

# Bank Indonesia's Policy Mix: The Framework and Its Implementation

**Aida S. Budiman**  
**Economic and Monetary Policy Department**

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# 1

## **Lower Global Growth, Rising Volatility**

- ✓ Lower global growth and trade as inward looking trade policy rises
- ✓ Volatile capital flows and exchange rates

# 2

## **Central Bank Policy Responses**

- ✓ The necessity of central bank policy mix
- ✓ Institutional setting: Independency vs policy coordination

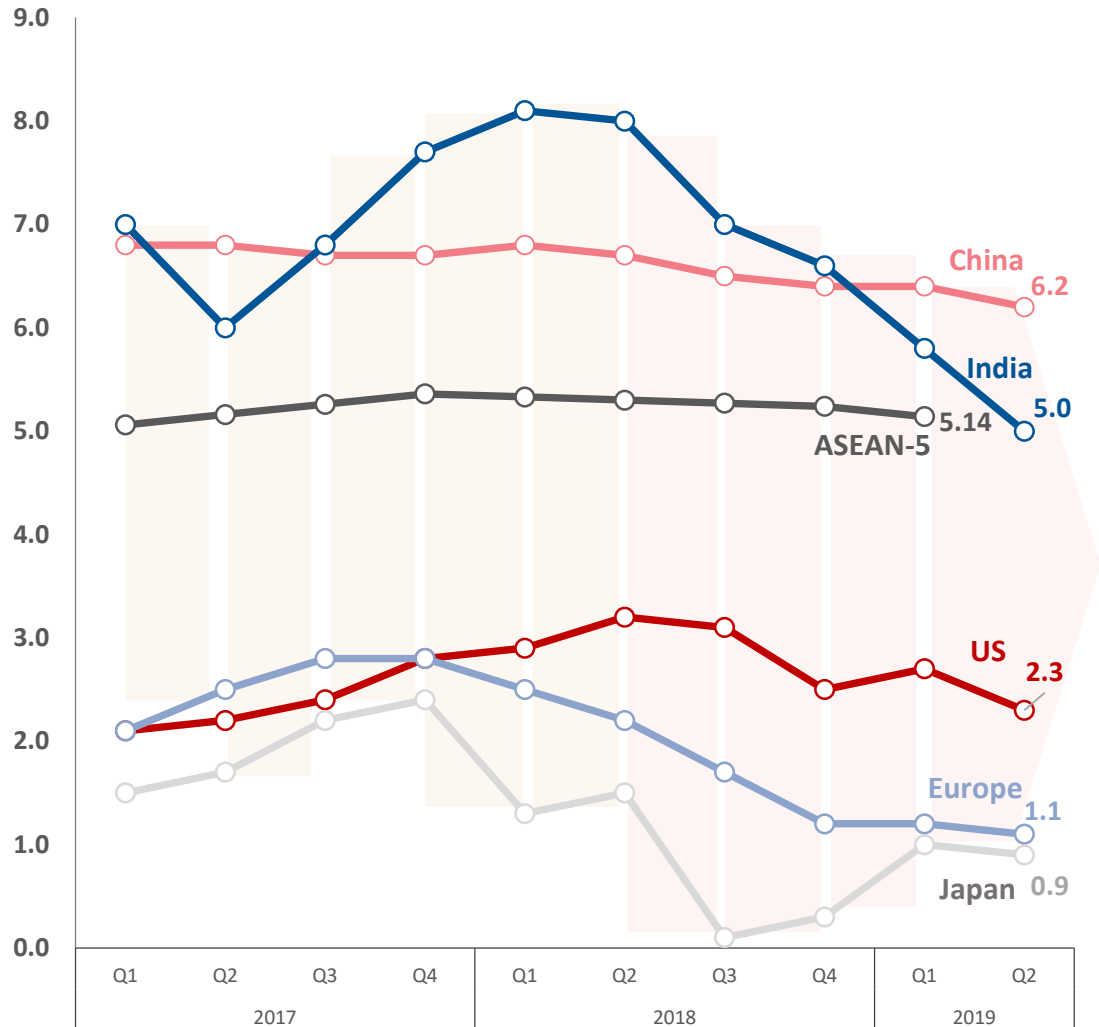
# 3

## **Indonesia's Experience**

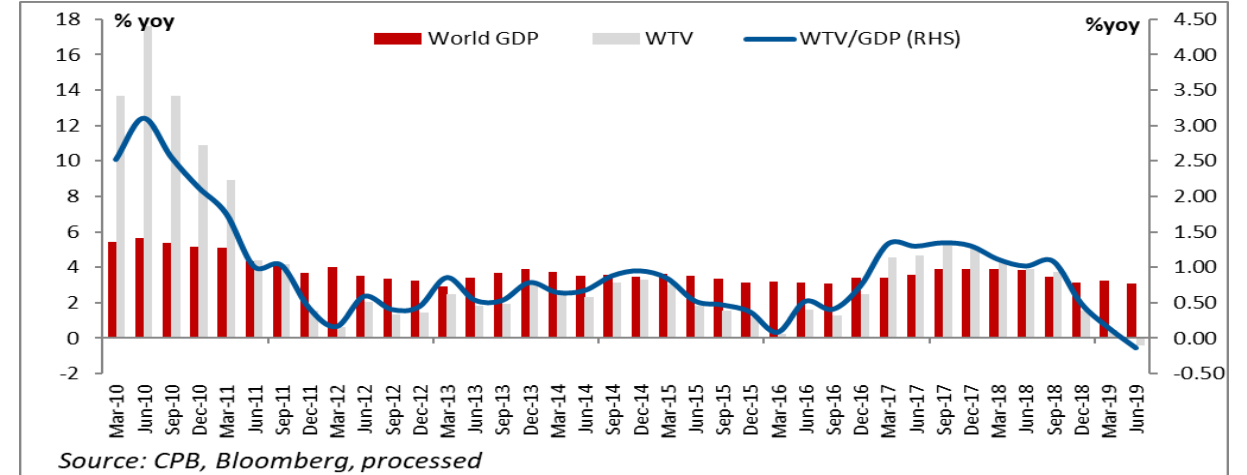
- **Bank Indonesia policy mix response**
- **Recent economic development**
- **Closer policy coordination with Government and FSA**

**Trade wars between US and China, and other inward trade policies, have negative impacts to world trade volume and global economic growth, which eventually prompted lower commodity prices...**

**US'S STRONG ECONOMY GROWTH IN 2018, CONVERGENT LOWER GLOBAL GROWTH IN 2019...**



**AND DEPRESS THE WORLD TRADE VOLUME...**



**PROMPTED LOWER COMMODITY PRICES...**

Commodity	2016	2017	2018	2019 YTD
Copper	-10.5	27.1	6.7	-7.2
Coal	6.8	48.2	2.5	-7.2
CPO	21.3	5.7	-19.2	-9.2
Rubber	-2.2	28.1	-16.8	16.8
Nickel	-15.4	8.9	27.8	-0.6
Tin	13.1	13.1	0.5	-3.2
Aluminium	-3.5	22.9	7.4	-13.3
Coffee	4.3	-2.9	-15.4	-12.0
Others	1.0	6.8	1.2	0.2
Indonesian Export Commodity Price Index	5.4	21.7	-2.8	-3.4

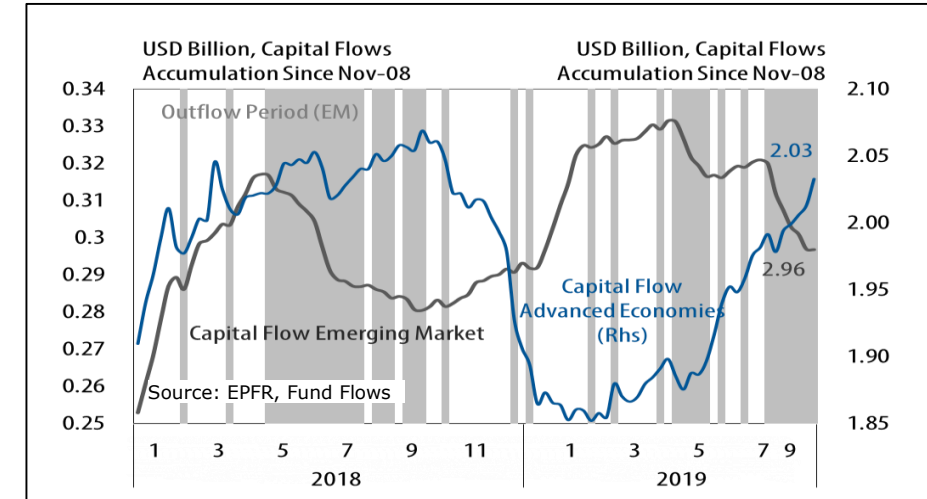
Source: Bloomberg, as of Sept 5<sup>th</sup>, 2019

# The global monetary policy stance and the Capital Flows to EM

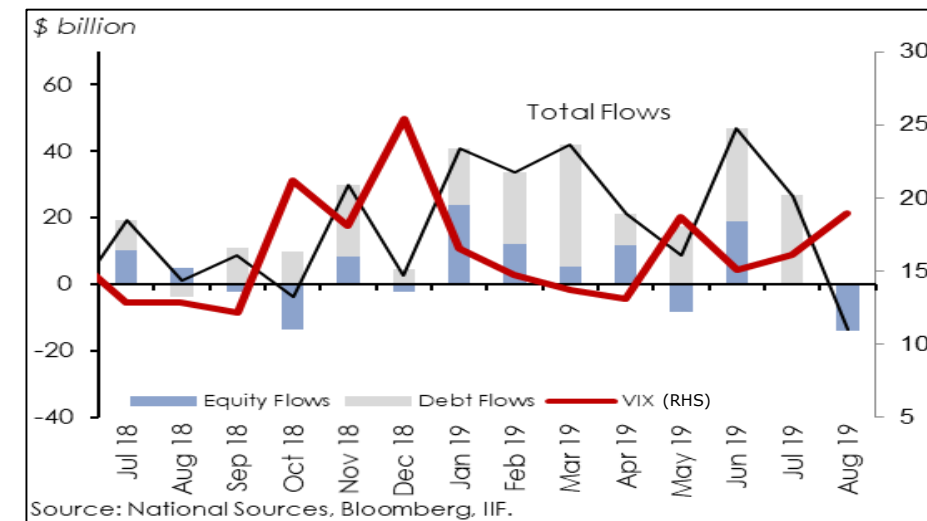
*As the Fed tightened its stance in 2018, EM experienced outflow. In 2019 the wave of dovish monetary policy responding to lower growth brings inflow to EM although trade war triggers risk averse and volatility...*

BANK SENTRAL	TOT'18 (bps)	YTD'19 (bps)	QI'18 (%)	QII'18 (%)	QIII'18 (%)	QIV'18 (%)	QI'19 (%)	QII'19 (%)	QIII'19 (%)	QIV'19 (%)
FED	+75	-50	1.75	2.00	2.25	2.50	2.50	2.50	2.00	1.75
RBI	+50	-110	6.00	6.25	6.50	6.50	6.25	5.75	5.40	5.10
BSP	+175	-50	3.00	3.50	4.50	4.75	4.75	4.50	4.25	4.00
BOT	+25	-25	1.50	1.50	1.50	1.75	1.75	1.75	1.50	1.25
RBNZ	0	-75	1.75	1.75	1.75	1.75	1.75	1.50	1.00	1.00
RBA	0	-50	1.50	1.50	1.50	1.50	1.50	1.25	1.00	0.75
BdeM	+75	-25	7.50	7.75	7.75	8.25	8.25	8.25	8.00	7.50
BCB	0	-50	6.50	6.50	6.50	6.50	6.50	6.50	6.00	5.25
BNM	0	-25	3.25	3.25	3.25	3.25	3.25	3.00	3.00	2.75
BOK	+25	-25	1.50	1.50	1.50	1.75	1.75	1.75	1.50	1.25
ECB	0	0	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
BOJ	0	0	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10

## CAPITAL OUTFLOWS FROM EMERGING MARKETS DURING RISK OFF PERIOD



## VOLATILE CAPITAL INFLOWS TO EM AS VIX FLUCTUATES



# 1

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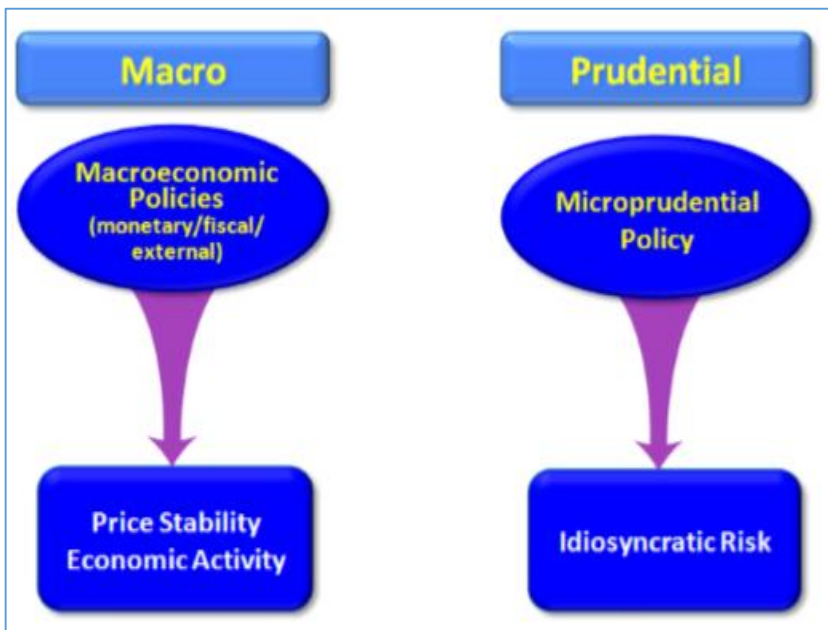
## **Indonesia's Experience**

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- **Recent economic development**
- **Closer policy coordination with Government and FSA**

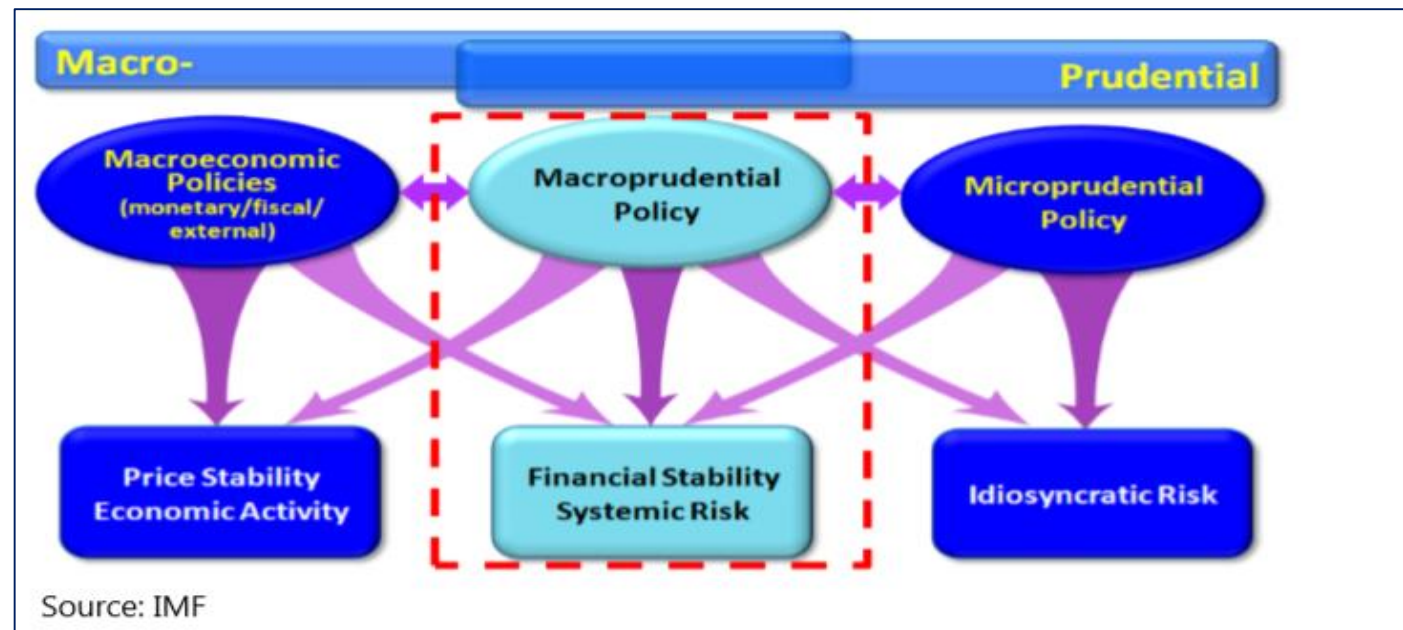
*The global financial crises emphasize the importance to maintain financial system stability through integration of macroeconomic, macroprudential, and microprudential policies...*

- **Macroeconomic Policy (Fiscal/Monetary/External)**: maintain macroeconomic stability (inflation, current account deficit, and fiscal deficit) and support/boost economic growth.
- **Microprudential Policy**: maintain the soundness of individual financial institution, banks and non-bank. Necessary, but not sufficient to maintain financial system stability.
- **Macroprudential Policy**: maintain financial system stability from macro perspective (macro-financial linkages) and mitigate systemic risk.

PRE-GFC...



POST-GFC...



**Central bank’s mandate of price stability needs to be enlarged with supporting financial system stability. FX intervention to stabilize exchange rate may be needed to strengthen the effectiveness of interest rate policy for achieving price and external stability. Monetary policy need to be complemented with macroprudential policy to support financial stability.**

**INTEGRATED INFLATION TARGETING (IITF) FRAMEWORK**

Macroeconomic Target	Macroeconomic Indicator	FITF (pre-crisis)	FITF (post-crisis)	IITF (post-crisis)
Price Stability	Inflation Gap (I) Output Gap (O)	Taylor-rule with I & O	Taylor-rule with I, O & FX factors	Central bank rule with I, O, C & FX factors
Financial Stability	Credit Gap (C)	Microprudential Instruments (MiP)	Micro-Macroprudential Instruments (MiP and MaP)	Monetary & macroprudential instruments calibrated together (Mon+MaP) & Coordinated Micro-Macroprudential instruments (MiP+MaP)
External Stability	Exchange Rate (FX) Volatility	Free-Floating Exchange Rate regime	Floating Exchange Rate regime with FX intervention	Floating Exchange Rate regime with FX intervention and foreign capital flow management

Source: Warjiyo & Juhro (2019, p.478), adapted from Agenor & da Silva (2013).

**To achieve high, sustainable and inclusive growth with macroeconomic and financial stability, it is important to have close coordination between central bank policy, fiscal policy and structural reforms...**

## Central bank policy mix

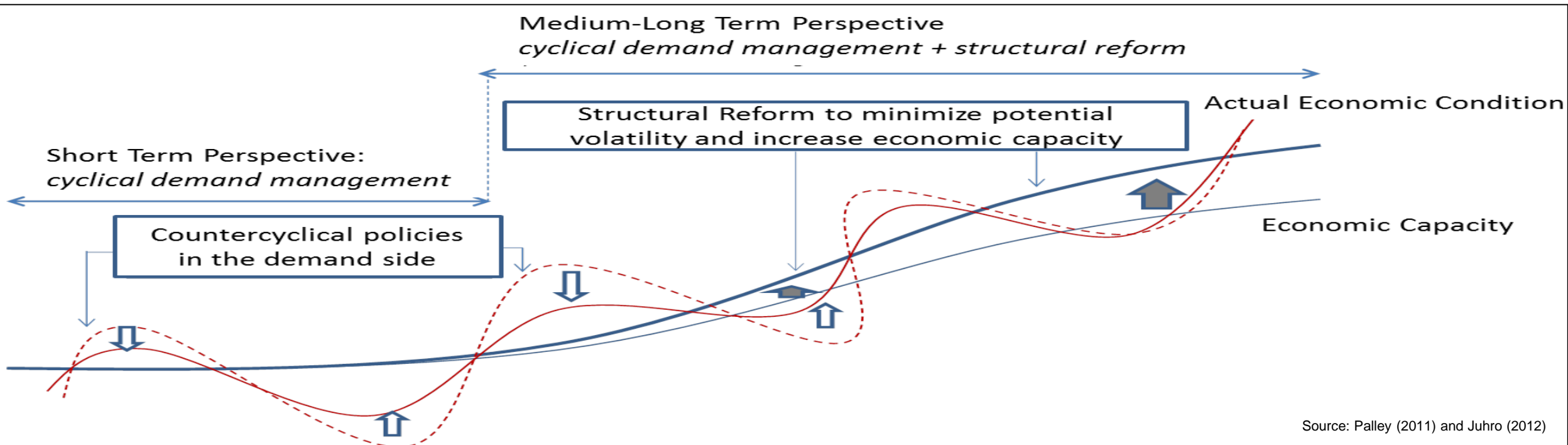
- Maintaining price stability and supporting financial stability
- Policy mix of interest rate, exchange rate, capital flow management and macroprudential measures.

## Structural reforms

- Achieving higher growth through productivity of capital, labor, and technological change
- Reforms in infrastructure, investment climate, product and market, and labor.

## Fiscal policy

- Macroeconomic stability through sustainable fiscal deficit and public debt.
- Tax policy and allocation of productive spending for stimulating higher & inclusive growth



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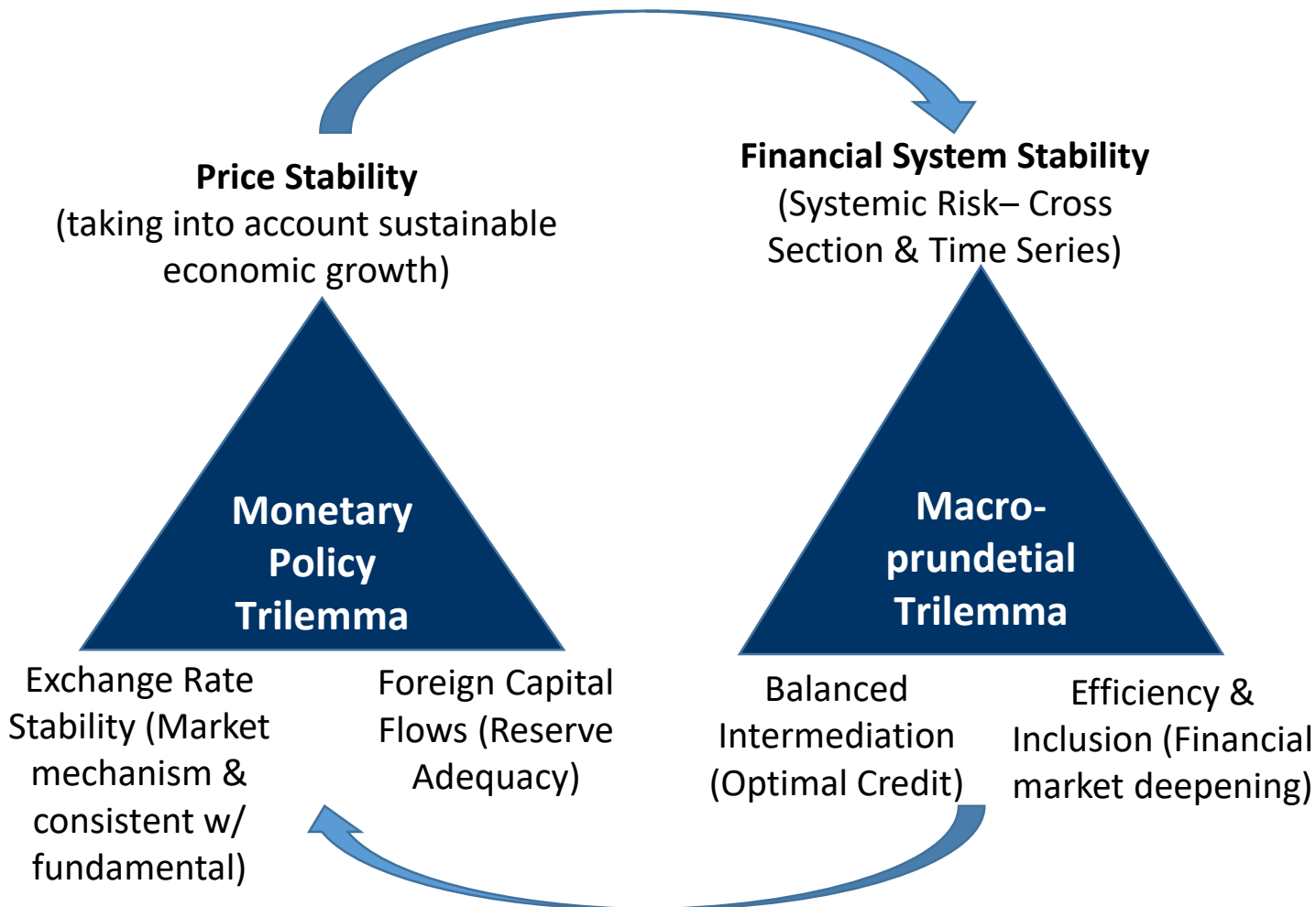
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- **Goal:** to achieve price stability (inflation target & exchange rate stability) & to support financial system stability (FSS).
- **Monetary side:** enhance the effectiveness of monetary policy transmission through various channels (the interest rate, exchange rate, liquidity, bank credit, as well as in terms of risk-taking behavior & expectation).
- **FSS side:** to manage procyclicality and mitigate the build up of systemic risk, especially from credit, property, foreign debt, & capital flows.



**Goal: Price Stability and support FSS**

• **Strategy: Bank Indonesia's Policy Mix**

## 1. Interest Rate Policy:

- BI7DRR Rate
- Corridor & term structure OM

## 2. Exchange Rate Policy

- Consistent with fundamental
- (Short-term) volatility

## 3. Capital Flows Management

- Support ER stability, manage procyclicality & mitigate systemic risk

## 4. Macroprudential Policy

- Support effective monetary transmission
- Mitigate procyclicality & mitigate build-up systemic risks

## 5. Coordination & Communication

- With Government (inflation, fiscal, & structural reforms)
- Communication to manage expectations

		Forecasted Price Stability Risk	
		Low	High
Forecasted Financial Stability Risk	High	<p><b><u>Quadrant II</u></b></p> <ul style="list-style-type: none"> <li>• Monetary NEUTRAL/ LEANING</li> <li>• Macroprudential TIGHT</li> </ul>	<p><b><u>Quadrant IV</u></b></p> <ul style="list-style-type: none"> <li>• Monetary TIGHT</li> <li>• Macroprudential TIGHT</li> </ul>
	Low	<p><b><u>Quadrant I</u></b></p> <ul style="list-style-type: none"> <li>• Monetary NEUTRAL/ LOOSE</li> <li>• Macroprudential NEUTRAL/LOOSE</li> </ul>	<p><b><u>Quadrant III</u></b></p> <ul style="list-style-type: none"> <li>• Monetary TIGHT</li> <li>• Macroprudential NEUTRAL/LEANING</li> </ul>

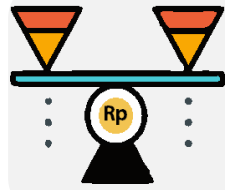
## Four Cases of Policy Mix:

- **Quadrant I**: Inflation within the target range & low credit growth; hence monetary policy may be relaxed and accommodative macroprudential policy may be implemented (i.e. easing LTV). For example Indonesia during mid 2015-2017 and starting mid-2019.
- **Quadrant II**: Low inflation but high credit growth, hence tight macroprudential policy (increase LTV) & neutral/accommodative monetary may be implemented. For example Indonesia during the period of 2010-mid 2013.
- **Quadrant III**: High inflation but low credit growth; hence accommodative macroprudential policy (easing LTV) & tight monetary policy (increase/high interest rate). For example Indonesia during end 2014 - mid 2015 & 2018 (tight monetary policy to maintain exchange rate stability).
- **Quadrant IV**: High inflation (above target range) & high credit growth; hence tight monetary policy (increase policy rate & RRR) & tight macroprudential policy (increase LTV). For example Indonesia during the period of mid-2013 - end 2014.

*Pre-emptive, front loading, and ahead the curve policy measures to ensure the economic stability while supporting economic growth momentum*



Policy Rate /RR



Exchange Rate Policy



Monetary Operation



Macroprudential Policy

Policy Coordination

## 2018

- 175 bps BI7DRR increase

## 2019

- 75 bps BI7DRR decrease
- 50 bps Reserve Requirement cut

- Exchange Rate along the fundamental
- Optimizing dual intervention strategy in the FX market and debt market for stabilization and ensuring the Rupiah liquidity
- Domestic NDF
- Ensuring liquidity in FX market through regular auctions:

- FX SBBI
- FX Swap
- FX Treasury Deposits

## Q2-Q3 2018

- Ensuring adequate liquidity
  - Optimizing frequency RR SBN
  - Reactivation of SBI
  - Optimizing longer term RR SBN

## Q4 2018 - NOW

- Liquidity to support economic financing, by giving banks greater access to manage liquidity
  - RR Averaging
  - Expansion and Contraction MO

## Accommodative Measures

- relaxing the LTV ratio
- establishing a min 20% target for MSME loan
- changing the LFR to Macroprudential Intermediation Ratio (MIR)
- increasing flexibility in bank liquidity management: Macroprudential Liquidity Buffer (MLB)
- Countercyclical Capital Buffer (CCB)

- Coordinating efforts in controlling inflation and reducing Current Account Deficit
- Accelerating structural reforms agenda
- Maintaining financial system stability
- Accelerates financial market deepening

....includes prudential measures, improving reporting system, and comprehensive financial deepening program

## PRUDENTIAL MEASURES

### Prudential Measures

#### Bank

- Bank's NOP regulation
- Bank's market risk mitigation incl. FX risk in risk based ratings

#### Non Banks

- External Debt Reporting System
- Prudential Regulation on Non-bank external debt
- Non-Bank Financial Institution regulation on FX Debt (incl. external debt)

#### Government

- Maximum fiscal deficit 3% of GDP
- Maximum debt 60% of GDP

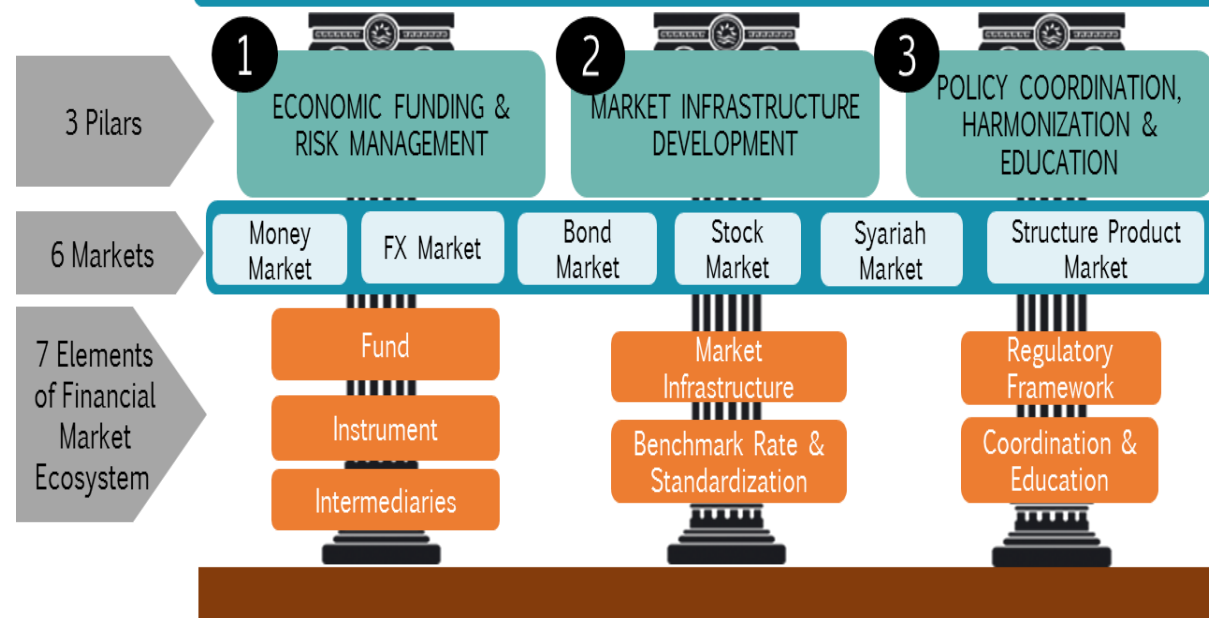
## COMPREHENSIVE FINANCIAL DEEPENING PROGRAM

Mission: Financial Market as Sources of National Development Financing

TARGET

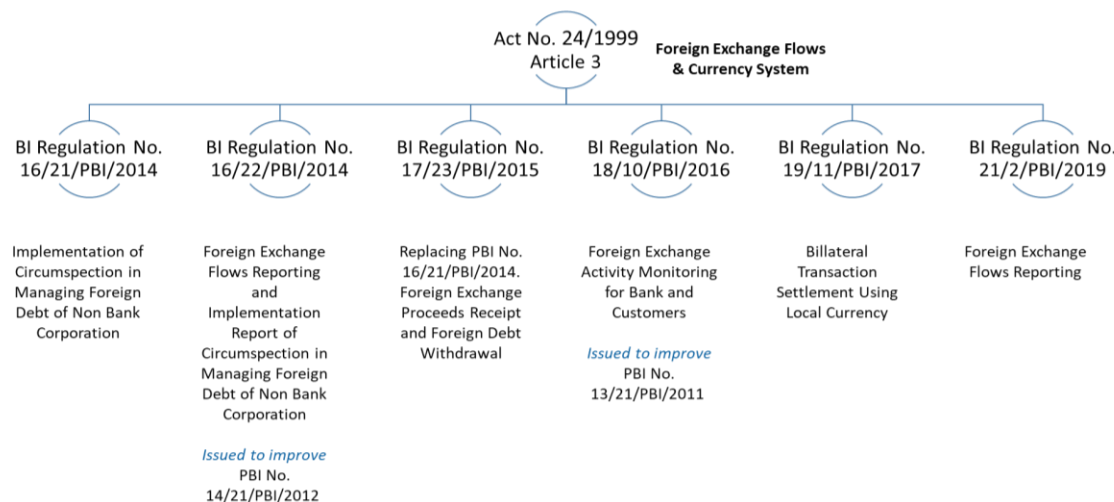
KEY PERFORMANCE INDICATOR

STRATEGIC ACTION PLAN



- Launching Rupiah Interest Rate Swaps (IRS) and Overnight Index Swap (OIS) (2018)
- Launching Domestic non-Deliverable Forward (DNDF) (2018)
- Developing Market Instruments for Financing Infrastructure (2019)
- Improving financial market infrastructures (2019)
- Issuing sharia instrument and sharia hedging instrument to stimulate the development of sharia financial institutions in Indonesia

## IMPROVING REPORTING SYSTEM



THE POLICY MIX EFFECTIVELY MAINTAINED ECONOMIC GROWTH MOMENTUM ...

EXTERNAL RESILIENCE IS MAINTAINED DESPITE STRONG GLOBAL HEADWINDS & SEASONAL TRENDS...

Components	2018					2019	
	I	II	III	IV	Total	I	II
<b>GDP</b>	<b>5.06</b>	<b>5.27</b>	<b>5.17</b>	<b>5.18</b>	<b>5.17</b>	<b>5.07</b>	<b>5.05</b>
Household Cons.	4.94	5.16	5.00	5.08	5.05	5.02	5.17
Government Cons.	2.71	5.2	6.27	4.56	4.8	5.21	8.23
Investment	7.94	5.85	6.96	6.01	6.67	5.03	5.01
Non-building	13.56	8.33	10.73	8.96	10.31	3.69	3.70
Building	6.16	5.02	5.66	5.02	5.45	5.48	5.46
Exports	5.94	7.65	8.08	4.33	6.48	-1.86	-1.81
Imports	12.64	15.17	14.02	7.1	12.04	-7.36	-6.73

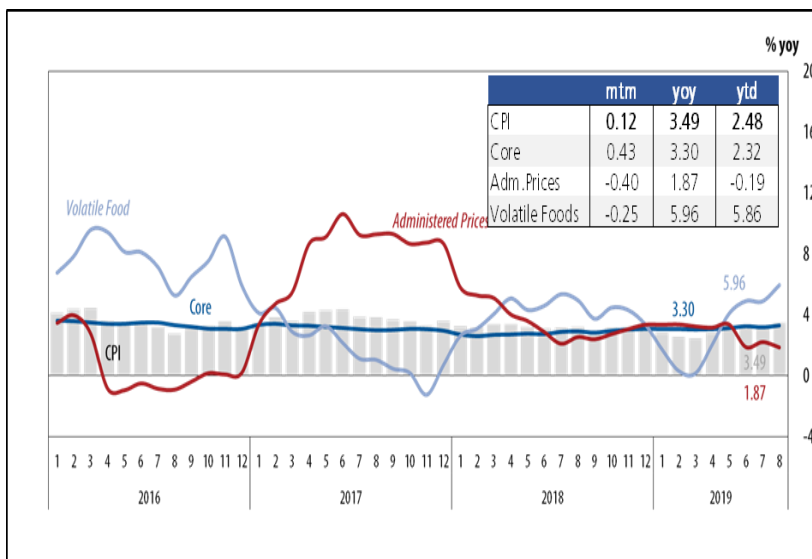
Source: BPS, processed

**INFLATION IS LOW & STABLE...**

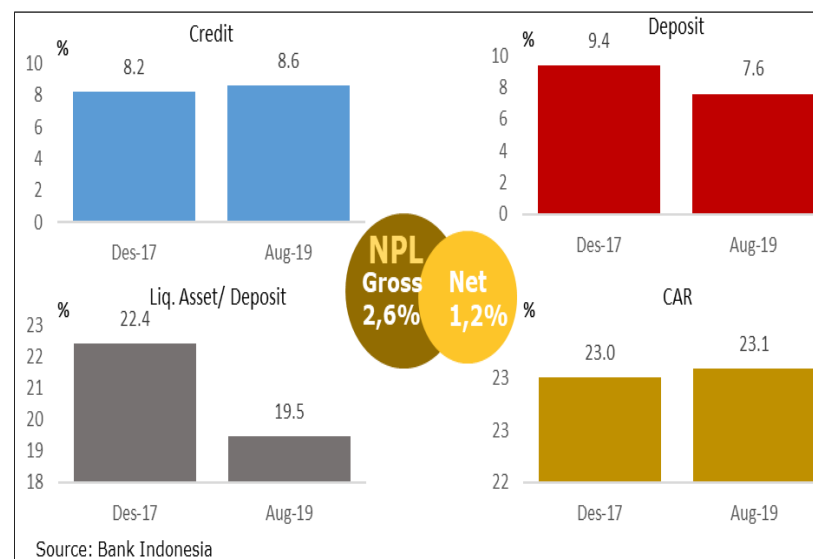
Components (Billion USD)	2016	2017					2018					2019	
		Q1*	Q2*	Q3*	Q4*	Total*	Q1*	Q2*	Q3**	Q4*	Total*	Q1**	Q2***
<b>Current Account</b>	<b>-17.0</b>	<b>-2.2</b>	<b>-4.6</b>	<b>-4.6</b>	<b>-5.9</b>	<b>-17.3</b>	<b>-5.2</b>	<b>-8.0</b>	<b>-8.7</b>	<b>-9.2</b>	<b>-31.0</b>	<b>-7.0</b>	<b>-8.4</b>
A. Goods	15.3	5.6	4.8	5.3	3.1	18.8	2.3	0.3	-0.5	-2.6	-0.4	1.2	0.2
- Exports, fob	144.5	40.8	39.2	43.4	45.5	168.9	44.4	43.7	47.7	44.9	180.7	41.2	40.1
- Imports, fob	-129.2	-35.1	-34.3	-38.1	-42.5	-150.1	-42.1	-43.5	-48.2	-47.5	-181.2	-40.0	-39.9
a. Non-Oil and Gas	19.5	7.6	6.1	6.3	5.2	25.2	4.4	3.2	3.4	0.1	11.2	2.9	3.0
b. Oil and Gas	-4.8	-2.2	-1.5	-1.3	-2.4	-7.3	-2.4	-2.8	-3.6	-2.9	-11.6	-2.2	-3.2
B. Services, Primary Income, Secondary Income	-32.3	-7.9	-9.4	-9.9	-8.9	-36.1	-7.5	-8.2	-8.2	-6.6	-30.6	-8.2	-8.6
<b>Capital and Financial Account</b>	<b>29.3</b>	<b>6.7</b>	<b>5.3</b>	<b>10.3</b>	<b>7.0</b>	<b>29.4</b>	<b>2.2</b>	<b>3.1</b>	<b>3.9</b>	<b>15.8</b>	<b>24.9</b>	<b>9.9</b>	<b>7.1</b>
1. Direct Investment	16.1	2.8	4.4	7.4	4.7	19.3	4.7	2.4	4.5	1.8	13.4	5.3	5.4
2. Portfolio Investment	19.0	6.5	8.1	4.0	2.2	20.9	-1.1	0.1	-0.1	10.5	9.3	5.4	4.5
3. Other Investment	-5.8	-2.5	-7.2	-1.1	0.1	-10.7	-1.5	0.6	-0.6	3.6	2.1	-0.8	-2.8
<b>Overall Balance</b>	<b>12.1</b>	<b>4.5</b>	<b>0.7</b>	<b>5.4</b>	<b>1.0</b>	<b>11.6</b>	<b>-3.9</b>	<b>-4.3</b>	<b>-4.4</b>	<b>5.4</b>	<b>-7.1</b>	<b>2.4</b>	<b>-2.0</b>
Memorandum :													
- Reserve Assets Position	116.4	121.8	123.1	129.4	130.2	130.2	126.0	119.8	114.8	120.7	120.7	124.5	123.8
In Months of Imports & Official Debt Repayment	8.4	8.6	8.6	8.6	8.3	8.3	7.7	6.9	6.3	6.5	6.5	6.8	6.8
<b>- Current Account (% GDP)</b>	<b>-1.8</b>	<b>-0.9</b>	<b>-1.8</b>	<b>-1.8</b>	<b>-2.3</b>	<b>-1.7</b>	<b>-2.0</b>	<b>-3.0</b>	<b>-3.3</b>	<b>-3.6</b>	<b>-3.0</b>	<b>-2.6</b>	<b>-3.0</b>

A STABLE & EFFICIENT MONEY MARKET HAS BEEN MAINTAINED...

THE RUPIAH CONTINUES TO MOVE IN LINE WITH THE CURRENCY'S FUNDAMENTAL VALUE...

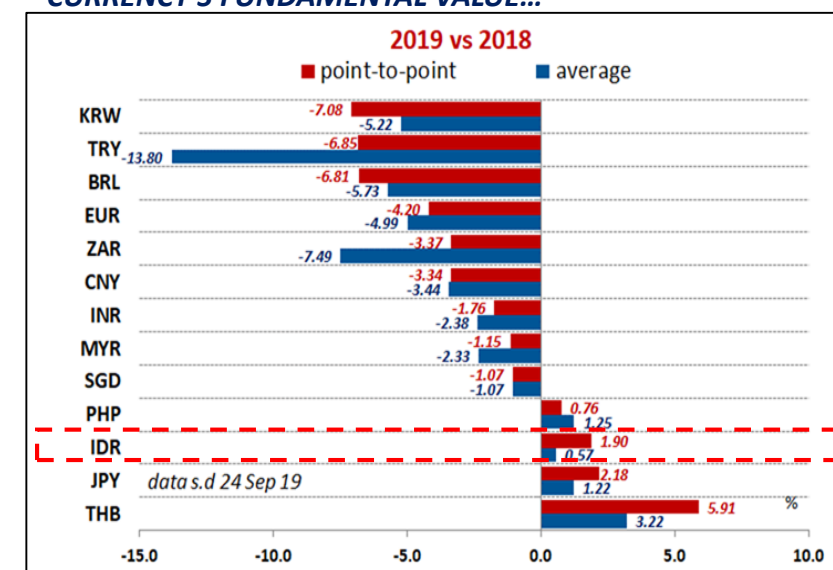


Source: BPS, processed



Source: Bank Indonesia

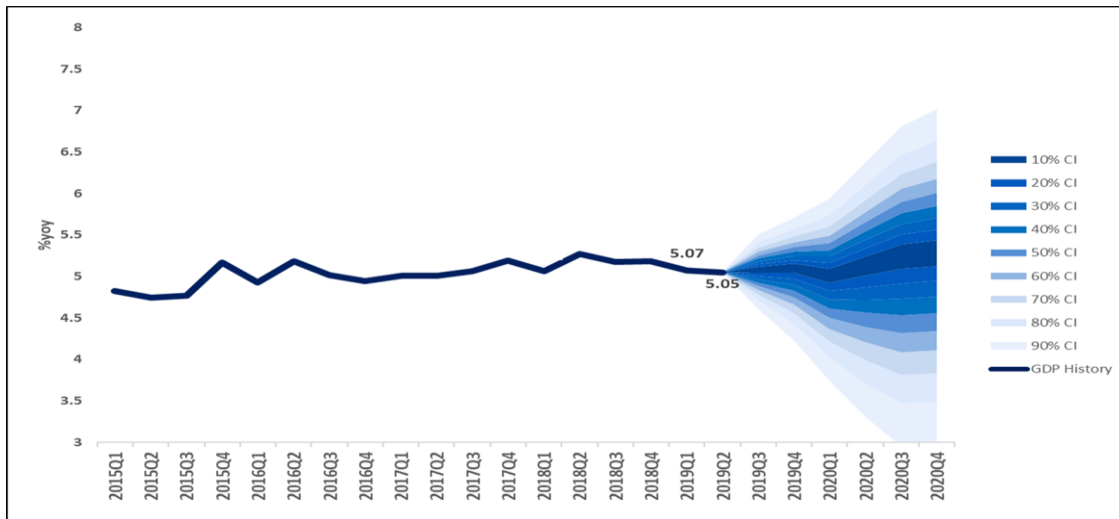
Sumber: Bank Indonesia



*Indonesia's economic outlook for 2019 is predicted to be below the midpoint of the range 5.0-5.4% before increasing towards the midpoint of the 5.1-5.5% range in 2020. Meanwhile, inflation is projected to remain contained and below the midpoint of the inflation target range of 3.5 ± 1% in 2019 and stays within 3.0%±1% target range for 2020.*

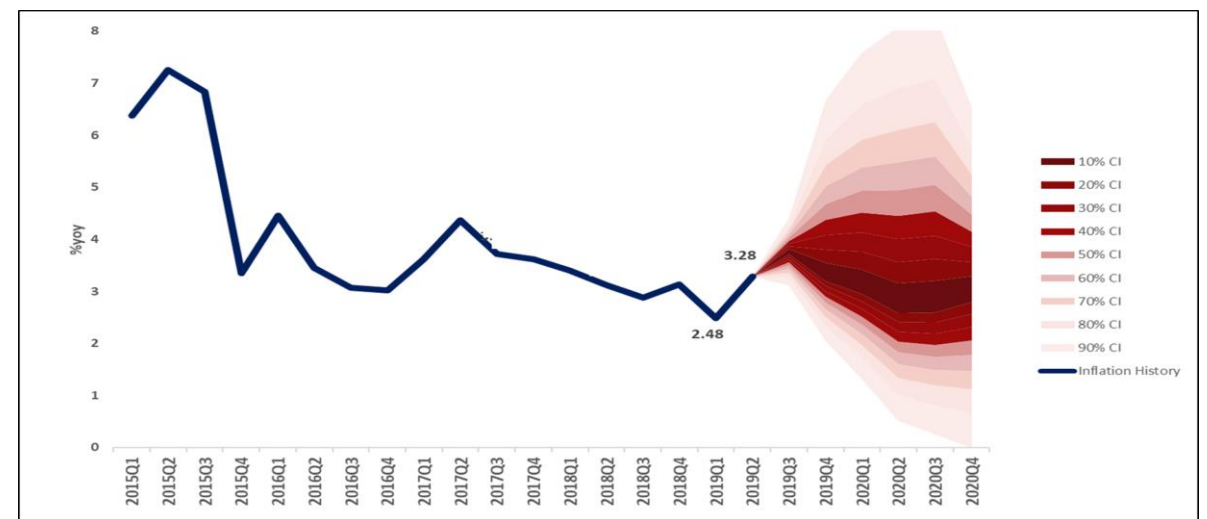
<b>2019</b>	5.0-5.4%	3.5%±1%	2.5-3.0% GDP	10-12%	7-9%
<b>2020</b>	5.1-5.5%	3.0%±1%	2.5-3.0% GDP	11-13%	8-10%

GDP Growth Fan Chart



Source: Bank Indonesia Projection

Inflation Fan Chart



Source: Bank Indonesia Projection

- 1** The policy is consistent with low inflation projected below the midpoint of the target corridor, attractive returns on domestic financial investment assets and as a pre-emptive measure to stimulate domestic economic growth momentum against a backdrop of global economic moderation.
- 2** To strengthen the policy mix to spur economic growth momentum, Bank Indonesia has relaxed macroprudential policy, aimed at increasing bank lending capacity and catalyse demand for new loans. Relaxation is achieved through refinement of Macroprudential Intermediation Ratio (RIM) / Sharia RIM and relaxed the Loan to Value / Financing to Value (LTV / FTV) Ratio for property loans/financing by 5% and down payments for motor vehicles.
- 3** Bank Indonesia has also strengthened its monetary operations strategy in order to maintain adequate liquidity and increase efficiency in the money market, thus enhancing transmission of the accommodative policy mix. The open market operations instrument will only use reverse repo tradable government securities (RR SBN) for all tenors from 7 days - 12 months, while announcing plans to auction 12-month RR SBN to replace 12-month SBI, commencing 4th October 2019..
- 4** Moving forward, Bank Indonesia will maintain an accommodative policy mix in line with low projected inflation, sustained external stability and the need to spur economic growth momentum.
- 5** Coordination between Bank Indonesia, the Government and other relevant authorities is constantly strengthened in order to maintain economic stability and catalyse domestic demand, while boosting exports and tourism and attracting foreign capital inflows, including foreign direct investment (FDI).

*Thank  
you!*