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PERSPECTIVE

RESEARCHERS AT ISEAS – YUSOF ISHAK INSTITUTE ANALYSE CURRENT EVENTS

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COVID-19's Impact on Indonesia's Economy and Financial Markets

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EXECUTIVE SUMMARY

- The Indonesia economy has started to recover gradually but unevenly across sectors. With weak economic demand, there is a limit to what monetary policy can do. Instead, an expansive fiscal policy has become important.

- Concerned about the insufficient take up of government bonds, the government came up with a controversial "burden sharing" programme. The government is sensitive to the market's "BI's independency" and has been careful to ensure that this programme carries a deadline, currently set for end-2020.

- Net external fund flows have been negative throughout most of the year, with local investors taking up some of the slack. The rising local investor composition in both the bond and equity market is a welcomed stabilizing trend. However, a prolonged slowdown would seriously hurt the more vulnerable businesses, especially those with high debt levels.

- Non-performing loans (NPLs) has crept up from 2.5% in January 2020 to 3.1% by mid-year. The government has allowed more lenient requirements for the restructuring of problem loans, thus providing some breathing room for both borrowers and lenders.

- A prolonged pandemic would adversely affect economic recovery and further erode the banking sector's capital levels next year.

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INTRODUCTION

On September 10, 2020, Jakarta Governor Anies Baswedan announced his intention to re-tighten social distancing measures (PSBB) as a response to rising covid-19 infections. As a result, Indonesia's stock market index (JCI) tumbled by more than 5%, triggering a halt in that day's first trading session. The JCI dropped from 5,150 to a low of 4,892, with bank stocks taking the largest hit, falling by 5.94%.

This event is just a snapshot of how the pandemic's adverse impact on business sentiment in one trading day has hurt the country's financial markets. This essay attempts to review the Covid-19 pandemic's broader impact on Indonesia's economy and its financial markets.

LATEST COVID-19 DEVELOPMENTS AND GOVERNMENT RESPONSES

Indonesia has been trailing its ASEAN neighbours on Covid-19 testing, which is a key measure to control the spread of the pandemic. Although The Philippines, with less than half of Indonesia's population, has a slightly higher Covid-19 case count as of 14 October 2020, its testing rate is double that of Indonesia. Indonesia has also the highest daily increases in Covid-19 cases, which currently hovers around the 4,000 level, followed by The Philippines at 1,823 and Myanmar at 1,123 (**Table 1**). By end-October, this number for Indonesia had declined to the 3,000 level.[1]

The Indonesian government imposed its first social distancing measures (PSBB I) on April 9, 2020. Less than a month later, on 5 June 2020, with the number of new Covid-19 cases appearing to be stabilized, the government eased these restrictions and shifted into a transition mode (PSBB Transition I). In hindsight, the government's decision to ease social distancing rules was premature and the number of daily new cases spiked further thereafter (**Figure 1**).

On 14 September 2020, as the hospitals started to fill up and with health front-liners working overtime, the government reverted back to its social distancing measure (PSBB II/Emergency Brake) with an added emphasis on wearing masks and associated fines.[2] However, there was a brief drop in daily confirmed cases and with the occupancy rates easing, so on 12 October, the government moved back to a new transition mode (PSBB Transition II) with stricter and more detailed guidelines. Daily rates have moved up again, but still below its early-October peak. Some of the key measures at each PSBB phase are summarized in **Table 2** below.

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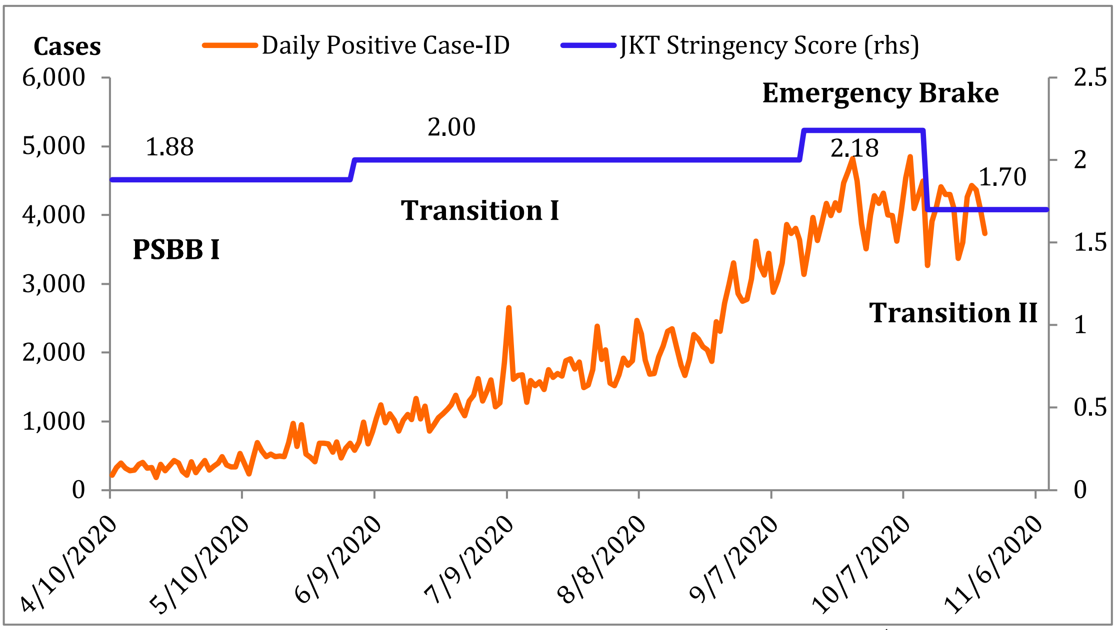
Table 1. Comparative COVID-19 Statistics[3]

Country	Cases	Cases last 24 hours	Deaths	Tests	Recovered	Cases per million	Population
World	38,204,270	329,537	1,087,391		26,508,893	4,898	7,800,000,000
China	90,858	20	4,739		85,797	63	1,439.324,000
US	7,859,417	53,518	215,194	117,357,626	3,124,593	23,744	331,003,000
Indonesia	344,749	4,127	12,156	2,415,606	267,851	1,286	268,000,000
Philippines	346,536	1,823	6,449	4,231,916	293,860	3,303	104,900,000
Vietnam	1,122	9	35	1,253,381	1,029	12	95,540,000
Thailand	3,652	9	59	878,477	3,457	53	69,400,000
Malaysia	17,540	660	167	1,768,210	11,605	562	31,200,000
Singapore	57,889	5	28	3,290,291	57,740	10,315	5,612,000

Source: *https://www.csis.org/programs/southeast-asia-program/southeast-asia-covid-19-tracker-0) as of 14 October 2020.*

Figure 1: COVID-19 Positive Daily Confirmed Cases – Indonesia



Source: www.corona.jakarta.go.id, Bank Danamon Indonesia[4]

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Table 2. Government Measures to Control COVID-19 Spread

	School	Office	Places of Worship	Mall & Markets	Transport	Motor-cycle	Covid Isolation & Others
PSBB I 9Apr-4Jun	Closed and schools moving online	Closed with most offices moving to work from home (WFH) Exception to 11 essential activities	Closed with services moving virtual	Closed except supermarket, pharmacies and traditional markets Restaurants only take out	Cars 50% capacity Public transport 50% Partial restriction between provinces	Only for carrying goods	Mild symptoms can self-isolate at home Covid-designated hospital and isolation wards set up
PSBB Transition I 5Jun-13Sep	No change	50% WFH	50% capacity	Mall open 50% capacity Restaurants open with social distancing	No change & no travel limits between provinces	Allowed to carry persons within same residence	Continue to expand beds for Covid patients
PSBB II (Emergency Brake) 14Sep-11Oct	No change additional restriction of student gatherings	75% WFH	No change	No change except restaurants now closed and only take outs allowed	No change	No change	Self-isolation at home not allowed. All cases have to isolated and designated places (added several hotels) Wearing masks compulsory with sanctions
PSBB Transition II 12Oct-now	No change	50% WFH	No change	No change Restaurants allowed open but with social distancing	No change	No change	No change

Source: https://covid19.go.id/storage/app/media/Regulasi/Kisi-Kisi%20Pelaksanaan%20PSBB.pdf

There has also been much criticism in several media reports that the PSBB measures themselves were not strict enough, for example, in the enforcement of travel restrictions between provinces with a high number of infected cases.[5] A few raised the issue of

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inconsistent and clear messaging from the government, especially when there were different views between the central and provincial governments at the early stages of the PSBB implementation. To overcome this problem, a specially designated task force was set up to help with coordination and messaging. This task force was also set to ensure the budget allocations for Covid-19 is properly spent. Going forward, the government needs to further tighten enforcement of its PSBB measures and reassess its long-term public health plans.[6]

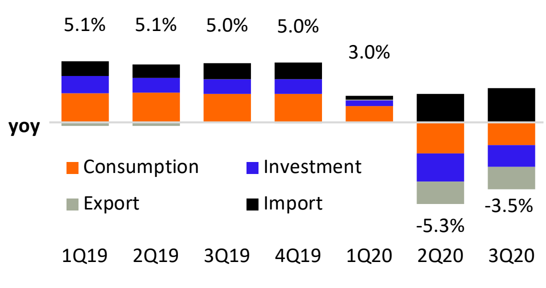
IMPACT OF COVID-19 ON THE ECONOMY

Indonesia's first Covid-19 case was reported in March 2020, but growth for 1st quarter 2020 declined from the usual average year-on-year (YoY) growth of 5.0% to 3.0%. This was followed by consecutive contractions of 5.3% in 2nd quarter 2020 and 3.5% in 3rd quarter 2020, which brings the cumulative growth to -2.0%. Private consumption, investment, and exports had collapsed due to the pandemic's impact on business activity. As a result, economic growth was dependent largely on government spending and a deep drop in import demand (**Figure 2**).[7]

The external account saw a notable decline in Foreign Direct Investment (FDI), which was worsened by portfolio investment outflow, amounting to USD7.7bn just in March alone (**Figure 3**). This is the largest monthly outflow recorded after the 1998 Asian Financial Crisis. However, this was soon offset with sizable trade surpluses starting in May 2020 and USD7.5bn worth of external corporate bond issuances, causing a positive drop in the Current Account Deficit from 2.7% of GDP in the 1st half of 2019 to 1.2% of GDP in the same period of 2020. Meanwhile, Foreign Exchange (FX) reserves fell USD10.7bn during 1st quarter 2020, to a low of USD121bn and then gradually recovered to USD137bn by August 2020.

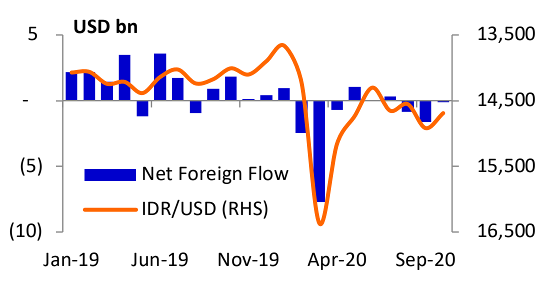
Bank Indonesia, supported by a low inflation environment, moved to cut its policy rate by 100bps through 4 separate rate revisions (**Figure 4** and **Figure 5**). This pushed down the yield of 10-year government bonds from a high of 7.9% in March to 6.8% by July. This also pushed down bank deposit and lending rates, but with the weak demand bank loans remaining stagnant.

Figure 2: GDP Growth and Contribution



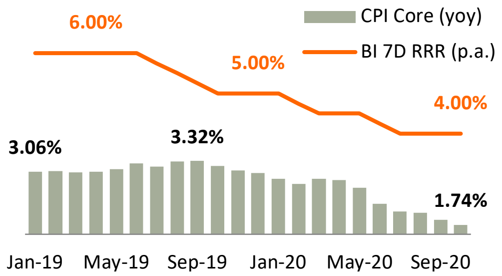
Source: Central Bureau of Statistics

Figure 3: IDR and Foreign Fund Flows



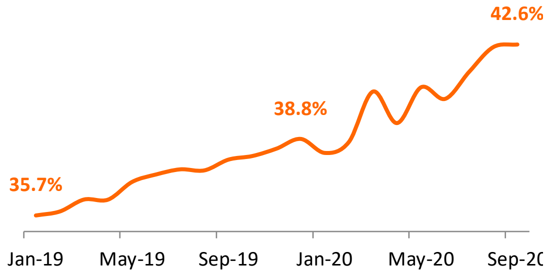
Source: Bank Indonesia, MoF, IDX

Figure 4: Policy Rate and Core Inflation



Source: Bank Indonesia, Central Bureau of Statistics

Figure 5: M2 per Nominal GDP



Source: Bank Indonesia, Central Bureau of Statistics

FISCAL AND MONETARY RESPONSE (THE STIMULUS AND "BURDEN SHARING" PROGRAMMES)

Based on past experiences, Indonesia's policymakers' immediate response was to safeguard financial market liquidity as foreign funds flowed abroad. But with domestic players taking up the slack, market liquidity was not a major issue. The more critical problem was the drop in business activity. The monetary authorities began to use a wide range of traditional monetary tools focusing on exchange rates and interest rates to stimulate the economy. When these did little to stop the capital flight (**Figure 3**) and overturn market confidence, they proceeded to arrange a repurchase agreement or repo-line under the Federal Reserves' FIMA facility in early April.[8] As it turned out, there was sufficient liquidity and the above measures did calm the market. It was after Bank Indonesia's Quantitative Easing (QE) and Debt Monetization initiatives between April and July, that the market realized how systemic liquidity risk was not as problematic as initially thought (**Figure 5**).

Meanwhile, the Ministry of Finance (MoF) made sure that sufficient funds were available to fund the government's stimulus programme. Taking an "extraordinary situation" approach, they temporarily lifted the state budget's 3.0% (of GDP) deficit cap.[9] This potentially opened the gate for more bond issuances should the deficit widen; but if this occurred, there were questions whether the market would take it up.

After a series of meetings, the Financial System Stability Committee (KKSK) reached an agreement, where the MoF would issue another IDR838tn worth of bonds to add to the initial IDR691tn of bonds planned, to finance the stimulus programme (**Table 3**). The receipts will be spent on social protection and for stimulating demand through six channels (**Figure 6**), to revive the economy. However, there were the usual problems with prompt spending of the government budget. Disbursements for the health and business sectors only started to accelerate in August, with the government needing time to learn and work through the system while following tighter governance standards. Only social security as well as Micro and SME spending went relatively well; this did not involve new or additional bureaucracy, and so could meet realization targets (**Figure 7**).[10]

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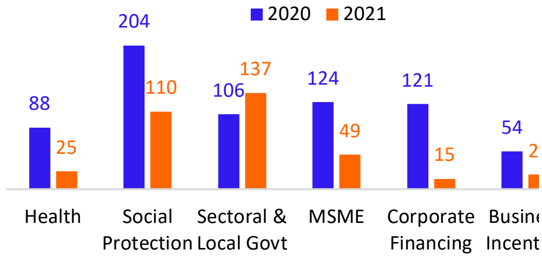
Table 3: Government Budget

Item (IDR Tn)	2019 Auditted	2020 Pres.Decree 72	2020 % yoy	2021 Budget	2021 % yo
A. State Revenue	***1,960.6***	***1,699.9***	***(13.3)***	***1,743.6***	***2***
I.Domestic Revenue	1,955.1	1,698.6	(13.1)	1,742.7	2
1. Tax revenue	1,546.1	1,404.5	(9.2)	1,444.5	2
2.Non-Tax Revenue	409.0	294.1	(28.1)	298.2	1
II. Grant	5.5	1.3	(76.4)	0.9	(30
B. State Expenditure	***2,309.3***	***2,739.2***	***18.6***	***2,750.0***	***0***
I.Central Government Expenditure	1,496.3	1,975.2	32.0	1,954.5	(1
II. Regional Transfer	913.0	763.9	(6.0)	795.5	4
C. Primary Balance	**(73.1)**	**(700.4)**		**(633.1)**	
D. Surplus/ (Deficit)	**(348.7)**	**(1,039.2)**		**(1,006.4)**	
% to GDP	(2.2)	(6.3)		(5.7)	
Bond Issuance (Gross)	**921.5**	**1,528.7**		**1,574.5**	

Source: MoF

Figure 6: Economic Recovery Program (IDR tn)



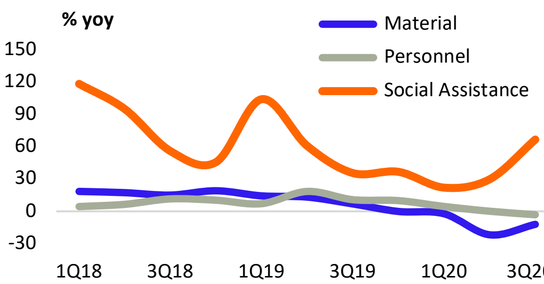
Source: MoF

Bank Indonesia was also allowed to purchase government bonds directly from the MoF and act as a standby buyer in the primary market. Market analysts and academicians were worried that the active participation of the central bank in buying government bonds in the primary market would compromise its "independence", especially with regard to its role of controlling inflation, and be a cause for a potential drop in the country's sovereign credit ratings.

Immediate market reaction was negative, with investors selling USD1.6bn worth of IDR securities and causing a 2.5% drop in the value of the Rupiah. Market participants were worried that this "burden sharing" scheme, which became part of the central bank's Quantitative Easing programme, could be prolonged beyond its end-2020 deadline. However, there is also a limit to how much the central bank can buy. BI has a capital clause which requires a minimum capital of IDR2tn and a capital ratio of at least 10.0% of total monetary liabilities.

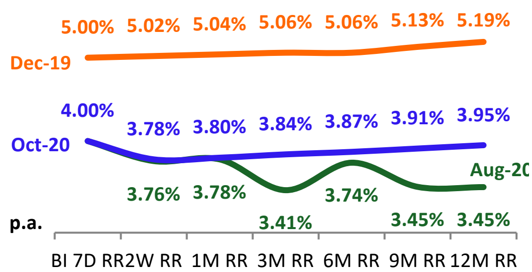
With liquidity not being an issue as initially feared, BI discouraged commercial banks from placing their excess liquidity back to the central bank, by aggressively cutting down their monetary operation rates. Term structure was inverted for the first time in history due to a combination of ample liquidity and a cost-conscious central bank (**Figure 8**).

Figure 7: Government Spending



Source: MoF

Figure 8: Policy Rate and Term Structure



Source: Bank Indonesia

Another measure closely followed by the financial markets is the ratification of the omnibus law, which parliament passed on October 8, 2020. This bill was designed to attract

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investment by simplifying the country's existing overlapping and tedious investment laws, totaling 8,451 regulations at the central government level and another 15,965 rulings at the provincial level.[11] But, this newly introduced bill has so far been met with country-wide street protests, with labour unions, students and opposition political parties strongly opposing it. President Joko Widodo has signed the bill, however, and detailed implementation regulations are being drawn up.

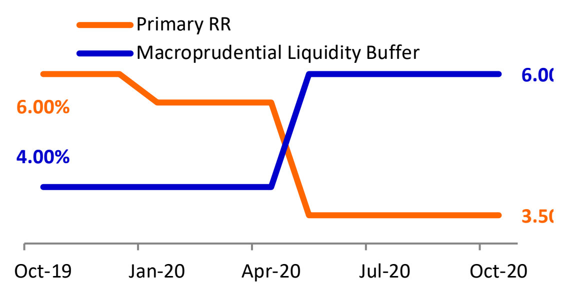
COVID-19 IMPACT ON FINANCIAL MARKET

Impact on the Bond Market

One monetary measure that affected both the bond markets and the commercial banks was the 2.0% shift from the banks' primary reserve requirement to be converted into bonds in May 2020 (**Figure 9**). This move basically shifted around IDR120tn (or 17% of additional financing needs) worth of banks' reserve requirement at Bank Indonesia to buy government bonds in the primary market, without having any effect on overall liquidity. This has made onshore banks the largest holders of IDR government bonds with a 36.9% share.

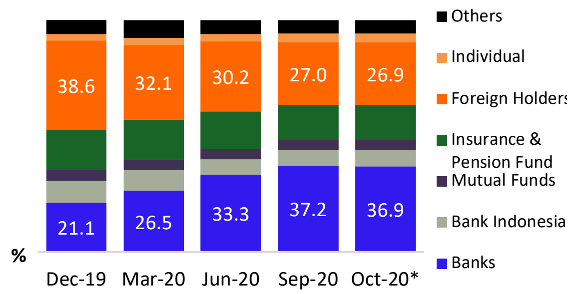
This has also lessened the dominance of foreign investors in tradable government bonds, whose share declined from 38.6% last year to 26.9% currently (**Figure 10**). Moreover, foreign investors' strategy on local currency/IDR bonds was reducing the duration to below 1 year, reflecting concerns over the economy.

Figure 9: Banks' Reserve Requirement



Source: Bank Indonesia

Figure 10: Ownership of IDR Government Bonds



Source: MoF as of 6 October 2020

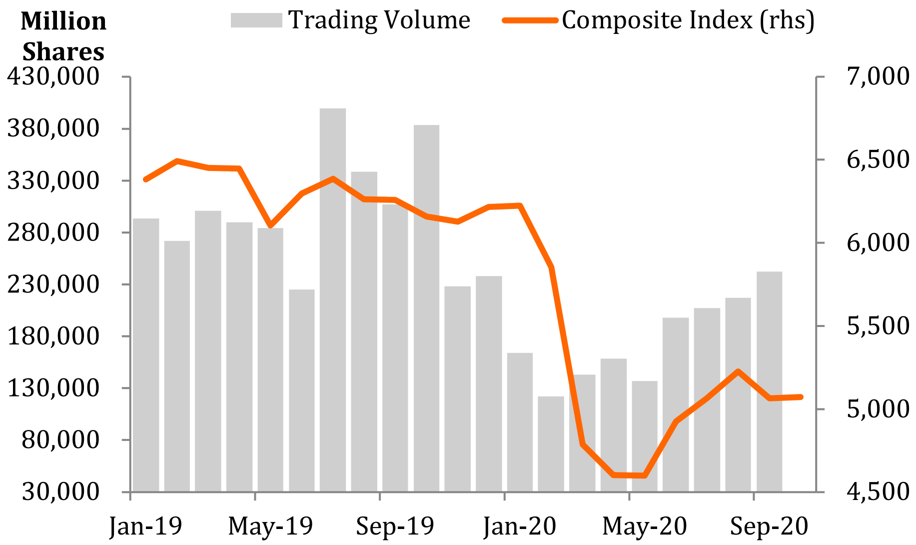
Impact on the Stock Market

The net foreign outflow also impacted the stock market, especially in mid-March, when the government was discussing the first social distancing program (PSBB I). On March 16, 2020, the Jakarta Composite Index (JCI) tumbled by 33% from January 2020 to 3,918, its lowest point in eight years.

However, since then, the JCI has crawled back up to its current 5,100 level in mid-October 2020, but still below its pre-Covid-19 levels (**Figure 11**). Stock market trade data show that a larger portion of trades was taken up by local investors during this pandemic year, although the split between foreign and locally-owned shares by source of investor remains roughly equal at 50% each. Amongst the local investors, the six largest are corporates with

48%, followed by individuals at 23%, insurance companies 15%, fund management companies 8%, financial institutions 3% and pension funds with 2%.[12] With the drop in interest rates following the drop in BI policy rates, it is expected that the share of individuals, insurance, fund management and pension fund companies will increase over time.

Figure 11: Jakarta Composite Index & Trading Volume



Source: Indonesia Stock Exchange

Financials of most listed companies still showed positive results in the 1st quarter of 2020 and it was only in the 2nd quarter of 2020, when PSBB I came into effect that their performance started to suffer. The experience of 10 major listed share from different sectors reflects this worsening trend (**Table 4**).

As expected, Covid-19 had a major impact on the financial performance of Garuda (airlines) and Bumi Serpong Damai (property). Both companies have experienced a considerable decline in their respective share prices. Their positive net income in the 1st half of 2019 has turned into losses this year. Unilever (consumer), Indofood (food), Kalbe (pharmaceuticals) and Gudang Garam (tobacco) have actually experienced improved sales and net profits in the first half of 2020 compared to a year ago. There are some exceptions, however. Telekom's net profits were roughly flat, while Gudang Garam's was down 10.8%. Revenue from Bank Mandiri (Banking), Adaro (Coal mining) and Astra International (Auto) also took a hit. But Mandiri's and Adaro's net profits dropped sharply on rising provisions for Mandiri and weak coal prices.[13]

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Table 4. Frequently-traded Listed Companies as of 21 October 2020

Sector	Company	Share Price (IDR)	Share Price Change since Dec 31, 2019	Revenue 1H20 (IDR bn & *USD mn)	Revenue Change from 1H19	Net Profit 1H20 (IDR bn & *USD mn)	Net Profit Change from 1H19
Airlines	Garuda Indonesia (GIAA)	242	-51.1%	917*	-58.2%	-723*	-
Property	Bumi Serpong Damai (BSDE)	835	-30.7%	2,338	-35.1%	-15.6	-
Banking	Mandiri (BMRI)	5,525	-29.2%	29,778	-0.1%	10,552	-24.6%
Consumer	Unilever (UNVR)	7,950	-6.4%	21,772	+1.5%	3,620	-2.1%
Food	Indofood (INDF)	7,075	-10.3%	23,047	+4.1%	3,585	+31.4%
Telecoms	Telekom (TLKM)	2,680	-31.2%	66,856	-3.6%	15,433	-0.4%
Pharma-ceutical	Kalbe Farma (KLBF)	1,565	-2.1%	11,605	+3.8%	1,408	+10.2%
Mining	Adaro (ADRO)	1,200	-21.0%	1,363*	-23.2%	167*	-48.0%
Auto	Astra Internatio-nal (ASII)	5,250	-25.0%	89,795	-22.7%	13,137	+6.8%
Tobacco	Gudang Garam (GGRM)	40,925	-20.1%	53,655	+1.7%	3,821	-10.8%

Source: Bloomberg, Reuters and Quarterly Financial Reports from the listed companies.

Impact on Banks

As bank customers suffer from the impact of the pandemic, so does the banking sector. This was especially felt during 2nd quarter of 2020, when the stock market also took a dive. However, unlike the 1997/98 Asian financial crisis, the problem for the banks this time is more a loan deterioration than a tight liquidity problem. Still, the Financial Services Authority (OJK) and Bank Indonesia (BI) did not take any chances and made sure liquidity was sufficient in addition to easing the banks' non-performing loan burden.

On the banks' problem loans, OJK eased the bank's restructuring requirements, for borrowers hurt by the pandemic, especially those with loans below IDR10bn. Under OJK's scheme which runs till March 2021, restructured borrowers, screened and selected by each bank, could defer their principal repayment schedule, thus providing them some breathing room. But not all restructured loans will be able to meet their obligations and thus a portion might still fall into Non-performing loans (NPLs) eventually. NPLs have been on an upward trend, from 2.5% at end-2019 to 2.8% in March 2020 and further deteriorating to 3.1% in June 2020 **(Table 5)**. This trend is expected to worsen by year-end. However, the banking sector's strong capital levels remain at a 23% level, which should be sufficient to tidy over the banks' for this year. However, capital levels could be eroded should the economy not sufficiently recover in 2021.

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Table 5. Banking Sector Performance

	31 Dec 2017	31 Dec 2018	31 Dec 2019	30 Mar 2020	30 Jun 2020
Loan (IDR Tn)	4,738	5,295	5,617	5,712	5,549
Loan growth	8.2%	11.8%	6.1%	1.7%	-2.8%
Deposit (IDR Tn)	5,289	5,630	5,999	6,214	6,260
Deposit growth	9.4%	6.4%	6.6%	3.6%	0.7%
Non-Performing Loans (NPL)	2.6%	2.4%	2.5%	2.8%	3.1%
Capital Adequacy Ratio (CAR)	23.2%	23.0%	23.4%	21.7%	23.0%
Loan Deposit Ratio (LDR)	90.0%	94.8%	94.4%	92.6%	89.1%
Net Interest Margin (NIM)	5.3%	5.1%	4.9%	4.3%	4.5%
Return on Assets (ROA)	2.5%	2.6%	2.5%	2.6%	1.9%

Source: OJK Indonesian Banking Statistics July 2020.

CONCLUSION

Government efforts to control the Covid-19 pandemic remains a work in progress. Meanwhile, the government has also set up an aggressive budget to help kickstart the economy in 2020. The economy is recovering but its pace remains weak. Foreign funds that left earlier are starting to trickle back.

The bonds and stock market are also recovering and so is the Rupiah, strengthening to Rp14,200 per USD level from Rp16,700 level in early April 2020.

The challenge ahead will be to bring down Covid-19 infections to a more manageable level so that the economic recovery as well as activity in business and financial market can be sustained.

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[1] See daily https://covid19.go.id/peta-sebaran.

[2] Source: https://covid19.go.id/storage/app/media/Regulasi/Kisi-Kisi%20Pelaksanaan%20PSBB.pdf).

[3] Source: https://www.csis.org/programs/southeast-asia-program/southeast-asia-covid-19-tracker-0) as of 14 October 2020.

[4] Stringency score is calculated by Bank Danamon Indonesia, defined as simple average score of all sectors based on allowed capacity utilization according to Governor regulation. >50% capacity utilization is scored 1, >25% to 50% is scored 2, and <25% is scored 3. Higher stringency indicates tighter restriction.

[5] https://www.reuters.com/article/us-health-coronavirus-indonesia-insight/endless-first-wave-how-indonesia-failed-to-control-coronavirus-idUSKCN25G02J.

[6] In the longer term, the government's health programme emphasis on addressing non-communicable diseases (stroke, cardio-vascular, cancer and diabetes, among others) needs to be rebalanced to properly address the future spread of similarly dangerous communicable diseases, such as Covid-19. Countries that had to deal with similar outbreaks like SARS, MERS and Ebola, for instance, have shown themselves to be better prepared to deal with these outbreaks.

[7] An obvious yet helpful buffer, since half of export output has import contents and is also directly linked to capital goods for investments as well as some parts of consumption. From a production perspective, there remains only one sector that booked better performance than the previous year, namely Information-Communication-Technology (ICT). Another reasonable outcome as demand for technology and communication surged along with staying at and working from home.

[8] A repo-line enables Bank Indonesia to receive Dollars in cash by pledging the same amount of securities to the Fed in return.

[9] This was thought necessary, as this 3.0% limit was set soon after the Asian Financial Crisis.

[10] Under two separate joint agreements between BI and the MoF, dated April 16 and July 7, interest costs would be borne by both institutions. The additional interest expense amounted to IDR50tn, where IDR34tn is covered by the central bank and the rest by MoF.

[11] UU Cipta Kerja, Pemahaman dan Implikasi, KeMenKo Kemaritiman dan Investasi, 14 Oktober 2020.

[12] p 12, Statistik Pasar Modal Agustus Mingguan ke-4 2020.

[13] Astra's net profit rose largely due to a one-off sale of their stake in Bank Permata, which was sold to Bangkok Bank.

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