Analytical work on Indonesian macroeconomic and financial issues, with an overarching theme on building institutions and policies for prosperity and inclusive growth. The book begins with a 20-year economic overview by former Finance Minister Chatib Basri, with subsequent chapters covering diverse sectors of the economy as well as Indonesia's place in the global economy.

Realizing Indonesia's Economic Potential

Front Matter

Part I: Building Upon a Strong Foundation
Indonesia’s financial system has great potential for evolving to support inclusive growth. Indonesia has a young population, and the country can expect a sizable demographic dividend in the future (IMF 2018); the share of the working-age population is projected to peak at 70 percent in 2030. This growing working population will demand a greater range of more complex goods and services, especially financial services, including home mortgages, working capital for more start-ups, equity financing as companies expand, and financial products for risk sharing among investors and stable incomes for retirees. Indonesia also faces a large infrastructure gap, which financial deepening can support to finance.

Progress toward developing the financial system, however, has remained slow since the Asian financial crisis (AFC). Bank failures during the crisis affected the public’s perception of the domestic financial sector, undermining financial development during the subsequent two decades. Credit intermediation and deposit penetration have been lower than their pre-AFC levels. The government and the corporate sector rely heavily on funding from abroad (61 and 33 percent of total debt, respectively), leaving Indonesia susceptible to capital flow reversals.

To fulfill its potential, Indonesia needs to chart out possible paths for meeting the increasing expectations of its vast population and financing its large infrastructure needs. To supplement and alleviate traditional bank and fiscal channels, capital markets need to deepen further to strengthen financial intermediation and risk sharing, diversify sources of funding, and mitigate capital flow volatility. Moreover, technological innovation should contribute to extending the reach of finance to rural and previously unbanked areas, leading to greater financial inclusion.

Promoting financial deepening and inclusion has been a government priority. The government aims to achieve higher potential growth by unlocking the infrastructure bottleneck and taking advantage of the demographic dividend, as well as by undertaking structural reforms, and thus financial development has become a central part of the policy agenda. The authorities published the National Strategy for Financial Inclusion in 2016 and are preparing for an ambitious national strategy for financial market development, as recommended in IMF (2017).

This chapter is organized as follows: The next section takes stock of financial market development and is followed by a section that discusses credit intermediation from a financial inclusion perspective. The existing and draft national strategies for financial deepening and inclusion are discussed, and priorities are proposed to enhance the role of the financial system for inclusive growth.

Status of Financial Market Development

Indonesia’s financial market has room for improvement. Based on the financial development index constructed by Sahay and others (2015), which captures depth, access, and efficiency, overall financial development in Indonesia trailed behind other emerging market economies in Asia. A similar observation applies to the subindices, especially for financial markets (Figure 11.1). At the end of 2015, aggregate assets of financial institutions amounted to 72 percent of GDP. The market value of bond and stock markets equaled 63 percent of GDP in 2016. Outstanding domestic debt securities and stock market capitalization amounted to 18 percent and 45 percent of GDP, respectively, both well below the Asian emerging market peer medians of 76 and 77 percent, respectively (Figure 11.2). Although the financial sector is expected to grow as economic development progresses, the depth of financial markets in Indonesia largely lags behind that of its regional peers.

Figure 11.1. Selected Asian Countries: Financial Development Indices, 2014

Sources: Sahay and others 2015; and IMF staff estimates.

Note: Sahay and others (2015) develop two sets of three subindices that summarize how developed financial institutions and financial markets are in their depth, access, and efficiency, culminating in a composite index of financial development, the so-called Financial Development Index. It ranges between 0 and 1, with a higher value representing more advanced stages of financial development.

Figure 11.2. Selected Asian Countries: Size of Capital Markets, 2015

Sources: Bank for International Settlements Debt Securities Statistics; Bloomberg L.P.; and IMF staff calculations.

Banks remain dominant in Indonesia’s financial system. As mentioned in Chapter 13, “Reinforcing Financial Stability,” bank assets are equal to 55 percent of GDP, and account for about 80 percent of aggregate assets of financial institutions. Banks tend to be quite conservatively run, and they rely on retail deposits for funding. Given the short-term nature of retail deposits, banks provide limited financing for long-term investments and focus instead on commercial lending (about 70 percent of total loans). Asset holdings by domestic institutional investors, such as pension funds and insurance companies, remain relatively small, with outstanding assets under management of pension funds equal to about 2 percent of GDP and those of insurance companies at less than 5 percent of GDP at the end of 2015. It reflects the narrowness of the domestic institutional investor base. It is associated with the underdevelopment of capital markets. Figure 11.3 shows a high correlation between the size of the institutional investor base and the size of capital markets. Developing a critical mass of long-term institutional investors will be important for supporting financial deepening.

Figure 11.3. Institutional Investors and Capital Markets, 2015
The money market is dominated by short-dated, unsecured interbank transactions. The daily average volume of the unsecured interbank market was Rp 11.8 trillion in 2016, which is less than 0.1 percent of GDP, compared with 0.3 percent of GDP in Malaysia and Thailand. Turnover is skewed to the overnight market, which accounted for about 60 percent of interbank market activity in 2016. Both facts reflect the low liquidity in the money market. Banks manage their liquidity in the interbank market through unsecured, repo, and foreign exchange (FX) swap transactions, but also invest their excess liquidity in various Bank Indonesia (BI) instruments.

Interbank markets are segmented. Liquidity providers in the interbank rupiah market are state-owned banks and BUKU 4 banks. Foreign banks demand rupiah liquidity, while they provide FX liquidity in the interbank FX swap market (usually short in rupiah liquidity and long in FX). Foreign banks mainly trade with large domestic banks in the FX swap market. Developing the domestic money market will reduce segmentation, improve excess liquidity conditions, and ultimately increase the effectiveness of BI’s monetary policy (IMF 2017).

Daily FX transactions were about US$5 billion in 2016, equivalent to 0.6 percent of GDP. While the spot market is the most liquid segment of the FX markets, with daily turnover of about US$3.1 billion in 2016 (or 60 percent of total FX turnover), it is still smaller than those in other Asian emerging markets according to the 2016 Bank for International Settlements Triennial Central Bank Survey of FX and over-the-counter derivatives markets (Figure 11.4). The interbank FX market is largely oriented toward meeting non-financial customers’ currency demands underpinned by real economic needs. Because of relatively thin FX markets and some speculative activities, the rupiah exchange rate experienced a few incidents of volatility in 2013–14. BI has been focusing on development of FX markets to increase the flexibility of financial institutions to manage their exchange rate risk since 2014. The FX market turnover has gradually increased in 2015–17 in line with more complex products such as cross-currency swap and call spread options, and liquidity in the markets has been improving, with US dollar—rupiah bid-ask spreads narrowing.

Figure 11.4
Over-the-Counter Foreign Exchange Turnover, Turnover by Market Segment, April 2016


Note: Turnover is adjusted for local interdealer double-counting (that is, “net-gross” basis).

The bond market remains dominated by long-term government securities with low daily turnover of about Rp 14 trillion in 2016. Outstanding debt securities denominated in rupiah amounted to only about 18 percent of GDP in 2016 (see Figure 11.2). To mitigate short-term refinancing risk, the Indonesian authorities have focused on development of the long-term government securities market. This strategy has led to an increase in the average maturity of tradable public debt to more than nine years. Liquidity in the Indonesian government bond market is low because of the predominant buy-and-hold investment strategy for obtaining lucrative yields. Liquidity is far lower in the corporate bond market with daily turnover of less than Rp 1 trillion in 2016. The corporate bond market equates to less than 3 percent of GDP, two-thirds of which is accounted for by financial institutions; the rest is issued mainly by state-owned enterprises (SOEs).

Foreign ownership of government securities has been increasing in the past three years. Foreign investors hold about 39 percent of government securities denominated in local currency, one of the highest penetration rates among emerging markets (26 percent in Asia, on average). Foreign investors’ share is particularly significant in maturities of five years and longer. Banks are the second-largest group of investors, holding about 30 percent of tradable securities. Banks are currently the dominant holders of shorter maturities. Domestic pension funds’, insurance companies’, and mutual funds’ holdings of government bonds have increased since the introduction of a regulation in November 2016 (No.1/POJK.05/2016) requiring a minimum holding of government securities by institutional investors. The high share of foreign investors can be seen as a double-edged sword (Jeasakul, Kang, and Lim 2015). On the one hand, it promotes risk sharing with a diverse investor base. On the other hand, this combination of high foreign participation and shallow markets leaves Indonesia susceptible to capital flow reversals.

The Indonesian stock market is relatively small and has room for further development. The total number of listed firms in the market increased to 566 in 2017, even though it is still relatively small compared with Asian peers (806 in Malaysia and 750 in Singapore), and share turnover is quite low (Figure 11.5). Lipinsky and Ono (2014) point out noise trading—that is, stocks are not traded based on fundamentals—as a symptom of inefficient pricing in most stock markets in Asia, including Indonesia, and argue that improvements in the regulation of securities markets could enhance the role of stock markets as stable and reliable sources of financing.

Figure 11.5
Stock Market Turnover Ratio and Outstanding Balance of Local Corporate Bonds

Corporate financing through capital markets remains low. Government securities accounted for about 85 percent of outstanding debt securities, indicating that the bond market is not an important funding source for corporations and financial institutions in Indonesia. Although corporate bond issuance nearly doubled to Rp 116 billion in 2016 from Rp 58 billion in 2013, the development gap remains evident in the low outstanding amounts compared with its regional peers (Figure 11.6), as well as the small share of issuance by...
nonfinancial corporations and the short-term maturity profile. The low demand for corporate bonds is partly driven by concerns about weak insolvency and creditor rights regimes. Corporate financing through the stock market also remains low as reflected in the small number of companies issuing initial public offerings (16 firms a year, on average, during 2014–16). Ekberg and others (2015) note that corporations complain about inefficient bond issuance processes and costly regulatory filings and shareholder communications, quoting interviewers who point out that it takes about four to six months to finish the bond issuance process, or about two or three times longer than the normal issuance time in other members of the Association of Southeast Asian Nations.

**Figure 11.6.**
Financial Access in Asia, 2014

Source: World Bank, Global Findex Database.

Financing long-term investment, including in infrastructure projects and in human capital, remains a challenging issue given the limited financing capacity of the domestic financial system. Indonesia is currently at a crossroads. It needs structural reforms to boost long-term potential economic growth to ensure the growing working-age population can be absorbed into the economy at rising real wages, and to avoid falling into the middle-income trap. Corporations and households need long-term financing for undertaking fixed-investment projects, purchasing land and residences, and building human capital. In recent years, the government announced an ambitious plan to complete large-scale infrastructure projects that will require financing beyond what the budget and the domestic financial market can supply today. The banking sector plays an important role in providing long-term financing, but up to a certain limit because of regulatory requirements, its risk-averse business model, and the short-term funding structure. The development of capital markets to mobilize private long-term finance is needed to supplement traditional bank and fiscal channels.

**Credit Intermediation and Financial Inclusion**

The legacy of the AFC still affects credit and deposit penetration in Indonesia. Credit intermediation is lower, with private domestic credit amounting to 38 percent of GDP at the end of 2016, compared with 60 percent of GDP at mid-1997. Outstanding bank deposits were 38 percent of GDP at the end of 2016, about 10 percentage points lower than the pre-AFC level.

Access to the formal financial system and financial literacy have improved recently, although they are still quite low. About 36 percent of adults had transaction accounts with formal financial institutions in 2014, up from 20 percent in 2011, according to the Global Findex database (Figure 11.6). But that proportion is still low compared with the average (59 percent) among other emerging market peers in the region. The national financial literacy index was 29.7 percent in 2016, up from 21.8 percent in 2013, according to a survey in 2016 by the Financial Services Authority (OJK).

Financial access varies markedly across regions within Indonesia. Financial access is high in Jakarta, the political, economic, and financial capital of the country, but is low outside of Jakarta (Figure 11.7).

**Figure 11.7.**
Indonesia: Regional Financial Development, 2014

Source: Bank Indonesia; CEIC Data Co. Ltd.; and IMF staff calculations.

Bank intermediation is still inefficient in Indonesia, holding back financial inclusion. Given Indonesia’s bank-centric system, these inefficiencies have adverse implications for savings mobilization, credit intermediation, and financial inclusion. The World Bank (2017) finds that the small size of the banking system, weaknesses in the legal and institutional environment, high market power, and operational inefficiencies contribute to weak intermediation efficiency. The four largest banks, which account for about 45 percent of banking sector assets, have strong market power given their broad branch networks and niche financial services. Increased competition in the banking system would help lower domestic financing costs and potentially reduce reliance on direct cross-border borrowing.

Net interest margins, a commonly used measure of bank intermediation efficiency, are structurally higher in Indonesia than in many other emerging markets (Figure 11.8). The authorities’ policy measures to address high net interest margins appear unable to increase the efficiency of bank intermediation. These measures include caps on deposit rates, allegedly to discourage aggressive pricing behavior by some banks; moral suasion to induce banks to lower lending rates to single-digit levels, particularly for the corporate and mortgage segments; and requirements for all banks to meet minimum lending exposure quotas to micro, small, and medium-sized enterprises. These measures have not helped reduce the high net interest margins and have the unintended effects of distorting capital allocation and the pricing of risk, and thus are likely to negatively affect financial deepening and impede the effectiveness of monetary policy operations.

**Figure 11.8.**
Bank Net Interest Margin


Note: Peer countries are Brazil, Chile, China, India, Mexico, Malaysia, the Philippines, Russia, Thailand, Turkey, Vietnam, and South Africa. The expected median is a statistical benchmark based on a quantile regression applied to a global country database for the period 1980–2015 using a country’s structural characteristics, such as income, population size and density, age distribution, and whether it is an oil exporter or offshore financial market.
The use of digital financial services (DFS) has rapidly increased, and offers a promising channel for overcoming Indonesia’s unique geographical barriers to financial inclusion.\(^4\) The value of e-money transactions increased about 13 times from Rp 0.5 trillion in 2009 to Rp 7.1 trillion in 2016 (Figure 11.9).\(^5\) Surveys by PricewaterhouseCoopers (2017)\(^6\) highlight that, although branch channels still dominate, there is a clear and rapid trend of bank customer transactions moving to mobile and Internet. From 75 percent in 2015, the share of respondents who conducted more than half of their transactions through branches decreased to 45 percent in 2017. In contrast, the share of respondents who had at least one-fourth of transactions via mobile and Internet increased from 27 percent in 2015 to 48 percent in 2017.

**Figure 11.9.**
Financial Transactions via Cards and E-Money

![Figure 11.9](image)

Source: CEIC Data Co. Ltd.

Note: ATM = automated teller machine.

E-money transactions have quadrupled since 2015, albeit from a small base (Figure 11.9). Automated teller machines and debit cards continue to grow and dominate noncash transaction values and volumes, and e-money transaction values also continue to be very modest, close to Rp 2 trillion and well below 0.1 percent of GDP in 2017. In volume, however, the increase in e-money transactions is more noticeable because the average amount of the transactions is lower than with more traditional automated teller machine and debit card transactions. E-money tends to be used by lower-income individuals, including to receive social transfers, contributing to financial inclusion.

National Strategies for and Recent Progress Toward Financial Deepening and Inclusion

Promoting financial deepening and inclusion has been a priority of the government in recent years. Indonesia faces a challenging long-term finance and investment gap, particularly in infrastructure. Capital market development to mobilize private long-term finance is needed to supplement traditional bank and fiscal channels. The government has created a national council for financial inclusion and a high-level joint forum for financial deepening to promote interagency coordination. The national council, chaired by the president, adopted the National Strategy for Financial Inclusion (SNKI) in 2016.\(^7\)

The high-level joint forum is currently preparing an ambitious national strategy for financial market development. Figure 11.10 summarizes the draft national strategy to develop six financial markets in parallel—money, foreign exchange, bond, equity, sharia financial, and structured product markets. The strategy aims to allocate resources and manage risks efficiently through deep and liquid financial markets by developing market infrastructure and harmonizing regulations under close policy coordination. To promote successful implementation, the authorities will design a detailed multyear strategic action plan that has a quantitative target (size of each market as a percentage of GDP) along with key performance indicators through three separate phases (2017–19, 2020–22, 2023–24).

**Figure 11.10.**
Fundamental Framework for Financial Market Development

![Figure 11.10](image)


The authorities are taking steps to advance money market development. In August 2016, BI introduced a regular seven-day reverse repo operation with a fixed rate, full allotment, and the attached rate as the main policy rate. The interest rate corridor was narrowed to 150 basis points from 250 basis points. In July 2017, BI also launched partial reserve requirement averaging of 1.5 percent, out of the current 6.5 percent primary reserve requirement ratio, over a two-week period, allowing the floor of the reserve requirement ratio to be 5 percent on a given day. This reform has benefited small banks with liquidity shortages. BI already stopped issuing three-month-maturity securities with the regular three-month Treasury bill issuances by the Ministry of Finance. Issuance of Treasury bills has risen, providing more instruments at the short end of the yield curve. In addition, BI implemented a regulation regarding transactions of negotiable certificates of deposit and issuance of commercial paper in 2017 to support money market deepening and increase the variety of instruments for liquidity management.

The authorities have also taken significant steps to develop the repo market since 2013. An abridged domestic master repurchase agreement was first issued to boost the market and restore momentum to the process of creating an internationally compatible domestic agreement based on the international standard.\(^8\) However, after a promising start, the adoption of the abridged domestic agreement has not been able to attract most foreign banks, which continue to rely mainly on the FX swap market for liquidity management. Some small banks also still prefer funding their needs on the unsecured interbank market. In January 2016, the OJK launched the global master repurchase agreement, aimed at further developing the repo market and attracting all market participants. As of November 2016, 73 of 106 conventional banks had signed the global master repurchase agreement. To reduce market segmentation and promote the use of repo transactions, BI is currently undertaking a series of actions, including the organization of seminars and workshops on the adoption of the global master repurchase agreement and trading of repo operations. The settlement of repo operations ensures the transfer of property of the underlying collateral.\(^9\) Market associations are in the process of drafting the determination of the haircut.

To spur FX market development, BI has overhauled its FX regulatory framework. In 2014, the scope of operations acceptable as underlying transactions for derivatives transactions was expanded. In September 2015, BI changed the threshold for providing underlying transactions for FX forward sales from US$1 million to US$5 million equivalent per transaction. For FX hedging, BI issued regulation No. 18/18/PBI/2016 regarding FX against rupiah transactions between banks and domestic parties, and No. 18/19/PBI/2016...
dispersed over thousands of islands, Indonesia needs to overcome geographical challenges with financial
culture, an efficient price mechanism, enhanced regulatory and supervisory frameworks, robust financial
management, and intermediate payments and transactions. To provide more efficient and safer financial
services that finance consumption and investment, support wealth and risk
management, and mitigate risks to the financial system. The OJK has established an internal cross-departmental group to promote sustainable growth of fintech
and the implementation of single investor identification for government bonds. Initiatives being implemented include development of infrastructure for third-party repo transactions and the establishment of an electronic trading platform for bonds.

The two agencies have been providing financial education to enhance financial literacy. Financial literacy
education activities were implemented in 144 cities. The targeted participants for all these programs include households, MSMEs, farmers and
fishermen, high school and university students, employees, and retirees. Between 2013 and 2016, 289
financial education activities were implemented in 144 cities.

Source: Coordinating Ministry for Economic Affairs 2016.

The authorities have made progress in enhancing interagency coordination to develop capital markets.
Substantial cross-agency coordination and private sector consultation occurs through the Capital Market Infrastructure Development Program Team and the Bond Market Development Program Team. These initiatives have been instrumental in various positive reforms, including development of a capital market
data warehouse and the implementation of single investor identification for government bonds. Initiatives being implemented include development of infrastructure for third-party repo transactions and the establishment of an electronic trading platform for bonds.

The 2016 National Strategy for Financial Inclusion (NSFI) has raised the profile of the financial inclusion
agenda (Figure 11.11). The NSFI has five pillars—financial education, public property rights, expansion of financial products, distribution of government transfers, and consumer protection—supported by three foundations, comprising conducive policies and regulations, supportive information technology and infrastructure, and effective coordination and implementation. The strategy has an ambitious goal of achieving 75 percent of adults with a transaction account by the end of 2019. Before the launch of the NSFI, the government established the People’s Business Loan (Kredit Usaha Rakyat, or KUR) program in 2007 to enhance access of micro, small, and medium-sized enterprises (MSMEs) to bank loans through the provision of subsidized, partial credit guarantees covering 70 percent of the loss. Under the program, the government provides interest subsidies to participating banks, allowing them to lend to MSMEs at capped interest rates. The KUR supported outstanding loans of Rp 53 trillion in August 2017.

The fintech sector has expanded rapidly in recent years and attracted about US$15 billion in investments in 2016. BI has established a fintech office, and the OJK has established an internal cross-departmental group to promote sustainable growth of fintech
and mitigate risks to the financial system. The OJK issued a regulation on peer-to-peer lending and proposals to establish a fintech incubator in 2016. BI issued a regulation in December 2016 on fintech
players in payment and transaction processing services, such as e-money, card-based payment
instruments, e-wallets, and payment gateways. The authorities also intend to establish a regulatory sandbox
where innovators can operate on a limited basis under the authorities’ supervision without having to worry
about tripping over regulatory issues.

The two agencies have been providing financial education to enhance financial literacy. Financial literacy
helps people make economic decisions more wisely and thus also enhances market discipline and financial
stability. Soedarmono and Prasetyantoko (2017) find that individuals with higher financial literacy
are associated with higher demand for bank credit. The study argues that higher demand for formal
financial services is positively driven by the availability of publicly disseminated information about the services, highlighting the importance of widening public awareness programs in Indonesia. OJK (2017) notes that financial education has been provided through several types of activities, such as community
education, outreach programs, general lectures, public service advertising, education expos, and mobile
theater. The targeted participants for all these programs include households, MSMEs, farmers and
fishermen, high school and university students, employees, and retirees. Between 2013 and 2016, 289
financial education activities were implemented in 144 cities.

Financial development strategies should aim to provide wide-ranging, efficient, and safe financial services
that can overcome geographical barriers. The financial sector—comprising institutions and markets—
provides extensive financial services that finance consumption and investment, support wealth and risk
management, and intermediate payments and transactions. To provide more efficient and safer financial
services, an improvement to financial institutions and markets is required, supported by a strong credit
culture, an efficient price mechanism, enhanced regulatory and supervisory frameworks, robust financial
safety nets, and strong financial infrastructure. To increase the financial access of a large population
dispersed over thousands of islands, Indonesia needs to overcome geographical challenges with financial
The authorities are making progress toward achieving the goal, but it will be essential to prioritize strategic actions effectively. The authorities’ progress in developing a national strategy for capital market development is commendable, and reflects high-level political support and enhanced interagency coordination. Priority should be given to improving fundamentals for financial deepening and inclusion, as recommended in IMF (2017), including the following elements:

- Strengthening credit culture and financial infrastructure
- Upgrading the supervisory and regulatory framework along with financial market development
- Establishing a liquid benchmark yield curve
- Promoting long-term financing with new financial instruments
- Expanding the domestic investor base
- Supporting financial innovation while preserving financial stability
- Enhancing financial literacy

A stronger credit culture and improved financial infrastructure are important for sustainable financial development. Provision of financial services is essentially based on financial contracts that need to be effectively enforced through strong financial infrastructure (such as an insolvency and creditor rights [ICR] regime, a public credit registry and private credit bureaus, and collateral registries). For example, an effective credit registry and credit bureaus would mitigate information asymmetries and enhance financial institutions’ ability to conduct credit risk assessments. The authorities improved the use of movable collateral by moving toward an online collateral registry in 2013. The transformation from manual to online resulted in a huge increase in the number of total registrations (World Bank 2017). The introduction of a credit registry and the recent licensing of private credit bureaus were positive steps toward improving the credit culture. Current Indonesian ICR legislation is a significant improvement over pre-2004 laws, but out-of-court restructuring is still the preferred method. Efforts can be stepped up to operationalize the credit registry and bureaus, and to continue to improve ICR regimes. The authorities should also review the effectiveness of the KUR program, including its potential fiscal costs and whether it is achieving increased lending to new borrowers, as recommended in IMF (2017).

The supervisory and regulatory framework needs to evolve along with financial market development. The authorities have stepped up the regulatory and supervisory framework. To reduce the silo structure in financial oversight, which will require changes to the OJK law, the OJK has established a new department for integrated supervision (the Integrated Supervisory and Regulatory Department), which brings internal coordination directly under the authority of the chairman. The OJK should also tackle its silo structure formally through amendment of its law and strengthen financial oversight and the enforcement of prudential regulations, including with respect to financial conglomerates. Another priority includes eliminating interest rate caps, which will help improve monetary policy transmission. Portfolio exposure targets, including minimum MSME exposure targets and the minimum investment requirement on government bonds and infrastructure-related SOE bonds on nonbank financial institutions, could be reviewed. Measures that directly address market failures would be more appropriate for promoting MSME financing. The existing regulatory requirement may distort banks’ risk business models and undermine their risk-management practices. Countries have taken a variety of approaches, including provision of guarantees on MSME lending, improvement of credit bureaus, and development of joint venture financing.

Continued efforts are needed to build a liquid benchmark yield curve. The Ministry of Finance observes good practices regarding its issuance program, including market communication and auctions. Benchmark securities of 5-, 10-, 15-, and 20-year maturities are perceived to be reasonably liquid, but liquidity is thin in shorter segments of the yield curve. BI has stopped issuing securities of three-month maturities with the regular three-month Treasury bill issuances by the Ministry of Finance. Further improvements can be considered to better anchor the short end of the yield curve, including (1) the gradual move to further reduce average maturity planned; (2) the gradual consolidation of BI liquidity-management instruments to support the move to the mid-corridor system; and (3) the maintenance of regular issuance of Treasury bills to avoid competition between BI instruments and Treasury bills of the same maturities.

The authorities have been mobilizing private long-term financing with new financial instruments, but there is scope for further improvement. The development of capital markets to mobilize private long-term finance is needed to supplement traditional bank and fiscal channels. The government has sought to fund infrastructure projects by issuing SOE bonds and structured products (for example, asset-backed securities) in addition to traditional bank funding. It will be important to ensure that these products are introduced without compromising prudential standards or creating undue risk in the form of high and concentrated exposures to infrastructure-related instruments or SOE debt on the balance sheets of financial institutions. Also, the development of FX and derivatives markets is important to support the development of bond and stock markets, because FX and derivatives markets help market participants hedge risk exposure in their holdings of debt and equity securities.

Enlargement of the domestic investor base should go hand in hand with the expansion of capital markets. The paucity of domestic institutional investors is not just a constraint on capital market development but also a source of vulnerability in the financial system. Institutional investors, in addition to serving as major asset holders, could help provide market liquidity and act as market stabilizers because capital market development would broaden their investment opportunities. They can also help intermediate large national savings domestically and thus mitigate the heavy reliance on foreign funding. Therefore, developing a critical mass of long-term institutional investors will be important to support economic development as well as financial market deepening. Improved financial literacy and initial public offering distribution could
enhance retail investors’ participation, helping diversify the investor base. Also, greater participation by domestic institutional and retail investors in capital markets requires an overhaul of the tax and regulatory framework for financial products and improvements in hedging instruments (World Bank 2017).

Financial innovation needs to accompany financial stability. BI and the OJK could step up their oversight activities of DFS and fintech, and expand collaboration to fully monitor and ensure the safety, efficiency, and reliability of these services. In particular, they should engage the telecommunications regulator and payment system operators to enhance the operational reliability of DFS. Continuing to improve communication infrastructure would reduce operational risks and sustain the confidence of agents and customers.

The authorities should continue to raise the public’s financial literacy, especially about DFS, through education. The OJK needs to continue its seminars, short training courses, and workshops targeted at diverse groups of people. Youth education in a school context would substantially strengthen progress toward a financially literate society. In addition, the authorities could consider launching a nationwide campaign, in partnership with financial institutions, to spread awareness of DFS.

Conclusion

The development of Indonesia’s financial markets has been slow, and financial access is currently low. The size and depth of financial markets has not increased since the AFC, while some of Indonesia’s regional peers (for instance, Malaysia and Thailand) have made progress. The financial system, however, has the potential to evolve and support inclusive growth. To fulfill this potential, participants in Indonesia’s financial system need to exert collaborative efforts to meet the increasing demand for financial services of its vast population and finance its large infrastructure needs. Financial markets are gradually moving in the right direction to strengthen financial intermediation, and technological innovation is offering a promising channel for overcoming Indonesia’s unique geographical barriers to financial inclusion.

The authorities’ efforts to promote financial deepening and inclusion are commendable. The authorities issued a national strategy for financial inclusion in 2016, targeting a population group in rural and remote communities without financial access. This strategy helps the public and private agents identify inclusion gaps, strengthen national attention, and facilitate interagency coordination. The authorities are also preparing an ambitious national strategy for financial market development and have already begun to tackle challenges in several financial markets in parallel, reflecting high-level political support and enhanced inter-agency coordination.

To achieve financial deepening and greater inclusion, Indonesia should continue to strengthen fundamentals, including upgrading the supervisory and regulatory framework along with financial market development, establishing a liquid benchmark yield curve, promoting long-term financing with new financial instruments, expanding the domestic investor base, supporting financial innovation, and enhancing financial literacy. These changes, however, should not give rise to undue financial stability risks. Policy coordination strengthening should also continue.

Advancing Financial Inclusion through FinTech in ASEAN. Takehiko Nakao, President Asian Development Bank. ASEAN Finance Ministers’ and Central Bank Governor’s Joint Meeting (AFMGM) 6 April 2018 | Singapore. New technologies driving changes. 3D printing Artificial intelligence and robotics The Internet of Things. ■Cllillmaetkee reesssillieneetnt. 3. Leveraging digital platforms and mobile technologies to offer Inclusive financial services. 1 billion. adults have no bank account in developing Asia. 3.7 billion. have a mobile phone. Source: Word Bank, Global Financial Inclusion Database and World Development Indicators. 4. ADB support for financial inclusion using fintech. 5. SME financing: Technology enabled credit scoring system in. Greater Mekong Subregion. Deep financial inclusion. We believe CBDCs are essential in establishing payment networks and stimulating economies at the local level. We aim to work with central banks to achieve our goal of deep financial, economic and social inclusion. What is deep inclusion? Well, we believe that the work of financial inclusion isn’t done when someone in a rural village or emerging economy can make payments. We intend to use CBDC to support grassroots and community initiatives and stimulate local economies. Why CBDC? Blockchain technology offers an opportunity to digitise cash and preserve its

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This chapter was prepared by Heedon Kang with contributions from Phakawa Jeasakul, Mariam El Hamiani Khatat, and Cormac Sullivan.

1 The size of the domestic bond and stock markets continues to increase, standing at 18 percent and 48 percent of GDP, respectively, in July 2017.

2 The authorities established a primary dealers system and a trading structure that supports transactions in a range of long-term government bonds. The annual auction calendar is announced at the beginning of each year and defines the securities to be sold at each auction.

3 Minimum 20 percent of total investment at the end of December 2016, and 30 percent at the end of December 2017.

4 A sudden and sizable pullback by foreign investors usually triggers market turmoil and a spike in risk premiums. IMF (2014) also notes that portfolio flows are likely to become more sensitive to global financial conditions.

5 The term DFS is defined in Indonesia as tailored financial services and products delivered through channels other than traditional bank branches.

6 E-money is a noncash payment instrument that satisfies the following features: (1) issued on the basis of the value of money paid in advance by the holder to the issuer; (2) the value of money stored electronically in a medium such as a server or a chip; (3) used as a means of payment to merchants that are not the issuer of the electronic money; and (4) the value of electronic money deposited by the holders and managed by the issuer does not represent deposits as defined by the laws regulating the banking sector. Prepaid cards or e-wallets are the main form of e-money operated by banks, telecommunication companies, and transportation companies such as Go-Jek.

7 Other countries in the region have also formulated or are in the process of formulating financial-inclusion
Advancing Financial Inclusion through FinTech in ASEAN. Takehiko Nakao. President Asian Development Bank. ASEAN Finance Ministers’ and Central Bank Governor’s Joint Meeting (AFMGM) 6 April 2018 | Singapore.

New technologies driving changes. 3D printing, Artificial intelligence, and robotics, The Internet of Things.

Leveraging digital platforms and mobile technologies to offer Inclusive financial services. 1 billion adults have no bank account in developing Asia. 3.7 billion have a mobile phone. Source: World Bank, Global Financial Inclusion Database and World Development Indicators.

ADB support for financial inclusion using FinTech. 5. SME financing: Technology enabled credit scoring system in the Greater Mekong Subregion. Deep financial inclusion. We believe CBDCs are essential in establishing payment networks and stimulating economies at the local level. We aim to work with central banks to achieve our goal of deep financial, economic, and social inclusion. What is deep inclusion? Well, we believe that the work of financial inclusion isn’t done when someone in a rural village or emerging economy can make payments. We intend to use CBDC to support grassroots and community initiatives and stimulate local economies. Why CBDC? Blockchain technology offers an opportunity to digitise cash and preserve its main feature.