Lower Down Payment Regulation To Boost Loan Growth, In Exchange Of Higher Credit Risk

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The economic environment in 2015 remains tight, due to the strengthening of the US dollar and increasing interest and inflation rates, triggered by the prolonged recovery process from the global economic downturn. The nation's economic growth expanded by 4.7% in the first quarter of 2015 (1Q2015), down from 5.1% in 1Q2014. This has softened the demand for loans, as reflected by slower loan growth in the banking industry of 11.3% in 1Q2015 compared to 1Q2014 at 19.5%. In line with the deceleration in the banking industry, financing industry growth has been subdued at 5% at end February 2015 (2M2015) compared to 14.9% in 2M2014.

The high lending rates and depreciation of the Rupiah have weighed on Indonesian companies in operating and exploring their businesses, as seen in the productive loan segment, which grew by 11.2% as of 1Q2015, significantly lower than 22.2% as of 1Q2014. Slower growth in the financing industry was mainly attributable to the contraction in the leasing segment, as seen by its lower disbursement to IDR113 trillion as of 2M2015 from IDR115.2 trillion as of 2M2014. The leasing business focuses on the natural resources sector, therefore its growth and the quality of financing are strongly influenced by commodity prices, which are projected to remain modest due to global economic uncertainty. Against this backdrop, most finance companies have limited their financing to mitigate the elevated credit risk as a consequence of the high cost of funds.

Figure 1. Loan distribution to third-party non-banks (IDR Billion)

Type of use	1Q2015	FY2014	1Q2014	FY2013	1Q2013	FY2012
Working capital	1,729,294	1,757,449	1,572,862	1,585,659	1,349,146	1,316,689
Investment	924,297	903,194	814,094	798,157	604,627	591,425
Productive*	2,653,591	2,660,642	2,386,956	2,383,816	1,953,772	1,908,114
Growth productive y-o-y	11.2%	11.6%	22.2%	24.9%	-	-
Consumer	1,026,280	1,013,666	919,942	909,058	814,599	799,748
Growth consumer y-o-y	11.6%	11.5%	12.9%	13.7%	-	-
Total loans	3,679,871	3,674,308	3,306,899	3,292,874	2,768,371	2,707,862
Growth y-o-y	11.3%	11.6%	19.5%	21.6%	-	-

**Productive = Working capital and investment, y-o-y = year-on-year*

Source: Indonesia Banking Statistic

Figure 2. Financing receivables (IDR Billion)

Type of use	2M2015	FY2014	2M2014	FY2013	2M2013	FY2012
Leasing	112,980	110,951	115,197	117,363	105,002	105,088
Factoring	9,436	9,419	7,822	7,691	4,952	5,148
Credit card	33	30	4	4	2	2
Consumer financing	246,161	245,805	228,026	222,968	195,464	191,841
Total financing	368,610	366,205	351,048	348,026	305,419	302,079
Growth y-o-y	5.0%	5.2%	14.9%	15.2%	-	-

On-balance figures, y-o-y = year-on-year
Source: Finance companies' financial highlights, Indonesia Finance Services Association

Figure 3. Automotive sales and production

(Units)	1Q2015	FY2014	FY2013	FY2012
Car sales	282,345	1,208,019	1,229,916	1,116,230
Car production	299,409	1,298,523	1,208,211	1,053,270
Motorcycle sales	538,744*	7,867,195	7,743,879	7,064,457
Motorcycle production	2,206,914*	7,926,104	7,736,295	7,079,721

**Data as of April 30, 2015*

Source: AISI and GAIKINDO statistics

Consumer loans expected to be the key driver

Amid the tight economic environment and significant negative movement in the productive loan segment, it is noted that the consumer loan segment grew steadily by 11.6% as of 1Q2015 despite decreasing from 12.9% as of 1Q2014. Likewise in the financing industry, while the leasing segment has been on a downward trend, the consumer financing and credit card segments showed positive growth of 8% as of 2M2014, albeit lower than 16.7% in the previous period. Lower financing disbursement was affected by debtors' weakening purchasing power, as shown by lower car and motorcycle sales at 14% in 1Q2015 and 27.9% in April 2015 (4M2015), respectively. Automotive producers are also curbing production volume, as production costs are higher due to rising inflation and the strengthening US dollar.

Along with the slower loan growth and the debtors' weakening purchasing power, pressure on asset quality has increased. The banking industry's non-performing loans (NPL) ratio for the productive loan segment worsened to 2.7% as of 1Q2015 from 2.4% as of FY2014. For consumer loans, the NPL ratio increased to 1.6% from 1.4% in the same period. With a higher lending rate averaging 13%-14%, we consider the consumer segment more attractive than the productive segment with its average lending rate of 12%-13%. Moreover, it consistently booked a lower NPL ratio than the productive loan segment. Although the consumer loan is not expected to enjoy as high growth as it did in previous years, we expect it to be the key driver for overall loan growth in 2015.

Figure 4. Average lending rate of commercial banks to third-party non-banks

Type of use	1Q2015	FY2014	FY2013	FY2012
Working capital	12.8%	12.8%	12.1%	11.5%
Investment	12.3%	12.4%	11.8%	11.3%
Consumer	13.7%	13.6%	13.1%	13.6%

IDR loan

Source: Indonesia Banking Statistic

Figure 5. NPL ratio to third-party non-banks

Type of use	1Q2015	FY2014	FY2013	FY2012
Working capital	2.8%	2.5%	2.0%	2.2%
Investment	2.6%	2.3%	1.7%	1.7%
Productive*	**2.7%**	**2.4%**	**1.9%**	**2.0%**
Consumer	1.6%	1.4%	1.4%	1.5%
Total NPL	**2.4%**	**2.2%**	**1.8%**	**1.9%**

**Productive = Working capital and investment*

Source: Indonesia Banking Statistic

Bank Indonesia relaxed loan-to-value (LTV) regulation

To boost banking industry loan growth amid unfavorable economic conditions, Bank Indonesia has issued a new macro prudential regulation under *Peraturan Bank Indonesia* (PBI) No.17/10/PBI2015 which is effective since June 18, 2015. A new regulation set a lower minimum down payment (DP) for the mortgage and automotive sectors under conventional and sharia principles. The DP relaxation for mortgage is set at 10% and lowered by 5% for automotive sector. Different percentages is applied depending on certain categories, i.e. house and vehicle types.

The new regulation is also expected to bolster low automotive sales due to weaker purchasing power, soft commodity prices, and lower economic growth; which may, in turn, support financing industry growth. To anticipate further NPL ratio deterioration in the banking industry, the regulator will only apply the new regulation to banks with a maximum NPL ratio of 5%.

Impact on banks and finance companies in PEFINDO's portfolio

In the medium term, PEFINDO expects the new regulation will reignite the banking industry's loan growth, particularly in the consumer segment, and we believe that most banks will benefit. However, the biggest impact will be felt by the five largest mortgage lenders in Indonesia: PT Bank Tabungan Negara (Persero) Tbk (BBTN, rated idAA/Stable), PT Bank Central Asia Tbk (BBCA), PT Bank Negara Indonesia (Persero) Tbk (BBNI, rated idAAA/Stable), PT Bank Mandiri (Persero) Tbk (BMRI, rated idAAA/Stable), and PT Bank CIMB Niaga Tbk (BNGA, rated idAAA/Stable). Finance companies engaged in the consumer financing segment will also gain advantages in disbursing their financing, particularly those focusing on automotive and mortgage financing. The outlooks of these companies are stable and, therefore, we do not expect rating changes of the rated 34 Indonesian banks and 21 finance companies within PEFINDO's portfolio as a result of the new regulation, as they are being more selective in their loan disbursement.

Figure 6. Published ratings of consumer finance companies

Company	Rating	Outlook
PT Adira Dinamika Multi Finance Tbk	idAAA	Stable
PT Astra Sedaya Finance	idAAA	Stable
PT BCA Finance	idAAA	Stable
PT Federal International Finance	idAAA	Stable
PT Sarana Multigriya Finansial (Persero)	idAA+	Stable
PT Toyota Astra Financial Services	idAA+	Stable
PT Mandiri Tunas Finance	idAA	Stable
PT Summit Oto Finance	idAA	Stable
PT Clipan Finance Indonesia Tbk	idA+	Stable
PT Indomobil Finance Indonesia	idA	Stable
PT Mandala Multifinance Tbk	idA	Stable
PT Verena Multi Finance Tbk	idA-	Stable
PT Finansia Multi Finance	idBBB+	Stable
PT Batavia Prosperindo Finance Tbk	idBBB	Stable

Source: PEFINDO database, as of May 31, 2015

Challenges in controlling asset quality

We believe the magnifying credit risk is inevitable as a consequence of the higher risk of non-payment given the higher LTV. To manage the performance of asset quality, banks and finance companies need to apply more conservative approaches in extending loans. This should include stricter risk management, more selective underwriting assessment, and more intensive credit monitoring.

The banks and finance companies' attempts to safeguard their asset quality will be challenged by the economic downturn. We expect them to have difficulties in maintaining their asset quality at the current level. As such, we project NPL ratios from the consumer segment in the banking industry and the consumer financing segment in the financing industry to slightly increase in the medium term. Following our expectations on the increasing pressure in the consumer segment, we project the NPL ratios of the overall banking and financing industries will continue to deteriorate.