BANK INDONESIA
CENTRAL BANK OF THE REPUBLIC OF INDONESIA

COVID-19 PANDEMIC RESPONSE:

MAINTAINING FINANCIAL SYSTEM STABILITY, ACCELERATING NATIONAL ECONOMIC RECOVERY

Financial Stability Review
No.35, September 2020

BANK INDONESIA

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GLOSSARY

AL	Liquid Assets
APBD	Regional Revenue and Expenditure Budget
APBN	State Revenue and Expenditure Budget
AS	United States of America
ATMR	*Risk-Weighted Assets (RWA)*
ATO	Asset Turnover
BAZNAS	National Amil Zakat Board
BCBS	Basel Committee on Banking Supervision
BI	Bank Indonesia
BEI	Indonesia Stock Exchange
BI7DRR	BI 7-Day (Reverse) Repo Rate
BLT	Direct Cash Assistance
BMPD	Regional Banking Consultative Board
BPJS	Social Security Management Agency
BPNT	Noncash Food Assistance Program
BPR	Rural Bank
Bps	Basis Point
BST	Cash Social Assistance
BUK	Conventional Commercial Bank
BUMN	State-Owned Enterprise
BUS	Islamic Bank
CA	Current Assets
CAPEX	Capital Expenditure
CAR	Capital Adequacy Ratio
CCB	Countercyclical Buffer
CCT	Crisis Communication Test
CDS	Credit Default Swap
CKPN	Provisions for Impairment Losses
CMRF	Crisis Management Resolution Framework
COVID-19	Coronavirus Disease 2019
CWLS	Cash Waqf-Linked Sukuk
CPO	Crude Palm Oil
DAR	Debt at Risk
DF	Deposit Facility
DNDF	Domestic Non-Deliverable Forwards
DPK	Third-Party Funds
DSR	Debt Service Ratio
DTI	Debt-to-Income Ratio
EKD	Digital Economy and Finance
ELA	Emergency Liquidity Assistance
EM	Emerging Market
EMEAP	Executives' Meeting in East Asia Pacific
EPU	Economic Policy Uncertainty

FASBI	Bank Indonesia Rupiah Deposit Facility
FKPPPK	Coordination Forum for Development Financing through Financial Markets
FSB	Financial Stability Board
FTV	Financing-to-Value Ratio
GHOS	Group of Central Bank Governors and Heads of Supervision
GWM	Reserve Requirements
HQLA	High-Quality Liquid Asset
ICR	Interest Coverage Ratio
IEK	Consumer Expectation Index (CEI)
IHSG	Jakarta Composite Index (JCI)
IKE	Current Economic Condition Index (CECI)
IKK	Consumer Confidence Index (CCI)
IKNB	Nonbank Financial Institution
ILS	Lending Standards Index
IPK	Financial Market Infrastructures (FMIs)
IPO	Initial Public Offerings
IPR	Real Sales Index (RSI)
ISSK	Financial System Stability Index (FSSI)
ITO	Inventory Turnover
Jabodetabek	Jakarta, Bogor, Depok, Tangerang, and Bekasi (Jakarta Metropolitan Area)

Kemnaker	Ministry of Manpower of the Republic of Indonesia
KI	Investment Loan
KK	Consumer Loan
KKB	Automotive Loan
KKMB	Bank Partner Financial Consultant
KMK	Working Capital Loan
KPPK	Implementation of Prudential Principles
KPR	Housing Loans
KP/PP	Property Loans/Financing
KSK	Financial Stability Review (FSR)
KSSK	Financial System Stability Committee
LaR	Loan at Risk
LCR	Liquidity Coverage Ratio
LPEI	Indonesia Eximbank
LPS	Indonesia Deposit Insurance Corporation
LDR	Loan-to-Deposit Ratio
LoLR	Lender of Last Resort
LTV	Loan-to-Value Ratio
MDR	Merchant Discount Rate
MtM	Month-to-Month
MV	Venture Capital
NIM	Net Interest Margin

NK	Memorandum of Understanding
NLE	National Logistics Ecosystem
NPF	Non-Performing Financing
NPI	Indonesia's Balance of Payments (BOP)
NPL	Non-Performing Loans
NSFR	Net Stable Funding Ratio
OJK	Financial Services Authority
OPEC	Organisation of the Petroleum Exporting Countries
PDB	Gross Domestic Product (GDP)
Perbanas	Association of Indonesian Private Commercial Banks
PEN	National Economic Recovery
PEPP	Pandemic Emergency Purchase Programme
PHK	Termination of Employment
PJSP	Payment System Service Provider
PKH	Family Hope Program
PLJP	Short-Term Liquidity Assistance
PLK	Special Liquidity Loan
PLM	Macroprudential Liquidity Buffer (MPLB)
PP	Finance Company
PPKSK	Financial System Crisis Prevention and Mitigation
PSBB	Large-Scale Social Restrictions
PUAS	Islamic Interbank Money Market

QE	Quantitative Easing
QRIS	Quick Response Code Indonesia Standard
RIM	Macroprudential Intermediation Ratio (MIR)
RNH	Halal Value Chain
ROA	Return on Assets
ROE	Return on Equity
RT	Household
RUPS	General Meeting of Shareholders
SBBI	Bank Indonesia Foreign Exchange Bills (BI FX Bills)
SBI	Bank Indonesia Certificates
SBK	Commercial Papers
SBN	Tradeable Government Securities
SBSN	Government Islamic Securities
SBT	Weighted Net Balance (WNB)
SDBI	Bank Indonesia Certificates of Deposit
SiKA	Interbank Sharia-Compliant Commodity Trading Certificates
SIMA	Interbank Mudharabah Investment Certificates
SiPA	Interbank Islamic Funds Management Certificates
SKDU	Bank Indonesia Business Survey
SKNBI	National Clearing System
SNEKI	National Financial and Economic Inclusion Strategy

SN-PPPK	National Financial Market Development and Deepening Strategy
SNRT	Household Balance Sheet Survey
SSK	Financial System Stability (FSS)
SUN	Government Debt Securities
TD	Term Deposit
THR	Annual Religious Holiday Allowance
TWP	Default Rate
ULN	External Debt
UMKM	Micro, Small and Medium Enterprises (MSME)
UU PPKSK	Financial System Crisis Prevention and Mitigation Act
VIX	Volatility Index
WHO	World Health Organisation
YoY	year-on-year
ZCP	Zakat Core Principles
ZISWAF	Zakat, Infaq, Sadaqah and Waqf

FOREWORD

The Coronavirus Disease 2019 (COVID-19) pandemic, which has spread with rapidity since the beginning of 2020, caused widespread global financial market panic and triggered a global economic recession in 2020. In addition to the human aspect, the COVID-19 pandemic and extraordinary policy measures taken by authorities around the world to break the domestic chain of transmission have suppressed economic activity, increased unemployment, and undermined private incomes. Despite fiscal stimuli introduced by government administrations and lower interest rates adopted by central banks, coupled with large-scale liquidity injections, a global economic recession was regrettably inevitable. In the global financial markets, panic amongst investors, and market players triggered large capital outflows, US dollar tightness globally, and broad-based currency pressures.

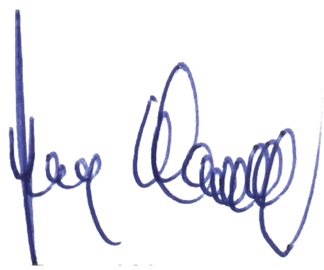
At home, domestic economic dynamics have been influenced by global economic developments and COVID-19 transmission. Indonesia's external sector began to experience pressures in the first quarter of 2020 as domestic economic growth retreated significantly before slipping into contraction in the second quarter of 2020. Despite the intense pressures, financial sector stability was maintained yet with an intermediation function in need of improvement. Notwithstanding, several of the latest indicators point to improvements in terms of public mobility, retail sales, consumer confidence, and business expectations. Consequently, we are confident that domestic economic growth will improve on stronger domestic demand in line with greater state budget realisation, ongoing monetary stimuli, accommodative macroprudential policy, progress in credit and corporate restructuring, as well as the positive impact of greater digital technology uptake in economic activity.

Moving forward, Bank Indonesia will continue to orient all policy instruments towards supporting economic growth in close coordination with the Government and Financial System Stability Committee, while maintaining macroeconomic and financial system stability. Bank Indonesia will maintain an accommodative monetary and macroprudential policy stance in order to accelerate the national economic recovery. Liquidity will also be provided to the banking industry in order to maintain the loan and corporate restructuring program. In addition, Bank Indonesia will continue to strengthen the resilience and recovery of micro, small and medium enterprises (MSMEs), develop the Islamic economy and finance, strengthen financial market deepening, and accelerate economic and financial digitalisation, while strengthening policy synergy and coordination with other relevant authorities.

The salient economic developments and policy responses taken are presented in this the 35th edition of the Financial Stability Review (FSR), entitled "COVID-19 Pandemic Response: Maintaining Financial System Stability, Accelerating National Economic Recovery". The title accurately illustrates the efforts and commitment by Bank Indonesia to create and maintain financial system stability, while driving the national economic recovery. We present the FSR to national financial industry players, all elements of the government, academia, public, and Indonesia's international partners. We expect the FSR to be used as reference material for policymakers and corporate decision-makers so that we may strengthen synergy together in order to maintain the financial system stability and accelerate the national economic recovery.

In closing, may God Almighty always provide protection, health, and blessings for each of our endeavours and prayers in maintaining financial system stability and the economic recovery in Indonesia.

Jakarta, 11th November 2020



Governor of Bank Indonesia
Perry Warjiyo

EXECUTIVE SUMMARY

At the beginning of 2020, the COVID-19 outbreak began to spread with rapidity to numerous countries. Such conditions not only represented a health phenomenon yet also had a significant economic impact by compressing demand and constraining supply through public mobility restrictions. Furthermore, less corporate and household activity intensified pressures on the financial sector. Despite the onerous challenges, the extraordinary fiscal, monetary, and macroprudential policy response instituted by the government and other relevant authorities, along with financial sector policies, to rescue the national economy effectively mitigated the impact of the COVID-19 pandemic, with a gradual economic recovery process now underway and financial system stability maintained.

A surge of COVID-19 cases forced governments around the world to restrict social activities, thereby reducing the demand for and supply of goods and services and undermining world trade activity. Consequently, international commodity prices plummeted. Global economic growth in the first semester of 2020, particularly in the second quarter, contracted sharply. In addition to the demand-side constraints, the corporate sector also encountered significant supply-side issues. Restrictions on international mobility for goods and people, coupled with stringent procedures for the importation and exportation of goods in various trading partners severely impeded the supply of raw materials for production. Production constraints and deteriorating sales performance left the corporate sector reeling and reluctant to invest, while reducing operational costs through workforce rationalisation, amongst others. This further reduced household purchasing power in terms of consumption. Uncertainty concerning when the pandemic would end together with weaker performance forced the corporate sector to postpone business expansion and lowered demand for financing. On the other hand, the banking industry became risk averse and undertook risk mitigation measures in line with lower corporate and household repayment capacity, which hindered the intermediation function.

Given the significant impact on the economy and financial system stability, the Government in conjunction with other institutional members of the Financial System Stability Committee implemented an extraordinary policy response and measures to rescue the national economy and maintain financial system stability, which were contained in Act No. 2 of 2020 concerning the Enactment of Government Regulation instead of Law No. 1 of 2020 regarding 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 into law. The legislation strengthened the respective authority of the Ministry of Finance, Bank Indonesia, Financial Services Authority (OJK), and Indonesia Deposit Insurance Corporation (LPS) in terms of mitigating potential economic and financial system decline.

Bank Indonesia implemented a policy mix through accommodative monetary and macroprudential policies to strengthen foreign exchange market stability, maintain adequate liquidity in the financial system, and stimulate the bank intermediation function. In terms of monetary policy, measures were taken to stabilise exchange rates and provide liquidity. First, Bank Indonesia increased the intensity of the triple intervention policy in the spot market, domestic non-deliverable forwards (DNDF) market, and SBN market. Second, Bank Indonesia lowered the policy rate by 100 bps to 4.00% from the beginning of the year until September 2020. Third, Bank Indonesia injected liquidity into the money market and banking system through SBN purchases in the secondary market and by lowering the rupiah reserve requirements by 200 bps for conventional commercial banks and by 50 bps for Islamic banks/business units, effective from 1st May 2020. On the macroprudential side, the policy was implemented to maintain banking resilience and stimulate the intermediation function through several policy measures. First, to maintain a liquidity buffer amidst elevated risks and uncertainty, Bank Indonesia raised the Macroprudential Liquidity Buffer (MPLB) by 50 bps for Islamic banks/business units. Second, Bank Indonesia relaxed the Macroprudential Intermediation Ratio (MIR). Third, Bank Indonesia lowered the reserve requirements by 50 bps for banks extending loans for export and import activities and/or to micro, small and medium enterprises (MSME). Fourth, Bank Indonesia relaxed the downpayment policy on green automotive loans and financing. Congruently, Bank Indonesia also maintained the countercyclical buffer (CCB) at 0% to stimulate the bank intermediation function. In accordance with Act No. 2 of 2020, Bank Indonesia strengthened the lender of last resort function through refinements to the short-term liquidity assistance facility in order to reinforce financial system stability.

The various coordinated policy measures of the Government, Bank Indonesia, Financial Services Authority (OJK), and Indonesia Deposit Insurance Corporation (LPS) successfully maintained financial system stability in the first semester of 2020. In the banking sector, liquidity remained adequate and resilient, as reflected by a high liquidity ratio, contained credit risk and adequate capital. In the financial and capital markets, the risk-off behaviour observed amongst investors in March and April 2020 has eased as investor confidence has been restored. For corporates and households, efforts to break the domestic chain of COVID-19 transmission through large-scale social restrictions that impeded the mobility of people and goods intensified pressures, which subsequently eased as the social restrictions were relaxed.

Early indications of global economic improvements have already been observed in the second semester, driven by the economic recovery underway in China. At home, increasing public mobility as large-scale social restrictions are relaxed, higher state budget realisation in the form of fiscal stimuli, ongoing monetary stimuli, progress in terms of the loan restructuring program, faster development of the digital economy and finance, as well as empowerment of micro, small and medium enterprises (MSME) have provided optimism concerning potential economic momentum. Furthermore, the domestic economy is projected to improve in the second semester of 2020 after contracting in the second quarter of the year.

Moving forward, maintaining financial system stability will be strengthened in line with milder real sector pressures, which will boost financial sector performance. In anticipation of a potential second wave of COVID-19, Bank Indonesia will continue to monitor economic dynamics and COVID-19 transmission when formulating the follow-up policy measures required, while minimising the potential economic impact in Indonesia. Furthermore, Bank Indonesia will maintain an accommodative macroprudential policy stance to accelerate national economic recovery. Policy coordination between financial sector authorities under the auspices of the Financial System Stability Committee and other international authorities, will also be strengthened to maintain macroeconomic and financial system stability as well as accelerate the national economic recovery.

Note: Except as otherwise noted, all data and information cited in this report are current as of September 30, 2020.

BANK INDONESIA

CHAPTER 1

MACROFINANCIAL CONDITIONS

The COVID-19 pandemic has been the main challenge facing global economic dynamics. Restrictions on economic activity to break the domestic chain of COVID-19 transmission triggered a global economic contraction. In line with global economic weaknesses, trade volume experienced a sharp contraction, accompanied by significantly lower international commodity prices.

COVID-19 transmission in Indonesia has triggered a domestic economic contraction. Large-scale social restrictions introduced by the government to contain COVID-19 have restricted the mobility of people and goods, thereby reducing domestic demand as well as production and investment activity.

Compressed global demand and commodity price pressures have undermined export and import performance with corporate activity also shrinking. The implementation of large-scale social restrictions that curbed domestic economic activity has also impacted corporate sales as well as micro, small, and medium enterprises (MSME). Corporate sector pressures have spilled over into the household sector, primarily affecting the middle class as well as those towards the bottom of the pyramid.

Fiscal, monetary, macroprudential, and microprudential policy synergy to save the national economy aims to alleviate the adverse impact of the COVID-19 pandemic in the real sector and financial sector. Policy formulation is based on forward-looking assessments of the transmission mechanism for the pandemic impact on macroeconomic and financial system stability.

In general, the COVID-19 pandemic has triggered significant pressures on financial system resilience and intermediation. Nevertheless, the policy response effectively maintained financial system stability throughout the first semester of 2020, as reflected by adequate liquidity and capital in the banking industry. Furthermore, the Financial System Stability Index (FSSI) remained within the normal zone.

1.1 Global Economic Contraction and Financial Market Uncertainty

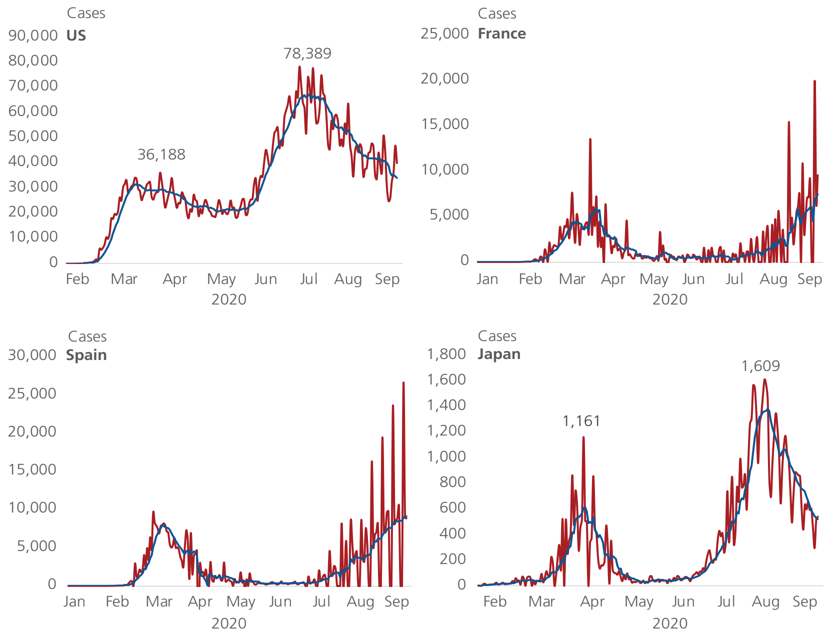
The COVID-19 pandemic has been the major challenge for the dynamics of the global economy. Total COVID-19 cases have continued to soar globally (Table 1.1.1), accompanied by a second wave of infections in many countries despite a flattening of the fatality rate (Graph 1.1.1). In response, authorities in most countries are taking monetary and fiscal stimuli. From a monetary perspective, central banks around the world have lowered policy rates and injecting liquidity. Large-scale quantitative easing (QE) has also been implemented through a variety of instruments, including government bond purchases, lower reserve requirements, and the Pandemic Emergency Purchase Programme (PEPP). On the fiscal side, governments have allocated stimuli to mitigate the risks associated with the COVID-19 pandemic and stimulate economic recovery. The fiscal stimuli include larger health budgets and social safety nets as well as support for impacted businesses and sectors through tax breaks and an economic recovery budget.

Table 1.1.1 Confirmed COVID-19 Cases

No	Country	Total Cases	Total Fatalities	Fatality Rate (%)	Total Recovered
1	United States	6,708,458	198,520	2.96	3,974,949
2	India	4,845,003	79,754	1.65	3,777,044
3	Brazil	4,330,455	131,663	3.04	3,573,958
4	Russia	1,062,811	18,578	1.75	876,225
5	Peru	729,619	30,710	4.21	566,796
6	Colombia	716,319	22,924	3.20	599,385
7	Mexico	668,381	70,821	10.60	471,623
8	South Africa	649,793	15,447	2.38	577,906
9	Spain	576,697	29,747	5.16	150,376
10	Argentina	555,537	11,352	2.04	419,513
23	Indonesia	218,382	8,723	3.99	155,010
	Other COuntries	8,118,697	310,007	3.82	5,813,831
Total Cases		**29,180,152**	**928,246**	**3.18**	**20,806,240**

Source: www.worldometers.info/coronavirus; as of 13th September 2020

Graph 1.1.1 Global Second Wave COVID-19 Cases



Source: Bloomberg, processed

The impact of COVID-19, which severely restricted economic activity in many countries, caused a global economic contraction. Economic growth in the first and second quarters of 2020 contracted sharply in most advanced and developing economies due to limited public mobility in order to mitigate COVID-19 transmission. The global economic contraction was prompted by weak demand, low economic expectations as well as subdued export demand. Nevertheless, economic growth in a number of countries began to improve beyond previous projections in the second quarter of 2020, supported by fiscal stimuli to catalyse consumption and investment. The latest developments have shown early indications of economic recovery in several countries, China in particular, as the impact of the COVID-19 pandemic begins to fade and in line with the extraordinary fiscal policy stimuli.

Consistent with lower global demand, world trade volume and international commodity prices also experienced deep contractions. World trade volume contraction in the first quarter of 2020 due to the major impact of the COVID-19 outbreak in China in February 2020 and the subsequent transmission around the world in March 2020. Consistent with retreating world trade volume, international commodity prices contracted until May 2020, despite prices of several commodities, including crude palm oil (CPO), nickel, and coffee, rising on limited supply and inclement weather. Other commodities, however, particularly mining commodities, experienced sliding prices in line with lower global demand. The global oil price also sank on weak demand, despite lower supply due to the production cuts agreed by OPEC+ (Table 1.1.2).

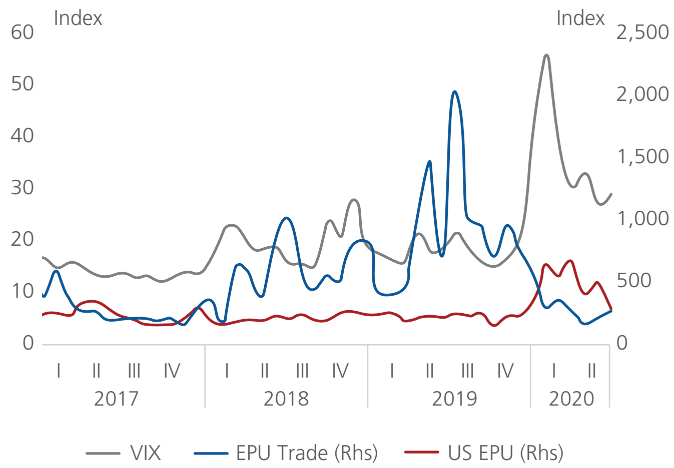
Global financial market uncertainty increased in the first quarter of 2020 yet began to ease shortly thereafter in the subsequent period. The rapid transmission of the COVID-19 pandemic to various countries around the world elevated global financial market uncertainty in the first quarter of 2020 and triggering a sudden capital reversal as investors sought safe haven assets. Nevertheless, global financial market uncertainty began to subside in the second quarter of 2020 on the back of positive sentiment given the accommodative global policy response and flattening of the fatality rate. Lower uncertainty in the global financial markets was confirmed by decreases recorded in the Economic Policy Uncertainty (EPU) Index and Volatility Index (VIX), despite remaining above pre-pandemic levels (Graph 1.1.2). This decreasing uncertainty then had a positive impact on capital flows to developing countries which began to increase, although it was still limited. This development then eased pressure on the exchange rate of developing countries, including Indonesia (Graph 1.1.3). The latest developments in July and August 2020 pointed is still high global financial market uncertainty, stoked by concerns over the second wave of COVID-19 infections, the global economic recovery outlook and rising geopolitical tensions between the United States and China.

Table 1.1.2 Commodity Prices

Commodity	2018	2019	2020	
			Q I	Q II
Copper	6.7	-7.8	-7.8	-12.3
Coal	2.5	-8.6	-8	-28.2
CPO	-19.2	-2.3	33.3	14
Rubber	-16.8	12.4	-18.6	-22.7
Nickel	27.8	7.0	3.8	0
Lead	0.5	-7.5	-17.2	-20.4
Aluminium	7.4	-14.1	-5.8	-15.9
Coffee	-15.4	-11.8	14.8	-2.8
Other Commodities	1.2	-0.7	-2.1	-5.6
Indonesia Export Price Index (IHKEI)	**-2.8**	**-3.0**	**1.5**	**-10.4**
Oil (Brent)**	**71**	**64**	**51**	**31**

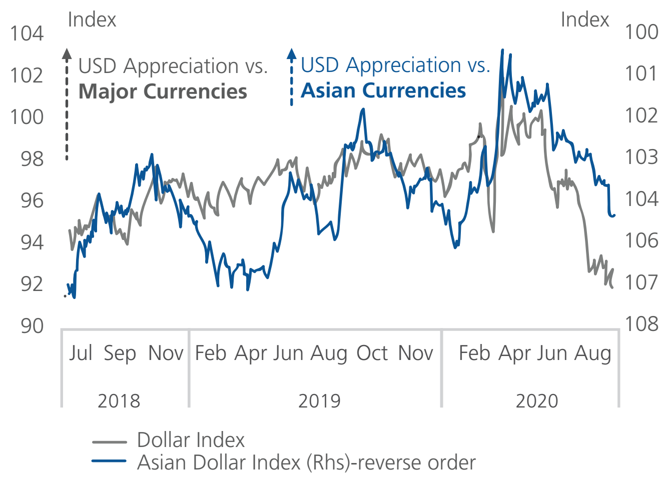
**) in US dollars per barrel; Other Commodities (%, yoy)
Source: Bloomberg, processed

Graph 1.1.2 VIX and EPU



Source: Bloomberg, processed, data as of 31st August, 2020

Graph 1.1.3 Exchange Rate Pressures in Developing Economies



Source: Bloomberg, processed, data as of 31st August, 2020

1.2 Domestic Economic and Financial Dynamics

Domestic economic growth in Indonesia has contracted in response to the COVID-19 pandemic. The large-scale social restrictions introduced by the government to break the domestic chain of COVID-19 transmission severely hampered the mobility of people and goods, thus reducing domestic demand as well as production and investment activity. In the second quarter of 2020, economic growth contracted 5.32% (yoy) after decelerating to 2.97% (yoy) in the first quarter of 2020 (Table 1.2.1). Meanwhile, the export contraction was not as significant as previously projected due to demand from China for several export commodities, including iron and steel, metal ore as well as pulp and waste paper.

The spread of COVID-19 has severely disrupted domestic economic activity, including corporate performance. Weakening global demand and commodity price pressures have suppressed export and import performance and, thus, corporate activity. The implementation of a pandemic handling policy containment measures in the form of the large-scale social restrictions that curbed domestic economic activity further exacerbated pressures on corporate sales and micro, small, and medium enterprises (MSME).

Pressures on corporate performance also spilled over into the household sector, particularly affecting the middle class and those towards the bottom of the period. Corporations implemented rationalisation in terms of operating and investment costs. Operating costs were reduced through workforce rationalisation, which impacted household activity and performance, as reflected by slower credit growth and a build-up of credit risk in the household sector.

Portfolio rebalancing by investors at the beginning of the COVID-19 outbreak elevated global financial market uncertainty and triggered capital outflows from developing economies in favour of safe haven assets. This intensified pressures on rupiah exchange rates and domestic financial market performance. In March 2020, the rupiah depreciated against the US dollar, accompanied by high volatility. In addition, deteriorating domestic financial market performance was indicated by higher yields on securities in the bond market coupled with deep stock market corrections.

Fiscal, monetary, macroprudential, and microprudential policy synergy by the respective authorities to bolster the national economic recovery aims to alleviate the adverse impact of the COVID-19 pandemic in the real sector and financial sector. The policy was formulated based on forward-looking assessments concerning the transmission mechanism for the impact of the pandemic on macroeconomic and financial system stability. The government issued a series of fiscal and non-fiscal stimuli measures to minimise the impact of the pandemic and catalyse

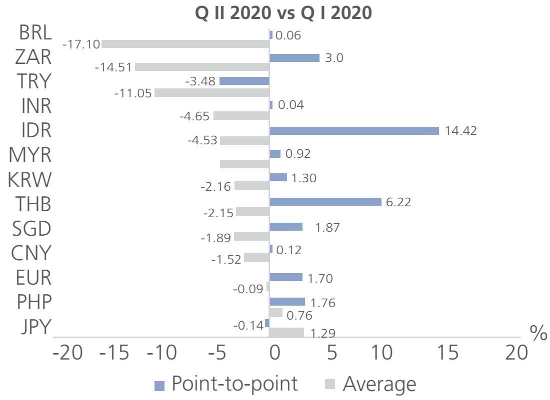
Table 1.2.1 Economic Growth on Expenditure Side

Component	2018				2018	2019				2019	2020	
	I	II	III	IV		I	II	III	IV		I	II
Household Consumption	4.96	5.17	5.00	5.08	5.05	5.02	5.18	5.01	4.97	5.04	2.83	-5.51
NPISH Consumption	8.12	8.77	8.61	10.82	9.10	16.96	15.29	7.41	3.53	10.62	-5.09	-7.76
Government Consumption	2.71	5.21	6.26	4.56	4.80	5.22	8.23	0.98	0.48	3.25	3.75	-6.90
Investment (GDFCF)	7.92	5.81	6.92	6.01	6.64	5.03	4.55	4.21	4.06	4.45	1.70	-8.61
Building Investment	6.12	4.96	5.60	5.02	5.41	5.48	5.46	5.03	5.53	5.37	2.76	-5.26
Non-Building Investment	13.56	8.33	10.73	8.96	10.31	3.69	1.96	1.95	-0.13	1.80	-1.46	-18.62
Exports	5.84	7.48	8.34	4.59	6.55	-1.58	-1.73	0.10	-0.39	-0.87	0.23	-11.66
Imports	12.46	14.94	13.77	7.11	11.88	-7.47	-6.84	-8.30	-8.05	-7.69	-2.19	-16.96
GDP	**5.06**	**5.27**	**5.17**	**5.18**	**5.17**	**5.07**	**5.05**	**5.02**	**4.97**	**5.02**	**2.97**	**-5.32**

Source: BPS-Statistics Indonesia, processed domestic economic recovery momentum. To that end, Bank Indonesia has played an active role in terms of funding the 2020 state budget through SBN purchases in the primary market, based on market mechanisms and private placement, as part of the efforts to accelerate the national economic recovery program, while maintaining macroeconomic stability. In addition, Bank Indonesia has also implemented a monetary, macroprudential, and payment system policy mix to strengthen macroeconomic stability, reduce volatility in the foreign exchange, and financial markets as well as bolster banking industry resilience and the bank intermediation function. In response to the lower policy rate and liquidity conditions in the banking industry, the Indonesia Deposit Insurance Corporation (LPS) issued a number of pre-emptive policies for the banking industry, capital market, and nonbank financial industry in order to provide space for the public and financial services institutions impacted directly and indirectly by the COVID-19 pandemic.

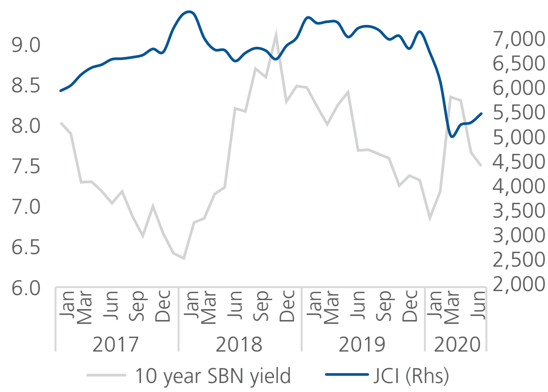
Entering the second quarter of 2020, the rupiah exchange rate and domestic financial market performance to strengthen. The rupiah appreciated 14.42% (ptp) in the second quarter of 2020 on the back of a surge of foreign capital inflows to domestic financial markets in May and June 2020 as global financial market uncertainty eased and the economic outlook for Indonesia remained promising (Graph 1.2.1). In addition, SBN yield tracked a downward trend in line with the BI 7-Day (Reverse) Repo Rate reductions, and the Jakarta Composite Index (JCI) began to rally (Graph 1.2.2).

Graph 1.2.1 Exchange Rate Appreciation/ Depreciation of Peer Currencies



Source: Reuters, Bloomberg, processed, data as of 30th June, 2020

Graph 1.2.2 Benchmark 10-year SBN Yield and Jakarta Composite Index (JCI)



Source: Reuters, Bloomberg, processed, data as of 30th June, 2020

Amidst slowing economic growth, economic stability in Indonesia was maintained. External stability was supported by a significant USD 9.2 billion surplus recorded in Indonesia's Balance of Payments (BOP) after amassing an USD 8.5 billion deficit in the previous period (Table 1.2.2). The improvement in the BOP performance is supported by a decrease in the current account deficit and a large surplus in the capital and financial account. Meanwhile, internal stability was also maintained, as reflected by persistently low inflation in line with domestic demand compressed by the COVID-19 pandemic, policy consistency by Bank Indonesia to anchor inflation expectations as well as sustained exchange rate stability (Graph 1.2.3).

The decline in corporate and household performance has resulted in increased credit risk. Banking non-performing loans (NPLs) increased during first semester of 2020 and was recorded at 3.11% at the end of June 2020. This NPL increased compared to 2.53% at the end of December 2019 (Graph 1.2.4). The level of non-performing loans increased as repayment capacity in the real sector declined despite subdued credit growth during the pandemic. Notwithstanding, the banking industry maintained a gross NPL ratio below the 5% threshold, supported by OJK policy to relax loan restructuring requirements.

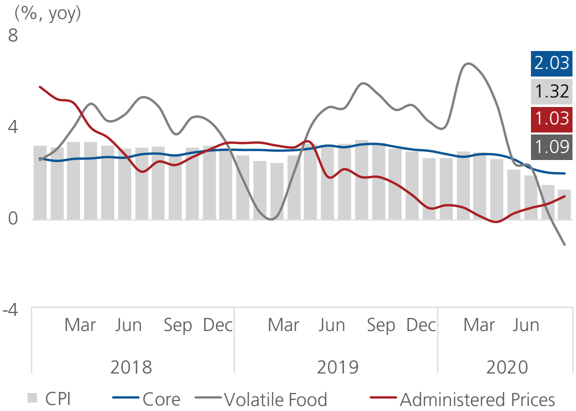
Liquidity in the banking system was maintained despite the high level of loan restructuring. Loose liquidity in the banking industry was reflected by a high ratio of liquid assets to third-party funds at 26.24% at the end of June 2020, up from 20.86% at the end of December 2019 (Graph 1.2.5). A surge of third-party funds in the banking industry boosted liquidity as credit growth remained sluggish during the pandemic. Liquidity in the banking industry was also supported by Bank Indonesia's quantitative easing policy through lower rupiah reserve requirements. Loan restructuring was dominated by MSME and corporate loans (including commercial). MSME loan restructuring spiked in April 2020, with a significant increase in corporate loan restructuring recorded in May 2020. Towards the end of the first semester of 2020, however, loan restructuring had begun to decrease.

Table 1.2.2 Indonesia's Balance of Payments (BOP)

Component (USD, billions)	2019*					2020	
	I	II	III	IV	Total	I*	II**
Current Account	-6.6	-8.2	-7.5	-8.1	-30.4	-3.7	-2.9
A, Goods	1.3	0.6	1.4	0.3	3.5	4.4	4.0
- Exports (FOB)	41.2	40.2	43.7	43.4	168.5	41.8	34.7
- Imports, (FOB)	-39.9	-39.6	-42.3	-43.1	-164.9	-37.3	-30.7
a. Non-Oil and Gas	2.9	3.1	2.7	3.2	12.0	5.8	3.3
b. Oil and Gas	-2.1	-2.9	-2.1	-3.2	-10.3	-2.7	-0.8
B. Services	-1.6	-1.9	-2.3	-2.1	-7.7	-1.9	-2.2
C. Primary Income	-8.1	-8.9	-8.4	-8.3	-33.8	-7.9	-6.2
D. Secondary Income	1.8	2.0	1.8	2.0	7.6	1.7	1.4
Capital and Financial Account	9.9	6.8	7.5	12.6	36.7	-3.0	10.5
1. Direct Investment	6.0	5.8	5.2	3.2	20.1	4.1	3.4
2. Portfolio Investment	5.2	4.6	4.9	7.1	21.7	-6.1	9.8
3. Other Investment	-1.4	-3.6	-2.7	2.4	-5.4	-0.7	-2.7
Overall Balance	2.4	-2.0	0.0	4.3	4.7	-8.5	9.2
Memorandum:							
Reserve Assets	124.5	123.8	124.3	129.2	129.2	121.0	131.7
in Months of Imports and Servicing Government External Debt	6.7	6.8	6.9	7.3	7.3	7.0	8.1
Current Account (% of GDP)	-2.5	-3.0	-2.6	-2.8	-2.7	-1.4	-1.2

*preliminary
**projected
Source: Bank Indonesia, processed

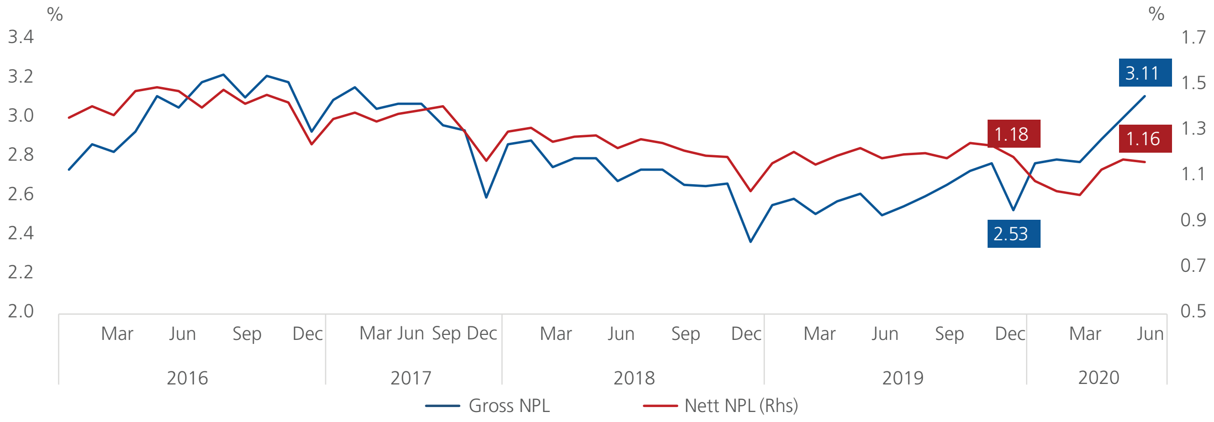
Graph 1.2.3 Inflation Developments



Source: BPS-Statistics Indonesia, processed

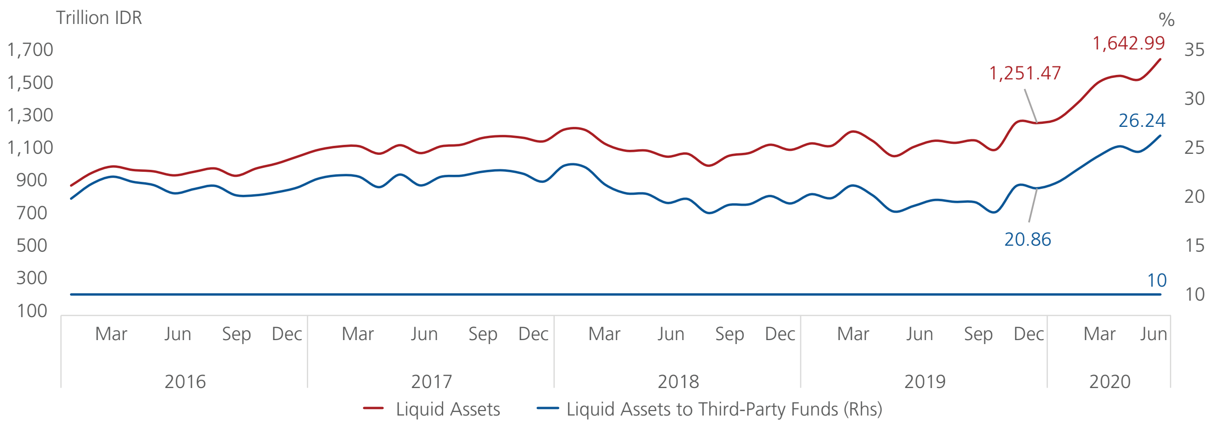
The COVID-19 pandemic has an impact on decreasing bank profitability. The decline in bank profitability was reflected in ROA which was recorded at 1.92% at the end of June 2020, lower than December 2019 at 2.44%. The decline in bank profits was due to eroding credit interest income, as reflected in the Net Interest Margin (NIM), which fell from 4.80% at the end of December 2019 to 4.33% at the end of June 2020 (Graph 1.2.6). In addition, non-interest income also decreased as a result of the increase in the formation of Allowance for Impairment Losses (CKPN) in line with the implementation of credit restructuring.

Graph 1.2.4 Credit Risk in Banking Industry



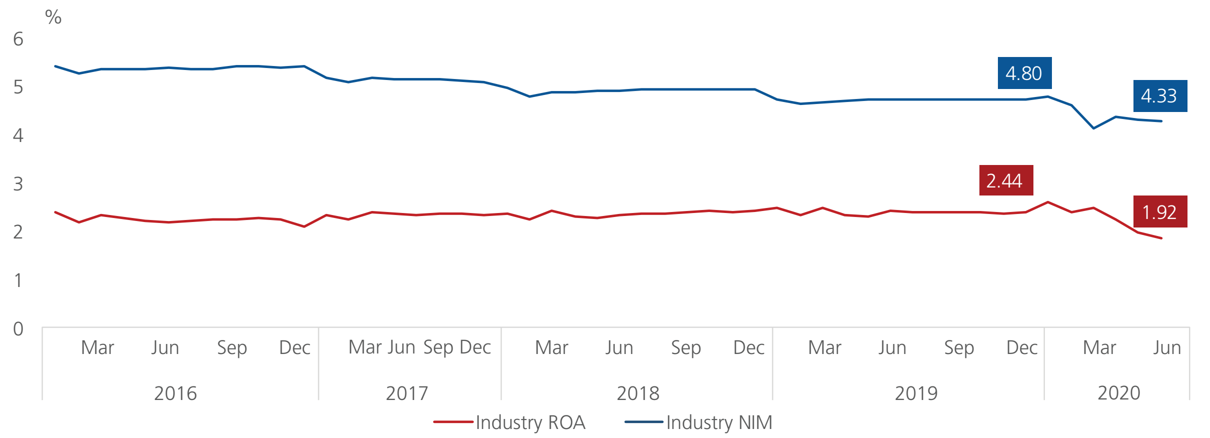
Source: Financial Services Authority (OJK), processed

Graph 1.2.5 Bank Liquidity



Source: Bank Indonesia, processed

Graph 1.2.6 Bank Profitability



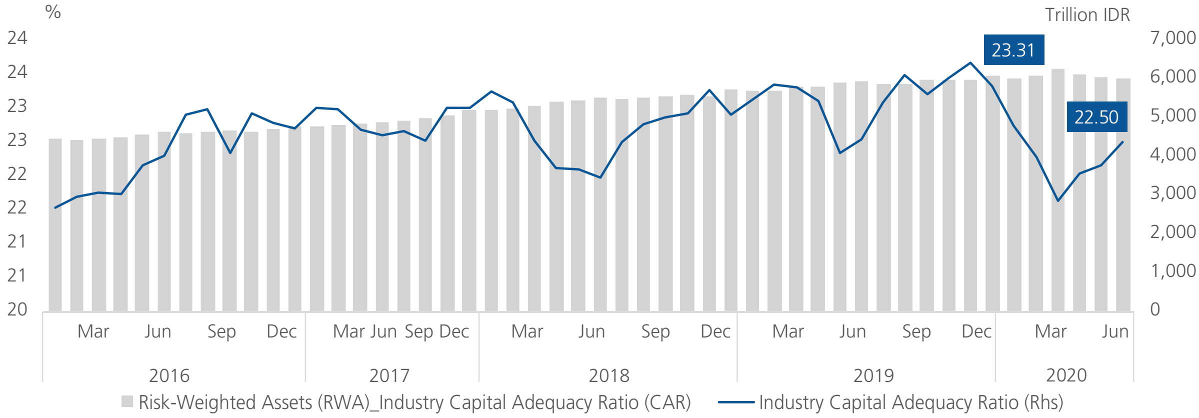
Source: Financial Services Authority (OJK), processed

Capital resilience was maintained despite increasing credit risk and lower profitability. Albeit down on the 23.31% recorded in December 2019, the Capital Adequacy Ratio (CAR) remained high in June 2020 at 22.50% (Graph 1.2.7).

The bank intermediation function was restrained because of weak domestic demand, coupled with a cautious and risk-averse banking industry due to the perception of high risk. The banks adopted selective lending in order to maintain credit quality. Overall, economic financing moderated in line with sluggish economic growth impacted by the COVID-19 pandemic.

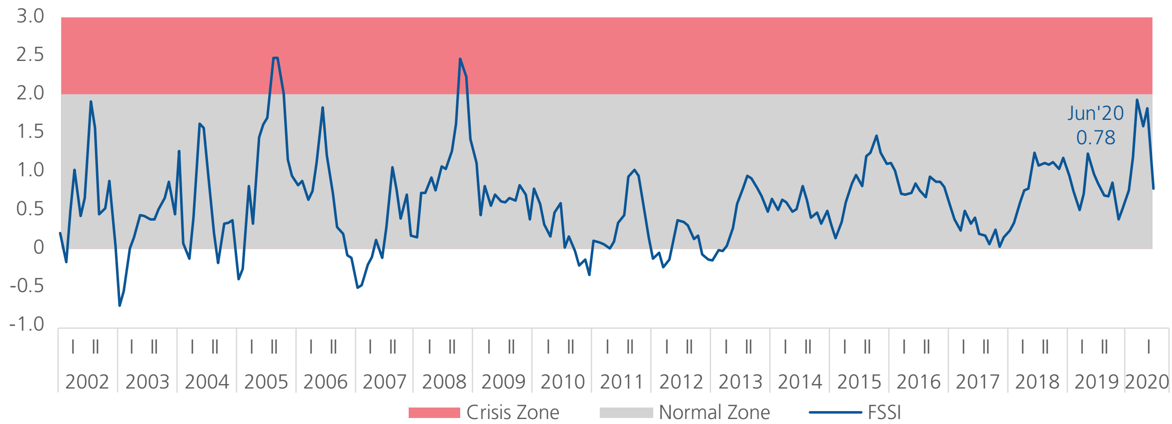
In general, the COVID-19 pandemic created significant pressures on financial system resilience and intermediation performance, yet the policy response taken effectively maintained financial system stability throughout the first semester of 2020. The Financial System Stability Index (FSSI) remained in the normal zone throughout the first semester of 2020, with a reading of 0.78 at the end of June 2020[1] (Graph 1.2.8).

Graph 1.2.7 Bank Capital



Source : Financial Services Authority (OJK), processed

Graph 1.2.8 Financial System Stability Index (FSSI)



Source: Bank Indonesia, processed

1 The Financial System Stability Index (FSSI), which is used to monitor financial system stability, has been refined through a number of improvements as follows: (1) expanding the scope of financial institution performance indicators with the inclusion of finance company indicators; (2) refining the sub-index, covering three aspects of FSS performance, namely Resilience, Intermediation and Efficiency; and (3) including the aspect of systemic risk contribution by each respective bank. The refinements are expected to create a more representative Financial System Stability Index that can illustrate the latest financial system conditions and performance comprehensively.

BANK INDONESIA

CHAPTER 2

FINANCIAL SYSTEM STABILITY CONDITIONS

The COVID-19 pandemic has forced global investors to rebalance their portfolios by selling higher risk assets in favour of safe haven assets. Such risk-off behaviour impacted domestic financial market and capital market performance, particularly during the pandemic outbreak in the first quarter of 2020. Entering the second quarter, however, financial and capital market pressures in Indonesia began to ease as investor optimism was restored concerning the favourable impact of the policies issued by the Government, Bank Indonesia, Financial Services Authority (OJK), and Indonesia Deposit Insurance Corporation (LPS) to save the economy.

The pandemic has also severely compressed global demand and impeded the supply of raw materials for production, thus impacting corporate sales performance. Such dynamics intensified pressure on corporate profitability, particularly amongst small and medium enterprises. Nevertheless, the ability of large corporations to meet their financial obligations remained solid and helped to drive the recovery process. By sector, the manufacturing industry as well as sectors related to tourism, such as trade and transportation, were the hardest hit by COVID-19 and remain a point of vulnerability that demands vigilance.

Restrained corporate performance has impacted labour absorption and household incomes, particularly amongst the middle class and those towards the bottom of the period. The contraction in household income has resulted in pressure on household consumption and credit growth. Credit risk in the household sector has increased and based on income, household repayment capacity has declined particularly amongst low and middle-income earners. Nevertheless, households have maintained adequate savings, as reflected by a savings and credit surplus at the end of the first semester of 2020.

Bank and non-bank exposure to deteriorating corporate and household performance intensified credit risk in the banking industry and financing risk in the nonbank financial industry in the first semester of 2020, yet the risks have been contained. The national economic recovery program, which relaxed loan restructuring policy, has helped contain credit risk in the banking industry. Nonetheless, the banking industry and nonbank financial industry have become risk averse, which led to sluggish credit and financing growth in the first semester of 2020 when combined with the wait-and-see posture of the corporate sector. Despite the credit contraction, liquidity in the banking industry has improved. In addition, stress testing has shown that the capital adequacy ratio of the banking industry and finance companies remains sufficient to offset higher credit and financing risk, even under severe macroeconomic conditions. Moving forward, capital and liquidity conditions in the banking and nonbank financial industry will be maintained to support a stronger intermediation function.

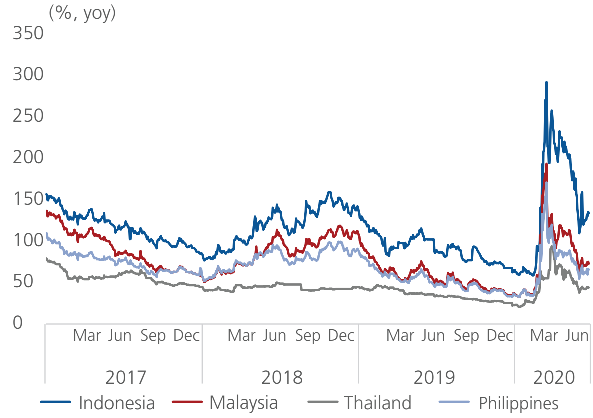
2.1 Global Portfolio Rebalancing and Domestic Financial Market Conditions

The COVID-19 pandemic has prompted global investors to rebalance their portfolios by selling higher risk assets in favour of safe haven assets. This risk-off behavior depressed of the financial and capital market domestic performance, particularly during the initial outbreak in the first quarter of 2020. Entering the second quarter of 2020, however, domestic financial and capital market pressures began to ease as investor optimism was restored by the extraordinary policies issued by financial sector authorities to rescue the economy. Nevertheless, financial and capital market performance in Indonesia have not recovered to pre-pandemic levels.

The phenomenon amongst investors of risk-off behaviour at the beginning of the COVID-19 pandemic was felt in the majority of emerging market exchanges, including Indonesia. Investors tended to release domestic currencies, shares and securities as risk perception increased concerning investing in emerging market economies (Graph 2.1.1), as well as to switch to safe haven assets, which edged up the price of gold and value of the US dollar (Graph 2.1.2).

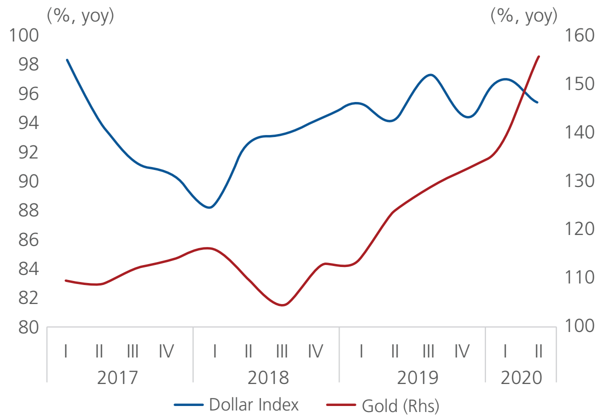
Such conditions prompted a net outflow from stock markets in emerging market economies (Graph 2.1.3), which exacerbated exchange rate volatility and share prices in affected countries, including Indonesia (Graph 2.1.4 and 2.1.5). The net outflow from Indonesia's stock market triggered a lower Jakarta Composite Index (JCI) and rupiah depreciation, particularly in the first quarter of 2020 (Graph 2.1.6).

Graph 2.1.1 CDS Performance in Selected Countries



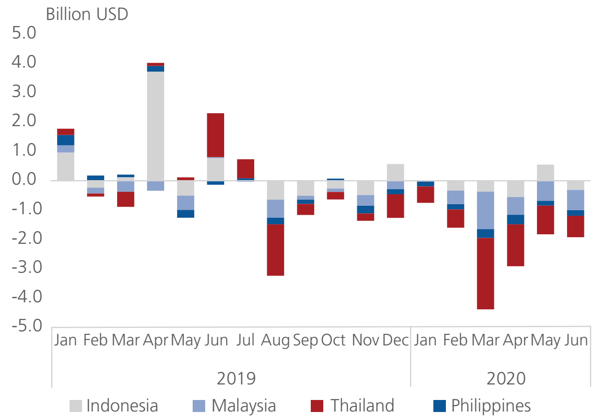
Source: Bloomberg, processed

Graph 2.1.2 Prices of Safe Haven Assets



Source: Bloomberg, processed

Graph 2.1.3 Net Flow in Regional Stock Exchanges



Source: Bloomberg, processed

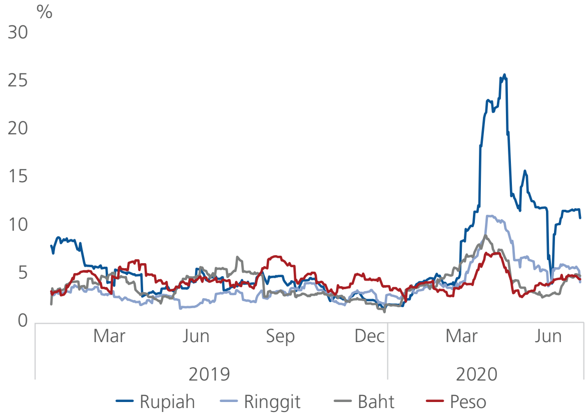
Exchange rate depreciation intensified market risk, particularly for corporations holding external debt. Notwithstanding, a potential default due to a larger foreign currency debt repayment burden was effectively suppressed through the hedging strategies employed by most corporations. In the first quarter of 2020, 73% of the 2,064 non-bank corporations with external debt met the minimum hedging ratio[1] for foreign currency obligations maturing till the next six months.

In addition, corporations also strived to maintain repayment capacity through debt reprofiling towards longer maturity periods, as evidenced by an increase in the share of external debt maturing in more than one year from 80.83% in the second semester of 2019 to 82.39% in the first semester of 2020. Therefore, foreign currency liability management in the non-bank corporate sector is considered relatively sound.

In the stock market, a net foreign outflow was recorded in the property sector in line with weak demand for property during the COVID-19 pandemic (Graph 2.1.7). In the bond market, government securities (SBN) released by foreign investors led to an increase in SBN yield (Graph 2.1.8). The SBN released by foreign investors were purchased by the domestic banking industry as an attractive alternative investment instrument amidst a credit contraction caused by low real sector demand for financing combined with a cautious and selective banking industry in terms of lending (Table 2.1.1).

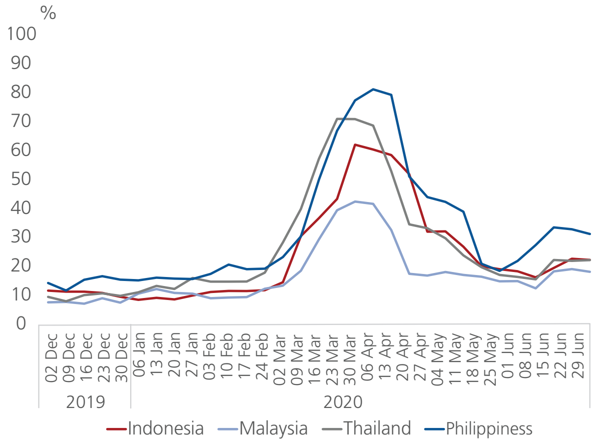
Entering the second quarter of 2020, investors exhibited less risk-off behaviour in line with the various policies issued by the central bank and government to recover the economy. Nevertheless, the respective positions of the Jakarta Composite Index (JCI), rupiah exchange rates and government bond yields at the end of the first semester of 2020 had not recovered to pre-pandemic levels.

Graph 2.1.4 Regional Domestic Currency Volatility



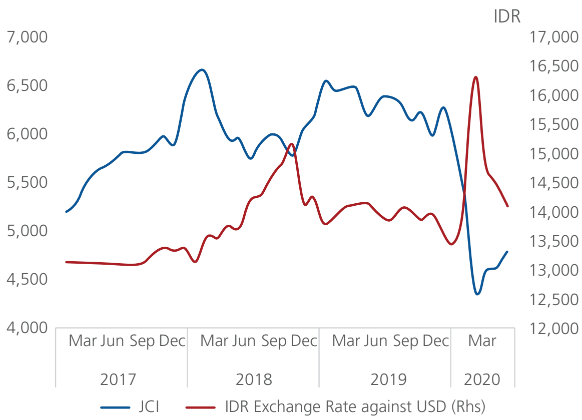
Source: Bloomberg, processed

Graph 2.1.5 Regional Stock Price Volatility



Source: Bloomberg, processed

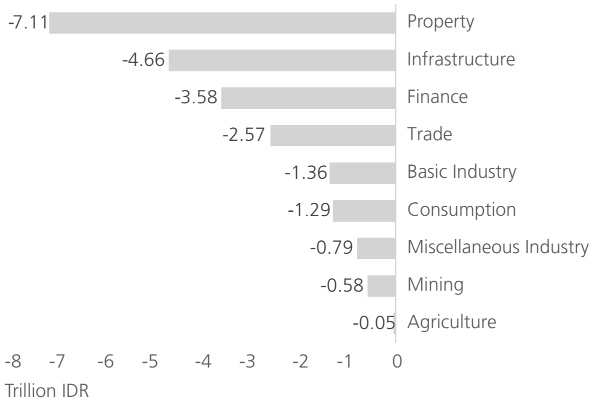
Graph 2.1.6 Jakarta Composite Index (JCI) and Rupiah Exchange Rate



Source: Bloomberg, processed

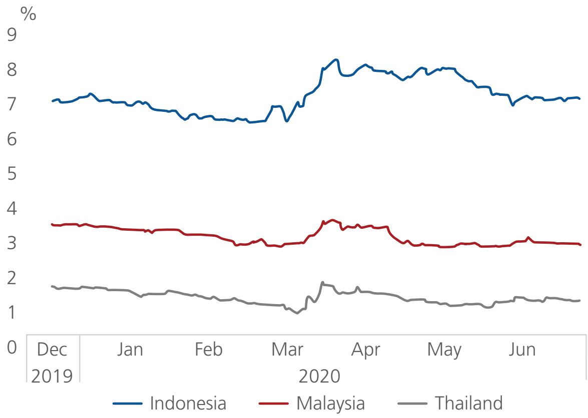
1 Bank Indonesia Regulation (PBI) No. 16/21/PBI/2014 requires nonbank corporations with external debt to meet a minimum hedging ratio of 25% of the negative difference between foreign currency assets and foreign currency liabilities maturing in : (i) 3 months; and (ii) 3-6 months.

Graph 2.1.7 Stock Outflow by Sector



Source: Bloomberg, processed

Graph 2.1.8 Government Bond Yield



Source: Bloomberg, processed

Table 2.1.1 Holdings of Government Securities (SBN)

Institution	Sem I 2019 (Trillion IDR)	Sem II 2019 (Trillion IDR)	Sem III 2019 (Trillion IDR)	Sem II 2020			Share
				Outstanding	Growth (ytd)	Growth (yoy)	
Banks:	589	581	763	1,034	78%	76%	32%
Bank Indonesia	154	262	255	208	-21%	35%	7%
Nonbanks:	1,788	1,909	1,815	1,956	2%	9%	61%
Investment Funds	107	131	129	136	4%	28%	4%
Insurance	213	215	226	278	29%	31%	9%
Foreign	989	1,062	927	937	-11.8%	-5.2%	29.3%
Pension Funds	237	257	272	230	-10%	-3%	7%
Individual	77	81	87	93	14%	20%	3%
Others Institutions	166	163	173	282	73%	70%	9%
Total	**2,531**	**2,753**	**2,833**	**3,199**	**16.20%**	**16.23%**	**100%**

Source: Indonesian Central Securities Depository (KSEI), processed

2.2 Corporate and Household Dynamics during the COVID-19 Pandemic

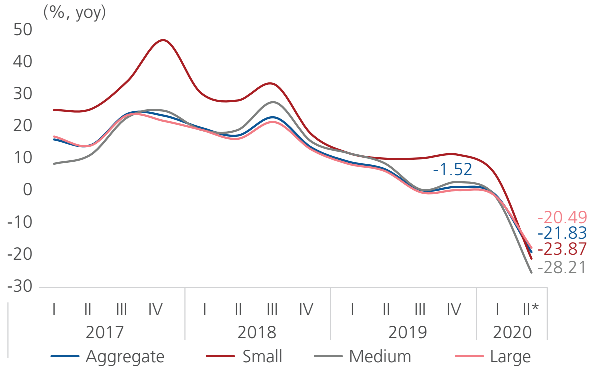
2.2.1 Corporate Performance and Resilience

The COVID-19 pandemic triggered negative economic growth in many countries during the first half of 2020, particularly in the second quarter. Consequently, world trade volume has experienced a significant decline, thus compounding dwindling global trade that has endured for the past three years due to the trade war waged between the United States and China. As described in Chapter I, shrinking world trade has impacted demand for Indonesia's export commodities. Lower export sales have directly increased non-financial corporate sector vulnerabilities because exports are still one of the main revenue sources for corporations in Indonesia.

In addition to decreasing exports, domestic sales also experienced intense pressures due to less public mobility during the large-scale social restrictions introduced in nearly all regions of Indonesia until the end of the second quarter of 2020. As an aggregate, domestic sales performance contracted sharply from -1.52% (yoy) in the fourth quarter of 2019 to -21.83% (yoy) in the second quarter of 2020, with small and medium enterprises hardest hit, experiencing -23.87% (yoy) and -28.21% (yoy)[2] sales contractions respectively (Graph 2.2.1.1).

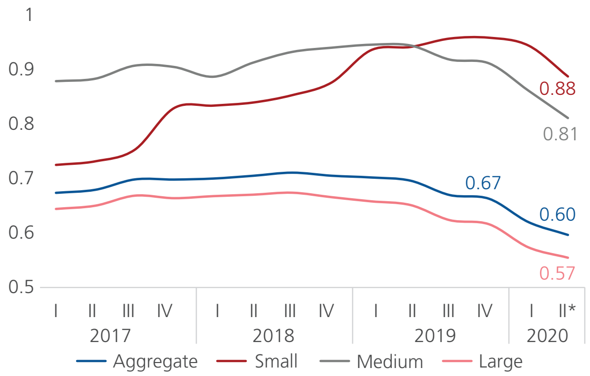
The corporate sector also encountered supply-side issues. The COVID-19 pandemic has caused disruptions in the global supply chain. Restrictions on the flow of goods and people at the beginning of the pandemic, coupled with stringent health quarantine procedures and security inspections within the customs territory of various partner countries, China in particular, impeded the supply of raw materials for production. Consequently, production experienced intense pressures in the second quarter of 2020. Asset turnover (ATO) retreated from 0.67 at the end of 2019 to 0.60 in the second quarter of 2020 (Graph 2.2.1.2). Furthermore, inventory turnover (ITO) also fell from 6.08 at the end of 2019 to 5.59 in the second quarter of 2020 (Graph 2.2.1.3).

Graph 2.2.1.1 Sales Performance of Public Corporations based on Asset Size



*) preliminary realisation data for 494 corporations
Source: Corporate Financial Reports, processed

Graph 2.2.1.2 Corporate Asset Turnover

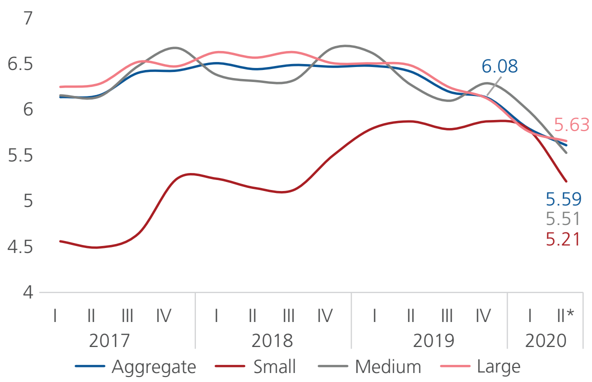


*) preliminary realisation data for 494 corporations
Source: Indonesia Stock Exchange (IDX), processed

2 The classifications for large, medium and small enterprises are based on corporate asset share in 2019. Corporations with assets exceeding the 75th percentile are considered large, 50-75 medium and below the 50th percentile are small.

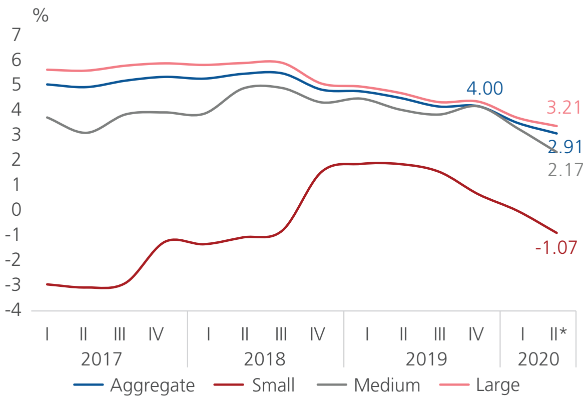
Sluggish sales performance due to COVID-19 has eroded corporate profitability. As an aggregate, the return on assets (ROA) declined significantly from 4.00% in the fourth quarter of 2019 to 2.91% in the second quarter of 2020 (Graph 2.2.1.4). Consistent with the lower ROA, investors received lower yields, from 8.51% in the fourth quarter of 2019 to 6.33% in the second quarter of 2020 (Graph 2.2.1.5). Based on both ratios, the profitability of small and medium enterprises was impacted more severely than large corporations, which were more resilient through diversified business lines and larger market share (as market leaders), as well as solid business group support.

Graph 2.2.1.3 Corporate Inventory Turnover



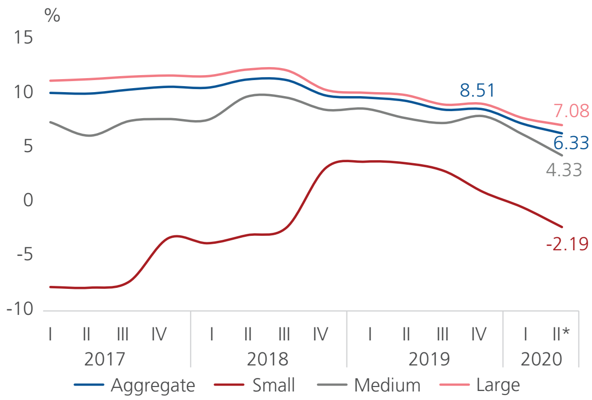
*) preliminary realisation data for 494 corporations
Source: Corporate Financial Reports, processed

Graph 2.2.1.4 Corporate Return on Assets (ROA)



*) preliminary realisation data for 494 corporations
Source: Corporate Financial Reports, processed

Graph 2.2.1.5 Corporate Return on Equity (ROE)



*) preliminary realisation data for 494 corporations
Source: Corporate Financial Reports, processed

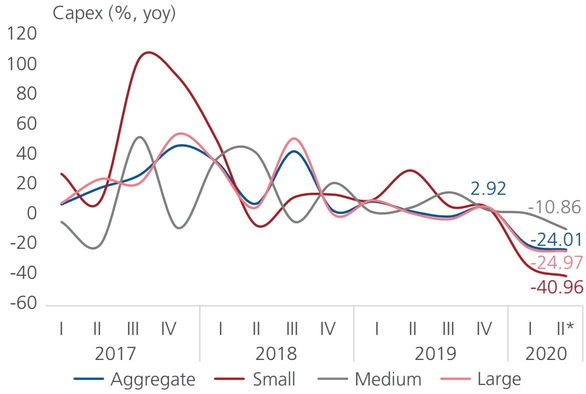
Corporate capacity to generate returns declined significantly in the first half of 2020, forcing the corporate sector to evaluate and adjust long-term investment decisions, as reflected by capital expenditure rationalisation in the interim financial statements. As an aggregate, corporates reduced capital spending by as much as -24.01% (yoy) in the second quarter of 2020. In line with intense pressures on profitability, compared with other corporate groups, capital spending at small enterprises contracted by -40.96% (yoy) at the end of the first semester of 2020 (Graph 2.2.1.6).

Deteriorating corporate performance also impacted corporate ability to meet financial obligations. Around 50% of corporations had an interest coverage ratio (ICR) below 0.47 at the end of the second quarter of 2020, down considerably from a level of 2.32 at the end of 2019. Large corporations were comparatively resilient, with 50% maintaining an ICR exceeding 1.26 (Graph 2.2.1.7).

In terms of the business field, several economic sectors successfully maintained positive sales performance in the first quarter of 2020, namely agriculture, corporate services, social services, and trade (Table 2.2.1.1). In the second quarter, however, all economic sectors experienced sales contractions, except agriculture which maintained positive 13.35% (yoy) in line with sales growth after the main harvesting season was delayed until the beginning of the second quarter of 2020. The manufacturing industry, trade as well as transportation were hardest hit by COVID-19 and represent a source of vulnerability that demands vigilance considering the large-scale social restrictions disrupted the flow of people and goods, which compressed domestic demand as well as production and investment activity in those three sectors.

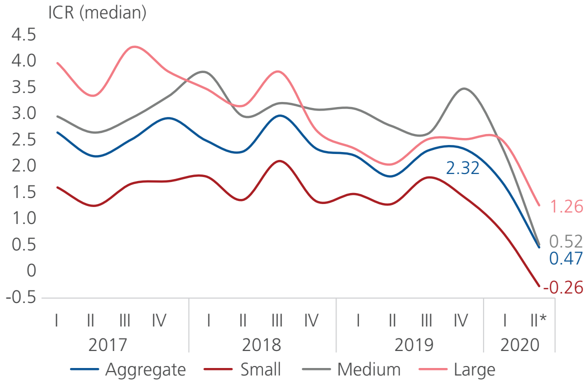
The tourism sector has been severely impacted by mobility restrictions during the COVID-19 pandemic, as reflected by trade and transportation sector performance. International arrivals fell sharply from 4.03 million in the fourth quarter of 2019 to just 483 thousand in the second quarter of 2020 (Graph 2.2.1.8). Fewer international travellers to Indonesia has also impacted hotel occupancy rates, which have fallen significantly since March 2020 from a national average of above 50% over the past three years to just 19.7% in June 2020. Meanwhile, hotels in Bali and Jakarta, which have historically enjoyed higher occupancy rates, only recorded 2.07% and 26.47% respectively in June 2020, even after the government relaxed large-scale social restrictions (Graph 2.2.1.9).

Graph 2.2.1.6 Capital Expenditure by Public Corporations



*) preliminary realisation data for 494 corporations
Source: Corporate Financial Reports, processed

Graph 2.2.1.7 Repayment Capacity of Public Corporations



*) preliminary realisation data for 494 corporations
Source: Corporate Financial Reports, processed

Corporate repayment capacity also contracted in the first half of 2020 on deteriorating corporate performance. Based on the interest coverage ratio (ICR), all economic sectors experienced lower repayment capacity, with all sectors maintaining a median ICR of below one, except mining, which was comparatively resilient with 50% of corporations maintaining an ICR above 1.68.

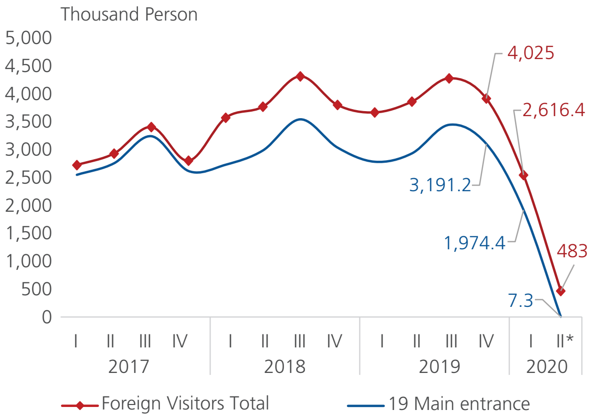
The COVID-19 pandemic has also impacted micro, small and medium enterprises (MSME) as part of the corporate value chain. Based on an online survey conducted by Bank Indonesia at the end of the second quarter of 2020 with a sample of 935 MSMEs under the mentorship or in partnership with Bank Indonesia, around 71.5% were experiencing declining performance, 56% lower sales, 35% capital shortfalls and 50% raw material issues. The most resilient MSMEs in the survey were operating in the agricultural sector (34%), followed by processed foods (26.1%), handicrafts and fashion (29.9%), as well as exports (10%). In total, 76.4% of the sample MSMEs did not require new loans or apply for loan restructuring facilities. Furthermore, most MSMEs maintained adequate cash flow or preferred to use savings/ internal funds.

Table 2.2.1.1 Corporate Financial Performance by Economic Sector

No.	Sector	Sales Growth (%)						CAPEX Growth (%)						ICR (Median)					
		Q IV 18	Q I 19	Q II 19	Q IV 19	Q I 20	Q II 20*	Q IV 18	Q I 19	Q II 19	Q IV 19	Q I 20	Q II 20*	Q IV 18	Q I 19	Q II 19	Q IV 19	Q I 20	Q II 20*
1	Agriculture	0.51	5.75	(8.36)	1.02	7.88	13.35	(35.93)	20.00	14.64	27.44	(15.56)	(26.66)	(0.11)	0.95	(0.65)	1.18	0.95	0.11
2	Mining	24.31	9.51	16.88	(4.43)	(3.17)	(21.95)	9.21	7.13	(6.50)	8.23	(22.08)	(30.64)	1.88	2.24	3.44	2.17	3.99	1.68
3	Industry	16.21	6.68	4.20	(2.96)	(4.22)	(19.11)	51.49	11.29	10.35	(23.91)	(31.23)	(40.86)	2.81	2.69	1.93	2.33	2.26	0.70
4	Electricity, Gas, Water	(19.25)	(1.26)	(1.97)	(0.21)	(0.81)	(29.48)	(46.50)	(36.94)	(41.42)	(62.46)	(35.94)	(17.23)	1.34	5.17	5.44	(0.75)	4.63	(0.89)
5	Construction	(5.70)	(8.80)	(15.77)	(9.54)	(22.41)	(38.41)	(23.16)	(13.00)	(43.94)	(3.48)	(14.03)	(17.95)	2.61	2.16	1.25	2.70	0.87	0.21
6	Trade	12.95	8.97	2.73	1.84	0.42	(27.30)	61.17	35.19	(1.94)	(32.57)	(37.03)	(28.46)	2.45	1.59	1.63	2.79	0.94	(0.51)
7	Transportation	1.11	9.68	9.38	2.29	(4.07)	(22.71)	(19.41)	14.24	31.34	82.37	4.02	4.51	0.73	1.79	2.18	1.46	1.42	0.63
8	Business Services	9.63	9.80	19.58	21.43	7.50	(23.89)	24.90	(10.09)	(31.54)	(65.33)	(48.07)	(8.18)	2.33	2.79	2.67	3.77	1.94	0.10
9	Social Services	23.60	14.79	10.40	10.29	0.91	(17.46)	(47.78)	(24.50)	(42.45)	(21.43)	(31.29)	(42.90)	3.61	2.40	4.36	5.05	2.95	0.41
	Aggregate	**10.79**	**6.38**	**4.03**	**(1.52)**	**(3.81)**	**(21.83)**	**1.02**	**6.82**	**0.64**	**2.92**	**(20.76)**	**(22.03)**	**2.33**	**2.21**	**1.81**	**2.32**	**1.70**	**0.47**

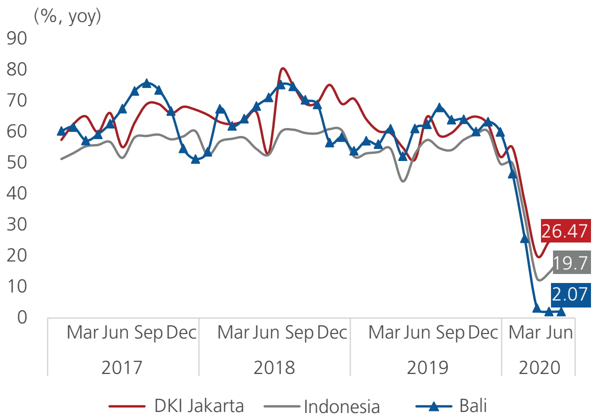
*) interim figures. data on the realization of 494 corporations
Source: Corporate Financial Reports, processed

Graph 2.2.1.8 International Arrivals



*) preliminary realisation data for 494 corporations
Source: Indonesian Economic and Financial Statistics (SEKI), processed

Graph 2.2.1.9 Hotel Occupancy Rates



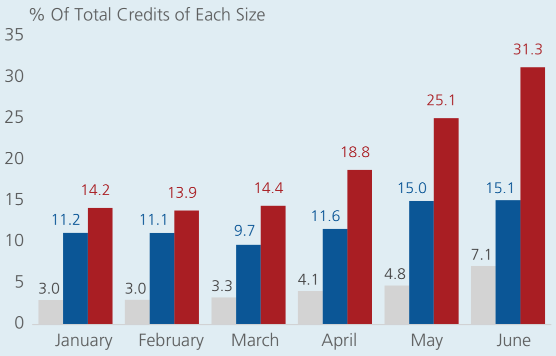
Source: BPS-Statistics Indonesia, processed

Box 2.2.1. Restructuring to Maintain Corporate Liquidity and Repayment Capacity

The impact of COVID-19 and the large-scale social restrictions introduced to break the domestic chain of transmission have forced a number of corporations into loan restructuring facilities in accordance by OJK Regulation (POJK) No.11/POJK.03/2020. This was confirmed by a surge of loan restructuring activity since the end of the first quarter of 2020, which accelerated through to the end of the second quarter of 2020 (Graph B2.2.1.1). Based on asset size, corporations with total assets of less than Rp2 trillion experienced the largest increase in terms of loan restructuring. By sector, most loan restructuring affected corporations providing tertiary needs, such as construction, trade, transportation, and corporate services, as well as suppliers of non-health-related tertiary needs (Graph B2.2.1.2). On the other hand, commodity-based corporations, as well as suppliers of food, health products, electricity, and telecommunication facilities have remained resilient.

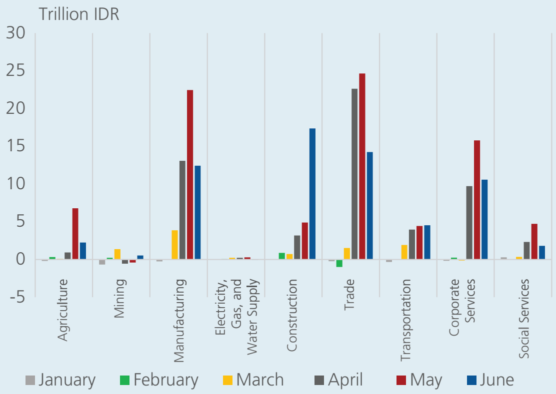
Despite growing demand for loan restructuring, financial system stability was maintained in the normal zone. In general, small corporations with various repayment and liquidity conditions dominated applications for additional restructuring facilities. On one hand, large corporations with existing loan restructuring facilities had an adequate asset buffer and maintained corporate reputation. The results of mapping corporate repayment capacity based on June 2020 data showed that most corporations with high repayment capacity did not apply for new restructuring facilities, located in Quadrant I and Quadrant II. Prudential principles remained a key priority of the banking system, as confirmed by low utilisation of additional restructuring facilities amongst corporations with low liquidity and repayment capacity (Quadrant III). Nevertheless, corporations with low repayment capacity that had applied for additional restructuring facilities did not face further liquidity constraints (Quadrant IV), indicating that facilities to postpone maturing payment obligations in the near term provided sufficient space for small corporations to maintain liquidity in the normal zone (Graph B2.2.1.3).

Graph B2.2.1.1 Loan Restructuring by Corporation Size



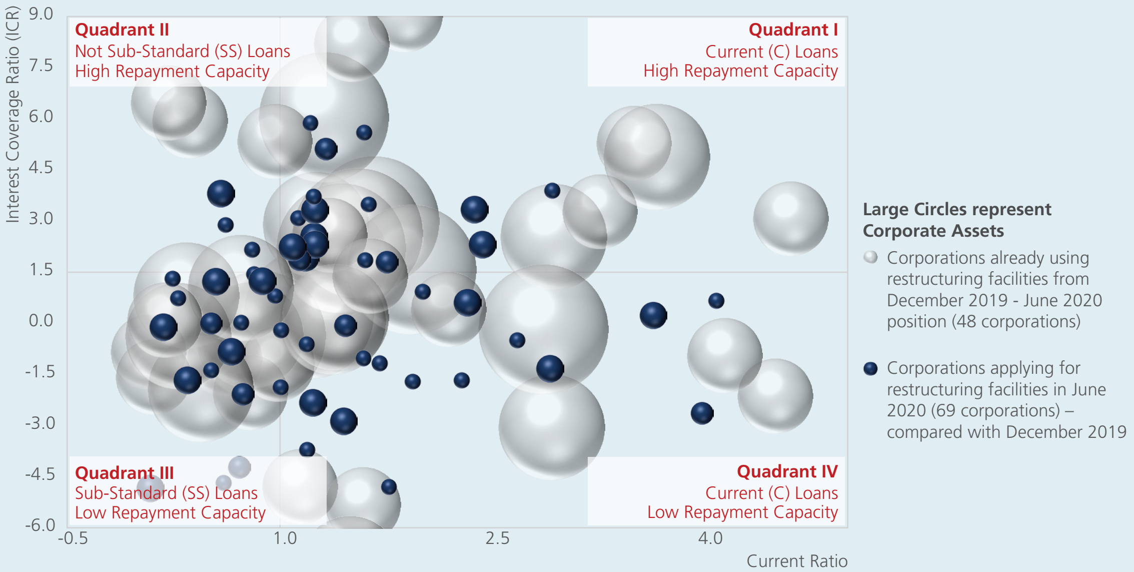
Source: Financial Services Authority (OJK), processed

Graph B2.2.1.2 Loan Restructuring by Sector



Source: Financial Services Authority (OJK), processed

Graph B2.2.1.3 Distribution of Loan Restructuring based on Loan Status and Corporate Repayment Capacity



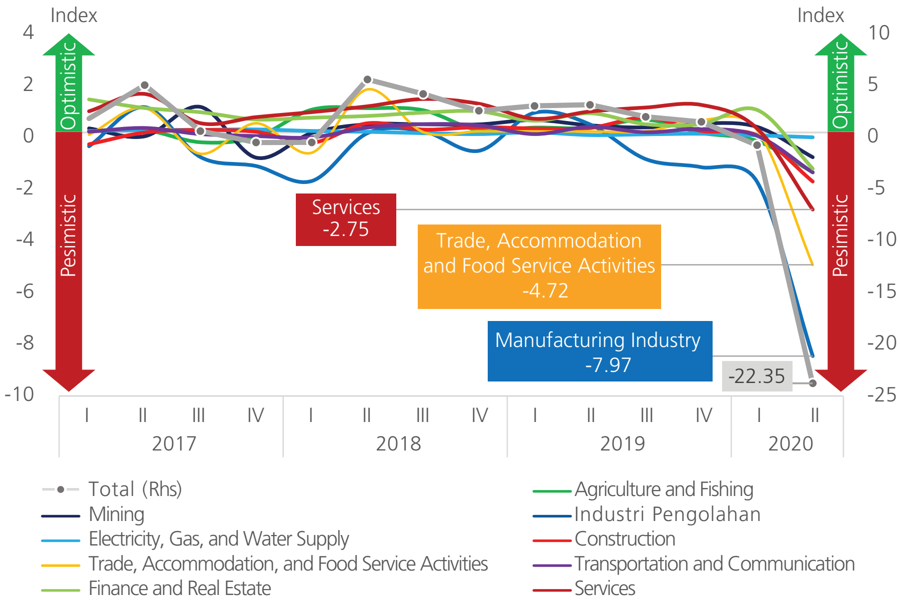
Source: Bank Indonesia and Financial Statements of Public Corporations, processed

2.2.2 Household Performance and Resilience

Restrained corporate performance has impacted labour absorption and household sector incomes, particularly amongst the middle class and those towards the bottom of the pyramid. The sectors hardest hit in terms of lower labour absorption include the manufacturing industry, followed by trade, accommodation, and food service activities as well as the services sector (Graph 2.2.2.1). Lower labour absorption is also in line with a lower job availability index, fewer advertisements for job vacancies and high labour vulnerability as announced in the mass media, despite early signs of improvement in June 2020 after the government began to relax large-scale social restrictions (Graph 2.2.2.2). Labour market shocks have reduced household income, thereby pressuring income indexes across all sectors, particularly the manufacturing and trade sectors, as well as hotels and restaurants.

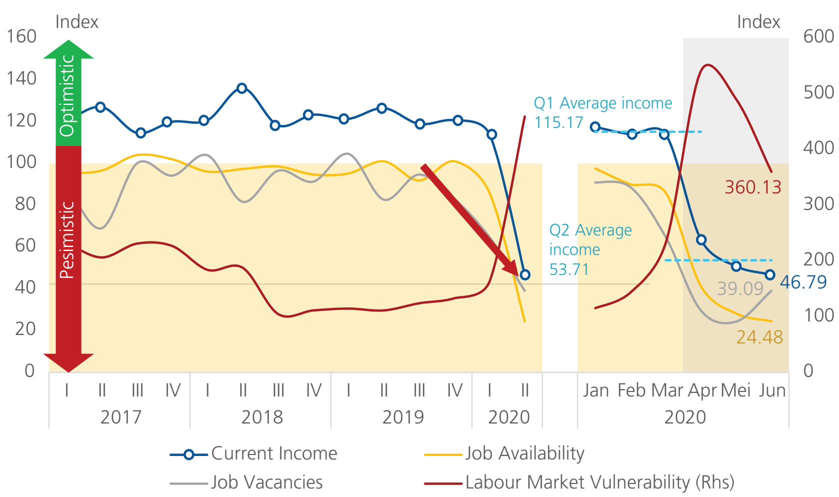
Lower labour absorption and incomes have precipitated a shift in the consumption behaviour of households during the pandemic. Weak household demand during the large-scale social restrictions and during the transition to the new normal era have been reflected by an ongoing contraction in the Consumer Confidence Index

Graph 2.2.2.1 Labour Absorption by Sector



Source: Bank Indonesia, processed

Graph 2.2.2.2 Income, Job Availability, and Employment Indicators

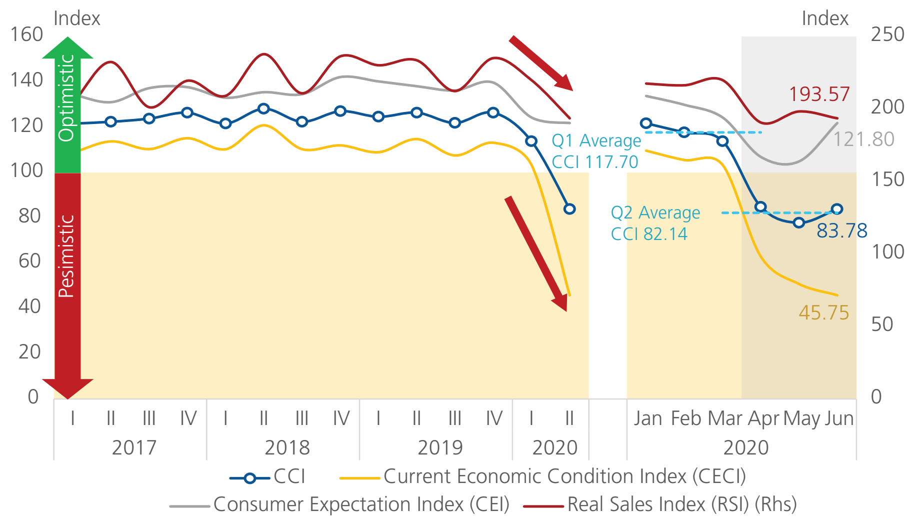


Source: Bank Indonesia, processed

(CCI), as a measure of consumer confidence in economic conditions. The CCI contraction was impacted by both component indexes, namely the Current Economic Condition Index (CECI) and Consumer Expectation Index (CEI). In addition, compressed household demand was also confirmed by a decline recorded in the Real Sales Index (RSI) during the first semester of 2020 (Graph 2.2.2.3).

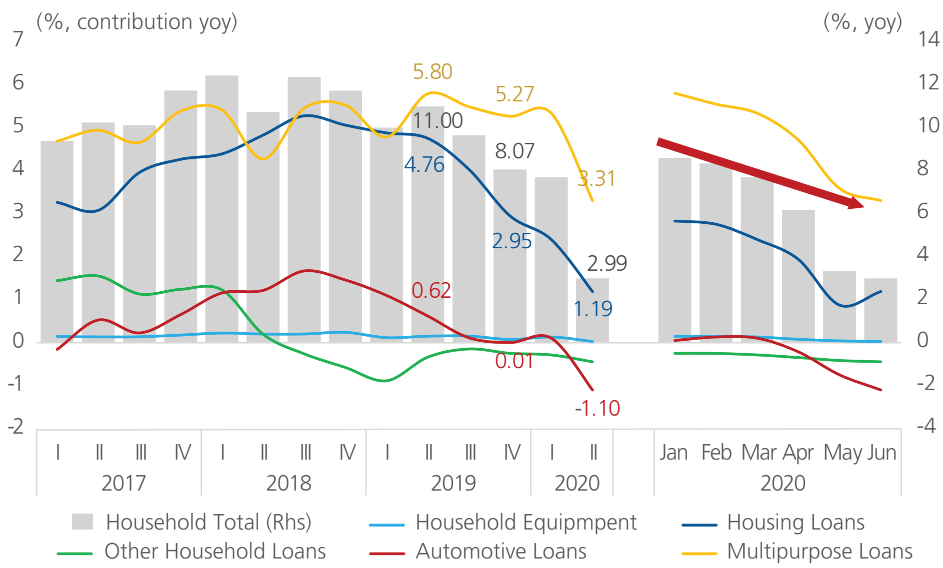
The deleterious impact of COVID-19 transmission on sluggish household credit growth was amplified after the government introduced large-scale social restrictions. Consumer loans disbursed to individual borrowers (households) slumped from 8.07% (yoy) at the end of 2019 to 2.99% (yoy) at the end of the first semester of 2020 (Graph 2.2.2.4). Slower growth affected all types of household consumer loans disbursed by the banking industry, led by automotive loans (-1.10% yoy). Meanwhile, growth of multipurpose loans, which dominated 45.22% of total household loans, decelerated from 5.27% (yoy) at the end of 2019 to 3.31% (yoy) at the end of the first semester of 2020.

Graph 2.2.2.3 Consumer Confidence and Real Sales Indicators



Source: Bank Indonesia, processed

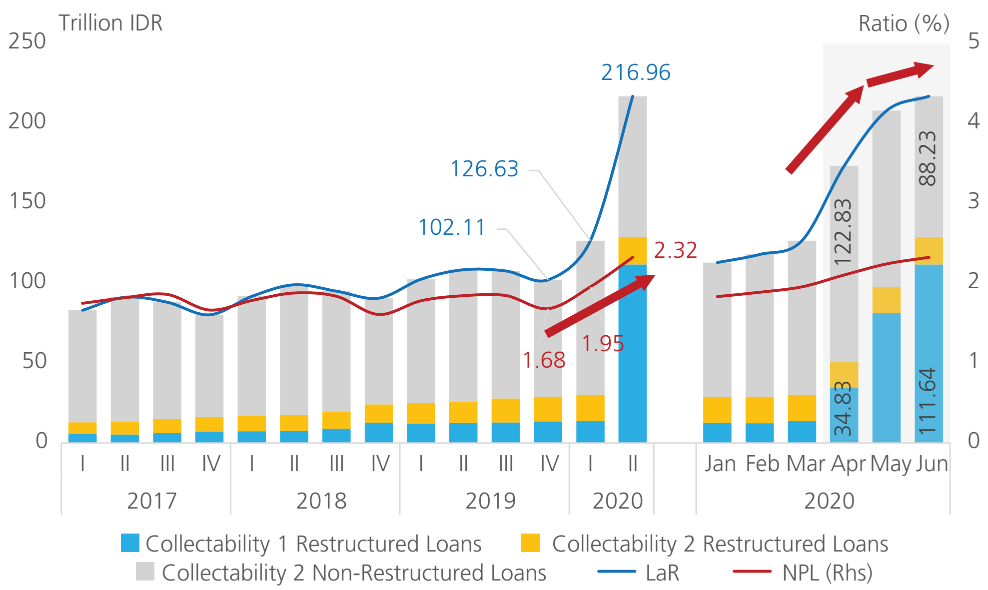
Graph 2.2.2.4 Consumer Loans for Individual Borrowers



Source: Bank Indonesia, processed

Pressures on households undermined the repayment capacity of individual borrowers. Despite slower credit growth, credit risk in the household sector increased significantly in line with the notable bump in Loans at Risk (LaR), which doubled from Rp102.11 trillion at the end of 2019 to Rp216.96 trillion at the end of the first semester of 2020 (Graph 2.2.2.5). The doubling of loans at risk was caused by a spike in loan restructuring (collectability one), which began when large-scale social restrictions were introduced in April 2020 until the transition towards the new normal era in June 2020. The increase in loans at risk primarily impacted housing loans for home stores/home offices as well as residences measuring 22-70 m². Consistent with the increase, the NPL ratio on household loans also climbed from 1.68% at the end of 2019 to 2.32% at the end of the second semester of 2020, which is nevertheless still below the 5% threshold (Table 2.2.2.1 and Table 2.2.2.2). The build-up of credit risk primarily stemmed from housing loans, for home stores/home

Graph 2.2.2.5 LaR and NPL for Individual Borrowers



Source: Bank Indonesia, processed

Table 2.2.2.1 LaR and NPL of housing loans

Type of Housing Loan	Collectability 1 Restructured Loans (IDR Trillion)			LaR (%)			NPL (%)		
	2019	2020		2019	2020		2019	2020	
	Q IV	Q I	Q II	Q IV	Q I	Q II	Q IV	Q I	Q II
Landed House < 22m²	0.41	0.58	4.30	8.04	11.60	10.53	2.26	2.90	3.55
Landed House 22-70m²	5.53	6.12	39.68	8.27	11.03	11.36	1.81	1.98	2.38
Landed House > 70m²	1.81	1.49	19.10	7.27	9.48	9.98	2.63	2.95	4.02
Apartment < 22m²	0.02	0.01	0.07	6.71	5.98	6.48	2.02	1.98	2.15
Apartment 22-70m²	0.08	0.09	1.03	5.73	7.66	8.51	1.34	1.60	2.00
Apartment > 70m²	0.03	0.05	1.05	6.24	8.38	9.14	1.01	1.90	3.02
Home Store/Home Office	0.52	0.35	3.99	9.67	11.92	13.07	4.95	5.05	6.42

Source: Bank Indonesia, processed

offices in particular, which were most affected by the large-scale social restrictions. Proportionally, however, the increase was not considered significant.

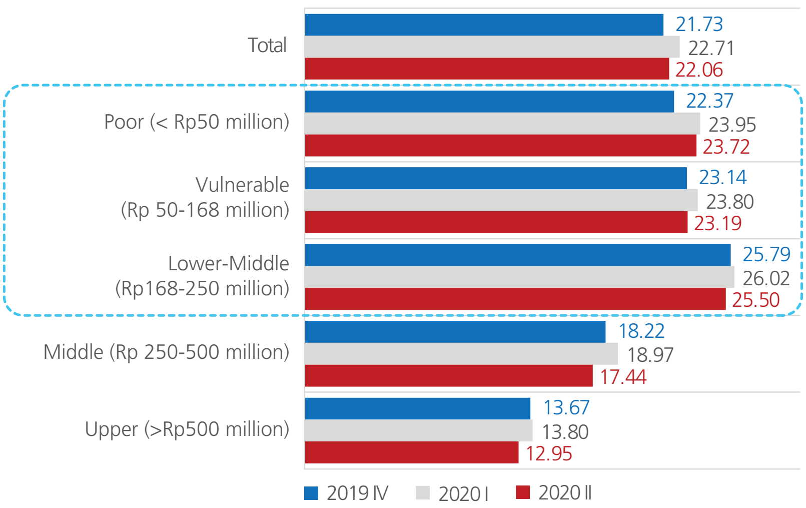
Based on household income classifications, pressures on repayment capacity were most evident amongst low- and middle-income households. The debt service ratio (DSR), as a measure of debt repayments to income, has increased across all income brackets. DSR spiked in the first quarter of 2020 before declining thereafter in the second quarter in line with the household loan restructuring program (Graph 2.2.2.6). Mirroring the DSR trend, the debt-to-income (DTI) ratio has also increased, particularly amongst middle-income earners. Overall, however, the DTI ratio contracted in May 2020, primarily due to high-income earners (Graph 2.2.2.7).

Table 2.2.2.2 LaR and NPL for Individual Borrowers by Subsector

Household Consumer Loan	Collectability 1 Restructured Loans			LaR (%)			NPL (%)		
	2019	2020		2019	2020		2019	2020	
	Q IV	Q I	Q II	Q IV	Q I	Q II	Q IV	Q I	Q II
Automotive Loans	0.13	0.15	13.00	10.87	13.29	24.25	1.33	1.56	2.86
Housing Loans	8.39	8.70	69.22	11.64	14.28	24.66	2.62	2.99	3.31
Multipurpose Loans	4.35	4.30	27.15	3.83	4.76	8.57	0.97	1.19	1.37
Household Equipment	0.07	0.05	0.38	4.63	6.53	12.04	1.33	1.76	2.71
Other Household Loans	0.69	0.60	1.89	5.01	6.16	8.85	1.19	1.28	1.71
Total	13.63	13.80	111.64	7.76	9.53	16.65	1.68	1.95	2.32

Source: Bank Indonesia, processed

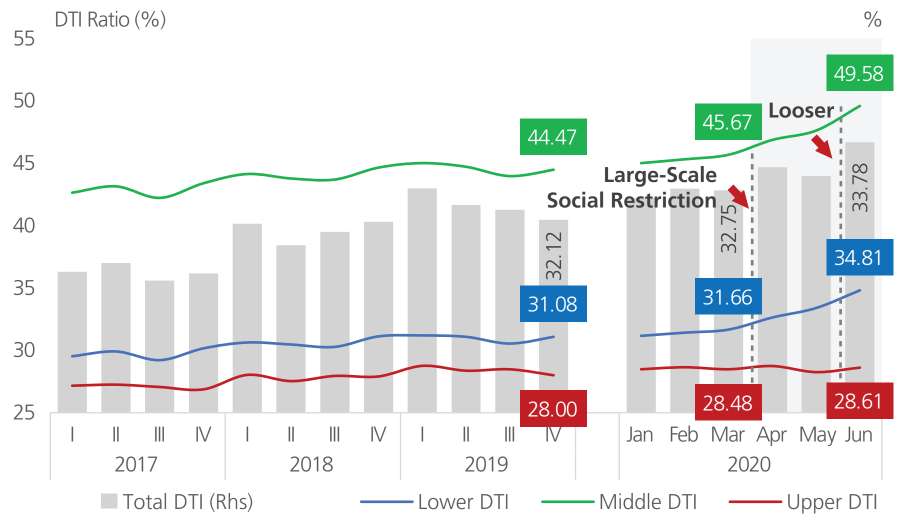
Graph 2.2.2.6 Debt Service Ratio (DSR) for Individual Borrowers by Income Bracket (%)



Source: Financial Services Authority (OJK), Bank Indonesia, processed

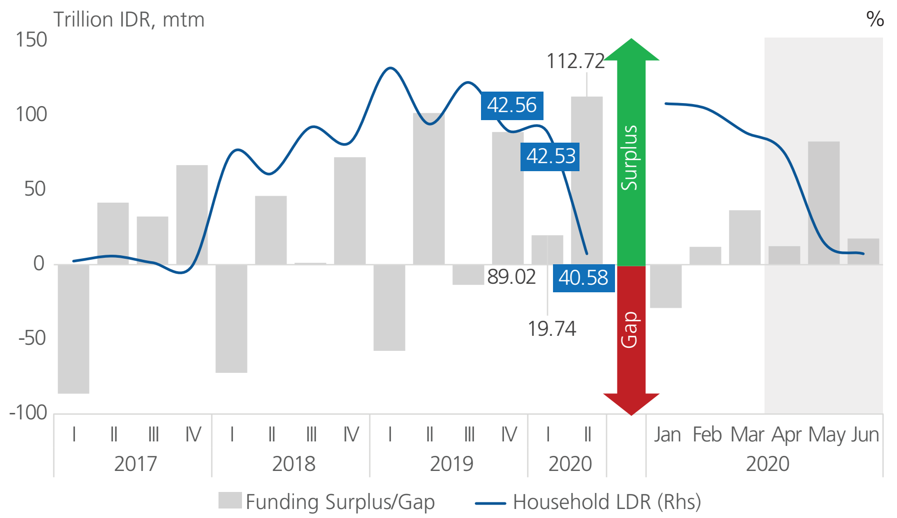
Despite the build-up of credit risk faced, households have maintained sufficient savings during the pandemic era. The household funding surplus recorded an additional Rp19.74 trillion in the first quarter of 2020 and Rp112.72 trillion in the second quarter of 2020 (Graph 2.2.2.8). This was in line with a lower loan-to-deposit ratio (LDR) for individual customers, falling from 42.56% at the end of 2019 to 40.58% at the end of the first semester of 2020, as households were more inclined to save, particularly after receiving the annual religious holiday allowance (THR) before Eid al-Fitr in May 2020, in response to the pandemic by adjusting consumption, particularly amongst middle- and upper-income households.

Graph 2.2.2.7 Household DTI Ratio



Source: BPS-Statistics Indonesia, Financial Information Services System (SLIK),

Graph 2.2.2.8 Funding Surplus/Gap for Individual Costumers



Source: Bank Indonesia, processed

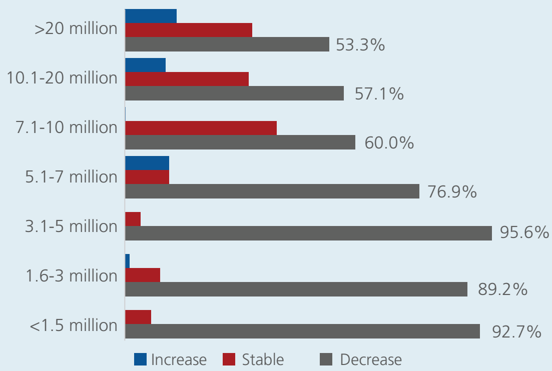
Box 2.2.2. Social Aid Program Disbursements as Household Consumption Buffer

The COVID-19 pandemic has hit the Indonesian economy hard from two sides simultaneously, namely demand and supply. On the demand side, Indonesia's economy still relies on household consumption, which contributes around 55-60% of gross domestic product (GDP). Therefore, the social restrictions introduced in April 2020 had a direct impact on lower household consumption growth in the second quarter of 2020 at 5.51% (yoy). This was the single largest contributor to the national economic contraction experienced in the second quarter of 2020.

Declining household consumption was also linked to lower household income during the COVID-19 pandemic. Many businesses introduced work-from-home protocols and some were even forced to terminate work contracts due to sluggish economic activity. At the end of the second quarter of 2020, the Ministry of Manpower recorded more than 3 million employees working from home or who had had their employment contracts terminated. The actual figure is likely to be much higher because 56.5% of the labour force in Indonesia is employed in the informal sector[1].

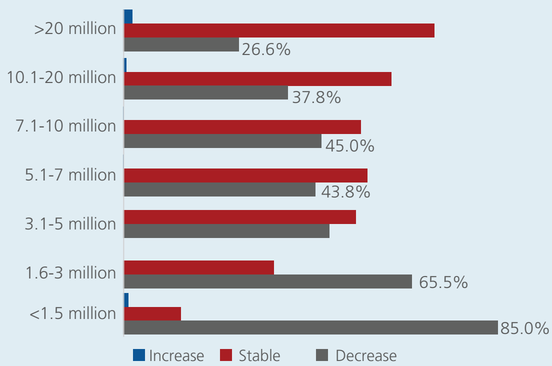
The Indonesian Institute of Sciences (LIPI) recently released a survey concerning the economic impact of COVID-19 on households. Based on the results of that survey, lower incomes were confirmed by the majority of sample households, particularly amongst household businesses (MSME) forced to reduced production or close due to the COVID-19 pandemic (Graph B2.2.2.1). Meanwhile, salaried households maintained more stable income, excluding those earning less than Rp3 million per month (Graph B2.2.2.2). Consequently, households were forced to use their savings or borrow from family members to overcome financial difficulties (Graph B2.2.2.3). Lower incomes were accompanied by lower household consumption, particularly in terms of prepared foods, transportation, and recreation.

Graph B2.2.2.1 Changes in Income of Household Enterprises



Source: Indonesian Institute of Sciences (LIPI), 2020

Graph B2.2.2.2 Changes in Income of Household Workers



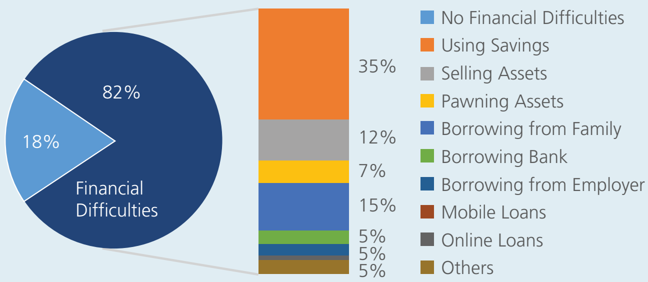
Source: Indonesian Institute of Sciences (LIPI), 2020

1 National Labour Force Survey (SAKERNAS), BPS-Statistics Indonesia, February 2020.

Seeking to buffer household consumption and alleviate the impact of COVID-19 on increasing poverty incidence, the Indonesian Government expanded the scope and increased the value of regular and non-regular social aid program (bansos) disbursements through the relevant ministries. The regular programs include all existing programs, namely the Sembako (basic essentials) program and Family Hope Program (PKH), targeting poor and vulnerable households. The non-regular programs include electricity subsidies, pre-employment cards, sembako disbursements in Jabodetabek, non-Jabodetabek cash social assistance, as well as village fund direct cash assistance, targeting households impacted by COVID-19 (Graph B2.2.2.4).

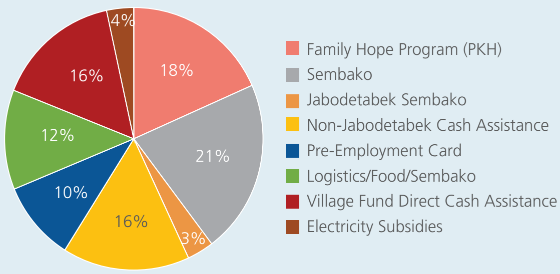
The total government budget disbursed for social protection programs totals Rp203.9 trillion, equivalent to approximately 29.3% of the total national economic recovery budget and the largest budget entry. At the beginning of September 2020, around Rp101.06 trillion, or

Graph B2.2.2.3 Household Financial Conditions during Pandemic



Source: Indonesian Institute of Sciences (LIPI), 2020

Graph B2.2.2.4 Composition of Social Protection Budget



Source: Indonesian Institute of Sciences (LIPI), 2020

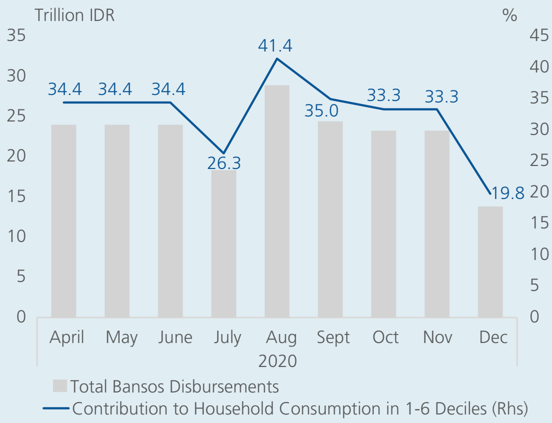
52.2%, of the budget had been absorbed[2], led by the Family Hope Program (PKH) with 78%, followed by the Sembako Program with 69% and Non-Jabodetabek Cash Assistance with 67%

Not resting on its laurels, commencing in August 2020, the Government will disburse social aid program (bansos) payments worth Rp 600,000 per month for four months (September-December 2020) to workers earning less than Rp5 million per month, targeting 15.7 million workers registered as active participants of the Social Security Management Agency (BPJS). The Government has prepared a budget of Rp37.87 trillion to support this program (Table B2.2.2.1).

Considering the pandemic is expected to endure at least until the end of the year, the Government has extended the cash assistance, Jabodetabek sembako, and village fund direct cash assistance programs until the end of 2020 at 50% of the value of the previous social aid program (bansos). Therefore, social aid program disbursements by the Government total Rp13.8-28.9 trillion per month, targeting households with a welfare level in decile 1 to decile 6, or the poorest 60% of Indonesia's population.

Based on the Household Balance Sheet Survey (SNRT) in 2019, spending on households in the first 6 deciles totals Rp69.79 trillion per month. Based on that assumption, the government's social assistance program contributes around 19.8-41.4% of total consumption beneficiary households (Graph B2.2.2.5), which is thus expected to buffer household consumption that has declined due to the COVID-19 pandemic.

Graph B2.2.2.5 Expected Contribution of Social Aid Program (bansos) Disbursements to Household Consumption



Source: Bank Indonesia, calculated

Table B2.2.2.1 Summary of Government's Social Aid Program (Bansos)*

Program	Total Budget (Trillion IDR)	Total Beneficiaries (Million of family)	Value (Thousands IDR)								
			April	May	June	July	Aug	Sept	Oct	Nov	Dec
Family Hope Program (PKH)	37.4	10	415.56	415.56	415.56	415.56	415.56	415.56	415.56	415.56	415.56
Sembako Card	43.6	20	200	200	200	200	200	200	200	200	200
Electricity Subsidy	6.9	31.2	36.86	36.86	36.86	36.86	36.86	36.86			
Non-Jabodetabek Cash Assistance	32.4	9	600	600	600	300	300	300	300	300	300
Non-PKH Cash Assistance	4.5	9					500				
Jabodetabek Sembako	6.8	1.9	600	600	600	300	300	300	300	300	300
Village Fund Direct Cash Assistance	31.8	8	600	600	600	300	300	300	300	300	300
Non-PKH Cash Assistance	4.5	9					500				
Pre-Employment Card	20	5.6	600	600	600	600					
Salary Subsidy (<Rp5 million)	37.87	15.72					600	600	600	600	

*Compiled from various sources

2 Source: Directorate General of the Treasury, Ministry of Finance

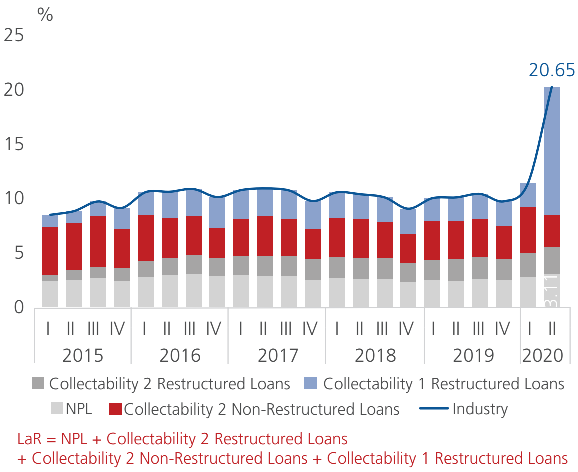
2.3 Banking Industry and Nonbank Financial Industry Dynamics during COVID-19 Pandemic

2.3.1 Bank Intermediation Function and Banking Industry Resilience

Banking industry exposure to deteriorating corporate and household performance intensified credit risk in the banking industry during the first half of 2020. Nevertheless, the banks effectively contained the risks. The national economic recovery program, which relaxed loan restructuring policy, helped to offset increasing credit risk in the banking industry. However, the risk averseness of banks and corporate wait-and-see resulted in lower credit growth in the first semester of 2020. Despite the credit squeeze, liquidity conditions in the banking industry improved. Furthermore, stress testing bank resilience showed that the current capital adequacy ratio is high enough to negate higher credit risk, even under a worst-case macroeconomic scenario. Moving forward, the banking industry is expected to maintain capital and liquidity conditions, thus providing sufficient space to stimulate bank intermediation activity.

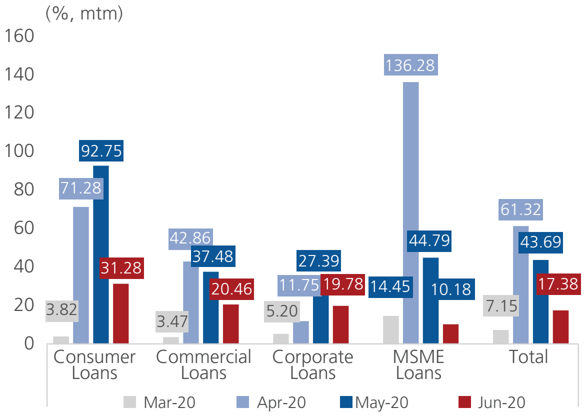
The decline corporate and household sector performance due to COVID-19 was followed by large-scale social restrictions, which undermined debt repayment capacity, as reflected by a build-up of credit risk in the banking industry. This was confirmed by commensurate increases in the ratios of Loans at Risk (LaR) to 20.65% and non-performing loans (NPL) to 3.11% in the second quarter of 2020 (Graph 2.3.1.1). Notwithstanding, the increase recorded in the NPL ratio was curbed by the implementation of OJK Regulation (POJK) No.11/POJK.03/2020 concerning National Economic Stimuli as Countercyclical Policy to the Impact of COVID-19 Transmission, which facilitated loan restructuring in the banking industry. Therefore, the banking industry was able to actively restructure loans from the beginning of the pandemic, with restructuring peaking in April-May 2020 before easing in June 2020 (Graph 2.3.1.2).

Graph 2.3.1.1 Credit Risk



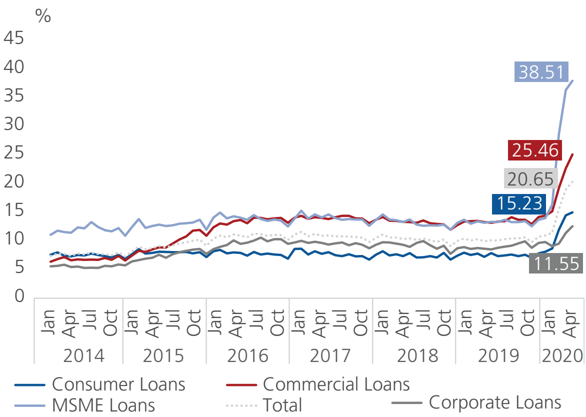
Source: Bank Indonesia, processed

Graph 2.3.1.2 Growth of Restructured Loans (%, mtm)



Source: Bank Indonesia, processed

Graph 2.3.1.3 LaR by Credit Segment



Notes:

Corporate loans have a limit of more than Rp100 billion, excluding MSME loans and consumer loans.

Commercial loans have a limit of less than Rp100 billion, excluding MSME loans and consumer loans.

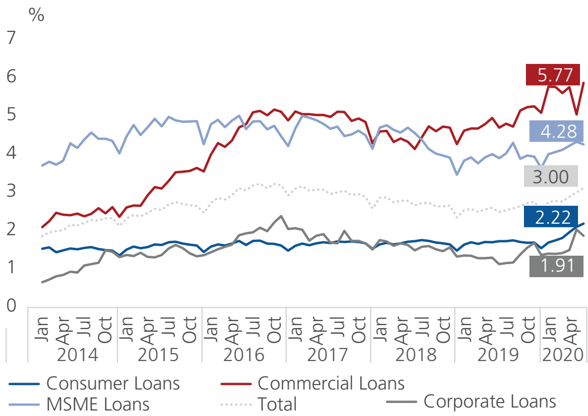
Source: Bank Indonesia, processed

Credit risk has increased across all segments (Graph 2.3.1.3 and Graph 2.3.1.4). The highest LaR ratio was recorded in the MSME segment, indicating that the COVID-19 pandemic has impacted the financial performance of micro, small and medium enterprises (MSME) hardest, thus requiring loan restructuring to prevent a further build-up of credit risk.

The LaR and NPL ratios also increased significantly for corporations engaged in economic sectors impacted directly by the COVID-19 pandemic and large-scale social restrictions, such as trade and the manufacturing industry (Table 2.3.1.1).

Consistent with corporate sector performance, lower public purchasing power increased credit risk on consumer loans, primarily affecting housing loans, automotive loans, and multipurpose loans (Table 2.3.1.2).

Graph 2.3.1.4 NPL by Credit Segment



Note:
Corporate loans have a limit of more than Rp100 billion, excluding MSME loans and consumer loans.
Commercial loans have a limit of less than Rp100 billion, excluding MSME loans and consumer loans.
Source: Bank Indonesia, processed

Table 2.3.1.1 LaR and NPL by Economic Sector (%)

Sector	LaR Ratio (%)			LaR Share (%)	NPL Ratio (%)			NPL Share (%)
	2019		2020	2020	2019		2020	2020
	Sem I	Sem II	Sem I	Sem I	Sem I	Sem II	Sem I	Sem I
Trade	13.09	12.26	33.62	31.09	3.94	3.66	4.73	29.04
Others (Household Consumption)	8.00	7.17	15.25	20.49	1.78	1.60	2.23	19.92
Manufacturing	10.45	12.68	21.11	16.82	2.87	3.88	4.57	24.18
Transportation and Telecommunications	10.56	8.92	19.05	4.25	2.07	1.64	2.05	3.03
Construction	17.35	15.29	20.01	6.35	3.67	3.55	3.84	8.08
Agriculture	9.72	9.41	19.08	6.53	1.46	1.66	1.91	4.34
Corporate Services	9.17	8.71	19.10	8.41	1.65	1.43	1.51	4.42
Social Services	8.40	7.51	26.20	3.65	1.78	1.50	1.90	1.76
Mining	12.34	10.35	14.06	1.80	3.58	3.58	4.96	4.23
Electricity Supply	2.96	2.88	3.26	0.61	0.86	0.89	0.81	1.00
Total	**10.29**	**9.93**	**20.65**	**100.00**	**2.50**	**2.53**	**3.11**	**100.00**

Source: Bank Indonesia, processed

Table 2.3.1.2 Credit Risk on Consumer Loans (%)

Sector	LaR Ratio (%)			LaR Share (%)	NPL Ratio (%)			NPL Share (%)
	2019		2020	2020	2019		2020	2020
	Sem I	Sem II	Sem I	Sem I	Sem I	Sem II	Sem I	Sem I
Housing Loans	12.39	11.65	24.67	59.84	2.78	2.62	3.32	57.6
Automotive Loa	12.15	10.87	24.23	14.28	1.61	1.36	2.88	12.2
Multipurpose Loans	4.33	3.83	8.51	23.30	1.09	0.97	1.36	26.5
Household Equipment	5.64	4.63	12.03	0.49	1.33	1.32	2.71	0.79
Other Household Loans	6.24	4.98	8.84	2.09	1.28	1.19	1.70	2.86
Total	**8.55**	**7.76**	**16.59**	**100.00**	**1.84**	**1.68**	**2.32**	**100.0**

Source: Bank Indonesia, processed

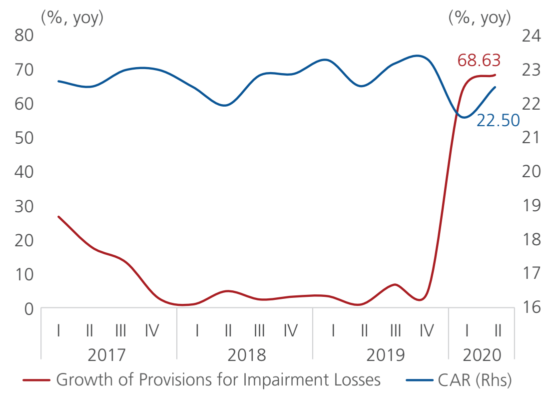
The recent increase in terms of credit risk has left the banking industry more risk averse, thus leading to a higher level of provisions for impairment losses as a form of risk mitigation, while maintaining a high Capital Adequacy Ratio (CAR) (Graph 2.3.1.5). The results of stress tests conducted by Bank Indonesia indicated that the high CAR maintained in the second quarter of 2020 could effectively absorb losses caused by elevated credit risk under a worst-case macroeconomic scenario. In general, the simulations revealed that the banking industry could maintain a Capital Adequacy Ratio (CAR) above the threshold to support intermediation despite weakening macroeconomic conditions.

The decline in corporate performance in the reporting period undermined economic financing, primarily due to less financing from bank loans. Loan growth moderated as the banking industry became more risk averse in the face of increasing credit risk, leading to more selective lending, coupled with the wait-and-see attitude of the corporate and household sectors, which has resulted in lower demand for financing.

At the same time, weaker supply and demand translated into lower credit growth in the first half of 2020, recorded at just 1.49%. The banking industry has become more selective when lending during the pandemic, as indicated by a significant tightening in the Lending Standard Index (SLI) observed in the second quarter of 2020, peaking at its highest level for the past five years (Graph 2.3.1.6).

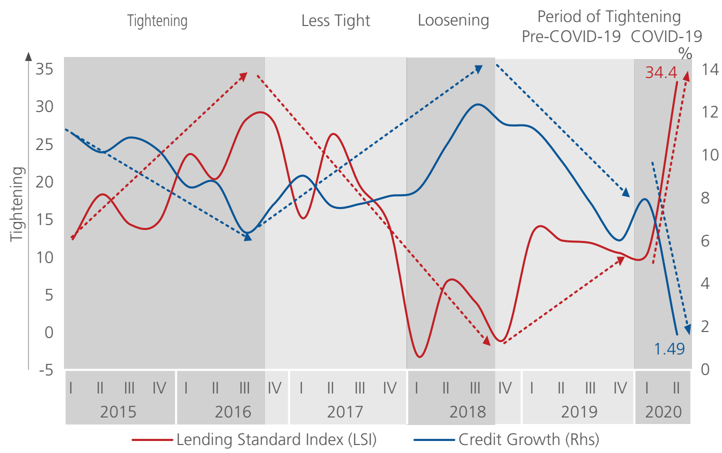
Year-to-date performance of outstanding loans disbursed by the banking industry also pointed to an increase of risk-averseness in the banking

Graph 2.3.1.5 Provisions for Impairment Losses and Capital Adequacy Ratio (CAR) in the Banking Industry



Source: Bank Indonesia, processed

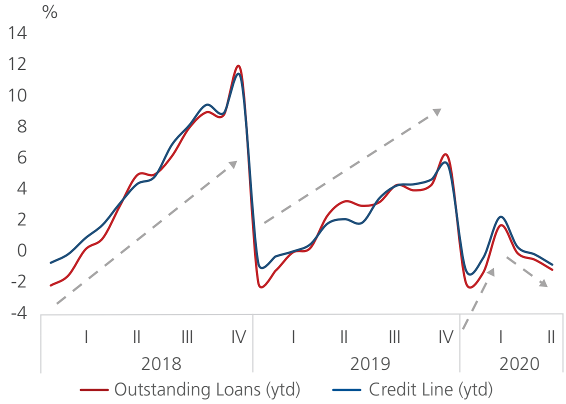
Graph 2.3.1.6 Loan Growth and Lending Standard Index



Source: Bank Indonesia, processed

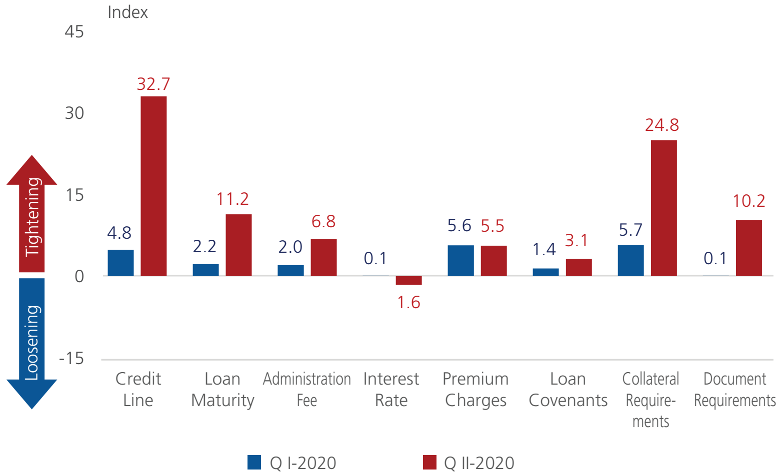
industry (Graph 2.3.1.7). Departing from trends in previous years, where growth of outstanding loans disbursed by the banking industry has consistently increased from the beginning of each year, outstanding loans decelerated in the second quarter of 2020. This was confirmed by the Banking Survey conducted by Bank Indonesia in the second quarter of 2020, which revealed how the banking industry was tightening the limit on outstanding loans in the first quarter of 2020 more than any other aspect of lending policy (Graph 2.3.1.8). Such conditions demonstrate the adverse impact of COVID-19 on credit supply in the banking system.

Graph 2.3.1.7 Growth of Outstanding Loans and Credit Line



Source: Bank Indonesia, processed

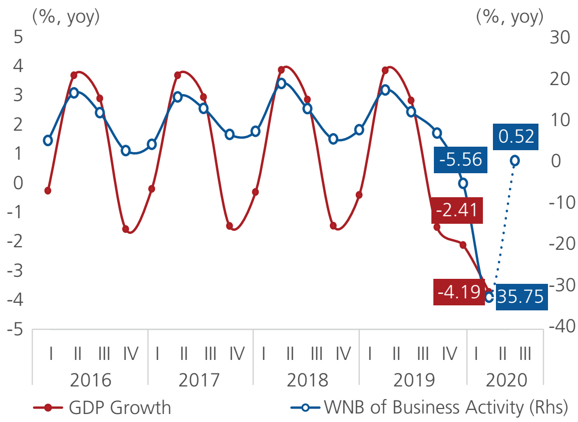
Graph 2.3.1.8 Bank Lending Policy



Source: Bank Indonesia, processed

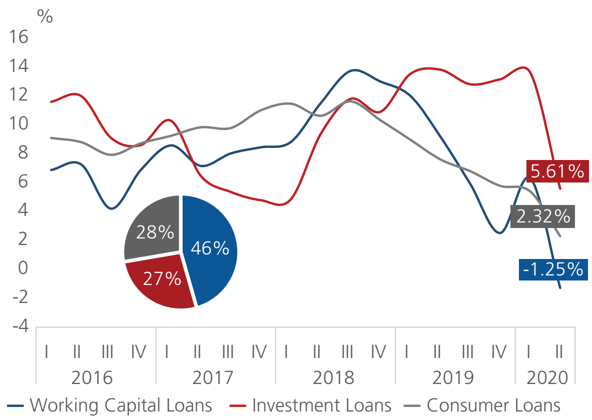
Wait-and-see behaviour in the real sector during the economic contraction caused by the COVID-19 pandemic was also confirmed by the Business Survey (SKDU) conducted by Bank Indonesia, which demonstrated declining business activity in the second quarter of 2020 (Graph 2.3.1.9). A weighted net balance (WNB) of -35.75% recorded in the second quarter of 2020 indicated a declining trend that has persisted since the first quarter of 2020. Consistent with less real sector activity, growth of working capital loans and investment loans experienced deep contractions in the second quarter of 2020 (Graph 2.3.1.10). Dominating outstanding loans disbursed by the banking industry, working capital loans recorded the lowest growth at -1.25% (yoy) in the second quarter of 2020. Weak demand in the real sector for working capital loans was also reflected by an increase of undisbursed loans in the first semester of 2020 (Graph 2.3.1.11). Furthermore, working capital loan and investment loan contractions occurred across all segments, namely commercial, MSME, and corporate loans (Graph 2.3.1.12).

Graph 2.3.1.9 GDP and Business Activity



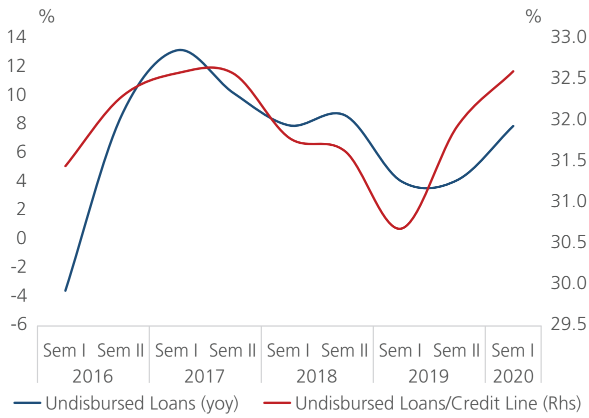
Source: Bank Indonesia, processed

Graph 2.3.1.10 Credit Growth by Loan Type (%, yoy)



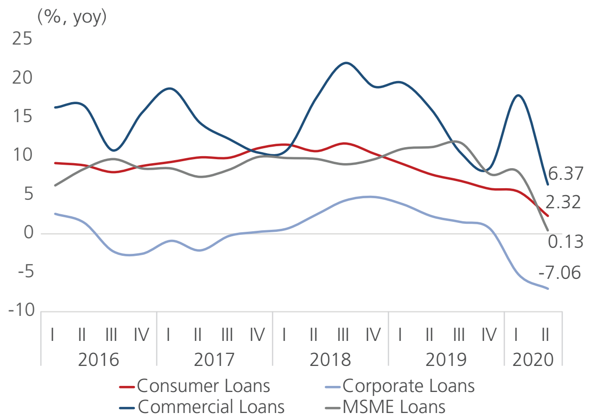
Source: Bank Indonesia, processed

Graph 2.3.1.11 Undisbursed Working Capital Loans



Source: Bank Indonesia, processed

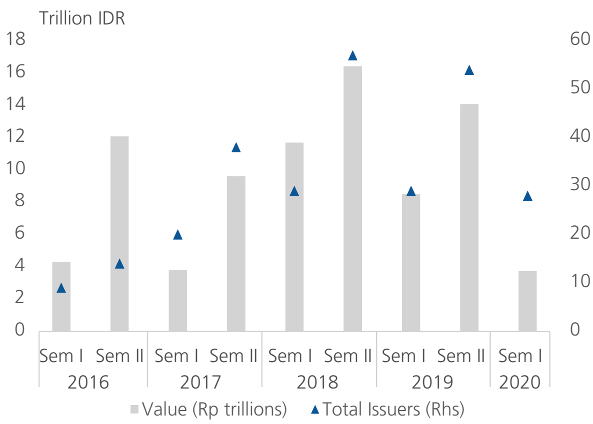
Graph 2.3.1.12 Credit Growth by Segment (%, yoy)



Source: Bank Indonesia, processed

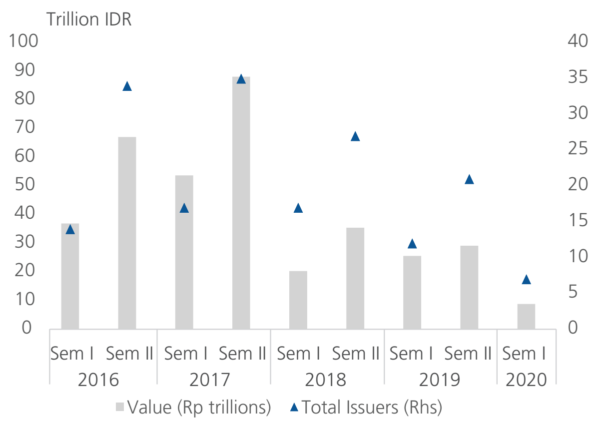
Lower corporate demand for financing was also confirmed in terms of slower corporate financing growth in the capital market. Initial public offerings (IPO) (Graph 2.3.1.13), rights issues (Graph 2.3.1.14), and corporate bond issuances (Graph 2.3.1.15) recorded declines in terms of total financing and total issuers in the capital market in the first semester of 2020 compared with conditions in the same period one year earlier. The reduced demand for financing in the capital market is due to the increasingly high costs that corporations must pay to obtain financing in the capital market. Furthermore, investor concerns of a potential deterioration in financial performance at corporations impacted by COVID-19 edged up the risk premium, as reflected by a higher coupon rate applicable to corporations in the first semester of 2020 (Graph 2.3.1.16).

Graph 2.3.1.13 Initial Public Offerings (IPO)



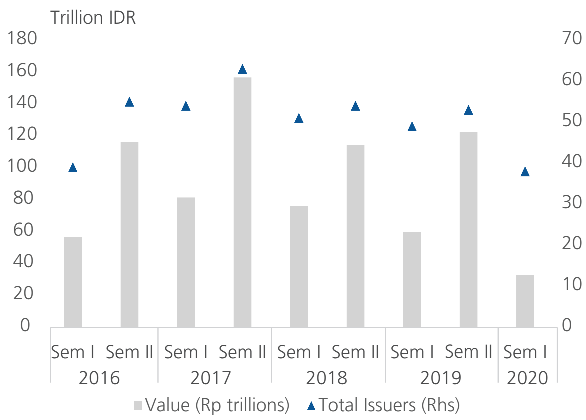
Source: Financial Services Authority (OJK), processed

Graph 2.3.1.14 Rights Issues



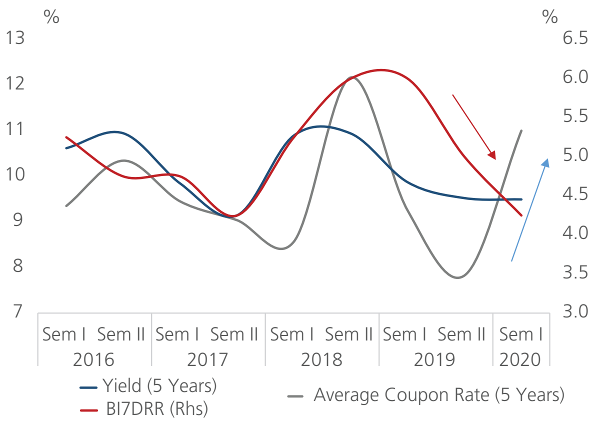
Source: Financial Services Authority (OJK), processed

Graph 2.3.1.15 Bond Issuances



Source: Financial Services Authority (OJK), processed

Graph 2.3.1.16 Coupon Rate and Policy Rate



Source: Bank Indonesia, processed

Lower demand for funding in the real sector was also evidenced by moderating sectoral credit growth in the first semester of 2020 compared with conditions in the same period in 2019 (Table 2.3.1.3). Economic sectors with a dominant share of outstanding loans, such as the manufacturing industry and corporate services, experienced negative credit growth, predominantly due to low demand for non-essential items together with constraints to the flow of raw materials for production at the beginning of the COVID-19 pandemic. Credit growth in the mining sector fared better in line with restored demand for mining exports as the manufacturing industry in China began to ramp up production in the second quarter of 2020.

Restrained business activity undermined household sector activity and performance, which impeded bank disbursements of consumer loans. Consequently, growth of consumer loans has decelerated, as shown in Graph 2.3.1.10, Graph 2.3.1.12 and Table 2.3.1.3 in terms of other sectors.

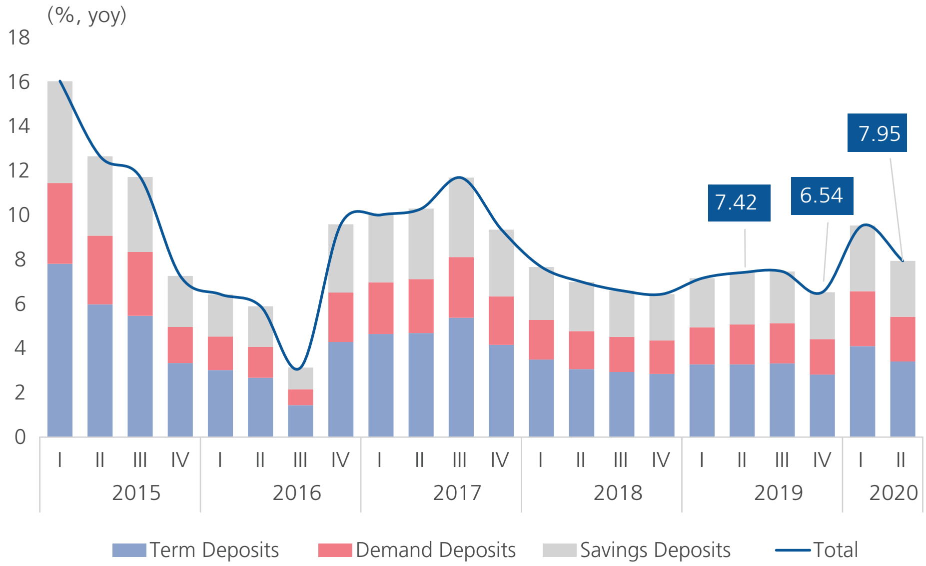
The wait-and-see attitude of corporations and households in response to subdued economic activity during the COVID-19 pandemic sparked an increase of precautionary saving. Growth of third-party funds in the banking industry stood at 7.95% (yoy) in the second quarter of 2020, up from 6.54% in the previous semester and 7.42% in the second quarter of 2019 (Graph 2.3.1.17). Stronger growth was reported by the banking industry for all types of third-party funds.

Table 2.3.1.3 Credit Growth by Economic Sector (%, ytd)

Sector	Sem I 2018	Sem I 2019	Sem I 2020	Share (%)
				Sem I 2020
Agriculture	5.20	2.34	2.20	7.07
Mining	-0.09	-0.99	9.48	2.65
Manufacturing	2.40	0.33	-2.00	16.45
Electricity, Gas, and Water Supply	12.69	22.76	7.38	3.84
Construction	7.06	10.20	0.39	6.55
Trade	4.52	2.63	-5.03	19.10
Transportation & Communication	17.30	6.97	3.53	4.61
Corporate Services	5.62	3.20	-2.75	9.10
Social Services	1.05	2.62	-1.91	2.88
Other Sectors	4.53	1.94	-1.38	27.75

Source: Bank Indonesia, processed

Graph 2.3.1.17 Third-Party Funds Growth (%, yoy)

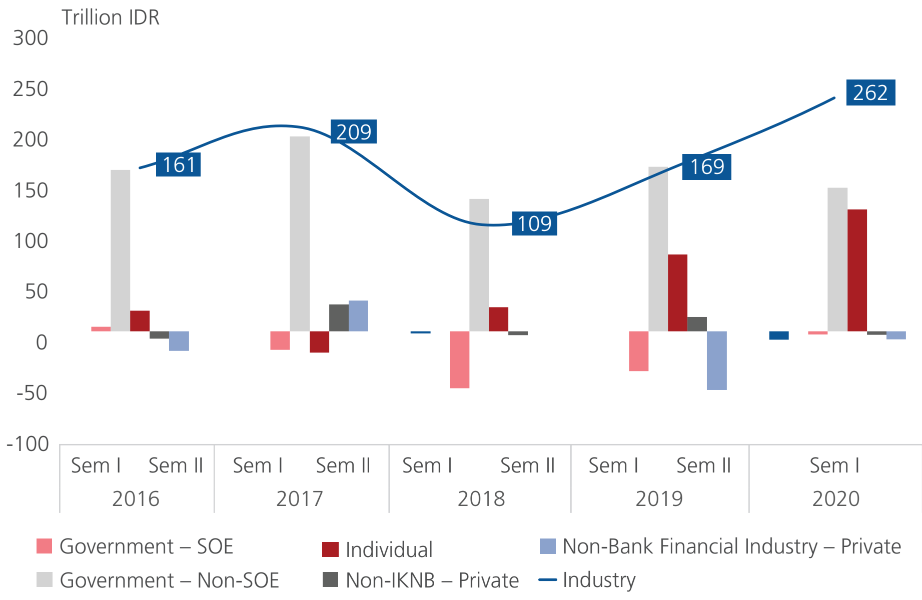


Source: Bank Indonesia, processed

The first semester of 2020 recorded the highest level of third-party funds in the past five years, reaching Rp262 trillion (Graph 2.3.1.18). The increase was driven by expansive fiscal policy, more private savings and restrained private sector spending in line with muted economic activity during the pandemic.

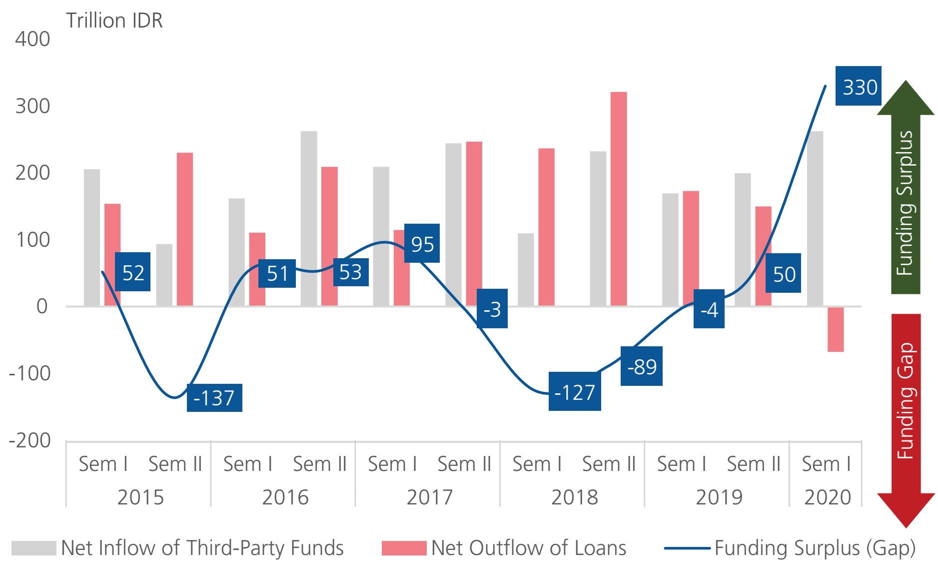
Stronger growth of third-party funds amidst a credit contraction spurred a funding surplus in the banking industry, which peaked in the first semester of 2020 at Rp330 trillion, the highest level recorded in the past six years (Graph 2.3.1.19).

Graph 2.3.1.18 Value of Third-Party Funds Value (ytd) in Semester I



Source: Bank Indonesia, processed

Graph 2.3.1.19 Funding Surplus (Gap) in Banking Industry



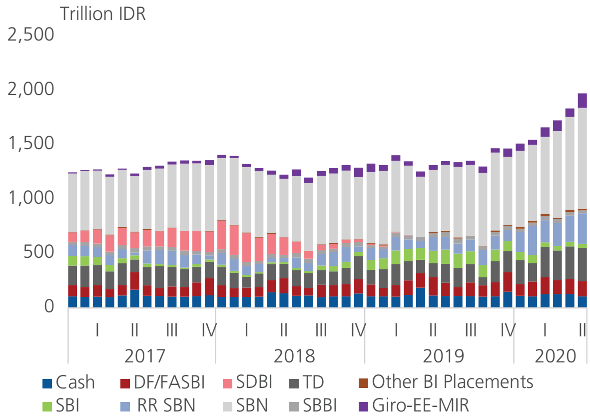
Source: Bank Indonesia, processed

The risk-averse behavior banking industry and low demand for financing in the real sector prompted banks to place their excess liquidity in risk-free assets, such as government securities and placements at Bank Indonesia, which increased the ratio of liquid assets[1] in the banking industry (Graph 2.3.1.20). The ratio of liquid assets to third-party funds in the banking industry stood at 26.24% in the first semester of 2020, up significantly from 20.86% in the previous semester and from 19.05% in the same month of the previous year. The ratio of liquid assets to third-party funds was, therefore, maintained well above the 10% threshold (Graph 2.3.1.21).

Increasing liquidity in the banking industry was also reflected in the upward Macroprudential Liquidity Buffer (MPLB) trend experienced since the beginning of the pandemic, reaching 19.6% in the first semester of 2020 (Graph 2.3.1.22). The resilience of short- and long-term liquidity also strengthened in the reporting period, as confirmed by a Liquidity Coverage Ratio (LCR)[2] of 226.17% and Net Stable Funding Ratio (NSFR)[3] of 132.32% in the first semester of 2020, well above the 100% threshold (Graph 2.3.1.23). Moving forward, the banking industry is expected to maintain adequate liquidity to implement an effective intermediation function.

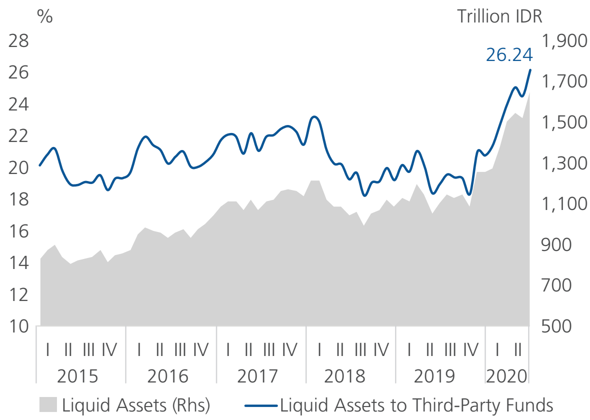
Increasing bank liquidity, primarily in the form of tradeable government securities (SBN), is expected to stifle declining bank profitability due to weaker credit growth and higher provisions for impairment losses in line with the build-up of credit risk. Bank profitability, Return on Assets

Graph 2.3.1.20 Liquid Assets Composition



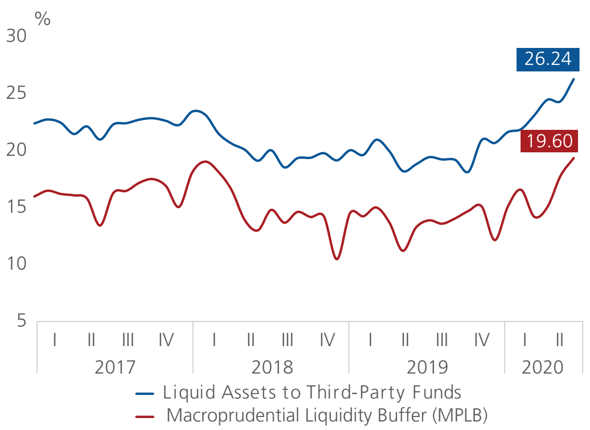
Source: Bank Indonesia, processed

Graph 2.3.1.21 Ratio of Liquid Assets to Third-Party Funds and Liquid Assets



Source: Bank Indonesia, processed

Graph 2.3.1.22 Ratio of Liquid Assets to Deposits and Macroprudential Liquidity Buffer (MPLB)



Source: Bank Indonesia, processed

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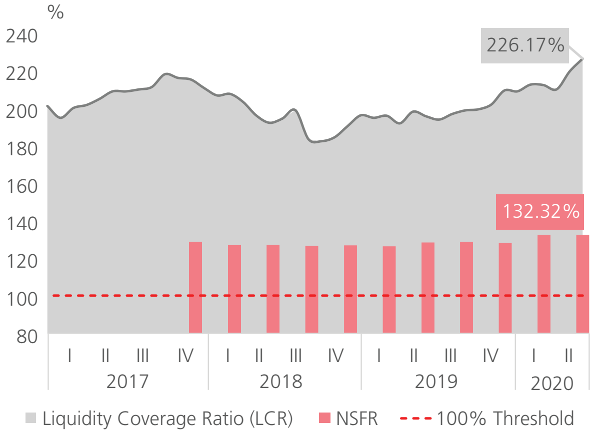
1 Liquid assets are calculated as follows:(Csh + Placements at BI + Government Securities) – (RR + MPLB + MIR)

2 The Liquidity Coverage Ratio (LCR) refers to OJK Regulation (POJK) No. 42/POJK.03/2015 concerning the Liquidity Coverage Ratio for Commercial Banks.

3 The Net Stable Funding Ratio (NSFR) refers to OJK Regulation (POJK) No. 50/POJK.03/2017 concerning the Net Stable Funding Ratio for Commercial Banks.

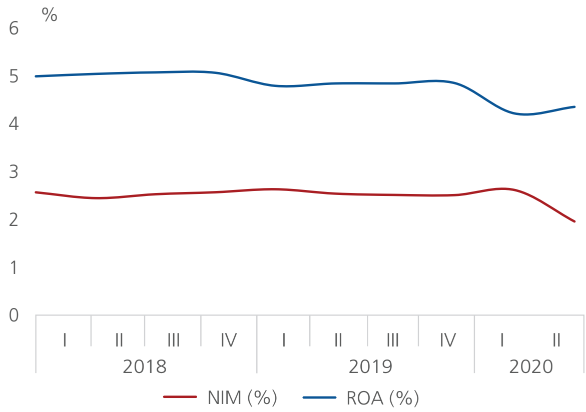
(ROA), and Net Interest Margin (NIM) declined in the second quarter of 2020 compared with the respective positions in the same period one year earlier (Graph 2.3.1.24). More bank interest income has come from securities, while the portion of loan interest income, which dominates overall bank interest income, tended to decrease during the first semester of 2020 (Graph 2.3.1.25). Although declining profitability has eroded capital, the banks still maintained a high Capital Adequacy Ratio (CAR) of 22.50% in the second quarter of 2020, thereby maintaining overall resilience.

Graph 2.3.1.23 Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)[4]



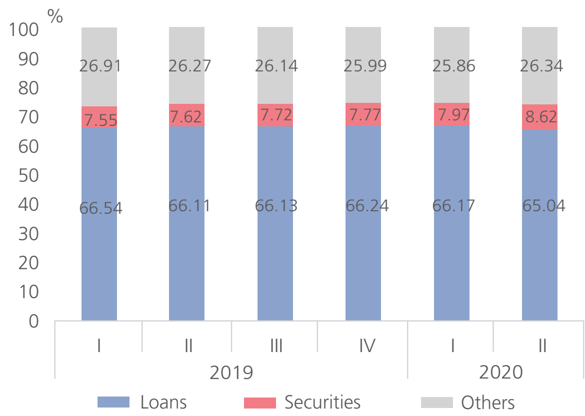
Source: Financial Services Authority (OJK), processed

Graph 2.3.1.24 Bank Profitability



Source: Financial Services Authority (OJK), processed

Graph 2.3.1.25 Composition of Bank Interest Income



Source: Bank Indonesia, processed

4 In total, 49 banks reported LCR and NSFR in the first semester of 2020, including BUKU 4, BUKU 3, and foreign banks.

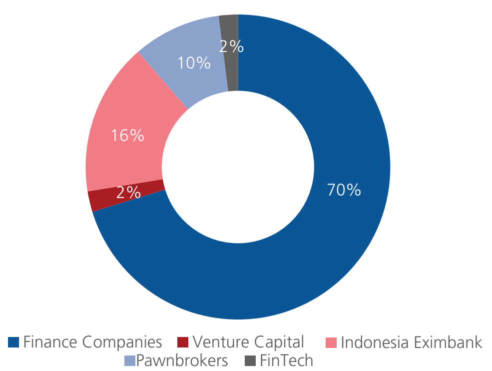
2.3.2 Intermediation Function of Nonbank Financial Industry

The weakening performance of the real sector prompted a build-up of financing risk together with moderating financing disbursed by the nonbank financial industry, finance companies in particular, during the first semester of 2020. Nevertheless, capital in the finance industry remained solid enough to absorb the higher risk of default. In addition, liquidity in the insurance and pension funds industry tended to improve during the reporting period in line with greater capacity to pay claims and maturing benefits to customers.

Finance companies, which dominate financing in the nonbank financial industry (Graph 2.3.2.1), experienced higher credit risk in the first semester of 2020, as reflected by a bump in the ratio of non-performing financing (NPF) to 5.17% in the second quarter of 2020 (Graph 2.3.2.2). Higher risk coupled with compressed private demand for financing prompted a sharp -8.77% contraction in terms of finance company lending in the first semester of 2020, with all types of financing impacted (Graph 2.3.2.3). Although financing risk increased, stress testing by Bank Indonesia showed that the level of capital in the finance industry would be adequate to absorb losses due to customer default under a worst-case macroeconomic scenario. Such a capital buffer would also prop up lending performance at finance companies moving forward.

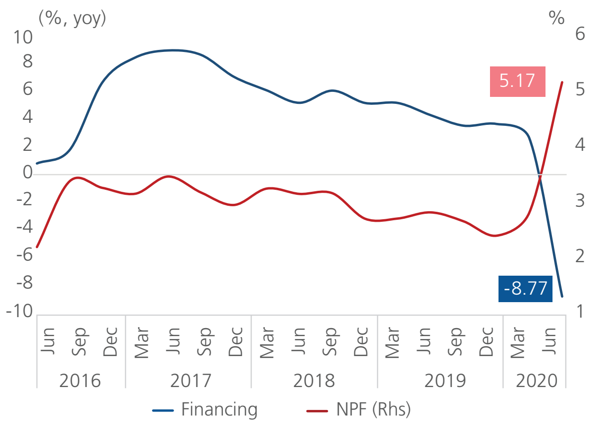
Disbursed financing also tracked a downward trend in terms of pawnbrokers, Indonesia Eximbank, and venture capital firms. (Graph 2.3.2.4). Financing disbursed by Indonesia Eximbank and venture capital firms declined in line with a higher level of NPF at both institutions.

Graph 2.3.2.1 Composition of Nonbank Financial Industry Financing



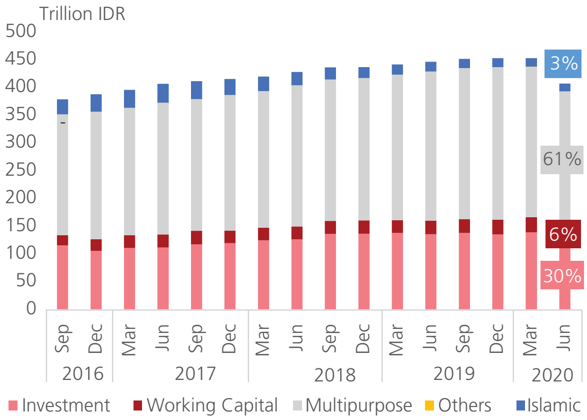
Source: Financial Services Authority (OJK), processed

Graph 2.3.2.2 Financing Growth and Non-Performing Financing (NPF) at Finance Companies



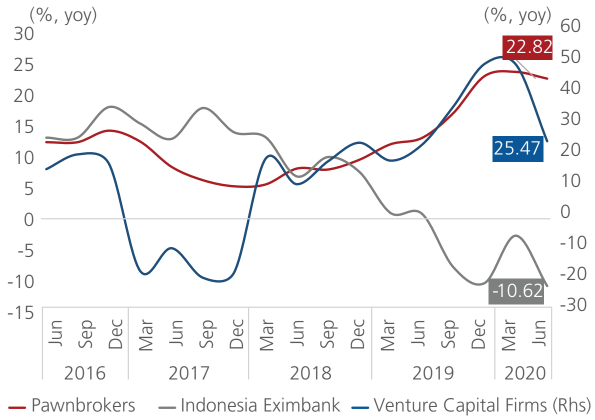
Source: Financial Services Authority (OJK), processed

Graph 2.3.2.3 Finance Company Financing by Type



Source: Financial Services Authority (OJK), processed

Graph 2.3.2.4 Financing Growth (yoy) at Pawnbrokers, Indonesia Eximbank, and Venture Capital Firm



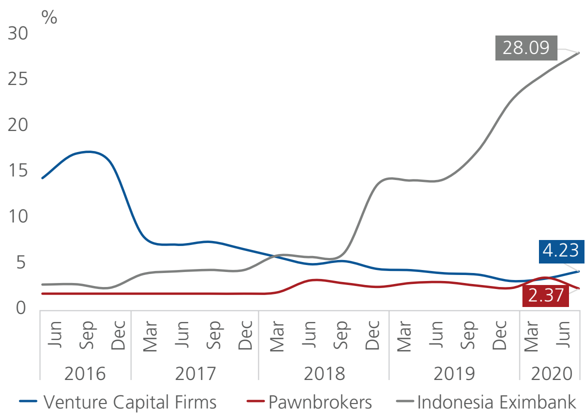
Source: Financial Services Authority (OJK), processed

(Graph 2.3.2.5). Pawnbrokers effectively contained NPF at a level of 2.37%, while NPF at Indonesia Eximbank soared to 28.09% in the first semester of 2020.

The FinTech industry also experienced a higher risk of default and lower lending growth, as confirmed by an increment in the 90-day non-performing loan rate (TWP) for FinTech lending in the first semester of 2020. Consistent with the higher risk of default, FinTech lending decelerated in the reporting period (Graph 2.3.2.6).

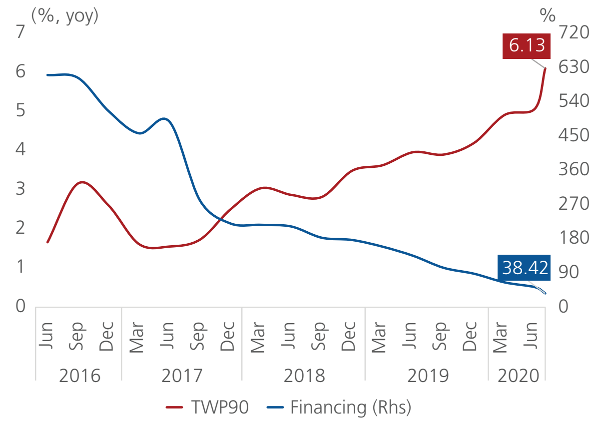
On the other hand, the insurance and pension funds industries have fared comparatively better during the pandemic than other nonbank financial industries, as indicated by an uptick in the ratio of gross premiums to gross claims in the second quarter of 2020, reaching 136.81% (Graph 2.3.2.7). Similarly, the pension funds industry collected more contributions than the increase recorded in terms of maturing benefits throughout the first semester of 2020, with the contributions thus covering the maturing benefit claims (Graph 2.3.2.8).

Graph 2.3.2.5 Non-Performing Financing (NPF) at Pawnbrokers, Indonesia Eximbank, and Venture Capital Firms



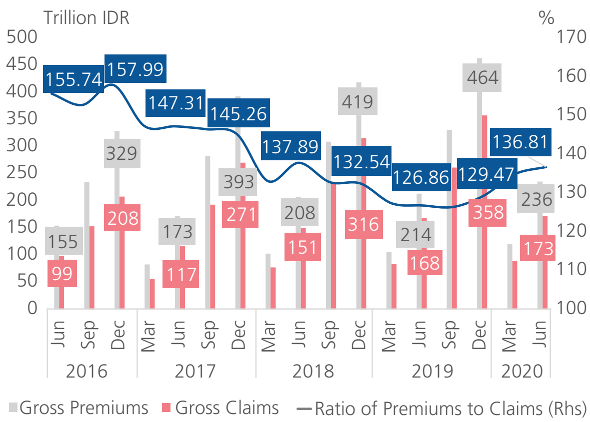
Source: Financial Services Authority (OJK) and PT Pegadaian, processed

Graph 2.3.2.6 Financing Growth and TWP90 FinTech Lending



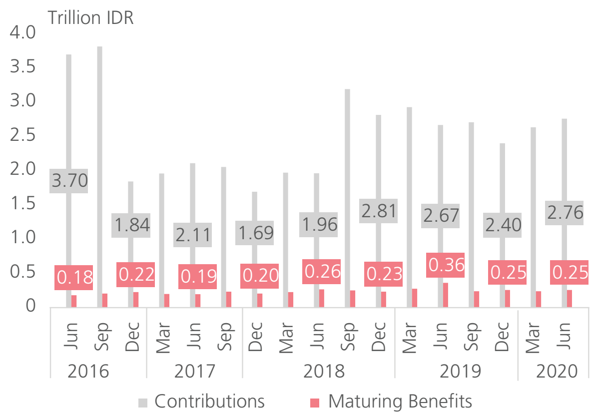
Source: Financial Services Authority (OJK), processed

Graph 2.3.2.7 Insurance Industry Gross Premiums and Claims



Source: Financial Services Authority (OJK), processed

Graph 2.3.2.8 Pension Fund Contributions and Benefits



Source: Financial Services Authority (OJK), processed

Box 2.3.2 Support for MSME Recovery during COVID-19 Pandemic

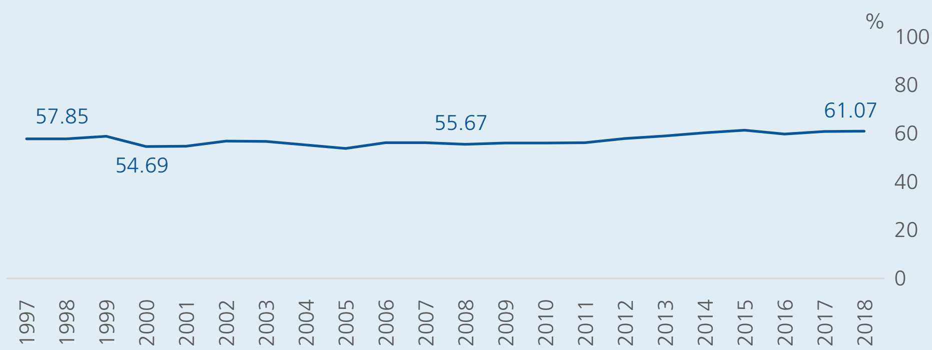
Micro, small, and medium enterprises (MSME) play an essential and strategic role in national economic development. MSMEs are dominant contributors in terms of economic growth and labour absorption. After the Asian Financial Crisis in 1997/98, MSMEs remained solid and helped drive the post-crisis economic recovery in Indonesia. This was reflected in the entrepreneurial contributions of MSMEs to economic growth, which remained above 50% and tended to increase after the crisis (Graph B2.3.3.1).

The salient factors supporting MSME growth during a crisis period include: (i) MSMEs produce consumer goods and services consistent with public demand; (ii) in general, MSMEs utilise local resources in terms of human resources, capital, raw materials, and equipment, and are not reliant on imports; and (iii) most MSMEs utilise internal funds rather than bank loans[1].

Notwithstanding, very different conditions are facing MSMEs during the COVID-19 pandemic. The large-scale social restrictions introduced by the Government in most regions of Indonesia have led to distribution constraints for MSMEs, including inputs for production and finished products, compounded by lower demand for MSME products. Such constraints have primarily emerged due to the propensity of most MSMEs to interact with their customers directly face-to-face through offline channels. The results of a recent survey conducted by Bank Indonesia using a sample of partner MSMEs showed that 71.1% of respondents have been impacted by the COVID-19 pandemic[2], primarily in terms of lower sales, capital constraints and distribution issues.

To help MSMEs survive the COVID-19 pandemic, the Government has issued several macro and micro policies. Supporting the effectiveness of Government Regulation in Lieu of Law

Graph B2.3.3.1 MSME Contribution to GDP



Source: Bank Indonesia, processed

1 Meryana, Ester (2012). *Tiga Hal yang Buat UMKM Tahan Krisis* (Three Factors Making MSMEs Resilient to Crises).

2 Survey of 960 BI-mentored and partner MSMEs conducted on 11th July 2020

No. 1 of 2020, dated 31st March 2020, which stipulates Bank Indonesia's role in terms of Financial System Stability, Bank Indonesia has implemented several initiatives to help rescue MSMEs as follows:

1. Communicated emergency COVID-19 policies to MSMEs in conjunction with relevant local authorities;
2. Increased MSME capacity through training;
3. Expanded access to financing/capital in conjunction with the Regional Banking Consultative Council (BMPD), Association of Indonesian Private Commercial Banks (PERBANAS), state-owned enterprises and Bank Partner Financial Consultants (KKMB), including the Bank Indonesia Corporate Social Responsibility Program; and
4. Developed and rolled out digital applications for payments and marketing at traditional markets and retail businesses to ensure more effective and efficient transactions.

The four initiatives have helped 81.88% of MSMEs survive the pandemic, as reflected by sales performance that expanded up to 50% compared with conditions prior to the rescue measures. In addition, MSMEs were also eligible to receive capital support in the form of loan restructuring, new loans or additional loads.

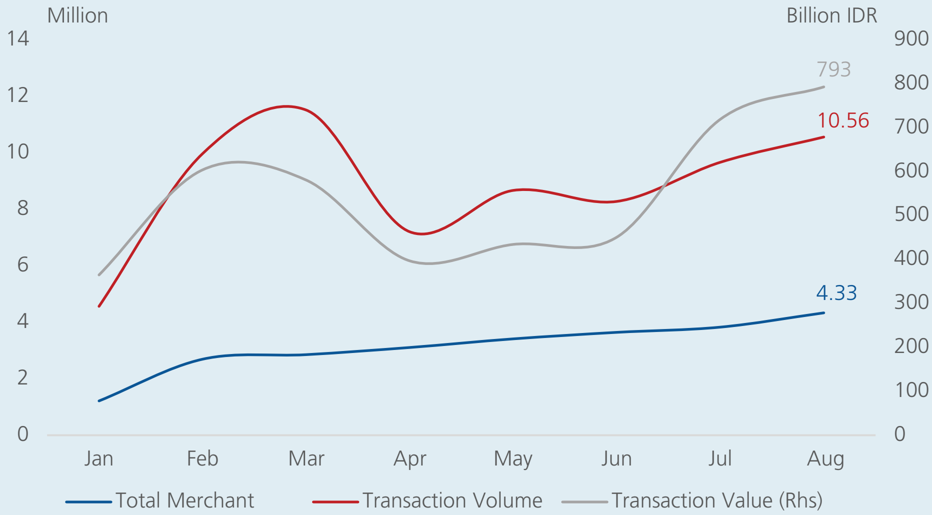
The key to success for MSMEs to survive the COVID-19 pandemic is the ability to shift production to goods in higher demand during the pandemic through digital platforms for marketing and payment activity. MSMEs can receive a range of benefits from using Quick Response Code Indonesia Standard (QRIS), which has expanded rapidly during the COVID-19 pandemic due to contactless payments that reduce the transmission risk through physical media. QRIS is now available in all 34 Indonesian provinces and nearly all regencies and cities of the archipelago.

3 Survey of 960 BI-mentored and partner MSMEs conducted on 11th July 2020.

Seeking to support MSMEs impacted by COVID-19, Bank Indonesia has set the merchant discount rate (MDR) for QRIS transactions at 0% applicable to all micro enterprises, effective from 1st April 2020 until 30th September 2020, which will be extended throughout the COVID-19 pandemic. This program has been warmly received by the public, as confirmed by the growing number of merchants as well as transaction volume and value, which reached approximately Rp793 billion in August 2020 (Graph B2.3.3.2). In addition, Bank Indonesia has also developed remote QRIS (QRIS TTM) to support online sales.

In addition to a 0% MDR for micro enterprises and development of QRIS TTM, the QRIS standard also helps micro, small and medium enterprises (MSME) log a transaction history. Recording the transaction history can help the banking industry prepare credit profiles, which will provide an opportunity for MSMEs to secure additional working capital during the difficult times associated with COVID-19. The range of benefits available to MSMEs through QRIS use is expected to help MSMEs survive the COVID-19 pandemic.

Graph B2.3.3.2 QRIS Performance in 2020



Source: Bank Indonesia, processed

BANK INDONESIA

CHAPTER 3

STRENGTHENING SYNERGY AND COORDINATION AND THE NATIONAL POLICY RESPONSE IN TERMS OF ECONOMIC RECOVERY AND FINANCIAL SYSTEM STABILITY

The COVID-19 pandemic is an extraordinary event that continues to intensify, causing dynamic and rapid disruptions to the economy and financial sector stability. The extraordinary event requires extraordinary policies and measures from the government and other relevant authorities to maintain financial system stability. Act No. 2 of 2020 represents an extraordinary piece of legislation issued by the Government that strengthens the jurisdiction of Financial System Stability Committee members, namely the Ministry of Finance, Bank Indonesia, Financial Services Authority (OJK), and Indonesia Deposit Insurance Corporation (LPS), to apply a national policy mix that maintains stability in the financial system. Coordination and synergy in the face of the COVID-19 pandemic has also been forthcoming at the international level, with Indonesia playing an active role in international discussions concerning COVID-19 containment measures that impact the financial sector.

Bank Indonesia coordinates closely with the Government and Financial System Stability Committee to strengthen all monetary, macroprudential, and payment system policy mix instruments in order to stabilise rupiah exchange rates, control inflation, support financial system stability, and simultaneously prevent further economic decline.

3.1. Policy Synergy and Coordination between Authorities towards National Economic Recovery

COVID-19 transmission has disrupted the global economy with a spillover effect impacting socioeconomic conditions in terms of lower incomes, weaker purchasing power and higher unemployment due to restrictions placed on economic activity. Consistent with international financial market shocks and global economic disruptions, pressures have also spilled over into domestic financial markets. Rupiah depreciation, sluggish stock market performance, and higher yields on tradeable government securities (SBN) reflect shocks in the domestic financial markets. Disruptions to public, business, investment, and financial market activities have prompted a worsening of the domestic economy.

Seeking to anticipate the extraordinary pressures on the domestic economy and financial stability exacerbated by transmission of the COVID-19 pandemic, the Government issued extraordinary fiscal and non-fiscal stimuli in the form of a larger health budget, social assistance for households and workers, broader social safety nets, and an economic recovery program specifically targeting those impacted by COVID-19. The first phase of fiscal stimuli was issued in February 2020 to prevent economic moderation, targeting sectors impacted directly by the COVID-19 pandemic through expenditure stimuli, while accelerating spending and policies to catalyse labour-intensive sectors in order to reinforce the domestic economy. In March 2020, the Government issued the second phase of fiscal stimuli to maintain public purchasing power and sustain the business community for the upcoming six months (April – September 2020) through the relaxation of income tax (PPh 21), postponement of income tax (PPh 22), income tax (PPh 25) relief, and VAT restitution for specific economic sectors. Furthermore, the Government also issued non-fiscal stimuli for export-import activity by streamlining and reducing restrictions on exports and imports of raw materials, expediting the export-import process for reputable traders, as well as increasing and accelerating export-import services and supervision through the National Logistics Ecosystem (NLE) in order to enhance the efficiency of logistics nationally. In addition, the Government also refocused its programs and reallocated state and regional revenue and expenditure budgets (APBN/APBD), while exploiting reserve funds to expedite COVID-19 containment measures.

In addition to the stimuli introduced by the Government, Bank Indonesia also honed its monetary, macroprudential, and payment system policy mix, primarily to strengthen stabilisation efforts in the foreign exchange market and financial markets, while bolstering financing disbursed by the banking industry and facilitating non-cash social aid program disbursements by the government. The various policies implemented by Bank Indonesia are as follows:

1. Lowering the policy rate, the BI 7-Day (Reverse) Repo Rate (BI7DRR);
2. Stabilising rupiah exchange rates by increasing the intensity of triple intervention policy in the spot market and domestic non-deliverable forwards (DNDF) market, while purchasing SBN in the secondary market;
3. Lowering foreign currency reserve requirements;
4. Lowering rupiah reserve requirements for banks financing export-import activity, micro, small, and medium enterprises (MSME) and/or other priority sectors;
5. Loosening the Macroprudential Intermediation Ratio (MIR); and
6. Circulating hygienic currency, reducing National Clearing System (SKNBI) fees and supporting noncash disbursements for government programs, such as the Family Hope Program (PKH), Noncash Food Assistance Program (BPNT), Pre-Employment Card, and Indonesia Smartcard.

As the authority responsible for regulating and supervising financial services institutions, the Financial Services Authority (OJK) issued various pre-emptive policies in the banking sector, capital market, and nonbank financial industry in order to provide space for members of the public and financial services institutions impacted directly and indirectly by the pandemic. The capital market policy sought to dampen volatility and relax specific provisions to support physical distancing protocols. Other policies included: (i) a buyback scheme for shares by issuers or public companies during significant market fluctuations; (ii) a share trading mechanism in the capital market; (iii) relaxing requirements on the submission of periodic reports; (iv) holding a general meeting of shareholders by issuers and public companies; and (v) adjusting the trading hours in the stock exchange. In addition, the Financial Services Authority (OJK) relaxed regulations concerning asset quality assessments for loans/financing restructured to become current loans/financing in the banking industry and financial institutions up to a maximum of one year for borrowers impacted by COVID-19 in order to mitigate a potential build-up of credit risk and provide greater convenience for the business community and members of the public to maintain business activity.

In response to a lower policy rate and liquidity conditions in the banking industry, the Indonesia Deposit Insurance Corporation (LPS) lowered the guaranteed rate on rupiah savings at commercial banks as well as rupiah savings at rural banks by 125 basis points from January to October 2020, while maintaining the guaranteed rate for foreign currency deposits at commercial banks.

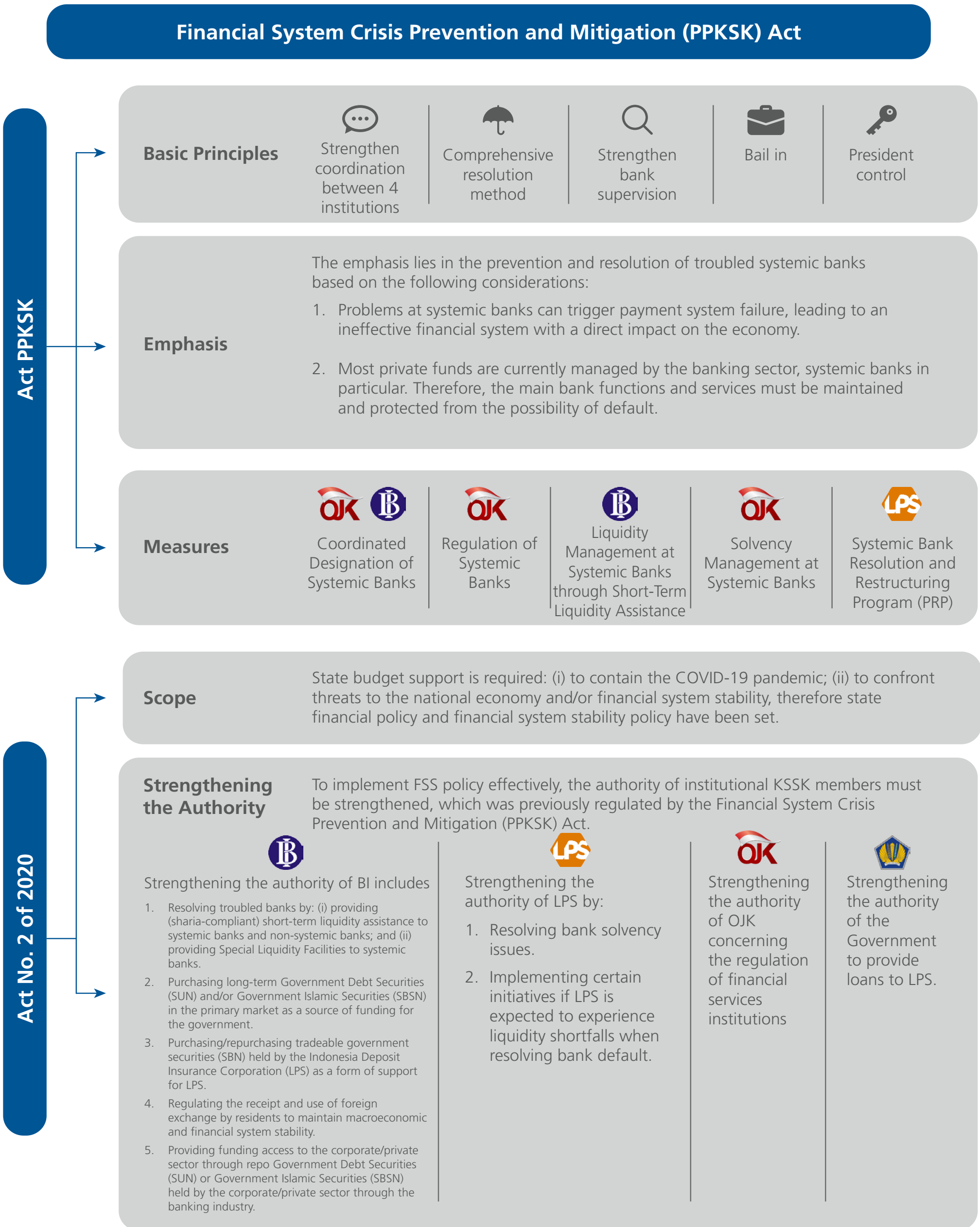
Considering the potential economic slump, which could disrupt financial system stability in Indonesia, as indicated by declining domestic economic activity, appropriate, and adequate mitigation measures are required from the Government and other relevant authorities. Nonetheless, this would not be possible if the respective authorities based their assessments and policy response solely on historical data. Therefore, forward-looking assessments have been conducted based on current economic and financial market developments, coupled with early signals of deterioration in the financial sector. Underlying the policy measures required, institutional members of the Financial System Stability Committee, namely the Ministry of Finance, Bank Indonesia, Financial Services Authority, and Indonesia Deposit Insurance Corporation (LPS), are working in synergy to take forward-looking anticipatory measures concerning the impact of COVID-19 on the economy and financial sector. The COVID-19 pandemic is an extraordinary event, with no clear end currently in sight. The Government and other relevant authorities need to take immediate and extraordinary policy measures to safeguard public health, save the national economy and maintain financial system stability by relaxing certain policies and strengthening the jurisdiction of various institutions in the financial sector in order to handle the current emergency conditions (force majeure).

Similar conditions have been experienced in all countries, where authorities have taken an extraordinary COVID-19 pandemic response to prevent a health crisis and anticipate the economic fallout. In the case of Indonesia, the extraordinary measures were contained in a government regulation in lieu of law that was subsequently enacted as Act No. 2 of 2020 concerning Stipulation of Government Regulations in lieu of law Act No. 1 of 2020 concerning State Financial Policy 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.

Under COVID-19 pandemic conditions, Act No. 2 of 2020 complemented the existing Act No. 9 of 2016 concerning Financial System Crisis Prevention and Mitigation (PPKSK) as the legal foundation for crisis management. As mandated by Act No. 2 of 2020, the jurisdiction of the four institutional members of the Financial System Stability Committee (Ministry of Finance, Bank Indonesia, Financial Services Authority, and Indonesia Deposit Insurance Corporation) was strengthened in order to mitigate the risk of future financial crises.

The law strengthened Bank Indonesia's authority as follows: (i) disburse short-term liquidity loans or short-term liquidity financing in compliance with sharia principles to systemic banks and non-systemic banks; (ii) provide Special Liquidity Facilities to systemic banks experiencing liquidity difficulties and unable to meet the minimum requirements for short-term liquidity loans or short-term liquidity financing in compliance with sharia principles, which is guaranteed by the Government and granted based on a KSSK decision; (iii) purchase long-term Government Debt Securities (SUN) and/or Government Islamic Securities (SBSN) in the primary market in order to resolve financial system issues that endanger the national economy, including Government Debt Securities (SUN) and/or Government Islamic Securities (SBSN) issued for specific purposes, such as containing the COVID-19 pandemic; (iv) purchase/repo tradeable government securities (SBN) held by the Indonesia Deposit Insurance Corporation (LPS) in order to finance the resolution of solvency issues at systemic banks and non-systemic banks; (v) regulate the receipt and use of foreign exchange by residents, including provisions concerning the surrender, repatriation and conversion of foreign exchange to maintain

Figure 3.1.1 Financial System Crisis Prevention and Mitigation (PPKSK) Act and Act No. 2 of 2020 as Legal Basis for the Prevention and Mitigation of Financial System Crises



Source: Bank Indonesia

macroeconomic and financial system stability; and (vi) provide funding access to the corporate/private sector through repo Government Debt Securities (SUN) or Government Islamic Securities (SBSN) held by the corporate/private sector through the banking industry.

Act No. 2 of 2020, specifically the provisions concerning (sharia-compliant) short-term liquidity assistance and special liquidity facilities, has strengthened Bank Indonesia's authority as Lender of Last Resort (LOLR). Furthermore, Act No. 2 of 2020 stipulates that OJK is responsible for assessing the solvency and health status of a bank applying for short-term liquidity assistance. Such a bank must hold high-quality collateral as a guarantee against the short-term liquidity assistance that meets the specific requirements stated in a Bank Indonesia regulation concerning short-term liquidity assistance, and the bank must be deemed capable of repaying the liquidity assistance. Through the regulation, there is closer synergy and coordination between Bank Indonesia and the Financial Services Authority (OJK) in terms of resolving troubled banks. As lender and bearer of credit risk associated with the short-term liquidity assistance, Bank Indonesia must receive assurance regarding the repayment capacity of the bank in question. To that end, coordination between Bank Indonesia and OJK has been strengthened: (i) to increase the intensity of exchanging information on banks with potential liquidity difficulties and deteriorating health status; (ii) to ensure the solvency and health requirements have been met by the bank applying for short-term liquidity assistance; and (iii) to hold coordination meetings between members of the Bank Indonesia Board of Governors and OJK Board of Commissioners. Stronger synergy and coordination between Bank Indonesia and the financial services authority is contained within an amendment to the existing Joint Decree and Cooperation Agreement concerning the (sharia-compliant) short-term liquidity assistance.

Concerning Bank Indonesia's role as lender of last resort (LOLR), Act No. 2 of 2020 authorises Bank Indonesia to disburse Special Liquidity Facilities (PLK) to systemic banks experiencing liquidity difficulties and unable to meet the minimum requirements for short-term liquidity loans or short-term liquidity financing in compliance with sharia principles, which is guaranteed by the Government and granted based on a KSSK decision. Considering that all the costs incurred for crisis prevention and management are ultimately borne by the Government, the Government's early involvement in the form of a PLK guarantee would reduce the cost of a crisis. At the time of writing, PLK implementation regulations are still being discussed amongst members of the Financial System Stability Committee.

As an integral part of the national economic recovery program, Bank Indonesia is authorised to purchase Government Debt Securities (SUN) and/or Government Islamic Securities (SBSN) in the primary market in order to resolve financial system issues that threaten the national economy, including Government Debt Securities (SUN) and/or Government Islamic Securities (SBSN) issued for specific purposes, such as containing the COVID-19 pandemic. SBN purchases by Bank Indonesia are only permitted when the market fails to absorb all SUN and/or SBSN issued by the Government due to high volume or yield. Therefore, Bank Indonesia will act as a last resort and, under normal circumstances, Bank Indonesia will not finance the fiscal deficit through SUN and/or SBSN purchases in the primary market in accordance with the Bank Indonesia Act.

The basic principles of SUN and/or SBSN purchases in the primary market are as follows: (i) purchases must be made through market mechanisms; (ii) the impact on inflation must be considered; (iii) only tradable and marketable SUN and/or SBSN are eligible for purchase; and (iv) Bank Indonesia only acts as a last resort if market capacity is unable to absorb all SUN and/or SBSN issued by the Government. In accordance with the Joint Decree of the Minister of Finance and Governor of Bank Indonesia, dated 16th April 2020, SUN and/or SBSN can be purchased in the primary market through the following mechanisms: (i) SUN and/or SBSN auctions using a non-competitive bidder mechanism; (ii) additional SUN and/or SBSN auctions (greenshoe option) if the auction target has not been met; (iii) private placement if the auction target or additional SUN and/or SBSN auction target have not been met (Figure 3.1.2).

Figure 3.1.2 SUN and/or SBSN Purchase Mechanism in Primary Market

Phase I

NON-COMPETITIVE BIDDER

Yield in line with weighted average of primary auction on same day

- Max. SUN bid: 25% of maximum auction target;
- Max. SBSN > 1-Year bid: 30% of maximum auction target

Phase II

GREENSHOE OPTION

Yield in line with weighted average of primary auction on previous day

- If incoming bid is lower than auction target;
- Maximum offer same as previous offer

Phase III

PRIVATE PLACEMENT

Refers to latest market price (Indonesia Bond Pricing Agency - IBPA)

- If Government requires additional financing
- Terms and conditions applicable

Source: Bank Indonesia

The Government and Bank Indonesia are also working in synergy to prudently share the burden of COVID-19 containment measures and the national economic recovery program through good governance, transparency and accountability. In practice, burden sharing is expected to generate sustainable economic growth while maintaining the credibility and integrity of economic, fiscal and monetary management. In accordance with the Joint Decree of the Minister of Finance and Governor of Bank Indonesia, dated 20th July 2020, the burden sharing scheme between the Government and Bank Indonesia includes the following provisions: (i) financing public goods, consisting of healthcare, social protections as well as government ministries/departments and regional administrations; and (ii) financing non-public goods for the economic recovery and business community, including micro, small, and medium enterprises (MSME) and the non-MSME corporate sector. In terms of financing public goods, Bank Indonesia is purchasing tradeable government securities (SBN) through private placement and bearing all initial costs by returning the interest in full to the Government. Regarding the financing of non-public goods for MSME and the non-MSME corporate sector, the Government is selling SBN to the market, while Bank Indonesia contributes by sharing the cost burden with the Government. On the other hand, the costs associated with financing other non-public goods, excluding MSME and the non-MSME corporate sector, are borne fully by the Government.

With the Joint Decree signed between the Ministry of Finance and Bank Indonesia mentioned previously, more effective and efficient coordination has been achieved in terms of planning SUN and/or SBSN issuances, evaluating SUN and/or SBSN purchases, re-profiling SUN and/or SBSN as well as taxation. Such coordination is implemented periodically and as required.

Act No 2 of 2020 also strengthens Bank Indonesia's authority in terms of purchasing/repurchasing SBN held by the Indonesia Deposit Insurance Corporation (LPS) in order to resolve solvency issues at systemic and non-systemic banks. SBN purchases to resolve solvency issues at systemic banks are made based on a decree issued by the Financial System Stability Committee, while SBN purchases to resolve solvency issues at non-systemic banks may be executed directly by the Indonesia Deposit Insurance Corporation (LPS) through Bank Indonesia. Regarding SBN repurchase agreements, LPS is authorised to act directly in order to meet the liquidity required to resolve the solvency issues at systemic or non-systemic banks through Bank Indonesia. Direct purchases are permitted in order to minimise potential market distortions in accordance with Government Regulation No. 33 of 2020 concerning Deposit Insurance Corporation Authority to Resolve Financial System Stability Issues, which is regulated in more detail through Indonesia Deposit Insurance Corporation (LPS) Regulation No. 3 of 2020. Strengthening LPS authority was the basis for amending the Memorandum of

Understanding between Bank Indonesia and the Indonesia Deposit Insurance Corporation (LPS), while preparing a more detailed coordination mechanism in the PKS. Pursuant to the MoU and PKS, SBN purchases and/or repurchases must prioritise accountability and good governance principles in line with prevailing regulations and referring to market mechanisms.

Efforts to maintain macroeconomic and financial system stability have also been realised through regulations concerning the International Transaction Reporting System (ITRS) under the auspices of Bank Indonesia. It is nevertheless important to realise that this policy is not a form of foreign exchange control. The free flow of foreign exchange for foreign investors remains assured in the form of portfolio investment and foreign direct investment (FDI), which are still critical for the Indonesian economy. Regulations concerning foreign exchange flows for Indonesian residents are still consistent with prudent macroeconomic management principles in line with international best practices, particularly under extraordinary economic circumstances, such as the COVID-19 pandemic. This regulation aims to support rupiah exchange rate stability and external economic resilience in Indonesia.

Additionally, Act No. 2 of 2020 also strengthens Bank Indonesia's authority to provide access to funding for the corporate/private sector through repurchase agreements for SUN/SBSN held by the corporate/private sector through the banking industry. Thus far, Bank Indonesia has provided such facilities through term repo instruments with tenors of up to 12 months and daily auctions.

Synergy and coordination between institutional members of the Financial System Stability Committee have been strengthened considering the cross-sectoral nature of crisis prevention and resolution efforts. Routine bilateral coordination between Bank Indonesia and the Financial Services Authority (OJK) will be continued in terms of harmonising macroprudential and macroprudential policies, updating the list of systemic banks and coordinating bank inspections. Furthermore, Bank Indonesia and the Indonesia Deposit Insurance Corporation (LPS) are coordinating to exchange data and/or information in order to support task implementation and respective institutional responsibilities, while coordinating to prepare implementation guidelines for the operational relationship between bridge banks and Bank Indonesia as a follow-up action to the regulations issued by Bank Indonesia and LPS concerning bridge banks. Tripartite cooperation, synergy and coordination between Bank Indonesia, the Financial Services Authority (OJK) and Indonesia Deposit Insurance Corporation (LPS) have also been strengthened through integrated bank reporting via a single portal mechanism. In addition, Bank Indonesia backs stronger joint research together with OJK and LPS to support policy formulation at each respective institution, particularly in terms of financial system stability issues. The joint research topics have also been directed towards answering the salient needs and challenges of the three institutions in terms of facing disruptions, such as the COVID-19 pandemic and Industry 4.0. Synergy between Bank Indonesia, OJK and LPS has also been realised through a joint HR competency development program as a medium to exchange information and developments concerning financial system stability or other issues occurring at each respective institution.

Coordinated International Policy Response to COVID-19 Pandemic

Internationally, cross-border coordination and cooperation are constantly being strengthened, especially since COVID-19 was declared an international pandemic by the World Health Organisation (WHO), affecting most countries worldwide, including Indonesia, and a global health crisis that could deteriorate into a global economic and financial crisis. COVID-19 has been financial system stability's strongest test since the global financial crisis in 2008/2009. Although the financial system is currently more resilient since implementation of global financial reforms, including Basel III, mitigating potential default at systemic financial institutions and the economic impact, monitoring non-bank financial intermediaries and over-the-counter (OTC) derivatives market reforms, and prolonged pressure from the COVID-19 pandemic could potentially impact financial system performance and resilience. In response, authorities around the world have introduced extraordinary yet temporary measures to enhance risk absorption capacity at financial institutions, while maintaining the sustainability of the intermediation function and financial market stability.

Considering the COVID-19 impact has touched all corners of the world, it has become vital for authorities around the world to exchange information concerning the latest developments in each respective jurisdiction. To that end, various international forums, such as the G20, have increased the intensity of virtual meetings in order to exchange information regarding the risks and vulnerabilities faced by member countries, including the policies available and implemented to mitigate the impact of the COVID-19 pandemic.

At the G20 Finance Ministers and Central Bank Governors Meeting held in April 2020, the G20 mandated the Financial Stability Board (FSB) with monitoring financial sector vulnerabilities, while coordinating the regulatory and supervisory measures applied by G20/FSB members as well as standard-setting bodies. Based on that mandate, FSB regularly coordinates a compilation of measures applied by financial authorities as FSB members, and facilitates the exchange of views and information amongst its members. The scope of information exchanged includes the challenges and risks faced, the policies instituted and available in future, as well as the effectiveness and planned exit from the extraordinary measures. Such information is subsequently used as inputs when implementing the FSB's function as an international forum that assesses potential global financial vulnerabilities and coordinates the global policy response. Assessments include the long-term impact of the COVID-19 pandemic and subsequent temporary measures on financial system stability. In terms of monitoring, the Financial Stability Board (FSB) focuses on financial system elements deemed critical for financial system stability, such as the ability of financial institutions and financial markets to extend financing during periods of economic downturn caused by the COVID-19 pandemic, the availability of US dollar funding in emerging markets, the capacity of financial intermediaries to manage liquidity risk as well as the ability of financial market infrastructure to mitigate counterparty risk.

The Financial Stability Board (FSB) has twice published the results of its assessments and compilation of policy measures implemented by G20 members at the G20 meetings in April and July 2020[1]. Seeking to ensure the policy response taken in each respective member jurisdiction is well coordinated globally, in its report to the G20 in April 2020, the FSB outlined a number of principles for the attention of global players in terms of mitigating the potential COVID-19 risks. The principles include: (i) the importance of early monitoring and quickly exchanging timely information; (ii) promoting the use of a flexible buffer in the banking industry without reducing compliance to international standards; (iii) minimising the operating expenses of institutions and authorities; and (iv) the importance of policy coordination, particularly regarding the planned unwinding of temporary measures in order to mitigate the potential impacts that may emerge.

Exchanging information and experiences amongst member countries not only provides invaluable lessons and insight for other members yet also serves as a reference for standard-setting bodies, such as the Basel Committee on Banking Supervision (BCBS), when formulating the policy stance and support for member countries as well as when evaluating the existing standards and regulations. Through the Group of Central Bank Governors and Heads of Supervision (GHOS), the Basel Committee on Banking Supervision (BCBS) has endorsed a number of measures that provide the banking industry and supervisory authorities greater leeway to respond to COVID-19, including the postponement of Basel III final reforms and the revision to the market risk framework and

1 https://www.fsb.org/2020/04/covid-19-pandemic-financial-stability-implications-and-policy-measures-taken/ and https://www.fsb.org/2020/07/covid-19-pandemic-financial-stability-implications-and-policy-measures-taken/

disclosure requirements under Pillar 3[2]. BCBS has also issued technical guidelines concerning the exceptional measures to contain COVID-19 and guidelines for calculating expected credit loss[3]. In addition, BCBS has released a statement on using the Basel III buffer to encourage the banking industry and relevant authorities to exploit existing capital buffers to extend credit and absorb losses caused by COVID-19.

Indonesia is an active participant and contributor at international discussion forums concerning COVID-19 containment. As a member of the G20 and FSB, Bank Indonesia is actively involved in exchanging information regarding the policies instituted to contain COVID-19. Furthermore, Bank Indonesia regularly submits updates with respect to the policies implemented to contain COVID-19, particularly in terms of implementing the national economic recovery program in accordance with Act No. 2 of 2020. In addition, Indonesia also regularly contributes inputs at G20/FSB forums to ensure decision-making harmony in line with the national interest and conditions. This also helps to ensure global endorsement of the policies and avoids policy conflict with the authorities in Indonesia as an emerging market economy that does not fully share the same characteristics as advanced economies, implying that the policies instituted by advanced countries may not be fully applicable for implementation in Indonesia.

Bank Indonesia was also an active participant of the EMEAP Crisis Communication Test 2020 held in March 2020. Supporting preparations for the Crisis Management Resolution Framework (CMRF) of EMEAP, crisis communication simulations are regularly held for EMEAP members in the form of a Crisis Communication Test (CCT). CCT aims to hone preparations in member countries, particularly in terms of facing potential crises with cross-border spillovers in the Asia-Pacific region. Bank Indonesia's participation in the crisis communication test intends to increase vigilance and ensure an adequate crisis management protocol at Bank Indonesia to anticipate crises that may occur in the Asia-Pacific region.

2 https://www.bis.org/press/p200327.htm

3 https://www.bis.org/press/p200403.htm

3.2 Monetary Policy and Financial System Stability

Bank Indonesia has instituted an optimal policy mix to mitigate the economic impact of COVID-19 and catalyse the national economic recovery. As the monetary and macroprudential authority, Bank Indonesia constantly strengthens its policy mix instruments in order to maintain rupiah exchange rate stability and control inflation, while supporting financial system stability.

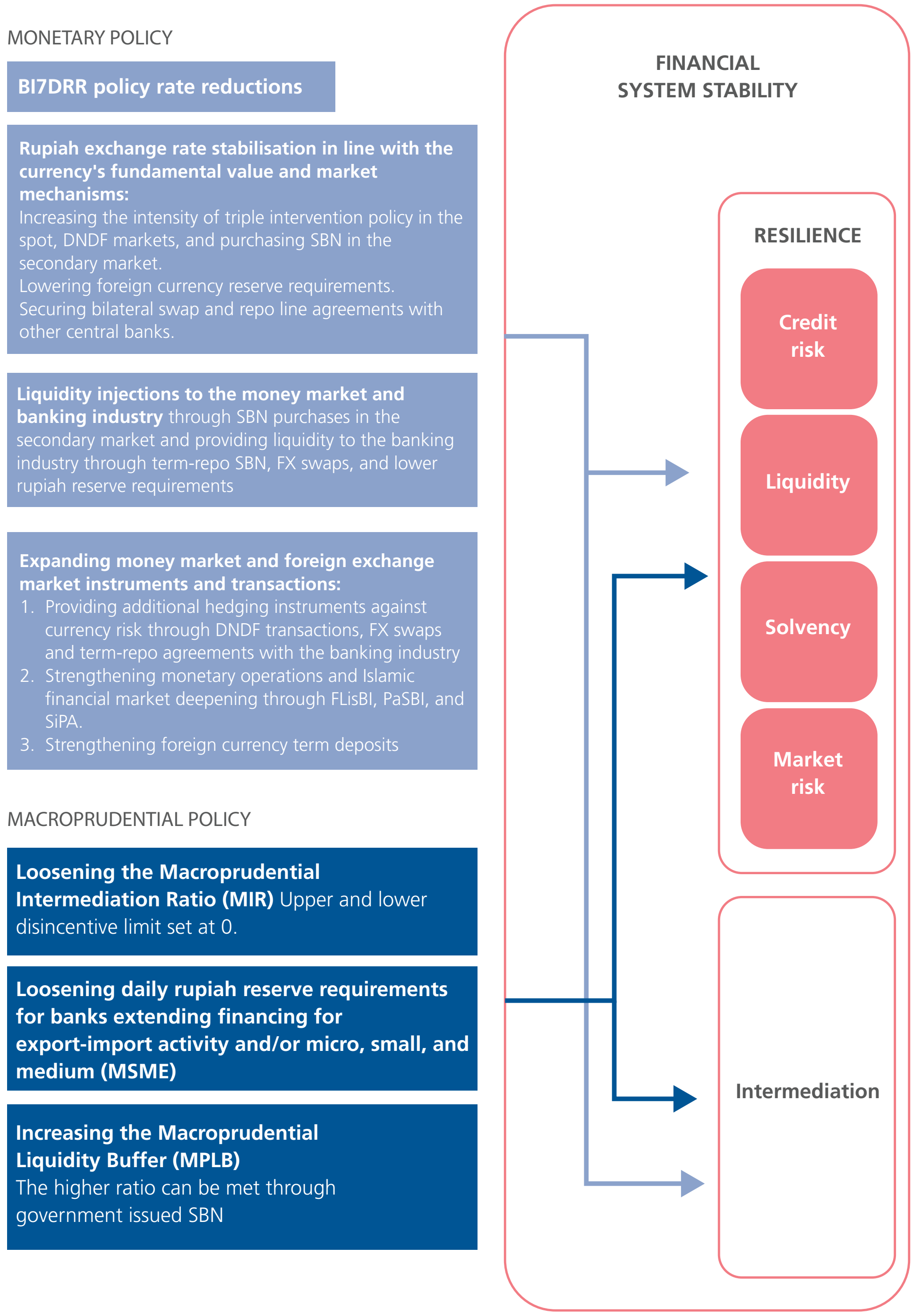
From January - September 2020, Bank Indonesia reduced its policy rate, namely the BI 7-Day (Reverse) Repo Rate, by 100 basis points to a level of 4.00%. Policy rate reductions of 25bps were implemented in February, March, June, and July 2020. The move was consistent with persistently low projected inflation and maintained external stability, while simultaneously stimulating an economic recovery from the devastating impact of the COVID-19 pandemic.

To stabilise rupiah exchange rates in line with the currency's fundamental value and market mechanisms amidst persistently high global financial market uncertainty, Bank Indonesia has increased the intensity of triple intervention policy in the spot and DNDF markets and purchased SBN in the secondary market. In addition, Bank Indonesia has lowered foreign currency reserve requirements in order to boost foreign exchange liquidity in the banking industry and simultaneously alleviate foreign exchange market pressures, while expanding the types of underlying transactions available to foreign investors as alternative hedging instruments against rupiah holdings. Exchange rate stabilisation policy is supported by efforts to strengthen external resilience by securing bilateral swap and repo line agreements with other central banks, including the US Federal Reserve and People's Bank of China (PBoC).

In addition, Bank Indonesia has expanded money market and foreign exchange market instruments and transactions in order to provide more hedging instruments against currency risk through DNDF transactions, FX swaps and term-repo agreements with the banking industry, while strengthening monetary operations and Islamic financial market deepening through the Sharia-Compliant Liquidity Facility (FLisBI), Sharia-Compliant Liquidity Management (PaSBI) and Sharia-Compliant Interbank Fund Management Certificates (SiPA). Furthermore, Bank Indonesia has also strengthened foreign currency term deposits in order to enhance foreign currency liquidity management in domestic markets, while encouraging the banking industry to utilise the lower foreign currency reserve requirements for domestic purposes.

Bank Indonesia has injected liquidity through quantitative easing (QE) to the money market and banking industry in order to stimulate financing for the business community and national economic recovery. Bank Indonesia has injected liquidity through various channels, including SBN purchases in the secondary market, repo SBN with the banking industry and FX swaps, as well as lower rupiah reserve requirements. As of 15th September 2020, Bank Indonesia had injected additional liquidity totalling Rp662.1 trillion, including Rp155 trillion from lower reserve requirements and Rp491.3 trillion from expansive monetary policy. Bank Indonesia is focusing on the quantity channel by providing liquidity to stimulate economic recovery during the COVID-19 pandemic, including Bank Indonesia support for the Government in terms of accelerating state budget realisation in 2020.

Figure 3.2.1 Monetary Policy, Macroprudential Policy, and Financial System Stability



Source: Bank Indonesia

BI 7-Day (Reverse) Repo Rate reductions and various rupiah exchange rate stabilisation measures have bolstered financial system resilience. Rupiah exchange rate stability also reduced real sector exposure to market risk. Stronger real sector resilience combined with maintained repayment capacity has helped to contain credit risk in the banking industry and, hence, sustain bank solvency. On the other hand, exchange rate stability also supports stable asset value in the banking industry, which has contributed to maintain bank solvency.

Monetary loosening by Bank Indonesia has been transmitted through the asset price channel. In the bond market, liquidity remains adequate and BI 7-Day (Reverse) Repo Rate reductions have contributed to lower bond yields, including SBN.

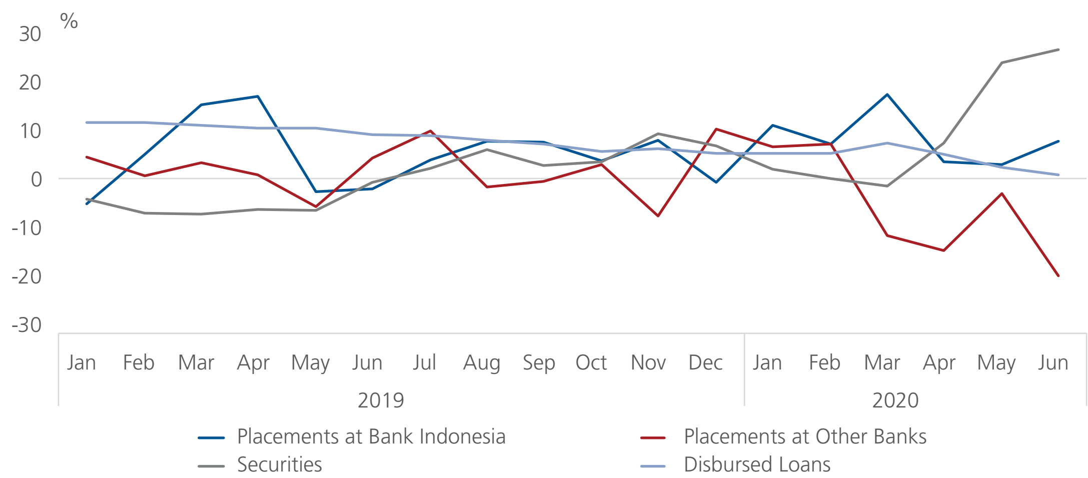
Stable prices and SBN yields also support banking industry resilience through relatively stable asset value despite elevated global financial market uncertainty.

Quantitative easing policy has also supported bank liquidity. Bank Indonesia has expanded the availability of term repo transactions, which can be optimised by the banking industry when additional liquidity is required. Such policy has also helped maintain the resilience of several banks experiencing declining third-party funds amidst subdued economic activity and increasing loan restructuring. Bank Indonesia also lowered rupiah and foreign currency reserve requirements in order to provide additional liquidity for the banking industry. When lowering the foreign currency reserve requirements, Bank Indonesia also strengthened foreign currency term deposit instruments in order to incentivise the banking industry to take advantage of the lower reserve requirements for domestic purposes. Banks can maintain liquidity resilience through foreign currency term deposit placements amidst sluggish demand for new loans. By increasing the resilience of liquidity, banks are expected to stimulate the intermediation function that has retreated significantly during the COVID-19 pandemic.

In addition to increasing liquidity in the banking industry, BI policy to lower reserve requirements also supported bank profitability despite less interest income from lending. Banks placed the additional liquidity from lower reserve requirements in government securities and placements at Bank Indonesia, which yielded returns and helped to offset further profitability declines. Since April 2020, growth of productive assets in the banking industry has stemmed from a significant increase of securities against the persistent downward credit growth trend.

In line with BI 7-Day (Reverse) Repo Rate reductions, the banking industry has also been inclined to lower interest rates, yet credit growth remains subdued as a corollary of flagging economic growth. Moving forward, expansive monetary policy by Bank Indonesia, which has thus far remained in the banking industry, is expected to support the bank intermediation function more effectively and, thus, accelerate the economic recovery process.

Graph 3.2.1 Productive Asset Growth in Banking Industry (%, yoy)



Source: Bank Indonesia, processed

3.3. Accommodative Macroprudential Policy to Strengthen Resilience and Support Intermediation

In the first semester of 2020, financial system stability was maintained despite the risks associated with COVID-19 on financial system stability demanding continued vigilance. The intermediation function in the financial sector remains weak due to muted credit growth in line with domestic demand compressed by a corporate sector impacted by COVID-19 and a cautious banking industry. Seeking to reinforce monetary policy and in response to the vulnerabilities and risks found in the corporate and household sectors that could trigger risks in the banking and nonbank financial industries as intermediation institutions, Bank Indonesia has maintained accommodative macroprudential policy. Such policy includes reducing the rupiah reserve requirement by 200 basis points for conventional commercial banks and by 50bps for Islamic banks/business units, effective from 1st May 2020, along with raising the Macroprudential Liquidity Buffer (MPLB) by 200bps for conventional commercial banks and by 50bps for Islamic banks/commercial conventional bank, which must be met through SUN/SBSN purchases issued by the Government in the primary market. The move intends to strengthen liquidity management in the banking industry.

Supporting the national economic recovery and Bank Indonesia's mandate to maintain financial system stability, Bank Indonesia also issued incentives for the banking industry to allocate targeted funds for certain economic activities as part of the macroprudential policy mix. Bank Indonesia also relaxed the (sharia) Macroprudential Intermediation Ratio (MIR) and downpayment requirements on green automotive loans or financing. Consistent with Bank Indonesia's policy mix to stimulate credit growth, the Countercyclical Buffer (CCB) was held at 0%.

Providing Incentives for Banks Providing Provision of Funds for Certain Economic Activities as Support for Economies Affected by COVID-19.

As part of Bank Indonesia's efforts to contain the economic impact of COVID-19, Bank Indonesia issued Bank Indonesia Regulation (PBI) No.22/4/PBI/2020 in March 2020 concerning Incentives for the Banking Industry to Provide Available Funds for Specific Economic Activities to Support the Economy Impacted by COVID-19. The policy was motivated by the rapid onset of the COVID-19 pandemic, which could potentially disrupt domestic production activity and, hence, undermine the financial cycle, thereby necessitating a solid bank intermediation function through accommodative macroprudential policy.

The incentive policy is provided in the form of leniency on the mandatory reserve requirement (GWM) in Rupiah which must be met daily at 50 bps for banks that provide temporary provision of funds for certain economic activities (targeted). The scope of economic activities included exports, imports, MSME and/or other priority sectors as determined by Bank Indonesia by providing the following funds:

1. Export loans or export financing;
2. Productive import loans/financing;
3. Letters of credit (L/C);
4. MSME loans/financing;
5. Other loans/financing determined by Bank Indonesia.

The measures form an integral part of the efforts to strengthen intermediation and, ultimately, underpin financial system resilience. The incentives are applicable to conventional commercial banks, Islamic banks, and Islamic business units from 1st April 2020 until 31st December 2020, with the first incentives released on 16th April 2020. Based on the monthly Board of Governors Meeting (RDG) in September 2020, rupiah reserve requirements were lowered by

50bps for banks disbursing targeted loans to MSMEs as well as for export-import activity and to non-MSMEs in priority sectors as stipulated in the national economic recovery program. The eligibility period for the incentives was subsequently expanded from 31st December 2020 until 30th June 2021.

Relaxing the Macroprudential Intermediation Ratio (MIR/MIR Sharia) and Adjusting the Macroprudential Liquidity Buffer (MPLB/MPLB Sharia)

Domestic economic disruptions caused by COVID-19 have implications on banking industry conditions, particularly in terms of the bank intermediation function and liquidity. Seeking to mitigate the impact on slower bank intermediation growth and simultaneously strengthen liquidity in the banking industry, Bank Indonesia amended the (Sharia) Macroprudential Intermediation Ratio (MIR) and (Sharia) Macroprudential Liquidity Buffer (MPLB) which generally regulate easing in the form of adjusting the Sharia RIM / RIM disincentive parameters and strengthening banking liquidity by adjusting the MIR disincentive parameters and the MPLB level.

First, the upper and lower disincentive parameters were adjusted to 0, thus giving banks with a (sharia) MIR falling outside the limits relief from giro obligations (Table 3.3.1). This policy is effective for one year from 1st May 2020 until 30th April 2021 and aims to maintain intermediation by striking an optimal balance between the target and capacity of the economy impacted by COVID-19. The move was also taken with bank intermediation capacity in consideration in order to avoid triggering pressures and a build-up of risk in the banking industry.

Second, Bank Indonesia adjusted the Macroprudential Liquidity Buffer (MPLB) for conventional commercial banks from 4% to 6% of third-party funds in rupiah and adjusted the Macroprudential Liquidity Buffer (MPLB) for Islamic banks from 4% to 4.5% of third-party funds in rupiah (Table 3.3.2). The higher (sharia) MPLB

Table 3.3.1 Regulations for (Sharia) Macroprudential Intermediation Ratio (MIR) Disincentive Parameters

Previous Regulation (PADG No.21/22/PADG/2019)	New Regulation (PADG No. 22/11/PADG/2020)
Lower Disincentive Parameter 1. at 0, if Bank maintains: a) Gross NPL or NPF ratio ≥ 5%; or b) Minimum Capital Adequacy Requirement (KPMM) ≤ Incentive KPMM; 2. at 0.1, if Bank maintains: a) Gross NPL or NPF ratio < 5%; and b) KPMM > Incentive KPMM and ≤ 19%; and 3. at 0.15, if Bank maintains: a) Gross NPL or NPF ratio < 5%; and b) KPMM > 19%	**Lower Disincentive Parameter** 1. at 0, if Bank maintains: a) Gross NPL or NPF ratio ≥ 5%; or b) Minimum Capital Adequacy Requirement (KPMM) ≤ Incentive KPMM; 2. at 0, if Bank maintains: a) Gross NPL or NPF ratio < 5%; and b) KPMM > Incentive KPMM and ≤ 19%; and 3. at 0, if Bank maintains: a) Gross NPL or NPF ratio < 5%; and b) KPMM > 19%
Upper Disincentive Parameter: 1. at 0, if Bank maintains KPMM ≥ Incentive KPMM; or 2. at 0.2, if Bank maintains KPMM < Incentive KPMM.	**Upper Disincentive Parameter:** 1. at 0, if Bank maintains KPMM ≥ Incentive KPMM; or 2. at 0, if Bank maintains KPMM < Incentive KPMM.

Source : Bank Indonesia

can be met for the first time using tradeable government securities - SBN (SUN and/or SBSN) purchased on the primary market through private placement.

The policy aims to strengthen liquidity in the banking system by maintaining adequate high-quality liquid assets (HQLA). This will reinforce liquidity in the banking industry, thereby increasing resilience as financial market pressures tend to escalate. In addition, SBN purchases in the primary market through private placement also represent a form of support for the Government's economic recovery efforts..

Third, Islamic banks and commercial conventional bank are eligible to repurchase the securities used to meet the sharia Macroprudential Liquidity Buffer (MPLB) through an agreement with Bank Indonesia. This will help Islamic banks optimise liquidity management through repo flexibility with Bank Indonesia.

Loosening Down Payment Requirements on Green Automotive Loans/Financing

The Government has afforded special attention to development of the green economy. Acknowledging the importance of creating a green economy for economic sustainability in Indonesia, Bank Indonesia supports the initiative through green financing policy in terms of the Loan-to-Value or Financing-to-Value (LTV/FTV) Ratios for property loans/financing as well as downpayment requirements for automotive loans/financing.

The implementation of green financing policies for motor vehicles is seen as not experiencing significant growth, so that the Government continues to accelerate the environmentally sound motor vehicle program, one of which is by harmonizing various policies issued by various authorities. The government is encouraging the acceleration of the Battery-Based Electric Motor

Table 3.3.2 Regulations for Level of (Sharia) Macroprudential Liquidity Buffer (MPLB)

Previous Regulation (PADG No.21/22/PADG/2019)	New Regulation (PADG No. 22/11/PADG/2020)
Level of (sharia) Macroprudential Liquidity Buffer (MPLB): 1. MPLB set at 4% of third-party funds in rupiah. 2. Sharia MPLB set at 4% of third-party funds in rupiah.	Level of (sharia) Macroprudential Liquidity Buffer (MPLB): 1. MPLB set at 6% of third-party funds in rupiah. 2. Sharia MPLB set at 4.5% of third-party funds in rupiah. **MPLB:** at least 2% of rupiah third-party funds at a conventional commercial bank met using SB and/or SBS in rupiah as securities in the form of SBN purchased in the primary market through private placement. **Sharia MPLB:** at least 0.5 of rupiah third-party funds at an Islamic bank using SBS in rupiah as securities in the form of SBSN purchased in the primary market through private placement.

Source : Bank Indonesia

Table 3.3.3 Provisions for Flexibility of (Sharia) Macroprudential Liquidity Buffer (MPLB)

Previous Regulation (PADG No.21/22/PADG/2019)	New Regulation (PADG No. 22/11/PADG/2020)
Use of securities in repo transactions limited to 4% of third-party funds at Islamic bank/ commercial conventional bank in rupiah.	Use of securities in repo transactions limited to: 1. BUK : 6% of rupiah third-party funds for commercial conventional bank. 2. BUS : 4.5% of rupiah third-party funds for Islamic bank.

Source : Bank Indonesia

Vehicle (KBL BB) program for transportation, among others, through fiscal incentives. However, the acceleration of the program is still constrained by an underdeveloped market. In addition, the distribution of motor vehicle credit / financing by banks also experienced a contraction due to COVID-19 with the ratio of non-performing loans / financing (NPL / NPF) slightly increasing, but still at a safe level.

In line with accommodative macroprudential policy and efforts to catalyse the green economy, Bank Indonesia has relaxed the downpayment requirements on green automotive loans in compliance with prudential principles. Bank Indonesia has amended the downpayment requirements on green automotive loans/ financing, which became effective on 1st October 2020. For banks meeting the NPL/NPF requirements, the minimum downpayment has been reduced to 0% for all motor vehicle types, including commercial and non-commercial vehicles. For banks failing to meet the NPL/NPF requirements, the minimum downpayment has been held at 10%-20% depending on the vehicle type (Table 3.3.4).

Holding the Countercyclical Buffer (CCB) at 0%

The Countercyclical Buffer (CCB) is additional capital that functions as a buffer to anticipate losses stemming from excessive credit growth with the potential to disrupt financial system stability. Bank Indonesia evaluates the CCB level and effective period at least once every six months. In May 2020, Bank Indonesia once again held the Countercyclical Buffer (CCB) at 0% as part of its accommodative macroprudential policy stance based on an assessment of financial sector conditions that confirmed no indications of excessive credit growth that could trigger systemic risk based on the primary indicator, namely the credit-to-GDP gap, which remained below the threshold.

With a CCB of 0%, the banking industry is expected to accelerate the intermediation function in order to stimulate economic growth by obviating the need for the banking industry to maintain an additional capital buffer.

Table 3.3.4 Provisions for Downpayments on Green Automotive Loans/Financing

Vehicle Type	Previous Regulation (PBI No. 21/13/PBI/2019)		Amendment	
	Meeting NPL/NPF Criteria	Not Meeting NPL/ NPF Criteria	Meeting NPL/NPF Criteria	Not Meeting NPL/ NPF Criteria
Two wheels	10%	15%	0%	15%
Three wheels or more (non-commercial)	10%	20%	0%	20%
Three wheels or more (commercial)	5%	10%	0%	10%

NPL/NPF Criteria as follows:
1. Gross NPL/NPF ratio < 5%; and
2. Net NPL/NPF ratio on automotive loans < 5%.

Source : Bank Indonesia

Box 3.3.1 Strengthening Bank Indonesia's Role as Lender of Last Resort

The COVID-19 economic crisis, which began as a health crisis, has intensified discussions concerning lender of last resort (LOLR) to maintain financial system stability. LOLR was popularised by Walter Bagehot (1873)[1] through his classic approach that viewed LOLR as a central bank function to provide liquidity assistance to illiquid but solvent financial institutions supported by high-quality collateral and a high penalty rate. From Bagehot's perspective, there are several solid reasons for not guaranteeing funds at an insolvent financial institution. Lending to a financial institution with net negative assets is considered highly risky due to potential bankruptcy, ultimately implying the loans will remain unpaid. In addition, the central bank must remain independent and not provide liquidity support to maintain the solvent condition of a financial institution, even at the behest of Government[2]. This would lead to moral hazard. Furthermore, using LOLR to bail out a financial institution would create a negative stigma for the central bank and could even trigger legal proceedings if prudential principles are ignored.

To avoid moral hazard, Bagehot (1873) emphasised three main prerequisites for the LOLR function: (i) illiquid but solvent, only illiquid but solvent financial institutions are eligible to receive LOLR support; (ii) guarantee, financial institutions receiving liquidity assistance must provide high-quality collateral, such as government-issued securities; (iii) penalty rate, which is higher than the market rate or policy rate in order to discourage arbitrage. Naturally, the high penalty rate also prevents financial institutions from seeking easy access to loans[3]. Therefore, the high penalty rate encourages financial institutions to seek alternative funding prior to accessing central bank facilities as a last resort. Nevertheless, the penalty rate must not be so high as to exacerbate liquidity pressures and constrain financial institutions from repaying their obligations[4].

As LOLR, the central bank aims to safeguard liquidity availability in the financial system through a number of facilities, including standing facilities as a form of central bank support to maintain financial market continuity, individual bank support to overcome idiosyncratic liquidity issues at a financial institution, as well as systemwide support to overcome liquidity issues at a systemically important financial institution (SIFI). In this case, standing facilities represent market-based liquidity provision in the form of lending facilities, repo facilities and other intraday facilities. The availability of adequate standing facilities from the central bank and is essential to ensure sufficient liquidity in the banking system for day-to-day operations. As one of the central bank's efforts to maintain financial system stability, the provision of standing facilities is closely linked to efforts to overcome disruptions in the transmission mechanism of monetary policy to the financial markets and is also linked to efforts to maintain payment system availability as a critical element of the economy.

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1 Bagehot, Walter, 1873. "Lombard Street: A Description of the Money Market," Henry S. King & Co., London.

2 Tucker, Paul, 2014. "The Lender of Last Resort and Modern Central Banking: Principles and Reconstruction," BIS Papers No 79.

3 Gortsos, Christos V., 2020. "Last Resort Lending – The (Still) Limited Role of the European Central Bank in the Emergency Liquidity Assistance Mechanism," Florence School of Banking and Finance.

4 Dobler, M., Gray, S., Murphy, D., and Radzewicz-Bak, B., 2016. "The Lender of Last Resort Function After the Global Financial Crisis," IMF Working Paper 16/10, International Monetary Fund.

On the other hand, individual bank support and system-wide support are LOLR facilities also known as Emergency Liquidity Assistance (ELA). Departing from standing facilities, a central bank response through ELA provision is discretionary and must be triggered by regulatory oversight. Therefore, ELA provision is based on central bank discretion and encompasses more intense oversight from the supervisory authorities of the financial institutions involved. According to the LOLR framework in Indonesia, individual bank support facilities are represented by the short-term liquidity assistance for conventional and Islamic commercial banks offered by Bank Indonesia to illiquid but solvent non-systemic banks and systemic banks. Meanwhile, systemwide support in Indonesia is represented by the Special Liquidity Loan (PLK)[5] facilities for illiquid but solvent systemic banks.

In many jurisdictions, the LOLR function focuses on banks based on their economic importance (Dobler et al., 2016). The same is true in Indonesia, where banks are the most dominant financial institution. To protect the banks' economic function, financial safety nets are available in the form of access to Bank Indonesia's LOLR facilities. Furthermore, Bank Indonesia's LOLR function aims to prevent financial system instability by providing liquidity to illiquid but solvent banks under normal and crisis conditions.

Currently, Bank Indonesia activates LOLR facilities in accordance with Act No. 23 of 1999[6], Act No. 21 of 2011[7] and the Financial System Crisis Prevention and Mitigation (PPKSK) Act[8]. In practice, the role of Bank Indonesia as lender of last resort (LOLR) was strengthened in 2020 with the promulgation of Act No. 2 as the legal basis for the COVID-19 pandemic response through extraordinary policy measures to mitigate the risks of financial crisis and the impact on financial system stability.

Act No. 2 of 2020 has strengthened Bank Indonesia's authority in terms of handling troubled banks through (sharia) short-term liquidity assistance (PLJP/PLJPS) for systemic banks and non-systemic banks. By honing the assistance mechanism, the Financial Services Authority (OJK) assesses the solvency and health status of any bank applying for short-term liquidity assistance. In addition, the applicant bank must also hold sufficient high-quality collateral as a guarantee against the short-term liquidity assistance and the repayment capacity must be assessed. In terms of a Special Liquidity Loan (PLK), a systemic bank experiencing liquidity difficulties yet failing to meet the short-term liquidity assistance requirements may apply to Bank Indonesia for a Special Liquidity Loan (PLK). The PLK is guaranteed by the Government and disbursed based on a decision by the Financial System Stability Committee. Following up on the promulgation

5 PLK is mandated in accordance with Act No. 2 of 2020. At the time of writing in September 2020, PLK was being prepared as a draft government regulation under the auspices of the Ministry of Finance, Bank Indonesia, Financial Services Authority (OJK), and Indonesia Deposit Insurance Corporation (LPS).

6 Article 11 of Act No. 23 of 1999 concerning Bank Indonesia states that Bank Indonesia can provide loans or financing based on Islamic principles for a maximum period of up to 90 days to banking institutions in order to overcome short-term funding difficulties, guaranteed by high-quality collateral with the same minimum value as the disbursed loan/financing.

7 Article 41 of Act No. 21 of 2011 concerning the Financial Services Authority (OJK) states that if OJK identifies a specific bank experiencing liquidity difficulties and/or deteriorating health conditions, OJK will immediately inform Bank Indonesia in order to take the necessary measures in accordance with Bank Indonesia's authority. Furthermore, Article 41 states that measures in accordance with Bank Indonesia's authority include providing short-term facilities to execute Bank Indonesia's function as lender of last resort (LOLR).

8 Article 20 of Act No. 9 of 2016 concerning Financial System Crisis Prevention and Mitigation (PPKSK) states that a Systemic Bank experiencing liquidity difficulties may apply to Bank Indonesia for short-term liquidity loans or short-term liquidity financing based on Islamic principles. In addition, Article 30 states that regulations concerning the disbursement of short-term liquidity loans or short-term liquidity financing based on Islamic principles referred to in Article 20 are also applicable, mutatis mutandis, for non-systemic banks.

of Act No. 2 of 2020, PLJP/PLJPS regulations were refined in April 2020 by including OJK participation when assessing the solvency and health status of a bank applying for PLJP/PLJPS facilities. Coordination with OJK, as the macroprudential supervisory authority, is critical considering Bank Indonesia's function as lender and bearer of the credit risk associated with PLJP/PLJPS, thus requiring assurance concerning the bank's repayment capacity. As one of the efforts to strengthen financial system stability amidst extraordinary pressures on the national economy stemming from the COVID-19 pandemic, Bank Indonesia constantly strengthens its LOLR function.

To that end, in September 2020, PLJP/PLJPS regulations were refined again in order to expedite the disbursement process while maintaining prudential principles and good governance. The main provisions of the amendment included adjustments to the penalty rate applicable to PLJP/PLJPS, the collateral requirements, additional collateral as a guarantee for risk mitigation, expediting processes at Bank Indonesia and honing the asset verification and valuation process by an independent party prior to PLJP/PLJPS application. On 20th October 2020, Bank Indonesia and OJK agreed to strengthen the end-to-end coordination process when disbursing PLJP/PLJPS, as contained in a Joint Decree concerning PLJP/PLJPS. The Joint Decree strengthened Bank Indonesia's LOLR function, strengthened OJK's supervision function in terms of banks and financial services institutions as well as clarified the mechanisms and accountability of each respective institution.

Irrespective of Bank Indonesia's role as lender of last resort (LOLR) in order to maintain financial system stability, the involvement of the Ministry of Finance, Financial Services Authority (OJK), and Indonesia Deposit Insurance Corporation (LPS) is required in the LOLR disbursement process and thereafter. Disbursing LOLR facilities will trigger more stringent supervisory oversight by the supervisory authority, in this case OJK. Under crisis conditions, it can be more difficult to differentiate between liquidity and solvency issues considering the narrow timeframe and financial system conditions that can deteriorate rapidly and suddenly. Therefore, LPS, as the resolution authority, is required to undertake early intervention and prepare resolution options to prevent spillover from the troubled bank into the financial system. On the government side, all crisis prevention and handling costs are ultimately borne by the Government, therefore government involvement is required from an early stage of the LOLR disbursement process, particularly for systemic banks.

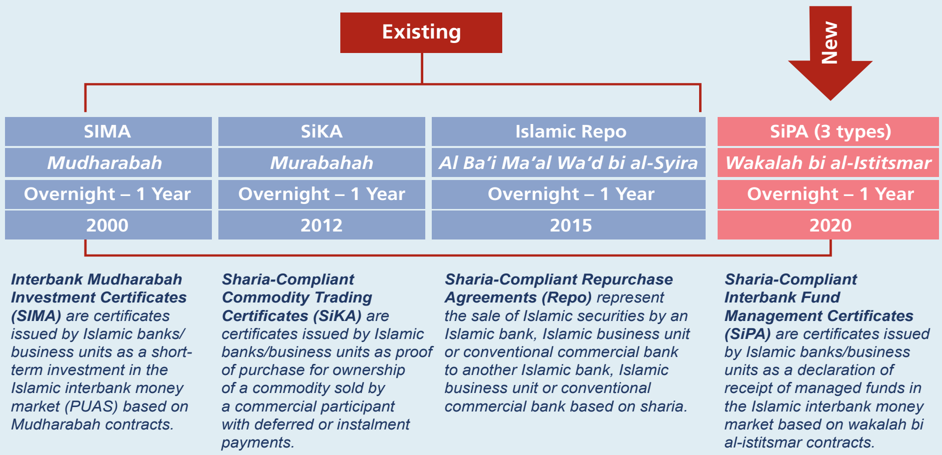
Another essential reason for involving authorities other than Bank Indonesia is that the mandate to maintain financial system stability is the joint responsibility of the Ministry of Finance, Bank Indonesia, OJK, and LPS under the auspices of the Financial System Stability Committee. To that end, synergy and coordination between committee members are constantly nurtured and strengthened.

Box 3.3.2 Sharia-Compliant Interbank Fund Management Certificates (SiPA) - New Interbank Money Market Instrument based on Sharia Principles

To achieve the overarching target of monetary policy, one method of monetary control, based on Islamic principles, is through Islamic monetary operations to affect liquidity in the Islamic interbank money market (PUAS). To that end, Bank Indonesia has developed a well-functioning Islamic interbank money market as an integral part of the money market. A well-functioning Islamic interbank money market supports Islamic financial industry resilience as a means to manage liquidity risk. PUAS facilitates short-term interbank financial transactions based on Islamic principles in rupiah and foreign currencies using sharia-compliant financial instruments. PUAS transactions are influenced by real demand for liquidity in the interbank money market. PUAS transactions are not profit-seeking and are only used to meet demand for liquidity.

In the approximately 20 years since the first PUAS regulation was enacted, the Islamic interbank money market has evolved constantly. Referring to the Development Blueprint for the Islamic Economy and Finance, PUAS development has encapsulated regulatory strengthening, instrument development, infrastructure and institutional strengthening as well as issuer and investor base expansion. Development has reflected the prevailing needs of the Islamic banking industry. Seeking to increase the variety of PUAS instruments as alternative liquidity management tools for the Islamic banking industry, in the first semester of 2020 Bank Indonesia introduced a new PUAS instrument, namely Sharia-Compliant Interbank Fund Management Certificates (SiPA). As a new PUAS instrument, SiPA has increased the number of existing instruments, namely Interbank Mudharabah Investment Certificates (SIMA), Sharia-Compliant Commodity Trading Certificates (SiKA) and Sharia-Compliant Repurchase Agreements (Repo). With the inclusion of SiPA, therefore, the new structure of PUAS instruments is illustrated in Figure B3.3.2.1.

Figure B3.3.2.1 Structure of Islamic Interbank Money Market (PUAS) Instruments



Source: Bank Indonesia, processed

Sharia-Compliant Interbank Fund Management Certificates (SiPA) are issued based on Wakalah bi al-Istitsmar contracts, which allow Islamic banks, Islamic business units and/or conventional commercial banks as muwakkil/mustatsmir to authorise another Islamic bank/business unit as wakil/mutsmir in order to manage (istitsmar) funds without ujrah (wakalah bi ghairi al-ujrah). When issuing SiPA, PUAS participants act as wakil or muwakkil. Participants acting as a muwakkil authorise the participant acting as a wakil to manage the funds. Islamic banks/business units can act as a wakil or muwakkil, while conventional commercial banks can only act as a muwakkil.

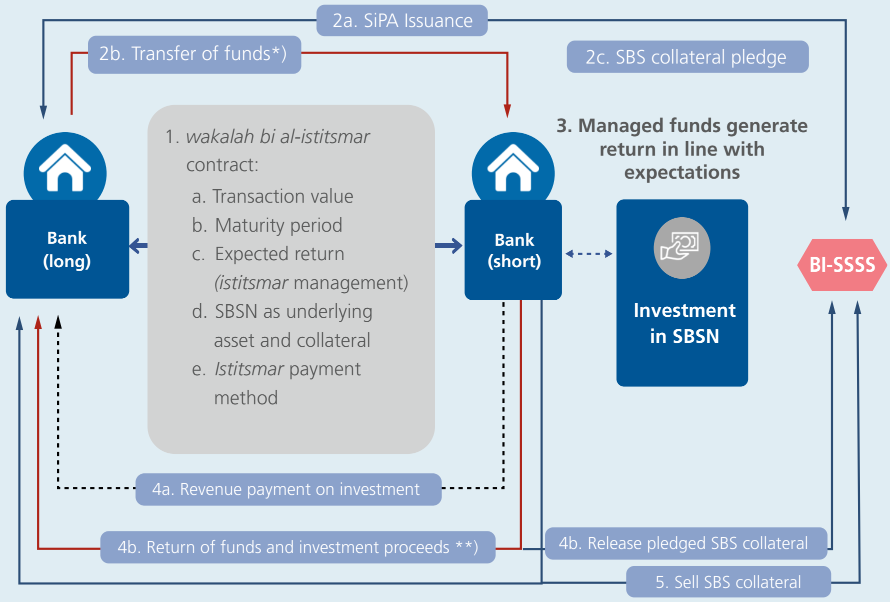
The characteristics of SiPA instruments were developed based on the opinion of the National Sharia Board of the Indonesian Council of Ulama (DSN-MUI) as follows:

1. Issued based on wakalah bi al-istitsmar contracts;
2. Denominated in rupiah;
3. Scripless;
4. Overnight – 1 Year
5. Non-transferable before maturity;
6. Funds received used to finance business activity, with or without restrictions;
7. Provide income from fund management; and
8. Can be accompanied by collateral in the form of Government Islamic Securities (SBSN) and/or Bank Indonesia Sukuk (SukBI).

There are three types of SiPA instrument as follows:

1. Type 1. Issued using underlying SBSN accompanied by collateral pledged in the form of Islamic securities (SBSN and/or SukBI).
2. Type 2. Issued using underlying assets in the form of general bank business activity (mutlaqah) or specific bank business activity (muqayyadah), accompanied by collateral pledged in the form of Islamic securities (SBSN and/or SukBI).
3. Type 3. Issued using underlying assets in the form of general bank business activity (mutlaqah) or specific bank business activity (muqayyadah).

Figure B3.3.2.2 Type 1 SiPA Transaction Mechanism



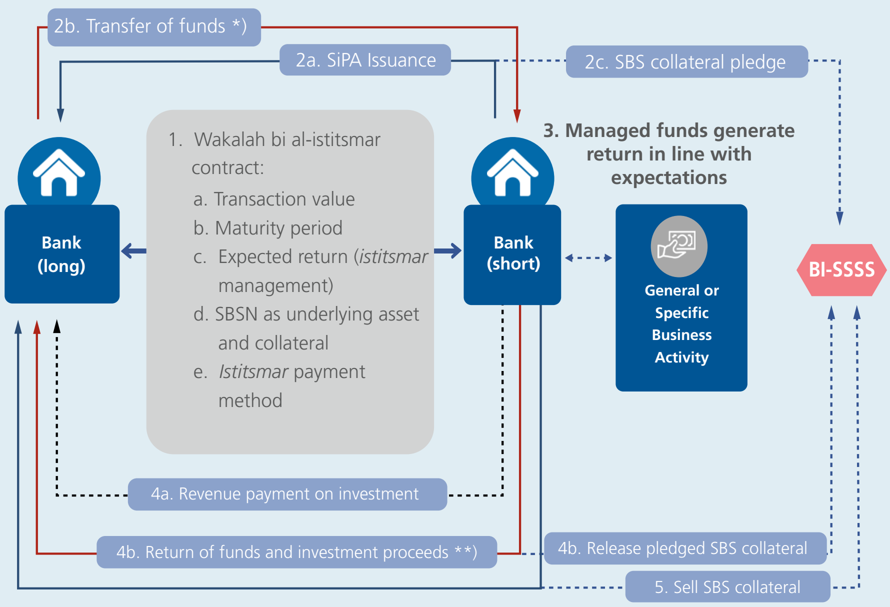
*) 1st leg value = value of collateralised SBS x (SBS Price – Haircut)
**) 2nd leg value = 1st leg value + return (istitsmar)

Source: Bank Indonesia

Type 1 SiPA are issued using underlying Islamic securities (SBS) in the form of Government Islamic Securities (SBSN) based on the following transaction mechanism:

1. Transaction is initiated by a Bank with a long position agreeing with a Bank with a short position using a *wakalah bi al-istitsmar* contract in the form of fund management for investment in SBSN.N.
2. a. Bank (short) issues the scripless SiPA based on the underlying SBSN and Bank (long) transfers the funds to Bank (short) through the Bank Indonesia – Real Time Gross Settlement (BI-RTGS) system.
   b. Bank (short) pledges SBSN as the underlying asset to Bank (long) through Bank Indonesia – Scripless Securities Settlement System (BI-SSSS).
3. Bank (short) manages funds for investment in SBSN.
4. a. Bank (short) pays return on investment (*istitsmar*), if instalments have been agreed.
   b. Upon maturity:
      1). Bank (short) returns the funds and the return on investment to Bank (long). Any additional return on investment is granted to Bank (short) as an incentive; and
      2). Pledge is released through Bank Indonesia – Scripless Securities Settlement System (BI-SSSS)..
5. If Bank (short) fails to return the funds to Bank (long) upon maturity, Bank (short) sells SBS collateral to Bank (long) outright at market prices to settle the obligations.

Figure B3.3.2.3 Type 2 SiPA Transaction Mechanism



*) 1st leg value = value of collateralised SBS x (SBS Price – Haircut)
**) 2nd leg value = 1st leg value + return (istitsmar)
Source: Bank Indonesia, processed

Type 2 SiPA are issued using underlying assets in the form of general bank business activity (*mutlaqah*) or specific bank business activity (*muqayyadah*), accompanied by collateral pledged in the form of Islamic securities (SBSN and/or SukBI) based on the following transaction mechanism:

1. Transaction is initiated by a Bank with a long position agreeing with a Bank with a short position using a wakalah bi al-istitsmar contract in the form of fund management for investment in bank business activity.
2. a. Bank (short) issues the scripless SiPA.

   b. Bank (long) transfers the funds to Bank (short) through the Bank Indonesia – Real Time Gross Settlement (BI-RTGS) system.

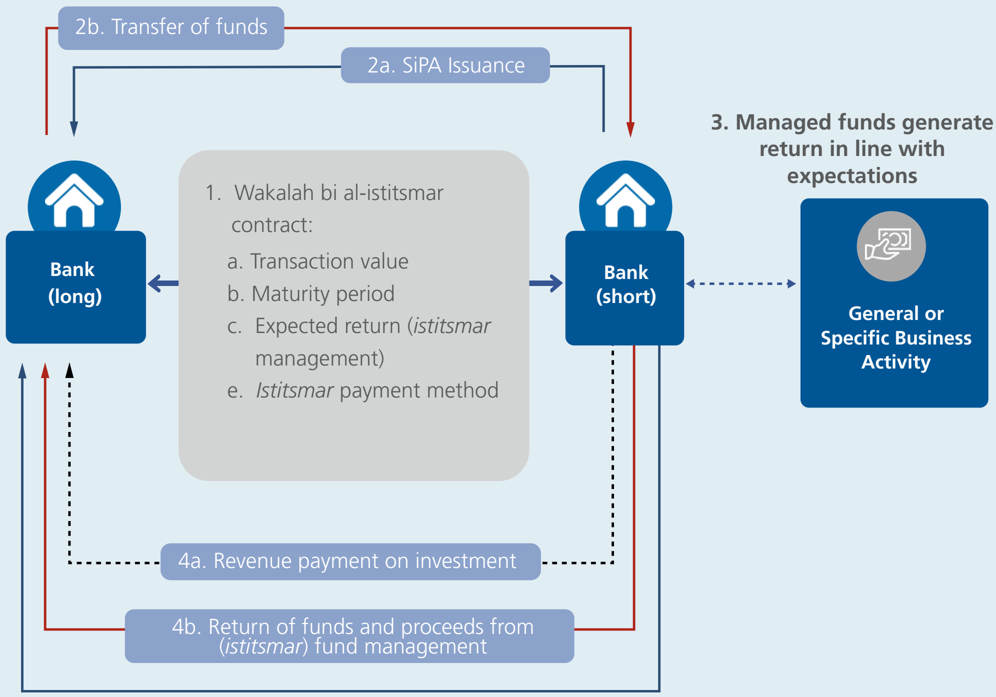
   c. Bank (short) pledges Islamic securities (SBSN and/or SukBI) as underlying assets to Bank (long) through the Bank Indonesia – Scripless Securities Settlement System (BI-SSSS).
3. Bank (short) manages funds for investment in general bank business activity (*mutlaqah*) or specific bank business activity (*muqayyadah*).
4. a. Bank (short) pays return on investment (*istitsmar*), if instalments have been agreed.

   b. Upon maturity:

      1). Bank (short) returns the funds and the return on investment to Bank (long). Any additional return on investment is granted to Bank (short) as an incentive; and

      2). Pledge is released through Bank Indonesia – Scripless Securities Settlement System (BI-SSSS).
5. If Bank (short) fails to return the funds to Bank (long) upon maturity, Bank (short) sells SBS collateral (SukBI/SBSN) to Bank (long) outright at market prices to settle the obligations.

Figure B3.3.2.4 Type 3 SiPA Transaction Mechanism



Source: Bank Indonesia, processed

Type 3 SiPA are issued using underlying assets in the form of general bank business activity (mutlaqah) or specific bank business activity (muqayyadah), without collateral (unsecured), based on the following transaction mechanism:

1. Transaction is initiated by a Bank with long position agreeing with a Bank with a short position using a wakalah bi al-istitsmar contract in the form of fund management for investment in bank business activity.

2. a. Bank (short) issues the scripless SiPA.

   b. Bank (long) transfers funds to Bank (short) through the Bank Indonesia – Real Time Gross Settlement (BI-RTGS) system.

3. Bank (short) manages the funds for investment in general bank business activity (mutlaqah) or specific bank business activity (muqayyadah).

4. a. Bank (short) pays return on investment (istitsmar), if instalments have been agreed.

   b. Upon maturity, Bank (short) returns the funds and the return on investment to Bank (long). Any additional returns on investment are granted to Bank (short) as an incentive.f.

CHAPTER 4

OUTLOOK AND POLICY DIRECTION

Entering the second semester of 2020, Bank Indonesia expects to maintain financial system stability in line with early indications of economic recovery. Financial system resilience will remain under control as intermediation is expected to improve gradually, albeit not quite to pre-pandemic levels. In addition to greater public mobility and stronger economic performance, the recovery outlook will continue to rely on policy synergy between Bank Indonesia, the Government and other financial authorities, which will be strengthened moving forward.

In 2020, Bank Indonesia has maintained an accommodative macroprudential policy stance with a focus on two aspects, namely maintaining financial system resilience to mitigate the impact of COVID-19 in the financial sector, as well as accelerating the economic recovery by expanding the role of financing. Accommodative macroprudential policy will be maintained based on prudential principles in order to ensure that intermediation activity does not exacerbate the risks or disrupt financial system stability during the COVID-19 pandemic, which have not fully recovered to pre-pandemic levels.

Bank Indonesia will continue to evaluate whether the accommodative macroprudential policies implemented during the first semester of 2020 can be extended, including the looser Macroprudential Intermediation Ratio (MIR) and lower reserve requirements for banks extending loans to MSMEs and for export-import activity. Efforts to maintain financial system stability through macroprudential policy will also be supported by stronger financing growth through financial inclusion and financial sector digitalisation.

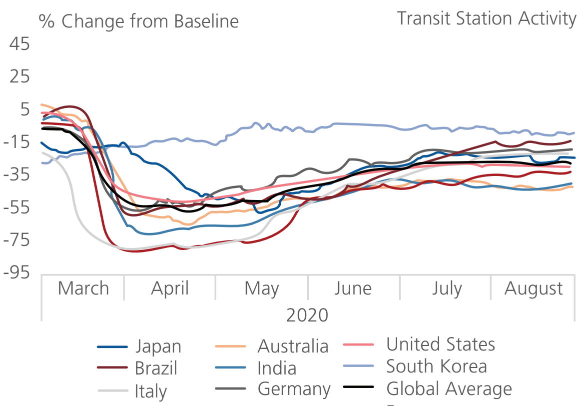
Moving forward, Bank Indonesia will continue to monitor economic dynamics and COVID-19 transmission when formulating follow-up policy measures as required, thereby minimising the potential economic impact in Indonesia. Furthermore, policy coordination will be strengthened to maintain macroeconomic and financial system stability, while accelerating the national economic recovery.

4.1 Nascent Signs of Global and Domestic Economic Improvements

The global economy is projected to improve during the second semester of 2020. Such indications have begun to emerge in several countries, China in particular, as the impact of the COVID-19 pandemic begins to fade, boosted by the extraordinary fiscal stimuli. Several early indicators reflect the direction of the global recovery, such as increasing public mobility globally, including commuting, retail and recreational activities (Graph 4.1.1). Consumer and business confidence in many countries have shown incipient signs of improvement, accompanied by increasing production activity, as confirmed by recent gains in the Manufacturing Purchasing Managers Index (PMI) in the United States, Europe and China (Graph 4.1.2). The speed of the global economic recovery moving forward will be influenced by the COVID-19 pandemic, economic mobility in response to the pandemic, the magnitude and speed of policy stimuli, fiscal stimuli in particular, financial and corporate sector conditions as well as the economic structure of the country.

The economic improvements projected for the second semester of 2020 will potentially boost world trade volume and elevate international commodity prices. Improving economic activity in the major global players, such as the United States and China, is restoring demand for global exports and imports, leading to a shallower world trade volume contraction (Graph 4.1.3). Congruently, the international commodity price contraction has also decreased. Metal prices, including copper and nickel, have risen on increasing demand in China for infrastructure projects. The rising CPO price trend is the result of strong demand in China and limited supply in Malaysia (Table 4.1.1).

Graph 4.1.1 Public Mobility

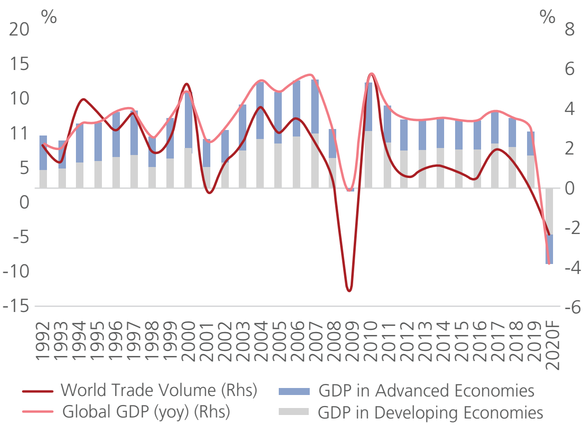


Source: Google Mobility Report; data as of 5th August , 2020

Graph 4.1.2 US Manufacturing PMI

Source: IHS Markit, processed

Graph 4.1.3 World Trade Volume



Source: CPB, IMF, processed

Table 4.1.1 Commodity Prices

KOMODITAS	2016	2017	2018	2019	2020 (YTD)*
Copper	-10.5	27.1	6.7	-7.8	-5.0
Coal	6.8	48.2	2.5	-8.6	-17.3
CPO	21.3	5.7	-19.2	-2.3	17.7
Rubber	-2.2	28.1	-16.8	12.4	-11.4
Nickel	-15.4	8.9	27.8	7.0	-7.9
Lead	13.1	13.1	0.5	-7.5	-10.9
Aluminium	-3.5	22.9	7.4	-14.1	-8.7
Coffee	4.3	-2.9	-15.4	-11.8	2.3
Other Commodities	1.0	6.8	1.2	-0.7	-4.6
Indonesia Export Price Index (IHKEI)	5.4	21.7	-2.8	-3.0	-4.7
Oil (Brent)**	44.1	54.4	71.2	64.0	41.5

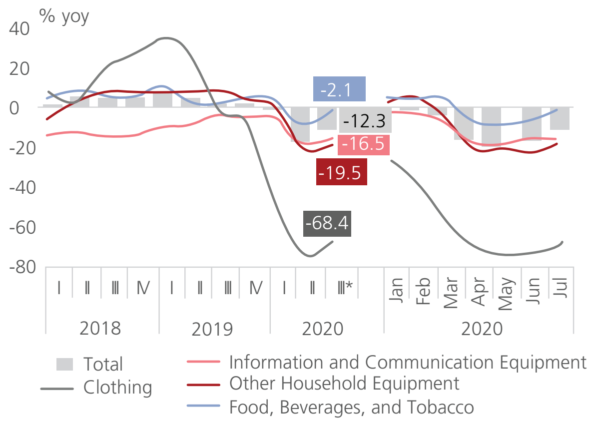
Source: Bloomberg
*) IHKEI and Oil as of 18th August 2020
**in US dollars per barrel; Other Commodities (%, yoy)

Global financial market uncertainty is expected to remain elevated. Several factors are driving up uncertainty, including concerns over a second wave of COVID-19 infections, the global economic recovery outlook as well as ongoing geopolitical tensions between the United States and China. High global financial market uncertainty is reflected in high EPU and VIX indexes. Furthermore, a global rebalancing of capital flows has triggered a surge of capital outflows from many countries, particularly in developing economies that have experienced higher risk. The capital reversal has intensified currency pressures, especially in developing economies. Such conditions could potentially restrain capital flows to developing economies, including Indonesia, thereby intensifying currency pressures.

The domestic economy is projected to improve after contracting in the second quarter of 2020. The promising national economic outlook will be influenced by public mobility, increasing state budget realisation as a form of fiscal stimulus, ongoing monetary policy stimuli, progress in the loan and corporate restructuring programs, as well as faster development of the digital economy and finance, including MSME empowerment. In addition, the promising domestic economic outlook will also be driven by a shallower-than-previously-expected export contraction in line with the favourable global economic prospect.

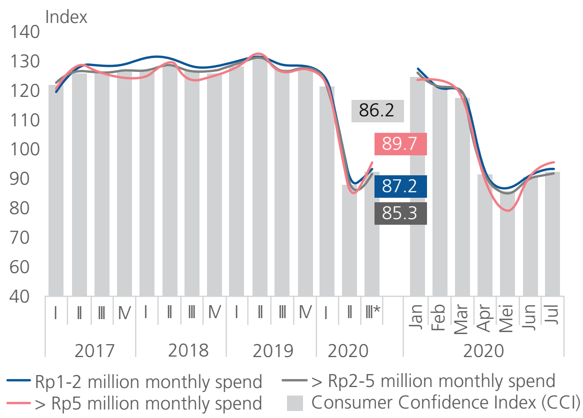
Domestic demand has shown early signs of recovery after the Government relaxed large-scale social restrictions, which increased public mobility. Retail sales are tracking an upward trend, particularly in terms of food, beverages, and tobacco, as public mobility is restored in line with the Government's decision to gradually unwind large-scale social restrictions (Graph 4.1.4). Similarly, online sales are increasing due to faster digital media uptake during the period of social restrictions. Consumption is recovering with the support of growing consumer optimism (Graph 4.1.5). Early signs of investment gains have been confirmed by cement sales, the Prompt Manufacturing Index (PMI) and investment performance based on the Business Survey (SKDU) conducted by Bank Indonesia in the third quarter of 2020. Externally, positive export performance has persisted, as reflected by higher

Graph 4.1.4 Retail Sales



Source: Bank Indonesia, processed

Graph 4.1.5 Consumer Confidence Index (CCI)



Source: Bank Indonesia, processed

exports of several commodities entering the second semester of 2020, led by iron and steel as well as metal ore, supported by increasing demand for iron and steel in China, which is expected to remain solid in line with a proliferation of infrastructure projects. Likewise, CPO exports have been maintained by demand in China and India. On the other hand, services exports will remain under pressure as a result of fewer visits to Indonesia by international travellers.

4.2. Financial System Stability Improving as Pressures Ease

Entering the second semester of 2020, financial system stability was increasingly maintained. The recovery outlook is strongly influenced by public mobility in line with the fading impact of COVID-19 transmission. Financial system resilience has been maintained, while intermediation is expected to gradually improve albeit not to pre-pandemic levels. In addition to restored public and economic mobility, the recovery outlook will remain a function of policy synergy between Bank Indonesia, other financial authorities and the Government, which will be strengthened moving forward.

Corporate performance is also expected to gradually recover in the second semester of 2020 in line with improving global and domestic economic performance. Indications of economic gains in several countries, China in particular, accompanied by increasing world trade volume and international commodity prices, will potentially boost global demand. Historically, the commodity sector is a pull-factor in terms of recovering corporate sales performance in Indonesia. Meanwhile, China is a major destination for Indonesian exports, with approximately 50% of exported products originating from the commodity sector. Therefore, economic gains in China are expected to drive corporate performance in Indonesia. In addition to the positive impact on demand, the nascent global economic recovery could potentially reduce global supply chain issues that have undermined corporate production during the pandemic.

Increasing economic and public mobility after relaxation of the large-scale social restrictions will potentially alleviate pressures on corporate sales. Based on an internal survey conducted by Bank Indonesia, 97% of corporations that closed or pared back operational activities during the period of large-scale social restrictions had reopened entering the second semester of 2020, although 36% of those were operating on a limited basis and had adopted a wait-and-see posture. This shows that corporate production activity has begun to recover. In addition, increasing business activity in the wake of large-scale social restrictions is expected to accelerate domestic demand. Early indications of recovering global and domestic demand as well as corporate production will gradually restore sales, revenues and, hence, corporate repayment capacity in the second half of 2020. Such performance gains are expected to contain contagion risk in the financial system, while the gradual reopening of businesses will restore corporate propensity to invest and demand for financing moving forward.

Pessimism in the household sector is expected to fade in the second semester of 2020. Indications of corporate recovery will edge up labour absorption and, thus, increase household income. This will potentially reduce household risk and boost household consumption moving forward. For middle- and high-income earners, who have been less inclined to consume during the pandemic, instead preferring to save, the relaxation of large-scale social restrictions is expected to drive up consumption. This is in line with indications of respective improvements in the Consumer Confidence Index (CCI), Current Economic Condition Index (CECI), and Consumer Expectation Index (CEI). Nevertheless, with the gradual and multispeed recovery, use of the household liquidity buffer in the form of third-party funds is expected to continue, particularly for those with lower middle income. Looking ahead, there is optimism surrounding a consumption recovery following greater public mobility, which will potentially stimulate household demand for financing.

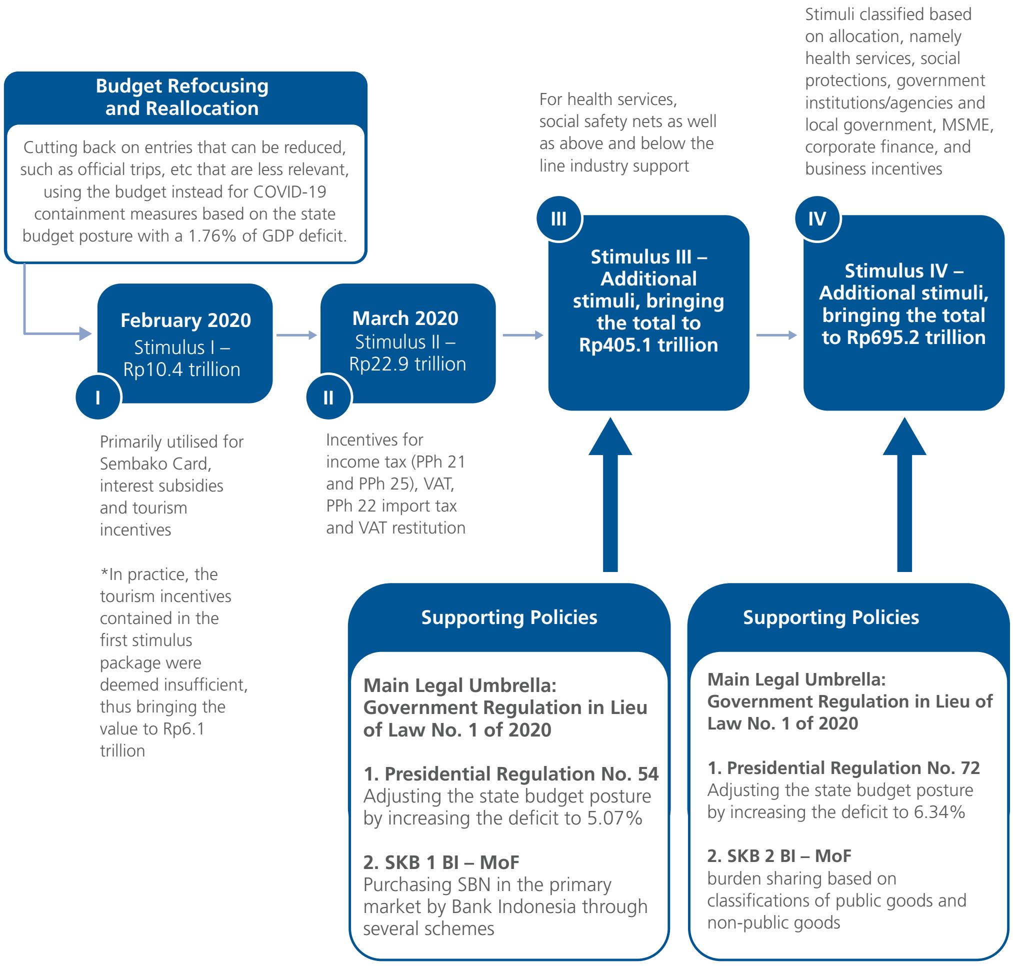
Expectations of economic improvement accompanied by mild real sector pressures will impact banking industry performance favourably. Risk in the banking system is expected to remain under control in the second semester of 2020. Corporate and household sector recovery will alleviate borrower default pressures, supported by the national economic recovery program that includes loan restructuring. Loan restructuring peaked in the first semester of 2020, accompanied by sluggish growth, indicating a contained risk outlook. Meanwhile, liquidity in the banking system is resilient, as reflected by a high liquidity ratio and supported by fiscal expansion by the Government and policy to loosen liquidity by Bank Indonesia. In addition to contained risk and resilient liquidity, banking industry performance will be propped up in the latter half of 2020 by adequate capital. The Capital Adequacy Ratio (CAR) in the banking industry remains well above the minimum threshold. Therefore, banks have maintained sufficient risk absorption capacity. In general, the ability of the banking industry to maintain performance is not expected to significantly erode bank profitability.

Moving forward, bank intermediation is expected to gradually recover despite limited growth. This is in line with the promising corporate outlook, domestic economic recovery, and consistent policy synergy amongst the authorities. On the demand side, stronger corporate performance and the domestic economic recovery are expected to catalyse corporate and household demand for financing with a lower risk of default. Notwithstanding, demand for financing is expected to recover gradually before ultimately reaching pre-pandemic levels in line with the measured domestic economic recovery and weight-and-see attitude adopted by the corporate sector. On the supply side, financial institutions, banks in particular, have maintained solid financing capacity supported by adequate liquidity and capital. In line with contained risk and sufficient financing capacity, banks are expected to ease lending standards further. Such conditions will be reinforced by government fund placements in member banks of the Association of State-Owned Banks (HIMBARA) as well as several regional banks. In addition, the accommodative monetary and macroprudential policy stance maintained by Bank Indonesia, together with government policies, such as loan restructuring and guarantees, are expected to accelerate the bank intermediation function and economic recovery moving forward.

4.3. Maintaining Accommodative Macroprudential Policy to Support National Economic Recovery

Bank Indonesia constantly strengthens all elements of its policy mix in order to mitigate the economic risks associated with COVID-19 and accelerate national economic recovery momentum. Through an optimal mix of monetary, macroprudential and payment system policies, Bank Indonesia consistently maintains rupiah exchange rate stability, controls inflation, guarantees adequate liquidity, supports financial system stability, including the intermediation function, and maintains payment system availability despite intense COVID-19 pressures. Rupiah exchange rates remain under control in line with Bank Indonesia's stabilisation measures. Inflation is persistently low on compressed demand despite early signs of improvement. Liquidity conditions remain loose following the liquidity injections by Bank Indonesia. Furthermore, financial system resilience is solid, although the risks associated with COVID-19 transmission on financial system stability continue to demand vigilance. The intermediation function of the financial sector remains weak, yet with early indications of improvement in line with signs of

Figure 4.3.1 Government Fiscal Stimuli



Source: Bank Indonesia and Ministry of Finance increasing demand and looser lending standards in the second semester of 2020. Meanwhile, cash and noncash payment system transactions are increasing in line with the economic recovery, accompanied by rapid economic, and financial digitalisation.

Moving forward, Bank Indonesia will continue to monitor economic and COVID-19 transmission dynamics in order to formulate the follow-up policy measures necessary to minimise the economic impact in Indonesia. In the second semester of 2020, the domestic economic recovery outlook will mainly be influenced by public mobility, the speed of central and local government budget realisation, progress in terms of loan restructuring and guarantees, as well as development of the digital economy and finance, including MSME empowerment in particular. To that end and to accelerate the national economic recovery, Bank Indonesia will strengthen monetary expansion synergy with fiscal stimuli by the Government. Thus far, the Government has provided fiscal stimuli totalling Rp695.2 trillion to minimise the pandemic impact and catalyse domestic economic recovery momentum (Figure 4.3.1). Therefore, such synergy includes Bank Indonesia's role in funding the 2020 state budget through SBN purchases in the primary market, via market mechanisms and private placement, as part of the efforts to accelerate national economic recovery program implementation, while maintaining macroeconomic stability.

In 2020, Bank Indonesia has maintained an accommodative macroprudential policy stance with a focus on two goals. First, maintaining financial system resilience to mitigate the impact of COVID-19 on the financial sector. Second, accelerating the economic recovery by increasing the contribution of financing. To maintain resilience, Bank Indonesia strengthened liquidity and optimised liquidity management in the banking industry through the Macroprudential Liquidity Buffer (MPLB). Not only guaranteeing the quantity, MPLB also ensures the banking industry maintains high-quality liquid assets. Consistent with Bank Indonesia's quantitative easing policy, liquidity conditions in the banking industry remain loose and conducive to economic financing. In addition, adequate liquidity in the banking industry is currently required to support the loan restructuring program, in particular for MSME with formal loans from the banking industry. Moving forward, Bank Indonesia will regularly evaluate MPLB implementation in terms of the ratio that must be maintained by the banks as well as the corresponding repo facility flexibility. In addition to resilient liquidity, Bank Indonesia also maintains bank capital through the countercyclical buffer (CCB), which allows Bank Indonesia to ensure the financing disbursed by the banking industry does not trigger risks that could erode capital. Considering the currently restrained intermediation conditions, Bank Indonesia will hold the CCB at a level of 0% for the foreseeable future but also regularly evaluate and assess the CCB level.

Bank Indonesia has maintained an accommodative macroprudential policy stance to accelerate the recovery through efforts to strengthen balanced and quality financing through two salient approaches. First, by developing macroprudential policy instruments for financing. Second, through periodic evaluations of the accommodative macroprudential policy instruments conducive to financing instituted in the first semester of 2020. To stimulate the recovery, efforts to boost financing moving forward will focus on potential sectors, including MSME, namely those sectors with a high contribution to faster growth as well as sectors aligned with the direction of government policy, including green financing. In addition, Bank Indonesia is consistently catalysing intermediation in line with indications of improving corporate and household performance as well as banking industry potential to loosen lending standard policy commensurate with the more contained level of risk. To that end, attention is focused on sectors with high demand yet inadequate supply of financing. In addition, Bank Indonesia will continue to evaluate the accommodative macroprudential policies adopted in the first half of 2020 to gauge the possibility for further implementation. Such policies include a looser Macroprudential Intermediation Ratio (MIR) and lower reserve requirements to incentivise the financing of specific sectors. MIR policy has been relaxed by obviating the need for additional giro requirements through upper and lower disincentive parameters of 0. Furthermore, Bank Indonesia reduced the rupiah reserve requirements by 50 basis points for banks extending loans to MSMEs and for export-import activity, as well as for priority sectors stipulated in the national economic recovery program. To accelerate financing, accommodative macroprudential policy remains compliant with prudential principles to ensure intermediation activity, which is yet to reach pre-pandemic levels, does not trigger additional risks or disrupt financial system stability amidst intense COVID-19 pressures.

Moving forward, Bank Indonesia will strengthen policy coordination to maintain macroeconomic and financial system stability as well as accelerate the national economic recovery. Through its policy mix, Bank Indonesia will strengthen coordination with the Government and Financial System Stability Committee to ensure the policies implemented continue to effectively stimulate economic recovery. To that end, Bank Indonesia is fully committed to directing the full panoply of policy instruments towards supporting the national economic recovery, while maintaining macroeconomic and financial system stability. Therefore, Bank Indonesia is emphasising the quantity channel by providing liquidity to recover the economy from the impact of the COVID-19 pandemic, including support for the Government to accelerate state budget realisation in 2020. Bank Indonesia continues its commitment to funding the 2020 state budget through SBN purchases in the primary market based on market mechanisms and private placement. Furthermore, Bank Indonesia will continue to provide liquidity to the banking industry to ensure smooth loan (financing) and corporate restructuring programs to support the national economic recovery. In terms of macroprudential policy, Bank Indonesia will synergise with the fiscal policies of the Government, microprudential supervision policies of the Financial Services Authority (OJK), and loan guarantee program of the Indonesia Deposit Insurance Corporation (LPS) to strengthen financial system stability as well as stimulate lending for the national economic recovery.

4.4. Accelerating Financing through Financial Inclusion Support

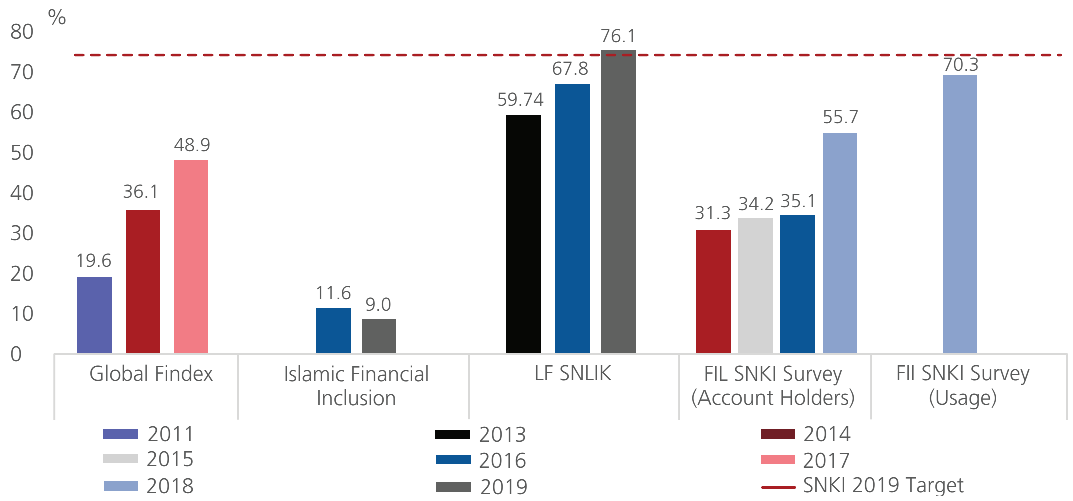
Financial Inclusion

Financial inclusion plays a critical role in terms of accelerating economic growth. Financial inclusion is a condition where individuals have safe access to useful, affordable and quality formal financial services to meet their needs and capabilities.[1] Moreover, financial inclusion his key to increasing prosperity, alleviating poverty and accelerating growth, ultimately leading to solid, balanced, sustainable and inclusive economic growth. The importance of financial inclusion has prompted many countries, including Indonesia, to focus efforts on financial inclusion by providing greater public access and usage of formal financial services. In Indonesia, the authorities have prioritised low-income earners, MSMEs, residents in disadvantaged areas as well as students and young people to receive access to finance through financial inclusion efforts.

The results of financial inclusion surveys have shown that the level of financial inclusion in Indonesia has increased. Based on several surveys (Graph 4.4.1), approximately 48.9% of adults in Indonesia now have access to formal financial institutions (Global Findex, 2017). Meanwhile, 70.3% of adults have used financial products or services and 55.7% have an account (National Financial Inclusion Strategy, 2018). In 2019, OJK's National Financial Literacy and Inclusion Survey (SNLIK) confirmed a Financial Inclusion Index of 76.19% and a Financial Literacy Index of 38.03%. Compared with other peer countries, access to financial services in Indonesia is comparatively good with further potential to increase usage. Nonetheless, several indicators in Indonesia, including formal loans and deposit accounts at a bank as well as total transactions via mobile and the internet, remain behind other countries such as Malaysia, Thailand, India, and Brazil.[2]

Financial inclusion growth in Indonesia must remain balanced with higher usage and financial literacy. Therefore, a strategy is required to raise financial inclusivity that is not restricted to expanding access to and usage of formal financial services yet also focuses on how financial inclusion can empower people and ultimately stimulate economic growth. To that end, Bank Indonesia has formulated a strategy to stimulate economic and financial inclusion, namely the National Economic

Graph 4.4.1 Indonesia Financial Inclusion Survey (%)



Source: BI, OJK, FII, World Bank

1 Based on the definition contained in the Attachment to Presidential Regulation No. 82 of 2016 concerning the National Financial Inclusion Strategy.

2 Based on data from the IMF Financial Access Survey, 2019. The proxies for access and usage indicators refer to the Financial Inclusion Indicators published by the G20.

and Financial Inclusion Strategy (SNKEI).[3] Based on that strategy, there are two main targets of Bank Indonesia's Economic and Financial Inclusion Strategy, namely the subsistence group and MSME group, using conventional and Islamic approaches. The overarching vision is to increase access to broad economic opportunities and quality formal financial services in line with the individual's needs and abilities in order to ameliorate public prosperity.

Support for financial inclusion has been strengthened to stimulate economic recovery in the pandemic era. Bank Indonesia is developing economic and financial inclusion to increase and expand access to economic opportunities for unbanked and underserved populations through corporatisation, higher capacity and the provision of services. Furthermore, economic and financial inclusion aims to create productive, innovative and resilient micro, small, and medium enterprises (MSME) as a new force of the national economy across three financial phases. First, the near term (2020-2021) focuses on efforts to maintain MSME resilience. During this stage, strengthening policy synergy will be directed towards recovering and maintaining MSME resilience during the pandemic. Second, the medium term (2022-2023) focuses on efforts to increase the economic contribution of MSMEs. During this phase, strengthening financial inclusion will include efforts to expand the MSME development program in order to accelerate the national economic recovery. Third, the long term (2024-2025) will focus on efforts to create MSMEs as a new force of the national economy. During this phase, financial inclusion will be strengthened through sustainable and innovative MSME development. Moving forward, the role of financial inclusion is critical in line with Bank Indonesia's accommodative policy stance to stimulate financing towards faster recovery. Through the second pillar of SNEKI, Bank Indonesia will continue to increase access to financing. Broader access to affordable financing will increase the opportunity to accelerate growth. Based on SNEKI, broader access to financing will commence with the subsistence groups and MSMEs, with financing running the whole gamut from social funding to commercial financing.

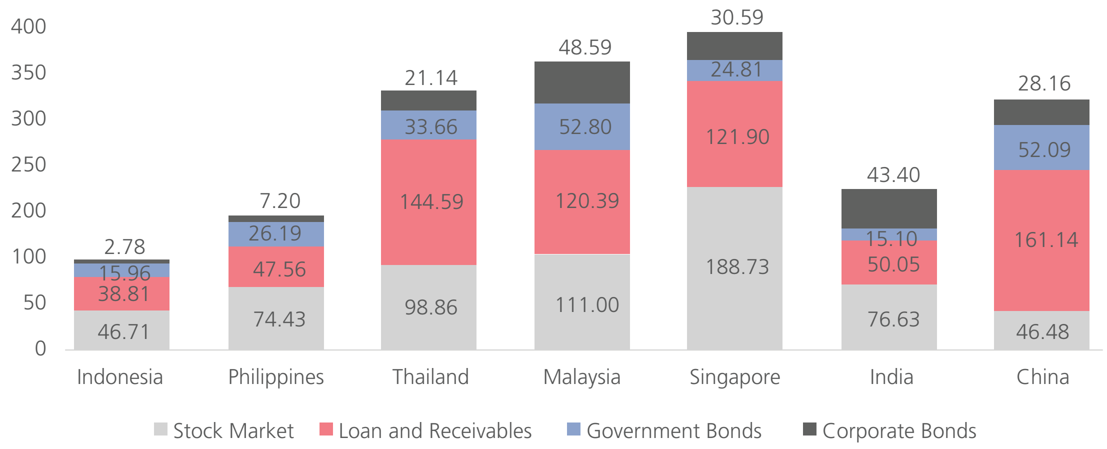
Financial Market Development

Deep and efficient financial markets are a critical element of sustainable economic growth. Price stability in the financial markets is a macro indicator that influences monetary stability, financial system stability, fiscal sustainability and the micro aspects of market players. Therefore, special attention is required in terms of financial market development and deepening. The depth of financial markets in Indonesia is relatively shallow compared with other peer countries, such as the Philippines, Thailand, Malaysia, Singapore, India, and China. For example, the percentage of total outstanding financial assets (shares, debt, SBN, and corporate bonds) to gross domestic product (GDP) in Indonesia reached 105% in 2018, compared with 155% in the Philippines, 299% in Thailand, and 333% in Malaysia (Graph 4.4.2). In response, Bank Indonesia has initiated strategic measures to accelerate the development of liquid and efficient financial markets, including establishment of the Coordination Forum for Development Financing through Financial Markets (FKPPPK). The FKPPPK has formulated a comprehensive and measured Financial Market Development Blueprint for Indonesia, known as the National Financial Market Development and Deepening Strategy (SN-PPPK). A key focus area of SN-PPPK 2018-2024 in terms of financial market development in Indonesia is to develop sources of economic financing and risk management for investments in the financial markets. SN-PPPK also reflects enthusiasm to integrate financial market infrastructure through coordination between authorities.

Bank Indonesia has formulated its financial market development strategy as a comprehensive Financial Market Infrastructure Blueprint, targeting the money market and foreign exchange market, while utilising digital technology and financial market infrastructure development based on integration and interconnectedness amongst all financial market infrastructures. The

3 Refer to Box 4.1 National Economic and Financial Inclusion Strategy.

Graph 4.4.2 Financial Assets to GDP in 2018 (%)



Source: World Bank, ADB, CEIC

pillars of the Blueprint include: (i) financial market infrastructure digitalisation and strengthening; (i) strengthening monetary policy transmission effectiveness; and (iii) developing sources of economic financing and risk management.

Developing sources of economic financing is the third pillar of the Financial Market Infrastructure Blueprint, which is achieved through four strategies. First, developing alternative sources of financing. Second, utilising digital technology in financing development. Third, supporting financial literacy and education and developing the investor base. Fourth, strengthening financial market development coordination. To stimulate development of alternative financing sources, Bank Indonesia supports financial instrument innovation, including short-term financial instruments, such as asset securitisation, green and sustainable financing as well as asset-backed and green commercial securities. Meanwhile, risk management is strengthened by contributing to assessments of short-term financial market instrument development, conventional and Islamic, as well as hedging long-term interest rates/exchange rates. Efforts to develop alternative financing sources and risk management are supported by coordinated financial market development, including internal coordination at Bank Indonesia, coordination through the Coordination Forum for Development Financing through Financial Markets (FKPPPK) as well as coordination at international financial market forums. To accelerate pandemic recovery efforts, Bank Indonesia will continue to develop money market instruments, particularly to support corporate and MSME financing, in line with the national economic recovery program.

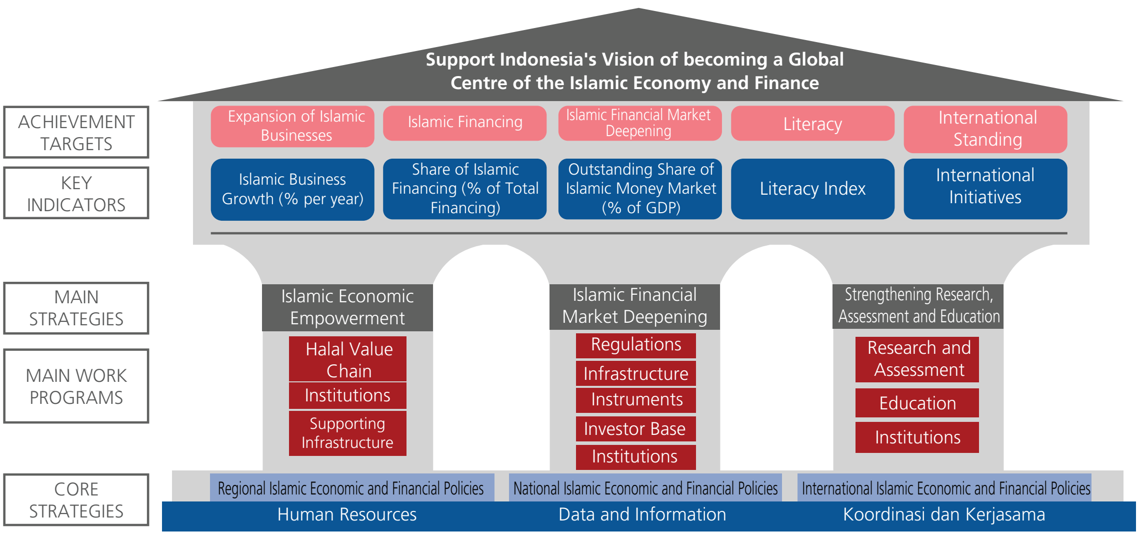
Islamic Financial Development

Islamic financial market development policy is an integral part of the Bank Indonesia policy mix. Therefore, Bank Indonesia has compiled an Islamic Economy and Finance Development Blueprint as a reference for integrated development policies, strategies and programs for the Islamic economy and finance at Bank Indonesia. The strategy framework is supported by three main pillars: (i) Islamic economic empowerment; (ii) Islamic financial market deepening; and (iii) Strengthening research, assessments and education (Figure 4.4.1). In practice, Bank Indonesia not only acts as regulator in terms of its functions as the monetary, macroprudential and payment system authority, yet also contributes as an accelerator and initiator. The two expanded roles are primarily needed to develop the existing Islamic economic and financial ecosystem, which requires a systematic approach. Therefore, close coordination between the relevant institutions and authorities is a prerequisite to the effectiveness of the Islamic economic and financial development program and strategy because such efforts cannot be implemented partially.

Efforts to increase sources of Islamic economic financing must be strengthened to accelerate the recovery. Based on the Islamic Economic and Financial Development Blueprint, efforts to increase the share of Islamic finance are an integral part of Islamic financial market deepening activities (Pillar II). Development will be achieved through strategies to expand the variety of Islamic financial instruments, increase total investors and transaction volume as well as strengthen regulations and infrastructure. The scope of the strategy is not limited to the commercial financial sector yet also includes Islamic social finance, such as zakat, infaq, sadaqah, and waqf (ZISWAF) in accordance with prevailing usage principles. In terms of commercial financial sector development, in order to accelerate the recovery, Bank Indonesia continues to develop financial instruments to strengthen Islamic financial market deepening as follows: (i) Sharia-Compliant Liquidity Facilities (FLisBI); (ii) Sharia-Compliant Liquidity Management (PaSBI); and (iii) Sharia-Compliant Interbank Fund Management Certificates (SiPA). Meanwhile, in terms of social finance, optimisation has been achieved through collaboration and/or integration with Islamic commercial finance, encompassing the banking industry, FinTech, microfinance institutions, and the capital market. Such collaboration has produced cash waqf-linked sukuk (CWLS)[4]. Zakat is another instrument of Islamic social Finance.

The role and contribution of Islamic social finance will be increased to support recovery during the COVID-19 pandemic. Moving forward, the Indonesia Waqf Board (BWI), Ministry of Finance, Bank Indonesia, and other relevant authorities will release other waqf-linked sukuk, including retail CWLS. Retail CWLS target individual investors, allowing members of the public to participate in the development of public facilities and simultaneously stimulate social finance in Indonesia. In addition, Bank Indonesia and other members of the International Working Group on Waqf Core Principles will continue preparing the Technical Notes of Waqf Core Principles for Risk Management.[5] In terms of Zakat development as an instrument of Islamic social finance, Bank Indonesia has compiled the Technical Notes of Zakat Core Principles (ZCP) on Disclosure and Transparency and the Technical Notes of Zakat

Figure 4.4.1 Bank Indonesia Islamic Economy and Finance Development Pillars



Source: Bank Indonesia, processed

4 Cash waqf-linked sukuk (CWLS) is a waqf placement instrument in Government Islamic Securities (SBSN) to support social development programs developed by Bank Indonesia in conjunction with the Indonesia Waqf Board (BWI), Ministry of Finance and nazhir (waqf managers). On 10th March 2020, the first series of CWLS was released through private placement with a value of Rp50.8 billion. The coupon rate and rewards were utilised to develop new waqf assets, namely the Rumah Sakit Achmad Wardi Retina Centre in Serang, Banten.

5 The Technical Notes of Waqf Core Principles for Risk Management are the minimum standards for risk-based waqf asset management. The aim is to provide greater understanding of waqf risk management and provide minimum standards for the risk management framework applied by nazhir (waqf managers).

Core Principles (ZCP) on Financial Reporting and External Audit in conjunction with the National Amil Zakat Board (Baznas). ZCP and the technical notes thereof represent an international zakat regulatory framework to improve governance for zakat management.

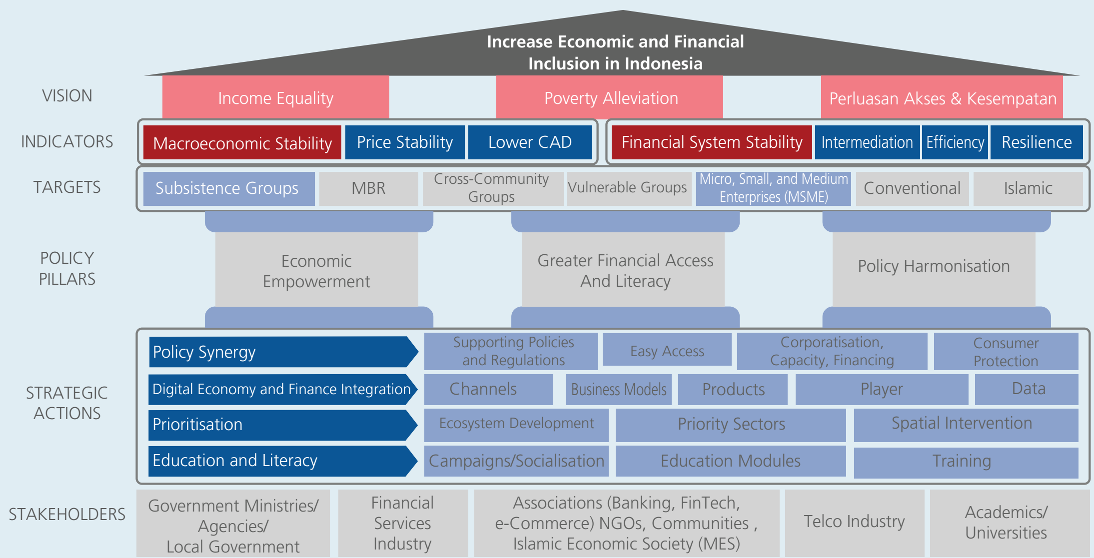
Islamic economic empowerment will also aid the COVID-19 recovery. The Islamic economic empowerment strategy is implemented through programs to strengthen the halal value chain ecosystem. This is intended to create and maintain a productive, inclusive and integrated ecosystem in order to develop local, regional and national economic independence sustainably. Bank Indonesia is committed to Islamic economic empowerment through various programs, including strengthening specific sectors as the strategic targets of Bank Indonesia's main work program. This will be achieved by strengthening the infrastructure and institutional cooperation to support Bank Indonesia's goals through monetary, macroprudential and payment system policy transmission. Halal value chain development is focused on four priority sectors, namely integrated farming, halal food, and Muslim fashion, Muslim friendly tourism as well as new and renewable energy, through cooperation with various business players, including the pesantren community, Islamic MSMEs, corporate sector, and other industry players. Since the COVID-19 outbreak, Bank Indonesia has regularly disbursed assistance to break the domestic chain of transmission in the pesantren community through 46 domestic representative offices distributed throughout Indonesia. Pesantren represent a significant space due to the thousands of students living and staying within the community, which is therefore a hotbed for COVID-19 transmission.

Box 4.4 National Economic and Financial Inclusion Strategy

Bank Indonesia has formulated a strategy to stimulate economic and financial inclusion through the National Economic and Financial Inclusion Strategy (SNEKI). SNEKI refers to the principle that in order to achieve public prosperity, aspects of the economy and financial inclusion are inseparable and must be combined. Through three pillars, namely economic empowerment (capacity), expanding financial access and literacy (financing), and policy harmonisation (corporatisation), inclusive economic and financial development are required to achieve macroeconomic and financial system stability. Macroeconomic and financial system stability are the foundation to achieve income equality, poverty alleviation as well as greater access and opportunities, while accomplishing the vision to increase economic and financial inclusion in Indonesia.

Inclusive economic and financial development through the National Economic and Financial Inclusion Strategy (SNEKI) is based on targets and main strategies. There are two main targets of Bank Indonesia's economic development and inclusion program, namely the subsistence groups, consisting of low-income earners, cross-community groups and vulnerable groups as well as micro, small and medium enterprises (MSME). Both targets are tackled through conventional and Islamic approaches. Development is achieved through five strategic actions, namely policy synergy, digital economy and finance integration, prioritisation as well as education and literacy. In practice, when implementing the strategic actions, digital innovation is the strength to integrate and accelerate economic and financial inclusion through the utilisation of a digital ecosystem for individuals, business players and communities.

Figure B4.4.1 National Financial and Economic Inclusion Strategy



Source: Bank Indonesia, processed

Inclusive economic and financial development activities under each SNEKI pillar have been translated into business chains. The first pillar, the economic empowerment chain, is applied by increasing capacity end-to-end for the subsistence groups and MSMEs, with the ultimate goal of increasing productivity. Efforts to increase capacity are focused on three aggregates, namely increasing production, business management, and marketing. For the subsistence groups, capacity is increased through the mentorship of beneficiary families (KPM) receiving non-cash social aid program (bansos) disbursements to gain the skills and abilities necessary to run a business. The second pillar, the greater access and financial literacy chain, seeks to utilise financial access through payment digitalisation, and stimulating financing. Efforts to increase public access to finance are achieved by expanding payment digitalisation as an entry point to financial services. Bank Indonesia is expanding uptake of QR Indonesian Standard (QRIS) and electronic money, as well as digital payments across various retail businesses and traditional markets.

Broader access to finance includes the subsistence groups and MSMEs, with financing from social funding to commercial financing. The third pillar is the policy harmonisation chain. Policy harmonisation is achieved through synergy between government ministries/agencies to support broader MSME corporatisation and create a healthy and vibrant MSME ecosystem. MSME corporatisation consists of three levels. First, individual corporatisation, namely the grouping of individuals into a unit. For example, farmer groups (Gapoktan), travel conscious groups (Pokdarwis), and associations, which increase MSME capacity and financing. Second, MSME corporatisation, namely the consolidation of micro, small, and medium enterprises that have fallen into decline or are experiencing capital constraints. Product diversification or the creation of new, more prospective, businesses under new management are one option. Third, corporatisation of MSME zones. This measure includes the end-to-end development of specialised MSME hubs or zones.

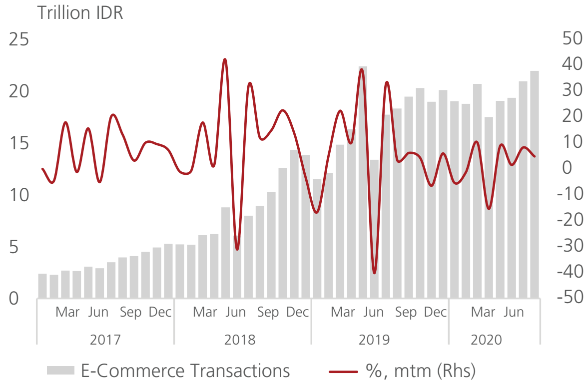
4.5. Accelerating Digitalisation for Financial System Recovery

Direction of Digital Finance Policy to Support Financial System Stability

Digitalisation is impacting the economy, creating a shift in the pattern of public transactions and disrupting conventional functions, including the financial sector. Digitalisation has been accompanied by the sharing economy and platform economy as well as increasingly modular business trends. Modular business models consider data as assets and key to competitiveness in the digital era. Access to digital infrastructure has become more widespread and affordable, thus strengthening digital literacy tendencies amongst the populace and accelerating the flow of digitalisation. In the financial sector, public acceptance of FinTech and e-commerce services has risen, with e-commerce transactions and FinTech lending[1] expanding exponentially. From 2017 until May 2020, e-commerce transactions posted significant growth (Graph 4.5.1). Meanwhile, FinTech payments, dominated by e-money issuers, have also increased (Graph 4.5.2). On the other hand, economic and financial digitalisation also have inherent risk implications that could disrupt monetary stability, financial system stability, and payment system availability.

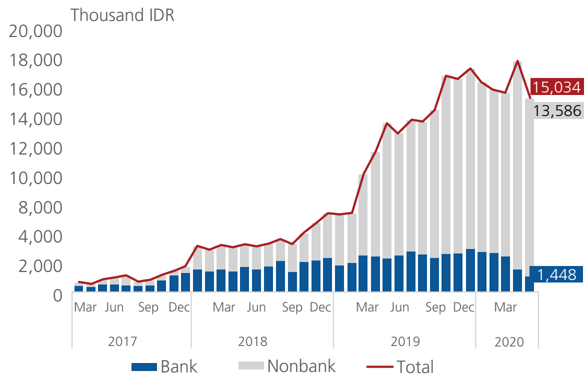
Digitalisation must flow in a corridor that safeguards the central bank's mandate. The banking industry must be encouraged to transform digitally as a whole. Interlinkages between the banking industry and FinTech must be strengthened. The regulatory framework, entry policy, reporting and supervision must be aligned with the demands of the digital era, including risk management and the national interest. The digital revolution in the Industry 4.0 era requires Bank Indonesia to understand the shift in public needs, opportunities and risk dimensions in order to maintain the quality of public services. Such developments impact three aspects. First, economic and financial digitalisation open the

Graph 4.5.1 E-Commerce Transactions



Source: Bank Indonesia, processed

Graph 4.5.2 FinTech Payment Transactions



Source: Bank Indonesia, processed

door to vast financial inclusion opportunities. Second, granular data and information are key to integrating the digital economy and finance. Third, the role of nonbanks is strengthening, thereby changing the structure and order of the financial sector. Therefore, to develop a healthy ecosystem and as an initiator of digital and financial economic development, Bank Indonesia formulated the Indonesia Payment System Blueprint 2025 (BSPI 2025). BSPI was prepared based on five main visions (Figure 4.5.1) to be achieved through five initiatives, namely open banking, retail payments, financial market infrastructure, data and regulations, licensing as well as oversight. The initiatives will be implemented directly by Bank Indonesia and in collaboration through productive coordination with relevant government ministries/agencies and industries.

1 In this case, FinTech lending business models are defined as peer-to-peer lending, balance-sheet lending and online instalment repayment platforms.

Referring to the blueprint, digitalisation is part of payment system policy, which must be accelerated. Bank Indonesia has oriented payment system policy specifically towards optimising the benefits of digitalisation to ensure rapid, convenient, affordable, secure, and reliable payment system services. In addition, Bank Indonesia is focusing its payment system policy on supporting digital economic and financial integration, including economic and financial inclusion. Moving forward, digital innovation will strengthen the interlinkages between economic agents, from the smallest to the largest, from individual consumers and MSMEs to large corporations. Digital economic and financial integration will strengthen the effectiveness of currency in circulation, monetary policy transmission, financial system stability as well as economic and financial inclusion. Seeking to catalyse financial inclusion, which includes economic financing for MSMEs, Bank Indonesia is increasing synergy between the banking industry and FinTech through Open API, encompassing data and technical standardisation, security and governance. Standardised Open API is expected to facilitate openness and interoperability, thus accelerating economic digitalisation, financial inclusion and MSME access, while simultaneously alleviating the risk of shadow banking.

Digitalisation demands rapid, mobile, secure, and affordable payment methods. In addition, digitalisation, which is characterised by massive data growth, also requires the availability of adequate data management infrastructure. To that end, Bank Indonesia has made a number of improvements to the retail and wholesale payment systems, while providing public infrastructure for data in pursuance of BSPI 2025. Strengthening the retail payment system configuration is oriented towards creating a new order that facilitates a healthy digital ecosystem. Modernisation of more efficient retail payment system infrastructure is achieved using the latest technologies. The end state is development of a fast, convenient, affordable, secure, and reliable payment system, operating 24/7 in real-time. Bank Indonesia is strengthening retail payment system infrastructure and simultaneously strengthening financial market infrastructure in order to increase transparency, efficiency, and governance in terms of financial market transactions, while fulfilling the G20 mandate and Principles for Financial Market Infrastructures (PFMI). With the change in the strategic environment through transformation in the digital era, Bank Indonesia is refining the regulatory framework by formulating payment system regulations concerning the institutions,

Figure 4.5.1 Indonesia Payment System Vision 2025

1. SPI 2025 supports **national digital economic-financial integration**, thereby safeguarding central bank functions, including currency in circulation, monetary policy and financial system stability, while accelerating financial inclusion.
2. SPI 2025 supports **banking industry digitalisation** as the dominant institutions of the digital economy and finance through open banking, while utilising digital technology and data in the financial business.
3. SPI 2025 safeguards **interlinkages between FinTech and the banking industry** to contain the risk of shadow banking through digital RegTech (such as API), business cooperation and corporate ownership.
4. SPI 2025 ensures a **balance between innovation, consumer protection, integrity and stability as well as healthy business competition** through the application of KYC and AML-CFT principles, data/information/public business openness and disclosure, as well as the implementation of RegTech and SupTech in the reporting, regulatory, and supervisory responsibilities.
5. SPI 2025 safeguards the **national interest in the cross-border digital economy and finance** through compulsory domestic processing of all transactions processed in the territory of the Republic of Indonesia and through cooperation between foreign and domestic services providers, while complying with reciprocity principles.

Source: Bank Indonesia, processed

infrastructure, mechanisms, instruments, and cross-border transactions. Bank Indonesia is also making improvements on the licensing side to ensure healthy business practices and safeguard consumer protection principles. With the dynamic challenges and needs of the digital era, oversight of payment system service providers is founded on risk-based supervision and compliance. The measures taken by Bank Indonesia to realise BSPI 2025 are also measures to create and maintain financial system stability, with the financial system thus expected to function efficiently and effectively, while remaining resilient to internal and external vulnerabilities.

During the pandemic era, Bank Indonesia has consistently strengthened payment system policy to stimulate economic growth, particularly in terms of developing the digital economy and finance. Also during the pandemic, Bank Indonesia has remained committed to fulfilling its responsibilities and providing quality public services in order to maintain monetary stability, financial stability and the availability of a secure, uninterrupted, reliable, and efficient payment system, which includes the circulation of hygienic currency. In conjunction with the Indonesian Financial Services Authority (OJK), financial services institutions, payment system service providers, and rupiah currency management services providers (PJPUR), Bank Indonesia has continued to provide financial transaction services and payment transactions to facilitate economic activity and meet public demand despite extraordinary efforts to break the domestic chain of COVID-19 transmission. Bank Indonesia has implemented a new operational and public services schedule in the new normal era to support the national economic recovery program. In addition, Bank Indonesia has maintained efforts to accelerate the current shift in public behaviour towards cashless transactions in order to prevent the wider spread of COVID-19. Moving forward, Bank Indonesia will continue to accelerate payment digitalisation and expand the digital ecosystem through collaboration with the Government, banking industry, FinTech and e-commerce platforms towards national economic recovery, especially in terms of the Government's social aid program (bansos), lending and MSME digitalisation. Furthermore, Bank Indonesia will also continue to expand the QRIS ecosystem, utilise big data and the application programming interface (API), as well as strengthen efforts to eradicate fraud and cybercrime in the digital payments space. Moreover, Bank Indonesia will continue to expedite BSPI implementation by improving the relevant infrastructure, regulations, and incentive mechanisms through payment system policy, including supporting the effectiveness of various government programs towards the national economic recovery.

Open API Implementation

Standardised Open API payment transactions will facilitate interconnectivity and increase the integrity of the Open API[2] ecosystem for payment transactions. Bank Indonesia has compiled Open API standards in the payment transaction space as a manifestation of Vision 2 and Vision 3 of BSP 2025, namely to support digitalisation and ensure interlinkages between FinTech and the banking industry. Open API standards target payment system service providers as joint providers of Open API payment transactions. The focus on standardisation is in response to the rapid expansion and dominant share of payment transactions in terms of total digital transactions. Open API standards will stimulate and facilitate interconnectedness amongst Open API providers through integration into the Open API ecosystem based on universal standards. This will accelerate digital transformation in the payments space and facilitate interlinkages between FinTech and the banking industry, leading not only to innovation but also the adoption of digital payment services by economic agents, including MSMEs. In addition, the application of Open API standards, which prioritise safety and governance, will also help to create Open API ecosystem integrity in terms of payment transactions. This is achieved,

2 Refer to FSR No. 34, March 2020, Box 5.1 Open Application Programming Interface (API) Standards for Payment Transactions as Bank Indonesia Support for Digital Transformation of the Banking Industry.

amongst others, through risk mitigation with the implementation of security standards and adequate data protection and governance. Ecosystem integrity is key to gaining public trust in the security, reliability, and availability of digital payment services through Open API.

Bank Indonesia is implementing Open API standards gradually, with 2021 an early milestone in terms of accelerating the transformation of digital payment services. Publication of a Consultative Paper (CP) on Open API Standards at the end of the first quarter of 2020 represents initial preparations for industry implementation. The consultative paper contains information on the direction of standardisation by Bank Indonesia and also provides an opportunity for the industry to offer input concerning the standards. Gradual implementation in 2021 is expected to accelerate the transformation of digital payment services. Furthermore, acceptance amongst economic agents of digital payment services is increasing in line with the application of Open API standards, which maintains a level playing field in terms of the service providers and users. Implementation will begin with the development stage, followed by trials and evaluation and full implementation. Gradual implementation will provide adequate opportunity for the industry to refine API payment transactions in accordance with the standards issued by Bank Indonesia.

FINANCIAL STABILITY REVIEW NO. 35, SEPTEMBER 2020

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This edition of the Financial Stability Review was published in September 2020 based on data and information as of June 2020, unless stated otherwise.

THE PDF FORMAT IS DOWNLOADABLE FROM
http://www.bi.go.id
Data sources are from Bank Indonesia, unless stated otherwise.

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