Document of

The World Bank

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Report No: PGD3915

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

SUPPLEMENTAL FINANCING DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF JPY 31,975.6 MILLION (US$ 300 MILLION EQUIVALENT)

TO

THE REPUBLIC OF INDONESIA

FOR THE

Indonesia First Financial Sector Reform Development Policy Financing: COVID-19 Supplemental Financing

May 8, 2020

Finance, Competitiveness and Innovation Global Practice
Macroeconomics, Trade and Investment Global Practice
East Asia and Pacific Region

Republic of Indonesia

GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of April 30, 2020)
Currency Unit: Rupiah (IDR)
US$ 1.00 = IDR 14,874
US$ 1.00 = JPY 106.585
JPY 1 = IDR 140

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
AF	Additional Financing
AFD	French Development Agency
AIIB	Asia Infrastructure Investment Bank
API	Application Program Interface
ASEAN	Association of Southeast Asian Nations
Bappenas	Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
BI	Bank Indonesia
BKF	Badan Kebijakan Fiskal (Fiscal Policy Agency)
BoP	Balance of payments
CAD	Current Account Deficit
CAR	Capital Adequacy Ratio
CMEA	Coordinating Ministry of Economic Affairs
COVID-19	Coronavirus disease 2019
CPF	Country Partnership Framework
CPI	Consumer Price Index
DFAT	Australia Department of Foreign Affairs and Trade
DJAHU	Direktorat Jenderal Administrasi Hukum Umum (Directorate General Legal Affairs)
DJPPR	Direktorat Jenderal Pengelolaan Pembiayaan dan Risiko (Directorate General of Financing and Risk Management
DNDF	Domestic Non-Deliverable Forward
DPL	Development Policy Loan
DPO	Development Policy Operation
DRFI	Disaster Relief Financing and Insurance
DTKS	Indonesia Social Registry
EAP	East Asia Pacific
FDI	Foreign Direct Investment
FI	Financial Institution
FX	Forex (Foreign Exchange)
FY	Fiscal Year
G2P	Government to Person
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GNP	Gross National Product
GoI	Government of Indonesia
GRS	Grievance Redress Service
IBRD	International Bank for Reconstruction and Development
IDR	Indonesian Rupiah
IEC	Information, Education and Communication
IFC	International Finance Corporation
IMF	International Monetary Fund
IPF	Investment Project Financing
IsDB	Islamic Development Bank
KOMINFO	Kementerian Komunikasi dan Informatika (Ministry of Communication and Informatics)
KSSK	Komite Stabilitas Sistem Keuangan (Financial System Stability Coordinating Forum)
JICA	Japan International Cooperation Agency
Laku Pandai	Layanan Keuangan Tanpa Kantor (Branchless Banking Service)
LKD	Layanan Keuangan Digital (Digital Financial Services)
LPS	Lembaga Penjamin Simpanan (Indonesia Deposit Insurance Corporation)
LSSR	Large Scale Social Restrictions
MoF	Ministry of Finance
MoLHR	Ministry of Law and Human Rights
MSMEs	Micro, Small and Medium-sized Enterprises
NBFI	Non-Bank Financial Institution
NPLs	Non-performing Loans

OJK	Otoritas Jasa Keuangan (Indonesia Financial Service Authority)
PBC	Performance Based Conditions
PBL	Policy Based Loan
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
Perppu	Peraturan Pemerintah Pengganti Undang-undang (Government Regulation in-lieu of Law)
PerPres	Peraturan Presiden (Presidential decree)
PforR	Program for Results
PKH	Conditional Cash Transfers Program
PMK	Peraturan Menteri Keuangan (Minister of Finance Regulation)
POJK	Peraturan Otoritas Jasa Keuangan (Indonesia Financial Service Authority Regulation)
QR code	Quick Response Code
QRIS	QR Code Indonesia Standard
RRR	Reserve Requirement Ratio
SBN	Government Bonds
SCD	Systematic Country Diagnostic
SCV	Single Customer View
SIKS NG	Indonesia Information System
SMEs	Small and Medium-sized Enterprises
SOEs	State-owned enterprises
TA	Technical Assistance
ToT	Terms of Trade
UNICEF	United Nations Children Fund
UNOCHA	United Nations Office for the Coordination of Humanitarian Affairs
USAID	United States Agency for International Development
USD	US Dollar
VAT	Value Added Tax
WB	World Bank
WBG	World Bank Group
WHO	World Health Organization

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REPUBLIC OF INDONESIA

INDONESIA FIRST FINANCIAL SECTOR REFORM DEVELOPMENT POLICY FINANCING: COVID-19 SUPPLEMENTAL FINANCING

TABLE OF CONTENTS

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Parent Project
P174025	P170940

Proposed Development Objective(s)

The program development objective of this programmatic operation is to support financial sector reforms that will assist the Government of Indonesia (GoI) in achieving a deep, efficient and resilient financial sector. The proposed operation is the first in a series of three programmatic operations.

This programmatic DPL series is structured around the following three pillars and set of objectives:
• Pillar A: Increasing the Depth of the Financial Sector. Pillar objectives: to expand the size of the financial sector by increasing outreach, broadening financial market products and mobilizing long-term savings.
• Pillar B: Improving the Efficiency of the Financial Sector. Pillar objectives: to lower the costs for individuals and enterprises by strengthening the insolvency and creditor rights framework, protecting consumers and personal data and promoting interoperability of payment systems.
• Pillar C: Strengthening the Resilience of the Financial Sector. Pillar objectives: to strengthen the capacity of the sector to withstand financial and non-financial shocks by strengthening the resolution framework, implementing sustainable finance practices and establishing disaster risk finance mechanisms.

Organizations

Borrower:	REPUBLIC OF INDONESIA
Implementing Agency:	FISCAL POLICY AGENCY, MINISTRY OF FINANCE

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**300.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	300.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Substantial

Results

Indicator Name	Baseline	Target
1 - Reduction in the percentage of adults stating distance is the foremost barrier to opening a transaction account (FI account and mobile money) (%)	19.3 [2017]	10.2 [2022]
2 - Average transactions by beneficiaries through social assistance (KKS) accounts per year	0.8 [2019]	2 [2022]
3 - Outstanding IDR-denominated private debt securities (IDR trillion)	412 [2018]	711 [2022]
4 - Reduced portion of short-term investments (cash, bank deposits) in pension fund portfolios (%)	19.3 [2017]	16 [2022]
5 - Number of insolvency cases opened by the court, evidencing greater access by firms	304 [2018]	334 [2022]
6 - Number of financial product marketing violations detected per year	200 [2018]	400 [2022]
7 – Number of payment services providers (bank and non-bank financial institutions) facilitating QR payments	8 [2018]	40 [2022]
8 - Number of days for LPS to pay out insured depositors in closed commercial banks	90 [2018]	7 [2022]
9 - Number of bank resolution plans finalized by LPS	0 [2019]	All systemic banks [2022]
10 – Commercial banks complying with sustainable finance practices (%)	0 [2019]	75 [2022]
11 - Utilization of the pooling fund for disaster response financing.	Pooling Fund not established [2019]	Pooling fund utilized in disaster response [2022]

IBRD SUPPLEMENTAL FINANCING DOCUMENT FOR A PROPOSED LOAN TO REPUBLIC OF INDONESIA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed operation provides JPY 31,975.6 million (US$ 300 million equivalent) in supplemental financing for the First Financial Sector Reform Development Policy Operation (DPO1) to help the Government of Indonesia (GoI) cover an unanticipated financing gap that has arisen due to the impact of the COVID-19 outbreak**. On March 20, 2020, the Board approved DPO1 – valued at US$ 300 million – which had the development objective of: i) increasing the depth, ii) improving the efficiency and iii) strengthening the resilience of the financial sector. The request for supplemental financing is consistent with the World Bank policy on Development Policy Financing.

2. **The escalating COVID-19 outbreak constitutes a twin supply and demand shock with financial, fiscal, and social ramifications whose full magnitude and duration remain unclear.** With the rapid spread around the world, the outbreak has reached pandemic proportions and prompted a flurry of emergency measures – including containment measures (travel bans, mandatory closure of businesses, limitations on gatherings), fiscal relief packages to cushion the impact on households and firms (social protection and assistance measures, interest rate cuts, liquidity support, etc.) and measures to avert a dislocation in financial markets. Indonesia declared its first official cases on March 2, 2020. Since then, the daily rate of contagion has increased rapidly. As of April 26th, Indonesia has recorded nearly 9,000 cases along with almost 750 deaths, but poor testing limits the reliability of these figures. The recorded fatality rate of 8.4 percent in Indonesia is the highest in ASEAN. The GoI decided to ban the annual Idul Fitri holiday exodus (*mudik*) and suspended commercial air transportation services as well as applied traffic restrictions on toll roads for public transport and private vehicles from April 24th until June 1st, 2020. Moreover, authorities in Jakarta and satellite cities have imposed Large Scale Social Restriction (LSSR) measures to stem the spread of COVID-19 and several other cities have instructed people to stay at home. The peak of the outbreak and its second-round effects are yet to come.

3. **The public health measures taken to manage the outbreak have led most economic activities to come to a sharp halt, and policy responses have been announced to soften the impact on the economy.** Markets for products and services are affected by shrinking demand and supply. Industries that were first to be hit include tourism and transportation; however, given the scale of the outbreak and the measures, the adverse impact is widespread. These negative economic effects will increase with the duration and severity of the outbreak. In response, the Government is implementing a number of measures to cushion the expected adverse economic effects, focusing on three priority areas: enhancing healthcare, expanding social protection and preventing mass bankruptcies in the private sector that could adversely affect potential output. A Government Regulation in-lieu of Law (Perppu No1/2020), issued by President Jokowi on March 31st, allows the authorities to undertake extraordinary measures to fight the COVID-19 outbreak, including a relaxation of the 3 percent of GDP fiscal deficit rule through 2020-22 and allowing Bank Indonesia to purchase government bonds directly in the primary market. A sequence of three packages of measures, for a total US$ 28.7 billion (2.7 percent of GDP), has been issued by the Ministry of Finance (MoF), including US$ 9.9 billion (35 percent of total financing) for loan restructuring programs

and credit facilities for SMEs and US$ 7.3 billion (25 percent of total financing) for social safety nets.[1] The MoF is also working closely with Bank Indonesia (BI), the Financial Services Authority (OJK) and Deposit Insurance Corporation (LPS) to avoid a systemic crisis. BI has implemented various measures to cushion the depreciation of the currency and inject liquidity in the market while OJK has issued regulations which, among others, temporarily allow special treatment to lending to MSMEs and other COVID-affected debtors and provide relaxation for the establishment of attendance quorum in General Shareholders Meetings.

4. **Despite GoI budget reallocations, the health-related expenses and fiscal measures to support the poor and vulnerable and the economy have contributed to substantial unanticipated financing needs that would be challenging for the GoI to meet solely by financing through capital markets.** The Government's unanticipated gross fiscal financing need is estimated to increase by IDR 600 trillion (US$ 39.7 billion or 3.8 percent of GDP) in 2020. Further unanticipated financing needs are likely to arise with a protracted duration of the pandemic. Global financial markets remain extremely volatile as investors struggle to assess and price the rapidly evolving impact of the outbreak and the effectiveness of emerging policy responses. As a result of this uncertainty, risk aversion has soared, and investors continue to scramble for traditional safe haven assets. In Indonesia, while the financial sector remains resilient, the volume of bids in government bond auctions has declined sharply, and spreads and yields have risen rapidly, especially for IDR-denominated 5- and 10-year bonds whose yields have increased by around 120 bps. This indicates that financing the additional fiscal needs through bond markets is likely to be more costly, leading to larger debt servicing costs in the medium-term, underscoring the critical need for multilateral financing. Diversifying funding sources using MDB financing is also important as it provides a positive signaling effect to financial markets.

5. **This proposed US$ 300 million equivalent in supplemental financing is part of a broader emergency package offered by the World Bank, anchored to the key measures taken by the Government and complemented by the support of other development partners.** The World Bank emergency package also includes a US$ 250 million health-related operation and a US$ 100 million top-up of additional financing for social protection. This will be followed by another package of World Bank operations that would support Indonesia during the post pandemic economic recovery phase. The planned operations would, on one hand, promote structural and transformative reforms to diversify the Indonesian economy by attracting more investments into key sectors, relaxing trade barriers, reforming SOEs and increasing infrastructure investment. On the other hand, the operations would also strengthen the country's financial and fiscal resilience to disasters, potentially including also epidemics. The proposed World Bank emergency package has led to complementary efforts from other multilateral and bilateral development partners such as the Asian Development Bank (ADB), Asian Infrastructure Investment Bank (AIIB), Islamic Development Bank (IsDB) and others. Total short-term emergency financing from international donors currently amounts to nearly US$ 3.9 billion with the World Bank contributing 16.7 percent.[2] Further financing is expected to be mobilized for the economic recovery phase. To date,

[1] The three packages include an (i) IDR 8 trillion (US$ 529 million) package to protect the tourism sector and affected households; (ii) an IDR 21 trillion (US$ 1.4 billion) package focused on protecting supply chains and (iii) an IDR 405 trillion (US$ 26.8 billion) package to provide immediate support to three priority areas: healthcare (IDR 75 trillion; US$ 4.9 billion), social safety nets (IDR 110 trillion, US$ 7.2 billion) and business sector (IDR 70 trillion/US$ 4.6 billion in tax incentives and IDR 150 trillion/US$ 9.9 billion for loan restructuring programs and credit facilities for SMEs).

[2] Based on information obtained from development partners as of May 7, 2020.

Indonesia has not requested financing from the International Monetary Fund (IMF).

6. **The program supported by the three-DPO programmatic series remains on track and its reforms are highly relevant for supporting the Government's response to COVID-19.** The package of supplemental and regular DPOs of the programmatic series plays a key role in cushioning the COVID-related crisis by supporting the real economy (i.e. channeling funds to households and firms while maintaining the resilience of the financial sector) and managing second round effects related to the deterioration of asset quality and banks' balance sheets. The DPO series supports reforms to develop new long-term instruments to broaden Indonesia's investor base and deepen its capital markets, which are critical in rendering Indonesia's asset market less vulnerable to foreign portfolio outflows; reforms to increase the number of payment channels, which are crucial for the implementation of large-scale social assistance payments to protect livelihoods during the crisis; and reforms to strengthen the resolution framework for troubled banks and establish a clear funding mechanism, which will be a key element of a recovery strategy. Supplemental financing for DPO1 is a preferable option to attempting to accelerate the processing of DPO2, given that several reforms supported by DPO2 involve substantial regulatory changes that will require considerable government attention to complete. Requiring progress on these reforms to be accelerated under the current circumstances would be inconsistent with the GoI's current need to focus on the COVID-19 response.

7. **The Government remains committed to the implementation of the supported actions in DPO1 which are even more important in light of the COVID-19 outbreak.** The Government has already started to take significant steps towards completion of the indicative triggers for DPO2 (see Table 5 for details). These are particularly important as financial sector resilience – one of the key development objectives of the DPO program – could be tested, with local banks facing pressures as volatile financial markets weigh on funding to the real sector and the risk of SME bankruptcies likely to impact banks' balance sheets. While the banking system is well capitalized, and profitability is high, the lack of depth in the Indonesian financial markets, with a high share (approximately 40 percent) of government bonds being held by non-residents and a narrow institutional investor base, makes the country more vulnerable to external shocks. The presence of non-bank financial institutions (NBFIs) vulnerable to a liquidity crunch, higher capital outflows following flight-to-safety effects, the deterioration in corporate credit quality compounded by a weak insolvency framework, the refinancing risk of maturing debt on the corporate bond market and the higher cost of capital on the equity market are all potential transmission channels of the crisis through the financial sector, that the specific reforms of the current DPO series can help to address and mitigate.

2. THE IMPACT OF THE CRISIS, ECONOMIC DEVELOPMENTS AND OUTLOOK

8. **An outbreak of the COVID-19 infection has been spreading rapidly across the world since December 2019, following the diagnosis of initial cases in Wuhan, Hubei Province, China.** COVID-19 is one of several infectious diseases outbreaks in recent decades that have emerged from animals in contact with humans, resulting in major infections with significant public health and economic impacts. On March 11, 2020, the World Health Organization (WHO) declared COVID-19 a global pandemic. As of April 26th, the outbreak has spread to almost 3 million people with over 200,000 deaths across 185 countries and

territories.[3]

9. **The coronavirus pandemic threatens to reverse Indonesia's gains in poverty reduction.** With 9.4 percent of Indonesians living below the national poverty line in March 2019, the country has made impressive progress in reducing poverty. But the pace of declines post-2010 has slowed down to only about half that between 2003 and 2010, while leaving 20 percent of the population with living standards just above the poverty line and highly vulnerable to falling into poverty. In the context of slowing economic growth, declining commodity prices, and increasing global uncertainty, the coronavirus pandemic threatens to reverse the recent gains in poverty reduction, due to adverse impacts stemming from the direct and indirect effects of illness, preventive behaviors of people, and the transmission control policies of the government. Preliminary estimates suggest that the pandemic could increase poverty incidence by 2.1 to 3.6 percentage points, translating into between 5.6 to 9.6 million additional poor relative to 2020 without the pandemic.

10. **Poor and vulnerable Indonesians are at particular risk of adverse outcomes, with urban populations already being affected.** First, the vulnerability to infection and burden of disease for the poor and vulnerable in directly affected urban areas is more intense than among the non-poor due to risk factors such as poorer diets, lower access to quality health services, higher prevalence of smoking, poorer hygiene and sanitation practices, and inability to afford inputs to preventive behaviors (e.g. masks, hand sanitizers, etc.). Second, past research shows that increased labor supply among healthy household members and transfers from non-resident members play a role in helping Indonesian households cope with shocks from illnesses. Neither of these mechanisms will mitigate the present situation, given that the economic effects are widespread and adversely impact the sectors that employ many poor and vulnerable. Much of the progress in reducing poverty between 2000 and 2017 was due to addition of jobs in low-value-added services, such as wholesale and retail trade, accommodation and food/beverage services, and other services, which accounted for nearly half of all new jobs created during this period. International travel restrictions have dramatically reduced demand for these services in the tourism sector, while demand among Indonesian consumers has dropped dramatically due to the social distancing measures introduced in urban areas. Many vulnerable Indonesians work informally in these sectors, including the gig economy, without employment insurance, work contracts, or provisions for sick leave, and therefore have no protection whatsoever when cash-constrained enterprises let workers go as these jobs do not allow for remote work. Third, any increase in prices of imported staple foods, resulting from a decline in exports from countries severely affected by the pandemic, disproportionally hurts the poor and vulnerable, for whom food expenditures average 66 to 75 percent of the household budget. These hit the urban poor the hardest. Rural poor deriving incomes from agricultural activities remain initially buffered, as food production in Indonesia is a largely domestically-oriented and protected industry. However, both agricultural and non-agricultural labor incomes may decline if the Government is unable to contain transmission within urban areas and the pandemic spreads to rural areas. Domestic migration patterns may exacerbate this.

11. **Most Indonesians are employed in micro, small, and medium-size enterprises, which often have less capital for day-to-day operations than bigger companies and are highly vulnerable to shocks.** In sectors outside of agriculture and public administration, less than 2 percent of firms have 20 workers or

[3] John Hopkins COVID-19 Dashboard. https://coronavirus.jhu.edu/map.html

more, while more than 89 percent have fewer than 5 workers and are classified as microenterprises. Further, over 90 percent of business enterprises are in the informal sector, with at least half in retail or wholesale and restaurant or food and beverage services, and hence highly vulnerable to global trends in the tourism industry as well as demand for services in the domestic market. These enterprises routinely report lack of access to credit as a constraint to growth, and this also contributes to low resilience in face of shocks to demand such as those stemming from the pandemic.

RECENT ECONOMIC DEVELOPMENTS

12. **Like many other East Asian countries, Indonesia entered 2020 and the COVID-19 crisis on the back of a 2019 growth that slowed, due to unfavorable external demand conditions.** Annual GDP growth for 2019 was 5.0 percent,[4] down from 5.2 percent in 2018, as domestic drivers of growth weakened (Table 1, Pre-COVID Projections). Government consumption growth slowed with weak revenue collection contributing to spending restraint towards the end of the year. Fixed investment growth also slowed as commodity prices contracted, global trade policy uncertainty lingered, and public infrastructure projects wrapped up. In contrast, partly lifted by strong political party spending in the first half of the year, private consumption grew the fastest since 2014. The weaker domestic demand was mirrored by a strong contraction in imports. With tepid external conditions, exports also declined, but by a smaller magnitude, leading net exports to make a large contribution to growth.

Table 1. Evolution of Forecasts of Key Macroeconomic Indicators

	2019*	2020	2021	2022	2020	2021	2022	2023
	Actual	Pre-COVID Projections			Current baseline projections			
Real economy								
Real GDP (% change)	5.0	5.1	5.2	5.2	0.0	5.4	5.5	5.2
Private Consumption (% change)	5.2	5.1	5.2	5.2	0.0	6.0	5.4	5.2
Gross Fixed Investment (% change)	4.4	5.0	5.3	5.5	-3.0	5.0	5.7	5.0
Exports (% change)	-0.9	1.5	2.5	3.5	-12.5	-3.0	4.5	5.0
Imports (% change)	-7.7	0.5	1.8	3.0	-16.0	-5.0	3.0	4.0
CPI (year-average, %)	2.8	3.5	3.5	3.0	2.9	3.0	2.7	2.7
Fiscal accounts of Central Government, percent of GDP								
Revenues	12.4	12.8	13.2	13.3	10.5	11.1	11.6	12.3
of which tax revenue	9.8	10.4	10.8	11.0	8.7	9.0	9.5	10.2
Expenditures	14.6	14.8	15.2	15.4	15.6	15.1	14.9	15.0
Fiscal Balance	-2.2	-2.1	-2.0	-2.0	-5.1	-4.0	-3.3	-2.7
Net Financing	2.2	2.1	2.0	2.0	5.1	4.0	3.3	2.7
Use of financial assets (if positive)	-0.3	0.0	0.0	0.0	-0.7	0.3	0.2	0.0
Net Borrowing	2.6	2.1	2.0	2.0	5.8	3.7	3.1	2.7
Net local currency borrowing		1.8	1.8	1.7	5.3	3.1	2.6	2.1

[4] Q4 2019 national accounts data were released on February 5, 2020 confirming the GDP growth of 5.0 percent for 2019.

Net foreign currency borrowing		0.2	0.2	0.3	0.4	0.7	0.5	0.7
Central Government Debt	30.2	30.2	30.1	30.2	36.6	37.5	37.8	38.2
Balance of Payments, percent of GDP unless indicated otherwise								
Balance of Payments	0.4	0.2	0.3	0.5	-1.6	1.1	1.1	1.2
Current account balance, of which	-2.7	-2.7	-2.6	-2.4	-2.6	-2.4	-2.2	-2.3
Goods trade balance	0.3	-0.1	-0.3	-0.3	1.0	1.1	0.8	0.1
Service trade balance	-0.7	-0.4	-0.3	-0.3	-1.1	-1.2	-0.9	-0.3
Income balance	-2.3	-2.1	-2.0	-1.8	-2.5	-2.3	-2.1	-2.0
Financial account, of which	3.3	2.9	2.9	2.9	1.0	3.5	3.3	3.5
Net FDI inflows	1.8	1.8	1.9	1.9	1.0	1.6	1.7	1.7
Net portfolio inflows	1.9	0.8	0.7	0.6	0.3	2.0	1.8	1.9
Net other investment inflows (incl loans)	-0.5	0.2	0.3	0.4	-0.2	-0.2	-0.2	-0.1
FX reserves (months of imports)	8.7	…	…	…	…	…	…	…
Exchange rate	14148.0	…	…	…	…	…	…	…
GDP nominal in US$ (billions)	1,119	1,208	1,308	1,415	1,059	1,181	1,306	1,391

(1) Includes projected securities repayments from 2020-22. These are not included in the historical data from 2017-19, as these data are not published. (2) capital account, derivatives and errors and omissions. *The 2019 Figures are actuals; The Parent DPL had Q3 figures projections for 2019. All Projections for pre-COVID refer to the projections in the parent DPL and Current baseline projections refers to current projections as of late March 2020, keeping in mind that the crisis is still unfolding. Source: Ministry of Finance, Bank Indonesia, World Bank staff projections for 2020-2023.

13. **Due to the narrower current account deficit (CAD) and larger financial account surplus, the Balance of Payments (BoP) swung to a surplus in 2019, leading to higher reserves.** The CAD narrowed from 2.9 percent of GDP in 2018 to 2.7 percent of GDP in 2019, on account of total imports values contracting faster than exports values, and more than offsetting a deterioration in the terms-of-trade. With stronger direct and portfolio investment, the financial account surplus widened for the year. Capital inflows also supported the Rupiah, which hovered around IDR 14,100 per US$ for most of 2019, while bond yields fell. Due to the narrower CAD and larger financial account surplus, the BoP swung to a surplus of 0.4 percent GDP in 2019 from a deficit of 0.7 percent GDP in the previous year. Foreign reserves were also adequate, with over 8.7 months of import cover at the end of 2019.

14. **The fiscal deficit in 2019 widened to 2.2 percent of GDP from 1.8 percent in 2018, primarily due to lower revenue growth.** The smaller increase in revenue collections was due to streamlined tax refunds, and lower commodities prices and contracting imports, which weighed on both tax and nontax revenues. Subsequently, the tax-to-GDP ratio dropped to 9.8 percent of GDP, 0.4 percentage point lower than in 2018. Fiscal expenditures amounted to 14.6 percent of GDP, less than the 14.9 percent in the previous year, partly due to contractions in material, capital, and energy subsidy spending. The 2.2 percent of GDP deficit was wider than the budgeted target of 1.8 percent of GDP, but still well below the 3 percent legal limit at that time. Central government-to-GDP reached 30.2 percent of GDP, also well below the legal limit. The GoI has limited exposure to explicit contingent liabilities in the form of loan guarantees to SOEs (1.4 percent of GDP for 2019, well under the guarantee ceiling of 6.0 percent of GDP), and non-financial

SOE borrowing at 6.5 percent of GDP at end-2019.

MACROECONOMIC OUTLOOK

15. **Economic growth is expected to plunge to zero percent in 2020 on account of COVID-19 effects.** At the beginning of 2020, the medium-term macroeconomic outlook was positive, subject to downside risks related to lingering global trade policy uncertainty and a possible slowdown in China.[5] GDP growth was projected to be 5.1 percent for 2020 and was expected to gradually pick up to an average of 5.2 percent in 2021-22 with stronger global economic growth and international trade flows partly owing to the endorsement of the U.S.-China Phase One Trade Agreement. However, reflecting significantly weaker private consumption and investment growth due to the COVID-19 outbreak, real GDP is now expected to be flat in 2020, despite expansionary monetary and fiscal policy.[6] This growth outlook is predicated on continued social distancing measures throughout Indonesia and a stringent lockdown of Jakarta and satellite cities for two months into early June. In addition, it is assumed that the global economy experiences a recession in 2020 that is substantially worse than the 2008-09 Global Financial Crisis (GFC). Uncertainty surrounding the growth outlook is extremely high, given that the infection is still evolving locally and globally and could still impact domestic and external economic conditions.

16. **Private consumption and investment are expected to slow sharply with the imposition of the Large Scale Social Restriction (LSSR).**[7] As a growing proportion of the population undertakes home-based-work and other personal preventive behaviors to avoid infection, consumption of services such as transportation, food and beverages and entertainment, are all expected to sharply decline. Job losses, resulting from the plunge in economic activity,[8] as well as the decline in consumer confidence,[9] will exacerbate the slowdown in private consumption. Similarly, investment growth is also projected to fall markedly due to the large uncertainty associated with the infection and its containment, weaker economic activity, lower commodity prices and the global slowdown. While Government consumption growth is projected to accelerate significantly with fiscal mitigation measures, it is unlikely to offset the weaker components of domestic demand.[10] Both export volumes and import volumes are projected to contract on adverse external conditions, with imports shrinking more rapidly on sharply weaker domestic demand.[11] Net exports are expected to make a positive contribution to overall headline growth. Despite

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[5] Macroeconomic forecasts were previously updated on February 10, 2020 with release of the Q4 2019 national accounts data (February 5) and Q4 2019 BoP data (February 10). This was prior to the first official occurrence of infection in Indonesia on March 2.

[6] Bank Indonesia lowered the policy rate 25 bps each in February and March. Similarly, with the implementation of fiscal measures, the Government expects the fiscal deficit to widen to 5.1 percent of GDP this year from 2.2 percent of GDP in 2019.

[7] On April 10, authorities in Jakarta imposed the Large-Scale Social Restriction (LSSR) to stem the spread of COVID-19. Schools and most workplaces are closed, with eight essential sectors being exempted. In addition, gatherings of more than 5 people are banned and public transportation vehicles are limited to 50 percent capacity with restricted operating hours.

[8] In March 2020, the Indonesia Manufacturing PMI fell to a survey record low of 45.3, while retail sales contracted 5.4 percent, the weakest in more than 8 years.

[9] Consumer confidence, as measured by the Bank Indonesia Consumer Confidence Index, fell to a 3.5 year-low in March 2020.

[10] There are components of the Government's fiscal measures that will not be counted as government consumption, such as cash transfers to the poor and reductions and waivers of corporate and personal income tax.

[11] Under the current scenario, the global economy is projected to undergo a severe recession such that Indonesia's exports contracts 25 percent more than the observed decline in exports during the Global Financial Crisis in 2009. Given that Indonesia's real exports contracted around 10 percent in 2009, exports are therefore assumed to contract 12.5 percent in 2020. Due to a number of factors, imports have been trailing exports for a number of quarters and are expected to continue doing so this year,

the severity and the extent of the economic fallout associated with the pandemic, the economic effects are expected to be transitory and an economic recovery is projected once the infection is contained locally and globally. The precise magnitude of the recovery, however, will be largely dependent on the extent of mobility measures, which will in turn be contingent on the extent, severity and duration of the infection.[12] Proposed economic reforms along with continued monetary and fiscal measures could facilitate a more rapid recovery.[13]

17. **The CAD is projected to slightly narrow to 2.6 percent of GDP in 2020 due to an improving trade balance amid broadly flat terms-of-trade.**[14] Under the pre-COVID scenario, the current account deficit was expected to be flat at 2.7 percent in 2020 and to gradually narrow to 2.4 percent of GDP in 2022 (Table 1, Pre-COVID Projections), reflecting continued policy measures to manage imports. The current baseline projections scenario entails a modestly narrower CAD of 2.6 percent of GDP in 2020 in line with the trade balance improving due to import values contracting more than export values, despite a sharp decline in tourism exports because of widespread travel restrictions. Underpinning the modestly narrower CAD is a broadly stable net terms-of-trade (ToT), with lower projected prices of Indonesia's key commodity exports[15] being offset by lower expected oil prices as Indonesia is a net oil importer.

18. **Indonesia is dependent on portfolio capital to partially finance its CAD and the recent capital outflows from emerging markets due to flight-to-safety effects will exert pressure on the financial account balance (Table 2).** Although the gross external financing needs are not expected to change significantly, the key financing sources are expected to be different. While Indonesia has already issued US$ 7.4 billion in FX bonds, this does not cover the full amount that it was expected to issue in its original financing plan for 2020. Meanwhile, non-resident investors sold approximately US$ 8.4 billion local

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especially given the observed slump in imports from China in Q1 this year. In addition, as observed in past crisis years, the sharp demand in domestic demand is expected to lead to import compression, which further contributes to a weaker performance relative to exports.

[12] Recent anecdotal evidence suggests that the Jakarta LSSR is only casually enforced which poses an upside risk to the growth outlook. Furthermore, the recent agreement among oil producing countries to reduce oil production is likely to support prices of oil and other energy commodities, which poses an additional upside to the growth outlook. The team will continue to evaluate the situation and adjust the forecast accordingly.

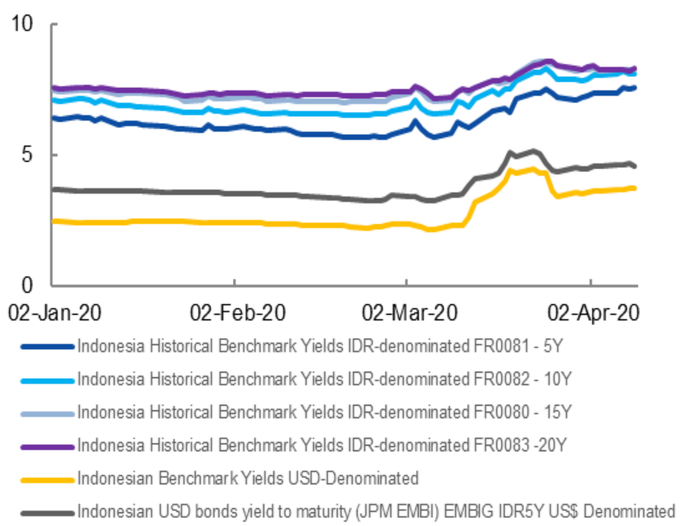
[13] The growth outlook assumes a post-COVID economic recovery that spans two years (2021-22) with private consumption gradually recovering first, then followed by private investment. Stronger real GDP growth is therefore expected for 2021 supported by stronger private consumption, and for 2022 supported by investment growth, before GDP growth moderates towards potential in 2023. This is because firms' balance sheets will take time to be repaired before investment can begin flowing freely again. In addition, with banks' high exposure to the corporate sector, the banking sector may also require time to recapitalize and to reduce the share of non-performing loans. While corporate FX regulations have helped nonfinancial corporates to increase their share of hedged FX loans, their elevated foreign-currency debt levels (close to 45 percent of total nonfinancial corporate debt) also leaves them exposed to FX volatility. The refinancing risk of maturing corporate debt and higher cost of funding in the capital markets is likely to put further pressure on Indonesian corporations and local banks.

[14] One contributing factor to the difference between the WB post-COVID CAD outlook and the IMF's projection for the CAD presented in the Fund Relations Annex is the difference in the terms-of-trade (ToT) computation / assumption. Indonesia is an exporter of coal, natural gas, palm oil, rubber, and some base metals, but is a net importer of crude oil. In our computations of the changes in the net ToT, the decline in oil prices (weighted by its trade share) broadly offsets the decline in the prices of Indonesia's commodity exports, leaving the net ToT broadly unchanged for 2020. In its computation of the ToT, the IMF excludes oil (See Annex 2, Table 1), which would skew the ToT solely towards exports, resulting in a notable negative ToT shock for the current year.

[15] Prices of Indonesia's key export commodities are projected to decline between 7 to 40 percent this year from 2019.

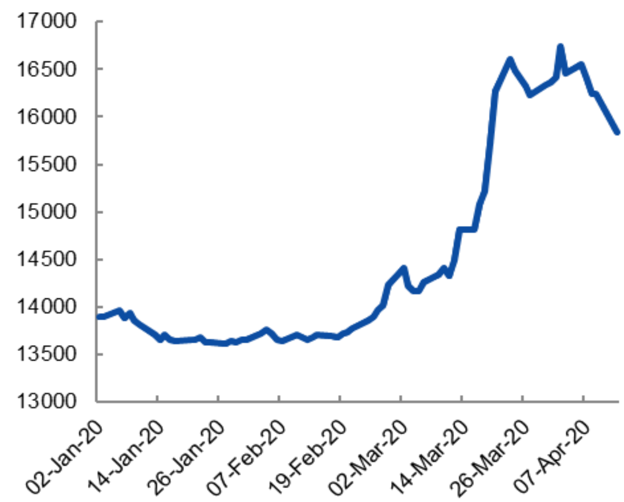
currency government bonds and US$ 740 million worth of listed equities in 2020 year-to-date.[16] Government local currency bond yields have therefore jumped significantly this year, by around 120 bps for five-year and ten-year bonds (Figure 1). Correspondingly, the Rupiah has depreciated as much as 20 percent against the U.S. Dollar this year (Figure 2). If the higher yields persist, debt servicing cost could increase by US$ 600 million per annum over the next 5-10 years.[17] Portfolio investment outflows coupled with declines in FDI inflows, on lower investor confidence, will exert pressure on the financial account balance.[18] Correspondingly, the BoP balance is expected to turn to a deficit in 2020.[19]

Figure 1. Indonesia Sovereign Bonds: Benchmark yields (January to April 13th, 2020),



Source: World Bank staff calculations based on MoF (DJPPR) statistics

Figure 2. IDR/USD Exchange Rate



Note: The EMBIG yields track the weighted average yields of external debt instruments issued by Indonesia and potentially quasi-sovereign entities, denominated in USD.
Source: World Bank staff calculations based on JP Morgan

[16] The bond market has been the most important source of financing for the government, comprising 80 percent of total government financing with the remaining 20 percent being bilateral/multilateral loans. Foreigners hold approximately 39 percent of the stock of government bonds.

[17] Assuming the GoI continues to issue bonds in the amount of approximately US$ 50 billion (based on 2019 projection) in local currency with the average tenor of 5-10 years and with yields 120 bps higher than the pre-COVID levels (based on most recent data). To limit the increase in additional debt service cost, the GoI has issued more USD-denominated bonds than the normal proportion because the yields did not increase as much as those for IDR bonds. However, as a result the GoI would be exposed to more currency risk.

[18] One contributing factor for the post-COVID projections for portfolio flows for 2020-21 being larger than the corresponding pre-COVID projections is that the pre-COVID projections were unusually low, reflecting the U.S. – China trade tensions at the time. The post-COVID projections for portfolio flows in 2020-21 are about 50 percent of observed portfolio flows for 2018-19, accounting for a more cautious investor sentiment in a post-COVID world.

[19] The BoP deficit is expected to be financed by increased multilateral and bilateral loans and foreign exchange reserves. However, the decrease in foreign exchange reserves will lead to a further reduction in the money supply and increased domestic liquidity pressure, and further monetary easing may be warranted.

Table 2: Balance of Payments gross external financing needs (US$ millions)

	2019	2020	2021	2022	2020	2021	2022	2023
	Actual	**Pre-COVID projections**			**Current baseline projections**			
Current account deficit	30,415	32,010	33,195	33,045	27,075	28,081	28,871	31,706
Scheduled government debt amortization	6,075	9,372	10,909	10,933	9,391	10,871	11,971	11,573
Total financing needs	**36,490**	**41,381**	**44,104**	**43,979**	**36,466**	**38,952**	**40,842**	**43,279**
Total financing sources	**36,490**	**41,381**	**44,104**	**43,979**	**36,466**	**38,952**	**40,842**	**43,279**
FDI inflows (net)	20,049	21,969	24,072	25,963	10,139	19,258	19,258	21,758
Portfolio inflows (net)*	21,630	5,127	5,359	5,537	-1,527	16,985	18,569	19,658
Other investment (net) excl government	-3,136	3,355	3,603	3,794	-2,974	-3,316	-3,666	-3,907
Government borrowing (gross)	3,692	13,631	14,893	14,956	14,014	19,052	18,337	20,686
Loans		5,592	5,804	5,759	6,594	6,698	6,447	7,273
Baseline loan projection		5,592	5,804	5,759	4,582	6,698	6,447	7,273
Emergency loans#					2,012	0	0	0
WB					650	0	0	0
Other creditors					1,362	0	0	0
FX bonds		8,039	10,706	10,622	7,420	12,354	11,890	13,413
Other items (net)	-1,069	39	42	44	-469	-355	-240	-132
Use of reserves	-4,676	-2,739	-3,864	-6,315	17,283	-12,672	-13,915	-16,501

Note:* Inc net purchases by non-residents. # The US$ 650 million emergency financing from WB includes this supplemental DPO, the Health PforR and Social Protection additional financing. Emergency financing from other creditors include US$ 1.362 billion based on information at April 22nd, 2020.
Source: World Bank staff calculations based on GoI statistics.

19. **The macroeconomic shock combined with falling revenues and three fiscal packages to mitigate the impact will lead to a wider fiscal deficit of 5.1 percent of GDP in 2020 (Figure 3) and an unanticipated increase in gross fiscal financing needs of 3.8 percent of GDP.** The pre-COVID medium-term fiscal outlook was stable with the budget deficit expected to remain well below 3 percent of GDP through 2022. The impact of the infection through reduced economic activity, potential tax payment difficulties and the fiscal relief measures for businesses and manufacturing workers will manifest itself through a projected drop of IDR 492 trillion (US$ 32.6 billion)[20] in revenue collections compared to the pre-COVID fiscal forecast.[21, 22] On the expenditure side, the Government announced a revised 2020 budget to accommodate the three fiscal packages worth IDR 434 trillion (US$ 28.7 billion)[23] (see Table 4), including notably, a package of IDR 405 trillion (US$ 26.8 billion), of which IDR 255 trillion (US$ 16.9 billion) is expensed through the budget and IDR 150 trillion (US$ 9.9 billion) in off-budget measures (below-the-line).

20. **The emergency response measures aim at strengthening the capacity of the health system,**

[20] Equivalent to 3.1 percent of GDP.
[21] These estimates assume that the CIT reduction will be delayed, as this poses a further 0.5 percent decline on the revenue envelope (WB Staff estimations). Details of the fiscal stimulus packages and other government responses are presented in Section 3.
[22] Revenue collections is expected to be even lower if economic conditions deteriorate further and the baseline GDP growth scenario is not realized.
[23] Equivalent to 2.7 percent of GDP.

protect households and support businesses to prevent mass bankruptcies that would deteriorate banks asset quality and reduce potential output. Due to the reduction in energy subsidy spending due to lower commodity prices, automatic expenditure adjustments in response to lower revenue collections and budget reallocations away from non-essential spending, the current projection for net expenditures through the budget (above-the-line), even when accounting for the costs of the three fiscal packages, is expected to decrease by IDR 28 trillion (US$ 1.9 billion). However, when including the aforementioned IDR 150 trillion (US$ 9.9 billion) in off-budget measures, total fiscal expenditures are projected to increase. With larger expenditures coupled with reduced revenue collections, the fiscal deficit is expected to widen sharply to 5.1 percent of GDP in 2020 from a pre-COVID projection of 2.1 percent. Accordingly, the Government has approved a temporary three-year suspension of the fiscal deficit rule, with the fiscal deficit mandated to return to 3 percent of GDP or under in 2023. A sharp increase in the primary deficit as well as the increase in below-the-line spending will lead to gross fiscal financial needs rising from IDR 766 trillion (US$ 50.7 billion) to IDR 1,365 trillion (US$ 90.4 billion) (Figure 4). Given that the infection is still evolving locally and globally, economic uncertainty remains high and fiscal financing needs are projected to further increase should economic conditions deteriorate more than expected.

Figure 3. Fiscal and Primary Balance (percent of GDP)

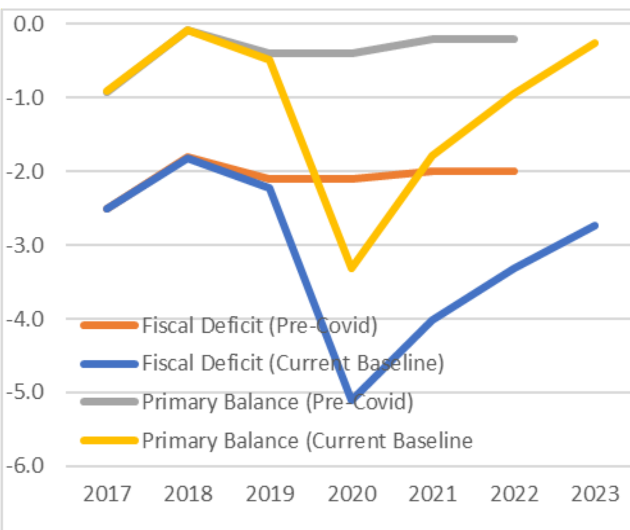
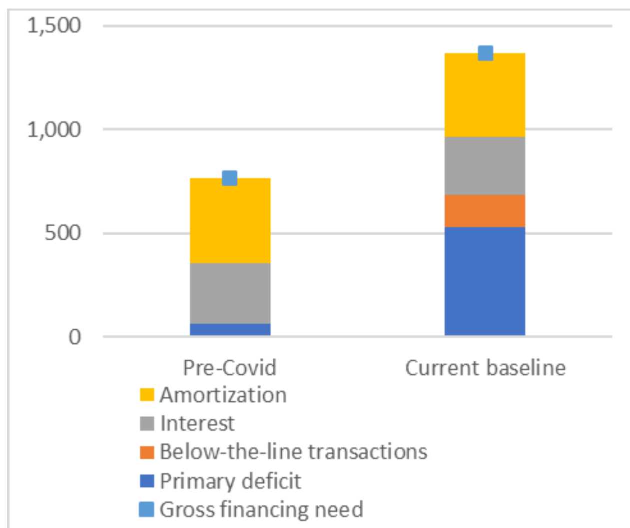


Figure 4. Gross financing needs is projected to increase by IDR 600 trillion



Note: All Projections for pre-COVID refer to the projections in the DPO1 Program Document for Indonesia First Financial Sector Reform Development Policy Financing (P170940), and Current baseline projections refers to current projections as of late March 2020, keeping in mind that the crisis is still unfolding.
Source: Ministry of Finance, Bank Indonesia, World Bank staff projections for 2020-2023.

21. **The higher gross fiscal financial need is expected to be covered by a combination of lending from the domestic banking system, multilateral financing and drawing down the unused stock of cash reserves and funds.** Part of the financing will come from the FX bonds already issued and scheduled loan disbursements, but the withdrawal of non-resident investors from the local currency bond market is expected to put pressure on the domestic financial system to absorb new debt. The banking system, while subject to lower liquidity and increases in non-performing loans, could also be expected to provide

additional financing, since banks have considerable holdings of BI certificates and reserves at BI, which could be reoriented to government bonds, including COVID bonds, if risk-adjusted yields are attractive, but this would mean a higher cost of funding for the Government. The banking system is therefore now projected to provide IDR 1,108 trillion of financing (Table 3).[24] The World Bank's loan package would finance around IDR 10 trillion[25] and other creditors would finance approximately IDR 20 trillion[26] in emergency loans. The remaining financing of 46 trillion is assumed to come from the MoF's stock of accumulated cash reserves, which amounted to around IDR 200 trillion at end-2019.[27]

Table 3. Changes in gross fiscal financing needs and sources for 2020 (IDR Trillion)

	Pre-COVID	Current baseline	*Difference*
Primary deficit	62	530	*468*
Below-the-line transactions	0	150	*150*
Interest	289	286	*-3*
Amortization	414	399	*-15*
Gross financing need	**766**	**1,365**	***600***
Financing sources	**766**	**1,365**	***600***
Cash Reserves and Funds	0	46	*46*
Net financing by non-residents	169	0	*-169*
LC debt for residents only	425	1,108	*683*
FX debt	172	212	*40*
Loans	60	100	*39*
Planned FX loans	60	69	*9*
Emergency FX loans		30	*30*
WB		10	*10*
Others #		21	*21*
FX Bonds	111	112	*1*

Note: Interest costs and amortization costs (=debt service) for 2020 are higher in the pre-COVID projections compared to our current projection, even if we now have a depreciated exchange rate and FX debt service should be higher, all else equal. The reason is the pre-COVID projected debt service for 2020 based on actual 2019 debt data and then projected the fiscal data for 2019, whereas we now use actual data for 2020 debt service. The differences (-3 and -15 trillion IDR in differences column) are not driving the results anyway as the key is the widening of the primary deficit and the additional below-the-line financing for the National Economic Recovery. # Emergency FX loans from others include IDR 21 trillion based on information at April 22nd, 2020.
Source: WB calculations based on GoI data.

[24] Based on this funding scenario, banks would plausibly become the major source of incremental Government funding. However, the risk of crowding out private sector credit is considered to be low because (i) BI is supporting bank liquidity by loosening monetary policy (both reserve ratio requirement and the policy rate have been reduced) and (ii) investment and private sector activities are likely to be curtailed by the pandemic.
[25] The three proposed operations of the WB emergency package for health, social protection and this Supplemental Financial Sector DPO amounts to US$ 650 million.
[26] Equivalent to US$ 1.36 billion based on information at April 22nd, 2020
[27] Cash reserves include unused education funds that have a reported balance of IDR 60 trillion, and they could be used exceptionally for budget financing for the COVID crisis.

22. **There are constraints to protracted expansionary monetary and fiscal policies in Indonesia as policy space for both tools are limited.** The impact of the cuts on lending growth has been limited with credit growth of only 6.1 percent. Financial stability indicators confirm the soundness of the sector, with the banking system being well-capitalized with a capital adequacy ratio (CAR) at 22.97 percent in 2019, well above the regulatory requirements and the regional median. However, the lack of depth in the Indonesian banking system, capital and financial markets, makes the country more vulnerable to external shocks.[28] The ratio of non-performing loans (NPLs) at 2.5 percent of gross loans is comparable with other countries, although some signals of possible liquidity pressures are emerging. Amidst a weaker currency, BI has limited policy space and slow policy transmission to the real economy. BI's focus on ensuring stable capital flows to finance Indonesia's current account is especially important during this crisis yet limits space for more monetary easing. The central bank has already spent IDR 163 trillion (US$ 10.1 billion) to buy government bonds in the secondary market to stabilize the Rupiah. Further cuts are unlikely to be effective given the slow transmission to the real economy, yet BI is likely to continue to ease monetary policy.[29] Already, the policy rate has been lowered by 50 bps this year to 4.50 percent to support growth amid the COVID-19 outbreak.

23. **A scenario with a deep recession could materialize if a full lockdown is enforced into Q3**. The projected GDP growth outlook, particularly for 2020, is highly uncertain and is predicated on the current continued imposition of social distancing measures and a stringent lockdown for at least Jakarta for a period of 2 months until early June and that the global economy undergoes a recession this year that is substantially worse than the 2008-09 Global Financial Crisis (GFC). Even with the significantly lowered growth forecast for 2020, risks to the outlook are still heavily tilted to the downside given the high uncertainty surrounding the spread of the virus and timing of its peak and possible containment. Should Indonesia impose a full lockdown in the coming months that extends into most of Q3, then private consumption and investment would be expected to slow and contract even further. At the same time, if external conditions also worsen, and the global economy slips into an even worse recession that is 50 percent deeper than the GFC, then investment and exports would be further dampened, again weighing on Indonesia's economic growth. Under such a scenario, the Indonesian economy would contract in 2020, by as much as 3.5 percent.[30]

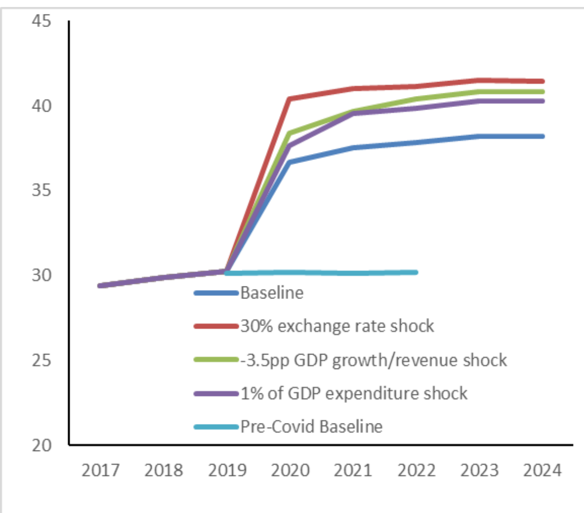
24. **While the impact of and the response to the COVID-19 crisis is projected to increase central government debt to an average of 37.5 percentage points over 2020-23, debt remains sustainable even under a deep recession scenario.** In the pre-COVID scenario, Indonesia central government debt-to-GDP was projected to remain stable around 30 percent during the projection period. The current baseline

[28] There are risks resulting from potential second-round effects such as the deterioration on corporate credit quality, and the refinancing risk of maturing debt on the corporate bond market. The latter is likely to put pressure on Indonesian corporations and local banks. As share prices and bond prices have weakened, companies that have hitherto relied on capital market funding may turn to banks as main source of funding, putting pressure on the banking system and possibly crowding out other firms relying on banks as their source of financing (such as smaller and younger firms). Despite large capital buffers and strong profitability of systemic banks, some small non-systemic banks are vulnerable to liquidity shocks, including FX liquidity shortfalls. Corporate credit quality is likely to deteriorate and banks' high exposure to the corporate sector is an important source of risk.
[29] Despite the rapid deterioration in external conditions, domestic liquidity and funding conditions appear broadly stable as judged by the spread between the interbank and the BI deposit-taking rate (MTI Daily Macroeconomic updates; March 20, 2020).
[30] A causally enforced lockdown and the recent agreement among oil producing countries to reduce oil production to support oil prices pose upside some risks to the growth outlook.

projects that the debt-to-GDP will stabilize at around 38 percent due mainly to the widened primary deficit, the national economic recovery program (below-the-line), and the shock to the exchange rate (Figure 5). A medium-term fiscal consolidation program with a focus on increasing revenue will narrow the primary deficit. A one-off 30 percent depreciation shock and a 1 percent of GDP expenditure shock lasting 2 years would increase the level debt further but would stabilize thereafter. In the event of the deep recession scenario, where GDP contracts by 3.5 percent in 2020 with a corresponding decline in revenue, unanticipated fiscal financing needs would increase to IDR 750 trillion (US$ 49.7 billion), debt-to-GDP would increase to 38.4 percent of GDP in 2020 and stabilize at 40.8 percent of GDP from 2023, all the while below the legal limit of 60 percent. The interest-to-revenue ratio would increase and peak at 21.7 in 2022 before declining (Figure 6). The fiscal deficit would widen to 5.7 percent of GDP in 2020 and is projected to return to pre-COVID level below of 3 percent of GDP in 2023, that is financeable with conventional instruments. With a higher, but stable level of debt, Indonesia can retain a credible fiscal framework.

Figure 5. Projected Central Government Debt-to-GDP, under current baseline, shocks <u>and pre-COVID baseline</u>

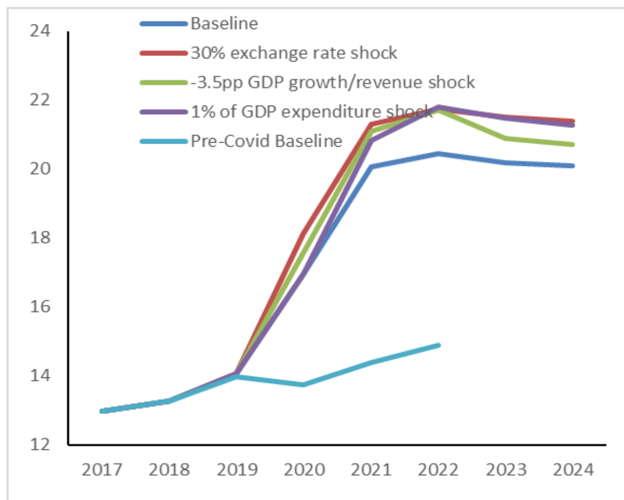
Percent of GDP



Source: MoF, World Bank staff projections.

Figure 6. Projected Central Government Interest-to-revenue ratio, under current baseline, shocks <u>and pre-COVID baseline</u>

Percent of revenue



Source: MoF, World Bank staff projections.

25. **The macroeconomic policy framework is considered adequate for the proposed operation.** Strong economic management has helped improve Indonesia's economic fundamentals with stable and largely resilient economic growth, low inflation, a conservative fiscal deficit, plus enhanced fiscal credibility. The policy mix in response to the COVID-19 crisis has been consistent with macroeconomic stability and the management of risks that may arise. Monetary policy continues to be credible and responsive to the shock within its limited space. The suspension of the 3 percent of GDP fiscal deficit rule to support the health, social and economic measures to mitigate the negative effects of the COVID-19 crisis is legally time-bound and will return in place from 2023, which will contain Indonesia's still low level

of debt. In addition, ongoing reforms such as the Omnibus Bill on Job Creation[31] will contribute to maintaining a conducive and stable fiscal framework, which will consequently support inclusive growth and expand potential growth.

3. RESPONSE TO THE CRISIS

3.1. THE GOVERNMENT'S RESPONSE

26. **The Government of Indonesia has declared COVID-19 a national emergency, and on March 13 designated a COVID-19 taskforce for scaling up response efforts.** The taskforce has been working on synergizing the central and regional governments, military, police, private sector, social foundations and universities. Subsequently, the President announced national social distancing measures for Indonesians encouraging working from home, studying from home, worshipping at home and postponing any activities with big number of participants. The Ministry of Health has expanded the network of COVID-19 referral hospitals from 100 to 359 by including military and state-owned enterprise hospitals and temporarily converted the athlete hotels built for the Asian Games 2018 into quarantine facilities preparing for the sharp increase of confirmed cases. The scaling up of Rapid Diagnostic Test using blood sample has also been announced.[32] The task force has launched a website that contains the updates on the epidemics, linkages with the local governments' corona websites, and information education and communication (IEC) materials.

27. **The Government is implementing measures to cushion the expected adverse economic effects, including interventions to enhance healthcare, expand social protection and prevent mass bankruptcies in the private sector.[33]** The Government has announced three packages of policy responses to the crisis amounting to a total of IDR 434 trillion (2.7 percent of GDP) (Table 4). The first package revealed in late February valued at IDR 8 trillion[34] and focused on protecting the tourism sector and affected households. The second package valued at IDR 21 trillion[35] announced in mid-March focused on protecting supply chains by giving tax relief and facilitating imports and exports through non-fiscal measures. The third package, announced on March 31, valued at IDR 405 trillion,[36] focused on implementing a response to the COVID crisis expanding health, social protection and industry support. These measures will be implemented through a revised budget for 2020.[37]

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[31] The Omnibus bill on Job Creation aims to improve the ease of doing business in Indonesia and attract investment, thereby boosting job opportunities and economic growth. The bill focuses on streamlining business licenses, making Indonesia more open to foreign investment and having a more flexible labor market. The bill would amend 73 laws and consists of 15 chapters and 174 articles. The landmark bill will affect most Indonesians as it covers a wide range of issues from business and education to halal certification and regional government powers.

[32] GoI has expanded the laboratory network to include 10 regional Ministry of Health and local government health laboratories, and two university-based research laboratories, and one non-government institute, The Eijkman Institute.

[33] The fiscal packages are a necessary, but not necessarily sufficient, response to the COVID outbreak. Authorities will need to closely monitor the adequateness of the measures vis-à-vis the projected depth of the shock.

[34] Equivalent to US$ 0.5 billion. Travel incentives valued at IDR 0.4 trillion were not implemented.

[35] Equivalent to US$ 1.4 billion. The announced acceleration of IDR 1.5 trillion worth of VAT refunds was excluded from computation because VAT refunds are assumed to only lead to different cashflows within the year and do not constitute an actual reduction in fiscal revenue.

[36] Equivalent to US$ 26.8 billion.

[37] Preliminary discussions with MoF indicate that the funding for the fiscal measures will be through budget reallocations, mainly

Table 4. Summary of fiscal packages of policy responses to the crisis with estimated costs
(cost of measures in IDR trillion)

Package #	Revenue		Expenditure		Financing[1]		Total Cost	Objectives
#1 Feb 2020[2]	Restaurants and hotels exempted from certain taxes for 6 months	3.3	Increase in subsidies for households' basic needs Tourism grant	4.6 0.1			8.0	Protect affected sectors and households
#2 Mar 2020[3]	For 6 months: - No collection of personal income tax (for manufacturing sector workers) -Postponement withholding tax on imports - Reduction of CIT by 30 percent	8.6 8.2 4.2					21.0	Protect supply chains
#3 Mar 31, 2020			- Health response - Temporary social protection scale-up, including food logistics and Housing subsidy expansion - Industrial support through tax subsidies - Credit stimulus for MSMEs	75 110 64 6	National economic recovery: 150	150	405	Implement COVID response for health, social protection and industry support
Total	24.3		259.8		150.0		434.0	

Notes: (1) These are below the line items and are not included in budgetary expenditure; (2) incentives to encourage tourism valued at IDR 0.4 trillion were not implemented; (3) The announced acceleration of IDR 1.5 trillion worth of VAT refunds was excluded from computation because VAT refunds are assumed to only lead to different cashflows within the year and do not constitute an actual reduction in fiscal revenue. Also not reflected is the Corporate Income Tax rate cut from 25 percent to 22 percent for 2020 and 2021. It may not have a large impact in 2020, as many businesses would make a loss and would already benefit from the 30 percent CIT reduction.

from infrastructure projects, increased borrowing and use of its own surplus funds. The cuts to infrastructure spending at all levels is likely to have a longer-term impact on potential output in the medium term.

28. **In response to expected welfare losses for poor and vulnerable households, the government has adjusted several of its social protection programs.** Given the reduction in labor income through lower consumption, poor and vulnerable households will likely face shocks to their welfare over the coming year. In anticipation and to mitigate those shocks, the government announced several measures in late March. The first was that 15.2 million food assistance e-voucher program (Sembako) beneficiary households would receive a 33 percent higher benefit for the coming nine months.[38] The adjustment brings the value of this social assistance program to comprise 10 percent of the national poverty line and will cost an estimated IDR 4.5 trillion. In addition, the government announced the program would be expanded to reach 20 million households approximately 30 percent of the population. The government has also allocated IDR 25 trillion to provide direct food assistance and logistical support in delivering food directly. Furthermore, for the flagship conditional cash transfer program (PKH), the government has decided to increase benefits by 25 percent for three months for 10 million households, approximately 15 percent of the population, and disburse the benefits monthly. In addition, full electricity subsidies have been announced for households using 450 Volt-Ampere (VA) connections and a 50 percent subsidy for those on 900VA connections between April and June.

29. **In early April, another round of social protection measures was announced.** First, additional direct food assistance of equal worth to the newly announced Unconditional Cash Transfer (BLT) programs (described below) for 1.2 million and 576,000 households in Jakarta and surrounding cities, respectively. Second, besides PKH and Sembako, all households in Indonesia’s Social Registry (DTKS) that do not yet benefit from either of these programs; approximately 9 million households, will receive a temporary unconditional cash transfer (BLT) worth approximately 30 percent of the national poverty line, comprising IDR 16.2 trillion. In parallel, part of the Village Funds (Dana Desa) will be used to fund an additional BLT worth IDR 21 trillion for up to 10 million families that are not receiving central government programs; this program is being organized by the Ministry of Villages. Both BLT variants will run for 3 months. The government also announced that new and existing cash for work programs will be provided additional funds; these include programs under the Ministry of Villages and the Ministry of Public Works and Housing comprising IDR 16.9 trillion for an estimated 600,000 workers.[39]

30. **Several of the social protection measures announced by the government protect both people and firms.** Key amongst them is the announcement of the full financing of employer and employee contributions to the national health insurance scheme for 30 million salaried workers. In addition, as part of the first package announced in later March, Indonesia’s Kartu Pra-Kerja, a program that provides subsidized vouchers for unemployed workers for skilling and re-skilling, has doubled in its allocated budget and will be launched in April. The program will be accessible to an estimated 5.6 million informal workers and small and micro enterprises who have been affected by COVID-19.

31. **Other non-fiscal responses have also been implemented to support the economy, including on international trade, monetary policy and the financial sector, largely in line with Indonesia’s competitiveness agenda.** On the trade front, these include simplification/reduction of Export Restrictions

[38] As of March 2020, Sembako beneficiaries receive IDR 200,000 per month per household that they can exchange at around 80,000 e-Warong shops for rice, eggs, vegetables, fish, chicken and fruit and other eligible produce. The program covers 25 percent of all households in Indonesia.
[39] As described in https://setkab.go.id/pemerintah-berikan-6-program-bantuan-tambahan-hadapi-pandemi-covid-19/

and Limitations (Lartas) for 749 HS codes; simplification/reduction of import restrictions and limitations for steel producers and its derivative commodities, strategic food commodities, horticulture commodities, live animals and animal products, medicines and food ingredients; fasten the process for export and import activities for reputable traders and faster process for exports and imports through National Logistics Ecosystem.

32. **On March 31, Government Regulation in Lieu of Law No. 1/2020 (a "Perppu" or emergency Law) on State Finance Policy and Financial System Stability for the handling of COVID-19 outbreak was issued.** Among others, key measures for the financial sector stability include: (i) that the Financial System Stability Committee may decide to provide short-term liquidity financing to systemic and non-systemic banks to address problems arising from COVID-19 outbreak; and additional, special financing may be extended to systemic banks, (ii) BI may purchase government securities, either in the primary market or secondary market to support government financing and providing market liquidity; similarly it may also provide additional financing to corporations collateralized with government securities (i.e. repo), (iii) Deposit Insurance Corporation (LPS) will intensify preparations for managing insolvent banks, reformulate and implement deposit insurance policy outside the current program, and (iv) OJK may issue instructions to financial service institutions to undergo merger, acquisition, takeover, integration and/or conversion to strengthen financial standing of these institutions.[40][41]

33. **BI has issued measures to stabilize the Rupiah while OJK has issued a regulation to facilitate additional credit for micro, small, and medium enterprises (MSME) and other affected debtors.** Both institutions have deployed appropriate measures given the circumstances, although their effectiveness require close monitoring. The impact of lowering the US$ reserve requirement ratio (RRR) to 4 percent from 8 percent and the Rupiah RRR by 50 basis points (bps) depends on the willingness of banks to extend their credit exposures in a rapidly deteriorating macroeconomic environment. BI has conducted also triple interventions in the financial market: stabilizing the Rupiah in the domestic non-deliverable forward (DNDF) and spot markets, as well as buying government bonds (SBN) on the secondary market.[42] OJK measures, on the other hand, are intended to help the affected sectors address liquidity issues arising from much reduced economic activities (travel restrictions, border closure, and lockdown).[43] The measures are subject to strict monitoring and are only temporary (until March 2021) in order to avoid sustainable deterioration of loan quality in the banking sector. The authorities are also considering a one-year moratorium for subsidized mortgage payments and individuals' auto loans for productive purposes (e.g., taxis and other ride-hailing services).

[40] OJK Regulation No.18/ POJK.03/ 2020.

[41] While policy actions on the financial sector are in line with the extraordinary measures called by the crisis, the authorities will need to monitor implications in the medium and term and consider trade-offs between crisis-response measures and the resilience of the financial sector.

[42] The central bank now allows foreign investors who sell rupiah bonds but place their proceeds in Indonesian banks to turn them into underlying transactions in the domestic non-deliverable forward (DNDF) market. Therefore, foreign investors no longer need to hedge to offshore indexes. BI also encouraged foreign investors to use domestic banks as custodians for investment activities.

[43] OJK Regulation No. 11/POJK.03/2020

3.2. THE BANK'S RESPONSE, STRATEGY, AND COLLABORATION WITH DEVELOPMENT PARTNERS

34. **On March 17, the Boards of Directors of the World Bank and IFC approved an increased $14 billion package of fast-track financing to assist companies and countries in their efforts to prevent, detect and respond to the rapid spread of COVID-19.**[44] The package will strengthen national systems for public health preparedness, including for disease containment, diagnosis, and treatment, and support the private sector. In Indonesia, the World Bank is supporting the Government with a package of operations for both the immediate emergency responses and for the economic recovery phase after containment of the acute infection. In addition to the present Supplemental DPO, the package of emergency support operations includes a US$ 250 million Program for Results (PforR) operation for health-related response measures and a US$ 100 million top up of Additional Financing (AF) of an ongoing Social Assistance PforR project. The health operation focuses on i) addressing the immediate needs of designated COVID-19 referral facilities, ii) strengthening the laboratory network and surveillance system, and iii) ensuring communications and coordination across sectors and levels of government. The social protection's AF top-up is to be disbursed against the introduction of temporary emergency cash transfer in response to COVID-19 and includes US$ 50 million to be disbursed upon the ability of Indonesia's social registry (DTKS) and information system (SIKS NG) to establish a disaster victim database to support better wider, swifter and more comprehensive response to disasters such as COVID-19, through social protection programs. This AF would contribute to increased effectiveness of the social assistance system and is consistent with the parent PforR's high level objective of improving poor and vulnerable families' welfare and opportunities.

35. **Beyond the emergency phase, the World Bank aims to support Indonesia in the post-COVID economic recovery phase through a dedicated package of fast disbursing operations.** The operations will focus on structural, transformative reforms that are expected to support economic diversification by enhancing openness and attracting more investments into key sectors, relaxing trade barriers, reforming SOEs and increasing infrastructure investment, all contributing to higher sustained economic development and poverty reduction. In parallel, an investment project financing (IPF) operation is under preparation and it is aimed at strengthening the financial and fiscal resilience of the Government of Indonesia to disasters, potentially including also epidemics, by establishing a pooling fund to protect the budget against disaster shocks; linking this to pre-arranged disbursement channels to provide targeted and timely response following disaster shocks; and building capacity in the government for the implementation of the National Disaster Risk Financing and Insurance (DRFI) Strategy.

36. **This Supplemental DPO financing helps meet unanticipated financing needs, complementing other sources of finance.** Development partners have committed support to the Government response on the technical (e.g. WHO, UNICEF, USAID – CDC, DFAT), humanitarian (e.g. UN system under the coordination of UNOCHA), as well as financial front. To date, total short-run emergency financing from international donors tentatively amounts to nearly US$ 3.9 billion with the World Bank contributing 16.7 percent.[45] Key development partners such as the Asian Infrastructure Investment Bank (AIIB) and the Islamic Development Bank (IsDB) will each provide co-financing and parallel financing, respectively, to the

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[44] On April 2, the World Bank's Board of Executive Directors approved a first set of emergency support operations for developing countries around the world, using the dedicated, fast-track facility for COVID-19 response. The first group of projects, amounting to $1.9 billion, will assist 25 countries, and new operations are moving forward in over 40 countries using the fast-track process.
[45] Based on information obtained from development partners as of May 7, 2020.

World Bank Health PforR operation. Asian Development Bank (ADB), AIIB and Kreditanstalt für Wiederaufbau (KfW) will also provide a co-financed policy-based loan under ADB's Counter-cyclical Support Facility Response Option (CPRO) while AFD will provide parallel financing to the World Bank's First Financial Sector Reform Development Policy Operation (DPO) based on the same matrix of reforms. Further financial support is expected to support the economic recovery post-COVID 19. Indonesia has not requested financing from the IMF. While DPO funds are not earmarked for specific purposes, quick disbursement of this Supplemental DPO financing would enable the Government to pursue immediate priorities that currently remain unfunded. This immediate availability of funding could help the Government reduce the longer-term impacts of the crisis, such as higher debt servicing costs and those related to reduced human capital (e.g., education delays, malnutrition), higher incidence and depth of poverty, and delays in infrastructure development.

37. **The proposed operation is consistent with the Bank's Country Partnership Framework (CPF) for Indonesia.** The FY16-20 WBG CPF for Indonesia draws on the 2015 Systematic Country Diagnostic (SCD) which identified three pathways for the elimination of extreme poverty and increasing shared prosperity: i.e. creation of better jobs, improving equality of opportunity, and helping Indonesia manage its vast endowment of natural resources in a sustainable way. An SCD Update is currently being finalized and will provide the analytical underpinnings for the new FY21-25 WBG CPF. The SCD Update posits four pathways to overcome the constraints to poverty reduction and shared prosperity: (i) strengthening the competitiveness and resilience of the economy; (ii) building more quality infrastructure, faster; (iii) nurturing world-class human capital; and (iv) managing natural assets. The proposed supplemental DPO, in line with the parent DPO, supports the FY2016-20 WBG Country Partnership Framework through two supporting beams (Supporting Beam I: "Leveraging the Private Sector - Investment, Business Climate and Functioning of Markets" and Supporting Beam II: "Shared Prosperity, Equality and Inclusion". Moreover, it is aligned with the "strengthening competitiveness and resilience of the economy" of the SCD Update.

4. THE REFORM PROGRAM SUPPORTED THROUGH ORIGINAL OPERATION: AN UPDATE

38. **The first DPO of the series supported reforms to increase the depth, improve the efficiency and strengthen the resilience of the financial sector.** Reforms focused on: (i) adopting a joint policy framework on agent networks between BI and OJK; (ii) establishing standard reporting and improving monitoring of issuances of debt securities in the private placement market; (iii) expanding the number of long-terms instruments eligible for investments by pension funds and insurance companies; (iv) enhancing supervision of insolvency practitioners; (v) introducing a new legal framework on general data protection and privacy; (vi) issuing Quick Response (QR) Indonesia Standards to advance interoperability of digital payment instruments; (vii) developing a single customer view based data reporting by banks to enhance timeliness and accuracy of the insured deposit payout function of the LPS; (viii) strengthening the institutional capacity of banks and supervisors on sustainable finance practices; (ix) and establishing the legal framework for a disaster mitigation pooling fund.

39. **The reform program of this DPO series includes a mix of reforms that are highly relevant for supporting the Government's response to COVID-19 both during the emergency as well as in the prospective recovery phase.** First, the implementation of large-scale social assistance payments to protect livelihoods during the crisis needs to be facilitated through reforms that increase the number of

payment channels. These include new payment service providers, changes to regulation for agents, and e-KYC, so that the number of access points can be maximized, and crowding and travel minimized. Reforms supported under reform areas 1 5 and 6 of DPO 1 (Table 5) can prove helpful in facilitating efficient social assistance payments.[46] Second, the government and the private sector will require significant financing for fiscal stimulus and the post-containment recovery. With the exodus of foreign portfolio investors, there is also a need to develop new long-term instruments to broaden Indonesia's investor base and deepen its capital markets. Reforms supported under reform areas 2 and 3 of the parent DPO will create additional financial instruments and broaden the investor base, potentially contributing to increasing the financing options for critical private and public investments. Third, the speed and strength of the economic recovery will depend on the ability of firms to start investing, and consumers to start buying again. This will require policies to preserve and repair the balance sheets of banks and corporates, while avoiding moral hazard. Reforms supported under reform area 7 of DPO 1 to strengthen the framework for resolution of troubled, non-viable banks will therefore be critical to a robust recovery. Finally establishing a pooling fund that could provide targeted and timely financing to beneficiaries through dedicated channels in case of a disaster, as stated under reform area 9, can be highly relevant in case of a pandemic.[47]

40. **The program is on track and the government has already made progress in the policy areas relevant for the next operation.** The negative sentiment in the capital markets due to the adverse economic impact of COVID-19 worldwide and on Indonesia, leading to substantial net capital outflows from the emerging markets, means that the impact of the reforms can only be assessed when markets return to normal. Yet, the Government remains committed to the implementation of the supported actions and to the overall reform agenda as supported by the three-DPO programmatic series. Progress on implementation of the DPO1 prior actions and towards completion of the indicative triggers for DPO2 is summarized in Table 6. Limited implementation capacity and competing priorities due to COVID-19 will be taken into account going forward. The DPO program includes key areas which are of direct relevance for the COVID-19 emergency and recovery phases (i.e. banking resolution, firms' insolvency regime, deepening of financial markets; promotion of digital payments). Further priority areas may emerge in the coming months that could warrant adjustments to the DPO program and its target indicators, to reflect priorities at that time.

Table 5: Summary of Implementation Progress on Policy Actions and Triggers from DPO1 & DPO2

Reform Area	Prior Actions and Triggers	Progress Update
Pillar A: Increasing the depth of the financial sector		
1. Increasing Access and	**Prior Action DPO1.** BI and OJK have adopted a joint policy framework on	BI is in the process of restructuring the payment system regulatory

[46] Reform #6 from DPO1, on the issuance of QR standards, has already become effective as BI included the broadening of QR acceptance as one of the key measures adopted at the onset of the crisis to promote digital transactions.

[47] The expansion in the scope of the pooling fund for disaster risk finance to cover also for pandemics is currently being discussed as part of the preparation of a parallel IPF planned for later in 2020. This reform might not be directly relevant in this phase given the different timeframe but it's nonetheless an important reform of the DPO package that, in light of the current outbreak, can be expanded to cover also for (future) pandemic risks.

Usage	agent networks to support the implementation of agent network programs (namely Laku Pandai and LKD). **Trigger DPO2.** BI and OJK have harmonized Laku Pandai and LKD programs in line with policy framework and as evidenced through [revised regulations no. and date]	framework to be more structured, proportionate, forward looking and agile. This framework will, among others, reclassify payment system providers based on activities, promote principle-based regulations, foster industry self-regulation, and aim for improved business conduct and increased access. OJK is developing a circular note to Laku Pandai providers to accommodate the reform based on the policy framework. The Bank is providing TA to both regulators to ensure the element of coordination and cooperation. Notes and examples have been shared per regulator requests.
2. Broadening Financial Markets Products	**Prior Action DPO1.** OJK has established standard reporting and improved monitoring of issuances of debt securities in the private placement market, as evidenced by Regulation No. 30/POJK.04/2019. **Trigger DPO2.** MOF has simplified taxes of capital market instruments and established a tax level-playing field for those instruments as evidenced through [regulation no. and date].	The regulation was issued in late November 2019, and the implementation is to begin on June 1, 2020. It is therefore too early to report the progress on implementation. Dialogue on tax reforms for capital market instruments continue, and gradual progress has been made on an instrument-by-instrument basis. In August 2019, the GoI issued a regulation (Government Regulation No. 55/2019) on taxes on debt securities investment by funds, among others leveling the tax applied to infrastructure funds with that for other types of funds (e.g. mutual funds). In addition, some elements of capital market taxation are included in the draft Tax Omnibus Law currently under deliberation.
3. Mobilizing	**Prior Action DPO1.** OJK has expanded	Since the issuance of new investment

Long-Term Savings	the number of long-term instruments to be eligible for investments by pension funds and insurance companies, as evidenced by OJK Regulations Nos. 27/POJK.05/2018, 28/POJK.05/2018 and 29/POJK.05/2018. **Trigger DPO2.** OJK has: (a) amended risk management [requirements/ rules] of pension funds; and (b) introduced age-relevant default investment choice for defined contribution funds as evidenced through [regulation no. and date].	regulations for insurance companies and pension funds, including inter alia infrastructure funds (locally named as DINFRA) in eligible investment list, such a new instrument has been created, the first of which is DINFRA Toll Road Mandiri-001, with some insurance companies investing. Another fund management company, Danareksa, also announced its plan to establish a new one. Progress is made for the achievement of next PDO milestones. The Financial Services Authority (OJK) has prepared draft (amended) regulations on (i) risk management of non-bank financial institutions, especially pension funds and insurance companies, and (ii) life-cycle funds for pension fund participants with defined contribution schemes. The amended regulation on risk management will inter alia enhance the risk management framework for pension funds and insurance companies and ensure their ability to honor their obligation to pension participants and premium holder in a sustainable manner (long-run). Meanwhile, the introduction of life-cycle funds would facilitate proper allocation of investment based on age (life-cycle) of the participants including longer-term investments for young participants. The WB team provides comments and conduct discussions with OJK on these draft regulations.
Pillar B: Improving the efficiency of the financial sector		
4. Strengthening Insolvency and Creditors Rights	**Prior Action DPO1.** MOLHR has enhanced supervision of insolvency practitioners as evidenced by MOLHR Regulation No. 37/2018 and Decree No. M.HH-03.AH.06.06/2019.	The Ministry of Law and Human Rights (MOLHR) is developing the platform for Insolvency Practitioner's registration and case monitoring. The platform will be installed in the DG General Legal

	Trigger DPO2. MOLHR has improved the remuneration system of receivers and administrators as evidenced through [regulation no. and date]	Affairs (DJ AHU) online register. In the meantime, the Joint Committee to supervise the Insolvency Practitioner has regularly met and discussed the registration and supervision process, including a joint curriculum and a single code of ethics. The Insolvency team under the Directorate General of General Law Administration (DJ AHU) of the Ministry of Law and Human Rights has prepared the draft minister regulation that will amend/replace the current minister regulation (No 2 Year 2017) regarding the renumeration of receivers and administrators
5. Protecting Consumers and Personal Data and Enhancing Transparency	**Prior Action DPO1.** KOMINFO has introduced a new legal framework on general data protection and privacy through the submission of the draft law on Protection of Personal Data to the Parliament, as confirmed by Nota Dinas No. ND-61/KF/2020 from the Fiscal Policy Agency, Ministry of Finance. **Trigger DPO2.** OJK has enabled specialized market conduct supervision to financial services institutions in accordance with OJK law as evidenced through [PDK regulation of enforcement of market conduct supervision]. BI has enabled specialized market conduct supervision as evidenced through [BI regulation no. and date]	A first parliamentary discussion for the draft law on Protection of Personal Data was held on February 26, 2020. The Parliament has not resumed since the COVID-19 outbreak. BI has developed the draft revised regulation on consumer protection which includes the element of market conduct. The draft is due to be discussed in the coming board of governor meeting. OJK has developed the academic paper to accompany the draft regulation on market conduct supervision. The issuance of the regulation has been put as one of the deliverables under OJK initiatives strategy no 4 for the year 2020 “accelerating the provision of financial access and strengthening of market conduct and consumer protection”. The Bank has been providing TA to

		both regulators in the form of advisory input to the draft regulation and capacity building – training for the implementation of the market conduct supervision.
6. Promoting Interoperability of Payment Systems	**Prior Action DPO1.** In order to advance interoperability of digital payment instruments, BI has issued QR Indonesia Standard (QRIS) for adoption by financial service providers as evidenced by BI Regulation No. 21/18/PADG/2019. **Trigger DPO2.** Application Programming Interface (API) standardization could be introduced, subject to the implementation timeline of the National Payment System Blueprint to be defined by dedicated working groups.	BI is developing a consultative paper that will provide the background for the open API standard guiding principles. The standard will cover the element of data, technical, security, and governance. The Bank is providing capacity building to BI in supporting the development of the consultative paper.
Pillar C: Strengthening the resilience of the financial sector		
7. Strengthening the Framework for Resolution of troubled, non-viable banks	**PA7 (Resolution Framework).** LPS has enhanced the timeliness and accuracy of its insured deposit payout function through the development of the single customer view (SCV) based data reporting by member banks, as evidenced through issuance of LPS Regulation No. 5/2019. **Trigger DPO2.** The Borrower has established the resolution fund and LPS has established the regulatory framework for resolution planning and resolvability assessments as evidenced through [GR No. and LPS Regulation No.]	LPS is in the process of implementing the SCV reporting system by end August 2020, in accordance with the regulatory provisions. Technical guidelines in the form of LPS Circular Letter for banks are being developed and aimed for finalization by end June 2020, with the underlying IT supporting system to be developed by end August 2020. The draft government regulation on establishment of resolution fund has been developed and is being discussed with stakeholders, including the banking industry. Meanwhile, the resolution planning pilot covering three systemic banks is well underway and aimed for completion by August 2020. Results and experiences from the pilot will feed into the LPS

		regulation on resolution planning and resolvability, which is expected to be finalized by December 2020.
8. Implementing Sustainable Finance Practices	**Prior Action DPO1.** OJK has strengthened the institutional capacity of banks and supervisors in implementing OJK Regulation No. 51/POJK.03/2017 on sustainable finance practices by issuing internal guidelines for banking supervisors. **Trigger DPO2.** OJK has monitored the implementation of sustainable finance principles in (BUKU III and IV) banks, as evidenced through [banks' Sustainability Reports to OJK].	OJK has rolled out the internal guidelines for banking supervisors on the implementation of sustainable finance practices by Indonesian banks. The guidelines will serve a one of main references for OJK supervisors in carrying out their supervisory duties in 2020. An analysis of the progress in implementation of sustainable finance principles through Sustainability Reports (to be published by Indonesian banks by end of April 2020) will be initiated in May 2020.
9. Establishing Disaster Risk Finance Mechanisms	**Prior Action DPO1**: The Borrower has taken steps to establish the legal framework for a disaster mitigation pooling fund by including it in the 2020 Budget Law as evidenced by Article 45, Law of the Republic of Indonesia No 20 of 2019 regarding the State Budget Fiscal Year 2020. **Trigger DPO2:** The Borrower has established a pooling fund and adopted appropriate operating procedures for its management as evidenced through [PerPres no. and Date and MoF Decree PMK no. and date].	Interministerial committee (PAK) has been formed to design and agree the appropriate functions and institutional responsibilities of the pooling fund. Next PAK meeting is planned for April. MOF has carried out a technical appraisal of various options for the establishment of the pooling fund and submitted the final recommendation to the Minister.

5. RATIONALE FOR PROPOSED SUPPLEMENTAL FINANCING

41. **The COVID-19 emergency responses have created substantial unanticipated fiscal financing needs that are challenging for the GoI to meet solely by financing through capital markets.** The request

for supplemental financing is consistent with Bank policy on development policy financing. The COVID-19 outbreak represents an exceptional twin supply and demand shock. The outbreak has created an additional unanticipated financing need of IDR 600 trillion (US$ 39.7 billion, 3.8 percent of GDP) in 2020, due to the revenue impact as a result of the downturn, relief measures and urgent new spending needs. Economic uncertainty remains high and fiscal financing needs is likely to increase with the outbreak and/or worsening economic conditions. While financial stability indicators confirm the soundness of the financial sector, the current challenges in accessing financial markets and mitigating the impact of capital outflows on external balances and on the Rupiah confirm the importance of two of the key development objectives of the DPO program, that are, increasing the depth of the Indonesian financial sector and strengthening its resilience to shocks. DPO supplemental financing is the fastest way for the World Bank to provide timely financing to Indonesia and has successfully been used to rapidly disburse financing following large unanticipated shocks in several other countries in the past. Financing from MDB sources helps diversify funding sources and have proven to be an important signal to markets.

42. **The program supported by the three-DPO programmatic series is currently on track, and the government remains committed to the implementation of actions supported in DPO1.** Implementation of the reforms supported under DPO1 is continuing. As noted above, an adequate macroeconomic framework has also been maintained, despite broad fiscal measures to stem the negative effects of the COVID-19 emergency. As outlined in Table 5, the Government is already taking steps toward completion of the indicative triggers for DPO2. While risks of implementation delays of certain reforms due to competing budgetary and capacity priorities arising from the COVID-19 outbreak cannot be excluded, the DPO program remains on track. The GoI also has a history of strong commitment to budget support programs, as demonstrated by the successful completion of the Indonesia Fiscal Reform DPO Series over the period from FY2016 to FY2019.

43. **The proposed US$ 300 million equivalent supplemental financing is needed to support the GoI in its emergency response to COVID-19, given the challenges to seek financing solely through capital markets in the current unfavorable external conditions.** The GoI has actively sought additional financing from development partners to cover the unanticipated financing needs as noted above. Indonesia is currently facing significant capital outflows as non-resident holders of government bonds are in a flight-to-safety mode. The cost of funding through the bond market has shot up, which, if it persists, could cost the Government US$ 600 million per year over the next 5-10 years in the form of additional debt servicing cost of the pre-COVID budget.[48] Besides, the additional and more urgent financing is currently needed (as unanticipated financing need arising from additional budget deficit, from lost revenues and fiscal stimulus packages) when many investors are leaving (up to US$ 8.4 billion worth of government bonds have been sold by foreign investors in 2020 to date), implying that the GoI would need to pay an even higher cost to obtain the financing. Should the GoI finance all of the additional financing need from the market, with an optimistic view that the yields remain at the current rate, the additional debt service could amount to US$ 450 million higher than the interest amount that would have been paid in the normal time, per year in the next several years (5 to 10 years depending on the tenor of the debt).[49] Therefore, the local currency

[48] Assuming the GoI continues to issue bonds in the amount of approximately US$ 50 billion (based on 2019 projection) with the average tenor of between 5-10 years.

[49] In total, funding through the market would increase the interest service by US$ 1.05 billion per year, even with an optimistic assumption that the yields remain at the current levels. A large additional borrowing would likely drive up the investors' required

bond market, which has thus far been the GoI's major funding source may not be a feasible option at this time. The GoI has turned to the hard-currency bond markets (primarily US Dollar); however, there too the cost has increased substantially although it increases more slowly than that of local currency bonds.[50] Therefore, an IBRD financing, whose price is less influenced by market volatility, would be appropriate. Moreover, the Government's ability to diversify its funding sources by obtaining financing from multilateral institutions would have a strong and positive signaling effect on the market.

6. OTHER DESIGN AND APPRAISAL ISSUES

POVERTY, SOCIAL AND ENVIRONMENTAL IMPACT

44. **This operation supports the Government in meeting unanticipated financing needs arising from emergency policy measures to mitigate the economic impacts of the COVID pandemic, which if left unchecked could reverse recent gains in poverty reduction.** Preliminary estimates suggest that the pandemic could lead to an increase in the number of poor of between 5.6 and 9.6 million in 2020 relative to a benchmark scenario without the pandemic.[51] The Government is implementing a number of measures to cushion the expected adverse economic effects, including interventions to enhance healthcare, expand social protection and prevent mass bankruptcies in the private sector. Collectively, these interventions could significantly benefit the poor and vulnerable, if appropriately targeted. Enhanced healthcare may help address vulnerability to infection and burden of disease among the poor and vulnerable, which is expected to be more intense than among the non-poor due to underlying risk factors described in section 2. Second, expanded social assistance aims to benefit a significant share of the poor and vulnerable, many of whom are employed informally in low-value-added service sectors such as wholesale and retail trade, accommodation and food/beverage services most adversely affected by the pandemic. Overall, the package of response measures would help mitigate the substantial risk of reversal of Indonesia's gains in poverty reduction in recent years.

45. **The results from the PSIA for DPO1 still apply in the context of the coronavirus pandemic, with no immediate adverse impacts for the poor and vulnerable and benefits likely to emerge in the long run.** The link between financial sector stability and poverty in crises is well-established in Indonesia. During the 1997-1998 Asian Financial Crisis, steep declines in employment, negative economic growth and rising food prices caused the poverty rate to increase from 17.5 percent in 1996 to 24.2 percent in 1998. While the pandemic is fast-evolving and much remains uncertain about its duration and depth of impact in

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rate of return, which could in turn create a vicious circle of a debt trap.

[50] For example, the 10.5-year US Dollar bonds issued by GoI in April 2020 carry an interest rate of 3.90 percent, which is 50 bps higher than similar bonds of comparable maturity issued in October 2019 (i.e. 3.40 percent for 10-year tenor). However, the 10-year credit default swap (CDS) spread for Indonesia has increased by about 175 bps in 2020 to date, indicating an increasing trend.

[51] The model for simulating the pandemic's impact on poverty combines macroeconomic projections for GDP and sectoral output growth with pre-crisis microdata from household and labor force surveys to predict income and consumption at the individual and household levels under three different scenarios (following Habib et al., 2010, and Olivieri et al., 2014): (i) business-as-usual (growth estimate of 5.0 percent); (ii) a mild shock (growth estimate of 0 percent estimated under assumptions of a deep global recession and moderate domestic restrictions); and (iii) a severe shock (growth estimate of -3.4 percent estimated under assumptions of a deep global recession and severe domestic restrictions).

Indonesia, it is likely that many of the same adverse impacts in terms of lost earnings, declines in employment and increases in poverty will be felt across the country, at least temporarily. The DPO1 aims to increase the depth of the financial sector and improve its efficiency and resilience, which contributes to a more favorable economic environment for growth and sustained poverty reduction in the long run. As such, the program's objectives promote financial stability and gain in significance in the context of the ongoing pandemic.

46. **Expanded access to financial sector services, including digitization of social assistance payments, is expected to benefit the poor in the medium term, as well as women and small entrepreneurs.** Deepening of the financial sector through increased availability of funds and access opportunities through outreach, financial market products and long-term saving, improved financial inclusion by supporting access to and usage of transaction accounts, and an increased pool of savings in the pension and insurance industries that eventually contributes to long-term investments, will benefit all Indonesians. The poor and vulnerable, and women in particular, would benefit from improvements in efficiency of social assistance payments through digitization and ultimately integration of programs. Overall, the policy reform is expected to expand access to financial services among the poor and vulnerable, strengthening their ability to manage risks. The policy actions in this area will also support Indonesia's large aspiring middle class, especially women and small entrepreneurs, to benefit from an expanded set of economic opportunities.

47. **Efficiency gains expected under the program lower costs for consumers and enterprises, creating in the long run an environment conducive to growing businesses and reducing vulnerability.** Efficiency gains are expected under the reform that supports channeling of savings into the most productive investment opportunities in a less costly, faster, safer and more transparent way through consumer protection, a reliable insolvency framework, improved creditor rights, and adequate financial infrastructure. Promoting interoperability and regulation for agents would provide a supporting environment for financial inclusion, which in turn will be fundamental to opening up pathways to the middle class for one in two Indonesians who have escaped poverty and vulnerability but still lack full economic security. This should ultimately lower costs for individuals and enterprises, supporting business growth and job creation. The DPO's policy actions will therefore help in poverty reduction by promoting job creation through business growth.

48. **The DPO contributes to building resilience at the system and household levels, protecting in the long run vulnerable Indonesians against shocks such as those associated with the ongoing pandemic.** A deeper financial sector and improved access to formal banking could help households cope with unexpected health shocks. Previous research in Indonesia shows that while those without access to formal savings are only somewhat less likely to fully smooth food consumption, consumption smoothing is achieved at the cost of substantial depletion of assets. Those with access to formal savings, but without access to credit, experienced a smaller decrease in their asset holdings than those without access to formal savings. And those with access to both savings and credit smoothed consumption not by drawing down on savings, but by increased borrowing. At the system level, the DPL's policy actions build resilience of the financial sector and contribute to financial stability by helping ensure effective resolution of troubled, non-viable banks, without severe disruption and taxpayer losses, and establishment of disaster risk finance mechanisms. The policy actions therefore contribute to creating a robust and stable financial system, which is a pre-requisite for economic growth, job creation, and ultimately poverty reduction and

upward economic mobility for all Indonesians.

49. **Among affected informal sector workers not reached under the government's emergency response package, the DPO1 and its supplement may help build resilience against future pandemics in the medium term.** Indonesia's social assistance registry covers the bottom 40 percent of the population, allowing in principle for rapid temporary scale-up of social assistance. This, together with the tax relief and financial support planned under the government's emergency response effort, will help relieve the burden on workers and enterprises in the formal sector of the economy. In addition, while the governments' planned expansion of social assistance programs to include 8 million households not currently receiving assistance and expansion of the Kartu Pra-Kerja program to provide skilling and re-skilling opportunities to informal workers affected by the pandemic will benefit informal sector workers largely employed in micro- and small enterprises, many are still likely to stay out of reach of these measures. In the short run, the DPO program does no harm to these groups, but in the medium to long run, it helps build resilience against future shocks by expanding access to financial services among the poor and vulnerable, strengthening their ability to manage risks.

50. **The emergence of the coronavirus pandemic has not affected environmental impacts expected under the DPO1.** The environmental assessment for parent operation found that two of the DPO1 prior actions are expected to have positive effects on the environment. Embedding sustainability in the practices of the financial services industry via Reform Area #8, with emphasis on climate change, will contribute to disaster prevention, disaster risk mitigation, climate change adaptation, and environmental management in Indonesia. Reform Area #9 has the potential to lead to significant positive effects on the natural and human/built environment. This is because the Disaster Risk Finance and Insurance (DRFI) Strategy recognizes that disaster management financing is needed for three periods – non-disaster, emergency response, and rehabilitation/reconstruction. Within the non-disaster period, pre-disaster financing is to be used, inter alia, for disaster risk mitigation activities or programs, disaster prevention programs, and education on disasters. Whether the potential for positive effects is realized or not will depend in part on the extent to which adoption of the DRFI Strategy leads to pre-disaster financing, and in part on other activities and programs of national and regional governments. The latter may include climate change resilience, disaster-resistant infrastructure, upgraded building codes, and early warning systems. None of the other prior actions will have positive or negative effects on environment, forest, or other natural resources. They will not result in construction, development or operation of facilities that could generate solid or liquid wastes or air emissions, conversion of natural habitat, damage to cultural heritage, loss of biodiversity, or changes in management policies or practices affecting forests or other natural resources.[52]

PFM, DISBURSEMENT AND AUDITING ASPECTS

51. **There have been no significant changes in the Public Financial Management system in Indonesia since the approval of the parent operation on March 20, 2020.** Consequently, the fiduciary rating remains

[52] It would be important that budgetary resource allocations intended for essential regulatory environment and natural resource management functions (e.g., by MoEF and local government authorities) be preserved (including, enforcement of environmental permitting requirements, provision of environmental services, and forest and biodiversity conservation) despite reallocations of budgets to support fiscal mitigation measures.

as "Moderate".

52. **The same requirements as for the parent operation will apply for disbursement of this supplemental operation.** Similar to the requirements in the parent operation, the Borrower agrees not to use the DPF proceeds to finance ineligible items, as defined in the General Conditions for IBRD Financing: Development Policy Financing (2018) (General Conditions). The closing date of the proposed supplemental financing is December 31, 2020.

MONITORING, EVALUATION, AND ACCOUNTABILITY

53. **Progress on the results indicators will be monitored and evaluated by the Borrower.** The Fiscal Policy Agency (BKF) under the MoF will be the executing agency for the proposed operation while BI, OJK, LPS, Ministry of Law and Human Rights (MoLHR), Ministry of National Development Planning (Bappenas) and Ministry of Communication and Information Technology (Kominfo) will act as implementing agencies. The BKF team is well-coordinated and given their experience in implementing DPOs with the World Bank, they are increasingly well prepared to obtain and share data to monitor implementation against the agreed results indicators. The World Bank closely follows this progress through supervision activities.

54. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank DPO may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org."

7. SUMMARY OF RISKS AND MITIGATION

55. **The overall risk level is substantial, an increase from the moderate risk assessment for the parent operation.** The change in the risk assessment from moderate to substantial is linked to a perceived increase in macroeconomic risk. Given the recent impact of COVID-19, there is now a risk that the policy reform agenda supported by the first DPO (and to be continued in DPO2) loses momentum due to competing priorities arising from the emergency and subsequent recovery phases, qualitatively increasing risks around limited institutional capacity.

56. **Macroeconomic and fiscal risks are substantial with the negative economic effects of the COVID infection and will increase with the duration of the outbreak.** As with most other countries, the pandemic

has unleashed an unprecedented economic impact on Indonesia through both domestic and external channels. Given that uncertainty remains high and the severity of the fallout could further increase, there is a risk that reforms are temporarily delayed as Government refocus its efforts and resources to cushion the negative economic effects of the infection on the economy and the population. In addition, because of the economic growth slowdown, tax revenue growth will also weaken while expenditures temporarily balloon, posing some risks to fiscal sustainability. The financing of the wider deficit will also weigh on fiscal debt sustainability in the medium term. These risks will increase with the duration of the outbreak which is still evolving locally and globally. This operation contributes to the mitigation of fiscal risks by providing multilateral financing which would lower debt service costs as compared to financing through capital markets. In addition, with an array of technical assistance projects and capacity enhancement programs, the World Bank remains strongly engaged in policy dialogue with the MoF and other central ministries, supporting continued fiscal reform momentum, further mitigating fiscal risk.

57. **The risks around technical design of the program and institutional capacity remain rated as substantial.** These are being mitigated by strong dialogue between the Bank and the Government, the coordination of technical assistance, and the decision to proceed with supplemental financing rather than attempting to accelerate the processing of the second DPO in the series. Through the course of the DPO program, the Government and the Bank have carefully selected a limited number of policy actions that are key government priorities and have had substantive discussions around the implementation requirements for each action, to ensure that expectations regarding capacity and timing are realistic. The implementation of the reforms supported by this DPO series requires strong collaboration among a large number of implementing agencies and strong coordination by the MoF as executing agency. The influence of the MoF on some of the implementing agencies, such as the OJK, might be limited and therefore requires a solid policy dialogue with each counterpart to make sure there is full alignment on the achievement of the program. Moreover, the proposed reforms require intense technical work to guarantee their completion and the sustainability of their results. The DPO mitigates this risk by providing strong technical support to each implementing agency under a parallel advisory service and analytical program in close coordination with the international development partners. The technical assistance program will be flexibility adapted to new emerging priorities related to the impact of COVID-19 and the policy dialogue on key reform areas will be shaped accordingly.

Table 6: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Moderate
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Substantial

5. Institutional Capacity for Implementation and Sustainability	● Substantial
6. Fiduciary	● Moderate
7. Environment and Social	● Low
8. Stakeholders	● Moderate
9. Other	
Overall	● Substantial

ANNEX 1: PARENT PROJECT POLICY AND RESULTS MATRIX

Reform area and lead counterpart	Prior Action (November 2019)	Trigger (Nov 2020)	Trigger (Nov 2021)	Results Indicator (2022)
Pillar A: Increasing the Depth of the Financial Sector				
Reform area #1: Increasing access and usage **Counterparts:** BI, OJK, Bappenas	**PA1.** BI and OJK have adopted a joint policy framework on agent networks to support the implementation of agent network programs (namely Laku Pandai and LKD).	BI and OJK have harmonized Laku Pandai and LKD programs in line with policy framework and as evidenced through [revised regulations no. and date]	Non-cash social assistance distribution channels have been expanded as evidenced through [revised regulation no. and date]	Reduction in the percentage of adults stating distance is the foremost barrier to opening a transaction account (FI account and mobile money): Baseline (2017): 19.3%; Target (2022): 10.2%; Average transactions by beneficiaries through social assistance (KKS) accounts per year. Baseline (2019): 0.8; Target (2022): 2
Reform area #2: Broadening financial markets products **Counterparts:** OJK, MOF, BI	**PA2.** OJK has established standard reporting and improved monitoring of issuances of debt securities in the private placement market, as evidenced by Regulation No. 30/POJK.04/2019.	MOF has simplified taxes of capital market instruments and established a tax level-playing field for those instruments as evidenced through [regulation no. and date].	BI and OJK have enabled the development of over-the-counter derivatives market in compliance with G20 commitments as evidenced through [regulation no. and date]	Outstanding IDR-denominated private debt securities (IDR trillion); Baseline (2018): 412; Target (2022): 711

Reform area #3: Mobilizing long-term savings **Counterparts:** OJK, MOF	**PA3.** OJK has expanded the number of long-term instruments to be eligible for investments by pension funds and insurance companies, as evidenced by OJK Regulations Nos. 27/POJK.05/2018, 28/POJK.05/2018 and 29/POJK.05/2018.	OJK has: (a) amended risk management [requirements/rules] of pension funds; and (b) introduced age-relevant default investment choice for defined contribution funds as evidenced through [regulation no. and date].	MOF has incentivized contributions to and disincentivized withdrawals from pension and old-age savings as evidenced through [revised tax policies and procedures no. and date].	Reduced portion of short-term investments (cash, bank deposits) in pension fund portfolios (%); Baseline (2017): 19.3; Target (2022): 16
Pillar B: Improving the Efficiency of the Financial Sector				
Reform area #4: Strengthening insolvency and creditor rights framework **Counterpart:** MOLHR	**PA4.** MOLHR has enhanced supervision of insolvency practitioners as evidenced by MOLHR Regulation No. 37/2018 and Decree No. M.HH-03.AH.06.06/2019.	MOLHR has improved the remuneration system of receivers and administrators as evidenced through [regulation no. and date]	The Borrower has submitted to Parliament the Amendment to the Bankruptcy Law to enhance creditor rights as evidenced through [submission letter no. & date].	Number of insolvency cases opened by the court, evidencing greater access by firms. Baseline (2018): 304 Target (2022): 334 (10% increase).
Reform area #5: Protecting consumers and personal data and enhancing transparency **Counterparts:** OJK, BI, Kominfo	**PA5.** KOMINFO has introduced a new legal framework on general data protection and privacy through the submission of the draft law on Protection of Personal Data to the Parliament, as confirmed by Nota Dinas No. ND-61/KF/2020 from the Fiscal Policy Agency, Ministry of Finance.	OJK has enabled specialized market conduct supervision to financial services institutions in accordance with OJK law as evidenced through [PDK regulation of enforcement of market conduct supervision]. BI has enabled specialized market conduct supervision as evidenced through [BI regulation no. and date]	OJK and BI have operationalized market conduct supervision as evidenced through the development of initial risk assessment processes and procedures for financial consumer protection	Number of financial product marketing violations detected per year. Baseline (2018): 200; Target (2022): 400.

Reform area 6: Promoting interoperability of payment systems **Counterpart:** BI	**PA6**. In order to advance interoperability of digital payment instruments, BI has issued QR Indonesia Standard (QRIS) for adoption by financial service providers as evidenced by BI Regulation No. 21/18/PADG/2019.	Application Programming Interface (API) standardization could be introduced, subject to the implementation timeline of the National Payment System Blueprint to be defined by dedicated working groups.	Faster Payments infrastructure could be introduced, subject to the implementation timeline of the National Payment System Blueprint to be defined by dedicated working groups.	Number of payment service providers (bank and non-bank financial institutions) facilitating QR payments. Baseline (2018): 8; Target (2022): 40
Pillar C: Strengthening the Resilience of the Financial Sector				
Reform area #7: Strengthening the framework for resolution of troubled, non-viable banks **Counterparts:** LPS and MOF	**PA7.** LPS has enhanced the timeliness and accuracy of its insured deposit payout function through the development of the single customer view (SCV) based data reporting by member banks, as evidenced through issuance of LPS Regulation No. 5/2019.	The Borrower has established the resolution fund and LPS has established the regulatory framework for resolution planning and resolvability assessments as evidenced through [GR No. and LPS Regulation No.]	(i) LPS has adjusted its operational structure to implement the revised deposit insurance and resolution frameworks and (ii) Reporting on Single Customer View has been implemented by all commercial banks	Number of days for LPS to pay out insured depositors in closed commercial banks. Baseline (2019):90 days; Target (2022): minimum 90% of eligible depositors to be repaid within 7 working days Number of bank resolution plans finalized by LPS. Baseline (2019): 0; Target (2022): all systemic banks.

Reform area #8: Implementing sustainable finance practices **Counterpart:** OJK	**PA8:** OJK has strengthened the institutional capacity of banks and supervisors in implementing OJK Regulation No. 51/POJK.03/2017 on sustainable finance practices by issuing internal guidelines for banking supervisors.	OJK has monitored the implementation of sustainable finance principles in (BUKU III and IV) banks, as evidenced through [banks' Sustainability Reports to OJK].	OJK has monitored the implementation of sustainable finance principles in all commercial banks, as evidenced through [banks' Sustainability Reports to OJK].	Commercial banks complying with sustainable finance practices (%). Baseline (2018): 0; Target (2022): 75
Reform area #9: Establishing Disaster Risk Finance Mechanisms **Counterpart:** MOF	**PA9.** The Borrower has taken steps to establish the legal framework for a disaster mitigation pooling fund by including it in the 2020 Budget Law as evidenced by Article 45, Law of the Republic of Indonesia No 20 of 2019 regarding the State Budget Fiscal Year 2020.	The Borrower has established a pooling fund and adopted appropriate operating procedures for its management as evidenced through [PerPres no. and Date and MoF Decree PMK no. and date].	MOF has adopted a policy to set up pre-arranged disbursement channels linked directly to the pooling fund management for more effective disaster response as evidenced through [MoF Decree PMK no. and date]	Utilization of the pooling fund for disaster response financing. Baseline (2019): Pooling Fund not established; Target (2022): Pooling fund utilized in disaster response.

ANNEX 2: FUND RELATIONS INDEX

Indonesia—Assessment Letter for the Asian Development Bank and World Bank
April 10, 2020

I. RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

Recent Developments

The Indonesian economy performed well in recent years. Growth was robust at about 5 percent between 2013 and 2019 and inflation was contained. Fiscal deficits were low, and Indonesia's external and public debt are moderate and sustainable. At around US$ 121 billion or 111 percent of the IMF's reserve adequacy metric (as of end-March 2020), gross international reserves are deemed adequate. Banks are well-capitalized.

The COVID-19 pandemic and associated financial market pressures are putting significant strain on the economy. With more than 3,200 confirmed COVID-19 cases and 280 deaths as of April 9, 2020, the Indonesian government has adopted various containment measures, including travel bans on foreign nationals, screening at ports of entry, school closures, and other restrictions on public events. As COVID-19 spreads worldwide, external financial conditions have tightened sharply amid exchange rate pressures and capital outflows from emerging markets, including Indonesia. Year-to-date the rupiah depreciated by 14.5 percent vis-à-vis the U.S. dollar, the yield on rupiah-denominated 10-year government bonds increased by 98 bps to 8 percent, equity prices dropped by 26 percent, and portfolio outflows exceeded US$ 9 billion. The impact on Indonesia in part reflects its reliance on portfolio inflows to finance the current account and fiscal deficits. Nonresident investors held about 40 percent of local currency government bonds and about a third of nonfinancial corporate debt at end-2019.

Outlook and Risks

The relatively bright outlook for Indonesia's economy at the beginning of the year has dimmed significantly with the drag from the COVID-19 pandemic. Growth is now expected to slow sharply to 0.5 percent in 2020, reflecting supply disruptions from containment measures; weaker consumer and business confidence; reduced net external demand, especially from tourism; and tighter external financial conditions. These are expected to weigh heavily on private consumption and investment during the second quarter of 2020. The slowdown in output growth in 2020 is expected to be temporary, with growth projected to rebound as the economy emerges from the COVID-19 shock, reaching 8.2 percent in 2021. Inflation is expected to remain close to the center of the target band (3±1percent), as downward price pressures from the slowing economy are expected to offset upward price pressures from supply disruptions. The current account deficit is projected to widen to 3.2 percent of GDP, driven by weaker tourism and lower commodity prices, more than offsetting reduced imports.

Downside risks are large. The uncertainty around the near-term outlook is greater than usual. The main risk is a prolonged COVID-19 outbreak and associated disruptions, which could extend the domestic demand shortfall and weigh on private and public sector balance sheets. Under such a scenario, growth would be materially lower in 2020, mostly driven by a larger contraction in private consumption, and the recovery in 2021 would be delayed. Other risks include persistent capital flow reversals, tighter financial conditions and financing challenges, protracted pandemic-prompted protectionist actions globally that could re-ignite broader international protectionist measures, and commodity prices remaining low for longer than expected. A deterioration in financial institutions' asset quality and funding positions could impair credit flows, further constraining investment and productivity.

II. POLICY FRAMEWORK AND SETTINGS

Fiscal Policy

In response to the COVID-19 pandemic, the government announced major fiscal support, with measures that are appropriately targeted towards strengthening health care and mitigating economic and social hardship. In addition to the first two packages amounting to IDR 33.2 trillion (0.2 percent of GDP), which include tax relief for the tourism and manufacturing sectors, and food aid to low-income households, the government announced a third sizeable stimulus package of IDR 405 trillion (2.6 percent of GDP) on March 31, 2020. The third package includes IDR 255 trillion (1.6 percent of GDP) in additional spending and tax relief, covering (i) support to the health care sector to boost testing and treatment capability for COVID-19 cases; (ii) increased benefits and broader coverage of existing social assistance schemes to low-income households such as food aid, conditional cash transfers, and electricity subsidy; (iii) expanded unemployment benefits, including for workers in the informal sector; (iv) tax relief for individuals (with an income ceiling); and (v) permanent reductions of the corporate income tax rate from 25 percent to 22 percent in 2020−21 and 20 percent starting in 2022. In addition to tax and spending measures, the last stimulus package includes IDR 150 trillion (0.9 percent of GDP) financing for a national economic program, including to support credit guarantees for the private sector. The stimulus packages also include measures to lift restrictions on imports and exports, aiming to ease global supply-chain disruptions caused by the virus. Reflecting mainly revenue shortfall, higher interest payments, and announced tax and spending measures in the stimulus packages, the fiscal deficit would widen from 2.2 percent of GDP in 2019 to 5.0 percent in 2020. Automatic stabilizers are expected to fully operate, amounting to about 0.3 percent of GDP, mostly from the tax side.

Considering the sizeable economic downturn, temporary deviation from the 3 percent fiscal deficit ceiling is appropriate to accommodate needed fiscal support. The authorities announced a temporary suspension of the 3 percent fiscal deficit ceiling for 3 years to accommodate the fiscal stimulus packages and lower fiscal revenues. Making the deviation from the fiscal rule temporary improves its countercyclical properties while preserving the institutional foundation for Indonesia's track record of prudent fiscal policy conduct. Early communication of specific tax policy and spending reduction measures to support the planned return to a 3 percent deficit ceiling by 2023 would further support market confidence. In that context, implementing a medium-term revenue strategy (MTRS), aiming to raise 5 percent of GDP in additional revenue over five years, could help rebuild fiscal buffers and finance permanently higher priority spending in health, education, infrastructure, and social safety nets (see also section on Macrostructural issues). A timely unwinding of the emergency fiscal measures post-virus while maintaining overall stimulus would help ensure that the economy reaches potential, taking into account implications for debt sustainability.

Monetary Policy

Faced with the COVID-19 shock, Bank Indonesia (BI) has appropriately eased monetary policy and intervened to maintain orderly market conditions while allowing exchange rate flexibility. BI reduced the policy rate by 25 bps to 4.75 percent on February 20, 2020, and by another 25 bps to 4.5 percent on March 19. BI intervened in the spot and domestic non-deliverable foreign exchange markets, and in the domestic government bond market to maintain orderly market conditions while allowing the exchange rate to depreciate. BI also announced measures to ease liquidity conditions, including: (i) lowering reserve requirement ratios for banks; (ii) increasing the maximum duration for repo and reverse repo operations (up to 12 months); (iii) introducing daily repo auctions; (iv) increasing the frequency of FX swap auctions for 1, 3, 6 and 12-month tenors from three times per week to daily auctions; and (v) increasing the size of the main weekly refinancing operations as needed.

Further monetary policy easing would be appropriate, given the deterioration in the near-term outlook, but its impact on capital outflow risks should be monitored. Against the backdrop of contained inflation risks, the widening of the expected output gap in 2020, and downside risks to the growth outlook, BI could use its policy space for a few additional rate cuts, while closely monitoring the impact on capital inflows, the exchange rate, and bank and corporate balance sheets. If needed, foreign exchange intervention should continue to maintain orderly market conditions, while allowing the exchange rate to move with underlying market forces. Prudent use of reserve buffers could help in preserving a backstop for local U.S. dollar funding liquidity. Clear and focused communication of objectives and policies should remain an integral part of the monetary policy framework.

Financial Sector

While the banking system is sound overall, the weakening outlook calls for close monitoring to prevent an adverse macro-financial feedback loop. The banking system is well capitalized, and profitability is high, with the return on assets at 2.5 percent. System-wide liquidity remains adequate, although some small non-systemic banks are vulnerable to liquidity shocks, including FX liquidity shortfalls. Nonperforming loans (NPLs) reached 2.8 percent in January 2020, up from 2.5 percent in December 2019. The share of problem loans (the sum of NPLs, special mention, and restructured loans) remains high and further increased from 9 percent to 10.5 percent of total loans over the same time horizon, driven by worsened profitability on the back of weaker domestic and external demand. Despite large capital buffers and strong profitability, banks' high exposure to the corporate sector is an important source of risk. While corporate FX regulations has helped nonfinancial corporates to increase the share of hedged FX loans, their elevated foreign-currency debt levels (close to 45 percent of total nonfinancial corporate debt) leaves them exposed to FX volatility.

Financial sector measures to address the credit and funding implications of temporary cash flow constraints would complement fiscal and monetary policies. To ease stock market volatility and facilitate loan restructuring, the Financial Services Authority (OJK) has relaxed share buyback policy by allowing listed companies to repurchase their shares without a prior shareholders' meeting; introduced limits on stock price declines; and relaxed loan classification and restructuring procedures for banks, also allowing banks to extend additional financing to impacted borrowers. Banks' existing capital buffers should be available to meet the financial costs of the restructuring and temporary losses due to deterioration in banks asset quality. However, some small and medium-sized banks could face capital shortfalls if the impact of the outbreak is longer lasting.

Preserving banks' lending capacity and easing liquidity (cash flow) constraints for affected corporates and households will be critical for "keeping the lights on" in this downturn and facilitate a rapid recovery afterwards. To support affected borrowers, a range of targeted measures, implemented in collaboration with the government, could be considered: (i) temporary forbearance; (ii) lending schemes and credit guarantee programs for borrowers in the most affected sectors; and (iii) debt service moratorium/repayment holidays. When implementing such measures, avoiding blanket relaxations of loan classifications and provisioning rules would be paramount. Banks that do not have adequate buffers or capital to fully absorb the losses from the virus outbreak without temporarily breaching regulatory minima, should work closely with OJK for a capital restoration plan to increase their capital back to the required levels. For such measures to work effectively without hampering financial stability, supervision should be intensified, especially for medium and small banks with high liquidity risks and weak balance sheets and for nonbank financial institutions. Efforts to strengthen financial oversight and crisis management frameworks, such as the ELA and resolution frameworks should also continue. The corporate prudential FX regulation should be further improved by extending its coverage to all FX liabilities of systemic corporates, which could reduce enforcement and compliance costs.

Macrostructural Issues

Achieving higher potential growth and harnessing the young and growing labor force will require ambitious reforms, which should be synchronized with the expected economic recovery. The timing of reforms should be carefully considered in light of the economic cycle. For instance, implementing reforms with potential short-term cost to output, such as labor reforms, would be more appropriate when the recovery is well underway. The reform priorities are (i) revenue mobilization to finance increased development spending (infrastructure, health, education, and social safety nets); (ii) financial deepening to lessen reliance on volatile capital inflows and promote financial inclusion; and (iii) streamlining of regulation and improving of labor and product markets. Early implementation of an MTRS that centers on tax policy reforms and improved tax administration is critical. In addition to raising revenue for higher development spending, an MTRS would also help improve business conditions and boost productivity, including by streamlining tax regimes, removing distortions, and improving the efficiency of tax filling and collection.

IMF Relations

Indonesia is on a standard 12-month Article IV consultation cycle. The 2019 Article IV consultation was concluded by the IMF's Executive Board on July 3, 2019.

Table 1. Indonesia: Selected Economic Indicators

Nominal GDP (2019): Rp 15,924 trillion or US$1,126 billion
Population (2019): 266.9 million
Main exports (percent of total, 2019): coal (12.9), palm oil (8.8), oil and gas (7.5), textile & textile products (7.7)
GDP per capita (2019): US$4,219
Unemployment rate (2019): 5.28 percent
Poverty headcount ratio at national poverty line (Sep. 2019): 9.22 percent of population

	2016	2017	2018	2019	2020 Proj.	2021 Proj.
Real GDP (percent change)	5.0	5.1	5.2	5.0	0.5	8.2
Domestic demand	4.6	5.0	6.1	4.0	0.5	7.9
Of which:						
Private consumption 1/	5.0	5.0	5.0	5.2	0.5	8.5
Government consumption	-0.1	2.1	4.8	3.2	14.0	-5.1
Gross fixed investment	4.5	6.2	7.9	4.4	-2.0	10.0
Change in stocks 2/	0.2	-0.1	0.4	-0.6	-0.2	0.3
Net exports 2/	0.1	0.3	-1.2	1.4	0.0	0.5
Saving and investment (in percent of GDP)						
Gross investment 3/	33.9	33.7	34.6	33.8	32.7	33.5
Gross national saving	32.0	32.1	31.6	31.1	29.6	30.8
Prices (12-month percent change)						
Consumer prices (end period)	3.0	3.6	3.2	2.6	3.1	3.0
Consumer prices (period average)	3.5	3.8	3.3	2.8	2.9	2.9
Public finances (in percent of GDP)						
General government revenue	14.3	14.1	14.9	14.2	12.4	12.5
General government expenditure	16.8	16.6	16.6	16.4	17.4	16.5
Of which : Energy subsidies	0.9	0.7	1.0	0.9	0.5	0.6
General government balance	-2.5	-2.5	-1.8	-2.2	-5.0	-4.0
Primary balance	-1.0	-0.9	0.0	-0.5	-3.2	-2.2
General government debt	28.0	29.4	30.1	30.4	36.9	37.6
Money and credit (12-month percent change; end of period)						
Rupiah M2	11.7	9.6	5.8	6.8	...	...
Base money	4.6	9.7	-1.5	3.9	...	...
Balance of payments (in billions of U.S. dollars, unless otherwise indicated)						
Current account balance	-17.0	-16.2	-30.6	-30.4	-32.7	-29.5
In percent of GDP	-1.8	-1.6	-2.9	-2.7	-3.2	-2.7
Trade balance	15.3	18.8	-0.2	3.5	0.5	2.8
Of which : Oil and gas (net)	-4.8	-7.3	-11.4	-10.3	-7.9	-10.1
Inward direct investment	3.9	20.6	20.6	23.4	15.9	18.2
Overall balance	12.1	11.6	-7.1	4.9	-13.3	14.7
Terms of trade, percent change (excluding oil)	0.4	1.3	0.4	-3.1	-9.0	1.7
Gross reserves						
In billions of U.S. dollars (end period)	116.4	130.2	120.7	129.2	115.9	130.6
In months of prospective imports of goods and services	7.6	7.1	7.1	9.5	7.8	8.2
As a percent of short-term debt 4/	213	237	201	205	173	176
Total external debt 5/						
In billions of U.S. dollars	320.0	352.5	375.4	404.3	427.4	474.4
In percent of GDP	34.3	34.7	36.0	36.1	41.4	43.2
Exchange rate						
Rupiah per U.S. dollar (period average)	13,306	13,383	14,231	14,140	...	...
Rupiah per U.S. dollar (end of period)	13,473	13,568	14,390	13,866	...	...
Memorandum items:						
Jakarta Stock Exchange (12-month percentage change, composite index)	15.3	20.0	-2.5	1.7	...	...
Oil production (thousands of barrels per day)	820	815	810	805	710	707
Nominal GDP (in trillions of rupiah)	12,402	13,590	14,838	15,834	16,369	18,232

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes NPISH consumption.
2/ Contribution to GDP growth (percentage points).
3/ Includes changes in stocks.
4/ Short-term debt on a remaining maturity basis.
5/ Public and private external debt.