ASEAN Connect
By Global Economics & Markets Research

ASEAN: Levelling financial depth is key to a stronger ASEAN

Summary

The ASEAN region is known to have differing levels of financial depth amongst its member countries. For example, while being the largest economy in ASEAN, Indonesia's financial sector only contributed 4% to Indonesia's GDP, even lower than before 2008 Global Financial Crisis (GFC) and lags behind its Asian peers. As a financial hub, Singapore kept its pole position with 13% share of GDP in financial services, followed by Philippines at 11%, Thailand and Malaysia at 8% and 7% respectively.

In terms of domestic credit to private sector, Indonesia recorded the lowest among Asian peers at 38.7% share of GDP in 2020, compared to Philippines (52% share of GDP) and other countries such as Vietnam, Thailand, Singapore, and Malaysia which have ratios of well above 100%. In terms of market capitalization to GDP, Indonesia is also at the lowest at around 46.9%, behind Vietnam and Philippines which stood at 53.7% and 73.4% respectively. Sub-par and under-optimal degree of financial inclusion and financial market development are the key reasons behind such diverse financial depths.

Singapore tops the regulatory and law enforcement effectiveness while it is still lacking in Indonesia. Overall in terms of regulation, Indonesia scores 6.46 points on a scale of 1-10. Compared to other countries in Asia, Indonesia is still relatively lagging behind with strict regulatory restrictions that hamper business and investment activities in Indonesia. Other countries such as Malaysia have a regulatory ease rating of 8.47, while other ASEAN countries such as Vietnam have a score of 6.96, Singapore 8.72, and Philippines 7.31.

Considering diminishing growth momentum in many parts of the world, ASEAN has not only proven itself as a resilient region but also offers many untapped growth potentials. Nevertheless, to achieve and unleash its utmost latent economic prowess, some levelling of financial depth is required. Deepening of financial market and enhancing the soundness of its financial institutions are some of the key reforms needed to achieve higher economic growth in this region. This is especially so amid an ever-changing financial world on the back of digitalization and challenges to traditional finances. We believe that by leveling and enhancing the financial depth across the region, it will forge an even stronger and more resilient ASEAN economy.

Understanding the financial depth playing field

The ASEAN region did not escape unscathed from the impact of the pandemic. After contracting by 4% in 2020, the ASEAN-6's economy rebounded strongly to register a 4.5% growth in 2021. The region grew even stronger at 6% in 2022. With the much tighter monetary policy environment to stem off inflationary pressures and unwinding of unprecedented fiscal stimulus measures, economic growth in ASEAN is expected to slow to around 4% in 2023. Note that during the pandemic years, the financial sector had held up relatively well.

Historically (and ironically!), Indonesia's financial[1] sector's share of GDP was one of the highest in ASEAN right after the 1998 Asian Financial Crisis, contributing around 8.5% to GDP while Singapore stood only at around 3%. While Singapore, Thailand, and the Philippines grew their respective financial sector consistently in those years that followed, Indonesia saw the share of financial sector declining to an average of 4% of GDP after Global Financial Crisis (GFC) in 2008. Thereafter, Singapore kept its pole position as the country with the largest finance sector contribution to the GDP at around 13%, followed by Philippines at 11%, and Thailand at 8%, and Malaysia at 6.1%.

The contribution of financial sector to GDP is a generally acceptable indicator of the depth of its financial sector, which will in turn fuel economic growth. Specifically, the increased intermediation function of the banking sector and strong financial penetration and sophistication of the formal financial institutions will in general result in spillover effects on business activities in other sectors.

For Indonesia, most of the financial services from formal financial institutions are credited to manufacturing sector which has the largest contribution to Indonesia's GDP with a share of 18.6%. The second largest share of financing is in the agriculture sector which is Indonesia's leading sector with a consistent share more than 10% of Indonesia's GDP.

For Malaysia, loans to the household sector primarily for residential home purchases continues to hold the largest share of overall loans (37.2% share as at Jul 23) while household loans take up 64% of overall loans. Business loans has 36% share of total loans outstanding albeit corporates also tap capital markets for financing. Outstanding corporate bonds issued totaled MYR566bn or 21% of total credit and 43% of credit to businesses.[2]

Figure 1. Financial sector contribution to GDP (2002-2022)

Source: ASEAN Statistics, UOB Global Economics & Markets Research

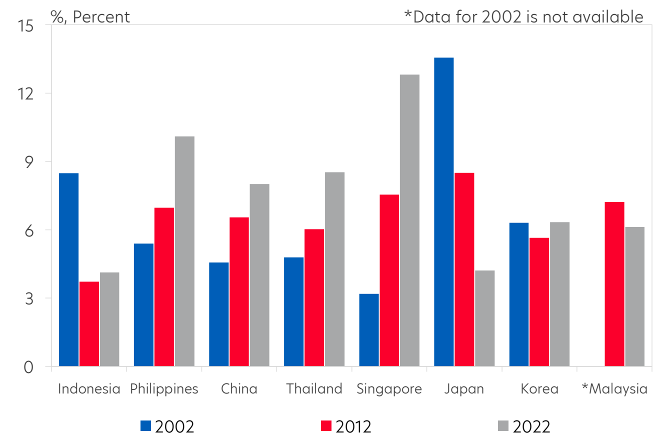
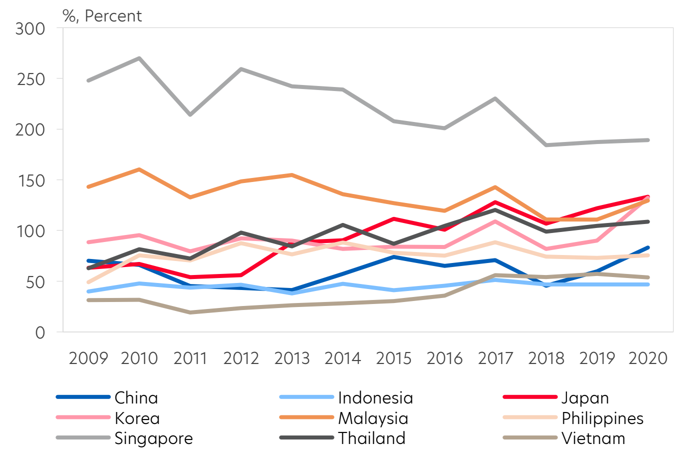


Figure 2. Market capitalization of listed domestic companies (% of GDP)

Source: World Bank, UOB Global Economics & Markets Research



Financial institutions matter

Some indicators to illustrate the development of financial depth is referring to the size of financial institutions and financial markets relative to the economy. Deeper financial institutions and market can drive economic growth through financial leverage. Therefore, it is imperative for ASEAN to continue to enhance its financial depth.

Financial institutions and markets in Asia have undergone significant deepening as evidenced by growth in domestic credit and saving, also stock market capitalization and the number of stocks listed and traded. The IMF's Financial Markets Depth Index, which looked at stocks traded and stocks market capitalization to GDP among others, ranks Indonesia much lower than its peers such as Malaysia and Thailand (Figures 2 and 3). Similar to financial markets depth index, financial institutions index also showed that Indonesia still lags Malaysia, Thailand, Philippines, and Vietnam in terms of domestic credit to private sectors (Figure 4).

[1] Refers to nominal GDP of finance and insurance sector, ditto for all other ASEAN countries in this note

Figure 3. Stocks traded (% of GDP)

Source: World Bank, UOB Global Economics & Markets Research

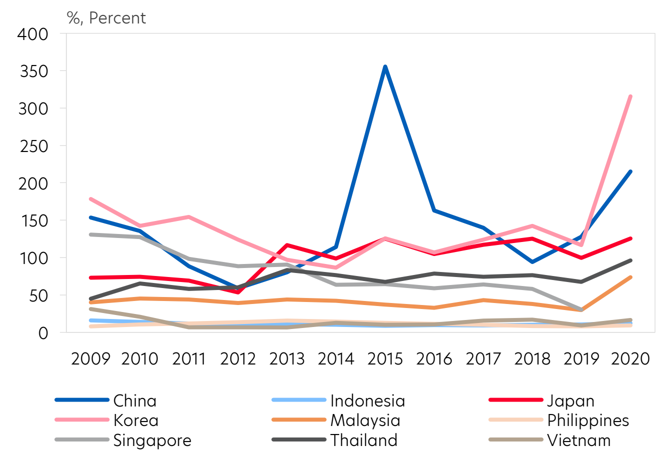
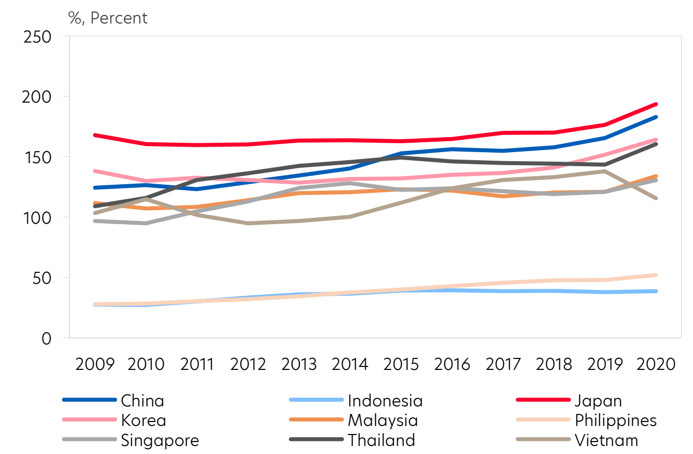


Figure 4. Domestic credit to private sector (% of GDP)

Source: World Bank, UOB Global Economics & Markets Research



Specifically, in 2020 Indonesia's domestic credit to private sector to GDP ratio was recorded at 38.7%, which is at the lowest level when compared to other Asian countries such as the Philippines with a ratio of 52% and other countries such as Vietnam, Thailand, Singapore, Malaysia and Japan which have ratios of more than 100%. The low ratio of domestic credit to GDP is due to the low financial inclusion in Indonesia. Some of the factors that influence the low financial inclusion of Indonesian people are low financial literacy due to high education gap between rural and urban residents, uneven Information Technology (IT) infrastructure between the urban and rural areas due to the large geography of the country, and unequal financial access in Indonesia. In 2020, Indonesia's financial literacy was only 49.7, much lower than Philippines, Thailand, Vietnam, and Singapore, which scored more than 65 points.

On the financial market side, Indonesia's market capitalization to GDP is also at the lowest level with a ratio of 46.9%, behind Vietnam, Philippines, and China which are recorded at 53.7%, 73.4%, and 83.2% respectively. Indonesia's position is still far below Thailand, Malaysia, Japan, and Singapore which have ratios of more than 100%. In terms of number, the total number of companies listed on the Indonesian stock exchange is around 858 companies, lower than Malaysia which has 998 companies listed on the stock exchange. The low ratio of Indonesia's market capitalization is on the back of complicated bureaucracy and administrative requirements. In addition, the lack of stocks traded in Indonesia also reaffirmed that by instruments, Indonesia financial market remains relatively shallower viz its ASEAN peers.

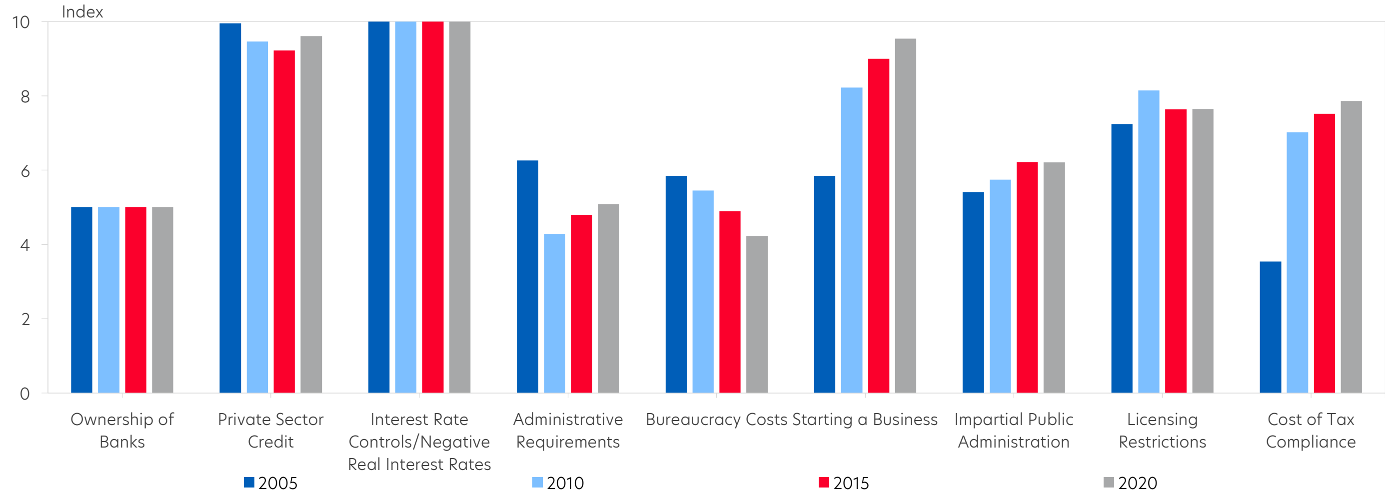
Regulatory concern and its impact to financial deepening

Weak institutional quality and efficiency compared to developed economies generally limits the pace of financial sector development in any country. In particular, efficiency and transparency from the government, insufficient law enforcement, limited financial market participation, geopolitical issues are frequently cited as key issues that require fast and steady resolutions and regulatory reforms. To illustrate this point further, we showcase the Economic Freedom of the World survey index which shows how bureaucracy costs and administrative requirements continued to be the main frictions in business regulations for Indonesia (Figure 5) as a case in point. This statistic highlights that regulatory and law enforcement effectiveness is still lacking in Indonesia. Overall, in terms of regulation, Indonesia scores 6.46 points on a scale of 1-10. Compared to other countries in Asia, Indonesia is still relatively lagging behind and is included as countries with strict regulatory restrictions that inhibit business and investment activities.

Other countries such as Malaysia have a regulatory ease rating of 8.47, while other ASEAN countries such as Vietnam have a score of 6.96, Singapore 8.72, and Philippines 7.31. Indonesia currently has an Online Single Submission - Risk Based Approach (OSS-RBA) application, but its implementation in several regions are still not optimal due to operational constraints and business players who are accustomed to the previous licensing mechanism. Furthermore, in terms of regulations, the government has amended the Job Creation Law (UU Cipta Kerja) and ratifying an embedded law which named Omnibus Law to accommodate the interests of business players and workers, increase industrial competitiveness, and investor interest due to the easier ecosystem of ease of doing business (EoDB) in Indonesia.

Figure 5. Indonesia: credit market and business regulations score

Source: Fraser Institute, UOB Global Economics & Market Research



Financial and digital literacy gap

Lack of financial inclusion and relatively low digital literacy could explain why some countries have shallower financial depth vis-à-vis other economies. For example, in terms of the use of digital payments, Indonesia still lags Philippines, Malaysia, Thailand and others. Poor technology infrastructure and digital literacy gap between urban and rural residents are responsible for Indonesia's digital financial literacy of only 37.2%. Furthermore, Indonesia's financial account ownership to total population aged 15 years ratio is only 50.5%, slightly higher than Philippines at 46%, but much lower than Malaysia, China and Thailand. The low accounts ownership in financial institutions is on the back of Indonesia's low financial literacy and inclusion. In addition, access inequality to information and infrastructure is a key factor of inclusion gap between urban and rural residents.

The low level of financial inclusion in Indonesia also reflected by unequal access to finance in some regions. Access to lending remained concentrated in Java, even with the development of Digital Financial Services (DFS) as part of the National Financial Inclusion Strategy (2016). While this phenomenon is partly caused by higher economic activity in Java, the geographical divergence emphasized some structural issues in Indonesia for financial deepening. Regions outside of Java are characterized by lower financial literacy levels and inadequate information and communications technology (ICT) infrastructure. This geographical divergence in financial inclusion would also impede access towards financial markets in regions outside of Java.

Akin to financial literacy, Indonesia's digital literacy also lags behind than its Asia peers. The development of internet infrastructure is the cause. Only 50.6% of Indonesians have access to the internet, much lower than the average of 80%+ in other Asian countries. In addition, the mobile phone ownership, though not low, stood relatively lower 73.2% of population aged 15 years and above, which remains below other countries that have reached more than 90%. Understandably so, majority of Indonesians are informal workers in the agricultural sector that likely needing more access to mobile phone and then subsequently digital literacy. This issue needs to be addressed as the low digital and financial literacy are necessary to better Indonesia’s relative standing amongst ASEAN member countries (Figure 10). In marked contrast to its neighbors, Singapore, participation of working age in Indonesia as the investors in capital market stood less than 5%, much lower than Malaysia (11%), South Korea (15.2%), China (16.9%), and Singapore (37.8%). Lack of access to digital information and low financial awareness impedes Indonesian digital and financial literacy to race against its Asian peers.

Figure 6. Financial account ownership 2021 (%, age 15+)

Source: World Bank, UOB Global Economics & Markets Research

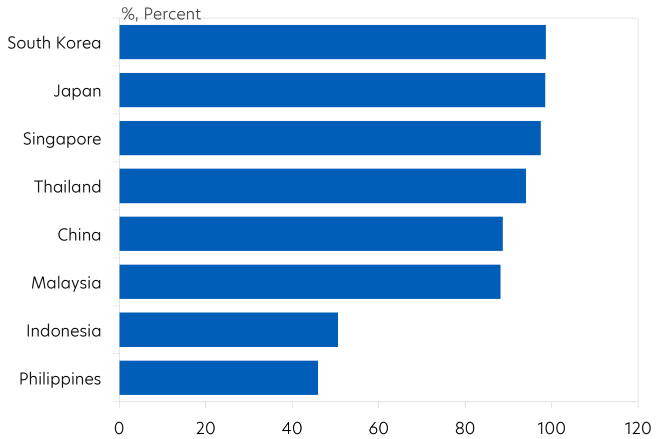


Figure 7. Made or received a digital payment 2021 (%, age 15+)

Source: World Bank, UOB Global Economics & Markets Research

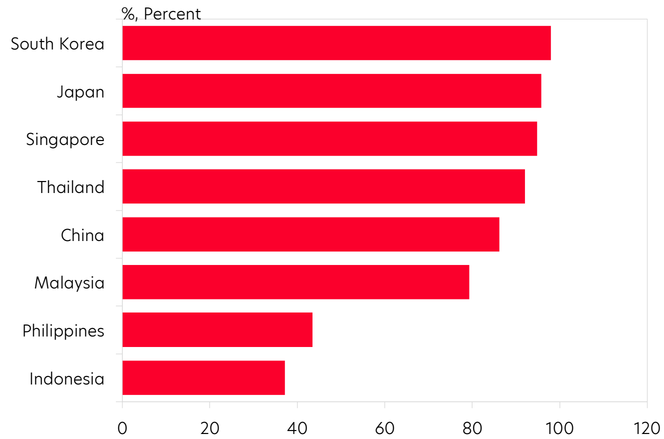


Figure 8. Connectivity with the internet 2021 (%, age 15+)

Source: World Bank, UOB Global Economics & Markets Research

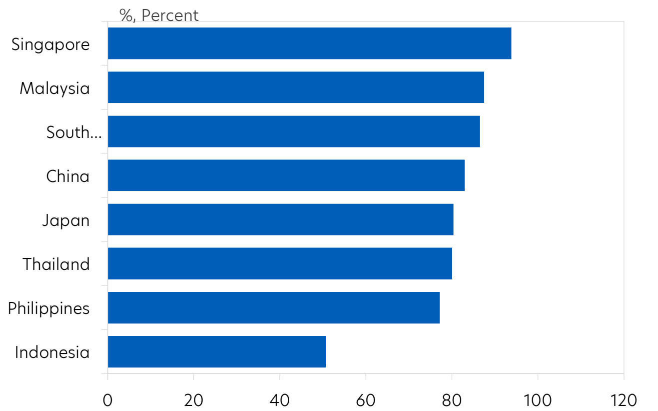


Figure 9. Mobile phone ownership 2021 (%, age 15+)

Source: World Bank, UOB Global Economics & Markets Research

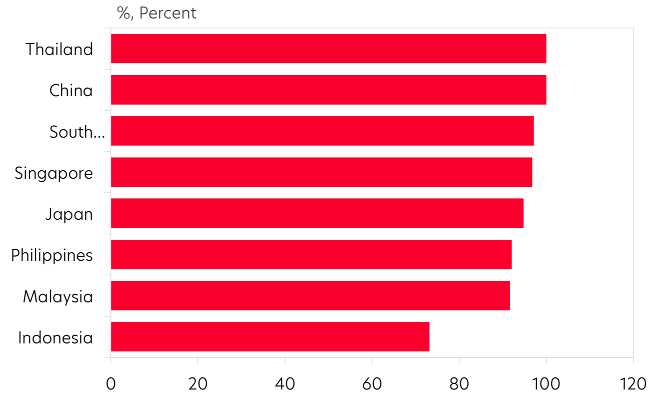


Figure 10. Financial access disparity in indonesia (loan outstanding)

Source: Bank Indonesia, UOB Global Economics & Markets Research

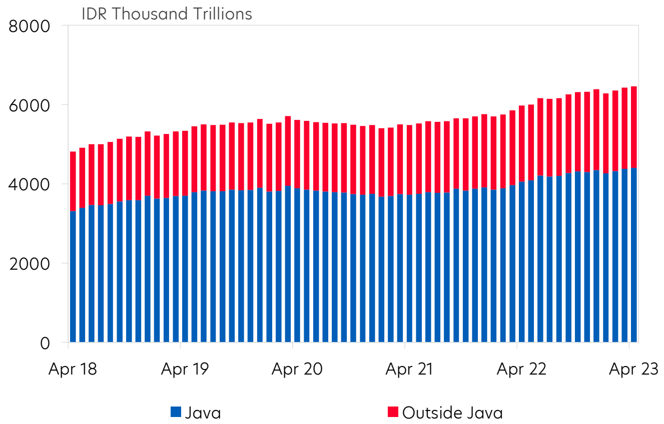
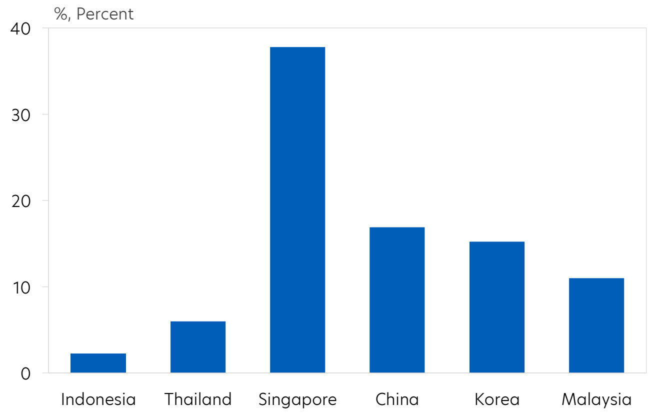


Figure 11. Investor participation in capital market 2022 (%, 15+)

Source: KSEI, CEIC, & World Bank, UOB Global Economics & Markets Research



Ease of accessing alternative sources of financing

Rapid development of Non-Bank Financial Institution (NBFI) in Indonesia is a good foundation for financial market deepening. However, compared to other Asian countries, Indonesia still lags in terms of total NBFI assets in financial system.

Looking at a broader view, globally most sources of financing are dominated by non-bank financial institutions. This is reflected by the share of NBFI assets to total assets in global financial system in 2021 of 49.2%, dominating among the assets of other financial institutions. Specifically, bank assets represent only 37.4% of total assets, while the rest comes from central banks and other public financial institutions. NBFIs in developed countries represent of 55.3%, almost double that developing countries which represent only 28%. The larger share of NBFIs in developed countries is in line with the rapid development of financial technology, which has increased the ease of non-bank financing access. Meanwhile, in the developing countries, where there is still high dependence on banks and strictly regulatory restrictions, inhibit NBFIs to grow.

In Asia, banking assets still dominate total assets in the financial system. This indicated that bank lending is still the main source of financing in Asia. Some countries such as Singapore, China, and Indonesia even recorded a share of bank assets compared to total assets in the financial system of more than 55%, where Indonesia stood the highest share of bank assets of 60.3%, followed by China (59.9%), and Singapore (57.1%). Meanwhile, non-bank assets in Indonesia only account for a share of less than 15%, lower than China, India, and the average developing country. Meanwhile, other countries in Asia such as South Korea actually recorded a share of NBFIs of 50.7%, which is larger than bank's share of only 44.1% in 2021. China, as the country with the second largest assets of NBFIs in the world, only has an NBFI asset share of 25.9%, less than half of the bank assets that have almost 60% of share.

Further, we highlighted NBFIs intermediaries such as multi finance and peer-to-peer lending (P2P) compared to loan outstanding in 2020, surprisingly multi finance lending in Indonesia stood at 15% of total bank outstanding loan. Indonesia's ratio of financing through multi finance to total bank loans is higher than China, Korea, Malaysia, Thailand and Japan. Indonesia is only less than 1% lower than Singapore, where multi-finance financing is equivalent to 15.8% of total bank loans outstanding. This suggests that the potential for NBFIs in Indonesia is still vast, but it seems to be limited to certain sectors.

Of note, the main share of multi-finance financing in Indonesia is for financing consumer goods such as vehicles, heavy equipment, electronics, education, and other household needs. While for P2P financing, China has the largest share of P2P financing among Asian peers, equivalent to 1.3% of total bank loans in China. The large share of P2P financing is in line with the number of P2P lending in China, with 6,607 platforms in 2022. Below China, South Korea recorded P2P financing at 0.7% of total bank financing, slightly higher than Indonesia which recorded at 0.6%.
Similar to consumers who choose multi-finance as an alternative financing, corporate bond issuance is also one of the financing alternatives besides bank loans. In Asia, South Korea is the largest share of corporate bond issuance to total bank loans at more than 80%. The second position is Malaysia with a share of around 41%, while other countries are still below 30%. The high corporate bond share indicates that corporate performance is still deemed sustainable, so they are able to provide high coupon yields and attract sustain financing from bond instrument. While for corporates, the high appetite in bonds issued provides alternative financing for the industry, especially to get a cheaper alternative financing cost.

A massive technology innovation is driving technology-based financing through Fintech. In Indonesia, Fintech has been in existence since 2006, but rapid development was only seen after Indonesia declared a pandemic emergency and mobility restrictions. During the pandemic, Fintech through peer-to-peer (P2P) lending grew rapidly from only USD1.1bn in 2020 to USD3.6bn in 2022. Changes in people's lifestyle due to mobility restrictions, encouraged people to use non-cash transactions. This drove the non-bank financial services industry to grow rapidly, especially P2P which grew more than 300% from the early Pandemic in 2020 to end of 2022. Strong growth in online shopping trends also incremented by the implementation of Work From Home (WFH) policy that grant workers time to do their other activities, especially for online shopping. This trend continues and entirely supported by the Indonesian government which continuously expands internet accessibility in all regions. Banks also rapidly developed their digital banking business to expand and optimize the momentum.

Figure 12. Global financial assets (2021)

Source: Financial Stability Board, UOB Global Economics & Markets Research

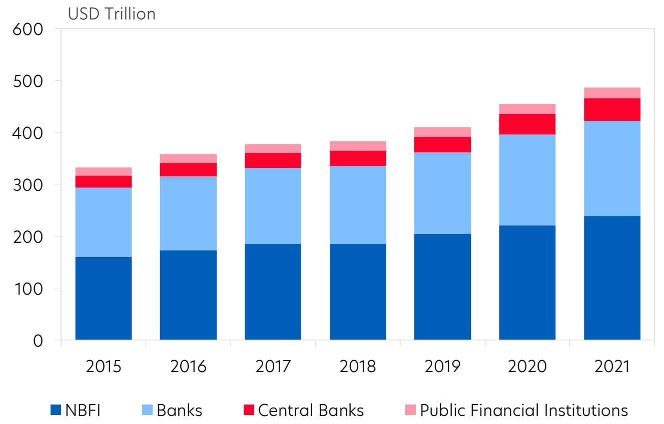


Figure 13. % Share of financial institution assets to total domestic financial assets (2021)

Source: Financial Stability Board, UOB Global Economics & Markets Research

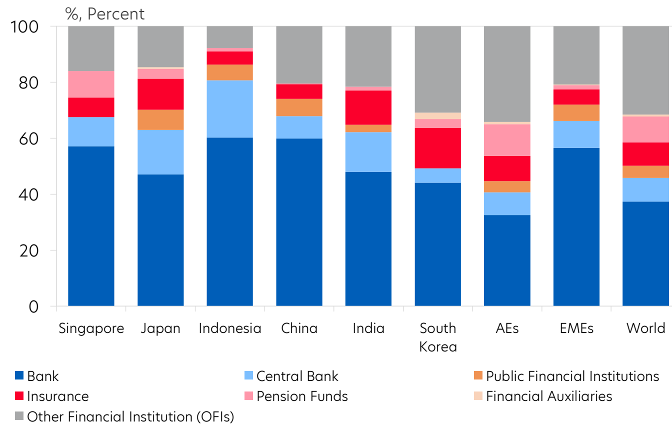


Figure 14. % Share of multi finance and p2p to loan outstanding (2020)

Source: OECD, Statista, & DBS Report, UOB Global Economics & Markets Research

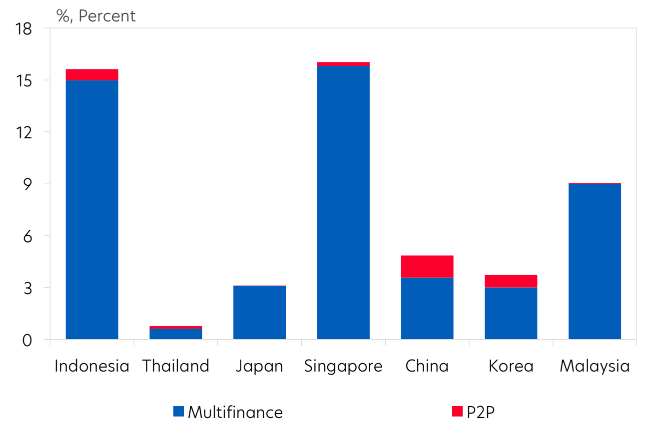
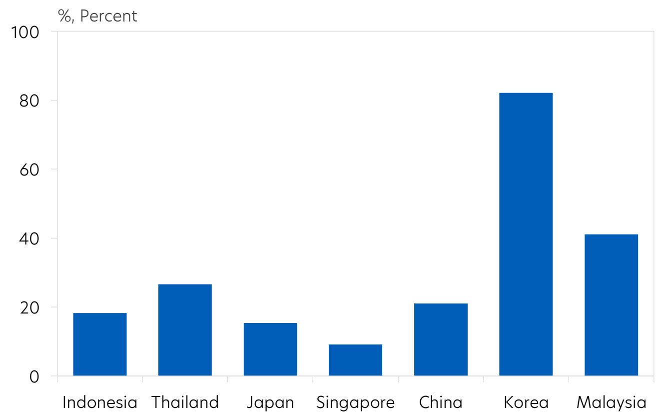


Figure 15. % Of corporate bond issuance to loan outstanding 2020

Source: Asian Bond Online & ADB, UOB Global Economics & Markets Research



Regulatory reforms are the crucial first step

Financial deepening policy is conducted to support sustainable economic growth. With deep and liquid financial market characteristics, capital allocation and intermediation will be more efficient so that it can become the basis for new sources of economic financing. For example, in Indonesia, Bank Indonesia (BI) accelerated capital market deepening through strengthening the domestic investor base and strengthening the professional investor market segment, as well as strengthening SBN investor diversification and increasing SBN liquidity. In addition, the Indonesian government also encourages business ease reform and bond market deepening through the ratification of Government Regulation (PP) No. 91 of 2021 to provide Income Tax (PPh) relief on bond interest for domestic investors.

Recent reforms such as Indonesia's Omnibus Law will also result in larger investor participation. In particular, the Presidential Regulation No. 10 of 2021 (effective as of 4 March 2021) will open up capital markets in Indonesia by allowing investment in all but 6 sectors and opening up Indonesia to more FDI. The revision of Article 17 of Income Tax Law to reduce corporate taxes from 25% to 22% in 2021/22 and 20% starting from 2023 should also induce more investments. A recent planned development for IDX is implementing Special Purpose Acquisition Company (SPAC) to list in the Indonesian stock market. SPACs are used to conduct IPOs and raise funds necessary for mergers, acquisitions or share purchases. As of now, OJK and IDX has come up with regulations for this type of company and prepare for implementing SPAC in really soon this year.

Indonesia's government which has ratified several regulations to protect financial deepening program in Indonesia is on the right trajectory. As peer-to-peer or Fintech lending is becoming more mainstream in Indonesia, Indonesian government has just issued Government Regulation (PP) No. 27 of 2022 on Personal Data Protection last year. With getting approval for online borrowing just as easy as giving your national ID, it becomes extremely imperative to ensure that the data being collected is safely kept. The passage of the law is hoped to encourage the relevant firms to step up the security of their data, in order to prevent any misuse of individuals' personal data. In addition, the recent launch of the Republic of Indonesia Satellite-1 (SATRIA-1) is another strategy implemented by the government to bolster internet connectivity nationwide, with the aim to provide coverage for Indonesians living in the most disadvantaged, frontier, and outermost regions. As such more Indonesians will be able to access financial services, particularly in areas that are underserved by the conventional banks.

In essence for Indonesia, its relatively shallow financial market could see more tailwinds in light of many issues with regulations to support the enhancement of its financial deepening process.

Malaysia's financial system has gone through several reforms and initiatives over the decades pursued under the Financial Sector Blueprints that helped to create a conducive financial sector that supports Malaysia's economic development. Financial regulations and laws have been modernized particularly with the enactment of the Central Bank of Malaysia Act 2009 (CBA), Financial Services Act 2013 (FSA), and Islamic Financial Services Act 2013 (IFSA). Enhanced legal powers paved the way for more effective oversight of more complex structures that have emerged. Regulatory reforms, corporate governance and risk management practices have been strengthened to create a strong, stable and progressive financial system that became a shock absorber and played a counter cyclical role during recent economic downturns.

Levelling financial depth is key to stronger ASEAN

Considering diminishing growth potential in many parts of the world, ASEAN has not only proven itself as a resilient region but also offers many untapped growth potentials. Nevertheless, to achieve and unleash its utmost latent economic prowess, some levelling of financial depth is called for.

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Enrico Tanuwidjaja
Economist
Enrico.Tanuwidjaja@UOBgroup.com

Agus Santoso
Junior Economist
Agus.Santoso@uob.co.id

With assistance from
Jason Maslin
Jason William Budiono

Research insights

www.uob.com.sg/research

Contact us

Email: GlobalEcoMktResearch@UOBgroup.com
Bloomberg: NH UOB <GO>

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