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Special Report
Indonesian Economy and Rating Seminar
- Jointly held with the Indonesian authorities, JBIC and JOI -

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Japan Credit Rating Agency, Ltd. (JCR) organized the "Indonesian Economy and Rating Seminar" in Tokyo in August 2015, together with Bank Indonesia (BI), Indonesia's Ministry of Finance (MOF), Japan Bank for International Cooperation (JBIC) and Japan Institute for Overseas Investment (JOI). Presentations were delivered by Mr Mirza Adityaswara, BI's Senior Deputy Governor, Dr Suahasil Nazara, Head of MOF's Fiscal Policy Agency, and representatives of JCR and JBIC. They explained Indonesia's economic outlook, new regulations on private external borrowing, JCR's sovereign rating perspective and JBIC's cooperation with Indonesia.

1 Overview

JCR organized the "Indonesian Economy and Rating Seminar" on 28 August 2015, supported by JBIC and JOI and in cooperation with BI and Indonesia MOF. This seminar, held during the visit of Indonesia's senior officials to Japan, was intended to explain to the Japanese business and financial community, Indonesia's latest economic outlook and its new regulations on the private external borrowing.

It began with opening remarks by Reza Anglingkusumo, BI's Chief Representative for East Asia. It was followed by (1) the first key note speech on "Indonesia's Economic Outlook and Economic Policy" by BI's Senior Deputy Governor Mirza Adityaswara, (2) the second key note speech on "Indonesia's Fiscal Policy" by Dr Suahasil Nazara, Head of Indonesia MOF's Fiscal Policy Agency, (3) the speech on "The angles of JCR Sovereign Rating on Indonesia" by Mr Atsushi Masuda, Chief Analyst of JCR's International Department, (4) the speech on "JBIC Cooperation with Indonesia" by Mr Kazunori Ogawa, Director General of JBIC's New Energy and Power Finance Department II, Infrastructure and Environment Finance Group, and (5) a Q&A session.

The event attracted more than 160 participants from the Japanese business and financial community; a sign of their strong interest in Indonesia. The audience came from various industries such as banks, securities, insurances, leases, non-banks, food, manufacturing, construction, engineering, gas, transportation, trade, game, law firms, auditing firms, and think tanks.

2 Indonesia's Economic Outlook and Economic Policy

The first keynote speech was delivered by BI's Senior Deputy Governor Mirza Adityaswara on the economic outlook and economic policy of Indonesia. He highlighted:

(1) Macroeconomic imbalances as represented by inflation and the current account deficit have been

Photo 1　BI's Senior Deputy Governor Mirza

coming down to a sustainable territory thanks to the monetary policy tightening and the ending impact of rising fuel prices due to a cut in subsidies;

(2) Short-term market fluctuations may be well absorbed amid a continuous inflow of foreign direct investment and sufficient level of foreign exchange reserves;

(3) Economic growth has been impeded by China's slowdown and falls in commodity prices; the impact varies across the regions within the country. Growth in Sumatra and Kalimantan slowed to around 1 to 2 percent year-on-year whereas Java and Sulawesi continued to keep pace at over 5% and 7.6%, respectively;

(4) In the financial sector: (a) unlike the time of Asian financial crisis, there is a deposit insurance system in place, (b) banks remain sound with more than 20% of capital adequacy ratio (CAR), 2.6% of non-performing loans (NPL) ratio, and a 89% loan-to-deposit ratio, and (c) to cope with private sector companies' rising external borrowings in recent years, a series of new regulations have been introduced in the areas of foreign exchange risks hedging, securing foreign exchange liquidity, and requiring credit ratings.*1

Photo 2 Dr Suahasil, Head of FPA, Indonesia MOF

Photo 3 Speech by Mr Atsushi Masuda from JCR

3 Indonesia's Fiscal Policy

The second keynote speech was made by Dr Suahasil Nazara, Head of Indonesia MOF's Fiscal Policy Agency. He first emphasized that the new administration is promoting "fiscal reform" and "fiscal stimulus" so as to underpin the country's economic growth. As concrete measures of the fiscal reform, he elaborated the "Revised FY2015 Budget" announced in January 2015 as follows:

(1) On the revenue front, revenue optimization is pursued to reduce the dependence on commodities by strengthening the tax administration and broadening the tax base without resorting to raising tax rates;

(2) On the expenditure side, the public finance is no longer exposed to international oil price fluctuations as fuel subsidies for gasoline and diesel are either abolished or fixed, and the appropriation for infrastructure and social protection are substantially expanded instead;

(3) On the fiscal sustainability, the size of fiscal deficit, legally capped at 3% of GDP, is projected at 1.9-2.2% for Fiscal 2015 and targeted at 2.1% for Fiscal 2016, which would leave the size of central government debt at around 25% of GDP.

Dr Suahasil also stressed that the government is undertaking the following fiscal stimulus measures: (a) to stimulate consumption by raising the non-taxable income by 50% and abolishing most of the excise duties and luxury taxes (except for private jets), (b) to

*1 Details are available at Bank Indonesia's press releases dated 30 October 2014 and 2 January 2015, available at http://www.bi.go.id/en/ruang-media/siaran-pers/Pages/sp_168014.aspx and http://www.bi.go.id/en/ruang-media/siaran-pers/Pages/sp_1610414.aspx accelerate the execution of public investments (by mid-August, 51-52% of the Revised Budget was expensed), and (c) to provide various kinds of government support to promote PPP-type infrastructure development that includes issuing comfort letters by the government, establishing the Viability Gap Fund, and giving them preferential tax treatment. He concluded the speech by explaining the key points of the draft budget for FY2016, scheduled for deliberations by Parliament in the coming weeks.

Photo 4 Speech by Mr Kazunori Ogawa from JBIC

Photo 5 Seminar participants

4 Perspectives of Indonesia's Sovereign Rating

In the following section, Mr Atsushi Masuda, Chief Analyst of JCR's International Department, talked about JCR's sovereign ratings on Indonesia. At the beginning, he cited the factors both supporting and constraining JCR's sovereign ratings on Indonesia at "BBB-/Stable" for foreign currency and "BBB/Stable" for local currency. He mentioned that, Indonesia's sovereign ratings are supported by the country's (a) solid economic growth underpinned by domestic demands by its 255 million population, (b) restrained budget deficit and public debt, (c) relatively sound banking sector balance sheets, and (d) certain extent of resilience to external shocks. Meanwhile, the ratings are constrained by its (i) high dependence on natural resources, (ii) persistent current account deficit and volatile private capital inflows, and (iii) inadequate infrastructure and undersized financial system that could potentially impede growth.

In addition, he raised some marked developments in recent years as follows:

(1) For a long time, the Indonesian authorities appeared to have had a "fear of floating" especially after it experienced the rupiah's massive depreciation by 85% at the Asian financial crisis in 1997-98. However, in recent years, they seem to have been gradually shifting to allow foreign exchange rate fluctuations and to respond to capital outflows by adjusting monetary policy, rather than intervening in the foreign exchange market;

(2) The surge in Credit Default Swap (CDS) spread for Indonesia after the Lehman Shock seemed to be in line with those for other emerging countries such as Russia, so it may have been driven not by Indonesia's particular factors but by the general sentiment of the international investors against emerging market countries;

(3) At the time of the Lehman shock, the government of Indonesia enhanced the resilience to market turbulences by establishing backup credit lines from the World Bank, JBIC, the Asian Development Bank, and the government of Australia;

(4) To prepare for the normalization of the US's monetary policy and possible foreign exchange rate fluctuations as a result, the Indonesian authorities have been, since 2014, proactively utilizing macro-prudential measures. They include the regulations to impose private non-financial companies in Indonesia with foreign currency external borrowings to keep certain foreign exchange risk hedging ratio,

liquidity ratio, and credit rating of "BB-" or higher;

(5) JCR has been accredited as one of the recognized credit rating agencies for the stated regulation;[*2]

(6) The size of Indonesia's financial and capital markets are small even in comparison with its neighboring countries, so further development of the financial and capital markets is essential to alleviate the market volatility; and

(7) Although the government expresses its intention to vigorously develop infrastructure with the funds made available by the cut in fuel subsidies, the pace of execution seems to be somewhat slow thus far.

5 JBIC's Cooperation with Indonesia

Mr Kazunori Ogawa, Director General, New Energy and Power Finance Department II, Infrastructure and Environment Finance Group, JBIC, then explained the overview of its cooperation with Indonesia. He explained that (a) Indonesia is, in terms of JBIC's overseas exposure, the fourth largest country after the US, Australia and Brazil, (b) It has extended loans in a wide range of sectors, among others, for natural resources and infrastructure projects, (c) It has, in the power sector, supported a number of private independent power producers (IPP) notably Paiton power station, (d) Japanese manufacturing companies regard Indonesia as the second "promising country for FDI destination for a medium-term" after India, though they also see "rising labor cost", "transparency in legal execution", and "underdeveloped infrastructure" remain as challenges among others, and (e) JBIC conducts fiscal policy dialogue with the government of Indonesia every year to discuss such topics as infrastructure, natural resources and macro-economy.

6 Questions and Answers

At the end of the seminar, the participants raised questions on the issues of (a) prospects of the banking sector's non-performing loans, (b) soundness of medium-sized banks and regional banks, and (c) the impact of the recent Cabinet reshuffle. Both Senior Deputy Governor Mirza and FPA Head Suahasil gave detailed replies, which brought to a conclusion to the seminar.

*2 See JCR's news release for details:
http://www.jcr.co.jp/reportqa/pdfen/2015011610e.pdf?PHPSESSID=23ba7241dfd9384625440d4d5f1896d3

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