Statement by Rosemary Lim, Executive Director for Indonesia;
Firman Mochtar, Alternative Executive Director; and
Ferry Kurniawan, Advisor to Executive Director
March 11, 2022

On behalf of our Indonesian authorities, we would like to thank the IMF mission team led by Ms. Cheng Hoon Lim for the constructive policy dialogue during the virtual 2022 Article IV consultation as well as the comprehensive and insightful staff report. The authorities found the discussionsvaluable and share staff's analysis and recommendations to navigate the economic recovery and advance structural reforms.

I. Economic Development and Outlook

The 2021 Indonesian GDP returned to its pre-pandemic level with stronger economic growth at 3.7 percent, higher than staff's projection of 3.3 percent. Swift policy responses to tackle the spread of COVID-19 Delta variant facilitated a gradual re-opening of the economy, hence supporting national economic recovery. The external sector exhibited resilience with strong international reserves position. Inflation remained low at 1.87 percent, below the 3.0±1 percent target range. Financial system stability remained solid with low NPL and ample liquidity, accompanied by a revival of credit growth at 5.2 percent. These positive developments have helped reverse pandemic- induced poverty increases, declining from 10.2 percent in 2020 to 9.7 percent in 2021.

The economic recovery momentum is expected to strengthen in 2022. Growth is projected in the range of 4.7–5.5 percent, supported by a faster vaccination program, broader reopening of theeconomy, and maintained policy stimuli. Inflation is expected to rise to the target band of 3.0±1.0 percent, while current account deficit remains low in the range of 1.1–1.9 percent of GDP. Financial system continues to be resilient, backed by adequate capital and liquidity buffers, and is well- positioned to support the recovery with the credit growth projected to accelerate to 6.0–8.0 percent. Inthe medium term, economic growth is projected to accelerate, consistent with improved productivity bolstered by ongoing structural reforms.

II. Policy Responses

The bold, comprehensive, and well-coordinated policy mix has cushioned the economy from the severe impact of the COVID-19 pandemic. The deployment of vaccines as a necessary condition was expedited to support the recovery. As at February 28, 2022, the first and second vaccination doses were delivered to 70.9 and 53.6 percent of the population respectively. This essential policy was supported by effective national policy mix, including reopening priority sectors that are productive and safe, expediting policy stimuli, and accelerating economic and financial digitalization tied in withstructural reforms.

Authorities will continue their solid measures to navigate a safe exit from the crisis and expeditethe recovery. Authorities share staff's view that policy support is needed until the

recovery firms up, while remaining nimble to mitigate downside risks and rebuild buffer to strengthen economic resilience. The Act No. 2 of 2020 provides the legal basis for undertaking extraordinary responses ina swift, transparent, and accountable manner during the pandemic, under the National Economic Recovery (PEN) framework. The Act stipulates a temporary relaxation of the budget deficit ceiling, which can be widened beyond 3 percent of GDP until 2022. Bank Indonesia (BI) is also permitted to purchase government bonds in the primary market until 2022.

The authorities are committed to strengthening policy synergy and remain adaptive to COVID- 19 dynamics, as well as global and domestic economic conditions, including financial sectors. Vaccination roll-out as a prerequisite for a sustainable recovery will continue to be accelerated, including implementing booster program, and accompanied by reopening priority sectors. Five policydirections to strengthen the recovery will be pursued, covering (i) faster real sector transformation andreform, (ii) synergy between fiscal, monetary, and financial sector policies, (iii) faster financial sectortransformation, (iv) economic and financial digitalization, and (v) green economy and finance. In line with these policy directions, fiscal policy will strike the balance between mitigating pandemic risk, accelerating recovery and supporting structural reforms. BI will direct monetary policy focusing on maintaining stability while pursuing other policies (macroprudential, payment system, money market development, inclusive and green financial-economy) in continuing to support economic recovery. These policies will be integrated with strengthening financial sector policies and advancing structural reforms to boost long-term growth.

Fiscal Policy

Fiscal policy continued to be accommodative as a countercyclical policy to cushion the impact ofthe COVID-19 crisis and support economic recovery. Fiscal deficit stood at 4.62 percent of GDPin 2021, already in declining path compared to 2020 outturn and lower than the initial budget at 5.70 percent as revenue surpassed its target along with optimal spending. Revenue exceeded the target and grew 21.6 percent, driven by tax revenue that has returned to the pre-pandemic level. Government spending increased by 7.4 percent to support the COVID-19 containment measures and several economic recovery programs in the health sector, social protection, and MSME assistance. With such performance, Indonesia’s public sector debt remains low and, as staff highlighted, in the sustainable path.

To ensure the effectiveness of fiscal measures related to the COVID-19 as well as to safeguard accountability, the Government conducted consultation with the Supreme Audit Agency (BPK). The consultation instituted monthly reporting requirements on COVID-19-related programs, and undertook an ex-post evaluation of the effectiveness of the incentives. The 2020 audited report by BPK that provided an Unqualified Opinion (WTP) on the Central Government Financial Report (LKPP) reinforces the government’s commitment to maintaining and improving governance, even during the challenging time. As

staff mentioned, Tax Expenditure Reports published since 2018 have helped to improve transparency and accountability regarding tax incentives.

In 2022, the authorities will direct fiscal policy to maintain the right balance between mitigatingpandemic risk, accelerating economic recovery and supporting structural reforms. The Government will increase revenue and start implementing tax reform by introducing tax regulation harmonization law. Spending quality will be enhanced and directed toward strengthening the COVID-19 handling strategy, supporting the recovery through social protection programs for businesses and MSMEs, and enforcing structural reforms. The Government envisages the 2022 budget deficit to continue to decline lower than the 2021 figure and the initial 2022 budget at 4.85 percent of GDP, contributed by the recent tax reform implementation.

The authorities reiterate their commitment to return to the 3.0 percent deficit ceiling by 2023 and acknowledged the importance of the Medium-term Revenue Strategy to maintain fiscal sustainability. Authorities acknowledge the strategic role of enhancing revenue measures to finance high priority spending critical to achieving Indonesia's development goals. In this context, the tax regulation harmonization law (HPP) has already come into effect and is expected to generate additional revenue. The HPP covers, among others, general provisions and tax procedures, voluntary disclosure program, strengthening the mechanism for determining excisable goods, income tax, VAT,and carbon tax. The authorities will implement additional efforts, including the launch of a core IT infrastructure by 2024 to improve tax compliance, reinforce auditing, and reduce tax avoidance.

As economic recovery is projected to be stronger in 2022, gradual energy subsidy reforms are considered. Prices of selected fuel oil with higher octane were adjusted in early February 2022 to follow the market price. Government has exercised several options to further transform the energy subsidy from commodities-based into targeted beneficiary-based. The Government will seek the right timing and balance between preserving price stability to safeguard the recovery momentum and reforming the energy subsidy.

Monetary and Exchange Rate Policy

Monetary policy remained accommodative in 2021 to support economic recovery while maintaining stability. BI cut its policy rate in February 2021 to 3.50 percent and continued maintaining ample liquidity in the banking sector by conducting quantitative easing totaling Rp147.8 trillion in 2021. BI recognized the accommodative policy has pushed down the overnight interbank rate, but viewed it to be consistent with efforts to achieve the inflation target as the rate remains within the standing facility corridor. BI continued to strengthen the Rupiah exchange rate policy in accordance with fundamentals and market mechanism. A stabilization policy to manage excessive volatility of Rupiah was implemented using triple intervention in the spot market, Domestic Non- Deliverable Forwards, and the purchase of government bond (SBN) in the secondary market.

In 2022, monetary policy will focus more on maintaining stability, while remaining supportive for economic recovery. The direction and phasing of monetary policy will be pre-emptive, ahead the curve, and front loading. The low policy rate will be maintained until there are signs of inflation pressures. Monetary policy normalization will be gradual by absorbing the abundant excess liquidity in the banking system without interfering the bank's ability to expand credit and participate in purchasing SBN. BI will gradually increase Rupiah Reserves Requirement starting in March 2022. These policies will be well-calibrated, planned, and communicated to allow banks to adjust smoothly and ensure the normalization process will not interrupt the ongoing economic recovery.

In anticipation of tightening by the Fed and other advanced economies, BI continues to strengthen Rupiah exchange rate policy to maintain exchange rate stability in line with market mechanism and economic fundamentals. This strategy is in line with staff's assessment, allowing exchange rate to act as a shock absorber. Adjustment in Rupiah exchange rates and SBN yields will remain measured to ensure a competitive yield differential. Foreign exchange intervention will be adopted as needed to address any disorderly market conditions, by optimizing triple intervention strategy. Close coordination with the Ministry of Finance will be strengthened further to maintain Rupiah and SBN market stability as well as manage adjustment according to prevailing global development.

BI committed to purchasing government bond (SBN) directly from the Government up to 2022, in accordance with Act No. 2 of 2020 as part of monetary-fiscal policy coordination. In 2021, in addition to purchasing SBN in the primary market in accordance with Joint Decree I (KB I) issued on April 16, 2020, BI committed to purchasing SBN directly from the Government in accordance with Joint Decree III (KB III) – between the Minister of Finance and Governor of BI on August 23, 2021. Under the KB I scheme, BI purchased SBN amounting to Rp143,3 trillion in 2021. In accordancewith KB III, BI committed to purchasing SBN directly from the Government, totaling Rp215 trillion in 2021 and Rp224 trillion in 2022.

The SBN purchases were carried out by sticking to the principles of governance, prudence, and monetary discipline, as well as the commitment to maintain monetary stability going forward. As previous joint decrees, the purchase in KB III is also focused on health and humanitarian financingto address the pandemic, including mitigating the rapid spread of the Delta variant in mid-2021. The purchase in KB III is carried out carefully and in a well-measured manner, while maintaining the prudent fiscal and monetary policy as well as considering both the sustainability of BI's financial capacity and fiscal sustainability. As staff recognized in Appendix VII, in the purchases implementation, BI adheres to four main principles, namely: (i) prioritizing market mechanisms; (ii) considering the impact on inflation; (iii) purchasing only tradable and marketable SBN; and (iv) BI's purchases on a last-resort basis. So far, the principles have succeeded in preserving policy credibility and maintaining the confidence of investors and rating agencies. This can be seen, *inter alia*, in

the return of capital inflows, particularly SBN and the retention of Indonesia's rating by the major rating agencies.

BI emphasizes focus on consistent formulation and implementation of the central bank policy mix to safeguard macroeconomic stability and support economic recovery. The central bank policy mix will optimize and integrate all available policies, comprising monetary policy, macroprudential policy, payment system policy, money market deepening, as well as inclusive and green financial economy. With regard to monetary policy, BI will not solely rely on the interest rateas a policy instrument to achieve price stability and manage external stability, but also integrate other instruments, such as quantity measures, exchange rate policy, and monetary operation strategy. Indonesia's experience showed that the integrated policy framework supported by an effective communication strategy has helped achieve the policy objective.

Financial Sector Policies

BI continued to pursue accommodative policies in 2021 to facilitate credit intermediation, while maintaining financial stability. To support intermediation activities, BI loosened the down payment requirements on automotive loans and Loan/Financing-to-Value (LTV/FTV) Ratio on Property Loansas well as gradually raised Macroprudential Intermediation Ratio. BI has also conducted and published in-depth assessments of Prime Lending Rate transparency in the banking industry since February 2021 to strengthen the transmission of monetary and macroprudential policies. BI refined and modernized the MSME Credit Ratio policy into the Macroprudential Inclusive Financing Ratio (RPIM).

Financial Services Authority (OJK) also strengthened prudential regulation. OJK extended the loan restructuring program applicable for commercial banks and rural banks and relaxed both the risk weighting policy for credit risk-weighted assets/motor vehicle financing and the risk-weighted assets for credit/mortgage funding depending on the LTV/FTV ratio. In line with BI and OJK's accommodative stance, the Government extended its credit guarantees to corporations and MSMEs within the PEN framework from 1 to 3 years, extended the priority sector criteria, increased the creditguarantee coverage, and lowered the minimum amount of the credit. These efforts succeeded in increasing the distribution of bank credit guarantees for the corporate and MSMEs segment.

BI will continue pursuing an accommodative macroprudential policy in 2022 to support the economic recovery, considering the financial cycle is still below the long-run trend. BI will provide incentives for banks disbursing financing to priority sectors and inclusive financing and/or banks achieving the RPIM target in the form of reduction in the reserve requirement of up to 1 percent, effective March 1, 2022. With regard to staff's concern on RPIM, BI has strengthened its implementation while preserving bank resilience, by adjusting the requirement, which is now set for each individual bank based on the bank's commitment as stated in their annual Business Plan.

In the same vein, OJK has set policy priorities, include (i) providing joint incentives to encourage financing to down streaming the commodity sector according to government priorities; (ii) developing an innovative financing scheme for green sectors, with the priority of green economy; (iii)expanding financial access to the public, especially MSMEs, to achieve the target of MSME lending of 30 percent 2024; and (iv) strengthening digital transformation policies in the financial services sector. Authorities will also remain vigilant to monitor the financial and non-financial corporate sector by strengthening supervisory. To maintain banking sector stability, authorities will extend the relaxation of loan classification standards until 2023Q1, considering the uncertain environment.

Authorities concur with staff that credit growth could be facilitated by reducing information asymmetries. In the same spirit and recognizing the importance of banks to better assess credit risks, OJK issued a regulation in 2019 on the Credit Information Managing Institutions. The rule allows the private sector to establish a credit bureau that supports the provision of credit information sharing between banks and borrowers where currently there have been licenses for some credit bureaus operating.

As staff underscored, BI will accelerate the digitalization of the payment system and financial market deepening. Digitalization as laid out in Indonesia Payment System Blueprint 2025 will be implemented through several programs including expanding both Quick Response Indonesian Standard (QRIS) uptake and the cross-border QRIS implementation, accelerating open banking through the National Standard of Open API for Payment (SNAP) in the payment system, and increasing greater acceptance of BI Fast Payment (BI-FAST). BI will accelerate preparations to issue digital rupiah. Meanwhile, financial market deepening reforms will be expedited through programs carried out as part of the Blueprint for Money Market Development 2025. BI also continues to accelerate the development of the national sharia economy and finance as a new source of inclusive and sustainable economic growth.

Structural Reforms

Efforts to reinforce structural reform in many areas continue apace, even during these challenging times. The Government has accelerated the implementation of the Omnibus Law on Job Creation, which staff acknowledged as a major reform to improve the ease of doing business in Indonesia. The Government has issued 51 regulations as a follow-up of the Law, promulgated on February 2, 2021, *inter alia* the regulations correspond to the Implementation of Risk-Based BusinessLicensing. The regulations cover the Norms, Standards, Procedures and Criteria of the licensing management system in Ministries/Institutions based on the Online Single Submission (OSS) system, as the simplification of licensing through the implementation of risk-based method OSS System.

In 2021, authorities improved the investment climate by changing the licensing process and expanding the business fields for investment. All business fields are open for

investment, except for business fields carried out only by the central government. The new 2021 regulation includes amending the 2016 regulation by expanding to 246 business activities as priority business and 182 business activities allocated for requiring partnership with cooperative and MSMEs.

Indonesia has been proactively tackling climate change issues and making significant progress. The Government's commitment to climate change mitigation has been formulated in the Nationally Determined Contribution, which set a conditional reduction target up to 41 percent and unconditional GHG reduction target of 29 percent; and Net Zero Emission which aim at reaching zero emissions in 2060 or sooner. The Government continues to develop innovative policies such as Climate Change Fiscal Framework, a framework to mobilize funds outside the budget, and carbon pricing or carbon economic value as a part of a comprehensive policy package for climate change mitigation. As an initial step to build awareness, the carbon tax will be applied to coal-fired power plants at a rate of IDR30,000/tCO2e starting April 1, 2022 and will be evaluated periodically and set higher or equal to the carbon price in the carbon market. OJK also supports the Government’s commitment through efforts of Sustainable Finance Roadmap, including recently released Indonesia Green Taxonomy. Thetaxonomy provides classification of green sectors/sub-sectors and the development of the regulatory framework of carbon exchange, financial services sector reporting system that includes green financing/instruments.

III. Conclusion

The authorities are committed to strengthening policy synergy to accelerate economic recovery, preserve stability and advance structural reform. The spirit of policy synergy is also brought up to the global forum in Indonesia’s G20 Presidency in 2022. Indonesia is determined to seek optimal solutions globally and ensure all countries recover together, while promoting policy reform to supportstronger, sustainable, balanced and inclusive post-pandemic economic growth, as reflected in the theme of “Recover Together, Recover Stronger.”