



## Covid-19 Pandemic and Financial System Stability in Indonesia

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### ABSTRACT

This study aims to determine how the impact of the covid-19 pandemic on financial system stability in Indonesia. The quantitative data analysis method is used to look at the causes of a phenomenon by explaining the differences between two or more problem topics that are suspected to be interrelated. The results showed that the corona virus or Covid 19 resulted in the government having to issue several policies, namely through work from home (PSBB) which reduced economic activity, resulting in inequality in the economic sector which was far below the optimal business and financial turnover. On the other hand, economic growth in 2020 is predicted to weaken sharply from 5.02% (yoy) in 2019 to the range of -2% to -1% (yoy). Pressure also occurred on price stability in the first semester of 2020 due to the high uncertainty of global financial markets, both due to the spread of COVID-19 and the prospect of a weakening world economy. Likewise, inflationary pressures resulted in weak domestic demand. However, on the financial institution side, banks are still experiencing fairly good conditions during the pandemic. Financial institutions remain in the resilience of the financial system that is running. This can be seen from the capital actors, the amount of credit, and healthy liquidity

## **INTRODUCTION**

The COVID-19 pandemic, coupled with falling commodity prices and turmoil in financial markets, will have a devastating impact on the global economy. Curbing the spread of the Coronavirus through large-scale restrictions (PSBB) that affect economic liquidity will inevitably place the Indonesian economy well below the optimal business and financial cycle volatility in 2020 (Junaedi and Salistia, 2020). Quoted from *cnnindonesia.com*, that the Minister of Finance, Sri Mulyani Indrawati in a video conference in Jakarta on Wednesday, April 1, 2020, said that Indonesia's economic growth is estimated to fall by 2.3% and can even penetrate -0.4% as a result of this Coronavirus.

Foreign capital inflows declined significantly, which led to a weakening of the exchange rate in the first half of 2020 (Rini and Wahyudi, 2023). In other terms, low inflationary pressures occurred due to weak domestic demand. Financial regulation as seen from good capital, good credit quality, and liquidity. However, weak domestic demand and banks' reluctance to lend during the Corona virus period.

As a result of this virus, there are fluctuations and instability in the country's financial system (Abdi, 2020). Financial system stability is a very important issue. And there is a growing recognition that financial system stability plays an important role in a country's economy. Every country tries to maintain the stability of its financial system by building a strong and high-quality banking system through various appropriate monetary policies. This is especially true for Indonesia, which is a developing country.

Unstable economic conditions are indicated by the high volatility of macroeconomic indicators and have an impact on the banking sector. The most critical financial crisis in Asian economies, including Indonesia, was the financial crisis that occurred in mid-1997 and affected currency exchange rates, stock markets, and asset prices (Zahra, Ascarya & Huda in Patria Yunita, 2022).

Bank Indonesia, as the monetary authority, has the responsibility to ensure the stability of the financial system. Although Indonesia's financial system has experienced a downturn during the COVID-19 pandemic, the challenge for Bank Indonesia is to find the right strategy to maintain its stability.

Based on previous research, the financial system (Indonesia Economic Report 2021) including the banking system was in good condition at the beginning of the pandemic. This system became a buffer so as to maintain the financial security system which was reflected in good capitalization, good credit quality and reflected liquidity. However, weak domestic demand and internal banking problems that were unable to extend credit during the Corona Virus pandemic caused 2020 credit growth to contract by 2.41% (yoy) in December 2020.

If the financial system is unstable, some bad things can happen. For example, there are two problems. First, monetary policy is poorly communicated and ineffective; second, the intermediation function does not work properly. They claim that this is caused by errors in the allocation of funds, which hinders economic growth.

The Financial System Stability Committee (KSSK) is aware of the risk of the spread of Covid-19 which could put pressure on the financial system, although financial system stability in the second quarter was still normal.

Indonesia's financial system remained stable in the second quarter despite continued pandemic uncertainty and the emergence of new risks due to the increase in pandemic cases. The Covid-19 pandemic has increased pressure on the economy. As a result of the lockdown implemented by countries in the world, the exchange rate of the rupiah against the US dollar experienced considerable fluctuations along with the uncertainty that occurred in the market.

Based on the explanation above, it can be explained that the purpose of this journal discussion is to measure and provide an analytical view for the economic stability of the State and how much impact COVID-19 has on the stability of the financial system in Indonesia.

## LITERATURE REVIEW

### Financial System

Since the financial sector always follows the progress of the real sector, the financial system plays a very important role in supporting the progress of the real sector in Indonesia (Robinson in Sukrudin, 2014). The success of economic development is measured by the effectiveness and performance of financial institutions, particularly the banking industry. The financial system has undergone some significant changes across Southeast Asia due to the banking crisis.

Banking performance can affect the efficiency and stability of the banking industry and the effectiveness of the financial system as a whole because the banking system is still the priority intermediary institution in Southeast Asian countries. Unstable economic conditions are indicated by the high volatility of macroeconomic indicators and have an impact on the banking sector. Yunita, 2022).

Maintaining macroeconomic stability and avoiding excessive economic volatility are the medium-term objectives of the macroeconomic terms of reference (Rangkuty and Rusiadi, 2020). However, the government's financial system depends on how financial institutions, especially banks, operate. Banks are an important part of Indonesia's financial system and serve as intermediaries between people's savings and other people's investments (Mankiw, 2019).

Albulescu and Goyeau said in Sukrudin (2014) that the stability of the system is always stable. If an internal or external problem occurs, he can still complete his duties as usual, i.e. Allocate funds appropriately, keep using a good payment system, avoid unfair prices, and continue to advertise. Indonesia's economy is growing rapidly.

### Financial System Stability

Chant (2003) argues that instability is a market condition that damages the economy, which threatens economic efficiency thereby paralyzing the financial situation of households, businesses and governments and restricting the flow of money. It also disrupts the activities of financial institutions.

Crockett (1996) defines economic stability as the absence of instability. Instability as a financial situation due to financial institutions failing to meet agreed obligations or due to sharp fluctuations in financial asset prices.

In contrast, financial stability is defined by the Deutsche Bundesbank (2003) as the balance that exists in the financial system so that it can manage capital, mitigate risks, make payments, and has the ability to handle financial disruptions, bankruptcies, and significant structural changes. Mishkin (1999) states that when the financial system is volatile due to information flow problems, financial instability occurs. In this case, the financial system cannot fulfill its duty to channel money into productive investments.

However, according to Schination (2006), financial stability is when the financial system: (1) efficiently facilitates capital allocation to investors and overall capital distribution; (2) has the ability to assess, analyze, and manage financial risks; and (3) can handle financial problems.

Gunadi et al. (2011) revealed that a stabilized system creates a new system that no longer functions and increases system stability. However, Nasution in Sukrudi (2014) states that a stable system is closely related to price stability and currency stability. In addition, the Indonesian financial system is strongly linked to the banking industry due to the close relationship between the two sectors and the stability of the Indonesian economic system (Crockett in Gunadi et al., 2011).

Furthermore, Kawai, et al. (2012) said that there is no generally agreed definition of financial stability, because the financial system is very complex with many dimensions, institutions, products, and markets. Indeed, it may be easier to describe financial instability than stability.

### **The Central Bank's Role in Maintaining Financial System Stability**

The role of the central bank in financial system stability is as follows:

First, the primary function of the central bank is to ensure currency stability through setting interest rates in the open market. Appropriate and balanced monetary policy should be the central bank's capability. To create currency stability, targeted inflationary measures are used, but the implementation of monetary policy with too tight interest rates can lead to a sluggish economy.

Second, ensuring the stable performance of financial institutions is a key responsibility of the central bank. Financial institutions are supervised and regulated by the central bank to prevent financial instability and disruption to the economy. As a result, an effective supervisory and regulatory system is needed. Market discipline should be implemented through monitoring.

Third, the central bank is authorized to establish and maintain the speed of the payment system. If a member of the payment system faces a default, it can then trigger effects that can disrupt the smooth running of the payment system.

Fourth, the central bank has the responsibility to conduct research and marketing. This is a feature that allows the central bank to access data that it deems could threaten financial stability. The central bank can keep an eye on vulnerabilities in the financial sector and discover potential shocks that could disrupt financial stability through surveillance.

Fifth, the central bank's role as manager of last resort (LoLR), which is part of the crisis management undertaken by banks to prevent financial system instability.

### **Previous Research**

Suparman (2021) investigated the government's financial management policies during the COVID-19 pandemic in Indonesia, which crippled small and medium enterprises due to a decline in people's purchasing power. In the manufacturing industry, sharp supply and demand imbalances led to supply chain disruptions and layoffs, resulting in a decline in government tax revenue.

Junaedi, et al. (2020) conducted a study aimed at (1) evaluating how the pandemic and various policies for handling the Covid-19 pandemic have an impact on Indonesia's currency stability; (2) evaluating how money supply, BI interest rates, market operations, and stock indices affect Indonesia's monetary stability. This study utilizes quantitative analysis with multiple dummy regression variables. The result is the stability of the rupiah is strongly influenced by various pandemic events and policy shifts. The rupiah exchange rate is simultaneously affected by variables such as the pandemic (number of cases, deaths, recoveries, and pandemic handling policies), money supply (M1, M2), market transactions (conventional and sharia), inflation rate, foreign exchange reserves, financial stock market index, and interest rate base (BI).

Elnahass and Li (2021) showed that this study is timely, in that we consider 1090 banks from 116 countries for quarterly periods across 2019–20. The results provide strong empirical evidence that, in the global banking sector, the Covid-19 outbreak has had detrimental impacts on financial performance across various indicators of financial performance (i.e., accounting-based and market-based performance measures) and financial stability (i.e., high-risk indicators including default risk, liquidity risk and asset risk). These results are consistently observed for various regions, countries (US, China and others), and different bank-level characteristics, and across income-generation levels among countries. We also find differential effects of the pandemic on alternative banking systems (i.e., conventional and Islamic).

### **METHODOLOGY**

To obtain the data needed, using the Quantitative Data Analysis method which is Comparative in nature to support the implementation of research where this comparative research aims to see the causes of a phenomenon by explaining the differences between two or more problem topics that are suspected of having a relationship with each other. Efforts to determine the effect of Covid-19 on the stability of financial methods in Indonesia, whether experiencing stability or instability, by looking for data to be processed, namely annual data starting from 2019-2021. Data was collected from Bank Indonesia (BI) and the Central Bureau of Statistics (BPS), and the Ministry of Finance.

## RESULTS AND DISCUSSION

Chart 1 shows that the Financial System Stability Checklist (ISCC) in 2019 was within the normal range, supported by the stable performance of financial institutions and financial markets. We are looking for annual data from 2019-2021 to process to determine the impact of COVID-19 on the stability or instability of Indonesia's financial system. Therefore, researchers should have a lot of theoretical basis to use when researching this phenomenon.

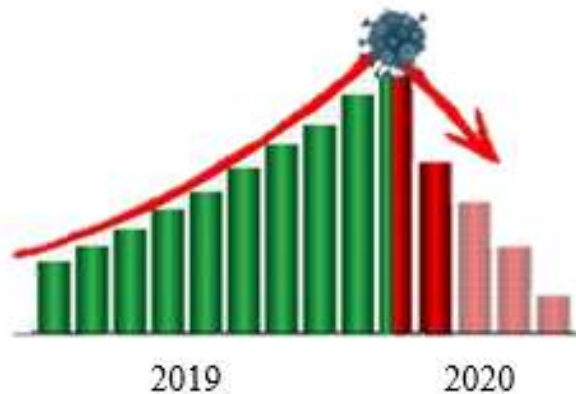


Figure 1. Pandemic Pressure on Economic Stability  
Source: The Central Bureau of Statistics (BPS)

Since the emergence of the corona Virus or Covid 19 for the first time in March 2020, it has greatly impacted the domestic economic order. In this regard, Suparman (2021) observed the COVID-19 Pandemic and the influence of government finances in his study explaining the State Cash Management policy implemented during the COVID-19 pandemic in Indonesia, which resulted in the paralysis of small and medium businesses, caused by a decrease in people's purchasing power. The crisis caused by the COVID-19 pandemic had many repercussions, which led the Indonesian government to take a number of exceptional measures.

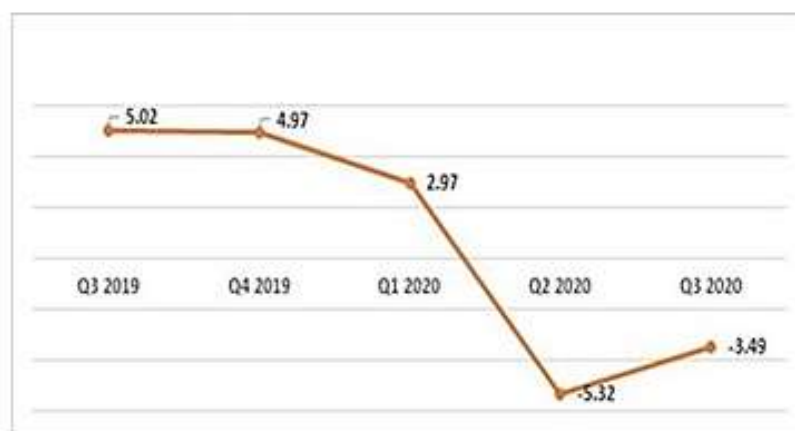


Figure 2. Indonesia's Economic Growth Index 2019-2020  
Source: The Ministry of Finance

COVID-19 is putting the stability of Indonesia's financial system under pressure. In addition, the Coronavirus, also known as the COVID-19 disease, has impacted the Indonesian economy (Fahrika and Roy, 2020). This is also in accordance with the following statement from Engkus et al. (2020) said that the wave of COVID-19 transmission quickly led to a significant economic slowdown, which in turn halted most economic activities.

The government can overcome the deeper socio-economic crisis by taking extraordinary breakthrough actions, such as the formulation and implementation of policies to expand the budget deficit and rescue the economy and financial system, in the unusual situation where the state budget is under tremendous pressure during the pandemic.

Alburescu and Goyot in Sukrudin (2014) stated that financial system stability can play its usual role, which is to improve financial system stability. Funds will be distributed effectively to ensure a good payment system, prevent price distortions, and continue to contribute significantly to Indonesia's economic growth. The results show that Indonesia's financial system stability is threatened by the COVID-19 outbreak.

Ade Novalina, Rusiadi, Huda Juliani et.al. (2022) analyzed the stability of the financial system caused by inflation that occurred in Indonesia during the COVID-19 pandemic based on the relationship between interest rates, money supply, and exchange rates relative to inflation. The concurrent results show that: shows that inflation increases when interest rates increase, an increase in total money supply as well as exchange rates can reduce inflation. Therefore, the government took extraordinary measures to save the financial system.

According to Bank Indonesia, financial system stability is the study of things that cause instability in the financial sector. Bank Indonesia has the responsibility to ensure financial system stability as the monetary authority. Although the COVID-19 pandemic caused a decline in the financial system, finding the right strategy to maintain Indonesia's economic and financial stability is a challenge for Bank Indonesia.

### **Indonesia's Financial System**

Since a long time ago, Indonesian economists have expressed their opinions about the Indonesian financial system, the process has changed fundamentally after entering the era of deregulation, the policy package of October 27, 1988 which finally issued several laws in the field of finance and banking since 1992, namely: (1) Law Number 7 of 1992 concerning Banking; (2) Law Number 2 of 1992 concerning Insurance; (3) Law No. 11 of 1992 on Pension Funds; (4) Law No. 8 of 1995 on Capital Market; (5) Law Number 10 of 1998 on the Amendment of Law Number 7 of 1992 on Banking; (6) Law No. 23 of 1999 on Bank Indonesia.

The country's economy should recover through vaccination and disciplinary measures in accordance with COVID-19 protocols. In addition, the outlook is supported by five policy measures, namely: (1) Opening up productive and safe sectors across the country and in every region; (2) Improving fiscal realization; (3) Increasing bank credit from both the demand and supply sides; and (4). Increasing monetary and macroprudential stimulus, as well as

accelerating economic and financial digitalization, particularly with regard to the development of Micro, Small and Medium Enterprises (MSMEs).

The Indonesian economy is expected to grow in the range of 4.8-5.8% in 2021 with the support of these various factors. Inflation is also expected to remain under control within the target range of 3.0-1.0-1%.

The impact of the Coronavirus has hit Indonesia's economy hard as there is no quick solution that can be presented in the first half of 2020. As of early December 2020, the number of positive cases of Covid-19 reached 743,198, while the number of positive cases of death reached 22,138. However, the government's plan to implement Covid-19 through mobile broadband, such as PSBB and health protocols, must be implemented as part of mass economic activities and due to the widespread spread of the virus. Therefore, the impact on the country's financial stability is inevitable. The total production of industry players also decreased, resulting in the termination of workers' contracts. Global market pressure on demand for goods is also affected.

## **CONCLUSION AND RECOMMENDATION**

Since early March 2020, COVID-19 has spread across Indonesia, putting significant pressure on the country's economy, business and monetary cycles. On the one hand, economic growth is expected to decline sharply in 2020, from 5.02 percent year-over-year in 2019 to a range of -2% to -1% year-over-year. Due to the spread of COVID-19 and the possible weakening of the global economy, as well as increased uncertainty in global financial markets, external stability also came under pressure in the first half of 2020. The exchange rate started to weaken in the first half of 2020 as a result of a significant decline in foreign capital inflows. On the other hand, weak domestic demand was recorded to dampen inflationary pressures. However, in December 2020, credit growth contracted by 2.41 percent. (yoy).

The study is expected to be a reference for research with the same theme. Suggestions for further research development so that the covid-19 phenomenon can be compared with other countries. How is the contraction that occurs, how big is the impact and what variables directly respond both positively and negatively to the existence of covid-19. Up-to-date and valid data is very important in future research.

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