BANK INDONESIA

INDONESIAN BANKING DEVELOPMENT:

Financial services liberalization, the regulatory framework, and financial stability

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Workshop On Trade In Financial Services And Development

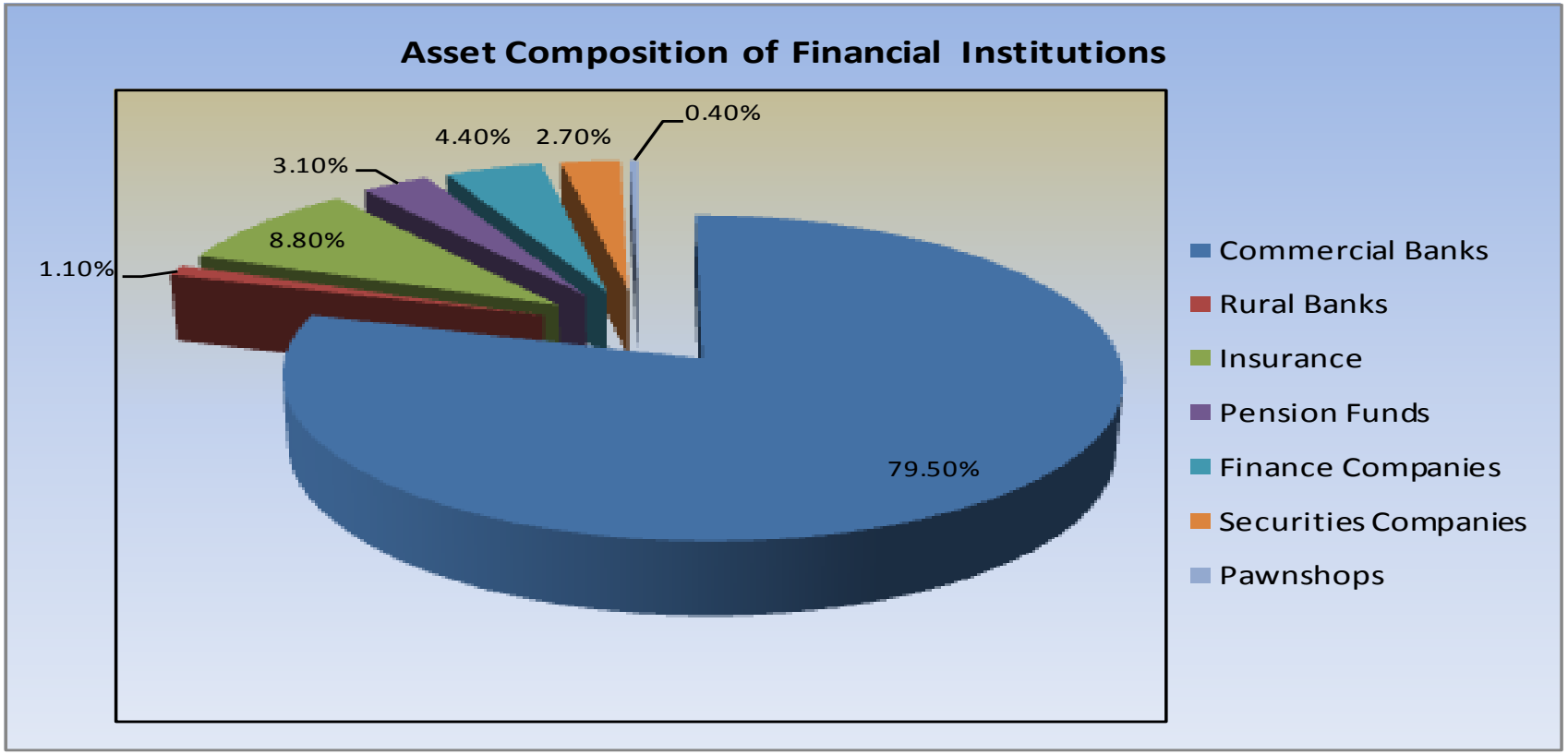
Geneva, June 2012

Agenda

1. **Indonesia's Experience**
2. Challenges Facing Indonesia's Banking/Financial Sectors
3. Conclusions

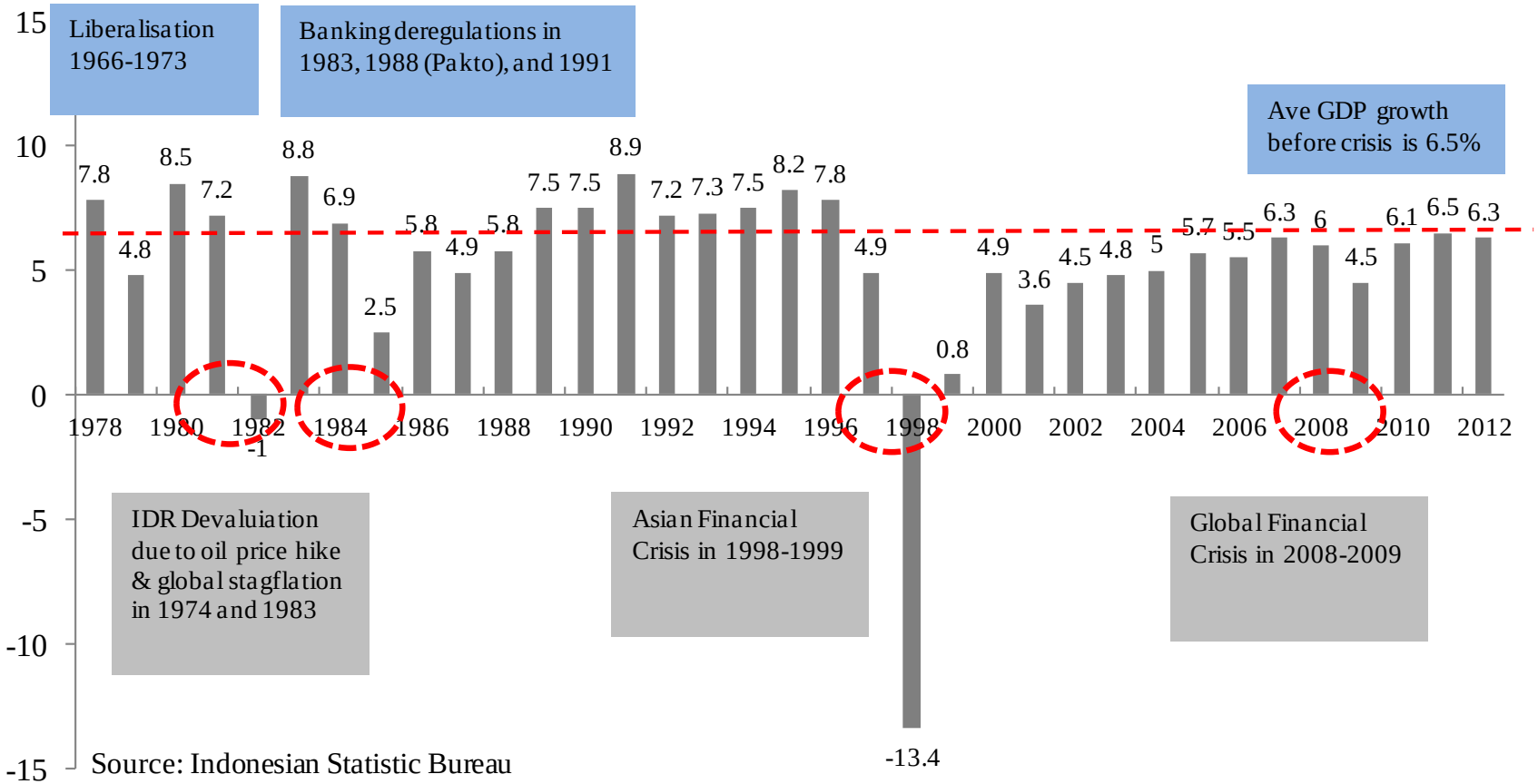
Appendix

Indonesia's Financial Sector



Indonesia is a bank-based financial system (79.5% is the share of bank's asset). There are 121 banks with 13.453 offices. 14 largest banks hold 70% of the banking assets. There are 47 banks owned by foreigners with 45,8% of the share.

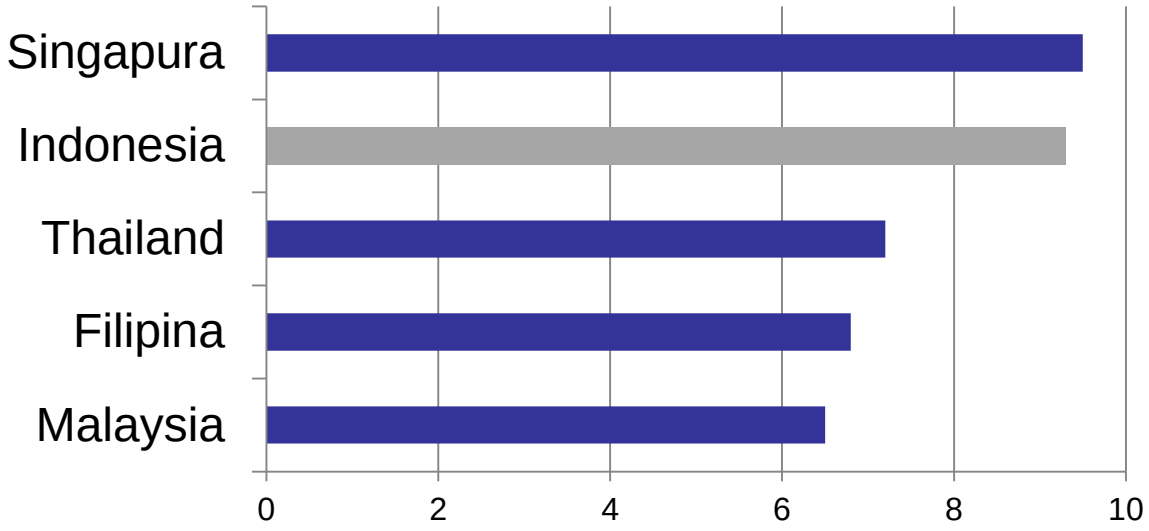
Indonesian experience: liberalisation and crisis



Crisis after financial services liberalizations. Financial liberalization is likely to have a positive effect on growth through financial development, even if it increases financial fragility.

Comparison of Banking Liberalization in ASEAN

Level of Banking liberalization in ASEAN 5



Indonesia has relatively liberalized banking markets compared to other ASEAN countries.

Country	License	Min. Capital (USD mil)	Foreign Equity Participation	Hosting bank from ASEAN	Restriction
INDONESIA	Single	334	99%	7 banks	No
SINGAPORE	Multiple	1,200	>10% need MAS approval	9 banks	Branch, ATM
MALAYSIA	Multiple	600	30%	6 banks	Branch, ATM, product
THAILAND	Multiple	325	40%	6 banks	Branch, ATM
PHILLIPINES	Multiple	150	49%	4 banks	Branch, ATM

Agenda

1 Overview of Indonesia's Economic and Banking Development

2 **Challenges Facing Indonesia's Financial Sectors**

3 Conclusions

Appendix

Challenges facing Indonesia's Financial Sectors

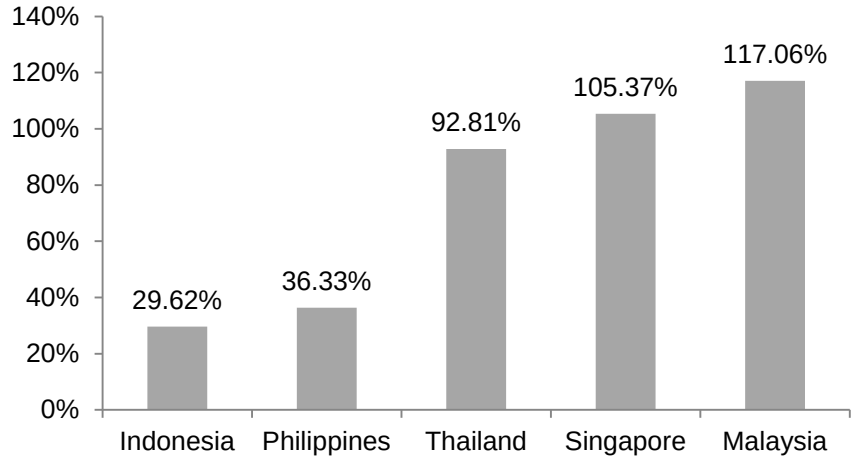
- **Mitigate the negative impacts from financial liberalization and global financial crisis.** Financial liberalization, by giving banks and other financial intermediaries more freedom of action, can increase the opportunities to take on risk, thereby increasing financial fragility. Indonesia as an open and relatively liberalized economy could be affected by the crisis via trade and financial channels. To survive, Indonesia need to develop its economy while consider its global financial reform commitments that restricted the banks and intermediation process.

- **Improve financial sector (banks) competitiveness.** Banks conduct inefficient operations (domestic and regional). Banking market is characterized by oligopoly type of market. Financial/banking services and products are relatively limited.

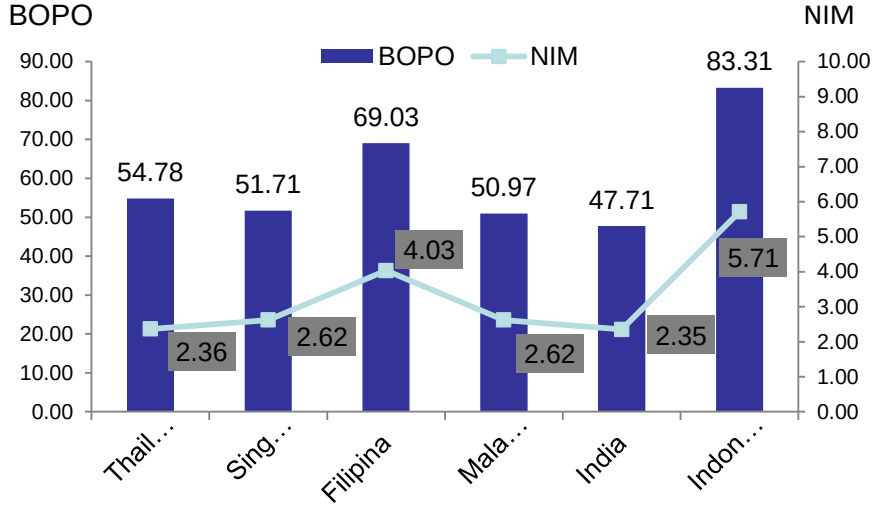
- **Enhanced access to finance for all public.** Indonesia's financial sectors are still relatively limited and concentrated in big cities. Meanwhile there has been increasing demand due to rising middle class workers.

Banking Challenges: Regional Comparison

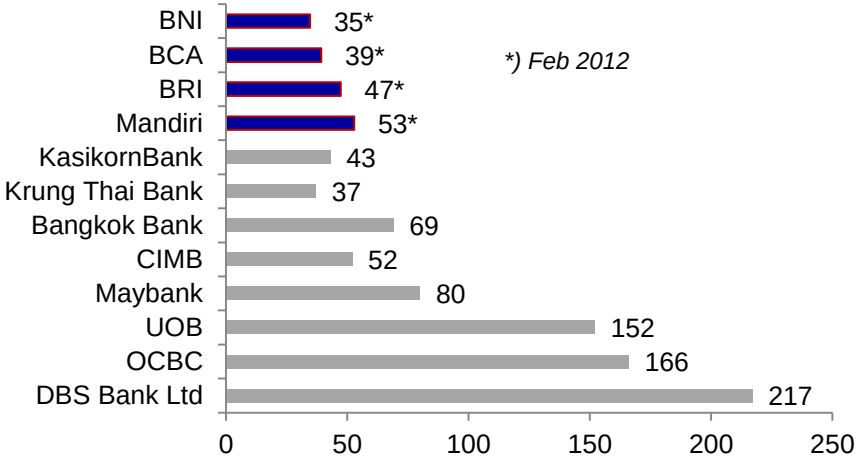
Loan to GDP ratio (December 2011)



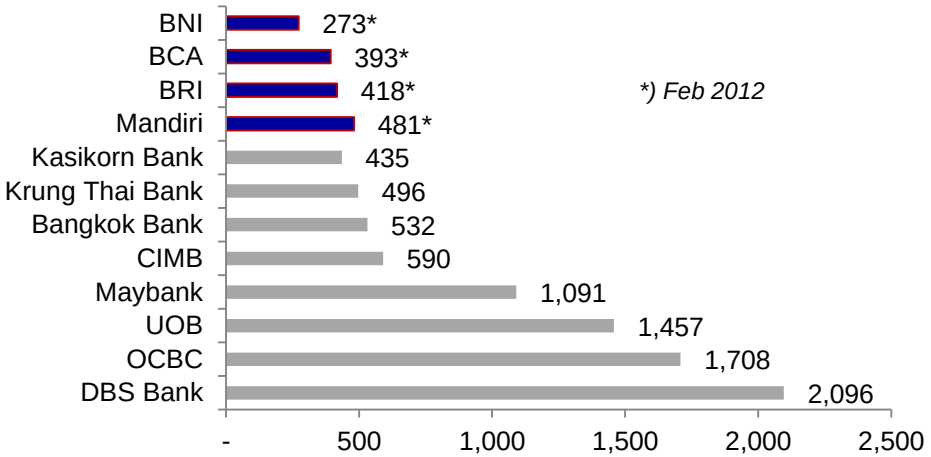
NIM & CTI ratio (Dec 2011)



Tier -1 Cap (Rp T) (Dec 2011)



Total Asset (Rp T) (Dec 2011)



Source: Central banks, IMF and Bankscope

Banking Indicators and Challenges

Banking System is sound with stable CAR, continuous credit expansion and low NPL. But some problems remains and need to be resolved.

Indicators	Dec-08	Dec-09	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11	Jan-12	Feb-12	Mar-12
Total Asset (T Rp)	**2,310.6**	**2,534.1**	**3,008.9**	**2,990.7**	**2,993.1**	**3,065.8**	**3,069.1**	**3,136.4**	**3,195.1**	**3,216.8**	**3,252.6**	**3,371.5**	**3,407.5**	**3,569.9**	**3,651.8**	**3,598.7**	**3,628.1**	**3,708.7**
Deposits (T Rp)	1,753.3	1,973.0	2,338.8	2,302.1	2,287.8	2,351.4	2,340.2	2,397.2	2,438.0	2,464.1	2,459.9	2,544.9	2,587.3	2,644.7	2,784.1	2,742.3	2,763.9	2,826.0
- Demand Deposits	430.0	465.9	535.9	530.6	529.8	540.8	528.3	561.2	577.0	567.3	524.2	580.6	596.5	616.5	652.6	645.7	624.2	656.0
- Savings Accounts	498.6	605.4	733.2	715.8	713.2	722.7	734.5	740.8	753.7	763.5	785.7	797.0	802.7	827.7	897.9	865.9	883.9	888.0
- Time Deposit	824.7	901.7	1,069.8	1,055.6	1,044.9	1,087.8	1,077.4	1,095.2	1,107.3	1,133.3	1,150.0	1,167.3	1,188.1	1,200.6	1,233.6	1,230.8	1,255.8	1,281.0
- Loans (T Rp)	1,307.7	1,437.9	1,796.0	1,776.1	1,803.9	1,844.2	1,872.6	1,918.6	1,979.6	2,002.3	2,060.8	2,108.6	2,135.5	2,180.5	2,228.5	2,189.2	2,231.7	2,294.9
Capital Adequacy Ratio (%)	**16.8**	**17.4**	**17.0**	**17.0**	**18.0**	**17.6**	**17.8**	**17.4**	**17.0**	**17.2**	**17.3**	**16.7**	**17.1**	**16.6**	**16.1**	**18.4**	**18.5**	**18.3**
NPL Gross (without channeling) (%)	**-**	**-**	**2.6**	**2.8**	**2.8**	**2.8**	**2.8**	**2.9**	**2.7**	**2.8**	**2.8**	**2.7**	**2.7**	**2.5**	**2.2**	**2.4**	**2.3**	**2.3**
Return on Assets (%)	2.3	2.6	2.7	3.0	2.8	3.1	3.0	3.0	3.1	3.0	3.0	3.1	3.1	3.1	3.0	3.7	3.4	3.1
Net Interest Margin (%)	5.7	5.6	5.7	5.6	5.5	5.9	5.8	5.8	5.8	5.8	5.9	6.0	6.0	5.9	5.9	6.1	5.4	5.2
Ops. Expense/Ops. Income (%)	88.6	86.6	80.0	83.5	80.5	77.8	78.5	78.2	80.0	81.6	80.8	79.4	79.1	79.0	81.5	91.8	77.5	
Loan to Deposit Ratio (%)*	**74.6**	**72.9**	**75.5**	**75.8**	**77.5**	**77.2**	**78.8**	**78.8**	**80.0**	**80.1**	**82.6**	**81.7**	**81.4**	**81.3**	**79.0**	**78.8**	**79.7**	**80.2**
No. of Banks	124	121	122	121	121	121	121	121	121	120	120	120	120	120	120	120	120	120

Financial stability challenges

- The case for macroprudential policy – Fills a clear gap.
  The macroprudential approach provides targeted and effective policy action. But, need to study the impact and continue develop theory and policy

- Macroprudential policy in Indonesia – An emerging framework.
  It helps to manage large capital inflow to Indonesia but important challenges remain:
  - Difficulties to identify risks early
  - Data and understanding of systemic risk and how to fight it
  - Coordination between authorities in crisis management and resolution.
  - Need a clear mandate in crisis prevention and management/resolution

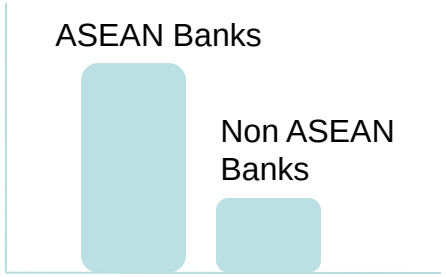
- Improving financial system – Necessary condition
  Indonesia banking sector is still developing and has incompetitive market.

ASEAN Banking Integration Framework 2020

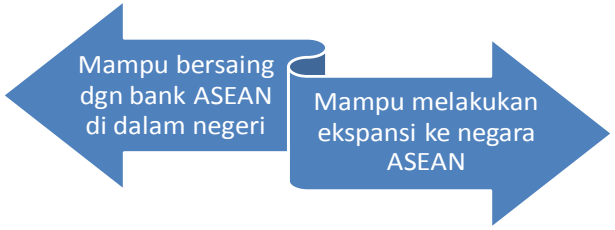
ASEAN Banking Integration Framework (ABIF)

Key Performance Indicators

- Good performance

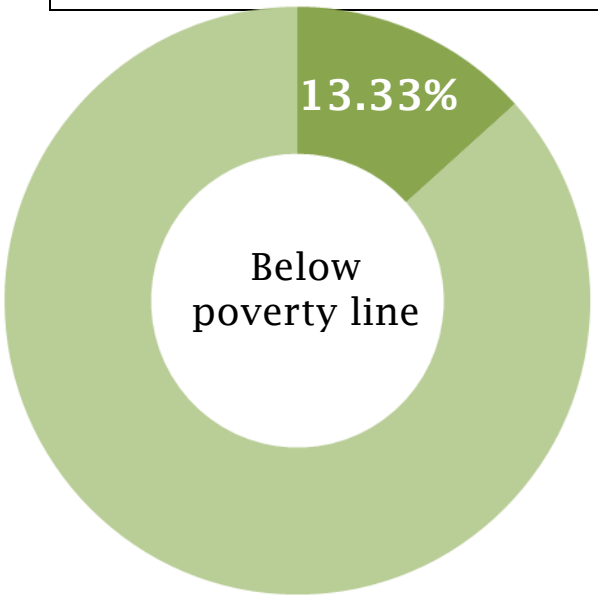


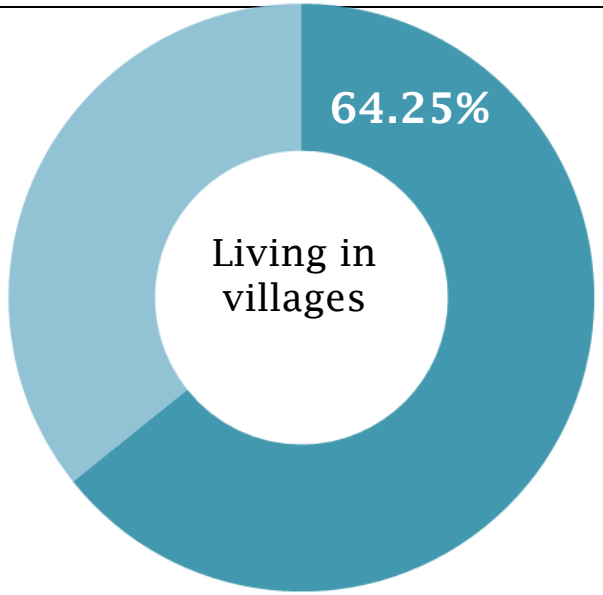
- Presence of QAB in ASEAN
- Optimal competition

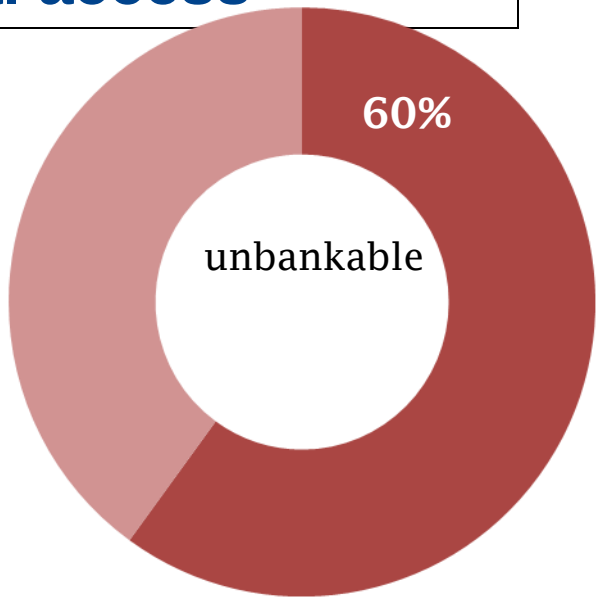


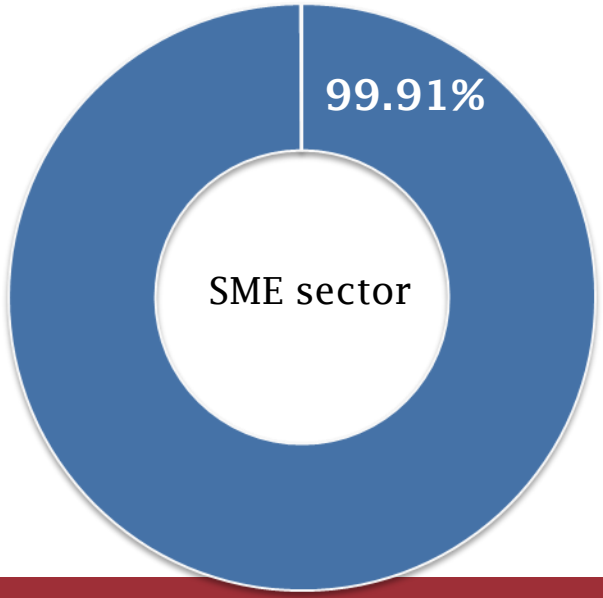
Strong and competitive banking sector

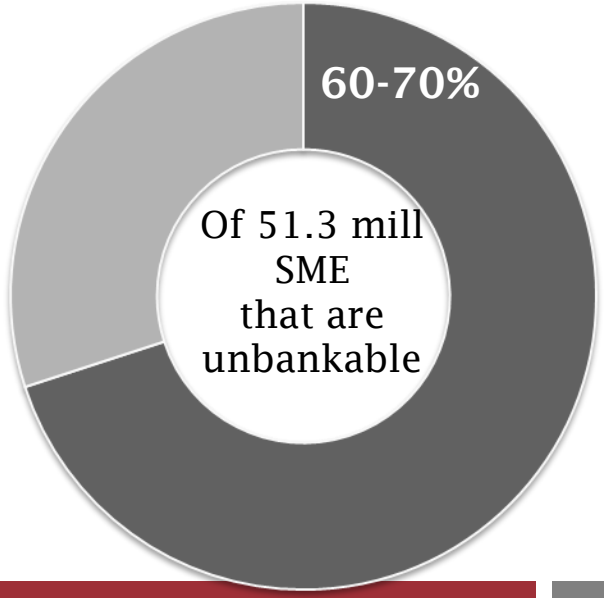
Challenges to improve financial access











Sumber : Biro Pusat Statistik dan Worldbank

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2 Challenges Facing Indonesia's Financial Sectors

3 **Conclusions**

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Summary

- **Indonesia and other countries have experienced the cycle of financial liberalization, development and crisis.** The successful financial liberalization should be supported by a sound financial stability infrastructure, good governance, and access to finance based on national characteristics. Strong institutions cannot be created overnight, more research effort should be focused on the design and implementation of prudential regulations and supervision especially in developing countries.

- **This global financial crisis adds more aspects to be considered.** There are dynamic interactions between financial liberalization, financial prudential regulation/policy, economic policy and politics. But, the most important issue is really on how we could do it gradually by considering economic development and increase international trade.

- **Next challenges are to deal with global stagnation, systemic risk/crisis and contagion effects (trade and financial).** Would implementing global commitments, macroprudential policy and strengthening financial sector be sufficient? It will need stronger commitments, discipline, sacrifice and real work to ensure that the problems are effectively solved.

Thank You

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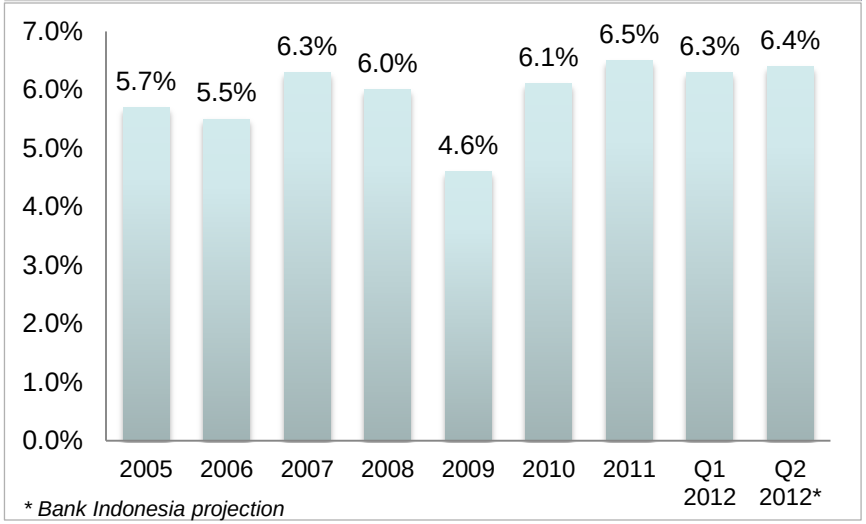
Appendixes

Map of Indonesia

This figure shows the map of Indonesia. There are 33 provinces separated in five big islands: Java, Sumatra, Kalimantan, Sulawesi (Celebes), and Irian Jaya. The capital city is Jakarta located in Java. Source: Central Intelligence Agency (2009). Available at : https://www.cia.gov/library/publications/the-world-factbook/geos/id.html.

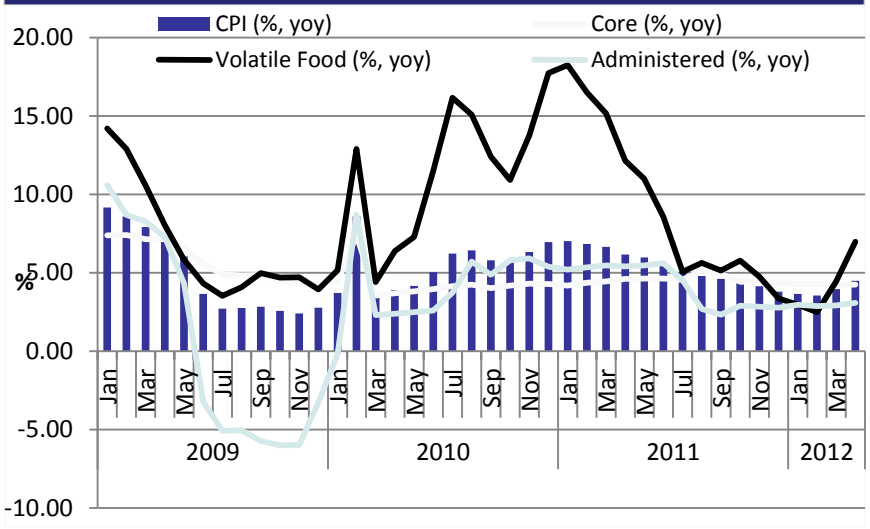
Macroeconomic indicators shows good condition

GDP Growth

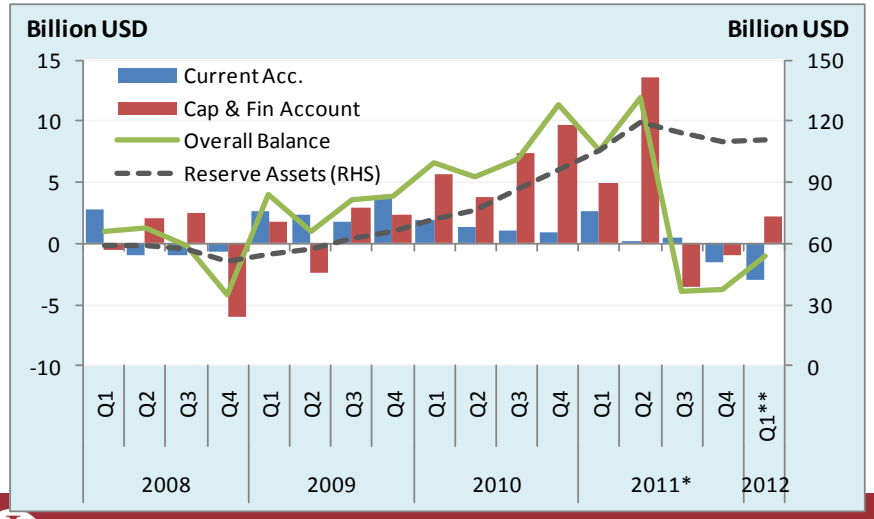


* Bank Indonesia projection

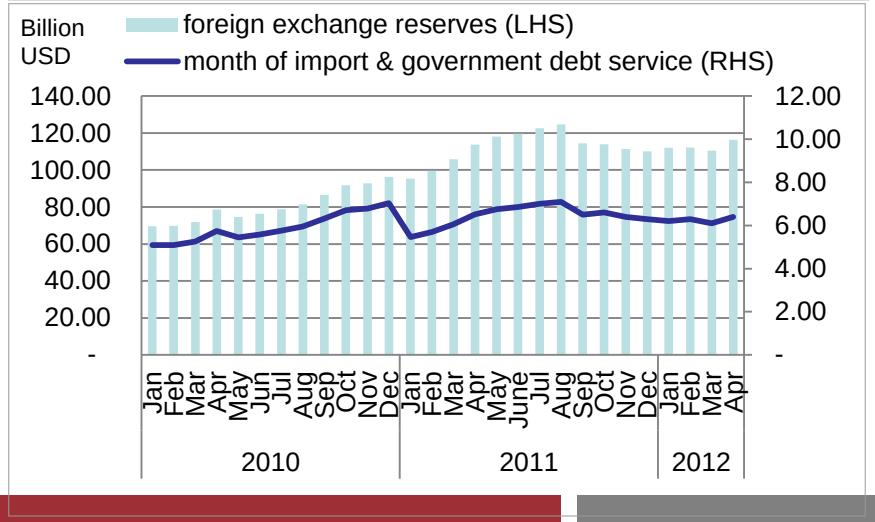
Inflation



Balance of Payments



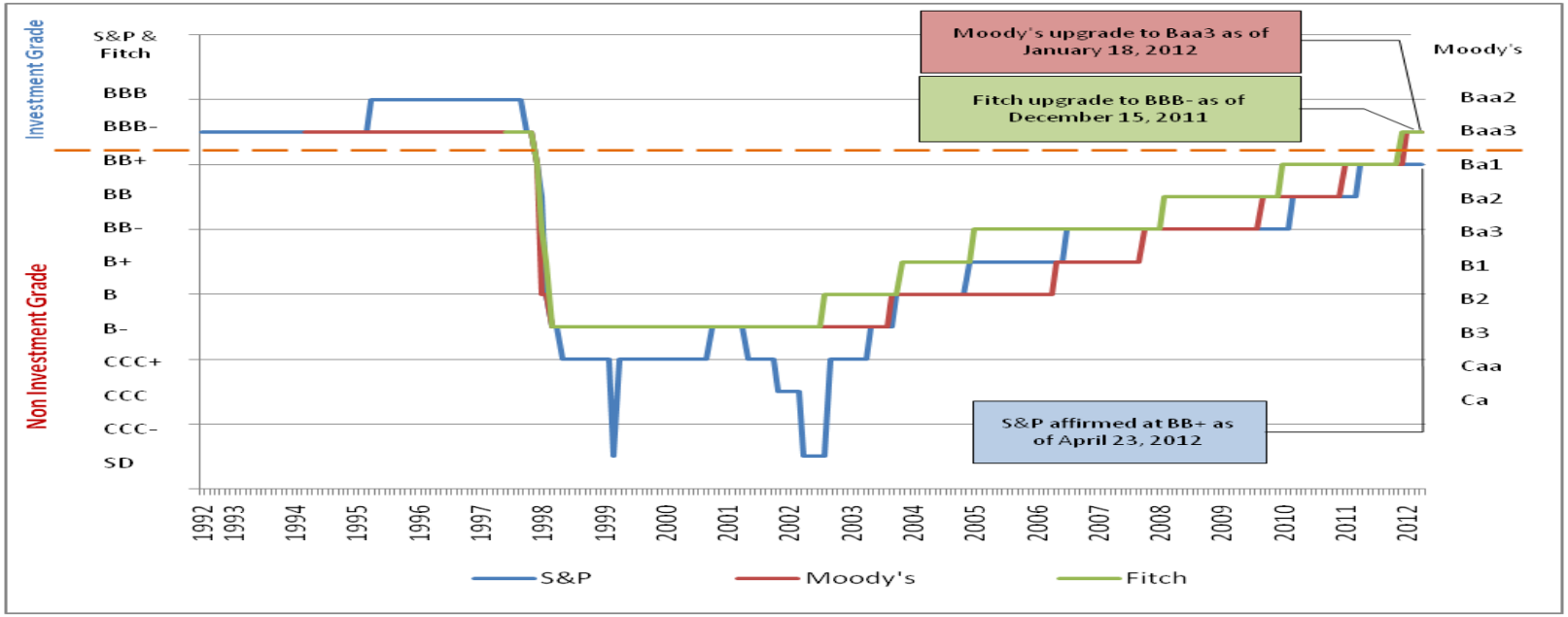
Foreign Exchange Reserves



Source: Bank Indonesia

Market view on Indonesia's condition-rating

Rating history

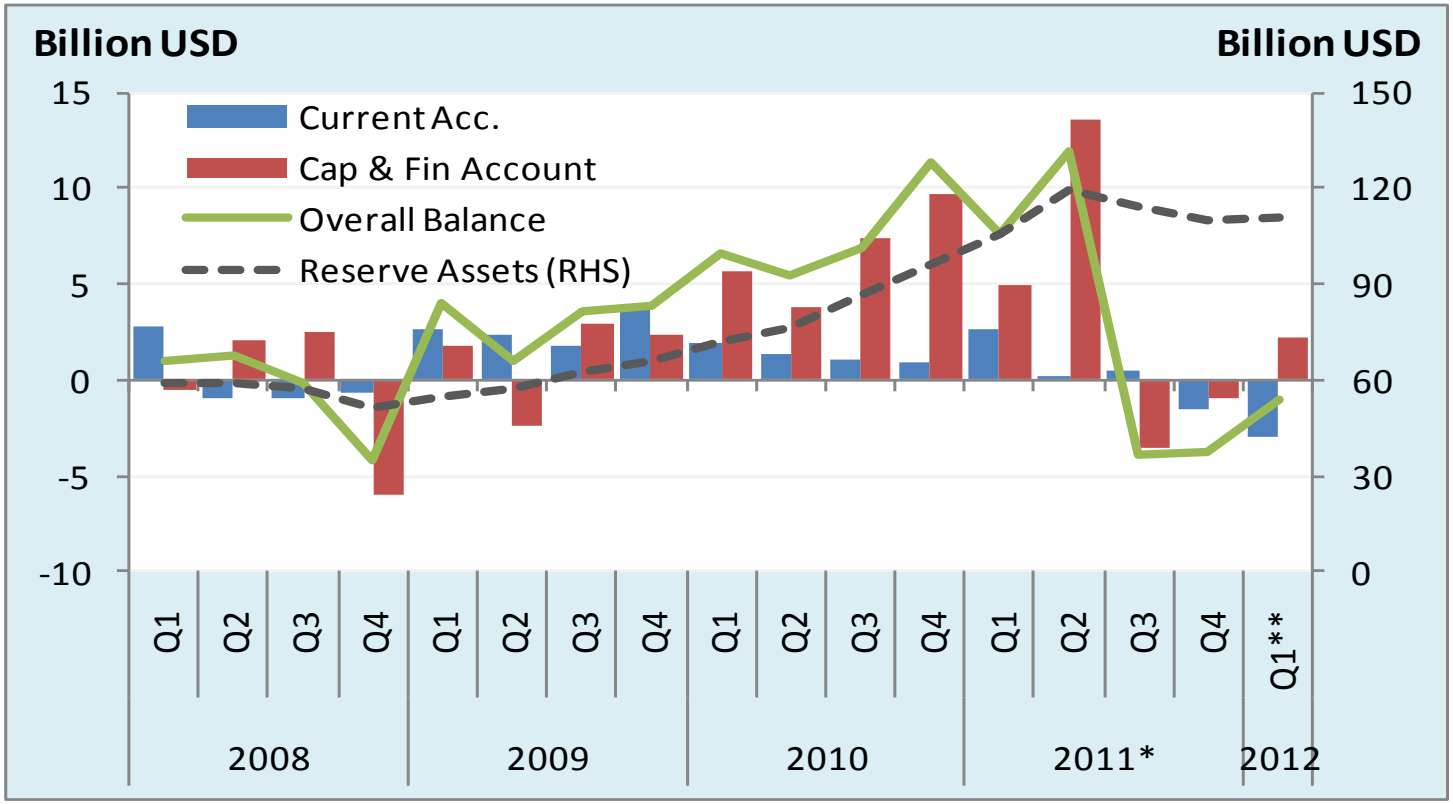


Market view on Indonesia development. After liberalization, Indonesian rating slightly improved but dropped during the financial crisis. Now, it is an investment grade.

Balance of Payments

Indonesia's Balance of Payments in Q1/2012 strengthened by recording a lower deficit of US$1.0 billion deficit compared to US$3.7 billion deficit in Q4/2012.

Balance of Payments

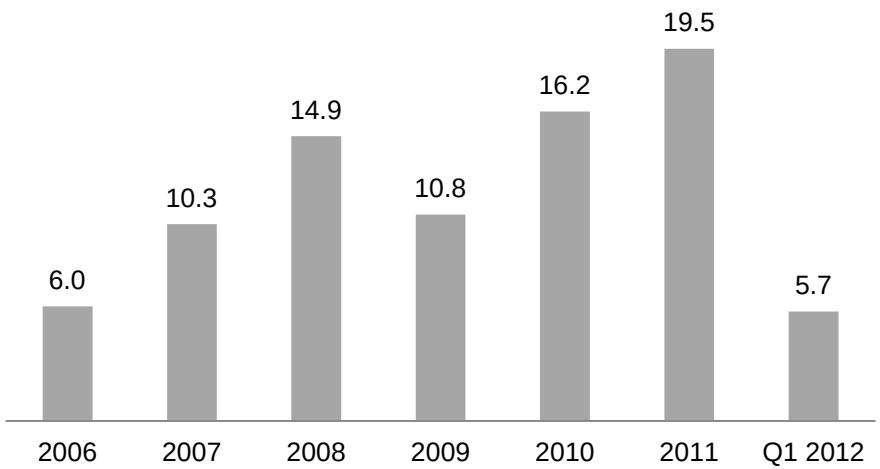


Foreign Direct Investment

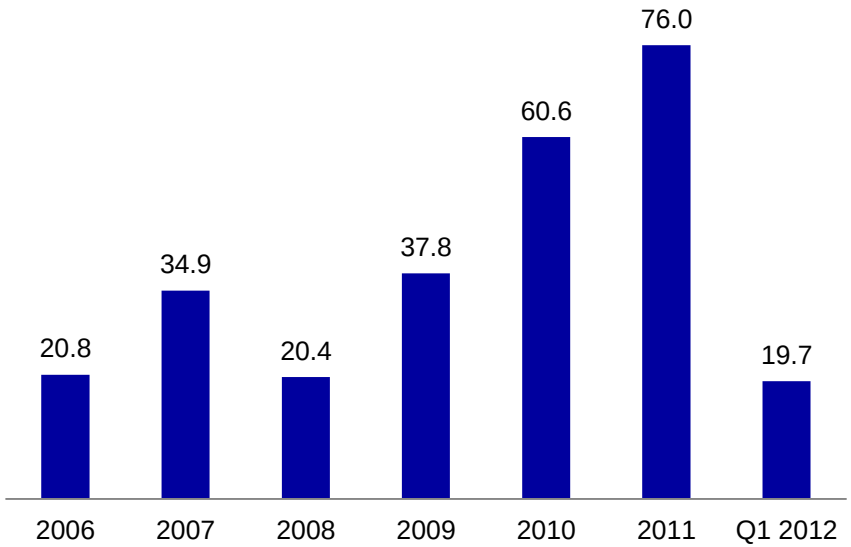
- The investment realization on Quarter 1 (January - March) of 2012 is Rp 71.2 trillion consisted of Rp 19.7 trillion of Domestic Direct Investment (PMDN) and Rp 51.5 trillion of Foreign Direct Investment (FDI). It increases 32% compared to the same period in 2011.

- Although there are some uncertainties in United States of America and European economy, the investment activities in Indonesia are doing well.

Realized foreign direct investment (USD billion)



Realized domestic direct investment (IDR trillion)



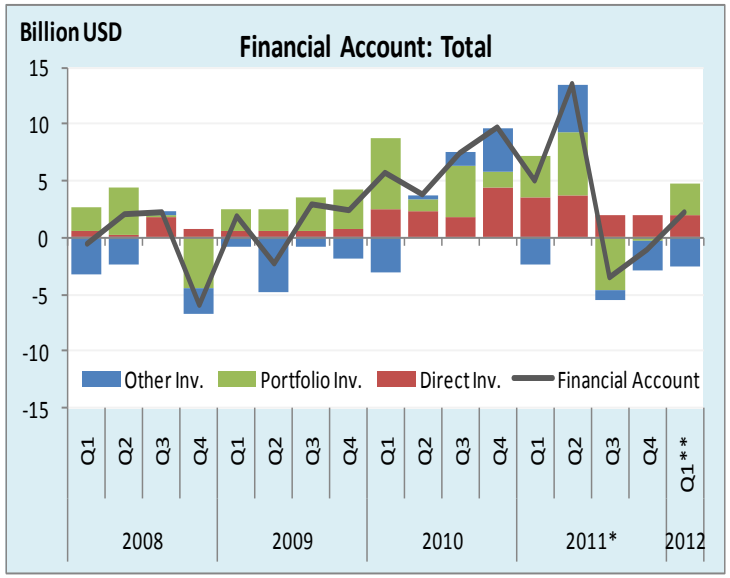
Source: BKPM

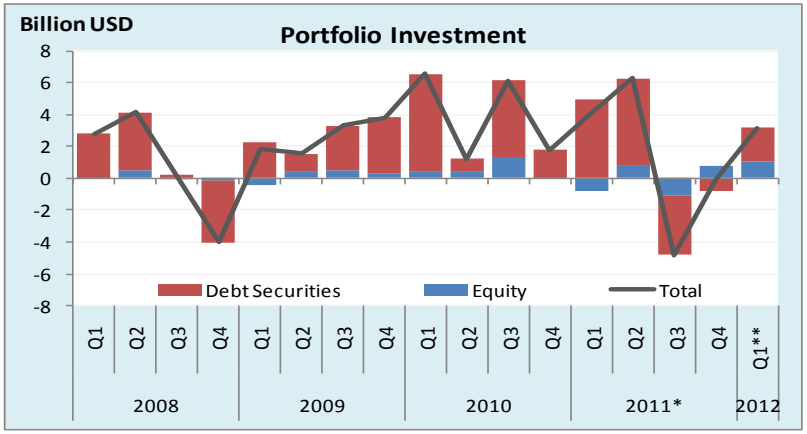
* US$ / Rp. exchange rate of 9,180, the BI middle exchange rate as of March 30, 2012.

Financial Account

Financial Account: Total

In Q1/2012, the financial account shifted to a surplus at US$2.2 billion from a deficit of US$1.0 billion in the Q4/2011. This surplus was mainly supported by purchases of foreign currency-denominated government securities, followed by purchases of stocks and private sector debt securities in line with positive market perceptions of the domestic economy.





Foreign portfolio investment recorded a surplus of US$3.2 billion in Q1/2012 after experienced net outflows in the last two quarters. Such a significant jumped up was especially due to large inflows in foreign currency-denominated government and corporate debt securities and domestic stocks.

Indonesian banks – Foreign and domestic banks

No	Type of banks	Des-00	Des-06	Des-11	Mar-12	% change bw 2000 and 2008
1	State owned banks:					
	a. Government of Republic of Indonesia	5	5	4	4	-25,0
	b. Local (provincial) governments	26	26	26	26	0,0
2	Private domestic owned banks	78	55	56	56	-39,3
3	Foreign owned banks:					
	a. Subsidiary (Joint Venture)	29	29	13	13	-123,1
	b. Branch office	10	11	10	10	0,0
4	Sharia banks	3	4	11	11	72,7
	Total	151	130	120	120	-25,8

This table shows number of banks based on different types of banks operating in Indonesia from Dec 2000 to March 2012. Various years. Source: Indonesian Banking Statistics. Bank Indonesia

Foreign and domestic banks activities

(unit IDR T)

Bank Type	Assets (% of Total)		Loans (% of Total)		Demand Deposits (% of Total)		Savings Accounts (% of Total)		Time Deposits (% of Totals)	
	Dec-00	Mar-12	Dec-00	Mar-12	Dec-00	Mar-12	Dec-00	Mar-12	Dec-00	Mar-12
State owned banks	522,4	1328,2	108,1	776,8	59,3	242,9	68,5	395,4	184,7	401,0
	50,2	36,4	38,2	35,3	37,2	37,2	44,6	44,0	48,1	32,5
Private domestic owned banks	358,3	1454,2	86,3	908,0	52,7	218,9	76,9	371,8	146,5	570,8
	34,4	39,8	30,5	41,3	33,1	33,5	50,1	41,4	38,2	46,3
Provincial government banks	26,1	304,0	10,1	175,7	10,8	88,4	4,8	67,3	4,2	79,5
	2,5	8,3	3,6	8,0	6,8	13,5	3,1	7,5	1,1	6,4
Subsidiary (JV) banks	50,2	181,1	30,4	120,4	9,8	25,2	0,4	18,4	12,5	67,3
	4,8	5,0	10,7	5,5	6,1	3,9	0,3	2,0	3,3	5,5
Foreign branch offices	82,3	268,5	46,9	136,5	26,7	67,2	2,7	18,7	35,4	55,6
	7,9	7,3	16,6	6,2	16,7	10,3	1,8	2,1	9,2	4,5
Sharia banks	1,9	116,9	1,3	82,7	0,2	10,1	0,3	26,6	0,5	59,8
	0,2	4,0	0,5	3,8	0,1	1,6	0,2	3,0	0,1	4,8
Total	1041,2	3652,8	283,1	2200,1	159,5	652,6	153,6	898,3	383,8	1234,0

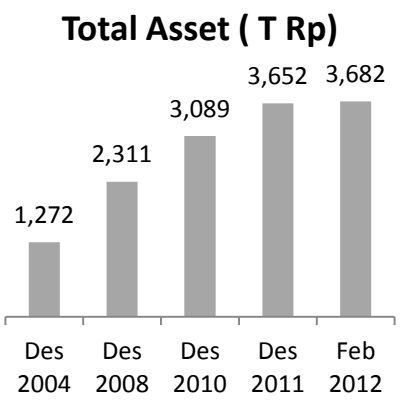
This table presents market share of Indonesian banks in December 2000 and March 2012. Source: Bank Indonesia. December 2000 and March 2012. Indonesian Banking Statistics.

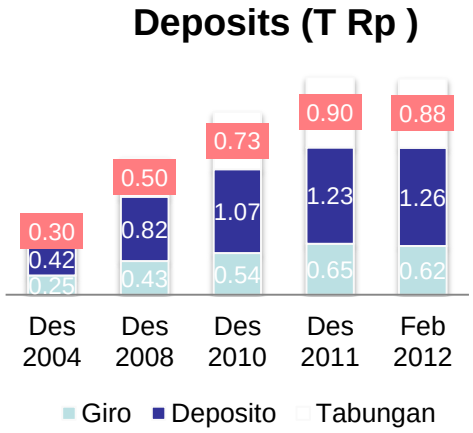
Banking market competition

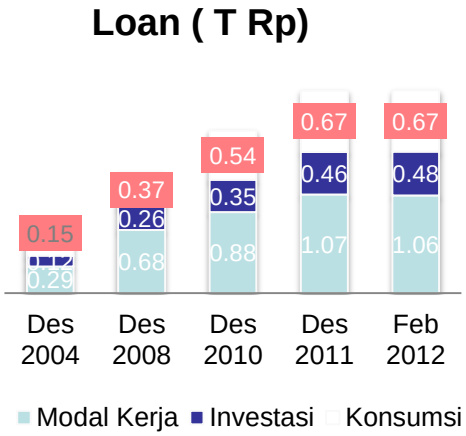
Variables	All		Metropolitan Area		Java & Sumatra		The Periphery	
	Dependent Variable: Total revenue							
	Coefficient	*P-value*	Coefficient	*P-value*	Coefficient	*P-value*	Coefficient	*P-value*
	(1)		(2)		(3)		(4)	
Lagged total revenue	-0.022	0.000	-0.319	0.000	0.012	0.000	-0.006	0.848
Fixed asset cost	0.050	0.000	0.107	0.002	0.100	0.000	0.030	0.000
Labor cost	0.304	0.000	0.184	0.007	0.180	0.000	0.218	0.000
Wholesale funding cost	0.102	0.000	0.113	0.120	0.336	0.003	0.274	0.042
Total Deposit	0.695	0.000	0.429	0.000	0.706	0.000	0.892	0.000
Time	0.124	0.000	-0.213	0.000	0.155	0.000	-0.019	0.719
Number of obs	4,366		323		1,111		1,172	
Number of banks	132		54		55		41	
H-stat	**0.45**		**0.31**		**0.62**		**0.52**	
F-statistics for H=0	7379.6	0.000	11.91	0.000	31.02	0.000	10.15	0.000
F-statistics for H=1	11430.3	0.000	61.09	0.000	11.27	0.000	8.75	0.000
AR(2) *p-value*	0.655		0.664		0.753		0.542	
Sargan -Hansen, *p-value*	1.0		1.0		1.0		1.0	

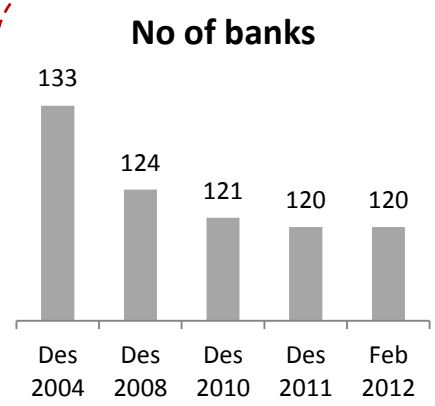
This table shows the result of Panzar-Rosse (1987) using Two steps Generalized Method of Moment (Arellano Bond, 1991) with robust standard errors. The dependent variable is total revenue. The set of explanatory variables are fixed asset cost, labor cost, wholesale funding cost, bank's deposit market. All variables are in logarithmic value. AR(2) is the p-value for the test for 2nd-order autocorrelation in the residuals. Sargan is the p-value for the Sargan test for the validity of the over-identifying restrictions. Hansen J the p-value for the Hansen test for the validity of the over-identifying restrictions. Metropolitan area is Jakarta, Banten and West Java that is most populated and active banking market. Java and Sumatra is provinces in Java and Sumatra islands excluding Jakarta, Banten and West Java. The Periphery is other provinces that are less populated and less active banking markets (See section 3.2 for further details).

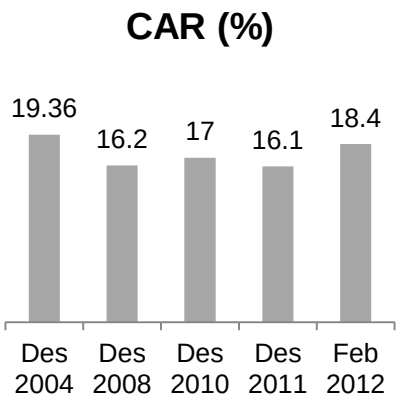
Banking performance is also positive

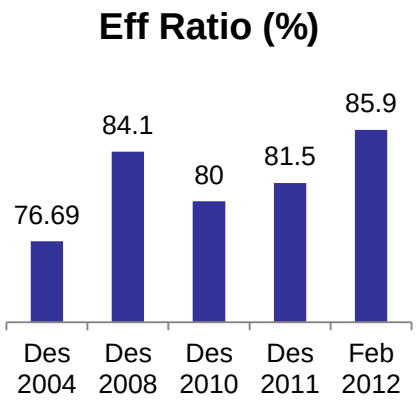


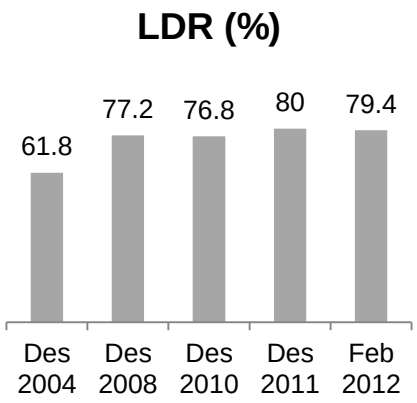


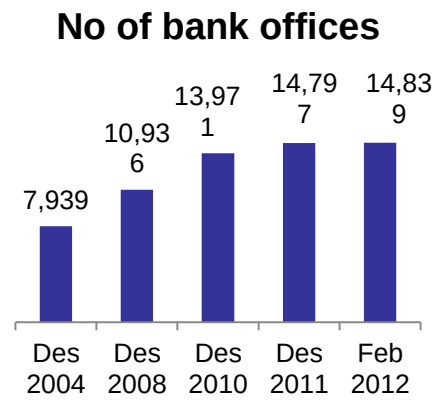








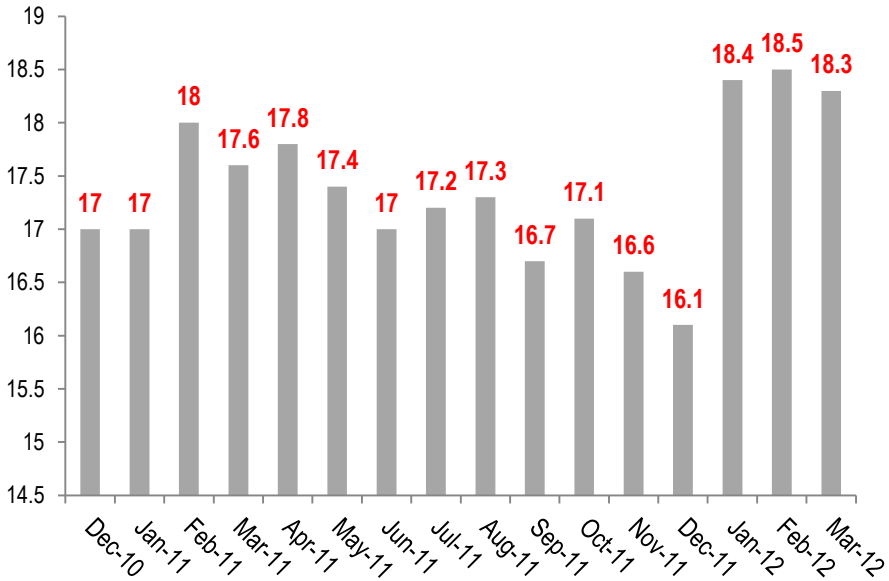




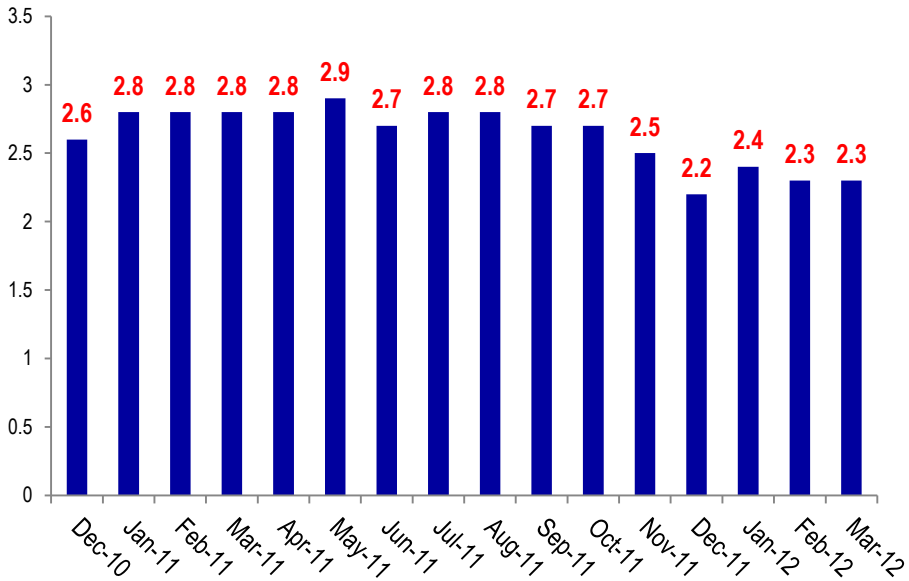
Sound Financial Sector

Stability in the banking system remains firm alongside steady improvement in credit growth

Sufficient CAR (%)



Sound level of NPLs (%)



Global Financial Sector Reform- G20's Committments

1. Improving bank capital and liquidity standards
2. Addressing systemically important financial institutions (SIFIs)
3. Expanding and refining the regulatory perimeter
4. Improving the OTC and Commodity Derivatives Markets
5. Developing macro-prudential frameworks and tools
6. Strengthening and converging accounting standards
7. Strengthening adherence to international supervisory and regulatory standards
8. Other issues

- Implementation of Basel III and strenghtened bank risk management
- Methodology to supervise SIFIs
- *Shadow banking, hedge funds, securitization*
- OTC *derivatives' standard contract*, CCP, etc
- R*egulatory system revision*, *macro prudential policy frameworks*, *Early Warning Exercise* (EWE)
- Accounting standard convergence under the IASB and FASB in many fronts
- FSAP, international standard, peer review, etc
- EMDEs, *consumer finance protection*, *credit rating agencies*, etc

Global financial sector reform: Basel III

	2012	2013	2014	2015	2016	2017	2018	2019
BASEL II (Pillar 1, Pillar 2, Pillar 3)	Issue regulations							
BASEL III CAPITAL								
Minimum Total Capital		8,0	8,0	8,0	8,0	8,0	8,0	8,0
Minimum Total Capital + Conservation Buffer		8,0	8,0	8,0	8,625	9,25	9,875	10,5
Capital Instruments excl from Tier 1 and Tier 2		Phased Out gradually 10 years from 2013 to 2023 or early redemption date before 2023						
Countercyclical Cap Buffer					Maximum 2,5			

Financial Stability Policy-
Macroprudential policy in Indonesia

- Bank Indonesia has the mandate to conduct macroprudential policy. (Indonesia FSA Act, article 40). This mandate will also be stated in Bank Indonesia Act.

- In a crisis management, there is Financial Stability Coordination Committee (FSCC) (Indonesia FSA Act. Article 44)

- Members of the FSCC:
  - Minister of Finance
  - Governor of Bank Indonesia
  - Head of Board of Commisioner of Financial Services Authority
  - Head of Board of Commisioner of Indonesia Deposit Insurance Agency
- Financial safety nets arrangement will be regulated in the Indonesian Financial Safety Nets Act

Financial stability issues-
Macroprudential Policies for Managing Capital Flows

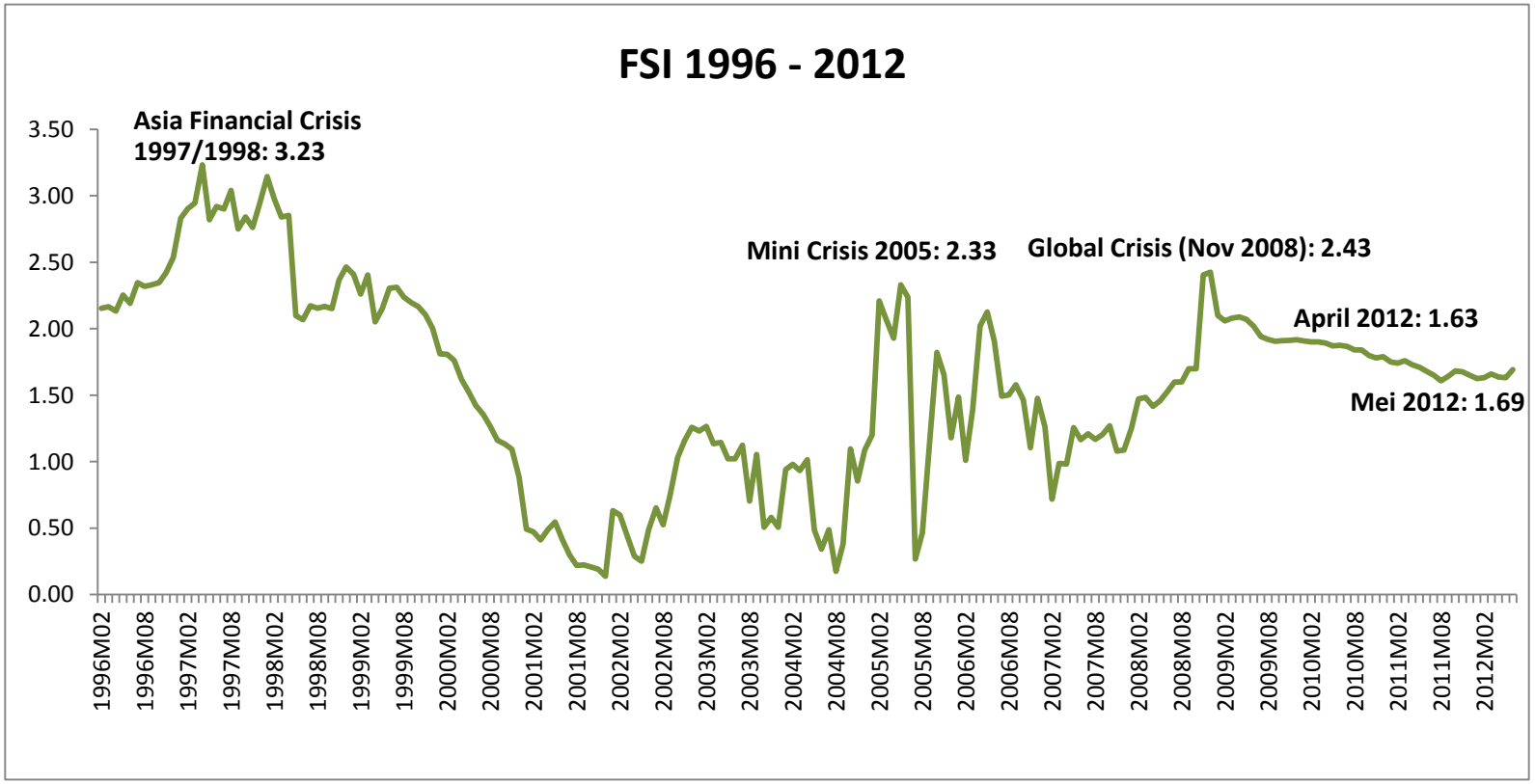
The Measures	Objectives
• **Minimum Holding Period** on BI bills, 1 month holding period (June 2010) and 6 month holding (May 2011)	• To "put sand in the wheels" on short-term and speculative capital inflows, and mitigate risks of sudden reversals.
Reinstate **limits on short-term offshore borrowing** of the banks • Maximum of 30% of capital • Effective end January 2011	• To limit the short-term and volatile capital inflows. • To limit FX exposure of the banking system stemming from capital inflows.
Increase **FX reserve requirements** of the banks from 1% of FX deposits to: • 5% effective March 2011 • 8% effective June 2011	• To strengthen FX liquidity management, thereby the resilience, of the banking system in facing increasing FX exposure stemming from capital inflows • Helps absorb domestic liquidity.

Financial Stability Policy-
Macroprudential Policies for Managing Domestic Liquidity & Credit Overheat

The Measures	Objectives
• Lengthen (from weekly to monthly) auction and offer longer maturity (3, 6, 9 months) of BI bills since June 2010.	• To enhance the effectiveness of domestic liquidity management, including from capital inflows, by locking up to longer term and helsp develop domestic financial markets.
• Increase **Rupiah reserve requirement** from 5% to 8%, effective Nov 2010.	• To absorb domestic liquidity and enhance liquidity management of the banks, without exerting negative impact on lendings that are needed to stimulate growth.

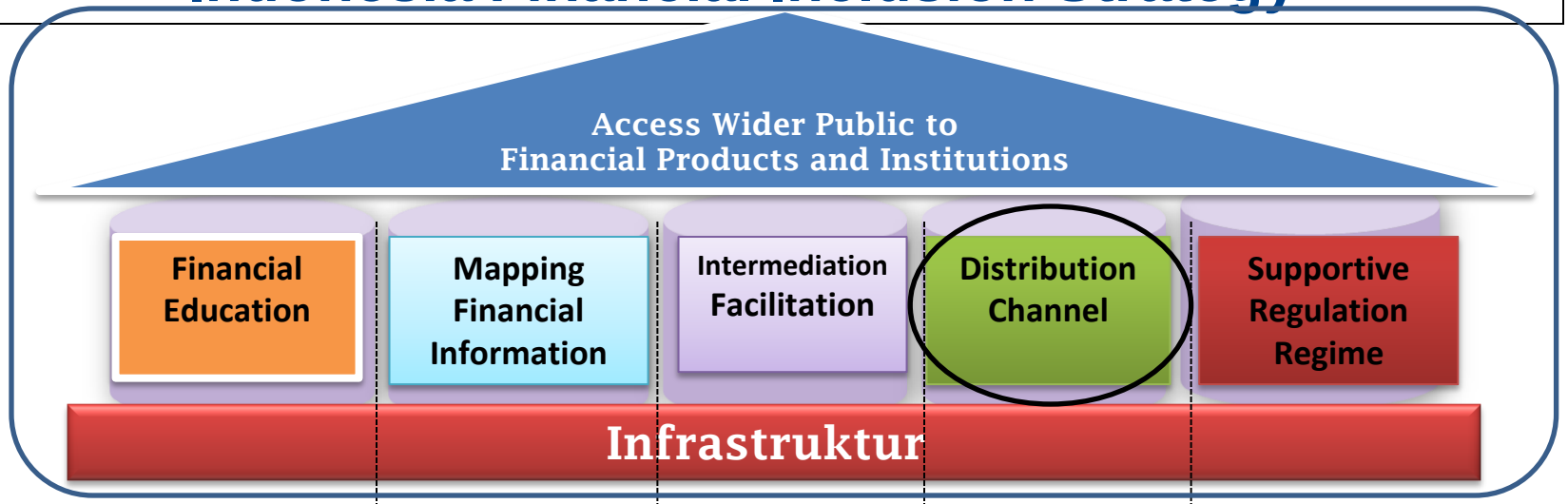
The Measures	Objectives
• Implement Loan to Value Ratio (LTV) for mortgage and Down Payment for Automotive loans since June 2012.	• To reduce excessive growth of specific consumptions loans (housing and automotive) and mitigate increasing credit risk in banking sector.

Financial Stability Condition



Overall Indonesian Financial System has been relatively stable since global crisis in 2007-08

Indonesia Financial Inclusion Strategy



- Curriculum (Elementary-Junior High School)
- Education for Indonesian workers to work in abroad

- Financial identification number
- Household Survey

- Bazaar intermediation
- Workshop on entrepreneurship
- My saving program

- Branchless banking
- Mobile banking

- Research
- benchmarking
- consultancy
- seminar
- focus group discussion

- KYC
- Agent