General Review

Synergy for Resilience and Growth

In 2018, the Indonesian economy continued to perform strongly amid rising global uncertainty. The policy synergy forged by Bank Indonesia, the Government and relevant authorities safeguarded the country's economic resilience and sustained the momentum for economic growth. Looking ahead, the forecast is for improvement in the Indonesian economy, underpinned by a balanced and robust economic structure.

In 2018, the Indonesian economy faced major challenges triggered by rising global uncertainties. Indonesia is an open economy and the global uncertainties posed challenges for external sector management in both the trade and financial channels. In the trade channel, export performance declined in response to the slowdown in global economic growth and falling commodity prices. The challenges from the trade channel mounted, because this decline in export performance was accompanied by sizable demand for imports for infrastructure projects. This added to the complexity of managing the current account deficit at a sound level. In the financial channel, the challenges were related to the contraction in foreign capital inflows in emerging market countries, including Indonesia, triggered by US monetary policy rate increases and uncertainty on global financial markets. These global challenges then adversely impacted the performance of the Indonesia balance of payments (BoP), particularly in the second and third quarters of 2018, and placed added pressure on the rupiah exchange rate.

Bank Indonesia, the Government and other relevant authorities worked consistently and resolutely to implement a policy mix to drive more robust economic stability, specifically the stability of the rupiah, and to sustain the economic growth momentum. The policy priorities were to mitigate risks in the external sector that could disrupt the Indonesia BoP, put pressure on the exchange rate and undermine overall economic stability. The policy strategy was balanced by measures to sustain economic growth momentum. In keeping with this, there was a need to create more space to boost credit as a source of financing, given that the financial cycle was below long-term trends. Overall, a series of policies were implemented in a measured manner to keep inflation within the target range and maintain financial system stability.

Bank Indonesia applied a policy mix: monetary, financial market deepening, macroprudential and payment system policies. Bank Indonesia also made preemptive, front-loading and ahead-of-the-curve increases in the monetary policy rate to bolster the attractiveness of domestic financial assets and curb the current account deficit to within prudent limits. The financial market deepening policy was pursued to support economic financing. Accommodative macroprudential policies were adopted to strengthen economic growth momentum while maintaining consistently financial system stability. Payment system policy focused on supporting economic growth through more secure and efficient payment transactions.

Bank Indonesia policy was brought into synergy with fiscal policy and the structural reform policies implemented by the Government. Fiscal policies were prudently managed to bolster the stability of the economy by strengthening the fiscal sustainability outlook, while continuing to optimize space to promote short-term economic growth. Policy was also supported by an expanded role for regional fiscal policy, strengthened implementation of infrastructure projects and acceleration of various structural reforms to increase the capacity of the economy and support the sustainability of economic growth.

In 2018, the policy synergy implemented by Bank Indonesia, the Government and other relevant authorities guided the Indonesian economy along a path of maintained resilience and strengthened growth. In the fourth quarter of 2018, economic indicators pointed to positive developments. Foreign capital inflows resurged at the end of 2018, driven by the strong attractiveness of the Indonesian financial market and the buoyant outlook for the economy, as well as the reduced uncertainty on global financial markets. Imports also began to slow in the fourth quarter of 2018 as policies began to take effect; these policies included flexible movement of the exchange rate. In turn, the slowdown in imports was sufficient to mitigate the effect of the decline in exports, which had created the risk of an escalating current account deficit. The current account deficit was held at a safe level of 2.98% of gross domestic product (GDP) for 2018 as a whole.

In the fourth quarter of 2018, these positive developments brought the Indonesia BoP back into surplus and placed the rupiah on an appreciating trend. At the same time, inflation had been contained at a low 3.13%, within the 3.5±1% target range. The financial system remained stable with the support of improved bank intermediation, steady and adequate levels of liquidity, high levels of capital and subdued credit risk. Taken together, the prudently managed economic stability contributed to a 5.17% increase in Indonesia's economic growth, which was spurred on by strong domestic demand.

Looking ahead, the Indonesian economy is predicted to remain sound, despite a number of global challenges that call for ongoing vigilance. As before, the challenges of the global environment relate to the flagging outlook for world economic growth, a fall in commodity prices and financial market uncertainty that must be watched constantly. In 2019, the Indonesian economy is forecast to continue to grow at a healthy rate of between 5.0% and 5.4% on strong domestic demand. The current account deficit is predicted to narrow to about 2.5% of GDP and inflation to remain subdued within the 3.5%±1% range. The buoyant economic outlook for 2019 forms the basis of continued strengthening of the Indonesian economy in the medium term. Economic growth is forecast to climb to a range of 5.5% to 6.1% in 2024, while the current account deficit will chart a steady decline to less than 2% of GDP, accompanied by low inflation.

Bank Indonesia, the Government, the Financial Services Authority (OJK) and other authorities will forge even more robust synergy to bolster the outlook for the Indonesian economy. Monetary and fiscal policies will maintain macroeconomic stability, while continuing to make use of available space to provide stimuli for the economy. Indonesia's measures for delivering stimuli to the economy include the financial market deepening policy, macroprudential policies, payment system policy and policies for sharia economics and finance. Policies will be implemented in synergy to ensure that structural reforms for strengthening economic resilience advance consistently, and to achieve strong, sustainable, balanced and inclusive economic growth.

Major Challenges in 2018

The dynamics of the Indonesian economy in 2018 were strongly influenced by three issues of global uncertainty, the first being slowing global economic growth. World economic growth entered a period of slowdown, most visible during the second half of 2018. Overall, the world economy grew by 3.7% in 2018, slipping from the 3.8% achieved in 2017. The slowdown in global economic growth came in response to flagging growth in the Eurozone and Japan in keeping with falling external demand and weak domestic demand. Growth in emerging market economies also fell given weaker growth in China and Latin America, despite strong economic growth in India and the Middle East.

The slowing world economy also led to reduced growth in world trade volume and commodity prices. Growth in world trade volume tapered off in the second half of the year, pushing growth for the full year to 3.7%, down from 4.7% in 2017. A downward trend was also visible in commodity prices, including for Indonesia's mainstay export commodities, such as coal, palm oil and rubber, with the steepest decline recorded in the second half of 2018. On a composite basis, Indonesia's export prices contracted 2.8% in 2018 from a positive 21.7% growth in 2017. Oil prices, however, trended upwards until October 2018 before falling sharply in November 2018. The average prices for Brent and Minas crude both stood at USD71 per barrel in 2018, up from the 2017 prices of USD54 and USD52 per barrel respectively.

The second source of global uncertainty was the series of increases in the US monetary policy rate, the Federal Funds Rate (FFR), which rose faster and higher than previously. The increases in the FFR were closely tied to efforts by the Federal Reserve to mitigate the risk of rising inflation, as the expansion in US economic activity exceeded the economic growth potential. In 2018, the Federal Reserve raised the FFR four times by a total of 100 basis points, surpassing the three 25 basis point rate increases in 2017, and the single increases of 25 basis points apiece in 2016 and 2015. Following these changes, the FFR at end-2018 was in a range of 2.25% to 2.50%.

In combination with the effects of US fiscal expansion, the upward movement in the FFR triggered increases in yields on US treasury bonds to as much as 3.24% for the 10-year tenor. US monetary policy tightening also received a boost from the Federal Reserve's policy of balance sheet reduction, which is part of the process of normalizing the quantitative easing launched during the global financial crisis in 2008. These developments set off a round of global appreciation in the dollar, as demonstrated in the rise in the US dollar index to 96.2 in 2018 from 92.1 in 2017.

The latter element of uncertainty was fueled by turbulent global financial markets that have driven up the risk premium for investment in emerging markets. Conditions on global financial markets were affected by the escalation in trade tensions between the US and a number of trading partners, including China, Canada, Mexico and Europe. In addition, the economic crises in Argentina and Turkey kindled negative sentiment around emerging markets. Global financial market uncertainty was also fueled by geopolitical risks, including the ongoing Brexit negotiations between the United Kingdom and the European Union, and economic problems in Italy.

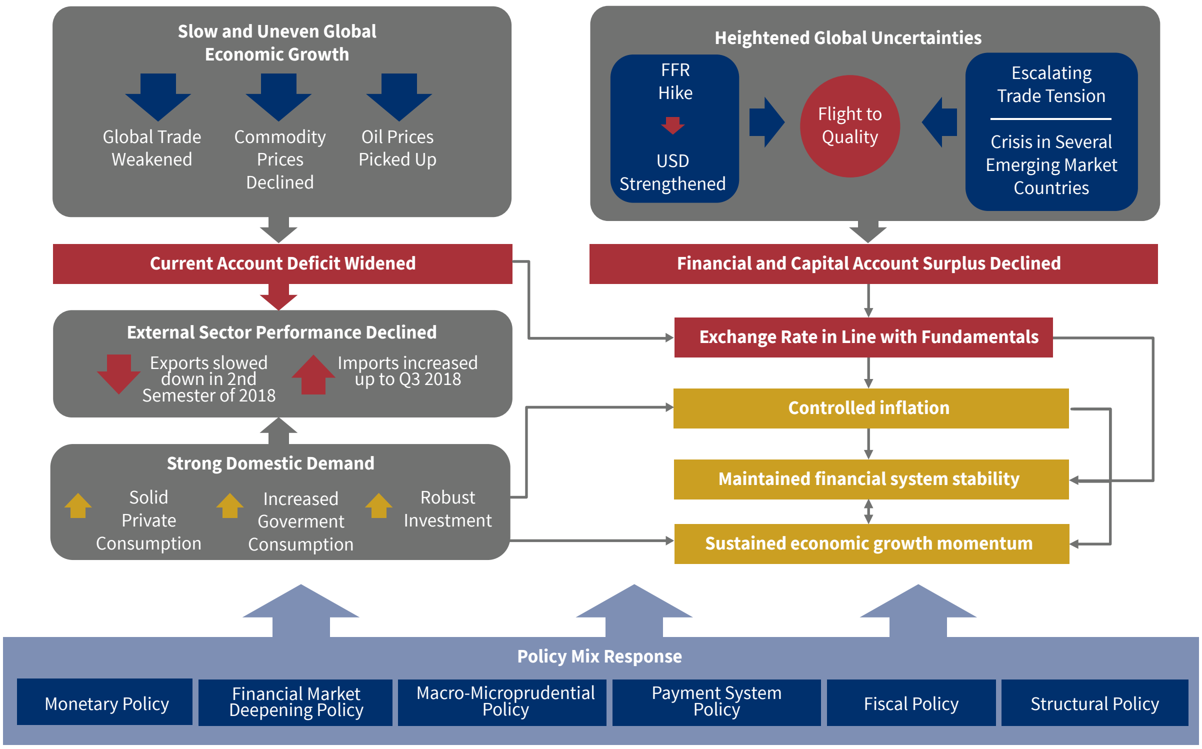
In turn, uncertainty on financial markets eroded the performance of stock and bond markets in many countries, with both advanced economies and emerging markets affected. The heightened uncertainty on global financial markets also prompted increases in the risk premium for investment in emerging markets, reflected in the rise in the Volatility Index (VIX) and the J.P. Morgan Emerging Market Bond Index (JP EMBI).

The adverse global developments were unavoidable and posed a challenge for Indonesia's external sector in the trade and financial channels (Diagram 1). In the trade channel, global uncertainties began to affect Indonesian exports from the second half of 2018. The gradual decline in world economic growth, partly in response to declining growth in the economies of Indonesia's key trading partners such as China, resulted in lower demand for goods exported from Indonesia. Exports also weakened further because at the same time, Indonesia's terms of trade (ToT) deteriorated due to the fall in prices for Indonesia's export commodities.

Several developments pointed to a decline in Indonesia's export performance during the second half of 2018. In the third quarter of the year, non-oil and gas exports grew 8.9% year-on-year (yoy), followed by a 1.9% yoy contraction in the fourth quarter, down from 9.6% yoy growth in the first half of 2018. Breaking down the fourth quarter figures by destination, non-oil and gas exports fell most to major trading partners – China, Japan and the Philippines. By export commodity type, the fall in non-oil and gas exports was attributed mainly to crude palm oil (CPO) and processed rubber, particularly during the fourth quarter of 2018. Measured over the full year 2018, the value of coal exports grew 17.1%, down sharply from 40.6% growth in 2017, while the value of CPO exports fell 10.7%, versus growth of 28.9% in 2017; these movements were representative of Indonesia's major export commodities.

At the same time, the complexity of challenges from the trade channel was exacerbated by high imports that persisted for the first three quarters of 2018 in line with buoyant domestic demand, particularly for infrastructure projects. In the first three quarters of 2018, non-oil and gas import growth posted brisk average growth at 23.4%

Diagram 1. Global Economic Transmission to Indonesian Economy



yoy. All import components grew, with imports of capital goods accounting for the highest average growth (29.3%), followed by consumer goods (26.8%) and raw materials (18.6%). The increase in raw material imports was driven mainly by industries producing goods for the domestic market, as well as export-oriented manufacturing. The first three quarters of 2018 also recorded high imports of oil and gas at USD21.9 billion, an increase of 35.0% over the previous year. These developments represented the effect of sustained and robust domestic demand and the upward trend in world oil prices.

The downturn in exports during the second half of 2018 and high imports for the first three quarters of the year posed challenges in maintaining control of the current account deficit. The current account deficit widened to 3.3% of GDP in the third quarter of 2018 from 3.0% in the second. The rising volume of imported goods created higher payments for freight services, which also contributed to the burgeoning current account deficit. The deficit in transport services climbed to USD6.4 billion for the first three quarters of 2018 from USD4.7 billion in the same period of 2017. This increase is explained by higher payments for freight services in line with growing import activity.

In the financial channel, global uncertainties weighed on foreign capital inflows into Indonesia. The increases in the FFR reduced the attractiveness of assets in emerging markets and prompted an exodus of capital from emerging market nations, including Indonesia. Furthermore, uncertainty on global financial markets, which resulted in higher risk premiums on investment in emerging markets, also impacted foreign capital inflows in Indonesia. These developments in turn adversely affected performance in the capital and financial account during the second and third quarters of 2018. In these quarters, the capital and financial account surplus registered USD3.3 billion and USD3.9 billion respectively, below the levels recorded in the corresponding quarters of 2017.

The widening current account deficit and the contraction in the capital and financial account surplus contributed to a weaker BoP in the second and third quarters of 2018, and led to additional pressure on the rupiah. The

BoP reached a sizable deficit of USD4.31 billion in the second quarter of 2018 and USD4.39 billion in the third. The most significant factor in this was the fall in foreign capital inflows. Consistent with the dynamics of the BoP, the rupiah exchange rate came under pressure in this period. Average depreciation in the rupiah in the second quarter came to 2.7% and in the third to 4.5%, with the rupiah closing at IDR14,902 to the US dollar at the end of September 2018.

The decline in foreign capital inflows during the second and third quarters of 2018 also impacted domestic liquidity. Although capital inflows remained at a safe level, the drop in these inflows contributed to reduced growth in economic liquidity. M1 expanded by 8.2% in September 2018, and M2 by 7.6%. This compares to M1 growth of 12.4% at the end of 2017, and M2 growth at 8.3%. The slowdown in M2 growth is explained by reduced expansion in quasi-money, recorded in September at 6.3%, down from the end-2017 level of 6.9%. In keeping with these developments, bank placements held in Bank Indonesia monetary operations instruments also fell to IDR302.0 trillion in September 2018 from IDR471.2 trillion at end-2017. Despite contracting, the position of bank placements in instruments for Bank Indonesia monetary operations continued to show adequate liquidity.

Amid the pressure on Indonesia's external balance, developments in the internal balance and the financial system stability remained favorable. The economy grew solidly from the third quarter of 2018, driven by domestic demand, which itself was driven primarily by infrastructure projects. These have generated multiplier effects in household consumption and in construction and non-construction investment. Indonesia's economic growth reached 5.17% in the first three quarters of 2018, versus the same period of 2017. Inflation was subdued, reflecting healthy internal balances. Rupiah depreciation did not push inflation upwards excessively; September 2018 inflation stood at 2.88% yoy. Meanwhile, financial system stability remained strong, as indicated by high levels of capital, higher growth in lending and credit risk maintained at low levels.

Forging Policy Synergy

Bank Indonesia, the Government and relevant authorities acted resolutely and consistently to implement a policy mix that would strengthen economic stability – in particular rupiah stability – while sustaining the economic recovery. The challenges to the economy in 2018 emerged mostly from external balances, while internal balances were solid. For this reason, policy was focused on mitigating external sector risks that could adversely impact the BoP and pressure the exchange rate. Immediate action was necessary to forestall these developments which, unchecked, could have destabilized the economy.

Policy also sought to strengthen the existing momentum for economic recovery. According to Bank Indonesia estimates, the upwards trend of Indonesia's economic growth did not disrupt internal balances, given that growth remained below potential capacity. The policy mix was geared to provide continued support for economic growth, enabling growth to climb towards the potential capacity of the economy. The pro-growth measures were also consistent with the financial cycle which, according to indicators, was below long-term projections, despite being on an upward trend. Overall, the policy mix was balanced with inflation control measures in order to keep inflation on target and financial systems stable.

Bank Indonesia, the Government and other authorities synergized their policy choices. Bank Indonesia optimized a mix of monetary, financial market deepening, macroprudential and payment system policies with the aim of maintaining stability and supporting economic growth. The Bank Indonesia policy mix was managed in synergy with the fiscal and structural policies of the Government and OJK to safeguard the resilience of the financial system and growth momentum.

The direction of the monetary policy rate in 2018 was placed within a framework of determining an optimum monetary policy for a nation with an open economy. Changes were introduced to formulate the policy rate independently, taking account of two other important elements: free movement of foreign capital and continued exchange rate flexibility. Interest rate policy on one hand sought to create adequate interest rate differentials and bolster the attractiveness of investing foreign capital in domestic financial market assets. On the other hand, the policy rate also needed to remain consistent with measures to keep inflation on target. At the same time, exchange rate policy was focused on maintaining exchange rate stability at about the level of fundamentals, so that it could serve as an instrument for mitigating shocks to the economy from external factors.

In line with this policy framework, Bank Indonesia implemented a preemptive, front-loading and ahead-of-the-curve monetary policy to ensure continued safeguarding of economic stability. The preemptive step by Bank Indonesia in raising the 7-Day (Reverse) Repo Rate (BI7DRR) was linked to its anticipation of an increase in the FFR and uncertainty on global financial markets. The front-loading response meant that the magnitude of the increase in the policy rate factored in the possible magnitude of hikes in the FFR. This was to ensure the interest rate differential was sufficiently large to maintain the attractiveness of domestic assets. And the ahead-of-the-curve response was related to the magnitude of increases and the need to stay ahead of other emerging market countries that might also increase interest rates; this would ensure that Indonesia's financial market would remain attractive and competitive.

After careful consideration of the economic outlook amid global uncertainties and the risk to Indonesia's external resilience, Bank Indonesia raised the BI7DRR monetary policy rate by 175 basis points over the year to bolster the attractiveness of domestic financial assets and bring down the current account deficit. In May 2018, Bank Indonesia began phased increases in the BI7DRR, which rose to 6.0% by year-end. The BI7DRR was raised 100 basis points during the second quarter of 2018, with a 50 basis points increase in June 2018 due to escalating global uncertainty, and as increases in the FFR were predicted to take a more aggressive turn. Rising oil prices and tensions in US–China trade relations also contributed to the need to raise the BI7DRR. Following this, the policy rate increased 50 basis points in the third quarter of 2018 and 25 basis points in the fourth.

Exchange rate policy was aimed at maintaining flexibility in movement of the rupiah in line with fundamentals, and while maintaining market mechanism. The rupiah stabilization policy was used to minimize the rising volatility in a period of global uncertainty that, it was feared, could influence the expectations of economic actors. The rupiah stabilization policy was implemented in a twofold strategy. First, this policy involved a strategy for optimizing dual interventions by Bank Indonesia on the forex market and the government bonds market. This strategy was pursued to maintain exchange rate stability, while safeguarding an adequate level of rupiah liquidity. Second was a strategy for management of forex liquidity to maintain adequate forex market liquidity. This policy was supported by measures to deepen the forex market; these included the development of hedging instruments including overnight index swaps (OIS), interest rate swaps (IRS) and domestic non-deliverable forwards (DNDF).

The direction of monetary policy was reinforced by an operational strategy to maintain adequate liquidity on the money market and in the banking system. This was needed because a decline in foreign capital inflows would reduce money market and banking liquidity, and could have impacted financial system stability. To this end, Bank Indonesia employed a number of strategies in the second and third quarters of 2018 to ensure the availability of liquidity on the money market and forex market, amid mounting global pressures. Bank Indonesia increased the frequency of auctions of short-term government securities reverse repo (RR SBN) instruments with tenors of one week, two weeks and one month during this period.

Bank Indonesia also introduced measures to optimize the RR SBN instruments in open market operations (OMOs). Besides maintaining adequate liquidity, this also reinforced the use of government securities as an OMO instrument, promoted consolidation of the debt securities market and deepened financial markets. Bank Indonesia also reactivated the Bank Indonesia Certificate (SBI) auction for the 9-month and 12-month tenors in July 2018 in an effort to attract foreign capital inflows.

In the fourth quarter of 2018, the focus of the monetary operations strategy began to shift towards support for economic financing while continuing to safeguard economic stability. This policy direction also took account of the economic stability that was under control, which afforded space for implementing this strategy. During this period, Bank Indonesia strengthened the monetary operations by introducing broader access for the banking system via term repos, as a measure to increase liquidity. This strategy was taken forward by continuing the strengthening of monetary operations, including fine tune operations and auctioning of foreign exchange (FX) swaps.

The monetary policy operational strategy for maintaining adequate liquidity was bolstered by an increase in the average statutory reserve requirement. In 2018, the average statutory reserve requirement was increased twice, first to 2% in July 2018 from 1.5% and then to 3% in December 2018. In tandem with the strategy for ensuring adequacy of liquidity, Bank Indonesia also issued sharia financial instruments, in this case sharia certificates of deposit and Bank Indonesia Sukuk (SukBI).

In addition, Bank Indonesia strengthened cooperation with the authorities of other countries and international agencies in order to improve external resilience. In 2018, Bank Indonesia extended its bilateral swaps arrangement (BSA) with Bank of Japan (BoJ), enabling it to conduct rupiah swap transactions against the Japanese yen, as well as the US dollar. With the People's Bank of China (PBoC), Bank Indonesia expanded the bilateral currency swap arrangement (BCSA) for facilitating trade and investment between the two nations and to assist in providing short-term liquidity for financial market stability. And Bank Indonesia also entered into cooperation with the Monetary Authority of Singapore (MAS), enabling the two nations to raise short-term liquidity through exchange of their local currencies. Cooperation was also initiated with the authorities of Malaysia and Thailand for use of local currency settlement (LCS) in bilateral trade transactions. In addition, Bank Indonesia extended the BCSA with the Reserve Bank of Australia (RBA), a facility aimed at providing support for trade transactions and which may also be used for other purposes if both parties agree.

To improve economic stability and, in particular, to maintain subdued inflation, Bank Indonesia forged closer cooperation with the Government through the Central Inflation Controlling Team (TPIP) and Regional Inflation Controlling Teams (TPID). Bank Indonesia worked with national and regional government to ensure affordability of prices, availability of supply, expeditious distribution and effective communications on policy to anchor inflation expectations. This coordination in inflation control also demonstrated the commitment of the Government and Bank Indonesia to achieving the inflation target of 3.5%±1% in 2019 and 3.0%±1% in 2020 and 2021.

Bank Indonesia also proceeded with the financial market deepening policy, aiming to expand the role of the financial market in supporting sustainable economic growth. To this end, Bank Indonesia, OJK and Ministry of Finance worked together in the Coordination Forum on Development Financing by Means of Financial Markets (FK–PPPK) to write the National Financial Market Development and Deepening Strategy (SN-PPPK) for accelerating the pace of financial market deepening.

Consistent with this strategy, in 2018 the Bank Indonesia financial market deepening policy focused on efficiency improvements on the money and forex markets. This is part of its drive to promote long-term financing as a source of economic financing. One strategy involved the development of instruments to boost market activity in hedging by regulating rupiah interest rate derivatives using IRS and OIS instruments. Measures to expand the forex derivatives market included the introduction of DNDF transactions and development of the market for call spread options (CSOs). Bank Indonesia also reformed the benchmark rates on the rupiah money market by establishing the Indonesia overnight index average (IndONIA) and strengthening the Jakarta interbank offered rate (JIBOR).

The financial market deepening policy was also designed to support the development of long-term investment on the capital market. Other measures for strengthening the role of financial markets included more extensive innovation of instruments for financing infrastructure projects. This was achieved in coordination with the Government, OJK and a number of financial institutions. Under this coordinated action, financing agreements for strategic infrastructure projects worth USD13.6 billion were concluded in October 2018.

Macroprudential policies were targeted at strengthening the momentum for economic growth while continuing to safeguard financial system stability. Measures to promote higher economic growth were introduced in a number of accommodative macroprudential policies. Among these was the relaxation of the loan-to-value ratio (LTV) to facilitate home ownership for first-time buyers and promote investment in the housing sector. Bank Indonesia also held a consistent course in improving financial access for micro, small and medium enterprises (MSMEs) by establishing a minimum 20% target for MSME loan in 2018, with sanctions for non-compliance, consistent with phased implementation that was adopted in 2015.

The accommodative macroprudential policies put in place also included changes to the loan-to-funding ratio (LFR), which is now known as the macroprudential intermediation ratio (RIM). This instrument was developed by expanding economic financing from credit to include purchasing of quality securities issued by non-financial sector corporates. Bank Indonesia also increased flexibility in bank liquidity management through introduction of the macroprudential liquidity buffer (MLB) regulation, an enhancement of the secondary statutory reserve requirement. The MLB provisions comprise a secondary statutory reserve requirement of 4% of deposits, which requires banks to hold securities that can be traded with Bank Indonesia in repo transactions. In 2018, the percentage of securities that could be traded in repo transactions with Bank Indonesia was increased to 4% of deposits from 2%. Alongside this, the capital requirement for the countercyclical capital buffer (CCB) was maintained at 0% to strike a balance between promotion of intermediation and mitigation of risks. In other actions, Bank Indonesia worked with OJK to strengthen surveillance of the financial system, principally for large banks and corporates, and to establish closer coordination under the Financial System Stability Committee (KSSK), while strengthening collaboration in international forums.

Payment system policy was similarly directed at supporting economic activity by making payment transactions more secure and efficient. In this regard, Bank Indonesia strengthened the policy strategy for the payment systems for both non-cash and cash transactions. On the non-cash side, Bank Indonesia promoted the acceleration and expansion of electronic processing of non-cash payments in a variety of areas, including disbursements under government social programs, payments in the transport sector and management of regional government financial transactions. Bank Indonesia also went further, strengthening the payments ecosystem and digital finance by implementing the national payment gateway (NPG) and developing the ecosystem for financial technology (fintech), most importantly within the scope of the payment system. For cash payments, Bank Indonesia worked steadfastly to ensure that currency fit for circulation was provided throughout Indonesia. Amid this drive to support economic activity, Bank Indonesia also continues to ensure payment system services are prudently implemented, by employing risk management and consumer protection measures. Last, Bank Indonesia also worked with other institutions to ensure that the national payments system worked efficiently and securely.

Bank Indonesia encouraged the development of sharia economics and finance both as part of its own policy mix and also in coordination with the National Committee for Sharia Finance (KNKS). In 2018, a number of sharia-compliant instruments were introduced in the monetary sector, including SukBI, negotiable certificates of deposit (NCD) and sharia-compliant hedging instruments. Accompanying this were macroprudential actions involving the relaxation of sharia-based RIM and MLB, which were introduced in parallel with equivalent regulations applying to conventional banking.

Bank Indonesia also began to develop core principles for sharia-compliant financial instruments for social purposes, such as zakat infaq sadakah (on mandatory and voluntary almsgiving) and waqf (on charitable endowments) to support financing of economic activity. The development of halal value chains has taken place through economic empowerment of Islamic boarding schools, and in a number of sectors and commodities, including tourism, food, fashion and MSMEs. The Sharia Economics Festival (FeSyar), which takes place in three Indonesian cities, and the international-level Indonesia Sharia Economic Festival (ISEF) are regular events. They are intended as public education and campaigns to develop sharia finance and economics and halal (religiously lawful) lifestyles.

The Government pursued a prudent fiscal policy aimed at supporting economic stability while continuing to optimize space for promoting economic growth. In regard to upholding economic stability, the objective of fiscal policy in 2018, as before, was to safeguard the fiscal sustainability outlook by managing the primary balance and the overall state budget deficit. In 2018, the primary deficit came to -0.01% of GDP (IDR1.8 trillion), representing a significant reduction from the previous year's level of -0.91% (IDR124.4 trillion). Positive developments were also reflected in the 2018 budget deficit of 1.8% of GDP, narrowing from 2.5% of GDP in 2017. In turn, this enabled the Government to hold the level of official debt at a comfortably safe level of 29.8% of GDP.

In 2018, the Government continued to optimize fiscal policy as an instrument to promote economic growth. Among other measures, the Government increased spending on social assistance from the beginning of 2018. And in a further action to improve the investment climate, the Government provided a tax incentive in which pioneer industries could benefit from a tax holiday of between 5 and 20 years, depending on the value of their investment.

Regional fiscal policy and infrastructure project construction played an increased role in fiscal policy strategy. To strengthen the fiscal role of the regions, Indonesia pursued measures to increase regional government revenues, with a primary emphasis on optimizing local sources of regional government revenues and central government transfers. Parallel with this, issues with regional spending were addressed, primarily to improve the quality of regional government spending and direct it towards more productive outcomes.

Relating to infrastructure project construction, the Government pressed forward with infrastructure development with involvement from state-owned enterprises and by promoting private sector participation. In 2018, the focus was on accelerating construction of projects that would improve interregional connectivity in Indonesia. Working through the Committee for Acceleration of Priority Infrastructure Delivery (KPPIP), the Government selected strategic and highly urgent projects and provided facilities to expedite project execution. These projects were all national strategic projects (NSP).

The Government also moved forward with structural reforms to expand the capacity of the economy. These reforms were aimed at improving the ease of doing business and investment in order to boost the competitiveness of the economy. The reforms focused on improvements in regulations and bureaucratic administration, as achieved under the sixteenth economic policy package in 2018. This package was aimed specifically at attracting foreign capital and investment to Indonesia. The Government also streamlined licensing procedures by developing an electronically integrated business licensing system, known as online single submission (OSS).

The Government strengthened human resources (HR) development in preparation for the Industry 4.0 era. This work was launched with the new Industry Human Resources Development Agency, tasked with improving human resource competences for industry. The structural reforms were also geared to promote export growth; actions included new regulations to expedite licensing and customs and excise requirements. This included streamlining the licensing process for export-oriented imports. The drive for export growth was accompanied by measures to phase out dependence on imports, including the expansion of the Biodiesel 20 (B20) program mandating the use of 20% biodiesel in automotive diesel fuel. In other areas, the Government increased the pace of tourism development to support growth in exports of services.

The Economy Remained Strong in 2018

The policy mix implemented by Bank Indonesia, the Government and other authorities proved successful in safeguarding the Indonesian economy through 2018. Economic stability returned to a comfortably safe level in the fourth quarter of 2018, and economic growth momentum was sustained.

Positive developments were reflected in the rise in foreign capital inflows in the fourth quarter of 2018. Data from the Institute of International Finance shows that foreign capital inflows into Indonesia were higher than capital inflows into all other emerging markets. This resulted in an increase in the capital and financial account surplus to

USD15.7 billion in the fourth quarter of 2018, up from the second and third quarters of the year.

At the same time, imports slowed in line with the positive impact of policy. In the fourth quarter of 2018, growth in total non-oil and gas imports reached 12.5% yoy, down from 21.3% yoy in the third quarter of 2018. However, efforts to reduce the current account deficit through the slowdown in non-oil and gas imports were hampered by the concurrent fall in exports. Exports fell in response to flagging growth in the world economy and falling commodity prices. Against this background, Indonesia posted a USD5.4 billion surplus in its BoP in the fourth quarter of 2018, reversing the deficit of the preceding quarter (Table 1).

Overall, the improving trend in foreign capital inflows and imports in the fourth quarter of 2018 had a positive effect on external sector resilience. The current account deficit remained at a prudent level of 2.98% of GDP, despite widening from 1.60% of GDP in 2017. Other indicators also demonstrate that external resilience remained sound. At the end of 2018, foreign reserves stood at USD120.7 billion, more than enough to finance six and a half months of imports and servicing of government external debt, and also sufficient to guard against the possibility of foreign capital outflows. Bank Indonesia also established closer international cooperation with other Asia-Pacific central banks – under the Global Financial Safety Net (GFSN). This is a second line of defense to bolster external sector resilience.

The improving BoP and surplus posted in the fourth quarter of 2018 led to rupiah appreciation during November and December 2018. The rupiah strengthened to an average IDR14,661 to the US dollar in November 2018 and IDR14,493 in December 2018, from IDR15,176 in October 2018.

In response to these events and in line with global developments, the rupiah depreciated 6.05% in the full year 2018, and had weakened 5.65% point-to-point at end-2018, versus end-2017. The rupiah depreciated less than other currencies such as the Indian rupee, South African rand, Brazilian real and Turkish lira. Volatility in the rupiah was also mild at 8.5%, below the volatility experienced by several other currencies.

Inflation remained low and stable in 2018, amid turbulence in the external sector. Consumer prices inflation came in at 3.13% in 2018, within the 3.5%±1% target range, with core inflation, volatile foods (VF) and administered prices (AP) inflation subdued. Indonesia's inflation has been on target for the past four years.

A downward trend in inflation resulted from both cyclical and structural factors. Cyclical factors such as falling global prices for food commodities and steady demand led to a steady decline in inflationary pressure. On the other hand, the effect of structural improvements in the character of Indonesia's inflation were positive, having a permanent impact in helping to create progressively lower inflation. These structural factors were related to consistent monetary policy, more competitive market structures, improved market information and prompter distribution and freight logistics. In addition, the central and regional governments cooperated more closely and this also benefited the inflation picture. The structural-level improvements in inflation also influenced inflation behavior, as demonstrated in declining inflation expectations, the progressively reduced second-round effects of increases in VF and AP inflation on core inflation, and the diminished impact of exchange rate depreciation on inflation.

Financial system stability remained well under control with the support of robust banking capital and adequate liquidity. The banking system maintained high capital ratios; the capital adequacy ratio stood at 22.9% at the end of 2018. Banking liquidity also remained at adequate levels during 2018, reflected in the 19.3% ratio of liquid instruments to deposits. Bank placements in monetary operations instruments also increased, coming in at IDR382.8 trillion at the end of 2018.

In line with this trend, lending also increased and credit risk was kept within prudent limits. The intermediation function showed steady expansion, visible in credit growth that climbed to 11.8% in 2018. Amid the more vibrant credit expansion, prudent management of credit risk was reflected in the steady, low non-performing loan (NPL) ratios of 2.4% (gross) and 1.0% (net), both in sound territory below 5%. In other developments, issues of shares (initial public offerings/IPOs and rights issues), corporate bonds, medium-term notes and NCDs,

Table 1. Domestic Economic Indicators

Component	2016	2017	2018				
			I	II	III	IV	Total
Economic growth (Percent, yoy)	5.03	5.07	5.06	5.27	5.17	5.18	5.17
Household consumption (Percent, yoy)	5.01	4.94	4.94	5.16	5.00	5.08	5.05
Government consumption (Percent, yoy)	-0.14	2.13	2.71	5.20	6.27	4.56	4.80
GFCF (Percent, yoy)	4.47	6.15	7.94	5.85	6.96	6.01	6.67
GFCF construction (Percent, yoy)	5.18	6.24	6.16	5.02	5.66	5.02	5.45
GFCF non-construction (Percent, yoy)	2.43	5.90	13.56	8.33	10.73	8.96	10.31
Export of goods and services (Percent, yoy)	-1.66	8.91	5.94	7.65	8.08	4.33	6.48
Import of goods and services (Percent, yoy)	-2.41	8.06	12.64	15.17	14.02	7.10	12.04
CPI Inflation (Percent, yoy)	3.02	3.61	3.40	3.12	2.88	3.13	3.13
Core Inflation (Percent, yoy)	3.07	2.95	2.67	2.72	2.82	3.07	3.07
Volatile Food Inflation (Percent, yoy)	5.92	0.71	4.06	4.60	3.75	3.39	3.39
Administered Prices Inflation (Percent, yoy)	0.21	8.70	5.11	2.88	2.40	3.36	3.36
Balance of Payment							
Current Account Deficit (Percent, GDP)	1.82	1.60	2.07	3.01	3.28	3.57	2.98
Capital and Financial Account (USD billion)	29.3	28.7	2.3	3.3	3.9	15.7	25.2
Overall Balance (USD billion)	12.1	11.6	-3.9	-4.3	-4.4	5.4	-7.1
Official Reserve Assets (USD billion)	116.4	130.2	126.0	119.8	114.8	120.7	120.7
Exchange rate (Average; USD/IDR)	13,305	13,385	13,576	13,952	14,601	14,798	14,246
JCI (Index)	5,297	6,356	6,189	5,799	5,977	6,056	6,056
10-year government bond yields (Percent)	7.9	6.3	6.7	7.7	8.1	8.0	8.0
Banking							
Total Credit (Percent, yoy)	7.9	8.2	8.5	10.7	12.7	11.8	11.8
CAR (end of period, Percent)	22.7	23.0	22.5	22.0	22.9	22.9	22.9
NPL (end of period, Percent)	2.9	2.6	2.8	2.7	2.7	2.4	2.4
State Budget							
Tax (Percent GDP)	10.4	9.9	1.7	2.7	2.5	3.4	10.3
Primary balance (Percent GDP)	-1.0	-0.9	-0.16	0.25	-0.10	0.00	-0.01
State budget deficit (Percent GDP)	2.5	2.5	0.6	0.1	0.6	0.4	1.8

Source: BPS, Bank Indonesia, Ministry of Finance, OJK, and BEI.

all representing various forms of financing from the capital market, were recorded at IDR168.1 trillion (gross). This points to improvement in corporate financing from domestic sources, including both banks and the capital market.

Strong resilience amid the heightened global uncertainties kept Indonesia's economic growth on a solid footing. In 2018, economic growth reached 5.17%, up from 5.07% in 2017, and the highest level for the past five years. The gain in economic growth was driven by strong domestic demand fueled by brisk growth in consumption and ongoing investment in infrastructure construction. However, the net export contribution was negative, as imports grew rapidly and export growth tapered off. By region, higher growth in Java, Sumatra and Maluku-Papua (Mapua) underpinned the 2018 economic growth. By sector, economic growth was driven primarily by businesses linked to the strong growth in domestic demand and commodity exports.

Three Important Lessons of 2018

The dynamics of the Indonesian economy in 2018 teach three vital lessons for future strengthening of economic resilience. The first lesson is the need for continued reinforcement of stability and resilience in the economy. The history of economics demonstrates that successfully navigating boom and bust periods is closely linked to prudent management of monetary, banking and fiscal policies. These boom and bust periods are linked with fluctuations in exports in keeping with the commodity price cycle, or runaway expansion in the property sector, and external debt. For these reasons, it is necessary to maintain low and stable inflation, a stable rupiah exchange rate, a low fiscal deficit, a stable financial system and a current account deficit at a safe level of below 3% of GDP.

The second lesson is the need for continuous improvement in competitiveness and productivity to generate momentum for higher economic growth. In this regard, the export structure needs to be strengthened by moving away from dependence on exports of primary commodities, which are vulnerable to cyclical shocks. The weakening of exports in 2018 was closely linked to these global cyclical shocks.

To address this issue, it is necessary to strengthen manufacturing and tourism, boost domestic production capability to reduce imports, and redouble efforts to increase foreign and domestic direct investment. Structural reinforcement of the national economy must also be supported by further measures for downstream development of industry in order to increase added value, and by natural resources processing, particularly in the mining, plantations, agriculture and fisheries sectors. Manufacturing, for example in the automotive, electronics, textiles, steel and chemical industries, must also be developed further to boost exports by seizing the advantages offered by global supply chains.

The third lesson is that synergy among various authorities in the policy mix is key to reinforcing the structure of the national economy. Monetary, fiscal and financial sector policies will be directed at maintaining macroeconomic and financial system stability. At the same time, it is necessary to expand and increase the pace of structural reforms in the real sector. These structural reforms will be decisive in improving competitiveness, productivity, investment, trade, labor conditions and legal certainty.

More needs to be done to speed up the efficiency improvements in bureaucracy at the central government and regional levels, and to upscale the implementation of the integrated licensing program (OSS) in order to enhance the business and investment climate. Construction of infrastructure must be carried out on a broader scale, particularly for connectivity, and should be targeted to support the development of economic and tourism zones.

Economic Outlook Remains Strong

The outlook for the Indonesian economy is buoyant, notwithstanding adverse global economic conditions that require continual monitoring. Indonesia's economic growth is predicted to strengthen in 2019 to a range of 5.0% to 5.4%, despite a further decline in the global economy. This upbeat outlook for Indonesia's economic growth is driven by strong domestic demand in both consumption and investment. The forecast is for strong household consumption in keeping with rising incomes, and this is underpinned by subdued inflation, increased distribution of social assistance (bansos), and consumption for logistics purposes relating to the presidential and legislative elections. Meanwhile, investment is predicted to continue to grow strongly driven by both increased non-construction investment and ongoing infrastructure projects. Higher economic growth will also benefit from improvement in net exports in tandem with weaker growth in imports.

External resilience is set to improve further, bolstered by a reduction in the current account deficit and higher foreign capital inflows. The current account deficit is predicted to ease to about 2.5% of GDP in 2019. Reduction in the current account deficit will be supported by various measures to curb imports, such as the B20 program. In tandem with this, various measures to promote export growth – with a focus on manufactured products and tourism services – are expected to begin to yield positive results. Meanwhile, higher foreign capital inflows will be spurred by attractive domestic financial assets as global uncertainties fade. Under this forecast, the capital and financial account surplus is set to improve, exceeding the level achieved in 2018. This surplus will be bolstered mainly by higher inflows of foreign direct investment, improvements to the business climate and a buoyant outlook for the domestic economy. Portfolio investment is projected to improve as uncertainty fades on global financial markets.

In 2019, consumer price inflation (CPI) is predicted to hold steady within the 3.5±1% target range. This will be supported by carefully managed core inflation with the ability to make adequate supply-side responses to demand-side pressures, anchored inflation expectations, and little movement in the rupiah exchange rate. Ongoing government measures to safeguard food supplies and efficient distribution systems, in tandem with robust coordination on inflation control, will also have a positive impact, resulting in safe levels of VF inflation. In addition, AP inflation is also expected to remain steady, with few expected increases in official charges and prices for strategic commodities. Subdued inflation will also be achieved with the aid of improvements in inflation behavior, such as the minimal impact of rupiah depreciation on inflation, and reduced second-round effects from decisions on administrative prices for other commodities.

Financial system stability will improve and risks will be kept under control. Credit risk will be appropriately managed as before and will be accompanied by more vigorous growth in bank lending. Credit growth is predicted to reach between 10% and 12%, and to be accompanied by expansion in bank deposits in a range of 8% to 10%, thus maintaining adequate levels of liquidity. Improvement is also predicted for non-bank financing, in keeping with the growing sophistication of the domestic financial market.

In the medium term, economic growth is forecast to improve, reaching a range of 5.5% to 6.1% in 2024. Various structural reforms, including accelerated infrastructure construction, development of human capital, and deregulation, will bring future improvements in productivity.

Given these factors, external resilience will improve further, resulting in a steady decline in the current account deficit and greater macroeconomic stability, with a steady reduction in inflation. Economic growth will also be bolstered by additional sources of financing. With this medium-term outlook, the improvement achieved in per capita income will place Indonesia in the category of middle- to upper-income nations.

Future Policy Direction

The buoyant outlook for the Indonesian economy will be underpinned by deepening policy synergy between Bank Indonesia, the Government, OJK and other authorities in a mutually reinforcing economic policy mix. Monetary and fiscal policy coordination will continue to target macroeconomic stability, while using the available fiscal space to deliver an economic growth stimulus. Financial system stability will also be strengthened further under close coordination and supervision involving the Ministry of Finance, Bank Indonesia, OJK and the Indonesian Deposit Insurance Corporation (LPS), within the KSSK. This will include measures for prevention and dealing with financial crises.

Bank Indonesia will continue to pursue a policy mix to strengthen external stability and to support measures for sustaining economic growth momentum. This policy mix will be implemented through monetary, financial market deepening, macroprudential and payment system policies. Policies for development of sharia economics and finance will support this mix, as will further strengthening of coordination with the Government and other authorities.

Consistent with this policy direction, Bank Indonesia will stay the course with preemptive and ahead-of-the-curve monetary policy in 2019. As before, interest rates will be calibrated to domestic and global economic developments, ensuring inflation remains on target. Exchange rate stabilization measures will involve further efficiency improvements in market mechanisms supported by a dual intervention strategy, should it become necessary, and initiatives for financial market deepening. Adequate international reserves will be maintained with support from strengthened cooperation under the auspices of the GFSN at the bilateral, regional and multilateral level. The cooperation will also be expanded to include use of local currencies in intraregional trade transactions and bilateral investment.

Furthermore, Bank Indonesia will maintain adequate liquidity on the money market and in the banking system and thus support money market stability. Where possible, Bank Indonesia will also facilitate economic financing. These measures will be implemented in monetary operations and ongoing assessments of the adequacy of liquidity on the money market and in the economy. Bank Indonesia will work in synergy with OJK to ensure adequate availability of liquidity down to the banking level.

Bank Indonesia will also accelerate the pace of financial market deepening to support economic financing on a broader scale and stability on the money market.

Consistent with maintaining stability, Bank Indonesia will continue with measures to boost transaction volumes and promote the use of spot, swap and DNDF instruments as means of increasing liquidity and enhancing efficiency and market conduct in the formation of the rupiah exchange rate on the forex market, via market mechanisms. On the money market, transaction volume and the use of repo agreements and IRS will be developed further to increase liquidity, enhance efficiency and improve market conduct on the interbank money market in the forming of yield curves in various tenors.

Financial market deepening will also be strengthened through the regulation of market operators and development of the infrastructure for electronic trading platforms and trade repositories, and the establishment of a central counterparty for derivative transactions. In addition, Bank Indonesia will also participate actively in the development of various funding instruments for infrastructure construction. To improve the effectiveness of this policy, coordination of policy actions will be pursued further in such forums as the FK–PPPK, involving the Ministry of Finance, Bank Indonesia and OJK.

Bank Indonesia will maintain an accommodative macroprudential policy stance to promote banking intermediation, while continuing to safeguard financial system stability. The MIR policy will seek to encourage bank lending, while simultaneously expanding funding and financing for the economy through offerings of securities.

A further objective of accommodative macroprudential policies will be to strengthen the bank intermediation function to support the development of MSMEs and priority sectors, including exports and tourism. The policy will be implemented through increases in ratios of MSME financing to a bank's total financing, and development of financing target ratios for priority sectors. PLM provisions will be monitored to support flexibility in management of banking liquidity. In addition, safeguarding of financial system resilience will be reinforced by actions including surveillance of large banks and systemically important corporations, mainly in the primary commodity and property sectors, and those with high foreign debt exposure.

Bank Indonesia will continue to prioritize the role of payment system policy in supporting economic activity. The strategy for supporting economic activity will involve further expansion of the electronification program for non-cash distribution of social assistance aid, non-cash payments in the transport sector and support for management of government financial transactions. On the cash side, Bank Indonesia will pursue further improvement in the quality of rupiah in circulation and will optimize currency distribution within Indonesia, particularly to border, outlying and remote areas (3T).

In keeping with the direction of payment system policy, Bank Indonesia will continue to develop the infrastructure, instruments and mechanisms for the wholesale and retail non-cash payment systems. The payment system infrastructure for high value transactions will be developed further for efficiency in cross-border transactions; this will bolster industry capability to process transactions on a broader scale. Alongside this, measures to promote the retail side of the industry will involve the development of payment instruments and channels that will support economic efficiency, financial inclusion and digital economics and finance. The NPG infrastructure will be further strengthened by expanding interconnection and interoperability facilities for payment instruments, standardization of quick response (QR) barcodes by Bank Indonesia and online payments. Bank Indonesia and OJK will also work to expand the electronification program and development of fintech. Synergy in fintech will include the development of e-commerce and start-ups – part of efforts to boost the MSME sector.

Bank Indonesia will also continue to support the development of sharia economics and finance down to the regional level to promote development of new sources of economic growth. Development of sharia economics and finance will be catalyzed through development of the ecosystem for halal value chains and expansion of sharia-compliant financial instruments. Capacity for sharia-compliant business in the Islamic boarding school community will be expanded through various business linkages among the boarding schools, including development of an e-commerce market.

Bank Indonesia will also be active in promoting economic financing through issuances of sukuk (Islamic bonds), most importantly for infrastructure development, but also for integration of the social and commercial sectors of sharia finance, including finding ways to make zakat (almsgiving levy) and waqf (endowments) productive. Bank Indonesia will also continue to campaign for development of sharia economics and finance by holding sharia economic festivals in several cities, and continuing with the internationally acclaimed ISEF.

Bank Indonesia will expand MSME development programs and focus on inflation control and reduction of the current account deficit. Development of MSME clusters in various regions for production of strategic commodities – including rice, red chili peppers, shallots, garlic and beef – will be expanded to support inflation control. Indonesia also intends to develop clusters of MSME handicrafts businesses, such as batik, and cottage industries, in keeping with the unique characteristics of local cultures.

Similarly, clusters of MSMEs working in agriculture, for example in coffee, and in fashion will be strengthened further, with a focus on exports and tourism. In addition, there will be development of Go Digital MSMEs and MSMEs integrated into sharia-compliant business ventures. The national and international exhibitions regularly organized by Bank Indonesia provide an opportunity for MSMEs to expand their operations. On these occasions, MSMEs can forge business relationships with banks and the business community, boosting exports and welfare.

Bank Indonesia will continue to build synergy with the Government and other authorities to accelerate structural reforms that will ensure economic growth is sustainable. Close policy synergy will be pursued within the scope of the national economic policy mix for strengthening coordination of Bank Indonesia policy, fiscal policy and structural reforms. The inflation control coordinated by the TPIP and TPIDs will focus on the 4K strategy of affordability of prices, availability of supplies, smooth distribution and effective communications. Bank Indonesia will continue to build closer coordination with the Government in forums that include the Central Government, Regional Government and Bank Indonesia Coordinating Meeting (Rakorpusda), which is focused on achieving reductions in the current account deficit. This will involve the development of export-oriented manufacturing, tourism, investment financing dedicated to infrastructure, and development of digital economics and finance for structural improvement of the economy. Bank Indonesia will also strengthen coordination for crisis prevention and resolution under the KSSK, which convenes regularly to safeguard financial system stability.

The Government aims, through its fiscal policy, to keep the economy stable while optimizing efforts to sustain economic growth momentum. To bolster economic stability, the Government will focus on safeguarding the fiscal sustainability outlook by maintaining equilibrium in the overall budget primary balance and deficit. In this regard, the Government has set targets for the primary balance and deficit in the 2019 state budget at -0.12% and 1.84% of GDP respectively.

To strengthen the fiscal sustainability outlook, efforts relating to deficit financing will include the development and combination of creative sources of funding and financing, with efficiency in risks and costs prioritized. Parallel with this, the Government will pursue measures to bolster economic growth by optimizing spending and others improvements to develop a climate conducive to investment. The economic stimulus through government spending will be concentrated on programs to improve the quality of human capital, social protections, completion of infrastructure projects and fiscal strengthening of the regions.

The Government will also work consistently to advance structural reforms that promote stronger, more sustainable, balanced and inclusive growth in the national economy. The structural reform policies are aligned to four key strategies. First is the strategy for improving the competitiveness of Indonesia's economy. This will be implemented through the strengthening of four basic elements: availability of infrastructure, quality of human capital, adoption of technology and institutional support (Diagram 2). Regarding the availability of infrastructure, the Government will keep improving the carrying capacity of infrastructure, including connectivity and energy.

Second, the Government intends to build capacity and capability in industry by focusing on downstream development and increasing the added value from processing of natural resources. This is also aimed at acquiring a greater role in global supply chains. Third is the strategy for optimizing the use of the digital economy to improve medium-term productivity and capacity of

Diagram 2. Domestic Structural Element

the economy. Fourth, expanding sources of economic financing will require financial market deepening and other innovations.

Consistent with these structural reforms, the Government will press forward with further development of tourism as a source of economic growth. The upward trend in Indonesia's tourism is an opportunity for the regions also to pursue higher economic growth by developing into tourist destinations. Tourism development will also contribute to foreign exchange earnings and strengthen the services account. Tourism development in Indonesia's regions will move forward in synergy with the expansion of the non-cash payment system to improve transaction efficiency and financial inclusion at the regional level.