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GRAY/21/431

February 10, 2021

Statement by Mr. Buissé, Mr. Rozan, and Ms. de Waziers on Indonesia
(Preliminary)
Executive Board Meeting
February 12, 2021

We thank staff for the quality of these comprehensive reports and Ms. Mahasandana, Mr. Mochtar, Ms. Susiandri for their insightful Buff statement. We broadly share staff's assessment and recommendations. We wish to offer the following comments for emphasis.

We commend the authorities for the sound macroeconomic frameworks, which have allowed for an accumulation of buffers in the period preceding the crisis, and the strong coordinated policy response implemented to contain the negative impact of the Covid-19 pandemic which underpinned the relatively favorable growth outlook despite the harsh downturn in the first half of 2020. We agree nevertheless with staff on the huge uncertainty surrounding the recovery, given the protracted pandemic. *In this regard, could staff elaborate on the modalities of the on-going ambitious vaccination program in terms of financing and distribution?*

We welcome the pragmatic approach of the authorities to maintain an accommodative policy stance until the health and economic recovery is fully entrenched, though we underline the risk of budget under-execution. Premature withdrawal of accommodative policies could jeopardize the healing process of the domestic and global economy. We support staff's recommendation that the "flexibility to reallocate budget should be used as needed" as the Indonesian economic and financial conditions, with low inflation and large fiscal space, can accommodate larger spending, especially, during the given exceptional time. Given the budget under-execution in 2020, institutional capacities constraints including governance and rigidities on public spending should be addressed.

Going forward, we welcome the plan to return to the budget deficit ceiling by 2023 and support staff's call for a medium-term fiscal strategy to preserve policy credibility. We strongly encourage the authorities to preserve the needed public expenditures for development (education, health, infrastructure, social safety nets) and to focus their efforts on the low domestic revenue mobilization. It will also be critical to ensure that the measures in the omnibus law will not further increase tax revenue erosion. We welcome staff' technical assistance in this area. Regarding debt sustainability, we note the decreased exposure to external shocks due to the high reduction in nonresident participation in the local currency bonds markets, but also see in the selected issues paper that this would also increase bond yields. *Staff's precision on the overall evolution of the sovereign risk in 2020 as a result of these changes would be appreciated.*

We broadly agree with staff's appreciation of the unconventional monetary policy undertaken by the Bank of Indonesia (BI) through a mix of policy rate cuts and government bond purchases in 2020. However, these measures should remain exceptional. Indeed, BI's monetary policy response was among the first to react to the financial market shock. BI progressively increased the size of its APP, reaching about 2% of GDP in January 21, while many EM central banks already exited from QE. Given the correction in financial markets after March/April sell off and the current financing conditions, the financing of the government on the primary market, which is a sign of fiscal dominance as assessed in October 2020 GFSR, carries credibility risks for BI's monetary policy. **Therefore, we consider that the exceptional nature of monetary budget financing should be emphasized and made credible by specifying the criteria of the last-resort basis**. Some recommendations on the way Central Bank should communicate should be added to the report (details on the aim, size and duration of the purchase program).

We welcome the authorities' commitment to pursue structural reforms. Regulatory reforms such as the omnibus bill to enhance business climate and attract foreign investors are very welcome steps, and particular focus will be needed on their implementation, with both transparency and strong governance standards. On the financial sector, the deepening of the reform of financial markets will help mobilize national savings against the high level of external debt of the non-financial corporate sector.

We strongly support staff's recommendation to consider further reforms regarding climate change adaptation and mitigation measures, especially reforestation and energy transition incentives. The SIP on this issue was a very useful contribution to the policy debate, including on carbon pricing. Given Indonesia's high exposure to climate change risks and the significance of coal in the economy, we encourage staff to further detail the benefits of such measures for the Indonesian economy. As Indonesia prepares to update its NDC under the Paris Agreement ahead of the COP26, we strongly encourage the authorities to seize this opportunity to set more ambitious GHG emission reduction targets. We also welcome and encourage green finance efforts. We regret the postponement of the reform of energy subsidies due to the Covid crisis.