Macroeconomics Analysis Series

Indonesia Economic Outlook

Q2-2021

LPEM FEB UI
UNIVERSITAS INDONESIA

Key Figures

GDP Growth (y.o.y, Q4' 20)
-2.19%

Inflation (y.o.y. Apr '21)
1.42%

Credit Growth (y.o.y. Feb '21)
-2.15%

BI 7-Day Repo Rate (Apr '21)
3.50%

Current Account Balance (%GDP) (Q4 '20)
0.40%

IDR/USD (Apr '21)
IDR14,550

To keep you updated with our free monthly and quarterly reports, please subscribe. Scan the QR code below

or go to http://bit.ly/LPEMCommentarySubscription

Macroeconomic & Financial Sector Policy Research

Jahen F. Rezki, Ph.D.
jahen@lpem-feui.org

Syahda Sabrina
syahda.sabrina@lpem-feui.org

Nauli A. Desdiani
nauli.desdiani@lpem-feui.org

Teuku Riefky
teuku.riefky@lpem-feui.org

Amalia Cesarina
amalia.cesarina@lpem-feui.org

Meila Husna
meila.husna@lpem-feui.org

Faradina Alifia Maizar
faradina@lpem-feui.org

Highway to Recession, Stairway to Recovery: A Year of Covid-19

Highlights

- *GDP growth in Q1-2021 is expected to reach around -0.6% (estimate range from -0.8% to -0.4%); around 4.4% to 4.8% for overall 2021.*
- *Indonesia's recovery path consists of three stages: the deep recession, the initial rebound, and the full recovery.*
- *The deep recession (first stage) is attributed with the sharp decline in economic growth. Indonesia was in this stage during Q1 and Q2 2020 with the GDP growth of -5.32% (y.o.y) in Q2 2020, the lowest in decades.*
- *The initial rebound happened in Q3 and Q4 2020. This stage is attributed by a rebound in economic activity after the relaxation of initial social restrictions.*
- *The third stage of recovery is the path towards achieving the pre-pandemic long-term growth level. Indonesia is considered already in this stage (2021 onwards). The main challenge is to shorten the length to achieve the pre-pandemic level.*
- *To recover to the pre-pandemic level, Indonesia will face the challenge of pandemic containment and vaccine rollout in the short-term, risk of taper tantrum and deficit mandate of 2023 in medium-term, and structural reform in the long-term.*

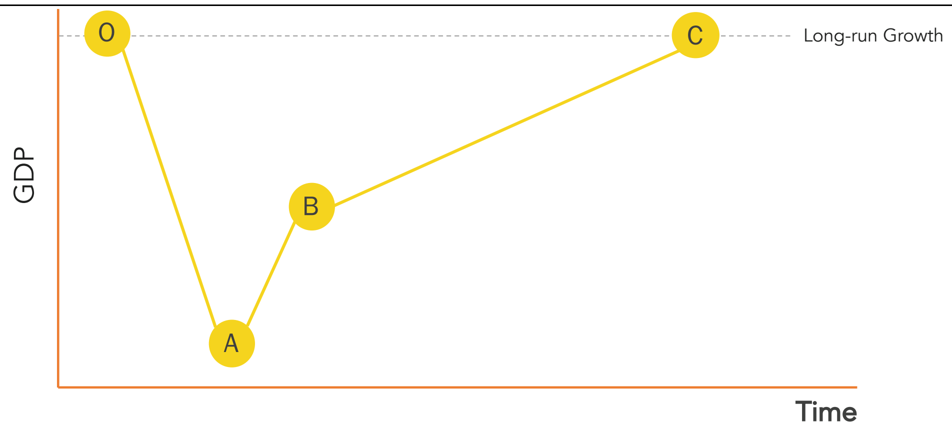
The Covid-19 pandemic is a crisis like never before. In economic sense, the current crisis is not originated from any economic aspects like credit crunch, banking sector collapse, or sovereign debt overhang. Thus, we are facing a crisis that has never been explained in any economic textbooks and it leaves almost everyone's clueless. After more than a year living in a pseudo-dystopic world, we have seen enough calamity to the point extraordinary policy measures and practices to weather the crises is a norm. Excessive sovereign debt accumulation, central banks step-in to fund fiscal policies, and the quickest vaccine development in human history has taken place just to save the population from mounting death counts and help the poorest meet their subsistence.

Without any clear guidance from the scientific theoretical perspective and no prominent example in the history, each policy implemented by the governments across the world are in shortage of the accurate prediction of how people would react. For instance, while it seems obvious to keep people at home until the health risks become manageable, the implementation is anything but easy. People has never been enforced to stay more than a few months at home before and after a while they started to experience a 'virtual insanity' or lockdown fatigue; thus, starting to go out. Also, for people who works in services, such as waitress and ride-hailing drivers, staying at home means not earning any income.

Therefore, it creates further complications for policymakers to manage the Covid-19 crisis for a long time. With limited fiscal space and no previous case studies to handle the current crisis, policymakers are rightly on the "trial-and-error" manner to manage the impact of the pandemic.

The implementation of large-scale social restrictions or *Pembatasan Sosial Berskala Besar* (PSBB) is expected to give a beneficial impact toward people's health condition as the pipeline of virus transmission become limited. However, the implementation of social restriction measures is basically freezing the economy in which the current crisis, in its nature, hits not only the supply side but also the demand side. As the current pandemic is unprecedented, economists and policymakers have put extensive thoughts and research to predict the shape of the recovery. The accurate shape recovery is crucial as it tells policymakers what kind of measures and stimulus needs to be implemented. Economists and researchers have come up with several 'recovery-shape' projections such as U-shape, V-shape, W-shape, L-shape, or even 'Nike'-shaped recovery. Looking at the most recent data of Indonesian economy, we suggest that a more pertinent 'recovery path' to explain the Indonesian economic condition is using the framework of 'ABC' recovery. Proposed by Ricardo Reis (2020), 'ABC' recovery framework is attributed by three stages during the pandemic (Figure 1). While on the micro level the recovery path would likely to be a K-Shaped (as there is an unequal damage of Covid-19 in terms of income groups, sectors, and regional), 'ABC' recovery would be more likely to happen on a macro level.

Figure 1: Recovery Path of Indonesian Economy



Source: Reis (2020)

The first stage of 'ABC' recovery is the period from point O to A in Figure 1 during Q1 and Q2 of 2020. In this period, the focus is on how deep the economic decline. The freezing economy is causing a sharp fall in the GDP, both from demand and supply side. Indonesia experienced this stage during the first half of 2020, in which the first implementation of PSBB halted major businesses activities, particularly those who rely on face-to-face interactions. Unfortunately, the manufacturing and wholesale and retail sector which hold the largest proportion in Indonesia GDP, were severely hit by the Covid-19 crisis. As the result, Indonesia's economy was contracted by 5.32% (y.o.y) in Q2-2020. With economic contraction happening, there is no doubt that unemployment rises to its highest level of

7.07% since 2011. To dampen the halted economic condition, Government of Indonesia (GoI) carries the additional government expenditure required by rising the fiscal budget deficit to 6.20% from 1.76% in 2020 budget. This high cost of the pandemic was then settled by financing scenarios including the debt financing. The GoI has faced the challenge of controlling the reasonable amount of debt while putting efforts to maintain and boost the economy.

The second stage of 'ABC' recovery is the period from point A to B in Figure 1 during Q3 and Q4 of 2020. During this stage, the focus is on how high the initial rebound would be. The second stage is attributed by a rebound in economic activity after the relaxation of initial social restrictions. After the implementation of strict PSBB from April-June last year, Indonesia's economy was slowly recovering in the second half of 2020 due to the gradual re-opening of the domestic and global economic activities as well as massive policy support. Although the growth is still under the pre-pandemic level, the relaxation of PSBB since June has slightly increased the economic growth from the contraction of 5.3% in Q2-2020 to 3.5% and 2.2% in Q3-2020 and Q4-2020, respectively. People are gradually going out to public places as reflected by the higher community mobility at the transit stations, parks, and grocery & retail shops. However, being complacent of the ongoing health risks by going outside, the number of Covid-19 cases were unsurpsingly surging between August and September 2020. As the result, GoI forced several regional government to hit the "emergency break" by reimposing the PSBB II on mid-September 2020. Considered as quite effective in containing the spread, the government was relaxing the social restriction too soon in mid-October 2020, thus, continuing the rise of Covid-19 at the end of 2020. Specifically in the second stage, besides the deterioration on the health aspect, there is a pattern of K-Shaped recovery on a micro level as there is unequal decline of economic activity across income groups, sectors, and regions.

The third stage of 'ABC' recovery is the period from point B to C in Figure 1 during 2021 onwards. The main focus in the third stage is on how long it would take for Indonesian economy to fully recover and reach the pre-pandemic level of long-run growth trend. In the future, the prospect of Indonesian economy will be strongly relied on the accommodative fiscal and monetary policies as well as GoI's measurement to control the pandemic level. The outlook for recovery faces several challenges in short, medium, and long-term. Despite significant improvements in the external situations such as trade balance surpluses, consumption and investment are expected to increase on a limited basis as the escalation of Covid-19 cases persists. In the short-run, the length of recovery would depend on the government's effort in containing the spread of the virus through vaccination. The supply of vaccines is currently limited while the demand far exceeds the capacity of distribution. With the assumption of vaccination rates in Indonesia during the last two months, we estimate that the time needed to reach the target population that received at least one vaccine dose is 33 months and the time needed to reach the fully vaccinated population is 56 months. At the current vaccine rates, Indonesia could face a prolonged period to curb the spread of Covid-19 which may result in a slower-than-expected recovery to its growth trajectory.

While in the medium-term, Indonesia is facing the risks of external pressure from the potential tapering-off by developed countries (especially the US). If the health crisis is not managed well, by the time tapering-off is implemented, Indonesia will face a massive financial volatility due to rapid capital outflows. At the same time, policymakers will be in no position to minimize the damage as tightening monetary policy is not an option amidst the slowdown. Another medium-term challenge faced by GoI is to meet the mandate of bringing down the deficit level below 3% in 2023. Realistically, looking at the current condition of still muted demand and low budget revenue, it would be difficult to achieve such mandate without jeopardizing macroeconomic stability. If the crisis persists and demand has not yet picked up in 2021 or 2022, the only way to achieve that mandate is by significantly reduce spending, which consists of stimulus needed to jumpstart the economy and cushion the most fragile population. On the other hand, the monetary measures took by BI should also be maintained to stabilize the economy in the medium run. Looking at the current progress of economic recovery, we see that the economic growth is estimated to reach around -0.6% (in the range of -0.8% to -0.4%) in Q1-2021, while the growth for FY2021 is expected at around 4.6%.

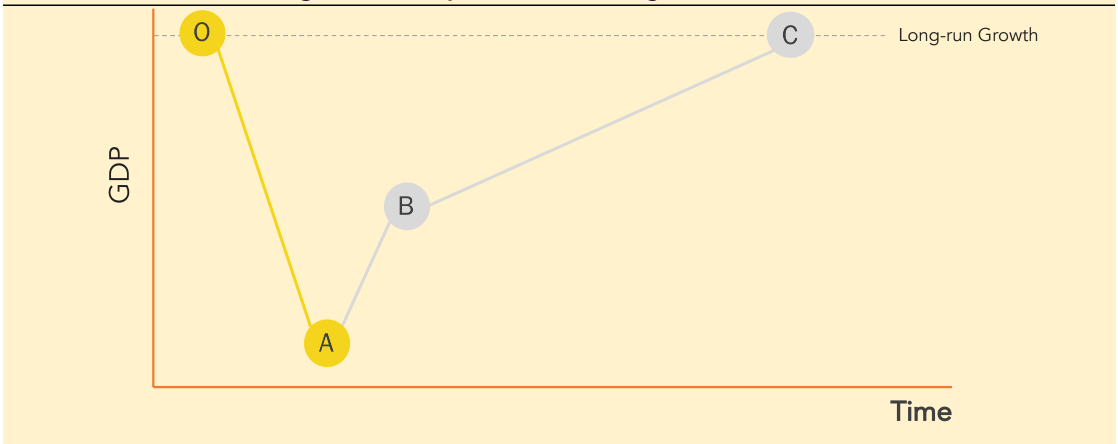
Table 1: LPEM FEB UI GDP Growth Forecast (y.o.y)

Q1-2021	FY 2021
-0.8% to -0.4%	4.4% to 4.8%

To triumph the long-term robust growth during the economic recovery, the fundamental economic reforms is necessary. Thus far, GoI has already taken several initiatives in preparing a better economic situation after the pandemic ends. Fundamental reforms could be achieved by improving the quality of education, health, and effective social security to boost the quality of human resources and continuing to accelerate infrastructure development through digital infrastructure and logistical efficiency and connectivity. GoI has also put efforts to improve the business and investment climate by releasing Omnibus Law on Job Creation and establishing a Sovereign Wealth Fund called Indonesia Investment Authority (INA). These initiatives are expected to increase the business and investment climate, create jobs, and strengthen investment in 2021 that leads to long-term recovery. However, GoI also needs to pay attention to the future fiscal condition which highly requires higher revenue stream. The potential wider tax base from the better digital infrastructure would help GoI to increase its revenue prospect. Moreover, GoI should prepare the long-term sustainable growth by maintaing the economic development while pursuing the environmental agenda.

The Depth of Recession (Q1 and Q2 2020)

Figure 2: Deep Recession Stage – Point O to A



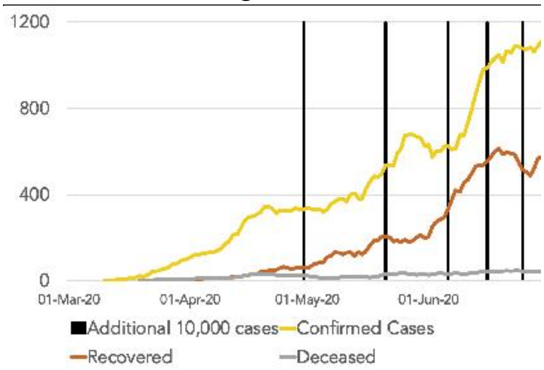
Source: Reis (2020)

"The refusal of lockdown measures led us to believe that the administration was torn between prioritizing public health and limiting damage to the economy."

The Initial Hit of Covid-19

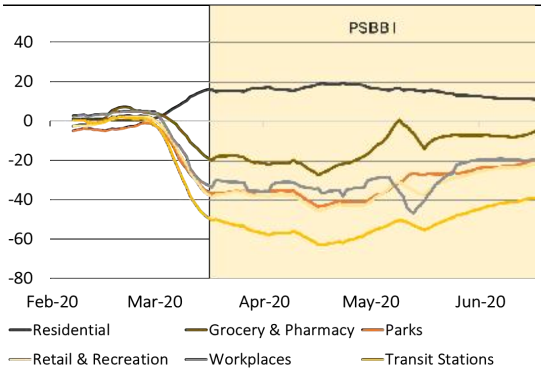
This month marks a little over a year since President Joko Widodo announced Indonesia's first two confirmed Covid-19 cases on March 2nd, 2020. Despite pressure to impose a lockdown, the administration rejected lockdown proposals by a number of regions, including the capital city. Instead, the President signed into law Government Regulation No. 21 of 2020, which regulated the PSBB, allowing regional governments to restrict the movement of people and goods within their controlled zones provided they obtained permission from the Minister of Health. The large-scale social restrictions, including the closure of schools and workplaces, restrictions on religious activities, and restrictions on activities in public places were not much different from what several regional administrations have been imposing before the President announced them.

Figure 3: Confirmed Cases, Recoveries, an Deaths of Covid-19 (7 Day Moving Average), 1H-2020



Source: CEIC

Figure 4: Mobility Index (% Change, 7 Day Moving Average) Feb-Jun 2020



Source: Google Mobility Index

The refusal of lockdown measures led us to believe that the administration was torn between prioritizing public health and limiting damage to the economy. At the end of April 2020, in less than 60 days, the number of confirmed cases hit the milestone of 10,000 with no sign of slowing down. The same increment was reached in only 21, 16, 10 and then nine days until the total number of cases crossed 50,000 in late June 2020.

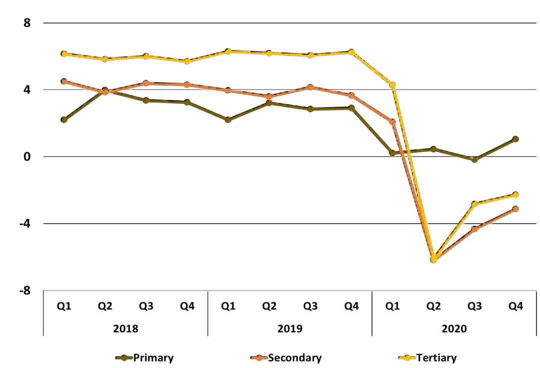
The surge of Covid-19 cases has finally put the GoI in no position to bargain as the transmission of the virus appeared to present a rigorous increase. By the end of April 2020, GoI declared to follow other countries' step of lockdown policy. Put a somewhat different approach than lockdown policy in EU countries such as Italy and Spain; GoI established the policy by implementing PSBB. With PSBB came into effect, people's mobility was limited. Retrieved from Google Mobility Index, the majority of activity types show a significant decrease with the deepest slump recorded by transit station and workplace areas. On the other side, residential activity has begun to increase along with work from home and online classes activity that started to become a new habit amid the pandemic. Grocery and pharmacy group shows a rather slight decrease as mart and other retail was still permitted with a strict health protocol measure.

Muted Engine of Growth

"Given the magnitude of growth decline, both manufacturing and wholesale and retail sectors significantly dragged down the national growth.

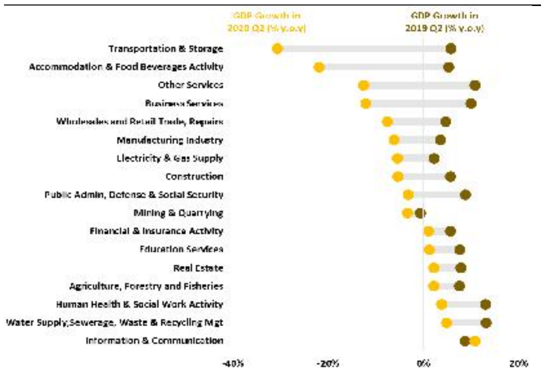
The implementation of PSBB is expected to positively impact people's health conditions as the pipeline of virus transmission becomes limited. However, other impacts that followed the implementation of such policy present a serious challenge, especially to economic conditions. The overall GDP growth in Q2-2020 recorded a negative value of -5.32% (y.o.y) and was declared the lowest growth since the Asian Financial Crisis in 1998. As mobility has become lower than usual, several sectors experienced the *so-called* unprecedented condition, marked by a profound decline, especially in the secondary and tertiary sectors.

Figure 5: GDP Growth by Sector Type (% y.o.y), 2018-2020



Source: CEIC

Figure 6: GDP Growth by Sector, 2019Q2 vs 2020Q2



Source: CEIC

Looking back to Q2-2020, the manufacturing and wholesale and retail sector, which hold the largest proportion in Indonesia GDP by 21% and 13.2%, was severely hit with respective growth of -6.19% (y.o.y) and -7.58% (y.o.y) compared to 2.06% (y.o.y) and 1.54% (y.o.y) in the previous quarter. The temporary halt of economic activity detained both the supply and demand side, resulting in negative economic growth. Given the magnitude of growth decline, both manufacturing and wholesale and retail sectors significantly dragged down the national growth. Assuming Indonesia's natural growth rate is 5.00% (y.o.y), the manufacturing and wholesale and retail sectors were estimated to drag down the Q2 2020 national GDP up to -1.28% and -1.00%, respectively, from the total of -5.32%.

Further, the transportation and storage sector encountered the deepest shrink by -30.76% (y.o.y) in Q2 2020, significantly lower than 1.41% (y.o.y) growth in the preceding quarter. The transportation and storage sector is considered the main loser in the pandemic era due to the implementation of PSBB, which substantially limits people's mobility. Despite the rather small contribution of 3.1% to national GDP, compared to manufacture and wholesale & retail sectors, the negative growth of the transportation and storage sector could tear overall GDP growth up to -1.29% from its natural growth rate of 5.00%. Such a big decline successfully made transportation and storage the main sectors that drag the overall GDP to -5.32% (y.o.y) in Q2-2020. While many sectors suffered and marked a negative growth, the ICT sector enjoyed a positive growth with 10.88% (y.o.y), increasing from 9.80% (y.o.y) in the previous quarter. Higher intensity of internet use during the pandemic to support work from home and online class activity contributed substantially to the growth of the ICT sector. Last but not least, the overall primary sector also maintained an impressive performance that mostly contributed by the agriculture sector with 2.21% (y.o.y) growth in Q2-2020. Since this sector does not necessarily require any social-distancing practice, the implementation of PSBB has become less material compared to other sectors mentioned above.

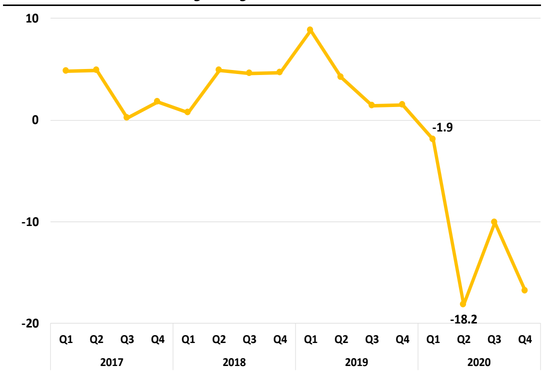
"Household consumption also marked its lowest-growth-in-history with -5.50% (y.o.y) in Q2-2020."

Deterioration of Household Income and Spending

The impact of the pandemic has gradually evolved and spread from one aspect to another. While the way out seems unclear, aside from virus Covid-19, pandemic also brings uncertainty toward all affected aspects ranging from social to economic. After the implementation of PSBB, the impact on lower infected cases was still vague, but the impact on economic growth has vividly appeared and marked by a negative growth. On the demand side, the pandemic has also presented the unfavorable impact reflected by a plunge in consumption, especially household consumption. Drew a similar pattern as economic growth, household consumption also marked its lowest-growth-in-history with -5.50% (y.o.y) in Q2-2020 compared to 2.85% (y.o.y) in the preceding quarter. Specifically to retail sales, data from Bank Indonesia (BI) shows a substantial decline in retail sales index growth starting at -1.9% (y.o.y) in Q1-2020 to -18.2 (y.o.y) in Q2-2020. Some might argue about the impact of the pandemic that makes people feel cautious about the uncertain condition, so they choose to retain their consumption and other spending activity.

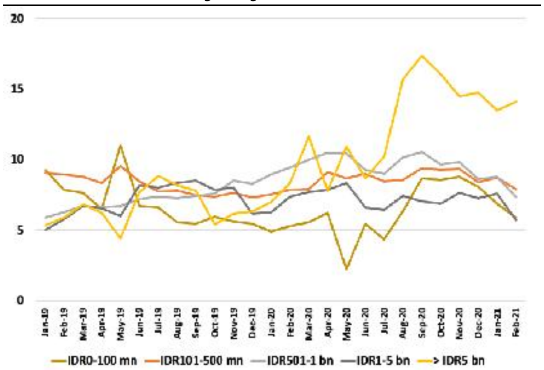
Mirroring to consumption, we look further to the growth of saving and distinguish nominal deposit to several groups from IDR0-100 million to more than IDR5 billion. Each of the nominal groups has its own pattern at the beginning of the pandemic era. However, we may see that the group with the smallest nominal deposit (IDR0-100 million) and biggest nominal deposit (>IDR5 billion) showed a relatively similar pattern. Both groups recorded a notable decline in the early pandemic era although highest nominal group seems to encountered it way sooner. While consumption growth and retail sales also recorded a similar pattern, this might indicate a declining income during the early period pandemic. The prevailing policy of PSBB has put many out of business and layoffs in the number of workers became inevitable. With no certain job, some people, especially the lowest nominal group, must lower their consumption as well as their savings. As for the group with the highest nominal deposit, lower savings growth may lead to two speculative answers. First, the impact of the Covid-19 pandemic has severely hit their business and resulted in lower income that instantly affects their nominal deposit. Second, a shift in safe assets such as gold and government bonds may also trigger the lower growth in nominal deposits.

Figure 7: Growth of Retail Sales Index (% y.o.y), 2017-2020



Source: Bank Indonesia

Figure 8: Growth of Third-Party Funds (% y.o.y) 2019-2020



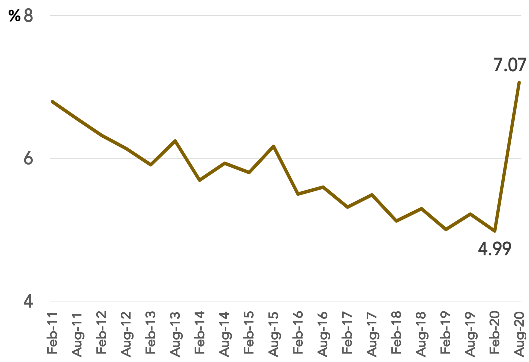
Source: CEIC

"The pandemic also triggered a rise in informal workers and a fall in formal workers."

GoI's Swift Initial Response

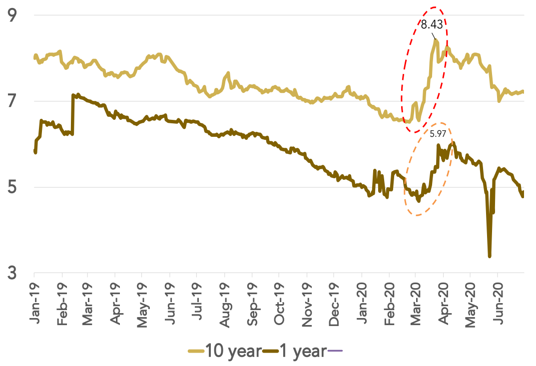
With economic contraction happening, there is no doubt that unemployment rises. The number of unemployed people across the country was at 9.77 million in August 2020, resulting in 7.07% % of the open unemployment rate, the highest level since August 2011. Of all workforces, 29.12 million people, or 14.28%, were affected by the Covid-19 pandemic where 24.03 million people worked shorter hours, 1.7 million people had been furloughed, 2.56 million people had lost their jobs, and 760 thousand people were no longer considered as part of the workforce. The pandemic also triggered a rise in informal workers and a fall in formal workers. There were 77.68 million people or 60.47% of the total workforce who were informal workers in August 2020, up by 4.59 percentage points from the same period last year. On the other hand, formal workers made up 39.53% of total workers in August 2020, or 50.77 million people, down by 4.59 percentage points from August 2019. Looking into the composition of the workforce by sector, there were little to no effects of Covid-19 on it. Three sectors with the highest number of workers in August 2020 were still agriculture, trade, and manufacturing, with 38.22 million, 24.70 million, and 17.48 million workers, respectively, amounting to 62.6% of the total workforce. This figure was slightly higher than in August 2019, with total workers of 82.44 million workers or 61.21% of the total workforce in the three sectors.

Figure 9: Open Unemployment Rate (%)



Source: CEIC

Figure 10: Government Bonds Yield (% pa)



Source: CEIC

Previously launched as one of President Joko Widodo's commitment to providing job seekers with training, Pre-Employment Card has been adjusted to serve as one measure to counteract the effect of the Covid-19 pandemic for both job seekers and laid-off workers. The program aims to increase productivity and competitiveness for productive age populations currently employed, temporarily unemployed, or unemployed specified in Presidential Regulation No. 36 of 2020 on Job Competency Development Through the Pre-Employment Card Program. In 2020, there are 11 batches of the program with around 5.5 million participants.

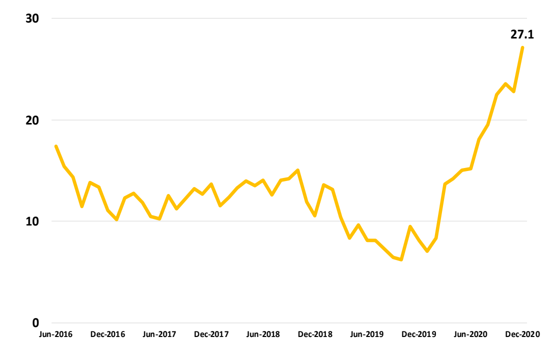
"The first two fiscal packages were launched in late February 2020 and mid-March 2020. As a result, foreign investors reduce their domestic bond holdings, causing yields to increase."

From a monetary policy perspective, responding to low inflation and the pandemic outbreak, BI started to cut its benchmark rate in February 2020 to 4.75%. During the first half of 2020, BI then made two another cut in March, June 2020, resulting in the benchmark rate at 4.25%. In late March 2020, 10-year and 1-year bond yields started to increase, moving in the opposite direction from the BI 7-day repo rate, reaching 8.43% and 5.97%, respectively. An increase in bond yields happened as investors move their portfolios to safer investments amid global uncertainty. Another reason is that foreign bond investors were concerned about an increase in budget deficits as GoI launched the third fiscal stimulus package to mitigate the negative economic impacts of Covid-19. The first two fiscal packages were launched in late February 2020 and mid-March 2020. As a result, foreign investors reduce their domestic bond holdings, causing yields to increase. The bond yields began to stabilize in April 2020 as the government announced large-scale social restrictions.

Looking further at the fiscal perspective, the pandemic costs a large amount of money to overcome the terrible impact and make a proper buffer for the overall economic condition. The prudent decision made by investors in the financial market triggered by the rise in the budget deficit now seems reasonable. A high pandemic cost resulted in a broader budget deficit from 1.76% (FY 2020 State Budget) to 6.20% after the pandemic period (FY 2020 State Budget Revision in Presidential Decree 72/2020). Aside from the immense increase in expenditures, lower government revenue also worsens the budget structure. A high cost caused by pandemic was then settled by several financing scenarios, including debt financing. The scenario showed rapid growth from 7.1% (y.o.y) in January 2020 to 27.1%

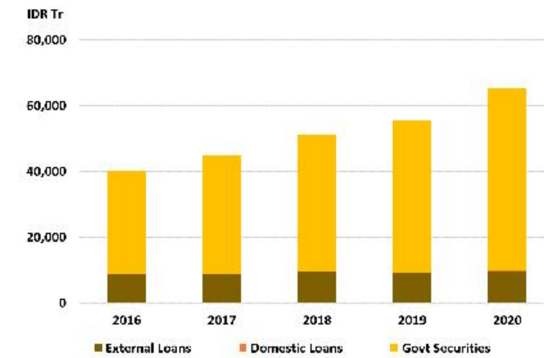
(y.o.y) in December 2020. Finally, looking at the composition of central government debt, government securities hold most of the proportion of 84.7% of the overall debt.

Figure 11: Growth of Central Government Debt (% y.o.y)



Source: CEIC

Figure 12: Composition of Central Government Debt



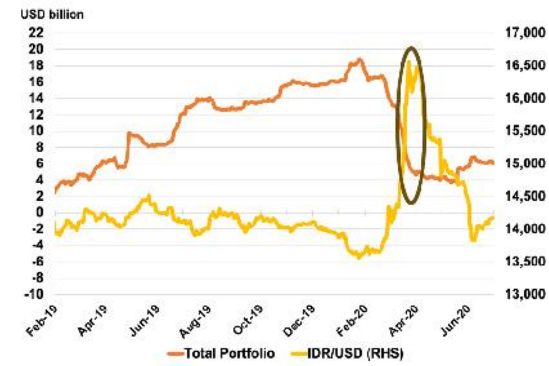
Source: CEIC

Forceful External Pressure

> *"Despite the trade surplus, raw material imports had plunged 2.82%, and imports of capital goods had plummeted by 13.07%. These conditions have impacted the industrial, trade, and investment sectors at the beginning of the pandemic."*

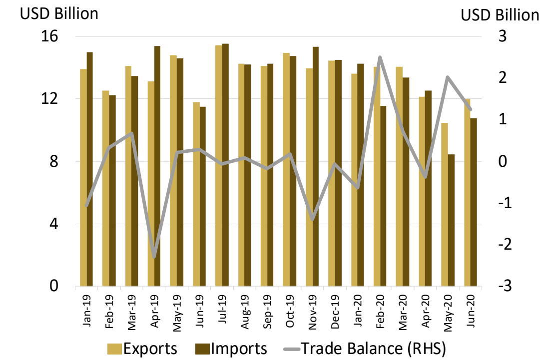
Rupiah underwent rapid depreciation from IDR14,340 per USD at the end of February 2020 to IDR16,300 per USD at the end of March 2020. The depreciation was mostly attributable to capital flows from both bonds and the stock markets. At the end of March 2020, there was a capital outflow of USD14.06 million compared to the end of January 2020. Since early April 2020, Rupiah had gradually strengthened with capital inflow started to progress in early May 2020. This condition was a result of the combination of efforts from BI and the government in managing volatility.

Figure 13: IDR/USD and Accumulated Portfolio Capital Inflow



Source: CEIC

Figure 14: Trade Balance, 1H-2020



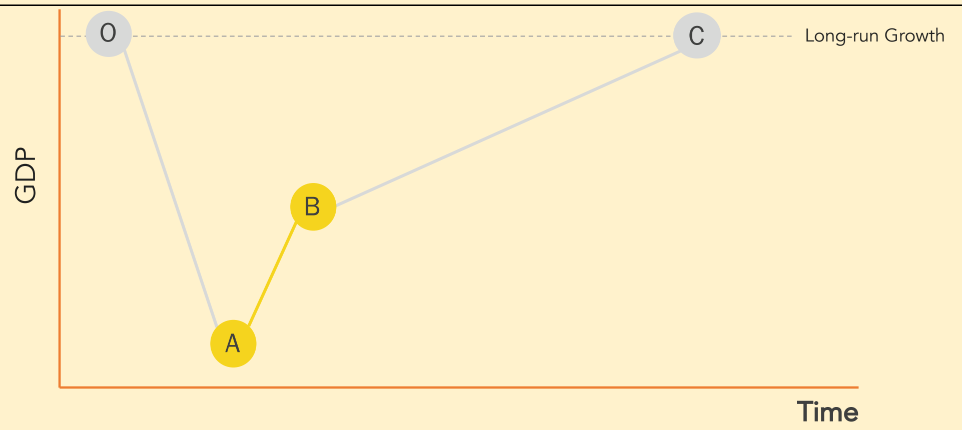
Source: CEIC

Looking at Indonesia's trade balance, it recorded a surplus of USD2.59 billion, with the export of USD41.76 billion and imports of USD39.17 billion during the first three months of 2020. This was better than the same period in the previous year, where a deficit of USD62.8 million was recorded. Despite the trade surplus, raw material imports had plunged 2.82%, and imports of capital goods had plummeted by 13.07%. These *"from April until mid-June of 2020, the number of active and new cases were relatively manageable compared to the bigger picture of the whole 2020."*

conditions have impacted the industrial, trade, and investment sectors at the beginning of the pandemic. During the second quarter of 2020, our trade balance recorded a surplus of USD2.89 billion, thanks to lower imports due to weakening domestic demand.

The Height of Initial Rebound (Q3 and Q4 2020)

Figure 15: Initial Rebound Stage – A to B

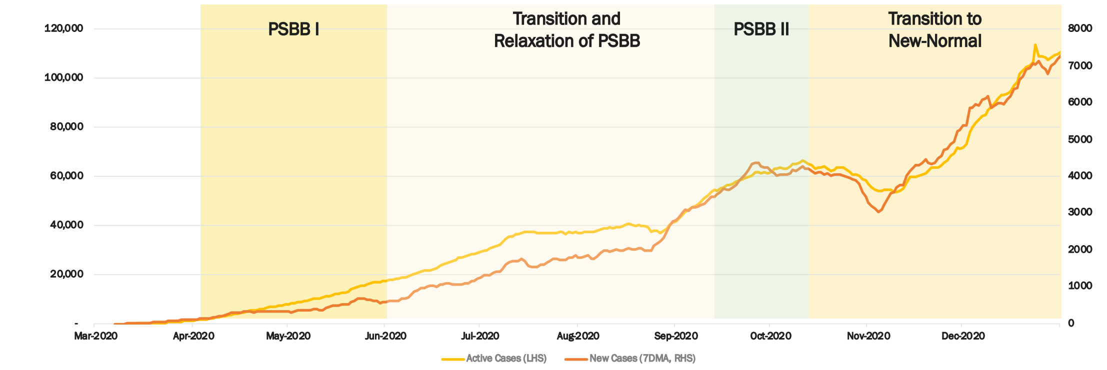


Source: Reis (2020)

Unprecedented Crisis Leave Everyone's Clueless

After the confirmed case of Covid-19 patient zero in Indonesia in early March of 2020, the following circumstances of the domestic condition is an extended episode of trial-and-error. Since then, the rest of 2020 was quite eventful despite still fighting the same crisis. In the early days of the Covid-19 pandemic in Indonesia, national and regional governments quickly responded by implementing the first episode of large-scale social restriction (PSBB I). Despite several flaws during the implementation, PSBB I was considered a period with quite a steady increase in Covid-19 cases. As shown in Figure 16, from April until mid-June of 2020, the number of active and new cases were relatively manageable compared to the bigger picture of the whole 2020. Despite its reluctance to impose total lockdown measures, the paranoia was forceful enough to keep people at home. The series PSBB I took place in April-June 2020 has been remarked by the temporary closing of several public places, including schools, malls, restaurants, entertainment, and recreational sites, to contain the spread of Covid-19. The restrictions hit several economic activities, particularly the economic sectors that require face-to-face interactions. In turn, the economy was contracted by 5.3% (y.o.y) in Q2-2020.

Figure 16: Covid-19 Active and New Cases

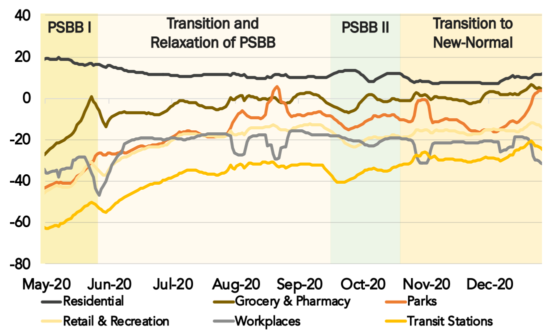


Source: CEIC

However, after two months of stay-at-home, social restriction fatigues emerged, and people who lost their income were starting to run out of saving to meet their subsistence. With the GoI struggled to provide sizable stimulus to keep people at home, the relaxation of PSBB I was implemented in June 2020. Being complacent of the ongoing health risks by going outside, the number of Covid-19 cases was unsurprisingly surging between August and September 2020. The rapid increase of Covid-19 cases in a matter of few days forced several regional governments to hit the "emergency brake" by reimposing the large-scale social restriction (PSBB II) in mid-September 2020. Considered quite effective in containing the spread, the government was repeating the same mistake by relaxing the social restriction too soon in mid-October 2020. The impact on daily cases of the second relaxation did not take long to take its toll. The rise of Covid-19 cases was increasing steeply in the last two months of 2020.

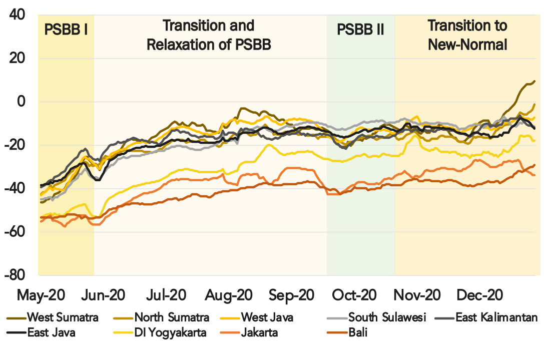
"The rapid increase of Covid-19 cases in a matter of few days forced several regional governments to hit the "emergency brake" by reimposing the large-scale social restriction (PSBB II) in mid-September 2020."

Figure 17: Mobility Index (% Change, 7-Day Moving Average) May-Dec 2020



Source: Google Mobility Index

Figure 18: Mobility Index by Province (% Change, 7-Day Moving Average) May-Dec 2020



Source: Google Mobility Index

People are gradually going out to public places during this transition phase. The period was reflected by the increase in community mobility, with the highest jump is recorded in the mobility at the transit stations and parks category. The time spent at the grocery and retail shops were also higher than during the implementation of the PSBB I. As people's fears of going out have been gradually easing, the first relaxation of PSBB in June is extended by the government until mid-September, right before the government imposed the PSBB II. Although this second restriction only took a month, it has put the brake on the economic activity improvement seen by the relatively unchanged community mobility in Q4-2020 compared to its change in Q3-2020 from Q2-2020. The time spent in workplaces is even lower in Q4-2020 compared to the previous quarters. Even though the government has allowed the essential businesses to fully re-open and non-essential businesses to return at 50% of their capacity during the transition phase, the lower mobility in workplaces indicates the continuation of hindered business activities.

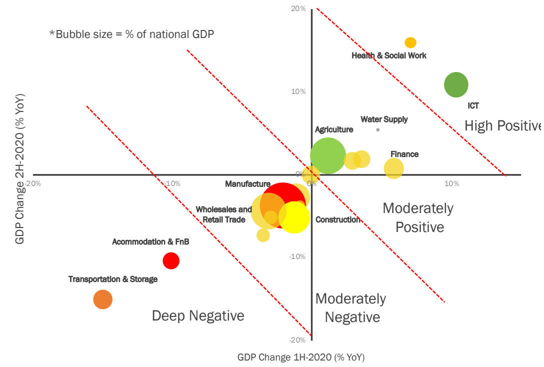
"…in terms of sectors, the impact of the Covid-19 crisis on the economic sectors could be classified into four groups, varied by its dependency on physical economic activity."

Further, the economic activity during the transition phase into the "new normal" is also represented by the community mobility data across provinces. Based on the mobility data from Figure 18, Bali, DKI Jakarta, and DI Yogyakarta are the hardest-hit provinces at the end of Q2-2020 due to massive social and physical restrictions in PSBB I. The lockdown has hit the economic activities in these provinces as the physical contact-intensive sectors mainly contribute to its economy. The average time spent by people in public places and workplaces in these provinces was relatively muted until the end of the year, despite the relaxation and transitional phase. The mobility in these provinces was also still the lowest compared to the other provinces in Q4-2020. While some other provinces' mobility, namely Gorontalo, Southeast Sulawesi, and East Nusa Tenggara, were the highest at the end of Q4-2020. These provinces are less likely to be affected by the GoI's social restrictions measures during the Covid-19 pandemic as the primary contributor to these economies is coming from natural resources sectors.

Potential K-Shaped Recovery on Sectoral and Regional Level

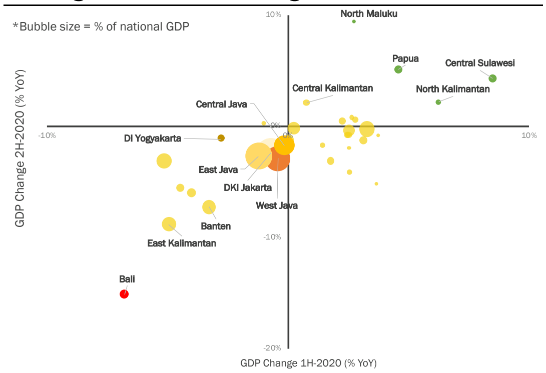
In short, 2020 marked a long struggle between the Covid-19 pandemic with the government and the people. While we have seen several other countries that quite successfully managed the pandemic since the early days (e.g. China, Vietnam, and New Zealand) and could focus on reviving the economy later in 2020, Indonesia was still focusing on managing the health problems till the last day of 2020. The extended episode of grapple with the Covid-19 pandemic throughout 2020 has left the economy with unequal damage as some economic groups/sectors were hit severely, while others were enjoying a minimum growth loss, even enjoying rapid positive growth. As shown in Figure 19, in terms of sectors, the impact of the Covid-19 crisis on the economic sectors could be classified into four groups, varied by its dependency on physical economic activity. Transportation & storage and accommodation & FnB had a profound negative growth for both the first and second half of 2020 as these sectors rely heavily on human interaction. Other major sectors, such as manufacturing, wholesale & retail trade, and construction, also had negative growth on both semesters of 2020, despite on a milder scale. Despite a more moderate negative growth, the impact of these sector shrinks was quite substantial in the overall GDP figure due to its sizable contribution. On the other hand, agriculture and finance recorded moderate positive growth in 2020 as these sectors' activity did not affected by social restriction measures. Furthermore, the health & social work sectors' growth were boosted during the pandemic as its activity increased significantly and recorded high positive growth in 2020. Similarly, the social restriction measure has forced the worker to work from home and students to engage in the online class, accelerating ICT growth, which recorded a growth of 10.59% (y.o.y) throughout 2020, enjoying the highest growth rate since 2012.

Figure 19: 2020 Sectoral GDP Growth



Source: CEIC

Figure 20: 2020 Regional GDP Growth



Source: CEIC

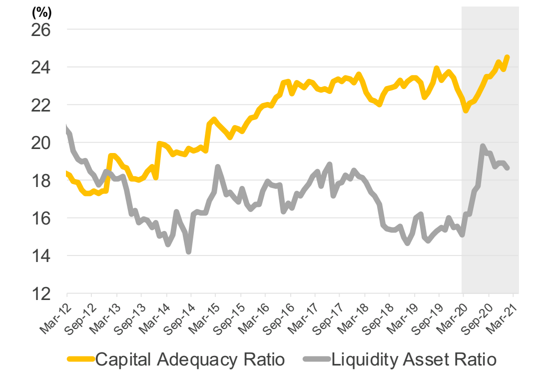
"The economic growth of each economic sector in 2020 has painted a picture of how the pandemic brought unequal damage to the economy. Similarly, the same story could be seen on the spatial aspect."

The economic growth of each economic sector in 2020 has painted a picture of how the pandemic brought unequal damage to the economy. Similarly, the same story could be seen on the spatial aspect (Figure 20). Observing the regional growth, all major provinces in Java recorded negative growth in both semesters of 2020 as these regions have a dense population level. The impact on the national GDP is quite enormous as Java is accounted for almost 60% of Indonesia's economic activity. Bali is considered the most significant loser during 2020, with the most profound negative growth among other provinces in Indonesia. Bali is the province with a high dependency on tourism-related sectors, such as accommodation and FnB; thus, it recorded a decrease in GDP of 6.80% (y.o.y) in 1H 2020 and -15.90 (y.o.y) in 2H 2020.

The Bottleneck of the Banking Sector

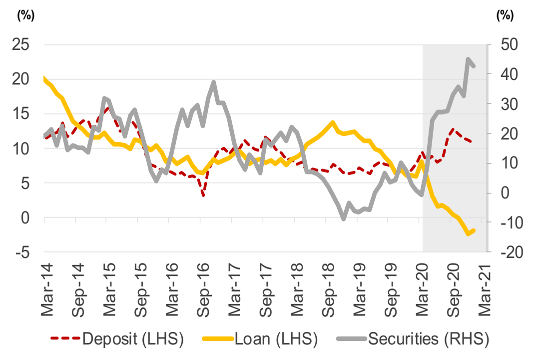
In times of recession, the escalation of panic by the population, which led to a massive bank-run, is a common phenomenon throughout history. However, the Covid-19 pandemic hits the banking sector quite differently. Contrary to what has been predicted in the early days of Covid-19 economic crisis emergence, the banking sector experienced a surge in liquidity. Driven by the high population's risk-aversion, middle-upper income groups of the population accumulated their savings since March 2020, increasing the banks' Capital Adequacy Ratio (CAR) (Figure 21). However, with muted real sectors, the massive liquidity put the banks' profitability under enormous pressure. Due to their business model, banks need to create a productive credit/loan to increase their business performance. However, a massive demand shortage in the real sector has decreased the credit channeled by the banking sector significantly (Figure 22), reflected by the loan growth of 8.05% (y.o.y) in March 2020 to a -2.39% (y.o.y) in December 2020, marking its slowest growth in decades. Furthermore, to manage the liquidity bottleneck, banks were increasing their purchase of securities to manage the pressure on their profitability. In March 2020, the growth of securities as uses of banking funds recorded at -0.64% (y.o.y) and grew rapidly until its highest level in December 2020 of 44.85% (y.o.y).

Figure 21: Capital Adequacy Ratio & Liqui Asset Ratio (%)



Source: CEIC

Figure 22: Banks' Distribution of Funds

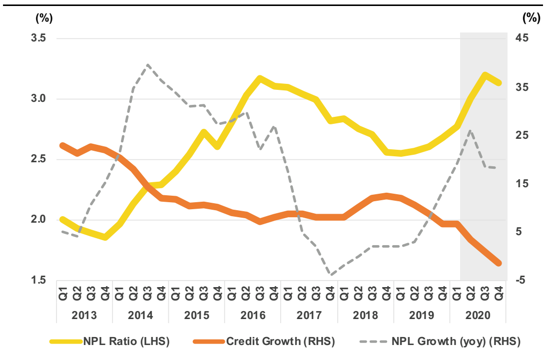


Source: CEIC

"Besides the difficulty of loan creation during the pandemic, the banking sector also experienced another source of pressure from the previous loan channeled. As the real sector was at a massive halt, the ratio of NPL was surging after the first quarter of 2020."

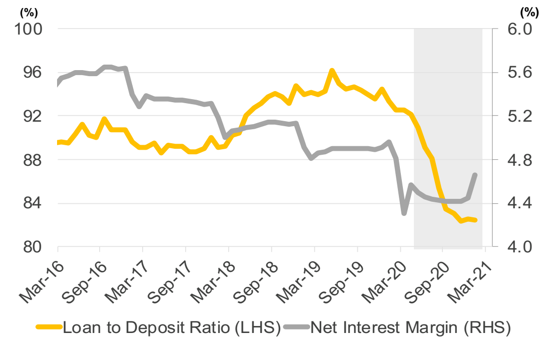
Besides the difficulty of loan creation during the pandemic, the banking sector also experienced another source of pressure from the previous loan channeled. As the real sector was at a massive halt, the ratio of NPL was surging after the first quarter of 2020 (Figure 23). The condition of double-hit from lack of credit demand and the non-performing existing loan has battered the profitability of the domestic banking sector. As shown by Figure 24, Net Interest Margin (NIM) as a proxy of banks' profitability showed a decreasing pattern from April until November 2020, contrary to the previous years in which NIM usually increased or was stable throughout the year.

Figure 23: Credit Growth and NPL



Source: CEIC

Figure 24: Loan-to-Deposit Ratio and Net Interest Margin

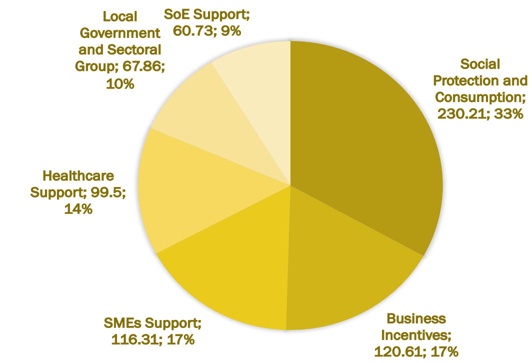


Source: CEIC

Fiscal and Monetary Extended Response

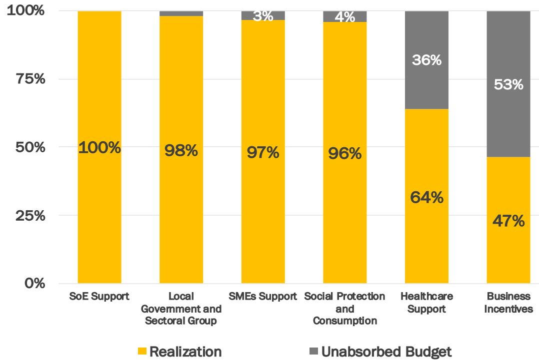
Indonesia's economy is slowly recovering during the second half of 2020. The gradual re-opening of domestic and global economic activities and massive policy support are helping Indonesia slightly bounce from the worst economic contraction of 5.3% in Q2-2020 to 3.5% and 2.2% in Q3-2020 and Q4-2020, respectively. The improvement was mainly driven by the increase in its GDP component, including higher consumption and government spending. The improvement in domestic consumption was in line with the government spending as they imposed a government stimulus program to boost the economy last year. The most remarkable move from the government in dealing with the Covid-19 pandemic is accepting the wider state budget deficit to 6.34% from the previous 1.76% (2020 State Budget). The government is mandated to adjust the budget deficit as they have been facing lower state revenue due to the muted economic activity and higher state expenditure allocated for curbing the health crisis and boosting the economy.

Figure 25: PEN Program Allocation in 2020



Source: CEIC

Figure 26: PEN Program Realization in 2020



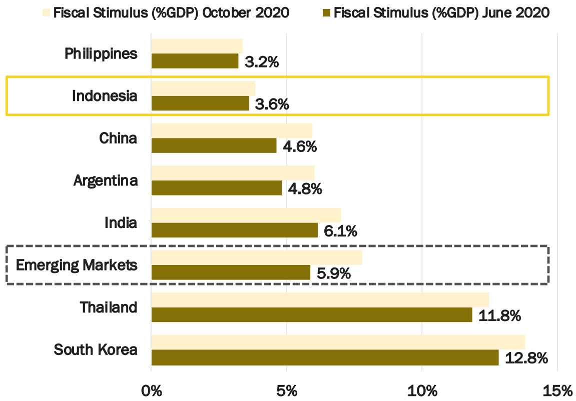
Source: CEIC

"GoI's efforts to increase their spending throughout 2020 is most likely became the source of economic cushion in the second half of 2020 as it increases the domestic purchasing power, thus stimulate business activity."

GoI's efforts to increase their spending throughout 2020 is most likely became the source of economic cushion in the second half of 2020 as it increases the domestic purchasing power, thus stimulate business activity. From the unadjusted budget realization, the budget of state government expenditure has been absorbed by 95% at the end of the year, where the unabsorbed budget was recorded in the central government expenditures. It might be explained by the realization of National Economic Recovery (Pemulihan Ekonomi Nasional/PEN) program funds which are recorded below its target in the budget. From the total IDR695.2 trillion funds for the PEN program, the government had reached only 83.4% of budget absorption, with the highest realization achieved by the funds allocated for State-owned Enterprise (SoE) support and local government and sectoral group. In comparison, the budget realization of the funds allocated for business incentives is the lowest.

Although it has not been fully maximized, the PEN program fund was already allocated evenly by the GoI to curb the negative impact of the pandemic through the supply and demand sides. The allocation of social protection funds has maintained the lowest income group and boost the domestic demand. In contrast, the allocation for business incentives and Small and Medium Enterprises (SMEs) supports is dedicated to lowering the costs faced by the businesses. In the short-run, government spending in social protection, which is the direct cash transfer (Bantuan Langsung Tunai – BLT) for the people affected by Covid-19, has the highest aids for the poor and vulnerable population. In the theoretical framework, the additional money transferred to this group will be spent immediately as they need to buy daily groceries for the household. In addition, the Indonesia Fiscal Policy Agency also reported that the social protection program has also reached the affected middle class population through wage assistance, pre-employment cards, and internet quota subsidies. The higher capability of these groups to maintain their consumption after the allocation of social protection funds has contributed to the partial recovery in Indonesia's domestic consumption throughout 2H-2020.

Figure 27: Fiscal Stimulus (% GDP) Emerging Countries



Source: IMF Policy Responses to Covid-19 Database

"The government has allocated the most efficient fiscal stimulus, which is already reached 3.8% of GDP in 2020. The amount is relatively manageable compared to the average emerging countries."

Even though the demand is partly recovered, business activities are still muted. It might be explained by the relatively unchanged consumption of the middle and affluent groups, which tend to hold back consumption due to the limited mobility amidst the persistent increase in the number of Covid-19. The muted consumption of the middle and rich population contributed to the slow economic recovery last year. Even if there are business incentives in import tax exemption, as long as the demand remains low, the incentive for businesses to continue the production would be diminished. This circumstance could explain why fiscal stimulus absorption in the form of business incentives was far below the budget allocation, which is only 47% of the total IDR120.61 trillion funds allocated. It might also explain the relatively muted manufacturing industry growth in 2H-2020 compared to its figure in 1H-2020. However, the allocation of fiscal stimulus has contributed to the economic recovery from its lowest contraction in Q2-2020, although the figure has not returned to the pre-pandemic level. Thus far, the government has allocated the efficient fiscal stimulus which is already reached 3.8% of GDP in 2020. The amount is relatively low and manageable compared to the average emerging countries. Nevertheless, the amount of fiscal stimulus in all countries was higher in October 2020 than in June 2020 as the government seeks to speed up the recovery.

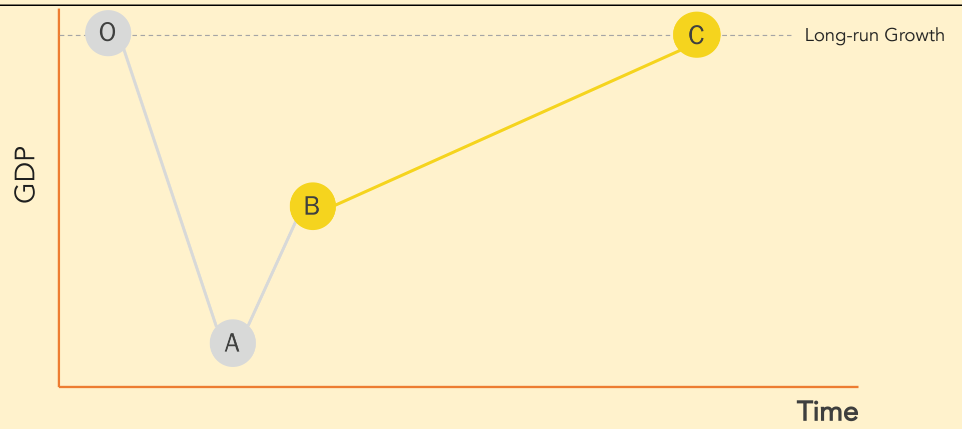
While the government has put extra efforts to spend more money in recovering the economy, the central bank's responses to the unprecedented event of health crisis throughout 2020 has also been convincing. Thus far, the central bank has helped the government maintain financial stability and finance the fiscal deficit. To boost the economy while maintaining financial stability, BI has put much effort during the Covid-19, which includes the 125bps BI policy rate cuts, IDR682 trillion of quantitative easing, and relaxation of lending macroprudential rules to ease liquidity conditions and support bond market stability. The efforts in maintaining liquidity conditions include lowering reserve requirement ratios for banks; increasing maximum duration for repo and reverse repo operations (up to 12 months); adding daily repo auctions; increasing the frequency of foreign currency swap (FX swap) auctions; increasing the size of the main weekly refinancing operations as needed.

Further, BI has also adjusted its macroprudential requirement to support the economic recovery while maintaining liquidity. Some efforts which BI has done are the easing of minimum down payment requirements on automotive loans and the loan-to-value ratio for residential real estate. As mandated by the government through Presidential Decree, BI has broader authority during the pandemic as they now could maintain the financial system stability with the liquidity assistance to banks, financing program to Deposit Insurance Agency or *Lembaga Penjamin Simpanan* (LPS) for bank solvency problems, and direct government bonds purchase in the primary market. In addition, BI has supported the government to finance economic response to the pandemic with the burden sharing scheme. So far last year, BI announced that they had allocated IDR682 trillion of quantitative easing, with more than half of which was in the form of direct government bond purchases. It indicates that the BI local-currency government bond purchase program has amounted to at least 2.2% of GDP (or around IDR341 trillion). The measurement is one of the most significant stimulus packages allocated across emerging markets whose averaged monetary responses is amounted to 1.7% of GDP. All in all, the monetary stimulus imposed by the central bank last year has not only stabilized the capital flows and the Rupiah, which has recovered from its significant depreciation at the first outbreak of the Covid-19 case in Indonesia, but also maintained the stability in the financial system and supported the government in financing the budget deficit.

"BI has supported the government to finance economic response to the pandemic with the burden sharing scheme. So far last year, BI announced that they had allocated IDR682 trillion of quantitative easing, with more than half of which was in the form of direct government bond purchases."

The Length of Recovery to Pre-Pandemic Level (2021 Onwards)

Figure 28: Full Recovery Stage – B to C



Source: Reis (2020)

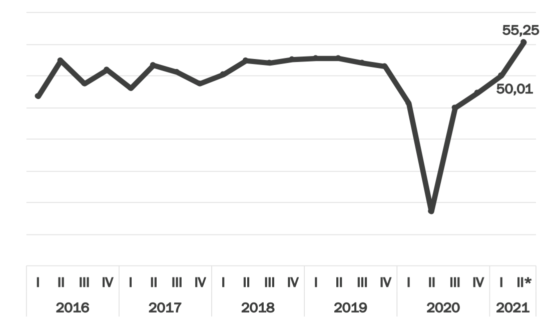
Emerging Signs of Recovery

A year after the pandemic and amidst the ongoing rise in Covid-19 cases, Indonesia has been showing signs of economic recovery with a gradual resumption of economic dynamism. Several major indicators of national economic recovery can be seen from manufacturing performance, consumer's confidence, investment, and trade performance which are starting to show a positive trend based on the latest report. After contracting by 2.07% in 2020, we expect GDP to begin to recover, growing by around 4.4 to 4.8% this year. However, the baseline of economic growth forecast is still highly uncertain since the risk of the pandemic remains, ongoing partial mobility restrictions in several major cities, and consumer hesitancy that may inhibit activity and prevent a more fulsome recovery. In addition, the speed of vaccine rollout also poses challenges to how quickly the economy will return to the pre-pandemic levels.

The first sign of domestic recovery comes from the manufacturing sector, which improves and continues on an expansionary path. A higher Prompt Manufacturing Index reflected more robust manufacturing industry performance in Q1 2021, which recorded at 50.01% increased from 47.29% in the previous quarter, indicating that manufacturing activity has started to pick up after being hit by the Covid-19 pandemic last year. By subsector, there is an improving performance in manufacturing activity during Q1 2021 led by food, beverages and tobacco industry; fertilizers, chemicals and rubber products industry; as well as textiles, leather products and footwear industry, which remained in an expansionary phase with an index above 50% respectively. Moreover, manufacturing performance is expected to gradually improve in Q2 2021 with a Prompt Manufacturing Index projection of 55.25%, driven by a seasonal spike in demand during the holy fasting month of Ramadan and Eid-ul-Fitr festive.

"…there is an improving performance in manufacturing activity during Q1 2021 led by food, beverages and tobacco industry; fertilizers, chemicals and rubber products industry …"

Figure 29: Prompt Manufacturing Index, 2016Q1-2021Q2



Source: Bank Indonesia

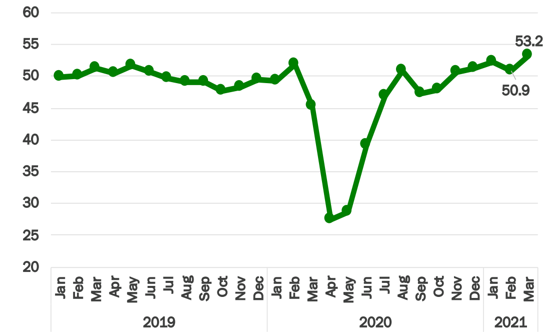
Figure 30: Prompt Manufacturing Index by Sectors, 2021Q1-2021Q2

Subsector	2021	
	1Q	2Q*
Food, beverages and tobacco	53,55	57,75
Textile, leather products ang footwear	51,43	52,21
Wood products & other wood products	42,47	52,82
Paper and printing	47,50	58,75
Fertilizers, chemicals and rubber products	51,83	56,13
Cement and non metallic mineral products	40,90	54,31
Iron and basic steel	49,19	52,06
Transport equipment, machinery & apparatus	49,03	52,99

Source: Bank Indonesia

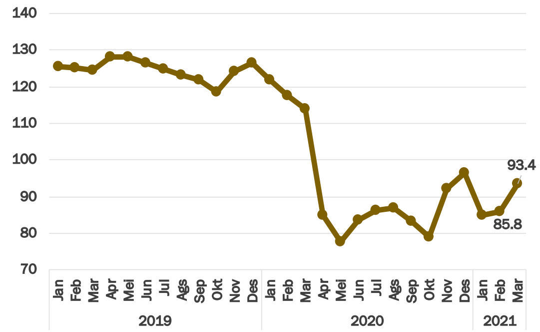
Another sign of improvement in manufacturing activity is a continuing positive trend of Indonesia's Purchasing Managers' Index (PMI) recorded at 53.2 in March 2021, rose from 50.9 level in February 2021. The March PMI figure shows an expansion for five consecutive months and becomes the highest since April 2011, supported by vaccine rollout, people's mobility, and an increase in demand for commodities, resulting in higher commodity prices. While consumer's confidence also continued its upward trend since January 2021, showed by an increase in the Consumer Confidence Index (CCI) to a level of 93.4 from 85.8 and 84.9 in February and January 2021, respectively. Higher consumer confidence was buoyed by the expeditious and orderly national vaccination program rollout, which increased public confidence in the current economic conditions and future economic and health recovery expectations.

Figure 31: Purchasing Manager's Index, 2019-2021



Source: IHS Markit

Figure 32: Consumer's Confidence Index, 2019-2021



Source: Bank Indonesia

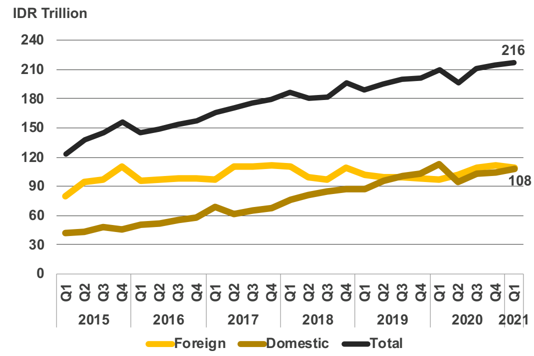
"The impact of Omnibus Law on Job Creation could start to take place in 2H-2021 after various regulatory adjustments."

Looking deeper at investment conditions, the Indonesian Investment Coordinating Board (BKPM) recorded a 3.3% increase in total investment realization in Q1-2021. This improvement was mainly contributed by an increasing foreign investment at 12.01% (y.o.y), while the realization of domestic investment dropped by -4.18%. The sectors that experienced an increase in foreign investment including the food industry, chemical & pharmaceutical industry, basic metal, machinery, and textile industry. Several strategies pursued by the government are already on the right track. The ease of investing in Indonesia has been legitimized by the presence of Omnibus Law on Job Creation which is expected to have a positive impact on medium-term economic growth. Moreover, the establishment of the Indonesia Investment Authority (INA) will help the government to provide funding support for infrastructure development in the next few years.

The impact of Omnibus Law on Job Creation could start to take place in 2H-2021 after various regulatory adjustments. Notwithstanding, the GoI also needs to improve several aspects to boost investment, particularly the high ICOR and logistics costs. High ICOR indicates that Indonesia's investment is inefficient compared to neighboring countries such as Malaysia, Vietnam, and Thailand. To reduce logistics costs, the government should focus on infrastructure outside Java. On the other hand, to maintain a trade balance surplus and support job creation, GoI should encourage investment focused on export-oriented and higher value-added manufacturing industry.

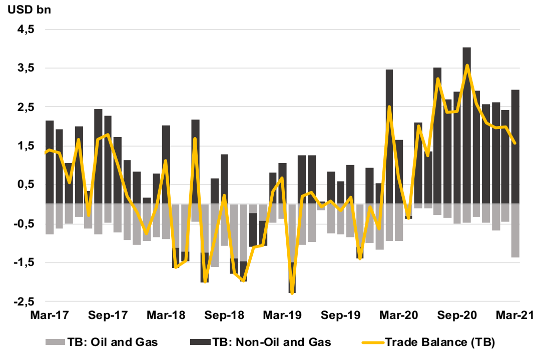
Observing the foreign trade profile in Q1-2021, Indonesia continues a series of trade balance surpluses since last year with a total surplus of USD1.57 billion in March and a surplus of USD5.52 billion in Q1-2021 supported by increases in both exports and imports. Exports rose by 20% from February to USD18.4 billion in March, or 30% higher than the same month last year. Similarly, imports also grew by more than expected last month, reached USD16.8 billion in March, increased by 27% compared to February, or 26% from March 2020, as domestic manufacturing activity improved. A relatively higher surge of Indonesia's exports in March is due to higher commodity prices such as CPO and coal and rebounding global demand, besides a depreciation of Rupiah, contributing to a more competitive Indonesia's commodity prices. Overall, a narrow trade balance surplus in March compared to the surplus in January (USD1.96 billion) and February (USD1.99 billion) indicates a promising sign of real sector recovery as imports start picking up.

Figure 33: FDI and Domestic Investment (Nominal)



Source: CEIC

Figure 34: Monthly Trade Balance (Nominal) (Mar'17-Mar'21)

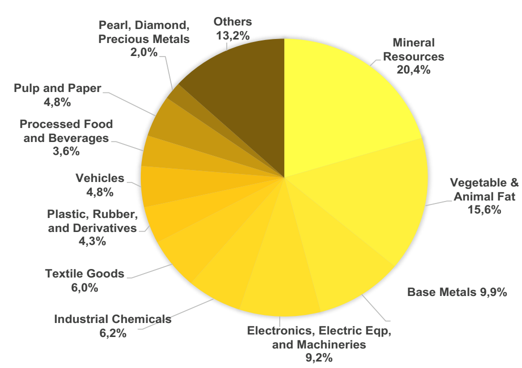


Source: CEIC

"Since imports mainly consist of raw and capital goods, the higher number of imports suggesting businesses ramping up production to fulfill rising domestic demand."

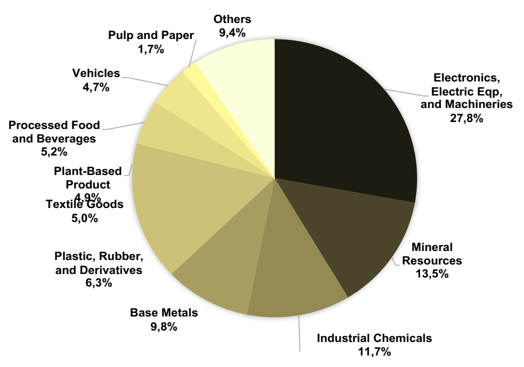
Since imports mainly consist of raw and capital goods, the higher number of imports suggesting businesses ramping up production to fulfill rising domestic demand. Meanwhile, the composition of Indonesia's exports and imports are relatively unchanged, with exports are still dominated by mineral resources, vegetable & animal fat, and base metals, while the electronics and machinery products stand as the highest contributor to imports.

Figure 35: Indonesia Export Profile (Dec'2020 - Jan'2021)



Source: CEIC

Figure 36: Indonesia Import Profile (Dec'2020 - Jan'2021)



Source: CEIC

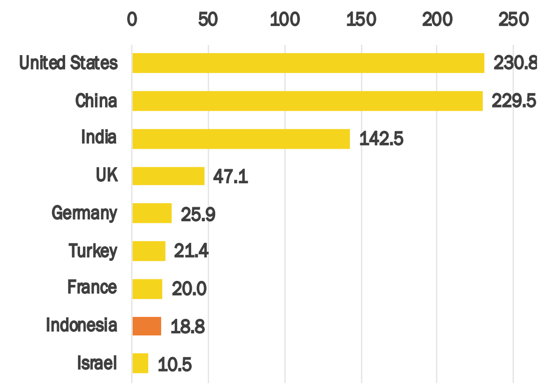
Overall, we sum up several risks ahead regarding trade performance. First, if commodity prices fall at any time, Indonesia's trade balance surplus could turn into a deficit, as it did before the pandemic. Second, even we currently enjoying an increase in both exports and imports, the rise may not be sustainable as rising Covid-19 cases in India and abroad which leads to uncertainty. There might be a potential decline in demand for CPO from India if there is a lockdown in the long term as India is our largest palm oil consumer. On the other hand, there will also be disruptions from the import side since businesses in India will be unable to operate at full capacity. Therefore, apart from seizing opportunities from the economic recovery in a number of other export destination countries, it is essential to boost exports of high-value-added goods. Furthermore, Indonesia must also optimize the trade agreements that have been implemented, particularly in facilitating the transfer of technology and investment between countries.

Short-Term Focus: Vaccine and Sector-Specific Policies

"The prospect of Indonesia's economy ahead will heavily depend on accommodative fiscal and monetary policies and how the government controls the pandemic level through the vaccination program."

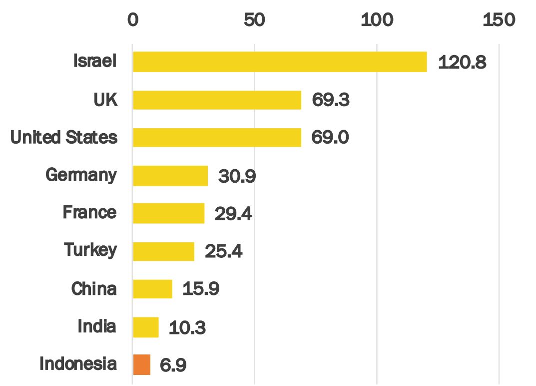
The prospect of Indonesia's economy ahead will heavily depend on accommodative fiscal and monetary policies and how the government controls the pandemic level through the vaccination program. The outlook for recovery faces several challenges; here, we divide those downside risks into three periods; short, medium, and long-term challenges. In the short run, despite significant improvements in the external situations such as trade balance surpluses, consumption and investment are predicted to improve on a limited basis, in line with the escalation of the Covid-19 pandemic that might hold back confidence level. A smaller share of the net trade balance to GDP than consumption and investment may restrain the economy from fully rebound as development in private consumption and investment realization have not shown any signs of improvement during Q1-2021. Several types of consumption that remain in negative growth territory are transportation and restaurants & hotels, spent mainly by the upper-middle class income group. We do not see any improvements in consumption in Q2-2021 since there is a mobility restrictions policy, particularly the prohibition of homecoming during Ied-ul-Fitr celebration. Despite calls for holiday allowances (THR) disbursement for workers, there might be a possibility that people will choose to save their money instead of spending it. In addition, lower THR for ASN, especially there is no THR for echelon I and II for the State Civil Service (ASN) might lower consumption and hinder the economic recovery. This year's THR is only in the form of basic salary plus additional allowances, such as family allowances but it does not include a performance allowance.

Figure 37: Total Number of Vaccination Doses Administered (Million doses, As of 26 April 2021)



Source: Our World in Data

Figure 38: Total number of vaccination doses administered per 100 people in the total population (As of 26 April 2021)



Source: Our World in Data

Another risk in the short run is the availability of supply and distribution of vaccines and the spread of new virus mutations that could hinder and disrupt the economic recovery. Particularly, tough global competition for vaccines, rising infections in vaccine-producing countries, and logistic challenges will hamper the government's vaccination plans and stall the economy's reopening. Indonesia is one of the top 10 countries with the highest number of vaccines implemented. However, the main problem is the limited supply of vaccines that have arrived in the country while demand far exceeds the capacity of distribution. When comparing the total number of vaccination doses per person, Indonesia lags behind other countries by an average of 6,9 out of 100 people who have been vaccinated.

"…tough global competition for vaccines, rising infections in vaccine-producing countries, and logistic challenges will hamper the government's vaccination plans and stall the economy's reopening."

Figure 39: Estimated Time Needed to Reach the Vaccination Target

Target			
181.500.000 (67%)			
Total Population			
271.349.889 (Based on Sensus 2020)			
Share of the total population that received **at least one vaccine dose** (As of 27 April 2021)		Share of the total population that **have received all doses prescribed by the vaccination protocol** (As of 27 April 2021)	
4,39%		2,64%	
11.912.260	Total number of people that received **at least one vaccine dose**	7.163.637	Total number of people **that are fully vaccinated**
5.155.648	Average number of people that received **at least one vaccine dose per month**	3.093.389	Average number of people **that are fully vaccinated per month**
Estimation of the total population that **haven't received vaccine at all**		Estimation of the total population that **haven't received two doses vaccine**	
169.587.740		174.336.363	
Estimated time needed to reach the target population **that received at least one vaccine dose**		Estimated time needed to reach the target population **to be fully vaccinated**	
33 months or 2.7 years		**56 months or 4.7 years**	

Source: Our World in Data, processed. Calculation is based on assumption of vaccination rates in the last two months. Data as of 27 April 2021

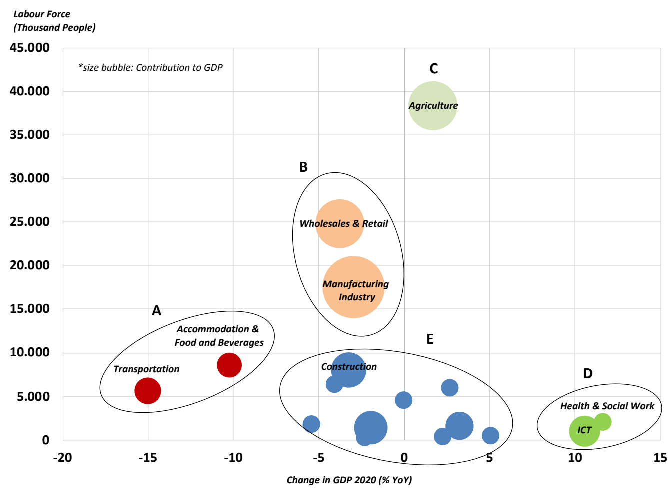
The government's vaccination program entails 181.5 million people (67% of the population) being vaccinated for free in two phases. The first phase will cover 1.3 million health workers, 17.4 million public service officers, and 21.5 million people over age 60. The second phase will cover 63.9 million socially and economically vulnerable people at high transmission risk and 77.4 million community leaders and people who contribute to local businesses. As of 27 April 2021, around 11.9 million people had been vaccinated at least one dose, equivalent to 4 people per 100 population, while around 7.1 million people had been fully vaccinated. With the assumption of vaccination rates in the last two months, the estimated time needed to reach the target population that received at least one vaccine dose is 33 months or 2.7 years. With a similar assumption, the estimated time need to reach the target population to be fully vaccinated is 56 months or 4.1 years. At the current vaccine rates, Indonesia could face a prolonged period to curb the spread of Covid-19, resulting in a slower-than-expected recovery to its growth trajectory. Therefore, besides implementing strict health protocols, the government needs to accelerate the speed of vaccine delivery to boost public optimism and revive economic activity.

Furthermore, we map the sectoral performance during 2020 based on its growth and number of employees to observe which sectors are the most affected by the pandemic and require specific policies to bring them back to their positive growth. From Figure 41, group A consists of the most affected sectors with the deepest economic contraction (transportation & accommodation and food & beverages sectors). To accelerate growth of these sectors, the government needs to provide fiscal stimulus in the tourism sector to

"To accelerate growth of these sectors, the government needs to provide fiscal stimulus in the tourism sector to boost demand, prioritize vaccine for workers in this sectoral group, and provide state capital injection in SOEs engaged in both sectors, particularly in the transportation sector."

boost demand, prioritize vaccine for workers in this sectoral group, and provide state capital injection in SOEs engaged in both sectors, particularly in the transportation sector. Nevertheless, improvement in consumption tends to be limited in the short run, in line with the prohibition of homecoming and mobility restrictions.

Figure 40: Sectoral Performance in 2020



Source: CEIC

In addition, group B consists of manufacture and wholesale & retail sectors which becomes the largest contributor to GDP and have a relatively higher labour force than others. During 2020, these sectors were also severely hit the hardest by the pandemic with overall growth in FY2020 for manufacturing sector of -2.93% (yoy) and -3.75% (yoy) for wholesales & retail. Several policies could be taken by the government to boost the growth of these sectors: prioritize vaccine for workers, provide tax relief facilities such as withholding income tax and tax holiday especially for pioneer and high-investment industries, continue providing fiscal stimulus and credit restructuring for SMEs in wholesales and retail sector, and allocate subsidy for companies. On the other hand, group D consists of the most benefited sectors during the pandemic with the highest positive growth such as ICT and health sectors. Going forward, the government must be able to ensure that the growth of these sectors continues to grow positively by building ICT infrastructure as well as improving and adding health facilities especially outside Java and in remote areas.

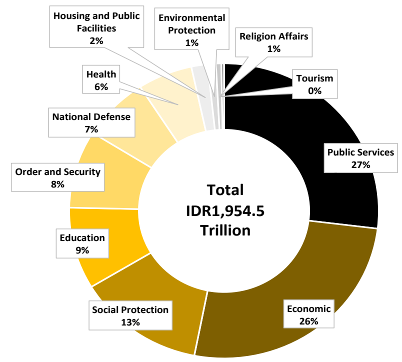
GoI set the state revenue and expenditure target to be increased to IDR1,743.6 trillion and IDR 2,750.0 trillion, respectively, in the state budget for 2021. The revenue target for 2021 is 6.7% higher compared to the realization in 2020. The tax revenue also targeted to reach IDR 1,444 trillion in 2021, while the realization in 2020 only reached IDR 1,282 trillion, which means that taxation must grow 12.6% to achieve the target. The GoI has hard work to do because, until February 2021, the tax revenue only reached 12.5%. The GoI must continuously optimize all sources of revenue so that the target will be achieved and the budget deficit can be reduced. However, the condition is still considered unfavorable for the government as the economy remains under duress caused by the Covid-19 and several tax-related benefits during the pandemic, such as tax relaxation and the new government policy for sales tax for cars and properties.

Figure 41: Indonesia's State Budget (APBN) in 2021

Description (in IDR trillion)	State Budget (APBN)			
	2020	2021	Realization as of Feb 2021	% of State Budget
State Revenue	**1,699.95**	**1,743.65**	**219.15**	**12.57**
1. Tax Revenues	1,404.51	1,444.54	181.75	12.58
2. Non-Tax Revenues (PNBP)	294.14	298.20	37.34	12.52
3. Grant	1.30	0.90	0.06	6.21
State Expenditures	**2,739.17**	**2,750.03**	**282.72**	**10.28**
1. Central Government Expenditures	1,975.40	1,954.55	179.68	9.19
2. Local Budget Transfer (TKDD)	763.93	795.48	103.03	12.95
Primary Balance	(700.43)	(633.12)	(23.18)	3.66
Deficit	**(1,039.22)**	**(1,006.38)**	**(63.57)**	**6.32**
(% of GDP)	**(6.34)**	**(5.70)**	**(0.36)**	
Budget Financing	**1,039.22**	**1,006.38**	**273.05**	**27.13**

Source: Ministry of Finance, 2021

Figure 42: Central Government Expenditure in 2021 State Budget

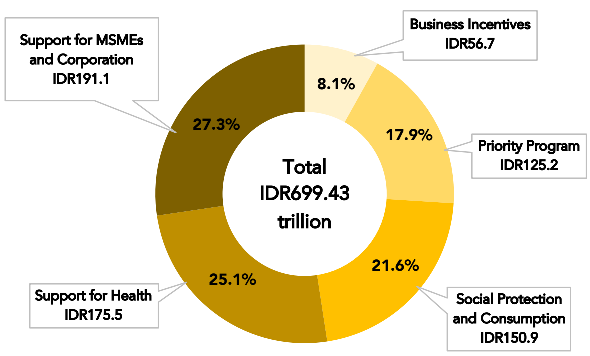


Source: Ministry of Finance, 2021

"GoI must continuously optimize all sources of revenue so that the target will be achieved, and the budget deficit can be reduced. However, the condition is still considered unfavorable for the government as the economy remains under duress caused by the Covid-19…"

On the other hand, the state expenditures are targeted slightly increased. The GoI strategy for the state expenditures for 2021 is reducing central government expenditures while increase local budget transfer to support local government. Three main functions that become the priority of the central government are public services, economy, and social protection. Those functions will only be limited to help in reducing the economic impact of the COVID-19 crisis. Therefore, the GoI ought to pay more attention to the allocation of health functions considering that there are no signs either that the pandemic will be end soon or herd immunity will be achieved in the near future. To maximize the existing fund, the GoI needs to refocus on the most effective policy. One of which GoI can pursue to spend their budget effectively is by shifting the focus from the any low realized budget to the health and social protection incentives. By shifting the focus, the GoI is expected to gain benefits in the short-run without hurting the budget in the long-run.

Figure 43: PEN Program Allocation in 2021



Source: Ministry of Finance, 2021

In responding Covid-19 crisis, the GoI also allocated a budget for the PEN program in 2021. The Ministry of Finance (MoF) allocated a dedicated budget for PEN of IDR 699.43

trillion. This budget increased IDR 11.1 trillion compared to the one in 2020, especially supporting the health sector. The increase in the 2021 PEN budget allocation is expected to maintain the momentum of economic recovery, notably to boost economic growth in the first quarter of this year. The budget increased for supporting the health sector shows that the government is trying to achieve long-run recovery by managing the pandemic situation. This is the right step to step out of the happening crisis due to the pandemic situation. However, the government also needs to be agile in refocusing the budget if the realization is still low. As of April 16, 2021, the realization of the PEN program has only reached IDR134.07 trillion or 19.2% of the total allocated budget.

Medium-Term Focus: Risk of Taper Tantrum and Budget Deficit Reduction

At the beginning of the Covid-19 crisis, the GoI has relaxed the budget deficit target under law No. 2/2020 and targeted it will slowly decrease until it reaches below 3% in 2023. Although Indonesia's fiscal deficit condition is better than India or China, Indonesia still has a higher fiscal deficit than the other countries in Southeast Asia. The GoI still believes the ambitious target will be reached because economic performance has started to show signs of recovery this year. However, because the pandemic continues and less likely to be ending in the foreseeable future, the government may not necessarily be able to revoke the stimulus programs that have been implemented to mitigate the impact of the Covid-19 pandemic and restore the economy. Therefore, the GoI needs to provide an alternative solution plan if this target cannot be achieved by 2023.

"Reflecting Indonesia's current condition, Indonesia is still under a risk of experiencing a slower recovery compared to other countries."

Reflecting Indonesia's current condition, Indonesia is still under a risk of experiencing a slower recovery compared to other countries. This risk is strengthened by the number of Covid-19 cases that are still increasing. The progress of vaccination in the United States raises optimism about a faster-than-expected economic recovery in the second half of this year. This trend also triggered the Federal Reserve's discourse to gradually reduce the bond-buying program that sustains the economic recovery from the pandemic, which is known as tapering off. At the same time, China, as the first major economy to beat back Covid-19, is now also taking the global lead in moving to unwind its pandemic-driven economic stimulus efforts. On the other hand, the signs of economic recovery in developed countries may trigger global investors to withdraw their funds from emerging markets, including Indonesia. If this is not properly anticipated, it will put pressure on the rupiah exchange rate due to capital flights. The occurrence of capital flight will generate growth costs, limiting the potential for national economic growth that will be followed by other negative consequences. In this case, BI cannot use the same conventional tools as in 2013, by tightening monetary policy to overcome the impact of the taper tantrum given the unstable and uncertain conditions of the domestic economy. Therefore, the GoI ought to be prepared by accelerating the recovery process and maintaining the domestic economic stability to face this challenge in the medium run.

If taper tantrum happens, Indonesia may lose market confidence due to mounting debts. The tantrum will also complicate the recovery effort that GoI has already planned. Indonesia's current debt condition is showing high risk if it is not managed carefully. As of February 2021, Indonesia's foreign debt reached USD422.6 billion, which is 3.97% higher compared to the previous year. In addition, Indonesia's debt-to-GDP ratio would rise to

37% this year, from 29.8% at the end of last year, driven by an increase in borrowings to cover the widening budget deficit, also to cope with the economic slowdown and Rupiah depreciation. Therefore, the government must provide assurances over its fiscal strategy to raise revenues back to, at least, the 2018 level to flatten the debt curve.

Long-Term Focus: Structural Transformation

"GoI could also pursue a more sustainable agenda such as sustainable financing to achieve sustainable long-term economic growth."

Despite the current economic situation, the GoI has already taken several initiatives in preparing a better economic situation after the pandemic ends. Fundamental reforms include improving the quality of education, health, and effective social security to boost the quality of human resources and continue to accelerate infrastructure development through digital infrastructure and logistical efficiency and connectivity. Other than that, the GoI also implements structural reform by releasing Omnibus Law on Job Creation and establishing SWF called INA. These initiatives may increase the business and investment climate, create jobs, and strengthen investment in 2021, leading to long-term recovery. However, The GoI also needs to pay attention to the fiscal conditions. The Covid-19 pandemic has taken the government to a whole new level in terms of data management. It is like a blessing in disguise and is supposed to be utilized. For instance, in terms of fiscal management, the GoI could increase the tax base based on the database they currently have from the pandemic handling effort. Moreover, the GoI could also pursue a more sustainable agenda such as sustainable financing to achieve sustainable long-term economic growth.