FPCi FOREIGN POLICY COMMUNITY OF INDONESIA

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FPCI Virtual Public Discussion
Coronavirus Crisis? Assessing the Impact of COVID-19
on the Indonesian and World Economy
Monday, 13th April 2020

Speakers:

1. **Dr. Muhammad Chatib Basri**
Indonesian Finance Minister 2013-2014

2. **Enrico Tanuwidjaja**
Head of Economic and Research UOB Indonesia

3. **Dr. Abdul Abiad**
Director, Macroeconomic Research Division, Asian Development Bank

4. **Said Zaidansyah**
Deputy Country Director of Asian Development Bank for Indonesia

Moderator:

1. **Dr. Dino Patti Djalal**
Founder of Foreign Policy Community of Indonesia (FPCI)

MODERATOR OPENING REMARKS

Dr. Dino Patti Djalal

- We are feeling the crunch of the Coronavirus (COVID-19) and it is so fast, and it started in early January and is now in April. Now, it seems that we are not seeing even the worst of it. This global pandemic is paralyzing societies, impacting everyone and I think we are worried about whether or not this will lead to a crisis. If so, what kind of crisis and for how long?
- Last year people talked about uncertainties; but, I think this year, if there is anything certain, the fact that global growth is going to slow down and there is going to be an economic crisis. Moreover, social and political crisis in some countries is also possible. Therefore, my question is how bad would it be and can we still avert a crisis?

PRESENTATION

Dr. Muhammad Chatib Basri

- I would like to highlight three issues about the mechanism. First, how the Indonesian economy will be impacted by this COVID-19. Second, how deep it could be and as Dr. Dino has mentioned about the possibility of the recession. Third, I will try to lay out some government policy responses.
- Unlike the 2008 Global Financial Crisis, the current COVID-19 situation is very different. In 2008, the crisis was triggered by subprime mortgage in the United States and it hit the Indonesian economy only through the demand side because the global trade collapsed and the government's response at that time was relatively easy.
- If the external factors become a problem, then we only have to focus on the domestic economy. What the government did at that time was they introduced the so called "The Keep Buying Strategy" in use to purchasing power, basically to focus on domestic demand. That is the reason why Indonesia could maintain growth of about 4,6.
- Unfortunately, the current situation is a combination of both demand and supply shock. On the demand side, China is accounted for about 20% of the global supply chain. Therefore, when China slows down, due to the COVID-19, there will be lesser demand from China and it will hit some countries like Indonesia through the export and investment because the export sector is affected. Some people outside Java, especially in Kalimantan and Sumatra will be affected, in which affects the purchasing power.
- In addition to that, there is also a 'supply shock' because China exports components to many countries. If China fails to produce some of the components, it is going to hit the global supply chain and as a result the global production will decline.

- If we respond to the situation using the old and traditional policy like what we did in 2008 by boosting demand, when the production is slowing down, it will end up with higher inflation.
- Thus, the approach should be very different. Market means interaction between demand, supply, and people interaction. However, the related issue is social distancing and lockdown which means you are not allowed to have a physical presence. Both buyer and supplier could not meet, and the market will not exist unless you can substitute virtually. The impact from the demand side may occur because people are unable to come to the market while from the supply side, it is because people could not go to the factory.
- Regarding the situation, I will recall my experience from last January. I was in Davos at that time for the World Economy Forum and it was quite funny because we were still talking about a good global economy for 2020 and the possibility of the United States raising the interest rate because the United States was in a good shape. All of sudden, in the end of January, we were shocked by the news of COVID-19 from Wuhan. After that, the financial market collapsed because it is flight to quality to the US T Bills.
- Forty percent of our government bonds are sold by the foreign investors and they converted it from Rupiah to the US Dollar. That explains why Rupiah depreciated almost 20% in the last one month. It is a capital outflow from the emerging market.
- The question is how deep the impact would be to the economy. The Indonesian Ministry of Finance came up with a scenario that the GDP growth would be between -0.4% to 2.3%.
- There is an interesting study conducted by Warwick Mckibbin and Fernando Roshen from the Australia National University. They made several scenarios and under their fifth scenario; “Middle” level of severity. Under that scenario, Indonesian economy will get hit by -2.8% from the baseline. It means that if the Indonesian economy in 2019 grew for about 5%, it could only grow about 2.3% under the medium scenario.

- In the high impact scenario, the Indonesian economy will decline as much as 4.7% to become 0.3%. The situation is very significant, as China is the center of the global production network, as China own 30% of the share of global export for electronics such as computers and optical products. My point is that China is one of the most important suppliers and when China gets affected, the global supply chain will also get disrupted.
- Now let us focus on the banking and market risk. The banking sector will see the possibility that within three to six months some of the companies will not be able to pay their debt. As a result, the Non-Performing Loan (NPL) will increase and liquidity especially dollar liquidity will be very high.
- The question is if we do not support the companies especially the small and medium enterprises, they will collapse and there will be a massive unemployment. It is important for the banking sector to continue to provide the credit line.
- The problem is, if they provide the credit line then we are going to end up with a high Non-Performing Loan, thus the government should step in. It reminds me of the situation in the 2008 global financial crisis where no one would like to export at that time and what we did, the G20 members and the government guaranteed the export credit by trade financing. Now the government should do the same. They should provide a guarantee for banks to continue lending the companies and that is one of the reasons why the government introduced the Government Regulation in Lieu of Acts (*Peraturan Pemerintah Pengganti Undang-Undang / Perppu*), the emergency state law which was announced about a week ago.
- The first two stimulus package are no longer relevant because at that time the government assumed that there was no social distancing and lockdown. They provide a discount for airfare and hotel for about 10.3 Trillion Rupiah but now no one will go on a vacation.
- Now, I will explain the leading indicators of economic activities that require physical presence declines. Economic Development Corporation (EDC) based on the merchant data dropped by 30 to 50% but interestingly, groceries supermarkets

increased by 47%. The telecommunication companies are also performing well because people shift to online activity. Therefore, some companies are relatively fine but the companies that require physical presence will be in trouble.

- The way I look at this, the government needs to look at the policy response in sequence. There is no point to cut the interest rate because the needs for the people is the component as the traditional aggregate demand – that are boosting the purchasing power, demand, and monetary policy will no longer work.
- If the people need is on combatting the COVID-19; indeed, the stimulus package needs to focus on the health sector and getting the outbreak under control should be the top priority. What I mean by the health sector means providing rapid test kits, ventilators, paramedics and hospitals. These should be the first priority to contain the outbreak because when people get sick and they are unable to work, the economy will get hit anyway.
- However, there will be consequences if the government focus on the health sector. The government needs to provide social protection for the people to stay at home. “they are being paid to stay at home”. That is why the BLT (*Bantuan Langsung Tunai*) or the cash transfer is very important as we need to compensate people to stay at home. Otherwise they will go out to make a living.
- In three to six months many companies will be under financial pressure as they could not pay their debt. If the banking sector stop their credit line, there will be a massive unemployment. Therefore, the government should step in and ensure the continuity of the credit line making it as their third priority besides health sector and social protection.
- The government should also focus on the urban sector. The population’s density is very high and 55% of the population live in the urban areas. It will be very dangerous if there is not enough stimulus in the urban area and it will make people to go to the rural areas where the health facilities are very poor. Once it spreads out, the government will have a hard time to control it.
- After the pandemic ends, then we can talk about the traditional pump-priming policy to boost purchasing power and to provide tax relaxation.

- There are three things to focus on right now namely: the health sector, social protection and to support the companies.
- In the long term, there will be a different global supply chain because people learn that they could not allow China to become the center of the global production network. Everyone will start to diversify their production base and Indonesia can take an opportunity on this. For example, I remember when I was the chairman of the investment board, there was a flood in Thailand and Toyota in Southeast Asia were not able to continue their production. We came to Japan and persuaded them to put Indonesia as a production base and Toyota decided to do it.

Dr. Dino Patti Djalal

- Before we move on, I will ask one follow-up question to Dr. Chatib Basri. You were involved a lot in G20 when you were a finance minister and from your view point, is the G20 providing a credible platform to get the world out of this potential crisis?

Dr. Muhammad Chatib Basri

- Yes and no, because the situation is quite different. If you recall in 2008 before President Trump became the president, G20 got a full support from the United States. Now, the situation is very different as the United States does not entirely support the multilateral approach, they do not put their resources in the World Bank, International Monetary Fund and the G20. Even though when there is an agreement between the G20 member states, I am not really sure about the implementation because the situation is very different compared to 2008 when the big countries were still committed.
- The second thing, this will require huge resources. For example, the Indonesian government runs a budget deficit of about 5% and the question is "how do we finance this?" If we focus on the local, there will be a crowding out and if we focus on the global market, the yield will be very expensive. Thus, it is very important for Indonesia to get the international support such as from the World Bank and the Asian Development Bank.

- During my time, there was a scheme where if we do not an access to the global market because the bond yields are too expensive, we are allowed to borrow money from the Asian Development Bank, World Bank, Japan and Australia at the rate 100 or 200 basis points above LIBOR (London Inter-Bank Offered Rate). Unfortunately, this scheme is no longer available. Therefore, in my opinion the Finance Minister and Central Bankers should call for international support in order to address this issue.

Enrico Tanuwidjaja

- It goes down to two major possibilities, the first will be a long period of time for the pandemic will last with ineffective interventions and the second is an effective control of virus spread with effective policy response.
- As of now, I am not seeing an effective control of the pandemic, whereas an intervention economic policy is partially effective – since the monetary policy has been ultra-loose.

- It is only useful when the recovery sets in, but what I want to highlight is that we are in an uncharted water. Not even comparing to the 1929, added by the 1918 Spanish flu plus the extent of 2008, it is a combo of three different shocks all together hitting the demand and supply side.
- If we are in the scenario of partially effective policy intervention and following with an effective virus control; certainly, we are going to have at least a slower long-term growth and recovery.
- Pak Chatib is also mentioned about the financial distress that will cause the delayed spending and postponed investment, but for me what is important is the C component (cash transfer to help households and to boost businesses that are affected by the pandemic) because in Indonesia, it encountered 54% of the GDP and this is the one that needs to be targeted.
- Pak Chatib is right about the BLT or cash transfer that it will answer the social issue, but my question is "For how long? Has the government done enough and how the banking sector could play a cooperative role?"

- The International demand shock will hit us but not so much compared to the business sectors which I fear the most. In that account, we come out with a broader analysis with what are the less impacted sectors and most severely impacted sectors. Unfortunately, those that command the largest share of the economy such as mining, manufacturing and construction are the most severely impacted sectors compared to agriculture and human health. The government needs to make sure that the stimulus should be targeted directly into those sectors without crowding out the private and banking sector.
- The GDP will conservatively be at 2.5%. This is because a hit to our domestic demand; whereas, our export and import are muted. We are focusing more on how to revive or at least maintain the private consumption; as well as, how we deal with the delayed investment expenditure.
- As the previous two package stimulus are no longer relevant, I want to focus on the third stimulus package especially on number 4 which is about “Financing to support the National Economic Recovery Program” amounting 150 trillion Rupiah. What I am inclined to discuss more is “how are we going to finance using this 150 trillion?” because there are no details in the data.
- If we look at the key sectors that could be affected, these are the loans setting in the Indonesian economy. About 5600 trillion of outstanding loans at the moment, we are already having 142 Non-Performing Loan (NPL) cases. Assuming that the most severely impacted sectors account for a minimum 50% of the economy, more provision should be guided towards this. Even those that absorb a lot of workers, the MSME (Micro, Small and Medium Enterprises) accounts for more than a thousand trillion of the outstanding loan. My prediction is that at least we need four to five times of that 150 trillion to be set aside for the recovery, to make sure that we are not in it for a protracted slowdown.
- The government needs to set their eyes on the biggest part of the economy which is the consumption part while also allowing the delayed investment to resume over time. However, we are also facing the financial market crisis which is the strengthening Dollar.

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- I want to emphasize that the current situation is very different from the situation in 2008 and 1998. The first difference is that there is a dislocation in Dollar liquidity. The Fed has cut to the bottom, injecting more trillions. Look at the difference between the one month liable and the Fed Fund Rate. They are not converging whereas in historical sense they should be. The dislocation happened shortly in 2008 but it is corrected immediately once they can quantify the economic shock.
- The second point is that we have not been able to quantify the extent of the damage. That is why until it happens, the Fed is going to keep on pumping the liquidity. Even they are buying junk bonds for the sake of injecting liquidity. However, the fight to safety so dollar assets will continue at least there is a convergence between the one month liable, the inter-bank, how the US economy is being run to the Fed Fund Rate. This is why Rupiah will keep on depreciating.
- The capital outflows this year have been high in terms of the bond market. The number has increased to 8.8 billion and there will be an additional for at least 4 billion in-flow in the next week or so. The inflow will be better but then afterwards there is a risk of resurgence and if there is panic in the market, we may see a continued outflow. This will be the second reasons why the Rupiah will still be under pressure.
- One difference from the 1998 is that it only took a few weeks to depreciate 700% whereas it took between eight to nine years to depreciate about 50% for the rupiah that is equivalent to about 5- 6% depreciation. Except this time, when we depreciate double digit close to 16%, this is an overshooting. When the market settles down, I think Indonesian Rupiah will gain strength quickly.
- There are two things I would like to highlight in terms of the risks going forward: We will have a longer time for recovery thus the government needs to rely almost entirely on the fiscal stimulus. But I think the monetary policy has pretty much done the setting so when there is a rebound it will be very quick. Furthermore, the government needs to do more as they only allow 150 trillion for economic recovery.

- I have also outlined the sectors which the government should put more focus on. In terms of fiscal policy, I know it is under pressure, but we need to use this opportunity to bring the 55% informal sector of the economy as this will help to increase the tax base. When we return to the fiscal discipline of 3% or lower, we will have a sustainable growth.

Dr. Abdul Abiad

- Let me begin by summarizing the key messages of our Asian development outlook report which was released ten days ago on April 3rd. Please keep in mind that ten days in this current environment is like an eternity because the situation is changing rapidly. The forecast was finalized using the information up to March 20 which is a long time ago. I will talk about how it shaped the forecast later.
- First, we downgraded our growth forecast for the region to 2.2% this year primarily because of the pandemic. We expect a rebound to 6.2% in 2021 on the assumption that countries are able to contain the outbreak and normalize economic activity within this year. The risk is that there is a possibility that it will not happen.
- Second, the downturn will touch all the economies in the region even to the largest economies including China and India. Both will substantially slow down this year.
- Third, inflation will increase slowly to 3.2% this year due to higher food prices before easing to 2.3% in 2021. However, there are also many other forces affecting inflation such as a potential supply disruption as Pak Chatib mentioned. Furthermore, there are also a weaker global and domestic demand and lower commodity prices. There is uncertainty in inflation forecast now.
- Fourth, risks are extremely large due to uncertain evolution and effects of the COVID-19 pandemic. This year, growth could be lower and recovery could be slower than what we have forecasted.
- Due to the rapid changing environment the ADB will come up with an updated forecast soon.
- I will explain further the main points I have just said. The ADB predicted that the GDP growth for developing countries in Asia will decline to 2.2% this year. That is about a 3.3% reduction from what we have forecasted on September last year. If

the newly industrialized economies are not included in the data, there is still a similar pattern of decrease to 2.4%. However, we predicted that there will be a V-shape growth recovery rebounding to 6.2% for Asian developing countries. I will talk again a little bit about what that requires and what are the risks to achieve that.

- One reason the region will be hit hard is that the outbreak has become a global pandemic and it is hitting the major economies. I will explain about the ADB's forecast for the US, Europe, and Japan. What we see is basically a contraction. We revised our forecast down, by about 2 percentage point and this is actually outdated. As I have mentioned, the data is based on data from up to March 20. But in the last three weeks, we have seen that the US in particular has 16 million new unemployment benefits claimed, which is by far the largest in history. If we look at the consensus forecast for the US, a contraction for this year range from about 3 to 6% while for the Euro area we see a similar large range between maybe 4 to 10%. For oil we forecasted an average of $35 per barrel for Brent oil until the end of year.
- The region's two largest economies, China and India have already slowing down last year due to several factors and their growth are to continue slowing down this year. Last year in China there were trade tension, weakening domestic demand, and now the economy was hit really hard in the first quarter. Industrial production decline by 13% in January and February 2020. They have a monthly series for the services production and contracted about the same amount. In March it has not recovered fully, therefore China we will be seeing a double digit decline for China in Q1. While on the demand side, retail sales are even declining by more than 20% in January and February 2020.
- On the other hand, India's story is quite different. There was a tightening financial conditions. India experienced a collapse of non-bank financial institutions that has led to tightening of credit and has it slowing down the economy last year. With global conditions will be weak now, to cope with the outbreak in India is relatively muted compared to other economies, although that situation could change. However, weak global demand would drag it down not to mention the containment

measures that are being implemented. Therefore, we expect India's growth to also slow down this year.

- The underlying assumption is that the outbreak will be contained this year and we will see a rebound in growth next year. The reason you are seeing a relatively high growth rate is based on the fact you are comparing to depress output in 2020 when you get the 2022 growth will return to more normal levels.
- The ADB forecast assumes containment this year and a return to normal activity by next year but there are also risks.
    - First, the outbreak can spread to more countries.
    - Second, it may take longer to contain. We assume that countries will take three to six months to both contain the outbreak and start normal economic activity. However, it may take longer time.
    - Third, economic effects may be larger than what we are anticipating.
    - Fourth, as both speakers had already explained financial turmoil and crisis are definitely possible.
    - Fifth, it could result in fundamental, long-run changes to the global economy. I think globalization already took a hit from the trade conflict that we have had in the past two years but this is an additional blow to globalization.
- There is a need for quick and decisive policy actions focusing first on public health and supporting social protection to support the most vulnerable, and ensuring adequate liquidity especially for Small Medium Enterprises (SMEs). Moreover, as I have already mentioned, forecasts quickly become outdated in this fast-changing environment and the ADB will update as needed.
- Since the ADB's initial estimate of the COVID-19 outbreak impact on March 6, there have been big changes that have taken place. First, when we did the March 6 assessment the outbreak was still primarily concentrated in China with 93% of cases and 97% of fatalities at that time were in China. However, it has turned into a global pandemic and now only 5% of cases are in China.

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- The second change is the use of containment policies where quarantines and travel bans have increased dramatically especially from mid-March. The ADB calculated that travel bans now affect 740 million international trips in a typical year and that is about 53% of global total. Obviously even without travel bans people just do not want to travel. Therefore, travel and trade sectors will still be hit.
- The third change is the data that came out from China where there is a big decline in both supply and demand side. We initially assumed smaller shocks to consumption and investment but now we have to revise our assessment because of the numbers we have seen from China.
- As a result, the estimated global and regional economic impacts are now substantially larger. For the world as a whole, the ADB estimated that the pandemic will result in the loss of global GDP between 2.3% to 4.8%. Global growth last year was about 2.5% so a global recession is a definite possibility. Please note that this does not account for fiscal stimulus.

Said Zaidansyah

- The ADB as a regional development bank is ready to assist developing member countries including Indonesia facing the economic turmoil due to the impact of the COVID-19.
- One of the problem that Indonesia encounters is the huge budget deficit. Indonesia, under the state finance law is allowed to have 3% fiscal deficit but under the recent Government Regulation in Lieu of Acts (*Peraturan Pemerintah Pengganti Undang-Undang / Perppu*) that limit has been lifted. Due to the lack of generated revenue and the increase in expenditures, Indonesia might have a fiscal deficit that goes beyond 3%.
- Looking at the projection of the central government revenue in 2020 by using the exchange rate of 17.500 Rupiah per US Dollar, a decline of around $27 billion USD in terms of revenue is expected. The substantial increase in expenditure is because there is an increase in expenditures related to address the COVID-19 pandemic for example the three economic stimulus packages the government has introduced. Even in the health sector, there is a requirement to have 5% of the

state budget allocated to the health sector. However, for this year we expect at least 8% of the state budget will be allocated. Not to mention, there are other fiscal stimulus that have created additional expenditures.

- How is ADB supporting Indonesia? The ADB is providing a grant in the amount of $3 million USD as a quick relieve to help the government meet some of its urgent medical supplies. The ADB is also preparing a budget support but at the amount is still being discussed.
- We are also mobilizing budget support from other donors as a total package to be provided to the government, a substantial amount that hopefully can relieve some of the deficit. On top of that we also have what we call a "contingent disaster financing facility" to be provided to the government by the end of August. The initial support, we call it a "countercyclical support facility" is ready for disbursement by the end of April. We are also providing an emergency assistance project that will be able to deliver the needed goods and services to the Ministry of Health or to other ministries that are combating the COVID-19.

Dr. Dino Patti Djalal

- In 1998, the situation in Indonesia was bad with the economic contracted by 30% and there was a political crisis too. Fortunately, the 2008 crisis did not reach to Indonesia, but in some other countries we saw a terrible economic crisis. Am I right in assuming that the economic challenges that we have now is such that the likelihood of riots is much less likely compared to 1998 and 2008 in some other countries?

Dr. Muhammad Chatib Basri

- In my opinion, it depends on the government capabilities to provide enough social protection. If the government urged people to stay at their home, they need to compensate the people. Moreover, the second key aspect is the food supply. If there is a shortage of food, then there is a risk of social unrest. The government should focus on that two key factors to avoid social unrest.

Dr. Dino Patti Djalal

- Do you think the stimulus of 2.5% of the GDP is enough to prevent economic meltdown. Do you share similar view with Bank Indonesia that Rupiah could strengthen to 15.000 rupiah?

Enrico Tanuwidjaja

- As I have mentioned earlier, this is an overshooting of the exchange rate because the current account deficit accounts for roughly three percent. Rupiah depreciated after the global commodity collapse in 2012 until today at an annual rate on average about five to six, which is acceptable. If they tripled or even quadrupled, it is an overshooting because of the three factors.
- First, the dollar dislocation which means everybody is flocking into the dollar on scarcity bases.
- Second, there is a continued capital outflows because during uncertain times people only buy dollars.
- Third, there is a seasonality in dollar dividend payment. Once the factors are corrected, once the borrow approach the fed fund rate, dislocation disappear, we will see a massive strengthening of Rupiah. Depending on the peak, if the peak is 18.000, Rupiah may shoot back to 15,500 or 16,000, if it is in the current level probably they can go back to where it was before.
- However, the uncertainty remains, meaning because of those three pressures it may continue to go up. But when it comes back, Indonesian yields are very effective. Back in 2008, the yield seeking behavior will return into the minds of investor. Rupiah will come back very quickly but it depends on how stretch it will go. My sense based on the data, it is not the end yet, it could be a temporary relief.

MODERATOR CLOSING REMARKS

Dr. Dino Patti Djalal

- On behalf of FPCI and our viewers, we want to thank all the speakers for their informative insight and assessment. We all learned a lot and I am optimist about the scenario in the coming months. Thank you very much for spending your time here with us, I hope we meet again in another public discussion.