OVERVIEW

# SYNERGIZE TO BUILD OPTIMISM FOR ECONOMIC RECOVERY

The 2019 coronavirus disease (Covid-19) pandemic has significantly impacted many areas of life, not only in health and humanitarian concerns, but also the world economy. In 2020 and especially during the first half of the year, Indonesia's economic growth came under considerable pressure as a result of the world economic slowdown triggered by Covid-19 and the large-scale social restrictions (PSSB) imposed to mitigate Covid-19 transmission. Interagency policy synergies resulted in urgent and extraordinary measures to cushion the impact of Covid-19. These succeeded in bringing about a gradual recovery in the economy during the second half of 2020, while maintaining stability. Looking forward, the outlook for the Indonesian economy is predicted to improve further in 2021, bolstered by strong interagency policies, and it would return to an upward path in the medium-term. This optimism for economic recovery is further supported by a range of measures to promote more rapid structural transformation, including acceleration of the digital economy and finance, reform of the money market and strengthening of MSMEs in support of progress towards an Advanced Indonesia.

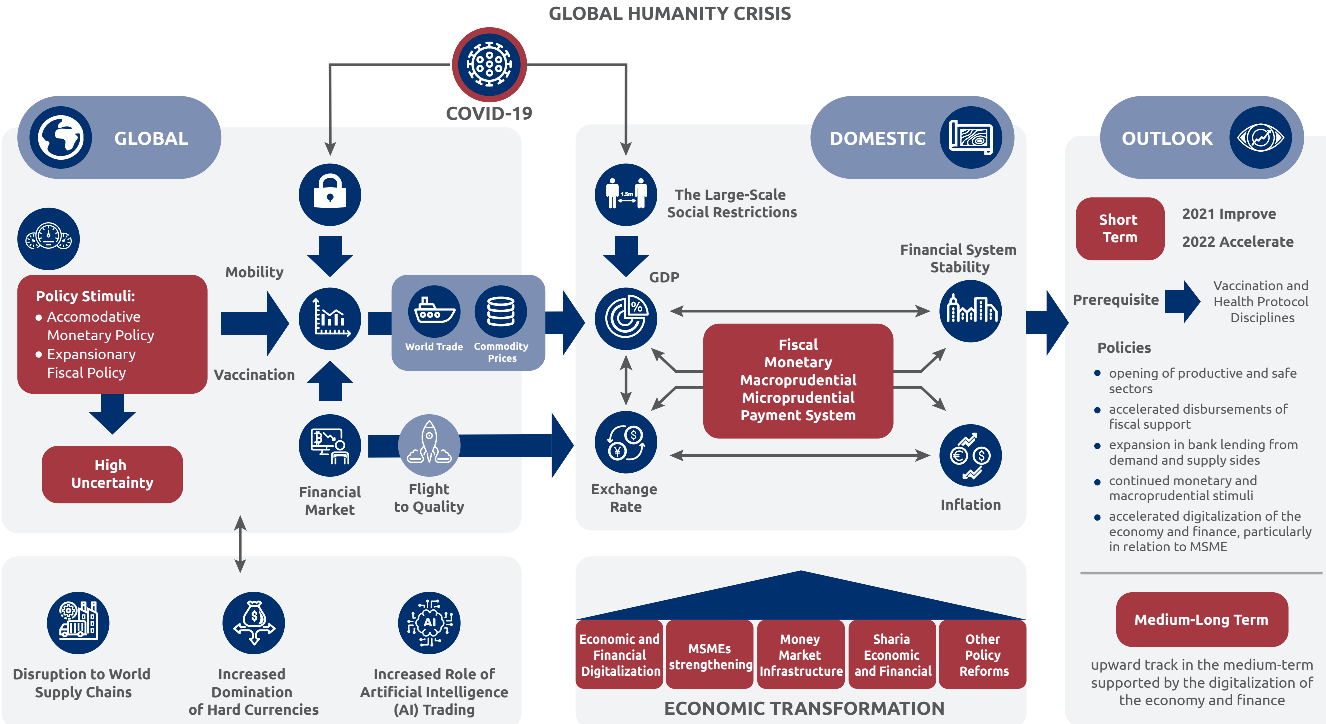
**The 2019 corona virus disease (Covid-19) pandemic had an extraordinary impact on the dynamics of the world economy in 2020, including in Indonesia.** Covid-19 spread quickly to almost 178 nations in the world, infecting more than 85 million persons and causing more than 1.8 million deaths in 2020. This not only created a health and humanitarian crisis, but also triggered an economic crisis and increased poverty levels in many countries. These adverse developments in the global economy were unavoidable, owing to mobility-restricting policies that were needed to contain the spread of Covid-19. There was a steep decline in consumption, investment and production in many countries, resulting in a downturn in international trade. Financial markets also came under heavy pressure due to the uncertain global outlook; if allowed to persist, the pressures would have spread and impacted financial system stability (Diagram 1).

**Covid-19 placed the Indonesian economy under enormous pressure in 2020, with sources of turbulence unlike anything before.** As experienced worldwide, the turbulence in Indonesia arose from health and humanitarian issues that caused serious problems for the economy. The immediate Government response to curb the spread of Covid-19 through imposition of large-scale social restrictions, inevitably weighed on economic performance. Policies aimed at containing the spread of Covid-19, led to reduced personal mobility and a drop in spending on goods and services. Consumption, investment, transportation, tourism, production and the confidence of economic agents fell significantly, resulting in a sharp drop in economic growth. The weakened economy became a focus of wide concern; if not tackled quickly, these conditions could have severely disrupted economic and financial system stability and de-railed the drive for more rapid transformation of Indonesia into an advanced nation.

**Policy synergies pursued by the Government, Bank Indonesia and relevant authorities sought to mitigate the extraordinary impact of Covid-19 and work continually to build optimism for economic recovery.** The synergy was underpinned by the robust legal foundation of Act No. 2 of 2020, so that responses for dealing with the turmoil caused by Covid-19 would continue to be built on prudential principle, good governance, transparency and accountability. In this regard, the Government pursued an expansionary fiscal policy by delivering a large-scale stimulus with the consequence of an enlarged deficit and increased financing needs for the 2020 State Budget. Against a background of low inflation, Bank Indonesia pursued an accommodative policy mix by providing a monetary stimulus through repeated interest rate cuts and large-scale quantitative easing (QE). This policy was supported by measures to stabilize the rupiah, relaxation of macroprudential policies and digitalization of the payment system. Actions were also taken to reinforce policy coordination with the aim of safeguarding financial system stability under a restructuring program for MSMEs and corporates and other initiatives implemented by the Financial Services Authority (OJK) for safeguarding the financial intermediation function. The Indonesia Deposit Insurance Corporation (LPS) also relaxed policies to reduce liquidity pressure on the banking system.

**Policy synergy led to gradual improvements in the domestic economy during the second half of the year, bolstered by sustained, multifaceted actions for greater policy empowerment.** The Indonesian economy plunged deeply during the first half of 2020. Pressure mounted from the downturn in exports in keeping with deteriorating economic performance and disruption to world supply chains, and from the impact of the reduced mobility caused by imposition of the large-scale social restrictions. These conditions led to a steep contraction in GDP during the second quarter that reached almost all economic sectors and many of Indonesia's regions. As uncertainties mounted on global financial markets early in the pandemic, investors sought safe havens, causing large capital outflows that put pressure on the rupiah. Economic pressures gradually eased during the second half of 2020, consistent with the responses in the national policy mix. GDP contraction eased in the third quarter, and as a result, overall 2020 economic growth is predicted in the range of -2% to -1%. Throughout this episode, inflationary pressure remained low in keeping with weak domestic demand. At the outbreak of the pandemic, the financial system was in good condition, which

**Diagram 1.** Synergize to Build Optimism for Economic Recovery




provided a buffer that shored up financial resilience. However, credit growth continued to contract in response to weak domestic demand and bank caution in lending.

**Looking ahead, the economic outlook for Indonesia is predicted to regain momentum, buoyed by progress in dealing with Covid-19, including vaccinations; recovery in the global economy; the policy stimuli; and strengthening of other policies.** Indonesia's economic recovery, which began to emerge in the second half of 2020, is forecast to continue in 2021. The progress in Covid-19 responses, including vaccinations, the global economic recovery, macroeconomic policy stimulus actions and the various other efforts underpin optimism for strengthening of the economy. Vaccinations and discipline in adherence to Covid-19 protocols are a prerequisite for economic recovery. Policies also play an important role, specifically five policy actions: (i) opening of productive and safe sectors on a nationwide basis and in individual regions; (ii) accelerated disbursements of fiscal support; (iii) expansion in bank lending on the side of both demand and supply; (iv) continued monetary and macroprudential stimuli; and (v) accelerated digitalization of the economy and finance, most importantly in relation to MSME development. With the support of these various factors, Indonesia's economic growth in 2021 is forecast in the range of 4.8%-5.8%. Inflation is also projected to remain low in the 3.0%±1% target range.

**In the medium-term, the Indonesian economy is predicted to continue on an upward track in the medium-term.** Supporting this outlook is improvement in the global economy and increased domestic productivity in response to structural reforms, including more rapid digitalization of the economy and finance, reform of the money market, and strengthening of MSMEs. However, to support economic improvement in the medium-term, it remains necessary to allow for potential for changes in the global economy, as indicated by three vital lessons about the global economic structure, taught by the Covid-19 period. The first lesson relates to the behavior of some nations that have increasingly adopted inward-looking policies within a context of an international trade system that is still underpinned by a particular nation. Second, heavy dependence on major world currencies indicates potential for systemic risk on global financial markets when under heavy pressure; it could aggravate the external vulnerability of developing nations.

Third, the growing influence of non-bank financial institutions (NBFIs) that use of algorithm trading, has contributed to rising susceptibility of the global financial system, particularly when pressures rise to the surface. All three factors are cause for concern and need to be resolved by strengthening initiatives at the domestic, regional and global levels in order to safeguard the continuity of future global economic growth. These initiatives include actions to promote formation of multipolar linkages in international trade; increased use of local currencies in cross-border trade and investment; and better regulation and supervision of NBFIs.

## Under Pressure in the First Half, Regaining Strength in the Second Half of 2020

**Covid-19 impacted heavily on the Indonesian economy during the first half of 2020.** On one hand, it was necessary to impose mobility restrictions, because after early March 2020 (when Indonesia first declared infections) Covid-19 rapidly spread across the nation. By the end of December 2020, the total number of positive Covid-19 cases reached 743,198 nationwide with deaths recorded at 22,138. But on the other hand, Government policies for curbing the spread of Covid-19, involved restrictions on the public's mobility with imposition of health protocols and large-scale social restrictions in some regions. Inevitably these restrictions brought about a sharp decline in overall economic activities. Growth slowed to 2.97% (yoy) in the first quarter of 2020, and the economy contracted by 5.32% (yoy) in the second quarter (Table 1). There were declines across all growth components, including household consumption and investment activity by the Government and the private sector. Almost all exports of goods were impacted by slumping global demand, with the exception of some manufactured exports that benefited from quicker recovery in China. During the first half of 2020, efforts to stimulate economic growth were hampered by limited Government stimulus, stemming from impediments in disbursement processes.

**Pressures emerged on external stability due to uncertainty over the spread of Covid-19 and its impact on the economy.** Uncertainty on global financial markets led to a rebalancing of global investment portfolios; financial investments plunged in emerging market nations, including Indonesia, with investors fleeing to safe haven assets. As a result, the capital and financial account (CFA) in the Indonesia balance of payments recorded a capital reversal and in the first quarter of 2020 with the CFA recording a USD3.1 billion deficit. This shift in capital flows caused the rupiah to depreciate, to a post-pandemic, low point of IDR16,575 to the US dollar on 23 March 2020, accompanied by rising volatility. With the introduction of measures by Bank Indonesia to stabilize the exchange rate, buttressed by intense communication with the public, pressure eased on the rupiah. External adjustments unfolded over time, in keeping with the impact of exchange rate flexibility; the drop in domestic demand contributed to a narrowing of the current account deficit from 1.3% of GDP in the first quarter of 2020 to1.2% of GDP in the second quarter. Overall, the Indonesia balance of payments recorded a surplus of USD700.5 million in the first half of 2020, with the international reserves reaching USD131.7 billion. At this level, reserves were equivalent to 8.1 months of imports and servicing of government debt, well above the international standard of three months.

**Price stability held firm amid falling economic growth.** Inflation measured by the Consumer Price Index (CPI) remained low in line with weak domestic demand and adequately maintained supply; there were no widespread disruptions to production and distribution. In June 2020, CPI inflation was recorded at 1.96% (yoy), down sharply from 2.96% (yoy) in February 2020 before the outbreak of Covid-19. In June 2020, core inflation eased to 2.26% (yoy) in response to weak domestic demand; falling global commodity prices; limited exchange rate pass-through; and subdued inflationary expectations among economic agents. Volatile foods (VF) inflation remained low, due to weak demand and adequate levels of supply. Inflation in administered prices (AP) also slowed from the effect of reduced mobility and demand.

**Financial system stability remained sound, bolstered by strong buffers of solvency and liquidity, both in place before the pandemic.** With these cushions in place, the financial system absorbed the pandemic-driven disruptions, safeguarding monetary policy transmission through the interest rate channel. Relaxed monetary policy

**Tabel 1.** Domestic Economic Indicators

| Components | 2018 | 2019 | 2020 | | | |
|---|---|---|---|---|---|---|
| | | | I | II | III | IV |
| **Economic growth (Percent, yoy)** | **5.17** | **5.02** | **2.97** | **-5.32** | **-3.49** | |
| Household consumption (Percent, yoy) | 5.05 | 5.04 | 2.83 | -5.52 | -4.04 | |
| Government consumption (Percent, yoy) | 4.8 | 3.25 | 3.75 | -6.9 | 9.76 | |
| GFCF (Percent, yoy) | 6.67 | 4.45 | 1.7 | -8.61 | -6.48 | |
| GFCF construction (Percent, yoy) | 5.45 | 5.37 | 2.76 | -5.26 | -5.6 | |
| GFCF non-construction (Percent, yoy) | 10.31 | 1.8 | -1.46 | -18.62 | -8.99 | |
| Export of goods and services (Percent, yoy) | 6.48 | -0.87 | 0.23 | -11.68 | -10.82 | |
| Import of goods and services (Percent, yoy) | 12.04 | -7.69 | -2.18 | -16.98 | -21.86 | |
| **CPI Inflation (Percent, yoy)** | **3.13** | **2.72** | **2.96** | **1.96** | **1.42** | **1.68** |
| Core Inflation (Percent, yoy) | 3.07 | 3.02 | 2.87 | 2.26 | 1.86 | 1.60 |
| Volatile Food Inflation (Percent, yoy) | 3.39 | 4.3 | 6.48 | 2.32 | 0.55 | 3.62 |
| Administered Prices Inflation (Percent, yoy) | 3.36 | 0.51 | 0.16 | 0.52 | 0.63 | 0.25 |
| **Balance of Payment** | | | | | | |
| Current Account Deficit (Percent, GDP) | 2.94 | -2.71 | -1.34 | -1.2 | 0.36 | |
| Capital and Financial Account (USD billion) | 25.12 | 36.61 | -3.07 | 10.63 | 1.04 | |
| Overall Balance (USD billion) | -7.13 | 4.68 | -8.54 | 9.25 | 2.05 | |
| Official Reserve Assets (USD billion) | 120.65 | 129.18 | 121 | 131.7 | 135.2 | 135.9 |
| **Exchange rate (Average; USD/IDR)** | **14,246** | **14,139** | **14,219** | **14,893** | **14,669** | **14,339** |
| **JCI (Index)** | **6,194.5** | **6,299.54** | **4,538.93** | **4,905.39** | **4,870.04** | **5,979.07** |
| **10-year government bond yields (Percent)** | **7.98** | **7.04** | **7.85** | **7.18** | **6.93** | **5.86** |
| **Banking** | | | | | | |
| Total Credit (Percent, yoy) | 11.75 | 6.08 | 7.95 | 1.49 | 0.12 | -2.41 |
| CAR (end of period, Percent)* | 22.89 | 23.31 | 21.63 | 22.5 | 23.41 | 24.13 |
| NPL (end of period, Percent) | 2.37 | 2.53 | 2.77 | 3.11 | 3.15 | 3.06 |
| **State Budget** | | | | | | |
| Tax (Percent GDP) | 10.24 | 9.76 | 1.81 | 2.23 | 1.73 | 2.52** |
| Primary balance (Percent GDP) | -0.08 | -0.46 | -0.01 | -0.63 | -2.23 | -1.26** |
| State budget deficit (Percent GDP) | -1.82 | -2.20 | -0.49 | -1.17 | -2.73 | -1.78** |

**Notes:** *as of November 2020; **Preliminary Figures
**Source:** BPS, Bank Indonesia, Bloomberg, Reuters, OJK, Ministry of Finance and BEI

was transmitted through domestic interest rates, as reflected in an 81 bps decline in the interbank money market rate and in the progressive easing of bank interest rates. The weighted average time deposit rate was down 57 bps in June 2020 compared to December 2019, and the weighted average lending rate on working capital loans was similarly down by 61 bps over the same period. At the same time, continuing financial system stability was reflected in: the Financial System Stability Index that remained in the normal-stable zone; non-performing loans (NPLs) of 3.11%, below the prudential threshold; and an increase in the liquidity ratio to 26.24% in June 2020. Financial system resilience remained strong, as reflected in the increased level of the capital adequacy ratio (CAR) at 22.50%. However, the slowing pace of bank lending, mainly due to limited economic activity and demand for loans, was cause for concern. Growth in deposit (third party funds) mounted in keeping with fiscal expansion and wait-and-see behavior, resulting in higher growth of narrow money (M1) and broad money (M2); both increased by 8.21% (yoy) in June 2020. In analysis by factors affecting M2, the rise in M2 resulted from expansion in government financial operations and increased net foreign assets.

**The economic slowdown caused by Covid-19 also led to reduced payment activity.** Cash payments underwent contraction in keeping with the imposition of large-scale social restrictions that reduced mobility and public demand for cash transactions. Accompanying this was a lower volume and value of non-cash payments carried out with ATMs, debit cards, credit cards and electronic money. Similarly, digital banking declined in value and volume during the first half of 2020. Nevertheless, some positive developments emerged during the pandemic, for example, a growing public demand for digital platforms and instruments, which has taken place through shopping on e-commerce platforms for daily items. During the first half of 2020, e-commerce

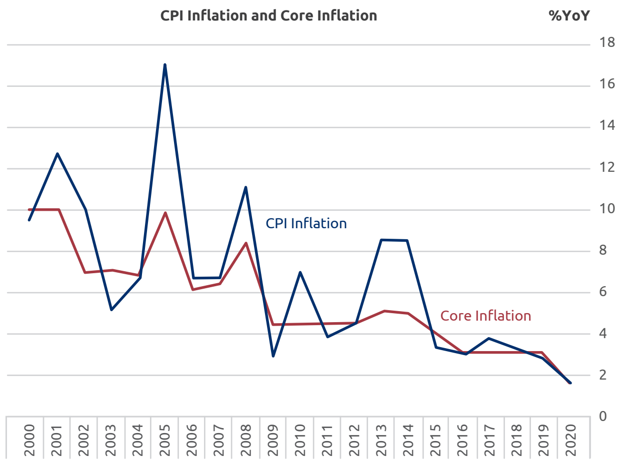
Amid the restrictions imposed on mobility, private consumption was bolstered by digital transactions.

transactions continued to rise, albeit at a much slower pace 7.28% (yoy) in the second quarter versus 51.98% (yoy) in the first quarter.

**During the second half of the year, economic growth began to improve in response to relaxation of large-scale social restrictions, accelerated disbursements of fiscal stimulus and improvement in the global economy.** Relaxation of the large-scale social restrictions were possible following the positive outcomes of health measures and implementation of health protocols, and these lead to increased mobility of persons, goods and services. At the same time, higher disbursements of Government spending delivered a fiscal stimulus that helped to sustain consumption, particularly among the lower income groups, while enabling more rapid and effective responses to Covid-19. Increased mobility contributed to a recovery in household consumption, led by spending on transportation, restaurants and hotels. This recovery in consumption prompted an improvement in investment, led by the non-construction component. Meanwhile, the initial upturn in global demand, especially in China and the United States, spurred higher exports of some commodities, such as iron and steel, pulp and paper, garments and textile fibers. As a result of these developments, the contraction in economic growth eased to 3.49% in the third quarter with a further improvement predicted for the fourth quarter. This would bring the overall growth for 2020 into the range of -2% to -1% range. Economic gains in the second semester of 2020 were confirmed by the performance of economic sectors engaged in exports or relating to mobility. In geographical analysis, strengthening external and domestic demand spurred economic recovery in some regions.

**Improvement in the global and domestic economies contributed to continued macroeconomic stability.** Further improvement in the Indonesia Balance of Payments is predicted for the second half of 2020, in the form of a wider overall surplus compared to the first half. For 2020 as a whole, the Indonesia Balance of Payments are forecast to be in a surplus position; a continued large surplus on capital account would more than fully offset a current account deficit at about 0.5% of GDP. Reflecting this overall surplus, international reserves climbed to USD135.9 billion at the end of 2020, equivalent to 9.8 months of imports and servicing of official external debt and well above the international adequacy standard, of approximately three months of imports. The capital and financial surplus is reflected in a 1.46% (ptp) appreciation in the rupiah during the second half, with the rupiah closing 2020 at IDR14,050 to the US dollar. Regarding internal stability, CPI inflation reached 1.68% (yoy) in December 2020, below the 3.0%±1% targeting range and representing the lowest level of inflation for the past 20 years (Chart 1). Core inflation remained low in response to weak demand; Bank Indonesia's policies for shaping inflation; and lower pressure from exchange rate pass-though. VF inflation was

**Chart 1.** Consumer Price Index and Core Inflation




**Source:** BPS

subdued amid the seasonal factors after the harvest season, while AP inflation slowed due to lack of strong demand, low Government-determined price adjustments and deferments in some excise rates.

**Financial system stability steadily improved in response to the positive impact from a relaxed macroeconomic policy and reduced uncertainty on global financial markets**. Monetary policy transmission was sustained in 2020, as reflected in lower interest rates and volumes of interbank transactions in the second half of the year. For the year as a whole, interbank rates fell by 184 bps, accompanied by declining volumes on the interbank money market. Transmission to bank interest rates continued, although less than optimum, especially in the case of lending rates. The total decline in interest rates for time deposits and working capital loans in the second half amounted to 121 bps and 27 bps, respectively. As for stability indicators, the Financial System Stability Index remained firmly within the normal-stable zone and below the prudential threshold, bolstered by implementation of the debt restructuring program which kept NPLs at safe levels of 3.06% (gross) in December 2020 and 0.99% (net) in November 2020. The bank capital adequacy ratio (CAR) was recorded at 24.13% while the liquidity ratio improved to 31.67%. Nonetheless, continued contraction in banking intermediation remained a cause of concern. Unlike loans, growth in deposit climbed steadily to reach 11.11% (yoy) in December 2020, causing growth in M1 and M2 to increase to 18.54% (yoy) and 12.44% (yoy).

**Cash and non-cash payment transactions showed improvement in the second half with the overall economic recovery.** By December 2020, cash in circulation had rebounded from the contraction, mentioned above, to expand by 13.25% (yoy). Payment transactions carried out with ATMs, debit cards, credit cards and electronic money had also returned to positive growth by December 2020. Similarly, the value of digital banking transactions began improving in September 2020; digital banking volumes reached 513.7 million transactions by December, with growth at 41.53% (yoy). The nominal value of e-commerce transactions rebounded in the third quarter, growing at 19.55% (yoy). Overall expansion for 2020 reached 29.6% (yoy) on growing public preferences and promotional strategies pursued in some marketplaces. Also contributing to the rise in transactions was the growing convenience of these payment methods during the pandemic; the use of electronic money, as a leading payment method, accounted for a 41.71% share in the fourth quarter of 2020. Digitalization of the payment system was also reflected in the expanded coverage of the QRIS, most importantly for MSMEs and retail trade. The QRIS is now in use nationwide, connected to about 5.8 million retail merchants, most of whom are MSMEs. More than 3.6 million merchants are micro enterprises and about 1.2 million are small-scale enterprises.

## Key Role of Policy Synergy in Mitigating Covid-19 Impact

**Positive developments in the Indonesian economy in the second half of 2020 owed much to the policy synergies pursued by the Government, Bank Indonesia and relevant authorities.** Policy synergy was geared towards minimizing and offsetting the impact of restrictions on personal mobility that put pressure on the national economy. In this regard, the fiscal stimulus was increased, not only to cope with health care needs arising from the Covid-19 pandemic, but also to promote recovery for the flagging economy. Monetary policy was directed at supporting economic recovery while maintaining economic stability and ensuring adequate liquidity in the banking system. Macroprudential and microprudential policies were reinforced further in support of banking intermediation while maintaining financial system stability. These various measures were bolstered by payment system policies that facilitated the smooth processing of digitized transactions and by other supporting policies for economic recovery to progress quickly and effectively.

**Policy synergy was underpinned by the robust legal basis of Act No. 2 of 2020.** This legal foundation enabled authorities to act quickly to take extraordinary measures and remain accountable in their response to the pandemic. Act No. 2 of 2020 empowered the Government to implement policies relating to expansion of the fiscal deficit and 2020 budget financing. Powers granted to Bank Indonesia included the purchasing of long-term government securities from the Government on the primary market. OJK was granted powers relating to the consolidation, merger, takeover, integration and conversion of financial services institutions. The LPS was also granted powers to strengthen its role in trouble-shooting bank problems and in guaranteeing funds deposited in banks.

**The Government pursued an expansionary fiscal policy to deal with both the health and humanitarian fallout from the pandemic and the impact leading to a steep decline in the economy.** At the start of the pandemic, the Government launched a stimulus involving tax incentives, non-fiscal measures and expenditures, while providing social assistance and guarantees of food security. As the impact of the pandemic mounted, the expansionary direction of fiscal policy, which was reinforced by Act No. of 2020, paved the way for the Government to increase the fiscal deficit above 3% of GDP until 2022. The Government then issued Presidential Regulation No. 54 of 2020 as a basis for widening the 2020 State Budget deficit to 5.07% of GDP with focus on health care spending and the social safety net. With the growing severity of the pandemic, the Government revised the 2020 State Budget deficit upwards to 6.34% of GDP in Presidential Regulation No. 72 of 2020. The state expenditure target was raised to IDR2,639.2 trillion largely due to the additional IDR695.2 trillion expenditure for the National Economic Recovery (PEN) program. This program includes allocation of IDR397.56 trillion for public goods expenditures for health care; social protection; government ministries/agencies and regional governments; and IDR297.64 trillion for non-public goods comprising business incentives, MSME support and corporate financing. In the second half of 2020, the Government worked steadily to expand and adapt the PEN for better implementation and ease in execution so that the projects would be effective in supporting economic recovery. High growth in budget expenditure outcomes amid contraction in revenues would result in a fiscal deficit of 6.09% of GDP.

**Bank Indonesia pursued an accommodative policy mix in support of national economic recovery while maintaining macroeconomic and financial system stability.** The primary factors considered by Bank Indonesia in relaxing the monetary policy stance were low inflation and external stability, which was progressively brought back under control. The relaxation of policies was carried out through reductions in the BI 7-Day Reverse Repo Rate (BI7DRR) policy rate and large-scale liquidity injections, provided by lower statutory reserve requirements and monetary expansion. This policy was supported by stabilization measures for keeping the exchange rate aligned with fundamentals, while safeguarding market mechanisms and reinforcing the strategy for monetary operations. Accommodative macroprudential policies were also undertaken in light of the control maintained over financial system stability and the financing cycle that remained below the long-term trend. Bank Indonesia relaxed some macroprudential provisions to encourage banks to provide financing for business and the economy and to maintain financial system resilience. In the payment system, Bank Indonesia accelerated the pace of payment system digitalization on the basis of the Indonesia Payment System Blueprint (BSPI) 2025; eased regulatory requirements; and promoted electronification of payments to shore up activity in the digital economy and finance during the pandemic period.

**Concerning the 2020 State Budget financing requirement, the synergy between the Government and Bank Indonesia was conducted by prioritizing prudential principles, good governance, transparency and accountability.** In Act No. 2 of 2020, the Government was empowered to issue government securities for specific objectives within the scope of the Covid-19 pandemic. In this regard, Bank Indonesia was granted power to purchase long-term Indonesian government bonds on the primary market to address issues in the financial system endangering the national economy, including for specific purposes within the scope of the Covid-19 pandemic. The scheme and coordination mechanism for these government bond purchases were set out in the Joint Decree of the Minister of Finance and the Governor of Bank Indonesia dated April 16, 2020 (subsequently known as KB I) and the Joint Decree of the Minister of Finance and the Governor of Bank Indonesia dated July 7, 2020 (subsequently known as KB II). KB I prescribed the purchasing of long-term Indonesian government bonds/sharia government bonds by Bank Indonesia, employing market mechanisms, for funding of the 2020 State Budget. Meanwhile under KB II, Bank Indonesia conducted direct purchases of Indonesian government bonds/sharia government bonds for funding of public goods worth IDR397.56 trillion in the 2020 State Budget and bore the entire cost of this government securities issue. In addition, Bank Indonesia participated in a burden-sharing arrangement with the Government in the issuance of government securities for IDR177.03 trillion in 2020 State Budget funding for non-public goods related to MSMEs and corporations.

**To reinforce financial system stability, OJK and LPS pursued a range of policy actions.** OJK issued various forward-looking and counter-cyclical policies for banks, the capital market and the non-bank financial services industry. The aim was to keep the Covid-19 pandemic from putting further pressure on the financial services industry and in so doing endanger the national economy and the livelihoods and welfare of the people. This policy was also implemented in support of Government actions to accelerate national economic recovery, including for MSMEs and corporate debt restructuring. Meanwhile, in addition to reducing the deposit guarantee rate, LPS also eased the financial penalties for late premium payments in order to reduce pressure on liquidity and mitigate the impact of deteriorating financial system stability in the midst of the pandemic. To support the economic recovery program, LPS also prioritized the return of government funds placed in participating banks in the form of deposits. In other actions, OJK, LPS, Bank Indonesia and the Government also strengthened coordination in the implementation of Act No. 2 of 2020 relating to the operation of the lender of last resort (LoLR) function, purchasing Indonesian government securities and/or sharia government securities on the primary market, purchasing government securities held by LPS outright or under repo agreements, regulating foreign exchange flows, and providing funding access to the corporate/private sector through SBN repurchase (repo) agreements.

## Bank Indonesia Stimulus Actions Supported Economic Recovery

**Bank Indonesia strengthened the policy mix for continued economic stability, while promoting recovery in an economy under pressure from the Covid-19 pandemic.** In this context, the underlying concept for the direction of Bank Indonesia policy was that of close linkages between growth and economic stability, including financial system stability, that complement and reinforce each other. On one side, the policy response was aimed at maintaining economic stability with a focus on external stability, which had come under considerable pressure from uncertainties on global financial markets. A further objective of this policy of stability was to ensure continued financial system stability, including the continued resilience and adequacy of banking liquidity. Alongside this, inflation eased in response to weak domestic demand consistent with the impact of reduced mobility in the economy during the Covid-19 period. These actions for safeguarding economic stability were envisaged as supportive of the economy and providing the basis for recovery. Viewed from the side of economic recovery, the policy mix was a series of balanced actions to stimulate economic growth following the sharp contraction early in the Covid-19 period. This effort to promote sustainable economic growth became a focus of Bank Indonesia for the reason that strong economic growth would support economic stability. The banking system would remain resilient with high levels of capital matched by robust credit quality. Healthy economic growth would also bolster positive perceptions of the outlook for the Indonesian economy and ultimately encourage foreign capital inflows and strengthen external stability. Taken together, these two approaches were mutually complementary and reinforcing, and could therefore promote more rapid economic recovery.

**Bank Indonesia pursued this policy direction with an accommodative policy mix that optimized the various instruments at its disposal.** Bank Indonesia resorted to accommodative polices in consideration of the 2020 Indonesian economy operating well below potential. On monetary policy, with inflation pressure at low levels, Bank Indonesia reduced the BI7DRR policy rate and conducted quantitative easing (QE) to stimulate economic growth and provide assurance of financial system stability. Measures were also taken to strengthen monetary operations in support of the policy direction. The stabilization policy for the rupiah exchange rate was aligned to fundamentals and market mechanisms in a triple intervention strategy to safeguard external stability and manage economic adjustments to proceed smoothly amid external and domestic pressures. The accommodative macroprudential policy direction involved the easing of some regulations to encourage bank financing for business and the economy and to safeguard financial system resilience. Payment system policy involved accelerating the digitalization of the payment system under various transformational initiatives envisaged by the Indonesia Payment System Blueprint (BSPI 2025). In addition to these three main policies, Bank Indonesia implemented other supporting policies, such as for financial market deepening; sharia economics and finance and MSME development; and international policies. These policies were strengthened further to boost momentum for national economic recovery.

**In closer detail, Bank Indonesia pursued a course of monetary policy relaxation in support of national economic recovery while maintaining economic stability.** Bank Indonesia embarked on a loose monetary policy by lowering the BI7DRR policy rate and injecting liquidity in a program of QE. During 2020, Bank Indonesia announced five policy rate cuts totaling 125 bps, bringing the policy rate down to an historical low of 3.75% by the end of the year. The reductions were announced in increments of 25 bps in the Board of Governors Meetings of February, March, June, July and November 2020. The decision to reduce interest rates was carried out in measured increments to promote economic recovery, while taking note of inflation and the need to safeguard the competitiveness of domestic financial assets and external stability. Bank Indonesia also conducted rupiah quantitative easing totaling about IDR726.57 trillion (about 4.7% of GDP), mainly by lowering the minimum statutory reserves by about IDR155 trillion and conducting monetary expansion in the amount of IDR555.77 trillion through December 30, 2020.

**Bank Indonesia took further policy measures for stronger stabilization in order to safeguard rupiah exchange rate and reinforce the monetary operations strategy.** The exchange rate stabilization policy was pursued in line with fundamentals and market mechanisms involving triple intervention on the spot market; domestic non-deliverable forward (DNDF) market; and purchases of government securities on the secondary market. This policy was also supported by adequate international reserves and cooperation in bilateral swaps with some financial authorities and repo lines, including the New York Fed in the USA and BIS, for reinforcing the second-line of defense. Cooperation in local currency settlement (LCS) was also strengthened with countries in the region. To build optimism and support the policy of rupiah stabilization, Bank Indonesia also held intensive communications with investors, rating agencies and domestic and foreign market players in order to build optimism and support policies. These measures also benefited the Indonesia sovereign credit rating, which remained firm, at a time when many nations were being downgraded. To safeguard adequate liquidity and improve money market efficiency, Bank Indonesia continued the implementation of two-sided monetary operations, covering both absorption injections. Bank Indonesia also made improvements to the operating strategy for DNDF instruments; strengthened the Term Deposit instrument; and made available a wider range of hedging instruments. Strengthening of monetary operations and deepening of the sharia financial market also took place with introduction of the Sharia Liquidity Facility (FLiSBI) and Sharia Liquidity Management (PaSBI).

**Bank Indonesia stayed the course with accommodative macroprudential polices to mitigate financial contagion from Covid-19 and to support economic recovery.** This policy was kept in place after considering the prudently maintained financial system stability and the financing cycle that was well below the long-term trend. Bank Indonesia eased the rupiah statutory reserve requirement by 50 bps as an incentive for banks to engage in export and import financing for productive purposes; MSMEs; and certain priority sectors defined in the PEN program, through June 30, 2021. To support the intermediation function, Bank Indonesia maintained the countercyclical capital buffer (CCB) at 0% and relaxed the MIR/Sharia MIR requirement, by not imposing a penalty on banks with MIR/Sharia MIR outside the prescribed targeting range (84%-94%). In addition, the disincentive parameter for the upper and lower limits of the MIR was reduced to 0 (zero). Bank Indonesia also took measures to increase bank liquidity by strengthening the Macroprudential Liquidity Buffer (MLB/Sharia MLB) provisions. Furthermore, Bank Indonesia reduced the minimum down payment for financing of environmentally friendly motor vehicles to 0% in order to promote economic growth.

**Bank Indonesia pursued actions in follow up to Act No. 2 of 2020 as part of the national policy response under the pressing conditions caused by the pandemic.** As explained in an earlier section, Bank Indonesia adhered to its commitment to funding and burden sharing for the 2020 State Budget while holding to prudential principles in order to maintain economic stability, including impact on inflation. During 2020 overall, Bank Indonesia purchased long-term Indonesian government securities worth IDR75.86 trillion on the primary market under KB I. Funding disbursements and burden sharing for funding of public goods in the 2020 State Budget under KB II totaled about IDR397.56 trillion. Accordingly, Bank Indonesia conducted purchases of Indonesian government securities of about IDR473.42 trillion for funding and burden sharing in the 2020 State Budget. Bank Indonesia also engaged in burden sharing with the Government regarding issuance of Indonesian government securities for IDR114.81 trillion in 2020 State Budget funding for MSME non-public goods and IDR62.22 trillion for non-public goods in the corporate sector.

**Bank Indonesia strengthened its lender of last resort (LoLR) function and regulation of foreign exchange flows in follow up to Act No. 2 of 2020.** Bank Indonesia introduced improvements to the regulations for Short-Term Liquidity Loans to Conventional Commercial Banks (PLJP) and Short-Term Liquidity Financing for Sharia Commercial Banks (PLJPS). This policy reinforcement took place in the Coordinating Forum for Macroprudential-Microprudential Supervision (FKMM) between Bank Indonesia and OJK, under the Joint Agreement of the Governor of Bank Indonesia and Chairman of the OJK Board of Commissioners dated October 19, 2020. This joint agreement strengthens the operation of the LoLR function, which is performed by Bank Indonesia, and of the supervisory function for banks and financial services institutions, performed by OJK. Bank Indonesia and other financial authorities worked closely to coordinate their drafting of regulatory provisions concerning Special Liquidity Loans (PLK) for systemically important banks facing a liquidity crunch and not satisfying the criteria for provision of PLJP/PLJPS loans. In regard to foreign exchange flows, Bank Indonesia took further actions, after stipulating the obligation for residents in receipt and use of foreign exchange, in its planned issuance of a Bank Indonesia Regulation concerning the obligation for repatriation of foreign exchange proceeds from resource-based exports, should this become necessary.

**Bank Indonesia accelerated the digitalization of the payment system by implementing BSPI 2025, easing regulations and expanding acceptance of the Quick Response Code Indonesia Standard (QRIS).** Some progress was achieved in implementing BSPI 2025 in synergy with the banking system; the Association of Indonesian Payment Systems (ASPI); OJK; and the Government (central agencies and the regions). During 2020, Bank Indonesia completed a conceptual design to be tested and implemented starting in 2021. At the end of 2020, Bank Indonesia also issued Bank Indonesia Regulation No. 22/23/PBI/2020 concerning the Payment System in order to restructure the national payment system industry. On the regulatory side, Bank Indonesia lowered the ceiling for fees for funds transfers through the Bank Indonesia National Clearing System (SKNBI) to encourage greater use and efficiency of non-cash transactions during the Covid-19 pandemic. Bank Indonesia also eased requirements in a package of credit card regulations, including support for credit card issuers in lengthening repayment periods during the pandemic period. Regarding the QRIS, Bank Indonesia revised the QRIS Merchant Discount Rate (MDR) downwards to 0% for merchants in the micro business category. This is a policy aimed at promoting the digitalization of MSMEs in line with the "Proud of Made in Indonesian Product" National Movement. Meanwhile, efforts to promote broader acceptance of the QRIS were continued with innovation of the Non-Present QRIS feature for remote payments and continued public education targeting consumers and merchants.

**The Bank Indonesia synergy with the Government in promoting use of non-cash transactions was strengthened further with the payment electronification program.** Electronification of payments in support of Government social aid disbursements was enhanced further to ensure better targeting; accurate payment amounts; timely payments; and better governance in the midst of the pandemic. Electronification of local government financial transactions also expanded further with coverage totaling 542 regional governments, consisting of 34 provinces, 93 municipalities and 415 districts. This electronification of local government transactions also applies to the levying of taxes and user charges, in addition to procurement and expenditures. The electronification is expected to strengthen local government financial administration by increasing tax revenues and allowing expenditures to be managed more efficiently for better results.

**The supporting policies were also pursued for greater effectiveness of the Bank Indonesia policy mix amid the Covid-19 pandemic.** These supporting policies focused on financial market deepening; the sharia economy and finance; MSMEs; and international cooperation. With regard to financial market deepening, in 2020 Bank Indonesia launched the Blueprint for Money Market Development (BPPU) 2025 with the aim of creating a modern, sophisticated money market in support of monetary stability, financial system stability and a conducive climate for national development financing. Concerning the policy for the sharia economy and finance, the main focus was the building of an ecosystem for halal value chains and strengthening of sharia finance through improvements in bank liquidity management to expand their role in financing for the economy. Concerning MSMEs, the development program was enhanced further with policies for corporatization, capacity and finance designed to promote MSMEs as a new economic force in the digital era. In international policy, international cooperation was directed at supporting economic recovery and maintaining macroeconomic and financial system stability at the global level and in Indonesia.

## Indonesian Economy to Gather Strength in Medium-term

**Looking to the future, Bank Indonesia believes that the Indonesian economy will strengthen further during 2021, bolstered by global recovery and domestic factors**. Key to this forecast is the outlook for the global economic recovery, with growth in 2021 projected in the 5% range. This outlook assumes progress in carrying out vaccinations, the opening up of economies and continuation of policy stimulus actions. These improvements will produce growth in world trade volumes and increases in global commodity prices. At home, developments in a number of early indicators through the end of December 2020 support the projection for further recovery in domestic economy. For example, an improvement in the Purchasing Managers' Index (PMI) in manufacturing and rising consumer confidence and expectations concerning incomes, availability of employment and business activities. The outlook for rapid recovery will depend a great deal on vaccinations and public discipline in complying with the Covid-19 protocols, a prerequisite for national economic recovery. In addition, other factors affecting the outlook for domestic economic recovery are the various policy actions for (i) opening up productive and safe sectors on a nationwide basis and in individual regions; (ii) expedited fiscal disbursements; (iii) expansion in bank lending on the sides of both demand and supply; (iv) continuation of the monetary and macroprudential stimulus measures; and (v) accelerated digitalization of the economy and finance with particular focus on MSME transformation. Bolstered by these various supporting factors, Indonesia's economic growth in 2021 is predicted to increase in the range of 4.8%-5.8%.

**The outlook for a recovery in economic growth is also underpinned by continuing macroeconomic stability**. Economic stability will continue in 2021, firmly supported by the 2021 balance of payments that is predicted to record a surplus. Balance of payments performance will be characterized by a strong capital account surplus, partly offset by a current deficit projected in the 1.0%-2.0% range. Exports would grow in line with the recovery in global demand while imports would rise to satisfy domestic demand. Inflation in 2021 will remain subdued within the 3.0%±1% targeting range, benefiting from the predicted stability in core inflation despite some increase in line with rising domestic demand. Among the components of inflation, higher core inflation would be driven by domestic demand, consistent with a steady increase in the public's mobility and rising global commodity prices. Subdued inflation in most regions would contribute to achievement of the inflation target of 3.0%±1%. Meanwhile, financial system stability is projected to remain assured with banking intermediation expected to climb, in keeping with the outlook for domestic economic recovery. In Bank Indonesia forecasts for 2021, growth in bank lending and third-party funds would come into the 7.0%-9.0% range.

**Bank Indonesia predicts a continuing, steady improvement in the Indonesian economy, driven by gains in the global economy, strengthening of various domestic factors and continuing macroeconomic stability.** Global economic growth is predicted to climb above 3.8% in 2022 as pressures from Covid-19 ease and in response to the continued fiscal and monetary stimuli. World trade would recover in line with the improving outlook for global economic growth, which will subsequently lead to increases in world commodity prices, thereby boosting key Indonesian exports. Various domestic factors acting in concert with positive influences in the global economy will also strengthen the Indonesian economy through the next few years. The upward trend in global economic growth will bolster the fortunes of Indonesian exports, which in turn will increase production and investment activity. Improvement in the business climate resulting from implementation of the Omnibus Law will also bolster domestic investment. Private consumption will also recover on the strength of increased incomes, particularly in response to steadily improving export performance. The forging of closer synergies in the policies of Bank Indonesia, the Government and other relevant authorities, including the ongoing structural reform policies, will promote more rapid recovery in the nation's economy. In view of these developments, more vibrant domestic economic growth is projected for 2022 in the range of 5.4%-5.9%.

**In the medium-term forecast, the Indonesian economy will gather strength in line with improvements in the global economy and the positive impact of structural reforms.** At the global level, economic recovery will spur activity in world trade, thus creating opportunities for Indonesia to increase exports through closer cooperation with major trading partners and export diversification involving non-traditional markets. At home, structural reforms will have a positive impact in improving Indonesia's productivity. The demographic bonus, which still represents an advantage for Indonesia, will need to be leveraged in support of higher productivity. Given the above factors, the Indonesian economy has a buoyant outlook with growth projected to reach 5.5%-6.1% by 2025. The medium-term will also see improvement in the balance of payments from a narrower current account deficit and a sustained CFA surplus. Inflation in the medium-term is forecast to remain within the inflation targeting range in response to efficiency and productivity improvements in the economy. The medium-term outlook for economic growth will be accompanied by rising per capita incomes. In the latest assessment by the World Bank, Indonesia's GNI per capita increased in 2019 to USD4,050 from USD3,850 previously. This improvement has raised Indonesia to the ranks of upper middle-income nations. In the medium- to long-term outlook, the Indonesian economy will become progressively stronger, placing Indonesia on the path to become a high-income advanced nation by 2045.

## Structural Policies Key to the Medium-Term Outlook

**Bank Indonesia holds firmly that structural policies will be key to economic improvement in the medium-term and will accelerate economic transformation as Indonesia becomes an advanced nation.** A series of structural reforms is vital for improving efficiency and productivity in pursuit of higher and more sustainable economic growth in tandem with managed stability. They are essential to create new sources of growth; increase the added value in production; forge closer integration across sectors and regions; and promote inclusive growth. In addition, further strengthening of infrastructure development policies will be necessary to develop connectivity for industry and tourism in order to bring down costs of freight and logistics, increase competitiveness and improve income equality in the economy. Improvements in the business and investment climate involving the streamlining of regulation and bureaucracy, such as with the implementation of the Omnibus Law, will also be necessary to promote investment and secure additional sources of development financing. A national strategy for development of the digital economy and finance will also be needed to strengthen digitalization of the payment system. This in turn will boost the efficiency of the economy and add to the numbers of participating economic agents, thereby promoting more inclusive economic growth. More robust policies for building the quality of human resources will be similarly essential for achieving higher levels of productivity.

**This structural transformation will need to be accompanied by reform in the money market to improve the effectiveness of money policy transmission while ensuring the availability of necessary economic financing.** To this end, Bank Indonesia has developed an action plan in the BPPU 2025 for money market deepening. The BPPU 2025 is fully oriented towards creating the conditions of a liquid and efficient financial market that will support monetary stability, financial system stability and a conducive climate for financing national development. The BPPU 2025 has been designed with three key initiatives to achieve a modern, sophisticated money market complying end-to-end at international standards with regard to instruments, the market actor base, credible benchmark rates and infrastructure (market infrastructure, the regulatory framework and coordination and education). The three main initiatives of the BPPU 2025 are : (i) the promotion of digitalization and strengthening of financial market infrastructure; (ii) reinforcement of monetary policy effectiveness; and (iii) development of sources of economic financing and risk management. The first initiative relates to the strengthening of digitalization and infrastructure to serve as the primary foundation and catalyst for the second and third initiatives. The strengthening of digitalization and infrastructure is being implemented in response to growing digital transformation in tandem with the development of new manufacturing industries (also known as Industry 4.0).

**The strategy for accelerating progress towards an advanced Indonesia must also be supported by various other measures to foster more robust and inclusive economic growth.** This can be achieved, among others, by optimizing the potential of MSMEs, which have a strategic role in the Indonesian economy. In this regard, Bank Indonesia has steadily expanded its MSME development program involving corporatization, capacity building and financing to improve economies of scale for MSMEs with focus on priority sectors. The program will thus be able to expand the MSME contribution to the GDP and promote Go Export and Go Digital MSMEs. The corporatization program is aimed at encouraging MSMEs to become part of the digital ecosystem through facilitation for simplified licensing, establishment of production clusters and provision of MSME digital infrastructure. The capacity building program is aimed at end-to-end building of MSME capacity, ranging from product development and management and finance training programs, to preparing for market access under the MSME Onboarding Program (e-payments, e-commerce and e-financing). Similarly, the financing program operates through implementation of regulations on targets for bank and non-bank lending to MSMEs and expansion of MSME access through empowerment of subsidized credit/people's business credit (KUR) for accelerated integration of inclusion and the digital economy and finance on a nationwide scale. Indonesian Creative Works (KKI) festival that successfully raised the profile of Go Export and Go

Digital MSMEs will redouble its efforts in 2021 while strengthening synergy with the Government for the success of the "Proud of Made in Indonesian Product" National Movement (Gernas BBI).

**Accelerated MSME development will also require support from digital transformation.** The rapid development of the digital economy and finance has led to the growth of various digital platforms offering innovations in production, consumption, collaboration and sharing. This digitalization has created opportunities for MSMEs to adapt and undergo transformation in order to survive and emerge with higher growth accompanied by increased corporatization, capacity and financing. One of the important lessons in the Covid-19 pandemic concerns the sharp rise in use of digital media in meeting consumer needs, in production activities and in investment transactions. Accordingly, the use of digital platforms can encourage MSMEs to become stronger by building more productive and innovative capacity, and facilitate greater access to the marketplace, industry and financial institutions. The expansion of MSMEs' access to digitalization in production and service processes, innovations for production and financing services will encourage MSMEs to become more sophisticated with facilitation and support for business expansion and to be competitive in the post-Covid-19 era of the new normal. Looking ahead, the optimizing of the MSME role as a backbone of the economy must continue to focus on improvements in productivity and inclusive economic growth, including adaptation to digital change.