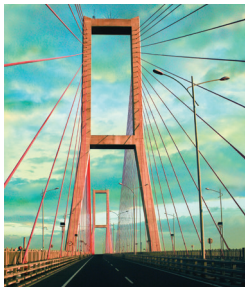


**Synergy in Strengthening Resilience,
Capitalizing the Momentum
of Economic Recovery**

2016
ECONOMIC REPORT ON INDONESIA



Cover image caption:

Bridge is a strategic infrastructure to improve interregional connectivity and enhance synergy in economic activities in Indonesia. Therefore, a bridge is a symbol of Indonesia economy's resilience amidst intense global challenges.



**2016 ECONOMIC REPORT
ON INDONESIA**

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VISION

To be a credible institution and the best central bank in the region by strengthening the strategic values held as well as through the achievement of low inflation along with a stable exchange rate.

MISSION

To achieve rupiah exchange rate stability and maintain the efficacy of monetary policy transmission in order to drive quality economic growth.

To nurture an effective and efficient national financial system that can withstand internal and external shocks in order to support the allocation of funding/financing that contributes to national economic stability and growth.

To ensure a secure, efficient and smooth payment system that contributes to the domestic economy and helps maintain monetary as well as financial system stability whilst broadening access in the national interest.

To build and maintain the organization and human resources of Bank Indonesia, who are performance based and honour integrity, as well as to enforce good corporate governance in the implementation of tasks as mandated in prevailing laws.

STRATEGIC VALUES

The values that form the basis of Bank Indonesia, the management and employees to act and or behave, consisting of **Trust and Integrity – Professionalism – Excellence – Public Interest – Coordination and Teamwork.**

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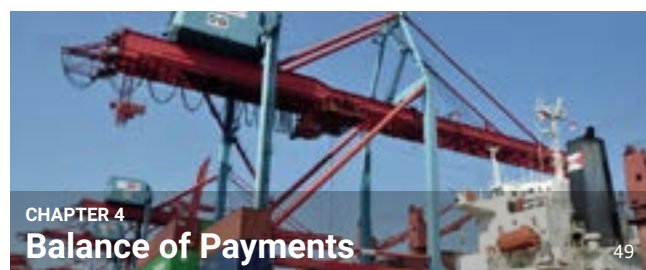
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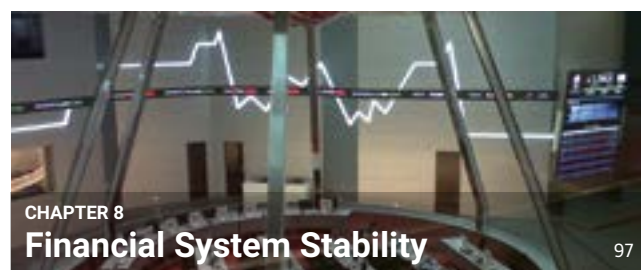
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BOARD OF GOVERNORS



Erwin Rijanto
Deputy Governor

**Agus D. W.
Martowardojo**
Governor

Perry Warjiyo
Deputy Governor



Rosmaya Hadi
Deputy Governor

**Mirza
Adityaswara**
Senior Deputy Governor

Sugeng
Deputy Governor

BOARD OF GOVERNORS



Hendar
Deputy Governor

until 27 December 2016



Ronald Waas
Deputy Governor

until 27 December 2016



"Timely and consistent responses in a macroeconomic policy mix applied in a disciplined manner are key in capitalizing momentum for economic growth, while maintaining macroeconomic and financial system stability."

Agus D. W. Martowardojo
Governor

FOREWORD

The year 2016 that began with expectations of accelerated recovery in the domestic economy instead became a year fraught with challenges befitting the discouraging state of global developments. The global economy failed to mount the hoped-for recovery, instead remaining shrouded in uncertainty. In 2016, the dynamics of the global economy revolved around three major issues that have persisted since 2015: sluggish global economic growth, prolonged low commodity prices, and chronically high uncertainty on financial markets.

In 2016, global economic growth continued to lack momentum, failing even to reach the level achieved in 2015. Economic consolidation continued in many parts of the world, including China. In a similar vein, world trade volume also slackened in keeping with flagging export performance, particularly in emerging markets including Indonesia. These events impacted global commodity prices, which remained stubbornly low at

least until the third quarter of 2016. Meanwhile, uncertainty mounted on global financial markets, notably during the period leading up to the US central bank decision to raise the Fed Funds Rate (FFR), a time marked by US dollar appreciation.

The issues of the world economy gained added complexity in the wake of geopolitical developments affecting some major world powers. At the end of the first half of 2016, the United Kingdom referendum that resolved to leave the European Union (Brexit) sparked heightened uncertainty in response to an outcome clearly at odds with earlier market expectations. Uncertainty flared again when the result of the US presidential elections was not inline with the market expectations. The uncertainty stemmed mainly from plans for an expansionary fiscal policy despite the heavy burden of government debt, greater trade protectionism, and more restrictive immigration policy.

The adverse global developments brought with them several challenges that affected the continuity of domestic economic recovery during 2016. Flagging exports that weighed down

on economic growth also impacted corporate performance, prompting companies to pursue internal consolidation and cut back on business expansion. This in turn sapped demand for credit and increased credit risk. These conditions impaired the effectiveness of monetary policy transmission and performance in the financial sector, including the banking system.

Facing with the global and domestic challenges, macroeconomic policy sought to achieve four main policy objectives. First, to mitigate the risk of flagging economic growth by strengthening the role of domestic demand as a source of growth. Second, to safeguard and improve macroeconomic and financial system stability as the basis for economic growth. Third, to pursue reinforcement of economic structures by improving efficiency, productivity, and competitiveness in the medium and long-term. Fourth, to ensure that the various policies set in motion would remain within the corridor of sound macroeconomic policy.

The policy stance in 2016 was pursued through policy coordination and synergy involving the Government, Bank Indonesia, and the Financial Services Authority (OJK). The policy synergy was implemented in the form of a policy mix that brought together fiscal policy, monetary policy, macroprudential policies, microprudential policies, and structural reform policies. The policy mix not only sought to mitigate short-term cyclical risks, but also to strengthen the economic structure in the medium to long-term.

In the fiscal side, the Government delivered a more robust fiscal stimulus by increasing expenditures allocated to productive sectors while maintaining fiscal sustainability. This strategy was supported by an expansion in fiscal space following the energy subsidy reform. Furthermore, the Government optimised tax revenues under the tax amnesty program that succeeded in collecting the largest ever tax redemptions in the world.

On the monetary side, Bank Indonesia implemented a more relaxed monetary policy stance to boost momentum for economic recovery while maintaining macroeconomic stability. Monetary policy effectiveness was strengthened through reformulation of the monetary policy operation framework in which the Bank Indonesia policy rate was changed from BI Rate to the BI 7-day (Reverse) Repo Rate (BI7DRR) on 19 August 2016, followed by measures to accelerate financial market deepening. In addition, Bank Indonesia took measures to curb excessive volatility in the rupiah exchange rate through strengthening the management of foreign exchange supply and demand.

To promote banking intermediation, Bank Indonesia undertook a selective relaxation of macroprudential policies involving adjustments in the regulations for loan/financing to value (LTV/FTV), the loan to funding ratio (LFR), and the countercyclical capital buffer (CCB).

In the area of payment system, Bank Indonesia worked tirelessly to ensure a secure, smoothly operating, and efficient payment system while devoting attention to expansion of access and the national interest. During 2016, Bank Indonesia focused on measures ranging from building more robust infrastructure and institutional structures to development of a business model for electronification. Important progress included completion of the design and testing of the National Payment Gateway (NPG) concept, launching of the Bank Indonesia Fintech Office including a regulatory sandbox function, and regulation of e-commerce. In 2016, in conjunction with the relevant ministries and agencies, Bank Indonesia successfully completed the National Strategy for Financial Inclusion (SNKI) and realise the integrated, cross-program, non-cash disbursement of social assistance via the banking system with the use of digital financial services (DFS).

In currency management, Bank Indonesia policy focused to ensure cash availability for public in an adequate volume and appropriate denomination, with timely provision, and in condition fit for circulation in all regions of the Republic of Indonesia. With this policy, during 2016, Bank Indonesia made further improvements to its distribution network for currency circulation throughout Indonesia. Bank Indonesia also issued 7 new banknotes and 4 coin denominations for circulation at the end of 2016, all released at a single moment. This itself marked a historical milestone, as never before had 11 denominations been simultaneously issued and launched in circulation since Indonesia attained independence.

On the microprudential side, Financial Services Authority (OJK) employed various policies to ensure the proper, transparent, and accountable operation of activities in financial services as part of the policy synergy for maintaining financial system stability. In addition, OJK was also focus to ensure consumers protection maintained in the financial sector.

In the real sector, the implementation of a range of structural reforms moved forward in order to increase efficiency and productivity, and improve the competitiveness of the economy. The structural reform policies focused on several priority issues, including regulatory harmonization, ease of licensing, and fiscal incentives to promote investment. In 2016, the structural reform policies were set out in Economic Policy Packages IX-XIV,

which carried forward from the policy packages launched in 2015. In addition, the Government constructed and will continue building energy infrastructure, including power plants under the 35,000 MW program, and connectivity infrastructure such as roads, ports, railways, and airports.

Coordination was strengthened further between the Government, Bank Indonesia, and other stakeholders, to support the policy mix that already in place. This involved coordination to control inflation at the national and regional levels, promotion of financial market deepening and financial inclusion, and measures for safeguarding financial system stability. The adoption of the Act on Financial System Crisis Prevention and Resolution was one of the most important achievement as a result of solid coordination in the financial system.

With a coordinated and synergic policy mix, the Indonesian economy was able to mitigate various risks amid the lingering adversities posed by global economic conditions. Economic growth in Indonesia showed improvement in 2016 compared to the preceding year. In addition, macroeconomic stability remained firmly in hand as reflected in sustained low inflation within the inflation targeting range, the current account deficit declined and at a safe level, and well maintained the rupiah exchange rate volatility. The financial system stability was also maintained and supported by a reliable national payment system.

The dynamics and challenges of the economy throughout the year 2016 provide some important lessons for future economic policies formulation. First, timely and consistent responses in a macroeconomic policy mix applied in a disciplined manner are key in capitalizing momentum for economic growth, while maintaining macroeconomic and financial system stability. Second, good coordination and synergy of policy among stakeholders, including the central and regional governments, Bank Indonesia and other relevant authorities, has proven able to deliver greater resilience and flexibility in the economy to make some adjustments on shocks while continuing to harness the momentum for growth. Third, the dynamics of domestic economy that are highly dependent on global developments provide lessons on the importance of consistency and continuity of structural reforms and efforts to diversify sources of economic growth in order to strengthen the foundations of the economy.

Looking forward, the Indonesian economy is predicted to continue to improve along with positive developments in global and domestic. A careful watch will still be required for some

global and domestic challenges that could adversely affect the economic outlook. At the global level, there are four key challenges demand sustained vigilance: the risk of further loss of global economic growth should economic consolidation by leading nations fail to progress as expected; the protectionist trend in the international trade policy of advanced countries; global financial uncertainty over the US policy stance; and rising global inflation. At domestic side, the challenges are related to ability to improve tax revenue capacity in order to increase the fiscal stimulus, completion of corporate and banking consolidation, improve the effectiveness of monetary policy transmission, and mitigate in the potential for inflationary pressure in the face of price increases on energy and other global commodities.

This book, Economic Report on Indonesia 2016, sets out a comprehensive analysis of the dynamics and economic challenges throughout 2016, policy responses set in motion, policy directions and the economic outlook. Our hope is that the readers of this book can grasp the fundamental reasoning for the various policies adopted by Bank Indonesia, the Government, and other relevant authorities in promoting economic recovery momentum while continuing to safeguard macroeconomic and financial system stability throughout the year of 2016. In this book, we also present the strategies and policy directions that will need to be followed to strengthen the capacity and competitiveness of the economy in order to achieve quality, sustainable economic growth.

Finally, on behalf of the Board of Governors of Bank Indonesia, I would like to present the Economic Report on Indonesia 2016 to the public of Indonesia. We are confident that this book will serve as an important and trusted, quality reference for all of us in preparing future plans in order to achieve higher economic growth on a sustainable and equitable basis.

May God the Almighty bless each and every step we take in working for our beloved nation, Indonesia.

Jakarta, April 2017

Governor of Bank Indonesia



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