

FINANCIAL SECTOR RESTRUCTURING AND REFORM

KEY POINTS

- The new banking sector has fewer banks, more stringent capitalisation requirements and tighter bank supervision, especially of lending practices. These changes, based on international best practice, should provide firm foundations for the future.
- The Government's determination to repair and reform Indonesia's financial sector and ensure the economic recovery continues is generating opportunities for foreign financial institutions and service suppliers.
- These opportunities stem from the Government's sale of restructured loans, and bank and corporate assets it currently holds, as well as the relaxation of foreign investment laws in the financial sector.
- Performance of the newly recapitalised private sector banks improved over 2000, and they resumed modest credit expansion.
- However, the banks' non-performing loan levels remain high at 30 per cent, and the slow pace and in some cases, shallow nature of corporate restructuring is slowing a return to health. State banks, which hold the majority of the bank deposits, should be recapitalised by the end of 2000, but they have the highest share of non-performing loans and concerns exist regarding the extent of their managerial restructuring.

The Government recognises repair and reform of Indonesia's financial sector is key to restoring sustainable economic growth, and drives the significant changes occurring in this sector. The Government has announced it will use the reform process to re-position Indonesia's financial sector in line with international best practice, adopting substantial measures to reduce and limit exposure to risk, introduce international capital adequacy ratio, CAR, standards, sell assets to the private sector and increase sector-wide supervision using an independent agency.¹ As these reforms are implemented, the financial sector should become more transparent, open and regulated. However, in the short term, the Government is balancing national concerns about employment and maximising returns on assets with these longer term objectives.

By late 2000, the Government's major program of restructuring and refinancing the banking system was essentially complete, and in 2000, some banks were starting to extend new loans. Bank Indonesia reported new bank lending in June and July 2000 reached 6 per cent of bank assets, although this also included restructured loans (World Bank, 2000a). However, this refinancing program was expensive, costing at least 75 per cent of GDP.

Central to restoring banking sector efficiency is the Government's return of nationalised bank assets to efficient private ownership. Australia's financial institutions and dynamic financial sector are well placed to access these opportunities and provide support for associated reforms. This chapter describes the impact of the crisis on the financial sector, and details the Government's response. It outlines the opportunities for foreign direct investment in Indonesia's financial sector and exports of financial services to Indonesia.

IMPACT OF THE CRISIS

The Asian financial crisis much more severely affected the Indonesian banking sector, and through it, the corporate sector, than occurred elsewhere in the region. Inadequately monitored deregulation intensified the banking sector's vulnerability to crisis and the crisis' effects on the sector.

Banking Sector Vulnerability

The rapid growth of undercapitalised banks and their lack of supervision made the Indonesian banking sector highly vulnerable to the crisis. As the financial sector was deregulated in the 1980s, bank numbers more than doubled from 111 in 1988 to 240 in 1994. Large conglomerates founded many banks to serve their own commercial funding requirements and often to lend to related parties. Where lending was at arm's length, collateral values rather than credit and cash flow analysis determined loan suitability. Expectations of persistent strong economic growth and ever increasing asset prices encouraged and disguised risky lending practices. Finally, many banks undertook significant unhedged, short term foreign currency liabilities.

As in many other regional economies in the 1990s, and Australia in the 1980s, bank deregulation inadvertently weakened banking system prudential controls. For example, when regulators removed controls on banks' foreign borrowing and asset allocations, some banks did not increase their own risk management strategies, exposing themselves to risky foreign borrowing and domestic lending. Regulations allowed banks to minimise reporting of under-performing loans in their portfolios through

¹ Capital adequacy ratio is the ratio of bank equity to total bank assets, weighted by assets' level of risk.

various practices, including reclassifying loans as performing after only one payment (International Monetary Fund, 2000a). Banks made limited provisions against non-performing loans and were significantly undercapitalised, increasing their vulnerability to a deterioration in loan quality.

Impact on the Financial Sector

The Asian financial crisis quickly exposed these financial sector weaknesses. By early 1998, the rupiah's 70 per cent depreciation had damaged most banks' balance sheets. Firstly, it increased dramatically the domestic value of banks' own unhedged foreign currency borrowing. Secondly, the corporate sector's over-exposure to short term foreign currency debt impaired its ability to service domestic loans, causing non-performing loans to escalate. This reduced further banks' CARs, in many cases to negative values. Thirdly, throughout early 1998, as Bank Indonesia lifted interest rates on deposits in response to the depreciating exchange rate, bank revenue flows fell as banks could not pass higher rates on to distressed corporate borrowers. During most of 1998, this resulted in negative interest rate spreads, reducing banks' net income and damaging their capital adequacy.

RESPONSES TO THE CRISIS

Initially, the Government responded to the crisis with an 'emergency' program to guarantee bank deposits and quickly repair the banking system using public funds to recapitalise it. The Government's longer term, ongoing response is to restructure non-performing loans in the banking sector, return the nationalised banks and associated assets to the private sector, and thoroughly overhaul the regulations governing the financial system.

Initial Response

In January 1998, the Government announced its immediate priorities were to:

- restore confidence in the financial system by guaranteeing deposits²
- consolidate the banking industry by liquidating insolvent banks which failed to meet minimum CAR and non-performing loan standards
- recapitalise banks with weak CARs, but which met minimum capital adequacy levels.

To implement the first objective, Bank Indonesia allocated large amounts of liquidity support to banks facing runs on their deposits. To achieve the remaining objectives, the Government established the Indonesian Bank Restructuring Authority, IBRA, under a January 1998 presidential decree.

² In an attempt to boost depositor confidence and demonstrate a commitment to reform, the Government liquidated 16 insolvent private domestic banks in November 1997. However, the announcement of bank closures intensified runs on private domestic banks, threatening a collapse of the banking system in early 1998. Bank Indonesia responded with liquidity support to the affected banks, and in January 1998, the Government announced a blanket guarantee for all depositors and creditors of domestically incorporated banks. Presidential Decree No. 26 stipulated the Government Guarantee for Commercial Bank Liabilities, pledging all payments related to the liabilities of commercial banks would be covered, including inter-bank transactions and trade finance (Indonesian Bank Restructuring Agency, 2000).

Establishing IBRA

On behalf of the Government, IBRA oversees financial sector rehabilitation. Its role is to:

- assess the adequacy of bank capital, and restructure viable banks through merger and recapitalisation, starting with private banks then state banks
- close non-viable banks and take over their assets; these functions were delegated to the Bank Restructuring Unit, BRU
- manage and sell corporate assets received as collateral for Bank Indonesia liquidity support; this function was delegated to IBRA's Asset Management Unit, Investments, AMI, with asset sales undertaken by the Asset Disposal Unit, ADU
- transfer non-performing loans from banks' balance sheets to its Asset Management Unit, Credits, AMC, to manage and maximise recovery of these loans.

Restructuring Private Banks

During 1998, IBRA employed international accounting firms to assess the capital adequacy of all private banks. Then banks were classified as:

- category A, with CAR above 4 per cent, which were deemed healthy and not needing recapitalisation
- category B, with CAR between 4 and –25 per cent, which the Government decided to recapitalise providing they could demonstrate sound management and future viability; those unable to do so were liquidated
- category C, with CAR below –25 per cent, which were liquidated immediately.

IBRA classified 74 banks as category A banks, mainly small foreign joint ventures, holding only 5 per cent of total deposits. Of the 36 banks classified as category B, 21 subsequently failed to meet the IBRA's sound management criteria and were liquidated; IBRA took over a further seven banks; and the Government and their private owners identified a further eight for merger and recapitalisation. Seventeen banks, accounting for 0.9 per cent of total banking assets, fell into category C, and were liquidated immediately; their assets were transferred to IBRA in March 1999 (East Asia Analytical Unit, 1999).

Capital Adequacy Ratios and Non-performing Loans

The Government continues to determine whether a bank will come under IBRA supervision by using the minimum 4 per cent CAR. By the end of 2000, all Indonesian banks will be subject to this requirement. If a bank's CAR falls below 2 per cent, it will be transferred to IBRA. By the end of 2001, bank CARs must reach 8 per cent and non-performing loans must fall below 5 per cent. This requirement could continue to restrain banks' willingness to lend in 2001.

In March 2000, Bank Indonesia also required banks with non-performing loans exceeding 35 per cent of their outstanding loans to be placed under IBRA surveillance. In late 2000, average non-performing loan levels were 30 per cent of bank assets (Figure 7.1). If a bank's non-performing loan level exceeds 35 per cent, IBRA will monitor the bank for three to six months. By the end of 2001, bank non-performing loans must fall below 5 per cent.

Refinancing Banks

Bank refinancing has been very costly; the Government has issued about Rp. 650 trillion (US\$75 billion) of sovereign bonds, equal to about 76 per cent of 1999 GDP.³ Around Rp. 268 trillion (US\$31 billion) of these went to refinance state banks, and this program requires a further Rp. 18 trillion by the end of 2000 to complete it. IBRA also issued sovereign bonds worth Rp. 158 trillion (US\$18.3 billion) to refinance 11 category B private banks and 12 regional development banks to raise their CARs to 4 per cent.⁴ Before receiving capital injections, banks must receive IBRA acceptance for their business plans and sign a performance contract.

A LEANER BANKING SYSTEM

The Asian financial crisis has profoundly affected the Indonesian banking sector, reducing the number of banks from 237 to 161 (Table 7.1). Government control of around 70 per cent of banking system deposits in Indonesia compares with 40 per cent in the Republic of Korea. Four state banks, Mandiri, BNI, BRI and BTN represent 50 per cent of banking system assets. In addition, through recapitalisation, the Government holds significant shares in private banks. Despite banks transferring Rp. 256 trillion (US\$30 billion) of non-performing loans to IBRA, non-performing loans still represent 30 per cent of bank assets (Figure 7.1). However, banks have provisioned for 94 per cent of these (World Bank, 2000a).

In 2000, banks were beginning to lend again, and some were even starting to show profits. A June 2000 Bank Indonesia survey of 15 banks representing 75 per cent of total deposits showed these banks had extended Rp. 15.8 trillion (US\$1.8 billion) new loans since the beginning of 2000, representing 5.7 per cent year to year growth. However, as this included restructured loans, the extent of new lending is unclear (World Bank, 2000a).

Restructuring State Banks

The Government anticipates state banks, which account for over 70 per cent of bank deposits, will be recapitalised by late 2000. State banks also have the highest share of banking system non-performing loans, reflecting weak credit analysis, risk management and accounting practices. Ongoing efforts have yet to produce adequate operational restructuring, including cutting staff and branch numbers or strengthening senior management teams. IBRA merged into Bank Mandiri, four state banks under its initial surveillance; this alone required Rp. 178 trillion (US\$20.5 billion) in recapitalisation. Recapitalisation of the other state banks, including BRI, BNI and BTN followed.⁵ These banks' non-performing loans were transferred to IBRA's AMC.

³ Around Rp. 220 trillion (US\$25 billion) of this was used to cover Bank Indonesia liquidity to the banking system (World Bank, 2000b).

⁴ The Government also issued Rp. 218 trillion (US\$25 billion) in bonds to honour its guarantee of bank deposits, including reimbursing Bank Indonesia for the liquidity support it issued to banks at the height of the crisis (World Bank, 2000b).

To refinance undercapitalised private banks, IBRA issued banks with government bonds in return for government equity in these banks and a proportion of their non-performing loans; these were transferred to IBRA.

⁵ In April 1998, IBRA merged eight nationalised banks into Bank Danamon, which had a CAR of 32.5 per cent.

Table 7.1

State Banks Now Dominate Rationalised Banking System
Structure of Indonesian Banking System, 1997 and 2000

	Number of banks		Share of deposits	
	June 1997	June 2000	June 1997	June 2000
State owned	34	43 ^a	37	70
Private	160	79	57	18
Foreign and joint venture	43	39	6	12
Total	237	161	100	100

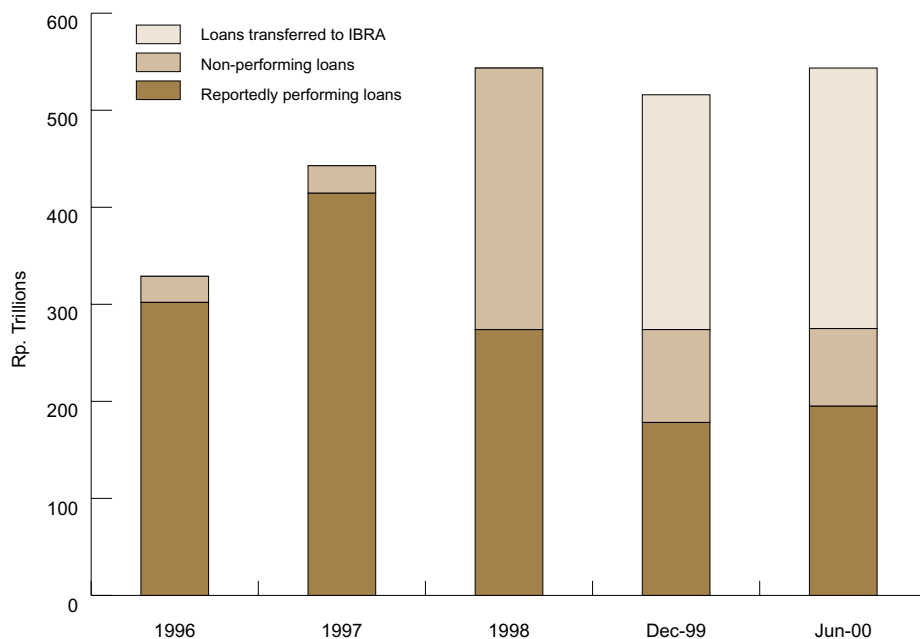
Note: a Of the 43 state owned banks in mid 2000, four were state owned before the crisis, 12 were nationalised recently, 26 were rural development banks and one was the export import bank.

Source: World Bank, 2000a.

Figure 7.1

Non-performing Loan Levels Falling, but Still High

Banking System Assets, Rp. trillion



Source: World Bank, 2000a.

IBRA'S ASSET SALES

Now bank sector restructuring is nearly complete, IBRA's priority is to sell its large stock of assets to the private sector to return them to productive use and reduce government debt accumulated through bank recapitalisation. However, IBRA does not intend to sell assets unless it receives what it regards as a fair price, and the sale does not threaten employment and output in the economy. Consequently, the Government has delayed asset sales. If IBRA asset sales resume in 2001 as announced, they should generate significant opportunities for foreign financial institutions and service providers.

Scope of IBRA Assets

IBRA's assets have a face value of Rp. 564 trillion (US\$65 billion).⁶ This includes loan portfolios transferred as part of bank restructuring (categories 1 to 4), non-performing loans (category 5), and equity in recapitalised banks and corporate assets, including banks, pledged as collateral for liquidity support (Table 7.2). Compiling, valuing and transferring these assets, with international accounting firm assistance, involved considerable effort and took IBRA until 2000 to complete.

IBRA recently enhanced its control over these assets by establishing compliance teams to monitor individual enterprises and identify specific problems. It also replaced the management of several enterprises under its control to maximise their sale value.

Table 7.2

IBRA is Indonesia's Biggest Creditor IBRA Assets by Category, October 2000

Asset	Value (Rp. trillion)	Value (US\$ billion)
Category 1 to 4 loans transferred from frozen banks ^a	40	4.6
Category 5, non-performing loans transferred from recapitalised, state owned, taken over and frozen banks ^b	258	29.7
Indonesian government investment in recapitalised and taken over banks	139	16.5
Assets from shareholder loan settlements for Bank Indonesia liquidity credits	127	14.6
Total	564	65.0

Note: a IBRA categorises loans into five groups. Category 1 to 4 loans range from normal to special notice, but essentially currently perform, using the five-tier international criteria.

b Category 5 loans are non-performing, having interest and capital outstanding for more than six months.

Source: World Bank, 2000a.

⁶ Asset sales so far suggest the real value is significantly lower.

Sale of Banking and Financial Assets

The sale of IBRA's sizeable bank asset holdings may present good investment opportunities for those seeking to enter the Indonesian banking sector. IBRA favours a market driven approach to sell fully recapitalised banks, using initial public offerings and private placements with strategic investors. Most banks under IBRA's supervision are listed on the Jakarta Stock Exchange and hence will be relatively easy to sell. The size and high prudential and risk management standards of Australian banks should help them to access these opportunities. (See box on ANZ's part purchase of Panin Bank, Chapter 3 - *Foreign Investment*.)

Since its inception in 1998, IBRA has generated revenue of Rp. 35 trillion, or about 8 per cent of its assets, via asset sales and interest earnings. Its asset recovery target for the nine month financial year 2000 is Rp. 18.9 trillion; it had realised Rp. 12 trillion of this by September 2000. In June 2000, IBRA sold off 22 per cent of Bank Central Asia's shares realising 13 per cent of their book value.

IBRA intends to complete the sale of all nationalised banks by 2001, including selling a majority share of Bank Danamon. IBRA has indicated it remains committed to completing the privatisation of nationalised Bank Central Asia and Bank Niaga, despite deferring these sales in October 2000. Since the performance of seven recapitalised private banks improved in early 2000, IBRA also will sell some of its interests in these banks (Table 7.3).⁷

Table 7.3

Private Bank Non-performing Loans, Profitability Improving Key Performance Indicators of Seven Recapitalised Private Banks^a

Key indicators	Average percentage		
	May 2000	June 2000	July 2000
Capital adequacy ratio, CAR	10.4	12.0	11.2
Ratio of loans to deposits	43.0	44.9	45.0
Ratio of non-performing to total loans	27.5	25.6	23.7
Provision for loan loss/total loans	11.1	10.9	10.7
Growth of total assets	0.6	1.0	0.9
Growth of total loans	7.4	4.8	2.5
Growth of total equity	1.7	2.7	1.1
Growth of operating expenses	3.2	-6.3	4.9
Net interest margin	0.2	0.3	0.3
Return on assets	0.1	0.04	0.1
Return on equity	2.7	1.9	2.7

Note: a As at 31 July 2000.

Source: Indonesian Bank Restructuring Agency, 2000.

⁷ These comprise the BII, Bank Lippo, Universal, Patriot, Artemedia, Prima Ekspres and Bukopin Banks.

Bank Recapitalisation Bonds

Bank recapitalisation bonds now are on sale on the secondary market, clearing the way for banks to reduce their bond holdings as opportunities arise to increase lending. The coupon rate on these bonds ranges from 12 to 14 per cent, providing reasonable returns for potential foreign investors. However, the current thin trading in recapitalisation bonds reflects bank reluctance to sell interest bearing assets, given limited opportunities to lend to viable firms.

IBRA DEBT RESTRUCTURING

Another IBRA priority is to negotiate restructuring and repayment of over Rp. 298 trillion (US\$33 billion) in debts transferred to it as part of bank restructuring. While IBRA has sought to restructure large loans itself, it sells most smaller loans to the private market.⁸ The sale of loans may provide opportunities for Australian business experienced in debt restructuring (International Monetary Fund, 2000b). The Government's AMC aims to collect Rp. 10.3 trillion (US\$1.2 billion) in fiscal year 2000, mostly from selling restructured loans (Indonesian Bank Restructuring Agency, 2000).⁹ (See Chapter 8 - *Corporate Restructuring* for IBRA's progress in this area.)

Potential for Securitisation

As the restructuring of non-performing loans advances, banks increasingly could use securitisation of their under-performing loan portfolio to improve their capital adequacy ratios. Australia possesses significant expertise in asset securitisation, and is well placed to assist with this emerging business.

IMPROVING FINANCIAL SECTOR GOVERNANCE

The Government has indicated it aims to establish a sound and resilient financial sector to increase the long term growth potential of the Indonesian economy and safeguard against future financial shocks. It has implemented substantial financial sector reforms since the crisis, including improving prudential supervision, financial reporting and relevant commercial laws. Australia also can assist in the ongoing process of strengthening Indonesia's financial system, and access commercial opportunities.

PRUDENTIAL SUPERVISION

The Government is upgrading its prudential regulatory and supervisory framework in response to the crisis. To achieve this, it has relied on a mix of self regulation, to tighten loan classifications, reporting requirements and capital adequacy standards, and direct prudential supervision to deter high risk lending practices.

⁸ The AMC loan portfolio crosses a range of industries, including primary industry (41 per cent), trading and distribution (11 per cent), building and construction (9 per cent) and real estate and finance (8 per cent each).

⁹ The remainder comes from payment of interest on debts to IBRA.

Capital Adequacy

Ensuring capital adequacy is crucial to protect depositors and other creditors from excessive risk taking. To assist bank rehabilitation and promote lending, the Government temporarily lowered minimum bank CARs to 4 per cent during the crisis, but banks must reach the minimum internationally acceptable CAR of 8 per cent by the end of 2001.

Loan Classification and Provisioning

Bank Indonesia now requires banks to adopt more stringent loan classifications, more closely in line with internationally accepted practice. Banks must classify loans into four categories: normal, special mention, doubtful and loss (East Asia Analytical Unit, 1999).¹⁰

Bank Supervision

Bank Indonesia already has strengthened bank supervision and plans further improvements. It now conducts annual on-site inspections of all banks. Further, all banks must employ a compliance director to ensure daily compliance with prudential regulations. Bank Indonesia has established a permanent supervisory presence at all banks and is monitoring, on a quarterly basis, all banks' progress against their business plans, including ensuring they will achieve 8 per cent capital adequacy by the end of 2001. If a bank cannot comply, Bank Indonesia will take prompt corrective action in accordance with recently enacted criteria (International Monetary Fund, 2000d).

The Government also introduced laws establishing a new independent bank supervisor, the Financial Supervisory Agency, to supervise banks from the end of 2002. As well as banks, the Financial Supervisory Agency will supervise insurance companies, pension funds and other non-bank financial institutions (East Asia Analytical Unit, 1999).

The Government also established a special unit monitoring state owned banks within the Ministry of Finance. It will conduct quarterly reviews of banks' compliance with their performance contracts, including business plans, and monitor closely data on financial activities, including credit and loan restructuring activities. It will tender publicly annual audits of state owned banks to international firms (International Monetary Fund, 2000c).

Exposure Limits

Limiting financial institutions' exposure to foreign and related party transactions is critical to prevent another crisis like the 1997 crisis. Authorities are keen to discourage widespread, short term, unhedged foreign currency exposures. Since March 2000, all banks have had to report foreign exchange transactions exceeding US\$10 000 to Bank Indonesia, and detail the financial relationship between sender and receiver. Regulations controlling related party lending accord with best practice. Bank Indonesia also is working to increase its supervision capacity.

¹⁰ IBRA uses a five-tier classification but Bank Indonesia uses a four-tier system. Special mention loans are overdue from 1 to 90 days, requiring provision of 5 per cent; doubtful loans are overdue more than 180 days, requiring provision of 50 per cent; and loss loans are overdue more than 270 days, requiring 100 per cent provision.

NEW CENTRAL BANK ACT

The new Central Bank Act, enacted in May 1999, is designed to establish Bank Indonesia as an independent central bank. The new act gives Bank Indonesia the exclusive authority to:

- design and implement monetary policy, including:
 - determining monetary targets to achieve the inflation target of 5 to 7 per cent
 - conducting open market operations in the money market
 - stipulating discount rates
 - setting banks' minimum reserve requirements
 - managing credit and financing
- regulate and safeguard the smooth operation of the payments system
- regulate and supervise banks.

Source: Deacons, 2000.

The Government stresses that maintaining tolerable credit risk, market risk and operational risk systems is critical to banks' future successful functioning.¹¹ Australia's world class risk management professionals could help Indonesian banks in their transition to risk management based operating systems.

Deposit Insurance

By replacing its blanket guarantee on deposits with a deposit insurance scheme, the Government plans to limit its potential exposure to future financial system failures, and clarify the incentive structure under which banks and depositors operate. The Government has not yet formally announced details of its proposed deposit guarantee scheme (KPMG, 2000).

TRANSPARENCY

The Government is aware that to promote trust in the financial system and ensure its efficient functioning, depositors and other creditors need access to sufficient information to distinguish between well managed and solvent, and badly managed and insolvent institutions. Bank Indonesia has developed a range of measures to improve financial system transparency (Reserve Bank of Australia, 1997).

¹¹ Credit risk is risk of default on loan repayments; market risk is risk of trading losses from unfavourable movements in market prices; and operational risk is risk from poor management practices.

Since April 1999, banks must publish quarterly financial statements. They also report fortnightly on their consolidated global operations, outlining their domestic and foreign currency liquidity profile and any need to cover potential liquidity shortages (International Monetary Fund, 2000d). Bank Indonesia also introduced significant penalties for non-compliance.¹²

CAPITAL MARKET REFORM

Well functioning capital markets compete with the banking sector as a source of investment funding, encouraging banks to operate more efficiently and prudently. Significant regulatory reform of Indonesian capital markets is underway, although increasing the depth of these markets will be gradual.

Stock Market

Since late 1997, the Government has augmented the power of Bapepam, the capital market supervisory agency, to encourage broader participation in the share market through strengthening minority shareholder rights and attracting institutional investors to the market. A new code of conduct, as well as more staff, should help to enforce these new laws. Bapepam also intends to improve coordination with other capital market players, including the Indonesian stock exchanges (Bapepam, 2000a).

To improve corporate sector risk management, both the Jakarta and Surabaya Stock Exchanges offer options and futures products. This should increase corporate participation in the equity market (Bapepam, 2000b).

Technology upgrades are improving Indonesia's stock markets. The Jakarta Stock Exchange has over 500 personal computers and a sophisticated computer facility enables remote trading for brokers. These facilities, wide use of email and high quality corporate web pages suggest significant potential for e-commerce business. Since June 2000, the Jakarta Stock Exchange has traded in Internet start up companies, further boosting e-commerce. Australian e-business operators can help the Jakarta Stock Exchange exploit these opportunities.

Bond Markets

In 1995, the Government significantly improved the corporate bond market's regulatory regime, bringing it into line with international best practice. Bapepam is taking steps to better enforce these regulations.

Banks' short term reluctance to lend to companies should encourage larger, more reputable corporates to seek access to other forms of finance, including the domestic corporate bond market. In the Republic of Korea and Thailand, the economic crisis promoted corporate bond market growth, as larger, more reputable corporates have better credit ratings than most banks, still suffering from high non-performing loans.

¹² Australia's legal and accounting professionals and banks have significant expertise in sound financial reporting, providing them with opportunities to assist their Indonesian counterparts in implementing these requirements.

However, without a deep secondary market and investor confidence, the bond market offers limited competition to the banking sector. The development of a government bond market, as banks sell their sovereign recapitalisation bonds, should support creation of a benchmark yield curve, assisting corporate bond market development. In the medium to long term, corporate restructuring and ongoing economic recovery should improve Indonesian corporates' credit ratings, promoting local bond market growth.

Improving the Payments System

An efficient payments system is important in restoring confidence in the Indonesian financial system. Bank Indonesia plans to replace the current manual settlement system with a real time gross settlement system by the end of 2000 (Deacons, 2000).¹³

Improvements in the payments system should encourage credit card market development. Only 4 per cent of Indonesians hold a payments card, well below the 20 per cent average for the Asia Pacific region. As ANZ recognised, this could provide opportunities for Australian business to develop the credit card market (*Jakarta Post*, 14 July 1999, p. 8).

PROSPECTS

Indonesia's financial system, particularly its banking system, was highly exposed in 1997-98, and nearly collapsed as a result of bank runs. However, over the past three years, the Government has succeeded in restructuring and refinancing a viable group of private banks. Government recognises the main problems remain the slow pace of restructuring corporate non-performing loans and the continuing problems in the state banking sector. Also, while Bank Indonesia has raised prudential control standards, in many cases to international levels, in the short term, limits on human resources and operational effectiveness may affect supervision.

In the medium term, as the Government implements more effectively new prudential standards, and completes bank and corporate asset sales, significant commercial opportunities may emerge for Australian financial institutions and service providers.

¹³ During the 1990s, most South East Asian economies moved to an electronic payments system to reduce systemic and settlement risk. Bank Indonesia planned to move to a real time gross settlement, RTGS, system in 1997, but the Asian financial crisis put this plan on hold.

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