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# POLICY SYNERGY TO MAINTAIN FINANCIAL SYSTEM RESILIENCE AND REVIVE INTERMEDIATION FOR ECONOMIC RECOVERY


**FINANCIAL STABILITY REVIEW**
NO. 36, MARCH 2021

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ISSN 2620-9241
MACROPRUDENTIAL POLICY DEPARTMENT

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# Foreword

Accompanied by The Pleasure of Allah SWT, Bank Indonesia presents the 36th edition of the Financial Stability Review (FSR), March 2021, entitled "Policy Synergy to Maintain Financial System Resilience and Revive Intermediation for Economic Recovery". This publication provides an overview of financial system developments in Indonesia and the macroprudential policy response instituted by Bank Indonesia from the beginning of 2020 until March 2021. FSR also contains the macroprudential policy orientation moving forward as an integral part of policy synergy towards the national economic recovery as well as the Bank Indonesia policy mix. Bank Indonesia presents this publication for players and decision-makers in the national financial industry, government officials and other relevant authorities, academics, and the Indonesian public as well as Bank Indonesia's international partners. FSR also serves as a reference for stakeholders to solidify existing synergy moving forward in order to build optimism, maintain financial system stability and accelerate the national economic recovery.

One year has already passed since the Indonesian Government introduced large-scale social restrictions to break the domestic chain of COVID-19 transmission in Indonesia. Alhamdulillah, financial system resilience in Indonesia has been sustained despite the various exceptional challenges brought about by the COVID-19 pandemic. Resilience in Indonesia stems from an acute awareness that financial system stability is a shared responsibility, realised through solid synergy amongst all relevant authorities, including the Government, Indonesian Financial Services Authority (OJK), Deposit Insurance Corporation (LPS), and Bank Indonesia together with the business community and all elements of the public. Strong inter-authority synergy is facilitated by a solid legal foundation, in this case Act No. 2 of 2020. The collaborative efforts and commitments of all parties have ensured the economy and financial system in Indonesia can survive despite the unprecedented distress reaped by the pandemic, with a solid economic rebound and recovery projected moving forward.

Bank Indonesia maintained an accommodative policy mix during the reporting period, including the macroprudential policy stance. All strengthening efforts have been oriented towards maintaining financial system stability and accelerating the economic recovery by recalibrating the incentive parameters of: (i) rupiah reserve requirements; (ii) Macroprudential Intermediation Ratio (MIR); (iii) Macroprudential Liquidity Buffer (MPLB); (iv) countercyclical buffer (CCB); (v) Loan/Financing-to-Value (LTV/FTV) Ratio on property loans/financing; and (vi) minimum downpayment requirements on automotive loans. In addition, Bank Indonesia has honed short-term liquidity assistance regulations for conventional and sharia banks, strengthened policy rate transmission and urged the banking industry to lower lending rates by publishing an assessment of prime lending rates in the banking industry. Not resting on its laurels, Bank Indonesia has also maintained its burden sharing commitment to the Government in terms of funding the State Revenue and Expenditure Budget (APBN). During the pandemic, Bank Indonesia has injected liquidity totalling approximately Rp776.87 trillion (5.03% of GDP), with Rp726.57 trillion injected in 2020 and Rp50.29 trillion in 2021, as of 16th March 2021.

Entering 2021, financial system stability is forecast to remain strong, accompanied by an increasing bank intermediation function in response to the domestic economic recovery outlook. To that end, various regulatory measures will be continued as policy synergy within the Financial System Stability Committee (KSSK) framework, involving the banking industry and business community to maintain optimism and overcome the supply and demand-side constraints to lending/financing. Bank Indonesia will maintain an accommodative policy stance based on the latest data as part of its accommodative policy mix synergy and an integral part of integrated policy by authorities in the financial system and the Government to expedite the national economic recovery. In closing, may God Almighty always provide protection and bless us in our endeavours to maintain financial system stability and recover the national economy.

Jakarta, April 2021

Bank Indonesia Governor
**Perry Warjiyo**

# Executive Summary

Financial system stability in Indonesia was maintained throughout 2020 despite the exceptional distress caused by the COVID-19 pandemic. Notwithstanding, the extraordinary economic impact of the pandemic was prevented from spilling over into the financial system. The synergic policy response instituted by the Government, Bank Indonesia and OJK effectively dampened the pandemic impact on the economy and financial system. The national economy, which experienced a deep second-quarter contraction, has gradually recovered since the third quarter of 2020. Financial stability has been maintained along with relatively stable financial markets and solid banking industry resilience in terms of capital, liquidity and profitability. The enduring challenge of the economic recovery process and maintaining financial system stability is how to restore the bank intermediation function and safeguard credit quality after the loan restructuring process has ended.

In the corporate sector, milder economic pressures have improved corporate resilience, as signalled by incrementally stronger corporate performance. Growing export demand has alleviated the sales contraction, particularly amongst large corporations. When conducting business, however, corporations are relying on internal sources of funds rather than seeking new loans, while also repaying obligations earlier. Improving corporate performance has bolstered repayment capacity, as confirmed by a recovery in the Interest Coverage Ratio (ICR), particularly amongst large corporations, despite an aggregate ratio below the 1.5 threshold. In addition, a lower Probability of Default (PoD), after peaking in the second quarter of 2020, is evidence of lower corporate vulnerability.

Mirroring the gradual corporate sector improvements, households are also gaining momentum. Such conditions are reflected in a restrained consumption recovery, limited to fulfilling primary needs, growing interest amongst retail investors and a paradigm shift in the workplace in an effort to survive. Declining economic activity in response to mobility restrictions and low income, accompanied by future uncertainty, have led to an increase of precautionary saving amongst households. Consequently, savings deposits in the banking industry have increased compared with pre-pandemic conditions. Nevertheless, comparatively low deposit rates have pushed households, particularly more affluent households, towards investing in financial assets such as shares, government bonds and mutual funds in search of higher returns. Household propensity to invest has been a contributing factor to the Jakarta Composite Index (JCI) recovery and increasing sales of tradeable government securities (SBN). In addition to financial assets, property investment, particularly large residences, has begun to increase with property sales slowly increasing yet remaining below pre-pandemic levels.

With early signs of optimism in the real sector, banking and nonbank financial industry (NBFI) resilience has been maintained. The synergic policy measures instituted by Bank Indonesia, the Government and other relevant authorities have strengthened credit and financing risk management. Nonetheless, compressed demand for loans amongst borrowers, coupled with the high-risk perception in the banking industry, has severely undermined the bank intermediation function. Fewer placement outlets have forced the banking industry to increase securities holdings. In anticipation of the cliff-edge effect, the banking industry has increased provisions for impairment losses despite fundamentally sound NPL ratios and solid capital. In addition, finance companies have maintained capital resilience, accompanied by a lower gearing ratio. Seeking to offset declining financing quality, finance companies have focused on maintaining financing amongst existing customers rather than disbursing new financing.

Financial sector resilience has been successfully maintained as the shared responsibility of the Government, Bank Indonesia and other relevant authorities. Extraordinary national economic recovery measures have been taken to mitigate the deleterious pandemic impact on the economy and financial system. Policy synergy is achieved under the auspices of the KSSK[1] through coordinated formulation of an Integrated Policy Package to Increase Corporate Sector Financing and Accelerate The Economic Recovery. The integrated policy package contains: (i) fiscal incentives as well as government spending and financial support; (ii) monetary, macroprudential and payment system policies; (iii) financial sector prudential policy (iv) deposit guarantee policy; and (v) structural strengthening policy. Such policies were formulated based on economic sector mapping in accordance with the specific sectoral challenges and prospects faced. Three priority sector categories were determined, namely resilient, growth drivers and slow starters. Through such mapping efforts, each element of the national policy mix is implemented by the respective member of the KSSK based on the bespoke needs of each sector.

Consistent with the Integrated Policy Package, Bank Indonesia implemented a measured policy mix. From a macroprudential policy perspective, Bank Indonesia published its Assessment of Prime Lending Rates, relaxed the Loan-to-Value (LTV) ratio on property loans and down payment requirements on automotive loans, and incrementally reactivated the Macroprudential Intermediation Ratio (MIR) to revive bank lending. Moving forward, incentives to catalyse lending to priority sectors and export activity will be launched in an effort to accelerate the economic recovery. Meanwhile, Bank Indonesia will also expand the scope of SME financing by issuing regulations concerning the Macroprudential Inclusive Financing Ratio to increase access to finance for micro, small and medium enterprises (MSME). The regulations will require each bank to allocate productive assets to an inclusive financing portfolio. Furthermore, Bank Indonesia will continue to formulate innovative, optimal and measured policies to expedite the national economic recovery while maintaining resilient financial system stability.

Moving forward, a successful vaccination program rollout is the main prerequisite to restore public mobility and, therefore, spur a stronger global and domestic economic outlook. Bank Indonesia expects to maintain financial system stability, accompanied by growth of the bank intermediation function in line with the national economic recovery. Corporate performance is predicted to improve and trigger demand for new loans. Consequently, the prospect of higher incomes, coupled with large liquidity reserves in the household sector, is expected to drive consumption and increase demand for new loans. In the banking sector, the accommodative macroprudential policy stance along with broader prime lending rate transparency will revive credit and financing growth. Supported by a surge of capital inflows and enthusiasm amongst domestic retail investors, the economic financing role of the capital market is expected to increase in line with the real sector recovery outlook. Learning from the successful experience of preventing a deeper crisis in 2020, Bank Indonesia will continue to accelerate the national economic recovery by prioritising strong collaboration and synergy amongst all relevant authorities when formulating and implementing the policy response.

1 The members of the KSSK are Bank Indonesia, Indonesia Financial Services Authority (OJK), Indonesia Deposit Insurance Corporation (LPS) and the Ministry of Finance.

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Chapter 1

# Macrofinancial Recovery Amidst COVID-19 Pandemic

The global economy in 2020 was characterised by the COVID-19 pandemic, which had an extraordinary impact on health, the economy and financial system stability. The global economy began to show early signs of recovery in the third and fourth quarters of 2020 after experiencing a deep second-quarter of 2020 contraction. In response to the incipient global economic recovery, world trade volume and international commodity prices began to rise, while global uncertainty started to ease yet remained elevated beyond pre-pandemic levels.

In the latter half of 2020, the global policy response instituted by governments and financial sector authorities around the world effectively maintained banking industry resilience in terms of capital, liquidity and credit risk. Ultra-accommodative financial system conditions, coupled with high market optimism stoked by the policy response, raised financial asset prices in several advanced economies and exacerbated vulnerabilities in the global financial system, which could impact economic growth moving forward. The multispeed global economic recovery outlook remains divergent between advanced economies and emerging markets, triggering a spillover effect, particularly in developing economies where the economic recovery process is lagging. Therefore, an accommodative policy stance will be maintained for the foreseeable future due to elevated global uncertainty fuelled by pandemic unpredictability from a health perspective.

At home, Indonesia's economy began to recover in the second semester of 2020 in line with close policy synergy and global economic improvements. The domestic economic gains came amidst stronger sectoral performance, driven by exports and greater mobility in particular. External stability was maintained given the domestic economic recovery, as reflected by a persistent Indonesia's Balance of Payments (BOP) surplus throughout 2020 and exchange rate appreciation in the second half of the year. Financial system stability was also maintained in the second semester of 2020. Fiscal, monetary, macroprudential and microprudential policy synergy was built amongst the financial sector authorities to accelerate the national economic recovery, targeting the real sector and financial sector. Forward-looking assessments regarding transmission of the COVID-19 pandemic to macroeconomic and financial system stability underlaid the policymaking process.

The array of policies instituted in 2020 to strengthen the financial sector effectively maintained financial system stability, as reflected by persistently low credit risk in the banking industry, loose bank liquidity conditions throughout 2020 and bank profitability that remained in positive territory. Notwithstanding, compressed domestic demand and a cautious banking industry reluctant to lend due to the high-risk perception looking forward undermined the bank intermediation function. Furthermore, economic moderation caused by the COVID-19 pandemic also fed through to weaker economic financing performance in the second semester of 2020.

Chapter 2

# Financial System Resilience Maintained

Financial system resilience in Indonesia has been maintained despite the ongoing COVID-19 pandemic. Globally, exceptional financial market shocks and distress at the onset of the pandemic in March 2020 began to ease in the latter half of the year. In response to COVID-19 transmission, global investors have rebalanced their portfolios by releasing higher risk assets in favour of safe-haven assets. Risk-off behaviour intensified domestic financial and capital market pressures, particular in March and April 2020. Entering the second semester of 2020, however, pressures in the domestic financial and capital markets began to subside due to investor optimism, which was gradually restored given the extraordinary global and domestic economic stimuli. Concerning the banking sector and NBFI, policy synergy built between Bank Indonesia, the Government and other relevant authorities effectively maintained resilience in terms of capital, liquidity and profitability. Nonetheless, compressed demand for new loans amongst borrowers and high-risk perception on the supply side mean that weak bank intermediation remains a challenge.

In the corporate sector, various policies have helped sustain corporate financial conditions. The global economic recovery, driven by China and several advanced economies, increased demand for export commodities and stimulated corporate sales in the second semester of 2020. Sales performance has improved primarily at large corporations, contrasting the ongoing sales contractions experienced by smaller enterprises. Shallower sales contractions are nevertheless expected to persist in the first quarter of 2021 in response to higher prices and growing export demand, particularly for crude palm oil (CPO) and coal. Limited corporate gains are increasing repayment capacity despite remaining below the threshold. In addition, the probability of default (PoD) has also decreased after peaking in the second quarter of 2020.

Mirroring corporate sector conditions, households have also started to feel milder pressures, albeit with a lag due to ongoing mobility restrictions. Household propensity to consume remains focused on fulfilling primary needs. Nevertheless, declines in the formal workforce and lower incomes in 2020 have not led to an aggregate dissaving. Growth of third-party funds has continued to accelerate, accompanied by increasing retail investment in financial assets amongst middle- and upper-class households. Consequently, SBN sales have exceeded all targets, accompanied by an expansion of the capital market investor base and stronger residential property sales. With the prevailing trend of urban inhabitants moving to rural areas as a corollary of the pandemic, the Social Protection Policy (Perlinsos) in 2021 must be oriented towards strengthening the contribution of villages to mitigate the COVID-19 impact on workers.

In the financial sector, resilience has been maintained amidst the economic distress caused by COVID-19, yet the main challenge is how to recover the bank intermediation function and support the economic recovery. The impact of deteriorating corporate and household performance on credit risk in the banking industry and financing risk in the nonbank financial industry has been contained with the support of various accommodative policies implemented by Bank Indonesia, the Government and other relevant authorities. The relaxation of several regulations has prevented an excessive build-up of credit risk. Stress tests have shown that risks stemming from the cliff-edge effect of the mature relaxation program remain under control. Nonetheless, the credit/financing contraction persisted into the first quarter of 2021 on the back of demand and supply-side constraints. Ongoing weaknesses in the corporate and household sectors have undermined demand for credit, while high-risk perception in the banking industry concerning borrower quality has led to tighter lending standards.

Chapter 3

# Policy Synergy to Maintain Financial System Resilience and Revive Intermediation

The Government, Bank Indonesia and other relevant authorities have strengthened policy synergy as part of the extraordinary measures taken to overcome the COVID-19 impact on the domestic economy and financial system. Providing a solid legal foundation for the exceptional measures necessary, the Government issued Government Regulation in Lieu of Law (PERPPU) Number 1 of 2020, which was subsequently enacted as Act Number 2 of 2020 concerning State Financial and Financial System Stability Policies to Contain the COVID-19 Pandemic[1]. Based on that legal foundation, the Government instituted expansive fiscal policy stimuli through a national economic recovery program. Such policy complemented the massive loosening of monetary and fiscal policies to sustain the economy and public trust in the financial system. To that end, the Government and Bank Indonesia strengthened fiscal-monetary synergy through a burden sharing mechanism pursuant to the first and second joint decrees. Such measures were strengthened further through structural reforms in accordance with Act Number 11 of 2020, namely the Omnibus Law on Job Creation.

The scope of inter-authority policy synergy, as part of the shared responsibility to maintain financial system stability, was expanded in line with the unfolding economic and financial market dynamics impacted by the COVID-19 pandemic. In the context of shared responsibility in the financial sector, synergy amongst the financial authorities was strengthened to accelerate the national economic recovery through the KSSK. In practice, the Government supported financial system stability through interest rate subsidies, credit guarantees, fund placements in commercial banks, investment and regional loans. Meanwhile, the Indonesia OJK introduced loan restructuring policy to mitigate the COVID-19 risks in the financial services industry. LPS promulgated regulations concerning LPS fund placements to resolve financial system issues that could precipitate bank default. Furthermore, BI, OJK, and LPS policies are harmonized both bilaterally and tripartitely, and among others are realized in the form of an integrated policy package. National policy synergy was also supported by collaboration through international forums and cooperation.

As a form of synergy, Bank Indonesia maintained an accommodative monetary and macroprudential policy mix to accelerate the economic recovery, while maintaining financial system stability. Bank Indonesia loosened monetary policy in terms of prices and quantity. In terms of monetary management, a number of instruments are strengthened, both in rupiah and foreign exchange monetary operations, including sharia monetary instruments. Monetary policy was strengthened through accommodative macroprudential policy to maintain adequate liquidity and revive intermediation to overcome the credit crunch. To that end, Bank Indonesia encouraged the financing of priority sectors by extending and expanding the scope of lower rupiah reserve requirement incentives, while supporting the availability of liquidity by relaxing the (sharia) Macroprudential Intermediation Ratio (MIR). In addition, Bank Indonesia adjusted the Macroprudential Liquidity Buffer (MPLB) as a form of

1 Act Number 2 of 2020, dated 1st April 2020, concerning State Financial and Financial System Stability Policies to Contain the Coronavirus Disease 2019 (COVID-19) Pandemic and/or Confront Threats to the National Economy and/or Financial System Stability.

fiscal and macroprudential policy synergy to support the national economic recovery. Macroprudential policy was also oriented towards sustaining bank capital by holding the Countercyclical Buffer (CCB) at 0%. As an anticipatory measure to maintain financial system stability amidst the COVID-19 pandemic, Bank Indonesia also strengthened the lender of last resort (LoLR) function by refining short-term liquidity assistance for conventional commercial banks and sharia-compliant short-term liquidity assistance for sharia banks. Seeking to revive banking sector intermediation further, Bank Indonesia also relaxed the Loan/Financing-to-Value (LTV/FTV) Ratio for property loans/financing and the minimum downpayment requirements on automotive loans/financing.

Bank Indonesia accelerated SME development and payment system digitalisation to hasten the economic recovery. Bank Indonesia adopted a national two-sided supply and demand strategy to stimulate SMEs. Furthermore, Bank Indonesia also accelerated payment system digitalisation towards the realisation of a digital economy and finance through implementation of the Indonesia Payment System Blueprint (BSPI) 2025, and issued a new Bank Indonesia Regulation (PBI) concerning the Payment System as a regulatory reform to facilitate digital innovation and increase competitiveness to accelerate the national economic recovery. Finally, Bank Indonesia has expanded acceptance of the Quick Response Code Indonesia Standard (QRIS) to support digitalisation of the payments space, particularly targeting SMEs.

Chapter 4

# Building Financial Sector Optimism, Accelerating the National Economic Recovery Moving Forward

A successful vaccination program rollout is key to the economic recovery due to its favourable impact on the global and domestic economic outlook. Vaccinations are a prerequisite of greater mobility that will allow economic activity to return to normal. In addition, the prospect of a faster recovery is also influenced by public discipline in terms of applying COVID-19 protocols. Ongoing policy stimuli and stronger national economic policy synergy will also accelerate economic expansion.

Consistent with the national economic recovery outlook, financial system stability is expected to remain solid in line with efforts to revive the bank intermediation function. On the demand side, corporate performance is forecast to recover gradually on the back of various policy stimuli from Bank Indonesia, the Government and other relevant authorities, coupled with increasing public mobility. Households are also expected to recover, thus driving consumption. With strong capital support and adequate liquidity, the banking industry is disbursing loans selectively to the real sector on target and in line with contained credit risk. Financing from the capital market is anticipated to grow in response to potential corporate expansion. Notwithstanding, a stronger intermediation function in 2021 remains overshadowed by several risks associated with the successful vaccination program rollout, virus mutations and business model uncertainty after the COVID-19 pandemic.

Observing the economic dynamics and various challenges moving forward, Bank Indonesia will maintain an accommodative macroprudential policy stance throughout 2021 to increase credit and financing growth and accelerate the national economic recovery. Such policies include prime lending rate transparency in the banking industry, reactivating the Macroprudential Intermediation Ratio (MIR), providing incentives for loans extended to priority sectors and export activities, as well as the Macroprudential Inclusive Financing Ratio. Such accommodative macroprudential policies are part of the overall policy mix that encompasses monetary policy based on the latest data and payment system policies, including digitalisation. The ongoing digitalisation trend has strengthened Bank Indonesia's efforts to continue developing a digital economic and financial ecosystem in order to accelerate the national economic recovery.

Bank Indonesia strives to constantly strengthen collaboration and synergy amongst relevant authorities in Indonesia to accelerate the national economic recovery, which has proven successful in terms of preventing an economic crisis during the pandemic. Therefore, Bank Indonesia will continue to strengthen coordination under the auspices of the KSSK to formulate new policies and monitor implementation of the Integrated Policy Package launched recently. Inter-authority coordination will also be strengthened to maintain financial sector resilience during the economic recovery and revive intermediation to help accelerate the recovery.

# FINANCIAL STABILITY REVIEW NO. 36, MARCH 2021

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This edition of the Financial Stability Review was published in March 2021 based on data and information as of December 2020, unless stated otherwise.

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Data sources are from Bank Indonesia, unless stated otherwise.


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