

## **Agus D W Martowardojo: Strengthening stability, accelerating structural reform to reinforce economic fundamentals**

Keynote address by Mr Agus D W Martowardojo, Governor of Bank Indonesia, at the discussion and launching of the 2014 Indonesia Economic Report (LPI), Jakarta, 29 April 2015.

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- The honorable former Governors of Bank Indonesia,
- Members of the House of Representatives and Audit Board of RI,
- Members of BSBI,
- Members of the Board of Governors of Bank Indonesia,
- Speakers, Responders, and Moderators,
- Dear Invitees and Ladies and Gentlemen,

***Assalamu'alaikum warahmatullahi wabarakatuh,***

***Good morning and may God bless us all,***

1. First of all, allow us to ask you to thank God the Almighty for his blessings that we are given the opportunity to attend this event. Insyah Allah, we will soon witness the launching of 2014 Indonesia Economic Report (LPI) Book, which will continue to a discussion themed “*Strengthening Stability, Accelerating Structural Reform to Reinforce Economic Fundamentals*”.

2. LPI Book is an annual publication of Bank Indonesia, which comprehensively contains national economic dynamics in 2014. In addition to documenting the journey of Indonesia’s economy, LPI also seeks to present the lessons learned during such period. The efforts to learn such lessons are very important as a foundation for strengthening and improvement of policies in the future.

***Ladies and Gentlemen,***

3. *Slide 2:* 2014 turns out to be full of challenges for Indonesia’s economy. Global economic condition is not as bright as initially predicted. Recovery is still taking place in various major economies in the world, but at an unexpected and unequal speed. The world’s commodity prices continuously decrease due to weakening demands, particularly from China.

4. *Slide 3:* As a country with open economic and financial system, Indonesia will closely relate to the global economic constellation. Furthermore, amidst the world’s divergent monetary policies and changing perception of external risks resulting in the increasingly stronger US dollar on a global scale.

5. *Slide 4:* Throughout 2014, Indonesia must face different financial market turbulence. Occurrences throughout 2014, such the default of Argentine, stronger expectation for interest rate increase in US, decrease in euro exchange rate as the impact of loosening monetary policies by ECB, and sharp fall in Russian ruble at the end of 2014, contribute to the Indonesia’s economic dynamics.

6. Such different external pressures have in turn resulted in domestic economy instability, one of which is the outgoing foreign capital flows from Indonesia. Such instability also serves to reflect different structural issues in the real sector. The structural issues are not new since they have been subsisting within the last several years.

7. *Slide 5:* We observe that our high dependency on exports of low value- added natural resources has resulted in vulnerable economic growth against price fluctuation. Our

exports sharply fall due to weakening demands from major trade partner countries and declining prices of natural resources based export commodities. Consequently, the economic growth in most provinces whose economy is based on exports of extractive products, primarily Sumatera and Kalimantan, also drastically decreases.

8. *Slide 6:* Moreover, weak energy resilience makes energy requirements fail to be fulfilled by ourselves, thereby we keep importing. Such weak energy resilience has also caused the Government to adjust fuel price in June 2013 and November 2014 to maintain fiscal sustainability. It then triggers inflation, which pressure we still experience until the end of 2014.

9. *Slide 7:* Our fragile production structure amidst external pressure has made the national economic growth rate hindered by deficit in the current transaction balance, which has been taking place until now. As a result, exchange rate depreciation becomes inevitable and even necessary to ensure such deficit will not increase and economic slowdown will be controlled.

10. *Slide 8:* In addition, we still also see the emerging additional vulnerabilities at a micro level. **The first** is the increasingly higher corporate external debts, but most are unprotected from fluctuating exchange rate risks. *Slide 9:* **The second** is a huge accumulated portfolio capital by foreign investors on government bonds, which may easily flow out of the country and trigger exchange rate fluctuation. In addition, our shallow financial market may intensify such turbulence if spillover effects occur.

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

11. The Government and Bank Indonesia adopt various policies to maintain macro stability in order to control economic growth slowdown in the short run. Policies are directed to ensure inflation is controlled, stability of rupiah exchange rate is maintained on its fundamental condition, and deficit in the current transaction balance may be reduced towards a healthier level.

12. *Slide 10:* In such policy direction, Bank Indonesia has strengthened its policy mix, namely (i) continue the “tight bias” policy by increasing BI Rate by 25 bps to 7.75% in November 2014, (ii) strengthen monetary operations, (iii) stabilize rupiah exchange rate, and (iv) strengthen macro- prudential policy.

13. *Slide 11:* Bank Indonesia’s policy to increase BI Rate in November 2014 is an “ahead to curve” step to mitigate expected inflation increase risks and ensure inflation pressure post-increase in subsidized fuel price will be controlled and temporary and may immediately return to the targeted track.

14. We believe that with inflation and its expectation anchored to low rate, people’s real savings and purchase power will not be eroded; therefore, it becomes the foundation for stronger economic growth and poverty alleviation in the future.

15. The monetary policies we have adopted are accompanied by the strengthening of inflation control coordination through the Inflation Control Team (TPI) and Regional Inflation Control Team (TPID).

16. The tight bias policy we have adopted also aims to ensure that the deficit in the current transaction balance, which has been taking place for three years, will remain controlled at 2.5–3 percent of GDP and will not increase. Controlled deficit in the current transaction balance is very vital to ensure the national economy will grow strong and balanced and job creation will continue.

***Ladies and Gentlemen,***

17. We also see that efforts to maintain macroeconomic stability must also be supported by the principle of prudence in the business world. We observe that such prudence is primarily required for businesses obtaining foreign loans.

18. *Slide 12:* In this relation, Bank Indonesia has obliged corporations to do hedging by applying the following rules: (i) minimum hedging ratio, (ii) maintenance of forex liquidity adequacy, and (iii) minimum credit rating. We will consistently monitor the private foreign loans and take advanced steps if necessary.

19. *Slide 13:* In the financial sector, we also see that structural challenges must also be tackled to deepen financial market. Alternative financing sources in our economy still focuses on the banking sector and remains undiversified, while the roles of bond market have been insignificant.

20. *Slide 14:* Efforts to deepen financial market by developing “hedging” market have become very urgent as well because we will face increasingly complex global challenges. Therefore, Bank Indonesia in cooperation with the Financial Services Authority (OJK) has established a foreign exchange market committee, issued market conduct, simplified and deregulated some provisions to facilitate hedging transactions on the forex market, encouraged interbank repurchase activities, and improved provisions for JIBOR (Jakarta Interbank Offer Rate).

***Distinguished Ladies and Gentlemen,***

21. We are pleased and record that strategic and tactical steps have been initiated by the Government on urgent structural reform nodes in order to build a stronger supporting environment for investment. Such nodes, primarily strengthening of physical connectivity focusing on maritime and its integration to land connectivity, we believe will significantly decrease logistics cost, making businesses more competitive in the global market and eventually achieving equal cost efficiency throughout the country.

22. *Slide 15:* Another important thing is the Government’s efforts to reform fuel subsidy, which is very vital to be shifted to strengthen development’s basic capital. Development of HR quality, infrastructures, and innovative and institutional capacity, which are the basic capital for the national economy to grow stronger and more sustainable, has been hostage to improperly targeted subsidy. Therefore, Bank Indonesia fully supports the “firm step”, the benefits of which will be experienced in the coming years.

***Distinguished Ladies and Gentlemen,***

23. *Slide 16:* At the end of 2014, some initial indications of economic recovery have been observable. Stability oriented policies have prevented the national economy from increasingly stronger pressures. The deficit in the current transaction balance in 2014 has been lower to reach  $-2.87\%$  of GDP, compared to  $-3.18\%$  in 2013.

24. *Slide 17:* Stability oriented policy has also put more confidence of investors in the quality of Indonesia’s macroeconomic policies. It is depicted by the large incoming flows of portfolio investment, which reaches Rp 181.5 Trillion in 2014. The flows maintain investment enthusiasm in the market price and government securities (SBN).

25. *Slide 18:* Along with direct investment, such portfolio investment flows have supported the surplus in Indonesia’s Balance of Payment, making the foreign exchange reserves at the end of 2014 reach USD 111.9 billion (equal to 6.5 months of requirements for imports and payment of the Government’s external debts), compared to USD 99.40 billion at the end of 2013.

26. Therefore, it will not be exaggerating to say that policy measures taken by the Government and Bank Indonesia have been proven successful at recovering the macroeconomic condition in 2014 to the “path of stability”.

**Ladies and Gentlemen,**

27. Overall, Indonesia’s economic dynamics in 2014 bring some valuable lessons to support sustainable economic growth.

28. **First**, it is important to maintain consistent macroeconomic policies, both fiscal and monetary policies. Such maintained consistency will grow trust in and credibility for the policies. **Second**, amidst diverse and increasingly complex economic challenges as well as various vulnerabilities, including high current transaction deficit and inflation, a synergy of monetary and fiscal policies and structural reform are required to allow higher economic growth with maintained macro stability. **Third**, timeliness is important in adopting policies. Bank Indonesia considers that policy mix should be implemented in a timely and measurable manner.

**Ladies and Gentlemen,**

29. Although external and internal challenges for the national economy ahead will become increasingly serious, it does not necessarily mean that the enthusiasm of our present economic achievement prospect will go dim. We think optimism over our economy ahead will remain high.

30. *Slide 19:* With such optimism, we estimate that Indonesia’s economy will grow by 5.4%–5.8% in 2015 and 5.6%–6.0% in 2016, in a reduced deficit in the current transaction balance. With such prognosis, it is estimated that real exchange rate will relatively stable. To ensure that different structural reform programs supporting economic growth will be implemented, we are consistent in seeking to anchor inflation rate and its expectation on the medium term target at 4±1%.

31. However, various positive prospects are not easily realized because there are some risks and challenges ahead. Global economic condition ahead will remain full of uncertainty. Divergent global monetary policies will make the world’s financial market vulnerable to shifting perception. Global turbulence risks may spillover quickly to our economy through the financial market and trade.

32. Meanwhile, we are still struggling with diverse structural rigidity and inefficiency, thereby making the supply side of our economy unresponsive.

33. Considering the global and domestic economic constellations require consistent stability-oriented monetary policies and “firm” structural reform policies to increase the capacity and competitiveness on the supply side; therefore, we expect our economy ahead will sustainably grow high from “non-artificial” forces.

**Ladies and Gentlemen,**

34. I conclude my brief introduction. Further description of the journey of Indonesia’s economy in 2014 has been prepared in a 2014 Indonesia Economy Report book (LPI), which you all will receive at the end of this event.

35. We invite all of you to thoroughly observe the contents of the book, which is the eminent regular publication of Bank Indonesia. As an illustration of the book cover, we have selected a figure of the “Gradon Boat” traditional sport, representing our fighting spirit in work. In addition to power and speed, a dragon boat also requires coordination and teamwork to be able to come out as a winner.

36. I also wish to extend my appreciation to the resource persons, responders, and moderator who accept our invitation to this morning's discussion. We expect the discussion will make our determination stronger to reinforce economic fundamentals.

37. To conclude, on behalf of the Board of Governors of Bank Indonesia, I present 2014 LPI and expect this book will give broad knowledge to the readers. This book is expected to be able to continue LPI's reputation as a quality and reliable reference for the journey of Indonesia's economy in wading through the sea of challenges towards the port of welfare and prosperity.

38. May God bless our steps and always give the guidance, direction, and blessings to Indonesia to remain productive. Thank you.

***Wassalamu 'alaikum warahmatullahi wabarakatuh.***