INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/46

INDONESIA

March 2021

2020 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 2020 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 February 12, 2021 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 February 12, 2021, following discussions that ended on December 10, 2020, 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 January 29, 2021.
- 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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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR21/54

IMF Executive Board Concludes 2020 Article IV Consultation with Indonesia

FOR IMMEDIATE RELEASE

Washington, DC – March 1, 2021: The Executive Board of the International Monetary Fund (IMF) concluded the 2020 Article IV consultation[1] with Indonesia.

The Indonesian economy is gradually recovering, owing in part to a bold, comprehensive, and coordinated policy response to address the socio-economic hardship inflicted by the COVID-19 pandemic in the first half of 2020. Real GDP increased by 3.2 percent in 2020:Q3 (q/q, s.a.) and is expected to have contracted by a modest 1.9 percent in 2020 as a whole. Headline inflation reached 1.7 percent (y/y) at end-2020, below the Bank Indonesia's target band (3±1 percent), partly due to a strong harvest leading to lower food prices. The current account deficit is expected to have narrowed to 0.5 percent of GDP in 2020, mostly due to a relatively sharper contraction of imports.

The outlook is positive. Real GDP is projected to expand by 4.8 percent in 2021 and 6 percent in 2022, led by strong policy support measures, including increased public investment and COVID-19 vaccine distribution plans, as well as improved global economic and financial conditions. Inflation is projected to rise gradually to 3 percent (y/y) at end-2021. The current account deficit is projected to widen to 1.5 percent of GDP in 2021, reflecting higher imports driven by economic recovery. Credit growth is expected to pick up in 2021 with stronger activity, albeit remaining below nominal GDP growth due to increased risks to asset quality and bank profitability. The uncertainty surrounding the growth outlook is nevertheless larger than usual. Early widespread vaccination is an upside risk, while delays could lead to a more protracted pandemic, a downside risk. The macro-financial fallout of the pandemic and economic downturn could be larger-than-expected, and credit conditions could be slow to improve.

Executive Board Assessment[2]

Executive Directors commended the authorities' containment measures and supportive macroeconomic policies, which have been instrumental in cushioning the economic impact of the pandemic. They noted that Indonesia's strong fundamentals and prudent macroeconomic policy track record have contributed to its economy's resilience.

Directors noted that supportive monetary and fiscal policies along with the envisaged increase in public investment should help foster economic recovery. They observed that risks to the outlook are tilted to the downside, mainly due to domestic and global uncertainties associated

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[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.

[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.

with the pandemic. Early completion of a widespread vaccination program, however, is an upside risk, and Directors were encouraged by the recent increase in the funding for the health policy response to the pandemic. They observed that Indonesia has the macroeconomic policy space to provide additional support if downside risks materialize. They welcomed the measures to foster transparency and ensure the effectiveness of pandemic-related spending.

Directors commended the authorities' commitment to return to the statutory budget deficit ceiling by 2023, noting the importance of unwinding the exceptional measures in a balanced manner. They stressed the need to underpin the fiscal rules with a medium-term fiscal strategy that includes revenue measures. Higher government revenues would help create space to boost development spending and support sustainable and inclusive growth. Capacity building support will be crucial.

Directors agreed that maintaining an accommodative monetary policy stance, contingent on the inflation outlook, is appropriate. They noted the authorities' strategy of pursuing monetary accommodation through a combination of lower policy interest rates and government bond purchases by Bank Indonesia in the current exceptional circumstances. To balance the benefits and risks of temporary monetary budget financing, they welcomed Bank Indonesia's plan to conduct bond purchases in 2021 only as a last resort under the market mechanism. They suggested that clarifying the last-resort criteria would help enhance the monetary policy framework and safeguard Bank Indonesia's operational independence. Directors also noted the role of exchange rate flexibility in absorbing shocks.

Directors noted that the banking system remains stable, but continued monitoring on bank asset quality is warranted. They emphasized that proactive loan loss provisioning will be critical for banks' ability to weather any deterioration in asset quality. They noted that additional targeted policy steps to revive credit might be necessary if bank lending to the private sector does not rebound. Directors also highlighted the importance to continue upgrading crisis management and resolution frameworks.

Directors welcomed the authorities' push for structural reforms with the omnibus bill on job creation, as well as their plans to close infrastructure gaps. They encouraged the authorities to sustain the reform momentum, with a focus on developing a medium-term government revenue strategy, financial deepening and digitalization, and fostering a greener economy and tackling challenges related to climate change.

Indonesia: Selected Economic Indicators

	2016	2017	2018	2019	2020 1/ Est.	2021 Proj.
Real GDP (percent change)	5.0	5.1	5.2	5.0	-1.9	4.8
Domestic demand	4.6	5.0	6.1	4.0	-2.8	5.1
Of which:						
Private consumption 2/	5.0	5.0	5.0	5.2	-2.5	5.0
Government consumption	-0.1	2.1	4.8	3.2	6.0	5.0
Gross fixed investment	4.5	6.2	7.9	4.4	-4.7	4.5
Change in stocks 3/	0.2	-0.1	0.4	-0.6	-0.3	0.3
Net exports 3/	0.1	0.3	-1.2	1.4	0.8	-0.1
Saving and investment (in percent of GDP)						
Gross investment 4/	33.9	33.7	34.6	33.8	32.5	32.7
Gross national saving	32.0	32.1	31.6	31.1	32.0	31.2
Prices (12-month percent change)						
Consumer prices (end period)	3.0	3.6	3.2	2.6	1.7	3.0
Consumer prices (period average)	3.5	3.8	3.3	2.8	2.0	2.0
Public finances (in percent of GDP)						
General government revenue	14.3	14.1	14.9	14.2	12.1	12.1
General government expenditure	16.8	16.6	16.6	16.4	17.8	18.0
Of which: Energy subsidies	0.9	0.7	1.0	0.9	0.7	0.6
General government balance	-2.5	-2.5	-1.8	-2.2	-5.7	-5.9
Primary balance	-1.0	-0.9	0.0	-0.5	-3.7	-4.0
General government debt	28.0	29.4	30.4	30.6	35.7	40.1
Money and credit (12-month percent change; end of period)						
Rupiah M2	10.0	8.3	6.3	6.5	11.5	7.0
Base money	3.9	8.9	0.2	2.9	-6.5	7.0
Claims on private sector	7.7	7.2	10.3	5.8	-0.5	5.6
One-month interbank rate (period average)	6.5	5.6	6.2	6.4	4.5	…
Balance of payments (in billions of U.S. dollars, unless otherwise indicated)						
Current account balance	-17.0	-16.2	-30.6	-30.4	-5.5	-17.4
In percent of GDP	-1.8	-1.6	-2.9	-2.7	-0.5	-1.5
Trade balance	15.3	18.8	-0.2	3.5	23.4	20.3
Of which: Oil and gas (net)	-4.8	-7.3	-11.4	-10.3	-9.2	-8.7
Inward direct investment	3.9	20.6	20.6	23.5	13.6	18.8
Overall balance	12.1	11.6	-7.1	4.7	6.7	16.4
Terms of trade, percent change (excluding oil)	0.4	1.3	0.4	-2.7	-5.4	1.7
Gross reserves						
In billions of U.S. dollars (end period)	116.4	130.2	120.7	129.2	135.9	152.3
In months of prospective imports of goods and services	7.6	7.1	7.1	9.9	7.9	8.1
As a percent of short-term debt 5/	213	237	201	204	207	217
Total external debt 6/						
In billions of U.S. dollars	320.0	352.5	375.4	403.5	416.6	446.9
In percent of GDP	34.3	34.7	36.0	36.1	38.3	38.5
Exchange rate						
Rupiah per U.S. dollar (period average)	13,306	13,383	14,231	14,140	14,541	…
Rupiah per U.S. dollar (end of period)	13,473	13,568	14,390	13,866	14,050	…
Memorandum items:						
Jakarta Stock Exchange (12-month percentage change, composite index)	15.3	20.0	-2.5	1.7	-5.1	…
Oil production (thousands of barrels per day)	820	815	810	805	710	707
Nominal GDP (in trillions of rupiah)	12,402	13,590	14,838	15,834	15,841	16,939

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

1/ Based on data as of January 29, 2021 and does not include the national accounts data for 2020:Q4 released on February 5, 2021. The actual real GDP growth rate in 2020 was -2.1 percent.

2/ Includes NPISH consumption.

3/ Contribution to GDP growth (percentage points).

4/ Includes changes in stocks.

5/ Short-term debt on a remaining maturity basis.

6/ Public and private external debt.

INTERNATIONAL MONETARY FUND

INDONESIA

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

January 29, 2021

KEY ISSUES

Context. Indonesia has responded with a bold and comprehensive policy package to cushion the impact of the COVID-19 pandemic. The economy rebounded in the third quarter of 2020, and the economic recovery is projected to strengthen in 2021 and 2022. Strong policy support and an improving global economy will be the main drivers initially, and greater mobility and confidence will follow with the planned vaccination program in 2021. The uncertainty surrounding the growth outlook is larger than usual. Early completion of a widespread vaccination program is an upside risk, while a protracted pandemic remains a downside risk. The macro-financial fallout of the pandemic and economic downturn could be larger than expected, and credit conditions could be slow to improve. Ongoing reforms aimed at promoting investment are expected to help mitigate the scarring effects from the pandemic and put the economy on a sustained growth path that builds on Indonesia's favorable demographics.

Main Policy Recommendations

- The moderately expansionary fiscal policy stance planned for 2021, together with the envisaged increase in public investment, should help foster economic recovery. The flexibility to reallocate budget should be used as needed. If downside risks materialize, there is space for a more expansionary macroeconomic policy response.
- The plan to return to the budget ceiling of 3 percent of GDP by 2023 is a welcome commitment to the fiscal rules. It should be backed by a medium-term fiscal strategy, which would help anchor expectations, and should include revenue measures.
- Pursuing monetary accommodation through a combination of lower policy interest rates and government bond purchases by Bank Indonesia (BI) is appropriate in the current exceptional circumstances. The plan for BI to conduct bond purchases in 2021 only on a last-resort basis under the market mechanism will help balance the benefits and risks of temporary monetary budget financing.
- Proactive loan loss provisioning also under the partially relaxed loan classification rules will be critical for banks' ability to weather the expected deterioration in asset quality. Additional targeted policy steps to revive credit might be needed if bank lending to the private sector does not rebound with the economic recovery.
- The strong structural reform momentum should be sustained, with the focus shifting to financial deepening and digitalization, and a medium-term government revenue strategy to secure the tax revenue gains needed for higher development spending.

Approved By
Odd Per Brekk and Ana Ilyina

Mission dates: November 25-December 10, 2020
Mission team: Thomas Helbling (Head), Eugenio Cerutti, Koki Harada, Agnes Isnawangsih, Minsuk Kim, James Walsh (senior resident representative) (all APD), William Gbohoui (FAD), Hou Wang (MCM), and Francisco Arizala (SPR). Alisara Mahasandana, Executive Director; Firman Mochtar, Alternate Executive Director, and Dian Susiandri, Advisor (all OED); and Odd Per Brekk (APD) joined the concluding meetings. Purva Khera (MCM), Robin Koepke (APD), and Manasa Patnam (EUR) contributed to the preparations for the mission and presented background papers during the mission. Nong Jotikasthira contributed to the preparation of this report.

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TABLES

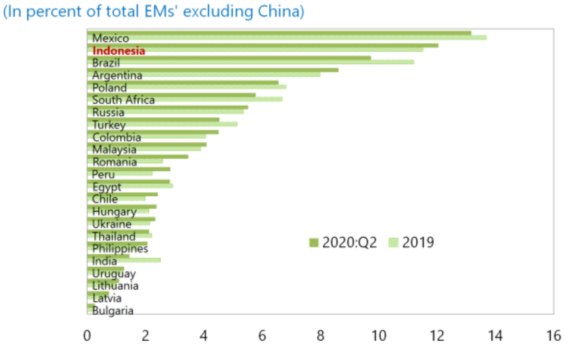
APPENDICES

PRE-COVID-19 LANDSCAPE

1. **Indonesia has established a prudent macroeconomic policy track record and enjoyed stable growth of around 5 percent in the years before the pandemic**. Macroeconomic indicators were favorable, including low inflation of around 3 percent that fluctuated well within Bank Indonesia's (BI's) target range, low budget deficits, and a low public debt ratio. The banking system is well-capitalized and liquid. The track record has been underpinned by solid policy frameworks, including fiscal rules, an inflation targeting regime, and, for most of the banking system, regulations in line with Basel III.

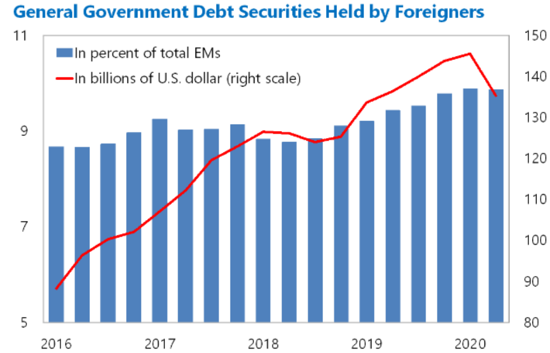
2. **Indonesia has also faced structural challenges and vulnerabilities**. If addressed, economic growth could be higher, harnessing the country's demographic dividend. A low revenue intake has limited the scope for government spending on development. In recent years, net external portfolio liabilities have risen with large capital inflows. As a result, Indonesia has now one of the highest shares of nonresident holdings of public debt across emerging markets (EMs) and accounts for a substantial share in total EM public debt held by nonresident investors. The rupiah government bond market has thus become an important channel of transmission for external financial disturbances, and the currency risk premium on rupiah assets is relatively high, comparable to those in other major emerging market economies.[1] Progress with structural reforms has been slow.

General Government Debt Securities Held by Foreigners
(In percent of total EMs' excluding China)



Sources: Sovereign Investor Based Estimates by Arslanalp and Tsuda (2014), and IMF staff estimates.

General Government Debt Securities Held by Foreigners



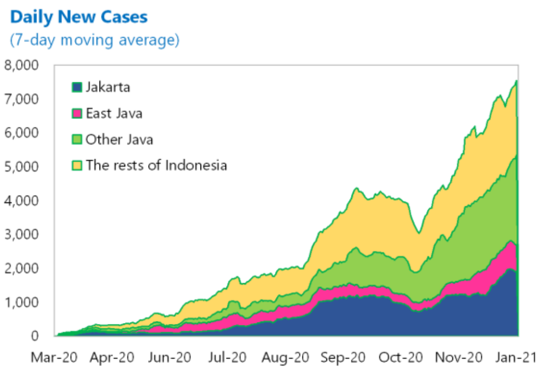
Sources: Sovereign Investor Based estimates by Arslanalp and Tsuda (2014); and IMF staff estimates.

THE COVID-19 CRISIS AND THE POLICY RESPONSE

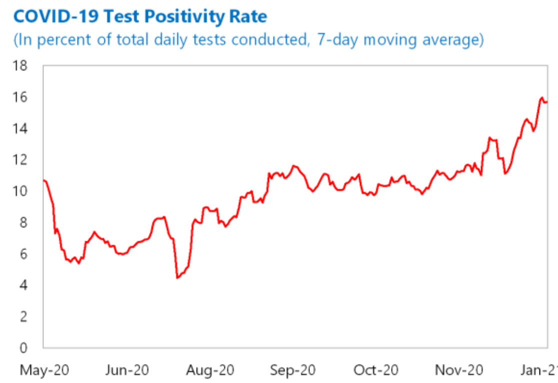
3. **The COVID-19 pandemic has accelerated again recently**. After a period with limited domestic transmission and a lockdown, virus infections accelerated in the second half of 2020. This acceleration was in part driven by the economic reopening but also reflected increased testing after an initially slow health policy response. More recently, after a period of relative stabilization, daily new cases have increased again, and test positivity rates remain high (Figure 1). An ambitious

[1] Analysis of the role of nonresidents in domestic bond markets indicates that while a larger share of nonresident participation in bond markets tends to reduce the level of local currency government bond yields, it also tends to increase their sensitivity to changes in global risk aversion (see Chapter 1 of the *Selected Issues* for further details).

vaccination program began in January 2021, with the goal of inoculating about two thirds of the population (or about 182 million people) by March 2022. Free vaccines will be made available to the public in phases, starting with health workers and public service workers.

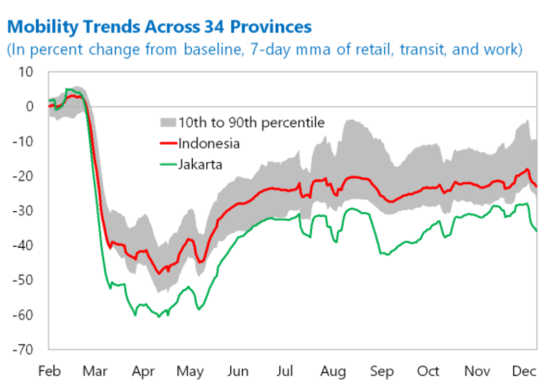


Sources: Indonesian Ministry of Health; and IMF staff estimates.

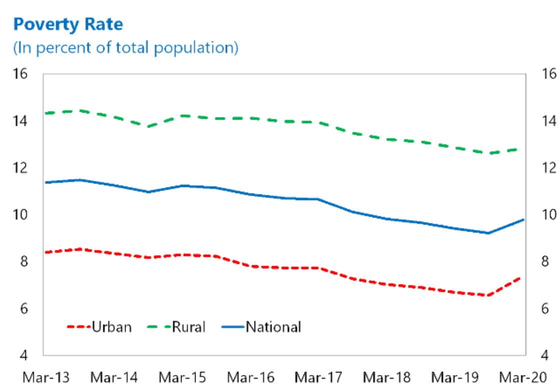


Sources: Indonesian authorities; and IMF staff estimates.

4. The pandemic and containment measures triggered a major economic downturn in the first half of 2020, although the economy is now recovering. Indonesia introduced international travel restrictions in early February 2020 and then adopted domestic containment measures that led to further supply and mobility disruptions in the economy. Real GDP contracted by 3.5 percent in the first half of the year (H/H, s.a.). While large, the initial economic impact of the pandemic was milder than in many other countries, reflecting relatively less stringent containment measures and lower shares of some high-impact sectors (e.g., tourism) in value added. Meanwhile, the nationwide poverty rate increased to 9.8 percent in March 2020, up from 9.4 percent a year ago. With the easing of containment measures, economic activity rebounded from its second-quarter lows in July, and real GDP increased by 3.2 percent in the third quarter (q/q, s.a.), led by government consumption and net exports (Figure 2).

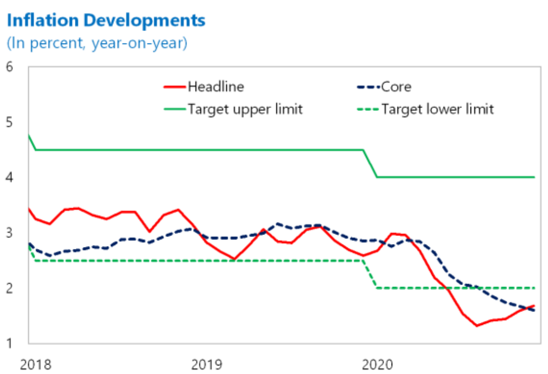


Sources: Google, COVID-19 Community Mobility Reports; and IMF staff estimates.

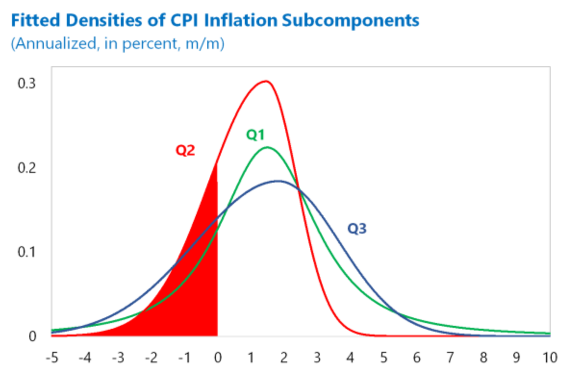


Sources: Statistics Indonesia (BPS); and IMF staff estimates.

5. Headline inflation has fallen below the lower bound of the BI's inflation target range, partly reflecting a positive food supply shock. Headline inflation declined faster than core inflation through much of 2020, as disinflation was partially driven by lower prices of food due to a strong harvest (Figure 3). More recently, and as examined in Chapter 2 of the *Selected Issues*, the two inflation measures have realigned, suggesting that the disinflationary effects associated with the pandemic reflect mainly the negative aggregate and sectoral demand impacts. These impacts manifested themselves in most CPI subcomponents experiencing lower price changes, especially in 2020:Q2.



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



Sources: Statistsics Indonesia (BPS); and IMF staff estimates.

6. Indonesia experienced major portfolio outflows during the global financial market turmoil in early 2020, but these were more than offset by subsequent inflows. Net portfolio inflows resumed strongly in 2020:Q2, more than offsetting the outflows in the previous quarter. While the portfolio flows turned negative again in 2020:Q3, in line with developments in other EMs, cumulatively, net portfolio flows were positive as of September 2020. However, much of the rebound in portfolio and other inflows reflected net purchases of foreign currency-denominated government and corporate securities by nonresidents, while the rebound in local currency debt and equity flows was modest (Figure 4). The overall balance of Indonesia's BOP in the first three quarters of 2020 was also supported by a substantial narrowing of the current account deficit as exports contracted less than imports, with the latter responding strongly to the retrenchment in domestic demand (Figure 6). The BI's foreign exchange reserves increased by US$7 billion to US$136 billion by year-end in 2020, resulting in a broadly unchanged reserve adequacy metric of 121 percent (Figure 5).

7. The authorities responded with a bold, comprehensive, and coordinated policy package to the unprecedented shocks and their complex demand and supply effects. The response required temporary changes to key pillars of the macroeconomic policy framework, which had underpinned Indonesia's strong economic performance in recent years. In particular, the ceiling on the budget deficit of 3 percent of GDP was suspended through 2022 and the ban on BI purchases of longer-term, government bonds in the primary market was removed. The major policy measures included the following:

- Four successive fiscal packages aimed at strengthening healthcare and mitigating the economic and social hardship of the pandemic. The total allocation for the COVID-19 response under the six subprograms of the National Economic Recovery Program (PEN) amounted to 4.4 percent of GDP in 2020. The 2020 fiscal deficit was projected to widen to 6.3 percent of GDP in the revised final budget, from 1.8 percent in the initial budget (Figure 6), with an estimated fiscal impulse (net of budget reallocation) of 3½ percent of GDP.[2]

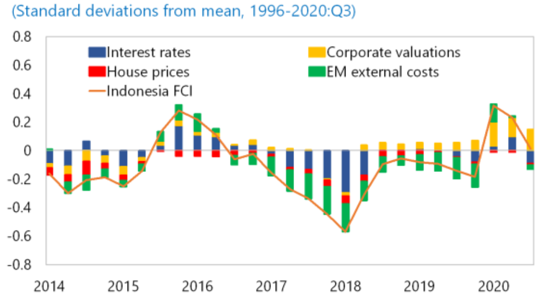
List of Measures (Announced or under implementation)	Expected Size (Percent of GDP)	Expiration Date
Fiscal		
Targeted support to hard-hit industries 1/	0.2	
Support to health care to fight COVID-19	0.5	
Strengthening of existing social protection programs 2/	1.3	
Support to promote restructuring and financing for MSMEs 3/	0.8	
Corporate income tax rate reduction 4/	0.1	Permanent
Tax relief and incentives for firms and low-income households	0.6	
Capital injections and loans to state-owned enterprises	0.3	
Other support measures through local governments	0.6	
Credit guarantees on working capital loans to labor-intensive industries	0.6	
Monetary		
Policy rate reduction (125 bps, from 5 to 3.75 percent)		
"Triple intervention" to stabilize domestic financial markets		
Cuts in the FX and domestic reserve requirement ratios for banks		
Macroprudential liquidity buffer ratio for banks raised by 200 bps		
Enhanced liquidity support targeted to banks 5/		
Relaxed the macroprudential intermediation ratio		
Liquidity provision to banks and firms through term-repo transactions		
Provision of funding to LPS for handling of bank solvency problems		
BI purchases of government bonds under burden sharing agreement 6/		End-2020
BI to act as buyer of last resort for local-currency government bonds 6/		End-2022
Financial		
Relaxed loan classification and loan restructuring procedures		Mar. 2022
Measures aimed to mitigate stock market volatility 7/		
Delayed the implementation of the Basel III reform standards		Jan. 2023
Postponement of mark-to-market valuation of securities for six months		Sep. 2020
Allowance to use the Capital Conservation Buffer		Mar. 2022
Relaxed LCR and NSFR requirements for banks 8/		Mar. 2022
Relaxed rules on credit cards to support cashless transactions 9/		
Lower down payment requirements for environment-friendly vehicles		

1/ For tourism and other labor-intensive industries.
2/ These include food aid, cash transfers, electricity subsidies, and unemployment benefits.
3/ These include interest subsidies, credit guarantees, and loan restructuring funds.
4/ From 25 percent to 22 percent for 2020-2021 and to 20 percent starting in 2022.
5/ These include: introducing daily repo auctions; increasing the max duration for repo and reverse repo transactions; and increasing the frequency of FX swap auctions.
6/ See Appendix V for details.
7/ These include prohibition of short selling and allowing listed firms to buy back their shares without a prior shareholders' meeting.
8/ LCR and NSFR stand for Liquidity Coverage Ratio and Net Stable Funding Ratio, respectively.
9/ Lowered the credit card interest rates, minimum credit card payment, and late payment penalty.

- BI cut its policy rate by 125 bps and increased liquidity support to banks (Figure 7). In March and April 2020, it aimed to stabilize domestic market conditions by using a "triple-intervention" strategy in the spot and domestic non-deliverable forward (DNDF) foreign exchange (FX) markets, and the local currency government bond markets. Banks have been allowed to run down their capital conservation buffers; while loan classification and restructuring policies have been partially relaxed.

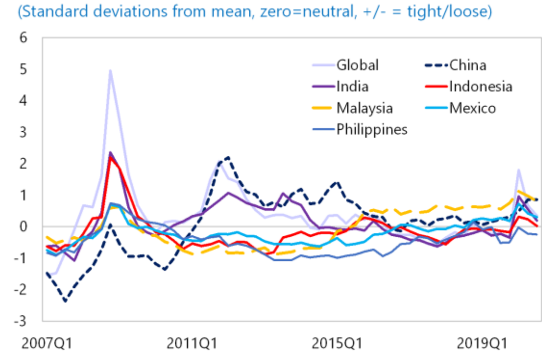
8. **The pandemic resulted in temporarily tighter financial conditions**. Financial conditions tightened markedly during the global financial market turmoil in March and early April 2020, but

Financial Conditions Index (FCI) 1/
(Standard deviations from mean, 1996-2020:Q3)



Sources: IMF staff calculations.
1/ The weights of the sub-components are derived from PCA. Negative values represent financial conditions that are loose relative to the historical average of 1996 or earliest data available through 2020; the interest rates category includes the real short-term rate, the sovereign spread on local currency debt, and the interbank spread; the corporate valuations category includes the equity market price-to-book ratio; and the external costs category includes the sovereign spread and the corporate spread on external debt, and the external debt-weighted exchange rate.

Financial Conditions Index
(Standard deviations from mean, zero=neutral, +/- = tight/loose)

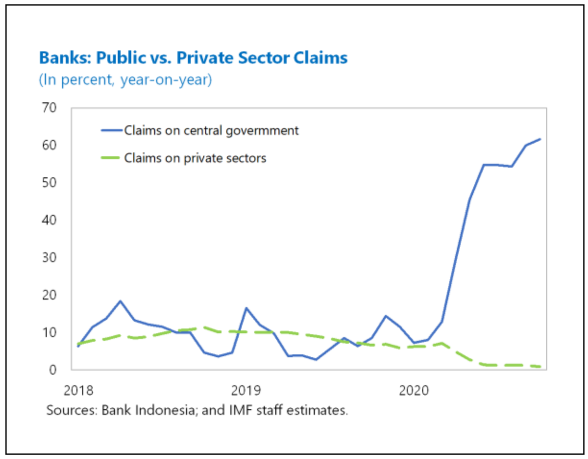


Source: IMF staff estimates.

[2] The difference between the estimated budget allocation and the estimated fiscal impulse reflects the reallocation of some budgetary spending to the PEN program.

have eased since, reflecting BI's swift policy response and global developments. Only a few price indicators, notably sovereign spreads and stock market indices, have not yet recovered to pre-pandemic levels (Figure 4).

9. The policy response has accommodated an increased demand for liquidity by banks and the private sector. Nevertheless, growth in credit to the private sector has slowed sharply amid increased risk aversion sentiment by banks and weak loan demand, with an outright decline in credit of 0.5 percent (y/y) by end-October (Figure 8). As in previous crises, albeit not to the same extent, lending by public banks has declined less than that by other banks, thereby cushioning the overall impact (Chapter 3, *Selected Issues*). Overall, bank funding conditions improved last year, reflecting BI liquidity support and increased deposits, especially demand deposits. Bank holdings of liquid assets, notably government bonds, have risen by similar amounts. Banks had restructured about one-fifth of their loans by end-October 2020, reflecting in part a temporary relaxation of loan classification standards (rescinding the usual requirement to reclassify restructured loans to substandard immediately). In this context, NPL ratios have deteriorated only marginally, while other financial soundness indicators have remained relatively steady (Figure 9).



10. Budget execution accelerated in the last quarter of 2020. The implementation of the PEN rose from 38.2 percent at end-September to 62.1 percent as of November 25, 2020, but with uneven execution across the six subprograms. More than 80 percent of allocations on the social safety net and on micro-, small-, and medium-sized enterprise (MSME) incentives, and around half of budget transfers to subnational governments were disbursed, while execution lagged in other sectors, notably healthcare-related spending and corporate incentives. Regular budget spending was broadly on track, with the execution rate reaching around 93 percent by end-2020, in line with the average budget execution rate of the past 5 years.

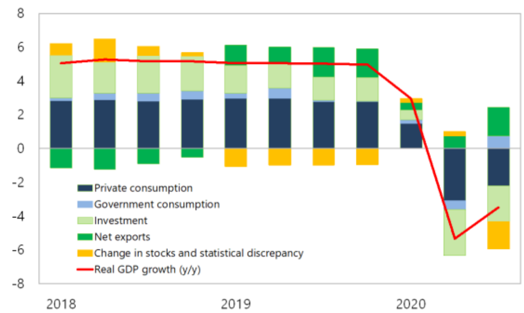
THE NASCENT RECOVERY, PROSPECTS, AND RISKS AND VULNERABILITIES

A. Outlook

11. The economy has started recovering gradually. Economic activity rebounded in mid-2020 with the easing of virus containment measures. After an early pickup, mobility indicators moved mostly sideways, consistent with the unsettled domestic virus situation in the second half of 2020.

Continued strong growth in government spending is expected with the acceleration in budget execution. Real GDP increased by 3.2 percent in 2020:Q3 (q/q, s.a.) and a broadly similar increase is anticipated in 2020:Q4. All told, the economy is estimated to have contracted by 1.9 percent in 2020.

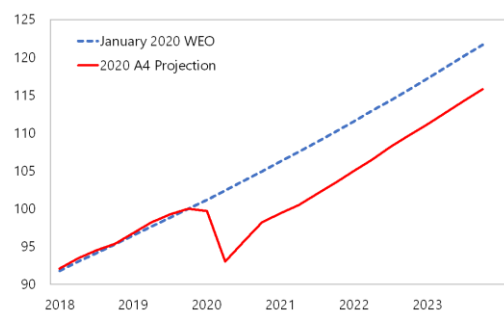
Contribution to Real GDP Growth
(In percent, year-over-year)



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

12. Macroeconomic policy support and greater mobility and confidence from an improving pandemic situation are expected to sustain the near-term recovery. Real GDP is projected to grow at 4.8 percent in 2021. The improvement partly reflects a recovery in private sector demand from continued policy support, including from increased public investment, an improved global economy, and further economic reopening as the pandemic situation improves, benefiting from the envisaged vaccination program. Lagged income effects and financial constraints, however, are expected to weigh on domestic demand for some time. Inflation is projected to increase gradually, rising from 1.7 percent at end-2020 to 3 percent at end-2021. Credit growth is expected to pick up in 2021 with stronger activity, albeit remaining below nominal GDP growth, as banks remain cautious in their lending due to increased risks to asset quality and bank profitability.

Real GDP
(Index 2019 Q4=100, seasonally adjusted)



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

13. The medium-term outlook incorporates persistent effects on output of the pandemic. In 2025, the level of real GDP is projected to be 5 percent below the level envisaged in the January 2020 WEO trajectory. The persistent if not permanent output level losses reflect the damage inflicted by the COVID-19 crisis to productive capacity, including through labor- and firm-related scarring effects. Contact-intensive industries such as the hotel and restaurant industry have been hit particularly hard and are likely to see persistent reductions in output. At the same time, there is some evidence of sectoral reallocation of resources during the pandemic, with low-contact sectors such as information and communication, real estate and agriculture posting positive growth despite the pandemic.

B. Risks

14. The economic outlook is subject to a larger-than-usual uncertainty, and some vulnerabilities are expected to increase (Appendix I).

- ***Risks relating to vaccine distribution and more protracted pandemic***. On the upside, a wide distribution of COVID-19 vaccines in early 2021 could accelerate the recovery. At the same time, a more protracted COVID-19 outbreak and associated disruptions to demand and supply or delays in the vaccination program could hold back the recovery, increasing risks associated with economic scarring and weakened balance sheets.

- ***Increased banking and nonfinancial corporate sector risks***. Neither credit nor liquidity exposures appear to pose imminent systemic risk to the banking sector, although the underlying asset quality has deteriorated. Nevertheless, loans at risk have increased, and the fallout of the pandemic on reported bank asset quality could be larger than expected, especially once the partial relaxation of loan classification rules and other policy support expire.[3] Credit conditions could be slow to improve, depending in part on the extent of non-provisioned losses in the banking system or changes in global financial market conditions. A particular concern in this regard is the vulnerable initial position of the nonfinancial corporate (NFC) sector (Chapter 4, *Selected Issues*) and the banking sector's large exposure to these corporates. Bank deleveraging to rebuild capital buffers could further worsen credit conditions.

- ***External risks***. Tighter external financial conditions could induce domestic financial stress, given balance sheet exposures to changes in global financial market conditions. Banks would be affected indirectly through domestic FX linkages and greater exposure to the sovereign.[4]

- ***Climate change risks***. Indonesia is among the countries most susceptible to climate change-related natural hazards, which could lead to more economic disruption and fiscal pressures over time. Indonesia also faces transition risks on the path to a greener global economy, given the significance of coal in the economy.

C. External Sector Assessment

15. On a preliminary basis, and adjusting for transitory factors, recent developments suggest that the external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies. However, this assessment is highly uncertain given the lack of full-year data for 2020 and the COVID-19 crisis, and a complete analysis will be provided in the *2021 External Sector Report*. After narrowing to 0.5 percent of GDP in 2020—mostly due to a relatively sharper contraction of imports—the current account deficit is projected to increase to 1.5 percent of GDP in 2021 reflecting the economic recovery and higher imports (Figure 5). The reduced external financing needs in 2020−21 implied by the lower current account deficit provide a welcome cushion against capital flow volatility with the pandemic. They also provide some offset to the negative exchange rate-related valuation effects on external debt and other stock-related vulnerability indicators. The reserve position remains adequate under the

[3] In addition to NPLs and special mention loans, the wider loans at risk concept also considers restructured loans, irrespective of their current performance. This reflects the expectations that future loan performance risks are higher for this particular loan category after the pandemic.

[4] While NFCs are the largest borrowers abroad on a gross basis, they also have substantial foreign assets, much of which are liquid deposits (NFCs' FX deposits abroad and in local banks covered 90 percent of their total FX external debt in 2018:Q4). Moreover, corporate prudential FX regulations helped increase NFCs' share of hedged FX loans. However, banks' might deplete their FX liquid asset buffers if NFCs drew on their domestic FX deposits buffers and credit lines, and if the household sector withdrew FX cash.

baseline outlook. The passing of the omnibus law on job creation and the implementation of the Regional Comprehensive Economic Partnership in Indonesia are, however, expected to boost export competitiveness and attract more FDI over the medium term.

Authorities' Views

16. **The authorities broadly agreed with the macroeconomic outlook and risks, while noting the large uncertainty surrounding the baseline outlook**. They expect a positive growth outlook for 2021, led by a targeted deployment of COVID-19 vaccines in early 2021 and a coordinated policy strategy with the following elements: (1) reopening of priority sectors based on their contribution to growth and employment; (2) front-loading of government spending; (3) tackling the credit crunch; (4) maintaining an accommodative monetary and macro-prudential policy stance; and (5) fostering digitalization. The improvements in mobility and global growth, together with continued benign global financial conditions, are also expected to support growth in 2021.

17. **The authorities shared staff's assessment that Indonesia's external position is in line with the level implied by medium-term fundamentals and desirable policies**. They also agreed that the current account deficit will likely widen in 2021 with the expected economic recovery, although it will remain below recent pre-pandemic levels. They also foresee that portfolio inflows will continue to pick up in 2021, on the back of the projected domestic and global economic recovery. The authorities believed that ongoing and planned reforms, including the omnibus bill on job creation and the implementation of the Regional Comprehensive Economic Partnership, would promote export competitiveness and contribute to attracting more FDI.

POLICIES TO SECURE THE RECOVERY AND BOLSTER MEDIUM-TERM PROSPECTS

18. **The policy discussions focused on how to unwind the exceptional, pandemic-related policy support in a balanced manner**. Within this broad focus, discussions centered on the following issues:

- ***A fiscal and monetary policy mix to nurture the recovery***. The nature of COVID-19 and its asymmetric, large economic impact call for continued fiscal support in 2021 since budget measures can best target the most affected sectors and households. Monetary policy should also be accommodative and facilitate the fiscal policy response through monetary budget financing as a backstop. Moving to a framework that clearly delineates the backstop as a temporary measure on a last-resort basis would help in managing the risks to the credibility of the monetary policy framework from such financing.

- ***A medium-term fiscal strategy for the unwinding of the exceptional fiscal policy support amid uncertainty***. Adequate public demand will be essential for the recovery in 2021 and, possibly, beyond. Indonesia has the fiscal space to deploy contingent supplementary budget packages if needed. Nevertheless, the unwinding of the exceptional support will be critical for preserving the policy credibility from Indonesia's strong, prudent policy track record and eliminate the need for a central bank backstop for budget financing. An explicit medium-term fiscal strategy, backed by revenue measures, even if implemented later, would add to the credibility of the commitment to restore the fiscal rules after their temporary suspension.

- ***Preparing for financial sector stresses while maintaining credit flows***. Commercial banks will likely face further asset quality deterioration, which, if substantial, would require temporary intervention to revive credit and stronger frameworks for dealing with distressed institutions.
- ***Reinforcing the recent structural reform momentum***. The passing in October 2020 of the omnibus bill on job creation could be the beginning of a welcome strengthening of the investment climate. Efforts now focus on financial sector reform, but broad-based government revenue reform is also urgently needed.

A. Fiscal Policy

19. The 2021 budget passed by parliament envisages a modest reduction in the deficit target, with larger deficit reductions planned in 2022 and 2023. The reduction in the deficit target from 6.3 percent of GDP in the final revised 2020 budget to 5.7 percent in the 2021 budget reflects the partial unwinding of exceptional spending under the PEN program. All six subprogram areas under PEN, including health and social protection, will continue to be funded in the budget. Other spending, including public investment, will increase, both relative to the revised 2020 budget and the 2019 budget outcome. This reallocation aims to meet longstanding infrastructure needs. The government plans for larger deficit reductions of around 1½ percent of GDP in each of the following two years to meet the deficit ceiling of 3 percent of GDP when it is reinstated in 2023.

20. The fiscal policy settings planned for 2021 will provide for a welcome, modest fiscal impulse to the economic recovery. Staff expects the fiscal stance implied by the 2021 budget to be moderately expansionary. Some of the unspent 2020 budget allocations are expected to be authorized as carryovers for spending in 2021, On this basis, staff projects, on a cash basis, a budget deficit of 5.9 percent of GDP. At the same time, tentative actual figures suggest that because of underspending, the realized budget deficit in 2020 will be below target at around 5.7 percent of GDP. The increase in public investment spending, with a focus on labor-intensive projects, will reinforce the modest positive fiscal impulse. The authorities' determination to continue strengthening budget execution capacity will be critical for the positive demand impact to materialize. The flexibility to reallocate budget resources in 2021 provides a basis to respond rapidly to shifting needs or to redesign policy responses amid high uncertainty.[5]

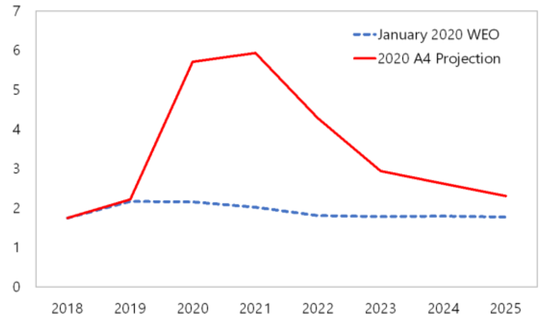
21. Indonesia retains some fiscal space that should be used if downside risks materialize. Despite the exceptional policy responses to the pandemic in 2020, the public debt ratio is projected to remain below the 60 percent threshold under the baseline and in DSA risk scenarios despite temporarily higher budget deficits (Appendix III). Nevertheless, vulnerabilities related to the high

[5] In 2021 and, most likely, in 2022, the government still has the exceptional authority to reallocate budgetary resources without parliamentary approval. This authority was granted under the emergency law for PEN.

share of public debt held by nonresidents are a constraint, and fiscal space is predicated on the ability of the authorities to secure orderly market debt financing. Staff thus recommend that the authorities use the space if downside risks to the outlook materialize and budgetary reallocation proves insufficient to cushion the impact.

Budget Deficit Targets

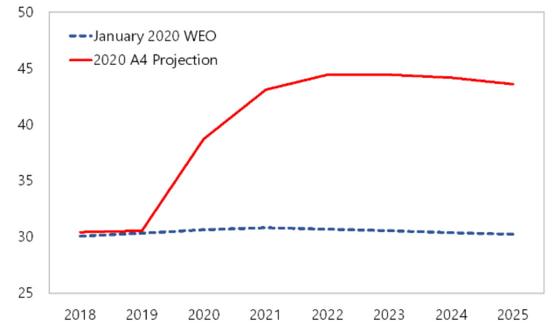
(In percent of GDP)



Source: IMF, World Economic Outlook.

General Government Gross Debt

(In percent of GDP)



Source: IMF, World Economic Outlook.

22. The plan to return to the budget deficit ceiling by 2023 is a welcome commitment to the fiscal rules and should be backed by a detailed medium-term fiscal strategy. The planned return to the deficit ceiling would help preserve the integrity of the fiscal policy framework and rules. But the current medium-term fiscal plans lack details and could raise credibility concerns, given downside risks to the near-term outlook and the heavy reliance on expenditure measures.

Indonesia: Government Budgets, 2019–21

(In percent of GDP)

	2019	2020			2021
	Outcome	Original Budget	Revised Budget 1/	Preliminary Outcome 1/	Budget 1/
Revenue and grants	12.2	12.8	10.7	10.3	10.3
Tax revenue	9.7	10.7	8.9	8.1	8.5
Expenditure	14.4	14.5	17.3	16.0	16.2
Current	13.3	13.5	16.4	15.0	14.8
Interest payments	1.7	1.7	2.1	2.0	2.2
Capital	1.1	1.1	0.9	1.0	1.5
Of which:					
PEN 2/	...	...	4.4	4.4	2.1
Health	...	...	0.6	0.6	0.1
Social protection	...	...	1.5	1.5	0.7
SME support	...	...	0.8	0.8	0.1
Other business support	...	...	0.7	0.7	0.3
Regional transfers	...	...	0.4	0.4	0.1
Primary balance	-0.5	-0.1	-4.4	-3.7	-3.7
Balance	-2.2	-1.8	-6.6	-5.7	-5.9
Financing	2.5	1.8	6.6	7.3	5.9
Of which:					
Net bond issuance	2.8	2.2	7.4	7.4	7.1
Investment financing	-0.3	-0.4	-1.6	-0.8	-1.1
Memorandum item:					
Cyclically-adjusted primary balance	-0.4	...	-3.8	-3.0	-3.4

Source: Indonesian authorities; and IMF staff estimates.

1/ Based on staff projections for nominal GDP.

2/ Spending under the National Economic Recovery Program (PEN), which is included in the budget and includes tax relief and below-the-line measures (e.g., loan guarantees).

- Under current policies, reducing the budget deficit below 3 percent of GDP by 2023 will rely heavily on expenditure consolidation, as the cyclical recovery in tax revenue will be small and partly offset by the impact of the gradual, permanent reduction in corporate income tax (CIT) rates initiated in 2020 and new tax facilities (lower income taxes for some taxpayers, broader input VAT credit eligibility, investment tax incentives) offered by the omnibus bill on job creation. The envisaged annual consolidation by the authorities in both 2022 and 2023 will be sizeable at around 1½ percent of GDP, well above the net additional spending on the PEN program remaining in 2021. Risks are that the consolidation could prevent the warranted increase in spending on development—infrastructure, education, and social safety nets. While there is scope for reducing other expenditure, notably on energy subsidies, these reductions would likely be insufficient.

- The credibility of the commitment to the deficit ceiling would be stronger if it were underpinned by a more detailed medium-term fiscal strategy. A specific plan for the return to the ceiling detailing the underlying measures could help anchor expectations about the medium-term fiscal position and reduce risks to policy credibility, especially if also backed by revenue measures. The latter would lessen the trade-offs between deficit reduction and development expenditure needs and should be part of the broader set of measures identified for a medium-term revenue strategy (MTRS). Taking advantage of the current reform momentum to design and adopt an MTRS would be critical for a higher medium-term growth and reduced reliance on external sources of financing (Appendix IV). Priority should be given to steps that could compensate for some of the revenue loss implied by the omnibus bill, including broadening the personal income tax base; eliminating the special corporate income tax regimes now that the standard CIT rate has been lowered; introducing excise taxes on fuels; enhancing the compliance of professional services providers and high-wealth individuals; and eliminating distortionary VAT exemptions.

- The timing of the return to the deficit ceiling should depend on the state of the economy. Risks to policy credibility from a delay in meeting the target could be reduced with a well-articulated escape clause or regular progress reviews.

23. To ensure the effectiveness of COVID-19-related fiscal measures, the authorities adopted a three-pronged approach to foster transparency and safeguard public accountability. The Ministry of Finance (MOF) officials initiated early consultation with the Audit Board of Indonesia at the design stage of the programs included in the National Economic Recovery (PEN) to ensure that the programs and related regulation meet accountability and effectiveness standards before their rollout. The MOF has also instituted monthly reporting requirements on COVID-19-related programs to assess the use, the traction and the effectiveness of the programs with respect to stated objectives. Finally, there are plans for an ex-post evaluation of the effectiveness of the incentives. The tax expenditure under the PEN program will be part of the MOF's *2020 Tax Expenditure Report*, which will be published in 2021. These reports, published since 2018, have provided for a welcome increase in fiscal transparency.

Authorities' Views

24. The authorities agreed that a premature withdrawal of fiscal support could jeopardize the recovery. To that end, they will continue to take expansionary policies to support the economic recovery. In this context, fiscal policy will aim to encourage the effectiveness of the COVID-19 handling and accelerate the economic recovery. Following a data-driven approach, they will seek to strike a balance between the unwinding of fiscal support and crowding out the private sector recovery through fiscal deficits. They will take advantage of the flexibility provided by the 2020 budget law to carry over unspent 2020 budget allocations under the PEN to 2021. They are closely monitoring the execution of PEN and will reallocate spending to the most affected sectors and areas with higher growth impacts if needed. The state budget will gradually be less expansive and focus more on consolidation between 2021 and 2023. They confirmed their commitment to return to the 3 percent of GDP budget deficit rule by 2023, through higher spending efficiency, revenue optimization reforms and encouraging innovative financing (e.g., digital platforms to facilitate sales of government bonds to retail investors).

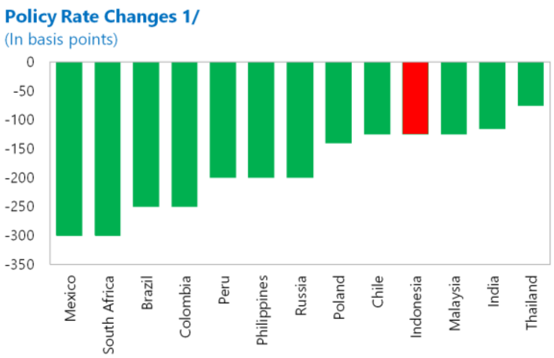
25. The authorities concurred with the importance of further revenue mobilization in supporting medium-term fiscal adjustment. Fiscal policy needs to maintain a balance between countercyclical policies to strengthen the economic recovery and prudent and sustainable budget management. The government agrees that a coherent tax reform is crucial to acquire an increasing tax revenue to fund the State budget. However, the COVID-19 pandemic has disrupted tax policy plans everywhere, including in Indonesia. Like other countries, Indonesia has taken extraordinary measures to tackle this crisis. They reiterated their ambition to explore all possible avenues to improve revenue mobilization despite political constraints. Recent and ongoing revenue reforms are focusing on a broad range of tax administration (risk-based audits, IT development, and use of taxpayer bank data to support audits) and tax policy measures (extension of excise taxes, imposition of VAT on cross border electronic transaction, and reductions in CIT rate). The authorities appreciate that the Fund stands ready to provide CD support on these issues.

B. Monetary Policy and the Policy Mix

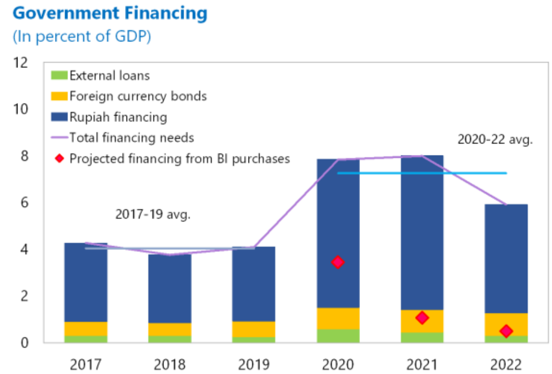
26. The timely adjustment of BI's policy mix helped ease monetary conditions and support orderly financial market functioning amid large capital flow volatility. BI cut the policy rate, including, and in contrast to earlier episodes, during the period of market stress, and it enhanced its liquidity provision to banks and key markets. BI also allowed for greater exchange rate flexibility during the global market turmoil in March 2020 than it did in other recent episodes of emerging market asset selloffs and was able to rely more on interventions in the domestic non-deliverable forward FX market, thereby preserving FX reserves for potential use in a prolonged stress scenario.[6]

27. BI has emphasized that its monetary budget financing is supporting the fiscal response and, thereby, the recovery. While recognizing that it had room for further rate cuts, given price stability objectives, BI cut the policy interest rate less aggressively than many other EM central banks in 2020, given perceived risks of excessive currency volatility under prevailing market conditions. However, under its quantitative easing strategy, BI has purchased rupiah-denominated government bonds under two different programs, one based on a last resort strategy under a "market mechanism" and one based on a burden sharing agreement (Appendix V).

[6] The DNDF instruments, launched in November 2018, consist of an outright forward transaction with the net settlement paid out in rupiah. An empirical investigation discussed in Chapter 5 of the *Selected Issues* shows that both DNDFs and FX swap interventions were associated with lower FX liquidity pressures during periods of global market stress.



Sources: Haver Analytics; and IMF staff estimates.
1/ COVID-19 is the period January 2020 to January 5, 2021.



Sources: Indonesian authorities; and IMF staff estimates.

28. Monetary budget financing as a backstop for fiscal policy is appropriate in the current exceptional circumstances. Using this tool in combination with the conventional policy rate tool is more likely to achieve accommodative financial conditions along the rupiah yield curve than relying on policy rates only.[7] Risks of higher yields have increased, given higher budget deficits and associated financing needs in a relatively shallow domestic bond market and the important but volatile demand of nonresident investors (Appendix V). Higher domestic yields would constrain the fiscal policy response and further weigh on domestic credit even with relatively weak monetary policy transmission.[8] Government bond purchases by BI have already contributed to avoiding bond market disruptions after the large capital outflows in March and early April 2020. They have not only enabled the fiscal policy response but also contributed to improving banks' liquidity conditions and lending capacity—specifically, injections of funds via public expenditure have worked through the system and partly explain increased private deposits in banks.

29. The monetary budget financing should be guided by a framework to manage associated risks. Such a framework would have two essential elements. First, it would entail a clear delineation of the temporary use of the tool in the recovery from the pandemic. Second, the bond purchases should be triggered by well-defined last resort criteria, based on bond market conditions, and not involve pre-defined amounts based primarily on fiscal considerations. An explicit objective for the purchases would facilitate their coherence with the established monetary policy framework and achievement of monetary policy objectives. With such a framework for bond purchases, risks to central bank operational independence, including from fiscal dominance, and of balance of

[7] While monetary accommodation through a lowering of policy rates could also lower longer-term yields, its effect would be more limited if increases in the latter reflect higher risk premiums, which is likely given the underlying shock. At the same time, the transmission of changes in the policy rates to longer-term rates is weak, especially in times of market stress, given substantial market segmentation and lack of arbitrage. Domestic demand for bonds by banks, institutional investors, and retail investors centers on the short end of the maturity spectrum, while foreign investors focus on the long end. Volatility in the demand from foreign investors tends to translate into volatility in longer-term bond rates and is not mitigated by offsetting shifts in the maturity structure of the bond demand by domestic investors.

[8] The weak transmission is evident in the fragile relationship between bank lending and monetary policy rates (see Chapter 3, *Selected Issues*).

payments pressures or crowding out private credit as the recovery advances would be more contained.

30. The plan to use only bond purchases under the market-mechanism approach in 2021 will help balance the benefits and risks of monetary budget financing. The 2020 burden sharing agreement was complex, involving different tranches and pre-defined amounts of bond purchases irrespective of market conditions.[9] Under the market-mechanism approach, which was put forward in April 2020, there are no pre-defined amounts of bond purchases and the BI acts as a backstop in primary bond market auctions should market demand fall short, using noncompetitive bidding. This approach includes many elements of the framework laid out above. Building on this framework, BI could adopt more specific criteria for last resort conditions to further clarify the use of this tool. As the track record with bond purchases builds, BI should increasingly be able to achieve its objectives through conventional secondary market operations rather than primary market transactions.

31. The monetary policy stance is appropriately accommodative, and BI should stand ready to respond to downside risks. If downside risks materialize, BI has room to cut the policy rate and expand liquidity provision, while the exchange rate should continue to be an important shock absorber. If exchange rate acts as a shock amplifier, however—for example, in the event of external market pressures—foreign exchange interventions could appropriately be used to counter disorderly market conditions and mitigate the impact on balance sheets with currency mismatches.[10]

32. Possible changes to the BI Law should refrain from limiting BI's operational independence and setting unrealistic monetary policy objectives. The BI's financial stability mandate places it at the center of some financial sector reforms, leading the authorities to consider a broader overhaul of the BI Law. In staff's view, BI's operational independence has served Indonesia well and has not impeded policy coordination in exceptional times. An additional growth or employment objective for BI would need to recognize that monetary policy can only address cyclical fluctuations in these variables, not longer-term trends.

Authorities' Views

33. The authorities intend to maintain an accommodative monetary policy stance until early signs of inflation pressures emerge. With inflation below BI's target range of 3±1 percent, the authorities considered that continued monetary accommodation was called for. Considering the ample liquidity in the banking system, they nevertheless saw the demand-boosting effect of additional policy rate cuts or liquidity provision to banks as likely being limited in the near term. They deemed fiscal policy to be a better instrument to boost demand in the current context. The authorities noted that the burden sharing agreement defined in July 2020 between BI and the Ministry of Finance was a one-off arrangement for 2020 that would not be continued. Instead, monetary budget financing in 2021 will follow a market mechanism arrangement defined in

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[9] See Appendix V for details on the burden sharing agreement.

[10] Chapter 4 of the *Selected Issues* shows that Indonesian nonfinancial firms have recently increased the share of FX debt on their balance sheets, especially in industries with low foreign sales (e.g., utilities, discretionary consumer items, and real estate).

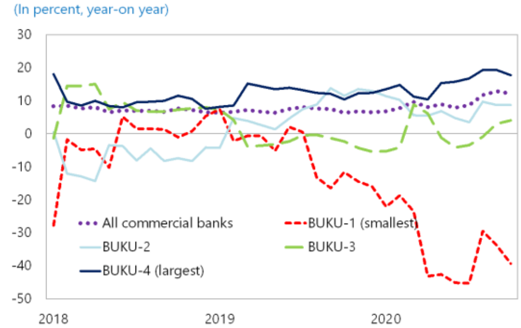
April 2020. BI will purchase government bonds in the primary market as a stand-by buyer, on a last-resort basis, with the maximum amounts per auction capped at prudent levels.

34. The authorities reiterated their commitment to exchange rate flexibility and the further development of payment systems and money markets. If the exchange rate acted as a shock amplifier rather than a shock absorber, they were prepared to use foreign exchange interventions to counter disorderly FX market conditions. The authorities will also accelerate the implementation of the Indonesian Payment System Blueprint 2025 as well as the deepening of the money market according to the Money Market Deepening Blueprint 2025.

C. Financial Sector Policies

35. The financial sector and monetary policy responses have kept the banking system stable, but bank asset quality needs to be closely monitored. The capital adequacy ratio of commercial banks has remained well above 20 percent (Figure 9), and their liquidity position has strengthened. The easing of macroprudential policies and loan classification rules have facilitated the adjustment of banks and corporates to pandemic-related disruptions, but have not resolved initial financial vulnerabilities of the nonfinancial corporate sector or those stemming from the economic downturn.[11] So far, NPL ratios have remained stable, and loan loss allowances as a share of NPLs have been high, 160 percent on average as of 2020:Q3. There is, however, considerable variation across banks, leaving some more vulnerable to losses. At the same time, loans at risk have increased sharply, and key bank ratios, including capital adequacy ratios, could be biased due to the relaxation of loan classification requirements. Overall, risks of a deterioration in asset quality have increased. The eventual deterioration will depend, among other factors, on the viability of the restructured loans and the pace of the recovery.

Commercial Banks: Deposit Growth by Bank Size
(In percent, year-on year)



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

36. The credit slump could hold back the recovery. To counter adverse credit supply effects, BI has injected liquidity into the banking system while the Financial Services Authority (OJK) has eased prudential regulations.[12] Nevertheless, overall bank credit growth has continued to slow, with the year-on-year rate being in negative territory since September. The credit slump partly reflects weak credit demand after the economic downturn. But it could also reflect credit supply frictions. Banks temporarily tightened credit standards in the first half of 2020 and could remain reluctant to extend credit, particularly if they anticipate increases in losses on their assets. The authorities have

[11] The relaxation includes simplified assessments of credit quality and allows banks to classify debtors who receive the restructuring scheme to remain as Stage 1 borrowers, without additional provisions.

[12] The easing includes relaxing the obligation to fulfill the Liquidity Coverage Ratio and Net Stable Funding Ratio requirements and allowing the use of the Capital Conservation Buffer.

established programs supporting credit to corporates and MSMEs in view of adverse credit supply conditions, including through interest subsidies and credit guarantees.

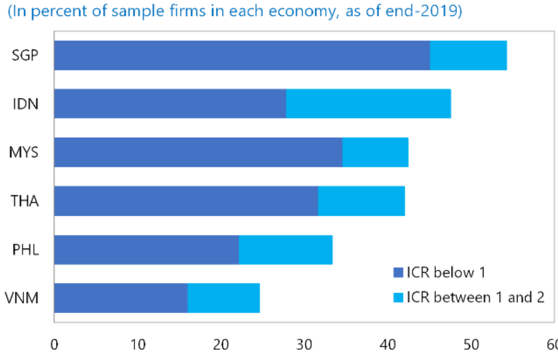
37. Against this backdrop, policies should aim to support credit and prepare for potential banking problems in the recovery.

- ***The general regulatory relief measures for borrowers should be supplemented by provisioning requirements and incentives for banks to use their capital buffers***. OJK recently extended the partial relaxation of loan reclassification standards for another year, until March 2022. While helping the recovery, the extension raises risks to bank balance sheets. To address these risks, banks should provision for credit losses early and continue to properly classify and monitor loans, including restructured loans, with guidance from OJK. As the pandemic uncertainty subsides, loan restructuring should increasingly be tied to businesses with a high likelihood of post-pandemic viability. Moreover, general distribution restrictions (e.g., on dividends) and greater supervisory clarity and flexibility for rebuilding prudential buffers could help incentivize banks to draw on their buffers to lend.[13]

- ***If aggregate credit does not recover, additional government support measures to viable firms, including through credit guarantees, should be considered***. With the economic recovery underway, credit to the private sector should rebound. Nevertheless, with continued uncertainty and underlying vulnerabilities in the nonfinancial corporate sector, credit standards might become stricter than usual. Under such a scenario, the authorities' plan to provide greater policy certainty through guidance on sectoral priorities in the economic reopening and policy support measures for nonfinancial corporates might not provide adequate incentives for bank

Firm-at-Risk

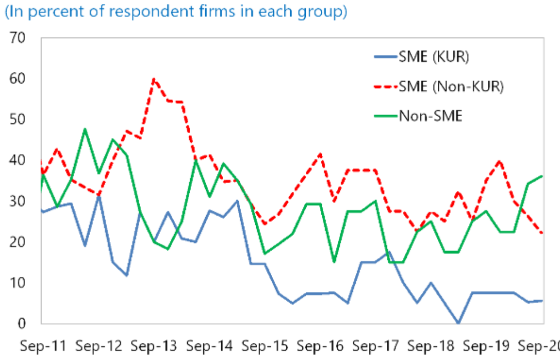
(In percent of sample firms in each economy, as of end-2019)



Sources: S&P Capital IQ; and IMF staff estimates.

Share of Firms with Below-Target Borrowing from Banks

(In percent of respondent firms in each group)



Sources: Bank Indonesia, Banking Survey; and IMF staff estimates.

[13] See "Special Series on Financial Policies to Respond to COVID-19: Main Operational Aspects for Macroprudential Policy Relaxation."

lending.[14] An upgrade of the loan guarantee program (e.g., a longer time horizon for such guarantees) or other targeted support measures could then be considered. Such an upgrade could be especially effective for larger corporates that do not qualify for current, more extensive MSME support and that are not part of a conglomerate structure.

- ***Changes to crisis management and resolution frameworks should be a high priority***. Some smaller banks have faced significant deposit outflows since the onset of the pandemic, amplifying pre-pandemic legacy issues at a few, mostly small, and rural banks. Some of the outflows seem related to concerns about banks' eventual compliance with minimum capital standards, which will increase to IDR 2 trillion (about US$143 million) by end-2021 and IDR 3 trillion (about US$220 million) by end-2022. OJK has addressed issues related to failing small banks through consolidation and intends to continue using this approach. To maintain a sound banking system and avoid adverse confidence effects, solvency or capital adequacy issues in individual banks need to be recognized and addressed upfront.[15] Addressing failing banks through consolidation can be a solution, but it may not always be feasible or it may be too slow a process, and resolution might be needed. The PEN program has alleviated the impediments on the effectiveness of emergency liquidity framework identified in the 2017 FSAP, but other steps toward the recommended strengthening of the crisis management and resolution frameworks are still under consideration (Table 11).

38. The accelerated efforts at promoting financial deepening are welcome. BI's blueprint on payment systems will support digital economic and financial integration in order to improve monetary policy transmission, as well as economic and financial inclusion. More broadly, laying the foundations for new financial market products and broader market participation, including by institutional investors, would help mobilize long-term savings and reduce the reliance on volatile foreign funding. Meanwhile, the digital revolution in the financial sector calls for an upgrade of the regulatory framework, to promote better understanding of financial products by market participants and safeguard financial stability.

39. The financial sector omnibus bill underway represents an opportunity to lay the legal foundation for further financial deepening and tackle regulatory reforms. On the latter, the bill could include the remaining steps needed for a stronger crisis management and resolution frameworks noted above, address other FSAP recommendations, and update the regulatory framework to accommodate fintech.

[14] The sectoral priorities involve (i) identifying those sectors that are important to growth and employment, and can be safely opened if a supportive health protocol is in place; and (ii) providing more information to banks on the safe reopening of the those sectors, their prospects after the pandemic, and support measures available to firms in those sectors.

[15] Undercapitalized banks should provide supervisors with clear plans to return to capital adequacy, while insolvent banks should be resolved. See "Special Series on Financial policies to Respond to COVID-19: Supervisory Actions and Priorities in Response to the COVID-19 Pandemic Crisis."

Authorities' Views

40. **The authorities shared the assessment that while the systemic risk in the financial sector had remained contained so far, vulnerabilities were yet to be addressed**. They agreed that banks should continue to monitor loans and provision for credit loss from restructured loans. They noted that credit conditions could be slow to improve, given the low credit demand during the pandemic. The authorities did not see any notable financial strain for nonfinancial firms in the formal sector, as indicated by their improving performance recently, but were carefully monitoring small- and medium-sized firms in labor-intensive industries. The authorities emphasized the role that policymakers can play in terms of reducing the asymmetric information between the banks and borrowers to facilitate credit expansion. The authorities considered that the prudential regulation relaxation could be gradually withdrawn as the economy recovers, but also acknowledged the great uncertainty ahead and that the normalization of prudential policies may take longer than expected.

41. **The authorities were considering a broad range of reforms of financial regulation and financial markets**. On the regulatory front, the reforms would aim to strengthen financial oversight and crisis management. They would include legislative amendments to clarify institutional responsibilities for the supervisory entities (OJK, BI, MoF, the Indonesia Deposit Insurance Corporation (LPS)) and to improve interagency cooperation and coordination, addressing issues raised in the 2017 FSAP; however, the government emphasized that any changes would safeguard the operational independence of BI. The authorities also reiterated their commitment to financial deepening with appropriate prudential standards, as laid out in their blueprint for money market development. The closing of the financial market infrastructure gap was seen as a necessary condition for broadening the set of financial instruments in Indonesia, which would help attract domestic and international investors and enhance monetary policy transmission. The establishment of central clearing counterparty (CCP) was urgently needed, to help reduce both counterparty risks and market segmentation. The authorities expected a better anchoring of the short-term end of the yield curve and further deepening in the repo and foreign exchange derivatives markets as the financial market infrastructure develops.

D. Other Structural Reforms

42. **The passing of the omnibus bill on job creation should help lower obstacles to job-creating investment and boost productivity**. The omnibus approach combines several reforms in one bill and entails changes across many laws, reflecting the authorities' goal of achieving a significant easing of the regulatory burden on private sector activity and restrictions on investment in one sweep. If successfully implemented, and on the back of Indonesia's favorable demographics, this easing would help in attracting productive foreign capital, reducing the cost of investment, and promoting export competitiveness. The implementation of the Regional Comprehensive Economic Partnership in Indonesia could reinforce these benefits. High-quality governance and transparency standards for regulatory settings and changes therein will also be critical for the effectiveness of the reforms and their traction. The easing of labor market restrictions included in the bill will be beneficial in the longer term, although the pace of implementation should consider the phase of the recovery to help prevent short-term costs in terms of activity and employment.

43. The Nusantara Investment Authority (NIA) is designed to channel institutional and corporate investment towards infrastructure. The NIA, established by the omnibus bill on job creation, will be an equity fund focused on financing infrastructure projects with foreign, private, and Indonesian government participation. The NIA would start with relatively low risk, mature infrastructure investments, such as completed toll roads, and move on to higher risk green- and brownfield investment. Considering that such a financing structure entails quasi-fiscal risks, strong governance settings and focus on areas where other forms of financing will be less competitive will be important for its success.

44. A medium-term revenue strategy (MTRS) centered around revenue-raising tax policy reform should be a macro-structural reform priority. Indonesia has an urgent need to increase government spending on development—education, infrastructure, health, and social safety nets—to unlock its growth potential and meet the Sustainable Development Goals.[16] The tax reform initiated in 2017 remains incomplete as it specified only tax administration initiatives and reduced the corporate income tax rate. The omnibus bill on job creation contains important tax policy incentives to improve the business climate, but it will be critical for the regulations implementing the incentives not to introduce additional legal loopholes in the tax system. Moreover, the omnibus bill does not include measures that would enhance the base of major taxes, or streamline tax schedules and exemptions. Such measures should all be integrated into the MTRS, to coherently address the root causes of the weak revenue performance (Appendix IV).

45. Digitalization could be harnessed to mitigate the economic impact of the pandemic, and support the recovery. The adoption of e-commerce and digital financial services has increased rapidly amidst COVID-related lockdowns and social distancing, mitigating the economic fallout. The authorities have facilitated this expansion through regulatory measures. However, to tap its potential, important challenges need to be addressed in the areas of digital infrastructure, worker skills, regulations, with due regard to financial stability and integrity, and consumer protection (see Chapter 6, *Selected Issues*).

46. Indonesia has been proactively tackling climate change but could consider further reforms toward a greener economy. A comprehensive transition plan toward a greener economy should be part of the policy strategy underpinning the recovery. The plan could include reforestation incentives, greater support for building renewable energy generation capacity and reducing reliance on coal, and reforms of energy subsidy schemes. Further progress in the monitoring and execution of adaptation plans to increase the resilience to climate change would be desirable, given the high exposure to related natural hazards (see Chapter 7, *Selected Issues*).

Authorities' Views

47. Structural reforms are a central part of the government's policy strategy towards a sustained economic recovery. The omnibus bill on job creation overhauls Indonesia's investment policy in order to attract investment and build confidence. The authorities highlighted that the

[16] See IMF Policy Paper, *ASEAN Progress Towards Sustainable Development Goals and the Role of the IMF* (Washington, DC, 2018).

Nusantara Investment Authority, which is mandated in the job creation omnibus bill, would seek to attract foreign investment to finance infrastructure projects and stimulate economic growth, based on a funding model that attracts equity rather than debt. It would be based on best practice in good governance. The authorities also expected digital transformation to become an important driver of growth. They are seeking to promote digitalization in several areas, including government services, open banking, retail payments, financial market infrastructure, public data infrastructure, and regulatory frameworks. Finally, the authorities concurred with the need to act on climate change related risks and agreed on the necessity of transitioning to a greener economy. They are committed to continuous policy efforts to achieve the objectives set out in Indonesia's nationally determined contribution (NDC) to emission reduction under the Paris Agreement, as well as to formulating policies and developing instruments to deal with climate change issues.

STAFF APPRAISAL

48. Indonesia has responded with a bold and comprehensive policy package to cushion the impact of the COVID-19 pandemic. As elsewhere, the COVID-19 pandemic has led to socio-economic hardship and an economic downturn. The policy response has helped to save lives and livelihoods, and to preserve macro-financial and external stability through the downturn and a period of global market stress.

49. The Indonesian economy is positioned for recovery under currently appropriate accommodative monetary and fiscal policy settings. In the near term, strong policy support measures will be the main driver, including through a widening of COVID-19 vaccine distribution and the associated increase in mobility, and improved global economic and financial conditions. Ongoing reforms aimed at promoting investment are expected to help mitigate the scarring effects from the pandemic.

50. The economic outlook is subject to a larger-than-usual uncertainty, and some vulnerabilities are expected to increase. An early distribution of COVID-19 vaccines would be an upside risk, while delays in the vaccination program and a protracted pandemic would be downside risks. The underlying asset quality in the banking system has deteriorated with the economic downturn, but the systemic risks picture in the banking sector is unlikely to be materially affected, given the sound initial position of the sector. Nevertheless, credit conditions could remain slow to improve, depending in part on the extent of non-provisioned losses in the banking system. While recent developments suggest that, on a preliminary basis and after adjusting for transitory factors, the external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies, the large share of portfolio investment in external liabilities exposes the economy to fluctuations in global financial conditions.

51. The fiscal policy settings planned for 2021 would help foster the recovery. The budget implies a moderately expansionary fiscal stance, given preliminary 2020 fiscal outcomes, reinforced by the envisaged increase in public investment. The flexibility to reallocate budget resources in 2021 also provides a basis to respond rapidly to shifting needs or redesign policy responses amid high uncertainty.

52. The plan to return to the budget deficit ceiling by 2023 is a welcome commitment to fiscal rules and should be backed by a detailed medium-term fiscal strategy. The return to the ceiling could be challenging in the absence of revenue measures, as it will require substantial expenditure consolidation of around 1½ percent of GDP in both 2022 and 2023. A specific medium-term fiscal strategy could help anchor expectations and reduce risks to policy credibility amid high uncertainty around the outlook, especially if it is also backed by revenue measures, preferably in the form of an MTRS.

53. The plan for BI to conduct bond purchases under the market mechanism in 2021 will balance the benefits and risks of monetary budget financing. Pursuing accommodative conditions along the broader rupiah yield curve through BI bond purchases could be an appropriate strategy under current exceptional circumstances, provided adequate safeguards are in place. The market mechanism framework would reaffirm a monetary policy framework in which such purchases would be used only temporarily and on a last-resort basis in exceptional circumstances, thereby containing risks to monetary policy credibility. BI could consider enhancing the framework by clarifying the last resort criteria, based on bond market conditions.

54. Proactive management of credit risks will be essential to ensuring banks can support the recovery. The credit restructuring has helped the adjustment to pandemic-related disruptions but cannot *per se* resolve underlying vulnerabilities. With the partial relaxation of loan classification rules until March 2022, OJK should provide guidance for appropriate provisioning. Additional, targeted policy steps to revive credit might also be needed. With a larger-than-expected deterioration in asset quality a possibility, banks might keep up tighter credit standards, which, in turn, could hold back credit and the recovery. If credit continues to slump, an upgrade to the loan guarantee program or other targeted measures could be considered.

55. The accelerated efforts at promoting financial deepening are welcome, and the financial sector omnibus bill underway represents an opportunity to advance these efforts. Financial deepening would help mobilize long-term savings and reduce reliance on volatile foreign funding. The digital revolution in the financial sector also calls for an upgrade of the regulatory framework. Regulatory issues related to crisis management, resolution, and the financial safety net should also be addressed. Possible changes to the BI Law under the umbrella of the omnibus law should not limit BI's operational independence or set unrealistic monetary policy objectives.

56. The passing of the omnibus bill on job creation could be an important step toward boosting investment, but high-quality governance standards will be required for success. The Nusantara Investment Authority that is being set up could be a useful conduit for infrastructure investment. Since it entails quasi-fiscal risks, strong governance settings will be important for an effective, transparent use of public resources and its success.

57. **A medium-term government revenue strategy is a macro-structural reform priority, and preparations should begin without delay**. A coherent strategy addressing the root causes of the weak revenue performance is essential for securing the higher government revenue needed for sustained increases in spending on development to harness the growth potential.

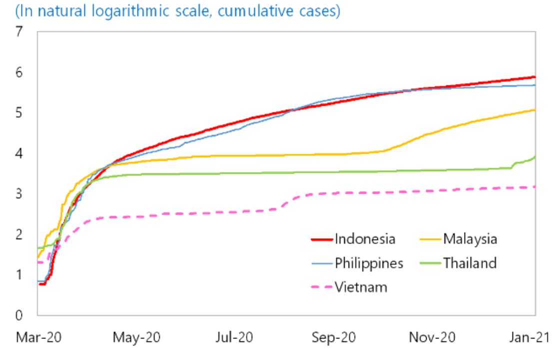
58. **Indonesia's proactive policies tackling climate change could put further emphasis on a greener economy**. A comprehensive transition plan would contribute to the economic recovery. Further progress in the monitoring and execution of adaptation plans would provide a welcome increase in resilience to climate change, given Indonesia's high exposure to related natural hazards.

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

Figure 1. COVID-19 Developments

Indonesia has seen significant spread of COVID-19.

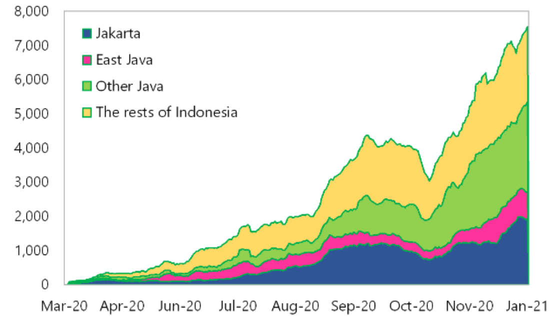
ASEAN: Number of Cases
(In natural logarithmic scale, cumulative cases)



Sources: World Health Organization; and IMF staff estimates.

Daily new cases have started picking up recently.

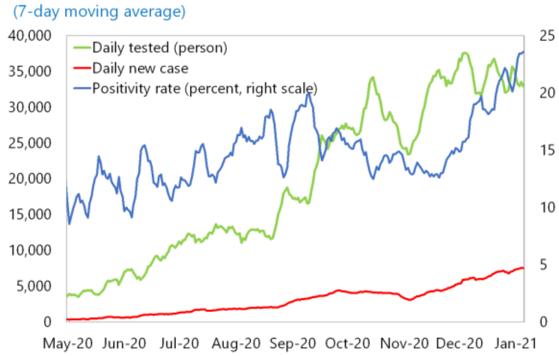
Daily New Cases
(7-day moving average)



Sources: Indonesian Ministry of Health; and IMF staff estimates.

COVID-19 testing has increased substantially, although the positivity rate of daily tests remains elevated.

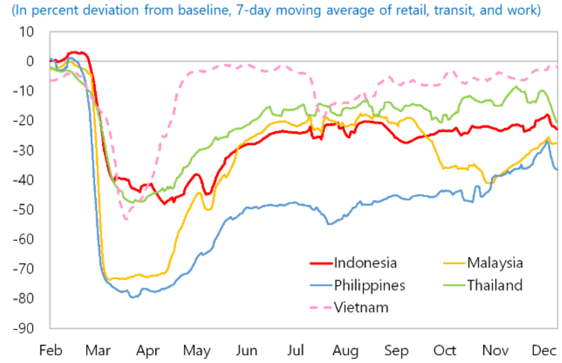
New Case and Daily Test
(7-day moving average)



Sources: Ministry of Health; and IMF staff estimates.

Mobility fell less than in ASEAN peers in the early stage of the pandemic but has also been slower to recover.

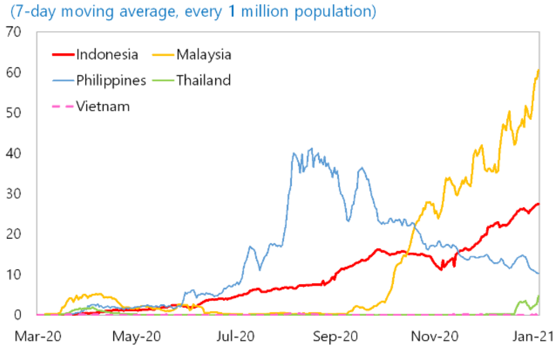
ASEAN: Mobility Trends, 2020
(In percent deviation from baseline, 7-day moving average of retail, transit, and work)



Sources: Google, COVID-19 Community Mobility Reports; and IMF staff estimates.

Daily new cases increased for longer than in other ASEAN countries.

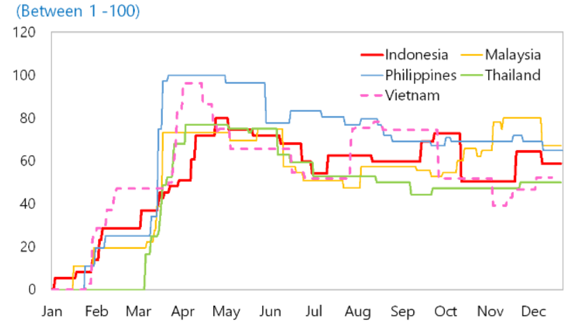
ASEAN: Number of New Cases
(7-day moving average, every 1 million population)



Sources: World Health Organization; and IMF staff estimates.

Indonesia's social restrictions were generally less stringent initially than ASEAN peers, but remain substantial.

ASEAN: Index of Stringency, 2020 1/
(Between 1 -100)

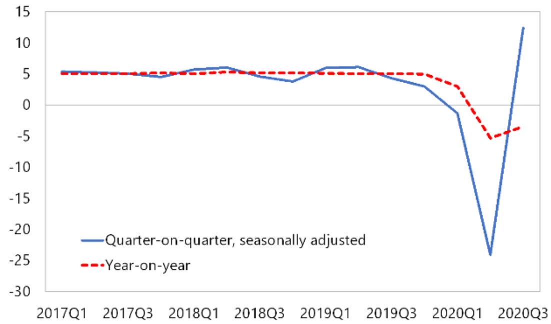


Source: University of Oxford, The Oxford COVID-19 Government Response Tracker.
1/ The index records the strictness of lockdown style policies; not scoring the appropriateness or effectiveness of a country's response. A higher number does not necessarily mean better.

Figure 2. Recent Economic Developments

Real GDP growth rebounded in 2020:Q3…

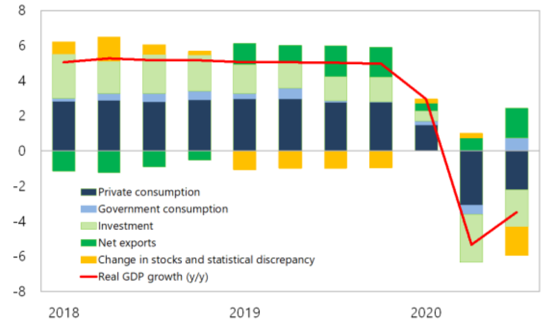
Real GDP Growth
(In percent)



Sources: Indonesian authorities; and IMF staff estimates.

…led by government consumption and net exports.

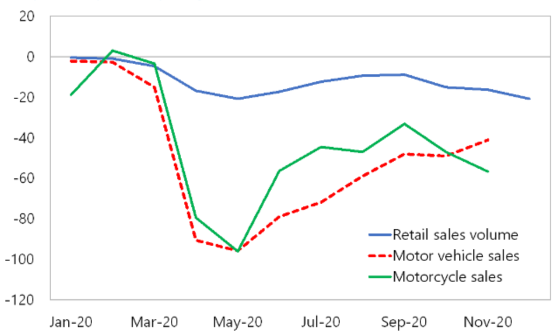
Contribution to Real GDP Growth
(In percent, year-over-year)



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

Private consumption appears to be slowly recovering…

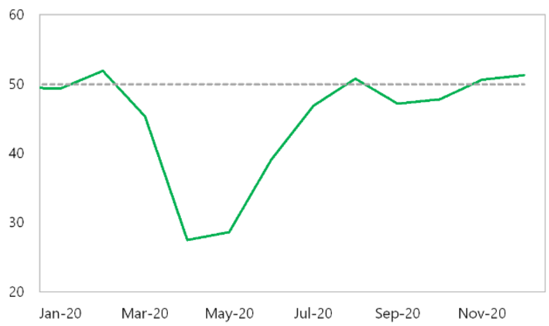
Indicators of Private Consumption Activities
(In percent, year-on-year growth)



Sources: Haver Analytics; and IMF staff estimates.

…together with manufacturing production.

Manufacturing Purchasing Managers' Index
(Index >50 = expansion, seasonally adjusted)



Source: Haver Analytics.

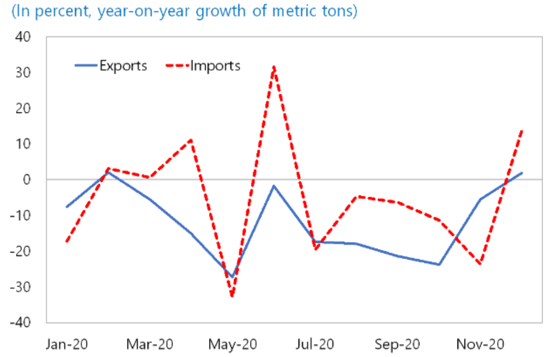
Consumer sentiment remains weak…

Consumer Confidence Index
(Index >100= expansion, not seasonally adjusted)

Source: Bank Indonesia via Haver Analytics.

… while the volume of non-oil and gas merchandise trade has just returned to the pre-pandemic levels.

Non-oil and Gas Merchandise Trade Volume
(In percent, year-on-year growth of metric tons)

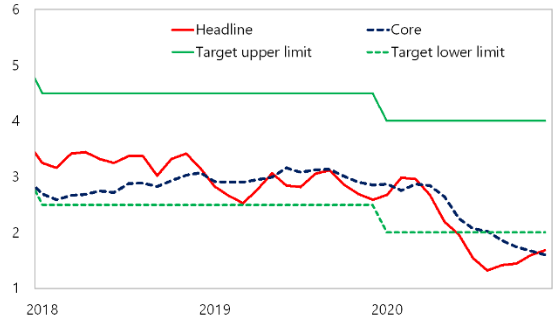


Sources: Haver Analytics; and IMF staff estimates.

Figure 3. Inflation Dynamics

Inflation has fallen below the lower limit of the target band…

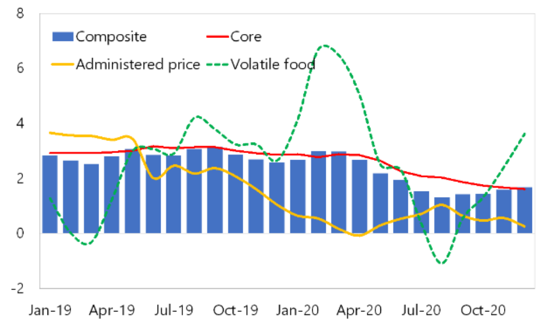
Inflation Developments
(In percent, year-on-year)



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

…reflecting weak domestic demand and a strong harvest.

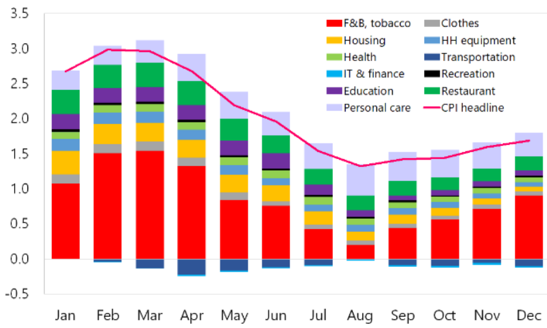
Components of CPI Inflation
(In percent, year-on-year)



Source: Statistics Indonesia (BPS).

Disinflationary pressures appear to be broad-based, both across products…

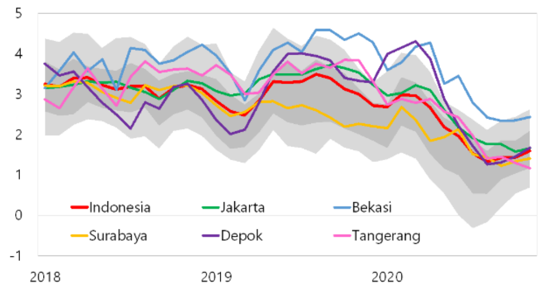
Contribution to Headline Inflation, 2020
(In percent, of year-on-year)



Sources: Statistics Indonesia (BPS); CEIC Data Ltd.; IMF staff estimates.

…and across regions.

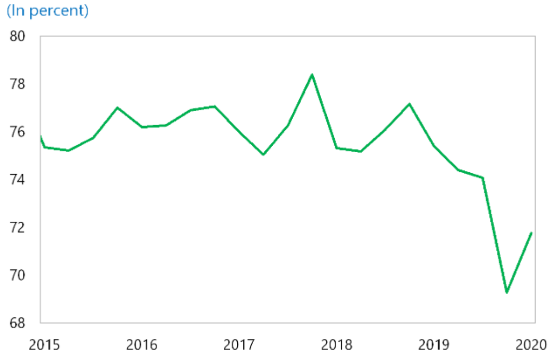
CPI in 90 Cities 1/
(In percent, year-on-year)



Sources: Statistics Indonesia (BPS); Haver Analytics; IMF staff estimates.
1/ Darker shade indicates 25th to 75th percentiles, lighter shade indicates 10th to 25th and 75th to 90th percentiles.

Capacity utilization has increased but is still well below the pre-pandemic levels.

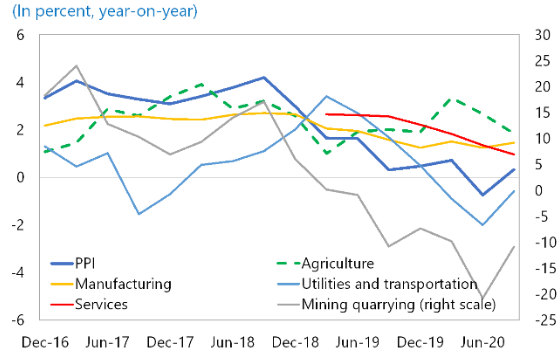
Capacity Utilization
(In percent)



Source: Bank Indonesia via Haver Analytics.

PPI inflation rebounded somewhat in 2020:Q3, following gradual disinflation since late 2018.

Components of PPI Inflation
(In percent, year-on-year)



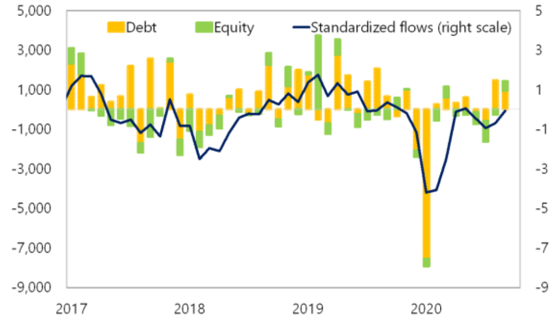
Sources: Statistics Indonesia (BPS); IMF staff estimates.

Figure 4. Capital Flows and Market Developments

Portfolio investment flows have stabilized after a bout of large outflows in February and March 2020.

Portfolio Equity and Debt Flows

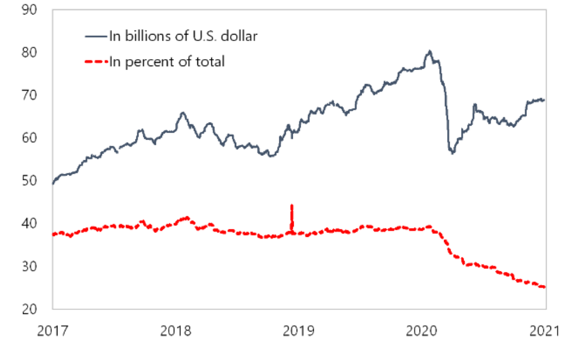
(Left scale, in millions of U.S. dollar; right scale, in standardized values)



Sources: IIF; and IMF staff estimates.

The share of foreign investors' holdings of rupiah government bonds has yet to recover its pre-pandemic levels.

Foreign Ownership of Rupiah Government Bonds

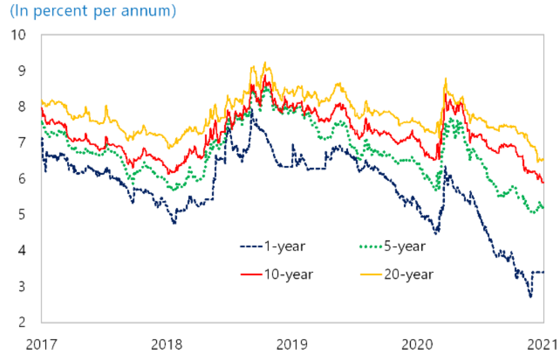


Sources: Bloomberg L.P.; CEIC Data Co., Ltd.; and IMF staff estimates.

Markets interest rates have declined recently…

Domestic Government Bond Yields

(In percent per annum)

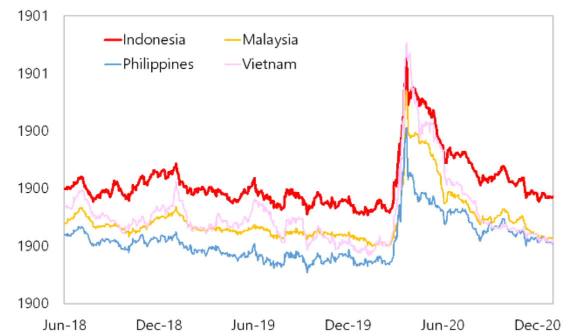


Source: Bloomberg L.P.

…partly reflecting lower sovereign premium.

Selected Asian Economies: EMBIG Spreads

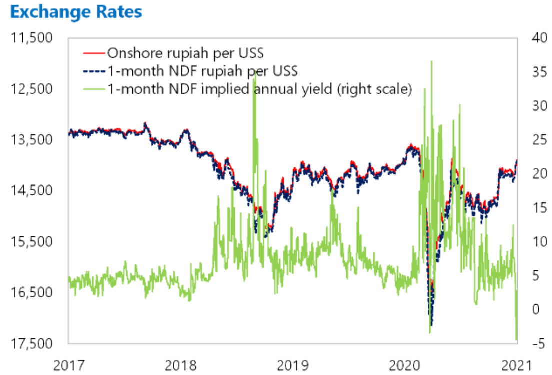
(In basis points)



Source: Bloomberg L.P.

…and exchange rate appreciation.

Exchange Rates

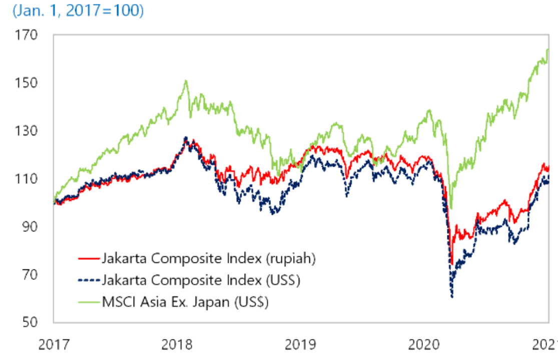


Source: Bloomberg L.P.

Although stock prices have increased since April, they remain below the pre-pandemic levels.

Equity Market Indices

(Jan. 1, 2017=100)

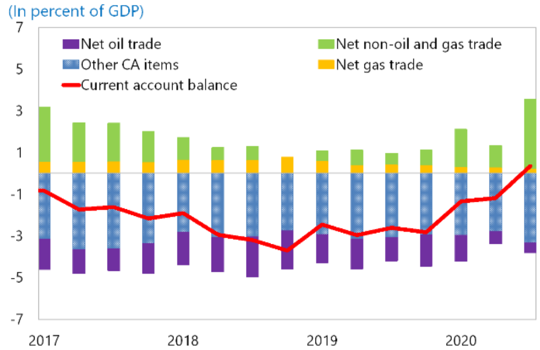


Sources: Bloomberg L.P.; and IMF staff estimates.

Figure 5. External Sector

The current account balance turned to surplus in 2020:Q3, driven by an increase in the non-oil and gas trade surplus.

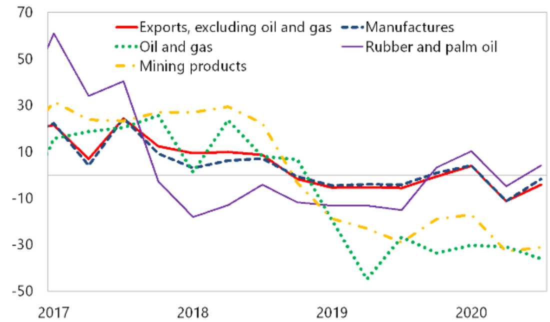
Current Account Balance
(In percent of GDP)



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

The drop of export growth in 2020 has been broad based, although significantly stronger for oil and mining.

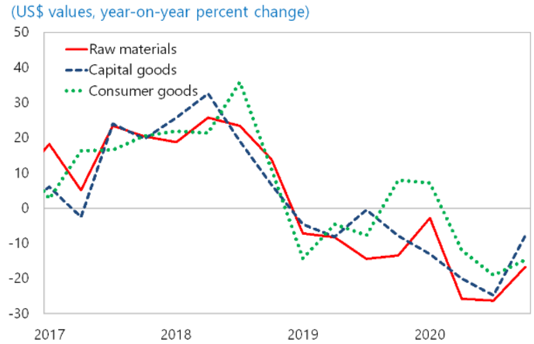
Exports of Goods
(US$ values, year-on-year percent change)



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

Imports declined sharply, particularly capital goods and raw material, on the back of weak domestic activity.

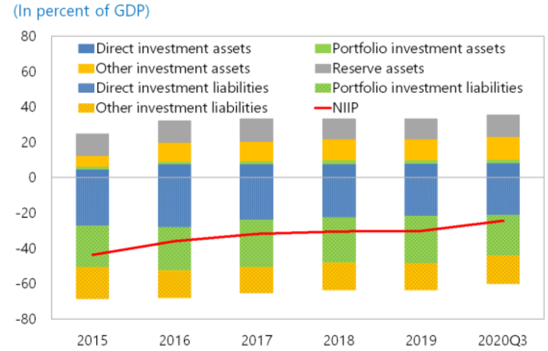
Imports of Goods
(US$ values, year-on-year percent change)



Source: CEIC Data Co. Ltd.

In 2020:Q3, the NIIP improved since end-2019, mainly due to a decline in portfolio liabilities.

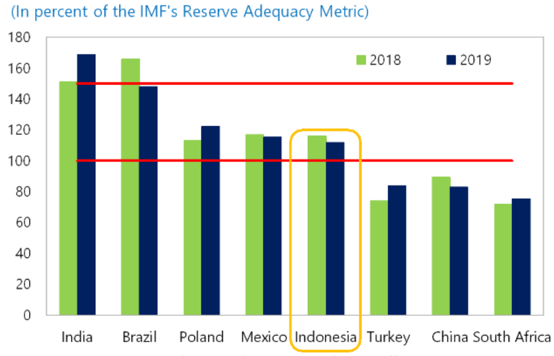
Net International Investment Position
(In percent of GDP)



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

Indonesia's foreign reserves in 2019 stood at an adequate level.

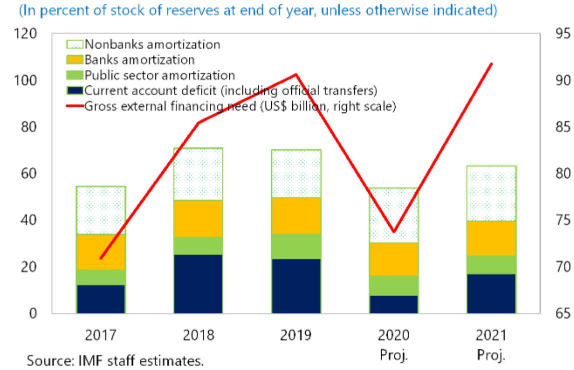
Gross International Reserves
(In percent of the IMF's Reserve Adequacy Metric)



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

External financing needs are projected to increase in 2021 mainly due to a widening of the current account deficit.

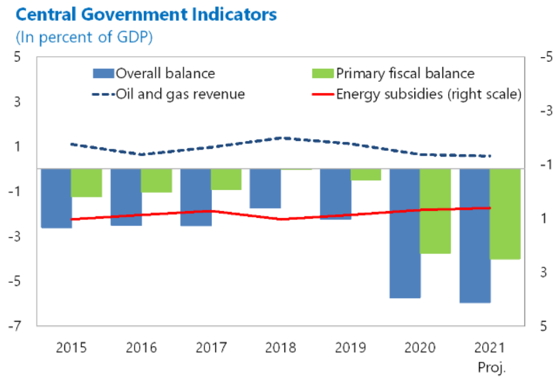
Gross External Financing Needs
(In percent of stock of reserves at end of year, unless otherwise indicated)



Source: IMF staff estimates.

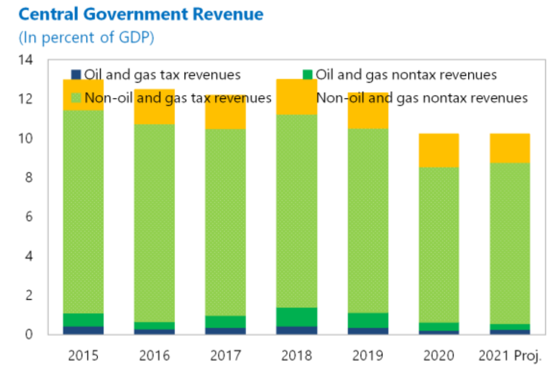
Figure 6. Fiscal Sector

The primary deficit is expected to have widened in 2020, reflecting fiscal measures to tackle the COVID-19 crisis.



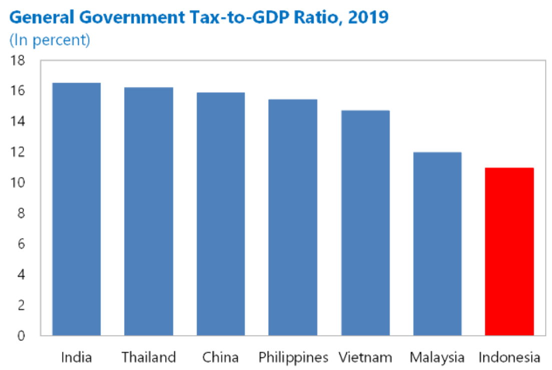
Sources: Indonesian authorities; and IMF staff estimates and projections.

Total revenue-to-GDP ratio decreased in 2019 and is expected to have declined further in 2020.



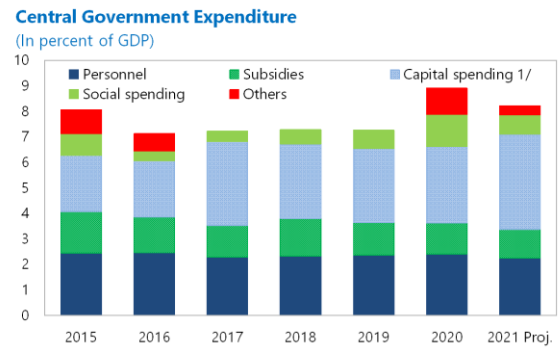
Sources: Indonesian authorities; and IMF staff estimates and projections.

Indonesia's tax-to-GDP ratio lags behind EM peers in Asia.



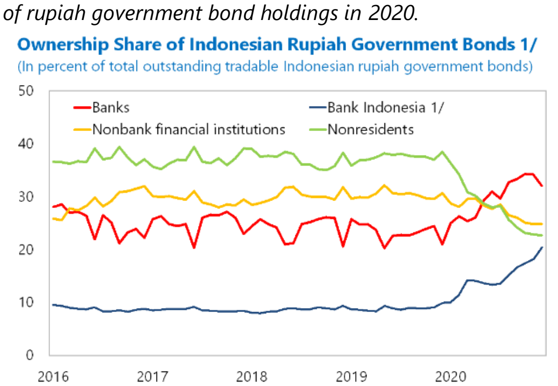
Sources: IMF, *WEO Database*; and authorities' data.

Social spending is expected to have more than doubled in 2020.



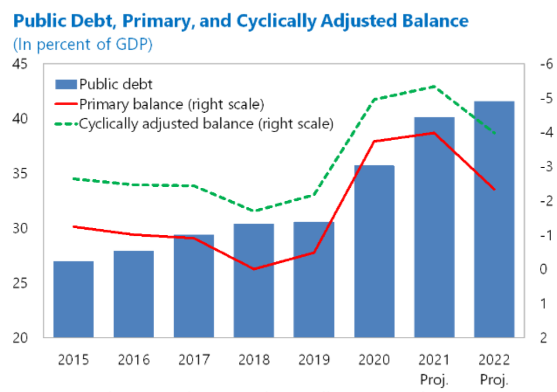
Sources: Indonesian authorities; and IMF staff estimates and projections.
1/ Includes transfers to local governments for infrastructure.

Commercial banks and BI have increased their relative shares of rupiah government bond holdings in 2020.



Sources: Indonesian authorities via Haver Analytics; and IMF staff estimates.
1/ Including government bonds held by Bank Indonesia for monetary operations.

Public debt is expected to have increased in the medium term but remain at a moderate level.

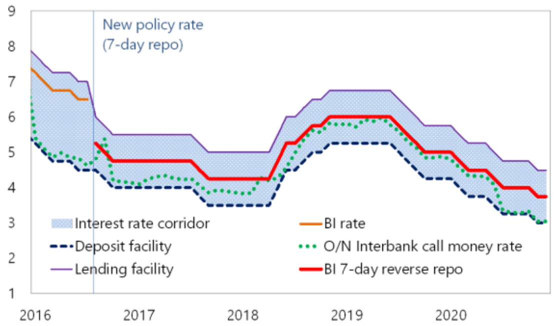


Sources: Indonesian authorities; and IMF staff estimates and projections.

Figure 7. Monetary Sector

BI has reduced its policy rate five times by a cumulative 125 bps in 2020…

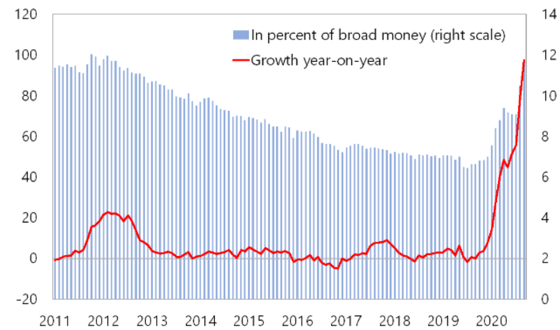
Monetary Policy and Interbank Rates
(In percent)



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

…and purchased government bonds to support the national economic recovery program.

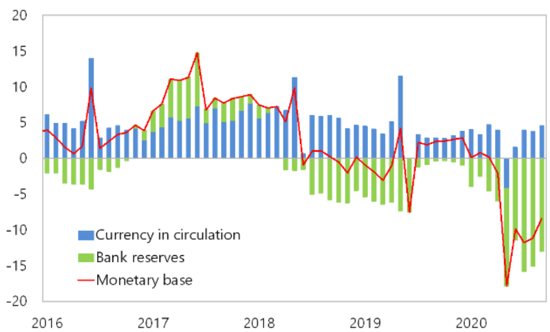
Bank Indonesia Claims on Central Government
(In percent)



Sources: Haver Analytics; and IMF staff estimates.

Monetary base has declined in 2020, reflecting a cut in the reserve requirement ratio and BI's liquidity absorption…

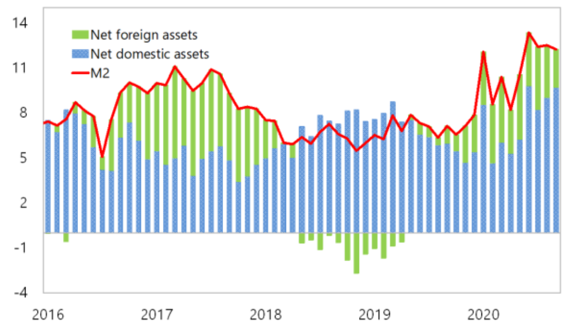
Monetary Base Growth
(In percent year-on-year contribution to growth)



Sources: Haver Analytics; and IMF staff estimates.

… while broad money has expanded.

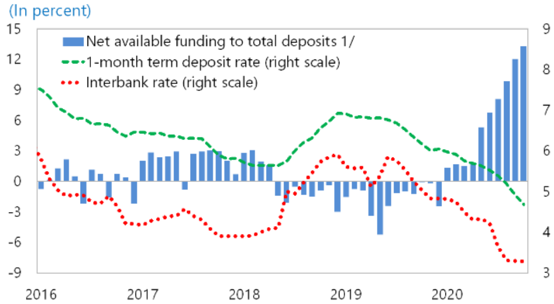
Broad Money Growth
(Contribution to growth, year-on-year)



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

The banking system as a whole has ample liquidity…

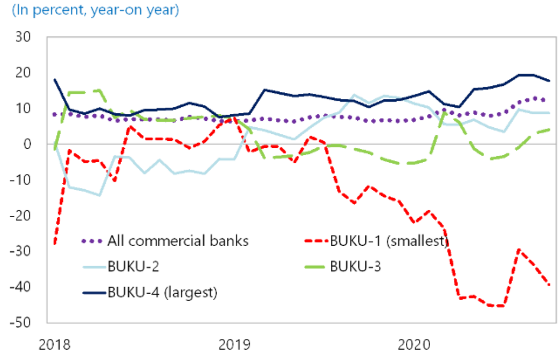
Funding Pressure
(In percent)



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 small banks continue to experience deposit outflows.

Commercial Banks: Deposit Growth by Bank Size
(In percent, year-on year)

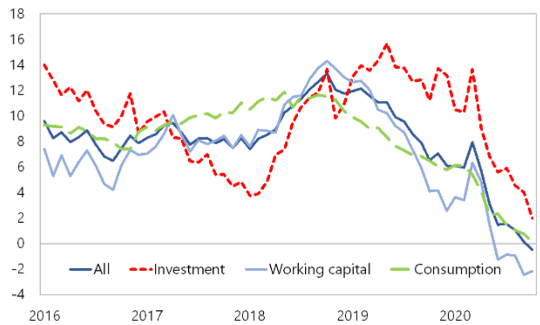


Sources: Indonesia Financial Services Authority; and IMF staff estimates.

Figure 8. Macrofinancial Developments

Credit growth, which was slowing down even prior to the pandemic, has fallen sharply in 2020...

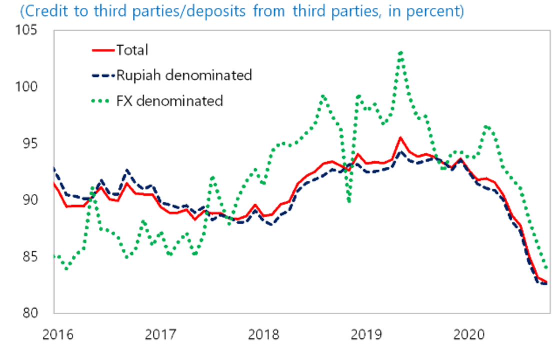
Loan Growth by Type
(In percent, year-on-year)



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

The loan-to-deposit ratio has declined in 2020.

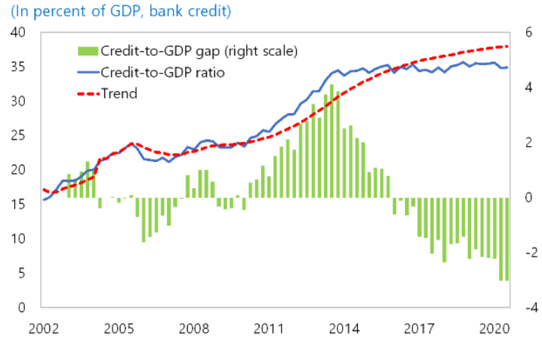
Commercial Bank Loan to Deposit Ratios
(Credit to third parties/deposits from third parties, in percent)



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

The credit gap has widened from −1.6 percent in 2019:Q4 to −3.6 percent in 2020:Q3.

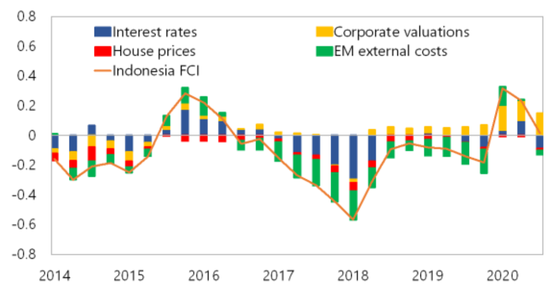
Credit-to-GDP Ratio and Gap
(In percent of GDP, bank credit)



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

Financial conditions have eased after a brief tightening in March.

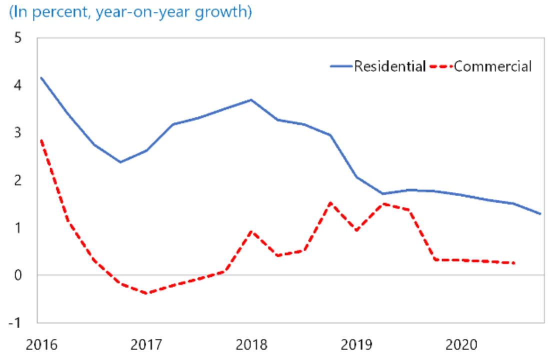
Financial Conditions Index (FCI)
(Standard deviations from mean, 1996-2020:Q3)



Sources: IMF staff calculation; Note: the weights of the sub-components are derived from PCA. Less than zero represent financial conditions that are loose relative to the historical average of 1996 or earliest data available through 2020; the interest rates category includes the real short-term rate, the sovereign spread on local currency debt, and the interbank spread; the corporate valuations category includes the equity market price-to-book ratio; and the external costs category includes the sovereign spread and the corporate spread on external debt, and the external debt-weighted exchange rate.

Property prices remain stable...

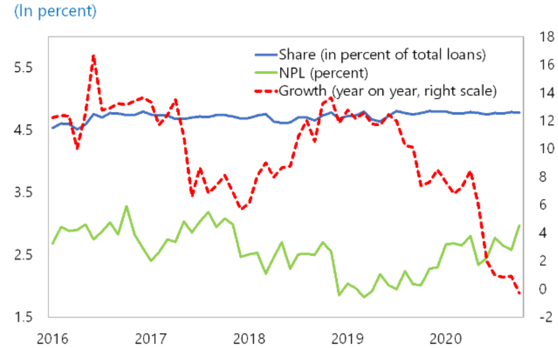
Property Prices
(In percent, year-on-year growth)



Sources: Haver Analytics; and IMF staff estimates.

...although real estate loan growth has slowed in 2020.

Real Estate Loans
(In percent)

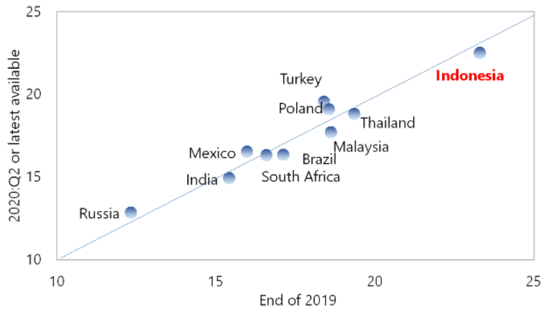


Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

Figure 9. Selected Emerging Market Economies: Financial Soundness Indicators

Indonesia's banking system capital remains adequate…

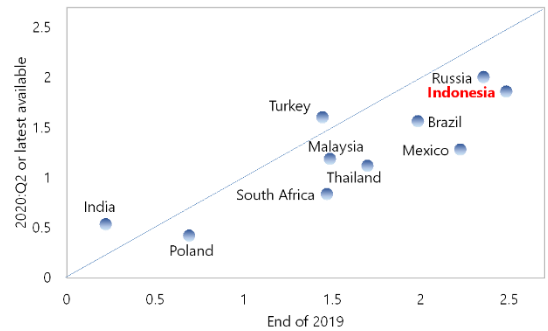
Regulatory Capital to Risk Weighted Assets 1/
(In percent)



Source: IMF, Financial Soundness Indicators.
1/ Includes capital impact of the transition to IFRS9 in January 2020.

…and although declining, profitability remains at a high level in comparison to peers reflecting large interest margins.

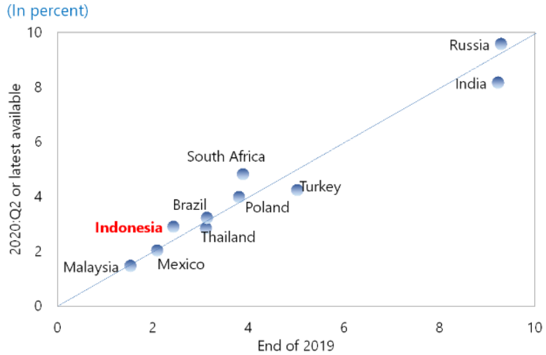
Return on Assets
(In percent)



Source: IMF, Financial Soundness Indicators.

Nonperforming loans have increased since the pandemic and remain moderate compared to peers.

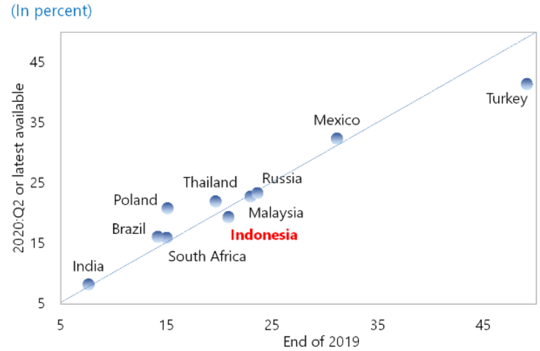
Nonperforming Loans to Total Loans
(In percent)



Source: IMF, Financial Soundness Indicators.

System-wide bank liquidity remains ample and around the median for emerging economies.

Liquid Assets to Total Assets
(In percent)



Source: IMF, Financial Soundness Indicators.

Table 1. Indonesia: Selected Economic Indicators, 2016–21

Nominal GDP (2019): Rp 15,834 trillion or US$1,120 billion
Population (2019): 266.9 million
Main exports (percent of total, 2019): coal (12.9), palm oil (8.8), oil and gas (7.5), textile & textile products (7.7)
GDP per capita (2019): US$4,219
Unemployment rate (2019): 5.28 percent
Poverty headcount ratio at national poverty line (March 2020): 9.78 percent of population

	2016	2017	2018	2019	2020 Proj.	2021 Proj.
Real GDP (percent change)	5.0	5.1	5.2	5.0	-1.9	4.8
Domestic demand	4.6	5.0	6.1	4.0	-2.8	5.1
Of which:						
Private consumption 1/	5.0	5.0	5.0	5.2	-2.5	5.0
Government consumption	-0.1	2.1	4.8	3.2	6.0	5.0
Gross fixed investment	4.5	6.2	7.9	4.4	-4.7	4.5
Change in stocks 2/	0.2	-0.1	0.4	-0.6	-0.3	0.3
Net exports 2/	0.1	0.3	-1.2	1.4	0.8	-0.1
Saving and investment (in percent of GDP)						
Gross investment 3/	33.9	33.7	34.6	33.8	32.5	32.7
Gross national saving	32.0	32.1	31.6	31.1	32.0	31.2
Prices (12-month percent change)						
Consumer prices (end period)	3.0	3.6	3.2	2.6	1.7	3.0
Consumer prices (period average)	3.5	3.8	3.3	2.8	2.0	2.0
Public finances (in percent of GDP)						
General government revenue	14.3	14.1	14.9	14.2	12.1	12.1
General government expenditure	16.8	16.6	16.6	16.4	17.8	18.0
Of which : Energy subsidies	0.9	0.7	1.0	0.9	0.7	0.6
General government balance	-2.5	-2.5	-1.8	-2.2	-5.7	-5.9
Primary balance	-1.0	-0.9	0.0	-0.5	-3.7	-4.0
General government debt	28.0	29.4	30.4	30.6	35.7	40.1
Money and credit (12-month percent change; end of period)						
Rupiah M2	10.0	8.3	6.3	6.5	11.5	7.0
Base money	3.9	8.9	0.2	2.9	-6.5	7.0
Claims on private sector	7.7	7.2	10.3	5.8	-0.5	5.6
One-month interbank rate (period average)	6.5	5.6	6.2	6.4	4.5	...
Balance of payments (in billions of U.S. dollars, unless otherwise indicated)						
Current account balance	-17.0	-16.2	-30.6	-30.4	-5.5	-17.4
In percent of GDP	-1.8	-1.6	-2.9	-2.7	-0.5	-1.5
Trade balance	15.3	18.8	-0.2	3.5	23.4	20.3
Of which : Oil and gas (net)	-4.8	-7.3	-11.4	-10.3	-9.2	-8.7
Inward direct investment	3.9	20.6	20.6	23.5	13.6	18.8
Overall balance	12.1	11.6	-7.1	4.7	6.7	16.4
Terms of trade, percent change (excluding oil)	0.4	1.3	0.4	-2.7	-5.4	1.7
Gross reserves						
In billions of U.S. dollars (end period)	116.4	130.2	120.7	129.2	135.9	152.3
In months of prospective imports of goods and services	7.6	7.1	7.1	9.9	7.9	8.1
As a percent of short-term debt 4/	213	237	201	204	207	217
Total external debt 5/						
In billions of U.S. dollars	320.0	352.5	375.4	403.5	416.6	446.9
In percent of GDP	34.3	34.7	36.0	36.1	38.3	38.5
Exchange rate						
Rupiah per U.S. dollar (period average)	13,306	13,383	14,231	14,140	14,541	...
Rupiah per U.S. dollar (end of period)	13,473	13,568	14,390	13,866	14,050	...
Memorandum items:						
Jakarta Stock Exchange (12-month percentage change, composite index)	15.3	20.0	-2.5	1.7	-5.1	...
Oil production (thousands of barrels per day)	820	815	810	805	710	707
Nominal GDP (in trillions of rupiah)	12,402	13,590	14,838	15,834	15,841	16,939

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, 2016–20

	2016	2017	2018	2019	2020	Data as of
Key economic and market indicators						
Real GDP growth (in percent)	5.0	5.1	5.2	5.0	-1.9	Proj.
CPI inflation (in percent, end of period, e.o.p.)	3.0	3.6	3.2	2.6	1.7	Proj.
Short-term (ST) interest rate (in percent, e.o.p.) 1/	7.8	5.5	7.5	5.4	3.8	Dec.
Ten-year government bond yield (in percent, e.o.p.)	8.0	6.3	8.0	7.1	5.9	Dec.
Indonesia EMBI spread (basis points (bps), e.o.p.)	237	166	237	155	186	Dec.
Exchange rate (rupiah per U.S. dollar, e.o.p.)	13,473	13,568	14,390	13,866	14,050	Dec.
External sector						
Current account balance (in percent of GDP)	-1.8	-1.6	-2.9	-2.7	-0.5	Proj.
Net FDI inflows (in percent of GDP)	1.7	1.8	1.2	1.8	1.0	Proj.
Exports of goods and nonfactor services (GNFS) (percentage change, in US$ terms)	-2.1	15.7	9.1	-5.6	-13.2	Proj.
Real effective exchange rate (e.o.p.; 2010=100)	92.1	93.4	87.9	91.6	90.4	Nov.
Gross international reserves (in US$ billion)	116.4	130.2	120.7	129.2	135.9	Dec.
In percent of ST debt at remaining maturity (RM)	212.7	237.5	200.5	205.4	206.5	Proj.
Total gross external debt (in percent of exports of GNFS)	190.7	181.5	177.1	202.1	240.0	Proj.
Gross external financing requirement (in US$ billion) 2/	72.5	70.9	85.5	90.6	68.4	Proj.
Public sector (PS) 3/						
Overall balance (in percent of GDP)	-2.5	-2.5	-1.7	-2.2	-5.7	Proj.
Primary balance (in percent of GDP)	-1.0	-0.9	0.0	-0.5	-3.7	Proj.
Gross PS financing requirement (in percent of GDP) 4/	4.2	4.7	4.0	4.1	8.1	Proj.
Public sector gross debt (PSGD) (in percent of GDP)	28.0	29.4	30.4	30.6	35.7	Proj.
Exposed to exchange rate risk (in percent of total PSGD) 5/	41.8	41.3	41.1	37.5	35.3	Proj.
Exposed to interest rate risk (in percent of total PSGD) 6/	2.0	1.3	0.8	0.4	0.0	Proj.
Financial sector (FS)						
Capital to risk-weighted assets (in percent) 7/	22.9	23.2	23.0	23.4	23.8	Oct.
Nonperforming loans (in percent of total loans)	2.9	2.6	2.4	2.5	3.2	Oct.
Foreign currency deposits at commercial banks (in percent of total deposits)	14.9	13.8	14.0	13.7	13.6	Nov.
Foreign currency loans at commercial banks (in percent of total loans)	13.3	13.2	13.6	12.4	12.1	Nov.
Government debt held by financial system (percent of total financial system assets)	8.7	8.4	7.8	8.1	13.9	Nov.
Private sector credit of banking system (annual percentage change)	7.7	7.2	10.3	5.8	-0.5	Proj.

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/ Debt in foreign currency or linked to the exchange rate.
6/ Government securities at variable interest rates.
7/ Includes capital charge for operational risk.

Table 3. Indonesia: Balance of Payments, 2015–21

(In percent of GDP)

	2015	2016	2017	2018	2019	2020 Est.	2021 Proj.
Current account	-2.0	-1.8	-1.6	-2.9	-2.7	-0.5	-1.5
Goods, net (trade balance)	1.6	1.6	1.9	0.0	0.3	2.2	1.7
Exports, f.o.b.	17.3	15.5	16.6	17.3	15.0	14.1	16.1
Oil and gas	2.0	1.4	1.5	1.7	1.1	0.7	1.2
Non-oil and gas	15.2	14.0	14.9	15.4	13.7	13.1	14.5
Agriculture	0.7	0.6	0.6	0.6	0.5	0.5	0.5
Manufacturing	12.2	11.4	11.9	12.0	10.8	10.5	11.3
Palm oil	1.8	1.5	1.8	1.6	1.3	1.5	1.5
Rubber products	0.7	0.6	0.7	0.6	0.5	0.6	0.6
Other manufacturing	9.7	9.2	9.3	9.8	9.0	8.5	9.2
Mining	2.3	2.0	2.4	2.8	2.2	1.9	2.6
Other exports	0.2	0.1	0.2	0.2	0.3	0.3	0.3
Imports, f.o.b.	-15.7	-13.9	-14.8	-17.4	-14.7	-11.9	-14.3
Oil and gas	-2.7	-1.9	-2.3	-2.8	-2.0	-1.6	-2.0
Non-oil and gas	-13.0	-12.0	-12.5	-14.6	-12.7	-10.4	-12.3
Consumption	-1.2	-1.3	-1.3	-1.6	-1.4	-1.2	-1.3
Raw materials	-9.5	-8.7	-9.1	-10.4	-9.0	-7.1	-9.0
Capital goods	-2.9	-2.4	-2.5	-2.9	-2.6	-2.3	-2.3
Other	0.5	0.4	0.4	0.4	0.3	0.3	0.0
Services, net	-1.0	-0.8	-0.7	-0.6	-0.7	-0.7	-0.9
Services exports	2.6	2.5	2.5	3.0	2.8	1.9	2.6
Services imports	-3.6	-3.3	-3.2	-3.6	-3.5	-2.5	-3.5
Primary income, net	-3.3	-3.2	-3.2	-3.0	-3.0	-2.5	-2.8
Secondary income, net	0.6	0.5	0.4	0.7	0.7	0.5	0.5
Capital and financial account	2.0	3.1	2.8	2.4	3.3	1.1	2.9
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	2.0	3.1	2.8	2.4	3.3	1.1	2.9
Direct investment, net	1.2	1.7	1.8	1.2	1.8	1.0	1.3
Abroad, net	-0.7	1.3	-0.2	-0.8	-0.3	-0.3	-0.3
In Indonesia (FDI), net	1.9	0.4	2.0	2.0	2.1	1.2	1.6
Portfolio investment, net	1.9	2.0	2.1	0.9	1.9	0.7	2.1
Equity, net	-0.3	0.1	-0.4	-0.5	-0.1	-0.2	-0.2
Portfolio debt, net	2.1	1.9	2.5	1.4	2.0	0.8	2.3
Other investment	-1.2	-0.6	-1.1	0.3	-0.5	-0.5	-0.5
Assets	-1.4	0.2	-1.3	-0.8	-1.0	-1.0	-1.0
Liabilities	0.2	-0.8	0.3	1.1	0.6	0.5	0.5
Errors and omissions	-0.1	0.0	-0.1	-0.2	-0.1	0.0	0.0
Reserves and related items	0.7	-1.1	-1.4	0.9	-0.8	-0.6	-1.4
Memorandum items:							
Reserves assets (US$ billions)	106	116	130	121	129	136	152
Reserve assets (in percent of ARA)	121	131	139	119	120	121	128
Reserve assets (in percent of GDP)	12.3	12.5	12.8	11.6	11.5	12.5	13.1
Nominal GDP (in billions of U.S. dollars)	861	932	1,015	1,043	1,120	1,088	1,162

Sources: Data provided by Bank Indonesia; and Fund staff estimates.

Table 4. Indonesia: Medium-Term Macroeconomic Framework, 2017–25

	2017	2018	2019	2020 Est.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.	2025 Proj.
Real GDP (percent change)	5.1	5.2	5.0	-1.9	4.8	6.0	5.6	5.3	5.2
Domestic demand	5.0	6.1	4.0	-2.8	5.1	5.9	5.6	5.5	5.4
Of which:									
Private consumption 1/	5.0	5.0	5.2	-2.5	5.0	5.9	5.5	5.3	5.5
Government Consumption	2.1	4.8	3.2	6.0	5.0	5.0	4.0	4.0	4.0
Gross fixed investment	6.2	7.9	4.4	-4.7	4.5	6.5	6.5	6.3	5.7
Net exports 2/	0.3	-1.2	1.4	0.8	-0.1	0.2	0.1	0.0	0.0
Statistical discrepancy 2/	-0.1	0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Output gap	-0.5	-0.3	-0.3	-4.7	-3.7	-2.1	-1.0	-0.3	0.0
Prices (12-month percent change)									
Consumer prices (end period)	3.6	3.2	2.6	1.7	3.0	3.0	2.8	2.8	2.8
Consumer prices (period average)	3.8	3.3	2.8	2.0	2.0	3.0	2.9	2.8	2.8
Public finances (percent of GDP)									
General government revenue	14.1	14.9	14.2	12.1	12.1	12.5	13.0	13.3	13.5
General government expenditure	16.6	16.6	16.4	17.8	18.0	16.8	15.9	15.9	15.8
General government balance	-2.5	-1.8	-2.2	-5.7	-5.9	-4.3	-2.9	-2.6	-2.3
General government primary balance	-0.9	0.0	-0.5	-3.7	-4.0	-2.3	-1.0	-0.8	-0.5
General government debt	29.4	30.4	30.6	35.7	40.1	41.6	41.7	41.7	41.3
Balance of payments (billions of U.S. dollars)									
Current account balance	-16.2	-30.6	-30.4	-5.5	-17.4	-20.7	-23.3	-23.7	-24.2
In percent of GDP	-1.6	-2.9	-2.7	-0.5	-1.5	-1.6	-1.7	-1.6	-1.5
Trade balance	18.8	-0.2	3.5	23.4	20.3	20.0	21.3	23.5	26.3
In percent of GDP	1.9	0.0	0.3	2.2	1.8	1.5	1.5	1.6	1.6
Oil and gas	-7.3	-11.4	-10.3	-9.2	-8.7	-14.6	-19.8	-26.8	-37.1
Overall balance	11.6	-7.1	4.9	6.7	16.4	15.9	7.9	14.2	16.9
Gross reserves									
In billions of U.S. dollars (end period)	130.2	120.7	129.2	135.9	152.3	168.2	176.1	190.3	207.2
In months of prospective imports	7.1	7.1	9.9	7.9	8.1	8.2	7.8	7.7	7.4
As a percent of short-term debt 3/	237.5	200.5	205.4	206.5	217.4	225.8	223.7	228.5	234.9
Total external debt									
In billions of U.S. dollars	352.5	375.4	404.3	416.6	446.9	477.9	502.6	530.9	561.0
In percent of GDP	34.7	36.0	36.1	38.3	38.5	37.0	36.0	35.5	35.0
Credit									
Private sector credit growth (percent)	7.2	10.3	5.8	-0.5	5.6	9.7	10.7	10.2	9.9
Credit-to-GDP gap (percent) 4/	-1.5	-1.4	-2.2	-2.1	-1.3	-0.3	0.6	0.0	0.0
Memorandum items:									
Oil production (thousands of barrels per day)	815	810	805	710	707	704	701	698	695
Indonesian oil price (period average, in U.S. dollars per barrel)	51.2	67.5	62.4	41.2	52.5	50.1	48.9	48.3	47.9
Nominal GDP (trillions of rupiah)	13,590	14,838	15,834	15,841	16,939	18,488	20,082	21,738	23,514
Nominal GDP (billions of U.S. dollars)	1,015	1,043	1,120	…	…	…	…	…	…

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, 2015–21

(In trillions of rupiah)

	2015	2016	2017	2018	2019	2020 Est.	2021 Proj.
Revenues and grants	1,508	1,556	1,666	1,942	1,957	1,632	1,744
Of which: tax revenues	1,240	1,285	1,344	1,521	1,545	1,283	1,432
Oil and gas revenues	128	81	132	208	180	103	97
Tax revenues	50	36	50	65	59	33	46
Nontax revenues	78	45	82	143	120	70	52
Non-oil and gas revenues	1,368	1,466	1,523	1,720	1,771	1,517	1,633
Tax revenues	1,191	1,249	1,293	1,457	1,486	1,250	1,386
Income tax	553	630	596	687	711	561	638
Of which : tax amnesty		114	25	57	32	-125	0
VAT	424	412	481	538	533	448	504
Other	214	207	216	232	242	241	244
Nontax revenues	177	217	229	264	285	267	247
Grants	12	9	12	14	7	12	13
Expenditure and net lending	1,808	1,864	2,007	2,202	2,310	2,537	2,750
Current expenditure	871	935	1,001	1,176	1,205	1,416	1,505
Personnel	281	305	313	347	376	380	381
Subsidies	186	174	166	217	202	194	193
Of which : energy subsidies	119	107	98	154	137	109	102
Fuel	61	44	47	97	84	48	42
Electricity	58	63	51	57	53	61	60
Interest	156	183	217	258	276	314	331
Other	248	273	306	354	352	528	600
Development expenditure	314	219	264	269	303	469	516
Capital spending	217	169	209	185	190	271	389
Social assistance spending 1/	97	50	55	84	113	198	127
Transfers to local governments	623	710	742	758	802	652	729
Of which : transfers for infrastructure 2/	39	101	239	248	268	204	242
Overall balance	-300	-308	-341	-260	-353	-906	-1,006
Financing	300	308	341	260	353	906	1,006
Net issuance of government securities	367	408	442	358	1,142	750	1,066
Program and project loans (net)	15	-11	-13	65	-34	51	65
SOE recapitalization and land acquisition	-60	-91	-60	-66	-65	-16	-65
Other	-23	2	-28	-98	-690	121	-59

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, 2015–21

(In percent of GDP, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020 Est.	2021 Proj.
Revenues and grants	13.1	12.5	12.3	13.1	12.4	10.3	10.3
Of which: tax revenues	10.8	10.4	9.9	10.3	9.8	8.1	8.5
Oil and gas revenues	1.1	0.7	1.0	1.4	1.1	0.6	0.6
Tax revenues	0.4	0.3	0.4	0.4	0.4	0.2	0.3
Nontax revenues	0.7	0.4	0.6	1.0	0.8	0.4	0.3
Non-oil and gas revenues	11.9	11.8	11.2	11.6	11.2	9.6	9.6
Tax revenues	10.3	10.1	9.5	9.8	9.4	7.9	8.2
Income tax	4.8	5.1	4.4	4.6	4.5	3.5	3.8
Of which : tax amnesty	...	0.9	0.2	...	...	...	...
VAT	3.7	3.3	3.5	3.6	3.4	2.8	3.0
Other	1.9	1.7	1.6	1.6	1.5	1.5	1.4
Nontax revenues	1.5	1.8	1.7	1.8	1.8	1.7	1.5
Grants	0.1	0.1	0.1	0.1	0.0	0.1	0.1
Expenditure and net lending	15.7	15.0	14.8	14.8	14.6	16.0	16.2
Current expenditure	7.6	7.5	7.4	7.9	7.6	8.9	8.9
Personnel	2.4	2.5	2.3	2.3	2.4	2.4	2.2
Subsidies	1.6	1.4	1.2	1.5	1.3	1.2	1.1
Of which : energy subsidies	1.0	0.9	0.7	1.0	0.9	0.7	0.6
Fuel	0.5	0.4	0.3	0.7	0.5	0.3	0.2
Electricity	0.5	0.5	0.4	0.4	0.3	0.4	0.4
Interest	1.4	1.5	1.6	1.7	1.7	2.0	2.0
Other	2.1	2.2	2.2	2.4	2.2	3.3	3.5
Development expenditure	2.7	1.8	1.9	1.8	1.9	3.0	3.0
Capital spending	1.9	1.4	1.5	1.2	1.2	1.7	2.3
Social assistance spending 1/	0.8	0.4	0.4	0.6	0.7	1.3	0.7
Transfers to local governments	5.4	5.7	5.5	5.1	5.1	4.1	4.3
Of which : transfers for infrastructure 2/	0.3	0.8	1.8	1.7	1.7	1.3	1.4
Overall balance	-2.6	-2.5	-2.5	-1.7	-2.2	-5.7	-5.9
Memorandum items:							
Net issuance of government securities (in trillions of rupiah)	367	408	442	358	1,142	750	1,066
SOE recapitalization and land acquisition (in trillions of rupiah)	65	91	60	66	65	16	65
Primary balance (percent of GDP)	-1.2	-1.0	-0.9	0.0	-0.5	-3.7	-4.0
Cyclically-adjusted primary balance (percent of GDP)	-1.3	-1.0	-0.8	0.0	-0.4	-3.0	-3.4
Capital spending and transfers (percent of GDP) 3/	2.2	2.2	3.3	2.9	2.9	3.0	3.7
General government debt (percent of GDP)	27.0	28.0	29.4	30.4	30.6	35.7	40.1
Indonesian crude oil price (US$ per barrel)	49.2	40.2	51.2	67.5	62.4	41.2	52.5
Oil production (thousands of barrels per day)	800	820	815	810	805	710	707
Nominal GDP (in trillions of rupiah)	11,526	12,402	13,590	14,838	15,834	15,841	16,939

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.
3/ Sum of capital spending and transfers for infrastructure.

Table 7. Indonesia: Summary of General Government Operations, 2015–21

	2015	2016	2017	2018	2019	2020 Est.	2021 Proj.
			(In trillions of rupiah)				
Total revenue and grants	1,715	1,778	1,910	2,208	2,241	1,916	2,047
Taxes	1,379	1,434	1,506	1,699	1,735	1,473	1,635
Taxes on income, profits, and capital gains	602	666	647	752	770	594	684
Taxes on goods and services	568	556	634	698	705	625	676
VAT and luxury taxes	424	412	481	538	533	448	504
Excise	145	144	153	160	172	176	172
Taxes on international trade and transactions	35	35	39	46	41	36	45
Taxes not elsewhere classified	173	176	186	204	219	218	230
Grants	12	9	12	14	7	12	13
Other revenue	324	335	392	495	499	431	399
Total expenditure	2,015	2,086	2,251	2,468	2,594	2,821	3,053
Expense	1,605	1,645	1,735	1,938	2,024	2,159	2,233
Of which :							
Compensation of employees	630	681	724	796	856	860	894
Purchases/use of goods and services	233	260	291	337	334	402	466
Interest	156	183	217	258	276	314	331
Energy subsidies	119	107	98	154	137	109	102
Social benefit	112	68	79	112	147	235	170
Net acquisition of nonfinancial assets	410	441	516	530	570	662	820
Net lending/borrowing	-300	-308	-341	-260	-353	-906	-1,006
Net acquisition of financial assets	82	89	61	41	755	-105	124
Of which : policy lending	3	5	0	0	0	0	0
Net incurrence of liabilities	382	397	402	300	1,108	801	1,130
			(In percent of GDP)				
Total revenue and grants	14.9	14.3	14.1	14.9	14.2	12.1	12.1
Taxes	12.0	11.6	11.1	11.5	11.0	9.3	9.7
Taxes on income, profits, and capital gains	5.2	5.4	4.8	5.1	4.9	3.7	4.0
Taxes on goods and services	4.9	4.5	4.7	4.7	4.5	3.9	4.0
VAT and luxury taxes	3.7	3.3	3.5	3.6	3.4	2.8	3.0
Excise	1.3	1.2	1.1	1.1	1.1	1.1	1.0
Taxes on international trade and transactions	0.3	0.3	0.3	0.3	0.3	0.2	0.3
Taxes not elsewhere classified	1.5	1.4	1.4	1.4	1.4	1.4	1.4
Grants	0.1	0.1	0.1	0.1	0.0	0.1	0.1
Other revenue	2.8	2.7	2.9	3.3	3.2	2.7	2.4
Total expenditure	17.5	16.8	16.6	16.6	16.4	17.8	18.0
Expense	13.9	13.3	12.8	13.1	12.8	13.6	13.2
Of which :							
Compensation of employees	5.5	5.5	5.3	5.4	5.4	5.4	5.3
Purchases/use of goods and services	2.0	2.1	2.1	2.3	2.1	2.5	2.8
Interest	1.4	1.5	1.6	1.7	1.7	2.0	2.0
Energy subsidies	1.0	0.9	0.7	1.0	0.9	0.7	0.6
Social benefit	1.0	0.6	0.6	0.8	0.9	1.5	1.0
Net acquisition of nonfinancial assets	3.6	3.6	3.8	3.6	3.6	4.2	4.8
Net lending/borrowing	-2.6	-2.5	-2.5	-1.8	-2.2	-5.7	-5.9
Net acquisition of financial assets	0.7	0.7	0.4	0.3	4.8	-0.7	0.7
Of which : policy lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	3.3	3.2	3.0	2.0	7.0	5.1	6.7
Memorandum items:							
General government debt (In percent of GDP)	27.0	28.0	29.4	30.4	30.6	35.7	40.1
Nominal GDP (In trillions of rupiah)	11,526	12,402	13,590	14,838	15,834	15,841	16,939

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

Table 8. Indonesia: Monetary Survey, 2016–21

	2016	2017	2018	2019	Est. 2020	Proj. 2021
	(In trillions of rupiah)					
Net foreign assets	1,297.5	1,541.8	1,442.5	1,506.6	1,657.0	1,898.1
Claims on nonresidents	1,761.7	1,996.3	1,970.6	2,026.3	2,174.6	2,429.9
Central bank	1,565.6	1,766.1	1,748.9	1,797.5	1,912.0	2,167.3
Other depository corporations	196.1	230.2	221.6	228.8	262.6	262.6
Liabilities to nonresidents	-464.2	-454.6	-528.1	-519.7	-517.5	-531.8
Central bank	-41.3	-38.3	-40.4	-38.5	-41.8	-41.8
Other depository corporations	-422.9	-416.2	-487.6	-481.2	-475.7	-490.0
Net domestic assets	3,707.5	3,877.4	4,317.5	4,629.9	5,186.4	5,426.7
Net claims on central government	632.4	635.1	624.7	714.9	1,456.7	1,625.5
of which: held by Bank Indonesia	235.6	229.1	223.4	266.8	745.3	710.3
Claims on state and local government	0.6	4.5	5.2	2.3	1.6	1.8
Claims on public nonfinancial corporations	304.8	345.3	480.1	508.6	507.7	507.4
Claims on NBFIs	290.0	324.9	371.3	377.3	335.0	334.8
Claims on private sector	4,115.8	4,412.7	4,868.6	5,152.5	5,126.8	5,414.4
Corporates	2,002.0	2,090.1	2,336.3	2,455.1	...	...
Households	2,113.8	2,322.6	2,532.3	2,697.4	...	...
Capital and Reserves (-)	1,276.6	1,451.8	1,630.2	1,735.4	1,822.2	2,010.4
Other items, net (-, including discrepancy)	359.6	393.3	402.2	390.2	419.2	446.8
Broad money	5,005.0	5,419.2	5,760.0	6,136.6	6,843.5	7,324.8
Currency in circulation	508.1	586.6	625.4	654.7	730.1	781.5
Transferable deposits	988.9	1,051.6	1,111.1	1,224.7	1,365.8	1,461.9
Other deposits	3,494.4	3,762.6	4,003.1	4,231.2	4,718.6	5,050.5
Securities	13.5	18.4	20.5	26.0	29.0	31.0
Other liabilities	330.7	410.8	440.4	445.5	419.2	446.8
	(Annual percentage change)					
Net foreign assets	10.3	18.8	-6.4	4.4	10.0	14.5
Net domestic assets	9.9	4.6	11.4	7.2	12.0	4.6
Claims on private sector	7.7	7.2	10.3	5.8	-0.5	5.6
Corporates	6.6	4.4	11.8	5.1	...	...
Households	8.7	9.9	9.0	6.5	...	...
Broad money	10.0	8.3	6.3	6.5	11.5	7.0
	(In percent of GDP, end of period)					
Net foreign assets	10.5	11.3	9.7	9.5	10.5	11.2
Net domestic assets	29.9	28.5	29.1	29.2	32.7	32.0
Claims on private sector	33.2	32.5	32.8	32.5	32.4	32.0
Corporates	16.1	15.4	15.7	15.5	...	...
Households	17.0	17.1	17.1	17.0	...	...
Broad money	40.4	39.9	38.8	38.8	43.2	43.2
Memorandum items:						
Base money (annual percentage change)	3.9	8.9	0.2	2.9	-6.5	7.0
Velocity (nominal GDP/broad money)	2.5	2.5	2.6	2.6	2.3	2.3
Nominal GDP (in trillions of rupiah)	12,401.7	13,589.8	14,838.3	15,833.9	15,840.6	16,938.8

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

Table 9. Indonesia: Financial Soundness Indicators, 2016–20

(In percent; unless otherwise indicated)

	2016	2017	2018	2019	2020	
					Latest observation	
Depository institutions						
Capital adequacy						
Regulatory capital to risk-weighted assets	22.9	23.2	23.0	23.4	23.5	Q3
Core Tier-1 capital to risk-weighted assets	21.2	21.5	21.3	21.9	21.8	Q3
Capital to assets	14.4	15.2	15.1	15.6	14.4	Q3
Large exposures to capital	0.5	0.4	0.4	0.4	0.4	Q3
Asset quality						
Nonperforming loans to total gross loans	2.9	2.6	2.3	2.4	2.9	Q3
Nonperforming loans, net of provisions to capital	5.7	5.0	4.4	5.0	4.5	Q3
Specific provisions to nonperforming loans	57.8	55.2	57.6	53.3	66.3	Q3
Earning and profitability						
Return on assets	2.1	2.4	2.5	2.5	1.7	Q3
Return on equity	14.5	15.8	16.7	16.0	11.3	Q3
Interest margin to gross income	68.0	69.3	69.8	65.3	61.4	Q3
Trading income to gross income	1.2	3.8	2.7	4.2	5.6	Q3
Noninterest expenses to gross income	46.6	49.7	48.1	46.3	46.5	Q3
Personnel expenses to noninterest expenses	41.8	40.7	41.9	41.7	42.7	Q3
Liquidity and funding						
Liquid assets to total assets	22.4	21.7	21.9	20.9	20.1	Q3
Liquid assets to short-term liabilities	32.6	31.7	32.0	30.8	29.0	Q3
Non-interbank loans to customer deposits	96.3	96.4	102.2	103.3	96.1	Q3
Sensitivity to market risk						
Net open position in foreign exchange to capital	1.8	1.6	1.7	1.6	0.8	Q3
Foreign currency denominated loans to total loans	13.3	13.2	13.6	12.4	13.1	Q3
Foreign currency denominated liabilities to total liabilities	20.9	19.3	20.0	18.9	19.3	Q3
Gross asset position in financial derivatives to capital	1.4	0.7	1.8	1.6	1.6	Q3
Gross liability position in financial derivatives to capital	1.5	0.6	2.2	1.2	1.6	Q3
Nonfinancial corporates						
Corporate debt (in percent of GDP)	40.0	39.6	41.4	40.9	42.8	Q3
Leverage						
Total liabilities to total assets	44.3	45.2	50.4	48.1	47.8	Q3
Profitability 1/						
Return on assets	13.5	14.3	14.0	10.6	9.5	Q3
Liquidity 1/						
Current assets to current liabilities	220.9	226.6	218.0	196.0	204.7	Q3
Liquid assets to current liabilities	114.0	122.8	126.6	121.0	127.5	Q3
Debt servicing capacity						
Companies with negative equity (in percent of total assets)	2.8	1.7	1.3	0.5	4.0	Q3
Companies with negative equity (in percent of total firms)	6.1	6.4	6.8	5.1	5.7	Q3
Households						
Household debt (in percent of GDP)	17.0	17.0	17.0	17.0	16.9	Q2
Real estate markets						
Residential real estate prices (year-on-year percentage change)	2.4	3.5	3.0	1.8	1.2	Q3
Residential real estate loans to total loans	8.3	8.5	8.5	8.6	8.3	Q3
Commercial real estate loans to total loans	8.5	8.9	9.1	9.5	9.3	Q3

Sources: Authorities data; Bloomberg L.P.; 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.

Table 10. Indonesia: Key Poverty and Social Indicators

Population	269.6 millions	(2020)
Life expectancy at birth, total	71.5 years	(2018)
Mortality rate, under 5	25.0 per 1,000 live births	(2018)
Secondary school enrollment:		
Total	88.9 percent	(2018)
Female	90.0 percent	(2018)
Male	87.8 percent	(2018)
GINI index	38.1	(2020)
Income share held by highest 20%	46.1 percent	(2018)
Income share held by lowest 20%	6.7 percent	(2018)
Poverty rate	9.8 percent	(2020)
CO2 emissions	2.2 metric tons per capita	(2016)
Population with basic drinking water	89.3 percent	(2017)
Population with basic sanitation	73.1 percent	(2017)
Human development index	0.71	(2018)
Rank	111	
Gender inequality index	0.45	(2018)

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

Table 11. Indonesia: Key FSAP Recommendations

	Key Recommendations	Authorities' Actions
	Institutional and legal arrangements	
1	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.	The proposed amendments of BI Law, OJK Law, and LPS Law are included in the National Legislation Program (Prolegnas) 2020–24. On OJK Law, OJK has submitted its response to inquiry made by the Secretary General and Expertise Body of the Parliament on April 13, 2020, and followed by a meeting between OJK and the Parliament on May 12, 2020. On BI Law, BI will actively discuss with the initiator of the law and follow the process optimally with relevant stakeholders to ensure the accommodation of BI's task and function.
2	Amend the Insurance Law to specify policyholder protection as principal objective of OJK.	The establishment of an insurance policy guarantee program and a policy guarantee institution is in one of the 19 bills in Prolegnas 2020–24, and is under intensive discussion with MoF. In addition, MoF is preparing and discussing the possibility of including the policy guarantee program in the draft Bill on Development and Strengthening of the Financial Sector (Omnibus Law for Financial Sector). Hence, the arrangements regarding the policy guarantee program may be issued sooner than previously expected.
3	Strengthen legal protection of supervisors and officials of all agencies involved in financial oversight and crisis management in line with global standards.	The coverage of legal protection for OJK supervisors and officials has been included in the material of the amendment of OJK Law in Prolegnas 2020–24. For BI, currently Article 45 of the BI Law provides the legal basis for protection of its officials. Such legal basis is further affirmed in the Article 48 of the Law No. 9 of 2016 on the Prevention and Resolution of Financial System Crisis (PPKSK Law). Recently, provision of legal protection for supervisors and officials of all agencies involved in financial oversight and crisis management provision is also regulated in Article 27 Section 2 of the Law Number 2 Year 2020. With the affirmation of the legal protection of the parties referred to in Article 48 of PPKSK Law and Article 27 of the Law Number 2 Year 2020, the provisions concerning legal protection for the decision makers and officers stipulated in BI Law will most likely be the object of deliberation within Parliament.
	Systemic risk monitoring and prudential policy	
4	Introduce a foreign currency liquidity coverage ratio (LCR).	OJK has been imposing LCR based on significant currencies as monitoring tool as stipulated in regulation No. 42/2015 concerning Liquidity Coverage Ratio Requirement for Commercial Banks. Article 51 and its elucidation of such regulation requires banks to monitor LCR based on significant currencies.
5	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 DSIBs regularly.	BI and OJK have been implementing Joint Stress Test (JST) regularly once a year. OJK coordinates Bottom Up Stress Test (BUST) for systemic banks (D-SIB) and other large banks, while BI performs Top Down Stress Test (TDST) and designs macroeconomic scenario. Since 2017, JST has been held three times. The results of TDST have been regularly reported to the Board Meeting of BI. During 2019–20, BI has continued to improve its stress test (ST) capabilities and framework, with strong TA supports from the IMF and other central banks. In 2020, BI received two technical assistance from Bundesbank and Bank of England on solvency ST and macro ST. In the area of systemic risk surveillance, BI further enhanced Bank-Led surveillance framework (Dynamic Systemic Risk Surveillance). BI has maintained close coordination with OJK, with High Level Meeting (Governor/Deputy Governor Level) performed regularly on a monthly basis, in addition to regular technical level meeting (Department Head). In post-COVID-19 period, BI and OJK performed more frequent meetings on the technical level, with at least twice a month to monitor and address any concern about individual banks. Discussion also focused on specific issues regarding BI short-term liquidity assistance and banks' behavior in payment system and monetary operation activities.
	Financial sector oversight	
6	Reduce OJK's silo structure, including by revising the OJK Law to remove the responsibilities of individual Commissioners for the supervision of specific sectors.	OJK's proposal to revise the OJK Law to reduce silos has been submitted to the Parliament. However, such proposal needs to be included by the Parliament in the draft amendment of OJK Law. At this time the discussion of the amendment of OJK Law has been included in Prolegnas 2020–24.
7	Strengthen the banking supervisory approach and continue enhancing supervisory practices for financial conglomerates (FCs).	OJK has issued OJK Regulation No.45/POJK.03/2020 on Financial Conglomerates that takes into account the mandate of Article 5 of Law Number 21 of 2011 (stating OJK's function to conduct an integrated regulatory and supervisory system for all activities in the financial services sector), as well as recommendations from the IMF and World Bank technical assistance. The regulation aimed to review the current definition of a financial conglomerate, bearing in mind the materiality of FCs as well as the need to enact a threshold based on certain criteria considering the heterogeneous nature of Indonesia's FCs. This regulation further reinforced OJK Regulation No.17/POJK,03/2014 on Integrated Risk Management for Financial Conglomerates and OJK Regulation No.18/POJK.04/2014 on Integrated Governance for Financial Conglomerates.
8	Further strengthen the enforcement of credit and risk management regulations.	OJK has issued a payment holiday and guidelines for accounting treatment, especially in the application of PSAK 71-Financial Instruments (IFRS 9) and PSAK 68-Fair Value Measurement, in light of the COVID-19 pandemic which has caused global and domestic economic uncertainty and significantly influenced the judgment of entities in preparing financial reports. Along with additional instructions issued by the Financial Accounting Standards Board—Indonesian Institute of Accountants—the guidelines were stipulated by No.11/POJK.03/2020.
9	Revise the insurance supervisory framework (three-strikes approach) to allow prompt actions.	FSAP recommendation has been implemented on April 17, 2017 through issuance of OJK Regulation Number 17/POJK.05/2017 concerning the imposition of administrative sanctions in the form of revocation of business license without prior imposition of other administrative sanctions, in cases where there is a drastic deterioration of financial conditions, shareholders are not cooperative and no way of solving the problems that endanger the interests of policyholders, the insured, or the participants.
	Governance of financial conglomerates (FCs)	
10	Strengthen corporate governance practices within the financial system, including the boards of commissioners' oversight roles and responsibilities.	OJK has issued a regulation that sets general principle of governance to be adopted by FCs. The regulation not only stipulates the principle of governance for lead entity of FCs, but also other financial institutions as conglomerations' members.
11	Introduce legal provisions for licensed non-operating financial holding companies.	At this time the discussion of the amendment of OJK Law has been included in Prolegnas 2020–24.

Table 11. Indonesia: Key FSAP Recommendations (Concluded)

	Key Recommendations	Authorities' Actions
	Crisis management and resolution, and safety nets	
12	Revise the PPKSK Law to clarify the role of the Financial System Stability Committee (KSSK) as solely a coordination body; limit the involvement of the President to approving public funding.	Given the lengthy protocols entailed and potential political interests involved in an amendment of the Law, the authorities are carefully evaluating the best option to achieve the desired outcomes.
13	Adjust the emergency liquidity assistance (ELA) framework to ensure it is effective.	Indonesia has issued Law Number 2 Year 2020, which provides stronger mandates for BI in relation to ELA, either in the forms of (i) short-term liquidity assistance (Pinjaman Likuiditas Jangka Pendek/PLJP) for all banks; and (ii) special liquidity assistance (Pinjaman Likuiditas Khusus/PLK) for systemic banks. Following the issuance of the Law, BI has amended its regulation on PLJP, with two main amendments: (i) BI Regulation Number 22/5/PBI/2020 in April 2020 which includes provisions regarding requirements for banks to obtain liquidity assistance, collateral, and application documents; and (ii) BI Regulation Number 22/15/PBI/2020 in September 2020 which includes provisions regarding interest rate, collateral, bank preparations prior to the application, application documents, post-approval process, and default conditions. Several adjustments were made to enhance the accessibility of PLJP such as lowering interest rate (rate of BI lending facility plus 100 bps), reducing the number of criteria of loan assets (from 11 criteria to 8), as well as allowing restructured loan assets and building or land assets to be calculated as collateral with specific conditions. Under the new regulation, OJK is now fully responsible for defining solvency and bank rating criteria. Hence, BI will no longer set pre-determined criteria for solvency and bank rating. Collateral for PLJP must be valued and verified by independent experts, up to 3 months before the application. In accordance to the Law Number 2 of 2020, any provision of PLK for systemic bank requires prior approval from KSSK. Furthermore, PLK shall be given to a systemic bank that has yet to recover from liquidity problems despite having received PLJP and will be guaranteed by the government. Currently, government regulation related to PLK is on discussion process among MoF, BI, OJK, and LPS.
14	Amend the relevant laws to ensure that resolution powers can be exercised over FCs.	The authorities have initiated internal discussions regarding this issue. Resolution power over FCs is amongst the topics to be discussed and considered in the amendment of LPS Law.
15	Develop resolution options and implementation guidelines for banks, and resolvability assessment and resolution planning frameworks for D-SIBs.	LPS, OJK, BI, MoF, and Secretariat of the KSSK have established a working group regarding resolution issues. LPS is developing a comprehensive resolution framework that sets out guidance on the selection and implementation of resolution options, supported by World Bank technical assistance.
	Financial integrity	
16	Integrate key money laundering or terrorist financing (ML/TF) risks in the priorities and operations of relevant agencies.	The National Committee of Prevention and Eradication of the Criminal Act of Money Laundering (NCC) has established the National AML/CFT Strategy 2020. Responding to Financial Action Task Force (FATF) publication concerning the Risk and Policy Responses on COVID-19 related Money Laundering and Terrorist Financing, BI issued a policy in 2020 on the use of digital signatures for onboarding customers for credit cards, issued Customer Due Diligence (CDD) Guidelines, including electronics CDD for the expansion of digital payment adoption. Furthermore, BI has submitted a letter to Non-Bank Payment System Service Providers and Non-Bank Foreign Exchange Service Providers on April 3, 2020 regarding the risks as a result of COVID-19 and issued guidelines for remote supervision.
17	Finalize and implement risk-based anti-money laundering and counter financing of terrorism (AML/CFT) supervisory tools.	In 2020, OJK has implemented risk-based AML/CFT supervision effectively and consistently, using RBS Tools that had been enhanced in 2019. BI has issued guidelines for the implementation of risk-based AML-CFT based on FATF recommendations in the area of payment system sector. During period of 2019–20, BI disseminated and implemented risk assessments at the national, regional and sectoral levels as a reference for payment system service providers in implementing AML-CFT policies. This is also monitored by the BI supervisory team both at the head office and in the regions using a risk-based approach. In 2020, BI has conducted risk rating of payment system providers, foreign exchange providers and money transfer providers, as well as performed joint-audits with Indonesia Financial Transaction Reports and Analysis Centre over several foreign exchange service and money transfer providers.
	Financial deepening and inclusion	
18	Develop an integrated roadmap for promoting financial deepening and inclusion.	In 2018, BI, MOF and OJK has launched the National Financial Market Development and Deepening Strategy (SN-PPPK) which also involves LPS as a non-voting member in October 2019. The strategy has been divided into three implementation stages or phases, namely Strengthening the Foundations (2018–19), Acceleration (2020–22) and Deepening period (2023–24). The Foundation Phase was passed. BI has successfully implemented the following programs: (i) Expanded the participation of financial services institutions in repo market and educated money market players concerning repo transactions, certificates of deposit and commercial paper in the money market; (ii) Stimulated the increase of Appointed Cross Currency Dealer banks (ACCD) transaction volume with respect to the existing Local Currency Settlement (LCS) scheme, while expanding the LCS scheme to other major trading partner countries in the forex market; (iii) Increased the scale and outreach of the capacity building for Foreign Currencies against Rupiah transactions regulation program in conjunction with financial institution associations, domestic banks, exporter-importer associations and other stakeholders; (iv) Revised the domestic non-deliverable forward (DNDF) regulation in order to increase the transaction volume in both supply and demand side; (v) Regulated the market operators (money brokers, systematic internalizes and electronic trading platform for FX and money market) to develop financial market infrastructure; (vi) Released regulation of central counterparty establishment for FX and money market transaction clearing; (vii) Strived to expand the implementation of treasury certificates and a code of conduct for all treasury dealer on FX market and money market. An update of the SN-PPPK is in progress and will be launched shortly.
19	Enhance bond yield curve by consolidating debt issuance and improving secondary markets.	MoF has been implementing strategies to increase the liquidity of its debt instruments, supported by IMF technical assistance. To develop the secondary bond market, Indonesian Government Bond Futures has been developed to provide hedging for market players.

Table 12. Integrating Fund Surveillance and Capacity Development

Area	Surveillance Recommendations	Capacity Development Recent Actions/Plans
Monetary policy and central bank communication	Clear and focused communication on monetary and financial policy is critical, especially during times of financial stress	The Fund provided technical assistance covering communication on monetary policy and financial stability.
Statistics	Use of big data for timely economic monitoring could support prompt policy decision making.	The Fund provided technical assistance on the use of big data to develop an enhanced residential property price index and on developing the integrated sectoral accounts and balance sheets statistics. The Fund also provided virtual-format assistance on expanding the coverage of the producer price index to include additional service activities.
Tax policy and administration	Implement a medium-term revenue strategy (MTRS) to raise revenue by at least 3 percent of GDP over five years to finance spending on infrastructure, education, and health.	The Fund provided technical assistance in August 2017 to set a strategy, which includes specific recommendations on tax policy and administration reforms.
Public financial management	Improve fiscal governance, including infrastructure governance and public investment management.	The Fund conducted Indonesia's PIMA in February 2019, which lists priority actions to improve public investment management, and a Public Sector Balance Sheet Analysis in October 2019.
Financial sector	Improve financial oversight, crisis management framework, and the monitoring of corporate vulnerabilities.	The Fund provided technical assistance on financial conglomerate supervision, risk-based supervision, financial crisis management, and on strengthening bank and corporate stress testing frameworks and systemic risk analysis
Financial sector supervision during COVID-19	Preparation and timely implementation of financial regulatory and supervisory response to the pandemic.	The Fund provided technical assistance on financial supervision, IFRS9 implementation and supervisory treatment under COVID-19.

Appendix I. Risk Assessment Matrix[1]

	Source of Risks	Likelihood	Expected Impact	Policy Recommendation
Global	**Unexpected shift in the COVID-19 pandemic**			
	• Prolonged pandemic 1/	Medium	**High.** Larger economic scarring effects (e.g., higher structural unemployment and persistent underinvestment); a decline in capital inflows, leading to currency depreciation and tighter domestic credit conditions; higher poverty rate.	Fiscal stance should be loosened further in 2021. Monetary and macroprudential policies should be loosened further. The exchange rate should remain flexible and market driven.
	• Faster containment 2/	Medium	**Medium-High**. Investment and employment recover; capital inflows resume, leading to currency appreciation and easier domestic credit conditions.	Accelerate the implementation of the MTRS. Increase infrastructure investment and social spending. Monetary policy should be on hold or gradually tightened in line with the inflation outlook. Regulatory relief measures should be let expire.
	• Asynchronous progress 3/	Medium	**Medium**. Higher volatility in global financial markets leads to currency depreciation and slower capital inflows or outflows. Exports to economies at advanced stages of vaccination increase.	Expedite the inoculation of COVID-19 vaccines. Additional government support measures to viable firms should be considered.
	Sharp rise in global risk premia exposes financial and fiscal vulnerabilities. 4/	Medium	**High**. Lower GDP growth; larger economic scarring effects; a decline in capital inflows, leading to currency depreciation and further tightening of domestic credit conditions.	Fiscal stance should be loosened further in 2021. Monetary and macroprudential policies should be loosened further. The exchange rate should remain flexible and market driven.
	Accelerating de-globalization 5/	Medium	**Medium**. Weaker exports; reduced FDI inflows; increased uncertainty leading to weaker investment.	Augment trade liberalization efforts within the ASEAN region. Accelerate structural reforms aimed at promoting competition and financial deepening.
Domestic	**Sharper deterioration in banks' asset quality and funding positions** Provision of credit is significantly impaired by larger-than-expected COVID-19-related credit losses and the expected weakening of nonfinancial firms' debt service capacity.	Medium to High	**High**. Lower GDP growth; larger economic scarring effects; a decline in capital inflows, leading to currency depreciation and further tightening of domestic credit conditions.	Solvency and capital adequacy issues should be recognized and addressed upfront. Banks should start provisioning against credit losses even under the relaxed loan standards, which will be critical for banks' ability to weather the deterioration in asset quality.
	Natural disasters Major natural disasters (e.g., volcano eruptions and/or earthquakes) disrupt economic activity and affect sentiment, resulting in higher fiscal expenditure.	Medium	**Low**. Disruption in economic activity in the affected region; slower economic growth accompanied by a decline in portfolio inflows.	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 disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable. For countries with policy space, prolonged support—while needed to cushion the economy—exacerbates stretched asset valuations, fueling financial vulnerabilities. For those with limited space, especially EMs, policy support is insufficient.

[2] Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity.

[3] Limited access to, and longer-than-expected deployment of, vaccines in some countries—combined with dwindling policy space—prompt a reassessment of their growth prospects (for some Emerging and Frontier Markets triggering capital outflows, depreciation and inflation pressures, and debt defaults).

[4] A reassessment of market fundamentals (e.g., in response to adverse Covid-19 developments) triggers a widespread risk-off event. Risk asset prices fall sharply and volatility spikes, leading to significant losses in major nonbank financial institutions. Higher risk premia generate financing difficulties for leveraged firms (including those operating in unviable activities) and households, and a wave of bankruptcies erode banks' capital buffers. Financing difficulties extend to sovereigns with excessive public debt, leading to cascading debt defaults.

[5] Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation. Reshoring and less trade reduce potential growth.

[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 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 and 30 percent, and "high" a probability between 30 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.

Appendix II. External Assessment

Overall Assessment: On a preliminary basis, and adjusting for transitory factors, recent developments suggest that the external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies. However, this assessment is highly uncertain given the lack of full-year data for 2020 and the COVID-19 crisis, and a complete analysis will be provided in the 2021 External Sector Report. Exchange rate flexibility and structural policies should help contain the current account deficit over the medium-term. External financing needs appear sustainable. However, they are sizeable, and with a large share of foreign portfolio investment, they expose the economy to fluctuations in global financial conditions.

Potential Policy Responses: Maintaining external balance will require structural reforms to boost competitiveness. Reforms should include higher infrastructure and social spending aimed at fostering human capital development (while maintaining fiscal sustainability through revenue mobilization); fewer restrictions on FDI and external trade (nontariff trade barriers), and labor market flexibility (e.g., streamlining stringent job protection, improving job placement services). Flexibility of the exchange rate should continue to support external stability in a context of increased market volatility associated with the COVID-19 pandemic.

Foreign Asset and Liability Position and Trajectory

Background. At end of September 2020, Indonesia's net international investment position (NIIP) was −24 percent of GDP, improving from −30 percent at the end of 2019. The improvement in the NIIP is mainly explained by a decline of 4.5 percentage points of GDP in portfolio equity liabilities. In September 2020, gross external assets reached 34.5 percent of GDP (of which, 35 percent were reserve assets) and gross external liabilities, 58 percent of GDP. Indonesia's gross external debt was moderate at 38 percent of GDP at end-September 2020 and 84 percent was maturing after one year.

Assessment. The level and composition of the NIIP and gross external debt indicate that Indonesia's external position is sustainable and subject to limited roll-over risk. The share of nonresident holdings of rupiah denominated government bonds declined from 38 percent of the total stock at the end of 2019 to 27 percent (or 5.6 percent of GDP) at end-September 2020 but remains sizeable, making Indonesia vulnerable to global financial volatility, higher U.S. interest rates, and a stronger U.S. dollar. Staff projections for the current account suggest that the NIIP as a percent of GDP will continue to strengthen over the medium term.

2020:Q3 (% GDP)	NIIP: −23.7	Gross Assets: 34.5	Res. Assets: 12.1	Gross Liab.: 58.2	Debt Liab.: 34.3

Current Account

Background. Indonesia's current account deficit narrowed to 2.7 percent of GDP in 2019, from a 2.9 percent deficit in 2018, driven mainly by weak import growth. On a cumulative basis as of the third quarter of 2020, the current account deficit narrowed compared to 2019 as the softening in domestic demand led to an import contraction that more than compensated the decline in exports that was associated with low commodity prices and a weak external demand. The CA deficit is projected to narrow to 0.5 percent in 2020, driven by a contraction in domestic demand and imports, partly compensated by the negative impact on tourism of the COVID-19 pandemic. Structural policies are expected to help limit the current account deficit in the medium-term.

Assessment. Staff estimates a CA gap of 0.9 percent for 2020, consistent with an estimated cyclically adjusted CA deficit of −0.7 percent of GDP and a staff-assessed norm of −0.5 percent of GDP.[1] Considering uncertainties in the estimation of the norm, the CA gap for 2020 is in the range of −0.6 percent to 2.4 percent of GDP.[2] Maintaining external balance will require structural reforms to strengthen health, education, infrastructure, and increase labor market flexibility, which is consistent with the suggested room for higher fiscal spending identified by the policy gaps.

2020 (% GDP)	Actual (Proj.) CA: −0.5	Cycl. Adj. CA: −0.7	EBA CA Norm: −0.5	EBA CA Gap: -0.2	Staff Adj.: 1.06	Staff CA Gap: 0.9

Real Exchange Rate

Background. In 2019, the average REER appreciated by 4.3 percent relative to the 2018 average, following an easing of global financial conditions and an inflow of capital. With the COVID-19 shock, the REER depreciated by about 10 percent between February and April, before recovering towards the middle of the year. As of October 2020, the REER had depreciated by 1.3 percent compared to the 2019 average.

Assessment. The REER index and level REER models point to 2020 REER gaps of about 4.9 percent to −6.8 percent respectively, with an upward shift in the range of the estimated gaps compared to 2019. Meanwhile, the staff CA gap estimate of 0.9 percent of GDP implies an REER gap of −4.8 percent with standard elasticities.[3] In staff's assessment, the EBA Index and CA models are most relevant for Indonesia. Considering all inputs as well as the REER moderate depreciation in 2020, staff assesses the REER gap in the −4.9 to 5.1 percent range, with a midpoint of -0.3 percent.[4]

Capital and Financial Accounts: Flows and Policy Measures

Background. In 2019, net capital and financial account inflows (3.3 percent of GDP) were sustained by net FDI inflows (1.8 percent of GDP), net portfolio inflows (1.9 percent of GDP), and net other investment inflows of -0.5 percent of GDP. Starting in March 2020, Indonesia faced large capital outflows from the sales of rupiah denominated securities by nonresident investors, although these outflows were largely offset by inflows from the subsequent issuance of foreign currency denominated government bonds.

Assessment. Net and gross financial flows continue to be prone to periods of volatility. The broadly contained current account deficit and strengthened policy frameworks, including exchange rate flexibility since mid-2013 have helped reduce capital flow volatility. Continued strong policies, focused on safeguarding the fiscal position, keeping inflation in check, advancing financial deepening and easing supply bottlenecks would help sustain capital inflows in the medium term.

FX Intervention and Reserves Level

Background. Since mid-2013, Indonesia has had a more flexible exchange rate policy framework. At end-2019, reserves were US$129.2 billion, compared with US$120.7 billion at end-2018. The reserve accumulation reflects mainly the net capital inflows and foreign exchange receipts from oil/gas and other sectors. In addition, contingencies and swap lines amounting to about US$95 billion are in place. In a context of increased market volatility associated with the COVID-19 pandemic, Bank of Indonesia (BI) intervened in the non-spot and spot FX markets in March and April 2020 and introduce daily FX swap auctions to ensure adequate market liquidity. International reserves recovered from April 2020 onward and reached US$136 billion in December 2020.

Assessment. The current level of reserves (equal to 12.5 percent of GDP, about 121 percent of the IMF's reserve adequacy metric, and about 8 months of prospective imports of goods and services) should provide sufficient buffer against a wide range of possible external shocks, with predetermined drains also manageable. Exchange rate flexibility should continue to play its role as a shock absorber. If external pressures result in disorderly market conditions in the exchange rate market, the use of FXI can be appropriate to mitigate the negative impact on balance sheet exposures.

1/ The 2020 assessment includes an adjustment for tourism and oil sectors for all countries to account for the temporary impact of the crisis. For Indonesia, these adjustors are -0.27 percentage points and 0.11 percentage points, respectively, leading to an adjustment of 0.16 percentage points of GDP. As Indonesia is among the few outlier countries regarding adult mortality rates, the demographic indicators are adjusted to account for the younger average prime age and exit age from the workforce. This results in an adjustor of 0.9 percentage point being applied to the model-estimated CA norm. The sum of these adjustments is equal to 1.06 percentage points of GDP.
2/ A range of ±1.5 percent is added to reflect the fact that the EBA regression estimates are subject to normal uncertainty (the standard error of the EBA norm is 1.3 percent).
3/ The semi-elasticity of CA/GDP with respect to REER, based on trade adjustment, is estimated to be −0.18 for Indonesia.
4/ The mid-point of the REER range is calculated by taking the average of the estimated gap from the EBA index model (i.e., 4.9 percent) and the REER gap implied by the staff CA gap estimate of 0.9 percent of GDP (i.e., −4.8 percent). To obtain the width of the range for the REER gap, the standard +/-5 percent interval was applied to the midpoint of 0.1 percent, leading to a range of −4.9 to 5.1.

Appendix III. Debt Sustainability Analysis

Indonesia's external and public debt remain 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. The reduction in nonresident participation in the local currency bonds markets has contributed to a reduction of vulnerabilities, but the reliance on foreign investors remains sizable.

External Debt Sustainability

1. **Indonesia's external debt has remained broadly stable in recent years**. External debt reached 36.1 percent of GDP in 2019, about the same level as in 2018 when it was 36.0 percent of GDP. General government external debt remained stable, only showing a small shift in its composition, with a small increase in the share of internationally issued bonds compensated by a decline in the holdings of domestic bonds by nonresidents. External debt is estimated to have increase to 38.3 percent of GDP by end-2020 (Figure 1 and Table 1), driven mainly by an increase in government borrowing.

2. **External debt is projected to gradually decline in the medium term**. In the baseline scenario, external debt would reach 35 percent of GDP in 2025, reflecting lower needs to finance the declining current account and fiscal deficits.

3. **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 38 percent of GDP by 2025). Exchange rate depreciation would have the largest impact—a 30 percent depreciation in 2021 would raise external debt to 53.6 percent of GDP in 2021 and it would remain above 49 percent of GDP until 2025.

Public Debt Sustainability

4. **Indonesia's public sector debt remains low**. General government debt has declined steadily from 87 percent of GDP in 2000 to 30.6 percent in 2019, owing to a prudent fiscal stance that has been anchored by fiscal rules since 2003.[1] On the composition of debt, foreign-currency denominated debt stays at about 38 percent. Dependence on foreign investors remains sizable, with nonresidents holding around 58 percent of general government debt.

5. **Public sector debt is projected to stabilize at around 41 percent of GDP over the medium term** (Figure 3). The fiscal rule is suspended for 2020−22. The baseline scenario envisages the general government deficit to increase up to 5.9 percent in 2021 before declining to 2.3 percent of GDP over the medium term. The primary deficit is estimated to reach 4.0 percent of GDP in 2021, and thereafter converging to 0.5 percent over the medium term. Despite a negative interest rate-

[1] The rules cap general government deficit at 3 percent of GDP and debt at 60 percent.

growth differential (of around −1.3 percent) over the medium term, public debt would rise from 35.7 percent in 2020 to around 41.3 percent of GDP in 2025, mainly driven by the relatively higher primary deficits. Gross financing needs are expected to remain moderate, gradually falling from a peak of 8.3 percent of GDP in 2020 to around 4.8 percent of GDP in 2025.

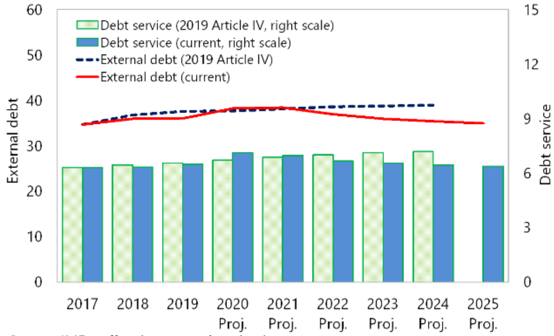
6. Public debt dynamics are robust to both standard shocks and stress tests (Figures 4 and 5). Even under the most severe scenario with a combined macro-fiscal shock, total government debt would stabilize at around 48.4 percent of GDP or 359.7 percent of revenue by 2025, while gross financing needs would gradually decline to around 6.1 percent of GDP. Nonetheless, fiscal risks arising from potentially weaker-than-expected revenue, expanding balance sheets of SOEs, and PPPs, will need to be managed carefully, especially as the recovery could be slower than projected in the baseline.

Authorities' Views

7. The authorities agreed with the external and public debt sustainability analysis.

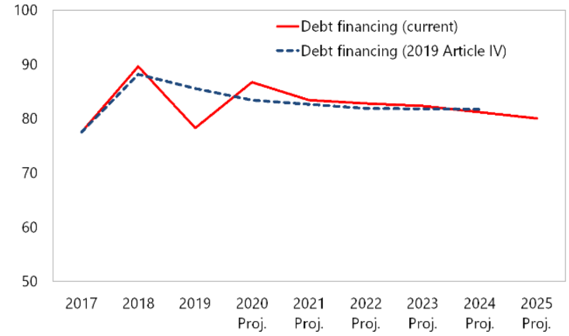
Figure 1. Indonesia: External Debt and Debt Service

Indonesia: External Debt Projections, 2017-25
(In percent of GDP)



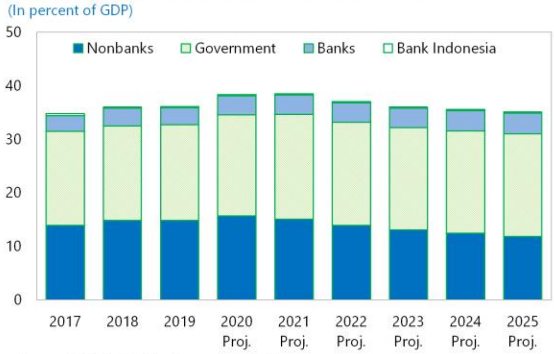
Source: IMF staff estimates and projections.

Indonesia: Debt Financing, 2017–25
(In percent of the gross external financing requirement)



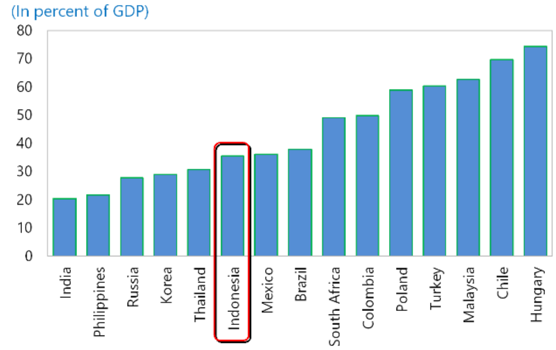
Source: IMF staff estimates and projections.

Indonesia: Composition of External Debt, 2017-25
(In percent of GDP)



Source: IMF staff estimates and projections.

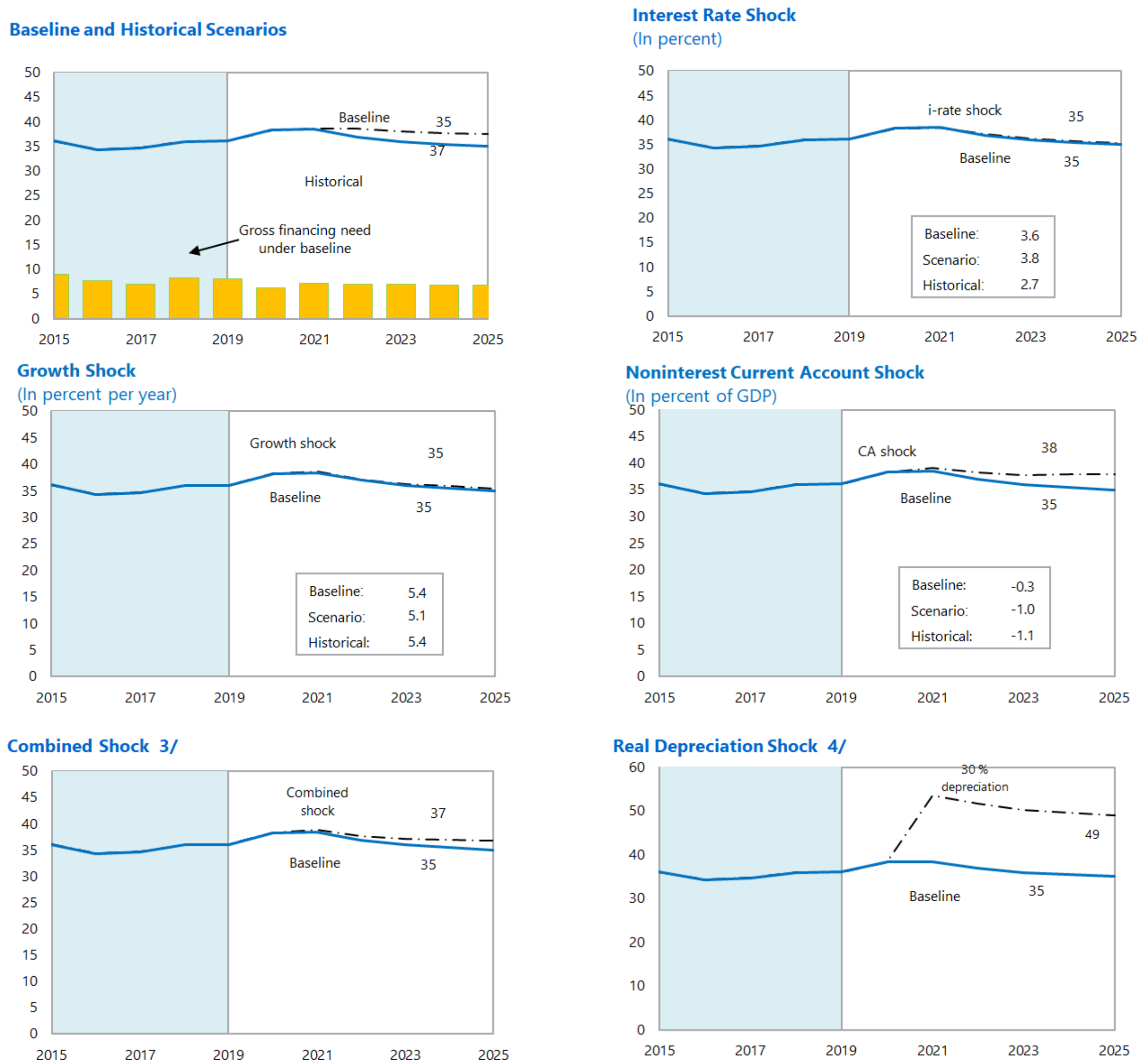
External Debt, 2019
(In percent of GDP)



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 2021.

Table 1. Indonesia: External Debt Sustainability Framework, 2015–2025

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2015	2016	2017	2018	2019			2020	2021	2022	2023	2024	2025	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	36.1	34.3	34.7	36.0	36.1			38.3	38.5	37.0	36.0	35.5	35.0	-2.5
2 Change in external debt	3.2	-1.8	0.4	1.3	0.1			2.2	0.2	-1.5	-1.0	-0.5	-0.5	
3 Identified external debt-creating flows (4+8+9)	1.6	-2.8	-2.8	0.8	-1.5			0.4	-1.4	-1.7	-1.5	-1.5	-1.6	
4 Current account deficit, excluding interest payments	1.1	0.9	0.6	1.9	1.6			-0.8	0.2	0.4	0.4	0.4	0.3	
5 Deficit in balance of goods and services	0.6	0.9	1.1	-0.6	-0.4			1.5	0.8	0.6	0.6	0.6	0.7	
6 Exports	19.9	18.0	19.1	20.3	17.9			16.0	18.7	18.1	18.2	18.6	19.1	
7 Imports	-19.3	-17.1	-18.0	-21.0	-18.2			-14.5	-17.8	-17.5	-17.6	-18.0	-18.4	
8 Net nondebt creating capital inflows (negative)	-1.1	-1.9	-1.6	-0.8	-1.8			-0.8	-1.2	-1.2	-1.2	-1.3	-1.3	
9 Automatic debt dynamics 1/	1.5	-1.8	-1.9	-0.2	-1.3			2.1	-0.4	-0.8	-0.7	-0.6	-0.5	
10 Contribution from nominal interest rate	0.9	0.9	0.9	1.1	1.1			1.3	1.3	1.2	1.2	1.2	1.2	
11 Contribution from real GDP growth	-1.7	-1.7	-1.6	-1.7	-1.7			0.7	-1.7	-2.1	-1.9	-1.8	-1.7	
12 Contribution from price and exchange rate changes 2/	2.3	-1.1	-1.3	0.5	-0.8			...	...	...	...	...	...	
13 Residual, including change in gross foreign assets (2-3) 3/	1.6	1.0	3.2	0.5	1.6			1.8	1.6	0.2	0.5	1.0	1.1	
External debt-to-exports ratio (in percent)	181.3	190.7	181.5	177.1	202.1			240.0	206.2	204.2	197.7	190.4	183.2	
Gross external financing need (in billions of U.S. dollars) 4/	76.8	72.5	70.9	85.5	90.6			68.4	83.2	90.7	97.8	102.4	107.5	
In percent of GDP	8.9	7.8	7.0	8.2	8.1			6.3	7.2	7.0	7.0	6.8	6.7	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	38.3	38.6	38.6	38.0	37.7	37.5	-3.1
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	4.9	5.0	5.1	5.2	5.0	5.4	0.6	-1.9	4.8	6.0	5.6	5.3	5.2	
GDP deflator in U.S. dollars (change in percent)	-7.9	3.1	3.7	-2.4	2.3	1.7	9.5	-1.0	1.9	5.0	2.3	1.8	1.8	
Nominal external interest rate (in percent)	2.6	2.8	3.0	3.2	3.4	2.7	0.4	3.6	3.6	3.6	3.6	3.6	3.6	
Growth of exports (U.S. dollar terms, in percent)	-13.8	-2.1	15.7	9.1	-5.6	5.0	13.9	-13.2	24.9	8.0	8.7	9.7	9.8	
Growth of imports (U.S. dollar terms, in percent)	-17.8	-3.9	14.5	19.6	-6.5	7.4	16.4	-23.0	31.5	9.2	8.8	9.5	9.5	
Current account balance, excluding interest payments	-1.1	-0.9	-0.6	-1.9	-1.6	-1.1	1.3	0.8	-0.2	-0.4	-0.4	-0.4	-0.3	
Net nondebt creating capital inflows	1.1	1.9	1.6	0.8	1.8	1.5	0.4	0.8	1.2	1.2	1.2	1.3	1.3	

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)

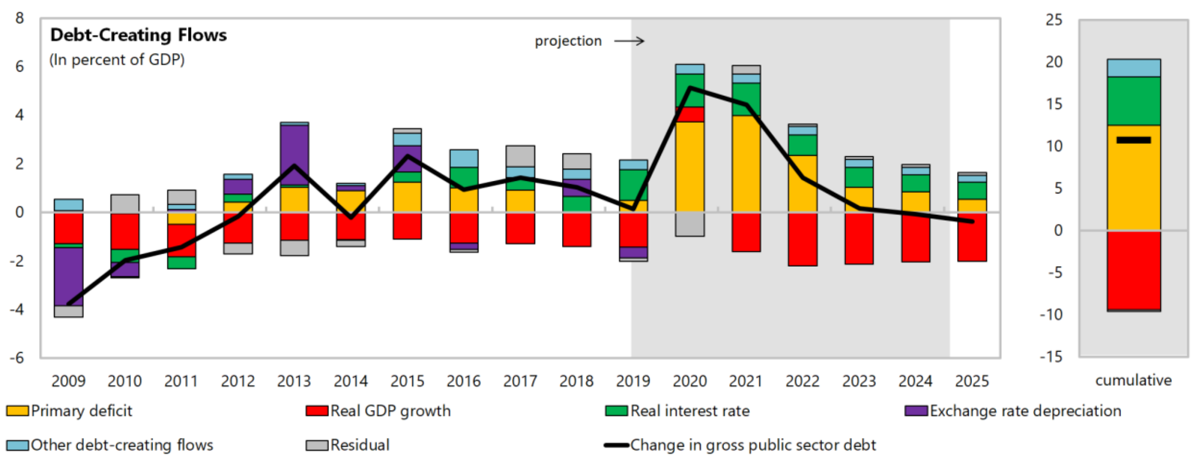
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2009-2017 [2/]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	25.7	30.4	30.6	35.7	40.1	41.6	41.7	41.7	41.3
Public gross financing needs	3.8	4.0	4.1	8.3	8.0	6.2	7.1	6.1	4.8
Real GDP growth (in percent)	5.4	5.2	5.0	-1.9	4.8	6.0	5.6	5.3	5.2
Inflation (GDP deflator, in percent)	5.1	3.8	1.6	2.0	2.0	3.0	2.9	2.8	2.8
Nominal GDP growth (in percent)	10.8	9.2	6.7	0.0	6.9	9.1	8.6	8.2	8.2
Effective interest rate (in percent) [4/]	5.8	6.5	6.1	6.4	6.1	5.5	5.2	4.8	4.8

As of October 16, 2020		
Sovereign Spreads		
EMBIG (bp) 3/		209
5Y CDS (bp)		95
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB	BBB

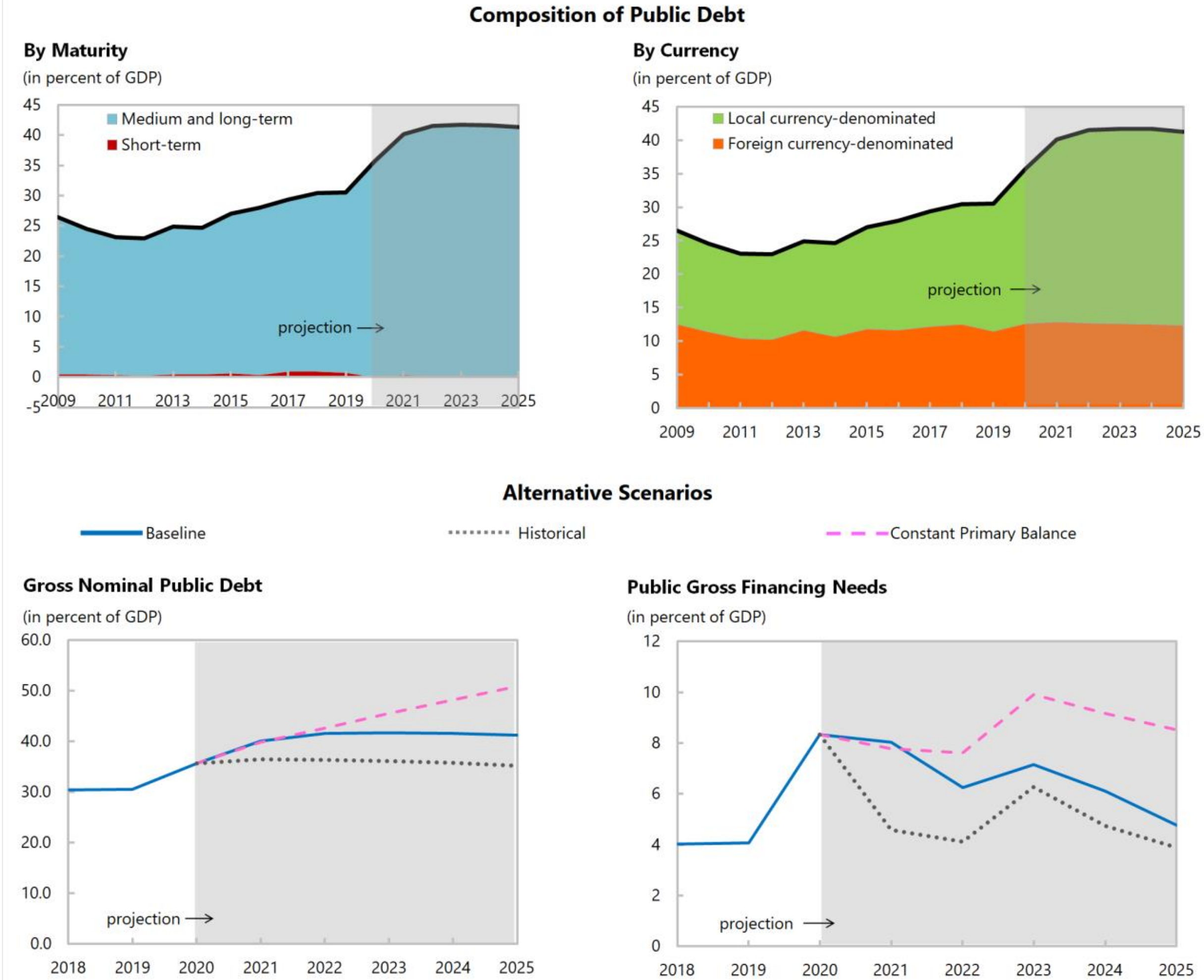
Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.1	1.0	0.1	5.1	4.4	1.4	0.2	-0.1	-0.4	10.7	-1.0
Identified debt-creating flows	-0.1	0.4	0.3	6.1	4.1	1.4	0.0	-0.2	-0.5	10.9	
Primary deficit	0.6	0.0	0.5	3.7	4.0	2.3	1.0	0.8	0.5	12.5	
Primary (noninterest) revenue and grants	15.8	14.9	14.2	12.1	12.1	12.5	13.0	13.3	13.5	76.4	
Primary (noninterest) expenditure	16.3	14.9	14.6	15.8	16.1	14.8	14.0	14.1	14.0	88.8	
Automatic debt dynamics [5/]	-1.0	-0.1	-0.6	2.0	-0.3	-1.3	-1.3	-1.3	-1.3	-3.6	
Interest rate/growth differential [6/]	-1.2	-0.7	-0.2	2.0	-0.3	-1.3	-1.3	-1.3	-1.3	-3.6	
Of which: real interest rate	0.1	0.7	1.3	1.4	1.3	0.9	0.8	0.7	0.7	5.8	
Of which: real GDP growth	-1.3	-1.4	-1.4	0.6	-1.6	-2.2	-2.1	-2.0	-2.0	-9.4	
Exchange rate depreciation [7/]	0.1	0.7	-0.4	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.3	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	2.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
SOE recapitalization and land acquisition	0.3	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	2.0	
Residual, including asset changes [8/]	0.0	0.6	-0.2	-1.0	0.3	0.1	0.1	0.1	0.1	-0.2	



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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (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



Underlying Assumptions

(in percent)

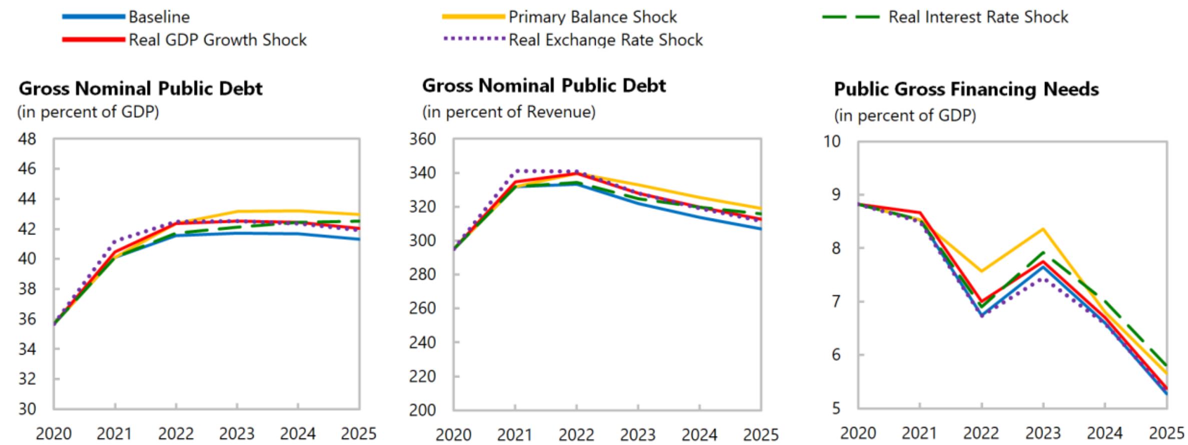
Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-1.9	4.8	6.0	5.6	5.3	5.2
Inflation	2.0	2.0	3.0	2.9	2.8	2.8
Primary Balance	-3.7	-4.0	-2.3	-1.0	-0.8	-0.5
Effective interest rate	6.4	6.1	5.5	5.2	4.8	4.8
Constant Primary Balance Scenario						
Real GDP growth	-1.9	4.8	6.0	5.6	5.3	5.2
Inflation	2.0	2.0	3.0	2.9	2.8	2.8
Primary Balance	-3.7	-3.7	-3.7	-3.7	-3.7	-3.7
Effective interest rate	6.4	6.1	5.5	5.2	4.8	4.8

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-1.9	5.4	5.4	5.4	5.4	5.4
Inflation	2.0	2.0	3.0	2.9	2.8	2.8
Primary Balance	-3.7	-0.5	-0.5	-0.5	-0.5	-0.5
Effective interest rate	6.4	6.1	5.4	4.9	4.3	4.1

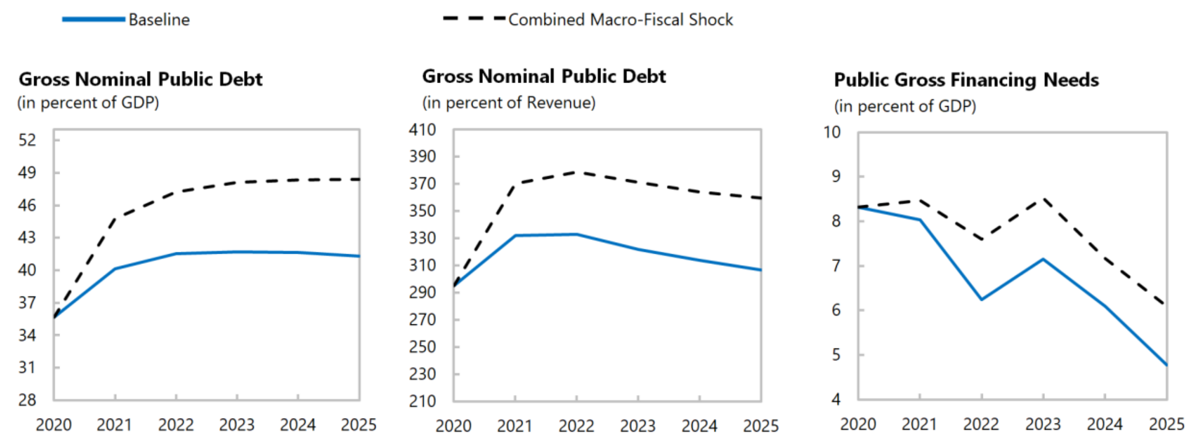
Source: IMF staff.

Figure 5. Indonesia: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2020	2021	2022	2023	2024	2025
Primary Balance Shock						
Real GDP growth	-1.9	4.8	6.0	5.6	5.3	5.2
Inflation	2.0	2.0	3.0	2.9	2.8	2.8
Primary balance	-3.7	-4.0	-3.2	-1.7	-0.9	-0.7
Effective interest rate	6.4	6.1	5.5	5.2	4.9	4.8
Real Interest Rate Shock						
Real GDP growth	-1.9	4.8	6.0	5.6	5.3	5.2
Inflation	2.0	2.0	3.0	2.9	2.8	2.8
Primary balance	-3.7	-4.0	-2.3	-1.0	-0.8	-0.5
Effective interest rate	6.4	6.1	5.9	5.9	5.8	5.9
Combined Shock						
Real GDP growth	-1.9	4.3	5.4	5.6	5.3	5.2
Inflation	2.0	1.9	2.9	2.9	2.8	2.8
Primary balance	-3.7	-4.1	-3.2	-1.7	-0.9	-0.7
Effective interest rate	6.4	6.4	5.6	5.6	5.6	5.8

	2020	2021	2022	2023	2024	2025
Real GDP Growth Shock						
Real GDP growth	-1.9	4.3	5.4	5.6	5.3	5.2
Inflation	2.0	1.9	2.9	2.9	2.8	2.8
Primary balance	-3.7	-4.1	-2.5	-1.0	-0.8	-0.5
Effective interest rate	6.4	6.1	5.5	5.2	4.8	4.8
Real Exchange Rate Shock						
Real GDP growth	-1.9	4.8	6.0	5.6	5.3	5.2
Inflation	2.0	10.8	3.0	2.9	2.8	2.8
Primary balance	-3.7	-4.0	-2.3	-1.0	-0.8	-0.5
Effective interest rate	6.4	6.4	5.2	5.0	4.7	4.6

Source: IMF staff.

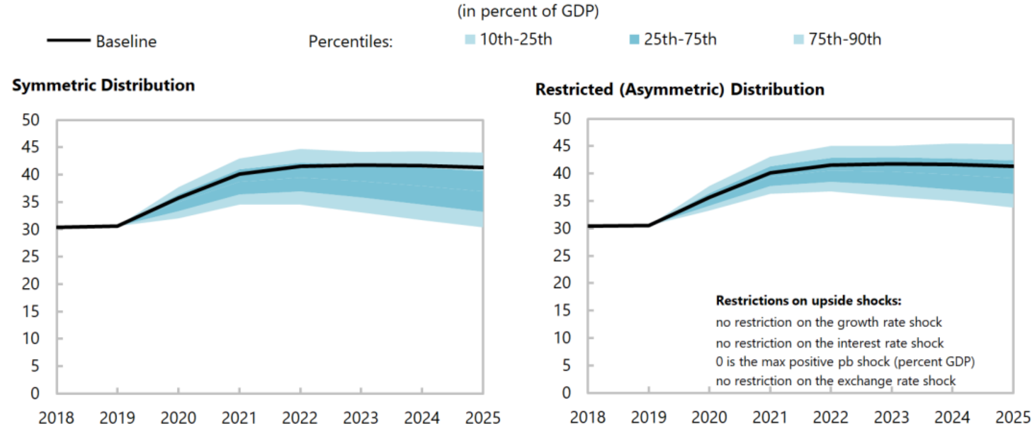
Figure 6. Indonesia: Public DSA—Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

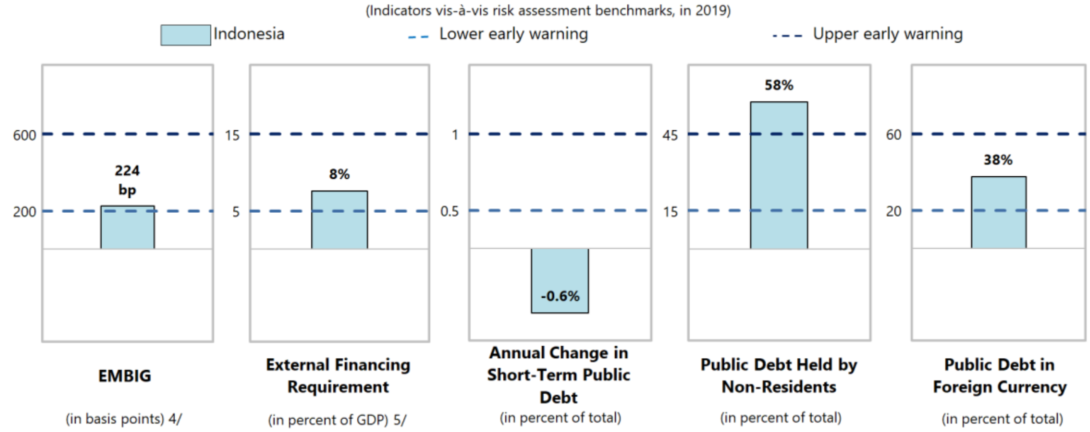
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2019)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 18-Jul-20 through 16-Oct-20.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

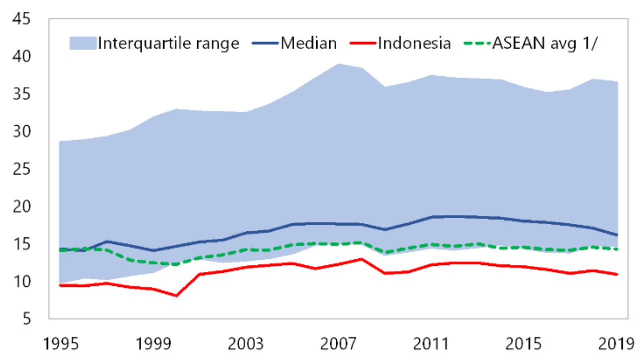
Appendix IV. Designing a Medium-Term Revenue Strategy for Stronger and More Sustainable and Inclusive Post-Pandemic Growth in Indonesia[1]

Indonesia is facing large spending needs in human capital, infrastructure and social safety nets that can only be fulfilled by a substantial and sustainable increase in revenue mobilization. The pandemic has exacerbated these needs, providing the opportunity for policymakers to mobilize stakeholders' support for a comprehensive Medium-Term Revenue Strategy (MTRS) that should complete the ongoing tax administration initiatives with the needed tax policy measures. This note discusses key reform priorities and shows that the design of an MTRS should start now for it to be ready for implementation once the recovery is firmly underway.

1. **The ratio of general government tax revenue to GDP in Indonesia is the lowest among G-20 countries and is trailing behind emerging market (EM) and ASEAN peers**. Averaging around 11 percent of GDP, the tax revenue to GDP ratio has been low and relatively flat over the last two decades. Moreover, it has been declining since 2014, primarily reflecting a decline in oil and gas tax revenue from an average of around 0.9 percent of GDP in 2010−2014 to 0.4 percent in 2015−2019. Tax revenue mobilization in Indonesia has also persistently underperformed compared to EM peers and other ASEAN countries.

Revenue mobilization is lagging EM peers, and has been decreasing in recent years.

Emerging Markets: Tax Revenue
(In percent of GDP)



Sources: IMF, *World Economic Outlook*; and IMF staff estimates.
1/ Indonesia, Philippines, Thailand, and Vietnam.

2. **The low government revenue reflects a narrow tax base, inefficient collection, weak compliance, and the complexity of the tax system**. The basic structure of the tax system and the headline rates of the most important taxes (corporate income tax, personal income tax, value added tax) are broadly in line with ASEAN peers. But weaknesses in the tax policy framework generate weaker revenue performance and create inefficiencies, leading to suboptimal outcomes, inequities, and complexities in administration and compliance. For example, the myriad of sector-based special regimes in the corporate income tax (CIT) system along with multiple discretionary incentives prevent a level playing field across sectors and firms, distorting factor allocation across sectors. High basic exemption threshold for the personal income tax (PIT) excludes a large share of the population, notably the growing middle class, from sharing the tax burden. A very long number of value-added tax (VAT)-exempt activities combined with an exceptionally high registration threshold partially explains the low VAT revenue, which have been declining as a percent of GDP since 2014.

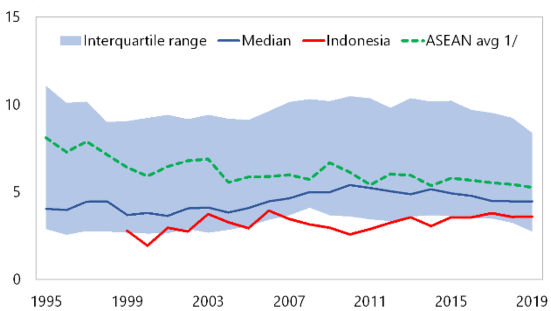
[1] Prepared by William Gbohoui (FAD).

Beyond their revenue effects, these exemptions distort production patterns, reduce welfare, and create breaks in the VAT chain which, in turn, reduces voluntary compliance. Moreover, Indonesia levies only 1.2 percent of GDP in excise revenue, mainly on tobacco, in contrast to other ASEAN countries where excise taxes on a broader range of products yield close to 2 percent of GDP. Simulations suggest that Indonesia could raise up to 0.3 percent of GDP by bringing the diesel excise to the ASEAN average (De Mooij and others, 2018).

3. Low government revenue intake has led to underinvestment both in public physical and human capital. Averaging around 3.6 percent of GDP in the last two decades, public investment has been low in Indonesia, and the gap with other ASEAN countries has been widening since 2015. Public expenditures in health and education also remain below other EM and ASEAN peers. Despite a strong commitment to achieve the Sustainable Development Goals (SDG), expenditure needs as of 2020 remain sizable across sector sectors, especially in health, infrastructure, and sanitation. Indonesia's water and sanitation SDG index is only 66.4 against 72.8 and 77.2 for the average among ASEAN countries and the median for EM peers, respectively. Indonesia is also trailing behind other EMs and ASEAN countries in terms of the SDG health index. Moreover, the lack of modern transport infrastructure is a major bottleneck for sustainable growth.

Public investment in infrastructure is low,...

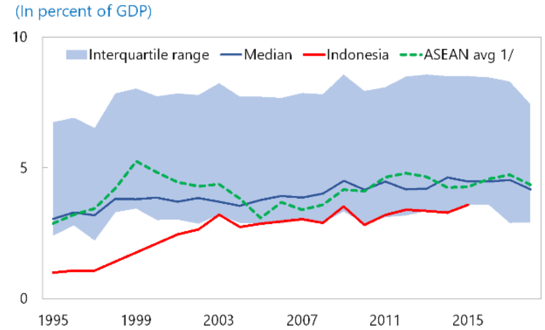
Emerging Markets: Public Investment
(In percent of GDP)



Sources: IMF, *World Economic Outlook*; and IMF staff estimates.
1/ Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

...as are public expenditures in education and...

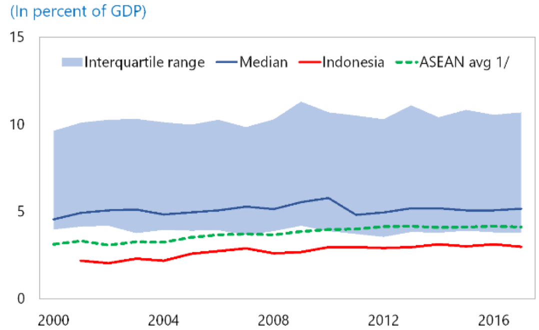
Emerging Markets: Education Expenditure
(In percent of GDP)



Sources: World Bank, *World Development Indicators*; and IMF staff estimates.
1/ Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

...health, where Indonesia is...

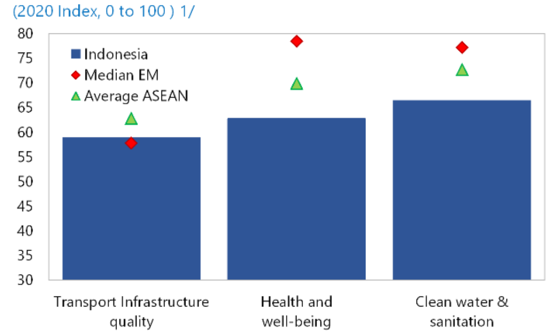
Emerging Markets: Health Expenditure
(In percent of GDP)



Sources: World Bank, *World Development Indicators*; and IMF staff estimates.
1/ Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

...trailing behind peers regarding the SDG.

Selected Sustainable Development Goals
(2020 Index, 0 to 100) 1/



Sources: Sachs and others (2020); and IMF staff estimates
1/ 0 indicates worst and 1 best.

4. **Substantially higher revenue mobilization is crucial for fostering long-term development in Indonesia**. Previous studies suggest that significant increases in public expenditures, both to invest in human capital (health and education) and to expand public infrastructure are necessary to unlock Indonesia's growth potential, to secure sustainable economic growth and to mitigate inequalities (see e.g., Kinda and Doumbia, 2019, AIPEG 2016, IMF 2016). Spending gaps analysis in 2018 estimated additional government spending needs, necessary to achieve SDGs, of up to 5½ percent of GDP per year, with health and road infrastructure accounting for two-thirds of the additional needs (IMF 2019). But with a very low revenue ratio, Indonesia does not have the debt capacity to accommodate such a large stepping-up of investment, despite relatively low debt to GDP ratio. Increasing revenue mobilization is then a critical prerequisite for Indonesia to afford the needed public expenditures.

5. **The tax-system reform underway lacks overarching coherence, which would be critical for success**. Several reforms of the tax system sought to enhance revenue performance in the past and generated mostly temporary increases in the tax revenue ratio. General government tax revenue to GDP ratio reached 12.5 percent in 2012, but fall subsequently, to 11 percent in 2019, around the same level as in 2001. While the ongoing reform initiated in 2017 had promising features, it has remained incomplete. So far, the authorities have mainly specified tax administration measures, reduced the corporate income tax rate, increased the excise on tobacco, extended VAT to imports of digital goods and services, and imposed an excise on plastic bags. But they have not taken the main measures needed for a coherent MTRS, especially in the tax policy domain. Also, the reform agenda lacks clearly identified specific initiatives in tax policy and administration to lift taxpayer compliance. Without addressing all the contributing factors to the low revenue intake, it is unlikely that the reform will succeed in achieving substantial revenue increases on a sustained basis.

6. **A medium-term revenue strategy could help increase the revenue intake**. The advantage of using a MTRS is that it would address all the root causes of the lower revenue performance and would provide for the overarching coherence across measures required for a successful revenue reform. An MTRS that builds on current tax administration initiatives (e.g., Core Tax project framework) and includes the additional steps, and tax reforms needed could substantially and sustainably increase revenue mobilization.[2] In that respect, previous IMF technical assistance has proposed a strategy, summarized in Table 1, involving both tax policy, tax administration, and institutional reforms, including changes to the legal framework. For instance:

- Priority tax policy measures encompass reducing VAT exemption to standard services like education, and healthcare, lowering the registration threshold, and later gradually increasing the rate. A uniform CIT rate should be applied to all corporations, discretionary incentives eliminated, and preferential treatment abolished while any revenue gain from these CIT measures could be used to reduce the CIT rate. The PIT structure should shift to an individual

[2] Baseline simulations suggest that a well-designed MTRS could increase revenue by to 5 percent of GDP over a period of 5 years (De Mooij and others 2018).

base (rather family base), the base exemption threshold lowered to broaden the PIT base, and the brackets re-calibrated to further strengthen progressivity.

- The excise tax base should also be broadened beyond tobacco in line with ASEAN peers. In that respect, the sales tax on luxury goods should be replaced by a specific price-independent vehicle excise tax based on the engine size of the vehicle. A net tax[3] should be levied on gasoline, and the diesel excise rate be brought to the ASEAN average.

- Appropriate tax administration measures are crucial to ensure that businesses comply with their obligations to withhold and remit tax on their wage payments, and to enhance the compliance of professional services providers and high-wealth individuals. It is also critical to foster and enforce VAT registration, filing, correct reporting, and payment.

- Institutional reforms are necessary to provide additional flexibilities to the DGT to manage its budget and workforce, as well as to enhance its organizational structure, office network and information systems.

7. Beyond the revenue goal, an MTRS could also reduce other distortions that have held back growth. Streamlining the business income tax structure, reducing special regimes and discretionary exemptions in the VAT system would also help to improve the allocation of capital and labor for increased productivity. By leveling the playing field among businesses, these measures would improve the investment climate, thereby fostering competition and increasing the attractiveness of Indonesia as destination of FDI. Increasing the progressivity of the PIT and an annual publication of tax expenditure assessments could also increase the perceived fairness of the tax system and foster self-compliance.

8. The government should seize the opportunity of the crisis to design and endorse an MTRS now, although the implementation of the tax policy reforms should wait until the recovery is firmly underway. The crisis has further highlighted the importance to increase public expenditures on infrastructure, health care, and other social services, bringing to the forefront the criticality of increasing revenue mobilization. While the government has focused on providing tax incentives to support the recovery during the COVID-19 crisis, it should also use this opportunity to build the momentum necessary to mobilize stakeholders' support for an MTRS. Moreover, the MTRS would not hurt the recovery because even if work on its design starts now, it will take time to bring it to the legislative and implementation stages. For instance, the design of an MTRS encompasses significant preparatory work, which could be time-consuming as it requires drafting of tax policy and administration regulations and would involve several stakeholders, including government, parliament, civil society, businesses, and other stakeholders.

9. In the short term, the fiscal strategy should encompass revenue measures to avoid pressure for premature withdrawal of fiscal support measures. In the near-term, it is necessary to safeguard tax revenues to avoid a precipitate unwinding of support measures that could fragilize

[3] The net tax is defined as the difference between the consumer price and the supply cost.

the recovery. To avoid further erosion of tax revenue, it is critical to ensure that the regulations implementing the job creation omnibus law are carefully designed to avoid abuse of the new tax facilities and mitigate their negative revenue effects. Strategies to protect revenue mobilization include designing a formal business continuity plan if Indonesia gets hit by subsequent COVID-19 waves, assisting taxpayers and facilitating compliance burdens, and swiftly implementing fiscal packages while ensuring that support measures are not abused. Revenue administrations should also redirect their effort from arrears collection to focus on emerging compliance risks and industries less affected by the crisis. Customs administration should maintain a minimum of risk-based inspections to monitor and enforce anti-smuggling while easing the flow of essential goods. As the pandemic abates, the strategy should be adjusted to ensure an effective collection of tax arears that might have built up during the crisis.

Table 1. Proposed Indonesia's Medium-Term Revenue Strategy

Tax Policy Reform	Tax Administration Reform	Legal Framework Reform
Value-Added Tax • Remove several exemptions. • Reduce the registration threshold. • Removal of the sales tax on luxury goods. • Increase (gradually) the standard rate by 2 percentage points. **Excise Taxes** • New excises on vehicles. • New excises on fuel. **Corporate Income Tax** • Replace the myriad of special regimes for corporate businesses by one single CIT regime. • Introduce alternative minimum tax. **Personal Income Tax** • Broaden PIT base by including the middle class. • Strengthen the progressivity of PIT. • Reduce the threshold of the SME regime. **Property Tax** • Allow higher rate, while reducing local transfers. **Institutional Reforms in Tax Policy** • Strengthen capacity for revenue analysis in the Tax Policy Unit of the BKF.	**Taxpayers' Compliance Management** *Launch a Compliance Improvement Program (CIP) with targeted, well-resourced, and supervised plans for*: • Value-added tax. • Employer withholding obligations. • Ultra-high wealth individuals. • Wealthy Indonesians—High-income earners and high-wealth individuals, and professionals. *Underpin the CIP with five supporting initiatives:* • Strengthening audit. • Building a powerful data matching capability. • National deployment of compliance risk management (CRM). • Increasing efficiency of support and supervision. • Leveraging the tax amnesty and AEOI intelligence. **Institutional Reforms in Tax Administration** • Grant greater autonomy within the auspices of the Ministry of Finance. • Modernize HR management (gradually), prioritizing policies in operational areas to support the CIP. • Revamp and relaunch the code of conduct. • Streamline organization following international trends. • Deploy a program of ICT improvements to support CIP, in anticipation of the full ICT redevelopment.	**KUP Changes** • Modernize General Provisions Procedures law (RUU KUP) to improve its structure by simplifying and clarifying provisions and procedures to ensure a proper balance between revenue collection and the rights of taxpayers. • Substantially relax the requirement for auditing all or most refund audits in favor of a more risk-based approach. **Substantive Law Changes** • VAT Law (RUU PPN) to strengthen revenue performance through measures that improve VAT system design. • Income Tax Law to simplify the law and eliminate distortions; and broaden the base to include the middle class while improving progressivity. • Eliminate the requirement to file a tax return for employees whose only source of income is from a single job. • Excise Laws for revenue mobilization and addressing environmental externalities. • Property tax changes to boost local revenue—enabling the central government to reduce its transfers. **Decrees and Regulations** • Strengthen the governance framework for tax system reform to ensure effective implementation of the MTRS. • Provide authority to MOF to change internal structure, allocate staff, and re-grade positions.

Political Support	External Resources
• Strengthen reform governance and management. • Commit to multi-year budgets to secure reform implementation. • Ensure government-led effort based on a whole-of-government approach. • Involve a wide base of stakeholders to achieve a country-owned effort. • Launch an 'Amnesty-like' socialization campaign for the MTRS.	• Identify capacity requirements to reform development and implementation. • Identify available external support from CD partners to fill capacity constraints. • Formalize an agreement with CD partners to support the government-led MTRS.

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Appendix V. COVID-19, Exceptional Policies, and Monetary Budget Financing in Indonesia

Context

1. **Indonesia, like many other emerging market economies, faces higher budget deficits in the next few years because of the policy responses to and as a result of COVID-19**. Inevitably, domestic bond issuance will be higher, given constraints and risks on external foreign currency financing. BI has provided direct budget financing; initially, financing was provided on a last-resort basis in primary markets in end-March, with BI as a non-competitive bidder. Subsequently, the arrangement was changed to a three-tranche "burden sharing" arrangement (BSA) for 2020, with pre-defined amounts of BI bond purchases by tranche (each tranche associated with a different type of expenditures) and seignorage transfers designed to lower effective interest cost to the budget, depending on the tranche.

Burden Sharing Agreement

In early July, a burden sharing agreement between the Minister of Finance and the Governor of Bank Indonesia was announced. The agreement sets out a three-tranche approach for government bond purchases by Bank Indonesia, delineated along the type of additional spending in 2020 relative to the original budget. Some tranches entail BI profit ("seignorage") transfers to the budget to reduce effective interest costs to the budget.

Tranche	Expenditure	Amounts	Terms	Seignorage
First	Priority spending on public goods such as health and social protection	IDR 398 trillion (2.5 percent of GDP)	Variable rate bonds with rates at reverse repo rate	BI transfers all interest receipt on these bonds to the Ministry of Finance.
Second	Spending on SME and other business support	IDR 177 billion (1.1 percent of GDP)	Long-term bonds at market rates	On each bond, BI transfers the difference between the bond coupon and a coupon based on the reverse repo rate (minus 1 percent) to the Ministry of Finance.
Third	Other PEN spending	As needed on a last resort basis	Long-term bonds at market rates	None

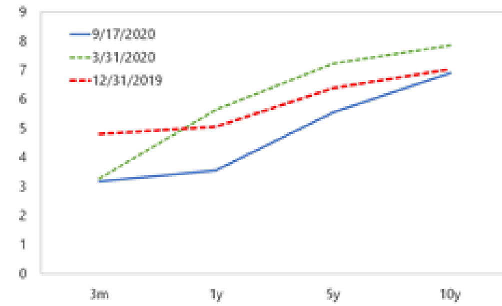
What Has Been Achieved?

2. **The direct budget financing by BI has helped to avoid bond market uncertainty and contributed to a normalization of local currency bond yields after the spike experienced during the global financial market turmoil in March**. As a result, broad financial conditions have eased, lowering credit costs, notably also for the government, while the rupiah has remained broadly stable.[1] The lower interest costs for the additional financing needs allow for even higher primary expenditure by the government for a given deficit target. The government has thus greater scope to

[1] This is in line the early evidence on asset purchases by emerging market central banks during COVID-19. These purchases have been effective in reducing bond yields and have not contributed to currency depreciation (IMF, 2020; Fratto and others 2021; and Arslan and others, 2020).

respond to the COVID-19 pandemic, especially when considering the pandemic asymmetric impact across economic sectors. In addition, as funds injected through the monetary budget financing of public expenditure work through the economy, deposits in banks have increased, boosting bank liquidity and, in principle, supporting a recovery in bank lending.

Indonesia: Sovereign Bond Yield Curve
(In percent per year)



Source: Bloomberg L.P.

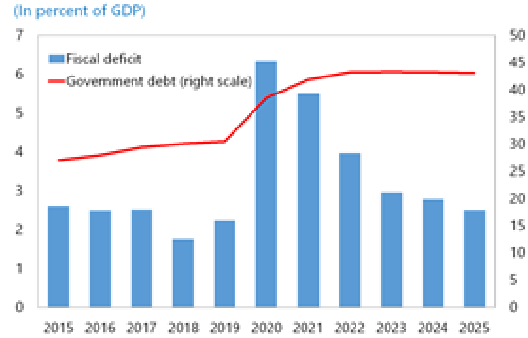
What Are the Risks?

3. **There are well-known risks from direct budget financing by central banks**. If the financing leads to a large expansion of the monetary base, it might not be consistent with price and currency stability objectives, depending on money demand. While monetary operations could, in principle, reconcile large financing with price stability objectives, the implied increase in interest rates could lead to an increase in budgetary financing costs, one of the key outcomes that BI budget financing was seeking to avoid. If fiscal policy considerations have priority over monetary policy objectives under such conditions, often referred to as "fiscal dominance," BI's operational independence would be impaired, thereby damaging its credibility and leading to both higher inflation expectations and nominal interest rates, also implying that BI financing would not achieve its objective.

Assessment

4. **There is a case for BI bond purchases on a last-resort basis**. Nonresident investors hold a substantial share of rupiah-denominated government bonds, especially at the longer maturity spectrum, but have not been willing for further increase their exposure. Domestic bond demand is more inelastic and limited in size, especially for longer durations, given few institutional investors. While domestic banks have nearly doubled their holdings of government bonds in 2020, the scope for further increases seems more limited. The high growth has largely reflected one-off, pandemic related factors, notably increased risk aversion. Higher net issuance in domestic markets by the government will thus come with risks of market dislocation and higher yields.

Indonesia: Fiscal Deficit and Government Debt
(In percent of GDP)



Source: IMF, World Economic Outlook.

5. **Indonesia's public debt ratio is relatively low, and the change in budgetary interest cost from the higher budget deficits is small, around 0.1 percent of GDP**. As such, risks of fiscal dominance seem small. On the other hand, despite the relatively small impact of the increased, exceptional budget deficits on budgetary interest costs, the pre-defined tranche-based design of

the BSA centers around budget considerations, while monetary policy considerations seem less prominent. Moreover, the pre-defined amounts of BI purchases in the BSA are relatively large compared to base money, suggesting a possible need for sterilization by BI to meet price and external stability objectives. If so, BI seignorage would be smaller, highlighting the potential inconsistencies with the tranche approach.

6. **The possibility of further direct budgetary financing in the next few years, given continued larger-than-usual budget deficits, raises uncertainty about modalities and time horizon of exceptional monetary policy**. The BSA only covers 2020.

7. **Going forward, the monetary budget financing scheme should not be pre-defined and should be guided by well-defined last resort criteria, based on bond market and broader financial conditions**. Such an approach could be integrated into the established monetary policy framework, which would reduce risks from these exceptional policies.

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INTERNATIONAL MONETARY FUND

INDONESIA

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 29, 2021

Prepared By | Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of December 31, 2020)

Membership Status: Joined February 21, 1967; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	4,648.40	100.00
IMF's holdings of currency (holding rate)	3,860.13	83.04
Reserve tranche position	788.27	16.96

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	1,980.44	100.00
Holdings	1,114.59	56.28

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				
	2021	2022	2023	2024	2025
Principal					
Charges/Interest	0.75	0.72	0.72	0.72	0.72
Total	0.75	0.72	0.72	0.72	0.72

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 14,050 per U.S. dollar as of December 31, 2020. 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. 19/250) was discussed by the Executive Board on July 3, 2019.

Resident Representative

Mr. James Walsh replaced Mr. John Nelmes as the Senior Resident Representative in August 2020.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- World Bank: https://financesapp.worldbank.org/en/countries/Indonesia/
- Asian Development Bank https://www.adb.org/countries/indonesia/main

STATISTICAL ISSUES

I. 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. A TA mission to evaluate the methods used to compile quarterly volume measures of household consumption and taxes on products is planned for 2021. 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 2010–2019 at the end of January 2021. BPS also expects to finalize the 2015 supply and use tables in 2021

Price statistics: An updated CPI with weight and index reference periods of 2018 was introduced in January 2020. This update improved the CPI representativeness of current consumer expenditure patterns and incorporated improved imputation methods and expanded coverage of ecommerce transactions. The PPI is released quarterly with an index and weight reference period for PPI is 2010. The weights should be updated to better reflect current production. BPS has expanded PPI coverage to include some services activities, including passenger transport and hotel and restaurants. A July 2020 mission supported the BPS with creating a workplan to further expand PPI coverage to freight transportation and telecommunications. In 2019, STA assisted Bank Indonesia with the development of an enhanced Residential Property Price Index (RPPI) using Internet property listings datasets.

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, Indonesia now reports to STA annual general government data (including balance sheet data) covering the period from 2008 onwards. Annual general government GFS are currently available within 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. Aggregated monthly data on the budget of the central government are available with a one-month lag.

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 with quarterly data published in the World Bank's Quarterly Public Sector Debt Database.

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. BI also reports 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). MFS data are reported on a monthly basis. A Fund TA mission in October 2014 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 four encouraged FSIs for the real estate sector, which are published quarterly on the Fund's FSI website**.** Indonesia reports data on some key series and indicators of the Financial Access Survey (FAS), including mobile money and the two indicators adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

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 improved considerably with the introduction of an External Debt Information System (EDIS) in 2002 and the subsequent 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.

II. Data Standards and Quality

Indonesia has subscribed to the Special Data Dissemination Standard (SDDS) since September 1996. Indonesia uses the SDDS flexibility options for the timeliness of the labor market categories (employment, unemployment, and wages/earnings) and general government operations.	

Indonesia: Table of Common Indicators Required for Surveillance

(As of January 5, 2021)

	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]	Data Quality—Accuracy and Reliability[3]
Exchange rates	1/5/2020	1/5/2021	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities[4]	11/2020	12/2020	M	M	M		
Reserve/base money	10/2020	12/2020	W/M	W/M	W/M	O, LO, O, O	LO, O, O, LO, O
Broad money	10/2020	12/2020	M	M	M		
Central bank balance sheet	10/2020	12/2020	M	M	M		
Consolidated balance sheet of the banking system	10/2020	12/2020	M	M	M		
Interest rates[5]	1/5/2021	1/5/2021	D	D	D		
Consumer price index	12/2020	1/2021	M	M	M		
Revenue, expenditure, balance and composition of financing[6]—central government	11/20	12/20	M	M	Mid-year	LNO, LNO, LO, LNO	LNO, LO, LO, LO, LNO
Stocks of central government and central government–guaranteed debt	11/20	12/20	Q	Q	Q		
External current account balance	Q3/2020	11/2020	Q	Q	Q	LO, LO, LO, LO	LO, O, LO, O, O
Exports and imports of goods and services	Q3/2020	11/2020	Q	Q	Q		
GDP/GNP	Q3/2020	11/2020	Q	Q	Q	LO, LO, O, LO	LO, LO, LO, LO, LNO
Gross external debt[7]	10/20	12/20	M	M	M		
International investment position[8]	Q3/2020	12/2020	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 Alisara Mahasandana, Executive Director for Indonesia;
Firman Mochtar, Alternative Executive Director; and
Dian Susiandri, Advisor to Executive Director
February 12, 2021

On behalf of Indonesian authorities, we would like to thank the IMF mission team for a comprehensive and effective mission under an exceptional circumstance. We value staff's deep dive into Indonesia's economic development to build a constructive policy dialogue during the 2020 Article IV consultation. The authorities found the discussions valuable and broadly share staff's analysis and recommendations, in particular on how to navigate the recovery.

A. Recent Economic Development and Outlook

The COVID-19 outbreak has generated unprecedented pressures on the health and socio- economic conditions, but the prompt and bold policy responses have successfully mitigated the fallouts. Economic growth has contracted sharply in the second quarter of 2020, before rebounding in the following quarter owing to gradual economic reopening and a package of policy supports. GDP growth in 2020 recorded at -2.07 percent was better than the estimated regional average of -3.7 percent. External sector has exhibited resilience supported by higher capital inflows and lower current account deficit (CAD) resulting in the balance of payment recording a surplus in 2020 and a strong international reserves position. Exchange rate has remained flexible and continued to play a role as a shock absorber to the economy. Consumer Price Index (CPI) inflation has declined to 1.68 percent at the end of 2020, below the target range of 3.0±1.0 percent, mainly due to a positive food supply shock reflecting a strong harvest and weak demand. Financial system stability was also maintained backed by adequate buffers built prior to the pandemic and ongoing liquidity support by the central bank, Bank Indonesia (BI). The stress-test result indicated that the capital adequacy ratio (CAR) of the banking industry and finance companies remains sufficient to offset higher credit and financing risk, even under severe macroeconomic conditions. Nonetheless, waning domestic demand and increasing risk perception of banks amid the pandemic shock have become a challenge to spur credit growth.

Economic recovery is expected to strengthen in 2021. Staff's GDP projection of 4.8 percent for 2021 lies within the lower bound of the authorities' forecast (4.8 – 5.8 percent). The sanguine outlook is underpinned by global economic recovery, accelerated vaccines rollout, and continued strong policy stimulus packages. Inflation is expected to be well-contained within the target band of 3.0±1.0 percent. CAD is predicted to be within 1.0-2.0 percent of GDP in 2021, a slight increase compared to 2020 in line with the expected economic recovery. Financial system stability continues to be well-maintained with the credit growth projected to accelerate to 7.0–9.0 percent. In the medium term, Indonesia's economic growth will continue to recover in the range of 5.5 – 6.1 percent in 2025, consistent with improved productivity and buttressed by ongoing structural reforms.

The authorities, however, remain vigilant amid the uncertainties surrounding the pandemic and measures were adopted to mitigate the risks. With their adequate policy space as a result of credible policy framework, the authorities stand ready to undertake necessary policy actions as needed to preserve macroeconomic stability. In dealing with the pandemic, the Government is committed to providing free vaccines to all citizen in two stages. The first stage (Jan-April 2021) is targeted for health workers and public service officers, while the second stage (April 2021- March 2022) will be delivered to the rest of population. In this regard, they have secured a large amount of vaccines (more than 300 million doses) from various producers and are closely monitoring its distribution nationwide. On the non-financial corporate (NFC) sector, the authorities viewed that the risk remains manageable, in line with recent positive developments. The data show that corporate sales started to pick up in the third quarter of 2020, followed by improving corporates buffer as reflected in their accelerated deposit growth in banks. In addition, many of those corporates are conglomerate firms, which enables them to receive intra-group financing supports. To facilitate corporate revival, the authorities have provided guidance on gradual reopening of priority sectors in accordance with their productivity and safety level. Going forward, the authorities will continue to closely monitor the situation and stand ready to provide further support if needed. On external risks, the corporates' balance sheet FX risk has declined significantly due to the authorities' prudential regulation imposing hedging requirement on corporate FX loans. Recent data showed that more than 90 percent of corporates complied with this regulation, making corporates' balance sheet less susceptible to currency risk.

B. Policy Responses

As highlighted in the Staff Report, the authorities have taken a bold, comprehensive, and coordinated policy response to mitigate the unprecedented impact of the crisis and to steer the economic recovery. To enhance policy efficacy, the authorities enacted Law No. 2 of 2020 as the legal basis for undertaking extraordinary responses in a swift, transparent, and accountable manner during the COVID-19 pandemic. This law provides for a temporary relaxation of the budget deficit ceiling which can be widened beyond 3 percent of GDP until 2022. BI is also permitted to purchase government bonds (SBN) in the primary market from the Government, in accordance with the prudential principles cited in the Act. The law also includes financial system stability policies aimed at enhancing the role of the financial service authority (Otoritas Jasa Keuangan/OJK) and deposit insurance corporation (Lembaga Penjaminan Simpanan/LPS).

Going forward, the authorities remain committed to supporting economic recovery and advancing structural reforms. In the near-term, the authorities are expediting the deployment of the vaccines. These essential policies would be buttressed by five-coordinated policy strategies, namely (i) reopening of productive and safe sectors; (ii) expediting fiscal stimuli; (iii) stimulating bank lending on the supply and demand sides; (iv) maintaining monetary and macroprudential stimuli, and (v) accelerating economic and financial digitalization. These policies will be tied in with structural reforms to boost long-term growth.

Fiscal Policy

The Government has implemented an expansionary fiscal policy in 2020 as a countercyclical policy to cushion the impact of the COVID-19 crisis and support economic recovery. Government expenditures were significantly increased to support the COVID-19 and the national economic recovery program (Program Pemulihan Ekonomi Nasional/PEN) amounting to Rp. 695.2 trillion (4.2 percent of GDP), for public goods (i.e. health, social assistance, and public services) as well as non-public goods (i.e. incentives to MSMEs, business and corporations). These large fiscal stimuli have widened the budget deficit to 6.1 percent of GDP in 2020 from 2.2 percent of GDP in 2019. To ensure the effectiveness of fiscal measures related to the COVID-19 as well as to safeguard accountability, staff has rightly pointed out the three-pronged approach adopted by the Government, namely to initiate early consultation with the Audit Board of Indonesia, to institute monthly reporting requirements on COVID-19-related programs, and to plan for an ex-post evaluation of the effectiveness of the incentives.

In 2021, the Government will continue to adopt countercyclical fiscal policy to secure economic recovery, followed by a gradual reduction of budget deficit to ensure fiscal sustainability. In this regard, overall budget deficit is expected to be around 5.7 percent of GDP in 2021. The authorities would like to reiterate their commitment to gradually bring the budget deficit back below 3 percent of GDP in 2023, supported by further revenue mobilization and enhanced spending efficiency.

The Government will continue to enhance revenue mobilization and improve spending efficiency to support medium-term fiscal adjustment. As the authorities acknowledge the importance of the Medium-term Revenue Strategy (MTRS), their intention to continue improving fiscal revenue has been set out on a 2020-2024 strategic plan, which is formally adopted in the Minister of Finance regulation (PMK) number 77/PMK.01/2020. Several strategic initiatives would be undertaken to increase potential sources of revenue (i.e. tax, duty, excise and other non- tax revenue), including (i) improving tax compliance, in particular taxation (VAT) of e- commerce transaction, (ii) developing digital-based tax and other revenue services, (iii) expanding tax-base and non-tax base, and (iv) modernizing revenue administration. The revenue reforms will be underpinned by enhancement in many aspects, such as institution, human resources, IT and databases, business processes, and tax regulations. These initiatives would be complemented by regulatory reforms related to taxation, such as the Omnibus bill. On the expenditure front, government spending will be prioritized to facilitate the resilient recovery with a focus on health, education, infrastructure, food security, social safety net, tourism, and MSMEs. The authorities underscore that fiscal policy will be flexibly implemented within the 2021 budget spending envelope following a data-driven approach, along with more targeted subsidy and effective social assistance to protect the most vulnerable group. Also, excess financing (SiLPA) from the 2020 State Budget amounting to Rp. 234.7 trillion, in part (Rp. 50.9 trillion) will be carried over to 2021 to finance the vaccination program and support SMEs and corporate sectors, meanwhile the rest will remain in the cumulative financing surplus (SAL).

Monetary and Exchange Rate Policy

In dealing with the extraordinary crisis, BI has pursued an accommodative monetary policy, utilizing all available policy instruments. BI has lowered its policy rates (BI7DRR) five times by 125 bps to 3.75 percent in 2020, the lowest level in history. BI has also injected large amounts of liquidity into the banking system, particularly through a 300 bps reduction in the statutory reserve requirement and monetary expansion by buying government bonds in the secondary market. Amidst global financial market uncertainties, exchange rate stabilization policy has been adopted such that the value of the Rupiah is in line with its fundamentals and market mechanism. Stabilization policy to manage excessive volatility was undertaken through a ‘triple intervention’ via outright buying and selling of foreign exchange in the spot market, Domestic Non-Deliverable Forward (DNDF), and purchases of SBN from the secondary market.

In accordance with Law No.2 of 2020, the purchase of SBN in the primary market has been conducted prudently, consistent with good governance principles, so as to preserve macroeconomic stability. The purchase of SBN in the primary market by BI to finance the 2020 State Budget deficit is carried out through 2 mechanisms. As laid out in the first joint agreement between the Minister of Finance and the Governor of BI (April 16, 2020), the purchase of SBN will follow four main principles, namely: (i) using market mechanism; (ii) considering the impact on inflation; (iii) purchasing only tradable and marketable SBN; and (iv) BI purchasing SBN on a last-resort basis. Under this first Joint Agreement, BI has purchased SBN in the primary market amounting to Rp. 75.86 trillion. There was also a second joint agreement between the Minister of Finance and the Governor of BI (on July 7, 2020), where BI purchased SBN directly from the Government for public goods financing in the 2020 State Budget amounting to Rp. 397.56 trillion, with the interest to be borne by BI. Under this second Joint Agreement, BI also bear a portion of the interest burden to finance non-public goods related to MSMEs and corporate incentives, amounting to Rp. 177 trillion. The authorities have confirmed that this second joint agreement is a one-off policy and thus only applicable in 2020. BI's support for fiscal financing in the context of handling Covid, which was carried out by adhering to the principles of governance, prudence, and monetary discipline, has succeeded in maintaining the confidence of investors and rating agencies. This can be seen in the return of capital inflows, particularly to SBN and the retention of Indonesia's rating by the major rating agencies.

Looking ahead, monetary policy in 2021 would continue to support economic recovery, while safeguarding macroeconomic stability. Low interest rates and ample liquidity will be maintained while closely keeping an eye on inflationary pressures. Liquidity will remain loose to support bank lending and financial system stability. Moreover, the stability of the Rupiah exchange rate will be maintained in accordance to its fundamentals and market mechanism. The FXI will be adopted as needed to address any disorderly market conditions. The Government's effort to continuously develop the retail bond market to widen domestic-based investor will contribute positively to exchange rate stabilization. In addition, several reform initiatives to attract long term investment, particularly through FDI, will eventually improve capital flows composition as well as enhance external sector resiliency.

BI and the Government will continue to closely coordinate their monetary and fiscal stimulus to accelerate the economic recovery. The direct purchase of SBN by BI in accordance with the second joint agreement will not be continued in the 2021 State Budget. However, as the recovery in the post COVID-19 episode is still underway, the first joint agreement is extended until December 31, 2021, in which the purchase of SBN will be in accordance with the four aforementioned main principles to ensure price stability.

Macroprudential and Financial Sector Policy

BI continues to pursue accommodative macroprudential policies to mitigate the adverse impact of the pandemic-related shock on the financial system as well as to support the economic recovery. Since April 1, 2020, BI has lowered the reserve requirement ratio by 50 bps—in addition to the 300 bps reduction in the statutory reserve requirement—for banks' lending to export-oriented businesses, SMEs, or priority sectors and has extended this policy until June 2021. To stimulate banking intermediation, BI kept the Countercyclical Capital Buffer at 0 percent and relaxed the Macroprudential Intermediation Ratio. BI has also strengthened banking liquidity through the regulation on Macroprudential Liquidity Support. In addition, BI relaxed the provision for the Loan to Value ratio for environmentally friendly motor vehicle loans to 0 percent.

OJK and LPS have also embarked on various policies to dampen the impact of the pandemic. OJK has deployed a policy package that aims at relaxing certain regulatory provisions in the banking sector to alleviate financial and liquidity pressure during the crisis. The policy package for banks include relaxation measures related to reporting, credit treatment, and governance of restructured credit, as well as postponement of the implementation of Basel III reforms. As of December 2020, restructured credit has reached Rp. 971 trillion (18 % of total credit). In this context, partial relaxation of loan classification rules will also be extended until March 2022. The extension of loan restructuring relaxation is expected to minimize the potential cliff effects due to tighter risk management requirements. Banks are required to ensure debtors' viability throughout the relaxation period by implementing continuous assessment of debtors' conditions. In this context, banks must build provisions accordingly. Furthermore, banks have adequate capital to absorb the possible increase in provisions going forward. In addition, LPS has relaxed the penalty for late premium payments to ease the liquidity pressures during the crisis.

Going forward, financial sector policy will remain accommodative to boost credit growth during the recovery process, while preserving financial system stability. BI will assess the possibility to further ease a number of existing and new macroprudential policy instruments. To promote MSMEs-based growth, BI will issue a macroprudential policy by expanding the target and coverage of inclusive financing, provide incentives for banks that encourage the corporatization of MSMEs (particularly in the priority sectors), and promote the securitization of MSMEs loans. This will be complemented by OJK's microprudential supervision, as described in the Indonesian Financial Services Sector Master Plan (MPSJKI) 2021-2025. This will address the short-term challenges related to the COVID-19 shock as well as the long-term structural challenges to promote a stable, contributive and inclusive financial industry. In addition, coordination through the Financial System Stability Committee will also be fortified, including enhancing the crisis management protocol in the financial system. Crisis management and resolution frameworks along with maintaining financial stability have become a high priority for the authorities.

Structural Reforms

The authorities will continue their reform agenda to improve productivity and to achieve a strong, sustainable and inclusive growth, while also steering towards a greener economy. Continuous efforts are underway in the multi-dimensional aspects of the reforms. Recent notable reforms are on the financial sector, regulatory reform through the omnibus bill, establishment of the Sovereign Wealth Fund (SWF), and green economy policies.

On the financial sector, BI continues to accelerate money market deepening and digitalization of the payment system. BI has formulated the 2025 Money Market Deepening Blueprint that could strengthen monetary policy transmission as well as support financing for the economy. Moreover, BI has launched the 2025 Indonesian Payment System Blueprint to speed up the digitalization of the payment system. Payment system regulatory reforms directed at the establishment of end-to-end digital economy and finance ecosystem between digital banking, FinTech, e-commerce, merchants and consumers are also underway.

Simplifying regulations is the top reform agenda to enhance business climate and create jobs. The authorities have enacted the omnibus bill on job creation on November 2, 2020, which includes tax related matters. This entails a massive process of synchronization of existing laws, including the revision of 80 laws and 1.200 articles. The bill will streamline business permits, improve the ease of doing business, create employment opportunities as well as protect employees. It also includes tax incentives for businesses, including through adjustment of the corporate income tax rate. The enactment of the bill together with the implementation of the Regional Comprehensive Economic Partnership (RCEP) will benefit the Indonesian economy. Meanwhile, the omnibus bill to develop and strengthen the financial sector is still under discussion, and the authorities underscored that the bill will secure the central bank's independence.

Following the enactment of Omnibus Law on Job Creation, the government has established a new SWF called the Indonesia Investment Authority (INA). This aims at deepening access to finance to boost investment and accelerate infrastructure projects and other priority sectors, which in turn will generate new job opportunities and improve productivity. Under Government Regulation No. 72 of 2020, the Government provides initial capital to INA amounting to Rp. 15 trillion (or around US$ 1 billion).

The authorities are committed to strengthening ongoing efforts towards a greener economy. In the wake of the 2011 National Action Plan for Greenhouse Gas Emission Reduction, the authorities have established an Environmental Fund Management Agency (BPLDH) in 2019 to attract national and international donors as well as to effectively mobilize public and private funds in order to support the programs. Recently, the Medium-Term Development Plan 2020- 2024 reflects Indonesia's strong commitment to shift to a low carbon economy and a more climate resilient path, through several key initiatives such as renewable energy and energy efficient development, forest conservation and reforestation, waste management, land intensification, and others. Indonesia has also continued to develop a green bond market through the issuance of the Green Sukuk (Islamic bonds) since 2018.