

## **Agus D W Martowardojo: Making headway towards sustainable growth – challenges in a volatile world**

Keynote address by Mr Agus D W Martowardojo, Governor of Bank Indonesia, at “Managing ASEAN Risk”, American Indonesia Chamber of Commerce, New York, 14 April 2014.

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***Good morning,***

***Distinguished guests, Ladies and Gentlemen***

1. It is a distinct pleasure to be here, on my way back to Indonesia after attending the World Bank/IMF meeting in Washington DC. I would like to thank American Indonesian Chamber of Commerce for the invitation.
2. I also like to say that this event-theme namely “Managing ASIAN Risk” is timely and appealing. Since last couple weeks, you must have already heard many interesting discussions about the parliamentary and presidential election in Indonesia.
3. And, here, I would like to reaffirm that given the political transitions is underway, Indonesian economy remain offering causes for optimism.

***Ladies and Gentlemen***

4. I am pleased to share that the recent development particularly since the final quarter of 2013 showed that the preemptive and decisive policy measures carried out by Bank Indonesia and the Government has effectively steered the economy to the right track.
5. Despite unfavorable weather condition, in the last three months inflation remains under control and back to its normal path. 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 1.98% of GDP, which is well below the 3.85% of GDP reported in the third quarter of 2013.
6. Since I took the office in May 2013, I was in the view that the policy shift is needed to lower the current account deficit gradually to a sustainable level.  
  
It's my firm believe that any delay in responding to economic imbalance often cause us to lose momentum, which carries a harmful consequences on the economy as a whole. As well, a sustainable economic growth requires not only a low and stable inflation, but also a healthy posture in current account.
7. For that reason, we (Bank Indonesia and Government) geared policy mix to put priority on the stabilization over the growth, and commit to safeguard the adjustment process to be a soft landing one. Given saw moderation in domestic demand, we have managed to allow for an orderly adjustment in the economy, without sacrificing too much growth. Last year, economic growth stood at 5,8% which reasonably high compared to our peers countries.
8. The dynamics in the economy throughout 2013 has also brought home a lesson that in order to achieve the desired optimal balance in the economy we need a discipline, forward looking, and bold macroeconomic policy. In fact, improved economic fundamentals supported by strong policy have bolstered confidence among global investor, hence attracted foreign portfolio flows back to domestic financial market.
9. Since early January until April 4, 2014, the influx of global portfolio flows into Indonesia's financial market reached US\$6.9 billion. As a result, the Indonesian Rupiah gained 7,0%, become the strongest currency among Emerging Market currencies. Once considered a “fragile five currencies”, the Indonesia rupiah now set itself apart as a result of preemptive and strong policy actions.

10. This picture is contrast against the event in mid-2013 at the time I joined Bank Indonesia where the changing market's enthusiastic reactions to Federal Reserve's signal of so-called "QE tapering" led to a sell-off of emerging market debt and equities, and reversal of foreign capital flows.

11. There is also a mark positive in the microstructure of onshore foreign exchange market. Foreign exchange liquidity in onshore market is currently ampler with a greater interbank trading volume, thus buffering the IDR exchange rate against unwanted volatility due to the sudden surge in dollar demand. With a greater market volume certainly help alleviate the past perception where the central bank was perceived as the sole main supplier of US dollar.

12. Likewise, there is a greater transparency in the foreign exchange price discovery and JISDOR (Jakarta Interbank Spot Dollar Rate) has been well accepted by the market, including by the ABS Singapore formally as spot reference for NDF market in last February 2014.

## **Managing short term volatility**

### ***Ladies and Gentlemen***

11. Indeed, in the recent months, turbulence in the global financial markets seems to have somewhat been moderated. This possibly reflects the fact that much of future risk of the Fed tapering has been priced in during the second half of 2013 outflow episodes.

12. This is, however, not to say that short-term volatilities are no longer with us. In these uncertain times and with all the increased interconnectedness of the world economy, volatility and short-term fickleness of marketplace are unavoidable.

13. The interplay between market players' expectations, their self-fulfilling nature and spillover effects frequently paves the way for market exuberance in response to a trigger event. Therefore, we should realize that we are definitely not out of the woods and it's not going to be an easy task to be sustained.

14. Beside, emerging market like Indonesia still has to prepare to face a rocky and bumpy road ahead. The G20/IMF meeting last week raise concern that the balance of risks to global growth has improved, but that some hurdles along the way remain. These include the potential risk for reversal in capital flows from emerging markets to advanced economies as risk averse investors seek relatively more attractive advanced economies' assets.

15. And there is a risk of renewed bouts of market volatility with the expected normalization to a more neutral monetary policy stance in the United States. In either case, the result could likely lead to financial turmoil and difficult adjustments in some emerging markets, with a risk of contagion.

16. These risks if not well-managed could reawaken similar environment that have put many emerging market economy in jeopardy last year. Hence, the challenges going forward for policymakers are, not only to have the right set of "firm policy responses in place" to deal with these short-term volatilities, but also to assure that all the market participants are well prepared for the scenarios that could be expected.

17. In this regard, I have frequently encouraged the business sector at home to manage their foreign exchange risk. In this context, Bank Indonesia has taken many steps to promote the use of hedging instrument including by relaxing the foreign exchange regulation. I believe, in these uncertain times where information and confidence are very important in influencing market actions, protection against the foreign exchange risks should be viewed as the foremost strategy.

## **Upgrading of the supply slide**

### ***Ladies and Gentlemen***

18. Although short-term volatility has often caught us by surprise, there is a pressing need to consider longer-term issues. And to support long-term perspective, Bank Indonesia has set macroeconomic and financial environment to support such goal. Indeed, sound macroeconomic have been instrumental in safeguarding economic stability and for some extend helping Indonesia weather through numerous shocks that have come its way.

19. But, we should also not be under the illusion that sound macroeconomic practices can be taken for granted. It would be a mistake to be soothed into complacency by the success of short-term volatility management.

20. In particular, there remain important long-term challenges to the sustainability of growth in Indonesia. As we all aware, in many emerging market including Indonesia most policy responses have been focused on demand-side management through monetary or fiscal policy. After all, pursuing demand management policies alone can only take us so far – somewhat akin to stepping on the gas pedal without “upgrading” or modifying the car we drive.

21. Thus, from domestic backdrop, Bank Indonesia give serious consideration on the need to address structural issues to be very pressing since the real lift of potential growth of the economy must essentially come from supply-side progress. 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.

22. Indeed, the task is not going to be easy. Reorienting the economic growth strategy to focus more on skills development, innovation, and productivity involves deliberate planning over relatively long stretch of time. Two principles are of the essence: consistency and continuity. Due to the long-term nature of structural readjustments, continuity of policy implementation is required for the policy measures to take meaningful effect on the economy.

23. The good news is that some of the infrastructure projects in Indonesia have already been in progress and will continue move on regardless of “the political regime shift”. Last month, the construction of double tract railways just completed, connecting Jakarta and Surabaya, as the biggest and second biggest city respectively. Meanwhile, the other many ongoing projects remain the responsibility of the next administration to ensure adequate infrastructure in the medium term.

24. To be sure, in Indonesia, democracy is a continuous process since its conception fourteen years ago rather than a fixed state of bliss to be attained. The process is shaped by voices of the people, under an institutional setup that provides checks and balances. With more than 500 elected offices throughout the archipelago, election and peaceful transition of power actually occur almost every day in Indonesia. I am confident that the upcoming 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. It’s my firm believe that the next administration will ensure quality public policy that can enhance the country’s competitiveness and sustain long-term growth.

## **Outlook 2014**

### ***Ladies and Gentlemen***

25. Against the background of quite an unpredictable external environment, I believe that the Indonesian economy would be more stable, balanced, and growth at reasonable rate in the range of 5,5–5,9%. Many of the supporting factors remain in place, including stronger export and improving business confidence which should provide an enabling environment for growth.

26. Bank credit is projected to grow at 15–17% range which is reliable with the effort to bring the current account to a healthier. That being said, we expect the current account deficit to continue shrinking below 3,0%. Indeed, latest trade figure already pointed to an upbeat-sign as shown by the surplus of trade balance in February and March 2014.

27. Inflation will remain under control and within its target corridor of 4.5%±1% in 2014. With many uncertainties ahead, it is wise to keep the inflation rate low to ensure that the economy remains competitive and to minimize pockets of instability, whether through excessive growth of bank credits or asset price bubbles.

## **Closing**

### ***Distinguished guests, Ladies and Gentlemen***

28. I would like to end my talk this morning by stressing that despite many roles that Bank Indonesia plays in ensuring economic and financial stability, Bank Indonesia's policy alone cannot ensure sustainable economic growth.

29. A sustainable growth requires a structural reform for having a reliable infrastructure, – in terms of physical, financial, institutions, and human capital – as an enabler for Indonesia to grow and break into the high-income level bracket.

30. If infrastructure development is unable to keep up with expanding economy and growing demand of the population, the economic growth is constantly constrained to achieve its full potential. Encouragingly, in Indonesia, progress has been observed in many projects although room for improvement remains.

31. I believe the next administration remain placing emphasize on the structural reform, while Bank Indonesia will continue to ensure a stable financial and economic environment, so that businesses can continue to thrive and individuals can enjoy better standards of living on a sustainable basis.

Thank you.