

## Agus D W Martowardojo: The future of Asia's finance – financing for development

Welcoming remarks by Mr Agus D W Martowardojo, Governor of Bank Indonesia, at the Joint IMF-Bank Indonesia Conference “The Future of Asia's Finance: Financing for Development”, Jakarta, 2 September 2015.

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- Honorable Managing Director Christine Lagarde, the co-host of this Conference;
- Honorable Minister Bambang Brodjonegoro,
- Honorable Governors, Deputy Governors, Ambassadors, Representatives from regional and multilateral institutions, business community, our colleagues from academics, distinguished panelists,
- Ladies and Gentlemen,

Good morning and warm welcome to all of you.

1. It offers me great pleasures to welcome you to this Conference jointly co-hosted by Bank Indonesia and the IMF with the topic of **“The Future of Asia's Finance: Financing for Development.”** The topic is indeed crucial considering wide financial gaps still exist in the region. In this regard, searching for an optimum financing would be challenging in the midst of current circumstances.
2. Before I share my views on financing issues, allow me to discuss the global economic development. Asia's finance is now facing great challenges. In the near term, we may still confront an episode of heightened capital flows volatilities as consequences of unfavorable global economic condition. Sluggish global economic growth continues to depress production and outlook. Strong U.S. dollar following partial U.S. recovery and easing in Europe and Japan have tested some of Asia's economic buffers. Weak commodity price has significantly hurt exports of some key regional economies. And more recently, China's decision to rejuvenate its moderating growth through exchange rate policy has made the risk of external funding intensified. In fact, the increasing, yet again, global financial volatility, in a tune of 2013 global tantrum, is happening as we are sitting here, and it has led to a pull-back in capital flows from some emerging markets, including in Asia.
3. While Asia has remained broadly resilient to the risks, and it has led global growth for the past thirty years, its role to support global economic recovery seems to be weakening a little bit. A number of emerging market economies in the region are experiencing a declined economic growth and facing increased financial vulnerability, mostly related to capital reversal.
4. Asia definitely needs the right policy mix to secure growth and contain risks. Past experience taught us the importance of authorities to take decisive and credible policy actions to safeguard macroeconomic and financial stability. “Stability over growth” policy direction following May 2013 the Federal Reserve's move is an interesting example. Indeed, the subsequent moderated growth is considered very crucial for the economy to progress further, not only in the near term but also for a longer horizon.
5. In Indonesia's case, in response to current situation, Bank Indonesia has consistently implemented tight bias monetary policy since mid-2013. Some positive results have emerged. Although Indonesia's economic growth is slowing following the global economy slowdown, the growth was still recorded at a relatively high rate of 4.67% in the second quarter of 2015. The fundamental economy of Indonesia

remains sound and shows some improvements as indicated by improvement of current account deficits, trade balance surplus in the last two quarters of 2015, and a manageable inflation rate which is expected to fall within Bank Indonesia's target of 4±1% in 2015.

6. Furthermore, financial system stability remained solid, underpinned by a resilient banking system and relatively stable financial markets. To further support the macroeconomic stability, Bank Indonesia introduced prudential measure for business sectors which have access to foreign debt to conduct hedging by applying hedging ratio rules and preserve adequate foreign exchange liquidity by implementing liquidity ratio rules. In addition, to accelerate the deepening of financial markets, Bank Indonesia has revised some measures relating to foreign exchange transactions against the rupiah and net foreign exchange position of commercial banks.
7. Those positive achievements gained recognition from international institution, among others Standard and Poor's (S & P) that has revised Indonesia's rating outlook from Stable to Positive.

***Distinguished guest, ladies and gentlemen,***

8. Given the unfavorable global economic development, it is important for emerging market economies to improve domestic demand in order to sustain and bolster economic growth. In that respect, infrastructure investment will help to unlock potential growth and preserve sustainable growth in the medium term. However, this effort should be accompanied by structural reforms to improve business climate and to strengthen institutional capacity. Thus, to set infrastructure investment priorities by taking into account country specificities and lesson learned from successful countries would be of important in doing the infrastructure investment.
9. Infrastructure investment definitely requires long-term financing. The challenge has been how to provide sustainable financing in the midst of heightened financial regulation, weak corporate sector spending, limited government resources, and lingering global uncertainty. We note that there are regional and global arrangements initiated to deal with infrastructure financing, to name a few: the Asian Bond Markets Initiative (ABMI) under ASEAN+3 cooperation, the ASEAN Infrastructure Fund (AIF) under ASEAN cooperation together with ADB, Global Infrastructure Fund (GIF) under the G20 cooperation. Further in national level, government has also set aside the funding for infrastructure development. Would all initiatives be sufficient?
10. Let us look into this question. How much does Asia need to finance its economy? ADB estimates that over USD1 trillion must be spent on infrastructure to maintain ASEAN's current economic growth trajectory in a ten-year period. Furthermore, it is also estimated that during the same period, Asia will need to invest approximately USD8 trillion in overall national infrastructures for energy, transport, telecommunications, water, and sanitation. In addition, the region will need to spend approximately USD300 billion on regional pipeline infrastructure projects, involving physical construction works and coordinated policies spanning two or more Asian countries as well as having a significant cross-border positive impact.
11. Financially, the demand for cross-border and regional infrastructure funding often competes with funding for improved national infrastructure. The tremendous need on building infrastructure projects has resulted a large financing gap, or the difference between total financial requirements and the likely available financing through direct public resources.

12. On that note, it is inevitably we need to redouble the effort of financing for development. Allow me to name a few options. Private-Public Partnership (PPP) is an alternative solution to accelerate infrastructure development. While it potentially advances infrastructure investment, we should be mindful of its risk to fiscal position as PPP typically creates contingent for future liabilities. Good projects have to be selected carefully. Good governance and strong regulation enforcement are necessary.
13. Furthermore, financial sector should definitely play an active role in financing for development. Strengthening prudential and safeguarding measures should also complement this role. With its sound macroeconomic policies, rising middle-income, high saving, abundant labor resources, higher education level, and rapid technological adoption, Asia has the right components for sustaining growth and attracting investment.
14. I am also of the view that promoting capital market development and reducing heavy reliance of bank-based financial intermediation are both urgent and essential. Asia has embarked into this area by furthering its integration in financial sector. When ASEAN Economic Community is finally established at the end of this year, we should start thinking beyond 2015, and among ultimate objectives of post-2015 ASEAN financial integration in my opinion should be the creation of the best ecosystem of financing for development in the region.
15. That said, central banks in Asia have challenging tasks, i.e., to balance the need to deepen the financial market and to ensure the financial stability. Deepening capital markets and fostering financial inclusion would expand investor base and providing alternative financing. Financial inclusion should change the face of finance to become more people-centered, supporting investors with more outlets, small and medium enterprises with more funds to tap, and consumers with mortgages and other credits to smooth consumption. However, we should remain cautious as more dynamic capital market may also invite risks related to commitment and composition of capital flows. ***Distinguished guest, ladies and gentlemen,***
16. Now allow me to provide you with a glimpse on Indonesia. The current administration has put great attention on boosting infrastructure investment to facilitate stronger and sustainable growth. The government in particular places priority on strengthening of physical connectivity, primarily in marine connectivity as well as integration between marine and land connectivity such as railway and digital connectivity. Improvement in these nodes will profoundly lower the logistical cost, increasing competitiveness, and lead to cost efficiency across the nation. In the next five years, the government aims to build 5,000 km of railways, 2,600 km of roads, 49 dams, 24 seaports and power plants with a capacity of 35,000 megawatts.
17. On the financing side, the government has committed to conduct fuel subsidy reform. The government's decision to reduce fuel subsidy in 2014 created a fiscal space of approximately US\$19 billion for infrastructure investment. Furthermore, various measures have been undertaken such as providing fiscal incentives for investment with a better-targeted system, providing social safety net for the poor, continuing the financial deepening program to mobilize domestic savings for private and public investment financing, and increasing private sector involvement through enhancing PPP framework and establishing PPP Center. Yet, with the immense magnitude of financing needed, more initiative is needed to materialize our plan comprehensively.

***Distinguished guest, ladies and gentlemen,***

18. As a final note, I would emphasize that today's Conference is very important as it will discuss the key opportunities for Asia's development financing now and in the future. It is also a good avenue for authorities and private sector to share their

experience and exchange their views for breakthrough in creating sustainable financing for development. Asia is now facing great challenges and we must work together to choose the right path. I have no doubt that this Conference will contribute useful understanding and policy advice on this very crucial subject.

19. Lastly, allow me to thank the distinguished panelists and guests for coming to Jakarta and the organizing committee for arranging this conference.

Thank you and I hope you will have a fruitful discussion.