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February 10, 2021

Statement by Ms. Mannathoko and Mr. Jappah on Indonesia
(Preliminary)
Executive Board Meeting
February 12, 2021

We thank staff for the set of well-written reports, and Ms. Mahasandana, Mr. Mochtar, and Ms. Susiandri for their informative Buff Statement. We are in broad agreement with the staff assessment and will focus our statement on several points related to risks identified. The outlook remains subject to significant uncertainty over the evolution and duration of the pandemic, and the timeliness and effectiveness of the vaccine rollout, following an increase in new daily cases amidst already high infection rates. There are also possible emerging banking sector vulnerabilities, as well as the potential for changes in global financial market conditions. Policy measures as articulated in the National Economic Recovery Program should remain focused on fiscal support to protect lives with a focus on deployment of additional resources to health and social programs prioritizing vulnerable sub-groups. Addressing structural weaknesses in the economy, and supporting digitalization as discussed in the Selected Issues Paper are also important at this time to support growth potential.

As noted in the APD briefing, the slow vaccine rollout in Indonesia relative to the rest of the region, is likely to delay recovery, we therefore encourage the authorities to prioritize faster implementation of associated logistics. The impact of COVID-19 has increased unemployment significantly and driven many into poverty, and delays in recovery will only worsen scarring. *Could staff clarify if the delays in vaccine rollout are the same delays cited for health spending and indicate what the main obstacles to faster vaccine rollout are?*

We encourage the authorities to prioritize safeguarding human capital through timely health expenditures and effective social safety and education spending, with an emphasis on vulnerable segments such as girls and poorer women – and in particular female-headed households. We note that Indonesia has the largest populations and highest number of COVID-19 infections among ASEAN countries, and some reporting indicates that the data underestimates infections due to limited testing capacity compared to other countries. The numbers of women affected are significant. *We are also interested if staff have a view on the Indonesia strategy to prioritize vaccinating working age adults over the elderly (though the latter are more vulnerable), with the aim of reaching herd immunity fast and reviving the economy?*

We encourage a robust medium-term fiscal reform plan which we believe can help preserve Indonesia's standing in credit markets. Notwithstanding the relatively low tax/GDP ratio, given the sharp increase in the total debt service to revenue ratio (which almost doubled in 2020), there is likely to be significant pressure on public finances for a few years and so we encourage a robust fiscal plan with a focus on revenue mobilization. A medium-term fiscal strategy is also crucial to facilitate the eventual unwinding of exceptional fiscal support. Plans to withdraw policy support must be informed by developments in the data recognizing social and economic realities, in order not to compromise the recovery.

We encourage caution in continuing monetary financing of the budget in 2021 given the risks to central bank independence from prolonged monetary budget financing. While we support staffs' recommendation for continued monetary accommodation, to the extent possible this should focus on further easing policy rates and genuinely treat government bond purchases by Bank Indonesia (BI) as an absolute last resort. We note the authorities' commitment to trigger the use of these purchases only as a last resort, but also urge a clear articulation of criteria for last resort conditions from the start. Given that it took years to build up the credibility of the central bank through the prudent use of its independence, it is important to guard against continued monetary financing affecting BI's independence from the Ministry of Finance.

As measures such as relaxation of prudential requirements to help banks and corporates deal with the effects of the pandemic are to last for another year, we urge regulatory vigilance and close monitoring of asset quality. Additional pressures could also arise from nonfinancial corporate entities holding significant foreign debt and susceptible to foreign exchange risks. That said, we commend the authorities for the progress made in implementing the 2017 FSAP recommendations and welcome the consideration of measures to strengthen prudential policy and financial oversight, monitoring of systemic risks and the crisis management framework.

On non-performing loans (NPLs), while we agree that these are not high, nevertheless reporting shows that over a fifth were at risk by mid-2020. *Could staff clarify the implications of BI rescinding the usual requirement to reclassify restructured loans to substandard – do staff have a view on the viability of the restructured loans?*