AMRO Annual Consultation Report

Indonesia - 2019

The ASEAN+3 Macroeconomic Research Office (AMRO)

December 2019

Acknowledgements

1. This Annual Consultation Report on Indonesia has been prepared in accordance with the functions of AMRO to monitor and assess the macroeconomic status and financial soundness of its members; identify relevant risks and vulnerabilities; report these to member authorities; and if requested, assist them in mitigating these risks through the timely formulation of policy recommendations. This is being done in accordance with Article 3(a) and (b) of the AMRO Agreement.

2. This Report is drafted on the basis of the Annual Consultation Visit of AMRO to Indonesia from July 1-10, 2019 (Article 5 (b) of AMRO Agreement). The AMRO Mission team was headed by Dr Sumio Ishikawa, Group Head and Lead Economist. Members include Dr Cuc Thi Kim Nguyen (Senior Economist), Mr Muhammad Firdauz Muttaqin (Economist), Dr Dan Lu (Economist)*, Dr Jade Vichyanond (Economist), Dr Abdurohman (Fiscal Sector Specialist), and Mr Edmond Choo Chiang Yong (Research Analyst). AMRO Director Mr Toshinori Doi and Chief Economist Dr Hoe Ee Khor also participated in key policy meetings with the authorities. This AMRO Annual Consultation Report on Indonesia for 2019 was peer reviewed by Dr Jae Young Lee (Group Head and Lead Economist) and Ms Diana Rose del Rosario (Economist); and approved by Dr Hoe Ee Khor, AMRO Chief Economist.

3. The analysis in this Report is based on information available up to 15 September 2019.

4. By making any designation of or reference to a particular territory or geographical area, or by using the term “member” or “country” in this Report, AMRO does not intend to make any judgements as to the legal or other status of any territory or area.

5. On behalf of AMRO, the Mission team wishes to thank the Indonesian authorities for their comments on this Report, as well as their excellent meeting arrangements and hospitality during our visit.

*/ until 23 September 2019

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Executive Summary

Indonesia's economic prospects have been solid amidst ongoing external headwinds, supported by a large-scale infrastructure investment program and the continuation of structural reforms. Short-term risks, meanwhile, are mainly external, which would continue to affect Indonesia adversely via trade and financial channels. Against these backdrops, continued prudence in the macroeconomic policy mix and structural reforms remain essential in strengthening external resilience and supporting economic growth.

1. **Despite external headwinds, the economy is expected to grow solidly, supported by resilient consumption and sustained investment.** Real GDP, which grew at 5.2 percent in 2018, is projected to grow at 5.1 percent in 2019, while inflation is firmly anchored within the target band of 3.5±1 percent. Export performance, meanwhile, continues to be constrained by a weaker global outlook and subdued commodity prices. The re-election of President Joko Widodo, with a strong majority, for a second five-year term starting in October 2019, is expected to strengthen structural reform momentum and enhance Indonesia's economic growth prospects.

2. **Easing global financial conditions have alleviated downward pressure on the external position.** Indonesian financial markets came under pressure in 2018, reflecting foreign investors' pullback from emerging markets (EMs), driven by a stronger U.S. dollar, coupled with Fed rate hikes and escalating global trade tensions. Foreign investors have since returned to net-purchase of rupiah-denominated bonds and equities, following a decline in U.S. Treasury yields and a dovish pivot by the Fed and other major central banks. Indonesia's recent sovereign upgrade by S&P Ratings has also boosted investors' confidence. These developments, combined with the authorities' timely policy responses, have strengthened the rupiah from a year earlier, and increased the gross foreign reserves from USD114.8 billion in September 2018 to USD126.4 billion as of August 2019. Going forward, a financial and capital account surplus, driven by a rebound in FDI inflows and sustained portfolio investment, is projected to continue financing the current account deficit, and supporting the overall balance of payments in the rest of 2019.

3. **The banking sector remains sound with strong capital buffers and stable asset quality.** Despite some tightening, especially in a number of smaller banks, liquidity has been adequate in the overall system. Credit growth, having peaked in Q3 2018, has moderated recently but is expected to remain solid to support domestic economic activity.

4. **The authorities have pro-actively recalibrated the policy mix to strengthen resilience and support growth.** On monetary policy, Bank Indonesia (BI)'s "pre-emptive, front-loading, and ahead-of-the-curve" policy rate hikes had reassured investors and supported the economy in weathering the EM turbulence in 2018. While the downward pressure on the rupiah has slackened somewhat, following easing financial conditions and a dovish pivot by the Fed and other advanced central banks, BI was prudent in putting its policy rates on hold in early 2019, as financial markets were still volatile reflecting continuing uncertainties over the U.S.-China trade tension and its impact on the global economy. With capital outflow pressures easing further, BI lowered its policy rates three times in July-September by a total of 75 basis points, to support growth in a benign inflationary environment. In June, BI reduced the rupiah reserve requirement ratio for conventional and sharia banks by 50 basis points to 6 percent and 4.5 percent, respectively, while keeping the average reserve requirement ratio unchanged at 3 percent.

5. **On the fiscal front, the authorities have adopted a prudent fiscal stance and taken steps to broaden the tax base and enhance tax compliance, and to improve spending quality.** Initiatives to encourage compliance include a reduction of the tax rate to micro, small and medium-sized enterprises first in 2013, and further in 2018, and a Tax Amnesty (TA) program enrolled in 2016-2017. Enhanced tax administration, on the back of a broader tax base, coupled with higher oil revenue, led to an improved revenue of about 13.1 percent of GDP and a lower fiscal deficit of 1.8 percent of GDP in 2018. On the expenditure front, to promote productive spending, the authorities reduced energy

subsidies and stepped up performance-based transfers to regional governments and village funds.

6. **Downside risks in the short-term are mainly external and will continue to affect Indonesia adversely via trade and financial channels.** As close to half of its exports are commodities, Indonesia is vulnerable to shocks related to commodity prices and demand, particularly from a major trading partner such as China. In this regard, a sharper-than-expected slowdown in global demand, especially from China, aggravated by ongoing trade tensions, could weigh on Indonesia's exports and growth. There is a risk that the recent escalation in geopolitical tensions in the Middle East could lead to a sharp rise in global oil prices and worsen Indonesia's trade balance. As foreign investors hold a significant share of rupiah-denominated assets, Indonesia remains susceptible to risks of capital flows.

7. **In light of ongoing headwinds, it is recommended that the authorities continue to strike an appropriate balance in the policy mix to strengthen resilience and support growth.** A still-benign inflationary environment has provided BI with room to pursue an accommodative policy stance if the domestic economy were to weaken unexpectedly, provided external stability is maintained. It is also crucial to maintain a market-based exchange rate mechanism with judicious interventions to mitigate excessive rupiah volatility. On the fiscal front, efforts to strengthen tax administration and broaden the tax base need to continue, considering Indonesia's relatively low tax revenue. Ongoing efforts to strengthen tax officers' capacity are commendable, and the newly-established Data Management Unit under the Directorate General of Taxes that focuses on analyzing data and information, including those retrieved from the Automatic Exchange of Information initiative and TA program, is expected to enhance tax compliance. Energy subsidy reforms, which have been stalled since the second half of 2017, should be renewed to enhance budget spending quality and reduce the burden of the subsidies on the budget.

8. **Significant strides have been made towards addressing structural challenges facing Indonesia in the long-term.** Infrastructure gaps, regulatory bottlenecks, and labor market rigidities have been identified as factors hampering Indonesia's competitiveness and growth potential. To narrow the infrastructure gap, the authorities have been implementing a number of major infrastructure projects under the Medium-term National Development Plan (RPJMN) 2015-2019, with joint funding from the private sector. In addition, efforts on financial deepening have been stepped up, including the introduction of new financial instruments and policy measures to broaden the domestic investor base. The authorities have rolled out 16 economic packages since 2014, with the latest package extending tax incentives to a wider range of investment activities and opening more sectors to foreign investors. The authorities' recent shift in priorities to focus more on human capital development for the next RPJMN 2020-2024, especially in the areas of education, vocational training, healthcare, and social safety net, is also a welcome move.

9. **Continued structural reforms, coupled with ongoing economic diversification efforts, are essential to boost Indonesia's growth potential.** To enhance the investment climate, further streamlining investment procedures, in particular enhancing the Online Single Submission platform, is crucial. A review of the current policy that indexes minimum wage increase to nominal GDP growth is recommended to maintain labor cost competitiveness. As regarding economic diversification, Indonesia is poised to realize its tourism potential, benefiting from initiatives such as the "10 New Balis", alongside enhanced connectivity and tourism-related infrastructure development. In addition, Indonesia should make a concerted effort to attract more FDIs into manufacturing for exports and adopt policies to embrace the digital technology and promote e-services, such as e-commerce and ride sharing, to leverage on a rapidly growing middle class. The current pension fund system and (tax) incentives for long-term savings/investment could be reviewed to broaden the domestic investor base. As a considerable proportion of the current population still do not have access to banking services, a fast-growing but well-regulated fintech sector could promise to promote both financial inclusion and deepening.

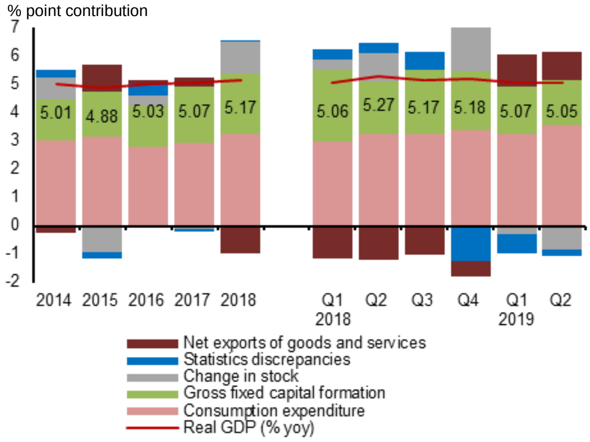
A. Recent Developments and Outlook

A.1. Real Sector Developments and Outlook

1. **Strengthened domestic demand supported a pick-up in real GDP growth in 2018 in spite of external headwinds.** Real GDP growth increased from 5.1 percent in 2017 to 5.2 percent in 2018, driven by robust domestic consumption and investment (Figure 1). In particular, household consumption rebounded on strengthened confidence and income gain, while government spending also increased significantly on the back of social assistance ramp-up. Gross fixed capital formation grew at 6.7 percent, up from 6.2 percent a year earlier, supporting the continued infrastructure development drive. Strengthened domestic demand offset the impact of slowing net exports, which turned into a drag on overall growth, as export growth moderated on the back of weakening external demand alongside elevated imports.

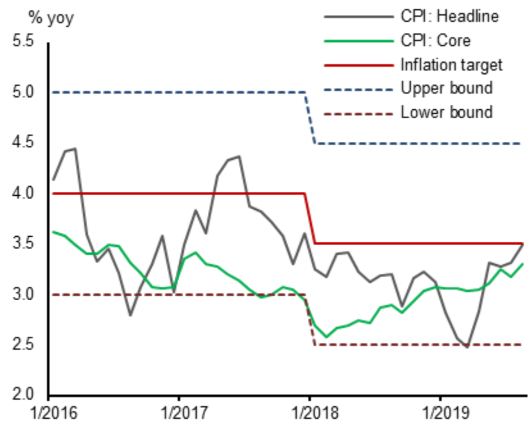
2. **Growth is expected to remain solid in 2019, supported by resilient domestic demand in the face of continued headwinds.** Real GDP growth dipped to 5.1 percent in H1 2019, as investment slowed on account of a wait-and-see attitude by firms prior to the April elections and a downturn in the mining capex cycle. A dimmer global outlook, coupled with rising trade protectionism, also adversely affected Indonesian exports, commodity exports in particular. Net exports, meanwhile, reversed to a positive contribution to overall growth, as imports contracted even more sharply than exports. Against these backdrops, real GDP growth is projected to slow somewhat from a year earlier but remain solid at 5.1 percent in 2019, driven by resilient domestic consumption and continued investment. Solid growth prospects, underpinned by a widely-expected continuation of structural reforms post-election, have contributed to Indonesia's rating upgrade by S&P Ratings.[1]

Figure 1. Contribution to Real GDP Growth: Demand Side



Sources: Statistics Indonesia (BPS)

Figure 2. Headline and Core CPI



Sources: BPS

3. **Inflation is expected to remain well-anchored within BI's target band of 3.5±1 percent.** Contained food price increases and stable, albeit subsidized, fuel prices, kept inflation under control in 2018, with both headline and core CPI standing at 3.1 percent (yoy) as of December. Rising food prices around the Ramadan month have driven headline CPI

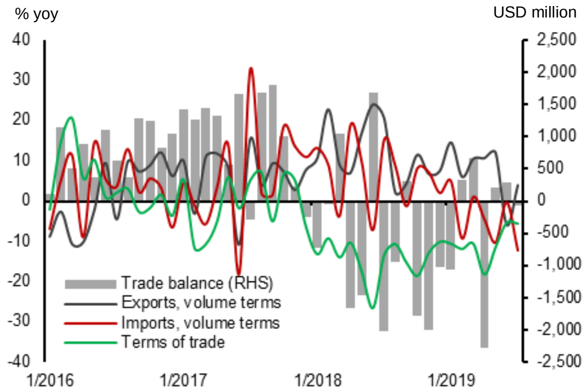
[1] In May 2019, S&P Ratings upgraded Indonesia's sovereign rating to the "investment" BBB grade with stable outlook. With this, Indonesia has been graded "investment" grade by all three big rating agencies, i.e. "BBB" grade by Fitch Rating and S&P Ratings, and Baa2 by Moody's. The upgrade has boosted investors' confidence, leading in lower sovereign bond yields issued by the Government of Indonesia in both international and domestic markets.

inflation higher in recent months, standing at 3.5 percent in August 2019 (Figure 2). Core CPI inflation also picked up but remained anchored at 3.3 percent. The inflation outlook is likely to be benign on subdued commodity prices, with headline CPI inflation projected at 3.3 percent (yoy) in 2019.

A.2. External Sector

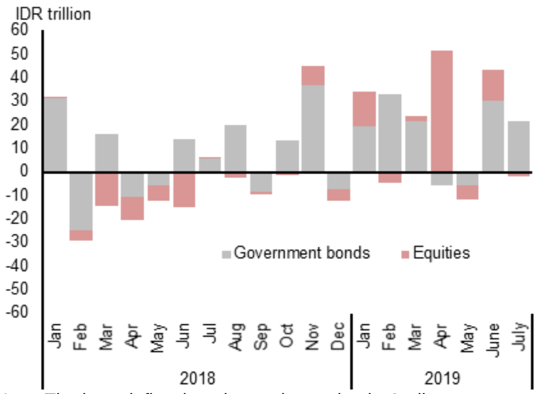
4. **Indonesia's external position came under significant pressure in 2018.** The current account deficit widened to 2.98 percent of GDP, reflecting a worsening trade balance. A strong rebound in global fuel prices in the first 9 months of 2018 led to a higher oil and gas deficit, while lower prices of Indonesia's key non-oil commodities, such as palm oil and rubber, adversely affected the non-oil and gas trade balance, especially in light of robust capital goods imports to support the investment drive (Figure 3). Financial markets also experienced high volatility in 2018, reflecting foreign investors' pullback from EMs, driven by rising U.S. interest rates and a strengthening U.S. dollar (Figure 4). Meanwhile, FDI inflows to Indonesia in percent of GDP slowed, likely due to investors' wait-and-see attitude prior to the General Elections in April 2019.[2] Reflecting the weakening external position, the rupiah weakened to about IDR15,000 per U.S. dollar and the gross foreign reserves fell from USD130.2 billion in December 2017 to USD120.7 billion in December 2018.

Figure 3. Terms of Trade and Trade Balance



Source: BPS

Figure 4. Monthly Net Bond and Equity Flows



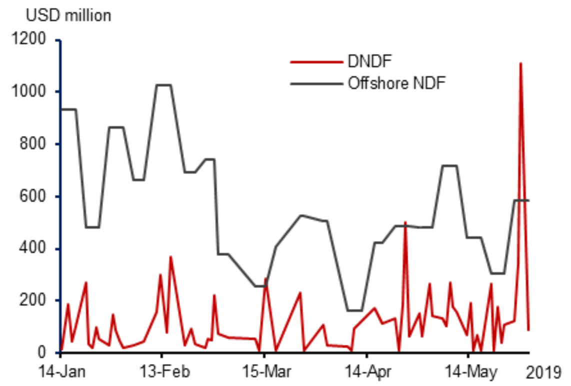
Note: The large inflow into the equity market in April was accounted for by the acquisition of two domestic banks (Bank Danamon & Bank Nasional Parahyangan) by the Tokyo-based MUFG Bank. The acquisition amount is IDR49.6 trillion for Bank Danamon, and IDR3 trillion for Bank Nasional Parahyangan - equivalent to USD3.7 billion in total. Source: Jakarta Stock Exchange, Ministry of Finance, and AMRO staff calculations

5. **Policy responses were timely and successful in maintaining financial stability and strengthening external resilience.** To stem capital outflows, BI raised its key policy rate – the 7-day reverse repurchase (repo) rate – six times between May and November 2018 by a total of 175 basis points to 6 percent. More FX hedging options were offered via the launch of a domestic non-deliverable forward (DNDF) market in November with increased participation and trading volume (Figure 5), and the development of a market for call spread options (CSO). In addition, an overnight index swap (OIS) was introduced as hedging tools against interest rate risks with the preparation for actual operation being underway, supplementing the existing interest rate swap (IRS) market, in order to strengthen the overall

[2] Net FDI inflows to Indonesia moderated from 1.8 percent of GDP in 2017 to 1.3 percent of GDP in 2018. In value terms, net FDI inflows, however, still showed an increase from USD20.58 billion in 2017 to USD21.47 billion in 2018.

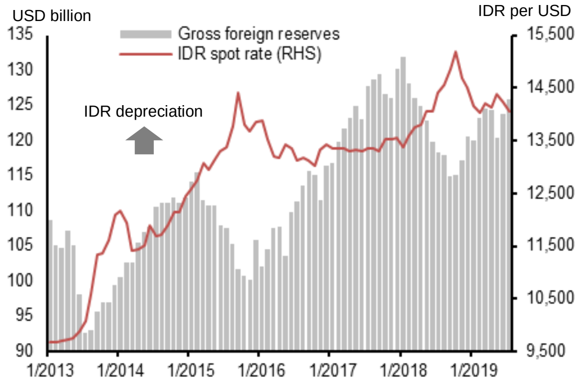
development of the interest rate derivatives market.[3] To contain a widening current account deficit, the authorities implemented export-promotion measures[4], while pushing for a mandatory implementation of 20 percent (palm oil based) biodiesel blend (B-20) policy,[5] and reprioritizing certain infrastructure projects to reduce related imports. Advance collection of corporate income tax was increased for about 1,147 import items, which are mostly consumption goods or intermediate inputs that could be sourced locally, since late 2018.[6] Against these backdrops and a decline in global oil prices, the trade balance has improved in recent months, supporting a smaller current account deficit of 2.8 percent of GDP in H1 2019.[7] Foreign investors have also returned to net-purchase of rupiah-denominated government bonds and equities, following a recent dovish turn in monetary policy by the Fed and other advanced central banks. Improving trade balance and rebounding capital inflows supported the rupiah to strengthen to around IDR14,200 per U.S. dollar and resulted in an increase in gross foreign reserves to USD126.4 billion in August 2019 (Figure 6).[8]

Figure 5. Daily Transaction of 1-Month Rupiah DNDF and Offshore NDF



Source: Bank Indonesia, Thomson Reuters Datastream

Figure 6. Gross Foreign Reserves and IDR Spot Rate



Source: Bank Indonesia

6. **Generally easing global financial conditions, coupled with policy measures, are likely to support the overall balance of payments in 2019.** Easier global financial conditions are expected to continue supporting the return of net portfolio inflows into Indonesia's capital markets.[9] Net FDI inflows have also rebounded, following a dip in Q4 2018. Policy measures to reduce imports and boost exports are also expected to help contain the current account deficit, which widened somewhat in Q2 amid deteriorating terms of trade and weaker global demand (Figure 7). Going forward, a financial and capital account surplus is projected to

[3] The reference rate for OIS is the Indonesia Overnight Index Average or INDONIA – the overnight benchmark based on actual market transactions, newly introduced in August 2018 to replace the old overnight JIBOR which was based on banks' quotations and hence may not reflect market conditions accurately. While the reference rates used for IRS tools are still the JIBOR for other terms, there is a plan to align OIS and IRS in the future.

[4] For instance, a National Interest Account (NIA) program has been implemented by Indonesia's Eximbank to expand exports to African countries. Fiscal incentives have been offered to attached FDIs into export-oriented sectors and industries.

[5] As the world's largest producer, Indonesia could make use of its palm oil stock to produce biodiesel, reducing the import of fuel-based diesel. A B-30 policy has been also implemented on a pilot basis.

[6] According to the Income Tax Law (PPh) Number 36 of 2008, Article 22 on Income Tax, importers are required to pay in advance from 2.5-7.5 percent of import prices/value when importing items as a prepayment of corporate income tax. The prepayment ratio has been increased to the range of 2.5-10 percent for the above-mentioned 1,147 import items since late 2018.

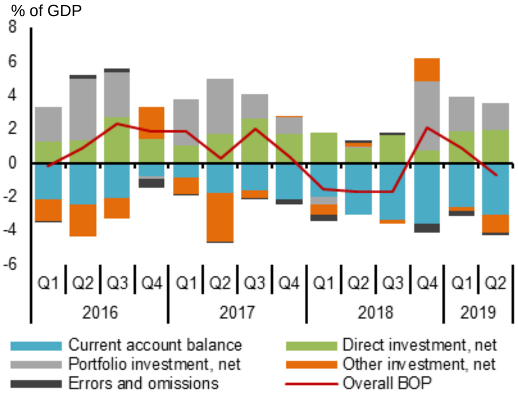
[7] The current account deficit narrowed to 2.6 percent of GDP in Q1 2019, before widening to 3 percent in Q2 2019. In addition to higher oil prices, increased imports during the Eid-ul-Fitr and school holidays, coupled with higher dividends repatriation and bond interest payments also contributed to a larger current account deficit in Q2 2019.

[8] This is equivalent to 7.3 months of imports or 7 months of imports and servicing of government external debt, compared to the conventional standard of 3 months of imports of goods and services.

[9] Bouts of capital outflows were, meanwhile, observed in April-May, and early August 2019, as risk aversion among global investors flared up with escalating U.S.-China trade tensions. Notwithstanding this, capital flow data still indicate a cumulative net inflow of about IDR170 trillion, or USD12 billion, into Indonesian stock and bond markets as of mid-August 2019.

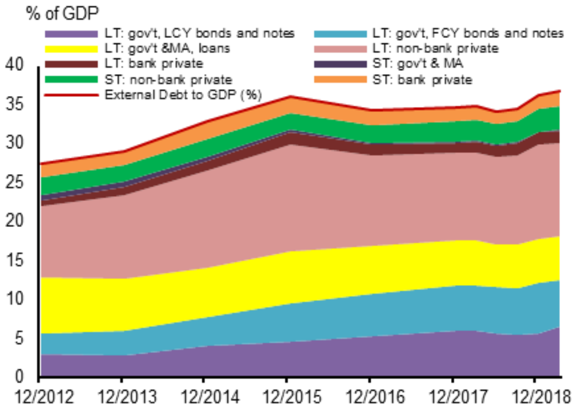
continue financing the current account deficit, and supporting the overall balance of payments in the rest of 2019.

Figure 7. Overall Balance of Payments



Source: Bank Indonesia, AMRO staff calculations

Figure 8. External Debt by Maturity and Holders



Note: LT stands for long-term external debt, ST stands for short-term external debt. Source: Bank Indonesia and Ministry of Finance

7. **External debts have increased, mainly driven by State-Owned-Enterprise (SOE) borrowing, but vulnerabilities remain contained.** Indonesia's external debt picked up to 36.2 percent of GDP in 2018, up from 34.7 percent a year earlier (Figure 8). SOEs in the mining and energy sectors stepped up their issuance of medium-term notes (MTN) and bonds in global markets to finance investment activity in 2018, which pushed up non-bank corporate long-term external debt from 11.3 percent of GDP in 2017 to 12.2 percent in 2018.[10] Albeit rising, banks' long-term external borrowings remained low at 1.6 percent of GDP; government long-term external debt was also stable at 17.5 percent of GDP in 2018.[11] Short-term external debt has been contained at below 5 percent of GDP, as of end-2018. To mitigate the currency mismatch risk, non-bank corporates are required to hedge at least 25 percent of their net FX liabilities maturing within the following six months, and maintained a minimum liquidity ratio of 70 percent of their net FX liabilities up to three months.[12]

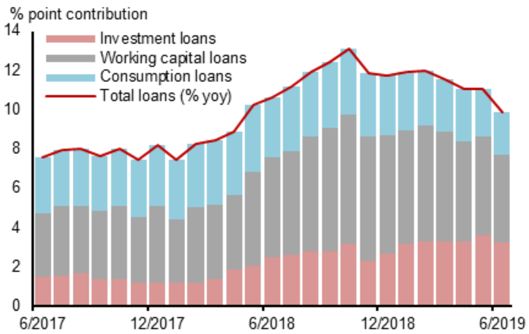
A.3. Monetary Conditions and Banking Sector

8. **Credit growth has rebounded to support economic activity.** Bank loans, having grown at double-digit levels since mid-2018, moderated recently but remained at around 10 percent, driven by lending for productive activity, i.e. working capital and investment loans (Figure 9). Consumption loans have slowed on account of vehicle loans and other personal consumption loans, whereas mortgage loans, in particular for residential apartment and landed-house segments, have held steady. In light of the policy rate hikes to safeguard external stability in 2018, BI has removed the regulatory cap on loan-to-value for first-time home buyers, among other measures, to support the property market.[13]

[10] For example, PT Indonesia Asahan Aluminium (Inalum), a state-owned firm in the mining sector, issued global bonds worth USD4 billion in late 2018 to finance its acquisition of a majority stake in the Indonesian gold and copper mining unit of the U.S.-based Freeport-McMoRan (Grasberg mine). The two SOEs in the energy sector, i.e. Pertamina and PLN, also reportedly issued global medium-term notes and bonds to finance their business expansion last year.
[11] Government's long-term external debt consists of FCY bonds, LCY bonds held by foreign investors, and external loans.
[12] As of end-2018, the compliance rate among non-bank corporates is above 90 percent for the hedging requirement and close to 90 percent for the liquidity requirement. In addition, non-bank corporates also need to obtain a credit rating of no less than equivalent to BB- by a rating agency recognized by BI (BI's regulation No 16/21/PBI/2014).
[13] In addition, the amount and pace of loan/ financing disbursement has been adjusted, allowing up to 50 percent and 90 percent of the loan amount to be disbursed upon the completion of footing and rooftop work, respectively, compared to previously 40 percent and 70/ 80 percent. For further details on those adjustments, please refer to BI's press release and appendix on its policy

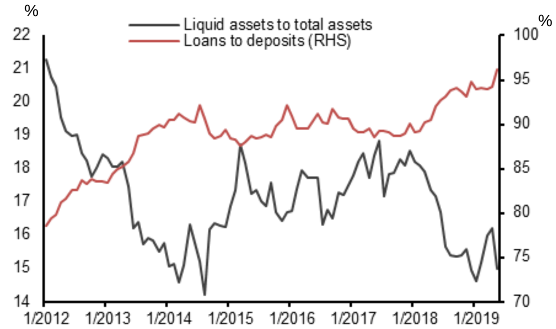
9. **Liquidity among banks has moderated, but is still adequate with liquidity indicators above their minimum thresholds.** The loan-to-deposit ratio increased from 90 percent in December 2017 to 94.8 percent in December 2018, and stood at 94 percent in July 2019. This reflected an elevated credit growth amid a slowdown in deposit growth, mainly on account of net capital outflows. Likewise, the liquid asset to total deposit ratio has moderated since early 2019 (Figure 10 and Annex 2). Some banks, particularly smaller ones, have experienced tighter liquidity conditions but have since tapped into BI's repo and SWAP facilities, respectively. Liquidity indicators for the whole system, such as the liquidity coverage ratio and liquid assets to non-core deposits ratio, remained elevated at 201 percent and 113.2 percent in March 2019[14], respectively, compared to the threshold of 100 percent and 50 percent. Going forward, BI's recent policy move, including a 50 bps-reduction in the rupiah reserve requirement ratio for banks in June and a total of 75 bps decrease in key policy rates in July-September, coupled with net capital inflows and government disbursement, should help alleviate liquidity pressure among banks.[15]

Figure 9. Contribution to Bank Loan Growth: by Loan Purpose



Source: BI

Figure 10. Bank Liquidity Conditions



Source: OJK, CEIC

10. **The banking sector remains sound with strong capital buffer and stable asset quality.** Banks continue to be well capitalized, with the capital adequacy ratio for commercial conventional banks standing at 22.6 percent[16], as of June 2019, compared to the regulatory minimum of 8 percent (Figure 11a). Bank asset quality, reflected via both non-performing loans and other loans-at-risk ratios, has been also kept stable.[17] As banks have raised their deposit rates in response to slower deposit growth while keeping lending rates unchanged, net interest margins moderated to about 4.9 percent on average in the first half of 2019 (Figure 11b). Likewise, the return on asset ratio has moderated somewhat to 2.5 percent, as of June 2019, but remained strong relative to regional peers.[18]

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rate hike in June 2018, available at Bank Indonesia. 2018. "BI 7-day Reverse Repo Rate Raised by 50 bps to 5.2 percent: Further Policy Mix Response to Strengthen Economic Stability." https://www.bi.go.id/en/ruang-media/siaran-pers/Pages/sp_205118.aspx (29 June 2018).

[14] Source: OJK.

[15] For detailed information on BI's policy moves, one can refer to the corresponding press release in June and July 2019 by browsing the following links. Bank Indonesia. 2019. "BI 7-Day Reverse Repo Rate Held at 6.00%, Rupiah Reserve Requirement Lowered by 50 bps: Maintaining External Stability, Stimulating Economic Growth."https://www.bi.go.id/en/ruang-media/siaran-pers/Pages/SP_214619.aspx (June 20, 2019).Bank Indonesia. 2019. "BI 7-Day Reverse Repo Rate Lowered 25 bps to 5.75% Maintained Stability, Driving Growth Momentum." https://www.bi.go.id/en/ruang-media/siaran-pers/Pages/SP_215219.aspx (July 18, 2019)..

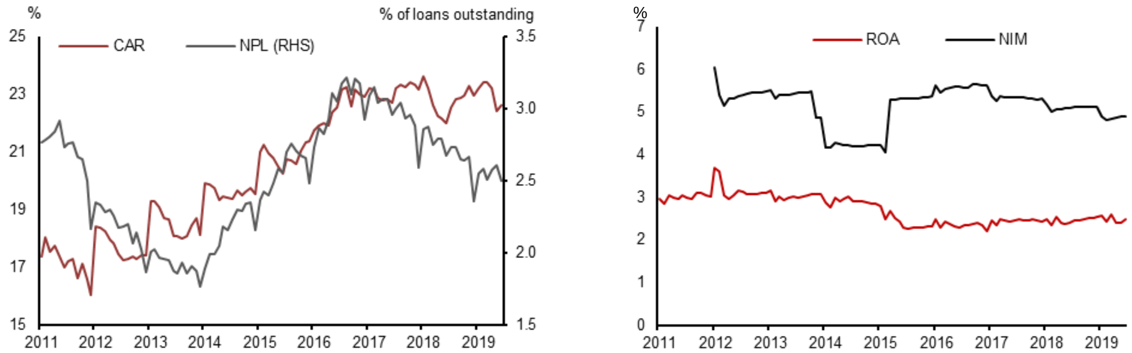
[16] The capital adequacy ratio for the whole banking system, including sharia banks, was even higher at 23.2 percent, as of June 2019. Source: OJK (https://www.ojk.go.id/id/berita-dan-kegiatan/info-terkini/Pages/Stabilitas-Sektor-Jasa-Keuangan-Terjaga---Semester-I-2019.aspx).

[17] The NPL ratio was 2.6 percent, as of May 2019. Other loans at risk, i.e. loans classified in Collect 2 "special mention" and restructured loans reclassified in Collect 1 "standard loans", stood at 5.2 percent and 2.2 percent, respectively, largely unchanged from early 2019, and improved from a year earlier.

[18] The return on assets among banks in neighboring ASEAN countries ranged from 1.0-1.7 percent.

Figure 11. Banks' Soundness Indicators

a. Capital Adequacy and Non-performing Loans **b. Return on Assets and Net Interest Margins**



Source: OJK

Source: OJK

Authorities' Views

11. The authorities emphasized that policy actions had been taken to ensure adequate liquidity in the market. In particular, BI issued PBI No. 20/4/PBI/2018 on the macroprudential intermediary ratio (MIR) and macroprudential liquidity buffer (MPLB) for conventional banks, sharia banks, and sharia business units. In MIR, bank investment in corporate bonds issued by non-bank institutions can be calculated as a component of financing in addition to traditional lending. Under the MPLB regulation, banks are now allowed to use all their marketable securities calculated as secondary reserves as an underlying asset in reserve repo transactions with BI, providing banks with more options for liquidity access. The OJK, as the supervisor of banks in Indonesia, issued POJK No. 50/POJK.03/2017 on the obligation of commercial banks to fulfill the Net Stable Funding Ratio (NSFR) in compliance with the Basel III accord. The regulation required commercial banks to maintain a minimum NSFR – the ratio of available stable funding needed – of 100 percent, applicable to banks categorized under the commercial bank groups (BUKU) III and IV, as well as foreign banks. This regulation complemented other liquidity-related regulations recently issued by the OJK, such as POJK No. 42/POJK.03/2015 on the obligation for commercial banks to meet the liquidity coverage ratio. Going forward, the authorities opined that bank liquidity may continue to be affected by global dynamism, in particular the U.S. – China trade tension which could result in a volatile rupiah and upward pressure on interest rates. Challenges also come from a potential increase in the US Fed fund rate and commodity price volatility.

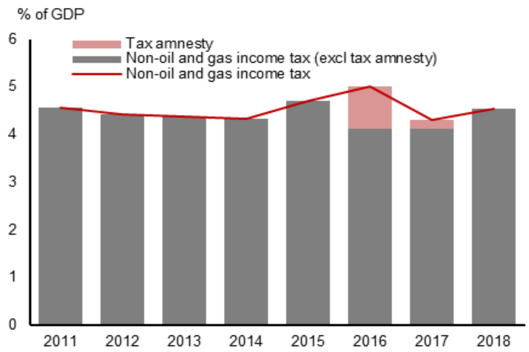
A.4. Fiscal Sector

12. **The authorities have adopted a prudent fiscal stance and taken steps to broaden the tax base, enhance tax compliance, and improve spending quality, supporting a prudent fiscal stance.** A single final tax rate of as low as 1 percent in 2014 – which was revised down further to 0.5 percent in 2018[19] - has been applied for micro, small and medium-sized enterprises (MSMEs) with turnover up to IDR4.8 billion[20] to encourage formalization and tax registration. This has contributed to a steady increase in the number of registered tax payers from about 27.5 million in 2013 to 39.2 million in 2017, marking an annual growth of 9

[19] This is compared to the standard corporate income tax of 25 percent, and value-added-tax rate of 10 percent.
[20] Prior to 2014, the turnover threshold was IDR600 million.

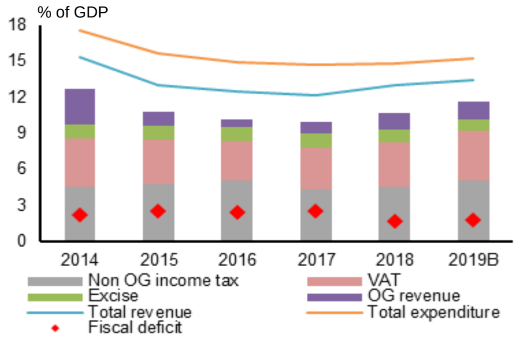
percent on average. In addition to a one-time revenue boost, equivalent to about 1.1 percent of GDP (Figure 12), the tax amnesty program in 2016-2017 has broadened the tax base, in terms of both declared asset size and number of new tax payers.[21] Tax buoyancy improved in 2018[22], which, coupled with strengthened oil and gas revenue due to higher-than-budgeted oil prices, lifted tax revenue to 10.2 percent of GDP, up from 9.9 percent a year earlier. On the expenditure front, the authorities took advantage of low oil prices between 2014-2017 to reduce energy subsidies, which helped free up resources for other priorities.[23] While capital spending in the central government budget declined in recent years, transfers to regional budgets and village funds were stepped up. The overall fiscal deficit narrowed from 2.5 percent of GDP in FY2017 to 1.8 percent of GDP in FY2018[24] (Figure 13). Public debt was maintained at 29.8 percent of GDP, as of end-2018.

Figure 12. Impact of Tax Amnesty on Income Tax



Source: Ministry of Finance, AMRO staff calculations

Figure 13. Budget Performance



Source: Ministry of Finance, AMRO staff calculations

13. **The overall fiscal deficit may widen somewhat in 2019, due to subdued revenue collection, but should remain contained well below the fiscal rule of 3 percent of GDP.** Ongoing efforts to broaden the tax base including the initiative to cooperate with local governments in incorporating tax clearance requirements in the business license/permit application and tender participation, have contributed to increased taxpayer registration. A Data Management Unit (DMU), in particular the division of Compliance Risk Management (CRM), was established under the Directorate General of Taxes (DGT), to strengthen data analysis, including those obtained from the Automatic Exchange of Information (AEoI) Initiative[25]. Tax compliance is expected to improve following the completion of data matching, scheduled for August 2019. Other measures to enhance tax administration include simplifying tax registration, increasing the number of service centres, expanding e-filing coverage, and simplifying tax refund procedures.[26] Notwithstanding the enhancement, tax collection in the

[21] Indonesia's Tax Amnesty (TA) program was rolled out between June 2016 and March 2017. It is estimated that the one-time impact of the TA program on the budget revenue is a "clearance levy", equivalent to about 1.1 percent of GDP, of which 0.9 percent of GDP was reflected in 2016 Budget statistics, and 0.2 percent of GDP was accounted in 2017 Budget statistics. More importantly, the program has broadened the tax base, in terms of both asset declaration size and number of new tax payers. By the end of the TA program, the total value of asset declaration amounted to about 30 percent of GDP, of which 1.2 percent of GDP were repatriated. Among about 973 thousand TA participants (of which more than 723 thousand have submitted their tax files), about 53 thousand are new taxpayers.

[22] Tax buoyancy increased from less than 1 during 2013-2017 to 1.04 in 2018.

[23] Energy subsidies declined from 3.2 percent of GDP in 2014 to 0.7 percent in 2017. While energy subsidies increased again in 2018 as energy subsidy reforms stalled, they remained relatively low at 1 percent of GDP.

[24] In Indonesia, the fiscal year is the calendar year, starting from 1 January and ending on 31 December.

[25] Indonesia has participated since 2018, with the DGT starting to receive financial information on Indonesian corporates and individuals from 69 jurisdictions, including Singapore.

[26] In December 2018, Ministry of Finance issued Regulation 210 to require e-commerce firms/platforms to provide sale data on their suppliers/members to tax authorities, as part of the ongoing efforts to broaden tax base and enhance tax compliance. The regulation was however withdrawn, to avoid misunderstanding about the policy intent prior to the April elections.

first six months of 2019 posted a smaller increase on the back of softer economic activity and lower commodity prices, including oil prices. Furthermore, accelerated tax refund procedure led to a contraction in VAT revenue (Appendix 4). Budget expenditure was in line with the budget, as a robust central government's recurrent spending and regional transfers, including those to village funds, offset sluggish capital spending. Despite a weaker-than-budgeted revenue, lower energy subsidies and a reduction in revenue sharing with local governments amid lower commodity prices, are projected to keep the overall deficit contained at around 1.9 percent of GDP in 2019.

Table 1. National Strategic Projects and Program: Plan and Implementation

Types of project/program	Sectors/Areas	2015-19 plan	Completed/Progress as of 2018
National Strategic Projects (PSNs)	Toll roads	69 ($49.7bn)	22
	Dams	51	11
	SEZs + IEs	29 ($31bn)	9
	Railways	16 ($29.2bn)	2
	Energy	11 ($89.8bn)	1
	Ports	10	1
	Clean water	8	-
	Airports	7	9
	Smelters	6	4
	Technology	4	-
	Housing	3	-
	Fishery and farming	1	1
	Sea dikes	1	-
	Education	1	-
	Irrigation	6	2
	Total	***223***	***62 completed, 32 partially completed, 100 under construction, 29 under procurement and preparation***
Programs	Electricity (35,000 MW)	1 ($76.7bn)	8% operational, 58% under construction, 27% signed PPA, 4% under procurement, & 3% planning
	Aeroplane industry	1	-
	Economic equality	1	-
	Total	***3***	
Overall	***223 PSNs and 3 Programs ($310bn)***		

Source: Coordinating Ministry of Economic Affairs (Committee for Acceleration of Priority Infrastructure Delivery- KPPIP)

14. **The authorities have boosted infrastructure spending under the Medium-term National Development Plan (RPJMN) for 2015-2019, with joint funding from the private sector.** The Government has selected 223 National Strategic Projects (PSNs) and three Programs of a total size of USD310 billion.[27] Of the total, about 37 projects worth about USD184 billion were specifically selected as National Priority Projects. The progress of the RPJMN has been encouraging with about 62 projects fully completed, 32 partially completed, and another 100 projects under construction by end-2018. Notable progress has been observed with the development of airports, toll roads, smelters, and special economic zones and industrial parks (Table 1 and Appendix 5). This is underpinned by a supportive legal framework and active funding by the private sector in light of recent fiscal constraints. In particular, initiatives such as the establishment of the National Asset Management Agency (LMAN) in 2015 which provides land acquisition fund for all PSNs, have smoothened land acquisition and site clearance to a considerable extent. In terms of funding progress, about 25 percent has been realized, with the private sector accounting for a major share of 64 percent, followed by SOEs (20 percent) and the government budget (16 percent).[28]

15. **Liabilities continue to build up at SOEs, in part due to their involvement in infrastructure development**. The debt-to-equity ratio among SOEs in the construction and

[27] This accounts for about half of the nation-wide infrastructure development size planned for the same period.
[28] The private sector has been particularly active in toll roads, electricity and water treatment projects.

transportation sector has increased, as a result of the accelerated construction of infrastructure projects such as toll roads, ports and industrial estates.[29] Ample profits and liquidity, backed by completed toll roads, meanwhile, helped maintain overall financial soundness among those SOEs, as reflected in stable current ratios and interest coverage ratios (Appendix 6.1).[30] Firm-level data, meanwhile, suggest mixed performance for energy SOEs. The revenue prior to subsidies of Indonesia's largest integrated oil and gas company, PT Pertamina, increased in 2018 while that of electricity producer PT Perusahaan Listrik Negara (PLN) moderated somewhat. That said, both Pertamina and PLN relied more on government subsidies to adjust for the shortfall between the market-linked formula price and the government-stipulated price (Appendix 6.2).[31] PLN's debt-to-equity ratio also rose on the back of bank borrowing and bond issuance to finance the power plant projects.[32] Against this backdrop, non-financial SOEs' debt liabilities increased from 4.7 percent of GDP in 2017 to 6.2 percent in 2018[33], government guarantee also picked up from 0.7 percent of GDP to 1.2 percent in the same period.[34]

B. Risks, Vulnerabilities and Challenges

16. **Indonesia remains susceptible to the risk of capital flow and asset price volatility as foreign investors hold a large share of its financial assets in both equity and bond markets**. Indonesia has become more resilient over time, with the 2018 EM turbulence having a smaller impact than in the past (Table 2). While financial deepening has progressed gradually alongside policy efforts to introduce new financial instruments and broaden the investor base, Indonesia's capital markets remain modest in size with a fairly narrow base of domestic long-term investors, thereby limiting resident investors' ability to absorb a sell-down by non-residents (Box A). Foreigners have been the largest group of investors in the domestic bond market, holding about 37 percent of total rupiah-denominated government bonds outstanding at end-2018, the highest in the region (Figure 14). Likewise, foreign investors' securities ownership in the stock market is high, with 52 percent of tradeable shares in the Indonesia Stock Exchange in 2018 held by foreigners.[35] As a result, Indonesia remains vulnerable to risks of capital flow reversal, especially in light of the continuing uncertainty over the outcome of US-China trade negotiations.[36]

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[29] Liabilities have accumulated over the past few years as these companies relied on bank loans, bond issuances and other instruments to finance these projects.

[30] The profit of infrastructure-related SOEs increased 23.2 percent in 2018 from a year earlier.

[31] The notable increase in Pertamina's FY2018 revenue was mainly due to stronger exports of crude oil, natural gas and oil products (up by 94 percent); an increase in subsidy reimbursement from government (up by 57 percent); and an one-off compensation for the shortfall between market-based formula price and government- stipulated price reflected in revenues from other operating activities (USD3.1 billion). Similarly in PLN's 2018 other incomes, there is a steeper adjustment of fuel and lubricant price (IDR4.0 trillion) and compensation incomes of IDR7.5 trillion and IDR23.2 trillion from the government on electricity supplies on some groups of customers whose rates for selling electricity were lower than the procuring rates (BPP) in 2017 and 2018, respectively.

[32] Including the Fast Track Programs 1 and 2, and the 35 GW program. PLN covers the construction of 24 GW out of the total 56 GW generated by these programs.

[33] AMRO staff calculations based on Indonesia Public Sector Debt Statistics. Bank Indonesia. 2019. "Indonesia Public Sector Debt Statistics Quarter IV 2018."https://www.bi.go.id/en/statistik/suspi/Pages/SUSPI_TWIV_2018.aspx (March 29, 2019).

[34] New guarantees worth of about IDR103.4 trillion, equivalent to about 0.7 percent of GDP, were granted in 2018 for a number of infrastructure projects, including Jobodebek LRT, PPP project for South Japek II toll road, Probowangi toll road, and Sumatra toll road, among others. This is part of the Maximum Guarantee Limit (MGL) for 2018-2021 which could be up to 6 percent of the 2021 GDP. Source: Directorate General of Budget Financing and Risk Management, Ministry of Finance of Indonesia.

[35] Source: OJK.

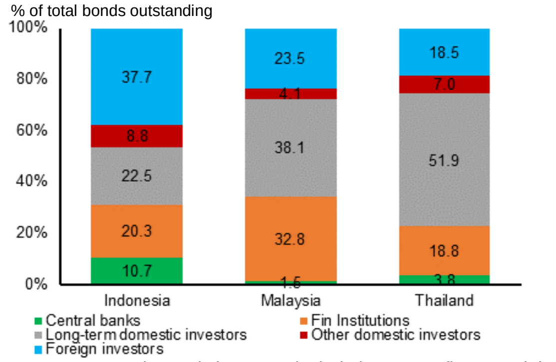
[36] A preliminary study by AMRO staff on determinants of non-residents' holding of rupiah-denominated government bonds using the Generalized Methods of Moments indicated that non-resident bond flows were influenced by a host of push and pull factors. Among the push factors, rising global uncertainties and investors' risk aversion, measured via the CBOE Volatility Index (VIX index), is found strongly correlated with net bond outflows. Among the pull factors, a low inflation rate and stable/appreciated

Table 2. Indonesian Financial Markets Against Headwinds

Timelines	GFC 2008	Taper Tantrum May-13	RMB depreciation Aug-Sep 2015	EM turbulence Jan-Oct 2018
IDR depreciation, %	7.4	11.5	12.8	12.0
10Y gov't bond yield increase, bps	441	344	177	229
LCY bond held by foreigners decline, %	17.9	6.6	2.6	2.2
Foreign holding of equities decline, %	-	23.2	20.1	14.4
JCI decline, %	54.8	17.2	19.0	11.7

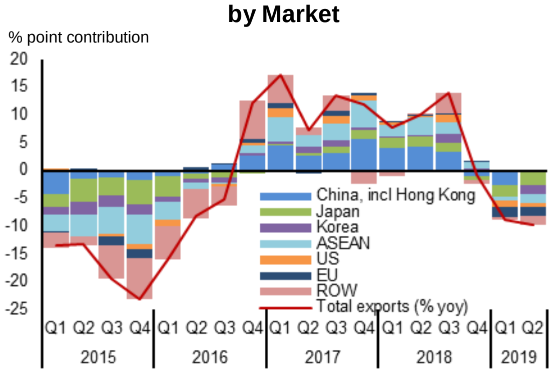
Note: JCI stands for Jakarta Composite Index
Source: National Authorities, CEIC, Thomson Reuters Datastream, AMRO staff calculations

Figure 14. Government Bond Profile by Investors: Selected ASEAN, 2018



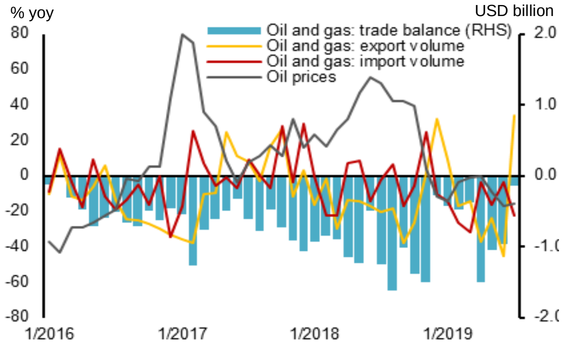
Note: Long-term domestic investors include insurance firms, social security funds, and/or contractual savings funds, and mutual funds.
Source: National Authorities, Asian Bonds Online

Figure 15. Contribution to Export Growth, by Market



Source: National Authorities, CEIC, AMRO staff calculations

Figure 16. Indonesia's Oil and Gas Trade Balance vs. Oil Prices



Source: National Authorities, CEIC, AMRO staff calculations

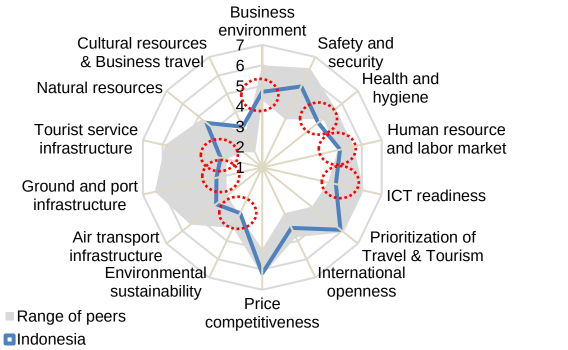
17. **A sharper slowdown in global demand, triggered by rising trade protectionism, could adversely affect Indonesia via the commodity trade channel.** With close to half of its exports still commodities, Indonesia is vulnerable to shocks related to commodity prices and demand, particularly from a major trading partner such as China (Figure 15). In this regard, a sharper-than-expected deceleration in global demand, particularly in China, aggravated by ongoing trade tensions, could weigh on Indonesia's commodity exports and growth. According to AMRO's simulations using the Oxford Economics model, in a worst-case scenario of further escalation in trade tension, while Indonesia could be one of the least affected regional economies, its growth may still see 0.1 percentage point shaved off in 2019 and 0.2 percentage point in 2020.[37] There is also a risk that the recent escalation in geopolitical tensions in the Middle East could lead to a sharp rise in global oil prices, which would worsen Indonesia's trade balance (Figure 16).

18. **Infrastructure gaps, regulatory bottlenecks and labour market rigidities are among key factors that have restrained Indonesia's competitiveness and growth potential.** Despite encouraging progress, infrastructure development in the areas of seaports, railways, clean water, and energy has lagged behind, hindering efforts on economic diversification towards tourism and export-oriented manufacturing. For tourism, the capacity and quality of Indonesia's ports and ground transport infrastructure, as well as tourism-specific

rupiah is found statistically correlated with a net inflow, whereas increased rupiah volatility are associated with a net outflow. A strengthened current account balance and bullish stock market are also correlated with lower non-resident bond flows.
[37] It is noted that the Oxford Economics model does not fully capture the trade and investment diversion effect, as well as potential impacts stemming from the (investor) sentiment channel.

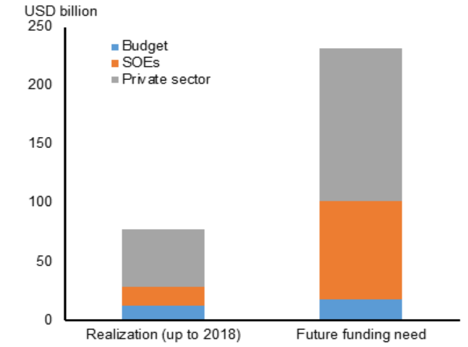
infrastructure, such as hotels, restaurants, and other service amenities, are still below the regional average (Figure 17). Likewise, still-high logistics and transportation costs have made manufacturing for exports industries in Indonesia less cost-effective.[38] Moving forward, progress in infrastructure development will depend on continued efforts towards resolving outstanding issues in project preparation, land acquisition, and funding. A considerable amount of funding of about USD230 billion or equivalent to about 20 percent of the 2018 GDP, will be needed to complete the investment projects under the RPJMN 2015-2019 (Figure 18). While the overall regulatory environment continues to improve, frequent changes in regulations are seen as challenges in doing business in Indonesia. Indonesia's average wages in manufacturing are low relative to regional peers, but rigid labor regulations, including a formula that indexes annual minimum wage increase to nominal GDP growth, may affect Indonesia's labor cost competitiveness moving forward[39]. Increased advance collection of income tax on importers of the aforementioned 1,147 items at the border since late-2018[40], insufficient issuance of work permits for foreign workers, and the lack of skilled labor, among others, have been also identified as issues foreign investors have faced in doing business in Indonesia.

Figure 17. Travel & Tourism Competitiveness Index 2019



Note: Scores from 1 to 7, whereas 7 equals to best. Competitors are Malaysia, the Philippines, Singapore, Thailand, and Vietnam. Source: World Economic Forum (2019)

Figure 18. PSN Funding Progress



Source: Coordinating Ministry of Economic Affairs (Committee for Acceleration of Priority Infrastructure Delivery- KPPIP)

[38] According to the latest Logistics Performance Index database released by the World Bank, Indonesia moved up 17 places to the 43rd rank among 160 countries in 2018, which is, however, still below Thailand (32nd), Vietnam (39th), and Malaysia (41st). Infrastructure conditions and logistics quality and competence are the factors that have lagged behind regional peers.

[39] With the introduction of the formula of minimum wage hike in line with real GDP growth and inflation rate, the pace of minimum wage hike in Indonesia has been more predictable than in the past. Notwithstanding this, following the formula, Indonesia's minimum wages increased on average at around 8 percent for the past few years and may continue to growth at similar rates in the future, which is relatively high in comparison with neighboring countries. For instance, Thailand increased its minimum wages from 2-7 percent in 2018 for the first time since 2013. The pace of hiking minimum wages in Vietnam has also slowed significantly in the past few years to 5.3 percent in 2019. This may deter potential FDI firms who are interested in investing in labor-intensive industries, such as garment and textile, in Indonesia.

[40] According to the Income Tax Law (PPh) Number 36 of 2008, Article 22 on Income Tax (PPh 22), importers have been required to pay in advance from 2.5-7.5 percent of import prices/value when importing items as a prepayment of corporate income tax, which has been raised to the range of 2.5-10 percent for about 1,147 items as mentioned above. The settlement of corporate income tax is finalized only by the year-end, with firms being refunded with the overpaid amount. In such cases, firms' cash flows and re-investment activity during the year could be adversely affected, in particular among those with low profit margins. This also affects the performance of exporters, who could be FDI firms, who need to import raw materials and/or intermediate goods from 22outside Indonesia.

Box A. Financial Deepening in Indonesia[41]

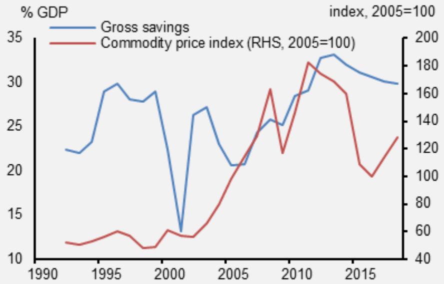
Indonesia has seen gradual financial deepening after the Global Financial Crisis (GFC), in tandem with a higher saving rate and greater financial inclusion. As far as the banking sector is concerned, bank assets have rebounded to the level observed prior to the GFC, standing at about 54.4 percent of GDP in 2018. Developments in the capital market have been biased toward to the stock market, with stock market capitalization doubling the pre-GFC level to about 46.7 percent of GDP in 2018. The bond market has also increased, with government bonds outstanding rising from about 9 percent of GDP in 2010 to 15.2 percent of GDP in 2018. The corporate bond market has grown rapidly, albeit from a low base, to stand at 3.1 percent of GDP in 2018 (Table A1). The commodity boom until the early 2010s have lifted Indonesia's saving rate to a level on par with regional peers in recent years (Figures A1&A2). Financial inclusion has also expanded, with the share of adult population having a bank account increasing rapidly from 19 percent in 2011 to almost 50 percent in 2017 (Figure A3).

Table A1. Indonesia's Financial Sector Development Indicators, 1995-2018

% GDP, unless otherwise indicated	1995	2000	2005	2010	2015	2016	2017	2018
Bank assets	-	-	53.0	43.8	53.2	54.3	54.4	54.4
Domestic credit	51.8	60.7	46.2	34.2	46.8	48.0	47.0	47.2
o/w net claim on the government	-4.4	37.7	18.2	5.5	5.7	6.1	5.7	5.2
o/w claim on other sectors	56.2	23.0	28.0	28.7	41.1	41.9	41.3	42.1
Stock market capitalization	32.9	16.2	28.5	47.7	41.0	45.7	51.3	46.7
Bonds outstanding	-	-	-	10.6	14.7	16.3	18.1	18.3
o/w government bonds	-	-	-	9.0	12.3	13.6	14.9	15.2
o/w corporate bonds	-	-	-	1.7	2.4	2.7	3.1	3.1

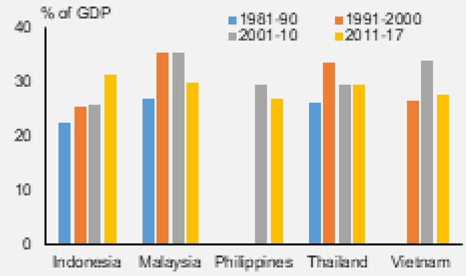
Note: Domestic credit refer to total credit provided by banks and non-bank deposit taking corporations to the economy, which include net claims on the government and claims on the rest in the economy. Source: National authorities, IMF, World Bank, ADB Asian Bonds Online Database, AMRO Staff Calculations

Figure A1. Indonesia's Gross Savings Ratio and Commodity Price Index



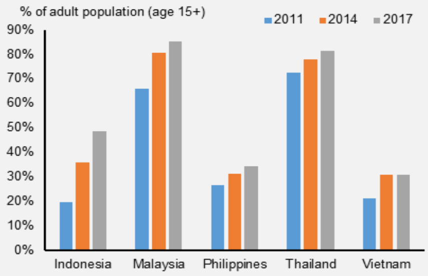
Source: World Bank, IMF, AMRO staff calculations

Figure A2. Gross National Savings in ASEAN-5



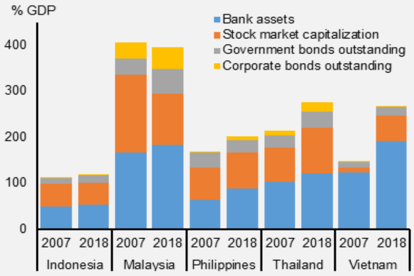
Note: Data for the Philippines are net national savings (which exclude consumption/depreciation of fixed capital assets).
Source: World Bank, IMF, AMRO staff calculations

Figure A3. Bank Account Ownership in ASEAN-5



Source: World Bank Global Findex Database

Figure A4. Bank Assets and Size of Capital Market in ASEAN-5



Source: National Authorities, World Bank, AMRO Staff Calculations

Notwithstanding these development, Indonesia's financial markets, or capital markets in particular, remain modest in size, with a relatively narrow investor base. Despite recent progress in financial deepening, the size of Indonesia's financial markets is still among the smallest in the region. Financial markets in ASEAN-5, with the exception of Malaysia, have grown more robustly than Indonesia over the past decade (Figure A4). As far as financial institutions are concerned, commercial banks have accounted for about three quarters of total assets in the system, with relatively high concentration on a number of state-owned banks (Figure 1.5a); meanwhile, non-bank financial institutions are still small (Figure A5b). Despite reform efforts to centralize and upsize the social security (mandatory pension) system, pension funds in Indonesia are still fragmented and modest in size, under the management of various SOEs and quasi-governmental agencies.[42]

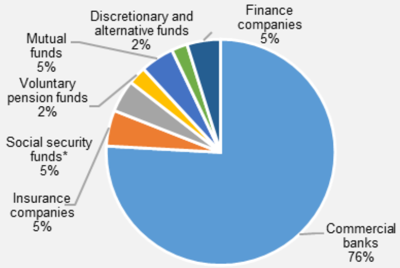
Indonesia's domestic investor base, in particular long-term institutional investors, hence remains narrow relative to regional peers such as Malaysia and Thailand (Figure A6). With a higher ratio of foreign holdings in LCY government bonds, Indonesia has been more susceptible to risks related to capital flow reversals and asset price volatility.

Figure A5. Financial Institutions in Indonesia: Asset Size

a. in percent of GDP

in percent of GDP	2016	2018
Commercial banks	54.3	54.4
o/w State-owned banks	21.3	22.1
Insurance companies	3.3	3.7
Social security funds*	3.0	3.3
Voluntary pension funds	1.8	1.9
Mutual funds	2.7	3.4
Discretionary and alternative funds**	1.5	1.6
Finance companies	3.6	3.4

b. in percent of total assets, as at 2018

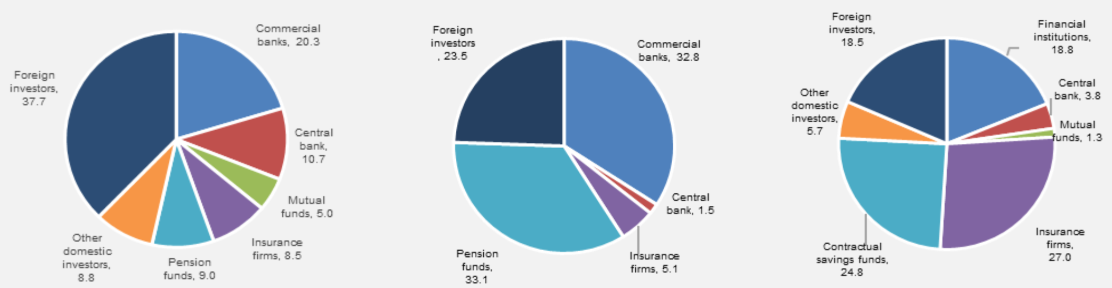


Note: */ Social security funds include funds managed by BPJS, Taspen, Asabri, and Jasa Raharja. **/ Alternative investment funds include private equity funds, asset backed securities, real estate investment funds, and infrastructure investment funds.
Source: National authorities, AMRO Staff Calculations

Efforts towards greater financial deepening include the introduction of new financial instruments and policy measures to broaden the investor base. The authorities have adopted a National Strategy for Financial Inclusion and another National Strategy for Financial Market Developments, which provide guiding principles for a detailed multi-year strategic action plan until 2024. Innovative financial instruments have been developed across different market segments to widen the range and availability of financial assets to meet savers' demand. In the FX market, a DNDF market was implemented in 2018 to provide investors with more FX risk hedging options, and it has witnessed a steady increase in the number of participants and transaction volume. In the money market, OIS and IRS were also introduced as hedging tools against interest rate risks, with preparation for actual operation being underway. In the capital market, new financial instruments, such as revenue-backed securities, infrastructure development funds and green bonds, have been launched. The government has increased the issuance of retail bonds and an online platform (e-SBN) has been launched to enhance access by the public. The inclusion of fintech firms in the network of agents distributing government retail bonds has helped to expand the investor base by reaching out to the millennial. Tax incentives have been offered selectively to a number of domestic institutional investors, such as pension funds and mutual funds[43]. A regulation was issued by OJK that requires non-bank financial institutions such as pension funds and insurance firms to invest up to 50 percent of their assets/portfolios in government debt securities from 2017 onwards.[44]

Figure A6. LCY Government Bond Investor Profile, selected ASEAN, as of December 2018

a. Indonesia b. Malaysia c. Thailand



Source: ADB Asian Bonds Online Database

[41] Prepared by Nguyen Thi Kim Cuc
[42] Social security fund managers include, among others, quasi-governmental agencies such as BPJS Ketenagakerjaan and BPJS Ketehasan which are in charge of managing funds contributed by employees working in the formal sector other than government agencies, or State-owned enterprises such as PT Taspen and PT Asabri which are in charge of funds for civil servants, the military and the arm force.
[43] In particular, a zero withholding tax rate is applicable to pension funds, while a 5-percent withholding tax rate is applicable to mutual funds until 2010 (and 10-pecent tax rate from 2021 onwards), compared to a tax rate of 15 percent applicable to insurance firms and other investors.
[44] According to OJK Regulation No. POJK 56/POJK.05/2017. As of 2018, for pension funds, the bulk of investment is still with bank deposits and savings accounts (27 percent of their portfolio), followed by government securities (23 percent), corporate bonds and sukuk (22 percent) and equities (12 percent). For insurance firms, bank deposits and savings used to the largest item in their portfolio, but have declined since 2016. As of 2018, about 27 percent of their investment is in government securities, followed by mutual funds (24 percent), equities (22 percent) and bank deposits and savings (12 percent), corporate bonds and sukuk (11 percent).

C. Policy Discussions and Recommendations

19. **In light of the shifting headwinds in the external environment, it is recommended that the authorities continue to prudently re-calibrate the policy mix to strike the proper balance between safeguarding stability and supporting growth.[45]** On the monetary front, BI's policy rate hikes and judicious forex interventions had supported the external sector in weathering spillovers from the EM turbulence, rising U.S. interest rates, and a strengthening U.S. dollar in 2018. At the same time, BI had relaxed macroprudential measures to ensure adequate liquidity in the banking system and to bolster bank financing to the real sector. While the EM turbulence has subsided, global financial conditions have eased, and the Fed and other advanced central banks have moved to a dovish stance, BI was prudent in putting its policy rates on hold in early 2019, as financial markets were still volatile as a result of continuing uncertainties over the U.S.-China trade tension and the underlying strength of the global economy. With the return of capital flows into its equity and bond markets and the rebound of the rupiah recently, BI lowered its policy rates three times in July-September by a total of 75 basis points to support the economy, particularly in light of a benign inflationary environment. This followed an earlier move to lower the rupiah reserve requirement ratio by 50 basis points to 6.0 percent and 4.5 percent, for conventional and sharia banks, respectively, while keeping the average reserve ratio unchanged at 3 percent. In our view, BI still has room to ease policy if the domestic economy were to weaken unexpectedly. As far as FX policy is concerned, it is crucial to maintain a market-based exchange rate mechanism with judicious interventions to mitigate excessive rupiah volatility.

20. **On the fiscal front, ongoing efforts to strengthen tax administration and broaden the tax base are commendable and should continue; the renewal of energy subsidy reforms is also recommended.** Indonesia's tax rates are comparable or even higher than some of its ASEAN peers[46], but tax revenue is still relatively low, in particular from income and profits (Figure 19). This suggests there is still scope to increase tax collection, in light of ongoing tax administration and policy reforms. Taxpayer registration has increased over time with initiatives to encourage formalization, but remains modest relative to the population size (Figure 20). The number of active tax payers is particularly small.[47] To maintain and broaden the tax base, existing tax exemptions could be streamlined. Indonesia's current turnover threshold of IDR4.8 billion for VAT registration is considered high relative to regional peers and conventional standards.[48] In the area of tax administration, to effectively leverage on the

[45] The policy mix framework at the macro level point to a coordination among various Governmental agencies and Bank Indonesia in the design and implementation of macroeconomic (monetary and fiscal) policies and structural reforms, to maintain macroeconomic stability and growth momentum. Within Bank Indonesia, the concept of policy mix embraces the implementation of monetary policy, macroprudential measures, FX management policy, policy related to payment systems, and financial deepening measures, in a coordinated manner to ensure the achievement of inflation target and financial stability.

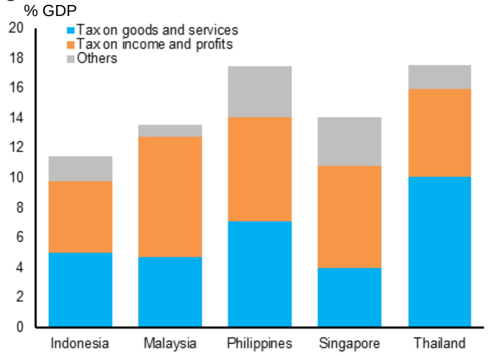
[46] For instance, Indonesia's standard VAT rate is 10 percent, which is lower than the Philippines (12 percent), but higher than most Malaysia(6 percent), Singapore and Thailand (7 percent), and similar to Vietnam (10 percent). Similarly, the corporate income tax is 25 percent, which is lower than the Philippines (30 percent), while higher than the rest (Malaysia: 24 percent, Thailand and Vietnam: 20 percent, Singapore: 17 percent).

[47] In terms of compliance, according to a recent OECD study, Indonesia's tax filing rates have picked up steadily in recent years, but remain lagged behind both OECD and non-OECD average. Source: Lewis C. (2019), Raising more public revenue in Indonesia in a growth and equity-friendly way, OECD Economics Department Working Paper No. 1539.

[48] The current turnover threshold for VAT registration in Indonesia is equivalent to USD340,000, using the current exchange rate. According to Lewis (2019), this could be considered high relative to some OECD countries and the IMF-recommended level of USD100,000. Similarly, most of regional peers have a lower threshold than Indonesia, including Malaysia (equivalent to USD119,000), the Philippines (USD57,700), and Thailand (USD58,500). There is no minimum turnover threshold for VAT

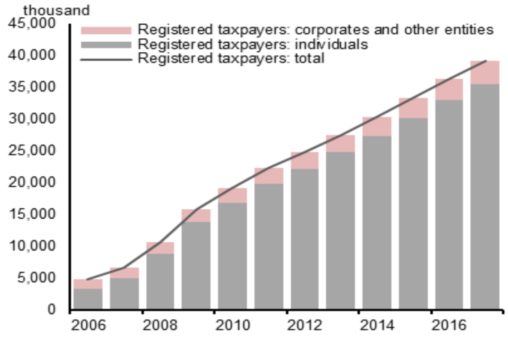
AEoI initiative and Tax Amnesty program, it is important to invest more in human resource and information technology in the newly-established DMU under the DGT. Renewed efforts should be made to strengthen tax compliance in the face of digitalization and e-commerce boom. As far as budget expenditure is concerned, AMRO welcomes ongoing efforts to improve spending allocation and quality, which is crucial in light of the large amount of funding needed for developmental purposes. In this regard, energy subsidy reforms should be renewed particularly in light of the current lower global oil prices. Energy subsidy reforms will help improve the finances of energy SOEs, i.e. Pertamina and PLN, reduce the transfers to those SOEs, and free up resources in the budget for other spending priorities.

Figure 19. Tax Revenue: Selected ASEAN, 2017



Sources: OECD Global Revenue Statistics Database

Figure 20. Registered Taxpayers in Indonesia



Sources: National authorities, CEIC, AMRO staff calculations

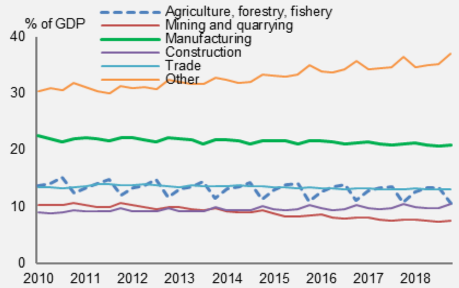
21. **Further structural reforms could support ongoing economic diversification efforts and boost growth potential.** Policy measures have been implemented to promote exports and FDI, such as expanding non-traditional markets and inviting FDIs into export-oriented manufacturing. While the automotive industry has been a key engine for manufacturing growth, it has been oriented largely towards producing for the domestic market. In our view, Indonesia should encourage the auto industry to expand its production for the exports to regional markets, such as Australia and the rest of Southeast Asia (Box B). Endowed with more than 17,000 islands and eight UNESCO World Heritage sites, Indonesia is poised to realize its tourism potential, benefiting from initiatives such as the “10 New Balis”, alongside enhanced connectivity and tourism-related infrastructure development (Annex 1). The latest (16th) Economic Package has extended tax incentives to a wider range of investment activities of higher value-add and has sought to revisit the Negative Investment List. Further streamlining investment procedures, in particular enhancement of the Online Single Submission platform, is crucial in creating a more investment-friendly regulatory environment. Besides the ongoing infrastructure development drive, the emphasis on human capital development, particularly in healthcare and education, is in the right direction. A review of the current policy on minimum wage hike is recommended to maintain labor cost competitiveness. In addition, Indonesia should adopt policies to embrace the digital technology and promote e-services such as e-commerce and ride sharing to leverage on Indonesia’s rapidly growing middle class.

registration in Vietnam. Only Singapore’s VAT registration threshold (equivalent to USD724,000) is currently higher than Indonesia.

Box B. How to Revive the Manufacturing Sector: Lesson from the Automotive Industry[49]

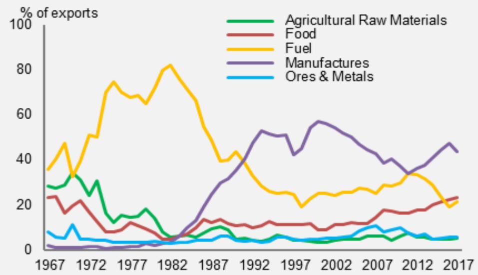
Over the past few decades, manufacturing has receded as a driver of growth in Indonesia. Its share of GDP fell from around 25-27 percent of GDP at the onset of the Asian Financial crisis in 1998 to about 21 percent today (Figure B1). The diminished role of manufacturing is more pronounced when viewed through the lens of exports: after reaching a high of 57 percent in 2000, the share of manufacturing in total exports slid to 34 percent in 2011, only to rebound to 44 percent in 2017 (Figure B2). While part of the fluctuation in manufacturing exports can be explained by cyclical factors—particularly commodity prices, which directly affect Indonesia's commodity exports such as coal, rubber and palm oil—the significance of structural factors should not to be understated. Some of these factors are external in nature, such as regional peers' success in attracting foreign investments in the textile industry, leading to relocation from Indonesia, while others are domestic, such as rigid labor policies and lack of a skilled workforce.

Figure B1. GDP by Industry



Sources: CEIC and AMRO staff calculations.

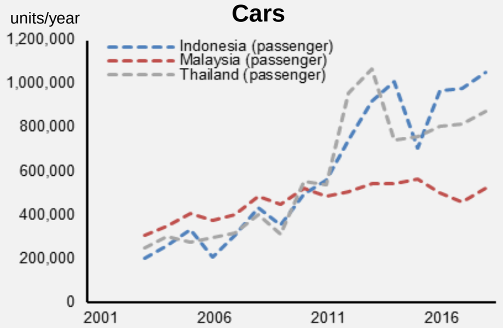
Figure B2. Export Composition



Source: CEIC, Gaikindo, and AMRO staff calculations

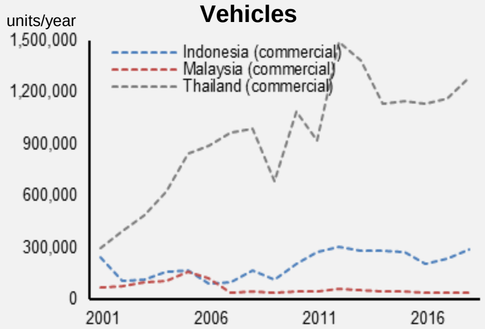
Thanks to foreign direct investment, the auto industry is widely recognized as a key engine of the country's manufacturing sector. The long-established presence of foreign car producers, mostly from Japan, has made Indonesia Southeast Asia's largest producer of passenger vehicles and second largest producer of commercial vehicles (Figures B3 & B4).[50] Multi-purpose vehicles (MPVs) are the backbone of Indonesia's passenger vehicle segment, accounting for around 94 percent of production in 2018, while sedans and sports-utility vehicles (SUVs) each represent only 3 percent of production (Figure B5). As for commercial vehicles, trucks and pickups constitute the lion's share of production, at around 58 percent and 41 percent of total commercial vehicles, respectively (the remaining is buses). In terms of exports, MPVs account for a disproportionate share of Indonesia's auto exports.

Figure B3. Regional Production of Passenger Cars



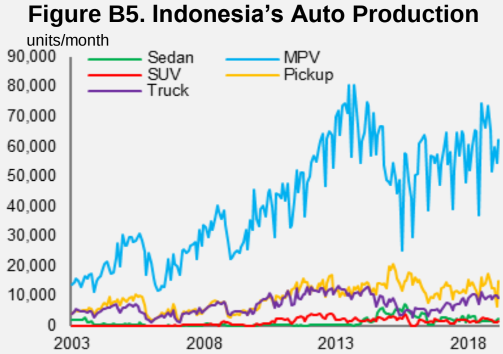
Sources: CEIC, AMRO staff calculations

Figure B4. Regional Production of Commercial Vehicles



Source: CEIC, AMRO staff calculations

Figure B5. Indonesia's Auto Production



Source: CEIC, Gaikindo, AMRO staff calculations

While the auto industry has experienced considerable growth in recent years, the country's rising middle class, enhanced road infrastructure, and wider usage for ride-hailing, point to

greater domestic demand for passenger cars going forward. With a relatively low car ownership rate (around 87 cars per 1000 persons, compared to about 230 in Thailand and 400 in Malaysia), there is ample room for growth in Indonesia's domestic car sales. In fact, car sales in Java used to account for around 80 percent of total domestic sales but have since declined to roughly 60 percent, reflecting the growing middle class and better road infrastructure across the country outside Java. The bulk of domestic car sales are MPVs, largely a result of larger-than-average family size, and tax incentives (see below). More recently, the proliferation of ride-hailing mobile apps such as Grab and home-grown Gojek, has become another key determinant of the outlook of the passenger car market.

With regard to external demand, although car exports have gained traction in recent years, further improvement in competitiveness, including a recent move to revise the luxury car tax, may help Indonesia capture a greater share of the global market.[51] While the country is relatively successful in exporting MPVs, it remains a minor exporter of sedans and SUVs. The different tax rates applicable to MPVs (10-20 percent) and sedans and SUVs (30-40 percent)[52] have stimulated domestic demand for MPVs but resulted in meagre demand for sedans and SUVs, constraining Indonesia's ability to develop adequate economies of scale to produce sedans and SUVs for exports. Going forward, however, as the luxury car tax is being revised in accordance with the volume of carbon emission, the country may be able to increase its manufacturing and exports of sedans and SUVs. As far as competitiveness is concerned, new port projects being constructed under Jokowi's infrastructure program could help lower logistic costs for the automotive industry. At present, most car exports are shipped through the Tanjung Priok port, in North Jakarta, whose capacity is already overstretched. However, another port—the Patimban port, in Subang, West Java—is under construction and expected to be finished by the end of this year. Compared to the old port, traffic between the new port and most car production sites is much less congested (despite a slightly greater distance) and the new port can potentially accommodate more shipments. Upon operation, the new port will likely lower logistics costs and enhance Indonesia's ability to compete as a regional car exporter.

Non-traditional export markets are a promising area of future growth for Indonesia's auto industry. With Australia no longer producing cars since 2017 (largely due to rising costs), Indonesia may wish to capitalize on the opportunity to supply cars to Australia, which is closer to Indonesia than to regional rivals such as Thailand. Moreover, burgeoning demand from within the ASEAN region, particularly Vietnam and the Philippines, constitutes another potential source of growth for the Indonesian auto industry going forward.[53]

Although the prospect for the domestic electric vehicle (EV) market may not be favourable at the moment, EV exports are another potential source of growth for Indonesia's auto industry in the medium to long term. While EVs are generally more environmentally-friendly and could prove cost-effective in the long run, it may be difficult for EVs to gain traction among Indonesian consumers at the current juncture. First and foremost, EVs are too expensive for the average population. Moreover, maintenance costs for EVs tend to be higher than for traditional cars.[54] In addition, the majority of residential units in Indonesia would require electricity rewiring to accommodate the increased load demanded by the charging of EVs. However, with increasing global appetite for EVs, Indonesia can leverage on the abundance of nickel ores—which are essential in EV batteries—in the country, as well as the existing manufacturing capability, to become a major producer of EVs for the global market. To that end, the authorities are already preparing fiscal incentives for EV producers and preferential tax rates for low-emission vehicles, and a number of carmakers have expressed interest in building EV production facilities in Indonesia. As in the past, Indonesia will likely benefit from foreign direct investment in EVs and battery production in its attempt to catapult the manufacturing sector, a point well recognized by their authorities, as shown by, for example, the granting of tax holiday for industries that use new technologies and embody high value added.

[49] Prepared by Jade Vichyanond

[50] According to data from Gaikindo, passenger vehicles consist of sedans, MPVs, and SUVs, while commercial vehicles comprise buses and trucks.

[51] In 2018 Indonesia produced 1.3 million cars and exported 346,000 units.

[52] These vehicle types were once considered luxury cars and are therefore subject to higher tax rates.

[53] At the beginning of 2018, Vietnam started requiring that imported cars be certified according to its own safety and environmental standards (VTA), which has the potential to negatively affect the outlook for Indonesia's car exports to Vietnam.

[54] For example, battery life for EVs is short in tropical countries such as Indonesia, at around three years, and replacement is costly.

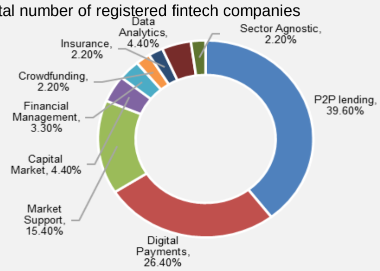
Box C. Fintech Developments in Indonesia[55]

Fintech has developed rapidly in Indonesia, fueled by the country's growing internet infrastructure and technology-savvy consumers. The number of registered fintech firms in the country rose to about 250 by 2018, led by peer-to-peer (P2P) lending platforms (39.6 percent of the total), and followed by online payment (26.4 percent) and market support (15.4 percent) (Figure C1). The size of fintech-related transactions increased rapidly from a low base to an estimated 2 percent of GDP in 2018. Fintech investment in Indonesia almost doubled in 2018, amounting to USD111.2 million. Investors are bullish on the industry's potential in Indonesia, which is supported by a large population with more than half remaining unbanked, a sharp rise in smartphone penetration, and a booming e-commerce segment.

P2P lending has been an important driver of fintech growth, although the size of loans outstanding is still relatively small. In 2018, cumulative disbursement of P2P lending increased by 567 percent from a year earlier to reach IDR22.6 trillion, equivalent to 0.4 percent of bank credit. About 40 percent of P2P lending are consumption loans, while the remaining 60 percent goes to productive sectors. As of May 2019, about 70 percent of a total of six million P2P borrowers, are young, aged from 19 to 34 years. P2P lending players have so far managed to keep their NPLs at relatively low levels with the support of big data. However, the NPL ratio has increased in recent quarters, in tandem with rapid loan disbursement (Figure C2). Purchasing insurance schemes provided by (private) insurance companies, meanwhile, could help P2P lenders offset part of the credit loss due to borrower defaults.

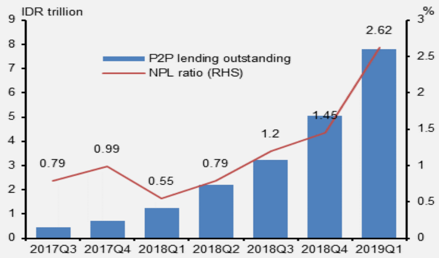
Figure C1. Types of Fintech Companies

% of total number of registered fintech companies



Source: Indonesia Fintech Association (AFTECH)

Figure C2. P2P Lending Outstanding and NPL



Source: OJK

Fintech can play an important role in both financial inclusion, as well as financial deepening. The traditional banking system faces a major challenge in reaching out to customers in remote areas due to the prohibitive cost of expanding its branch network outside the big cities. With the development of fintech, the unbanked population in remote areas can now open bank accounts and conduct online payments and money transfers through e-payment companies using their mobile networks. For individuals and SMEs previously excluded from bank loan access, P2P companies can provide them with a funding avenue as they have means to assess borrowers' credit risk. Fintech firms can also play an active role in supporting the growth of retail financial market, such as retail government bonds. Meanwhile, traditional financial institutions have sought to form partnership with fintech players to find innovative ways to engage customers.

The evolving regulatory framework has been generally supportive of the development of fintech companies, while maintaining close supervision of the industry at the same time. The authorities have adopted initiatives to prop up the fintech sector, including setting up a fintech office under BI, launching a national payment gateway including e-payments, and establishing a fintech regulatory sandbox. On the other hand, to contain risks emanating from fintech, the authorities have issued regulations on P2P lending, equity crowdfunding, and fintech innovation. OJK has regulated P2P lending platforms as licensed financial institutions. As of August 2019, there were 127 registered P2P companies, while about 41 companies were waiting OJK approval. The Indonesia Fintech Association (AFTECH) and the more recently-established Indonesian Fintech Lenders Association (AFPI and AFSI) have also played an active role in monitoring their members' daily operations.

To ensure sustainable fintech development, it is recommended the authorities maintain prudent supervision to mitigate potential risks. Incentives should be provided to channel funds to productive SMEs and individuals. As P2P interest rates are relatively high, it is important for the authorities to ensure that the fintech companies are well regulated and abiding by the relevant customer protection or investor protection rules and regulations in order to protect SMEs and low-income earners from scams, over-indebtedness and financial distress.

[55] Prepared by Dan Lu

22. **Financial deepening is necessary to mobilize funds for financing infrastructure development and to strengthen resilience against shocks related to capital outflows.** In contrast to regional peers where pension funds have played a significant role as investors in the bond market, the pension fund system in Indonesia remains small and fragmented. This is despite the establishment of the BPJS Ketenagakerjaan in 2015 to manage mandatory provident funds and pension funds for employees in the formal sector[56] (Appendix 7). In this regard, AMRO welcomes the initiative to step up pension fund reforms with a view to expanding coverage, raising contribution rates for mandatory pension funds, and prohibiting early withdrawal from provident funds. While tax incentives have been offered to selected groups of investors, a comprehensive review of the current system of (tax) incentives may be warranted to support the development of long-term institutional investors on a broader basis (Box A). Fintech services, especially e-payment platforms and peer-to-peer (P2P) lending, have grown rapidly in recent years, fueled by improved internet infrastructure and technology-savvy consumers (Box C). In light of a relatively low ratio of adults having bank accounts in Indonesia, fintech developments promise to promote both financial inclusion and deepening, such as the inclusion of fintech firms in the network of agents distributing government retail bonds. We welcome the authorities' promotion and support for the development of fintech which has the potential to expand the reach of financial services to the whole population and improve the access by SMEs and lower income households to financing at more affordable rates. Going forward, it is important to continue developing the ecosystem and synergy between fintech startups and conventional financial institutions, particularly banks.

Authorities' Views

23. The authorities welcomed AMRO's balanced and fair assessment on the economy of Indonesia. During the policy discussion session, the authorities also shared their insights on recent macroeconomic developments, risks and vulnerabilities, and the policy mix response to maintain stability and support growth amidst external headwinds. BI is committed to continue optimizing the policy mix of monetary policy, financial market deepening, macroprudential, payment systems and sharia financial economic policies, as well as to strengthen coordination with the OJK and other government agencies in maintaining economic stability and external resilience, including controlling the current account deficit (Box D). On the fiscal front, the authorities reiterated that tax reforms have been prioritized and ongoing, with one of the priorities being strengthening the capacity and size of human resources in general, not limited to the newly-established Data Management Unit (DMU) under DG Tax. From the budget expenditure perspective, the reform agenda consists of four key areas, namely energy subsidy reform, budget reallocation towards productive spending, budget value for money, and performance-based fiscal transfers. The authorities also highlighted a number of ongoing efforts to deepen the domestic financial market, and encourage public involvement in infrastructure financing, which include, among others, tax incentives in the form of a

[56] Excluding funds contributed for those working in government agencies, the military, and the arm force, which are still managed by several SOEs.

reduction in Income Tax (PPh) on interest on bonds and/or discounts for investment in the infrastructure sector.[57]

24. To boost tourism as an economic growth driver and a source of foreign exchange supplies, the government has prioritized to develop four destinations (Lake Toba, Borobudur, Mandalika, and Labuan Bajo) among the 10 targeted to become new Balis in 2020 under the concerted efforts from various ministerial authorities.[58] The development of these priority destinations has been included in the strategic policy and given a special allocation in the 2020 State Budget Plan.[59] The long-term vision for boosting tourism would include (i) spatial control arrangements; (ii) improvement of access to connectivity to tourist destinations; (iii) improvement of facilities available at tourist sites; (iv) improving the capacity of human resources[60]; (v) encouraging the local specialty product markets for boosting the local economy and introducing the native culture to the tourists; and (vi) massive promotion for attracting tourists to visit Indonesia's tourist destinations.

25. The authorities also shared their determination to achieve higher growth rates with continued push on infrastructure investment, structural reforms, and supportive policies going forward. The policy mix will continue to be recalibrated to support a shift in growth drivers, (i) from the national level to regional level developments beyond the island of Java, (ii) from extractive/resource industries to export-oriented manufacturing sectors, tourism, and the new digital economy, and (iii) from physical infrastructure to human capital development. Against these backdrops, the authorities were confident of improving total factor productivity, and raising potential growth from the current range of 5.2-5.3 percent to 6-7 percent in the longer-run.

[57] Government Regulation (PP) Number 55 in 2019 concerning Second Amendment Government Regulation Number 16 of 2009 concerning Income Taxes on Income in the Form of Interest on Bonds. This provision only extends to interest and/or discounts received by taxpayers (WP) mutual funds, infrastructure investment funds in the form of collective investment contracts (KIK DINFRA), real estate investment funds in the form of collective investment contracts (KIK DIRE), and asset-backed securities in the form of collective investment contracts (KIK EBA) that are registered or recorded on Financial Services Authority (OJK).

[58] Which are the Ministry of Tourism, Ministry of Public Works & Housing, Ministry of Transportation, Ministry of Environment and Forestry, Ministry of Village, Disadvantaged Regions Development and Transmigration, Ministry of Education and Culture, and the Creative Economy Agency.

[59] The government has allocated a budget of 6.4 trillion Rupiah in 2020 for the construction of priority destination infrastructure. The infrastructure that must be fulfilled are adequate road access, airports, port repairs, availability of water and electricity, and internet networks. Construction of basic utilities is expected to be completed in 2020 so further developments can be carried out immediately.

[60] Local governments need to develop sufficient capacity to handle the affairs of street vendors and hotel entrepreneurs and provide tourism management training for ship owners and/or cruise operators.

Box D. BI's Policy Mix in 2018-2019*

BI optimized the policy mix of monetary policy, financial market deepening, macroprudential measures, payment systems and sharia finance policies to maintain stability and sustain economic growth in 2018. In this regard, monetary policy was pursued pre-emptively, front loading, and ahead of the curve to preserve economic stability. The direction of monetary policy was supported by the operational strategy to maintain adequate liquidity on the money market and banking system. BI also strengthened the cooperation with other authorities and international institutions to improve external resilience. The exchange rate policy was conducted to ensure the alignment of the rupiah with its fundamental value while maintaining market mechanism. BI also continued to conduct policy measures to deepen the financial market to enhance its role in supporting sustainable growth.

The macroprudential policy was directed at sustaining growth momentum while maintaining financial system stability. In light of this, BI had instituted accommodative macroprudential measures by holding the countercyclical capital buffer (CCB) at zero percent, the Macroprudential Liquidity Buffer (MPLB) at 4 percent with flexible repos at 4 percent and the Macroprudential Intermediation Ratio (MIR) in the 84-94 percent range. These measures were aimed to ensure adequate liquidity in the banking system and to support the property market. Payment system policies were also conducted towards supporting economic activity through increased smoothness, security and efficiency of payment transactions. Meanwhile, Islamic financial economic policy encourages the development of Islamic financial economy to optimize its potential as a source of new economic growth.

Coordination between BI and government agencies, OJK, and other relevant authorities was strengthened to maintain economic stability and external resilience, including controlling the current account deficit. Coordination was also carried out to accelerate financial market deepening to improve the effectiveness of policy transmission and expand economic financing alternatives. In addition, BI has actively involved in the Inflation Control Team at the national level and at the regional level. Lastly, policies to support the development of the Islamic economy and finance have been implemented, as part of BI's policy mix, and through coordination with the National Sharia Finance Committee.

In 2019, BI has adopted a more accommodative monetary policy by lowering its policy rate. BI lowered its policy rate twice in July and August 2019, by a total of 50 basis points.[61] This policy has been conducted in line with continued low inflation forecasts and the need to boost economic growth momentum, amid global financial market uncertainty and controlled external stability. This complements BI policy to maintain adequate liquidity including by (i) increasing the portion of the Reserve Requirement Averaging from 1 percent to 2 percent and further increase to 3 percent in 2018 and (ii) reducing the Reserve Requirement by a total of 100 bps in 2018-2019. Macroprudential policies also remains accommodative to encourage bank lending and expand financing in the economy. To stimulate domestic demand, BI also expanded its accommodative policy stance, including: (i) enhancing retail payment efficiency by expanding National Clearing System (SKNBI) services; (ii) implementing market operator regulation in the money market and foreign exchange market; (iii) developing the Commercial Papers (SBK) market as an alternative source of short-term funding for the corporate sector; (iv) expanding electronification of the noncash social aid program (social assistance), village fund programs, transportation sector and fiscal operations; and (v) launching QR Code Indonesian Standard (QRIS) to enhance transaction efficiency, accelerate financial inclusion and advance MSMEs. In BI's view, there is still room for accommodative monetary policy in line with low inflation forecasts and the need to stimulate further economic growth momentum going forward. BI is also committed to strengthening coordination with the Government and related authorities to maintain economic stability, encourage domestic demand, and increase exports, tourism, and foreign capital inflows, including Foreign Direct Investment.

*/ Provided by Bank Indonesia

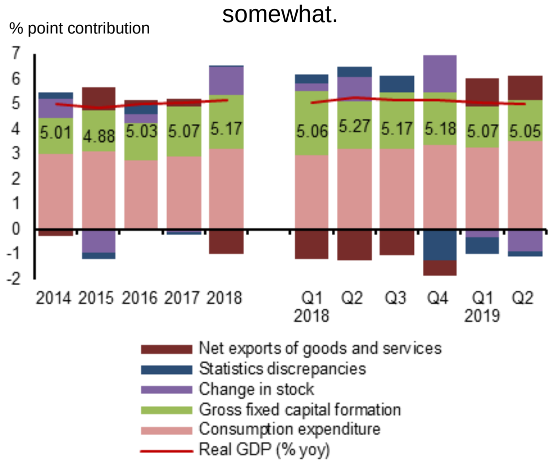
[61] BI cut the policy rate further in September 2019 by another 25 basis points to 5.25 percent.

Appendices

Appendix 1. Selected Figures for Major Economic Indicators

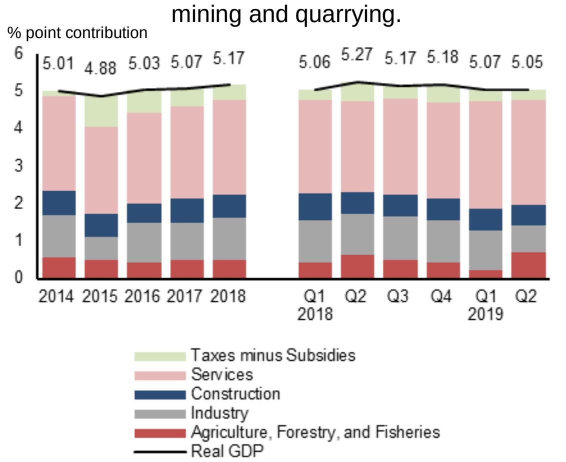
Figure 1.1. Real Sector

Real GDP growth dipped but remained solid at 5.1 percent in H1 2019, supported by resilient consumption as investment growth eased somewhat.



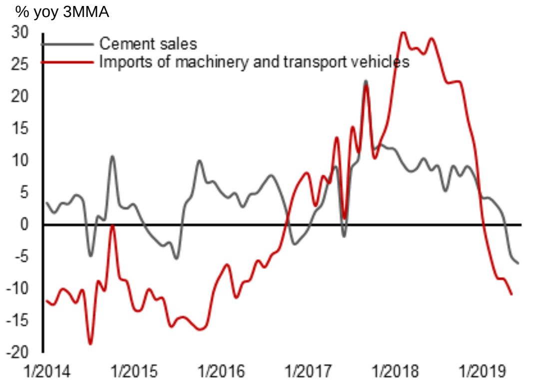
Source: Statistics Indonesia (BPS)

Growth was supported by a rebounding agricultural sector, and solid construction and services, although industrial output fell, driven by a contraction in mining and quarrying.



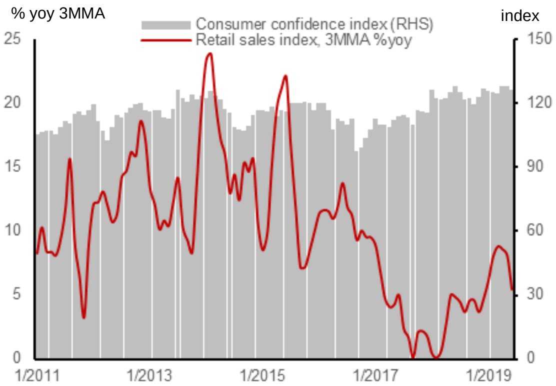
Source: BPS

A “wait-and-watch” approach adopted by investors prior to the April election is believed to have caused some easing in investment ...



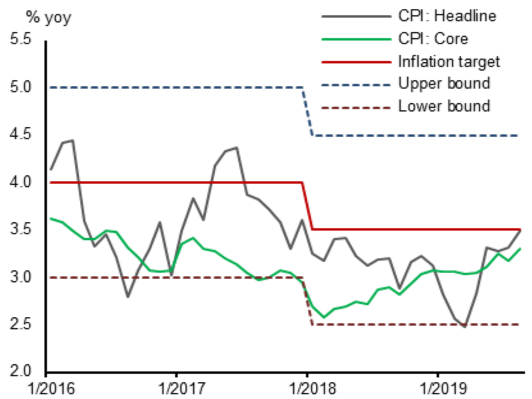
Sources: Bank Indonesia, BPS

… but household consumption held up.



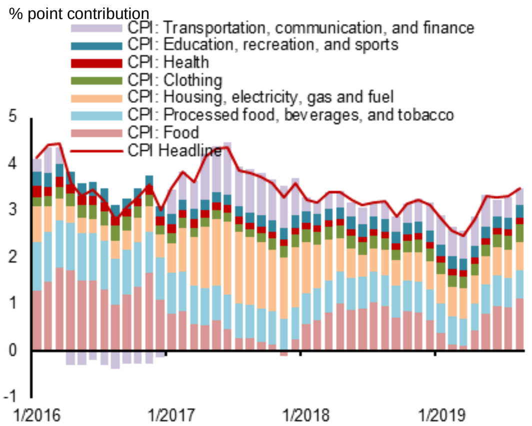
Source: Bank Indonesia, BPS

Inflation rebounded in recent months, but remained well anchored within BI’s target range.



Source: BPS

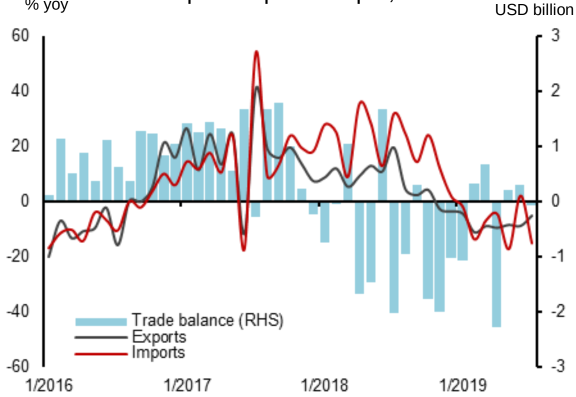
The recent pick-up in headline CPI was driven by higher food prices around the Ramadan month.



Sources: Bank Indonesia, BPS

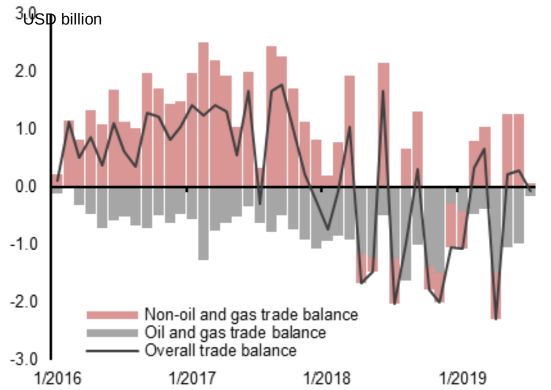
Figure 1.2. Merchandise Trade

Trade balance generally improved in early 2019, despite a spike in April,…



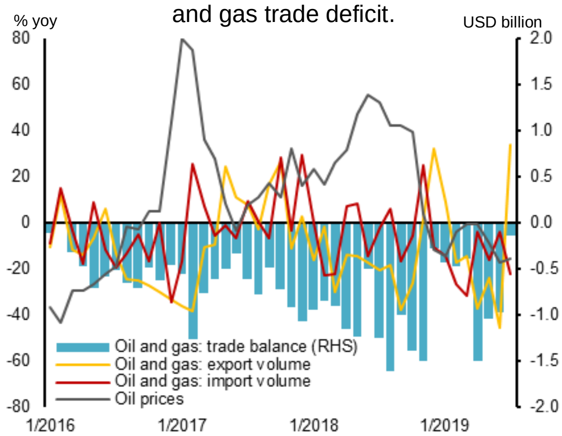
Sources: BPS, AMRO staff calculations

… driven by an improvement in non-oil and gas trade balance…



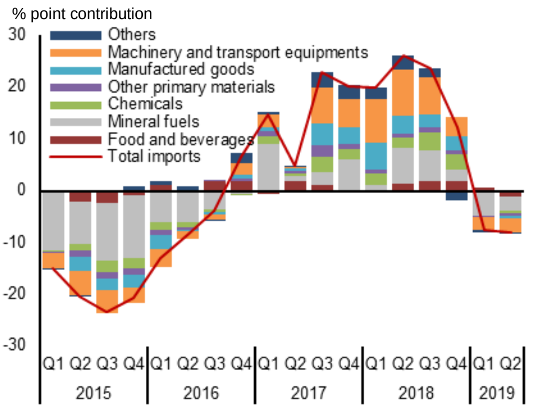
Sources: BPS, AMRO staff calculations

…while weaker oil exports coupled with rebounding oil prices and import volume continued to sustain oil and gas trade deficit.



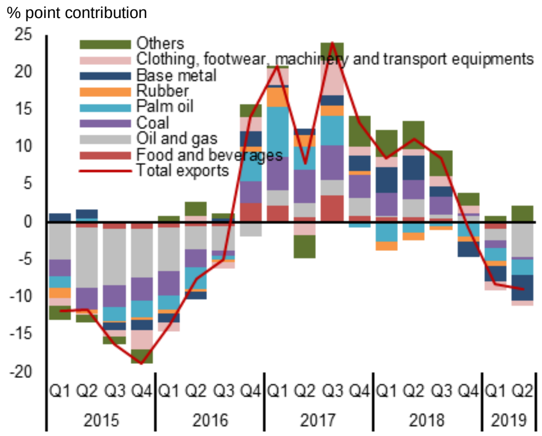
Sources: BPS, AMRO staff calculations

Import growth contracted in H1, due to lower oil and gas imports, as well as machinery and transport equipment.



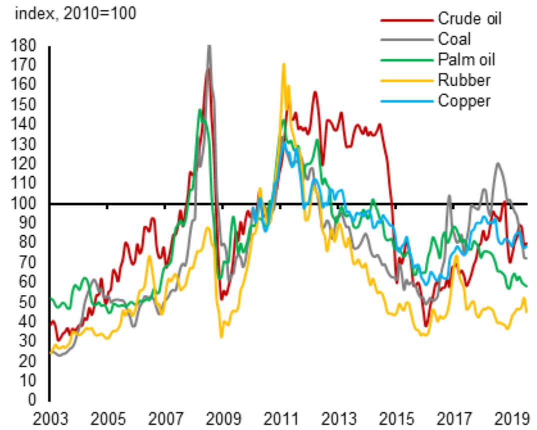
Sources: BPS, AMRO staff calculations

Exports, meanwhile, contracted on a broad basis, across Indonesia's key commodity exports…



Sources: BPS, AMRO staff calculations

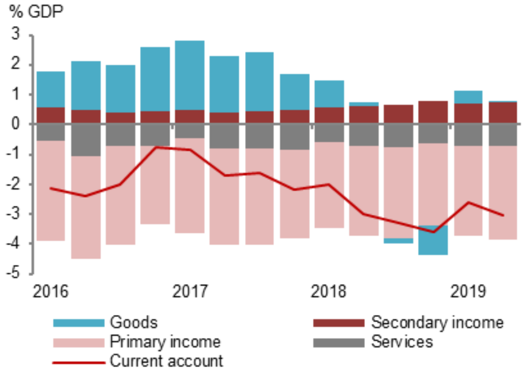
…driven mainly by a downturn in commodity prices and lower demand from several major importers.



Sources: CEIC, AMRO staff calculations

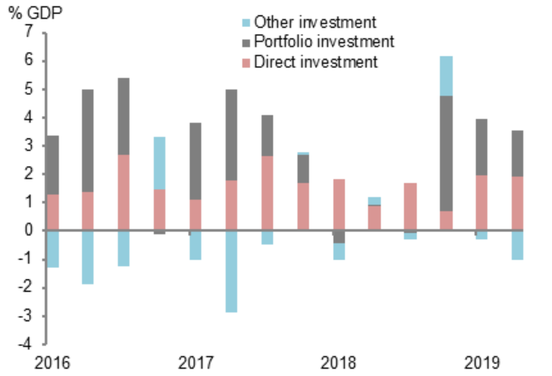
Figure 1.3. External Sector

The current account deficit, which initially narrowed to 2.6 percent of GDP in Q1 2019, widened somewhat in Q2, led by a deteriorating trade balance.



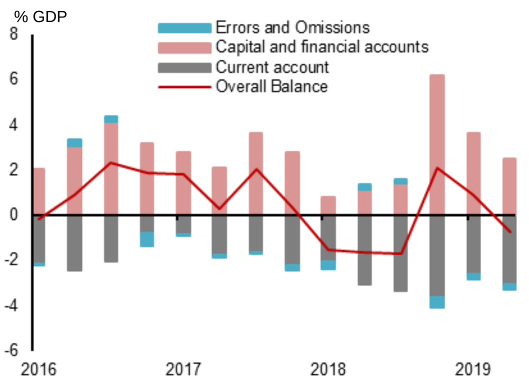
Sources: BPS, AMRO staff calculations

Meanwhile, capital inflows continued, driven by FDI and portfolio investment…



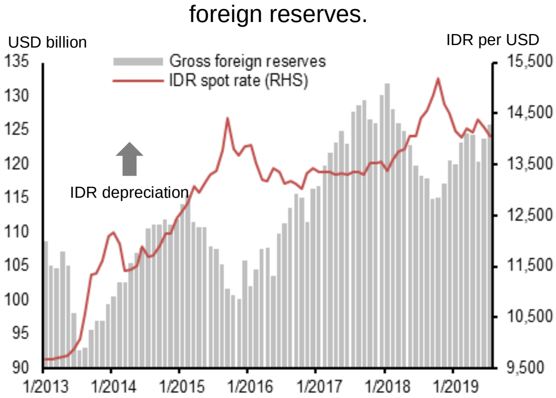
Sources: Bank Indonesia, AMRO staff calculations

… continuing to finance the current account deficit.



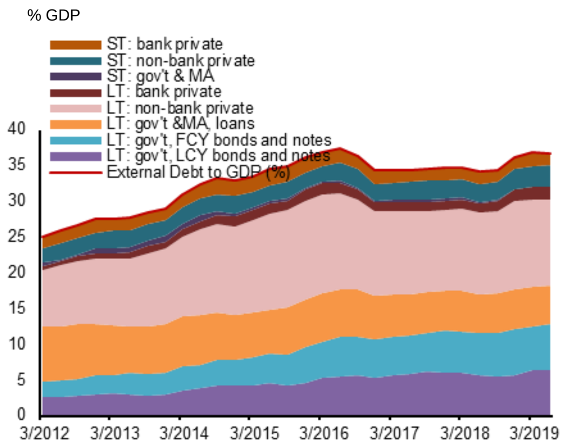
Sources: Bank Indonesia, AMRO staff calculations

… and contributing to an accumulation in gross foreign reserves.



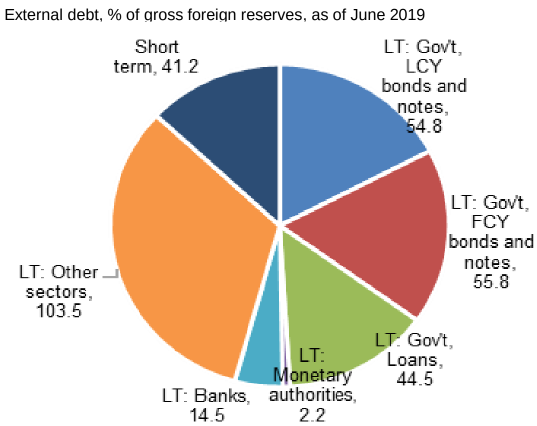
Sources: Bank Indonesia, CEIC, and AMRO staff calculations

Gross external debt, having increased since 2018, stabilized at around to 36.8 percent of GDP in Q2 2019.



Sources: Bank Indonesia, AMRO staff calculations

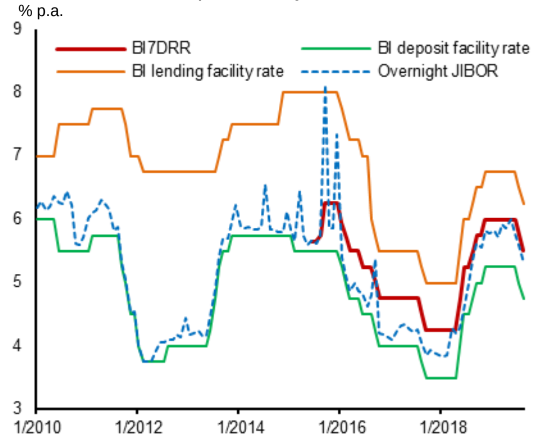
Short-term external debt rose to about 5.1 percent of GDP, equivalent to about 43.3 percent of gross reserves.



Sources: Bank Indonesia, AMRO staff calculations

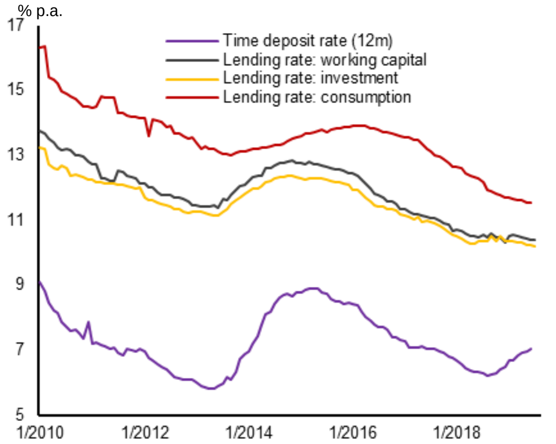
Figure 1.4. Monetary and Banking Sector

BI's 7DRR rate was lowered by 75bps in July-September, after being put on hold earlier in 2019, following six hikes of a total of 175 bps in the previous year.



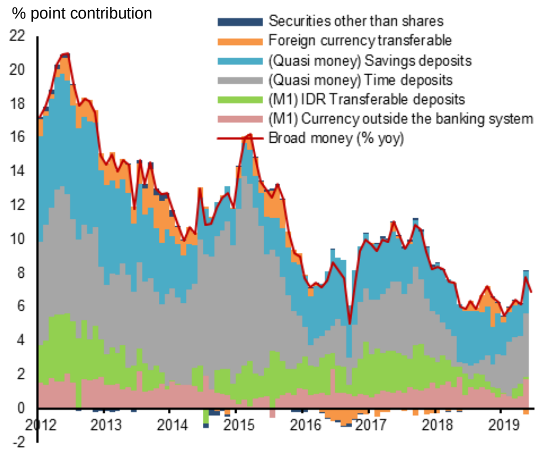
Sources: Bank Indonesia, AMRO staff calculations

Lending rates continued to trend downward, despite a pick-up in deposit rates …



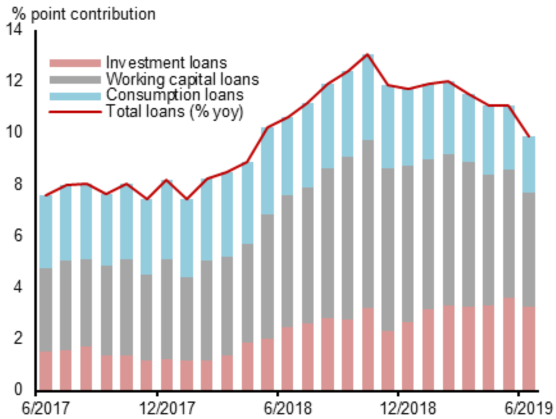
Sources: Bank Indonesia, AMRO staff calculations

… in light of tighter liquidity conditions.



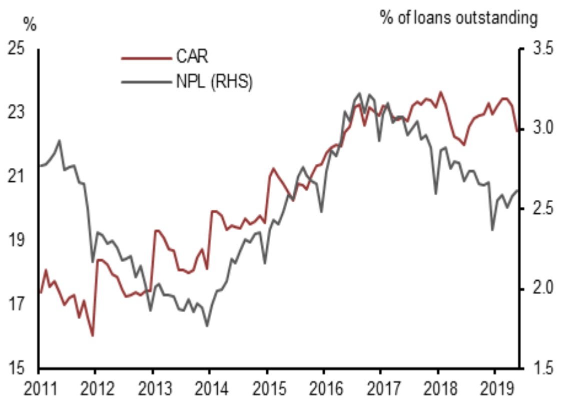
Sources: Bank Indonesia, OJK, AMRO staff calculations

Credit growth slowed in recent months as consumption loans eased.



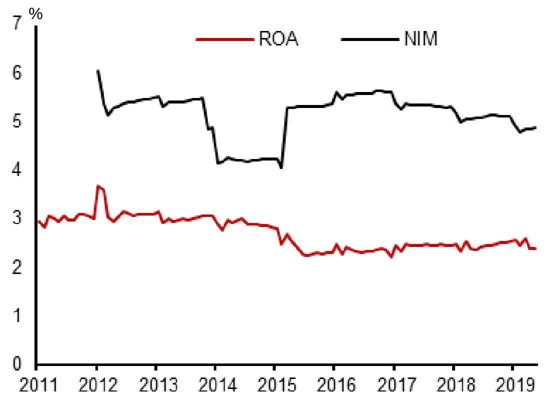
Sources: Bank Indonesia, OJK, AMRO staff calculations

Banks remain sound with elevated CAR and relatively stable NPL, ...



Sources: OJK, AMRO staff calculations

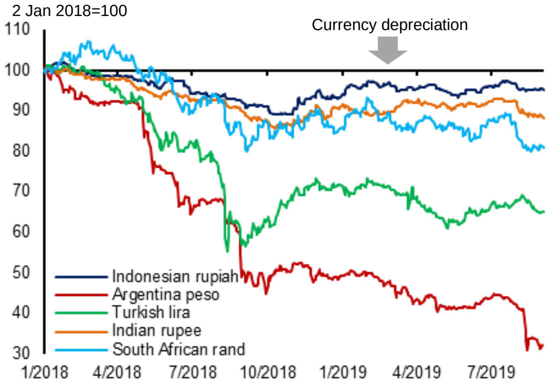
... while ROA held up amid a moderation in net interest margins.



Sources: OJK, AMRO staff calculations

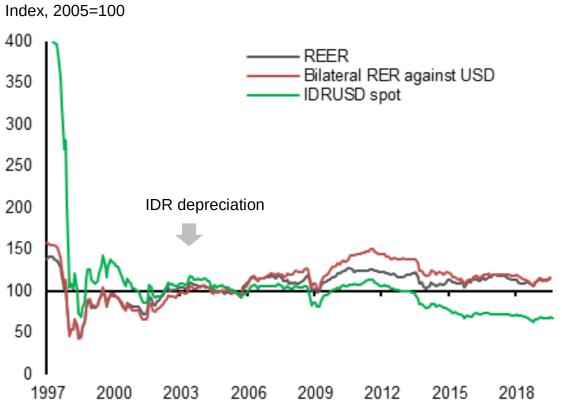
Figure 1.5. Forex and Financial Markets

The rupiah, having rebounded since October 2018, depreciated in recent months as investors' risk aversion sentiments returned on trade tension re-escalation…



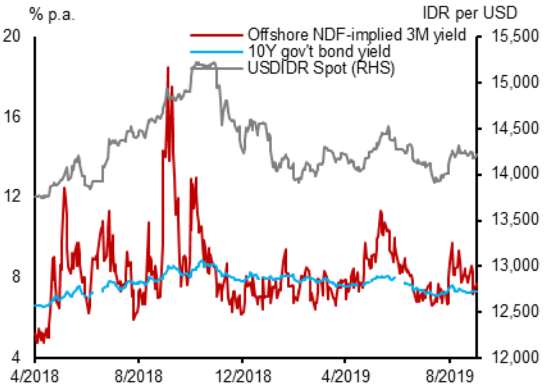
Sources: Thomson Reuters Datastream, AMRO staff calculations

… but still appreciated in real terms.



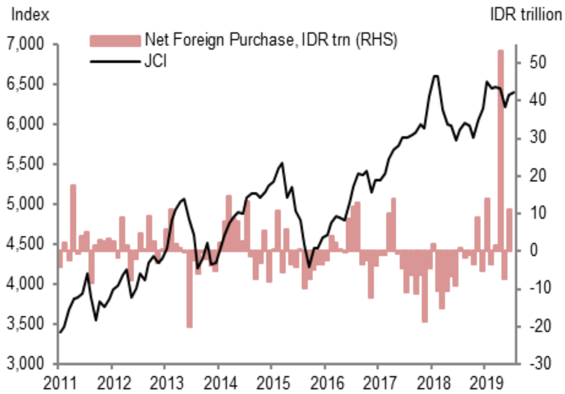
Sources: BIS, CEIC, AMRO staff calculations

Offshore rupiah hedging costs, having spiked in May, moderated on a generally easing financing condition globally …



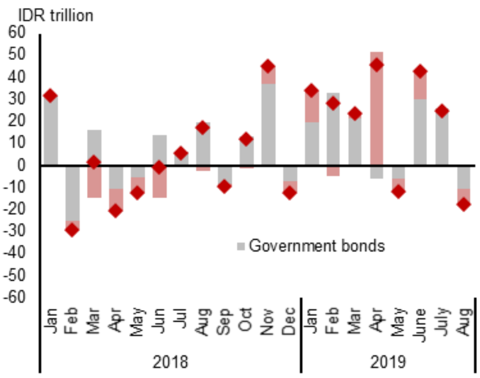
Sources: Thomson Reuters Datastream, AMRO staff calculations

… leading to resumed net capital inflows in the equity market



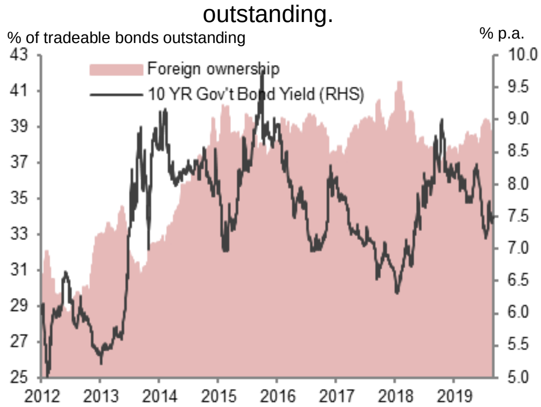
Sources: Jakarta Stock Exchange, CEIC, AMRO staff calculations

… and government bond market.



Note: Monthly data are up to week ending 8 March 2019.
Sources: Jakarta Stock Exchange, Ministry of Finance, AMRO staff calculations

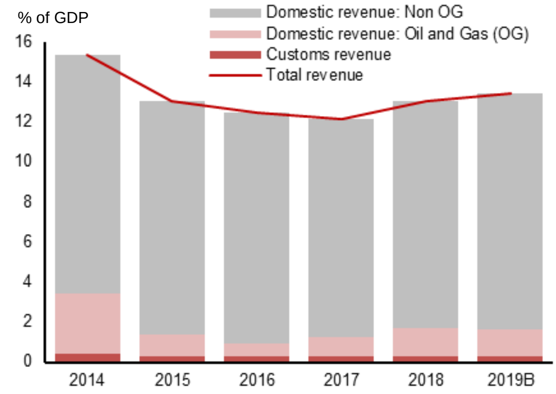
10-year government bond yields, having also spiked in May, have moderated recently alongside an increase in foreign holding of government bonds outstanding.



Sources: Ministry of Finance and Bond Pricing Agency

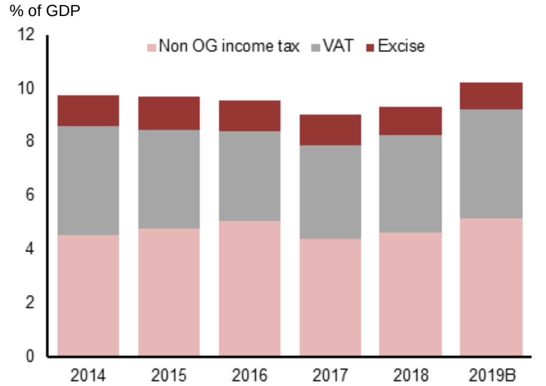
Figure 1.6. Fiscal Sector

Budget revenue improved in 2018 ...



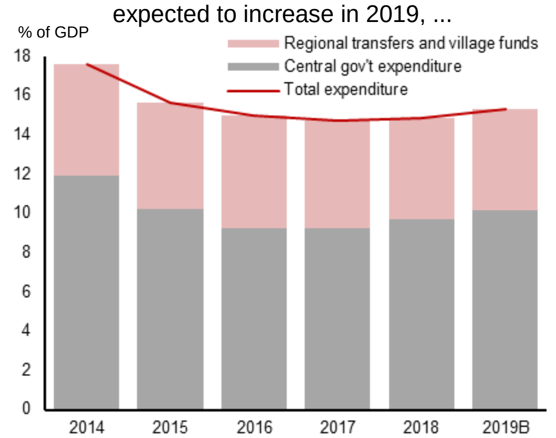
Note: 2018 and 2019 data are from the authorities' budget
Sources: Ministry of Finance and AMRO staff calculations

… driven by a broad-based expansion in major tax items.



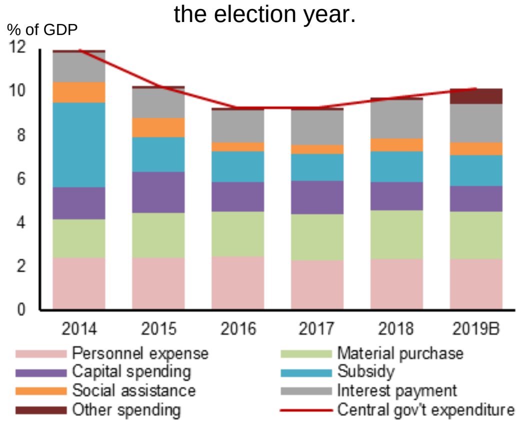
Note: 2018 and 2019 data are from the authorities' budget
Sources: Ministry of Finance and AMRO staff calculations

Budget expenditure, having stabilized in 2018, is expected to increase in 2019, ...



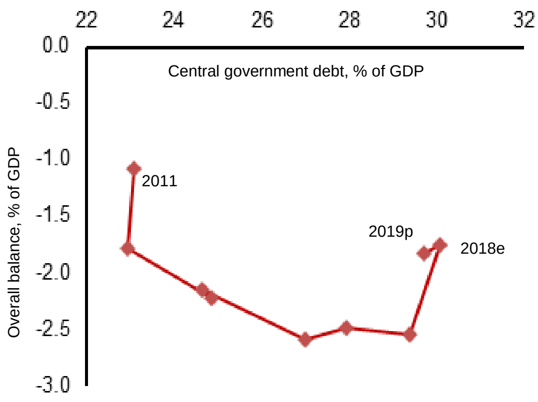
Note: 2018 and 2019 data are from the authorities' budget.
Sources: Ministry of Finance and AMRO staff calculations

… pushed up partly by a ramp-up in spending in the election year.



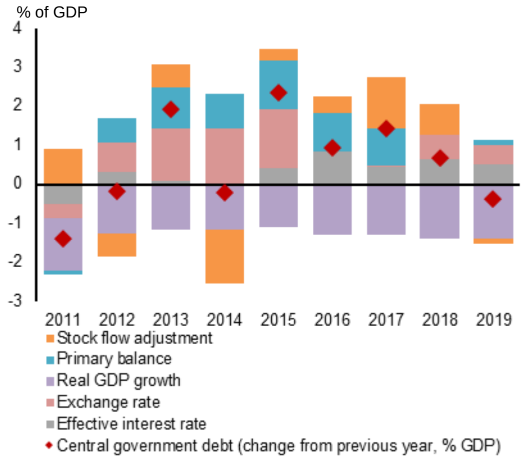
Note: 2018 data are from the authorities' budget outlook as of August 2018, 2019 data are from the 2019 Budget.
Sources: Ministry of Finance and AMRO staff calculations

Central government debt is expected to remain contained at below 30 percent of GDP …



Note: 2018 data are AMRO staff projections
Sources: Ministry of Finance and AMRO staff calculations

… supported by recent fiscal consolidation efforts.



Note: 2018 data are AMRO staff projections
Sources: Ministry of Finance and AMRO staff calculations

Appendix 2. Selected Economic Indicators for Indonesia

	2015	2016	2017	2018	Projections	
					2019	2020
Real GDP (percent change yoy)	4.9	5.0	5.1	5.2	5.1	5.1
Household consumption	5.0	5.0	4.9	5.0	5.0	5.1
Government consumption	5.3	-0.1	2.1	4.8	6.4	5.1
Gross fixed capital formation	5.0	4.5	6.2	6.7	6.4	6.5
Exports	-2.1	-1.7	8.9	6.5	3.2	6.3
Imports	-6.2	-2.4	8.1	12.0	2.8	8.6
Balance of payments (percent of GDP)						
Current account balance	-2.0	-1.8	-1.7	-3.0	-2.7	-2.4
Trade balance	1.6	1.6	1.9	0.0	0.2	0.7
Oil and gas	-0.5	-0.5	-0.7	-1.1	-0.8	-0.7
Non-oil and gas	2.2	2.2	2.6	1.0	1.0	1.5
Financial account balance	2.0	3.1	2.8	2.4	3.0	2.9
Foreign direct investment (net)	1.2	1.7	1.8	1.3	1.6	1.7
Portfolio investment (net)	1.9	2.0	2.1	0.9	1.4	1.2
Other investment (net)	-1.2	-0.6	-1.1	0.2	-0.1	0.1
Overall balance	-0.1	1.3	1.1	-0.7	0.2	0.6
Central government (percent of GDP)						
Revenue and grant	13.1	12.5	12.3	13.1	13.1	13.3
Expenditure	15.6	15.0	14.7	14.9	15.0	15.1
Budget balance	-2.6	-2.5	-2.5	-1.8	-1.9	-1.8
Money and credit (percent change yoy)						
Broad money	9.0	10.0	8.3	6.3	8.5	7.9
Private sector credit	8.9	9.3	7.7	12.6	11.2	10.3
Memorandum Items:						
Headline inflation (yoy, end of period)	3.4	3.0	3.6	3.1	3.5	3.5
Headline inflation (yoy, period average)	6.4	3.5	3.8	3.2	3.3	3.3
BI Policy Rate	7.50	4.75	4.25	6.00	-	-
Exchange rate (rupiah/USD, period average)	13,392	13,305	13,385	14,246	14,522	14,812
Gross foreign reserves (USD bn)	105.9	116.4	130.2	120.7	123.3	129.9
Nominal GDP (USD bn)	861	932	1,015	1,042	1,118	1,199
Nominal GDP (IDR trn)	11,526	12,402	13,587	14,837	16,232	17,760

Note: */ Data for 2019-2020 are AMRO staff projections, BI policy rate is end of period.
Source: National Authorities, AMRO Staff Calculations

Appendix 3. Balance of Payments

in % of GDP, unless otherwise indicated	2014	2015	2016	2017	2018
Current Account	**-3.1**	**-2.0**	**-1.8**	**-1.6**	**-3.0**
Goods	0.8	1.6	1.6	1.9	0.0
Oil-and-gas balance	-1.3	-0.7	-0.5	-0.7	-1.1
Non-oil-and-gas balance	2.1	2.4	2.2	2.7	1.3
Exports	19.7	17.3	15.5	16.6	17.3
Oil	1.5	0.9	0.7	0.7	0.8
Gas	1.7	1.1	0.7	0.8	0.9
Non-oil & gas	16.3	15.2	14.0	14.9	15.5
Imports	18.9	15.7	13.9	14.8	17.2
Oil	4.2	2.4	1.7	2.0	2.5
Gas	0.3	0.2	0.2	0.3	0.3
Non-oil & gas	14.3	13.0	11.9	12.4	14.4
Services	-1.1	-1.0	-0.8	-0.7	-0.7
Primary Income	-3.3	-3.3	-3.2	-3.2	-2.9
Secondary Income	0.6	0.6	0.5	0.4	0.7
Financial Account	**5.0**	**2.0**	**3.1**	**2.8**	**2.4**
Direct Investment, net	1.7	1.2	1.7	1.8	1.3
Portfolio Investment, net	2.9	1.9	2.0	2.1	0.9
Other Investment, net	0.5	-1.2	-0.6	-1.1	0.2
Net Error & Omissions	**-0.2**	**-0.1**	**0.0**	**-0.1**	**-0.1**
Overall Balance	**1.7**	**-0.1**	**1.3**	**1.1**	**-0.7**
Memorandum items:					
International reserves (USD bn)	111.9	105.9	116.4	130.2	120.7
External debt	32.9	36.1	34.3	34.7	36.2
Exchange rate (rupiah/USD)	11,876	13,392	13,305	13,385	14,246
Nominal GDP (USD bn)	891	861	932	1,015	1,042

Source: National authorities, AMRO Staff Calculations

Appendix 4. Central Government Budget

(Data in IDR trillion, unless otherwise indicated)

Items	2016	2017	2018	2019	Changes (%)			H1'19 realization		
					2017	2018	2019B	IDR	% yoy	% of
	Act	Act	Act	Budget	f/r 2016	f/r 2017	f/r 2018	trillion		2019B
A. Total Revenue and Grants	**1,555.9**	**1,666.4**	**1,943.7**	**2,165.1**	**7.1**	**16.6**	**11.4**	**898.7**	**7.8**	**41.5**
I. Domestic Revenue	1,546.9	1,654.7	1,618.1	2,164.7	7.0	-2.2	33.8	898.0	8.2	41.5
1. Taxes Revenue	1,285.0	1,343.5	1,518.8	1,786.4	4.6	13.0	17.6	688.9	5.4	38.6
a. Domestic taxes	1,249.5	1,304.3	1,472.9	1,743.1	4.4	12.9	18.3	670.0	5.9	38.4
i.Income Taxes	666.2	646.8	750.0	894.4	-2.9	16.0	19.3	376.3	4.7	42.1
- Oil and Gas	36.1	50.3	38.1	66.2	39.3	-24.3	73.6	30.2	0.3	45.6
- Non-Oil and Gas	630.1	596.5	817.0	828.3	-5.3	37.0	1.4	346.2	5.1	41.8
ii.VAT	412.2	480.7	537.3	655.3	16.6	11.8	22.0	212.3	-2.7	32.4
iv.Excise	143.5	153.3	159.6	165.5	6.8	4.1	3.7	66.7	30.9	40.3
b. International Taxes	35.5	39.2	45.9	43.3	10.4	17.1	-5.6	18.9	-10.0	43.6
i.Import Duties	32.5	35.1	39.1	38.9	8.0	11.4	-0.5	17.3	-2.5	44.4
ii.Export Tax	3.0	4.1	6.8	4.4	36.7	65.9	-35.0	1.6	-50.3	36.9
2. Non tax Revenue	262.0	311.2	409.3	378.3	18.8	31.5	-7.6	209.1	18.2	55.3
a. Natural resources	64.9	111.1	180.6	190.8	71.2	62.6	5.6	70.7	-5.8	37.1
i. Oil and Gas	44.1	81.8	142.8	159.7	85.5	74.6	11.8	54.6	-7.1	34.2
ii. Non Oil and Gas	20.8	29.3	37.8	31.1	40.9	29.0	-17.8	16.2	-1.2	52.2
b. Others	197.1	200.1	228.7	187.5	1.5	14.3	-18.0	138.4	36.0	73.8
II. Grants	9.0	11.6	15.6	0.4	28.9	34.5	-97.4	0.7	-76.5	168.7
B. Government Expenditures	**1,864.3**	**2,007.4**	**2,213.1**	**2,461.1**	**7.7**	**10.2**	**11.2**	**1,034.5**	**4.1**	**42.0**
1. Central Government	1,154.0	1,265.4	1,455.3	1,634.3	9.7	15.0	12.3	630.6	12.9	38.6
a. Personnel	305.1	312.7	346.9	381.6	2.5	10.9	10.0	198.3	16.0	52.0
b. Materials	259.6	291.5	347.5	345.2	12.3	19.2	-0.7	119.3	12.2	34.6
c. Capital	169.5	208.7	184.1	189.3	23.1	-11.8	2.8	34.7	-14.9	18.3
d. Interest Payment	167.8	216.6	258.0	275.9	29.1	19.1	6.9	134.8	11.7	48.9
e.Subsidies	174.2	166.4	216.9	224.3	-4.5	30.3	3.4	71.9	-2.8	32.0
Energy	43.7	97.6	153.5	160.0	123.4	57.3	4.2	56.2	-5.6	35.1
Non Energy	67.4	68.7	63.4	64.3	1.9	-7.7	1.5	15.7	8.7	24.4
f. Grants spending	7.1	5.4	1.5	1.9	-23.9	-72.2	29.4	0.0	-81.9	0.2
g. Social	49.6	55.3	84.3	102.1	11.5	52.4	21.1	70.5	56.4	69.1
h. Other Spendings	6.0	8.8	16.2	114.0	46.7	84.1	603.7	1.1	45.0	1.0
2. Transfer to Region & Village Funds	710.3	742.0	757.8	826.8	4.5	2.1	9.1	403.9	4.8	48.9
a. Transfer to Regions	663.6	682.2	697.9	756.8	2.8	2.3	8.4	362.1	3.5	47.8
b. Village Fund	46.7	59.8	59.9	70.0	28.0	0.2	16.9	41.8	16.7	59.8
D.Overal Balance	**-308.3**	**-345.8**	**-269.4**	**-296.0**				**-135.8**		
% of GDP	*-2.5*	*-2.5*	*-1.8*	*-1.8*				*-0.8*		

Source: Ministry of Finance

Appendix 5. Summary and Progress of Selected Priority PSN Infrastructure Projects

Project	Description and Progress	Expected Operation	Estimated Investment Value	Funding Scheme/ Financing
Central Java Power Plant	• Largest PPP electricity project by capacity in Asia (coal fired plant to provide whole of Java with 2 x 1000 MW capacity) • Also the largest project with PPP scheme • Construction phase was delayed for two years due to land acquisition, environmental assessment and disputes with local landowners • Construction reached 63% in December 2018 and to be completed by 2019	Phase 1: 2019 Phase 2: Q1 2020	USD4.2 billion	Scheme: Public-Private Partnership (PPP) Source of funding: Multiple infrastructure and foreign banks[62] Investors: Consortium consisting J-Power, Adaro Power, Itochu Corporation Concession period: 25 years Project owner: Ministry of Energy and Mineral Resources/ PLN This project is guaranteed by the Indonesia Infrastructure Guarantee Fund (IIGF) and the Central government on political and force majeure[63] risks.
Soekarno–Hatta International Airport (SHIA) Express Railway	• Express railway (36km) to reduce traveling time from Central Jakarta to SHIA to 30 minutes • The project suffered long setbacks due to land acquisition issues and frequent plan changes • However, the railway between SHIA and BNI City was opened in December 2017 and officially inaugurated in January 2018 • The railway was extended to Bekasi Station in June 2018 and Manggarai in March 2019 • As of November 2018, the occupancy rate for the airport train has only reached 26%	2017	USD 1.8 billion	Scheme: PPP Concession period: 30 years Project owner: Ministry of Transportation Investors: PT Kereta Api Indonesia and PT Angkasa Pura II, PT Railink
Makassar–Parepare Railway	• First phase (142km with 23 stations) of the Trans-Sulawesi Railway project connects the ports in South Sulawesi • The railway is divided into six segments which have different financing schemes for construction. • In January 2019, the tender was awarded to PTPP consortium to construct 14km of Segment F and maintain Segments BCD and F • In transaction phase with consortium	2020	USD620 million	Scheme: State budget via Ministry of Transportation and PPP for Phase 3 Concession period: 18.5 years Project owner: Ministry of Transportation Investor: PTPP consortium[64] This project is guaranteed by PT Penjaminan Infrastruktur Indonesia.
Bontang Oil Refinery	• Indonesia's largest oil refinery in East Kalimantan has capacity to produce 300,000 barrels/ day from the grass roots refinery and a petrochemical plant • The production is prioritized to satisfy domestic fuel demand and reduce imports	2026	USD14 billion	Scheme: State-owned enterprise Project owner: PT Pertamina Investors: PT Pertamina and Overseas Oil & Gas (Oman)

[62] Including World Bank, JBIC, Sumitomo Mitsui Banking Corporation, Bank of Tokyo-Mitsubishi UFJ, Mizuho Bank, Sumitomo Mitsui Trust Bank, Mitsubishi UFJ Trust and Banking Corporation, Shinsei Bank and Norinchukin Bank, DBS Bank, and Oversea-Chinese Banking Corporation.
[63] Force majeure is a legal clause that allows companies to walk away from contracts soured by external events.
[64] Consortium includes PT Pembangunan Perumahan (Persero) Tbk, PT Bumi Karsa, PT China Communication Construction Engineering Indonesia, and PT Iroda Mitra.

Project	Description and Progress	Expected Operation	Estimated Investment Value	Funding Scheme/ Financing
	• Expected operation timeline was delayed by four years from initial target due to the need to complete a bankable feasibility study (BPS) and front-end engineering design • However, land and supporting infrastructure have been made available			
Kuala Tanjung International Hub Port	• The port in North Sumatra is expected to increase the volume of container traffic up to 12.4 million TEUs in 2039 • Also for large cruise ships to moor • Strategically to serve Sei Mangkei SEZ and Kuala Tanjung Industrial Zone, boost tourism and reduce logistics costs • Construction completed and operational in March 2019	2019	USD2.25 billion	Scheme: SOE Project owner: Ministry of Transportation Investor: Perlindo I
Yogyakarta–Bawen Toll Road	• The 72km toll road is expected to support tourism around Yogyakarta, Semarang and Solo, including Borobudur • The 72km toll road is expected to handle 16,322 cars/day on average • Currently requesting for proposals from interested business entities to finance, construct, operate and maintain the road during concession period • In preparation phase. Construction expected to start Q2 2021	2021	USD 1.02 billion	Scheme: PPP Concession period: 40 years Project owner: Indonesia Toll Road Authority (BPJT) Investor: Not yet awarded
Palapa Ring Broadband	• This nationwide project aims to provide fiber optic-based broadband network across Indonesia. • Implementing agencies include PT Palapa Ring Barat (West Package); PT Len Komunikasi Indonesia (Central); and PT Palapa Timur Telematika (East)[65] • All packages have been operational except East package	West, Central: 2018 East: 2019	USD546 million	Scheme: Private sector with bank loan Concession period: 15 years Source of funding: Multiple banks[66] Project owner: Ministry of Communication and Information Technology Investors: PT Palapa Ring Barat, PT Len Komunikasi Indonesia and PT Palapa Timur Telematika This project is guaranteed by the IIGF
Umbulan Drinking Water Treatment System	• Financial close on December 2016 after preparation process delayed for 40 years • The project aims to provide clean drinking water for 320,000 households and industrial area in East Java	2020	USD141 million	Scheme: PPP Concession period: 25 years Project owner: East Java province Investors: PT Meta Adhya Tirta Umbulan Consortium consisting of PT. Medco Gas Indonesia and PT. Bangun Cipta Kontraktor

[65] Palapa Ring Broadband project aims to provide internet services in rural parts of Indonesia. Geographic coverage of the project includes parts of Sumatra and Riau islands (West package); parts of Kalimantan, Sulawesi and North Maluku islands (Central package) and parts of East Nusa Tenggara and Papua (East package).
[66] Including PT Bank BNI, ICBC Indonesia, Bank Papua, Bank Maluku Malut, Bank Sulsebar, Bank Mandiri, etc.

Project	Description and Progress	Expected Operation	Estimated Investment Value	Funding Scheme/ Financing
	• Tender awarded to PT Meta Adhya Tirta Umbulan consortium which will build, operate and transfer the system • Under construction			This project is guaranteed by the government through PT Penjaminan Infrastruktur Indonesia. Financiers are PT IIF and PT SMI (Persero)
Legok Nangka Waste to Energy Project	• One of the priority waste-to-energy conversion projects in 8 cities • Obtain solid waste from 6 regencies in West Java (1,845 tons/ day) and convert to 20MW of electricity for PLN • Second market sounding in progress after the first one failed to attract investors. • West Java provincial government, Ministry of Finance and Japan International Cooperation Agency (JICA) in process of finalizing Project Development Facilities (PDF)[67] • Previous issue on tipping fee payment framework has been resolved. • Still in preparation phase	2022	USD253 million	Scheme: PPP Concession period: 20 years Project owner: West Java province Investor: Not yet awarded
MRT Jakarta (North – South corridor)	• MRT Jakarta was built to ease traffic congestion, provide an alternative mode of transportation and hence reduce carbon emission • The project consists of two phases 1. Lebak Bulus–Bundaran HI 2. Bundaran HI–Kota (original -Kampung Bandan) • Phase 1 (16km, 13 stations) opened in March 2019 • Groundbreaking for Phase 2 (8km, 7 stations) was delayed for 3 months to March 2019, due to land acquisition and permit issues • Phase 3 which is part of the East-West corridor, is currently under design stage and targeted constructing in 2020	Phase 1: 2019 Phase 2: 2024	USD 2.8 billion	Scheme: ODI from Japan (JICA) Funding from Japan amounts to IDR41 trillion for both phases Project owner: Provincial Government of Jakarta Rolling stocks from Japan (consortium led by Sumitomo Corporation

Source: KPPIP; Indonesia Investment Coordinating Board (BKPM); World Bank; Global Infrastructure Hub; SourceWatch; various news sources

[67] Project development facility assists the government contracting agency in PPP project preparation.

Appendix 6. Financial Performance of Selected SOEs

Appendix 6.1 Selected Financial Ratios of Infrastructure SOEs

Current ratio	2012	2013	2014	2015	2016	2017	2018
Jasa Marga	0.68	0.78	0.82	0.49	0.70	0.76	0.38
Waskita Karya	1.47	1.43	1.31	1.16	1.27	1.00	1.18
Wijaya Karya	1.10	1.16	1.21	1.24	1.59	1.34	1.54
Adhi Karya	1.24	1.39	1.30	1.56	1.29	1.41	1.34
Debt-to-equity ratio	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Jasa Marga	1.53	1.66	1.89	1.97	2.27	3.31	3.08
Waskita Karya	3.17	2.69	3.54	2.12	2.66	3.30	3.31
Wijaya Karya	2.89	3.01	2.26	2.60	1.46	2.12	2.44
Adhi Karya	5.67	5.28	5.37	2.25	2.68	3.83	3.79
Interest coverage ratio	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Jasa Marga	3.24	2.82	2.52	2.47	2.76	3.56	2.75
Waskita Karya	3.70	7.31	5.17	5.11	3.19	3.39	3.25
Wijaya Karya	23.98	16.88	5.31	2.74	3.98	3.16	3.43
Adhi Karya	5.91	7.62	5.39	6.46	3.37	2.17	2.24
Receivables turnover ratio	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Jasa Marga	23.97	4.71	8.01	4.38	0.20	0.16	0.31
Waskita Karya	0.13	0.16	0.16	0.27	0.15	0.29	0.34
Wijaya Karya	0.26	0.22	0.23	0.17	0.21	0.15	0.16
Adhi Karya	0.09	0.15	0.11	0.26	0.10	0.14	0.12

Source: SOE financial statements; AMRO staff calculations

Appendix 6.2 Financial Performance of Energy SOEs

a. Income Statement, Selected Components, % of GDP

Pertamina	2012	2013	2014	2015	2016	2017	2018
Revenues (excl. govt subsidy)	5.50	6.49	6.14	4.62	3.67	4.23	5.10
Cost of revenues	7.18	8.35	7.46	4.28	3.03	3.75	4.75
Gross profit	-1.68	-1.87	-1.32	0.33	0.65	0.48	0.35
Government subsidy	2.46	2.59	2.10	0.38	0.28	0.36	0.55
Gross profit (incl. govt subsidy)	0.78	0.73	0.78	0.71	0.93	0.84	0.90
PLN	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Revenues (excl. govt subsidy)	1.50	1.68	1.83	1.89	1.80	1.88	1.84
Cost of revenues	2.36	2.31	2.34	1.96	2.05	2.03	2.08
Gross profit	-0.86	-0.63	-0.51	-0.07	-0.25	-0.15	-0.24
Government subsidy	1.20	1.06	0.94	0.49	0.47	0.34	0.32
Gross profit (incl. govt subsidy)	0.34	0.43	0.42	0.42	0.21	0.19	0.09

Source: SOE financial statements; AMRO staff calculations

b. Selected Financial Ratios

Pertamina	2012	2013	2014	2015	2016	2017	2018
Current ratio	1.56	1.46	1.49	1.68	2.00	1.95	1.66
Debt-to-equity ratio	1.70	1.73	1.69	1.34	1.14	1.13	1.19
Interest coverage ratio	14.58	10.52	7.46	5.98	8.76	5.73	7.86
Receivables turnover ratio	0.57	0.58	0.31	0.36	0.82	0.72	0.66
PLN	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Current ratio	1.04	0.95	0.98	0.66	0.81	0.67	0.72
Debt-to-equity ratio	2.45	2.93	2.96	0.63	0.45	0.54	0.61
Interest coverage ratio	1.04	-0.15	1.42	0.60	1.73	1.46	1.92
Receivables turnover ratio	0.09	-0.62	0.18	16.86	0.16	-0.19	1.01

Note: 1/ PLN's asset revaluation in 2015 and 2016 results in higher equity, and hence lower debt-to-equity ratios in those years than previous years. 2/ Receivable turnover ratio is calculated by dividing total comprehensive income for the year by total receivable.
Source: SOE financial statements; AMRO staff calculations

Appendix 7. BPJS Ketenagakerjaan: Fund Structure and Size

Mandatory	Coverage	Contribution	Benefit	Other features	Size, as of May 2019
Provident Fund	Employees of both SMEs and large corporates, including both SOEs and private companies No of participants: 39 million	Employee: 2% Employer: 3.7% Basic salary	• Lump sum payment of cumulative principal plus dividend, pension age of 56 years old • No minimum period of contribution, as long as the contributor becomes unemployed up to one month	• The provident fund was initially designed as a bridging fund for pensioners while they await to enjoy full pension fund benefits • However, early withdrawal due to change in employment status has been allowed since 2015, turning this old age pension scheme into a de facto unemployment benefit fund	~IDR289 trillion
Pension Fund	Employees of large corporates (with assets of IDR5 billion and above) Number of participants is 16 million, of which 12 million are active members and 4 million are non-active (unemployed and not contributing to the fund)	Employee: 1% Employer: 2% Basic salary (excluding bonus + allowances) Up to a wage ceiling of IDR8.5 million per month but could be subject to changes Contributions are tax free	• Benefit = 1% * number of years of contribution * career ratio indexed to inflation • Minimum 15 years of contribution, pension age: 57 years, with an increase of 1 year every three year until the pension age reaches 65 in 2022 • In case of an early withdrawal, benefits are similar to those provided by the provident fund • Benefits are subject to personal income tax, with a tax-deductible threshold of IDR50 million per annum		~IDR47 trillion
Insurance fund for accidents at work	-	-	-	-	~IDR53 trillion
Insurance fund for death benefits	-	-	-	-	
BPJS fund	-	-	-	-	~IDR 11 trillion

Source: BPJS Ketenagakerjaan, AMRO staff compilation

Appendix 8. Data Adequacy for Surveillance Purposes: a Preliminary Assessment

Criteria/ Key Indicators for Surveillance	Availability[i]	Reporting Frequency/ Timeliness[ii]	Data Quality[iii]	Consistency[iv]	Others, if Any[v]
National Account	Available	Quarterly data is available within 3 months after the end of the reference period	-	-	-
Balance of Payment (BOP) and External Position	Available	Quarterly data is available within 3 months after the end of the reference period	-	-	-
State Budget and Government/External Debt	Available	Annual data is available within 6 months after the end of the reference period	-	-	-
Money Supply and Credit Growth	Available	Monthly data is available within 3 months after the end of the reference period	-	-	-
Financial Sector Soundness Indicators	Available	Monthly data is available within 3 months after the end of the reference period	-	-	-
State-Owned-Enterprises Statistics	Available	Annual data is available upon request	-	-	-
Others, if relevant					

Notes:
(i) Data availability refers to whether the official data are available for public access by any means.
(ii) Reporting frequency refers to the periodicity that the available data are published. Timeliness refers to how up-to-date the published data are relatively with the publication date.
(iii) Data quality refers to the accuracy and reliability of the available data given the data methodologies are taken into account.
(iv) Consistency refers to both internal consistency within the data series itself and its horizontal consistency with other data series of either same or different categories.
(v) Other criteria might also apply, if relevant. Examples include but are not limited to potential areas of improvement for data adequacy.

Source: AMRO staff compilations.

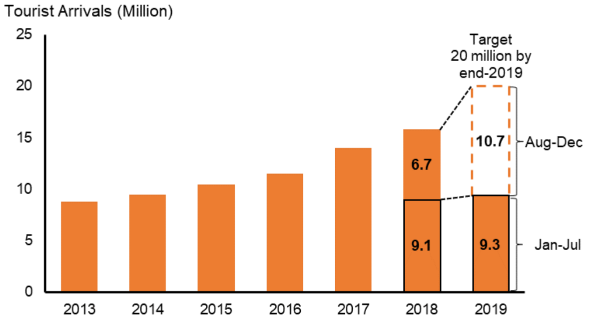
Annexes: Selected Issues

Annex 1. Boosting Tourism Sector in Indonesia[68]

1. **Richly-endowed with natural and cultural resources, Indonesia is poised to realize higher growth potential by creating a more robust tourism sector.** Since the start of his first term, President Jokowi has laid strong emphasis on boosting foreign exchange earnings and diversifying growth engines by accelerating inbound tourism. In this selected issue, we identify where in the tourism sector Indonesia lags its regional peers, despite being richly endowed with more than 17,500 islands and eight UNESCO[69] world heritage sites. In an attempt to bridge these gaps, the government has implemented strategic plans and reforms, alongside ongoing infrastructure development. To complement those plans, we will end with some policy discussion on creating a more robust tourism sector and in the process, raising the growth potential of Indonesia.

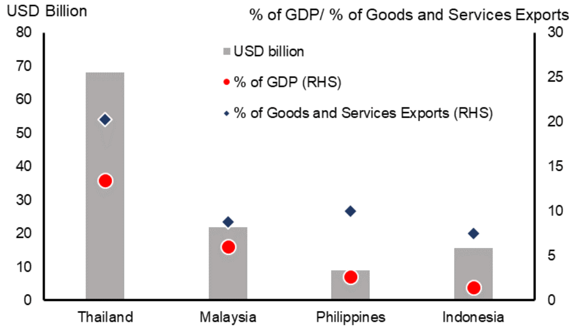
2. **Inbound tourism has picked up in recent years, although attaining the Medium-Term Plan target will be a challenge.** Tourist arrivals have gained pace since 2016 as a result of strong marketing efforts by the Ministry of Tourism, coordination between central and local authorities and businesses, as well as visa exemption for citizens from 169 countries. However, achieving the target of 20 million arrivals this year under the Medium-Term Plan 2015-2019 for the tourism sector will be challenging as on-year arrival growth would have to increase by 59.0 percent from August 2019 onwards, compared to the January-July period growth of 2.6 percent (Figure A1.1), notwithstanding stronger external headwinds. Moreover, with domestic airfares still comparatively high, tourists are deterred from visiting other destinations in Indonesia,[70] which is a missed opportunity for the country to earn more from the tourists.

Figure A1.1. Tourist Arrivals and Corresponding Medium-Term Target



Source: BPS

Figure A1.2. Foreign Exchange Earnings



Note: Foreign exchange earnings refer to the sum of travel exports and passenger transportation exports in the balance of payments account. Source: National authorities

3. **While Indonesia's tourism sector falls short of regional peers', it has several competitive advantages.** Compared to regional peers, Indonesia has relatively low tourist

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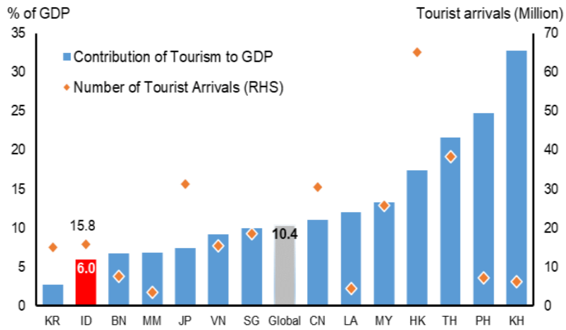
[68] Prepared by Edmond Choo Chiang Yong

[69] United Nations Educational, Scientific and Cultural Organization.

[70] The domestic airline industry saw some consolidation in October 2018 when the state-owned Garuda Group bought Sriwijaya Airlines, resulting in a duopoly which it now shares with Lion Group. Airfares have increased significantly since then and have reduced despite efforts from the Ministry of Transportation in adjusting down the maximum fare ceiling that airline companies can charge. According to data for Garuda's domestic business, passenger yields, which is the proxy for average air ticket prices, grew 42 percent in the first six months of 2019 as compared to the same period last year. That said, the authorities have stepped up efforts to manage fares by reducing value-added tax for importing aircraft, imposing a jet fuel import ban (to control prices by sourcing locally-produced fuel) and providing fiscal incentives for airlines to reduce their fares by 50 percent.

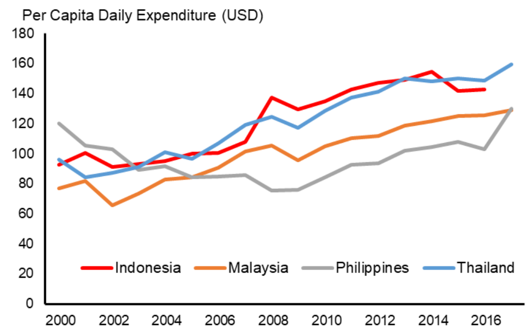
arrivals and received the lowest earnings from tourism in terms of percentage of GDP, and percentage of total goods and services exports (Figure A1.2). Tourism contribution to GDP is also relatively low, at 6 percent of GDP in 2018, below the global average and most of its ASEAN+3 peers (Figure A1.3). However, these data underline the tremendous potential for growing the tourism industry in Indonesia if the tourism ecosystem is developed well. In addition to many tourist attractions, another aspect in favor of Indonesia is that tourists already tend to stay longer in the country (8.4 days versus 6.5 days in Malaysia, for example[71]) and spend more than in Malaysia and the Philippines per capita per day (Figure A1.4).

Figure A1.3. Contribution of Tourism to GDP and Tourist Arrivals in 2018, ASEAN+3 Countries



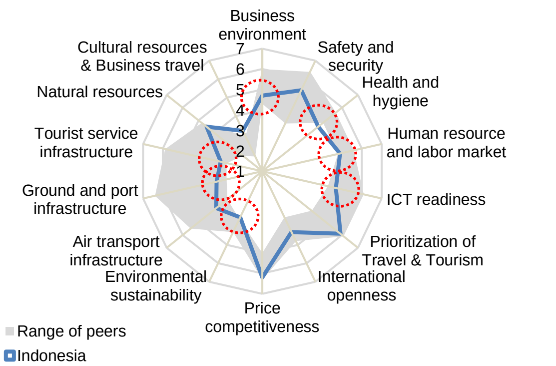
Note: Brunei's tourist arrivals refer to 2016 data.
Source: World Travel and Tourism Council; National authorities

Figure A1.4. Daily Spending Per Capita



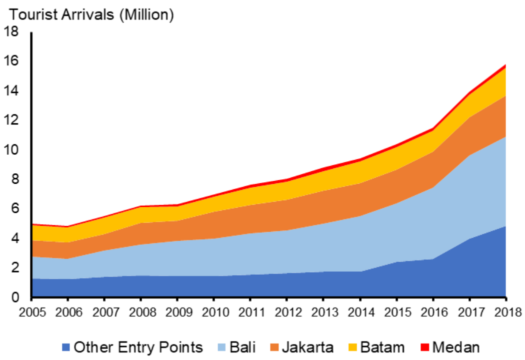
Note: Data for the Philippines refer to tourist spending in Metro Manila only. Data up to 2017 except for Indonesia (2016).
Source: National authorities

Figure A1.5. Travel & Tourism Competitiveness Index 2019 (Score 1-7 where 7 = best)



Note: Range of peers refer to the range of scores for Malaysia, the Philippines, Singapore, Thailand and Vietnam.
Source: World Economic Forum Travel and Tourism Competitiveness Index 2019; AMRO staff compilation

Figure A1.6. Tourist Arrivals by Entry Points



Source: BPS

4. **Structural and perennial challenges need to be properly addressed to promote competitiveness and resilience in the tourism-related sectors.** According to the World Economic Forum's Travel and Tourism Competitiveness Report 2019, the tourism industry in Indonesia has improved over the years. It rose from rank 50 in 2015 to rank 40 out of 140 countries in 2019, above the Philippines (75) and Vietnam (63) but below Malaysia (29) and Thailand (31). Compared to its peers, however, structural gaps in sub-categories such as business environment, infrastructure (tourist service, ground and port), environmental sustainability, ICT readiness[72], human resources and labor market, and health and hygiene still exist (Figure A1.5). These gaps need to be closed in order to enhance competitiveness in the sector. Another challenge, which is perennial in nature, is Indonesia's susceptibility to

[71] Indonesia's data as of 2016 while Malaysia's is as of 2018.
[72] Refers to Information and Computer Technology.

natural disasters. A string of natural disasters in 2017 and 2018, especially those that occurred in Bali and Lombok, had a significant impact on tourist confidence, arrivals and infrastructure.

Figure A1.7 The Locations of the 10 New Balis

Note: Destinations in red labels refer to the four priority destinations (of the 10 hubs) the government wants to focus on.
Source: Medium-Term Plan 2015-2019 for tourism; AMRO staff compilation; Aggressor Adventures

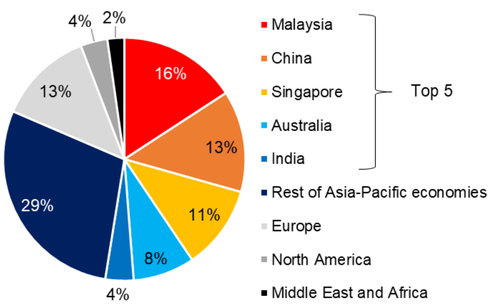
5. **The government is embarking on strategies and reforms to mitigate some of the challenges.** The authorities are already speeding up infrastructure development with priority given to new tourist destinations, and have enhanced marketing efforts as well as the liberalization of entry and business processes. The Medium-Term Plan 2015-2019 for the tourism sector has laid out important strategies and reforms such as the "Ten New Balis" development plan[73] (Figure A1.7). This strategy plans to draw tourists to other promising tourist hubs by replicating the success of Bali. There are encouraging signs already with other Indonesian tourist destinations registering more arrivals since 2016 (Figure A1.6). Furthermore, the ongoing connectivity expansion[74] and the designation of special economic zone status to certain destinations [75] have enhanced accessibility and also attracted investments in hotels and amenities. The authorities have also relaxed visa requirements, the cruise cabotage law[76] and foreign ownership in certain sectors such as hotels and restaurants, to attract more tourists and investments. In addition, more vocational schools will be built to address the skills shortages.

6. **On policy recommendations, current strategies and reforms must be strengthened to boost the promising tourism sector.** In preparation for the next Medium Term Plan 2020-2024 for the tourism sector, Indonesian authorities should study the results and possible areas of improvement before the current plan ends this year. A market-based business environment should be cultivated in the tourism-related sector, especially the airline industry, in order to enhance competitiveness and attract price-sensitive regional and domestic tourists. Further relaxation of the Negative Investment List[77] (DNI) could attract more

[73] The 10 new destinations are Lake Toba in North Sumatra province, Tanjung Lesung in Banten, the Thousand Islands in Jakarta, Tanjung Kelayang in Bangka Belitung, Borobudur in Central Java, Mount Bromo in East Java, Mandalika Lombok in West Nusa Tenggara, Labuan Bajo in East Nusa Tenggara, Wakatobi in South Sulawesi and Morotai Island in North Maluka.
[74] See Annex for the summary on infrastructure progress in the 10 new destinations.
[75] Mandalika, Tanjung Kelayang, Tanjung Lesung and Morotai.
[76] Deregulation efforts include the waiver of cabotage so that foreign cruise ships are able to embark and disembark passengers at the five appointed sea ports. Before this, such vessels could only dock at Bali port, and passengers who wished to travel to other Indonesian ports had to go back to Singapore to do so.
[77] For example, in business fields like museums, travel agents, ecotourism business, spa services, MICE services and commercial air transportation.

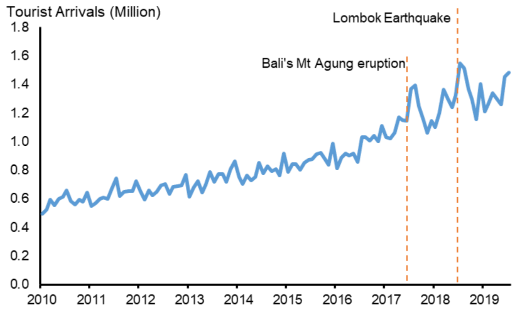
investors to participate in the development of the Ten New Balis' sites. On infrastructure gaps, the new tourism hubs have benefited from the improvement in connectivity through the building or expansion of airports. However, more effort could be directed towards enabling seamless transportation networks through roads, railways, airports and Special Economic Zones while ensuring reliable electricity and internet connectivity as well as the availability of water supply and healthcare facilities (see Table A1.1). Human capital in the hospitality sector must be enhanced too, highlighting the urgent need for training in specific skillsets such as venue/ event/ trip management and foreign language proficiency, especially when tourism related to meetings, incentives, conferences and exhibitions (MICE) begins to flourish. Moreover, the establishment of a good waste management system as well as the promotion of the local community's role in protecting the environment and sustaining its cultural heritage should be part of the plan to promote sustainable tourism.

Figure A1.8. Share of Tourist Arrivals by Nationality in 2018



Source: BPS

Figure A1.9. Monthly Tourist Arrivals and the Impact from Major Disasters in 2017-18



Source: BPS

7. **The Ministry of Tourism (MoT) and other institutions may adopt a strategic approach by collaborating with one another to harness their expertise.** Working with tour agencies and digital travel platforms to promote multi-destination tours can increase the length of stay and spending. For example, packaging Bali tours to include Lombok and Labuan Bajo will likely attract beach and adventure-seekers as the destinations are not far from one another. In addition, tourism promotion, with support from the budget, should continue and target specific segments, such as Asian and domestic tourists which are among an expanding middle income population. Moreover, with favorable global travel trends like the rising usage of online travel platforms and growing affluence and wanderlust among the Muslim population,[78] Indonesia can leverage on its Muslim-friendly[79] and digital-savvy environment, to bring in more millennial and Muslim travelers, particularly from the Middle East and Malaysia, whose citizens are among the top visitors in terms of numbers (Figure A1.9). Disaster management is one area where the National Agency for Disaster Management (BNPB) can provide possible early warnings or diversion plans for all tourist attractions to cushion disruptions in tourist arrivals (Figure A1.8). MoT can also cooperate with the Coordinating Ministry for Economic Affairs (KPPIP) to identify and build disaster-resilient infrastructure to facilitate a quicker rebound from natural disasters.

[78] The Mastercard-CrescentRating Global Muslim Travel Index (GMTI) 2019 projects international Muslim tourists will 230 million by 2026, up from the estimated 140 million tourists in 2018. https://newsroom.mastercard.com/asia-pacific/press-releases/mastercard-crescentrating-global-muslim-travel-index-gmti-2019-indonesia-and-malaysia-take-the-top-positions-in-the-fast-growing-muslim-travel-market/

[79] Indonesia is joint-first with Malaysia in the Mastercard-CrescentRating – Organization of Islamic Cooperation (OIC) category.

Table A1.1. Summary of Related Infrastructure Projects of "Ten New Balis" and Infrastructure Gaps

Ten Priority Destinations (and Provinces)	Super Priority Destinations	SEZ (KEK) for Tourism	Related Key Infrastructure Projects Ongoing and Completed (including PSNs)	Expected Completion	Further Hard and Soft Infrastructure Gaps
Danau Toba (Lake Toba) – North Sumatra	Yes	No	1. Upgrading of Silangit Domestic Airport (20 minutes to Lake Toba) to an international airport with a capacity of 1 million passengers per year 2. Development of Medan Kualanamu Airport (2 hours to Lake Toba) as an international aviation hub with capacity of 50 million by 2030 3. Renovation of Sibisa Airport 4. **Medan-Kualanamu-Tebing Tinggi toll road** (Part of larger Trans-Sumatra Toll Road network, 61.7km) 5. **Tebing Tinggi–Siantar–Parapat Toll Roads** (35km + 27km) undergoing feasibility study. Along with the Medan–Tebing Tinggi toll road, it will shorten traveling time from Kualanamu Airport to Lake Toba to 2 hours 6. Siantar–Danau Toba railway to reduce travel time from Medan to Lake Toba to 3.5 hours	1. 2019 2. 2030 3. 2019 4. 2017 5. 2025 6. 2019	• International flights to Silangit Airport • Road networks connecting other regions and airports • Water treatment plants, power plants to produce potable water, electricity • Waste management • Accommodation especially in the luxury segment • Muslim-friendly services
Borobudur – Central Java	Yes	No	1. **Kulon Progo International Airport in Yogyakarta**, with a capacity of 14 million passengers per year to replace Adi Sucipto International Airport 2. **Yogyakarta–Bawen Toll Road** (72km) will connect existing toll road to support tourism around Yogyakarta 3. **Semarang–Solo–Yogyakarta Toll Road** (73km + 40km) will connect the Trans-Java toll road to improve access to Borobudur and surrounding areas 4. **Development of the Menoreh Resort**, a three-star resort to serve Borobudur's visitors (4km from Borobudur)	1. 2020 2. 2021 3. 2020 4. N.A.	• Prioritized power supply network to Borobudur area • Water treatment plants to produce potable water for nearby accommodations • Muslim-friendly services – for example, restaurants, Arabic-speaking guides
Mandalika – West Nusa Tenggara	Yes	Yes	1. **SEZ in Lombok**, focusing on MICE, halal and eco-tourism, occupying 1,175ha of land with 12,000 hotel rooms, a 350,000m^2 commercial space, a 78-berth marina and a 120ha theme park planned. Also feature a street circuit complex to host the MotoGP in 2021. 2. Expansion of Lombok International Airport to capacity of 3.3 million passengers per year 3. Broadening of road linking the airport to Mandalika (20km) 4. Gili Mas Port for ships up to 400m with capacity of 4,000 passengers to dock, including terminal and container lots 5. Revitalization of Sekotong–Buwun Mas road to ease traffic between Gili Mas Port and Mandalika 6. Increase of electricity power using a 15MW solar plant 7. Reservoir for distribution of treated RO water with capacity of 5,000m^3 and reverse osmosis to provide 750m^3/ day of clean water	1. 2019-2021 2. 2028 3. 2020 4. 2020 5. 2020 6. 2018 7. 2017-2020	• Ferry ports to be expanded or maintained to facilitate more tourist arrivals from regional territories, particularly from Bali • Reliable public transport network to improve connectivity upon completion of SEZ • Amenities/ staff to anticipate influx of MICE-related tourists Tourism academic institutions
Labuan Bajo – East Nusa Tenggara	Yes	No	1. **Development of Labuan Bajo Airport** and conversion into an international airport with capacity of 4 million passengers 2. Marina port to ferry tourists to Komodo Island 3. Trans-Flores highway – 662km 4. Lintas Utara Road (18km) to support strategic development 5. Macan Pacar port with container terminal	1. 2019 2. 2019 3. 2017 4. 2020 5. 2020 6. 2018	• Reliable electricity supply • Infrastructure/ regulations to support fauna and flora conservation efforts

Ten Priority Destinations (and Provinces)	Super Priority Destinations	SEZ (KEK) for Tourism	Related Key Infrastructure Projects Ongoing and Completed (including PSNs)	Expected Completion	Further Hard and Soft Infrastructure Gaps
			6. Culinary center in Kampung Ujung 7. Waste water treatment plant with a capacity of 170m^3/ day	7. 2018	
Tanjung Kelayang – Bangka Belitung	No	Yes	1. **Basic infrastructure for SEZ** (35.9ha) including roads, clean water, waste water systems and electricity networks 2. **Revitalization and conversion of Belitung HAS Hanandjoeddin Airport to an international airport** 3. Development and broadening road from Belitung airport to Tanjung Kelayang (41km) 4. Improvement of national roads to the area	1. 2019 2. 2016-2017 3. 2017 4. N.A.	• Roads connecting Tanjung Kelayang to other regions • Telecommunication network • Hotels, hospital of international standard
Tanjung Lesung – Banten	No	Yes	1. **South Banten, Panimbang Airport** is located 20km from Tanjung Lesung, with capacity of up to 1 million passengers and could reduce the logistic cost from Pandeglang Industrial Estate to Jakarta and the surrounding areas. 2. **New Serang–Panimbang toll road** (84km) via THE Jakarta–Merak toll road to improve connectivity with Jakarta (3.5 hours) and Ujung Kulon National Park (UNESCO world heritage site) 3. Building a 1km airstrip to accommodate chartered flights from Jakarta's Halim Perdanakusuma Airport (40 minutes flight) 4. 600 dock-cruise terminal and marina by Jababeka and Pelindo II to support cruise tours to Jakarta 5. Rangkasbitung – Labuan (reactivation) – Panimbang railway (56km + 30km)	1. 2018 2. 2019 3. 2016 4. 2017 5. 2021	• Water treatment plants to produce potable water for nearby accommodations • Reliable electricity supply • Hotels, hospital of international standard • Tourism academic institutions Muslim-friendly services – for example, foreign language guides, and food and beverages
Morotai – North Maluku	No	Yes	1. **Basic infrastructure for SEZ** focusing on tourism, fishery, logistics and manufacturing 2. **Trans-Morotai Ring Road** (255km) around the island to open access to and from Daruba City to boost tourism 3. Revitalization of Leo Watimena Airport, formerly known as Pitu Morotai Airport, to accommodate larger aircrafts	1. 2019 2. 2019 3. 2018	• Expansion of seaport (Daruba harbor) which facilitates arrival of domestic tourists from neighboring islands • Integration and accessibility with more developed parts of Indonesia – for example, North Sulawesi, Raja Ampat • Telecommunication network
Wakatobi – South Sulawesi	No	No	1. **Newly built terminal in Matahora Airport and upgrade to an international airport** to increase present capacity 2. Development of Wanci harbor 3. Development of Murhum Baubau Port to meet increasing demand	1. 2016/ 2019 2. N.A. 3. 2021	• Integration and accessibility with more developed parts of Indonesia e.g. North/ South Sulawesi, Raja Ampat • Amenities – for example, hotels and hospitals
Kepuluan Seribu (Thousand Islands) - Jakarta	No	No	1. Development of Pulau Panjang Airport 2. Improvement of mainland Jakarta's seaports to ferry tourists to Thousand Islands 3.	1. 2017 2. N.A.	• Reliable electricity and water supply • Waste management system
Mount Bromo – East Java	No	No	1. Development of Juanda International Airport (third busiest after Soekarno-Hatta and Ngurah Rai airports, 4 hours to Bromo) with a capacity of 1 million passengers 2. **Pandaan–Malang Toll road** (38km), part of Trans Java Toll Road, to enhance connectivity in the area by cutting travel time to less than an hour	1. 2019 2. 2019 3. 2019	• Development for alternative roads via Pasuruan, Tumpang, Muslim-friendly services such as food and beverages, and foreign language guides

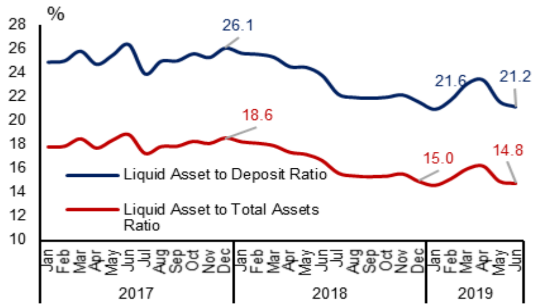
Ten Priority Destinations (and Provinces)	Super Priority Destinations	SEZ (KEK) for Tourism	Related Key Infrastructure Projects Ongoing and Completed (including PSNs)	Expected Completion	Further Hard and Soft Infrastructure Gaps
			3. **Pasuruan-Probolinggo Toll Road** (31km), part of the Trans Java Toll Road 4.		
All Destinations			1. **Transportation, electricity and clean water infrastructure acceleration for the 10 New Balis sites**		• Enhanced synergy and coordination between central and local governments • Staff looking after the UNESCO world heritage sites as well as in supporting sectors – for example, hospitality, tour guides • Disaster-resilient (natural or technological) infrastructure – for example, disaster/ safety awareness of public; reliable early warning systems • Sustainability measures – for example, crowd control, cultural preservation, and engagement with the local community • Hygiene and cleanliness infrastructure --- for example, waste management • Delay in Palapa Ring Broadband Project hindering telecommunication access across Indonesia

Sources: The Committee for Acceleration of Priority Infrastructure Delivery (KPPIP); Ministry of Public Works and Housing Regional Infrastructure Development Agency (BPIW) Integrated Tourism Master Plan (ITMP); Indonesia Tourism Investment; Indonesia Investment Coordinating Board (BKPM); Bank Indonesia Nusantara Reports; Global Infrastructure Hub; Mastercard-Crescentrating Indonesia Muslim Travel Index 2019; various news sources; and AMRO staff summary and assessment.

Annex 2. Bank Liquidity Conditions[80]

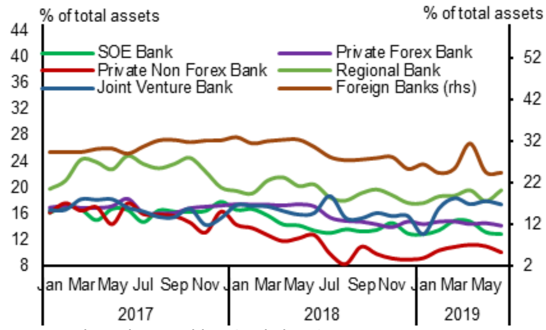
1. Liquidity among Indonesian banks has tightened since early 2018, although key liquidity indicators are still above their minimum thresholds by a large margin. The liquid asset[81] to total asset ratio (hereinafter called liquidity ratio) declined from 18.6 percent in December 2017 to 15.0 percent in December 2018, while some improvement was observed in early 2019[82] (Figure A2.1). In particular, the liquidity ratio of small-scale private non forex banks[83] declined to below 10 percent mostly in the second half of 2018 (Figure A2.2)**.** The liquid asset-to-total deposit ratio also moderated from 26.1 percent to 21.6 percent during the same period, which is however, well above the threshold of 10 percent (Figure A2.1). Liquidity tightness has also been exhibited in the interbank market through a significant increase in the transaction volume across all maturities[84] since early 2018 amidst rising interest rates in line with BI's policy rate hikes (Figure A2.3). The loan-to-deposit ratio increased from 90 percent in December 2017 to 94.8 percent in December 2018, and further to 96.2 percent in May 2019, before easing to 94 percent in July 2019 (Figure A2.4).

Figure A2.1. Liquidity Indicators



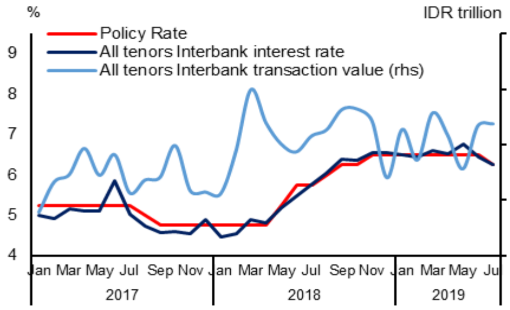
Source: CEIC and Indonesian Banking Statistics-OJK

Figure A2.2. Liquidity Ratio of Groups of Banks



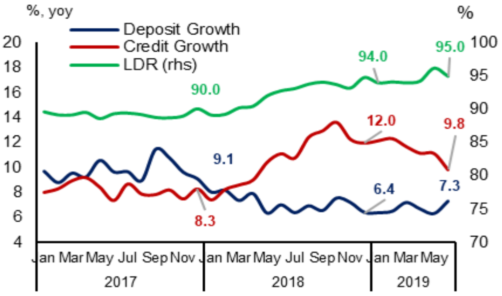
Source: Indonesian Banking Statistics-OJK

Figure A2.3. Interbank Transactions and BI Policy Rate



Source: Indonesian Banking Statistics-OJK

Figure A2.4. Credit to Deposit Ratio, Credit and Deposit Growth



Source: Indonesian Banking Statistics-OJK

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[80] Prepared by Muhammad Firdauz Muttaqin. This selected issue focusses on commercial banks excluding sharia banks. Analysis is based on the Indonesian Banking Statistics-OJK up to June 2019.

[81] Based on OJK data, liquid assets consist of cash, central bank instruments, and government bonds owned by bank.

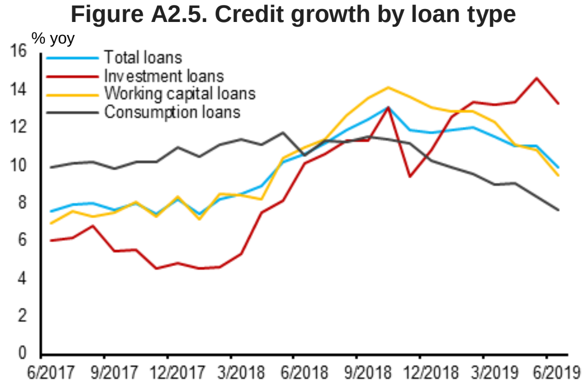
[82] The temporary seasonal tightening of liquidity around the Eid-ul-Fitr holiday took place in May 2019.

[83] Until 2018, the number of commercial banks in Indonesia is 115 banks which could be classified according to their ownership and business activities. Based on ownership, banks can be divided into state-owned banks, domestic private banks, regional government-owned banks, foreign-owned banks and joint venture banks. Based on business activities, banks are classified as BUKU (Bank Umum Kegiatan Usaha or Commercial Bank based on Business activities) that categorizes banks into BUKU 1 (group banks with the smallest core capital) to 4 (group banks with the biggest core capital). The small-scale private non forex banks and some small regional banks are included in the BUKU1 group, which consists of banks with core capital below IDR 1 trillion consisting of several small regional government-owned banks and non-foreign exchange domestic private banks. In terms of size, private non forex banks account for less than 1 percent of the total banking system.

[84] Transactions in the interbank money market for all maturities (the most of which, around 60-70%, are overnight transactions) rose quite sharply from an average of around IDR 15 trillion per day in 2017 to IDR 22 trillion per day during 2018. In addition, interbank money market interest rates for all maturities that were always below Bank Indonesia policy rate and only increased high in the Eid-ul-Fitr celebrations period and end of year, from July 2018 tend to be above the policy rate.

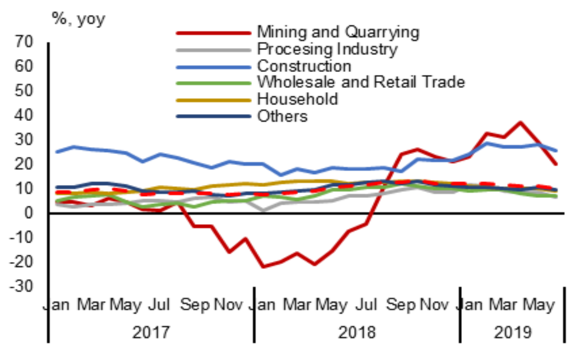
2. **The moderation in bank liquidity was due to elevated credit growth and a slowdown in deposit growth, reflecting capital outflows in 2018.** Credit growth has rebounded to two-digit levels since mid-2018, led by lending for productive activity, i.e. working capital and investment loans (Figure A2.5).[85] In particular, lending to mining and construction related to infrastructure projects has led credit growth (Figure A2.6). In contrast, deposit growth slowed from 8.3 percent (yoy) in 2017 to 6.1 percent (yoy) in 2018, driven by a squeeze in time deposits by non-bank financial institutions, including insurance firms. This is closely associated with an increase of those institutions' holding of government bonds in periods of foreign investors' net-selling in 2018[86] (Table A2.1).

Figure A2.5. Credit growth by loan type



Source: BI

Figure A2.6. Credit growth by sector



Source: OJK

Table A2.1. Deposit Growth and LCY Government Bond Holdings

Annual growth, % yoy	2014	2015	2016	2017	2018				2019	
					Mar	Jun	Sep	Dec	Mar	Jun
Total deposits, owned by	12.2	8.0	9.6	8.3	7.3	6.3	6.5	6.1	6.3	7.2
Non-financial corporate sector	8.4	9.9	11.1	14.0	12.1	10.9	8.0	5.3	7.9	2.8
Individuals	12.5	7.7	9.5	5.6	8.1	7.3	8.2	7.1	5.3	8.0
Others, of which	17.9	6.1	6.9	10.2	-3.3	-5.1	-2.7	2.8	7.9	11.6
Non-bank financial institutions	28.6	5.9	-7.2	16.8	0.7	-5.5	-6.9	-3.1	5.5	16.4
Non-financial public sector	4.8	6.4	27.9	3.2	-6.9	-4.7	0.9	10.1	10.2	7.5
Holding of LCY government bonds, by NBFIs	13.3	18.1	45.3	10.1	12.6	15.8	18.9	17.7	14.3	10.5

Note: Deposit data in this table are sourced from Bank Indonesia, which may differ slightly from OJK's deposit data presented in Figure S2.1. Non-bank financial institutions include pension funds, insurance companies, finance and securities firms, as well as mutual funds, among others. The non-financial public sector refers to state and local governments, and state owned enterprises.
Source: Bank Indonesia and ADB (Asian Bonds Online Database)

3. **Banks have raised deposit rates and stepped up seeking non-deposit funding to maintain adequate liquidity.** Time deposit rates[87] increased by 130 basis points in 2018 on average, while higher deposit rate hikes were observed in the group of foreign banks, joint venture banks and state-owned banks (Table A2.2), mainly due to higher pace of credit expansion among those banks. In addition to raising deposit rates, banks, especially large banks in BUKU3 and

[85] Despite policy rate hikes of 175 bps in total during May-November 2018, banks lowered lending rate by 19 bps during May and December 2018.
[86] According to the authorities, this is mainly to meet the regulatory requirement of government bonds holding by year-end.
[87] Refer to one-month time deposits

BUKU4, have issued corporate bonds and public offerings in the capital market, and increased external borrowing, which has helped to narrow their funding gap (Table A2.3)[88].

Table A2.2. Time Deposit Rates Increase (bps)

	May-Dec'18	Jan - Jun'19
Policy Rate	175	0
1m Deposit Rate	130	-22
Working capital credit Rate	-20	5
BUKU1	121	-41
BUKU2	100	-30
BUKU3	140	-30
BUKU4	128	-6
SOE Bank	138	-19
Private Forex Bank	125	-18
Private Non Forex Bank	108	-41
Regional Bank	110	-43
Joint Venture Bank	173	-35
Foreign Banks	167	-36

Source: Indonesian Financial Statistics – BI, Indonesian Stock Exchange Statistics

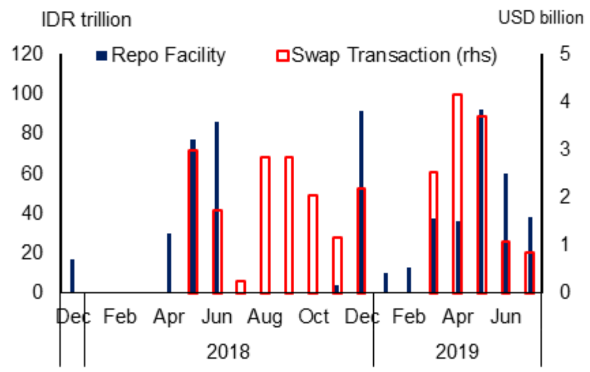
Table A2.3. Banks Source of Funding (IDR trillion)

	2008	2013	2018	2019
Δ Credit	306	561	557	582 [1]
Δ Deposit	242	413	341	450 [1]
Funding gap	-63	-148	-216	-132
Issuance fr Capital/Bond market	n.a	20	36	12 [2]
Securities Issued	n.a	6	24	12
IPO/Right Issued	n.a	14	12	0
Bank's Foreign Loan	22	42	64	23 [3]
Δ Total Liquid Assets	n.a	-6	-158	12 [3]
Δ Primary Liquid assets	n.a	-27	-64	-58 [3]

Notes: 1/ Credit and deposit growth in 2019 is estimated at 11% and 8%, respectively; 2/ Realization data up to July 2019; 3/ Realization data up to June 2019. Source: Indonesia Banking Statistics-OJK, Indonesian Financial Statistics-BI, Indonesian Stock Exchange Statistics

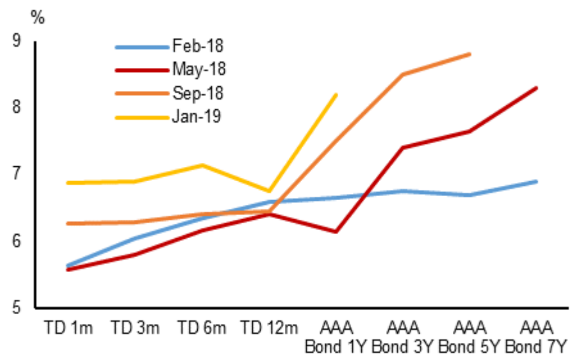
4. **The authorities have conducted pro-active monetary operations and adjusted relevant macroprudential policies to ensure adequate liquidity.** Bank Indonesia (BI) has increased the frequency of repo facility transactions and foreign exchange (FX) swap auctions, as part of open market operations (OMO) since May 2018 (Figure A2.7). In terms of macroprudential policy, BI raised the Macroprudential Liquidity Buffer Ratio[89] that can be repo-ed with BI from 2 percent to 4 percent in November 2018 to increase banks' flexibility in liquidity management. On the monetary policy front, within the total statutory reserve requirement in IDR of 6.5 percent, BI has increased the average statutory reserve component from 1.5 percent to 2 percent in July 2018 and 3 percent in December 2018, to allow more flexibility in banks' daily liquidity management. In June 2019, the total statutory reserve requirement was reduced from 6.5 percent to 6 percent, which may help increase bank liquidity by about IDR25 trillion.

Figure A2.7. Bank Indonesia Term Repo and Swap Transaction Value



Source: Indonesian Financial Statistics – BI

Figure A2.8. Time Deposits and Banks Bond Rates



Source: Indonesian Financial Statistics and Monetary Operation - BI

[88] Total funding through these various instruments were about IDR 121 trillion in 2018, compared to a funding gap of IDR 216 trillion – which is the difference between the increase in bank loans outstanding and deposit stock. Banks external debt, albeit increased by 14 percent (yoy) in 2018, is still at a safe level, partly due to the tight regulations for banks to borrow externally, which was further tightened in the regulation in March 2019[88].

[89] This policy was first implemented in July 2018 replacing the secondary reserve requirement policy. Similar to the previous policy, a bank is required to place 4 percent of its deposits into BI securities or government bonds, but this policy allows banks to repo 2 percent of the securities to BI in the case of tight liquidity.

5. **Despite some improvement in early 2019, continued monitoring of liquidity conditions is warranted given ongoing uncertainty in the global financial market.** Despite a dip in May, possibly due to the increased liquidity demand during the Eid-ul-Fitr celebrations, the liquidity ratio has generally increased in general since early 2019 (Figure A2.3). The return of capital inflows, coupled with above-mentioned policy measures, are expected to support banks' liquidity moving forward. However, risks of financial market volatility remain, which may lead to recurrent liquidity tightness, and rising funding costs. While bond issuance is a stable source of funding, the mobilization of funds through the capital market carries risks, especially when there is pressure on the markets. In a depressed financial market condition, yields demanded by market participants could increase significantly as happened in the second half of 2018 (Figure A2.8). In this regard, the authorities should prepare various policy options to maintain adequate banking liquidity conditions, including recalibrating the statutory reserve requirement and making BI's repo and swap facilities available for the banks.