

# Strengthening the Financial Sector to support an inclusive and sustainable recovery – Part B

Indonesia Economic Prospects  
June 2022

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# Why Financial Deepening matters?

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A deeper financial sector, as measured by the size of banks and non-bank financial intermediaries:

1

**Allows for greater financial access as more resources are available for allocation to household and firms**



2

**Increases financial efficiency if more competition in the sector lowers the cost of intermediation.**



3

**Contributes to increased financial resilience by giving access to financial instruments that can help to recover from adverse economic shocks (such as job losses, unanticipated expenses, or natural disasters).**





**Financial depth is important for Indonesia's economic development...**



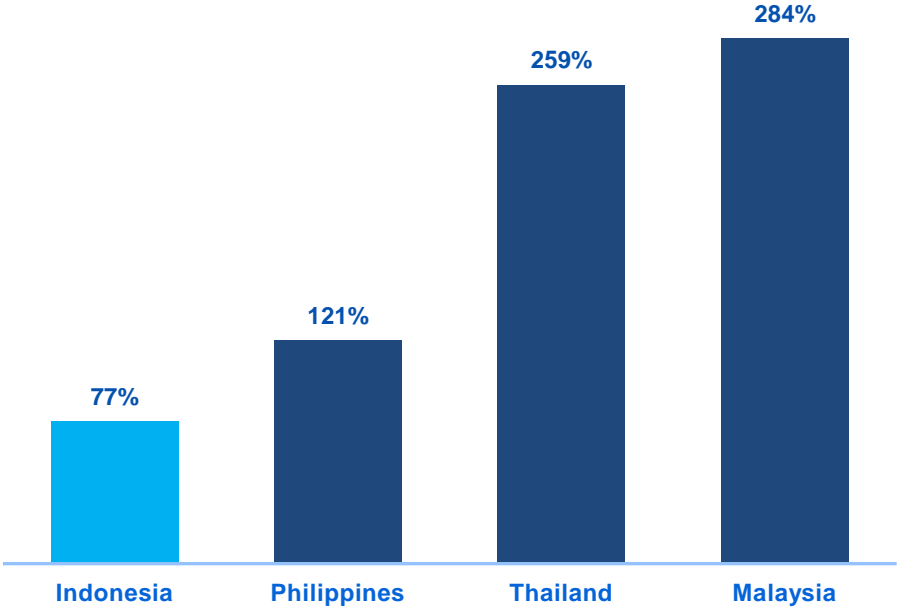
**but is the Indonesian financial sector sufficiently deep?**



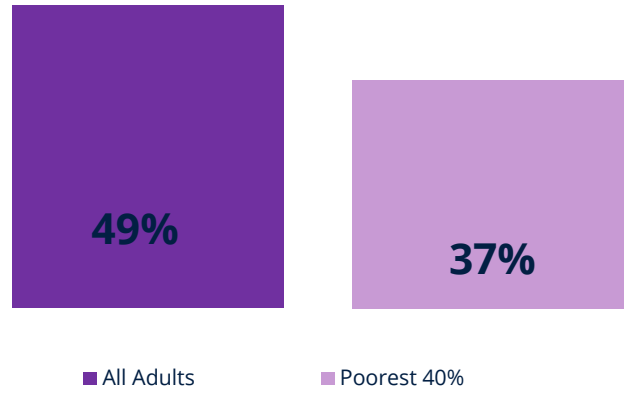
# Despite substantial progress, Indonesia's financial sector is not yet sufficiently able to fund development needs and sustainability objectives as it is:

small...

Financial Sector Assets (% of GDP)



Account ownership (Financial Institution or Mobile Money Account)

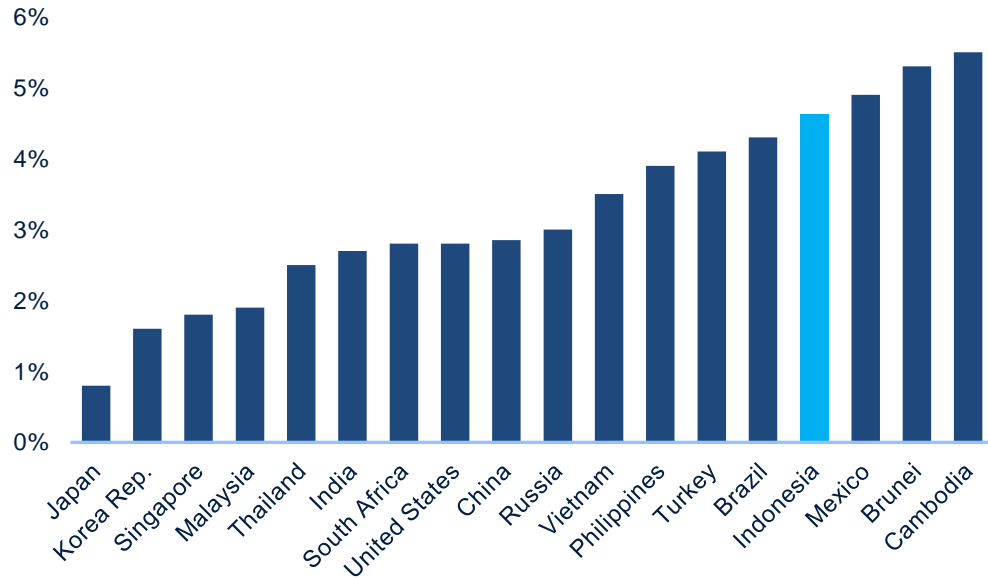


95 million adults in Indonesia (and 2/3 of the poorest adults) do not have an account at a financial institution

# Despite substantial progress, Indonesia's financial sector is not yet sufficiently able to fund development needs and sustainability objectives as it is:

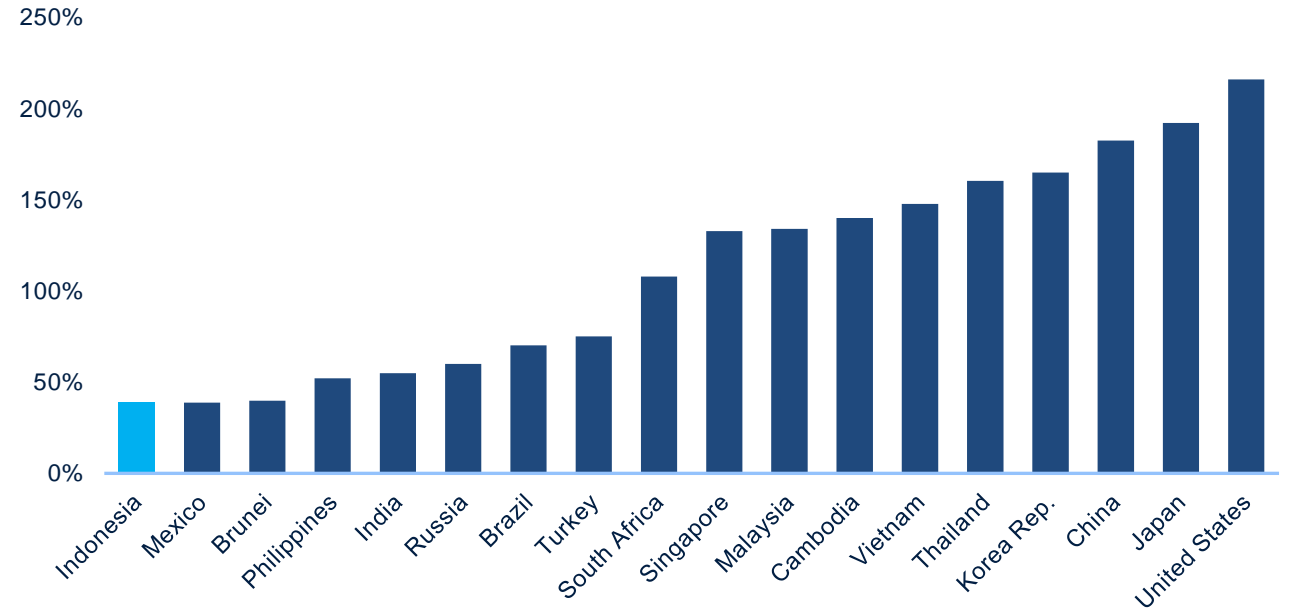
...costly...

### Net Interest Margin (%)



High interest spreads can negatively impact domestic savings and investment, and inhibit bank lending

### Private Credit / GDP (%)

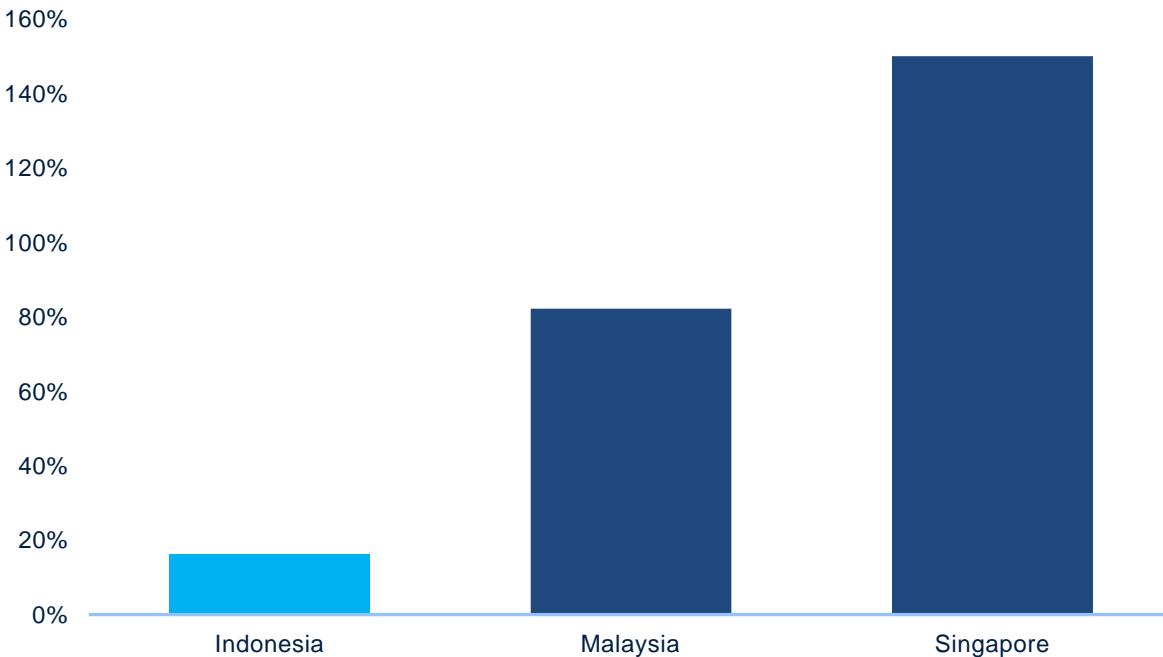


Several factors including lack of competition, weaknesses in the institutional environment and operational inefficiencies can contribute to the weak intermediation efficiency

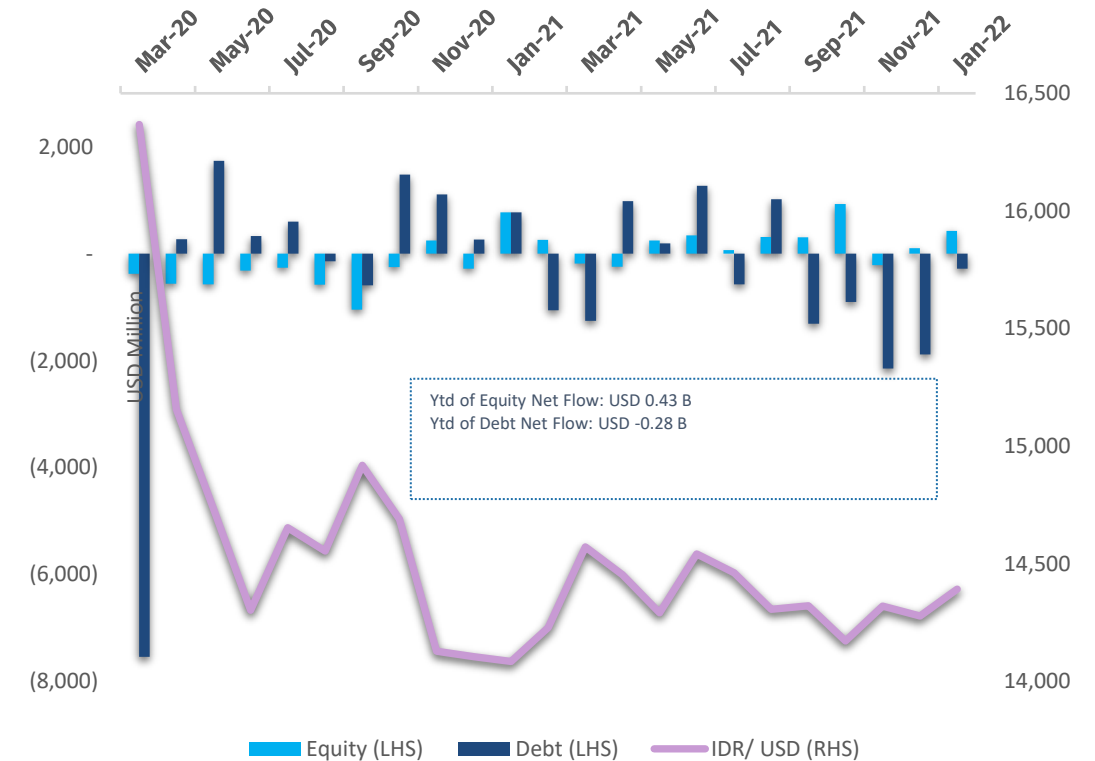
# Despite substantial progress, Indonesia's financial sector is not yet sufficiently able to fund development needs and sustainability objectives as it is:

...and exposed to global risks.

### Institutional Investors / GDP (%)



### Net Capital Flows (IDR/USD)



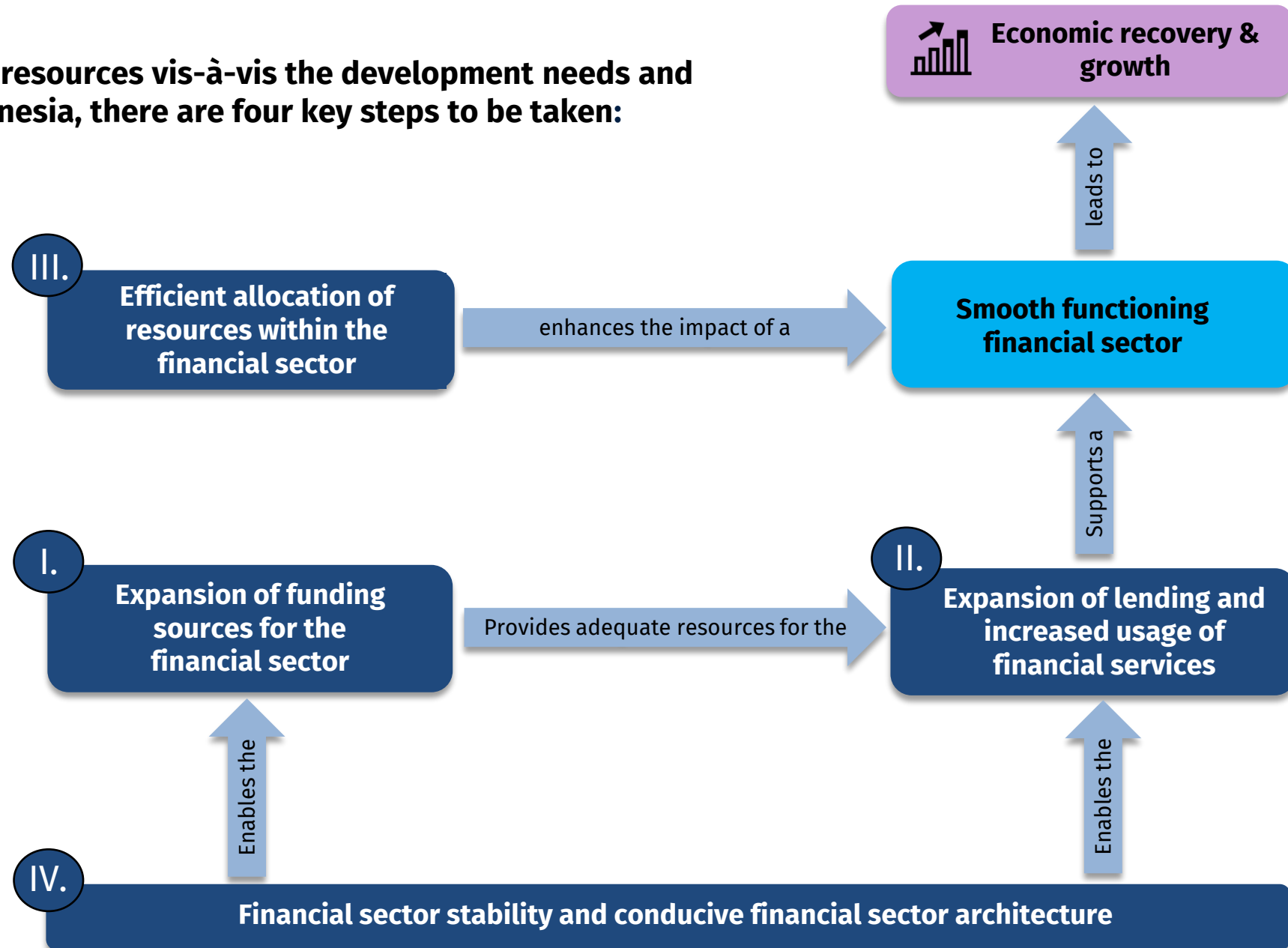


**Which are the opportunities to deepen the Indonesian financial sector?**



# Indonesian policymakers have various opportunities to deepen the financial sector.

Given the scarcity of resources vis-à-vis the development needs and the potential of Indonesia, there are four key steps to be taken:





# How to expand the sources of funding?

I.

## Expansion of funding sources for the financial sector



### 1.1 Expanding access to digital financial services

**Digital financial services (DFS) are financial services which rely on digital technologies for their delivery and use by consumers**

*DFS can lower costs, increase speed, transparency, security, and availability of more tailored financial services serving the poor at scale*

*Digital credit is one form of DFS that has already begun to make substantial inroads in expanding access to finance in Indonesia (76 million borrowers in total).*



### 1.2 Expanding institutional investors

**Institutional investors are an important source of capital in the economy**

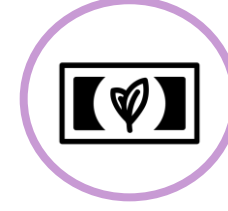
*Institutional investor will bring opportunities to:*

- *Reduce reliance on foreign investors*
- *Complement Bank lending and increase financing diversification*
- *Expand access to long-term financing (e.g., through capital markets).*

# How to expand lending to underserved segments?

II.

## Expansion of lending and increased usage of financial services



### 2.1 Products/Services for individuals

Transaction accounts are essential for individuals and businesses

Basic savings account and agent network services have been successfully introduced.

Large-volume and recurrent payment streams (e.g., G2P payments, utility payments, employer payrolls etc.) are a good opportunities to expand access.

### 2.2 Products/Services for MSMEs

Digital loans can reach previously unbanked firms, reduce or eliminate reliance on fixed assets as collateral, and can reach those without formal credit histories.

E-commerce allows firms to expand their access to markets and increase their sales.

### 2.3 Development of Green Financial Markets

Central role in facilitating investments in the short run and a transition toward more sustainable economies in the longer run.

Sustainable financial markets in Indonesia do not have yet the scale required to meet the funding needs for the country's various sustainability objectives

Funding for the private sector is very limited.

# ...it is not sufficient to mobilize resources. It is also necessary to allocate them in an efficient manner...

III.

## Efficient allocation of resources within the financial sector

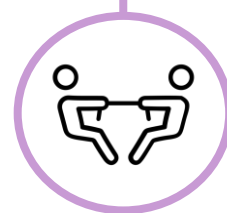


### 3.1 Digital Finance

**Digital finance can mitigate risk through innovative product design or by integrating new technologies for financial services**

*Banks are expanding digital banking services but there is a risk of segments left behind*

*New agent business models aggregating different types of transactions at the agent level are needed*



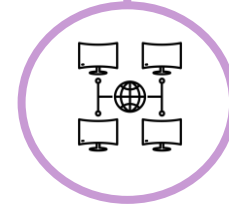
### 3.2 Competition

**Competition in the financial sector constrains market power and improves the efficiency of risk pricing and encourages innovation.**

*Banking system is dominated by a few players that wield considerable market power*

*SOBs play an important role in servicing government businesses as well MSMEs*

*Signs of a universal pricing policy across Indonesia, which negatively affects the efficient allocation of resources*



### 3.3 Financial Infrastructure

**A sound financial infrastructure provides the enabling environment for an efficient financial sector.**

*Need for effective credit information systems*

*Collateral registry: moving beyond immovable assets as collateral*

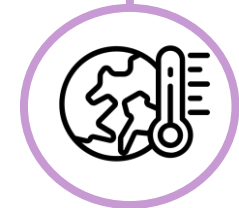
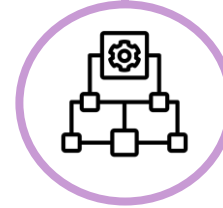
*Insolvency framework: Limited uptake of firms and lack of access by smaller firms*

*Consumer protection: over 60% of Indonesians lack awareness of financial services*



# ... while maintaining the resilience of the financial system to internal and external vulnerabilities

## IV. Financial sector stability and conducive financial sector architecture



### 4.1 Integrated Supervision

- Dominated by Financial Conglomerates (80% of banking sector).
- Most FCs have a non-regulated holding company controlling the group.
- No legal authority to OJK to supervise holding companies

### 4.2 Legal Protection

- Legal protection for supervisory staff is a key element of supervisory and resolution frameworks .
- Particularly important with the adoption of risk-based supervision

### 4.3 Banking Crisis Mgmt & Resolution Framework

- Despite good progress, the legal and institutional set-up for crisis management remains fragmented.
- Segregation of responsibilities results in significant challenges for inter-agency coordination and collaboration.

### 4.4. Addressing climate-related risks

- Physical risks can lead to economic costs & financial loss as they threaten profitability and solvency of banks.
- Transition risks are related to adjustment costs during the transition towards a greener, carbon-neutral economy.

**What can be done to address those challenges and ...**



**seize those opportunities?**

# A three-pillar reform strategy can help to deepen Indonesia's financial sector

## Pillar 1: Increasing Demand & Supply of Finance

### 1 Increasing Access and Usage of Financial Services

1.1 Establishing **government data platforms** and **creating digital ID**.

1.2 Establishing a **fully interoperable payment system** and developing credit infrastructure that can **use alternative data**.

1.3 Promoting **open banking services** and policies that create demand for digital financial services

### 2 Broadening and improving the quality of financial market products


2.1 Continuing to introduce **new financial market products** (e.g., green bonds; covered bonds; infrastructure project bonds; municipal bonds...)


2.2 Developing a **market for risk hedging to attract international investors**, incl. by establishing central counterparty for clearing and close-out netting

### 3 Mobilizing long-term savings

3.1 Accumulating savings through institutional investors, by **expanding coverage, increasing contributions and reducing withdrawals**.

3.2 Promoting professional management and appropriate **long-term investments of pension fund assets**.

 = Short Term (up to 1 year)

 = Medium Term (up to 1-3 years)



# A three-pillar reform strategy can help to deepen Indonesia's financial sector

## Pillar 2: Improving the allocation of resources through the financial sector

### 1 Promoting competition in the banking sector

1.1 Strengthening the capacity of lenders to **adopt risk-based pricing**.

1.2 Opening the **servicing of government business** to the most capable service provider, **regardless of ownership type**.

1.3 Expanding partial credit guarantees for MSMEs and supporting effective **graduation policies from the KUR program**

### 2 Strengthening the insolvency framework


2.1 Incentivizing informal restructurings, such as **out-of-court workouts**, that do not resort to the court system to address financial distress.

2.2 Ensuring adequate protection of creditors' interests through key **amendments to the Bankruptcy Law**.

### 3 Protecting consumers

3.1 Implementing financial consumer protection laws and regulations monitored and enforced through **market conduct supervision (MCS)**

3.2 Finalizing the **personal data protection law**, currently pending since 2019.

 = Short Term (up to 1 year)

 = Medium Term (up to 1-3 years)

# A three-pillar reform strategy can help to deepen Indonesia's financial sector

## Pillar 3: Strengthen the capacity to withstand financial and non-financial shocks

### 1 Advancing the effectiveness of financial sector oversight

1.1 Addressing gaps and limitations in the **supervision of financial conglomerates**.

1.2 Strengthening **legal protection for financial supervisors**.

### 2 Strengthening crisis preparedness and resolution framework


2.1 Enhancing legal framework to establish **effective bank resolution regime and inter-agency coordination**.

2.2 Providing **clear arrangements for resolution funding**, including provisions for extraordinary funding when required.

### 3 Promoting climate and natural disaster related risk management

3.1 Developing policies (including assessment, disclosure and reporting) for **managing climate related risks for the financial sector**.

3.2 Deepening **catastrophe insurance markets** to provide financial risk management services to government, businesses and households.

 = Short Term (up to 1 year)

 = Medium Term (up to 1-3 years)

# Thank You

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