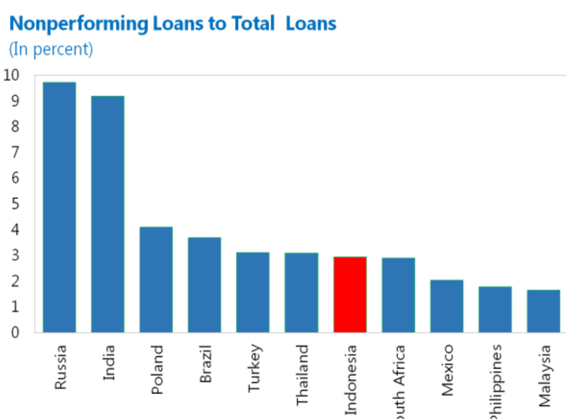
Source: IMF, *Financial Soundness Indicators* database.

…and has a high level of profitability reflecting the large interest margins.



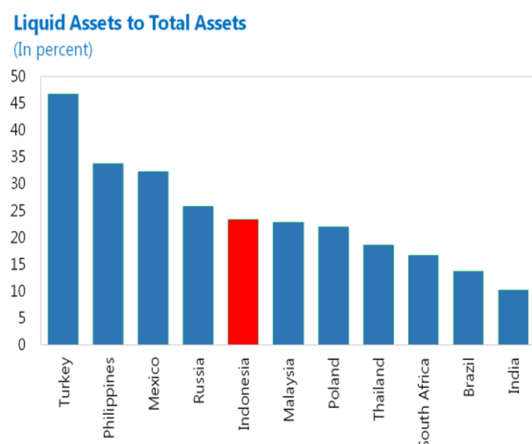
Source: IMF, *Financial Soundness Indicators* database.

Nonperforming loans have increased in recent years, but remain moderate compared to peers.



Source: IMF, *Financial Soundness Indicators* database.

Bank liquidity is ample and around the median for emerging market economies.



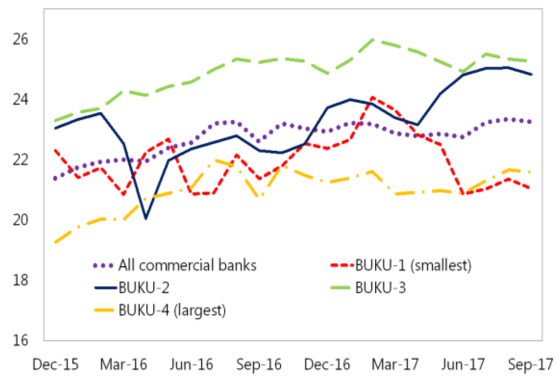
Source: IMF, *Financial Soundness Indicators* database.

1/ Or latest available data.

Figure 8. Financial Soundness Indicators by Size of Commercial Banks

Indonesia's high bank capitalization is broad based, including for small and large banks...

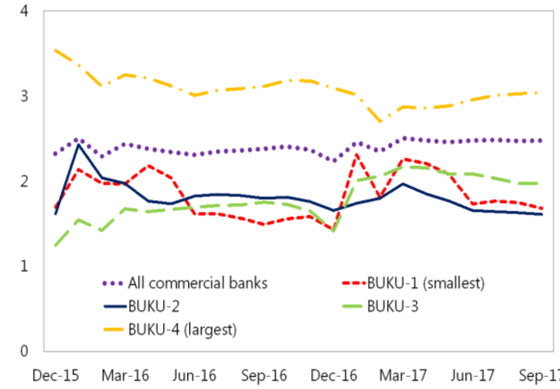
Capital Adequacy Ratio



Sources: Indonesia Financial Services Authority; and IMF staff estimates.

...but profitability is high for the large banks and low for the smaller ones.

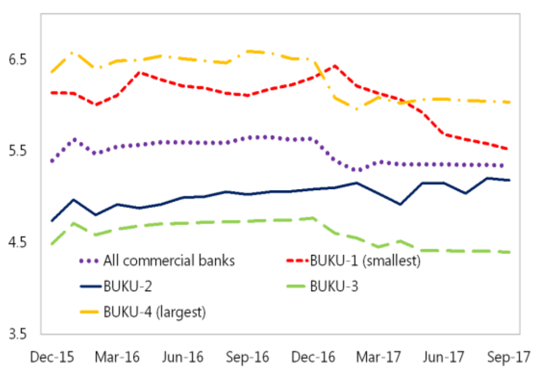
Return on Assets



Sources: Indonesia Financial Services Authority; and IMF staff estimates.

The net interest margin is high for larger banks and low for smaller banks, which affects profitability...

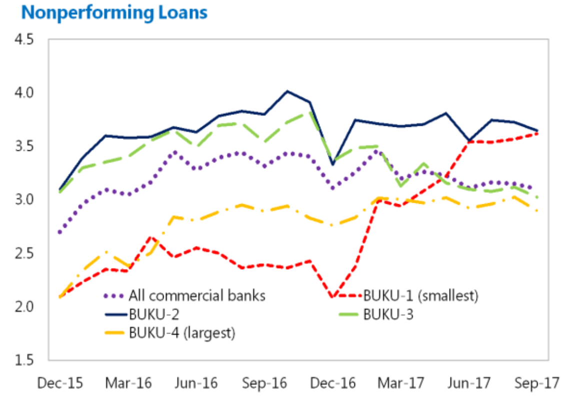
Net Interest Margin



Sources: Indonesia Financial Services Authority; and IMF staff estimates.

...and asset quality is better for larger banks, which have lower NPL ratios than the medium- and small-sized banks.

Nonperforming Loans



Sources: Indonesia Financial Services Authority; and IMF staff estimates.

Table 1. Indonesia: Selected Economic Indicators, 2013–18

Nominal GDP (2016): Rp 12,407 trillion or US$ 932 billion
Population (2016): 258.7 million
Main exports (percent of total, 2016): Coal (10.1), palm oil (9.9), oil and gas (9.1), textile & textile products (8.2)
GDP per capita (2016): US$3,604
Unemployment rate (August 2016): 5.6 percent
Poverty headcount ratio at national poverty line (2016): 10.9 percent of population

	2013	2014	2015	2016	2017	2017		2018
					Prel.	Latest outturn		Proj.
Real GDP (percent change)	5.6	5.0	4.9	5.0	5.1	5.0	Q1-Q3	5.3
Domestic demand	4.7	5.0	4.2	4.6	4.7	4.5	Q1-Q3	5.1
Of which:								
Private consumption 1/	5.5	5.3	4.8	5.0	5.0	5.0	Q1-Q3	5.0
Government consumption	6.7	1.2	5.3	-0.1	2.1	1.3	Q1-Q3	2.0
Gross fixed investment	5.0	4.4	5.0	4.5	6.0	5.8	Q1-Q3	6.2
Change in stocks 2/	-0.6	0.5	-0.6	0.3	-0.2	-0.3	Q1-Q3	0.0
Net exports 2/	0.6	-0.2	1.0	0.1	0.7	0.8	Q1-Q3	0.3
Saving and investment (in percent of GDP)								
Gross investment 3/	33.8	34.6	34.2	34.3	34.0	...	...	34.1
Gross national saving	30.7	31.5	32.1	32.5	32.4	...	...	32.3
Prices (12-month percent change)								
Consumer prices (end period)	8.1	8.4	3.4	3.0	3.3	3.3	Nov.	3.6
Consumer prices (period average)	6.4	6.4	6.4	3.5	3.8	3.8	Jan.-Nov.	3.4
Public finances (in percent of GDP)								
Central government revenue	15.1	14.7	13.1	12.5	12.0	8.1	Jan.-Sept.	12.2
Central government expenditure	17.3	16.8	15.7	15.0	14.7	10.1	Jan.-Sept.	14.7
Of which: Energy subsidies	3.2	3.2	1.0	0.9	0.7	0.4	Jan.-Sept.	0.7
Central government balance	-2.2	-2.1	-2.6	-2.5	-2.7	-2.0	Jan.-Sept.	-2.5
Primary balance	-1.0	-0.9	-1.2	-1.0	-1.0	-0.8	Jan.-Sept.	-0.9
Central government debt	24.8	24.7	27.4	28.3	29.0	...	...	29.5
Money and credit (12-month percent change; end of period)								
Rupiah M2	9.4	13.5	9.0	11.7	12.0	9.8	Jul.	...
Base money	16.7	11.6	3.0	4.6	9.8	7.2	Jul.	...
Private Sector Credit	20.0	11.8	10.3	7.7	8.6	7.5	Sept.	10.3
One-month interbank rate (period average)	5.8	7.5	7.2	6.9	...			...
Balance of payments (in billions of U.S. dollars, unless otherwise indicated)								
Current account balance	-29.1	-27.5	-17.5	-16.8	-16.9	-11.5	Q1-Q3	-20.4
In percent of GDP	-3.2	-3.1	-2.0	-1.8	-1.7	-1.5	Q1-Q3	-1.9
Trade balance	5.8	7.0	14.0	15.4	18.4	15.8	Q1-Q3	14.8
Of which: Oil and gas (net)	-9.7	-11.8	-5.7	-4.8	-6.9	-5.0	Q1-Q3	-7.6
Inward direct investment	18.8	21.8	16.6	3.8	23.8	16.8	Q1-Q3	26.6
Overall balance	-7.3	15.2	-1.1	12.1	11.3	10.6	Q1-Q3	7.3
Terms of trade, percent change (excluding oil)	-2.5	-3.3	-14.6	-0.2	6.5	...	...	2.7
Gross reserves								
In billions of U.S. dollars (end period)	99.4	111.9	105.9	116.4	127.6	126.5	Oct.	135.0
In months of prospective imports of goods and services	5.9	8.1	8.0	7.9	8.0	7.9	Oct.	7.9
As a percent of short-term debt 4/	177	189	191	213	226	224	Oct.	234
Total external debt 5/								
In billions of U.S. dollars	266.1	293.3	310.7	318.8	345.4	335.4	Q2	359.3
In percent of GDP	29.0	32.9	36.1	34.2	34.0	33.0	Q2	32.8
Exchange rate								
Rupiah per U.S. dollar (period average)	10,414	11,862	13,391	13,306	...	13,382	Jan.- Dec.	...
Rupiah per U.S. dollar (end of period)	12,171	12,435	13,788	13,473	...	13,579	Dec. 18	...
Memorandum items:								
Jakarta Stock Exchange (12-month percentage change, composite index)	-1.0	22.3	-12.1	15.3	...	15.5	Dec. 18 (ytd)	...
Oil production (thousands of barrels per day)	830	794	800	820	815			800
Nominal GDP (in trillions of rupiah)	9,546	10,570	11,532	12,407	13,604			14,852

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes NPISH consumption.
2/ Contribution to GDP growth (percentage points).
3/ Includes changes in stocks.
4/ Short-term debt on a remaining maturity basis.
5/ Public and private external debt.

Table 2. Indonesia: Selected Vulnerability Indicators, 2013–17

	2013	2014	2015	2016	2017 Proj. or latest	Observation
Key economic and market indicators						
Real GDP growth (in percent)	5.6	5.0	4.9	5.0	5.1	Proj.
CPI inflation (in percent, end of period, e.o.p.)	8.1	8.4	3.4	3.0	3.3	Proj.
Short-term (ST) interest rate (in percent, e.o.p.) 1/	7.6	6.6	8.6	7.0	4.8	Nov. 2017
Ten-year government bond yield (in percent, e.o.p.)	8.5	7.8	8.7	6.8	6.5	Nov. 2017
Indonesia EMBI spread (basis points (bps), e.o.p.)	292	266	329	195	168	Nov. 2017
Exchange rate (rupiah per U.S. dollar, e.o.p.)	12,171	12,435	13,788	13,473	13,579	
External sector						
Current account balance (in percent of GDP)	-3.2	-3.1	-2.0	-1.8	-1.7	Proj.
Net FDI inflows (in percent of GDP)	1.3	1.7	1.2	1.7	2.0	Proj.
Exports of goods and nonfactor services (GNFS) (percentage change, in US$ terms)	-2.8	-3.0	-13.8	-2.1	12.3	Proj.
Real effective exchange rate (e.o.p.; 2010=100)	83.5	92.4	91.5	94.2	94.1	Sept. 2017
Gross international reserves (in US$ billion)	99.4	111.9	105.9	116.4	127.6	Proj.
In percent of ST debt at remaining maturity (RM)	176.6	188.8	190.9	212.9	225.8	Proj.
Total gross external debt (in percent of exports of GNFS)	129.8	147.5	181.3	190.0	183.3	Proj.
Gross external financing requirement (in US$ billion) 2/	83.8	83.8	76.8	72.3	71.6	Proj.
Public sector (PS) 3/						
Overall balance (in percent of GDP)	-2.2	-2.1	-2.6	-2.5	-2.7	Proj.
Primary balance (in percent of GDP)	-1.0	-0.9	-1.2	-1.0	-1.0	Proj.
Gross PS financing requirement (in percent of GDP) 4/	4.0	4.4	4.2	4.2	3.7	Proj.
Public sector gross debt (PSGD) (in percent of GDP)	24.8	24.7	27.4	28.3	29.0	Proj.
Of which : Exposed to rollover risk (in percent of total PSGD) 5/	7.0	7.6	7.5	7.0	7.4	Proj.
Exposed to exchange rate risk (in percent of total PSGD) 6/	46.7	43.4	44.5	42.6	39.0	Proj.
Exposed to interest rate risk (in percent of total PSGD) 7/	5.2	4.0	2.8	2.0	1.3	Proj.
Financial sector (FS)						
Capital to risk-weighted assets (in percent) 8/	18.1	19.6	21.4	22.9	23.2	Q3
Nonperforming loans (in percent of total loans)	1.8	2.2	2.5	2.9	2.9	Q3
Foreign currency deposits at commercial banks (in percent of total deposits)	17.0	15.9	16.5	14.5	13.7	Jul. 2017
Foreign currency loans at commercial banks (in percent of total loans)	16.5	15.7	14.3	13.3	13.0	Q2
Government debt held by financial system (percent of total financial system assets)	5.9	6.0	7.5	8.4	8.1	Sept. 2017
Private sector credit of banking system (annual percentage change)	20.0	11.8	10.3	7.7	7.5	Sept. 2017

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ One-month Jakarta Interbank offered rate.
2/ Defined as current account deficit, plus amortization on medium- and long-term debt and short-term debt at end of previous period.
3/ Public sector covers central government only.
4/ Overall balance plus debt amortization.
5/ Short-term debt and maturing medium- and long-term debt.
6/ Debt in foreign currency or linked to the exchange rate.
7/ Government securities at variable interest rates.
8/ Includes capital charge for operational risk.

Table 3. Indonesia: Balance of Payments, 2013–18

(In billions of U.S. dollar, unless otherwise indicated)

	2013	2014	2015	2016	2017 Prel.	2018 Proj.
Current account	-29.1	-27.5	-17.5	-16.8	-16.9	-20.4
Goods, net (trade balance)	5.8	7.0	14.0	15.4	18.4	14.8
Exports, f.o.b.	182.1	175.3	149.1	144.4	164.5	173.2
Oil and gas	33.6	28.8	17.2	12.9	14.9	16.4
Non-oil and gas 1/	148.5	146.5	131.9	131.6	149.5	156.8
Of which : Manufacturing	109.3	115.4	104.8	105.9	118.8	124.7
Palm oil	16.5	17.5	15.4	14.4	18.4	17.4
Rubber products	9.3	7.0	5.8	5.5	7.5	6.1
Other manufacturing	83.5	91.0	83.5	86.0	93.0	101.2
Mining	30.4	21.8	19.5	18.2	22.5	24.1
Imports, f.o.b.	-176.3	-168.3	-135.1	-129.0	-146.1	-158.4
Oil and gas	-43.3	-40.6	-22.9	-17.7	-21.8	-24.0
Non-oil and gas	-133.0	-127.7	-112.2	-111.3	-124.2	-134.4
Services, net	-12.1	-10.0	-8.7	-7.0	-7.6	-6.9
Income, net	-27.1	-29.7	-28.4	-29.7	-31.8	-32.5
Current transfers, net	4.2	5.2	5.5	4.4	4.1	4.3
Capital and financial account	22.0	44.9	16.9	28.9	28.2	27.7
Capital account	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	21.9	44.9	16.8	28.6	28.2	27.7
Direct investment, net 2/	12.2	14.7	10.7	16.1	20.5	21.0
Abroad, net	-6.6	-7.1	-5.9	12.2	-3.4	-5.6
In Indonesia (FDI), net	18.8	21.8	16.6	3.8	23.8	26.6
Portfolio investment, net	10.9	26.1	16.2	19.0	19.5	8.3
Assets, net	-1.3	2.6	-1.3	2.2	-1.9	-2.0
Liabilities	12.1	23.5	17.5	16.8	21.4	10.3
Equity securities	-1.9	3.3	-1.5	1.3	-1.9	0.7
Debt securities	14.0	20.2	19.0	15.5	23.3	9.6
Other investment	-0.8	4.3	-10.1	-6.5	-11.8	-1.6
Assets	-3.4	-3.4	-11.8	2.5	-12.3	-3.3
Public sector	0.0	0.0	0.0	-0.3	0.0	0.0
Private sector	-3.4	-3.4	-11.8	2.8	-12.3	-3.3
Liabilities	2.6	7.7	1.7	-9.0	0.5	1.7
Public sector	-1.4	-4.2	-0.2	-3.3	-1.3	-1.2
Private sector	4.0	11.9	1.9	-5.7	1.8	2.9
Total	-7.1	17.4	-0.7	11.8	11.3	7.3
Errors and omissions	-0.2	-2.2	-0.4	0.3	0.0	0.0
Overall balance	-7.3	15.2	-1.1	12.4	11.3	7.3
Valuation changes	-6.1	-2.8	-4.8	-1.9	0.0	0.0
Change in reserve assets (- = increase)	13.4	-12.5	5.9	-10.4	-11.3	-7.3
Memorandum items:						
Reserve assets position (eop)	99.4	111.9	105.9	116.4	127.6	135.0
In months of prospective imports of goods and services	5.9	8.1	8.0	7.9	8.0	7.9
In percent of short-term (ST) debt at remaining maturity (RM)	177	189	191	213	226	234
In percent of ST debt at RM plus the current account deficit	119	146	147	163	166	170
Current account (- deficit, percent of GDP)	-3.2	-3.1	-2.0	-1.8	-1.7	-1.9
Non-oil and gas exports, volume growth	4.8	4.5	0.0	-1.0	11.3	4.8
Non-oil and gas imports, volume growth	-1.2	-1.0	0.9	5.2	6.6	6.2
Terms of trade, percent change (excluding oil)	-2.5	-3.3	-14.6	-0.2	6.5	2.7
Terms of trade, percent change (including oil)	-3.1	-2.4	-2.5	3.1	2.6	0.5
Gross external financing requirement (in US$ billion) 3/	83.8 #	83.8	76.8	72.3	71.6	76.9

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes "other exports" category.
2/ FDI developments in 2016 reflected some one-off transactions associated with the tax amnesty program.
3/ Defined as current account deficit, plus amortization on medium- and long-term debt and short-term debt at end of previous period.

Table 4. Indonesia: Medium-Term Macroeconomic Framework, 2015–22

	2015	2016	2017 Est.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.
Real GDP (percent change)	4.9	5.0	5.1	5.3	5.5	5.6	5.6	5.6
Domestic demand	4.2	4.6	4.7	5.1	5.3	5.4	5.5	5.5
Of which:								
Private consumption 1/	4.8	5.0	5.0	5.0	5.2	5.2	5.3	5.3
Government Consumption	5.3	-0.1	2.1	2.0	3.8	4.2	4.1	4.0
Gross fixed investment	5.0	4.5	6.0	6.2	6.2	6.3	6.4	6.3
Net exports 2/	1.0	0.1	0.7	0.3	0.3	0.3	0.3	0.3
Output gap	0.3	-0.1	-0.5	-0.4	-0.1	0.0	0.0	0.0
Prices (12-month percent change)								
Consumer prices (end period)	3.4	3.0	3.3	3.6	3.8	3.7	3.5	3.6
Consumer prices (period average)	6.4	3.5	3.8	3.4	3.7	3.7	3.6	3.6
Public finances (in percent of GDP)								
General government revenue	14.9	14.3	13.8	14.0	13.9	13.9	13.9	13.9
General government expenditure	17.5	16.8	16.5	16.5	16.4	16.4	16.4	16.4
General government balance	-2.6	-2.5	-2.7	-2.5	-2.5	-2.5	-2.5	-2.5
General government primary balance	-1.2	-1.0	-1.0	-0.9	-0.8	-0.8	-0.9	-0.9
General government debt	27.4	28.3	29.0	29.5	29.9	30.2	30.3	30.4
Balance of payments (in billions of U.S. dollars)								
Current account balance	-17.5	-16.8	-16.9	-20.4	-21.9	-25.4	-28.1	-32.0
In percent of GDP	-2.0	-1.8	-1.7	-1.9	-1.8	-1.9	-2.0	-2.0
Trade balance	14.0	15.4	18.4	14.8	14.7	14.6	13.7	13.8
In percent of GDP	1.6	1.7	1.8	1.3	1.2	1.1	1.0	0.9
Of which : Oil and gas (net)	-5.7	-4.8	-6.9	-7.6	-7.1	-7.3	-7.3	-7.6
Service balance (in percent of GDP)	-1.0	-0.8	-0.7	-0.6	-0.6	-0.6	-0.5	-0.5
Overall balance	-1.1	12.1	11.3	7.3	9.4	7.9	10.0	11.2
Gross reserves								
In billions of U.S. dollars (end period)	105.9	116.4	127.6	135.0	144.4	152.3	162.3	173.4
In months of prospective imports	8.0	7.9	8.0	7.9	7.8	7.6	7.5	7.5
As a percent of short-term debt 3/	190.9	212.9	225.8	234.3	245.5	256.2	270.6	286.9
Total external debt								
In billions of U.S. dollars	310.7	318.8	345.4	359.3	374.4	389.0	405.5	423.3
In percent of GDP	36.1	34.2	34.0	32.8	31.4	29.8	28.3	26.6
Credit								
Private Sector Credit	10.3	7.7	8.6	10.3	11.2	12.3	12.3	12.3
Credit-to-GDP gap 4/	0.9	-0.3	-1.0	-0.7	-0.4	0.0	0.1	0.3
Memorandum items:								
Oil production (thousands of barrels per day)	800	820	815	800	740	710	710	710
Indonesian oil price (period average, in U.S. dollars per barrel)	49.2	40.2	49.5	55.9	53.7	52.3	51.8	51.6
Nominal GDP (in trillions of rupiah)	11,532	12,407	13,604	14,852	16,245	17,794	19,469	21,296
Nominal GDP (in billions of U.S. dollars)	861	932	…	…	…	…	…	…

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes NPISH consumption.
2/ Contribution to GDP growth.
3/ Short-term debt on a remaining maturity basis.
4/ Follows the guidance of the Basel Committee on Banking Supervision.

Table 5. Indonesia: Summary of Central Government Operations, 2014–18

(In trillions of rupiah)

	2014	2015	2016	2017		2018	
				Proj.	Revised Budget	Proj.	Budget
Revenues and grants	1,550	1,508	1,556	1,637	1,736	1,816	1,895
Of which: tax revenues	1,147	1,240	1,285	1,338	1,473	1,486	1,618
Oil and gas revenues	304	128	81	118	114	135	118
Tax revenues	87	50	36	46	42	52	38
Nontax revenues	217	78	45	72	72	82	80
Non-oil and gas revenues	1,241	1,368	1,466	1,518	1,619	1,680	1,775
Tax revenues	1,059	1,191	1,249	1,292	1,431	1,433	1,580
Income tax	459	553	630	593	742	650	817
Of which: tax amnesty			114	21	21	0	0
VAT	409	424	412	469	476	530	542
Other	192	214	207	231	213	253	221
Nontax revenues	182	177	217	226	188	247	195
Grants	5	12	9	1	3	1	1
Expenditure and net lending	1,777	1,808	1,864	2,000	2,133	2,189	2,221
Current expenditure	958	871	935	1,047	1,103	1,162	1,194
Personnel	244	281	305	340	340	369	366
Subsidies	392	186	174	171	169	168	156
Of which: energy subsidies	342	119	107	92	90	106	95
Fuel	240	61	44	43	45	52	47
Electricity	102	58	63	49	45	54	48
Interest	133	156	183	221	219	242	239
Other	189	248	273	315	374	384	433
Development expenditure	245	314	219	197	264	260	260
Capital spending	147	217	169	139	206	179	179
Social assistance spending 1/	98	97	50	58	58	81	81
Transfers to local governments	574	623	710	756	766	766	766
Of which: transfers for infrastructure 2/	32	39	101	232	239	230	230
Overall balance	-227	-300	-308	-363	-397	-373	-326
Financing	227	300	308	363	397	373	326
Net issuance of government securities	274	367	408	436	467	451	415
Rupiah bond issuance	353	408	440	572	…	641	…
External bond issuance	86	87	109	86	…	81	…
Amortization	-165	-128	-140	-223	…	-271	…
Program loan (gross issuance)	18	55	35	13	-6	-6	…
SOE recapitalization and land acquisition	…	-60	-91	-60	-60	-66	-66
Other	…	-63	-45	-27	-4	-7	…

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Some social assistance spending was reclassified to other expenditure in 2016.

2/ Special purpose transfers (DAK) for physical infrastructure and Village Fund transfers. Starting 2017, 25 percent of general transfer and revenue sharing is included.

Table 6. Indonesia: Summary of Central Government Operations, 2014–18

(In percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017		2018	
				Proj.	Revised Budget	Proj.	Budget
Revenues and grants	14.7	13.1	12.5	12.0	12.8	12.2	12.8
Of which: tax revenues	10.9	10.8	10.4	9.8	10.8	10.0	10.9
Oil and gas revenues	2.9	1.1	0.7	0.9	0.8	0.9	0.8
Tax revenues	0.8	0.4	0.3	0.3	0.3	0.4	0.3
Nontax revenues	2.1	0.7	0.4	0.5	0.5	0.6	0.5
Non-oil and gas revenues	11.7	11.9	11.8	11.2	11.9	11.3	12.0
Tax revenues	10.0	10.3	10.1	9.5	10.5	9.6	10.6
Income tax	4.3	4.8	5.1	4.4	5.5	4.4	5.5
Of which: tax amnesty			0.9	0.2	…	…	0.0
VAT	3.9	3.7	3.3	3.4	3.5	3.6	3.6
Other	1.8	1.9	1.7	1.7	1.6	1.7	1.5
Nontax revenues	1.7	1.5	1.7	1.7	1.4	1.7	1.3
Grants	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Expenditure and net lending	16.8	15.7	15.0	14.7	15.7	14.7	15.0
Current expenditure	9.1	7.6	7.5	7.7	8.1	7.8	8.0
Personnel	2.3	2.4	2.5	2.5	2.5	2.5	2.5
Subsidies	3.7	1.6	1.4	1.3	1.2	1.1	1.1
Of which: energy subsidies	3.2	1.0	0.9	0.7	0.7	0.7	0.6
Fuel	2.3	0.5	0.4	0.3	0.3	0.3	0.3
Electricity	1.0	0.5	0.5	0.4	0.3	0.4	0.3
Interest	1.3	1.4	1.5	1.6	1.6	1.6	1.6
Other	1.8	2.1	2.2	2.3	2.8	2.6	2.9
Development expenditure	2.3	2.7	1.8	1.4	1.9	1.8	1.8
Capital spending	1.4	1.9	1.4	1.0	1.5	1.2	1.2
Social assistance spending 1/	0.9	0.8	0.4	0.4	0.4	0.5	0.5
Transfers to local governments	5.4	5.4	5.7	5.6	5.6	5.2	5.2
Of which: transfers for infrastructure 2/	0.3	0.3	0.8	1.7	1.8	1.5	1.5
Overall balance	-2.1	-2.6	-2.5	-2.7	-2.9	-2.5	-2.2
Financing	2.1	2.6	2.5	2.7	2.9	2.5	2.2
Memorandum items:							
Net issuance of government securities (in trillions of rupiah)	274	367	408	436	467	451	415
SOE recapitalization and land acquisition (in trillions of rupiah)	…	65	91	60	60	66	66
Primary balance (percent of GDP)	-0.9	-1.2	-1.0	-1.0	-1.3	-0.9	-0.6
Cyclically-adjusted primary balance (percent of GDP)	-1.0	-1.3	-1.0	-1.0	…	-0.8	…
Capital spending and transfers (percent of GDP) 3/	1.7	2.2	2.2	2.7	3.3	2.8	2.8
General government debt (percent of GDP)	24.7	27.4	28.3	29.0	…	29.5	…
Indonesian crude oil price (US$ per barrel)	96.5	49.2	40.2	49.5	45.0	55.9	48.0
Oil production (thousands of barrels per day)	794	800	820	815	815	800	800
Nominal GDP (in trillions of rupiah)	10,570	11,532	12,407	13,604	13,604	14,852	14,852

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Some social assistance spending was reclassified to other expenditure in 2016.

2/ Special purpose transfers (DAK) for physical infrastructure and Village Fund transfers. Starting 2017, 25 percent of general transfer and

3/ Sum of capital spending and transfers for infrastructure.

Table 7. Indonesia: Summary of General Government Operations, 2014–18

	2014	2015	2016	2017 Proj.	2018 Proj.
			(In trillions of rupiah)		
Total revenue and grants	1,740	1,715	1,778	1,881	2,082
Taxes	1,274	1,379	1,434	1,501	1,664
Taxes on income, profits, and capital gains	546	602	666	638	703
Taxes on goods and services	527	568	556	638	716
VAT and luxury taxes	409	424	412	469	530
Excise	118	145	144	169	186
Taxes on international trade and transactions	44	35	35	40	43
Taxes not elsewhere classified	157	173	176	185	202
Grants	5	12	9	1	1
Other revenue	461	324	335	379	417
Total expenditure	1,967	2,015	2,087	2,243	2,455
Expense	1,642	1,605	1,645	1,798	1,930
Of which :					
Compensation of employees	564	631	681	752	819
Purchases/use of goods and services	177	233	260	301	368
Interest	133	156	183	221	242
Energy subsidies	342	119	107	92	106
Social benefit	110	112	68	82	109
Net acquisition of nonfinancial assets	324	410	442	446	525
Net lending/borrowing	-227	-300	-308	-363	-373
Net acquisition of financial assets	35	82	89	57	63
Of which : policy lending	3	3	5	0	0
Net incurrence of liabilities	262	382	397	419	436
			(In percent of GDP)		
Total revenue and grants	16.5	14.9	14.3	13.8	14.0
Taxes	12.0	12.0	11.6	11.0	11.2
Taxes on income, profits, and capital gains	5.2	5.2	5.4	4.7	4.7
Taxes on goods and services	5.0	4.9	4.5	4.7	4.8
VAT and luxury taxes	3.9	3.7	3.3	3.4	3.6
Excise	1.1	1.3	1.2	1.2	1.3
Taxes on international trade and transactions	0.4	0.3	0.3	0.3	0.3
Taxes not elsewhere classified	1.5	1.5	1.4	1.4	1.4
Grants	0.0	0.1	0.1	0.0	0.0
Other revenue	4.4	2.8	2.7	2.8	2.8
Total expenditure	18.6	17.5	16.8	16.5	16.5
Expense	15.5	13.9	13.3	13.2	13.0
Of which :					
Compensation of employees	5.3	5.5	5.5	5.5	5.5
Purchases/use of goods and services	1.7	2.0	2.1	2.2	2.5
Interest	1.3	1.4	1.5	1.6	1.6
Energy subsidies	3.2	1.0	0.9	0.7	0.7
Social benefit	1.0	1.0	0.6	0.6	0.7
Net acquisition of nonfinancial assets	3.1	3.6	3.6	3.3	3.5
Net lending/borrowing	-2.1	-2.6	-2.5	-2.7	-2.5
Net acquisition of financial assets	0.3	0.7	0.7	0.4	0.4
Of which : policy lending	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	2.5	3.3	3.2	3.1	2.9
Memorandum items:					
General government debt (In percent of GDP)	24.7	27.4	28.3	29.0	29.5
Nominal GDP (In trillions of rupiah)	10,570	11,532	12,407	13,604	14,852

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

Table 8. Indonesia: Monetary Survey, 2013–17

(In trillions of rupiah, unless otherwise indicated, end of period)

	2013	2014	2015	2016	2017 Est.
Bank Indonesia					
Net foreign assets	1,166	1,349	1,385	1,440	1,641
Net domestic assets	-343	-431	-439	-450	-555
Monetary base	823	918	946	990	1,086
Monetary survey					
Net foreign assets	1,008	1,108	1,139	1,213	1,523
Net domestic assets	2,723	3,072	3,410	3,792	4,028
Net claims on central government	493	625	571	632	566
Claims on other nonfinancial public sector	211	241	224	305	370
Private sector credit	3,098	3,465	3,822	4,116	4,471
Other items, net	-1,079	-1,258	-1,208	-1,262	-1,379
Broad money 1/	3,730	4,173	4,549	4,863	5,355
Rupiah M2	3,144	3,568	3,889	4,345	4,866
Currency in circulation	400	529	587	613	683
Deposits	2,744	3,115	3,420	3,837	4,297
Foreign currency deposits	564	592	646	647	669
Annual percentage change:					
Broad money	12.8	11.9	9.0	6.9	10.1
Rupiah M2	9.4	13.5	9.0	11.7	12.0
Monetary base	16.7	11.6	3.0	4.6	9.8
Private sector credit	20.0	11.8	10.3	7.7	8.6
Memorandum items:					
Money multiplier (rupiah M2)	3.8	3.9	4.1	4.4	4.5
Base money velocity 2/	11.6	11.5	12.2	12.5	12.5
Rupiah M2 velocity 2/	3.0	3.0	3.0	2.9	2.8
Credit by borrower (annual percentage change)					
Corporate	25.8	12.1	11.8	10.3	...
Non-corporate	17.0	10.9	8.4	8.3	...
Credit by sector (annual percentage change)					
Agriculture	23.9	19.1	19.8	20.0	...
Mining	22.8	11.7	-8.0	-13.7	...
Manufacturing	29.3	14.0	14.3	11.9	...
Services	23.0	9.5	9.3	8.8	...
Household	14.1	11.8	9.1	9.3	...

Sources: Bank Indonesia; and IMF, *International Financial Statistics;* and staff projections.

1/ Includes securities classified as broad money.
2/ Calculated using end-period quarterly GDP, annualized.

Table 9. Indonesia: Financial Soundness Indicators, 2013–17

(In percent; unless otherwise indicated)

	2013	2014	2015	2016	2017 Latest observation	
Depository institutions						
Capital adequacy						
Regulatory capital to risk-weighted assets	18.1	19.6	21.4	22.9	23.2	Q3
Core Tier-1 capital to risk-weighted assets	16.4	18.0	19.0	21.2	21.5	Q3
Capital to assets	12.5	12.8	13.6	14.4	14.9	Q3
Large exposures to capital	0.8	1.0	0.4	0.5	0.4	Q3
Asset quality						
Nonperforming loans to total gross loans	1.7	2.1	2.4	2.9	2.9	Q2
Nonperforming loans, net of provisions to capital	4.6	5.5	5.9	5.7	6.1	Q2
Specific provisions to nonperforming loans	50.9	46.8	51.5	57.8	52.8	Q2
Earning and profitability						
Return on assets	3.1	2.7	2.2	2.1	2.4	Q2
Return on equity	24.5	21.3	17.3	14.5	16.0	Q2
Interest margin to gross income	68.8	69.0	70.3	68.0	68.6	Q2
Trading income to gross income	3.2	2.7	2.8	1.2	3.9	Q2
Noninterest expenses to gross income	49.2	50.3	50.0	46.6	49.0	Q2
Personnel expenses to noninterest expenses	41.3	40.4	40.7	41.8	41.5	Q2
Liquidity and funding						
Liquid assets to total assets	23.5	22.9	23.9	22.4	23.3	Q2
Liquid assets to short-term liabilities	30.5	33.3	35.0	32.6	33.9	Q2
Non-interbank loans to customer deposits	99.6	99.2	100.7	96.3	95.2	Q2
Sensitivity to market risk						
Net open position in foreign exchange to capital	1.7	2.4	0.9	1.8	1.9	Q2
Foreign currency denominated loans to total loans	16.5	15.7	14.3	13.3	13.0	Q2
Foreign currency denominated liabilities to total liabilities	24.4	22.9	24.1	20.9	19.6	Q2
Gross asset position in financial derivatives to capital	4.2	2.4	2.5	1.4	1.1	Q2
Gross liability position in financial derivatives to capital	4.9	2.6	3.3	1.5	1.0	Q2
Nonfinancial corporates						
Leverage						
Total liabilities to total assets	46.8	48.5	44.5	44.1	43.7	Q3
Profitability 1/						
Return on assets	14.8	14.1	13.9	13.7	14.6	Q3
Liquidity 1/						
Current assets to current liabilities	249.0	280.1	261.7	220.8	214.5	Q3
Liquid assets to current liabilities	171.8	204.7	125.2	113.7	137.0	Q3
Debt servicing capacity						
Companies with negative equity (in percent of total assets)	5.7	5.4	2.6	2.3	0.7	Q3
Companies with financial distress (in percent of total debt) 2/	5.0	5.5	4.5	5.1	4.2	Q3
Households						
Household debt (in percent of GDP)	17.0	17.1	16.8	17.0	16.9	Q1
Real estate markets						
Residential real estate prices (year-on-year percentage change)	11.5	6.3	4.6	2.4	3.3	Q3
Residential real estate loans to total loans	8.0	8.2	8.2	8.3	8.3	Q2
Commercial real estate loans to total loans	6.3	6.8	7.4	8.5	8.3	Q2

Sources: Bloomberg Data LP.; IMF, *Financial Soundness Indicators*; Bank for International Settlements; CEIC Data Co. Ltd.; and IMF staff estimates.

1/ Based on capitalization-weighted average of listed companies.
2/ Companies with financial distress are those with earnings before interest, tax, depreciation and amortization (EBIT) less than interest payments.

Table 10. Indonesia: Key Poverty and Social Indicators

Population	261.9	millions	(2017)
Life expectancy at birth, total	69.1	years	(2015)
Mortality rate, under 5	27.2	per 1,000 live births	(2015)
Secondary school enrollment:			
Total	85.8	percent	(2015)
Female	86.0	percent	(2015)
Male	85.7	percent	(2015)
GINI index	39.3		(2017)
Income share held by highest 20%	47.4	percent	(2013)
Income share held by lowest 20%	7.2	percent	(2013)
Poverty rate	11.0	percent	(2017)
CO2 emissions	1.9	metric tons per capita	(2013)
Population with access to improved water	87.4	percent	(2015)
Population with access to sanitation	60.8	percent	(2015)
Human development index	0.69		(2015)
Rank	113		
Gender inequality index	0.47		(2015)
Rank	105		

Sources: World Bank; Badan Pusat Statistik; and United Nations Development Programme.

Table 11. Indonesia: Key FSAP Recommendations

Key Recommendations	Time
Institutional and legal arrangements	
Revise OJK Law to give primacy to objective of safeguarding stability, BI Law to include a financial stability and macroprudential policy mandate focused on systemic risk of the financial system, with access to data; and LPS Law to focus objectives on the maintenance of financial stability, continuity of critical functions, protection of insured deposits, and minimization of resolution costs.	Medium term (MT)
Amend the Insurance Law to specify policyholder protection as principal objective of OJK.	MT
Strengthen legal protection of supervisors and officials of all agencies involved in financial oversight and crisis management in line with global standards.	MT
Systemic risk monitoring and prudential policy	
Strengthen BI's capacity for systemic risk analysis and macroprudential stress tests, and OJK's capacity for regulatory stress tests; OJK should do bottom-up stress tests for D-SIBs regularly.	Near term (NT)
Introduce a foreign currency liquidity coverage ratio.	NT
Financial sector oversight	
Reduce OJK's silo structure, including by revising the OJK Law to remove the responsibilities of individual Commissioners for the supervision of specific sectors.	MT
Strengthen the banking supervisory approach and continue enhancing supervisory practices for financial conglomerates.	NT
Further strengthen the enforcement of credit and risk management regulations.	MT
Revise the insurance supervisory framework (three strikes-approach) to allow prompt actions.	MT
Governance of financial conglomerates	
Strengthen corporate governance practices within the financial system, including the Board of Commissioners' oversight roles and responsibilities.	MT
Introduce legal provisions for licensed non-operating financial holding companies.	MT
Crisis management and resolution, and safety nets	
Revise the PPKSK Law to clarify the role of the KSSK as solely a coordination body; limit the involvement of the President to approving public funding.	MT
Adjust the emergency liquidity assistance framework to ensure it is effective.	NT
Amend the relevant laws to ensure that resolution powers can be exercised over financial conglomerates.	MT
Develop resolution options and implementation guidelines for banks, and resolvability assessment and resolution planning frameworks for D-SIBs.	NT
Financial integrity	
Integrate key ML/TF risks in the priorities and operations of relevant agencies.	NT
Finalize and implement risk-based AML/CFT supervisory tools.	NT
Financial deepening and inclusion	
Develop an integrated roadmap for promoting financial deepening and inclusion.	MT
Enhance bond yield curve by consolidating debt issuance and improving secondary markets.	MT

Appendix I. Risk Assessment Matrix 1/

	Source of Risks	Relative Likelihood	Expected Impacts	Recommended Policy Responses
Global	**Tighter global financial conditions**. Fed normalization and tapering by ECB increase global rates and term premia, strengthen the U.S. dollar and the euro vis-à-vis the other currencies, and correct market valuations. Adjustments could be disruptive if there are policy surprises. Higher debt service and refinancing risks could stress leveraged firms, households, and vulnerable sovereigns, including through capital account pressures.	**High**	**Medium** Capital inflows decline due to weaker investor appetite for emerging market (EM) assets, creating funding pressures for the current account (CA) deficit. Tighter external financial conditions put pressure on the balance sheets of the public, financial, and corporate sectors. Bank funding becomes constrained, leading to a crunch in domestic credit growth and higher domestic borrowing costs. Rollover risks rise for the public, financial, and corporate sectors, and the balance sheet of households (including property) weaken. Economic growth falls, reinforced by asset price corrections and lower confidence. The rupiah depreciates and imports decline, reducing the CA deficit.	Maintain exchange rate flexibility and market-determined bond yields. Preserve a sound fiscal position, while allowing automatic stabilizers to work. Tighten monetary policy and support banks facing funding pressures to preserve financial stability and avoid negative feedback loops with capital outflows. Closely monitor corporate sector vulnerabilities. Maintain vigilance on exchange rate pass-through to inflation. Access contingent external financing if needed.
Global	**Significant China slowdown**. Efforts to rein in financial risks expose vulnerabilities and reduce near-term growth. Over the medium term, ambitious growth targets lead to unsustainable policies and higher financial imbalances. A sharp slowdown leads to lower commodity prices, global financial market volatility, and lower global growth.	**Medium**	**High** Lower export volume and prices (particularly those of commodities) could widen the current account deficit, putting pressure on FX reserves and the exchange rate. The fiscal balance would deteriorate on weaker oil and gas revenues and knock-on effects to domestic demand, with the financial sector exposed to losses from loans to the commodity sector and a broader economic slowdown. Corporate profits would decline from weak commodity related activities.	Maintain exchange rate flexibility to help reduce the current account deficit and limit FX reserve losses. More stringent fiscal measures to contain the budget deficit might be necessary if the slowdown in EMs were accompanied by protracted financial market volatility that restricts funding. Accelerate infrastructure spending and structural reforms to boost productivity and employment in non-resource sectors, and export diversification.
Global	**Retreat from cross-border integration** lead to reduced global and regional policy collaboration with negative effects on trade, capital and labor flows, and growth.	**Medium**	**Low-Medium** Exports and capital inflows decline, putting pressure on the exchange rate and foreign reserves. The balance sheets of the public, financial, and corporate sectors weaken, and domestic financial conditions tighten. Domestic credit growth slows and borrowing costs rise.	Resist protectionism and deepen regional trade integration. Seek new opportunities to enhance position in global value chains. Strengthen domestic drivers of growth by enhancing infrastructure and implementing structural reforms.
Global	**Stronger global growth and commodity prices**. The global recovery strengthens more than expected, leading to higher commodity prices due to robust demand.	**Low**	**Medium** The fiscal position strengthens due to higher oil and gas revenues, increasing the fiscal space for public investment and other expenditure, with positive spillovers to growth. Private investment and exports also pick up, especially in commodity-related sectors, boosting growth.	In addition to increasing public investment and other priority spending, use the extra fiscal space to rebuild fiscal buffers and support costly structural reforms. Remain vigilant to overheating risks, and adjust policies as needed.
Domestic	**Revenue shortfalls or larger financing needs due to higher interest rates, constrain fiscal space, with adverse spillovers to growth**. Large ad-hoc cuts in public spending are taken to keep the budget deficit below the statutory ceiling.	**Medium**	**Medium** The fiscal impulse becomes negative, resulting in a growth slowdown that can damage investor confidence, curb capital inflows, raise bank NPLs, increase the country risk premium, and raise costs for corporate external borrowing. Corporate are forced to reduce costs by laying off workers, which further weaken domestic demand.	Implement growth-friendly revenue reforms to raise collections, and prioritize spending in growth-critical areas. Accelerate structural reforms to the trade and investment regime to boost productivity, private investment, and exports. Ease monetary policy if necessary, provide support to banks in need to preserve financial stability, and monitor corporate borrowers at risk.
Domestic	**Natural disasters**, disrupt economic activity and affect sentiment, resulting in higher fiscal expenditure.	**Medium**	**Low** Economic activity in the affected regions is disrupted and business sentiment suffers. Economic growth slows leading to a decline in portfolio inflows. Fiscal expenditure increases to provide disaster relief and for reconstruction.	Implement revenue enhancing reforms and prioritize expenditure to the affected region. If the economy slows significantly, ease monetary policy, provide support to banks, and monitor corporate borrowers at risk.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 percent and 30 percent, and "high" a probability between 30 percent and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Appendix II. External Sector Report

<table>
<tr><th></th><th>Indonesia</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. At end-June 2017, Indonesia's net international investment position (NIIP) stood at -35¾ percent of GDP, compared to -43¾ percent of GDP at end-2015 (and -39¼ percent at end-2012). The less negative net liability position was largely due to the disclosure of external financial assets held by residents under the tax amnesty program. At end-June 2017, gross external assets stood at 32½ percent of GDP (close to 40 percent being reserve assets) and gross external liabilities at 68¼ percent of GDP. Indonesia's gross external debt was moderate at 34¼ percent of GDP at end-June 2017, with 19½ percent of external debt denominated in rupiah. About one-third of government's external debt (at 17 percent of GDP at end-June 2017) was denominated in rupiah.

Assessment. The level and composition of the NIIP and gross external debt indicate that Indonesia's external position is sustainable, but nonresident holdings of rupiah denominated government bonds, with a 38 percent share of the total stock (or 6 percent of GDP) at end-October 2017, could be affected by global financial volatility. Staff projections for the current account suggest that the NIIP position as a percent of GDP will strengthen over the medium term.</td><td rowspan="5">Overall Assessment
The external position of Indonesia in 2017 was assessed to be broadly consistent with medium-term fundamentals and desirable policies. The recovery of commodity prices and external demand and relatively low projected world oil prices should help to contain the current account deficit. External financing appears sustainable, although the large share of foreign portfolio holdings makes the economy vulnerable to external shocks.

Potential Policy Responses
Continued flexibility of the exchange rate and market-determined bond yields would continue to underpin external stability, supported by monetary policy focused on containing inflation within Bank Indonesia's target band. The fiscal position should be strengthened by accelerating tax reforms to boost investor confidence, keeping the fiscal deficit within the statutory limit. While expanding the safety-net could lead to a widening in the CA deficit over the medium term, pro-competitive structural policies, particularly easing non-tariff trade barriers and FDI restrictions would bolster exports and external competitiveness, helping contain the CA deficit, and continuing infrastructure investment and strengthening human capital (including through job placement services, vocational training, and better education) can help ease supply bottlenecks. Deepening financial markets would help to strengthen resilience to external shocks.</td></tr>
<tr><td>Current account</td><td>Background. Indonesia's current account deficit is projected at 1.7 percent of GDP in 2017, an improvement from the peak of 3.2 percent in 2013, as the economy has adjusted to the low commodity prices. Exports and imports started to pick up in Q4: 2016, as commodity prices bottomed out. Over the medium term, a moderate increase in the current account deficit is expected from a rise in capital goods and raw material imports tied to infrastructure investment and a pickup in domestic demand. A gradual increase in manufacturing exports, stronger demand from trading partners, and relatively low projected world oil prices should help limit the current account deficit.

Assessment. The EBA CA model suggests a gap of -0.1 percent for 2017, consistent with an estimated cyclically-adjusted CA balance of -1.4 percent of GDP and a norm of -1.3 percent of GDP. Taking uncertainties around the estimates into account, staff assesses that a norm of -2.3 percent to -0.3 percent of GDP is appropriate.[1/] This suggests that the CA gap range of about -1.1 percent to 0.9 percent of GDP for 2017. Domestic policy gaps, including in social spending and policy gaps in partner countries (particularly fiscal) are largely offset by other distortions not captured by the model.</td></tr>
<tr><td>Real exchange rate</td><td>Background. Compared to the 2016 average, the average REER appreciated by 2.1 percent in the first ten months of 2017, due to relatively higher inflation rate than its trading partners, as the average NEER remained broadly the same.

Assessment. EBA index and level REER results point to an REER gap of about 0.5 percent to 3.9 percent for 2017, respectively, in line with staff's REER gap assessment in the range of -4.5 percent to 5.5 percent (based on the CA assessment and estimated elasticities).</td></tr>
<tr><td>Capital and financial accounts:

flows and policy measures</td><td>Background. In 2017: Q1–Q3, net capital and financial account inflows (3.1 percent of GDP) have been sustained by net FDI inflows (1.9 percent of GDP) and net portfolio inflows (2.5 percent of GDP), while net other investment inflows were at -1.3 percent.

Assessment. Net and gross financial flows have been steady since the global financial crisis despite some short periods of volatility. The narrower current account deficit and strengthened policy framework, including exchange rate flexibility since mid-2013 have also helped reduce capital flow volatility. Continued strong policies focused on strengthening the fiscal position, keeping inflation in check, and easing supply bottlenecks would help sustain capital inflows in the medium term.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. Since mid-2013, Indonesia has had a more flexible exchange rate policy framework. Its floating regime has better facilitated adjustments in exchange rates to market conditions. At end-November 2017, reserves were US$126 billion (equal to 12½ percent of GDP, about 133 percent of IMF's reserve adequacy metric, and about 8 months of prospective imports of goods and services) compared to US$116.4 billion at end-2016. In addition, contingencies and swap lines amounting to about US$81½ billion are in place.

Assessment. Volatile capital flows could cause reserves to decline significantly. While the composite metric may not adequately account for commodity price volatility, the current level of reserves (US$126 billion at end-November) should be sufficient to absorb most shocks, with predetermined drains also manageable. Intervention should aim primarily at preventing disorderly market conditions, while allowing the exchange rate to adjust to external shocks.</td></tr>
<tr><td>Technical Background Notes</td><td>1/ A range of +/- 1 percent is added to reflect the fact that the EBA-regression estimates are subject to normal uncertainty.</td><td></td></tr>
</table>

Appendix III. Debt Sustainability Analysis

Indonesia's external debt remains moderate and sustainable, supported by robust real GDP growth and high nondebt generating capital inflows. Public debt is also moderate and sustainable. However, potentially weaker-than-expected revenue, contingent liabilities from state-owned enterprises (SOEs) and public-private partnerships (PPPs) should be carefully monitored. Reliance on foreign investors remains sizable, which could leave Indonesia susceptible to capital flow reversals.

External Debt Sustainability

Indonesia's external debt has stabilized at a moderate level after steady increases in recent years. External debt reached 34¼ percent of GDP in 2016, down from 36 percent in 2015, reflecting a decline in external debt of the nonbank private sector. General government external debt has been stable, including internationally issued bonds and holdings of domestic bonds by nonresidents. These trends are projected to continue, with external debt declining to 34 percent of GDP at end-2017 (Figure 1 and Table 1).

External debt is projected to gradually decline in the medium term. In the baseline scenario, external debt would decline to 26.6 percent in 2022 reflecting strong real GDP growth and higher nondebt creating capital inflows to finance the current account deficits. Public and private external debt are expected to decline as external borrowing by the public sector is tightly regulated by an inter-ministerial committee and the domestic financial market develops.

External debt sustainability is robust to interest rate and GDP shocks, but is more sensitive to current account and exchange rate shocks (Figure 2). A widening of the current account deficit from current levels would cause external debt to rise moderately (a one standard deviation shock would increase external debt to 31 percent of GDP by 2022). Exchange rate depreciation would have the largest impact—a 30 percent depreciation in 2018 would raise external debt to 46 percent of GDP in 2018 followed by a gradual decline to 37 percent of GDP by 2022.

Public Debt Sustainability

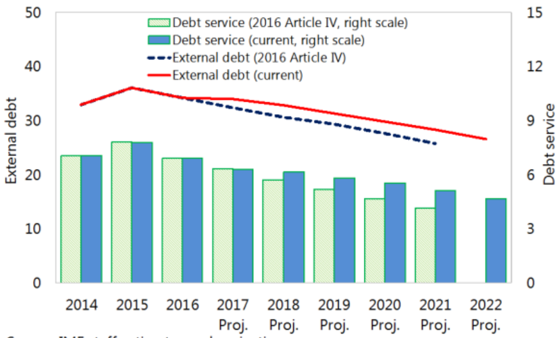
Indonesia's public sector debt remains moderate. General government debt has declined steadily from 87 percent of GDP in 2000 to 28 percent in 2016, owing to a prudent fiscal stance, which has been anchored by a fiscal rule since 2003. This rule caps the general government deficit at 3 percent of GDP and debt at 60 percent. The debt dynamics have been also favorable, with strong real GDP growth and moderate real interest rates. In 2017, public debt is projected to rise to 29 percent of GDP, reflecting a slightly larger primary deficit than in the past but still within the fiscal rule. At the same time, foreign-currency denominated debt has fallen to less than half of total public sector debt, as issuance in the domestic rupiah bond market has grown. However, dependence on foreign investors remains sizable, with nonresidents holding 61 percent of general government debt. Moreover, the share of foreign ownership of rupiah-denominated government bonds rose from 20 percent in 2009 to 40 percent in September 2017.

Public sector debt is expected to increase modestly over the medium term (Figure 3). The baseline scenario envisages the general government deficit to remain at 2.5 percent of GDP over the medium term, resulting in a primary deficit of 0.9 percent of GDP. Favorable debt dynamics, with a negative interest rate-growth differential (-0.9 percent over the medium term), would limit the increase in the debt-to-GDP ratio, which is expected to reach 30½ percent by 2022. Gross financing needs are also expected to remain moderate at around 4.4 percent of GDP over the medium term.

Public debt dynamics are robust to both standard shocks and stress tests (Figures 4 and 5). Even under the most severe scenario with a combined macro-fiscal shock, total government debt would stabilize at 36 percent of GDP or 258 percent of revenue by 2022, with gross financing needs staying below 6 percent of GDP. Nevertheless, fiscal risks arising from potentially weaker-than-expected revenue and expanding balance sheets of SOEs and PPPs, will need to be managed carefully.

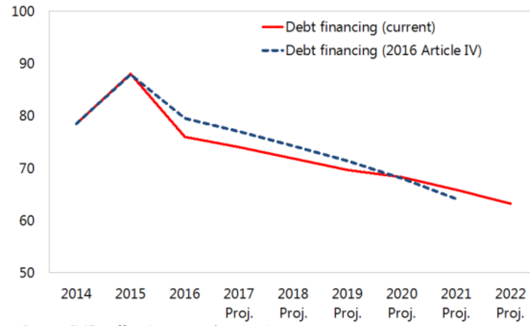
Figure 1. Indonesia: External Debt and Debt Service

Indonesia: External Debt Projections, 2014-22
(In percent of GDP)



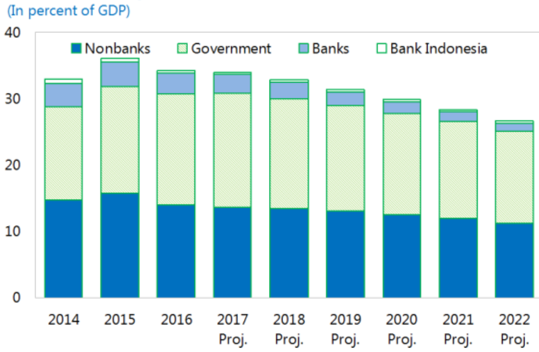
Source: IMF staff estimates and projections.

Indonesia: Debt Financing, 2014–22
(In percent of the gross external financing requirement)



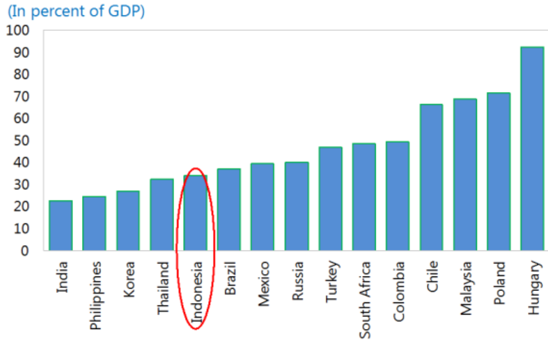
Source: IMF staff estimates and projections.

Indonesia: Composition of External Debt, 2014-22
(In percent of GDP)



Source: IMF staff estimates and projections.

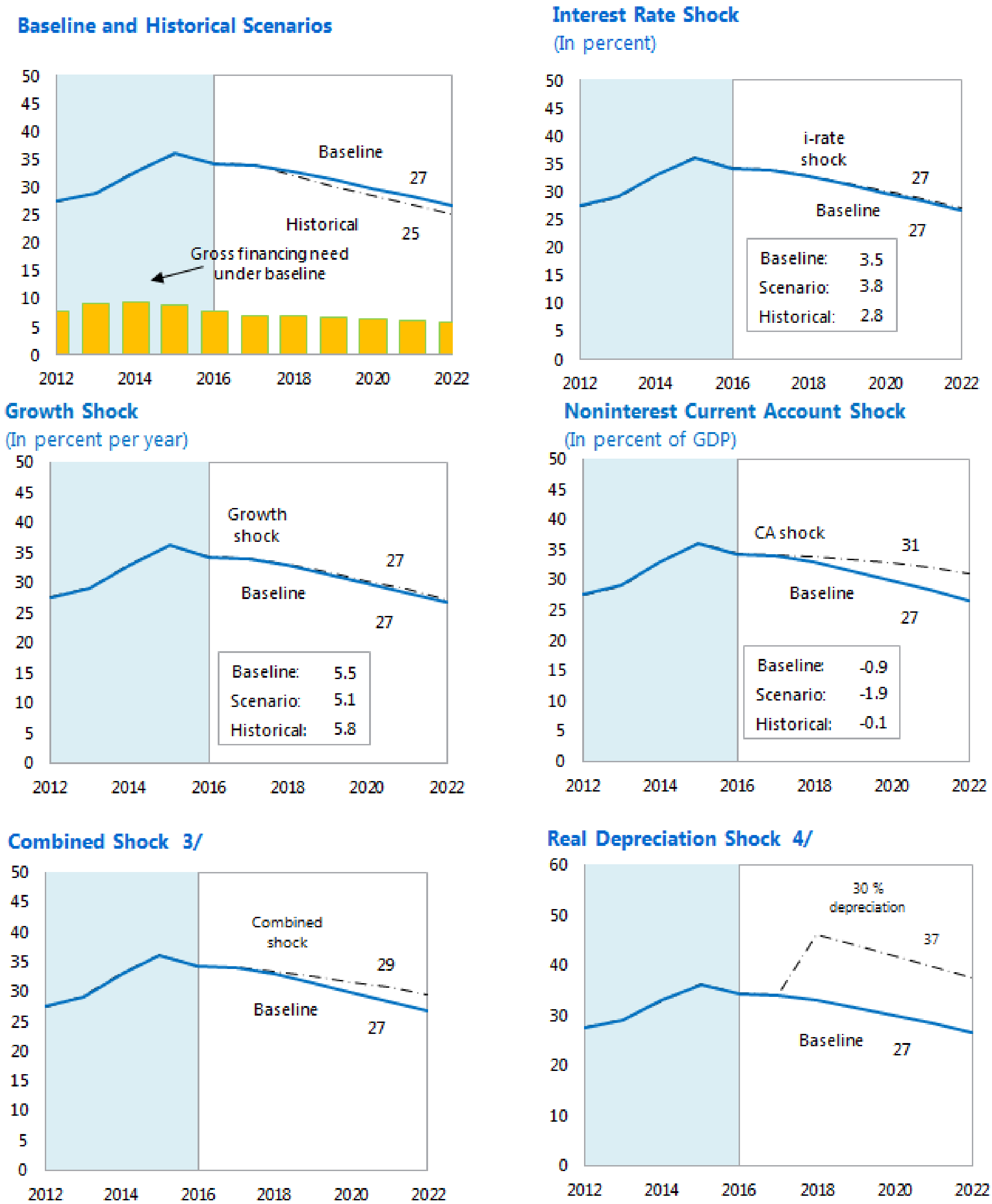
External Debt, 2016
(In percent of GDP)



Source: IMF, *World Economic Outlook*.

Figure 2. Indonesia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data; and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2018.

Table 1. Indonesia: External Debt Sustainability Framework, 2012–2022

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	27.5	29.0	32.9	36.1	34.2			34.0	32.8	31.4	29.8	28.3	26.6	-3.9
2 Change in external debt	2.2	1.6	3.9	3.2	-1.9			-0.2	-1.2	-1.4	-1.5	-1.5	-1.7	
3 Identified external debt-creating flows (4+8+9)	0.1	1.8	1.5	1.6	-2.8			-1.8	-1.8	-1.8	-1.7	-1.6	-1.5	
4 Current account deficit, excluding interest payments	2.1	2.6	2.4	1.1	0.9			0.7	0.9	0.8	0.9	1.0	1.1	
5 Deficit in balance of goods and services	-0.2	-0.7	-0.3	0.6	0.9			1.1	0.7	0.6	0.5	0.5	0.4	
6 Exports	23.0	22.4	22.3	19.9	18.0			18.5	18.3	17.9	17.7	17.2	16.7	
7 Imports	-23.2	-23.0	-22.7	-19.3	-17.1			-17.5	-17.6	-17.3	-17.1	-16.7	-16.3	
8 Net nondebt creating capital inflows (negative)	-1.7	-1.1	-2.0	-1.1	-1.9			-1.8	-2.0	-2.0	-2.1	-2.1	-2.1	
9 Automatic debt dynamics 1/	-0.3	0.3	1.2	1.5	-1.8			-0.7	-0.7	-0.6	-0.6	-0.6	-0.5	
10 Contribution from nominal interest rate	0.6	0.6	0.7	0.9	0.9			0.9	1.0	1.0	1.0	1.0	0.9	
11 Contribution from real GDP growth	-1.5	-1.5	-1.5	-1.7	-1.7			-1.6	-1.7	-1.7	-1.6	-1.5	-1.4	
12 Contribution from price and exchange rate changes 2/	0.6	1.3	2.0	2.3	-1.1			...	...	...	...	...	...	
13 Residual, including change in gross foreign assets (2-3) 3/	2.1	-0.2	2.4	1.6	0.9			1.5	0.6	0.4	0.2	0.1	-0.2	
External debt-to-exports ratio (in percent)	119.6	129.8	147.5	181.3	190.0			183.3	179.5	175.1	168.9	165.1	159.0	
Gross external financing need (in billions of U.S. dollars) 4/	71.2	83.8	83.8	76.8	72.3			71.6	76.9	79.5	84.2	87.5	92.0	
In percent of GDP	7.7	9.1	9.4	8.9	7.8			7.0	7.0	6.7	6.5	6.1	5.8	
Scenario with key variables at their historical averages 5/								34.0	32.0	30.3	28.4	26.7	25.1	-2.8
Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	6.0	5.6	5.0	4.9	5.0	5.8	0.9	5.1	5.3	5.5	5.6	5.6	5.6	
GDP deflator in U.S. dollars (change in percent)	-2.9	-5.5	-7.4	-7.8	3.1	3.5	10.3	3.8	2.3	3.3	3.4	4.0	5.3	
Nominal external interest rate (in percent)	2.3	2.0	2.4	2.6	2.8	2.8	0.7	3.0	3.2	3.4	3.6	3.6	3.6	
Growth of exports (U.S. dollar terms, in percent)	-0.9	-2.8	-3.0	-13.8	-2.1	5.0	15.7	12.3	6.2	6.8	7.8	6.6	8.4	
Growth of imports (U.S. dollar terms, in percent)	12.7	-0.8	-4.5	-17.8	-4.0	7.0	20.1	11.5	8.3	7.2	8.3	7.1	8.8	
Current account balance, excluding interest payments	-2.1	-2.6	-2.4	-1.1	-0.9	-0.1	2.0	-0.7	-0.9	-0.8	-0.9	-1.0	-1.1	
Net nondebt creating capital inflows	1.7	1.1	2.0	1.1	1.9	1.3	0.5	1.8	2.0	2.0	2.1	2.1	2.1	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 3. Indonesia: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

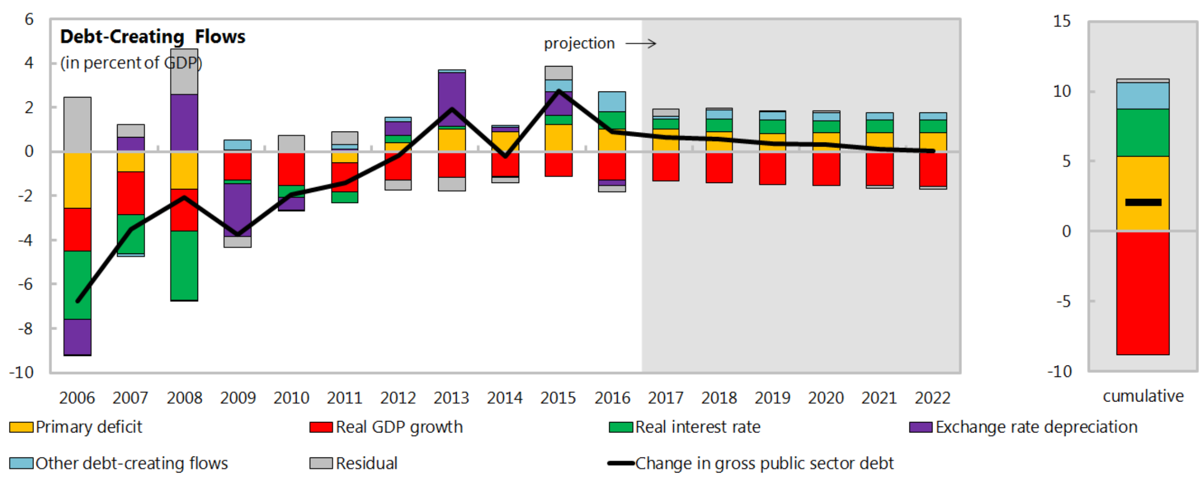
	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	27.2	27.4	28.3	29.0	29.5	29.9	30.2	30.3	30.4
Public gross financing needs	3.1	4.3	4.2	4.8	4.8	4.5	4.3	4.1	4.3
Real GDP growth (in percent)	5.9	4.9	5.0	5.1	5.3	5.5	5.6	5.6	5.6
Inflation (GDP deflator, in percent)	8.6	4.0	2.5	4.3	3.7	3.7	3.7	3.6	3.6
Nominal GDP growth (in percent)	15.1	9.1	7.6	9.7	9.2	9.4	9.5	9.4	9.4
Effective interest rate (in percent) [4/]	5.8	6.0	5.8	6.3	6.1	6.1	6.0	5.9	5.9

As of November 30, 2017

Sovereign Spreads		
EMBIG (bp) 3/	168	
5Y CDS (bp)	93	
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	BBB-	BBB-
Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.0	2.8	0.9	0.6	0.6	0.4	0.3	0.1	0.1	2.1	
Identified debt-creating flows	-2.5	2.1	1.2	0.3	0.5	0.3	0.2	0.2	0.2	1.8	
Primary deficit	-0.4	1.2	1.0	1.0	0.9	0.8	0.8	0.9	0.9	5.3	-0.7
Primary (noninterest) revenue and grants	17.2	14.9	14.3	13.8	14.0	13.9	13.9	13.9	13.9	83.4	
Primary (noninterest) expenditure	16.8	16.1	15.3	14.9	14.9	14.8	14.7	14.7	14.7	88.7	
Automatic debt dynamics [5/]	-2.2	0.4	-0.7	-0.9	-0.8	-0.9	-1.0	-1.0	-1.0	-5.4	
Interest rate/growth differential [6/]	-2.5	-0.7	-0.5	-0.9	-0.8	-0.9	-1.0	-1.0	-1.0	-5.4	
Of which: real interest rate	-1.0	0.4	0.8	0.4	0.6	0.6	0.6	0.6	0.6	3.4	
Of which: real GDP growth	-1.5	-1.1	-1.3	-1.3	-1.4	-1.5	-1.5	-1.5	-1.6	-8.8	
Exchange rate depreciation [7/]	0.2	1.1	-0.3	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.1	0.5	0.9	0.1	0.4	0.4	0.4	0.3	0.3	1.9	
Please specify (1) (e.g., drawdown of deposits) (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.1	0.5	0.9	0.1	0.4	0.4	0.4	0.3	0.3	1.9	
Residual, including asset changes [8/]	0.5	0.6	-0.3	0.4	0.1	0.0	0.1	-0.1	-0.1	0.3	



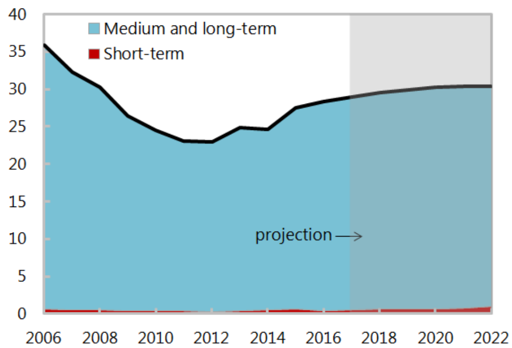
Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate;
a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as $-g$.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 4. Indonesia: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

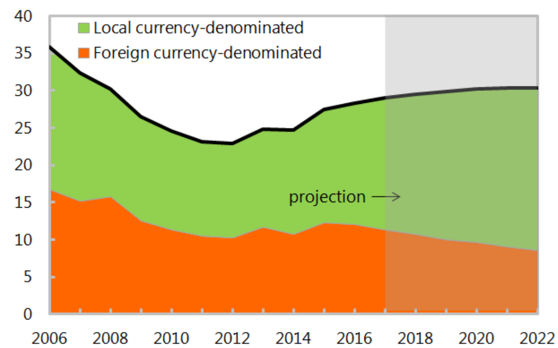
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

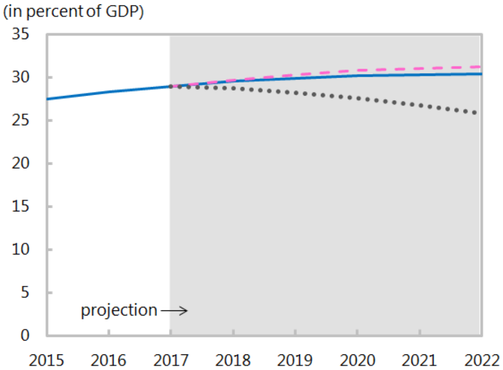


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

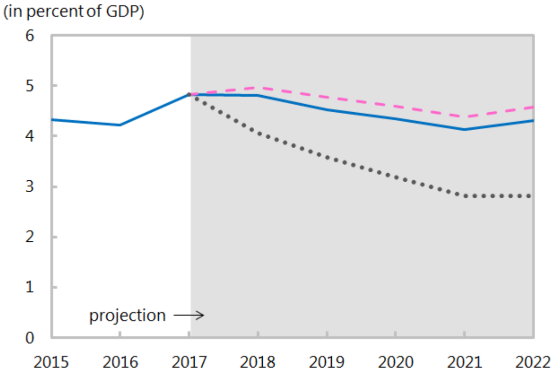
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

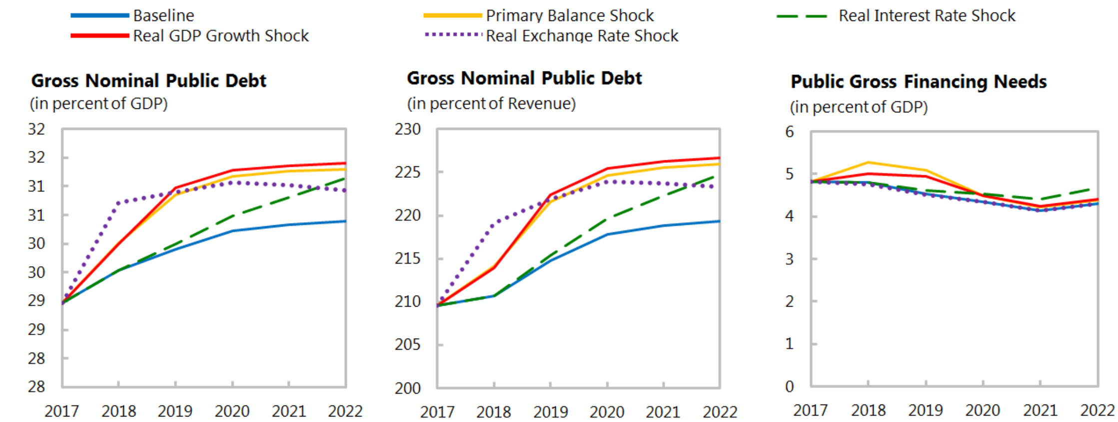
Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	5.1	5.3	5.5	5.6	5.6	5.6
Inflation	4.3	3.7	3.7	3.7	3.6	3.6
Primary Balance	-1.0	-0.9	-0.8	-0.8	-0.9	-0.9
Effective interest rate	6.3	6.1	6.1	6.0	5.9	5.9
Constant Primary Balance Scenario						
Real GDP growth	5.1	5.3	5.5	5.6	5.6	5.6
Inflation	4.3	3.7	3.7	3.7	3.6	3.6
Primary Balance	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Effective interest rate	6.3	6.1	6.1	6.0	6.0	5.9

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	5.1	5.8	5.8	5.8	5.8	5.8
Inflation	4.3	3.7	3.7	3.7	3.6	3.6
Primary Balance	-1.0	-0.2	-0.2	-0.2	-0.2	-0.2
Effective interest rate	6.3	6.1	5.6	5.1	4.7	4.5

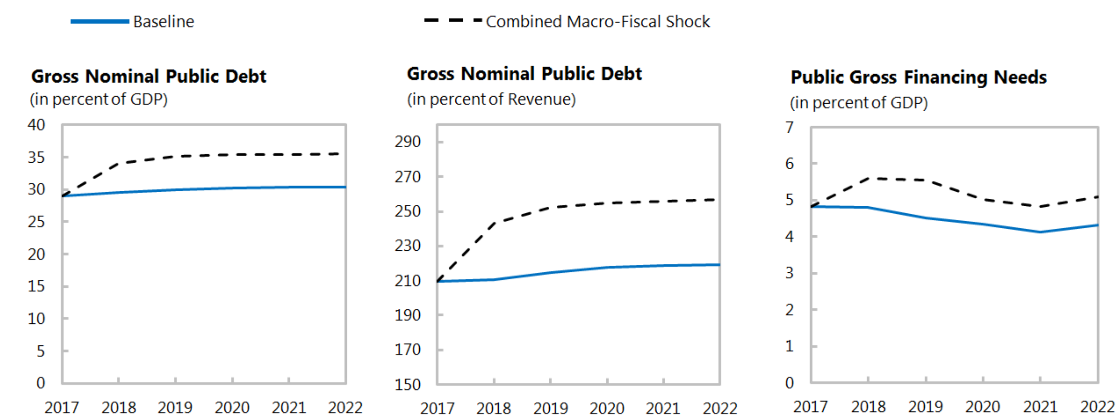
Source: IMF staff.

Figure 5. Indonesia: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2017	2018	2019	2020	2021	2022
Primary Balance Shock						
Real GDP growth	5.1	5.3	5.5	5.6	5.6	5.6
Inflation	4.3	3.7	3.7	3.7	3.6	3.6
Primary balance	-1.0	-1.4	-1.3	-0.8	-0.9	-0.9
Effective interest rate	6.3	6.1	6.1	6.1	6.0	6.0
Real Interest Rate Shock						
Real GDP growth	5.1	5.3	5.5	5.6	5.6	5.6
Inflation	4.3	3.7	3.7	3.7	3.6	3.6
Primary balance	-1.0	-0.9	-0.8	-0.8	-0.9	-0.9
Effective interest rate	6.3	6.1	6.4	6.6	6.8	6.9
Combined Shock						
Real GDP growth	5.1	4.4	4.6	5.6	5.6	5.6
Inflation	4.3	3.5	3.5	3.7	3.6	3.6
Primary balance	-1.0	-1.4	-1.3	-0.8	-0.9	-0.9
Effective interest rate	6.3	6.4	6.0	6.3	6.5	6.7

	2017	2018	2019	2020	2021	2022
Real GDP Growth Shock						
Real GDP growth	5.1	4.4	4.6	5.6	5.6	5.6
Inflation	4.3	3.5	3.5	3.7	3.6	3.6
Primary balance	-1.0	-1.0	-1.1	-0.8	-0.9	-0.9
Effective interest rate	6.3	6.1	6.1	6.0	6.0	6.0
Real Exchange Rate Shock						
Real GDP growth	5.1	5.3	5.5	5.6	5.6	5.6
Inflation	4.3	12.4	3.7	3.7	3.6	3.6
Primary balance	-1.0	-0.9	-0.8	-0.8	-0.9	-0.9
Effective interest rate	6.3	6.4	5.6	5.6	5.6	5.7

Source: IMF staff.

Appendix IV. The Authorities' Economic Policy Packages

The authorities have issued 16 economic policy packages since September 2015. These packages aim to improve competitiveness and boost exports and investment by harmonizing regulations, simplifying bureaucratic processes, and ensuring law enforceability.

Progress has been made in several areas. About 215 regulations have been revised to lower administrative burdens for businesses and reduce trade barriers; a transparent minimum wage formula has been adopted; the land acquisition process has been simplified; a 3-hour one-stop service has been launched; and a single submission system linked to local government regulations is being introduced. These reforms have led to a notable raise in Indonesia's ranking in the World Bank's *Doing Business* from the 114th position in 2015 to the 72nd position in 2017.

The authorities' have adopted a more holistic approach in recent policy packages, with clear communication and strong coordination with local governments.

- Earlier packages entailed ad-hoc or general measures rather than specific measures to address bottlenecks in each sector. The most recent packages, however, have adopted a more strategic, thematic, and holistic approach. For example, the 14th package intends to create a roadmap for the e-commerce industry; the 15th package aims to improve logistics; and the 16th package seeks to create a single submission system.

- The authorities have improved their communication strategy, providing diagnostics of critical constraints in selected sectors and clarifying policy objectives and targets.

- The authorities are also strengthening coordination with local governments. The impact of earlier packages was limited due to bottlenecks in the regional governments due to concerns about their revenue streams or lack of capacity. More recently, the government has focused on standardizing regulations and strengthening capacity, cooperation and coordination with local governments.

The authorities are committed to continue improving the business climate. They will make a comprehensive review of the key issues in the major sectors of the economy, address underlying bottlenecks, and continue to strengthen coordination with regional governments.

Key measures in the 16 economic policy packages:

Deregulation

The authorities have revised 215 regulations, including 50 regulations at the Presidential Level and 165 regulations at the Ministerial/Institutional level. Deregulation efforts have centered on reducing administrative burdens for corporates, lowering barriers to trade, and easing legal barriers that protect existing businesses.

The FDI regime has been partially liberalized. To support infrastructure development, the foreign ownership limit for toll road operators, telecommunications, and testing companies has risen to 100 percent from 95 percent; and that for distribution and warehousing to 87 percent from 33 percent. Other measures include allowing for partnership with SMEs; introducing a grandfathering clause protecting existing foreign investor from potentially tighter protection in the future; and strengthening coordination with ministries, agencies, and regional governments.

Foreign Ownership Limit

(In percent)

	Before	After
Cold storage	33	100
Toll road operator, telecommunication, testing company	95	100
Distribution, warehousing	33	87
Consultancy for construction	55	67
Telecommunication provider with integrated services	65	67
Restaurants, bars	51	100
Rharmaceutical raw materials manufacturing	85	100
Sports center, film processing lab, crumb rubber	49	100
Professional training, golf course management, air transport support service, travel bureau	49	67

Source: Data provided by the Indonesian authorities.

Investment Certainty

The setting of the minimum wage has been made more transparent and predictable. Since 2016, the increases in the minimum wage is set by a formula that aligns it with inflation and real GDP growth. This formula has already been applied in major provinces, improving certainty for investors compared with past practices. For instance, the minimum wage rose by 40 percent in Jakarta in 2013, which significantly undermined business confidence in the region.

The land acquisition process has been expedited. The new land acquisition regulation allows investors to pay for land in advance and be reimbursed after. This regulation is expected to avoid delays due to unallocated budget or late budget disbursements. Using the new regulation, the land acquisition process of Palembang-Indralaya section of the Tans-Sumatera toll road project and Java North Line Double track rail project have been completed after years of delay.

Business Permit Procedures

A one-stop 3-hour licensing service has been launched for nine types of licenses. These include licenses for business startups (investment license, tax registration number, certificate of incorporation, and company registration); trade (import identification, customs registration); employment (employment plan, working permit); and land information (letter of land availability). This initiative aims to lower waiting time, particularly for the energy and mineral resources sector, which had to wait for up to 40 days to obtain each license. In 2017, 130 projects have used this service, including 40 projects in the energy and mineral resources sector.

A single submission system is being created. To expedite the issuance of business permits, the government is creating an online single submission system, where investors can obtain all required licenses at one place, including those of regional governments. The authorities are also forming task forces in ministries, agencies, and regional governments to implement the improved business licensing process and to oversee its implementation.

Construction permits are also being expedited. A direct construction permit has been adopted to attract investment in 32 industrial estates. Investors can start construction projects before obtaining construction permits, obtaining them in parallel to the construction process. Through August 2017, 91 projects had used the Direct Construction Permit.

Logistics Support

Several measures to reduce logistics costs have been adopted. These includes reducing the operational costs of transportation services; eliminating the requirement for goods transport permits; reducing the port business investment cost; standardizing documents on domestic goods flow; and developing regional distribution centers. Other measures include reducing the number of prohibited and restricted goods; strengthening the Indonesia National Single Window authority; and enhancing the role of transportation insurance.

Export and import procedures have been streamlined. Customs inspection at ports has been harmonized to curtail dwell time. Export and import permits have been simplified through single licensing at the border. Permits and documents settlement have been automated through the National Single Window in over 21 ports. Risk management at customs has been implemented, gradually moving control from border to post border. Once fully implemented, only 19 percent of products will be inspected at the border, significantly less than the current 49 percent.

A Bonded Logistics Center has been launched to improve efficiency and lower the cost of transportation. Around 30 bonded logistics centers have been introduced to support various industries, including food and beverage, textiles, automotive, oil and gas, and mining.

Indonesia: 16 Economic Policy Packages		
Package	Announcement	Key Measures
1	September 9, 2015	• Boost industrial competitiveness through deregulation • Curtail red tape • Enhance law enforcement & business certainty
2	September 30, 2015	• Interest rate tax cuts for exporters • Speed up investment licensing for investment in industrial estates • Relaxation import taxes on capital goods in industrial estates & aviation
3	October 7, 2015	• Cut energy tariffs for labor-intensive industries
4	October 15, 2015	• Fixed formula to determine increases in labor wages • Soft micro loans for >30 small & medium, export-oriented, labor-intensive businesses
5	October 22, 2015	• Tax incentive for asset revaluation • Scrap double taxation on real estate investment trusts • Deregulation in Islamic banking
6	November 5, 2015	• Tax incentives for investment in special economic zones
7	December 4, 2015	• Waive income tax for workers in the nation's labor-intensive industries • Free leasehold certificates for street vendors operating in 34 state-owned designated areas
8	December 21, 2015	• Scrap income tax for 21 categories of airplane spare parts • Incentives for the development of oil refineries by the private sector • One-map policy to harmonize the utilization of land
9	January 27, 2016	• Single billing system for port services conducted by SOEs • Integrate National Single Window system with 'inaportnet' system • Mandatory use of Indonesian rupiah for payments related to transportation activities • Remove price difference between private commercial and state postal services
10	February 11, 2016	• Removing foreign ownership cap on 35 businesses • Protecting small & medium enterprises as well as cooperatives
11	March 29, 2016	• Lower tax rate on property acquired by local real estate investment trusts • Harmonization of customs checks at ports (to curtail dwell time) • Government subsidizes loans for export-oriented small & medium enterprises • Roadmap for the pharmaceutical industry
12	April 28, 2016	• Enhancing the ease of doing business in Indonesia by cutting procedures, permits and costs
13	August 24, 2016	• Deregulation for residential property projects for low-income families
14	November 10, 2016	• Creating a roadmap for the nation's e-commerce industry: ◆ Easing and widening access to funding ◆ Offer tax incentives ◆ Harmonize regulations and gradually develop a national payment gateway ◆ Promote e-commerce awareness campaigns and improve e-commerce education ◆ Accelerate the development of high-speed broadband network ◆ Improve the e-commerce logistics system
15	June 15, 2017	• Improving Indonesia's logistics: ◆ Enhance the role of transportation insurance ◆ Reduce costs for logistic service providers ◆ Strengthen the Indonesia National Single Window (INSW) authority ◆ Reduce the number of prohibited and restricted goods
16	August 31, 2017	• Single submission system: ◆ Integrate business licensing services ◆ Utilize information technology ◆ Enhance cooperation/coordination among government agencies on central and local level

Source: Indonesia-investments.com.

Appendix V. Impact of Fiscal and Other Structural Reforms

The IMF's Global Integrated Monetary and Fiscal (GIMF) model is used to estimate the macroeconomic effects of fiscal reforms in Indonesia. GIMF is a multi-country general equilibrium model that includes a detailed specification of fiscal policy, including different taxes (consumption, labor, and corporate) and different expenditure items (government consumption, public investment, general and targeted transfers, and interest payments). The main properties of the GIMF model calibrated for Indonesia are as follows:

- The multiplier on output from a 1 percent of GDP permanent increase in infrastructure investment is 1 percent in the first year, rising gradually to over 2 percent in 10 years. The rise in the multiplier in the medium term is driven by the increase in private investment, as the higher stock of public capital raises the productivity of private capital.

- The multipliers on output from a 1 percent of GDP permanent rise in social transfers are modest in the first year, ranging between 0.15 percent for targeted transfers to the poor and 0.05 percent for untargeted general transfers. The medium-term impact is slightly negative as taxes are raised or spending is cut to keep the fiscal deficit unchanged.

- The multipliers on output in the first year from a 1 percent of GDP permanent rise in revenue due to higher taxes are –0.2 percent for consumption taxes, –0.3 percent for labor taxes, and –0.5 percent for corporate taxes. The negative impact on output from higher consumption taxes declines over time to nearly zero after 10 years, while that from higher labor taxes rises increases to 0.5 percent in the second year, remaining at that level for the following eight years. The negative impact on output from higher corporate taxes increases gradually over time to 1.5 percent after 10 years.

As the GIMF model cannot estimate the impact of other structural reforms directly, these are estimated indirectly in the GIMF model through an estimated impact of these reforms on total factor productivity (TFP). Barnes (2014)[1] finds that a benchmark reduction in the product market regulation (PMR) index could increase TFP by around 2 percent over 5 years, with larger gains for emerging market economies. For example, a 10 percent reduction in the PMR index could lead to gains in TFP of about 1.7 percent for BRICS and 1.3 percent for OECD countries. Dabla-Norris and others (2016)[2] finds that trade and foreign direct investment (FDI) liberalization, as well as labor market reforms to remove excessive rigidities, can significantly boost TFP in emerging market economies. Moreover, the short-term costs of these reforms are small, while the medium-term benefits are sizable and long lasting.

The reform scenario includes higher spending in infrastructure and targeted transfers financed mainly by higher consumption taxes, reduced barriers to trade and FDI, and

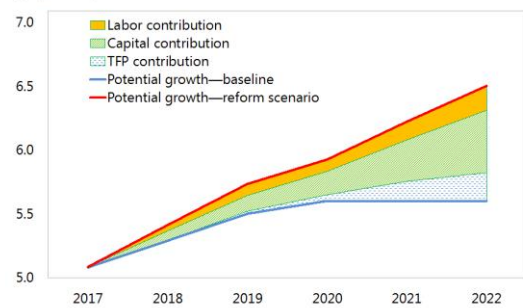
[1] Barnes, Sebastian, 2014, "Reforms and Growth: A Quantification Exercise," presentation at the Nero Meeting (Paris: Organisation for Economic Co-operation and Development).

[2] Dabla-Norris, Era, Giang Ho, and Annette Kyobe, 2016, "Structural Reforms and Productivity Growth in Emerging Market and Developing Economies," IMF Working Paper No. 16/15 (Washington: International Monetary Fund).

structural reforms to the product and labor markets. About 2 percent of GDP of the extra revenue from the MRTS would come from consumption taxes such as VAT and excises on fuel, vehicles, and plastic bags, which have low negative multipliers. The other 1 percent of GDP would come from taxes with larger negative multipliers. This extra revenue would be used to increase spending in infrastructure (1.3 percent of GDP) and targeted transfers in education, health and social programs (1.5 percent of GDP), which have larger multipliers. Other structural reforms would center on reducing restrictions to trade and FDI, and streamlining product and labor market regulations to promote entry, rationalize the role of SOEs, and foster employment.

Most of the gains in real GDP growth in the initial years would come from fiscal reforms, with gains in TFP from other structural reforms playing a role in the outer years. Real GDP growth would increase gradually to 6.5 percent by 2022, 0.9 percentage points higher than the baseline scenario. Higher infrastructure investment and FDI, which would also catalyze private investment and employment, would be the main growth drivers in the first two years, raising real GDP growth by 0.2 percent. Gains in TFP from other structural reforms would raise real GDP growth by 0.1 percent in 2020−21 and 0.2 percent in 2022. Higher public and private investment and employment growth would play an increasing role over time, raising real GDP growth by 0.5 and 0.2 percentage points relative to the baseline by 2022, respectively.

Indonesia: Growth Under Reform Scenario
(In percent)



Sources: Penn World Trade; and IMF staff estimates.

The reform scenario also assumes continued macroeconomic stability. Inflation would rise to around 4 percent (y/y) in the initial years due to the demand stimulus and higher consumption taxes, but it would moderate afterwards due to a tighter monetary stance, stronger domestic competition and expanded production capacity. The current account deficit would widen to around 2.3 percent of GDP due to higher public and private investment-related imports (or a lower saving-investment gap in the private sector), which would be partly offset by higher exports due to enhanced competitiveness.

INTERNATIONAL MONETARY FUND

INDONESIA

December 21, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of November 30, 2017)

Membership Status: Joined February 21, 1967; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	4,648.40	100.00
Fund holdings of currency	3,860.56	83.05
Reserve tranche position in Fund	787.86	16.95

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	1,980.44	100.00
Holdings	1,117.86	56.44

Outstanding Purchases and Loans: None

Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Millions)	Amount Drawn (SDR Millions)
EFF	02/04/00	12/31/03	3,638.00	3,638.00
EFF	08/25/98	02/03/00	5,383.10	3,797.70
Stand by	11/05/97	08/25/98	8,338.24	3,669.12

Projected Payments to Fund (SDR millions; based on existing use of resources and present holdings of SDRs):

	Forthcoming			
	2018	2019	2020	2021
Principal				
Charges/Interest	6.33	6.36	6.36	6.35
Total	6.33	6.36	6.36	6.35

Exchange Arrangements

The rupiah has had a *de jure* free floating exchange arrangement since August 14, 1997, and the current *de facto* arrangement is floating. The market exchange rate was Rp 13,560 per U.S. dollar as of October 31, 2017. Indonesia has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions.

Article IV Consultation

The last Article IV consultation report (IMF Country Report No. 17/37) was discussed by the Executive Board on January 25, 2017.

Resident Representative

Mr. John Nelmes has been the Senior Resident Representative since September 2016.

WORLD BANK-IMF COLLABORATION

The working relationship between the IMF and the World Bank in Indonesia is very strong, with joint working programs and close coordination through frequent meetings between resident offices and missions from headquarters, including during the Article IV consultation.

Key Areas with Joint Programs

Budget Reforms

- The reform agenda for budget and treasury remains a high priority for both institutions. Currently, the World Bank's support is being provided through the Public Financial Management Multi-Donor Trust Fund (PFM-MDTF) and Support for Enhanced Macro-Economic and Fiscal Programmatic Assistance (SEMEFPA) programs, as well as development policy loans (DPLs), with elements in support of (a) promoting budget efficiency; (b) improving subnational transfers; (c) supporting more strategic management of PFM across units at MoF; (d) public expenditure reviews (a multi-phase PER is ongoing); and (e) improved composition of spending, budget execution and efficiency of spending. Highlights of the engagement includes:
    - In 2015, Indonesia completed rollout of a treasury financial management information system, the Sistem Perbendaharaan dan Anggaran Negara (SPAN), which was financed with a World Bank loan and whose implementation was supported by the PFM-MDTF.
    - A Public Expenditure and Financial Accountability (PEFA) assessment was completed in November 2017. PEFA documents an overall improvement in the core PFM system across the budget cycle and finds Indonesia has a strong legal and regulatory framework, and a PFM system largely aligned with international standards. It also identifies challenges such as the management of contingent liabilities and the reliability of budget projections.
    - An ongoing series of Development Policy Loans on fiscal reforms ("Fiscal DPL series") supports reforms to enhance the allocative efficiency and effectiveness of public spending.
- The IMF has complemented this work through recent technical assistance (TA) on developing a medium-term expenditure strategy.

Taxation Issues

- Revenue (tax and nontax revenue) issues are a priority for the IMF and the World Bank, with broadening the revenue base and increasing revenues an important issue for both macro-fiscal stability and the investment climate. The Fund conducted a mission on tax policy and administration in September 2017 to develop a medium-term revenue strategy (MTRS). The Bank provides tax policy (including international tax) and administration support through trust funded TA to the Fiscal Policy Agency and DG Tax, and the ongoing Fiscal DPL series. The Bank has also been providing analytical support on nontax revenue administration through the Natural Resources for Development program. The next phase of reforms, to be implemented under a government-owned MTRS, envisions changes to tax laws and improvements to tax administration to improve compliance.

Asset-Liability Management

- The World Bank and IMF have been leading an effort to improve asset-liability management, including at the Treasury and Debt Management Office of the Ministry of Finance and at Bank Indonesia, with continued collaboration envisaged, as needed.
- The Bank has been providing technical assistance to the middle-office of the DGBFRM under the Government Debt and Risk Management (GDRM) program. The TA has been focused on building cost-risk models for debt management strategy development, improved quantification and analysis of risks related to contingent liabilities related to support to infrastructure development, establishing a framework for government guarantees, and the joint IMF-World Bank support to Sovereign Asset Liability Management (SALM). The program is entering its second phase, and discussions on potential further support are ongoing.

Crisis Preparedness

- In recent years, the World Bank has focused on supporting the authorities in Indonesia to create a robust crisis prevention and management framework. Most recently, this support has included analysis of the financial sector stability framework through the 2017 FSAP and initial discussions have been held on support to MoF on developing a fiscal crisis monitoring protocol. The IMF has supported work in this area through past TA on reviewing the legal framework underpinning Indonesia's financial stability architecture and in its current surveillance dialogue with the authorities and exchange of views with the Bank.

Financial Sector

- The World Bank has a broad technical assistance program covering Financial Sector Stability, Financial Inclusion and Long Term Finance and Risk Management. A FSAP has been completed in 2017 and found the banking system to be profitable, well capitalized and resilient to severe shocks. The existing financial sector advisory activities are being brought together under a Programmatic Approach, Indonesia Financial Sector Technical Assistance (IFSTA), which will form the basis for sector engagement until 2022. The technical assistance program complements existing investment lending operations (concentrated in infrastructure finance) and is intended to serve as a basis for future lending, most immediately an upcoming Development Policy Loan (DPL) which will seek to address further reforms, particularly in the area of financial stability, guided by the FSAP recommendations.

Statistics

- The World Bank had a program of capacity building with the statistics agency that was launched in 2011 and closed in 2016. The IMF has focused recent training and TA on government finance statistics, monetary and financial statistics, sectoral accounts and balance sheets, and on measuring natural resources.

Macroeconomics

- The IMF continues to take the lead in monetary and exchange rate policies, with the Article IV mission and staff visits, focusing on fiscal, monetary, and exchange rate policies; macro-financial linkages, financial sector reforms, and crisis management, as well as the external position and spillover effects. The Fund also updates the Debt Sustainability Analysis at the time of the Article IV consultation. The Bank has also taken on a larger role, including on macroeconomic monitoring, macroeconomic policy dialogue, fiscal policy analysis and capacity building, with ongoing coordination with the Fund. The Bank continues to assist the Ministry of Finance's Fiscal Policy Office to improve capacity for macroeconomic monitoring, forecasting, and evidence-based macroeconomic and fiscal policy analysis.

These threads of work are expected to be continued by both institutions, with periodic meetings aimed at keeping each other informed about ongoing work and joint areas of interest. Issues being addressed by the IMF include domestic and external vulnerabilities, exchange rate management, medium-term external and fiscal sustainability, and macro-financial linkages and financial stability risks; and by the Bank the link between macro-fiscal policy and real economic outcomes, including growth and poverty, resource-sector fiscal revenues, and longstanding problems in the implementation and effectiveness of government spending.

JOINT MANAGERIAL ACTION PLAN, 2016–17

Title	Products	Provisional Timing of Missions	Expected Delivery Date (Tentative)
A. Mutual Information on Relevant Work Programs			
Bank work program for next 12 months	Indonesia Economic Quarterly		Four issues a year; FY18: October, December (2017); March, June (2018)
	Follow up to FSAP		Ongoing
	Energy DPL		Ongoing
	Fiscal reform DPL		Ongoing
	Technical assistance related to developing and implementing Indonesia's Medium-Term Revenue Strategy		Ongoing
IMF work program for next 12 months	**Macroeconomic surveillance**		
	2016 Article IV consultation	November 2016	Board discussion took place in January 2017
	2017 staff visit	July 2017	
	2017 Article IV consultation	November 2017	Board discussion will take place in January 2018
	Technical assistance		
	Financial deepening and market development	Ongoing	Periodic visits
	Tax policy and revenue administration	Ongoing	
	Statistical policies	Ongoing	
	Consolidated supervision (resident advisor)	Ongoing	
B. Request for Work Program Inputs			
Fund request to Bank	Assessment of economic developments and structural policies		Ongoing
	Information sharing		Ongoing
Bank request to Fund	Assessment of macroeconomic developments and policies		Ongoing
	Information sharing		Ongoing
C. Agreement on Joint Products and Missions			
Joint work program	Note on education for Article IV		December 2017

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

Indonesia is an Asian Development Bank (ADB) founding member since 1966. ADB has approved $32.7 billion in sovereign and nonsovereign loans (excluding cofinancing), and $894.02 million in technical assistance and grants for Indonesia. Cumulative disbursements to Indonesia for lending and grants financed by ordinary capital resources, the Asian Development Fund, and other special funds amount to $26.11 billion. The sectors with the largest shares in cumulative ADB assistance are public sector management (18.8 percent), energy (17.5 percent), agriculture and natural resources (13.2 percent), and finance (13 percent).[1]

The total indicative lending program for sovereign operations for 2018–2020 amounts to $7.45 billion. About $1.22 billion in cofinancing is anticipated. The lending pipeline will focus on the energy sector (42 percent of total lending); public sector management (18 percent); agriculture, natural resource, and rural development (15 percent); education (13 percent); finance (6 percent); and water and urban services (6 percent). The nonlending program for 2018–2020, which amounts to $43.55 million, consists of a grant and 26 technical assistance (TA) projects, including 12 TA projects with a total value of $7.55 million financed from ADB's Technical Assistance Special Fund (TASF).

Development Partnership Framework

The ADB's support to Indonesia is guided by the Country Partnership Strategy, which in turn is aligned to the National Medium-Term Development Plans (RPJMN) and ADB's Strategy 2020 Midterm Review. The current Country Partnership Strategy (2016-2019) aims to support Indonesia in achieving higher, more inclusive, and environmentally sustainable growth. The CPS focuses on three high-priority areas, as defined by the RPJMN: (i) improved infrastructure services, (ii) better economic governance, and (iii) enhanced human resource development.

On infrastructure ADB is supporting better policies, institutional arrangements, and strategic investment programs. ADB support will complement the government's rural electrification program, improvements in renewable energy policy and finance investments to extend the reach, reliability, and efficiency of the national electricity grid, and to foster greater use of clean sources of energy. ADB will provide a combination of policy support, rural irrigation and water supply infrastructure investment, and support for development of value-chains and diversification into high-value agricultural commodities. These measures will improve rural productivity and create wider employment and off-farm opportunities for small farmers and landless laborers. ADB will integrate climate mitigation and adaptation into infrastructure projects and introduction of new technology will be prioritized.

[1] See Table 2.

On economic governance, ADB will support fiscal reforms to aid government efforts to protect critical public spending and to boost revenue mobilization over the medium to long term. Support will be provided to assist the government strengthen the medium-term expenditure framework, and protect priority public expenditure on infrastructure, health, education, and social protection, in line with the SDGs. To strengthen public sector management and service delivery, ADB support will help strengthen tax administration capacity at the sub-national level, as well as improve efficiency, transparency, and accountability by using information technology.

ADB will continue to assist in deepening the finance sector by improving market infrastructure and encouraging product diversification in the bond market. ADB will support enhanced financial inclusion by addressing regulatory impediments, poor financial literacy, weak consumer protection, and by developing innovative microcredit products to better meet the needs of the poor. ADB will provide advisory, technical, and financial support to small and medium-sized enterprises to enable them to build viable value-chains and integrate into regional and global markets.

On human resources development, ADB support will be focused primarily on improving education quality and skills development. ADB will assist government efforts to improve the quality and relevance of education spending through support for education policy reforms, improved education sector management, and for the design and implementation of key government reform programs.

The Country Partnership Strategy is underpinned by three-year rolling Country Operations Business Plan (COBP). The COBP 2018–2020 reflects efforts to further enhance ADB's development effectiveness in Indonesia, including: (i) focusing on long-term engagement and a programmatic approach in core sectors; (ii) incorporating knowledge, innovation, and high quality technology in projects; (iii) ensuring project readiness and quality-at-entry to minimize implementation delays; (iv) deepening the partnership with executing and implementing agencies; (v) enhancing the capacity and flexibility to effectively respond to the government's evolving needs and priorities; and (vi) applying an effective and balanced mix of ADB's assistance modalities. ADB is also redoubling efforts to maximize synergies between sovereign and nonsovereign operations including the promotion of public-private partnerships in Indonesia.

Figure 1. Relations with the Asian Development Bank

Year of membership	1966
Country classification	Group C (Regular OCR-only country)
Resource available for approval, 2017	$1,800 million (Regular OCR)
Operational strategy	Country Partnership Strategy 2016–2019
Approval date:	October 2016
CPS Objective:	Supporting inclusive and sustainable economic growth
Strategic thrusts:	(i) improved infrastructure services; (ii) better economic governance; and (iii) enhanced human resource development
Shareholding and voting power (As of 30 June 2017)	
Number of shares held:	578,100 (5.446 percent of total shares)
Votes:	617,707 (4.655 percent of total membership 7.145 percent of total regional membership)
Overall capital subscription:	$8.04 billion
Paid–in capital subscription:	$402.03 million
Board of Governors	Sri Mulyani Indrawati (Governor) Bambang P.S. Brodjonegoro (Alternate Governor)
Board of Directors (constituency of Armenia; Cook Islands; Fiji; Indonesia; Kyrgyz Republic; New Zealand; Samoa; Tonga)	Syurkani Ishak Kasim (Executive Director) Mario Di Maio (Alternate Executive Director)
ADB Resident Mission	
Name of Country Director:	Winfried Wicklein
Year of Establishment of RM:	1987
No of staff (IS, NS, and AS):	IS = 7, NS = 14 and AS = 15; Outposted IS: 5
Contributions to the ADF (committed):	$14.96 million
Contributions to the TASF (committed):	$0.29 million
Contributions to the ADBI (committed):	$0.50 million
(As of 30 June 2017)	
Official cofinancing (As of 30 June 2017)	None

Source: Asian Development Bank.

Table 1. Sovereign Loan Approvals and Disbursements to Indonesia
(In millions of U.S. dollars)

	2010	2011	2012	2013	2014	2015	2016
Loan approvals	785.0	580.0	1,232.8	1,013.9	554.4	1,375.0	1,256.9
Loan disbursements	1,079.8	631.9	862.5	588.1	543.7	1.401.8	1,324.6

Source: Asian Development Bank.

Table 2. Cumulative Lending, Grant and Technical Assistance to Indonesia
(As of December 2016)

Sector	Loans (No.)	Amount (US$ millions)	Percent 1/
Agriculture, Natural resources and Rural development	275	4,425.10	13.20
Education	80	2,455.75	7.33
Energy	90	5,864.89	17.49
Finance	67	4,352.93	12.98
Health	46	1,104.99	3.30
Industry and trade	40	1,160.58	3.46
Public sector management	111	6,302.69	18.80
Transport	90	3,702.25	11.04
Water and other urban infrastructure and services	93	2,358.25	7.03
Multisector	28	1,797.20	5.36

Source: Asian Development Bank, *Indonesia Fact Sheet 2016*.

1/ Total may not add up because of rounding.

STATISTICAL ISSUES

Assessment of Data Adequacy for Surveillance	
General: Data provision is broadly adequate for surveillance with some shortcomings in fiscal and external sector statistics.	
National accounts: Statistics Indonesia (BPS) disseminates annual and quarterly GDP (QGDP) by economic activity and expenditure components at current prices and in volume terms at 2010 prices regularly. In general, GDP estimates are based on the latest international methodologies following the System of National Accounts 2008. The QGDP estimates are based on a limited set of indirect indicators. Some sectors are influenced strongly by seasonality, with seasonally adjusted data prepared but not published. BPS has been leading the work on developing sectoral accounts and balance sheets jointly with Bank Indonesia (BI) with TA from STA. BPS and BI expect to finalize the provisional data for the years 2010–2014 by the end of 2017. The next TA mission on Sectoral Accounts will be fielded in January 2018.	
Price statistics: Price statistics are broadly adequate for surveillance. The base year for PPI is 2010. The base year for CPI is 2012. In October 2013, BPS released the new Producer Price Index (PPI) covering agriculture, mining and quarrying, and manufacturing with 2010 as the base period, and has published the PPI index quarterly. BPS has also expanded the mining sample to include oil and natural gas extraction, coal, and gold, and has started work to further expand PPI coverage to include 15 service industries. Currently PPI for the following service industries are disseminated: electricity, water and gas; passenger transport; hotel and restaurants. There is a need to increase dissemination frequency and update the weights. Bank Indonesia and BPS have jointly begun work to expand the coverage of the residential property price index (RPPI) to include resales (the current RPPI includes only the sales of newly constructed units).	
Government finance statistics (GFS): The Ministry of Finance (MOF) is committed to keeping the requirements of fiscal statistics at the forefront of ongoing fiscal reforms, with better statistical monitoring one of the goals of the current efforts. The authorities are continuing their efforts to adopt the GFSM 2001/2014 standards, with assistance from STA as part of a regional GFS project. Significant progress has been made in these areas and, in 2013, Indonesia reported for the first time to STA general government data (including balance sheet data) covering the period 2008 onwards. Aggregated data on the budget of the central government are available with a one-month lag. Annual general government GFS are currently available 12 months after the end of the reference period and these data are published on the GFS website: http://www.gfs.djpbn.kemenkeu.go.id/en. The timeliness of the annual data will improve once all systems are in place. In late 2015, the authorities have started to compile quarterly general government data based on estimates of local government data. Quarterly general government GFS (operations statement) are available 6 months after the end of the reference quarter. The quarterly general government data are yet to be published on the GFS website because the authorities are improving these data in terms of coverage of local governments and timeliness with the development of new regional financial information system. Limited quarterly general government GFS data are published in IFS. The coverage and timeliness of public debt statistics are generally adequate.	
Monetary and financial statistics (MFS) and financial soundness indicators (FSIs): Good quality monetary statistics are compiled by BI on a timely basis. BI compiles and reports monetary data using the Standardized Report Forms (SRFs), from which an integrated database and alternative presentations of monetary statistics can be drawn to meet the needs of BI and the IMF. Additional challenges include timely revisions of published banking sector data after supervisory verification. With the support of a Fund TA mission in October 2014, BI expanded the coverage of the OFCs survey, which since January 2015 includes finance companies, insurance companies, pension funds, the state-owned pawn shop (PT Pegadaian), and the Indonesian export financing institution (Eximbank); achieving almost full coverage of the subsector. OFC data are reported on a monthly basis. The mission also assisted BI in advancing the production of flow-based monetary statistics and quarterly financial accounts. BI compiles and reports to the Fund all (12) core and 12 encouraged financial soundness indicators (FSIs) for deposit takers, all (two) encouraged FSIs for OFCs, two encouraged FSIs for nonfinancial corporations, one encouraged FSI for households, two encouraged FSIs for market liquidity, and three encouraged FSIs for the real estate sector, which are published quarterly on the Fund's FSI website**.**	
External sector statistics (ESS): Trade data have been improved in recent years. Import and export transactions of free trade zones and bonded warehouses are captured in goods data of balance of payments (BOP) statistics. For financial account, the methodological basis for the compilation of direct investment (DI) data needs substantial improvement. Inflows are currently calculated based on loan disbursements to companies that have foreign equity using a fixed ratio to estimate equity inflows. The errors and omissions in BOP has been large and predominantly negative and could be related to the under coverage of imports in current account or assets in the financial account. Financial transactions data are reconciled with changes in the international investment position (IIP), except data on DI. IIP data are compiled and published annually and quarterly. External debt statistics have improved considerably with the introduction of an External Debt Information System (EDIS) in 2002 and the recent initiative to publish monthly indicators. Also, as a result of the ongoing reconciliation of data conducted by BI, the IIP and external debt data are fully consistent. However, improvements are still needed with respect to components of private corporate sector data, particularly in distinguishing between scheduled and actual debt service, in estimating the accumulation/reduction of private sector payments arrears, and in estimating reschedulings/debt reductions received by the private sector from external creditors.	
Data Standards and Quality	
Indonesia has subscribed to the Special Data Dissemination Standard (SDDS) since September 1996, observing most of the SDDS requirements. Indonesia uses the SDDS flexibility options for the timeliness of the labor market categories (employment, unemployment, and wages/earnings) and general government operations.	Data *Reports on the Observance of Standards and Codes* (ROSC) was completed in 2005.

Indonesia: Table of Common Indicators Required for Surveillance

(As of December 8, 2017)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]	Memorandum Items: Data Quality—Methodological Soundness[2]	Memorandum Items: Data Quality—Accuracy and Reliability[3]
Exchange rates	12/8/17	12/8/17	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities[4]	10/17	12/17	M	M	M		
Reserve/base money	10/17	12/17	W/M	W/M	W/M	O, LO, O, O	LO, O, O, LO, O
Broad money	10/17	12/17	M	M	M		
Central bank balance sheet	11/17	12/17	M	M	M		
Consolidated balance sheet of the banking system	10/17	12/17	M	M	M		
Interest rates[5]	12/8/17	12/8/17	D	D	D		
Consumer price index	11/17	12/17	M	M	M		
Revenue, expenditure, balance and composition of financing[6]—central government	9/17	11/17	M	M	Mid-year	LNO, LNO, LO, LNO	LNO, LO, LO, LO, LNO
Stocks of central government and central government–guaranteed debt	9/17	11/17	Q	Q	Q		
External current account balance	Q3/17	11/17	Q	Q	Q	LO, LO, LO, LO	LO, O, LO, O, O
Exports and imports of goods and services	Q3/17	11/17	Q	Q	Q		
GDP/GNP	Q3/17	11/17	Q	Q	Q	LO, LO, O, LO	LO, LO, LO, LO, LNO
Gross external debt[7]	Q3/17	11/17	Q	Q	Q		
International investment position[8]	Q3/17	11/17	Q	Q	Q		

1 Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); NA: Not Available.
2 Reflects the assessment provided in the data ROSC published on July 20, 2005 (based on the findings of the mission that took place during March 28-April 11, 2005), for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
3 Including currency and maturity composition, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.
4 Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
5 Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
6 Foreign, domestic bank, and domestic nonbank financing.
7 Including currency and maturity composition.
8 Includes external gross financial assets and liability positions vis-à-vis nonresidents.

Statement by Juda Agung, Executive Director for Indonesia and Arief Machmud, Senior Advisor to Executive Director
January 10, 2018

The Indonesian authorities would like to express their appreciation to the IMF mission team for the constructive discussions and policy dialogue during the 2017 Article IV consultation. They are encouraged by staff's acknowledgement of Indonesia's solid performance and resilience. Indonesian economy has continued to perform well with a well-maintained macroeconomic and financial stability. The authorities have also proceeded to implement a series of structural reform with positive results, and will continue to strengthen structural reform efforts in order to increase Indonesia's potential output. To that end, the authorities will maintain their unwavering commitment towards macroeconomic and financial stability as well as broad based structural reform. The authorities broadly concur with the gist of the Indonesia 2017 Article IV and would like to raise several points for emphasis.

Recent Economic Development and Outlook

Indonesian economy continues to perform well, supported by prudent macroeconomic policies and a concerted strategy of structural reforms. Economic growth has exhibited an upward trend since the last three years, on the back of exports and investment recovery. Overall, the economy is expected to grow at 5.1% in 2017, higher than last year's growth. Macroeconomic stability has been maintained as indicated by benign inflation, sound current account deficit, and stable exchange rates. Going forward, economic growth is expected to improve further**.** Growth in 2018 is projected at 5.1-5.5% (yoy). The continuing growth momentum will likely be driven primarily by domestic demand, particularly investment growth. In addition, recovery of export growth is also expected to continue.

Fiscal and Structural Reform

Fiscal realization continued to improve in 2017, with higher revenue collection and better quality of expenditure. Budget deficit realization was maintained below statutory ceiling at around 2.6 percent of GDP, while government debt ratio remained at low level of 28.6 percent of GDP. Revenue collection increased by 6.4 percent, with the strong growth in VAT and non-oil and gas income tax. The quality of spending has also been improving as indicated by continuous increase in the share of capital expenditures to total expenditure (18.7 percent) to support infrastructure development. Looking ahead, fiscal policy in 2018 remains directed to support growth, while at the same time to maintain the fiscal sustainability. The budget deficit in 2018 is targeted to 2.2 percent of GDP. The fiscal strategy focuses on optimizing revenue, improving the quality of public spending, and ensuring sustainable budget financing. To optimize tax revenue, comprehensive tax reform will focus on expanding taxpayer database, improving human resources and business processes, and strengthening IT support system. On the expenditure side, efforts to enhance the quality of public spending will include improving the quality of capital expenditure, ensuring efficient non-priority spending, refocusing priority spending (infrastructure, education, and health), synergizing social protection programs, and improving quality of fiscal decentralization.

The Indonesian authorities have implemented a concerted strategy of structural reforms with positive results. The authorities have embarked on a series of structural reforms to improve the economy's competitiveness and the business climate. These efforts in combination with the authorities' consistency in preserving macroeconomic stability have been recognized by credit rating agencies and international organizations. Standard & Poor's (S&P) rating upgraded Indonesia to investment grade (BBB-) with a stable outlook in May 2017, confirming the upgrade to investment grade by rival agencies (Fitch and Moody's) in 2011 and 2012. More recently (December 2017), Fitch Ratings (Fitch) upgraded Indonesia's sovereign credit rating by a notch from BBB- to BBB with stable outlook. Additionally, Indonesia's rank in the World Bank's *Doing Business* also improved from 91 to 72 in 2018.

The authorities welcome IMF's focus on structural reforms in this Article IV and the results of the IMF's policy scenario noting that Indonesia's potential growth can reach 6.5% in the medium term with a combination of fiscal and structural reforms. The authorities would also like to emphasize the importance of a sequential phase to implement structural reform efforts, especially in light of the long-term nature of these reforms. They would also like to stress the significance of choosing appropriate reforms that would benefit the country most. Thus, the authorities encourage the IMF to advice the authorities on the optimal sequence of the reforms which is currently missing in the report.

The authorities would like to emphasize that reform progress is not necessarily reflected in the form of market access and/or market price. Indonesia currently continues to implement a wide range of structural reform efforts to ensure economic competitiveness, diversify the source of growth, and improve the social welfare. The implementation of the said reforms would require strategy and finesse including ways to phase out the process whilst taking into account the impact to low-income society. The authorities would like to highlight that the effort to move from product subsidy towards a more targeted subsidy in the energy sector has been progressing very well in an integrated approach. In particular, for fuel subsidy, they have combined the pace of the shift towards pure market-based fuel price with quantitative measures[1] by limiting the volume and availability of gas stations providing subsidized fuel (RON 88), as well as limiting the types of vehicles allowed to consume the subsidized fuel. These efforts have increased the usage of market-based fuel type (i.e. RON 90 and RON 92). Additionally, since the abolishment of fuel subsidy policy, the authorities no longer allocate fuel subsidy fund in the fiscal budget. Thus, the authorities' effort to ensure smoothness of reform implementation should not be seen as a delay, rather it should be seen as progress in the right direction.

The authorities continue to press ahead with major infrastructure projects. In this context,

[1] Except for a very small fixed subsidy on diesel and kerosene, which is mostly consumed by low-income society.

various reforms have been made, including by the establishment of Committee for Acceleration of Priority Infrastructure Delivery (KPPIP) to carry out feasibility study, monitoring, and debottlenecking strategies of priority projects, and the establishment of Indonesia Asset Management Agency (LMAN) to expedite land acquisition procedures. The significant progress has been made in expediting infrastructure projects after SOEs played key role in the projects that had been stalled for years under the privates. While the SOEs' financial performance involved in infrastructure projects are sound, indicated by strong profits and low leverage, the authorities continue to closely monitor the implication on fiscal risks and prudently keep the pace of infrastructure development in line with the financial availability.

Monetary Policy

Monetary policy is always geared to maintain macroeconomic and financial stability, so as to allow policy room to support recovery momentum of domestic economy. The authorities view current monetary policy stance as neutral and will continue to ensure macroeconomic and financial stability. The strategy has allowed the monetary policy to support a more sustainable and inclusive economic growth. They will continue to employ "the policy mix", namely monetary policy, exchange rate policy, macro-prudential policy, payment system policy, and strong coordination with the government. Looking ahead, the authorities will remain vigilant of global and domestic risk development and will formulate monetary policy accordingly in line with the above-mentioned developments. Thus, **the authorities caution IMF in using a directive forward guidance especially in emerging market countries as it can possibly trigger unintended consequences.** Further, **they believe building authorities' credibility in managing macroeconomic and financial condition is of far more importance** compared to establishing such forward guidance.

The authorities continue to be committed to maintain exchange rate flexibility. Exchange rate flexibility is always at the core of Indonesia's exchange rate policy. To that end, as a lesson learned from the taper-tantrum episode, Indonesia has also strengthened the exchange rate policy by ensuring the rupiah to be in line with its fundamental value. Nevertheless, in the event of excessive volatility or fundamental exchange rate misalignment, the authorities will not shy away from conducting FX intervention to prevent disorderly market condition as well as to mitigate risk to the achievement of the inflation target.

External Sector

The Indonesian authorities largely concur with staff assessment on Indonesia's external position. The external position is seen as broadly consistent with fundamental and desirable policies while external debt remains sustainable. The authorities are pleased with the progress Indonesia has achieved thus far, namely on directing the current account deficit (CAD) from a peak of 3.2 percent of GDP in 2013 towards a more sustainable CAD (forecasted at 1.7 percent of GDP for 2017). They are cognizant of the importance of external sector sustainability and value the importance of a reliable reference on it. This includes Current Account norm (CA norm) result from the IMF EBA methodology. Therefore, **they have voiced concern regarding the level of CA norm for Indonesia. This is especially pertaining to consistency between the CA norm and the overall macroeconomic scenario.** The authorities view that the estimated CA norm (-1.3 percent of GDP) does not adequately reflect Indonesia's need of higher CA deficit to finance investment on infrastructure and other structural reforms. Noting that the EBA model is based on a multilaterally consistent approach with a limited set of explanatory variables, the authorities encouraged the IMF to always consider additional country specific factors in its external assessment.

On the issue of external debt, the authorities concur with staff assessment that Indonesia's external debt remains sustainable. Currently, external debt remained moderate at 34.4 percent of GDP (September 2017). They believe that this condition is the result of measures implemented by the authorities to moderate risks from external debt. One such measures is the corporate external debt regulation[2] (KPPK) which requires hedging (at least 25 percent) of **net** FX liability of corporate with external debt maturing within six months. [3] he authorities view that this prudential regulation has helped curb the rise of corporate external debt and moderate the risks of overall external debt. In the end, the measure has helped improve Indonesia's resilience toward the external shocks. This corporate external debt regulation was never intended to limit capital flows and is aimed to ensure macro financial stability through the adoption of prudential principle of corporate borrowing, thus it should be categorized as 'other policies' and not as a CFM or CFM/MPM. That said, the authorities remain open to conduct a cost-benefit analysis to extend the coverage of the regulation.

Financial Sector

The authorities welcome staff's assessment on financial sector reform and concurred that the Indonesian banking system has remained sound, liquid, and profitable. The financial soundness indicators point to high capital adequacy, strong profitability, improved banking efficiency, relatively stable NPL, and sufficient liquidity. High capital buffers and strong profitability has also helped to absorb most of credit losses, under the most severe FSAP's stress tests. **The authorities have also continued to strengthen financial oversight and crisis management in line with FSAP recommendation.** However, regarding staff's suggestion in paragraph 53[4] to "extend emergency lending to banks that are assessed by OJK as viable even if its capital is temporary below minimum requirements", they would like to convey that **Indonesia**

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[2] Sometimes also referred as "corporate prudential FX regulation".

[3] Corporate external debt maturing up to 3 month and maturing between 3 to 6 months.

[4] "Consideration should be given to emergency liquidity assistance (ELA) eligibility criteria to allow extending emergency lending to banks that are assessed by OJK as viable even if its capital is temporary below minimum requirements. The ELA framework should also enable BI, in situations where it is not satisfied with a bank's solvency and viability, or with collateral, to request an indemnity from the government subject to appropriate safeguards."

has deliberately chosen to limit the eligibility of ELA for solvent banks. In this case, the parliament, in line with global standard recommendation, has strongly disapproved the use of public funding to extend ELA for insolvent banks. To that end, the authorities encourage the IMF to honor the authorities' decision on this issue.

Conclusion

Indonesia has embarked in an integrated policy reform efforts to improve resilience and boost potential growth so as to achieve strong, sustainable, balanced and inclusive growth. Indonesia is ready to be part of the major players in the global economy. To that end, the authorities will maintain their unwavering commitment towards macroeconomic and financial stability as well as broad-based structural reforms.

On a special note, the authorities would like to appreciate the excellent collaboration between the Fund and the authorities in preparing the 2018 IMF-WB Annual Meetings. They would also request IMF member's support to ensure the success of the event. Soon, they will be arriving at another important milestone for Voyage to Indonesia (VTI), which is the **High Level Conference on "New Growth Model in a Changing Global Landscape"** in February. This conference will be held in Jakarta, Indonesia and in this occasion, the authorities would like to invite all IMF members to attend.