IMF Country Reports 19/250

Indonesia: 2019 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Indonesia

INTERNATIONAL MONETARY FUND

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IMF Country Report No. 19/250

INDONESIA

July 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR INDONESIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Indonesia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 3, 2019 consideration of the staff report that concluded the Article IV consultation with Indonesia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 3, 2019, following discussions that ended on May 14, 2019, with the officials of Indonesia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 12, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Indonesia.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 19/305
FOR IMMEDIATE RELEASE
July 31, 2019

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with Indonesia

On July 3, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Indonesia.

The Indonesian economy performed well in 2018, despite external headwinds, including capital flow reversals. Growth stabilized at above 5 percent, as robust domestic demand offset a decline in net exports. The recovery of credit growth supported economic activity. Inflation eased to around 3 percent, the lower half of the official target band (3.5±1percent), as food price increases were subdued, electricity and some fuel prices were frozen, and macroeconomic policies were tightened. Core inflation is stable at 3 percent. The current account deficit widened to 2.98 percent of GDP in 2018 (1.6 percent in 2017), mainly due to lower commodity exports and higher infrastructure-related imports.

The economic outlook is positive. Real GDP growth is projected to remain stable at 5.2 percent in 2019 and 2020, and rise to the level of potential (5.3 percent) over the medium term, underpinned by robust domestic demand. Strong bank balance sheets and continued economic growth would sustain credit growth at about 12 percent. Inflation is projected to remain within the target band. The current account deficit would continue its gradual decline to 2.6 percent of GDP over the medium term. The fiscal deficit is projected to remain constant at 1.8 percent of GDP. Risks to the outlook are tilted to the downside. The main risks are external and include rising trade tensions, sharp tightening of global financial conditions, weaker-than-expected growth in China, and large swings in commodity prices, especially higher oil prices that would translate into higher current account deficit. On the upside, the start of the Administration's second term could lead to intensified reform efforts, which would boost confidence, investment, and growth.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors commended the authorities' policy response in the face of strong external headwinds in 2018, which supported positive economic performance. While noting the favorable economic outlook, Directors encouraged the authorities to remain vigilant against risks, including from capital flow reversals, considering Indonesia's reliance on external financing. They considered that achieving higher potential growth requires a comprehensive structural reform package, including higher domestic revenue mobilization and financial deepening, which will reduce vulnerabilities and facilitate complementary reforms in human capital, infrastructure, and labor and products markets.

Directors welcomed the appropriate focus of the near-term policy mix on protecting macroeconomic and financial stability, safeguarding buffers, and addressing vulnerabilities. They supported maintaining a neutral fiscal stance and closely assessing macroprudential policies to ensure financial system stability. With inflation within the target band, Directors saw scope for cautious relaxation of the monetary policy stance, unless significant capital account pressures reemerge. They encouraged allowing the exchange rate to continue moving in line with market forces, with FX intervention limited to preventing disorderly market conditions.

Directors welcomed the authorities' continued efforts to protect fiscal buffers, including with the elimination of the primary deficit in 2018, and improve the quality of spending by rebalancing expenditure toward infrastructure, education, health, and social safety nets. However, Directors noted that government revenues remain below peer countries and insufficient to finance the authorities' development goals. In this context, they highlighted the critical need to implement a medium-term revenue strategy, which combines well-sequenced and prioritized tax policy and administration reforms, to finance priority spending and structural reforms, and lessen reliance on external financing. Directors also called for monitoring risks and contingent liabilities arising from state-owned enterprises and public-private partnerships.

Directors commended efforts to improve infrastructure, streamline regulations and reform the education and health sectors, which have contributed to improvements in the economic environment. They encouraged the authorities to expand these efforts and to address remaining structural impediments to higher growth, including by strengthening governance and the business environment. Priority actions also include improving human capital, increasing female labor participation, easing restrictions to foreign direct investment, and streamlining labor and product market regulations.

Directors welcomed the progress in strengthening the frameworks for financial oversight and crisis management in recent years, in line with FSAP recommendations. Going forward, they

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

encouraged the authorities to focus on the areas identified by the FSAP where further improvement is needed, including clarifying institutional mandates, improving supervision of nonbank financial institutions and financial conglomerates, strengthening the legal framework for financial oversight and crisis management, and enhancing crisis management frameworks. Continued strengthening of the AML/CFT regime was also encouraged.

Indonesia: Selected Economic Indicators, 2014–2020

	2014	2015	2016	2017	2018	2019 Proj.	2020 Proj.
Real GDP (percent change)	5.0	4.9	5.0	5.1	5.2	5.2	5.2
Domestic demand	5.0	4.2	4.6	5.0	6.3	5.4	5.2
Of which:							
Private consumption 1/	5.3	4.8	5.0	5.0	5.1	5.1	5.1
Government consumption	1.2	5.3	-0.1	2.1	4.8	4.5	4.5
Gross fixed investment	4.4	5.0	4.5	6.2	6.7	6.2	5.9
Change in stocks 2/	0.5	-0.6	0.2	-0.1	0.7	0.0	0.0
Net exports 2/	-0.2	0.9	0.1	0.3	-1.0	-0.1	0.0
Saving and investment (in percent of GDP)							
Gross investment 3/	34.6	34.1	33.9	33.7	34.5	34.7	34.9
Gross national saving	31.5	32.0	32.0	32.1	31.4	31.8	32.0
Prices (12-month percent change)							
Consumer prices (end period)	8.4	3.4	3.0	3.6	3.1	3.1	3.1
Consumer prices (period average)	6.4	6.4	3.5	3.8	3.2	3.1	3.1
Public finances (in percent of GDP)							
General government revenue	16.5	14.9	14.3	14.1	14.9	14.8	14.9
General government expenditure	18.6	17.5	16.8	16.6	16.6	16.7	16.7
Of which: Energy subsidies	3.2	1.0	0.9	0.7	1.0	1.0	1.0
General government balance	-2.1	-2.6	-2.5	-2.5	-1.8	-1.8	-1.8
Primary balance	-0.9	-1.2	-1.0	-0.9	0.0	-0.1	-0.1
General government debt	24.7	27.0	28.0	29.4	30.1	30.2	29.9
Money and credit (12-month percent change; end of period)							
Rupiah M2	13.3	9.2	11.7	9.6	5.8	...	...
Base money	11.6	3.0	4.6	9.7	-1.5	...	...
Private Sector Credit	11.8	10.3	7.7	8.7	12.0	12.3	12.4
One-month interbank rate (period average)	7.5	7.1	6.5	5.6	6.2	...	...
Balance of payments (in billions of U.S. dollars, unless otherwise indicated)							
Current account balance	-27.5	-17.5	-17.0	-16.2	-31.1	-32.4	-34.7
In percent of GDP	-3.1	-2.0	-1.8	-1.6	-3.0	-2.9	-2.9
Trade balance	7.0	14.0	15.3	18.8	-0.4	-4.6	-0.6
Of which: Oil and gas (net)	-11.8	-5.7	-4.8	-7.3	-11.6	-16.2	-17.0
Inward direct investment	21.8	16.6	3.9	20.6	22.0	23.7	27.0
Overall balance	15.2	-1.1	12.1	11.6	-7.1	1.2	2.8
Terms of trade, percent change (excluding oil)	1.4	-1.8	0.4	1.3	1.1	-0.6	-0.1
Gross reserves							
In billions of U.S. dollars (end period)	111.9	105.9	116.4	130.2	120.7	121.9	124.7
In months of prospective imports of goods and services	8.1	8.0	7.6	7.2	6.4	6.0	5.7
As a percent of short-term debt 4/	189	191	213	237	203	185	171
Total external debt 5/							
In billions of U.S. dollars	293.3	310.7	320.0	352.5	376.8	415.0	455.2
In percent of GDP	32.9	36.1	34.3	34.7	36.9	37.7	37.7
Exchange rate							
Rupiah per U.S. dollar (period average)	11,862	13,391	13,306	13,383	14,231	...	...
Rupiah per U.S. dollar (end of period)	12,435	13,788	13,473	13,568	14,390	...	...
Memorandum items:							
Jakarta Stock Exchange (12-month percentage change, composite index)	22.3	-12.1	15.3	20.0	-2.5	...	...
Oil production (thousands of barrels per day)	794	800	820	815	800	740	710
Nominal GDP (in trillions of rupiah)	10,570	11,526	12,402	13,587	14,826	16,047	17,409

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes NPISH consumption.

2/ Contribution to GDP growth (percentage points).

3/ Includes changes in stocks.

4/ Short-term debt on a remaining maturity basis.

5/ Public and private external debt.

INTERNATIONAL MONETARY FUND

INDONESIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

June 12, 2019

KEY ISSUES

Context. The Indonesian economy performed well in 2018, despite external headwinds, including capital flow reversals. Growth stabilized above 5 percent and inflation eased to around 3 percent. A surge in imports and weak export growth contributed to a higher current account deficit. Growth is projected to remain stable over the medium term. Inflation is expected to remain within the target band and the current account deficit is expected to narrow gradually on lower imports. Risks are tilted to the downside and are mainly external. Reliance on portfolio inflows to finance the twin deficits leaves Indonesia vulnerable to capital flow reversals. President Joko Widodo has been re-elected for a second term and has committed to push ahead with economic reforms. Creating quality jobs for the young and growing population to harness Indonesia's demographic dividend requires a stronger impetus to growth, which has been constrained by structural weaknesses, including low tax revenues, shallow financial markets, and labor and product market rigidities.

Main Policy Recommendations:

- The policy mix should remain focused on protecting macroeconomic and financial stability, including by maintaining exchange rate flexibility and protecting buffers, while intensifying structural reform efforts to address vulnerabilities and boost potential growth.
- As the monetary policy stance is tight and inflation pressures modest, the interest rate hikes in response to external pressures in 2018 could be partially and gradually unwound, unless significant capital account pressures reemerge. Macroprudential policy should focus on containing systemic risks.
- A neutral fiscal stance would balance the need to underpin growth and build resilience by protecting buffers.
- Efforts should continue to enhance financial oversight and crisis management in line with the FSAP recommendations.
- Boosting potential growth requires a comprehensive structural reform package. Reform priorities include higher domestic revenue mobilization and financial deepening, which will reduce vulnerabilities and facilitate complementary reforms in human capital, infrastructure, and labor and products markets.

Approved By
Odd Per Brekk and Petya Koeva Brooks

Mission dates: May 1–14, 2019
Mission team: L. Breuer (Head), C. Ahokpossi, T. Kinda, (all APD), B. Shang (FAD), H. Kang (MCM), M. Patnam (SPR), and J. Nelmes (senior resident representative). A. Mahasandana, Executive Director and M. Anwar, Senior Advisor (both OED), and O. P. Brekk (APD) joined the concluding meetings. A. Isnawangsih and N. Jotikasthira (both APD) contributed to the preparation of this report.

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OVERVIEW

1. **The Indonesian economy performed well in 2018, despite external headwinds**. Tighter global financial conditions in 2018 resulted in episodes of exchange rate pressures and capital outflows from Indonesia, which was relatively hard hit compared to other emerging markets in Asia (Figure 1). External pressures have moderated since October 2018 and inflows have resumed, although considerable volatility remains, including from heightened trade tensions. Faced with external headwinds, policy flexibility supported a positive macroeconomic performance in 2018—growth stabilized at above 5 percent and inflation was moderate at around 3 percent.

2. **However, Indonesia still confronts vulnerabilities and challenges**. Major vulnerabilities stem from low tax revenues and shallow financial markets, which have led to heavy reliance on volatile portfolio inflows to finance the twin budget and current account deficits. Nonresident investors hold about 40 percent of rupiah-denominated government bonds and a third of corporate debt financing, leaving the country vulnerable to capital flow reversals. Furthermore, labor and product market rigidities have constrained growth, which needs to be boosted to harness the young and growing labor force.

3. **Discussions focused on post-election reform priorities to boost inclusive growth**. With President Joko Widodo re-election, the start of his second term will provide a window of opportunity to push ahead with structural reforms. In addition to macrofinancial policies to protect stability, the consultation focused on structural reforms to address vulnerabilities and boost growth, centering on two pillars: (i) operationalizing a medium-term revenue strategy that would raise resources to finance priority spending; and (ii) accelerating financial deepening to promote stable financing. These reforms would lessen Indonesia's reliance on volatile capital inflows and facilitate complementary reforms in the labor and product markets, in particular human capital development, infrastructure enhancement, and improvement of the business environment, which are essential to lift potential growth.

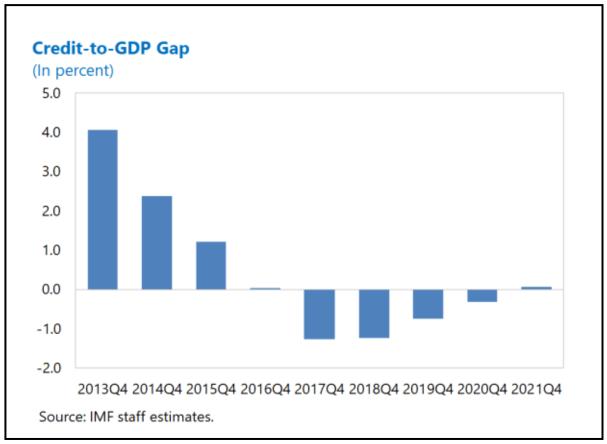
4. **The authorities' policies were appropriate given the external pressures in 2018**. Considering downside risks to the outlook, the small estimated output gap, the economy's vulnerabilities, and external shocks to the current and financial accounts, the policy strategy that prioritized macroeconomic and financial stability in the presence of unexpected external pressures in 2018 was appropriate. Tightened fiscal and monetary policy helped reduce the financing needs of the public sector and protected investor confidence. The authorities are taking steps to implement the 2017 FSAP recommendations (Table 11). However, progress in implementing a medium-term revenue strategy to raise resources has been slow, as the authorities have focused only on the tax administration angle of the strategy.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

A. Recent Developments

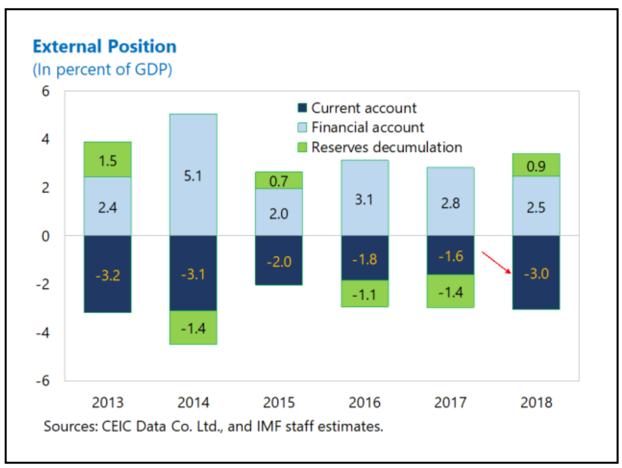
5. **Real GDP growth reached 5.2 percent in 2018**, up from 5.1 percent in 2017, as robust domestic demand offset a decline in net exports. Gross fixed investment, which grew at 6.7 percent, was a driver of domestic demand. Solid consumer confidence supported private consumption, which grew by 5.1 percent. The output gap was estimated at about -0.3 percent of GDP in 2018. At 5.1 percent, growth remained broadly stable in 2019:Q1.

6. **Bank credit to the private sector is recovering**. Loan growth increased to 12 percent (y/y) in February 2019, from 8 percent in 2017, driven by corporate borrowing, especially in the mining and manufacturing sectors. The credit gap has been reduced to −1.2 percent of GDP in 2018:Q4. There are no signs of asset bubbles—residential property prices grew by 3 percent (y/y) in 2018:Q4, while commercial property prices have been flat since 2017.



7. **Inflation eased** to 2.8 percent (y/y) in April 2019, close to the lower bound of the target band (3.5±1percent), as food price increases were subdued, electricity and some fuel prices were frozen, and macroeconomic policies were tightened in 2018. Core inflation is stable at 3 percent.

8. **The current account deficit** (CAD) **widened** to 3 percent of GDP in 2018 (1.6 percent in 2017), mainly due to lower commodity exports and higher infrastructure-related imports. Tighter global financial conditions during Q2/Q3 2018 led to a sharp decline in net portfolio and FDI flows, which combined fell by 1.6 percent of GDP relative to 2017.[1] Overall, the balance of payments (BoP) reached a deficit of 0.7 percent of GDP, with the current account deficit more than offsetting the financial account surplus. Gross international reserves declined by 0.9 percent of GDP to US$121 billion (6½ months of imports) in December 2018, from US$130 billion at end-2017, and



[1] The decline in net portfolio flows was driven by both equity and bond outflows. Net FDI flows were weakened by divestment of foreign ownership and an increase in outward investment by Indonesian corporations.

recovered to about US$124.5 billion in March 2019 (118 percent of the IMF's reserve adequacy metric).

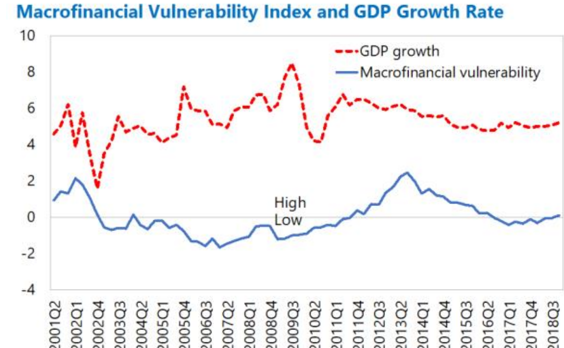
B. Outlook and Risks

9. Macroeconomic performance is projected to improve gradually in the near term. Real GDP growth is projected to remain stable at 5.2 percent in 2019 and 2020, led by strong domestic demand. Projected at 12.5 percent in 2019 and 2020, credit growth would support economic activity. Inflation is projected to remain stable at 3.1 percent in 2019, below the mid-point of the target range, as food prices rebound. The CAD would narrow slightly to 2.9 percent of GDP in 2019 on the back of weaker import growth, due to slower investment and the lagged effects of depreciation. The financial account is expected to recover, with higher net portfolio inflows building on the buoyant inflows of 2019:Q1, notwithstanding some turbulence from global trade uncertainties. The overall BoP is projected to move back into a small surplus in 2019, leading to an accumulation of reserves.

10. Over the medium term, macroeconomic indicators are expected to further improve gradually. Real GDP growth is expected to rise to the level of potential (5.3 percent) underpinned by robust domestic demand. Inflation is projected to remain within the target band. The current account deficit would continue its gradual decline. The fiscal deficit is projected to remain constant at 1.8 percent of GDP. Strong bank balance sheets and continued economic growth would sustain credit growth at about 12 percent. Three free trade agreements concluded with Australia, Chile, and the European Free Trade Area in 2018 and early 2019 could support exports by providing greater access to the markets of key trading partners.

11. Risks to the outlook are tilted to the downside (Appendix I). The main risks are external and include rising trade tensions, sharp tightening of global financial conditions, weaker-than-expected growth in China, and large swings in commodity prices, especially higher oil prices that would translate into higher current account deficits.[2] On the upside, the start of the President's second term could lead to intensified reform efforts, which would boost confidence, investment, and growth.

Macrofinancial Vulnerability Index and GDP Growth Rate



Source: IMF staff estimates.
1/ The MVI is normalized to have zero mean and a standard deviation of one over 2001–2018.

12. Systemic macrofinancial risks are contained, but the economy remains vulnerable to capital flow reversals. Indonesia's external and public debt are

[2] Global financial conditions could quickly tighten in response to an escalation of trade tensions, which could have overall negative effects, given Indonesia's reliance on external financing. From the trade angle exclusively, Indonesia could potentially benefit from a contained tariff war between the United States and China as trade diversion could more than offset the negative spillovers along the value chain (Appendix II).

moderate and sustainable (Appendix III), and systemic risks are low. However, the large share of foreign portfolio holdings makes the economy vulnerable to a sharp tightening of global financial conditions and to capital flow reversals. Despite large capital buffers and strong profitability, banks' high exposure to the corporate sector is also a source of risk.

C. External Sector Assessment

13. Indonesia's external position in 2018 was assessed to be moderately weaker than implied by medium-term fundamentals and desirable policies. The estimate of the CA gap for 2018 is -1.5 percent of GDP, with an REER undervaluation of 4 percent (Appendix IV).[3] The short-run divergence between the exchange rate and current account assessments reflects lags in the CA response to the REER depreciation in 2018.[4] Exchange rate flexibility and trade-related policy actions (import compression and export promotion) together with broadly stable (projected) commodity prices are expected to modestly reduce the current account deficit over the medium term, though risks of higher current account deficits remain. External financing appears sustainable but could be affected by shocks to capital flows.

Authorities' Views

14. The authorities broadly agreed with the macroeconomic outlook and risks, the external sector assessment and the debt sustainability analysis. The authorities see a gradual improvement in the outlook as the ongoing and planned reforms improve growth and entrench stability. Nonetheless, they also see a need for the current account deficit to narrow somewhat, to around 2½ percent of GDP, given the uncertain external conditions, and have taken policy steps to achieve this, while protecting domestic growth. On the external assessment, they broadly agreed with the findings but reiterated fundamental concerns, arguing that the CA deficit norm resulting from the EBA model is too low and does not reflect Indonesia's needs for infrastructure investment and critical structural reforms.

POLICY DISCUSSIONS

15. Policy mix under the baseline. Considering existing vulnerabilities, downside risks, and the nearly closed output gap, policies should remain focused on protecting macroeconomic and financial stability, safeguarding buffers, and addressing vulnerabilities with renewed efforts. This entails maintaining a neutral stance on fiscal and macroprudential policies. With inflation within the target band, there is scope for a cautious relaxation of the monetary policy stance, unless significant capital account pressures reemerge. Financial sector policy should continue to enhance the legal and supervisory framework in line with the FSAP recommendations. Greater efforts on domestic

[3] The REER undervaluation of 4 percent is within the (+/- 5 percent) interval described as broadly in line with fundamentals in the Fund's External Balance Assessment.

[4] "Exchange Rate and Trade Dynamics in Indonesia: Connecting the Dots" in the accompanying selected issues paper analyzes the relationship between the exchange rate and imports and exports.

revenue mobilization and financial deepening, complemented by structural reforms in the product and labor markets, will be critical to boost growth.

16. In the event of severe external pressures, policy flexibility would help contain shocks. The exchange rate should continue to move in line with market forces, with intervention limited to addressing disorderly market conditions. A sharp rupiah depreciation would have negative balance sheet effects.[5] Policy tightening could be considered only in the face of above-target inflation or drying up of capital inflows. In the case of short-lived restricted access to external financing, targeted measures to alleviate funding pressures for solvent banks (e.g., repos and FX swaps) would help preserve macrofinancial stability. A rebound in portfolio and debt-creating inflows, on the other hand, would provide an opportunity to build up reserves while maintaining exchange rate flexibility, and cautiously ease the monetary policy stance. In either case, communicating clearly the rationale for the measures adopted would be critical, and should be an integral part of the overall policy framework.

17. Integration of Fund capacity building and surveillance. Recent and future Fund's capacity building efforts in various areas, including on the medium-term revenue strategy, financial sector oversight and safety net, corporate and bank stress testing, fiscal governance, and cash management, support the implementation of policy advice (Table 12). In collaboration with Bank Indonesia and Statistics Netherlands, the IMF recently launched its first pilot project on big data, which leverages scanner data to close data gaps, improve economic monitoring, and contribute to the compilation of official statistics.

Authorities' Views

18. The authorities are focused on protecting macroeconomic and financial stability, while setting the conditions for higher potential growth. They affirmed their priority to maintain macrofinancial stability and stressed that macro policies will continue to react flexibly to shocks, while structural reforms are pursued to boost equitable growth. They appreciated the Fund's well-targeted capacity development support.

A. Monetary, Exchange Rate, and Macroprudential Policy—Flexibility to Protect Macrofinancial Stability

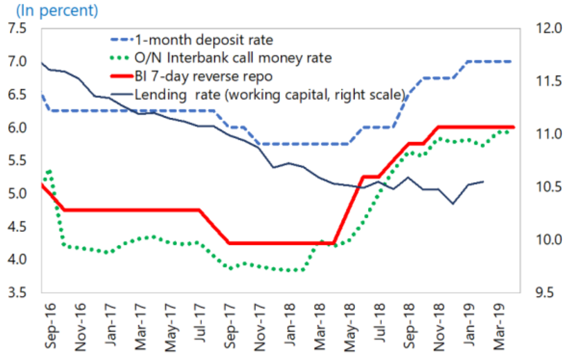
19. Bank Indonesia (BI) took a range of monetary and macroprudential measures to manage external pressures in 2018.[6] BI's policy framework has evolved over time in response to shifting challenges (Box 1). With low inflation and contained inflation risks in 2018, policies focused

[5] The DSA suggests that external debt-to-GDP would increase by approximately 20 percentage points after a 30 percent depreciation but will remain below 60 percent of GDP. The 2017 FSAP stress tests indicate that capital buffers and high profitability make banks resilient to severe shocks.

[6] The authorities also introduced import compression measures (higher tariffs on a small number of mainly conspicuous consumption goods and a slowdown of infrastructure investment) and announced plans to incentivize repatriation of export proceeds.

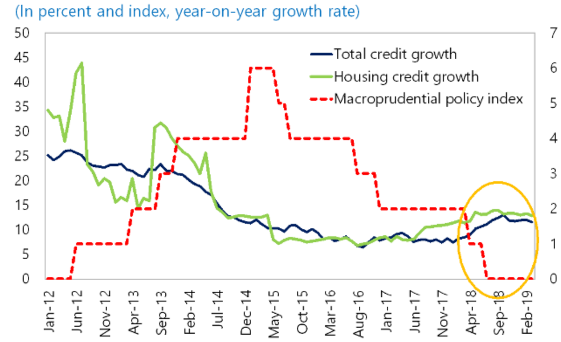
on protecting external and financial stability. In the course of the year, BI raised the policy rate six times (by 175 basis points cumulatively, to 6 percent) to maintain external financing and reduce pressures on the financial account. BI also allowed the rupiah to depreciate against the U.S. dollar by 6.3 percent while intervening in the FX (FXI) and government bonds markets to limit volatility. In 2018, international reserves declined by around US$10 billion, or 7 percent. Also, against the backdrop of a small negative credit gap, BI relaxed loan-to-value limits for first-time homebuyers in July 2018, loosened the macroprudential intermediation ratio in March 2019, and provided liquidity through monetary operations.[7] These actions weakened the transmission channel from tighter monetary policy to aggregate demand, which was also affected by segmented and shallow money markets. Reflecting the weakened monetary policy transmission channel as well as segmented and shallow money markets, bank lending rates have declined despite increases in the policy rates.

Monetary Policy and Bank Interest Rates
(In percent)



Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

Credit Growth and Macroprudential Policy
(In percent and index, year-on-year growth rate)



Sources: Haver Analytics; and IMF staff estimates.

20. Overall, policies successfully helped manage the 2018 external pressure episode, although some actions may involve risks. The policy mix relied on the policy rate to target the external balance, while providing domestic liquidity and relaxing macroprudential policies preventively to limit potential stress in the financial sector, including the impact of monetary policy tightening. This approach was successful in managing a period of high financial volatility without materially compromising the recovery of bank credit and economic growth. However, it may have slowed the adjustment of the current account deficit. Furthermore, if sustained, the strong presence of BI in the money and FX markets could hamper financial deepening. In addition, communication challenges around the evolving policy framework could generate uncertainties.

21. Looking ahead, there is room to cautiously loosen the monetary policy stance. While inflation expectations remain relatively high at around 3.8 percent, the associated real policy rate (2.2 percent) is above the estimated neutral real rate (2 percent) and inflation risks appear contained.

[7] "Indonesia's Growth-at-Risk" analysis in the accompanying selected issues paper does not suggest that there was a pressing need to relax macroprudential policies given neutral financial conditions and low financial stability risk. The macroprudential intermediation ratio was relaxed from 80−92 percent to 84−94 percent to support credit growth, while maintaining liquidity buffers.

The authorities have space to partially and gradually unwind the interest rates hikes adopted in response to the 2018 EM selloff, unless significant capital account pressures reemerge, but need to proceed cautiously. They need to closely monitor the impact on capital inflows, the exchange rate, and on bank and corporate balance sheets. Current and expected macrofinancial conditions suggest that there is no room for further relaxation of macroprudential policies. Instead, BI should assess the effects of recent relaxations of macroprudential measures. Maintaining liquidity buffers (including reserve requirements) would save ammunition to face possible future shocks.

22. Exchange rate flexibility remains critical to the economy's resilience to external shocks. BI should continue to allow the exchange rate to move freely in line with market forces, with FX intervention aimed to address disorderly market conditions. Financial sector liquidity should continue to be monitored closely, with monetary operations conducted in a prudent manner to avoid exacerbating the volatility of the exchange rate during periods of market stress, when the FX market becomes one-sided.

23. The continued reform of BI's monetary operations is welcome. Following the introduction of a 7-day reverse repo rate and a narrowing of the interest rate corridor in August 2016, BI gradually introduced reserve requirement averaging starting in July 2017. These actions contributed to the interbank rate moving closer to the policy rate. Building on this, averaging should be extended to cover all primary reserve requirements. BI introduced DNDFs in November 2018 to enhance hedging opportunities and has started auctioning its securities across the yield curve to encourage price discovery.[8]

24. The authorities seek to facilitate a private sector-driven DNDF market and have capped BI's offers to limit potential quasi-fiscal costs. They have taken early steps by reducing documentation requirements for the supply of DNDFs by market participants, although the purchase of the derivatives is still subject to an underlying transaction. Continued review of the requirements as well as the infrastructure for DNDF transactions is merited.

25. Communication should be an integral part of the monetary and financial stability policy framework.[9] Clear communication of the framework, including policy objectives, strategy to achieve them, the toolkit in the areas of monetary, exchange rate, and macroprudential policies and the conditions under which different policy levers will be used, will contribute to the effectiveness of policies. This would be facilitated by undertaking scenario analysis around main risks to further improve messaging, as well as the calibration of policies. In this context, the publication of FXI data

[8] A domestic non-deliverable forward (DNDF) is a rupiah-settled and onshore-fixed non-deliverable forward FX instrument.

[9] The "Impacts of Monetary Policy Communication in Indonesia" in the accompanying selected issues paper suggests that while the BI has strengthened transparency significantly in recent years, there is room to strengthen message clarity.

with appropriate lags would improve transparency and could strengthen policy effectiveness. Ongoing initiatives to use big data for timely economic monitoring could also facilitate prompt policy responses.[10]

Authorities' Views

26. The authorities broadly concurred with the assessment of the policy reaction to the 2018 EM selloff, the monetary stance, and monetary reform priorities. The authorities explain that BI's policy mix adapted to changing external conditions. With the overarching objective of maintaining stability, BI sought to strike a balance in the policy response between exchange rate flexibility, FXI, and higher policy rates. The exchange rate was allowed to respond to market forces with interventions to avoid excessive volatility. Policy rate increases aimed to keep Indonesian assets attractive to nonresident investors. Macroprudential policy was eased on the basis of a forward-looking assessment of macrofinancial conditions, which indicated that supporting private bank credit growth would be consistent with maintaining financial stability. They view this framework as having been effective in dealing with the 2018 EM selloff by preserving robust growth and moderate inflation, and plan on maintaining a similar framework going forward, with actions taken as warranted by economic conditions. In this light, some space for cautiously reducing the policy rate might be considered, as allowed by external pressures. The authorities agreed with the reform priorities to further strengthen monetary transmission and facilitate a private sector-driven DNDF.

27. The authorities reiterated their commitment to exchange rate flexibility. BI maintains a flexible exchange rate policy with intervention in the FX market directed at containing disorderly market movements. The authorities indicated that they would consider publishing data on FXI once ongoing efforts to deepen financial markets and improve efficiency bear fruit, characterized by a deep, efficient, and market driven FX market.

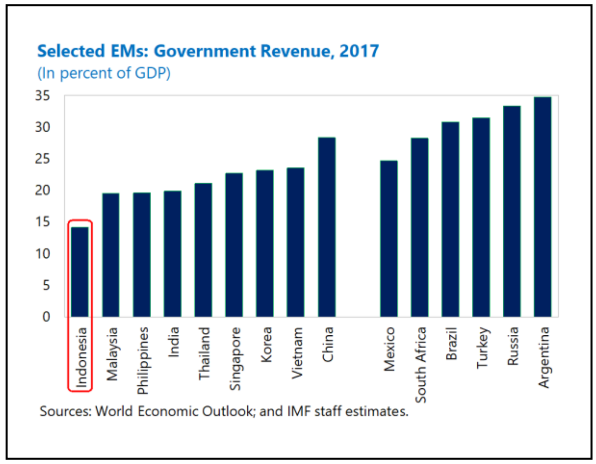
B. A Two Pillar Post-Election Reform Agenda to Boost Inclusive Growth—Implementing Tax Reform and Accelerating Financial Deepening

28. Fiscal revenue mobilization and financial deepening would facilitate other essential structural reforms, including in the labor and product markets. Revenue mobilization will be critical to finance government priorities in the areas of education, health, infrastructure, and social safety nets, and could support labor reform by facilitating the strengthening of social safety nets. Tax reform can also lead to significant productivity gains through simplification of the tax system

[10] Using textual and network analysis, and other machine learning techniques, BI has developed several indicators to support policy decisions. The indicators cover various sectors, including the labor market, the property market, online commerce, retail trade, and infrastructure development.

and by reducing compliance cost, thereby boosting investment and economic growth. Financial deepening would help mobilize domestic resources to finance the economy and lessen reliance on volatile external financing.

Implementing a Comprehensive Tax Reform to Finance Development Spending



29. Government revenues in Indonesia remain below peer countries and insufficient to meet the authorities' development goals.[11] The overall deficit fell to 1.8 percent of GDP (2.5 percent of GDP in 2017), supported by strong revenue growth (16 percent, y/y), in both oil/gas revenues and non-oil/gas revenues. Important steps have been taken to improve tax administration—such as risk-based audits, lifting bank secrecy, and ongoing development of IT system, which supported the positive revenue performance in 2018. As electricity and some fuel prices were frozen, energy subsidies increased (50 percent, y/y)—although partially offset by restraints of other expenditures (capital expenditure in particular). Indonesia's general government revenue to GDP ratio is below 15 percent, trailing revenue collection in most EMs, and constraining development and growth-enhancing spending. Low fiscal revenues have also resulted in reliance on SOEs and PPPs to channel recent increases in infrastructure spending, increasing fiscal risks from contingent liabilities.[12]

30. A neutral fiscal stance is appropriate in the near term. With the primary balance at zero, and above the debt stabilizing level of -0.5 percent of GDP, fiscal policy should focus on protecting growth, preserving buffers, and creating additional space through tax reform.[13] While Indonesia has some fiscal space, a neutral fiscal stance in 2019 and 2020 strikes the right balance between supporting growth and protecting macrofinancial stability, in the context of uncertainties surrounding external financing and rising fiscal risks from contingent liabilities. Improving the composition and efficiency of spending, including by reducing energy subsidies through automatic adjustments of fuel prices, while strengthening means-tested social assistance and public

[11] IMF Staff analysis suggests that achieving the SDGs by 2030 in selected areas of health, education, and infrastructure would require additional spending of 5½ percent of GDP per year. See *ASEAN Progress Towards Sustainable Development Goals and the Role of the IMF*.

[12] While outstanding explicit government guarantees at the end of 2018 amounted to only 1.2 percent of GDP, additional fiscal risks could stem from implicit guarantees of SOE debt and PPPs.

[13] While the fiscal rules cap the deficit at 3 percent of GDP, projected fiscal deficits of 1.8 percent of GDP imply that there is room to pursue countercyclical fiscal policies if negative shocks to growth were to materialize.

investment is also important. The 2019 budget appears realistic even if current projections for oil prices are below those used in the budget, which would lead to both lower revenues and energy subsidies compared to the budget.

31. Implementing a medium-term revenue strategy (MTRS) will be critical to finance priority spending and avoid measures that erode the tax base. The MTRS should aim to raise revenue by around 5 percent of GDP over five years to finance priority spending on infrastructure, education, health, and social safety nets. Fund staff analytical work suggest that this could boost growth, including through significant economy-wide productivity gains and improvements in the business environment (IMF, 2018).[14] Using revenues from the MTRS to finance priority spending could also reduce the Gini coefficient by 0.5 points annually, which will reverse over 10 years the net increase in income inequality of the past two decades.[15] As the MTRS covers both tax policy and tax administration reforms comprehensively, implementation challenges call for careful prioritization and sequencing (Box 2).[16] The government should avoid measures that would weaken revenues, including additional tax incentives.

32. The authorities' continued efforts to improve spending efficiency are welcome. The recent public investment management assessment (PIMA) recommends actions in six priority areas, including enhancing the focus on capital projects and their visibility; identifying major capital projects in the medium-term development plans; strengthening multiyear budgeting framework for capital spending; improving the quality of project preparation and selection; modernizing capital portfolio oversight and monitoring; and strengthening capital project management.

Authorities' Views

33. The authorities are focusing on a broad range of fiscal reforms. The main reforms include revenue mobilization and improving the quality and efficiency of spending. They concurred with the importance of implementing a MTRS. They also indicated that tax administration reforms were advancing (risk-based audits, IT development, and use of taxpayer bank data to support audits) and will continue. The authorities agreed on the merits of a broadly neutral fiscal stance in 2019–20, and on improving the efficiency and quality of spending at all levels of governments, including by better targeting energy subsidies, expanding social assistance and reviewing the quality of spending in priority sectors.

34. The authorities are taking further steps to strengthen the management of contingent liabilities from SOEs and PPPs. While SOEs have been supporting the development of

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[14] "Indonesia's Growth Strategy: Boosting Potential Growth with Structural Reforms," in *Indonesia—Selected Issues*, IMF Country Report No. 18/33.

[15] T. Kinda and D. Doumbia, 2019, "Reallocating Public Spending to Reduce Income Inequality: Can It Work?," IMF Working Paper, forthcoming.

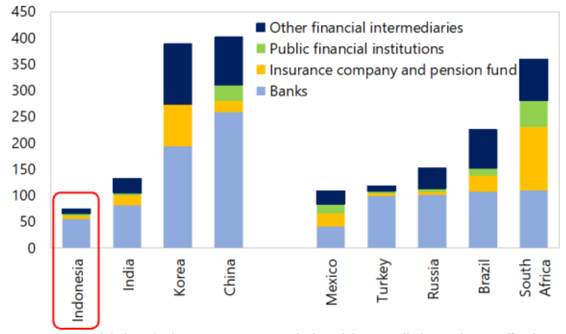
[16] "Operationalizing A Medium-Term Revenue Strategy in Indonesia" in the accompanying selected issues paper presents a more detailed discussion of prioritization, sequencing and phasing of the reforms under the MTRS.

infrastructure, the authorities are monitoring fiscal risks closely and continue to seek more private participation in investment projects.

Accelerating Financial Deepening to Promote Stable Financing Sources

35. Indonesia's financial system is shallow. Total assets of the financial sector stood at 75 percent of GDP at end-2017, below EM peers and with bank assets accounting for about ¾ of the total. The domestic institutional investor base is narrow, with insurance companies and pension funds accounting for only 8 percent of assets. Outstanding domestic debt securities and stock market capitalization are also below the levels in peer countries in Asia.

Size of Financial Sector, 2017
(In percent of GDP)



Sources: FSB, *Global Monitoring Report on Non-Bank Financial Intermediation*; and IMF staff estimates.

36. The authorities have started implementing a financial development strategy.[17] BI began to publish the Indonesia Overnight Index Average (IndONIA), a money market benchmark rate based on market transactions (overnight rupiah interbank lending), in August 2018. Issuance of T-bills by the MOF has also risen, providing more instruments at the short end of the yield curve. The authorities approved a blueprint for payment system reform, along the lines of the Bali Fintech Agenda, and launched a national payment gateway to facilitate the interconnection and interoperability of the retail payment systems. However, plans to create a holding company of public sector financial institutions need to be carefully assessed as this could involve significant risks to financial deepening and financial stability by reducing competition and creating supervisory challenges.

37. Advancing financial deepening while protecting prudential standards is essential. Legal upgrades are needed to align and strengthen the mandates and toolkits of BI, OJK, and the Deposit Insurance Corporation (LPS) to lay the foundations for sustainable financial deepening. The legal upgrades needed include (i) introducing a financial stability mandate for BI and giving primacy to the financial stability objective for OJK; (ii) clearly specifying the statutory objectives of LPS, including to protect insured depositors; (iii) facilitating consolidated supervision by OJK by reducing silos in financial oversight; (iv) improving legal protection for staff; and (v) strengthening the lender of last resort of BI. Developing the money market, including by expanding the role of the IndONIA as a reference rate, better anchoring the short-term end of the yield curve, reviewing tax treatments on financial instruments, and stimulating progress in the repo and foreign exchange derivatives markets, are also essential for financial deepening and improving the transmission of monetary

[17] *National Strategy for Financial Market Development 2018-2024*.

policy (Box 3). A well-developed money market will constitute the foundation upon which to build a solid financial market.

38. Technological innovation offers a promising channel to overcome Indonesia's unique geographical barriers to financial inclusion but can be associated with financial stability and integrity risks. Pursuing the implementation of the Bali Fintech agenda, including enhancing foundational infrastructures such as broadband internet, mobile data services, data repositories, and payment and settlement services, will support financial inclusion. In addition, the development of e-commerce is a potential new engine for growth through higher productivity and exports (Box 4).[18] However, financial innovations may give rise to financial stability and integrity risks through the growing role of new firms/activities that lie outside the current regulatory perimeter, as well as increased exposure to cyberattacks. To secure the benefits of financial innovation, supervisors should include cybersecurity in the regular monitoring and audits of financial institutions. The establishment of a dedicated group to collect and share information on cyber events and develop a broader strategy for the financial sector would prove useful.

Authorities' Views

39. The authorities are committed to financial deepening. They broadly agreed to undertake the reform priorities, including the need to advance the legal upgrades relating to BI and the supervisory agencies, and develop the money market. Furthermore, financial deepening reforms aim to expand the domestic and individual investor base and financial instruments, including by promoting a conducive environment and dynamic interactions among participants through solid intermediaries, credible reference pricing, and adequate financial literacy. The authorities also highlighted their strategy, which is expected to better integrate the digital economy with the financial sector, including through the recently announced vision of Indonesia's Payment System 2025 and initiatives for a new Blueprint of Payment System. To this effect, they are encouraging the use of digital payments, including on social transfers. They concurred with the need to improve the oversight and management of cyber risks.

C. Labor, Product Market, and Governance Reforms—Supporting Potential Growth and Inclusion

40. Despite the recent progress in streamlining regulations, Indonesia's productivity and growth are constrained by structural challenges in the labor and product markets. Past efforts to streamline regulations and reform education and health sectors have led to improvements in the World Bank's Doing Business ranking. However, important structural bottlenecks remain in the labor and product markets, including limited human capital development and associated skills mismatches; rigid labor markets; low female labor participation; still complex regulations, in particular in local governments; restrictions on FDI; and a strong presence of SOEs that limits

[18] Based on T. Kinda, 2019, "E-commerce as a Potential New Engine for Growth in Asia," IMF Working Paper, forthcoming.

competition. Reforms to address these issues, giving priority to those that address vulnerabilities, including by shifting the composition of capital inflows towards FDI and increasing the productivity of investment, will support growth and job creation, which is essential for Indonesia to reap its demographic dividend (Box 5).

41. Elements of fiscal governance, the regulatory framework, and the rule of law can generate vulnerabilities to corruption. In terms of fiscal governance, procurement management and the monitoring of fiscal risks arising from subnational governments and SOEs are areas that would benefit from improvement. Following up on tax audit reports and moving to risk-based auditing will also help focus on the riskiest tax payers, while improving resource allocation in the tax office. Regarding the regulatory framework, removing excessive protection of firms, including SOEs, would boost competition, including by lowering antitrust exemptions and streamlining legal entry barriers. Easing nontariff barriers to trade and FDI restrictions, and further facilitating processes to start a business and obtaining construction permits are critical to support competitiveness. Concerning the rule of law, strengthening investor protection and the integrity of contracts and property rights are important. Notably, the relatively small number of debt enforcement cases brought to courts may suggest weak trust, which could translate into higher transaction costs, reduced access to credit, and sub-optimal growth. There is also a need to strengthen the effectiveness of the AML/CFT regime by ensuring that licensed and registered financial institutions adequately implement the obligations established by law and regulations.

Authorities' Views

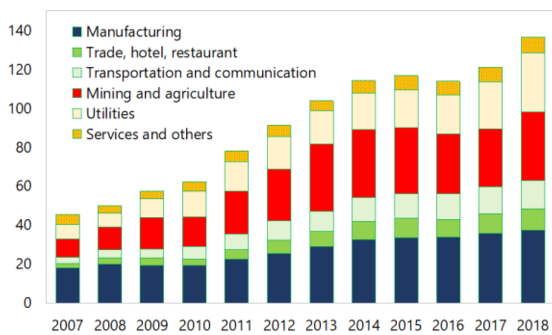
42. The authorities have been implementing growth-enhancing structural reforms. They highlighted past efforts to streamline regulations, expand infrastructure, reform education and health, and open some sectors to FDI. They also reaffirmed their commitment to accelerate structural reforms, including improving access to quality education, enhancing labor skills, and building a more business friendly investment climate, which they view as essential to boost growth and employment. As part of the post-election reform agenda, the authorities are considering labor market reforms to increase flexibility and align wage growth with productivity growth. This includes reforms to improve social safety nets (pension, health and life insurance) to make the relaxation of stringent labor market regulations acceptable and effective. The authorities also plan on allocating more resources to vocational training.

43. The authorities agreed with the need to continue improving governance and noted several recent efforts. To address vulnerabilities to corruption related to the procurement process, some regional governments are moving to electronics portals to limit physical contacts between civil servants and patrons. The authorities also noted that BI and OJK issued regulations to implement risk-based AML/CFT supervision and emphasized their commitment to ensure that these regulations are effectively implemented.

D. Financial and Corporate Sector Issues—Enhancing the Supervisory Framework

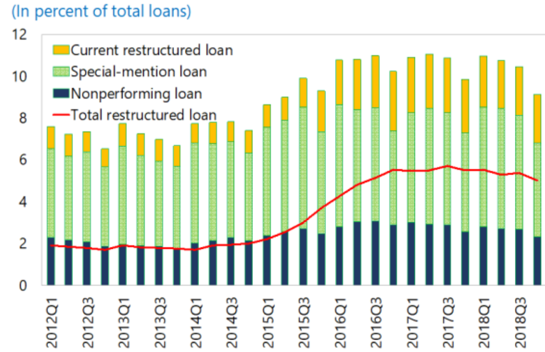
44. The banking system remains sound overall, but the corporate sector is exposed to FX risk. Corporate external debt continued to rise despite improved corporate profitability on cost-cutting efforts. While corporate FX regulations helped corporates increase the share of hedged FX loans, elevated foreign-currency debt of corporates (close to half of total debt) leave them exposed to rupiah volatility. This could have spillovers to the banking sector, as most bank loans (52 percent) are extended to the corporate sector. The banking system is well capitalized, and profitability is high with return on assets at 2.5 percent (Table 9). System-wide liquidity remains adequate, although some small non-systemic banks are vulnerable to liquidity shock, including FX liquidity shortfalls. NPLs have stabilized at 2.4 percent and are expected to decline further, but the share of problem loans (the sum of NPLs, special mention, and restructured loans) remains high at about 9 percent of total loans.

Private External Debt by Industry
(In billions of U.S. dollar)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

Problem Loans
(In percent of total loans)



Sources: Otoritas Jasa Keuangan; and IMF staff estimates.

45. The authorities have taken several actions in line with the FSAP recommendations (Table 11). Basel III standards have been implemented: a regulation on large exposures and a consultation paper for leverage ratio were published in December 2018 and January 2019, respectively. BI and OJK continue to improve their stress test framework, including corporate vulnerability analysis, and have implemented a joint stress test with BI's top-down and OJK's bottom-up tests. OJK has enhanced the internal coordination for the supervision of financial conglomerates with periodic committee meetings of chief executives of banking and non-banking sectors. The authorities have conducted several joint crisis simulation exercises. LPS has issued regulations on systemic and non-systemic bank resolution, and on bank restructuring. BI and OJK also issued regulations to implement risk-based AML/CFT supervision.

46. Building on this progress, further efforts are needed to strengthen financial oversight and crisis management. Specifically, there is a need to complete the new legal framework for financial sector agencies and the resolution regime, in line with the FSAP recommendations. A proposal to introduce changes to current laws in an "omnibus bill" to ensure consistency would be

welcome. In addition, OJK should continue efforts to strengthen enforcement of prudential regulations, including on credit and risk management and supervision of financial conglomerates. Finally, stronger coordination between LPS and OJK on bank recovery and resolution will further strengthen the crisis management framework.

47. The corporate prudential FX regulation should be further improved by extending its coverage to all FX liabilities, focusing on systemic corporates. The FX regulation, which requires a minimum rating and hedging of short-term external debt, is assessed as a residency-based capital flow management measure and as a macroprudential measure.[19] This regulation should be periodically reviewed and could be revisited as steps are taken to strengthen regulation and supervision to address systemic financial risks. While the FX regulation has helped moderate risks from corporate external debt, it should be further improved by extending its coverage to all FX liabilities of systemic corporates, which could reduce enforcement and compliance costs.

48. Caution should be exercised in adopting measures to increase repatriation of export proceeds. One of the measures, which are expected to come into force in July 2019, mandates natural resource exporters to repatriate export proceeds into special accounts in Indonesia, with the deposits subject to limited restrictions (authorized utilization includes profit remittances, payment of dividends, loans, and other levies, and investments). While it is unclear what the impact of the repatriation measure would be, it could risk undermining confidence at a time of uncertainty, and thus should be reconsidered. Other measures include tax incentives on interest incomes to encourage natural resource exporters to maintain their export proceeds in domestic banks and convert them into rupiah.

Authorities' Views

49. The authorities broadly agreed with the reform priorities on financial supervision and risk management. They reaffirmed their commitment to take further steps to strengthen the financial sector and promote financial deepening and inclusion. These include amending the laws of BI, OJK, and LPS to strengthen and clarify their roles and statutory objectives and enhancing the legal protection of officials involved in financial oversight and crisis management. The authorities acknowledged cyber risks emanating from rapid technological innovations and the need to continue strengthening cyber security.

50. The authorities reiterated that the corporate prudential FX regulation should not be seen as a CFM nor a CFM/MPM. The regulation aims to ensure macrofinancial stability through the adoption of prudential principles on corporate foreign borrowing. As only few years have passed since the introduction of the regulation, the authorities indicated that it would be appropriate to assess the impact of the initial regulation over time before considering further changes.

[19] This regulation is assessed as a residency-based capital flow management measure (CFM) and a macroprudential measure under the IMF's Institutional View and IMF (2017), because it applies only to FX liabilities of corporates with external debt, while it is intended to mitigate a buildup of systemic risks.

STAFF APPRAISAL

51. The Indonesian economy performed well in 2018, despite external headwinds. Policy flexibility supported positive macroeconomic performance and maintained financial stability in face of tighter global financial conditions and episodes of capital outflows. Economic growth stabilized at above 5 percent and inflation eased to around 3 percent. A surge in imports and weaker-than-expected export growth contributed to an increase in the current account deficit. Indonesia's external position in 2018 was assessed to be moderately weaker than implied by medium-term fundamentals and desirable policies.

52. The economic outlook is positive, although Indonesia remains vulnerable to reversals in capital inflows. Growth and inflation are projected to remain stable, the current account is expected to narrow gradually, and systemic macrofinancial risks are contained. Risks are tilted to the downside and are mainly external. The public and corporate sectors heavy reliance on external financing leaves Indonesia vulnerable to capital flow reversals.

53. The near-term policy mix appropriately focuses on protecting macroeconomic and financial stability. As the current monetary stance is tight and inflation pressures are modest; BI could partially and gradually unwind the interest rate hikes adopted in response to the 2018 EM selloff, unless significant capital account pressures reemerge. BI should continue to allow the exchange rate to move freely in line with market forces, with FX intervention limited to preventing disorderly market conditions. The largely neutral fiscal stance is appropriate for the near term as it balances the need to build resilience and underpin growth. Further relaxation of macroprudential policies appears not warranted, given the current and expected macrofinancial conditions.

54. Achieving higher potential growth and harnessing the young and growing labor force calls for ambitious reforms. The policy priority should be a reform package that mobilizes revenues to finance development spending (infrastructure, education, health, and social safety nets), and accelerate financial deepening to lessen reliance on volatile capital inflows. This reform package would also help finance and support essential and complementary reforms in the labor and product markets, including human capital development, higher female labor force participation, and improvement of the business environment. The start of the President's second term will provide a unique window of opportunity to implement these critical reforms.

55. Early implementation of a MTRS to finance growth-enhancing priority spending and structural reforms is critical. Building on gradual gains from tax administration reforms, the MTRS should also focus early on streamlining existing taxes, including removing VAT exemptions and replacing special regimes with a single corporate income tax. Over time, additional tax reforms should include introducing fuel excises, increasing the standard VAT rate, raising property tax rates, and broadening the PIT base. In addition to raising revenue to finance priority spending, the MTRS would also help improve the business climate and boost productivity. Sound risk management would help mitigate fiscal risks from contingent liabilities from SOEs' debt and PPPs.

56. Financial deepening with appropriate prudential standards would help promote stable financing, including for infrastructure development. Recent progress, including the approval of a blueprint for payment systems and the launch in 2017 of the national payment gateway reflects high-level political support and enhanced inter-agency coordination. Looking ahead, priorities include legal upgrades to align the mandates of BI, OJK, and LPS with the new regulatory landscape. Developing the money market, including by identifying a reference rate for interest rate swaps, better anchoring the short-term end of the yield curve, and stimulating progress in the repo and foreign exchange derivatives markets are also essential. Technological innovation offers a promising channel for financial inclusion but cyber security in the financial system should be enhanced in parallel. The corporate prudential FX regulation should be further improved by extending its coverage to all FX liabilities of systemic corporates.

57. Improving education and easing labor market regulations would support growth and employment. Ensuring more equitable access to quality education requires improving the efficiency of education spending and the quality of education. Promoting formal employment and reducing the use of short-term contracts requires streamlining stringent job protection, while improving vocational training and job placement services. Enhancing labor productivity and female labor participation requires a more open immigration policy for skilled labor, flexible work arrangements, and affordable childcare.

58. Efforts to streamline regulations should target areas with the largest potential gains for the economy, such as improving governance and reducing state control, antitrust exemptions, and barriers in the network sector. Avoiding conflicting regulations requires greater coordination among ministries and regional governments. Rationalizing non-tariff measures and FDI restrictions would support linkages with global value chains and competitiveness. Improving fiscal governance, the regulatory framework, and the rule of law would help reduce vulnerabilities to corruption. For instance, improving the insolvency and creditor rights regimes would raise participation in the corporate bond market and financial access for MSMEs.

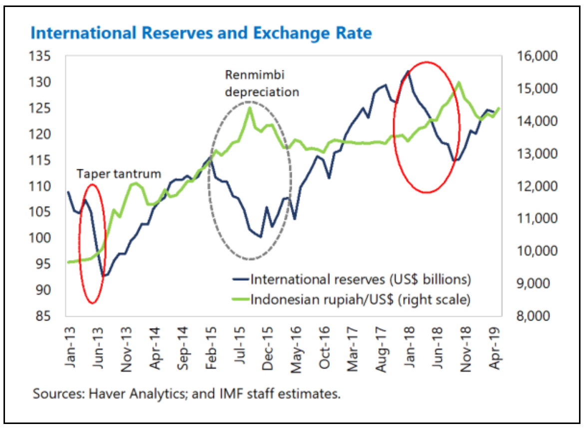
59. The authorities' continued efforts to strengthen financial oversight and crisis management in line with FSAP recommendations are welcome. The authorities have made progress in strengthening the frameworks for financial oversight and crisis management and resolution in recent years. The 2017 FSAP identified several areas where further improvement is needed, including clarifying institutional mandates, improving supervision of nonbank financial institutions and financial conglomerates, strengthening legal protection of officials involved in financial oversight and crisis management, and enhancing crisis management frameworks, such as the ELA and resolution frameworks.

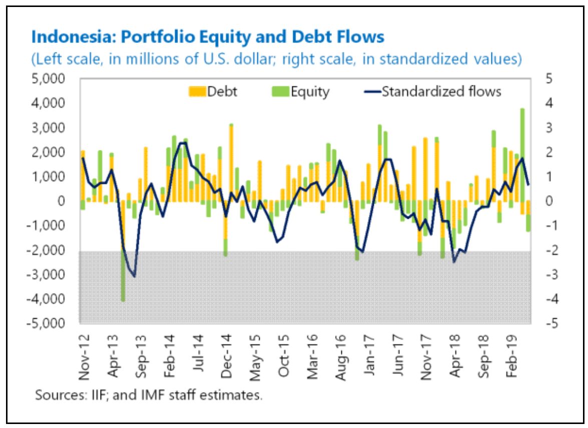
60. It is recommended that the next Article IV consultation take place on a standard 12-month cycle.

Box 1. Indonesia's Macroeconomic Policy Framework

Indonesia's strengthened policy frameworks have helped improved macroeconomic outcomes. Over the past two decades, Indonesia has strengthened its macroeconomic policy frameworks. Notably, fiscal rules capping the deficit at 3 percent of GDP and public debt at 60 percent of GDP were adopted in 2003. An inflation targeting (IT) framework, along with a managed floating exchange rate regime were introduced in 2005. While price stability is the primary objective of the IT framework, ensuring financial stability, limiting excessive volatility of the exchange rate, and maintaining attractiveness to capital inflows to finance the fiscal and current account deficits have also been part of the framework. Indonesia has also used macroprudential measures and capital flow management measures to influence credit growth and capital flows respectively. The framework achieved positive macroeconomic outcomes with growth stable at about 5 percent since 2013, inflation within the target band since 2016, and public debt at about 30 percent of GDP since the global financial crisis.

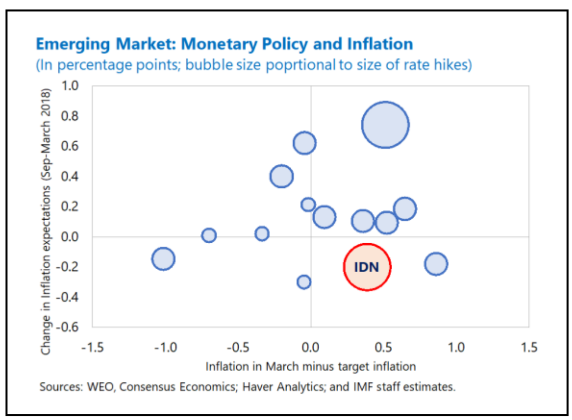
Recent episodes of external pressures tested the framework. Indonesia faced two recent episodes of exchange market pressures during which the exchange rate depreciated rapidly, and capital inflows reversed sharply: The Taper Tantrum (TT) (2013: May to December) and the 2018 EM selloff (2018: February to October). Indonesia was relatively more affected than most large EMs, particularly in Asia.





The Policy Framework Reacted During the Two Episodes:

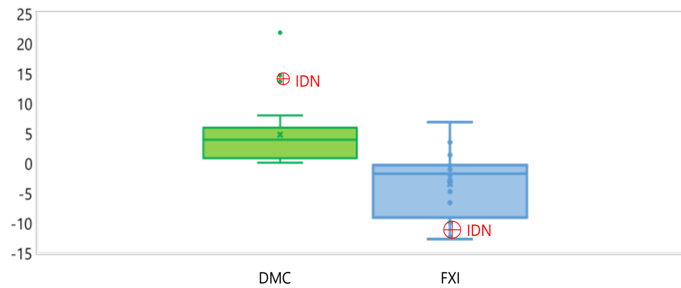
- **Monetary policy was tightened by a similar magnitude** (+175 bps interest rate hikes) during both episodes. While inflation was largely above target during the TT, inflation was well within the target band and inflation expectations were stable during the 2018 selloff.[1/] From a cross-country perspective, Indonesia stands out as one of the countries with the largest cumulative rate hikes in 2018, despite low inflation gap and contained inflation risks. The interest rate hikes in 2018 responded mostly to external conditions (higher global interest rates) to maintain attractiveness to external financing, considering Indonesia's heavy reliance on portfolio inflows to finance its twin deficits.



Box 1. Indonesia's Macroeconomic Policy Framework (Concluded)

- **The exchange rate was allowed to depreciate during both episodes, along with foreign exchange interventions**. The rupiah depreciated against the U.S. dollar by close to 25 percent during the TT and around 13 percent during the 2018 EM selloff. International reserves declined by close to 6 percent during the TT and around 13 percent during the 2018 EM selloff, mostly to contain sharp depreciation pressures. From a cross-country perspective, Indonesia had relatively higher FXI in 2018 but also a relatively higher number of days of disorderly market conditions.

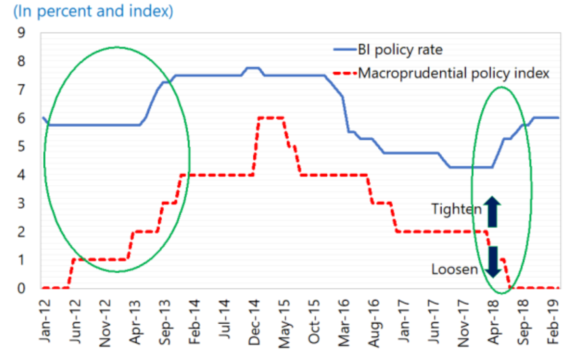
EM Disorderly Market Condition and FX Intervention, 2018 1/
(In percent of DMC days during episode and reserves)



Source: IMF staff estimates.
1/ This graph plots the distributions during the 2018 EM selloff episode of (i) the share of disorderly market conditions days (DMC); and (ii) the ratio of estimated foreign exchange interventions to reserves (FXI). The upper and lower bands of the box represent the first and third quartiles of the distribution; dots outside the box represent outliers.

- **Macroprudential measures** (MPMs) **were tightened during the TT but loosened during the 2018 EM selloff**. Along with tighter monetary policy, Indonesia tightened macroprudential policies during the TT to curb fast mortgage credit growth (around 30 percent). In contrast, MPMs were loosened preemptively (in presence of a slightly negative credit gap) during the 2018 EM selloff as the sharp capital outflows and the following policy reactions, including FXI and policy rate hikes, could have generated financial stress, especially a deterioration of liquidity conditions in some banks. BI allowed banks to use a larger share of the macroprudential liquidity buffer (the secondary reserve requirements) as collateral in repo transactions with BI and relaxed the macroprudential intermediation ratio requirement from 80–92 percent to 84–94 percent.

Monetary and Macroprudential Policy
(In percent and index)



Sources: Haver Analytics; and IMF staff estimates.

1/ The output gap was positive during the TT (+1.5 percent) and slightly negative in 2018 (-0.3 percent).

Box 2. Operationalizing a Medium-Term Revenue Strategy (MTRS) in Indonesia

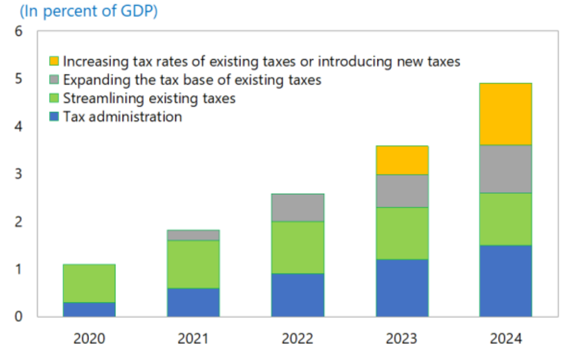
The MTRS represents a road-map for a comprehensive reform of the tax system. The MTRS touches nearly all aspects of taxation, including VAT, excises, CIT, PIT, property tax and tax administration. It centers on tax policy and administration reforms to streamline tax regimes and remove distortions, improve compliance and the efficiency of tax filing and collection, and raise additional revenues through less distortionary taxes. In addition, the success of the MTRS in promoting inclusive growth requires complementary reforms from the expenditure side, either to ensure an efficient use of the additional revenues (improving spending efficiency) or as a pre-requisite for certain tax reforms (strengthening social safety net and removing energy subsidies).

Implementing the MTRS requires careful prioritization, sequencing and phasing. Given the complexity and interdependence of the MTRS reforms, it is neither possible nor desirable to implement all of them in one go (it may still be desirable to make all legislative changes for each tax law at once, with phased implementation). The MTRS reforms include:

- Tax administration reforms. These reforms are designed to better enforce existing laws and are mostly under the control of the MOF. In addition to improve administration and compliance, these reforms also tend to have beneficial effects on efficiency and equity. Important progress has been made in recent years, and reform efforts should be further intensified as the benefits of the reforms will only materialize over time and tax administration reforms also help enhance the impact of tax policy reforms.
- Tax reforms that streamline existing taxes. These reforms are primarily designed to improve the functioning of existing taxes and tend to improve efficiency, equity, and administration and compliance. Some of the reforms, however, could face resistance by certain interest groups, and revisions of tax laws may be required.
- Tax reforms that expand the base of existing taxes. These reforms broaden the tax base, and could potentially have negative impacts on efficiency, equity, or administration and compliance. They tend to require revisions to laws and may need extensive consultations with the public and stakeholders. In addition, lowering the thresholds for VAT and SME turnover tax would better take place after VAT exemptions are removed and the CIT is streamlined.
- Tax reforms that increase the rates of existing taxes or introduce new taxes. These reforms can raise substantial revenues, but also tend to have negative impacts on efficiency or equity and are likely the most difficult to implement. In addition, fuel excises can only be implemented after fuel subsidies are removed; VAT rate increase should happen after VAT exemptions are removed and thresholds lowered; and a strong social safety net is needed to protect the most vulnerable before fuel prices or VAT rates are increased.

Tax Administration Reforms	
Launching CIPs in four areas	VAT Employer withholding tax Ultra-high wealth individuals High wealth Indonesians
Implementing five supporting initiatives	Strengthening the audit workforce Building a data matching capacity National deployment of compliance risk management Increasing efficiency of support and supervision Leveraging the tax amnesty and automatic exchange of information
Rolling out institutional reforms	Granting greater autonomy and budget flexibility for DGT Modernizing HR management Revamping and relaunching the code of conduct Streamlining organization following international trends Improving the IT system to support CIP

Cumulative Revenue Gain—From an Illustrative Scenario
(In percent of GDP)



Source: IMF staff estimates.

Box 2. Operationalizing a Medium-Term Revenue Strategy (MTRS) in Indonesia (Concluded)

Early reform efforts should focus on a public communication campaign, improving tax administration, and streamlining existing taxes. This would help garner public support for the implementation of the MTRS, generate sizable revenues upfront, and create the conditions for other MTRS reforms. Implementing the MTRS represents a major fiscal policy shift and could potentially be a milestone in Indonesia's economic development. As it touches many interests and will create winners and losers, at least in the short term, it will inevitably face resistance from various groups. Building public support strategically through a public communication campaign is thus crucial for the success of the MTRS. Tax administration reforms will continue, centering around the designs and launches of Compliance Improvement Programs (CIPs), supported by the implementation of supporting initiatives and institutional reforms. Streamlining existing taxes involves reviewing current schemes, preparing reform proposals, and introducing new or revised laws, which could start immediately and be effective in 2020.

Reform Prioritization, Sequencing and Phasing

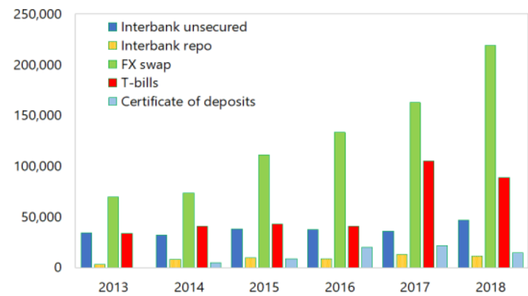
Areas	Measures	Reform Considerations	Timeline
Improving tax administration	CIPs and the supporting initiatives; institutional reforms	Improve efficiency, equity or administration and compliance; many reforms under the direct control of MOF and only a few revisions of laws are needed; requires improvements in tax administration capacity	Year 1 to Year 5
Streamlining existing taxes	Remove certain VAT exemptions Replace STLG with VAT and vehicle excise Replace special regimes with one single corporate income tax Reduce property transaction tax and increase property tax	Improve efficiency, equity or administration and compliance; require revisions of laws	Year 1 to Year 3
Expanding the tax base of existing taxes	Lower VAT registration threshold Introduce alternative minimum tax Broaden PIT base by including the middle class and strengthen progressivity Reduce the threshold of the SMEs regime	May have some negative impacts on efficiency, equity or administration and compliance; requires revisions of laws	Year 2 to Year 5
Increasing tax rates of existing taxes or introducing new taxes	Higher VAT rate New fuel excise	Large revenue impact; negative impact on efficiency or equity; may require mitigating measures from the expenditure side; should be implemented after some other reforms are completed; requires revisions of laws	Year 4 to Year 5

Box 3. Developing the Money Market

Deep money markets are critical for liquidity management in the financial system and represent the cornerstone for the development of other financial markets. Well-functioning money markets provide price references for the short-end of the yield curve and for the creation of products such as floating-rate bonds and hedging tools, which facilitate the development of capital markets.

The authorities have made considerable efforts to advance the development of money markets. In 2018, they launched the National Strategy on Financial Market Development (2018–2024) to highlight financial deepening as one of the policy priorities. BI issued several regulations and guidelines in recent years, including on negotiable certificate of deposits for banks, commercial papers for nonbank corporations, and interest rate derivatives for both, to help them diversify funding sources and facilitate risk sharing and longer-term financing. In August 2018, BI started publishing a transaction-based Indonesia Overnight Index Average (IndONIA) to replace the quotation-based overnight JIBOR as the overnight money market benchmark rate. Also, BI has organized seminars and workshops to promote a wider use of repo and FX transactions. The authorities have increased the frequency of T-Bills issuances to enhance liquidity and price formation at the short-end of the yield curve. Thanks to these efforts, the daily average volume of money market instruments grew strongly in recent years (about 12.3 percent, y/y). However, the daily average volume and outstanding balance of the unsecured interbank market were still small at Rp 16.6 trillion and Rp 46.8 trillion, about 0.1 and 0.3 percent of GDP, respectively in December 2018. The outstanding interbank repos amounted to only about Rp 11.7 trillion, even smaller than the unsecured transaction.

Outstanding Money Market Instruments
(In billion of rupiah)



Source: Data provided by the authorities.

Several factors constrain the development of money markets, particularly repo transactions. They include structural excess liquidity in the banking system (though some small non-systemic banks are vulnerable to liquidity shocks), market segmentation, limited capacity and lack of incentives of smaller banks, and tax constraints on repos. Excess liquidity reduces banks' need to engage in interbank market transactions, thereby undermining market development. Smaller banks prefer funding their needs on the unsecured interbank market because of complexity to maintain collaterals for repo transactions. The lack of tax rate synchronization among instruments has impeded the development of the money market: for example, unequal tax treatment between short-term (20 percent) and long-term financial instrument (15 percent) and between banks' repo transactions (non-final tax) and those on non-banks (final tax).

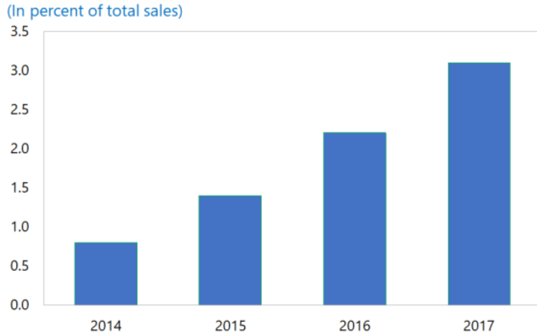
Pursuing ongoing efforts through a number of actions will help further improve Indonesia's money market. First, to strengthen the short-end of the yield curve, BI should expand the tenor of the IndONIA to longer tenors, the MOF should continue to gradually increase the stock of T-bills and keep reducing the overlap between T-bills and BI securities on the same maturities. Second, BI should extend averaging to cover all primary reserve requirements, which would allow banks to improve liquidity management. Third, efforts to enhance the use of the global master repurchase agreement (GMRA) should continue to help smaller banks increase their participation in the interbank repo transactions. Fourth, the MOF should review tax treatments on financial instruments and repo transactions. Fifth, the bankruptcy law needs to be amended, so that close-out netting can happen to mitigate counterparty credit risk.

Box 4. E-commerce in Indonesia: A Potential New Engine to Boost Productivity and Exports

Indonesia has witnessed rapid growth of online commerce in recent years, supported by a vibrant digital ecosystem and a growing youth population that is digitally savvy. Between 2014 and 2017, the share of online sales in total retail sales increased fourfold, from less than 1 percent to about 3 percent. Supporting this rapid growth, the number of users of the mobile Internet and digital payments has exploded in recent years. Between 2015 and 2017, the number of mobile Internet users increased by about 21 percent. While the size of the bandwidth per user and the average connection speed may be low compared to peers, mobile data are cheap in Indonesia at about half the price of peer ASEAN countries. The share of digitally active users in the banked population also increased rapidly between 2014 and 2017, with the average consumer making nearly 50 percent more transactions via smartphone than three years ago.

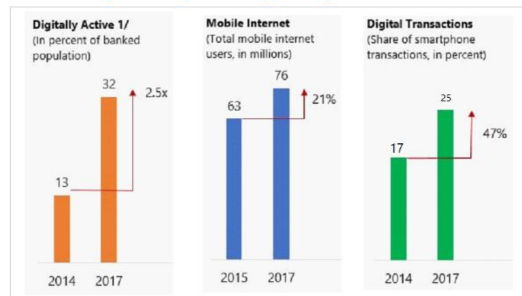
Indonesia: E-commerce Sales

(In percent of total sales)



Sources: eMarketer; and staff estimates.

A Vibrant Digital Ecosystem Supporting E-commerce

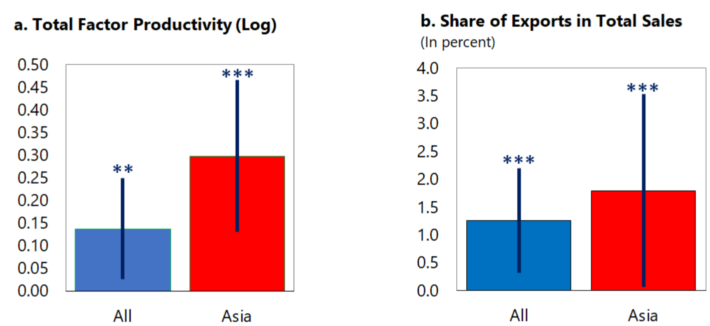


Source: Source: Statista and McKinsey (2016, 2018).

1/ Uses digital banking at least fortnightly and made an e-tailing purchase in the past six months.

IMF Staff research suggests that firms engaged in online commerce in Asia, including Indonesia, are at least 30 percent more productive and export at least 50 percent more on average.[1] A study by McKinsey shows that shopping online helps consumers in non-Java regions save between 11 and 25 percent (Das and others 2018). With up to 35 percent of online sales generated by women, compared to 15 percent for offline retail, e-commerce can help promote social equality by lowering the persistent gender gap.

Estimated Impact of E-commerce Participation on Productivity and Export 1/



Source: World Bank Enterprises Surveys and IMF staff estimates.

1/ These figures illustrate coefficients and confidence intervals from two firm-level estimations: (a) the impact of e-commerce participation on total factor productivity, controlling for firms' age, size, foreign ownership, export status, and human capital; and (b) the impact of e-commerce participation on the share of exports in total sales, controlling for firms' age, size, foreign ownership, and human capital. The error bars refer to the 95 percent confidence intervals around the estimated coefficients. For Asia, the estimated coefficients imply that participation in e-commerce is associated with a 30 percent increase in total factor productivity and an increase in the share of exports to total sales by close to 2 units, corresponding to a 50 percent rise.** $p<0.05$; *** $p<0.01$.

Box 4. E-commerce in Indonesia: A Potential New Engine to Boost Productivity and Exports (Concluded)

Yet, Indonesia faces a digital divide and gaps in various factors that impede a thriving online commerce sector. For instance, only a quarter of the overall population uses the Internet and about half of the population has access to financial services. Indonesia's logistics infrastructure lags its regional peers, ranking 63rd out of 160 countries globally in 2016, with issues related to both insufficient coverage and inconsistent service quality.

To reap the digital dividend in Indonesia, priority actions would include expanding the quality of internet coverage (including in rural areas) to reduce the digital divide; expanding reliable logistics infrastructure for pickups and deliveries; leveraging the rise of e-commerce to further expand cashless payments and support lending, especially to smaller enterprises; enhancing human capital to meet the demand of talent from the emerging digital sector; and encouraging SMEs to go online, in particular through online marketplaces. Large marketplaces could also provide various benefits to SMEs, including marketing analytics, inventory management, and access to credit. Addressing these issues will help Indonesia fully expand its online commerce and truly harness its benefits, including supporting productivity and export. The Indonesian authorities have started to implement various measures to support the rise of e-commerce. These include expanding logistics infrastructure through the National Logistic System Development and ASEAN Logistic Service Integration; improving the quality of internet coverage through the Palapa Ring Project; enhancing human capital through the Digital Talent Scholarship Program; and encouraging SMEs to go online through the on-Boarding SME program.

1/ Kinda, T., 2019, "E-commerce as a Potential New Engine for Growth in Asia," IMF Working Paper, forthcoming.

Box 5. Labor and Product Market Priorities in Indonesia 1/

Raising potential growth, which is needed to address Indonesia's socioeconomic challenges, requires a comprehensive structural reform package. In addition to domestic revenue mobilization and financial deepening, Indonesia needs labor and product market reforms to create quality jobs for its young and growing labor force, and reap the demographic dividend. Fund research suggests through an illustrative scenario that raising revenue of 3 percent of GDP to expand public spending in infrastructure, education, and health, along with structural reforms to the labor and product markets (e.g., reduction of trade and FDI restrictions and lowering of state control in the economy) would increase potential growth by 1 percentage point over the medium-term.[1]

The authorities have made progress on structural reforms in recent years. They have advanced infrastructure development, a government priority in recent years, including by increasing public capital spending by 1 percent of GDP between 2014 and 2017 and improving the institutional framework by creating the Committee for Acceleration of Priority Infrastructure Delivery (KPPIP). There were also efforts to improve the business environment by streamlining regulations. A transparent minimum wage formula was adopted, the land acquisition process was simplified, and the FDI regime was partially liberalized. These efforts have led to a notable rise in Indonesia's *Doing Business* ranking, from the 106th in 2016 to the 73rd in 2019.

Notwithstanding these efforts, pursuing labor and product market reforms would remove important impediments to growth. Considering Indonesia's reliance on volatile portfolio flows (a main source of vulnerability) and the country's social needs despite the relatively high investment to GDP ratio, reforms that shift the composition of capital flows towards FDI and improve the productivity of investment are particularly important. Priorities include:

- **Reducing regulatory protection to existing firms and streamlining barriers to investment and trade**.
  - *Protection to existing firms*. Easing regulations on state control, antitrust exemptions, and barriers in the network sector (electricity and transport) and limiting the role of SOEs to strategically relevant and commercially viable areas would lower fiscal support needs, foster market-based incentives and competition, and improve governance and efficiency. This could also help attract private investment, including FDI, for instance in the energy sector where large investment is needed.
  - *Further easing FDI restrictions and streamlining nontariff measures* would strengthen links with global value chains and support competitiveness.
- **Improving education and easing labor market regulations to support productivity and employment**.
  - *Education*. Strengthening the link between compensation and performance in the education sector would improve the efficiency of spending and the quality of education. Savings from these measures and additional resources could be directed to ensure more equitable access to quality education, especially in rural areas. Improved access to student loans would increase enrollment in higher education. The monitoring framework of the local government's budget spending and schools' performance should also be improved.
  - *Labor markets*. Streamlining stringent job protection, including administrative dismissal procedures and severance payments, while improving vocational training, would promote youth employment and reduce the use of short-term contracts. Active labor market policies, including job placement services and vocational training, would help labor mobility. Adopting a more open immigration policy for skilled labor, and improving the quality of education, can lower skill mismatches, especially in professional services. Female labor force participation can be enhanced by providing flexible work arrangements and improving access to childcare.
- **Greater coordination would help avoid conflicting regulations between the central and local governments**. Introducing merits and competition factors into fiscal transfers to local governments and capacity building would also enhance accountability and coordination.

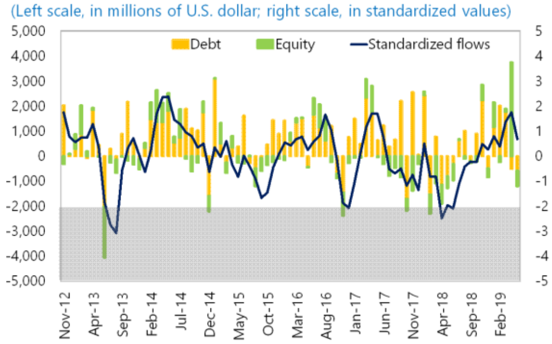
1/ *Indonesia—Staff Report for the 2017 Article IV Consultation* provides a comprehensive discussion of structural reforms priorities, including the expected impact on growth.

Figure 1. Indonesia and Emerging Markets: Recent Developments

Capital inflows to Indonesia sharply reversed between February and October 2018.

Indonesia: Portfolio Equity and Debt Flows

(Left scale, in millions of U.S. dollar; right scale, in standardized values)

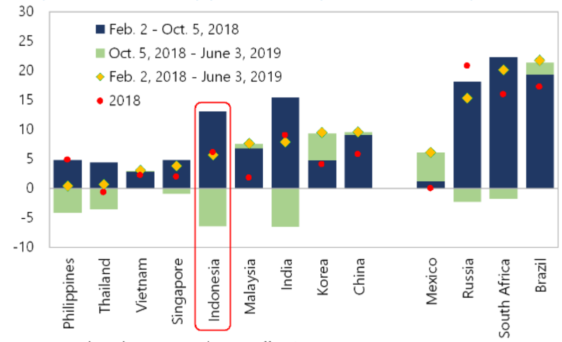


Sources: IIF; and IMF staff estimates.

The rupiah depreciated by about 13 percent during this period, more than is most Asian EMs…

Selected Emerging Market Exchange Rate Changes

(In percent, local currency per U.S. dollar, positive value is a depreciation)

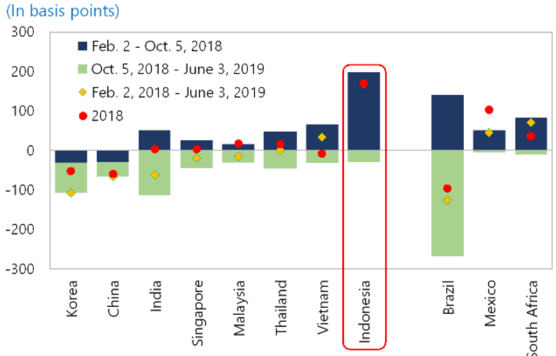


Sources: Bloomberg L.P.; and IMF staff estimates.

…and Indonesia's 10-year bond yield increased by close to 200 bps, more than Asian EMs…

Change in 10-Year Government Bond Yields

(In basis points)

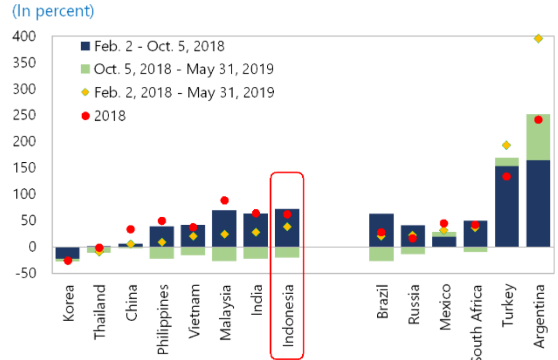


Sources: Bloomberg L.P; Haver Analytics; and IMF staff estimates.

Reflecting stress in the financial markets, credit default swaps increased in most Asian EMs.

Change in Credit Default Swap

(In percent)

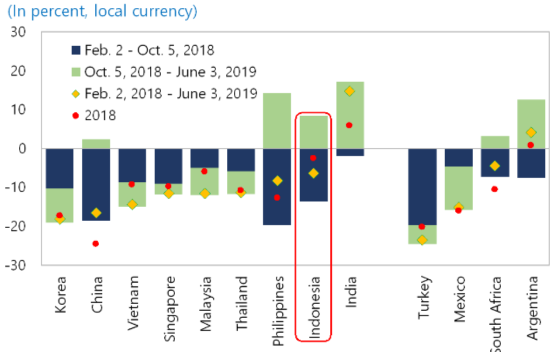


Sources: Bloomberg L.P; Haver Analytics; and IMF staff estimates.

Equity prices fell across countries and by more than 10 percent in Indonesia.

Equity Prices Changes

(In percent, local currency)

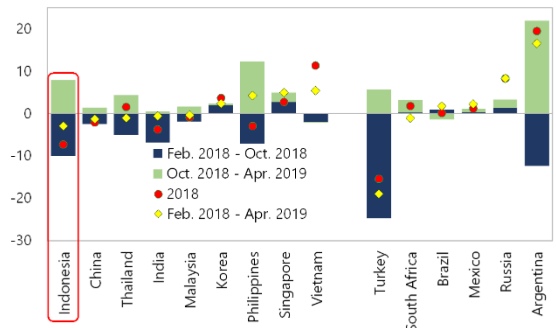


Sources: Bloomberg L.P.; Haver Analytics; and IMF staff estimates.

…and reserved dropped by about 13 percent in Indonesia, more than in peer Asian EMs.

Change in Gross International Reserves

(In percent)



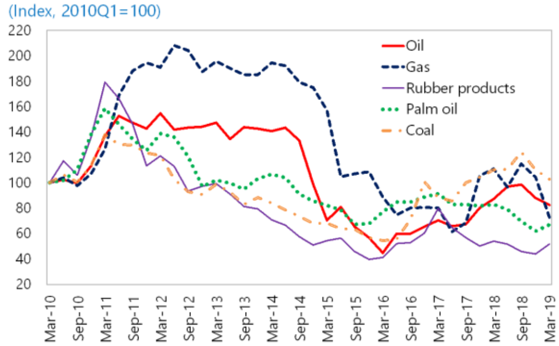
Sources: Country authorities; Haver Analytics; and IMF staff estimates.

Figure 2. Indonesia: Macrofinancial Developments

Following some increase in 2018, most commodity prices have abated since early 2019.

Key Commodity Prices

(Index, 2010Q1=100)

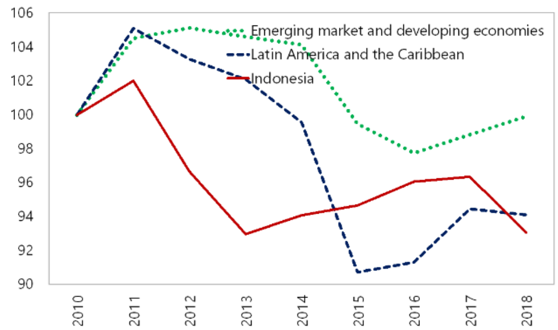


Sources: IMF, Commodity Price System database; and staff estimates.

Yet, Indonesia's overall terms of trade did not improve in 2018.

Terms of Trade

(Index, 2010=100)

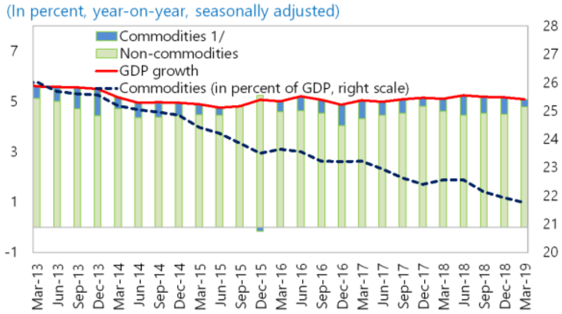


Sources: IMF, *World Economic Outlook;* and IMF staff estimates.

Growth has stabilized at near 5 percent since 2014, with the share of the commodity sector still declining.

Contribution to Real GDP Growth

(In percent, year-on-year, seasonally adjusted)



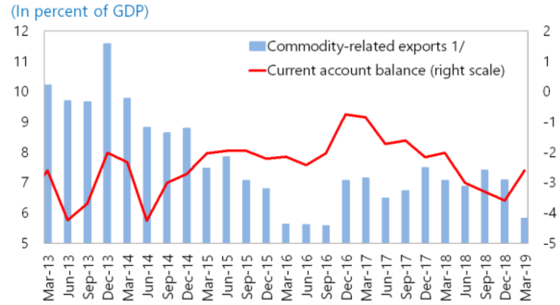
Sources: Haver Analytics; and IMF staff estimates.

1/ Includes agriculture, mining and quarrying, manufacturing coal, petroleum and gas.

The current account deficit widened in 2018 due to stronger imports, reflecting mainly non-oil and gas investment growth.

Current Account Balance and Commodity Exports

(In percent of GDP)



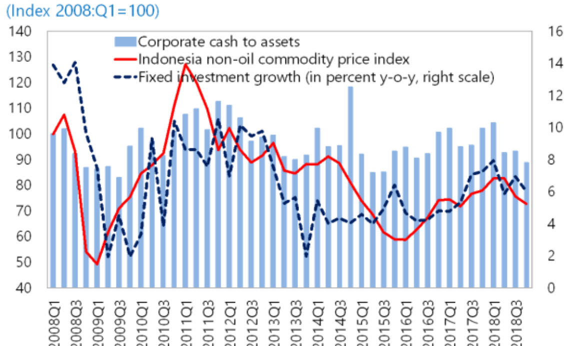
Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

1/ Includes agriculture products, palm oils, processed rubber, oil products, and mining products.

The corporate sector has started to recover from the commodity down cycle, with rising investment growth.

Commodity Prices, Corporate Cash and Fixed Investment

(Index 2008:Q1=100)

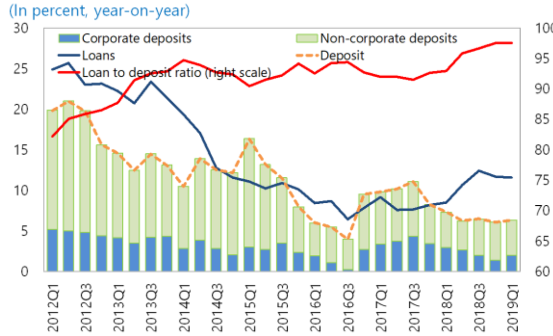


Sources: CEIC Data Co. Ltd; Bloomberg L.P.; and IMF staff estimates.

Unlike deposit growth, which has remained subdued, loan growth has started to recover but remained flat more recently.

Loan and Deposit Growth 1/

(In percent, year-on-year)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

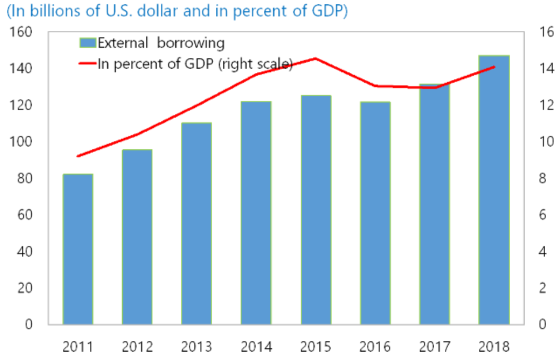
1/ Commercial and rural banks.

Figure 2. Indonesia: Macrofinancial Developments (Concluded)

After having stabilized in 2016–17, corporate external debt slightly increased in 2018 …

Corporate External Debt

(In billions of U.S. dollar and in percent of GDP)

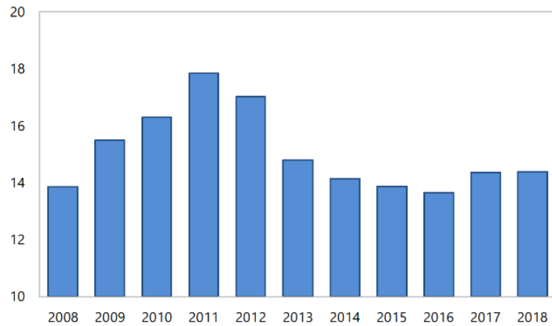


Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

…while corporate profitability also improved slightly in 2017-18, in line with the gradual recovery in commodity prices.

Corporate Return on Assets

(In percent)

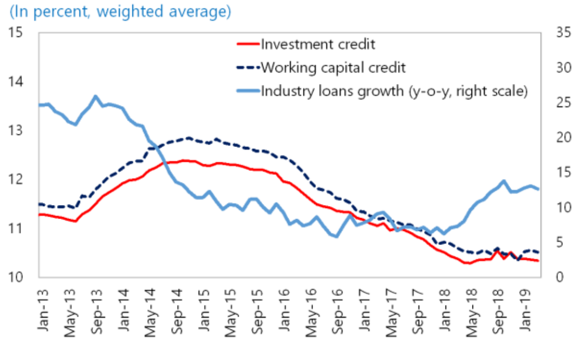


Sources: Bloomberg LP.; and IMF staff estimates.

Monetary tightening in 2018 was not fully transmitted to lending rates and credit growth.

Commercial Banks' Lending Rates and Credit Growth

(In percent, weighted average)

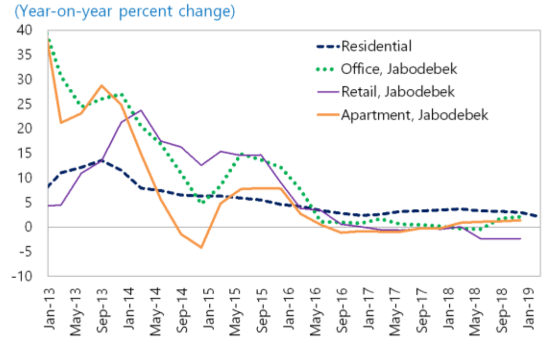


Source: CEIC Data Co. Ltd.

Property prices remained stable in 2018.

Property Prices

(Year-on-year percent change)

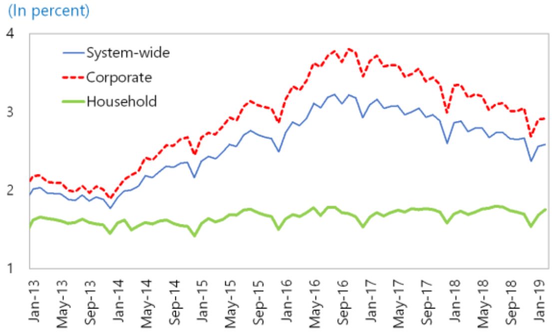


Source: Bank Indonesia, *Commercial Property Survey*.

NPLs in the banking system have declined in 2018 after rising sharply during 2014-16.

Nonperforming Loan Ratio

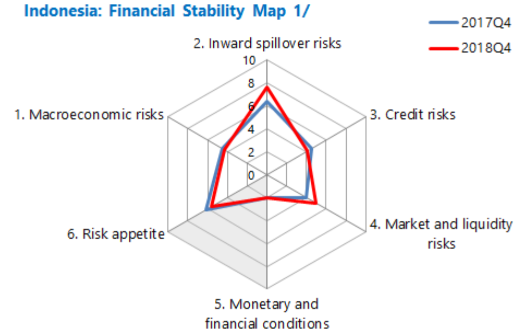
(In percent)



Sources: Indonesia Financial Services Authority (OJK); CEIC Data Co. Ltd; and IMF staff estimates.

Inward spillover, and market and liquidity risks increased in 2018.

Indonesia: Financial Stability Map 1/

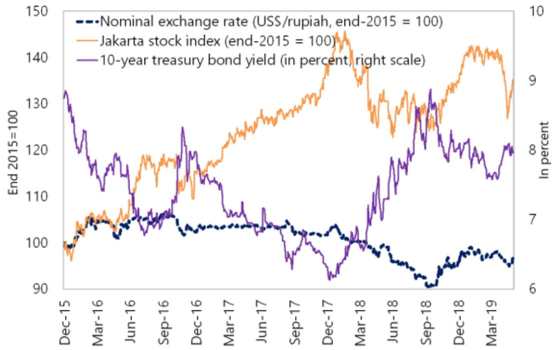


1/ Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

Figure 3. Indonesia: Recent Market Developments

After a marked tightening in 2018, domestic financial conditions have partially eased since late 2018.

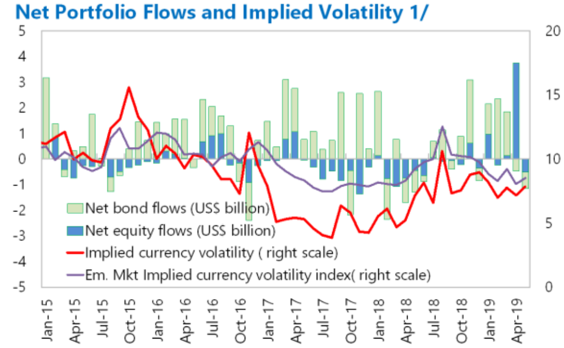
Domestic Financial Conditions



Source: Bloomberg LP; and IMF staff estimates.

Following episodes of outflows in 2018, portfolio inflows have resumed in 2019 although they remain volatile.

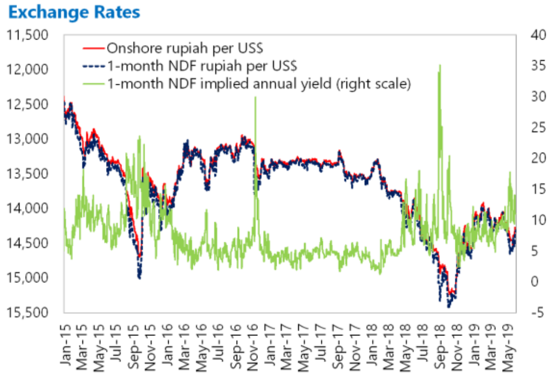
Net Portfolio Flows and Implied Volatility 1/



Sources: Bloomberg L.P.; and IMF staff calculations.
1/ High implied volatility indicates potential for large price swings in either direction.

The rupiah has partially reversed the large depreciation in 2018 …

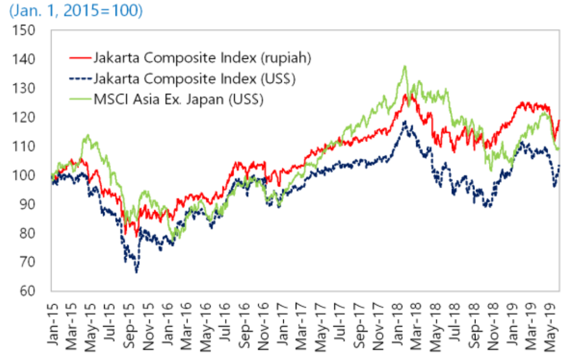
Exchange Rates



Source: Bloomberg L.P.

…and equity prices have declined recently, on the back of heightened trade tensions, following gains since late 2018.

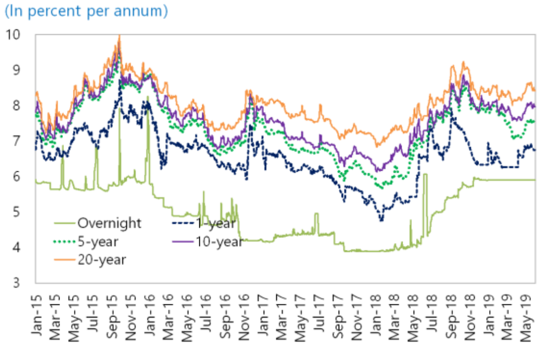
Equity Market Indices
(Jan. 1, 2015=100)



Sources: Bloomberg L.P.; and IMF staff estimates.

Domestic bond yields have increased significantly in 2018 on episodes of portfolio outflows but have receded recently.

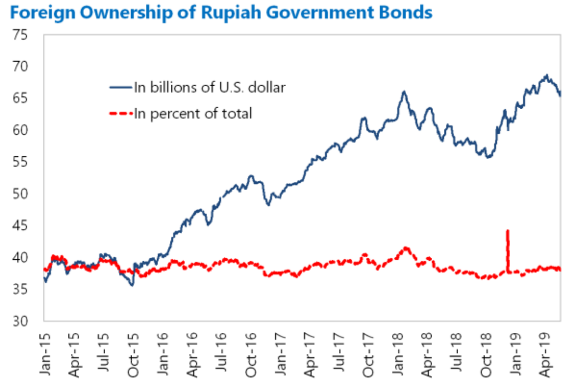
Domestic Government Bond Yields
(In percent per annum)



Source: Bloomberg L.P.

Foreign investors participation in rupiah government bonds has remained broadly stable at around 40 percent.

Foreign Ownership of Rupiah Government Bonds

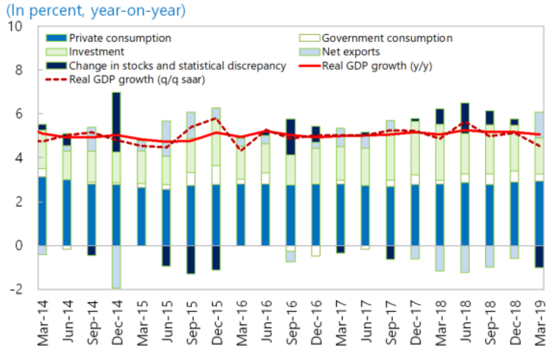


Sources: Bloomberg L.P.; CEIC Data Co., Ltd.; and IMF staff estimates.

Figure 4. Indonesia: Real Sector

Real GDP growth has been stable at near 5 percent in 2018, supported by robust investment and private consumption.

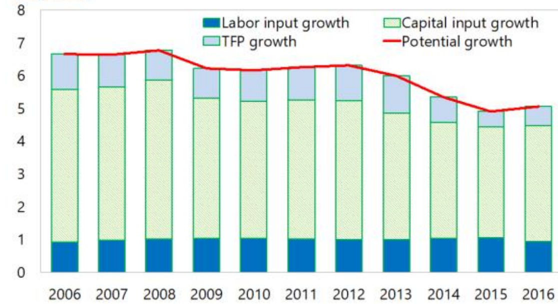
Contribution to Real GDP Growth
(In percent, year-on-year)



Sources: CEIC Data Company Ltd.; and IMF staff estimates.

Potential growth has declined to close to 5½ percent, reflecting lower contributions from capital and TFP growth.

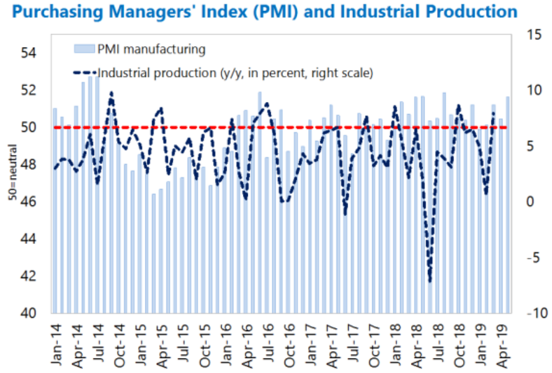
Contribution to Potential GDP Growth
(In percent)



Source: IMF staff estimates.

Industrial production growth has dropped since early 2019, but the PMI was mostly above neutral levels.

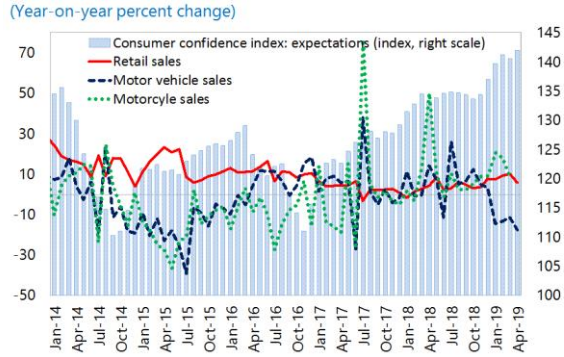
Purchasing Managers' Index (PMI) and Industrial Production



Sources: Haver Analytics; and CEIC Data Company Ltd.

While consumer confidence has picked up, vehicle sales have slowed, giving mixed signals on consumption.

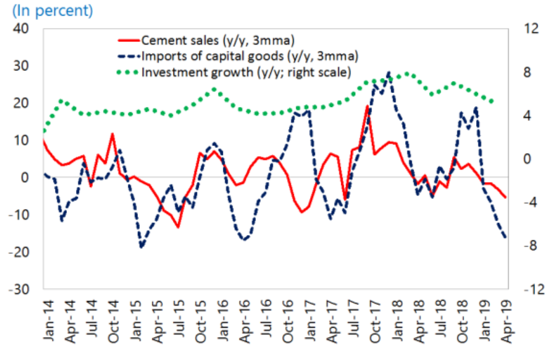
Indicators of Private Consumption Activity
(Year-on-year percent change)



Sources: CEIC Data Company Ltd.; IMF staff estimates.

Cement sales and capital goods imports have dropped in 2019, mirroring the drop in industrial production.

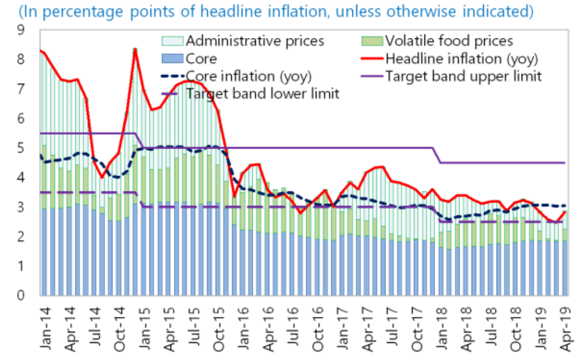
Indicators of Investment Activity
(In percent)



Source: CEIC Data Company Ltd.

Inflation dropped close to the lower limit of the target band due to controlled energy prices and interest rate increases by BI.

Inflation Developments
(In percentage points of headline inflation, unless otherwise indicated)



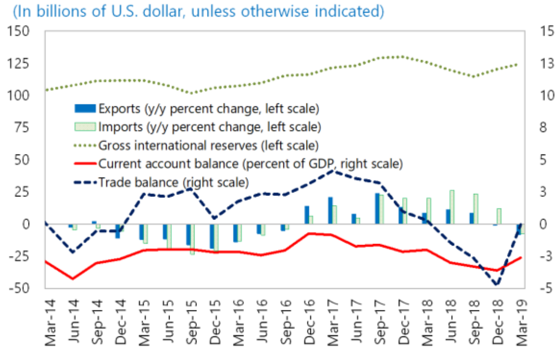
Sources: CEIC Data Company Ltd; and IMF staff estimates.

Figure 5. Indonesia: External Sector

The current account deficit widened in 2018, mostly due to an increase in imports to support investment growth…

Current Account Balance and International Reserves

(In billions of U.S. dollar, unless otherwise indicated)

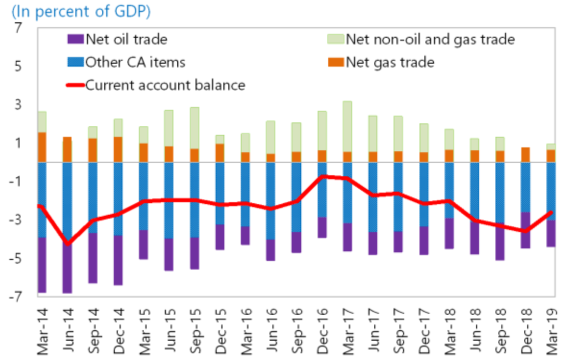


Sources: CEIC Data Company Ltd; and IMF staff estimates.

…as reflected in the deterioration in the non-oil and gas trade balance.

Current Account Balance

(In percent of GDP)

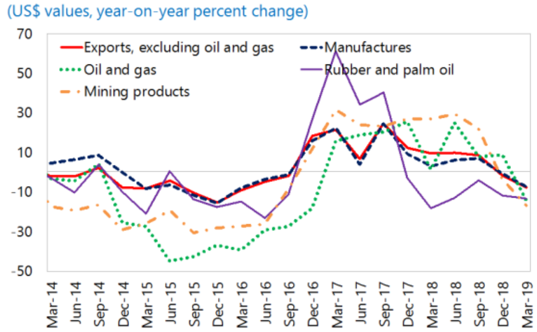


Sources: CEIC Data Company Ltd.; and IMF staff estimates.

The drop of export growth in 2018 has been broad based, although significantly stronger for rubber and palm oil.

Exports of Goods

(US$ values, year-on-year percent change)

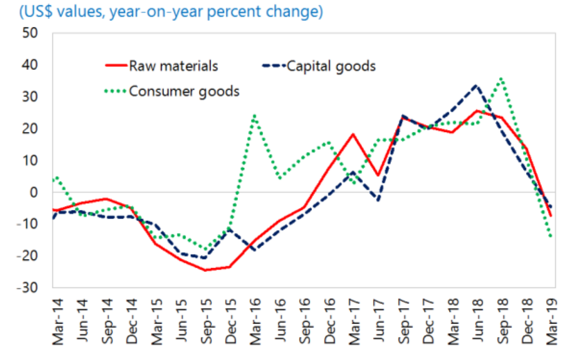


Sources: CEIC Data Company Ltd.; and IMF staff estimates.

Following a broad-based increase during 2018 Q1/Q3, imports have started to decline since late 2018.

Imports of Goods

(US$ values, year-on-year percent change)

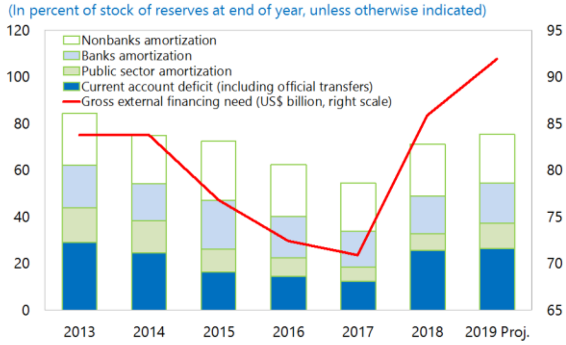


Source: CEIC Data Company Ltd.

External financing needs would increase in 2019 due to higher current account deficit and public debt amortization.

Gross External Financing Needs

(In percent of stock of reserves at end of year, unless otherwise indicated)

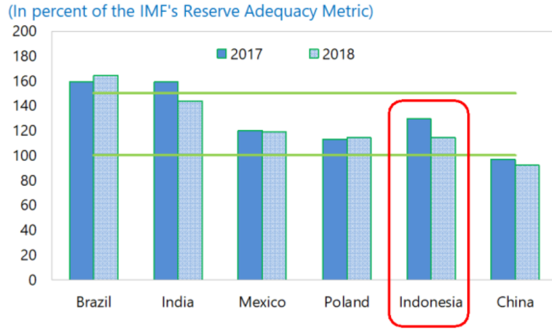


Source: IMF staff estimates.

Indonesia's foreign reserves declined to US$121 billion in 2018 but remain within the IMF's Reserve Adequacy Metric.

Gross International Reserves

(In percent of the IMF's Reserve Adequacy Metric)

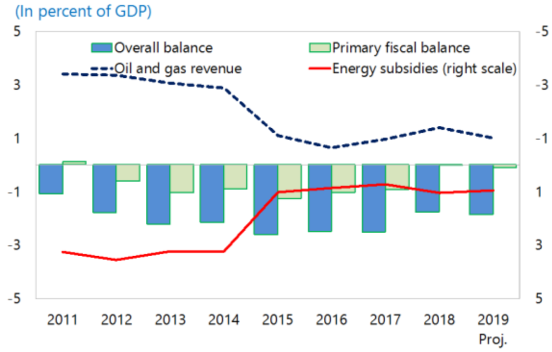


Sources: IMF, *International Financial Statistics*; and IMF staff estimates.

Figure 6. Indonesia: Fiscal Sector

The primary deficit was eliminated in 2018, despite some increases in energy subsidies…

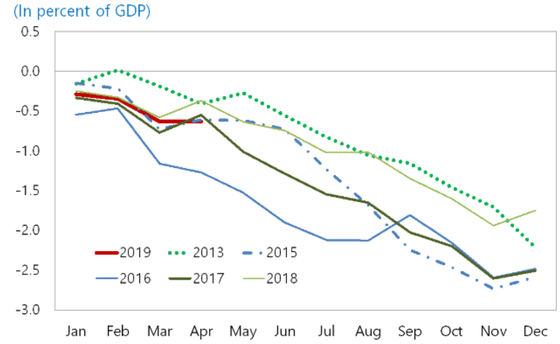
Central Government Indicators
(In percent of GDP)



Sources: Indonesian authorities; and IMF staff estimates and projections.

…and outcomes so far in 2019 point to a moderate fiscal deficit.

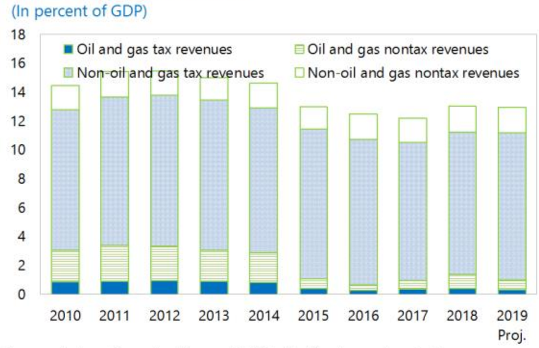
Central Government Deficit Path, 2013-2019
(In percent of GDP)



Sources: Indonesian authorities; and IMF staff estimates.

Overall revenue increased in 2018 due to both higher oil and gas and non-oil and gas revenues…

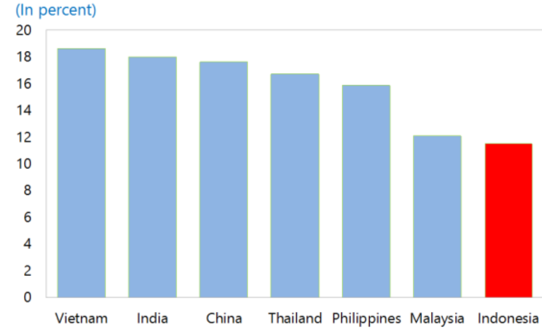
Central Government Revenue
(In percent of GDP)



Sources: Indonesian authorities; and IMF staff estimates and projections.

…yet Indonesia's tax-to-GDP ratio remains low compared to peers in Asia.

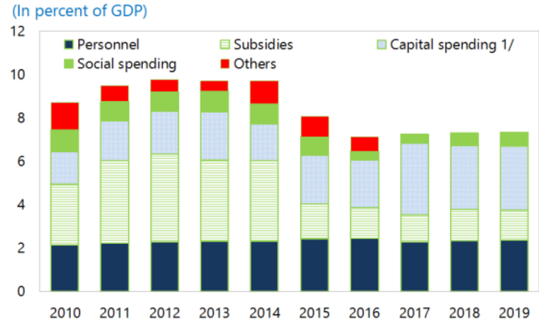
General Government Tax-to-GDP Ratio, 2018
(In percent)



Sources: IMF, *WEO Database*; and Authority data.

Government capital spending has increased despite broadly constant total government expenditure.

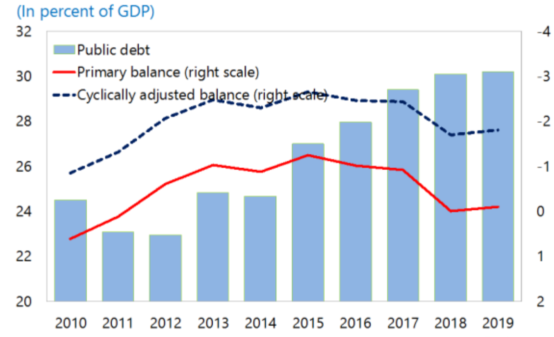
Central Government Expenditure
(In percent of GDP)



Sources: Indonesian authorities; and IMF staff estimates and projections.
1/ Includes transfers to local governments for infrastructure.

Public debt has marginally increased due to rupiah depreciation but remains moderate.

Public Debt, Primary, and Cyclically Adjusted Balance
(In percent of GDP)

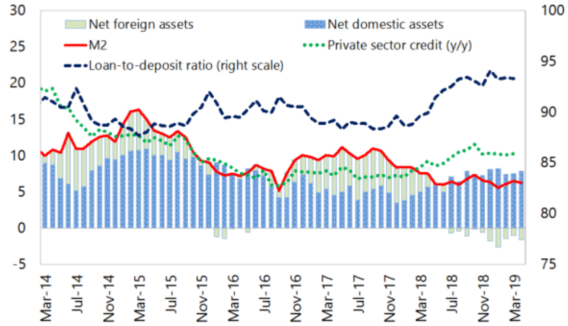


Sources: Indonesian authorities; and IMF staff estimates and projections.

Figure 7. Indonesia: Monetary Sector and Bank Liquidity Developments

With double-digit credit growth in 2018, the credit cycle moved out of a prolonged downturn.

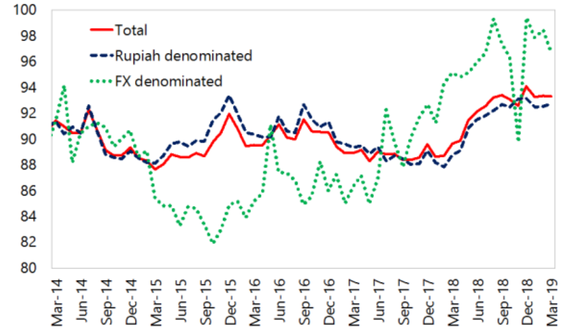
Monetary Aggregates and Loan-to-Deposit Ratios
(Contribution to growth, year-on-year)



Sources: CEIC Data Company Ltd; and IMF staff estimates.

The loan-to-deposit ratio (LDR) has increased in 2018, while the one in FX has recently dropped before recovering.

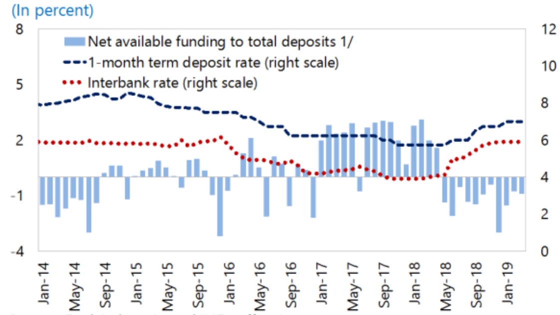
Commercial Bank Loan to Deposit Ratios
(Credit to third parties/deposits from third parties, in percent)



Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

Net available funding has declined in 2018 due to lower capital inflows...

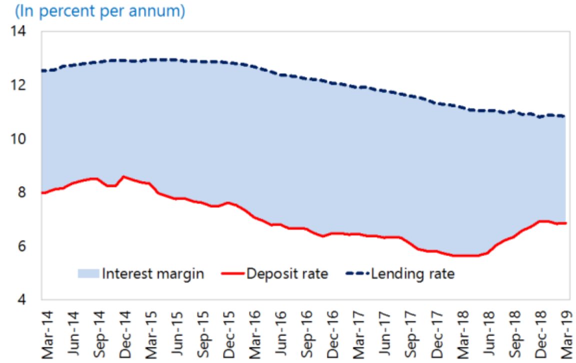
Funding Pressure
(In percent)



Sources: Bank Indonesia; and IMF staff estimates.
1/ Net available funding is defined as third-party funding less third-party credit and statutory reserves.

...and banks' interest margins remain large, despite increases in deposit rates and the decline in lending rates.

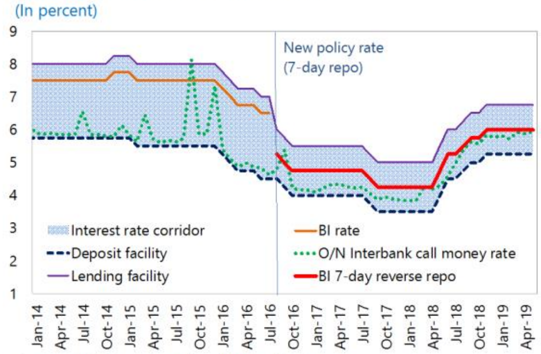
Banking System Interest Margin
(In percent per annum)



Source: Bank Indonesia.

BI increased the policy rate by 175 bps in May-November 2018 in response to external pressures.

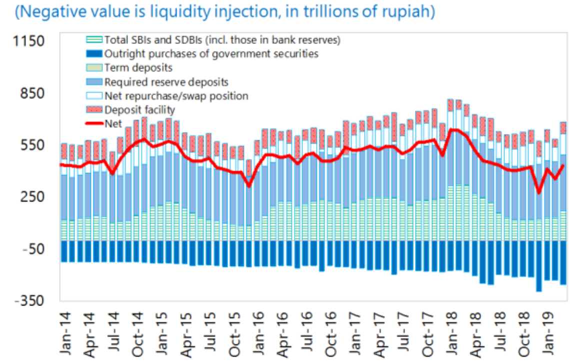
Monetary Policy and Interbank Rates
(In percent)



Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

BI has reduced its liquidity absorption along with the hikes in the policy rates.

Bank Indonesia's Liquidity Absorption by Instrument
(Negative value is liquidity injection, in trillions of rupiah)

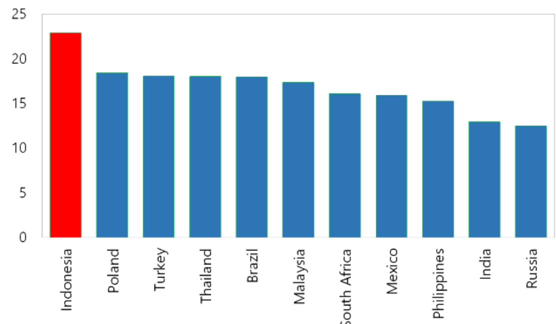


Sources: Bank Indonesia; CEIC Data Co. Ltd; Bloomberg LP; and IMF staff estimates.

Figure 8. Selected Emerging Market Economies: Financial Soundness Indicators, 2018:Q4 1/

Indonesia's banking system is well capitalized compared to other emerging market economies…

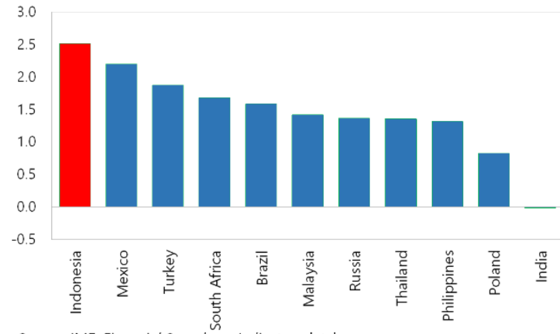
Regulatory Capital to Risk-Weighted Assets
(In percent)



Source: IMF, *Financial Soundness Indicators* database.

…and has a high level of profitability.

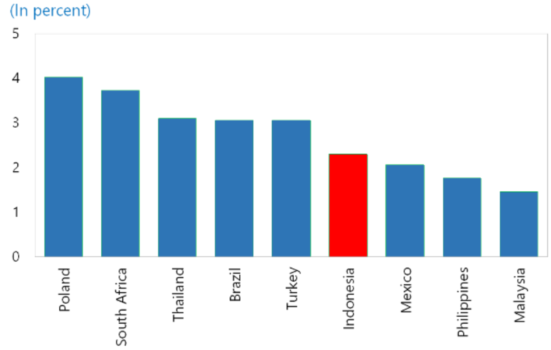
Return on Assets
(In percent)



Source: IMF, *Financial Soundness Indicators* database.

Nonperforming loans have declined in 2018 and remain moderate compared to peers.

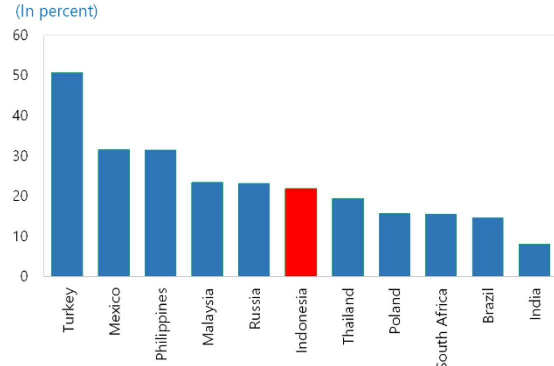
Nonperforming Loans to Total Loans
(In percent)



Source: IMF, *Financial Soundness Indicators* database.

System-wide bank liquidity is ample and around the median for emerging market economies.

Liquid Assets to Total Assets
(In percent)



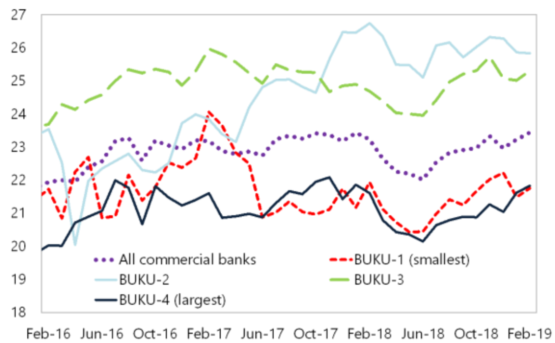
Source: IMF, *Financial Soundness Indicators* database.

1/ Or latest available data.

Figure 9. Indonesia: Financial Soundness Indicators by Size of Commercial Banks

Indonesia's high bank capitalization is broad based, including for small and large banks…

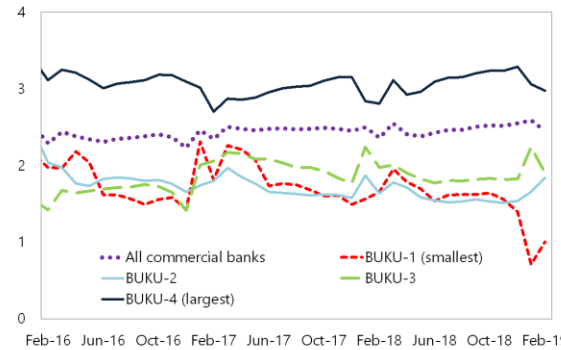
Capital Adequacy Ratio



Sources: Indonesia Financial Services Authority; and IMF staff estimates.

…but profitability is high for the large banks and lower for the smaller ones.

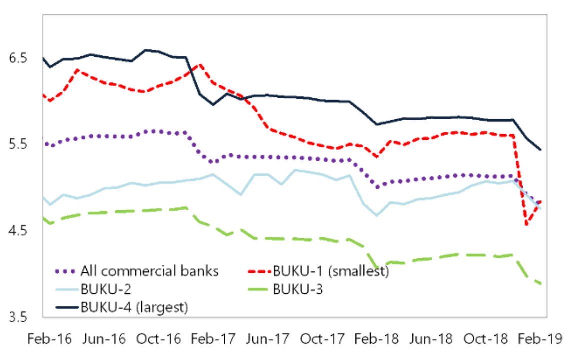
Return on Assets



Sources: Indonesia Financial Services Authority; and IMF staff estimates.

The net interest margin is high for large banks and low for small banks, affecting profitability…

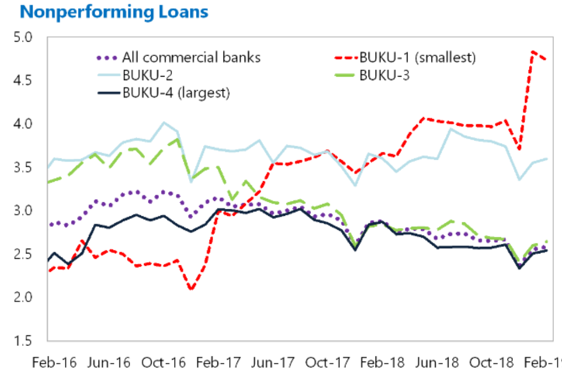
Net Interest Margin



Sources: Indonesia Financial Services Authority; and IMF staff estimates.

…and asset quality is better for large banks than for medium- and small-sized banks.

Nonperforming Loans



Sources: Indonesia Financial Services Authority; and IMF staff estimates.

Table 1. Indonesia: Selected Economic Indicators, 2014–20

Nominal GDP (2018): Rp 14,826 trillion or US$ 1022 billion
Population (2018): 264.2 million
Main exports (percent of total, 2018): coal (13.3), oil and gas (9.6), palm oil (9.2), textile & textile products (7.4)
GDP per capita (2018): US$3,871
Unemployment rate (2018): 5.3 percent
Poverty headcount ratio at national poverty line (Sept. 2018): 9.66 percent of population

	2014	2015	2016	2017	2018	2019 Proj.	2020 Proj.
Real GDP (percent change)	5.0	4.9	5.0	5.1	5.2	5.2	5.2
Domestic demand	5.0	4.2	4.6	5.0	6.3	5.4	5.2
Of which:							
Private consumption 1/	5.3	4.8	5.0	5.0	5.1	5.1	5.1
Government consumption	1.2	5.3	-0.1	2.1	4.8	4.5	4.5
Gross fixed investment	4.4	5.0	4.5	6.2	6.7	6.2	5.9
Change in stocks 2/	0.5	-0.6	0.2	-0.1	0.7	0.0	0.0
Net exports 2/	-0.2	0.9	0.1	0.3	-1.0	-0.1	0.0
Saving and investment (in percent of GDP)							
Gross investment 3/	34.6	34.1	33.9	33.7	34.5	34.7	34.9
Gross national saving	31.5	32.0	32.0	32.1	31.4	31.8	32.0
Prices (12-month percent change)							
Consumer prices (end period)	8.4	3.4	3.0	3.6	3.1	3.1	3.1
Consumer prices (period average)	6.4	6.4	3.5	3.8	3.2	3.1	3.1
Public finances (in percent of GDP)							
General government revenue	16.5	14.9	14.3	14.1	14.9	14.8	14.9
General government expenditure	18.6	17.5	16.8	16.6	16.6	16.7	16.7
Of which: Energy subsidies	3.2	1.0	0.9	0.7	1.0	1.0	1.0
General government balance	-2.1	-2.6	-2.5	-2.5	-1.8	-1.8	-1.8
Primary balance	-0.9	-1.2	-1.0	-0.9	0.0	-0.1	-0.1
General government debt	24.7	27.0	28.0	29.4	30.1	30.2	29.9
Money and credit (12-month percent change; end of period)							
Rupiah M2	13.3	9.2	11.7	9.6	5.8	…	…
Base money	11.6	3.0	4.6	9.7	-1.5	…	…
Private Sector Credit	11.8	10.3	7.7	8.7	12.0	12.3	12.4
One-month interbank rate (period average)	7.5	7.1	6.5	5.6	6.2	…	…
Balance of payments (in billions of U.S. dollars, unless otherwise indicated)							
Current account balance	-27.5	-17.5	-17.0	-16.2	-31.1	-32.4	-34.7
In percent of GDP	-3.1	-2.0	-1.8	-1.6	-3.0	-2.9	-2.9
Trade balance	7.0	14.0	15.3	18.8	-0.4	-4.6	-0.6
Of which: Oil and gas (net)	-11.8	-5.7	-4.8	-7.3	-11.6	-16.2	-17.0
Inward direct investment	21.8	16.6	3.9	20.6	22.0	23.7	27.0
Overall balance	15.2	-1.1	12.1	11.6	-7.1	1.2	2.8
Terms of trade, percent change (excluding oil)	1.4	-1.8	0.4	1.3	1.1	-0.6	-0.1
Gross reserves							
In billions of U.S. dollars (end period)	111.9	105.9	116.4	130.2	120.7	121.9	124.7
In months of prospective imports of goods and services	8.1	8.0	7.6	7.2	6.4	6.0	5.7
As a percent of short-term debt 4/	189	191	213	237	203	185	171
Total external debt 5/							
In billions of U.S. dollars	293.3	310.7	320.0	352.5	376.8	415.0	455.2
In percent of GDP	32.9	36.1	34.3	34.7	36.9	37.7	37.7
Exchange rate							
Rupiah per U.S. dollar (period average)	11,862	13,391	13,306	13,383	14,231	…	…
Rupiah per U.S. dollar (end of period)	12,435	13,788	13,473	13,568	14,390	…	…
Memorandum items:							
Jakarta Stock Exchange (12-month percentage change, composite index)	22.3	-12.1	15.3	20.0	-2.5	…	…
Oil production (thousands of barrels per day)	794	800	820	815	800	740	710
Nominal GDP (in trillions of rupiah)	10,570	11,526	12,402	13,587	14,826	16,047	17,409

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes NPISH consumption.
2/ Contribution to GDP growth (percentage points).
3/ Includes changes in stocks.
4/ Short-term debt on a remaining maturity basis.
5/ Public and private external debt.

Table 2. Indonesia: Selected Vulnerability Indicators, 2014–18

	2014	2015	2016	2017	2018
Key economic and market indicators					
Real GDP growth (in percent)	5.0	4.9	5.0	5.1	5.2
CPI inflation (in percent, end of period, e.o.p.)	8.4	3.4	3.0	3.6	3.1
Short-term (ST) interest rate (in percent, e.o.p.) 1/	6.6	8.6	7.8	5.5	7.5
Ten-year government bond yield (in percent, e.o.p.)	7.8	8.7	8.0	6.3	8.0
Indonesia EMBI spread (basis points (bps), e.o.p.)	266.0	329.0	237.0	166.0	237.0
Exchange rate (rupiah per U.S. dollar, e.o.p.)	12,435	13,788	13,473	13,568	14,390
External sector					
Current account balance (in percent of GDP)	-3.1	-2.0	-1.8	-1.6	-3.0
Net FDI inflows (in percent of GDP)	1.7	1.2	1.7	1.8	1.4
Exports of goods and nonfactor services (GNFS) (percentage change, in US$ terms)	-3.0	-13.8	-2.1	15.7	7.4
Real effective exchange rate (e.o.p.; 2010=100)	92.4	91.5	94.2	92.8	90.6
Gross international reserves (in US$ billion)	111.9	105.9	116.4	130.2	120.7
In percent of ST debt at remaining maturity (RM)	188.8	190.9	212.7	237.5	202.6
Total gross external debt (in percent of exports of GNFS)	147.5	181.3	190.7	181.5	180.6
Gross external financing requirement (in US$ billion) 2/	83.8	76.8	72.5	70.9	85.9
Public sector (PS) 3/					
Overall balance (in percent of GDP)	-2.1	-2.6	-2.5	-2.5	-1.8
Primary balance (in percent of GDP)	-0.9	-1.2	-1.0	-0.9	0.0
Gross PS financing requirement (in percent of GDP) 4/	4.4	4.2	4.2	3.7	4.6
Public sector gross debt (PSGD) (in percent of GDP)	24.7	27.0	28.0	29.4	30.1
Of which : Exposed to rollover risk (in percent of total PSGD) 5/	7.4	8.3	6.3	9.9	10.5
Exposed to exchange rate risk (in percent of total PSGD) 6/	43.4	43.6	41.8	41.3	41.5
Exposed to interest rate risk (in percent of total PSGD) 7/	4.0	2.8	2.0	1.3	0.8
Financial sector (FS)					
Capital to risk-weighted assets (in percent) 8/	19.6	21.4	22.9	23.2	23.0
Nonperforming loans (in percent of total loans)	2.2	2.5	2.9	2.6	2.4
Foreign currency deposits at commercial banks (in percent of total deposits)	15.9	16.5	14.5	13.8	13.6
Foreign currency loans at commercial banks (in percent of total loans)	15.7	14.3	13.3	13.2	13.6
Government debt held by financial system (percent of total financial system assets)	6.0	7.5	8.4	8.4	8.0
Private sector credit of banking system (annual percentage change)	11.8	10.3	7.7	7.2	8.3

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ One-month Jakarta Interbank offered rate.
2/ Defined as current account deficit, plus amortization on medium- and long-term debt and short-term debt at end of previous period.
3/ Public sector covers central government only.
4/ Overall balance plus debt amortization.
5/ Short-term debt and maturing medium- and long-term debt.
6/ Debt in foreign currency or linked to the exchange rate.
7/ Government securities at variable interest rates.
8/ Includes capital charge for operational risk.

Table 3. Indonesia: Balance of Payments, 2014–20

(In billions of U.S. dollar, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019 Proj.	2020 Proj.
Current account	-27.5	-17.5	-17.0	-16.2	-31.1	-32.4	-34.7
Goods, net (trade balance)	7.0	14.0	15.3	18.8	-0.4	-4.6	-0.6
Exports, f.o.b.	175.3	149.1	144.5	168.9	180.7	184.2	202.5
Oil and gas	28.8	17.2	12.9	15.6	17.6	13.0	13.3
Non-oil and gas 1/	146.5	131.9	131.6	153.3	163.1	171.2	189.2
Of which : Manufacturing	115.4	104.8	105.9	120.6	125.2	133.5	150.0
Palm oil	17.5	15.4	14.4	18.5	16.5	16.6	17.5
Rubber products	7.0	5.8	5.5	7.2	6.1	7.1	7.5
Other manufacturing	91.0	83.5	86.0	94.9	102.5	109.8	125.0
Mining	21.8	19.5	18.2	23.9	29.3	28.7	29.7
Imports, f.o.b.	-168.3	-135.1	-129.2	-150.1	-181.2	-188.9	-203.1
Oil and gas	-40.6	-22.9	-17.7	-22.9	-29.2	-29.3	-30.3
Non-oil and gas	-127.7	-112.2	-111.5	-127.1	-151.9	-159.6	-172.8
Services, net	-10.0	-8.7	-7.1	-7.4	-7.1	-8.6	-9.9
Income, net	-29.7	-28.4	-29.6	-32.1	-30.4	-27.7	-33.1
Current transfers, net	5.2	5.5	4.5	4.5	6.9	8.5	8.9
Capital and financial account	44.9	16.9	29.6	28.7	25.2	33.6	37.5
Capital account	0.0	0.0	0.0	0.0	0.1	0.0	0.1
Financial account	44.9	16.8	29.6	28.7	25.1	33.6	37.4
Direct investment, net 2/	14.7	10.7	16.1	18.5	13.8	15.2	17.8
Abroad, net	-7.1	-5.9	12.2	-2.1	-8.1	-8.5	-9.2
In Indonesia (FDI), net	21.8	16.6	3.9	20.6	22.0	23.7	27.0
Portfolio investment, net	26.1	16.2	19.0	21.1	9.3	14.2	16.3
Assets, net	2.6	-1.3	2.2	-3.4	-5.2	-4.6	-3.7
Liabilities	23.5	17.5	16.8	24.4	14.5	18.9	20.0
Equity securities	3.3	-1.5	1.3	-2.5	-3.7	-2.0	-1.1
Debt securities	20.2	19.0	15.5	27.0	18.2	20.8	21.1
Other investment	4.3	-10.1	-5.5	-10.7	2.0	4.2	3.3
Assets	-3.4	-11.8	1.8	-13.5	-9.2	-6.5	-7.1
Public sector	0.0	0.0	-0.3	0.0	0.0	0.0	0.0
Private sector	-3.4	-11.8	1.8	-13.5	-9.2	-6.5	-7.1
Liabilities	7.7	1.7	-7.3	2.7	11.2	10.7	10.4
Public sector	-4.2	-0.2	-2.4	-1.4	-1.0	-2.3	-2.9
Private sector	11.9	1.9	-4.9	4.1	12.2	13.0	13.3
Total	17.4	-0.7	12.7	12.5	-5.9	1.2	2.8
Errors and omissions	-2.2	-0.4	-0.3	-1.0	-1.3	0.0	0.0
Overall balance	15.2	-1.1	12.4	11.6	-7.1	1.2	2.8
Valuation changes	-2.8	-4.8	-1.9	2.2	-2.4	0.0	0.0
Change in reserve assets (- = increase)	-12.5	5.9	-10.4	-13.8	9.5	-1.2	-2.8
Memorandum items:							
Reserve assets position (eop)	111.9	105.9	116.4	130.2	120.7	121.9	124.7
In months of prospective imports of goods and services	8.1	8.0	7.6	7.2	6.4	6.0	5.7
In percent of short-term (ST) debt at remaining maturity (RM)	189	191	213	237	203	185	171
In percent of ST debt at RM plus the current account deficit	146	146	164	152	131	121	115
Current account (- deficit, percent of GDP)	-3.1	-2.0	-1.8	-1.6	-3.0	-2.9	-2.9
Non-oil and gas exports, volume growth	-0.9	-5.5	4.8	14.5	3.3	4.8	10.3
Non-oil and gas imports, volume growth	-1.3	0.6	5.1	9.5	14.7	5.4	7.9
Terms of trade, percent change (excluding oil)	1.4	-1.8	0.4	1.3	1.1	-0.6	-0.1
Terms of trade, percent change (including oil)	1.2	0.6	1.5	0.3	-3.4	0.2	0.4
Gross external financing requirement (in US$ billion) 3/	83.8	76.8	72.5	70.9	85.9	91.9	100.7

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes "other exports" category.
2/ FDI developments in 2016 reflected some one-off transactions associated with the tax amnesty program.
3/ Defined as current account deficit, plus amortization on medium- and long-term debt and short-term debt at end of previous period.

Table 4. Indonesia: Medium-Term Macroeconomic Framework, 2017–24

	2017	2018	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
Real GDP (percent change)	5.1	5.2	5.2	5.2	5.2	5.3	5.3	5.3
Domestic demand	5.0	6.3	5.4	5.2	5.2	5.3	5.3	5.3
Of which:								
Private consumption 1/	5.0	5.1	5.1	5.1	5.1	5.1	5.1	5.1
Government Consumption	2.1	4.8	4.5	4.5	4.5	4.0	4.0	4.0
Gross fixed investment	6.2	6.7	6.2	5.9	5.8	6.0	6.0	6.0
Net exports 2/	0.3	-1.0	-0.1	0.0	0.1	0.1	0.2	0.2
Output gap	-0.5	-0.3	-0.2	-0.1	0.0	0.0	0.0	0.0
Prices (12-month percent change)								
Consumer prices (end period)	3.6	3.1	3.1	3.1	3.1	3.0	3.0	3.0
Consumer prices (period average)	3.8	3.2	3.1	3.1	3.1	3.1	3.0	3.0
Public finances (percent of GDP)								
General government revenue	14.1	14.9	14.8	14.9	14.9	14.9	14.9	15.0
General government expenditure	16.6	16.6	16.7	16.7	16.8	16.8	16.8	16.8
General government balance	-2.5	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
General government primary balance	-0.9	0.0	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3
General government debt	29.4	30.1	30.2	29.9	29.9	29.8	29.7	29.5
Balance of payments (billions of U.S. dollars)								
Current account balance	-16.2	-31.1	-31.7	-34.0	-34.7	-36.6	-38.7	-41.5
In percent of GDP	-1.6	-3.0	-2.9	-2.8	-2.7	-2.6	-2.6	-2.6
Trade balance	18.8	-0.4	-4.6	-0.6	2.4	6.9	11.3	11.3
In percent of GDP	1.9	0.0	-0.4	0.0	0.2	0.5	0.8	0.7
Of which : Oil and gas (net)	-7.3	-11.6	-16.3	-17.0	-18.6	-21.2	-24.9	-32.5
Service balance (percent of GDP)	-0.7	-0.7	-0.8	-0.8	-0.9	-0.9	-0.9	-0.9
Overall balance	11.6	-7.1	1.6	3.1	8.5	10.0	9.4	10.8
Gross reserves								
In billions of U.S. dollars (end period)	130.2	120.7	122.2	125.3	133.8	143.8	153.3	164.1
In months of prospective imports	7.2	6.4	6.0	5.8	5.8	5.9	6.2	7.3
As a percent of short-term debt 3/	237.5	202.6	185.3	172.2	167.9	165.7	163.0	160.8
Total external debt								
In billions of U.S. dollars	352.5	376.8	414.8	454.9	496.1	537.4	578.9	623.9
In percent of GDP	34.7	36.9	37.7	37.7	38.2	38.6	38.8	39.0
Credit								
Private sector credit growth (percent)	8.7	12.0	12.3	12.4	12.5	12.6	12.6	12.5
Credit-to-GDP gap (percent) 4/	-1.3	-1.2	-0.7	-0.3	0.1	0.4	0.8	1.1
Memorandum items:								
Oil production (thousands of barrels per day)	815	800	740	710	707	704	701	698
Indonesian oil price (period average, in U.S. dollars per barrel)	51.2	66.9	64.4	63.0	59.7	57.6	56.6	56.3
Nominal GDP (trillions of rupiah)	13,587	14,826	16,047	17,432	18,885	20,489	22,228	24,113
Nominal GDP (billions of U.S. dollars)	1,015	1,022	…	…	…	…	…	…

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes NPISH consumption.
2/ Contribution to GDP growth.
3/ Short-term debt on a remaining maturity basis.
4/ Follows the guidance of the Basel Committee on Banking Supervision.

Table 5. Indonesia: Summary of Central Government Operations, 2014–20

(In trillions of rupiah)

	2014	2015	2016	2017	2018	2019		2020
					Prel.	Proj.	Budget	Proj.
Revenues and grants	1,550	1,508	1,556	1,666	1,942	2,093	2,165	2,287
Of which: tax revenues	1,147	1,240	1,285	1,344	1,521	1,684	1,786	1,855
Oil and gas revenues	304	128	81	132	208	160	226	156
Tax revenues	87	50	36	50	65	52	66	51
Nontax revenues	217	78	45	82	143	108	160	105
Non-oil and gas revenues	1,241	1,368	1,466	1,523	1,720	1,918	1,939	2,115
Tax revenues	1,059	1,191	1,249	1,293	1,457	1,632	1,720	1,805
Income tax	459	553	630	596	687	762	828	835
Of which: tax amnesty			114	25	57	0	...	0
VAT	409	424	412	481	538	621	655	698
Other	192	214	207	216	232	250	237	272
Nontax revenues	182	177	217	229	264	286	219	310
Grants	5	12	9	12	14	15	0	16
Expenditure and net lending	1,777	1,808	1,864	2,007	2,202	2,388	2,461	2,604
Current expenditure	958	871	935	1,001	1,176	1,263	1,353	1,374
Personnel	244	281	305	313	347	379	381	415
Subsidies	392	186	174	166	217	223	224	247
Of which: energy subsidies	342	119	107	98	154	154	160	173
Fuel	240	61	44	47	97	104	101	110
Electricity	102	58	63	51	57	50	59	63
Interest	133	156	183	217	258	278	276	296
Other	189	248	273	306	354	383	472	416
Development expenditure	245	314	219	264	269	305	281	340
Capital spending	147	217	169	209	185	203	179	229
Social assistance spending 1/	98	97	50	55	84	102	102	111
Transfers to local governments	574	623	710	742	758	820	827	890
Of which: transfers for infrastructure 2/	32	39	101	239	248	268	270	291
Overall balance	-227	-300	-308	-341	-260	-295	-296	-317
Financing	227	300	308	341	260	295	296	317
Net issuance of government securities	274	367	408	442	358	396	389	425
Program and project loans (net)	-12	15	-11	-13	-1	-30	60	-38
SOE recapitalization and land acquisition	...	-60	-91	-60	-66	-65	-76	-65
Other	-35	-23	2	-28	-32	-6	-77	-6

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Some social assistance spending was reclassified to other expenditure in 2016.

2/ Special purpose transfers (DAK) for physical infrastructure and Village Fund transfers. Starting 2017, 25 percent of general transfer and revenue sharing is included.

Table 6. Indonesia: Summary of Central Government Operations, 2014–20

(In percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019		2020
					Prel.	Proj.	Budget	Proj.
Revenues and grants	14.7	13.1	12.5	12.3	13.1	13.0	13.4	13.1
Of which: tax revenues	10.9	10.8	10.4	9.9	10.3	10.5	11.1	10.7
Oil and gas revenues	2.9	1.1	0.7	1.0	1.4	1.0	1.4	0.9
Tax revenues	0.8	0.4	0.3	0.4	0.4	0.3	0.4	0.3
Nontax revenues	2.1	0.7	0.4	0.6	1.0	0.7	1.0	0.6
Non-oil and gas revenues	11.7	11.9	11.8	11.2	11.6	12.0	12.0	12.1
Tax revenues	10.0	10.3	10.1	9.5	9.8	10.2	10.7	10.4
Income tax	4.3	4.8	5.1	4.4	4.6	4.7	5.1	4.8
Of which: tax amnesty	…	…	0.9	0.2	…	…	…	…
VAT	3.9	3.7	3.3	3.5	3.6	3.9	4.1	4.0
Other	1.8	1.9	1.7	1.6	1.6	1.6	1.5	1.6
Nontax revenues	1.7	1.5	1.8	1.7	1.8	1.8	1.4	1.8
Grants	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.1
Expenditure and net lending	16.8	15.7	15.0	14.8	14.9	14.9	15.3	15.0
Current expenditure	9.1	7.6	7.5	7.4	7.9	7.9	8.4	7.9
Personnel	2.3	2.4	2.5	2.3	2.3	2.4	2.4	2.4
Subsidies	3.7	1.6	1.4	1.2	1.5	1.4	1.4	1.4
Of which: energy subsidies	3.2	1.0	0.9	0.7	1.0	1.0	1.0	1.0
Fuel	2.3	0.5	0.4	0.3	0.7	0.6	0.6	0.6
Electricity	1.0	0.5	0.5	0.4	0.4	0.3	0.4	0.4
Interest	1.3	1.4	1.5	1.6	1.7	1.7	1.7	1.7
Other	1.8	2.1	2.2	2.2	2.4	2.4	2.9	2.4
Development expenditure	2.3	2.7	1.8	1.9	1.8	1.9	1.7	2.0
Capital spending	1.4	1.9	1.4	1.5	1.2	1.3	1.1	1.3
Social assistance spending 1/	0.9	0.8	0.4	0.4	0.6	0.6	0.6	0.6
Transfers to local governments	5.4	5.4	5.7	5.5	5.1	5.1	5.1	5.1
Of which: transfers for infrastructure 2/	0.3	0.3	0.8	1.8	1.7	1.7	1.7	1.7
Overall balance	-2.1	-2.6	-2.5	-2.5	-1.8	-1.8	-1.8	-1.8
Financing	2.1	2.6	2.5	2.5	1.8	1.8	1.8	1.8
Memorandum items:								
Net issuance of government securities (in trillions of rupiah)	274	367	408	442	358	396	389	425
SOE recapitalization and land acquisition (in trillions of rupiah)	…	65	91	60	66	65	76	76
Primary balance (percent of GDP)	-0.9	-1.2	-1.0	-0.9	0.0	-0.1	-0.1	-0.1
Cyclically-adjusted primary balance (percent of GDP)	-1.0	-1.3	-1.0	-0.8	0.0	-0.1	…	-0.1
Capital spending and transfers (percent of GDP) 3/	1.7	2.2	2.2	3.3	2.9	2.9	2.8	3.0
General government debt (percent of GDP)	24.7	27.0	28.0	29.4	30.1	30.2	…	29.9
Indonesian crude oil price (US$ per barrel)	96.5	49.2	40.2	51.2	66.9	64.4	70	63.0
Oil production (thousands of barrels per day)	794	800	820	815	800	740	775	710
Nominal GDP (in trillions of rupiah)	10,570	11,526	12,402	13,587	14,826	16,047	16,125	17,409

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Some social assistance spending was reclassified to other expenditure in 2016.

2/ Special purpose transfers (DAK) for physical infrastructure and Village Fund transfers. Starting 2017, 25 percent of general transfer and revenue sharing is included.

3/ Sum of capital spending and transfers for infrastructure.

Table 7. Indonesia: Summary of General Government Operations, 2014–20

	2014	2015	2016	2017	2018 Prel.	2019 Proj.	2020 Proj.
				(In trillions of rupiah)			
Total revenue and grants	1,740	1,715	1,778	1,910	2,208	2,381	2,599
Taxes	1,274	1,379	1,434	1,506	1,699	1,877	2,064
Taxes on income, profits, and capital gains	546	602	666	647	752	814	885
Taxes on goods and services	527	568	556	634	698	794	888
VAT and luxury taxes	409	424	412	481	538	621	698
Excise	118	145	144	153	160	173	190
Taxes on international trade and transactions	44	35	35	39	46	49	53
Taxes not elsewhere classified	157	173	176	186	204	220	238
Grants	5	12	9	12	14	15	16
Other revenue	461	324	335	392	495	489	518
Total expenditure	1,967	2,015	2,086	2,251	2,468	2,676	2,916
Expense	1,642	1,605	1,645	1,735	1,938	2,088	2,257
Of which :							
Compensation of employees	564	630	681	724	796	865	943
Purchases/use of goods and services	177	233	260	291	337	365	396
Interest	133	156	183	217	258	278	296
Energy subsidies	342	119	107	98	154	154	173
Social benefit	110	112	68	79	112	136	151
Net acquisition of nonfinancial assets	324	410	441	516	530	588	659
Net lending/borrowing	-227	-300	-308	-341	-260	-295	-317
Net acquisition of financial assets	35	82	89	61	41	71	71
Of which : policy lending	3	3	5	0	0	0	0
Net incurrence of liabilities	262	382	397	402	300	366	388
				(In percent of GDP)			
Total revenue and grants	16.5	14.9	14.3	14.1	14.9	14.8	14.9
Taxes	12.0	12.0	11.6	11.1	11.5	11.7	11.9
Taxes on income, profits, and capital gains	5.2	5.2	5.4	4.8	5.1	5.1	5.1
Taxes on goods and services	5.0	4.9	4.5	4.7	4.7	4.9	5.1
VAT and luxury taxes	3.9	3.7	3.3	3.5	3.6	3.9	4.0
Excise	1.1	1.3	1.2	1.1	1.1	1.1	1.1
Taxes on international trade and transactions	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Taxes not elsewhere classified	1.5	1.5	1.4	1.4	1.4	1.4	1.4
Grants	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	4.4	2.8	2.7	2.9	3.3	3.0	3.0
Total expenditure	18.6	17.5	16.8	16.6	16.6	16.7	16.7
Expense	15.5	13.9	13.3	12.8	13.1	13.0	13.0
Of which :							
Compensation of employees	5.3	5.5	5.5	5.3	5.4	5.4	5.4
Purchases/use of goods and services	1.7	2.0	2.1	2.1	2.3	2.3	2.3
Interest	1.3	1.4	1.5	1.6	1.7	1.7	1.7
Energy subsidies	3.2	1.0	0.9	0.7	1.0	1.0	1.0
Social benefit	1.0	1.0	0.6	0.6	0.8	0.8	0.9
Net acquisition of nonfinancial assets	3.1	3.6	3.6	3.8	3.6	3.7	3.8
Net lending/borrowing	-2.1	-2.6	-2.5	-2.5	-1.8	-1.8	-1.8
Net acquisition of financial assets	0.3	0.7	0.7	0.4	0.3	0.4	0.4
Of which : policy lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	2.5	3.3	3.2	3.0	2.0	2.3	2.2
Memorandum items:							
General government debt (In percent of GDP)	24.7	27.0	28.0	29.4	30.1	30.2	29.9
Nominal GDP (In trillions of rupiah)	10,570	11,526	12,402	13,587	14,826	16,047	17,409

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

Table 8. Indonesia: Monetary Survey, 2014–18

(In trillions of rupiah, unless otherwise indicated, end of period)

	2014	2015	2016	2017	2018
Bank Indonesia					
Net foreign assets	1,349	1,385	1,440	1,642	1,616
Net domestic assets	-431	-439	-450	-556	-546
Monetary base	918	946	990	1,086	1,070
Monetary survey					
Net foreign assets	1,104	1,139	1,213	1,456	1,350
Net domestic assets	3,070	3,410	3,792	3,963	4,410
Net claims on central government	520	571	632	635	625
Claims on other nonfinancial public sector	220	224	305	350	485
Private sector credit	3,465	3,822	4,116	4,474	5,011
Other items, net	-1,159	-1,208	-1,262	-1,435	-1,568
Broad money 1/	4,173	4,549	4,861	5,349	5,914
Rupiah M2	3,562	3,889	4,345	4,762	5,036
Currency in circulation	419	470	508	587	625
Deposits	3,143	3,420	3,837	4,175	4,411
Foreign currency deposits	590	646	647	639	703
Annual percentage change:					
Broad money	11.9	9.0	6.9	10.0	10.6
Rupiah M2	13.3	9.2	11.7	9.6	5.8
Monetary base	11.6	3.0	4.6	9.7	-1.5
Private sector credit	11.8	10.3	7.7	8.7	12.0
Memorandum items:					
Money multiplier (rupiah M2)	4.0	4.2	4.4	4.5	4.7
Base money velocity 2/	11.5	12.2	12.5	12.5	13.9
Rupiah M2 velocity 2/	3.0	3.0	2.9	2.9	2.9
Credit by borrower (annual percentage change)					
Corporate	12.1	11.8	8.3	6.8	14.3
Non-corporate	10.9	8.4	7.6	9.5	9.0
Credit by sector (annual percentage change)					
Agriculture	19.1	19.8	12.1	11.5	11.8
Mining	11.7	-8.0	-9.2	-11.6	19.4
Manufacturing	14.0	14.3	2.1	4.9	9.4
Services	9.5	9.3	10.1	8.4	13.1
Household	11.8	9.1	8.9	11.0	10.3

Sources: Bank Indonesia; and IMF, *International Financial Statistics;* and staff projections.

1/ Includes securities classified as broad money.
2/ Calculated using end-period quarterly GDP, annualized.

Table 9. Indonesia: Financial Soundness Indicators, 2014–18

(In percent; unless otherwise indicated)

	2014	2015	2016	2017	2018	
					Latest observation	
Depository institutions						
Capital adequacy						
Regulatory capital to risk-weighted assets	19.6	21.4	22.9	23.2	23.0	Q4
Core Tier-1 capital to risk-weighted assets	18.0	19.0	21.2	21.5	21.3	Q4
Capital to assets	12.8	13.6	14.4	15.2	15.1	Q4
Large exposures to capital	1.0	0.4	0.5	0.4	0.4	Q4
Asset quality						
Nonperforming loans to total gross loans	2.1	2.4	2.9	2.6	2.3	Q4
Nonperforming loans, net of provisions to capital	5.5	5.9	5.7	5.0	4.4	Q4
Specific provisions to nonperforming loans	46.8	51.5	57.8	55.2	57.6	Q4
Earning and profitability						
Return on assets	2.7	2.2	2.1	2.4	2.5	Q4
Return on equity	21.3	17.3	14.5	15.8	16.7	Q4
Interest margin to gross income	69.0	70.3	68.0	69.3	69.8	Q4
Trading income to gross income	2.7	2.8	1.2	3.8	2.7	Q4
Noninterest expenses to gross income	50.3	50.0	46.6	49.7	48.1	Q4
Personnel expenses to noninterest expenses	40.4	40.7	41.8	40.7	41.9	Q4
Liquidity and funding						
Liquid assets to total assets	22.9	23.9	22.4	21.7	21.9	Q4
Liquid assets to short-term liabilities	33.3	35.0	32.6	31.7	32.0	Q4
Non-interbank loans to customer deposits	99.2	100.7	96.3	96.4	102.2	Q4
Sensitivity to market risk						
Net open position in foreign exchange to capital	2.4	0.9	1.8	1.6	1.7	Q4
Foreign currency denominated loans to total loans	15.7	14.3	13.3	13.2	13.6	Q4
Foreign currency denominated liabilities to total liabilities	22.9	24.1	20.9	19.3	20.0	Q4
Gross asset position in financial derivatives to capital	2.4	2.5	1.4	0.7	1.8	Q4
Gross liability position in financial derivatives to capital	2.6	3.3	1.5	0.6	2.2	Q4
Nonfinancial corporates						
Corporate debt (in percent of GDP)	41.5	43.0	40.0	39.6	41.5	Q4
Leverage						
Total liabilities to total assets	48.5	44.5	44.3	45.1	44.0	Q4
Profitability 1/						
Return on assets	14.1	13.9	13.7	14.4	14.4	Q4
Liquidity 1/						
Current assets to current liabilities	280.1	261.7	220.9	226.6	216.0	Q4
Liquid assets to current liabilities	204.7	125.2	114.0	122.8	127.1	Q4
Debt servicing capacity						
Companies with negative equity (in percent of total assets)	5.4	2.6	2.8	1.9	0.6	Q4
Companies with financial distress (in percent of total) 2/	5.5	4.5	6.1	6.2	4.1	Q4
Households						
Household debt (in percent of GDP)	17.1	16.8	17.0	17.0	17.0	Q3
Real estate markets						
Residential real estate prices (year-on-year percentage change)	6.3	4.6	2.4	3.5	3.0	Q4
Residential real estate loans to total loans	8.2	8.2	8.3	8.5	8.5	Q4
Commercial real estate loans to total loans	6.8	7.4	8.5	8.9	9.1	Q4

Sources: Bloomberg L.P.; IMF, *Financial Soundness Indicators*; Bank for International Settlements; CEIC Data Co. Ltd.; and IMF staff estimates.

1/ Based on capitalization-weighted average of listed companies.

2/ Companies with financial distress are those with earnings before interest, tax, depreciation and amortization (EBIT) less than interest payments.

Table 10. Indonesia: Key Poverty and Social Indicators

Population	265.0	millions	(2018)
Life expectancy at birth, total	69.2	years	(2016)
Mortality rate, under 5	25.4	per 1,000 live births	(2017)
Secondary school enrollment:			
Total	87.8	percent	(2017)
Female	89.1	percent	(2017)
Male	86.5	percent	(2017)
GINI index	38.4		(2018)
Income share held by highest 20%	45.2	percent	(2017)
Income share held by lowest 20%	6.8	percent	(2017)
Poverty rate	9.7	percent	(2018)
CO2 emissions	1.8	metric tons per capita	(2014)
Population with basic drinking water	89.5	percent	(2015)
Population with basic sanitation	67.9	percent	(2015)
Human development index	0.69		(2017)
Rank	116		
Gender inequality index	0.45		(2017)
Rank	104		

Sources: World Bank; Badan Pusat Statistik; and United Nations Development Programme.

Table 11. Indonesia: Key FSAP Recommendations

Key Recommendations	Authorities' Actions
Institutional and legal arrangements	
Revise OJK Law to give primacy to objective of safeguarding stability, BI Law to include a financial stability and macroprudential policy mandate focused on systemic risk of the financial system, with access to data; and LPS Law to focus objectives on the maintenance of financial stability, continuity of critical functions, protection of insured deposits, and minimization of resolution costs.	The authorities have held several discussions with the Parliament on the amendment of relevant laws. A draft bill amending the BI Law is included in the 2015-19 National Legislation Program. The Program also includes an initiative to amend the OJK Law.
Amend the Insurance Law to specify policyholder protection as principal objective of OJK.	The authorities have initiated discussions regarding this issue with related parties, will include it in the amendment of the Insurance Law and propose this issue to the Parliament.
Strengthen legal protection of supervisors and officials of all agencies involved in financial oversight and crisis management in line with global standards.	The authorities have incorporated this issue in the discussion material with the Parliament. OJK will also put the legal protection on cases related to supervisory duties in the draft amendment of OJK Law.
Systemic risk monitoring and prudential policy	
Introduce a foreign currency liquidity coverage ratio.	OJK has been imposing LCR based on significant currencies as a monitoring tool, compliant with the Basel LCR standards, but does not have a plan to introduce it as a regulatory requirement.
Strengthen BI's capacity for systemic risk analysis and macroprudential stress tests, and OJK's capacity for regulatory stress tests; OJK should do bottom-up stress tests for D-SIBs regularly.	OJK has implemented the annual bottom-up stress tests for D-SIBs and other large banks. BI and OJK have established a framework for a joint stress test and data sharing. The authorities continue to improve their stress test framework, supported by the IMF technical assistance.
Financial sector oversight	
Reduce OJK's silo structure, including by revising the OJK Law to remove the responsibilities of individual Commissioners for the supervision of specific sectors.	To advance on the recommendation to reduce silos in financial oversight, which ultimately requires changes to the OJK Law, OJK has enhanced the internal coordination: Chief executives of all sectors meet and coordinate through Committee Meetings.
Strengthen the banking supervisory approach and continue enhancing supervisory practices for FCs.	OJK has put integrated supervision of financial conglomerate (FC) and the coordination among chief executives as primary agendas. As the majority of FCs is led by banks, bank supervisors play a leading role in the supervision of FCs. However, OJK reversed the establishment of the Integrated Supervisory and Regulatory Department which brought internal coordination for the conglomerate supervision directly under the authority of the Chairman.
Further strengthen the enforcement of credit and risk management regulations.	OJK has set up Risk Management Working Group and put the enforcement of credit and risk management regulations as priority for the related departments.
Revise the insurance supervisory framework (three strikes-approach) to allow prompt actions.	OJK has issued a regulation concerning the imposition of administrative sanctions in the form of revocation of business license without prior imposition of other administrative sanctions in cases where there is a drastic deterioration of financial conditions, shareholders are not cooperative, and there is no way of solving the problems that endanger the interests of policyholders, the insured, or the participants.
Governance of financial conglomerates (FCs)	
Strengthen corporate governance practices within the financial system, including the BoC's oversight roles and responsibilities.	OJK has issued a regulation that set the general principle of governance to be adopted by FCs, specifically roles of the BoC of the lead entity of FCs.
Introduce legal provisions for licensed non-operating financial holding companies.	OJK is working together with MoF to achieve the broadening of authority toward holding companies. New articles have been proposed to be incorporated into the amendment of OJK law, stipulating OJK's authority to license and oversee non-operating financial holding companies.
Crisis management and resolution, and safety nets	
Revise the PPKSK Law to clarify the role of the KSSK as solely a coordination body; limit the involvement of the President to approving public funding.	Given the lengthy protocols entailed and potential political interests involved in an amendment of the Law, the authorities are carefully evaluating the best option to achieve the desired outcomes.
Adjust the emergency liquidity assistance framework to ensure it is effective.	The current ELA framework is in accordance with the legal basis governed under the PPKSK Law, any proposed amendment to the current framework should be based on the underlying legal basis. The authorities are carefully evaluating the best option to achieve the desired outcomes.
Amend the relevant laws to ensure that resolution powers can be exercised over FCs.	The authorities have initiated discussions regarding this issue and LPS is considering this issue in the enhancement of resolution.
Develop resolution options and implementation guidelines for banks, and resolvability assessment and resolution planning frameworks for D-SIBs.	LPS, OJK, and BI have established a working group on resolution plan and resolvability assessment. LPS is developing a comprehensive resolution framework that sets out guidance on the selection and implementation of resolution options, supported by the IMF technical assistance
Financial integrity	
Integrate key ML/TF risks in the priorities and operations of relevant agencies.	The National Committee for the Prevention and Eradication of Money Laundering has established a national AML/CFT strategy which covers the priorities and operations of related authorities.
Finalize and implement risk-based AML/CFT supervisory tools.	BI and OJK have published regulations related to risk-based AML/CFT supervisory tools, supported by the IMF technical assistance. Based on Indonesia's Mutual Evaluation Report (MER), published in September 2018 by the Asia Pacific Group, OJK is assessed as adequate in its regulation and implementation based on AML/CFT international standards.
Financial deepening and inclusion	
Develop an integrated roadmap for promoting financial deepening and inclusion.	The authorities have published the 2018-2024 National Strategy for Financial Market Development in 2018.
Enhance bond yield curve by consolidating debt issuance and improving secondary markets.	MoF has been implementing strategies to increase the liquidity of its debt instruments, supported by the IMF technical assistance. To develop the secondary bond market, Indonesian Government Bond Futures has been developed to provide hedging for market players.

Table 12. Indonesia: Integrating Fund Surveillance and Capacity Development		
Area	**Surveillance Recommendations**	**Capacity Development Recent Actions/Plans**
Monetary policy and central bank communication	Clear and focused communication on monetary and financial policy is critical, especially during times of financial stress	The Fund will provide technical assistance in 2019 covering communication on monetary policy and financial stability.
Statistics	Use of big data for timely economic monitoring could support prompt policy decision making.	The Fund is providing technical assistance on the use of big data to develop an enhanced residential property price index. The Fund also participated in a pilot project on big data using scanner data to enhance private consumption and consumer price statistics.
Cash management	Improve cash management.	The Fund is providing technical assistance to improve cash management, which could also support monetary policy operations.
Tax Policy and Administration	Implement a medium-term revenue strategy (MTRS) to raise revenue by at least 3 percent of GDP over five years to finance spending on infrastructure, education, and health.	The Fund provided technical assistance in December 2014 to set a strategy, which includes specific recommendations on tax policy and administration reforms.
Public Financial Management	Improve fiscal governance, including infrastructure governance and public investment management.	The Fund conducted Indonesia's PIMA in February 2019, which lists priority actions to improve public investment management.
AML/CFT Regime	Strengthen AML/CFT supervisory regime for the Financial Services.	The Fund is providing technical assistance to strengthen supervisory framework for AML/CFT and capacity for risk-based supervision
Financial sector	Improve financial oversight, crisis management framework, and the monitoring of corporate vulnerabilities.	The Fund is providing technical assistance on strengthening bank and corporate stress testing frameworks and systemic risk analysis

Appendix I. Risk Assessment Matrix 1/

	Source of Risks	Relative Likelihood	Expected Impacts	Recommended Policy Responses
Global	**Rising protectionism and retreat from multilateralism**. In the near term, escalating and sustained trade actions threaten the global trade system, regional integration, as well as global and regional collaboration. Additional barriers and the threat of new actions reduce growth both directly and through adverse confidence effects (increasing financial market volatility). In the medium term, geopolitical competition and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on growth and stability.	**High**	**Low-Medium** Lower exports that widen the current account deficit, combined with a decline in capital inflows will put pressure on the exchange rate and foreign reserves. The balance sheets of the public, financial, and corporate sectors weaken, and domestic financial conditions tighten. Domestic credit growth slows and borrowing costs rise.	Resist protectionism and deepen regional trade integration. Seek new opportunities to enhance position in global value chains. Strengthen domestic drivers of growth by enhancing infrastructure and implementing structural reforms.
Global	**Sharp tightening of global financial conditions**. The tightening could be a result of: (i) market expectation of tighter U.S. monetary policy triggered by strong wage growth and higher-than-expected inflation and (ii) sustained rise in risk premium in reaction to concerns about debt levels in some euro area countries; a disorderly Brexit; or idiosyncratic policy missteps in large emerging markets.	**Low** **Medium**	**High** This causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn. Capital inflows decline due to weaker investor appetite for emerging market (EM) assets, creating funding pressures for the current account (CA) deficit. Tighter external financial conditions put pressure on the balance sheets of the public, financial, and corporate sectors. Bank funding becomes constrained, leading to a crunch in domestic credit growth and higher domestic borrowing costs. Rollover risks rise for the public, financial, and corporate sectors, and the balance sheet of households (including property) weaken. Economic growth falls, reinforced by asset price corrections and lower confidence. Assuming prices are not controlled, the rupiah depreciates and imports decline, reducing the CA deficit.	Maintain exchange rate flexibility and market-determined bond yields. Preserve a sound fiscal position, while allowing automatic stabilizers to work. Tighten monetary policy and support banks facing funding pressures to preserve financial stability and avoid negative feedback loops with capital outflows. Closely monitor corporate sector vulnerabilities. Maintain vigilance on exchange rate pass-through to inflation. Access contingent external financing if needed.
Global	**Weaker-than-expected global growth and China slowdown**. The global growth slowdown could be synchronized as weakening outlooks in the U.S., Europe and China feed off each other and impact on earnings, asset prices and credit performance. In China, in the short term, intensification of trade tensions and/or a housing market downturn prompt a slowdown, which is not fully offset by policy easing. Deleveraging is delayed and financial stresses, including capital outflow and exchange rate pressures, emerge. In the medium term, insufficient progress in deleveraging and rebalancing in China reduces growth and raises the probability of a larger disruptive adjustment.	**Medium**	**High** Lower export volume and prices (particularly those of commodities) could widen the current account deficit, putting FX reserves and the exchange rate under pressure. The fiscal balance would deteriorate on weaker resource revenues and knock-on effects to domestic demand, with the financial sector exposed to losses from loans to the commodity sector and a broader economic slowdown. Corporate profits would decline from weak commodity related activities.	Maintain exchange rate flexibility to help reduce the current account deficit and limit FX reserve losses. More stringent fiscal measures to contain the budget deficit might be necessary if the slowdown in EMs were accompanied by protracted financial market volatility that restricts funding. Accelerate infrastructure spending and structural reforms to boost productivity and employment in non-resource sectors, and export diversification.
Global	**Large swings in energy prices.** Risks to prices are **broadly** balanced, reflecting offsetting—but large and uncertain—supply and demand shocks. In the near term, uncertainty surrounding the shocks translates to elevated price volatility, complicating economic management and adversely affecting investment in the energy sector. As shocks materialize, they may cause large and persistent price swings. While, on aggregate, higher oil prices would harm global growth, they would benefit oil exporters.	**Medium**	**Medium** Through higher uncertainty, large swings in energy prices would negatively impact investment in the sector and could ultimately weaken production and the fiscal position due to lower oil related revenues.	Implement upfront revenue reforms to raise non-oil revenues, and accelerate structural reforms, particularly product market regulations, to boost private investment and productivity.
Domestic	**Natural disasters, such as a large volcano eruption in Bali**, disrupt economic activity and affect sentiment, resulting in higher fiscal expenditure.	**Medium**	**Low** Economic activity in the affected regions is disrupted and business sentiment suffers. Economic growth slows leading to a decline in portfolio inflows. Fiscal expenditure increases to provide disaster relief and for reconstruction.	Implement revenue enhancing reforms and prioritize expenditure to the affected region. If the economy slows significantly, ease monetary policy, provide support to banks, and monitor corporate borrowers at risk.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

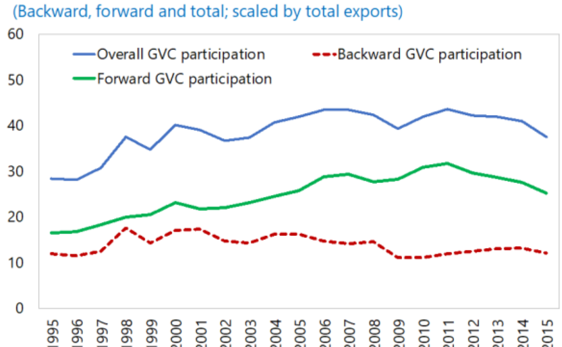
Appendix II. Tariffs Spillovers for Indonesia[1]

Global financial conditions could quickly tighten in response to an escalation of trade tensions, which could have overall negative effects on Indonesia, given the country's heavy reliance on external financing. Focusing on the trade angle exclusively, this note shows that Indonesia could potentially benefit from a contained tariff war between the United States and China as trade diversion could more than offset the negative spillovers along the value chain. The note also highlights the benefits that further trade liberalization among ASEAN countries could bring to all members, including Indonesia.

1. **This appendix illustrates how changes in tariffs, including among other countries, can affect economic activity in Indonesia**. Building on recent work, published in the *April 2019 World Economic Outlook* (WEO), it highlights how Indonesia could be affected by a permanent increase in tariffs, e.g., between the United States and China, and how it could benefit from a further regional trade liberalization.

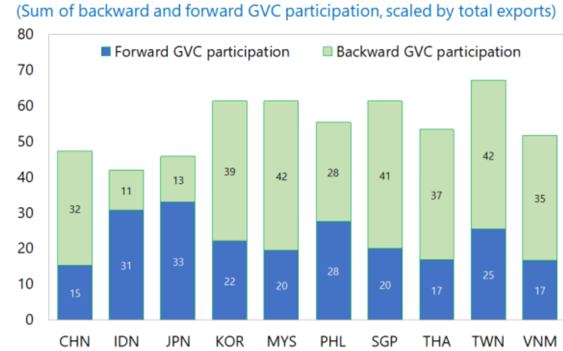
2. **Indonesia has gradually increased its participation in global value chains**. The share of Indonesia's exports that—roughly speaking—crosses two borders has increased from 28 percent in 1995 to 44 percent in 2011, before declining somewhat since then. While the trend in overall GVC participation is similar for many other countries in the region, the composition is not. For Indonesia, forward GVC participation (the exported domestic value added that is reexported by the importer) has recently been more than twice the size of backward participation (imported foreign value added that is re-exported). This suggests that Indonesia is relatively higher up in global value chains and particularly vulnerable to spillovers from further downstream.[2]

GVC Participation
(Backward, forward and total; scaled by total exports)



Sources: OECD TiVA database; and IMF staff estimates.

GVC Participation in 2010
(Sum of backward and forward GVC participation, scaled by total exports)



Sources: OECD TiVA database; and IMF staff estimates.

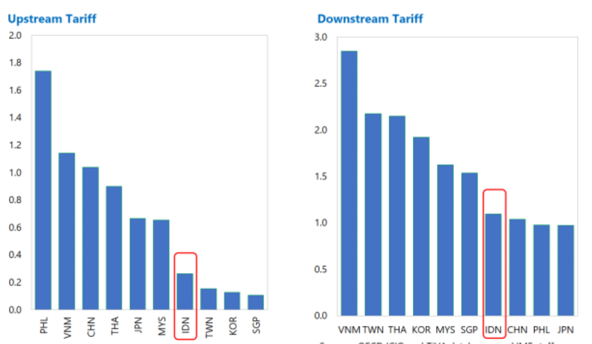
[1] Prepared by Johannes Luzius Eugster (RES).

[2] GVC participation measures are taken from the OECD TiVA database. The data of the 2016 vintage (available for 1995–2011) is extrapolated to 2015 based on the recently released 2018 vintage.

3. Nominal tariffs may affect economic outcomes through various channels, including beyond the country and sector directly targeted. The underlying empirical analysis relies on four measures that capture possible spillovers from tariffs, either vertically up and down the value chain, or horizontally through trade diversion. Specifically, upstream and downstream tariffs capture the average cumulative tariffs applied respectively to the imported intermediate inputs of the sector or its output.[3] The domestic protection tariff captures the average tariff (import-weighted) imposed on imports that compete with the domestic sector's output. Finally, the diversion tariff captures the weighted average tariff that partner countries impose on all other suppliers except the country-sector in question.

4. Indonesia's constructed tariff measures compare favorably to peers but hide substantial sectoral heterogeneity. The moderate reliance on imported intermediate inputs, combined with comparatively lower tariffs imposed on Indonesian imports and exports, lead to relatively lower levels of upstream and downstream tariffs.[4] The sectoral heterogeneity is however large. For example, the effect of tariffs on the cost of intermediate inputs for the local machinery industry is almost three times the manufacturing average. The textile sector on the other hand is by far the most affected by tariffs imposed either directly or indirectly on their output.

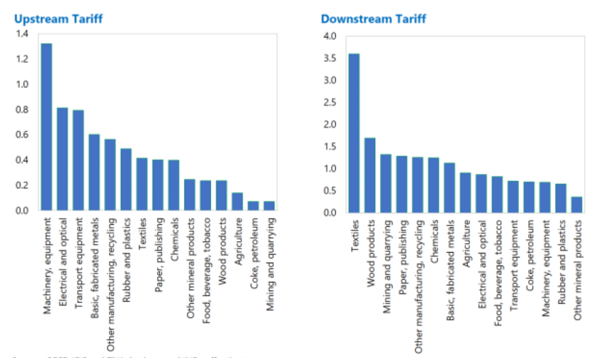
Upstream and Downstream Tariffs by Countries



Sources: OECD ICIO and TiVA databases; and IMF staff estimates.

Sources: OECD ICIO and TiVA databases; and IMF staff estimates.

Upstream and Downstream Tariffs by Sectors in Indonesia



Sources: OECD ICIO and TiVA database; and IMF staff estimates.

Sources: OECD ICIO and TiVA databases; and IMF staff estimates.

5. Regression results show significant tariff spillovers from up and down the value chain, but partly offsetting effects through trade diversion. A sectoral panel regression with country-time and country-industry fixed effects was used to assess the relative importance of the various channels for value added, employment, labor productivity and total factor productivity. Upstream and downstream tariffs are generally negative and significant, while the diversion tariff is positive

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[3] The cumulative tariffs are constructed based on the 2016 vintage of the OECD inter-country input-output tables (ICIO), covering 31 sectors (Isic 3) and 63 countries. Averages for domestic protection and the diversion tariff are based on simple trade weights from the OECD TiVA database.

[4] Indonesia also has numerous non-tariff barriers to trade.

and significant for output and employment. Given the rich set of fixed effects, the estimations capture partial equilibrium effects and likely amplify the effects at the country level, as the fixed effects absorb attenuating reactions stemming from the exchange rate, the interest rates, or wages.[5]

6. Two simulations help illustrate the economic significance of tariff spillovers. A first simulation looks at how a reciprocal tariff hike between China and the United States could affect Indonesia and other countries in the region. A second simulation studies the effect of a significant reduction in tariffs among ASEAN countries.[6]

7. Focusing only on the trade channels, Indonesia could potentially benefit from a contained tariff war between the United States and China, similarly to many countries in the region. The effects of trade diversion tend to more than offset the negative spillovers along the value chain. The net positive effect for Indonesia is in part due to the country relatively moderate ties to China's export industry. Looking at the sectoral differences, the net effects are most likely to be positive for the textile, paper and electrical sectors, which compete more directly with Chinese exports. The net effects tend to be more negative for sectors where Indonesia is higher up in relatively long value chains such as basic metals, motor vehicles and transport equipment.[7]

8. Important channels such as the exchange rate and the interest rate, which tend to react to confidence shocks, are likely to make tariff wars more disruptive than illustrated above. Recent market reactions to heightened trade tensions have shown that global financial conditions can tighten quickly in response to an escalation of trade tensions. The ensuing negative effects could be more widespread and surpass the positive pure trade channel as illustrated in Chapter 1 of the IMF's *October 2018 World Economic Outlook*. In particular, general equilibrium effects (for instance through wages, interest rates, and exchange rates) could reduce or more than offset the positive trade channel effect of tariff increases. Aggregate long-run results, as presented above, can also hide sectoral disruptions that can create stress in regional and sectoral markets, especially when there is no perfect mobility of workers across sectors and regions.

9. Trade liberalization in the region could benefit all countries involved, including Indonesia. Trade diversion, which tends to offset the spillovers through the value chain, are much less relevant in a scenario where ASEAN countries cut tariff on regional imports (for instance by half in this simulation).[8] Accordingly, the net effects of tariff reduction are positive for all countries, as

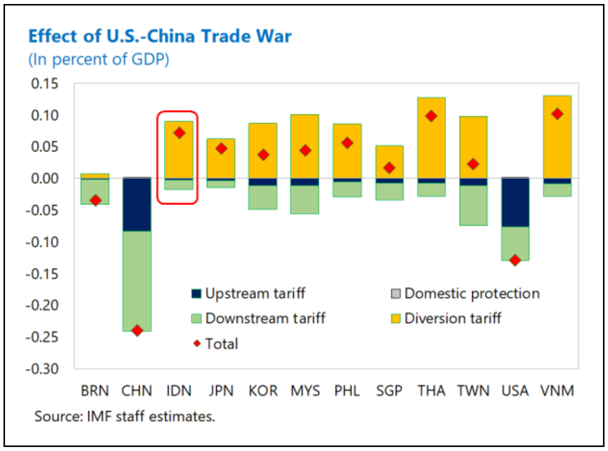
[5] Model simulation, to the extent comparable, suggest that the attenuating effects from a general equilibrium framework may be large. The simulations based on empirical estimates are thus used to illustrate the relative rather than absolute magnitude of the effects.

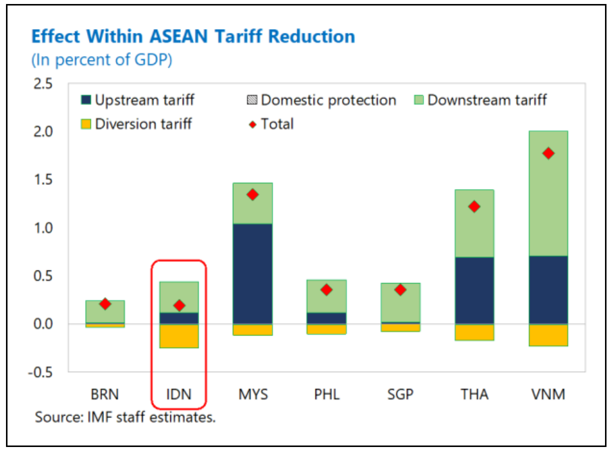
[6] Given data limitations, Lao P.D.R. and Myanmar could not be included in the simulations.

[7] The general result that East Asia (excluding China) may actually benefit from a contained trade war between China and the United States is supported by various DSGE models, summarized in Box 4.4 in the 2019 Spring WEO.

[8] The trade diversion effects are relatively larger the more discriminatory the tariff increases are (only between the United States and China, rather than between many trading partners) and the more important the two countries are in each other's imports (for instance the weight of China in U.S. imports).

they would reduce the cost of intermediate inputs and increase the international demand for their output. Consistent with estimation results, domestic protection has a negligible impact.[9] Indonesia, while among the less affected countries, would still benefit from trade liberalization among ASEAN countries. As trade liberalization can create disruptions with winners and losers, including within countries, it is important that accompanying policies facilitate adjustments to ensure that economic gains are widely and fairly shared.





[9] The zero result for domestic protection e.g., on value added may be due to a combination of two forces. A large empirical literature (e.g., Amiti and Konings, 2007 and Topalova and Khandelwal, 2010) has shown that tariffs, which tend to reduce competition, make domestic firms less productive. This negative effect could however be offset by an increase in domestic market shares.

Appendix III. Debt Sustainability Analysis

Indonesia's external and public debt remain moderate and sustainable. Nonetheless, potentially weaker-than-expected revenue, contingent liabilities from state-owned enterprises (SOEs) and public-private partnerships (PPPs) should be carefully monitored. Reliance on foreign investors remains sizable, which could leave Indonesia susceptible to capital flow reversals.

External Debt Sustainability

1. Indonesia's external debt has risen slightly to a moderate level. External debt reached 36.9 percent of GDP in 2018, up from 34.7 percent in 2017, reflecting an increase in external debt of the nonbank private sector. General government external debt has been stable, including internationally issued bonds, holdings of domestic bonds by nonresidents, and SOEs' external loans and debt securities. External debt is projected to increase to 37.7 percent of GDP at end-2019 (Figure 1 and Table 1), driven mainly by an increase in government borrowing.

2. External debt is projected to continue to gradually increase in the medium term. In the baseline scenario, external debt would reach 39.1 percent of GDP in 2024 reflecting the needs to finance the current account and fiscal deficits. Public and private external debt are expected to increase but total external debt is likely to remain contained at under 40 percent of GDP.

3. External debt sustainability is robust to interest rate and GDP shocks, but is more sensitive to current account and exchange rate shocks (Figure 2). A widening of the current account deficit from current levels would cause external debt to rise moderately (a one standard deviation shock would increase external debt to 43 percent of GDP by 2024). Exchange rate depreciation would have the largest impact—a 30 percent depreciation in 2018 would raise external debt to 56 percent of GDP in 2020 and thereafter.

Public Debt Sustainability

4. Indonesia's public sector debt remains moderate. General government debt has declined steadily from 87 percent of GDP in 2000 to 30.1 percent in 2018, owing to a prudent fiscal stance that has been anchored by fiscal rules since 2003.[1] On the composition of debt, foreign-currency denominated debt stays at about 40 percent of public debt. Dependence on foreign investors remains sizable, with nonresidents holding around 60 percent of general government debt.

5. Public sector debt is expected to stabilize at around 30 percent of GDP over the medium term (Figure 3). The baseline scenario envisages the general government deficit to remain at 1.8 percent of GDP over the medium term and a primary deficit at around 0.1−0.3 percent of GDP. The small fiscal deficits, together with favorable debt dynamics (a negative interest rate-growth differential of -0.8 percent over the medium term), would lead to a gradual reduction in public debt

[1] The rules cap general government deficit at 3 percent of GDP and debt at 60 percent of GDP.

from 30.2 percent of GDP in 2019 to 29.5 percent of GDP in 2024. Gross financing needs are also expected to remain moderate, peaking at 4.5 percent of GDP in 2020 and gradually falling to around 4.2 percent of GDP in 2024.

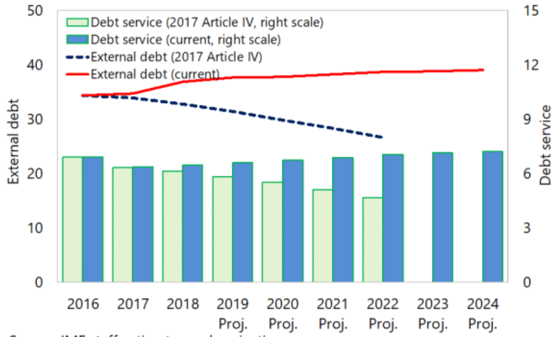
6. Public debt dynamics are robust to both standard shocks and stress tests (Figures 4 and 5). Even under the most severe scenario with a combined macro-fiscal shock, total government debt would stabilize at around 35 percent of GDP or 232 percent of revenue by 2024, while gross financing needs would stay below 5.4 percent of GDP. Nevertheless, fiscal risks arising from potentially weaker-than-expected revenue, expanding balance sheets of SOEs, and PPPs, will need to be managed carefully.

Authorities' Views

7. The authorities agreed with the external and public debt sustainability analysis.

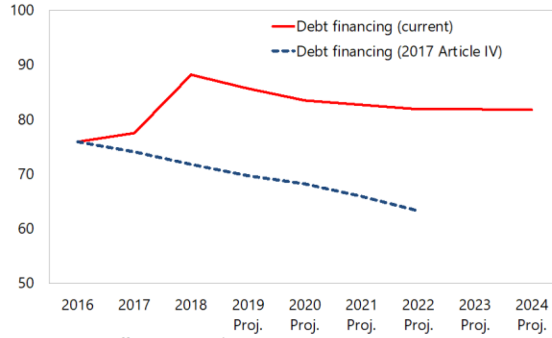
Figure 1. Indonesia: External Debt and Debt Service

Indonesia: External Debt Projections, 2016-24
(In percent of GDP)



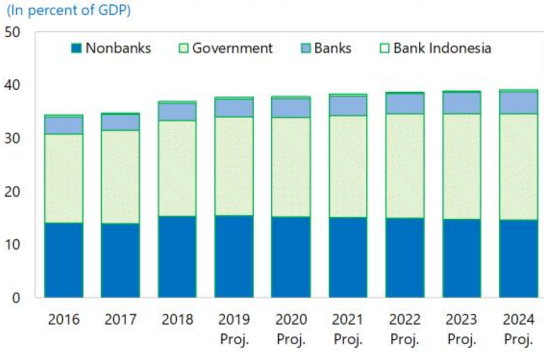
Source: IMF staff estimates and projections.

Indonesia: Debt Financing, 2016–24
(In percent of the gross external financing requirement)



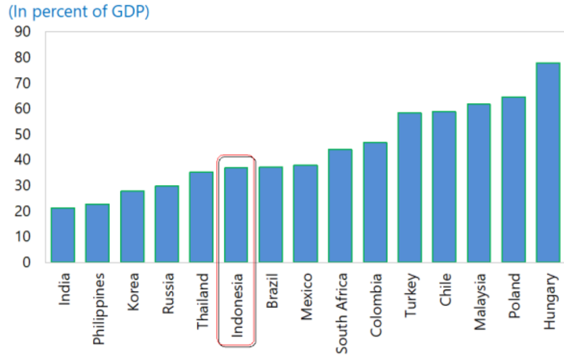
Source: IMF staff estimates and projections.

Indonesia: Composition of External Debt, 2016-24
(In percent of GDP)



Source: IMF staff estimates and projections.

External Debt, 2018
(In percent of GDP)



Source: IMF, *World Economic Outlook*.

Figure 2. Indonesia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)

Sources: International Monetary Fund, Country desk data; and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2018.

Table 1. Indonesia: External Debt Sustainability Framework, 2014–2024

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	32.9	36.1	34.3	34.7	36.9			37.7	37.7	38.2	38.6	38.8	39.1	-2.9
2 Change in external debt	3.9	3.2	-1.8	0.4	2.1			0.8	0.1	0.4	0.4	0.2	0.2	
3 Identified external debt-creating flows (4+8+9)	1.5	1.6	-2.8	-2.8	1.5			0.0	-0.3	-0.6	-0.7	-0.8	-0.8	
4 Current account deficit, excluding interest payments	2.4	1.1	0.9	0.6	1.9			1.8	1.6	1.5	1.4	1.3	1.3	
5 Deficit in balance of goods and services	-0.3	0.6	0.9	1.1	-0.7			-1.2	-0.9	-0.7	-0.4	-0.2	-0.2	
6 Exports	22.3	19.9	18.0	19.1	20.4			19.4	19.4	19.3	19.5	19.4	19.4	
7 Imports	-22.7	-19.3	-17.1	-18.0	-21.1			-20.6	-20.3	-20.0	-19.9	-19.6	-19.6	
8 Net nondebt creating capital inflows (negative)	-2.0	-1.1	-1.9	-1.6	-1.0			-1.2	-1.4	-1.4	-1.5	-1.5	-1.6	
9 Automatic debt dynamics 1/	1.2	1.5	-1.8	-1.9	0.6			-0.6	-0.5	-0.6	-0.6	-0.6	-0.6	
10 Contribution from nominal interest rate	0.7	0.9	0.9	0.9	1.1			1.2	1.2	1.3	1.3	1.3	1.3	
11 Contribution from real GDP growth	-1.5	-1.7	-1.7	-1.6	-1.8			-1.8	-1.8	-1.8	-1.9	-1.9	-1.9	
12 Contribution from price and exchange rate changes 2/	2.0	2.3	-1.1	-1.2	1.3			...	...	...	...	...	...	
13 Residual, including change in gross foreign assets (2-3) 3/	2.4	1.6	1.0	3.2	0.6			0.9	0.4	1.0	1.2	1.0	1.1	
External debt-to-exports ratio (in percent)	147.5	181.3	190.7	181.5	180.6			194.3	194.4	197.6	197.9	200.2	201.1	
Gross external financing need (in billions of U.S. dollars) 4/	83.8	76.8	72.5	70.9	85.9			91.9	100.7	108.2	117.2	126.4	136.6	
In percent of GDP	9.4	8.9	7.8	7.0	8.4			8.3	8.3	8.3	8.4	8.5	8.5	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	37.7	37.5	37.4	37.2	36.9	36.7	-2.8
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	5.0	4.9	5.0	5.1	5.2	5.4	0.6	5.2	5.2	5.2	5.3	5.3	5.3	
GDP deflator in U.S. dollars (change in percent)	-7.4	-7.9	3.1	3.7	-4.8	1.1	9.7	2.6	4.1	2.5	1.8	1.8	1.8	
Nominal external interest rate (in percent)	2.4	2.6	2.8	3.0	3.2	2.7	0.3	3.4	3.6	3.6	3.6	3.6	3.6	
Growth of exports (U.S. dollar terms, in percent)	-3.0	-13.8	-2.1	15.7	7.4	4.0	14.9	2.3	9.6	7.4	8.2	6.5	7.3	
Growth of imports (U.S. dollar terms, in percent)	-4.5	-17.8	-3.9	14.5	18.3	5.6	18.5	4.9	7.9	6.5	6.4	5.5	7.2	
Current account balance, excluding interest payments	-2.4	-1.1	-0.9	-0.6	-1.9	-0.7	1.7	-1.8	-1.6	-1.5	-1.4	-1.3	-1.3	
Net nondebt creating capital inflows	2.0	1.1	1.9	1.6	1.0	1.4	0.5	1.2	1.4	1.4	1.5	1.5	1.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 3. Indonesia: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

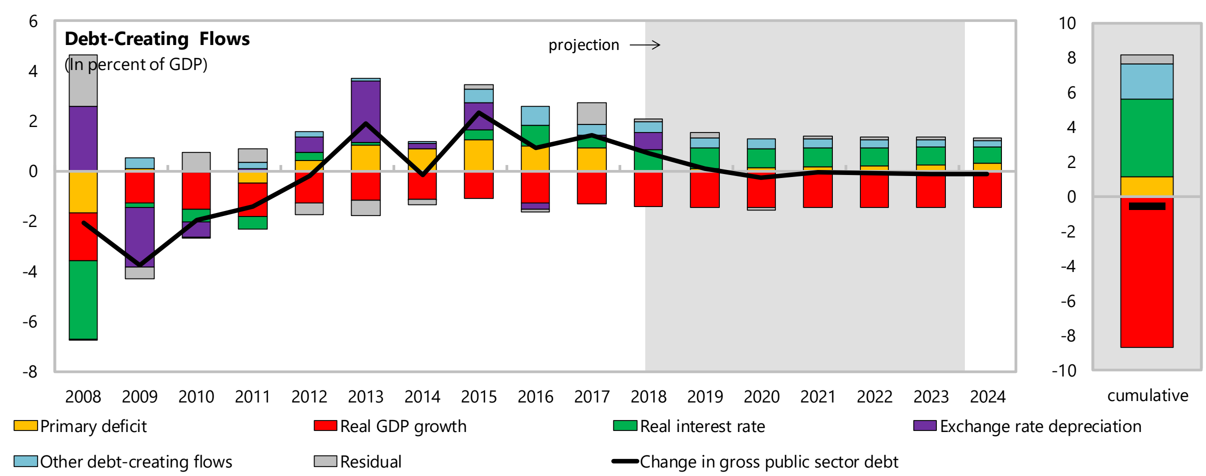
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of May 31, 2019		
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024	Sovereign Spreads		
Nominal gross public debt	25.8	29.4	30.1	30.2	29.9	29.9	29.8	29.7	29.5	EMBIG (bp) 3/		212
Public gross financing needs	3.5	4.7	4.0	4.3	4.5	4.3	4.4	4.3	4.2	5Y CDS (bp)		115
Real GDP growth (in percent)	5.7	5.1	5.2	5.2	5.2	5.2	5.3	5.3	5.3	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	6.5	4.3	3.2	3.1	3.1	3.1	3.1	3.0	3.0	Moody's	Baa2	Baa2
Nominal GDP growth (in percent)	12.6	9.6	9.1	8.2	8.5	8.5	8.5	8.5	8.5	S&Ps	BBB	BBB
Effective interest rate (in percent) [4/]	5.8	6.2	6.5	6.2	6.1	6.0	5.9	5.7	5.6	Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing
Change in gross public sector debt	-0.5	1.4	0.7	0.1	-0.3	0.0	-0.1	-0.1	-0.1	-0.5	primary
Identified debt-creating flows	-0.7	0.6	0.6	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1	balance [9/]
Primary deficit	0.3	0.9	0.0	0.1	0.1	0.2	0.2	0.3	0.3	1.1	-0.5
Primary (noninterest) revenue and grants	16.4	14.1	14.9	14.8	14.9	14.9	14.9	14.9	15.0	89.5	
Primary (noninterest) expenditure	16.6	15.0	14.9	14.9	15.0	15.1	15.1	15.2	15.2	90.7	
Automatic debt dynamics [5/]	-1.2	-0.8	0.1	-0.6	-0.7	-0.7	-0.7	-0.8	-0.8	-4.2	
Interest rate/growth differential [6/]	-1.6	-0.8	-0.6	-0.6	-0.7	-0.7	-0.7	-0.8	-0.8	-4.2	
Of which: real interest rate	-0.3	0.4	0.8	0.8	0.8	0.8	0.7	0.7	0.7	4.5	
Of which: real GDP growth	-1.3	-1.3	-1.4	-1.4	-1.4	-1.4	-1.5	-1.5	-1.5	-8.7	
Exchange rate depreciation [7/]	0.4	0.1	0.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	2.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
SOE recapitalization and land acquisition	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	2.0	
Residual, including asset changes [8/]	0.2	0.9	0.1	0.2	-0.1	0.1	0.1	0.1	0.1	0.5	

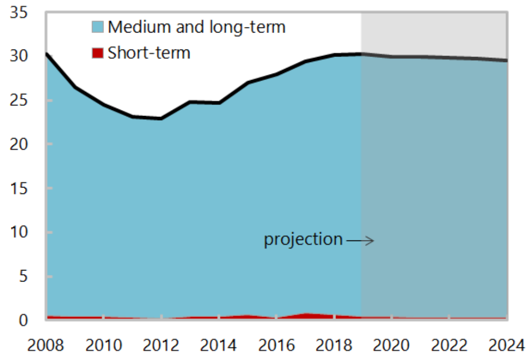


Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

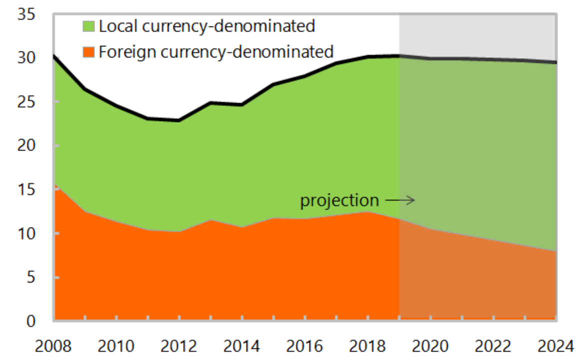
Figure 4. Indonesia: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



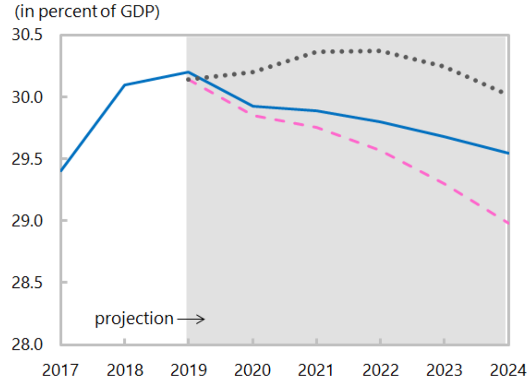
By Currency
(in percent of GDP)



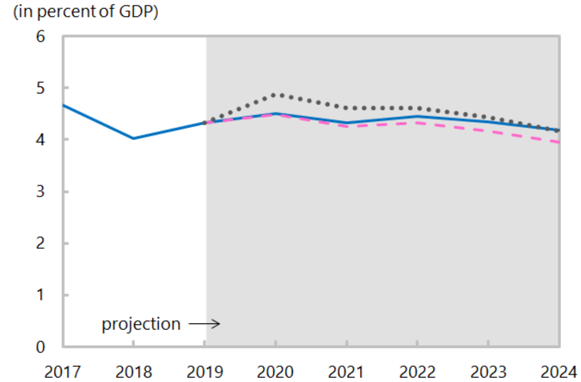
Alternative Scenarios

Baseline | Historical | Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

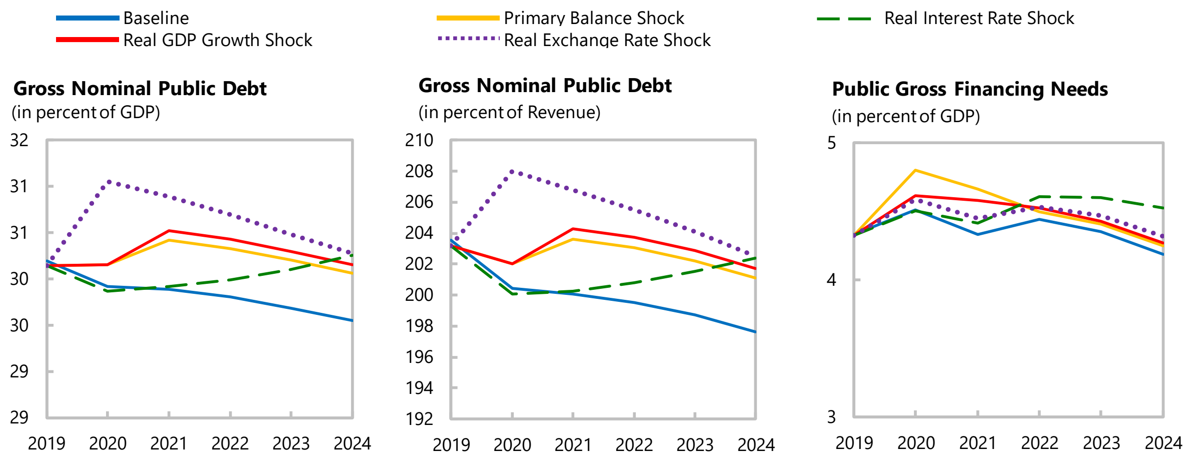
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	5.2	5.2	5.2	5.3	5.3	5.3
Inflation	3.1	3.1	3.1	3.1	3.0	3.0
Primary Balance	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3
Effective interest rate	6.2	6.1	6.0	5.9	5.7	5.6
Constant Primary Balance Scenario						
Real GDP growth	5.2	5.2	5.2	5.3	5.3	5.3
Inflation	3.1	3.1	3.1	3.1	3.0	3.0
Primary Balance	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Effective interest rate	6.2	6.1	6.0	5.9	5.7	5.6

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	5.2	5.4	5.4	5.4	5.4	5.4
Inflation	3.1	3.1	3.1	3.1	3.0	3.0
Primary Balance	-0.1	-0.5	-0.5	-0.5	-0.5	-0.5
Effective interest rate	6.2	6.1	5.7	5.3	4.9	4.6

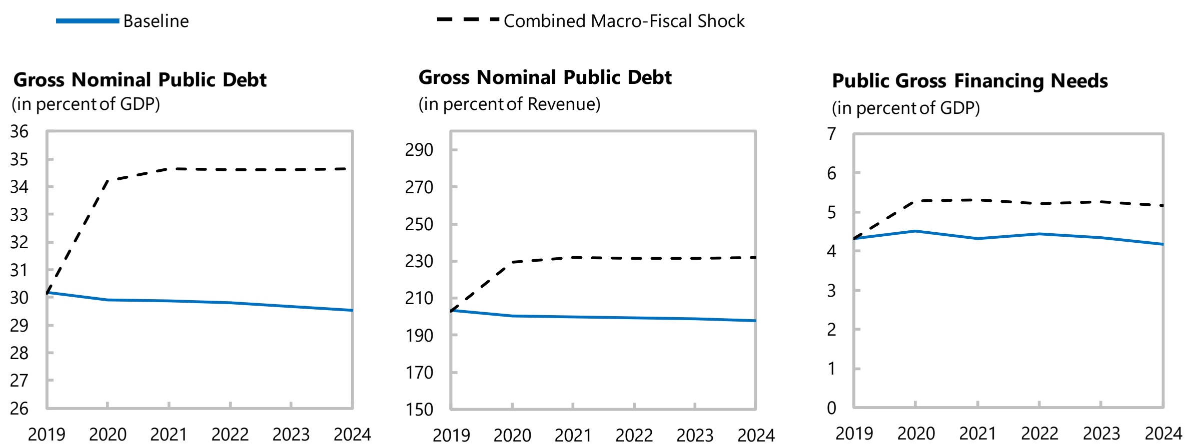
Source: IMF staff.

Figure 5. Indonesia: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2019	2020	2021	2022	2023	2024
Primary Balance Shock						
Real GDP growth	5.2	5.2	5.2	5.3	5.3	5.3
Inflation	3.1	3.1	3.1	3.1	3.0	3.0
Primary balance	-0.1	-0.4	-0.5	-0.2	-0.3	-0.3
Effective interest rate	6.2	6.1	6.1	5.9	5.7	5.6
Real Interest Rate Shock						
Real GDP growth	5.2	5.2	5.2	5.3	5.3	5.3
Inflation	3.1	3.1	3.1	3.1	3.0	3.0
Primary balance	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3
Effective interest rate	6.2	6.1	6.4	6.5	6.5	6.6
Combined Shock						
Real GDP growth	5.2	4.6	4.6	5.3	5.3	5.3
Inflation	3.1	3.0	2.9	3.1	3.0	3.0
Primary balance	-0.1	-0.4	-0.5	-0.2	-0.3	-0.3
Effective interest rate	6.2	6.4	6.0	6.2	6.3	6.5

	2019	2020	2021	2022	2023	2024
Real GDP Growth Shock						
Real GDP growth	5.2	4.6	4.6	5.3	5.3	5.3
Inflation	3.1	3.0	2.9	3.1	3.0	3.0
Primary balance	-0.1	-0.2	-0.4	-0.2	-0.3	-0.3
Effective interest rate	6.2	6.1	6.0	5.9	5.7	5.6
Real Exchange Rate Shock						
Real GDP growth	5.2	5.2	5.2	5.3	5.3	5.3
Inflation	3.1	11.9	3.1	3.1	3.0	3.0
Primary balance	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3
Effective interest rate	6.2	6.4	5.7	5.6	5.5	5.4

Source: IMF staff.

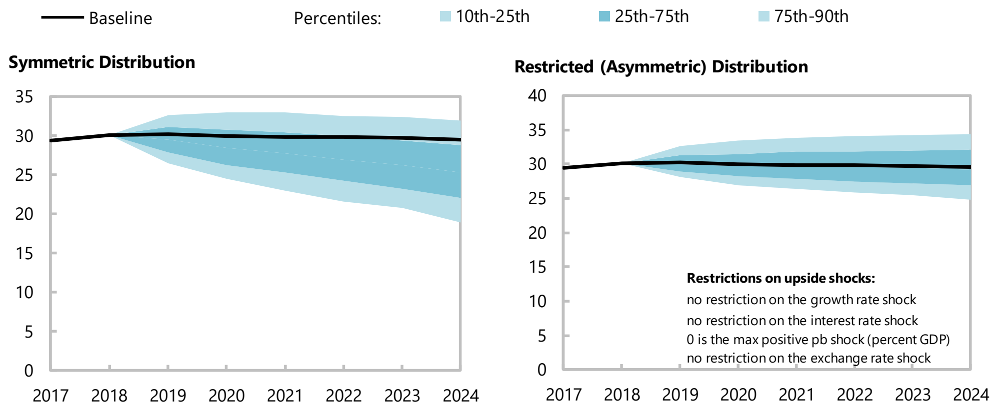
Figure 6. Indonesia: Public DSA—Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

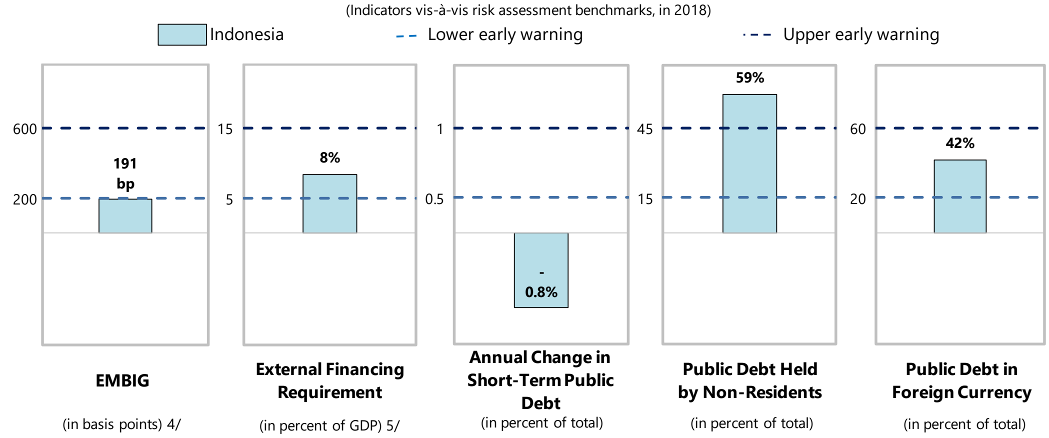
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 02-Mar-19 through 31-May-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Appendix IV. External Sector Assessment

<table>
<tr><th></th><th colspan="12">Indonesia</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td colspan="12">Background. At end-2018, Indonesia's net international investment position (NIIP) stood at -30 percent of GDP, compared with -33 percent of GDP at end-2017 (and -39½ percent at end-2012). Gross external assets reached 33.3 percent of GDP (of which, close to 35 percent were reserve assets) and gross external liabilities, 63.8 percent of GDP. Indonesia's gross external debt was moderate at 36.2 percent of GDP at end-2018, of which 19 percent was denominated in rupiah and 87 percent was maturing after one year. About one-third of the government's external debt was denominated in rupiah.
Assessment. The level and composition of the NIIP and gross external debt indicate that Indonesia's external position is sustainable and subject to limited roll-over risk, but nonresident holdings of rupiah denominated government bonds, at 34 percent of the total stock (or 6.4 percent of GDP) at end 2018, combined with shallow domestic financial markets, make Indonesia susceptible to global financial volatility, higher U.S. interest rates, and stronger U.S. dollar. Staff projections for the current account suggest that the NIIP position as a percent of GDP will be stable over the medium term.</td><td rowspan="9">Overall Assessment:
The external position of Indonesia in 2018 was assessed to be moderately weaker than medium-term fundamentals and desirable policies. Exchange rate flexibility and trade-related policy actions (import compression and export promotion) together with broadly stable (projected) commodity prices are expected to modestly reduce the current account deficit over the medium term. External financing appears sustainable, although the large share of foreign portfolio holdings makes the economy vulnerable to a sharp tightening of global financial conditions.

Potential policy responses:
Improving Indonesia's external position requires boosting competitiveness through higher infrastructure and social spending, while maintaining fiscal sustainability through the mobilization of revenues. In addition, structural policies are necessary to bolster global value chain participation, ease FDI and non-tariff trade restrictions, as well as strengthen labor markets and worker skills (e.g. streamlining stringent job protection, and improving job placement services, vocational training, and overall education). Flexibility of the exchange rate and market-determined bond yields should continue to support external stability.</td></tr>
<tr><td>2018 IIP (% GDP)</td><td>NIIP</td><td>-30.5</td><td>Gross Assets</td><td>33.3</td><td>Res. Assets</td><td>11.6</td><td>Gross Liab.</td><td>63.8</td><td>Debt Liab.</td><td>36.2</td><td></td><td></td></tr>
<tr><td>Current account</td><td colspan="12">Background. After narrowing since 2013, Indonesia's current account deficit increased to 3 percent of GDP in 2018, from a 1.6 percent deficit in 2017, driven by mainly by growing domestic demand and higher oil prices. The CA deficit is projected to narrow slightly to 2.9 percent in 2019 on the back of weaker import growth, in part due to the lagged effects of the sharp exchange rate depreciation since mid-2018 and lower oil prices. A gradual increase in manufacturing exports, underpinned by improved competitiveness and stronger demand from trading partners should help limit the current account deficit over the medium-term.
Assessment. Staff estimates a CA gap of -1.5 percent for 2018, consistent with an estimated cyclically adjusted CA balance of -3.2 percent of GDP and a staff-assessed norm of -1.7 percent of GDP. 1/ Taking into account uncertainties in the estimation of the norm, the CA gap for 2018 is in the range of -3 percent to 0 percent of GDP. 2/ The offsetting impact of domestic policy gaps suggests that addressing excess imbalances will require reforms to improve labor markets and competitiveness. The lagged effects of the weaker rupiah should help improve the CA deficit in the near term.</td></tr>
<tr><td>CA Assessment 2018</td><td>Actual CA</td><td>-3.0</td><td>Cycl. Adj. CA</td><td>-3.2</td><td>EBA CA Norm</td><td>-0.8</td><td>EBA CA Gap</td><td>-2.4</td><td>Staff Adj.</td><td>-0.9</td><td>Staff CA Gap</td><td>-1.5</td></tr>
<tr><td>Real exchange rate</td><td colspan="12">Background. The REER remained broadly stable between 2013 and 2017. In 2018, the average REER depreciated by 6.1 percent relative to the average of 2017 due to a depreciation of the nominal exchange rate by 8.5 percent from tighter global financial conditions that led to capital flow pressures. Estimates through 2019 Q1 show that the REER has appreciated by 3.1 percent relative to the 2018 average.
Assessment. The EBA index and level REER models point to an REER gap of about -3.2 percent to -14.8 percent for 2018, with the change driven by the depreciation of the REER. Meanwhile, the CA gap estimate of -1.5 percent of GDP with standard elasticities and uncertainty ranges (+/-5 percent), would indicate that the REER is overvalued in the range of [3,13] percent. Taking into account the depreciation in 2018, staff assesses the REER gap to be in the -9 to 1 percent range.3/</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td colspan="12">Background. In 2018, net capital and financial account inflows (2.5 percent of GDP) were sustained by net FDI inflows (1.4 percent of GDP), net portfolio inflows (0.9 percent of GDP), and net other investment inflows of 0.2 percent of GDP.
Assessment. Net and gross financial flows have been relatively steady since the global financial crisis despite some short periods of volatility. The contained current account deficit and strengthened policy frameworks, including exchange rate flexibility since mid-2013 have also helped reduce capital flow volatility. Continued strong policies focused on strengthening the fiscal position, keeping inflation in check, and easing supply bottlenecks would help sustain capital inflows in the medium term.</td></tr>
<tr><td>FX intervention and reserves level</td><td colspan="12">Background. Since mid-2013, Indonesia has had a more flexible exchange rate policy framework. Its floating regime has better facilitated adjustments in exchange rates to market conditions. At end-2018, reserves were US$120.7 billion (equal to 12 percent of GDP, about 118 percent of IMF's reserve adequacy metric, and about 6.4 months of prospective imports of goods and services), compared with US$130.2 billion at end-2017. The loss in international reserves reflect mainly FX intervention in response to the disorderly market conditions triggered by the tightening of global financial conditions last year. In addition, contingencies and swap lines amounting to about US$92.5 billion are in place.
Assessment. While the composite metric may not adequately account for commodity price volatility, the current level of reserves (US$124.3 billion at end-April) should provide sufficient buffer against a wide range of possible external shocks, with predetermined drains also manageable. FX intervention, while broadly appropriate last year, should continue to aim primarily at preventing disorderly market conditions, while allowing the exchange rate to adjust to external shocks.</td></tr>
<tr><td>Technical Background Notes</td><td colspan="12">1/ As Indonesia is among the few outlier countries regarding adult mortality rates, the demographic indicators are adjusted to account for the younger average prime-age and exit age from the workforce. This results in an adjustor of -0.9 percentage point being applied to the model-estimated CA norm (-0.8 percent of GDP).
2/ A range of +/-1.5 percent is added to reflect the fact that the EBA-regression estimates are subject to normal uncertainty (the standard error of the EBA norm is 1.5 percent).
3/ The staff assessed REER undervaluation of 4 percent is within the (+/-5 percent) interval described as broadly in line with fundamentals.</td></tr>
</table>

INTERNATIONAL MONETARY FUND

INDONESIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 12, 2019

Prepared By | Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of April 30, 2019)

Membership Status: Joined February 21, 1967; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	4,648.40	100.00
Fund holdings of currency	3,860.21	83.04
Reserve tranche position in Fund	788.27	16.96

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	1,980.44	100.00
Holdings	1,116.13	56.36

Outstanding Purchases and Loans: None

Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Millions)	Amount Drawn (SDR Millions)
EFF	02/04/00	12/31/03	3,638.00	3,638.00
EFF	08/25/98	02/03/00	5,383.10	3,797.70
Stand by	11/05/97	08/25/98	8,338.24	3,669.12

Projected Payments to Fund (SDR millions; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2019	2020	2021	2022	2023
Principal					
Charges/Interest	7.32	9.89	9.88	9.88	9.88
Total	7.32	9.89	9.88	9.88	9.88

Exchange Arrangements

The rupiah has had a *de jure* free floating exchange arrangement since August 14, 1997, and the current *de facto* arrangement is floating. The market exchange rate was Rp 14,187 per U.S. dollar as of April 30, 2019. Indonesia has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions.

Article IV Consultation

The last Article IV consultation report (IMF Country Report No. 18/32) was discussed by the Executive Board on January 10, 2018.

Resident Representative

Mr. John Nelmes has been the Senior Resident Representative since September 2016.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- World Bank: https://financesapp.worldbank.org/en/countries/Indonesia/
- Asian Development Bank https://www.adb.org/countries/indonesia/main

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance

General: Data provision is broadly adequate for surveillance with some shortcomings in fiscal and external sector statistics.

National accounts: Statistics Indonesia (BPS) disseminates annual and quarterly GDP (QGDP) by economic activity and expenditure components at current prices and in volume terms at 2010 prices regularly. In general, GDP estimates are based on the latest international methodologies following the System of National Accounts 2008. The QGDP estimates are based on a limited set of indirect indicators. Some sectors are influenced strongly by seasonality, with seasonally adjusted data prepared but not published. BPS has been leading the work on developing sectoral accounts and balance sheets jointly with Bank Indonesia (BI) with TA from STA. BPS and BI expect to finalize the provisional data for the years 2010–2014 by the end of 2019. The next TA mission on Sectoral Accounts will be conducted in August 2019.

Price statistics: Price statistics are broadly adequate for surveillance. The index and weight refence period for PPI is 2010. In October 2013, BPS released the new Producer Price Index (PPI) covering agriculture, mining and quarrying, and manufacturing, and has published the PPI index quarterly. BPS has also expanded the mining sample to include oil and natural gas extraction, coal, and gold, and has started work to further expand PPI coverage to include 15 service industries. Currently PPI for the following service industries are disseminated: electricity, water and gas; passenger transport; hotel and restaurants. There is a need to increase dissemination frequency and update the weights for the PPI. The index and weight reference period for CPI is 2012. A recent STA TA mission assisted with improving the CPI methodology and updating weights using the results of the 2018 household expenditure survey (Survei Biaya Hidup) . The new CPI is expected from the August 2019 index. STA is assisting Bank Indonesia to develop an enhanced RPPI using Big Data on property listings.

Government finance statistics (GFS): The Ministry of Finance (MOF) is committed to keeping the requirements of fiscal statistics at the forefront of ongoing fiscal reforms, with better statistical monitoring one of the goals of the current efforts. The authorities are continuing their efforts to adopt the GFSM 2001/2014 standards, with assistance from STA as part of a regional GFS project. Significant progress has been made in these areas and, Indonesia now reports to STA annual general government data (including balance sheet data) covering the period from 2008 onwards. Annual general government GFS are currently available 12 months after the end of the reference period and these data are published on the GFS website: http://www.gfs.djpbn.kemenkeu.go.id/en. The timeliness of the annual data will improve once all systems are in place. Aggregated monthly data on the budget of the central government are available with a one-month lag.

In late 2015, the authorities have started to compile quarterly general government data based on estimates of local government data. Quarterly general government GFS (operations statement) are available 6 months after the end of the reference quarter. The quarterly general government data are yet to be published on the GFS website because the authorities are improving these data in terms of coverage of local governments and timeliness with the development of new regional financial information system. Limited quarterly general government GFS data are published in IFS. The coverage and timeliness of public debt statistics are generally adequate.

Monetary and financial statistics (MFS) and financial soundness indicators (FSIs): Good quality monetary statistics are compiled by BI on a timely basis. BI compiles and reports monetary data using the Standardized Report Forms (SRFs), from which an integrated database and alternative presentations of monetary statistics can be drawn to meet the needs of BI and the IMF. Additional challenges include timely revisions of published banking sector data after supervisory verification. With the support of a Fund TA mission in October 2014, BI expanded the coverage of the OFCs survey, which since January 2015 includes finance companies, insurance companies, pension funds, the state-owned pawn shop (PT Pegadaian), and the Indonesian export financing institution (Eximbank); achieving almost full coverage of the subsector. OFC data are reported on a monthly basis. The mission also assisted BI in advancing the production of flow-based monetary statistics and quarterly financial accounts. BI compiles and reports to the Fund all (12) core and 12 encouraged financial soundness indicators (FSIs) for deposit takers, all (two) encouraged FSIs for OFCs, two encouraged FSIs for nonfinancial corporations, one encouraged FSI for households, two encouraged FSIs for market liquidity, and three encouraged FSIs for the real estate sector, which are published quarterly on the Fund's FSI website**.** Indonesia reports data on some key series and indicators of the Financial Access Survey (FAS), including mobile money and the two indicators adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

External sector statistics (ESS): Trade data have been improved in recent years. Import and export transactions of free trade zones and bonded warehouses are captured in goods data of balance of payments (BOP) statistics.

For financial account, the methodological basis for the compilation of direct investment (DI) data needs substantial improvement. Inflows are currently calculated based on loan disbursements to companies that have foreign equity using a fixed ratio to estimate equity inflows. The errors and omissions in BOP has been large and predominantly negative and could be related to the under coverage of imports in current account or assets in the financial account. Financial transactions data are reconciled with changes in the international investment position (IIP), except data on DI.

IIP data are compiled and published annually and quarterly. External debt statistics have improved considerably with the introduction of an External Debt Information System (EDIS) in 2002 and the recent initiative to publish monthly indicators. Also, as a result of the ongoing reconciliation of data conducted by BI, the IIP and external debt data are fully consistent. However, improvements are still needed with respect to components of private corporate sector data, particularly in distinguishing between scheduled and actual debt service, in estimating the accumulation/reduction of private sector payments arrears, and in estimating reschedulings/debt reductions received by the private sector from external creditors.

II. Data Standards and Quality

Indonesia has subscribed to the Special Data Dissemination Standard (SDDS) since September 1996, observing most of the SDDS requirements. Indonesia uses the SDDS flexibility options for the timeliness of the labor market categories (employment, unemployment, and wages/earnings) and general government operations.	Data *Reports on the Observance of Standards and Codes* (ROSC) was completed in 2005.

Indonesia: Table of Common Indicators Required for Surveillance

(As of May 10, 2019)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]	Memorandum Items: Data Quality—Methodological Soundness[2]	Memorandum Items: Data Quality—Accuracy and Reliability[3]
Exchange rates	5/10/19	5/10/19	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities[4]	4/19	5/19	M	M	M		
Reserve/base money	4/19	5/19	W/M	W/M	W/M	O, LO, O, O	LO, O, O, LO, O
Broad money	3/19	5/19	M	M	M		
Central bank balance sheet	4/19	5/19	M	M	M		
Consolidated balance sheet of the banking system	3/19	4/19	M	M	M		
Interest rates[5]	5/10/19	5/10/19	D	D	D		
Consumer price index	4/19	5/19	M	M	M		
Revenue, expenditure, balance and composition of financing[6]—central government	4/19	5/19	M	M	Mid-year	LNO, LNO, LO, LNO	LNO, LO, LO, LO, LNO
Stocks of central government and central government–guaranteed debt	3/19	5/19	Q	Q	Q		
External current account balance	Q1/19	5/19	Q	Q	Q	LO, LO, LO, LO	LO, O, LO, O, O
Exports and imports of goods and services	Q1/19	5/19	Q	Q	Q		
GDP/GNP	Q1/19	5/19	Q	Q	Q	LO, LO, O, LO	LO, LO, LO, LO, LNO
Gross external debt[7]	Q4/18	4/19	Q	Q	Q		
International investment position[8]	Q4/18	4/19	Q	Q	Q		

1 Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); NA: Not Available.
2 Reflects the assessment provided in the data ROSC published on July 20, 2005 (based on the findings of the mission that took place during March 28-April 11, 2005), for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
3 Including currency and maturity composition, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.
4 Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
5 Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
6 Foreign, domestic bank, and domestic nonbank financing.
7 Including currency and maturity composition.
8 Includes external gross financial assets and liability positions vis-à-vis nonresidents.

Statement by the Staff Representative on Indonesia
July 3, 2019

The information below has become available following the issuance of the staff report. It does not alter the thrust of the staff appraisal.

1. **On June 20, Bank Indonesia (BI) kept the policy rate unchanged, reduced bank reserve requirements, and indicated that it would keep an accommodative macroprudential policy stance**. The 7-Day Reverse Repo rate remains at 6.00 percent. BI lowered rupiah bank reserve requirement by 50 bps, to 6.0 percent for conventional banks and 4.5 percent for Islamic banks, effective from July 1, 2019. The BI also indicated that it would keep the accommodative macroprudential policy stance to support bank lending and, in coordination with the Government, continue to pursue payment system and financial deepening reforms to support growth.

2. **Headline inflation** increased to 3.3 percent (y/y) in May 2019, from 2.8 percent in April 2019, due mainly to higher food prices. Core inflation remained broadly stable at 3.1 percent (y/y). In line with historical dynamics, food price inflation is expected to moderate after the Ramadhan period, while headline inflation is expected to converge to the forecasted 3.1 percent by end-2019.

3. **The trade balance** improved in May 2019, registering a US$200 million surplus, compared to a deficit of US$2.3 billion in April 2019.

Statement by Alisara Mahasandana, Executive Director for Indonesia; Keng Heng Tan, Alternative Executive Director; Muslimin Anwar, Senior Advisor to Executive Director; and Dian Susiandri, Advisor to Executive Director
July 3, 2019

On behalf of the Indonesian authorities, we would like to thank the IMF mission team for the comprehensive and constructive policy dialogue during the 2019 Article IV consultation. The consultation has provided valuable venues to discuss the many progress of home-grown policies as well as reforms that Indonesia is currently undertaking. We appreciate staff's effort to understand the domestic economy and country specific challenges as well as authorities' policies and objectives. The authorities are encouraged by staff's acknowledgement of Indonesia's solid macroeconomic performance as well as favorable outlook. **Accordingly, the authorities broadly concur with the thrust of staff's appraisal with an important caveat on key recommendations, namely on macroprudential policy.**

Recent Economic Development and Outlook

The authorities' policy mix has successfully preserved macroeconomic stability and maintained growth momentum amidst rising global uncertainty in 2018. Economic growth gradually improved to 5.2% in 2018, with macroeconomic and financial stability intact as indicated by low and contained inflation and well-maintained financial system stability. External stability remained solid supported by the flexible exchange rates as an important shock absorber of the economy. Appropriate policy mix was implemented last year to strengthen macroeconomic stability, particularly the external stability, while preserving economic growth momentum.

Going forward, the outlook remains buoyant with economic growth expected to improve gradually in the medium term, as growth rate is seen to be slightly higher than staff's estimates. This favorable outlook benefitted in large from the structural reform efforts, which have started to bear fruit in terms of improved productivity. For 2019, the authorities projected economic growth to be within the range of 5.0-5.4% and will continue to grow further to 5.5-6.1% in the medium term. Inflation is forecasted to be below the midpoint of the 3.5%±1% target corridor in 2019, in line with well anchored inflation expectations. The current account deficit is expected to narrow due to various measures to curb imports and to promote exports. The authorities will continue to monitor global economic developments while assessing their policy mix.

Fiscal and Structural Reforms

In 2018, the authorities remain committed to maintaining fiscal sustainability, by ensuring that the primary balance and the budget deficit were below state budget target of -0.6% and 2.2% of GDP respectively. During the period of heightened global uncertainty, the authorities' policy consideration was mainly focused on ensuring fiscal sustainability to maintain economic stability. The primary balance and the budget deficit in 2018 were smaller than the target at -0.08% and 1.8% of GDP, respectively. This has enabled the Government to maintain the official debt level at 29.8% of GDP, far below the legal threshold of 60% of GDP. Going forward, the policy thrust will be to preserve fiscal sustainability while supporting

economic growth. Overall, the authorities agreed on the merits of a broadly neutral fiscal stance. The Government has set the target for primary balance and budget deficit in 2019 to be -0.12% and 1.84% of GDP, respectively.

The authorities concur with staff that revenue mobilization should be a top fiscal reform priority to build the fiscal buffers. In this vein, the comprehensive tax reform has been focused on improving tax administration, streamlining tax structures, broadening the tax base, and increasing compliance in order to increase fiscal buffer. The authorities supports the improvement of tax revenue mobilization through integrated and up-to-date data and information utilization, international tax treaty optimization, and the effectiveness of Automatic Exchange of Information implementation. The authorities have also been simplifying tax structures as a part of a tax reform plan and reviewing the income tax and value-added tax law.[1] They will also lessen the complexity of the current tax system, including to review tax exemptions to ensure the effectiveness. To this end, the authorities would welcome the IMF's support to enhance the current draft amendment of the income tax law.

On the expenditure side, the authorities will maintain their efforts to further improve the quality of public spending. This includes refocusing priority spending on infrastructure, ensuring efficiency in spending, as well as implementing better-targeted subsidies and more effective social protection programs. In this view, the Government implemented several short-term measures to stimulate the economy, while keeping long-term measures to boost the productivity including through human capital quality improvement. To this end, the authorities welcome the IMF's expertise to improve government capital expenditure strategy through technical assistance and capacity development. The authorities remain committed to energy subsidy reform, and will ensure that the economy can adjust smoothly. Gradual implementation of subsidy reform will be complemented by targeted measures for the vulnerable groups.

The authorities will also continue to pursue structural reforms to achieve sustainable and inclusive growth. Expanding infrastructures investment, improving the business climate, and promoting financial market deepening are some of the noteworthy actions. In order to maintain a healthy investment climate, the authorities commit to maintain market confidence. The authorities' steadfast implementation of the structural reform agenda as well as consistent performance in terms of macroeconomic stability have been recognized by the credit rating agencies. S&P has upgraded Indonesia's rating to BBB from BBB- with a stable outlook in May 2019. Therefore, Indonesia's sovereign ratings from all of the three major rating agencies, S&P, Moody's, and Fitch, are currently one notch above minimum investment grade level.

Authorities agree that maintaining market confidence is crucial in the period of global uncertaity. While financial market deepening is a strategic policy for strengthening economic resilience, the fact that most of export proceed never return to or stays in Indonesia has hampered financial deepening process and impacted domestic financial market. As a natural resource base economy, the repatriation of natural resource export proceed to Indonesia is very important for the economy to address the structural issues related to economic development.

[1] The income tax and value added tax are known as PPh and PPN respectively.

Monetary and Exchange Rate Policy

Monetary policy has focused on maintaining macroeconomic stability amidst heightened global uncertainty. In this regard, the central bank employed various policy instruments, including monetary policy rate, exchange rate flexibility, and foreign exchange intervention to meet its objectives.

In 2018, Bank Indonesia (BI) pursued a preemptive, front-loading, and ahead-of-the-curve policy by raising the policy rate by 175 bps to weather risks posed by interest rate hike in the US and other emerging markets, as well as uncertainty in global financial markets.[2] Looking ahead, BI concurs with staff's suggestion to cautiously consider the room for accommodative monetary policy to help stimulate domestic economy while ensuring inflation remains on target. Nevertheless, BI remains mindful of the global financial market dynamics and external stability and will undertake a comprehensive assessment of the policy direction to avoid adverse effects to macroeconomic and financial stability.

The authorities affirmed their commitment to allow exchange rate flexibility to serve as a shock absorber. In this context, intervention in the FX market will be limited to curbing excessive volatility. On the IMF's advice to publish the Forex Intervention (FXI) data, BI views that this requires prerequisite conditions to be met such as the existence of a deep, efficient and market driven foreign exchange market. BI will reconsider the publication of the FXI data once these preconditions are fulfilled.

BI continues to enhance its monetary operation strategy to maintain adequate liquidity in the money market and banking sector, especially during periods of high market volatility. In this light, BI increased the auction frequency of government securities reverse repo, reactivated the BI Certificate auctions, conducted forex swap auctions, and increased the portion of average statutory reserve requirement.[3] The implementation of reserve requirement (RR) averaging is aimed at giving more flexibility to banks in managing their liquidity, which can reduce the volatility of the interbank money market and strengthen the monetary policy transmission mechanism. The authorities took note of staff's recommendation on expanding the coverage of the averaging portion to all portions of the RR. BI will consider staff's advice when reviewing the effectiveness of RR averaging.

[2] The preemptive increases in the policy rate, namely BI 7-Day Reverse Repo Rate (BI7DRR), were linked to the forward-looking, anticipatory response of Bank Indonesia to the risk of increases in the Federal Funds Rate (FFR) and uncertainty on global financial markets. The front-loading response meant that the magnitude of the increase in the Indonesian policy rate had considered the possible extent of an increase in the FFR, so that the interest rate differential would remain sufficiently large to maintain the attractiveness of domestic assets. Alongside this, the ahead-of-the-curve response was related to the fact that the magnitude of Indonesia's policy rate increases would also anticipate interest rate increases in other emerging markets so that the domestic financial market would remain competitive.

[3] The government securities reverse repo and the BI Certificate are also called RR-SBN and SBI respectively.

External Sector

In 2018, the heightened global uncertainties posed increasing risk on external stability. This unfavorable condition adversely affected BoP performance, adding pressure to the rupiah, particularly during the second and third quarter of 2018. The policy mix executed by the authorities helped restore Indonesia's external stability. The current account deficit was kept at 2.98% of GDP for the whole 2018, despite widening to 3.6% of GDP in the fourth quarter. The current account deficit then narrowed to 2.6% of GDP in the first quarter of 2019. The improving trend of capital inflows by non-residents in the fourth quarter of 2018 and first quarter of 2019, together with the narrowing current account deficit in the first quarter of 2019, had a positive effect on external sector balance. The BoP eventually returned to surplus in the fourth quarter of 2018 and first quarter of 2019. External stability was further bolstered by adequate reserve assets to cover imports and to service government external debt, well above the international reserve adequacy standard of three months of imports.

Reiterating previous Article IV consultation, authorities view the estimated CA norm resulting from EBA model to be too low and does not adequately reflect Indonesia's need for higher investment and structural reforms. We encourage staff to consider how to better incorporate country-specific factors in the assessment of the current account norm, in particular the substantial infrastructure investment needs and critical structural reforms that the country is undertaking to promote sustainable growth.

External debt remained sustainable, including private debt. The authorities believe this favorable environment was backed by the prudential regulations on external borrowings. The corporate sector external debt regulation was aimed at ensuring macroeconomic and financial stability through the implementation of prudential principles on corporate foreign borrowings.[4] The authorities will review regularly the appropriateness of this regulation in supporting external stability.

Going forward, external stability is projected to improve. The current account deficit is predicted to ease, supported by close coordination between BI and the Government to address the issue, including through various measures to curb excessive import and to promote export. The current account deficit is projected at about 2.5–3.0 % of GDP in 2019 and will decline further in the medium-term. The capital and financial account surplus is also set to improve, exceeding the level achieved in 2018, bolstered mainly by higher inflows of FDI, improvements in the business climate, and a solid domestic economy outlook.

Macroprudential and Financial Sector Policy

Macroprudential policy will continue to safeguard financial system stability and mitigate systemic risk. Nevertheless, in the event that the financial cycle is below the long-term trend, macroprudential policy can be calibrated to support a more balanced growth of credit. The current accommodative macroprudential policy has helped boost bank lending growth. Meanwhile, financial system stability continues to be maintained by a well-capitalized banking

[4] This regulation is also known as KPPK.

sector. Going forward, the authorities view that there is room to maintain current accomodative macroprudential policy, while remaining vigilant to ensure financial system stability.

Financial system stability was maintained, underpinned by a robust banking capital position and adequate liquidity, as well as improvement in corporate financing. At the end of 2018, the capital adequacy ratio (CAR) and the liquid assets to deposits ratio stood at 22.9% and 19.3%, respectively. Credit growth was at 11.8%, while credit risk was kept within prudent limits as reflected in the low NPL ratios of 2.4% (gross) and 1.0% (net), both of which were within the 5% sound territory. Improvement also took place in non-bank financing. Total issuance of shares (IPOs and rights issues), corporate bonds, medium-term notes and negotiable certificate of deposits (NCDs), all representing various forms of financing from the capital market, were recorded at IDR168.1 trillion (gross). This points to an improvement in corporate financing from domestic sources, including from both banks and the capital market.

The authorities have made encouraging progress in harnessing the benefits and opportunities of rapid advances in the digital economy which have transformed the economic and financial landscape, while at the same time managing emerging risks. In this context, authorities have outlined a vision of Indonesia's Payment System (IPS) 2025 as well as an initiative for a new payment system blueprint to ensure that the current trend of digitalization develops within a conducive digital economic and financial ecosystem, along the lines of Bali Fintech Agenda.

<u>**Financial Market Deepening (FMD)**</u>

In 2018, the FMD policy was focused on improving the efficiency of money and forex markets to lay the foundation for promoting long-term economic financing. BI has taken several actions by introducing domestic non-deliverable forward (DNDF) transaction, developing market for call spread options (CSOs), establishing Indonesia Overnight Index Average (IndONIA) as a benchmark rate on the Rupiah money market and as a reference rate for Overnight Index Swap (OIS), as well as strengthening the Jakarta Interbank Offered Rate (JIBOR). BI, MoF, and OJK have also developed more innovative financing schemes to finance infrastructure development in Indonesia, including public-private partnerships (PPP), project bonds, infrastructure funds, asset and earning backed securities as well as blended finance. After successfully launching the SDG One Blended Finance roadmap at the IMF-World Bank Annual Meetings in Bali, the Indonesian government also released the first Green Sukuk bond at the beginning of this year. This represents Indonesia's tangible and avowed commitment to environmental infrastructure development.

The authorities also strengthened coordination to speed up financial market deepening. To that end, BI, the MoF, OJK have established the Coordination Forum on Development Financing by means of Financial Market.[5] The Coordination Forum was mandated to formulate a National Financial Market Development and Deepening Strategy as a comprehensive and measurable single policy framework oriented towards realizing the vision of creating deep, liquid, efficient, inclusive and secure financial markets.[6] The authorities have introduced a

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[5] This forum is also called FK-PPK.

[6] The National Financial Market Development and Deepening Strategy is also known as SN-PPPK.

national blue print to accelerate the pace of financial market deepening**.** The authorities have also been working on legal upgrade to align and strengthen the mandate of BI, OJK, and Indonesia Deposit Insurance Corporation (LPS) going forward in order to pursue financial deepening objectives.

Conclusion

Indonesia's economy continues to perform well, underpinned by sound macroeconomic policy aimed at maintaining macroeconomic stability while also promoting higher potential growth. The authorities' policy-mix has successfully preserved macroeconomic stability and maintained the growth momentum amidst rising global uncertainty in 2018. The central bank policies were brought into synergy with the Government's fiscal and structural reform policies. Fiscal policy was aimed to preserve fiscal sustainability outlook, while also providing room to promote economic growth. These policies were further supported by the acceleration of structural reforms efforts. Going forward, the authorities remain committed to maintain economic stability as well as to step up structural reforms to achieve strong, sustainable, balanced and inclusive economic growth.