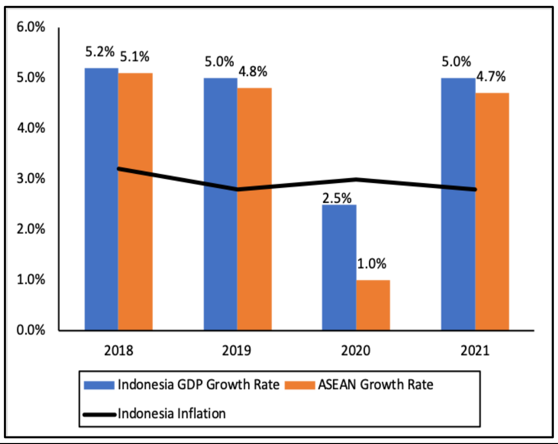
11 May 2020

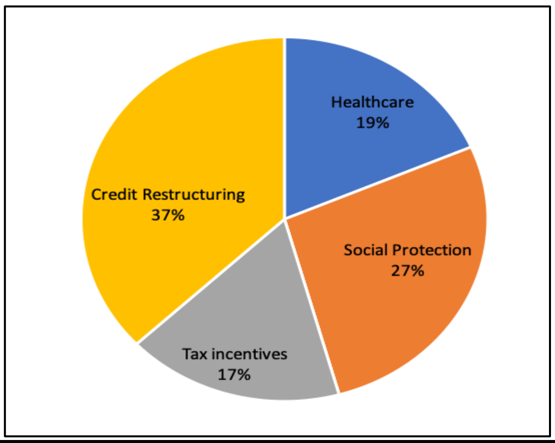
Country Insights - Covid-19 in Indonesia

Figure 1: Indonesia's Growth Rate, Inflation & ASEAN Growth Rate



Source: ADB Asian Outlook 2020

Figure 2: Distribution of Indonesia's Stimulus Package



Source: President Joko Widodo's Speech, 31st March 2020

"Lockdowns will inflict significant economic pain on those least able to take care of themselves. The government's priority has to be to find a way to soften the pain for both households and informal workers. This serves a double benefit – it softens the pain while also encouraging workers to stay at home."

-World Bank East Asia and Pacific Chief Economist Aditya Mattoo

When Indonesia announced its first Covid-19 case on March 2nd, there was a rising uncertainty about the ramifications of a highly contagious virus on ASEAN's largest economy. Within a month, it had spread to all 34 provinces of the nation, with Jakarta being the worst-hit. On 15th April, President Joko Widodo announced a partial lockdown bringing 34 million people under social distancing rules, banning Eid travel and postponing regional elections. As of May 11, the total number of cases stands at 14,092 (second in ASEAN after Singapore), with 973 fatalities. This makes Indonesia the country with the highest fatality rate in ASEAN, ostensibly due to insufficient testing.

Economic Toll - Tourism, Aviation, Retail

The outbreak has battered the economy, causing the Finance minister to announce a contraction of GDP growth from 5.7% to 2.3% this year, though the worst case scenario predicts a -0.4% growth. Similarly, the World Bank revised its GDP growth rate from 5.0% to 2.1% in the baseline scenario, and the Asian Development Bank revised from 5.5 to 2.5%. More worryingly, the World Bank predicts that the virus will bring 11 million people into poverty in Indonesia and East Pacific, since 55.7% of the country's workforce are in the informal sector. The worst hit sectors are travel, hotels and aviation; with the government reporting a revenue loss projection of USD 10 billion, assuming some recovery in the second half of the year . The F&B and retail industries have suffered as well due to the movement restrictions. Data from one of Indonesia's leading digital cashier services providers PT Moka Teknologi Indonesia reveals that Surabaya and Bali experienced F&B sales falls of 26% and 18% end March, and West Jakarta's daily earnings/outlet for the retail sector fell by 32%.

Financials – Effective Central Bank Interventions

On the financial side, Indonesia was in for a rough patch due to its large currency account deficit. Consequently, foreign investors traditionally hold between 35-40% of Indonesia's sovereign bonds, which puts Indonesia at risk for a liquidity crunch in these volatile times. Since January 2020, Indonesia experienced capital outflows of USD 4 billion, causing the Central Bank to buy US $10.1 billion worth of government bonds to stabilise the Rupiah. In spite of this, the Rupiah fell by 18% in March, though this stabilised by April on the back of further Central Bank interventions, including cuts of the benchmark seven-day reverse repo rate and reserve requirement ratio for banks. Moreover, Indonesia's dollar reserves are quite sufficient and represent 7.7 months of imports (well above the international adequacy standard of 3 months), and the Presidential Regulation No. 54/202 plans to raise funds from dollar-denominated bonds to increase forex reserves.

Stimulus Package – Implementation Issues

Initially, the government was limited in its ability to due to the state budget deficit limit of 3% GDP. However, recognising the extraordinary circumstances, the Finance Minister Sri Mulyani Indrawati relaxed the limit until 2022, which allowed the government to release a Rp 436.1 trillion (US$ 26.36billion) stimulus package. As outlined in Fig. 2, large portions of the package are allocated to social and business protection. Measures include food donation, free electricity and employment training programs for poorer households. Firms can avail of tax cuts, deferred payments, and increased access to credit. However, distribution remains an issue given that 50% of Indonesian adults do not own a bank account, and thus rely on cash transfers for aid. Additionally, workers raised complaints that the training programmes covered irrelevant skills that could be sourced for free, and merely funneled much-needed funds to private digital training platforms, rather than covering income loss of laid-off workers. Other means of coping with the outbreak include ADB's $1.5 billion grant to support vulnerable communities.

Recovery Prospects – Normalcy in a Year

Despite these volatilities, Indonesia is expected to return to normal growth in 2021, as seen in Fig. 1. This is due to well-coordinated, targeted measures by the financial authorities, such as Indonesia's first 50-year US Dollar Pandemic Bond, and the President's omnibus investment reforms. A key move in April was the issuance of the Government Regulation No. 1/2020 which permits the government to tax foreign companies with 'significant economic presence' providing digital services, such as Netflix and Spotify. This enables the government to profit of the growing digital services industry, by charging VAT taxes. Overall, Indonesia's economic outlook does face several risks in the form of extended virus outbreak and global financial volatility. However, an effective implementation of the stimulus package and balanced use of monetary intervention tools can carry the nation through the crisis, and back to normalcy in a year.