Darmin Nasution: Building efficient equilibrium towards sustainable growth

Speech by Dr Darmin Nasution, Governor of Bank Indonesia, at the Bankers' Dinner, Jakarta, 9 December 2011.

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Respectable Members of Parliament,
Prominent Bankers, Businessmen and Dignitaries,
Distinguished Guests, Ladies and Gentlemen,
Assalamu'alaikum Wr. Wb,
Good Evening and May God Bless Us All,

To open my speech here today held in such salubrious settings, I would like to invite you all to join me in expressing thanks and praise to God Almighty who has blessed us again with the opportunity to congregate here for the Bankers' Dinner at the end of 2011.

In distinction from the previous Bankers' Dinner's tradition usually held in the opening of a new year, this 2011, we have decided to organize this annual event at the closing of the year. By doing so, it is sincerely hoped that we have ample time to reflect on the success and failure over the past year as well as to discuss our expectations, risks and challenges to draw commitments ahead of time.

Distinguished Guests, Ladies, and Gentlemen,

It has come to our common understanding that changes in the constellation of the global economy since the global financial crisis of 2008 and its aftermath had left a profound and widespread fright. Against the backdrop of lingering effects from the global financial crisis, significant challenges in managing an increasingly complex macroeconomic stability has risen considerably. External shock and uncertainty seem becoming a constant dimension that incessantly shadows us along with the prevailing shifts and changes.

In this current era of globalization, every formulation and implementation would be surrounded by some degree of uncertainty. However, it is believed that every open economy such as Indonesia will be constantly challenged by different external shocks over time. The problem is we do not know when, how big and through which channel the shock will happen.

Nevertheless, we should be grateful. Despite the uncertainties, our economy has shown stronger performance this year compared to last year. Solid collaboration and close coordination, based on common understanding, have become fundamental elements in achieving and maintaining the successful management of our economy.

Therefore, prior to delivering the main substance of my annual address this evening, please allow me to express my sincere appreciation and thanks to the banking community, all elements of the Central and Local Government, the Parliament, business community, academics, observers, the media and all other parties that I am, unfortunately, unable to acknowledge individually, who have been so incredibly supportive of Bank Indonesia in fulfilling its duties.

For me personally, my journey in leading Bank Indonesia, a state institution with legal mandate to maintain national macroeconomic stability, is extremely precious and cherished experience. The experience in this arduous journey through labyrinths of trials and tribulations, has bestowed upon me a deeper understanding of our economic dynamics. Hence, as citizen of this great nation myself, the mandate has also provided great honor and opportunity for me to pay homage to our nation and all Indonesians by always giving my best.

This evening, the time has come for me to reflect on what Bank Indonesia has achieved during the years of my leadership and communicate the plans and strategies beforehand by presenting my views regarding the economic prospects and challenges to be faced in the years to come and their implications on Bank Indonesia. I genuinely hope that the future perspective I plan to present here this evening can serve as a contribution for us all in determining some common measures to achieve a better national economic future. For that reason, the theme of my speech this evening is “Building Efficient Equilibrium towards Sustainable Growth.”

Distinguished Guests, Ladies, and Gentlemen,

By the theme, I would like to bring your thoughts and views to meditate over the question on how we suppose to place the function and role of banking industries in achieving economic development goals. In particular, I am asking all of us here to contemplate on how to heal from inefficiency disease that has hindered our economy from growing higher and more sustainable. Only by such sustaining growth, then the problem of poverty and unemployment can be solved altogether.

It is technically believed that high and sustainable growth often refers to potential economic growth. Based on our estimate, the potential growth of Indonesian economy is around 7%, provided that investment could grow by 12% per year.

However, to achieve sustainable economic growth, two conditions have to be satisfied. First, there should be a continuous condusive macroeconomic environment. Second, capital accumulation and total factor productivity should grow so that economic capacity and competitiveness would steadily increase. Capital accumulation can be achieved through investment in the form of machinery, plants, research and development and human capital.

The sustainability of investment is influenced by multiple factors, such as profit expectation, investment climate, and not less important, the availability of financing. For Indonesian economy, the scarcity of financing is among the most binding constraints of investment activity. This has been reflected in the latest surveys on sectoral mapping and on business condition. More specifically, the surveys pointed to financing constraint suffered by business players, particularly difficulties in accessing bank loan, resulting from too high lending rate, too demanding collateral obligation, and too complicated administrative requirement.

Reflecting on the survey results, I would like to invite all of us to retrospect on the place and role of banking industry. There is no doubt that banking industry has its strategic role in our national economic chain. Looking back into its evolution through innumerable crises and elongated learning curve, it would not be excessive to say that our banking industry should have been transformed itself into better banking industry as expected by the public.

The public craves for banking industry that is not only sound and robust, but also capable to effectively and efficiently participate in financing the economy. The establishment of sound and robust banking industry on the one hand, and its successful in performing their intermediation function effectively and efficiently on the other hand, are two things that cannot stand apart. It’s like two sides of a coin. It is possibly there is a trade-off between the two, but we can certainly find the optimum point between the two.

We cannot remain silent, static and satisfied too soon, believing that our banking industry has reached a good equilibrium, while we know that banking industries in other Asian countries continue to pursue improvement and transform for the better to attain the real equilibrium of sound, robust, and efficient banking industries. If it is the bad equilibrium that prevails, then we will face difficulties and hardships in coping up with the imminent challenges laid bare before us in welcoming The ASEAN Economic Community (AEC) by 2015.

When we do not have the capability to compete in the globalization era, we become less compatible with other nations. Consequently, we become less able to benefit from globalization and only accept-induced harm.

Distinguished Guests, Ladies, and Gentlemen,

Amidst the increasingly strong currents of globalization, I see 2011 as a fascinating and worthy of note year. Throughout 2011, we have booked numerous successful achievements which bring immense satisfaction. Yet, the year is also full of dynamics and mounting challenges that have transformed us to become a relatively more matured entity in managing our national economic stability.

In managing our national economy during the year 2011, global fluctuations and uncertainty seem to be a constant threat looming incessantly over us. The uncertainty of European mechanism for sovereign debt crisis resolution and widespread fears of the lingering global recession have become two epicenters triggering turbulence and unrest in the global financial markets during 2011. In closely following up the European debt crisis, we experience an infinite uncertainty of walking into dark abyss. We do not know yet how profound and how much longer the European debt crisis will continue to last because the dimension of the crisis is significantly extensive and complex. At present, there are negative events producing more negative events in a reinforcing vicious cycle (adverse feedback loop) as reflected in the government debt crisis, worsening fragility of banking industries, and the simultaneous slowdown in economic activity which in turn escalates the crisis into precipitous and prolonged crisis.

Meanwhile, the U.S. economic recovery appears to remain stagnant due to the restricted maneuverability in fiscal policy to stimulate economic activity. The combination of a relatively constrained fiscal policy and economic slowdown has naturally compelled them to pin their hopes on their central bank as the savior of the economy.

However, the diminishing room to cut interest rate has coerced central banks like The Federal Reserve to invent creative policies to stimulate economy through “quantitative easing”. As an emerging market country, we, too, suffer the blows of such measure in the form of two-way cross border capital flows.

Retrospect to these highlights, it is not my intention to discourage us into a pessimist in looking up to the future. Quite the opposite, these highlights are presented to make us continue to be vigilant and devise stretched policy frameworks to withstand large adverse shocks in anticipation of global imbalances and uncertainty in the coming year that is predicted to be no much better than the current condition. We are also required to make adjustments and re-alignment over the prevailing forecasts.

Distinguished Guests, Ladies, and Gentlemen,

We should be grateful, in the midst of unrelenting global turmoil; the resilience of financial sector and national economy has been increasingly demonstrated robustness. At least, during 2011 the Indonesian economy has managed to insulate itself from the spillover effects of European debt crisis through trade channel due to its robust basis of largely domestic demand-driven economy within our economic structure.

Despite having successfully safe-guarded our financial system integrity, we believe that its spillover effects through financial markets channel had been felt ever since the start of the Greece’s fiscal crisis in mid 2010. In early 2011, a period in which optimism over the global economic recovery flourished, massive capital inflow flooded our market, thus rupiah was greatly appreciated. However, this optimism faded instantly in April and May 2011 following the credit rating downgrades for Portugal and Greece by Fitch.

In early September 2011, the scale of the crisis pressure escalated to Italy and Spain, prompting investors to reassess (repricing) the investment risk profiling and reposition the portfolio in emerging market assets, including in Indonesia. We have witnessed how rupiah has been considerably under pressure in the last three months amidst foreign currency excess demand situation.

Amidst imbalances of foreign exchange supply and demand within these last three months, Bank Indonesia has maintained a steady pace of rupiah depreciation in a relatively measured scale against regional currencies. The obtained range of fluctuations in exchange rates aligns consistently with the internal and external macroeconomic balance that create conducive atmosphere in providing greater certainty for business players in the real and financial sectors regarding the average exchange rate in the long run.

Distinguished Guests, Ladies, and Gentlemen,

We have been closely monitoring that amidst massive pressures on global financial markets, our economy had bred strong resilient forces that make it more apt to mitigate external turbulences. This heartening situation has provided us some space to direct various macro-economic indicators into the right track (on-track). Domestic household consumption expenditure remains strong, while investment and exports continue to rise. In spite of this, the inconsequential realization of fiscal capital spending has led to situation in which multiplier effects of fiscal operations towards limited Gross Domestic Product (GDP) is still inadequate.

With the ever-increasing investment, the investment ratio to GDP rose to 31.3% compared to 23.6% in 2005. The increased investment was also reflected in increased imports of capital goods mainly in the form of machinery, the high growth in investment lending, and the expansion of Foreign Direct Investment.

The increasing role of investment and export has paved the way to the well-maintained of a balanced economic growth in 2011. For 2011, the Indonesian economics is projected to grow 6.5%, surpassing the achievements of 2010 at 6.1%. Corresponding to the increased investment, manufacturing industry is projected to grow by 6.1% (yoy), offsetting the growth in the extractive sectors such as mining. It is heartening to note that the expansion of manufacturing industry has boosted absorption of workforce in formal sector. Consequently, unemployment rate fell to 6.6% in August 2011 from 7.1% in August 2010.

Portrayal of our success in maintaining exceptionally high economic growth even during the recent global downturn is deemed satisfactory with the Consumer Price Index (IHK) inflation remained under control. The IHK inflation is forecasted reached only 3.9% (yoy). Meanwhile, core inflation remains steady in these past three-years at around 4.0% which indicates that the economy is yet operating below its potential growth. This occurs because an increased production capacity is simultaneously correspond with increased investment.

I perceive this trend as a good start because it means capital accumulation process is on the lead to buttress the effectiveness of the productive capacity expansion of the economy. Our latest assessment on the phenomena of supply side constraint points to the fact that the sensitivity of price increase (core inflation) to growth increase has declined during the last 5 year, particularly compared to early 2000s.

Distinguished Guests, Ladies, and Gentlemen,

In the midst of sluggish economic recovery in developed countries and commodity price correction within global market, Indonesia’s exports performance remains solid. Exports grew 28.2% during 2011. We can take advantage of the increased intra-regional trade in Asia; so that adverse effects of the economic slowdown in developed countries can be compensated by increased exports to Asian countries having high economic growth such as China and India.

In the meantime, imports continued to grow rapidly (30.4%) as a consequence of accelerated economic activity. I conclude that the rising imports performance is still within a relatively safe and healthy outlook because it is likely associated with the imported raw materials and capital goods to spur increased production capacity.

Meanwhile, the quality of capital inflow structure is significantly improving with the increased foreign direct investment (FDI) exceeded portfolio investments. Overall, in 2011, the balance of payments booked surplus of USD 12.6 billion and foreign reserves rose to USD 111.0 (December 7, 2011).

Distinguished guests, ladies, and gentlemen,

The financial system stability preserved in the midst of global turbulence is also attributable to the resilience of our banking industry, which is increasingly able to absorb instability risks while maintaining its intermediation function.

Improvement in capital and consistent implementation of bank prudential principles appear to be effective in avoiding drastic deterioration in the industry. This is reflected in the low gross non-performing loan (NPL) ratio, reaching only 2.7%, far below the indicative threshold of 5%, while capital adequacy ratio (CAR) was recorded at 17.2% at end of October 2011.

Despite pressures on domestic foreign exchange market, the rupiah liquidity condition in the interbank money market (PUAB) remains unaffected, while banking liquidity also continues to be adequate. Third party fund (DPK) in 2011 (up the October) grew 19,0% yoy, while ratio of liquid assets to non-core deposits was kept above 100% (182.0%) as of October 2011.

The banking intermediation function is managed to run as planned. In 2011 credit growth reached 25.7% (yoy), while loan to deposit ratio (LDR) rose to 81.4% as of October 2011 from 75.5% at end 2010. The quality of the credit growth escalates as credit to productive sectors increases reflected by growth of investment credit that reached 31% as of October 2011.

In addition to the enhanced ability to absorb risks, our banking industry is also able to gain large amount of profit, in fact the largest among ASEAN countries. In October 2011, return on assets (ROA) of the banking industry stood at 3.11%, far above ASEAN average of 1.14%.

Meanwhile, for Islamic banking, based on a survey conducted by BMB Islamic Finance, Islamic business and management consultancy based in London, Indonesia Islamic financial industry occupied the 4th position in the world after Iran, Malaysia and Saudi Arabia. Indeed, this is a very satisfactory achievement.

In September 2011, total assets of Islamic banking has reached Rp 126, 6 trillion or 3.8% of total national banking assets, grew by 47.8% (yoy) and the highest in the last 3 years. The average CAR of Islamic Banks (BUS) and Sharia Unit (UUS) grew at 16%, while the average Capital adequacy Ratio (CAR) of Islamic Rural Bank (BPRS) 24.7% . In the rural banks group, in late October 2011 a year on year assets grew by 20.56%, credit 20.96%, third party fund (DPK) 21.31%, and the number of deposit accounts grew 9.72%, while Capital adequacy Ratio (CAR), in late October 2011 grew 28 , 58%.

Distinguished guests, ladies, and gentlemen,

I view the positive achievement of the national economy in 2011 as a result of hard work and strong cooperation among stakeholders, which is supported actively by the banking community, business agents and the general public.

In this opportunity, I would like to highlight several policy actions taken by Bank Indonesia in confronting the national economy dynamics during 2011. On the monetary side, Bank Indonesia's policy in 2011 is basically a strengthening of previous year's policy mix, but further calibrated to the dynamics and challenges of the economy during 2011.

Interest rate policy throughout 2011 is directed to be consistent with the predetermined inflation target of 5%±1% and 4,5%±1% in 2011 and 2012, respectively. In February 2011 Bank Indonesia increased BI Rate by 25 bps to 6.75% as a response to intensifying inflation expectation, which is attributable to high volatile food inflation.

Since September 2011, the monetary stance is turned to an easing phase, by decreasing the lower limit of interbank money market interest rate corridor. Further in October and November 2011, Bank Indonesia lowered BI rate by 25 bps and 50 bps, respectively to arrive at the 6.0% level. The decision to lower BI Rate is indeed quite delicate since it has to be taken in the middle of ongoing turmoil in the global financial market and against the market mainstream. However, we have strong belief supported by highly fundamental consideration. Since mid 2011, we have been convinced that CPI inflation would move down, possibly even reaching below the 5±1% target. On the other hand, we need to lay stronger basis for domestic demand in anticipation of global economic slowdown. It can be noted that this year Bank Indonesia is ahead of the curve by being the first central bank in Asia to lower policy interest rate.

We view that the national economy should also be ring-fenced from instability sources such as short term capital flows. In addition, the structure of capital flows needs to be amended by shifting it to longer instruments. Therefore, on 13 May 2011, the SBI's holding period is extended to 6 months from previously 1 month. This policy proves to be effective in halting capital inflows into SBI and shift foreign capital investment to government securities market.

Distinguished guests, ladies, and gentlemen,

Experience demonstrates that crisis management often bears extremely high economic and social cost and involves long recovery. Against this background, Bank Indonesia also implemented Crisis Management Protocol (CMP). However, the CMP needs to be equipped with proper guidance and legal basis which regulate crisis prevention and resolution process in a systematic and integrated way on a national scale, through Financial Safety Net Law.

Financial crisis generally starts with liquidity squeeze in the interbank market, market interest rate hike, and exchange rate pressure. For that reason, we intensify monitoring on financial market transactions, especially to scrutinize vulnerabilities that would lead to financial crisis.

Through the developed monitoring system, we wish to ensure the adequacy of rupiah and foreign exchange liquidity in the financial market, as well as to maintain exchange rate stability. Therefore, we conduct a combination of intervention in the foreign exchange market and acquisition of government securities (SBN) in the secondary market. This policy is quite effective in stabilizing the exchange rate and SBN price, while also increase SBN accumulation in Bank Indonesia for monetary operation purpose (Reverse Repo).

In order to maintain the stability of the exchange rate, we also need to seek long-term policy breakthrough by ensuring sustainable supply of foreign exchange.

Against this background, at end September 2011, we took the initiative to issue a regulation to obligate export proceed and proceed from external debt to be deposited in domestic banking system.

This policy can be considered soft compared to those in Thailand and Malaysia, who has regulated tightly foreign exchange flows related to exports and imports since decades ago. We have been taken hostage for too long by market mechanism, which in fact lead to market imperfection, and we need to correct it.

Considering the significant role of inflation from the supply side problem, Bank Indonesia has been in close coordination with the government to preserve price stability, particularly resulting from volatile nature of commodities prices and government's decision on administered prices.

Bank Indonesia has taken steps to increase the role of Inflation Control Teams, both in national and regional levels. Additionally, Bank Indonesia regional representative offices have also routinely published Regional Economic Study which serves as outlets of various aspects of the regional economy.

Distinguished guests, ladies, and gentlemen,

On the banking area, within 2011 bank Indonesia has pursued several policies framed by four pillars, namely:

a. Policy to boost banking intermediation role, to enable more efficient and transparent intermediation, as well as to open access of low-income community to financial services. Included in this policy is the policy on Transparency of Information on Primary Lending Rate and the continuation of financial inclusion program. I put strong attention this strengthening of banking transparency, which is expected to lead up to efficiency. First, a transparent banking industry would encourage healthy competition through better market discipline. Second, it would increase banks' ability in identifying aspects that influence cost structure such that higher efficiency level can be achieved.

b. Policy to enhance banking resilience, so that banks remain strong and sound in confronting competition, through more transparent management that refers to good governance principles. This policy includes improvement in the calculation of capital to suit better with risks, and obligate banks to implement anti fraud strategy, prudential principles in outsourcing and risk management in delivering services to prime customers.

c. Policy to strengthen supervisory function, aiming at increasing the effectiveness of bank supervision, especially in terms of the quality of early warning system. Consequently, we apply improvements to the regulation for bank reporting to Bank Indonesia.. Meanwhile, to enhance the effectiveness of resolution to banking problems, we impose deadline for every bank supervision status through the regulation of "Determination of Status and Follow-Up Supervision."

d. Strengthening of macroprudential policy. This policy is aimed to strengthen financial system stability through better implementation of macroprudential surveillance. Included in this policy is increase in foreign exchange reserve requirement and LDR-reserve requirement.

In the mean time, policy on syariah banking in 2011 continues to be pursued in terms harmonization of regulation with conventional banking, relaxation of regulation, and implementation of Law No.21 Year 2008 on Syariah Banking. Among the issued regulation is regulation on asset quality for syariah commercial bank, syariah business unit, and syariah rural banks, financing restructurization, and risk management for syariah commercial; bank and syariah business unit.

We also support research, training and facilitation of SMEs though policy and strategy to "Enhance SME's Access to Banks" and "Encourage Banks to finance SMEs". This policy is aimed to enable SMEs to enhance its eligibility and capability so that they can meet banks requirements (bankable), while also boosting regional economy capacity.

With intensifying payment transactions through means of payment such as credit card, ATM/debit card, and e-money, we pursue a number of policies to ensure the establishment of safe and efficient payment system.

This policy includes among others standardization of chip-based ATM/Debit Card, establishment of national payment gateway and standardization of electronic money.

Distinguished guests, ladies, and gentlemen,

It is important for me to say that we cannot and may not assume that our macro stability will definitely continue in the future. This assumption can lead us to comfort zone that would reduce our ability to anticipate future challenges early on.

For that reason, allow me in this part to highlight views on the challenges confronted by our economy, which requires hard works from all of us to anticipate and address them in 2012.

The increasingly difficult external challenge is related to vulnerability and recovery of the global economic recovery, which may be worse than predicted (downside risk). This is considering the complexity of European debt trap which definitely will affect global economy. IMF has just revised 2012 global growth from 4,0% to only 2,0%.

On the one hand, with the dismal global picture, national economic machinery will depends on effectivity of domestic absorption and the ability to benefit from local markets. In connection to that, the capacity to preserve growth momentum will be limited should banking intermediary and fiscal expenditure absorption are sub-optimal.

On the other hand, combination among global economic deterioration, low interest rate, dan global excess liquidity, tends to shift global portfolio allocation. Such situation is a source of instability which challenges emerging markets' authorities in sustaining its financial stability.

As a domestic challenge, we have a lot of homework to finish. Some of them are old issues we never solve and thus have created inefficiency in the economy. In financial sector, national banking industry after 1998 has been more vigilant. However, its contribution for economic development is still in the margin. If we look at the statistic, Indonesian banking asset to GDP ratio has reached 47,2% in September 2011. However, credit to GDP ratio is only 29,0%. As comparisons, credit to GDP ratios in the region vary, with Malaysia, Thailand and China recorded 111,4%, 117,0%, and 131.0%.

Opinions of business players provided a similar picture. From Bank Indonesia recent survey on "how to finance your company", the proportion of bank loan in total financing is very low, that is only 25% for working capital, and only 21% for investment. On the contrary, intental financing has been the main source of financing, 48% for working capital and 61% for investment.

In other words, it seems that the large asset size in banking industry is not followed by high contribution to the economy. This is also because there is a substantial portion of banking assets that are not productive from macroeconomic point of view. Those are ones in the forms of monetary instruments (Fasbi, TD, SBI) and government debts (SBN). The size of banks placement in monetary instruments and government debt securities are Rp 415.48 trillion and Rp 245.97 trillion, respectively, as of end of October 2011. In total, they constitute 31.4% of the total credit of Rp 2,106.2 trillion. About 60% of Bank Indonesia monetary instruments are currently held by the 10 biggest banks. Moreover, it seems that to preserve high probability, banks charge high lending rates to customers, partly also to compensate for the generally lower rate from placement in monetary instruments and government securities.

The low efficiency of banking industry has also contributed to high lending rate. This is reflected by operational cost to operational revenue ratio (BOPO) of 86.44% as of October 2011. For comparison, the same ratios for ASEAN countries are 40%–60%.

Although intermediation function somehow works, operational inefficiency generate high cost financing, resulting in low economic competitiveness. Such high financing cost can be illustrated by lending rate of working capital loan, investment loan dan consumption loan, which are 12.09%, 11.66%, and 13.40%, respectively, as of October 2011. This is despite BI rate having reached the lowest ever level of 6.0%. For comparison, with 3.0% policy rate in Malaysia and 4.5% in the Philippines, bank lending rates in Malaysia and the Philippines are only 6.5% and5.7%, respectively (October 2011).

The current structural problems which give rise to false equilibrium in the banking industry can not be solved by market mechanism alone. There is a need to put a corrective policy in place to bring the system back towards its real equilibrium.

On the real sector side, inefficiency still dominates the conduct of the economy following the weakness of market microstructure, which eventually hindered market capacity to efficient allocation of resources. This feature has significant impact on inflation rate particularly on foodstuff category which tends to be volatile and uneasy to subdued. The fragile microstructure of staple food markets has significant bearing on two fronts, namely production and distribution process.

On the production front, the less effective development strategy in the agricultural sector, for instance, gives rise to imbalances between supply and consumption of rice which unfortunately has taken place for a long period of time. The recent increase of rice supply resulted from rice import, seen as a mere short cut solution to the problem.

On the distribution front, the weakness of the market microstructure revolves around (i) the availability of logistics services, transportation, and transportation infrastructure related to foodstuff, (ii) the availability of a symmetric market information for suppliers, wholesalers, and retailers, and (iii) the presence of policy that favors particular market players which eventually create oligopolistic behavior in the distribution market, as well as rent-seeking activities. The weakness of the microstructure in the distribution market has caused rising prices in the consumer level, but not in the producer level.

Distinguished Guests, Ladies and Gentlemen,

The magnitude of challenges we face in the coming years should not discourage our optimism towards the prospect of the economy. In the future, we must strive to maintain a high sense of hope and optimism, macroeconomic stability and a strong economic growth momentum.

Amidst the global economic slowdown, we expect the domestic economy to grow 6.3%–6.7% in 2012, or slightly lower than in 2011 due to sluggish growth of export. For that reason, we are able to maintain stronger economic momentum provided that the foundation of domestic economic growth is strengthened.

We are confident that the lowering of the BI rate since October 2011 will revive domestic financing, particularly from the banking sector. An economic growth rate of 6.3%–6.7% will require financing (including credit channelling) amounting to Rp 598 trillion, or equivalent to a credit growth rate of 26,9% (yoy).

Investment growth rate which reached 7.7% in 2011 is expected to grow even higher in 2012 at 9.7%–10.1%. Vigorous investment will eventually buttressed purchasing power hence supporting household consumption growth in 2012 which is projected to reach 4.7%–5.1%.

Meanwhile, the role of fiscal stimulus is projected to be limited in line with the conservative fiscal deficit target (1,5% of GDP) along with the still significant budget allocation for subsidies.

CPI inflation in 2012 is projected to be consistent with the target of 4,5 percent ± 1 percent in 2012–2013 and is expected to be stable at around the level of 4,5%.

Distinguished Guests, Ladies and Gentlemen,

Considering that the management of the macroeconomy is still prone to global risk as well as the complexity of the domestic predicament, Bank Indonesia policy direction in 2012 will stay focused towards the following:

a. Optimizing the role of monetary policy in supporting economic capacity as well as in mitigating the risk of global crisis.

b. Increasing the efficiency of banks in optimizing their contribution to the economy, while strengthening banking resilience.

c. Increasing the efficiency and competitiveness of the payment systems in servicing national payments as well as international payments.

d. Strengthening the resilience of macroeconomic condition by enhancing coordination in the management of crisis prevention and resolution.

e. Supporting real sector empowerment including initiatives to broaden banking access to a wide-array of community (financial inclusion).

In 2012, policy mix of instruments will be strengthened and calibrated. Policy rate response will be anchored so as to be consistent with the CPI inflation target of 4,5 percent ± 1 percent in 2012 and 2013, while at the same time maintain the momentum toward economic strengthening and mitigate the risk of global economic slowdown. This interest rate policy will also be complemented with macro-prudential policy to mitigate the risk of vulnerabilities in the consumptive sectors which is seen unsustainable or potentially prone to asset bubble risk.

The monetary operation policy strategy will be directed to maintaining interest rate stability in the rupiah money market and to supporting exchange rate stability in the forex market. I am of the view that this kind of stability is needed to provide a broader leeway for domestic financial market deepening.

Therefore, monetary operation will be based on instruments which can directly stimulate transactions in the money market such as in the rupiah interbank money market (PUAB), Repurchase Agreement (Repo), and the swap market. This approach, I believe, will be able to encourage more efficient and sound liquidity management of banks, and lessen dependence on placement in monetary instrument. I also observe the need to continue the re-alignment process of interest rate structure in the financial market by refining mechanism of the open market operation.

Bank Indonesia policies on exchange rate will be centered on maintaining exchange rate stability while preserving external and internal balance of the economy, and providing certainty for all economic agents. Since January 2012, policy on exchange rate stability will be supported by the implementation of the regulation on export proceeds and foreign debt withdrawal through domestic banks. Bank Indonesia is also reviewing some regulations to enrich forex market instruments in order to revitalize hedging transactions.

To curb regional inflation, we will optimize the functions of Bank Indonesia Regional Offices (KBI) as facilitator and catalyst for the acceleration of development in the region, particularly in eastern Indonesia where growth is still having immense disparity. KBI will be encouraged to carry out its functions effectively by strengthening coordination and cooperation as well as synergizing with local government. In the future, Task Force for Regional Inflation Control Team (TPID) should be sustained by strategic consumer goods information systems primarily encompassing information on national production and stock. To achieve this target, strong commitment and support from a wide variety of parties, including from relevant ministries such as Ministry of Agriculture, Ministry of Commerce, as well as Local Government is significantly needed.

Distinguished Guests, Ladies and Gentlemen,

On the banking sector front, policy will be directed to maintain a proper balance between improving competitiveness and strengthening banks' resilience, as well as encouraging banks' intermediation function including broadening access to low cost banking services for the rural community.

In order to improve banks' competitiveness, kebijakan Suku Bunga Dasar Kredit (SBDK) will be carried on to ensure a well-functioning market mechanism so as policy targets could be achieved. From banking supervision perspective, we will continue to enhance enforcement of policy by requiring banks to include an appropriate level of targets on efficiency improvement and credit rates lowering in their business plan. Bank Indonesia is also looking into the practice of interest rate setting for third party above the level set by the Indonesia Deposit Insurance, as well as limiting the conduct of prize or gift offering to banks' customers.

Policy to strengthen banks' resilience will be conducted through improving banks' capital structure. It is hoped that such policy can reinforce bank in anticipating potential risk specifically amidst global economic uncertainty.

I see that policies on consumer protection and governance also need special attention. Following several act of banking frauds during the course of 2011, policy in these two aspects needs to be reviewed. For that reason, in 2012 we will continue to refine several aspects related to customers and potential customers protection.

Furthermore, to improve banks' governance, several regulations on financial report transparency would be reviewed particularly in relation to published financial report and regulation pertaining to appointment of public accountant by banks. We also will examine policy on banks' ownership and multi-licensing following the increased complexity of banks' activities.

Distinguished Guests, Ladies and Gentlemen,

We view that the strengthening of central bank's role as a systemic regulator following the enactment of the law on Otoritas Jasa Keuangan (OJK) is timely as the role of banking regulation and supervision will be handed over from Bank Indonesia to OJK at the end of 2013.

Going forward, Bank Indonesia will continue to escort banking industry in the context of financial stability system. For this purpose, Bank Indonesia will conduct surveillance both on banks and non banks, examine banks in the context of macro-prudential, and will coordinate closely in the context of crisis prevention and resolution. The function and the role of Bank Indonesia to achieve financial system stability is an important part of Bank Indonesia Law's amendment which was scheduled under 2012 National Legislation Program.

Distinguished Guests, Ladies and Gentlemen

Aside from bank competitiveness and resilience, we will encourage the process of banking intermediation through several measures:

a. By continuing the initiatives to broaden the community access to banks (financial inclusion), particularly low cost banking services for rural community, including improving "My Saving" program (Tabunganku), developing program on financial education, implementation of Financial Identity Number and conducting survey on financial literacy.

b. Working together with government agencies, facilitating intermediation to support financing in several potential economic sectors. We will also assess any potential barriers in the financing of those sectors with relatively low credit growth. With regards to financing needs of particular sectors which are commercially unviable for banks but possessing strategic roles for the economy, Bank Indonesia together with the Government, will develop a special financing scheme.

Initiative to increase competitiveness and governance is also center in the policy direction for sharia banking particularly sharia rural banks. In addition, we will also encourage the development of products and activities of sharia banking. Going forward, strategy to develop sharia rural banks will be directed in accordance with the characteristics of sharia rural banks as a community bank with a sound, robust, and productive feature with special focus on providing financial services for SMEs and rural community.

Similar to the banking sector, financial services sector will also be encouraged to lowering economic costs. This sector includes cash and non-cash payment systems as well as transaction settlements.

Bank Indonesia determines to take a lead in setting policy orientation for payment services development in the future. In this context, policy coordination among institutions and authorities is imperative, especially since the development of payment services will also involve many parties beyond the central bank. Going forward, the development of payment services industry will be performed by the following initiatives:

a. First, improving security and reliability of payment services providers by implementing risk mitigation including leveraging on technology advancement, strengthening legal framework, strengthening supervision, and improving the role of national payment services providers;

b. Second, improving efficiency of national payment services providers, including encouraging the setting-up of interoperability and interconnection among services providers.

c. Third, improving consumers' protection by enhancing transparency of services providers and strengthening regulation on consumers' protection.

Those abovementioned programs on payment services development are stipulated in an integrated blueprint which serves as a guideline to establish an efficient, secure, and reliable payment system.

Distinguished Guests, Ladies and Gentlemen,

This brings me to the end of my speech this evening. A thoughtful ponders on the challenges ahead lead us to an understanding that the years ahead will not be easier than previous years. Our commitment to carry out policies and measures as already presented will definitely call for support and cooperation from all of you.

As closing remarks, I would like to invite all of you "to release our nation from any traps of inefficiency, otherwise, we will be crushed by modernization and globalization". May Allah Almighty always be with us, bless us and lighten our way towards a better future. Thank you.