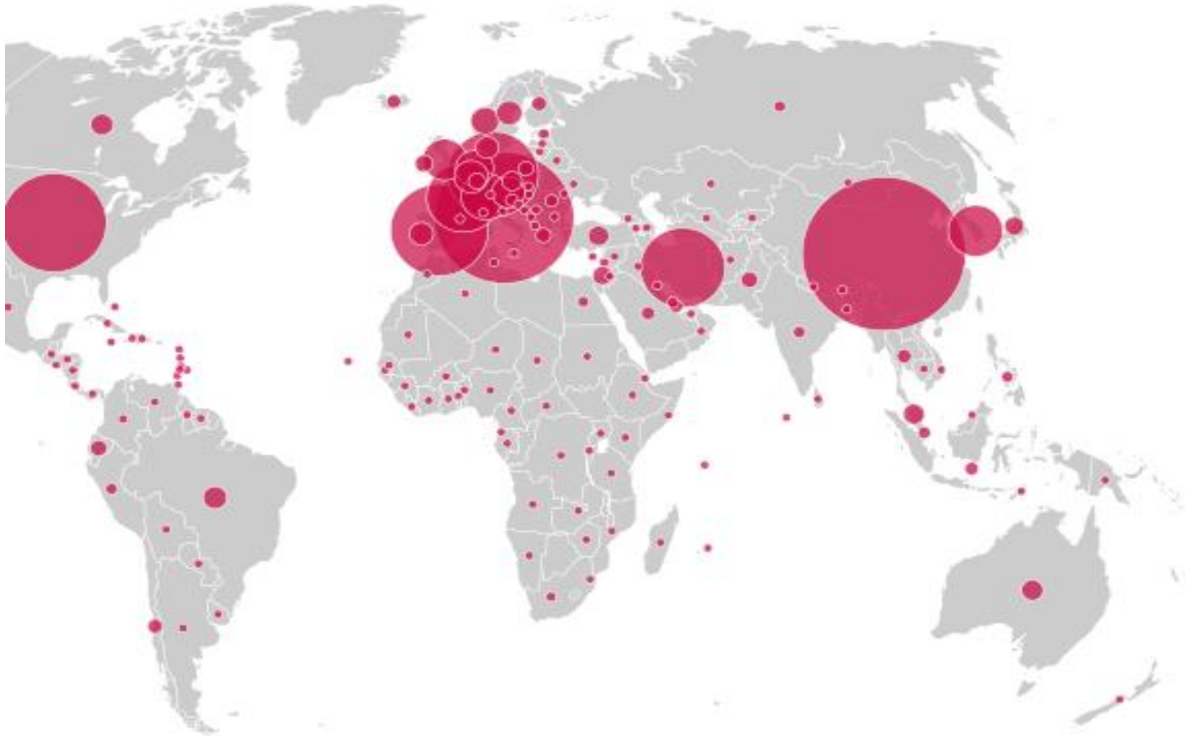

Outlook and challenges for Indonesia in the age of COVID-19

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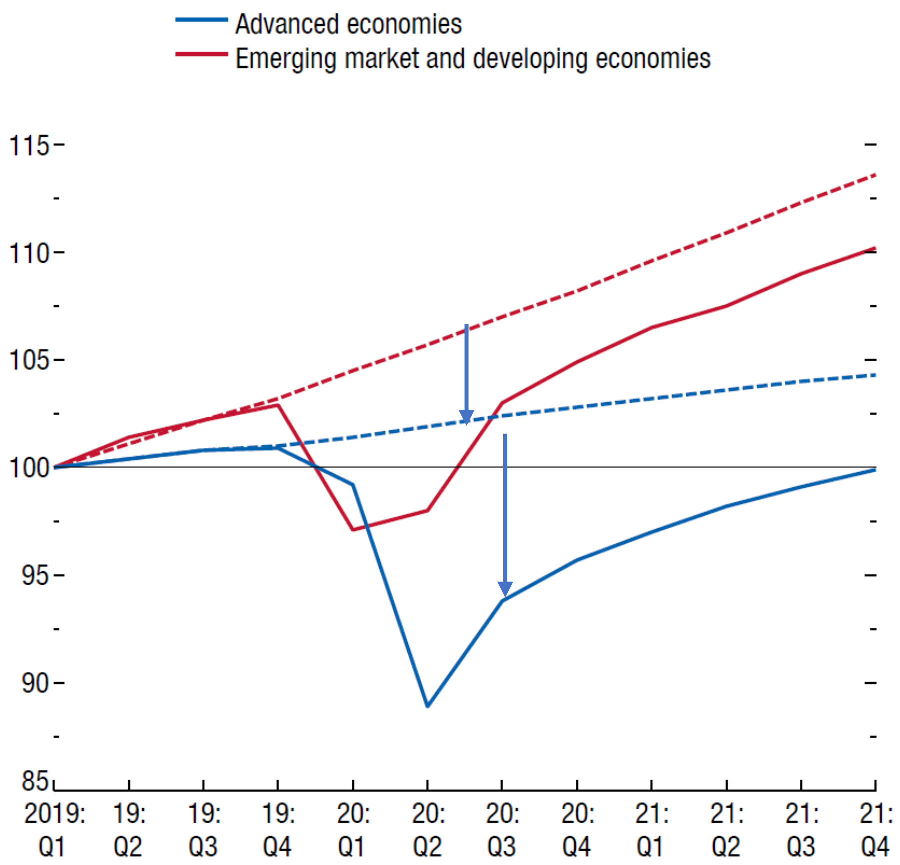
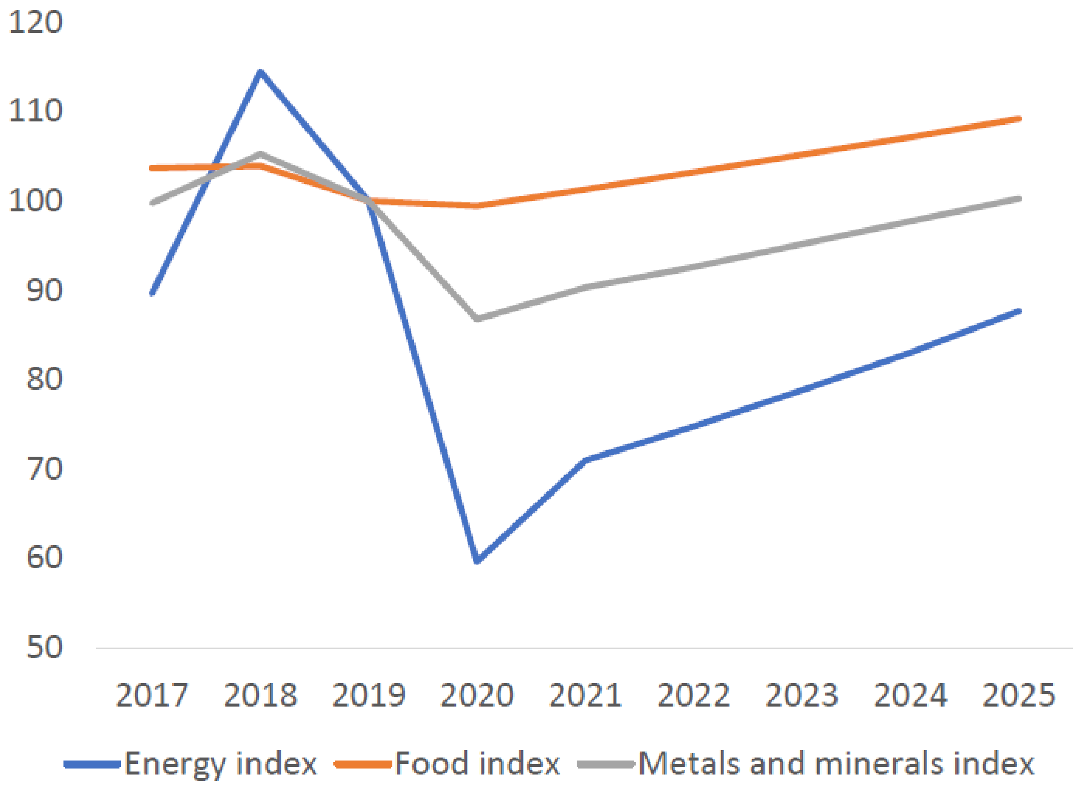
External shock: global growth, commodities

Figure 1.6. Quarterly World GDP
(2019:Q1 = 100; dashed lines indicate estimates from January 2020 World Economic Outlook Update)



Source: IMF staff estimates.

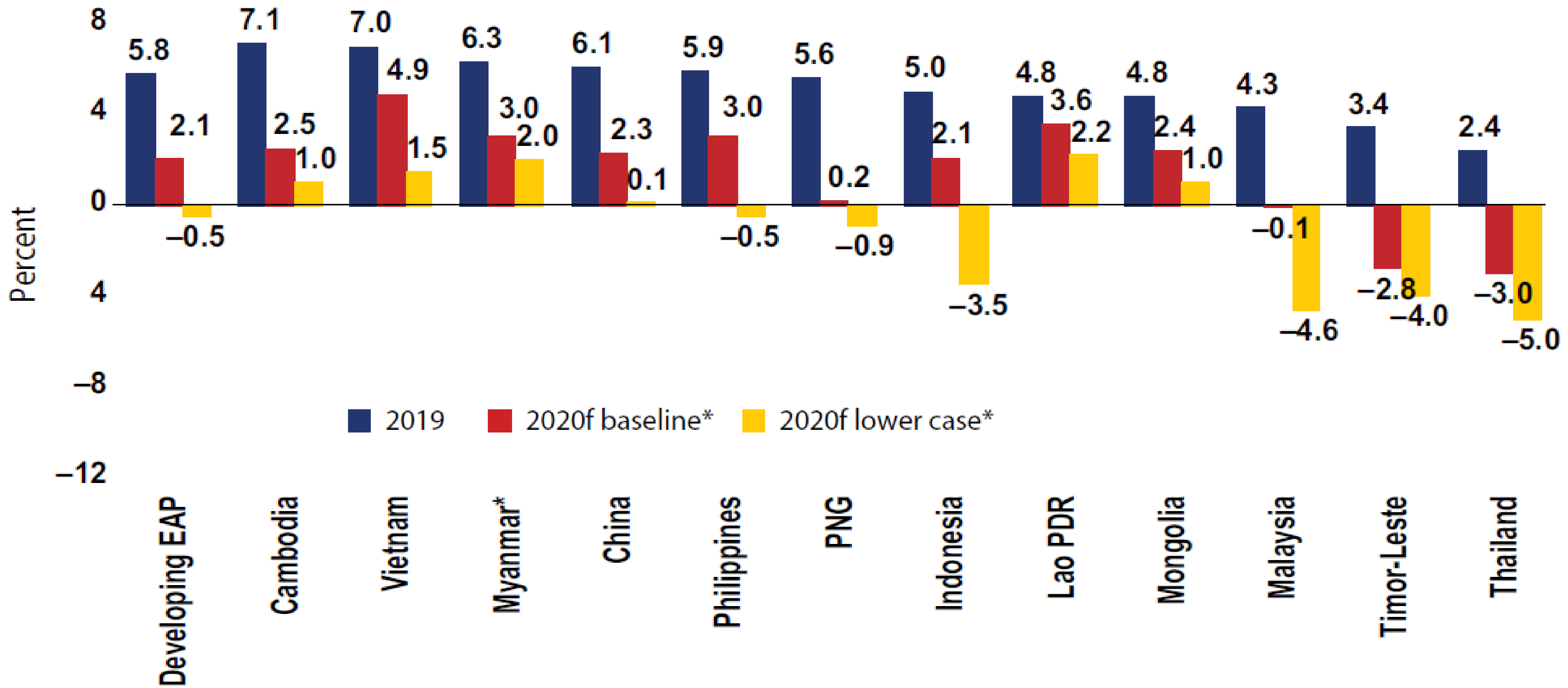
Commodity price projections (2019=100)



Source: World Bank commodity price projections, April, 2020

Source: World Bank commodity price projections, March 2020

As a result, growth is forecast to decline sharply in the region in 2020 (early April forecasts; will be revised downwards)

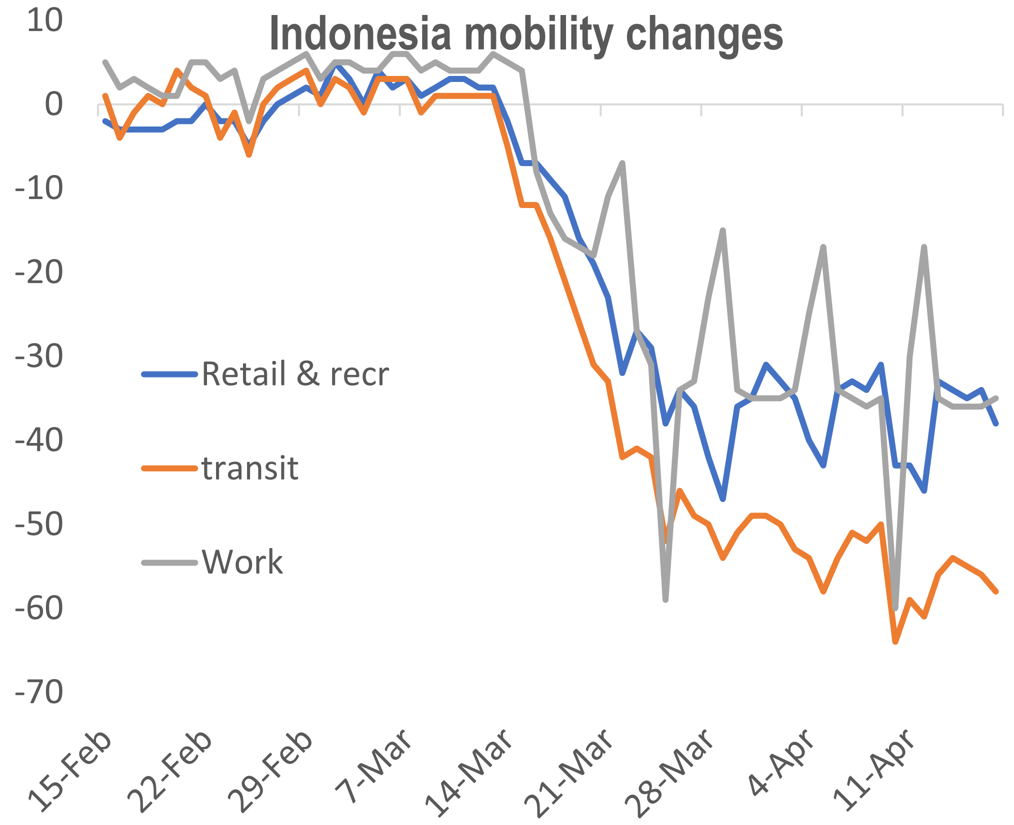


Source: World Bank. World Bank staff calculations.
Notes *Myanmar growth rates refer to the pre- and post-pandemic period for fiscal year from October to September.
Baseline refers to a scenario of severe growth slowdown followed by a strong recovery.
Lower case refers to a scenario of a deeper contraction followed by a sluggish recovery. Weighted averages are calculated for developing EAP

Growth projected to slow down strongly, from 5 percent pre-COVID

- Growth projected to slow down strongly in 2020 on account of COVID-19 effects (WB projected 2.1% in early April; will be revised downwards), **assuming two months of Large-Scale Social Restrictions**
- **Private consumption slowdown**: due to job losses, resulting from the plunge in economic activity, as well as the decline in consumer confidence.
- **Investment growth slowdown**: due to large uncertainty associated with the infection and its containment, weaker economic activity, lower commodity prices and the global slowdown
- Faster pick-up of global growth would dampen growth slowdown
- Longer LSSR could lead to further growth slowdown or negative growth

Q1: two weeks of lower mobility had a significant impact in certain sectors



	2016-19 average	Q1 2020
GDP	**5.0%**	**3.0%**
Agriculture	4.1%	0.0%
Manufacturing	4.2%	2.1%
Other Industry	1.0%	0.9%
Construction	6.4%	2.9%
Low-VA Svcs	5.7%	2.0%
High-VA Svcs	6.2%	7.3%

Poverty rate expected to go up; need for adequate protection of poor and vulnerable

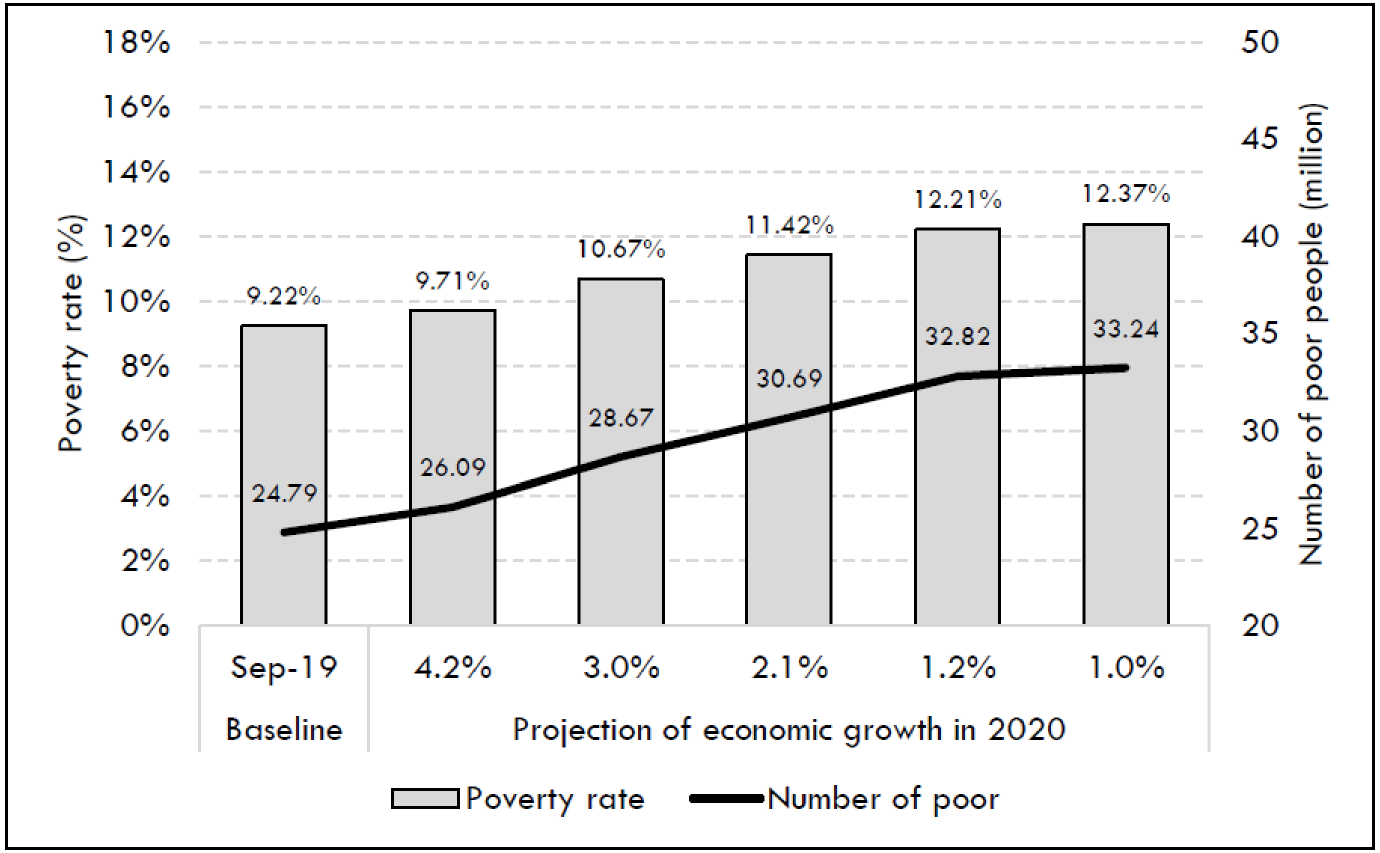
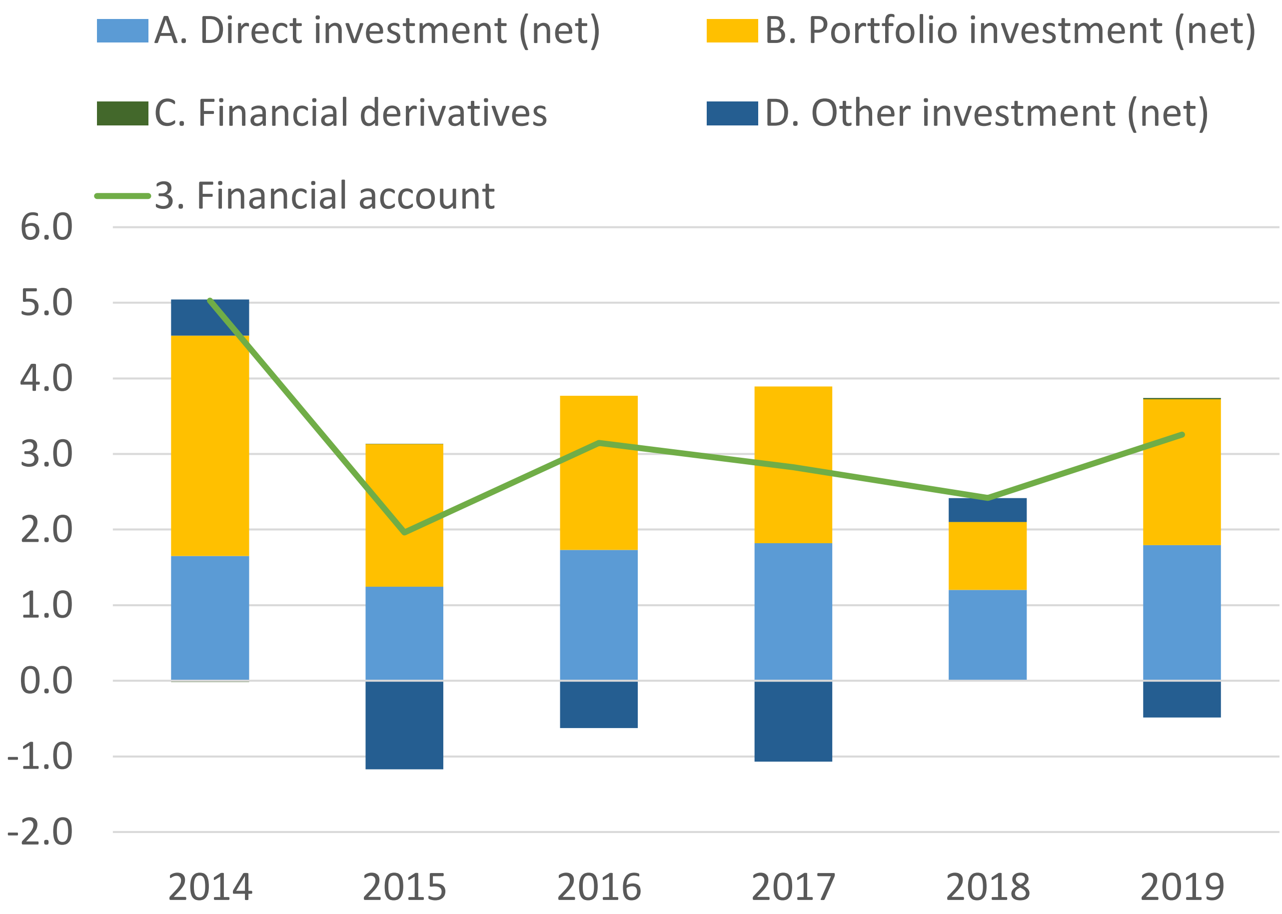


Figure 7. Projected impact of COVID-19 outbreak on poverty rate and number of poor people

"The Impact of COVID-19 Outbreak on Poverty: An Estimation for Indonesia", Asep Suryahadi, Ridho Al Izzati, Daniel Suryadarma, SMERU Working Paper, April 2020, www.smera.or.id

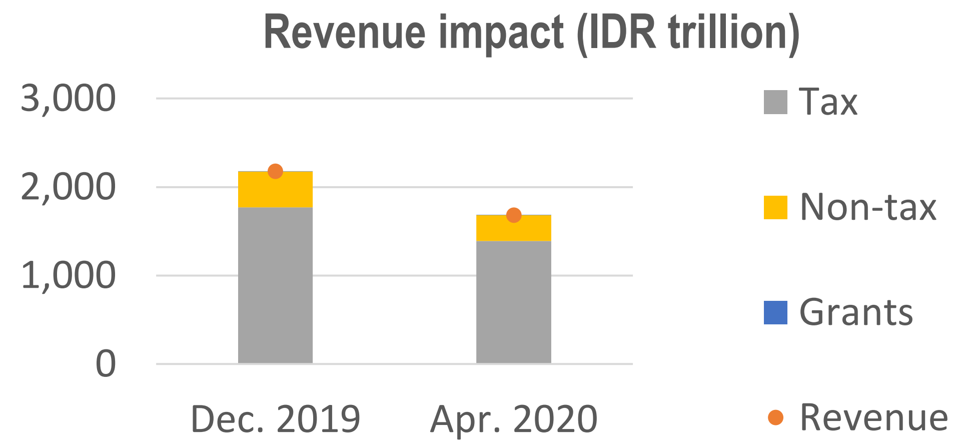
How to finance Balance of Payments?

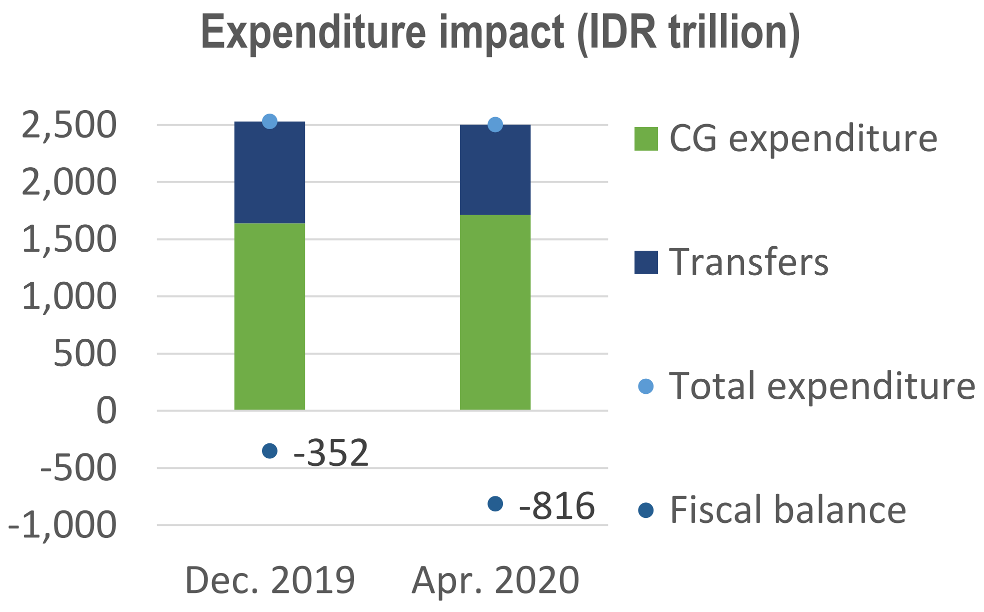
- Expect offsetting effects on the current account deficit
- BoP financing will see **major adjustments**:
  - Outflows of equity and non-resident debt investors (although recently slowed down)
  - Drop on FDI inflows
  - Additional FX loans from multilateral and bilateral partners; government targets about USD 4 billion in additional loans in its revised 2020 budget (ADB, WB and others)
  - Use of FX reserves (covering 9.1 months of imports at end-2019)
- **Network of currency swaps** incl USD 60 billion swap with US Fed available for short-term FX liquidity needs.



Impact of downturn and fiscal packages will lead to widened financing need

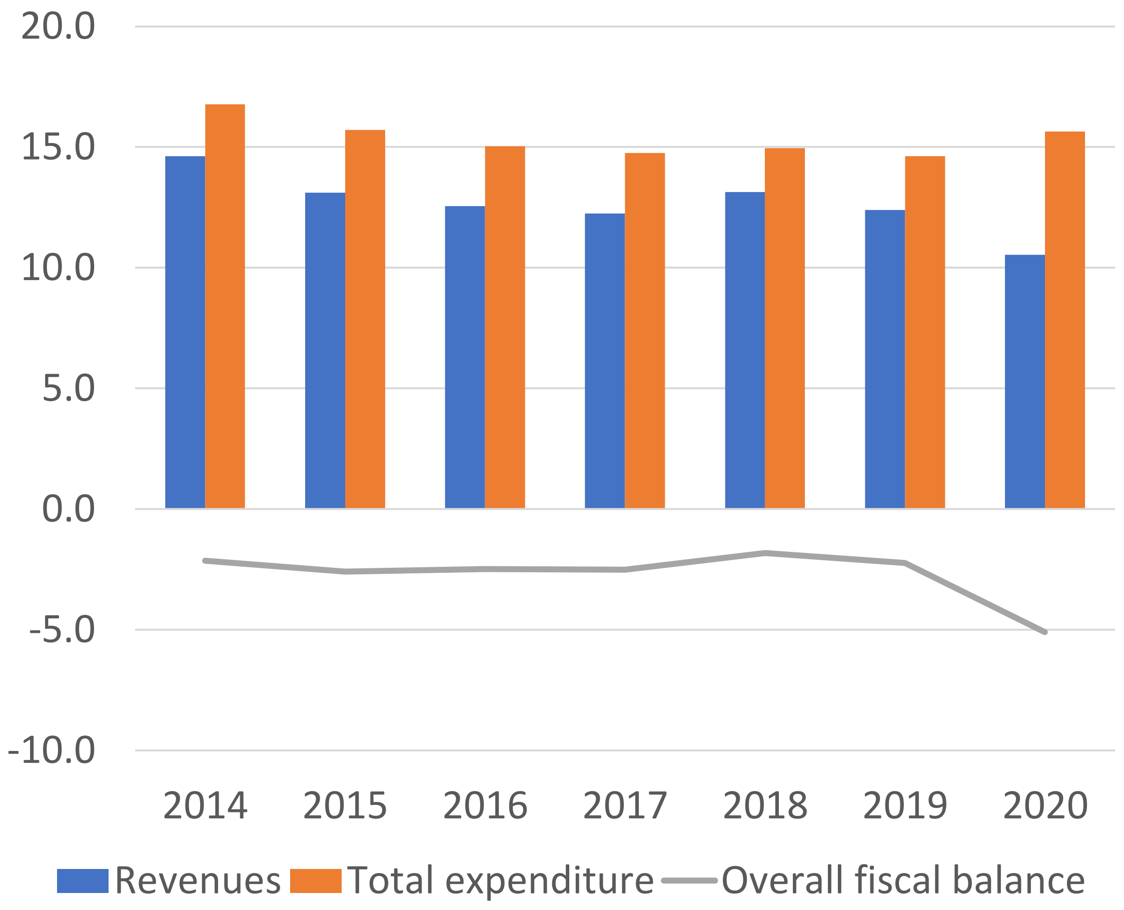
- Revenue response to lower commodity prices and growth slowdown and fiscal package 2 and CIT rate cut to lead to further decline.
- Revenue projections may still be optimistic as many firms may not have the cashflow to pay taxes in 2020.
- Expenditure drop due to downturn (energy subsidies and SNG transfers linked to revenue) and additional budget reallocations to accommodate IDR 20 trillion above-the-line package and target the 5.1% of GDP deficit.





Debt will rise strongly in 2020

- Driven by higher deficit, slower growth, XR depreciation, interest rate shocks, and more borrowing to finance the 3rd fiscal package
- Also, interest-to-revenue ratio hit by higher debt interest and lower revenue (CIT rate cut)
- Govt must maintain hard-earned market confidence
- Market cautiously welcomed recent fiscal package, but credit ratings agencies are concerned about the medium term
- Govt must show a credible path for the economy whereby these exceptional measures are unwound:
  - An eventual reinstatement of deficit ceiling
  - An end to Bank Indonesia's partial financing of the deficit



Policies need to be tailored to the distinct phases of the pandemic

Containment

- Respond to health crisis
  - Mobility restrictions
  - Increase system capacity
  - Massive testing
- Protect livelihoods
  - Social transfers
  - Food security
- Help firms hibernate
  - Minimize fixed costs: debt service, taxes, utilities, wages (while retaining workers)

Length of time mobility restrictions need to be in place for containment a **key variable**

Recovery

- Gradual reopening
- “Wake up” hibernating firms
  - Help affected firms while avoiding moral hazard and erosion of the tax base
  - Repair bank, corporate and sovereign balance sheets
  - Equip workers with skills and help restore employment
- Attract new investments
  - Structural reforms
  - Infrastructure
  - Human capital

The recovery in 2021 will depend on what remains to be done in 2020 during containment

To maximize the strength of the recovery in 2021, in 2020 Indonesia still needs to:

1. **Safely minimize the time** that mobility restrictions need to be in place
2. **Support the poor, vulnerable and informal sector workers and ensure affordable food** to protect Indonesia's human capital
3. **Help firms repurpose or hibernate** by reducing costs while incentivizing them to retain workers
4. **Implement structural reforms** today to ensure a strong recovery tomorrow, including passing the Omnibus Bill, but keep strong environmental protections and leave labor reforms provisions for a future comprehensive reform post-COVID to speed up the Bill

With more done during containment, APBN 2021 can more effectively focus policies towards recovery

APBN 2021 then needs to focus on:

1. **Ensuring banks' balance sheets are restored**, in the context of further reforms to increase financial sector depth, efficiency and resilience
2. **Resuming infrastructure development by reforming SOEs** to ensure their viability, stimulate investments and increase efficiency
3. **Sustaining higher levels of investment in health and social protection** to boost human capital and facilitate the return of workers to jobs

But how to spend more and better, when resources are less?

Therefore, Indonesia will need to spend more (and better) not only during COVID-19 containment but also for the recovery…

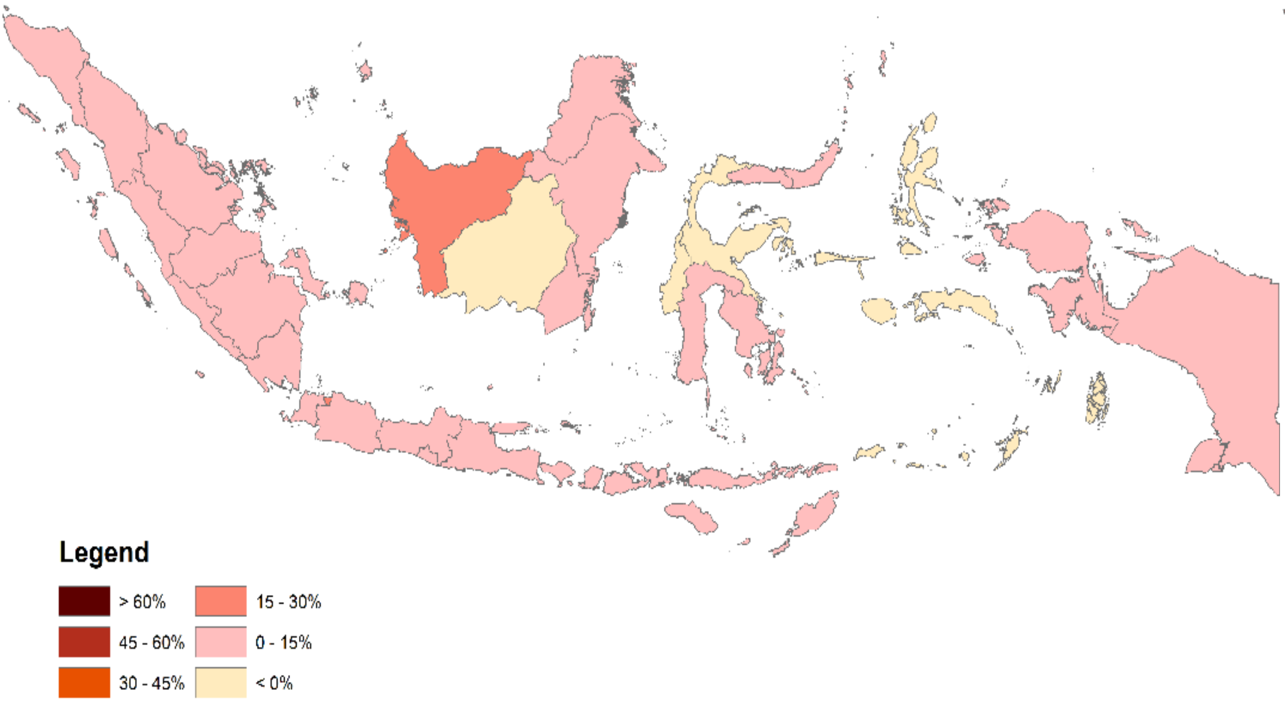
…but how to do that when there are less resources because of tax breaks and permanent tax cuts?

In the last month restrictions in Indonesia have intensified…

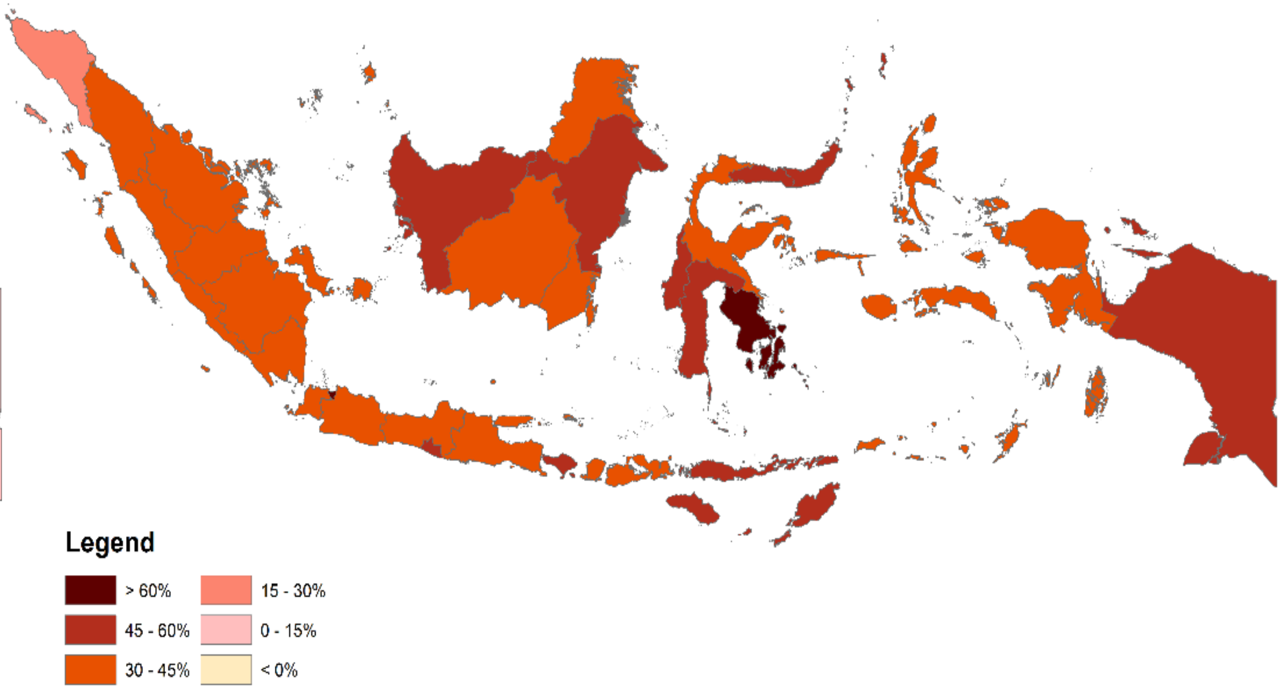
Jakarta and West Sumatra provinces and large areas of West Java, Riau, Central Java and South Sulawesi have imposed partial lock-down.

But every province has experienced a significant drop in mobility

Percentage Decrease in Mobility to Retail and Recreation Compared to Baseline, 15 March 2020



Percentage Decrease in Mobility to Retail and Recreation Compared to Baseline, 11 April 2020



Source: Google Mobility reports

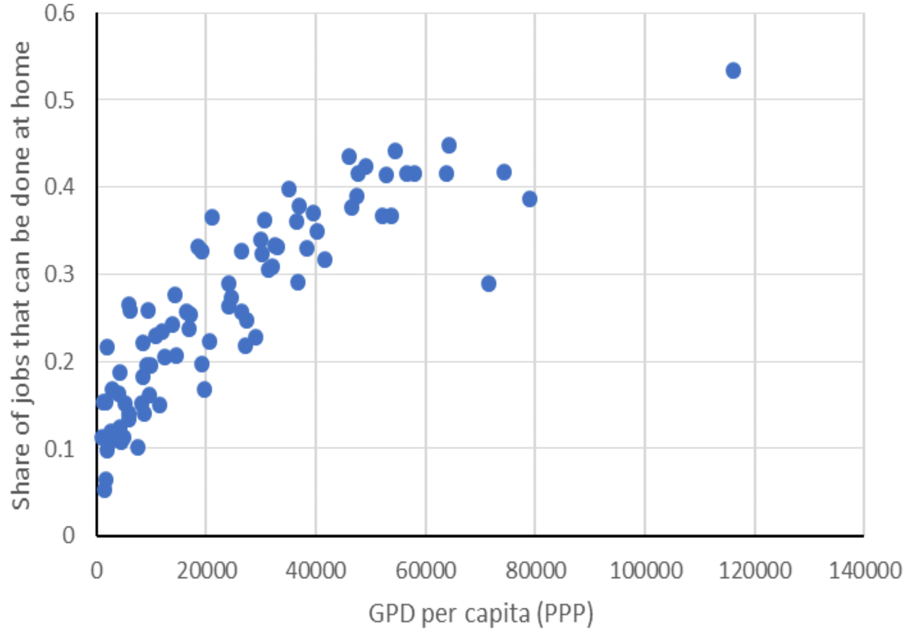
…with mounting losses to economic activity and jobs, and potentially a significant increase in poverty

The restrictions have prompted reductions in GDP growth forecasts for 2020:

Indonesian Ministry of Finance — January: 5.3% → April : 2.3%; lower bound: -0.4%

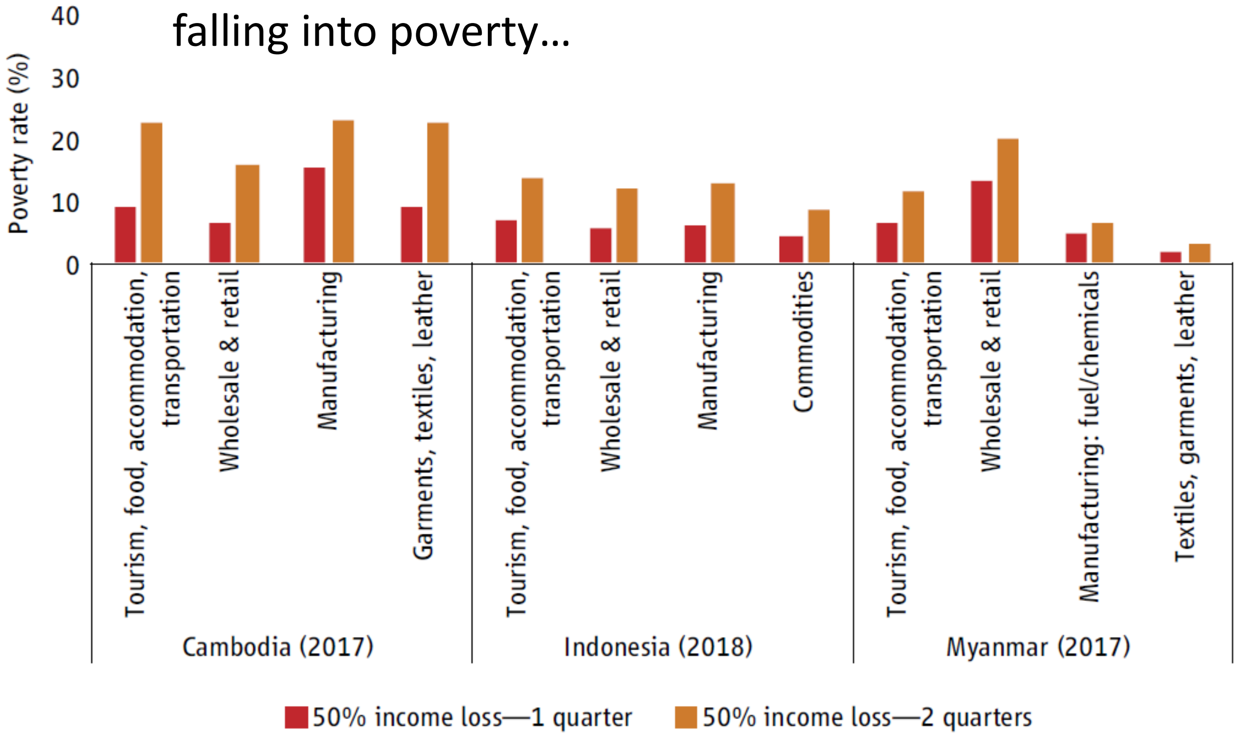
2.8 millions had lost the job between mid-March and first week of April, increasing unemployment by more than 2 percentage points

Countries with lower incomes have a lower share of jobs that can be done at home



Source: Dingel and Neiman, 2020

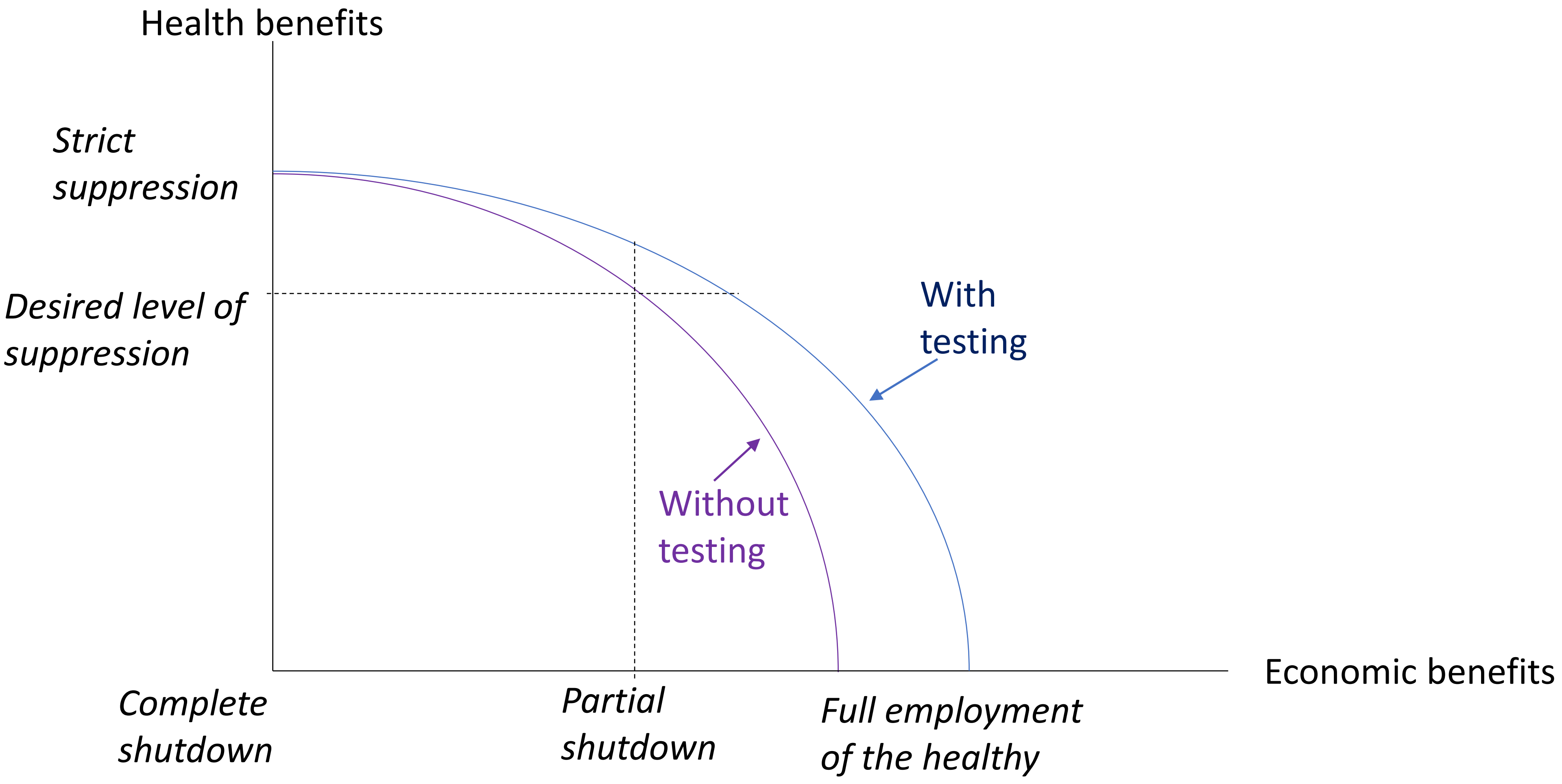
Households linked to affected sectors face a higher risk of falling into poverty…



The dilemma

- Faced with COVID-19, countries are taking drastic action based on limited information.
- These actions seen as the only option as the spread of the disease threatens to overwhelm the capacity to treat.
- But the dilemma:
  - Stringent controls → widespread economic distress.
  - Lifting controls → risk of unleashing the pandemic.
- Two questions:
  - How can policy action be better informed?
  - Is there a "third way" of limiting the duration and depth of controls?

As the government chooses optimal strategy, test information can ease tradeoff between health and economic benefits



Key messages

- **Deep global downturn in 2020**, falling commodity prices and freeze in tourism flows; domestically, mobility restrictions become more strict and widespread.
- **Growth slowdown** and **sizeable rise in poverty** from 8.8% (projected headcount for 2020):
  - First quarter GDP slowed to 3% with (still) limited impact of lower commodity prices and only 15 days of mobility restrictions
- **Fiscal packages: major shift away from infra to health, SA, industry support**, lead fiscal deficit to widen to 6.2% of GDP (from 2.2% of GDP originally projected).
- Still much to do in 2020 for containing and preparing for the recovery
- Priorities for recovery include **boosting spending on infrastructure, maintaining spending on human capital and ensuring financial sector soundness**.
- Sound fiscal strategy anchored on **credible measures to raise revenues needed to 'flatten the debt curve'**.
- Testing:
  - Tests are not a silver bullet and must be implemented as part of a battery of public health interventions.
  - Require a strengthening of capacity to use them and compete for resources with capacity to treat the victims of the disease.
  - But if capacity can be built in time, then tests can help reduce the number of victims - both of disease and economic immiseration due to suppression measures.