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February 10, 2021

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

1. We thank staff for the comprehensive set of reports and Ms. Mahasandana, Mr. Mochtar and Ms. Susiandri for the helpful buff statement. We broadly concur with the staff appraisal and recommendations and provide remarks for emphasis.

2. **Indonesia has responded to the COVID-19 pandemic with a strong policy package and the economy is positioned to recover**. Prior to the pandemic, Indonesia enjoyed stable economic growth with favourable macroeconomic indicators underpinned by solid policy frameworks, including fiscal rules and an inflation targeting regime, while the banking system was stable buttressed by regulations mostly in line with Basle III. However, containment measures associated with the COVID-19 pandemic triggered an economic downturn during the first half of 2020 with real GDP growth in negative territory. To mitigate the adverse impact of the COVID-19 shock, the authorities implemented a comprehensive policy package temporarily deviating from the key pillars of the country's macroeconomic frameworks that have underpinned the strong economic performance in recent years. The policy response has cushioned the impact of the pandemic. Economic activity rebounded in the third and fourth quarters of 2020 with higher government consumption and net exports, and the economy is expected to further strengthen in 2021 and 2022.

3. **We welcome the authorities' efforts at limiting the adverse social and economic effects of the pandemic to protect lives and livelihoods.** We note positively key investments made towards strengthening the health system and increased social assistance, including food aid, cash transfers and unemployment benefits, together with targeted support to hard-hit industries. Higher spending on social safety net measures is particularly important in the light of Indonesia's near double digit poverty rate, which is relatively high in comparison to its peers in the region. We welcome the ambitious vaccination program rolled out in January 2021 with the goal of

inoculating about two-thirds of the population by March 2022. We also welcome the accommodative monetary policy stance adopted by Bank Indonesia and the "Triple Intervention" policy followed to stabilize domestic financial markets.

4. **While the temporary deviation of the strong macroeconomic policy frameworks that have hitherto supported the country's economic performance is a necessity given current circumstances, we encourage the authorities to revert to these frameworks building on medium term measures.** We observe that the pandemic response required the temporary suspension of two key pillars - the deferral of the budget deficit ceiling under the fiscal rules framework and the removal of the ban on purchases of government bonds by Bank Indonesia in the primary market. While the higher budget deficit envisaged for 2021 incorporating increased public investment should help in the economic recovery, we welcome the commitment of the authorities to return to the envisaged budget deficit target under the fiscal rules by 2023. We concur with the staff view that going forward, the Indonesian authorities need to unwind the exceptional pandemic related policy support in a balanced manner to preserve credibility and safeguard Indonesia's strong policy track record. As suggested by staff, we agree that an explicit medium-term fiscal strategy, backed by revenue measures, would add to the credibility of the commitment to restore fiscal rules while resorting to monetary financing only as temporary measure would help manage risks to the credibility of the monetary policy framework.

5. **The authorities must reduce the reliance on volatile nonresident portfolio flows and address vulnerabilities associated with the domestic government bond market.** While the high share of nonresident participation in the local currency government bond market has benefitted the country by improving liquidity in the government securities market and lowering funding costs, it has also increased the country's vulnerability to sudden capital outflows reducing the resilience of the external sector. Such outflows can amplify domestic disorderly market conditions while leading to higher issuances of hard currency bonds thereby increasing foreign currency debt. Going forward, we encourage the authorities to explore other avenues of financing such as revenue mobilization, deepening domestic bank and nonbank financial markets and attracting FDI to reduce reliance on portfolio inflows.

6. **Indonesia must address a key structural challenge - low financial inclusion and limited access to finance - to sustain its growth momentum and achieve inclusive growth in the medium term.** We note that almost half of the population in Indonesia is without a bank account while data also indicates that nearly 6 percent of the global unbanked adults reside in Indonesia. Such numbers point to the need to address this issue on a priority basis. The limited access to financial inclusion will exacerbate the adverse impact of the COVID-19 shock on the lower income population and small businesses. We concur with the staff view that digitalization would provide an opportunity to close the country's gap in financial inclusion and bank financing.

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