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BANK SENTRAL REPUBLIK INDONESIA

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No.34, March 2020

# STRENGTHENING ACCOMMODATIVE MACROPRUDENTIAL POLICY SUPPORTING ECONOMIC FINANCING

# Strengthening Accommodative Macroprudential Policy Supporting Economic Financing

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MACROPRUDENTIAL POLICY DEPARTMENT

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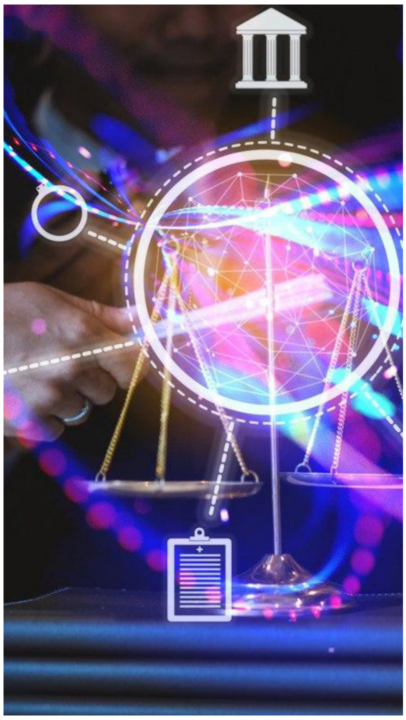



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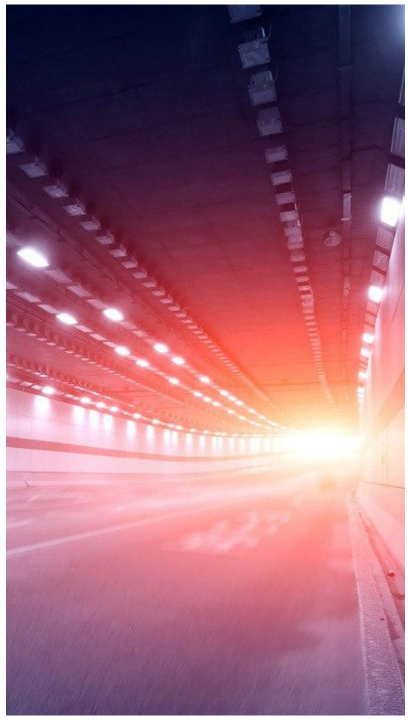
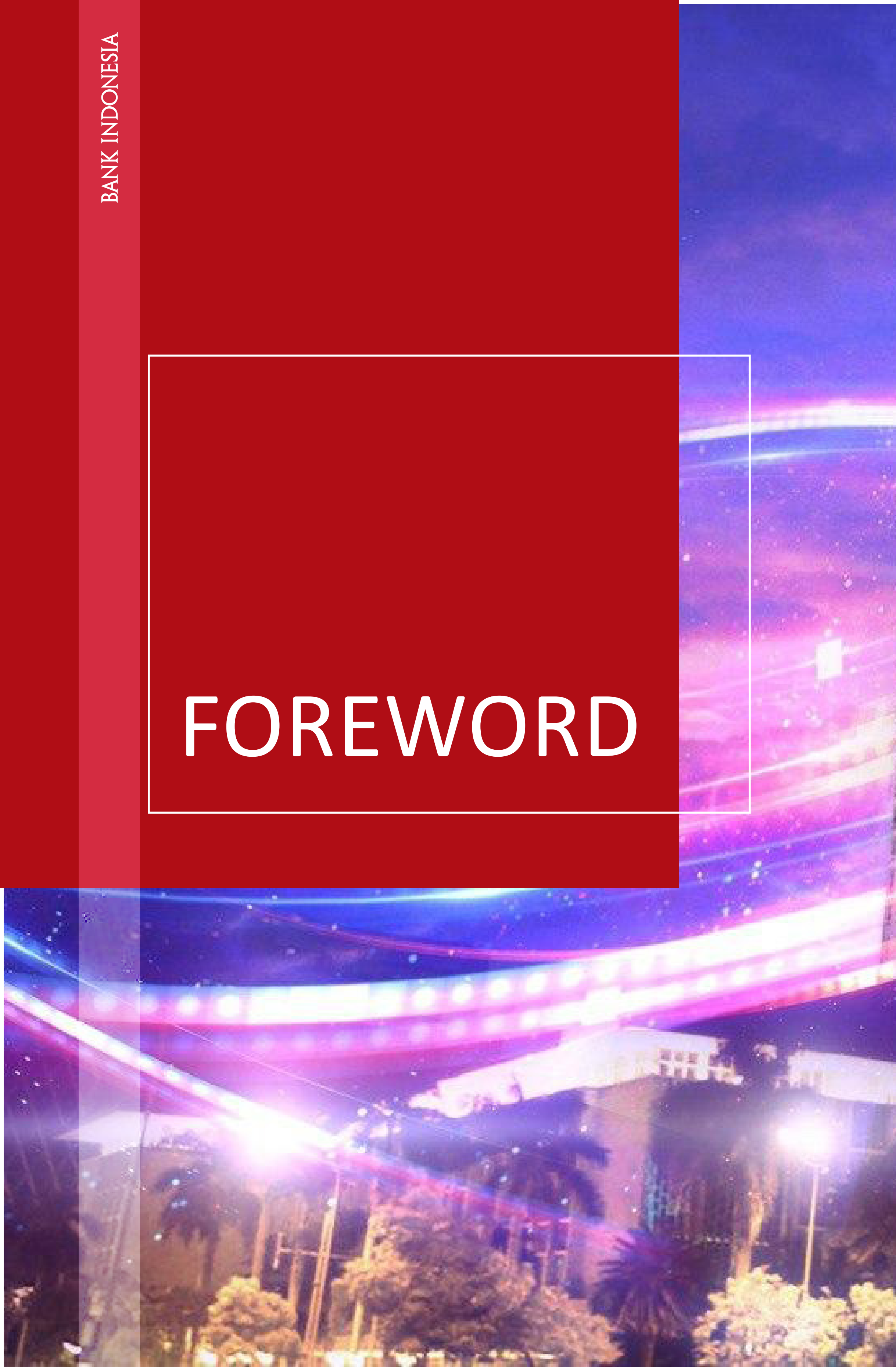


# GLOSSARY

| | |
|---|---|
| AL | : Liquid Assets |
| API | : Application Program Interface |
| AS | : United States |
| ATMR | : Risk-Weighted Assets (RWA) |
| BAPPEBTI | : Commodity Futures Trading Regulatory |
| BCBS | : Basel Committee on Banking Supervision |
| BEI | : Indonesia Stock Exchange (IDX) |
| BI-7DRR | : BI 7-Day (Reverse) Repo Rate |
| Bps | : Basis Point |
| BUK | : Conventional Commercial Bank |
| BUMN | : State-Owned Enterprise |
| BUS | : Islamic Bank |
| CA | : Current Assets |
| CAR | : Capital Adequacy Ratio |
| CCyB | : Countercyclical Capital Buffer |
| CCP | : Central Counterparty |
| CDS | : Credit Default Swap |
| CeBM | : Central Bank Money |
| CFM | : Capital Flow Management |
| CI | : Concordance Index |
| CL | : Current Liabilities |
| COVID-19 | : Coronavirus Disease 2019 |
| CPO | : Crude Palm Oil |
| CPR | : Country Peer Review |
| DAR | : Debt at Risk |
| DNDF | : Domestic Non-Deliverable Forwards |
| DPK | : Deposits |
| DSR | : Debt Service Ratio |
| DQM | : Data Quality Management |
| ECB | : European Central Bank |
| EM | : Emerging Market |
| EPU | : Economic Policy Uncertainty |
| EMEAP | : Executives' Meeting in East Asia Pacific |
| ETP | : Electronic Trading Platform |
| FASBI | : Financial Account and Balance Sheet Indonesia |
| FFR | : Federal Funds Rate |
| FMI | : Financial Market Infrastructure |
| FKMM | : Macro and Micro Coordination Forum |
| FSAP | : Financial Sector Assessment Program |
| FSB | : Financial Stability Board |
| FTV | : Financing-to-Value Ratio |
| GWM | : Reserve Requirements |
| HPP | : Cost of Goods Manufactured |
| ICR | : Interest Coverage Ratio |
| IDMA | : Inter-Dealer Market Association |
| IHPR | : Residential Property Price Index (RPPI) |
| IHSG | : Jakarta Composite Index (JCI) |
| IKK | : Consumer Confidence Index (CCI) |
| IKNB | : Nonbank Financial Institution |
| ILS | : Lending Standard Index (LSI) |
| IMF | : International Monetary Fund |
| IPO | : Initial Public Offering |
| ISEI | : Indonesian Economist Association (ISEI) |
| ISSK | : Financial System Stability Index (FSSI) |
| JST | : Joint Stress Test |
| KI | : Investment Loan |
| KK | : Consumer Loan |
| KKB | : Automotive Loan |
| KMK | : Working Capital Loan |
| KPPK | : Application of Prudential Principles |
| KPR | : Housing Loan |
| KP/PP | : Property Loan/Financing |
| KSEI | : Indonesian Central Securities Depository (KSEI) |
| KSK | : Financial Stability Review (FSR) |
| KSSK | : Financial System Stability Committee |
| LA | : Long-Term Assets |
| LaR | : Loan at Risk |
| LBU | : Monthly Commercial Bank Report |
| LBBU | : Periodic Commercial Bank Report |
| LBBUS | : Periodic Islamic Bank Report |
| LBBPR | : Monthly Rural Bank Report |
| LBBPRS | : Monthly Islamic Rural Bank Report |
| LCR | : Liquidity Coverage Ratio |
| LDR | : Loan-to-Deposit Ratio |
| LGA | : Electricity, Gas and Water |
| LHBU | : Daily Commercial Bank Report |
| LN | : Foreign |
| LPR | : Loan Prime Rate |
| LPS | : Deposit Insurance Corporation |
| LST | : Environmental, Social and Governance |
| LTV | : Loan-to-Value Ratio |
| MFT | : Managed File Transfer |
| MLF | : Medium-Term Lending Facility Rate |
| MTN | : Medium-Term Notes |

| | |
|---|---|
| NDC | : Nationally Determined Contribution |
| NFL | : Net Foreign Liabilities |
| NGFS | : Network for Greening the Financial System |
| NIM | : Net Interest Margin |
| NK | : Memorandum of Understanding (MoU) |
| NPL | : Non-Performing Loan |
| NSFR | : Net Stable Funding Ratio |
| OJK | : Indonesian Financial Services Authority |
| OM | : Monetary Operations |
| OTC | : Over the Counter |
| PACC | : Paris Agreement on Climate Change |
| PADG | : Board of Governors Regulation |
| PAPI | : Indonesian Banking Accounting Guidelines |
| PBI | : Bank Indonesia Regulation |
| PBoC | : People's Bank of China |
| PBR | : Plowback Ratio |
| PCA | : Principal Component Analysis |
| PCC | : Pair Copula Construction |
| PIC | : Person in Charge |
| PD | : Probability of Default |
| PDB | : Gross Domestic Product (GDP) |
| PJSP | : Payment System Service Providers |
| PLM | : Macroprudential Liquidity Buffer (MPLB) |
| PMI | : Purchasing Managers Index |
| PMK | : Crisis Management Protocol (CMP) |
| PNM | : Permodalan Nasional Madani (Persero) |
| PP | : Finance Company |
| PUT | : Limited Public Offering |
| QE | : Quantitative Easing |
| RIM | : Macroprudential Intermediation Ratio (MIR) |
| RSE | : Draft Circular Letter |
| RT | : Household |
| SAPIT | : Integrated Information Repository and Exchange |
| SBN | : Tradeable Government Security |
| SCSI | : Standing Committee on Standards Implementation |
| SDGs | : Sustainable Development Goals |
| SLF | : Standing Lending Facility |
| SimKrisNas | : National Crisis Simulation |
| SIP | : Banking Information System |
| SIPP | : Finance Company Reporting Information System |
| SKI | : Indonesia Financial Cycle |
| SPBI | : Bank Indonesia Noncash Payment System |
| SSK | : Financial System Stability |
| SNRT | : Household Balance Sheet Survey |
| Sulampua | : Sulawesi, Maluku and Papua |
| SUN | : Government Debt Security |
| TA | : Total Assets |
| TBS | : Fresh Fruit Bunches (FFB) |
| TD | : Term Deposit |
| TLTRO | : Target Longer-Term Refinancing Operation |
| UE | : European Union |
| ULN | : External Debt |
| UMKM | : Micro, Small and Medium Enterprises (MSME) |
| UNFCC | : United Nations Framework Convention on Climate Change |
| UU PPKSK | : Financial System Crisis Prevention and Mitigation Act |
| UUS | : Islamic Business Unit |
| VIX | : Volatility Index |
| WHO | : World Health Organisation |
| YOY | : Year on Year |

# FOREWORD



# GOVERNOR'S FOREWORD

The 34nd edition of the Financial Stability Review (FSR), March 2020 presents Bank Indonesia's latest research and assessments as the macroprudential regulatory and supervisory authority conducted throughout 2019 and up to March 2020 as a signal of macrofinancial risks and a risk mitigation reference. FSR No. 34 has been published amidst challenging conditions affecting the national economy and financial system in Indonesia, as well as businesses and households, due to transmission of the Corona Virus Disease 2019 (COVID-19), which has been declared a global pandemic. Currently, the whole world is struggling to break the chain of transmission of COVID-19 as well as mitigate the impact on the economy and financial system. As a form of support Bank Indonesia for the government efforts to delay the transfer COVID-19 in the community through various policy measures, Bank Indonesia has decided to launch FSR No. 34 virtually through Bank Indonesia's own YouTube channel as well as other online media.

FSR No. 34 is entitled “Strengthening Accommodative Macroprudential Policy, Supporting Economic Financing”. Financial system stability was maintained in Indonesia throughout 2019 amidst global economic and financial dynamics. Anti-globalisation sentiment, increasing global financial market risk and the emergence of new unknown risks are the salient challenges facing Indonesia's financial system. Economic moderation caused by the trade war between the United States and China as well as geopolitical risks have suppressed corporate and household performance and, thus, intensified financing risks and undermined intermediation. Against a backdrop of heightened risk and a suboptimal financial cycle, Bank Indonesia directed macroprudential policy in 2019 towards stimulating economic financing, while complying with prudential principles as part of the Bank Indonesia policy mix.

Transmission of the COVID-19 pandemic around the world, including Indonesia, at the beginning of 2020 has impeded the global and domestic macrofinancial recovery. Global contagion from COVID-19 has impacted Indonesia primarily through tourism, trade/exports and investment. Meanwhile, efforts to break the COVID-19 chain of transmission have the potential to reduce domestic production and economic activity. If the COVID-19 pandemic continues, pressure on Indonesia's financial system will become more intense and prolonged.

Moving forward, the macroprudential policy stance of Bank Indonesia will be focused on efforts to maintain financial system stability by anticipating the potentially higher risk in a financial sector affected by the spread of COVID-19. Coordination with the Government and other relevant financial authorities will constantly be improved in terms of policy mix formulation and mitigating risk increases in the financial system.

The front cover of this edition illustrates current macrofinancial conditions. The dark sky-blue hues denote a global financial system characterised by moderation and uncertainty. The global COVID-19 pandemic, with its economic, financial and social impacts, is depicted by the warmer red and orange colours enveloping the globe. The circular gradation portrays the non-financial shocks that have materialised into a financial crisis threat, which has manifested as a global threat demanding cross-border synergy. The wave represents Indonesia's financial cycle, which is currently suboptimal, thus affording policy room for an accommodative stance. The icons surrounding the earth signify ongoing digital disruption around the world, which is influencing financial behaviour and, on one hand, requires support due to its positive economic impact yet, on the other hand, necessitates strong regulation and supervision to ensure smooth and secure economic transactions. Finally, the bright flash is indicative of our joint optimism that macrofinancial conditions will improve after the COVID-19 pandemic has passed.

In closing, Bank Indonesia presents this book as a reference to strengthen our confidence in terms of maintaining financial system stability and supporting economic growth. May God Almighty always provide protection, health and blessings for each of our endeavours and prayers in maintaining financial system stability in Indonesia.

Jakarta, 28th April 2020

Governor of Bank Indonesia
**Perry Warjiyo**

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# EXECUTIVE SUMMARY

# EXECUTIVE SUMMARY

Financial system stability in Indonesia during the second semester of 2019 was maintained, despite persistent uncertainty due to declining globalization, increasing global financial market risk and the emergence of new unknown risks. Financial system stability was maintained on the back of solid banking industry resilience, supported by sustained profitability and contained liquidity risk, corporate and household sector resilience as well as strong policy synergy between Bank Indonesia, the Government and other relevant authorities to preserve economic growth momentum. Most corporations holding external debt have met their hedging obligations, thus helping to maintain corporate sector resilience. Trade tensions and escalating geopolitical risks have suppressed world trade volume and lowered commodity prices, leading to economic moderation in various countries. In response, central banks and government authorities have instituted an accommodative monetary policy stance, thus increasing the risk appetite of global investors towards emerging markets (EM), including Indonesia. The resultant capital inflows to Indonesia are in line with maintained domestic financial market stability as well as solid domestic economic resilience.

Global economic and financial dynamics have influenced domestic macrofinancial conditions. Decreasing world trade volume and lower international commodity prices have impaired corporate performance, yet corporate resilience in Indonesia has been maintained. Flatter sales performance has forced corporations to focus on comparative advantage, increasing efficiency and reducing debt burden in order to maintain prudential aspects. On the demand side, persistent uncertainty has prompted a wait-and-see attitude in the corporate sector, thus compressing demand for financing from domestic banks and external debt. On the supply side, risk perception in the banking industry concerning deteriorating corporate performance has increased. A bump in the Loan at Risk (LaR) ratio has triggered more cautious and selective bank lending, affecting new borrowers in particular. This combination of factors severely impaired growth of outstanding loans disbursed by the banking industry at the end of 2019 below initial predictions.

Cognisant of the domestic macrofinancial challenges in 2019, the risk build-up and suboptimal financial cycle, Bank Indonesia has strived to stimulate economic financing while complying with prudential principles. Bank Indonesia relaxed the (sharia) Macroprudential Intermediation Ratio (MIR) to 84-94% and prudently expanded bank funding, including foreign loans. Furthermore, Bank Indonesia also loosened the loan-to-value (LTV) ratio and financing-to-value (FTV) ratio by an average of 5-10% in order to drive house and vehicle ownership, including green buildings and vehicles. In addition to prudential aspects, policy to stimulate intermediation has been balanced with policy to maintain adequate capital and liquidity. Moreover, Bank Indonesia has also held the Countercyclical Buffer (CCB) and Macroprudential Liquidity Buffer (MPLB) at 0% and 4% respectively.

Moving forward, pressures on financial system stability are expected to intensify as the COVID-19 pandemic continues to spread around the world, including Indonesia, representing a grave threat to global and domestic macrofinancial stability. Global contagion from COVID-19 has impacted Indonesia primarily through tourism, trade/exports and investment. Meanwhile, efforts to break the COVID-19 chain of transmission have severely impaired domestic production and economic activity. Demand for labour has decreased, while income and consumption have been muted, which have ultimately compressed domestic demand. Heightened uncertainty has seen investors rebalance their portfolios, triggering outflows and exchange rate pressures on the rupiah. If the COVID-19 pandemic continues, pressure on corporate and household performance will intensify as the impact spreads to various sectors, which could potentially undermine the financial services industry, banking in particular.

Observing the potential accumulation of pressures on national economic and financial system stability, the President of the Republic of Indonesia took extraordinary and unconventional policy measures to rescue the national economy and maintain financial system stability as contained in Government Regulation in Lieu of Law No. 1 of 2020, which contains provisions concerning Bank Indonesia's role and jurisdiction. In addition, Bank Indonesia has also instituted a policy mix as an anticipative measure to maintain stability and strengthen economic stimuli in accordance with Bank Indonesia’s authority through commitment to synergy and coordination with the Government and Indonesian Financial Services Authority (OJK) as a national policy measure.

After the threat of COVID-19 has passed, the global economy is projected to regain upward momentum in 2021. In line with the promising global outlook and impact of the synergic policy response taken by the Government, Bank Indonesia and other relevant authorities in 2020, national economic growth in Indonesia is projected to recover and expand in the 5.2-5.6% range in 2021. Consistent with the favourable economic outlook, Bank Indonesia expects to control inflation within the 3.0%±1% target corridor. Furthermore, global and domestic economic gains will push the corporate and household sectors into an expansionary phase, which will stimulate stronger credit and third party funds growth in 2021, projected at 9-11% and 8-10% respectively.


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# Chapter I

## GLOBAL MACROECONOMIC CONDITIONS AND FINANCIAL SYSTEM STABILITY: DYNAMICS AND CHALLENGES FOR THE DOMESTIC FINANCIAL SYSTEM

Macroeconomic and financial system dynamics in Indonesia have been influenced by persistent global economic moderation and the risks associated with a global pandemic. Tension of trade wars between the United States and China and escalating geopolitical risks have reduced world trade volume and decreased commodity prices on global markets. Such conditions have also been characterised by the emergence of new unknown risks. The COVID-19 outbreak at the end of 2019, which spread rapidly to many countries, continues to threaten global macroeconomic and financial system stability.

Global economic moderation has transmitted to increased risk in global financial system. Central banks and global governments responded to these development has been an accommodative policy stance, coupled with stimulus measures. As the global pandemic exacerbated the risks, ultra-accommodative monetary and fiscal policies were introduced. On one hand, such policies eased global financial conditions yet, on the other hand, triggered search for yield (risk-taking) in emerging markets, including Indonesia, which has heightened capital flow and exchange rate volatility in developing economies.

Notwithstanding the build-up of global financial risk, financial system stability in Indonesia has been maintained. Financial system stability has been maintained in Indonesia in line with solid economic fundamentals and domestic financial system resilience, bolstered by adequate capital and liquidity in the banking system, despite intermediation still requiring attention. Nonetheless, the COVID-19 pandemic that emerged at the beginning of 2020 has amplified pressures on global macroeconomic and financial system conditions, including Indonesia, which are expected to hinder the global and domestic economic recovery process.

# Chapter II
## VULNERABILITIES

In the second semester of 2019, Indonesia's financial system was confronted four main sources of vulnerability with the potential to disrupt financial system resilience in the event of a global or domestic shock. The first vulnerability was influenced by linkages between corporate performance and global financial and macroeconomic dynamics, particularly in the affected commodity-based sectors and manufacturing industry. Corporate vulnerability in Indonesia could potentially increase if the decline of trade volume and goods exports from Indonesia that has persisted since last year continues, manifesting in a shock stemming from an unknown risk. If allowed to materialise, such a vulnerability would constitute a risk to financial system stability.

The second vulnerability emerged due to lower repayment capacity, particularly amongst corporations holding external debt. A comparatively high portion of external debt in terms of corporate financing could potentially compound market risk in the event of higher exchange rate volatility. On the other hand, additional global shocks could further suppress corporate repayment capacity. Consequently, the corporate sector is mitigating such risks through hedging activity to meet Bank Indonesia's mandatory hedging requirements for corporations holding foreign debt.

The third vulnerability stems from broad household exposure to corporate performance. External pressures on corporate performance relating to commodity exports and other impacted sectors are being transmitted to household incomes in the affected sectors. Household performance will be disrupted if the risks continue to transmit from the corporate sector and households fail to apply sound risk management principles.

The fourth vulnerability is the result of banking industry exposure to corporations and households in disrupted sectors, particularly where sectoral credit concentration is an issue. Deteriorating corporate performance in several sectors due to the impact of the trade war and lower commodity prices has reduced demand for new loans and increased Loans at Risk (LaR) in the corporate and household sectors. If pressures on corporate and household performance continue together with sluggish credit growth, further vulnerabilities could emerge with the potential to materialise into financial system stability risk.

# Chapter III

## FINANCIAL SYSTEM RISKS AND RESILIENCE

Despite persistent global uncertainty during the latter half of 2019, the impact of global economic and financial market shocks on Indonesia's financial system were effectively controlled. Spillover from global macrofinancial conditions transmitted to the domestic economy through the trade channel, as reflected by commodity sector developments, as well as the financial channel. Although the performance of several manufacturing and export-oriented corporations has declined marginally amidst intense global pressures, general conditions have been maintained. Domestic-oriented corporations continued to perform well on the back of solid domestic consumption. The corporate sector has pursued consolidation and efficiency gains, while adjusting the scale of business expansion in order to bolster performance. Nevertheless, the wait-and-see attitude of the corporate sector has pared back capital expenditure, as reflected by compressed corporate demand for financing.

In general, corporate repayment capacity remained adequate despite declining business activity due to global economic shocks. Typically, corporations holding external debt have maintained sound repayment capacity, with the maturity risk effectively contained. Furthermore, the quality of external debt has been maintained and corporations have successfully absorbed potential currency risks through hedging requirements and adequate foreign exchange liquidity. Granular analysis has shown that the exposure of corporate external debt in the affected sectors only accounts for a small portion of total corporate external debt.

Household resilience has been maintained through various strategies to overcome economic moderation. Weaker financial performance has left households less inclined to incur debt. Furthermore, households have strived to maintain consumption by seeking additional income, reducing tertiary expenditures and utilising savings to mitigate risk.

Amidst the current spate of global shocks, the banking industry has applied effective risk mitigation measures. Credit risk has slightly increased but remains below the threshold despite more intense pressures on corporate and household performance. The banking industry quickly responded and mitigated the early signs of escalating credit risk, thus remaining below the threshold. Furthermore, the banking industry is monitoring credit conditions more tightly, while prioritising quality credit growth through more selective and cautious lending. Risk buffers in the banking industry are also solid, as evidenced by a solid capital base and mitigated liquidity risk.

# Chapter IV
## MACROPRUDENTIAL POLICY RESPONSE

In response to the domestic macrofinancial challenges encountered in 2019, increasing risk and the suboptimal financial cycle, Bank Indonesia strived to stimulate economic financing in the second half of 2019 in order to break the cycle in compliance with prudential principles. Bank Indonesia perceived additional room to optimise intermediation and support sustainable economic growth momentum, while maintaining financial system stability. To that end, Bank Indonesia eased the (sharia) Macroprudential Intermediation Ratio (MIR) to 84-94% and expanded bank funding to include prudent foreign borrowings. Furthermore, Bank Indonesia also relaxed the loan-to-value/financing-to-value (LTV/FTV) ratios by an average of 5-10% to drive house and vehicle ownership, including green buildings and vehicles. In addition to prudential aspects, policy to stimulate intermediation was balanced with policy to maintain adequate capital and liquidity. Therefore, Bank Indonesia held the Countercyclical Buffer (CCB) at a level of 0% and the Macroprudential Liquidity Buffer (MPLB) at 4%. The policies were formulated amidst stronger synergy and coordination between Bank Indonesia and other members of the Financial System Stability Committee in order to maintain financial system stability in 2019. Internationally, synergy and coordination manifested through Bank Indonesia's active role at various international forums in the financial sector.

# Chapter V
## OUTLOOK AND POLICY DIRECTION

Growing global economic recovery optimism at the end of 2019 has been severely curtailed by COVID-19. The global economy is reeling from the rapid transmission of COVID-19 in China and across the world in the first quarter of 2020, which led to the outbreak being declared a global pandemic. Consequently, the world economic growth outlook has been downgraded due to disruptions in the global supply chain and compressed international demand, coupled with unprecedented measures to contain the outbreak that has brought economic activity to a standstill in many jurisdictions. Such inauspicious conditions have prompted significantly lower commodity prices and heightened global financial market uncertainty as well as increased the volatility of capital flows in developing countries. The economic impact was quickly felt in Indonesia through the trade, tourism and investment channels. Pressures on the domestic economy have intensified in 2020 after COVID-19 was transmitted to Indonesia. Based on such conditions, Bank Indonesia revised its domestic economic growth projection down for 2020.

Despite the onerous domestic and global challenges that have emerged, financial system stability in Indonesia has been maintained with the support of banking industry resilience. Nevertheless, growth of new loans in the first half of 2020 has been subdued with potentially higher credit risk due to the impact of COVID-19. Similarly, the corporate sector is under immense pressure due to lower world trade volume, disruptions in the global production chain, rupiah exchange rate depreciation and compressed domestic demand. Efforts to break the COVID-19 chain of transmission have drastically reduced production and economic activities, eroded demand for labour and impacted incomes and consumption, thus undermining domestic demand. Given the heightened uncertainty, investors have been forced to adjust their portfolios, triggering capital outflows and currency pressures on the rupiah. If spillover from the COVID-19 pandemic persists, credit risk in the corporate and household sectors will intensify and spread to multiple sectors, which could potentially impact financial industry performance, including the banking sector.

Anticipating a potential build-up of pressures on domestic economic and financial stability as the COVID-19 pandemic worsens, Bank Indonesia has instituted an optimal policy mix in close coordination with the Government and Indonesian Financial Services Authority (OJK). The President of the Republic of Indonesia has signed Government Regulation in Lieu of Law No. 1 of 2020 concerning State Financial and Financial System Stability Policies to Contain the Coronavirus Disease 2019 (Covid-19) Pandemic and/or Confront Threats to the National Economy and/or Financial System Stability. Furthermore, Bank Indonesia will continue to strengthen policy coordination and synergy with the Government, Indonesian Financial Services Authority (OJK) and Deposit Insurance Corporation (LPS) in order to maintain macroeconomic and financial system stability, while sustaining economic growth momentum. Internationally, cooperation and coordination with other monetary authorities has also been strengthened, amongst others, to maintain adequate foreign exchange liquidity in domestic markets as well as to exchange ideas and opinions concerning financial system conditions and the policy responses taken.

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