Notes for ANU Public Roundtable, 21/10/2008:
The global financial crisis and its implications for the Asia Pacific

Hedley Bull 1Building, 2pm

Indonesia

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(with thanks to Haryo Aswicahyono, Chatib Basri, Chris Manning for quick-return comments, notes, data)

This crisis very different from 1997-98:
This time, global financial crisis, originated in the US; likely to lead to sharp slowdown in global growth, probably zero at best for OECD bloc in 2009.
International contagion initially via capital accounts and financial markets, mainly in North America and Europe; now about to also affect real economy.

So, for RI, not a repeat of contagion from a neighbour (good news), but global economy likely to deteriorate (bad news).

1) Effects on capital flows and the financial sector

Indonesian banks have reportedly little exposure to US sub-prime market, etc; RI mostly still running a small CA surplus.
JSX declining (see below), but other asset prices (especially housing) holding up OK (property market comprises 16% of total bank credit, property NPL just 1.6% of total property credit).

Current liquidity is tightening; exporters reportedly experiencing some difficulties, eg, in opening LCs. As in other countries, flooding the market with liquidity no necessary solution, as banks now don’t trust each other.

Capital flow data? Not aware of estimates, but likely to be exodus, ‘flight to quality’, US absorbing more. One indicator is foreign ownership of SBIs (CB certificates), declined from Rp55T in July to Rp20T in early October.

Corporates mostly more cautious before 2008; major ones believed to have hedged on the ER.

2) Effects on the real economy

No official forecasts released recently. Consensus forecasts so far suggest that 2009 growth likely to be about5%, ie, 1.5 percentage points lower. Though could be subject to major downward revision.

RI trades more intensively with East Asia, so impacts will depend on how the region performs, ie, how much ‘Chindia’ can manage to decouple from the OECD. So far hopeful that growth be at least half of pre-crisis. Singapore, a major trade partner, already negative growth. Japan slow, but has been anyway since early 1990s.

3) Effects on inflation, interest rates, Rp

Global inflation concerns now abating. This positive news for RI, since inflation was becoming a serious concern, as it has been for some time (note re BI debates). Inflation projected to fall to about 8% in 2009.

Falling interest rates also a positive for heavily indebted economies like Indonesia.

Trends in Rp: modest decline (less than 10% so far, to about Rp10,000); about EA average, much less than A$.Would have been greater (capital exodus, commodity price declines) but BI intervening extensively in support; partly fear of 1997-98 repeat.

Though scope for intervention limited by reserves. RI reserves among lowest in EA, mid-year $57B, cf Singapore $252B, Malaysia $136B, Thailand $117B; and much higher in NE Asia. And on 'mobile capital' to reserves, Indonesia the most vulnerable in EA.

Asset prices: sharp fall in JSE, though broadly comparable to region. Eg, since 1/9/2008 (to last Friday), JSEdown 35%, similar to Nikkei (32%), Hang Seng (30%), Straits Times (31%).
Why decline (ie, anything country specific)?: withdrawal of foreign funds; some shares have fallen below the 'trigger point' where compulsory sales required; commodity prices declining.

But no sign yet of declining prices for residential and commercial properties; still quite buoyant.

Note that global financial problems also accompanied by very sharp decline in global oil prices, and also to lesser extent food prices.
Would expect that this would be a negative for RI. Although likely to reduce commodity exports, direct impact on the budget is minimal; in fact, lets the govt off the hook from a very embarrassing dilemma on fuel prices. Check budget fuel price assumptions. This might be an opportunity for the govt to re-activate automatic link to international prices; though election year looming, so unlikely.
Food price declines have minimal economy-wide impacts, since RI this year likely to import little rice owing to good season. But will help the poor, help ease inflation, and reduce pressure for the govt to get involved in food subsidies.

4) Govt response to date

Fiscal prudence since 2000 (often heavily criticized, misleading in my view) has paid off. Pubic debt/GDP fallen from about 100% to about 30%. Current fiscal deficit likely to be around 1.5% of GDP. So some, but limited, roomto move, in fiscal stimulus, bank supports, etc.

Though modest, could be some issues to do with funding the deficit; perhaps temporary increase in ODA for this and next year (Ani statement earlier in the year?).

More generally, the crisis could be helpful in strengthening the hand of MoF in election year context where spending pressure rises. Perhaps also help SBY a bit?

Recent measures:
JSX closed for 3 days week before last in face of panic buying.
Bank deposit guarantees – govt extended max guaranteed bank deposits (introduced in Jan 1998) 20x, to Rp2B (about $200K); estimated to cover 97% of depositors, but about 61% by value. (note that about 80% of country's financial assets held in banks)
Bank liquidity – the asset categories that illiquid banks can pledge as collateral to BI in exchange for emergency credit has been expanded.
BI cut min reserve requirement from 9.08% of total deposits to 7.5%.
Govt set aside Rp4T as reserve funds to buy shares in SOEs that were 'dumped in the JSE at irrationally low prices'(???).
MoF announced measures to ease procedures for govt procurement, as a pump priming measure.
But MoF mixed signals on fiscal policy: tightening to assure markets, but pressure to spend more (which was already building up for 2009 elections anyway). But general view is that deficit unlikely to get beyond 1.7% of GDP; ie, modest by international standards.
BI actively supporting the Rp; details.

5) Social impacts

No early release data, no evidence to date. Providing no major econ slowdown,adverse social impacts likely to be limited; declining food prices on balance good for the very poor. Any Rp decline would probably boost labour-intensive EO activities, manufactures, cash-crops, tourism. Labour absorption since the crisis in these activities had anyway been disappointing.

Not aware of any poverty, malnutrition indicators, and anyway too early for effects from financial crisis to be felt. Though impacts earlier in the year from rising good prices evident.
(In passing, estimates for the Philippines, from the SWS, report that 'moderate hunger' rose from 12.1% of families to 15.2% in Q3/2008. Defined as experiencing involuntary hunger a few times in past quarter.)

6) Broader lessons: 1997-98 crisis and now

Continuous search for better warning ('vulnerability') indicators; especially after painful lessons of 1997-98, when many conventional indicators looked OK.

Floating ER (though heavily managed at times) provides a shock absorber against sudden reversals in capital flows and terms of trade fluctuations.

Banks now much more cautious; prudential regulations also tighter, though not clear that this has had a major impact (& NPLs in SOBs still a problem).

Note also, that while not a criticism of ASEAN, no indication that the organization could be expected to play much of a role. Ditto, nascent AEC, etc.

Will restore the region's confidence, after being lectured to by the US/IMF, etc since 1997-98!