CHAPTER 10

Economic Outlook and Policy Direction

The outlook for the Indonesian economy is characterized by higher economic growth and sustained macroeconomic and financial system stability. This outlook is the result of increasingly solid policy synergies among Bank Indonesia, the Government, the Financial Services Authority and other authorities, as well as consistent structural reforms and therefore, placing Indonesia as an upper-middle-income countries.
Chapter 10
Economic Outlook and Policy Direction

The Indonesian economy has an improved outlook for 2019 despite persistent unfavorable global economic conditions that require ongoing attention. Indonesia’s economy is expected to maintain its momentum with growth in the range of 5.0% to 5.4%, supported by strong domestic demand. External resilience should strengthen on the back of a current account deficit that has fallen to around 2.5% of gross domestic product (GDP), and boosted by increased inflows of foreign capital. Price stability is also under control and inflation is predicted to be in the target range of 3.5±1%. The stability of the financial system will also be maintained, supported by improved intermediation, with credit growth of 10% to 12% in 2019.

In the medium term, the domestic economy is expected to maintain an upward trajectory. This outlook is in line with the positive impact of structural reforms that are predicted to improve economic efficiency and build economic capacity. The economic structure is also expected to be more resilient, supported by more permanent and healthy sources of financing. This improved structural outlook could, in turn, drive economic growth to between 5.5% and 6.1% by 2024. External resilience is continually improving, with downward trend in current account deficit as well as low and stable inflation.

Policy synergies among Bank Indonesia, the Government, the Financial Services Authority (OJK) and other authorities are increasingly solid, thereby further boosting Indonesia’s economic outlook. In this regard, monetary policy, financial sector policy and fiscal policy are still directed at safeguarding macroeconomic and financial sector stability, while using the space available to put in place economic growth stimuli. These economic stimuli include optimizing the financial market deepening policy, the macroprudential and payment system policies, and sharia economics and finance policy. Financial system stability also continues to improve through close coordination among the Ministry of Finance, Bank Indonesia, OJK and the Deposit Insurance Corporation (LPS), under the umbrella of the Financial System Stability Committee (KSSK). This close coordination also covers the prevention and resolution of financial crises.

Indonesia builds policy synergies to consistently take structural reforms in four main target areas: first, improving the competitiveness of the national economy, by boosting availability of infrastructure, quality of human capital, adoption of technology, and institutional support; second, developing the capacities and capabilities of the industrial sector; third, optimizing the use of the digital economy; fourth, broadening the sources of economic financing.

10.1. Global Economy to Remain Unfavorable

The global economy is expected to remain unfavorable in 2019, mainly due to persistently weak global economic growth. Global economic growth is predicted to slow to 3.6%, down from 3.7% in 2018. Due regard should be paid to this as it could affect the performance of the domestic economy through trade channels.

The downturn in world economic growth is largely due to the economic slowdown in developed economies such as the United States, the Eurozone and Japan (Table 10.1). The prospect of slowing US economic growth is in line with the diminishing impact of the country’s fiscal stimulus and ongoing trade tensions with several trading partners, most notably China. The Eurozone economy is also predicted to slow due to declining export performance and structural problems related to labor. Meanwhile, the continued slowdown in Japan is influenced by a reduction in the fiscal stimulus and

<table>
<thead>
<tr>
<th>Country/ Country Group</th>
<th>2018</th>
<th>Projection 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>World GDP</td>
<td>3.7</td>
<td>3.6</td>
</tr>
<tr>
<td>Developed Countries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>2.9</td>
<td>2.3</td>
</tr>
<tr>
<td>Europe</td>
<td>1.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Japan</td>
<td>0.9</td>
<td>0.8</td>
</tr>
<tr>
<td>Developing Countries</td>
<td>4.6</td>
<td>4.6</td>
</tr>
<tr>
<td>China</td>
<td>6.6</td>
<td>6.4</td>
</tr>
<tr>
<td>India</td>
<td>7.5</td>
<td>7.6</td>
</tr>
</tbody>
</table>

Source: IMF, CF, calculated
a shrinking workforce. But as developed economies continue to experience slowing growth, the economies of developing countries are predicted to be stable, supported in large part by the continued upturn in the Indian economy. The increase in India’s economic growth has been achieved through structural reforms and accelerated infrastructure projects. These are expected to have a positive impact on the Indian economy in the medium to long term. Meanwhile, China’s economic growth is expected to decelerate as it undergoes a rebalancing and deleveraging process, exacerbated by the trade tensions with the US.

The prospect of slowing global economic growth has a negative impact on the volume of global trade, which is forecast to grow modestly in 2019 at around 3.4%. The slowdown in the volume of global trade is also associated with sustained trade tensions between the US and China, and between the US and several other trading partners.

The global economic slowdown and ongoing trade tensions also have an impact on global commodity prices. The composite price of Indonesian export commodities is predicted to decline in 2019 – by around 3.1% – mainly due to lower prices of coal, copper, nickel and aluminium (Table 10.2). Meanwhile, the world oil price is estimated to drop to around USD63 per barrel in 2019 as supply from the US increases.

With the prospect of sluggish world economic growth, the direction of world monetary policy, including Federal Reserve policy, still needs to be watched. At the moment, the normalization of monetary policy in developed countries in 2019 is projected to be less aggressive than in 2018. The Federal Funds Rate (FFR) is expected to rise just once in 2019, much slower than 4 FFR hikes in 2018. The reduction in the balance sheet of the US Federal Reserve is also expected to be smaller than previously planned. Meanwhile, the European Central Bank (ECB) is expected to keep interest rates low in 2019.

Another global factor that may influence the outlook for the domestic economy is the uncertainty surrounding global financial markets. The risk of uncertainty surrounding global financial markets deserves ongoing attention as it can cause risk premiums for investment in developing countries to soar. This condition could trigger another reversal of capital flows from developing countries and could impact liquidity conditions. The possibility of continued trade tension between the US and China could also create further global market uncertainty. Risk perception and negative sentiment in global financial markets can also be worsened by economic vulnerability in other developing countries, such as the economic deterioration in Argentina and Turkey in 2018, the impact of which spread to other developing countries.

10.2. Domestic Economy to Remain Strong

Amid unfavorable global economic conditions, the domestic economy in 2019 is expected to remain strong, characterized by improved economic growth and sustained stability. Indonesia’s economic growth in 2019 is predicted to remain solid – in a range of 5.0% to 5.4% – supported by persistently robust domestic demand, both in consumption and investment (Table 10.3). However, net export contribution to growth is expected to be modest, in line with the slowing growth of the world economy.

Indonesia’s private consumption is expected to grow strongly in 2019 and to drive economic growth. Private consumption is projected to grow in a range of 5.2% to 5.6%, influenced by strong household consumption and higher consumption of non-profit institutions serving households (NPISH). Household consumption growth is expected to remain strong, supported by sustained purchasing power, higher income and low inflation, and

![Table 10.2. Projection of Export Commodity Price Index](image)

<table>
<thead>
<tr>
<th>Commodity</th>
<th>2018</th>
<th>Projection 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Copper</td>
<td>6.7</td>
<td>-3.8</td>
</tr>
<tr>
<td>Coal</td>
<td>2.5</td>
<td>-9.8</td>
</tr>
<tr>
<td>CPO</td>
<td>-19.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Rubber</td>
<td>-16.8</td>
<td>2.2</td>
</tr>
<tr>
<td>Nickel</td>
<td>27.8</td>
<td>-3.7</td>
</tr>
<tr>
<td>Tin</td>
<td>0.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Aluminium</td>
<td>7.4</td>
<td>-5.6</td>
</tr>
<tr>
<td>Coffee</td>
<td>-15.4</td>
<td>-4.1</td>
</tr>
<tr>
<td>Others</td>
<td>1.2</td>
<td>-0.3</td>
</tr>
</tbody>
</table>

Indonesia Export Commodity (Non-Oil and Gas) Price Index (IHKEI NM) Total

-4.4 -4.3

Indonesia Export Commodity (Non-Oil and Gas) Price Index (IHKEI NM) Total

-2.8 -3.1

Source: WEO (IMF) and Bloomberg, calculated

---

1 Private consumption consists of household consumption and consumption of non-profit institutions serving households (NPISH).
the positive economic impact of the general elections. The government fiscal stimulus – carried out through both social assistance and other fiscal instruments – also plays a role in supporting household consumption. NPISH consumption was boosted by spending related to the 2019 general election, and this in turn also pushed up private consumption.

The Government’s fiscal stimulus has helped to underpin strong private consumption. In the 2019 State Budget (APBN), the Government increased the budget allocation for social security programs, particularly for the poorest 40% of the population. For example, the Government raised the budget for the Family Hope Program (PKH) to IDR34.1 trillion in 2019 from IDR17.3 trillion in 2018. The Family Hope Program will support 10 million beneficiary families in 2019. In addition, the Government also expanded the number of people entitled to extra assistance with healthcare costs (PBI) to 97 million people from 92 million, and increased the number of recipients of the Indonesia Pintar (Smart Indonesia) and Bidik Misi (Mission Target) scholarship programs. The Government also raised energy and non-energy subsidies to maintain the purchasing power of low-income people. In addition, the increased budget allocation for Village Funds is intended to boost income and purchasing power of rural communities (Chart 10.1).

Gross fixed capital formation (GFCF) is expected to continue growing strongly, driven largely by higher non-construction investment. GFCF growth in 2019 is forecast between 6.4% and 6.8%. This projection is in line with the expected increase in exports, and completion of infrastructure projects. Non-construction investment growth, particularly in the form of machinery and equipment, is projected to be in the range of 8.1% to 8.5%. This high growth in non-construction investment is related to the non-construction component of infrastructure projects. The Government is likely to continue most infrastructure projects (some were under review), particularly national strategic projects (PSN). In 2019, the Government is expected to finish 31 projects, and another 25 projects, currently under construction, will begin operating (Chart 10.2).

The contribution of net exports in supporting economic growth in 2019 is expected to be modest. There are two parts to this: first, exports will weaken compared to 2018, in line with unfavorable global conditions. Exports in 2019 are projected to grow in the range of 4.4% to 4.8%, influenced by the slowing global trade growth and falling global commodity prices. Second, imports are also expected to slow, with growth in the range of 7.1% to 7.5%. A lower import growth is in line with a slowdown in export, together with government initiative to reduce imports by expanding the usage of B20 and fiscal incentives to accelerate development in upstream industries.

By business sector, the outlook for GDP is largely influenced by domestic demand. Manufacturing, the largest sector by output, is expected to strengthen in 2019 due to strong domestic demand. Manufacturing sector growth is forecast in a range of 4.3% to 4.7% for 2019, the result of successful efforts by the Government to improve competitiveness of industry. The Government has been promoting the competitiveness of the manufacturing sector by developing innovative and sustainable production systems. It has also been consistently improving the investment climate, infrastructure and connectivity, improvements that will...
also spur manufacturing sector performance. However, manufacturing sector growth will face challenges from the performance of industry based on natural resources, owing to the expected declines in commodity prices in 2019.

Slowing global economic growth and declining global commodity prices are likely to impact the agriculture and mining industries in 2019. The performance of the agriculture, forestry and fisheries sector is projected to grow moderately at 3.8% to 4.2% as improvement in the prices of major agricultural export commodities are limited. Mining and quarrying sector is expected to record limited growth of around 1.4% to 1.8%, as prices of coal and some base metals fall.

The performance of other sectors that are closely associated with domestic demand is predicted to improve. These sectors include trade, hotels and restaurants, transport and communication services, as well as construction (Table 10.4). The trade, hotels and restaurants sector is projected to grow 5.0% and 5.4%. This is due to an increase in household consumption and higher tourism activities, the latter being the result of intensive government efforts to promote tourism and accelerate the development of priority tourism destinations. The transport and communication sector in 2019 is projected to grow in the range of 7.1% to 7.5%, influenced by the rapid development of the digital economy, particularly e-commerce. Meanwhile, construction is likely to grow at a relatively high level of between 6.1% and 6.5% in 2019, driven by solid construction investment and acceleration in some infrastructure projects, particularly national strategic projects.

Sustained strong domestic demand will also prompt fairly robust growth in other sectors. The services sector is predicted to grow by between 5.6% and 6.0% as household spending on education and health continues to increase. In addition, an increase in government spending on social security programs and the presidential election and legislative elections in 2019 will also contribute to the growth of this sector. Meanwhile, the utilities sector – electricity, gas and water – is expected to grow in a range of 5.1% to 5.5% in 2019, above its average annual growth rate. Growth in utilities will stem from a rise in electricity consumption as economic activity increases, and will be supported by the completion of power plant projects.

Table 10.4. GDP Outlook by Industrial Origin 2019

<table>
<thead>
<tr>
<th>Industrial Origin</th>
<th>2018</th>
<th>Projection 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Domestic Bruto</td>
<td>5.2</td>
<td>5.0 - 5.4</td>
</tr>
<tr>
<td>Agriculture</td>
<td>3.9</td>
<td>3.8 - 4.2</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>2.2</td>
<td>1.4 - 1.8</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>4.3</td>
<td>4.3 - 4.7</td>
</tr>
<tr>
<td>Electricity, Gas &amp; Water</td>
<td>5.5</td>
<td>5.1 - 5.5</td>
</tr>
<tr>
<td>Construction</td>
<td>6.1</td>
<td>6.1 - 6.5</td>
</tr>
<tr>
<td>Trade, Hotel &amp; Restaurant</td>
<td>5.1</td>
<td>5.0 - 5.4</td>
</tr>
<tr>
<td>Transportation and Communication</td>
<td>7.1</td>
<td>7.1 - 7.5</td>
</tr>
<tr>
<td>Finance, Rental &amp; Services</td>
<td>4.9</td>
<td>4.9 - 5.3</td>
</tr>
<tr>
<td>Services</td>
<td>6.8</td>
<td>5.6 - 6.0</td>
</tr>
</tbody>
</table>

Source: BPS and Bank Indonesia
Continuing strong domestic demand is expected to drive higher growth in most regional economies. Domestic demand is forecast to remain robust in all regions as purchasing power is sustained, and due to better disbursement of social assistance and Village Funds, the positive impact of general election process, and the completion of infrastructure projects. Strong domestic demand will lead to high growth of manufacturing in Java, while the trade, hotels and restaurants sector is projected to grow robustly in all regions. However, manufacturing exports from Java and natural-resource-based commodity exports from regions outside Java are expected to be slightly restrained by slowing global demand and declining commodity prices. In line with declining commodity prices, the performance of the mining sector is restrained in Sumatra, Kalimantan, and in parts of Sulawesi, Maluku and Papua.

Indonesia’s Balance of Payments to Improve

Indonesia’s balance of payments (BoP) is forecast to improve in 2019 due to a reduced current account deficit and higher foreign capital inflow. In 2019, the current account deficit is expected to fall to around 2.5% of GDP. This positive outlook is partly due to ongoing government measures to reduce imports, such as the expansion of the B20 biodiesel program, which was implemented in the second half of 2018, and revisiting some of infrastructure projects that have a high proportion of imported inputs. Concurrently, measures are being taken to increase manufacturing exports and enhance the role of the tourism sector. Efforts to increase manufacturing exports focus on the implementation of policy packages and incentives to strengthen exports, and supporting infrastructure. Meanwhile, the Government is also working on efforts to develop the tourism sector in Indonesia and attract more foreign tourists.

Growing foreign capital inflow is expected to increase the capital and financial account surplus. This expansion in foreign capital inflow is supported by the attractiveness of domestic financial assets, and waning global uncertainty. With Indonesia’s economic growth gaining momentum, the capital and financial account surplus is expected to rise, exceeding the 2018 level. The improved surplus derives from a greater flow of direct investment, an improved business climate and a favorable domestic economy outlook. Portfolio investment is expected to improve as uncertainty over global financial markets diminishes, complemented by the normalization of monetary policy in the US and other developed countries, which is expected to unfold at a slower pace in 2019.

**Controlled Inflation Within Targets**

Inflation in 2019 is projected to remain under control and within the target range of 3.5±1%. This outlook is supported by all components of inflation – core, volatile food (VF) and administered prices (AP). Inflation expectations are also forecast to remain within the target range and this will support controlled inflation in the future (Chart 10.3). The anchoring of inflation expectations within the target range is due to the consistency of monetary policy, which has facilitated the achievement of inflation targets over the past four years.

Core inflation in 2019 is expected to remain under control in line with minimal global price pressures, adequate production capacity to meet domestic demand, and anchored inflation expectations. The prospect of moderate price pressure on imported non-oil and gas commodities is expected to have a positive, limited impact on inflationary pressure. Meanwhile, the prospect of ongoing strong domestic demand is likely to be balanced by adequate domestic production capacity. Controlled core inflation is also supported by inflation expectations that remained anchored within the target range. Slowing inflation over the past few years, along with policy consistency in keeping inflation within the target range, has helped to ensure that inflation

---

**Chart 10.3. Inflation Forecasts**

![Inflation Chart](chart.png)

Source: Consensus Forecast and WEO, calculated
expectations remain anchored to inflation targets. Meanwhile, the prospect of controlled VF and AP inflation in 2019 will also have a positive impact on core inflation.

VF inflation is expected to be mild, supported by intensive government measures to maintain food price stability. The Government will continue to focus on measures to maintain affordable prices, availability of supplies, seamless distribution and effective communication (together these are known as 4K in Indonesian). The Government has in recent years worked hard to strengthen the connectivity of infrastructure, the supporting infrastructure for agricultural production, and the management of food stocks, all of which play a major role in keeping VF inflation under control.

Administered prices inflation is expected to be benign due to relatively minimum pressure coming from strategic goods and services administered by the government. Therefore, the potential for rising inflation stemming from adjustments of fuel and energy prices is also expected to be minimal, as reflected in the 2019 State Budget. This is in line with expectations that upwards price pressure on global oil prices will be limited in 2019, amid moderate increase in oil prices. This oil price projection will help to keep AP inflation low, considering that the weight of fuel and energy in the inflation basket is relatively high.

Inflation in most regions is also expected to support the achievement of the national inflation target of 3.5±1%. This is due to improvements in food production and agricultural production facilities, schemes and technology. Infrastructure improvements, including ports in Sumatra and Sulampua, will have a positive impact on connectivity, and minimize distribution constraints.

The outlook for controlled regional inflation is also supported by intensifying interregional cooperation on food availability. In addition, stronger collaboration between the Central Inflation Control Team (TPIP) and Regional Inflation Control Teams (TPID) – contributes to the favorable inflation outlook. Inflation control coordination will be boosted in line with the 2019–2021 Regional Inflation Control Roadmap, which aims to achieve low and stable inflation. Regional efforts to control inflation are focused on making distribution and supply more effective. Smooth distribution is being pursued through the construction of wholesale markets, the revitalization of traditional markets, and infrastructure improvements. Meanwhile, supply availability is brought about, among other, through institutional strengthening, warehouse construction and warehouse receipt systems, assistance with production facilities for micro, small and medium enterprises (MSME), and the building of food stock (Figure 10.1).

**Increased Intermediation, Financial System Maintained**

In line with the favorable outlook for the domestic economy, banking intermediation is expected to perform better. Loans are expected to grow at a rate of 10% to 12% in 2019, and bank deposits are expected to grow at a rate of 8% to 10%, with liquidity remains adequate. The rise in loan growth will accompany an increase in economic activity, supported also by an increase in the growth of deposits as investors return to developing countries. Meanwhile, financing from financial markets is also expected to rise as the domestic financial market develops. Overall, the outlook for economic recovery is supported by increased financing through banks and non-banks.

Meanwhile, banking resilience and financial system stability are expected to remain sound. This is based on the ability of banks to manage credit risks well – contributing to ongoing profitability – and a high capital adequacy ratio. Bank liquidity conditions are also expected to be sustained. The ongoing stability of the financial system is supported by the macro-prudential policy mix adopted by Bank Indonesia and OJK.

**10.3. Optimism in the Medium Term**

The domestic economy is expected to continue improving in the medium term, despite forecasts that global economic growth will remain relatively unchanged. Medium-term world economic growth is forecast to remain at around 3.5%, held back by slowing productivity growth. Recent developments indicate that global productivity is lower than it was prior to the 2007–2008 global financial crisis (Chart 10.4). This can be attributed to aging populations in developed countries and low investment, which results in poor capital accumulation and slow technological innovation.
Slowing global economic growth means that world oil prices will follow a downward trend. The decline in world oil prices is also due to increased US shale production and increasing supply from members of the Organization of the Petroleum Exporting Countries (OPEC). Meanwhile, commodity prices are expected to remain unchanged, the Petroleum Exporting Countries (OPEC). Meanwhile, commodity prices are expected to remain unchanged, and the normalization of US monetary policy is likely to conclude at the end of 2019.

The Indonesian economy in the medium term is expected to strengthen further, supported by increased productivity and economic efficiency. Indonesia’s economic growth is forecast to rise to between 5.5% and 6.1% by 2024. This strengthening medium-term outlook will be complemented by an increase in productivity due to the positive impact of accelerating infrastructure development, the development of human capital, and deregulation. Infrastructure improvements – including power plants, toll roads, ports and airports – is expected to reduce production and distribution costs and have a positive impact on economic competitiveness and capacity. In addition, deregulation has taken place as part of the structural reform program, contributing to the improving investment climate in Indonesia.

Productivity is expected to increase, consistent with the improvement of the investment climate and the positive impact of better domestic infrastructure. Total factor productivity (TFP) is forecast to grow at around 1% per year, and its contribution to economic growth will also pick up. This rise in productivity will be accompanied by an accumulation of capital and an increase in investment. These improvements are the outcome of the Government’s structural reforms.

Higher productivity is also influenced by improved quality of human resources, and therefore increasing the supply of skilled workforce. The average schooling years is expected to continue to rise gradually to 9.2 years in 2024 from 8.7 years in 2018. This forms an integral part of government efforts to improve the quality of education, which includes developing vocational education and improving the quality of teachers. This is supported by...
increasingly adequate budget allocations for education and research.

The improvement in economic productivity is sustained by Indonesia’s strong economic structure, with an ever-greater role played by private consumption and investment, and by improvements in net export performance. Private consumption in the medium term is expected to buoyed by higher proportion of working-age population, representing a demographic bonus, as well as growing middle class. The improving domestic economy will lift incomes, and this in turn will encourage household consumption.

As with private consumption, government consumption growth is expected to trend upward, supported by higher state revenue. The Government is successfully optimizing the sources of state revenues, particularly through taxation, so that it can provide more fiscal space for productive spending.

Investment is expected to grow robustly as the investment climate and infrastructure improved. The Government’s efforts to expedite structural reforms, including through deregulation and the implementation of economic policy packages, will have a positive impact on competitiveness and investment climate. Investment will play more important role in the economy, with investment-to-GDP ratio trending upward.

Investment performance is also supported by construction and non-construction investment, including infrastructure projects financed by both government and the private sector. This is in response to strong domestic demand and the prospect of relatively high economic growth. However, the growth of non-construction investment is expected to exceed that of construction investment in the medium term as most infrastructure projects will soon reach completion stage (Chart 10.5). At the completion stage, demand for non-construction components are expected to be higher. GFCF, in the form of machinery and equipment from the private sector, is also expected to rise in line with growing domestic demand.

Export growth is expected to increase in the medium term driven by structural reforms and improved competitiveness. In line with increasing export growth, medium-term import growth is also expected to remain high, mainly in the form of machinery, equipment and components for infrastructure projects, as well as for replacement investment. Although remain high, import growth is expected to gradually declining overtime as domestic capacity expand.

Import growth is predicted to decline gradually in the medium term as the Government attempts to encourage the development of upstream and intermediate industries. In the medium term, imports of raw materials to produce export goods and to meet the needs of the domestic market are expected to decrease slightly. Imports of consumer goods are also expected to decline, as rising household consumption will be met by domestic production.

The structure of the economy is also strengthened by an expansion of business sectors, and particularly by the anticipated growing role of the manufacturing industry. The faster growth of manufacturing – and its mounting contribution to the economy – is supported by sustainable structural reforms, particularly by the increased capacity of energy and connectivity infrastructure. Deregulation via economic policy packages is expected to continue driving improvement in Indonesia’s investment climate and competitiveness. The expanding role of manufacturing is also complemented by new high-value-added industries, which will reduce Indonesia’s dependence on commodity-based exports. The transformation of Indonesian industry towards more advanced technology is also being enhanced by deeper integration into the global supply chain.

Domestic manufacturing sector, plays more important role, as domestic demand expands, together with
improvements in industrial capabilities and capacities. The improvements in the domestic economy, which is expected to gain strength in the medium term, will also greatly support domestic manufacturing. Strong domestic demand and a growing middle class pushes up demand for manufactured products, including demand for more complex products. Indonesia’s manufacturing sector is expected to build its capacities and capabilities in response to this increase in demand.

With greater competitiveness, it is thought that goods produced domestically will be able to compete with imports. Furthermore, government steps to encourage the development of Indonesian manufacturing by implementing the new Industry 4.0 strategy will have a positive impact on both the efficiency and productivity of the sector.

The development of manufacturing will drive the process of economic transformation in the medium term. However, a decline is anticipated in the role of several business sectors linked to commodities, such as agriculture, mining and quarrying. Activity is likely to shift from tradable sectors to non-tradable sectors such as transport and communications, and finance, real estate and corporate services, with the construction sector in particular expanding. These shifts or transformations are expected to occur because of the attractiveness of the non-tradable sectors.

Several external factors still need to be heeded as they may affect the expansion of Indonesian manufacturing. Notably, global competition is intensifying and global growth is persistently weak. As global trade becomes more open, competition also becomes more intense. This makes it more difficult for Indonesia to export its own manufactured goods. Largely unchanged global economic growth is also likely to result in limited export demand for manufactured products. And further, Indonesia’s involvement in the global value chain also requires consistent improvement.

More Robust External Resilience

Indonesia’s medium-term external resilience is expected to be stronger with positive outlook for Indonesia’s BoP. The performance of the BoP is expected to continue to improve on the back of a declining current account deficit and a rising capital and financial account surplus. Improvements to the external sector, along with the positive influence of the structural reforms undertaken by the Government, support the prospect of BoP. Meanwhile, the implementation of structural reforms will boost productivity and economic efficiency, and ultimately have a positive impact on Indonesia’s competitiveness. Further, this will stimulate an increase in capital flows to Indonesia. The combination of these positive factors will have a positive impact on the BoP and will support an increase in foreign exchange reserves.

The fall in the current account deficit is being driven by enhanced competitiveness, and is underpinned by continuing structural reforms. The non-oil and gas trade surplus will rise due to several factors: growth of export-oriented manufacturing, an improving import substitution industry and growing competitiveness. This increased non-oil and gas trade surplus is expected to compensate for the oil and gas deficit. Indonesia’s oil and gas sector is under pressure from a decline in domestic oil and gas lifting, amid rising domestic consumption. The service account deficit continues to narrow in line with improvement in domestic shipping and greater growth in tourism. Meanwhile, a rise in the flow of foreign direct investment (FDI) will cause the primary income deficit to increase. The secondary income surplus is expected to increase in line with the rising quality of Indonesian workers employed abroad. In the medium term, the current account deficit is projected to decline, heading to below 2.0% of GDP by 2024.

Indonesia is expected to post a consistently increasing capital and financial account surplus in the medium term. The flow of direct investment, which underpins this performance, is expected to continue gathering pace as the investment climate improves. This increase in FDI is facilitated by various government infrastructure projects and the positive impact of the implementation of economic policy packages on economic competitiveness. Meanwhile, the flow of portfolio investment is predicted to grow, consistent with the expected completion of policy normalization in developed countries. In line with the growing need for infrastructure funding and high export and import growth, other investment flows are also expected to be substantial.

More Robust External Resilience

Indonesia’s medium-term external resilience is expected to be stronger with positive outlook for Indonesia’s BoP. The performance of the BoP is expected to continue to improve on the back of a declining current account deficit and a rising capital and financial account surplus. Improvements to the external sector, along with the positive influence of the structural reforms undertaken by the Government, support the prospect of BoP. Meanwhile, the implementation of structural reforms will boost productivity and economic efficiency, and ultimately have a positive impact on Indonesia’s competitiveness. Further, this will stimulate an increase in capital flows to Indonesia. The combination of these positive factors will have a positive impact on the BoP and will support an increase in foreign exchange reserves.

The fall in the current account deficit is being driven by enhanced competitiveness, and is underpinned by continuing structural reforms. The non-oil and gas trade surplus will rise due to several factors: growth of export-oriented manufacturing, an improving import substitution industry and growing competitiveness. This increased non-oil and gas trade surplus is expected to compensate for the oil and gas deficit. Indonesia’s oil and gas sector is under pressure from a decline in domestic oil and gas lifting, amid rising domestic consumption. The service account deficit continues to narrow in line with improvement in domestic shipping and greater growth in tourism. Meanwhile, a rise in the flow of foreign direct investment (FDI) will cause the primary income deficit to increase. The secondary income surplus is expected to increase in line with the rising quality of Indonesian workers employed abroad. In the medium term, the current account deficit is projected to decline, heading to below 2.0% of GDP by 2024.

Indonesia is expected to post a consistently increasing capital and financial account surplus in the medium term. The flow of direct investment, which underpins this performance, is expected to continue gathering pace as the investment climate improves. This increase in FDI is facilitated by various government infrastructure projects and the positive impact of the implementation of economic policy packages on economic competitiveness. Meanwhile, the flow of portfolio investment is predicted to grow, consistent with the expected completion of policy normalization in developed countries. In line with the growing need for infrastructure funding and high export and import growth, other investment flows are also expected to be substantial.
Continued Declining Inflation

Inflation in the medium term is predicted to remain low, supported by improved economic efficiency and productivity. It is anticipated that inflation will continue to decline towards a range of 3.0±1%. Core inflation is forecast to be relatively low given supply-side improvements – stronger production capacity in response to increasing demand. Improving the distribution of goods and services through the availability of roads, bridges, ports and supporting infrastructure will also have a positive impact on transport and logistics costs, thus contributing to a decline in inflation. The expected downward inflationary trend will also be marked by a lower disparity in inflation among regions. This is due to an improved supply chain and the rising productivity of the agricultural sector.

Low inflationary pressure is also due to stable commodity prices in the medium term. The World Bank forecasts global food price increases – including for wheat, rice and beef – will be limited in the medium term. This outlook for limited price increases is related to: (i) declining global energy prices, given that energy is a major component of food production costs; (ii) US–China trade tensions that involve the imposition of food commodity tariffs, thus cutting demand and prices; (iii) an ongoing trend towards building food stocks, which has been generally increasing over the last decade. Furthermore, world oil prices are forecast to fall in the medium term, resulting in low AP inflationary pressure.

The downward trend in inflation is also expected to be supported by a decline in inflation expectations and a shift in consumption in the medium term. Inflation expectations are generally expected to continue to fall in line with the trend of gradually declining inflation, and are expected to remain within the inflation target range. In addition, frequency of disruption of supply of goods and services is also likely to be minimal due to infrastructure improvements. In addition, as per capita income is expected to increase, consumption pattern will also change, specifically it will reduce the proportion of income spent on food. On the other hand, demand for non-food commodities is expected to grow and, where price changes in these sectors are more limited. This will result in a general slowdown in price increases in the medium term. The success of various inflation control policies also contributes to reducing inflation expectations in the medium term.

Growing Role of Financial Sector

As the economy strengthens in the medium term and structural reforms continue, the financial sector is expected to record solid growth. Enhanced productivity and economic competitiveness due to structural reforms are expected to lead to more extensive financing activity from the financial market. This rise in financing is also supported by a projected increase in portfolio investment flows. These will be triggered by efforts to deepen financial markets that include providing investment alternatives and more diverse hedging instruments, thereby encouraging foreign capital inflow. In addition, the improvement in domestic economic conditions will also boost investment activities and creditworthiness due, among other reasons, to the prospect of increasing returns and reduced risks. This also has implications to better quality of credit and sound banking system. Overall, these conditions will help to maintain financial system stability.

As the financial sector continues to grow, the deepening of financial markets is also expected to accelerate. This could include broadening the base of domestic and foreign investors, increasing the volume of transactions, and improving and adding to financial market instruments and derivative products. As markets expand, product-marketing distribution channels for retail investors will be even more extensive. Based on projections from international data provider Statista, in addition to transactions in conventional financial markets, fintech transactions are also expected to continue increasing, albeit at a slower pace than in the past (Chart 10.6). Conventional financial institutions such as banks are also expected to continue developing products with digital features.

The strengthening of the financial sector will support the positive economic outlook in the medium term. The medium-term economic growth forecast has led to bank loan growth of 14% to 16%. In addition to banking sector financing, financing through the capital market is also expected to continue rising. This is due to greater corporate ability to issue self-financing instruments, and an expanding investor base. The ability of the Government to finance the economy is also expected to improve as tax revenues and other revenues increase.

---

These stronger revenues will give the Government even more space to reinforce the economy and provide stimuli to spur economic growth.

10.4. Increasingly Solid Policy Synergy

The outlook for the Indonesian economy is facilitated by an increasingly solid policy synergy by Bank Indonesia, the Government, OJK and other authorities in a mutually strengthening economic policy mix. Monetary and fiscal policies remain directed at macroeconomic stability, while continuing to use fiscal space for economic growth stimuli. Financial system stability is also improved through close coordination and supervision among the Ministry of Finance, Bank Indonesia, OJK, and the Deposit Insurance Corporation (LPS) within the KSSK, including in the prevention and resolution of financial crises.

Three important lessons learned in 2018 will inform future policy direction on maintaining stability and encouraging economic growth amid great global economic uncertainty. The first of these is that economic stability and resilience need to be improved by keeping inflation low, ensuring the rupiah exchange rate is stable, keeping the fiscal deficit low and stable financial system, and also keeping the current account deficit at a safe level. Second, Indonesia must continue to improve its competitiveness and productivity by sustaining a strong economic structure, to pave the way for higher economic growth. In this regard, it is necessary to strengthen policies and strategies to increase exports of high-value-added items and reduce import dependence, as well as to encourage direct investment from home and abroad. The third lesson is that policy synergy between authorities is key in efforts to maintain stability and bolster the structure of Indonesia’s economy. These three important lessons serve as a reference for the formulation of policies aimed at dealing with and mitigating future global and domestic economic challenges.

Monetary Policy

Bank Indonesia will continue to pursue a preemptive and ahead-of-the-curve monetary policy in 2019. Interest rate policy will continue to be calibrated according to domestic and global economic developments and in line with efforts to maintain macroeconomic stability, while ensuring the domestic economic recovery. Bank Indonesia will consistently pursue policies that boost external resilience, including steering the current account deficit within safe limits and maintaining the attractiveness of domestic financial assets.

Bank Indonesia will intensify its monetary operations strategy to improve the effectiveness of monetary policy transmission and maintain bank liquidity. The strengthening of the monetary operations strategy is pursued in three ways: (i) implementing regular open market operation auctions (targets, frequencies and tenors), by taking into account liquidity conditions; (ii) increasing flexibility in fine tune operations (FTO); and (iii) optimizing Bank Indonesia Sukuk (SukBI) as a sharia liquidity management instrument and to complement short-term tenors that, to date, have not been available in the sharia interbank money market. Bank Indonesia will also continue to optimize the use of government securities reverse repo (RR SBN) instruments to support the transmission of monetary policy, while communicating and coordinating with banks and related institutions. In addition, the reserve requirement will be evaluated regularly and gradually improved.

Bank Indonesia will continue to improve efficiency of market mechanisms, in order to stabilize the rupiah exchange rate. The stabilization of the exchange rate is supported by efforts to maintain adequate liquidity on the money market and on the forex market. In the event that markets come under pressure, the exchange rate stabilization policy is pursued via dual interventions in the foreign exchange market and the government securities (SBN) secondary market. Indonesia will continue to maintain adequate foreign exchange
reserves in order to be able to support the external sector and maintain macroeconomic and financial system stability. Meanwhile, exchange rate management will also be carried out through financial market deepening initiatives, thereby improving and adding to available instruments and enhancing market deepening.

Bank Indonesia will also strengthen bilateral cooperation with other central banks, and will pursue regional financial cooperation within the framework of the Global Financial Safety Net (GFSN). Cooperation enhances the management of foreign exchange reserves, helping to overcome BoP problems or short-term liquidity needs. In addition, financial cooperation with central banks in the region is also intended to reinforce the framework for managing foreign exchange reserves, boosting liquidity management, and encouraging the development of domestic financial markets in the region. Furthermore, in the context of diversifying the use of regional currencies and deepening financial markets, Bank Indonesia will continue to strengthen and expand bilateral cooperation with the central banks of partner countries in order to increase the use of local currency settlement (LCS) facilities in the settlement of bilateral trade transactions.

Financial Market Deepening Policy
Bank Indonesia will also accelerate financial market deepening as a means of sustaining financial market stability and expanding the financing of the economy. In an effort to maintain stability, Bank Indonesia will continue to encourage financial market deepening initiatives that improve and add to available instruments and increase market deepening. The volume of transactions and the use of spot, swap, call spread options (CSO) and domestic non-deliverable forward (DNDF) instruments will continue to be encouraged in order to increase liquidity, efficiency and market conduct in determining efficiently rupiah exchange rate, according to market mechanisms. On the money market, a higher volume of transactions and the use of repo instruments and interest rate swaps continue to be encouraged to enhance liquidity, efficiency and market conduct in the interbank money market in the formation of yield curves in various tenors. A deeper money market will support the growing development of long-term securities issuances and transactions as a means of financing the economy.

Financial market deepening will also be boosted by enhancing the financial market infrastructure. This will be done by (i) regulating central counterparty functions in the domestic financial market for derivatives transactions, in the context of over-the-counter derivatives market reform; (ii) developing trade repositories in order to improve market surveillance; and (iii) regulating market operators (electronic trading platforms) to streamline price formation on the money and forex markets. Bank Indonesia is also actively helping to develop new and innovative financing instruments for infrastructure development, and will continue to reinforce policy coordination to improve the effectiveness of financial market deepening efforts. This policy coordination will take place mainly in the Coordination Forum for the Development Financing through Financial Markets Deepening (FK-PPPK).

Macropuendential Policy
Bank Indonesia will continue to pursue accommodative macroprudential policies to encourage bank intermediation, while maintaining financial system stability. The loan-to-value (LTV)/financing-to-value (FTV) ratios for housing loans will be evaluated regularly to observe the cyclical impact of housing loan growth on the economic cycle. The macroprudential intermediation ratio (RIM) policy will be reviewed intermittently to stimulate bank lending and financing of the economy through the issuance of securities, including in sharia banking.

The future strengthening of intermediation will be aimed at supporting the development of priority sectors and MSMEs. Bank Indonesia continues to improve financial access and financing for MSMEs in order to bring about more balanced banking intermediation. Accommodative policies are also pursued through provisions on the macroprudential liquidity buffer (MLB) and countercyclical capital buffer (CCB). The MLB provisions will be monitored so as to provide higher flexibility for banks – including sharia banks – in managing liquidity. CCB instruments are continuously optimized to balance efforts directed towards greater intermediation and risk mitigation.

Bank Indonesia will also enhance surveillance in order to keep financial system stability. This stepped-up surveillance will be focused on large banks and corporations that wield significant influence in the financial and economic systems, such as corporations in the primary commodity and property sectors, and
those dependent on foreign financing. In addition, macroprudential assessments will continue to be enhanced through the use of national and regional balance sheet approaches in systemic risk assessment, and the identification of financial system imbalances. Monitoring of risks occurring outside the banking sector has also become increasingly important due to the development of non-bank financing, such as corporate bonds and fintech.

Payment System Policy

Bank Indonesia will maintain the role of payment system policy in supporting economic activities and ensuring financial system stability. To support economic activities, Bank Indonesia will expand the electronification program, and optimize opportunities for digitalization, for 2019 and beyond.

The electronification of the Government’s social security programs is focused on the distribution of social assistance, and on expediting the use of non-cash payments in the transportation sector. Bank Indonesia will continue to push for fintech and e-commerce players to make a positive contribution to the Indonesian economy. Innovation will be encouraged through several engagement programs, and a regulatory sandbox for an expanded range of businesses. Moreover, Bank Indonesia will also continue to push for synergies and collaboration between fintech players and MSMEs through MSME training programs and regional digital villages, the latter being a pilot project for electronification of Village Fund disbursement and spending.

Bank Indonesia also remains committed to currency management: it seeks to improve the quality of rupiah in circulation, improve the efficiency and coverage of its distribution of money to Indonesia’s regions, including to outermost, frontline and disadvantaged regions. Bank Indonesia will continue through centralized cash network planning to ensure that currency fit for circulation is distributed nationwide while protecting the public from counterfeits. Bank Indonesia will ensure that sufficient currency is available, both in terms of total amount and denomination. With regards to denomination, Bank Indonesia constantly monitors public demand for each denomination. Bank Indonesia will also work on cash services offered by other parties, refining synergies among cash custodians, banks and the BI-Jangkau (BI-Reach) cash service program for remote areas, and mobile cash services to islands (kas kepulauan).

The infrastructure, instruments and operating mechanisms for non-cash payment systems will continue to be developed, in both the wholesale and retail sectors. This will create a national payment system that is secure, reliable, efficient, and seamless. For wholesale payments, Bank Indonesia will expand the capacity and improve the quality of payment infrastructure, via new technology, increased service frequency and improved transaction-processing speed. Efforts will also be made to ensure that currency is more broadly available in order to streamline cross-border transactions, particularly exports.

In the retail sector, payment instruments and channels are being developed in order to support economic efficiency, financial inclusion and the digital economy as well as digital finance. In this regard, Bank Indonesia and industry will continue to enhance payment system infrastructure and national payment gateway (NPG) institutions. This will be achieved by enhancing the interconnection and interoperability of payment instruments, standardizing quick response (QR) codes – done by Bank Indonesia – and allowing consumers to pay bills online. Bank Indonesia will also continue working towards the target of one Garuda debit card per person by the end of 2021. Bank Indonesia will also increase the capacity of the Bank Indonesia national clearing system (SKNBI), and will continue to encourage innovation and collaboration between companies operating in the payment system industry by strengthening regulations, and making the industry more efficient so as to protect consumers.

Sharia Economy and Finance, and MSMEs

Bank Indonesia will continue to promote the development of the sharia economy and sharia finance to optimize their potential as sources of economic growth. This is done, among other ways, through the development of a halal value chain ecosystem, particularly for food, clothing and tourism, supported by a campaign to promote halal lifestyles. The capacity of sharia businesses in Islamic boarding schools (known as pesantren, they also act as community centers) will be enhanced by connecting them, and by developing simple virtual marketplaces.
Bank Indonesia also plays an active role in encouraging sharia financing by issuing sukuk (Islamic bonds), particularly for infrastructure financing, and also developing the socio-commercial integration of sharia finance. This includes the development of zakat and waqf (obligatory payments and endowments) to support productive activities. Furthermore, Bank Indonesia will also encourage halal lifestyle campaigns and education through regular sharia economic festivals in three Indonesian cities, as well as the international Indonesia Sharia Economic Festival (ISEF) (Box 10.3 Strengthening the Sharia Economic Development Platform).

In the MSME sector, Bank Indonesia is contributing to the expansion of development programs that will help control inflation and reduce the current account deficit. For example, inflation control efforts have seen Bank Indonesia support MSME clusters growing strategic commodities such as rice, red chili peppers, shallots, garlic and beef. The intention is to keep food supplies stable and develop MSMEs.

To help reduce the current account deficit, MSME development programs are directed at clusters that can provide high added value. This will be decided by looking at regional excellence and competitiveness, capabilities and potential, such as MSMEs operating in the tourism, coffee and textile product sectors. The development of Bank Indonesia-assisted MSMEs will also be carried out by encouraging MSMEs to go digital, and integration with sharia businesses. In addition, Bank Indonesia also encourages MSMEs to participate in national and international business expos.

International Policy

Bank Indonesia will play an active role in policy formulation in international institutions as a way of boosting positive perceptions of Indonesia. This is intended to build interest among other countries in establishing trade, investment and tourism relationships with Indonesia.

Bank Indonesia will also focus on enhancing international policy coordination. These policies include: the expansion and strengthening of cooperation in the use of local currencies in the settlement of trade transactions and the GFSN; increasing investment financing, particularly for infrastructure development; developing the digital economy and digital finance; and developing the sharia economy and sharia finance.

The policies adopted include establishing bilateral and Asian regional swap arrangements as part of the Chiang Mai initiative, thereby expanding the use of local currencies in trade and investment with other countries. Bank Indonesia will continue to build on its work with other ministries to optimize cooperation with trading partners – whether in the form of free trade agreements (FTA), comprehensive economic partnership agreements (CEPA) or other forms of collaboration. Bank Indonesia will also expand the role of its investor relations unit (IRU), regional investor relations unit (RIRU) and global investor relations unit (GIRU) to promote trade, investment and tourism both domestically and abroad.

Bank Indonesia Policy Coordination

Bank Indonesia continues to intensify coordination with the Government and related authorities to improve the effectiveness of policy. Inflation policy coordination will be reinforced to support macroeconomic stability, while coordination within the National Inflation Control Team Forum, which has been effective to date, will be further improved. The forum comprises the TPIP and TPIDs.

Policy coordination at present is aimed at bringing inflation onto a downward trend, and in line with targets. The Government and Bank Indonesia are committed to keeping inflation within the target range, particularly by keeping VF inflation within a maximum range of 4% to 5%.

Bank Indonesia will also work more closely with central and regional governments to boost the structure of the economy. This takes place through a forum and coordination meetings. Central and regional governments will focus on improving the current account deficit by

---

3 This goal is achieved through four main policies, known in Indonesian as 4K. In line with the 2019–2021 National Inflation Control Roadmap, these include prioritizing the availability of supplies and smoothness of distribution, supported by a more favorable ecosystem and accurate data.
developing export-oriented manufacturing, tourism, and investment financing particularly for infrastructure, and also by developing the digital economy and finance. Bank Indonesia will also optimize the policy coordination secretariat in the Task Force for the Acceleration and Effective Implementation of Economic Policy. Meanwhile, to develop the tourism sector, Bank Indonesia and the Government will enhance the joint monitoring of work programs.

Coordination on efforts related to prevention and resolution of financial crises will also continue to be improved. Coordination to maintain financial system stability carried out by Bank Indonesia, the Ministry of Finance, OJK and LPS will continue to be strengthened in the KSSK. This committee holds high-level meetings at least once every quarter, preceded by a deputies meeting.

In addition, the KSSK organizes regular national crisis simulations to improve technical readiness and preparedness for crisis coordination and decision-making. This includes the readiness of standard procedures and regulation. Bilaterally, Bank Indonesia and OJK will intensify coordination regarding the financial system through a forum for macroprudential and microprudential coordination. Financial system coordination is crucial to keep the financial sector stable, and foster the creation of a competitive and growing economic sector, and an economic structure that is increasingly resilient particularly in the face of shocks.

Bank Indonesia also intends to intensify coordination to expedite financial market deepening. This will mainly take place through the FK–PPPK. This coordination will be focused on harmonizing tax regulations on financial market instruments. Financial market infrastructure will be developed by refining regulations for implementing close-out netting and by means of innovations in various economic financing instruments through financial markets, including mentoring and facilitation programs to boost infrastructure financing.4

Work to deepen financial markets is based on Indonesia’s National Financial Market Development and Deepening Strategy (SN–PPPK), which has three pillars for development: (i) sources of economic financing and risk mitigation; (ii) financial market infrastructure; and (iii) coordination, harmonization of regulations, and education. Meanwhile, coordination on developing the digital economy and finance, particularly in 2019, will focus on optimizing the rapid development of digital technology to spur economic growth, while mitigating associated risks. Bank Indonesia continues to strengthen synergies with OJK, so that the development of digital finance in the payment system sector and in the field of financial intermediation complement each other.

**Fiscal Policy**

Fiscal policy will be directed at sustaining economic stability while optimizing efforts to maintain the momentum of economic growth. To support economic stability, the Government remains focused on maintaining fiscal sustainability by comprehensively managing the primary balance and State Budget (APBN) deficit. The Government set a primary balance target of -0.12% and deficit target of 1.84% of GDP in the 2019 State Budget. The Government will also reinforce its financing strategy by incorporating and developing creative funding sources and financing. In selecting these, the Government will prioritize those with the most acceptable risks and costs.

To maintain economic growth, fiscal policy must optimize the more productive components of spending and foster a favorable investment climate. Economic stimuli are focused on improving the quality of human resources, on social security, infrastructure completion and regional fiscal strengthening. To support this, education spending remains at 20% of the national budget to boost the quality of education and access to it. Likewise, health spending has been maintained at 5% to enhance the quality of healthcare and access to it.

The Government is also committed to providing protection to and improving the welfare of communities through the disbursement of social assistance, particularly for the lowest earning 40% of the population, and by creating strategies to mitigate natural disasters. To support infrastructure financing, the Government will work on creative forms of financing. Regional fiscal conditions will be improved by ensuring that regional government spending is effective, efficient and productive; this will reduce the gap between the central and regional government as well as gaps among the regions.

---

4 Close-out netting is a method of transaction settlement through which counterparties with a number of obligations to each other can offset and net those obligations in order to reduce settlement risks. It is achieved by carrying out early termination, then valuation and netting.
The Government is making improvements to ensure that fiscal management in the future is healthier and more sustainable. It is doing this by strengthening the allocation, distribution and stabilization functions. This is expected to optimize the role that fiscal policy plays in the economy and in improving welfare.

The allocation function is reinforced by increasing the quality of productive spending in order to stimulate the economy and the supply of public goods. The distribution function of fiscal policy is enhanced by expanding the role of tax as an instrument of income redistribution, improving the quality of fiscal decentralization and increasing the effectiveness of social security programs. This is needed because the percentage of poor people varies from province to province, and the income gap between provinces is still quite varied (Chart 10.7). The stabilization function is strengthened by maintaining macroeconomic balance, magnifying the role of the State Budget as a countercyclical tool, and encouraging prudent fiscal management. Improvements to fiscal management by the Government include controlling the budget deficit, keeping the debt ratio within safe limits, and pushing the primary balance towards positive territory.

In the medium term, fiscal policy will become more productive, efficient and sustainable. The Government’s fiscal management will take a three-pronged approach. First, expansionary policies will be pursued in a more directed and measured manner so as to enhance production capacity and competitiveness. In line with this, the budget deficit will be directed towards productive activities and accelerating Indonesia’s achievement of development targets, and will be aligned with the economic cycle. Second, efforts will be made to raise the tax-to-GDP ratio, in line with the capacity of the economy, while not impairing the investment climate or business environment. Fiscal incentives will also be applied to strategic economic activities. Third, the debt ratio will be contained within safe limits amid efforts to reduce it further, while directing debt towards productive activities.

10.5. Consistent Implementation of Structural Reforms

The policy synergy among Bank Indonesia, the Government, OJK and related authorities is underpinned by consistency in the implementation of structural reforms. Structural reforms continue to be undertaken to support an improved business and investment climate. This is also aimed at reinforcing the structure of the economy, thereby boosting efforts for strong, sustainable, balanced and inclusive economic growth.

Structural reforms can be pursued through four main channels: first, improving the competitiveness of Indonesia’s economy; second, developing industrial capacity and capability; third, optimizing use of the digital economy; and fourth, expanding financing sources.

Enhancing Economic Competitiveness

In seeking to improve economic competitiveness, Indonesia must consider at least four elements: the
availability of infrastructure; the quality of human capital; adoption of technology; and institutional support. These four elements complement each other and ultimately affect the speed of improvement in competitiveness.

In terms of the availability of infrastructure, the Government will continue to increase capacity of infrastructure so as to improve connectivity and energy supply, among other things. Increased infrastructure capacity will boost the national logistics network, thereby positively impacting on national industrial development. Improved overall connectivity will also lead to greater connectivity among regions. The Government’s development of infrastructure to support digital connectivity is underway, bringing Indonesia on par with other countries in the region. In addition, the Government will also proceed with efforts to increase energy supply, including via power plant construction and by working towards energy mix targets, which will expand energy sources.

Various steps have been taken by the Government to raise the standard of Indonesia’s infrastructure comparable with other countries in the region. So far, the Government’s efforts to accelerate infrastructure development have had positive results, as reflected in an improved infrastructure competitiveness ranking (Chart 10.8). Going forward, the Government will continue to improve infrastructure – including road, train and irrigation (Chart 10.9).

The Government will also expand efforts to increase infrastructure capacity in support of the development of special economic zones and tourism. The development of the tourism sector, in particular, is seen as a source of economic growth that can reinforce the structure of the national economy. This assessment is based on the year-by-year expansion of the sector. Tourism is increasingly significant in boosting foreign exchange earnings, bringing in a similar amount of foreign exchange to that generated by a number of leading export commodities.

Tourism is being developed to increase foreign exchange earnings, improve the balance of services account and boost employment. In addition, tourism development also represents an effort to diversify sources of economic growth. There is still plenty of space in the future to increase foreign exchange revenues from tourism given that the tourism potential in some regions has yet to be optimized (Box 10.1 Tourism to Boost Foreign Exchange).

With respect to developing human capital, Indonesia has several paths. As part of the national development strategy, the Government is striving for equal distribution of education services, and improvement in the quality, relevance and competitiveness of education. This includes ensuring that Indonesia has good teachers spread across all areas of the country, strengthening institutions, improving the quality of learning and academics, and raising literacy levels for greater prosperity.

Human resources must also be improved, considering that increasingly capable workers – one of the major factors of production – are instrumental in translating...
the demographic bonus into a driver of medium- and long-term economic growth. A greater availability of productive-age workers – this is the demographic bonus – needs to be matched by an increase in skills and abilities. This can be achieved by keeping children in school longer and improving the quality of their education. Affandi, Anugrah and Bary (2018) have demonstrated that human capital plays a role in variations in economic growth between provinces in Indonesia, and this role will be even more pronounced as manufacturing grows and takes a more dominant role in the economy. Capacity building in human resources is carried out through consistent work to implement compulsory education, improve educational facilities and infrastructure, open new vocational schools and design better curricula.

Improving the quality of Indonesia’s human resources must take into account the latest developments. The education level and outcomes in Indonesia have improved in recent years, but further work is needed if Indonesia is to match the education levels of other countries in the region, such as Malaysia and the Philippines (Chart 10.10). This will ultimately result in an improvement of Indonesia’s ranking in the United Nations Human Development Index, which still tends to be below average (Chart 10.11).

The adoption of technology also needs to be continually improved as a means of supporting economic competitiveness. In this regard, government and private sector research and development is forging ahead, including with an increase in the number of researches. The availability of a highly skilled workforce as well as research and development activities will improve productivity, lead to greater mastery of technology and result in greater Indonesian innovations in the years ahead. Indonesia’s ranking in the Global Innovation Index still lags behind Malaysia, China and India, meaning there is room for improvement (Chart 10.12).

In terms of institutional support, efforts to enhance the ease of doing business, improve governance and streamline bureaucracy – to facilitate a favorable business environment – are also needed in order to attract foreign direct investment. Indonesia has yet to fully implement the regulatory reforms necessary to improve the business environment, which has led to a situation whereby Indonesia lags behind other countries in the region in terms of regulatory quality and the efficiency of enforcement (Chart 10.13).
climate – will be continued. Indonesia’s ranking in the World Bank Ease of Doing Business index has rising significantly in recent years, despite slightly went down by one place in 2018 (Chart 10.13). Governance is also developing positively. The 2018 worldwide governance indicators report released by the World Bank shows that the quality of governance in Indonesia has improved, particularly in the areas of corruption control, government effectiveness and quality of regulations, but political stability and legal certainty need to be strengthened (Chart 10.14).

With regard to the improved ease of doing business, the implementation of online single submission (OSS) in 2018 – an electronic system that integrates business licensing processes – represents a positive step. There have been some obstacles in the implementation of this system – users have needed technical support to manage these issues – and the integration of licensing processes in the regions. Further improvement is needed in those areas. Other improvements are also needed to ensure system reliability, including making sure that managers have the requisite skills to handle the system properly. Other necessary general improvements relate to issues included in the World Bank survey, including payment of taxes and settlement of trade disputes.

**Developing Industrial Capacity and Capability**

Structural reforms will increase the capacity and capability of the manufacturing sector. One way in which Indonesia will achieve this is by downstreaming industry to boost value-added from natural resources manufacturing. Industrial development will lead to medium- and high-technology industries supported by an increasingly skilled workforce and boosted by Indonesia’s demographic bonus. By region, industry will be developed according to the characteristics and potential of each particular region (Box 10.2 Regional Economic Development Strategy). Overall, industrial development will target increasing exports through regional and global value chains.

Enhancing industrial capacities and capabilities is vital as it is closely related to strengthening the economic structure of Indonesia. It is also strategic given that growth in industry had been on a downward trend since the 1997/1998 crisis (Chart 10.15). This experience was shared by other countries in the region, including...
Malaysia and Thailand, which have since seen an upturn in industrial sector growth.

Building Indonesia’s industrial sector can reduce dependence on imports. An industrial sector with limited capacity and capability requires greater imports to support domestic production activities. This can adversely affect economic growth as it may trigger external imbalances.

If the demand for raw materials and capital goods can only be met by imports, it indicates an imbalance between the capacity of upstream industries as providers of raw materials and the capacity of downstream industries. Indonesia’s expanding middle class is pushing up demand for increasingly complex types of consumer goods. As long as the capacities and capabilities of domestic industry remain limited in producing these complex goods, the increasing demand from the middle class will also contribute to a rise in imports.

Expanding the capacity of the industrial sector can also improve the composition of Indonesia’s exports. Data shows that the proportion of exports made up of primary commodities and natural-resource-based products has been on an upward trend compared to the previous decade (Chart 10.16). This makes Indonesia’s export performance susceptible to global commodity price fluctuations. In times of high commodity prices, Indonesia’s export performance is strong, positively impacting economic growth. Conversely, when commodity prices endure a sharp decline, as in 2009, export performance is negatively impacted (Chart 10.17).

In this regard, efforts to strengthen industrial capacities and capabilities must be complemented by regional economic development strategies that are clearly based on the potential and characteristics of each region.

Efforts to improve industrial capacities and capabilities are also related to the promotion of diversified export products. Indonesia has a low level of export product diversification and remains dependent on commodity exports, mostly primary commodities. This has resulted in a limited number of market destinations for Indonesian exports. Compared to Indonesia, commodity exports from peer countries such as Malaysia, Thailand and the Philippines are more geared towards manufacturing as opposed to extractive commodities. These countries also take advantage of global value chains in Southeast Asia to expand their international trade.

Overall, this means that Indonesia needs to push the development in manufacturing sector, in particular medium- and high-tech industries that can produce high value-added export products. This policy direction is consistent with efforts to place Indonesia in the category of upper-middle-income countries. Data from 25 countries over more than two decades shows that per capita income rises as more people gain employment in the manufacturing industry (Chart 10.18). Then, as manufacturing expands, a shift to the services sector takes place, accompanied by another increase in per capita income. A study by Eichengreen, Park and Shin (2014) shows that a country needs to move its manufacturing industry towards medium- and high-tech industries that...
are supported by skilled employees if it is to become a country with high per capita income.\(^7\)

### Optimizing the Digital Economy

Structural reforms are also associated with efforts to optimize the digital economy. The digital economy provides many positive opportunities for the economy, including: employment; more efficient price setting, and wider choice of goods and services for consumers. In addition, digital technology and the digital economy can also raise productivity by increasing efficiency. However, the rapid development of the digital economy can expose the economy to a number of risks, and therefore needs to be well managed. Indonesia must therefore manage its rapidly developing digital economy in a balanced manner so as to optimize the opportunities and mitigate the risks.

The development of the digital economy is changing the structure of the workforce, and is complemented by a decline in technology prices (Morin, 2015).\(^8\) Automation in certain sectors is likely to reduce the need for a human workforce. However, there will be greater opportunities for workers in jobs that require creativity and high levels of social interaction. The digital economy also provides an opportunity for informal sector workers to enter the formal sector. This condition describes possible structural change in demand for labor force coming from rapid growth of digital economy. In light of this, it is important to promote enhanced digital literacy, as part of efforts to create highly skilled human resources.

The digital economy creates greater opportunities for market efficiency, but at the same time tightens competition. Digital technology is shaping the future of investment and cross-border trade. It encourages the development of new business models and also enables companies to operate globally without having to make large amounts of direct investment. The rapid development of the internet and digital technology has directly transformed the pattern of goods trading by creating broader consumer base. However, digital technology has also led to much fiercer competition. In this vein, a challenge is presented if the rapid development of the digital economy is not balanced by an increase in the ability and competitiveness of business actors.

Finally, the development of the digital economy can also foster a more inclusive economy, given that it promotes improved public access to goods and services which, in turn, creates opportunities for small- and medium-sized enterprises, to increase their earnings. In this context, the development of the digital economy needs to be complemented by increased public literacy so people can use it to develop business. This is particularly relevant for MSMEs.

### Expanding Economy’s Sources of Financing

Structural reforms also involve efforts to expand sustainable sources of economic financing, including through the financial market deepening policy. Various policy steps have been taken, and efforts made, to optimize the structure of financing while also providing alternative sources of economic financing. In line with the financial market deepening policy, the Government continues to encourage private participation by developing innovative and creative financing schemes. The Government continues to develop the public-private partnerships (KPBU) and non-budget investment financing (PINA). These are intended to support infrastructure financing, particularly for national strategic projects such as toll roads, energy, telecommunications and water supply, and other sectors including railways, airports, waste management and hospitals (Figure 10.2). The Government is also developing a blended finance scheme involving the private sector and the financial

---


services industry to support projects that bring Indonesia towards its sustainable development goals.

Going forward, Indonesia must continue to expand the sources of national economic financing. This will be done by taking into consideration the size of national development funding needs, as exemplified by the need for investment funding. Infrastructure financing needs are forecast to reach USD 1.7 trillion by 2040. In addition to the need for infrastructure spending, Indonesia also requires continuity of financing for state administration and for welfare improvements. In this regard, the challenge of reinforcing the structure of sustainable financing sources requires private sector participation and deepening of domestic financial markets.

Economic financing sources are also being expanded, because funding sources are dominated by short-term funds, both banking funds and bonds. The role of the banking industry in meeting economic financing needs for the longer term remains limited, given the mostly short-term nature of its funding sources. This is reflected by the fact that domestic bank funding sources are still dominated by one-month term deposits, which account for around 76% of total deposits. This situation has limited the ability of domestic banks to disburse long-term financing. Meanwhile, sources of long-term financing from the bond market also need to be expanded, considering that both the capacity and liquidity of the corporate bond market remain low. This is evident in the volume of bond trading, which is persistently low in comparison to that of neighboring countries, such as Malaysia and Singapore (Chart 10.19).

The expansion of financing sources is also related to efforts to broaden the domestic investor base. Recent figures show that foreign investors represent a substantial...
share in total source of financing. This is reflected in the fairly large proportion of foreign funds in government securities (SBN), amounting to 37%. This significant portion of foreign funds in SBN is higher than that in a number of other countries in the region (Chart 10.20). As domestic financial markets become increasingly integrated with global financial markets, the dynamics of these global markets will inevitably have an impact on domestic markets.

Chart 10.20. Foreign Ownership of Government Bond

Source: Ministry of Finance, Bank of Thailand, ADB, calculated
Tourism is being developed to increase foreign exchange earnings, and improve the balance of services account. It will also boost employment, and represents an effort to diversify sources of economic growth. There is still plenty of space to increase foreign exchange revenues from tourism given that tourism is underdeveloped in some regions. In this regard, Thailand’s tourism sector should be investigated, as the country enjoys the highest tourism rates in the region. Indonesia needs to improve in several key areas that shape tourism competitiveness, particularly those areas in which it currently lags behind peers. More particularly, Indonesia must improve in areas in which it falls behind Thailand. These key factors include connectivity infrastructure, particularly air transport, tourism service infrastructure including amenities, business climate, human resource quality and payment systems.

The Government has set some optimistic tourism goals for the short to medium term. To achieve these goals, the Government is targeting a number of major tourist destinations for national tourism branding and is prioritizing four destinations for tourism development. It is hoped this will lift the contribution of the sector to foreign exchange earnings. The four areas are Lake Toba, Borobudur temple, Mandalika Special Economic Zone and Labuan Bajo. Meanwhile, current major tourist destinations such as Jakarta, Bali, the Riau islands, Banyuwangi and Bromo require further development to improve the quality of infrastructure and services, and maintain the competitiveness of Indonesian tourism as a whole.

The development of Indonesia’s tourism sector will be expedited via three main strategies pertaining to the enhancement of destinations, market access, institutions and the tourism business ecosystem (Figure 1). The first strategy is to improve attractions, access and amenities. Improving the quality of attractions involves improving the quality and sustainability of destinations and encouraging increased tourist spending. Improving accessibility involves enhancing the quality of connectivity infrastructure in various destinations, particularly priority destinations that are still under development. Improving the quality of amenities involves making the tourism experience more comfortable by improving the quality of accommodation, restaurants, trusted local

---

1 The number of foreign tourists visiting Thailand in 2017 stood at 35 million, significantly higher than the corresponding figure for Indonesia (14 million visits).

2 The measurement of tourism competitiveness is based on the 2017 Travel and Tourism Competitiveness Index released by the World Economic Forum. Indonesia was ranked 42nd in terms of tourism competitiveness in 2017, lower than Thailand (34th) and Malaysia (26th).
transport, cleanliness and payment infrastructure, among other things. The second strategy centers on an effective marketing campaign: to improve the promotion of Indonesia as a tourism destination and increase brand awareness of Indonesia. The third strategy is to strengthen coordination concerning tourism development, to assist tourism-related businesses, including by ensuring tourism workers are available, and to provide finance for such businesses. This is mainly to support the development of tourism in destinations outside Java and Bali.

The development of tourism needs to be supported by greater promotion and the availability of reliable and up-to-date tourism data. Indonesia’s destination marketing and tourism branding must be managed professionally and consistently in order to raise and maintain brand awareness (Figure 2). Promotions should be carried out in potential markets, including countries whose citizens tend to visit other ASEAN+6 (Association of Southeast Asian Nations +6) countries besides Indonesia, as well as tourists from the Middle East. In addition, a strategy to enhance institutional cooperation, including with flight services, needs to be pursued to help push up tourist arrivals.

Furthermore, synergy must be strengthened between institutions at the central and regional levels, and between communities and the private sector. Strategic government efforts to support tourism development need to be maintained and accelerated. These include improving the quality of connectivity infrastructure, increasing access to financing for tourism businesses, and measures to enhance destination management and tourism-related human resources. Bank Indonesia will continue to provide support for national tourism development as part of efforts to reinforce the structure of the economy and improve the current account balance. A number of steps are being taken by Bank Indonesia in this regard, including optimizing the role of its investor relations unit in supporting tourism investment, developing halal value chains to support halal tourism, and developing MSMEs that support regional tourism.

Bank Indonesia is continuously improving the quality of the payment system – one of the reasons for this is to support the development of priority tourism destinations. Various steps have been taken, including the expansion of payment channels and use of non-cash instruments, meaning debit and credit cards. Improving the ease of using non-cash payment instruments in accommodation and tourism facilities is one of the first steps in encouraging the wider expansion of non-cash payments in those locations. Furthermore, the more businesses that can accept electronic payments, the more tourists will spend – and this will lead to greater foreign exchange revenues from tourism.
**Box 10.2.**

**Regional Economic Development Strategy**

Indonesia’s economy continues to grow gradually, reaching 5.17% in 2018. The strengthening of the economy’s structure so that it can grow more robustly represents a challenge at this time. A strong national economic structure needs to be supported by the regional economies – and regional economies are built by driving forward the main sectors in each province. The Growth Strategy research conducted by Bank Indonesia in 2018 identified opportunities to turn subsectors of excellence in each region into driving forces of the economy. Subsectors of potential in the regions can be identified by looking at their contribution to the growth of gross regional domestic product (GRDP), export growth and employment. Strategies are then formulated by looking at market access, input factors (technology, capital and labor) and infrastructure (Figure 1). Furthermore, the development of these subsectors emphasizes production efficiency, increased production capacity, and employment.

The research showed that priority subsectors vary from region to region. Priority subsectors in Sumatra tend to be based on natural commodities and their processing, including: (i) plantations, for example oil palm, coffee and cocoa; (ii) the food and beverage industry, for example crude palm oil and fruits; and (iii) fisheries. Similarly, the priority subsectors in Eastern Indonesia are also based on natural commodities such as fisheries (capture fisheries and aquaculture), plantations and mining (coal, nickel and copper). In contrast, Java is more dominated by manufacturing subsectors, including textiles and textile products, the automotive industry, the food and beverage sector and footwear (Figure 2).

With different priority subsectors in each region, the economic development strategy for each province will also be different. For example in Sumatra, the plantation subsector (oil palm) has a significant influence on rising GRDP and export growth, and employs increasing numbers in North Sumatra province. The development of the plantation subsector will increase GRDP by 0.29% above the baseline and export growth by 0.45% above the baseline. As such, oil palm should be developed. This can be done by: (i) increasing land productivity through replanting programs; and (ii) expanding partnerships between farmers and entrepreneurs through a scheme known as the ‘plasma core’ scheme. In Eastern Indonesia, fisheries is one of the leading subsectors. The development of the fisheries subsector in South Sulawesi has raised economic growth significantly – by 0.24% above the baseline. Strategies for the wider development of the fisheries subsector across other regions include: (i) developing guidance and coaching systems for fishermen; and (ii) increasing the use of land for aquaculture (fish, shrimp and seaweed). The natural-resources-based sector also plays a significant role in South Sulawesi and needs to be developed towards providing higher added value, particularly through downstream development.

In contrast to Sumatra and Eastern Indonesia, manufacturing dominates in Java, and the labor-intensive textile and textile products industry is prominent. Improving the input factors for the textile and textile

---

1. Supporting Province Economic Growth  
2. Improving Export Performance / Import Subtitution  
3. Improving Labor Absorption  

**Efficiency through Innovation and Technology**  
**Production Capacity Improvement**  
**Workforce Employment**

**Supporting Factors**  
- Market Access  
- Input Factor  
- Infrastructure

---


3 Here, baseline refers to a benchmark without a particular policy against which to assess policy progress.

products industry could encourage an increase in GRDP growth of 0.37%, and could also increase employment levels by 0.22% in West Java province.  

Consequently, one of the strategies for developing this province’s economy is to improve the performance of the textile and textile products sector. Several steps can be taken, including: (i) improving the skills and education of workers and youth; and (ii) using new technology to raise productivity.

The development of priority economic subsectors in each region has the potential to drive significant regional economic growth. The development of priority economic subsectors in each region can increase GRDP by an average of 0.63% (Eastern Indonesia), 0.59% (Java), and 0.44% (Sumatra) above the baseline. In terms of additional employment and export growth, Java has the highest potential compared to other regions with possible increases of 0.43% above the baseline in employment and 1.26% in exports. Overall, the strengthening of regional economies needs to begin with the formulation of priority subsector development strategies for each region, so as to encourage economic growth based on real potential. Ultimately, the development of priority subsectors in each region, in addition to improving the economy of the region itself, is also expected to play a role in improving the current account nationally.

---

**Box 10.3.**

**Strengthening the Sharia Economic Development Platform**

Under the Bank Indonesia Sharia Finance and Economy Development Blueprint, the year 2018 represented the final stage in laying the foundations of the development program. By 2018, sharia programs had successfully and sustainably achieved several goals. There are three main pillars to the sharia strategy. The first focuses on the national sharia economic development strategy, and the second on developing Islamic finance by deepening the sharia financial market to support economic financing based on sharia principles. The third pillar focuses on strengthening knowledge of the sharia economy and finance through education, and on increasing public understanding through outreach programs and public campaigns across Indonesia, including with the involvement of international parties.

One of the first-pillar programs seeks to enhance the economic independence of pesantren (Islamic boarding schools that also function as community centers). This program forms part of the national halal value chain development strategy aimed at improving the structure of the economy, and includes the integrative and comprehensive development of all factors in the pesantren business unit ecosystem. The missions of the program are as follows: (i) to build the economic capacity of pesantren to optimize pesantren assets; (ii) to build good governance in pesantren; (iii) to build the skills of pesantren managers and teachers; and (iv) to enhance the curriculum with new subjects. All these missions are performed in stages according to the road map (Figure 1). In line with this road map, the capacities of pesantren are built through the application of accounting systems suitable for them, and also through the replication of existing pesantren business models from several business sectors. The capacities of pesantren are also built through the development of virtual markets, in line with the dynamics of burgeoning digital technology, so as to maintain their competitiveness.

Another program related to halal value chain development is the strengthening of sharia businesses through product- and financing-based programs. In the product-based program, development is first focused on Muslim fashion and halal food. To encourage the development of sharia businesses in both these sectors, Bank Indonesia is cooperating with sharia business players to establish a platform for the Indonesian Sharia Creative Industry (IKRA Indonesia).  

The IKRA Indonesia platform aims to produce excellent, high-value sharia business products that can compete with global brands. As part of the financing-based program, a sharia business group pilot project has been developed with financing from zakat infaq shadaqah waqf (ziswaf) funds – funds based on sharia principles – in the agricultural sector. This will be replicated in other sectors by the development of business models with financing.

Under the second pillar, the deepening of the sharia financial market is carried out to support the financing of halal sharia businesses. This strategy involves expanding the variety of sharia financial instruments available, which will increase investment attractiveness and transaction volumes. But regulations and infrastructure must also be strengthened (Figure 2). The scope of this second pillar also includes sharia commercial finance programs and sharia social finance programs. These two sharia finance sectors will be integrated, and will reach production units that need financial access. So far, achievements include the creation of several sharia financial instruments, including sharia-based deposit certificates, SukBI

---

1. Bank Indonesia launched IKRA Indonesia during the 5th Indonesia Sharia Economic Festival (ISEF) on 11 December 2018 in Surabaya, in collaboration with sharia business players.
Figure 2. Sharia Financial Market Deepening

(Bank Indonesia Sukuk, or Islamic bonds), and hedging instruments based on sharia principles.

The development of sharia social finance programs uses an ecosystem-based approach. In order to strengthen the supporting infrastructure, core principles have been developed to improve governance and accountability in sharia social finance. To complement the zakat core principles, which were launched in 2016, Bank Indonesia collaborated with the Indonesian Waqf Agency to launch the waqf core principles at the 2018 IMF–World Bank Annual Meetings in Bali. In addition, cooperation between Bank Indonesia, the Ministry of Finance and Indonesian Waqf Agency in this program has produced cash waqf-linked sukuk products. These products are intended to allow people to play an active role in the construction of public facilities through cash waqf funds.

The third pillar aims to improve public knowledge of the sharia economy and sharia finance. This also includes building the competency of human resources to make people more reliable, professional and internationally competitive, and enhancing public understanding of the sharia economy and finance through a variety of outreach programs. In practice, Indonesia will develop more education programs with strong relevance to industrial needs, will develop relevant curricula for schools, and will enrich vocational and professional programs. Bank Indonesia has also been active in outreach. It has held the ISEF five times, and in the previous two years cooperated on this with the National Islamic Finance Committee and other sharia stakeholders. As part of the 2018 event, sharia festivals were also held in Java, Sumatra and Eastern Indonesia. In conclusion, it is noted that outreach and education play an important role in supporting the first and second pillars. It must be stressed that the success of all sharia economic and financial development programs depends on the level of public understanding of sharia economic and financial issues.