GOVERNOR’S ADDRESS

STRENGTHENING THE MOMENTUM

BANK INDONESIA’S ANNUAL MEETING 2017

Jakarta, November 28th 2017
Strengthening the Momentum

Agus D.W. Martowardojo
Governor of Bank Indonesia

Governor’s Address
Bank Indonesia Annual Meeting of 2017

Jakarta, 28th November 2017

His Excellency,
- The President of the Republic of Indonesia, Mr. Joko Widodo

Distinguished Guests,
- Leaders of state institutions: MPR, DPR, DPD, BPK, Supreme Court, Constitutional Court, and Judicial Commission;
- Cabinet Ministers and Leaders of Government Institutions;
- Chief of the Indonesian National Police, Attorney General and Chairman of KPK;
- Chairman, Deputy Chairman and Board of Commissioners of OJK;
- Chairman and Board of Commissioners of LPS;
- Chairman, Deputy Chairman and Members of Commission XI of DPR;
- Provincial Governors from throughout Indonesia;
- Former Governors of Bank Indonesia;
- Members of the Board of Governors of Bank Indonesia;
- Leaders of the Banking Industry and Nonbank Corporations;
- Academicians, Economists, and Leaders of National Media;
- Ladies and Gentlemen.
Assalamu’alaikum Warahmatullahi Wabarakatuh,
Greetings to all,
Om Swastiastu,
Namo Buddhaya.

Praise be to Allah, God Almighty, for all blessing so that we can gather together here this evening, in good health, at the 2017 Annual Meeting of Bank Indonesia.

I extend my sincerest thanks to the President of the Republic of Indonesia, Mr. Joko Widodo, and to all guests, for coming to this event. Your presence here this evening demonstrates our keen desire to move in unity to build Indonesia into a strong, just and prosperous economy.

The current economic recovery momentum represents early stages in our transformation to achieve strong, sustainable, balanced and inclusive economic growth. The complexity of the onerous challenges calls for a synergy of efforts to maintain policy sustainability at each stage of development to achieve our noble goals.

I take this opportunity to deliver Bank Indonesia’s perspectives on the latest economic developments, the challenges faced and the outlook moving forward, as well as the policy direction, summarized in the presentation with the theme of *Strengthening the Momentum*, which is particularly relevant to provide guidance for Indonesia’s economy going forward.
Global Economic Condition

The 2017 has been the year of global economic recovery. We have witnessed the emergence of global economic recovery momentum after its weakest point in 2016. Global economic growth has not only higher than the previous year but also become more broad-based. Furthermore, the global economic growth have been accompanied by rising international commodity prices and gradual monetary policy tightening in some advanced countries which have been well anticipated by the market, therefore reinforced global financial market stability this year.

We estimate the global economy will grow by 3.6% in 2017, exceeding our projection at the beginning of the year as well as last year’s growth realisation (Table 1). Furthermore, we expect to see more broad-based sources of global economic growth, with emerging countries also contributing as the engines of growth along with the advanced countries. Development in advanced countries during the first three quarters of 2017 confirmed continued recovery in the US economy on the back of solid labour conditions and investment. In Euro Area and Japan, indicators also points toward recovery in the economy.

Emerging countries have also achieved stronger economic growth in 2017. China, the world’s second largest economy and important trading partner of Indonesia, avoided the risk of slower growth through gradual economic rebalancing, which focus in domestic demand as an engine of growth. That strategy was combined with other policies to overcome financial sector vulnerabilities and capital outflow pressures, amongst others, by relaxing foreign investment regulations and implementing structural policies. China’s policy mix has helped to maintain economic growth this year on par with 2016 at 6.8% (Chart 1).

The solid economic performance in China has benefitted other developing countries. The main beneficiaries of growth in China have been commodity-producing countries, such as those in Latin America, where growth was at -1% in 2016 to 1% in 2017. Such developments underscore the importance of China as a key source of global economic growth (Chart 2). Furthermore, the economic gains in China have maintained a solid level of world trade volume (WTV).

<table>
<thead>
<tr>
<th>Region</th>
<th>Economic Growth (Percent, yoy)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2015</td>
</tr>
<tr>
<td>World</td>
<td>3.4</td>
</tr>
<tr>
<td>Advanced Economies</td>
<td>1.8</td>
</tr>
<tr>
<td>Japan</td>
<td>(0.1)</td>
</tr>
<tr>
<td>United States</td>
<td>2.4</td>
</tr>
<tr>
<td>Euro Area</td>
<td>0.9</td>
</tr>
<tr>
<td>Emerging Economies</td>
<td>4.6</td>
</tr>
<tr>
<td>China</td>
<td>7.3</td>
</tr>
<tr>
<td>India</td>
<td>7.3</td>
</tr>
</tbody>
</table>

Table 1. Global Economic Growth

Source: World Economic Outlook Database.
*Bank Indonesia projection.

Chart 1. China’s Economic Growth

Against a backdrop of economic recovery in emerging countries, India’s economy has slowed due to its specific factors relating to various domestic policies and issues.

The global economic recovery have helped push international commodity prices in the short run. Continuing the upward trend occurred since the middle of 2016, international commodity prices, such as coal and metals, have trended upwards this year due to higher demand from China. We predict Indonesia’s non-oil and gas export prices to tick upwards by 22% in 2017 (Chart 3). Concerning energy prices, the oil price has increased in line with OPEC and non–OPEC compliance to the oil output cut deal and higher demand for oil as global economic recovery continues.

The monetary authorities in advanced countries have responded cautiously to the stronger global economic performance. The Federal Reserve is expected to gradually normalise US monetary policy by rising the Federal Funds Rate (FFR) three times this year, while also commencing measured balance sheet reductions in October 2017. Canada and UK have also introduced a tighter monetary policy stance, while the European Central Bank (ECB) has reduced its monetary stimulus. We believe that an appropriate and transparent communication strategy on the implementation of monetary policy tightening has helped the markets to take anticipatory measures, thereby avoiding excessive shocks on global financial markets.

In general, external risks have improved in 2017, thus alleviating the uncertainty in the global financial markets. Milder risks have stemmed from stronger global economic recovery momentum and gradual monetary policy tightening implemented in some advanced

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1. Asia = HKG, IDN, KOR, PHL, SGP, THA. Commodity Exporters = AUS, BRA, CHL, COL, RUS, ZAF. East Europe = CZE, EST, HUN, LTU, LVA, POL, SVK, SVN, TUR. Systemic Advanced Economies = DEU, JPN, USA. Other Countries = ARG, AUT, BEL, CAN, CHE, DNL, ESP, FRA, FIN, GBR, GRC, ISR, IRL, ISL, ITA, LUX, MEX, NLD, NOR, NZL, PRT, SWE.
countries, which was well anticipated by the markets. The geopolitical risks have eased as elections in some advanced countries have concluded. Nevertheless, we must remain vigilant of rising political tension in the Korean Peninsula. Thus far, we view that international market players have anticipated well the global political constellation, thus avoiding any significant adverse impacts on the international financial market stability.

Domestic Economic Condition

Indonesia, as an open economy, is obviously dependent on the various external developments. Our latest assessment shows that improving external conditions have been a boon to the domestic economic recovery.

Domestic economic growth momentum has strengthened in the second half of 2017 after somewhat restrained in the first semester. Improvement on export performance has driven investment in 2017. The Government’s strategy to accelerate spending in the second half of the year, while maintaining good governance and striking an optimal balance between cyclical and structural polices, has proven to boost higher economic growth. We predict the Indonesia’s economy to grow by 5.1% this year, exceeding that achieved in most other emerging countries (Chart 4).

Macroeconomic and financial system stability have been maintained in 2017. Inflation has tracked a downward trend to within the target corridor for 2017 at 4.0±1%. In addition, the current account deficit has been managed at a healthy level. On the financial system side, a solid capital, coupled with low credit risk, has enabled the banking industry to maintain stability.

These condition was achieved on the back of consistent implementation of policy mix to stabilise the national economy. We still bear in our mind the economic instability we confronted in 2013, in the form of the hike of inflation that exceeded the target and a current account deficit that reached 4.2% of GDP in the second quarter of 2013. Addressing such challenges, we implemented stability over growth policy in order to stabilise the economy and create a solid foundation for sustainable economic growth. We
translated this strategy by strengthening the policy mix for stabilisation purposes through policy rate adjustments, strengthening monetary operations, rupiah exchange rate stabilisation in line with its fundamental value, and close coordination with the Government and other relevant authorities.

Close coordination with the Government, combined with policy consistency over time, has restored economic stability. Inflation has been controlled over the past three years within the target corridor. Despite inflationary pressures from administered prices, driven by higher electricity tariffs as part of the Government’s energy reforms, inflation in 2017 is predicted at 3.0 – 3.5% (Chart 6). Inflation has been contained by anchored inflation expectations, stable exchange rates, benign demand-side pressures, lower international food prices and controlled volatile food inflation. Contained volatile food prices have led to controlable inflation in nearly all regions in Indonesia (Chart 5). To that end, I extend my utmost appreciation to the Government for its efforts to manage food inflation by controlling strategic food prices, impro-
Domestic Economic Condition

ving distribution and reducing logistics costs throughout Indonesia. I also thank Regional Inflation Control Team (TPID) for all their hard work to manage inflation in their respective jurisdictions.

The ongoing improvement of current account deficit reflects a maintained macroeconomic stability. Controlled domestic demand, stable exchange rates and global economic recovery have contributed to current account improvement in 2017, which we predict to stay at below 2.0% of GDP. Surplus in the capital and financial account remains high, supported by higher foreign capital inflows in 2017, supported by solid investor confidence in Indonesia’s economy and reduced external risks (Chart 7).

Rupiah has been stable amid external pressure since September 2017, triggered by worldwide US dollar appreciation on the back of improvement in US economy. On average, rupiah until October 2017 depreciated by merely 0.36% accompanied by low volatility at just 3.2% (ytd), lower than in its peers countries (Chart 8). This condition has been supported by improving risk perception amongst inves-
tors (Chart 9), and Bank Indonesia’s consistency in managing liquidity in the foreign exchange market while also maintaining market mechanism. This consistency has boost confidence and therefore we saw an increase in foreign exchange supply from domestic corporations.

Rupiah stability also supported by some structural improvement in domestic financial market. Bank Indonesia’s efforts to create deep financial market has shown an encouraging result. Transaction volume in the money market and foreign exchange market rose, followed by improved efficiency in the transaction price (Chart 10 and 11). Improvement in the financial market also buoyed by issuance of regulation on Deposit Certificates and Commercial Paper to enhance financial instruments as an alternative source of financing.

Financial system stability has been maintained despite bank intermediation function that has not fully recovered. The banking industry has maintained solid resilience on the back of adequate capital and liquidity. Nevertheless, the bank
intermediation function has not quite fully recovered as expected. Credit in 2017 are expected to grow around 8%, up from the 7.86% posted in 2016 but lower than our projection at the beginning of the year (Chart 12). Sluggish credit growth is not only attributable to weak demand stemming from the corporate sector’s current consolidation strategy, but also supply-side issue as banks remain cautious in chanelling a new credit. Congruent with limited bank intermediation, credit risk in the banking industry showed an upward trend but remains well below the NPL threshold (Chart 13).

Against a backdrop of subdued credit growth, nonbank financing has escalated in 2017 (Chart 14). Total (gross) financing from the financial markets, namely capital market, bond market, and money market, as of October 2017 has reached Rp256 trillion, significantly higher than the Rp177 trillion registered in the same period of 2016. The rapid increase of financing from the financial markets was associated to expectations on promising domestic economic outlook, coupled with the strong foreign capital inflows that have lowered government and corporate bond yields (Chart 15). We welcome for such
developments as it can provide more alternative economic financing, enhancing overall financial system resilience to liquidity shocks and supporting more efficient interest rates.

As macroeconomic and financial system stability improved, Bank Indonesia has been able to adjust its policy mix accordingly. Continuing monetary policy easing undertaken since 2016, we have slashed the BI 7-Day (Reverse) Repo Rate by 50 bps this year in response to lower inflation expectations and projections for 2017 and 2018, coupled with a healthy current account deficit. This BI 7-Day (Reverse) Repo Rate cut complements monetary policy cycle to stabilise the economy that we have pursued since 2013 (Chart 16). Consistent monetary policy, prudent fiscal policy and close policy coordination with the Central Government and Regional Administrations as well as other relevant authorities

**Chart 14. Bank and Non Bank Financing (Flows)**

![Bank and Non Bank Financing (Flows)](source)

Source: KPEI and Indonesia Financial Services Authority, calculated. Note: year to date flows data.

**Chart 15. Corporate Bond Yield**

![Corporate Bond Yield](source)

Source: KPEI and Bank Indonesia.
has evidently enhanced economic stability and resilience (Chart 17). We believe that such condition represent a solid foundation to strengthen the momentum towards strong, sustainable, balanced and inclusive economic growth.

Our efforts to maintain macroeconomic stability, supported by increasing policy credibility and a promising economic outlook, have received international recognition. Standard & Poor’s (S&P) upgraded Indonesia’s rating to investment grade (BBB-) with a stable outlook in May 2017 after two other leading rating agencies affirmed similar rating (Chart 18). This is encouraging especially when our peer countries have had their ratings downgraded this year, including Turkey, Brazil and Azerbaijan. In the real sector, progress have been made in terms of competitiveness. After three years of declining Global Competitiveness Index (GCI) rank, Indonesia climbed to 36 out of 137 countries. The gains occurred in all major components, namely basic requirements, efficiency enhancers as well as innovation and sophistication factors. Investment climate also improved as reflected in the rating of ease of doing business from 91 to 72 for 2018 (Chart 19).

Economic Challenges

Amid ongoing economic recovery, we foresee that the domestic economy will still face both global and domestic challenges. Global challenges include monetary policy tightening in advanced countries, particularly the FFR hikes and the Fed’s plan to reduce assets on its balance sheet which has started on October 2017. Furthermore, geopolitical challenges affecting the Korean Peninsula are heating up. Such developments will influence global financial market dynamics and the direction of global liquidity. In addition, protectionism practices could hinder global economic growth and international trade.

The prospect of sustained world economic growth is also confronted by an increased accumulation of global financial system vulnerability. The low volatility of international financial markets amid abundant global liquidity prompted an improvement in investor perceptions of investment risks followed by significant increase in financial asset prices. This is reflected in, among others, the rise in the price earning ratio (PER) of stocks in various countries to the PER level before

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**Chart 18. Indonesia Sovereign Rating**

<table>
<thead>
<tr>
<th>Year</th>
<th>JCRA</th>
<th>Fitch</th>
<th>Moody’s</th>
<th>R&amp;I</th>
<th>S&amp;P</th>
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<td>2006</td>
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<tr>
<td>2017</td>
<td>BBB-</td>
<td>BBB-</td>
<td>BBB-</td>
<td>BBB-</td>
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</table>

Source: JCRA, Fitch, Moody’s, R&I, and S&P.

**Chart 19. Indonesia Ease of Doing Business Rank**

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<thead>
<tr>
<th>Year</th>
<th>Rank</th>
</tr>
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<tbody>
<tr>
<td>2010</td>
<td>122</td>
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<tr>
<td>2011</td>
<td>121</td>
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<tr>
<td>2012</td>
<td>129</td>
</tr>
<tr>
<td>2013</td>
<td>128</td>
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<tr>
<td>2014</td>
<td>120</td>
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<tr>
<td>2015</td>
<td>114</td>
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<tr>
<td>2016</td>
<td>106</td>
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<tr>
<td>2017</td>
<td>91</td>
</tr>
<tr>
<td>2018</td>
<td>72</td>
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the onset of world financial crisis (Chart 20). In addition, the vulnerability also comes from increased leverage of non-financial companies, followed by an increase in the debt service ratio (Chart 21), as seen in G20 member countries (IMF, 2017). These vulnerabilities face the risk of being materialized into instability and disrupt global economic growth if there is a change in perceptions of investor risk.

In the medium-long term, the currently positive global economic performance is still unable to guarantee a sustainable improvement in global economic growth. We are of the view that the current global economic recovery momentum is still vulnerable and temporary since it was driven by monetary and fiscal stimuli rather than tangible productivity gains. In this context, allow me to refer to the IMF’s 2017 study on total factor productivity (TFP) which indicates that global TFP is currently lower than that prior to the global financial crisis (Chart 22).

Productivity has not recovered due to persistently limited global investment. In addition to structural factors such as aging population and declining international trade, the main drag on global TFP appears to be low investment, which, in turn, impairs capital accumulation and

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**Chart 20. PER in Selected Countries**

![PER in Selected Countries](chart20.png)

Source: Bloomberg, calculated.

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**Chart 21. Change in Non Financial Corporation Debt and DSR from 2006-2016**

![Change in Non Financial Corporation Debt and DSR](chart21.png)


Note: size of circles represent debt to GDP ratio in 2016.
Economic Challenges

A balanced global economic recovery and persistently high commodity prices and world trade volumes. Additionally, several aspects of the domestic economic structure need to be solidified further.

First, the role of household consumption as a primary source of domestic economic growth is still restricted. Despite the dominant role of household consumption in the domestic economy, accounting for 54% of GDP, the contribution of household consumption to economic growth over the past two years has remained at 2.7%, down from an average of 2.9% in 2011-2014. Such stifled improvement in household consumption is related to the smoothing phenomenon, delayed consumption which is offset by an increase in bank savings and other financial assets and a shift in consumption behaviour as consumers have become more rational. Therefore, we need to observe unsatisfactory household micro indicators such as slow growth of real wage, declining trend of farmers’ terms of trade (ToT) surplus (Chart 24), limited absorption of formal labour force by micro and small scale businesses as well as consistently large informal sector

Chart 22. Total Factor Productivity Growth (TFP)

Note: 5-year average growth rate.
which primarily consist of middle and lower income groups (Chart 25). We need to discern these facts accordingly due to its potential impact on income uncertainty amongst middle and lower income groups which, in turn, could spur a vicious circle and undermine ongoing domestic economic recovery.

Second, the current economic growth structure is suboptimal for labour force absorption. The sectors that achieved robust growth in the third quarter of 2017 were those with limited labour absorption such as construction, transports, warehousing and communication, as well as financial services. In contrast, sectors that traditionally absorb more labour force, namely the manufacturing and agriculture, only showed limited growth (Chart 26). This unfavourable growth structure is one of the reasons for decreased elasticity in labour absorption elasticity in our economy. Moreover, limited labour absorption will in turn curb improvements to household consumption, which has always been the core of domestic economic growth.
The weak economic growth structure stems from unresolved structural problems, which affect the supply side of the economy. Consequently, our efforts to catalyse economic growth are often accompanied by increasing vulnerability or instability in the economy. Empirically, we have seen that periods of high economic growth were often characterised by a wider current account deficit (Table 2). Higher growth spurs imports as a result of limited economic capacity to fulfill domestic demand, which in turn impairs further growth. Moreover, the nascent middle class, with more complex consumption habits, further drives up imports. This limited economic capacity is due to low productivity, inadequate physical infrastructure and a less conducive investment climate. Our limited industrial capacity is also reflected in the lack of broad-based export structure as we still rely on commodities. Exports from Indonesia are mainly unprocessed natural resources (raw materials), accounting to more than 50% of our exports, while exports of manufactured goods have yet to show significant improvement. Such reliance on natural resources affects the dynamics of spatial growth throughout the archipelago. Sumatra, an island rich in natural oil and gas, experienced pressures during the first half of the year due to low oil price. Conversely, the economy of Kalimantan thrived as the prices of coal and crude palm oil (CPO) rebounded on the international market. Our reliance on commodities was also evident from the fluctuating economic growth reported in Maluku-Papua as well as Bali and Nusa Tenggara, which were linked to copper production and exports. Sulawesi is another region, whose economic performance tends to mirror nickel prices (Chart 27).

Our fragile export structure is not only reflected in the limited types of products,

Table 2. GDP and Current Account to GDP Ratio

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<tbody>
<tr>
<td>Current Account / GDP</td>
<td>-2.5 %</td>
<td>2.2 %</td>
<td>-2.5 %</td>
</tr>
<tr>
<td>Economic Growth</td>
<td>6.8 %</td>
<td>3.8 %</td>
<td>5.3 %</td>
</tr>
</tbody>
</table>

Source: BPS-Statistics Indonesia and Bank Indonesia.
translated this strategy by strengthening the policy mix for stabilisation purposes through policy rate adjustments, strengthening monetary operations, rupiah exchange rate stabilisation in line with its fundamental value, and close coordination with the Government and other relevant authorities.

Close coordination with the Government, combined with policy consistency over time, has restored economic stability. Inflation has been controlled over the past three years within the target corridor.

But also in less diversified export destinations. Unlike the global trend of a more diversified trade, Indonesia’s trade has become more centred on China (Chart 28). This reliance brings Indonesia to be vulnerable to China’s domestic economic shocks, especially if the expected slowdown takes hold in China.

Our limited economic capacity to meet domestic and export demand is strongly linked to the limited growth of manufacturing industry. Since 2011, there has been declined growth of the manufacturing sector which remained consistently below the pace of economic growth (Chart 29). On the other hand, commodity-based sectors have accelerated towards the growth levels achieved by the manufacturing industry. Furthermore, the share of the manufacturing sector has declined drastically since the year 2000, at a time when income per capita has remained low compared to other countries (Chart 30). Typically, a dominant manufacturing industry tends to decline after a country has achieved a high level of income per capita as the services sector begins to take over.

The limited industrial capacity is characterised by “missing in the middle” phenomenon in our industrial distribution pyramid. Our medium-scale industries are outnumbered by those in peer countries (Chart 31). On the other hand, small enterprises dominate our industrial distribution. Unfortunately, due to limited capacity, these small scale businesses are unable to meet domestic demand due to limited capacity and are also unable to meet the demand for higher quality exports. There are many impediments to growth that prevent small enterprises from becoming medium and large-scale industries, including legal, licensing and tax, as well as access to finance.

Chart 28. Indonesia’s Trade Dependence on China

Source: Bank Indonesia.
Limited economic capacity has not only affected our commodity-based sectors but also services sectors, as seen by the persistent deficit in Services Account. The Services Account deficit is dominated by transportation, insurance and financial services (Chart 32). The transportation services deficit is dominant at about 80%, due to export-import activities. Not only are most exports from Indonesia transported by foreign fleet, all imports are transported by foreign fleet via Singapore and Malaysia. Such conditions are among others due to our limited domestic shipping services, meaning that every increase in export-import will be accompanied by increase in transportation costs.

In addition to the real sector, structural problems also beset the financial sector. Domestic sources of financing for medium long term projects that could enhance national production capacity and competitiveness remain limited. Such constraints have led to the dominant role of foreign financing in the domestic economy. It is impossible to fully avoid the use of foreign funds, although we are aware that large portion, especially short term funds, potentially expose our economy to global shocks (Chart 33). Consequently, we shall prioritise longer-term foreign financing, particularly if used for investments that increases exports and labour absorption.

The combination of our dependency on foreign financing and suboptimal export proceeds could undermine our external resilience, as evidenced by the high and rising debt to service ratio (Chart 34). Consequently, efforts are required to offset the burden of foreign debt repayments by increasing value added to exports of goods and services. Such efforts must be accompanied by greater mobilisation of domestic funds. To that end, fiscal reforms to increase state revenues are necessary in order to fund development expenditure and reduce dependency on foreign debt. Currently, the ratio of tax revenue to GDP is relatively low and declining (Chart 35).

Another structural challenge stems from the fourth industrial revolution in the form of digital technology. This trend has not only affected production processes but also changed various aspect of human lives, such as decision making and interaction, and has spurred new business models that are much more efficient and innovative. If utilized well, the current digital revolution will provide digital dividends in the form of enhanced efficiency and productivity in various economic sectors, while spurring new innovations and creating a more inclusive economic ecosystem, the sum of which will elevate domestic economic growth.

In the financial sector, digital technology offers widened access, faster transactions and lower costs. However, business model innovation and digital technology also disrupt conventional functions, especially banking. Furthermore, financial sector risks are becoming increasingly complex, such as money laundering, terrorist funding, cyber threats, consumer protection risks and systemic risks which might interfere with financial system stability.
Principles of Public Policy and Key Element of Economic Growth

Addressing the challenges, we are aware that all authorities have already implemented reform measures. In the real sector, for example, the Government has accelerated the infrastructure projects, while intensifying structural reforms through deregulation and debureaucratization. In conjunction with the Government and other relevant financial authorities, Bank Indonesia has implemented financial market deepening measures to bolster financial system stability and promote sources of development finan-
Principles of Public Policy and Key Element of Economic Growth

...cinfing. Additionally, we have also taken measures with other related authorities to anticipate the rapid developments of technological innovation in the financial markets.

Nevertheless, the long road of structural reforms is still unwinding, and make it work will not be a simple task. Our efforts need to be strengthened in terms of policy implementation to ensure the recovery process. We need to strengthen this recovery momentum as successful economic recovery will serve as the foundation for creating strong, sustainable, balanced and inclusive economic growth.
growth. To that end, we need to implement progressive economic policies that can transform Indonesia’s economy. Economic policy priority should be aimed to some weak areas, such as institution, human resources, and innovation (Figure 1).

In this context, allow me to reiterate the importance of three principles of public policy with strategy focusing on three key elements of economic growth. First, forward-looking policy is a must. We must agree on an economic end state as the basis of formulating the economic
policies required to transform the economy. The end state must be forward looking, meaning that future economic dynamics are given due consideration.

Second, policies must be sustainable and synergized. In other words, economic policies should be clearly structured and have well-defined stages to achieve the end state. Policy makers must avoid recurrent changes in the policy substance, for instance due to lack of coordination among sectors or political environment. By maintaining policy sustainability, long-term assurance can be established, thus instilling confidence in the business community to take longer-term planning and investment.

Third, policies must be balanced. Balanced in this sense, comprises three dimensions which is relevant with current circumstances.

The first dimension is striking a balance between structural and cyclical policies or between long-term and short-term policies. We believe that structural policy is a must to attain sound economic growth. Nonetheless, structural reforms...
often require some time before bearing result and may sacrifice economic growth in the short run. Simultaneously, we are also facing various cyclical issues that demand immediate solution. To that end, structural policy aimed towards improving fundamental of the economy should be counterbalanced by cyclical policy to overcome short-term issues.

The second dimension is seeking a balance between quality and quantity of economic growth. Higher growth should be accompanied by higher quality of growth. We are of the view that strong economic growth does not always guarantee the inclusion of participation in economic activities or in terms of enjoying benefit from growth. Therefore, policy should be supportive to ensure that strong economic growth can also improve income inequality and participation rate in the development process. We also need to pay attention to disparities among regions as it would boost economic growth. In contrast, however, deterioration in these areas could disrupt political stability and, thus, economic stability. In this regard, we appreciate the Government’s ongoing efforts to develop infrastructure in the regions.

The third dimension relates to a balance between the conventional and modern sectors. We view that rapid development in digital technology will prompt monumental changes and trigger uncertainty regarding future economic models. We must anticipate the future developments come from this fundamental change. Sectors closely related to digital technology must be developed to provide optimal benefits. At the same time, economic sectors based on conventional technology, such as manufacturing, should also be developed. Any conventional sectors that remain relevant must also be strengthened utilizing new opportunities come from the advancement of digital technology.

From the implementation side, efforts to reinforce policy must remain focused on three key elements of economic growth. First, reinforcement in “physical capital” through acceleration of infrastructure projects. We extend our appreciation to Government’s efforts to accelerate infrastructure projects throughout Indonesia. This policy should be reinforced by some measures from financing aspect and private sectors participation. Second, policy to reinforce “human capital”. In this context we need to improve quality of education and labour skill, for instance through vocational school, to meet demand for skilled labour. We see a sense of urgency in reinforcing “human capital” so that we can take benefit from prevailing demographic dividend. Continued reform in the healthcare sector is also important. Third, policy focusing on improving productivity to enlarge value added on production factors. Reform in the labour market, state revenue, business regulation, corruption eradication, financial market deepening, and innovation, are some areas that require special attention to boost productivity in the economy so that steadily, we can be categorized as a high-income country.

Concerning the efforts to enhance industrial capacity, investment in manufacturing sector should be based on specific characteristic of each region. Based on our Growth Strategy research, we have identified potential and competitive regional industries based on the availability of raw materials and labour, global demand, downstream and upstream linkages to other industries as well as potential labour absorption (Figure 2).
Bank Indonesia’s Policy Direction

The various risks and challenges that have arisen could disrupt the ongoing economic recovery process. Consequently, cooperation and coordination amongst all stakeholders when formulating a synergic national policy mix are critical to maintain sustainability and strengthen domestic economic recovery momentum (Figure 3).

Bank Indonesia shall continue to focus our policy mix to maintain the macroeconomic and financial system stability. We believe that maintained macroeconomic stability is a basic prerequisite to create a more sustainable economic recovery. We complement our policy orientation with other policies to enhance efficiency and productivity, thereby ensuring that economic recovery will be promptly translated into strong, sustainable, balanced and inclusive economic growth. This policy direction is translated into Bank Indonesia’s policy mix, consisting of three pillars, namely monetary policy, macroprudential policy as well as payment system policy and management of currency circulation.

In terms of monetary policy, Bank Indonesia shall consistently pursue a measured monetary policy stance that is consistent with efforts to maintain inflation within the target corridor and manage the current account deficit at a healthy level. To enhance the effectiveness of monetary policy, Bank Indonesia will strengthen monetary operations, maintain exchange rate stability in line with its fundamental value and continue financial market deepening process.

Reinforcement in the monetary operation is aimed to provide flexibility in managing bank’s liquidity to help stabilize interest rate in the money market. In this regard, we will strengthen the implementation of Rupiah reserve requirement averaging. We view that the policy implemented since July this year has had a positive impact not only on the macroeconomic perspectives but also on banks. On the macro side, the policy has helped to accelerate financial market deepening...
through the creation of new instruments to absorb additional liquidity during maintaining period of Rupiah reserve requirement averaging, as well as strengthen money market stability. On the micro side, the policy has helped to increase the efficiency of daily liquidity management and optimise income, while maintaining prudential principles. Bank Indonesia will enhance the Rupiah reserve requirement averaging system so that in addition to Rupiah reserve requirement, the averaging system will also apply for foreign currency reserve requirement as well as for sharia banks. We will also make an adjustment to reserve requirement ratio as well as extending the fulfilment period. Such regulatory refinements shall be implemented gradually, while paying due regard to financial market conditions and the preparedness of the banking industry.

Bank Indonesia shall continue measured and prudent exchange rate management to maintain exchange rate stability in line with its fundamental value, while also maintaining market mechanisms. To strengthen rupiah stability, Bank Indonesia constantly encourages efforts to reduce dependence on certain foreign currency. For that reason, we continuously seek to strengthen bilateral cooperation to increase settlement of bilateral trade transactions using local currency through Local Currency Settlement (LCS). Our efforts improve LCS scheme is facilitated by the authorities/central bank, such as Bilateral Currency Swap Arrangements (BCSA) LCS scheme based on Appointed Cross Currency Dealers (ACCD) that involve the authorities and private sector, which we plan to implement in the early of 2018. In addition, we shall continue to develop non-USD hedging swaps at Bank Indonesia by expanding number of currencies eligible for transaction with Bank Indonesia.

Bank Indonesia shall also continue to encourage risk mitigation of nonbank corporates in managing its external debt activities. Regulations concerning the application of prudential principles to the management of nonbank corporate external debt shall constantly be strengthened, especially in terms of expanding the scope of external debt. In addition, Bank Indonesia will continue to encourage domestic banking industry to provide more efficient hedging instruments, in part through structured product such as Call-Spread Options.

Bank Indonesia shall also continue to enhance financial market efficiency by strengthening regulatory and institutional aspect of financial market. On the regulatory side, Bank Indonesia will issue market operator regulations for money market and foreign exchange market transactions to create fair and transparent financial markets. From the institutional perspective, in conjunction with other relevant authorities, Bank Indonesia will institute a Central Clearing Counterparty for over-the-counter financial derivative transactions. In addition, we shall consistently strengthen financial market credibility by requiring money market and foreign exchange market players to meet mandatory treasury certification policy, thereby enhancing professionalism and global competitiveness.

We shall continue to accelerate financial market deepening through coordination with relevant parties to create new sources of economic financing. Under Coordination Forum for Development Financing through Financial Market (FK-PPPK), Bank Indonesia will coordinate with the Ministry of Finance and Indonesia Financial Services Authority (OJK) to prepare the National Strategy for Financial Market Development and Deepening (SN-PPPK). This strategy shall elaborate the work
shall implement the Macroprudential Liquidity Buffer (MPLB) as a refinement to the secondary statutory reserve requirement. According to MPLB, banks are required to maintain a certain amount of liquid instruments, covering all bank securities that may be repurchased to Bank Indonesia pursuant to prevailing regulations on monetary operations. We shall determine the MPLB ratio paying due consideration to the financial cycle along with liquidity conditions in the financial system. Differing from the Liquidity Coverage Ratio (LCR), all banks shall be subject to the MPLB requirements.

From macroprudential perspectives, Bank Indonesia as the authority in the macroprudential area will continue to improve macroprudential policy to enhance resiliency of the financial market against systemic risk amid challenges and complexity in the financial market.

We shall continue to emphasis macroprudential policy towards bolstering financial system resilience. In terms of strengthening liquidity, Bank Indonesia shall implement the Macroprudential Liquidity Buffer (MPLB) as a refinement to the secondary statutory reserve requirement. According to MPLB, banks are required to maintain a certain amount of liquid instruments, covering all bank securities that may be repurchased to Bank Indonesia pursuant to prevailing regulations on monetary operations. We shall determine the MPLB ratio paying due consideration to the financial cycle along with liquidity conditions in the financial system. Differing from the Liquidity Coverage Ratio (LCR), all banks shall be subject to the MPLB requirements.

In terms of strengthening the quality of financial intermediation function, Bank Indonesia shall implement the Macroprudential Intermediation Ratio (RIMP) to substitute and improve the loan to

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**Figure 3. State of Indonesian Economy**

- **Higher Growth**
- **Lower Growth**
- **Rising Leverage**
- **Falling Leverage**

- **2015:** Falling Leverage
- **2016:** Decline
- **2017:** Consolidation
- **2018:** Recovery
- **2019:** Expansion
- **2022:** Higher Growth

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funding ratio (LFR). Differing from the LFR concept, however, RIMP will accommodate diverse bank intermediation by including bank investments on securities, such as corporate bonds, medium-term notes (MTN) and floating rate notes (FRN) that meet specific requirements, when calculating the Macroprudential Intermediation Ratio (RIMP).

Moving forward, Bank Indonesia shall strengthen loan-to-value (LTV) policy through Targeted LTV to boost instrument effectiveness. Targeted LTV policy has been designed to mitigate the risk of bubble in certain sector with more specific measures.
In pursuance of Bank Indonesia’s mandate to maintain stability, Bank Indonesia policy to develop micro, small and medium enterprises (MSME) shall be aligned with efforts to control cost-push inflation from the supply side. To that end, we shall strengthen MSME cluster development to control supply-side inflation, particularly in terms of strategic food commodities that influence inflationary pressures on volatile food (VF), such as shallots, red chillies, garlic, beef and rice. We are applying a value chain approach to development, starting by persuading members of farmer groups to produce certain commodity, then processing that commodity to realise value added and,
finally, marketing the product. In addition to promoting innovation in the existing clusters, we shall also create additional new clusters and develop clusters for other food commodities in areas that cannot grow volatile food based on the results of mapping volatile food in each respective region, as contained in the TPI/TPID Blueprint.

To enhance MSMEs’ capabilities, Bank Indonesia shall prepare policy and infrastructure to promote, among others, the ease of doing business, production, marketing and finance. To that end, Bank Indonesia shall strengthen its existing entrepreneurship development program. Through this program, we hope to optimize the existence of demographic bonus by creating new, reliable and innovative entrepreneurs who can drive the growth of new economic centres and, therefore, expand the availability of new jobs. Enhancing MSMEs’ capabilities, however, requires the support of increased bank intermediation with MSMEs. To that end, we extend our commitment to ensure commercial banks meet the MSME loan target ratio of 20% of total loans in 2018, without neglecting prudential principles.

Concerning the efforts to accelerate Islamic economic development as a complement to the conventional economy in Indonesia, Bank Indonesia shall implement the Islamic economy and finance blueprint that was launched earlier this year. We shall strengthen cooperation with all relevant stakeholders to consistently promote the three pillars of the Islamic economy and finance development strategy.

First, Islamic financial market deepening, shall be achieved by promoting issuances of walqf-based Islamic financial instruments, walqf-based sukuk instruments and Islamic Social Finance, as well as issuances of Islamic-based Bank Indonesia liquidity instruments that I alluded to earlier.

Second, Islamic economic empowerment, shall be implemented by expanding the halal supply chain by strengthening and implementing applicable business models, supported by the establishment of Islamic economic zones, institutional strengthening and reinforcing supporting infrastructure, including the establishment of a World Islamic Investment Bank and Islamic Inclusive Financial Services Board.

Third, strengthening research, assessments and education to develop the Islamic economy and finance, shall be implemented by accelerating activation of the zakat and waqf information system currently under development in conjunction with the Ministry of Religious Affairs, National Zakat Agency (Baznas) and Indonesian Waqf Board (BWI), while strengthening support by developing Islamic economy and finance curricula for various educational levels.

Regarding the payment system, we shall continue to support economic efficiency in accordance with the existing Payment System and Rupiah Currency Management Blueprint for 2017-2024. We shall ensure that all economic transactions, cash and noncash, are settled securely, efficiently and smoothly in order to strengthen the implementation of BI task in maintaining macroeconomic and financial system stability, while supporting the Government to realise its nine priority agenda items.

Bank Indonesia’s policy for the noncash payment system will focus on developing an interconnected, affordable, innovative and competitive noncash payment
Bank Indonesia’s Policy Direction

ecosystem that protects its users through three main strategies.

First, we shall promote the use of interconnected and interoperable instruments, channels and domestic retail payment infrastructure under the National Payment Gateway (NPG) policy. The respective positions and functions of Standards, Services and Switching Institutions, as operators of the NPG, shall be strengthened to ensure debit card and electronic money system interoperability. Furthermore, Bank Indonesia shall continue to support efforts to create and maintain an interconnected, interoperable and capable noncash payment system ecosystem in terms of domestic routing. In the NPG regulations, therefore, we have formalised the standardised instruments and transactions in terms of technology, price schemes, rules of the game and national logo. Moving forward, the National Payment Gateway shall act as the backbone of national retail payment transaction processing advancements, which we shall develop gradually to accommodate various noncash transactions, such as Electronic Billing and Invoicing Presentment and Payment (EBIPPP), credit cards, e-commerce, payment hubs and other retail payment services.

Second, we shall accelerate electronification to support various government programs. In terms of poverty alleviation, electronification synergy with government programs will be achieved by raising the target for noncash social assistance disbursements, including the Family Hope Program and the Noncash Food Aid Scheme, to 10 million beneficiary families in 2018. Program realisation this year, which extended financial access to 24% of the lowest-income families, shall be multiplied in accordance with the target contained in the National Strategy for Financial Inclusion (SNKI). To that end, Bank Indonesia and the Indonesia Financial Services Authority (OJK) shall strengthen the synergy between digital financial services (LKD) agents and branchless banking agents (Laku Pandai).

Bank Indonesia also supports government efforts to enhance the efficiency and strengthen the governance of financial transactions at the central government and regional administrations, commencing in January 2018 as stipulated by the Minister of Home Affairs. Accordingly, we shall expand the electronification program through noncash Village Funds and School Operational Assistance disbursements, as well as the development of smart cities.

We shall promote the electronification of public transport facilities and infrastructure to enhance efficiency and good governance. We shall realise e-money interoperability, as the preferred payment method in the sector, under the National Payment Gateway (NPG) policy. We shall also encourage the introduction of Electronic Fare Collection to integrate the payment systems for different modes of public transport across different operators in preparation for integrated transportation in the Jabodetabek region, commencing in 2018. This solution presented itself, institutionally, in the Electronic Toll Collection system, striving towards contactless technology (Multi-lane Free Flow), starting in December 2018.

Third, we shall hone the regulation for Fintech players, including e-commerce, to maintain business competition, risk mitigation and consumer protection. A level playing field with formal financial institutions must be maintained. We require all Fintech players to register with Bank Indonesia, report their activities and
complete Regulatory Sandbox trials. We prohibit the use and processing of virtual currencies in order to prevent money laundering as well as financing of terrorism and to preserve the rupiah’s status as legal tender in the territory of the Republic of Indonesia. We are also actively seeking to prevent arbitrage opportunities, unfair business practices and the control of businesses by parties operating beyond the legal reach of the Republic of Indonesia that could be detrimental to industry structure. We have set forth the rules of the game in Fintech regulations, while also refining the electronic money and Anti-Money Laundering and Terrorism Funding Prevention (APU-PPT) regulations.

We welcome close collaboration with the Indonesia Financial Services Authority (OJK), Ministry of Trade, Ministry of Manpower and the Ministry of Communication and Information. Policy synergy between the authorities through sound coordination is necessary for us to respond to the rapid development of digital technology. In addition, we also seek the commitment and compliance of all Fintech players to jointly build a healthy national financial industry.

We shall safeguard the aforementioned policies through the supervision function. Furthermore, we will strengthen risk-based supervision and law enforcement of regulatory violations and illegal business practices. We shall focus on meeting the commitments of mandatory rupiah usage, domestic processing, anti-money laundering and combatting the financing of terrorism, as well as consumer protection, while overseeing the operationalisation of the National Payment Gateway (NPG) and implementation of national ATM/debit card standards.

In terms of rupiah currency management, we shall ensure the adequate distribution of currency fit for circulation in the required quantity and denominations to all parts of the Indonesian archipelago through Centralised Cash Network Planning (CCNP) and protect the public from the risk of counterfeit currency through three main strategies.

First, we shall continue to synergise cash services with various parties. Through collaboration with the banking industry in the form of Cash Custodian, cash services have been extended to all districts and municipalities in 2017. Bank Indonesia has also extended the outreach of its cash services to sub-district as well as foremost, outermost and innermost regions through BI-Jangkau and distribution of rupiah bank notes to outer and remote islands. In accordance with government policy to develop borders area of the country and enforce rupiah as sovereign currency in all regions of Indonesia, Bank Indonesia together with banks and the National Agency for Border Management have provided ATM and Money Changer services at the Country Border Posts of Skouw (Papua), Entikong (West Kalimantan), Badau (West Kalimantan), Aruk (West Kalimantan), and Motain (East Nusa Tenggara). We also prepare the same services at the Country Border Posts at Motamasin and Wini in East Nusa Tenggara. Second, we shall maintain the supply of quality rupiah currency with enhanced security features. Third, we shall constantly improve the quality of rupiah currency and protect the public from the risk of counterfeit banknotes. To that end, the mentoring of Rupiah Currency Handling Services Providers (PJPUR) shall be intensified and integrated with efforts to improve the quality of education and coordination with related apparatus and institutions,
while integrating the BI-Counterfeit Analysis Centre with the banks and police apparatus as well as establishing laboratories to analyse counterfeit money in West Java, Central Java and East Java.

Bank Indonesia Regional Offices shall also be strengthened to support the transmission of the above policies in all regions and reinforce the commitment to be strategic partner of the regional governments. In this regard, we shall improve the quality of assessment and research on regional economy, control of regional inflation, implementation of Regional Financial Surveillance to monitor regional financial stability, and supervision of payment system. Human resources in Bank Indonesia Regional Offices shall also be enhanced with new recruit of best talents in Indonesia that is combined with continuous and quality training to enable them to provide reliable, timely and applicable recommendations for the regional government. Internally, Bank Indonesia shall continue to enhance internal capacity and capabilities in order to optimise the central bank’s contribution to the national economy. The refinements shall focus on three main organisational aspects, namely strengthening governance and risk management, enhancing the capacity of human capital and bolstering infrastructure.

In the context of refining governance and risk management at Bank Indonesia, we shall form Integrated One–Stop Licensing Services to enhance the efficiency of licensing certain activities in the monetary, macroprudential and payment system/rupee currency management sectors. In addition, Bank Indonesia shall strengthen foreign currency asset management through derivative transactions to be implemented in 2018, which aim to optimise the management of reserved assets and mitigate risks due to market fluctuations by referring to best practices in the peer group.

In terms of human capital development, Bank Indonesia is strengthening its research function and the publication of strategic research papers, to become a frontier of learning, while contributing to seek solutions to the pressing national economic issues. This is supported by having collaboration with research fellows and prominent domestic and international research institutions.

Concerning infrastructure, we have also improved the information system at Bank Indonesia by developing three Commercial Off-The-Shelf (COTS) strategic information systems that provide banking services to the stakeholders, foreign exchange management as well as planning, implementation, control and reporting of the financial business processes in order to produce better financial information on Bank Indonesia. Furthermore, Bank Indonesia has also initiated the Bank Indonesia – Export Proceeds Integrated Monitoring (BI–EPIM) as a prospective solution to the integrated and comprehensive management of import–export foreign exchange transactions, which had previously been managed by several institutions. Bank Indonesia has also continued to enhance its utilisation of big data in the policy formulation process. In this context, Bank Indonesia and the Government continue to develop the Information Centre for Strategic Food Price (PIHPS), which is not only available to the public seeking information on food commodities regionally and nationally, but also to policymakers when formulating development policy strategy, including national food sovereignty and the development of interregional connectivity infrastructure.
Policy Coordination

Striving to achieve our common goal of elevating public prosperity and welfare, we are starkly aware that the policies instituted by each authority must be mutually synergised. Therefore, policy at Bank Indonesia shall always be coordinated and aligned with other stakeholders, regionally and nationally.

The coordination media between Bank Indonesia and the Government is already sound, which we shall strengthen, including in term of the Round Table Policy Dialogue (RTPD), Inflation Control Team (TPI) and Regional Inflation Control Team (TPID), Coordination Meetings between Central/Regional Governments and Bank Indonesia, the national and regional Investor Relations Units (IRU), Financial System Stability Committee, the National Islamic Finance Committee (KNKS) as well as the Indonesia Payment System Forum (FSPI).

In terms of achieving and maintaining money market stability, Bank Indonesia shall continue to coordinate with the Government to optimally manage liquidity. Joint communication from the two institutions addressing the markets concerning commitment to maintain liquidity will constantly be strengthened as an anticipatory measure, especially during spikes in demand for currency due to certain events. Bank Indonesia also extends appreciation to the Government for the commitment to strengthening the liquidity management and planning system.

In relation to financial system stability, Bank Indonesia shall continue to strengthen coordination with the Indonesia Financial Services Authority (OJK) and Deposit Insurance Corporation (LPS).

Exchange of information on the supervision outcomes of the Domestic Systemically Important Banks (DSIBs) has been conducted periodically as mandated by Article 17 of the Financial System Crisis Prevention and Mitigation (PPKSK) Act. Furthermore, cooperation between Bank Indonesia and the Deposit Insurance Corporation (LPS) shall be strengthened, encompassing the exchange of data and information regarding LPS government securities (SBN) holdings, following the joint agreement that allows Bank Indonesia to purchase government securities owned by LPS.

Concerning the payment system function, coordination with all elements of the Counterfeit Money Eradication Coordinating Body (Botasupal) shall be strengthened, consisting of the State Intelligence Agency (BIN), the National Police, Attorney General, Ministry of Finance and Bank Indonesia to prevent, detect and prosecute illegal counterfeiting activities. Bank Indonesia sincerely appreciates the seriousness with which the National Police is uncovering networks of counterfeiters and distributors to the intellectual actors, as well as seeking the maximum legal recourse against such perpetrators.

On the international stage, we acknowledge the need to strengthen coordination in order to anticipate the expected proliferation of international trade agreements and the tendency of peer countries to implement similar arrangements. To that end, we need to design a comprehensive strategy and work mechanisms for Indonesia to exploit the maximum benefits of this newfound openness. In the context of broader international cooperation, Bank Indonesia’s involvement in the Government’s Free Trade Agreements (FTA) and
Comprehensive Economic Partnership Agreements (CEPA) aims to secure policy space as well as maintain commitment consistency to liberalisation, oriented towards development of the payment system services sector and Fintech, which has fallen under the auspices of Bank Indonesia. To that end, Bank Indonesia actively supports the Government in the financial services sector integration process. Additionally, to strengthen the formulation process concerning Indonesia’s position as well as to bolster national coordination, Bank Indonesia shall continue to support and facilitate dedicated team meetings with the financial sector to provide a means of coordination and calibration for the respective positions of the intuitions involved with FTA/CEPA.

Bank Indonesia shall consistently support the Government’s efforts to improve Indonesia’s Sovereign Credit Rating, including creating a positive perception concerning the national economy, including ensuring investors positive perception on Indonesia’s economy. Bank Indonesia shall also refine the Regional Investor Relations Unit (RIRU) and Global Investor Relations Unit (GIRU) by honing the investor relations function at domestic and international representative offices. Strengthening the RIRU and GIRU functions is expected to help facilitate foreign capital flows to Indonesia and, thus, support regional economic development through linkages between the three investor relations units, namely the Investor Relations Unit at Head Office, RIRU at domestic representative offices and GIRU at international representative offices. We are targeting three main elements of the investor relations units, namely the institutional arrangements, investor relations strategy as well as data and information dissemination.

Economic Outlook

The global economic dynamics, economic challenges and policy direction pursued by the Government and Bank Indonesia shall determine the economic outlook moving forward. We predict global economic growth to accelerate gradually in the upcoming years. In the near term, we expect more broad-based global economic growth, originating from both advanced and developing countries. In the medium-long term, however, developing countries will play a larger role as a source of global economic expansion. Accordingly, developing countries are expected to accelerate, with China and India remaining the main engines of growth. Advanced countries, such as the US, Europe and Japan, are expected to slow down due to the problem of ageing populations, coupled with productivity issues.

The incremental gains in terms of global economic growth will be accompanied by a similar trend of rising commodity prices. We predict commodity prices to contract slightly next year before increasing gradually in the subsequent years in line with global economic growth. In terms of the financial sector, we expect global interest rates to continue rising, congruent with the normalisation of US monetary policy. Furthermore, we also expect the Federal Reserve to hike its Federal Funds Rate (FFR) one more time this year and then three times next year.

Consequently, we believe economic growth in 2018 will reach 5.1-5.5%, driven primarily by domestic demand. In the near term, Government stimuli will play an important role in catalysing the national economy. Therefore, government stimuli, local elections and hosting the Asian Games in 2018 will stimulate
domestic demand, particularly consumption. Government investment in infrastructure projects will continue to characterise future investment growth. In contrast, export growth is predicted to slow on previous years, with a concentration on commodities rather than a broad-based export structure. Consistent with Bank Indonesia’s economic growth projection and commitment to steer inflation within its target corridor, we expect inflation within the target range for 2018 at 3.5±1%.

Based on the economic outlook, we predict bank loan and deposit growth in 2018 at 9–11% and 10–12% respectively. Meanwhile, congruous with the expected investment gains and intensification of infrastructure projects, we predict the current account deficit to widen but remain at a healthy level below 3% of GDP.

The near-term economic outlook represents a solid foundation for economic growth in the medium-long run. In the medium term, we expect the global economy to gradually gain momentum, while commodity prices should begin to rise as demand increases. At home, we feel that the Government will continue to implement the structural reforms necessary, based on the affirmed commitment of the Government. Furthermore, the Government is expected to accelerate infrastructure project implementation, which will have a significant impact on the economy, while issuing economic policy packages to create a more conducive investment climate in Indonesia. Regulatory reforms at central and regional government ministries and institutions should restore confidence and draw more investment. In addition, the integrated licensing system and ease of doing business should further facilitate economic activities. By accelerating structural reforms, economic productivity will also surely increase. Accompanied by supply-side improvements, economic growth will accelerate without disrupting stability.

We predict economic growth to accelerate further during the period from 2019–2022, increasing to around 5.8–6.2% by 2022. A more responsive supply side to accommodate demand should help to control inflation in the 3.0±1% range in 2022. Congruently, the current account deficit is expected to narrow and remain healthy at below 3% of GDP. We firmly believe that policies to build economic recovery momentum in the near term, offset by policies to expedite economic transformation, will help us achieve strong, sustainable, balanced and inclusive economic growth.
Closing Remarks

That is our rationale and policy direction I would like to convey at this opportunity. We know that, despite the ongoing economic recovery, many more challenges await us at home as well as in the global constellation. When confronting these challenges, we must avoid prioritising sectoral interests. We need to remain on the same page and advance through unity and synergy. When we march to the beat of the same drum, we build on the public confidence already garnered thus far.

Before closing, I would like to express my sincere appreciation, gratitude and pride to all members of the Board of Governors and Bank Indonesia employees for their contributions, dedication and diligence, thereby allowing Bank Indonesia to consistently pursue its mandate to maintain economic stability in Indonesia.

Thank you.

Wassalamualaikum Warahmatullahi Wabarokatuh

Agus D.W. Martowardjo,
Governor of Bank Indonesia