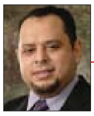
A review of the growth of the Indonesian Islamic finance industry in the last five years (2011-15)

Indonesia has the world's largest Muslim population and yet it still lags behind in terms of Islamic finance when compared with its neighbor Malaysia and the GCC countries. In this article, FAROUK ABDULLAH ALWYNI reviews the growth of the country's Islamic finance industry in the last five years from 2011 to 2015.



INDONESIA

By Farouk Abdullah Alwyni

Introduction

In the last five years, apart from the amount of government Sukuk issuance and the assets of Islamic life insurance, the Indonesian Islamic finance industry consisting of Islamic banking assets, Islamic rural bank assets, corporate Sukuk, Islamic mutual funds, Islamic general insurance and reinsurance assets has grown around 100% during the last five years (see Table 1).

The cumulative amount of government Sukuk issuance in 2015 has surpassed the total amount of Islamic banking assets, putting it as the most dominant player of Indonesia's Islamic finance industry, taking over from the Islamic banking sector that until 2014 was the leading sector in the industry.

The other fast-growing sector in Islamic finance is the Islamic insurance sector. Although it is still relatively small in its absolute value, the Islamic life insurance industry also has an above average growth in the industry during the last five years, where it grew almost three times to IDR21.61 trillion (US$1.63 billion) in 2015 from IDR7.25 trillion (US$548.1 million) in 2011.

Despite the slowing down of the growth of Islamic banking – a major driver of growth for the Islamic finance industry – in 2014 and 2015, as a whole, the growth of the Indonesian Islamic finance industry was three times faster than the growth of the overall financial industry. While the growth of the overall financial industry was at 42% between 2010 and 2014 (8% since 2013) and 7% compound annual growth rate (CAGR) since 2010, the Islamic finance industry grew at 139% year-on-year since 2010 (14% since 2013) and 19% CAGR-wise (Thompson Reuters, IRTI, and CIBAFI: 2016).

Table 1: Selected figures from the Indonesian Islamic finance industry (IDR trillion)

	2011	2012	2013	2014	2015
Assets of Islamic commercial banks and Islamic windows	145.47	195.02	242.28	272.34	296.26
Assets of Islamic rural banks	3.52	4.7	5.83	6.57	7.74
Sovereign Sukuk issuance ^(cumulative)	81.53	138.62	186.22	250.17	359.97
Corporate Sukuk issuance (cumulative)	7.92	9.79	11.99	12.96	15.98*
Islamic mutual funds (net asset value)	5.56	8.05	9.43	11.16	10.7*
Islamic life insurance assets	7.25	9.83	N/A	18.05	21.61
Islamic general insurance and re-insurance assets	1.91	3.23	N/A	4.31	4.9

Sources: Alwyni (2015), Financial Services Authority (OJK), Ministry of Finance, and calculated further.
*Notes: *As of November 2015; ^ includes all government Islamic securities issuance; US$1 = IDR13,794 (30th December 2015).*

Islamic banking sector

The year 2015 signified the stagnation faced by the Islamic banking industry, with the growth of the Islamic banking industry (ie assets of Islamic commercial banks and Islamic windows) at 8.78% year-on-year (Table 1). This is even lower than the already slow growth in 2014 when the Islamic banking industry only recorded a 12.4% year-on-year growth. This is the slowest-ever growth of the industry in the last five years. In fact, there had been a deceleration of growth between 2011 and 2015. The growth of the Islamic banking industry reached its peak in 2010 recording a 50% increase in total assets. Since then, the growth had been gradually declining to 33.8%, 34.1%, 23.6%, and 12.4% in 2011, 2012, 2013, and 2014.

The problems facing the Indonesian Islamic banking industry mainly come from two major Islamic banks in the country: Bank Syariah Mandiri and Bank Muamalat Indonesia (BMI). The assets of these two banks accounted for almost half of the total Islamic banking assets in the country. The aforementioned two banks had struggled with the issues of quality assets left by their previous executive managements. Significant write-offs were undertaken affecting the equity of the banks, with BMI's equity experiencing a 20.95% plunge to IDR3.55 trillion (US$268.38 million) in June 2015 from IDR4.49 trillion (US$339.44 million) in June 2014. BMI even needed to slash its 2013 profit to IDR165.14 billion (US$12.48 million) in its 2014 audited accounts from IDR475.85 billion (US$35.97 million) in its 2013 audited accounts (restatement), so as to avoid losses in 2014. Consequently, the asset growth of the banks was constrained in 2014 and 2015 due to the need for the new management to steer carefully in terms of financing new transactions.

Islamic rural banks seemed to have performed better in 2015 compared to Islamic banks although in terms of absolute value they are much smaller. They recorded a 17.8% year-on-year growth in 2015, faster than the growth in 2014 (12.7%), and more than twice faster than the growth of Islamic banks.

Macro factors also affected the growth of the Islamic banking industry significantly in 2014 and 2015, such as the effect of increase of the electricity and gasoline prices initiated toward the end of 2014, the significant depreciation of the rupiah throughout 2015, the drop of the Indonesian stock index and sociopolitical issues related to the seemingly weakening anti-graft body under the new administration which somehow contributed to the slower economic growth in the country.

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Islamic capital market: Sukuk and funds

2015 marked the first time the amount of Islamic securities issued by the government outpaced Islamic banking assets. The total cumulative issuance of Islamic government securities in 2015 stood at IDR359.97 trillion (US$27.21 billion) compared with total Islamic banking assets in the same year at IDR296.26 trillion (US$22.4 billion).

The growth of government Islamic securities in 2015 was 43.89%, significantly higher compared with the 34.3% growth in 2014. The government Islamic securities consist of Islamic fixed rate securities, retail sukuk (SR), US dollar-denominated global Sukuk (SNI), Islamic T-Bills, Hajj Fund Sukuk, and project-based Sukuk (PBS). PBS followed by SNI are the first and second largest government Sukuk issuance accounting for around 63% of total Islamic government securities issuance in 2015. SR was also increasingly important, successfully raising IDR21.96 trillion (US$1.66 billion). The growing importance of Sukuk as a means of international fund mobilization for Indonesia was also signified by the listing of its four global Sukuk amounting to US$6 billion on NASDAQ Dubai on the 31st May 2015, with one of the Sukuk amounting to US$2 billion issued in 2015.

On the corporate side, progress has not been like its sovereign counterpart although there is a sign of progress compared with 2014. Up to the end of November 2015, there were at least 13 corporate Sukuk issued amounting to IDR3.03 trillion (US$229.07 million), accounting for a 23.4% increase compared with the total issuance in 2014. This figure is much higher compared with the growth in 2014, accounting for 8.1%.

Another major progress in the area of corporate Sukuk in 2015 was the issuance of the US$500 million global unrated Sukuk by Garuda Indonesia, the state-owned Indonesian airline. The investors of this Sukuk came from the Middle East (56%), Asia (32%) and Europe (12%). This is the first Indonesian non-sovereign US dollar Sukuk, paving the way for other Indonesian state-owned enterprises and corporates to access the market. It is important to note here, however, that it seems this Sukuk issuance has not been recorded in the Financial Services Authority (OJK)'s statistical data.

For Islamic mutual funds, there was a 4.12% drop in terms of net asset value (NAV) up to November 2015 (the most current data available), but it is most likely that by the end of 2015, the NAV will reach around the same level in 2014. In any case, there was a relative stagnation in the area of Islamic mutual funds in the country. Although this stagnation could be attributed to the general fall of the country's stock index, it is not accompanied by an overall stagnation in the mutual funds industry.

In fact, the total NAV of the mutual funds industry still increased to IDR261.92 trillion (US$19.8 billion) in 2015 from IDR241.46 trillion (US$18.25 billion) in 2014. Consequently, the market share of Shariah compliant mutual funds went down to 4.11% in 2015 from 4.65% in 2014. Actually, this decline is somehow an anomaly considering the OJK had declared 2015 as an Islamic capital market year. However, one possible explanation is the gap between the OJK's declaration and actions taken in terms of issuing relevant regulations to support the Islamic capital market in Indonesia which only took place in November 2015. One of those regulations is related to the issuance and requirements of Shariah mutual funds (regulation POJK No. 19/POJK.4/2015) that has also permitted investment management companies to invest up to 100% of funds into Shariah compliant foreign securities, whether in Sukuk or shares. It is expected that a clearer regulatory framework coupled by the simplification in the process of opening an account could contribute to the increase of the market share of Shariah compliant funds in 2016.

Takaful

Islamic life insurance assets made a faster growth in the last five years compared to the Islamic banking industry. It grew around 200% to IDR21.61 trillion (US$1.63 billion) in 2015 from IDR7.25 trillion (US$548.1 million) in 2011. Islamic life insurance is the major growth contributor to the Takaful industry. Although the Takaful industry accounts for only 5% of total insurance industry premiums, its growth since 2010 was faster than conventional insurance (27% as against 12% at a CAGR) (Thompson Reuters, IRTI, and CIBAFI: 2016).

Conclusion: The way forward

Indonesia has a lot to do to catch up with its Malaysian and Gulf counterparts in strengthening the role of Islamic finance in the country's economy, especially its Islamic banking sector. The Indonesian Islamic banks' market share of around 5% is still very small compared with 20% and 50% respectively for Malaysia and Gulf countries.

In an effort to foster the growth of Islamic finance, there has been at least two recent government-led initiatives. Firstly, the government included the deregulation of the Islamic financial sector in the Economic Policy Package V issued in late October 2015, part of a number of economic policy packages issued by the government to deregulate the economy starting in September 2015. Secondly, the government will establish a national committee to drive the development of Islamic finance as announced by President Joko Widodo in early January 2016.

To really have an immediate impact in promoting the role of Islamic finance in the country, it is time for the Indonesian government to look into fiscal incentives to help Islamic finance, particularly Islamic banking and corporate Sukuk, in mobilizing bigger funds from the market and in turn bring down the cost of funds thus contributing to a more competitive Islamic financial sector and a more competitive financial sector in general.

Concrete policy actions that can be taken related to fiscal incentives include, first, the possibility to reduce the tax on the profit margin received from the deposits in the investment accounts of Islamic banks to 10% from 20% currently applied to Islamic and conventional banks. Secondly, corporates issuing Sukuk should be given tax incentives through lower taxes compared to companies issuing conventional bonds. Finally, fiscal incentives for companies sending their employees for Islamic finance education will also boost the level of acceptance of the industry at the corporate level.

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