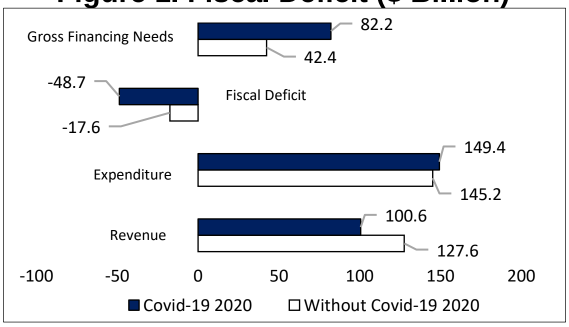
DEBT SUSTAINABILITY ASSESSMENT

1. **Overview of debt in Indonesia.** In the most recent IMF Article 4, a debt sustainability assessment was prepared which found Indonesia's domestic and external debt to be sustainable. According to the IMF, *"Indonesia's external and public debt remain moderate and sustainable. Nonetheless, potentially weaker-than-expected revenue, contingent liabilities from state-owned enterprises (SOEs) and public private partnerships (PPPs) should be carefully monitored. Reliance on foreign investors remains sizable, which could leave Indonesia susceptible to capital flow reversals"*.[1] Total government debt in 2019 was estimated at $282.7 billion,[2] with the composition of government debt including government securities at $237.2 billion (84%) and government loans at $45.5 billion (16%). Foreign currency debt remains stable at around 38% and local currency at around 62% of government debt. The composition of the debt portfolio was expected to remain stable, with low levels of short-term debt. Based on the debt sustainability analysis presented below, the debt to GDP ratio is expected to increase to 38%[3] in 2020 from 29.8% in 2019 driven by increased financing need. However, government's debt remains at sustainable level.

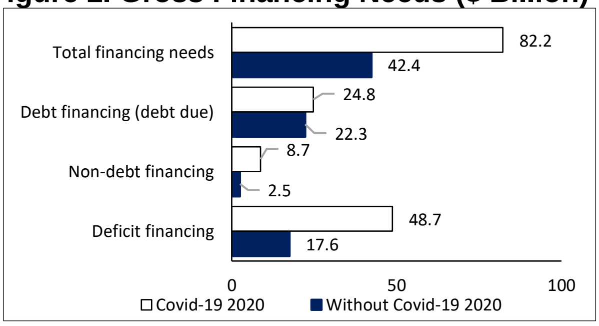
2. **Recent developments, including disruption from COVID-19 and developments in commodity and financial markets, are to have severe implications for Indonesia in 2020.** As events unfold, Indonesia's key trade partners already expect severe impacts on their economies, impacting on Indonesia's export earnings. Domestic demand is likely to weaken as business and consumer sentiment falls. GDP growth is accordingly forecast to decline to 2.3% in 2020. Based on these developments, a debt sustainability assessment is provided that considers implications for (i) gross financing needs, (ii) debt to GDP under a range of scenarios, (iii) government debt, (iv) external debt, (v) private sector debt, and (vi) official reserves.

Figure 1. Fiscal Deficit ($ Billion)



Source: Asian Development Bank

Figure 2. Gross Financing Needs ($ Billion)



Source: Asian Development Bank

3. **As growth and revenues slow while spending is maintained, gross financing needs are to increase.** The COVID-19 outbreak will have implications for GDP growth, with government using countercyclical policy measures to address the pandemic amid falling revenues. As a result, the government's budget deficit is to rise to 5.1% of GDP (Figure 1). Gross financing needs (fiscal deficit, debt amortization, and non-debt financing needs) are to be financed through sources including government securities as well as domestic and foreign loans. To meet gross financing needs, including countercyclical measures, the government is to raise approximately $82.2 billion in 2020, up from an original plan of $42.4 billion (Figure 2).

4. **Central government debt to remain sustainable.** Based on macroeconomic and fiscal assumptions, the central government debt to GDP ratio is expected to increase from

[1] Article IV IMF Indonesia July 2019.
[2] Exchange rate assumed at 17,500 per USD.
[3] DEBT to GDP with ADB 1.5 Billion Loan.

29.8% in 2019 to 37.8% in 2020 and decline to 37.1% in 2021 under a baseline scenario of 19.5% Rupiah depreciation and GDP growth declining to 2.3% due to the COVID-19 outbreak (Table 2). The central government debt to GDP ratio projection for 2020 indicates that central government debt would be sustainable if assumptions were to realize. Meanwhile, government debt to GDP with ADB's $1.5 billion loan would increase the ratio by 0.2% (from 37.8% to 38%) and government debt to GDP with a loan from ADB's $1.5 billion plus AIIB $250 million plus KfW €250 million would increase the ratio by 0.2% (from 37.8% to 38%).

5. **Results of the stress test show resilience.** Several shocks were conducted to analyse alternative macroeconomic assumptions of the key variables driving central government debt dynamics (Table 2). Parameters tested include increasing contingent liability defaulted to 10%, higher debt service, higher real interest rates, higher inflation rates, drop in oil price, depreciation of the Rupiah against the US dollar, and the slowdown in GDP growth. The combined effect of these shocks reduces the central government debt to GDP ratio from 37.8% to 36.7% of GDP by 2020 (Table 3). This is driven by the decline in oil price, which decreases government energy subsidy expenditures and supports domestic consumption through lower prices. The results of the stress test indicate that central government debt is resilient to a broad range of shocks.

6. **Government debt held by non-residents is to decline as investors leave emerging markets.** In January 2020, government debt held by residents was estimated at $77.8 billion and non-residents was $204.9 billion. Indonesia relies upon investment inflow to finance the current account deficit, therefore remains vulnerable to global risk sentiment, particularly as two-thirds of equity and sovereign bonds are foreign held. As the impacts of COVID-19 unfold, central government debt[4] held by residents is to increase by 19.5% as the Rupiah is depreciates against USD and as non-residents exit emerging markets. The bond yields are expected to increase due to the impacts of the COVID-19 outbreak, with the price of financing through the market becoming more expensive than in 2019. This entails a higher debt and dividends repayment. For state-owned enterprises bond issues at higher yields may have implications for future profits.

7. **Total external debt sustainable.** Indonesia's external debt in January 2020 amounted to $410.8 billion) or 36.1% of GDP, a slight decline from 36.2% a year earlier. Debt held by non-residents is predominantly long-term (88.3%), consisting of government and central bank's debt of $204.9 billion, and private debt (including SOEs) of $203 billion. In 2019 growth in the government's external debt was driven by an influx of foreign capital to the domestic government securities market and issuance of dual currency global bonds, namely in Euros and US dollars. External debt at the end of January 2020 grew by 7.2% year-on-year. While due to COVID-19, external debt at the end 2020 could climb to $483.7 billion (jump 16.3%) from $410.8 billion in January 2020.

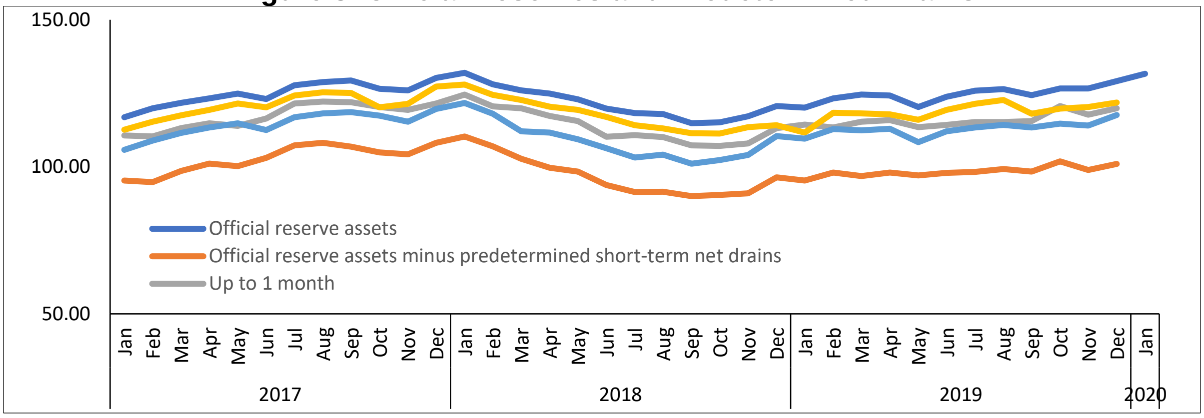
8. **Private sector external debt to increase but remain sustainable.** Corporate debt to GDP is also projected to increase from 10.7% in 2019 to 12.8% in 2020, compared with 10.1% under no pandemic scenario. As many private sectors are temporarily shutting down their operation for the unknown periods, workers are temporary asked to stay at home. If this continues for more than 1 month, the default rate on investment and working capital loans may increase as much as 25%, therefore additional debt is needed to restructure this component. Yet, this figure remains sustainable compared to Indonesia's GDP.

9. **Official reserves to remain ample.** Official reserves are also to increase as imports fall, but this increase would be partially offset as reserves are used by the central bank to intervene in the market to smooth the currency fluctuation. Official reserves to total foreign

[4] As of 24 March 2020.

currency loan is drop to 0.85 in 2020 from 1.00x in 2019.[5] In addition to this, official reserves to government external debt[6] are to decreases to 0,60x in 2020 from 0,68x in 2019. Official reserves stood at $129.2 billion at the end of December 2019, sufficient to cover 7.3 months of imports and government external debt service (Table 1). At the end of 2020, official reserves are expected to reach $109.3 billion, sufficient to cover 7.4 months of imports. Official reserves to monthly imports increase from 7 months to 7.4 months, due to the depreciation of Rupiah against USD and decline in imports, this means the value of official reserves increase. Official reserves minus predetermined drains has been very stable over the period from March 2019 to January 2020 and should continue to be stable. At the end of January 2020, official reserves minus predetermined drains were $102.7 billion (Figure 3), equivalent to 5.5 months of imports.

Figure 3. Official Reserves and Predetermined Drains



Source: Asian Development Bank.

Table 1. Key Economic Indicators

Indicator	2015	2016	2017	2018	2019
Total GDP (billion current $)	861.0	931.9	1,015.4	1,042.2	1,119.2
GDP per capita (current $)	3,331.7	3,562.8	3,836.9	3,893.6	4,175.0
Revenue[a] (% of GDP)	12.9	12.5	12.3	13.1	12.4
Fiscal balance[a] (% of GDP)	-2.6	-2.5	-2.5	-1.8	-2.2
Money supply (M2) growth (%)	8.9	10.0	8.3	6.3	6.5
Total external debt (% of GDP)	36.1	34.3	34.7	36.0	36.1
Total external debt service (% of exports & services)	30.6	35.4	25.5	25.1	26.0
Gross international reserves (in months of imports and official debt repayment)	7.4	8.4	8.3	6.5	7.3
Average exchange rate (rupiah/US dollar)	13,389	13,308	13,381	14,238	14,148

Source: Asian Development Bank.

[5] Before the outbreak of the COVID-19 pandemic.
[6] As of Q3 2019.

Table 2. Debt Sustainability Assessment, 2020–2021: Key Macroeconomic and Fiscal Assumptions Underlying Baseline

		Estimated 2020 (Full Year) without COVID-19	Estimated 2020 (Full Year) with COVID-19	Projected 2021
1	GDP	5,30%	2,30%	5,40%
2	USD TO IDR	14.400	17.500	17.500
3	Contingent Liability Defaulted 10%	-	10,00%	0,00%
4	Debt Servicing UP 20%	-	20,00%	0,00%
5	Interest Rate UP 3%	5,40%	8,40%	8,40%
6	Inflation	2,76%	6,76%	6,76%
7	Oil Price	US$63	US$23	US$23
8	Official Reserves (In Billion USD)	130,4	109,3	130,8

Source: Asian Development Bank; Indonesia Ministry of Finance; and Bank Indonesia.

Table 3. Debt Sustainability Assessment, 2020–2021: Stress Test

		Estimated 2020 (Full Year) without COVID-19	Estimated 2020 (Full Year) with COVID-19	Projected 2021	Maximum
	BASELINE	30,70%	37,84%	37,08%	60,00%
1	Contingent Liability Defaulted 10%	30,70%	38,37%	37,58%	60,00%
2	Debt Servicing UP 20%	30,70%	37,84%	37,08%	60,00%
3	Interest Rate UP 3%	30,70%	37,87%	37,11%	60,00%
4	Inflation	30,70%	36,16%	35,45%	60,00%
5	Oil Price	30,70%	37,74%	36,98%	60,00%
6	Combined	30,70%	36,66%	35,91%	60,00%
7	Official Reserves to Total Foreign Currency Loan	0,99	0,85	0,92	>=1.00
8	Official Reserves to Government External Debt	0,68	0,60	0,69	>=1.00
9	Official Reserves to Monthly Imports	6,99	7,37	8,01	>=3.00
10	Corporate Debt to GDP (Corporate Default Rate 25%)	10,12%	12,84%	11,95%	60,00%
11	DEBT to GDP with ADB 1.5B Loan		38,00%		
12	DEBT to GDP with ADB 1.5B, AIIB $250M, KfW €250M Loan		38,05%		

Source: Asian Development Bank; Indonesia Ministry of Finance; and Bank Indonesia.