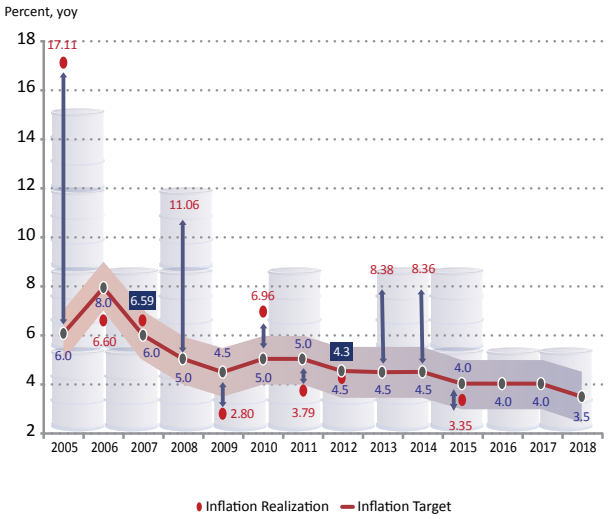
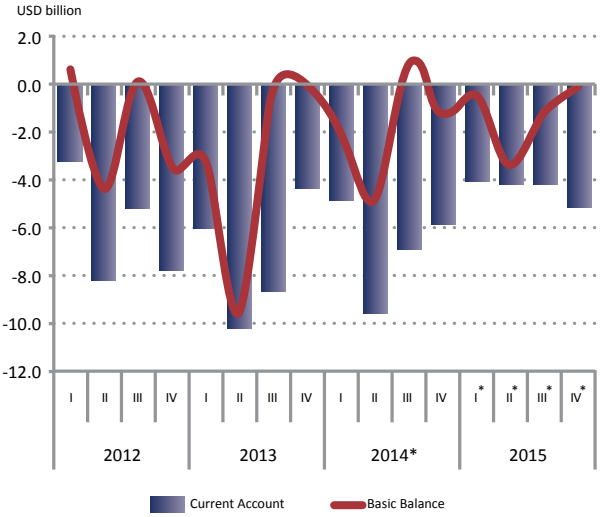
PART II DOMESTIC ECONOMY

MAINTAINED MACROECONOMIC STABILITY AND FINANCIAL SYSTEM

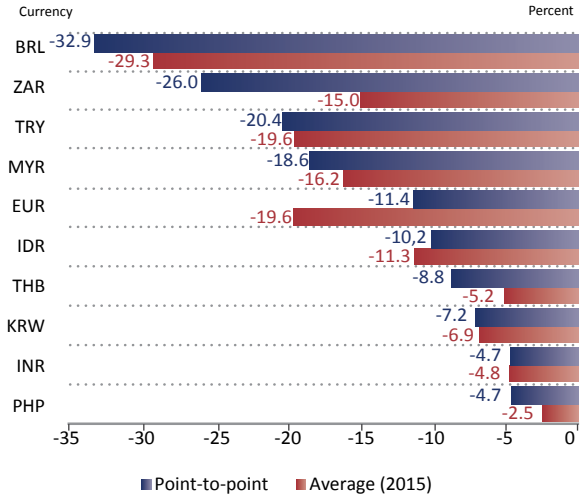
INFLATION WITHIN TARGET



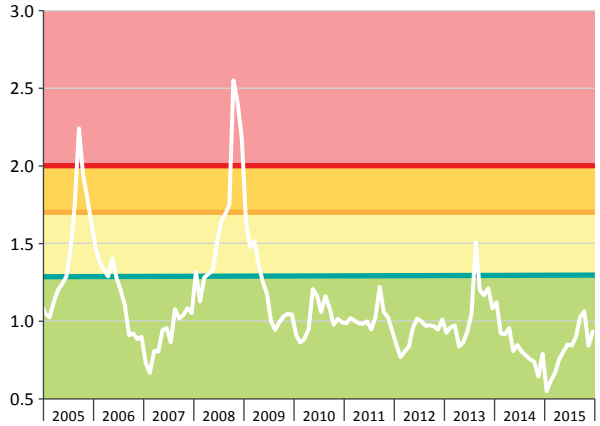
HEALTHIER LEVEL OF CAD



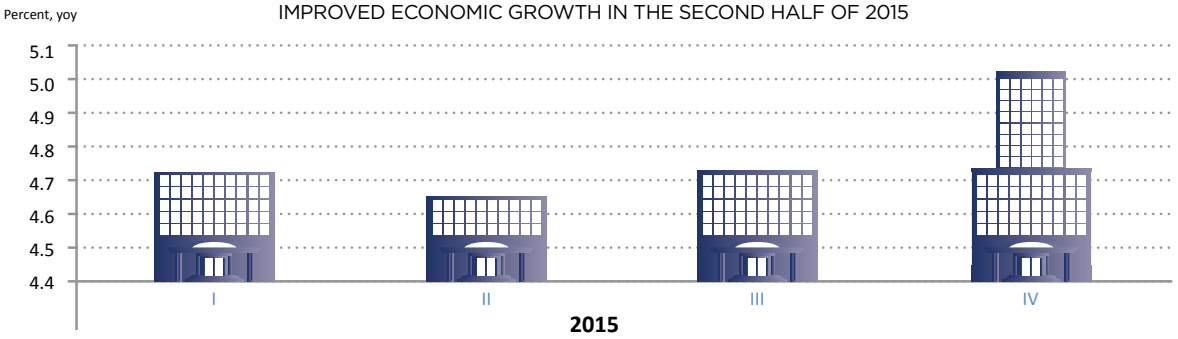
LIMITED DEPRECIATION



MAINTAINED FINANCIAL SYSTEM STABILITY



IMPROVED ECONOMIC GROWTH IN THE SECOND HALF OF 2015



PART II
DOMESTIC ECONOMY

In the midst of external and domestic challenges, the Indonesian economy charted positive achievements in 2015. Macroeconomic and financial system stability remained solid while economic growth began to gather momentum. Macroeconomic stability was reflected in inflation that returned to the targeting range of 4±1%, a reduction in the current account deficit to about 2% of GDP, subdued movement in the rupiah exchange rate, particularly from the last quarter of 2015, and a resilient financial system underpinned by high levels of capital adequacy. Meanwhile, economic growth pulled out of its previous downward trend as it gathered momentum for recovery in the second half of 2015. This achievement owes much to the policy synergy put in place by Bank Indonesia and the Government to safeguard macroeconomic and financial system stability and set in motion a process for economic recovery.

Uncertainty on global financial markets led to increased downward pressure on the rupiah during 2015. Quarterly dynamics in the rupiah exchange rate were affected most importantly by external factors, in this case uncertainty over increases in the Federal Funds Rate (FFR), concerns over fiscal negotiations with Greece, and the devaluation of the yuan. Pressure bearing down on the rupiah was exacerbated by domestic conditions, notably the deteriorating outlook for domestic economic growth, lack of deepening in the financial market and heavy corporate reliance on external financing. Despite this, downward pressure on the rupiah began to ease and the currency even charted an appreciating trend in the fourth quarter of 2015. Key to this was the increase in foreign capital inflows in keeping with the easing of uncertainty on global financial markets over expectations of delay in increases in the FFR. On the domestic side, the easing of pressure on the rupiah was assisted mainly by the policy actions by Bank Indonesia for stabilising the exchange rate, positive investor perceptions of the outlook for the domestic economy in the wake of a series of policy packages launched by the Government, and high returns on domestic assets. These positive factors contributed to appreciation in the rupiah that outweighed the currency gains in other countries. Throughout 2015, the rupiah experienced 10.2% (yoy) depreciation to Rp13,875 to the U.S. dollar, less than the depreciation sustained by the currencies of some peer countries.

In 2015, Indonesia's balance of payments recorded a deficit despite significant improvement that took place in the current account deficit, which came down from 3.1% of GDP in 2014 to 2.1% of GDP. The amelioration in the current account deficit was achieved mainly in the oil and gas trade balance and the non-oil and gas trade balance. In the oil and gas sector, the fall in world oil and gas prices and shrinking domestic consumption of fuels led to a significant reduction in oil and gas imports. The steeper drop in imports of oil and gas compared to oil and gas exports resulted from the combination of falling oil and gas prices and higher export volume from increased lifting of domestic oil. In the non-oil and gas sector, the trade balance recorded an enlarged surplus resulting mainly from contraction in non-oil and gas imports in line with weakening domestic demand and depreciation of the rupiah. This reduction in non-oil and gas imports outweighed the decline in non-oil and gas exports triggered by flagging global economic growth and commodity prices. Regarding the capital and financial account, the uncertainty on global financial markets led to significant decline in capital flows until the third quarter of 2015. Nevertheless, the easing of uncertainties on global financial markets and improving confidence in the outlook for the domestic economy from the fourth quarter of 2015 prompted a significant rise in capital inflows, particularly for portfolio investment in government bonds and direct investment. In line with the increased surplus in the capital and financial account, Indonesia's balance of payments posted a substantial surplus in the fourth quarter of 2015. For 2015 overall, the balance of payments recorded a deficit of about USD1.1 billion.

Despite the depreciation in the rupiah, inflation in 2015 reached 3.35% (yoy), within the 2015 inflation target range of 4±1%. The subdued inflation in 2015 is attributed to global and domestic factors. At the global level, plunging world oil prices created opportunity for the Government to lower domestic prices for fuel and 12kg bottled LPG gas and make adjustments to electricity billing rates. These price reductions were made possible by energy

reforms that provides for pricing of energy on the basis of economic viability. This helped to keep administered prices inflation at a low level during 2015. Second, the drop in global commodity prices, including prices of food staples, helped keep volatile foods inflation in relatively subdued territory. On the domestic side, while the rupiah suffered depreciation, the pass-through from the weakening exchange rate on inflation was comparatively limited. Key to this was the managed level of domestic demand and low inflation in prices for imported goods. Second, the adequate supply of strategic food commodities also contributed to subdued volatile foods inflation amid severe disruption from El Nino. The mild level of volatile foods inflation also owes much to the stronger coordination between the Government and Bank Indonesia in stimulating increased production, improving distribution and minimising various price distortions for staple foods. As a result, core inflation in 2015 reached only 3.95% (yoy) and administered prices inflation 0.39% (yoy), while volatile foods inflation came to 4.84% (yoy).

The Indonesian economy began to regain momentum in the second half of 2015. Throughout the first half of 2015, domestic economic growth steadily declined in tandem with the flagging performance of the global economy, downward movement in commodity prices and delays in government spending due to problems with nomenclature. Despite this, economic growth began to bounce back in the second half of 2015, bolstered by improvement in domestic demand. Government spending mounted significantly, buoyed by increases in government capital expenditure related mainly to infrastructure development. The government's fiscal stimulus also met with response from the private sector, reflected in stronger investment growth in some sectors such as construction. At the household level, buoyant consumer confidence helped household consumption to maintain relatively stable, resilient growth. During 2015 overall, economic growth slowed from 5.02% in 2014 to 4.79%. Despite this decline, Indonesia has managed relatively strong growth compared to other commodity-based economies. Spatially, the structure of Indonesia's economic growth is beginning to diversify, which also helped to keep the economic growth from further decline. In Java, the manufacturing-based economy generating high added value maintained vibrant growth that compensated for weak performance outside Java, where growth has suffered from the impact of weakening commodity prices.

In the financial sector, financial system stability remained sound despite escalating risks from adverse global economic developments. This was reflected in the Financial System Stability Index (FSSI) for 2015, which at 0.89 came within safe limits. The resilience of the banking industry remains strong as reflected in prudent levels of credit risk and liquidity risk, high profitability and robust capital adequacy. Credit risk remained at the low end of the scale despite an upward trend due to deterioration in corporates' ability to pay debt following decline in corporate revenues and household incomes. Reflecting this was an increase in non-performing loans (NPLs) to 2.5%, albeit still below the 5% threshold of safety. Decline in corporate revenues and household incomes also contributed to weaker growth in bank deposit at only 7.3%. The reduced growth in bank deposit in turn led to increased liquidity risk, although safe limits were not exceeded. The ratio of liquid instruments to bank deposit fell to 19.4%, but stayed well above the safe threshold of 8.5%. As regards banking intermediation, credit growth maintained a downward trend with growth reaching only 10.4%. This was explained by falling demand, a result of flagging growth in the domestic economy, and reduced supply, due to tightening of lending standards as banks responded to increases in NPLs. Lack of recovery in the intermediation function and mounting credit risk caused bank profitability levels to fall. Despite slipping to 2.27% in 2015, at this level profitability was still ahead of other nations in the region.

The decline in profitability levels had no significant impact on the resilience of the Indonesian banking system due to the high level of bank capital adequacy. At the end of 2015, the capital adequacy ratio of the Indonesian banking system was recorded at 21.2%, up from the 2014 level of 19.4%. Further confirmation of the resilience of Indonesia's banking system came from the results of stress testing of credit risk and market risk, which indicate that Indonesia's banks have high levels of capital resilience for

coping with worst-case scenarios. In the non-bank sector, the role of non-bank financing has expanded in line with the corporate response to the tightening of bank lending standards. Corporations appear to be seeking alternative funding sources on the bonds, stock and corporate Islamic bonds (sukuk) markets, and through medium term notes (MTNs) and negotiable certificates of deposit (NCDs).

Performance improved in the payment system during 2015. From the side of payment system operated by Bank Indonesia, this improvement was reflected in the reliability and availability of the payment system and effective contingency plan implementation. The industry-operated side of the payment system experienced no significant system failures. Growth in the value of payment system transactions processed by Bank Indonesia and the industry fell to 9.4% in line with more moderate economic growth. However, when measured by volume, growth improved from 18% to 19% in 2015. The increase took place mainly in the payment system operated by the industry, involving card-based payment instruments (CBPIs) and electronic money (E Money). This development is as envisaged in the payment instrument electronification program implemented through the National Non-Cash Movement (GNNT) and Government policy for using E Money for disbursing social assistance. The success of this drive for use of electronic payment instruments was also visible in the increased CBPI to GDP ratio, indicating an improvement in public preferences for use of non-cash payments. Regarding the cash payments system, rupiah cash management has become more reliable, as reflected in the expanding coverage of Bank Indonesia cash services and improving quality of cash in circulation. This reliable performance has been supported by a rupiah cash management policy that includes the development of a cash distribution network and cash services provided by cash pre-placements (Kas Titipan), an adequate cash position at Bank Indonesia, and improvement in the quality of cash in circulation under the clean money policy.

Against a backdrop of inauspicious external conditions, government spending on infrastructure was a key source of economic growth in Indonesia during 2015. Furthermore, labor absorption in the construction sector also increased.

Chapter 3

Economic Growth

Global economic dynamics marked by continued weakness in the world economy and a drop in capital flows to emerging market countries in 2015 put pressures on domestic economic growth. Congruously, the subsequent domestic economic moderation had an adverse effect on unemployment and welfare. In response to such conditions, Bank Indonesia and the Government instituted a range of policies to maintain macroeconomic stability and boost economic growth. Consistent with the policy response, risks in the economy were mitigated and confidence was restored, leading to gains in economic momentum during the second half of the year.

Weaker global growth than the year earlier undermined the domestic economy in 2015. Constrained growth in advanced economies were reported. Meanwhile, economic growth in emerging market countries, as the main drivers of global growth, tended to decelerate. China as the foremost growth engine of the global economy and a leading trade partner of Indonesia, suffered from persistent moderation. Furthermore, the global economic downswing perpetuated the international commodity price slide. Inauspicious global economic conditions spilled over to the domestic economy, reflecting an export contraction. With an economy reliant on natural resources, lower commodity prices undermined the terms of trade and overall domestic economic activities.

Against a backdrop of ubiquitous uncertainty blighting global financial markets, domestic economic moderation spurred economic risks and eroded confidence in the economy. Currency risk surfaced accompanied with decreasing confidence in the domestic economy. This resulted in lower capital inflows and increased pressure of the exchange rate. Domestic economic moderation and rupiah depreciation further sparked corporate risks in the form of weaker financial performance, which ultimately reduced investment and corporate repayment capacity. Simultaneously, banking risks escalated as non-performing loans (NPLs) increased but remained below the threshold. Addressing such circumstances, banks tightened lending standards, leading to a decline in disbursed loans. In turn, slower credit growth adversely affected the domestic economy, which exacerbated fiscal risks due to the limited room available for economic stimuli as a result of low tax revenues.

The Indonesian economy posted 4.8% (yoy) growth in 2015, down from 5.0% (yoy) the year earlier and below the Bank Indonesia projection of 5.4-5.8%. External sector performance decreased significantly, reflecting the deep export contraction. Due to the heavy reliance on natural resources exports, rupiah depreciation did not improve export performance in general. Meanwhile, manufacturing exports confronted a range of challenges stemming from sluggish demand for exports and a large import content amidst exchange rate depreciation. A decline in export earnings also affected domestic demand, particularly private consumption and non-building investment. In line with the export contraction and drop in domestic demand, imports also experienced a sufficiently deep contraction. By sector, economic moderation that initially affected the primary sector ultimately spread to other sectors.

Economic moderation undermined employment conditions and welfare. Accordingly, the level of unemployment increased slightly, accompanied by less elasticity of employment absorption in regard to economic growth. Furthermore, a decline in labor utilisation was observed to affect the mining, agriculture and manufacturing sectors. In contrast, the construction sector absorbed additional labor due to the increased realisation of various infrastructure projects. In line with unemployment conditions, public welfare also declined slightly which reflected in the increase of poverty rate and lack of improvement in the Gini coefficient.

Despite the general economic downturn recorded in 2015, recovery momentum gained traction during the second half of the year on the back of fiscal stimuli introduced by the Government. Against a backdrop of low tax revenues, fiscal reform policy, primarily in the form of subsidy reductions, provided space to stimulate the economy. Fiscal stimuli stemmed from increased government spending, specifically capital spending linked to government-led infrastructure projects. Domestic economic momentum improved risk perception and restored confidence in the economy, which was further bolstered by Bank Indonesia policy to consistently maintain macroeconomic stability. Despite widespread uncertainty disrupting global financial markets, Bank Indonesia eased macroprudential policy to stimulate the domestic economic recovery. The range of policies introduced has successfully catalysed domestic economic growth in the second half of 2015.

Moving forward, Bank Indonesia and the Government will continue to strengthen coordination in order to support further economic momentum, while preserving macroeconomic stability. Paying due consideration to the relatively limited knock-on effect of fiscal stimuli in the private sector, policy shall be directed towards building on existing economic momentum. To that end, the Government will continue and accelerate prevailing structural reforms. Meanwhile, Bank Indonesia will prudently loosen its monetary policy stance in order to reinforce confidence in the economy, which will contribute favourably to economic growth, macroeconomic stability and the financial system.

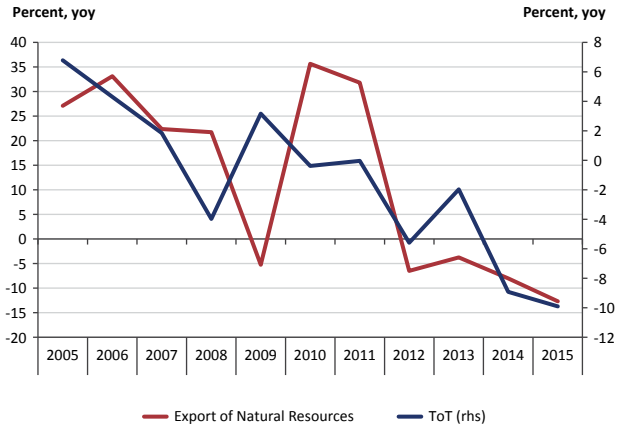
3.1. GDP – EXPENDITURE SIDE

Economic growth in 2015 stood at 4.8% (yoy), down from 5.0% (yoy) the year earlier despite early indications of recovery in the second half of the year. A deep slowdown occurred in the first semester of 2015, which began to reverse in the second semester (Table 3.1). Accordingly, during the first half of the reporting

year, domestic demand, consumption and investment tailed off significantly in line with the export decline. The drop in private consumption was due to the base effect of the General Election contested in 2014, which precipitated a contraction in the consumption of non-profit institutions serving households (NPISH). Meanwhile, government consumption and investment also faced administrative constraints in the form of ministerial/ institutional reorganisation. Hence, in the second semester, government fiscal stimuli was able to boost the momentum of economic recovery. In addition to the increase in government consumption, public investment also surged due to the expansion of infrastructure projects. The spillover of fiscal stimuli on the private sector began, albeit limited. Consumer confidence also began to improve, driving household consumption, particularly non-food consumption, towards the end of the year. In addition, non-building investment also began to rebound in line with positive business sentiment. In general, domestic demand was the main source of economic growth in 2015, amidst weak external conditions.

Global economic moderation and the declining of global commodity prices in 2015, weakened export performance in Indonesia. Exports from Indonesia were dominated by natural resources and as a consequence, falling global commodity prices significantly undermined the terms of trade (ToT) (Chart 3.1). Lower global commodity prices also led to export contraction, particularly for mining commodities, most notably affecting coal. Nonetheless, policy to extend export licenses for mineral concentrates (particularly copper) after smelter development had proceeded, successfully offset a deeper export contraction. Meanwhile, manufacturing exports failed to recover despite rupiah depreciation due to weak global demand

Chart 3.1. Terms of Trade and Export of Natural Resources



and the large import content of exports. The export decline was evidenced by the steep decline in exports to a leading trade partner, namely China, falling 20% on the year earlier. The drop stemmed primarily from commodity-based exports that dominate the export structure to China.[1] Nevertheless, automotive exports from Indonesia performed positively, with robust growth reported over the past two years (Table 3.2).

In line with lower revenues triggered by the export decline, households were also less inclined to consume. The downward consumption trend affected secondary and tertiary goods (non-food consumption) despite rebounding slightly towards the end of the year. In general, household consumption remained solid, surpassing conditions immediately after the global financial crisis, when growth of just 4% was reported at the end of 2009. A number

Table 3.1. GDP Growth by Expenditure

Percent, yoy

	2012	2013	2014*	2015**				
				I	II	III	IV	Total
Household Consumption	5.49	5.43	5.16	5.01	4.97	4.95	4.92	4.96
Non - Profit Institution Serving Household (NPISH) Consumption	6.68	8.18	12.19	-8.07	-7.99	6.56	8.32	-0.63
Government Expenditure	4.53	6.75	1.16	2.91	2.61	7.11	7.31	5.38
Gross Fixed Capital Formation	9.13	5.01	4.57	4.63	3.88	4.79	6.90	5.07
Building	8.13	6.74	5.52	5.47	4.82	6.25	8.21	6.23
Non Building	11.73	0.63	2.03	2.35	1.32	0.73	3.10	1.87
Export	1.61	4.17	1.00	-0.62	-0.01	-0.60	-6.44	-1.97
Import	8.00	1.86	2.19	-2.19	-6.97	-5.90	-8.05	-5.84
GDP	6.03	5.56	5.02	4.73	4.66	4.74	5.04	4.79

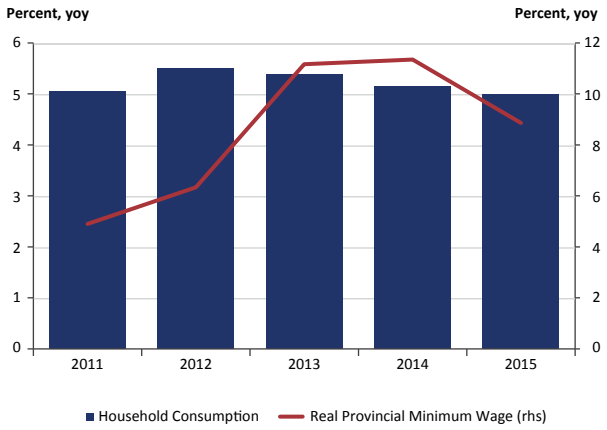
Source: BPS - Statistics Indonesia *preliminary **very preliminary

1 The share of commodity exports from Indonesia to China in terms of total exports from Indonesia accounted for 70% in 2015.

Table 3.2. Non-Oil and Gas Export

Export Commodity	Jan- Dec (USD Billion)		Growth (Percent, ytd)		Share 2014 ytd	Share 2015 ytd
	2014	2015	2014	2015		
Crude Palm Oil	20.0	17.8	8.6	-10.9	13.6	13.5
Coal	20.8	16.0	-14.5	-23.4	14.2	12.1
Clothes	7.7	7.6	-0.5	-1.3	5.2	5.7
Electronic Equipment	6.1	5.6	-1.5	-9.3	4.2	4.2
Textile	4.7	4.4	3.1	-7.3	3.3	3.4
Vehicle	5.2	5.4	14.5	3.1	3.6	4.1
Crude Rubber	4.8	3.7	-30.9	-21.9	3.3	2.9
Iron Ore and Steel	4.1	3.1	-4.0	-23.0	2.8	2.4
Spareparts	2.3	2.0	1.8	-13.3	1.5	1.5
Furniture	1.8	1.7	2.4	-4.0	1.2	1.3
Plastics	1.2	0.9	10.4	-23.1	0.8	0.7
Others	68.0	63.9	-1.3	-5.3	-52.8	-50.7
TOTAL NON-OIL AND GAS EXPORT	146.5	131.9	0.0	-8.1	1.0	1.0

Chart 3.3. Private Consumption and Real Provincial Minimum Wage



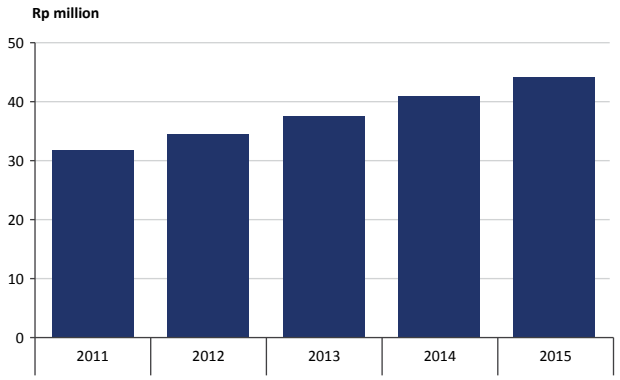
Source: Ministry of Manpower, BPS - Statistics Indonesia, processed

of macro indicators supported resilient consumption, including per capita income that followed an upward trend. Per capita income increased from Rp41.8 million in 2014 to Rp45.2 million (USD3,377.10) in 2015 (Chart 3.2). In addition, public purchasing power was maintained on the back of a hike in the real Provincial Minimum Wage (UMP). Over the past five years, the average increase in the provincial minimum wage has exceeded 7%, further jumping to 8.9% in 2015 (Chart 3.3). The increase in the provincial minimum wage has become a reference for wage hikes in various sectors, particularly formal labor.

To negate a deeper decline in consumption due to lower revenues from natural resources, households tended to dip into their savings to support consumption. Consequently, individual savings in rupiah followed a slower growth trend, indicating consumption smoothing, after a number of periods of increased savings accumulation, in particular when commodity prices soared (Chart 3.4). In addition to savings, cash withdrawals using credit cards have also increased over the past year, offering further indications of consumption smoothing.

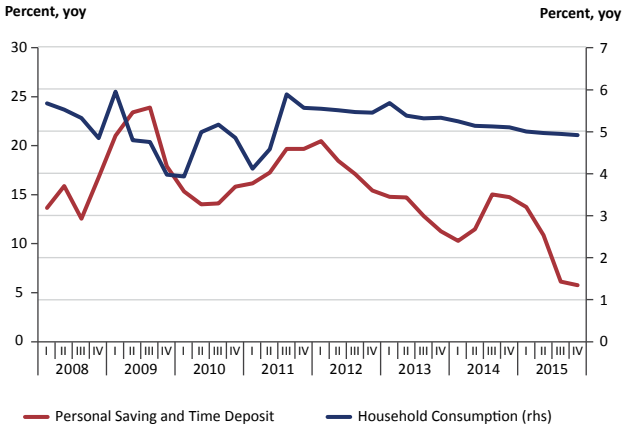
Against a backdrop of declining private consumption, the fiscal stimuli introduced in the second semester of 2015 restored optimism and drove economic momentum. After stagnating in the first half of the year due to government nomenclature reorganisation, public spending accelerated significantly in the second semester. Accordingly, government procurement increased to Rp170.5 trillion (40.9%, yoy) in the second semester after achieving just Rp60.1 trillion (8.1%, yoy) in the first semester. In

Chart 3.2. Income per Capita



Source: BPS - Statistics Indonesia

Chart 3.4. Household Consumption and Saving Growth

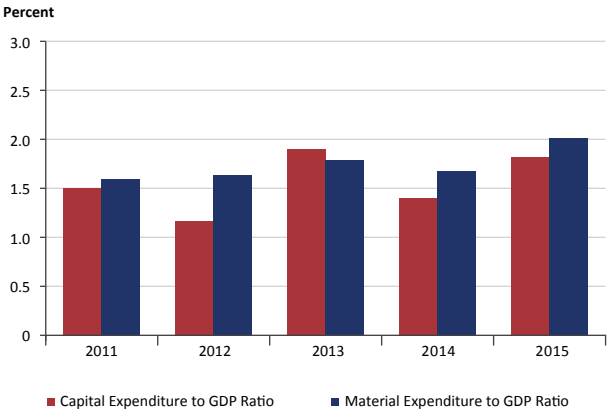


Source: BPS - Statistics Indonesia, processed

addition, government stimuli in the form of increased capital spending during the second semester supported infrastructure investment performance. Capital spending by the central government soared from just Rp30.2 trillion (6.7%, yoy) in the first semester to Rp178.4 trillion (49.9%, yoy) in the second semester. In general, actual capital spending in 2015 accounted for 1.8% of GDP (Chart 3.5). The dramatic increase in capital spending stemmed from expedited government infrastructure projects as part of the structural reform agenda. Amidst weak external and domestic private demand, fiscal stimuli were the main drivers of economic growth momentum, which boosted confidence in the economy, particularly amongst consumers, and helped improve household consumption, especially of non-foods, towards the end of the year (Chart 3.6).

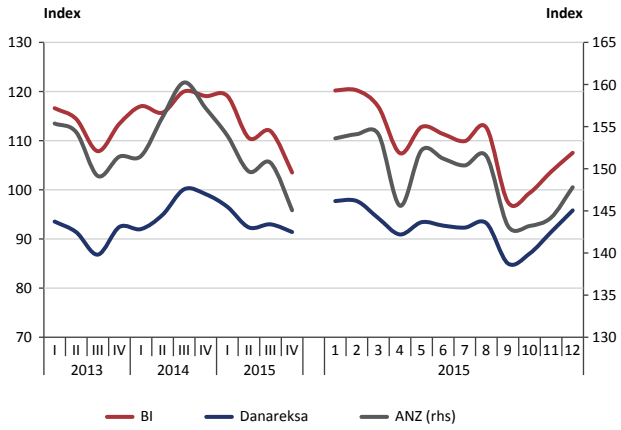
Although interest in private investment remained weak in 2015, the domestic economic recovery in the second half of the year drove optimism in the economic outlook. After following a downward trend during the first half of the year, investment began to show signs of improvement, in particular public infrastructure investment. Meanwhile, limited private non-building investment endured. Lower revenues due to dwindling demand for exports and domestic demand, accompanied by depreciatory pressures on the rupiah, spurred potential corporate risks through declines in financial performance. Risks primarily affected domestic-oriented corporations with a high import content along with highly indebted corporations with foreign loans. Such conditions ultimately eroded economic confidence and suppressed investment through to the third quarter of the year. The decline in non-building investment, which had previously been rooted in the primary sector, subsequently spread to the secondary and tertiary sectors

Chart 3.5. Infrastructure Spending and Capital



Source: Ministry of Finance, processed

Chart 3.6. Consumer Confidence Index

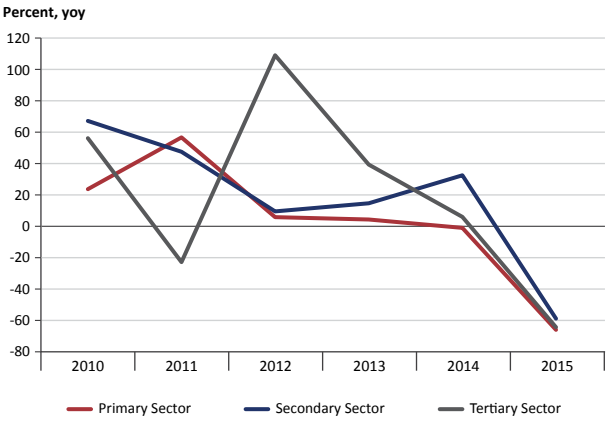


Source: ANZ Roy Morgan and Danareksa

(Chart 3.7). Nonetheless, economic gains in the fourth quarter, stemming from fiscal stimuli, restored economic optimism and non-building investment began to pick up (Chart 3.8).

The business climate also improved, reflecting an advancement in Indonesia's ease of doing business rating, which further bolstered the investment outlook. The rating jumped from 120 to 109 in 2016 (Table 3.3).[2] The improvement in Indonesia's rating was supported by a number of reforms undertaken during the past year. Facilitating investment, the Government streamlined the business licensing process, taxation, and access to bank

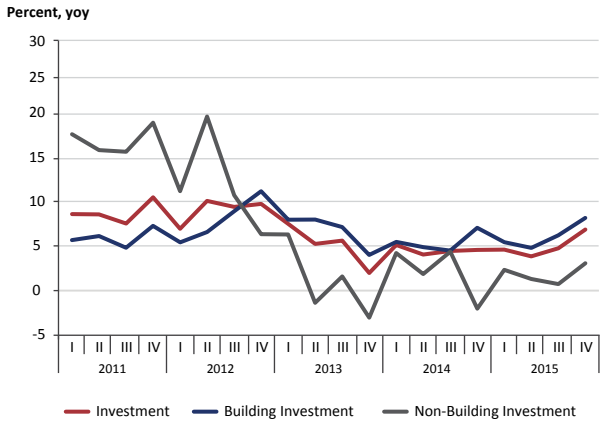
Chart 3.7. Investment by Sector



Source: Investment Coordinating Board

2 Indonesia's Doing Business (DB) rating in 2015 was 120 referring to the new method employed in the 2016 DB survey. Meanwhile, in the official 2015 publication, using the old method, Indonesia placed 114th.

Chart 3.8. Real Investment



Source: BPS - Statistics Indonesia

credit. The most significant improvements were made in terms of taxes, with the Government formulating an easier and cheaper tax payment scheme. To that end, the Government introduced an online payment scheme as a social safety net, while lowering the ceiling on tax for the workforce. Consequently, Indonesia's tax ranking improved significantly from 160 to 148. Looking ahead, the investment outlook of Indonesia will improve further in line with the 2015 launch of Government Policy Package I-VIII, with the majority of the policies therein focused on enhancing the investment climate while encouraging infrastructure development.

Import growth also contracted in line with weak export performance and sluggish domestic demand. In real terms, the import decline affected all types of goods, including consumer goods, capital goods and raw materials, with the most notable contraction affecting capital goods (Chart 3.9). Such conditions were in line with the investment slump, particularly non-building investment. In addition, the loss of confidence in the economy led to demand being partially met through inventory, which further obviated the requirement for imports. Notwithstanding, imports of capital goods began to pick up in the final quarter of the year, indicated by a shallower contraction.

3.2. GDP – PRODUCTION SIDE

Economic moderation occurred in almost all economic sectors, despite indications of gains in several sectors during the second half of the year. Triggered by sliding international commodity prices due to weak demand, the performance of commodity-based sectors declined, including (i) the mining and quarrying sector; and (ii) agriculture, forestry and fisheries. In fact, the mining and quarrying sector was observed to contract throughout 2015. In turn, declines in commodity-based sectors spilled over to erode the performance of other sectors. In addition to lower revenues, backward-forward linkages between sectors also exacerbated the declines. A downturn was also reported in the secondary sector, primarily the manufacturing industry. Furthermore, less demand for heavy equipment, spare parts and other components to support extractive sectors further compounded the manufacturing industry decline. Congruously, the performance of supporting industries, such as electricity and gas, also deteriorated due to decreasing production activities. The slowdown subsequently spread to the tertiary sector, including wholesale and retail trade, car and motorcycle repairs as

Table 3.3. Ease of Doing Business in Indonesia

INDICATOR	INDONESIA				
	2014	2015	2015*	2016	
Doing Business Rank	120	114	120	109	↑
Starting a Business	175	155	163	173	↓
Dealing with Construction Permit	88	153	110	107	↑
Getting Electricity	121	78	45	46	↓
Registering Property	101	117	131	131	→
Registering Credit	86	71	71	70	↑
Protecting Investor	52	43	87	88	↓
Paying Taxes	137	160	160	148	↑
Trading Across-Borders	54	62	104	105	↓
Enforcing Contracts	147	172	170	170	→
Bankruptcy Settlement	144	75	73	77	↓

* ranked revision refers to the new methodology used in Doing Business 2016
Source: World Bank

Chart 3.9. Non-Oil and Gas Import

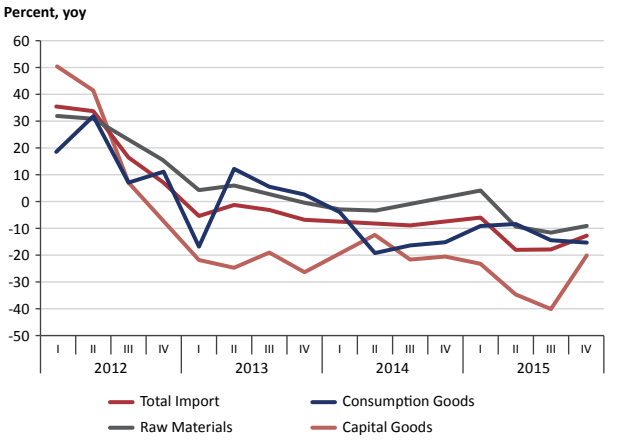


Table 3.4. GDP Growth by Industrial Origin

Percent, yoy

	2012	2013	2014*	2015**				
				I	II	III	IV	Total
Agriculture	4.59	4.20	4.24	4.01	6.86	3.34	1.57	4.02
Mining and Quarrying	3.02	2.53	0.72	-1.32	-5.20	-5.66	-7.91	-5.08
Manufacturing Industries	5.62	4.37	4.61	4.01	4.11	4.51	4.35	4.25
Electricity	10.06	5.23	5.57	1.73	0.76	0.56	1.81	1.21
Water Supply	3.34	3.32	5.87	5.39	7.76	8.75	6.77	7.17
Construction	6.56	6.11	6.97	6.03	5.35	6.82	8.24	6.65
Trade and Car Repair	5.40	4.81	5.16	4.12	1.70	1.39	2.77	2.47
Transportation and Warehousing	7.11	6.97	7.36	5.78	5.92	7.26	7.67	6.68
Accommodation, Food, and Water Supply	6.64	6.80	5.77	3.37	3.75	4.48	5.79	4.36
Information and Communication	12.28	10.39	10.10	10.09	9.66	10.74	9.74	10.06
Financial Services	9.54	8.76	4.68	8.57	2.63	10.36	12.52	8.53
Real Estate	7.41	6.54	5.00	5.26	5.03	4.78	4.25	4.82
Business Services	7.44	7.91	9.81	7.36	7.64	7.63	8.13	7.69
Government Administration	2.13	2.56	2.38	4.73	6.29	1.27	6.70	4.75
Education Services	8.22	7.44	5.55	5.03	11.71	8.08	5.32	7.45
Health Services	7.97	7.96	7.96	7.14	7.48	6.33	7.44	7.10
Other Services	5.76	6.40	8.93	7.98	8.06	8.11	8.15	8.08
Taxes Less Subsidies on Products	15.05	21.80	5.13	16.64	27.30	36.01	46.55	31.98
Gross Domestic Product	**6.03**	**5.56**	**5.02**	**4.73**	**4.66**	**4.74**	**5.04**	**4.79**

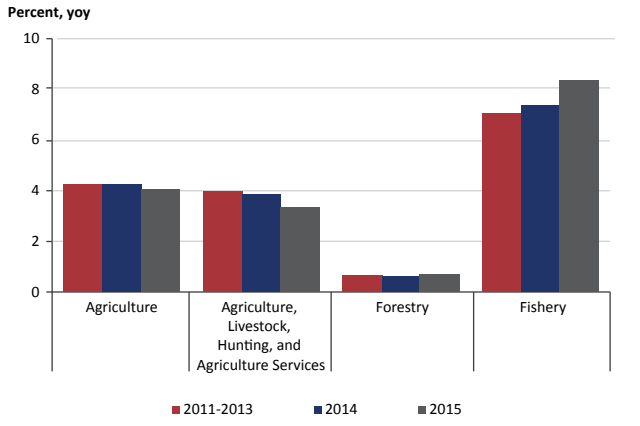
Source: BPS - Statistics Indonesia *preliminary **very preliminary

well as several services sectors. In the second semester, however, fiscal stimuli in the form of infrastructure projects drove construction sector gains, followed by limited gains in the trade sector, transportation and warehousing sector as well as several services sectors but the improvements were not felt in all sectors.

Growth of agriculture, forestry and fisheries tended to slow due to weak demand amidst the El Nino weather anomaly. Tumbling crude palm oil (CPO) prices adversely impacted the plantation subsector, with growth decelerating from 5.94% the year earlier to just 3.54% in 2015. Domestic policies in the form of a progressive export tax and mandatory B15 biodiesel use prevented further CPO declines, however. Policy to collect a CPO Supporting Fund, which began in July 2015, had a net positive effect in the medium term in relation to replanting and downstream industries. Meanwhile, robust food crop production growth prevented deeper declines in the agricultural subsector. Production of rice, maize and soybean grew respectively by 5.85%, 4.34%, and 2.93% on the previous year. The El Nino weather phenomenon had only a limited impact on food crop production, while the performance of the fisheries subsector improved on larger fishing catches and greater aquaculture fish production (Chart 3.10).

After the decelerating trend experienced since the end of 2012, mining sector performance contracted deeply in 2015 due to global economic moderation that eroded demand and simultaneously perpetuated the international commodity price slide. Policy in a number of countries to reduce sources of energy with high-pollutant emissions further reduced demand. Commodity prices plummeted, primarily coal as a leading commodity of Indonesia, which led to the closure of production at numerous small mining firms. Coal production in 2015 totalled just 380 million tons, below the Government's target of 425 million tons and falling from 458 million tons the year

Chart 3.10. Growth of Agricultural Industry



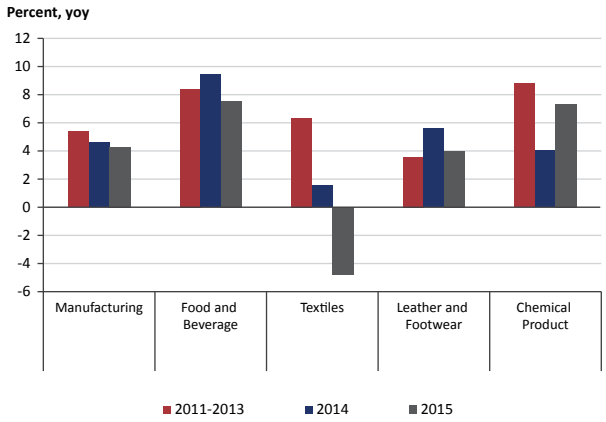
Source: BPS - Statistic Indonesia

earlier. Consequently, the coal and lignite mining subsector contracted -20.9% (yoy) in 2015 (Chart 3.11).

Growth of the secondary sector also slowed in 2015. The mining sector contraction undermined performance in sectors with close linkages, such as the heavy equipment industry. The production of heavy equipment fell in line with weaker sales data, achieving just one-third of that recorded in the previous year. Weak export performance and domestic demand placed pressures on the manufacturing industry. Several subsectors experienced strong pressures, including textiles and clothing, wood, and wood articles, leather and footwear as well as food and beverages (Chart 3.12).

Fiscal stimuli bolstered construction sector performance but the gains did not spread to other sectors. On an annualised basis, construction sector performance slowed, but improvement was seen in the second half of the year. Construction sector growth accelerated from below 6% (yoy) in the first semester to 6.8% (yoy) and 8.2% (yoy) in the third and fourth quarters respectively. Nonetheless, the trickle-down effect of the fiscal stimuli on other sectors was much more limited. In general, the wholesale and retail sector, car and motorcycle repairs, accommodation, food and beverages, transportation and warehousing as well as corporate services slowed significantly in line with economic moderation. Towards the end of the year, however, the performance of several sectors began to pick up due to gains in the construction sector, including the wholesale and retail sector, car and motorcycle repairs, transportation and warehousing as well as several services sectors.

Chart 3.12. Growth of Manufacturing Industry

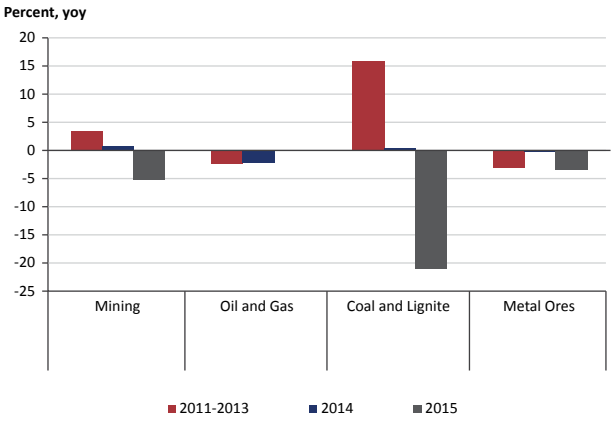


Source: BPS - Statistics Indonesia

3.3. CORPORATE AND HOUSEHOLD PERFORMANCE

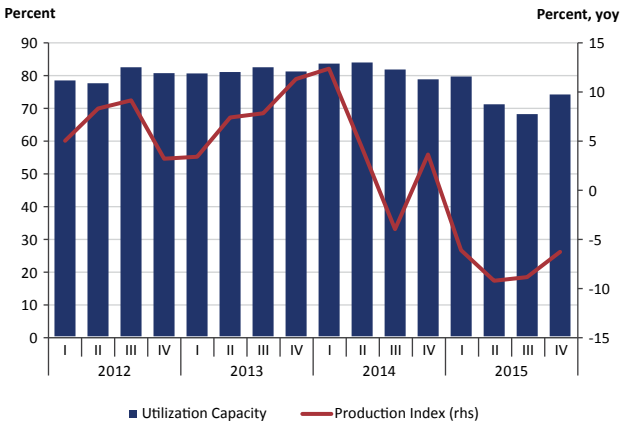
Corporate performance deteriorated as a result of economic moderation. Weak external and domestic demand reduced production, reflecting declines in the production index and production capacity utilisation in 2015 (Chart 3.13). Less production drained corporate revenues as reported in the financial statements, particularly of commodity-based corporations. This condition was further compounded by sliding global commodity prices (Chart 3.14).[3] Consequently, as the performance of the commodity sector declined, the commodity-driven domestic economy weakened public

Chart 3.11. Growth of Mining Industry



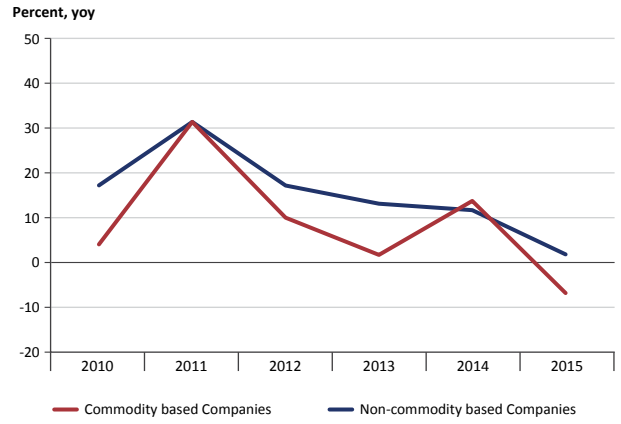
Source: BPS - Statistics Indonesia

Chart 3.13. Utilization Capacity and Production Index



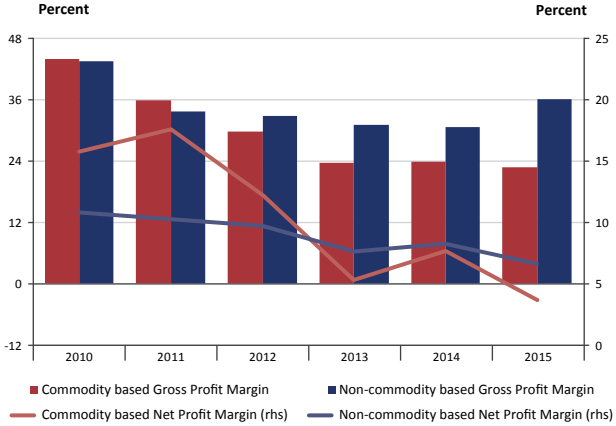
3 The assessment of corporate performance used data from 163 public companies listed on the Indonesia Stock Exchange.

Chart 3.14. Income of Listed Companies



Source: Bloomberg, processed

Chart 3.15. Gross and Net Profit Margin



Source: Bloomberg, processed

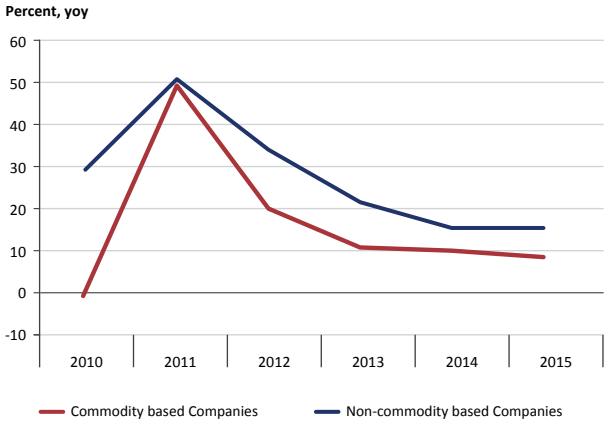
purchasing power. Furthermore, the revenues of other sectors also suffered, with some firms operating in the manufacturing industry reporting income contractions. Nevertheless, corporate revenues, particularly in the construction sector, began to rebound in the final quarter of the year.

The declines in corporate income were inadequately offset by lower expenses, which consumed profits. Lower revenues were accompanied by lower cost of goods sold and operating costs, albeit of more limited magnitude. In addition to lower sales volume, a lower cost of goods sold was precipitated by a contraction in terms of input costs, namely raw materials and energy. Firms using imported raw materials benefitted from lower commodity prices through less pressures on the cost of production as the rupiah depreciated. Consequently, lower input costs led to a more resilient gross profit margin at non-commodity based corporations. Meanwhile, for commodity-based corporations, drastically lower selling prices lowered revenues and also gross profit margin (Chart 3.15). On the other hand, businesses also undertook measures to enhance efficiency through lower operating costs. Reductions to operating costs were limited, however, due to the more fixed nature of the costs. As a result, the net profit margin of commodity-based companies narrowed.

Decreasing corporate profits could have potentially stifled further expansion. Declining corporate profits affected nearly all economic sectors, most notably commodity-based companies. Deteriorating financial conditions also limited future investment opportunities, reflecting an ongoing decline in retained earnings since 2011 (Chart 3.16). Data at the micro level confirmed that the proportion of retained earnings at the majority of corporations in 2015 decreased on the previous year.

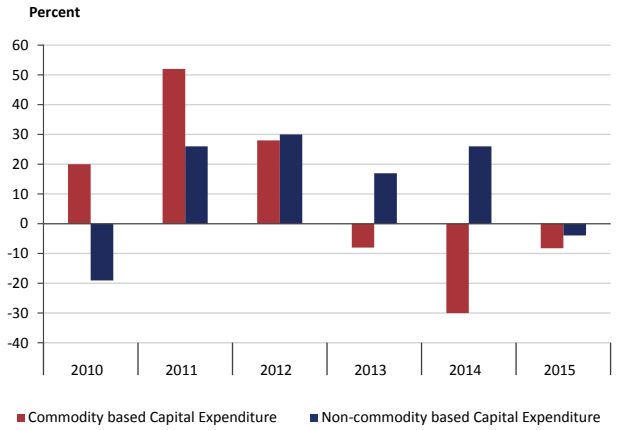
In addition to deteriorating financial conditions, a loss of business confidence also limited business expansion. The majority of issuers corroborated a decline in actual capital spending in line with a decrease in net profit, especially at commodity-based firms where a deep net profit contraction was reported, which acted as a disincentive to capital spending. At non-commodity based firms, however, capital spending still declined in general, with the exception of basic industry and property (Chart 3.17). Weaker financial performance also undermined confidence in economic conditions, reflecting corporate proclivity to reduce inventory in order to meet demand (Chart 3.18). Nevertheless, business sentiment rebounded towards the end of 2015, accompanied by an increase of private

Chart 3.16. Retained Earning of Listed Companies



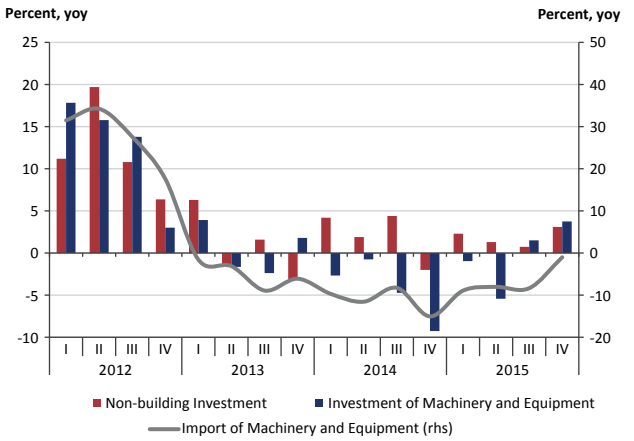
Source: Bloomberg and IDX, processed

Chart 3.17. Net Profit and Capital Expenditure



Source: Bloomberg and IDX, processed

Chart 3.19. Machinery Import and Non-building Investment



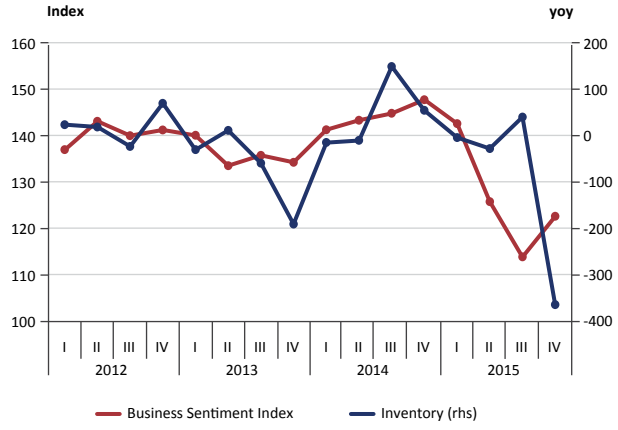
investment, particularly in machinery and equipment (Chart 3.19).

The production slump also led to a decline in household income, which indicated by the decrease in the index of consumer income (Chart 3.20). Lower consumer income triggered a shift in household behavior in terms of consumption and saving. Survey results revealed that the buying of durable goods index declined, confirming less non-food consumption. Furthermore, significant declines in household consumption were seen to affect clothing, housing and household equipment, contrasting robust consumption of basic necessities.

Despite slowing, household consumption remained resilient. Households responded to the indirect effect of economic moderation on income by reducing consumption and dipping into savings as a form of consumption smoothing. Households were more inclined to save when commodity prices were high but have subsequently saved less since 2012. In 2015, individual savings declined sharply in line with the growing portion of income used to meet consumption needs (Chart 3.21). In addition, households also smoothed consumption in line with growing optimism regarding the vastly more promising economic outlook (Chart 3.22).

Receipts, excluding household income, also helped maintain resilient consumption. The results of the Household Balance Sheet Survey (SNRT) conducted by Bank Indonesia in 2015 revealed that household income originating from production and services was insufficient to cover total household costs, which included the routine and non-routine expenses (Chart 3.23). Nonetheless,

Chart 3.18. Business Sentiment and Inventory



Source: Danareksa and BPS - Statistics Indonesia

Chart 3.20. Household Income and Expenditure

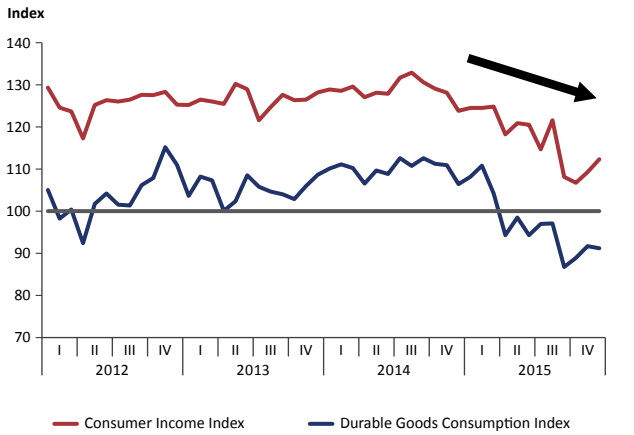


Chart 3.21. Share of Consumption, Saving, and Household Installment

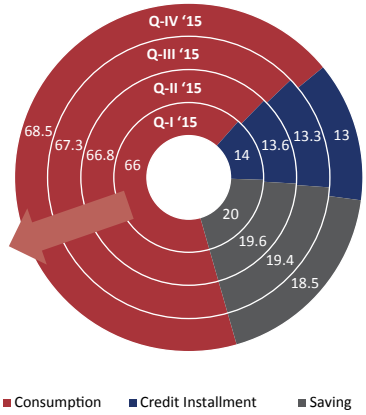
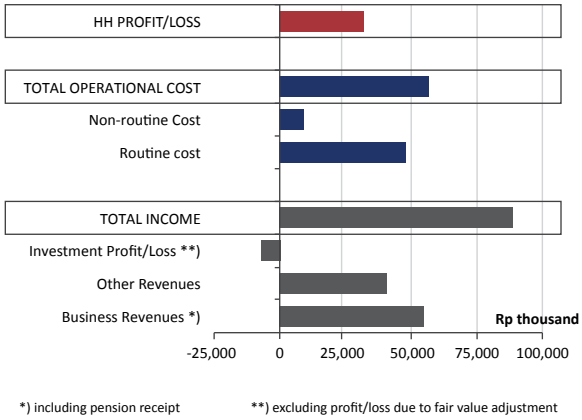


Chart 3.23. Household Income vs Operational Cost



*) including pension receipt

**) excluding profit/loss due to fair value adjustment

other receipts from third parties, including government assistance/transfers, in this instance, helped meet the needs of households. Fiscal stimuli through Social Assistance program was subsequently expanded 3.1% in 2015 from the previous year (Chart 3.24). Fiscal transfers under the auspices of social protection included School Assistance, Financial Aid for Poor Students and the Family Hope Program (PKH). Taking into consideration the various sources of income available, households booked a net surplus overall in 2015.

3.4. EMPLOYMENT AND WELFARE

Domestic economic moderation undermined employment conditions. Therefore, the unemployment rate increased in August 2015 to 6.2% from 5.9% the year earlier (Table 3.5), with unemployment up from 7.5 million persons in 2014 to 7.6 million in 2015. The rise in unemployment stemmed from low additional labor absorption in line with the domestic economic slowdown. With growth of just under 5%, the domestic economy only absorbed an additional 200 thousand workers in 2015 (August 2014 – August 2015).

Indicators of employment growth also demonstrated a low level of labor absorption in 2015. Job openings (vacancies) followed a downward trend in 2015 (Chart 3.25).[4] Slowing employment growth was in line with sluggish economic growth and also a decline in the elasticity of labor absorption in regard to economic growth. From 2010-

Chart 3.22. Index of Recent Economic Condition and Economic Expectation

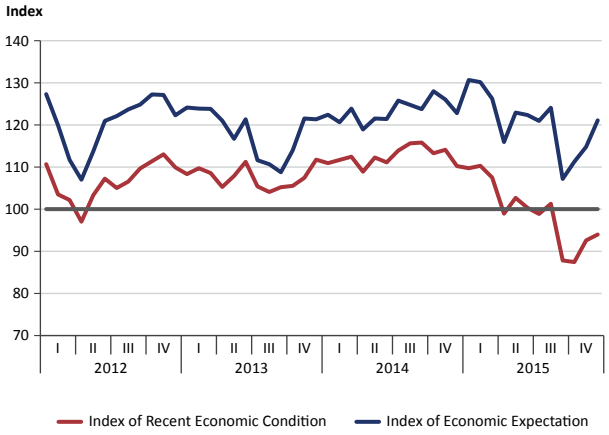
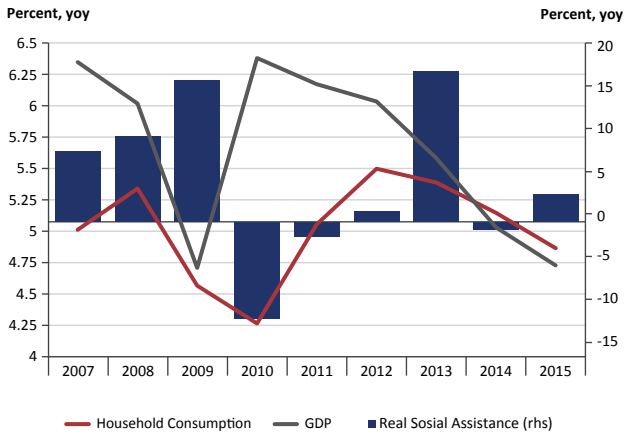


Chart 3.24. GDP, Household Consumption, and Social Assistance



Source: CEIC, processed

4 The job vacancy index is the result of utilising the Big Data by Bank Indonesia.

Table 3.5. Labor Force and Unemployment

in million people, unless otherwise stated

No.	Main Activities	2013		2014		2015	
		Feb	Aug	Feb	Aug	Feb	Aug
1	Productive Age (above 15 years)	178.1	180.0	181.2	183.0	184.6	186.1
	- Labor Force Participation (%)	69.2	66.8	69.2	66.6	69.5	65.8
2	Labor Force	123.2	120.2	125.3	121.9	128.3	122.4
	- Full Time Worker (%)	64.6	62.4	64.8	64.7	66.4	65.8
	- Part Time Worker (%)	18.4	22.3	21.1	21.4	20.0	20.1
	- Partial Unemployment (%)	11.1	9.2	8.4	7.9	7.8	8.0
	- Open Unemployment (%)	5.9	6.2	5.7	5.9	5.8	6.2

Source: BPS - Statistics Indonesia, processed

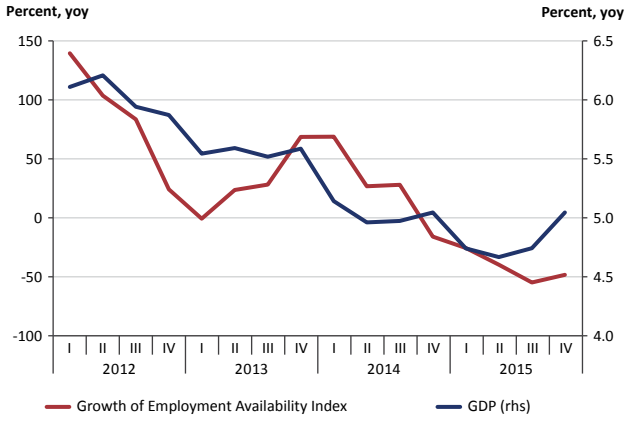
2012, each 1% increase in GDP absorbed an additional 500,000 workers, halving thereafter to just 250,000 in 2013-2015.

Hence, the fiscal stimuli introduced in 2015 had a positive impact on employment. By sector, most additional workers were absorbed into the construction sector as public investment picked up in the third quarter of 2015, in line with the implementation of government infrastructure projects (Chart 3.26). Such conditions alleviated further increase in unemployment, considering several sectors, especially tradeable sectors, suffered from a shrinking workforce, including the agricultural sector, mining sector and manufacturing industry due to unconducive externalities. The mining sector experienced a dramatic decline in the workforce due to the closure of various small-scale (coal) mines as a result of sliding commodity prices that could no longer offset production costs.
It is important to note, however, the improvement in workforce quality. In terms of education, the composition of the workforce educated to a primary level dropped from 47.1% to 44.3%, while the portion of those educated to a tertiary level increased from 9.8% to 11%.

In line with the increase in unemployment, public welfare also deteriorated, reflecting a bump in the percentage of the poor population on the previous year (Chart 3.27). In September 2015, poor people numbered 28.5 million (11.13%), up from 27.7 million (10.96%) the year before. The increase in poor people stemmed from domestic economic moderation coupled with inflationary pressures, which pushed the poverty line in September 2015 up 10.40% (yoy) to Rp344,809 per capita per month, compared to 6.61% (yoy) in September 2014. Nonetheless, welfare tended to improve in the second half of 2016 as the number of poor people declined relatively in line with early signs of economic momentum and fiscal stimuli through various assistance programs.

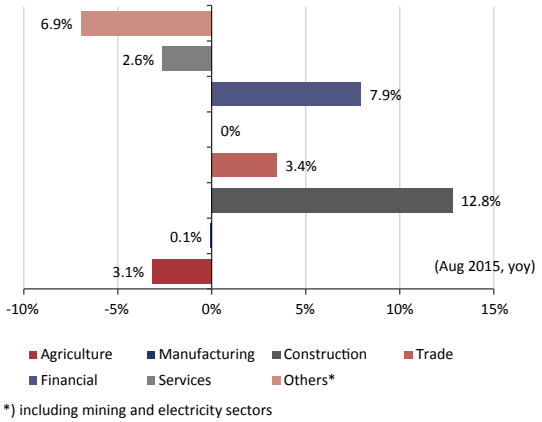
Income inequality has yet to show signs of improvement. The poverty gap index, as a measure of the intensity of poverty, increased in 2015 on the average of the previous

Chart 3.25. Availability of Employment and GDP



Source: BPS - Statistics Indonesia, processed

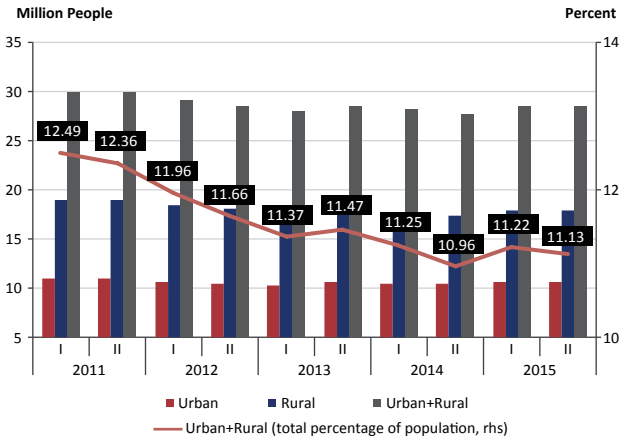
Chart 3.26. Changes in Numbers and Share of Labor by Economic Sector



*) including mining and electricity sectors

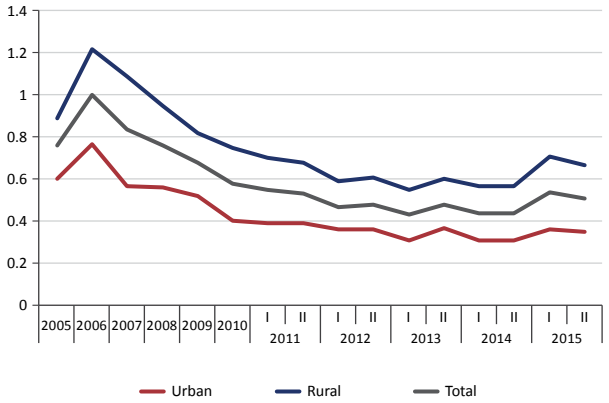
Source: BPS - Statistics Indonesia, processed

Chart 3.27. Level of Poverty



Source: BPS - Statistics Indonesia, processed

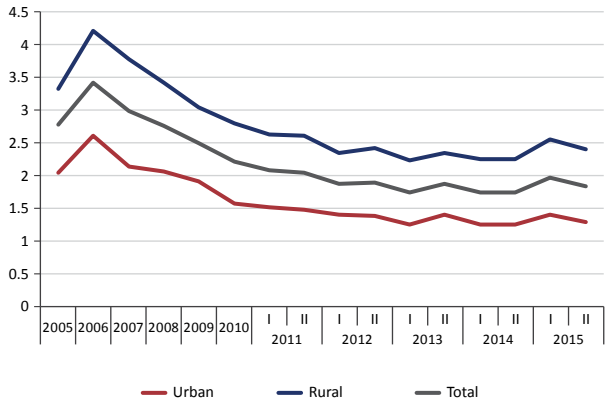
Chart 3.29. Poverty Severity Index



Source: BPS - Statistics Indonesia, processed

year (Chart 3.28).[5] Similar trends were observed for the poverty severity index, which increased on the year earlier (Chart 3.29). The index shows that disparity in spending between poor people also increased.[6] Another inequality indicator, namely the Gini coefficient, further confirmed income inequality, remaining at around 0.41 for the past five years.

Chart 3.28. Poverty Gap Index



Source: BPS - Statistics Indonesia, processed

5 The poverty gap index measures the average poverty gap in the population as a proportion of the poverty line. A higher index indicates a further distance, on average, the poor are from the poverty line or the average percentage shortfall in income for the population from the poverty line.

6 The poverty severity index is a measure of spending disparity between poor people. A higher index value is indicative of greater inequality between poor people.

Loading and unloading activities at the port mirror trade activity and are a key component of Indonesia's Balance of Payments (BOP). Despite a BOP deficit recorded in 2015, the current account deficit was observed to narrow while the capital and financial account also showed early signs of improvement in the fourth quarter.

Chapter 4

Balance of Payments

External sector fundamentals in Indonesia remained sound throughout 2015, supported by a narrower current account deficit and maintained capital and financial account surplus. The narrower current account deficit was bolstered by gains in the trade account, services account, and income account. On the other hand, the capital and financial account surplus was maintained despite widespread uncertainty in global financial markets. Overall, Indonesia's balance of payments (BOP) recorded a modest deficit because the capital and financial account surplus was inadequate to fully offset the current account deficit. Nonetheless, the 2015 BOP deficit was not considered large due to the significant improvements in the capital and financial account achieved in the fourth quarter.

In 2015, current account performance improved despite unconducive global conditions coupled with unresolved domestic structural issues. Current account gains were supported by an improvement of trade surplus as the import decline outpaced the corresponding decline of exports. Real non-oil and gas exports from Indonesia in 2015 enjoyed positive growth on the back of solid agricultural export volume. Nevertheless, sharp price corrections eroded the value of non-oil and gas exports. Additionally, rupiah depreciation was not exploited optimally, which would have boosted the competitiveness of export products from Indonesia. Such conditions were exacerbated further by sliding global commodity prices, including oil. Consequently, Indonesia's export performance declined on the previous year, in line with a weaker terms of trade (ToT).[1]

Regarding imports, domestic economic moderation, rupiah depreciation, and energy subsidies reforms affected import performance. Rupiah depreciation triggered relatively more expensive import prices, thus reducing shipments. Furthermore, government policy to cut energy subsidies raised the price of fuel and, therefore, lowered domestic consumption and reduced the need for oil imports. Such developments led to a steeper decrease in imports than the corresponding export decline, thereby boosting the trade surplus in 2015. The import decline began to ease in the fourth quarter of 2015 as the domestic economy rebounded, which curbed the overall import decline for the year.

In terms of the financial channel, the capital and financial account surplus was maintained in 2015 in spite of global economic moderation and growing uncertainty in global financial markets. Notwithstanding, capital and financial account performance deteriorated significantly during the first three quarters of 2015 but subsequently rebounded in the final quarter after global uncertainty eased and optimism in the auspicious economic outlook was restored. Such conditions reignited non-resident investor interest in long-term investment in Indonesia in the form of direct investment. Furthermore, the domestic economic uptick in the fourth quarter, coupled with attractive rate of returns in Indonesia, increased foreign capital in portfolio investment. Regarding other investments, a combination of unconducive global and domestic conditions prompted a net outflow of resident and non-resident capital and lessened demand for corporate funding through foreign loans in the first semester. In the second semester, however, other investments bucked the prevailing trend and recorded a surplus that continued until the end of 2015. Therefore, the capital and financial account surplus was maintained in 2015, despite narrowing on the year earlier. The narrower capital and financial account surplus was inadequate to fully offset the current account deficit. Consequently, the balance of payments (BOP) deficit in 2015 stood at a moderate USD1.1 billion (Table 4.1). Congruously, Indonesia's International Investment Position (IIP) recorded a smaller net liability in 2015 than the previous year (Table 4.2).

Consistent with the BOP deficit in 2015, the position of official reserve assets also declined as compare to the previous year but remained at a level considered safe. The declined in the official reserve assets was due to government external debt services and Bank Indonesia utilised the reserve assets to stabilize the rupiah in line with its fundamental value. The move was in pursuance of Bank Indonesia's avowed commitment to maintain rupiah stability and, therefore, macroeconomic and financial system stability. Despite declining, the position of reserve assets was still maintained at a level of USD105.9 billion, equivalent to 7.4 months of imports and servicing government external debt. Furthermore, Bank Indonesia perceived the position of official reserve assets as adequate to support external sector resilience and preserve sustainable economic growth in Indonesia moving forward.

Dwindling demand for offshore funding, in line with the domestic economic slowdown, alleviated the spiralling growth of external debt in 2015. The position of external debt increased in 2015, however, due to long-term foreign loans, while short-term debt eased. In terms of the risk profile, the position of external debt was considered relatively secure because only a small portion allocated to short-term non-affiliated nonbank corporate external debt, which is associated with the highest risk profile. In addition, Bank Indonesia also mitigated the risks linked to nonbank corporate debt by issuing Bank Indonesia Regulation (PBI) No. 16/21/PBI/2014 concerning the Implementation of Prudential Principles in Managing External Debt of Nonbank Corporation. By the end of 2015, implementation of the Bank Indonesia Regulation (PBI) had successfully improved efforts at nonbank corporations to mitigate risk by applying prudential principles when managing external debt.

Looking ahead, the current account deficit is predicted to widen as the domestic economy rebounds but remain within a safe limit. A surge of non-oil and gas imports, while the corresponding exports remain flat, will swell the current account deficit. Limited increases in global demand due to the global economic downturn, coupled

1 The terms of trade refers to the ratio of export prices to import prices.

Table 4.1. Indonesia's Balance of Payments

USD million

Items	2014*				Total*	2015**				Total**
	I	II	III	IV		I*	II*	III*	IV**	
I. Current Account	**-4,927**	**-9,585**	**-7,035**	**-5,953**	**-27,499**	**-4,159**	**-4,296**	**-4,190**	**-5,115**	**-17,761**
A. Goods, net	3,350	-375	1,560	2,448	6,983	3,063	4,125	4,141	1,953	13,281
- Export	43,937	44,505	43,606	43,245	175,293	37,827	39,685	36,086	34,743	148,341
- Import	-40,588	-44,880	-42,046	-40,797	-168,310	-34,764	-35,561	-31,945	-32,790	-135,060
1. General Merchandise	2,832	-703	1,192	2,153	5,474	2,690	3,810	4,047	2,004	12,551
- Export	43,414	44,171	43,232	42,944	173,760	37,450	39,366	35,728	34,397	146,941
- Import	-40,581	-44,874	-42,039	-40,791	-168,286	-34,760	-35,557	-31,680	-32,392	-134,389
a. Non Oil and Gas	5,581	2,475	4,326	4,922	17,304	3,947	5,932	6,158	2,987	19,024
- Export	35,822	36,657	35,970	36,560	145,008	33,068	34,722	32,038	30,698	130,526
- Import	-30,241	-34,182	-31,644	-31,638	-127,704	-29,122	-28,790	-25,880	-27,711	-111,502
b. Oil	-6,056	-6,137	-6,037	-5,672	-23,903	-3,184	-3,658	-3,521	-2,753	-13,115
- Export	3,500	3,885	3,590	2,831	13,806	1,927	2,611	1,786	1,500	7,823
- Import	-9,556	-10,022	-9,627	-8,503	-37,709	-5,111	-6,268	-5,307	-4,253	-20,938
c. Gas	3,308	2,959	2,904	2,903	12,074	1,927	1,535	1,410	1,770	6,643
- Export	4,092	3,629	3,672	3,553	14,946	2,455	2,034	1,904	2,198	8,592
- Import	-785	-670	-768	-649	-2,873	-528	-498	-494	-429	-1,949
2. Other Goods	518	328	368	295	1,509	372	315	94	-51	730
- Export	524	333	374	302	1,533	376	319	358	346	1,400
- Import	-6	-5	-6	-7	-24	-4	-4	-264	-398	-670
B. Services, net	-2,131	-2,831	-2,486	-2,561	-10,010	-1,845	-2,651	-2,151	-1,846	-8,493
C. Primary Income, net	-7,230	-7,912	-7,313	-7,236	-29,692	-6,805	-7,195	-7,452	-6,576	-28,028
D. Secondary Income, net	1,085	1,534	1,204	1,397	5,220	1,428	1,426	1,272	1,354	5,479
II. Capital and Financial Account	**6,388**	**14,492**	**14,535**	**9,574**	**44,989**	**5,087**	**2,241**	**279**	**9,529**	**17,136**
A. Capital Account	1	7	3	15	27	1	0	2	14	17
B. Financial Account	6,387	14,484	14,532	9,559	44,962	5,086	2,241	277	9,516	17,120
- Assets	-5,393	-2,960	-3,786	1,353	-10,786	-8,302	-8,524	-3,787	340	-20,273
- Liabilities	11,780	17,445	18,318	8,206	55,748	13,388	10,765	4,064	9,175	37,393
1. Direct Investment	2,023	4,353	5,752	2,661	14,788	1,695	3,467	1,782	2,315	9,259
a. Assets	-2,883	-2,407	-2,226	-2,871	-10,388	-3,451	-3,394	-1,345	-1,237	-9,427
b. Liabilities	4,906	6,760	7,979	5,532	25,176	5,146	6,860	3,127	3,553	18,686
2. Portfolio Investment	8,730	8,046	7,409	1,883	26,067	8,509	5,592	-2,218	4,825	16,707
a. Assets	465	-991	1,299	1,814	2,587	24	-737	-683	393	-1,003
b. Liabilities	8,265	9,037	6,110	69	23,481	8,484	6,329	-1,535	4,431	17,709
3. Financial Derivatives	-140	45	-20	-40	-156	93	-3	231	-301	20
a. Assets	239	64	11	128	441	205	229	196	37	667
b. Liabilities	-379	-19	-32	-168	-597	-112	-232	35	-338	-647
4. Other Investment	-4,225	2,040	1,390	5,056	4,262	-5,210	-6,815	483	2,677	-8,866
a. Assets	-3,214	375	-2,871	2,283	-3,426	-5,080	-4,622	-1,955	1,148	-10,510
b. Liabilities	-1,011	1,666	4,261	2,773	7,688	-130	-2,192	2,438	1,529	1,645
III. Total (I + II)	**1,462**	**4,907**	**7,500**	**3,621**	**17,489**	**928**	**-2,055**	**-3,912**	**4,415**	**-624**
III. Net Error and Omissions	**605**	**-610**	**-1,025**	**-1,211**	**-2,241**	**375**	**-870**	**-654**	**675**	**-474**
IV. Overall Balance (III + IV)	**2,066**	**4,297**	**6,475**	**2,410**	**15,249**	**1,303**	**-2,925**	**-4,565**	**5,089**	**-1,098**
VI. Reserves and Related Items	**-2,066**	**-4,297**	**-6,475**	**-2,410**	**-15,249**	**-1,303**	**2,925**	**4,565**	**-5,089**	**1,098**
Memorandum:										
- Reserve Assets Position	102,592	107,678	111,164	111,862	111,862	111,554	108,030	101,720	105,931	105,931
- In Months of Imports & Official Debt Repayment	5.7	6.1	6.3	6.4	6.4	6.6	6.8	6.8	7.4	7.4
- Current Account to GDP Ratio (%)	-2.3	-4.3	-3	-2.7	-3.1	-2	-2	-1.9	-2.4	-2.1

* preliminary figures
** very preliminary figures

Table 4.2. Indonesia's International Investment Position

USD million

Items	2014*				Total*	2015**				Total**
	I	II	III	IV		I*	II*	III*	IV**	
Indonesia's International Investment Position	**-367,160**	**-373,572**	**-392,390**	**-394,466**	**-394,466**	**-394,825**	**-380,044**	**-348,011**	**-380,672**	**-380,672**
- Direct Investment, net	-187,974	-190,734	-203,339	-202,359	-202,359	-198,494	-196,562	-186,711	-194,672	-194,672
- Portfolio Investment, net	-174,323	-179,939	-191,531	-192,656	-192,656	-202,455	-192,960	-163,295	-189,369	-189,369
- Financial Derivatives, net	98	37	21	30	30	1	61	-13	91	91
- Other Investment, net	-107,554	-110,614	-108,704	-111,342	-111,342	-105,431	-98,613	-99,712	-102,653	-102,653
- Reserves	102,592	107,678	111,164	111,862	111,862	111,554	108,030	101,720	105,931	105,931

* preliminary figures ** very preliminary figures

with soft global commodity and oil prices, will impeded export performance. On the other hand, growing domestic demand as the economy recovers will be met through a rise in non-oil and gas imports. In addition, predominantly government-led efforts to accelerate infrastructure development will also heighten import activity, especially imports of capital goods.

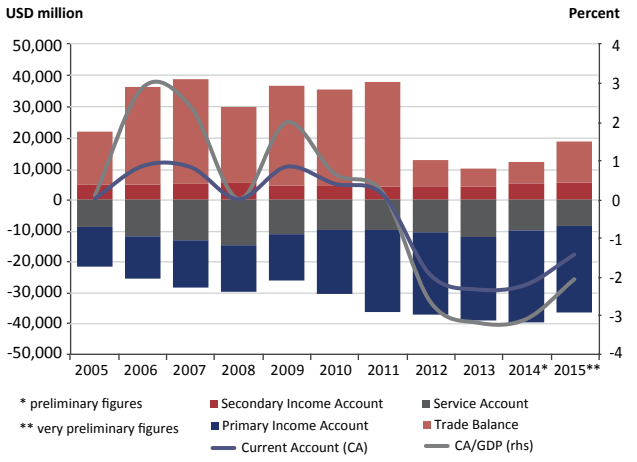
The capital and financial account performance is projected to improve with a significantly larger surplus envisioned. Consequently, the balance of payments should record a surplus, thus driving increases in the position of reserve assets. Global and domestic economic momentum, bolstered by structural reforms and the Government's I-VIII Policy Package in 2015, should prompt a deluge of non-resident capital inflows through direct investment. Furthermore, the expected gradual increase in the Federal Funds Rate (FFR) will also maintain the influx of portfolio capital inflows. Congruously, the other investment deficit will also improve as companies withdraw more foreign loans in line with the promising domestic economic outlook. The capital and financial account surplus is expected to exceed the current account deficit, thus precipitating a surplus balance of payments (BOP) once again. BOP performance is forecasted to improve, supported by an appropriate monetary and macroprudential policy mix along with policy coordination enhancement between Bank Indonesia and the Government. Nonetheless, global developments will continue to demand vigilance, particularly in terms of the economic downshift in China and the ongoing international commodity price slide, which could undermine the BOP overall performance.

4.1. CURRENT ACCOUNT

Against the inauspicious backdrop of global economic moderation, tumbling international commodity prices, and a domestic economic slowdown, the current account deficit improved in 2015. The current account recorded a deficit of USD17.8 billion in 2015, equivalent to 2.1% of GDP, down from USD27.5 billion the year earlier or 3.1% of GDP. The current account gains were supported by larger surpluses reported in the trade balance and secondary income account as well as narrower deficits in the services account and primary income account (Chart 4.1).

The trade balance posted a growing surplus in 2015 on the back of a larger non-oil and gas trade balance surplus combined with a narrower oil and gas trade balance deficit. The increase in non-oil and gas trade balance surplus in 2015 was driven by a decline in non-oil and gas imports that surpassed the corresponding export decline, affecting all goods, including consumer goods, raw materials, and capital goods. Dwindling domestic demand prompted the decline of consumer goods imports in line with less household consumption, which was accompanied by weaker sales data amidst economic moderation, thus suppressing demand for investment and working capital. Less demand for investment ultimately eroded imports,

Chart 4.1. Current Account Development



particularly of raw materials and capital goods. In addition, rupiah depreciation precipitated further declines of non-oil and gas imports as imported prices became relatively more expensive. Meanwhile, sluggish external demand due to the global downtick spurred the non-oil and gas export decline, which was further compounded by the unrelenting international commodity price slide. Moreover, Indonesia's export dependence on natural resources left the country reeling from low commodity prices. Furthermore, the low competitiveness of export products in comparison to competing countries undermined the favourable impact of rupiah depreciation.

The oil and gas trade balance deficit narrowed after oil imports decreased as a result of energy price reforms that reduced oil consumption and, therefore, the need for imports. Policy to remove energy subsidies and provide fixed fuel subsidies by the Government, which ultimately raised fuel prices, successfully depressed domestic fuel consumption. The domestic economic slowdown also reduced fuel consumption through lower demand. In addition, the significant drop in the international oil price throughout 2015 also lowered oil imports.

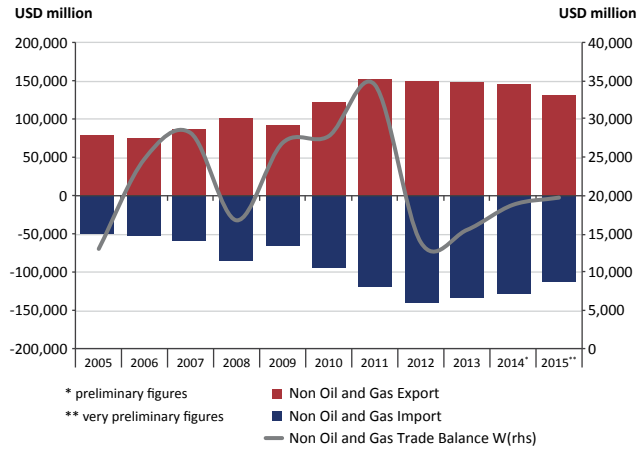
Further improvements on the current account were supported by narrower services account and income account deficits. The services account in 2015 was bolstered by lower payments of freight transportation services together with a growing travel services surplus. Meanwhile, the income account benefitted from a smaller primary income account deficit due to fewer direct investment dividend payments and a wider secondary income account surplus as a result of increasing remittances from Indonesian migrant workers (TKI).

Non-Oil and Gas Trade Balance

The non-oil and gas trade balance registered a growing surplus in 2015 as the main contributor to the narrower current account deficit and continued the prevailing upward trend since 2013. In 2015, the non-oil and gas trade balance recorded a surplus totalling USD19.8 billion, up from USD18.8 billion the year earlier. A 12.4% decline in non-oil and gas imports that exceeded the 10.0% drop in exports was instrumental in the larger surplus (Chart 4.2).

The fragile economic recovery in advanced countries, together with slower growth in developing countries, weakened demand for products exported from Indonesia. Weaker global demand was reflected in the exports to 10 leading trade partners of Indonesia, which all experienced declines with the exception of the Philippines (Table

Chart 4.2. Development of Non-Oil and Gas Trade Balance



4.3). Indonesian exports to the United States contracted by 3.5% despite the modest U.S. economic growth and robust consumption reported. Exports of manufacturing products, such as electrical equipment, processed foods, and processed natural rubber, as the backbone of Indonesian exports to the United States, declined. Such conditions were symptomatic of the weak competitiveness of Indonesian exports compared to competing countries. Furthermore, textile exports to the U.S., representing the largest Indonesian export component to the U.S., also contracted as a result of growing competition from Vietnam and Bangladesh.

Export growth to India, Japan, and China also decelerated. To India, exports of coal and crude palm oil (CPO) were primarily affected but shipments of copper ore and articles of non-precious metals actually enjoyed positive export performance in line with robust economic growth in India. Meanwhile, the economies of Japan and China were more lacklustre, which drove down demand from both countries, in particular for coal. Exports of textiles, measuring instruments and articles of non-precious metals to Japan also suffered, while exports of processed wood to China slumped. In contrast, exports of CPO and textiles to China still posted growth in positive territory.

Torpid export performance in Indonesia was primarily attributable to sliding commodity prices, reflecting lower prices of leading export commodities from Indonesia on the international market. The prices of the 10 leading export commodities from Indonesia fell by 7.1% in 2015 (Table 4.4), most notably affecting coal and CPO. The export price of coal fell by 13.7% in 2015, which saw coal exports slump by 23.4%. In addition to price factors, coal exports were also down by 12.3% in terms of volume as a

Table 4.3. Non-Oil and Gas Exports by Country

Items	Share (%)		Annual Growth (%, yoy)									
			2014*					2015**				
	2014*	2015**	I	II	III	IV	Total	I*	II*	III*	IV**	Total**
United States of America	10.8	11.6	2.6	7.6	6.5	5.5	5.6	-1.1	-0.4	-4.8	-7.6	-3.5
China	11.2	10.0	-2.7	-17.8	-24.8	-39.1	-22.2	-36.5	-13.1	-9.6	-13.8	-19.5
Japan	10.0	9.9	-12.6	-11.4	-5.6	-4.8	-8.7	-5.4	-8.4	-12.9	-17.1	-11.1
India	8.3	8.8	-13.9	-16.9	19.8	-7.1	-5.6	7.3	18.1	-27.0	-14.2	-5.1
Singapore	6.7	6.5	2.3	23.4	8.1	12.5	11.6	1.7	-19.4	-9.2	-16.8	-11.4
Malaysia	4.4	4.7	-19.9	-6.8	-8.0	-7.2	-10.6	3.5	0.2	-7.3	-9.8	-3.4
South Korea	3.9	4.1	-11.0	-6.5	2.9	-3.0	-4.6	0.1	0.4	-6.3	-16.8	-5.7
Thailand	3.4	3.5	-5.7	-10.4	2.8	-2.7	-4.2	-6.4	-4.0	-11.6	-10.2	-8.0
Philippines	2.7	3.0	-2.1	6.7	9.4	-0.1	3.4	-2.0	4.2	7.2	-7.2	0.8
Australia & Oceania	3.1	2.8	36.5	39.3	13.8	-15.6	15.2	-36.4	-17.0	7.4	-21.6	-17.5
Total of 10 Countries	**64.5**	**64.9**	**-5.1**	**-4.4**	**-1.2**	**-10.7**	**-5.5**	**-9.6**	**-4.4**	**-10.0**	**-13.5**	**-9.4**

* preliminary figures
** very preliminary figures

result of less demand from China, consistent with domestic policy to reduce coal use in order to combat rampant pollution and promote alternative sources of energy.

Demand for CPO exports remained resilient despite global economic moderation and lower international prices. The export price of CPO in Indonesia fell by 18.1% in 2015, which prompted a 10.7% drop in CPO exports. The lower CPO price in Indonesia was in line with sliding international CPO prices according to World Bank data, falling from an average of USD821 per metric ton (MT) in 2014 to USD623 per MT in 2015. Notwithstanding soft prices, demand for crude palm oil (CPO) actually increased in 2015 despite the global economic downswing, reflecting a 14.6% increase in export volume. Such conditions were indicative of growing demand for CPO year on year as the global population expands and awareness builds concerning alternative energy sources. Robust growth of CPO export volume also stemmed from the 0% export duty imposed on the product. The average international CPO price in 2015 failed to hit USD700 per MT, which is the threshold for export duties to apply. Consequently, the majority of CPO producers opted to export the product directly rather than by-products or derivatives. Consistent with sliding

Table 4.4. Export of 10 Main Non-Oil and Gas Commodities

Items	Share (%)		Growth (%, yoy)															
			Nominal						Real						Price Index					
	2014*	2015**	2014*	2015**					2014*	2015**					2014*	2015**				
				I*	II*	III*	IV**	Total**		I*	II*	III*	IV**	Total**		I*	II*	III*	IV**	Total**
Vegetable Oils	13.7	13.6	9.2	-12.6	6.0	-16.9	-17.9	-10.7	11.5	11.1	36.2	9.0	-1.0	14.6	-22.1	-21.2	-22.4	-23.7	-22.1	-18.1
Coal	14.2	12.1	-14.5	-17.7	-24.9	-24.9	-26.5	-23.4	-14.3	-7.0	-12.6	-13.2	-19.9	-12.3	-12.6	-11.6	-14.1	-13.6	-12.6	-13.7
Textile	8.8	9.4	0.6	-2.6	-2.7	-5.8	-4.8	-4.0	2.1	2.0	2.9	-0.4	0.7	1.5	-5.4	-4.5	-5.5	-5.4	-5.4	-3.9
Electricity	6.9	6.7	-5.7	-12.1	-11.8	-14.0	-14.7	-13.2	0.0	-5.9	-4.6	-7.8	-12.8	-7.5	-6.1	-6.5	-7.5	-6.9	-6.1	-2.6
Base Metal	6.2	5.8	5.5	-3.7	-16.1	-18.7	-24.9	-16.2	3.7	1.9	-8.5	-0.3	-5.8	-3.3	-13.4	-5.4	-8.2	-18.4	-13.4	-4.7
Processed Food	4.3	4.8	17.8	3.5	-0.4	-6.9	1.4	-0.6	12.1	3.4	-0.4	4.2	13.4	5.1	-5.4	0.1	-0.1	-10.5	-5.4	0.4
Processed Rubber	4.8	4.4	-24.5	-31.7	-13.2	-6.6	-12.1	-16.8	-16.4	-23.8	-4.0	17.2	19.3	-0.2	-16.6	-10.4	-9.5	-19.8	-16.6	-9.8
Vehicles and Parts	3.6	4.1	14.8	9.4	20.5	3.8	-16.4	3.3	12.3	3.0	14.1	1.1	-19.5	-1.4	4.8	6.2	5.5	2.7	4.8	5.9
Machineries	4.1	3.9	6.0	-15.8	-13.4	-9.1	-23.1	-15.5	6.5	-14.8	-12.4	-8.5	-21.3	-14.3	-1.4	-1.3	-1.1	-0.6	-1.4	-0.5
Processed Wood	2.7	2.9	11.3	-2.2	0.4	-4.2	-3.5	-2.3	10.1	12.8	31.9	34.8	40.6	29.6	-24.6	-13.3	-23.9	-28.9	-24.6	-7.6
Total of 10 Commodities	**69.3**	**67.6**	**-1.8**	**-11.0**	**-8.1**	**-13.6**	**-16.3**	**-12.2**	**-0.6**	**-2.6**	**2.9**	**1.4**	**-2.9**	**0.0**	**-12.3**	**-8.6**	**-10.6**	**-14.7**	**-12.3**	**-7.1**

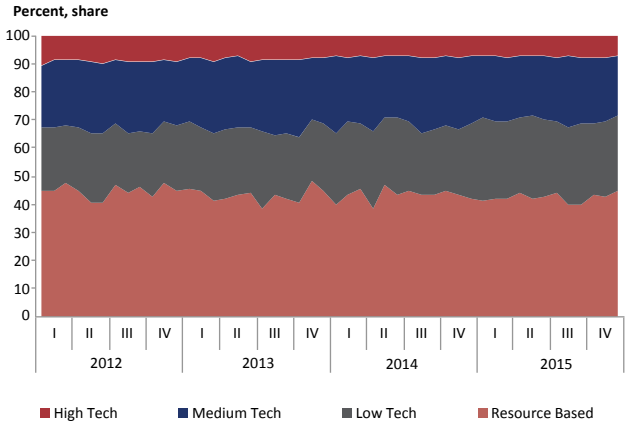
* preliminary figure
** very preliminary figure

commodity prices on the international market, Indonesia's terms of trade (ToT) decreased from 81.6 in December 2014 to 73.6 in December 2015.

Global economic moderation tended to affect demand for manufacturing products more than primary products from Indonesia, which rely to a greater extent on natural resources. The impact of the slowdown on manufacturing prices, however, was less pronounced than on the prices of primary products. In 2015, the volume of manufacturing exports fell by 7.4%, while the export volume of primary products enjoyed growth of 17.5%, buoyed by agricultural exports. Crude palm oil (CPO) was one such commodity that propped up export volume. In addition, agricultural exports were also supported by a greater export volume of coffee, fruits, and vegetables as well as pulp. Nevertheless, sliding commodity prices throughout 2015 triggered a precipitous drop in the export prices of primary products, falling from -4.4% in 2014 to -25.7% in 2015. Conversely, manufacturing product prices remained in positive territory, decreasing from 1.9% growth in 2014 to 0.5% in 2015 (Table 4.5).

Manufacturing export prices were relatively unaffected by the global economic slowdown but manufacturing exports were still plagued by structural issues. The structure of manufacturing products was still dominated natural resources (Chart 4.3), which left exports exposed to changes in commodity prices. Lower commodity prices, similar to trends throughout 2015, place pressures on manufacturing exports. Moreover, the import content

Chart 4.3. Composition of Indonesia Manufacturing Exports



Source: United Nations Industrial Development Organization (UNIDO)

of manufacturing products in Indonesia is high, thus preventing optimal exploitation of rupiah depreciation as raw materials become relatively more expensive. The manufacturing products that suffered the largest declines in 2015 include rubber products, clothing, and organic chemicals.

Exports of rubber products contracted by 7.0% in 2015 due to lower prices and volume despite a growing share in several export destination countries over the past few years. The contraction was felt most strongly by exports to Japan, Australia, and Germany. In contrast, exports to the United States achieved positive growth in 2015

Table 4.5. Non-Oil and Gas Exports According to SITC

Items	Annual Growth (%, yoy)									
	2014*					2015**				
	I	II	III	IV	Total	I	II*	III*	IV**	Total**
A. Primary Product										
Nominal	-9.0	-9.4	0.8	-13.4	-8.0	-10.2	-5.7	-16.2	-18.4	-12.7
Real	-3.4	-10.6	-0.4	0.4	-3.9	14.3	25.7	18.7	12.5	17.5
Price Index	-5.8	1.4	1.2	-13.8	-4.4	-21.4	-25.0	-29.5	-27.4	-25.7
B. Manufacturing Product										
Nominal	9.2	8.6	6.8	3.4	6.9	-4.9	-4.5	-4.9	-13.3	-6.9
Real	10.3	8.2	3.2	-1.3	5.0	-8.0	-7.4	-4.2	-10.3	-7.4
Price Index	-1.0	0.4	3.5	4.7	1.9	3.3	3.2	-0.7	-3.4	0.5
C. Others										
Nominal	41.3	20.8	-24.3	-32.2	-4.9	-26.1	-17.8	-14.0	-6.8	-17.0
Real	60.6	26.9	-23.4	-28.9	1.1	-22.2	-11.6	-2.1	1.7	-9.7
Price Index	-12.0	-4.9	-1.2	-4.7	-5.9	-4.9	-6.9	-12.2	-8.4	-8.1
Total										
Nominal	-0.3	-0.9	3.0	-6.5	-1.3	-8.0	-5.3	-10.9	-15.8	-10.0
Real	2.8	-2.6	-0.2	-2.2	-0.7	2.3	7.8	4.7	-3.4	2.8
Price Index	-3.0	1.8	3.2	-4.4	-0.7	-10.0	-12.1	-14.9	-12.8	-12.4

* preliminary figure
** very preliminary figure

Table 4.6. Indonesian Export of Rubber Products to Major Destination Countries

Items	Share 2015 (%)**	Growth (%, yoy)							
		2014*				2015**			
		I	II	III	IV	I*	II*	III*	IV**
Unites States of America	34.5	19.4	-6.6	-20.6	0.2	16.5	18.4	59.8	31.5
Japan	9.3	-10.1	5.2	0.5	-18.7	-18.3	-24.3	-21.6	-9.8
Australia	4.3	-17.6	3.1	4.2	-12.3	21.7	-4.4	-26.6	-10.5
Germany	4.2	-9.4	27.1	15.7	9.9	-1.6	-19.9	-6.6	-20.6
Malaysia	4.1	-35.4	-14.0	-23.1	-15.9	27.7	-16.3	-14.9	1.6

* preliminary figure
** very preliminary figure

(Table 4.6). Declining exports to Japan began with a decreasing market share over the past five years (2009-2014) while the shares of competitors, including China and Vietnam, have increased. In Australia, however, despite slower growth in 2015, the market share of Indonesia has increased over the last half decade (Table 4.7), indicating that Indonesia has successfully exploited the declining shares of competitors, such as Japan and South Korea, to gain market share in Australia. Nonetheless, China and Thailand were even more successful in terms of grabbing market share in Australia. On the U.S. market, the share of Indonesian exports has increased but yet again the shares China and Thailand increased even more impressively from 2009-2014.

Clothing exports fell by 1.3% in 2015 on volume but began to show signs of improvement in the third quarter (Table 4.8). The share of Indonesian clothing on the U.S. market as the main export destination has fallen persistently over the past five years (Table 4.9). In contrast, the share of clothing from Vietnam and Bangladesh, as the leading competitors, has increased. The dwindling share of Indonesian clothing is indicative of weak competitiveness compared to Vietnam, Bangladesh, and China. Competition has recently become even tighter after Europe provided a number of concessions to exporters from countries with low GDP, such as Vietnam, Cambodia, and Bangladesh. Nonetheless, since the third quarter of 2015, export growth to the U.S. and a number of other large countries was observed to rebound.

Exports of organic chemical products have fallen since October 2014, contracting 31.8%, due to price factors and volume in 2015. Exports initially declined to China and Japan but have more recently also decreased to India and the United States (Table 4.10). Nevertheless, declining exports to China have started to ease. In addition, from 2009-2014, Indonesia's position as supplier of organic chemicals to China improved from 10th to 7th, increasing 0.9% (Table 4.11). Indonesia's closest competitor, Malaysia, has improved over the same period from 9th to 8th, with share increasing by 0.2%. Moving forward, Malaysia has the potential to erode Indonesia's market share of chemical products. In terms of prices, organic chemical

Table 4.7. Market Share of Rubber Exporters in Japan, Australia, and the U.S.

Japan Market				Australia Market				U.S. Market			
Country of Origin	Share (%)			Country of Origin	Share (%)			Country of Origin	Share (%)		
	2009	2014	Δ		2009	2014	Δ		2009	2014	Δ
China	23.6	28.9	5.3 ↑	China	17.3	22.9	5.5 ↑	China	23.4	25.9	2.5 ↑
Thailand	16.3	15.7	-0.6 ↓	Japan	23.3	19.2	-4.1 ↓	Canada	18.4	12.9	-5.4 ↓
Indonesia	13.8	8.3	-5.5 ↓	Thailand	6.7	9.1	2.4 ↑	Japan	13.8	9.9	-3.8 ↓
South Korea	9.7	6.6	-3.1 ↓	South Korea	5.9	3.7	-2.2 ↓	Mexico	6.7	8.1	1.4 ↑
U.S.	7.9	6.4	-1.5 ↓	Germany	4.0	3.6	-0.5 ↓	South Korea	6.8	7.3	0.5 ↑
Vietnam	1.2	4.6	3.4 ↑	Spain	4.4	3.3	-1.1 ↓	Thailand	3.6	4.8	1.2 ↑
Germany	4.6	4.5	-0.1 ↓	Indonesia	2.2	3.0	0.9 ↑	Germany	4.5	4.5	0.0 ↑
France	2.0	2.7	0.7 ↑	Malaysia	1.9	2.4	0.5 ↑	Indonesia	1.9	2.5	0.6 ↑
Phillippines	1.7	2.4	0.7 ↑	India	1.5	1.7	0.2 ↑	France	2.1	2.1	0.0 ↓
Spain	1.2	2.4	1.2 ↑	France	2.2	1.5	-0.7 ↓	Chile	0.0	1.8	1.8 ↑

Source: UN Comtrade

Table 4.8. Indonesian Export of Clothing Products to Major Destination Countries

Items	Share 2014 (%)*	Share 2015 (%)**	Growth (%, yoy)							
			2014*				2015**			
			I	II	III	IV	I*	II*	III*	IV**
United States of America	49.4	49.9	-6.3	-3.9	-3.1	1.6	-7.2	-0.7	5.6	1.6
Japan	8.8	9.3	7.8	1.7	0.9	5.4	5.5	-3.3	5.5	10.1
Germany	7.4	6.2	9.5	24.7	-5.3	-7.8	-14.5	-21.9	-15.3	-13.3
South Korea	3.7	3.9	21.1	-3.5	-5.9	-4.2	-2.8	19.8	16.1	-12.0
England	3.5	2.8	-3.0	10.3	-14.5	-21.7	-28.9	-25.5	-19.4	-6.8

* preliminary figure
** very preliminary figure

export prices fell in step with lower CPO prices as a leading component of organic chemicals. Furthermore, the low international oil price, which had dropped to a level below the CPO price, made biodiesel prices uneconomical. Additionally, the 0% export duty on CPO compels producers to export directly hence limited the supply of CPO for organic chemicals downstream industries.

As non-oil and gas exports declined, so too did non-oil and gas imports. Non-oil and gas imports fell by 12.4% in 2015 compared to 3.9% the year earlier, affecting all commodity groups due to lower prices and volume. Fewer imports of consumer goods were the result of dwindling demand in line with less household consumption. Lower consumption was accompanied by weaker sales while players onfidence in the domestic economy were limited, thereby undermining demand for investment and working capital. Less demand for investment ultimately eroded imports, particularly of raw materials and capital goods. In addition, rupiah depreciation precipitated further declines of non-oil and gas imports as imported prices became relatively more expensive.

Table 4.9. Market Share of Clothing Exporters in the U.S.

U.S. Market			
Country of Origin	Share (%)		
	2009	2014	Δ
China	39.1	38.1	-1.0 ↓
Vietnam	7.4	10.4	3.0 ↑
Indonesia	**5.8**	**5.5**	**-0.2 ↓**
Bangladesh	5.0	5.4	0.4 ↑
Mexico	5.0	4.3	-0.7 ↓
India	4.3	4.1	-0.3 ↓
Honduras	3.0	2.9	-0.1 ↓
Cambodia	2.7	2.8	0.1 ↑
El Salvador	1.8	2.1	0.2 ↑
Sri Lanka	1.8	2.1	0.2 ↑

Source: UN Comtrade

Imports of consumer goods contracted by 9.9% in 2015 due to volume as a result of less household consumption (Table 4.12). Meanwhile, import prices fell in line with lower global prices. The import decline of consumer goods was attributed primarily to fresh/dried fruits (dropping 15.7% on 2014), fresh/frozen vegetables (13.6%), and processed edibles (3.0%). Further import declines were offset by medicaments (including veterinary medicaments) that surged 5.8% as well as imports of weapons and ammunition (9.7%).

The import decline of consumer goods was also accompanied by export contractions, hence driving down demand for imports of raw materials. Price corrections increasingly impeded raw material imports, dropping 12.3%. The decrease predominantly affected imports of livestock feed (17.0%), automotive components and equipment (15.9%), hydrocarbons, halogenates and sulphonates (24.4%) as well as other plastics in primary form (17.5%). Imports of electric circuit breakers and connectors prevented a further import decline of raw materials, however, recording positive growth of 4.8%.

The 15.6% decline in imports of capital goods was due to weaker demand in line with less investment activities. Prices actually increased by 12.5%, which prevented further declines of capital goods imports. The main contributors to the decline were telecommunications equipment and parts (29.2%), automatic data processing machinery and parts thereof (6.2%) as well as other specialised machinery for specific industries (9.2%). The pace of decline, however, was curbed by positive import growth of heating and cooling equipment (13.2%).

Oil and Gas Trade Balance

The oil and gas trade balance recorded a deficit totalling USD6.5 billion in 2015, improving on the USD11.8 billion deficit posted in 2014. The gains were mainly supported by a narrower oil deficit stemming from a deeper oil import

Table 4.10. Indonesian Export of Organic Chemical Products to Major Destination Countries

Items	Share 2014 (%)*	Share 2015 (%)**	Growth (%, yoy)							
			2014*				2015**			
			I	II	III	IV	I*	II*	III*	IV**
China	25.4	18.7	107.9	26.7	-9.5	-48.9	-62.6	-50.4	-41.4	-35.2
Netherlands	7.0	10.5	48.2	59.2	60.1	10.4	12.8	3.1	-20.8	19.3
Japan	6.0	7.9	-28.8	-8.1	-47.8	7.0	0.4	-22.8	4.3	-18.0
India	7.2	7.9	99.4	139.1	31.2	4.2	-20.6	-18.2	-40.2	-18.0
United States of America	6.6	7.4	13.4	78.3	3.0	-10.5	-16.2	-35.7	-26.2	-12.1

* preliminary figure
** very preliminary figure

contraction than export contraction. Therefore, the oil trade deficit narrowed 45.1% from USD23.9 billion to USD13.1 billion over the same period. The global oil price tumbled throughout 2015 due to oversupply from OPEC and non-OPEC countries, which was a salient factor of lower oil exports. Oil exports halved from USD13.8 billion in 2014 to USD7.8 billion in 2015. Nonetheless, oil export volume actually increased from 142.7 million barrels in 2014 to 155.7 million in 2015 as oil lifting surged from 788 thousand barrels per day to 791 thousand barrels per day respectively. In addition, weaker domestic demand for fuel provided the opportunity for a greater oil export growth.

Low international oil prices dragged the imported oil price down 42.1%. Consequently, oil imports fell sharply from USD37.7 billion in 2014 to USD20.9 billion in 2015. In addition to price corrections, fewer oil imports were also the result of a decline in import volume from 356.7 million barrels to 345.6 million barrels over the same period in line with less domestic fuel consumption stemming from economic moderation and government energy reforms. The energy reform policy applied by the government since the end of 2014 drove up fuel prices and reduced consumption, thereby narrowing the oil trade deficit.

The gas trade balance remained positive, recording a surplus of USD6.6 billion in 2015, down from USD12.1 billion the year earlier. The narrower surplus was ascribed to a deeper contraction of gas exports than imports. The 42.5% decline in gas exports was due to lower gas export prices in line with the sliding global oil price. Meanwhile, gas imports fell by 32.2% in 2015 on price factors, contrasting the increase in gas consumption that was met by greater gas lifting.

Services Account, Primary Income Account, and Secondary Income Account

The services account performed better in 2015, recording a narrower deficit and thus supporting gains in the current account. The services account deficit reduced 15.1% on the previous year due to a smaller transportation services deficit, specifically freight, consistent with fewer imports

Table 4.11. Market Share of Organic Chemical Product Exporters in China

Country by Origin	China Market		
	Share (%)		
	2009	2014	Δ
South Korea	21.6	22.9	1.3 ↑
Japan	17.4	13.7	-3.6 ↓
Saudi Arabia	7.5	9.7	2.2 ↑
Unites States of America	6.9	6.2	-0.7 ↓
Singapore	2.6	5.1	2.5 ↑
Thailand	3.3	4.1	0.8 ↑
Indonesia	**1.8**	**2.7**	**0.9 ↑**
Malaysia	2.1	2.3	0.2 ↑
Iran	2.3	2.3	0.0 ↓
Germany	2.5	2.0	-0.5 ↓

Source: UN Comtrade

Chart 4.4. Development of Oil and Gas Trade Balance and Oil Prices

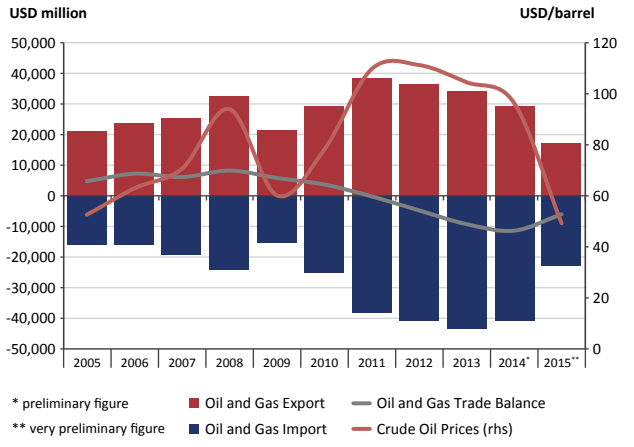


Chart 4.5. Services Account Development

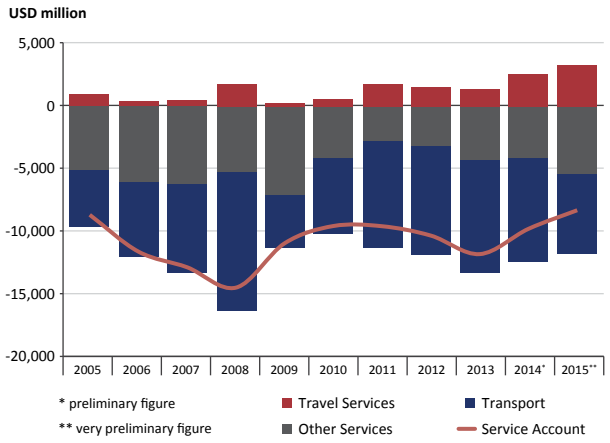
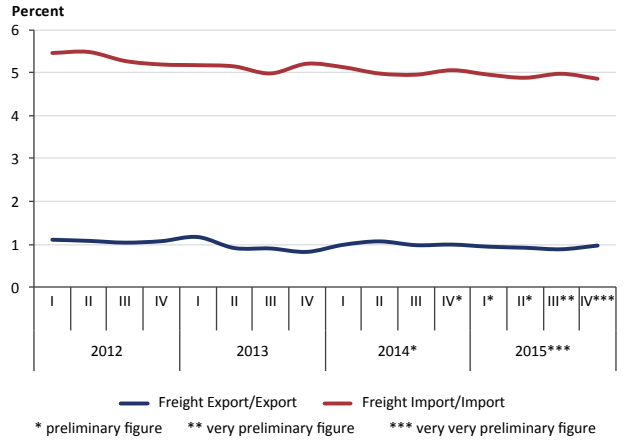


Chart 4.6. Freight Transportation Ratios



of goods (Chart 4.5). In addition, the services account was further bolstered by travel services receipts, which enjoyed a bump as visits by international travellers increased.

Government-led structural reform policy in the maritime sector still requires further honing in order to overcome the persistent services deficit, particularly freight services. The large and persistent deficit is symptomatic of extremely limited sea freight services using domestic vessels. Such conditions were further corroborated by the freight import to import ratio at around 5%, while the freight export to export ratio stood at just 1% (Chart 4.6).

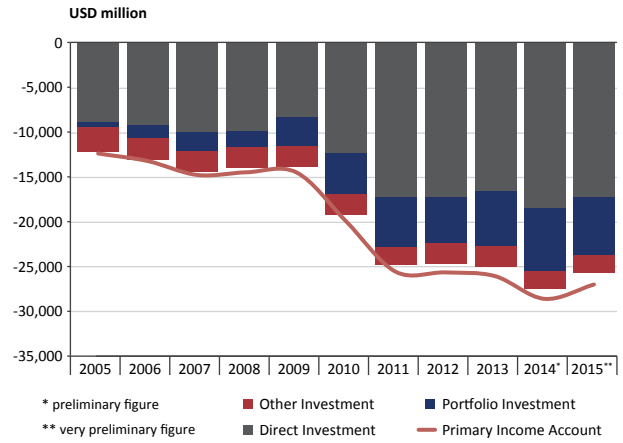
In terms of services, Indonesia remains an attractive tourist destination. Tourist visitors to the archipelago increased from 9.5 million in 2014 to 9.7 million in 2015. The increase, however, was not accompanied by a commensurate rise in tourist spending while visiting Indonesia due to U.S. dollar appreciation against the rupiah. Most foreign travellers visiting Indonesia originated from Singapore, Australia, Malaysia, Japan, and China, with Bali, Jakarta, and Batam cited as the favourite destinations. Consequently, travel services receipts in 2015 increased from USD10.3 billion the year earlier to USD10.7 billion.

Table 4.12. Non-Oil and Gas Imports by Groups of Goods

Items	Annual Growth (%, yoy)									
	2014*					2015**				
	I	II	III	IV	Total	I*	II*	III*	IV**	Total**
A. Consumption Goods										
Nominal	4.8	-8.8	-7.6	-10.3	-6.1	-8.8	-9.3	-14.9	-6.3	-9.9
Real	-2.6	-17.6	-14.5	-13.7	-13.1	-7.7	-7.1	-13.0	-6.1	-8.1
Price Index	7.6	10.7	8.0	3.9	8.1	-1.2	-2.4	-2.2	-0.3	-1.9
B. Raw Materials										
Nominal	-6.2	-4.8	-0.8	-1.7	-3.4	-1.7	-15.2	-17.7	-13.8	-12.3
Real	-1.7	-2.2	0.3	2.9	-0.8	5.2	-8.0	-10.3	-6.4	-4.4
Price Index	-4.7	-2.6	-1.0	-4.5	-2.7	-6.6	-7.9	-8.3	-8.0	-8.3
C. Capital Goods										
Nominal	-7.1	-0.8	-7.1	-4.0	-4.7	-8.7	-21.7	-20.6	-10.9	-15.6
Real	-17.7	-11.0	-19.8	-19.0	-15.5	-21.5	-32.8	-29.2	-15.7	-26.3
Price Index	12.8	11.6	15.8	18.5	12.8	16.3	16.5	12.2	5.7	14.5
Total										
Nominal	-5.6	-4.2	-2.9	-3.1	-3.9	-3.9	-16.3	-17.4	-11.4	-12.4
Real	-6.1	-6.9	-7.6	-6.3	-6.6	-4.7	-16.4	-16.4	-9.1	-11.9
Price Index	0.6	3.0	5.1	3.4	2.8	0.8	0.2	-1.1	-2.5	-0.5

* preliminary figure
** very preliminary figure

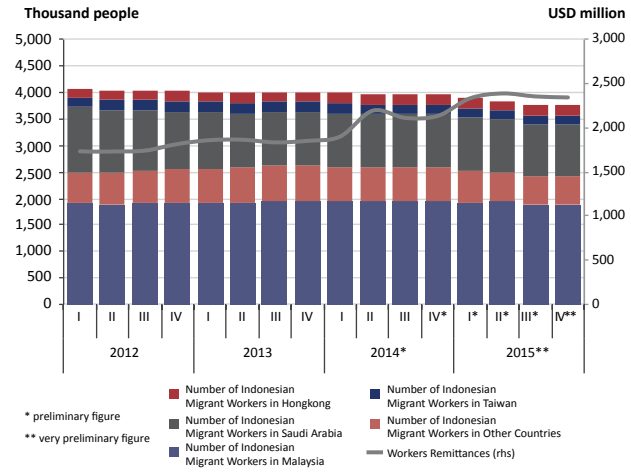
Chart 4.7. Development of Primary Income Account



The primary income account also improved, with the deficit narrowing from USD29.7 billion in 2014 to USD28.0 billion (Chart 4.7). The narrower deficit stemmed from a decline in the position of Foreign Financial Liabilities (FFL) as less non-resident investment entered Indonesia. Accordingly, a lower attribution of direct investment income was recorded in line with less direct investment activity in 2015. Further gains in the primary income account were stifled by an increase in interest payments on government bonds, consistent with the larger position of public portfolio investment liabilities.

Current account performance was also bolstered by a growing secondary income account surplus. In 2015, the secondary income account surplus stood at USD5.5 billion, up from USD5.2 billion the year earlier (Chart 4.8). An increase in remittances from Indonesian migrant workers

Chart 4.8. Number of Indonesian Migrant Workers and Worker's Remittance



(TKI) placed abroad from USD8.3 billion to USD9.4 billion shored up the secondary income account surplus due to a rise in the average TKI wage in a number of placement countries, including Hong Kong, South Korea, Taiwan, and Malaysia, despite a decline in the actual number of Indonesian migrant workers (TKI) from 3.9 to 3.7 million.

4.2. CAPITAL AND FINANCIAL ACCOUNT

Global economic moderation, uncertainty in global financial markets, and the domestic economic slowdown placed pressures on capital and financial account performance. Notwithstanding, the economic rebound late in the year served to boost the capital and financial account surplus significantly in 2015. Bureaucratic reforms and efforts to improve the investment climate garnered domestic investment. Positive domestic economic growth that even accelerated in the final quarter of 2015 successfully restored non-resident investor confidence in Indonesia and boosted direct investment. Growing uncertainty in global financial markets due to ambiguity surrounding the timing and magnitude of the proposed Federal Funds Rate (FFR) hike combined with yuan depreciation as China's economy slowed eroded non-resident capital inflows into portfolio investment instruments through to the third quarter of 2015. Nonetheless, the easing of FFR hike uncertainty, the momentum of domestic economy growth recovery in the second semester of 2015, and attractive investment returns reignited non-resident capital inflows to portfolio investment instruments in the fourth quarter of 2015. Furthermore, other investments, which experienced a deficit due to a deluge of capital outflow from the private sector in the first half of the year, recorded a surplus again in the second semester, thereby reducing a deeper deficit for the year in general. The net liability of non-resident investment in Indonesia in 2015 decreased in line with the smaller capital and financial account surplus. Such conditions were reflected in the declining net liability of Indonesia's International Investment Position (IIP).

Direct Investment

Non-resident direct investment (on the liabilities side) recorded a net inflow of USD18.7 billion as non-residents remained upbeat concerning the domestic economic outlook. Non-resident capital inflows to long-term investments were corroborated in the Business Survey conducted by Bank Indonesia in 2015, which indicated expansive domestic business activity throughout the year. Therefore, actual foreign direct investment (FDI) recorded

by the Indonesia Investment Coordinating Board (BKPM) increased 17.8% on the previous year. Nonetheless, relatively strong spillover pressures from global and domestic economic moderation reduced capital inflows on the previous year, totalling USD26.0 billion.

On the assets side, growing uncertainty in global financial markets, along with the global economic downswing, reduced resident investments abroad. In 2015, direct investment on the assets side fell from USD10.4 billion to USD9.4 billion, primarily affecting equity capital, while investments in debt instruments continued to rise. Consequently, direct investments in 2015 recorded a net surplus totalling USD9.3 billion, down from USD14.8 billion the year earlier. Congruously, the net liability of direct investments in Indonesia's International Investment Position (IIP) also declined from USD202.4 billion in 2014 to USD194.7 billion.

Based on country of origin, most foreign direct investment (FDI) flowed from Singapore, followed by Japan (Chart 4.9). The value of investment from the two countries amounted to USD12.1 billion in 2015, representing 84.2% of total FDI. On the other hand, ASEAN member countries were remain leading investors in Indonesia with a share of 61.3% of foreign direct investment (FDI), totalling USD8.8 billion.

By economic sector, the actual FDI in 2015 was concentrated in the manufacturing industry as well as the agricultural, fisheries, and forestry sector (Chart 4.10). The value of investment in the manufacturing industry was recorded at USD3.7 billion, with Singapore and Japan as the main investors. The agricultural, fisheries, and forestry sector, which has historically not been a favoured investment destination, followed a growing investment

Chart 4.9. Foreign Direct Investment by Major Investor Countries

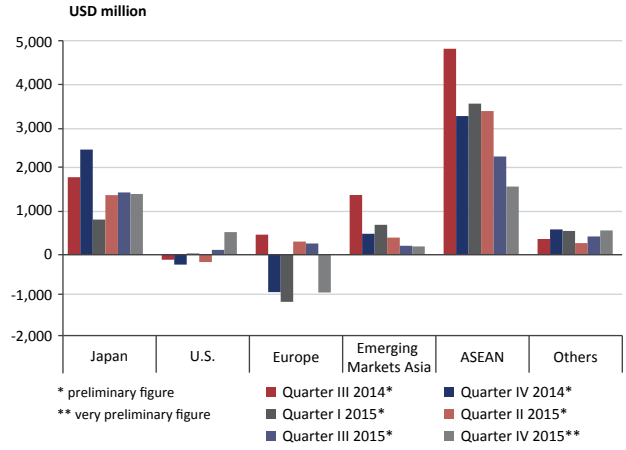
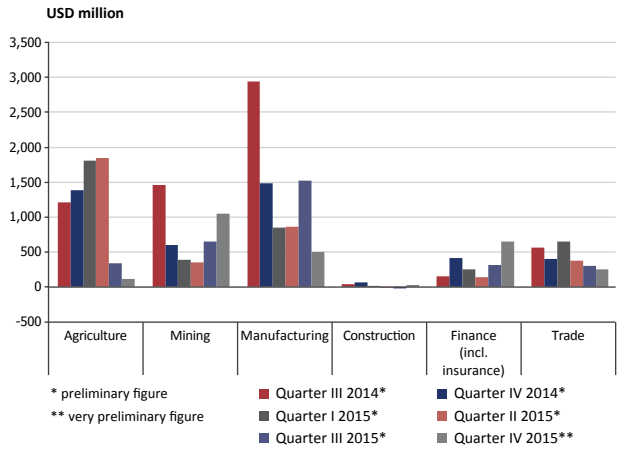


Chart 4.10. Foreign Direct Investment by Economic Sectors



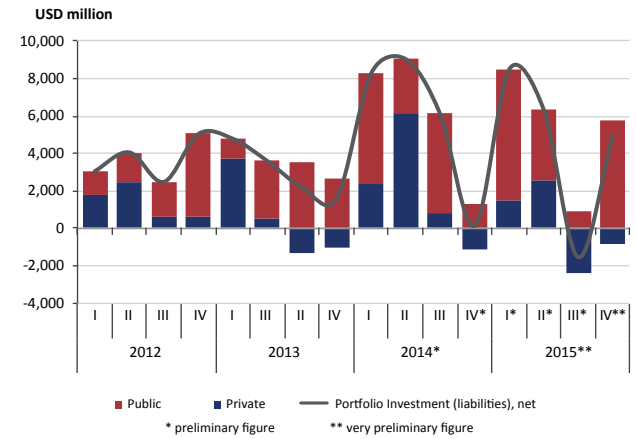
trend from 2013 to 2015. The value of investment in this sector totalled USD4.6 billion in 2015, with Singapore noted as the leading investor.

Based on distribution, Indonesia Investment Coordinating Board (BKPM) data shows that foreign direct investment (FDI) in 2015 was more equitably spread throughout the archipelago. The share of such investment outside of Java increased from 43.1% in 2014 to 45.6%, concentrated in East Kalimantan, West Kalimantan, North Sumatra, and Central Sulawesi. Based on economic corridor, however, most FDI outside of Java found its way to Kalimantan, Sumatra, Sulawesi, Maluku, Papua as well as Bali and Nusa Tenggara.

Portfolio Investment

Non-resident portfolio investment in Indonesia still recorded a surplus in 2015, totalling USD17.7 billion, for which the position gained momentum in the fourth quarter of 2015 (Chart 4.11). The surplus was, however, still lower than that recorded in the previous year, standing at USD23.5 billion. Global economic developments, including the global economic slowdown and potential speculation on the proposed FFR hike along with escalating global financial risks after the People's Bank of China (PBoC) devalued the yuan, precipitated more prudent investment activity in developing countries. Nevertheless, attractive returns and the favourable perception of non-resident investors in the economic outlook of Indonesia, coupled with stronger growth in the fourth quarter of 2015, boosted global investor interest in Indonesia towards the end of year. On the assets side, resident portfolio investments abroad recorded a deficit of USD1.0

Chart 4.11. Foreign Portfolio Investment in Indonesia



billion, consistent with the net buy of foreign portfolio instruments by residents.

Rupiah denominated portfolio instruments were the main contributor to portfolio investment inflows. Although lower than the previous year, non-resident inflows to rupiah government bonds (SUN) recorded a net inflow of USD7.7 billion. Meanwhile, foreign capital recorded a net outflow from Bank Indonesia Certificates (SBI) totalling USD0.1 billion, which was relatively unchanged from the previous year. Congruently, the position of non-resident rupiah SUN holdings surged from 41.6% at the end of 2014 to 42.9 at the end of 2015, while the position of non-resident SBI holdings fell from 2.1% to 0.0% over the same period. On the stock market, growing uncertainty in global financial markets over the FFR hike issue, which peaked in the third quarter of 2015, compelled non-resident investors to sell shares. Nonetheless, the net sell of shares by non-residents began to ease in the fourth quarter. Consequently, a net sell of just USD1.5 billion was reported for 2015 in general.

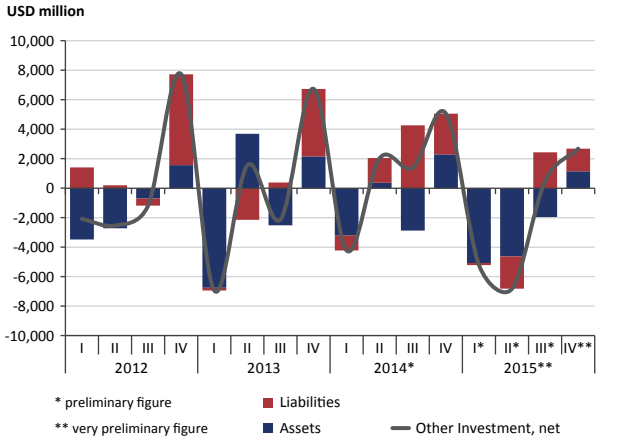
On the other hand, non-resident investors also expanded holdings of long-term government debt securities, including global bonds and sukuk. In 2015, the government issued global bonds to the tune of USD8.9 billion, consisting of global bonds (USD7.5 billion), euro bonds (€1.25 billion) in July 2015 and Samurai bonds (¥100 billion) in August 2015. In addition, the government also issued global Islamic bonds (sukuk) totalling USD2 billion in May 2015. Consequently, the net liability position of portfolio investment in Indonesia's International Investment Position (IIP) in 2015 totalled USD189.4 billion, down from USD192.7 billion the year earlier.

Other Investments

Other investment transactions experienced pressures in the first semester of 2015, when a significant deficit was recorded. In 2015, other investments posted a deficit of USD8.9 billion, contrasting the USD4.3 billion surplus registered in the previous year (Chart 4.12). The deficit primarily stemmed from a deficit of other Indonesian investments abroad (assets side), which expanded considerably from USD3.4 billion in 2014 to USD10.5 billion. Furthermore, the deficit was also contributed by a decline in the other investments surplus of non-residents in Indonesia (liabilities side) from USD7.7 billion to USD1.6 billion. Nonetheless, the other investments surplus began to recover in the third quarter and subsequently gained momentum in the fourth quarter on the assets and liabilities sides. Against this background, a deeper deficit of other investment transactions was avoided and the net liability of other investments in Indonesia's International Investment Position (IIP) fell from USD111.3 billion in 2014 to USD102.7 billion in 2015.

By institutional sector, the private sector contributed USD8.4 billion to the other investment deficit in 2015, reversing the USD8.5 billion surplus recorded the year earlier. The private sector deficit was primarily attributable to a larger deficit of resident asset placements abroad, which more than tripled from USD3.4 billion in 2014 to USD10.5 billion, mainly in the form of private sector deposits held at banks abroad. In addition to the increase in assets, the private sector other investment deficit also stemmed from a significantly smaller surplus on the liabilities side, decreasing from USD11.9 billion to USD2.1 billion as less non-affiliate private external debt was withdrawn in line with domestic economic moderation.

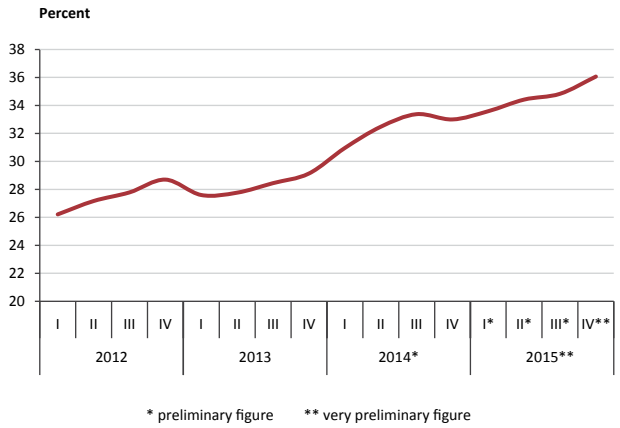
Chart 4.12. Development of Other Investment



Furthermore, a decline in non-resident deposits held at domestic banks also eroded the surplus on the liabilities side.

A deeper other investment deficit was avoided by corresponding improvements in the public sector. Accordingly, other investments of the public sector in 2015 recorded a deficit of USD0.5 billion, improving from a deficit of USD4.2 billion the year earlier. The improvement came from an increase in withdrawals of foreign loans by the government to offset the fiscal deficit. Withdrawals of foreign loans by the government increased from USD4.0 billion to USD4.8 billion, the majority of which was in the form of program loans. Meanwhile, government external debt repayments actually decreased slightly from USD5.3 billion to USD4.9 billion in 2015.

Chart 4.13. Ratio of External Debt to GDP



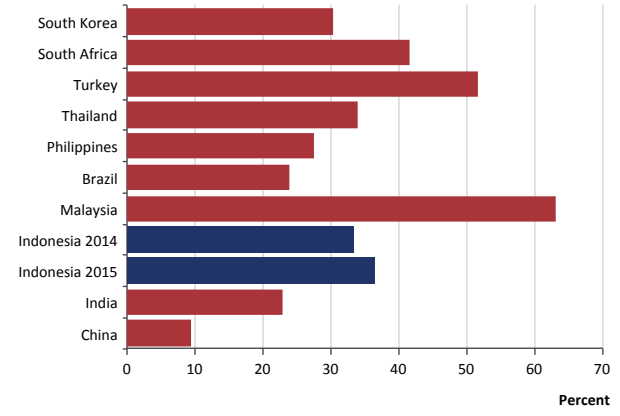
External Debt

Based on the original maturity profile, the external debt in Indonesia increased during 2015 due to long-term external debt in both the private and public sectors. Conversely, the position of short-term external debt declined in the private and public sectors as the domestic economy cooled. The structure of external debt was sound, with long-term debt dominating short-term debt in both the private and public sectors. In general, the external debt increased from USD293.8 billion in 2014 to USD310.7 billion. Congruous with the increase of external debt accompanied by slower GDP growth, the ratio of external debt to GDP was observed to rise from 33.0% to 36.1% over the same period but remained relatively sound and comparable to other peer group countries (Chart 4.13 and Chart 4.14). In addition, Indonesia's external debt growth slowed from 10.4% in 2014 to just 5.8% in 2015 due to the domestic economic slowdown.

The private sector continued to dominate external debt in 2015 with a share of 54.0% of the total, the majority of which was long-term (72.5% of total private external debt). The private external debt at the end of 2015 was USD167.7 billion, up from USD164.0 billion the year earlier due to an increase in long-term debt. Growth of private external debt slowed significantly, however, from 15.1% in 2014 to 2.2% due to fewer loan agreements and debt securities as the need for funding eased in line with economic moderation.

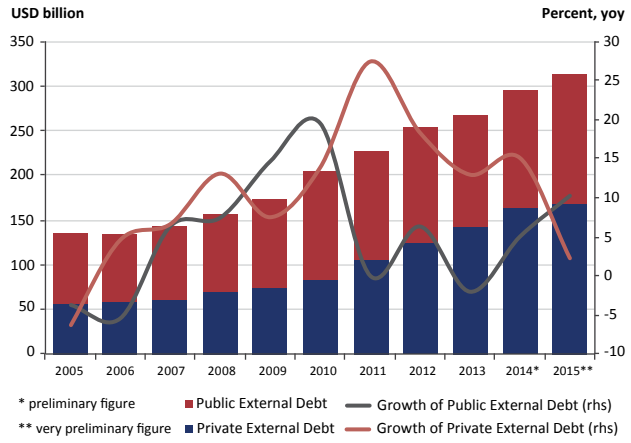
Conversely, the growth of public external debt, accounting for 46.0% of the total, accelerated from 5.0% in 2014 to 10.2% due to an increase in long-term debt (93.4% of total public external debt) as the Government sought to accelerate economic development. Congruently, the position of public external debt increased from USD129.7 billion in 2014 to USD143.0 billion (Chart 4.15). The increase stemmed primarily from larger non-resident holdings of government bonds as the deluge of foreign capital inflows in the form of portfolio investment were maintained and the government issued more global bonds and sukuk. The government external debt in the form of government bonds surged 19.5% on the previous year. Meanwhile, the need to fund the state budget deficit and infrastructure projects compelled the government to withdraw more foreign loans than in 2014. Consequently, public external debt in the form of loan agreements experienced a moderate 0.6% bump on the previous year from USD53.9 billion to USD54.2 billion.

Chart 4.14. Ratio of External Debt to GDP of Peer Group Countries



Source: World Bank (2014)

Chart 4.15. External Debt Growth by Group of Borrowers



Based on the remaining maturity profile, slower growth of external debt was caused by weaker growth of long-term external debt coupled with a decline in the short-term external debt (Chart 4.16). Growth of long-term external debt at the end of 2015 decelerated from 11.8% to 8.8%, while growth of short-term external debt contracted by 6.3%, reversing the positive 5.3% recorded in 2014. Consequently, the structure of external debt in Indonesia was considered heathier as long-term debt became more dominant in both the private and public sectors. The ratio of short to long-term external debt improved in 2015 from 25.3% the year earlier to 21.8%. Based on the group of borrowers, both the private and public sectors contributed to gains in the ratio. In terms of the public sector, the ratio of short to long-term external debt improved from 8.7% to 7.0%, while in the private sector the ratio improved from 42.5% to 38.0%.

Based on the risk profile, long-term external debt with a lower risk profile tended to dominate the private external debt. Furthermore, the outstanding of private external debt originating from affiliates was also fairly dominant, which is generally considered safer because the loan originates from a parent company, thereby guaranteeing the debt. In December 2015, the outstanding of long-term private external debt amounted for 77.7% of the total private external debt. Private external debt originating from an affiliate (short and long-term) stood at USD50.1 billion in 2015, accounting for 33.7% of the total.

The largest private external debt risk profile was associated with short-term non-affiliate nonbank debt but the portion of such debt in 2015 remained relatively small. In December 2015, the position of short-term non-affiliate nonbank corporate external debt stood at USD16.4 billion, accounting for just 9.8% of total private external debt and only 5.3% of total external debt (Chart 4.17). To mitigate the various risks linked to (nonbank corporation) external debt, including currency risk, liquidity risk, and overleverage risk, Bank Indonesia issued Bank Indonesia Regulation (PBI) No. 16/21/PBI/2014 concerning the Implementation of Prudential Principles in Managing External Debt of Nonbank Corporation. Furthermore, to monitor implementation, Bank Indonesia also subsequently released Bank Indonesia Regulation (PBI) No. 16/22/PBI/2014 regarding the Reporting of Foreign Exchange Flows and Reporting the Implementation of Prudential Principles in Managing External Debt Nonbank Corporation. Consequently, every indebted nonbank corporation with foreign loans operating in Indonesia is required to hedge at a certain ratio. Such corporations are also required to maintain adequate foreign currency assets to cover their corresponding maturing foreign currency

Chart 4.16. External Debt Position by Remaining Maturity

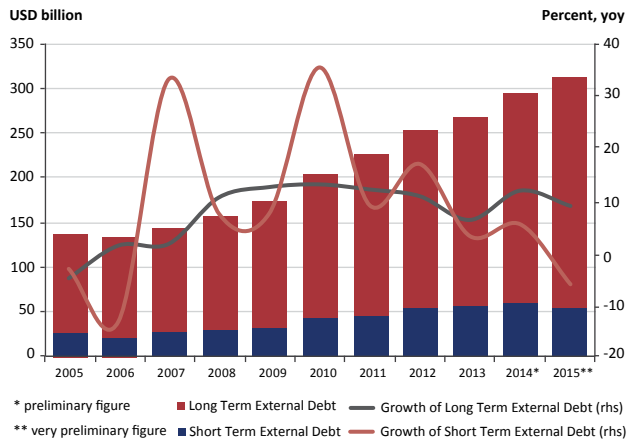
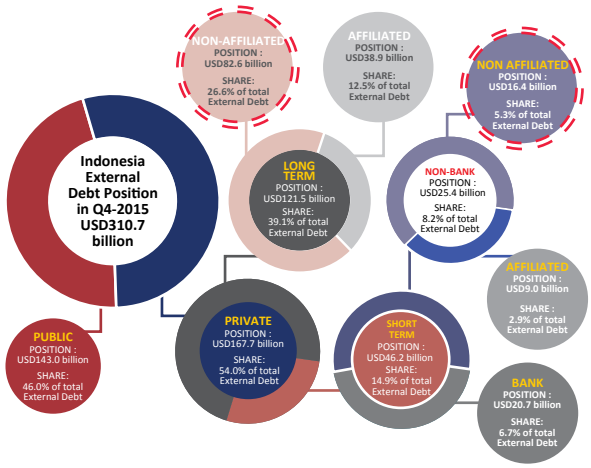


Chart 4.17. Composition of Indonesia External Debt *



*External Debt Position by Remaining Maturity

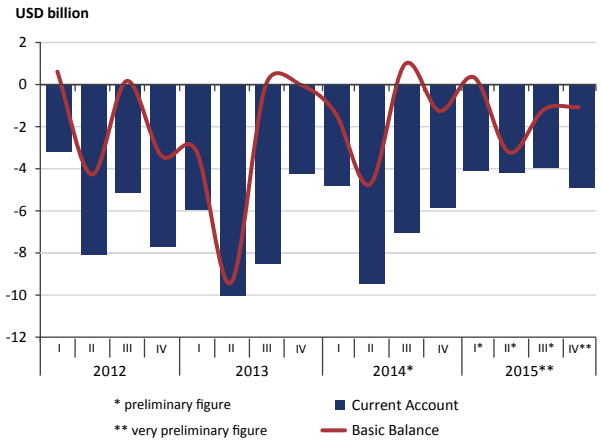
liabilities at a specific ratio, while meeting minimum rating requirements pursuant to prevailing regulations. As of the end of 2015, the implementation of the Bank Indonesia Regulation (PBI) showed an improvement on the nonbank corporations application of prudential principles, thereby successfully mitigating the risks associated with the external debt.[2]

4.3. EXTERNAL SUSTAINABILITY

In general, external sustainability indicators were sound in 2015. Sources of long-term financing to manage the current account deficit improved in line with the capital and financial account surplus as well as a smaller current account deficit. Consequently, the basic balance (Chart 4.18), which deteriorated in the second quarter of 2015, rebounded in the final two periods of the year.

In terms of solvency, a smaller portion of net liabilities in Indonesia's International Investment Position (IIP) to GDP evidenced gains. Other solvency indicators, however, demonstrated mounting pressures on external sector performance in Indonesia compared to the year earlier, albeit remaining at normal levels, due to domestic economic moderation combined with a decline in sources of foreign exchange receipts in the current account on the balance of payments to service external debt through to the third quarter of 2015. External sector pressures also originated from declining non-debt creating inflows as a relatively secure source of financing. After the economy rebounded in the third quarter of 2015, several solvency indicators also started to recover at the end of the year.

Chart 4.18. BOP Basic Balance



2 An in-depth discussion is presented in Box 4.1.

Regarding liquidity, external pressures on Indonesia's economy remained at normal levels. At the end of 2015, the amount of official reserve assets stood at USD105.9 billion, falling from USD111.9 billion the year earlier. Nonetheless, recent trends in the fourth quarter of 2015 indicated incremental growth in the position of foreign exchange reserves in line with accelerating domestic economic growth (Table 4.14). In addition, the position of reserve assets was equivalent to 7.7 months of imports or 7.4 months of imports and servicing short-term government external debt, which is well above international adequacy standards of three months (Chart 4.19). Moreover, the capacity of the reserve assets to meet the monetary system requirements of the domestic private sector was also relatively sound, reflected on a stable ratio of reserve assets to money supply. The increase in the position of foreign exchange reserves, coupled with the decline of short-term external debt, in the fourth quarter of 2015 boosted liquidity indicators towards the end of the year.

The Tier 1 Debt Service Ratio (DSR) (World Bank methodology) remained within norms in 2015 despite jumping from 23.1% to 29.1%.[3] The increase primarily stemmed from fewer current account receipts in 2015. In order to follow prudential principles, Bank Indonesia also used a more conservative methodology to calculate the Tier 2 Debt Service Ratio (DSR) by including trade credit to non-residents.[4] Based on risk, trade credit, which accounts for a relatively large share in the calculation of Tier 2 DSR, has a comparatively low risk profile. When calculated using the aforementioned methodology, Tier 2 DSR in 2015 exceeded Tier 1 DSR, increasing from 51.7% the year earlier to 61.7%. The private sector contributed to the increase in the debt service ratio (DSR) (Chart 4.20). Prudential principles were applied in conjunction with efforts to mitigate the risk of private sector default through constant monitoring of PBI implementation concerning the Implementation of Prudential Principles in Managing External Debt of Nonbank Corporation.

3 The Tier 1 Debt Service Ratio (DSR) represents a calculation methodology of the World Bank. Accordingly, Tier 1 DSR is the ratio of total external debt repayments (principal and interest) to current account receipts, where total external debt repayments include long-term external debt principal payments and total long and short-term external debt interest payments.

4 The Tier 2 Debt Service Ratio (DSR) is a calculation methodology of the World Bank that includes short-term loans and trade credit in order to more prudently managing external debt. The Tier 2 Debt Service Ratio (DSR) is defined as the ratio of total external debt repayments (principal and interest) to current account receipts, where total external debt repayments include external debt principal and interest payments in the form of direct investments, excluding those from subsidiaries operating internationally, as well as loans and trade credit to non-affiliates.

Table 4.13. External Solvency Indicators

	Indicator	Description	2010	2011	2012	2013	2014*	2015**
Solvency Ratio								
1.	Indonesia's Net IIP / GDP	The ratio used to measure share of IIP to whole domestic economy	38.2	35.3	36.4	35.9	44.3	44.2
2.	External Debt / GDP	The ratio of external debt role to finance domestic economy	26.5	25.0	27.4	29.1	33.0	36.1
3.	External Debt / Goods and Services Exports	The ratio used to measure share of external debt to income from goods and services exports.	121.5	105.8	119.6	129.8	147.8	182.5
4.	Net External Debt[1] / Current Account Receipts[2]	The ratio used to measure capability of current account income in servicing external debt net.	35.5	31.2	36.8	49.6	57.2	71.7
5.	Net Direct Investment Liabilities / GDP	The ratio used to measure direct investment role to domestic economy	22.7	22.1	21.5	21.9	26.9	27.5
6.	Non-debt creating inflow / GDP	The ratio used to measure non-debt capital inflows role to domestic economy finance	34.4	32.0	32.5	30.4	38.4	37.3

[1] Total of Goods and Services Exports Income and primary and secondary income
[2] The difference between the debt component on KFLN side and AFLM side in IIP Indonesia
* preliminary figure
** very preliminary figure

Therefore, to ensure the optimal contribution of nonbank corporations to the economy without triggering domestic economic instability, nonbank corporations are now required to: (i) mitigate risks associated with external debt activities; and (ii) pay due regards to general business management practices.

Table 4.14. External Liquidity Indicators

	Indicator	Description	2010	2011	2012	2013	2014*	2015**
Liquidity Ratio								
1.	Foreign Exchange Reserves / Imports of Goods and Services	Indicators used for measuring the adequacy of foreign exchange reserves in servicing the needs of goods and services imports	66.2	58.3	53.0	47.0	55.4	64.0
2.	Foreign Exchange Reserves / Broad Money (M2)	Indicators used to measure the potential impact of the decline in confidence against domestic currency	35.4	33.3	31.9	27.8	31.8	31.2
3.	Foreign Exchange Reserves / Short-Term Foreign Debt (remaining maturity)	Indicators used for measuring the adequacy of foreign exchange reserves in servicing short-term foreign debt based on remaining time period	224.2	235.5	206.4	176.6	188.8	190.7

* preliminary figure
** very preliminary figure

Chart 4.19. Foreign Exchange Reserves Development

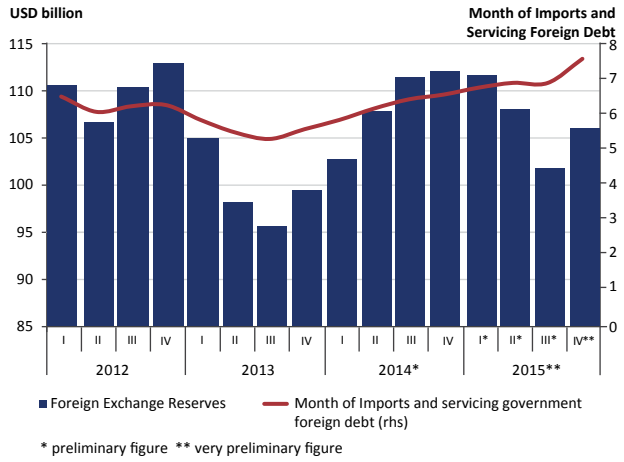
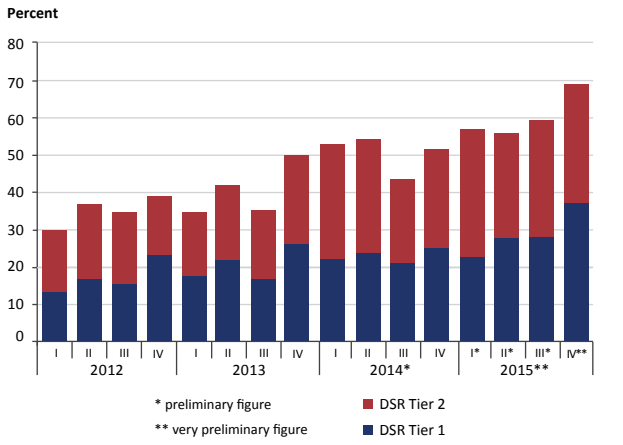


Chart 4.20. Indonesia's Debt Service Ratio



Box 4.1 Assessment on the Implementation of Prudential Principles in Managing External Debt of Nonbank Corporation

The application of prudential principles (KPPK) involves nonbank corporation activity to mitigate currency risk, liquidity risk, and overleverage risk linked to the external debt held. Such activities are regulated pursuant to Bank Indonesia Regulation (PBI) No. 16/21/PBI/2014 concerning the Implementation of Prudential Principles in Managing External Debt of Nonbank Corporation. According to the regulation, nonbank corporations are required to calculate their foreign currency assets and liabilities from period 0 up to three months and from three months to six months from the end of the reporting quarter. In 2015, therefore, nonbank corporations were required to apply prudential principles based on an assessment of foreign currency assets and liabilities for the two aforementioned periods, by maintaining:

1. A minimum hedging ratio of 20% of the difference between foreign currency assets and foreign currency liabilities that will mature within three months and from three to six months after the end of the reporting quarter. The minimum hedging ratio must be met by all nonbank corporations with a value of foreign currency assets below the value of foreign currency liabilities that will mature within three months and from three to six months after the end of the reporting quarter; and

2. A minimum liquidity ratio of 50%. Therefore, corporations are required to maintain foreign currency assets with a value of at least 50% of the value of foreign currency liabilities that will mature within three months of the reporting quarter.

Nonbank corporations were required to begin submitting a KPPK report to Bank Indonesia in the first quarter of 2015, during the transition period. Thereafter, KPPK reporting became mandatory starting the third quarter of 2015 financial report, with sanctions imposed on those nonbank corporations failing to comply. Meanwhile, sanctions for failure to adhere to the KPPK provisions became effective for foreign currency asset and liability data in the fourth quarter of 2015.

Moving forward, Bank Indonesia will continue to strengthen external debt management in order to provide an optimal contribution to the national economy. Commencing in 2016, the application of prudential principles will require nonbank corporations holding external debt to:

1. Maintain a minimum hedging ratio of 25%;

2. Maintain a minimum liquidity ratio of 70%; and

3. Maintain a minimum credit rating. Nonbank corporations seeking to withdraw foreign currency loans, commencing 1st January 2016, shall be required to comply with a minimum credit rating equivalent to BB- as affirmed by a rating agency approved by Bank Indonesia.

In the following year, on 1st January 2017, hedging transactions in compliance with KPPK shall mandatorily be conducted with banks operating in Indonesia. The policy aims to deepen the domestic foreign exchange market.

An Assessment of KPPK Implementation through to the Third Quarter of 2015

The number of nonbank corporations reporting KPPK has increased in each reporting period. Based on the third quarter of 2015 data, the number of nonbank corporation that held external debt reached 2,543 corporations. Eighty five percent of these corporations had reported their obligation of KPPK, an improvement from 70% in the previous quarter. The corporations' compliance on the KPPK regulation also increased. Regarding the minimum hedging ratio, nonbank corporations hedged 192% of the required value for the upcoming 0-3 months, increasing from 105% in the previous quarter (Chart 1).

Chart 1. Hedging Value to Hedging Liabilities for 0-3 Months Periods

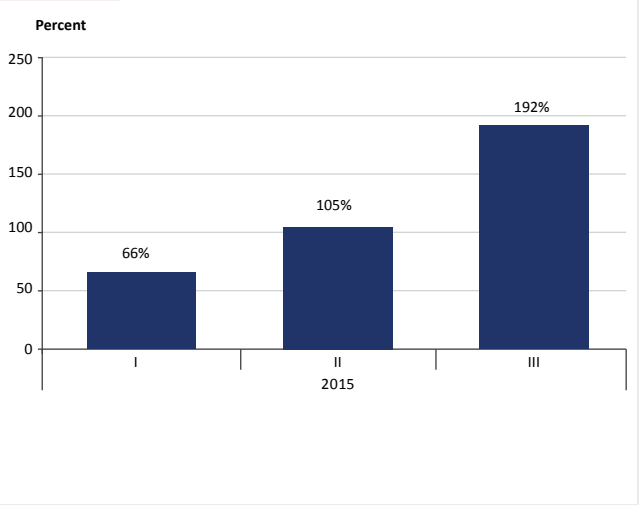


Chart 2. Hedging Value to Hedging Liabilities for 3-6 Months Periods

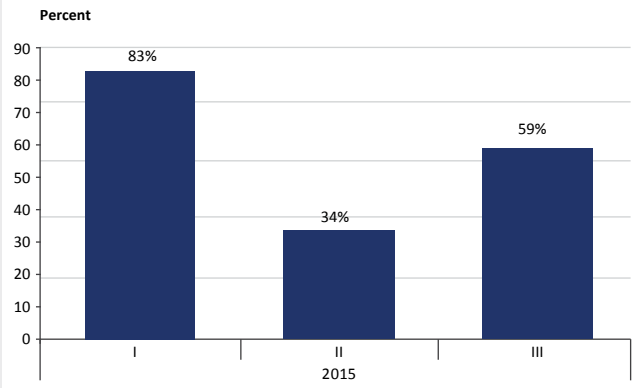
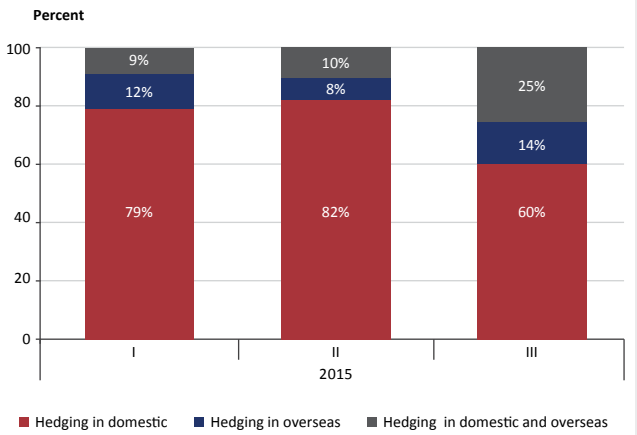


Chart 4. Hedging Distribution for 0-3 Months Periods



In terms of complying with the minimum hedging ratio for the upcoming 3-6 months, nonbank corporations hedged 59% of the total required, up from 34% in the second quarter of 2015 (Chart 2). Concerning the liquidity ratio, 83% of nonbank corporations had successfully complied with the ratio, up from 82% in June 2015 (Chart 3). Greater KPPK compliance was consistent with the number of corporations engaged in hedging activities (Chart 4 and 5), the majority of which was conducted with domestic banks.

KPPK provisions, which became effective in 2015, have been successful in managing foreign currency demand from nonbank corporations, thereby dissipating pressures on the rupiah. In addition, the implementation of prudential principles has increased the proportion of derivative transactions to 35% of total corporate foreign currency transactions, up from 33% in 2014. Looking forward, more derivatives activities by domestic corporations is expected to drive domestic foreign exchange market deepening efforts.

Chart 3. Rapporteurs of Borrowing Activity Based on Prudential Principle According to the Compliance of Liquidity Ratio Fulfillment

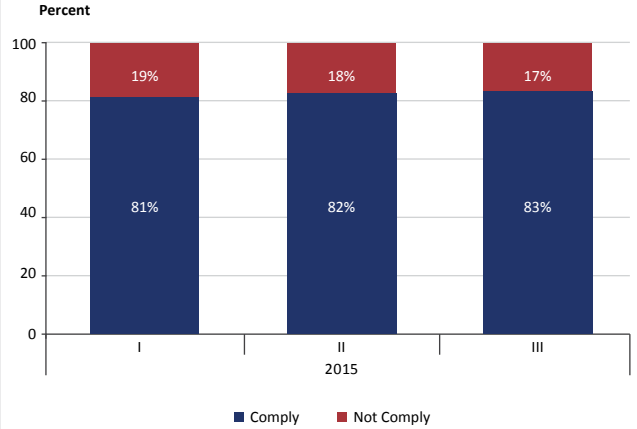
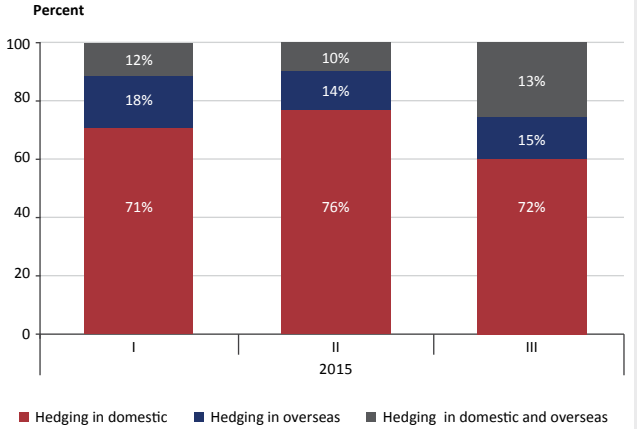


Chart 5. Hedging Distribution for 3-6 Months Periods



An overarching focus of Bank Indonesia's policy mix is to maintain rupiah stability, reflected in its value against other currencies. In 2015, rupiah stability confronted the arduous challenges of domestic and external pressures.

Chapter 5

Exchange Rate

In 2015, the rupiah was subjected to intense depreciatory pressures stemming primarily from external pressures. The main external sources of exchange rate pressures were linked to the U.S. monetary policy normalization, the debt crisis in Greece, yuan devaluation, and the global monetary policy divergence. Meanwhile on the domestic front, pressures originated from the domestic economic slowdown. Depreciatory pressures on the rupiah were prevalent from the first until third quarter of the year, peaking in September 2015. The rupiah subsequently entered a more stable period after Bank Indonesia, the Government, and the Financial Services Authority (OJK) announced a series of stabilization policies and uncertainty eased on global financial markets in relation to the timing of the Federal Funds Rate (FFR) hike.

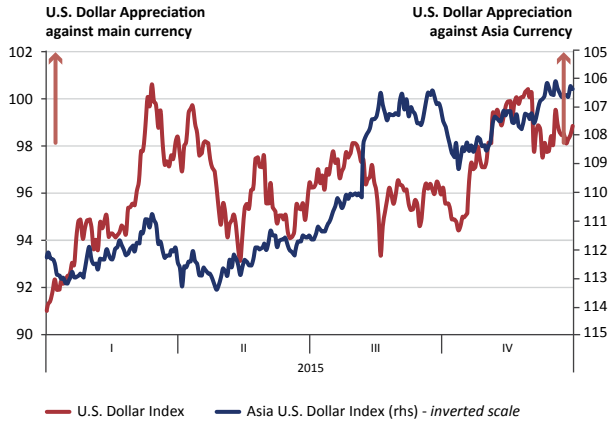
Rupiah stability encountered a variety of escalating risks throughout 2015, mostly external. Uncertainty surrounding the timing of FFR hike as a part of U.S. monetary policy normalization, the Greek debt crisis, unexpected yuan devaluation, and global monetary policy divergence were cited as the primary external factors affecting the rupiah movement. The ubiquitous uncertainty exacerbated volatility on global financial markets and affected negatively on non-resident capital inflows to financial assets in emerging economies, including Indonesia. Against a backdrop of widespread global uncertainties, rupiah exchange rates were further pressured by domestic economic moderation that had spilled over in part from the global economy. In addition, dwindling Indonesia's exports performance undermined the supply of foreign exchange, thus further compounding rupiah performance.

Intensifying domestic and external risks caused the rupiah depreciation more in 2015 than the year earlier. The rupiah depreciated 10.2% (yoy) in 2015 compared to 1.7% (yoy) in 2014. Furthermore, rupiah volatility increased from 10.2% to 11.1%. Notwithstanding the challenges, a synergy of monetary policy and structural reforms instituted by Bank Indonesia, the Government, and the Financial Services Authority (OJK), primarily from September 2015, helped to stabilize the rupiah through to the end of 2015. In the fourth quarter of 2015, the rupiah finally rebounded against the U.S. dollar as well as the currencies of peer countries.

Exchange rate pressures were also felt in other emerging countries due to intense external risk factors. Pressures in emerging countries were further exacerbated by monetary policy divergence in advanced economy countries that supported USD appreciation. On the one hand, loose monetary policy adopted by the European Central Bank (ECB), People's Bank of China (PBoC), and Bank of Japan (BoJ) led to euro, yuan, and yen depreciation correspondingly. On the other hand, however, the Federal Reserve was seeking to normalize its monetary policy stance. Such monetary policy divergence sparked broad U.S. dollar appreciation against the majority of global currencies. Consequently, the USD index appreciated from 90.3 in 2014 to 98.6 in 2015 (Chart 5.1). Therefore, depreciatory pressures on the currencies of emerging countries against the USD were unavoidable.

Rupiah depreciation loomed large from the first until the third quarter of 2015, before entering a more stable period in the final quarter of the year. Depreciatory pressures on the rupiah surfaced in the third week of January 2015 with rupiah volatility recorded at 10.5% in

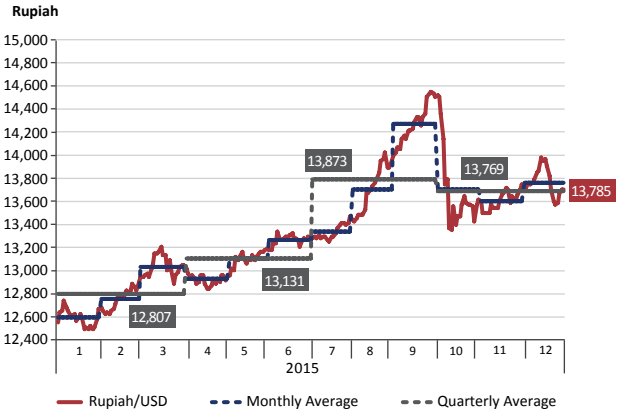
Chart 5.1. U.S. Dollar Development Index



Source: Bloomberg, processed

the first quarter of 2015, which subsequently eased to 5.7% in the following quarter. External shocks intensified, however, in the third quarter, primarily attributable to unexpected yuan devaluation by PBoC and uncertainty over the proposed FFR hike in the U.S., which pushed the rupiah to its lowest level (Rp14,698 per USD) (Chart 5.2). PBoC devalued the yuan in order to liberalize its exchange rate framework to be more market determined. The move came at a time of economic moderation, however, coupled with economic rebalancing to strengthen domestic consumption, which prompted uncertainty concerning the direction of economic policy in China. Furthermore, the turmoil in China occurred during an episode of widespread uncertainty surrounding the timing and magnitude of U.S. monetary policy normalization, thereby amplifying pressures on financial markets and exchange rates.

Chart 5.2. Rupiah Exchange Rate



As a response to mounting exchange rate pressure in the third quarter of 2015, Bank Indonesia, the Government, and OJK released a series of synergic stabilization policies, encompassing structural reforms, prudent monetary policy, various exchange rate stabilization measures, domestic foreign exchange market structure strengthening, and a series of economic policy packages.[1] The stabilization measures introduced by Bank Indonesia followed three strategic pillars. In this context, Bank Indonesia strived to maintain currency stability through measured intervention on the foreign exchange market, while maintaining the adequacy of reserve assets, and also improved regulations concerning foreign currency transactions against the rupiah. In addition, Bank Indonesia strengthened monetary operations to manage liquidity in the banking system and anchored market expectations. Bank Indonesia also monitored domestic foreign exchange market transactions for unusual activity and minimized speculative activity. In terms of financial market deepening, a number of regulations were amended to boost foreign currency supply and minimize speculation.

In the fourth quarter 2015, exchange rate stability returned and foreign capital flowed back into the country as external risk factors eased due to greater clarity regarding the direction of U.S. normalization policy after the FOMC meeting in December 2015. The rupiah stabilized and non-resident capital inflows returned until the end of the year. Non-resident investors had anticipated that the U.S. benchmark rate would rise gradually, thus limiting the impact on the domestic financial market volatility. Foreign investors sought to buy government bonds on rising yields in Indonesia that were more attractive than government bonds in other peer countries, which was further bolstered by rupiah stabilization measures taken by Bank Indonesia, the Government, and OJK as well as the favourable market perception concerning the promising domestic economic outlook.

In 2015, policy synergy successfully controlled rupiah volatility and depreciation compared to conditions in peer countries. The rupiah rebounded in October 2015 as foreign capital flowed back into the country during the fourth quarter. Furthermore, domestic risk factors eased, reflecting an improvement in credit default swaps (CDS) to a level of 230 after sinking to 282 at the end of September 2015. Consequently, rupiah depreciation was more limited (-10.2%) than the Brazilian real (-32.9%), South African rand (-26%), Turkish lira (-20.4%), and Malaysian ringgit (-18.6%). Congruously, the position of official reserve assets in Indonesia fell just USD5.9 billion, or 5.3%, in 2015, a more moderate decrease than observed in other countries such as Malaysia, Turkey, México, South Africa, and Russia that dropped respectively by 19%, 10%, 9%, 8%, and 6%.

5.1. EXCHANGE RATE DYNAMICS

Rupiah exchange rates were particularly dynamic in 2015. On average, the rupiah depreciated 11.3% from Rp11,876 per USD in 2014 to Rp13,392 per USD in 2015, compared to just 1.7% depreciation recorded in 2014. In general, the rupiah followed a depreciating trend from the first three quarters of the year, with depreciatory pressures escalating in the third quarter. Thereafter, however, the rupiah began to stabilize in the fourth quarter of 2015 as uncertainty eased on global financial markets. Non-resident capital subsequently began to flow back into the country and investor expectations in the domestic economic outlook were buoyed by the release of stabilization measures by Bank Indonesia, accompanied by a series of structural policies issued by the Government (Chart 5.3).

During the first two quarters of 2015, rupiah depreciation was kept relatively under control. Accordingly, the rupiah recorded limited depreciation of 5.3% (qtq) in the first quarter of 2015 to a level of Rp13,074 per USD before easing to just 1.9% (qtq) in the subsequent period to a level of Rp13,333 per USD. Exchange rate pressures in the first two quarters of 2015 primarily originated from broad USD appreciation against global currencies. A stronger USD index was consistent with ongoing U.S. economic improvements that strengthened the preconditions required to tighten U.S. monetary policy, additional stimuli introduced by the European Central Bank (ECB), and the deadlocked fiscal negotiations in Greece. Nonetheless, the aforementioned risk factors were thereupon offset by a number of positive domestic and international developments that prevented further rupiah depreciation. On the domestic side, the trade balance recorded a growing surplus and the outlook rating was revised upwards by Standard and Poor's from stable to positive in May 2015. On the external side, a more dovish statement in FOMC June 2015, allaying concerns over the proposed FFR hike by the Federal Reserve.

In the third quarter of 2015, however, pressures intensified on the rupiah, driving the currency down to its lowest ebb in 2015. Pressures predominantly stemmed from external factors due to unexpected yuan devaluation policy in China combined with widespread uncertainty surrounding the

1 A more detailed explanation of the policies instituted to maintain exchange rate stability is presented in Chapter 11.

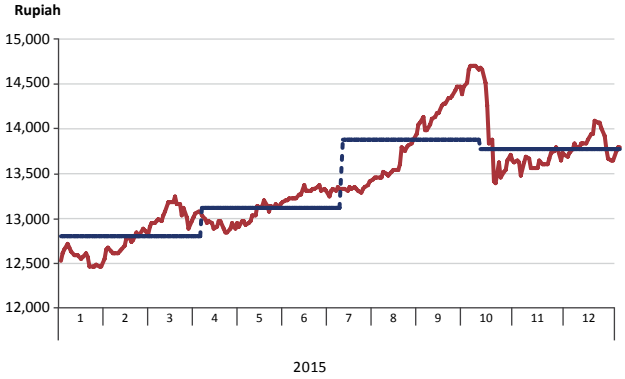
Chart 5.3. Event Analysis of Rupiah Exchange Rate

Quarter I 2015
- **Average Rp12,807/USD (depreciation 4.4% qtq)**
- **End-of-Period Rp13,074/USD (depreciation 5.3% qtq)**
- **Volatility 10.5%**

Depreciation pressure increases in line with increasing global uncertainty, among others sourced from: worries increase in the Federal Funds Rate (FFR) which triggers a strengthening U.S. dollar and concerns over the Greek debt negotiations that corrects risk appetite of global investors towards domestic assets.

Quarter II 2015
- **Average Rp13,131/USD (depreciation 2.5% qtq)**
- **End-of-Period Rp.13,333/USD (depreciation 1.9% qtq)**
- **Volatility 5.7%**

Rupiah depreciated by more mild pressure, but still higher than the historical average. A source of pressure comes from the domestic economic slowdown and the continuing strengthening of dollar index (DXY), which is supported by additional QE by the ECB in the middle of high concerns about the plan to increase the FFR by the U.S.



Quarter III 2015
- **Average Rp13,873/USD (depreciation 5.3% qtq)**
- **End-of-Period Rp14,650/USD (depreciation 9% qtq)**
- **Volatility 11.5%**

In Quarter III-15 downward pressure is increasing in line with peers currency depreciation. Sources of pressure came mainly from external dynamics related to the FFR increased planned by the Fed post improvement in U.S. GDP QII-15, as well as the implementation of yuan devaluation that cause volatility in global financial markets. From home front, pressure comes from the prospect of slowing domestic economic growth.

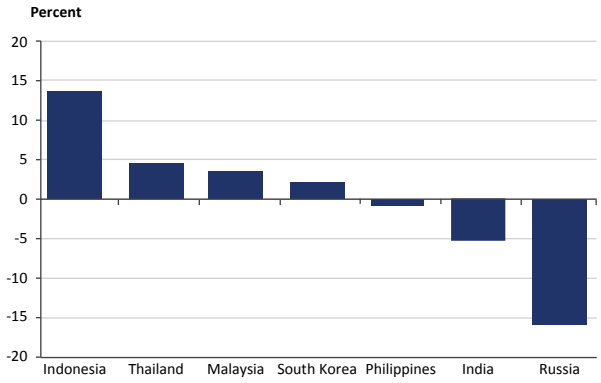
Quarter IV 2015
- **Average Rp13,769/USD (appreciation 0.8% qtq)**
- **End-of-Period Rp13,785/USD (appreciation 6.3% qtq)**
- **Volatility 16.9%**

Rupiah appreciated in Quarter IV-15 triggered by improvedsentiment towards emerging economies after the dovish FOMC Sept-15 andthe release of U.S. employment data is lower. The uncertainty about when FFR rise has also been wane. Meanwhile, from domestic, optimism overgovernment policy package raises optimism over the domestic economy.

normalization of U.S. monetary policy. Domestically, slower economic expansion affected negatively on exchange rate performance, which prompted a fall in non-resident holdings of domestic financial assets and hurt the rupiah further. Consequently, the rupiah depreciated 9% (qtq) to a level of Rp14,650 per USD in the third quarter of 2015 from just 1.9% (qtq) in the previous period. Furthermore, rupiah depreciation expectations increased, indicated by the average difference between the one-month non-deliverable forwards (NDF) and spot rate, which widened from 104 points to 168 points in the second quarter of 2015.[2]

Notwithstanding, the rupiah entered a period of relative stable in the fourth quarter of 2015 as non-resident capital flowed back into domestic assets. The deluge of foreign capital flows, primarily to government bonds, was triggered by more competitive yields than in peer countries (Chart 5.4). Furthermore, foreign capital inflows were maintained by investor confidence after Bank Indonesia, the Government, and OJK announced a series of stabilization policies. Consequently, non-resident capital inflows surged to USD2.27 billion in the fourth

Chart 5.4. Treasury Bond Investment Returns Quarter IV 2015



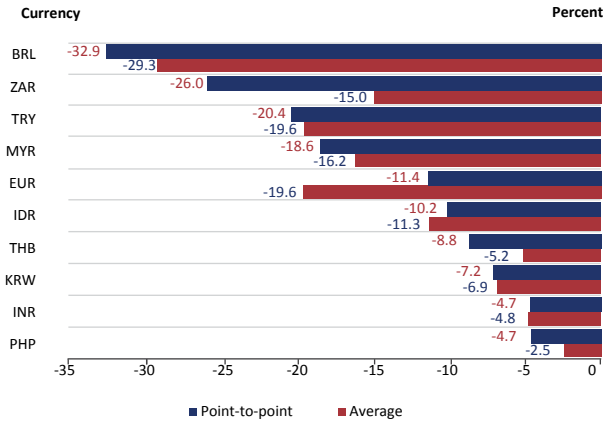
2 NDF is a forward transaction on an offshore market without submitting a notional amount at maturity. NDFs illustrate offshore market perception of future rupiah exchange rates.

quarter, contrasting the net outflow of USD1.85 billion in the third quarter.

The rupiah also appreciated as a result of less external uncertainty linked to the Federal Reserve's plan to raise its benchmark rate. External risks eased after the FOMC meeting in September 2015, relaying a more dovish statement. Expectations of the timing of the hike shifted from the fourth quarter of 2015 to the first quarter of 2016 , which precipitated rupiah appreciation in October 2015 in step with the majority of peer countries' currencies but to a greater degree. In addition, expectations of future depreciation were more managed, as indicated by a narrower gap between the NDF and spot rate (143 points).

After the FOMC meeting on 27-28th October 2015, pressures accumulated again on global financial markets as expectations of the planned FFR hike moved forward to the fourth quarter of 2015. Nevertheless, the impact was less pronounced due to clear communication from the Federal Reserve concerning the timing and gradual path of the policy rate hike. At several forums, officers from the Federal Reserve expressed more succinctly that the U.S. economy was ready to move on the normalization of monetary policy at the FOMC in December 2015. Confirming the timing of the hike helped market players anticipate the move, which triggered a positive market response. Consequently, the FFR hike in December 2015 did not spark financial market shocks. In fact, the rupiah actually appreciated 1.6% between the FFR hike and the end of 2015 in line with the deluge of foreign capital flowing into domestic financial assets (Chart 5.5).

Chart 5.6. Changes In Rupiah Exchange Rates and Peers In 2015



The amplitude of external pressures during 2015 also affected the currencies of most peer countries. Notwithstanding, solid economic fundamentals in Indonesia ensured currency depreciation was not felt as deeply as in Brazil, South Africa, Turkey, and Malaysia (Chart 5.6). In addition, the increase in volatility that accompanied rupiah depreciation was also experienced in the majority of peer countries. In 2015, rupiah volatility increased from 10.2% to 11.1%, which was still lower than that reported in Brazil, Turkey, South Africa, Malaysia, and South Korea (Chart 5.7).

Rupiah depreciation in 2015 was also congruent with limited non-resident inflows to rupiah assets. During 2015, inflows of non-resident stood at USD5.1 billion, down from USD15.4 billion the year earlier. Limited inflows to SUN instruments were recorded, amounting

Chart 5.5. Exchange Rate Peer Countries After FFR Increase in December 2015

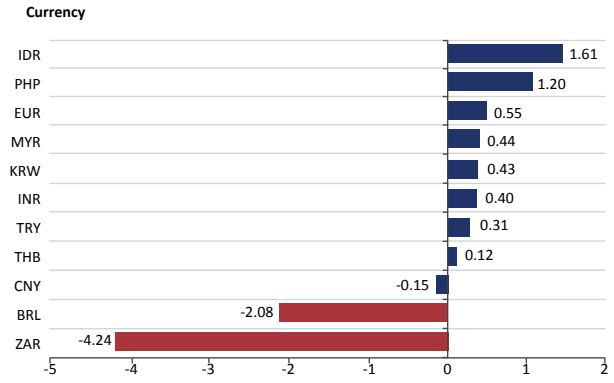


Chart 5.7. Rupiah Volatility and Peers

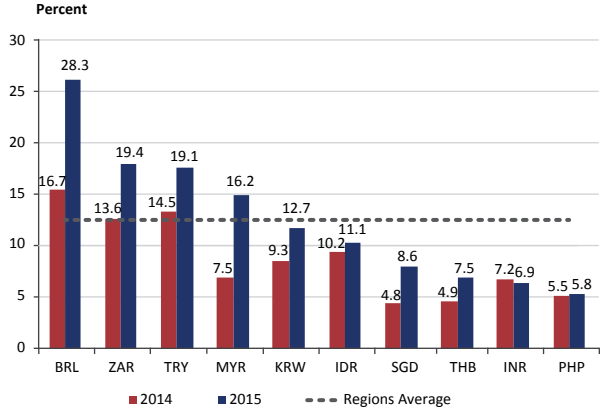


Chart 5.8. Flow of Funds of Non-Resident

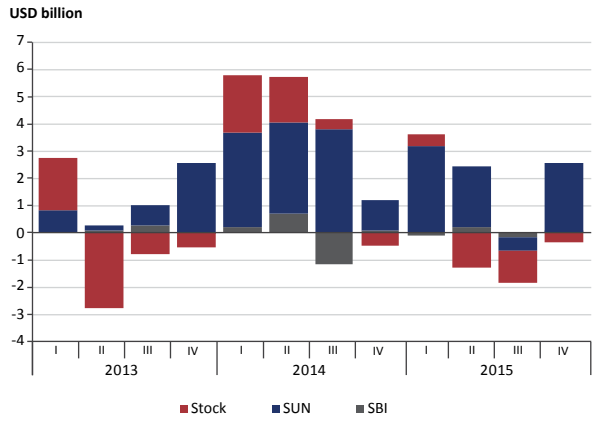
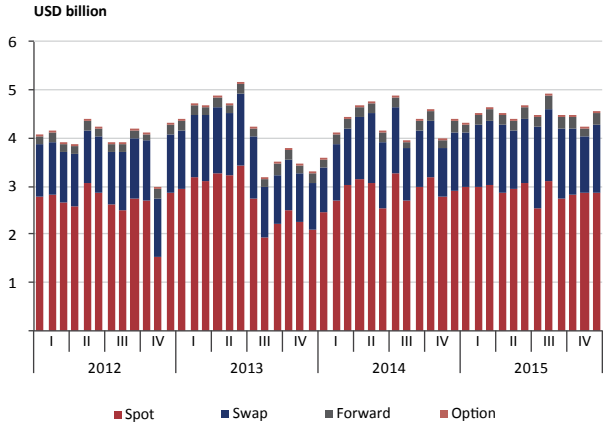


Chart 5.10. Domestic Foreign Exchange Transactions



to just USD7.6 billion. However, a fall in non-resident holdings were reported in terms of stocks and Bank Indonesia Certificates (SBI), totalling USD2.3 billion and USD135 million respectively (Chart 5.8). The fall in foreign holdings of rupiah assets primarily stemmed from traders due to the risk of U.S. monetary normalization policy. Trader holdings nosedived from 35% in 2012 to 13% in 2015, which actually improved the structure of foreign holdings of government bonds. At the end of 2015, real money dominated government bond holdings, increasing from 54% in 2012 to 60%. Meanwhile, the holdings of other market players also surged from 11% in 2012 to 27% as numerous new investors appeared on the market since 2014 (Chart 5.9).

5.2. DOMESTIC FOREIGN EXCHANGE MARKET STRUCTURE

An increase in transaction volume and daily average trading activity were indicative of deeper domestic financial markets. The increase in foreign exchange transaction volume was observed in spot, forward, and swap instruments. Furthermore, average daily foreign exchange transaction volume increased from USD4.3 billion in 2014 to USD4.5 billion in 2015, equivalent to 11.7% (Chart 5.10). The ratio to GDP also increased from 0.48% in 2014 to 0.52% of GDP in 2015 (Chart 5.11).

A growing portion of derivative transactions rather than spot transactions further evidenced gains in terms of the structure of the domestic foreign exchange market. The composition of derivatives on the domestic foreign

Chart 5.9. Foreign Government Bond Ownership

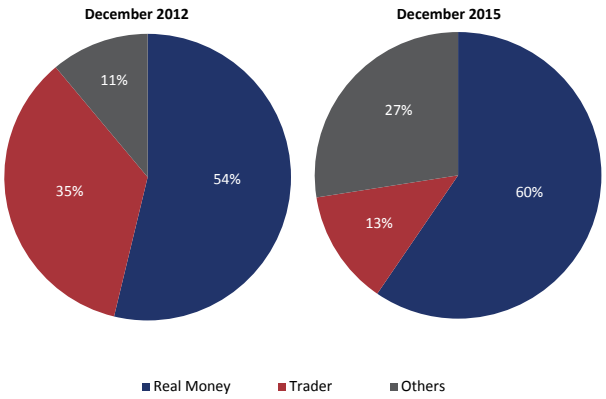


Chart 5.11. Ratio of Foreign Exchange Transactions to GDP

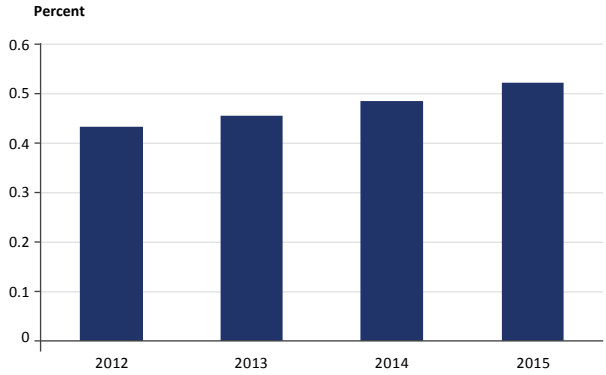


Chart 5.12. FX Spot vs FX Derivatives Composition

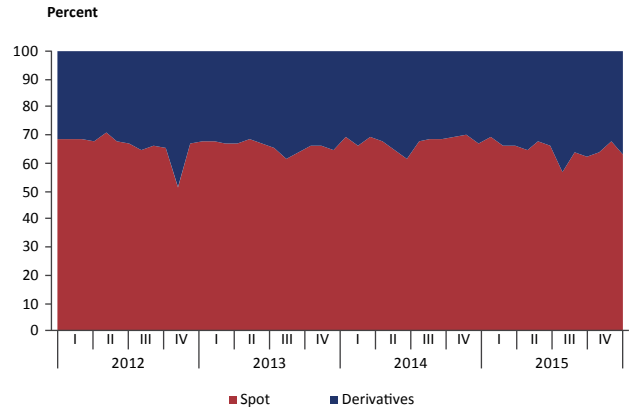
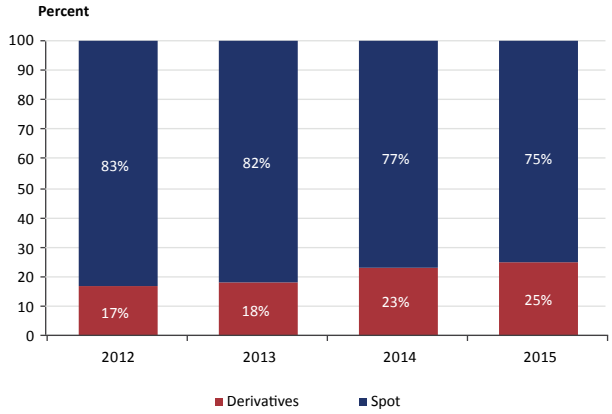


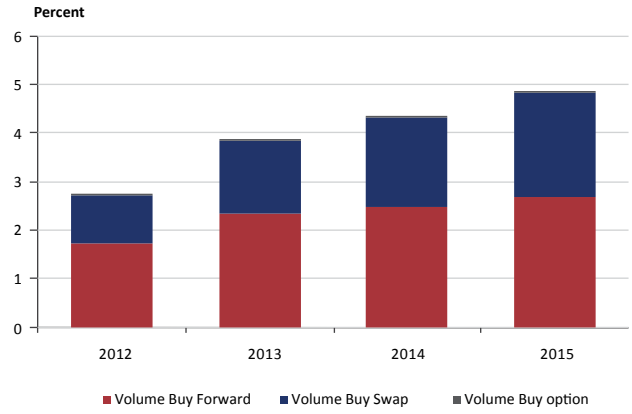
Chart 5.14. Proportion of The Distribution in Corporate Foreign Exchange Demand



exchange market swelled from 33% in 2014 to 35% in 2015 (Chart 5.12) in line with Bank Indonesia policy to provide greater market flexibility in order to hedge. This was achieved by relaxing a number of regulations and applying prudential principles in managing external debt of nonbank corporation (PBI No. 16/21/PBI/2014), effective from 1st January 2015. The new regulation requires all indebted nonbank corporations with foreign loans to hedge on the difference between the foreign currency assets and foreign currency liabilities with a maturity of up to six months. On the other hand, derivative transactions also experienced robust growth due to expectations of rupiah depreciation in 2015.

The implementation of prudential principles in managing external debt of nonbank corporation helped improve the demand structure for foreign exchange amongst corporate players. Consequently, the volume of corporate foreign exchange purchases for derivative instruments increased to 4.83% of GDP in 2015 from 4.13% the year earlier (Chart 5.13). The portion of corporate foreign exchange purchases allocated to derivative instruments also increased from 23% in 2014 to 25% in 2015 (Chart 5.14). Consequently, corporate demand for foreign exchange became more calculated in the mid of dwindling supply from non-residents.[3] Increasing corporate foreign exchange purchases of derivative instruments was accompanied by more limited demand for spot transactions, the volume of which dropped from USD10.4 billion in 2014 to USD9.6 billion in 2015.

Chart 5.13. Ratio of Volume of Foreign Exchange Buy in Derivatives to GDP



Domestic foreign exchange market deepening efforts continue to face a number of arduous challenges. Increased demand for foreign exchange due to greater market activity, both spot and derivative instruments, has not been met by an adequate increase in foreign exchange supply. Therefore, the domestic foreign exchange market is highly dependent on supply from non-residents. In 2015, the domestic foreign exchange market experienced a state of net demand that exceeded that reported in 2014 due to less supply from non-residents as flows of foreign capital to rupiah instruments slowed (Chart 5.15). Meanwhile, foreign exchange supply from domestic players also evaporated. Consistent with weaker export performance, export proceeds transferred to domestic banks also took a hit in 2015, falling from USD132 billion the year earlier to USD117 billion. In addition, the proportion of export earnings converted into rupiah as effective supply on the

3 A more thorough explanation on the development of nonbank hedging transactions is presented in Box 4.1. Assessing the implementation of prudential principles in managing external debt of nonbank corporation.

Chart 5.15. Foreign Exchange Supply-Demand

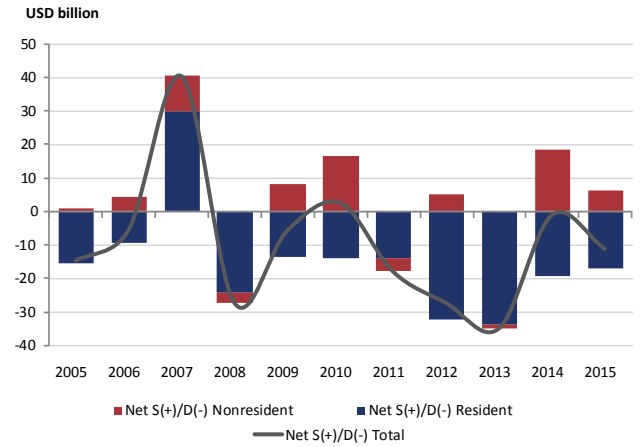
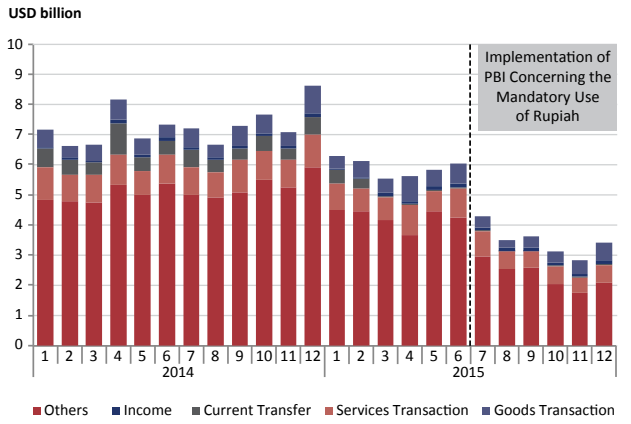


Chart 5.17. Foreign Exchange Transaction between Resident

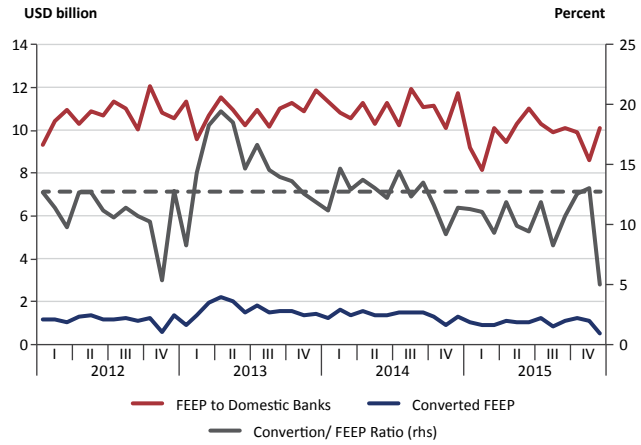


domestic foreign exchange market also shrank to 10% of the total transferred to domestic banks from 13% in 2014.

Anticipating pressures due to a potential foreign exchange supply and demand mismatch, Bank Indonesia introduced policy to boost supply on the domestic foreign exchange market. Steps were done through an amendment to the regulation concerning foreign exchange transactions against the rupiah to increase the threshold on forward transactions without underlying assets, extending the scope of underlying assets, and introducing forward intervention transactions.

Implementation of mandatory rupiah use within the territory of the Republic of Indonesia has had a favourable impact on exchange rate stability. Since Bank Indonesia Regulation (PBI) No. 17/3/PBI/2015 concerning mandatory rupiah use within the territory of the Republic of Indonesia came into effect on 1st July 2015, the monthly average of foreign currency transactions settled between residents has fallen from USD7.27 in 2014 to USD3.46 in 2015 (Chart 5.17).[4] Less use of foreign currencies for transactions between residents has reduced demand for foreign exchange and therefore, bolstered rupiah exchange rate stability.

Chart 5.16. Effective Foreign Exchange Supply from Foreign Exchange Export Proceeds (FEEP)



4 Payment transactions settled through banks operating in domestic. Excluding transactions with the central bank, foreign exchange trade, deposits, overbooking transactions, transactions of less than USD10,000, and funds from received from the Overseas Current Account (OCA).

In 2015, controlled volatile food (VF) inflation, consistent with adequate supply and tumbling international commodity prices, contributed to the successful attainment of the inflation target. VF inflation fell sharply compared to the previous year and even dropped below the historical average for the past four years due primarily to deflation of chilli and shallot prices as well as limited rice inflation.

Chapter 6

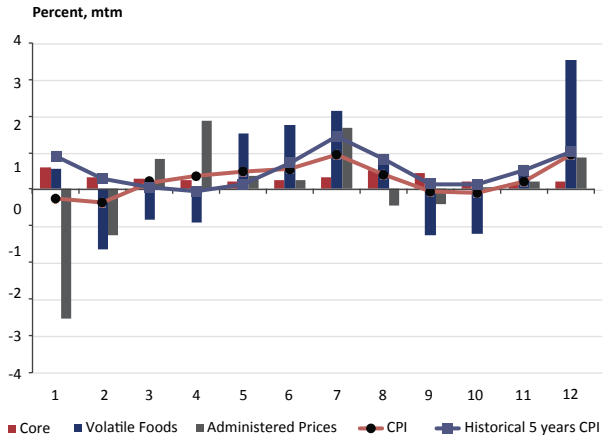
Inflation

The consistent monetary policy to safeguard macroeconomic stability, accompanied with policy coordination between Bank Indonesia and the Government, succeeded in curbing inflation in 2015. Global and domestic economic conditions supported the low rate of inflation at 3.35% (yoy) in 2015. The fall in world oil prices was a key factor of low inflation in administered prices amid the domestic energy subsidy reforms. While the correction in global food prices and Government policies related to food production and distribution, helped control inflationary pressure in volatile foods. Looking ahead, the coordination between Bank Indonesia and the Government under the Inflation Monitoring and Controlling Team (TPI) and their regional level counterparts (TPIDs) will be further strengthened to consistently achieve the inflation target.

The Consumer Price Index (CPI) inflation at 3.35% (yoy) in 2015 was within the inflation target range (4%±1%, yoy) and represented the lowest level of inflation in the past five years (Chart 6.1). The curbing of inflation in 2015 is observed in the monthly inflation dynamics during the second half of the year, consistent with the historical trend but at a much lower level (Chart 6.2). The deflation at the beginning of the year, in departure from the historical trend, was prompted by lower fuel prices and plentiful harvests of certain strategic food commodities. Overall, cost-push inflation in 2015 was minimal in contrast to the two preceding years marked by substantial cost-push pressures that spurred high levels of inflation.[1]

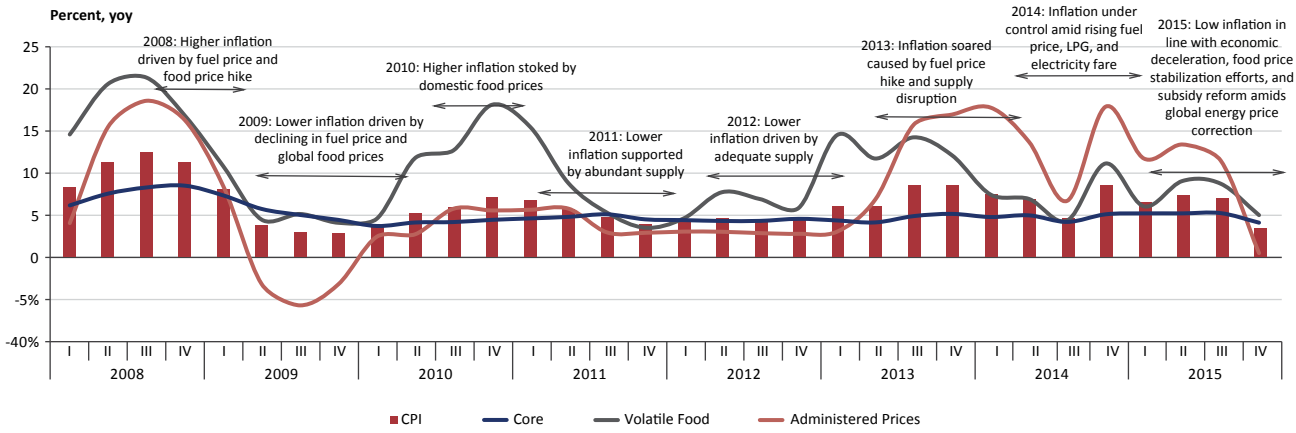
Despite the low inflation in 2015, measures for controlling inflation face considerable challenges in the future. The challenge in controlling core inflation lies mainly in managing inflation expectations to be more in line with the Government-set inflation target and safeguarding exchange rate stability. In the volatile foods (VF) inflation category, the limited infrastructure in the agriculture sector and limitations in policy instruments for price stabilization could lead to steep fluctuations in strategic food commodity prices at different times of the year. Meanwhile, consistency in energy reforms involving more appropriately targeted reallocation of energy subsidies has the potential to create inflationary pressure in administered prices (AP) should an upward correction take place in global energy prices.[2] Considering the substantial challenges for controlling inflation that lies ahead, strengthening the coordination between Bank Indonesia and the Government is necessary to consistently achieve the inflation target. Furthermore, in order to overcome the structural challenges of inflation control at the national and local government levels, the Inflation Monitoring and Controlling Team (TPI) and the Regional Inflation Monitoring and Controlling Team (TPID) have produced an Inflation Control Roadmap for 2015-2018, which serves as guidelines for inflation control policy initiatives.[3]

Chart 6.2. Monthly Historical Inflation Pattern



Source: BPS - Statistics Indonesia, processed

Chart 6.1. Event Analysis of Inflation



Source: BPS - Statistics Indonesia, processed

1 Inflation in 2013 and 2014 was recorded at 8.38% and 8.36% (yoy), driven mainly by high inflation in energy commodities (due to increased in fuel prices) and food commodities.

2 At this time, the Government still provides subsidies for 3 kg bottled LPG and electricity consumers with use restricted to 450 VA to 900 VA. In addition, automotive diesel still benefits from a fixed subsidy of Rp 1,000/liter.

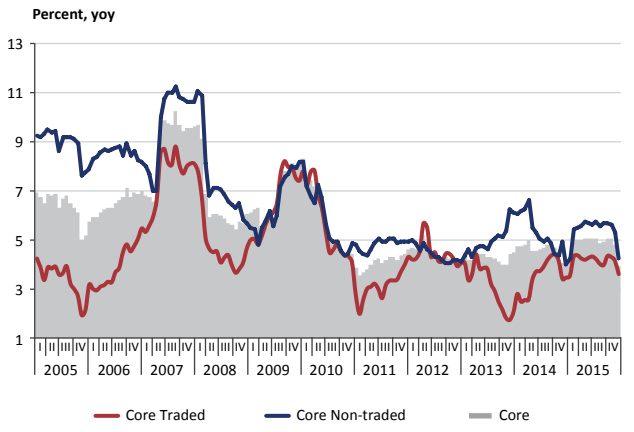
3 See Box: Accountability for Achievement of the 2015 Inflation Target.

6.1. CORE INFLATION

Price increases for core inflation items remained well under control in 2015. Core inflation reached 3.95% (yoy) at the end of 2015, down from 4.93% (yoy) in the preceding year and the lowest level achieved for the past decade (Chart 6.3). The decline in core inflation took place mainly in the second half of the year (Chart 6.4), affecting on both core traded and non-traded commodities (Chart 6.3).[4] This decline was prompted by low global commodity prices, weakened domestic demand and subdued inflation expectations.

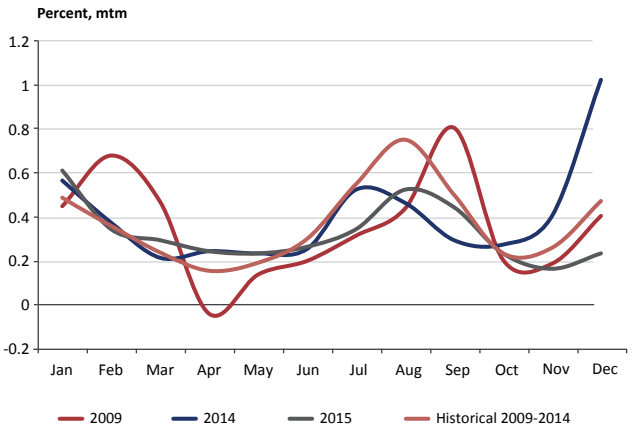
The lower level of core inflation was in line with the moderate level of cost push pressure. Cost push pressure driven by increases in fuel prices and VF prices fluctuations was quite limited. Low world oil prices kept upward pressure on administered prices inflation to a minimum. Government policy for curbing fluctuations in transportation fares also helped control second-round effects during the fuel price hikes.[5] Ongoing correction in global food commodity prices and plentiful domestic supply also resulted in a decline in core food inflation. There was a decline in contribution to inflation from core commodities that represent derivatives of VF items (such inflation in rice with accompanying dishes) and derivatives of food imports, such as noodles (Table 6.1).

Chart 6.3. Core Traded and Non-traded Inflation



Source: BPS - Statistics Indonesia, processed

Chart 6.4. Historical Core Inflation Pattern



Source: BPS - Statistics Indonesia, processed

As expected with mild economic growth, which was even below that of previous years, demand-side pressure was again minimal. The economic slowdown that had begun in 2011 continued to bite with economic growth slipping to 4.8% in 2015, the second lowest level achieved in the past 10 years after the 4.6% growth achieved in 2009. This contributed to mild inflationary pressure from the domestic demand side. The depressed level of purchasing power was confirmed by thin growth in the retail sales index and consumer confidence index (Chart 6.5). Price increases for commodities with elastic demand progressively eased, as demonstrated by non-traded non-food core inflation (Chart 6.6).

Table 6.1. Contribution to Core Food Inflation

No.	Commodities	2014	2015
Inflation			
1	Rice and Side Dish	0.18	0.14
2	Noodle	0.11	0.07
3	Sugar	-0.03	0.05
4	Mineral Water	0.04	0.04
5	Pastries	0.04	0.03
6	Grilled chicken	0.03	0.03
7	Porridge	0.05	0.03
8	Soup	0.04	0.02
9	Cake	0.03	0.02
10	Barbecued Chicken	0.04	0.02
Deflation			
11	Garlic	0.00	-0.0006
12	Purebred Chiken Egg	0.00	-0.0004
13	Fish	0.00	-0.0003

Source: BPS - Statistics Indonesia, processed

4 In analysis by underlying components, core inflation is formed from traded and non-traded components. Traded components depict core inflationary pressure from externals, while non-traded inflation represents domestic inflationary pressure. On the other hand, the definition of traded inflation is the category of goods traded in exports and imports, as reflected in the balance of trade.

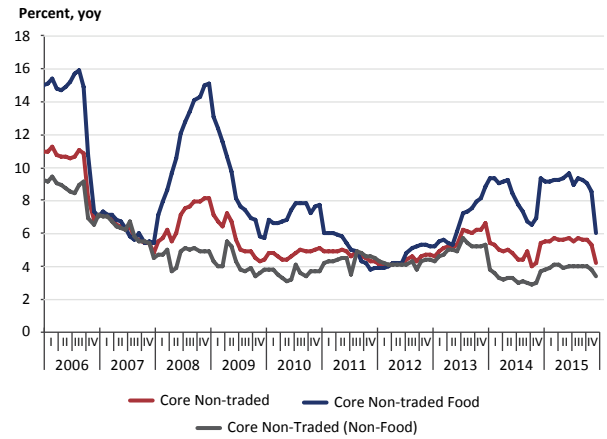
5 Under Regulation of the Minister of Transportation No. 31 of 2015, fare increases are permitted if energy price increases result in a 20% increase in the costs of providing transportation.

Table 6.2. Contributors to Core Non-food Inflation

No.	Commodities	2014	2015
Inflation			
1	House Rental Rates	0.12	0.13
2	Car	0.08	0.10
3	Contract House Tariff	0.11	0.10
4	Non Foreman Worker	0.07	0.08
5	Academy/College	0.04	0.06
6	House Keeper Salary	0.05	0.06
7	Elementary School	0.05	0.05
8	Junior High School	0.05	0.04
9	Senior High School	0.03	0.04
10	Gold Jewelery	-0.02	0.04
Deflation			
11	Cement	0.06	-0.02
12	Steel Bar	0.01	-0.01
13	Bricks	0.00	-0.01

Source: BPS - Statistics Indonesia, processed

Chart 6.6. Core Non-traded Inflation



Source: BPS - Statistics Indonesia, processed

The rupiah weakened considerably during 2015, but impact on domestic prices was contained. In 2015, the rupiah depreciated 11.33% (average, yoy) with the maximum depreciation recorded in September at 4.4% (mtm). At the beginning of the year, core inflation was running high at about 5% (yoy), above the normal level of 4.9% (yoy). This condition was due to the second round effects of the fuel price hike in November 2014. Even so, average monthly core inflation in 2015 was the lowest for the past five years at about 0.32% (mtm). A number of factors influenced the limited impact of exchange rate depreciation to inflation. First, the relatively subdued inflation expectations of economic actors during the period of exchange rate depreciation, as shown in the September survey (Chart 6.7). In December, inflation expectations eased in line with various exchange rate stabilization measures introduced by Bank Indonesia that brought stability and appreciation to the exchange rate. Second, the lingering weakness in public purchasing power led business to opt for temporary cuts in margins rather than to raise prices and then face the risk of losing market share (Chart 6.8). The subdued impact from exchange rate depreciation on price increases provided momentum for core inflation to return to a track consistent with historical performance. Following this, the rupiah appreciation in October accompanied by low demand-pull and cost-push pressure brought core inflation at year-end to below the historical average. The mild impact of rupiah depreciation on consumer prices and its effect on reducing retailer margins was evident from the disparity between wholesale

Chart 6.5. Real Sales Growth

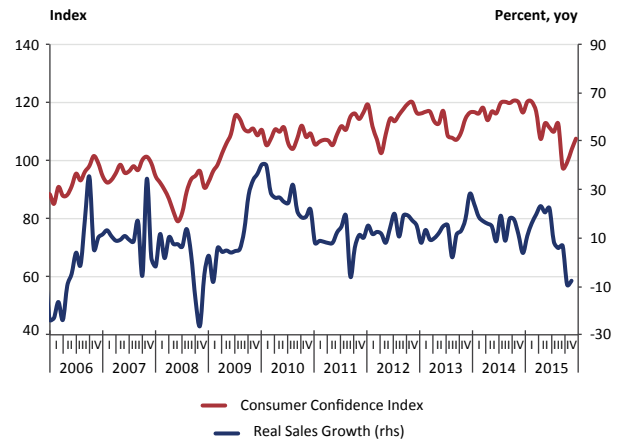
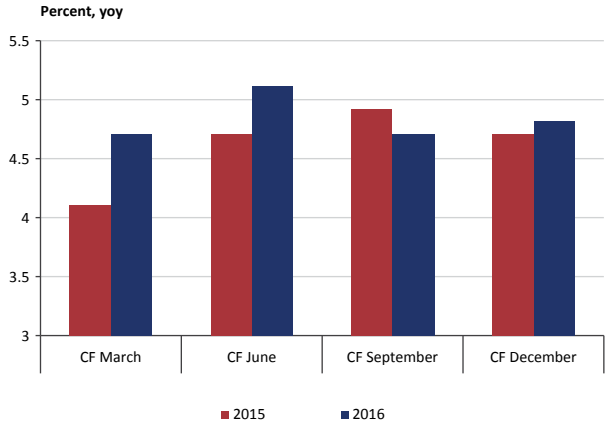


Chart 6.7. Consensus Forecast Expectation



Source: Consensus Economics

Chart 6.8. Margin Per Unit and Selling Price

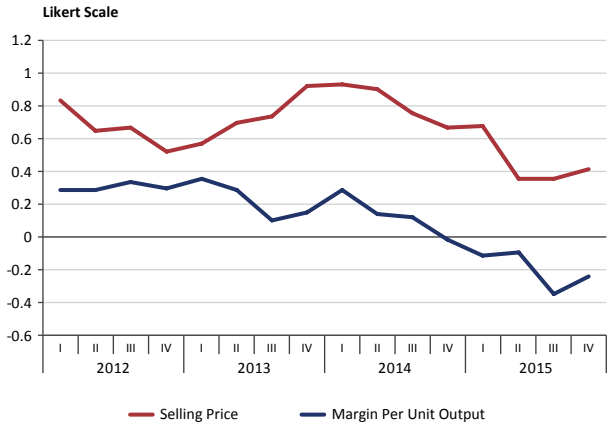
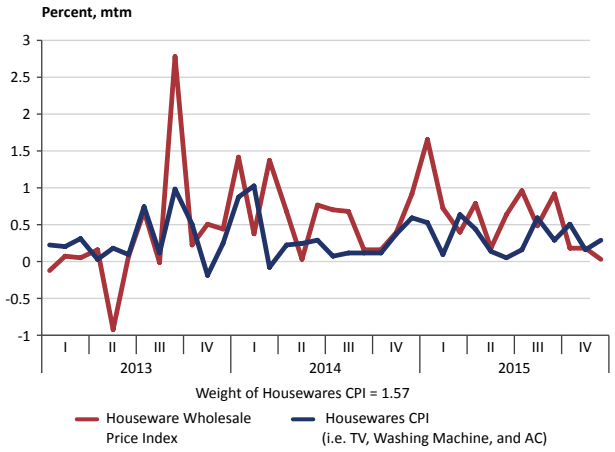


Chart 6.10. Housewares WPI and CPI Inflation



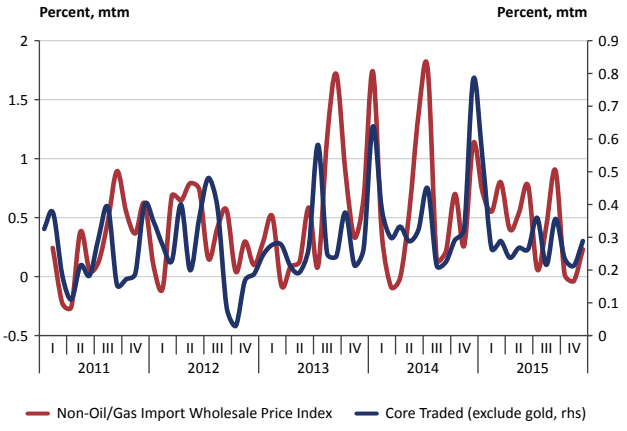
Source: BPS - Statistics Indonesia, processed

price index inflation for non-oil and gas imports and core traded items during 2015 (Chart 6.9). This disparity was particularly noticeable in some sectors, including household appliances, motor cycles and computers (Chart 6.10). The monetary policy consistently applied by Bank Indonesia with the aim of anchoring inflation expectations within the targeting range succeeded in curbing the impact of exchange rate depreciation on prices.

Subdued inflation expectations played a vital role in keeping core inflation under control. The consistency of the Bank Indonesia policy mix throughout 2015 succeeded in containing the impact of exchange rate depreciation on prices and curbing inflation expectations. Moderate short-term inflation expectations were reflected in the retailer and consumer index for inflation expectations during the period of the fuel price hike at the end of the first quarter of 2015, which was lower in comparison to expectations at the time of the previous fuel price hike (Charts 6.11 and 6.12). This points to growing confidence among economic actors that the shock of a fuel price hike will not have excessive impact, which is partly attributable to Government policy to minimize the second round effects of fuel price increases. The subdued inflation expectations of 2015, supported by domestic and global economic conditions, kept core inflation from excessive fluctuation and made the economy more resilient to shocks that did occur, such as depreciation in the rupiah and fluctuating adjustments in energy prices.

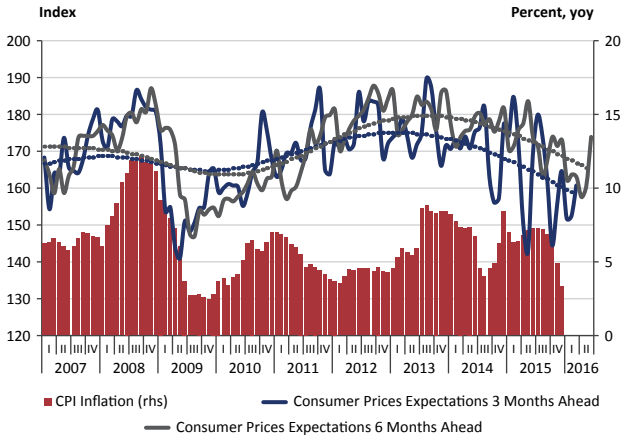
Going forward, indications for the medium-term point to further decline in inflation expectations. In the results of the Consensus Forecast (CF) survey (Chart 6.13), average inflation expectations 24 months forward

Chart 6.9. Import WPI Inflation and Core Traded Inflation



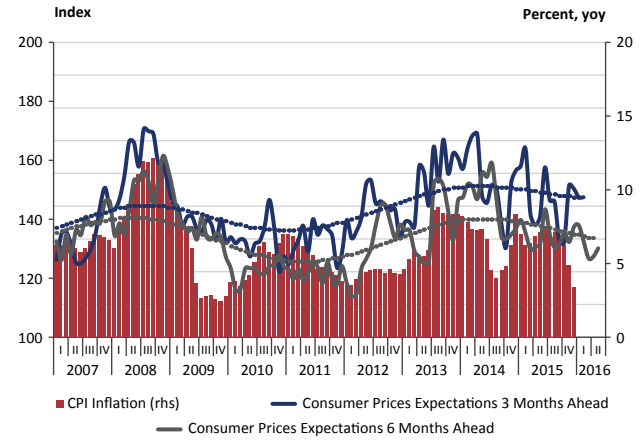
Source: BPS - Statistics Indonesia, processed

Chart 6.11. Consumer Prices Expectations



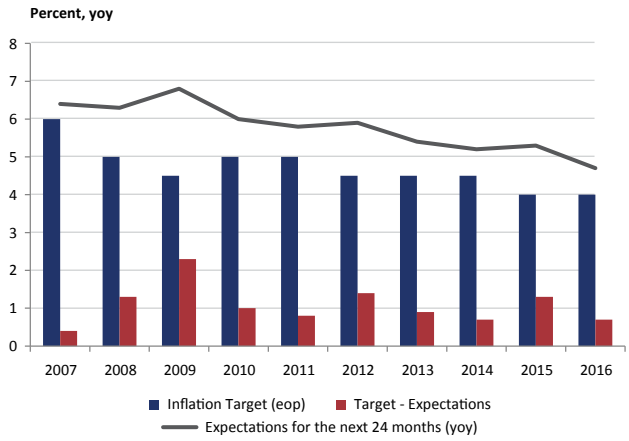
Source: BPS - Statistics Indonesia, processed

Chart 6.12. Retailers Expectations



Source: BPS - Statistics Indonesia, processed

Chart 6.13. 24 Months Inflation Expectations



Source: Consensus Economis, processed

showed a downward trend from 6.4% (yoy) in 2007 to 4.7% (yoy) in 2016.[6] This easing of expectations is consistent with the prescribed gradual decline in the path of the inflation target. Despite the difference that persists between inflation expectations and the target, the co-movement between the two indicates that the inflation target, which is set every 3 years, has created a stronger anchoring of inflation expectations. The downward trend in inflation expectations is also visible in many countries. Nevertheless, there are indications that countries implementing the Inflation Target Framework (ITF) have experienced more significant decline in inflation expectations.[7]

Although inflation expectations have eased in a general sense, the management of inflation expectations still represents a challenge for inflation control going forward. In the long-term, inflation expectations will maintain a downward trend and become more anchored. Even so, issues of concern persist, such as the higher level of expectations compared to both the inflation target and other countries in the region. Where inflation expectations are a key determinant in forming core inflation and future inflationary pressure, management of future expectations for achievement of the inflation target has not only gained importance, but also becoming increasingly fraught with challenges. Looking forward, improvement in the domestic and global economy will boost demand-side pressure that in turn will lead to increase core inflationary pressure. The continuation of energy reforms by the Government will also stoke pressure in the core category should there be any increase in world prices for energy commodities and downward pressure on the rupiah. On the other hand, the inflation target is prescribed to follow gradual decline, with targets of 4±1% in 2016-2017 and 3.5±1% in 2018. Inflation expectations will become more strongly anchored if the inflation target is consistently achieved and thus strengthens the credibility of the central bank and monetary policy. In conclusion, improved credibility of the central bank will keep inflation expectations more strongly anchored and thus create a virtuous circle between the two.

6.2. VOLATILE FOODS (VF) INFLATION

VF inflation was remarkably low. Recorded at 4.84% (yoy), VF inflation plunged dramatically in comparison to the previous year and came below the historical level for the past four years. The decline in VF inflation came in response to lower inflation in miscellaneous chilli peppers compared to the previous year (Table 6.3). In addition, the limited increase in rice prices despite a strong El Nino effect and the correction in global food prices helped keep VF inflation well in hand during 2015.

This subdued VF inflation is reflected in the milder monthly dynamics of VF inflation compared to one year before (Chart 6.14). In the second half of 2015, the VF inflation recorded at 0.33% (ytd), well below that of the same period in the year before (2.22% ytd). The mild VF inflation in the second half of 2015 resulted most substantially from the plentiful harvest of miscellaneous chilli peppers in response to favourable weather conditions and special measures taken by the Government related to expansion

6 Inflation expectations in 2007 and 2016 based on the figures of the Consensus Forecasts for January 2006 and January 2015.

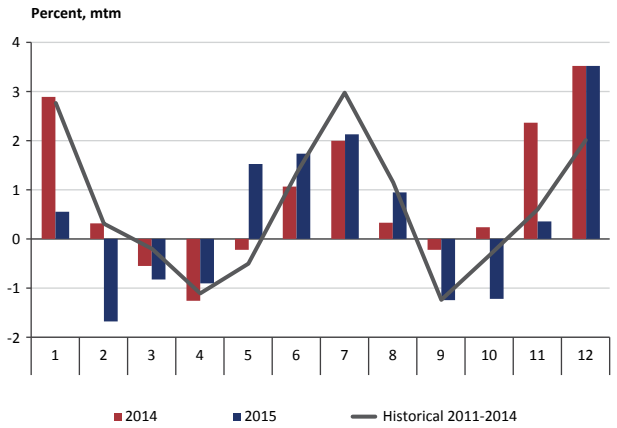
7 See Mehrotra and Yetman (2014) and Mishkin and Schmidt-Hebbel (2007).

Table 6.3. Inflation/Deflation Contribution of 9 Strategic Food Commodities

Commodities	2009	2013	2014	2015
Rice	0.26	0.14	0.36	0.31
Chicken Meat	0.07	0.10	0.07	0.15
Chicken Egg	-0.01	0.03	0.07	0.09
Garlic	0.18	-0.04	0.03	0.07
Beef	0.02	0.07	0.03	0.05
Onion	0.03	0.31	-0.17	0.15
Fried Noodle	-0.04	0.02	0.07	-0.04
Bird's Eye Chili	0.01	0.07	0.15	-0.13
Chilli	-0.05	0.32	0.41	-0.39

Source: BPS - Statistics Indonesia, processed

Chart 6.14. Volatile Foods Historical Pattern



Source: BPS - Statistics Indonesia, processed

of agricultural lands. In the second half of 2015, the lower VF inflation compared to the same period one year earlier resulted from a harvest of miscellaneous chilli peppers well beyond the seasonal trend, price corrections for chicken meat and eggs as a result of adequate supply, price correction for cooking oil due to low global CPO prices and limited rice inflation despite the strong El Nino.

The Government played a significant role in controlling food prices. The Government's inflation control in food prices focused mainly on stabilizing prices during the holy fasting month of Ramadan and mitigating the strong impact of El Nino in the fourth quarter of 2015. Price stabilization during Ramadan involved market operations for strategic food commodities, including rice, meat, garlic and shallots. To mitigate the strong impact of El Nino, the Government reinforced its buffer stocks of rice through such actions as imports of 700 thousand tons of rice by the National Logistics Agency (BULOG), distribution of the 13th and 14th month Welfare Rice (Rastra) and special measures for expansion of agricultural land and improvements to irrigation. Added to this the Government's deregulation of food imports (beef, horticultural products, corns, and soy beans) helps to maintain the supply of food and stability in national food prices.

The price stabilization program was also supported by the maritime highway system aimed at reducing price disparities among the regions. The development of the maritime highway system is a measure for provision of a regular, scheduled maritime shipping routes with the operation of shipping services (under a subsidy scheme) supported by improved port facilities. The goal of this program is to link the major ports around the archipelago. With these transport links between seaports, a system of connectivity will be created for smooth distribution of goods extended to remote areas and reducing disparities in prices among regions. The Ministry of Transportation now has operated three of the six routes that are stipulated under the Decree of the Director General of Maritime Transportation Number AL.108/6/2/DJPL-15 concerning route networks for operation of the public service obligation for cargo transport within the framework of the maritime highway system, as follows:

a. Route Code T-1: Tanjung Perak - Tual - Fak Fak - Kaimana - Timika - Kaimana - Fak Fak - Tual -Tanjung Perak. (Operated by KM. Caraka Jaya Niaga III - 32).

b. Route Code T-4: Tanjung Priok - Biak - Serui - Nabire -Wasior - Manokwari - Wasior - Nabire - Serui - Biak - Tanjung Priok. (Operated by KM. Caraka Jaya Niaga III - 22).

c. Route Code T-6: Tanjung Priok - Kijang - Natuna - Kijang - Tanjung Priok. (Operated by KM. Caraka Jaya Niaga III - 4).

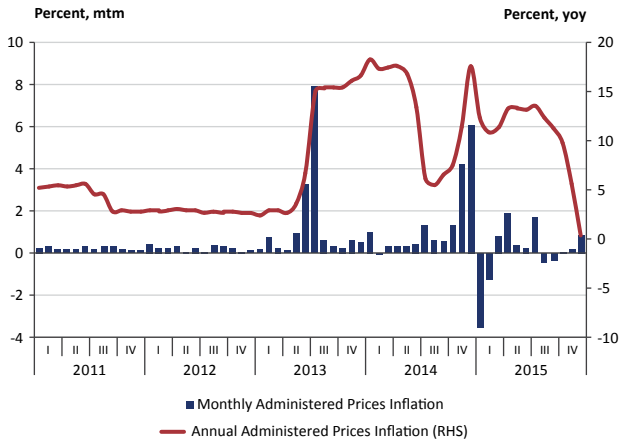
Although VF inflation was mostly low during the year, in December it mounted briefly above the historical level. This is an indication that various structural problems have not been fully overcome, and therefore considerable challenges remain for the future of inflation control. The lack of optimum infrastructure development in the agriculture sector and limitations in policy instruments for price stabilization have resulted in widely fluctuating prices for strategic food commodities at different times of the year. In regard to agricultural infrastructure, there has been inadequate progress in the construction of warehouses for storage of harvested strategic food commodities. Because of this, food commodity prices soared during the planting season and plunged when the harvest season arrived. In a similar vein, the policy instruments for stabilizing food prices are still limited to

setting the government floor price for rice procurement, market operations, and distribution of Welfare Rice (Rastra). The benchmarks of indicative prices for red chilli peppers, shallots, chicken, and beef have also not performed well in curbing price fluctuations occurring from time to time.

6.3. ADMINISTERED PRICES (AP) INFLATION

Low pressure from administered prices in 2015 is explained largely by the fall in world oil prices. In early 2015, the Government implemented an energy reform policy in support of more appropriately targeted allocations of subsidies (Picture 6.1).[8] The energy subsidy reform linked the selling price of gasoline and automotive diesel to the Mean of Platt Singapore (MOPS) prices and the exchange rate.[9] Similarly, the adjustment in calculation of the electricity billing rate links the selling price for electricity with the Indonesia Crude Price (ICP), the exchange rate and inflation. Selling prices for 12 kg bottled LPG gas also depend heavily on world gas prices. AP inflation was recorded at 0.39% (yoy), having fallen dramatically in comparison to the previous year and also below the historical level for the past four years

Chart 6.15. Inflation Administered Prices

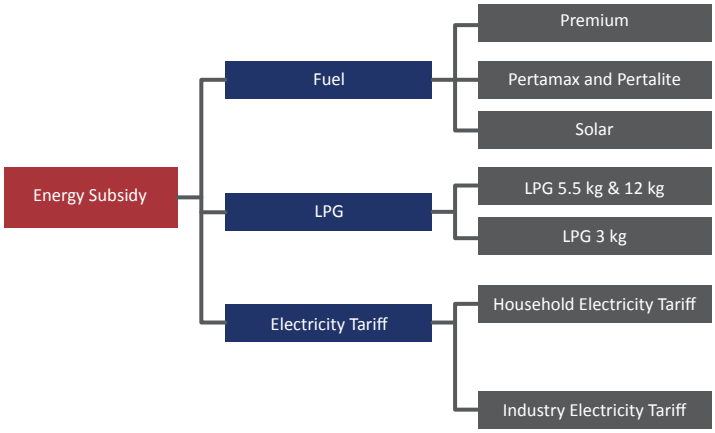


Source: BPS - Statistics Indonesia, processed

(Chart 6.15). Price movements for some AP commodities during 2015 are presented in Table 6.4.

Fuel prices underwent deflation (Chart 6.16). The fall in world oil prices early in the year prompted the Government to announce cuts in fuel prices on two occasions in January 2016. On 1 January 2015, the Government lowered the price for RON 88 Premium gasoline by Rp950 per liter and for automotive diesel by

Picture 6.1. Subsidy Reform in the Energy Sector



Policy	Timeline
Market Price considering domestic economy	Jan 1 2015
Market Price	Jan 19 2015
Fixed Subsidy: Rp1,000/L	Jan 1 2015
Market Price	2015
LPG 3 kg increased by Rp1,000 per kg	2016
Market Price (>2,200 VA) Market Price (1,300-2,200 VA)	2014 2015
Electricity subsidy reduction for 450VA-900VA	2016
Market Price (I3 and I4)	2014

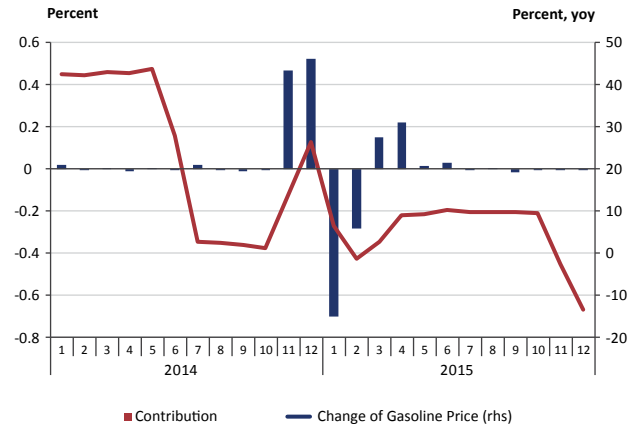
8 The electricity subsidy reform is stipulated in Regulation of the Minister of Energy and Mineral Resources No. 31 of 2014. Similarly, the fuel subsidy reform is set forth in Regulation of the Minister of Energy and Mineral Resources No. 4 of 2015 as amended by Regulation of the Minister of Energy and Mineral Resources No. 39 of 2015.

9 The Government continues to subsidise automotive diesel at a rate of Rp1,000 per liter and kerosene, for which the price is set at Rp2,500 per liter.

Table 6.4. Change of Several Administered Prices in 2015

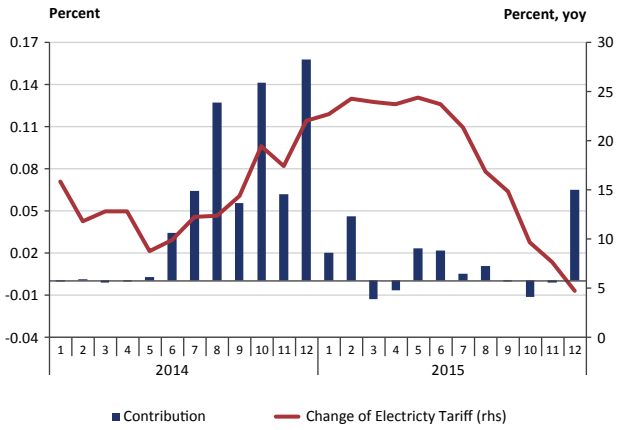
	Fuel		Electricity Tariff		Liquid Petrolium Gas (LPG)	Airfare	Toll Tariff
January	Jan 1: Price correction amounted Rp900/L for RON 88 gasoline and Rp250/L for subsidized solar	Jan 14: Price correction amounted Rp1,000/L for RON 88 gasoline and Rp850/L for subsidized solar	Jan 1: Electricity Tariff Adjustment for Industry, Business, Government Offices, and Household with Power above 2,200 VA			Lower limit air freight rates rose by 10% from the previous.	
February			Household electricity tariff with power above 2,200 VA down from Rp1,496/ kwh in January to Rp1,468/kwh in February.				
March	March 1: Price hike amounted Rp200/L for gasoline RON 88.	March 28: Price hike amounted Rp500/L for gasoline RON 88 and subsidized solar.	Household electricity tariff with power above 2,200 VA down from Rp1,468/ kwh in January to Rp1,426.6/kwh in February.		March 1: LPG 12 kg price hike amounted Rp5,000/tube or Rp417/kg.		
August			Household electricity tariff with power above 2,200 VA down from Rp1,547.9/ kwh in July to Rp1,546.6/kwh in August.				
September	Sept 4: Upper limit rates of the air transport rose by 10% from the previous, while the lower limit tariff corrected by 10% of previous provisions.		Household electricity tariff with power above 2,200 VA down from Rp1,546.6/ kwh in August to Rp1,523.4/kwh in September.		Sept 15: LPG 12 kg price correction amounted Rp6,000/tube or Rp500/kg		
October	Oct 9: Price correction amounted Rp200/L for subsidized solar.		Household electricity tariff with power above 2,200 VA down from Rp1,523.4/ kwh in September to Rp1,507.3/kwh in October.	Oct 7: Industrial electricity tariffs discounts I3 and I4 by 30% for electricity consumption at midnight (23:00) till morning (08:00).			
November							Nov 1: Toll tariff hike average amounted 15%.
December			Dec 1: Household electricity tariff adjustment with power of 1,300-2,200 VA down from Rp1,352/kwh in September to Rp1,508.8/kwh in October.	Household electricity tariff with power above 2,200 VA down from Rp1,532.8/ kwh in November to Rp1,508.8/kwh in December.			

Chart 6.16. Inflation Development and Contribution of Gasoline Inflation



Source: BPS - Statistics Indonesia, processed

Chart 6.17. Inflation Development and Contribution of Electricity Inflation



Source: BPS - Statistics Indonesia, processed

Rp250 per liter. On 14 January 2015, the Government again cut the price for RON 88 Premium gasoline, this time by Rp1,000 per liter, and for automotive diesel by Rp850 per liter. In line with the dynamics of world oil prices and the exchange rate, further changes in prices for RON 88 Premium gasoline and automotive diesel were announced in March and October 2015.[10] For the year as a whole, despite an increase in fuel prices in March, government policy for controlling transport fares was able to curb the second round effects of this hike in fuel prices.[11]

In addition, inflation in electricity tariff was also low, consistent with the decline in world oil prices. This low inflation is due to the factors influencing tariff adjustment, which is the ICP, exchange rate and inflation. During 2015, electricity billing rates were reduced on six occasions.[12] The low fluctuation in electricity inflation under this policy was also prompted by the phased increases in electricity billing rates since 2014. As a result, the contribution of electricity to inflation in 2015 was 0.15%, down from the 2014 level of 0.69% (Chart 6.17).

For the future, the challenges in control of AP inflation will be considerable. These challenges in controlling AP lie in the risk of upward movement in world oil prices and exchange rate depreciation. Furthermore, the government plan to increase prices for 3 kg bottled LPG gas and to upgrade 900 VA electricity customers to 1300 VA will be an added factor stoking pressure in AP inflation. For this reason, the Bank Indonesia and Government coordination of inflation control needs to be strengthened further to keep inflation at the prescribed level. Coordination of the magnitude and timing of energy price adjustments is vital in the effort to control AP inflation.

10 On 1 March 2015, the Government raised the price for RON 88 Premium gasoline by Rp200 per liter and on 15 March 2015 raised prices for RON 88 Premium and automotive diesel by Rp500 per liter. Under the Third Economic Policy Package in October 2015, the Government lowered the price for automotive diesel by Rp200 per liter.

11 To curb the second round effects of fuel price increases on transport fares, the Government promulgated Regulation of the Minister of Transportation No. 31 of 2015 on 10 February 2015. This regulation permits fares to be increased if an adjustment in energy prices result in a 20% change in the costs of providing transportation. One component in the cost of providing transportation is the price of automotive diesel, which accounts for about 39% of these costs. The steepest price increase for diesel in 2015 took place on 28 March on that year. At that time, automotive diesel price was raised from Rp6,400 per liter to Rp6,900 per liter. This represents a 7.8% increase, and therefore the effect of that on the cost of providing transportation was less than 20%.

12 Electricity billing rates were reduced six times, in February, March, August, September, October, and December.

In 2015, low international commodity prices severely eroded state revenues. On the other hand, the Government continued to actively spend, particularly on infrastructure, in order to counteract economic moderation. Nonetheless, the state budget deficit was successfully maintained at a healthy level below 3% of GDP.

Chapter 7

Fiscal

In 2015, the deficit of the Revised State Budget (APBN-P) was successfully secured at the level of 2.5% of the gross domestic product (GDP) amid domestic economic slowdown and falling commodity prices. The increase in the deficit was attributable to the lower domestic revenues than the target amid government attempts to boost fiscal stimulus. Even though the fiscal stimulus failed to deliver in the first half of 2015, government spending picked up rapidly in the other half. The increase in government expenditure, especially capital expenditure, in the second half of the year was instrumental in building up a momentum for domestic economic growth.

Amid pressures on the economy, the Government was still able to prop it up by keeping the deficit below 3% of GDP. The continuing decline in commodity prices that began in 2011 had elevated taxes to an increasingly significant position in state revenue. Due to economic slowdown and tax compliance issues, the tax revenue target that was put on a higher growth path under the Revised State Budget (APBN-P) could not be reached. Recognizing the importance of government spending as part of counter-cyclical measures in the economy, the Government opted for the consequences of the widening of deficit to 2.5% from 1.9% of GDP in the Revised State Budget (APBN-P). With sub-national fiscal realization estimated to remain in surplus at 0.2% of GDP, the overall deficit became lower than 2.5% of GDP.[1] Such deficit was well below the maximum limit of 3% of GDP stipulated under the Law on State Finances.

Throughout 2015, fiscal stimulus was provided on both the government revenue and expenditure sides. On the revenue side, stimulus was provided in various forms of tax incentives aimed at boosting consumption and incentives for investment, for example, by increasing the amount of Non-Taxable Income (PTKP) from IDR24 million to IDR36 million per Individual Taxpayer (OP). On the expenditure side, stimulus was provided mainly in the form of productive spending such as capital expenditure increase and the provision of interest subsidies under the People's Business Credit (KUR) program. Capital expenditure realization had increased by 43.1% from IDR147.3 trillion to IDR209.0 trillion. This increase was much higher compared to the last year's negative growth of 19.4%. Meanwhile, a 10% subsidy was accorded to the KUR interest rate, resulting in a drop of the rate from 22% to 12% in 2015. In the light of the lack of revenue generation, the room for fiscal stimulus in 2015 was significantly influenced by energy subsidy reduction policy. During 2015, fuel subsidies decreased by 74.7% from IDR240.0 trillion in 2014 to IDR60.8 trillion and electricity subsidies went down by 42.7% from IDR101.8 trillion to IDR58.3 trillion. Such decline in energy subsidies would have provided a sufficiently ample room for fiscal maneuver if revenue had not decreased. Fiscal stimulus absorption that was still limited throughout the year 2015 also appeared to be influenced by institutional factors which required increased institutional capacity.

Realization of macro assumptions that was quite different from that of the assumptions under the 2015 Revised State Budget (APBN-P) was the main reason for the failure to reach government revenue target (Table 7.1). The state revenue which recorded a 3.0% contraction was mainly influenced by a 36.3% decrease in Non-Tax State Revenues (PNBP) (Table 7.2). This decrease was related to the oil price level as well as oil and gas lifting prices that were lower than assumed. Meanwhile, tax revenue in 2015 was still capable of chalking up a positive growth of 8.2%, higher than that in 2014, which stood at 6.5%. In spite of this, however, with a higher tax revenue target set under the 2015 Revised State Budget, taxes could only reach 83.3% of the target (a tax shortfall of around IDR250 billion), lower than that achieved in 2014, which accounted for 92.0% of the target (Table 7.3). It was suspected that less than optimal tax revenue was also influenced by the weakening of macro economic conditions and underperforming tax compliance. This condition impacted on the Central Government's tax ratio that went down from 10.9% in 2014 to 10.7% in 2015.

Table 7.1. Macroeconomic Assumptions

Macroeconomic Assumption	2014			2015		
	State Budget	Revised Budget	Realization	State Budget	Revised Budget	Realization*
Economic growth yoy (%)	6.0	5.5	5.0	5.8	5.7	4.8
Inflation yoy (%)	5.5	5.3	8.4	4.4	5.0	3.4
Exchange rate (Rp to USD)	10,500	11,600	11,870	11,900	12,500	13,392
Average of 3-month SPN (Government Treasury Bills) interest rate (%)	5.5	6.0	5.8	6.0	6.2	5.97
Indonesia Crude Oil Price-ICP (U.S. dollar/barrel)	105	105	97	105	60	49.2
Indonesia Oil Lifting (thousand barrels per day)	870	818	794	900	825	777.6
Indonesia Gas Lifting (thousand barrels oil equivalence per day)	1,240	1,224	1,221	1,248	1,221	1,195

Source: LKPP 2014 and *Press Release of Ministry of Finance on January 22, 2016

1 Bank Indonesia's estimation.

On the expenditure side, administrative issues and structural constraints were suspected as the reasons why the multiplier effects of fiscal stimulus were still not optimal yet. Transitional administration included adjustment related to the budget nomenclature ministries/agencies led to the distribution of spending, especially spending on infrastructure, became effective in the third quarter of 2015. In addition, numerous infrastructure-related classic constraints, such as land acquisition and licensing issues were still impeding the progress of development. The same had also happened to the distribution of KUR that was still below the target because of the timing of the credit launching that had just commenced in the second half of 2015. Various obstacles in fiscal stimulus distribution and persistently weak global economic condition were suspected of causing the private sector to take a wait-and-see attitude that was quite persistent during 2015.

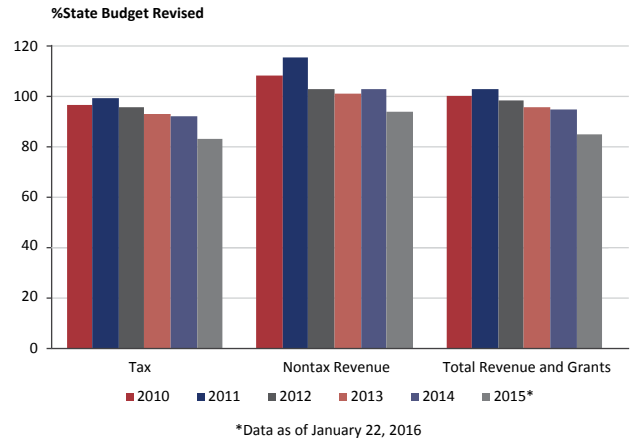
Realized deficit that was higher than targeted under the 2015 Revised State Budget had led to a significant increase in financing needs, especially in the second half of 2015. Widening to IDR292.1 trillion, the deficit was financed with the issuance of additional Government Securities (SBN) amounting to IDR416 trillion, program-based loans and standby loans that impacted on the increase in debt service ratio to around 26% of GDP. Anticipatory measures taken by the government to address the needs for extra financing had once led to turmoil in bank liquidity, especially in December. Unlike the patterns of yesteryears, in December 2015, the government's financial operations created an impact that led to the contraction of bank liquidity, despite an expansionary impact on liquidity for the entire year of 2015. These changes once led to a significant increase in liquidity demand that was reflected in the rising interest rates on the Interbank Money Market (PUAB). Due to a wide range of anticipatory measures taken to address the widening of such deficit, at the end of the transaction year the Government still generated the Budget Financing Surplus (SiLPA) of IDR26.1 trillion (Table 7.2).

Table 7.2. State Budget Realization 2014-2015

Items	Revised Budget 2014	Budget Realization 2014				Revised Budget 2015	Budget Realization 2015*			
	Rp Trillion	Rp Trillion	%GDP**	%yoy	% Revised Budget	Rp Trillion	Rp Trillion	%GDP**	%yoy	% Revised Budget
A. Total Revenue	**1,635.4**	**1,550.5**	**14.7**	**7.8**	**94.8**	**1,761.7**	**1,504.5**	**13.0**	**-3.0**	**85.4**
I. Domestic Revenue	1,633.1	1,545.5	14.7	7.9	94.6	1,758.4	1,494.1	12.9	-3.3	85.0
1. Tax Revenue	1,246.1	1,146.9	10.9	6.5	92.0	1,489.3	1,240.4	10.7	8.2	83.3
- Domestic Taxes	1,189.8	1,103.2	10.5	7.1	92.7	1,440.0	1,206	10.4	9.3	83.7
- International Trade Taxes	56.3	43.6	0.4	-8.0	77.6	49.3	35	0.3	-20.0	70.8
2. Nontax Revenue	386.9	398.6	3.8	12.4	103.0	269.1	253.7	2.2	-36.4	94.3
II. Grants	2.3	5.0	0.0	-26.3	216.5	3.3	10.4	0.1	105.6	313.6
B. Total Expenditure	**1,876.8**	**1,777.2**	**16.9**	**7.7**	**94.7**	**1,984.1**	**1,796.6**	**15.6**	**1.1**	**90.5**
I. Central Government Expenditures	1,280.3	1,203.6	11.4	5.8	94.0	1,319.5	1,173.6	10.2	-2.5	88.9
1. Ministries/Institutions Expenditure	678.1	626.4	5.9	13.1	92.4	795.5	724.7	6.3	15.7	91.1
2. Non-ministries/Institutions Expenditure	602.2	577.2	5.5	-1.1	95.8	524.1	448.9	3.9	-22.2	85.7
II. Transfer to Regions and Village Fund	596.5	573.7	5.4	11.8	96.2	664.6	623.0	5.4	8.6	93.7
1. Transfer to Regions	596.5	573.7	5.4	11.8	96.2	664.6	623.0	5.4	8.6	93.7
2. Village Fund	-	0.0	-	-	-	20.8	20.8	0.2	-	100.0
C. Primary Balance	**(106.0)**	**-93.3**	**-0.9**	**-5.3**	**88.0**	**(66.7)**	**-136**	**-1.2**	**45.9**	**204.0**
D. Surplus/Deficit	**(241.5)**	**-226.7**	**-2.2**	**7.2**	**93.9**	**(222.5)**	**-292**	**-2.5**	**28.9**	**131.3**
E. Financing (Net)	**241.5**	**248.9**	**2.4**	**5.1**	**103.1**	**267.0**	**329**	**2.9**	**32.3**	**123.4**
I. Domestic Financing	254.9	261.2	2.5	7.6	102.5	287.0	307	2.7	17.7	107.1
II. Foreign Financing	(13.4)	-12.3	-0.1	112.4	92.0	(20.0)	10	0.1	10.1	-52.0

Source: Ministry of Finance , *Based on realization update per January 22, 2016, **Based on GDP nominal base year 2010

Chart 7.1. Component of Tax Revenue to Revised State Budget Target Achievement



Source: Ministry of Finance, processed

7.1. STATE REVENUE

Global economic slowdown, decreased lifting costs and commodity price correction that increases in tax revenue could not offset were the reason for the failure to reach Government revenue target. State revenue only accounted for 85.4% of the target set under the Revised State Budget (APBN-P), which was quite low compared with the one achieved in 2014 that amounted to 94.8% and got contracted by 3.0% compared to the corresponding period last year (Chart 7.1). This development was mainly due to declining commodity prices and global economic condition that remained weak and thus impacted on Non-Tax State Revenue (PNPB) that went down significantly. The decrease was primarily due to revenues from natural resources that recorded a negative growth of 57.5% (Chart 7.2).

Table 7.3. Tax Shortfall Estimation

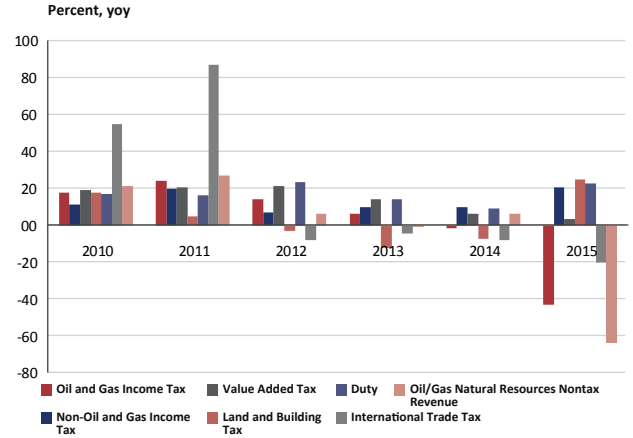
Institution	Tax Shortfall
World Bank	Rp296 trillion
IMF	Rp235 trillion
Center for Indonesia Taxation Analysis	Rp250 trillion

*) Total of Tax Shortfall includes
Source:: http://finansial.bisnis.com

The decline in Non-Tax State Revenue (PNPB) could not be offset by increased tax revenues. The tax revenue growth of 8.2% in 2015 was in line with realized economic growth of 4.79% and inflation of 3.35%. Of the high tax revenue target of IDR1,489.3 trillion, however, only 83.3% was realized, lower than last year's that accounted for 92% of the target set under the Revised State Budget (APBN-P). With this target, government tax ratio was targetted to increase by 2% of GDP from 10.9% in 2014 to 12.9% in 2015. Some analysts believed that this tax revenue target was way too high given the ongoing economic slowdown (Table 7.3).

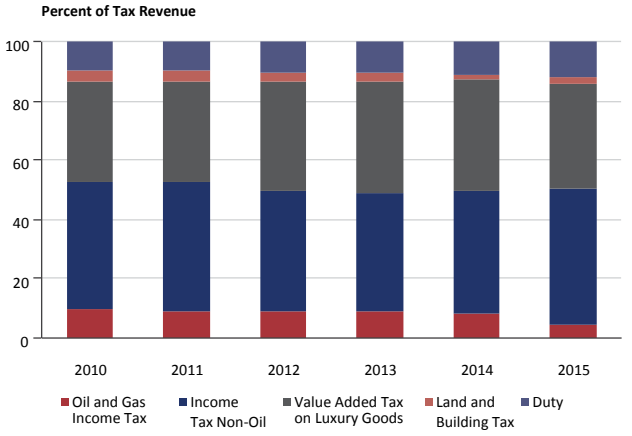
The Government had rolled out a series of policies in order to anticipate the downward trend in the tax to GDP ratio, in line with the inauguration of the year 2015 as the Tax Education Year. The policies included, among other things, a tax penalty relief policy introduced through the issuance of Finance Minister Regulation No. 91/PMK.03/2015 on the Reduction or Elimination of Administrative Sanctions due to Late Filing of Tax Returns, Tax Return Corrections, and Late Payment or Deposit of Taxes. The regulation was a legal means to provide incentives for the elimination of administrative sanctions if taxpayers made corrections to

Chart 7.2. Annual Growth of Tax Revenue Component Comparison



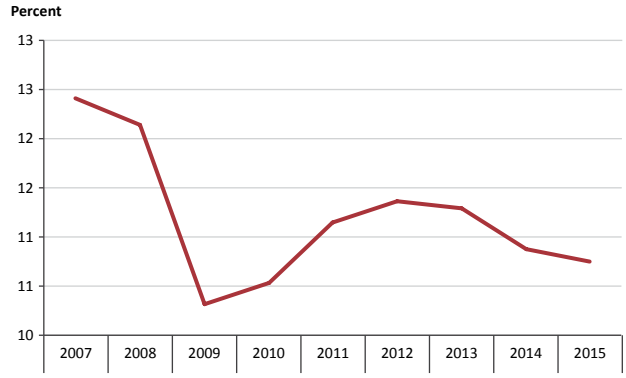
Source: Ministry of Finance, processed based on LKPP and Press Release of 2015 Provisional Realization Update January 22, 2016

Chart 7.3. Composition of Taxes Revenue



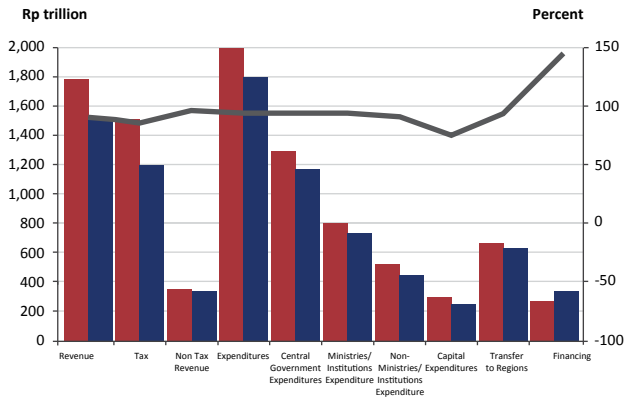
Source: Ministry of Finance, processed based on LKPP and Press Release of 2015 Provisional Realization update January 22, 2016

Chart 7.4. Tax Ratio Development



Source: Recent Indicator of Bank Indonesia and Ministry of Finance, processed from Press Release of 2015 Provisional Realization update January 22, 2016

Chart 7.5. Realization of 2015 Revised State Budget Achievement



Source: Ministry of Finance, processed based on provisional realization December 31 2015 update January 22, 2016

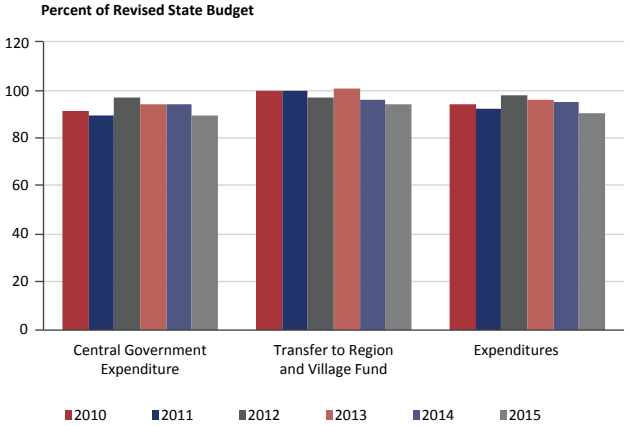
their tax returns (SPT). In addition, the Government had also adopted some law enforcement measures including, among others, *gijzeling* (incarceration) or corporal punishment forcibly imposed on taxpayers for failure to pay off their tax liability. The government had also issued the so-called reinventing policy including the provision of incentives for companies registering for revaluation of assets in 2015. This policy had been able to generate a tax revenue of IDR20.1 trillion. With these various policies, the Non-Oil and Gas Income Tax (PPh) posted a better performance compared to other types of state revenue. In terms of its composition, the non-oil and gas income tax revenue provided the greatest contribution to the domestic tax revenue. The portion of non-oil and gas income taxes accounted for 45.8% of all domestic tax revenues, followed by revenue gains from Value Added Taxes (VAT) and taxes on the sale of luxury goods (PPnBM) that amounted to 35.1% (Chart 7.3).

The portion increased slightly from 41.6% in 2014 due to the decline of oil and gas income tax revenues. In nominal terms, non-oil income taxes had increased by 20.5% (yoy), while the total VAT and luxury goods taxes recorded a contraction of 0.1% (yoy), mainly influenced by a decrease in import VAT. The decline in VAT and luxury goods tax revenues reflected slowing economic activity. The realization of oil and gas income tax decreased significantly by 43.2%, in line with falling oil prices and lifting costs. With these developments, the Central Government's tax ratio in 2015 stood at 10.7%, lower than that of in 2014 which stood at 10.9% (Chart 7.4).[2]

7.2. STATE EXPENDITURE

Achievement of state spending in 2015 was lower than the achievements of 2014 and 2013. It reached 90.5% of the ceiling of the Revised State Budget with Central Government spending being realized at 88.9% of the target set under the Revised State Budget (Chart 7.5 and 7.6). This was mainly due to budget absorption being hampered by nomenclature issues throughout the first semester of 2015. Although the 2015 Revised State Budget was approved in February 2015, issues arising from changes in the nomenclature for ministries/government agencies (K/L) and preparations for the Islamic Eid-ul-Fitr holidays had made absorption become truly effective only after entering the second half of 2015.

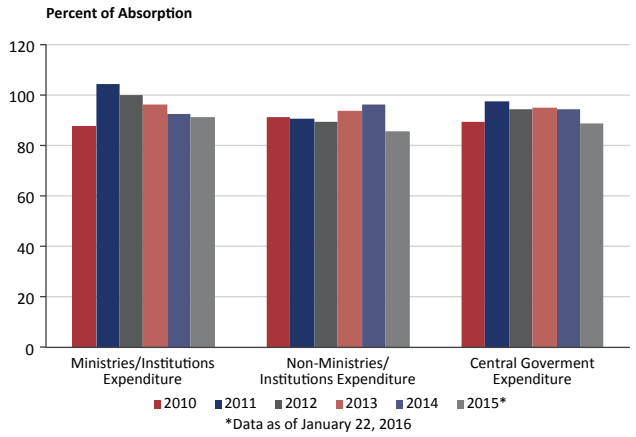
Chart 7.6. Expenditures Achievement



Source: Ministry of Finance, processed based on LKPP and Press Release of 2015 Provisional Realization Update January 22, 2016

2 This refers to *tax ratio* in a narrow sense, that is, the ratio of Central Government tax to GDP.

Chart 7.7. Absorption of Ministries/Institutions Expenditure and Non-Ministries/Institutions Expenditure



Source: Ministry of Finance, processed based on Press Release of 2015 Provisional Realization Update January 22, 2016

Overall, K/L spending absorption reached 91.1% while non K/L spending absorption reached 85.7% (Chart 7.7). K/L spending realization grew by 15.6%, compared to the 2014 growth of 13.1%. Meanwhile, the contraction of non K/L spending reached 19.8%, more than the 2014 contraction of 1.1%. Shifting in K/L and non K/L spending items reflected the continuation of reallocation of spending, visible from government policies to reallocate spending from energy subsidies to more productive types of spending, such as capital expenditures

Contraction of central government spending in 2015 was primarily due to a decrease in subsidies. Subsidies went down by 52.6% compared to last year's realization, most of which was due to a IDR222.7 trillion drop in energy subsidies from IDR341.8 trillion to IDR119.1 trillion with the biggest cut coming from the reduction of government spending on petroleum-based vehicle fuel (BBM), LPG (liquified petroleum gas) fuel, and biofuel (BBN) subsidies by 74.7% from IDR240.0 trillion in 2014 to IDR60.8 trillion in 2015. This decline was related to the government policy to phase out subsidies on 'Premium' gasoline and to introduce a fixed subsidy on diesel fuel at IDR1,000 per liter. Meanwhile, electricity subsidy fell by 42.7% from IDR101.8 trillion in 2014 to IDR58.3 trillion in 2015.

The savings made from such subsidies reduction had not been able to be optimally absorbed by other central government spending. Nevertheless, changes in the nomenclature for line ministries/agencies led to a significant increase in the realization of government spending on capital and goods only by the third quarter of 2015. Realized spending on goods and capital in the third quarter grew by 34.8% (yoy) and 58.7 % (yoy), respectively. Such increase in spending still continued in the fourth quarter as seen in goods and capital spending that posted a high growth of 56.1% (yoy) and 50.4% (yoy), respectively.

Accounting for only 75.8% of the target set under the Revised State Budget (APBN-P), capital expenditure realization in 2015 grew 41.9% (yoy). This substantial growth was driven by accelerated implementation of government infrastructure projects, particularly those of the Ministry of Public Works and Public Housing. Such capital expenditure acceleration had become the main engine of growth in investment, particularly in the construction sector in the third and fourth quarters of 2015 amid a wait-and-see attitude on the part of the private sector.

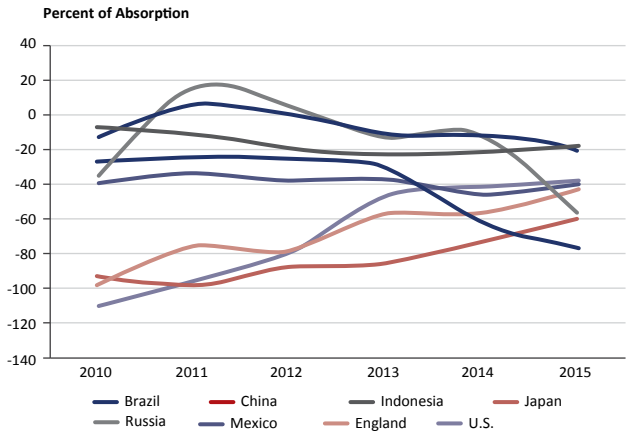
Social Assistance Realization slightly decreased by 0.9% (yoy) with absorption towards target reaching 90.1% of the Revised State Budget (APBN-P). This was in line with the spirit of reallocation of subsidies to spending to support government policies related to the strengthening of social protection and poverty reduction acceleration programs to reduce gaps among groups of various income levels. Measures taken to address the situation included, among others, (i) the implementation of a cash transfer program called Family Welfare Deposit Program (PSKS) made accessible through Family Welfare Card (KKS) issued to Target Households (RTS) including to Persons with Social Welfare Issues (PMKS), (ii) the provision of assistance to stimulate the development of productive economic business activities, and (iii) the implementation of Family Hope Program (PKH) that provides conditional cash transfers to Very Poor Families (KSM).

7.3. FINANCING

Substantial tax shortfall had affected on increasing financing. Such additional deficit was subsequently addressed by expanding the issuance of state securities and loans. The press release issued by the Ministry of Finance on January 22, 2016 said that the actual deficit on December 31, 2015 reached IDR292.1 trillion or 2.5% of GDP.

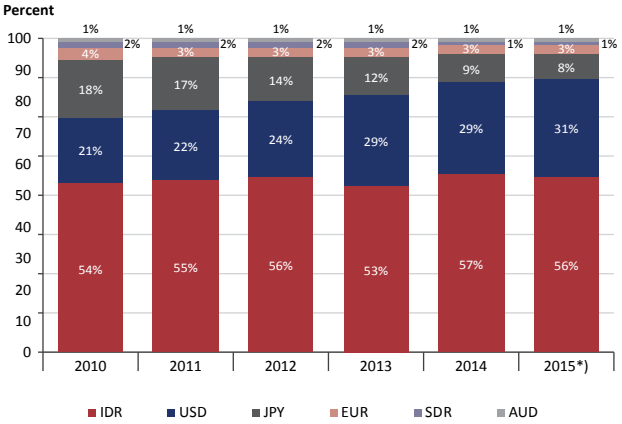
With such development, fiscal financing realization in 2015 reached IDR318.1 trillion, increasing by 34% (yoy) and exceeding the 43.0% target. Domestic financing went up by 23.4%, exceeding the 22.9% target while net foreign financing reached IDR20.0 trillion instead of the negative turnout of the same amount initially predicted. The exceeding of such financing generated a Budget Financing Surplus (SiLPA) of IDR26.1 trillion. The increase in the

Chart 7.8. Trend of Fiscal Deficit in Several Countries



Source: International Monetary Fund, World Economic Outlook Database, October 2015 and Ministry of Finance

Chart 7.10. Composition of Government Bond Denomination



Source: Central Government's Debt Profile January 2016, Directorate General of Budget Financing and Risk Management Ministry of Finance

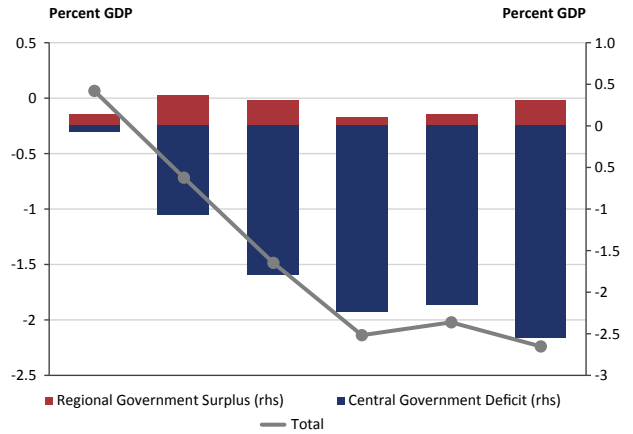
deficit was still lower than in some other countries, such as USA, Japan, Brazil, and the United Kingdom (Chart 7.8). Overall, with an estimated total of sub-national budget realization recording a surplus of 0.2% of GDP, the total deficit was still way well below the limit stipulated under Law No.17 of 2003 on State Finances that was set at a maximum of 3% of GDP (Chart 7.9).

In order to meet its financing needs, the Government re-implemented the front loading strategy. Overall, the net issuance of Government Securities (SBN) throughout 2015 reached IDR361.6 trillion (Chart 7.10). The portion of Central Government debts derived from state securities increased from 74.2% in 2014 to 75.7% in 2015, with the portion of rupiah-denominated SBN slightly down compared to 2014, that is, to 56% from 57%. The portion of SBN denominated in foreign currencies increased in line with the Government's diversification efforts including the issuance of Samurai Bonds. Yields on state securities rose for different loan tenures compared to 2014 (Chart 7.11).

Realization of financing had impacted on the increase in government debt ratios, though still being far from the maximum limit of 60% of GDP. The ratio of Central Government debts to GDP as of December 31, 2015 stood at 26.8% of GDP, which was a slight increase compared to the 2014 ratio of 24.7% (Chart 7.12). The ratio was still below the maximum limit of debt ratio set under Law No.17 of 2003 on State Finances of 60% of GDP, and was better than those of other countries.

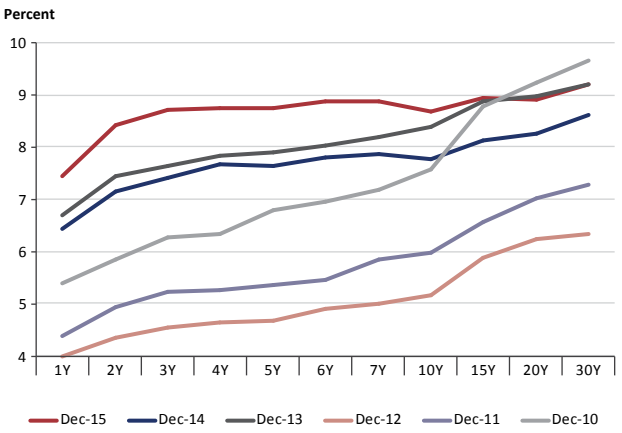
In order to accelerate the 2016 State Budget programs, the Government prefunded the 2016 State Budget. In December 2015, the Government issued Global Bonds

Chart 7.9. Aggregate Deficit Government Estimation



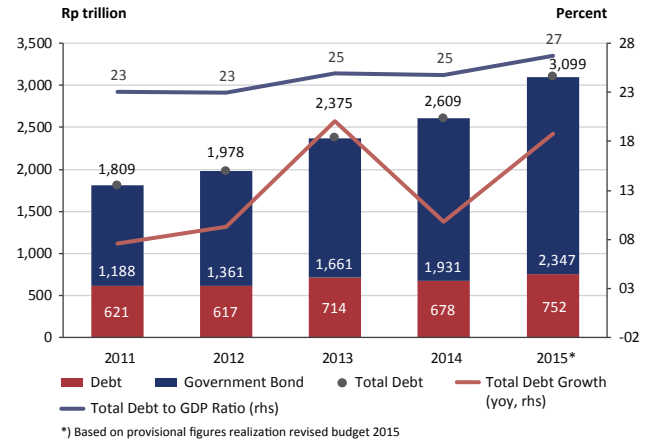
Source: Processed based on LKPP and Provisional Realization Projection December 31, 2015 Press Release update January 22, 2015
Regional Government Surplus is provisional estimation.

Chart 7.11. Government Bond Yield



Source: Central Government's Debt Profile January 2016, Directorate General of Budget Financing and Risk Management Ministry of Finance

Chart 7.12. Government Debt to GDP Ratio



*) Based on provisional figures realization revised budget 2015

Source: Ministry of Finance, processed based on LKPP and Press Release of Provisional Realization update January 22, 2015

Table 7.4. Net Claims on Government (NCG) 2013-2015

Rp billion

Explanation	Dec-13	Dec-14	Dec-15	Total 2015
Total Inflow	152,410	170,068	278,153	1,846,178
Total Outflow	221,605	173,383	230.,686	1,993,973
Net Contraction/ (Expansion) Rupiah	-69,195	-3,315	47,467	-147,794
Cumulative	-193,711	-170,790	-147,794	

worth USD3.5 billion and made Private Placement worth IDR15 trillion, thus bringing the total prefunding to around IDR63 trillion, which was equivalent to 12% of the planned gross SBN issuance in 2016. Efforts to provide faster financing for 2016 spending accompanied by an increase in tax revenues throughout December 2015 had affected on changes in the pattern of bank liquidity. Based on historical patterns, the financial operations of the government in December would lead to an expansionary effect in line with increased government spending. However, in December 2015, the prefunding policy and the significant increase in collected taxes impacted on liquidity contraction. This led to the decline in the net liquidity expansion of the government throughout the entire year of 2015 amid increased nominal deficit compared to previous years (Table 7.4). This change had quite an impact on the liquidity of banks in December 2015.

Domestic stock and bond markets experienced pressures congruent with widespread uncertainty on global financial markets. Nevertheless, financial system stability was maintained.

Chapter 8

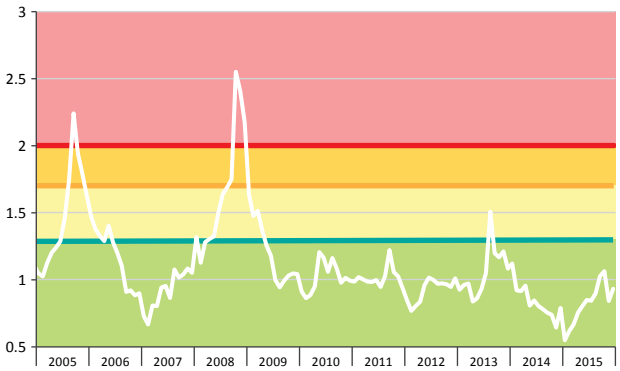
Financial System

The financial system stability has been maintained despite heightened pressures. Since the domestic economy has yet to fully recover coupled with an increase in credit risk as perceived by banks, easing macroprudential policy in supporting loans growth had a limited impact. Loans growth, including loans extended to micro, small, and medium enterprises (MSMEs), were relatively limited in 2015 and lower than earlier predicted. Despite this, strong capital support managed to help ensure the resiliency of the banking industry amid weakening in the financial performance of banks. In the financial markets, unconducive domestic and global conditions also put pressures on the stock and bond markets.

The financial system stability was still maintained at a safe level despite the slowdown in the domestic economy which started back in 2014. Policies which were taken by Bank Indonesia, the Government, and the Financial Services Authority (OJK) were able to rein in the risk of instability in the financial sector. One of the indicators which was used by Bank Indonesia to assess the stability of the financial system was the Financial System Stability Index (FSSI).[1] During 2015, the FSSI rose to a level of 0.93 from 0.79 in 2014, yet still quite far from the threshold of 2 (Chart 8.1).

In 2015, the performance of the banking industry, the Nonbank Financial Industry, and the capital markets experienced a slight slowdown in line with the slowing domestic economic growth. Nonetheless, facing several challenges, the national banking industry was still fairly resilient, as reflected in the high capital adequacy ratio and credit risk which was under control. Meanwhile, the Nonbank Financial Industry generally also showed a downturn in performance in 2015 as reflected in the slowing assets growth of financing companies, the insurance companies, and pension fund companies. From the risk side, the risk associated with financing companies and the insurance companies also increased, as reflected in the increase in the ratio of Non-Performing Financing (NPF) and the ratio of gross claims to gross premiums. The performance of the bond and equity markets also weakened in line with the heightened risks in the financial markets. The weaker performance of the bond and equity markets in 2015 was reflected in the higher yield on 10-year Government Bonds, the declines in the Jakarta Stock Exchange Composite Index (JCI), along with higher volatility of returns from Government Bonds and stocks.

Chart 8.1. Financial System Stability Index



Amid slowing loans growth, nonbank financing experienced an increase. The increase in nonbank financing was mostly undertaken by non-financial companies such that the market share for financial companies declined. The increase in nonbank financing was related to the more stringent lending standards for banks in channelling loans which was in accordance with the increased lending risk perceptions of banks. Against this backdrop, companies resorted to alternative financing besides bank loans, i.e. nonbank financing either from the stock market, bond and Islamic bond (sukuk) market, as well as the Medium-term Notes (MTN) market and Negotiable Certificates of Deposit (NCD).

8.1. BANKING PERFORMANCE

In 2015, the performance of the banking industry experienced a slight slowdown in line with the slowing domestic economic growth. Although bank intermediation slowed, the banking industry's profitability was still able to maintain its positive growth. Loans growth in 2015 slowed to 10.4% from 11.6% in 2014. As a result of this slowdown, the Return on Assets (ROA) and the Net Interest Margin (NIM) also experienced a decline, albeit still staying at fairly high levels.

Amid various challenges, the resiliency of the banking industry was still quite strong, as reflected in the high capital adequacy ratio and controlled loans risk. The Capital Adequacy Ratio (CAR) in 2015 rose to 21.2% from 19.5% in 2014. This level of CAR was far higher than the levels in other regional countries which had high CAR levels, such as Thailand with CAR of 17%. Credit risk was still maintained at a fairly low level, with Non-Performing-Loans (NPLs) of 2.5%, or up only slightly compared with the level at the end of 2014 of 2,2%. This condition encouraged banks to be more cautious in facing a slowing economy by maintaining their ability to absorb risks.

To maintain the economic growth momentum, Bank Indonesia issued a number of accommodative macroprudential policies to support loans growth. These macroprudential policies included: easing the Loan to Value (LTV) ratio, extending the basis for sources of bank funding by introducing the Loan to Funding Ratio (LFR), policies to develop Micro, Small, and Medium Enterprises (MSMEs), and policies to strengthen bank capital through Countercyclical Capital Buffer (CCB) requirements. These policies were able to contain the slowing loans growth

1 Components which make up the Financial System Stability Index (FSSI) are the Financial Institutions Stability Index which comprises the pressure, intermediation and bank efficiency components and the Financial Markets Stability Index.

which had fallen to 9.7% before increasing to above 10% and reducing NPLs which had reached 2.8% before falling to around 2.5%.

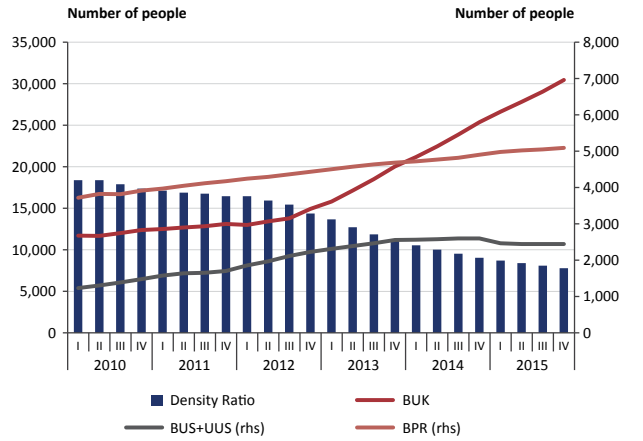
The Developments, Performance, and Risks of Commercial Banks

The structure of Indonesia's financial system in 2015 was still dominated by Commercial Banks and Rural Banks (BPR). This was reflected in the ratio of total assets of the banking industry to those of financial institutions which reached 78.2%.[2] Nonetheless, weak banking intermediation did lead to slowing growth of banking assets. Institutionally, the number of commercial banks declined from 119 banks to 118 banks and the number of BPR declined from 1,643 to 1,637. Nevertheless, total assets of the banking industry still increased from Rp5,615.1 trillion to Rp6,132.8 trillion in 2015, or increased by 9.2%. This increase was less than the previous year's increase of 13.4%. The increase in total assets was supported by the expansion of bank network infrastructure, as reflected in the increase in the number of commercial bank offices from 25,477 to 30,662 and the number of Rural Bank offices from 4,895 to 5,100.

The growth of bank office networks highlights the efforts of banks to expand and realize greater financial inclusion for the people. Greater financial inclusion was, among other things, reflected in a decline in the ratio of the number of bank offices to the population (the density ratio). The density ratio in 2015 shows that one bank office served 7,741 people, an improvement from the previous year's figure of 9,021 people (Chart 8.2).[3] Spatially, most regions in Indonesia already have a fairly good density ratio (Chart 8.3). A number of regions which still have a high density ratio represent a challenge for the banking industry to expand their office networks to these areas.

In 2015, bank loans grew at a slower pace of 10.4% compared with 11.6% in 2014, due to the impact of the slowing domestic economy. The slowing domestic economy encouraged companies to reduce their demand for working capital loans. Besides the weaker demand from companies, banks were also more cautious in channelling loans in order to keep credit risk at a safe level. Nevertheless, the lending standard index experienced a decline in the second half of 2015 to 5.9 at the end of

Chart 8.2. Number of Bank Office and Density Ratio Year 2010-2015



2015 in line with the beginning of nascent momentum of economic recovery (Chart 8.4).[4] In 2015, Bank Indonesia issued a number of regulations which were aimed at halting the slowing loans growth, i.e. by easing LTV, expanding sources of bank funding via the LFR regulation, and by developing MSMEs. Easing LTV is intended to give banks room to boost loans to the property and automotive sectors. Meanwhile, the LFR regulation is intended to give banks room to increase their intermediation role more widely by not only relying on bank deposits. These two policies were implemented in the context that macroprudential policy plays a countercyclical role, i.e. in arresting the slowing pace of loans growth as well as economic growth.

Although bank intermediation tended to slow, the role of banking in financing economic activities still increased. This was evident in the loans to GDP ratio which rose to 45.6% in 2015 from 40.1% in 2014. Yet if compared to other countries in the region, such as Malaysia, the ratio was still quite low. The ratio of loans to GDP in Malaysia had already reached 123.1% in 2015 (Chart 8.5).

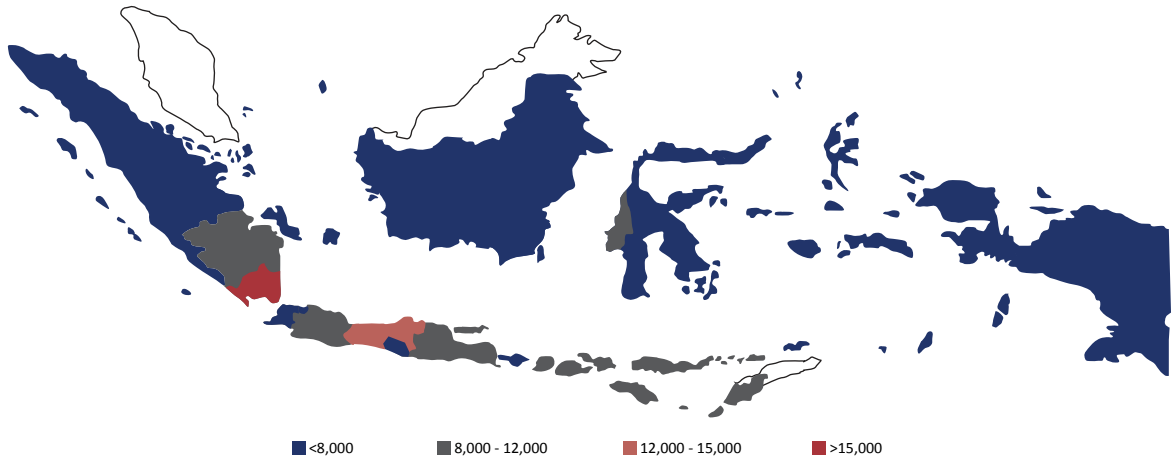
Based on its type of use, working capital loans (KMK) and consumption loans (KK) experienced a slowdown, while investment loans (KI) grew at a slightly faster pace. KMK grew at a slower pace of 9.0% at the end of 2015 compared with 2014's figure of 10.8%. Meanwhile, KI actually grew at a faster pace at the end of the year of 14.7% compared with 13.2% in 2014 (Chart 8.6). The slowing growth in KMK owed to weak demand and faster loan repayments by companies due to the slowdown

2 Study of Stability of Financial System, September 2015 edition.

3 Correction to data on a number of conventional bank (BUK) offices which was issued by the Financial Services Authority in Indonesia's Banking Statistics.

4 The index which shows changes in perceptions toward the level of stringency in bank lending.

Chart 8.3. Spatial Distribution Density Ratio



in economic activity which hit the performance of companies. Meanwhile, KK grew at a slower pace of 9.1% compared with 11.5% in 2014. Most consumption loans originated from the households sector, comprising Housing Loans (KPR) and Multiuse Loans. The weaker performance of companies was also behind the decline in household incomes, thereby reducing consumption loans. Nonetheless, the slowing pace of consumption loans was successfully reined in by easing the LTV regulation.

On a sectorial basis, the slow loans growth occurred in nearly all sectors of the economy with the sharpest slowdown in the mining, trading, and other sectors due to the decline in commodity prices which caused corporate performance to decline, either companies which produce or trade related commodities (Chart 8.7). In the first stage, the most highly affected sector was the mining sector. Nevertheless, the impact of the slowdown spread to the trading sector as the second round effect from declining commodity prices, especially in subsectors related to commodity exports trade. The second round effect resulted in a deeper slowdown in loans growth compared with the slowdown which occurred in 2014. In the mining sector, the performance of the coal subsector which produces one of the country's main commodities experienced a significant decline. Significantly weaker exports demand impacted on the worsening corporate business prospects such that demand for loans also declined. Due to the high risks faced by this subsector along with the delayed business expansion or restructuring of bad loans, companies which became debtors tended to repay their loans earlier than scheduled. Meanwhile, loans extended to other sectors as well as consumer loans which are mostly Housing Loans (KPR) and Multiuse loans also

Chart 8.4. The Development of the Standard Lending Index

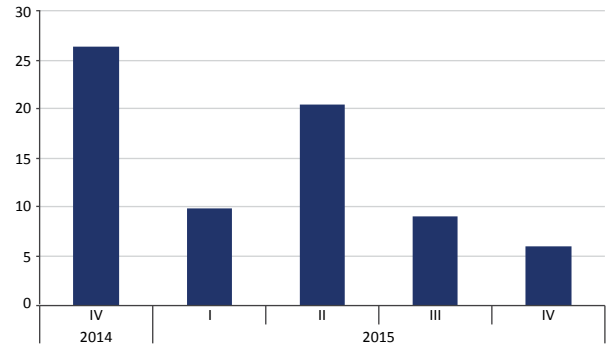


Chart 8.5. Credit to GDP Ratio

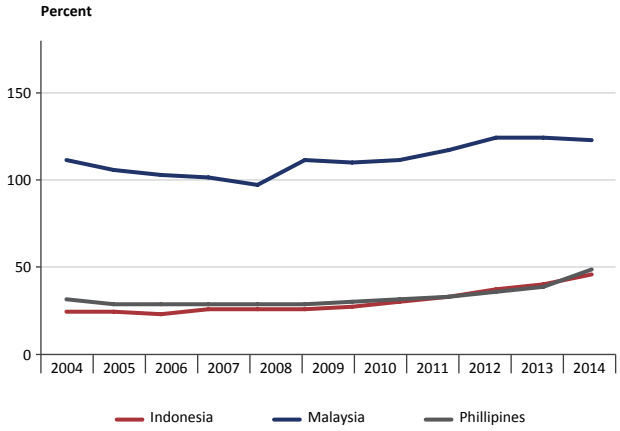


Chart 8.6. Total Credit Growth and Per Type of Use

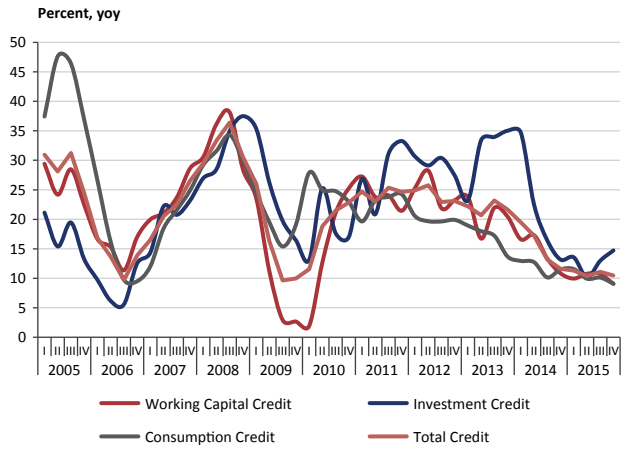


Chart 8.8. NPLs of Commercial Bank

experienced a fairly sharp slowdown due to the prolonged impact from the weaker corporate performance which, in turn, led to lower household incomes.

Bank credit risk tended to increase in 2015 although it still remained firmly within the safety threshold of 5%. The ratio of gross NPLs in 2015 rose to 2.5% from 2.2% in 2014 (Chart 8.8). The increase in NPLs mainly owed to weaker company performance in sectors which were hit by the impact of falling commodity prices. Given these conditions, sectors which experienced an increase in NPLs mainly originated from the mining, transportation, and trade sectors. Despite deteriorating compared to other sectors, the NPLs ratio for these three sectors was still in the safe range of below 5%.

For the mining sector, the increase in NPLs owed to the decline in the performance of mining companies on the back of lower demand, especially for coal, and falling prices in international markets. Deterioration in this sector had been evident since the previous year, although it gradually began to improve in late 2015. In line with this, banks reduced their loans channeled to this sector and were more proactive in taking efforts to settle previously channeled loans. The increase in credit risk in the transportation and trade sectors mainly owed to the second round effect from lower demand and falling commodity prices. In the transportation sector, the transportation of commodities by sea was impacted the most. Meanwhile, in the trade sector, the most heavily affected activity was commodity exports.

Chart 8.7. Loan Growth of Five Largest Economic Sector

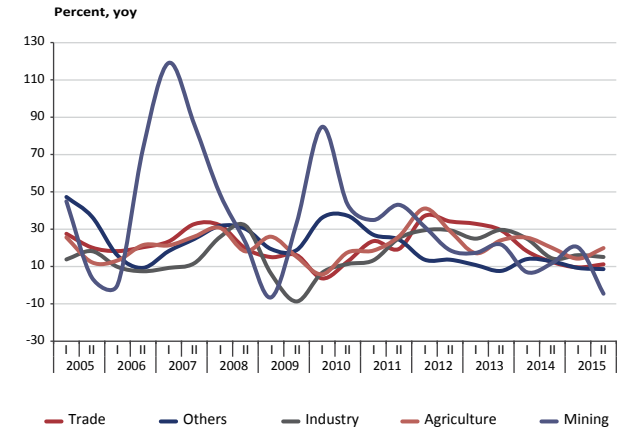
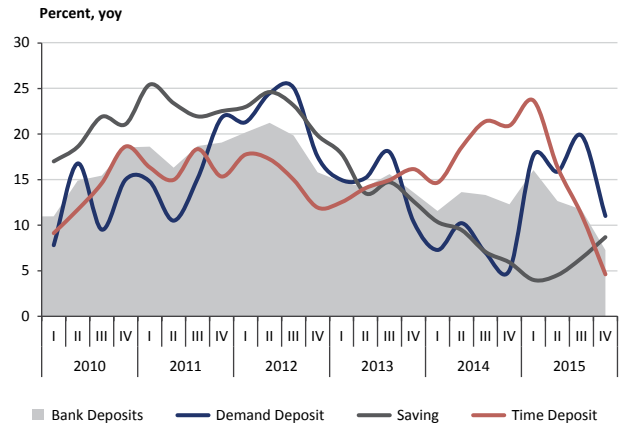


Chart 8.9. Growth of Bank Deposits

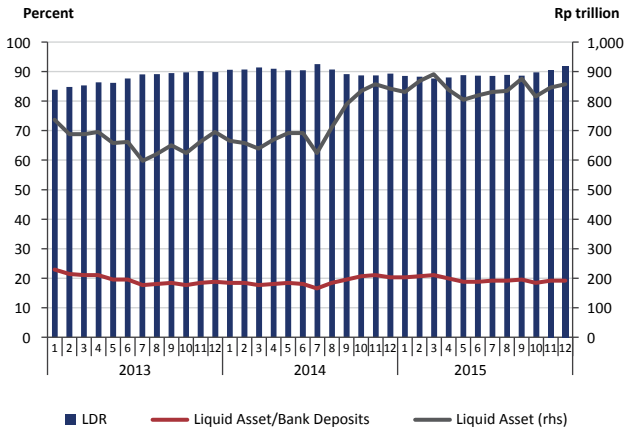


From the funding side, growth in bank deposits slowed to 7.3% at the end of 2015 compared with 12.3% in 2014 as loans growth slowed (Chart 8.9). The slowdown in the growth of bank deposits was related to factors including efficiency efforts made by banks through reducing funding costs which originated from costly funds in an effort to maintain the level of profitability. Besides that, the lower growth of bank deposits was also caused by declines in people's incomes, owing to weaker corporate performance, and the impact from the increase in the amount of securities held by Nonbank Financial Institutions in 2015.

The efficiency strategy of banks had resulted in fairly significant declined in deposit rates since early 2015. The decline in the cost of funds was accompanied by decreases in lending rates, although with a lagging effect and of less magnitude, such that the interest rates spread tended to widen (Chart 8.10). Although the growth in deposits slowed, liquidity in the banking sector during 2015 was relatively stable because loans growth also slowed. This was reflected in the relatively stable ratio of liquid assets to deposits which only fell slightly from 20.5% in 2014 to 19.4% at the end of 2015 (Chart 8.11). This liquidity ratio was still far above the safe level of 8.5%, indicating that banking conditions were still safe in face of the risk of a decline in liquidity which may occur.

The lack of recovery in the banking intermediation function led to a decline in the profitability and efficiency of the banking industry as reflected in a rise in ROA d and an increase in ratio of Operating Expenses to Operating Income (BOPO). The downturn in performance despite the ability of banks to reduce their cost of funds was due to the increase in provision expenses arising from the

Chart 8.11. LDR and Liquid Assets/Bank Deposits Ratio



slower loans growth which was accompanied by higher credit risk. Nevertheless, compared with other regional countries, the ROA in Indonesia's banking sector was still higher. The decline in the ROA was driven by the decline in the NIM due to tepid loans growth which had already led to a decline in interest income (Chart 8.12). The NIM at the end of 2015 was recorded at 5.2%, or lower than in the previous year (5.5%). Despite the decline, the NIM of banks in Indonesia was still far higher than in other countries in the region, such as Malaysia and Singapore where the NIM ranged between 1.6%-2.0%. Furthermore, the increase in provision expenses and the decline in interest income led to an increase in the BOPO ratio from 75.1% in 2014 to 82.2% at the end of 2015 (Chart 8.13).

Indonesia's banking sector continues to act prudently in addressing the increase in external risks and the slowdown

Chart 8.10. Average Lending Rates, Rupiah Time Deposit Rates and BI Rate

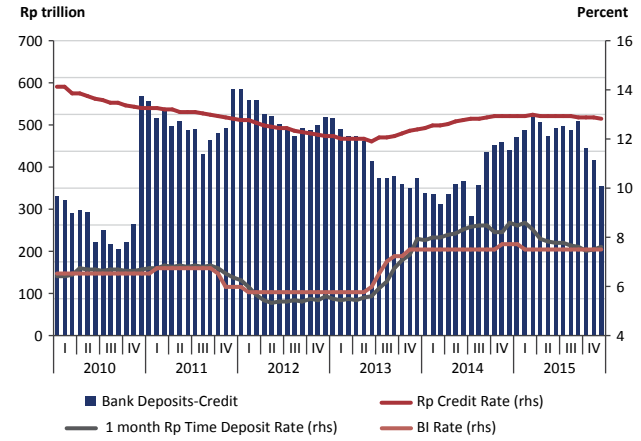


Chart 8.12. Return on Assets (ROA)

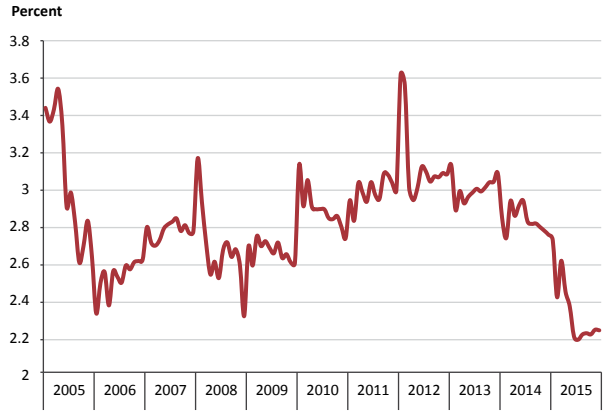
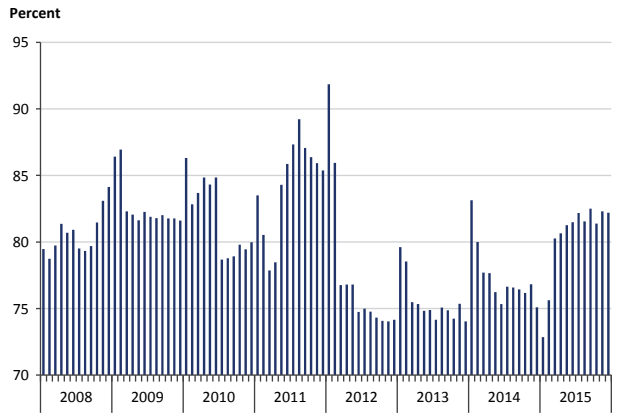


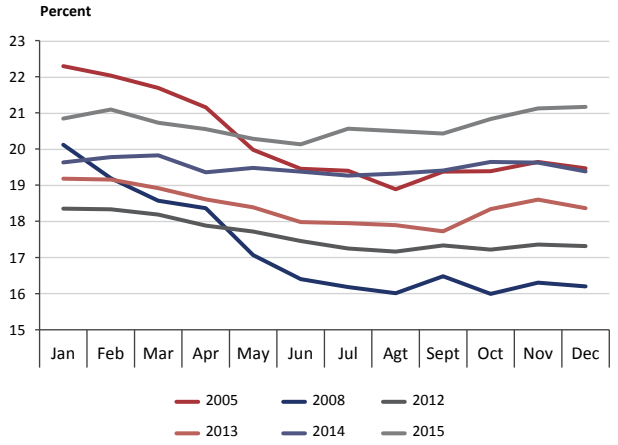
Chart 8.13. Operating Expenses to Operating Income



in domestic economic growth. In this regards, Indonesia's banking sector already witnessed an increase in the capital ratio in 2015 to cushion potential risks. Banking capital rose from Rp722.2 trillion in 2014 to Rp938.1 trillion at the end of 2015. The Capital Adequacy Ratio (CAR)at the end of 2015 was recorded at 21.2%, or higher than the previous year's 19.4% (Chart 8.14). The increase in capital was not only intended to maintain resiliency toward potential risks but also to prepare banks to face the enactment of the provisions of Basel III which stipulates higher capital ratios.

On a regular basis, Bank Indonesia undertook assessments on the CAR of banks toward credit risks and market risks by carrying out stress tests, either industry wide or on individual banks. Assessments of capital adequacy were tested against credit risk and market risk. The stress test

Chart 8.14. Capital Adequacy Ratio



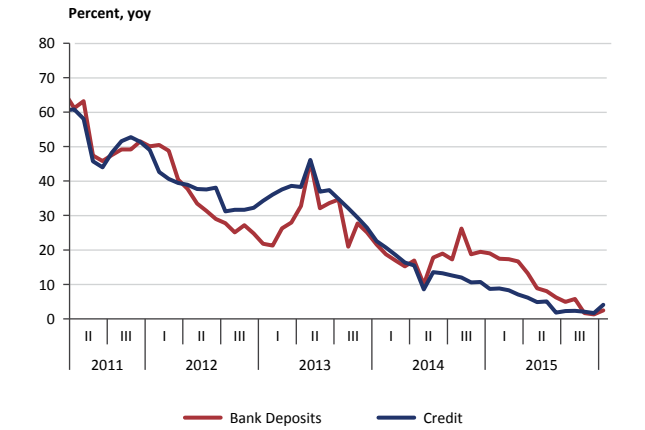
on credit risk was undertaken by taking into account the impact of an increase in NPLs toward the capital of banks. Meanwhile, the stress test on market risk was undertaken by taking into account the impact of an increase in interest rates, the exchange rate, and the decline in Government Bond (SBN) prices. The impact of the risk of rising interest rates on banks was measured through net assets exposure and short-term rupiah liabilities (below 1 year) based on the maturity profile data of the bank. The appraisal of capital adequacy toward the risk of exchange rate weakness was measured through the scenario of exchange rate depreciation. Meanwhile, the exposure of a bank's SBN portfolio in the trading and Available-for-Sale (AFS) categories was used to assess the vulnerability of banks toward the risk of falling SBN prices. The results of the stress test by using the worst-case scenario showed that despite a deterioration in banking conditions, the banking industry in general still had fairly strong capital adequacy. This was reflected in the CAR which was still above the safe limit. In the event of a sharp economic downturn, the integrated results of the stress test showed that there were a number of banks which need capital injections to maintain their CAR above the risk profile.

The Developments, Performance, and Risks of Sharia Banking

Developments in sharia banking were relatively stagnant in 2015. From the institutional side, the number of Sharia Commercial Banks (BUS) was recorded at 12, with 1,990 offices, or down from 2,151 offices in the previous year. Meanwhile, the number of Sharia Business Units (UUS) was unchanged at 22 UUS, with 311 offices. From the assets side, sharia banking's total assets at the end of 2015 reached Rp296.3 trillion, up by Rp23.9 trillion or 8.8% from 2014. Given this, the market share of the total assets of sharia banking to total assets of the banking system reached 4.8% or down slightly compared to the previous year.

Weak banking intermediation and heightened financing risk also affected sharia banking. In line with the slowdown in the channelling of bank loans, growth in the sharia banking industry's financing in 2015 slowed to 4.1% from 8.7% at the end of 2014 (Chart 8.15). The slowdown was also seen in the performance of bank deposits from 19.0% at the end of 2014 to 2.4% at the end of 2015. The deeper slowdown in sharia banking intermediation compared to that of the banking industry in general, with fairly high NPF of 4.8%, showed a slight improvement over the previous year's level of 5% (Chart 8.16).

Chart 8.15. Islamic Banking Intermediation



The slowdown in sharia banking intermediation was accompanied by weaker performance. In terms of profitability, there was stagnation for sharia banks at fairly low levels, as indicated by ROA which was far below that of the banking industry. The ROA of sharia banks in 2015 of 0.49% improved slightly from 0.41% in 2014. The low profitability ratio was accompanied by capital ratios which were lower than the industry's. The CAR of sharia banks in 2015 of 15.0% was down from 2014's level of 15.7%.

The Developments, Performance, and Risks of lending to MSMEs

The slowdown in domestic economic growth also led to a slowdown in demand for loans to Micro, Small, and Medium Enterprises (MSMEs) due to the fall in demand for goods and services. Meanwhile, the increase in credit risk perceptions encouraged banks to be more cautious in channelling loans. In 2015, MSMEs loans reached Rp790.5 trillion or only up 8.0% (yoy), or slower than the growth in 2014 of 15.1% (yoy). The slowdown in MSMEs lending was seen in nearly all sectors of the economy, such as the manufacturing sector where growth reached only 10.0%, or lower than 2014's 19.6%. The lower demand for goods and services also impacted on other sectors, such as the mining sector which originated from supporting MSMEs (truck rentals, equipment, and wages) and the transportation sector which experienced contractions of 19.2% and 4.6%, respectively.

Based on the business classification, the slowdown in MSMEs lending was mainly seen in the micro enterprises where growth reached 11.2%, much lower than the previous year's 33.4%. This is related to the strategies of banks, especially banks with limited networks and human resources, which tended to hold back from microenterprise lending due to rising NPLs. These banks were more focused on making efforts to reduce their NPLs in 2015. Meanwhile, lending to small enterprises showed brisker growth, up from 1.3% in 2014 to 6.4% in 2015.

The market share of MSMEs lending to total bank lending in 2015 reached 19.3%, or lower than 2014's 19.7%. It was mainly absorbed by the wholesale and retail trade sector reaching 52.2% (Rp412.7 trillion). Based on business classification, most MSMEs loans were channelled to medium sized enterprises with a share of 48.6%, followed by small sized enterprises with a share of 29.1%, and micro enterprises with a share of 22.3% (Chart 8.17). Meanwhile, based on project location, the absorption of MSMEs loans are still centerd on Java with a share of 57.8%, followed

Chart 8.16. NPF Development of Islamic Banking

Chart 8.17. MSMEs Lending Development

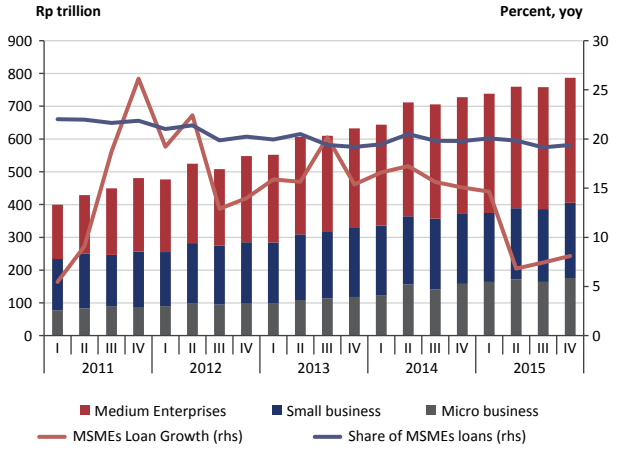


Table 8.1. People's Business Credit Scheme 2015

Items	Micro People's Business Credit	Retail People's Business Credit	Indonesia Migrant People's Business Credit
Business fields	Agriculture, fisheries, manufacturing, and related trade		Especially the placement of Singapore, Malaysia, Brunei, Hong Kong, Taiwan, South Korea and Japan
Ceiling	up to Rp25 million	> Rp25 million up to Rp500 million	up to Rp25 million
Source of funds	100% of funds provided by People's Business Credit executing bank		
Delivery mechanisms	- Directly from the executing bank - Through the linkage institutions (channeling)		- Directly from the executing bank - Through the linkage institutions (channeling or syndication)
Interest rate	12% (effective per annum) or can be adapted to the flat rate equivalent)		
Time period	- A maximum of 2 years for Working Capital Loan - Maximum of 4 years for Investment Loan	- A maximum of 3 years for Working Capital Loan - Maximum of 5 years for Investment Loan	The maximum working time during the term and do not exceed 3 years
Guarantee company	Perum Jamkrindo and PT. Askrindo		

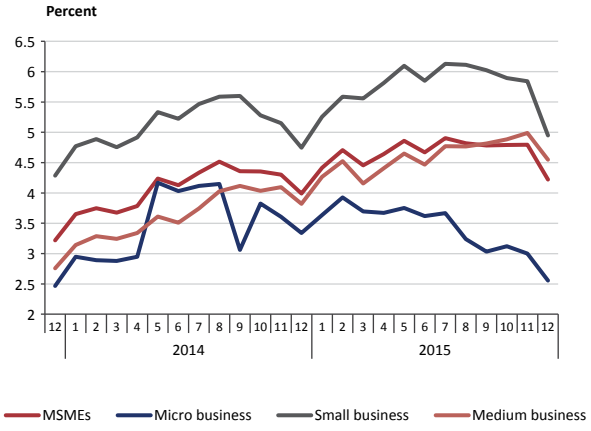
by Sumatra (20.3%), and Sulawesi (7.1%). The majority of MSMEs loans in these three areas were absorbed by the wholesale and retail trade sector at 50.7%, 51.3%, and 62.5% respectively.

To continue to support the channelling of loans to MSMEs which play a strategic role in the economy, Bank Indonesia issued a regulation in 2015 which provides incentives and disincentives for commercial banks in achieving their targets for channelling MSMEs loans. At the end of 2015, commercial banks were required to fulfil the early stages of the minimal MSMEs loans/financing ratio of 5% from the total loans/financing, while keeping the NPLs ratio below 5%. The majority of banks had already fulfilled the MSMEs loans ratio above 5%, and most of them were also able to maintain the NPLs ratio of MSMEs loans and NPLs of total loans below 5%.

Furthermore, the Government launched its new People's Business Credit (KUR) scheme through the Regulation of the Coordinating Minister for Economic Affairs (Permenko) No.6 Year 2015 concerning the Guidelines for People's Business Credit on 7 August 2015 (Table 8.1). The new KUR scheme comprises KUR Micro, KUR Retail, and KUR TKI with targeted KUR lending in 2015 of Rp30 trillion with an interest rate of 12%. Furthermore, to encourage the channelling of KUR, the Government changed the KUR scheme by issuing Permenko No. 8 Year 2015. The changes made include the following: (i) adding to the services sectors which previously only included the agriculture, fisheries, manufacturing, and trade sectors, (ii) not mandatory to have additional collateral, (iii) extension of the loan term, and (iv) channelling mechanism through linkages either channelling or executing. Banks appointed to channel KUR Micro and KUR Retail are BRI, BNI, and Bank Mandiri. Meanwhile, for KUR TKI the appointed banks are Sinarmas Bank and Maybank Indonesia with guarantees from Perum Jamkrindo and PT Askrindo.

From August 2015 until 31 December 2015, realisation of the new KUR scheme had just reached Rp22.8 trillion or 75.9% of the target. The amount channelled comprised Rp14.1 trillion (70.5% of the target) of KUR Micro, Rp8.7 trillion (96.2% of the target) of KUR Retail, and Rp4.7 billion (0.5% of the target) of KUR TKI. The shortfall in the KUR target for 2015 was related to several factors including the relatively short period for channelling KUR (five months), the limited number of channelling banks, along with a lack of socialisation of the new KUR scheme and implementing regulations. Besides that, the channelling

Chart 8.18. NPLs Ratio of MSMEs Loans



of KUR was also still concentrated in the areas of Java (East Java, Central Java, and West Java) with as many as 1,003,663 debtors.

The risks associated with MSMEs loans also increased in 2015. The ratio of NPLs of MSMEs loans in 2015 reached 4.2%, or up from 4% in 2014 (Chart 8.18). The deterioration in the NPLs of MSMEs loans mainly owed to the worsening financial conditions of debtors arising from the business slowdown due to declining purchasing power. Besides that, the deterioration in the NPLs of MSMEs loans also arose because of the lack of good analysis and monitoring undertaken by banks in channelling MSMEs loans. The high ratio for NPLs of MSMEs loans was mainly seen in the wholesale and retail trade sector, which contributed significantly to the formation of NPLs of MSMEs in 2015 at 49.2%. Meanwhile, the ratio of NPLs of MSMEs loans in the wholesale and retail trade sector reached 4%, or up from 3.8% in 2014. Based on the business classification, NPLs increased in the small and medium-sized enterprises, which in 2015 were recorded at 4.9% and 4.5% respectively. This level of NPLs was higher than in 2014 which reached 4.7% and 3.8% respectively. Nevertheless, the NPLs of micro businesses fell to 2.6% from 3.3% in 2014. This reflected the behavior of banks which tended to rein in the channelling of micro business loans, given the risk of rising NPLs, thereby prompting banks to focus more on improving NPLs.

8.2. THE PERFORMANCE OF THE CORPORATE SECTOR AND HOUSEHOLDS

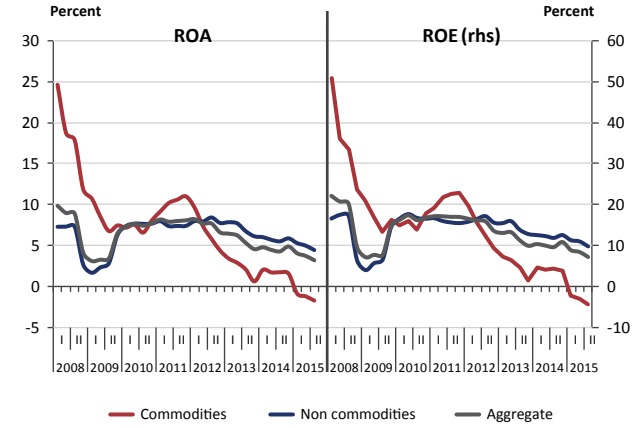
Although the performance of the corporate sector worsened in 2015, it still remained fairly resilient.

Corporate profitability experienced a decline which reduced the ability of companies to repay their debts. In addition, as exchange rate volatility increased in 2015, companies tended to reduce applications for credit and started to repay their outstanding loans.

In general, the performance of the corporate sector weakened in Indonesia, as reflected in lower profitability and reduced ability to completely repay corporate debts. The ROA and ROE, as profitability indicators, tended to decline in 2015. ROA fell from 4.9% at the end of 2014 to 3.2% at the end of September 2015. Meanwhile, ROE dropped from 10.9% at the end of 2014 to 7.3% at the end of September 2015 (Chart 8.19). This decline in profitability meant that the proportion of debt to equity increased, as reflected in the Debt to Equity Ratio (DER) which edged up from 1.2 at the end of 2014 to 1.3 in September 2015 (Chart 8.20). The weaker corporate financial performance mainly stemmed from the slowing domestic and global economic growth which led to declines in commodity prices.

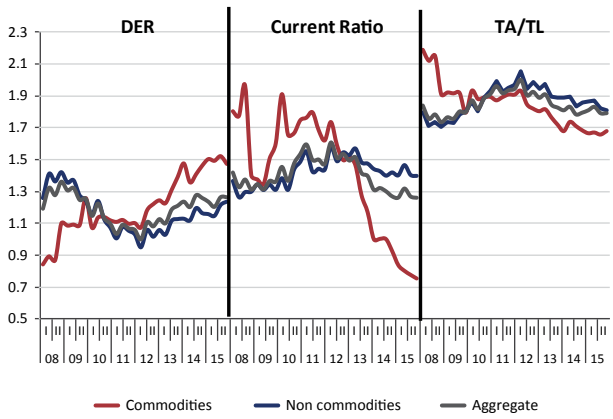
The continued downtrend in commodity prices since 2012 impacted the performance of companies which had exposure to commodities. Companies pursued various strategies in the face of commodity price declines, one of them being to raise export volumes, although also experiencing higher costs and narrower margins. As a result, companies operating in the commodities sector were less able to service their debt, as reflected in the Debt Service Ratio (DSR) which increased sharply from 144.5% in 2014 to 255.6% in 2015 (Chart 8.21). Besides that, the Interest Coverage Ratio (ICR) dropped from 2.6 in 2014 to 1.7 in 2015 (Chart 8.22).

Chart 8.19. Listed Companies Profitability Ratios



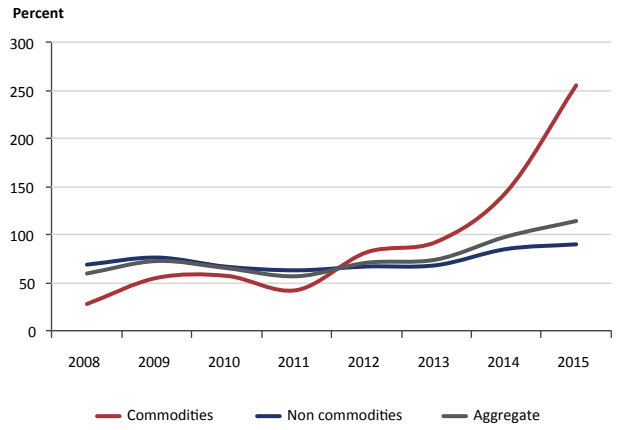
Source: Financial statements BEI and Bloomberg, processed

Chart 8.20. The Development of Listed Companies Debt



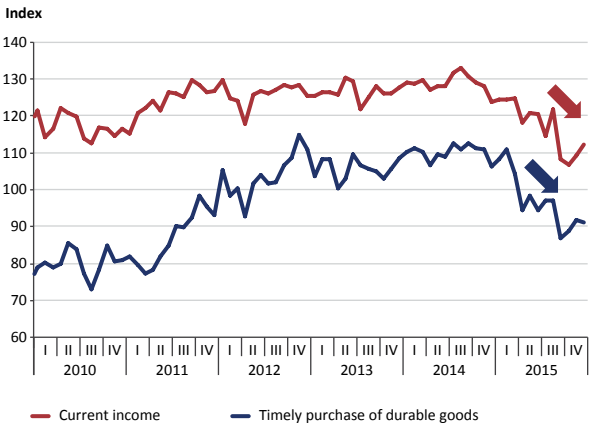
Source: Financial statements BEI and Bloomberg, processed

Chart 8.21. Debt Service Ratio of Listed Companies



Source: Financial statements BEI and Bloomberg, processed

Chart 8.23. Household Income



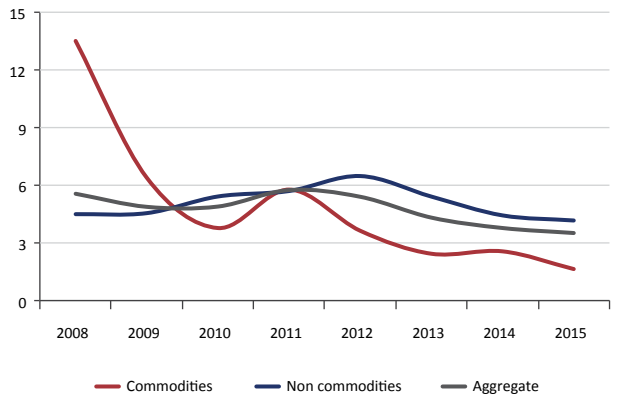
The weaker performance of companies led to lower demand for bank loans, especially compounded by the acceleration of loan repayments by corporations to reduce the risk of exchange rate volatility. Besides that, the weaker corporate performance also led to an increase in the credit risk faced by banks, which, in turn, had an impact on the overall performance of banks. Besides affecting the performance of banks, the decline in the performance of companies also adversely affected household incomes as reflected in the decline in the incomes index from 123,8% at the end of 2014 to 112,3% at the end of 2015 (Chart 8.23).

The decline in incomes was also reflected in the increase in the DSR of households from 13.0 at the end of 2014 to 13.2 at the end of 2015. This increase in the DSR of households indicates the increasing portion of instalments toward incomes. Besides that, the decline in incomes was also reflected in the growth in bank deposits owned by individuals which was lower than the growth in non-individual deposits (Chart 8.24). Besides bringing about a decline in the bank deposits owned by individuals, the decline in incomes also contributed toward the slowing growth and the increase in the NPLs ratio of consumption loans.

8.3. NONBANK FINANCIAL INDUSTRY AND PERFORMANCE OF THE FINANCIAL MARKETS

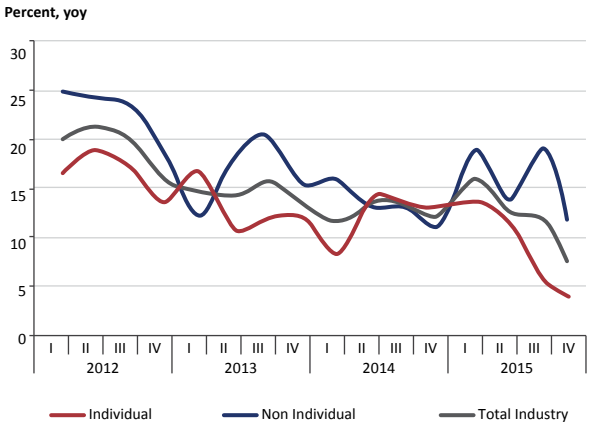
The Nonbank Financial Industry (LKNB) showed weaker performance in 2015. Financing companies, insurance and pension fund companies recorded a slowdown in assets

Chart 8.22. Interest Coverage Ratio of Listed Companies



Source: Financial statements BEI and Bloomberg, processed

Chart 8.24. Bank Deposits Based on Ownership



growth in line with the slowing economic growth in 2015. Meanwhile, pawnshop services recorded brisker assets growth in 2015 of 10.9%, or higher than the previous year's figure of 6.0%. From the risk side, as economic growth slowed, the LKNB risks also increased. Financing companies' risks rose, as reflected in the increase in the NPF ratio, albeit still remaining at a low level. Besides that, for the insurance companies, there was an increase in the risks at the operating level as shown by the ratio of gross claims toward gross premiums. Nonetheless, from another aspect, the insurance companies' liquidity risk was still relatively well controlled as reflected in the high level of the ratio of current assets to current liabilities.

The performance of the financial markets, either the bond or stock markets, also showed a decline in 2015. In the bond market, the weaker performance was reflected in the 10-year SBN yield which rose from 7.80% in 2014 to 8.75% in 2015. As for the stock market, the weaker performance was reflected in the decline in the JCI to 4,593.01 at the end of 2015, or down 12.13% from its level at the end of 2014 of 5,226.95. In line with this weaker performance, the risks in the bond and stock markets also increased. The increased risk in the bond market was reflected in both the increase of the 10-year SBN yield and the higher volatility in 10-year SBN yields. Meanwhile, the increased risk in the stock market in 2015 was reflected in the declines in the JCI and the higher JCI volatility.

Meanwhile, nonbank financing in 2015 experienced an increase. This nonbank financing was mostly undertaken by non-financial companies such that the share of financial companies declined. Nonbank financing, either through the stock market, bond market, or corporate sukuk, along with the MTN market and NCD in 2015 reached Rp136.1 trillion, or up from Rp111.4 trillion in 2014. This increase reflected, at least in part, the more stringent lending standards by banks in channelling loans in line with the increase in loan risk perceptions by banks. This condition encouraged companies to use alternative financing besides loans, i.e. nonbank financing either from the stock market, bond market, or corporate sukuk, along with the MTN market and NCD.

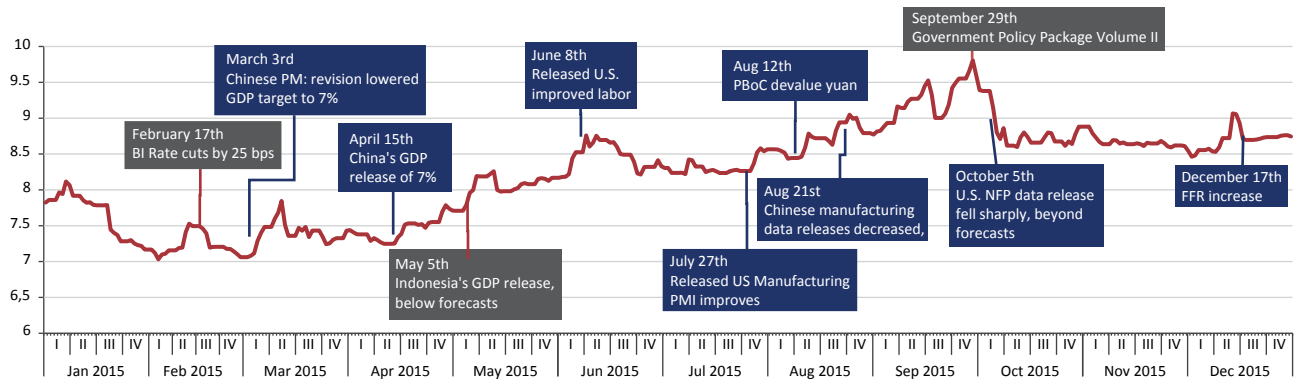
The Performance of the Nonbank Financial Industry (LKNB)

The LKNB generally recorded a slowdown in assets growth in line with the slowdown in economic growth in 2015. Financing companies, insurance and pension fund companies recorded slower assets growth in 2015, reaching 1.3%, 4.6%, and 10.2%, respectively, or down compared to the previous year's figures of 5%, 17.1%, and 13.7%. Meanwhile, pawnshop services recorded brisker growth in assets in 2015, reaching 10.9%, or higher than 6.0% in the previous year. The better performance of pawnshop services was also seen in the brisker growth in pawnshop services financing which grew by 12.3%, or higher than the growth in 2014 of 5.3%. One of the factors driving the faster growth in pawnshop services financing was the stronger demand in the business sector, such as convection and contracting services companies, to obtain short-term capital each year by pawning their assets to be more productive.

On the side of financing provided by financing companies, the financing growth in 2015 slowed to -0.8% from 5.2% in 2014 in line with the slowdown in economic growth in 2015. Based on the type of financing, leasing still recorded negative growth of -5.0%, although still an improvement compared to -5.5% in 2014. Meanwhile, consumer finance and factoring recorded positive growth reaching 0.5% and 14.1%, respectively, or slowing from 10.2% and 22.3% in 2014. Based on the type of financing, consumer finance still dominated the financing of financing companies with a contribution of around 68.0% from the total financing, or up from 67.12% in 2014. Meanwhile, leasing is the second largest type of financing with a share at the end of 2015 of 29.0%, or slightly down from 30.3% in 2014. In nominal terms, the amount of financing during 2015 reached Rp363.3 trillion in the form of consumer financing (Rp247.1 trillion), leasing (Rp105.4 trillion), factoring (Rp10,7 trillion), and credit cards (Rp95.0 billion). As such, as in previous years, the focus of financing companies is still on consumer financing, especially short-term consumer financing.

From the risk side, as the economic growth slowed, the financing companies and insurance companies risk also increased, as reflected in the increase in the NPF ratio and the ratio of gross claims compared to gross premiums. The NPF ratio in the first half of 2015 rose slightly from 1.41% at the end of 2014 to 1.44% in June 2015. Despite the increase, the NPF ratio was still maintained at a low level in line with the intensification of efforts by financing companies to collect bad financing. Meanwhile, for the insurance companies, the increase in business risk was reflected in the ratio of gross claims to gross premiums in the first semester of 2015 which reached 71.3% or up from 62.4% in the second semester of 2014. Nevertheless, the insurance companies' liquidity risk was relatively well maintained as reflected in the still high ratio of current assets to current liabilities.

Chart 8.25. Yield SBN 10 Years and Sentiment Factors in 2015



Source: Bloomberg, processed

The Performance of the Bond Market

The performance of the bond market weakened in 2015, as reflected in the increase in the SBN yield. The 10-year SBN yield at the end of 2015 was recorded at 8.75%, up 95 bps compared to 7.80% at the end of 2014 (Chart 8.25). In the primary market, the performance of the SBN market also showed a decline as reflected in the SBN yield which trended upwards. The SBN yield for 1 year tenors which were last offered in 2015 were recorded at 6.94% or up from 6.82% at the end of 2014. The weaker performance reflected, at least in part, the global economic sentiment, especially related to the continued slowdown in China's economic growth, uncertainty in global financial markets, especially surrounding FFR hikes and yuan devaluation, along with monetary policy divergence among advanced economies. Meanwhile, domestically, the release of worse-than-expected economic growth data also had a negative impact on the performance of the bond market.

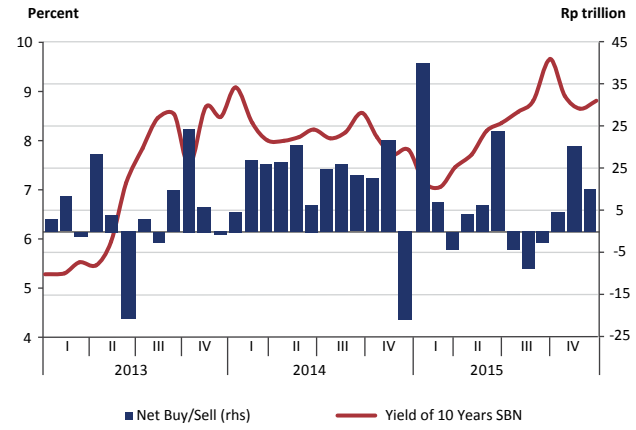
Bond market risk also increased in 2015 affected by declines in bond market performance indicators. This was reflected in increases in 10-year SBN yields in 2015. Besides that, the volatility of 10-year SBN yields in 2015 was recorded at 0.65 or up from 0.31 in 2014. Indonesia's Credit Default Swap (CDS) also deteriorated as reflected in the increase in the CDS from 160.31 at the end of 2014 to 222.92 at the end of 2015.

The market dynamics in 2015 were marked by an increase in the SBN yield in the first quarter or 2015 as investor confidence improved. This stronger optimism was a response to the policy mix of Bank Indonesia and the government in maintaining stability and undertaking structural reforms to promote further economic growth. BI policy which lowered the BI rate in February 2015 met with a positive response from the market with inflation expected to remain benign. Since the second quarter of 2015 to the end of 2015, the SBN showed weaker performance, as reflected in the SBN yield which continued to increase. Below market ecpectation economic growth in China, yuan devaluation policy by the People's Bank of China (PBoC), and mounting fears of FFR hikes, following the release of stronger U.S. data and manufacturing, created negative sentiment which pushed up SBN yields.

The uptrend in SBN yields could be contained thanks to the coordination of Bank Indonesia and the Government through its policy mix in facing pressures in the financial markets. The Government's policy packages, especially the Government's policy package No. 2 on 9 September 2015 (which was focused on improving the investment climate and maintaining stability of the rupiah exchange rate) had a positive impact on lowering SBN yields. In the same period, easing concerns on FFR hikes in line with the release of Nonfarm Payroll (NFP) data which unlike the market had predicted posted a decline, also helped push down SBN yields further. Nonetheless, the SBN yield at the end of 2015 was recorded at 8.75% or up 95 bps compared to 7.80% at the end of 2014.

The performance of the SBN market in 2015 which tended to weaken was also reflected in the weaker activities of non-resident investors who purchased SBN. During 2015, non-resident investors were net buyers in the SBN market to the tune of Rp96.1 trillion, or less than the figure of Rp137.5 trillion in 2014. In the first quarter of 2015, non-resident investors actually undertook quite large

Chart 8.26. SBN Yield and Net Foreign Buy/Sell

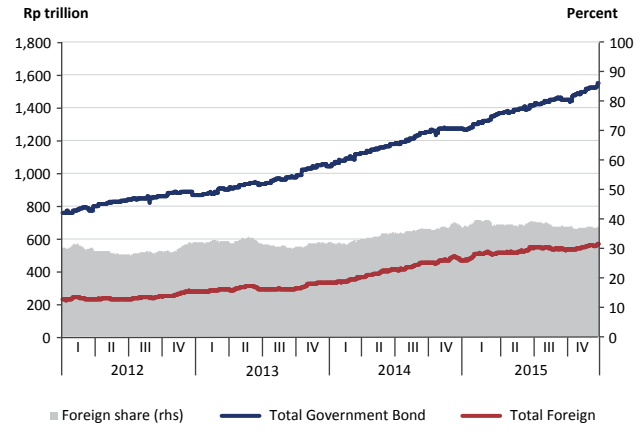


Source: Bloomberg, processed

net buying which reached Rp42.7 trillion as optimism improved in response to the policy mix of Bank Indonesia and the Government (Chart 8.26). Nonetheless, in the third quarter of 2015, non-resident investors were net sellers due to greater uncertainty in the global financial markets arising from weaker-than-expected economic growth in China, devaluation of the yuan, along with mounting concerns of FFR hikes. These conditions changed in the last quarter of 2015 as the uncertainty in the global financial markets eased thanks to growing optimism as steps to stabilize the rupiah were taken by Bank Indonesia and a series of economic policy packages were taken by the government.

The role of non-resident investors in the SBN market was still quite big. The share of non-resident investor holdings in the SBN market during 2015 was relatively stable

Chart 8.27. Share of Foreign Investor Ownership on the Government Securities



Source: Ministry of Finance, processed

at around 37%. On average, the share of non-resident investor holdings in the SBN market in 2015 was recorded at 37.4%, or up from 34.5% in 2014 (Chart 8.27). The fairly large contribution of non-resident investors in SBN holdings has implications on the strength of the external factors influencing the dynamics of the SBN market as well as translating into higher risks should there be a reversal of sentiment.

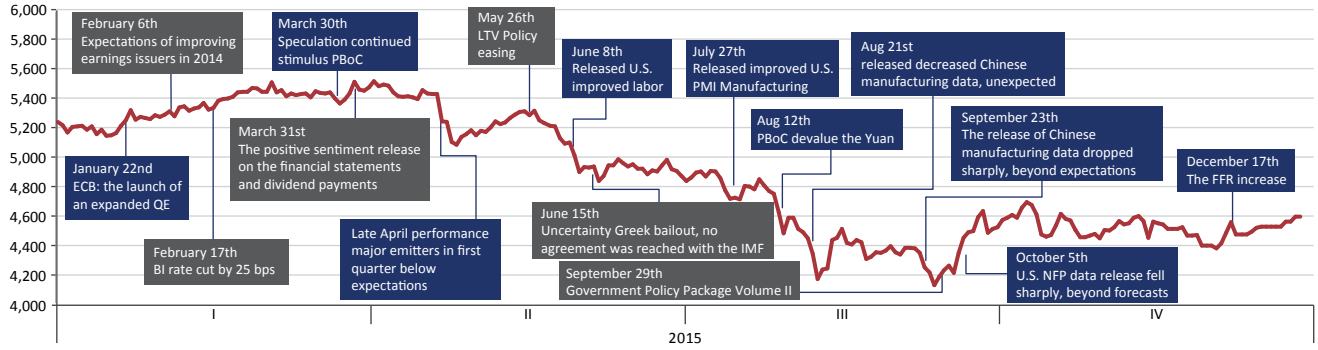
The Performance of the Stock Market

The domestic stock market also showed weaker performance, as reflected in the declines in the JCI to 4,593.01 at the end of 2015, or down 12.13% from its level at the end of 2014 of 5,226.95. In the first quarter of 2015, the JCI managed to eke out gains on better corporate earnings expectations for 2014 and positive sentiment on the release of financial reports and dividend payments by listed companies. Meanwhile, positive sentiment from global economic developments at the beginning of 2015 also helped push up the JCI. This positive sentiment on the external front included the launch of ECB policies at the end of January 2015 to expand QE and speculation of a further stimulus by the PBoC at the end of March 2015.

Stock market risk also showed an increase in 2015, as reflected in the declines in the JCI and increased JCI volatility. The JCI volatility in 2015 was recorded at 407.7, or up from 256.3 in 2014. This increased volatility owed, at least in part, to the dynamics of the JCI which showed a downtrend starting in the second quarter of 2015. In the second quarter until the end of 2015, the performance of the JCI weakened. Beginning with the negative sentiment on the performance of blue chips in the first quarter of 2015 which was below expectations, the JCI started to show a downward trend at the beginning of April 2015. Meanwhile, from the external side, negative sentiment from several factors which hit the bond market also weighed on stock prices (Chart 8.28).

The policy mix of Bank Indonesia and the government was able to stem the declines on the JCI. Like in the bond market, the downtrend in the JCI could be arrested thanks to coordination between Bank Indonesia and the government through its policy mix in facing financial market pressures, including government policy packages, especially the Government's policy package No.2 dated 9 September 2015. Easing market concerns in relation to the expected postponement of FFR hikes in October 2015 also helped push the JCI higher at the end of 2015. Nevertheless, overall in 2015, the IHSG reached 4,593.01

Chart 8.28. JCI and Sentiment Factors in 2015

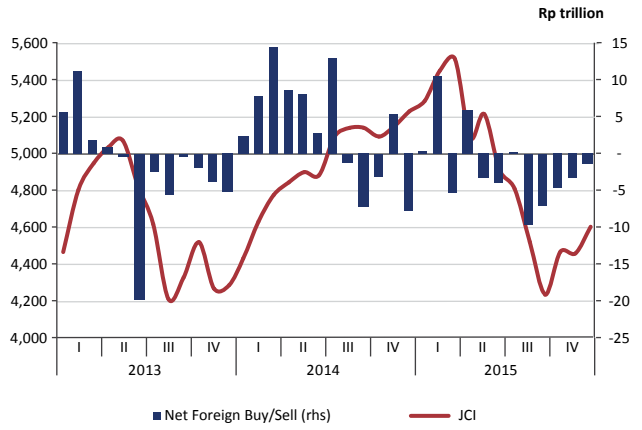


Source: Bloomberg, processed

at the end of 2015, or down 12.13% from its level at the end of 2014 of 5,226.95.

The weaker performance of the stock market in 2015 was also reflected in the high level of net selling by non-resident investors in the stock market. In 2015, non-resident investors were net sellers in the stock market to the tune of Rp22.6 trillion, while in 2014, non-resident investors undertook Rp42.6 trillion of net buying (Chart 8.29). Looking at the quarterly dynamics, in the first quarter of 2015, non-resident investors still undertook net buying of Rp5.4 trillion, supported by positive sentiment in the stock market, including better expectations of corporate performance, benign inflationary expectations, as well as ECB policy at the end of January 2015 to expand QE. Nonetheless, since the second quarter of 2015, selling pressure by non-resident investors increased on the back of negative sentiment, especially from the external side, including devaluation of the yuan, mounting concerns of FFR hikes, and weaker-than-expected economic growth in China. As in the bond market, net selling pressure started to ease, especially in the last quarter of 2015, as uncertainty in the global financial markets started to recede and domestic developments started to improve. Since the second quarter of 2015 until the end of the year, non-resident investors undertook Rp26.6 trillion of net selling.

Chart 8.29. JCI and Net Foreign Buy/Sell



The role of non-resident investors was still quite large in the stock market. The share of non-resident investors (buying) in trading value was fairly volatile, yet fairly large (>30%). On average, the share in trading value of non-resident investors in the stock market in 2015 was recorded at 42.2%, or slightly up from 42,0% in 2014. The fairly large contribution of non-resident investors in trading value reflects the strength of the external factors influencing the dynamics of the stock market as well as the sizeable risk of a reversal in the stock market.

Nonbank Financing

Nonbank financing increased in 2015 but with a declining share of the financial sector. Nonbank financing in 2015 reached Rp136.1 trillion, or up from Rp111.4 trillion in 2014 (Table 8.2). The nonbank financing in 2015 was mostly undertaken by non-finance sector companies such that the share of the financial sector declined. The decline in the share of the financial sector was mostly seen in financing through the stock market. This decline in the share of the financial sector in the stock market (or the greater role of the non-financial sector) is an

Table 8.2. Total Non-Bank Financing

indicators	2014	2015
Total Non-Bank Financing	**111.4**	**136.05**
Total o/w Financial Sector Issuers	52.3	60.4
Share of Financial Sector (%)	47.0	44.4
Stock	**47.7**	**53.5**
Stock o/w Financial Sector Issuers	9.8	3.9
Share of Financial Sector (%)	20.5	7.3
Bonds and Sukuk	**48.7**	**62.4**
Bond o/w Financial Sector Issuers	33.4	42.3
Share of Financial Sector (%)	68.5	67.7
MTN and Promissory Notes + NCD	**14.9**	**20.1**
MTN, NCD o/w Financial Sector Issuers	9.2	14.2
Share of Financial Sector (%)	61.3	70.6

Source: OJK and KSEI, processed

indication of the deepening of financing through the stock market. Meanwhile, the share of the financial sector was still dominant in other nonbank financing, either through bonds or through Medium-term Notes (MTN) and Negotiable Certificates of Deposit (NCD).

Nonbank financing either through the stock market, bond market or corporate sukuk along with the MTN market and NCD showed an increase in 2015 compared to the previous year. This increase could at least in part be attributed to the more stringent lending standards of banks in channelling loans which was in accordance with the increased lending risk perceptions of banks. This condition encouraged companies to use alternative financing besides loans, either from the stock market, bond market or corporate sukuk, along with the MTN market and NCD.

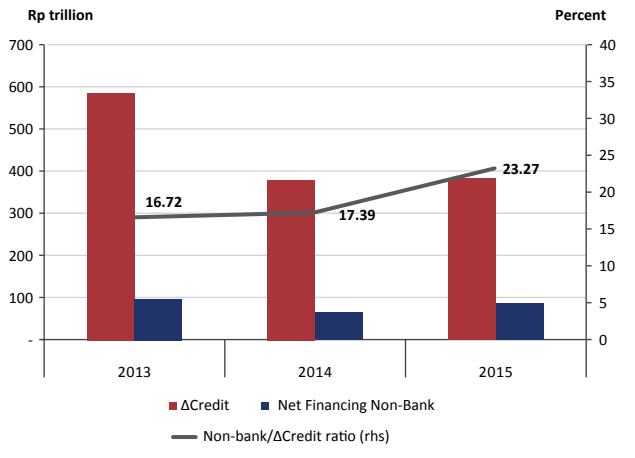
The amount of financing in the stock market in 2015, either through rights issues or Initial Public Offerings (IPO), reached Rp53.5 trillion, or up 12.3% compared with Rp47.7 trillion in 2014. The increase in financing in the stock market was supported by an increase in financing either through rights issues or IPO. Financing from rights issues in the primary market reached Rp42.3 trillion, or up by 7.3% from Rp39.2 trillion in 2014. Meanwhile, the amount of financing through Initial Public Offerings (IPO) was recorded at Rp11.3 trillion, or up 35.8% from Rp8,3 trillion in 2014 (Table 8.3). The increase in financing through the stock market was driven by companies in the infrastructure, property, consumer goods industry, and mining sectors. The increase in financing in the stock market came on the back of expectations of improving economic conditions in Indonesia, especially related to renewed economic growth momentum in the third quarter of 2015.

The issuance of corporate bonds and sukuk in 2015 reached Rp62.4 trillion, or up 28.1% from Rp48.7 trillion in 2014 (Table 8.4). After taking into account the maturing corporate bonds and sukuk, the net issuance of corporate bonds and sukuk during 2015 reached Rp26.9 trillion, an increase by more than threefold compared to the net issuances in 2014 of Rp7.1 trillion. The increase in financing through corporate bonds in 2015 mainly originated from companies in the infrastructure and finance sectors. The increase in issuances of corporate bonds, as alternative nonbank financing, appears to be related to the relatively low interest rates for bond issuances compared to bank lending rates in 2015.

Meanwhile, issuances of MTN and NCD during 2015 reached Rp20.1 trillion, or rise by 34.6% from Rp14.9 trillion in 2014. Nevertheless, the relatively high level of MTN and NCD issuances stems, at least in part, from the relatively high amount of MTN and NCD which fell due in 2015. As such, some of the MTN and NCD issuances are to replace the maturing MTN and NCD in 2015. After taking into account the maturing MTN and NCD, issuances of MTN and NCD in 2015 only reached Rp8.9 trillion, or down from Rp11.5 trillion in the previous year. Like in the previous year, issuances of MTN and NCD were dominated by companies operating in the financial sector.

The role of nonbank financing increased in 2015. Overall, the ratio of nonbank financing and bank lending in 2015 was recorded at 35.4%, or higher than the ratio in 2014 of 29.2% (Chart 8.30). The increasing trend was also

Chart 8.30. Credit Changes and Net Financing Non-Bank



Source: OJK, processed

Table 8.3. IPO Financing and Right Issue

IPO

Sectoral	Realization of 2014			Realization of 2015		
	Number of Issuers	Value*	Share (%)	Number of Issuers	Value*	Share (%)
Agriculture	1	0.2	2.4	-	-	-
Mining	1	0.3	3.9	1	0.8	7.4
Basic Industry	2	1.8	21.8	-	-	-
Various Industry	-	-	-	2	0.3	2.6
Consumer Goods Industry	1	0.1	1.2	1	0.9	7.7
Property and Real Estate	1	0.4	5.2	5	3.5	30.7
Infrastructure, Utilities, and Transportation	4	3.2	38.8	-	-	-
Finance	6	0.5	6.1	3	0.1	1.2
Trade, Services, and Investment	4	1.7	20.6	3	5.7	50.3
Total	**20**	**8.3**	**100**	**15**	**11.27**	**100**

Right Issue

Sectoral	Realization of 2014			Realization of 2015		
	Number of Issuers	Value*	Share (%)	Number of Issuers	Value*	Share (%)
Agriculture	1	10.8	27.6	-	-	-
Mining	3	1.9	4.9	1	5.4	12.7
Basic Industry	2	6	15.4	2	0.7	1.6
Various Industry	-	-	-	-	-	-
Consumer Goods Industry	-	-	-	1	20.8	49.2
Property and Real Estate	-	-	-	4	11.2	26.5
Infrastructure, Utilities, and Transportation	4	4.9	12.6	-	-	-
Finance	8	9.3	23.6	10	3.8	8.9
Trade, Services, and Investment	3	6.3	16	1	0.4	1.1
Total	**21**	**39.2**	**100**	**19**	**42.25**	**100**

*) in Rp trillion
Source: OJK, processed

still valid if the refinancing of maturing bonds, MTN and NCD which had a fairly large proportion were taken into account. After taking into account these factors, the ratio of nonbank financing to bank lending in 2015 still recorded an increase, up from 17.4% in 2014 to 23.3% in 2015. The increase in the ratio of nonbank financing to bank lending was also partly due to the decline in the channeling of loans.

Table 8.4. Corporate Bond and Sukuk Funding

Bond

Sectoral	Realization of 2014			Realization of 2015		
	Number of Issuers	Value*	Share (%)	Number of Issuers	Value*	Share (%)
Agriculture	-	-	-	-	-	-
Mining	-	-	-	-	-	-
Basic Industry	1	1.7	17.6	-	-	-
Various Industry	-	-	-	-	-	-
Consumer Goods Industry	1	2	20.7	-	-	-
Property and Real Estate	1	0.5	5.2	1	0.3	10.7
Infrastructure, Utilities, and Transportation	2	2	20.7	-	-	-
Finance	5	3.5	35.8	3	2.5	89.3
Trade, Services, and Investment	-	-	-	-	-	-
Total	**10**	**9.6**	**100**	**4**	**2.8**	**100**

Sustainable Public Offering of Bonds/Sukuk

Sectoral	Realization of 2014			Realization of 2015		
	Number of Issuers	Value*	Share (%)	Number of Issuers	Value*	Share (%)
Agriculture	-	-	-	-	-	-
Mining	-	-	-	-	-	-
Basic Industry	-	-	-	-	-	-
Various Industry	-	-	-	-	-	-
Consumer Goods Industry	1	0.25	0.6	1	0.5	0.8
Property and Real Estate	4	2.9	7.4	7	4.9	8.3
Infrastructure, Utilities, and Transportation	3	4	10.2	4	12.5	21
Finance	20	29.9	76.6	29	39.8	66.7
Trade, Services, and Investment	3	2	5.1	3	1.9	3.2
Total	**31**	**39.1**	**100**	**44**	**59.62**	**100**

*) in Rp trillion
Source: OJK, processed

Box 8.1 Strengthening of the Financial Sector Through Implementation of International Standards Regulation

Indonesia as a member of several international forums such as G-20[1], the Financial Stability Board (FSB), or the Basel Committee on Banking Supervision (BCBS) is bound by commitments to follow a number of international assessments. These assessments are aimed at assessing the resilience of the financial system to shocks and adherence to international standards. In 2016, Indonesia will face two international assessment processes, namely: the Financial Sector Assessment Program (FSAP) and the Regulatory Consistency Assessment Program (RCAP).

Financial Sector Assessment Program (FSAP)

FSAP is aimed at assessing the developments and stability of a country's financial sector in a comprehensive manner. Indonesia's participation in FSAP demonstrates Indonesia's commitment as a member of G-20 and FSB. Members of these two forums are required to follow the implementation of FSAP once every five years[2]. The FSAP which will be carried out in 2016 is the second FSAP, after the first FSAP in 2009/2010.

FSAP will assess the stability and health of the financial sector, whilst also assessing the potential contribution of the financial sector on growth and development. FSAP does not evaluate the health of individual financial institutions, and is not aimed at predicting or avoiding financial crises. Instead FSAP seeks to identify the source of the main vulnerabilities which can trigger crises in the financial sector.

Assessments of the financial sector stability will be carried out by undertaking reviews of the resiliency of the banking and nonbank sectors; stress-testing; systemic risk analysis including linkages between banks and nonbanks along with domestic or cross-border spillover; the microprudential and macroprudential framework; the quality of bank and nonbank supervision; oversight of Financial Market Infrastructure – FMIs; and evaluation of financial safety nets to effectively respond to systemic pressures. In relation to development aspects, FSAP assesses the need to develop institutions, markets, infrastructure, inclusivity; the quality of the legal framework and the payments system along with settlement; the identification of obstacles to competition and sector efficiencies; matters related to financial inclusion and retail payments; along with assessing its contribution to economic growth and development.

Bank Indonesia plays a crucial role in implementing FSAP 2016. This is considering that the FSAP coverage after the global financial crisis emphasised assessments of the macroprudential framework which is the authority of Bank Indonesia. Besides that, assessments of FMIs in the payments system also came under the authority of Bank Indonesia. In the macroprudential area, FSAP assessments were undertaken facing the macroprudential framework with coverage including the following: systemic risk in Indonesia's financial system, tools for identifying and monitoring systemic risk, the macroprudential framework along with implemented policies, linkages between the financial sector and institutions along with potential spillover, and institutional arrangement in jurisdictions. Besides that, assessments of the stress testing undertaken will also be reported in reports which focus on discussing stress-testing issues. In relation to the Payments System, the Payments System infrastructure which is organized by Bank Indonesia is considered as financial markets infrastructure (the payments system and securities settlement system) that must meet international standards for FMIs. FSAP assessments in the area of FMIs are aimed at seeing the effectiveness of the oversight FMIs framework or developments in regard to implementation of Principles for Financial Market Infrastructure. The usefulness of FSAP for the public including other national authorities along with investors is as a baseline assessment toward financial system stability in a particular jurisdiction. Because of that, FSAP is a strategic and crucial assessment for Indonesia. The results of FSAP assessments will become feedback for the authorities in Indonesia to improve the resiliency and stability of Indonesia's financial system going forward.

1 The G-20 members are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the U.K., the United States, and the European Union (represented by the European Commission and the European Central Bank).

2 Countries which are not G-20/FSB members yet designated by the IMF as countries with systemically important financial sectors are also required to join FSAP every five years. The list of countries with systemically important financial sectors and which are required to follow assessments is determined based on the size and interconnectedness of those countries' financial sectors. Countries deemed to have systemically important financial sectors by the IMF are Australia, Austria, Brazil, Belgium, Canada, China, France, Germany, Hong Kong, India, Ireland, Italy, Japan, Luxemburg, Mexico, the Netherlands, Russia, Singapore, South Korea, Spain, Sweden, Switzerland, Turkey, the U.K., the United States.

Regulatory Consistency Assessment Program (RCAP).

RCAP is the response from BCBS to the lessons learnt from the global financial crisis concerning the importance of implementing the Basel framework which is comprehensive, on time, and consistent. BCBS takes the view that public confidence in the resilience of the banking system, the effectiveness and public confidence in prudential ratios, and a level playing field cannot be expected, unless the Basel framework (the framework of Basel II, II.5, and III which will subsequently be referred to as the Basel III framework) is adopted and consistently implemented.

The purpose of implementing RCAP is to ensure the consistent implementation of the Basel III framework such that it can make a contribution toward global financial stability. RCAP consists of two different areas yet which are complementary, namely: i) monitoring the timeliness of adoption of the Basel III standards and ii) evaluating the consistency and completeness of the adoption of the Basel III standards, including evaluation of the significance of any deviation in the domestic regulatory framework with the Basel III standards. The findings of the assessments are expected to be able to provide insights concerning any existing or potential gaps in the domestic regulation toward financial stability. This feedback is expected to be able to help jurisdictions to make necessary reforms such that domestic regulations are more in line with Basel standards.

Prior to 2016, the scope of RCAP's focus included assessments on the adoption of the Basel III capital framework, the Liquidity Coverage Ratio (LCR), and the Systemically Important Banks (SIBs) framework. Assessments of the Basel III capital framework had already begun in 2012 so that nearly all BCBS member countries have already finished assessments on the consistency and completeness of their domestic regulation toward the Basel III capital framework. For LCR, the initial assessments were carried out in 2014 with assessments on the LCR of BCBS member jurisdictions which were issued in 1Q 2015. Meanwhile, for the SIBs framework, new assessments have been carried out since 2015. In line with the developments of the adoption of other Basel standards in accordance with the timeline already set by BCBS, the scope of RCAP will be widened starting in 2017, i.e. that is to also include the assessment of the consistency and completeness of the adoption of the standards for the Net Stable Funding Ratio (NSFR) and the Leverage Ratio.

RCAP for the purpose of monitoring the timeliness of the adoption of Basel III standards has already been followed by Indonesia on a regular basis every year. Meanwhile, RCAP for the purpose of evaluating the consistency and completeness of the adoption of Basel III standards in Indonesia will be followed by Indonesia for the first time in 2016. The scope of RCAP in Indonesia for the purpose of assessing the consistency and completeness of Indonesia's regulations includes the Basel III capital framework and LCR. In this regard, Bank Indonesia actively participates in regulation of macroprudential matters, such as regulation concerning the obligation to form a Countercyclical Capital Buffer (CCB) which was also the scope for Basel III capital framework. Besides that, Bank Indonesia also became a member of the RCAP Indonesia team for nearly all areas evaluated in RCAP. This is because the assessments toward the consistency and completeness of Indonesia's regulations compared with Basel III were also scrutinized by Bank Indonesia as the macroprudential authority.

The findings from RCAP will become feedback for the authorities of Indonesia's financial sector to coordinate the regulatory framework with the Basel framework. Nonetheless, Indonesia's specific characteristics still need to be given attention in order to strengthen the regulatory regime in Indonesia. With RCAP feedback, it is hoped that the resilience of the banking system can be improved further, an important matter in increasing the resilience of Indonesia's financial system.

Throughout 2015, Bank Indonesia consistently instituted various payment system and rupiah currency management (SPPUR) policies. In terms of rupiah currency management policy, Bank Indonesia provided mobile cash services to meet the demand for currency of appropriate denominations, on time and fit for circulation.

Chapter 9

Payment System and Currency Management

In 2015, payment systems and currency management were operated efficiently and smoothly, both by Bank Indonesia and the industry. On the side of payment system operated by Bank Indonesia, this was reflected in the reliability and availability of its systems, as well as in its effective contingency plans. Meanwhile, the operation of payment systems by industry also experienced no significant disruptions. In terms of currency management, the demand for cash was satisfied by the availability of currency in sufficient quantities, in appropriate denominations, in a timely manner, and in a condition fit for circulation.

Over the course of 2015, national payment systems performed well in supporting economic activities as well as the stability of the financial and monetary systems. The performance of the payment systems operated by Bank Indonesia was reflected in their reliability and availability as well as in the implementation of effective contingency plans that enabled Bank Indonesia's payment system services to process smoothly financial transactions associated with the economic activities carried out by the public, government, and business. Furthermore, payment systems operated by industry endured no significant disruptions. Meanwhile, in terms of currency management, positive achievements were reflected in the availability of currency in sufficient quantities, in appropriate denominations, in a timely manner, and in a condition fit for circulation. The efforts of Bank Indonesia to continue strengthening its policies in the field of payment systems and currency management played an integral part in maintaining the performance of national payment systems. In terms of payment systems, Bank Indonesia continued to focus on strengthening its infrastructure in order to improve the reliability and security of its payment systems. In addition, during 2015 Bank Indonesia implemented five integrated general policies aimed at strengthening currency management. These were to maintain sufficient Bank Indonesia cash position, to improve the quality of currency circulating in society, to expand its cash distribution network and cash services, to strengthen communication as to the characteristics of authentic currency, and to step up efforts to prevent and counter the circulation of counterfeit rupiah banknotes.

In terms of payment systems, the value of transactions performed through the payment systems operated by Bank Indonesia and the payment system industry over 2015 grew slower at 9.4%, compared to the previous year's figure of 11.0%, in line with the slowdown in domestic economic growth. Meanwhile, the volume of transactions grew by 18.6% from the previous figure of 18.0%. During 2015, national payment systems managed to process 5.5 billion transactions with a value of Rp33.3 thousand trillion. As to the value of transactions performed through the payment systems operated by Bank Indonesia alone, this increased by 9.1%, slightly smaller than the previous increased of 9.8%.

Furthermore, with respect to the payment system industry, Bank Indonesia pursued a policy of expanding the use of non-cash payment systems and instruments, including card-based payment instruments (CBPIs), electronic money, and fund transfers. The effort to expand the use of non-cash payment systems and instruments by Bank Indonesia sought to create synergies with the Government and the payment systems industry. In addition to the policy of expanding the use of non-cash payment systems and instruments, Bank Indonesia also sought to continually encourage the payment system industry to improve the security of its payment system operations. This was done in order to maintain public confidence in non-cash payment systems and instruments. This policy had positive results as evidenced by an increase in payment transactions using non-cash payment systems and instruments.

On the currency management front, the amount of currency in circulation (UYD) grew at a higher rate compared to the previous year's 5.7%, reaching 11.0%, or Rp586.8 trillion, by the end of 2015. In terms of trends, the dynamic of UYD growth in line with developments in economic activities. Growth in currency started to slack by mid-2015 but, subsequently, began increasing in the third quarter of the year in line with improving domestic economic growth. This upward trend in UYD growth was also confirmed by the withdrawal of currency (outflows) by State Budget distributing banks, which began to increase in the same period on the back of improvements in government consumption growth. Meanwhile, cash in vault slowed in line with the stagnant growth of bank deposits over 2015. Nevertheless, consistent with these economic dynamics, Bank Indonesia was still able to provide currency in sufficient quantities, in appropriate denominations, in a timely manner, and in a condition fit for circulation.

To ensure the sufficient availability of currency and its denominations, a variety of important measures were taken. These included encouraging money printing companies to increase their printing capacities, increasing the number of Cash Custodians (Kas Titipan) in areas previously unreached by Bank Indonesia's cash services, and enabling the exchange of money through Mobile Cash units in crowded places, as well as in rural areas and the outermost islands in the Republic of Indonesia. The number of bank branches providing Cash Custodian services rose from 30 in 2014 to 35 by the end of 2015, meaning that the coverage of Bank Indonesia's cash services increased from 61% of all cities/regencies in Indonesia in 2014 to 66% in 2015. Bank Indonesia also applied a clean money policy through improving the quality standards of its money treatment process (improved soil level) in both Bank Indonesia cash working units and in banks, in order to improve the quality of currency in circulation in society. In addition, to further protect the public, Bank Indonesia bolstered its coordination with all elements of the Coordinating

Agency for Eradication of Counterfeit Money (Botasupal) and other relevant government agencies through a variety of education activities aimed at familiarizing the public with the characteristics of authentic rupiah banknotes, while also stepping up efforts to prevent and counter the circulation of counterfeit rupiah banknotes. The various currency management policies pursued by Bank Indonesia showed good results. This was reflected, among other ways, in an improved quality level of currency circulating in society and increased public awareness and bank compliance in reporting the discovery of counterfeit rupiah to Bank Indonesia, as well as the disclosure of counterfeit currency supply networks by the Indonesian Police before this money made its way into public circulation.

9.1. PAYMENT SYSTEM PERFORMANCE

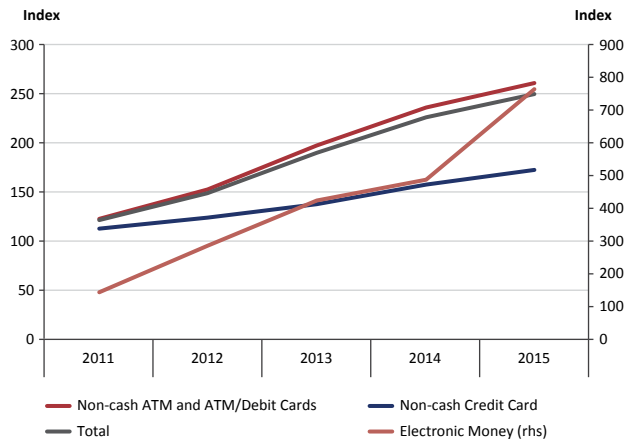
In general, the payment systems operated by Bank Indonesia ran efficiently and smoothly, in 2015. This was the result of Bank Indonesia's efforts to strengthen payment system infrastructure and to implement an effective continuity plan. These policies was designed so that the payment systems operated by Bank Indonesia would be always available and able to process the financial transactions associated with the economic activities carried out by the public, government, and business.[1] In addition, improvements were made to Business Continuity Management (BCM) and Standard Operating Procedures (SOP) as part of the Business Continuity Plan for Bank Indonesia's payment systems. Similarly, the payment systems operated by the banking industry also ran efficiently and smoothly. Bank Indonesia, along with the Government and banking industry, consistently encouraged the expansion of public access to non-cash payment instruments, as a follow-up on the declaration of the National Non-Cash Movement (GNNT) in 2014.

Bank Indonesia's policies, which for the most part were consistently geared towards maintaining public confidence in non-cash payment instruments, achieved ever more positive results. This was reflected in the increasing number of non-cash payment instruments within society and the growing proliferation of transactions using these types of instruments. In addition to efforts to maintain public confidence in non-cash payment instruments, Bank Indonesia also took measures to broaden public access to these instruments. These measures saw an increased use of non-cash payment instruments, as reflected in the rise of the non-cash payment system index. The public non-cash payment system index increased from 225 in 2014 to 249 in 2015 (Chart 9.1). The increase in this index serves as an indicator of the success of the measures taken after the declaration of the GNNT.

Looking at individual types of non-cash payment instruments, over the period from 2011-2015, the electronic money payment system index recorded the most marked improvement. This index increased from 142 in 2011 to 762 in 2015 (Chart 9.1). This dramatic increase was in part due to electronic money being the most recently developed non-cash payment instrument, but also due to the results of synergies between Bank Indonesia, the Government, and the banking industry. An example of such a synergy was the support Bank Indonesia gave to the Government to help it distribute social assistance program to the public (Government to Person funding), which was done using electronic money whereas previously such disbursements were made in cash. Furthermore, the indexes for credit cards and ATM cards (including ATM/debit cards) rose respectively from 112 and 123 in 2011 to 173 and 260 in 2015.

Furthermore, the support of retail payment systems in economic activity was demonstrated by the rising value of retail payment system transactions. Retail payment system transactions, consisting of the Bank Indonesia National Clearing System (SKNBI), Card-Based Payment Instruments (CBPIs), electronic money, and fund transfers, in 2015 enjoyed a 25.5% share of the total

Chart 9.1. Non-cash Payment System Index



1 In the first quarter of 2015 a malfunction occured in the Data Communication Network for accessing a payment system operated by Bank Indonesia. However, with the application of an effective continuity plan, the payment system service continued to operate properly.

Chart 9.2. Ratio of Retail Transactions to GDP

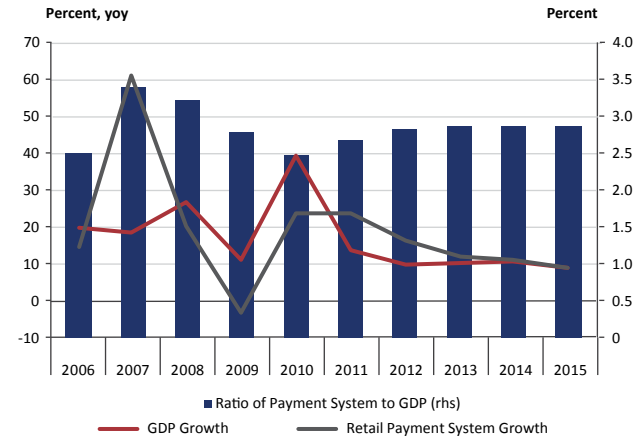
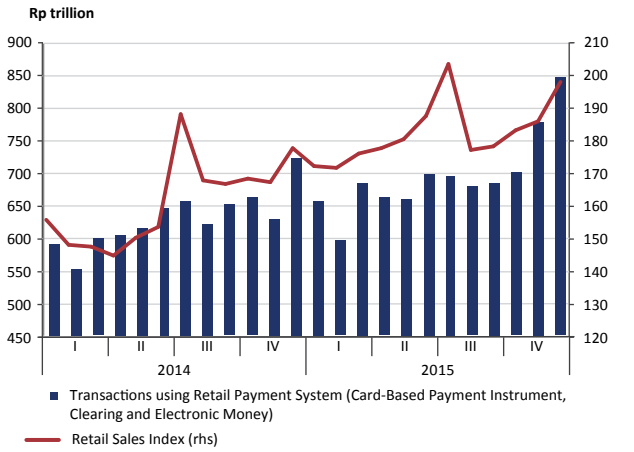
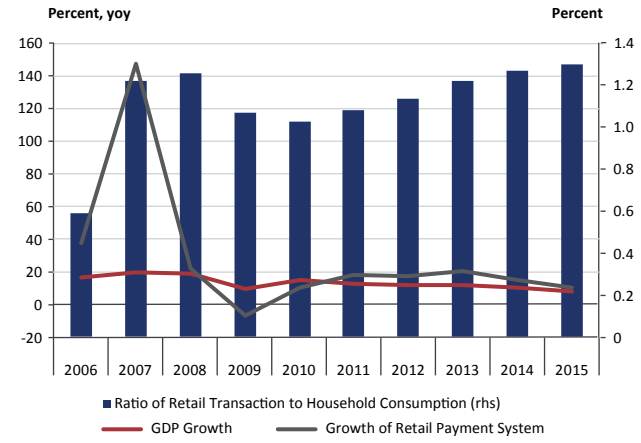


Chart 9.4. Retail Sales Index and Retail Transaction



value of payment system transactions which supported economic activity, amounting to Rp8.5 thousand trillion. Compared to the previous period, the value of retail payment system transactions represented an 11.7% increase from Rp7.6 thousand trillion. This increase was in line with the rise in the ratio of the value of retail payment system transactions to GDP, up from 0.72 in 2014 to 0.74 in 2015 (Chart 9.2). Meanwhile, the ratio of the value of retail payment system transactions to consumption also saw an increase, from 1.29 in 2014 to 1.31 in 2015. This indicates that people are growing increasingly accustomed to using non-cash payment instruments to finance consumption spending (Chart 9.3). These figures also confirm the strong relationship between the development of retail payment system transactions and the retail sales index (Chart 9.4).

Chart 9.3. Ratio of Retail Transaction to Household Consumption



Non-Cash Payment Systems Operated by Bank Indonesia

Bank Indonesia Real Time Gross Settlement (BI-RTGS)

Through the application of an effective continuity plan and infrastructure strengthening policy, the BI-RTGS system in 2015 generally ran smoothly and effectively. Among other things, this was reflected in the availability and capability of the BI-RTGS system as the estuary of all high value payments' settlement in Indonesia. Similarly, in terms of liquidity, participants in the BI-RTGS system retained sufficient funds to maintain successful transactions. Liquidity adequacy, among others, was reflected in the low level of unsettled transactions, the relatively small use of the Intraday Liquidity Facility (FLI) and the decline in turnover ratio.

The BI-RTGS system successfully settled 11.0 million transactions with a value of Rp112.7 thousand trillion over the course of 2015. This transaction volume represented a 37.8% decline from the previous period when 17.7 million transactions were settled. However, the value of the transactions represented a 1.7% increase over the previous period's figure of Rp110.9 thousand trillion. This increase in the value of BI-RTGS transactions was largely influenced by a rise in transactions between clients, foreign exchange transactions, and capital market transactions. Meanwhile, the average daily volume of transactions in the BI-RTGS system amounted to 45 thousand transactions at a value of Rp458.2 trillion (Chart 9.5).

The decline in the volume of payment transactions through the BI-RTGS system was brought about by the capping policy on the minimum transaction amount using the BI-RTGS

Chart 9.5. BI-RTGS Transaction

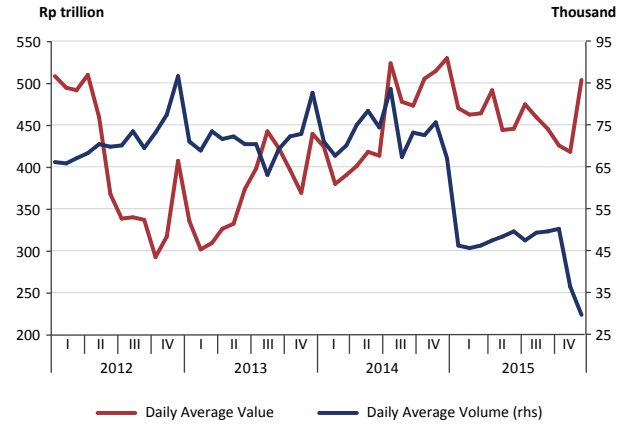
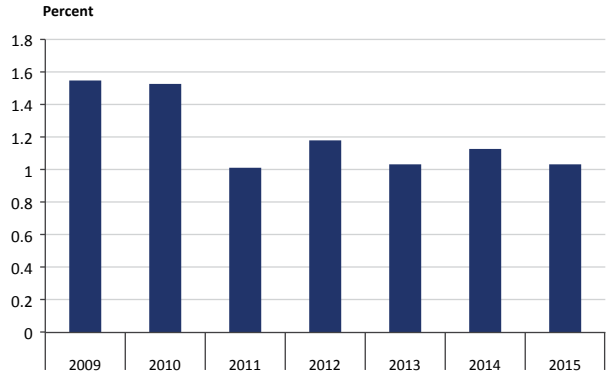


Chart 9.6. BI-RTGS Turn Over Ratio



system. The minimum transaction amount through the BI-RTGS system was raised to Rp500 million when the BI-RTGS Gen II System was implemented on 16 November, 2015. This represented an effort to mitigate operational risks at the early implementation of the BI-RTGS Gen II System. The enforcement of a minimum cap is only a temporary measure until the June 2016.

With respect to unsettled transactions, these were relatively few in 2015. In terms of transaction volume, unsettled transactions accounted for 0.004% of the total, while in terms of transaction value this figure was 0.027%. These relatively small percentages for unsettled transactions were the result of Bank Indonesia's policies which always seek to prioritize the importance of participants in the BI-RTGS system managing their liquidity. With such relatively small percentages, the unsettled transactions that did occur did not disrupt the smooth operation of the BI-RTGS system as a whole. With respect to the Intraday Liquidity Facility (FLI), there were only two occasions on which this was used in 2015. The low level of FLI usage coupled with the small proportion of unsettled transactions during 2015 indicated that, in general, participants in the BI-RTGS system retained sufficient funds to settle transactions. The liquidity adequacy of participants in BI-RTGS system was also reflected in the banking industry's turnover ratio indicator which decreased from 1.17 in 2014 to 1.04 in 2015 (Chart 9.6), illustrating a reduced dependence of participants on incoming transactions.

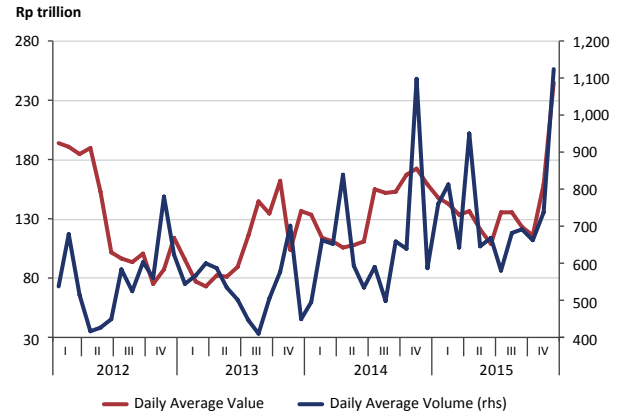
The Bank Indonesia Scripless Securities Settlement System (BI-SSSS)

During 2015, 183.6 thousand securities transactions were traded through BI-SSSS with a value of Rp34.9 thousand trillion. This volume represented a 15.2% increase over 2014 when 159.5 thousand transactions took place. In line with the increase in volume, the transaction value for securities in BI-SSSS of Rp34.9 thousand trillion represented a 4.1% rise from the previous figure of Rp33.57 thousand trillion. Meanwhile, in 2015 the average daily volume of BI-SSSS transactions was 747 with a value of Rp142.0 trillion (Chart 9.7).

The Bank Indonesia National Clearing System (SKNBI)

Over the course of 2015, 113.5 million SKNBI transactions were performed with a value of Rp3.2 thousand trillion.[2] This transaction volume represented an increase of 5.5%

Chart 9.7. BI-SSSS Transaction



2 SKNBI is an electronic funds transfer system that consists of debit and credit clearing in which the settlement of each transaction is conducted nationally.

compared to the SKNBI transaction volume in 2014 of 107.6 million transactions. The value of SKNBI transactions was also up 13.1% from the previous year's figure of Rp2.9 thousand trillion. The average daily volume of transactions performed through SKNBI stood at 441.2 thousand transactions with a value of Rp13.1 trillion (Chart 9.8). The rise in transactions through SKNBI was mainly due to the increased maximum credit clearing limit as well as the increase in the minimum transaction value limit through BI-RTGS from the previous Rp100 million to Rp500 million as of December 15, 2014, following the implementation of the BI-RTGS Generation II System in 2015.

Non-cash Payment Systems Operated by the Payment System Industry

Card-Based Payment Instruments (CBPIs)

The number of payment transactions with Card-Based Payment Instruments (CBPIs), which include ATM cards, ATM/debit cards, and credit cards, during 2015 showed an upward trend. The number of CBPIs used by the public increased by 12.5% to 137.1 million from the previous figure of 121.9 million instruments. Around 4.9billion transactions were performed using CBPIs in 2015 with a value of Rp5.2 thousand trillion. This represented a 12.1% rise in transaction volume from that in 2014 when 4.3 billion transactions were performed. The value of CBPIs transactions, meanwhile, increased by 10.2% over the value of such transactions in 2014. In terms of daily averages, the volume and value of CBPIs transactions in 2015 were recorded at 13.3 million transactions and Rp14.2 trillion per day respectively (Chart 9.9). The upward trend in CBPIs transactions was largely due to ATM card and ATM/debit card transactions. The increased volume and value of CBPIs transactions was supported by an increase in the supporting infrastructure for performing such transactions, like ATM and EDC machines. As of the end of 2015, there were approximately 97.8 thousand ATM units and 1 million EDC units in the country, an increase of 9.25% and 19.29% respectively from 2014, or in terms of numbers an additional 89.6 thousand ATM units and 842.6 thousand EDC units.

Chart 9.8. National Clearing (SKNBI) Transaction

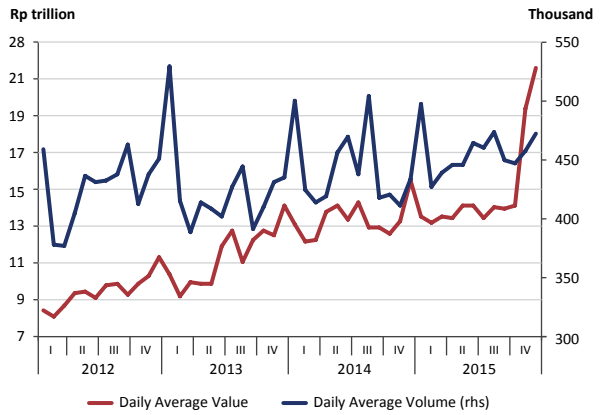
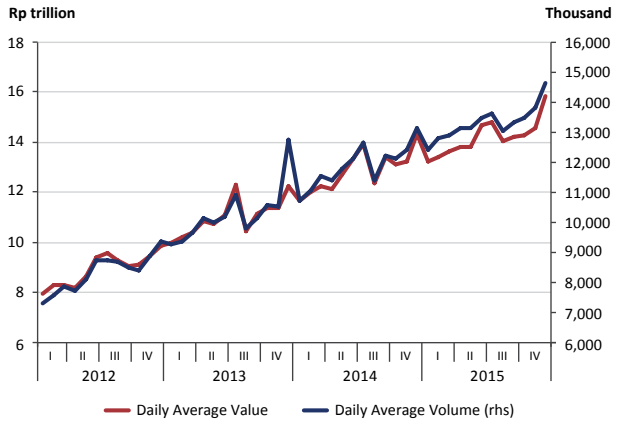


Chart 9.9. Card Based Payment Instrument Transaction



ATM Cards and ATM/Debit Cards

Bank Indonesia's policy of expanding the use of non-cash payment instruments showed positive results. This was reflected by an additional number of ATM cards and ATM/debit cards in circulation as well as an increase in transaction volume and value.[3] The number of ATM cards and ATM/debit cards in circulation in 2015 rose by 13.66% to 121 million cards from the previous year's figure of 105.8 million cards. In line with an increased number of cards in circulation, the number of transactions using ATM cards and ATM/debit cards also rose. Transaction volume went up by 12.18% to 4.9 billion transactions from the previous figure of 4.4 billion transactions. Furthermore, the value of transactions also increased by 10% to Rp4,897.7 trillion from the previous year's figure of Rp4,445.1 trillion. In terms of daily averages, the volume of ATM card and ATM/debit card transactions in 2015 stood

3 ATM Cards are a CBPI that can be used to make cash withdrawals and/or fund transfers. The obligation of the cardholder is fulfilled in real time by directly reducing funds saved in the cardholder's account. ATM/Debit Cards are a CBPI that can be used to make payments on obligations arising from economic activities, including spending transactions. The obligation of the cardholder is fulfilled in real time by directly reducing funds saved in the cardholder's account.

Chart 9.10. ATM and ATM/Debit Transaction

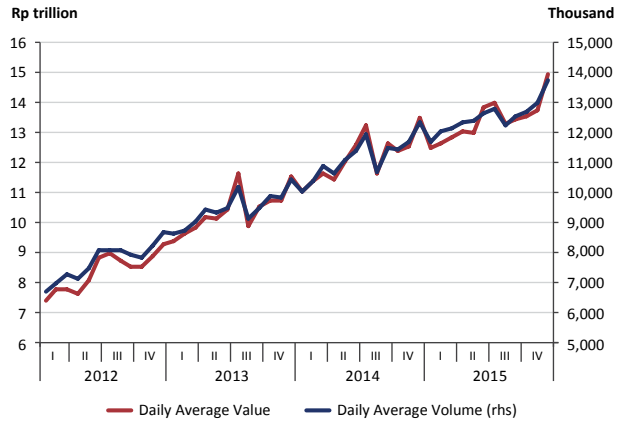
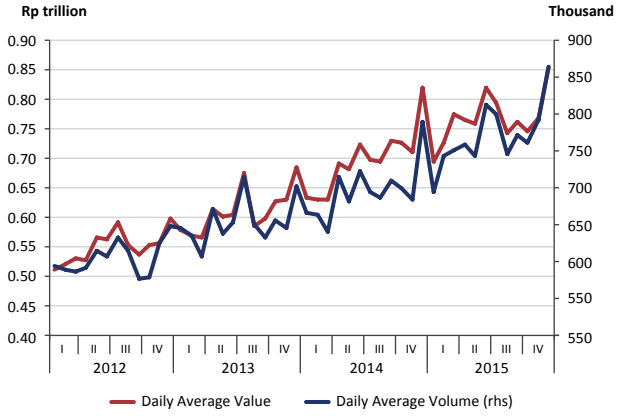


Chart 9.11. Credit Card Transaction



at 12.5 million transactions with a value of Rp13.4 trillion (Chart 9.10).

Credit Cards

The number of credit cards in circulation in 2015 stood at 16.9 million cards, up 5.1% from the previous figure of 16.0 million cards.[4] Meanwhile, the number of transactions using credit cards in 2015 was recorded at 281.3 million transactions with a value of Rp281.3 trillion. Credit card transaction volume showed growth of 10.62% from the previous year's volume of 254.3 million transactions. Likewise, the value of credit card transactions also rose by 10.0% from the previous year's value of Rp255.1 trillion. In terms of daily averages, the volume of credit card transactions in 2015 stood at 770.8 thousand transactions with a value of Rp768.6 billion per day (Chart 9.11).

By type of use, the proportion of cash advances rose in terms of both transaction volume and value. In 2015, the proportion of cash advances out of total credit card use, in terms of volume and value, stood at 2.4% and 2.7% respectively. This represented an increase from the 2014 levels of 1.5% and 1.9% respectively. The volume and value of cash advance transactions in 2015 amounted to 6,607 transactions with a value of Rp7.4 trillion. These figures were 80% and 55% higher than the respective figures recorded in 2014 of 3,777 transactions with a value of Rp4.9 trillion. Meanwhile, Non-Performing Loans (NPLs) remained in a relatively safe position despite a slight increase from 2.02% at the end of 2014 to 2.59% at the end of 2015 (Chart 9.12).

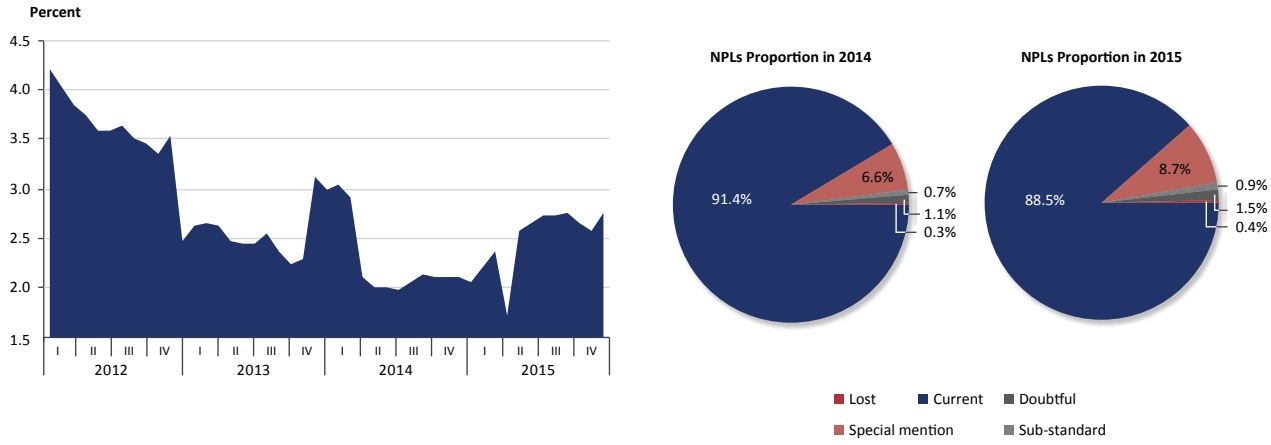
Electronic Money

In order to increase the use of payment system instruments, in particular retail instruments that can be used by the entire society, Bank Indonesia, together with the Government and the payment system industry, continued to encourage the use of electronic money. In 2015, the Government began distributing social assistance to people by means of electronic money, whereas previously this was done using cash.[5] In addition, the increased use of electronic money was also a result of the follow-up measures taken after the declaration of the National Non-Cash Movement (GNNT) in the previous period. These follow-up measures included the implementation of electronic parking transactions (e-Parking), the launch of the Bandung Smart Card, and the National Non-Cash Movement Festival. This range of measures managed to increase the number of electronic money instruments in circulation, as well as the volume and value of electronic money transactions.

4 Credit cards are a CBPIs that can be used to make payments on obligations arising from economic activities, including spending transactions and/or cash withdrawals, in which the obligation of the cardholder is fulfilled initially by the acquirer or issuer, and the cardholder undertakes to make payments at an agreed time, either all at once (charge card) or in instalments.

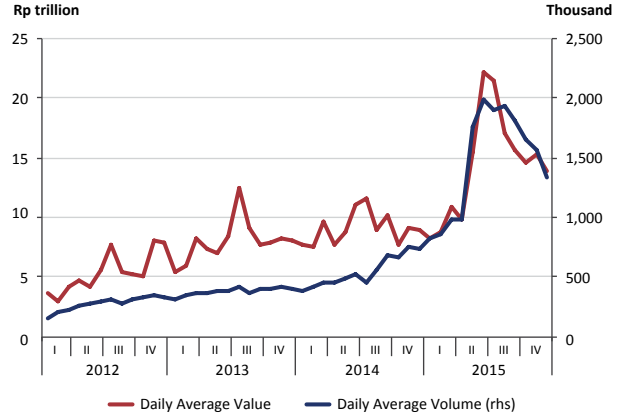
5 Electronic money is a payment instrument that involves the following elements (1) issued based on the amount of money paid initially by the user to the issuer; (2) the amount of money is stored electronically in media such as a server or chip; (3) used as a means of payment to merchants who are not electronic money issuers; and (4) the amount of electronic money paid by the user and managed by the issuer does not constitute savings as stipulated in the legislation governing banking.

Chart 9.12. NPLs of Credit Card



Compared with the position in 2014, the number of electronic money instruments in circulation in 2015 decreased by 4.0% to 34.3 million instruments from the previous period's 35.7 million instruments. This decline was caused by the removal of instruments associated with dormant accounts by electronic money issuers.[6] However, in contrast, the volume and value of electronic money transactions climbed significantly, amounting to a total of 535.6 million transactions and Rp5.3 trillion respectively. The positive growth reflected in these figures represented an increase in the volume and value of electronic money transactions of 163.4% and 59.1% respectively from the previous period's figures of 203.4 million transactions and Rp3.3 trillion. In terms of daily averages, the volume of transactions was recorded at 1.5 million transactions with a value of Rp14.5 billion per day (Chart 9.13). The improvement in electronic money transaction performance was greatly affected by regulations that required the use of electronic money for several transactions, included Jakarta Commuter Trains (KCJ) and the TransJakarta Busway, as well as measures by some companies to pay salaries via electronic money, and the distribution of government social assistance program to the public using electronic money.

Chart 9.13. Electronic Money Transaction



Nonbank Fund Transfer Operations

A total of 26.5 million fund transfers through nonbank fund transfer operators (TD BB) took place during 2015, with a value of Rp80.7 trillion.[7] The largest share of these fund transfers was made up of domestic fund transfers, which accounted for 57.4% of the total volume of transactions performed through nonbank fund transfer operators. Meanwhile, in terms of value, these transactions were dominated by incoming transactions with a 54.4% share of the total value (Chart 9.14). In order secure the transfer of funds from Indonesian migrant workers, Bank Indonesia sought to actively educate and familiarize prospective Indonesian migrant workers set to leave the country about fund transfers. Bank Indonesia also encouraged Indonesian migrant workers and prospective migrant workers to use non-bank fund transfer operators that have been licensed in their respective countries.

6 A dormant account is an account that is no longer active or has not been used for performing a transaction for a certain period of time.

7 A fund transfer consists of a series of activities that begin with an instruction from the sender of origin to move a certain amount of funds to a recipient named in the fund transfer instruction and end with the receipt of the funds by the recipient.

Chart 9.14. Share of Fund Transfer Transaction Volume and Value

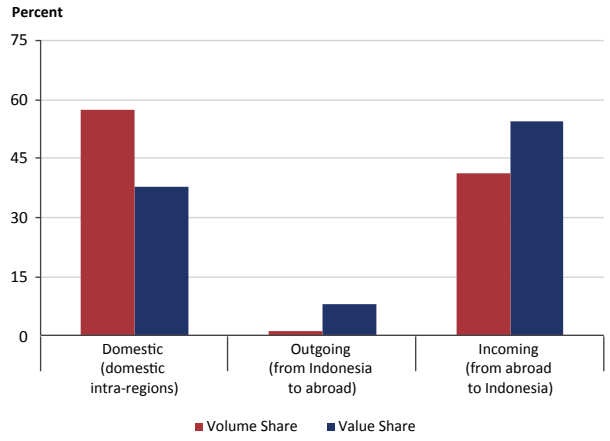
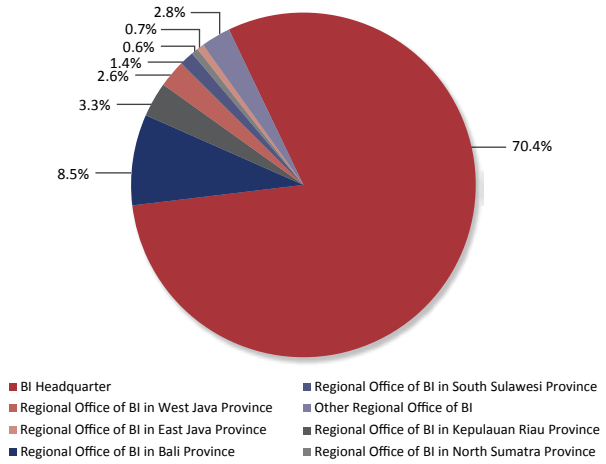


Chart 9.15. Share of Non-bank Operator in 2015



Nonbank Foreign Exchange Business Activities (KUPVA BB)

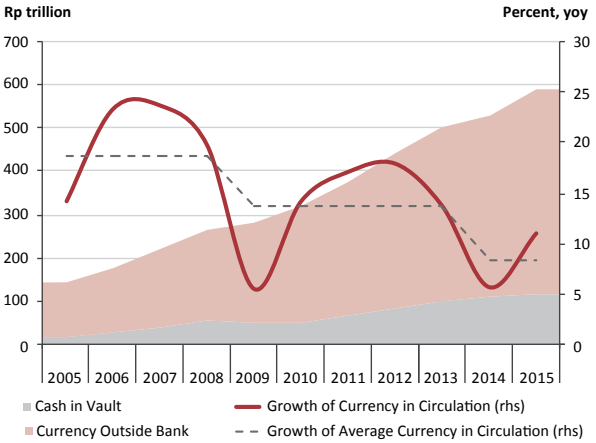
In 2015, the volume of sales and purchases of foreign banknotes (UKA) by KUPVA BB increased.[8] The value of such transactions increased 3.9% to Rp226.7 trillion from Rp218.0 trillion in 2014. The largest contribution to the buying and selling of UKA was made under the supervision of Bank Indonesia's Headquarters working area, amounting to Rp159.5 trillion or 70.4% of total foreign banknote transactions in Indonesia. The next biggest contributions were made by the Bank Indonesia Regional Representative Offices in the provinces of Bali and the Riau Islands, amounting to Rp28.9 trillion and Rp11 trillion respectively. The two Regional Representative Offices of Bali and the Riau Islands accounted for a 12.7% and 4.9% share of the overall value of UKA transactions respectively (Chart 9.15).

9.2. CURRENCY MANAGEMENT PERFORMANCE

In 2015, the value of currency in circulation (UYD) grew by 11.0% to reach Rp586.8 trillion, higher than the previous year's growth of 5.7%. In terms of trends, this growth in UYD echoes back to the average growth trajectory from 2009 - 2013, which stood at 13.7% per year (Chart 9.16). On a monthly basis, growth of UYD was affected by seasonal factors in certain periods, especially religious holidays (the period of Ramadan and Christmas) and public holidays. The most amount of money in circulation was recorded at the end of Ramadan in 2015, amounting to Rp604.2 trillion, an increase of 7.0% from the same period in 2014 when Rp564.5 trillion was in circulation (Chart 9.17).

In terms of denominations, the proportion of Rp100,000 banknotes had continually increased over recent years, from 35.4% of the total in 2005 to 62.8% in 2015. This was followed by the Rp50,000 denomination which accounted for 28.4% of all banknotes in circulation (Chart 9.18). The 11,0% growth in currency in circulation was largely supported by the growth in circulation of Rp100,000 and Rp50,000 banknotes, which stood at 12.2% and 9.4% respectively (Chart 9.19). These increases were driven by the public preference for larger denominations of rupiah because of practicality and efficiency. Also, these particular denominations

Chart 9.16. Currency in Circulation



8 Nonbank KUPVA operators are limited liability companies whose intent and purpose is to engage in the business of buying and selling foreign banknotes and purchasing traveler's cheque.

Chart 9.17. Daily Movement of Currency in Circulation

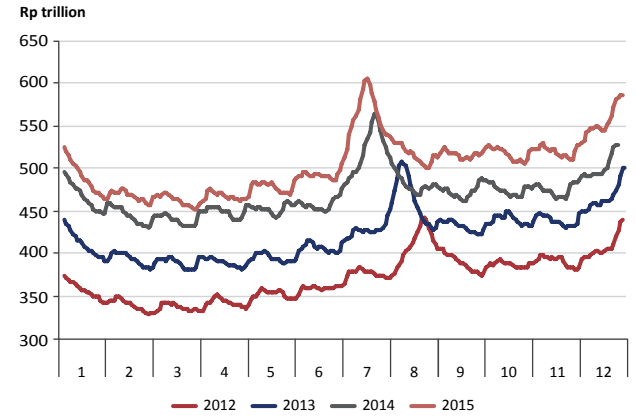
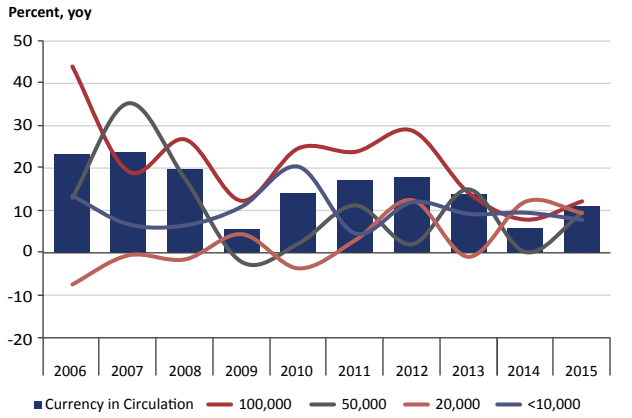
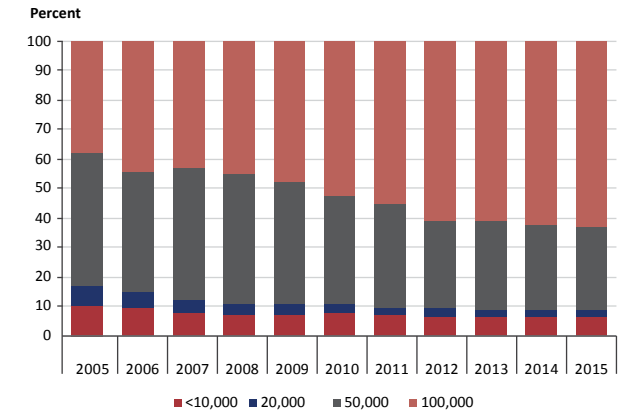


Chart 9.19. Growth of Currency in Circulation by Denomination



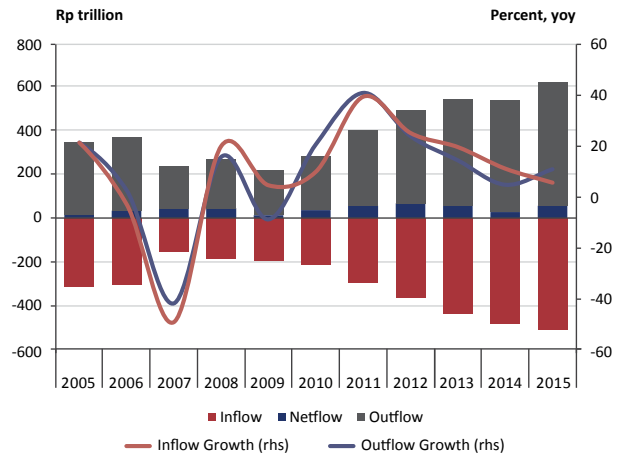
of banknotes were generally easier to access and obtain. This was confirmed by a survey conducted in several major cities in 2015 which indicated that the Rp100,000 and Rp50,000 banknotes were more easily obtained through Automatic Teller Machines (ATM).[9] The availability of these two denominations through ATM machines means that they were especially common given that the number of ATM machines in 2015 grew by 9.2% to 97,845 and the number of ATM/Debit cards grew by 13.7% to 120.3 million cards. Furthermore, the value of cash withdrawals via ATMs also increased by 9.4% to Rp2,100.8 trillion during 2015.

Chart 9.18. Composition of Currency in Circulation by Denominations



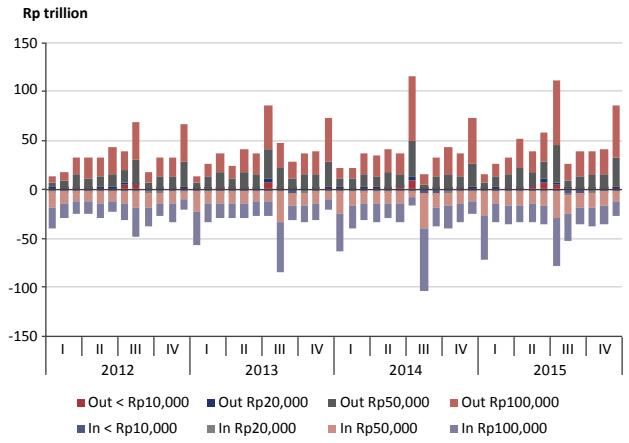
Movements in UYD were also reflected in the flows of currency through Bank Indonesia, which in 2015 experienced a net outflow of Rp56.4 trillion, higher than the net outflow in 2014 of only Rp27.9 trillion. The currency withdrawn by banks from Bank Indonesia (outflow) amounted to Rp566.3 trillion, or growth of 10.6%. Meanwhile, the currency deposited by banks in Bank Indonesia (inflow), some of which is money not fit for circulation, only amounted to Rp509.9 trillion, up 5.3% (Chart 9.20). In terms of seasonal patterns, the dynamics of cash transactions were affected by certain events that typically precipitate high outflows, such as Ramadan, which fell in July, Christmas, and the year-end holidays in December, after which a net inflow to Bank Indonesia was restored in the following few months. Outflow during the Ramadan period in 2015 amounted to Rp140 trillion, up 12.2% compared to the previous year's Ramadan.

Chart 9.20. Outflow and Inflow through Bank Indonesia



9 A survey of 487 respondents was conducted in Makassar, Banjarmasin, Denpasar, Surabaya, Semarang, Bandung, Palembang, Padang, Medan and Jakarta.

Chart 9.21. Cyclical Pattern of Inflow and Outflow through Bank Indonesia

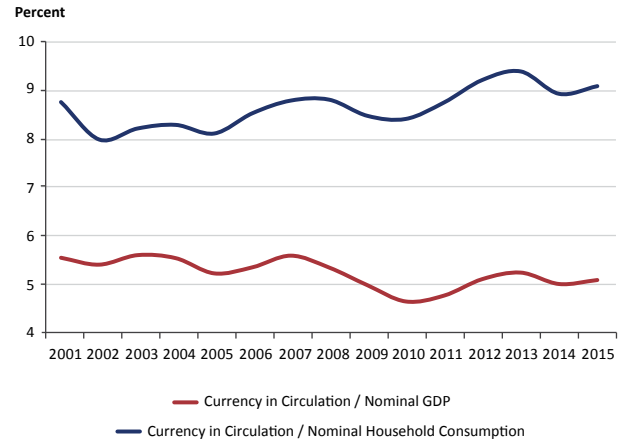


Meanwhile, outflow in the Christmas and year-end holiday period reached Rp85.6 trillion, up 17.5% compared to 2014 (Chart 9.21).

Currency as an Indicator of Economic and Liquidity

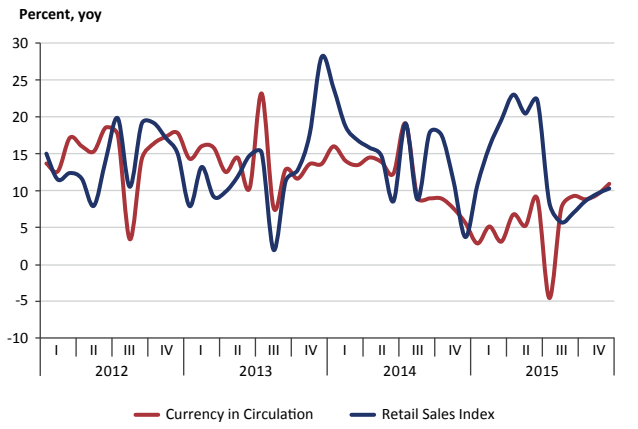
The continually prominent role played by currency in domestic economic activities was reflected in the ratio of UYD to GDP. In recent years, the ratio of UYD to GDP has been relatively stable at an average of 5.1%, or consistently in the 4.6-5.6% range. Meanwhile, the prominent role of currency in the economy's liquidity is reflected in the ratio of UYD to Household Consumption. In 2015, this ratio stood at 9.1%, higher than the previous year's figure of 8.9%, despite the slowing growth of household consumption (Chart 9.22). This was also confirmed by the growth pattern of UYD which was in line with the growth of the Retail Sales Index (IPE). The growth pattern of UYD and IPE showed a decline in the first 2 or 3 months of 2015, and 1 or 2 months after Ramadan. Conversely, UYD and IPE rose at other periods, particularly in the months leading up to Ramadan and ahead of the Christmas and year-end holidays (Chart 9.23).

Chart 9.22. Ratio of Currency in Circulation to GDP and Household Consumption



In recent years, the movement of UYD has remained within the projected range with a deviation closer to the lower limit of UYD projections.[10] This reflects the fact that the growth of UYD has been consistent with on-going weak economic growth (Chart 9.24). However, once seasonal factors are eliminated from the UYD growth trend, a bottoming-out from the lowest point in mid-2015 is evident.[11] This is in line with the economic growth rate which began to rise in the third quarter of 2015, reaching 4.74%, and continued to do so in the fourth quarter to 5.04% (Chart 9.25). The onset of an increase in UYD growth in the second half of 2015 was supported by increased government spending from the withdrawal of currency (outflow) by banks distributing the state budget. This was reflected in the growth of government consumption which began to increase in the third quarter of 2015, reaching 7.11%, and continued to do so in the fourth quarter of 2015 to 7.31% (Chart 9.26).

Chart 9.23. Growth of Currency in Circulation and Retail Sales Index



10 Currency in Circulation (UYD) projections are calculated using the Error Correction Model, which is influenced by several macroeconomic variables, namely economic growth, inflation rates, interest rates, and the BI Rate.

11 Seasonal factors refer to increased demand for currency at times of religious holidays, such in the Ramadan/Idul Fitri period as well as the Christmas and end of year holiday period.

Chart 9.24. Projection and Actual Currency in Circulation

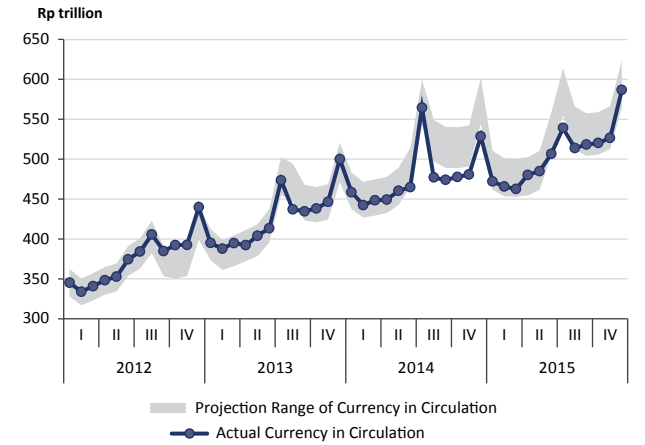
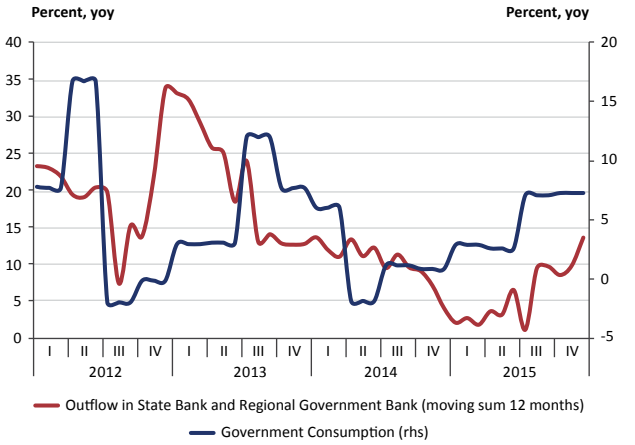
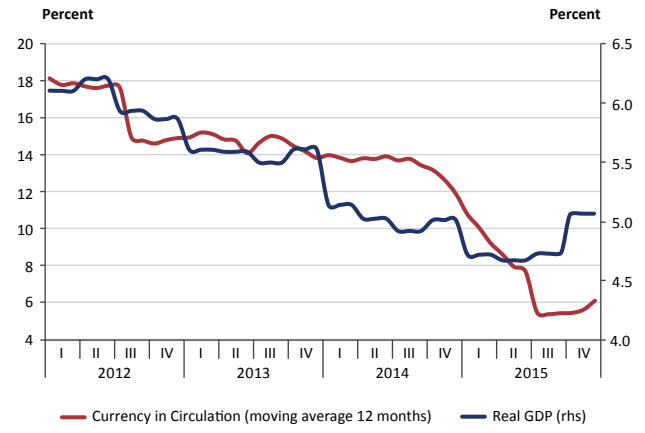


Chart 9.26. Growth of Currency Outflow in State Banks and Regional Government Banks, and Real Government Consumption



In terms of liquidity, another currency indicator, namely Cash in Vault (CiV), continued its slowing growth until the end of 2015.[12] This was in line with slowing growth in the bank deposits (DPK) in rupiah denominations in the same period (Chart 9.27). These movements in the growth of CiV and DPK were also confirmed by the slower growth in Interbank Currency Transactions (TUKAB) in Jakarta and its surrounding areas in the same period (Chart 9.28) [13]

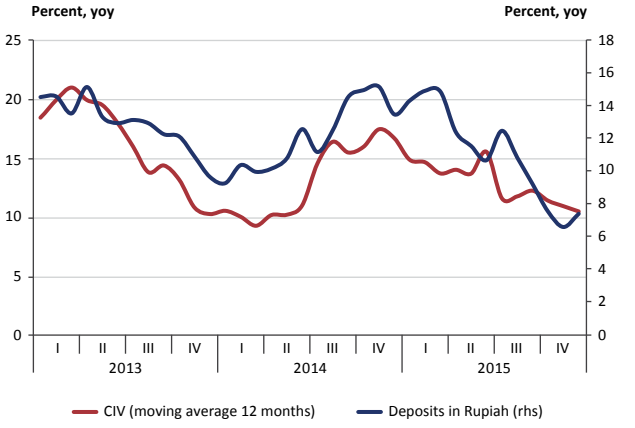
Chart 9.25. Growth of Currency in Circulation and Real GDP



Impact of Policy Implementation on Currency Management Performance

Throughout 2015, Bank Indonesia implemented a variety of currency management policies. The impact of the implementation of these policies was reflected in the availability of currency in sufficient quantities, in appropriate denominations, in a timely manner, and in a condition fit for circulation. As a first step in the implementation of its current management policies, Bank Indonesia continued to maintain the availability of currency throughout 2015 in order to ensure the smooth operation of cash payment transactions in every economic activity. This was reflected in Bank Indonesia's cash position ratio which stood at an average of 5.1 months of outflow throughout 2015, higher than the previous year's average figure of 3.1 months of outflow.

Chart 9.27. Growth of Cash in Vault and Bank Deposits



12 Cash in Vault (CiV) is a component of currency in circulation (UYD) held in the treasury of banks including in ATMs (Automatic Teller Machines). Another component of UYD is Currency outside Banks (CoB), which refers to currency circulating in society outside of the banking system.

13 Interbank Currency Transactions, or TUKAB, refer to activities between banks which include the demand, supply and exchange of rupiah currency that is still fit for circulation in order to meet needs in terms of amounts and/or type of denominations, in accordance with Bank Indonesia provisions.

Chart 9.28. Growth of Cash in Vault and Interbank Cash Exchange (TUKAB)

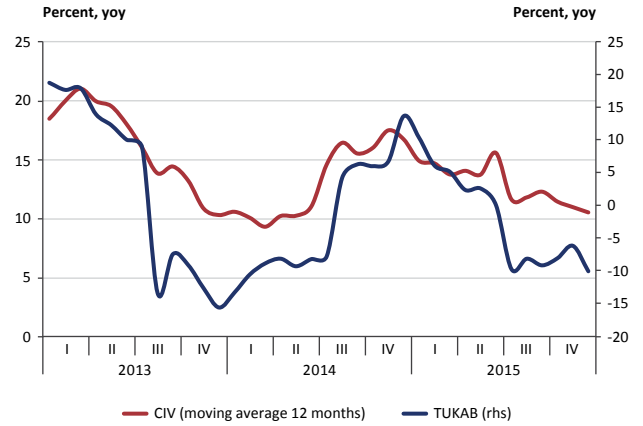
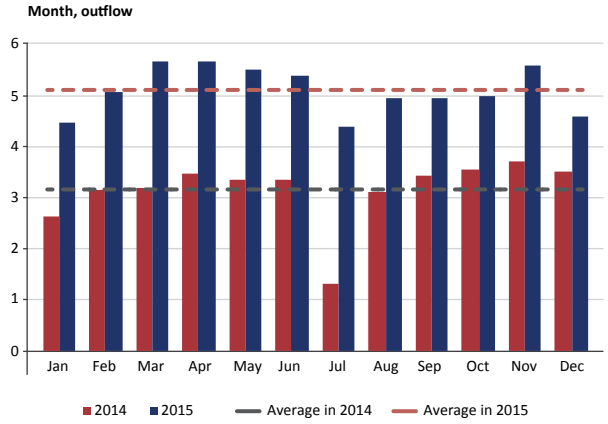


Chart 9.29. Ratio of Cash Position to the Average of Monthly Outflow

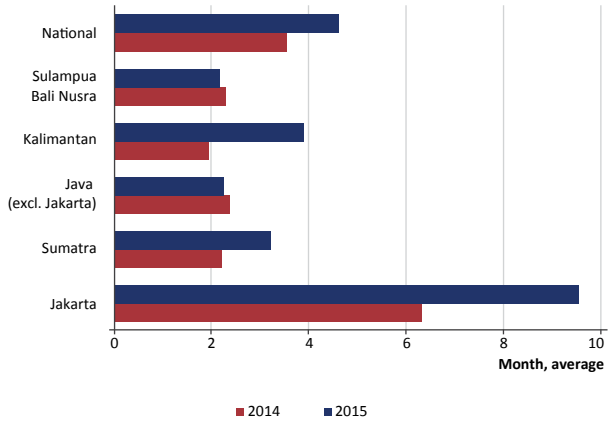


The highest cash position ratio came about in March and April of 2015, reaching 5.7 months of outflow in line with the reverse flow of currency from banks to Bank Indonesia after the Christmas and year-end holiday period in 2014, as well as the presence of a supply of printed money from The Indonesian Government Security Printing and Minting Corporation (Perum Peruri). In contrast, the lowest cash position came about in July 2015, reaching 4.4 months of average outflow triggered by the high level of currency withdrawals by banks in the 2015 Ramadan period (Chart 9.29). By area, the highest cash position ratio was at Bank Indonesia's Headquarters, reaching 9.4 months of outflow. This high cash ratio was intended to maintain the National Iron Stock (ISN) that has to be provided by Bank Indonesia in anticipation of withdrawals from banks, the majority of which are headquartered in the Jakarta area (Chart 9.30).[14]

The availability of currency in sufficient quantities is an integral result of the implementation of Interbank Cash Exchange (TUKAB) policy since 2011. This policy has prompted banks to first meet its rupiah currency liquidity needs from transactions with other banks. In the event that these currency needs are not met, banks can then fulfil their currency needs by making withdrawals from Bank Indonesia. In 2015, the number of TUKAB transactions in the Jakarta area stood at Rp66.3 trillion, a drop of 10.0% from the previous year's figure of Rp73.6 trillion (Chart 9.31). The contribution of TUKAB in meeting the currency needs of banks over the last 5 years has been an average of 50.1%, even though there was a fall in 2015 of 40.5%. This was caused by the slowing growth of bank deposits in 2015, meaning that the need for currency to be exchanged through TUKAB mechanisms also decreased (Chart 9.32).

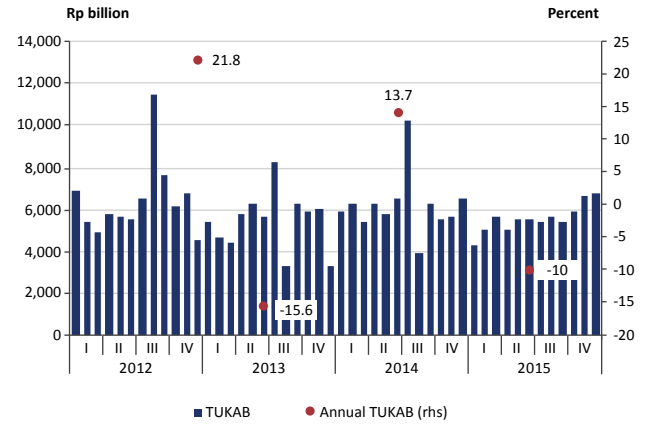
With the availability of currency in sufficient quantities in 2015, Bank Indonesia pursued a policy of reform in terms of its currency and cash services distribution. This policy involved infrastructure development (capacity building), by opening Bank Indonesia Regional Representative Offices in the province of West Sulawesi in October 2015 and collaborating with banks to open 6 new Cash Custodians in various areas of Indonesia

Chart 9.30. Ratio of Cash Position to the Average of Monthly Outflow According to Regions



14 The National Iron Stock is a standby inventory in anticipation of an increase in demand for currency that was not predicted at the time of preparation of the Currency Demand Estimation at the beginning of the year, and which could be precipitated, for example, by a rise in the fuel or electricity price in the current year. Setting the iron stock at 20% of projected currency in circulation (UYD) is in accordance with the best practices of other countries, for example the Central Bank of Spain and Central Bank of Korea.

Chart 9.31. TUKAB in Jakarta and Surrounding Area



previously unreached by Bank Indonesia's cash services in a direct sense.[15] By opening this Bank Indonesia Regional Representative Offices in West Sulawesi, one Cash Custodian in the city of Mamuju terminated its operations. This development meant that the number of Cash Custodians in 2015 was 35 commercial banks with 368 commercial bank branches spread throughout Indonesia. These figures were higher than those in 2014 when there were just 30 Cash Custodians managed by commercial banks with 267 commercial bank branches.

In 2015, total withdrawals through Cash Custodians to the value of Rp47.4 trillion were made, an increase of 31.1% on the previous year's figure of Rp36.1 trillion (Chart 9.33). This strong growth occurred largely in the second semester of 2015 in line with the addition of Cash Custodians and the religious holidays that fell at this time. In terms of region, these increases were most prominent in Cash Custodians in the provinces of Central Kalimantan, South Sumatra, and Papua. With the previously mentioned enhancement of capacity building, Bank Indonesia's cash services coverage reached 66%, or 338 cities/regencies in Indonesia in 2015. This figure was higher than the corresponding figure from 2014 of 61%, or 316 cities/regencies in Indonesia.

In addition to expanding the scope of its cash services to new areas through Cash Custodians, Bank Indonesia also continued to facilitate the exchange of money by means of Mobile Cash units across Indonesia, including in the country's remote areas and outermost islands.[16] These efforts were reflected in the 25.7% growth of money exchanges from Rp1.5 trillion to Rp1.8 trillion in 2015 (Chart 9.34). This high growth mainly occurred in the third quarter of 2015, and during the period of Ramadan/Eid Al Fitr 2015.

Bank Indonesia also consistently sought to raise the quality of currency in circulation in society (clean money policy), in all regions of Indonesia. This policy sought to improve soil levels, or maintain the quality of money in circulation by setting standards as to the state of soiled or mutilated

Chart 9.32. TUKAB Pattern in Jakarta and Bank Deposits

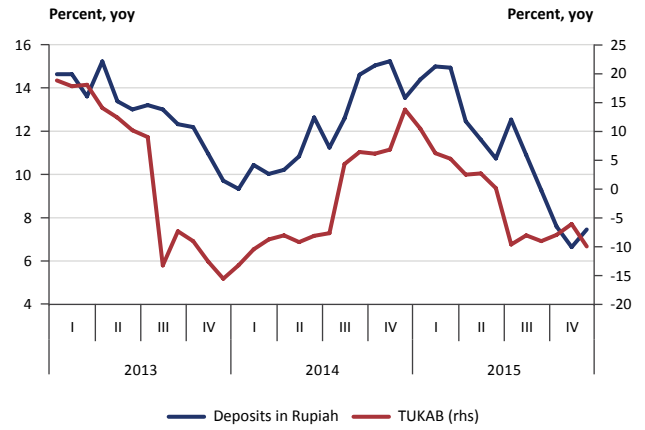
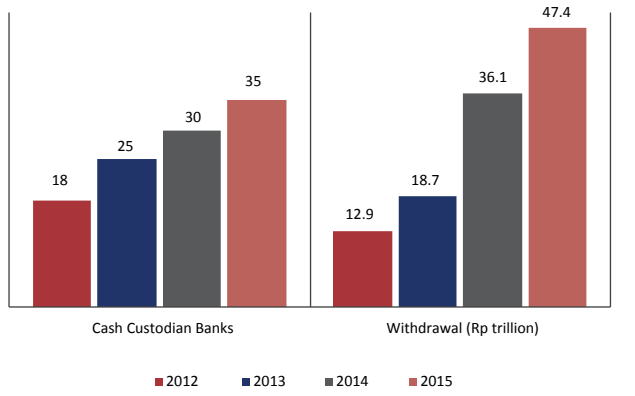


Chart 9.33. Number of Cash Custodian and Rupiah Withdrawal



15 Custodial Cash is an activity whereby supplies of currency are kept in a bank designated by Bank Indonesia in order to ensure a sufficient supply of bank cash and to meet the currency needs of the public in specific areas/regions.

16 Mobile Cash is a currency exchange facility provided by Bank Indonesia to the public, or other parties working with Bank Indonesia, which uses modes of transport; it is done through a retail mechanism (to the public) and a wholesale mechanism (to banks).

Chart 9.34. Rupiah Withdrawal Through Mobile Cash

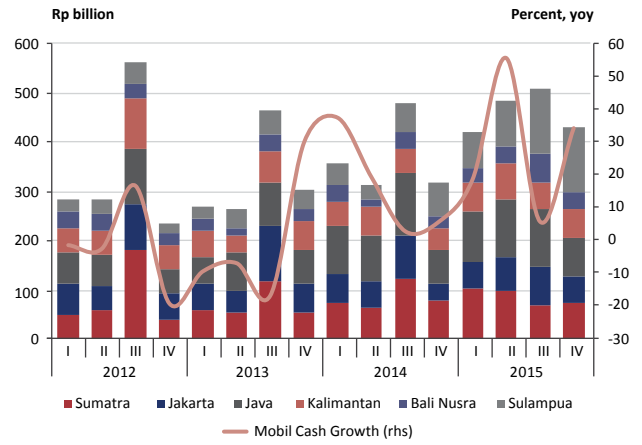
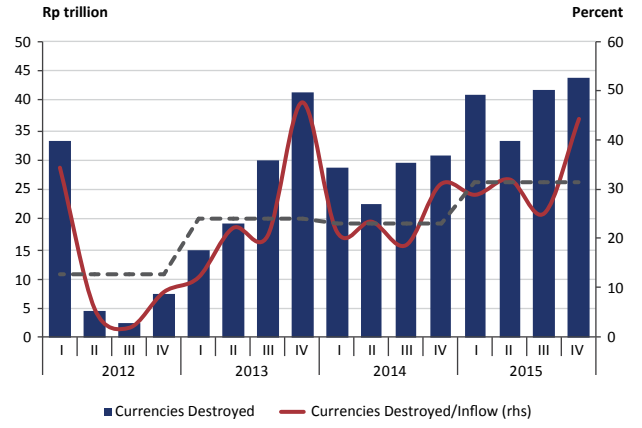


Chart 9.36. Ratio of Money Destruction to Inflow by Denomination

money, and to maintain standards for the processing and sorting of money fit for circulation (ULE) from that deemed unfit for circulation by Bank Indonesia and banks. Under the policy, the amount of money unfit for circulation (UTLE) deposited by banks in Bank Indonesia, which then went on to be destroyed and replaced with new fit for circulation money, increased. Over 2015, the value of destroyed UTLE stood at Rp160.3 trillion, up 43.6% over the previous year's figure of Rp111.6 trillion. This increase in destroyed UTLE was much higher than the increase in inflow, which stood at just 5.3%. With this development, the ratio of destroyed UTLE to inflow was 31.4%, higher than the previous year's ratio of 23.0% (Chart 9.35). In terms of denomination, more large banknotes were destroyed than small banknotes, bearing in mind that generally small banknotes are much more soiled or worn than large banknotes (Chart 9.36).

Chart 9.35. Destruction of Currency Unfit for Circulation



The successful implementation of currency management policies during 2015 was reflected in the results of a survey on the quality of currency fit for circulation in several towns in border areas and remote areas.[17] The survey results showed that the currency quality index in these towns in border areas and remote areas stood at 6.8, higher than the original target figure of 4. In terms of denominations, large banknotes (Rp100,000, Rp50,000, and Rp20,000) were indicated as being of a higher quality than small banknotes (Rp10,000, Rp5,000, and Rp2,000). Regionally, the currency quality index for large banknotes was the highest in the town of Ketapang, and the lowest in the town of Jeneponto. Meanwhile, the currency quality index for small banknotes was also the highest in the town of Ketapang, and the lowest in Sidangkalang, Kabanjahe, and Brastagi.

In addition, Bank Indonesia continued to strengthen coordination with all elements of the Coordinating Agency for Eradication of Counterfeit Money (Botasupal), in particular with the Indonesian National Police, to prevent the circulation of counterfeit money in the society. Moreover, Bank Indonesia also kept up efforts aimed at improving the compliance of banks in reporting rupiah of dubious authenticity to Bank Indonesia, and also organized activities aimed at educating the public about the characteristics of authentic currency and the prevention of counterfeit currency. The success of this coordination was reflected in an increased discovery of counterfeit currency in 2015, amounting to 313,538 notes, up 156.8% from the

17 A survey of 466 respondents was conducted in Southwest Sumba, West Manggarai, Sanggau, Ketapang, North Hulu Sungai, Rembang, Pekalongan, Sawahlunto-Sijunjung, Jeneponto, Mojokerto, Sampang/Pamekasan, Sidangkalang-Kabanjahe-Brastagi, Subang, Banyu Asin - Sungai Lilin, and Amlapura.

Chart 9.37. Ratio of Counterfeit Money to Currency in Circulation

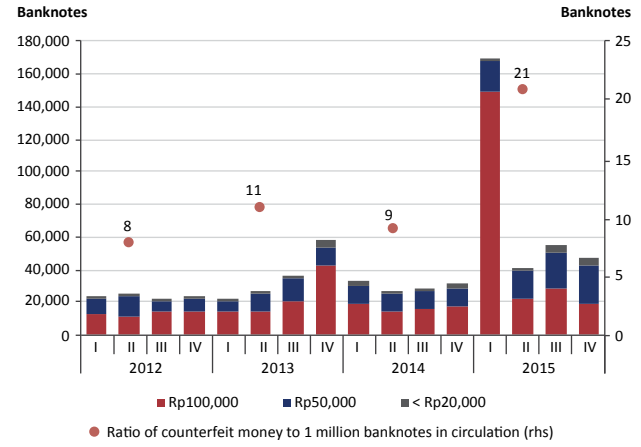
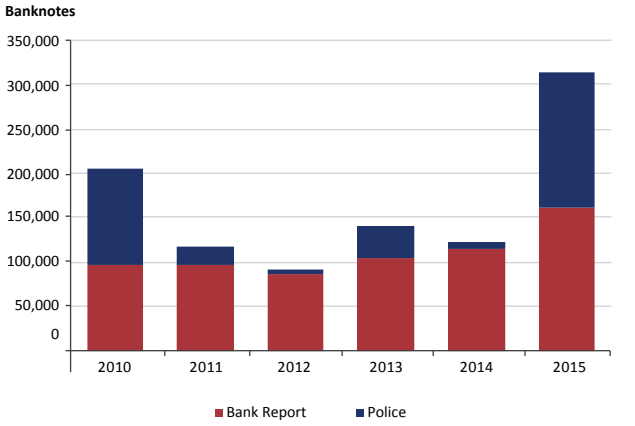


Chart 9.38. Finding of Counterfeit Money by Police and Bank Report



previous year's figure of 122,091 notes. Of the counterfeit banknotes discovered, most were in denominations of Rp100,000 and Rp50,000, with 209,752 notes (a 71.7% share) and 70,626 notes (a 24.1% share) respectively. In terms of distribution, the majority of counterfeit banknotes were discovered in Java, especially the province of East Java and Jakarta. These developments meant that the ratio of counterfeit currency in circulation rose from 9 notes to 21 notes per one million notes in circulation (Chart 9.37). The large amount of counterfeit money discovered was largely due to the active role played by the police in uncovering counterfeit money in circulation in 2015, particularly in the area of Jember in the first quarter of 2015 where 122,000 notes were discovered. In addition, the increased amount of counterfeit money discovered was also thanks to the compliance of banks in reporting counterfeit money to Bank Indonesia (Chart 9.38).

The Bank Indonesia National Clearing System (SKNBI) Generation II

The public is now able to perform fund transfers more easily, quickly, and affordably by means of the national clearing system. Whereas previously Fund Transfer Services by means of clearing could be performed 4 times a day, now they can be performed 5 times a day, at 09.00, 11.00, 13.00, 15.00, and 16.15 WIB, while Check Clearing Services can be performed 4 times as opposed to the previous one time. With these additional services, customer funds will be delivered within a maximum of 4 hours. This has been enabled by the onset of operations of the Bank Indonesia National Clearing System (SKNBI) Generation II on Friday, 5 June 2015.

Faster transfer times represent the first phase in the development of the Fund Transfer and Check Clearing Services of two phases in the development plan for the SKNBI Generation II. In the future, Bank Indonesia will develop a Multiple Transfer Service, a service which can process the transactions of more than one recipient and sender (multiple parties) aimed at facilitating a variety of routine payment/ billing transactions.

SKNBI Generation II, whose services are available from 06.30 WIB until 16.00 WIB (extended to 9.5 hours from the previous 8 hours), represents an improvement on SKNBI Generation I which had been in operation for 10 years. The improvements in SKNBI Generation II also include expanded participation access for Non-Bank Fund Transfer Operators specifically for Fund Transfer Services. This enables the public to perform fund transfers to any part of Indonesia securely, cheaply, and efficiently.

In order to enhance customer protection, transfer processing time obligations have been established for Sending Banks and Receiving Banks. Sending Banks have to forward fund transfers no later than 2 hours after receiving the mandate from a customer. Furthermore, Receiving Banks must record transfers in customer accounts no later than 2 hours after the settlement at Bank Indonesia. A maximum clearing fee has been set at Rp5,000 (five thousand rupiah). Considering that these two provisions require an adjustment to the internal systems of each SKNBI Generation II Participant, a transitional period has been stipulated which will take effect from 1 January, 2016.

There are several differences between performing transfers through SKNBI and Bank Indonesia Real Time Gross Settlement (BI-RTGS). Firstly, SKNBI settlements are performed at the end of the period (netting) while RTGS settlements are performed individually (gross). Secondly, in terms of amount limits, customer transactions can be processed through SKNBI to a maximum value of Rp500,000,000 (five hundred million rupiah) per transaction, whereas transactions through RTGS must be of a minimum value of Rp100,000,000 (one hundred million rupiah) per transaction. Thirdly, the fees charged by Bank Indonesia on SKNBI Participants are lower, amounting to Rp750 (seven hundred and fifty rupiah) per transaction, whereas for BI-RTGS the fee is Rp15,000 (fifteen thousand rupiah) per transaction.

In order to support the implementation of SKNBI Generation II, Bank Indonesia issued Bank Indonesia Regulation No. 17/9/PBI/2015, dated June 5, 2015, concerning the Operation of Fund Transfers and Scheduled Clearing by Bank Indonesia, Bank Indonesia Circular Letter No. 17/13/DPSP, dated June 5, 2015, concerning the Operation of Fund Transfers and Scheduled Clearing by Bank Indonesia and Bank Indonesia Circular Letter No. 17/14/DPSP dated June 5, 2015 concerning Customer Protection in the Operation of Fund Transfers and Scheduled Clearing Through the National Clearing System of Bank Indonesia. With the new system, the security and smooth operation of the payment system, as well as consumer protection, are expected to be further improved.

Bank Indonesia Real Time Gross Settlement (BI-RTGS) and Bank Indonesia Scripless Securities Settlement System (BI-SSSS) Parties

Payment system transaction activities in society are at present increasingly secure, fast, and reliable thanks to updated technology and improved customer protection. This was realized through the implementation of three updated BI systems on 16 November, 2015, namely BI-RTGS, Bank Indonesia Scripless Securities Settlement System (BI-SSSS), and Bank Indonesia Electronic Trading Platform (BI-ETP) Generation II. In addition to improving

Table 1. Comparison of SKNBI Generation I and II

NO.	ITEM	GENERATION I	GENERATION II
1.	Message Format	Propietary message format	ISO 20022 (xml format)
2.	Identification of Participants	Clearing Code	Bank Identifier Code (BIC)
3.	Type of Service	- Single Debit - Credit Transfer	- Single Debit Transfer - Single Credit Transfer - Multiple Debit Transfer - Multiple Credit Transfer
4.	Participant Scope	Bank	- Bank - Participants of Non-bank Funds Transfer
5.	Debit Clearing	Per region	Centralization
6.	Settlement of Funds Transfer	4 periods in 2 cycles	5 settlement periods
7.	Settlement of Debit Clearing	3 time zones in accordance with the time zone	4 clearing zones in accordance with the requisite
8.	Consumer Protection	Regulation on the onward transfer of funds to the customer on the same day	Regulation about the deadline for forwarding funds transfer orders and forwarding funds to customer accounts
9.	Minimum Prefund Provision for Funds Transfer	Minimal Rp1,-	-

the quality of its technology and communications networks, Bank Indonesia also sought to enhance customer protection by instructing that a mandatory maximum time limit for bank in processing customer fund transfers. Banks are now obliged to process customer fund transfers no longer than 1 hour after the receiving bank has obtained the funds in the BI-RTGS System.

The BI-RTGS system is an electronic fund transfer system between participants, for the most part banks. This system accommodates customer fund transfers in large amounts that can be settled instantly per transaction. BI-SSSS is used as a means of transaction with Bank Indonesia and for administering securities electronically. Meanwhile, BI-ETP is a Bank Indonesia means of transaction linked to monetary operations, Government transactions in the management of Government Securities (SBN), and money market transactions between banks, either by conventional banks (Interbank Money Market/PUAB) or sharia banks (Sharia Interbank Money Market Sharia / PUAS).

The implementation of the BI-RTGS, BI-SSSS, and BI-ETP Generation II Systems was based on the following five important considerations; improving the efficiency and capability of risk mitigation systems in accordance with international best practices; improving the ability to be connected (interoperability) with other infrastructure in financial markets/systems, both domestic as well as cross-border; accommodating the dynamics of both global and domestic financial markets/systems including policy changes both from BI and the Government; accommodating the development of an increasing transaction volume; and updating the technology of the BI-RTGS and BI-SSSS Generation I systems that have been operating for over 10 years.

For banks, the implementation of the Generation II systems will provide them with the opportunity to better manage their priority transactions and liquidity. In addition, money market transaction needs can also be well accommodated with these systems as information on money market transactions can be more easily obtained. Meanwhile, customer protection is also enhanced by the setting of time limits for processing BI-RTGS transactions as well as limits on BI-RTGS transaction charges - of Rp35,000 (thirty five thousand rupiah). These are both advantageous to customers in that they provide certainty as to transfer time and costs.

To support the implementation of these Generation II systems as well as to mitigate the risks that may arise from them, Bank Indonesia will issue related provisions and apply a transitional period for fund transfer settlement through the BI RTGS and SKNBI systems, as follows:

Table 2. Settlement Transition of Fund Transfer through BI RTGS system and National Clearing System (SKNBI)

Nominal Transactions		Validity Period
BI-RTGS	SKNBI	
The minimal limit of transaction is (flooring) Rp500 million	No limit	From 16 November 2015 until 30 June 2016
The minimal limit of transaction (flooring) is Rp100 million	The maximum limit of transaction is Rp500 million	From 1 July 2016

With the implementation of these Generation II systems, it is expected that national payment system activities will take place securely and smoothly, and will meet the needs of any developments in Indonesian financial markets. This, in turn, will support the stability of the financial system.

Regionally, economic moderation in 2015 was felt most grievously in areas reliant on commodities from natural resources. Consequently, efforts were required to diversify the economic structure, while paying due consideration to the potential of each respective region.

Chapter 10

Regional Economy

As global demand and prices for natural resource commodities declined, most provinces experienced slower economic growth in 2015, except for those in the Eastern Indonesia Region (KTI). A significant economic growth in KTI was attributable to, among others, the favorable result of downstreaming and diversification of the economy towards the industrial sector. On the fiscal side, an increase was seen in the central government's transfer and infrastructure spending despite their less than optimum use. In regards to prices, inflation remained under control in most provinces. Financial stability remained intact amid the slower credit expansion for corporate and household across the provinces.

Slower growth marked the economy of most provinces in 2015, except for those in KTI. Natural resource commodity prices that continued to decline and the relatively slow pace of global economic recovery had affected export and investment performance of the Indonesian regions. This condition had a significant impact on the economies outside Java, which are highly dependent on the export of natural resource commodities in the mining and plantation industries. Nevertheless, the slowdown did not impact all the provinces which have economies are based on natural resources like it did in 2014. The economy of KTI in 2015 experienced the highest growth compared to their historical growth in the last five years, which, among others, was attributable to the positive impact of a consistent natural resource-based downstreaming program.

The economic slowdown in provinces which economies are based on natural resources was related to the limited diversification of the economic structure. The structure of natural resource-based provincial economies proved to be more susceptible to fluctuations in natural resource commodity prices. The economic slowdown, especially in the last two years, confirmed the vulnerability of economic structures in a number of provinces outside Java which economies are based on natural resources, that is, in oil and gas producing provinces of Aceh, Riau, East Kalimantan and West Papua, the coal producing province of East Kalimantan and a few provinces in Kalimantan, and in South Sumatra Province, as well as mineral and metal concentrate producers spread in several provinces in KTI, Kalimantan, and Sumatra. As far as plantation industries are concerned, the volatility of commodity prices also affected the economic resilience of regions that depend on natural resources, including palm oil and rubber producing provinces in Sumatra and Kalimantan and producers of cocoa and copra in Sulawesi.

The economic vulnerability of provinces which economies are based on natural resources is also subjected to structural factors associated with rapid depletion of non-renewable natural resources. The growth contraction of a number of oil and gas producing provinces in Sumatra and Kalimantan was due to not only the significant impacts ofcontinuing decline in oil and gas prices in 2015, but also aging refineries and depletion of oil and gas reserves. The impacts of the decline in production and productivity of oil and gas exploration has compromised efforts to promote the downstreaming of oil and gas sector across regions. Today's oil and gas prices, which are far lower than their historical figures, has become a disincentive for both new exploration and investment in the oil and gas sector. This condition constitutes a fundamental economic challenge in oil and gas producing provinces or other provinces which economies are based on non-renewable natural resources, if no immediate action is taken to diversify the economic structure.

On the other hand, positive results have been obtained from a downstreaming program on mining resources in some provinces whose production is able to keep up the acceleration of economic growth particularly in KTI. This is especially true for the downstreaming of the mineral resources through investment in the construction of smelters, some of which have been running in a number of provinces in Sulawesi. The implementation of downstreaming policies has yielded significant positive effects to the economy of KTI, as indicated in the performance of the construction business and labor absorption. The operation of the new smelters has successfully contributed to the improvement in the performance of industrial and service businesses. However, efforts to promote the downstreaming program at regional levels is still met with challenges.[1] Of the 19 companies that have planned to build smelters in KTI, only seven have shown significant progress including two that commenced operations in 2015. Some constraints found in smelter development included issues related to energy supplies, land acquisitions, permits, environmental destructions, and financing aspects.[2]

Economic linkages between one region and another were responsible for spreading the economic slowdown from natural resources (SDA) based regions to non-SDA based ones. The decline in export revenues in a number of provinces outside Java had led to the weakening of consumers' purchasing power and households' consumption of goods and services that are mostly came from Java. The slowdown in inter-provincial export performance was confirmed in 2015. However,

1 Downstreaming program on plantation commodities such as palm oil in Sumatra was restrained by the currently lower commodity prices in which the export duties on CPO became relatively not so much different from those on its derivative products. In addition, the effectiveness of the use of biofuels which was initially intended to reduce domestic dependence on imported oil and gas, was also relatively limited. In the oil and gas sector, a downstreaming program through the development of petroleum refining and petrochemical industries driven by tax incentives, such as in Kalimantan, was also limited because of the huge cost of the investment.

2 Support on structural reforms by local governments was particularly directed to overcome trade facilitation and land acquisition issues. Some local governments have operated the one stop service (OSS) system and downsized the total number of licenses, although most of them were still not fully integrated. Some local governments have also supported the process of land acquisition including through coordination with a number of related government institutions (National Land Agency and the Ministry of Environment).

consumption growth that was supported by government spending would enable Java to withstand a deeper economic slump.

For main industries, the aggregate slowdown in growth had occurred in both tradable and non-tradable industries. As far as tradable industries are concerned, slowdown especially occured in the manufacturing industry, particularly in Java. The agricultural sector recorded improvement with increased production of food crops, especially in Java, while the performance of plantation industries in provinces outside of Java was still in decline. The mining industry had also recorded some improvement despite growing at a negative level. A significant improvement in mining sector in the KTI was able to offset the slowdown in the same industry in Sumatra and Kalimantan. As for non-tradable industries, wholesale and retail trading businesses experienced a slowdown in provinces outside Java, along with the decline in the performance of export of natural resources. Meanwhile, the construction sector slowed down in all provinces except in KTI, despite the expansion of government infrastructure projects.

Inflation rates declined throughout all the country's provinces in 2015, especially in the administered prices category. The decline in inflation recorded in Java and Sumatra was due to the sustainable supply and smooth distribution of foodstuffs. The impact of El Nino weather phenomenon in 2015 was relatively moderate on most areas of Java that served as the country's national food production center. On the other hand, Kalimantan and KTI experienced relatively higher inflationary pressures due to frequent disruption in foods distribution as there are still a limited connectivity, capacity, and quality of infrastructure.

From the aspect of regional bank financing, credit slowdown occurred in all provinces although financial stability was maintained. The sharpest decline in credit growth was recorded in Kalimantan and Java. The economic slowdown had also led to the slowdown in bank deposit across all provinces. In spite of this, the stabilization policy adopted by Bank Indonesia had been able to safeguard financial stability in the entire regions with credit risk kept below the safe limit. Meanwhile, on regional fiscal side, it's support to the economy is relatively insufficient due to lower budget absorption in 2015. The insufficiency in regional spending capability to stimulate the economy is also a result of the decline in regional revenues because of economic slowdown. Moreover, there are indications of increased fiscal risks in some provinces that were experiencing a decline in the revenue share of natural resource commodity export. On the other hand, there had been increased in central government's transfer and infrastructure spending in most provinces.

Looking ahead, the commitment and priority to accelerate structural reforms, especially through the development of strategic infrastructure in the area, is believed to be supporting the economic performance. The continued development of various infrastructure projects across regions is supported by the central government budget and through a significant increase in Special Transfer Funds to the regions.[3] In accordance with the National Medium-term Development Plan (RPJMN) target for a 2015 – 2019 period, the development of infrastructure in 2016 focused on the 35 thousand MW electricity power construction project which is becoming a major structural problem throughout the region, as well as agricultural infrastructure projects that support food security in regions. Connectivity supporting infrastructure development across regions (roads, ports, and airports) is also a priority in the Government's Annual Work Plan (RKP) for 2016, which will support the increased competitiveness of the economy.

Structural reforms across provinces had also emphasized diversification of economic structure by taking into account the potential of available resources. Structural reforms in provinces outside Java were directed at building natural resource-based manufacturing industries with higher added value that could serve as suppliers of raw materials for the manufacturing industry in Java. Meanwhile, structural reforms in Java were directed at integrated industrial transformation by prioritizing and strengthening of the integration of domestic and global industries as well as the making of Indonesia as a global production base. This had become a crucial factor in dealing with inter-regional competition that went beyond national borders in the era of the ASEAN Economic Community (AEC) and in controlling the domestic market.

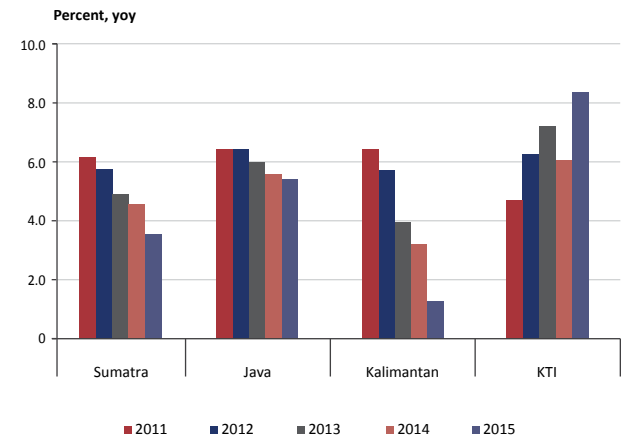
10.1. REGIONAL ECONOMIC GROWTH

Dynamics of Regional Economic Growth

Economic growth in 2015 slowed in all provinces, except in provinces in KTI. The deepest economic slowdown was experienced by provinces in Kalimantan and Sumatra (Chart 10.1). Meanwhile, the economic slowdown in Java, which has the largest share of the national economy

3 Of the 14.2% increase in the transfer of funds to provinces in 2016, the special transfer funds for infrastructure rose to the highest, reaching about a 266% increase (from IDR58.8 trillion in 2015 to IDR156.4 trillion in 2016).

Chart 10.1. Regional Economic Growth in 2015



Source: BPS-Statistics Indonesia, processed

and relatively more diversified sources of growth, was relatively moderate (-0.1% compared to its economic growth in 2014). Unfavorable global condition was the major cause of regional economic slowdown exacerbated through the decline in primary commodity export performance. Export growth was negative in Sumatra, Java and Kalimantan. On the other hand, exports in KTI were able to post a double-digit growth of 18.8% (yoy), thanks to the export of mining commodities, which drove the improvement of KTI's economy whose share was about 11.3% of GDP (2.3% higher than the annual growth in 2014). KTI's export improvement had also been a factor that increased investment in the region by 9.1%.[4]

The deepest economic slowdown in 2015 was primarily experienced by major oil and gas producing provinces. Aceh and East Kalimantan had recorded negative growth, while Riau was still capable of positive growth (Picture 10.1).[5] A slowdown in oil and gas mining sector as a result of the decline in world oil prices had also affected the performance of a number of related businesses, including the industrial sector, wholesale and retail trading businesses as well as construction businesses, all of which had recorded low growth. In addition, the sharp decline in the receipt of Revenue-Sharing Fund had put pressure on the economy in which spending was held back by limited fiscal capacity. Provinces outside Java, which were dependent on natural resources and experiencing quite a pronounced economic deceleration, were the coal producing ones, namely East Kalimantan and South Kalimantan.

The decline in Java's economic performance with the largest regional GDP share (58%) was instrumental in preventing the national economy from gaining full recovery. Slowing economic growth in Java was attributable to not only the effect of global economic slowdown but also the weakening of domestic economy. Export of manufactured goods that dominated the economic structure of Java was under pressure, both on overseas and domestic destination markets. Domestically, the decline in the export of manufactured goods from Java to provinces outside Java was due to the weakening of consumption in those provinces whose economy is based on natural resources. The phenomenon of Java's economic slowdown was also due to the declining competitiveness of its manufacturing industry.[6] In spite of this, however, robust consumption in Java was able to withstand further economic slowdown. The construction of various infrastructure projects supporting both connectivity or agriculture also had contributed to sustaining Java's economy, particularly in terms of investment and labor absorption.[7]

Improvement in KTI economy came from an increase in the output production of mining and industry. After the ban on the export of raw minerals in 2014, re-issuance of export permits for mine concentrates had provided a base effect factor on KTI economic performance, particularly in Papua and West Nusa Tenggara (Picture 10.1). The development of downstreaming policy characterized by the operation of smelter plants had also supported the economic performance of KTI regions especially Sulawesi with the operation of the two smelters in 2015. Construction of infrastructure projects in KTI, too, was a factor that could

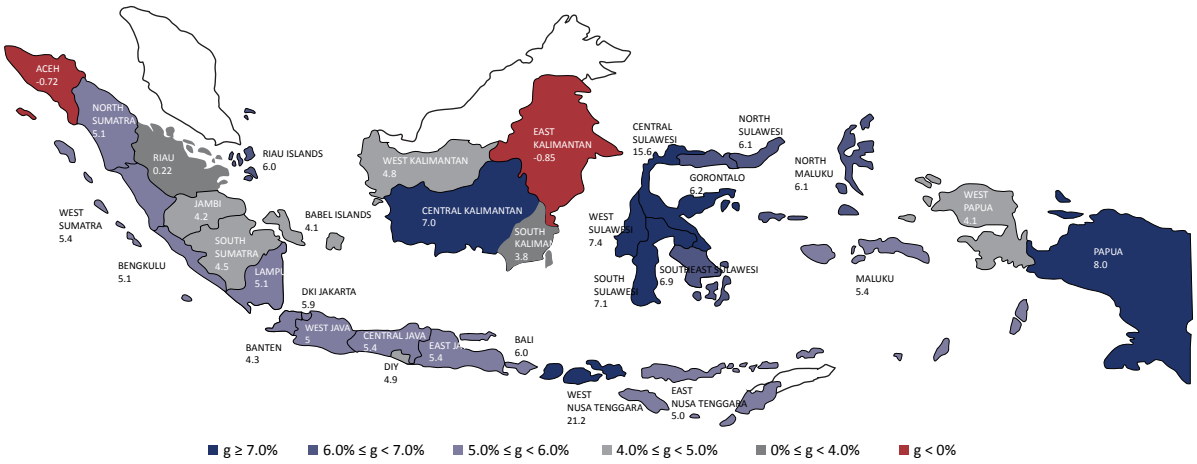
4 On the other hand, the growth of investment in Sumatra, Java and Kalimantan was slowing down, despite the support of the Government's infrastructure investment projects. Investment growth in these three regions was recorded at 3.3% (yoy), 4.3% (yoy), and 2.19% (yoy) respectively.

5 The economic growth of the provinces of Aceh, Riau and East Kalimantan in 2014 was still within the positive zone. Contraction of economic growth in the three provinces was a factor that lowered growth of Sumatra and Kalimantan. Depletion of oil and gas reserves had contributed to the decline in the performance of the oil and gas sector in these three provinces and in Aceh, which was also affected by the base effect factor of the cessation of the Arun gas refinery operations. Although efforts to convert Arun refinery into an LNG regasification plant had been made, its operation was still on a limited scale.

6 The decline in industrial competitiveness in Java was reflected in the decline in the share of industry in the regional GDP in the last 10 years. The decline in the share of the largest industries in the period was recorded in the provinces of East Kalimantan, Banten and Aceh.

7 Expansion of infrastructure projects in Java, which was mainly on transport infrastructure, was also a positive influence on the development of transportation and warehousing businesses, the business of providing accommodation and food and drink, as well as information and communication business. This condition was confirmed in Jakarta which has been conducting a large-scale transport infrastructure development (mass rapid transit).

Picture 10.1. Regional Economic Growth in 2015 (2010 Base Year)



Source: BPS-Statistics Indonesia, processed

give a positive impact (or multiplier effects) spreading from construction sector to transportation and warehousing businesses, and to financial services and insurance businesses as well. In terms of economic structure, the portion of the economy of provinces in KTI to the national economy had consistently increased over the last four years, thus indicating a signal of progress and equal development distribution.[8]

Sources of Sectoral Growth of Regional Economy

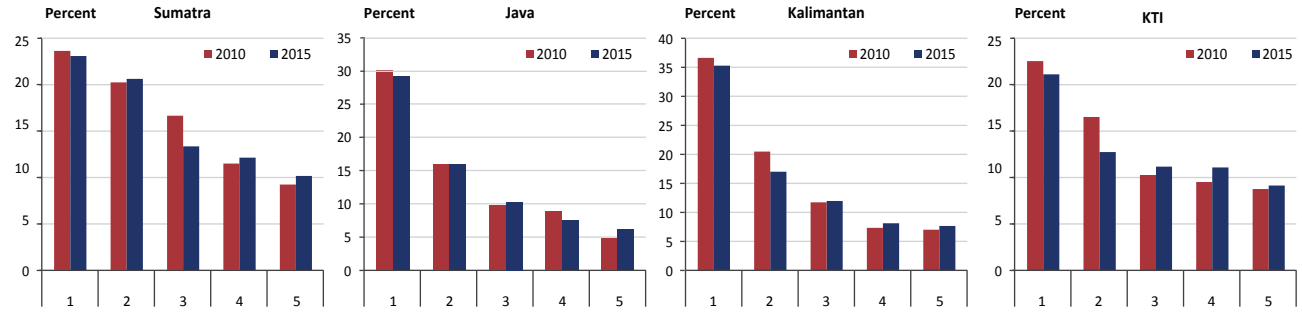
Agricultural sector grew in most regions in 2015. This was supported by the increase in the production of food crops whose biggest contribution came from increased rice production in Java. Java's agricultural sector increased significantly to 3.4% (yoy) in 2015, after growing 1.3% (yoy) in 2014. Special initiative in agricultural policy through the development of production infrastructure and facilities helped boost the performance of agricultural sector amid the risk of El Nino. The effect of El Nino on food crops production tended to be greater in regions outside Java, which rely on rain-fed land. Land conversion remained a challenge for the performance of agricultural enterprises, one of which was indicated from the decline in food crops production in West Java Province as a result of rapid urban and industrial zone development.

The continuing decline of the performance of plantation industries in all regions outside Java had prevented agricultural sector from posting a higher growth. Weakening global demand and prices had become the main factor behind the decreasing performance of plantation industries. The underperformance of the plantation industries in Sumatra and Kalimantan was attributable to the decline in the export of palm oil and rubber. Meanwhile, the output of plantation industries in KTI was affected by weaker exports of cocoa, cloves, and nutmeg. The impact of extreme weather caused by El Nino and forest fires had led to the decline in the performance of plantation production in Sumatra and Kalimantan. The decline in palm oil production due to forest fires in both regions was estimated at approximately 15%. In general, the portion of agricultural sector in the regional GDP in most regions was lower than 10 years ago, which was strongly influenced by the performance of plantation industries (Chart 10.2).

Improved performance in the mining industries only occurred in KTI that grew by 18.8% (yoy) and became the main driver of growth of its economy. In addition to the re-issuance of licenses for exporting mineral and metal concentrates, the downstreaming on mining commodities that had been ongoing in KTI had also contributed to the improved performance of the regions' mining industries as the need for smelters' raw materials was growing. Meanwhile, the use of technology to help increase the productivity of oil and gas refineries was relatively still insufficient. This was reflected on the lifting of oil and gas in 2015 that tended to be lower than the previous year. The more permanent downward trend in production due to aging wells had been experienced by most of the oil and gas refineries in Sumatra and Kalimantan. Moreover, newly operated refineries such as the Cepu Block in Java had not reached their optimum production capacity yet.

8 Although progress has been made, equal development distribution outside Java, especially in KTI, was still in need of attention, especially as far as Human Development Index (HDI) is concerned.

Chart 10.2. Share of Regional GDP by Main Industrial Origin in The Region

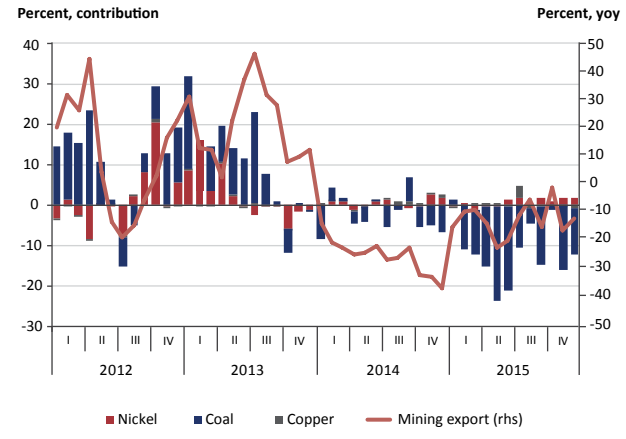


Source: BPS-Statistics Indonesia, processed

Mining industries slowed significantly in Kalimantan and Sumatra (Chart 10.3). The annual growth of mining industries in Kalimantan and Sumatra had contracted by 3.9% (yoy) and 2.8% (yoy) respectively. Mining operations in Kalimantan, whose share to the regional GDP was the largest, contracted for the first time within the last 5 years. The contraction was caused by the sharp decline in coal production, which went down by 75% compared to 2014, due to the decline in global demand, especially from China, and the lack of domestic demand. Meanwhile, the slowdown of mining industries in Sumatra was not as intense as in Kalimantan because Sumatra's economy was relatively more diversified. There was even an indication that coal production in South Sumatra had increased to meet the needs of a number of steam power plants, which began operation in 2015.[9]

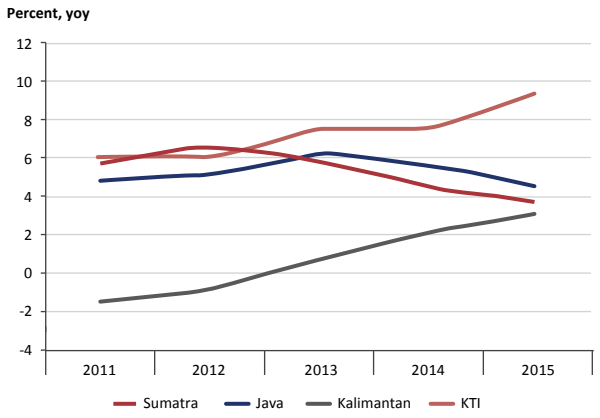
Manufacturing sector grew at a slower pace in Java, Sumatra, and Kalimantan (Chart 10.4), corresponding to the drop in export demand and the weakening of domestic demand for manufactured goods in Java, including motor vehicle products, textiles, and textile products (Chart 10.5). A liaison survey on businesses in the manufacturing sector confirmed that sales performance was mostly lower than 2014. The manufacturing sector, especially in Java, was also burdened by the dependency on the import of raw materials and an increase in production costs that affected

Chart 10.3. Mining Growth in Kalimantan and KTI



Source: BPS-Statistics Indonesia, processed

Chart 10.4. Regional Manufacturing Growth



Source: BPS-Statistics Indonesia, processed

9 A steam power plant with a capacity of 1,060 MW had been operated in southern and central Sumatra and another one with a capacity of 580 MW had been operated in northern Sumatra.

Chart 10.5. Java Manufacturing Export

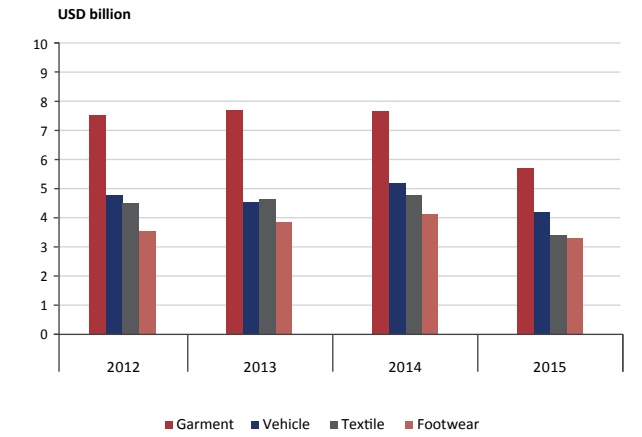
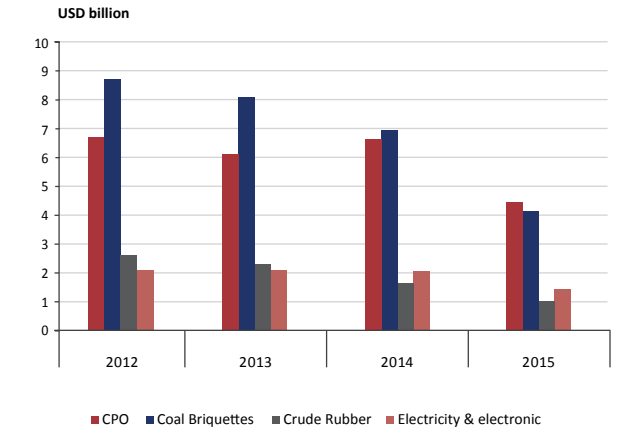


Chart 10.6. Sumatra and Kalimantan Manufacturing Export



competitiveness. The weakening of domestic consumption in regions outside Java had also posed a challenge for the sale of manufactured products in Java. In addition, the export of products from natural resource-based industries in Sumatra and Kalimantan such as palm oil and processed rubber products had also fell, mostly due to lower global demand (Chart 10.6).

On the other hand, manufacturing sector grew in KTI in line with the implementation of downstreaming policy. The operation of the Donggi Senoro LNG plant in Central Sulawesi Province and the operation of a number of ferronickel smelters in Central and Southeast Sulawesi provinces in 2015 had became the driving force behind increased industrial growth in KTI. Rapid industrial growth in KTI was also supported by financing from the banking sector which was recorded to have the highest growth. The progress of industrialization in KTI in recent years was reflected in a shift in the structure of growth across the regions (Chart 10.2). The decline in the share of regional GDP in mining sector was compensated by an increase in the share of manufacturing sector. This confirmed the existence of diversified economic structure and supported the indication of higher KTI's potential output growth.[10]

The performance of wholesale and retail trading sectors was declining in most regions, particularly in Kalimantan and Sumatra due to the weakening of people's purchasing power and limited revenues from the export of mining commodities. This was made worse by forest fires and haze disasters that disrupted economic activities in both regions. Sales turnover was estimated to decline in few provinces in Kalimantan and Sumatra by 40% -50% and 20% -30% respectively during the occurrence of haze. This was confirmed by the fact that the growth in household consumption and consumer confidence index was lower in Kalimantan and Sumatra, and the slowdown in credit expansion for wholesale and retail trading sectors in most regions. Wholesale and retail trading sectors in Java were still able to grow higher. This condition was affected by the commencement of large-scale infrastructure development and income improvement in the agricultural sector. Simultaneous regional elections in 263 provinces, districts, and municipalities had also had an impact at a moderate level. However, household consumption in Java declined slightly in 2015 in line with the moderation in consumer confidence. Meanwhile, wholesale and retail trading sectors were still able to grow higher in KTI, sustained by an increase in consumption and investment, in both mining (smelter) and infrastructure construction.

Construction sector grew slower in most regions in 2015, amid increasing intensity of infrastructure development. The slowing of construction performance, especially in Kalimantan and Sumatra, was the result of the lack of private construction projects. Construction sector in both regions slowed down considerably from 7.6% (yoy) to 2.8% (yoy) and from 7.0% (yoy) to 4.2% (yoy) respectively, thus contributing to increased credit risk in the construction business. The performance of the construction sector in Java slowed slightly as it grew by 4.8% (yoy) amid the ongoing construction of a number of agricultural infrastructure projects (dams and irrigation) and transport connectivity projects as well, such as the Jakarta Mass Rapid Transport (MRT) system, the Trans-Java highway, and airport expansion projects. Meanwhile,

10 On the other hand, the potential outputs of the other regions still tended to decline. Potential output was calculated using HP Filter with Regional GDP data from 2008 to 2015.

construction sector in KTI posted a higher growth, spurred by infrastructure and smelter construction projects. These developments boosted an increase in the rate of growth of the construction sector from 8.3% (yoy) to 9.6% (yoy) in KTI.

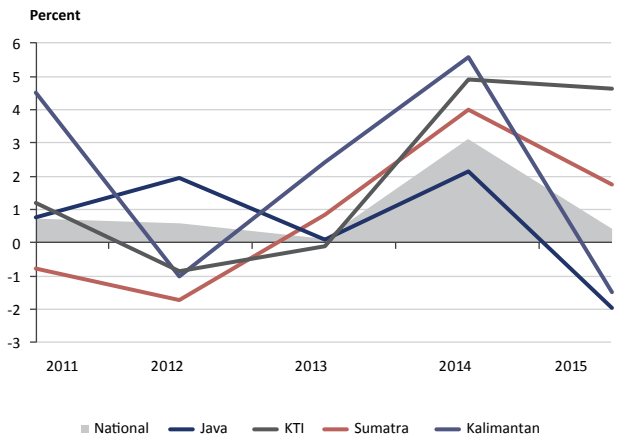
The progress of the government infrastructure projects that supported construction sector performance was evident in many regions. Based on monitoring and evaluation data from the Team for the Evaluation and Monitoring of Budget Realization (TEPRA), the realization of physical projects, especially in Sumatra and Kalimantan, was inline with the progress of power plants and new airports construction projects.[11] Of the total additional capacity of the steam power plants and mini gas power plants of 2,600 MW, approximately 63% were located in Sumatra. The large-scale airport projects in Kalimantan in 2015 included the expansion of the Supadio airport in Pontianak, West Kalimantan, and the construction of the Muara Teweh airport in North Barito and the Maratua airport in East Kalimantan. As far as agricultural infrastructure was concerned, construction was focused on 16 reservoirs spread in different regions. There were three reservoirs (Payaseunara and Marangkayu Rajui in Aceh and East Kalimantan respectively) that were nearing completion in 2015. Meanwhile, the progress of road construction was also visible in several regions, including, among others, the Trans-Sumatra toll road project and the Trans-Java toll road project (connecting the cities of Pejagan-Pemalang, Semarang-Solo and Solo-Ngawi).

Regional Employment and Welfare Condition

Growth in labor force decreased in all provinces across the country in 2015, particularly in Kalimantan and Java (Chart 10.7).[12]. Due to the uncertainty and volatility of natural resource-based economy, the majority of the workforce in provinces whose economy depends on natural resources were presumed to look for work in other provinces that had more favorable prospect of employement or went somewhere else in order to pursue higher education.

Economic contraction in Kalimantan, which occurred throughout the year, had led to the increase in unemployment rate, in correspondence with termination of employment in the mining sector. The

Chart 10.7. Growth of Regional Labor Force

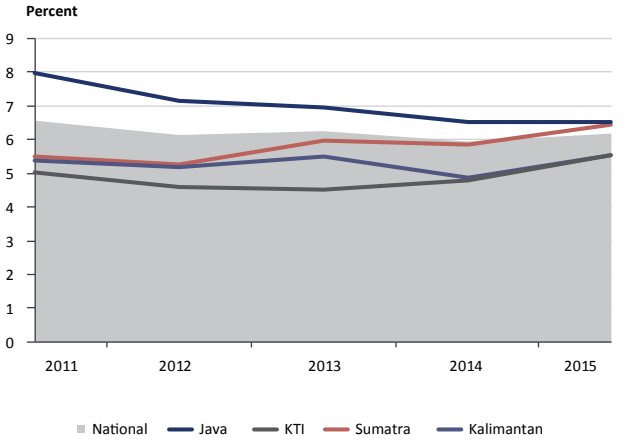


Source: BPS-Statistics Indonesia, processed

highest unemployment rate (7.5%) was recorded in East Kalimantan. Labor force had also declined quite significantly in Java, although open-unemployment rate tended to remain stable (Chart 10.8). In Java, agriculture and trade sectors that were still experiencing growth had helped labor absorption and increase in construction activity, due to the development of a number of large-scale infrastructure projects. On the other hand, the underperformance of a number of manufacturing subsectors had contributed to the unemployment level in Jakarta (7.2%) and West Java (8.7%) which were above the national average.

The growth of labor force in Sumatra and KTI had also decreased in 2015. The impact of the economic slowdown was reflected in increased unemployment, particularly

Chart 10.8. Regional Unemployment Rate



Source: BPS-Statistics Indonesia, processed

11 TEPRA data came from financial and physical project realization reporting submitted by regional Governments every month.

12 Residents who belong to the country's labor force are people of working age population (15 years and older) who are employed or self-employed, or have a job but are temporarily out of work and those who have no job.

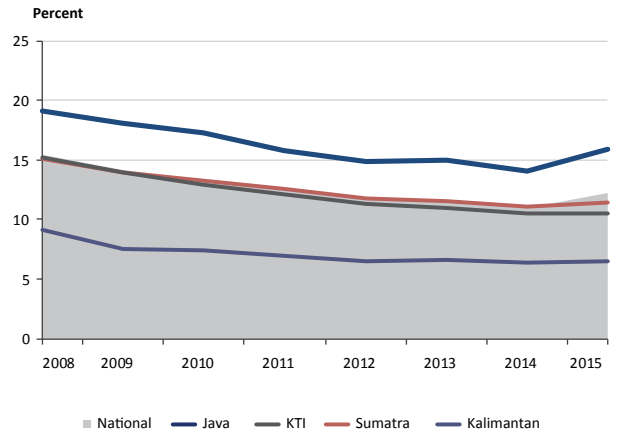
in Sumatra, which reached 6.4%. Provinces in Sumatra with a high unemployment rate were Aceh (9.9%) and Riau (7.8%). Meanwhile, unemployment rate in KTI was the lowest nationwide. The unemployment rates of most provinces in KTI were below the national average except in East Kalimantan, North Sulawesi, Maluku and West Papua. The lowest unemployment rate in KTI was recorded in Bali (2%).

Distribution of unemployment across provinces showed an increasingly narrowing trend (Chart 10.9). This indicated higher inter-provincial labor force movement, thus implying more optimal absorption in the labor market.

Hence, the distribution pattern of the unemployment rate showed that most of the provinces whose ratio to the regional GDP was quite small were the ones that had a relatively larger informal sector, which enabled them to absorb more labor.

Poverty rate increased in all provinces in line with economic slowdown in 2015. The poverty rate in KTI rose quite considerably, far above the national average in spite of economic expansion at the same time (Chart 10.10). Of the total 13 provinces in KTI, 11 were recorded to have a poverty rate that reached double digits. Papua, West Papua, and East Nusa Tenggara were the regions with the highest poverty rates in the last 5 years. Jakarta with a larger and more diversified economy had the lowest poverty rate compared to other provinces in the last 5 years. The informal sector which tended to play a dominant role in Jakarta appeared to serve as a buffer against economic slump. Kalimantan whose economic growth was the weakest compared to other regions had, in recent years, been able to keep poverty rate at the lowest end.

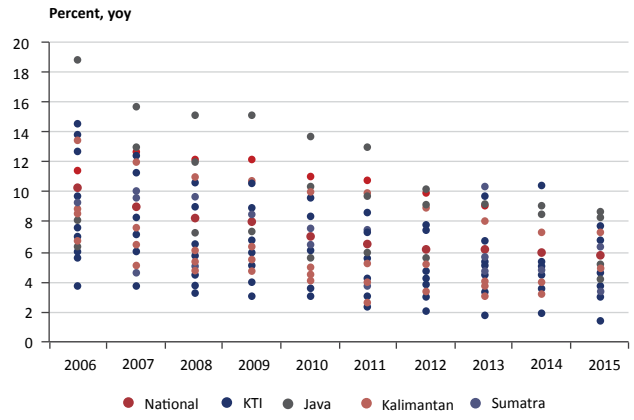
Chart 10.10. Regional Poverty Rate



Source: BPS-Statistics Indonesia, processed

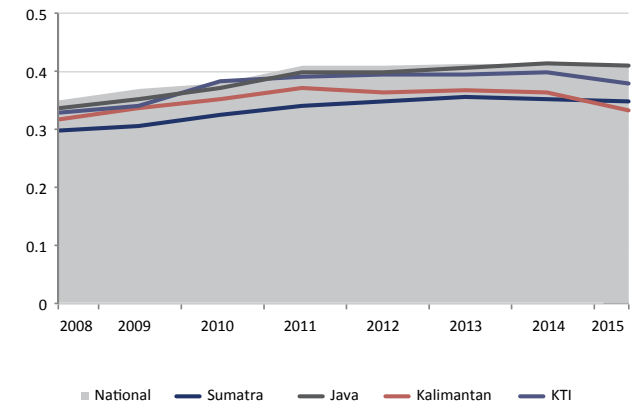
The gini ratio had also indicated lack of significant improvement to address inequality in most provinces. The gini ratios in Java and KTI were higher than in other regions in 2015 (Chart 10.11). However, inequality in KTI tended to decline in 2015, whereas in Java it was still equivalent at the national average level (0.41). Spatially, the highest gini ratio was recorded in the provinces of West Papua (0.44), DKI Jakarta (0.43), and the Special Region of Yogyakarta (0.43). Significant reduction in gini ratio occurred in North Sulawesi and Bali, while in Sumatra and Kalimantan the gini ratio was below the national average. The trend within the last 5 years indicated that gini ratio tended to increase as the effect of the boom in natural resource commodity

Chart 10.9. Regional Disparities in Unemployment Rate



Source: BPS-Statistics Indonesia, processed

Chart 10.11. Gini Ratio

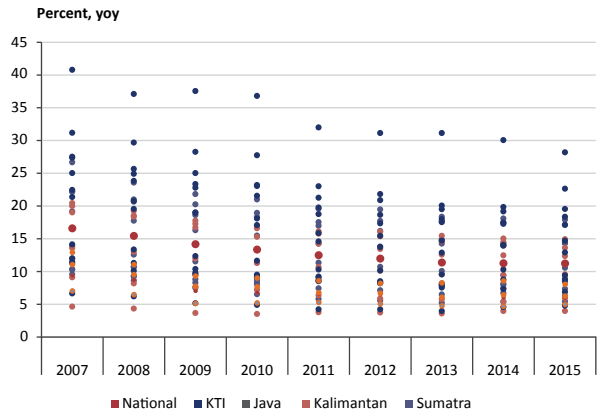


Source: BPS-Statistics Indonesia, processed

prices which reduced the inclusiveness of economic growth in some regions.

In general, the distribution of poverty in various provinces also showed an increasing tendency of narrowing. In 2015, the lowest poverty rate was recorded in Jakarta (3.6%) and the highest was recorded in Papua (28.4%). The overly wide disparity in the levels of poverty between Jakarta and Papua reflected the severity of poverty in KTI in comparison to Java. Poverty rates below the national average were for the most part recorded in KTI and Sumatra (Chart 10.12) whereas in Java and Kalimantan the distribution of poverty tended to be below the national average.

Chart 10.12. Regional Disparities in Poverty Level



Source: BPS-Statistics Indonesia, processed

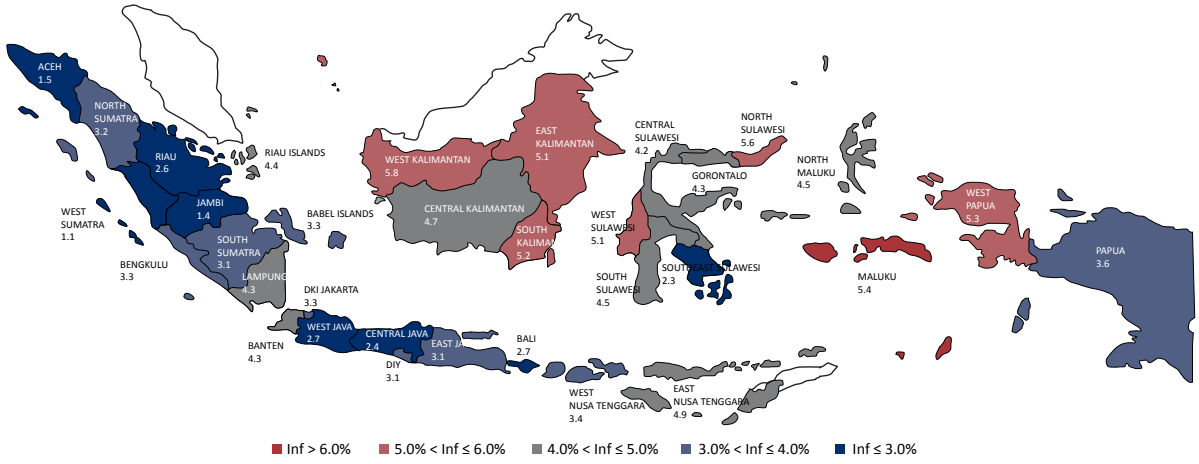
10.2. REGIONAL INFLATION

Regional Inflation Dynamics

The decline in regional inflation rates in 2015 occurred throughout the country, especially in Java and Sumatra.[13] As in 2014, sustained supply and smooth distribution of food commodities (Picture 10.2) were also instrumental in checking inflation in these two regions. The impact of El Nino that occurred in 2015 was relatively moderate on most areas of Java that served as the national food production center.

On the other hand, Kalimantan and KTI were experiencing relatively higher inflationary pressure due to disruption in the distribution of goods and services because of insufficient transport connectivity and limited infrastructure capacity and quality. The impact of the reduction in fuel prices was uneven spatially, due to variations in freight rates that were set through local government legislation.[14] In that regard, the Regional Inflation Monitoring and Controlling Team (TPID) continued to actively play its role of supporting measures to control inflation at regional levels through coordination

Picture 10.2. Regional Inflation in 2015 (Percent, yoy)



Source: BPS-Statistics Indonesia, processed

13 The share of Java and Sumatra's inflation rates, which stood at 62% and 19.6% respectively (according to the 2012 Cost of Living Survey), was the highest nationwide. Of the 14 provinces in Java and Sumatra, only one province in the Western Part of Java and two provinces in the Southern Part of Sumatra which recorded inflation rates above the national average.

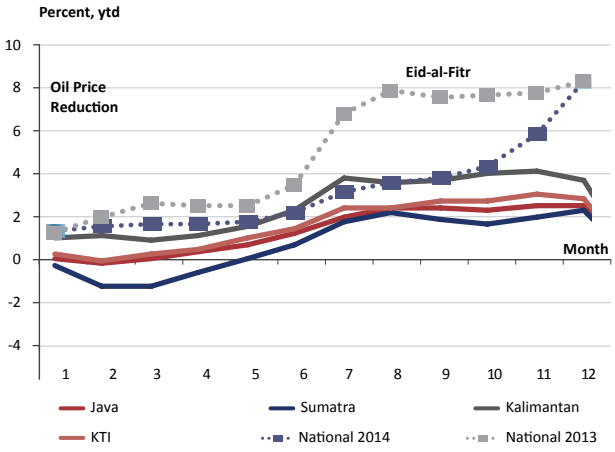
14 Variations in regional transport fare adjustments after the decline in fuel prices in January 2015 referred to a tariff reduction range of 5-10% under the regulation of the Minister of Transportation. In addition, the timing for transport fare adjustment also differed among regions due to the local regulations on transport fare setting mechanism that had to take into account the inputs from the local organizations of land transportation owners and operators.

of short-term policies and policies that were directed to address a more structural factor of inflation.

Inflationary pressure during the Eid-al-Fitr period in 2015 that was more moderate than the average over the last few years was also a factor that brought down inflation in most regions. The economic slowdown that occurred in 2015 had affected consumer purchasing power and demand, especially in Sumatra, Java, and KTI. Minimum disruption in the distribution and adequacy of food supplies in most regions had also helped control regional inflation during the Eid-al-Fitr period. On the other hand, inflation in Kalimantan during the Eid-al-Fitr period tended to be higher, driven by rising food prices and air freight rates (Chart 10.13).

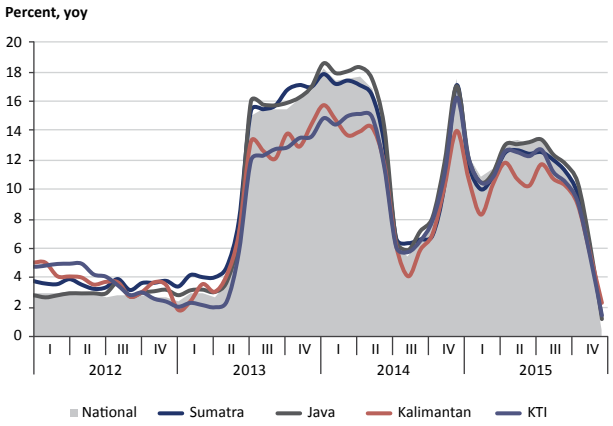
Spatially, Sumatra and Java recorded the lowest inflation rates in 2015 due to moderate demand and adequate supplies. Inflation rates in Sumatra and Java were recorded at 3.05% (yoy) and 3.12% respectively, the lowest within the last 6 years (Chart 10.14). The fall in inflation rates in Sumatra was brought about by a significant reduction in inflation in West Sumatra, Bengkulu, Jambi, and Aceh. The lowest inflation rate nationwide was recorded in West Sumatra (1.08%).[15] In Java, the largest decline in inflation occurred in Banten, Jakarta, and Central Java. Increased production of food crops in Java had helped secure the availability of food supplies and the stability of food prices.

Chart 10.13. Pattern of Regional Inflation



Source: BPS-Statistics Indonesia, processed

Chart 10.14. Development of Regional Inflation 2012-2015



Source: BPS-Statistics Indonesia, processed

Despite being lower than in 2014, inflation rates in Kalimantan and KTI in 2015, which were recorded at 5.12% and 4.06% respectively, were higher than the national inflation figure. The highest inflation in Kalimantan occurred in West Kalimantan Province (5.79%). Although demand was likely to weaken in line with significant economic slowdown in Kalimantan, limited transport connectivity and transportation facilities were still a major cause of inflation. Inflation in the sub-group of transportation was specifically an issue in West Kalimantan, due to the frequent increase in air freight rates. In KTI, provinces with relatively high inflation rates were Maluku, West Papua, North Sulawesi, and West Sulawesi. The highest inflation rate nationwide that reached 6.15% was recorded in Maluku.

Inflation that was still quite high in KTI was affected by foodcommodity prices, especially those of freshly caught fish commodities that were greatly weighted in the inflation basket. Moreover, in contrast to the condition of Kalimantan, the significant increase in KTI's economic growth was also a factor that led to stronger demand.

The impact of forest fires and the haze from the smoke of the forest fires on regional inflation was more concentrated in Kalimantan. Although the intensity of forest fires and the resulting haze were relatively more extensive in Sumatra, the damaging impact of the haze was more prevalent in Kalimantan.[16] Disruption of flights and distribution of goods by road, river and air adversely affected the availability of supplies and price stability in

15 West Sumatra recorded the highest inflation rate in 2014 and experienced the most significant decline in inflation in 2015, which stood at 9.67%. Operation of agribusiness terminals and collaboration between city governments were considered as one of the factors that contributed to the stabilization of food prices.

16 Although there was a disturbance in the distribution of goods in Sumatra, there were adequate supplies. It is caused also by the declining demand, associated with the lack of public mobility in conducting trade activities

Kalimantan, especially in West Kalimantan and Central Kalimantan, which were the worst hit by the haze.

Sources of Regional Inflation

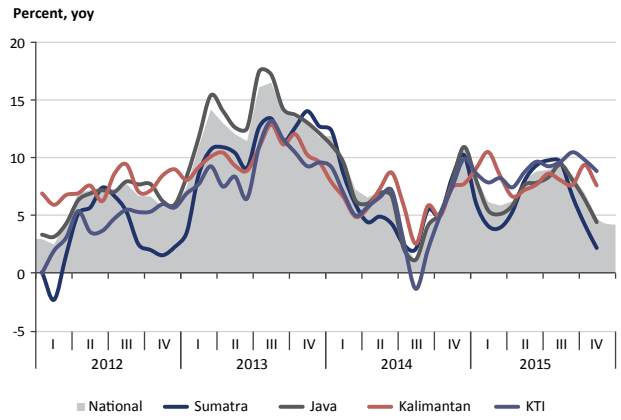
Significant decline in the administered prices inflation was mainly responsible for lower regional inflation in 2015. This happened mainly as a result of the cut in fuel prices and transport fares adjustment. The most significant impact of the reduction in fuel prices and transport fares was indicated in Kalimantan at the beginning of the year. In addition to land transport tariff reduction policy, adjustment made to river transport tariffs had also significantly affected the distribution cost of goods in Kalimantan. Sampling in a number of regions showed that the highest land transport tariff reduction was recorded in Sumatra (11.4%), followed by Java (9.8%), and Kalimantan (5.5%). However, compared to land transport fare adjustment after the increase in fuel prices in 2014, the tariff reduction in 2015 was far more moderate throughout all regions. On the other hand, there had been an increase in the price of household fuels (BBRT) and economical electricity tariff adjustments that applied throughout the region. The impact of regional inflation as a result of BBRT adjustment was subjected to disparities between the distribution costs and local government regulations that set the highest retail prices of LPG.[17] On average, the highest selling price of LPG was recorded in Sumatra, followed by Kalimantan and KTI. The average selling price of LPG in Java was lower due to lower distribution costs which, in turn, were due to the established transport infrastructure.[18]

Inflation under the foodstuff category contributed to the varying degree of decline in regional inflation in 2015 across the regions. The deepest decline in inflation under the foodstuff category was recorded in Sumatra and Java (Chart 10.15). This was in line with the relatively moderate demand, the adequacy of food supplies, as well as the smooth distribution of foodstuffs. Slightly declining demand as a result of forest fires and haze that lasted from February to October 2015 was also a factor that led to inflation decline under the foodstuff category in Sumatra.

17 The impact of electricity tariff adjustment on regional inflation, too, was varied, influenced by the number of consumers in each group of electrical power subscription that differed from region to region. In connection with economical electricity price adjustment in 2015, which was targeted at subscribers of 3500-6500 watts of power, the impact on Java was relatively greater compared to other regions.

18 The average selling price of LPG in Java was around 11.7% lower than in Sumatra (calculated using official selling prices by Pertamina marketing regions after a price hike in January 2015).

Chart 10.15. Foodstuff Inflation



Source: BPS-Statistics Indonesia, processed

Inflation under the foodstuff category experienced a decline in Sumatra, especially in the sub-category of spices that recorded a 28% decrease for the whole year.[19] Meanwhile, the decline in inflation under the foodstuff category in Kalimantan and KTI was more moderate, sustained by well-maintained supply, especially in the sub-category of grains, meat, and spices.

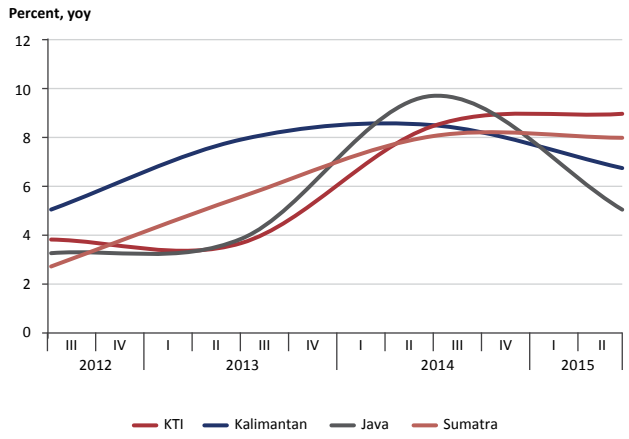
Controlled inflation of rice commodity in some regions was due to sustainable supply of rice produced domestically.[20] It was monitored that the rate of inflation of rice commodity in Java was lower than its historical figures (7.5%, yoy); so, it helped decrease the inflation of food items under the foodstuff category in the region (Chart 10.16). Despite being subjected to the effects of El Nino in 2015, the production of rice in Java was indicated to have increased due to the improvement of productivity and optimization of irrigation networks. In Kalimantan, the decline in rice commodity inflation was relatively lower, as a result of which inflation of food items under the foodstuff category didn't decrease much.

Inflationary pressures on commodities subjected to core inflation were relatively restrained in 2015, except

19 A drastic reduction of inflation in the sub-category of spices in Sumatra might offset inflation in rice commodity that was higher in 2015 (7.98%) compared to the previous year.

20 Projected rice production based on Forecast Figure II (ARAM II) indicated an increase both in Java and outside Java in 2015. In spite of this, there were a number of regions that were more strongly affected by El Nino than the other, and thus affected the performance of local rice production. The impact of El Nino in KTI tended to expand, especially in the northern part of KTI (Gorontalo and North Sulawesi), but the decline in production was relatively moderate thanks to the addition of agricultural land. Rice inflation in KTI in 2015 nearly reached 9%, the highest compared to all other regions.

Chart 10.16. Inflation of Grains Sub-Category



Source: BPS-Statistics Indonesia, processed

for Kalimantan. Inflationary pressures on commodities subjected to core inflation mainly came from processed food commodities. In addition to the demand and the weakening of the exchange rate of the rupiah that affected the production costs of processed food, there were also factors associated with domestic raw material prices. The volatility of the prices of local foodstuffs such as rice, beef, and chicken had driven the increase in the rate of inflation of finished food products such as rice and its side dishes. In Java, finished food products accounted for 18% of the overall CPI inflation in 2015. In Sumatra, Kalimantan and KTI, the contribution of the prices of finished food products to inflation was 14%, 21%, and 13% respectively. The greatest increase in the prices of finished food products was recorded in Kalimantan (10.6% yoy). This was attributable not only to food price hikes, but also increased BBRT prices.[21] Disparities in inter-regional distribution costs were also responsible for causing selling price variations of finished food products including processed food manufactured by industry.

Inflation in commodites included in core inflation in the entire region was also affected by the adjustment of wages and cost of living. A significant increase in minimum wages in some provinces had also contributed to the increase in core inflation due to wage adjustments in services.[22] The increase in the cost of living, especially in the housing and education categories contributed substantially to the overall CPI inflation in most regions. Housing costs were responsible for the largest inflation in Sumatra, which stood at 13%, followed by Kalimantan and KTI at 12% and 10% respectively. In Java, the cost of living's contribution to inflation was only 9%. In addition to the increase in demand and the public income level, a shortage of housing supply and construction costs that were relatively higher had also affected the inflation in housing cost category in regions outside Java. Another cost of living component that also affected regional inflation in 2015 was the cost of education whose contribution was the largest to the overall CPI inflation recorded in Sumatra and Java, each of which stood at 5%.

Challenges of Regional Inflation Control

The challenge of controlling inflation was strongly associated with increased food production and productivity. It was urgent to pay attention to the improvement (revitalization) of agricultural infrastructure in Java and agricultural infrastructure development outside Java.

Most recent data indicated that approximately 59% of irrigation networks under the authority of city/ district governments and approximately 53% of the irrigation network under the authority of provincial governments were in a damaged condition. A larger allocation to agricultural infrastructure financing in 2015 became the starting point of efforts to push for increased agricultural production and productivity through improved irrigation systems.

Inter-provincial trade cooperation is also a challenge in the medium to long run as far as controlling regional inflation is concerned. Trade cooperation, especially in order to maintain the supply of food commodities throughout the whole country is indispensable. This is linked to whether there is a food surplus or deficit from province to province and also to the production sustainability that affects food trade regulation. Realization of trade cooperation between one province and another is currently not quite optimal

21 The increase in volatile food inflation in Kalimantan confirmed the transmission of price inflation from foodstuffs to finished food product commodities. The upward trend in core inflation in Kalimantan that had been ongoing in recent years was presumed to be due to lack of efficiency of the logistics system in the region.

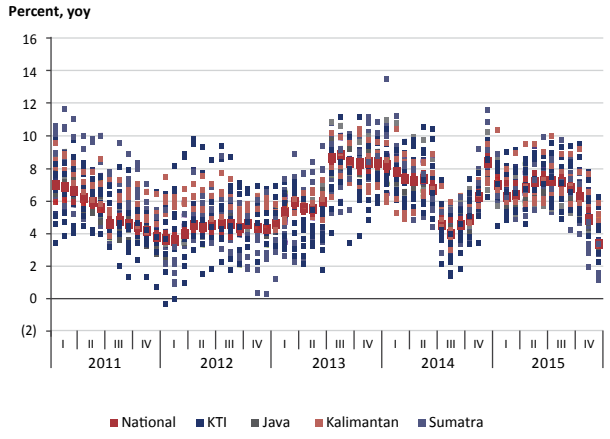
22 Provincial minimum wage (UMP) in the whole area rose at an average of over 10%. The minimum wage in Java increased by an average of 17% with substantial variations between regions. UMP in Banten increased 43%, while in Jakarta increased by 11%. As for the other provinces in Java area, a new UMP was not set. The average minimum wage in districts / cities (UMK) in East Java, Central Java, West Java, and Yogyakarta each rose 18%, 15%, 15% and 8%. In regions outside Java, the provinces with the highest increase in UMP are Bangka Belitung, Gorontalo, and Central Sulawesi with an increase of over 20%.

yet in spite of a number of initiatives that were taken in 2015.[23]

Convergence of regional inflation remained a challenge in controlling regional inflation in 2015. Compared with 2014, the gap between the highest and lowest inflations between regions increased in 2015 (Chart 10.17).[24] Geographically, the largest convergence of inter-regional inflation was seen in Sumatra and KTI as it also increased compared to the previous year.

Meanwhile, inflation convergence between provinces in Java was the lowest and was decreasing significantly. This condition indicated there were still challenges in the distribution and improvement of the trade regulation system. Smooth distribution would have a direct impact on increasing efficiency through reduction in distribution costs which had a significant portion in the structure of logistic cost. A number of connectivity supporting infrastructure development that begun in 2015, had an important role in supporting future inflation control in regions. Effort had been made to address these challenges through the creation of the Regional Inflation Control Roadmap. Inflation control policies and programs were expected to be more measurable and more focused on structural inflation risks that became the priority of the Regional Inflation Control Team (TPID) throughout the provinces.

Chart 10.17. Regional Inflation Convergence



Source: BPS-Statistics Indonesia, processed

10.3. REGIONAL FISCAL

In aggregate, total local budgets revenue increased 16,7% in 2015 despite economic slowdown.[25] Such significant increase results from the increase in transferred funds that included fiscal balance transfer and special autonomy funds (7.9%) and the provision of village funds amounting Rp20.77 trillion (under the 2015 Revised State Budget). An increase in local budgets (APBD) that was quite significant was indicated in parts of Java and KTI. Meanwhile, the increase in the local budgets in Sumatra and Kalimantan was relatively moderate. Of all the provinces, only East Kalimantan Province allocated a budget that was lower than in 2015, due to an expected decline in oil and gas revenue sharing funds (DBH). On the other hand, a handful of some other provinces whose economy was also based on natural resources such as Aceh, Riau, South Sumatra, South Kalimantan and West Papua, allocated a higher budget and yet the increase was moderate.

Realization of Local Revenue

Local fiscal realization showed a lower performance in 2015, especially in terms of revenue as regional economic slump in most regions led to lower revenues from taxes and levies, which constituted a major source of Local Revenues (PAD). On the expenditure side, amid an increase in the number of transfers to regions allocated for the development of strategic infrastructure projects, local governments were still unable to properly address annually recurring issues. This condition indicated fiscal stimulus failure to withstand worsening economic slowdown in 2015.

In aggregate, local revenue realization in 2015 was lower than the previous year due to a decrease in Local Revenues (PAD) and fiscal balance transfer. The PAD realization was forecasted to reach 108.3% in 2015, lower than the previous year and the average over the last 3 years (Table 10.1). Due to economic slowdown affecting trading and service-based business activities, targetted reveneus from various types of taxes and levies could not be achieved.[26]

23 Inter-provincial trade cooperation that was realized in 2015, including among others between the Government of the Province of the Special Capital Region of Jakarta and the Government of West Java Province in order to meet the need for rice in Jakarta and between the Government of the City of Pontianak and the Government of City of Probolinggo was focused on meeting the need for shallots in Pontianak.

24 In a longer period of time, the convergence of regional inflation rates would tend to narrow down, probably as a result of economic slowdown that had been ongoing over the last 3 years.

25 Total regional budget allocation for expenditure amounted to IDR922.4 trillion, representing approximately 42% of the total state expenditure (of the Central Government and Regional Governments).

26 The decline in trading and service-based business activities had reduced the amount of revenue generated from motor vehicle tax, motor vehicle fuel tax, hotel and restaurant tax, advertisement tax, and land and building (property) tax.

Table 10.1. Estimation of Regional Budget Realization in 2015

	2014			2015			
	Regional Budget	Realization		Regional Budget	Average 3 Years	Realization*	
Revenues	**759.5**	**799.4**	**105.3%**	**859.9**	**108.4%**	**882.96**	**102.7%**
Own-source Revenue	180.4	199.7	110.7%	222.9	116.1%	241.44	108.3%
Regional Fiscal Balance Funding	482.2	476.0	98.7%	498.6	101.6%	475.19	95.3%
Other Regional Legitimate Revenues	96.9	123.6	127.6%	138.4	-	166.32	120.2%
Expenditures	**817.7**	**764.0**	**93.4%**	**922.4**	**92.4%**	**864.38**	**93.7%**
Personnel	326.7	313.0	95.8%	371.1	109.9%	346.09	93.3%
Goods and Services	182.5	165.6	90.8%	202.8	96.8%	187.94	92.7%
Capital	213.7	181.0	84.7%	228.1	91.3%	206.03	90.3%
Others	94.7	104.3	110.1%	120.4	-	124.32	103.2%

Source: Directorate General of Fiscal Balance, Monistry of Finance (*estimation using preliminary data at the beginning of March 2016)

The amount of fiscal balance transfer had also decreased as the amount of revenue sharing funds (DBH) from natural resource processing as well as from tax sources such as income taxes had also decreased below the target due to layoffs in a number of provinces. Meanwhile, the amount of other local official revenues was higher than targetted, despite being lower than the one earned in 2014.

In order to strengthen local autonomy and implementation of infrastructure development, fiscal balance transfer to regions had increased significantly in the 2015 Revised State Budget. After the revision of the State Budget, fiscal balance transfer had increased by 2.7% and were broken down into Special Allocation Fund (DAK), Special Autonomy Fund (Otsus), Special Fund for the Special Region of Yogyakarta, and Village Fund.[27]As a result, DAK got an additional allocation of Rp25.8 trillion or twice the amount alloted to it under the state budget prior to the revision to support districts / municipalities in under-developed and border regions whose financial capacity was relatively low. Increased DAK was also meant to support the commitment of priority programs in infrastructure sector. Papua and Aceh in 2015 also obtained an additional Special Autonomy Fund to help finance infrastructure development.

In the meantime, under the Revised State Budget, the amount of allocated village funds was doubled to Rp20.8 trillion in order to accelerate development in rural and under-developed regions.[28] However, the realization of fiscal balance transfer in 2015 was lower than their allocation, due to the decline in oil and gas revenue sharing funds (DBH), in line with the trend of oil and gas prices that continued to weaken. Realization of fiscal balance transfer only reached 95.3%, lower than in 2014 and the average recorded 3 years ago.

Realization of Local Expenditure

Absorption of local spending in 2015 was estimated to be no higher than the previous year. Realized regional spending was projected to reach around 93.7%, with the realization of personnel expenditure tending to be slightly lower. The allocation of personnel expenditures, which grew 13.6% in 2015, indicated lower absorption compared to previous years. However, the portion of personnel expenditure to total expenditure in 2015 was 13.2%, slightly increased over the previous year. Meanwhile, spending on goods and services as well as capital expenditure grew by 11.1% and 6.8% respectively in 2015, and it was forecasted that both would go far below the average in the last 3 years. Absorption of spending on goods and services was projected to reach around 92.7% while absorption of capital expenditure hovered around 90.3%. A number of constraints both in terms of administration and on-the- spot implementation were responsible for the low absorption of spending on goods and services as well as capital goods.

27 The amount of funds allocated by the Central Government to be transferred to regional Governments had increased by 11.4% from 2014, with funding coming from reallocation of fuel subsidies. The transfers made in 2015 to regional Governments accounted for 33.3% of the total expenditure set under the 2015 Revised State Budget, or 1.5% higher than those made in 2014.

28 The presidential Nawa Cita (Nine Ideals) vision includes the concept of nation building starting from the periphery by strengthening regional and village economies.

Geographically, it was indicated that the largest regional spending absorption was recorded in Kalimantan and KTI.[29] Realized spending in the two regions accounted for around 93.5% and 92.9% respectively with the highest spending absorption projected in Central Kalimantan and Gorontalo. In Sumatra and Java, spending absorption reached about 91.1% and 88% respectively. The lowest spending absorption was recorded in Jakarta, at mere 68.9%, as a result of the prolonged delay in the fixing of its budget and the trimming of some budget posts under its revised budget for efficiency. The other provinces whose budget absorption was also low, according to the data from the Team for Evaluating and Monitoring the Realization of State and Regional Budgets (TEPRA), were Central Java (72.5%) and Banten (73.6%).

Spending absorption tended to be lower in provinces whose economy was based on oil and gas resources. This might be a result of the significant decline in the amount of oil and gas revenue sharing fund (DBH) that had became the source of funding for their budgets, even though in nominal terms, the DBH increased by 11.2% in 2015. Under this condition, adjustments to spending realization were indicated in order to reduce potential budget deficit that was limited to 3.25-6.25% of PAD for 2015.[30] Another factor that also affected the condition was the downward trend in the accumulation of unused budget (SILPA) in a number of provinces whose budgets depended on oil and gas revenue sharing funds (DBH).

The low spending absorption in 2015 was also attributable to the delay in budget ratification in a number of provinces. A compilation of dates on which regional governments ratified their budgets in 2015 showed an improved trend in ratification schedule with 431 out of 548 provinces and districts/ municipalities managing to ratify their budgets on time in December 2014. However, there were indications that the number of local budgets whose ratification took place way beyond the first quarter of 2015 was greater, one of which was that of Jakarta. Delays in the ratification of Jakarta's budget whose amount was quite significant (about 7.3% of the aggregate local budgets), had had a quite significant impact on the performance of local budget absorption nationwide. Factors delaying local budget ratification included, among others, incomprehensive budgetary planning which led to lengthy deliberations, whose time period was even prolonged by a transition period due to a change in local leadership.

In realizing capital spending, there were also issues concerning land acquisition at local level. Challenges met in the process of land acquisition were critical and sensitive issues in some provinces. Although there had been clearer legal and statutory bases and mechanisms for land acquisition, in reality, land acquisition in some regional regions turned out to be a prolonged process. Besides causing delays and uncertainty, this had also affected the multi-year budget planing in a number of provinces.

Regional Fiscal Challenges and Effort to Accelerate Budget Absorption

Low regional spending absorption had led to extensive placement of government funds in the banking sector. As of June 2015, the placement of local government funds in the banking sector still showed an upward trend, just as in 2014. As of June 2015, regional government funds in the banking sector reached Rp279.8 trillion, the highest in the last 3 years. Of these, 37% belonged to regional governments in Java. A number of factors affected this condition, including a significant increase in the transfer of funds from the state budget to regional governments' coffers that was not accompanied by the strengthening of budget absorption capacity of regional governments. This condition was exacerbated by indications that a massive amount of village funds kept by the governments of some districts/ cities had not been transferred to designated villages.[31] Idle funds accumulating in banks were also responsible for making the amount of unused budget (SiLPA) quite high at the end of the year. This had also confirmed the lack of fiscal support to withstand regional economic slowdown in 2015.

Structural regional fiscal challenges also included persistent dependency of regional financing sources on fiscal balance transfer. PAD was still unable to fully cover total financing cost in most regions. In 2015, decreased revenue sharing funds (DBH) in provinces whose economy was dependent on the export of natural resources had suppressed their self-financing sources. This was also reflected in the decline in fiscal capacity in most regions

29 Projected target of spending actually realized by each regional government at the end of 2015 (monitored and evaluated by the Team for Evaluating and Monitoring the Realization of State and Regional Budgets (TEPRA)).

30 Minister of Finance Regulation Number 183/PMK.07/2014 on the Maximum Cumulative Limit of Deficit of Regional Budget (APBD), the Maximum Limit of Deficit of Regional Government Budget (APBD) and the Maximum Cumulative Limit of Regional Loans for the 2015 Budget Year.

31 This was mainly due to administrative issues pertaining to the ratification of revised village budgets (APB) that included additional village fund allocations derived from Revised State Budget (APBN-P).

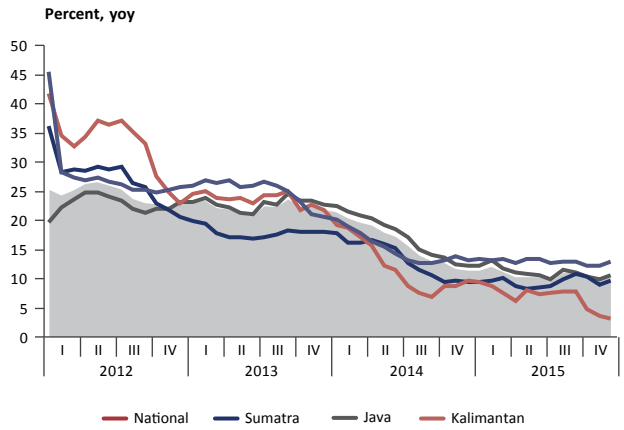
outside Java. Nonetheless, provinces with very high fiscal capacity other than Jakarta, that is, East Kalimantan, West Papua, and North Kalimantan, still continued to rely on exports of natural resources. The ratio of PAD to regional GDP in KTI was the lowest, while the highest, which was recorded in Kalimantan, was also affected by the efforts of local authorities to anticipate a decline in DBH.

A range of different initiatives had been undertaken by both the central government and the regional governments to accelerate the absorption of budget spending in 2015. Measures taken by the central government in general included the application of stricter monitoring of the reporting system on regional financial realization through the Team for the Evaluation and Monitoring of Budget Realization (TEPRA), revision of procurement rules, technology optimization to accelerate procurement (e-catalogs / the Government Procurement Agency (LKPP), e-procurement), and the imposition of an incentive (reward) and punishment system in order to encourage regional budget absorption (regional incentive funds). The Ministry of Home Affairs had also specially formed a team that would conduct direct monitoring of budget realization at regional levels.

10.4. REGIONAL FINANCIAL STABILITY

In 2015, corporate lending slowed down in all regions, particularly in Kalimantan and Java, which declined by 6% and 2.1% respectively compared to previous year. Lending to mining businesses in Kalimantan experienced the greatest pressure with a growth contraction of 2.8%, down 21.4% from 2014 (Chart 10.18).[32] The decline in the growth of credit extended to the mining industry both in Kalimantan and Sumatra, had impacted on the performance of credit extended to other businesses, primarily to those in the mineral processing and business support service industries (such as transportation and warehousing services, information and communications services, financial services, real estate, and corporate services). Meanwhile, the deepest slowdown of corporate lending in Java was recorded in the industrial sector both for working capital and investment purposes, as well as in the construction business. The growth of credit chanelled

Chart 10.18. Development of Regional Credit



to industry and construction businesses in Java decreased by 5.3% and 16.5% respectively compared to 2014.[33]

Corporate credit slowdown in Sumatra was the most moderate, sustained by credit that still kept on growing in the wholesale and retail trading sector and the industrial sector whose share was the largest in Sumatra.[34] Credit growth in the wholesale and retail trading sector stood at 10.9%, while credit extended to the industrial sector grew by 15.2%. Growth in corporate loans in KTI had also slowed but at moderate level thanks to economic performance that still kept on improving. Corporate loans whose growth was high in KTI were the ones extended to the industrial sector (41.6%), the agricultural sector (28.3%), the mining sector (12.1%), and the corporate service sector (9.7%).

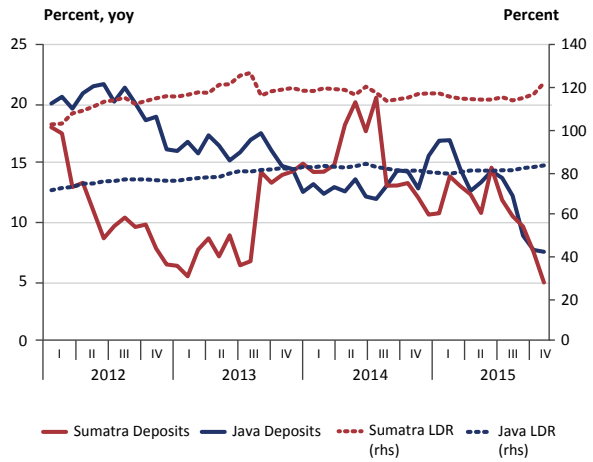
Credit financing from domestic sources through bank deposits (DPK) had also experienced a slowdown in all regions along with the decline in household savings. DPK growth slowed significantly in Java and Sumatra, which had the largest share (88.2%). DPK only grew by 6.9% in Java and 6.8% in Sumatra, much lower than its 2014 growth in the same regions by 12.9% and 12.1% respectively (Chart 10.19). With the growth of bank deposit lower than credit growth, the loan to deposit ratio (LDR) increased in all regions except in Kalimantan. Historically, Java had the lowest LDR, that is, around 83% in 2015. All regions

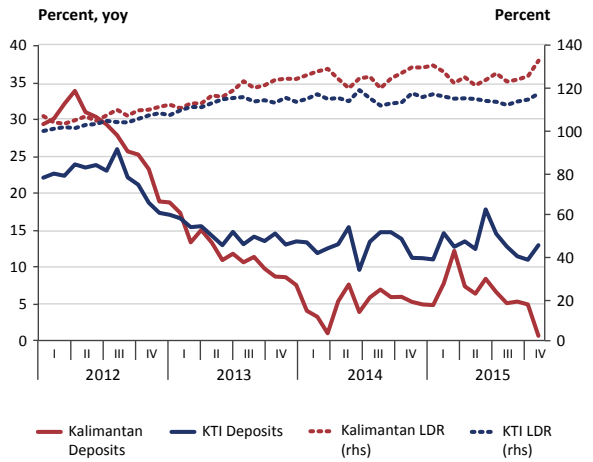
32 Credit extended to mining businesses in Kalimantan still grew by 17.39% (yoy) in 2014. The same could more or less be said of the credit chanelled to mining businesses in Sumatra whose growth contracted 5.37% or 24.3% lower than in 2014. However, the extension of credit to mining businesses in Sumatra was, in nominal terms, much lower.

33 The growth of credit chanelled to transportation and warehousing businesses as well as to information and communication businesses in Java had also slowed significantly as the impact of the weakening of the activity of manufacturing businesses and commercial property project developers.

34 The growth of credit extended to wholesale and retail trading businesses slowed in all regions except Sumatra.

Chart 10.19. Development of Deposits and LDR





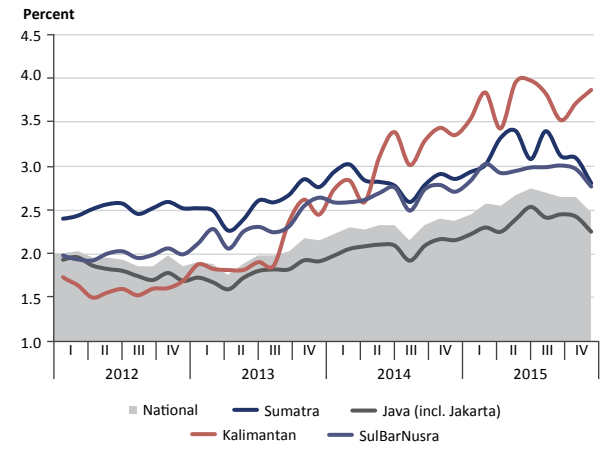
outside Java recorded LDR above 100%, which indicated dependence on sources of financing from Java, especially from Jakarta, the national financial center.

Credit risk was reflected in corporate non-performing loans (NPLs) that increased in all regions in line with the weakening of the ability to pay. In spite of this, however, corporate resilience remained intact. This condition was related not only to the pressure on corporate earnings in the mining and plantation sectors in regions outside Java but also experienced by a number of manufacturing businesses in Java. The highest increase in the rate of corporate NPLs occurred in Java, especially in Jakarta which recorded an increase of 0.4% compared to 2014 (Chart 10.20). Nevertheless, the rate of corporate NPLs in Java (2.4%) was much lower than that in regions outside Java. Corporate NPLs in Kalimantan and Sumatra also grew substantially, reaching 3.7% and 3.1% respectively. The increase in corporate NPLs in KTI was relatively more moderate, that is, 3%.

Based on their sectors, high NPLs rates in the mining industry were recorded in Kalimantan and Sumatra, at 3.7% and 3.1% respectively, and in the industrial sector and the agriculture sector in KTI at 6.6% and 5.5%, respectively. The NPLs rate in the industrial sector in Java was still within a safe limit (2.5%), despite a significant increase from 2014 (1.7%). NPLs rates that were relatively high throughout the regions had also occurred in the construction sector.[35]

Credit slowdown among micro, small, and medium-sized enterprises (MSMEs) had become a phenomenon across the regions. MSMEs credit slowdown was the deepest in Sumatra where such credit only grew 3.6% in 2015, much lower than 13.5% posted in 2014. Similarly, credit growth among MSMEs in Kalimantan was recorded at only 4.5%. The decline in commodity prices and smallholders' weak sales of oil palm and rubber both in Sumatra and Kalimantan had lowered demand for credit financing and compromised payability. On the other hand, credit

Chart 10.20. Development of Non-Performing Loans



35 Non-performing loans (NPLs) in the construction sector in Kalimantan had reached 10.69%, and in Sumatra and KTI they accounted for 8.58% and 7.12% respectively. The high rate of NPLs in the construction sector was affected by delays in the development of commercial property projects, including industrial infrastructure and facilities, due to the weakening of domestic economic condition.

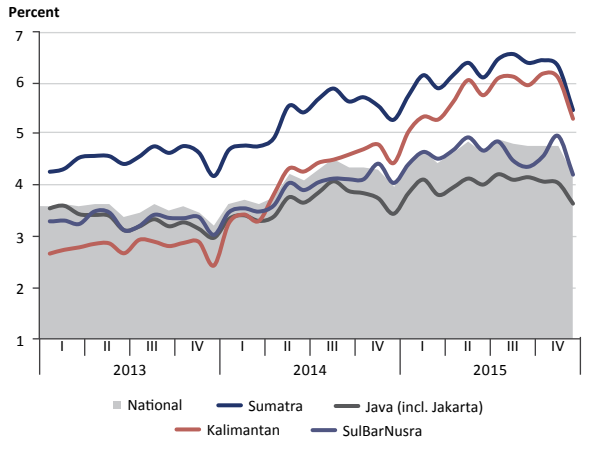
slowdown for MSMEs in KTI was the most moderate thanks to the region's improved economic conditions in 2015. Highest credit growth among MSMEs was recorded in KTI (9.4%) and Java (7.3%). MSMEs in KTI and Java were able to remain resilient (Chart 10.21) as their non-performing loans were lower than those of their counterparts in Sumatra and Kalimantan, which stood at 6.4% and 6.2% respectively.

Household credit slowed in all regions in 2015. Deepest slowdown in household credit occurred in KTI whose economic condition was better than other regions. Nevertheless, household credit growth in KTI was the highest, reaching 11.5%, followed by Java (10.2%), Kalimantan (9.6%), and Sumatra (9%). In aggregate, the highest increase in non-performing loans among households was recorded in Kalimantan and Java. Based on the type of household credit, the deepest slowdown occurred in multipurpose loans, especially in regions outside Java.[36] Motor vehicle credit slowdown, that was quite significant, also occured in regions outside Java, especially Kalimantan and KTI. Motor vehicle credit growth in Kalimantan had even contracted by 3.1% due to the decline in motor vehicle purchases by mining businesses and their support service providers. Meanwhile, the performance of lending for property purchases experienced the most moderate slowdown. With household credit constituting the largest component of property lending in nominal terms, credit slowdown in the real estate/ property sector (mortgage loans for a landed house (KPR), an apartment (KPA), a shophouse and an office house) mainly occurred in KTI and Java.

Households credit risk in 2015 remained at a safely guarded level in spite of being on the rise. The increase in NPLs among households in Java was the lowest and all kinds of household loans were still within the performing category. There were expectations that the agricultural sector's improved performance would be able to sustain household economic resilience. In KTI, agricultural sector performance was experiencing a slowdown but the rate of household NPLs was still quite low. Improved performance of its mining and industrial sectors was a factor that supported household economic resilience in the region.

Meanwhile, Kalimantan recorded the largest increase in household NPLs due to declining revenues and the weakening of economic performance. Based on the type of credit, the majority of household non-performing loans came from defaulted apartment loans (KPA), which accounted for 12.9%, most of which were taken out by debtors employed in the mining sector. The decline in the performance of the mining sector in Sumatra had also negatively impacted on the NPLs rate of KPA which, at 5.2%, had crossed the line.

Chart 10.21. Development of SME NPLs



10.5. PAYMENT SYSTEMS AND MONEY CIRCULATION

Rupiah Management Performance

In general, the net outflow of currency occurred in most provinces, whereas only a small number of provinces experienced a net inflow.[37] A very significant growth of net outflow occurred in Java, especially in Jakarta.[38] The changing pattern of net outflows in Java was affected by the government policy to significantly increase the transfer of funds to provinces and the holding of simultaneous regional elections financed mostly by funds obtained from Jakarta. After experiencing net inflows in 2014, Java posted a 137.1% growth of net outflows equivalent to Rp129.5 trillion in 2015. KTI experienced a 61.7% increased in the rate of net outflows as a result of the expansion of the region's economy and the holding of simultaneous regional elections, which were the largest in number.

36 Multipurpose credit still reached a two-digit growth in a number of regions (Java, KTI, and Sumatra). This was different from motor vehicle loans that posted a one digit growth in all regions in 2015, down from the two-digit growth they posted in 2014 in all regions.

37 Net inflow refers to the flow of currency coming into the banking system which is then credited back to Bank Indonesia.

38 The large net outflows in the Special Capital Province of Jakarta are also affected by the cash operation of banks, the majority of them are headquartered in Jakarta.

According to their pattern, net inflows were affected by the pattern of usage of, and the demand for, currency by the public, particularly during periods of national religious holidays. Net inflows were also associated with remittances sent by migrant workers to their hometowns. Sizeable net inflows in 2015 were recorded in West Java, Central Java, Yogyakarta, and East Java. Net inflows in these four provinces reached Rp72.9 trillion.

The year 2015 was also marked by the expansion of Bank Indonesia's cash distribution and cash services, which was reflected in the addition of the central bank's cash custodian units providing cash deposit services and the increasing flow of currency withdrawn from Bank Indonesia. Throughout the year 2015, six new cash custodian units that were established in cooperation with local commercial banks to provide cash deposit services were added in Tanjung Pandan, Serang, Batu Licin, Dumai, Tanjung Selor, and Pare-Pare. As a result of the addition, the number of the central bank's cash custodian units managed by 35 regional offices had now totalled 368 throughout Indonesia, much greater than the 267 of them that were operating in 2014. Such significant expansion in cash distribution had increased cash deposit-related net outflows, which increased from Rp14.7 trillion in 2014 to Rp22.9 trillion in 2015, up 55.7% (Chart 10.22). Such net outflows consisted of bank withdrawals amounting Rp47.4 trillion and bank deposits amounting to Rp24.5 trillion, the majority of which was not fit for circulation. Throughout the year 2015, the amount of money exchanged at mobile cashier units amounted to Rp1.8 trillion, up 25.7% compared to Rp1.5 trillion in the previous year. The increase in the exchange of money occurred mainly in KTI and Kalimantan, at 87.7% and 21.9% respectively (Chart 10.23).

Chart 10.22. Pattern of Withdrawal Through Mobile Cash

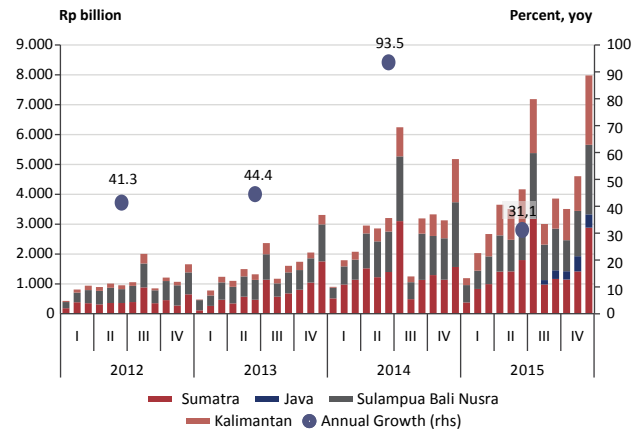
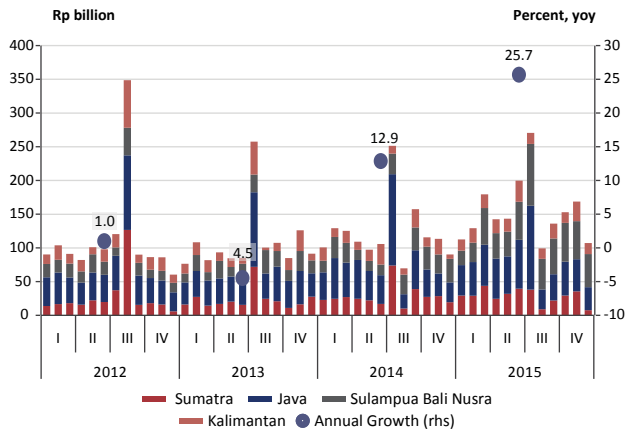


Chart 10.23. Pattern of Money Exchange Through Mobile Cash



Transfer of Money through Non-Bank Service Providers across Provinces

Transfers of money through non-bank money transfer service providers (TD BB) was on the rise both in terms of value and volume in almost all provinces across the country. Java accounted for more than 95% of non-bank money transfers in terms of both volume and value, followed by KTI and Sumatra. The portion of non-bank money transfers in Kalimantan was the smallest compared to that of other regions and went down compared to previous years. Geographically, money transfers through non-bank service providers are closely linked to the hometowns of Indonesian Migrant Workers (TKI) who mostly come from Java (West Java, Central Java and East Java), KTI, and Sumatra.

Types of money transfers through non-bank service providers differ from one region to another.[39] Money transfers that took place through non-bank service providers in Sumatra and Java were either domestic or incoming transfers. On the other hand, most transfers in Kalimantan and KTI are incoming transfers, which account for more than 95% of all the transfers. A relatively small portion of domestic transfers in Kalimantan and KTI was in line with the economic scale of both regions whose growth was still driven mainly by the role of the public sector and major private sector customers as transfers tend to be done through banks.

39 Domestic Transfers of Non-Bank Funds refer to transfers from one region to another within the country whereas the outgoing ones indicate transactions involving transfers from Indonesia to foreign countries and the incoming ones refer to transfers from foreign countries into Indonesia.

Business of Non-Bank Money Changers (KUPVA BB)

The number of Non-Bank Money Changers (KUPVA BB) was increasing in many different regions across Indonesia in 2015. Such increase corresponded to the growth in the number of foreign tourists coming to Indonesia thanks to the addition of visa-free facility to the country's visa policy. The largest increase was recorded in Java (14.1%), followed by Sumatra (4.6%) and KTI (2.8%) but a decline of 12% was recorded in Kalimantan. Approximately 78% of all foreign currency exchange transactions in 2015 took place in Java, and 15.2% in KTI. The lowest volume of foreign currency exchange transactions was recorded in Kalimantan at 0.7%. Java recorded the largest volume of foreign currency exchange transactions as the island's three major cities – Jakarta, Yogyakarta, and Surabaya – were frequented by foreign visitors for business or pleasure. As far as KTI is concerned, foreign currency exchange transactions mainly took place in Bali, which has become a major tourist destination for foreign travellers. The number of licensed non-bank money changers, too, had increased in 2015. The increase in the number of licensed non-bank money changers was recorded at 7.2% this year, or 994 in total. Non-bank money changers were mostly located in Jakarta (39%), Batam (14%), and Denpasar (13%).

The share of various foreign currencies exchanged through non-bank money changers in Sumatra, Kalimantan, Java and KTI varied. In Sumatra, more than 83% of foreign currencies traded were Singapore dollar and Malaysian ringgit due to the large number of Indonesian migrant workers who were sent to work in the two neighboring countries. In Kalimantan, foreign currency exchange transactions in Malaysian ringgit were so dominant they accounted for 65% of the total. In Java and KTI, the foreign currency exchange scene was dominated by U.S. dollar. Specifically in KTI, foreign currency exchange transactions with foreign tourists in Australian dollar, euro, and Japanese yen were also quite large in 2015.

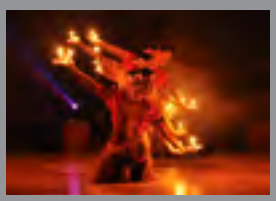
Box 10.1 Strengthening The Role of Economic Advisory

The transformation of regional economies had accelerated in recent years, prompting an increase in the role of institutions at regional levels. This was particularly so since the adoption of regional autonomy policy that gave more powers to regional governments in determining the direction of development in their territories, as well as greater responsibility over the implementation of development policies and programs in their jurisdictions. The complexity of regional economies was also increasing due to the growing economic linkages between one region to another and to the global economy as well. Today's regional economic challenges were also related to structural reform agenda that had been part of government commitment both at central and local levels. Inter-provincial structural reform disparities required strong cross-sector and cross-jurisdiction coordination and cooperation.

In line with the increasing role of regional institutions, Bank Indonesia had also played a role as a strategic partner in helping develop the vision of, and in supporting, regional economic development. Bank Indonesia's participation was directed not only to support the effectiveness of monetary policy so that optimal support could be given to economic activities in the real sector but also to maintain macroeconomic stability, especially in order to control inflation. Partnership between Bank Indonesia and the Government was carried out not only at the central level but also at regional levels through a number of coordination meetings, exchanges of data and information, and cooperation in capacity-building. Some concrete measures that were already implemented in 2015 included a collaboration between Bank Indonesia Regional Offices and the Office of the State Treasury in the preparation of assessment, in exploring the possibilities of concluding a Memorandum of Understanding with a number of ministries / institutions at the central level that would become the basis of partnership between Bank Indonesia and regional governments.

As regards the structural reform agenda aimed at supporting and safeguarding macroeconomic stability and accelerating regional economic growth, Bank Indonesia had also played an active role in it. This was part of measures to strengthen the advisory role of Bank Indonesia in regions. To support this, the central bank had rearranged the carrying out of the tasks of its regional offices in charge of monetary affairs, financial system stability, payment systems, MSMEs, and financial inclusion that were focused on supporting the effectiveness of monetary policy, maintaining macroeconomic stability and promoting sustainable and quality regional economic growth. In addition, Bank Indonesia at the end of 2014 had already set up a working unit that served as a coordinator for each region under its coordination in order to increase and improve the effectiveness of the advisory role of its regional offices in the regions. As one of the realization of the active role that Bank Indonesia played, coordination with the central government and regional governments to support the structural reform agenda had already been carried out through coordination meetings held in regions such as the ones in Ambon, Balikpapan, and Yogyakarta in 2015.[1]

1 To find out more, please refer to Chapter 14.



Similar to the Indonesian Candle Dance that must ensure balance for the best performance, the economic policy mix was directed towards striking an optimal balance for the domestic economy. Furthermore, Bank Indonesia constantly strengthened coordination with the Government and other relevant authorities.