

Indonesia Update 2020.
COVID and Monetary Policy

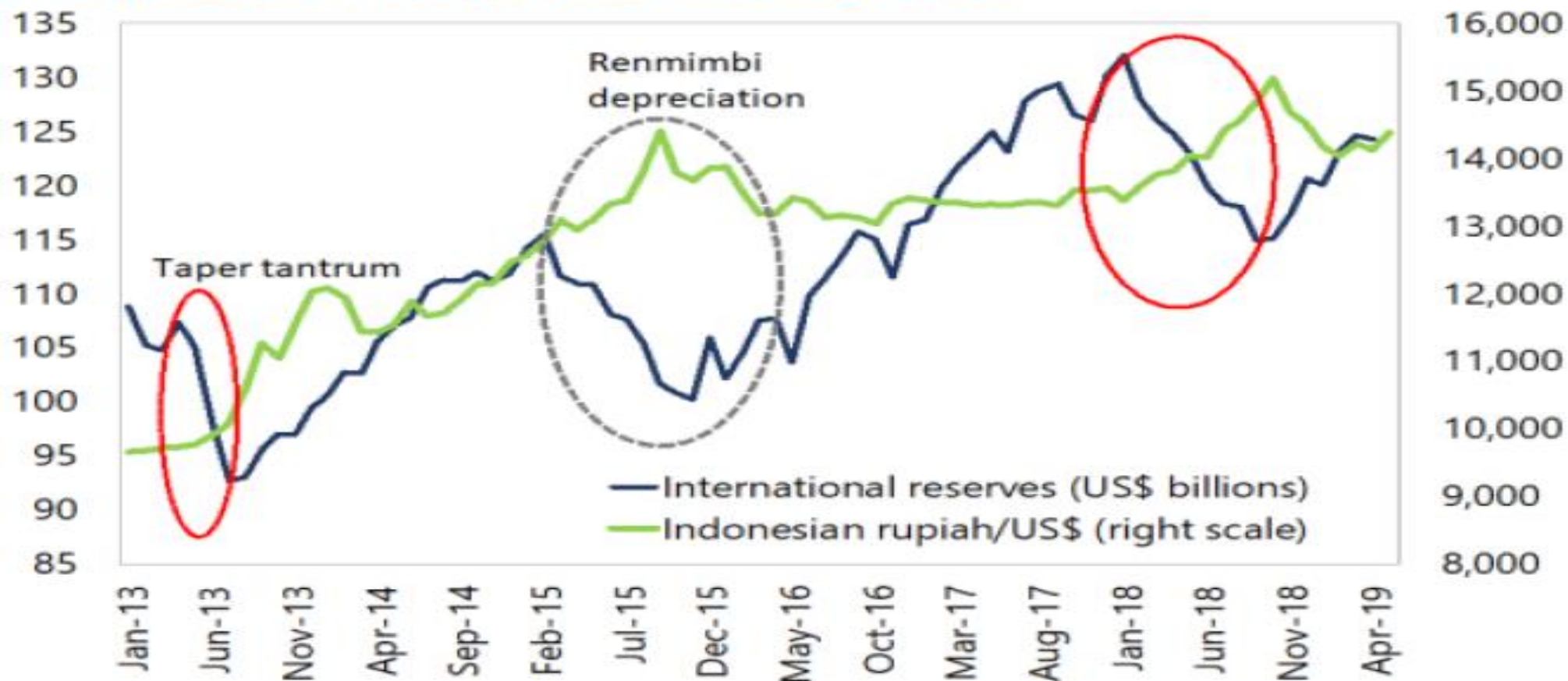
Monetary policy has a limited role in addressing the COVID crisis, with the main macro-economic challenge falling to fiscal policy.

That said, Bank Indonesia has two important tasks:

- To ensure the continuity of short-term portfolio inflows which fund both the budget and the external deficit.
- To help fund the COVID-expanded budget deficit.

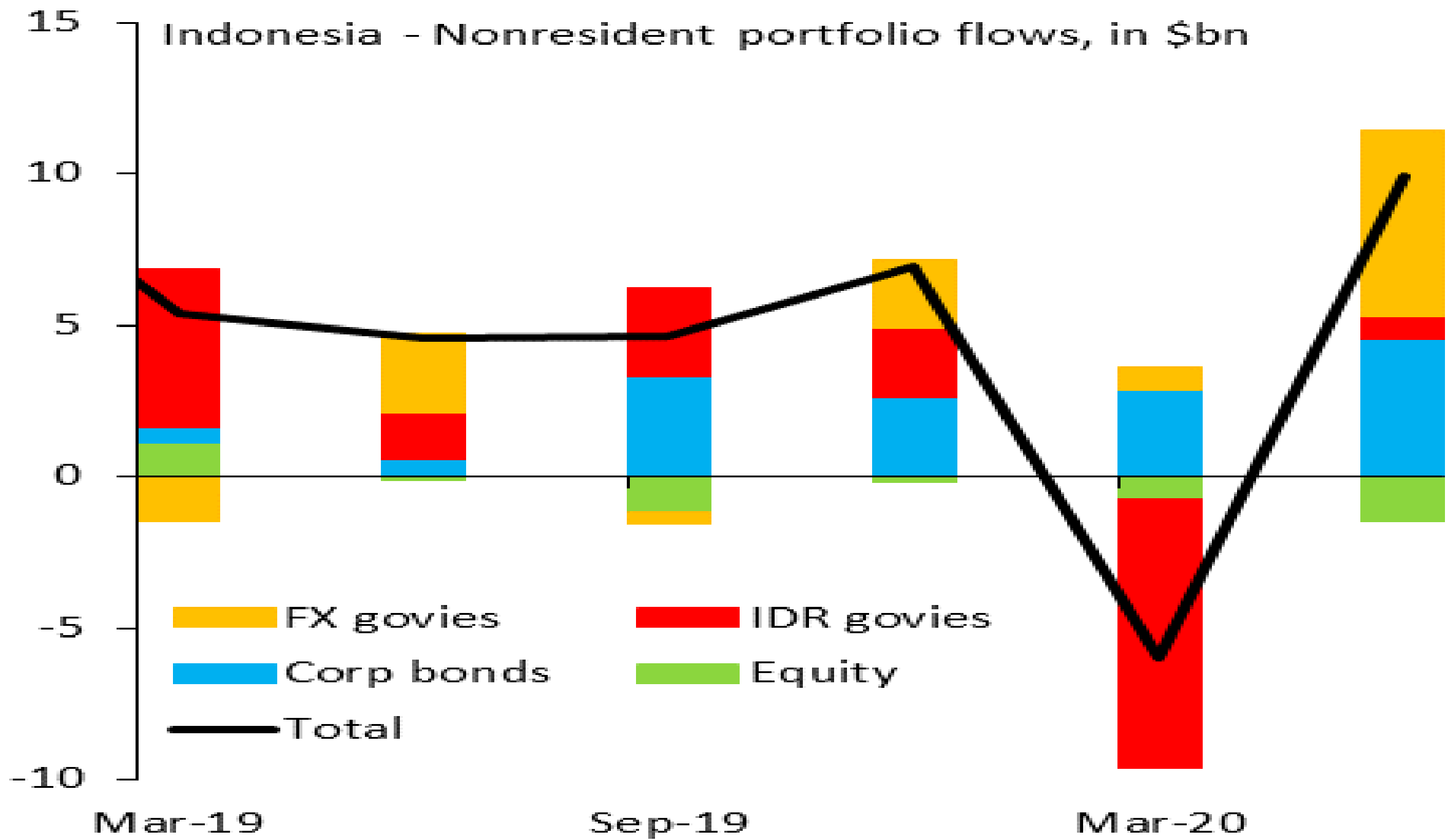
Capital flow ‘sudden stops’

International Reserves and Exchange Rate



Sources: Haver Analytics; and IMF staff estimates.

Indonesia - Nonresident portfolio flows, in \$bn



So far, so good but...

- The outflow was MUCH larger in this episode.
- BI's direct purchase of bonds from departing foreigners were MUCH larger.
- Market reaction remains a vulnerability.
- These episodes have been a major distraction to policy: the tail has wagged the dog.

Funding the budget deficit

- Long tradition of fiscal discipline. Balanced budgets and Bank Indonesia independence
- Alternative sources are limited.
- BI has bought bonds in the past in the secondary market to restrain yields.
- Now it has also agreed to buy bonds at tender ('standby') through non-competitive bidding.
- And it will buy some bonds directly from the government at yields which provide 'burden-sharing'.

“Money printing”

- Routine in rich countries since 2008 Global Financial Crisis
- Recently, ‘money-financed budget deficits’ (‘overt money financing’) have become common.
- Becoming common in emerging economies also, although Indonesia’s proposals are larger than most of its peers.

Concerns

- Not a “free lunch”
- Inflation? Not always a ‘monetary phenomenon’
- Budget profligacy? The ‘slippery slope’.
- Financial markets distortion (“financial repression”)?
- BI independence?
- Burden sharing?

- Exit strategy?
- New legislation on Bank Indonesia and OJK ??????

“A young state which is in need of capital for everything is consequently liable to find itself in the danger zone of inflation because it has to resort to loans from the central bank. ... There is so much talk all over the world about ‘deficit spending’. ... **To have recourse to the central bank threatens the stability of the national currency.**”

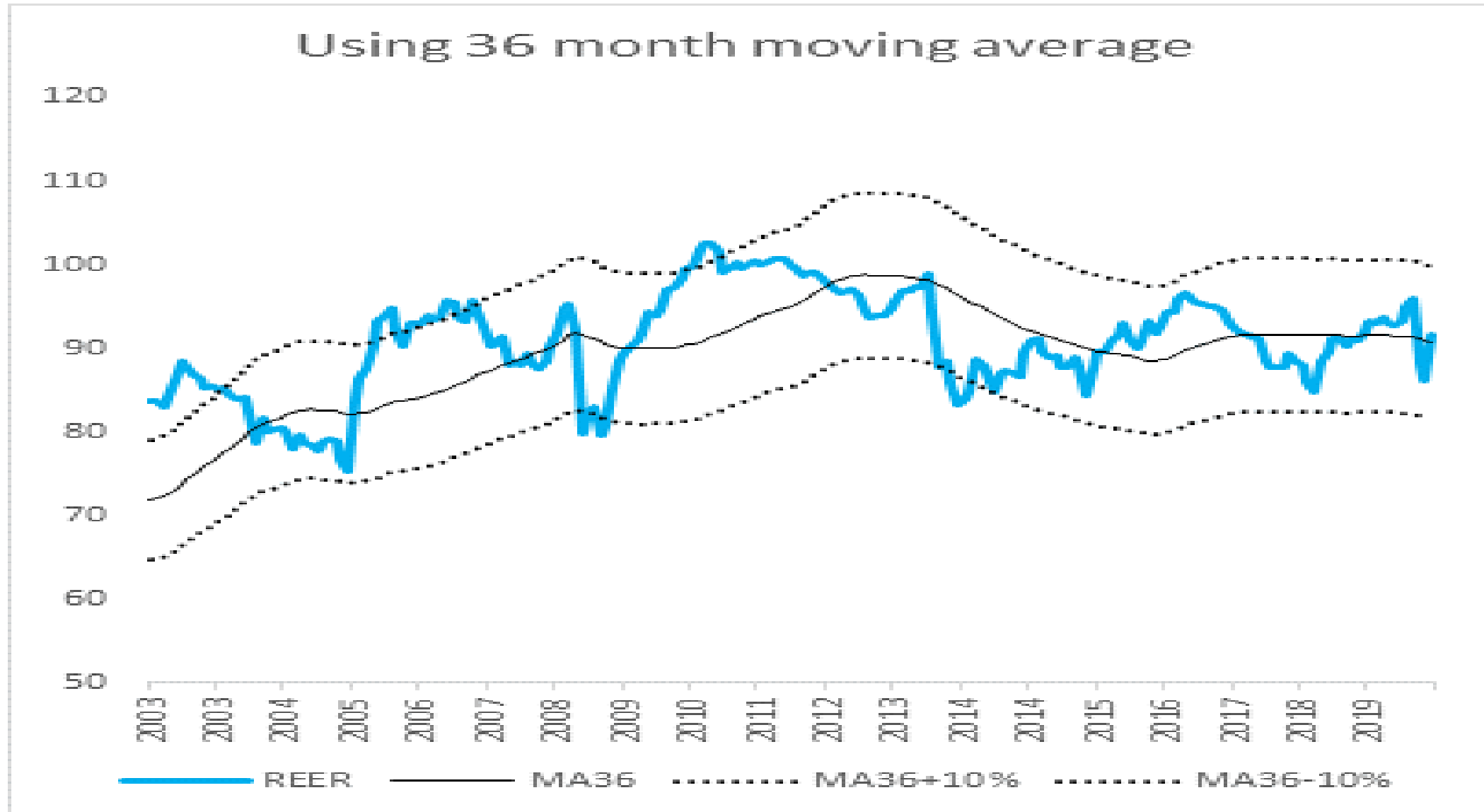
Hjalmar Schacht, Advice to the Indonesian Government , 1953.

Stabilising portfolio flows

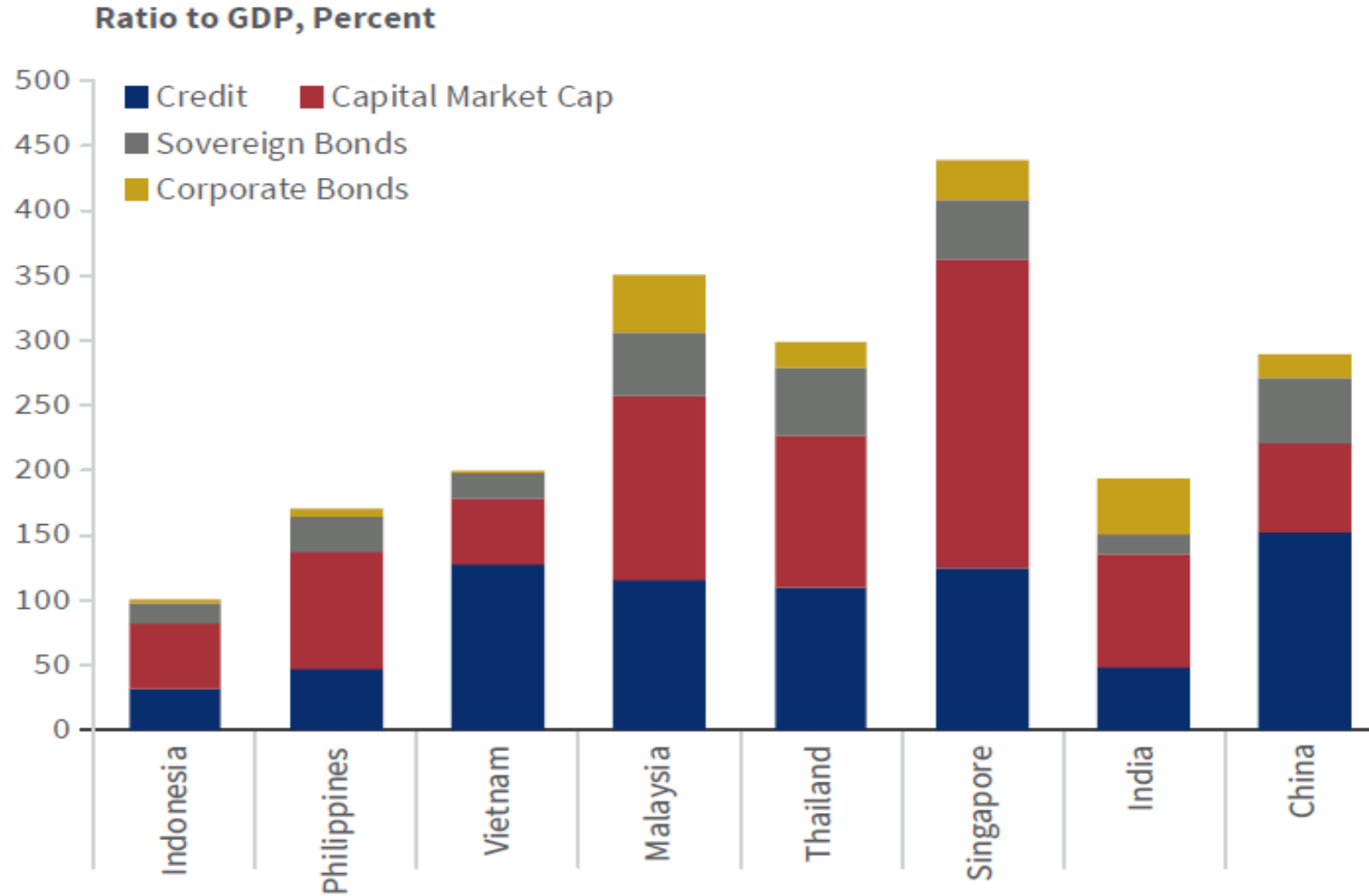
Bond markets: put a ceiling on yields, but don't intervene below the ceiling: 'yield-curve control'.

Foreign exchange markets: put a ceiling and floor on cyclical fluctuations, but don't intervene inside the band. ("BBC")

Band, basket, crawl



Develop the domestic bond market



Source: World Bank, Asian Development Bank

