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Statement by Mr. Bevilaqua, Ms. Mahabir, and Mr. Eckhorst on Indonesia (Preliminary)
Executive Board Meeting
May 22, 2023

We thank staff for the comprehensive report and Ms. Lim, Mr. Hendrayadi and Mr. Kurniawan for their statement. We broadly agree with staff's appraisal. Indonesia's economy has been resilient even when confronted with significant external and internal shocks.

Indonesia's inflation trend is promising, while post-pandemic unemployment remains challenging. Inflation rose significantly in 2022 on the back of strong international commodity price increases. However, the pressures have since subsided and is set to further stabilize around Bank of Indonesia's (BI) target range. At the same time, while unemployment has fallen, it remains above pre-pandemic levels which signals remaining weaknesses in the labor market. Despite these weaknesses, lower inflation has influenced real wage growth to pick-up. Additional incentives to key sectors to utilize a higher share of idle capacity can help increase economic activity in the Indonesian economy, despite the pandemic scarring that has reduced the rate of physical capital accumulation and jobs creation capacity.

Despite increased imports, the current account balance remained positive, compensating for the unprecedented portfolio investment outflows during 2021/22. Exports from non-oil and gas sectors have risen significantly and surpassed high imports resulting in continued current account surpluses. The combination of this surplus and large FDI inflows resulted in the country recording an overall BOP surplus in 2022. We urge the authorities to balance foreign exchange interventions with reserve accumulation efforts of the BI. In that regard, the BI's introduction of an FX term deposit facility is welcomed. While the exchange rate has functioned as an effective shock absorber, interventions should only be deployed if effective in dealing with destabilizing market conditions.

The stronger than expected fiscal performance is in line with Indonesia's ongoing recovery. The fiscal deficit reached pre-pandemic levels earlier than expected at 2.4 percent of GDP at the end of 2022. Increased revenues from mining commodities due to higher global commodity prices, was one of the main drivers of this lower deficit. The 2021 tax reform law contributed extensively to higher VAT revenues, as exemptions under the VAT were reduced, while the VAT rate was increased in 2022. We welcome the authorities' decision to reduce fuel subsidies which allowed for a redistribution of funds towards the social safety net. The authorities should consider further reform of energy subsidies. We broadly agree with the country's fiscal consolidation strategy that ultimately will keep the fiscal deficit, which is viewed as an important policy anchor, below the 3 per cent ceiling.

Indonesia's debt remains sustainable with an overall low risk of sovereign stress. However, we agree with staff's recommendation to broaden the domestic investor base to include other institutional lenders, as claims from domestic banks on government are relatively high. *Can staff comment on any plans that the supervisory authorities have to ensure that risk to financial stability remains contained if the financial sector's exposure to the government rises?*

Monetary policy has appropriately addressed increased risks to inflation. The BI has deployed several instruments to bring inflation back to BI's inflation target range. The authorities have increased the policy rate above the pre-pandemic level of 5 percent at end-2019. Various complementary measures were undertaken, including the gradual increase of the reserve requirement ratio for banks, reverse repo transactions and the introduction of "operation twist" - the selling of short term and purchasing of long-term government bonds. We encourage the authorities to continue monitoring for signs of underlying inflation pressures and take appropriate action when necessary. We also strongly recommend reinstating inflation expectations' surveys.

We wish the Government and people of Indonesia all the best in their further endeavors.