Indonesia

A. Medium-term economic outlook (forecast, 2019-23 average)

GDP growth (percentage change):	5.3
Current account balance (% of GDP):	-2.3
Fiscal balance (% of GDP) (central government):	-1.6

B. Medium-term plan

Period: 2015-19

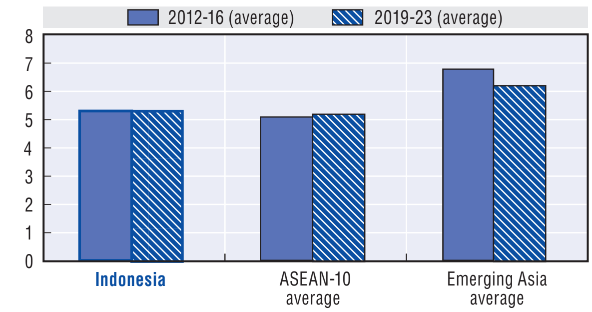
Theme: Strengthen security to maintain territorial sovereignty, support self-reliance in economy and establish community based on national personality and culture.

C. Basic data (in 2017)

Total population:	261.9 million *
Population of DKI Jakarta:	10.4 million *
Nominal GDP (US dollar):	1 015.4 billion **
GDP per capita at PPP:	12 403.7 (current International Dollar) **
Exchange rate in the first half of 2018 (period average):	13 773.4 (IDR/USD)

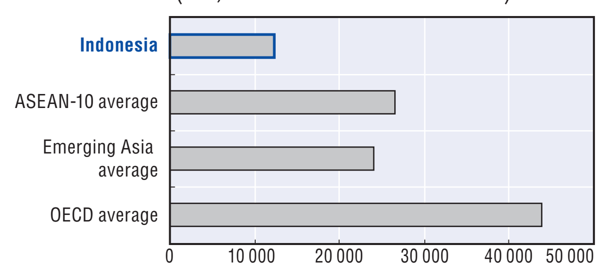
Note: * Population data are year-end government estimates.
** IMF estimate.
Sources: OECD Development Centre, national sources, CEIC and IMF.

GDP growth rates (percentage change)



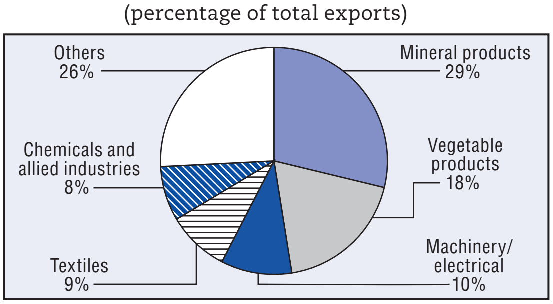
Source: OECD Development Centre, MPF-2019.

GDP per capita, 2017
(PPP, current international dollar)



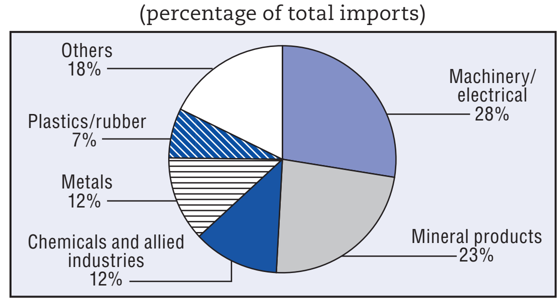
Source: IMF.

Composition of exports, 2017
(percentage of total exports)



Source: Trademap.

Composition of imports, 2017
(percentage of total imports)



Source: Trademap.

Structural policy challenges discussed in previous editions of the Outlook

2014	Education	Widening access to education, in particular for low-income households
	Disaster management	Strengthening natural-disaster management and protection infrastructure
	Social security reform	Accelerating reform of the pension system to improve transparency and quality
2015	Social security reform	Improving access to and the quality of health services and expanding the coverage of the newly implemented health insurance scheme
	Education	Further improving the education system, including through greater accessibility
	Inequality	Adequately addressing rising inequality
2016	Infrastructure	Improving infrastructure for maritime connectivity
	Social security	Reforming the national social security system
	Food security	Improving food security
2017	Tourism	Strengthening investment in tourism
	Infrastructure	Improving connectivity and infrastructure development
	Energy access	Reducing gaps in energy access between urban and rural areas
2018	Green finance	Fostering green finance

Recent developments in policy areas covered by previous editions of the Outlook

Energy: preventing electricity price hikes despite a soaring coal price

- Earlier this year, Indonesia's minister for energy and mineral resources signed a decree fixing the price of coal for electricity supply under the country's domestic market obligation system, which obliges coal producers in the country to supply the local market. The decree aimed both to prevent electricity price hikes and to ease the financial burden on the state-owned electricity company, PLN, from the increasing global coal price. Moreover, the government recently announced that it would not raise the prices of subsidised fuels and electricity before late 2019.

Food security: reducing rural poverty through agriculture

- Indonesia's agriculture ministry has launched a new programme to address rural poverty and improve farmers' welfare. Under the auspices of this programme, which is called BEKERJA, the government is providing livestock and seeds of various horticultural commodities to poor households in 1 000 villages over a six-month period.

POLICY FOCUS

Leveraging financial technology to bring banking services closer to the people

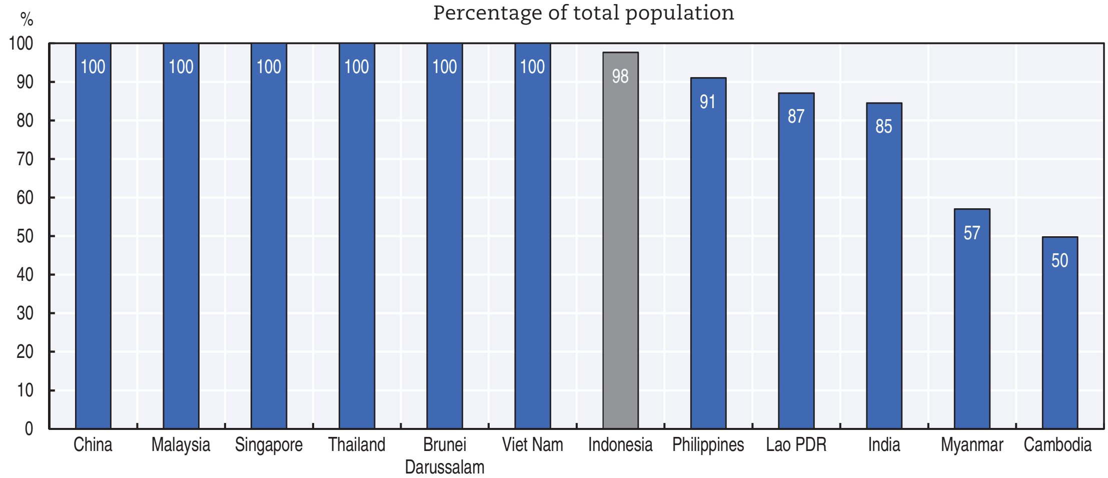
Development of Fintech holds great potential to improve access to financial services in Indonesia. In 2017, it is estimated that less than 49% of the adult population (aged 15 and above) has an account in a financial institution while commercial bank penetration is roughly 17.4 branches for every 100 000 adults in 2016 (World Bank, 2018). On both accounts, Indonesia is on par with the middle-income economies' average. To help address this issue, President Joko Widodo introduced a national strategy for financial inclusion in November 2016. One of the objectives of this plan is to expand the share of the adult population that holds an account in a financial institution to 75% in 2019.

Being an archipelago with more than 17 000 islands, Indonesia's geographical characteristics make it challenging for banks and other financial institutions to reach remote areas. Fintech could potentially improve this situation, reaching those who are unable to access bank branches and other financial institutions due to geographical constraints. In recent years, Indonesia's Fintech industry has grown in terms of investment, range of services and market penetration. Some Fintech branchless banking programmes like Laku Pandai, for instance, could help overcome the country's geographical barriers to financial inclusion. Accelerating the development of financial technology, however, puts domestic infrastructure's capacity and quality into question.

Indonesia's infrastructure has improved in recent years. For instance, the share of total population with access to electricity rose to 98% in 2016 from less than 50% in 1991, outperforming many of the Southeast Asian countries (Figure 3.1.1). Moreover, access to mobile phones in Indonesia is relatively high by ASEAN standards. Mobile cellular subscriptions is about 1.7 for every person, placing Indonesia second in the regional rankings (Figure 3.1.2). However, the total number of people who use the Internet on any type of device is still relatively low at just 32% of total population. To further develop Fintech, improving infrastructure, in particular ICT, is therefore necessary.

Figure 3.1.1. **Access to electricity, 2016**

Percentage of total population



Source: World Bank (2017).

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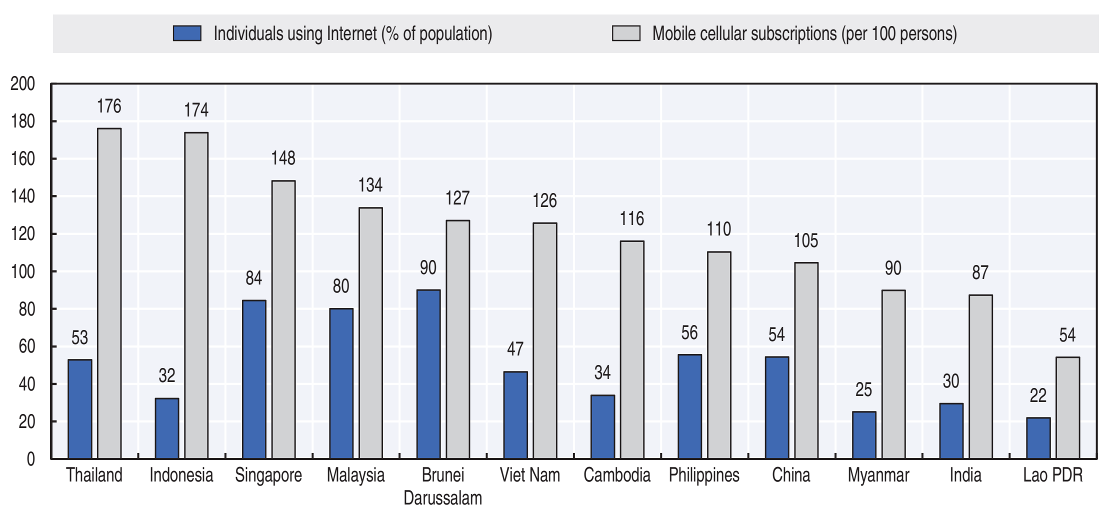
Figure 3.1.2. **Access to mobile cellular and Internet, 2017**



Source: World Bank (2017).

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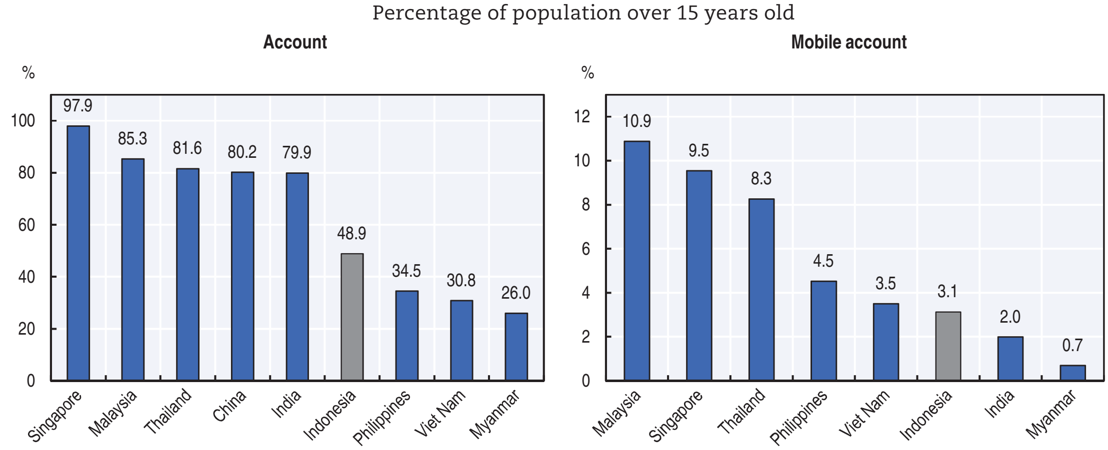
Despite the size of the market, the country's readiness to maximise the use of digital financial services remains low

According to the Financial Inclusion Insights survey in 2016, 43% of mobile phone users in Indonesia have a smartphone, but only 5% of phone users had ever made financial transactions on their phone (Financial Inclusion Insight, 2017). Cash remains the preferred mode to do transactions with banking services as the next option. Incidentally, not only bank branch penetration among adults is low, ownership of accounts that are accessible on a mobile device is one of the lowest in the region, at only about 3.1% of the adult population in 2017 (Figure 3.1.3).

Figure 3.1.3. **Account ownership at financial institutions, 2017**

Percentage of population over 15 years old



Source: World Bank (2018).

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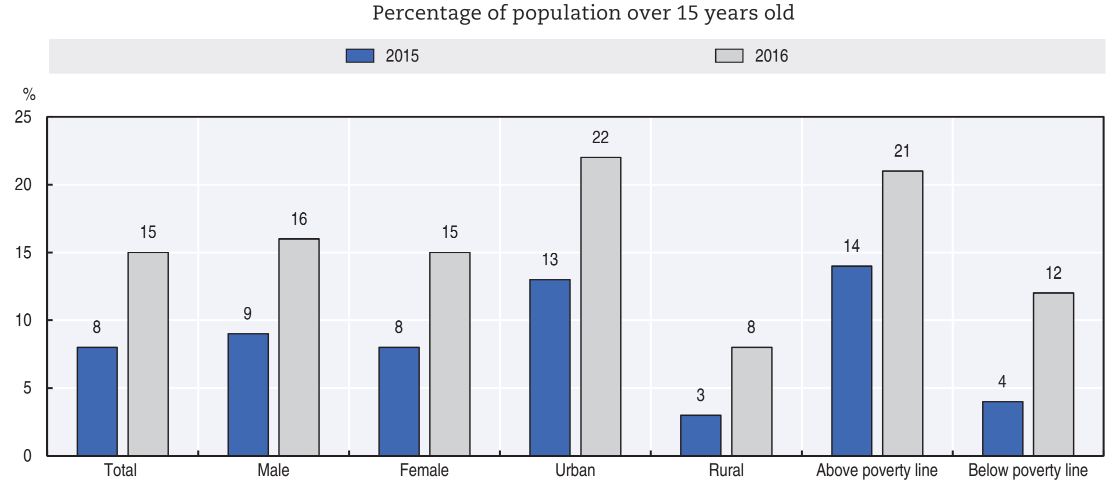
Another challenge is financial literacy and awareness despite the fact that 99% of the adults have the necessary basic numeracy skills. In 2016, just 14% of Indonesian adults were financially literate, and only 15% of them were aware of mobile money services (Financial Inclusion Insight, 2017). On the upside, awareness of mobile money has increased significantly across all demographic segments from 2015 to 2016 though financial literacy has been relatively stable in its performance (Figure 3.1.4). At the product level, awareness of other digital products (excluding mobile money), such as mobile network operators, payment providers, financial-planning companies, and digital-financial management, is slightly higher than the awareness of mobile money, standing at 16% of all adults (Financial Inclusion Insight, 2017).

Figure 3.1.4. **Mobile money awareness**

Percentage of population over 15 years old



Source: Financial Inclusion Insight (2017).

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Widespread use of informal financial services

In Indonesia, the use of informal financial services is common. Recent statistics have shown that only about 16% of the adult population has borrowed money from the banking sector in 2016, and that most of them borrowed from family, friends, or neighbours

(Financial Inclusion Insight, 2017).[1] There is also a culture of informal saving or lending groups – known locally as *arisan* – with people seeing it as a trusted loan-distribution system. In the *arisan* system, members pay in an agreed amount of money and then recoup a lump sum of money at a given moment. This culture could herald an opportunity for Fintech companies to reach new customers – in particular individuals and micro, small and medium-sized enterprises – by incorporating aspects of this widely-adopted culture into their own services. As alternative providers of financial services, Fintech companies have significant potential to improve financial inclusion across Indonesia.

Effective regulation and good co-ordination among regulators are crucial

The Indonesian government has been implementing some initiatives to support the rapid development of Fintech even though the development of Fintech regulation is still at a relatively early stage. This industry has four potential regulators. These include the financial services authority, Otoritas Jasa Keuangan (OJK), and Bank Indonesia, the country's central bank, as a regulator with purview over payments, the ministry for communication and information technology, or Menkominfo, with a role related to telecommunications and information technology, and the country's co-ordinating board for foreign investments, Badan Koordinasi Penanaman Modal (BKPM).

In October 2016, the OJK announced a plan to develop some regulations for digital financial services delivered through Fintech, releasing its first regulation in December 2016. The new rules were for lending services based on information technology and Fintech companies that run peer-to-peer (P2P) lending platforms. Under the new rules, Fintech P2P lending companies now have to register and then obtain a P2P licence. They have a minimum capital requirement of IDR 1 billion (Indonesian rupiahs) when they register, and IDR 2.5 billion at the point at which the company's licence comes into force. The new rules also cap foreign ownership at 85%, and insist on the server being inside Indonesia. More recently, in August 2018, OJK issued a new regulation on Fintech, covering a large number of issues related to innovation in digital technology for the financial sector.

Bank Indonesia has also set up a dedicated Fintech office to help developers in the sector. It will run a regulatory sandbox – a mechanism for developing regulation – to allow Fintech developers to test their new products under relaxed regulations, and to understand Indonesia's regulatory policies. In August 2016, Bank Indonesia published a regulation (no. 18/17/2016), which amended an existing regulation pertaining to electronic money (no. 11/12/PBI/2009). The new rules set out risk-management and prudential principles. They concern principals, issuers, acquirers, clearing processors, and financial-settlement operators. Moreover, at the end of 2017, Bank Indonesia brought in a new regulation for Fintech firms active in the field of payment systems. The regulation sets out a set of criteria that products must meet in order to qualify as Fintech. Those that do fulfil the criteria then have to register with Bank Indonesia.

Given the existence of multiple regulatory bodies, ensuring good co-ordination among them is crucial. It is also important to make sure that administrative processes are efficient, as this could facilitate the development of Fintech in the country. Indonesia's associations for Fintech and e-commerce – known respectively as AfTech and idEA – sent out a survey to all start-ups that plan to apply for a specific permit for electronic wallets and payment gateways. In all, 24 Fintech start-ups filled out the survey. More than 50% of the respondents stated that they were at the stage of having submitted an application for a permit, while 38% of respondents mentioned that they were waiting for clarifications concerning their permits. The survey showed that 52% of respondents saw the administrative process as the most difficult step in obtaining the permit, 31% of them cited unclear regulations as the biggest difficulties, with 17% underscoring other issues (Fintech Indonesia, 2017). As of June 2018, 64 Fintech companies operating in P2P lending had registered with the OJK.

Box 3.1.1. **The regulatory environment for P2P lending in the international market**

The most important factor for the favourable development of online finance is clear regulations, which can keep concerns like fraud and money-laundering to a minimum. Against a backdrop of rapid development in financial technology, many countries have been trying to forge an appropriate regulatory approach for P2P lending activities. For example:

- When it comes to Fintech, China is one of the most active countries in Asia. Recently, China's central bank has introduced a series of regulations relating to P2P lending and online payments. P2P platforms in China must register for a licence with the local financial authorities. While they do not have to meet minimum capital requirements, specific guidelines do impose credit limits and require a guarantee from the principal as well as debt securitisation in order to mitigate lenders' credit risks.
- In Hong Kong, China, current legislation from the Securities and Futures Ordinance prohibits retail investors from undertaking P2P lending activities.
- The United Kingdom has specific regulations or guidelines for the P2P sector. They have to obtain a licence from the Financial Conduct Authority if they wish to run an investment-based crowdfunding platform. The UK imposes a capital requirement of 20 000 pounds (GBP).
- In Singapore, platform operators facilitating securities-based crowdfunding offers (i.e. either debt-based or equity-based crowdfunding offers) between corporations and investors are required to hold a capital markets services licence. The corporations raising funds through SCF are subject to prospectus requirements under the SFA, unless exemptions apply. Peer-to-peer lending to businesses is considered as debt-based crowdfunding and thus falls under the SFA. In Singapore, platform operators which facilitate SCF offers between issuers and retail investors, need to fulfil the base capital requirement of SGD 500 000 or SGD 50 000 for offers made to accredited and institutional investors (provided the operators do not handle or hold investors' moneys, assets or positions, and do not act as principal against investors).
- In the United States, the current system asks platform operators to file full registration statements with the Securities and Exchange Commission, and to register the securities they offer to investors.

Source: DBS & EY (2016).

Banks are increasingly engaged in a process of technological transformation

While physical bank branches do still tend to dominate as centres for the provision of financial services, an increasing number of customers is migrating to digital services. In a recent survey of operators in the sector, 45% of respondents said that at least half of their customer transactions come from traditional branches. The survey also showed that a higher proportion of transactions go through traditional branches (55%) at Indonesian banks than at foreign banks (34%) (PWC, 2017). Moreover, foreign banks tend to take greater advantage of digital channels using mobile phones and the Internet.

In light of the recent trend for clients to migrate towards a digital approach to financial services, banks are changing their strategies and investing more in technology. According to the 2017 PWC survey, 84% of Indonesian banks are likely to invest in transforming their technology over the next 18 months. Meanwhile, 59% of global bankers expect the importance of branch banking to diminish significantly, as customers migrate to digital services. When the PWC survey was repeated this year, it was found that Indonesian banks continue to see technology as the primary driver of business transformation (PWC, 2018).

Another feature of the rise of Fintech is the widening of potential sources of financing. These new sources of financing are often less bureaucratic than traditional ones, and require little or no collateral. Amidst an increased competition with the rise of Fintech, traditional banks are increasingly transforming their own technology in order to stay competitive. Some of them, however, see a risk that alternative lenders will increase the level of competition in the sector and disrupt their business in the future. Over a quarter of respondents in the survey (28%) expressed concern that Fintech operators will significantly disrupt their bank's business by intensifying competition in the market over the coming five years, and 52% anticipated at least a moderate disruption. According to OJK data from May 2018, Fintech companies had provided loans of more than IDR 6 trillion with a total of 1 850 632 borrowers. Finding a balance between the benefits from increased competition and the risks of disrupting traditional banking is therefore crucial. Against this background, the Indonesian government is encouraging synergies and collaboration between banks and Fintech companies. Indeed, some banks in the country have already started to work together with Fintech players.

Financial inclusion is becoming an increasingly important agenda for the country. To help achieve this agenda, Fintech has great potential to reach those who have little or no access to financial services from conventional financial institutions. However, it is not without risk both for customers and for firms, and transparency through appropriate regulations is crucial to mitigate these risks.

Key government ministries in Indonesia

President	Joko Widodo
Co-ordinating Minister for Human Development and Culture	Puan Maharani
Co-ordinating Minister for Maritime Affairs	Luhut B. Pandjaitan
Co-ordinating Minister for Political, Legal, and Security Affairs	Wiranto
Co-ordinating Minister for Economic Affairs	Darmin Nasution
Administrative and Bureaucratic Reform	Syafruddin
Agrarian Affairs and Spatial Planning (National Land Agency)	Sofyan A. Djalil
Agriculture	Andi Amran Sulaiman
Communication and Informatics	Rudiantara
Co-operatives and SMEs	Anak Agung Gede Ngurah Puspayoga
Defense	Ryamizard Ryacudu
Education and Culture	Muhadjir Effendy
Energy and Mineral Resources	Ignasius Jonan
Environment and Forestry	Siti Nurbaya Bakar
Finance	Sri Mulyani Indrawati
Foreign Affairs	Retno L.P. Marsudi
Health	Nila Djuwita .F. Moeloek
Home Affairs	Tjahjo Kumolo
Industry	Airlangga Hartarto
Law and Human Rights	Yasonna Hamonangan Laoly
Manpower	Hanif Dhakiri
Marine Affairs and Fisheries	Susi Pudjiastuti
National Development Planning	Bambang P.S. Brodjonegoro

Key government ministries in Indonesia *(cont.)*

Public Works and Public Housing	M. Basoeki Hadimoeljono
Religious Affairs	Lukman Hakim Saifuddin
Research, Technology, and Higher Education	Mohamad Nasir
Social Affairs	Agus Gumiwang Kartasasmita
State Secretariat	Pratikno
State-owned Enterprises	Rini .M. Soemarno
Tourism	Arief Yahya
Trade	Enggartiasto Lukita
Transportation	Budi Karya Sumadi
Villages, Disadvantaged Regions and Transmigration	Eko Putro Sandjojo
Women Empowerment and Child Protection	Yohana Susana Yembise
Youth and Sports Affairs	Imam Nahrawi
Central Bank Governor	Perry Warjiyo

Note: Valid as of 16 October 2018.

Note

1. The financial literacy indicator is defined by using a combination of survey items that measure basic knowledge of four fundamental concepts including interest rates, interest compounding, inflation, and the diversification of risk in financial decision making.

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