The Future of International Monetary System from the Perspective of the Emerging Economies: Lesson from Indonesia

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Seminar "Where Global Finance is Heading? The Stake of Emerging Economies in the International Financial System", in Cusco-Peru, July 13-14, 2009

2. Some backgrounds for discussion

- **The last 10 yrs, no big change in the international monetary system**
- **Meanwhile, some countries have reformed, some have not**
- **In normal time, economic policies can insulate damages from shocks. It is now not normal time!**
- **The past and present economic crises all happened under the very same international monetary system.**
- **So did we learn good enough?**

Indonesia experience: a glimpse

- **We have reformed the banking and financial sectors**
  - banks do not get any kind of exposures from financial derivative products
  - risk management and good corporate governance are put in place in the banks operational

- **While still being a small open economy with free capital movements, we do not experience direct fallout from the latest sub-prime mortgage defaults.**

Lessons for Financial Institution

- The present international monetary regime lacks prudent practices.
- Market can not solve the problem by itself.
- The world needs an improvement of the international monetary regime that will guarantee less volatility to the world output
- Therefore, there is an urgent need for a broadening of the scope of supervision.

3. Improving the global monetary system

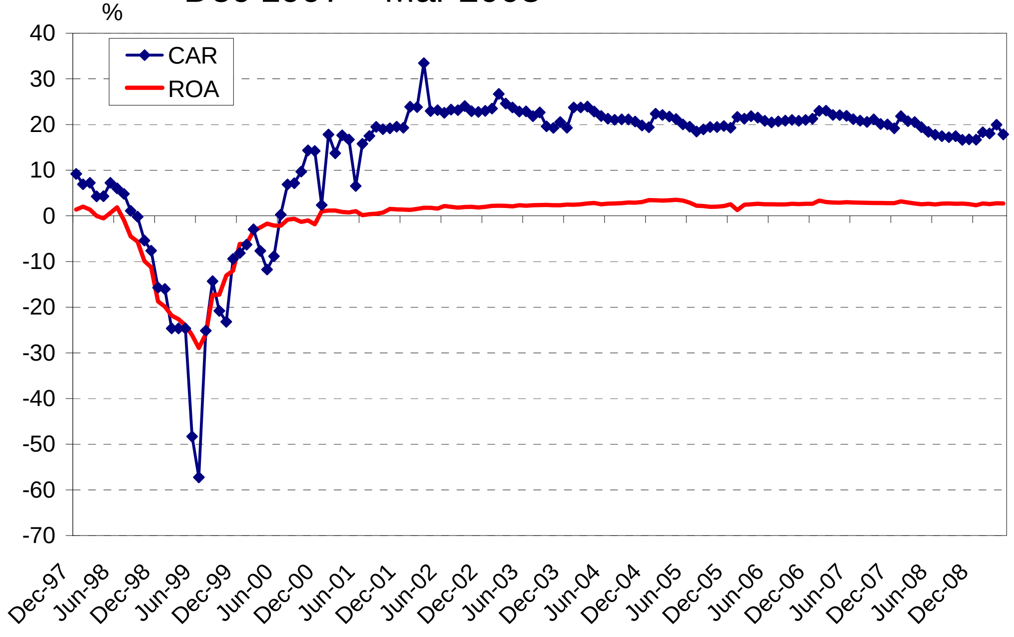
- **There is a need for a new form of partnership amongst the market player.**
- **Bretton Woods Institutions needs a new design, as global financial architecture changes.**

Thank you...

Financial Sector vs Exchange Rate Regime: Current Crisis

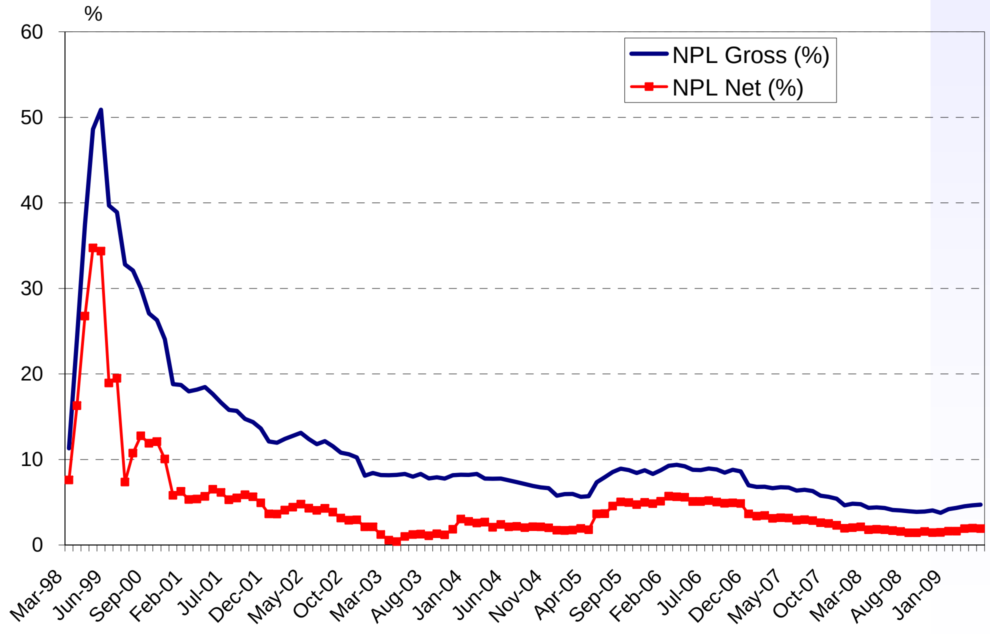
- **Recent banking indicators is still in a good shape:**
  - A very low NOP, around 3-5% during 2008.
  - CAR is 12%-15%, surpassed the minimum requirement of 8%
  - NPL dropped from 50% in March 1999 to a mere 4.71% in May 2009.

CAR and ROA – Banks in Indonesia, Dec 1997 – Mar 2008



Source: Bank Indonesia

NPLs – Banks in Indonesia, Mar 1998 – May 2008

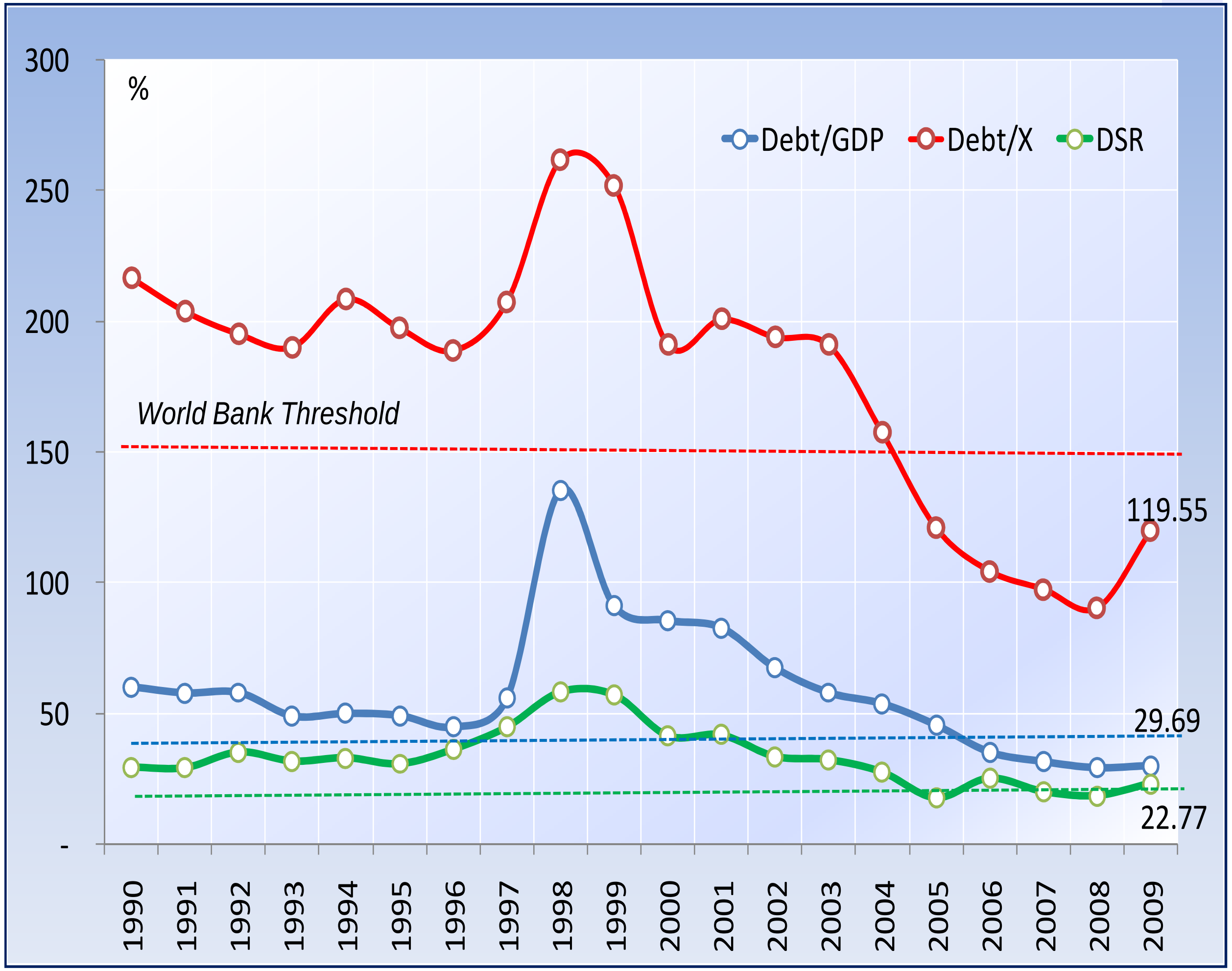


Source: Bank Indonesia

- **Sound and stable macroeconomic condition backed by healthy financial sector are necessary conditions**

Debt/GDP, DSR, and Debt/X, Indonesia, 1990 - 2009

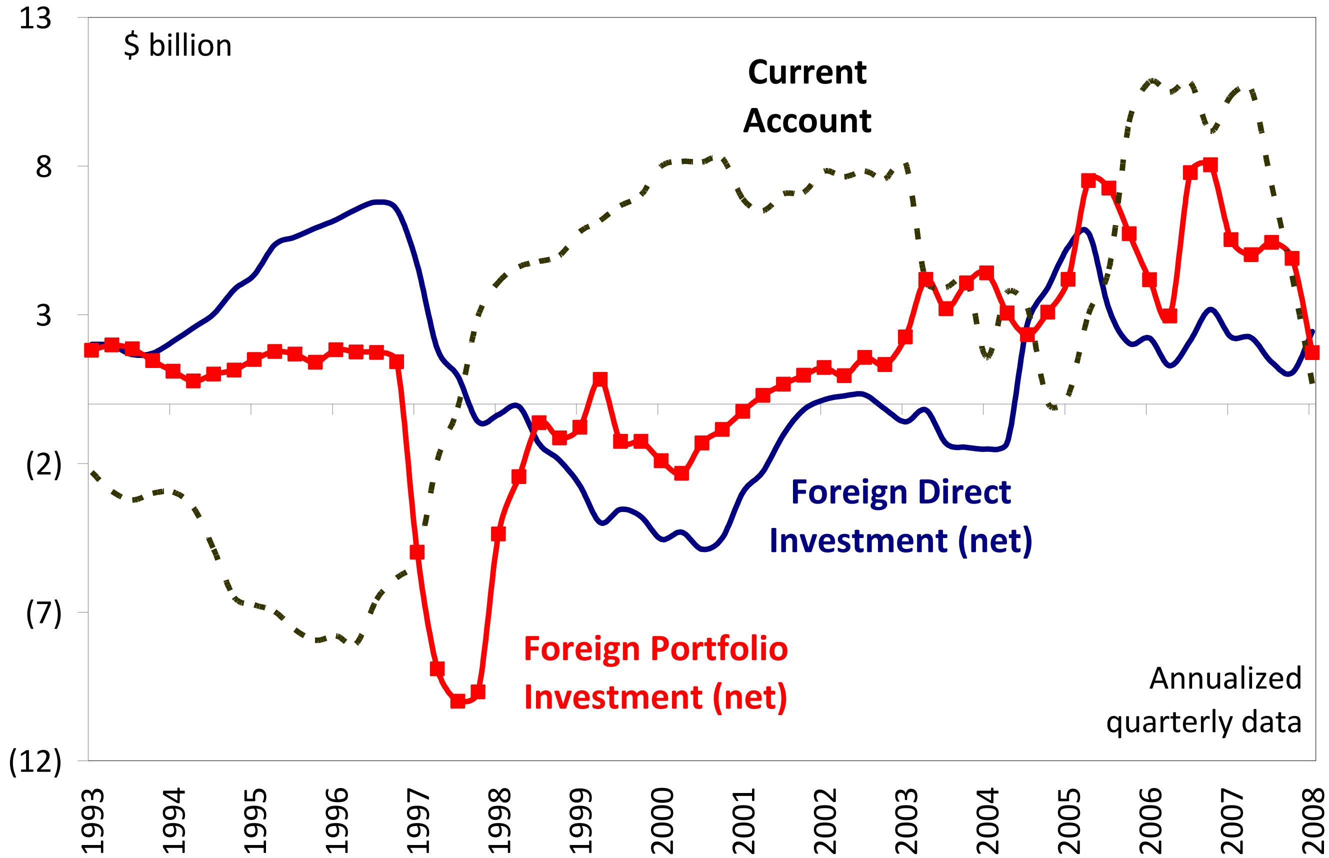
- Un-hedged foreign debts used to be problem in.1998
- It does not pose any threat in Oct 2008 despite the 14.5% depreciation.
- Lower debt to GDP, debt to Export, and the Debt to Service in 2008 as compared to the 1998 – 99 crisis.



Source: CEIC, calculated.

Current account and Capital Flows Lessons

- **Balance of Payment**
  - Since 1998, the FPI inflows gradually becomes dominant and that in itself creates stability issues especially for the Rupiah exchange rates.



3. Fisical and Monetary Policy Coordination

- The beauty of the fiscal and monetary policy coordination has been proven during the difficult time related to the latest crisis
  - The Government of Indonesia's current fiscal and monetary policies can be said to be an improvement on policies in the past.
  - Macroeconomic stability is more resilient

- The 2008 crisis is completely different from the 90's: The prescription of the policy mix now shifts to the opposite
  - Need to stimulate the faltering economy with the fiscal stimulus, accompanied by the unorthodox monetary policy easing in the form of the quantitative easing and the lowering of the interest rate.

4. Lessons for Financial Institution

- Emerging market is in the advantageous position of being able to learn from the risk-management and regulatory breakdown elsewhere
- Lesson for supervision: should give market participants incentive to endogenize the systemic consequences of their decisions.
- Look after the damaging “tail events” more than the short term return.
- Economic openness enhances productivity and increases wealth in the normal time, but can be very harsh during the crisis time.

Lessons for Financial Institution

- The recent crisis reveals how the present international monetary regime lacks prudent practices.
- Market was unable to solve the problem. All happened under the very monetary regime and, by all means, look at the origin…..!
- The world needs an improvement of the international monetary regime that will guarantee less volatility to the world output
- Therefore, there is an urgent need for a broadening of the scope of supervision.

Lessons for Financial Institution in the Medium Term

1. Deficiency of risk management practices of many financial institutions is observed.
2. The fast progress of the financial innovations, lacking details on prudential practices.
3. Weak accounting standards implementation and the financial products complexity matter.
4. Monetary authorities should be more aware of the complexities of the financial practices
5. Crisis management frameworks, including deposit insurance, have in some cases proved inadequate and need to be strengthened.

Lessons for International Monetary System

- Financial deepening should be properly sequenced.
- Recognize the risks, establish adequate surveillance and strong regulatory framework.
- Market discipline, prudential norms and supervisory oversight in financial sector are essential.
- However, there is a need to strike a balance between flexibility, so as to encourage financial innovation, robust regulation and better corporate governance.
- In addition, regional and international cooperation could help foster development and promote resilience of the financial markets in the region.

Lessons for International Monetary System

- The need for the International monetary system reforms, requires time table to set the speed.
- The discussion of the reforms need cooperation among involved contries, to outline the details of the sequences and preparations for the
- We surely learn now that monetary regimes stability hinges on the financial stability.