INDONESIAN ISLAMIC FINANCIAL MARKET:
FACTS AND CHALLENGES

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OUTLINE

1. Developing the Indonesian Islamic Economic and Finance
2. Roles of Bank Indonesia in Islamic Finance
3. Performance of the Islamic Financial Markets
4. Islamic Financial Market Deepening
5. Recent Regulation Related to Islamic Money Market
1. Developing the Indonesian Islamic Economic and Finance

**CURRENT CONDITIONS**

1. Less understanding on Islamic economy
2. Islamic economic conditions
   - Top 10 markets (GIEI) in each halal industry
     - but not a top player. Islamic economic share is still small.
   - Islamic finance is dominated by banking sector with small Islamic banking share (5.3%)
2. Less utilization of Islamic social funds.
   - Suboptimal collection and distribution of Islamic social funds.
3. Not strong enough national policy and political will on Islamic economics (no specific institution and initiatives).

**Global Environment**

- Frailty of the conventional economic system.
- Huge potential of the global halal market.
- Tight global liquidity.
- Downturning of the global trade.
- Varieties of Islamic school of thought.

**DEVELOPING THE INDONESIAN ISLAMIC FINANCIAL MARKET**

**OPPORTUNITIES**

- Establishment of KNKS.
- Potential of halal industry.
- Potential of Islamic social fund.
- Establishment of KEKS

**CHALLENGES**

- Imbalance business opportunities.
- High business concentration.

**EXPECTED CONDITIONS**

1. Improved public understanding
   - Higher Islamic economics literacy
2. Islamic Economics Performances
   - Top 10 players in each halal industry
   - Increase share in Islamic business.
3. Islamic Financial Market Performance
   - Increase share in Islamic financial market.
   - Improved share in Islamic money market.
4. Optimal collection and distribution of Islamic social funds (ZISWAF).
5. National level of Islamic Economics policy

**DEVELOPING ISLAMIC ECONOMIC AND FINANCE**

- Islamic Economic sector.
- Deepening the Islamic financial market.
- Developing the Islamic social sector

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**National Environment**

- Fragility of the conventional economic system.
- Huge potential of the global halal market.
Excess liquidity in the economy can be managed in some Islamic financial markets. However, it goes through a cooperation among regulators and market players. Such an excess liquidity is then linked with productive activities.

Challenges:
- Economic performance
- Less competitive to conventional banks
- Less optimal public trust
- Less occupying Islamic financial market

Roles of KNKS, mainly:
- Bank Indonesia
- Ministry of Finance
- Financial Services Authority (OJK)

Challenges:
- Lack of information
- Public trust on amil
- Integration of commercial & social funds
- No involvement of Islamic securities
- Less optimal portfolio allocation

Challenges:
- Limited instruments
- Limited forex supply
- No pricing benchmark
- Less active (freq., vol)
- Less preferred option for liquidity mgt
- Lack of infrastructures

Challenges:
- Less variety of instrument
- Less participation of iB and investors
- Less active (freq., vol)
- Less preferred option for liquidity mgt
- Lack of infrastructures

Challenges:
- Hold to maturity
- Limited Corporate Sukuk
- No pricing benchmark
- Lesser role in monetary operation

Challenges:
- Economic performance
- Less competitive to conventional banks
- Less optimal public trust
- Less occupying Islamic financial market

Challenges:
- Less supportive Islamic finance to Indonesian economy
- Limited role of Islamic instruments in economic policies
- Less optimal Islamic social sectors to solve social economic problems
2. Roles of Bank Indonesia in Islamic Finance

### ISLAMIC ECONOMIC AND FINANCE POLICIES IN BANK INDONESIA

**Bank Indonesia Main Policies**
- Achieve and Maintain Rupiah Stability

#### Monetary Policy
- Developing instrument, infrastructure, regulation & investor based in:
  - Islamic Money Market
  - Islamic Forex Market
  - Include engaging social sector through Islamic securities.
  - Developing infrastructure, regulation & real sector based monetary instrument.
  - Encouraging the development of sukuk market.
  - Developing real sector-return indexes as benchmark.

#### Macropurudential Policy
- Islamic Banks regulation and macro prudential supervision.
- Strengthening Islamic business:
  - Economy empowerment in pesantren (Islamic boarding school)
  - Increasing Islamic corporations' business
  - Increasing mustahik's business, including the optimization of ziswaf.
  - Encouraging the integration of commercial and Islamic social finance.

#### SP – PUR Policy
- SPN establishment, regulation, implementation and supervision including with Islamic Banks.
- Non-cash payment instrument and infrastructure which comply with Islamic principles.

#### REGIONAL POLICY OF ECONOMY AND FINANCE
1. Developing Islamic economy and finance research and studies in the regional level.
2. Strengthening Islamic economy empowerment.
3. Empowering ZISWAF and microfinance.
4. Strengthening and education of Islamic economy and finance in the regional level.

#### INTERNATIONAL POLICY
1. Involvement and membership in IDB, OIC, IIFM, IILM, IFSB forum, etc.
2. Actively involve in Int'l WG (zakat-waqaf core principles).
3. Establishment of Islamic Inclusive Financial Service Board (IIFSB) and encourage to establish World Islamic Infrastructure Bank (WIIB).
3. Performance of the Islamic Financial Markets
Islamic money market is getting more active with increasing volume and lower risk. However, it still is dominated by placement in Bank Indonesia instrument.

Islamic repo is the new transaction mechanism stipulated under Bank Indonesia Regulation (PBI) Number 17/4/PBI year 2015. It has been applied by Islamic banks and conventional banks. The Islamic repo transactions are ranged between Rp20 – Rp180 billion. In the 1 quarter of 2016, there has been more than Rp1.1 trillion Islamic repo transactions between Islamic banks and conventional banks.
4. Islamic Financial Market Deepening

DEVELOPING INSTRUMENTS AND INFRASTRUCTURES

Islamic Financial Market Instrument

Deepening Islamic Forex Market
- Existing:
  - Spot
  - Islamic hedging

Deepening Sukuk Market
- Existing:
  - SBSN (Govt Sukuk)
  - Conventional Bank Sukuk
  - Islamic Bank Sukuk
  - Corporate Sukuk
  - State Owned Enterprise (SOE) Sukuk

Deepening Islamic Money Market
- Existing:
  - SIMA (Mudarabah)
  - SIKA
  - Repo syariah (SBSN, Corporate Sukuk)

Islamic Monetary Operations
- Existing:
  - SBIS (jaalah)
  - Fasbis
  - Repo SBIS
  - Repo SBSN
  - Reverse repo
  - Islamic forex term deposit

Areas of Development
- OMO instrument
- Money market instrument
- Forex market instrument
- Sukuk market instrument
- Social fund instrument

There have been some Islamic instruments in the Islamic money, forex and sukuk market.
Bank Indonesia Islamic monetary operation has occupies sukuk as well.
The improvement of the instruments would capture those markets.
DEVELOPING INFRASTRUCTURES AND INVESTORS

Islamic Market Infrastructure

- Mini MRA Syariah (for Islamic repo)
- Islamic Financial Market Code of Conducts (iCOC)
- Settlement system for Islamic repo
- Islamic Accounting for Islamic repo and Islamic hedging

Areas of Development

- Islamic benchmark rate
- Islamic social fund information system
- Treasury certification
- Managing non government Sukuk for collateral

• Infrastructures are going to be developed in some areas (benchmark rate, treasury, etc.
• There is also a plan to expand domestic and foreign investors

Islamic Financial Market Investors

Domestic Investor

Existing:
- Bank konvensional

Foreign Investors

Existing:
- Individual via local bank
- Corporate via local bank

Areas of Development

DEVELOPING INSTRUMENTS AND INFRASTRUCTURES

Islamic Financial Market Regulations

BI Regulations on Islamic Instruments

Existing:
- instrumen moneter syariah BI (SBIS)
- Operasi moneter dengan Sukuk

BI Regulations on Trading of New (proposed) Money Market Instruments

BI Regulations on Trading in Islamic Money Market

Existing:
- Interbank trading
- BI & Bank (reverse repo SBSN)

Areas of Development

Islamic Money Market
Islamic Forex Market
Sukuk Market
Islamic Monetary Operation

• Regulations stand in 3 things: regulations for the existing instruments, new (proposal of) instruments and trading of instruments in the Islamic money market.
• Such regulations are coordinated with related regulators.
2. Recent Regulations Related to Islamic Money Market

- **ISLAMIC REPO (PBI No.17/4/PBI/2015)**

**Commitment time**
- Bank A promises to sell sukuk to Bank B in an agreed time (1st leg)
- Bank B agrees and promises to purchase sukuk in the 1st leg and will resell it in the 2nd leg

**First leg (time T)**
- SBSN
- Rp

**Second leg (time T+n)**
- SBSN
- Rp

- Islamic repo is based on true sale of Sukuk (government and corporate) with a mutual promise to resell/repurchase in an agreed time
- It can be applied by any bank (conventional and Islamic) having Sukuk
- Strong commitment among parties are needed.
ISLAMIC HEDGING (PBI No.18/2/PBI/2016)

Simple Hedging (Tahawwuth al basith):
By using Forward Agreement (Al-Muwa’adat li al-’Aqd al-Mustaqbal) followed by Spot in the maturity time.

Commitment time:
Each party mutually agrees (muwa’adah) to exchange (trade) the currency in an agreed time including currencies, nominal, exchange rate and premium and, settlement time

Maturity time:
Each party trade (exchange) the currencies (Spot transaction) with an agreed commitment followed by delivery

Complex Hedging (Tahawwuth al Murakkab):
By using a subsequent spot transaction and Forward Agreement followed by another Spot transaction in the maturity time.

On the spot time:
Each party conducts spot transaction and then mutually agrees to re-exchange (re-trade) the currency in an agreed time including currencies, nominal, exchange rate and premium and, settlement time

Maturity time:
Each party trade (exchange) the currencies (Spot transaction) with an agreed commitment followed by delivery

- Islamic hedging can take forms of simple and complex hedging.
- Those are based on mutual promise among parties
- There are consequences for a party who breaches the contract.

Thank you