**KAHLIL ROWTER**

Prospera

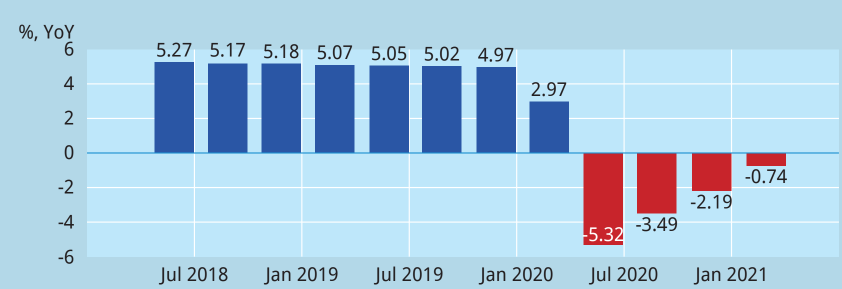
# Rise of Digital Channels and Retail Investors: A Tale of the Indonesian Financial Sector during the 2020 Pandemic

## Recent Developments

The COVID-19 pandemic hit the global economy in the first quarter of 2020. The Indonesian economy started to weaken at the end of that quarter and then declined deeply in the second quarter. Later quarters still saw negative growth but with less severity. The 2020 full year record was negative 2% y-o-y. Growth was still negative in the first quarter of 2021, but recovery should take place in subsequent quarters (Figure 1). Still, for the gross domestic product (GDP) level to return to pre-pandemic levels may take longer. Policy choices taken to mitigate the recession will have consequences, as returning fiscal and monetary policies to normal will take some time. The banking sector and financial markets will also need time to go back to normal behaviour.

When the COVID-19 pandemic hit, the Jakarta Composite Index dropped a lot. At first, the decline was in tandem with global indices late in 2019 and at the beginning of 2020, but then local transmission of the virus took place and investors began selling off. The big decline took place when only essential activities remained open. By late March 2020, the index had declined around 60%. Since then, the index has started to recover and by March 2021 it had returned to its pre-pandemic levels (Figure 2). Trading volume has also recov-

**Figure 1: Indonesian GDP Growth**




Source: Statistics Indonesia

**Figure 2: Indonesia Stock Market Index (Daily Closing Price)**


Source: Indonesia Stock Exchange

ered and even surpassed 2020 levels in the first four months of 2021.[1]

In the government bond market, the 10-year benchmark yield rose 128 basis points in March 2020 (Figure 3). The main sellers were foreign investors who reduced their ownership by around IDR100 trillion in the first four months of 2020. Meanwhile commercial banks and the central bank continue to accumulate government bonds. For banks the rationale was clear, lending was stagnant while liquidity remained ample. Liquidity in fact rose as the central bank relaxed capital standards and the Ministry of Finance deposited funds into the banking sector. This was a measure to support the economic recovery program.

Besides, when the sell-off started the central bank stepped in to stabilize the market. This added to the supply of IDR in the market. Bank Indonesia also intervened in the currency market to stabilize the currency. This was necessary as foreign investors sold their IDR positions for USD to transfer home.

By August 2020, the 10-year government bond yield had returned to pre-pandemic levels (Figure 3). Throughout the year 2020 and into 2021 daily trading volume remained stable. The recovery of the government bond yield is remarkable considering several developments. First, Bank Indonesia cut policy rates by 150 basis points from January 2020 to April 2021. Second, the fiscal deficit rose to over 6% (from below 3%) as spending rose and revenues dropped. And third, foreign investment in government bonds has not recovered.

It was fortunate that in 2020, very few corporates went into financial distress. Those that did were already under financial pressure before the pandemic. For example, the state-owned airline Garuda Indonesia and construction firm Waskita Karya were already under financial pressure before 2020. Also, no systemic financial institutions came under severe pressure during the pandemic.

## Structural Changes in the Financial Markets

Despite recovering market indicators, several structural changes will have longer term consequences. Ownership changes in the stock market are one example. In 2020 foreign investors sold down their positions. There was a slight inflow in January 2021, but outflow restarted in March and April 2021. The result is that foreign ownership in the stock market declined from around 45% in 2019 to around 40% in April 2021.[2]

In the government bond market, large ownership changes also took place in 2020. First, was the decline in foreign ownership. From a position of 39% early in 2020, it dropped to 25% by the end of the year. At the same time commercial banks raised their ownership from 23% to 37%. And Bank Indonesia also increased its ownership from 11% to 26% of the total outstanding.

When the government bond market came under pressure Bank Indonesia started stabilization moves, especially in March and April 2020. The central bank and the Ministry of Finance then agreed on a sweeping policy change that consisted of two components. The first was a large one-off Bank Indonesia participation in the primary market and the second was participation in further auctions. The one-off transaction was IDR400 trillion and the second part amounted to IDR70 trillion.[3] By March 2021, the central bank had bought an additional IDR65 trillion.[4]

Another significant development was the record increase in retail investors. In 2020 there was a 67% rise the number of accounts. The increases were 53%, 79% and 46% in the equity, mutual funds, and retail government bond accounts (Table 1). This was the largest annual increase for any of the accounts on record.

This increase in retail investors occurred in a recession, with a drop in consumption and rise in unemployment. One explanation is that there were many first-time individual investors with ample savings who were pulled into the capital market by low returns in the real sector and low bank deposit rates. Meanwhile, low stock indices and bond prices promised attractive valuations. It also means that there is confidence that the financial markets will remain resilient.

It is too early to tell if the rise in retail investors means stability of financial flows in the future. On one hand, the rise in the small investor segment means a more balanced spread of ownership. But retail investors usually have a shorter investment horizon. Once deposit rates and real sector investments recover, we will see to what extent these investors remain.

Aside from individual accounts, there was also a sharp rise in fintech accounts. This was particularly true for the peer-to-peer lending segment. In 2020 the number of lenders, borrowers, and

**Figure 3: 10-year Indonesian Government Bond Yield**


Source: Ministry of Finance, Indonesia

**Table 1: Number of Investor Accounts in the Indonesian Capital Market**

Thousand Persons

| | 2018 | 2019 | 2020 |
|---|---|---|---|
| Equity | 852 | 1,105 | 1,695 |
| Mutual Funds | 996 | 1,774 | 3,175 |
| Government Bond Accounts | 195 | 316 | 460 |
| All | 2,043 | 3,195 | 5,331 |

Source: Indonesia Central Securities Depository (KSEI)

**Table 2: Indonesian Fintech Key Lending Statistics**

| Data | 19-Dec | 20-Mar | 20-Jun | 20-Sep | 20-Dec |
|---|---|---|---|---|---|
| Lender Accounts (000) | 606 | 640 | 659 | 682 | 717 |
| Borrower Accounts (000) | 18,569 | 24,158 | 25,768 | 29,217 | 43,561 |
| Assets (IDR Trillion) | 3 | 3.7 | 3.2 | 3.3 | 3.7 |
| Average Disbursed Loans (IDR Million) | 99.7 | 122.5 | 135.7 | 142.5 | 113.8 |
| Outstanding Loans (IDR Trillion) | 13.2 | 14.8 | 11.8 | 12.7 | 15.3 |
| NPL (Over 90 Days Due) | 3.7% | 4.2% | 6.1% | 8.3% | 4.8% |

Source: Mandiri Sekuritas

amount of outstanding loans rose 18%, 135% and 16% respectively (Table 2). Ease of borrowing and the increased need to borrow may account for this rise.

The number of borrowers rose faster than the number of lenders and the amount of outstanding loans, which resulted in a decline in the average size of loans. This could mean than these loans were for consumption instead of investment. Note that the flat non-performing loan (NPL) levels suggest fintech lenders could select high quality borrowers.

The number of borrowers spiked in the fourth quarter of 2020, which was when economic activity was recovering and restrictions on peoples' movement were relaxed. At the same time government social handouts were still taking place. Hence, the increase in borrowers may point to a higher number of workers losing their jobs. They were likely also to run out of cash while not being eligible for government handouts.

## Rise in Digital Channels

A rise in digital channels also took place in banking, the payment system and e-commerce. For example, in 2020 Bank Mandiri, the largest bank in Indonesia and a state-owned firm saw a 40% increase in the number of online users and a 43% increase in transaction values. Online transactions overtook ATMs in transaction values from the first quarter of 2020. Meanwhile the two channels remained at par in frequency until the end of the year. Going forward, online transactions will likely dominate ATM transactions.

Another example is Bank Negara Indonesia (BNI), which is the fourth largest bank in Indonesia and state-owned. It saw a 60% rise in the number of mobile users, and close to a 50% rise in both online transactions value and frequency. But still, mobile and ATM channels remained almost equal in frequency and transaction value until the end of 2020. This may be because BNI has more ATMs in smaller towns.

Bank Rakyat Indonesia (BRI) is an interesting example of the rise in digital channels. It is state-owned and it has the most extensive network in Indonesia. Despite a 132% rise in the frequency of internet banking in 2020, the number of ATM transactions remained 37% higher. It appears that transactions in remote regions were still ATM-based.

Besides the general relative decline in ATM transactions, use of bank branches also fell. Bank Mandiri reported that branch use dropped 1% during 2020. Branches still serve small businesses which rely on cash for payments, but going forward they will likely move to digital payment means.

Before the pandemic the banking community expected that digital channels would dominate by the year 2023. As it turns out, the pandemic accelerated this by three years.

Another growing digital channel segment is e-commerce. In 2020 the gross market value (GMV) of e-commerce was USD32 billion, a 54% increase from 2019. E-commerce should grow by around 21% compound annual growth rate (CAGR) to reach USD83 billion in 2025. At the same time the digital economy should double from 4% of GDP in 2020 to 8.1% in 2025.[5] Yet e-commerce remains a tiny part of the consumer goods market at around 5%.[6]

Tokopedia and Gojek, Bukalapak and Shopee are the main drivers of e-commerce growth. There has also been a recent development in online fresh produce delivery, which became popular during the movement restrictions in 2020 when these firms grew 5 to 10 times. Some of them have linked-up with major e-commerce players. Post-lockdown, fresh produce delivery appears to remain higher than before the pandemic. This phenomenon also occurred in most other ASEAN countries. Going forward, online sales will rise and displace sales at brick and mortars stores. A few supermarket chains in Indonesia were early victims, for example Giant, while other chains are reducing the number of their stores.

## Regulatory Responses

The Ministry of Finance, Bank Indonesia and the Financial Services Authority (OJK) are the main financial sector regulators. They each issued policies to contain the effect of the pandemic on the financial system, but more regulatory power was needed. Hence, the government issued an emergency regulation, which became law number 2 / 2020, giving expanded powers to these authorities. The overarching goal was to preserve confidence in the system.

One important policy action was to expand the fiscal deficit, but only on a temporary basis until 2023, in order to allow the government to increase spending while tax revenues were declining. The 2020 budget deficit was thus raised from 1.7% of GDP to 6.34% in 2020. This new budget supported an economic revival plan with a focus on health, social assistance, and corporate support.[7]

Financing for the economic revival plan partly came from Bank Indonesia. Agreement between Bank Indonesia and the Ministry of Finance paved the way for this. The central bank supported the deficit to the tune of IDR400 trillion at first. It also participated in government bond auctions as a standby buyer. Absent this, market-based deficit financing would be disruptive.

OJK relaxed lending standards for banking and finance companies, making loan restructuring easier. These measures are effective until March 2022. Other measures include extension of reporting datelines and online meetings for regulatory compliance. Similar relaxations were also issued for insurance and pension funds.

For capital markets, new regulations focus on maintaining operational integrity and market stability. They include first, permitting online shareholder meetings; second, permitting several corporate actions for companies undergoing restructuring; third, reducing disclosure requirements for financial firms undergoing restructuring; and fourth allowing public firms to buy-back their shares without shareholder approval. These exclusions need regulatory consent.

The impact of these regulations was positive. First, financial panic was averted despite the large market correction. Second, no systemic financial firm went under. And third, the stock and bond markets rebounded within a few months.

In 2020, several firms defaulted on their debt instruments, and some underwent restructuring, but they were already in financial difficulties before the pandemic. One major company that got hit was Garuda Indonesia. Flight cancellations during the pandemic added to its financial woes. In 2020 Garuda Indonesia got a 3-year extension on its USD500 million global bond. Other troubled companies were the state-owned construction company Waskita Karya, which lost IDR7.4 in 2020, and the state-owned railroad company which booked a IDR1.6 trillion loss in 2020.

## Challenges Ahead

Going forward Indonesia's financial sector faces old as well as new challenges. Old issues include trust, governance and the gap between financial literacy and inclusion. Trust and governance relate to weak consumer protection. New challenges stem from the impact of recent policy choices. These include the enlarged fiscal deficit and large bank ownership of government bonds. Also, there are challenges surrounding the upcoming listing of tech unicorns.

Trust in the financial system was dented with the discovery of fraud at several large state-owned insurance companies. One was Asuransi Jiwasraya, one of the largest insurers in the country, which reportedly had been investing in questionable stocks that then lost value. Key personnel and a few other market participants were convicted by the corruption court. The losses amounted to IDR37 trillion. In response, the government created an insurance holding company to absorb Asuransi Jiwasraya and next, the state will inject fresh funds to partly compensate policy holders.

Another problem company is Asabri, insurer of armed forces personnel. Similar to Asuransi Jiwasraya its management also invested in dubious stocks. The resulting loss was about IDR23 trillion. A few key Asabri personnel are now accused in a criminal proceeding, but recovery and bailout are not clear.

In addition to issues of trust and governance, a second continuing challenge for the financial system is the gap between financial literacy and inclusion. The gap is quite large, with financial literacy recorded at 38% while financial inclusion was at 78%. Financial literacy means to what extent an individual has knowledge about basic financial products, while financial inclusion means that an individual has access to basic financial products such as a bank account.[8] This gap is becoming critical on account of two factors. First, a large part of the population has access to smartphones and is digitally savvy. Second there have been aggressive campaigns by several illegal fintech lending firms. This highlights the need for consumer education and protection. Towards this end the government has pushed for digital literacy campaigns. The latest campaign was in April 2021 by the Ministry of Communications,[9] while on consumer protection OJK is strengthening the dispute settlement framework. A recent initiative is to combine several alternative settlement bodies. [10]

Among the new challenges is reducing the deficit back to the 3% ceiling starting in 2023. With the slow economic recovery in 2021 tax revenues will remain weak. This slow recovery owes to several factors. First is the slow response to the pandemic last year. Second is the large informal sector where economic actors have little financial buffers. And third is the tenuous linkage with the global economy. On the positive side Indonesia has been quick to roll-out a vaccination program which was first focused on healthcare and essential workers and the elderly.

Another upcoming challenge is the need for the central bank to taper its large ownership of government bonds, at least in the medium term. As of May 2021, Bank Indonesia's holdings of government bonds amounted to IDR980 trillion. As a result of the central bank's fiscal support, broad money grew 12.4% in 2020 compared with GDP growth of -5.3%. This means in the medium term the central bank will need to reign in money growth. In the short term this runs against the need to maintain low interest rates to boost economic growth.

In the banking sector, there are two main challenges ahead. First is how to manage the rise in NPLs once the relaxation policy is over and second is how to sell down the sector's large ownership of government bonds. As of February 2021, around 18% of bank loans are being restructured, affecting close to 8 million borrowers, around 40% of which are small-to-medium scale enterprises. How these restructuring exercises fare would depend on resumption of commercial viability. Some sectors may not recover at all. These include transport and the hotel sectors. Now the prospects remain grim, especially in tourist destinations like Bali. State-owned banks are looking to write off loans that have no recovery prospects.

On the second issue, around 17% of banking sector assets now consists of government bonds. Loan growth in the future would entail reducing this amount. But a large sell down of government bonds can put severe pressure on the market. Besides there is also the capital adequacy consideration. Government bonds are safe assets and have zero weight in capital adequacy calculations, which is why the banking sector is under no pressure to raise equity. But replacing government bonds with corporate loans will pressure banks' equity.

In the equity market there is a significant new development: the coming listing of tech unicorns like Go-To (Gojek and Tokopedia) and others. These firms might conduct dual listing in Jakarta and another exchange. This would attract foreign (and domestic) investors into the Indonesian capital market and it will raise the weight of the Indonesian market in MSCI indices.

There are three key concerns regarding these prospective listings. First is the issue of different shareholders having different voting power. This is a common feature among tech firms that went through several funding rounds, and yet it is not recognized in the Indonesian regulatory structure. Second, there is no dual listing regulation in the Indonesia stock exchange. And third is the profitability rule. Most of these unicorns have not been profitable recently. Still, the Indonesian stock market is reviewing the regulations to accommodate these listings.

## Conclusions

The Indonesian capital market showed remarkable resilience during the pandemic. The stock index and government bond prices have returned to pre-pandemic levels. And yet, significant structural changes took place. And these will affect how the capital market evolves in the near and medium term. Policies taken in 2020 will impact monetary and fiscal policies going ahead.

First is the large size of central bank purchases of government bonds as a result of the early intervention in 2020 and later central bank support to finance the fiscal deficit. At some point the central bank needs to reduce its holding of government bonds. This will be in tandem with reducing money supply growth, which saw a large uptick during 2020. But the timing will be tricky as interest rates need to remain low to speed up economic recovery.

Next is the relaxation of lending standards issued by OJK. Once the relaxation expires, only loans of firms that weathered the storm can remain current. The rest will end up on banks' books as NPLs. Also, the restructuring done during the relaxation could depress earnings for a while. Another issue for banks is how to sell down their large ownership of government bonds.

The outcome of these regulatory changes was successful maintenance of confidence. Those firms that came under pressure were already in stress before the pandemic. One example was Garuda Indonesia, the state-owned flag carrier. It was already teetering before the pandemic, but travel restrictions made things worse. The company is now going into a major restructuring.

On the fiscal side, the government needs to return to a deficit of 3% in 2023 from the current level around 6%. A weak economy complicates this effort in addition to the need to continue spending heavily on health and social and corporate support.

For the stock exchange the challenge ahead is to handle listing of several tech unicorns. The authorities are also working to overcome long-standing issues including improving trust, increasing financial literacy and improving consumer protection. In the insurance sector, the government has formed a new insurance holding company and it plans to inject fresh capital to partly compensate Asuransi Jiwasraya policyholders. On literacy the government has various initiatives to raise digital literacy. For consumer protection, OJK is enhancing the alternative dispute settlement institutions.


### Notes

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### KAHLIL ROWTER

Senior Advisor, Prospera

Kahlil Rowter has over 30 years' experience in academics, the corporate world and the capital market. He is now a senior advisor in Prospera, an Australian-Indonesian government partnership program for economic development. He is also the independent commissioner at Danareksa Investment Management.

Until 2018 Kahlil was the chief economist of PT Danareksa Holding. He advised on economics across various lines of Danareksa business, including securities brokering, investment banking, asset management, treasury, and private equity.

From 2007 to 2010 Kahlil headed Pefindo, the largest debt rating agency in Indonesia. In 2009 he initiated the PEFINDO25 Index (for small and medium-sized enterprises) with the Indonesian Stock Exchange. He also initiated valuation coverage for small cap shares. Pefindo also underwent an ISO 9000 certification under his guidance. He was also a board member of the Association of Credit Rating Agencies in Asia where he helped in the formulation of Asian Credit Rating Best Practices.

Earlier, Kahlil spent over 10 years in Danareksa, Mandiri Sekuritas and CIMB in succeeding senior positions in fixed income and economic research.

Kahlil also lecturers at Universitas Indonesia's Graduate School of Management.