Chapter 4

NATIONAL ECONOMIC POLICY MIX SYNERGY: FIVE DIRECTIONS OF THE POLICY RESPONSE

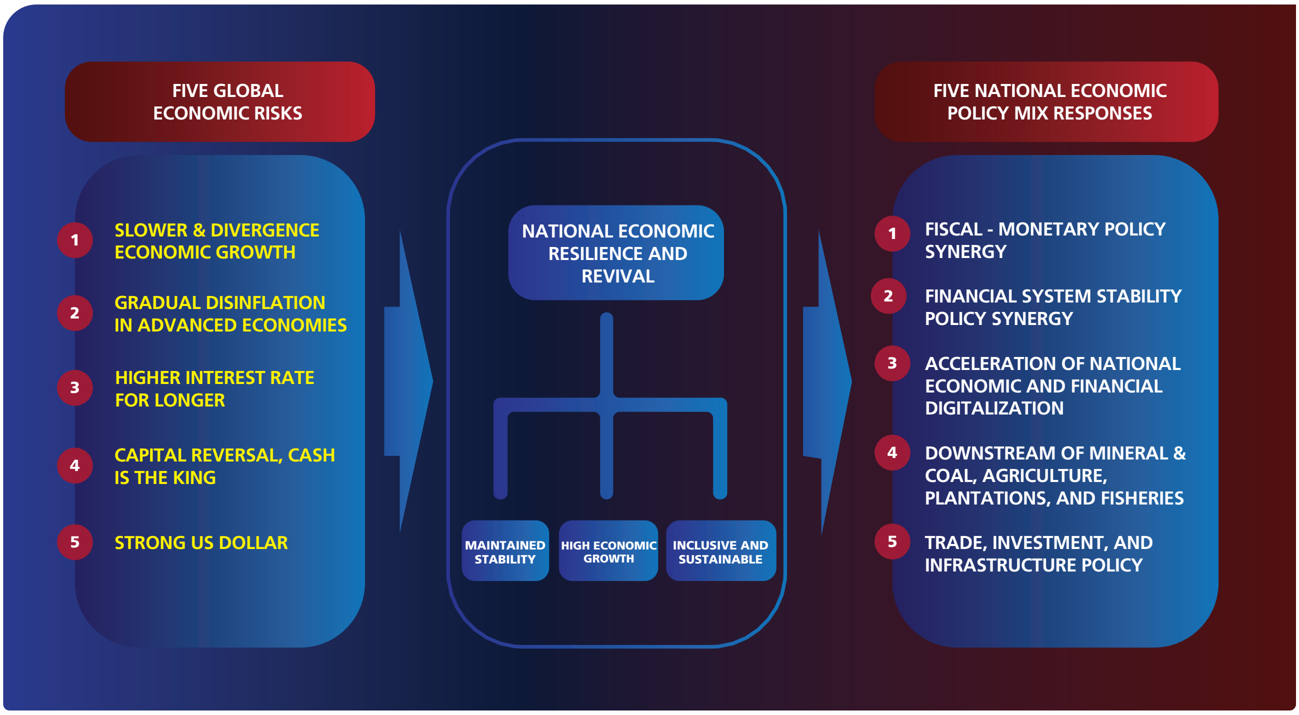
A synergetic policy response implemented in five directions is required to strengthen national economic resilience and revival. First, strengthening coordination between fiscal policy of the Government and monetary and macroprudential policies of Bank Indonesia to strike an optimal balance between macroeconomic stability and reviving economic growth. Second, strengthening policy coordination in the KSSK to maintain financial system stability and foster economic financing. Third, policy synergy to accelerate digitalization and increase economic and financial inclusion. Fourth, policy synergy to expand downstreaming of the mineral and mining sector to agriculture, plantation and fishing sectors to increase the value added of exports and to develop domestic industry in addition to strengthening food security and controlling inflation. Fifth, policy to expand trade and investment with trading partner countries characterised by promising growth prospects.

The national economic policy mix synergy must be strengthened to mitigate the adverse impact of global spillovers and maintain the momentum of national economic recovery. Several risks and global uncertainties will persist in 2024 and, therefore, demand stronger monetary-fiscal policy synergy between Bank Indonesia and the Government, along with policy coordination of the Financial System Stability Committee (KSSK) to maintain national economic resilience and stability. The main global risks include ongoing monetary policy tightening; higher government bond yields in Advanced Economies (AEs); portfolio investment outflows from Emerging Market and Developing Economies (EMDEs) to more liquid assets globally; persistent inflation and high international food and energy prices; and unresolved geopolitical tensions in several regions of the world. At the same time, global economic moderation and a polarization of growth sources demand stronger policy synergy and real sector transformation to bolster national economic growth, particularly in terms of consumption and investment as well as increasing value added and expanding export markets. To that end, policy synergy and real sector transformation must be strengthened to accelerate downstreaming, particularly in the mineral and mining sector, agriculture, plantation crops and fishing. Trade and investment must be expanded to several other major trading partners, such as India. Similarly, policies to strengthen MSMEs as well as to increase retail trade and domestic tourism must also be enhanced. Meanwhile, a fair and peaceful general election in Indonesia will support stability and economic momentum.

> " A close fiscal-monetary policy synergy, which has been running well, must be strengthened to maintain balance between macroeconomic stability and reviving economic growth. "

Moving forward, a synergetic policy response implemented in five directions to strengthen national economic resilience and revival is required. *First*, strengthening coordination between fiscal policy of the Government and monetary and macroprudential policies of Bank Indonesia to strike an optimal balance between macroeconomic stability and resilience against global shocks by nurturing growth despite fewer policy options (Figure 4.1). *Second*, strengthening policy coordination in the KSSK to maintain financial system stability and foster economic financing, financial market deepening to attract inflows of foreign portfolio investment as well as policy synergy for inclusive and green finance. *Third*, policy synergy to accelerate digitalization and increase economic and financial inclusion, while maintaining stability against the threats posed by crypto assets and cyber-attacks. *Fourth*, policy synergy to expand downstreaming of the mineral and mining sector to agriculture, plantation and fishing to increase the value added of exports and develop domestic industry in addition to strengthening food security and controlling inflation. *Fifth*, policy to expand trade and investment with trading partner countries characterised by promising growth prospects, such as India, in addition to strengthening a conducive investment climate and developing connectivity infrastructure to strengthen national supply and distribution networks.

Figure 4.1. National Economic Policy Mix Synergy and Innovation



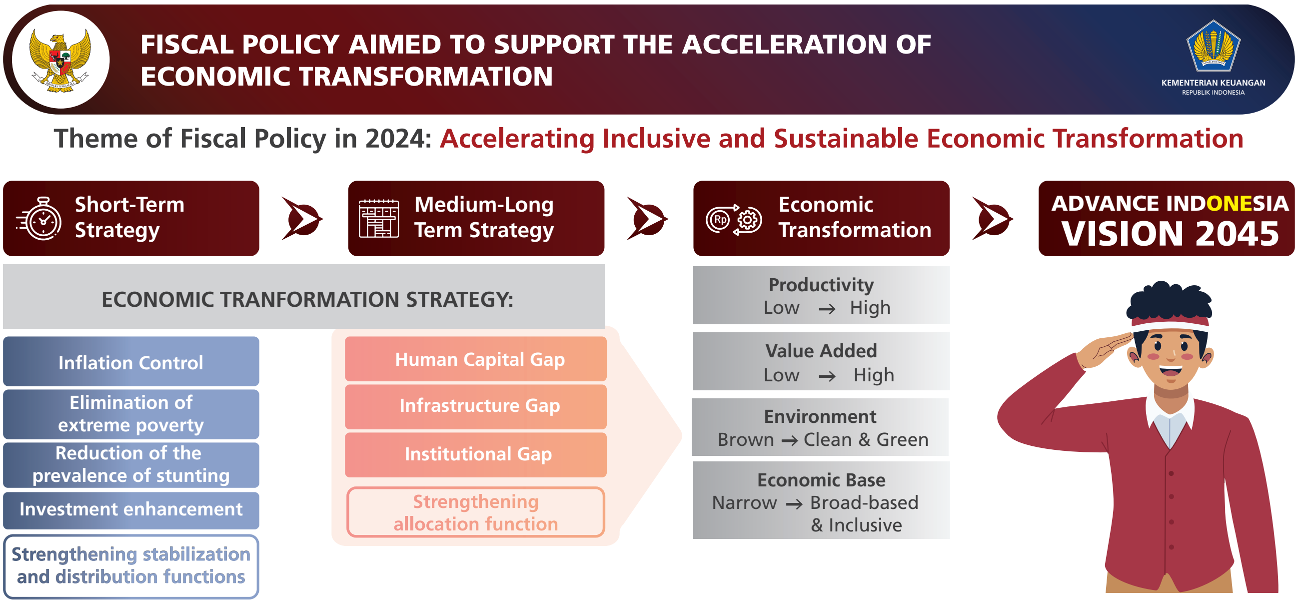
Source: Bank Indonesia

4.1. Bank Indonesia and Government Fiscal Policy Synergy

A close fiscal-monetary policy synergy, which has been running well, must be strengthened to maintain balance between macroeconomic stability and reviving economic growth. From Bank Indonesia's perspective, monetary policy is consistently oriented towards achieving the inflation target and currency stability to safeguard the domestic economy against global economic turmoil. Meanwhile, macroprudential policies are consistently directed towards reviving bank lending/financing to foster sustainable economic growth. From the Government's standpoint, the State Revenue and Expenditure Budget (APBN) in 2024 is oriented towards maintaining macroeconomic stability, while nurturing inclusive and sustainable economic transformation towards the vision of *Indonesia Maju* (Advanced Indonesia) by 2045 (Figure 4.2).

In the near-term, strengthening the fiscal policy distribution and stabilization function is focused on managing inflation (price stability), eradicating extreme poverty, reducing the prevalence of stunting and boosting investment. In the medium- to long-term, the fiscal budget allocation function is directed towards overcoming gaps in terms of human resources, infrastructure and institutional arrangements. Towards these ends, the APBN in 2024 is based on the following macroeconomic assumptions: 5.2% economic growth; 2.8% inflation; Rp15,000 per US dollar exchange rate; 6.7% rates on 10-year SUN; and an oil price of USD82 per barrel. Total state revenue is budgeted at Rp2,802.3 trillion with state expenditure of Rp3,325.1 trillion, leaving a manageable fiscal deficit of Rp522.8 trillion, or 2.29% of GDP. A close fiscal-monetary policy synergy is key to national economic revival and resilience moving forward against a backdrop of heightened global economic uncertainty.

Figure 4.2. Fiscal Policy Directions in 2024: Economic Stability and Transformation

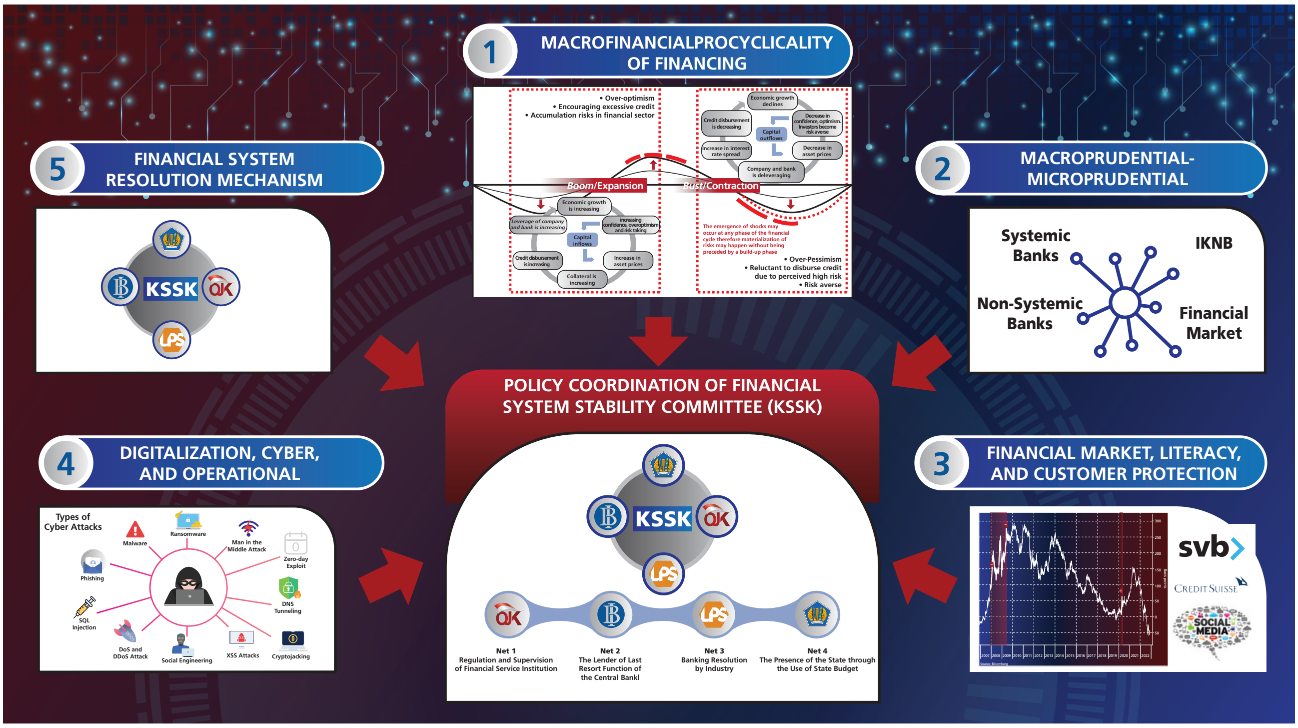


Source: Minister of Finance, Working Meeting and Hearing Session of Commission XI of the Indonesian House of Representatives with the Minister of Finance, Minister of National Development Planning/Head of Bappenas, Governor of Bank Indonesia, and Chairman of OJK, Jakarta, 31 August 2023

4.2. Financial System Stability Policy Synergy

Policy synergy within the KSSK is oriented towards maintaining financial system stability and reviving economic financing, including inclusive and green finance. KSSK meetings (Ministry of Finance, Bank Indonesia, Financial Services Authority/OJK and Indonesia Deposit Insurance Corporation/LPS) are held on a quarterly basis to assess financial system stability and requisite coordinated policy measures. The focus of policy coordination is oriented towards five salient aspects, namely: balanced economic financing; macroprudential and microprudential supervision; financial market deepening along with financial education and literacy; the supervision of operational risks and cyber-attacks; and the resolution and handling of troubled financial institutions (Figure 4.3). KSSK coordination is also focused on financial sector development and strengthening in accordance with the Financial Sector Development and Strengthening Act (P2SK Act). To that end, the policy synergy that has been working well in 2023 must be strengthened in 2024, which includes safeguarding the stability of the domestic financial system from the adverse impact of global spillovers and increasing financing for inclusive and sustainable economic growth. Seeking to revive financing to priority sectors (including the housing sector, MSMEs and KUR) Bank Indonesia provides liquidity incentives to the banking industry through Macroprudential Liquidity Incentives Policy (KLM), while the Ministry of Finance provides interest rate and funding incentives and exemptions from administration fees for MSMEs, KUR and public housing segments. Policy synergy to increase financing and financial market deepening between the Ministry of Finance, Bank Indonesia, OJK and LPS is also strengthened regularly through the capital market, money market and foreign exchange market, as well as financial education and literacy. Seeking to nurture sustainable finance, coordination aims to increase the capabilities of project preparation, financing modalities from the financial sector as well as promoting the investments required. Indonesia is one of just a handful of countries that has established a carbon exchange in accordance with the mandate of the P2SK Act.

Figure 4.3. Policy Coordination for Prevention and Handling of Financial System Crisis through the Financial System Stability Committee (KSSK)



Source: Bank Indonesia

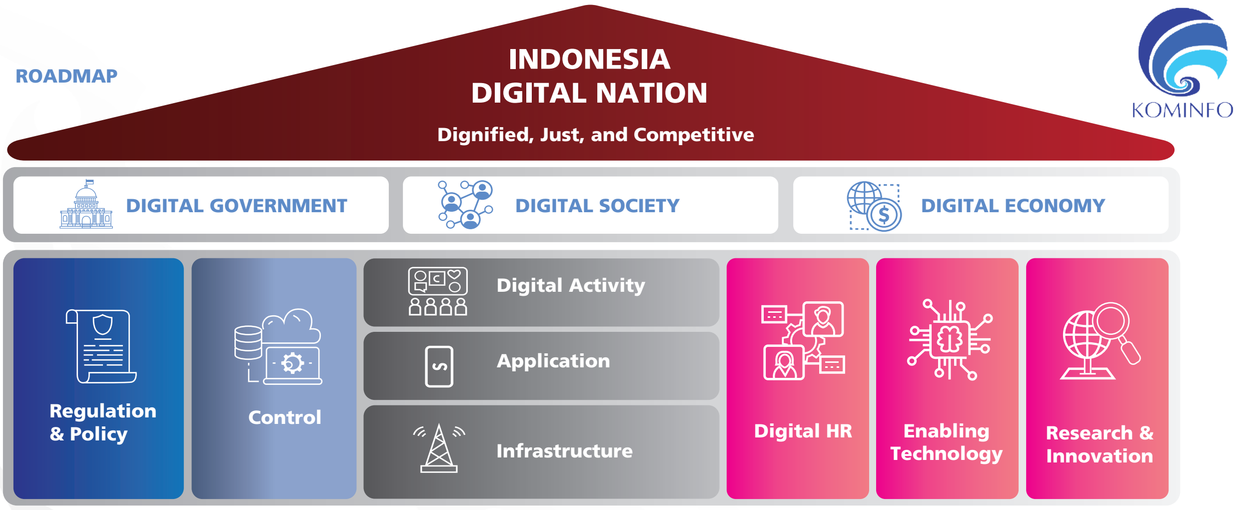
KSSK policy synergy is also oriented towards strengthening the stability of the financial system to bolster resilience in the face of global spillovers. Monetary-fiscal policy synergy between Bank Indonesia and the Government is focused on maintaining exchange rate stability and the government bond market against the adverse impact of global turmoil. This is reinforced by coordination between the macroprudential supervision of Bank Indonesia, which focuses system-wide on the large banks, and the microprudential supervision of the OJK, which focuses on the health of individual banks. OJK has also strengthened the supervision of non-bank financial institutions, the capital market and FinTech companies, while increasing consumer protection and financial services. Strengthening the bank resolution capabilities and process by LPS remain an ongoing concern in close coordination with the OJK to resolve troubled banks and with Bank Indonesia to provide short-term liquidity assistance as required. Simulations to test the readiness of bilateral coordination as well as coordination between KSSK institutions in terms of resolving financial sector issues is being continuously improved. KSSK coordination in terms of the P2SK Act in 2024 includes plans to enact 17 Government Regulations (PP); 1 Presidential Regulation (Perpres); 10 Bank Indonesia Regulations (PBI); 21 OJK Regulations (POJK); and 10 LPS Regulations (PLPS). In general, P2SK Act implementation is expected to strengthen financial sector development; support financial system stability; and increase economic financing for sustainable growth moving forward.

4.3. Acceleration of National Economic and Financial Digitalization

Digitalization policies are becoming more important as a driver of national economic revival in the medium- to long-term. In October 2016, a major international consulting firm (McKinsey &

Company) published its research paper entitled 'Unlocking Indonesia's Digital Opportunity', which detailed massive digitalization potential in Indonesia that could boost economic growth to the tune of USD150 billion each year before 2025. Since the Covid-19 pandemic reached Indonesia in early May 2020, financial and economic digitalization has developed rapidly in Indonesia. This has primarily been supported by faster digitalization of the payment system by Bank Indonesia through the implementation of five visions and concrete programs (detailed in the Indonesia Payment System Blueprint (BSPI) 2025), since QRIS implementation on 17th August 2019. In accordance with the Indonesia Digital Roadmap 2021-2024, the Government detailed its policy direction, implementation and targets to accelerate digital transformation in Indonesia (Figure 4.4). This is implemented through four development initiatives, namely: digital infrastructure; digital government; digital economy; and digital community. The roadmap maps 100 main initiatives in 10 sectors, including: digital tourism and transformation; digital trade; digital financial services; digital media and entertainment; digital agriculture and fishing; digital real estate and urban areas; digital education; digital health; industrial digitalization; and the digitalization of government institutions. Digitalization in Indonesia is expected to spur economic growth immediately and in the future. Based on the Medium-Term National Development Plan (RPJMN) 2020-2024, GDP growth of the information and telecommunication sector is forecast to increase from approximately 7% in 2020 to 7.5-8.8% in 2024, with the contribution of the digital economy accounting for 4.66%. Furthermore, faster economic digitalization could also reduce inflation. According to research conducted by Bank Indonesia, digitalization, as measured by a 1% increase in the ratio of internet users, could reduce core inflation by 0.076%. Reducing inflation through the supply side in the form of lowering marginal costs is possible because digitalization makes production more efficient, while reducing markup costs and real wages. On the demand side, digitalization lowers inflation expectations as the buying-selling process becomes faster and more convenient, by increasing the availability of selling price information across various media. Digitalization also reduces the impact of inflation on GDP (a flatter Phillips Curve) by reducing the need for resources through more efficient processes, thereby alleviating demand-side pressures

Figure 4.4. Direction of Indonesia's Digital Roadmap 2021-2024



Source: Ministry of Communication and Information Technology

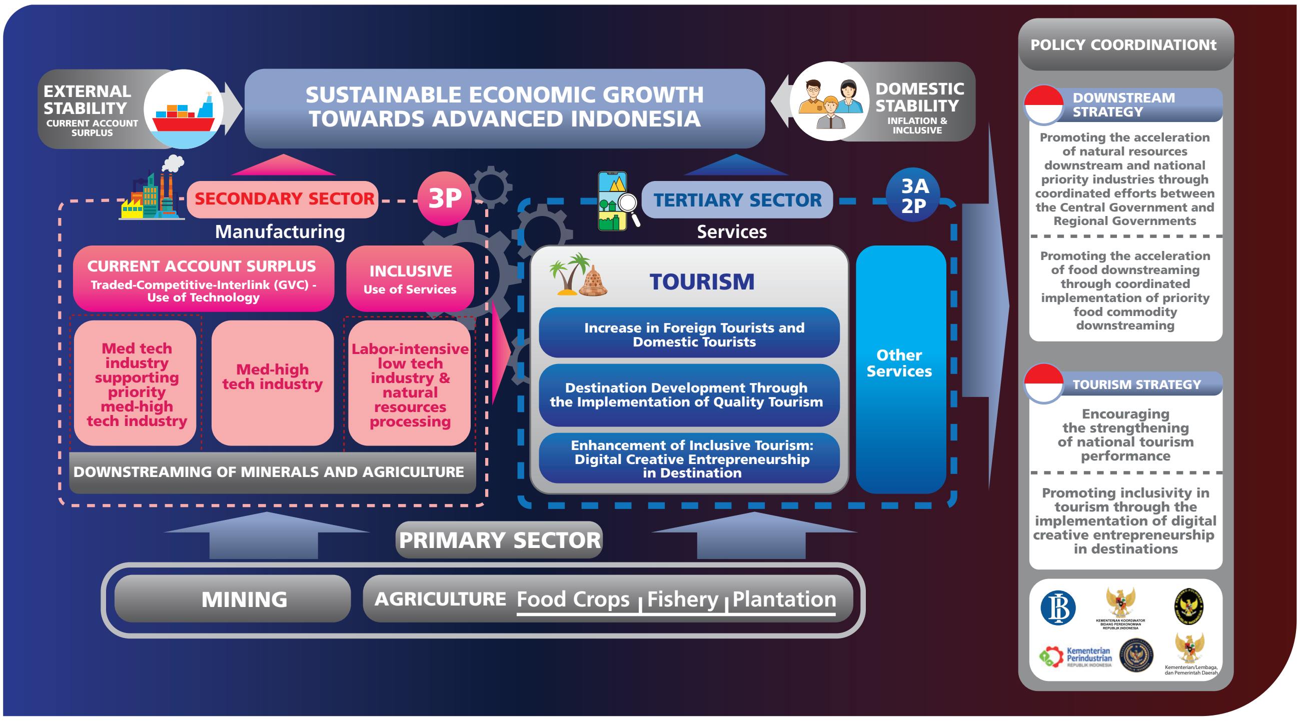
Governor of Bank Indonesia and Managing Director of the Monetary Authority of Singapore (MAS) Simulate QR Payments in the Implementation of Inter-Border QR Payment Interconnection between Indonesia and Singapore

4.4. Downstreaming of Minerals and Coal, Agriculture, Plantations and Fisheries

Downstreaming policies targeting natural resources must be improved to further develop the manufacturing industry and exports, thereby supporting high economic growth. Successful downstreaming of nickel into lithium batteries and for the battery electric vehicle (BEV) industry, as well as for various other downstream products, has been shown to increase the value added of exports and lead to higher economic growth, thereby strengthening Indonesia's external economic resilience. The higher value added of downstream nickel exports has driven growth in terms of aggregate demand and precipitated a healthier current account. Furthermore, a surge of capital from Foreign Direct Investment (FDI) to the mining sector and downstream nickel industry has increased potential economic output, thereby supporting non-inflationary growth. The downstreaming of natural resources and downstream industries must be accelerated to further increase potential output and boost economic growth, while considering existing reserves of natural resources; the development of new technologies; and the transition towards the green economy and sustainable finance. To that end, concrete measures are required to expand downstreaming to other minerals, metals and non-metals, while re-prioritising the development of downstream industries focused on natural resources in the medium- to long-term (Figure 4.5). Future downstreaming strategies and policies require an adjustment to the National Industrial Development Master Plan (RIPIN) 2015-2035. In implementation, the existing coordination forum between the Coordinating Ministry for Maritime Affairs and Investment, Ministry of Industry, Ministry of Finance and Bank Indonesia must be strengthened moving forward. The focus of policy coordination between the aforementioned government ministries/agencies aims to strengthen joint measures, focusing on determining priority industries in the medium- and long-term aligned with the adjusted RIPIN; financing to support downstreaming; and the formulation and implementation of the transition towards the green economy and sustainable finance.

Downstream policy must be expanded to the agricultural sector, plantation and fishing to spur higher economic growth and create job opportunities. Downstreaming in those three

Figure 4.5. Downstream Policy for Natural Resources-Based Manufacturing



Source: Bank Indonesia

sectors will strengthen price stability and help control inflation; boost exports and reduce imports which makes for a healthier current account; create wider job opportunities; and promote strong, inclusive economic growth (Figure 4.6). By sector, downstreaming the agricultural, plantation and fishing sectors must be implemented through three mutually supporting strategies. First, focus on downstreaming commodities that support price stability and regional comparative advantage to control inflation and accelerate regional economic growth. Second, downstreaming commodities that support external economic stability nationally with higher value added exports and import substitution. Third, downstreaming labor-intensive commodities to create job opportunities and improve public welfare. The most suitable commodities for those three strategies include: rice; various chili pepper and alliums; fish; seaweed; palm oil; and sugar cane. Concrete programs are required in the near-, medium- and long-term to increase the factors of production, regulations and institutional arrangements, supported by trade promotion and cooperation. Meanwhile, limited land, economies of scale, skills and access to finance must all be considered. A group approach is most suitable for the downstream development of agriculture, plantation and fisheries, which is sometimes called 'clustering' or 'corporatization', for example: farming groups (Gapoktan); pesantren business groups (Hebitren); and tourism awareness groups (Pokdarwis). The clustering approach facilitates the provision of technical and entrepreneurial assistance on the production side, increasing value added and branding, prices, as well as regional, national and even export marketing. This approach also facilitates the application of new technologies, digitalization and access to finance from the banking and non-bank financial sectors. The clustering or corporatization approach is applied end-to-end by Bank Indonesia through MSMEs empowerment programs, food security

Figure 4.6. Policy and Strategy of Strengthening Food Products Downstreaming

Source: Bank Indonesia

programs and sharia economy and finance programs to create a downstream ecosystem. Indeed, Bank Indonesia also organizes regular promotional activities and cooperation through the National Movement for Food Inflation Control (GNPIP); Karya Kreatif Indonesia (KKI); the Indonesia Sharia Economic Festival (ISEF); and the Indonesia Digital Economy and Finance Festival (FEKDI). These have successfully contributed tangibly to support growth and create job opportunities.

4.5. Trade, Investment and Infrastructure Policy

Trade and investment policies must be increased and expanded to non-traditional markets as new sources of global economic growth moving forward. Geopolitical fragmentation leads to an economic slowdown and divergences in the sources of global growth. Consequently, Indonesia must strengthen and expand trade and investment cooperation with existing and new trading partners. Indonesia's major export destinations currently include China, the US, Japan, India, South Korea and several ASEAN member states, with potential increases possible nationally and through diversification opportunities for export commodity markets from several regions (Graph 4.1). Regarding future economic prospects, India has massive potential for strengthening economic, financial and trade cooperation with Indonesia. India is a strategic partner of Indonesia as the fourth largest export destination and 21st largest source of foreign investment. Indonesia and India enjoy a similar economic structure, supported by strong manufacturing growth, technological advancement and significant innovation. Furthermore, both countries have achieved strong growth and solid resilience in the face of regional and global challenges. A number of initiatives have been implemented to strengthen cooperation between Indonesia

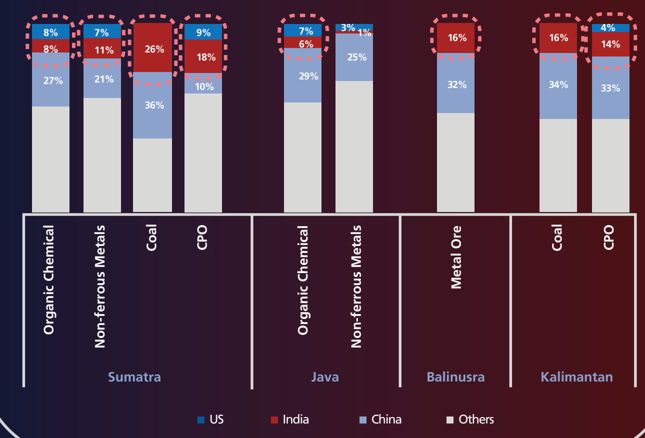
Graph 4.1. Export Destination and Potential for Diversification of Indonesia's Export Commodities

Share of Indonesia Export Destination Countries

	Country	Average Share (%)	
		2017 - 2019	2020 - 2023*
1	China	15.19	22.42
2	US	11.16	11.08
3	Japan	9.49	8.16
4	India	8.35	7.16
5	Malaysia	4.77	4.68
6	Philippines	4.28	4.20
7	Singapore	5.78	4.09
8	South Korea	4.22	3.68
9	Vietnam	2.80	3.08
10	Thailand	3.53	2.66
11	Others	30.44	28.79

*Average Up to August 2023

OPPORTUNITIES FOR DIVERSIFICATION OF EXPORT COMMODITY MARKET TO INDIA AND THE UNITED STATES



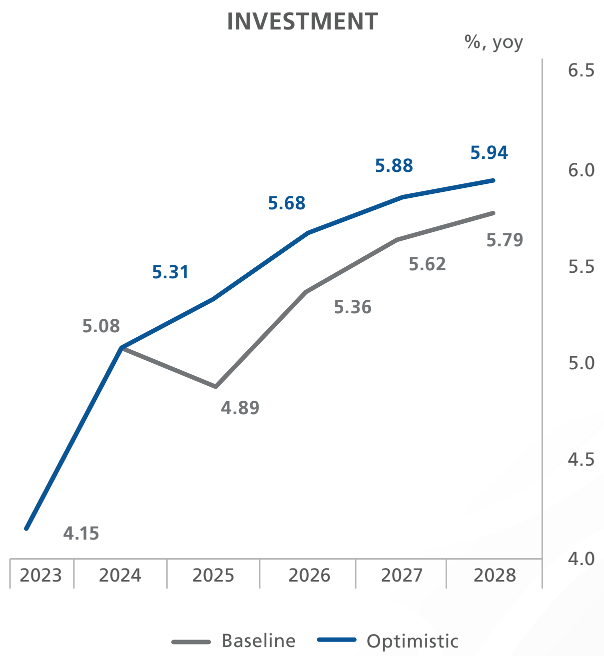
Source: Bank Indonesia

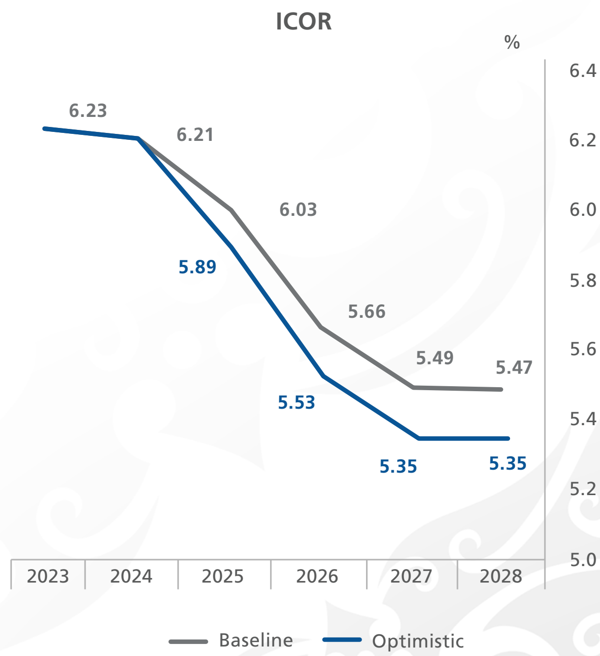
and India. In terms of trade, cooperation has been increased bilaterally as well as through the ASEAN-India Free Trade Agreement (FTA). Such efforts to enhance bilateral trade between both countries address a number of issues that have been hampering progress. For instance, issues related to exports of tires and fibre products from Indonesia to India and imports of water buffalo meat, automotive, sugar and rice from India to Indonesia. In terms of fiscal cooperation, the Ministries of Finance in both countries have discussed efforts to strengthen trade and investment cooperation, as well as efforts to address development issues together, including climate change and public health. Regarding central banking, Bank Indonesia and the Reserve Bank of India (RBI) signed a Memorandum of Understanding (MoU) on the sidelines of the 3rd Meeting of G20 Finance Ministers and Central Bank Governors (FMCBG) in Bali on 16th July 2022. Both central banks are firmly committed to strengthening relations and information exchange; cooperation in the payment system; digital and financial innovation; as well as the regulatory and supervisory frameworks for Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT).

The success of downstreaming policy, digitalization, trade and investment requires infrastructure development, particularly physical and digital connectivity. Infrastructure development is oriented towards strengthening national supply chains and integrating multipolar global supply chains with strategic trade and investment partners of Indonesia. As one example, the development of connectivity infrastructure requires the support of downstreaming policies for industry and exports of natural resources, which are dominated by the mining industry in Eastern regions of Indonesia along with the manufacturing and downstream industries in Java region, thereby improving national supply chains. As another example, the integrated development of connectivity infrastructure to support tourism policy at five Super Priority Tourism Destinations (DPSP) must be continued. Also, the strategic direction of infrastructure connectivity development policies will remain a consideration in the implementation of National Strategic Projects (PSN) moving forward. This also serves as the basis for foreign trade and investment policies with strategic partner countries to support the development of downstream natural resources and tourism. At the same time, implementation of the Omnibus Law on Job Creation must be continued to attract more domestic investment and FDI to Indonesia. At the macroeconomic level, comprehensive real sector transformation can increase investment growth and reduce the Incremental Capital Output Ratio (ICOR) (Graph 4.2). Bank Indonesia projects higher investment growth than the baseline scenario, from 5.79% to 5.94% in 2028 with a commensurate reduction in ICOR from 5.47% to 5.35% in the same period. These projections demonstrate the importance of policy synergy in terms of real sector transformation to create high economic growth by raising capital and improving productivity in accordance with the Endogenous Growth Model approach (see Chapter 7 or Box 4.2 of the Indonesia Economic Report 2022).

In general, policy synergies across the five salient aspects, discussed above, must be increased and be mutually reinforcing to strengthen national economic resilience and revival. Ongoing geopolitical fragmentation and the polarization of global growth sources have limited the policy options for maintaining balance between the goals of maintaining stability and nurturing growth. To address this issue, policy synergy to maintain macroeconomic and financial system stability must be prioritised to strengthen national economic resilience against the adverse effects of global risk spillovers. To that end, fiscal-monetary policy synergy to mitigate inflation, maintain Rupiah stability, fund the fiscal deficit and maintain money market and SBN market stability (the first policy synergy) must be strengthened through KSSK policy synergy (the second policy synergy), particularly in terms of macroprudential-microprudential supervision, operational risk supervision and readiness concerning the resolution of financial institutions. Maintaining economic growth momentum, synergy is required between the fiscal stimuli of the Government and accommodative macroprudential policies of Bank Indonesia through the Macroprudential Liquidity Incentives Policy (KLM) and reducing the Macroprudential Liquidity Buffer (MPLB) to revive bank lending/financing for sustainable economic growth. This synergy must be strengthened through policy coordination with the KSSK, primarily through financial market deepening to increase economic financing by issuing corporate shares and bonds in the capital market; by issuing retail SBN; and expanding the retail investor base, particularly among millennials, and sustainable finance (including the carbon exchange as well as through financial education and literacy.

Graph 4.2. **Prospect of Investment and ICOR**



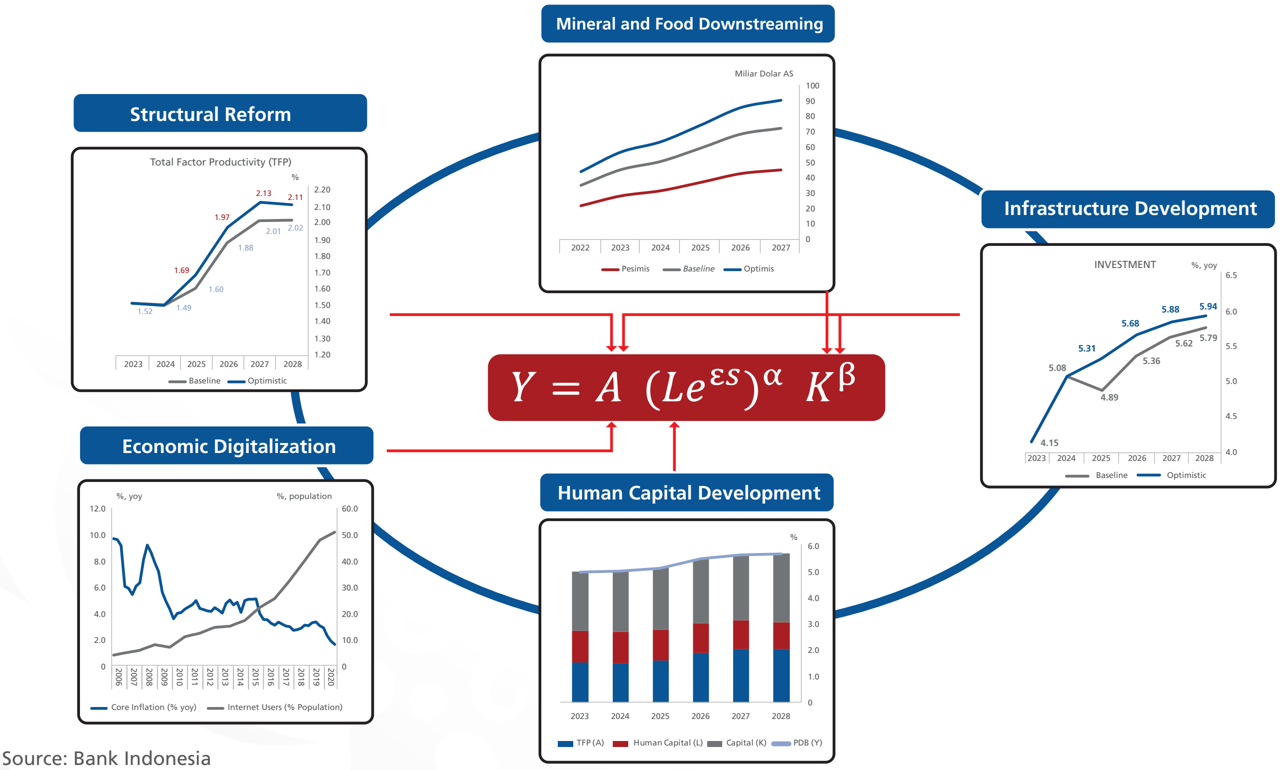


Source: Bank Indonesia

Downstreaming policy, trade and investment, infrastructure development and accelerating digitalization are oriented towards increasing economic capacity and achieving high growth in the medium-term. Based on the Endogenous Growth Model approach, transformation policy increases national economic capacity by raising capital and labor absorption, as well as improving the productivity of the factors of production (Figure 4.7). Downstreaming the mineral and mining, agriculture, plantation and fishing sectors can boost aggregate supply of various downstream products and industries; it also adds to aggregate demand by increasing investment, the value added of exports and wage income. Similarly, economic and financial digitalization will increase national economic efficiency and competitiveness, particularly the retail transaction segment and MSME sector, as well as the local economy. The development of physical and digital connectivity infrastructure will increase economic capacity, raise growth and boost productivity. In support, human resources development is critical, through formal education and vocational training as well as research and development (R&D) to increase the quality of the available labor force. Meanwhile, structural reforms to facilitate business and investment, including implementation of the Omnibus Law on Job Creation, will increase domestic and foreign capital investment, while boosting efficiency and productivity.

Close synergy, therefore, between macroeconomic policy and real sector transformation policy will strengthen and drive the national economic revival towards *Indonesia Maju* (Advanced Indonesia). Real sector transformation increases potential output in the medium-term, thereby fostering

Figure 4.7. Policy for Increasing Economic Capacity: Endogenous Growth Model Approach



Source: Bank Indonesia

"Downstreaming policy, trade and investment, infrastructure development and accelerating digitalization are oriented towards increasing economic capacity and achieving high growth in the medium-term."

higher non-inflationary growth. National economic growth in Indonesia is currently projected at 4.7-5.5% in 2024 and 4.8-5.6% in 2025, and real sector transformation is expected to lift economic growth further, to 5.1-5.9% in 2026 and 5.3-6.1% in 2028. At present, inflation is forecast to remain within the 2.5%±1% target corridor in 2024 and 2025. In subsequent years, economic transformation, as just discussed, will raise potential output, thereby accommodating stronger growth without generating higher inflation.

On the external side, resilience will strengthen as exports increase, which directly supports a healthy current account; it will also attract inflows of FDI, bolstering the capital and financial account. Low current account deficits will be maintained in the range of 0.1% to 0.9% of GDP in 2024, and 0.5% to 1.3% of GDP in 2025. This performance will accelerate national development and maintain Rupiah stability. As follow-on effects, higher economic growth and continued stability will fuel bank lending to the business sector; growth of loans disbursed by the banking industry is forecast at 10-12% in 2024 and 11-13% in 2025. The national economic outlook for Indonesia, characterised by high growth and continued macroeconomic stability, demonstrates the positive outcome of close synergy between macroeconomic policy and economic transformation policy, as discussed above. The optimistic economic outlook does not, however, reduce our need for vigilance of global dynamics that are prone to rapid change.