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February 10, 2021

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

We thank staff for the good set of papers and Ms. Mahasandana, Mr. Mochtar, and Ms. Susiandri for their comprehensive Buff statement.

Indonesia came into the crisis with a strong track record of prudent macroeconomic policy, and we welcome the authorities comprehensive and coordinated policy response which has successfully mitigated the economic impacts of the crisis. Early pandemic containment measures triggered an economic downturn, but with gradual reopening a nascent recovery has emerged. Continued strong policy support will likely be necessary to ensure the recovery. However, as for so many countries, the economic outlook remains highly uncertain due to the possibility of a protracted pandemic and risks related to vaccine distribution. Wider reforms to address structural challenges and promote investment will be required to mitigate any scarring effects and put the economy on a path to a greener and more inclusive recovery.

We welcome the measures taken by the authorities to support the economy during the crisis and agree that, given the available fiscal space, further measures should be considered if downside risks materialize. A moderately expansionary fiscal stance focused on increased public investment, including on infrastructure and social safety nets is appropriate. Whilst the temporary relaxation of the budget ceiling helped mitigate the impact of the pandemic, we welcome the recommitment to the fiscal rule by 2023. We agree with staff that a detailed medium-term fiscal strategy would add to the credibility of the commitment to restore the fiscal rules. In addition, a medium-term government revenue strategy should remain a priority. Key focus areas should include broadening the tax base, enhanced compliance, greater digitalization and eliminating distortionary VAT exemptions.

Pursuing monetary accommodation through a combination of lower policy interest rates, allowing for greater exchange rate flexibility, and government bond purchases by Bank Indonesia (BI) is appropriate in the current exceptional circumstances. This has helped the orderly functioning of financial markets and to manage volatile capital flows.

However, it will be important to maintain clear boundaries between fiscal and monetary policy; phasing out the burden sharing arrangement and safeguarding the Central Bank's independence. We agree that monetary budget financing should be guided by a framework to manage risks, including clear delineation for its temporary use and any bond purchases should be based on last resort principles. We welcome the recommendation that the financial sector omnibus bill should not limit BI's operational independence or set unrealistic monetary policy objectives.

Whilst the financial sector policy response has increased liquidity and kept the banking system stable, additional measures may be required and asset quality should be monitored closely. The authorities should be ready to undertake targeted policy steps if bank lending to the private sector does not rebound with the recovery. This could include provisioning requirements and incentives for banks to use their capital buffers, additional measures to protect viable firms and changes to crisis management and resolution frameworks. Proactive loan loss provisioning under the partially relaxed loan classification rules will help manage any deterioration in asset quality. We agree that efforts to promote financial sector deepening should be accelerated.

We welcome staff's coverage of climate issues, including in the informative SIP. Given Indonesia's susceptibility to climate change related natural disasters, and the current reliance on fossil fuels, we agree that a comprehensive transition plan is essential to support a greener recovery. The plan should include greater support for building renewable energy generation capacity, reducing reliance on coal, and reforms to energy subsidy schemes. Further progress in the monitoring and execution of adaptation plans to increase the resilience to climate change would be desirable, given the high exposure to natural disasters and climate related risks.