Agus D W Martowardojo: Maintaining balance for sustainable growth

Keynote speech by Mr Agus D W Martowardojo, Governor of Bank Indonesia, at the Fitch Ratings Credit Briefing on Indonesia, Jakarta, 13 March 2014.

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Accompanying charts can be found at the end of the speech.

Honorable Speakers, Distinguished Guests, Ladies and Gentlemen,

Good Morning to you all.

1. First of all, allow me to congratulate the organizer of this event, the Fitch Ratings Indonesia, for successfully arranging this forum. It gives me a warm feeling to see such of a good crowd of committed and distinguished business people attending this forum. I hope this gathering will give the opportunity of a healthy exchange of views to ensure better understanding of each others' visions for the future.

2. With that spirit, I find this event provides a great time to take a fresh look at the opportunities in Indonesia at this challenging juncture. To give you the background, I will share my view from the perspective of the central bank on "how Indonesia thus far successfully navigates throughout the global storm and our optimism to deliver a sustainable growth".

Indonesia in a challenging time

Ladies and Gentlemen,

3. The year of 2013 was, without doubt, a challenging time for Indonesia's economy. A combination of unfavorable elements in global environment such as slowing economic growth, declining commodity prices, and global liquidity shift from emerging to advanced economies, has generated considerable pressures on the country's economy and financial market through both trade and financial channel.

4. A combination of a slowdown of China's growth – as the main Indonesia's trading partners – and the deteriorating trend of commodity prices continues trimming down the Indonesia exports. Simultaneously, as the economy gained traction and grow with the speed more than 6%, in nature it would need sufficient support of imported goods, in particular, capital and intermediate goods. By 3rd quarter of 2013, as we all noticed, current account deficit widened. Meanwhile the inflation escalated as a consequence of the fiscal policy adjustment to reduce fuel subsidies.

5. We have also been through the most challenging time since the mid-2013 when the scale of the global financial shockwaves hitting Indonesia triggered by the announcement of the Fed tapering, followed with a massive portfolio out flows. During June 2013 alone, portfolio investment registered net outflows of $4.0 billion.

6. Since then, Indonesian rupiah have come under significant pressure and fall by 26% throughout 2013. I should accept the fact that the magnitude of pressure was exacerbated by thin forex liquidity in the domestic market. In the midst of heightening pressure stemming from capital outflows and strong depreciation, natural suppliers of dollars (exporters) have been on the sidelines which contributed to the low market volume.

7. The widespread ramifications of global factors to our economy should serve as an important "wake up call". It is a strong reminder that we have a number of home-grown structural problems as well, among others are reliance on primary resources commodities in our export, and high dependency on import for energy and food supply. On top of that, we have underdeveloped financial markets that often add complication to the existing problems.

8. Responding to the challenges, Bank Indonesia focused its policy to drive inflation back to its target corridor. The policies were also aimed at narrowing current account deficit to a healthier level to support the sustainability of the economic growth. This was performed in a pre-emptive way and therefore demonstrated our bold, decisive actions in preserving macroeconomic stability. Bank Indonesia also pursued an intensive coordination with the Government to ensure an optimal mix of monetary and fiscal policies. We realized that coordination is paramount in such challenging-time.

Indonesian economy is on the right track

Ladies and Gentlemen,

9. We proudly share that the recent development particularly since the final quarter of 2013 revealed that the pre-emptive and decisive policy action carried out by Bank Indonesia and the Government has successfully steered the economy to the right track. In the last two months inflation remains under control and expect could be brought back to its target corridor of 4.5%±1% in 2014 (***Graph 1***). Meanwhile, the economic growth for 2013 have been maintained at reasonably high 5.76% with a more balanced structure as a result of stronger real exports and moderation of domestic demand (***Graph 2***)

10. Current account deficit is moving towards a healthier and a more sustainable level. It decreased sharply during the final quarter of 2013, amounting to just USD 4 billion or 1.98% of GDP, which is well below the 3.85% of GDP reported in the 3rd quarter of 2013 (***Graph 3***). On the other hand, capital and financial account recorded an increasing surplus buttressed by a massive inflows both in terms of FDI and portfolio investment. After three quarters of deficit, BoP finally returned to positive territory by posting USD4,4 billion surplus in Q4 2013.

11. Better economic fundamentals braced by pro-active policy has bolstered market confidence, hence pushed foreign portfolio flows back to domestic financial market (***Graph 4***). As a result, since early January 2014, the Indonesian Rupiah gained 6,0% as of 7 March 2014 or as the strongest currency among Emerging Market currencies (***Table 1***). Likewise, the credit default swap premium dropped from 233 bps in December 2013 to 177 bps in 7 March 2014, suggesting a better appetite on the Indonesian financial asset (***Table 2***)

12. There also a mark positive in the microstructure of domestic foreign exchange market. Interbank forex liquidity is now easier with a greater interbank trading volume in the range of USD 1,5–1,8 billion a day, compared to only USD 200–500 million average during mid-2013 (***Graph 5***). Moreover, there is a greater transparency in the forex price discovery and the market seems to take the JISDOR onshore fix as positive.

13. This positive development in the forex market microstructure certainly help alleviate the past perception where the central bank was perceived as the sole main supplier of US dollar. As a result, the international reserve have been back on the rise and reached USD 102,6 billion at the end of February 2014 (***Graph 6***). Our next step is to implement the Code of Conduct to strengthen the credibility of domestic foreign exchange market.

14. Once considered a “fragile five currencies”, Rupiah now set itself apart as a result of careful and coordinated policy actions. In short, the policy mix pursued jointly by Bank Indonesia and the Government has managed to allow for an orderly adjustment in the economy without sacrificing too much growth. Indonesia’s economy is now running on the right track.

Lesson learned

Ladies and Gentlemen,

15. The dynamics in the economy throughout 2013 has brought home a lesson about the importance of having an optimal balance on external and internal sector. A sustainable economic growth requires not only a low and stable inflation, but also a healthy posture in

current account. In addition, such balance must also be attained in the dynamics between the goods market (ie. inflation) and the financial markets (ie. asset price).

16. This lesson has a few policy implications. ***First***, we need a discipline, forward looking, and bold macroeconomic policy from both monetary and fiscal authorities to achieve the desired optimal balance in the economy in the medium term.

17. ***Second***, the role of financial system stability cannot be undermined. It is critical to have a well-functioning financial system through which money would go to support productive economic activities. In this context, we have pursued various macroprudential policies to help navigate economic uncertainties in 2013.

18. ***Third***, macroeconomic policies alone are not sufficient. The dynamics in 2013 also taught an important lesson about the role of structural reform in sustaining economic growth. Without effective structural policy, an external shock would always require substantial adjustment in the demand side that will only intensify boom-and-bust cycle in the economy.

Economic outlook and risk

Ladies and Gentlemen,

19. Despite lingering uncertainties, we believe the economy will be more stable and balanced in 2014. Domestic demand will continue to moderate but exports are expected to perform more favourably in line with the global economic recovery. Therefore, growth in 2014 is projected to hit the lower end of the 5.8–6.2% range.

20. Bank Indonesia expects the balance of payments to continue improving in 2014, supported by shrinking current account deficit and growing surplus in the capital and financial account. We estimate the current account deficit will be below 3% in 2014. Bank Indonesia asserts that inflation will remain under control and within its target corridor of 4.5±1% in 2014. Credit is projected to grow at 15–17% range which is consistent with the effort to bring the economy to a healthier and more balanced level.

21. Going ahead, challenges remain. We have to prepare ourselves to face a rocky and bumpy road ahead. Global uncertainties concerning the Fed normalization policy as well as the risk of an economic slowdown in China are among the critical risk factors that we have to anticipate. These risks could rekindle similar environment that have put our economy in jeopardy last year.

Policy direction and further agenda

Ladies and Gentlemen,

22. For that reason, at no time we should be complacent. The bumpy road ahead necessitates a wide ranging policy initiatives to enable a smooth ride for the Indonesian economy.

23. Bank Indonesia will continue to pursue monetary policy that is consistently directed towards reducing current account deficit to healthier level and controlling inflation within its target corridor of 4.5±1% in 2014 and 4.0±1% in 2015. We do not tolerate inflation move beyond the upper bound of the target range. Bank Indonesia will also strengthen policy coordination with the Government to manage domestic demand.

24. But again, as I mentioned before about lesson from 2013 experience, a sound macroeconomic policy is not sufficient to sustain economic growth. It is imperative to augment it with structural reform. We have to address our reliance on the export of primary commodities given the boom of commodity prices is over. At the same time, efforts should be made to address our heavy reliance on energy and food imports.

25. In the financial sector, financial market reform is also imperative. We, in Bank Indonesia, with close collaboration with OJK, have committed to boost financial market deepening initiatives. This includes elements such as well-functioning securities and money market, seamless payment system, and well developed long-term financing.

A nation in transition

Ladies and Gentlemen,

26. The year of 2014 is rather special. With the general election at our doorstep, maintaining macroeconomic stability is a key. Macroeconomic stability, in our view, is the element of continuity for the Indonesian economy in transition. In this regard, I would like reiterate our commitment to maintain the stability of our economy.

27. I would also like to emphasize here the remarkable progress in the nation's journey to democracy. Less than two decades ago, if we recall, there was an imminent risk of "balkanisation" following a devastating financial crisis and an abrupt regime change. But now we are viewed as a strong and stable democracy, supported by institutional reforms in both private and public spheres.

28. With more than 500 elected offices throughout the archipelago, election and peaceful transition of power actually occur almost every day in this country. I am confident that the upcoming parliament and presidential elections will be no different. And it will be a testament to the strength of our democracy and its ability to support economic development.

Closing

Ladies and Gentlemen,

29. Before concluding this remark, I would like to remind us that Fitch Rating is the first rating agency to award investment grade to Indonesia after losing the credential due to 97/98 financial crisis. We believe that such decision was taken after an elaborate assessment on the country's economic and financial data. And as we all have witnessed in 2013, it turned out to be an accurate assessment. Indonesia's economy is indeed resilient and is able to withstand challenges that may have come to its way.

30. I am confident that Fitch Rating will continue to have faith in the prospect of the Indonesia's economy on the ground of careful and comprehensive analysis. In fact, we all need to believe in the ability of our economy to move forward despite challenges and doubts.

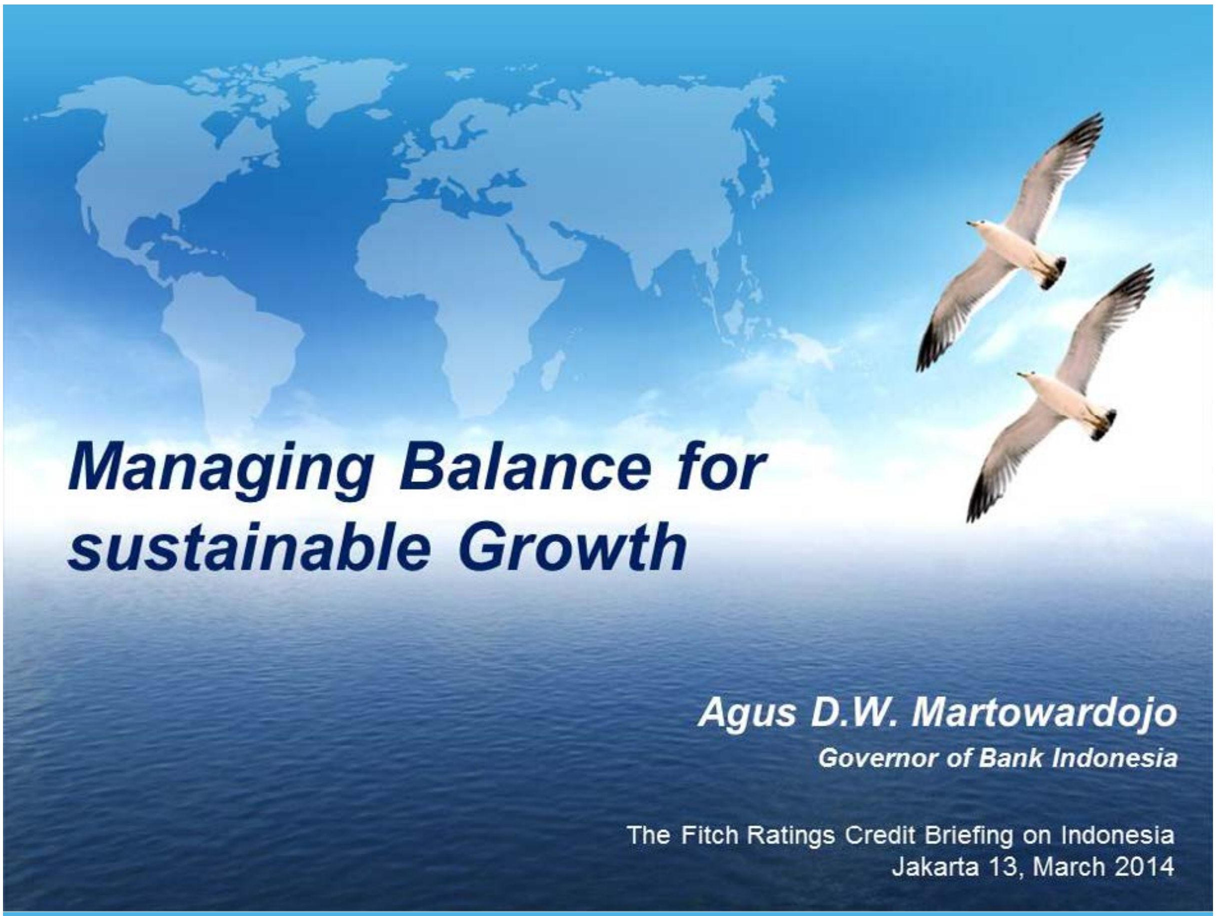
31. I am closing my speech today with a relevant quote from Franklin D. Roosevelt – former US President.

"The only limit to our realization of tomorrow will be our doubts of today. Let us move forward with strong and active faith."

Thank you and I wish you a fruitful discussion in the rest of the conference.

Governor of Bank Indonesia

Agus D.W. Martowardojo



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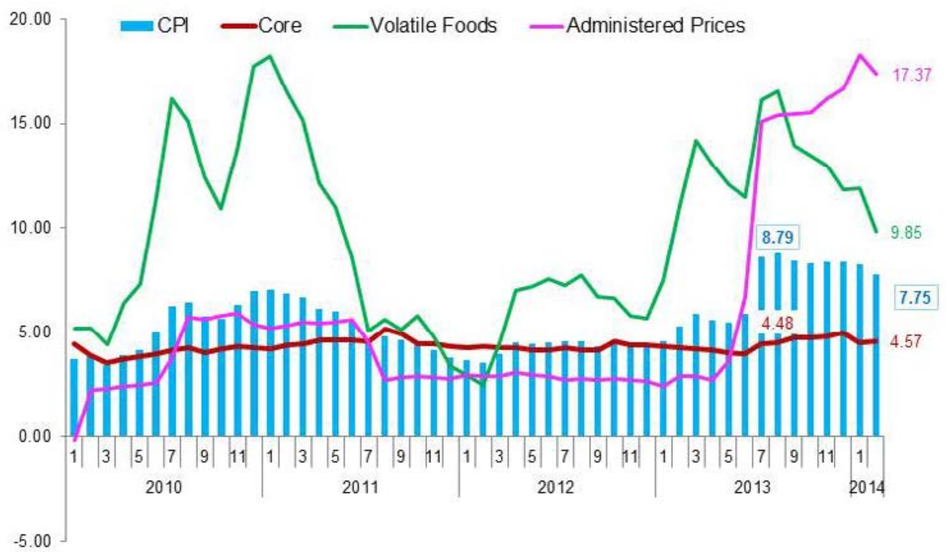
Graph 1

Inflation



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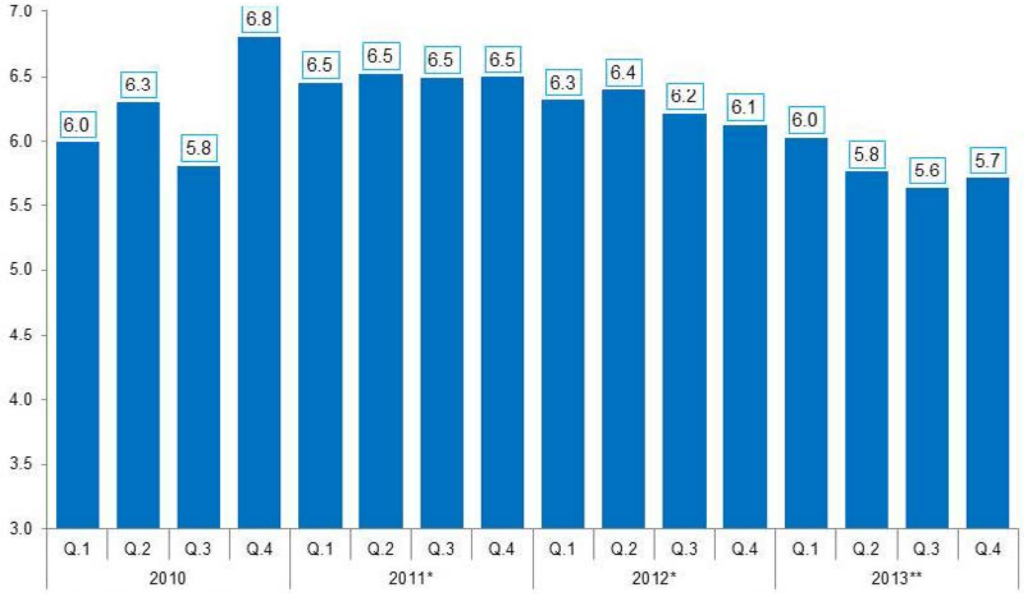
Graph 2

Economic Growth (quarterly % yoy)



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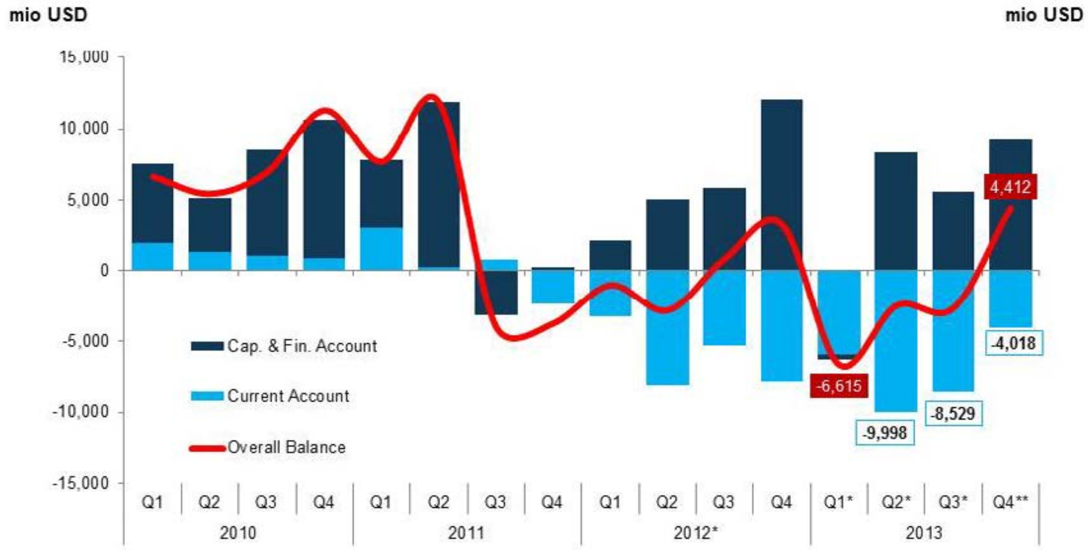
Graph 3

Balance of Payment



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Graph 4

Portfolio Investment Flows

Jan 2013-March 2014

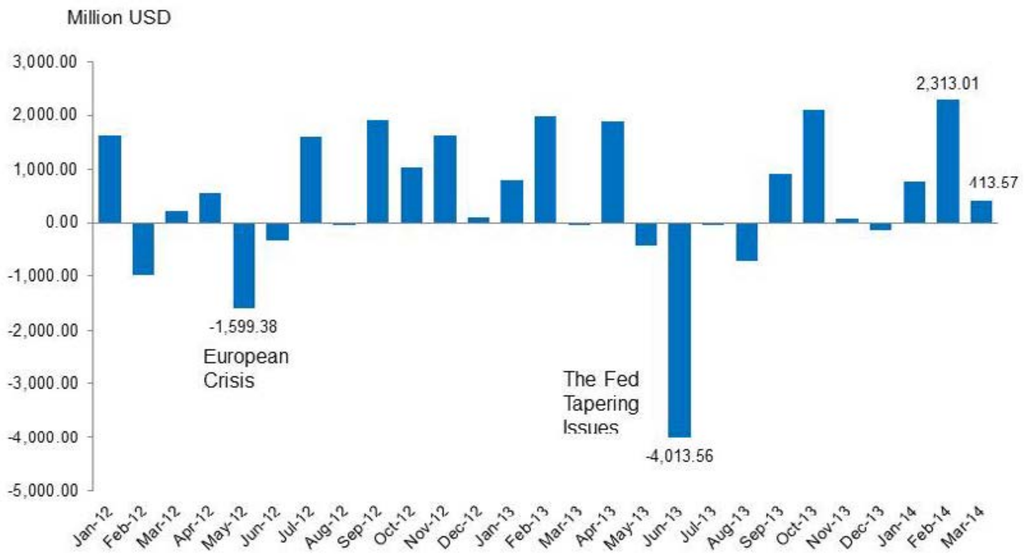

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Table 1

Currencies Performance

As of 7 March 2014

Currency	Dec 2012	May 2013	Dec 2013	7 March 2013	YTD 2013	YTD 2014
IDR	9630	9790	12160	11435	-26.27%	5.96%
JPY	86.74	100.46	105.3	103.25	-21.40%	1.95%
MYR	3.057	3.0975	3.277	3.2565	-7.20%	0.63%
THB	30.56	30.25	32.75	32.24	-7.17%	1.56%
PHP	41.01	42.295	44.37	44.37	-8.19%	0.00%
SGD	1.221	1.2638	1.263	1.2683	-3.44%	-0.42%
KRW	1063.24	1130.51	1049.5	1064.2	1.29%	-1.40%
CNY	6.2301	6.1345	6.0537	6.1258	2.83%	-1.19%
INR	54.68	56.66	61.82	61.05	-13.06%	1.25%

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Table 2

Credit Default Swap

As of 7 March 2014

Currency	Dec 2012	May 2013	Dec 2013	7 March 2014	YTD 2013	YTD 2014
Indonesia	136	175	233	→ 177	39	(56)
Korea	68	79	66	63	11	(3)
Filipina	106	105	114	102	(1)	(13)
Thailand	95	92	129	135	(2)	6
Malaysia	78	89	109	98	12	(12)

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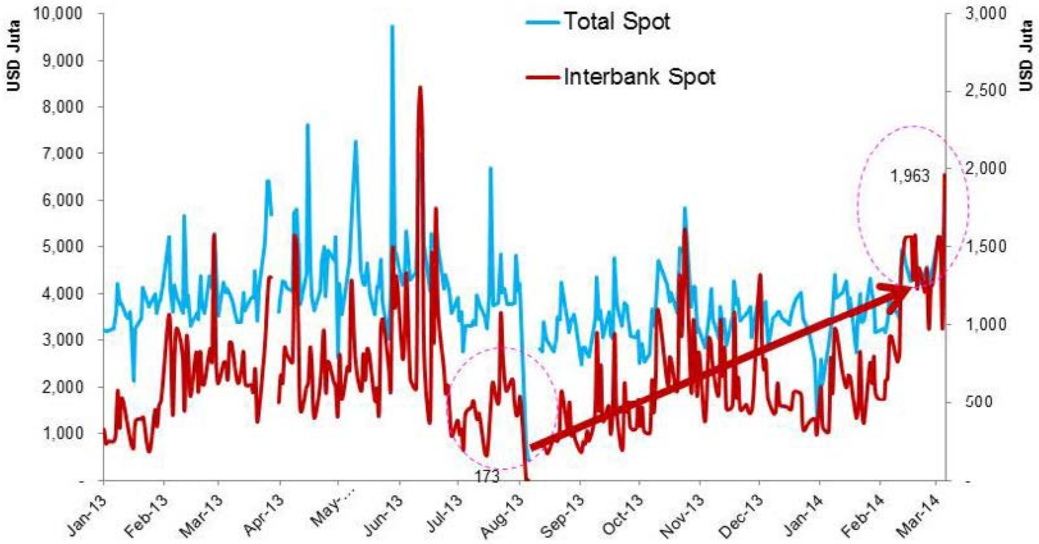
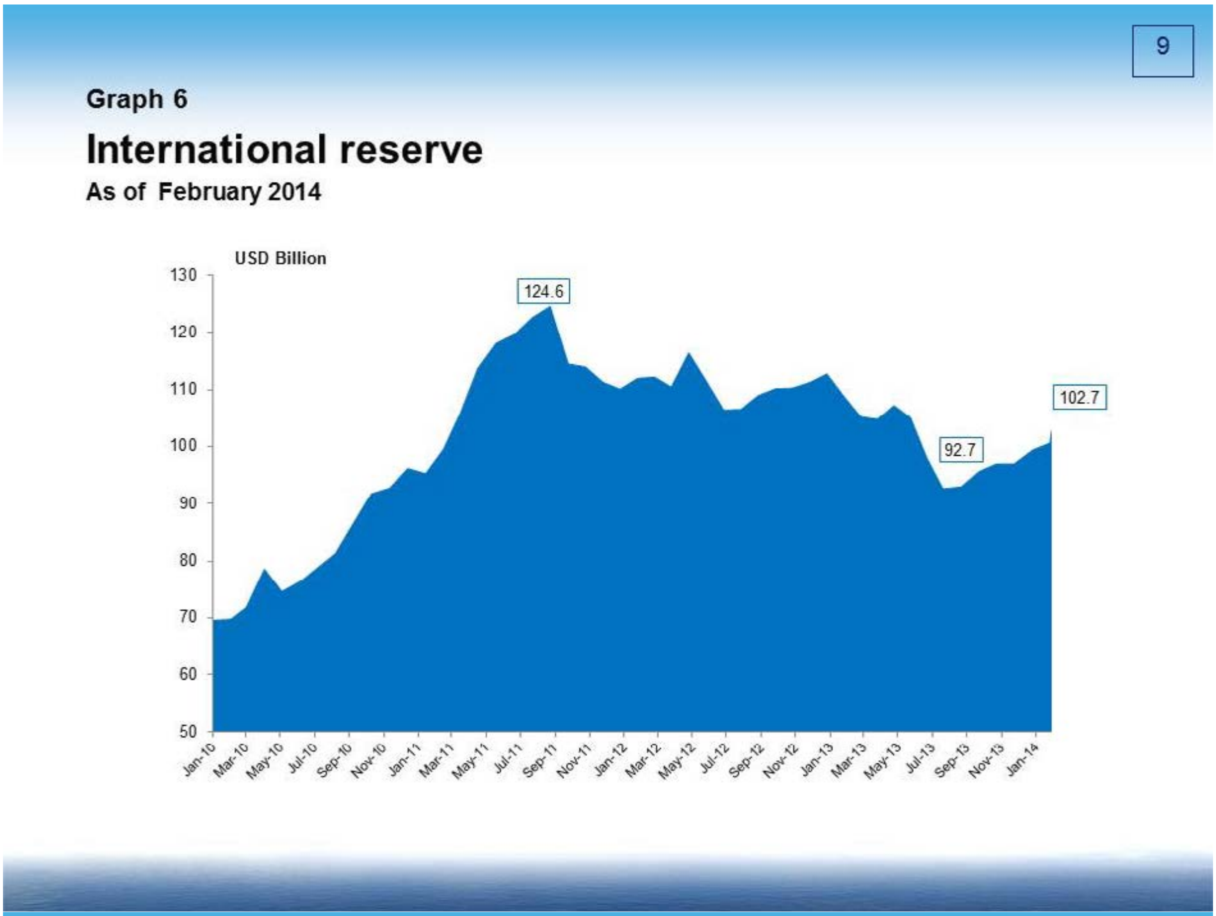
Graph 5

Interbank FX Spot Volume

As of 7 March 2014

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Graph 6
International reserve
As of February 2014
USD Billion
130
120
110
100
90
80
70
60
50
124.6
102.7
92.7
Jan-10
Mar-10
May-10
Jul-10
Sep-10
Nov-10
Jan-11
Mar-11
May-11
Jul-11
Sep-11
Nov-11
Jan-12
Mar-12
May-12
Jul-12
Sep-12
Nov-12
Jan-13
Mar-13
May-13
Jul-13
Sep-13
Nov-13
Jan-14


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Thank You !