

May 17, 2023

**Statement by Ms. Lim, Mr. Hendrayadi, and Mr. Kurniawan on Indonesia
Executive Board Meeting
May 22, 2023**

On behalf of our Indonesian authorities, we would like to thank the IMF mission team led by Ms. Cheng Hoon Lim for the constructive policy dialogue during the 2023 Article IV consultation and insightful staff report. Our authorities broadly share staff's analysis and recommendations to navigate the economic recovery and advance structural reforms.

I. Economic Development and Outlook

Indonesia has seen strong economic recovery from the pandemic in 2022. GDP grew by 5.31% (year-on-year), the highest since 2013 and has returned to the pre-pandemic growth path. External stability was supported by a surplus BOP and adequate international reserve position. Inflation was recorded at 5.51% (year-on-year), and while higher than the upper-bound target range due to soaring global commodity prices and domestic fuel price adjustment, inflation is considerably lower than market projection and is on a significant downward path. Financial system remained sound with sustained resilience and strong credit growth. The rapid development of digital economy and finance also contributed to the strong economic recovery.

The momentum in economic growth is expected to continue and strengthen in the medium term despite headwinds from the global economic environment. Economic growth in 2023 is predicted with an upward bias towards the top end of the range of 4.5-5.3%, with potential gains driven by improving domestic demand, primarily private consumption in line with the easing of mobility restrictions in 2022, and solid exports. GDP growth recorded at 5.03% in the first quarter of 2023, in line with authorities' projections. Inflation is expected to descend within the 3.0%±1% target range. The current account is also projected to remain at a healthy level in the range of a 0.4% surplus to a 0.4% deficit of GDP while capital and financial account is expected to record a larger surplus. Credit growth is projected to remain at the 10-12% (year-on-year) range on strong banking intermediation. In the medium term, supported by the progressing structural reform and acceleration of digitalization, the economy is expected to improve further and return to its long-term trajectory. Given the highly uncertain global economic environment, the authorities remain vigilant to both short-term and medium-term risks that could weaken the economic outlook.

II. Policy Responses

Indonesian authorities acted decisively and with strong policy coordination to maintain macroeconomic stability. Fiscal-monetary policy synergy was strengthened during the Covid-19 pandemic including through three types of Joint Agreement mechanism between Minister of Finance and the Governor of Bank Indonesia (BI).¹ Coordinated policy responses from the Financial System Stability Committee (KSSK) were also instrumental to maintain financial stability and accelerate recovery in the business sector. Price stability and food security were the main economic and financial challenges for Indonesia in 2022, as in other countries. Under the Inflation Controlling Team, both at central and regional levels, government efforts to contain food price increase and the spillover impact of fuel price adjustments worked in concert with the central bank to rein in inflation. The government utilized reserve funds for food price stabilization that has been allocated in the 2022 budget to support food security and topped up social assistance program for vulnerable families to sustain purchasing power affected by fuel price increases. The subnational governments were also required to spend 2% of general transfer fund to rein in inflation in the region. The National Movement for Food Inflation Control (GNPIP) was introduced as a new policy synergy to further support price stability. GNPIP seeks to optimize measures to control food inflation from the supply side and boost production to bolster food security.

Authorities will continue to enhance the economic policy mix, through innovation and synergy, to strengthen resilience, maintain economic recovery momentum and foster long-term growth potential. The policy mix includes five interrelated and complementary components, namely: (i) fiscal and monetary coordination; (ii) accelerate transformation of the financial sector; (iii) accelerate transformation of the real sector; (iv) digitalization of the economy and finance; and (v) green economy and finance. From the fiscal side, the 2023 state budget (APBN) which is formulated conservatively, will continue its role as a shock absorber to dampen the impact of global turmoil to macroeconomic stability, while strengthening spending priority on social protection, education, health, and infrastructure. The government remains committed to keeping fiscal deficit below 3% of GDP to preserve fiscal sustainability and expedite structural reform agendas including tax reform. BI will maintain a mix of policy instruments to maintain stability and support economic growth. Monetary policy will still be oriented towards maintaining stability (*pro-stability*), while the four other instruments (macroprudential policy, payment system digitalization, money market development, and the green and inclusive economy and finance) will continue to be directed to support recovery (*pro-growth*). Efforts to promote inclusive economic growth include accelerating the national sharia economy and finance and strengthening MSME competitiveness.

Fiscal Policy

Budget outturn in 2022 showed a strong performance. Fiscal deficit recorded at 2.38% of GDP (preliminary outturn), much lower than its target of 4.85%, and returned to the 3% ceiling² one year earlier than initially planned. Revenues grew significantly, 30.6% compared to the previous year, supported by solid economic recovery, higher commodity prices, and early gains of the tax reforms.

¹ First, the purchase of SBN by BI from the primary market as a stand-by buyer with a yield rate according to the market mechanism, when not all of the SBN auction targets for Government fiscal funding can be absorbed by the market which is valid for a period of three years (2020-2022). Second, the purchase of SBN by BI in the primary market directly with a burden sharing mechanism to meet the increasing needs of the APBN for social protection programs and national economic recovery, which applied to the 2020 APBN financing. Third, the purchase of SBN by BI in the primary market directly with a coupon at the Reverse Repo BI interest rate for three months to finance the enormous health and humanitarian funding needs in the 2021 and 2022 APBN due to the outbreak of the Covid-19 delta variant.

² Government Regulation in Lieu of Law Number 1 of 2020 and Law Number 2 of 2020 regarding fiscal consolidation set the deficit for 2023 below 3 % of GDP.

The implementation of the Harmonized Tax Regulations Law, such as voluntary program disclosure and adjustment of the value added tax rate, provided a positive contribution in improving compliance, broadening tax base, and increasing tax revenue. On the expenditure side, Government spending increased by 10.9% and supported the achievement of development targets such as bringing down poverty and unemployment rates, and functioning as a shock absorber in preserving economic recovery amid heightened global risk. With a lower state budget deficit than its initial target, the government debt ratio declined to 39.70% of GDP at the end of 2022 from 40.74% in 2021.

The 2023 state budget deficit is designed conservatively with fiscal deficit to be maintained below 3% of GDP to enhance fiscal sustainability. The Government projects the revenue collection very conservatively, considering weaker global demand as well as moderation of commodity prices amid continued efforts to enhance the effectiveness of the tax reform. On the expenditure side, spending priorities are geared towards enhancing productivity and protecting vulnerable groups, through well-targeted subsidy and social safety net programs. The Government commits to maintain allocation for priority spending to boost competitiveness and productivity, for example by maintaining 20% and 5% allocation of total spending for education and health, respectively. The share of social protection and infrastructure expenditures are also substantial, reaching around 15,5% and 12,8% of total budget. Based on the latest tracking, the budget outturn in the first quarter 2023 still showed promising sign, with revenue increasing by 29% from its high base in 2022.

Monetary Policy and Exchange Rate Policy

Monetary policy was implemented by optimizing exchange rate stabilization, liquidity normalization and policy rate hikes, while maintaining adequate foreign exchange (FX) reserves. BI continuously strengthened Rupiah exchange rate stabilization measures in line with the currency's fundamental value amid escalating external pressures. Exchange rate stabilization policy was implemented through FX market intervention, including spot and domestic non-deliverable forward (DNDF) transactions as well as buying/selling government bonds (SBN) in the secondary market and strengthened through an innovative “twist operation” by selling short-term SBN in the secondary market to increase the attractiveness of SBN yields for foreign portfolio investment inflows to strengthen Rupiah stabilization measures. As excess liquidity in the banking industry gradually normalized, authorities ensured sufficient liquidity in the system in anticipation of credit growth post pandemic. For the policy rate, after staying at historically low level at 3.50% for 18 months since August 2022, BI raised the rate as a front-loaded, pre-emptive, and forward-looking measure to ensure lower inflation expectations and inflation moving forward.

Monetary policy in 2023 will consistently focus on Rupiah stabilization and inflation control to ensure inflation returns to its target corridor as part of the mitigation measures against the spillover effects of global turmoil. The authorities view the policy rate, which is kept unchanged at 5.75% since February 2023, sufficient to direct core inflation within the level of 3.0%±1% and return CPI inflation within the target range of 3.0%±1%, sooner than previously projected. Rupiah stabilization measures will be directed to mitigate imported inflation. BI will continue its “twist operation” and prompt a return of portfolio investment inflows, thus supporting Rupiah stabilization efforts and maintaining adequate FX reserves. Stabilization policy to control imported inflation will be strengthened with foreign exchange proceeds of exports management through the implementation of foreign currency term deposit instruments in accordance with market mechanisms.

Macprudential and Financial Sector Policy

Macroprudential policy was kept accommodative to facilitate credit intermediation and support economic recovery while maintaining financial system stability. The policy focus is on balanced intermediation, financial sector resilience, and inclusion. BI refined Macroprudential Inclusive Financing Ratio (RPIM) policy to facilitate inclusive lending in line with banks' expertise and business model while adhering to robust risk management. BI continued to promote lending rate transparency by publishing the assessment of bank's prime lending rate. BI recently increased the macroprudential incentives to facilitate bank lending to targeted sectors, including inclusive and green finance in the form of reserve requirement reductions up to 280bps.

The financial sector remains sound, and authorities have further enhanced measures to strengthen financial services industry resilience and increase financial sector support for the economic recovery. The Financial Services Authority (OJK) unwound forbearance measures for loan/financing restructuring introduced during the pandemic, except for targeted sectors, mostly MSMEs, as they need longer time to overcome the impact of the pandemic due to scarring effect. These MSMEs mostly engage in accommodation and food service activities and labor-intensive business, namely the textile and footwear industries. The extension to March 31, 2024 was specifically allocated only to loans that were previously restructured during the pandemic-time and will be discontinued in time. OJK also strengthened anticipative and calibrated policies by increasing infrastructure, supervision, and governance in the financial sector, as well as consumer protection to maintain the financial sector stability, resilience, and its contribution to national economic recovery.

In 2023, macroprudential and microprudential policy will still be directed to facilitate bank lending and support the national economic recovery, while maintaining financial system stability. The accommodative macroprudential policies stance is consistent with the financial cycle that is still below its long-term trend. BI will maintain accommodative macroprudential policy stance in 2023 and gradually return the policy to pre-pandemic setting when the financial cycle closes the gap and enters the expansionary phase that is predicted to begin at the second quarter of 2024. The macroprudential policies will subsequently be tightened when the financial cycle is peaking up and nearing its peak, to avoid excessive risk taking that increases systemic risk to the financial system. From the microprudential side, three policy priorities will be laid out by OJK. First, strengthening financial service sector, which includes promoting bank consolidation and strengthening accountability in managing investments in NBFI capital market. Second, optimizing the role of the financial sector to support economic recovery, such as to continue to accelerate enhancement of financial access for MSMEs. Third, improving services and strengthening capacity of OJK in enhancing the system of Financial Information Service to create level playing field among financial services industry participants.

Financial market deepening will be accelerated to strengthen the effectiveness of monetary policy transmission as well as financing for infrastructure and businesses. Various programs were implemented as part of the BI Blueprint for Money Market Development (BPPU) 2025 based on three main initiatives: (i) digitalization and strengthening of financial market infrastructure; (ii) strengthening the effectiveness of monetary policy transmission; and (iii) developing financial instruments as a source of economic financing and strengthening risk management. To strengthen monetary policy transmission effectiveness, repurchase agreement transaction was developed in close coordination with relevant authorities and industry associations to standardize repo transaction among market participants and repo transactions under BI Open Market Operations. The application of the blueprint will also support efforts to diversify and strengthen the investor base in the context of SBN

holding, which has so far been dominated by banks. This will mitigate the risks arising from the 'sovereign-bank nexus', going forward.

Payment System Policy

Payment system digitalization continued to be accelerated and expanded. In accordance with the Indonesia Payment System Blueprint (BSPI) 2025, the policy focus in 2022 was oriented towards regulatory reform, retail payment system infrastructure development, and payment standardization. The retail payment infrastructure was modernized to be nationally driven and operating non-stop (24/7) in real time through its new settlement system (BI-FAST) to meet demand for retail transactions that is growing rapidly. BI expanded Quick Response Code Indonesia Standard (QRIS) use as the QR national standard to accelerate payment system digitalization. As of first quarter 2023, QRIS is accepted by 25.4 million merchants and utilized by more than 32 million users, becoming a key entry point to the digital ecosystem for MSMEs to support economic and financial inclusion. QRIS also enabled cross-border payment linkages in the region to reduce the cost. Application of the National Open API Payment Standard (SNAP) also strengthened to accelerate development of the digital economy and finance ecosystem.

Payment system policy in 2023 will be implemented through five key strategies that mutually strengthen national integration of the digital economy and finance ecosystem. First, formulating national standards as 'One Language' for payment system services collaboratively between BI and the industry as well as implementing a campaign of acceptance and use by consumers. Second, accelerating regulatory reform and end-to-end national payment system industry consolidation as 'One Nation' to develop healthy and innovative unicorns in Indonesia that are competitive nationally and internationally. Third, developing further (retail and wholesale) payment system infrastructure as 'One Country' to accelerate national integration of the digital economy and finance ecosystem and as a future prerequisite for issuance of the Digital Rupiah. Fourth, promoting safe, efficient and fair pricing policy and market practices for the national payment system industry to support the national interest and interests of consumers. Fifth, further development of the Digital Rupiah (CBDC) as legal tender through finalization of the conceptual design, development of business models, including preparations for access arrangement and development of the technology platforms required to issue and circulate the Digital Rupiah moving forward.

Structural Reforms

The authorities have reiterated their commitment to pursue comprehensive structural reform agenda to improve productivity, increase investment, create jobs, and boost export competitiveness. Among others, four reform milestones have been achieved through the issuance of the Omnibus Law on Job Creation, Harmonized Tax Regulations Law, Intergovernmental Fiscal Transfer Law, and Omnibus Law on Financial Sector Development and Strengthening (P2SK). The comprehensive and integrated reforms aim to build stronger economic fundamentals and enhance long-term growth potential. Implementing the Job Creation Law, such as speeding up business licensing process, accelerating the National Strategic Project, and implementing risk-based business analysis licensing to encourage FDI, will boost economic capacity through increased efficiency, productivity, and a more conducive business and investment climate. Furthermore, the tax and fiscal decentralization reforms underscore Indonesia's strong commitment to strengthening fiscal sustainability considering the vital role of fiscal policy in supporting the achievement of the development agenda and navigating global challenges. The enactment of the financial omnibus law is

a crucial moment for Indonesia to establish a deep, innovative, efficient, inclusive, trusted, and stable financial sector.

The post-pandemic world provides both challenges and opportunities to drive transformation and enhance economic resilience. The downstreaming policy aims to increase the added value and competitiveness of Indonesia's commodity exports and to revitalize manufacturing sector as a critical strategy for Indonesia's more sustainable and higher economic growth. This policy will ultimately improve the structure of the balance of payments, strengthen the external position and create a more resilient economy. Downstreaming policies cover various aspects of policy in a comprehensive manner including fiscal, financing and investment as well as real sector policies. These policies are implemented in line with the stepwise market approach and will be calibrated from time to time according to the stages of downstream development. The downstreaming policy is also expected to create jobs and attract more foreign investment. In this regard, the Government's decision to conduct downstreaming on nickel ore has stimulated domestic nickel processing and refining industry. Empirical data shows that this policy has had significant results, boosting exports and current account performance. According to the Indonesian Investment Coordinating Board (BKPM), foreign direct investment in 2022 recorded a new high, supported mainly by downstreaming policy. Downstreaming policy will also enable Indonesia to reap benefits from the emerging global trend, such as green economy, and support Indonesia's more intensive involvement in the global value chain, for instance, in the electric vehicle supply chain industry.

The green economy is a key pillar of Indonesia's economic transformation strategies. A roadmap to ensure just and affordable transition is being prepared, along with supporting policies, infrastructure, legislation, and social impact mitigation plan. The September 2022 Enhanced NDC highlights Indonesia's ambitions by increasing the country's emission reduction target from 29% to 31.89% within its own capacity, or 41% to 43.20% with international support. As a concrete step forward in the green economy, particularly in energy transition activity, Indonesia's Energy Transition Mechanism Country Platform was officially announced, which aims to mobilize international and private participation in financing. Accordingly, the Just Energy Transition Partnership (JETP) represents the largest partnership in support of ambitious new targets for Indonesia's just energy sector transition. Under its ASEAN chairmanship, Indonesia supports the ASEAN Taxonomy for Sustainable Finance (ATSF) Version 2, regarded as the first taxonomy to include energy transition activities in its green and amber categories of activities eligible for financing. Indonesia is also keen on developing different aspects of the green economy, including the roadmap of carbon pricing, development of the vehicle industry, as well as providing the basis for establishing a blue economy.

III. Conclusion

Consistency, innovation, and synergy are key elements to strengthen economic resilience, sustain economic recovery, and unlock Indonesia's potential in pursuit of Advanced Indonesia (Indonesia Maju). Consistency in formulating and implementing policies to achieve the set targets needs to be continued. Creative policy innovations are needed to deal with the dynamics and increasing complexity of the multifaceted challenges. Strong synergy between authorities and stakeholders is a necessity for optimizing the achievement of social welfare goals. The spirit of policy synergy is also brought up to the regional forum in Indonesia's ASEAN Chairmanship in 2023, adopting the theme 'ASEAN Matters: Epicentrum of Growth'.