Indonesia

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A Long Fight

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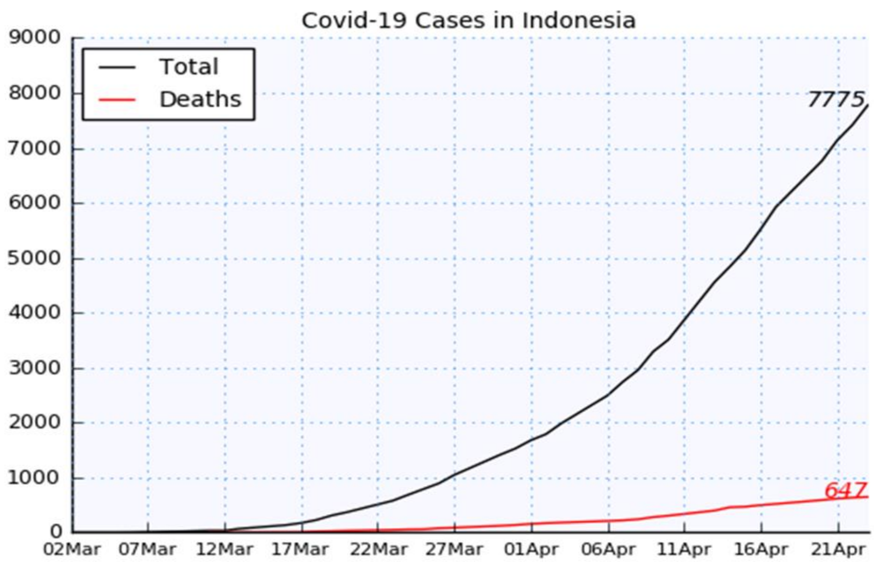
How Indonesia is coping with the Covid-19 fallout thus far

- Since the start of April, Covid-19 cases have more quintupled to nearly 7800 and are still showing no sign of levelling off any time soon. Moreover, the fatality rate remains one of the highest in the world, pointing to the challenges faced by the healthcare system and low testing rates.
- The authorities recently adopted tougher measures including broader restrictions such as a ban on plane and train trips ahead of the Ramadan holy month to minimize further contagion to outer lying islands. While helpful, the concern is that various parts of the country are already affected.
- The economic costs are mounting as well, compelling the authorities to speed up distribution of its stimulus package. The pressure is on for them to undertake even more spending, though any further fiscal deficit widening would push into uncharted territories ever more.

Waiting for the Flattening

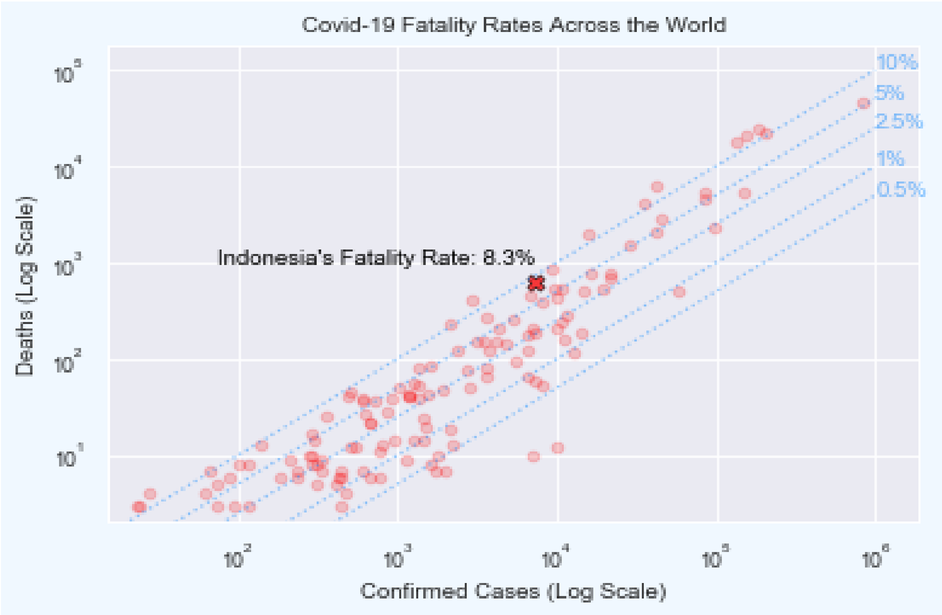
There used to be a time when senior Indonesian officials could quip that the country had been free of the Covid-19 epidemic because of the population's good habits and pious prayers. Unfortunately, things have moved on to a lot more challenging phase since then.

As of April 23rd, the official count for infected cases stands at 7775, about 5 times more than the figure at the end of March. The infection curve has yet to show any sign of flattening as well, with daily increments averaging 420 cases for the past week.



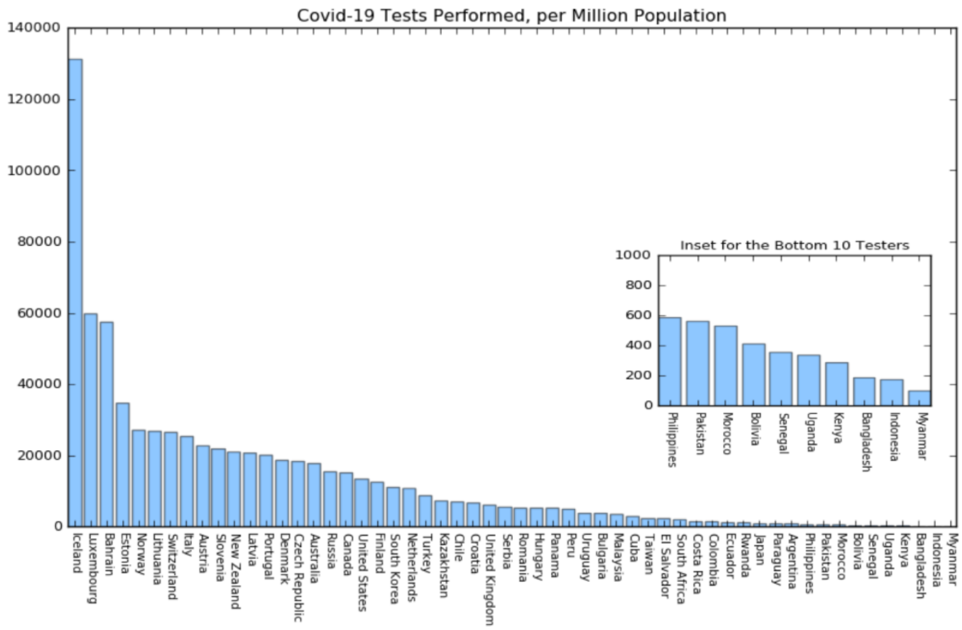
Source: OCBC, Bloomberg.

Moreover, the fatality rate for Indonesia ranks as among the highest in the world, at 8.3% as of the last data point and around 8.8% average since the start of April. Indeed, among countries with significant confirmed cases (of over 1000), its fatality rate stands as the 11th highest, behind mostly European countries with older populations that are more susceptible to the disease.



Source: OCBC, Johns Hopkins University Coronavirus Resource Center.

Given that Indonesia's population is a lot younger, the high fatality rate may be reflective of the challenges faced by the country's healthcare system. It could also be reflective of the low prevalence of testing in the country thus far.



Source: OCBC, OurWorldinData.org

Among the 58 countries which reported their testing data on April 22nd, Indonesia unfortunately ranks 2nd from the bottom when adjusted for population size. At 174 tests per million population, it sits just ahead of Myanmar but behind countries like the Philippines and Bangladesh. While this is still a vast improvement from the 36 per million rate of early April, it is still indicative of how much more work is needed to have a more complete picture of the rate of infections in the country.

Hence, there is a sense that when it comes to the viral outbreak, Indonesia might have to go through worse before things get better.

This may be especially so as we welcome the Ramadan fasting month, when up to 75 million Indonesians travel back to their hometowns to celebrate in the festivities. While the government has imposed a ban on such "mudik" trips, including announcing a stop on all flights and rail trips, the concern is that most of such trips might have already taken place before anyway.

The closure of businesses and schools over the past few weeks in major metropolitan areas such as Jakarta might have prompted people to go back to their hometowns earlier. Therefore, there is a risk of further infection upticks in the outer-lying regions, where healthcare provisions might be even more lacking. For one, infections have been detected in each and every of the country's 34 provinces already.

For now, we remain of the view – or perhaps, hope – that the number of infections would indeed peak at 95,000 cases by the end of May, as the government has modelled. This underpins our growth forecast of 1.5% for the year. Should the situation appear to have the potential of deviating considerably from that baseline view, the downside risk may be considerable. For what it's worth, the IMF has recently pencilled in 2020 growth of 0.5%, although no granular country-level detailed assumptions were provided.

Battling on

Against the backdrop of what is likely to be a long fight against the Covid-19 outbreak, the government has launched a IDR405tn fiscal stimulus package on March 31st. Within that, as much as IDR75tn (USD4.6bn) has been allocated to ramp up the healthcare response, including equipping the 132 hospitals across the country that are dedicated for the treatment of Covid-19 patients.

Meanwhile, up to IDR110tn was slated to bolster the social safety net. While it includes cash handouts to the poor, there have been some concerns about some other aspects of the package. These include provisions within the so-called pre-employment card for up to IDR1mn (USD64) for online classes that are meant to improve the employment prospects for those who have lost their jobs. Critics have highlighted, however, that most of the classes – with some featuring courses on how to make puddings and "cheesy chicken croquette" – are not exactly resume-boosters.

All in all, given the unprecedented scale of the challenges, in coming up with effective ways to stimulate the economy and protect livelihoods, teething problems are to be expected and remedies to be found in time.

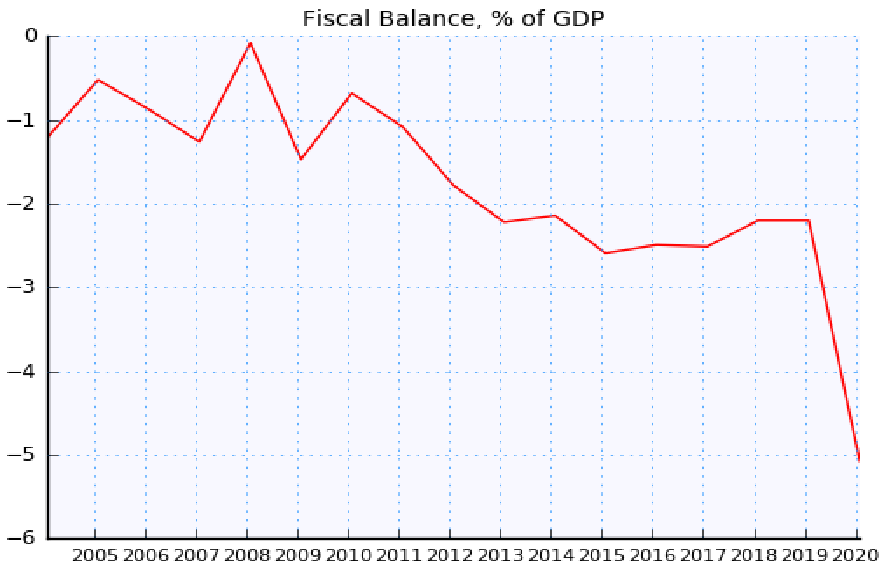
Still, with economic momentum decelerating, speed is important.

Details on a IDR150tn "recovery program" that is part of the stimulus, for example, have yet to be announced nearly a month after the initial announcement, however. Measures such as credit restructuring provisions and a guarantee fund for working loans to SMEs are slated to be part of this sub-package. For businesses that are suffering through this crisis, and run into issues either servicing their current loans or obtaining new ones, every day of delay may make the difference between survival and bankruptcy.

No cap in name, but in practice

Given the urgency of the situation, it is no surprise then that there have been more and more talks about how the Indonesian government would have to add even more stimulus. For instance, the Chamber of Commerce highlighted a need for extra spending of up to IDR1600tn, to bolster the economy.

To us, it is crucial to make sure the infrastructure of stimulus disbursement is well in place first before we even talk about another ramp-up in potential expenditure, given that the existing package has yet to be rolled out fully yet.



Source: OCBC, Bloomberg.

Moreover, there is the obvious impact on fiscal deficit if spending is ramped up further. As detailed in our *Wiggle Room report*, even for the current package alone, Indonesia has had to suspend its long-time sentiment anchor of capping the fiscal deficit at 3% of GDP, in order to allow room for the new target of 5.07% of GDP. Ballooning the deficit even further at this stage would thus be especially tricky. Even if spending is ramped up by just half of the amount touted by the Chamber of Commerce, deficit would have to go up to as much as 10% of GDP, for instance.

At the end of the day, even if there is no more deficit cap by name for the next three years, the need to source for financing never goes away and this imposes a cap in practice on just how much and how quickly deficit can go up.

While the authorities have successfully raised USD4.3bn in global bonds issuance recently, including via a new 50-year bond, investors' confidence is always flighty and is in large part dependent on global factors beyond Indonesia's control.

Moreover, even though Bank Indonesia is now allowed to purchase government bonds in the primary market to help fund the deficit expansion, the mechanism remains new. While the authorities have repeatedly emphasized that the central bank would only step in when market mechanism runs into issues, and that its participation would be capped at 25% for conventional bonds and 30% for sukuk bonds in non-competitive bids to limit its effects on pricing, the longer term impact of such primary purchases remain uncertain especially for emerging markets. While the notion of inflation would appear to be a distant phenomenon given the demand crunch, it would nevertheless feature in investors' minds.

Hence, until market gets familiarized with both higher deficit levels planned by the Ministry of Finance and the primary purchase to partially fund the extra deficit by the central bank, it is perhaps best to adopt a gingerly attitude.

This may be especially so given that the ratings agencies are watching this space closely. Already, on April 17th, even though S&P has affirmed its BBB rating on Indonesia's sovereign, it has nonetheless slapped a negative outlook on it. To be sure, the timeline alluded to in the S&P's statement – saying how it may lower the rating if growth suffers "over the next two years" – does not signal any immediate downgrade. However, it should serve as a reminder of the need to keep to at least some stricture of fiscal prudence despite the need to cushion the economy at this point.

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