Focusing on the ECONOMY at the dawn of

President Jokowi's administration on May 26, 2020, introduced the 'new normal' term aimed at transferring the public's trust and confidence to do business as usual as well as supporting the effort to recover the economy. Almost all business sectors are susceptible to the impact of COVID-19 pandemic that has forced the government to limit the people's movement and public activities. A survey by LIPI in June 2020 found that almost 95% of SMEs suffer from the worsening business environment with more than 40% of business in various levels experience more than 75% decline in sales. Another survey in May 2020 also revealed that 41% business can only survive for less than three months, 24% can survive for 3 to 6 months, 11% can survive for 6-12 months, and 24% are able to survive for more than 12 months.

The Minister of Finance Sri Mulyani revised the prospect of Indonesia's economic growth in 2020 down to 2.3% from 5.3%. The most depressing period is Q2, when the government boosted the COVID-19 test capacity to 400 per 1 million citizens. The Central Bank projected a -4.4% contraction which was then confirmed by President Jokowi on July 15 that the Q2 GDP might shrunk by 4.3%.

On the supply side of the economy, the most impacted sectors are manufacture, trade, and transportation, which only contribute 1-2% to GDP in Q1 2020, less than their 3-5.5% contribution in Q1 2019 (Bappenas). At the same time, on the demand side of the economy, public consumption has significantly decreased, followed by the rise of unemployment and poverty. Four million more people are predicted to slip below the poverty line as the poverty rate increase by 0.5% point reaching 9.7% by the end of 2020.

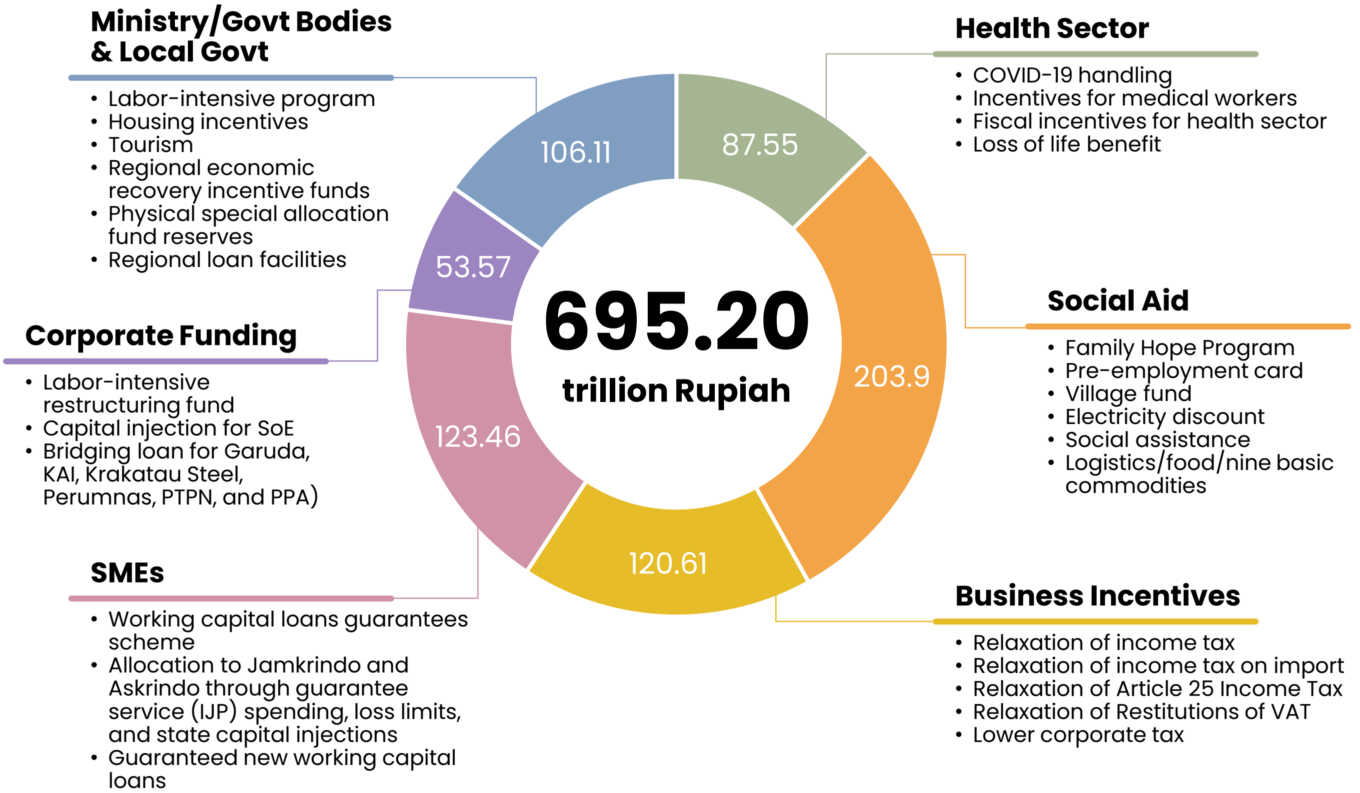
To help combat the economic downturn and softening the impact of the COVID-19 pandemic, the government in early May 2020 has rolled out the National Economic Recovery Program (*Pemulihan Ekonomi Nasional*, or PEN) to provide economic stimulus for the next three years until 2022. Initially, the government set the budget for PEN in 2020 at Rp318 trillion, and in less than a month it doubled to Rp641 trillion. The number kept going up and until the end of July 2020 it stood at Rp695.20 trillion (US$4.7 billion) with the focus on health, social aid, micro, small and medium enterprises (SMEs), the business sector, and regional governments.

THE **STRATEGY** FOR NATIONAL ECONOMIC RECOVERY PROGRAM (PEN)

The main strategy of the government's PEN budget allocation is to support both the demand and the supply sides to keep the economy running. Excluding the budget for health sector to combat COVID-19 pandemic, the total stimulus package in 2020 is amounted to Rp607.65 trillion.

To maintain the consumers' purchasing power on the demand side (Rp205.20 trillion), the government allocates one-third of the total budget on social aid, pre-employment card, village fund, housing incentives for low-income households, the Family Hope Program (*Program Keluarga Harapan*, or PKH), and discount on electricity bill. To reduce the COVID-19 impact on the economy, the government supports the supply side (Rp402.45 trillion) through financing schemes and fiscal incentives for SMEs, corporation, state-owned enterprises (SOEs), and ministry/governmental bodies and regional governments.

COVID-19 IMPACT MITIGATION AND THE NATIONAL ECONOMIC RECOVERY



The government opts to maximize the role of SOEs by prioritizing those which operate in labor-intensive or the most severely impacted sectors such transportation, commodity, infrastructure, and housing. The government will provide Rp29.65 trillion of bridging loan to SOEs which are heavily impacted by the crisis, a sort of bail out scheme to prop the companies up until the economy fully recovers. In addition, Rp20.05 trillion of capital injection to five SoEs to enable them to execute the government's agenda:

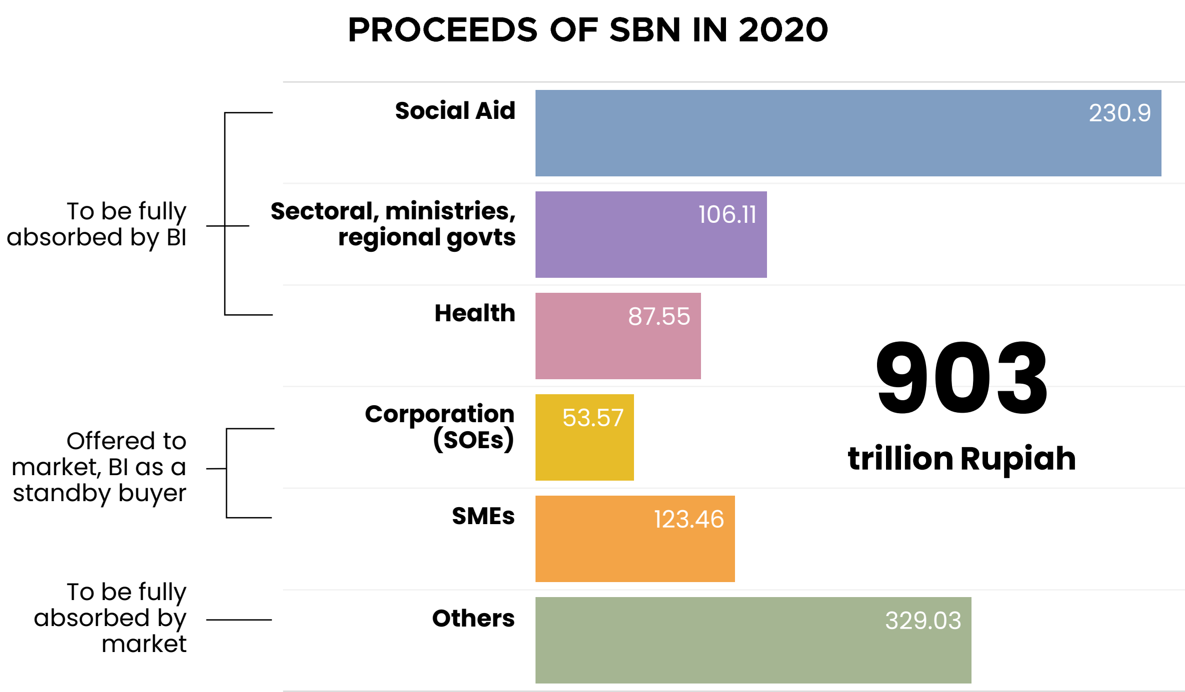
- Hutama Karya to complete the construction of Trans Sumatra Toll Road;
- PT Permodalan Nasional Madani to support the sustainability of SMEs financing;
- PT Bahana Pembinaan Usaha Indonesia to support the SMEs loan guarantee program;
- Indonesia Tourism Development Corporation to continue developing Mandalika Project in West Nusa Tenggara; and
- PT Perusahaan Pengelola Aset to continue restructuring underperformed SOEs.

FINANCING THE NATIONAL ECONOMIC RECOVERY PROGRAM

The stimulus package will raise the government's fiscal deficit significantly to Rp1,039.22 trillion or equal to 6.34% of GDP from the previously planned Rp307 trillion in early 2020 since the revenue from taxes is predicted to fall drastically. The government and parliament have agreed to remove the budget deficit cap that previously was set at 3% of GDP.

To finance the deficit in 2020, the government will raise its debt to up to Rp1,645 trillion, a whopping 122% hike from the planned Rp741 trillion of debt in the initial 2020 fiscal plan. The government and Bank Indonesia (BI) will share the burden of financing the projected Rp903 trillion of additional debt in 2020 through the issuance of massive government bond (*Surat Berharga Negara*, or SBN), literally pumping extra liquidity into the economy.

- Rp397.56 trillion of SBN will be directly absorbed by BI;
- Rp505.86 trillion of SBN will be offered to the market:
  - BI to act as a standby buyer for the Rp177.03 trillion of SBN; and
  - Market to absorb the remaining Rp329.03 trillion of SBN.



SOEs TO **SPEARHEAD** THE ECONOMIC RECOVERY

To steer the economic recovery and handle the COVID-19 pandemic, the government recently formed the COVID-19 Mitigation and National Economic Recovery Policy Committee (Team). The Minister of SoE Erick Thohir will serve as the chief executive of the Team, while the Coordinating Minister of Economic Affair Airlangga Hartarto will act as the chairman. Budi Sadikin, the Vice Minister of SoE will serve as the head of the Economic Recovery Task Force which focuses on the execution of economic aspect; while Doni Monardo will lead the new COVID-19's Handling Task Force which focuses more on public health aspect.

The composition of the new Team further reaffirms the government's priority ahead: the economy. The appointment of Erick Thohir to lead the Team means that the government emphasizes on minimizing the risk of recession by reactivating the economy which most probably will be spearheaded by SOEs whose growing role in the national economy has become even more apparent. It has become more obvious with the appointment of Budi Sadikin, Erick's right hand man in the Ministry of SOE, as the head of the economic recovery team.

President Jokowi's fondness of Erick's quick decision-making seems to be stronger in these difficult times, especially after Erick took a bold decision by converting Wisma Atlet as a temporary hospital in mid-March 2020. Against this backdrop, we can expect that SOEs will continue to play a pivotal role in the business landscape, as was the case in President Jokowi's first term, by leading the economic recovery drive in the next 2-3 years.

THE **IMPLICATION** FOR BUSINESSES

Economic recovery programs will significantly increase the fiscal deficit in 2020, 2021, and 2022, and the Minister of Finance Sri Mulyani on June 19, 2020, warned that the budget for PEN could easily reach Rp905 trillion. The government wants to keep the deficit in the fiscal year of 2023 and beyond at the level of 3% of GDP.

However, there is a risk that the deficit will run higher along with the possible increase of stimulus package in 2021. In addition, the economic recovery plan can only work as long as the government can keep the COVID-19 pandemic in check. The occurrence of second wave of COVID-19 outbreak can override what the government has planned.

As the economic stimulus will likely drive the money supply in the economy, there is also the risk of inflation and exchange rate that the government and BI will closely monitor. The weakening rupiah or rising inflation will reduce investors' appetite to buy SBN that will make it more difficult for the government to provide the next round of stimulus in 2021 and 2022.

Nevertheless, the current recession will give another rise to the bigger government's dominance in the economy as the private sector is stalling. Learning from what the nation had gone through in 1997-1998 economic crisis when the authorities led the economic turnaround, in lieu of the democratization process, it is expected that the government's role will subside once the economy starts to move on its own. However, it may not be the case for the SOEs that will remain big and prominent as the driver of the development and economic growth.

Businesses can expect that the combined government-central bank's record-breaking stimulus can help to turn the economy in the second half of 2020 or early 2021 at the latest, provided that the government is able to deliver the stimulus packages in a timely manner.

The government's scenario dictates that in the first quarter of PEN implementation, ideally in Q2 2020, the majority of stimulus packages can be delivered to keep the economy afloat, hence public consumption can start to pick up in the next quarter (Q3 2020). Therefore, the government in the following quarter (Q4 2020) can deliver the remaining stimulus packages.

In addition, there will be an additional short-term boost to the regional economy in the end of Q4 2020 as government and parliament has agreed to continue with the simultaneous local election to be held this year in December, although its contribution to the national economic growth remains to be seen.

In the last leg of 2020 stimulus packages, government aims to jump start businesses and further push the demand side of the economy by focusing on boosting the consumption of the middle class especially in tourism, transportation, and F&B sector. If all goes well, businesses need to take up the slack after the economy starts moving on its own.*