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February 10, 2021

Statement by Mr. Pösö and Mr. Slettvag on Indonesia
(Preliminary)
Executive Board Meeting
February 12, 2021

We thank staff for the good report and Ms. Mahasandana, Mr. Mochtar, and Ms. Susiandri for their informative Buff statement. Indonesia entered the crisis in a strong position after robust pre-pandemic performance and a prudent macroeconomic track record. This facilitated a comprehensive policy response that has helped contain the economic fallout from the pandemic, providing the ground for a strong recovery. Going forward, the focus should increasingly shift to how to unwind the exceptional support in a balanced manner, while incorporating green objectives more clearly in the recovery. **We broadly concur with staff's assessment and would like to offer some comments for emphasis.**

The bold fiscal policy response to the pandemic has been appropriate, and we commend the steps taken to ensure effectiveness and accountability of the measures taken. We welcome the plan to return to the budget deficit ceiling by 2023 but are somewhat concerned about the impact of the sizeable consolidation this entails in 2022 and 2023, which risks preventing critical spending on infrastructure, education, and social safety nets. **In this regard, we see merit in a faster unwinding of some pandemic-related programs, in particular if upside risks related to early vaccination materializes.** This could help ease the consolidation in the medium term, smooth the transition to private sector demand and eliminate the need for a central bank backstop for financing. We further encourage the development of a medium-term revenue strategy aimed at bringing tax revenue towards peer level. This would add credibility to the fiscal plans, reduce reliance on external financing and help lessen the trade-offs between deficit reduction and development expenditures. *Given the high share of public debt help by non-residents, could staff comment on how fiscal space could evolve in a scenario with deteriorating risk sentiment and tighter global financial conditions?*

We are concerned about the possibility of further direct budgetary financing and associate ourselves with the concerns put forward by Mr. Tanaka in his statement on monetary financing. We acknowledge the positive effects of the Bank of Indonesia's purchases of government bonds in the primary market in the midst of the global financial market turmoil in March. Still, monetary financing is an exceptional measure carrying significant risks to the central bank's operational independence and price stability objectives, and we encourage the Bank of Indonesia to strive to achieve its objectives through conventional secondary market operations going forward.

Underlying solvency and capital adequacy issues in the banking system should be recognized and addressed upfront. Easing of macroprudential policies and loan classification rules have successfully facilitated the adjustment of banks and corporates during the crisis. However, the relaxation of loan capital requirements could have biased key bank ratios including capital adequacy ratios, and bank asset quality should be monitored closely as the unwinding of policy support could reveal a larger than expected fallout from the pandemic. We support staff's calls for banks to start provisioning against credit losses, even under the relaxed loan standards, and for the Financial Services Authority to provide clearer guidance for appropriate provisioning going forward.

We commend the authorities for looking beyond the pandemic with the introduction of the omnibus bill on job creation. The comprehensive law package could reduce the cost of investment and attract foreign productive capital in a range of sectors by easing regulatory burden. Implementation risks are however considerable and high-quality governance and transparency will be critical for the success of the reforms. Steps should be taken to limit environmental impacts from deregulation in the mining sector and the deviations from former firm demands on environmental assessments. The bill also contains several measures that will further reduce the already low tax revenue, and steps should be taken to compensate for this revenue loss, including broadening the personal income tax base.

Indonesia should implement further reforms to tackle climate change and build a greener economy. Indonesia is one of the most vulnerable countries to climate change related risks and has room to further step up execution of adaptation plans to increase resilience to climate change. We also encourage the authorities better facilitate the transition to a green economy, including by putting more emphasis on green investments in the mandate of the new Nusantara Investment Authority to ensure that it goes beyond traditional infrastructure such as roads, ports, and airports. We note positively that Indonesia is projected to overachieve on its commitment under the Paris Agreement, and would encourage the authorities to consider a carbon neutrality pledge which could serve as a solid commitment toward a greener economy and further boosting green investment.