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February 10, 2021

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

We thank staff for their comprehensive reports and Ms. Mahasandana, Mr. Mochtar, and Ms. Susiandri for their insightful Buff statement. A comprehensive policy response has been crucial to mitigate the economic impact of the pandemic and preserve macro-financial and external stability. Looking ahead, we take note of staff's assessment that Indonesia's economy is in a good position for a continued gradual recovery, although the outlook remains uncertain. Progress with reforms is indispensable to mitigate scarring effects from the pandemic.

An expansionary fiscal stance remains warranted to underpin the recovery. We share staff's assessment that the envisaged moderately expansionary fiscal stance implied by the 2021 budget is adequate. Given that Indonesia's public debt ratio is projected to remain below the 60 percent threshold, the authorities have some room left for further stimulus, should downside risks materialize. At the same time, we welcome the authorities' commitment to return to the deficit ceiling and start rebuilding fiscal buffers once economic growth is back on a more sustainable footing. A detailed medium-term fiscal strategy, as suggested by staff, would strengthen the credibility of this commitment and should be backed by improved revenue mobilization. In line with its upper middle-income country status, Indonesia has scope to enhance the tax-to-GDP ratio.

The policy mix of Bank Indonesia (BI) is appropriate for the time being. BI's policy rate cuts and ample liquidity provision were important to safeguard the normal functioning of financial markets. Given the risk of a prolonged challenging market environment, it remains key to respond to potential renewed volatilities in a timely manner. The temporary local-currency government bond purchases have also supported stability and helped to avoid bond market disruptions. Considering the macro-financial tradeoffs related to this exceptional policy measure, we support staff's view that it should be guided by well-defined last resort criteria. We share staff's view that the BI's operational independence has served Indonesia well and second their call to avoid any changes to the central bank law that would limit this independence.

The crisis management and resolution frameworks should be strengthened, as recommended in the 2017 FSAP. Indonesia's banking system remains well-capitalized and NPL ratios have deteriorated only marginally, despite challenging conditions during the pandemic. Nevertheless, we take note of staff's assessment that risks of a deterioration in asset quality have increased and some smaller banks are facing capital adequacy and deposit outflow problems. The established crisis coordination committee is an important mechanism to strengthen resilience and ensure crisis preparedness. Similarly, efforts to improve financial deepening are welcome and should continue.

Structural reforms to boost productivity and job creation remain important. Past efforts to improve the business climate have clearly yielded some success. The newly enacted omnibus bill on job creation has a strong potential to improve the ease of doing business in Indonesia, attract investment, create new jobs, and stimulate the economy. A careful implementation of the bill will be key to harness the full potential of the reforms while preventing short-term social costs. We also see merit in the ongoing reforms to advance digitalization, and we encourage the authorities to continue these efforts.