Indonesia’s Economic Outlook, Economic Challenges & Policy Responses

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Outline:

(1) Indonesia’s economic outlook;

(2) Indonesia’s economic challenges – both general and financial sector-specific; and

(3) The Government’s and OJK’s policy responses to these challenges.
Indonesia’s Economic Outlook

Cautious Optimism

Amidst moderating domestic growth and macroeconomic challenges, Indonesia’s economic outlook generally remains robust, with manageable risks.
Indonesia: Asia’s Emerging Powerhouse

- World’s 16th-largest economy, and the only country in South-East Asia to be in the G-20.
- World’s third-largest democracy, with a stable political and social environment.
- Rapidly-growing middle-class, which according to AC Nielsen is expected to grow by 147% between 2012 to 2020.
- Entering an era of positive demographic trends, and expected to enjoy a “demographic dividend” between 2020 to 2030.
- Abundant natural resources which are diverse and evenly distributed throughout the country.
- Like Australia, Indonesia is one of the few countries in the world whose economies had proved resilient during the 2007 Global Financial Crisis.
- Regarded as one of the most desirable destinations for prospective foreign investment, according to “Where Asia-Pacific is leading the World” Survey, conducted by PwC.
Indonesia’s Economic Challenges

Despite its solid fundamentals and enviable reputation, Indonesia is currently facing a number of economic challenges - impacting both: (1) Indonesia’s general economy as a whole; and (2) its financial sector specifically.
Indonesia’s General Economic Challenges

- Infrastructure shortages, which limit domestic production capacity;
- An antiquated domestic production structure, which is still highly dependent on primary products and low value-adding technology;
- Economic disparities between regions and income groups;
- Limited sources of long-term financing.
Indonesia’s Financial Sector-Specific Challenges

Like Australia’s financial sector, the Indonesian financial sector is not immune to fluctuations in the broader economy, which has been impacted by recent external events such as:

- The slowing growth of emerging markets, esp. China;
- Policy normalization in the U.S;
- The weakening global commodity prices;
- The decelerating global trade;
- A certain amount of capital outflow, triggered by the negative global and domestic sentiments.
Bright prospects for Indonesia’s Economy

Fortunately, the impact of the global downturn on Indonesia’s economic growth has been relatively modest. Indonesia’s economic stability both general and financial sector-specific remains relatively solid.

In Q3 2015, Indonesia’s GDP growth rate reached 4.73% yoy, and this is expected to increase at the end of year 2015, aided in part by the Government’s capital expenditure.

According to IMF projections, Indonesia’s GDP growth rate, along with India’s, has continued to perform well relative to other emerging countries.

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<td>7.75</td>
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<td>Brazil</td>
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<td>3.23</td>
<td>-3.03</td>
<td>-1.04</td>
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<td>Malaysia</td>
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<td>5.47</td>
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<td>4.70</td>
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<td>2.22</td>
<td>2.21</td>
<td>1.53</td>
<td>2.44</td>
<td>1.40</td>
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<td>Turkey</td>
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<td>2.13</td>
<td>4.19</td>
<td>2.91</td>
<td>5.43</td>
<td>3.04</td>
<td>2.88</td>
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</tbody>
</table>

Source: BPS, Statistics Indonesia
Source: IMF Projection

* IMF Projection
Financial institutions remain robust and less vulnerable to possible shocks

Financial performance of domestic financial institutions generally remains robust. The banking sector's capital adequacy ratio and insurers’ risk-based capital are well above minimum requirements. Profitability and leverage remain at relatively high levels. Gearing (debt-to-equity) ratio of multi-finance companies is 3.4 times (well below the maximum requirement of 10 times), providing room for further growth...

Banking sector's capital adequacy ratio (CAR) is maintained at a high level...

Risk-based capital (RBC) of the insurance industry remains high, well above the minimum threshold...

Gearing ratio of multifinance companies is quite low, providing ample room for future growth...

Source: OJK
Adequate liquidity and low credit risks

Banks are found to possess adequate liquid assets to anticipate depositors’ withdrawals. The insurance industry continues to maintain investment adequacy levels at above 100%. Meanwhile, credit risks in banks and financing companies are quite low, as evidenced by the levels of non-performing loans/financing.

The ratio of liquid assets to deposit is well above the minimum threshold...

Investment adequacy ratio in the insurance industry is maintained above 100%...

Non-performing loan (NPL) in the banking sector remains at a low level...

... and so does non-performing financing (NPF) in multifinance companies...

Source: OJK
Growth of financial intermediaries starts to accelerate

After moderating in March-July 2015, financial intermediaries’ activities started to accelerate in August. Capital raisings through IPOs and corporate bond issuances within the capital market remained relatively stable amidst the fluctuating market. Meanwhile, insurance penetration levels rose significantly last year due to the implementation of the Government’s social security programs.

Growth of bank loans started to accelerate in Q3-2015...

Capital raising through IPOs and corporate bond issuance in the capital market is relatively stable...

Following their banking counterparts, multifinance companies are expected to boost their financing activities...

There was a jump in insurance penetration and density due to social security programs...

Source: OJK
Despite its economic challenges, the prospects for the Indonesian financial sector remain fairly bright. It is expected that Indonesia's 2016 growth rate will improve compared to that of 2015. Although we believe that our national financial sector will remain resilient enough to withstand potential shocks, we will always remain vigilant, closely monitor all possible developments and undertake appropriate measures where necessary.

- It is expected that the outflow pressures in the domestic capital market will continue to ease, as we believe that investors have anticipated the Fed rate hike and already priced this in.
- In line with the improving growth, intermediary activities of domestic financial institutions are also projected to accelerate. After moderating in 2015, banking loans are projected to achieve a growth rate of 12.7% yoy in 2016 (2015 forecast: 11.1% yoy).
- The credit and market risks of domestic financial institutions are expected to remain manageable, in line with the improving domestic growth and moderating volatility in the financial market.
The Government’s and OJK’s Responses to the Challenges

For 2015 and beyond, key priorities and programs have been clearly set out to combat the economic challenges. The Indonesian government is continuously undertaking a series of structural reforms, aimed at creating greater and more sustainable economic growth.

OJK, on its part, is contributing to the Government’s economic development agenda by undertaking a countercyclical approach to accelerate domestic growth, whilst maintaining financial stability.
Measures adopted within the domestic financial sector to boost growth and maintain stability

As part of national efforts to reverse the recent economic slowdown, OJK has issued a series of measures aimed at the domestic financial sector. Such measures are directed at, among others: maintaining the level of private consumption; supporting financial inclusion including Small Medium Enterprises (SMEs); and maintaining confidence in the domestic financial market.

21 August 2015
- Regulations on shares buyback for listed companies

24 August 2015
- Changes on auto-rejection limit for equity trading on the stock exchange

8 October 2015
- Financial sector policy packages
- Deregulation in the Islamic banking sector

24 July 2015
- Financial sector policy packages

21 August 2015
- Regulations on shares buyback for listed companies

24 August 2015
- Changes on auto-rejection limit for equity trading on the stock exchange

3 September 2015
- Relaxation of regulations for insurers and pension funds on the valuation of investments.

9 September 2015
- Relaxation of regulations for foreign citizens in opening accounts in Indonesian banks
Financial sector policy packages to boost growth

As part of national efforts to reverse the recent economic slowdown, OJK has issued a series of financial sector policies. Such measures are directed at, among others, maintaining the level of household/private consumption and supporting the Government’s infrastructure development agenda.

July 2015

- **Banking sector**: Measures are focused on increasing bank loans to MSMEs and housing financing
  - Adjustment of risk weighting for certain types of loans
  - Relaxation of requirements for debt restructuring
- **Capital market sector**: Measures are focused on supporting financing for housing and infrastructure, as well as developing SMEs through financing from the capital market
  - Development & expansion of investment products
  - Development of municipal bonds
  - Unlocking opportunities for SMEs to go public
- **NBFI sector**: Measures are focused on fostering the growth of multifinance companies and microfinance institutions
  - Relaxation of regulations on NPF in multifinance companies
  - Development of microfinance institutions
  - Establishment of a rating agency for MSMEs

October 2015

- Relaxation of regulations on business trust
- Preparation of agricultural insurance scheme
- Revitalization of venture capitals, especially to finance start-up businesses
- Establishment of financing industry consortium, especially to provide financing for creative industry, export-oriented businesses, and MSMEs
- Empowerment of the Indonesia Export Financing Agency (LPEI)
- Implementation of one-project concept in assessing quality of loans
- Promoting Crop Insurance (consortium among government agencies & insurance industries)
- Relaxation on Sharia Bank Licensing for activities
Three directions for Indonesia’s financial sector

OJK has clearly set out three directions to develop the domestic financial sector in the medium term. From each direction, key priorities and programs are derived. A comprehensive “Indonesia’s Financial Sector Masterplan” is scheduled to be launched in Q4-2015.

1. Enhancing financial sector’s role in boosting economic activities

In ongoing efforts to achieve a robust and sustainable economic growth, the domestic financial sector is directed to play a more vital role in terms of catalyzing national economic activities.

2. Strengthening financial sector’s resilience to maintain financial system stability

To support the sustainability of economic development, financial stability plays an important role. To that end, financial sector must maintain its resilience to confront possible shocks that could emerge from the domestic or external environments.

3. Enhancing financial sector’s role in improving financial inclusion and promoting equality

Financial sector has the opportunity to play an increasingly significant role in overcoming inequality that may arise. Initiatives undertaken by OJK include promoting financial inclusion and catalyzing local economy.
Two Way Trade & Investment Levels…

Indonesia vs Australia

Despite our geographical proximity and close relationship, two-way trade and investment between Indonesia and Australia have remained stubbornly low - however they have tremendous potential to grow.

In 2014, Australia was only Indonesia’s 10th and 9th-largest trading partner in terms of exports and imports respectively – way below countries such as Singapore, Japan and China.

Indonesia’s principal export destinations, 2014
1. Japan (13,61%)
2. China (10,0%)
3. Singapore (9,5%)
10. Australia (2,9%)

Indonesia’s principal import sources, 2014
1. China (17,2%)
2. Singapore (14,1%)
3. Japan (9,5%)
9. Australia (3,2%)

Source: Australian Department of Foreign Affairs and Trade

FDI in Indonesia demonstrated an increasing trend over the past 5 years

Between 2010-2014, Australian FDI in Indonesia declined – however this is expected to increase from 2015 and beyond

Source: Bank Indonesia
End of Presentation
Indonesia: Member of G-20 & The World’s 16th Largest Economy

Like Australia, as a member of the G20, Indonesia is expected to play a prime role in the global recovery amidst the economic turbulence.

Given its reputation as potential “economic powerhouse”, Indonesia is expected to boost its economy and move from the 16th-largest to the 7th-largest economy in the world by 2030.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>GDP (2022, billion USD)</th>
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<tbody>
<tr>
<td>1</td>
<td>United States</td>
<td>17,348,075</td>
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<tr>
<td>2</td>
<td>China</td>
<td>10,356,508</td>
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<tr>
<td>3</td>
<td>Japan</td>
<td>4,602,367</td>
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<td>4</td>
<td>Germany</td>
<td>3,874,437</td>
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<td>5</td>
<td>United Kingdom</td>
<td>2,950,039</td>
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<td>6</td>
<td>France</td>
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<td>7</td>
<td>Brazil</td>
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<td>8</td>
<td>Italy</td>
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<td>9</td>
<td>India</td>
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<td>10</td>
<td>Russia</td>
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<td>11</td>
<td>Canada</td>
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<td>20</td>
<td>Switzerland</td>
<td>703,852</td>
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</table>

Source: IMF, World Bank, McKinsey
Indonesia is currently enjoying a “demographic dividend” era. Moreover, the country’s economic growth over the past decade has resulted in a rapidly-growing middle-class population, providing opportunities for an economic boost.

Indonesia’s young population is potentially productive and therefore can function as the engine of the national economy.

Millions of Indonesians will join the consuming class during the next two decades...

Source: BPS Statistics Indonesia, the National Development Planning Board (Bappenas) and UNFPA

Source: McKinsey Global Institute Analysis
Diverse, abundant natural resources...

Indonesia's abundance and variety of commodities is a vital asset to the country's economy. Being mainly a raw commodity-exporting country, the Government is currently focusing on stimulating the establishment of downstream processing industries to deliver value-added products.

Abundance of natural resources is seen across the archipelago...
Indonesia is among the most preferred destinations in Asia by multinational corporations for future business expansion. The Indonesian Government continues to improve the country’s business and investment climate, hence attracting greater foreign direct investment and fostering the local economy.

A survey by the American Chamber of Commerce reported that Indonesia is the most preferred market for US companies to expand their business in ASEAN...

Foreign direct investments in Indonesia demonstrated a positive trend...

Source: ASEAN Business Outlook Survey 2015, The American Chamber of Commerce

Source: Bank Indonesia
Lack of adequate infrastructure...

Indonesia is still facing a so-called “infrastructure deficit”, which limits its domestic production capacity. This deficit can be seen, among others, in the energy and transportation sectors. A lack of adequate infrastructure has caused Indonesia's logistics costs to rise.

The availability of electricity in Indonesia is relatively limited and unevenly distributed...

Source: Statistics Indonesia
Primary products-based production structure...

The domestic production structure is still dominated by primary products and non-renewable natural resources (accounting for 63% of total exports), while manufacturing commodities have a low technology content. In a move towards a high value-added economy, there needs to be a revitalization of the domestic manufacturing industry.

High tech-based manufacturing exports, 2013...

Source: World Bank
Economic inequality amongst provinces & income groups...

Economic inequality amongst provinces has been a classic problem, and has impeded the nation’s economic development. Java, an island constituting 6.8% of Indonesia’s total land area, appears to be the centre for economic activities, accounting for 58% of total GDP. Another challenge is the widening gap among income groups.

Java contributes more than half of Indonesia’s GDP...

The share of assets owned by the 20%-highest income group demonstrates an increase...

<table>
<thead>
<tr>
<th>Year</th>
<th>20% highest income</th>
<th>40% Middle income</th>
<th>40% lowest income</th>
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<tbody>
<tr>
<td>2008</td>
<td>44,86%</td>
<td>36,43%</td>
<td>18,72%</td>
</tr>
<tr>
<td>2013</td>
<td>49,04%</td>
<td>34,09%</td>
<td>16,87%</td>
</tr>
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</table>

Source: Statistics Indonesia
Limitation in long-term financing sources...

The Indonesian financial sector is still dominated by the banking sector, which naturally has a short-term fund structure and is exposed to mismatch risks. This issue is compounded by the fact that the utilization of the capital market by corporations is relatively limited. The capital market has great potential as a funding source for infrastructure development, and hence needs to be fully optimized in the future.

Banking sector, the dominant player in financial sector, experiences a slowing growth...

Provision of long-term funding by the capital market is relatively limited...

Source: OJK