

MITIGATING THE EFFECT OF GLOBAL SPILLOVERS: Indonesia's Experience

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**INTERNATIONAL SEMINAR ON
COPING WITH MACROECONOMIC VULNERABILITIES AND SPILLOVERS
TOKYO, NOVEMBER 7-8, 2016**

Outline

1. Global Environment and Spillovers

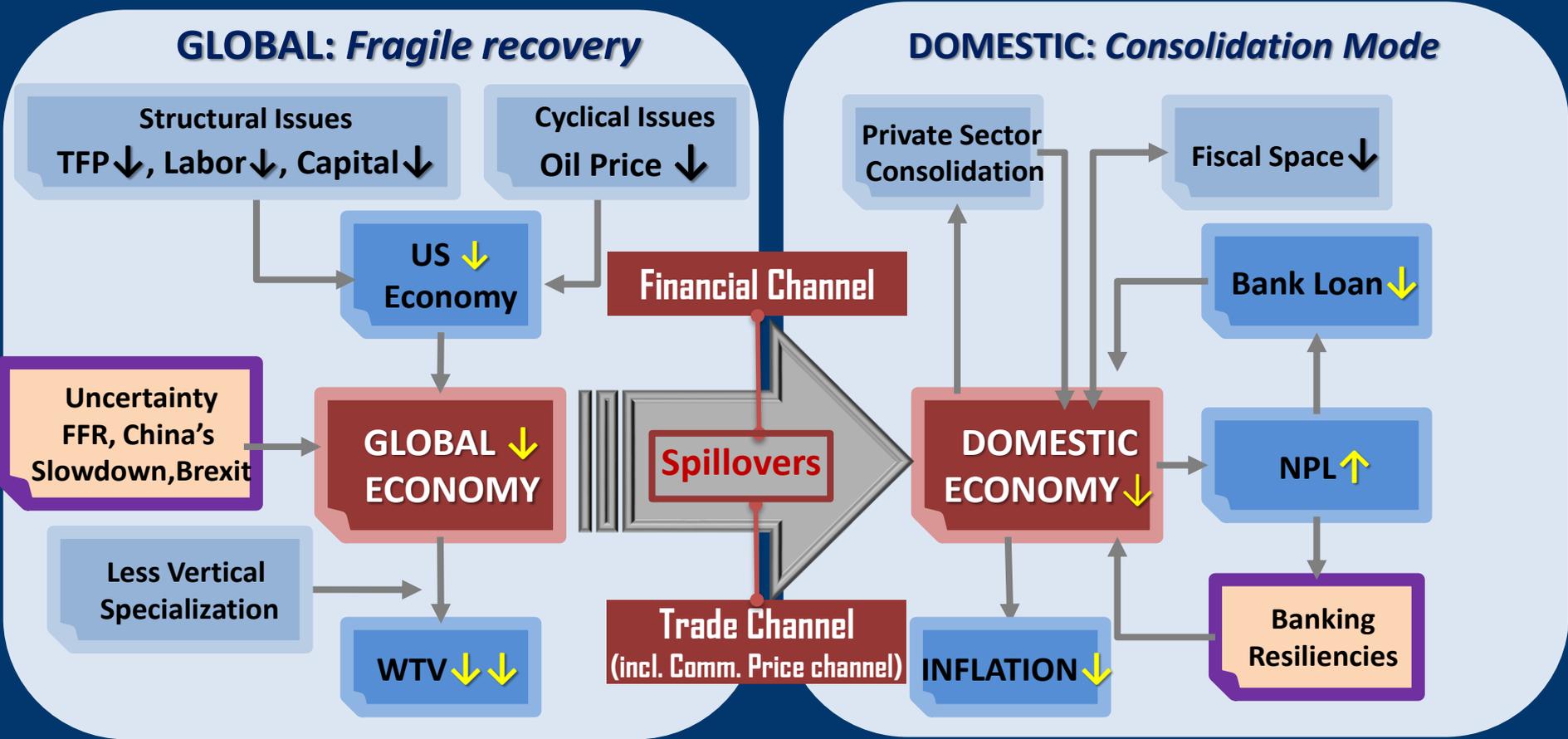
2. Domestic Economy Issues

3. Policy Responses

4. Economic Performances



Global Spillovers Effect on Indonesian Economy



POLICY COORDINATION

Monetary Policy

Fiscal Policy

Micro/Macroprudential Policy

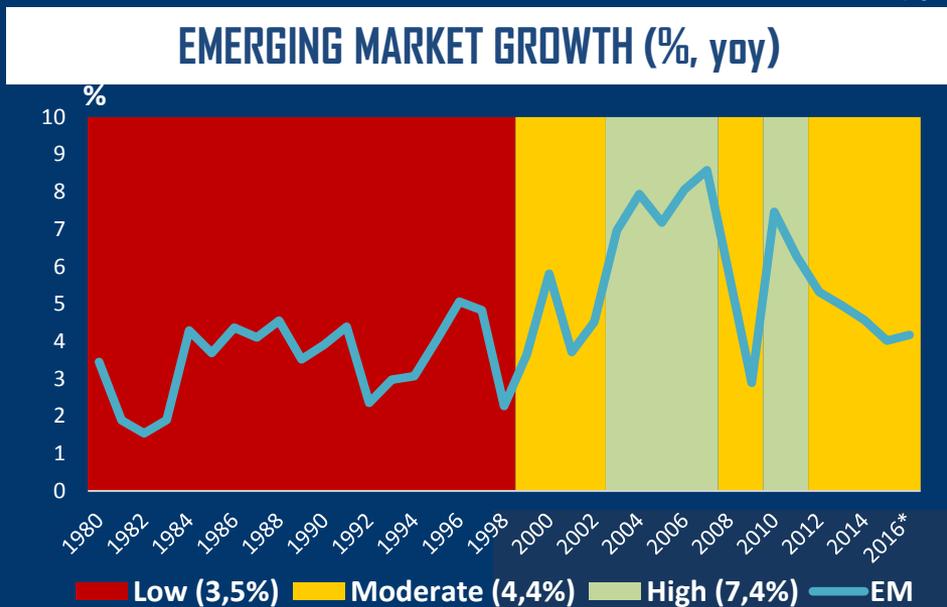
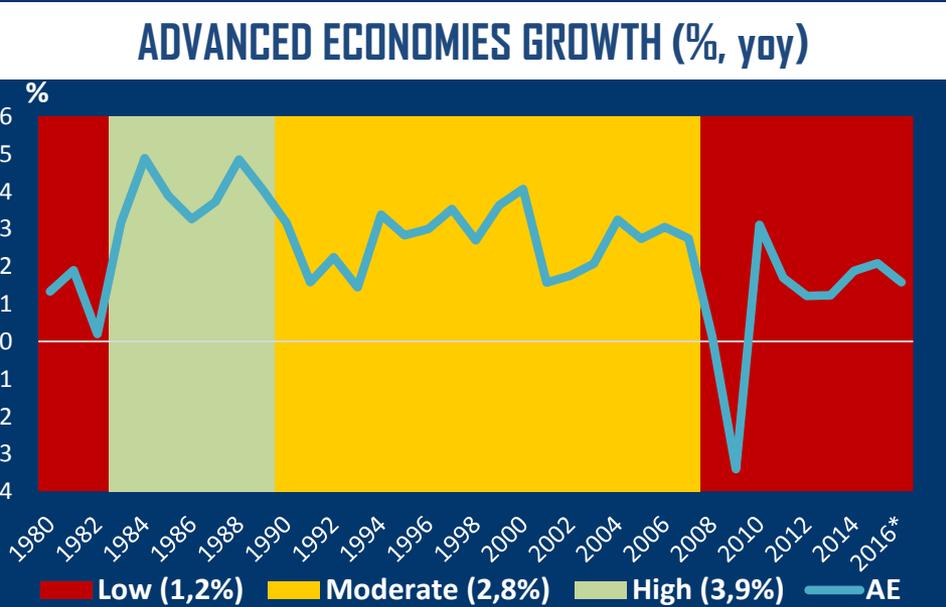
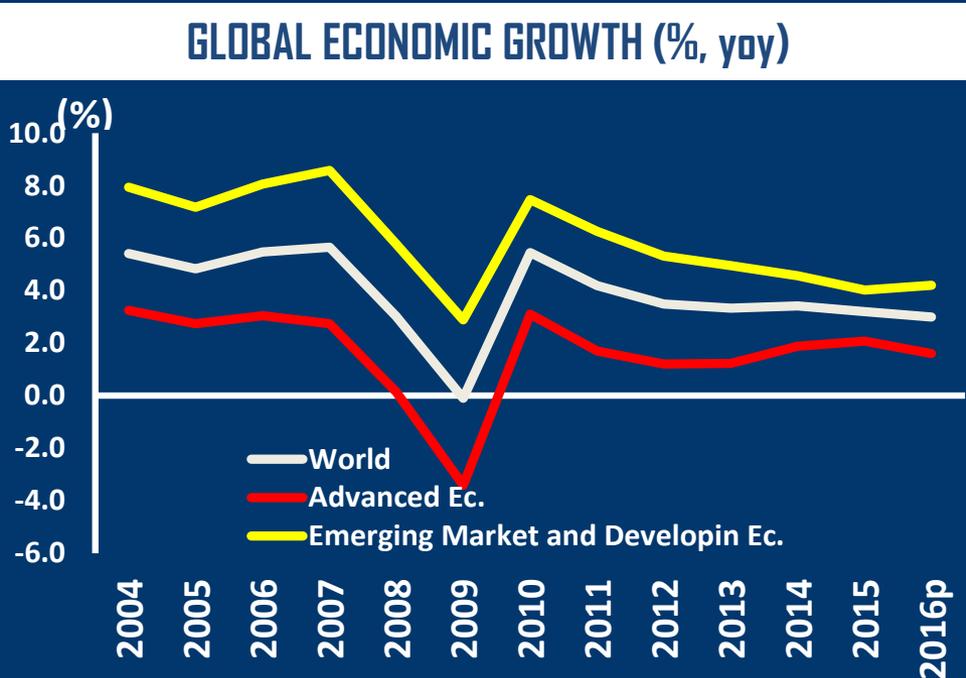
Structural Policy

GLOBAL ENVIRONMENT & SPILLOVERS

Challenge #1: Uneven and Slow Global Economic Recoveries

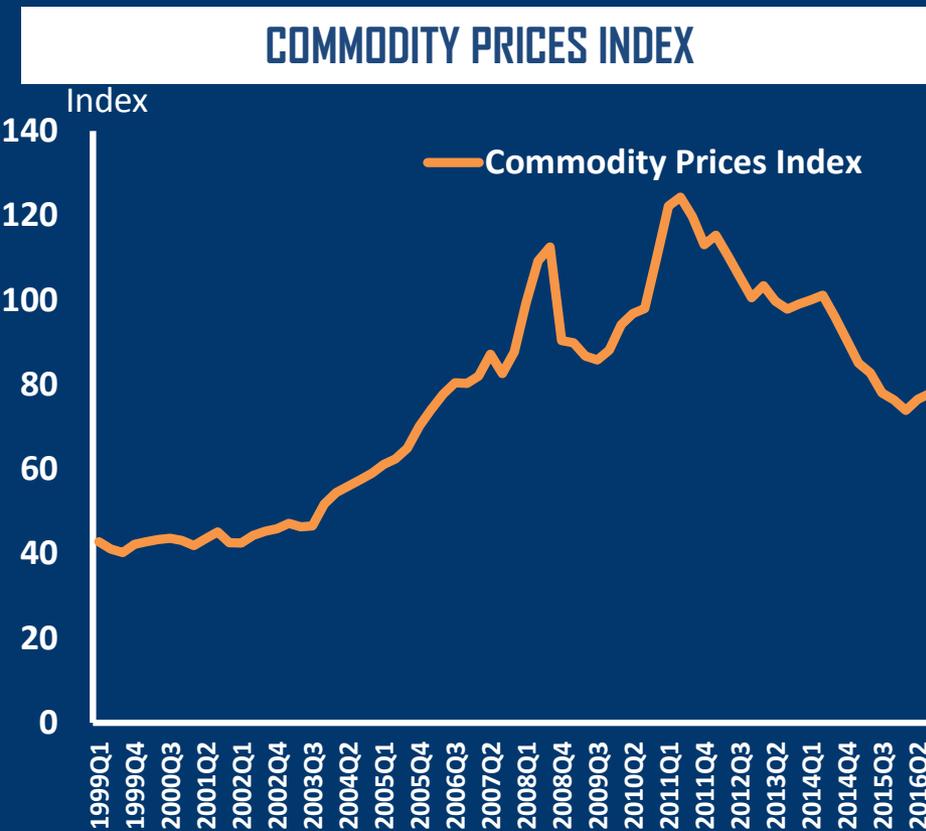
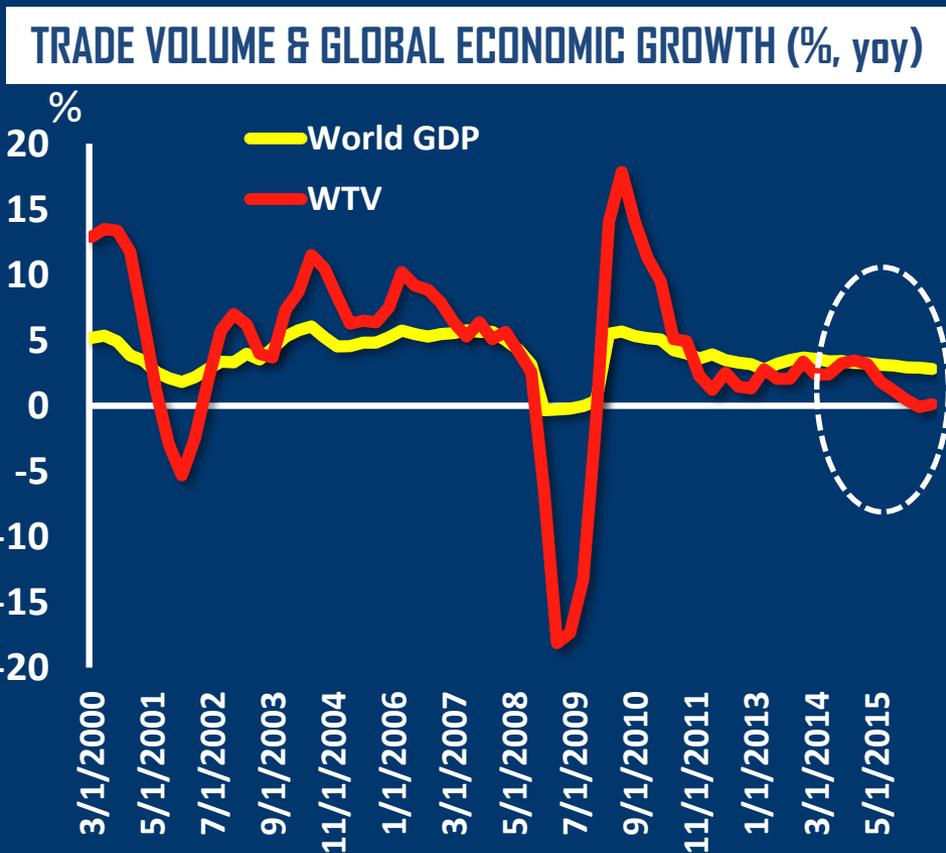
In the period following the GFC, world economy is facing a "New Norm" of lower economic growth...

- AE countries tend to stay at low economic growth regime
- EM countries stay in the moderate growth regime



Challenge #2: Declining World Trade Volume & Commodity Prices

The decline in world trade volume also contributed by weakened relationship between global growth and international trade...

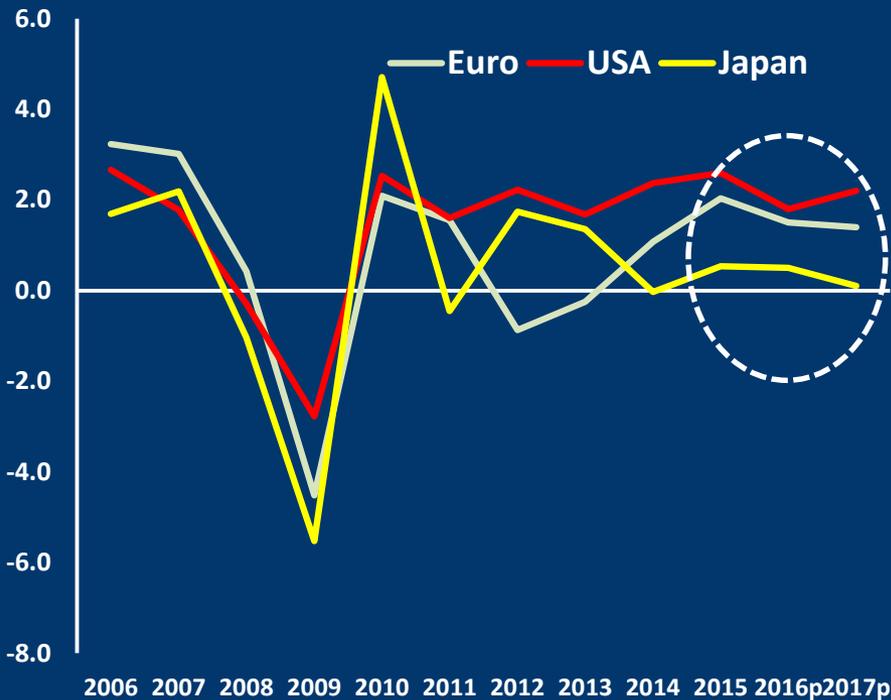


Source: Bloomberg, CPB, (processed)

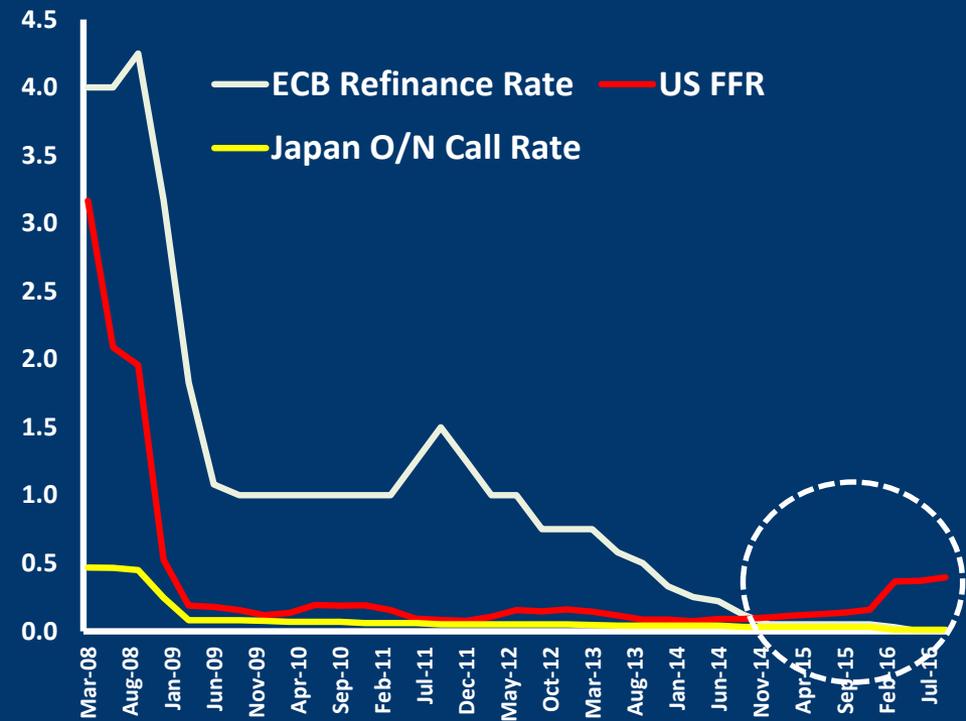
Challenge #3: Asynchronous Monetary Policies in Advanced Ec.

Uneven pace of economy recoveries lead to different state of monetary policies particularly in Advanced Economies...

ADVANCED ECONOMIES GROWTH (% , yoy)



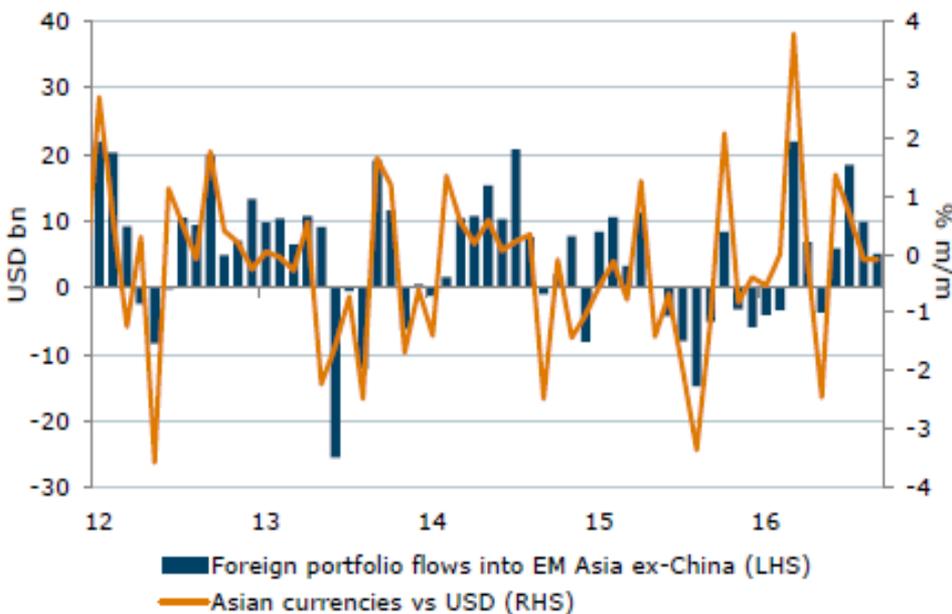
POLICY RATES IN ADVANCED ECONOMIES (% , yoy)



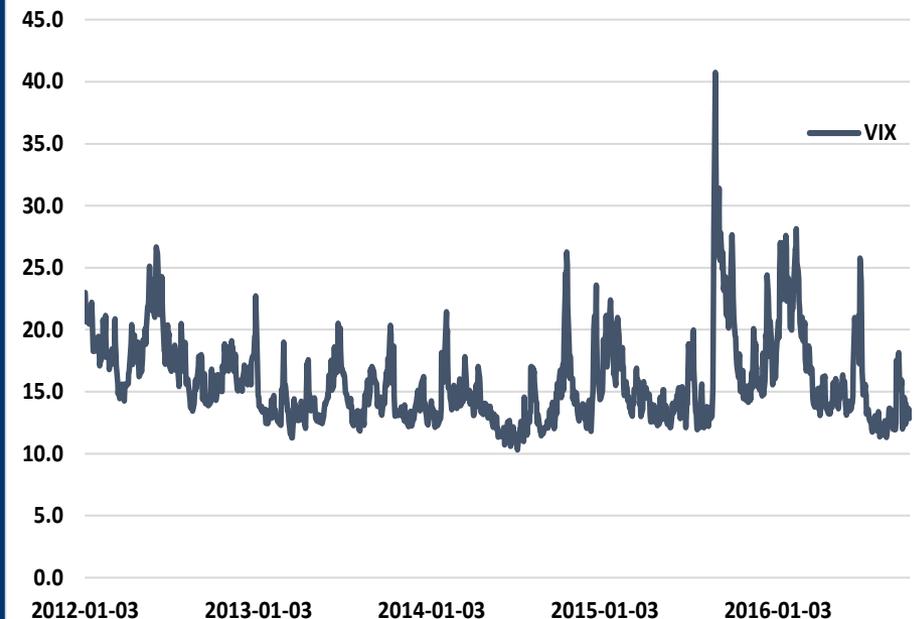
Global Challenges Lead to Volatile Capital Flows to EMs

Uncertainties in global financial market due to asynchronous monetary policies in Advanced Economies and China's economic slowdown led to volatile capital flows to emerging market...

FOREIGN PORTFOLIO FLOWS to EMs



RISK PERCEPTIONS (VIX)



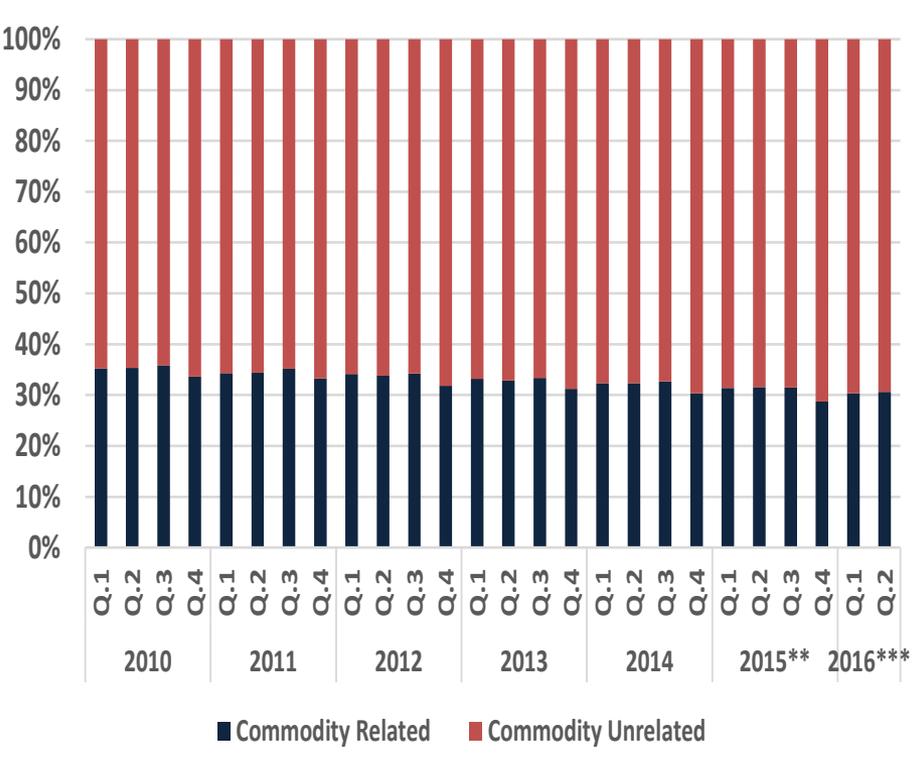
Source: ANZ

DOMESTIC ECONOMY ISSUES & IMPACT OF SPILLOVERS

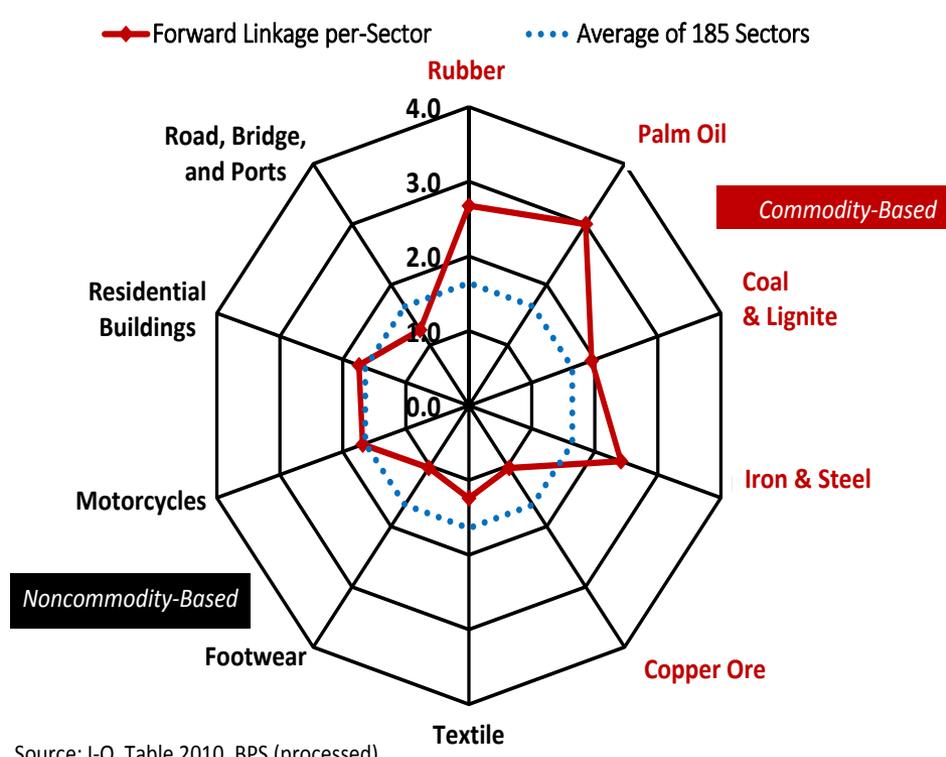
Issue #1: Indonesian Commodity Based Economy

The spillover effect of declining in global economic growth and commodity prices are amplified by Indonesian economy structure that is dominated by commodity sector...

COMMODITIES & NONCOMMODITIES SHARE of GDP (%)



COMMODITIES FORWARD LINKAGES in GDP

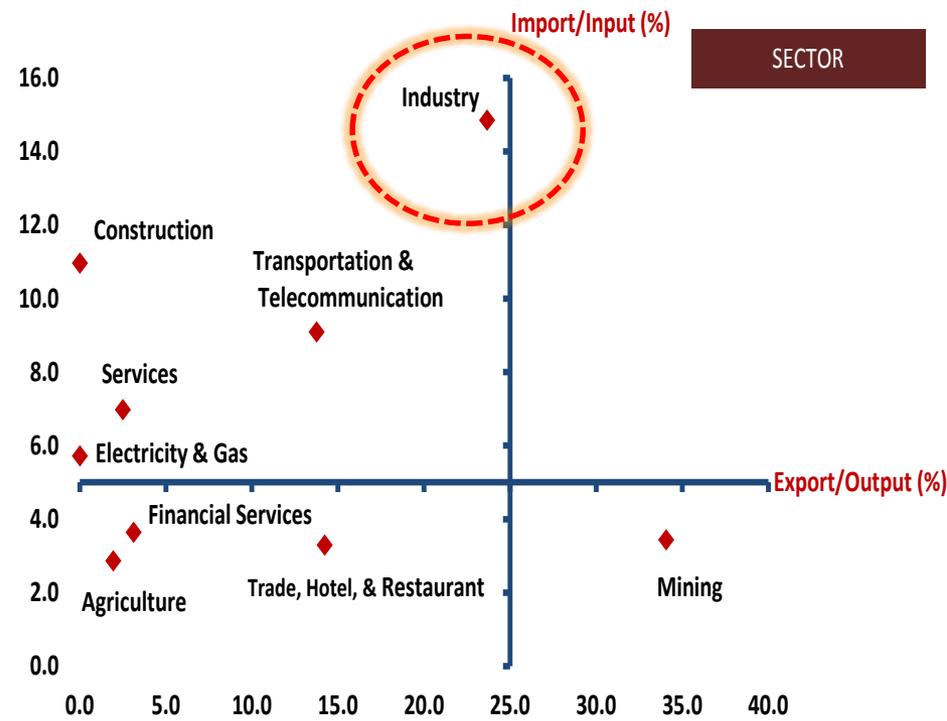


Source: I-O Table 2010, BPS (processed)

Issue #2: High Import Content in Indonesian Export Product

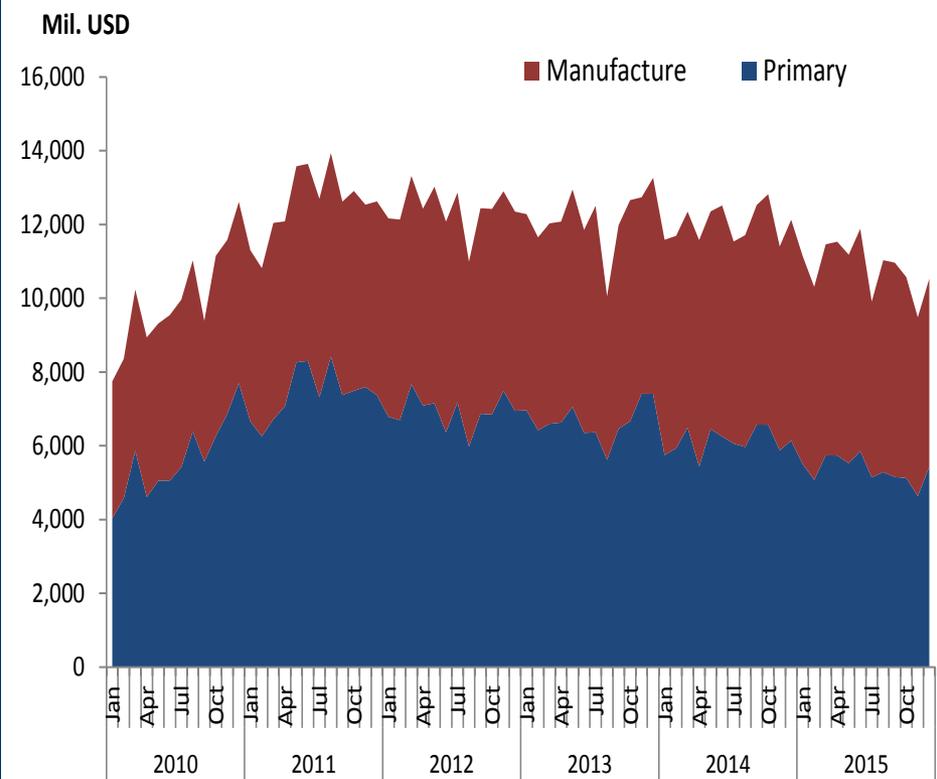
Indonesian export not only mainly related to commodity, but also has high import content...

IMPORT CONTENT of INDONESIA EXPORT (%)



Source: I-O Table, BPS - (processed)

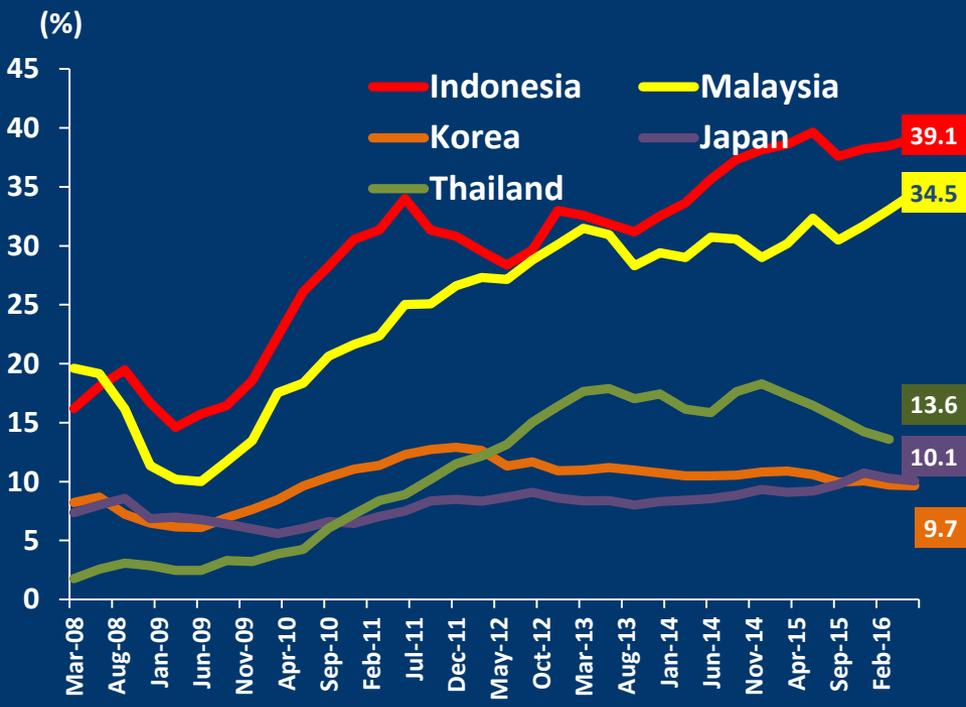
PRIMARY PRODUCT & MANUFACTURE EXPORT



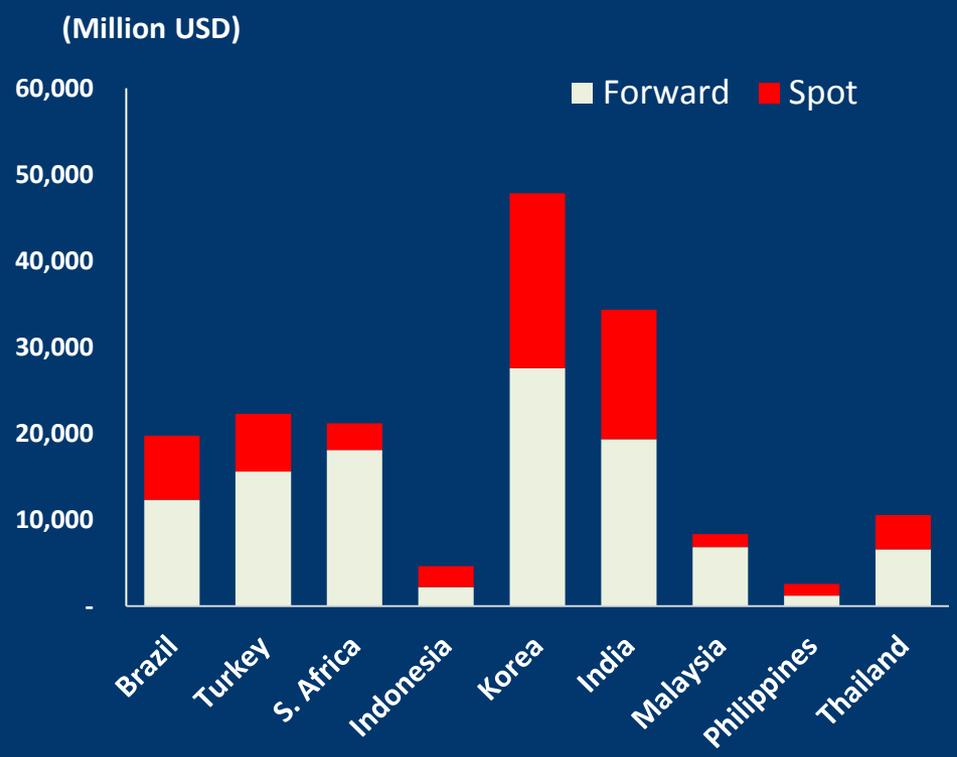
Issue #3: Indonesian Shallow Financial Sector

While financial sector openness creates opportunity to harvest benefit from access to global financial market, it creates vulnerability on Indonesian economy to external shocks...

FOREIGN HOLDING on GOVERNMENT BONDS



DAILY TURNOVER FOREX TRANSACTIONS 2016

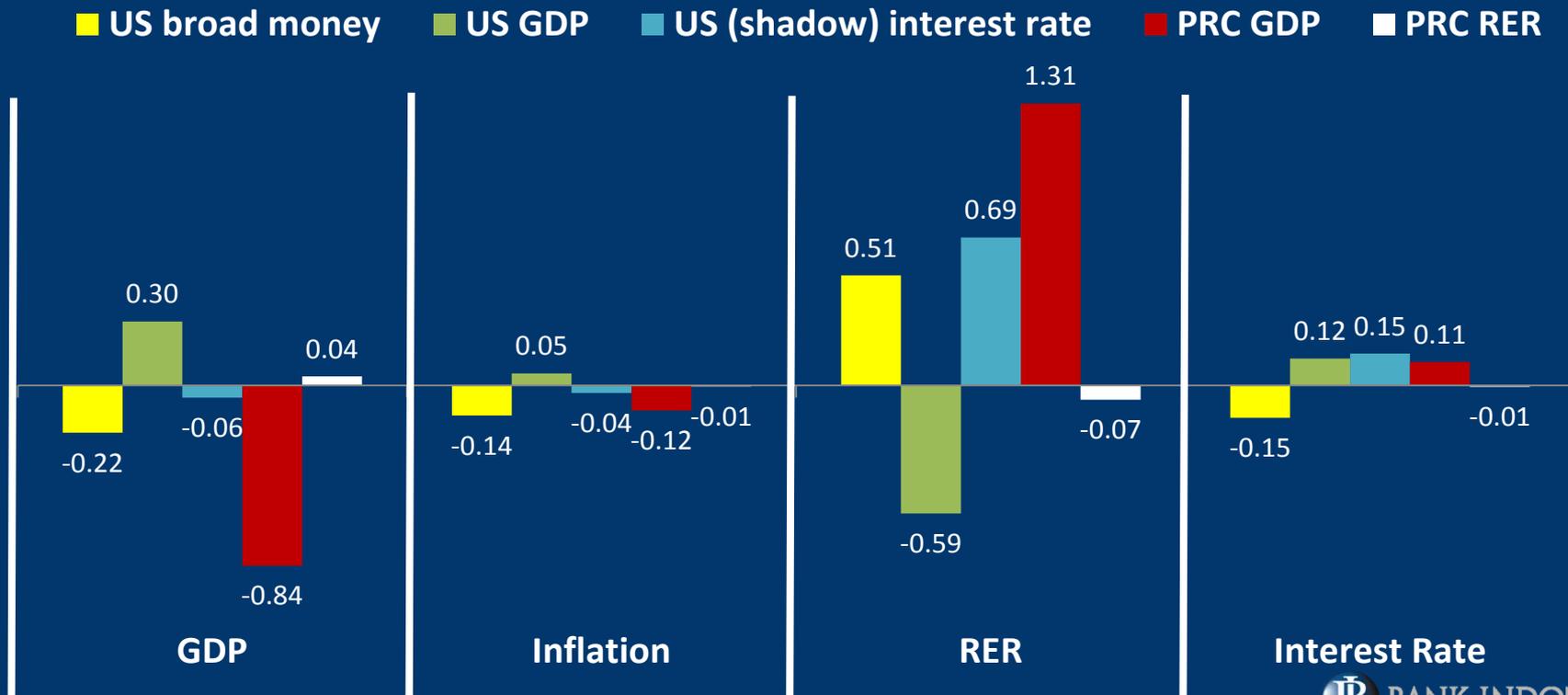


The Effect of Spillovers on Indonesian Economy

US and China have significant effects to Indonesian macro variables

- ✓ The greatest risk to Indonesian economic growth is China's economic growth slowdown (through trade channel).
- ✓ One of the greatest risks to Indonesian exchange rate stability is US interest rate hike (through financial channel).
- ✓ Shocks from US and China (broad money, GDP, and interest rate).

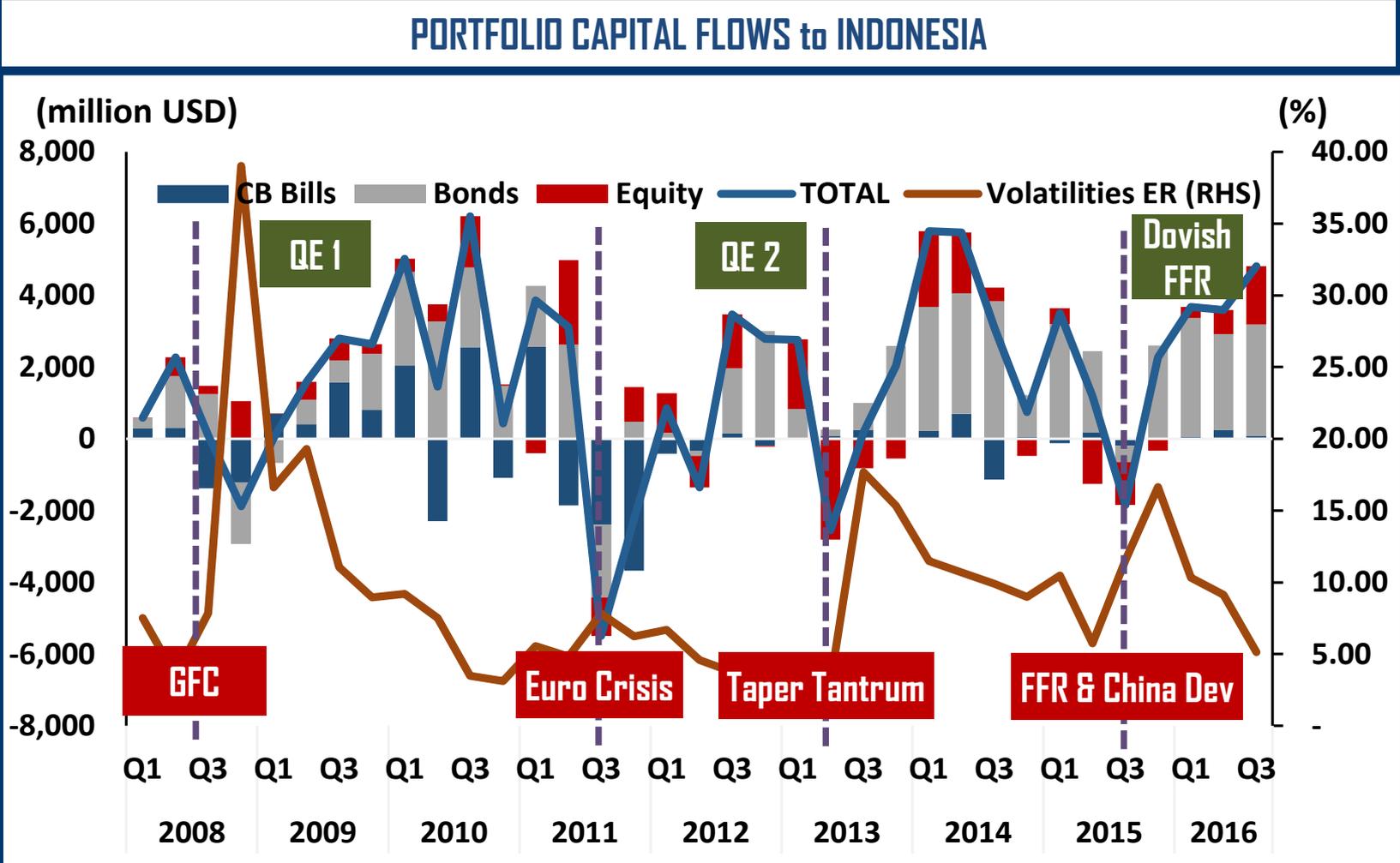
SUMMARY of GLOBAL SPILLOVERS' IMPACT on INDONESIA ECONOMY



Source: Harahap et al (2016)

Spillover Impact through Financial Channel

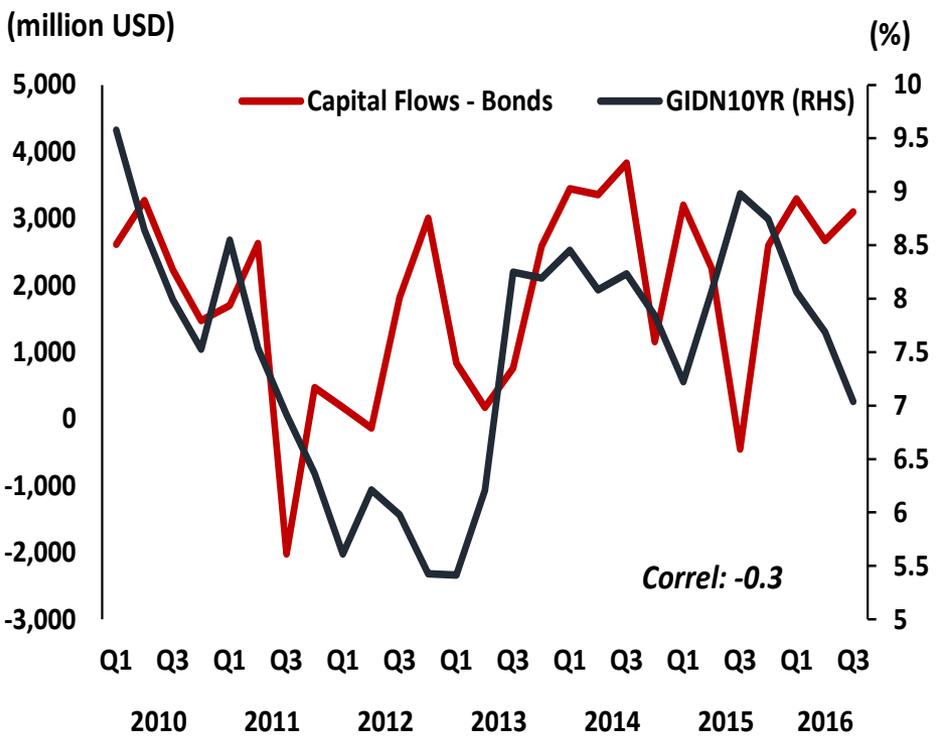
Global uncertainties significantly affect Indonesian portfolio capital flows as well as Rupiah exchange rate stability...



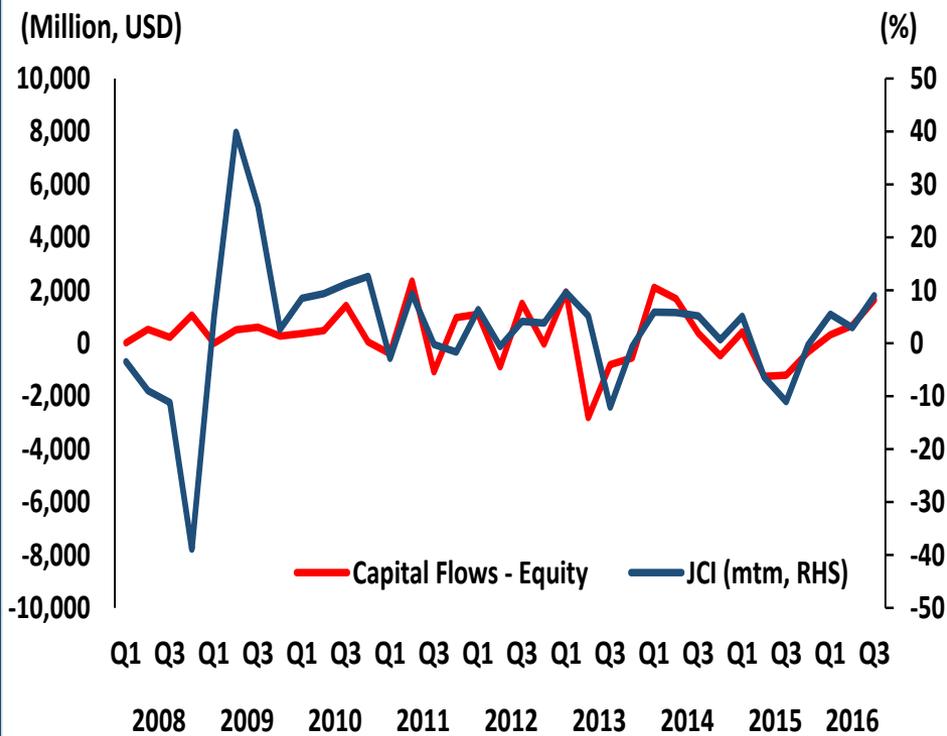
Capital Flows Affect Domestic Financial Asset Prices

Capital flows contribute on Indonesian asset prices movement both on bond and capital market...

CAPITAL FLOWS & INDONESIA'S BOND MARKET



CAPITAL FLOWS & INDONESIA'S STOCK MARKET



Spillover Impact through Trade Channel

China's economy has the most significant impact on Indonesian export

- From the trade channel, the spillover of declining China's GDP has the most significant impact on Indonesian export compared to US and EU.
- Due to high elasticity of some exported commodity to China such as metal, processed food dan electrical appliances.

Countries	Impact of Real Export*)
US	-0,78%
China	-1,45%
EU	-0,12%

*) assuming 1% decline in each country – ceteris paribus

SHOCK of -1% US GDP		
Variables		10 Main Cntr.
Export	TOTAL	-0.78
	Other Commodities	-0.59
	10 Main Comm.	-0.92
1	Chemical	-1.0
2	Coal	-1.4
3	Copper	0.0
4	CPO	-4.1
5	Elect. Appliance	-1.2
6	Processed Food	-2.6
7	Metal Product	-0.9
8	Pulp & Paper	-0.5
9	Rubber Product	-0.3
10	Textile	-1.3
Share	TOTAL	0.71
	Other Commodities	0.25
	10 Main Comm.	0.46

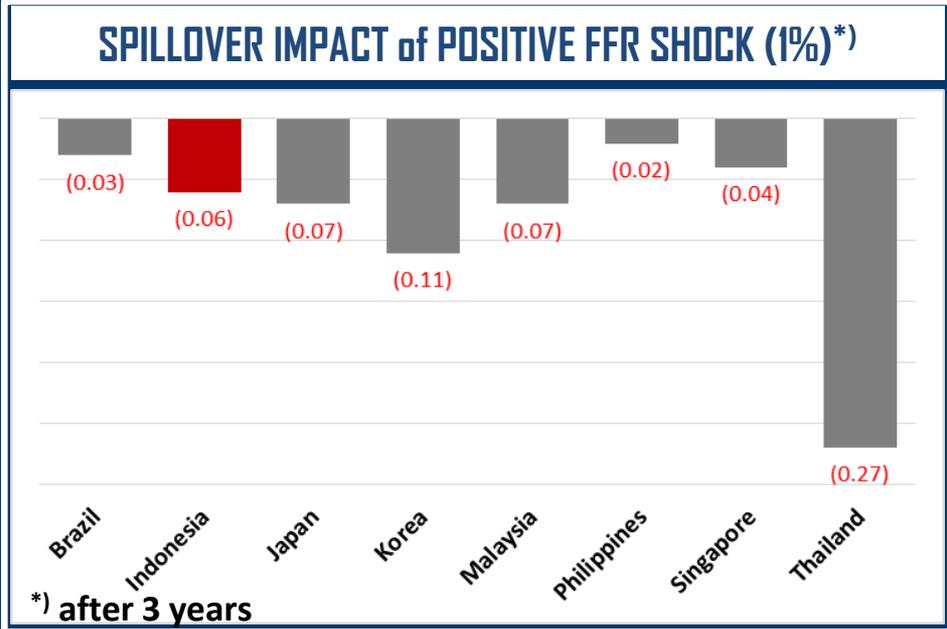
SHOCK of -1% CHINA's GDP		
Variables		10 Main Cntr.
Export	TOTAL	-1.45
	Other Commodities	-2.54
	10 Main Comm.	-0.71
1	Chemical	-0.9
2	Coal	-1.2
3	Copper	0.0
4	CPO	-3.6
5	Elect. Appliance	-1.0
6	Processed Food	-2.3
7	Metal Product	-0.8
8	Pulp & Paper	-0.4
9	Rubber Product	-0.3
10	Textile	-1.2
Share	TOTAL	0.71
	Other Commodities	0.25
	10 Main Comm.	0.46

SHOCK of -1% EU's GDP		
Variables		10 Main Cntr.
Export	TOTAL	-0.12
	Other Commodities	-0.09
	10 Main Comm.	-0.14
1	Chemical	-0.7
2	Coal	-1.1
3	Copper	0.0
4	CPO	-3.1
5	Elect. Appliance	-0.9
6	Processed Food	-2.0
7	Metal Product	-0.7
8	Pulp & Paper	-0.4
9	Rubber Product	-0.2
10	Textile	-1.0
Share	TOTAL	0.71
	Other Commodities	0.25
	10 Main Comm.	0.46

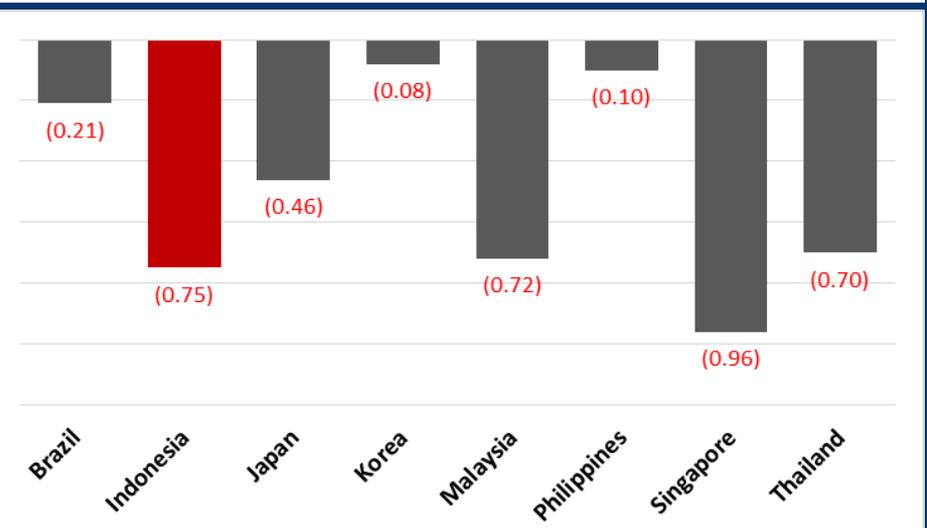
Spillover Impact on Indonesian Economic Growth

Indonesian economy is the most sensitive to China's economy due to its export structure...

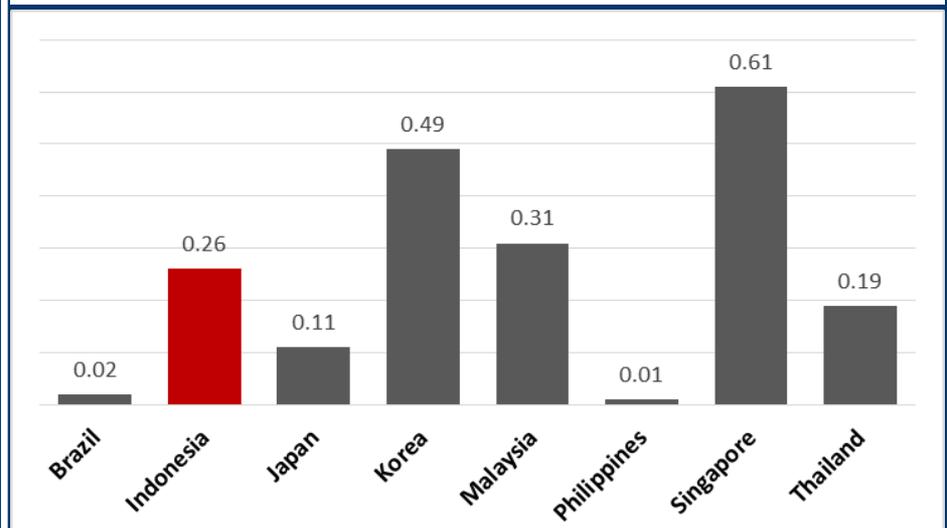
- The effect of China's slowing down greater than that of the US
 - China's Shock : GDP declines up to 0.52% in the first year → higher than Brazil, Korea, and Japan
 - US' Shock : GDP declines up to 0.28% in the first year
- Indonesian economy is also prone to FFR shock



SPILOVER IMPACT of NEGATIVE CHINA'S GDP SHOCK (-1%)



SPILOVER IMPACT of POSITIVE US' GDP SHOCK (1%)



POLICY RESPONSES

Bank Indonesia Policy Mix: Managing the Trilema

Monetary and Macro-prudential Policy (instrument) mix

Maintaining monetary policy autonomy to achieve price stability and financial stability

- Interest rate to address inflation expectation
- Macro-prudential measures to manage liquidity and financial stability



Exchange Rate Management

Stabilizing exchange rate movement in line with its fundamental

- Smoothing out ER volatility
- Accumulate FX reserves during inflows and use the reserve during outflows (self insurance)

Capital Flow Management

Managing capital flow

- Manage capital flow especially short term
- Risk management of corporate sector borrowings
- Promote financial deepening (FX market, bonds market, money market)

Monetary Policy Measures

Sterilized FX market intervention

Dual intervention (FX and bonds intervention simultaneously)

Interest rate

FX Reserve accumulation

Capital Flows Management

Minimum Holding periods for short term bills (CB bills)
- Increase duration during inflows
- Reduce duration during outflows

Risk Management of Corporate FX borrowings (hedging requirement, FX liquidity req, credit rating)

Macroprudential Measures

Reserve Requirement Rp and FX

LDR-linked reserve requirement

Introducing LFR

Abolishment the 30 minutes NOP

Limiting Short Terms Borrowings Exposure of Banks (eg 30% capital)

Loan To Value Ratio for Housing Loans and Down Payment Rule for Automotive Loans

Structural Policy

Financial market deepening (FX market, bonds market and money market)

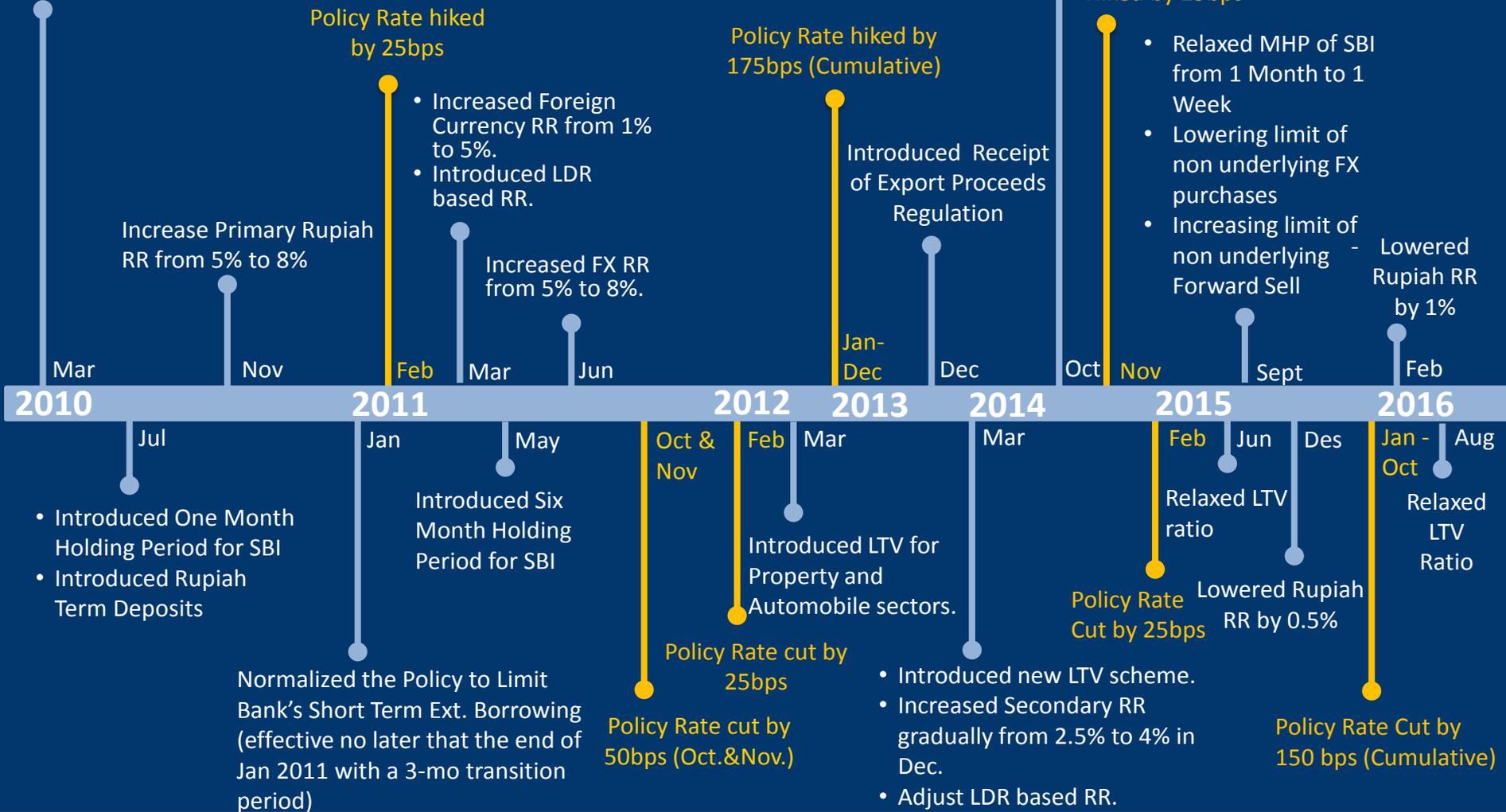
Export proceed regulation

Bank Indonesia's Policy Mix in the Post GFC Period

		2010-2012 <i>Early Global Recovery...</i>	2013-2014 <i>Uncertainties Era...</i>	2015 – Present <i>Sluggish Global Recovery..</i>
CONSIDERATIONS	GLOBAL	<ul style="list-style-type: none"> Global GDP slowdown Commodity prices peak in Q2-2011 & started to fall Global excess liquidity Ultra low interest rate Quantitative easing in US and EZ Moderate global market volatility 	<ul style="list-style-type: none"> GDP slowdown esp. In EM China rebalancing Commodity prices continue to fall High global volatility Fed initiates monetary policy normalization (tapering) 	<ul style="list-style-type: none"> Uneven and slow global growth EM picking up; AE weaken Consolidation in commodity prices Moderate global uncertainty Monetary Policy Divergence: <ul style="list-style-type: none"> FFR hiked, further increase IS expected at a slower pace Continued easing MonPol in EZ & JP
	DOMESTIC	<ul style="list-style-type: none"> Current Account deterioration Surge in capital inflow as portfolio inflows and debt Rupiah appreciation Stable inflation, inflation pressure from administered prices (fuel) Solid GDP growth fueled by solid domestic demand and export Strong credit growth 	<ul style="list-style-type: none"> CA deficit reach highest level Large capital outflow in 2013 but inflow 2014 Rupiah depreciation High inflation pressure, from volatile and administered goods Slow growth due to deterioration of external sector Slower credit growth 	<ul style="list-style-type: none"> CAD improved; Capital inflows starting 4th q 2015 Rupiah stabilized in 2015, appreciation trend in 2016 Low inflation <u>Low exchange rate pass-through</u> due to weak demand & fuel Reform Sluggish growth due to export & limited fiscal space Single digit credit growth
POLICY MIX		<ul style="list-style-type: none"> Easing Monetary Policy : <ul style="list-style-type: none"> Policy rate cut by 75 bps Intervention to control volatility Macroprudential Policy: <ul style="list-style-type: none"> Enhancing bank risk management Increased Rp. reserve requirement Introduced LTV Tightening CFM's <ul style="list-style-type: none"> “Putting sand on the wheel” to mitigate impact of capital surges Increased FX reserve requirement Coordination with government <ul style="list-style-type: none"> Regional inflation coordination team 	<ul style="list-style-type: none"> Tightening Monetary Policy <ul style="list-style-type: none"> Stability over growth Policy rate increased by 200 bps Intervention to control volatility Macroprudential Policy: <ul style="list-style-type: none"> Tighter LTV requirement LDR reserve requirement Easing of CFM's <ul style="list-style-type: none"> Smoothing capital flow volatility Coordination with government <ul style="list-style-type: none"> 2nd round inflation effect of AP hikes Structural reform: subsidy policy 	<ul style="list-style-type: none"> Easing Bias Monetary Policy : <ul style="list-style-type: none"> Easing Bias policy from Nov 2015 Policy rate cut by 150 bps New policy rate (Aug 2016) Rp. reserve requirement cut by 1.5% Intervention to control volatility Macroprudential Policy <ul style="list-style-type: none"> Relaxing LTV requirement Easing of CFM's <ul style="list-style-type: none"> Smoothing capital flow volatility Coordination with government <ul style="list-style-type: none"> Structural reform: infrastructure & investment climate

Timeline: Bank Indonesia Policy Mix

Introduced SBI Lengthening Maturity Profile (implemented in a number of phases from Mar to Dec 2011)

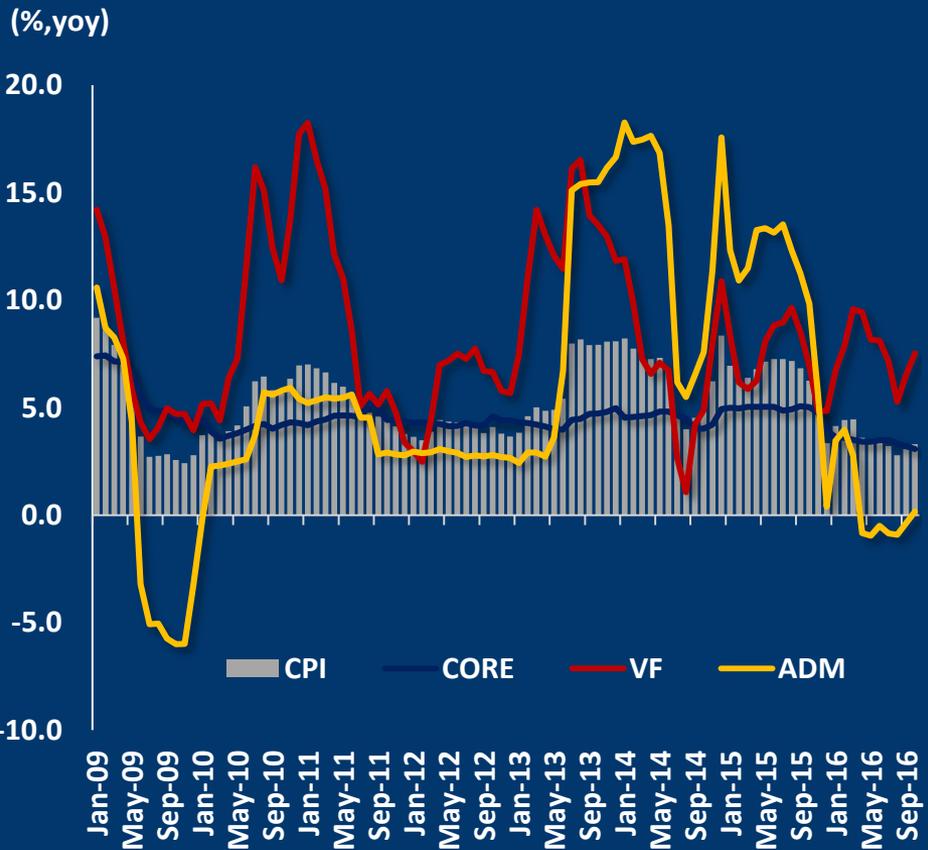


ECONOMIC PERFORMANCES

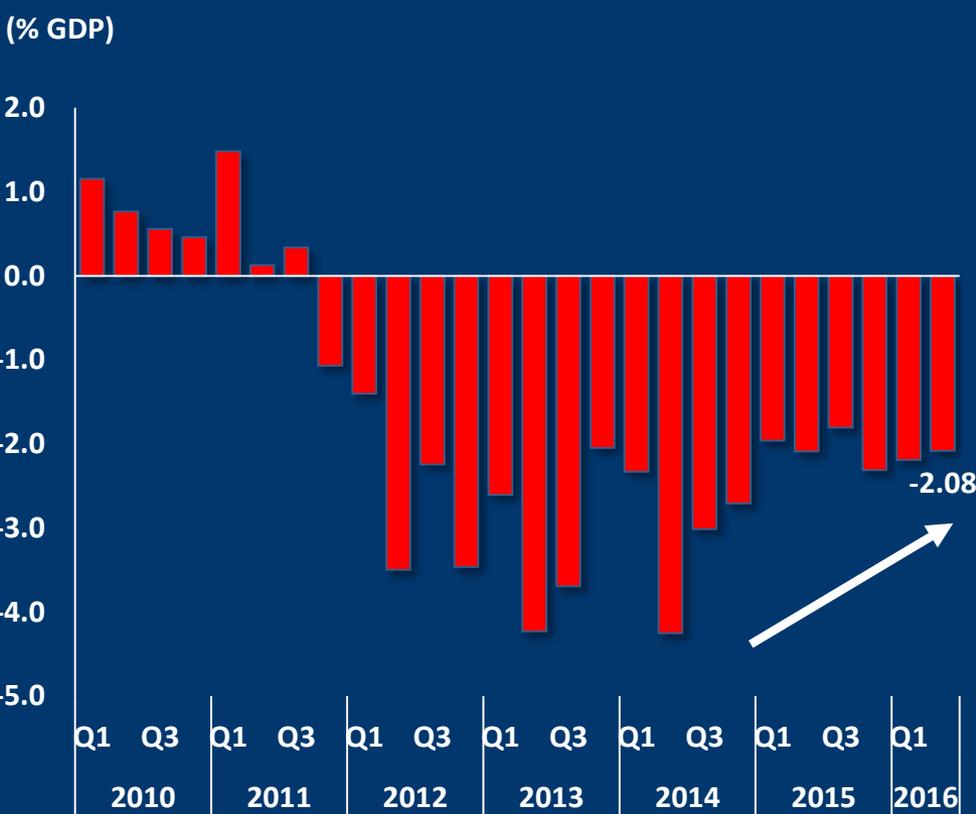
Macroeconomic Stability has been restored

The consistency of macroeconomic policy mix implementation has been able to regain macroeconomic stability as reflected on the within target inflation rate and lower current account deficit...

INDONESIAN INFLATION (% , yoy)



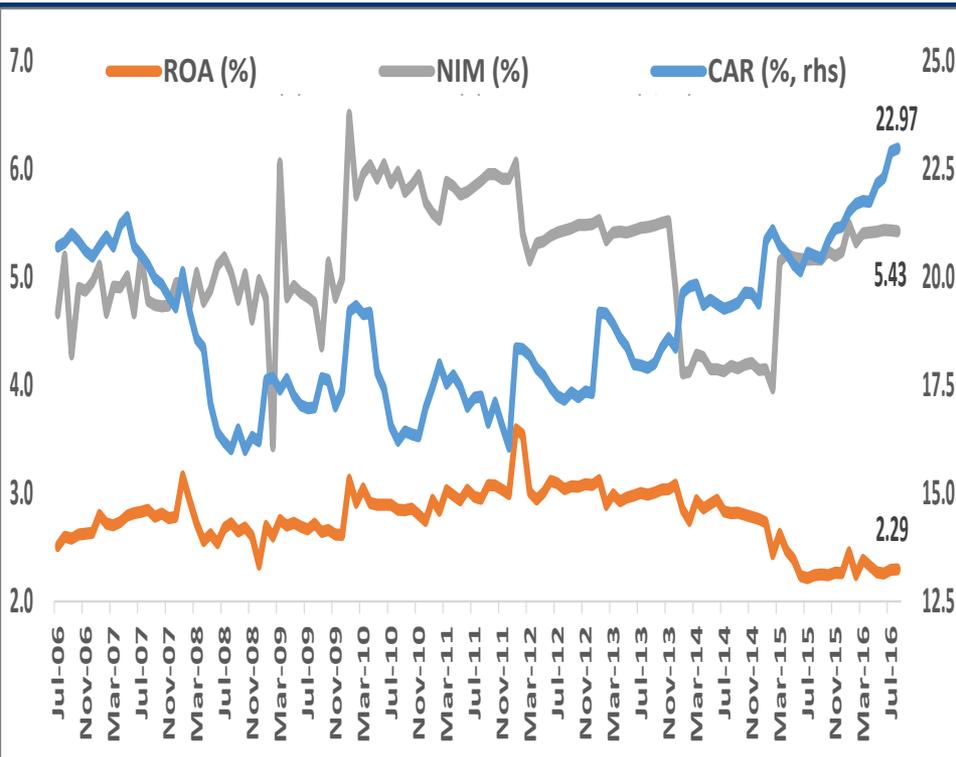
INDONESIAN CURRENT ACCOUNT (% GDP)



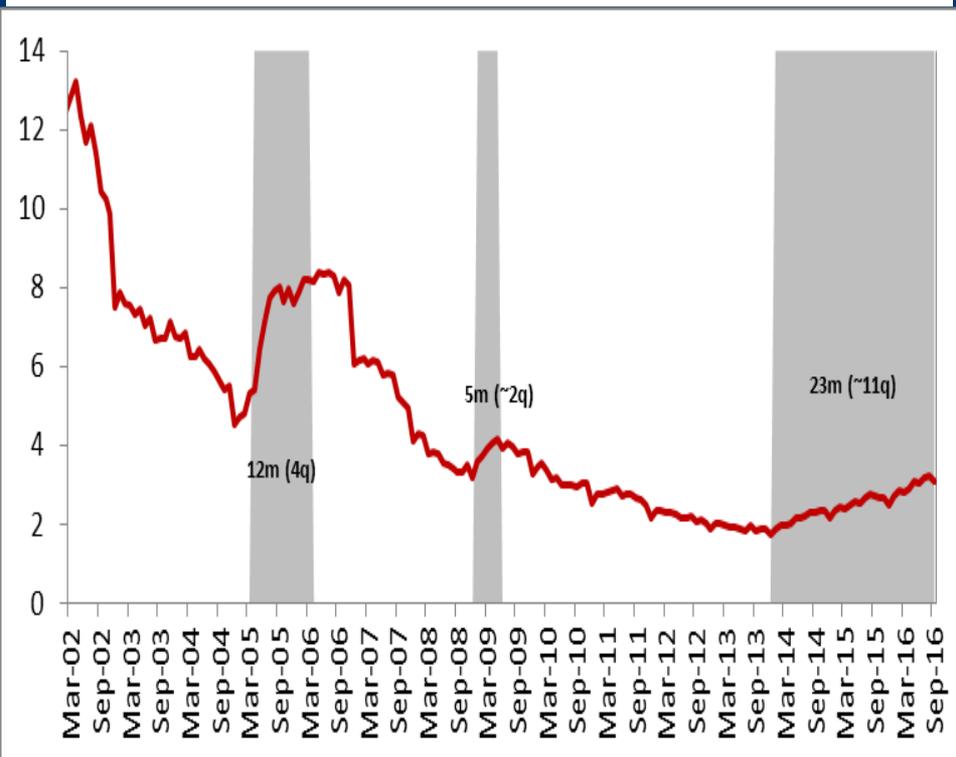
Financial System Stability remains strong

Indonesia's financial stability remains robust supported by high capital and Net Interest Rate Margin. Although NPL tends to increase, it is still much lower than the threshold...

INDONESIAN BANKING PERFORMANCES (%)



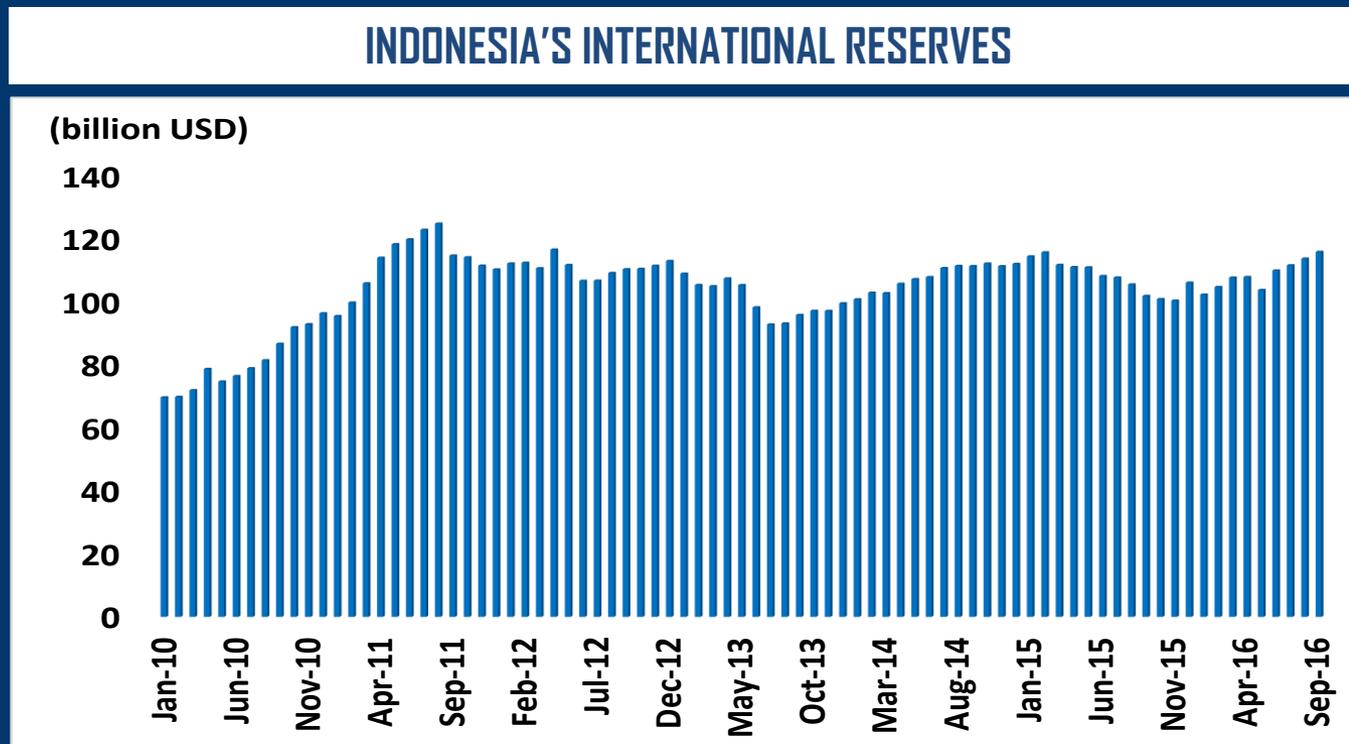
NON PERFORMING LOAN (%)



Macroeconomic Vulnerability also improves

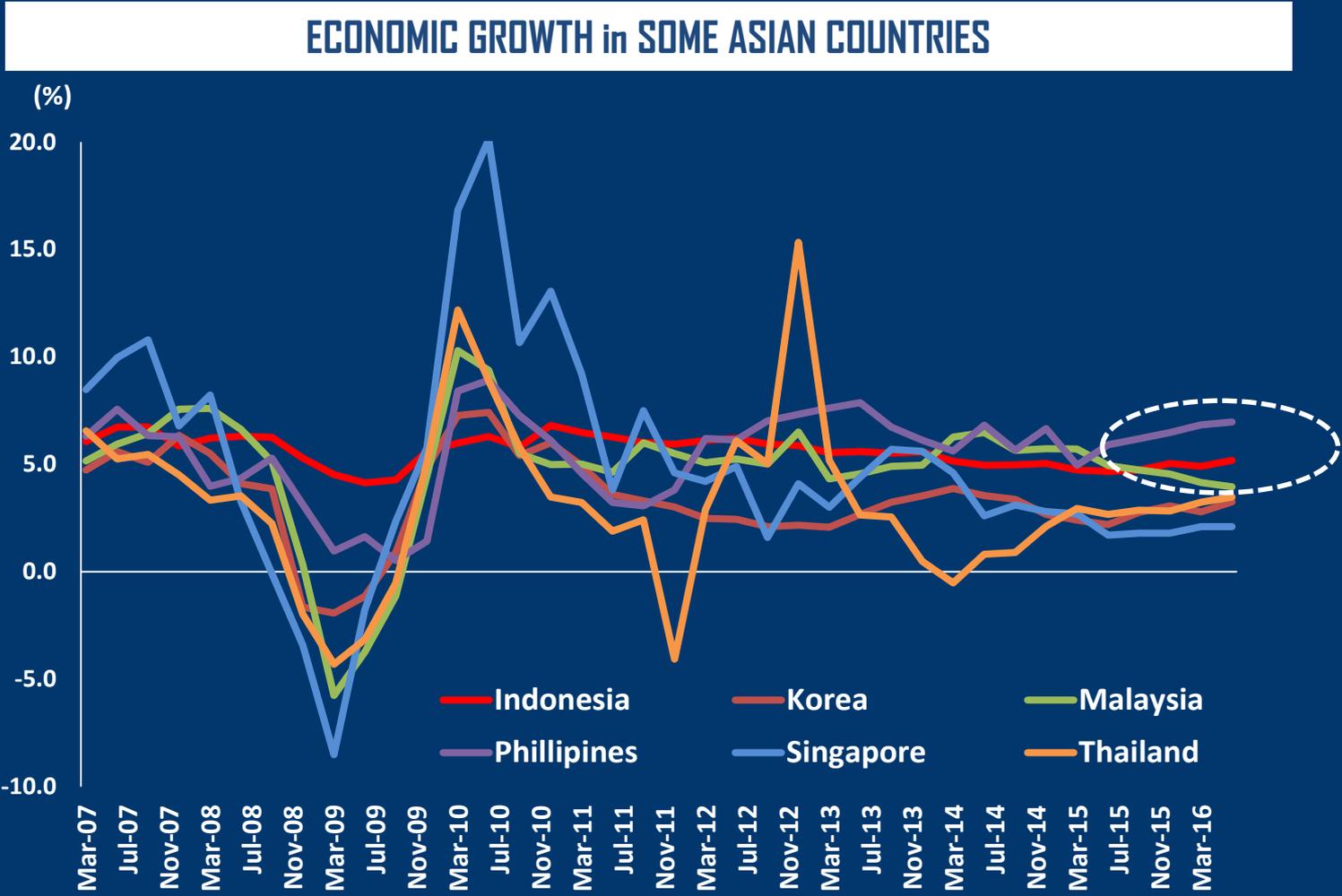
Macroeconomic vulnerability continues to improve mainly due to diminishing public and real sector vulnerabilities...

- Strong International Reserve also provides enough cushion in the even of external shock
- The Indonesian Government effort to control the government debt contributes positively on the increasing the resiliencies of public sector
- On the other hand, the consistency of Bank Indonesia to maintain inflation inline with the target reduces the vulnerabilities of real sector



Indonesian Economic Growth has been stabilized

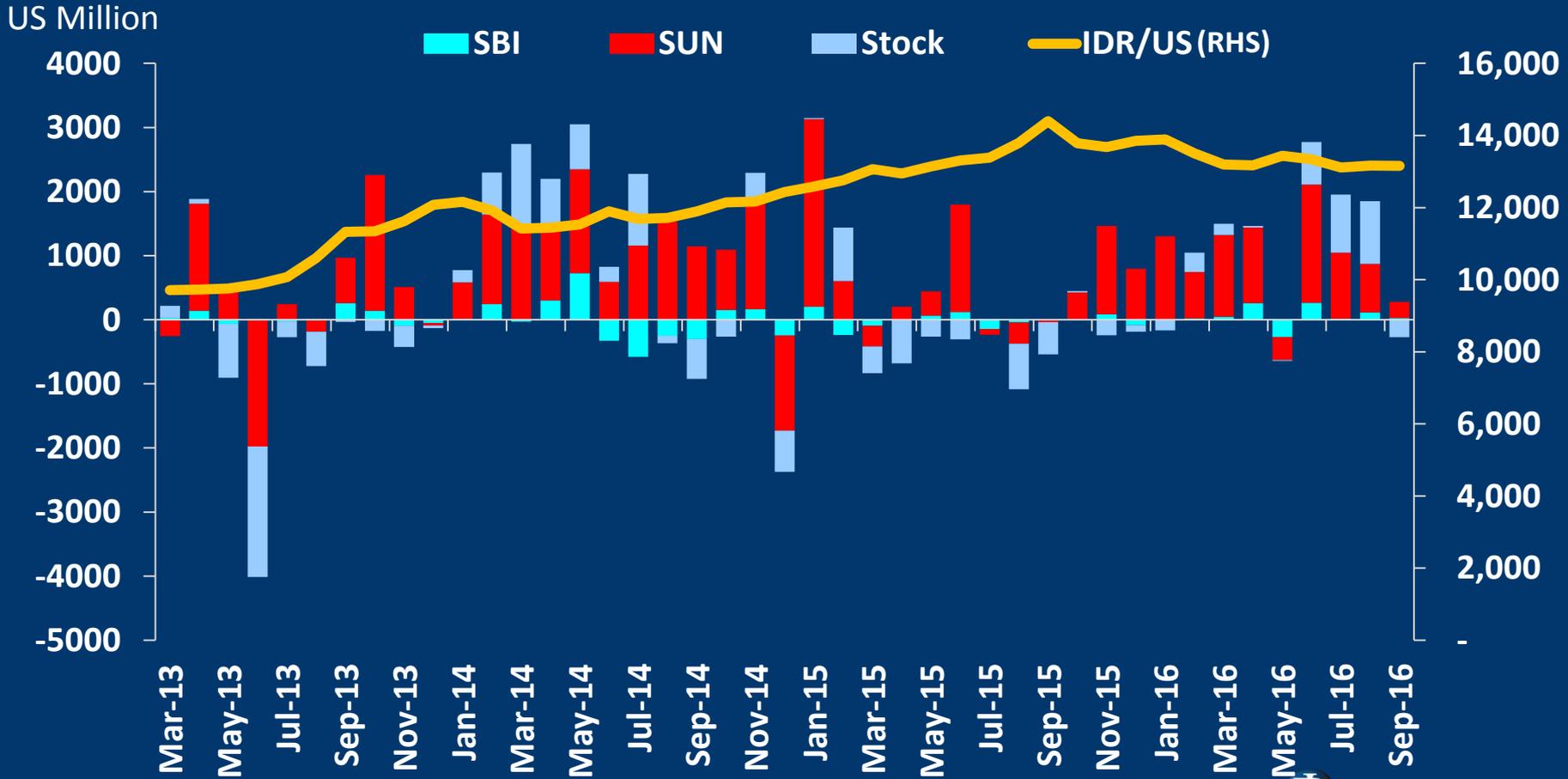
The consistency of macroeconomic policy mix implementation has also paved the growth momentum of Indonesian economic in the midst of sluggish global economic recovery and declining commodity prices...



Capital Inflows to Indonesia remains strong

Well maintained market confidence due to strong performance of Indonesian economic and attractive yields support capital inflows as well as Rupiah exchange rate appreciation...

PORTFOLIO CAPITAL FLOWS & RUPIAH EXCHANGE RATE



Source: Bank Indonesia, IDX, Bloomberg





THANK YOU

Vulnerable Global Economic Recovery

Global economic growth is not as strong as what we expected before ...

		2014	2015	2016						2017					
				Feb 2016 Estimation	Jun 2016 Estimation	Sept 2016 Estimation	WEO*	Feb 2016 Estimation	Jun 2016 Estimation	Sept 2016 Estimation	WEO*				
	World	3.4	3.1	3.4	↓	3.1	↓	3.0	3.1	3.6	↓	3.3	↓	3.2	3.4
	AS	2.4	2.4	2.6	↓	2.0	↓	1.8	2.2	2.5	↓	2.2	■	2.2	2.5
	Euro	0.9	1.7	1.7	↓	1.5	■	1.5	1.6	1.7	↓	1.6	↓	1.4	1.4
	Japan	0.0	0.5	1.0	↓	0.5	■	0.5	0.3	0.4	↓	0.0	↑	0.1	0.1
	China	7.3	6.9	6.3	↑	6.5	■	6.5	6.6	6.0	↑	6.2	■	6.2	0.1
	India	7.2	7.6	7.5	■	7.5	↓	7.3	7.4	7.5	■	7.5	↓	7.4	0.1

*Juli 2016 estimation