Indonesia: Growing dominance of government Sukuk

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Similar to the year of 2015, the growth of the Islamic banking industry in Indonesia is still continuing on a decelerating trend. In 2014, the Islamic banking industry grew 12.4%. The growth then dipped in 2015 to 8.8%.

As at August 2016, it recorded a 3.1% growth. It is, of course, a tentative growth figure for 2016 but it at least indicates persistent slow growth experienced by the Indonesian Islamic banking industry. The same also applies to the Islamic rural bank industry that has so far recorded slower growth compared with 2015 although it still recorded higher growth compared to its Islamic bank counterpart.

However, comparatively speaking, it is important to note that there has been a small increase in the market share of the Islamic banking industry to 4.95% in August 2016 from 4.71% in August 2015, meaning that the growth of Islamic banking is still faster than conventional banking.

Contrary to the growth of the Islamic banking industry, the year 2016 saw the acceleration in the growth of government Sukuk issuance. Sovereign Sukuk issuance up to August 2016 (from December 2015) reached 45.05%. It maintained a fast growth momentum and is most likely to surpass the full year growth of 2015 which was at 54.23%. Government Sukuk issuance has now become the most dominant player in the Indonesian Islamic finance industry.

The Islamic insurance industry is another component of the Islamic finance industry that has also shown encouraging growth in 2016 (as at August 2016) although its asset size is still small compared to Islamic banking. The Islamic life insurance industry and general (and reinsurance) industry recorded growth of 22.9% and 22.2% respectively.

Corporate Sukuk have still not made any major progress so far. The same can be said for the Islamic mutual fund industry. It even recorded negative growth as at August 2016 although it has yet to be seen how it will perform until the end of 2016.

Apart from the aforementioned industry perspectives, a general slowdown in the global economy also contributed to some extent to the slower economic growth in the country, which in turn, also affected the growth of the Islamic banking industry.

Review of 2016

Despite the fact that the growth of the Islamic banking industry is still comparatively faster than conventional banking, the growth is historically reaching a record low. Two major Islamic banks, Bank Syariah Mandiri (BSM) and Bank Muamalat Indonesia (BMI), whose assets accounted for 43% of total Islamic banking assets in 2015, have entered their slowest growth periods since 2014. BMI even experienced negative growth in 2015, experiencing a 7.4% decline in assets to IDR57.8 billion (US$4.28 million) in 2015 from IDR62.4 billion (US$4.62 million) in 2014. Worse still for BMI, by August 2016, its total assets went down further to IDR52.6 billion (US$3.89 million).

In fact, the market share of BSM and BMI have declined over time; in 2010, their market shares were 33.3% and 22% respectively and by 2015, their market shares declined to 23.7% and 19.3%

Table 1: Selected figures from the Indonesian Islamic finance industry (IDR trillion)						
	2011	2012	2013	2014	2015	2016
Assets of Islamic commercial banks and Islamic windows	145.47	195.02	242.28	272.34	296.26	305.29*
Assets of Islamic rural banks	3.52	4.7	5.83	6.57	7.74	8.59*
Sovereign Sukuk issuance^ (cumulative)	81.53	138.62	186.22	250.17	385.85	559.67**
Corporate Sukuk issuance (cumulative)	7.92	9.79	11.99	12.96	16.08	17.33***
Islamic mutual funds (net asset value)	5.56	8.05	9.43	11.16	11.02	9.93***
Assets of Islamic life insurance	7.25	9.83	N/A	18.05	21.61	26.57*
Assets of Islamic general insurance and reinsurance	1.91	3.23	N/A	4.31	4.91	6*

Sources: Alwyni (2016), Financial Services Authority (OJK), Ministry of Finance, and calculated further.
*Notes: *As at August 2016; **As at the 6th October 2016; ***As at July 2016; ^includes all government Islamic securities issuances; US$1 = IDR13,640 (22nd October 2015).*

respectively. While these two largest Islamic banks experienced declining market shares, second-tier Islamic banks such as Bank Negara Indonesia Syariah (BNIS), Bank Rakyat Indonesia Syariah (BRIS) and Permata Syariah (the Islamic window of Permata Bank) increased their market shares.

BRIS, BNIS, and Permata Syariah increased their market shares to 8.2%, 7.8% and 5.1% respectively in 2015 from 7%, 6.5% and 2.3% in 2010. It is most likely that this trend will continue by the end of 2016.

While the Islamic banking industry is facing a slowdown, Islamic government securities are continuing their upward trend. In fact, according to data from the Ministry of Finance, as at the 6th October 2016, total issuance of government global Sukuk is the largest in the world amounting to US$10.15 billion, followed by the Emirate of Dubai (US$7.07 billion), Malaysia (US$6.85 billion) and Turkey (US$4.86 billion).

In 2016, the Indonesian government issued two global Sukuk facilities with two different tenors and pricings. The first one has an issuance size of US$750 million with a five-year tenor and a 3.4% pricing while the other issue of US$1.75 billion had a 10-year tenor and a 4.55% pricing. The government also issued its first savings Sukuk facility intended for local retail investors in 2016, mobilizing around almost US$200 million in local currency. This saving Sukuk facility offered a 6.9% return under the Wakalah structure with the minimum order at around US$150.

On the corporate side, the progress has not been like its sovereign counterpart. Up to the end of July 2016, there was only a 7.8% increase in issuances compared with 2015. However, it is expected that more Sukuk can be issued by the end of 2016. In fact, in November 2016, BRIS issued its first Sukuk Mudarabah in the amount of around IDR1 trillion (US$74 million).

The other segment of the Islamic finance industry that recorded a significant increase in 2016 is Islamic life insurance. Considering that the market penetration of the insurance industry as a whole is still low, Islamic life insurance has the potential to grow further. According to the Indonesian Islamic Insurance Association, only 9.4% of the Indonesian population know that there are Islamic life insurance products.

Although it is still small in absolute value, similar progress can also be seen in the general insurance and reinsurance segment where it recorded growth of 22.2% up until August 2016, surpassing the full year growth of 13.9% in 2015. Unfortunately, Islamic mutual funds experienced an almost 10% decline in terms of the net asset value up until July 2016.

Preview of 2017

Government Sukuk have continued the trend to be a dominant player in the Indonesian Islamic finance industry and this is expected to continue in 2017. It is most likely that government Sukuk will also play a more important role in the global Sukuk market, especially considering the fact that the government has looked into Sukuk more and more to plug its budget deficit and finance many infrastructure projects.

The challenge for Indonesia is now more on how to make other components of Islamic finance such as Islamic banking, corporate Sukuk, Islamic insurance and Islamic mutual funds more competitive and grow further.

Although the intention is actually there by the authorities to support the growth of Islamic finance as a whole (see IFN Annual Guide 2016), it seems that there is a lack of understanding on what actions to take to really stimulate the growth.

Officials in Indonesia's OJK claimed that it has created a comprehensive infrastructure to support the growth of Islamic finance by issuing many regulations. However, it is high time to discuss whether those regulations are simplifying the businesses or complicating them. The issue here is not about how many regulations are issued, but how effective they are in stimulating the development of Islamic finance.

Like any other business, the Islamic finance industry needs a less bureaucratic environment to grow. Government Sukuk, taking advantage of its sovereign status, may not have as much bureaucratic barriers than those faced by its private counterparts.

Apart from bureaucratic issues, the government may need to encourage its state-owned enterprises to place more of their funding into Islamic banks and/or Islamic mutual funds. Alternatively, they may also be encouraged to issue more Sukuk instead of conventional bonds.

Last but not the least, fiscal incentives is the area that has not been touched by the government to promote the growth of Islamic banking and corporate Sukuk. As an infant industry in the country, giving fiscal incentives to Islamic finance is to put it on a more level playing field with its conventional counterpart.

Conclusion

Notwithstanding the aforementioned issues, Indonesia needs to consider Islamic finance as a way to attract more funds into the country in view of the current global political climate, especially in the US and Europe which are not perceived to be very friendly with Muslim countries and further exacerbated by the election of Donald Trump as the US president-elect and the growing influence of 'far right' politics in Europe.

However, it is imperative for the country to create a more business-friendly environment with less bureaucracy, fewer unnecessary regulations and better rules of law. All of these factors are critical to attract capital, including Shariah compliant capital.