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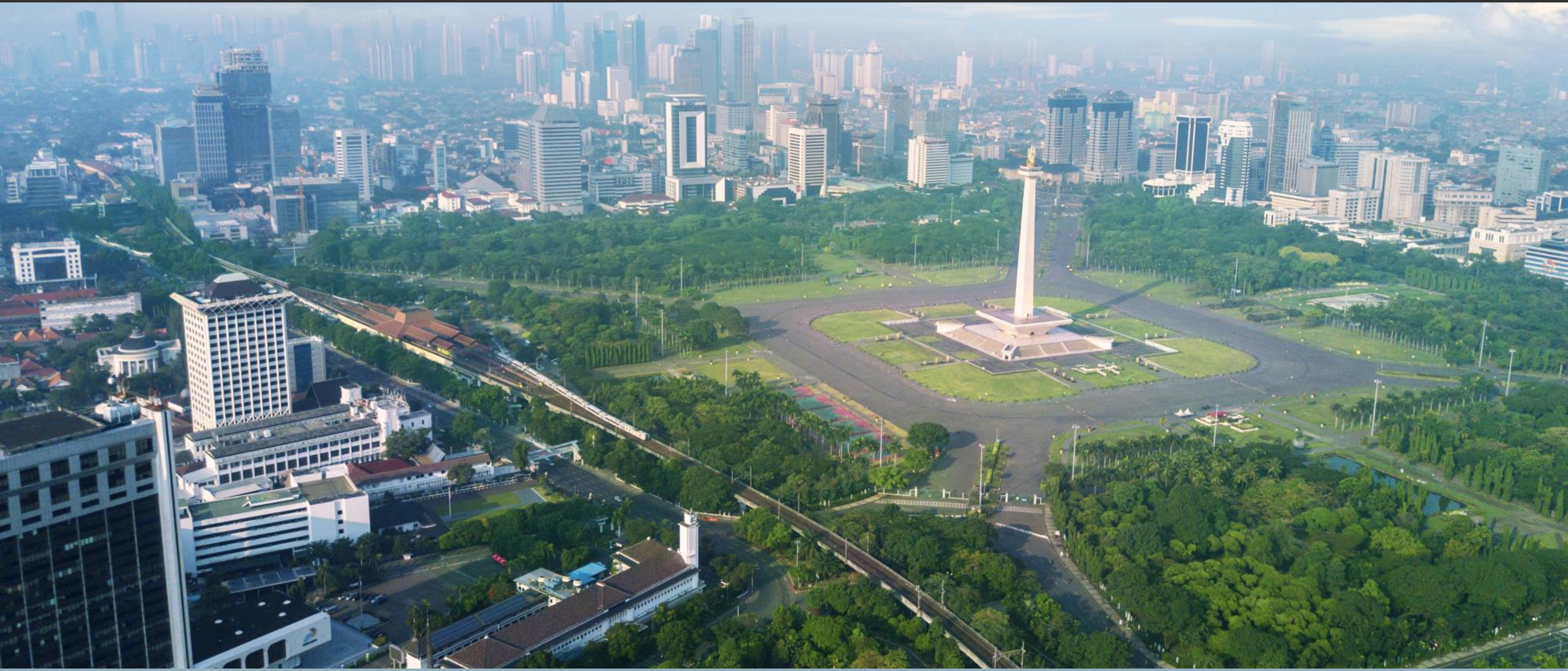


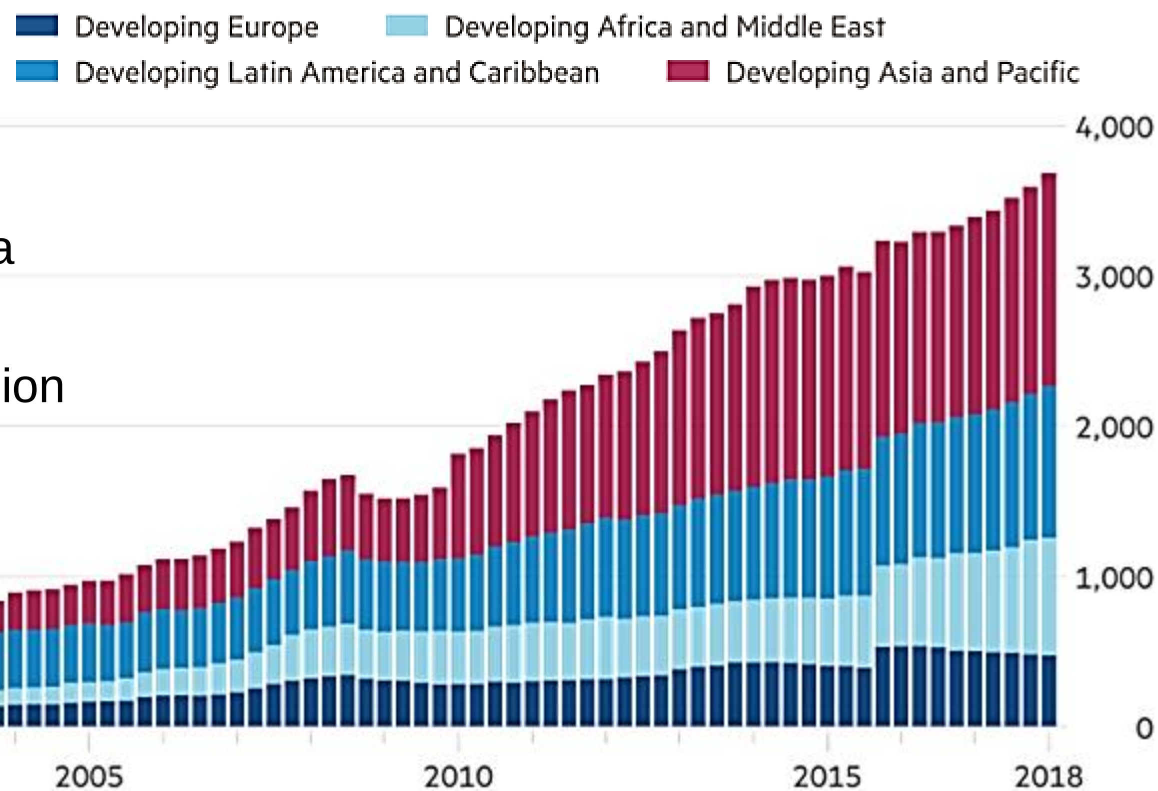
Risks, Resilience and Reforms: Indonesia’s financial system in 2019

Febrio Kacaribu, Adam Triggs, Jiao Wang

Risks facing Asia

- Public and private debt stocks
- Interest rate risks
- Currency risks
- Maturity risks
- Trade war
- Slowing global growth
- Slowing growth in China
- Policy uncertainty
- Prospects of US recession
- Geopolitical risks

Figure 1: Dollar-denominated debt ($b)



Indonesia: A case study for managing financial risks in Asia

- Indonesia on the receiving end of many, but not all, of the financial and economic risks facing the region

- Indonesia has developed a forward-thinking crisis response framework: the Prevention and Resolution of Financial System Crisis Law (PPKSK Law)

- Indonesia, like others, is seeking to balance competing objectives: deepening its financial system while preserving financial stability.

Risks: macroeconomic developments

Broad picture of the Indonesian economy

- 2018 was a big test for Indonesia's economy resiliency. In retrospect, the economy turned out to be in much better position compared to at the end of 2013-2015 or, obviously, 1997-1998.

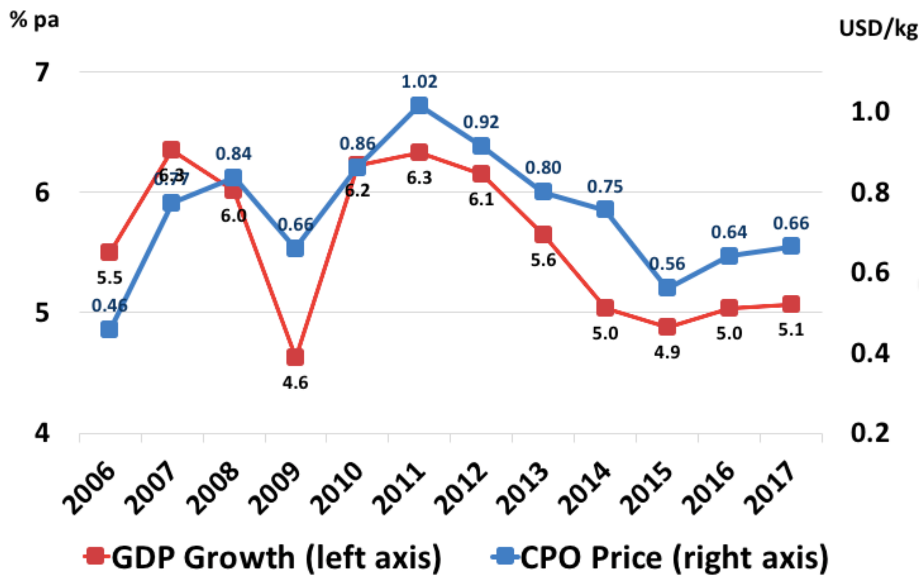
- Bank of Indonesia (BI) and the Ministry of Finance (MoF) focused their attention on the exchange rate.

- 1998 was always in the background.

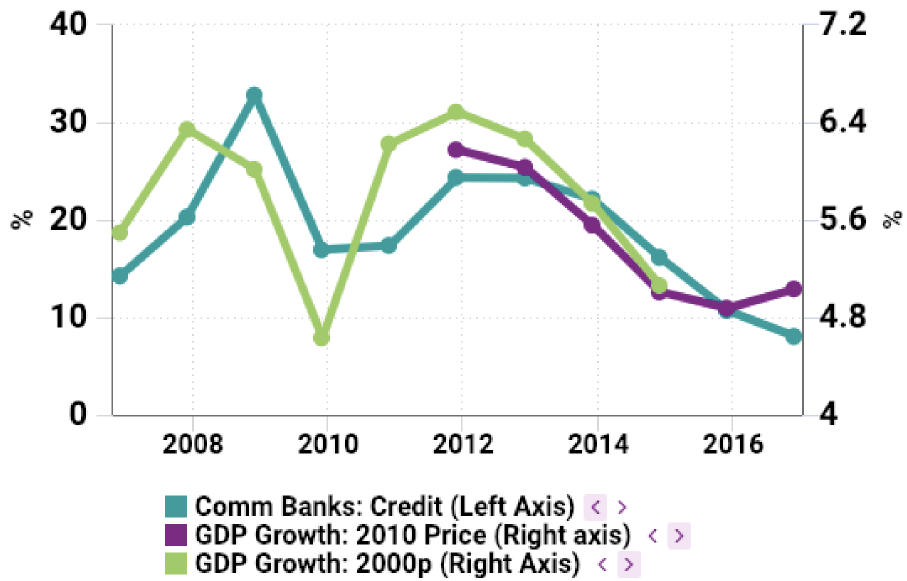
- BI and the MoF agreed on "stability over growth" consensus.
  - Newly appointed Governor of BI, Perry Warjiyo, and the MoF, representing a populist administration of Joko Widodo, < 1 year away from the upcoming presidential election

- GDP growth rate has slowed down since the period of commodity boom that peaked in 2011.
- The economic activity follows the commodity prices quite closely.
- The Taper tantrum contributed to the faster deceleration of growth in 2013-2015; liquidity problem in the banking sector made worse by the short-term capital outflows.
- The GDP growth rate reached its bottom at 4.9% in 2015, after which it slowly accelerated again to 5.0% (2016) and 5.1% (2017)

GDP Growth & CPO Price, 2006-2017

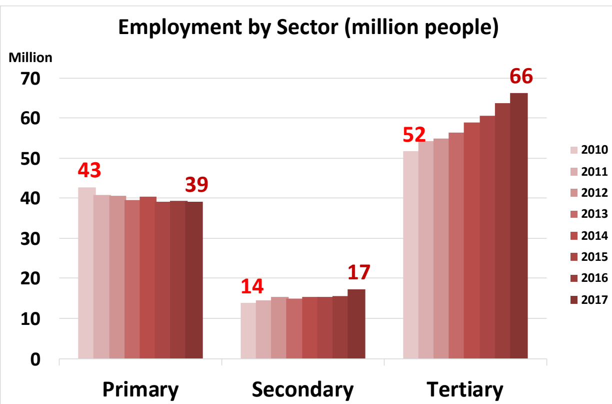


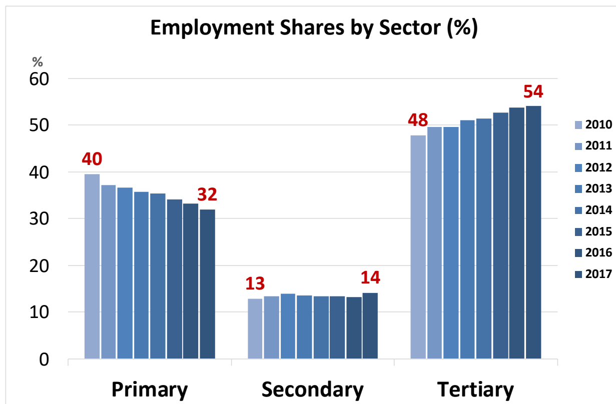
GDP Growth and Credit, 2006-2017

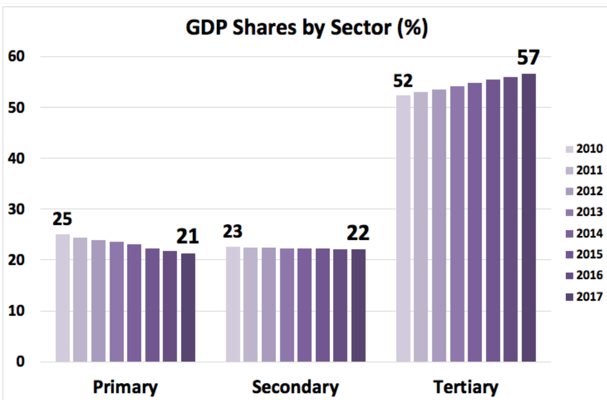


Structural Transformation

- The economy is transforming; the labor market is too
- Primary sector (mainly agriculture) is not the biggest employer; it is the service sectors instead
- Secondary sector (manufacturing) is increasing in terms of employment but not in terms production
- Primary sector's labor productivity increases (5%) relative to secondary (-11%) and tertiary sectors (-3%)
- Slowing down in Manufacturing Sector is a serious threat







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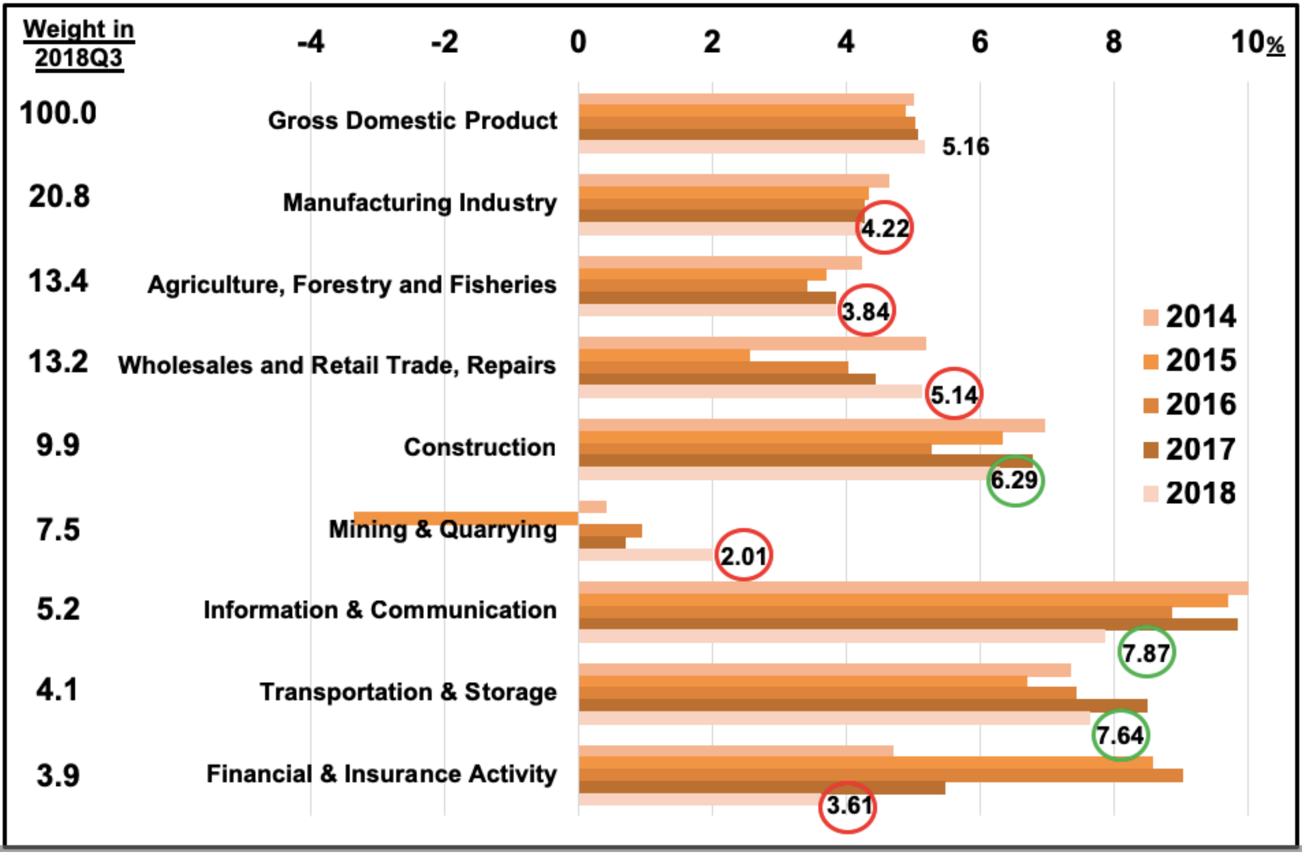
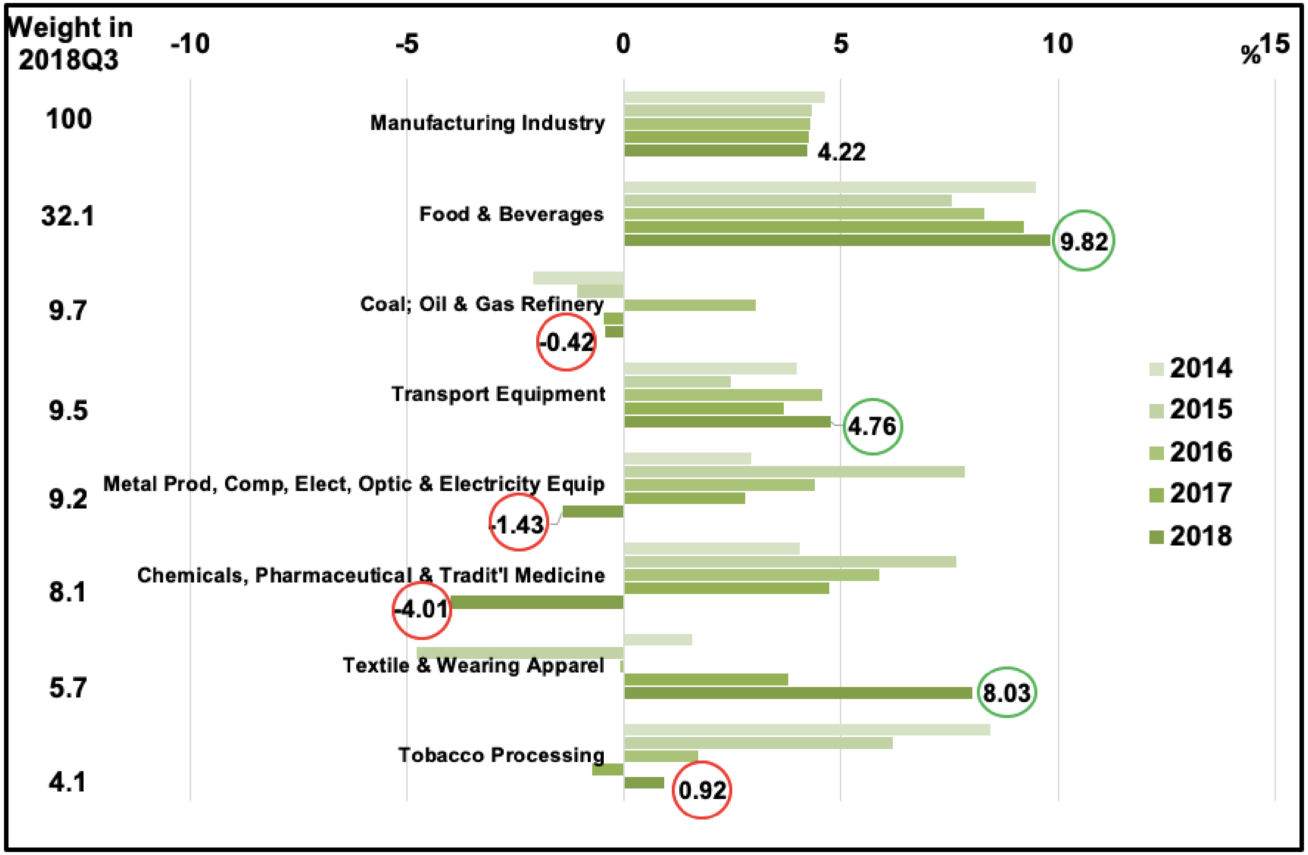
Trends in Production (2014Q1-2018Q3)



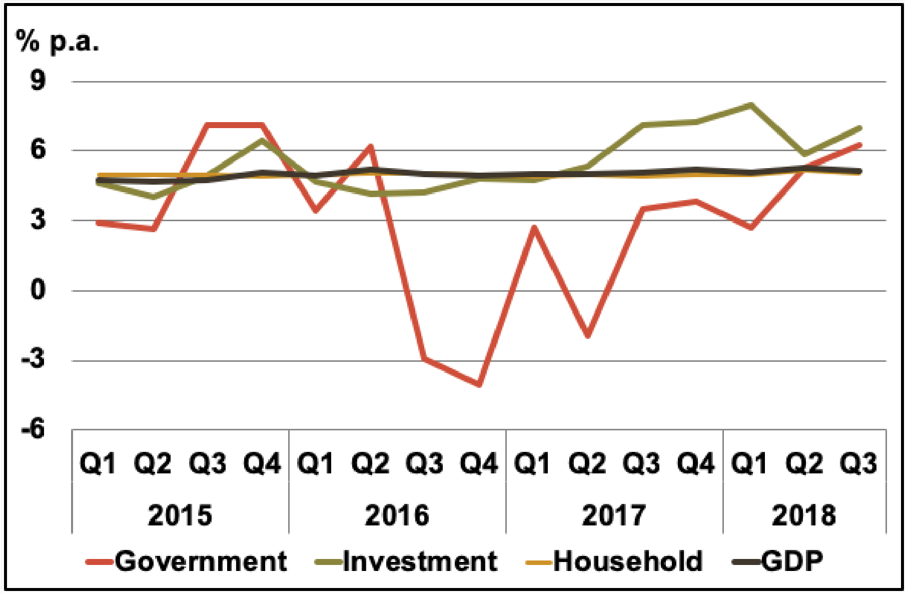
- GDP growth continues its recovery since 2015 low
- Manufacturing sector surprises with low growth in 1H2018 after steadily grown faster through Q4 2017
- Retail sector is recovering
- No signs of recovery in Agriculture, Forestry, and Fishery due to decreasing commodity prices
- Construction thrives due to infrastructure projects
- ICT is and still going to be the champion
- Strong growths in Transportation-and-Storage and Accommodation-and-F&B-service (not shown)
- Forecast: 5.2% for 2018, 5.2-5.3% for 2019.

Trends in Manufacturing Sector

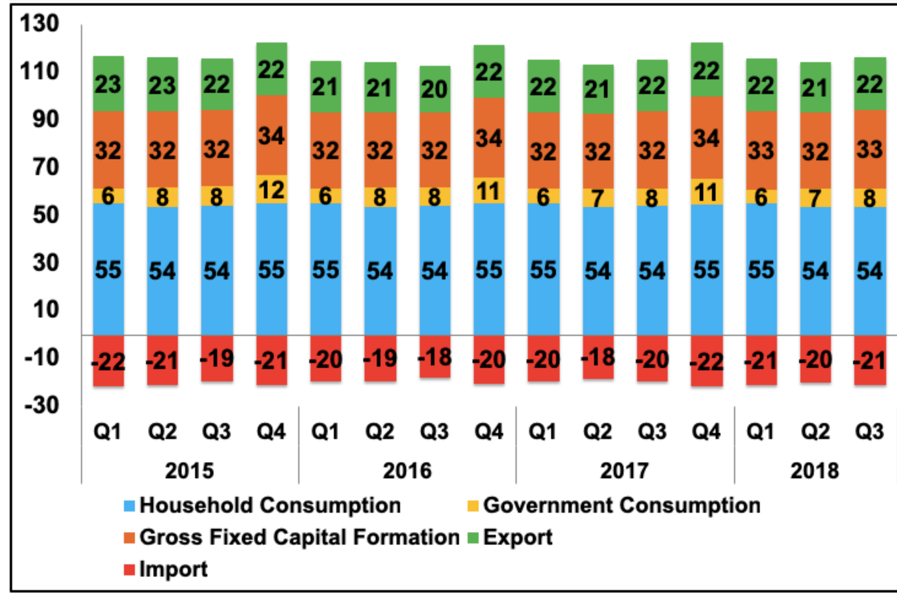


- Manufacturing sector surprises with low growth in 1H2018 after steadily grown faster through Q4 2017
- Food and Beverages constitute about 32% of Indonesian manufacturing sector and it's growing very strongly since its bottom back in 2015
- Textile and Wearing Apparels are following the F&B trend
- These two are among the highest employment sectors
- All other sectors, especially w/ high import contents are struggling due to the stronger USD.

Growth (yoy) of Expenditure



Shares of Expenditure Components



- Consumption still slightly below GDP growth but higher than 5%.
- Investment showed some strength since 2017, to continue into 2019 despite significant drop in 2Q2018
- Stable composition of GDP from the expenditure side. Uptick patterns in Q4
- Consumption still hovers around 54% while investment around 32%
- Without a significant reform in manufacturing sector, Indonesia's consumption increase means higher imports.

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Risks: Macroeconomic developments

Tightening global financial conditions. Recent impact on Indonesian markets.

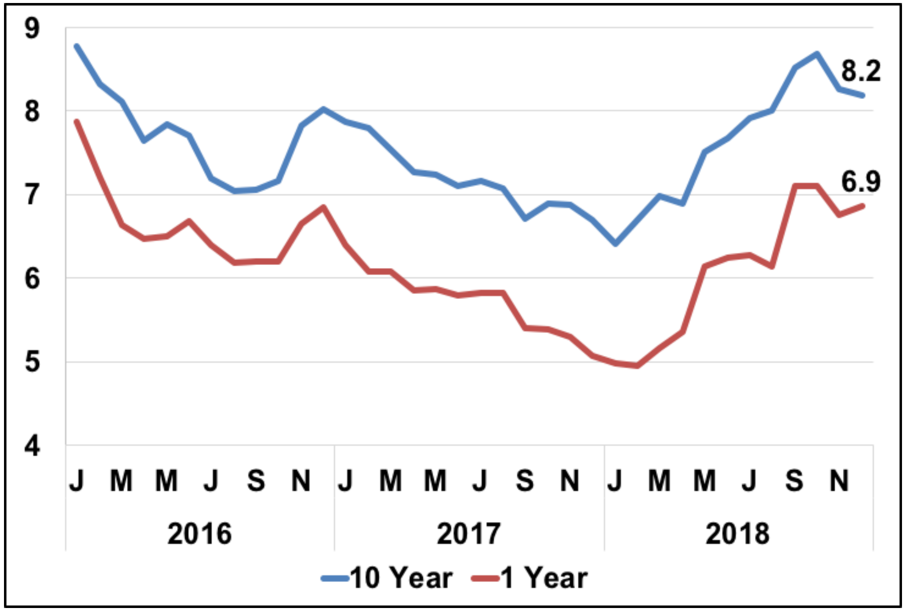
- The year of 2018 did not come as a surprise. Everybody knew that The Fed would hike the Fed funds rate four times in 2018.

- BI accumulated about USD32 billion since the end of the Taper Tantrum period at the end of 2015 to get ready for 2018.

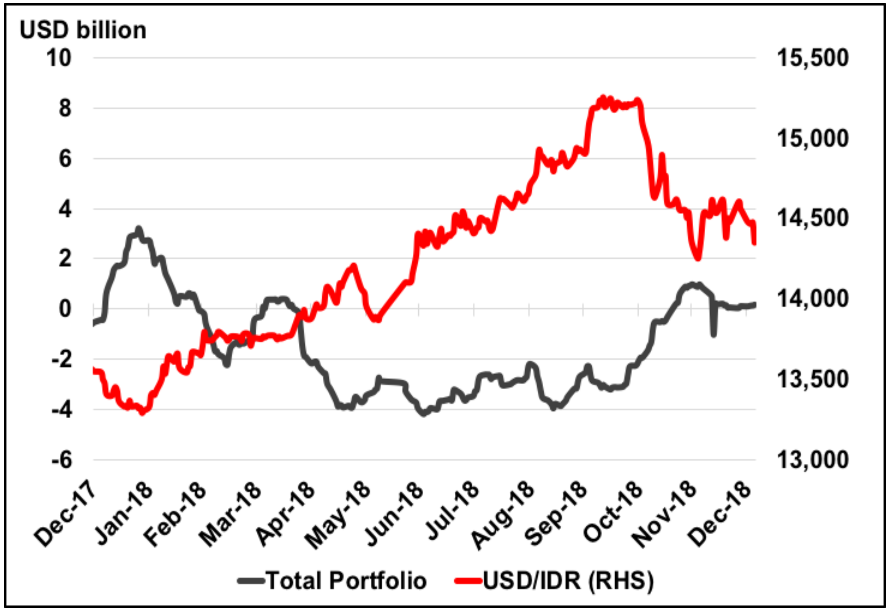
- The portfolio investment exited the emerging markets (EMs)' currencies bringing almost all EMs' currencies depreciated fast towards the mid-2018.

- By mid-2018 BI was implicitly targeting a 6 percent depreciation rate for the whole year, until several new shocks happened in the global market.

Government Bonds Yield (% pa)



IDR/USD and Accumulated Portfolio Capital Inflow (Last 12 months)



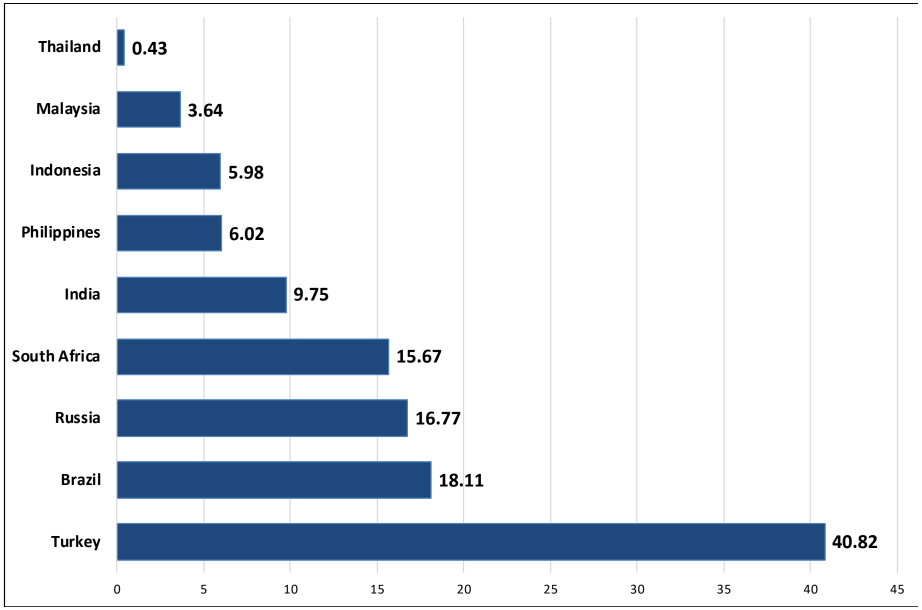
- Turkey, Venezuela, Brazil, South Africa happened; crude oil price was also trending up. These shocks were looking to create a perfect storm scenario for Rupiah.
- 10 months into 2018, there USD8 billion capital outflow from portfolio investment only.

- The yields of Indonesian government bonds increased rapidly, peaking in October.

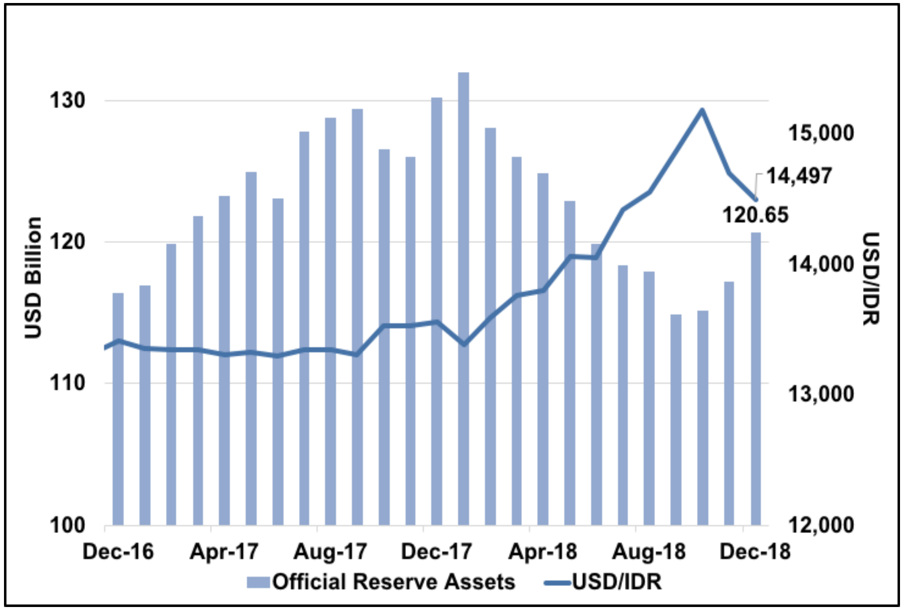
- Along with the pressure from the Current Account Deficit, this strong portfolio investment capital outflow forced BI to intervene the forex market using about USD18 billion of its forex reserves and hiked its policy rates by 150 bps only to see Rupiah depreciated to above 12 percent by October (year to date).

- Falling crude oil price since October, among other factors, helped IDR to appreciate and ended the year with depreciation rate just 6% (ytd)

Year to Date Depreciation Rates of Selected EMs (Last updated 19-Dec-18)



IDR/USD Official Reserve Assets (Last 24 months)



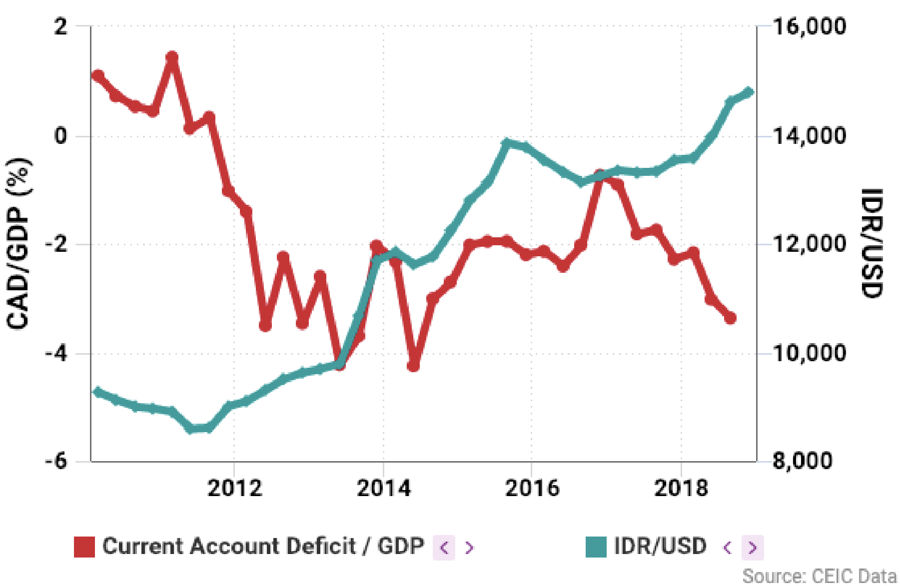
- Several other global events helped IDR
  - US Mid-term election
  - Trump-Xi talk and temporary truce

- Domestically, GDP growth rate turned out to be OK, even slightly better than expected

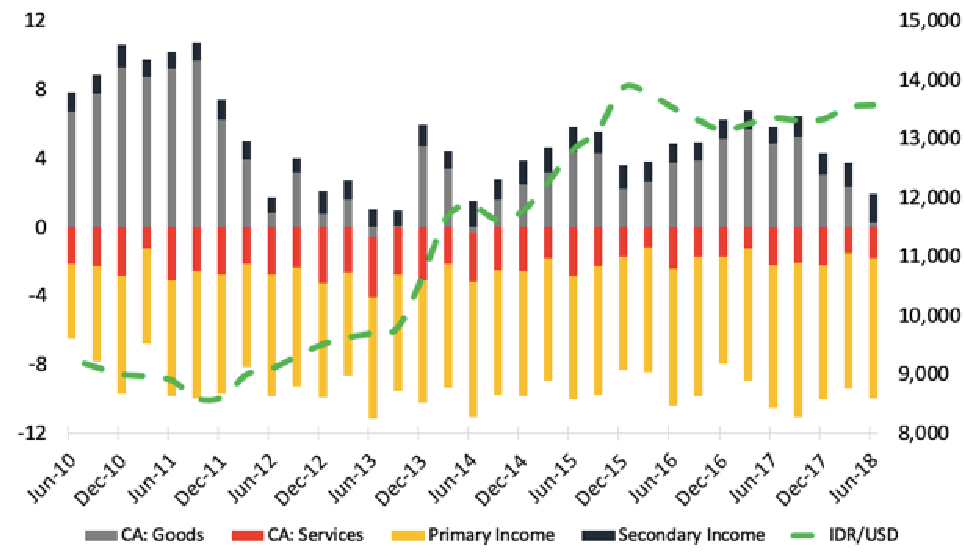
Risks: Macroeconomic developments

Current Account Deficit

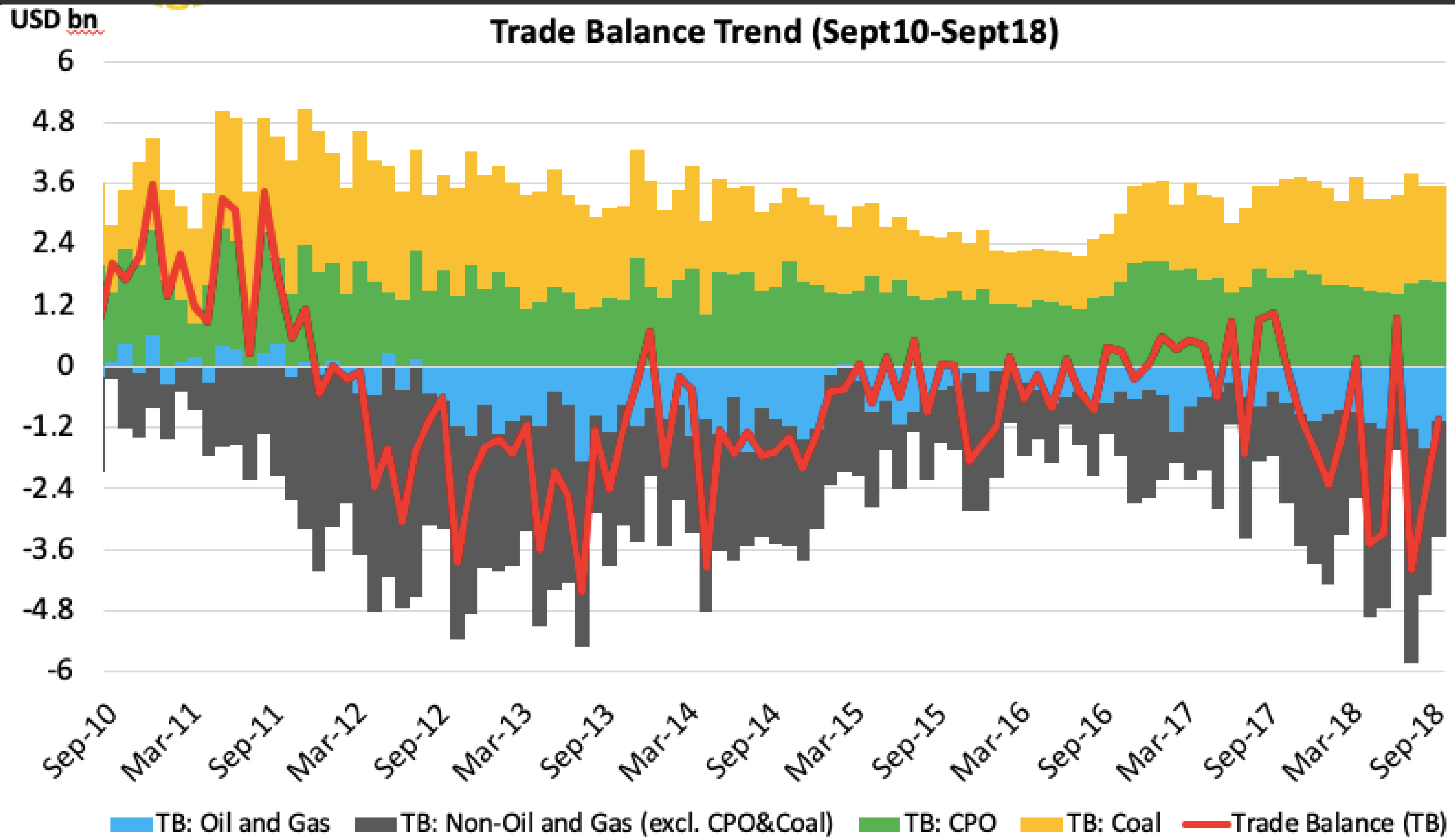
CAD and Exchange Rate



Current Account Components

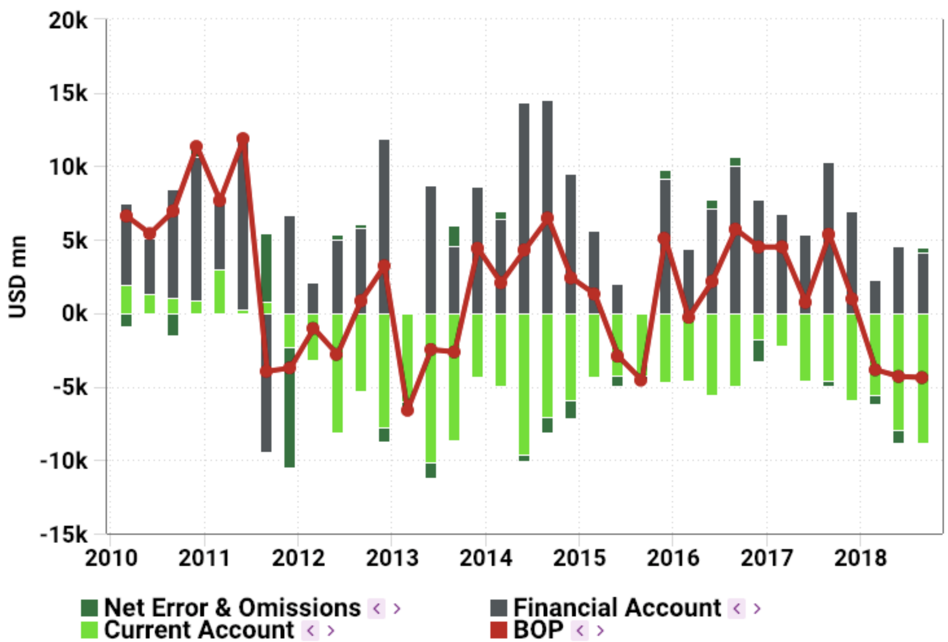


- Current Account Deficit (CAD) is increasingly become a problem in the last two years.
- The goods trade balance is getting smaller as the export grows much slower than before as it is getting harder to sell export goods, China is slowing down

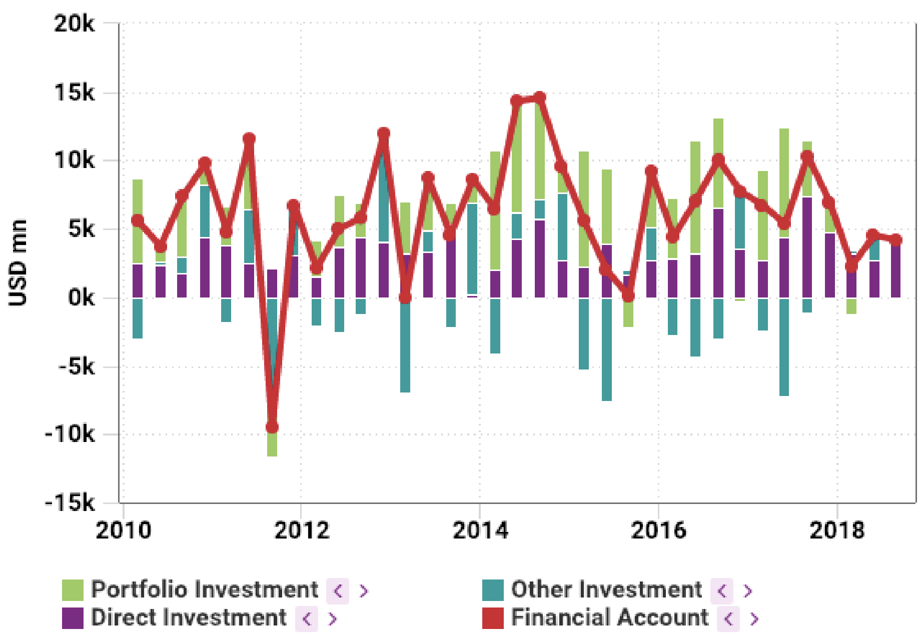


- Continuous deficit in oil and gas trade has recorded since 2013; the trend was attributable to the low oil and gas production as well as high demand for fuels
- However, oil and gas is not the only culprit of worsening CAD as non-oil and gas balance, excluding coal and palm oil, has recorded a higher trade deficit

Balance of Payment



Financial Account



- The financial account cannot support the CAD in 2018, leading to a BOP deficit.
- Bank of Indonesia used USD18 billion out of USD132 billion forex reserves.
- In the financial account context, 2018 is not a typical developing economy mismatches story that could lead to a typical 1990s currency crisis.
- The financial account is supported by steady FDI inflows. Portfolio investment net inflow is almost zero in 2018.

- The economy is increasingly attracting more of FDI, averaged about USD16,5 billion/year in 2016-2018; only USD 12 billion/year in 2010-2015.
- Ease of Doing Business ranking which improved significantly in the last three years from 120s in 2015 to 72 in 2017 but drop slightly to 73 in 2018.
- Even with the problems in improving the Ease of Doing Business ranking, FDI still comes at about the same speed in 2018.
- The improvement in the Logistic Performance Index might have helped. The infrastructure development is largely responsible for this achievement.

Risks: Macroeconomic developments

Concerns about SOEs (especially infrastructure)

- Jokowi introduced a big plan in 2014 for infrastructure development. A *Proyek Strategis Nasional* (PSN) was introduced to consist of toll roads, seaports, airports, power plants, and clean water projects which amount to about USD350 billion worth of projects during his first term, 2014-2019 period.

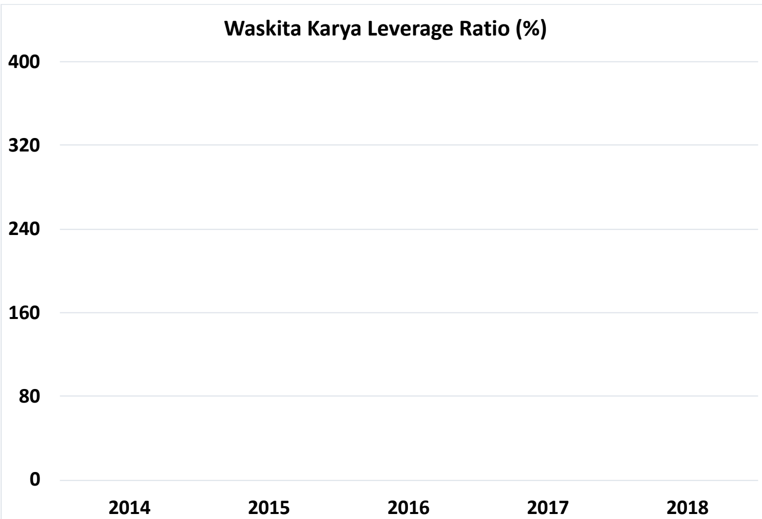
- 40 percent of the financing is planned to come from the government budget while the rest is expected to come from the state-owned enterprises (SOEs) and the private enterprises.

- In the first three years, the budget for infrastructure development has been always at around USD30 billion every year. The SOEs' role is pushed as well at the same time.

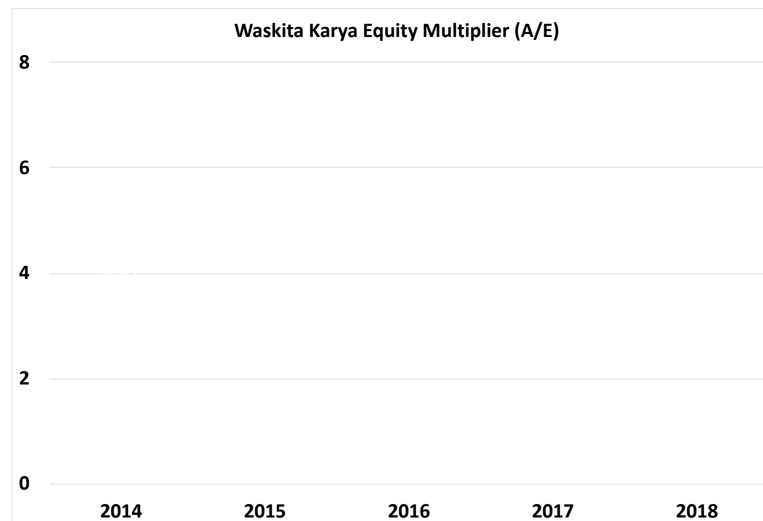
- What has been left out is the significant role of the private enterprises. Almost all of the newly built seaports, airports, toll roads, and power plants are built by the SOEs.

- As the result, the infrastructure SOEs have increased its leverage ratio fast and this makes a lot of people including the media worry. Are the risks really increasing fast as well?

PT. Waskita Karya



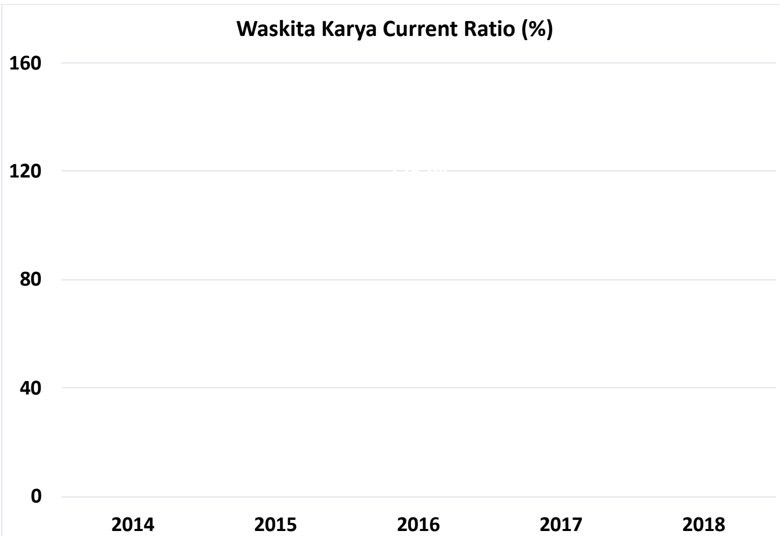
Debt Equity Ratio has increased substantially to 353,59% in 2018, from 111,25% in 2014. The Company's DER increased its company and bank debt used to acquire Turnkey projects



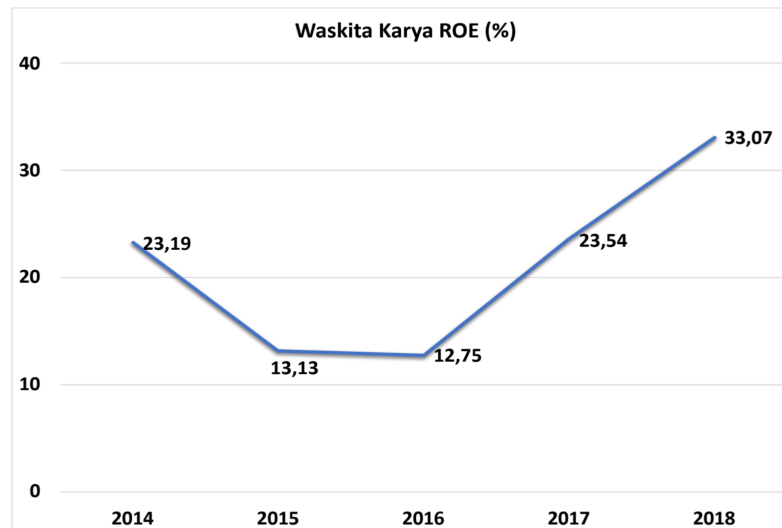
Overall, the equity multiplier of PT. Wijaya Karya recorded an increase of 3% in the last 5 years, from 4.41 in 2014 to 7.41 in 2018.

Source: financial statements of PT Waskita Karya, PEFINDO, Investing.com

PT. Waskita Karya



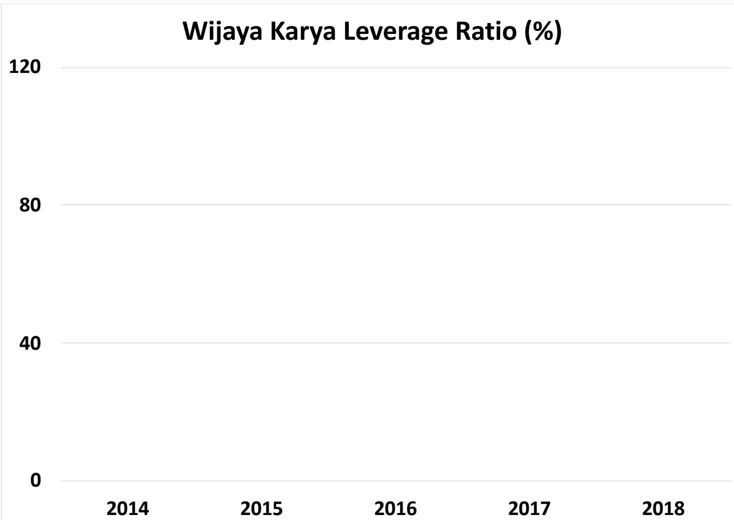
Current ratio of PT. Waskita Karya overall has decreased slightly.



ROE of PT. Wijaya Karya Tbk based on the data in 2018 recorded at 33,07% and experienced a fairly high increase of 20% from 13,13% in 2015. The significant rise in ROE shows that there are greater rights of shareholders from the profits earned by the company for every Rupiah that the shareholders invest.

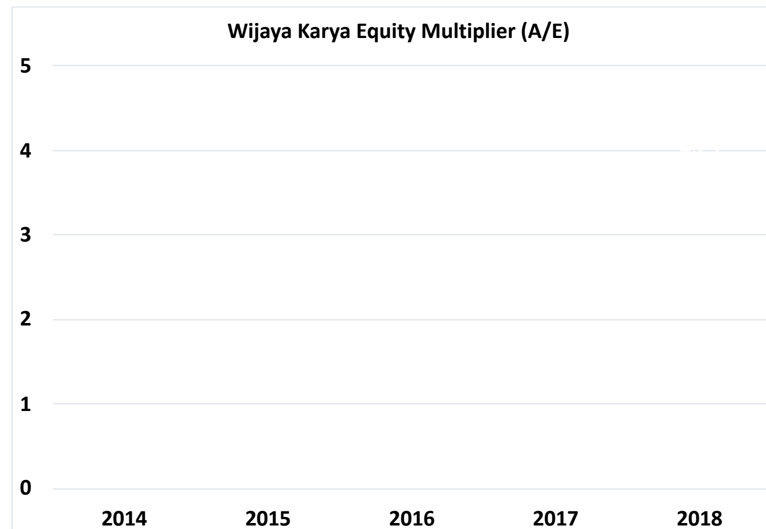
Source: financial statements of PT Waskita Karya, PEFINDO, Investing.com

PT. Wijaya Karya



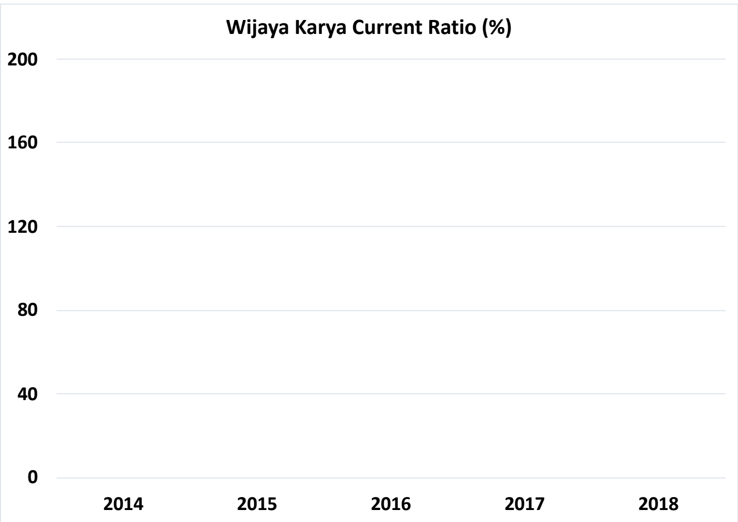
The solvency ratio showing the ability of the Company to pay its obligations and can be measured through the ratio of liabilities to equity. The leverage ratio of PT. Wijaya Karya fluctuates, with a minimum ratio of 58,94% in 2016 and the maximum of 111,4% in 2018.

Overall equity multiplier of PT. Wijaya Karya has fluctuated. Starting from 4,09 in 2014, then rose to the highest EM at 4,48 in 2015. However, the EM substantially decreased to its lowest point at 2,74 in 2016. Afterward, it gradually increased until it back to the range of 4,29 in 2018.



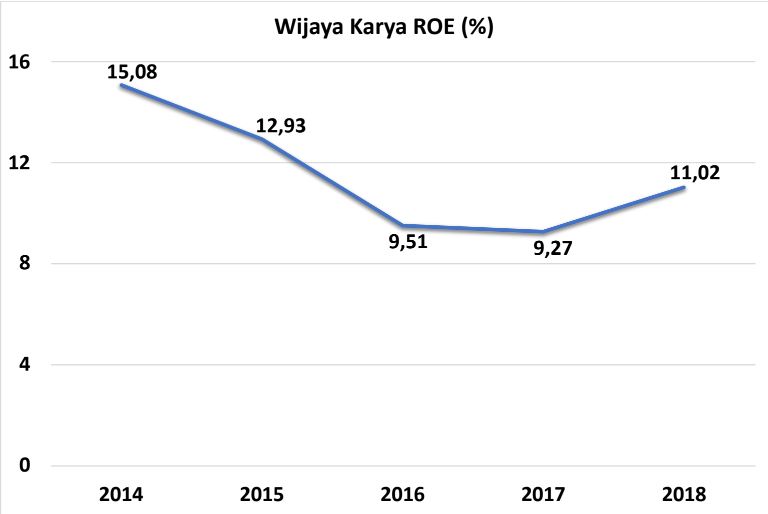
Source: financial statements of PT Wijaya Karya, PEFINDO, Investing.com

PT. Wijaya Karya



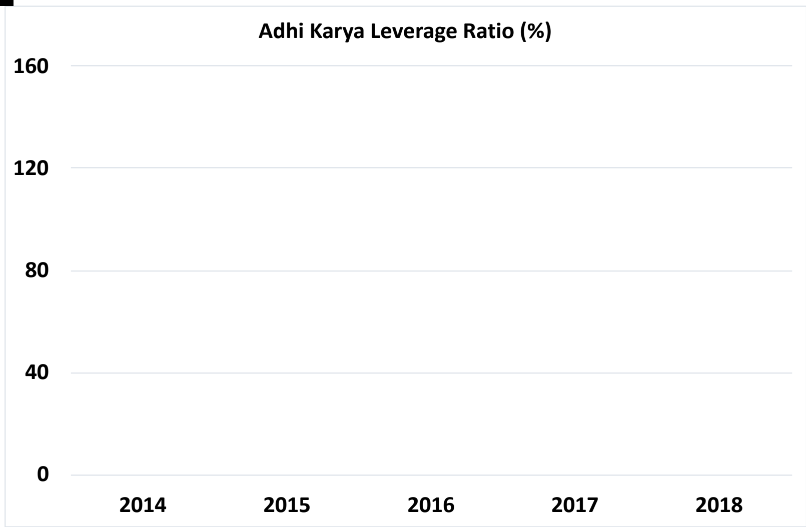
The ratio of liquidity is measured by using the current ratio with the achievement of 157,05% in 2018. This indicates that the company's ability to repay its debt in 2018 remains relatively good.

The overall realization of PT. Wijaya Karya's ROE has declined during the last five years. From 15,08% in 2014 to 11,02% in 2018.

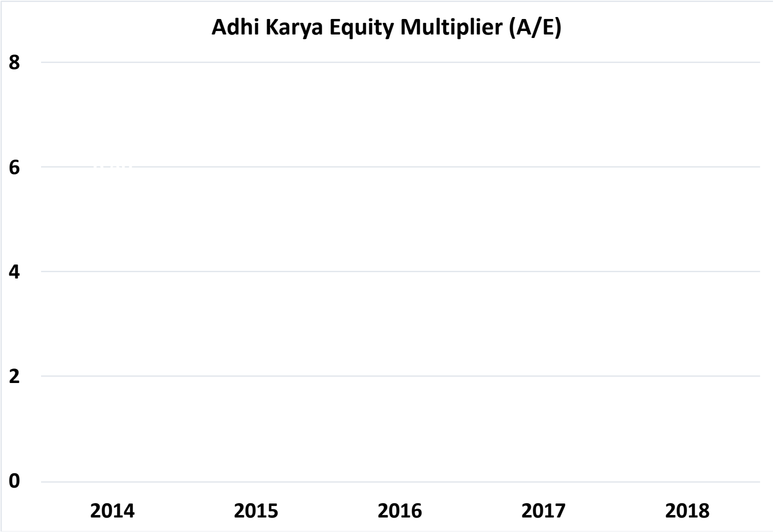


Source: financial statements of PT Wijaya Karya, PEFINDO, Investing.com

PT. Adhi Karya



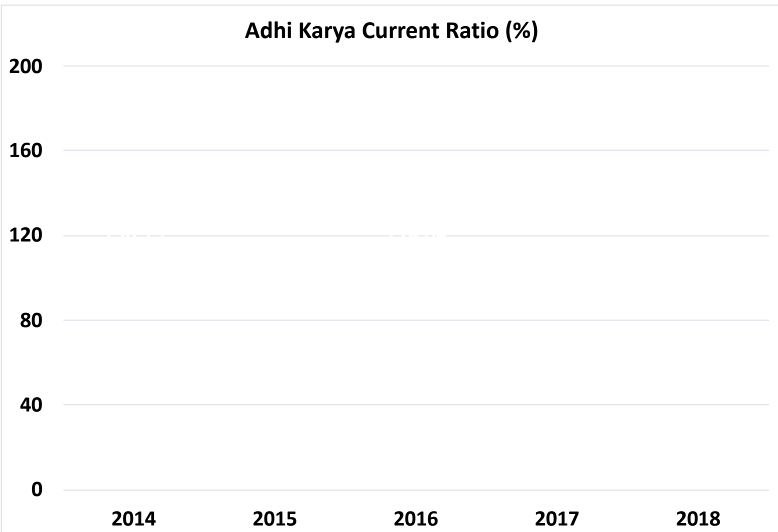
Adhi Karya's debt to equity ratio (DER) in 2017 is 144,26% and falls to 134,43% in September 2018. The value was still considered normal and below the stipulated conditions where the covenant stipulated for DER was at a maximum 2.75 times or equals 275%. Since ADHI debts are mostly used for expansion, thus the future prospects of the company are still promising.



Adhi Karya Equity Multiplier declined to half of its value from 6,4 in 2014 to 3,25 in 2015. Then, it increased proportionally to 4,65 in 2018.

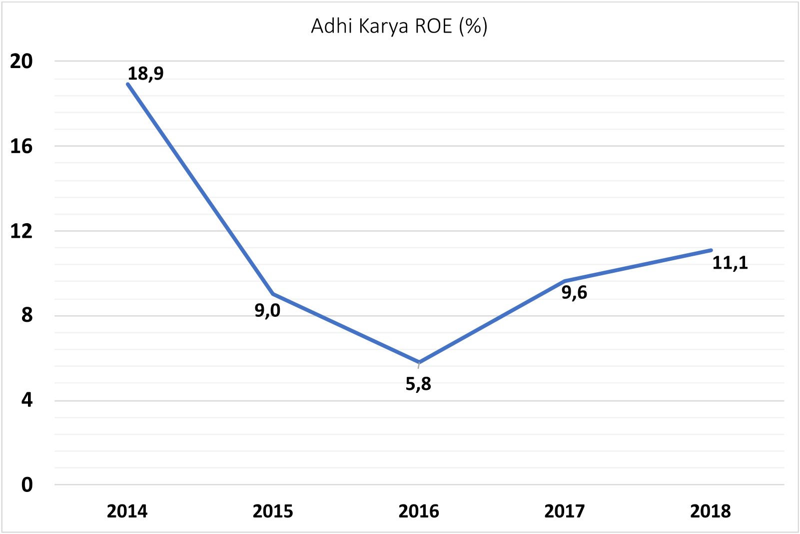
Source: financial statements of PT Adhi Karya, PEFINDO, Investing.com

PT. Adhi Karya



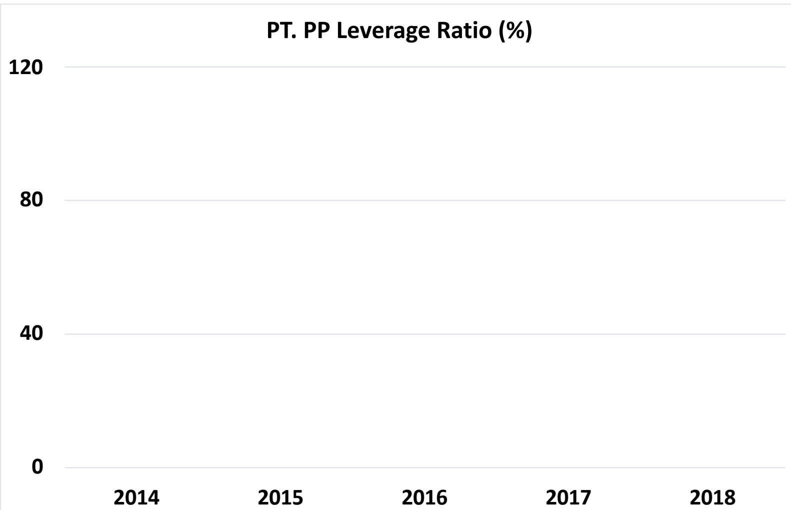
The current ratio of PT. Adhi Karya is relatively stable in 5 years, with a total average of 140%. That indicates that a firm has enough resources to meet its short-term obligations.

Return on Equity (ROE) of PT. Adhi Karya significantly decreased from 18,9% in 2014 to the lowest point, stood at 5,8% in 2016. However, ROE then rose rapidly to 11,1% in 2018.

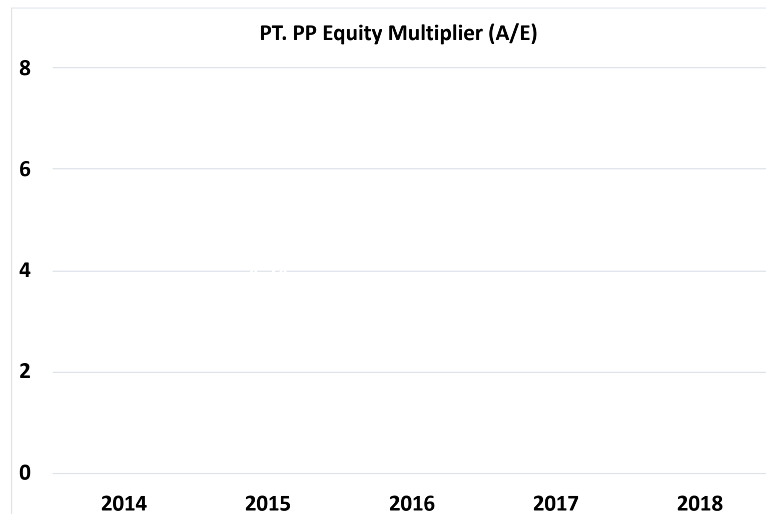


Source: financial statements of PT Adhi Karya, PEFINDO, Investing.com

PT. Pembangunan Perumahan (PT. PP)



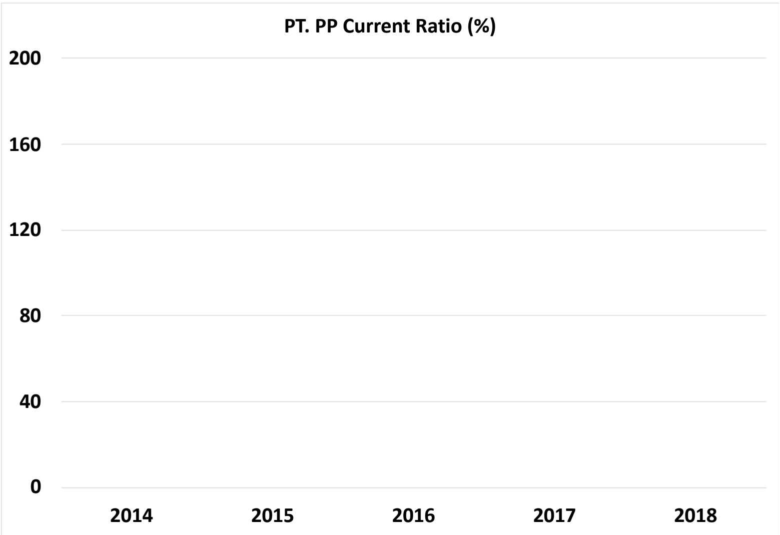
The leverage ratio of PT. PP overall decreased. Starting from 2014, it stood at 113,7%, then dropped to 72,4% in 2018. Debt to equity ratio of PT. PP becomes the lowest ratio compared to other four SOEs.



The equity multiplier of PT. PP overall decreased. From 6,21 in 2014 to 4,04 in 2018. As an equity multiplier, it measures a company's financial leverage by using a ratio of the company's total assets to its stockholders' equity, thus it is better to have a low equity multiplier, because that means a company needs to use less debt to finance its assets.

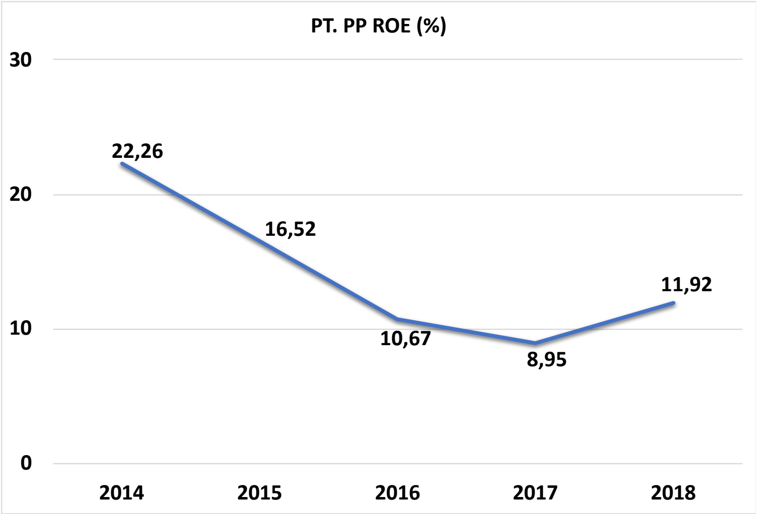
Source: financial statements of PT PP, PEFINDO, Investing.com

PT. Pembangunan Perumahan (PT. PP)



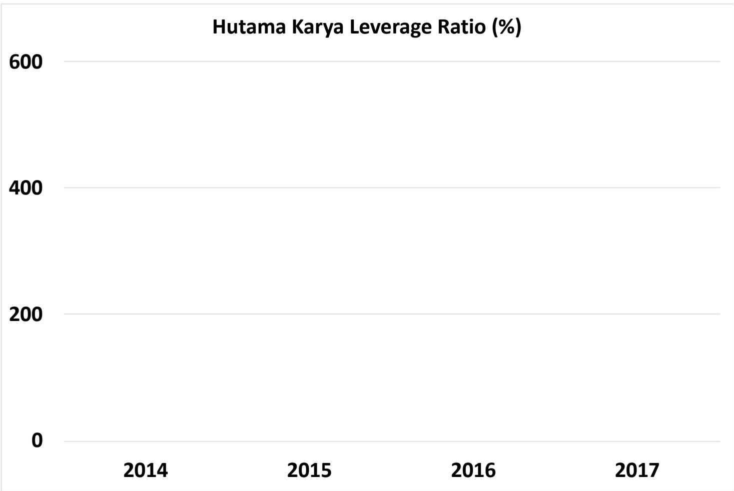
The current ratio of PT. PP is relatively stable in 5 years, with a total average of 146%. This indicates that a firm has enough resources to meet its short-term obligations.

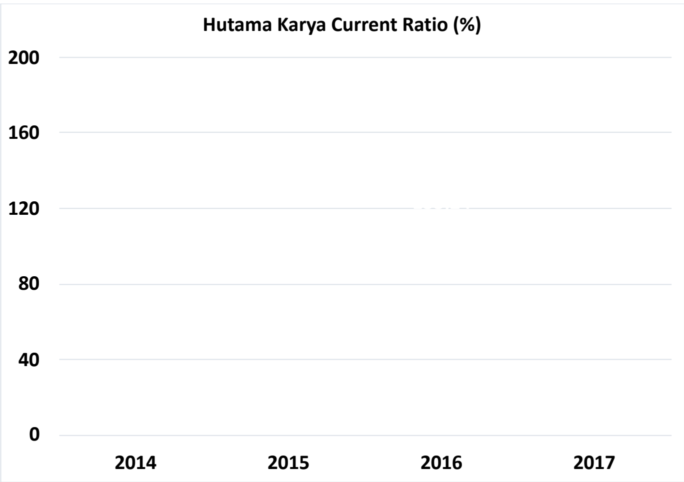
In 2017, Return on Equity (ROE) of PT. PP experienced a decline to 11,92% from its value in 2014 with a ratio of 22,26%. The falling ROE shows a relatively low profit a company generates with each dollar of shareholders' equity.



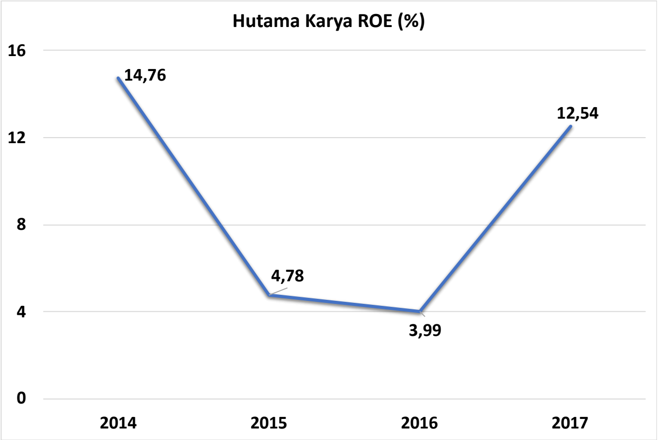
Source: financial statements of PT PP, PEFINDO, Investing.com

PT. Hutama Karya





PT. Hutama Karya’s capability to pay its liabilities is measured from financial ratio that explained a 25% decrease in current ratio from 133.24% in 2016 to 108.22% in 2017, while the position of Debt to Equity Ratio (Leverage ratio) increased by 164,95% from 157.17% in 2016 to 322.12% in 2017 and the Return on Equity (ROE) increased by 8.54% from 4% in 2016 to 12.54% in 2017.



Source: financial statements of PT Hutama Karya

- Looking into the financial reports of these SOEs present a different picture.
- Waskita Karya, Wijaya Karya, Hutama Karya, Perum Perumahan, and Adhi Karya are among the biggest infrastructure SOEs who have built most of the infrastructures in the last three years.
- The leverage ratios of all of these companies have increased significantly.
    - Waskita Karya is the most leveraged faster than the rest with its leverage ratio increased from 111 percent in 2014 to 353 percent in 2018.
    - PT Perum Perumahan’s leverage ratio actually decreased from 113 percent to 72 percent during the same time period.

- There is a pattern on the profitability of these firms; it was trending down from 2014 to 2016.
- It gets better in 2017 and much better in 2018.
- All of them suffered a sub-10 percent return on equity (ROE) in 2016, with Hutama Karya having the worst ROE at 4 percent.
- Nevertheless, ROEs are getting better in 2017 and even much better in 2018.
- All of these firms enjoy above-10 percent ROE, with Waskita Karya having the best ROE at 33 percent in 2018.

Risks: Macroeconomic developments

Trade War

- The trade war increased the uncertainty in the financial market. The increased uncertainty in general is always responded by the flight-to-safety behaviour of the investors, leaving EM assets and buying USD assets.
- By October, after more certainty emerged about the results of Mid-term Election in the US, coupled by news about Trump-Xi potential upcoming meeting, this uncertainty dissipated quite substantially.
- The market revised its prediction on the outlook on US economic activity in 2019 as the potential second round of Trump's tax cut is no longer possible.
- The diminished uncertainty contributed to the appreciation of Rupiah since October 2018.

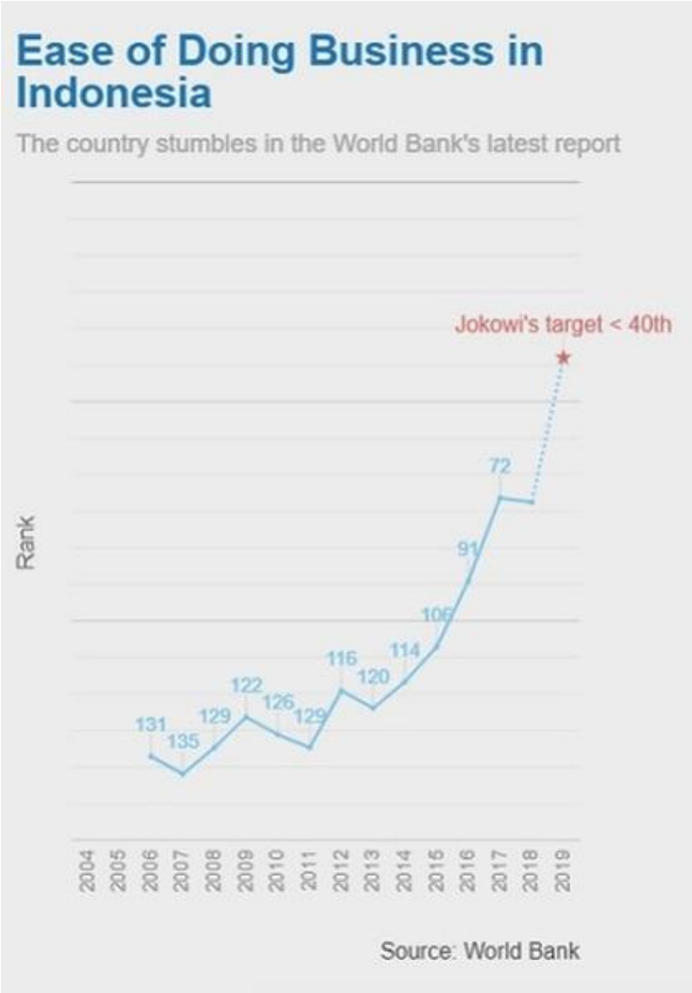
- In the real sector, there is a trend of exodus of direct investment from China; the destination of this exodus is mostly Southeast Asia region.
- Unfortunately for Indonesian economy, these investors will first consider Vietnam, Thailand, and Malaysia before Indonesia. Indonesia does not see any increase of FDI as the result of this exodus. It is fair to say that Indonesian economy is not affected by the trade war in general.

Logistic Performance Index Ranking 2016 vs 2018

Thailand	45	32
Vietnam	64	39
Malaysia	32	41
Indonesia	63	42

Ease of Doing Business Rangking 2016 vs 2018

Malaysia	23	15
Thailand	46	27
Vietnam	82	69
Indonesia	91	73



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Risks: Macroeconomic developments

Geopolitical tensions in the region and their implications for Indonesia

- China is increasingly becoming more influential geopolitically. Started from the rebalancing effort, China has exported much capital to other countries through the One Belt One Road (OBOR) initiative. Like in Africa and South Asia, the OBOR infrastructure projects are dominating in the Southeast Asia region as well.
- Arguably, Indonesia is not poised to take advantage of this opportunity optimally due to bad perception about China in general in Indonesia
- As a result, there has been relatively limited number of significant investments coming from China directly to Indonesia.

Resilience

Is Indonesia's new crisis-response framework up to the task?

The PPKSK Law

- The Prevention and Resolution of Financial System Crisis Law (PPKSK)
  - Clarifies the role of different institutions in a crisis
  - Defines the rules regarding crisis response and bailouts
  - Defines the process for resolving crises and troubled banks

- Indonesia leading the region in forward-thinking on crisis management. But the framework has serious deficiencies:
  - The framework removes Bank Indonesia from being a lender of last resort
  - The framework could result in simple liquidity challenges becoming full-blown solvency crises
  - The framework absolves institutions of independence, autonomy and responsibility
  - The framework slows the response to crises
  - The framework politicises a complex, technocratic process

- If not reformed, this framework could exacerbate future crises, making them longer and more severe.

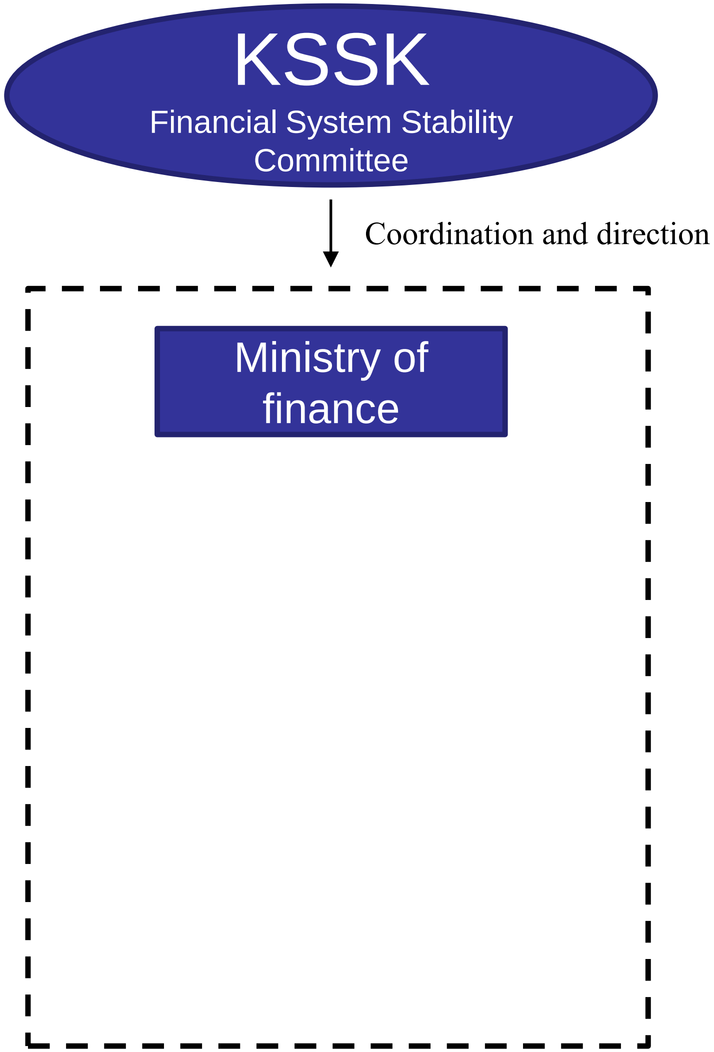
- Reforming the framework requires an understanding of its political-economy origins

The PPKSK Law: Crisis-response framework

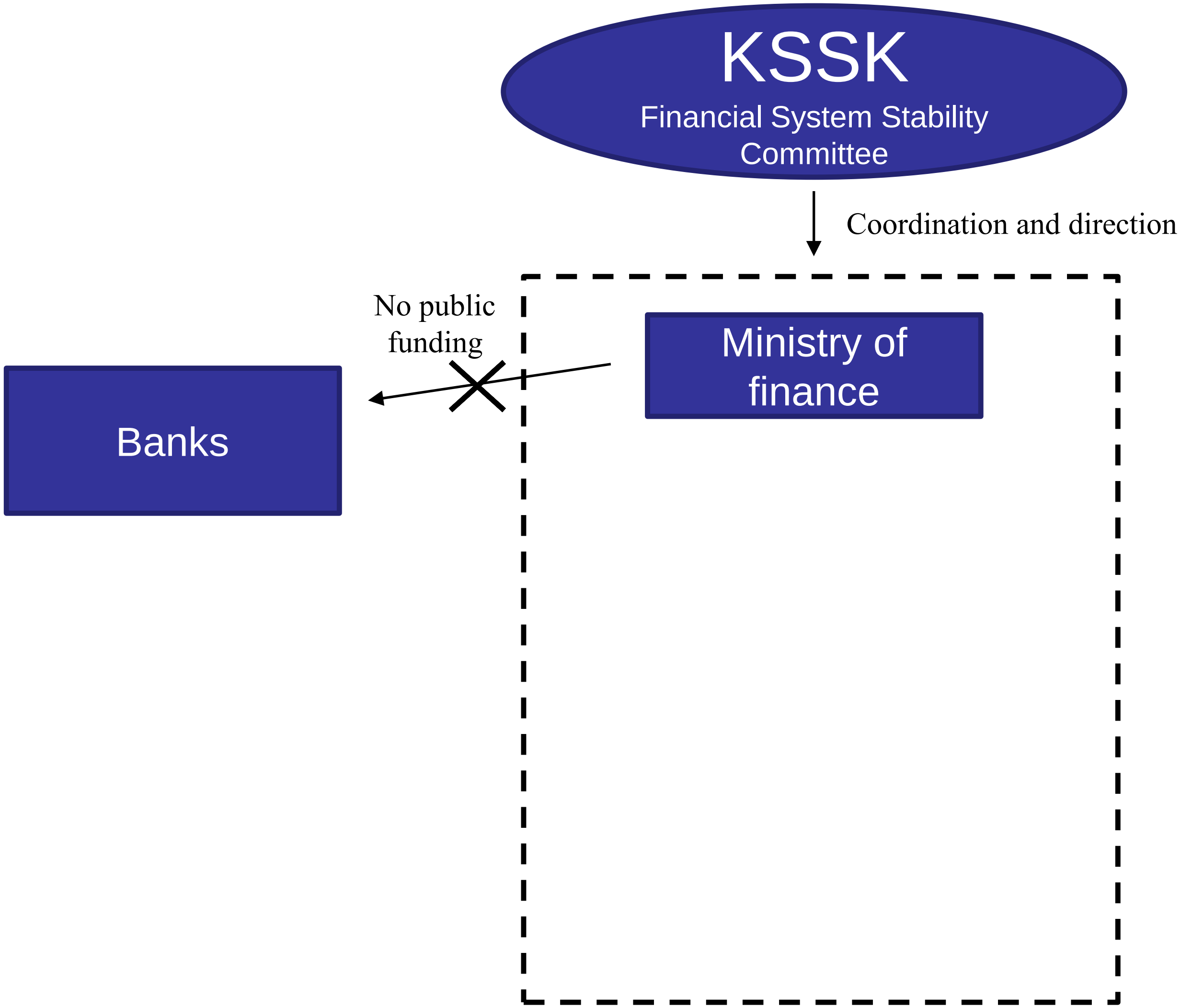
KSSK

Financial System Stability Committee

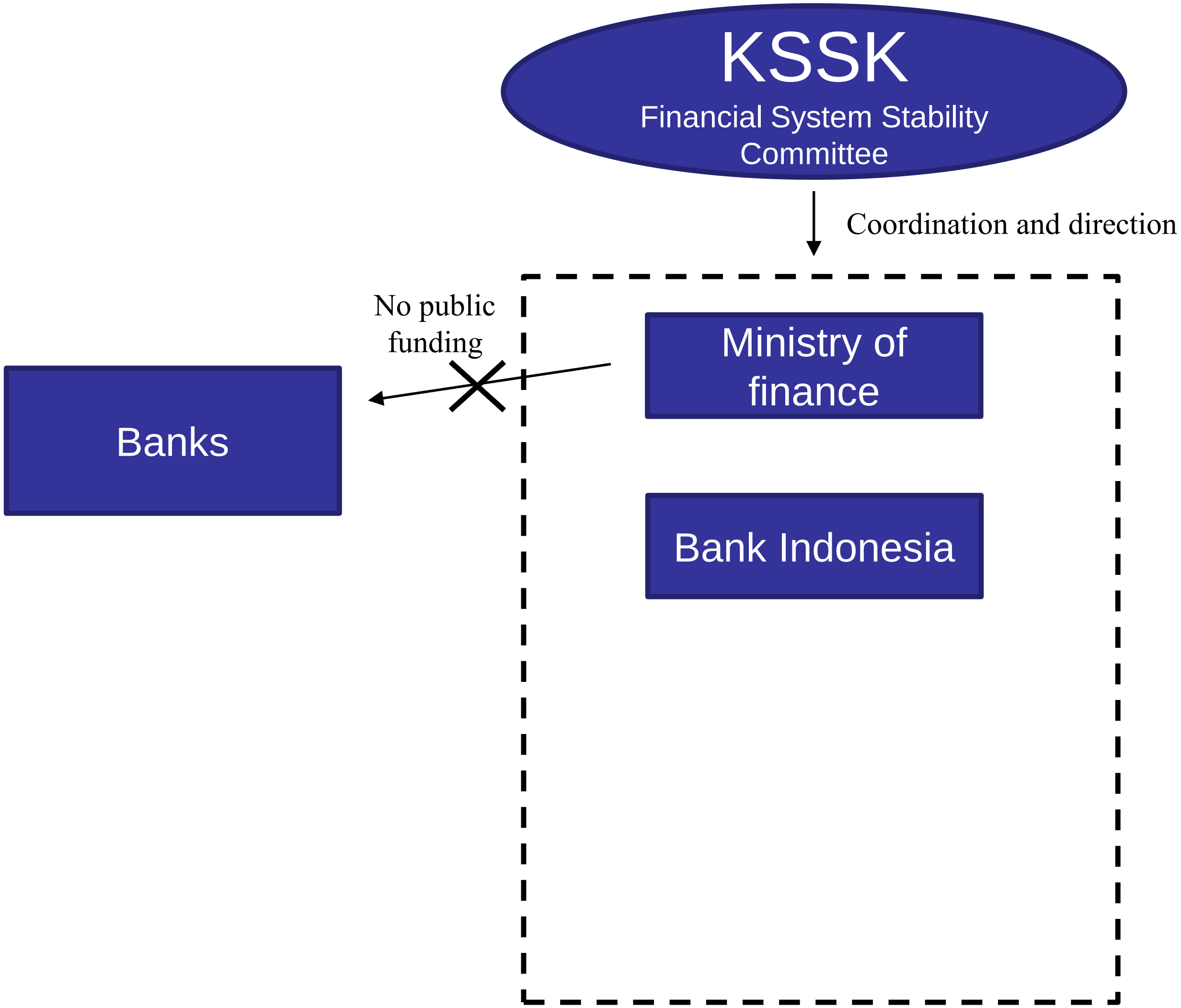
The PPKSK Law: Crisis-response framework



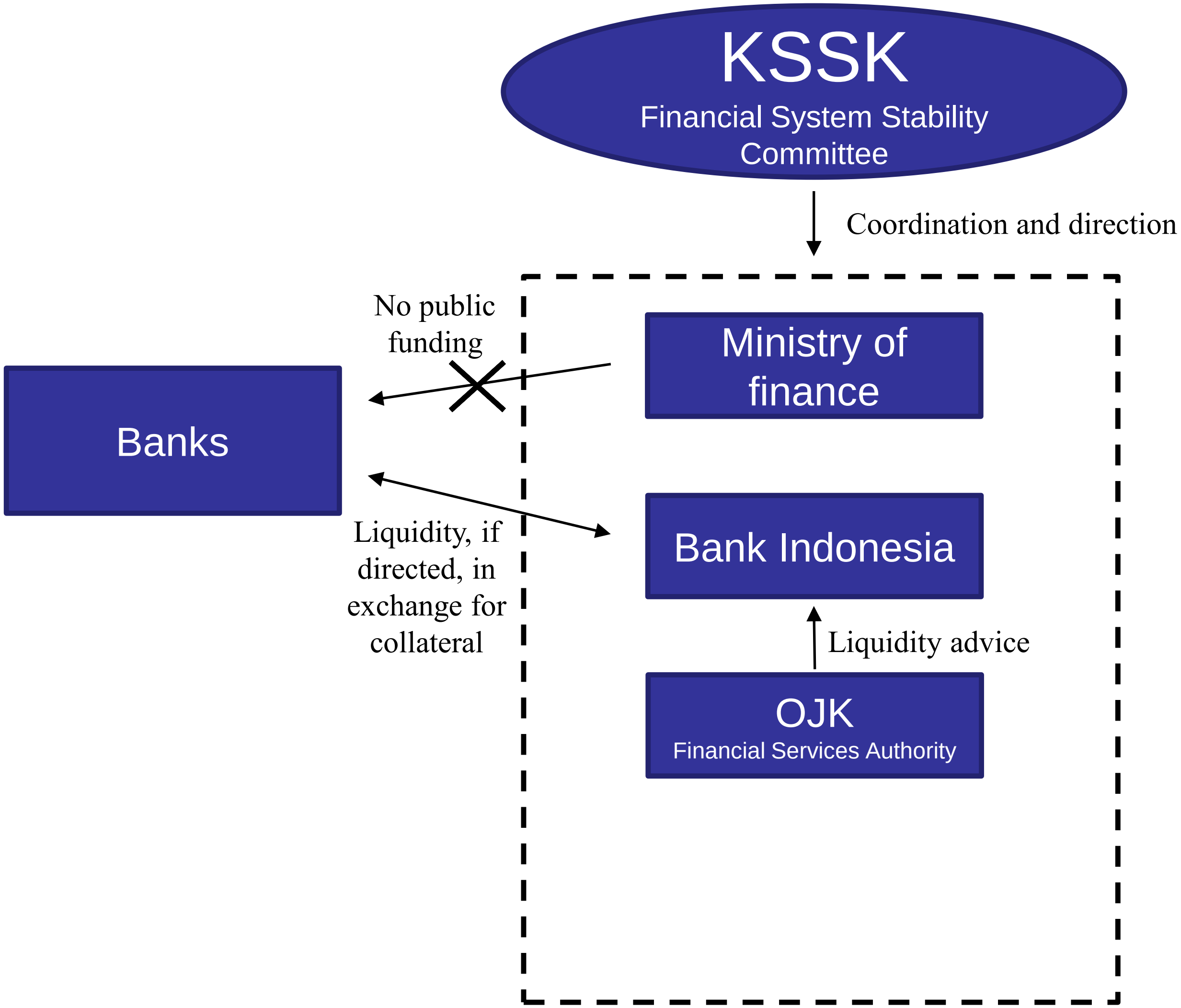
The PPKSK Law: Crisis-response framework



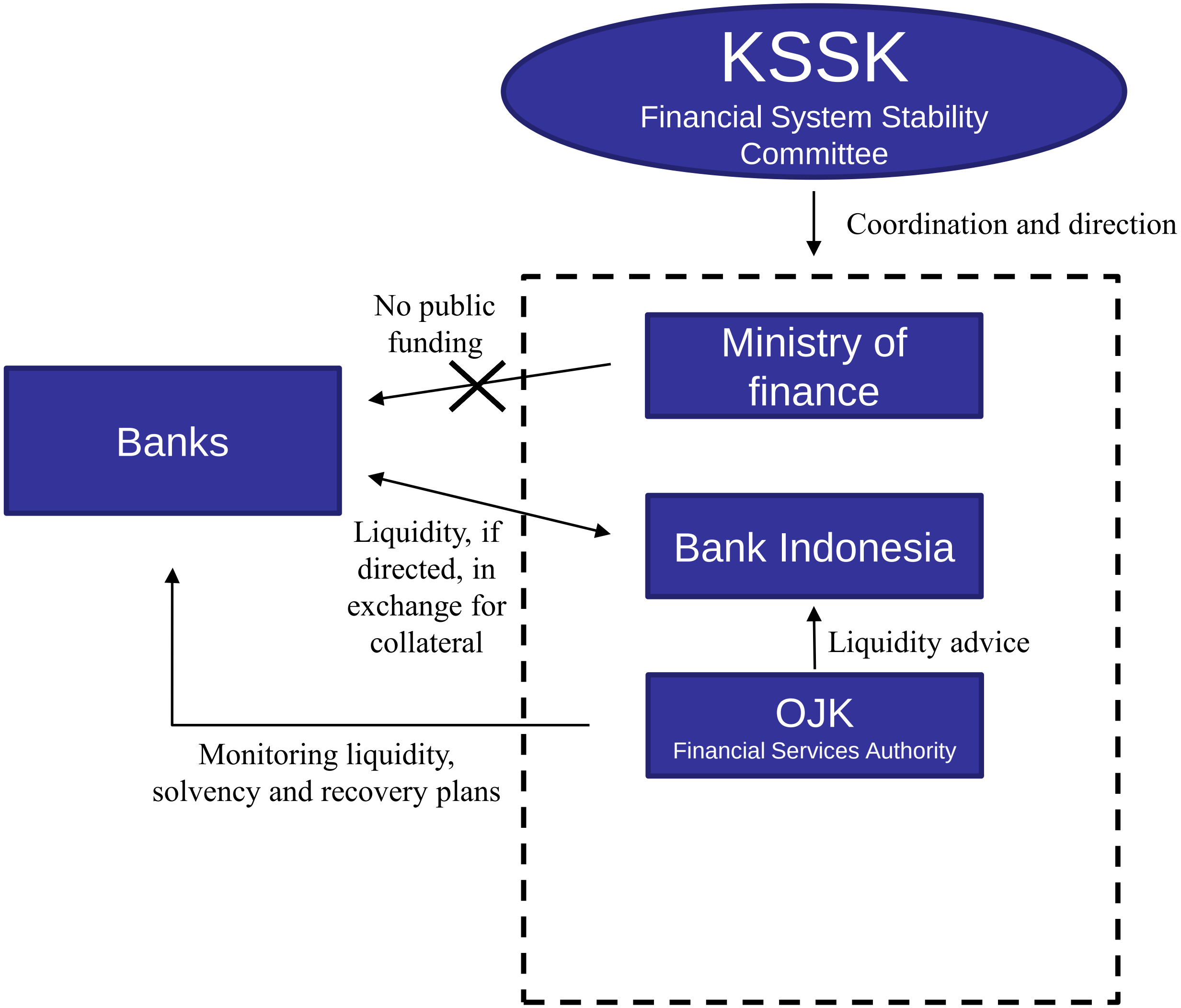
The PPKSK Law: Crisis-response framework



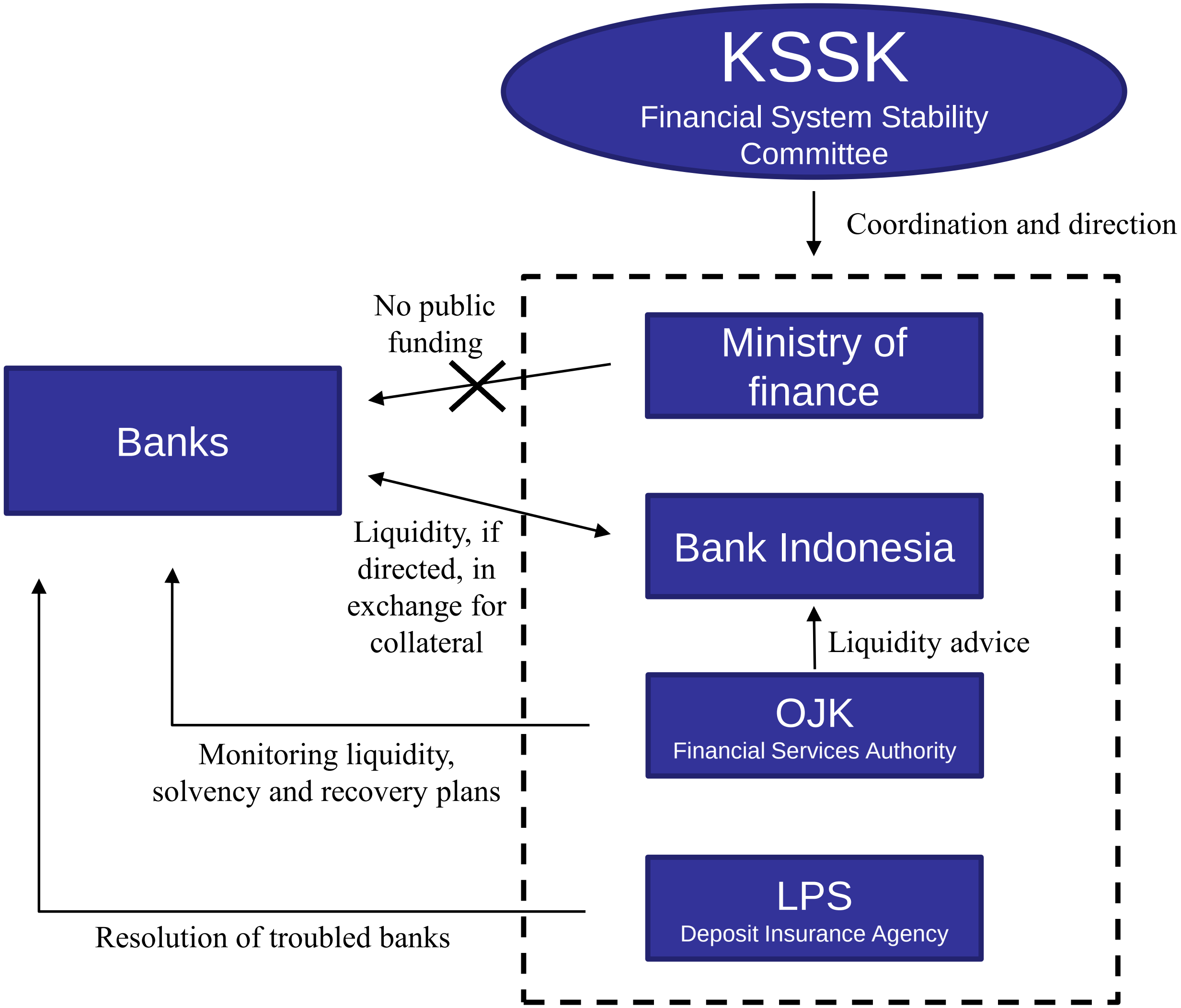
The PPKSK Law: Crisis-response framework



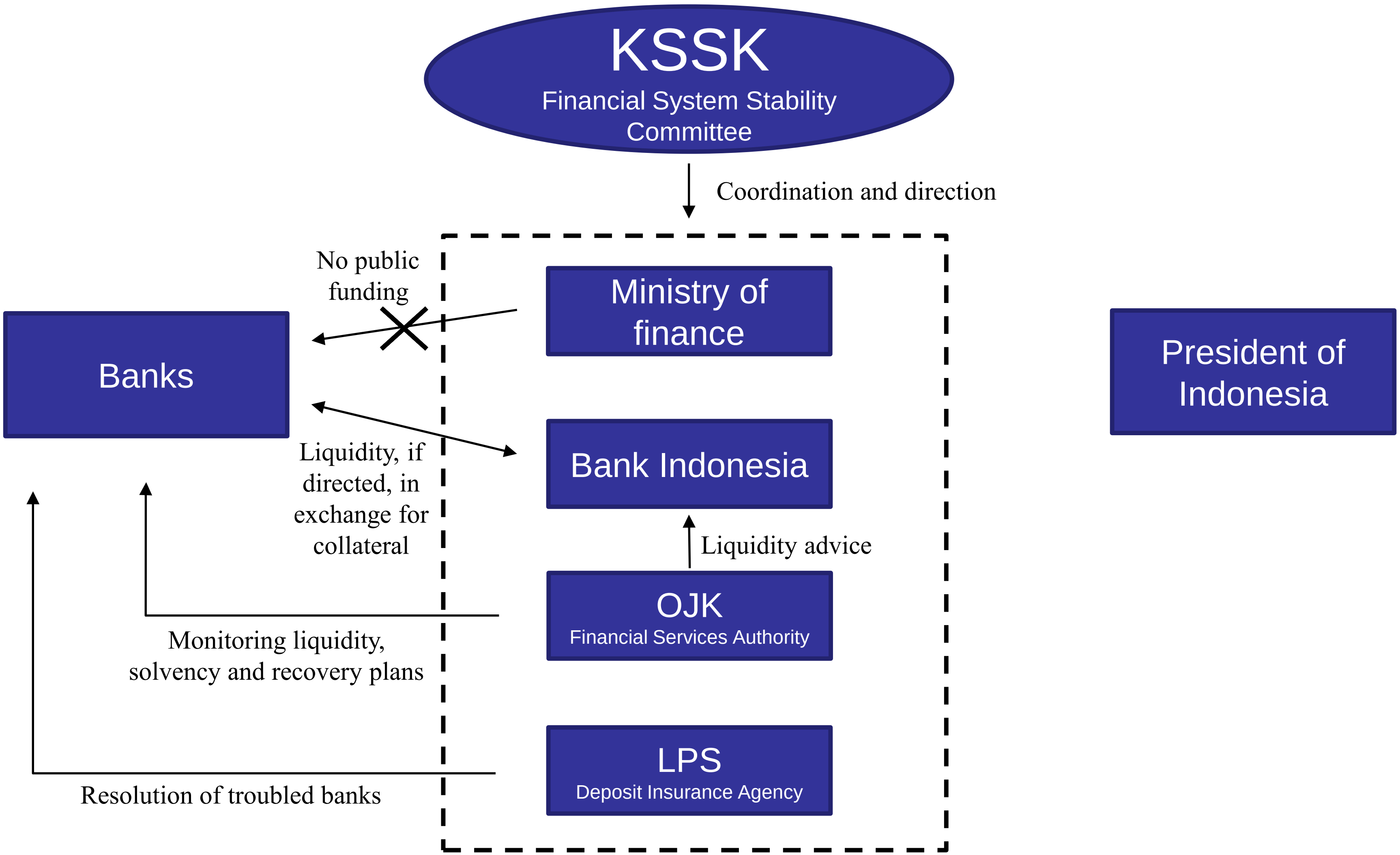
The PPKSK Law: Crisis-response framework



The PPKSK Law: Crisis-response framework



The PPKSK Law: Crisis-response framework



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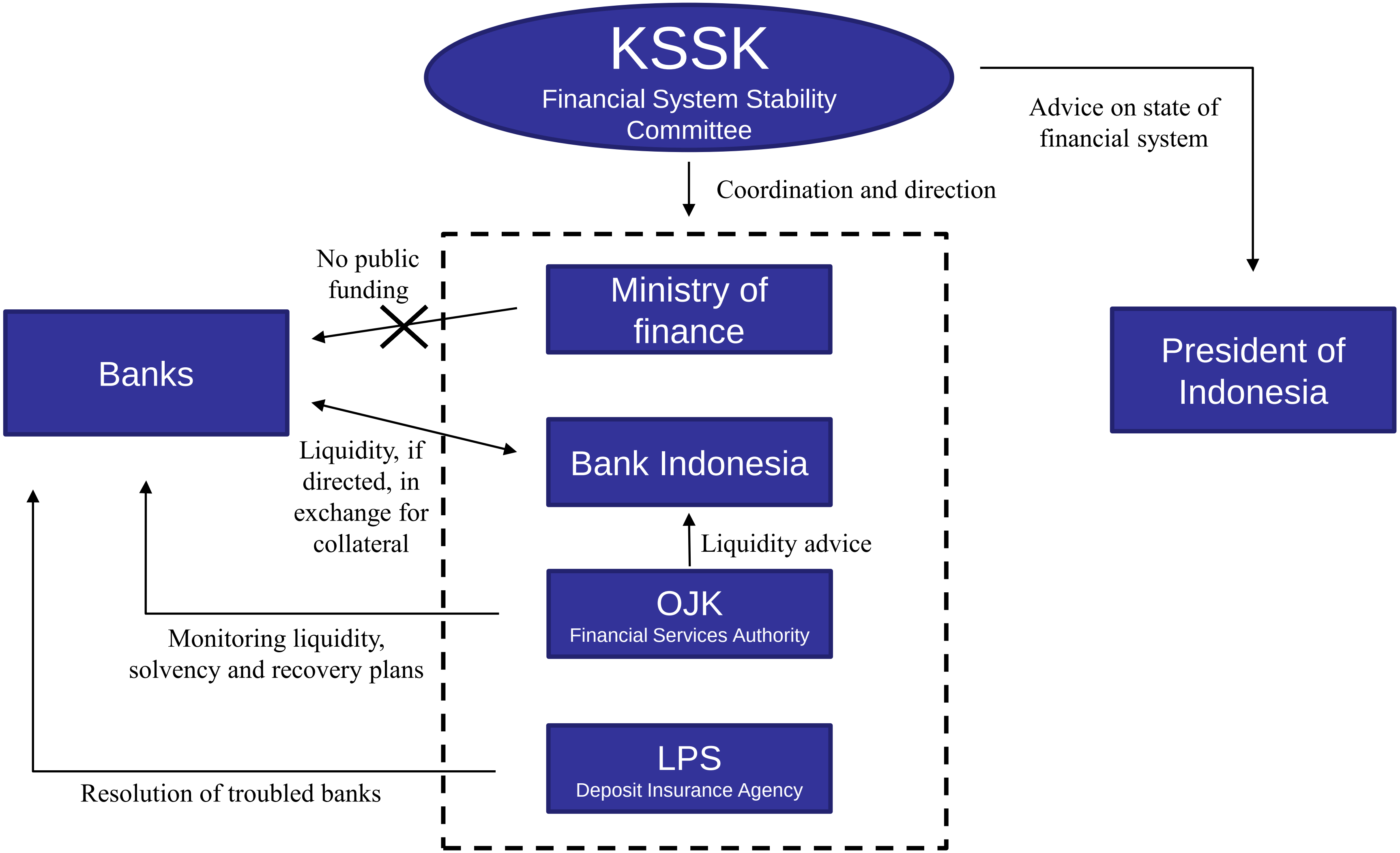
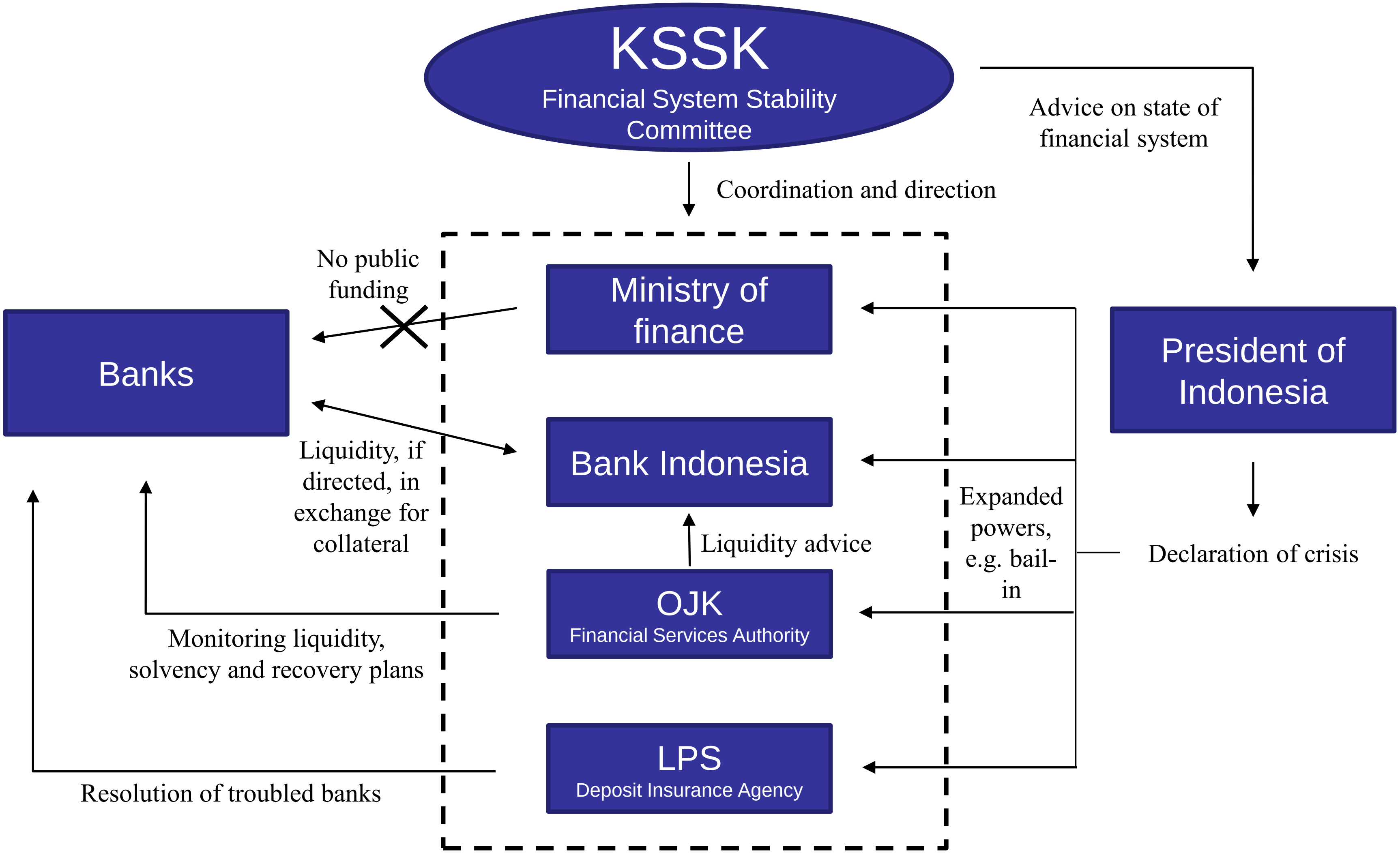


The PPKSK Law: Crisis-response framework



A hypothetical liquidity crunch

- Suppose a systemic bank faces a liquidity crunch caused by interest rate, currency or maturity mismatch
- STEP 1: Bank informs Bank Indonesia of the problem
- STEP 2: Bank Indonesia informs the KSSK
- STEP 3: OJK prepares advice and analysis on whether the firm is facing a liquidity challenge and whether support should be provided
- STEP 4: KSSK devises a plan of response, including how much support should be provided
- STEP 5: Bank Indonesia consults with the Bank to confirm how much collateral they have and if it covers the liquidity assistance being sought
- STEP 6: Liquidity assistance provided

A hypothetical liquidity crunch

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- STEP 5: Bank Indonesia consults with the Bank to confirm how much collateral they have and if it covers the liquidity assistance being sought
- STEP 5a: KSSK consults other banks to provide the liquidity assistance
- STEP 5b: KSSK briefs the President and seeks approval for action
- STEP 6: Liquidity assistance provided

A hypothetical liquidity crunch

- Significant delays causing a liquidity crunch to become a solvency crisis
- Indonesia removed from being a lender of last resort, at least in any immediate sense

- STEP 7: Onus of responsibility shifts to the resolution agency, LPS. Insufficient resources, inability to access funding requires the President to be briefed
- STEP 8: President of Indonesia is briefed.
- STEP 9: President of Indonesia declares a ‘status of financial system crisis’
- STEP 10: Bail-in powers are activated

The long shadow of the Bank Century bailout

"Indonesian Mob Wants Blood After Treasury Secretary Spends A Fortune Bailing Out Banks" – The Australian, 3 March 2010

Reforming the PPKSK

- KSSK a demonstrably useful body: has improved coordination, communication and information sharing between agencies
- KSSK's role should focus solely on coordination. It should not direct member agencies in the implementation of their mandates
- The autonomy, independence and responsibility of individual agencies should be reinstated
- Bank Indonesia Law should be reformed to expressly include a macroprudential mandate
- OJK Law should be strengthened to better regulate financial conglomerates
- LPS should have bail-in powers without Presidential declarations
- The role of the President should be limited to deciding whether public funds can be used or not.
- PPKSK Law should be strengthened to provide legal protection to officials:
- Legal test should be 'good faith' rather than 'misuse of authority'

Reforms

Reforms on financial inclusion and capital market deepening

Background

- In light of a possible slow-down of the GDP growth and upcoming referendum, 2019 is critical to Indonesia.
- It represents a window of opportunity for the leadership elected to push forward a number of financial reforms, which have been absent in the current economic and financial policies and agenda.
- They would help ease the pressure on stabilising the current account, and help boost domestic savings, develop domestic financial market and promote more inclusive economic growth in the long run.

- Deepening domestic capital market
- Addressing current account deficits

Deepening domestic capital market

Issues on domestic capital market

- Banks dominated single structure of the financial sector
- Increasingly tightened credit conditions
- Crowding out effects of government bonds
- Financial Services Authority (OJK) policies

Banks dominance

- The banking sector takes up 76 per cent of the total assets in the financial sector in 2018.
- Bank loans account for more than half of domestic financing (RP 357 trillions) in 2017.

Increasingly tightened credit conditions

- Banks remained well capitalised.
  - Capital adequacy ratio: 21.67% in October 2018
  - Nonperforming loans as a share of total assets: 49% in 1998 to 2.7% in 2018
- The capital to assets ratio of the Indonesian banks is higher than the standard set by the Financial Stability Board
- Due to a strong awareness of self-insurance
  - “Bail-in, no bail-out” policy
- This leads to banks holding extra liquidity and a tighter credit condition.

Crowding out effects of government bonds

- Indonesian government bond (some in form of corporate bonds issued by state owned enterprises)
  - A competing player
  - Rate of return at 7.8 per cent in June 2018
  - More attractive than bank deposit rate at around 5.5 per cent
- Crowding out commercial banks, more prominently for the BUKU 3 and 4 banks
  - Credit to deposit ratio of the BUKU 1 banks: 83 per cent
  - Credit to deposit ratio of the BUKU 3 and 4: more than 100 per cent

Financial Services Authority (OJK)

- Indonesia’s Financial Services Authority (OJK) is an independent and integrated regulator who is responsible for the regulation and supervision of the entire financial sector, including banks, capital markets, insurances and pension funds.
- OJK has made significant progress since it was established in 2011.

Issues on some OJK policies

- Likely to induce instabilities to the financial sector.
- Capital requirements may not be sufficient for regulating the insurance sector.
  - The majority of insurers is highly interconnected with banks. This interconnectedness needs to be taken into account.
- Policies asking banks to expand credit
  - Especially instability inducing for the BUKU 3 and 4 banks
- Tax cut on government bond
  - Exacerbate the crowding-out effect on banks

Reforms on deepening capital market

- Policies should be made to further develop the pension fund market and the insurance market in Indonesia.
- Such policies would provide more diversified choices to depositors beyond bank deposits and government bonds.
- Enrich the structure of the financial market and develop the direct-financing channels of the capital market.

Reforms on deepening capital market

- Technological innovations provide another avenue.
- The development of Financial Technology (FinTech)
  - Households in remote areas and small and micro businesses get access to bank loans and P2P financing.
  - The development has been within the banking sector
  - An ease to the credit conditions for banks, not a parallel credit market
- Huge potentials in the development of FinTech and policies should accommodate it to grow.

Reforms on deepening capital market

- Reforms to reduce the crowding-out effects of government bonds in financial market.
  - To ensure a level play field for all participants in the financial market.
  - To ensure the effectiveness of other capital market deepening reforms.

Reforms on deepening capital market

- Reforms should be to revise the OJK policies on capital requirements for insurers, credit expansion, and tax cut on government bonds
- Putting more emphases on financial stability and interconnectedness of different financial intermediaries.
- OJK policies in general should be about promoting financial inclusion.

Addressing current account deficits

Issues on current account deficits

- Monetary policy targeting nation’s current account deficits
- Current FDI policies
- Labour law

BI targeting current account deficits

- Bank Indonesia (BI) is one of the few central banks that targets its nation's current account deficits.
  - Upper limit: 3 per cent of the GDP
  - Actively raised interest rates in 2018 to stabilise the current account deficits to about 2.86 per cent of the GDP

BI targeting current account deficits

- Targeting current account deficits as a central bank objective is not the effective and inclusive approach to address the imbalance issue.
- Need to look at the structure of the economy:
  - Importing capital goods and intermediate goods
  - Import share rising while export share falling
  - A net importer of capital, a characteristic shared by many developing economies in shortage of capital
- Directly targeting current account deficits would potentially kill off the imports of capital and hurt economic growth in both short and long terms.

Reforms on current account deficits

- Promoting development of export oriented sectors
- Sources of financing
- Labour law

Promoting export sectors

- Current FDI policies encourage investment in domestic market oriented sectors and current tax subsidy makes it more attractive to invest in such sectors.

Promoting export sectors

- The reform should be reviewing current FDI policies to encourage more FDI in export sectors.
  - such as resources and commodity sector and high added value manufacturing sector
- By promoting exports growth, Indonesia would secure supply of foreign exchange, and address the issue of current account imbalance without sacrificing long-term growth potentials.

Reforms on the sources of financing

- Currently about half of the Indonesia's current account deficits are financed by FDI and half by portfolio investment.
- Reforms on directing the sources of financing from portfolio investment to FDI would
  - shield the country from volatile capital flows across boarder
  - and prevent large scale capital flows once the Tax Amnesty expires.

Reforms on labour law

- In order to facilitate export oriented FDI policies, it is equally important to push forward reforms that legislate promotions of export sectors into Indonesian Labour Law.
- Reforms should be to encourage and compensate workers move from more capital-intensive sectors towards more labour-intensive export sectors.

Recap: Financial reforms

- Deepening domestic capital market
- Addressing current account deficits