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Green vs. dirty financing in Indonesia

As we previously wrote about Indonesia being in a sweet spot due to its commodity exports under the current inflationary environment, what is largely unknown to the rest of the world is that the country is also trying hard to avoid its resources curse. The country's environmental commitment came as a pleasant surprise when it announced its carbon neutrality goal at the COP26 summit in 2021. As a result of the commitment, major Indonesian lenders have started to take action by underwriting more green loans and terminating fossil-fuel related financings.

PT Bank Rakyat Indonesia (BRI, Bloomberg ticker: BBRI IJ), one of the country's largest state-owned banks, has recently announced to stop financing the fossil fuel sector such as coal and oil projects. According to BRI's President Sunarso, the bank's current exposure to the energy sector is approximately 3% of its total loan book. According to the announcement, BRI is expected to start withdrawing its financial involvement from the PLTU Java 9 & 10 power plants, a mega coal-fired project with a capacity of 2,000 MW that would cost Rp 40 trillion ($2.7bn). Meanwhile, BRI has been reported to be aggressively channelling its credit exposure to the agricultural sector, taking 28.3% of the sector's lending market share in Indonesia last year.

BRI isn't alone in utilising its lending capacity to fight climate change. Another major Indonesian state-owned bank, PT Bank Negara Indonesia (Persero) Tbk (BNI, Bloomberg ticker: BBNI IJ) recently raised Rp 5 trillion ($343mn) through the sale of green bonds to finance green projects such as renewable energy, waste management, green buildings, etc. BNI's efforts in supporting the green transition have been evidenced by its fast-growing green portfolio, which reached Rp 170.5 trillion ($11.8bn) at the end of March 2022. According to the bank's Q1 results, its exposure to green loans recorded a 21.8% YoY growth whereas its overall credit grew at a much slower pace of 7%.

Despite the Indonesian banks' increasing efforts to shift away from the fossil-fuel industry, well-known international banks have been doing the complete opposite by capitalising on the high demand for capital from miners and other commodity producers. As commodity prices skyrocketed, international lending giants including Citigroup, BNP Paribas and Standard Chartered have been providing waves of new loans to miners, effectively keeping the fossil fuel industry afloat. According to official data, the boom in lending is particularly pronounced in the province of East Kalimantan, the country's coal-mining heartland, where loans to the industry have grown by 74.4% YoY in February 2022, compared to 18.9% growth in overall lending.

The increasing flow of funding to Indonesian coal miners from international lenders is apparently at odds with the global megatrend of avoiding fossil-fuel investments. By betting on surging energy prices and continuing to fund mining companies, financial institutions are not only risking reputational damage but also making themselves complicit in massive environmental destruction, not to mention credit risks once the cycle inevitably turns into a bust.

However, given the world's heavy dependence on fossil fuels, an outright termination of investments in the sector may not be the most ideal solution either, in our view. Alternatively, responsible financial institutions could have taken a strategic approach, besides underwriting more green loans, by inserting environmental requirements and KPIs in the loan covenants they sign with borrowers and thus encouraging them to engage in more environmentally responsible practices. The unfortunate fact that we are not yet ready to fully get rid of dirty coal doesn't mean we should ever stop trying. Rather, it places an increasingly important responsibility on financial institutions to effectively facilitate the transition with their lending and investment capacities.

At JK Capital we continue to take a proactive stance on monitoring investments in carbon intensive industries. In February 2021 we made a firm wide commitment to stop any new purchases of securities issued by dedicated thermal coal producers. In December 2021 our fixed income portfolio had completely exited all exposure to the Indonesian thermal coal sector two years ahead of our internal target, joining the existing position of our equity funds which have for many years maintained a zero-coal positioning. This is no small feat considering that Indonesian coal producers have traditionally been a dominant sector within the Asian high yield universe. More recently we have been shifting our focus to second order exposures and our fixed income portfolio has been adding positions in Indonesian banks which have been taking a leading position in ESG initiatives in the country. This includes mortgage lender PT Bank Tabungan Negara which focusses on low-income housing financing and BRI which as mentioned above is taking a prominent role on decarbonisation efforts in Indonesia.