March 30, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/59-2

2:30 p.m., July 3, 2019

2. Indonesia—2019 Article IV Consultation

Documents: SM/19/155 and Correction 1; Supplement 1; SM/19/162; and Correction 1

Staff: Breuer Mojoli, APD; Porter, SPR

Length: 1 hour, 3 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	W. Nakunyada (AE), Temporary
M. Raghani (AF)	
	R. Morales (AG), Temporary
	J. Shin (AP), Temporary
	B. Saraiva (BR)
	P. Sun (CC)
	J. Montero (CE), Temporary
L. Levonian (CO)	
R. Kaya (EC)	
	A. Castets (FF)
S. Meyer (GR)	
	M. Siriwardana (IN)
	M. Psalidopoulos (IT)
	Y. Saito (JA)
	M. Daïri (MD)
	F. Al-Kohlany (MI), Temporary
	S. Harutyunyan (NE), Temporary
	J. Sigurgeirsson (NO)
A. Mozhin (RU)	
	R. Alkhareif (SA)
A. Mahasandana (ST)	
	P. Trabinski (SZ)
	D. Ronicle (UK)
	P. Pollard (US), Temporary

H. Al-Atrash, Acting Secretary
S. Maxwell, Summing Up Officer
M. Gislen, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: O. Brekk, L. Breuer Mojoli, E. Cerutti, T. Helbling, A. Isnawangsih, T. Kinda. Fiscal Affairs Department: B. Shang. Monetary and Capital Markets Department: H. Kang. Strategy, Policy, and Review Department: H. Lin, M. Patnam, N. Porter. World Bank Group: D. Djoldosheva. Executive Director: G. Lopetegui (AG). Alternate Executive Director: A. Guerra (CE), A. McKiernan (CO), K.Tan (ST).

Senior Advisors to Executive Directors: Z. Abenoja (ST), A. Muslimin (ST), S. Evjen (NO), Z.Mohammed (BR), T. Nguema-Affane (AF), S. Potapov (RU), C. Williams (CO). Advisors to Executive Directors: S. Buetzer (GR), S. Chea (ST), D. Crane (US), G. Kim (AP), U. Latu (ST), H. Mori (JA), K. Osei-Yeboah (MD), R. Pandit (ST), D. Susiandri (ST), S. Yoe (ST), A. Zaborovskiy (EC), K. Hennings (BR), K. Lok (CC), J. Freeman (UK), A. Sode (FF).

2. INDONESIA—2019 ARTICLE IV CONSULTATION

The staff representative submitted the following statement:

> The information below has become available following the issuance of the staff report (SM/19/155). It does not alter the thrust of the staff appraisal.
>
> On June 20, Bank Indonesia (BI) kept the policy rate unchanged, reduced bank reserve requirements, and indicated that it would keep an accommodative macroprudential policy stance. The 7-Day Reverse Repo rate remains at 6.00 percent. BI lowered rupiah bank reserve requirement by 50 bps, to 6.0 percent for conventional banks and 4.5 percent for Islamic banks, effective from July 1, 2019. The BI also indicated that it would keep the accommodative macroprudential policy stance to support bank lending and, in coordination with the Government, continue to pursue payment system and financial deepening reforms to support growth.
>
> Headline inflation increased to 3.3 percent (y/y) in May 2019, from 2.8 percent in April 2019, due mainly to higher food prices. Core inflation remained broadly stable at 3.1 percent (y/y). In line with historical dynamics, food price inflation is expected to moderate after the Ramadhan period, while headline inflation is expected to converge to the forecasted 3.1 percent by end-2019.
>
> The trade balance improved in May 2019, registering a US$200 million surplus, compared to a deficit of US$2.3 billion in April 2019.

Ms. Mahasandana, Mr. Tan, Mr. Anwar and Ms. Susiandri submitted the following statement:

> On behalf of the Indonesian authorities, we would like to thank the IMF mission team for the comprehensive and constructive policy dialogue during the 2019 Article IV consultation. The consultation has provided valuable venues to discuss the many progress of home-grown policies as well as reforms that Indonesia is currently undertaking. We appreciate staff’s effort to understand the domestic economy and country specific challenges as well as authorities’ policies and objectives. The authorities are encouraged by staff’s acknowledgement of Indonesia’s solid macroeconomic performance as well as favorable outlook. Accordingly, the authorities broadly concur with the thrust of staff’s appraisal with an important caveat on key recommendations, namely on macroprudential policy.

Recent Economic Development and Outlook

The authorities' policy mix has successfully preserved macroeconomic stability and maintained growth momentum amidst rising global uncertainty in 2018. Economic growth gradually improved to 5.2 percent in 2018, with macroeconomic and financial stability intact as indicated by low and contained inflation and well-maintained financial system stability. External stability remained solid supported by the flexible exchange rates as an important shock absorber of the economy. Appropriate policy mix was implemented last year to strengthen macroeconomic stability, particularly the external stability, while preserving economic growth momentum.

Going forward, the outlook remains buoyant with economic growth expected to improve gradually in the medium term, as growth rate is seen to be slightly higher than staff's estimates. This favorable outlook benefitted in large from the structural reform efforts, which have started to bear fruit in terms of improved productivity. For 2019, the authorities projected economic growth to be within the range of 5.0-5.4 percent and will continue to grow further to 5.5-6.1 percent in the medium term. Inflation is forecasted to be below the midpoint of the 3.5 percent±1 percent target corridor in 2019, in line with well anchored inflation expectations. The current account deficit is expected to narrow due to various measures to curb imports and to promote exports. The authorities will continue to monitor global economic developments while assessing their policy mix.

Fiscal and Structural Reforms

In 2018, the authorities remain committed to maintaining fiscal sustainability, by ensuring that the primary balance and the budget deficit were below state budget target of -0.6 percent and 2.2 percent of GDP respectively. During the period of heightened global uncertainty, the authorities' policy consideration was mainly focused on ensuring fiscal sustainability to maintain economic stability. The primary balance and the budget deficit in 2018 were smaller than the target at -0.08 percent and 1.8 percent of GDP, respectively. This has enabled the Government to maintain the official debt level at 29.8 percent of GDP, far below the legal threshold of 60 percent of GDP. Going forward, the policy thrust will be to preserve fiscal sustainability while supporting economic growth. Overall, the authorities agreed on the merits of a broadly neutral fiscal stance. The Government has set the target for primary balance and budget deficit in 2019 to be -0.12 percent and 1.84 percent of GDP, respectively.

The authorities concur with staff that revenue mobilization should be a top fiscal reform priority to build the fiscal buffers. In this vein, the comprehensive tax reform has been focused on improving tax administration, streamlining tax structures, broadening the tax base, and increasing compliance in order to increase fiscal buffer. The authorities supports the improvement of tax revenue mobilization through integrated and up-to-date data and information utilization, international tax treaty optimization, and the effectiveness of Automatic Exchange of Information implementation. The authorities have also been simplifying tax structures as a part of a tax reform plan and reviewing the income tax and value-added tax law.[1] They will also lessen the complexity of the current tax system, including to review tax exemptions to ensure the effectiveness. To this end, the authorities would welcome the IMF's support to enhance the current draft amendment of the income tax law.

On the expenditure side, the authorities will maintain their efforts to further improve the quality of public spending. This includes refocusing priority spending on infrastructure, ensuring efficiency in spending, as well as implementing better-targeted subsidies and more effective social protection programs. In this view, the Government implemented several short-term measures to stimulate the economy, while keeping long-term measures to boost the productivity including through human capital quality improvement. To this end, the authorities welcome the IMF's expertise to improve government capital expenditure strategy through technical assistance and capacity development. The authorities remain committed to energy subsidy reform, and will ensure that the economy can adjust smoothly. Gradual implementation of subsidy reform will be complemented by targeted measures for the vulnerable groups.

The authorities will also continue to pursue structural reforms to achieve sustainable and inclusive growth. Expanding infrastructures investment, improving the business climate, and promoting financial market deepening are some of the noteworthy actions. In order to maintain a healthy investment climate, the authorities commit to maintain market confidence. The authorities' steadfast implementation of the structural reform agenda as well as consistent performance in terms of macroeconomic stability have been recognized by the credit rating agencies. S&P has upgraded Indonesia's rating to BBB from BBB- with a stable outlook in May 2019. Therefore, Indonesia's

[1] The income tax and value added tax are known domestically as Pajak Penghasilan (PPh) and Pajak Pertambahan Nilai (PPN), respectively.

sovereign ratings from all of the three major rating agencies, S&P, Moody's, and Fitch, are currently one notch above minimum investment grade level.

Monetary and Exchange Rate Policy

Monetary policy has focused on maintaining macroeconomic stability amidst heightened global uncertainty. In this regard, the central bank employed various policy instruments, including monetary policy rate, exchange rate flexibility, and foreign exchange intervention to meet its objectives.

In 2018, Bank Indonesia (BI) pursued a preemptive, front-loading, and ahead-of-the-curve policy by raising the policy rate by 175 bps to weather risks posed by interest rate hike in the US and other emerging markets, as well as uncertainty in global financial markets.[2] Looking ahead, BI concurs with staff's suggestion to cautiously consider the room for accommodative monetary policy to help stimulate domestic economy while ensuring inflation remains on target. Nevertheless, BI remains mindful of the global financial market dynamics and external stability and will undertake a comprehensive assessment of the policy direction to avoid adverse effects to macroeconomic and financial stability.

The authorities affirmed their commitment to allow exchange rate flexibility to serve as a shock absorber. In this context, intervention in the FX market will be limited to curbing excessive volatility. On the IMF's advice to publish the Forex Intervention (FXI) data, BI views that this requires prerequisite conditions to be met such as the existence of a deep, efficient and market driven foreign exchange market. BI will reconsider the publication of the FXI data once these preconditions are fulfilled.

BI continues to enhance its monetary operation strategy to maintain adequate liquidity in the money market and banking sector, especially during periods of high market volatility. In this light, BI increased the auction frequency of government securities reverse repo, reactivated the BI Certificate auctions, conducted forex swap auctions, and increased the portion of average

[2] The preemptive increases in the policy rate, namely BI 7-Day Reverse Repo Rate (BI7DRR), were linked to the forward-looking, anticipatory response of Bank Indonesia to the risk of increases in the Federal Funds Rate (FFR) and uncertainty on global financial markets. The front-loading response meant that the magnitude of the increase in the Indonesian policy rate had considered the possible extent of an increase in the FFR, so that the interest rate differential would remain sufficiently large to maintain the attractiveness of domestic assets. Alongside this, the ahead-of-the-curve response was related to the fact that the magnitude of Indonesia's policy rate increases would also anticipate interest rate increases in other emerging markets so that the domestic financial market would remain competitive.

statutory reserve requirement.[3] The implementation of reserve requirement (RR) averaging is aimed at giving more flexibility to banks in managing their liquidity, which can reduce the volatility of the interbank money market and strengthen the monetary policy transmission mechanism. The authorities took note of staff's recommendation on expanding the coverage of the averaging portion to all portions of the RR. BI will consider staff's advice when reviewing the effectiveness of RR averaging.

External Sector

In 2018, the heightened global uncertainties posed increasing risk on external stability. This unfavorable condition adversely affected BoP performance, adding pressure to the rupiah, particularly during the second and third quarter of 2018. The policy mix executed by the authorities helped restore Indonesia's external stability. The current account deficit was kept at 2.98 percent of GDP for the whole 2018, despite widening to 3.6 percent of GDP in the fourth quarter. The current account deficit then narrowed to 2.6 percent of GDP in the first quarter of 2019. The improving trend of capital inflows by non-residents in the fourth quarter of 2018 and first quarter of 2019, together with the narrowing current account deficit in the first quarter of 2019, had a positive effect on external sector balance. The BoP eventually returned to surplus in the fourth quarter of 2018 and first quarter of 2019. External stability was further bolstered by adequate reserve assets to cover imports and to service government external debt, well above the international reserve adequacy standard of three months of imports.

Reiterating previous Article IV consultation, authorities view the estimated CA norm resulting from EBA model to be too low and does not adequately reflect Indonesia's need for higher investment and structural reforms. We encourage staff to consider how to better incorporate country-specific factors in the assessment of the current account norm, in particular the substantial infrastructure investment needs and critical structural reforms that the country is undertaking to promote sustainable growth.

External debt remained sustainable, including private debt. The authorities believe this favorable environment was backed by the prudential regulations on external borrowings. The corporate sector external debt regulation was aimed at ensuring macroeconomic and financial stability through the implementation of prudential principles on corporate foreign

[3] Locally, the government securities reverse repo and the BI Certificate are called Reverse Repo-Surat Berharga Negara (RR-SBN) and Sertifikat Bank Indonesia (SBI), respectively.

borrowings.[4] The authorities will review regularly the appropriateness of this regulation in supporting external stability.

Going forward, external stability is projected to improve. The current account deficit is predicted to ease, supported by close coordination between BI and the Government to address the issue, including through various measures to curb excessive import and to promote export. The current account deficit is projected at about 2.5–3.0 percent of GDP in 2019 and will decline further in the medium-term. The capital and financial account surplus is also set to improve, exceeding the level achieved in 2018, bolstered mainly by higher inflows of FDI, improvements in the business climate, and a solid domestic economy outlook.

Macroprudential and Financial Sector Policy

Macroprudential policy will continue to safeguard financial system stability and mitigate systemic risk. Nevertheless, in the event that the financial cycle is below the long-term trend, macroprudential policy can be calibrated to support a more balanced growth of credit. The current accommodative macroprudential policy has helped boost bank lending growth. Meanwhile, financial system stability continues to be maintained by a well-capitalized banking sector. Going forward, the authorities view that there is room to maintain current accomodative macroprudential policy, while remaining vigilant to ensure financial system stability.

Financial system stability was maintained, underpinned by a robust banking capital position and adequate liquidity, as well as improvement in corporate financing. At the end of 2018, the capital adequacy ratio (CAR) and the liquid assets to deposits ratio stood at 22.9 percent and 19.3 percent, respectively. Credit growth was at 11.8 percent, while credit risk was kept within prudent limits as reflected in the low NPL ratios of 2.4 percent (gross) and 1.0 percent (net), both of which were within the 5 percent sound territory. Improvement also took place in non-bank financing. Total issuance of shares (IPOs and rights issues), corporate bonds, medium-term notes and negotiable certificate of deposits (NCDs), all representing various forms of financing from the capital market, were recorded at IDR168.1 trillion (gross). This points to an improvement in corporate financing from domestic sources, including from both banks and the capital market.

[4] In Indonesia, this regulation is known as Kegiatan Penerapan Prinsip Kehati-hatian (KPPK).

The authorities have made encouraging progress in harnessing the benefits and opportunities of rapid advances in the digital economy which have transformed the economic and financial landscape, while at the same time managing emerging risks. In this context, authorities have outlined a vision of Indonesia's Payment System (IPS) 2025 as well as an initiative for a new payment system blueprint to ensure that the current trend of digitalization develops within a conducive digital economic and financial ecosystem, along the lines of Bali Fintech Agenda.

Financial Market Deepening (FMD)

In 2018, the FMD policy was focused on improving the efficiency of money and forex markets to lay the foundation for promoting long-term economic financing. BI has taken several actions by introducing domestic non-deliverable forward (DNDF) transaction, developing market for call spread options (CSOs), establishing Indonesia Overnight Index Average (IndONIA) as a benchmark rate on the Rupiah money market and as a reference rate for Overnight Index Swap (OIS), as well as strengthening the Jakarta Interbank Offered Rate (JIBOR). BI, MoF, and OJK have also developed more innovative financing schemes to finance infrastructure development in Indonesia, including public-private partnerships (PPP), project bonds, infrastructure funds, asset and earning backed securities as well as blended finance. After successfully launching the SDG One Blended Finance roadmap at the IMF-World Bank Annual Meetings in Bali, the Indonesian government also released the first Green Sukuk bond at the beginning of this year. This represents Indonesia's tangible and avowed commitment to environmental infrastructure development.

The authorities also strengthened coordination to speed up financial market deepening. To that end, BI, the MoF, OJK have established the Coordination Forum on Development Financing by means of Financial Market.[5] The Coordination Forum was mandated to formulate a National Financial Market Development and Deepening Strategy as a comprehensive and measurable single policy framework oriented towards realizing the vision of creating deep, liquid, efficient, inclusive and secure financial markets.[6] The authorities have introduced a national blue print to accelerate the pace of financial market deepening. The authorities have also been working on legal upgrade to align and strengthen the mandate of BI, OJK, and Indonesia

[5] This forum in Indonesian is called Forum Koordinasi Pembiayaan Pembangunan melalui Pasar Keuangan (FK-PPPK)

[6] Strategi Nasional Pengembangan dan Pendalaman Pasar Keuangan (SN-PPPK) is another name for The National Financial Market Development and Deepening Strategy in Indonesian.

Deposit Insurance Corporation (LPS) going forward in order to pursue financial deepening objectives.

Conclusion

Indonesia's economy continues to perform well, underpinned by sound macroeconomic policy aimed at maintaining macroeconomic stability while also promoting higher potential growth. The authorities' policy-mix has successfully preserved macroeconomic stability and maintained the growth momentum amidst rising global uncertainty in 2018. The central bank policies were brought into synergy with the Government's fiscal and structural reform policies. Fiscal policy was aimed to preserve fiscal sustainability outlook, while also providing room to promote economic growth. These policies were further supported by the acceleration of structural reforms efforts. Going forward, the authorities remain committed to maintain economic stability as well as to step up structural reforms to achieve strong, sustainable, balanced and inclusive economic growth.

Mr. Mahlinza and Mr. Nakunyada submitted the following statement:

We thank staff for a comprehensive set of reports, as well as Messrs. Mahasandana, Tan, Anwar, and Susiandri for their helpful buff statement.

The Indonesian economy has maintained strong growth supported by sound macroeconomic policy frameworks which have guided fiscal sustainability as well as price and financial stability. The pace of growth, however, remains constrained by underlying structural weaknesses, fragmented and shallow financial markets, tight global financial conditions, and heightened trade tensions. To boost the growth potential and create employment opportunities for the growing youth population, we urge the authorities to implement comprehensive structural reforms, deepen the domestic financial markets, and preserve macroeconomic stability. We broadly concur with the thrust of the staff appraisal and emphasize the following points.

Domestic revenue mobilization efforts should be intensified to build fiscal buffers and finance development needs. In this regard, we welcome efforts to improve tax administration, streamline tax structures, broaden the tax base, review tax exemptions and simplify the general tax system. Further efforts through the Medium-Term Revenue Strategy (MTRS) will create additional fiscal space and raise revenues required to mitigate the risks of volatile external financing. That said, we commend the authorities for continued efforts to improve spending efficiency but emphasize the need to fully implement the recommendations of the recent PIMA assessment. We also welcome the efforts by the authorities to closely monitor fiscal risks from SOEs while promoting greater private sector participation in the development of infrastructure. Going forward, sound risk management practices would be critical to mitigate fiscal risks arising from contingent liabilities from SOEs debt and PPP arrangements.

Financial deepening remains central to unlocking domestic resources and reducing reliance on volatile capital flows. In this connection, we welcome the authorities' efforts to further develop the financial sector, through the adoption of more short-term instruments, and the launch of the national payment gateway to facilitate retail payment systems. That said, plans to establish the holding company of public sector financial institutions should be carefully considered to mitigate potential risks to financial deepening and stability. On the other hand, priority should be placed on completing legal upgrades to strengthen and align the institutional mandates of BI, OJK and LPS. While we appreciate the important steps taken to promote financial inclusion in order to overcome existing geographical obstacles and other regulatory impediments, caution is required to monitor financial innovations that fall outside the current regulatory perimeter. Considering elevated cyber security risks stemming from increased financial innovation, we emphasize the need to strengthen the oversight and management of cyber risks. We, however, commend the authorities for the progress made in the implementation of the 2017 FSAP recommendations and underline the need for progress in strengthening financial oversight and crisis management. We note staff's recommendation to gradually loosen monetary policy despite tightening global financial conditions and wonder if this stance would not trigger capital flight. Could staff comment on the appropriate pace for monetary policy loosening that maintains this delicate balance?

Comprehensive structural reforms remain essential to improve productivity and achieve higher potential growth. In this vein, we commend the authorities for notable progress made in streamlining regulations, expanding infrastructure, reforming education and health, and opening selected sectors to FDI. We also welcome the authorities' plans to undertake labor market reforms to increase flexibility and align wage growth with productivity. To further foster competitiveness, we urge the authorities to remove excessive protection of firms, FDI restrictions, and trade barriers. Enforcement of the rule of law would also be important to strengthen investor protection, the integrity of contracts and property rights. Furthermore, we urge the authorities to implement fiscal governance reforms to reduce vulnerabilities to corruption. Finally, we welcome the issuance of regulations to implement risk-based AML/CFT supervision but underscore the need to effectively implement the established obligations.

Mr. Sun and Ms. Lok submitted the following statement:

We thank staff for the comprehensive set of reports and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their useful buff statement. With the support of robust domestic demand, the Indonesian economy performed well in 2018 despite increased external pressures. That said, risks to the outlook are tilted to the downside and mainly stemming from external factors. Continued prudent policy management would be essential for safeguarding the economy’s resilience while supporting potential and inclusive growth. We broadly share the thrust of staff’s appraisal and would limit our comments to the following.

To fully harness Indonesia’s potential and promote inclusive growth, a comprehensive set of policies and reforms is needed. On the fiscal front, there is room for increasing government revenues, which would be key to supporting spending on infrastructure, health, education, and social safety nets. We take positive note that revenue mobilization is a top priority for the authorities and welcome the various tax reform measures to improve tax administration, streamline tax structures, and broaden the tax base. Implementing a medium-term revenue strategy would help guide and further solidify revenue mobilization efforts. On the expenditure side, the authorities’ actions are rightly focused on enhancing the quality of public spending, prioritization, and efficiency. Further steps to strengthen management of contingent liabilities from SOEs and PPPs are also welcome.

On the structural front, further reforms to tackle challenges in the labor and product markets would be critical for boosting potential growth and inclusion. The authorities should build on the progress achieved in infrastructure development so far and implement further reforms to create quality jobs for Indonesia’s young and growing workforce. These include, among others, improving education and vocational training, as well as enhancing governance and the overall business environment to further encourage private investment. Advancing financial deepening would complement the above efforts by enabling the financial sector to provide greater access to financing and support further private sector development. The rapid development of e-commerce in recent years demonstrates promising potential from technological innovation for Indonesia. We welcome the fact that the authorities are facilitating the integration of the digital economy with the financial sector and the broader economy, while being mindful of emerging risks. Could staff elaborate a bit more on their suggestion to establish a dedicated group on cybersecurity, and the authorities' views on this suggestion?

The combination of monetary and macroprudential measures undertaken by Bank Indonesia has helped the economy weather through a period of financial volatility. Given persistent uncertainties surrounding the external environment, policy action going forward should be proceeded with care, taking into account both domestic conditions and the global financial environment. In calibrating the appropriate macroprudential policy, the authorities are faced with the challenge of balancing between the goals of mitigating systemic financial stability risks and supporting healthy credit growth. While we see reasons for maintaining the current accommodative macroprudential policy stance, it is important to closely monitor the related policy impacts and stand ready to adjust as appropriate should vulnerabilities and risks to the financial system increase. In this regard, we take comfort from the authorities' continued vigilance to ensure financial stability. Meanwhile, we welcome the progress so far by the authorities in implementing the 2017 FSAP recommendations and encourage the authorities to continue to strengthen Indonesia's oversight and crisis management frameworks in the financial sector going forward.

Finally, we note that the authorities continued to view that the EBA model estimated CA norm does not adequately reflect Indonesia's need for higher investment and structural reforms. We join the authorities in encouraging staff to consider how to better incorporate country-specific factors in their assessments.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Sigurgeirsson and Mr. Evjen submitted the following statement:

We thank staff for the good report and Mr. Tan, Mr. Anwar, and Ms. Susiandri for their informative buff statement. We broadly concur with staff's assessment and would like to offer some comments for emphasis.

We commend the authorities for sound macroeconomic policies and Indonesia's strong economic performance, despite external headwinds. According to staff projections both growth and inflation will remain stable for the next few years. The current account deficit is expected to narrow gradually. However, high reliance on portfolio inflows to finance the twin fiscal and current account deficits leaves Indonesia vulnerable to a sharp tightening of global financial conditions and capital flow reversals. We welcome the free trade agreements concluded with Australia, Chile, and the European Free Trade Area which should support exports and hopefully help reduce the current account deficit.

We note staff's assessment that government revenues remain insufficient to meet development goals. Low fiscal revenues have resulted in reliance on SOEs and PPS, increasing fiscal risks. Hence, we encourage the authorities to implement a medium-term revenue strategy to finance priority spending on infrastructure, education, health, and social safety nets. We note positively that using these revenues to finance priority spending may help reverse the increase in income inequality.

Structural reforms are needed to help raise potential growth and create jobs for its young and growing labor force. We encourage the authorities to address bottlenecks in labor and product markets, including limited human capital development, skills mismatches, and low female labor participation. We note staff's assessment that female labor force participation can be enhanced by improving access to affordable childcare and flexible work arrangements.

Monetary policy successfully helped manage the 2018 external pressure episode. The policy mix relied on the policy rate to target the external balance, while liquidity provisions and looser macroprudential policies has limited the impact of monetary policy tightening on the financial sector and domestic conditions. As a result, banks' lending rates have declined despite increases in the policy rates. This policy mix seems somewhat unusual but still successful in this case. We agree that there is room to cautiously loosen the monetary policy stance, while closely monitoring the impact on capital inflows, the exchange rate, and on bank and corporate balance sheets.

The corporate sector is exposed to FX risk. Elevated foreign-currency debt of corporates leaves them exposed to rupiah volatility which could have spillovers to the banking sector. We agree with staff's assessment that the corporate prudential FX regulation should be further improved by extending its coverage to all FX liabilities, focusing on systemic corporates. We note positively, however, that the banking system is well capitalized. Finally, we welcome the authorities' efforts to strengthen financial oversight and crisis management in line with FSAP recommendations, including issuing regulations to implement risk-based AML/CFT supervision.

Mr. Lopetegui and Mr. Morales submitted the following statement:

We thank staff for their well-written report and Ms. Mahasandana, Mr. Anwar, and Ms. Susiandri for their informative buff statement.

Indonesia's economy has been successful at stabilizing growth despite external headwinds. GDP growth picked up to 5.2 percent in 2018 spurred by robust domestic demand. Investment accelerated, and consumer confidence improved in response to sound macroeconomic policies. The recently re-elected government has committed to embark on structural reforms that would allow Indonesia to take advantage of its demographic dividend. Key priority tasks for further reform are raising the tax revenue potential, developing financial markets and removing rigidities in labor and product markets.

Over the years, key policy decisions have supported a stable macroeconomic environment in Indonesia as highlighted in the analysis of Indonesia's Macroeconomic Policy Framework. On structural measures, the well-established fiscal rules and inflation targeting framework adopted more than a decade ago, together with the prudent use of macroprudential measures and capital flow management measures to influence credit growth and capital flows, have been instrumental in ensuring macroeconomic stability. As Ms. Mahasandrana, Mr. Anwar and Ms. Susiandri indicate in their buff statement, the authorities rightly focused on ensuring fiscal sustainability in this period, keeping the primary and budget deficits below target. Regarding Indonesia's response to shocks, Indonesia stands out as one of the countries with the largest cumulative rate hikes in 2018 following an increase in global interest rates despite showing a low inflation gap. We commend the authorities for maintaining a flexible exchange rate regime during this period that helped contain a potentially destabilizing decline in international reserves.

We agree with giving high priority to tax reform in the post-election reform agenda. Government revenue in Indonesia remains below peers, constraining spending in key areas. We welcome the authorities' intention to introduce amendments to the income tax law with Fund staff assistance, and we encourage them to build on recent progress with risk-based audits, institutional upgrades, and the modernization of IT systems to embark on comprehensive reform within the framework of a medium-term revenue strategy (MTRS). This would allow sustainable financing of infrastructure, education, health and social safety net outlays that would support inclusive growth. We agree with staff that the implementation of the MTRS should take place with careful prioritization, sequencing and phasing. This would support more sustainable results on streamlining tax regimes, removing distortions, and improving compliance and efficiency. Regarding government expenditures, we welcome the authorities' continuous efforts to improve spending efficiency, including through the implementation of recommendations from the recent PIMA exercise, particularly on appropriate identification, preparation and selection of key projects in the context of a multiyear budgeting framework, and upgrades in capital projects' oversight, monitoring and management. In addition, deepening energy subsidy reform while targeting measures to compensate the vulnerable population would further contribute to improving spending efficiency.

Macroeconomic stability has helped contain external pressures, and capital inflows have resumed following a sharp decline in 2018. However, the economy is vulnerable to capital flow reversals because of the high share of non-resident investors in domestic securities markets and corporate financing. In addition to that, risks are tilted to the downside, related to possible rising trade tensions, tightening of global financial conditions, slowdown in China, and volatility in commodity prices. For this reason, building external buffers appears advisable taking advantage of continuous capital inflows, while maintaining exchange rate flexibility. At the same time, we agree with the authorities that, looking forward, Fund staff external assessments should be mindful of key structural breaks as Indonesia embarks on an effort to upgrade infrastructure.

Macroprudential policy has aimed at accommodating higher financial intermediation. However, since 2018 monetary policy and macroprudential policy have moved in opposite directions to achieve stability while containing financial risks during a period of high volatility, as illustrated by the bottom chart in Box 1 This appears to have temporarily weakened the monetary policy transmission to aggregate demand. Given that monetary policy has been successful in containing inflation risks in the context of neutral financial conditions according to the staff's growth-at-risk exercise, we agree with staff that there is room to cautiously loosen the monetary policy stance unless significant capital account pressures emerge. In this regard, the recent reduction in reserve requirements is a step in the right direction. We also agree with staff that clear communication of a shift of the monetary policy stance would be critical to its successful implementation. In parallel, we encourage the authorities to monitor the impact of recent relaxations of macroprudential measures. The staff could usefully explain the channels through which the recently relaxed macroprudential ratio would affect financial conditions in the current circumstances.

We note that the Indonesian financial system remains sound and stable, with a robust capital position and adequate liquidity. We welcome Bank Indonesia's (BI) measures to support a more efficient liquidity management by banks, including the increase in the frequency of government securities reserve repo and the implementation of reserve requirement averaging. Also, the Coordination Forum on Development Financing with the participation of BI, Financial Services Authority (OJK), and the Ministry of Finance and would be an opportunity to coordinate the implementation of pending FSAP recommendations, including strengthening supervision of financial conglomerates, upgrading safety nets, and further developing secondary financial markets.

Structural bottlenecks in labor and product markets conspire against Indonesia's efforts to reach higher economic growth. Structural reform should be accompanied by efforts to accelerate human capital development, narrow skill mismatches, raise female labor participation and make labor markets more flexible. In addition, post-election reforms should give priority to further simplify regulations and remove restrictions to private business, especially to FDI, in order to strengthen links with global value chains. Moreover, we agree with staff that greater coordination to avoid conflicting regulations between the central and local governments could contribute significantly to improve the business environment.

Finally, we encourage the authorities to continue to upgrade its AML/CFT framework in line with the recommendation from the 2018 Mutual Evaluation Report of the Asia-Pacific Group on Money Laundering. These include, among others, increasing Money-Laundering investigation agencies' capabilities and capacity to investigate complex cases, enhancing the capacity of the Asset Recovery Center to execute its mandate, and implementing a risk-based approach for all reporting entities under the OJK jurisdiction.

Mr. Ray and Mr. Shin submitted the following statement:

We thank staff for their comprehensive reports on Indonesia and Ms. Mahasandana and Mr. Tan, Mr. Anwar and Ms. Susiandri for their informative buff statement. The Indonesian economy, which is the sixth largest economy in the world, has weathered well the recent external headwinds. The medium-term outlook is favorable with annual growth projected to exceed 5 percent, but external vulnerabilities remain. We broadly agree with the staff assessment and have the following comments for emphasis and clarification.

In light of the ongoing risk of capital flow reversal, the main focus of the policy mix needs to continue to be on preserving macroeconomic and financial stability. We commend the authorities for their decisive actions in response to the pressures in emerging markets in 2018. Indonesia's experience could provide an interesting case sturdy for the work on the "Integrated Policy Framework". We note that staff suggest cautious relaxation of the monetary policy stance unless significant capital account pressures reemerge. Does staff have an estimate of how sensitive the capital outflows have been to the level of domestic interest rates? In the longer perspective, we support the authorities' reform priority of deepening domestic financial markets, which could lower the reliance on external financing in both the public and corporate sectors.

Exchange rate flexibility remains critical, so do avoiding excessive volatility and managing FX liquidity risks. In this regard, we welcome the authorities' move to facilitate a private sector-driven DNDF market. We are aware that the recent revision of regulation was intended to provide greater convenience for market players to hedge against currency risk using DNDF transactions. Could staff further explain the size of the DNDF market and the expected stabilizing effect of this action? On the publication of FX intervention data, we support the authorities' view that such a decision needs to be made cautiously, taking the country-specific circumstances fully into consideration. On the ESA, staff acknowledged the divergence between the exchange rate and current account assessments (moderately weaker external position vs. REER undervaluation) and attribute it to the lags in the current account response to the REER depreciation. We note that the current account deficit is projected to remain around 3 percent of GDP over the next couple of years. Staff's further comments would be welcome.

We would encourage the authorities to further accelerate the implementation of a MTRS in a well-sequenced manner, given the trend decline in oil and gas revenue. On the expenditure front, protecting growth-enhancing capital spending with higher efficiency of other spending would be the key.

Structural reforms to improve education and labor market flexibility are a crucial step to reap the benefit of the demographic dividend. We agree that Indonesia has a window of opportunity to take advantage of its demographic dividend unlike some other Asian peers. We welcome the authorities' efforts to improve the quality of education and to strengthen vocational training and job placement services. We note from Table 1 that the unemployment rate lies around 5.3 percent in 2018. Could staff elaborate on the job market conditions for youth, including the current youth unemployment rate? More broadly, continuing to reduce the reliance on SOEs and transitioning towards more private sector driven growth will be important to absorb the growing labor force and to sustain rising income per capita.

Mr. Saraiva and Ms. Mohammed submitted the following statement:

We thank staff for the report and the insightful buff statement of Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their helpful statement. We commend the Indonesian authorities for the sound macroeconomic performance with robust growth, appropriate fiscal stance, contained inflation and stable financial sector. Although the outlook remains very encouraging with high growth, narrowing current account deficit, and stable inflation and financial sector, the risk is tilted to the downside due to external factors, including rising trade tensions, sharp tightening of global financial conditions and large swings in commodity prices. The successful implementation of the reform-package would be essential in ensuring macroeconomic stability, sustainability and resilience to shocks.

Implementation of the medium-term revenue strategy (MTRS) will help enhance inclusive growth and boost productivity. The authorities are commended for adhering to the fiscal rules and ensuring that there is space to pursue countercyclical policies if necessary. We believe that revenue mobilization is crucial to promote inclusive growth and finance key areas of education, health, infrastructure, and social safety nets, which could support labor reform by facilitating the strengthening of social safety nets. On the expenditure side the authorities are encouraged to continue to improve the quality and efficiency of spending at all levels of governments, including by streamlining and better targeting energy subsidies, expanding social assistance and reviewing the quality of spending in priority sectors. Like staff, we emphasize that implementation of the MTRS reforms requires careful prioritization and sequencing, given the interdependence of the reforms.

The authorities' commitment to the exchange rate flexibility is welcomed. Indonesia flexible exchange rate regime has been beneficial in serving as a shock absorber in volatile financial condition and remains critical to the economy's resilience to future shocks. We agree with staff that FX intervention should continue to be used mainly to address disorderly market condition and the authorities should further strengthen the monetary transmission mechanism. We take note from the statement of Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri that the Forex Intervention (FXI) data cannot be published as advised by staff because the prerequisite conditions, such as the existence of a deep, efficient and market driven foreign exchange market, have not been fulfilled. Staff views are welcomed.

Current circumstances and prospects seem to warrant a cautious unwinding of some of the interest rate hikes of last year. We understand that BI acted preemptively in the face of tightening international financial conditions. Moreover, we acknowledge the vulnerability of Indonesian economy to shifts in market conditions, given its high reliance in portfolio flows to finance the current account and fiscal deficits and the need to monitor those conditions and act accordingly. That said, with the more benign – albeit not risk-free – international environment and well-anchored inflation and inflation expectations, there might be a case for easing monetary policy in a cautious and gradual way.

Deepening Indonesia’s financial system while protecting prudential standards is warranted. The authorities are commended for the progress made in better integrating the digital economy with the financial sector. We welcome the launch of the national payment gateway and the approval of a blueprint for payment system reforms, along the lines of the Bali Fintech Agenda. However, like staff, we believe that technological innovation offers a promising channel for financial inclusion, but oversight and management of cyber risk in the financial system must be enhanced simultaneously. We also welcome the IMF technical support to the authorities in using big data to enhance housing price statistics, as well as the Bank of Indonesia (BI) pilot, in collaboration with Netherlands Statistics, on consumer price and consumption statistics. Comments on preliminary findings would be welcome.

The banking sector is healthy, with adequate capitalization, profitability, and liquidity, however, vulnerabilities exist across banks. We commend the authorities on their strengthening of the financial oversight and crisis management in line with the FSAP recommendations and welcome the regulations issued to implement risk-based AML/CFT supervision, as well as the enhanced regulation on systemic and non-systemic bank resolution/restructuring. However, the authorities should build on this progress and further improve institutional mandates, supervision of nonbank financial institutions and financial conglomerates, legal protection of officials involved in financial oversight and crisis management, and crisis management frameworks, such as the ELA and resolution frameworks. Staff underscores that restricted access to external financing could affect macrofinancial stability and that targeted measures could alleviate funding pressures for solvent banks. This suggests that there could be a role for a facility like the Short-term Liquidity Swap (SLS), which was previously proposed but didn't get enough support for approval by the Board. Staff comments are welcomed.

Structural reforms are essential in improving potential growth and inclusion. Ensuring more equitable access to quality education and easing labor market reforms would promote employment and demographic dividend. We encourage the authorities to increase their efforts in implementing reforms to improving governance and reduce the role of the state, antitrust exemptions, and barriers in the network sector.

We take note of the authorities' views that the CA norm resulting from EBA model is too low and does not adequately reflect Indonesia's need for higher investment and structural reforms. We sympathize with the authorities' call to encouraging staff to consider how to better incorporate country-specific factors in the assessment of the current account norm.

Mr. Kaya and Mr. Zaborovskiy submitted the following statement:

We thank staff for the informative set of papers and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their insightful buff statement. The Indonesian authorities' sound policy response to external headwinds, including capital flow reversals, helped preserve macroeconomic and financial stability and ensure the economy's good performance in 2018. We commend the authorities for their policy achievements and welcome their plans to step up structural reforms as outlined in the buff statement. We broadly agree with the thrust of staff's appraisal and note the broad concordance between staff and the authorities except for the external sector assessment and macroprudential policy recommendations. On the latter, we sympathize with the authorities' views and would have preferred a more nuanced discussion about these issues in the staff report.

Prudent fiscal policies, underpinned by growth-friendly revenue mobilization and public financial management reforms, would further boost Indonesia's growth potential. We agree with staff's recommendations on maintaining the neutral fiscal stance and pressing ahead with the fiscal structural reforms aimed at boosting budget revenues (based on the medium-term revenue strategy - MTRS) and increasing expenditure efficiency. Considering that the MTRS implementation requires careful prioritization and sequencing, it is important to focus the early reform efforts on improving the existing tax system and administration. To garner broad public support for the far-reaching tax reform, a well-designed communication campaign will be helpful. We also encourage the authorities to remain vigilant about fiscal risks and contingent liabilities, stemming from the state-owned enterprises and Public-Private Partnerships (PPPs). Staff's update on the authorities' recent measures to enhance fiscal risk management is welcome. We positively note that the public investment management assessment (PIMA) has been completed recently and the authorities' plans to move forward with implementing the PIMA recommendations.

Proactive and data-dependent monetary policy and exchange rate flexibility continues to serve Indonesia well. The Bank Indonesia's (BI's) preemptive, front-loading, and ahead-of-the-curve monetary policy response helped successfully manage the 2018 Emerging Market selloff which affected Indonesia. Monetary policy tightening and exchange rate flexibility were instrumental in easing pressures while the accommodative monetary policy stance supported credit growth. Contrary to staff's recommendation to gradually ease monetary policy, unless significant capital account pressures reemerge, on June 20, the BI kept the policy rate unchanged and indicated that it would keep an accommodative macroprudential policy stance. Can staff comment on whether they consider tightening the macroprudential policy stance while lowering the policy rate an advisable policy decision? We welcome the authorities' commitments to the exchange rate flexibility. Regarding the current account (CA) norm for Indonesia, like the authorities, we find the CA-norm of -0.8 percent of GDP without staff's adjustment (and -1.7 percent of GDP after staff's adjustment) as surprisingly small for an emerging market economy with significant development needs. Could staff compare the CA-norm for Indonesia with the CA-norms of countries with a similar level of GDP per capita?

Developments in the financial sector are encouraging and should be sustained by implementing the FSAP recommendations and strengthening oversight and risk management. We welcome that the Indonesian banking system is well-capitalized with healthy balance-sheets and adequate liquidity and capital buffers. Since the Indonesian corporate sector is exposed to FX risks, we see merit in the authorities' efforts to ensure macrofinancial stability through the corporate prudential FX regulation. We note that staff's and the authorities' views continue to differ on the CFM/MPM classification of this regulation. Could staff clarify their views on any alternative measures which are advisable, considering Indonesia's circumstances? Notwithstanding the remaining pockets of vulnerabilities, the financial system remains resilient and performs well. We welcome the financial market deepening, money and forex markets developments and commend the Indonesian authorities for the notable progress in harnessing the benefits and opportunities of rapid advances in the digital economy while at the same time managing emerging risks.

We commend the authorities' commitment to pursue structural reforms to achieve sustainable and inclusive growth. Like staff, we believe that the current window of opportunity is well suited for accelerating structural reforms to boost economic resilience and competitiveness. We welcome the authorities' and staff's concurrence on the main reform priorities. Far-reaching labor, product market, and governance reforms could significantly lift the Indonesian growth potential and enhance inclusion.

With these remarks we wish the Indonesian authorities every success in their policy endeavors.

Mr. Geadah and Mr. Al-Kohlany submitted the following statement:

We thank staff for their reports, and Ms. Mahasandana, Messrs. Tan and Anwar, and Ms. Susiandri for their informative buff statement. Indonesia's economy continued to perform well in 2018, driven by robust domestic demand and supported by effective macroeconomic policies and growth-enhancing structural reforms. We commend the authorities for effectively mitigating the impact of the exchange rate pressures and capital outflow episodes. The outlook is positive but with downside risks stemming from global trade tensions, slower growth in trading partners, and unfavorable commodity prices. Indonesia's reliance on portfolio inflows to finance fiscal and current account deficits amidst shallow domestic financial markets leaves the economy somewhat susceptible to global financial volatility and reversal in capital inflows. Addressing these risks will require maintaining a policy mix that protects macroeconomic and financial stability and safeguards buffers, while implementing reforms that address vulnerabilities and boost potential growth.

We welcome the progress in tax administration reforms, especially since revenues are below peer countries and low relative to development spending needs. There is merit in implementing a Medium-Term Revenue Strategy (MTRS) that centers on further tax administration and policy reforms to streamline the tax regime, remove distortions, and improve compliance. In addition to raising revenues—estimated at an additional 5 percent of GDP over 5 years—the reforms would help lessen the need for external financing and may lead to productivity gains. We agree with staff on the proposed implementation plan for the MTRS, starting with streamlining existing taxes, removing VAT exemptions, broadening the tax base, and at a later stage introducing excises and considering higher tax rates. Developing a careful communication strategy will be important for public support to the reforms. Could staff provide additional information on the status of the MTRS?

On monetary and exchange rate policy, the authorities appropriately tightened monetary policy and allowed the rupiah to depreciate in response to the 2018 EM selloff. Given the current positive outlook, anchored inflation expectations, and a real policy rate exceeding the estimated neutral rate, we concur with staff that there is room to gradually lower interest rates. The exchange rate should continue to move freely in line with market forces to act as a key shock absorber for the economy, limiting foreign exchange intervention to absorb disorderly market conditions. The external sector position is assessed as weaker than suggested by fundamentals and desirable policies. Nonetheless, it is expected to gradually improve over the medium term, supported by the flexibility in the exchange rate, improved competitiveness, as well as trade-centric policies and structural reforms. To this end, we support the authorities' view that the current account norm should take into account Indonesia's needs for infrastructure investments and critical structural reforms to promote sustainable growth.

The financial sector is broadly healthy. Further reforms to deepen the financial system would help to reduce vulnerabilities, promote stable financing, and lessen Indonesia's reliance on potentially volatile capital inflows. We agree with staff that identifying a reference rate for interest rate swaps, better anchoring the short-term end of the yield curve, and stimulating progress in the repo and foreign exchange derivatives markets are important measures to deepen the money market. We welcome the authorities' progress in implementing FSAP recommendations (summarized in Table 11) and encourage them to enhance financial oversight and crisis management in line with the FSAP recommendations.

Mr. Saito and Ms. Mori submitted the following statement:

We thank staff for the comprehensive reports and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their informative statement. It is encouraging that the Indonesian economy performed well in 2018, despite external head winds including capital flow reversals, and macroeconomic indicators are expected to further improve gradually. While growth is projected to remain stable over the medium term, risks are tilted to downside and vulnerabilities stemming from high reliance on portfolio inflows, low tax revenues and shallow financial markets exist. We positively note that the re-elected president Joko Widodo has committed to push ahead economic reforms. We encourage the authorities to continue their reforms to preserve macroeconomic stability and boost growth. As we broadly concur with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

We agree with staff that a neutral fiscal stance would balance the need to underpin growth and build resilience by protecting buffers. Given that government revenues remain below peer countries and insufficient to meet the authorities' development goals, revenue mobilization is a top priority of fiscal reforms. In this regard, we welcome that the authorities developed a medium-term revenue strategy (MTRS) and have been taking steps to improve tax administration. As the SIP chapter of operationalizing a MTRS illustrates, careful prioritization, sequencing and phasing are crucial for the implementation of MTRS and we encourage the authorities' effort including strengthening public communication campaign, improving tax administration and streamlining existing taxes. Do the Fund or other development partners provide any technical assistances to support the implementation of MTRS? We also encourage the authorities' continued efforts to improve the efficiency and quality of spending including implementation of PIMA recommendations.

Monetary Policy

We commend that the Bank Indonesia (BI) well managed external pressures in 2018 by the combination of tightening monetary policy and loosening macroprudential measures (MPM) while maintaining exchange rate flexibility. For the monetary policy stance, we agree with staff that there is a space to cautiously and gradually unwind the interest hike adopted in 2018. For the MPM, we encourage the BI to assess the effects of recent relaxation while remaining vigilant to ensure financial system stability. We also welcome that BI continues to reform monetary operation and improve communication. Having said so, the monetary policy transmission channel needs to be strengthened going forward. For the communication, we note that the BI insists that there are some prerequisite conditions to be met for the publication of the forex intervention data. We would like to hear staff's view on it and expected timeline for fulfilling those conditions.

Financial Sector

Advancing financial deepening is indispensable to address the vulnerabilities stemming from the high reliance on external financing. We acknowledge the authorities' efforts toward domestic market development including the development and implementation of National Financial Market Development and Deepening Strategy and coordination among relevant authorities. In the meantime, we note that the authority plans to create a holding company of public sector financial institutions. Could staff elaborate more on this plan, what is the rational and motivation for the authorities, and how do staff evaluate the implication on the country's financial deepening.

Corporate Prudential FX regulation

While we fully acknowledge that the corporate prudential FX regulation is intended to mitigate a buildup of systemic risks, we support staff's view that it is assessed as a residency-based capital flow management measure (CFM) and as a MPM. It is important to focus, not on whether it is labeled as CFM/MPM or not but, on the appropriateness and effectiveness of the measures given a specific situation. In this regard, we agree with staff that it should be further improved by extending its coverage to all FX liability of systemic corporates. While the authorities indicate that it would be appropriate to assess the initial measure over time before considering further changes, we encourage them to review the measure in a timely manner.

Structural Reforms

We welcome the structural reform progress in recent years including infrastructure development by increasing public capital spending and improving institutional framework and business environment improvement by streamlining regulation. We encourage the authorities' further effort to reform labor and product market, which help attract private investment including FDI, to remove impediments to growth.

Mr. de Villeroché, Mr. Castets and Mr. Sode submitted the following statement:

We thank staff for the quality of their document and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their insightful buff Statement. We commend the authorities for their skillful macroeconomic management of the country which allowed for a continued period of growth and the preservation of sound policy fundamentals. To pursue on its upward trajectory, Indonesia will now need to undertake ambitious structural reforms in terms of tax policy, governance and financial deepening. The reelection of the president for a second term provides a window of opportunity for such transformative reforms and we encourage the authorities to use the current favorable conditions to design and implement reforms in the coming months. While we agree with the thrust of staff appraisal and recommendations, we would like to make the following points for emphasis:

Given existing needs in terms of infrastructure, education, health and social protection, a significant increase in public revenue is a priority for Indonesia. The proposal of staff concerning a Medium-Term Revenue Strategy which aim at raising 5 percent of GDP of new revenues by broadening tax-bases and strengthening the revenue administration appears sensible and warranted. To overcome the political economy difficulty of raising taxes, we encourage the authorities to highlight and communicate on the short term and medium term economic and social benefits that these new public revenues would generate. If well implemented and accompanied by a strengthening of spending efficiency and strengthened public infrastructure management, such a tax reform could raise the potential growth rate and improve the living conditions of the population. We also encourage staff to work closely with the World Bank on the design and implementation of the MTRS since the World Bank group has a large presence on the ground and has recently undertaken a series of budget support aimed at improving fiscal governance.

Since Indonesia has fiscal space and while DRM appears as the priority, we encourage the authorities and staff to reflect further on a potential increase in public investment financed by debt. Indonesia public debt is low, interest rates are moderate, and the planned public deficit is already above the level that would stabilize debt. This means that there is space to undertake additional selected public investment projects through debt financing. If carefully selected and implement, such project could accelerate the economic catch-up of Indonesia without jeopardizing its fiscal buffers. Given the low levels of public debt and deficit, we encourage the authorities to choose a fiscal stance that maintain the current debt level and share staff's views that there is no need or further decrease of its level. Moreover, could staff elaborate on the role of SoEs in public investment, the potential risk of contingent liabilities and on the quality of fiscal reporting of SoEs?

On the external sector, we see the need to enhance resilience through enhancing more long-term investment rather than short term portfolio. This would imply alleviating the constraints on FDI. We note that staff assesses the external position as moderately weaker than required by the fundamentals.

An ambitious energy policy for Indonesia will be crucial to reduce CO_2 emissions, improve air quality in major cities and could help the country to reduce its external current account deficit. While important reforms of energy subsidies had been undertaken in the past, recent backtracking have undermined past efforts. Could staff describe the recent reforms (over the last 5 years) of fuel subsidies in Indonesia detailing their fiscal, environmental and redistributive consequences, and specify their recommendations going forward. Moreover, we strongly encourage staff to work with the authorities on climate change policies in future Article IV consultations both in terms of adaptation and mitigation.

To boost medium term productivity and potential growth, Indonesia will also need to improve governance, deepen its financial market and modernize the functioning of its product and labor markets. Opening up access to the Indonesian market by reducing FDI restrictions could both improve productivity, better connect Indonesia with global value chains and make the financing of the current account more stable. Lifting restrictions about foreign employees hiring could also help to improve the skills of Indonesia workforce and attract foreign investment and technology. Governance reforms of SoEs, better enforcement of contracts, and a solid anticorruption legal framework (in line with the OECD anticorruption convention) would greatly improve the business climate.

Mr. Daïri and Mr. Osei Yeboah submitted the following statement:

We thank staff for a well-written set of papers and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their helpful buff statement. We broadly concur with staff appraisal and wish to highlight a few issues.

Amidst a weak and uncertain global environment, the Indonesia's economy continued its strong performance through 2018, with robust and sustained growth bolstered by domestic demand, continued financial stability, well-contained inflation, and the twin deficits in comfortable territories, while the reserve position is recovering following reversal in capital outflows. Public debt is low and external debt (mainly of the nonfinancial private sector) is moderate. This positive outcome owes much to the authorities' policy flexibility for which they are to be commended. While the outlook is for continued improvement in the macroeconomic situation, risks are skewed to the downside mainly from global risk factors. Therefore, maintaining macroeconomic and financial stability and building resilience to exogenous shocks are key priorities.

Flexibility in monetary, exchange rate, and macroprudential policy mix has helped safeguard macroeconomic and financial stability in dealing with external pressures in 2018. The appropriately tight policy response reduced external financing pressures and kept inflation within the lower bound of the target, while loosening macroprudential policies adequately provided liquidity to the financial system. We note staff recommendation to take advantage of the prevailing monetary and financial conditions to gradually unwind the interest rates hikes while maintaining the macroprudential stance unchanged to preserve macroeconomic stability. The authorities' cautious approach to interest rate cuts, mindful of the risks from global financial conditions, as indicated by Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri, is appropriate. We welcome the on-going Bank of Indonesia's monetary operation reforms which should help strengthen the transmission channels.

We welcome the authorities' recognition of the key role of exchange rate flexibility in maintaining the resilience of the economy and their commitment to allow the exchange rate to reflect market forces, with intervention limited to curbing excessive volatility, as indicated by Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri. We also share their concern about the low current account norm under EBA, which may not reflect Indonesia's specific circumstances and needs.

The banking system is broadly sound and liquid, and bank profitability has increased. Nonetheless, some banks are vulnerable to liquidity shocks. We are pleased to note that authorities have agreed to implement FSAP recommendations. We agree in particular with staff call for strengthening the crisis management framework regime while enhancing enforcement of prudential norms.

The report alludes to vulnerabilities from low revenue mobilization and the shallow financial system hampering medium-term prospects and inclusive growth and making the government and corporate sectors highly dependent on volatile capital flows. We agree with staff that a comprehensive tax reform aimed at broadening the base and enhancing compliance will help create space for pro-growth and pro-poor spending and build buffers against shocks. We welcome the ongoing work toward a financial development and deepening strategy geared at addressing lack of domestic long-term funds for productive investment while strengthening coordination among key partners in financial oversight. A well-developed money market and promoting technological innovation while monitoring risks should be part of this strategy.

Structural reforms to ease labor and product market rigidities will support potential growth and ensure that growth dividends are broadly shared. While the report recognizes past efforts at improving the business environment and enhancing human capital, further reforms in the education and health sectors, together with labor market flexibility and increased infrastructure spending, will improve productivity and increase employment. Considering the strong SOE presence in the economy, reforms to enhance governance and accountability will benefit efficiency and competitiveness while mitigating fiscal risks.

We wish the authorities further success in their endeavors.

Mr. Mozhin and Mr. Potapov submitted the following statement:

We thank staff for their insightful report supported by the well-focused SIP chapters and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their informative buff statement. In the face of the challenging external environment, the Indonesian economy demonstrated resilience and continued strong growth. The authorities' policy response to the 2018 emerging markets selloff episode was effective in supporting macroeconomic and financial stability. With a growth rate above 5 percent, inflation within the target band, and external and fiscal buffers adequate, the authorities are in a good position to address remaining challenges. We note that the authorities broadly agree with staff on the analysis of current developments and on policy recommendations.

According to Figure 1 of the report, the financial turbulence last year affected the Indonesian economy to slightly greater extent than other emerging markets in Asia. Staff believe that reliance on volatile portfolio flows to finance the twin deficits exposes the economy to a sudden stop in capital flows. From the risks perspective, these vulnerabilities can be exacerbated by rising global interest rates and heightened trade tensions. At the same time, extra volatility in the financial markets in 2018 seems to be at odds with the country's overall economic fundamentals. The latter have been substantially improved over the recent years. We would appreciate staff's additional elaboration on the key reasons that led to a higher negative impact of the 2018 EM selloff on the Indonesian economy than on its regional peers.

We commend the authorities for their successful policy response to the 2018 external pressure episode that was based on the tightening of monetary policy and the relaxation of macroprudential measures, while maintaining the exchange rate flexibility. Foreign exchange interventions have been used to mitigate the risks of disruptive changes. The corporate prudential FX regulation has helped moderate systemic financial risks from corporate external debt. At the same time, we note staff's concerns about the authorities' plans to adopt measures aimed at increasing repatriation of export proceeds. Could staff elaborate on possible risks associated with these measures and alternative options that can be considered by the authorities?

The current macroeconomic policy mix combines moderately tight monetary policy with a broadly neutral fiscal stance. After several policy rate hikes in 2018, monetary policy remains on hold, as growth is gradually rising towards potential, and there is no evidence of inflationary pressures. The authorities and staff seem to agree on a possible easing of monetary policy, subject to external developments. We agree with staff that a neutral fiscal stance is appropriate in the near term, striking the right balance between supporting growth and preserving fiscal buffers. We also support staff's recommendations to assess the effectiveness of the recent relaxation of macroprudential measures and continue to closely monitor macrofinancial risks.

Although public debt is relatively low and sustainable, fiscal space is constrained, as revenues remain at relatively low levels. In this context, the implementation of the medium-term revenue strategy is critical for financing priority spending on infrastructure, education, health, and social safety nets. As rightly highlighted in the SIP, the proper sequencing and prioritization of the reforms need to reflect their economic and social impact. Immediate priorities include improving tax administration and streamlining existing taxes. To enhance the composition and efficiency of spending it is important to reduce energy subsidies, strengthen social assistance, and improve public investment. Could staff elaborate on the fiscal risks related to contingent liabilities from SOEs and PPPs? Could staff highlight the challenges in the area of fiscal transparency, if any? Do the authorities plan to conduct the Fiscal Transparency Evaluation in the near future?

On the external sector, we note that the current account deficit widened from 1.6 percent of GDP in 2017 to 3 percent of GDP in 2018. Staff assessed the external position "to be moderately weaker than warranted by medium-term fundamentals and desirable policies". At the same time, the authorities expressed concerns about the estimated CA norm under the EBA models, which do not fully reflect the country's needs for higher infrastructure investment and structural reforms. In our view, high uncertainty of the estimates requires caution in interpreting the outcomes of model-based assessments by staff, while country-specific factors should be carefully considered.

Indonesia's banking sector remains sound and resilient to shocks. Banks are well capitalized and liquid, while NPLs remain low at 2.5 percent. At the same time, the financial system is shallow, with a narrow domestic institutional investor base. According to staff, this has contributed to the economy's reliance on external financing. Against this background, we welcome the authorities' efforts to develop the money market, promote financial inclusion, and strengthen financial regulation in line with the recent FSAP recommendations.

Implementation of structural reforms is critical to further boosting productivity, strengthening private sector development, and improving the business environment. We welcome the authorities' focus on competition, education, labor and product markets regulation, financial market development, and public finances. Over the recent years, the authorities have made important progress in some areas, as reflected in the World Bank's Doing Business ranking. Further opening of the economy to foreign investment will help foster its competitive edge.

We note that the Fund is providing technical assistance on the use of big data to develop an enhanced residential property price index. The Fund also participated in a pilot project on big data using scanner data to enhance private consumption and consumer price statistics. Could staff elaborate on this work? Do staff plan to expand these approaches in any other countries or, perhaps, across the broader group of the Fund' members?

Mr. Doornbosch, Mr. Psalidopoulos, Mr. Di Lorenzo and Ms. Harutyunyan submitted the following joint statement:

We thank staff for the comprehensive set of papers and Ms. Mahasandana, Mr. Tan, Mr. Anwar and Ms. Susiandri for their informative buff statement. We commend the Indonesian authorities for a sound macroeconomic performance and stable financial system against the background of external headwinds and reversal in capital flows in 2018. Looking ahead, the medium-term outlook is favorable with stable economic growth, moderate inflation, sustainable public debt and contained systemic macrofinancial risks. Notwithstanding this, the external risks are tilted to the downside, and the economy remains vulnerable to capital flow reversals. These call for vigilance and policy flexibility. Since we broadly agree with the thrust of staff's appraisal, the following comments are offered for emphasis.

We welcome the authorities' two-pillar reform agenda targeting fiscal revenue mobilization and financial deepening. Notwithstanding the progress with the tax administration reforms and the strong revenue growth in 2018, we note that tax revenues in Indonesia remain low and below peer countries. To this end, we stress the importance of revenue mobilization to finance priority spending, especially in the areas of health, education, infrastructure, and social safety nets. We welcome the operationalization of the Medium-Term Revenue Strategy (MTRS) focused on tax administration and policy reforms to promote compliance and the efficiency of tax filing and collection, streamline tax regimes, and expand the tax base. In this context, we emphasize the need for increasing the efficiency and quality of government spending to ensure the success of the MTRS and promote sustainable and inclusive growth. We urge the authorities to carefully monitor the fiscal risks related to contingent liabilities and implicit guarantees from SOEs and PPPs and would like to ask staff to elaborate on the specific measures planned in this regard.

We stress the importance of financial deepening aligned with appropriate prudential standards. Given the shallow financial markets and high reliance on volatile external financing, efforts will need to be intensified to decrease the vulnerability to capital flow reversals. To this end, we welcome the implementation of the 2018-2024 national strategy for financial market development, particularly the approval of a blueprint for payment system reform and the publishing of a money market rate. We are encouraged by the authorities' commitment to push the financial deepening reforms forward. The planned legal upgrades to align and strengthen the mandates of BI, OJK, and the DIS are well taken. Going forward, further efforts are needed to strengthen financial oversight and crisis management in line with the 2017 FSAP recommendations. We support the implementation of the Bali Fintech agenda, and the integration of the digital economy with the financial sector. Meanwhile, to secure the benefits of financial innovation, we encourage the authorities to strengthen the oversight and management of cyber risks.

Structural reforms in the labor and product markets are paramount to promote sustainable and inclusive growth. We commend the Indonesian authorities for the progress made on structural reforms in recent years, including the development of the infrastructures along with the institutional framework, improvement of the business environment through streamlined regulations, and partial liberalization of the FDI regime. Nevertheless, important bottlenecks remain related to human capital development, skills mismatches, rigid labor markets and low female labor participation. These call for comprehensive structural reforms to promote job creation for the young and growing labor force and to reap demographic dividend. To this end, we welcome the authorities' commitment to improve access to quality education, to enhance labor skills, and to create a more favorable investment climate. Going forward, we encourage the authorities to further strengthen fiscal governance, the regulatory framework and the rule of law. The easing of regulations on state control, the reduction of antitrust exemptions, non-tariff barriers and FDI restrictions are important. We agree with staff that further efforts are needed to strengthen the AML/CFT regime.

We welcome the authorities' commitment to maintaining exchange rate flexibility. We emphasize the importance of maintaining a flexible exchange rate policy with interventions limited to addressing disorderly market conditions and communicated as appropriate. While we note that monetary and macroprudential policies have been successful in preserving the financial and macroeconomic stability in the wake of the 2018 EM selloff, we encourage the authorities to consider a less tight monetary policy while remaining cautious about easing macroprudential policy, considering the external vulnerabilities outlined in the report.

Finally, we welcome the integration of recent actions and plans on Capacity Development (CD) with Fund Surveillance in Table 12 as a good leap forward to support the implementation of policy advice. We encourage staff to complement the table with information on past training of officials by topic, assess if past training enhanced Indonesia's capacity, and specify the training priorities.

With these remarks, we wish the Indonesian authorities all the success in their future endeavors.

Mr. Meyer and Mr. Buetzer submitted the following statement:

We thank staff for its report and concur with the thrust of its analysis. We also thank Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their helpful buff statement. Despite last year's tighter global financial conditions, Indonesia's economy has performed well owing to its overall sound fundamentals and decisive policy responses that attached high importance to maintaining macrofinancial stability. Going forward, it remains vital to preserve and build up additional buffers by continued prudent macrofinancial policies and strong financial oversight to contain vulnerabilities. These will need to be supported by structural reforms conducive to long term productivity growth and inclusiveness.

Given that Indonesia faces a number of external downside risks it is all the more important to promote resilience through appropriate domestic policies. Looking exclusively through the prism of trade, the economy's integration in diversified regional and international value chains can lessen some of the potential fallout from an escalating trade conflict. In addition, the authorities have appropriately emphasized the role of exchange rate flexibility as an external shock absorber, although the central bank's footprint in the FX market remains large and should be gradually reduced. In this context, we support staff's recommendation to improve transparency and strengthen policy effectiveness by publishing data on foreign exchange interventions with appropriate lags. At the same time, a high reliance on portfolio investments exposes the country to the risk of capital flow reversals, especially during periods of tightening international financing conditions such as in 2018. Against this background, attracting more stable FDIs is a worthwhile strategy to secure external financing of the country's current account deficit. To promote such stable and productive investment flows we encourage the authorities to consider more decisive actions aimed at liberalizing the current FDI regime and to accompany these efforts with structural reforms to further improve the investment climate.

The fiscal strategy should preserve stability while providing the necessary means for meeting pressing development needs. Prudent fiscal policies are essential in order not to jeopardize the moderate public debt level and limit the debt exposure to non-residents. The implementation of the authorities' medium-term revenue strategy is paramount to collect sufficient domestic resources for priority spending in infrastructure, human capital development and improving the social safety net and public services. Acknowledging the need for careful management of spending efforts, determination at all government layers will be required to improve public financial management to enhance spending efficiency. We encourage the authorities to continue to modernize and streamline the tax system and administration, which would also help to raise Indonesia's low revenue ratio. We note that the DSA rightly points out the need to manage risks from PPPs carefully. As no PPP-contingent liability shock is performed, we wonder if staff could provide further details on the structure and risks of PPPs in the country, in particular with view to planned infrastructure projects in the near future.

Financial sector risks appear contained. We take note that the banking sector enjoys adequate capital and liquidity levels combined with relatively strong profitability. Following the last FSAP recommendations, the authorities have embarked on financial sector reforms aimed at strengthening the monitoring of systemic risk and crisis management, and we strongly encourage continuing on this path. We take note of staff's assessment that room for further relaxing macroprudential policies is exhausted (para. 21), thereby constraining the authorities' scope to repeat the combination of monetary and macroprudential measures taken amid external pressures in 2018. At the same time, the authorities indicate that macroprudential policy can still be calibrated to support policy objectives as laid out in the buff statement. We would therefore welcome further comments on this issue.

Initiatives of the authorities to build deeper and stronger financial markets should be maintained featuring aspects of inclusiveness and adequacy of supervisory and regulatory capacities. Furthermore, reforms aimed at the money market should be pursued to facilitate the functioning of the monetary transmission mechanism. With persistent vulnerabilities to corporate balance sheets, we concur with staff that extending FX prudential regulations for corporates to all FX denominated liabilities appears warranted.

Lastly, we strongly encourage the authorities to consent to publication of the staff report.

Mr. Guerra and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for the informative set of reports, and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their comprehensive buff statement. Despite a complex external environment, the Indonesian economy had a good performance in 2018. The authorities' policy-mix successfully preserved macroeconomic resilience and maintained growth momentum. Going forward, we concur with the overall staff assessment that the policy mix should remain focused on protecting macroeconomic and financial stability, including by maintaining exchange rate flexibility and increasing structural reform efforts.

We commend the authorities' efforts on a broad range of fiscal reforms that will be instrumental to finance and improve efficiency of priority spending. While calling for an early implementation of the MTRS, reforms should be prioritized, sequenced and phased-in to maximize their social impact, and to cope with implementation challenges. The reforms include improving tax administration and streamlining tax structures. In this regard, we support the authorities’ request for Fund TA to enhance the current draft amendment of the income tax law.

Exchange rate flexibility should continue to play an important role in the macro policy framework. The authorities are committed to maintain a flexible exchange rate policy with intervention in the FX market only in case of disorderly market movements. We note the authorities’ view that macroprudential policy was eased on the basis of a forward-looking assessment of macrofinancial conditions. Going forward, we support the authorities’ position to remain vigilant to ensure the financial system’s stability and to take policy actions as warranted by economic conditions.

We support the staff’s appraisal that technological innovations offer a promising channel for financial inclusion, but cyber security should be also enhanced in the process. In this regard, as stated in the buff, we highlight that the authorities are formulating a National Financial Market Development and Deepening Strategy as a policy framework towards creating deep, inclusive, and secure financial markets. We welcome the Indonesian authorities’ commitment to environmentally-responsible infrastructure development, including the release of the first green Sukuk bond at the beginning of the year.

Finally, we appreciate the information on the integration of Fund Surveillance and Capacity Development activities. We notice that the authorities have benefited from the well-targeted IMF’s capacity development support. In this regard, can staff briefly comment on the TA that will be provided on the use of big data to develop and enhance the residential property price index? Developing these indicators is important to ensure proper assessment of financial stability in emerging economies.

Mr. Raghani, Mr. Sylla and Mr. Nguema-Affane submitted the following statement:

We thank staff for a set of interesting papers and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their helpful buff statement.

Indonesia’s economic performance continued to be positive in 2018 amid a challenging external environment, thanks to a sound macroeconomic policy framework. Real GDP growth remained solid at 5.2 percent in 2018 supported by a strong` domestic demand, inflation stayed within the central bank’s target band, and international reserves were well above the IMF’s reserve adequacy metric. We note that the robust domestic demand is expected to carry forward growth momentum in 2019 and 2020 amid significant downside risks stemming from an escalation of trade tensions or tightening of global financial conditions. That said, the exchange rate pressures and capital outflows in 2018 have highlighted substantial revenue and financial vulnerabilities from heavy reliance on volatile capital inflows. We therefore welcome the authorities’ plan to address those vulnerabilities by strengthening macroeconomic and financial stability through notably improving domestic revenue mobilization and deepening its financial markets, while pursuing structural reforms to achieve a more sustainable and inclusive growth. We broadly agree with the staff policy recommendations and would like to make some comments for emphasis.

Domestic revenue mobilization efforts should be stepped up to reduce budget reliance on volatile external private financing. Fiscal policy tightening in 2018 has improved fiscal sustainability as fiscal deficit narrowed in 2018. We support the envisaged neutral growth-friendly fiscal stance in 2019. Nonetheless, fiscal revenues are low compared to other EM countries and budget financing is highly dependent on foreign investors’ appetite for Indonesian papers. Fiscal reforms, including the implementation of a medium-term revenue strategy (MTRS) and the PIMA recommendations, to increase domestic revenue mobilization and to improve the quality and efficiency of spending should be accelerated to lessen dependence on foreign investors and improve debt sustainability, while increasing space to expand social assistance.

Monetary, exchange rate and macroprudential policies have been appropriately flexible in reaction to heightened external pressures and should be cautiously unwound as those pressures abate. We commend the central bank for successfully striking the right balance between exchange rate flexibility, foreign exchange interventions and tighter monetary policy, which helped preserve robust growth and moderate inflation. We welcome the central bank’s continued commitment to policy flexibility going forward. We agree that, as external pressures subside and inflation remains subdued, consideration should be given to unwind some of the policies adopted in response to the 2018 EM selloff. Could staff indicate whether actions in that regard are expected in the near-term? We encourage the authorities to pursue the reforms of the central bank operations and communication.

Significant progress has been made in strengthening the financial supervision framework and efforts in that regard should continue. We welcome the authorities’ commitment to further enhance financial supervision and risk management, in line with FSAP recommendations. We note the disagreement between the authorities and staff on the assessment of the corporate prudential FX regulation. We see merit in the authorities' approach to regularly assessing the impact of the regulation before making any changes. We would appreciate further elaboration on staff's recommendation to extend the coverage of the regulation at this time. We also note that staff is asking the Indonesian authorities to reconsider the repatriation measure whereas staff has encouraged the CEMAC authorities to implement such measure. Could staff explain that differentiated advice on the same issue?

Advancing sustainable financial deepening and financial inclusion will be essential to develop domestic financing sources for the government and support sustainable and inclusive growth while reducing vulnerabilities to external shocks. We commend the authorities for the significant steps already taken to foster financial market deepening, and the establishment of the Coordination Forum on Development Financing by the means of Financial Market tasked with formulating a National Financial Market Development and Deepening Strategy, as indicated by Ms. Mahasandana in the buff statement. We particularly note the progress in the implementation of the Bali Fintech Agenda, with notably the adoption of a blueprint for payment system reform that will also facilitate financial inclusion. As regards the authorities' plan to create a holding company of public financial institutions, could staff share the experience of other countries with such entity?

Structural reforms to lift impediments to competitiveness and higher and inclusive growth should be sustained and their focus on labor market and governance is appropriate. Past reforms were successful in strengthening education and health sector productivity. We agree that the recent reelection of the incumbent president offers an opportunity to step up reform momentum. We find appropriate the authorities' focus on labor, product market and governance reforms to further remove obstacles to competitiveness and growth. We encourage the authorities to continue to address vulnerabilities in the fiscal governance, regulatory framework and rule of law that could be sources of corruption. We note the progress made in enhancing the AML/CFT framework and welcome the authorities' commitment to ensure its effective implementation.

With these remarks, we wish the Indonesian authorities success in their endeavors.

Mr. Trabinski and Mr. Imashov submitted the following statement:

We take note of the favorable outcome over the surveillance cycle. The Indonesian economy continues to deliver robust growth, moderate inflation, and relatively low fiscal and current account deficits. Nonetheless, vulnerabilities associated with country's reliance on external financing remain. Raising potential growth through structural reforms and investment in infrastructure is a further challenge, which could be addressed by the authorities' strong ownership of reform effort. We thank staff for the documents and broadly agree with the thrust of their appraisal. We are equally grateful to Ms. Mahasandana, Mr. Tan, Mr. Anwar and Ms. Susiandri for their candid buff statement.

Continued efforts to improve the fiscal position are needed. We welcome the recent PIMA exercise, as well as the ongoing push to strengthen public spending efficiency, and to attract private sector participation in infrastructure financing. In this regard, can the staff provide an update on the extent of private sector participation in PPPs to date and what scenarios they see looking ahead? We support implementation of the medium-term revenue strategy, which should be instrumental in lifting revenue from its low level. As a result, increased space for infrastructure and social spending would improve equal access and further reduce poverty. At the same time, the authorities should mitigate contingent liability risks associated with SOE infrastructure spending.

The policy mix should remain focused on macroeconomic and financial stability. Maintaining exchange rate flexibility remains critical to the economy's resilience to adverse shocks, and we welcome the authorities' commitment in this regard. Looking forward, macroprudential policy should aim at containing systemic risks in the financial sector. In light of potential tightening of global financial conditions, we note the risks associated with the large share of foreign portfolio holdings. Could staff elaborate on the differences with the authorities on the current account norm, as emphasized in the buff?

We encourage the authorities to continue their efforts to further improve financial sector supervision, ensure sufficient risk management capacity and to implement the remaining FSAP recommendations. We note the finding that the banking system is well capitalized, liquid and profitable. However, vulnerabilities persist with regard to the elevated foreign-currency debt of corporates, which could spill over to the banking sector. We agree with staff that the corporate prudential FX regulation should be further improved and encourage the authorities to periodically review the measure classified as a residency-based CFM. We would be grateful to learn the status on discussions on rupiah redenomination.

Structural reforms should be a priority over the short- and medium-term. Despite the significant advancement in the World Bank's Doing Business ranking over the past years, there is still much room for further improvement of the business climate, addressing skills gaps, easing labor market restrictions, and enhancing the social safety net. Also, we note the potential of e-commerce to increase productivity and exports. Finally, we are encouraged by the authorities' strategy to align the digital economy with the financial sector as contained in the Indonesia's Payment System 2025 vision. Could staff provide more details on the goals and milestones envisaged by the authorities in this regard?

Mr. Ronicle and Ms. Freeman submitted the following statement:

We support staff's assessment of the Indonesian economy, and thank Ms Mahasandana, Mr Tan, Mr Anwar, and Ms Susiandri for their informative buff statement. We welcome the authorities' efforts to contain systemic risks through maintaining stable economic growth, managing the current account deficit and containing inflation. In that context, we were very pleased to see the application of the growth at risk framework to Indonesia, in the set of high quality and topical selected issues papers and reassured by the low recession probability that staff estimate.

We agree with staff's advice that the near-term priority should be on macroeconomic and financial stability, while boosting growth through higher domestic revenue mobilization and financial deepening. We welcome the Authorities' planned income tax reforms as an essential part of increasing revenue mobilization. However, we note the difficulties with implementing the other aspects of the medium-term revenue strategy and agree that operationalization of the entire strategy should be a sustained focus going forward. Can staff comment on whether the the IMF is planning to support the tax reforms, as requested by the Authorities, and whether any further support is being provided for MTRS implementation?

On financial deepening, we welcome the boxes in the report on the macroeconomic policy framework and money market reform. We support the recommendation to advance legal upgrades to the Bank of Indonesia and the supervisory agencies, and to further develop the money market. The report makes a strong case for the benefits of delivering further structural reforms and we encourage their adoption.

Fully adopting revenue reforms and financial deepening are critical to funding further inclusive growth and creating jobs for Indonesia's growing population. We strongly agree with Staff on the need to harness the demographic dividend by boosting economic growth through labor market reforms. This includes investing in human capital, such as social safety nets, health, and education, as well as labor market opportunities for the young and women, who are currently underutilized in the economy. We note that while Indonesia has raised its scores in the World Bank's Doing Business ranking, it ranks amongst the bottom two of the G20 in opportunities for women in the World Bank's Women, Business and the Law report. A rating of 64.38 means that, in a third of indicators measured, there is gender inequality in access to business and employment. Can staff comment on whether this report has been considered in discussions, and what impact these considerations may have on labor reform decisions?

We support the authorities in demonstrating the Bali FinTech agenda at home and note the thriving digital economy and Government vision for further growth. We also welcome the staff analysis provided on the benefits of embracing e-commerce in Indonesia, for both productivity and exports, as well as the focus on e-payment and financial inclusion. The digital agenda can really be transformative and play its role in boosting growth. However, as staff highlight, there are risks of digitalization enhancing inequality and further creating monopolies. We therefore support the need to focus on strategies that are inclusive, particularly for women and those in rural areas, open and competitive, and manage cyber and privacy risks.

Within the buff statement, we support the commitment made by the authorities to environmental development and were encouraged by the launch of the first Green Sukuk bond. Could staff comment on the opportunities for further green financing?

Finally, we wanted to thank the Authorities for their hospitality at the successful Annual Meetings last year, and for the leadership demonstrated.

Mr. Rosen, Ms. Pollard and Ms. Crane submitted the following statement:

We thank staff for the informative papers and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for the helpful buff statement. Indonesia's sound macroeconomic management has helped the economy weather volatility over the past year while preserving growth and low inflation. We appreciate staff's focus in the consultations on tackling underlying weaknesses of low domestic revenues and shallow financial markets, which could make the economy more resilient by reducing reliance on capital flows. We also welcome the focus on labor and product market reforms that could boost growth (an area identified in the Review of Conditionality as meriting greater attention by IMF staff). We concur with the thrust of the staff appraisal and would like to highlight several points.

Fiscal. Fiscal management has been sound, but revenues are low compared to peers and development needs are large. We underscore the importance of domestic revenue mobilization through a medium-term revenue strategy. There is a broad range of potential reforms — from compliance to simplification to base broadening—and the MTRS can offer a constructive way to sequence and prioritize them. We appreciate that the DSA analysis shows debt risks as moderate, but emphasize the importance of capturing contingent liabilities given the reliance on state-owned enterprise borrowing and PPPs.

Financial Market Deepening. Further development of capital markets is another important way to increase resilience by reducing the reliance on non-resident investors. We appreciated staff recommendations on legal upgrades needed to lay the ground for financial deepening, as well as steps to develop the money market.

Structural Reforms. We agree with staff that reforms to labor and product markets could boost Indonesia's growth potential. These could include streamlining labor requirements and improving education and training to bolster employment. There is also significant room for streamlining of business regulations as well as further trade liberalization, particularly to encourage foreign direct investment in manufacturing.

Financial and Corporate Sector. Despite large capital buffers and strong profitability, banks' high exposure to foreign exchange risk in the corporate sector is also a source of concern. We note that Indonesia eased documentation requirements to transact in the domestic non-deliverable forward market and look forward to the authorities' further efforts to develop this market. Can staff comment on what other steps are needed to help the corporate sector hedge more fully their foreign-currency debt? We took note of staff's recommendation to extend the coverage of the corporate prudential FX regulation to all foreign exchange liabilities of systemic corporates. Can staff comment on what kind of timeframe the authorities might have for considering such a change, since they preferred not to make a change now? Finally, while the IMF notes that there are no signs of asset bubbles, we recommend that the authorities remain vigilant of the debt-financed commercial real estate construction, particularly as potential oversupply weighs on prices and borrowers' repayment capacity.

Monetary Policy and Exchange Rate. We support staff's recommendations on the stance of monetary policy. We appreciated the analysis in the Selected Issues Paper on Monetary Policy Communication and agree with staff on the need to enhance communication and deepen financial markets to improve the transparency of monetary policy. We welcome Bank Indonesia's commitment to a flexible exchange rate and urge it to publish intervention data. We note the authorities view that Indonesia's CA norm should be more negative. Could staff provide more information on the factors driving the norm?

Ms. Levonian, Ms. McKiernan and Mr. Williams submitted the following statement:

We thank staff for their well-written set of papers and Ms. Mahasandana, Messrs. Tan and Anwar, and Ms. Susiandri, for their insightful buff statement. Indonesia's solid economic performance and favorable outlook derive from sound macroeconomic policies and profound reforms, amid heightened uncertainty and tighter conditions in the global financial landscape. Still, external risks loom large. To alleviate these pressures and sustain the growth momentum to benefit the large and growing population, the authorities are advised to accelerate reform measures, particularly in the areas of revenue mobilization, financial sector deepening, and governance. We broadly concur with staff's assessments and recommendations and offer the following remarks for emphasis.

Fiscal sustainability and external viability must remain priority considerations for Indonesia. While macroeconomic improvements are forecast to continue, lingering vulnerabilities could weigh on the outlook, disrupt market and investor confidence, and reverse recent gains in macrofinancial stability. In this regard, the report rightly focused on measures to further mobilize revenue to support development objectives, and on steps to safeguard financial system stability from volatile capital flows.

The moderate debt levels are congruent with a neutral fiscal stance. Fiscal policy should be directed at priority growth-friendly development spending with adequate social protection, building buffers, and reinforcing macroeconomic stability. These considerations underscore the criticality of accelerating efforts to improve revenue collections. In this context, we find staff's comprehensive presentation on a medium-term revenue strategy (MTRS) in the SIP quite useful in sketching out a roadmap for reform that would not only raise revenue but also simplify the tax system. The latter is key for lowering administrative costs and enhancing the business environment. Proper sequencing and broad stakeholder consultations will be important to secure buy-in for the MTRS.

We see merit in a cautiously accommodative monetary policy stance. Policy rate hikes by the Bank of Indonesia (BI) in 2018 helped to rein in price increases and moderated external pressures. More recently, with inflation risks largely contained, we agree that there is room for monetary relaxation. The BI should however, keep a close eye on capital flows and be ready to act to avert any jolt to the financial system and to avoid disorderly exchange rate movements. A well-measured relaxation of monetary policy complemented by the current sound fiscal position would provide a conducive setting for greater exchange rate flexibility and competitiveness gains. Relatedly, we welcome the improved transparency of monetary policy while echoing staff's call for clearer messaging to enhance policy effectiveness.

Efforts to safeguard financial system stability and promote financial deepening are crucial to Indonesia's long-term development. We welcome progress with implementing key recommendations from the 2017 FSAP and urge further actions on legal upgrades to strengthen the supervisory and resolution regime. We also encourage the authorities to continue to enhance the AML/CFT framework. Looking ahead, risks associated with capital flow volatility underscores the criticality of shifting reliance away from external financing. Against this backdrop, we appreciate the information in the buff of an improvement in financing to the corporate sector from domestic sources. Further development of the domestic market is crucial for mobilizing resources locally and for helping to shield the financial system from instability in external flows. In this regard, we welcome staff's recommendations in Box 3 to develop the money market. Moreover, we are heartened that the authorities are moving with urgency to deepen the financial system, including enhancing the payment system in line with the Bali Fintech Agenda. At the same time, we emphasize the importance of ensuring that robust safeguards are in place to counter cyber risks.

We note continued dissonance between staff and the authorities on the categorization of corporate prudential FX regulation as a capital flow management measure. We look forward to the authorities' assessment of the impact of the regulation. Regarding plans that will require natural resource exporters to repatriate proceeds to Indonesia, we invite staff to comment on any preliminary reactions from exporters and to elaborate on the associated risks.

Finally, further structural reforms are integral to improving governance, preserving macroeconomic gains, and boosting potential growth. Efforts to mobilize revenue and strengthen the fiscal framework should be supported by measures to improve procurement - including with technology-driven mechanisms - and to enhance oversight of SOEs. We also urge the authorities to fast track plans to reform the labor market, ease restrictions to trade and FDI, and expand access to education and skills training.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the well written reports and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their informative buff statement. The Indonesian economy has continued to perform well with the support of prudent macroeconomic policies and structural reforms, despite rising global uncertainties. The strong growth momentum is expected to continue in the medium-term, driven by domestic demand. The S&P upgrade of Indonesia's rating with a stable outlook in May 2019 largely reflects the improvements made in the recent past. Going forward, like staff, we also see that the President Widodo's re-election has created a window of opportunity to intensify reforms efforts; to improve growth and entrench stability, create quality jobs for the young and growing population, and allow more investments to address socio-economic challenges towards providing benefits to the poor and near-poor. We broadly concur with the thrust of the staff's appraisal and would like to make following remarks for emphasis.

Maintaining a neutral fiscal stance in 2019 and 2020 seems appropriate. While commending the authorities for creating some fiscal space, we note the need for striking a balance between supporting growth and protecting macroeconomic stability. Given the very low government revenue, we see merit in giving priority to improving revenue collection, which is critically important to finance gaps in infrastructure and social spending, such as education and health and social safety nets. In this context, we support the careful integration of ongoing revenue reforms into an umbrella of the medium-term revenue strategy (MTRS) to modernize the tax system and tax administration to generate additional revenues of around 5 percent of GDP over five years. Could staff elaborate more on building public support for the envisaged reforms in MTRS? We also agree that there is scope to improve the composition and efficiency of spending, including better targeting of energy subsidies and expanding social assistance. The contingent liabilities from SOEs and PPPs need close vigilance to mitigate fiscal risks.

We commend the authorities for achieving strong growth and moderate inflation by maintaining an appropriate balance between exchange rate flexibility and tight monetary policy. Going forward, we concur with the staff's view on the scope for a cautious relaxation of the monetary policy stance given that inflation risks appear contained. In this regard, the authorities' agreement to undertake a comprehensive assessment of the policy direction, considering global financial market dynamics and external stability, as indicated in the buff statement, is welcome. Building on the recent achievements, we encourage Bank Indonesia (BI) to undertake additional reforms to further strengthen monetary policy transmission. The improvement of message clarity in monetary policy communication, as highlighted in the interesting SI paper, is essential for better outcomes.

Continued vigilance is important on the external sector. The susceptibility to capital flow reversal remains a key vulnerability and calls for containing the current account deficit to reduce capital flow volatility. We support the authorities' request, indicated in the buff Statement, to consider better incorporating country-specific factors in the assessment of the current account norm. We positively note BI's commitment to exchange rate flexibility, limiting intervention to curb excessive volatility, which has helped the country to navigate through volatile external conditions and improve resilience to shocks.

The banking system remains well capitalized and highly profitable with adequate liquidity. However, further efforts are required to safeguard financial stability and promote financial deepening and inclusion. Continued efforts in implementing FSAP recommendations are commendable. Relatedly, we encourage the introduction of a legal framework for financial sector agencies in further strengthening financial oversight and crisis management framework, building on the progress so far made. On the macroprudential policy, we support the authorities' indication to remain vigilant to ensure the financial system's stability to take policy actions based on economic conditions. Also, we encourage the completion of the legal upgrade to align and strengthen the mandate of BI, OJK, and Indonesia Deposit Insurance Corporation (LPS) to strengthen financial deepening. While commending the progress in e-commerce, we also stress the importance of effectively harnessing the digital dividend in Indonesia. We urge the authorities to closely monitor the potential financial stability risks arising from the increasing corporate external debt.

Ambitious reforms are required to enhance competitiveness, achieve growth potential and reap demographic dividend. We commend the authorities' efforts to improve the business environment, reflected in the rise in the World Bank's Doing Business Ranking. However, several factors, including limited human capital development, skills mis-matches, rigid labor markets, still complex regulations, infrastructure gaps and vulnerabilities to corruption, which impede the faster economic progress, remain as priority areas to address. Also, we believe that the benefits of growth should be distributed among a broader spectrum of people. In this regard, could staff comment on the existing poverty and the vulnerability of falling into poverty in Indonesia, as one of the most populous countries in the world?

With these remarks, we wish the Indonesian authorities all success in their future endeavors.

Mr. Mouminah, Mr. Alkhareif and Mr. Keshava submitted the following statement:

We thank staff for the well-written set of reports and Ms. Mahasandana, Mr. Tan, Mr. Anwar, and Ms. Susiandri for their insightful buff statement. We are in broad agreement with the thrust of the staff appraisal and would limit our remarks to the following issues.

We commend the Indonesian authorities for safeguarding macroeconomic and financial stability in 2018 despite external pressures. We also welcome the positive economic outlook but encourage the authorities to remain vigilant to risks especially those arising from a tightening of global financial conditions and a reversal of capital flows. The authorities should also continue their structural reform agenda, including expanding infrastructure investment, enhancing the business environment, and promoting financial deepening, to lift potential growth and create jobs for the young and growing population.

In the fiscal area, the authorities' focus is rightly on revenue mobilization and improving the quality and efficiency of spending. Increasing revenues is an important priority to help advance the authorities' development goals. In this connection, we take positive note of the important steps to improve tax administration. We are also encouraged by the agreement between staff and the authorities on implementing a medium-term revenue strategy to help improve the revenue-to-GDP ratio. This will facilitate additional priority spending, including on infrastructure, education, health, and social safety nets. On the expenditure side, we welcome efforts to improve the efficiency and quality of public spending, including through energy subsidy reform complemented by targeted measures for the vulnerable groups.

Bank of Indonesia (BI) has skillfully adapted its policies to changing external conditions. In this context, we are encouraged that BI took a range of monetary and macroprudential measures to manage external pressures in 2018. Looking ahead, BI should consider staff's recommendation to partially and gradually unwind the interest rate hikes implemented in 2018 in view of contained inflation risks, unless significant capital account pressures remerge. On the staff's recommendation to publish FXI data to improve transparency, we take note in the buff statement that BI is open to consider the publication once the precondition of a deep, efficient, and market driven foreign exchange market is met. To this end, we welcome the ongoing efforts to deepen financial markets and improve efficiency. As regards macroprudential policies, we would welcome staff elaboration on their view that further relaxation appears not warranted since the authorities only intend to maintain current policies.

On the external sector assessment, it is important to give due consideration to country-specific factors. For 2018, staff's overall assessment is that the external position was moderately weaker than medium-term fundamentals and desirable policies. At the same time, the current account deficit is projected to improve modestly over the medium term. In this connection, we take note of the authorities' view that the CA deficit norm should also reflect Indonesia's needs for infrastructure investment and critical structural reforms to promote sustainable growth.

With these remarks, we wish the authorities continued success.

The Acting Chair (Mr. Furusawa) made the following statement:

The Indonesian economy has performed well despite external headwinds. Directors' gray statements have noted that the outlook is favorable, but the risks are tilted to the downside and are mainly external. In order to unlock higher potential growth and harness the demographic dividends, Directors have encouraged a policy mix focused on preserving macroeconomic and financial stability, including revenue mobilization, and to enable higher development spending. Directors have also underscored the need for an appropriate monetary stance going forward, together with careful monitoring of financial sector and capital account developments. There was agreement on the importance of structural reforms to support the development of human capital infrastructure and labor and product markets.

The staff representative from the Asia Pacific Department (Mr. Breuer) made the following statement: [7]

> I will say a few words regarding the context of this year's consultation before turning over to my colleague, Mr. Porter, to answer one question from Directors.
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> The consultation mission took place in May, a few months after the Annual Meetings in Bali and the 2018 emerging market selloff, as well as a few weeks after the general parliamentary presidential and local elections in Indonesia. Directors may recall that during the Annual Meetings, the Indonesian economy was under strong external pressures coming from capital outflows, a strong U.S. dollar, higher oil prices, and higher U.S. interest rates. As a result, in October, the rupiah breached the 15,000 per U.S. dollar, which is a psychological barrier. Since then, markets have calmed down. Inflows have returned, and the rupiah closed today at 14,120. Against this backdrop, the consultations focused on two issues. One was the policy reaction to the 2018 emerging market selloff, and second, priority reforms for the new government.
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> In terms of the emerging market selloff, staff assessed that the way the authorities reacted, including by tightening fiscal policy and monetary policy ahead of general elections, was successful in managing external pressures without compromising growth in a material way. Going forward, there is broad agreement with the authorities on the policy strategy and tools that are appropriate for managing external turbulence, although there is one relatively minor difference. This is on how to use macroprudential policies in today's context—the authorities prefer to maintain an accommodative stance, while the staff do not see a need to further relax macroprudential policies since financial conditions appear supportive of growth. Having said this, the staff does not see any evidence today of financial risks derived from rapid credit growth or the emergence of asset bubbles. We will continue to monitor the situation closely.
>
> Now that the Constitutional Court has confirmed the reelection of President Jokowi, the government is well positioned to address the structural headwinds to growth. As Directors know, the government has made progress on reforms in its first term, including on infrastructure and deregulation, while maintaining economic stability in a volatile external environment. Indonesia is

[7] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

now in a good position to address the more difficult reforms, which President Jokowi has committed to do. The staff is of the view that tax reform is the top priority, as it would help finance other reforms and address economic vulnerabilities.

The staff representative from the Strategy, Policy, and Review Department (Mr. Porter), in response to questions and comments from Executive Directors, made the following statement:

I will make a few remarks related to the question about the short-term liquidity swap (SLS). The SLS which was proposed in 2017 was designed to be a renewable backstop for members with strong fundamentals and strong policy track records. It was designed to help such members face potential moderate short-term liquidity needs arising from external shocks and hence also potentially minimize the risk of such shocks occurring and also to limit the potential spillovers. The staff still believes that an SLS-type tool would be a valuable addition to the toolkit, and we could build something along these lines should there be sufficient interest in the future.

Mr. Saito made the following statement:

We thank the staff for the comprehensive report and Ms. Mahasandana and her staff for the informative statement. We commend the fact that Indonesia's policy reaction to the external uncertainty has successfully preserved economic stability and maintained growth momentum. We also positively note the authorities' commitment to push ahead economic reforms. As we issued a gray statement, we would like to offer a few comments for emphasis. First, on the fiscal policy, we welcome the current sound fiscal position and see it appropriate to maintain neutral fiscal stance while enhancing domestic revenue mobilization and increasing expenditure efficiency. In this context, we underscore the critical role of the Medium-Term Revenue Strategy (MTRS), which would help finance priority spending on infrastructure, education, health, and the social safety net. We also welcome that the staff has been providing deep and broad technical assistance (TA) in this area and encourage the staff to provide additional TA, depending on the authorities' needs.

Next, on the monetary policy and the financial sector policy, we welcome the combination of tightening monetary policy and loosening macroprudential policy, which has functioned well to preserve economic stability during the difficult time. Going forward, we encourage the authorities to closely monitor the situation and cautiously adjust the policy stances as needed. More importantly, mitigating risks from the high reliance on portfolio inflows by deepening domestic financial markets and broadening the investor base are needed. To this end, we encourage the authorities' continuous efforts, including the implementation of the countries' national strategy.

Finally, on the corporate prudential foreign exchange regulation, while we see the difference of views between the staff and the authorities on whether this is classified as capital flow management measure/macroprudential measure (CFM/MPM) or not, we are of the view that that should be assessed as residency-based CFM and MPM under the Fund's Institutional View. That being said, we would like to emphasize the importance of assessing the appropriateness and the effectiveness of the measure rather than simply focusing on the labeling. In this context, we urge the authorities to analyze the effect of the existing measures and take further action if necessary. At the same time, we would encourage the staff to conduct further analysis on the benefit of expanding corporate foreign exchange regulation coverage. With these remarks, we wish the authorities success.

Mr. Trabinski made the following statement:

Indonesia's strong economic growth is exemplary and visibly supported by the strong commitment of the authorities to sound policies. Moreover, the current outlook is positive, while some pockets of vulnerabilities and external risks remain. We encourage the authorities to maintain an adequate policy mix aimed at protecting macroeconomic stability while addressing challenges. We have already laid out our stance in the gray statement, but allow me to focus on some few additional points.

We agree with many other chairs that increasing fiscal revenues would be important to further increase economic growth through greater investment in infrastructure, education, health, and social protection. In this regard, we share staff's view that the MTRS implementation would be essential in realizing these objectives. We thank the staff for providing a detailed analysis of the MTRS operationalization, including reform, prioritization, sequencing, and phasing. We also appreciate the staff's answers to technical questions on fiscal policy more broadly. In addition, we would like to ask whether the staff sees any risks to the MTRS implementation that could materialize in the near future. We are encouraged by Indonesia's well-capitalized liquid and resilient financial sector. We take note of the vulnerabilities stemming from high foreign exchange corporate debts, and we already spoke about it in our gray statement, but let me emphasize one additional point. We also take note of the progress achieved so far by the authorities in implementing the 2017 Financial

Sector Assessment Program (FSAP) recommendations, one of which concerns the requirement to integrate key Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) risks into the priorities of relevant agencies. In this regard, we commend the authorities for this action, and I would just like to ask a more general question. I ask the staff to say a few words about this document because from our perspective, it is quite important that the authorities are tackling these issues. If not, we would appreciate if the staff could tackle likely the question of implementation of this AML/CFT strategy in the next Article IV consultation.

Finally, we take note of the authorities' stance enclosed in their buff statement that indicates Indonesia's needs for higher investment and structural reforms, which are not adequately reflected by the staff's estimate of current account norm. We would appreciate the staff's comment on reasons behind the differences in estimates. We asked this question in our gray statement, but I could not find the answer. In this regard, we would also like to encourage the staff to pay close attention to country-specific factors in making analysis, especially in case of subsequent discrepancies in views between the staff and the authorities.

Mr. Kaya made the following statement:

We highly appreciate the staff report, the excellent selected issues paper, and the answers to our questions as well as the detailed and informative buff statement by Ms. Mahasandana and her colleagues. We welcome the continued positive assessment of Indonesia's economic development, which enables the authorities to target ambitious development goals. We would like to add the following observations.

First, on the external sector assessment, a current account deficit remains inevitable for many emerging economies with significant development needs, a growing population, and consumption. Both the size of the external deficit and the sources of this financing, as well as an underpinning policy mix, play a role in determining external sustainability.

On the current account deficit norm for Indonesia, we take note of the staff's answers to ours and Mr. Rosen's questions. However, we feel that more research is still needed to economically explain the External Balance Assessment (EBA) regression results and make the appropriate adjustments to its outcome. We encourage the staff to continue working with the authorities on this matter.

Regarding the current account financing and policies, we commend the authorities' sound policy response to the heightened external volatility in 2018 and acknowledge the difficulty of calibrating a policy mix that strikes a right balance between portfolio investors' interests and medium-term economic needs. We agree with Mr. Ray's point that Indonesia could be an interesting case for the Fund's work on the Integrated Policy Framework (IPF). We are looking forward to structurally reducing the reserves' dependence on volatile short-term growth. Foreign direct investment should play a permanent role.

This leads to my final point, the importance of creating a conducive environment for FDI and broadly for private sector-led growth. We welcome the authorities' comprehensive reform agenda, stemming from fiscal structural reforms, including medium-term revenue mobilization, to financial market deepening, and labor and governance reforms as recommended by the staff. We commend the Indonesian authorities for their strong track record of positive economic performance supported by prudent policies aiming at unleashing the country's tremendous economic and human potential. We wish the authorities every success in their policy endeavors.

Mr. Morales made the following statement:

We are in agreement with the policy mix recommended by the staff, namely cautious unwinding of interest rate hikes, a neutral fiscal stance, and focusing macroprudential policies on containing systemic risks. We would like to emphasize a few points regarding the macroprudential policy and ask a few follow-up questions.

First, the growth-at-risk analysis, a very interesting report, shows that financial conditions and macrofinancial vulnerability are neutral and consistent with the expected GDP growth rate. The report highlights that the credit gap is closing as the credit cycle moves out of a prolonged long term downturn, including by further increases in corporate external debt. Moreover, the staff report indicates that corporate external debt has continued to rise to about 14 percent of GDP, an increase equivalent to 5 percent of GDP over the last seven years, exposing the corporate sector to rupiah volatility. Our question to the staff would be what could be the motivation for such an increase in external borrowing by corporates given recent experience with exchange rate volatility and apparently high access to commercial bank loans?

Second, we appreciate the chart in Box 1 showing diverging paths for monetary and macroprudential policies reflected in a higher central bank policy rate and a reduction in macroprudential policy index. This loosening of macroprudential policies comes from allowing a larger share of macroprudential liquidity buffers as collateral and relaxing the macroprudential intermediation ratio from a range of 80 to 92 to 84 to 94 percent. We believe that some additional information could be useful, especially about the potential impact of these measures. For example, how binding are these ratios? Figure 2 shows the loan-to-deposit ratio is already at the highest level of the last seven years. Would the impact of the new ceiling be significant?

Second, we understand that banks below the macroprudential flow ratio are subject to additional reserve requirements unless they increase lending. How many banks would be in that situation? Are they mainly smaller banks? Are they going to be incentivized to go beyond the risk tolerance? We would appreciate the staff's views in this regard.

Finally, I want to commend the authorities for their consistent macroeconomic policies that have successfully helped Indonesia transit from a period of turmoil to one of rising economic dynamism.

Mr. Meyer made the following statement:

I would like to highlight the two most important elements that we saw. In general, despite last year's tighter global financial conditions, Indonesia's economy has performed well owing to its overall sound fundamentals and decisive policy responses that attach a high importance to maintaining macrofinancial stability. We see the relatively low revenue-to-GDP ratio and pressing spending needs. Against this background, we encourage the authorities to intensify their efforts to raise revenues within a medium-term strategy. This would create room for growth-enhancing investments in infrastructure and human capital while allowing them to improve the social safety net and public services and at the same time safeguard the positive development on the fiscal side or on the debt-to-GDP side. Let me highlight, in 2000, general government debt was 87 percent of GDP. In 2018, it is only 30 percent. I would like to mention that this development was anchored by a fiscal rule that has a fiscal deficit rule of 3 percent and a 60 percent debt-to-GDP threshold, so I commend the authorities explicitly for that.

More on the external, we totally concur with the staff that the authorities should strive to deepen financial markets and expand accessibility to the market. This will include strengthening supervisory capacities, also the AML and CFT regime, but we believe this is very important to also shield against those external risks if they develop their own domestic financial market. On the external side, the second leg should be more decisive actions aimed at liberalizing the current FDI regime and to accompany these efforts with structural reforms to further improve the investment climate, to move FDI higher as a stable form of capital flows.

On macroprudential policy, we thank the staff for the answer given to our question, and as the mission chief described, there is probably not a big discrepancy. We would encourage the authorities to err on the side of caution and confer with the staff.

We share the authorities' sentiments, also echoed by the gray statements of Mr. Mozhin, Mr. Sun, Mr. Kaya, and Mr. Saraiva—that in view of the high uncertainty surrounding the current account norm estimates, caution should be applied when interpreting the EBA-implied outcomes, which should always take country-specific factors into account. I would explicitly indicate that the staff has done that in this case.

Like others, we thought that it was nice that the report connected capacity development and surveillance, but maybe it could have been elaborated further and more precisely.

Finally, we would appreciate if the authorities would consent to publication of the staff report. With this, I wish all the best to the authorities.

Mr. Castets made the following statement:

In our gray statement, we commended the authorities for their prudent macroeconomic management in a context marked last year by both the election and some external pressure. Going forward, we trust that the authorities will continue in that way. We share the emphasis of the mission chief on using the window of opportunity created by the reelection of the president and the the decrease in external pressures, so I will try to elaborate more specifically on three points that we see as priorities in this context.

First, we would put a strong emphasis on the need for a significant rise in public revenues given the elevated needs in terms of public investment and social spending in the country. In that regard, we are glad to see that the staff is working with the authorities to design an MTRS, and that this plan will tackle this particular challenge. We encourage the authorities to communicate to the population the benefits of raising taxation in terms of access to quality public services and social safety nets. This will help to create the buy-in that is necessary for this type of difficult reform to succeed.

Second, we encourage the authorities to step up their efforts on climate change policies in terms of adaptation and mitigation. Indonesia is one country that is exposed to natural disasters, so this issue is relevant for the country, and it also has fiscal implications since complete elimination of fossil fuel subsidies should remain a priority for the authorities. We expect the staff to support the government's effort in this regard, which implies a simultaneous strengthening of social benefits. More broadly, we once again call on the staff to cover this issue in upcoming Article IV reviews.

Third, we see some room to improve governance and the business climate in Indonesia, and this is linked to the point made by Mr. Meyer regarding opening to FDI. Reading the staff's report, we feel that there is not a high degree of concern around the level of the current account deficit but more on the composition of the current account, and given that external resilience is on the authorities' mind and also given past events, we feel that there is definitely the room for progress.

Ms. Pollard made the following statement:

My comments very much echo much of what has already been said around the table. We welcome Indonesia's sound macroeconomic management and believe it has clearly helped the country weather the external volatility over the past year, and we note that the authorities are largely in agreement with the staff on the priorities of revenue mobilization and financial sector deepening, and support the comments of others around the Board on that.

On a few other issues, I agree fully with what Mr. Saito has said about capital flow management and macroprudential management, so will not say anything further on that. On the EBA, we highly value the Fund's approach to external sector assessment through the EBA model and believe it provides room to take into account country specificities, as Mr. Meyer also noted in this case. We fully appreciate the staff's answer to our question and that of Mr. Kaya on the factors driving Indonesia's current account norm and also the comparison of Indonesia's norm to that of other emerging markets and the ASEAN countries.

We reiterate our comment on encouraging the authorities to publish their foreign exchange intervention data and fully appreciate the movements that have been made on increasing the flexibility of the exchange rate. I support Mr. Trabinski's comments on the AML/CFT strategy and Mr. Meyer's question about whether the staff report will be published.

Mr. Saraiva made the following statement:

I was not planning to say anything, but this report raised a series of uncommon issues that are of interest to other countries in addition to Indonesia itself. Some were mentioned here, such as the very nature of the policy mix that has been used to face a challenging external situation which could be of interest in the discussion of the IPF, particularly the fine-tuning of monetary policy and macroprudential policy measures, which is a non-trivial issue, and not necessarily a non-controversial issue as well.

Another point of interest is the pilot on use of big data for consumption and CPI as well as for housing, which is also something that could be an example and be of interest for several other countries. I appreciate the staff's additional information given on this aspect.

The one issue that I would like to highlight concerns the information given also by Mr. Porter on the SLS. I would like to see if Mr. Breuer agrees with that, I believe that Indonesia is a clear case in which a facility like the SLS would be highly useful, because it is a country with a very good performance and sound policies but that has a vulnerability in terms of its need of external funding to finance both the public sector but also the current account. In the situation like the one described in paragraph 16 of the staff report, where the country could face short-lived restricted access to external financing, the staff suggests some instruments to irrigate the domestic financial sector to avoid the liquidity crunch, but those domestic instruments could be supported by an external backstop, like the SLS. We do not need to discuss the issue now, but it is important in the future to see that there are concrete cases in which such a facility with those characteristics could be useful.

Mr. Alkhareif made the following statement:

We commend the authorities for safeguarding macroeconomic and financial stability despite the 2018 external pressure. We also take positive note of the good economic outlook for Indonesia. That being said, Indonesia faces risks, and the authorities should remain vigilant, especially to the risks of tightening financial conditions and reversal of capital flow. In this context, we commend the Bank of Indonesia for the skillful implementation of monetary policy and macroprudential tools.

Like Ms. Pollard and Mr. Castets, we commend the authorities for their efforts to enhance domestic revenue mobilization and improve the efficiency of government spending. On the external sector, we echo the comments made by Mr. Meyer and Ms. Pollard on the importance of taking into account country-specific factors. We believe Indonesia would benefit from infrastructure investment and structural reforms to boost potential GDP to enhance sustainability and inclusiveness. With these remarks, we wish the Indonesian authorities continued success.

Mr. Siriwardana made the following statement:

We thank the staff for their comprehensive reports and responses to our technical questions and also Ms. Mahasandana and her colleagues for their informative buff statement. Like others, we commend the Indonesian authorities' decisive and coordinated actions with policy synergy to safeguard the economic resilience and sustain growth momentum amid heightened external pressures. Like other Directors, we agree that more needs to be done to effectively address the remaining issues to solidify the expansion. We issued a detailed gray statement, and I would like to add two points for emphasis.

First, we note that some fuel prices have been frozen in Indonesia. The most recent fuel subsidy reform has occurred in 2015. As an importer of oil, regulation of oil subsidies while strengthening means-tested social assistance to protect the vulnerable will yield fiscal benefits in conjunction with the revenue-raising reforms. In this regard, we would like to hear more from the staff on the extent of any subsidies in Indonesia and the plans to streamline them going forward.

Second, we concur that the development of e-commerce will be a potential new engine for growth in Indonesia. However, as of now, the industry is still not mature, and online participation is much lower than that of other countries in the region. The authorities are clearly undertaking several measures to appropriately address this trend, which has been highlighted in the staff report in Box 4. Given that Indonesia's e-commerce is still in early stages of development, it is likely that burdensome regulations could halt the private sector's growth and dampen promising economic and social benefits. In this context, we would welcome the staff's comments on the regulatory environment, which is important to set out a strong foundation for the e-commerce industry in Indonesia. With these remarks, we wish the Indonesian authorities all success in their future endeavors.

Mr. Sun made the following statement:

We thank the staff for the very good report and Ms. Mahasandana and her colleagues for the useful buff statement. We have already issued a gray statement, so I will be brief and just add one point on the issue of publication of foreign exchange intervention data.

While we recognize the potential benefits from increasing transparency, we share the view of the authorities that certain preconditions need to be in place before it is appropriate to do so. This applies not only in the case of Indonesia but also other economies where market infrastructure and the supervisory frameworks may need to be further developed, being mindful of financial stability implications before potentially market-sensitive data can be released.

Going forward, we encourage the staff to continue to work with the authorities to further deepen and enhance Indonesia's financial markets. Once the necessary preconditions are met, the staff can further engage with the authorities as they consider publishing the data.

Mr. Daïri made the following statement:

We commend the authorities for their excellent work and their success in maintaining macroeconomic stability despite the volatility in capital flows last year. In our view, the authorities' policy mix has been very successful, and I have no reason to doubt that the same approach would be successful in case of any other instability in the international capital markets, so I wish them well in this area.

I also support the authorities' call for appropriately calibrating the EBA exercise to the country's investment and structural reforms. The staff are doing their best in this area, but there still are some areas where they cannot explain. I have not noted the size of the residual in that report, whether it has increased or declined recently, and also what potential factors can explain it, so I would appreciate the staff's clarification on the issue. Thank you.

The staff representative from the Asia Pacific Department (Mr. Breuer), in response to questions and comments from Executive Directors, made the following statement:

On the corporate prudential regulation, the authorities prefer not to call it a CFM/MPM, although we follow well-known internal processes of the

Fund in reviewing these policies. I do not believe there is much policy disagreement—what staff is recommending is that a portion of corporate foreign exchange debt which is currently not covered by the regulation, be covered. That would reduce any potential regulatory arbitrage and eliminate the CFM nature of the policy, which is arises from the residency treatment. The authorities face some data gaps in this area, and we are still discussing this issue with them.

In terms of risk for the MTRS, we do not see many risks now. On the contrary, we see opportunities, but obviously tax reforms are difficult. They generate winners and losers. Vested interests can influence outcomes, so this is a big challenge for the country, though we believe that the timing is very propitious.

On AML/CFT, the Financial Sector Supervisor has made significant progress in implementing AML/CFT policies. We have been working closely with them for over two years, and Indonesia is in the process of joining the Financial Action Task Force (FATF), which shows their commitment and the progress they have achieved in this sector.

There were a number of comments on the EBA, and we take careful note of these comments. Let me say a few things. First, this is a multilaterally consistent exercise, so the staff does not have discretion to bilaterally change the rules of the game or the equations. We have been working closely with the Indonesians, the Research Department (RES) and the Strategy, Policy, and Review Department (SPR) on the model. In fact, the current account norm with the new revised multilateral model is higher relative to the previous one, and there are some specific country issues that have led to adjustments, in particular population growth, where the adjustment is significant amounting to a larger current account deficit by almost a percentage point. Obviously more work is needed, and we will continue to engage both our colleagues in the Fund and the authorities to move forward on this issue.

On the increase of external borrowing in recent months, the sources are basically two. One is a few large state enterprises that bought a large mine and cement plants and borrowed externally in Q4 of last year, and led to a jump in the external debt numbers as well as higher trade credits linked to higher imports that in turn are associated with the infrastructure push. In terms of the changes to the regulations on the loan-to-deposit ratios and how binding they are, we do not believe these are very binding yet, but credit is growing faster than deposits, so the authorities need to manage the liquidity situation carefully.

On climate change, we take note of the suggestion, which is a very good one, and certainly would be taken into consideration for future analytical work for Indonesia.

On the big data pilot, that process is ongoing. It is a cooperative exercise between Bank Indonesia, the Dutch Statistical Agency, and the Statistics Department (STA), and we hope to complete that pilot program at the end of this year and then disseminate the findings in case there is interest in other countries.

In terms of energy subsidies, the amount we estimate for last year was about 1 percent of GDP, comprising fuel subsidies (about 0.7 percent) and electricity subsidies (about 0.3 percent).

On e-commerce, we have been following fintech developments in Indonesia quite closely, and the authorities, both the central bank and the financial sector agency, have adopted a sandbox approach and are monitoring the situation carefully. The Bali Fintech Agenda was approved during the Annual Meetings, and the Indonesians have taken these principles seriously and have been applying it, including by undertaking investments to increase the access of internet to the population.

On publication, we do not have information from the authorities. In the past, the authorities have agreed to the publication, and we are hopeful that they will again do so this year.

Ms. Mahasandana made the following concluding statement:

On behalf of my Indonesian authorities, I thank Directors for their thoughtful gray statements and useful comments during the Board discussion, which I will convey to my authorities, who will take them into consideration.

The Indonesian economy continued to perform well. Macroeconomic and financial stability remain intact while the growth momentum was successfully maintained. External stability has been restored after experiencing significant pressure last year. With the current account deficit narrowed and the capital and financial accounts saw surplus in the first quarter of this year, going forward Indonesia's economy is expected to gradually expand further, backed by stronger domestic demand, while inflation remains within the target range and the current account deficit continues to decline.

The positive growth outlook is also underpinned by improved productivity arising from structural reform. While the macroeconomic stability remains favorable, potential downside risks from global uncertainty still weigh on the external stability given the country's reliance on external financing. My authorities have a firm commitment to deal with the challenges arising in the external sector and to reduce countries' external vulnerabilities in the long-term. They have embarked on a series of structural reforms to attract more stable foreign capital while strengthening capabilities to mobilize domestic finances.

The authorities have been implementing reforms to reduce infrastructure bottlenecks, streamline the bureaucratic administration. They have been enhancing regulatory quality and transparency with an aim to facilitate more FDI inflows. Strategic initiatives to deepen the financial markets are also underway to enhance domestic financing. Priority is given to promoting long-term financing instruments and deepening money market and foreign exchange markets. While financial market deepening is a strategy for strengthening economic resilience, the fact that most of export proceeds never return to or stay in Indonesia has hampered the financial deepening process and impacts domestic financial markets. As a natural resource-based economy, repatriation of natural resource exports proceeds in Indonesia is very important for the economy to address structural issues related to economic developments. In this light, the authorities have been considering appropriate policy to boost these export proceeds inflows.

Along with the effort to promote domestic financing, the authorities are pursuing policy measures to mitigate risks of external borrowing through the corporate sector, and external debt hedging regulations. The authorities view that the coverage of the situation is appropriate with the current situation. As for domestic foreign exchange loans, there are already other policy measures to mitigate risks of these loans, including regulations on the state-owned enterprise hedging requirements and limitations on banks' foreign exchange exposures.

The reform to deepen financial market and strengthen domestic fund mobilization has been supported with the strategy to harness the benefits of the digital economy while managing the associated risks as well.

Bank Indonesia has launched the Indonesia payment system 2025 program and formulated a strategy to promote digital financial innovation, including e-commerce and electronic financial transactions, and to integrate the financial sector into the digital economy. The strategy to manage cyber risk has also been included in this blueprint. The authorities also plan to develop a national strategy on cyber resilience and ensuring cybersecurity regulation guidance and supervisory practices for the financial sector.

Revenue mobilization is also one of the crucial reforms to boost public sector saving, which should help support long-term sustainable growth, as well as reduce the role of foreign capital. In this light, the authorities continue their commitment to implement comprehensive tax reform as part of the MTRS in order to increase government revenues. Along with this, fiscal reform on the expenditure side will also be conducted by improving the quality of public spending. Apart from pursuing structural reform, my authorities also have firm commitment to prudent macroeconomic policy to ensure long-term sustainable growth and stability.

On fiscal policy, the authorities commit to maintain financial stability while continuing to pursue a neutral policy stance to facilitate growth momentum.

On the monetary policy, given the success of the policy mix in dealing with the difficult situation last year, the more relevant issue to discuss now is what is next. In this regard, my authorities would like to underscore that their monetary policy will be focused on maintaining macroeconomic stability. Bank Indonesia will cautiously consider the accommodative monetary policy to build policy buffers and support economic activity while ensuring that inflation remains at their targets.

The authorities also reaffirm their commitment to adopta flexible exchange rate with foreign exchange intervention limited to dealing with disorderly market movements. Macroprudential policy will continue to safeguard financial stability and mitigate systemic risks. In this light, the authorities view that under current conditions where credit growth is still below its potential level, they can continue to adopt the current accommodative macroprudential policy while remaining vigilant and stand ready to act to ensure financial system stability.

I would like to assure Directors that going forward, our authorities will remain vigilant in safeguarding macroeconomic policy and financial stability while pursuing structural reforms to promote more broad-based, balanced, and sustainable growth.

There are also two issues that have been discussed in this meeting that I would like to address. One is on the intervention data. The authorities view that intervention data publication requires prerequisite conditions to be met, such as existing of deep, efficient market, and a deep market foreign exchange. The failure to meet this prerequisite condition would induce speculative activity and may lead to excessive volatility in exchange rates. To this end, Bank Indonesia will consider publications of the foreign exchange data once these preconditions are fulfilled.

The other issue is the EBA, and we thank many Directors who are supporting our view regarding the Current Account (CA) norm, that the authorities view that the result from the model may be too low and does not adequately reflect the Indonesian need for higher investment in structural reforms. In this case, we encourage the staff to consider how to better incorporate country-specific factors in the assessment of the current account norm, in particular in the case of substantial infrastructure investment needs and critical structural reforms that the country needs to undertake and to promote sustainable growth.

Let me conclude my remarks by conveying the Indonesian authorities' appreciation to the Fund for constructive engagement and TA. We look forward to continued policy dialogue. I also would like to thank the mission chief, Mr. Breuer, and his team for his excellent work and also thank management and Directors for the fruitful discussions and useful recommendations. Thank you very much.

Mr. Meyer asked about the authorities' intention to publish the staff documents.

Ms. Mahasandana responded that she did not know the authorities' plans with regard to publication.

The Acting Chair (Mr. Furusawa) noted that Indonesia is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' policy response in the face of strong external headwinds in 2018, which supported positive economic performance. While noting the favorable economic outlook, Directors encouraged the authorities to remain vigilant against risks, including from capital flow reversals, considering Indonesia's reliance on external financing. They considered that achieving higher potential growth requires a comprehensive structural reform package, including higher domestic revenue mobilization and financial deepening, which will reduce vulnerabilities and facilitate complementary reforms in human capital, infrastructure, and labor and products markets.

Directors welcomed the appropriate focus of the near-term policy mix on protecting macroeconomic and financial stability, safeguarding buffers, and addressing vulnerabilities. They supported maintaining a neutral fiscal stance and closely assessing macroprudential policies to ensure financial system stability. With inflation within the target band, Directors saw scope for cautious relaxation of the monetary policy stance, unless significant capital account pressures reemerge. They encouraged allowing the exchange rate to continue moving in line with market forces, with FX intervention limited to preventing disorderly market conditions.

Directors welcomed the authorities' continued efforts to protect fiscal buffers, including with the elimination of the primary deficit in 2018, and improve the quality of spending by rebalancing expenditure toward infrastructure, education, health, and social safety nets. However, Directors noted that government revenues remain below peer countries and insufficient to finance the authorities' development goals. In this context, they highlighted the critical need to implement a medium-term revenue strategy, which combines well-sequenced and prioritized tax policy and administration reforms, to finance priority spending and structural reforms, and lessen reliance on external financing. Directors also called for monitoring risks and contingent liabilities arising from state-owned enterprises and public-private partnerships.

Directors commended efforts to improve infrastructure, streamline regulations and reform the education and health sectors, which have contributed to improvements in the economic environment. They encouraged the authorities to expand these efforts and to address remaining structural impediments to higher growth, including by strengthening governance and the business environment. Priority actions also include improving human capital, increasing female labor participation, easing restrictions to foreign direct investment, and streamlining labor and product market regulations.

Directors welcomed the progress in strengthening the frameworks for financial oversight and crisis management in recent years, in line with FSAP recommendations. Going forward, they encouraged the authorities to focus on the areas identified by the FSAP where further improvement is needed, including clarifying institutional mandates, improving supervision of nonbank financial institutions and financial conglomerates, strengthening the legal framework for financial oversight and crisis management, and enhancing crisis management frameworks. Continued strengthening of the AML/CFT regime was also encouraged.

It is expected that the next Article IV consultation with Indonesia will be held on the standard 12-month cycle.

APPROVAL: April 6, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Policy

1. ***Can the staff provide an update on the extent of private sector participation in PPPs to date and what scenarios they see looking ahead? Could staff update on the authorities' recent measures to enhance fiscal risk management, including PPPs, and on the challenges in the area of fiscal transparency? Do the authorities plan to conduct the Fiscal Transparency Evaluation in the near future?***

- SOEs have been actively supporting the development of infrastructure and are expected to continue to play an important role—over one third of National Priority Projects in 2019 and beyond are estimated to be channeled through SOEs.

- The authorities are closely monitoring the fiscal risks from SOEs and PPPs. Dedicated units in MOF are monitoring the balance sheets of individual SOEs and fiscal risks from PPP projects, and the authorities are working to improve information on SOE debt, including the appropriate consolidation among public entities, and PPPs. So far, the number of PPPs are small but of course this will increase in the future.

- On fiscal transparency, as some government policies (e.g., energy subsidies) are implemented through SOEs, the resulting financial transactions between the government and SOEs are sometimes not reported in a timely manner (for example, payment of subsidies requires ex post report of State Audit Agency). More broadly, however, many of the large SOEs are rated by rating agencies so they do provide frequent financial information. We have no information on the authorities' plan on fiscal transparency evaluation at this point.

2. ***Could staff provide additional information on the status of the MTRS?***

- Important progress on tax administration has been made over recent years, including lifting bank secrecy, the automatic exchange of information, piloting of compliance risk management (CRM), and ongoing development of the IT system. The CRM for VAT is ready for national deployment and the MOF is developing CRM for income tax. The authorities have indicated that they will be considering reforming VAT and CIT, with a focus on removing various VAT exemptions and streamlining various special CIT regimes.

3. ***Can staff comment on whether the IMF is planning to support the tax reforms, as requested by the Authorities, and whether any further support is being provided for MTRS implementation?***

- Yes, there is a broad and deep ongoing technical dialogue with Indonesia on this issue. FAD provided two MTRS TAs in recent years and stands ready to provide additional TAs if requested by the authorities.

4. ***Could staff elaborate on building public support for the envisaged reforms in MTRS?***

- The MTRS represents a comprehensive reform of the tax system and have implications on efficiency, equity, and ease of compliance and administration. It is important to engage stakeholders on the reform plan early on and communicate to the public, for example, the rationales of the reform, how the additional revenues will be used, and what measures will be taken to mitigate the impact on the vulnerable.

5. ***Could staff describe the recent reforms (over the last 5 years) of fuel subsidies in Indonesia detailing their fiscal, environmental and redistributive consequences, and specify their recommendations going forward.***

- The most recent fuel subsidy reform occurred in 2015, with the price of gasoline liberalized and the subsidies on diesel rationalized (capped at IDR 1,000 per liter). However, as international prices rose, domestic prices of low-grade gasoline and diesel have not been adjusted according to the reform plan since 2016. Going forward, staff would continue to urge the authorities to gradually eliminate fuel subsidies while strengthening social safety net to protect the vulnerable.

Monetary and Exchange Rate Policy

6. ***Could staff comment on the appropriate pace for monetary policy loosening that maintains this delicate balance?***

- Staff recommends that the policy interest rate hikes adopted in response to external pressures in 2018 could be partially and gradually unwound as external pressures have subsided. Such a move would be in line with recent monetary policy easing in many emerging market economies and help Indonesia build space for future hikes if external conditions were to deteriorate significantly. As indicated in staff analysis, the gradual and partial easing is a cautious approach that allows the authorities to monitor the impact of a looser monetary stance and adjust the policy as needed to avoid adverse market reactions.

7. ***Does staff have an estimate of how sensitive the capital outflows have been to the level of domestic interest rates?***

- Staff's ballpark estimate, based on the quarterly time series since 2014, is that a 1 percentage point increase in the policy rate is associated with an increase in capital flows of about 0.8-1.2 US$ billion (approximately 0.1 percent of GDP and 4 percent of the financial account in 2018). These effects are obtained from a time series regression of capital flows on changes in policy rates, conditioning on stock market volatility (VIX), U.S. interest rates and year-specific time effects. However, these estimates are not causal and are subject to a high amount of uncertainty given limited observations.

8. ***Could staff explain the size of the DNDF market and the expected stabilizing effect of this action?***

- The outstanding stock of DNDF is still small and amounts to near $US 1.2 billion. While DNDF can play a stabilizing role by acting as a "reservoir" for USD-buying pressure, participation in the DNDF market must be broadened beyond Bank Indonesia (BI) to ensure that the reservoir has ample capacity. Recent revision of regulation is expected to support a more private sector driven DNDF market.

9. ***We note that the BI insists that there are some prerequisite conditions to be met for the publication of the forex intervention data. We would like to hear staff's view on it and expected timeline for fulfilling those conditions.***

- Staff believe that the publication of foreign exchange intervention data with appropriate lags would improve transparency and could strengthen policy effectiveness. Having a time-bound plan that describes the specific objectives that the authorities pursue with financial deepening and a timetable for publication could support these objectives.

Corporate FX Regulations

10. ***We note that staff's and the authorities' views continue to differ on the CFM/MPM classification of this regulation. Could staff clarify their views on***

any alternative measures which are advisable, considering Indonesia's circumstances?

- Under the IMF's Institutional View and the macroprudential policy framework, the corporate FX regulation is assessed as a CFM/MPM because the regulation has a residency-based differentiation. Staff proposes to improve it by extending the coverage to all FX liabilities, focusing on systemic corporates. This change would remove the residency-based differentiation but continue to help the authorities achieve its policy purpose—moderating risks from corporate external debt—with lower enforcement and compliance costs.

11. ***We would appreciate further elaboration on staff's recommendation to extend the coverage of the corporate hedging regulation. We also note that staff is asking the Indonesian authorities to reconsider the repatriation measure whereas staff has encouraged the CEMAC authorities to implement such measure. Could staff explain that differentiated advice on the same issue?***

- As noted above, the corporate FX regulation was assessed as a CFM/MPM because the regulation has a residency-based differentiation. Staff proposes to improve it by extending the coverage to all FX liabilities, focusing on systemic corporates. This change would remove the residency-based differentiation but continue to help the authorities achieve its policy purpose—moderating risks from corporate external debt—with lower enforcement and compliance costs. In terms of the export repatriation measure, staff see potential risks to confidence from this action. Regarding Fund advice in other regions, these reflect the country's condition and are not necessarily applied to Indonesia.

12. ***Regarding plans that will require natural resource exporters to repatriate proceeds to Indonesia, we invite staff to comment on any preliminary reactions from exporters and to elaborate on the associated risks.***

- Staff believe that the regulation to increase repatriation of export proceeds in the natural resource sector could potentially risk undermining investor confidence as it could be perceived as restrictive. Staff believes that there is scope to address external pressures and promote financial deepening through macroeconomic, structural, and financial sector policies. For instance, staff recommend various financial sector policy measures (para 37) that will help with financial deepening while protecting prudential standards. So far, we have no information on the reaction of exporters.

13. ***We agree that, as external pressures subside and inflation remains subdued, consideration should be given to unwind some of the policies adopted in***

response to the 2018 EM selloff. Could staff indicate whether actions in unwinding interest rate hikes of 2018 are expected in the near-term?

- The authorities have publicly noted that they see space for lowering rates but that they are waiting for the appropriate time in light of uncertainties surrounding the global economy.

14. ***We would appreciate staff's additional elaboration on the key reasons that led to a higher negative impact of the 2018 EM selloff on the Indonesian economy than on its regional peers.***

- Small financial markets—which tend to amplify shocks—and reliance on portfolio inflows to fund the twin deficit contributed to the impact of the 2018 EM selloff on the economy. In addition, there was a surge in the current account deficit in 2018 that coincided with episodes of risk aversion and capital outflows from EMs.

External Sector Assessment

15. ***Staff acknowledged the divergence between the exchange rate and current account assessments (moderately weaker external position vs. REER undervaluation) and attribute it to the lags in the current account response to the REER depreciation. We note that the current account deficit is projected to remain around 3 percent of GDP over the next couple of years. Staff's further comments would be welcome.***

- The CA realization from 2019:Q1 shows that imports contracted significantly (both y/y and m-o-m), consistent with the lagged response to the REER depreciation in 2018. However, export growth continues to be weak, partly due to external factors (for e.g., trade tensions and weak export demand from China). Our baseline reflects a slight recovery in exports. but at the same time, a continued growth in imports, albeit at a weaker pace than last year, reflecting growing consumption and infrastructure needs.

16. ***We note the authorities view that Indonesia's CA norm should be more negative. Could staff provide more information on the factors driving the current account norm? Could staff compare the CA-norm for Indonesia with the CA-norms of countries with a similar level of GDP per capita?***

- For Indonesia, the staff assessed CA-norm is -1.8 percent of GDP which already reflects a significant staff adjustment (-0.9 percent) based on Indonesia specific demographic factors. Other factors that make the (unadjusted) CA norm less negative are the dependency ratio (reflecting the need for higher savings) and institutional/political environment. In comparison, countries with GDP levels close to Indonesia have reasonably similar CA-norms of: -2.3 (Turkey) and -1.5 (Poland). Indonesia also has a higher level of CA deficit norm than its peer ASEAN countries: -0.2 (Malaysia) and 0.1 (Thailand).

Structural Reforms

17. ***Could staff elaborate on their suggestion to establish a dedicated group on cybersecurity, and the authorities' views on this suggestion?***

- Cyber risk is an emerging risk to financial stability and exposures will grow with the digitalization of the financial system, which poses challenges to financial oversight. Financial innovation has increased the exposure to cyberattacks as greater use of technology could expand the range and numbers of cyber entry points into the financial system that hackers could target. Currently, a few agencies in Indonesia is monitoring cyber risk but there is no dedicated group among the agencies to gather and share information on cyber events and develop a national strategy to prevent cyber events and protect the financial system from cyberattacks. Staff stressed during the mission that it would be important to set up such a group with representatives from different agencies (e.g., BI, OJK, LPS, MOF, etc.). The authorities agreed that it is important to enhance monitoring of cyber risk and would consider such a setup.

18. ***Could staff provide more details on the goals and milestones envisaged by the authorities in the Indonesia's Payments system 2025 vision?***

- Indonesia's Payment System 2025 vision centers around five main initiatives to be implemented by BI, in collaboration and coordination with relevant ministries, institutions, and the financial industry. The five initiatives are (1) promote digital open banking and interlink with Fintech; (2) develop retail payment system to support the digital economy and finance; (3) develop wholesale payments and financial market infrastructure to support monetary policy, financial system stability, and interlink financial market infrastructure; (4) develop integrated national data to optimize benefits; and (5) develop solid regulation supervision, licensing, and reporting frameworks.

19. ***Could staff elaborate on the job market conditions for youth, including the current youth unemployment rate?***

- At about 20 percent in 2018, youth (15−29 years old) unemployment in Indonesia is significantly higher than in other age groups, likely due to stringent labor regulations, low education quality, and skill mismatches. High youth unemployment is also exacerbated high informal employment (58 percent).

20. ***While Indonesia has raised its scores in the World Bank's Doing Business ranking, it ranks amongst the bottom two of the G20 in opportunities for women in the World Bank's Women, Business and the Law report. Can staff comment on whether this report has been considered in discussions, and what impact these considerations may have on labor reform decisions?***

- Although Indonesia has achieved significant economic and social progress in the past two decades, gender disparities have fallen somewhat but remain prevalent. For example, the proportion of seats held by women in the national parliament more than doubled since 2000 but was still below 20 percent in 2017. The gender gap in labor force participation declined slightly between 1996 and 2016 but is still substantial, with the female labor force participation rate at 51 percent compared with 82 percent for men. In this context the report recommends enhancing female labor participation, including through flexible work arrangements, and affordable childcare. Staff did not discuss the specific World Bank report mentioned above.

21. ***Could staff comment on the existing poverty and the vulnerability of falling into poverty in Indonesia, as one of the most populous countries in the world?***

- Decades of strong and stable economic growth sharply reduced poverty in Indonesia, raising living standards for millions of people. Between 1996 and 2016, poverty was reduced by half, to 11 percent and extreme poverty (captured by a headcount ratio at $1.90 a day) decline from 46 percent to 7 percent. However, income inequality, a major issue, rose sharply between 2002 and 2013, although it has declined slightly in recent years. There are also gaps across income groups in access to health services and higher education

Macroprudential Policy

22. ***We take note of staff's assessment that room for further relaxing macroprudential policies is exhausted. At the same time, the authorities indicate that macroprudential policy can still be calibrated to support policy objectives as laid out in the buff statement. We would therefore welcome further staff comments on this issue.***

- Bank Indonesia loosened macroprudential instruments in 2018−19. It relaxed loan-to-value limits for first-time homebuyers in July 2018, loosened the macroprudential intermediation ratio in March 2019, and provided liquidity through monetary operations. These measures are expected to support banks' credit provision while the credit growth has already been recovering strongly (12 percent, y/y, February 2019).

- Staff assesses that the level of macrofinancial vulnerability would be elevated if credit, especially to the corporate sector, grows rapidly, grew rapidly and fed asset bubbles. While this is not currently the case, financial conditions nonetheless appear supportive of growth. At the same time, maintain liquidity buffers in the form of reserve requirements would protect the authorities' ammunition in case there is a need to respond to a future liquidity shock.

23. ***Can staff comment on whether they consider tightening the macroprudential policy stance while lowering the policy rate an advisable policy decision?***

- Staff recommendations are to keep a neutral stance on macroprudential policies and to loosen monetary policy, provided external pressures allow for it.

Financial and Corporate Sector

24. ***Staff underscores that restricted access to external financing could affect macrofinancial stability and that targeted measures could alleviate funding pressures for solvent banks. This suggests that there could be a role for a facility like the Short-term Liquidity Swap (SLS), which was previously proposed but didn't get enough support for approval by the Board. Staff comments are welcomed.***

- Staff will respond to this question during the Board meeting.

25. ***Could staff elaborate more on the plan to create a public holding company for public sector financial institutions, and how do staff evaluate the implication on the country's financial deepening.***

- The authorities plan to form a holding company that will own shares in all state-owned financial institutions, including Bank Mandiri, Bank Rakyat Indonesia, Bank Negara Indonesia and Bank Tabungan Negara, in order to support the government's development agenda, such as infrastructure investment and SME lending. The authorities expect that each state-owned bank would focus more finely on a given market segment and bank products/services and achieve cost efficiency by consolidating certain operational aspects of the banks. Staff, however, believes that careful consideration should be given by the authorities to the impact of the creation of a holding firm on bank competition and financial stability. In terms of international experience, a close example is Singapore where the authorities have created a holding company for state assets.

26. ***We would be grateful to learn the status on discussions on rupiah redenomination.***

- Rupiah redenomination was not part of the topics that were discussed during the 2019 Article IV consultation.

27. ***Can staff comment on what other steps are needed to help the corporate sector hedge more fully their foreign-currency debt?***

- Bank Indonesia introduced a domestic non-deliverable forward (DNDF) in November 2018 to enhance hedging opportunities. The DNDF is a rupiah-settled and onshore-fixed non-deliverable FX forward instruments. Deepening the DNDF market would help the corporate sector hedge more fully. The authorities seek to facilitate a private sector-driven DNDF market. They have taken early steps by reducing documentation requirements for the supply of DNDFs by market participants, although the purchase of the derivatives is still subject to an underlying transaction.

28. ***We took note of staff's recommendation to extend the coverage of the corporate prudential FX regulation to all foreign exchange liabilities of systemic corporates. Can staff comment on what kind of timeframe the authorities might have for considering such a change, since they preferred not to make a change now?***

- The authorities have not established a timeframe.

29. ***Could staff comment on the opportunities for further green financing?***

- The global economy is witnessing a rapid growth in green bonds and an increase of the capital flow to green projects. Indonesia often deals with the impacts of natural disasters and the authorities have been promoting green financing (e.g., the launch of the Green Sukuk bond). There is room for further green financing and BI have been promoting banks' green lending model in Indonesia by issuing relevant regulations in recent years.

Capacity Development Activities

30. ***We welcome the IMF technical support to the authorities in using big data to enhance housing price statistics, as well as the Bank of Indonesia (BI) pilot, in***

collaboration with Netherlands Statistics, on consumer price and consumption statistics. Can staff elaborate and provide comments on preliminary findings.

- In collaboration with BI and Statistics Netherlands, the IMF pilot project on big data, introduced a machine-learning algorithm to automatically map scanned items into the product classification used for the CPI. The mission, conducted in December 2018, produced preliminary retail sales indices and an experimental price index for rice. While these preliminary indices track well existing indices at times, differences across indices could be due to methodological issues or differing coverage. The pilot project is still ongoing and is expected to be concluded by end-2019.

31. ***Can staff briefly comment on the TA that will be provided on the use of big data to develop and enhance the residential property price index?***

- Bank Indonesia compiles and disseminates quarterly a residential property price index for new properties based on data collected from surveys of major developers, brokers and property buyers, in the absence of suitable administrative data on property transactions. The use of surveys is costly, presents challenges in respect of the coverage and representativity of the index, and limits the potential to adopt more sophisticated compilation methods. The use of Big Data on property listings for existing dwellings is an innovative solution to the challenges presented by the absence of suitable administrative data, since it will allow the Bank to broaden coverage and introduce a best-practice hedonic compilation methodology. A TA mission took place in December 2018 and a follow-up mission is planned for late 2019 to assist the authorities to finalize the new series.