“Central Bank Policy Mix in the Next Era: Coping with the Challenges of Digital Economy”

Solikin M. Juhro,
Executive Director, Head of Bank Indonesia Institute – Bank Indonesia

Opening Address at the International Workshop on Central Bank Policy Mix: Issues, Challenges and Policies, Jakarta, 9-13 April 2018

- Honourable Speakers: Dr. Stephan Danniger, Dr Natan Epstein, Rajan Govil and Yoke Wang Tok from IMF- STI; Dr Anand Prakash from Reserve Bank of India; Dr Devrim Yavuz from the Central Bank of the Republic of Turkey.
- Distinguished representatives of participating countries from Cambodia, Fiji, Nepal, Germany, Thailand, Timor Leste and Vietnam.
- Distinguished participants from the Ministry of Finance, Ministry of National Development Planning (BAPPENAS), Coordinating Ministry for Economic Affairs and Financial Services Authority (OJK).
- My colleagues from Bank Indonesia and all committee members/parties with whom we collaborated to hold this event.

Ladies and Gentlemen.

Assalaamu’alaikum Wr. Wb.,

Peace be upon us, Good Morning and Welcome to Jakarta ‘the capital city of the Republic of Indonesia’.

First, let us extend our praise to Allah, God Almighty, since only with His permission and blessings can we congregate here this morning to attend the international workshop on *Central Bank Policy Mix: Issues, Challenges and Policies*, Monday 9th April 2017, hosted by the Bank Indonesia Institute, in a very good collaboration with the Singapore Training Institute (STI) – IMF, Reserve Bank of India and the Central Bank of the Republic of Turkey (CBRT).

This workshop, spanning today and the subsequent two days, is international in scope and attended by participants from 8 countries (totalling 41 participants). The workshop aims to provide important and strategic matters concerning the new paradigm of central bank policy strategy, especially in the next era of digitalization.

It is an honour and a privilege to deliver my opening address on this auspicious occasion, providing a great opportunity to see and interact with so many representatives from central banks and other parties to share our views on post-GFC central bank policy strategy that may evolve alongside the exponential development of the digital economy.

Distinguished speakers and participants,

This workshop represents an integrated element of various programs organised internationally by the Bank Indonesia Institute. Since the beginning of this year, we have held several international events in the form of workshops, seminars and learning vehicles related to the core functions of the central bank, including monetary policy, financial system stability, and the payment system.

Of course, such events are necessary as tools to achieve our mission of creating national economic leaders by sharing central banking knowledge, as well as exchanging views and experiences amongst central bankers and other related parties around the world, as global economic uncertainties have heightened since the global financial crisis in 2008/09 (the GFC). Accordingly, the Bank Indonesia Institute has formulated an updated workshop, which may be the only one dedicated to central bankers as well as to other economic authorities and experts, and relates closely to central banking policy strategy.

Ladies and Gentlemen,

Referring to the evolution and reformation of central banks since their inception in the 17th Century until the aftermath of the GFC, a number of important lessons can be given (Warjiyo and Juhro, 2016).

- *Firstly,* the central bank plays a significant role in supporting sustainable economic growth through price (and exchange rate) stability, while creating and maintaining financial system stability. This dual mandate has existed since the formation of central banks and was tangibly reinforced by the GFC.

- *Secondly,* in pursuance of the dual mandate, the central bank requires jurisdiction over monetary policy (including foreign capital flow management), the payment system as well as macroprudential regulation and supervision. Experience in the Inflation Targeting Framework (ITF) era has shown that a focus on monetary policy by central banks contributed to financial instability that culminated in the GFC.
- *Thirdly,* central banks must be given autonomy to implement their authority in pursuit of the goals or mandate. Experience from a time when the government exercised control over the central bank demonstrated the adverse impact on macroeconomic stability, which ultimately resulted in economic crisis.
- *Fourthly,* institutional arrangements need to be strengthened to ensure that central bank independence is accompanied by public accountability and transparency.

Thus, recent crisis episodes have shown that monetary policy alone is insufficient to maintain macroeconomic stability. The GFC posed challenges for the monetary authority to pay closer attention not only to price stability but also financial system stability. This implies that, to achieve adequate preconditions, monetary policy should be accompanied by macroprudential policy and other policy measures, known as the "policy mix". This new kind of central bank policy strategy has, thus far, effectively mitigated the risks triggered by dynamics in the external and domestic financial sectors in order to maintain macroeconomic and financial stability (Juhro, 2015). The degree of effectiveness of this new kind of policy, however, depends on the central bank's ability to respond appropriately without neglecting domestic and external circumstances, such as domestic economic characteristics, the depth of financial markets, exchange rate and foreign-exchange regimes, global economic and financial development and the outlook.

Concerning the dynamic global environment nowadays, we remain hampered by a global economic period replete with onerous challenges, overshadowed by volatility, uncertainty, complexity and ambiguity (VUCA), which emerged from megatrends in terms of geopolitics, socio-economics, financial technology, (divergent) monetary policy as well as post-crisis regulatory reform and market structures (Sheng, 2016). Therefore, it is important for us to remain vigilant of global economic trends. Despite signs of improvement, the global economy, especially the advanced countries of Europe and US and also China, remains sluggish and fraught with fragilities.

During such uncertain times and with the flagging global economy, authorities are struggling to find appropriate ways to recover and achieve economic stability and a more sustainable path. Specifically, such unfavourable dynamics have elicited divergent responses by monetary authorities around the world through wider policies, combining conventional and unconventional measures.

This is not enough, however. Utilization of digital technology in the economy over the past few years continues to show significant progress. The emergence of financial technologies (fintech), e-commerce, virtual currencies, the mode of transportation based on online applications, the use of Artificial Intelligence (AI), and Big Data for data analysis are some of the evidences that digital technology increasingly crucial in the economy.

The phenomenon of digitisation is the biggest driver of innovation across businesses; one that is pervasive and knows no physical or territorial borders; one that has bolstered dramatic changes in all disciplines and sectors. Today, virtually all commerce is digital: e-commerce, cloud computing, online payment services, high-speed trading, app stores, online advertising, participative networked platforms. The importance of physical presence in the customer's market is decreasing, and that of intangibles is growing. It is safe to say that the digital economy is the economy itself, and that it cannot be isolated as a separate sector with its own set of rules.

In the era of digital economy there will be a lot of work taken over by technology, encouraging employment issues in various countries. In addition, all financial transactions will use technology bases provided by financial technology companies so it will potentially reduce the role of banks or other conventionally-operated financial companies. Artificial intelligence will integrate all existing systems in business services in the future. Another development is the increasing number of variations of the digital economy business model developed to encourage the creation of new type of businesses. All will lead to digitalization for all aspects of life including in business.

Distinguished speakers and participants,

These above fundamental shifts in the technological, macroeconomic, geopolitical, and competitive landscape suggest that waves of change pounding the financial sector may collectively represent more than just another cycle. From central bank perspectives, the rapid technological progress and new business models have resulted in many innovative products in retail payments. These innovations are also increasing the potential for major changes in the retail payment environment, including the decreased use of cash. Significant developments of digital or virtual currencies raise important questions for central banks, the financial system and the economy. In this regards, central banks should have a keen interest in monitoring developments in e-money, understanding their implications and establishing a view on the potential role of public institutions. Central banks should also examine their own role in light of these developments, including how effective their monetary policy transmission and whether to regulate digital currency or to develop their own digital currency.

This requires transformative shifts, including a change of mindset, a measure of interconnected behaviour and integrated policy formulation beyond standard central bank policy wisdom. Again, per the “policy mix” framework, coordinated implementation of various policy instruments is ultimately part of an important strategy to manage the monetary policy trilemma in the current climate blighted by ubiquitous uncertainty. Coordination is thus critical, not only to unwind sources of external and internal imbalances, but also to optimally manage the impact of monetary policy, while avoiding overkill and mutual exclusivity. Within that policy perspective, the achievement of macroeconomic stability is not only tied to monetary stability (price stability) but also to financial system stability.

It is now almost a decade since the eruption of the global financial crisis of 2008/09. Despite the challenges, much progress has been made to forge a vision for a stronger post-crisis central bank policy strategy. While having to strike a balance between pursuing stability and fostering growth momentum, amid the potential costs to financial intermediation, efforts have been made through the global financial reforms towards more sustainable economic development.

Ladies and Gentlemen,

Last point that I would like to point out, that, as technological change is an integral driver of economic development, central banks are well advised to be prudent and forward-looking when approaching the respective challenges – just as they are when implementing monetary and macroprudential policy to honour their mandates. Yves Mersch – member of the Executive Board of ECB -- (2107) said that in facing the uncertainties of technological change, central banks therefore should: (i) adapt policies to take into account technology-driven socio-economic changes,(ii) adopt appropriate technology that supports the various functions and tasks of a central banks, and (iii) anticipate technological risks to our operations. With these principles in mind, central banks can better manage the challenges stemming from technological change, even when it is disruptive.

Still in the same spirit, Bank Indonesia acknowledges various economic and financial potential of digital economy, such as efficiency and increased productivity. However, inclusive economic and finance require enhanced consumer protection and a stable financial system. To that end, Bank Indonesia has and will continue to review various opportunities and risks related to the digital economy. This is very important, given the development of technology that causes the use of the digital economy becomes inevitable.

In order to support the pace of technological innovation and penetration in the payment system, Bank Indonesia responds with a policy that is expected to make the innovation sustainable in prudential corridors. To that end, Bank Indonesia issued the policy of Bank Indonesia Regulation (PBI) No 18/40 / PBI / 2016 on the Implementation of Payment Transaction Processing, aimed at paying attention to innovation, security improvement, and consumer protection. The position of Bank Indonesia in Fintech's policies and arrangements lies in the authority relating to the stability of the financial system, payment systems, monetary, deepening financial markets, cyber security and consumer protection. Bank Indonesia has enforced the regulatory sandbox function for the digital economy since November 2016, along with the opening of Fintech

Office, which has several sections that serve as a facilitator for innovative ideas and Fintech development in Indonesia, then become business intelligence which is a forum to provide updates through dissemination of study results from related institutions.

Along with these advances, Bank Indonesia as the payment system authority always put forward the aspects of security and consumer protection as well as a healthy business climate to create a financial technology industry that is able to support the national economy. This is done, among others, by arranging and supervising the Service System Provider. Bank Indonesia shall conduct inspections and supervisory measures deemed necessary to ensure the preservation of consumer protection and the security of the Payment System of Indonesia.

Distinguished speakers and participants,

This workshop covers the conceptual dimensions of the central bank policy mix, including the integration of price stability and financial system stability, the mix of policy instruments used, as well as the transmission mechanisms. A special session will explore the policy mix instituted by Bank Indonesia as a new paradigm initiated in 2010, encompassing the targets and instruments, formulation of the interest rate, exchange rate and macroprudential policy along with foreign capital flow management as well as strengthening institutional arrangements and coordination with the Government and other relevant authorities.

Learning from others is the reason we need this workshop as a tool to exchange views and experiences amongst central bankers and other related parties around the world. Today and for the next couple days, we are going to learn the salient and updated materials from prominent speakers from the IMF, Central Bank of the Republic of Turkey, and also from Bank Indonesia. In the process, you, the participants, will be divided into several groups to work on a case study and prepare presentations on what has been learnt from this workshop facilitated by our colleagues from Bank Indonesia.

I sincerely hope this workshop yields the best results for all of us. I also wish you well in your discussions and presentations during the third day. To conclude the learning process of this flagship program, the participants are also expected to join an international seminar on the central bank current challenges and policy strategies in navigating digital economy, where we will learn pivotal issues from prominent resource speaker SEACEN, Central Bank of Philipines as well as our local expert.

Before I conclude my remarks, let me (on behalf of Bank Indonesia) express my appreciation to STI-IMF and CBRT for their avowed support and collaboration, as well as for delivering a successful event. Thanks also to all participants for attending this workshop.

Finally, I would like to say: "Enjoy a fruitful workshop and I expect an interesting and beneficial few days. Have a pleasant stay in Jakarta!"

Without further ado, allow me to declare this special event officially open.

Thank you very much.

Wassalamu'alaikum Wr. Wb.

Main References

Bank Indonesia, several press releses and publications.

Juhro, Solikin M. (2015), The Role of Central Bank in Promoting Sustainable Growth: Perspectives on The Implementation of Flexible ITF in Indonesia, *Afro Eurasian Studies Journal*, Volume 4, Issue 1, Spring.

Mersch, Yves (2017), Central banking in times of technological progress, speech at the Bank Negara Malaysia Monetary Policy Conference, Kuala Lumpur, July.

Warjiyo, Perry and Solikin M. Juhro (2016), *The Central Banking Policy: Theory and Practice*, Rajawali Grafindo, October.

Sheng, Andrew (2016), "The Global Economy under VUCA: How should central banks respond?", Inaugural Bank Indonesia Institute Lecture, Jakarta, 22 August.