

Agus D W Martowardojo: Strengthening financial system stability amidst global and domestic challenges

Keynote speech by Mr Agus D W Martowardojo, Governor of Bank Indonesia, at the discussion and launching of the Financial Stability Study book, Jakarta, 8 May 2015.

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The honorable:

- **Former Governors of Bank Indonesia,**
- **Members of the Board of Governors of Bank Indonesia,**
- **Heads of State Ministries and Institutions,**
- **Members of Bank Indonesia Supervisory Board,**
- **Representatives of businesses, industrial associations, and banking associations,**
- **Representatives of research institutes, observers, and academicians,**
- **Heads of national banks,**
- **Speakers and moderators,**
- **Distinguished invitees and ladies and gentlemen,**

Assalamu'alaikum warahmatullahi wabarakatuh,

Good morning and may God bless us all,

1. First of all, let us praise God the Almighty for all blessings so that we are given the opportunity and good health to attend this event. Insya Allah, we will follow a discussion themed "***Strengthening Financial System Stability amidst Global and Domestic Challenges***" and launching of Financial Stability Study Book No. 24, March 2015.
2. This FSS book reflects the dynamics in the second semester of 2014 and is a part of Bank Indonesia's routine publications to meet transparency and accountability of implementation of Bank Indonesia's duties in macroprudential field.
3. In general, the book's contents are the results of Bank Indonesia's monitoring and analysis of the development and dynamics covering our financial system. This includes description of assessment of potential risks and financial imbalance in financial institutions, financial markets, financial infrastructures, and corporations as well as households.
4. We expect such monitoring and analysis results may help the community and other stakeholders understand macroprudential policies adopted by Bank Indonesia to maintain and sustain financial system stability.

Distinguished Ladies and Gentlemen,

5. We just left 2014, a year full of challenges for Indonesia's economy. Many events to tell on how Indonesia's economy must face unfavorable global economic dynamics and domestic situations.

6. On the global level, we witness that global economic recovery is ongoing, but at an unexpected and unequal speed. Such dynamics transforming into global pressure become more apparent when world's commodity prices keep decreasing due to weak global demand, primarily from China. The emerging markets are then influenced and may potentially suffer from rapid capital reversal, including Indonesia.

7. Within the country, we also observe equally enormous pressures against the economy. Domestic economic growth slowdown is more intensified by vulnerabilities in the financial sector, such as increasing credit risks and rising private external debts exposed to exchange rate risks.

8. In addition, many issues must be immediately resolved since they affect financial system stability. Such issues among others are (i) frail domestic financial market, (ii) segmented Interbank Money Market, (iii) increase in short term high-cost fund in the bank's third party fund, and (iv) continued increase in property prices.

Distinguished Ladies and Gentlemen,

9. Alhamdulillah, amidst global and domestic challenge dynamics, Indonesia's financial system stability in the second semester of 2014 could be maintained in general as supported by better financial market performance. It is in line with the increasing global financial performance and high foreign capital inflow to Indonesia in 2014 reaching Rp181.5 trillion.

10. In addition, well maintained financial system condition is also supported by strong banking condition. It is among others reflected from bank's capital adequacy ratio (CAR) much higher than the minimum requirements, relatively high industrial liquidity, and relatively low ratio of non-performing loans. Moreover, more efficient, secure, and smooth payment system condition also contributes to the maintained financial system condition.

11. However, we must keep cautious of and observing different risks potentially arising against the financial system. We certainly do not wish to become indifferent to various achievements supporting financial resilience in 2014.

12. With the current economic and financial system characteristics of Indonesia, we note sources of financial vulnerability and imbalance may result in systemic risks. Such sources are apparent in at least 5 (five) areas.

13. **First**, banking procyclicality behavior following financial cycle and increase in short term high-cost fund in the bank's third party fund. **Second**, private external debt growth partially unprotected by hedging. **Third**, continuous decrease in the world's commodity prices affecting Indonesia's exports, which still rely on natural resources commodities.

14. **Fourth**, continuous uncertain normalization of the Fed's monetary policies and better US economy resulting in stronger US dollar. **Fifth**, continuous excessive increase in property prices resulting in intensifying credit risks and affecting inflation control efforts.

Distinguished Ladies and Gentlemen,

15. Imbalance sources and their potentials to become systemic risks must be carefully anticipated and responded in an effective and synergic manner. In this case, coordination and collaboration of policies between authority and institutions under the Financial System Stability Coordination Forum, namely Ministry of Finance, Bank Indonesia, OJK, and LPS, become an inevitable necessity.

16. As a macroprudential authority, in maintaining and sustaining financial system stability, Bank Indonesia contributes by continuing various macroprudential policies adopted since the middle of 2013.

17. Such macroprudential policies among others include application of Secondary Reserve Requirement (RR), RR connected with the Loan to Deposit Ratio (LDR), Loan to Value (LTV) policy, and financial market deepening as well as financial inclusion increase. In addition, Bank Indonesia has also issued policies which may be used as prudential guidelines in External Debt management by non-bank corporations.

18. We need to inform you that such macroprudential policies are basically temporary and not cross-sectoral. The policies may be at any time reviewed, fine-tuned, and refined to maintain financial system balance and stability as the objective of macroprudential policies.

Ladies and Gentlemen,

19. Observing the financial system condition and pressures as well as challenges of the national economy, Bank Indonesia's macroprudential policy direction in 2015 will focus on efforts to:

- (i) mitigate financial imbalance risks,
- (ii) maintain liquidity adequacy and deepen financial market, and
- (iii) boost quality credit growth in productive economy sectors to support economic capacity increase.

20. Such macroprudential policy direction is implemented among others through preparation of national and regional financial balance sheet, application of bank capital components in the form of Countercyclical Capital Buffer (CCB), and improvement of RR-LDR provisions.

21. Furthermore, macroprudential policy direction is implemented through the adoption of incentive/disincentive mechanism to boost quality MSME credit extension and strengthen the legal basis for Financial System Security Net (JPSK).

22. One thing we need to emphasize is efforts to maintain and sustain financial system stability and resilience relate not only to conventional financial system. Bank Indonesia, OJK, and the Government must also seek to increase stability and resilience in sharia finance. It is conducted among others through development of sharia finance instruments, Sukuk market deepening, and enabling regulation formulation.

23. We must also be alert to the constellation of global monetary policies, where divergence occurs in monetary policies of the Fed and other developed countries, which results in stronger US dollar. It will bring different challenges for us because Indonesia is at the same time facing current transaction balance deficit that still needs to be controlled. If improperly anticipated and responded, this condition will affect exchange rate stability, which will in turn influence financial system stability.

Distinguished Ladies and Gentlemen,

24. Above is my introduction to the discussion and launching of Financial Stability Study No. 24, March 2015. We expect the discussion will open wider horizons of Indonesia's financial system and result in constructive and strategic thoughts to maintain financial system stability.

25. To conclude, may God bless and guide our steps.

Thank you.

Wassalamu 'alaikum warahmatullahi wabarakatuh.