Darmin Nasution: Strengthening Indonesian banking, embracing global recovery

Speech by Dr Darmin Nasution, Acting Governor of Bank Indonesia, at the Bankers' Dinner 2010, Jakarta, 22 January 2010.

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We have successfully navigated 2009 with a number of achievements that would make anyone proud. Our economic resilience to the global economy remains relatively high. Economic growth in 2009 reached 4.3%, which includes our economy in the exclusive group of countries that achieved positive growth. Meanwhile, our accommodative monetary policy stance throughout 2009 bolstered economic performance and this policy was further buttressed by several operational measures, for example strengthening open market operations as well as refining the interest rate structure.

In future, monetary policy will be directed towards maintaining low and stable inflation in the 5%±1% range for 2010; and continuing its declining trend until it is as low as neighbouring countries at around 3%. Efforts to bring medium-term inflation down to a lower level are relevant in terms of maintaining the competitiveness of the domestic economy, especially in view of the upcoming ASEAN Economic Community in 2015.

In addition to sustaining economic conditions, financial sector stability was also maintained, which is inseparable from a number of policy measures instituted by the Government and Bank Indonesia to overcome the effects of the global crisis in the final quarter of 2008, followed by additional measures implemented in 2009. The financial sector, which was placed under significant pressure in November 2008 with the Financial Stability Index (FSI) peaking at 2.43, gradually recovered in December 2009 with FSI dropping to 1.91; below the critical indicative level of 2.0.

Direction of banking policy

Learning from our extensive experience with crises, Bank Indonesia introduced four incentive and disincentive based policies in 2010.

1. Strengthening the resilience of the banking system by underpinning a number of regulations, reinforcing the bank supervision system, restructuring the banking industry in Indonesia, as well as deepening the financial market.

    a. The applicable regulations include capital regulations in order to buttress the resilience of banks against risk, transparent financial reporting, improving the quality of good corporate governance, as well as improving the effectiveness of risk management.

    b. Policy to shore up the bank supervision system will be achieved by strengthening risk-based supervision, enhancing operational bank supervision, feasibility and compliance testing, as well as improving collaboration among supervisory authorities domestically and abroad.

    c. Policy to reorganize competition in the domestic banking industry will be achieved through bank restructuring in harmony with the appropriate business scale and capital requirement, as well as increasing the capacity to absorb business risk. In addition, several regulations will cover, among others, mergers, consolidation, sources of funds for bank acquisition, the terms for bank acquisitions, the role of individual/family owners, as well as the terms and conditions of business development.

d. Policy to deepen the financial market will encourage the development of financial products that can be used as an alternative by banks for productive channelling and placements to the real sector, especially infrastructure financing. Therefore, the financial market is expected to become more liquid with banks becoming less dependent on BI instruments.

2. Improving the bank intermediation function through refined regulations and greater availability of supporting infrastructure. The regulations in question include the Statutory Reserve Requirement, optimizing the efficiency of bank operations and simplifying the terms and conditions governing foreign exchange in order to stimulate credit allocation. BI will also help form an institution to supply credit basis data per sector, per region to assist banks asses risk.

3. Expanding the role played by sharia banks in the national economy and bolstering resilience. Sharia banking policy will become more intensive to raise capital, facilitate the development of sharia business units and facilitate the requirement for competent sharia human resources.

4. Improving the role of rural banks in terms of micro finance and strengthening resilience. This policy will become more intensive, among others, to raise capital and facilitate the requirement for competent human resources, as well as assert the position of rural banks as community banks.

A need will arise after the global crisis for a systemic regulator that can monitor the soundness and stability of the financial system as a whole. The role of such an institution will be to collate, analyze and report information regarding significant interactions on the markets and inter-institutional risk; investigate whether an institution is exposing the financial system to systemic risk; design and implement regulations; and coordinate with other regulatory institutions, including the fiscal authority, to resolve systemic crises that may emerge.

There are three reasons why the central bank may take the role of systemic regulator. First, the central bank has daily contact with market players in its function of implementing monetary policy.

Second, the responsibility of maintaining macro-economic stability corresponds closely with guaranteeing financial system stability. History has shown that economic crises around the world are always linked to financial crises; therefore, the central bank naturally has to consider interactions between the financial sector and monetary policy.

Third, the central bank has the function of lender of last resort. Therefore, the central bank must utilise its resources to supply short-term emergency funds during a crisis.

Bankers are expected the shift their business strategy away from merely surviving the crisis to exploiting the opportunities presented by the global economic recovery. Strengthening the banking industry does not imply that its soundness is in doubt, however, it will lead to more efficient banks and a more optimal intermediation function.