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The Habibie Center Quarterly on
Policies for Economic Recovery

by **Umar Juoro**

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Team of Editors

thc@habibiecenter.or.id www.habibiecenter.or.id

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The Habibie Center Quarterly on **Policies for Economic Recovery**

by **Umar Juoro**

Jakarta, Indonesia

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Umar Juoro is a Chairman of Institute for Democracy, Economics, and Ecology at The Habibie Center

Abstract

As Covid-19 hit Indonesia hard, the government laid down policies to overcome Covid-19 and support economic recovery. The main policies are higher budget allocation for health and social programs, and tax incentives for private sectors. Limitation of budget deficit is lifted up. For monetary policy, the policy rate is at historically low, and accommodative macro prudential measures by setting zero down payment for mortgage and vehicle loans. In addition, OJK (Financial Services Authority) is relaxing regulations for credit restructuring. The result is economic recovery with growth 7.1%, although slowing down to 3.5% in the third quarter of 2021.

Introduction

In response to Covid-19 pandemic, Indonesian government takes strong measures to overcome Covid-19 and economic recovery. The budget is increased significantly lifted the 3% GDP deficit limit, and very loose monetary policy with low policy rate, zero down payment for mortgage and car loans, burden sharing with BI to allow to buy bonds in the primary market, and relaxation for credit restructuring. This article explains the fiscal and monetary policies and the results that they achieved for economic recovery.

Expansive Fiscal Policy

The Ministry of Finance laid down the expansive fiscal policy with deficit 6.1% to GDP in 2020 and 5.7% in 2021. The law that passed to lift 3% limitation is used to support mainly for health and social spending to lessen the impact of Covid-19, and stimulate for economic recovery. To finance the deficit, Bank Indonesia issued more bonds to the market, and provided support by burden sharing, allowing banks to buy in the primary market with a determined interest rate that is lower than the market rate.

The National Economic Recovery Program (PEN) is the state financial policy to accelerate the handling of Covid-19 and economic recovery. PEN allocation in 2020 was Rp 575.5 trillion (3.7% GDP) and in 2021 is Rp 744.8 trillion (4.6% GDP). For health allocation consists of diagnostic, therapeutic, and vaccination. For social protection consists of assistance for the bottom 40% and vulnerable group (conditional cash transfer, non-cash food assistance, etc), priority program (labor intensive, food security, tourism, ICT), SME and corporate supports (assistance for macro enterprises, interest subsidy, fund placement for SOEs), tax incentives (income tax borne, SMEs income tax borne, luxury tax on cars and mortgage borne).

There was a problem in realization of budget, especially for funds that allocated to local government. Even budget allocation for health was not used in time. Bureaucratic problems hinder the effectiveness of budget realization, while allocation for social programs face with misused of funds.

The tax incentives assist companies to keep their cash-flow in difficult time. The companies asked for direct funding support from the government. However, this is not possible, as regulation prohibits that. The government can inject capital to SOEs in amount of Rp 11 trillion in 2020 and Rp 37 trillion in 2021. The Ministry of Finance also put fund in amount of Rp 15 trillion to be used by corporates. In addition, the Ministry of Finance allocates Rp 52 trillion as capital injection to SOEs. This capital injection is necessary as construction SOEs have to finish their infrastructure development tasks while their financial condition faces some strains with a run over costs and low return. For other SOEs, they need capital injection to continue their operation in difficult environment cause by pandemic

Managing Debt

The government raised debt significantly during the pandemic to finance the large budget deficit. However, the ratio of debt to GDP is still at the manageable level of 43.4% in September, with nominal government debt at Rp 6,711.5 trillion. Nevertheless, this ratio is higher than what the government set for this year at 41%. To manage the ratio at this level, the government cancelled the new issuance for conventional as well as Syariah bonds. With the increase of revenue especially from high commodity price and higher GDP growth, it is expected that the 41% level would be able to achieve.

The criticism that the government borrows money to pay debt caused by the difficult circumstances of the pandemic. The issue is how effective that debt is utilized in managing health and in facilitating economic recovery. It is a classical issue that ministries usually are not able to utilize budget in an effective way, so the local governments. Not to mention the misused of funds like what happened with social assistance (BANSOS).

Very Loose Monetary Policy

In responding to the downturn economy that ends up in recession, BI takes very loose monetary policy. Policy rate is the lowest in history at 3.5%, buying government bond in the primary market, lowering reserve requirement, and set a down payment for mortgage and car loans at zero. As the inflation is low at 1.7%, BI is confidence to continue to inject liquidity into the market. Liquidity at banking sector is still very high with growth at the third party's fund at 7.7%. However, credit growth is still very low at 2.2% in September 2021. Consumption credit grew at 2%, with mortgage grew at 8.7%. Corporate credit is still in contraction. Bank still perceive credit market at high risk with loan at risk higher than 20%.

BI actively buy government bonds at primary and secondary markets. BI bought around Rp 601.7 trillion or 53.8% of total government bonds issued in 2020. Up to October 2021, BI has bought Rp 142.5 trillion government bonds. These make total of government bonds at its balance sheet more than Rp 1000 trillion or around 30% of the assets. BI sees this as an appropriate policy in emergency condition. BI and the Ministry of Finance do not see this as a serious problem related to possibility for impact on inflation and depreciation of currency as the economy is undergoing recovery. There is no significant impact on inflation and value of rupiah currency so far, at least not yet. Even, Vice Minister of Finance stated that "the new economy", which is actually not new at all, that basically printing money to finance budget deficit, is worked in Indonesia, as shown by no impact to inflation and depreciation of currency that many critics are worried.

The burden sharing shows declining of BI independence, as the government imposed its will to BI to finance deficit, even though BI always refuses to acknowledge this. Moreover, with ballooning BI balance sheet, this constraints BI to do effective monetary policy. With the interest rate below the market rate, BI practically cannot use the bonds as tools for monetary operation, although the bonds are categorized as tradeable. The problem is that Ministry of Finance would be reluctant to convert the bonds into market rate that incurs cost to the budget. Therefore, the bonds likely stay at BI books for quite sometimes as non-yielding assets.

Accommodative Banking Supervision

OJK (Financial Service Authority) issued a regulation that is very accommodative for credit restructuring. Credit that is in trouble because of the pandemic can be restructured. The original time limit was March 2021, built it extends to March 2022. Around Rp 900 trillion is restructured, mainly at SOEs banks. Private banks are more stringent in giving restructuring facilities and, as much as possible, follow IFRS criteria. Loan at risk reached level more than 20%. Although gross NPL is relatively low around 3.3%, but this does not reflect the real banks condition. The banks have to increase the provision as the time for restructuring close to end.

As the concern of OJK, mainly for SMEs, that its credit restructuring focus to SMEs with around 50% of credit under restructured. After credit restructuring, SMEs in general can get new facility from banks as shown by credit growth for SMEs is running at 3%.

For corporates, they try hard to get support from the government and get protected from the lenders (banks). They lobby the parliament and the president to get support. Even, APINDO (Association of Employers) calls for moratorium of a PKPU (bankruptcy) proceeding, as they claim the process is biased to lenders. They also call for dent moratorium for the banks to let debtors not pay interest for certain period. For the bankruptcy proceeding, the independency of the court is weak, so many of call for moratorium by banks as the court rejects lenders.

Consumption Led

As limitation of social activities is loosened up, economic activities show recovery, especially in consumption. The zero down payment and zero (borne) luxurious taxes for mortgage and car loans support consumption significantly. Car sales increased by 123.5% (yoy) in August. Mortgage growth reached 8.7% in October.

For lower income group, the support of cash transfer and social assistance become the main support for them to maintain consumption. The unemployment benefits also play a role in keeping consumption for the unemployed that reaches the level of 6.3%. The training and stipend for youth unemployed assist them to get relevants skills while getting income and opportunity for getting good jobs.

Production and sales for FMCG (Fast Moving Consumption Goods) show a significant increase. This is shown by strong PMI 57.2 in October, the highest ever. This in line with credit growth for manufacturing sector that is 2% and continues to raise.

Consumption led recovery experiences slowing down as consumption growth was strong in the second quarter at 5.9% to 1% in the third quarter. The reason is the strengthening social movements limitation in July-August that slowed consumption down. With the opening up of social movements, as Covid-19 is under control, it is expected that consumption led recovery gets the momentum again.

Push for Investment

The government pushes for investment very much, especially FDI. Implementing the omnibus law of employment creation is intended to support investment. As the investment (term) loan is still in contraction, local companies that do investment are still using internal non-bank fundings or getting funding from abroad.

BPKM (Investment Promotion Agency) reported that FDI shows slowing down, as disruption in the global chain and inflation clouded the prospect of the economy. Meanwhile, domestic investment continues to grow, although this is not in line with the term loan that is still in contraction.

The effort to attract PMA is strong. The priority area is battery and electric car, also smelters for mineral processing, as mineral export is banned for the development of downstream processing to get higher value added, many see this as questionable economically. EU filed the appeal to WTO for Indonesia banned Nickel export. The electric car, this has not adequate infrastructure yet to support wide development.

It seems contradictory while the government takes a lot of effort to attract FDI, the existing FDI, especially in oil and gas, are leaving the country as the contracts are not extended. Meanwhile, SOEs that took over the ended contracts, Pertamina for oil and gas, and Inalum for mining are not well equipped with needed capital and technology.

Buoyant Commodity Export

The sharp increase of CPO and coal prices make the trade account positive. CPO price increased by 43% (yoy) in October. It is expected CPO price remains high in the rest to the end of the year. High demand from China, Korea and Europe increases the price of coal. The increase of CPO and coal export prop up trade surplus record in September USD 4.37 billion, the consecutive 17 moths for trade surplus. In addition, government revenue also increases that help ease the burden of the state budget.

However, the increase in price of CPO and Coal has consequences to the prospect of inflation. Just because of energy price is administered, and also food price, inflation can still maintain at the low level. The high price of CPO also gives pressure for producers that use CPO as material for home cares. The program for Biofuel 30 is also discouraging with high palm oil price.

Conclusions

Expansive fiscal and loose monetary policies can contribute significantly in controlling Covid-19 and support economic recovery. Covid-19 is under control through limitation of social movements, vaccination, and improvement in health facilities with higher budget allocation. The policies are also able to maintain financial stability, support companies in trouble because of pandemic, and support for lower income group with cash transfer, social programs, and unemployment benefits to get through the difficult times.

However, the task to bring back fiscal policy to the normal level, especially 3% budget deficit limitation, and increase tax revenue that in line with sustainable economic recovery is a very difficult task. Similarly, to bring back the monetary to normal level, by managing out the burden sharing by utilizing bonds at the book of BI for monetary policy is a delicate and difficult job. For BI, to prepare to deal with likely high inflation and adjust for higher policy rate, like other central banks, are very tricky job at the time the economic recovery is experiencing slow down. To facilitate credit restructuring and support higher credit growth for BI and OJK are challenging job.

About The Habibie Center

The Habibie Center was founded by Bacharuddin Jusuf Habibie and family in 1999 as an independent, non-government, non-profit organisation. The vision of The Habibie Center is to create a structurally democratic society founded on the morality and integrity of cultural and religious values. The mission of The Habibie Center are first, to establish a structurally and culturally democratic society that recognizes, respects, and promotes human rights by undertaking study and advocacy of issues related to democratization and human rights, and second, to increase the effectiveness of the management of human resources and the spread of technology.

The Habibie Center
Jl. Kemang Selatan No. 98, Jakarta - Indonesia 12560
Tel: 62 21 781 7211 | Fax: 62 21 781 7212
thc@habibiecenter.or.id | www.habibiecenter.or.id