Indonesian Islamic Banks Dashboard: 2020

New Islamic Banking Roadmap to Benefit Sector in Medium Term

Revamped Framework: Fitch Ratings believes a new five-year Islamic banking roadmap will help advance the sector in the medium term, but short-term benefits are likely to be muted. The framework, introduced by the Financial Services Authority (OJK), the central bank and national sharia board in 2019, focuses on strengthening regulations and corporate governance and boosting the penetration of sharia-compliant products. The plan targets a 20% market share for the Islamic financial industry by 2024, but no specific Islamic banking targets were announced.

Sharia Conversions to Boost Share: Two regional banks, Bank Riau Kepri and Bank Nagari, have announced plans to transform into Islamic banks. Branches of conventional banks in Aceh – a Muslim-majority province that operates under sharia law – are required to convert into sharia branches by 2021. We believe these developments should add around 1 percentage point to the Islamic banking industry's market share in the near term (end-2019: 6.3%). Islamic business units of conventional banks are required to be converted into standalone Islamic banks by 2023.

What to Watch

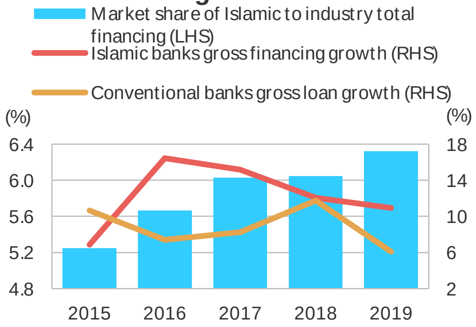
COVID-19: Fitch expects the coronavirus outbreak to hurt the performance of Indonesian banks, with the impact likely to be greater on banks with significant exposure to the tourism sector. Islamic banks are likely to be affected to a similar degree as conventional banks. However, downward rating pressure on most Fitch-rated banks is unlikely unless the outbreak escalates significantly as many of the banks' Issuer Default Ratings are based on support from higher-rated parents and their Viability Ratings incorporate generally satisfactory earnings and capital buffers.

IFRS 9: Fitch expects the adoption of IFRS 9 to affect Indonesia's Islamic banks more than conventional banks due to their significantly lower reserve cover and weaker - although adequate - capitalisation. However, Islamic banks are exempt from implementing IFRS 9 in 2020 while the board of sharia accountants develops the approach for calculating sharia-based asset impairment.

Faster Financing Growth: Fitch expects Islamic bank's financing growth to remain faster than that of their conventional peers in 2020, helped by the planned sharia conversions. Financing growth slowed to 10.9% in 2019 (2018: 12.1%) but was above that of conventional banks (6.1%).

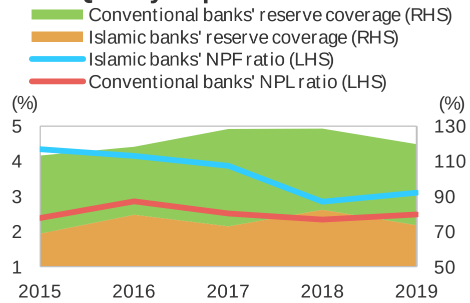
Weaker Sector Outlook: Fitch believes the asset quality and profitability gap between Islamic and conventional banks will persist, although it has narrowed in the last few years. We expect Indonesian banks to report weaker asset quality in 2020 and Islamic banks may be more affected than conventional banks due to their weaker underwriting standards and higher risk appetites.

Slower Financing Growth



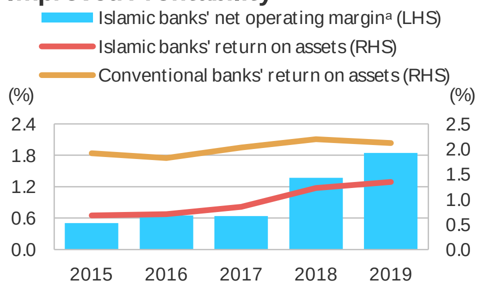
Source: Fitch Ratings, OJK

Asset Quality Gap to Persist



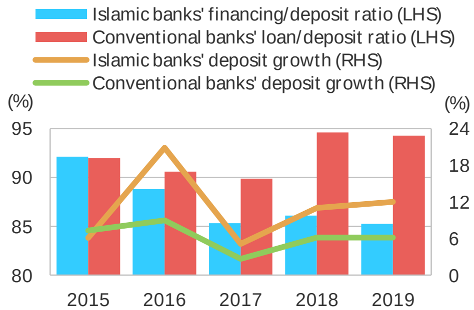
Non-performing financing (NPF): >90 days overdue
Source: Fitch Ratings, OJK

Improved Profitability



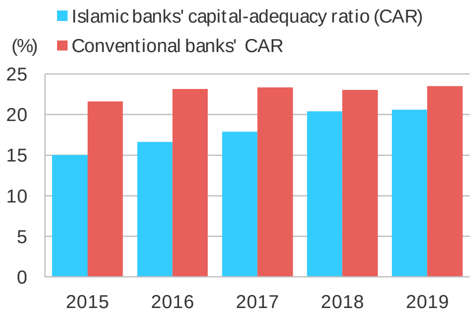
[a] Net financing income less operating expenditure and provisions to earning assets
Source: Fitch Ratings, OJK

Haj Funds Boost Deposits



Source: Fitch Ratings, OJK

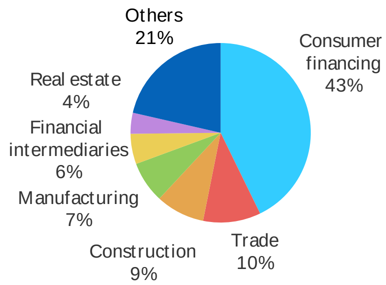
Adequate Capitalisation



Source: Fitch Ratings, OJK

Financing Composition

(End-2019)



Source: Fitch Ratings, OJK

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