Section 5

Monetary and Financial Factor: Credible Monetary Policy Track Record and Favourable Financial Sector

Bank Indonesia Policy Mix: May 2017

BANK INDONESIA
BANK SENTRAL REPUBLIK INDONESIA

The BI Board of Governors agreed on 18 May 2017 to hold the BI 7-days Repo Rate at 4.75%, as well as the Deposit Facility at 4.00% and Lending Facility at 5.50%

- Holds the BI 7-day Repo Rate at 4.75%
- Remains vigilant of the various global risks, including the proposed Fed Fund Rate (FFR) hike, US fiscal and trade policies, planned reduction to the Fed's balance sheet as well as geopolitical condition in various regions, especially the Korean Peninsula
- Predicts the domestic economy to grow in the range of 5.0-5.4% (yoy) in 2017, underpinned by stronger export and investment performance as well as tenacious consumption
- Continues to stabilize rupiah exchange rates, however, in line with the currency's fundamental value, while maintaining market mechanisms
- Continues to strengthen coordination with the Government to control inflation in the face of several risks, including adjustments to administered prices (AP) as part of the Government's energy reforms, as well as the risk of rising volatile food prices during the approach to the holy fasting month of Ramadan
- Predicts credit and deposit growth accelerate to 10-12% and 9-11% respectively in 2017, congruent with the expected economic gains and ongoing impact of monetary and macroprudential policy easing

Bank Indonesia Policy Mix: 2015-2017

18 Jun 2015
- Increase the Loan-to-Value (LTV) ratio
- Reduce down payments for automotive loans

26 Jun 2015
- RR-LDR → RR-LFR
- Accomodate banks SMEs loan in RR calculation

17 Nov 2015
Lowering IDR Primary RR by 50bps from 8.0% to 7.5%. Effective since 1 Dec 2015

14 Jan 2016
- Cut BI Rate 25 bps to 7.25%, DF & LF Rate at 5.25% & 7.75%
- BI lower its monetary operation rates even further, ranging from 25bps to 45bps (O/N to 1Y)

18 Feb 2016
- Cut BI Rate 25 bps to 7%, DF & LF Rate at 5% & 7.5%
- BI lower the rupiah denominated primary reserve requirement by 1%, from 7.5% to 6.5%, effective from Mar. 16th 2016

18 Mar 2016
Cut BI Rate 25 bps to 6.75%, DF & LF Rate at 4.75% & 7.25%

21 April 2016
- Held BI Rate at 6.75%, and maintained DF & LF Rate at 4.75% & 7.25% respectively.
- Reformulated policy rate from BI Rate into the 7 day (Reverse) Repo Rate to improve the effectiveness of monetary policy transmission. The change was effective on Aug. 19th 2016

16 Jun 2016
- Cut BI Rate 25 bps to 6.5%, DF & LF Rate at 4.5% & 7.0% respectively
- Relaxed the loan-to-value ratio (LTV) and financing-to-value ratio (FTV) on housing loans/financing
- Relaxed partially prepaid loans/financing
- Raised the floor on the Reserve Requirement - Loan to Funding Ratio (RR-LFR) from 78% to 80%, with the ceiling maintained at 92%. The change was effective on Aug. 2016

21 Jul 2016
- Held BI Rate at 6.5%, & maintained BI 7-day RR Rate, DF & LF Rate at 5.25%, 4.5% & 7.00% respectively.
- BI continued to conduct financial market deepening by introducing new investment & hedging products in the financial market, strengthened monetary management strategies, & encouraged the real sector to make optimal use of repatriation funds to support the implementation of the 2016 Tax Amnesty Law

19 Aug 2016
- Held BI 7-day RR Rate and DF Rate at 5.25% and 4.5%
- Cut LF Rate to 6.00%.

22 Sep 2016
Cut BI 7-day RR Rate to 5.0%, DF and LF Rate to 4.25% and 5.75%.

20 Oct 2016
Cut BI 7-day RR Rate to 4.75%, DF and LF Rate to 4.00% and 5.50%

17 Nov – 15 Dec 2016
Held BI 7-day RR Rate at 4.75%, DF Rate at 4.00% and LF Rate at 5.5 %

19 Jan – 18 May 2017
Held BI 7-day RR Rate at 4.75%, DF Rate at 4.00% and LF Rate at 5.5 %

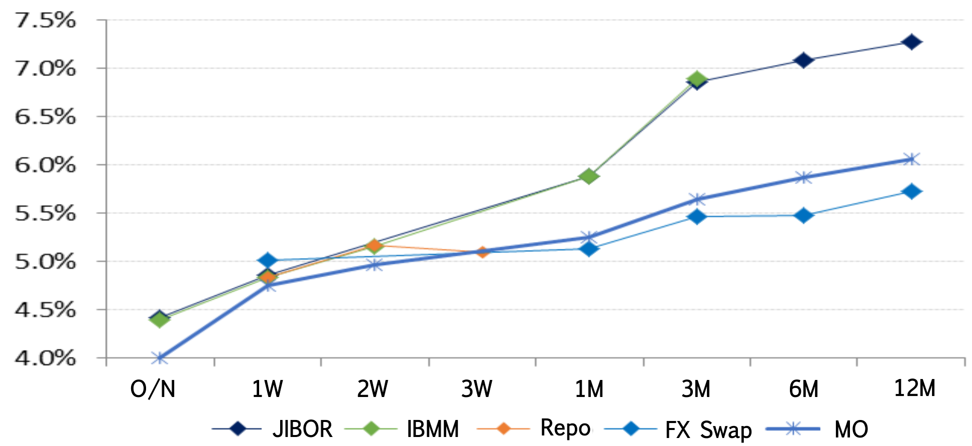
Enhancement of Monetary Operations Framework

...positive results thus far

Monetary operation term structure is being referred by money market rates

Domestic money market yield curve tend to converge

Domestic Money Market Yield Curve (2nd week of May 2017)



IBMM: Interbank Money Market MO: Monetary Operation

1. STRENGTHENED THE ROLE OF JIBOR AS REFERENCE RATE by regulatory enhancement.
2. ACCELERATED MARKET REPO TRANSACTIONS by promoting GMRA
3. REDUCED SEGMENTATION AND IMPROVE THE CAPACITY OF MARKET TRANSACTIONS by encouraging banks to open more access to counterparties — IN PROGRESS
4. MOVING FROM FIXED RATE TENDER (FRT) TO VARIABLE RATE TENDER (VRT)

PREVIOUS JIBOR

- Can be traded among contributor banks for 10 minutes.
- Up to the amount of Rp10 billion.
- Up to 1-month tenor.

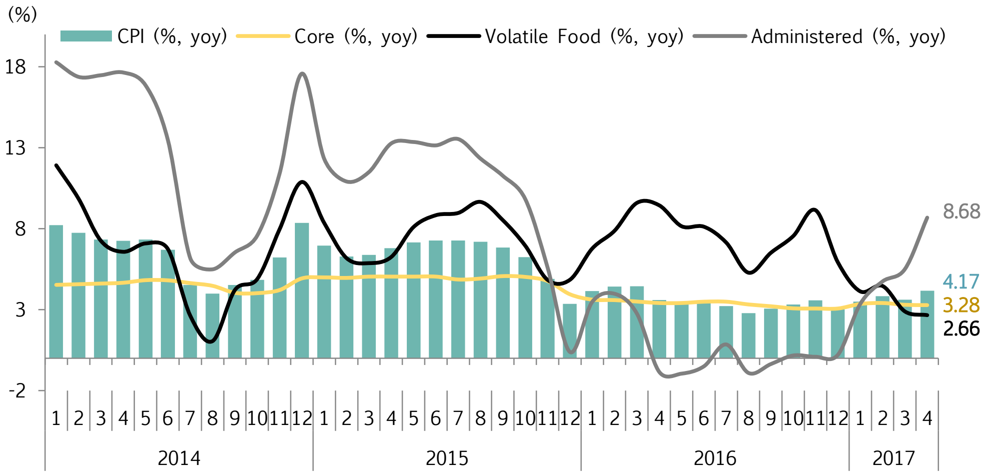
CURRENT JIBOR (as per June 1st, 2016)

- Can be traded among contributor banks for 20 minutes.
- Up to a total of Rp20 billion.
- Up to 3-month tenor.

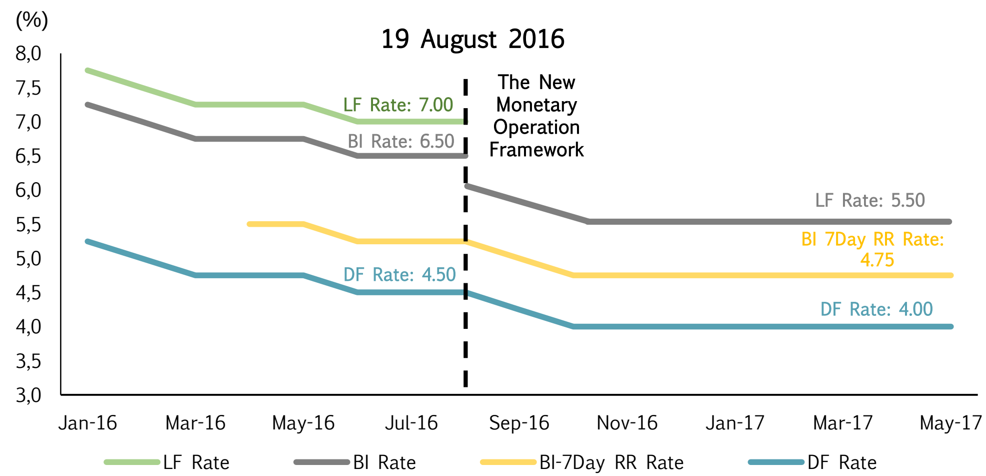
Source: Bank Indonesia

Stable Monetary Environment Despite Challenges

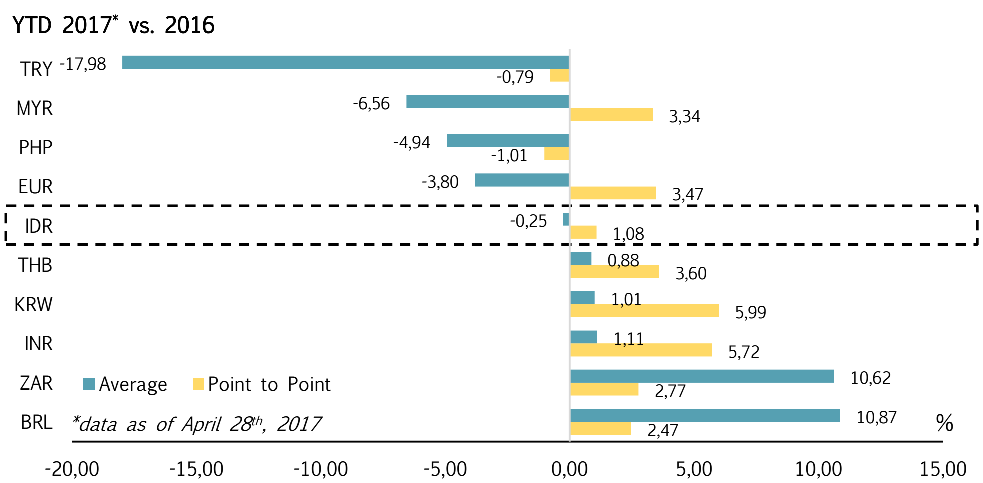
Downward Trend of Inflation Ensured Price Stability



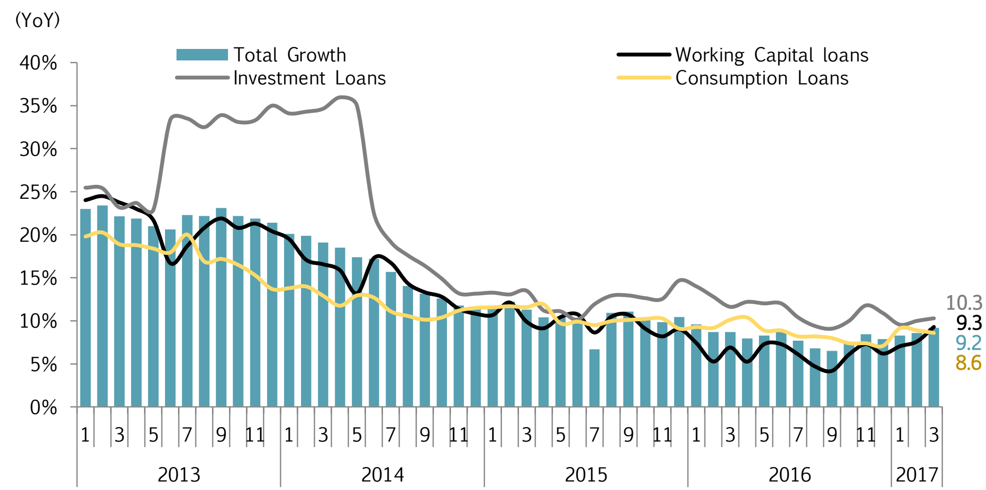
Strengthened Monetary Policy Framework



Rupiah Exchange Rate Remains Comparable to Peers



Credit Growth Supported by Macroprudential Policy



Source: Bank Indonesia

6 Measures to Control Inflation in 2017

On January 25th, 2017, the Government and Bank Indonesia agreed on six strategic measures to control inflation in 2017 within the target corridor of 4±1% (as well as in 2018 at 3.5±1%), while also setting the inflation targets for 2019-2021 at 3.5±1%, 3±1% and 3±1% respectively.

1 Maintaining volatile food (VF) inflation at 4-5% by:

- Strengthening infrastructure for food logistics in local areas, particularly warehousing for storage
- Developing a commodity flow data system, specifically for food commodity
- Utilising fiscal instruments and incentives to extend the local government's role in price stability
- Encouraging diverse food consumption in the community, especially of fresh chillies and alliums, by fostering product innovation in the processed foods industry
- Strengthening interregional cooperation
- Accelerating connectivity infrastructure development
- Improving planting patterns

2 Dampening the second-round effect of Administered Price adjustments

Example:
Controlling transportation fares

3 Introducing Administered Price Sequencing

Including the planned conversion of several direct subsidies to cash transfers (fertilizer, rice for the poor and 3kg LPG)

3kg

4 Establishing the National Inflation Control Team

Through Presidential Decree to strengthen the National Inflation Task Force (TPI) and Regional Inflation Task Forces (TPID)

5 Strengthening central and local government coordination

Through Eighth National TPID Coordination Meeting in July 2017

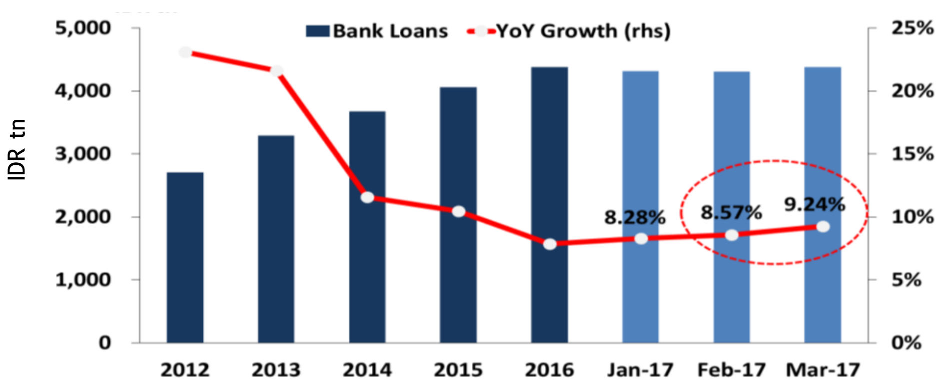
6 Strengthening the Bank Indonesia policy mix to maintain macroeconomic stability

Those measures are needed to address several onerous domestic and external challenges that demand vigilance and early mitigations. The external challenges mainly stem from rising international commodity prices, while the domestic challenges stem from ongoing energy reform through adjustments of electricity tariffs for 900VA subscribers as well as fuel prices as the global oil prices continues to rise. The current aforementioned reform is warranted to ensure equitable development and to create more healthy fiscal space.

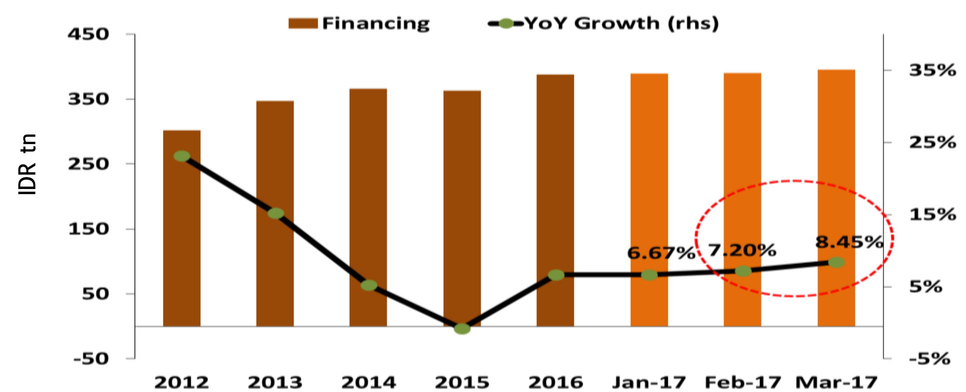
Financial Intermediation Improves in Early 2017

The growth of banking loans improved in early 2017, and is expected to further expand by 9-12% this year. In the domestic capital markets, capital raising by corporations (particularly right issues and corporate bond issuance) remained strong.

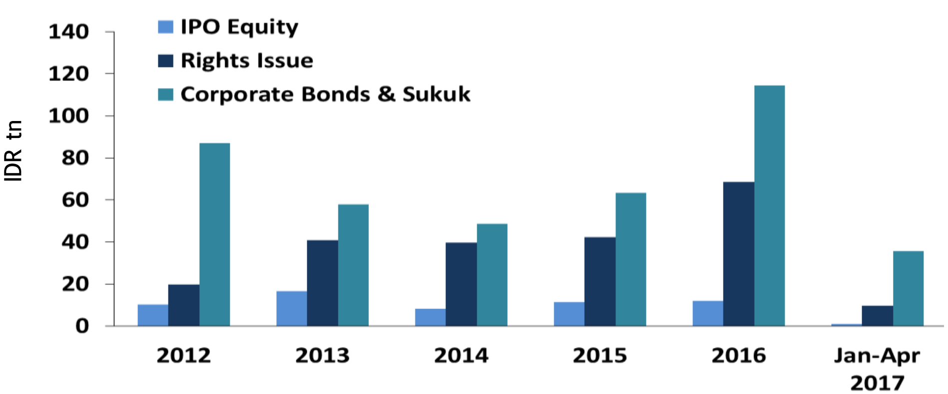
The growth of banking loans was 9.24% *(yoy)* in March 2017



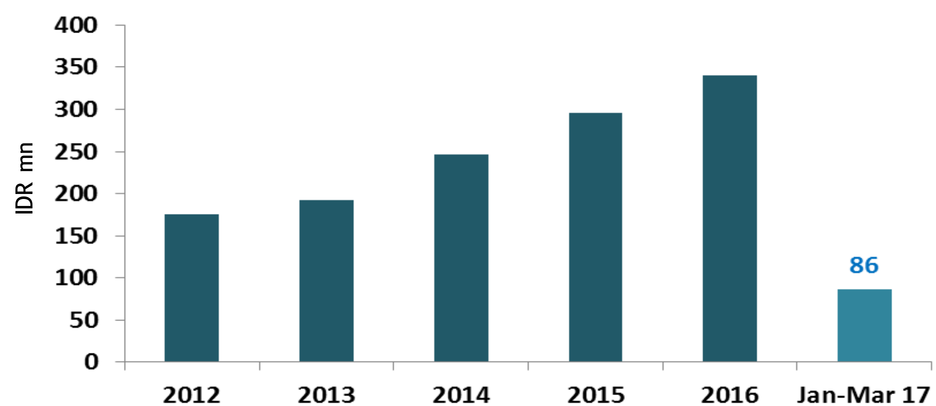
The growth of financing distributed by multifinance companies in March 2017 was still in an increasing trend



Capital raising through rights issues & corporate bond issuance in Jan-Apr 2017 increased from the same period last year



Gross premium revenue in the domestic insurance industry also demonstrated a continuous growth

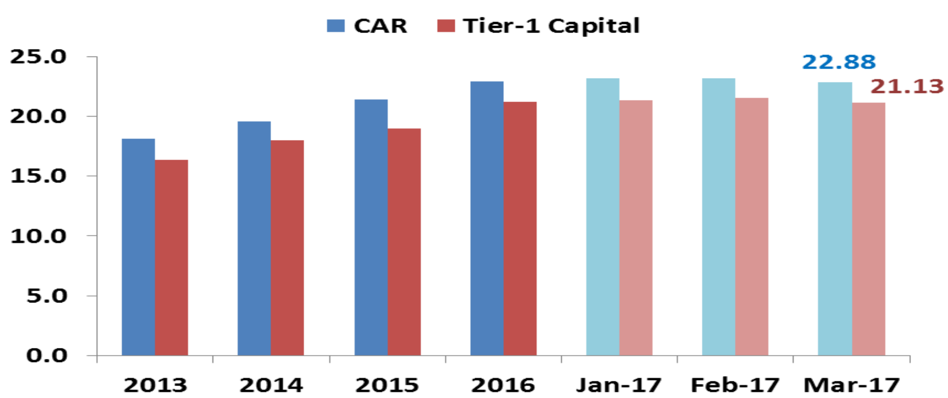


Source: Financial Service Authority (OJK)

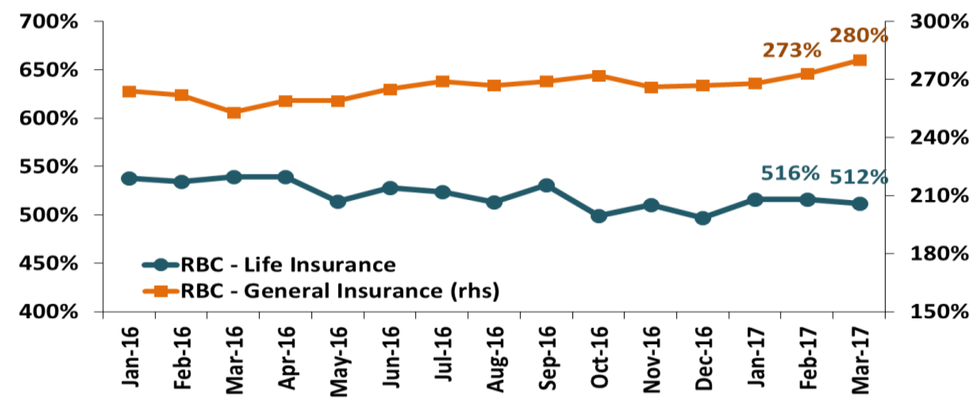
Financial Institutions Remain Robust and Less Vulnerable

Financial performance of domestic financial institutions generally remains robust. Capital adequacy is well above the minimum requirements. Profitability and leverage are maintained at a sufficient level. Further, gearing (debt-to-equity) ratio of multifinance companies provides ample room for future growth.

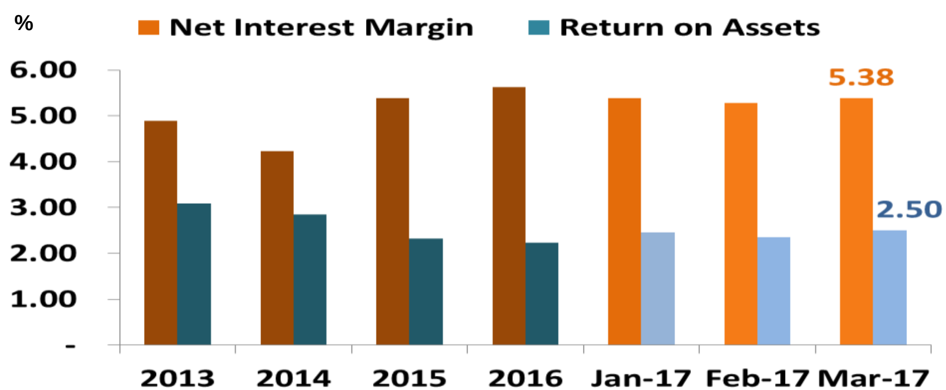
Banking sector's capital adequacy ratio (CAR) was maintained at a high level. As of Mar-17, CAR & Tier 1 Capital was 22.88% & 21.13% respectively



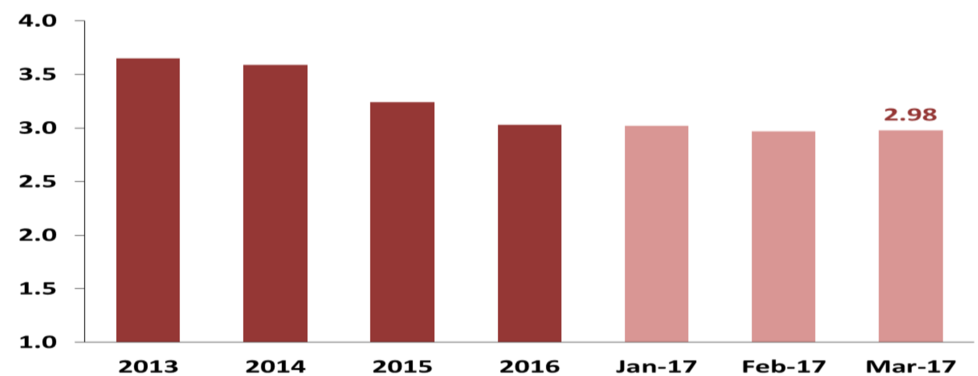
Risk-based capital (RBC) of the insurance industry also remains high, well above the minimum threshold (120%)



Profitability of the banking sector is relatively stable



Gearing ratio of multifinance companies was 2.98 times (well below the maximum requirement of 10 times), providing ample room for future growth

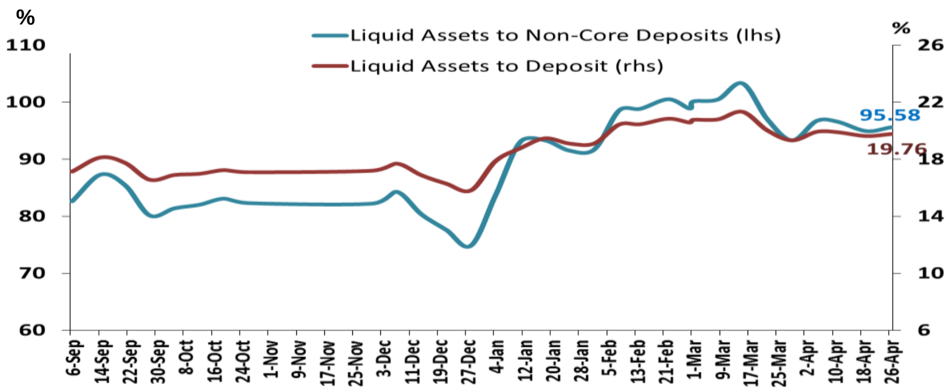


Source: Financial Service Authority (OJK)

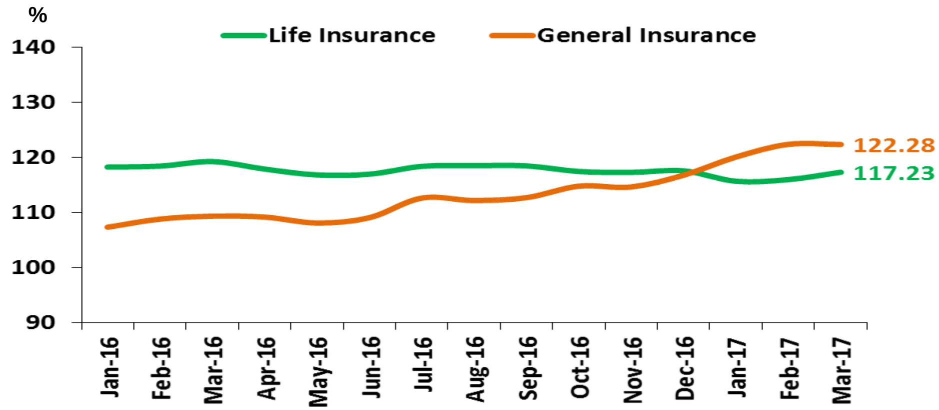
Adequate Liquidity, Manageable Credit Risks

Banks are found to possess adequate liquid assets to anticipate depositors' withdrawal. Insurance industry also demonstrates an enhanced level of investment adequacy ratio. The non-performing loan/financing (NPL/NPF) ratio is also maintained below the threshold.

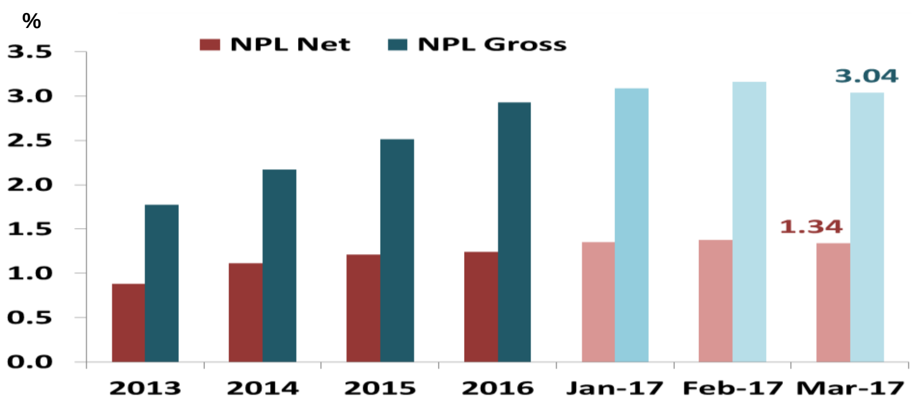
The ratio of liquid assets to deposits in the banking sector was well maintained at a high level.



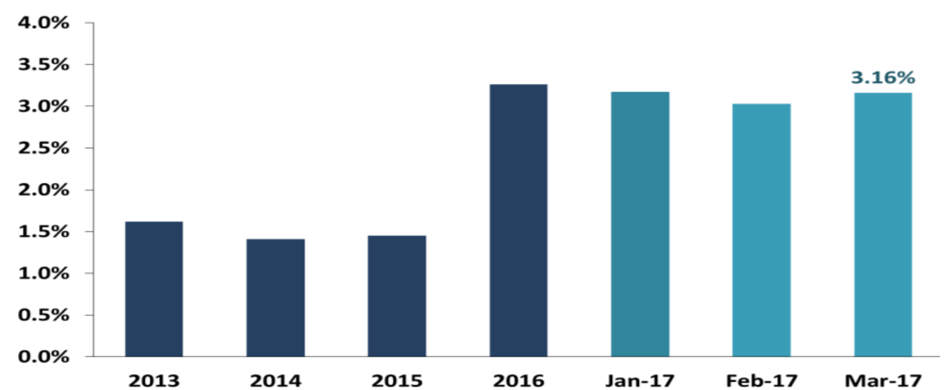
Investment adequacy ratio in the insurance industry is maintained above 100%



As of Mar-17, the gross & net NPL ratios of the banking sector were 3.04% & 1.34% respectively, maintained below the threshold



NPF ratio in the multifinance industry was 3.16% as of Mar-17, maintained well below the 5% threshold

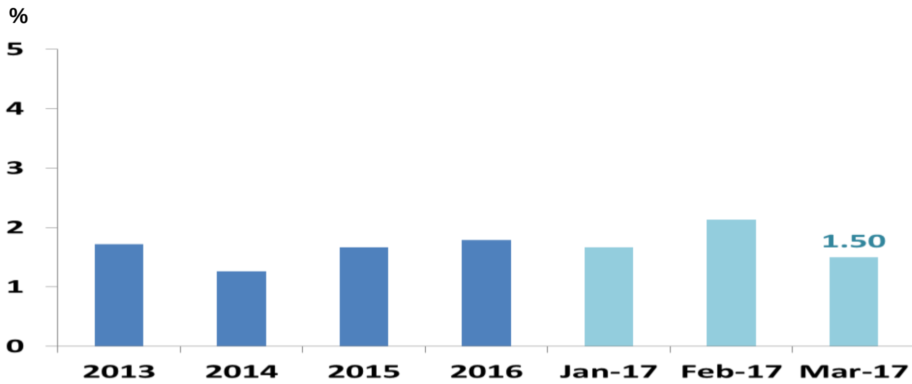


Source: Financial Service Authority (OJK)

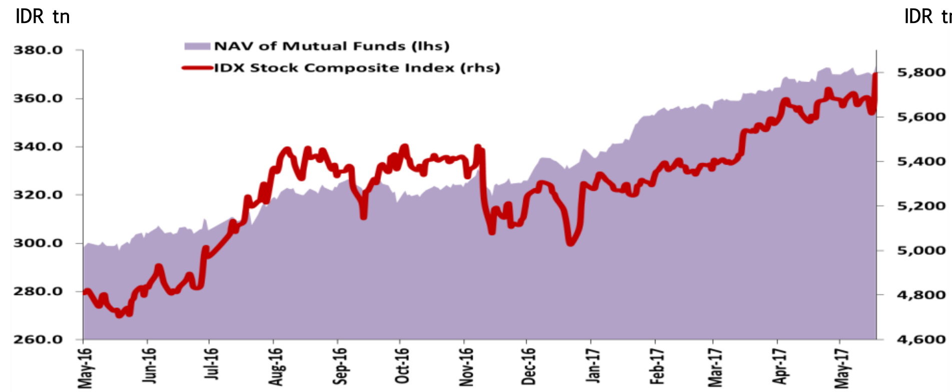
Manageable Market Risk Amidst Fluctuations

Being exposed to market fluctuations, financial institutions demonstrated resiliency in dealing with such risks. Net open position of the banking sector remains low, while the investment value of domestic institutional investors (mutual funds, insurers, and pension funds) continues to increase.

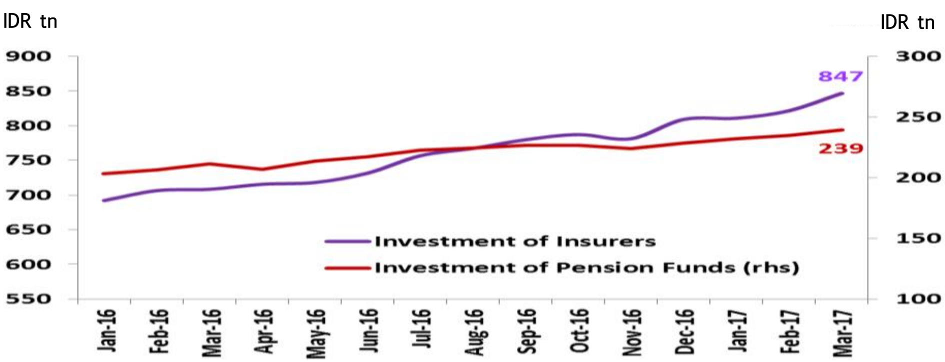
Net open position in the banking sector was kept far below the maximum limit (20%)



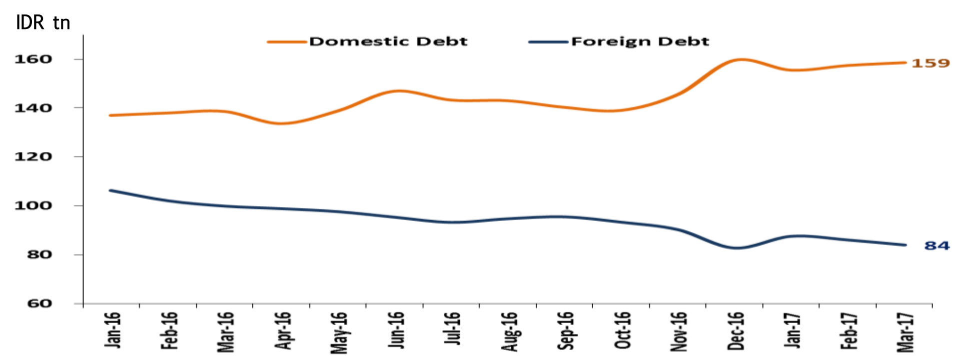
The movement of mutual funds' net asset value (NAV) is in line with that of market index, but with much lower volatility



The investment value of insurers & pension funds remained in an increasing trend



Multifinance companies' exposures to foreign debt have generally been mitigated through hedging measures

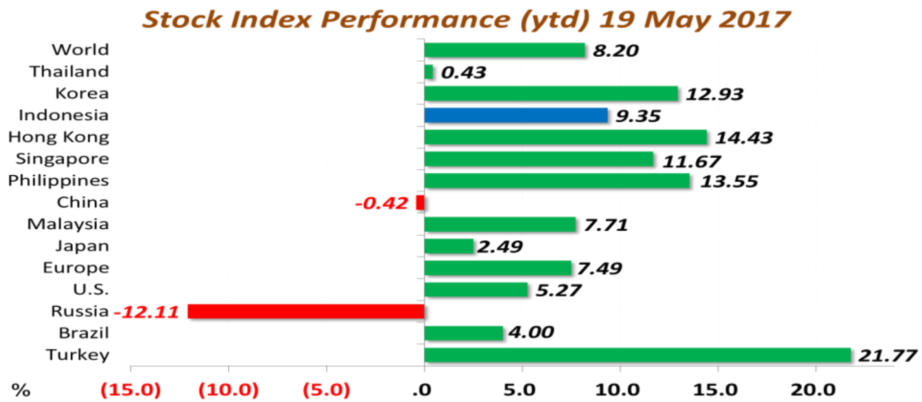


Source: Financial Service Authority (OJK)

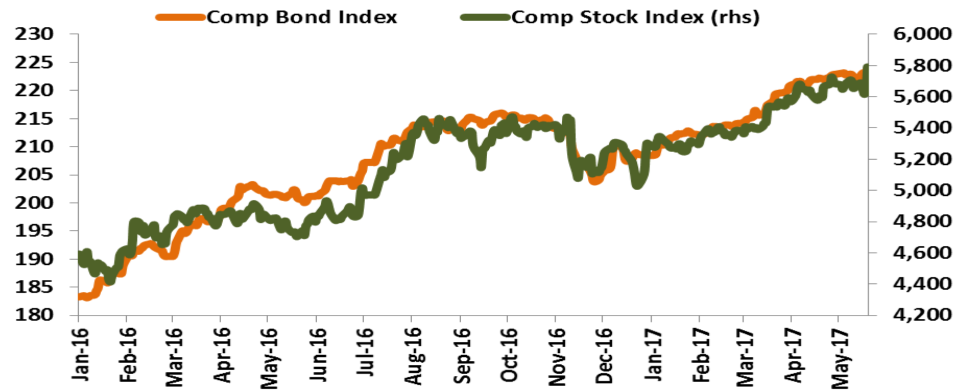
Capital Market Demonstrate Strengthening Trend

The domestic capital markets continued to demonstrate a strengthening trend, amidst uncertainties in the global economy and financial markets. This strengthening trend was accompanied by significant nonresident inflows in the government debt market.

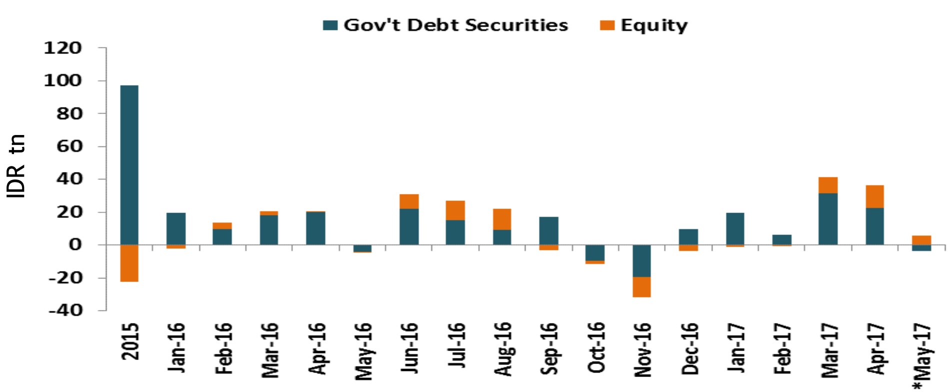
The IDX Stock Composite Index continues to strengthen and is among the best-performing indices in the region (ytd)



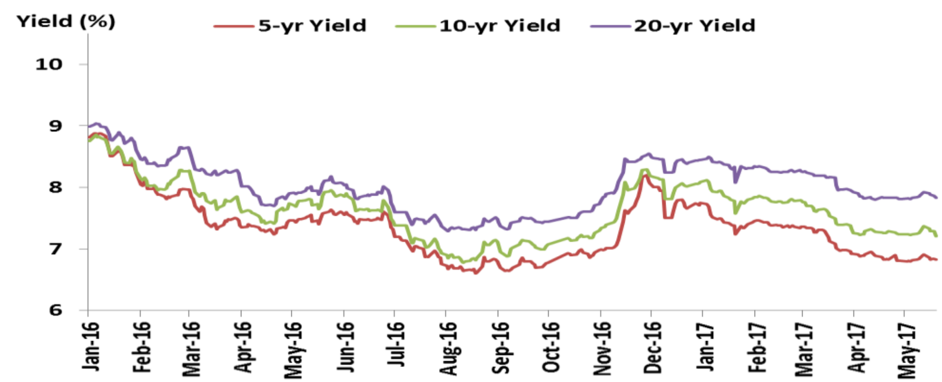
Both the stock & bond markets are in a strengthening trend in May 17, with a low level of volatility



Despite FFR hike, the equity and government debt markets still attract nonresident inflows



In line with the stabilizing IDR and improving domestic prospects, the government bond yields continued to decline



Source: Bloomberg, IBPA, Indonesia Stock Exchange, Ministry of Finance

Maintaining Financial System Stability

...maintaining resilience in confronting possible shocks and enhancing financial system stability

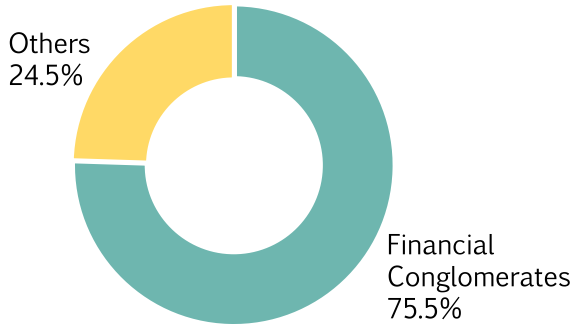
Strengthening financial sector supervision

- Assessment on the soundness of financial institutions
- Liquidity coverage ratio for banks
- Regulations on risk management for financial institutions
- Minimum capital requirement for banks
- Enhancement of GCG for financial institutions and publicly-listed companies

Strengthening & structuring financial sector based on international standards

- Risk-based supervision for all financial sectors
- Regulations on domestic systemically-important banks and capital surcharge
- Enhancement of crisis management protocol and interagency coordination

Financial conglomerates account for 75.5% of the total assets of financial sector…



Improving the integrated regulation & supervision framework…

- Such improvement has become even more important due to the dominance of financial conglomerates in the domestic financial sector.
- OJK has issued regulations on GCG, risk management, and minimum capital requirements for financial conglomerates. These will be followed by regulations on liquidity management, capital management, and intragroup transaction exposures.

Source: Financial Service Authority (OJK)

A Comprehensive Financial Deepening Program

...strategy to tackle challenges in deepening Indonesia's financial markets

Financial Market Deepening Program

First Priority: Continuous Basis

Monitoring, match making, and solution:
- Repo
- Hedging

Market Development

Money Market
Encourage well-functioning money market (deep and efficient, risk mitigation, and market integrity), through:
- Bank Indonesia Regulation (PBI) on Negotiable Certificate of Deposit (NCD)
  Enriching money market instruments, encourage banks to raise long term funding, and acts as an alternative investment for investors
- Bank Indonesia Regulation (PBI) on Commercial Paper
  Alternative sources of financing for non-bank corporations, as well as an investment outlet for investors

FX Market
- Development roadmap of Indonesia CCP in OTC Derivatives
  To support FX market development and reduce market segmentation.
- Establish Local Currency Settlement Framework
  Reducing dependency on USD payment for international trade.
- Encourage product development to increase hedging Supply in domestic market
  To provide hedging instrument alternative for corporations to manage their risk exposure

Coordination
- Corporate Bonds
- Government Bonds
- Medium term notes
- Other instruments
- Infrastructure (ETP, etc)

Supporting Regulations

Strengthening JISDOR
- Strengthening the credibility of JISDOR
- Extend the usage of JISDOR

Money Broker
- Increase the governance of money broker
- Revitalize role of money broker in financial market

Certification of Dealer and Code of Conduct
- Obligation on certification for dealers
- Obligation to honor code of conduct
- Dealers' training for certification

Inter-agency Cooperation

On April 2016, the Minister of Finance, the Governor of Bank Indonesia, and the Chairman of the Board of Commissioners of the Financial Services Authority have launched a Coordination Forum for the Development Financing through Financial Market (FK-PPPK). The three authorities have agreed to formulate "The National Strategy to Develop Indonesian Financial Market Towards 2025" which is expected to be concluded by the end of 2017/early 2018.

Source: Bank Indonesia

Progress on General Market Repo Agreement (GMRA)

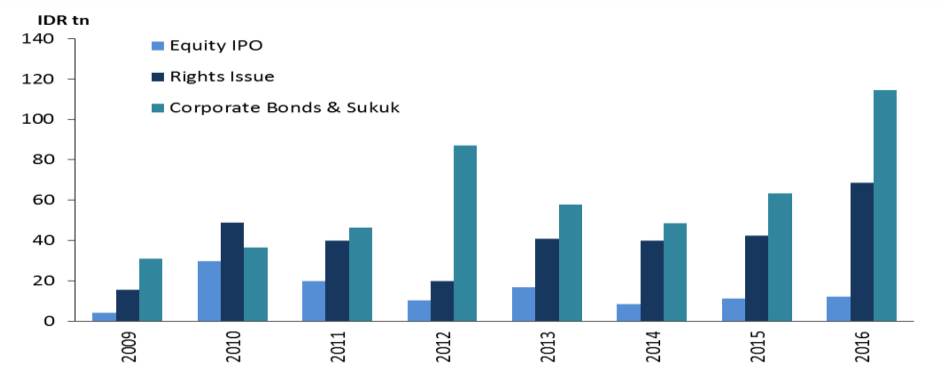
January 2016		March 2017
4 Banks	Signing	74 Banks
4 Banks	Transaction	47 Banks
IDR 0.0	Daily Volume	IDR 1.0 – 4.6 tn

Source: Bank Indonesia

Continuous Program on Capital Market Deepening

...continuously strengthened, including through capital market deepening initiatives

The utilization of capital markets by domestic corporations (including financial institutions) demonstrates an increasing trend



Strengthening market infrastructure

- Expansion of Single Investor Identification (SID) coverage
- Development of electronic trading platform (ETP) in the debt market
- Development of integrated investment management system
- Enhancement of the clearing and settlement process
- Enhancement of capital market data warehouse

Enhancing the supply-side

- Simplification of public-offering requirements & procedures
- Development of financial market products (mutual funds, private equity funds, REITs, ABS)
- Development of municipal bonds
- Cross-border offering (harmonizing regulations with ASEAN Disclosure Standards established by ACMF)

Enhancing the demand-side

- Expansion of the domestic investor base (conducting investor education programs)
- Expansion of mutual fund distribution channels, including the marketing methods of securities companies

Strengthening governance

- Development of market players' capacity
- Enhancement of GCG for publicly-listed companies
- Development of repo regulations and infrastructure

Source: Financial Service Authority (OJK)

Macroprudential Policy Mix to Support Growth

Effective from August 29th, 2016, Bank Indonesia relaxed the Loan to Value Ratio **(LTV)** and Financing to Value Ratio **(FTV)** on housing loans at 85-90% for the first mortgage lending facility, 80-85% for the second mortgage lending facility, and 75-80% for the third mortgage lending facility.

The relaxation is only applicable to banks with **nett** NPL for total loan below 5% and **gross** NPL for property loan/financing below 5%.

The rationale is to stimulate domestic demand in order to drive domestic economic growth momentum while maintaining compliance to prudential principles.

Housing Loans and Financing Based on Murabahah and Istishna Contracts

Property type (m^2)	Lending/Financing Facility		
	First	Second	Third
House			
>70 m^2	85%	80%	75%
22 - 70 m^2	-	85%	80%
<21 m^2	-	-	-
Apartment			
>70 m^2	85%	80%	75%
22 - 70 m^2	90%	85%	80%
<21 m^2	-	85%	80%
Home Shop/Office	-	85%	80%

Housing Financing Based on MMQ and IMBT Contracts

Property type (m^2)	Lending/Financing Facility		
	First	Second	Third
House			
>70 m^2	90%	85%	80%
22 - 70 m^2	-	90%	85%
<21 m^2	-	-	-
Apartment			
>70 m^2	90%	85%	80%
22 - 70 m^2	90%	85%	80%
<21 m^2	-	85%	80%
Home Shop/Office	-	85%	80%

Source: Bank Indonesia

Financial Sector: Fostering Domestic Growth

...boosting domestic economic activities and supporting the national economic development

Funding of infrastructure & priority economic sectors

- Enhancement of NBFI ownership in government bonds
- Private equity funds for infrastructure financing
- Asset-backed securities specifically designed for secondary mortgage financing
- Insurance for farmers and fishermen

Capacity building of financial institutions

- Strengthening the capital of financial institutions to increase their financing capacity
- Expansion of the business lines of multifinance companies
- Capital requirements for rural banks based on their operational zones

Development of financial products & services

- Expansion of the distribution channels for financial products & services
- Development of sustainable finance regulations
- Utilization of KYC information from third parties
- Facilitating access to capital market as a source of funding (e.g. simplification of public offering procedures)
- Capital market deepening initiatives

Development of Islamic financial sector

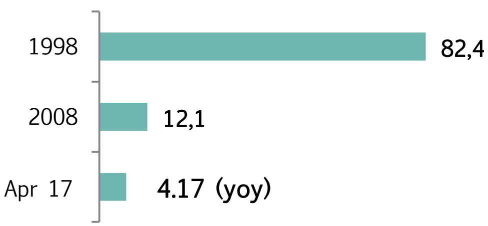
- Strengthening the capital of Islamic financial institutions
- Spin-off of the Islamic business units of commercial banks
- Development of Islamic financial product regulations (*sukuk*, mutual funds, asset-backed securities)
- Continuous education & socialization on Islamic financial products & services

Source: Financial Service Authority (OJK)

Stronger Fundamentals Facing the Headwinds

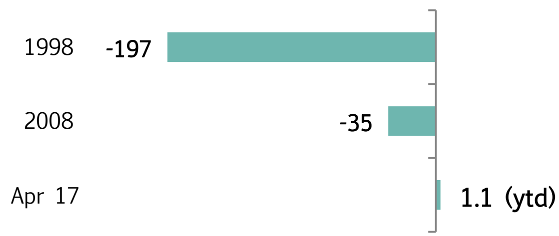
Inflation Rate (%)

Inflation controlled within the target range



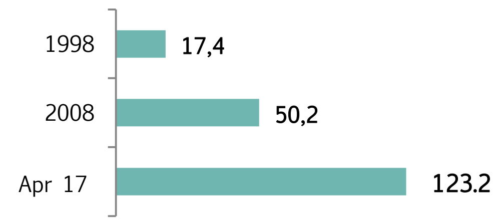
IDR Movement (%)

IDR still appreciated in early 2017



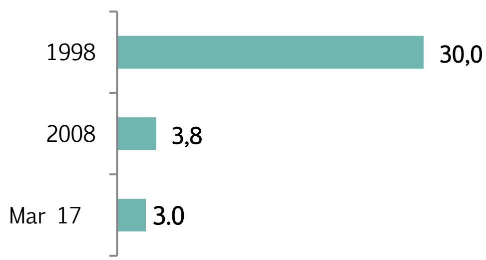
Foreign Reserves (USD bn)

Significantly higher than 1998 & 2008, ample to cover 8.6 months of import and external debt repayment



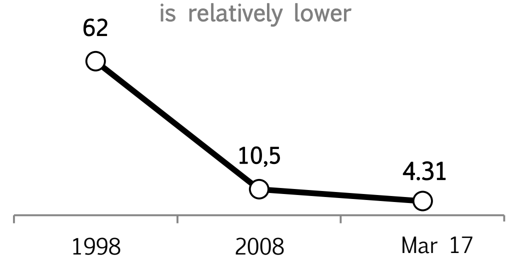
Non-Performing Loan/NPL (%)

NPL level is below the maximum threshold of 5%



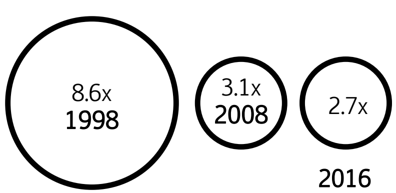
More Liquid Market (%)

Overnight interbank money market rate is relatively lower



External Debt (Public & Private) to FX Reserve Ratio

Significantly lower than 1998 crisis

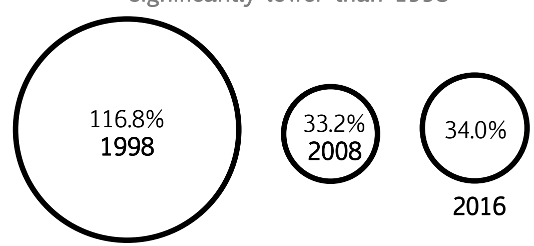


Government Debt/GDP

Consistently well-maintained below 30%

External Debt/GDP

Slightly higher than 2008, but significantly lower than 1998



Outlook of Domestic Economy Remains Robust

...domestic economic growth is predicted to be higher in 2017

2017 Economic Outlook

- Economy to grow in the range of 5.0-5.4% (yoy) in 2017, underpinned by stronger export and investment performance as well as tenacious consumption.
- Inflation is predicted to be within the 2017 inflation target of 4±1%, with the current account deficit projected below 2.5% of GDP
- Credit is projected to grow 10-12% in line with expectations of expected economic gains and ongoing impact of monetary and macroprudential policy easing

	Economic Growth	Inflation	CAD (% of GDP)	Credit Growth
2016 (Realization)	5.02%	3.02%	1.8%	7.9%
2017	5.0-5.4%	4.0±1%	<2.5%	10-12%

2017 Economic Opportunities & Challenges

	Global	Domestic
Opportunities	• Improving global economic growth • Increasing global commodity prices, oil and non-oil	• Improving domestic economic growth • Relatively low current account deficit
Challenges	• Fed Fund Rate (FFR) hike, US fiscal and trade policies, planned reduction to the Fed's balance sheet • Geopolitical risks, especially in Korean Peninsula	• Pressures on exchange rate from global factors • Pressures on inflation from administered prices

Source : Bank Indonesia