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Monetary Policy and Central Banking in the Covid Era

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Bank Indonesia's response to Covid-19: Synergise to build optimism for economic recovery

Perry Warjiyo
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EXTRAORDINARY MEASURES FOR AN EXTRAORDINARY CRISIS

In early 2020, Indonesia's economy was fuelled by optimism for stronger and more resilient economic growth. Several indicators pointed towards increased confidence in economic agents. Domestic demand as well as export and import activities were picking up and showing an encouraging development for the economy going forward. This development was also followed by higher foreign capital inflows to the domestic financial market, which encouraged the strengthening of the rupiah exchange rate.

However, optimism for the strengthening of Indonesia's economic growth started to fade when Covid-19 began to spread at the end of January 2020. The rapid worldwide spread of Covid-19 contributed to a decline in demand for Indonesian export products, in line with falling global demand and the disruption of global supply chains. It also triggered uncertainty in global financial markets and prompted an adjustment of investment to safe-haven assets. This put pressure on many world currencies, especially in developing countries, including Indonesia. Adjustments to foreign capital inflows on the domestic financial market from February 2020 depressed the rupiah exchange rate and were followed by increased volatility, causing the rupiah to depreciate to Rp16,575 against the US dollar on 23 March 2020, a depreciation of 16.24% (point-to-point) compared to the position at the end of 2019.

To mitigate the spread of Covid-19 in Indonesia, the government immediately implemented a number of policies, including on restricting mobility. The implementation of a large-scale social restriction policy (*Pembatasan Sosial Berskala Besar*, or PSBB) from April 2020 significantly reduced individual mobility. PSBB included restrictions on school activities (school from home) and office activities (work from home), the closure of public facilities including places of recreation and worship, restrictions on the operating of public transport, and restrictions on mobility between countries. This policy drastically reduced domestic economic activity, which resulted in a significant reduction in household consumption and investment activity. Indonesia's export performance also deteriorated due to the global economic slowdown. These unfavourable developments put the Indonesian economy under pressure, particularly during the first half of 2020. Indonesia's economic growth fell to 2.97% (year-on-year) in the first quarter of 2020 and posted a contraction of -5.32% (year-on-year) in the second quarter.

The government, Bank Indonesia, and related authorities considered that the multidimensional and complex impact of Covid-19 would lead to a significant and rapid deterioration of health, social, and economic conditions. To prevent this, BI and related authorities saw the need for extraordinary policy responses that were immediate, massive, and pre-emptive – not only in terms of health and social aspects, but also economic aspects. From an economic perspective, the extraordinary policy responses were primarily directed at providing massive fiscal and monetary stimulus to the domestic economy in order to avoid a crisis, ensure economic recovery, and maintain macroeconomic and financial system stability.

A new law was established to support these extraordinary measures. As a pre-emptive, quick and extraordinary step to respond to the outbreak of the Covid-19 pandemic in Indonesia, as highlighted above, on 31 March 2020 the government issued Government Regulation in Lieu of Law (*Peraturan Pemerintah Pengganti Undang-undang*, or PERPPU) No.1 of 2020 concerning "State Financial Policy and Financial System Stability for Handling the Covid-19 Pandemic and/or in the context of Facing Threats that endanger the National Economy and/or Financial System Stability". This PERPPU was later stipulated as Law (*Undang-undang*, or UU) No. 2 of 2020 on 16 May 2020, and was followed by the issuance of other supporting regulations to address the urgency of the Covid-19 pandemic, while continuing to prioritise the principles of prudence in the implementation of good governance, as well as transparency and accountability.

SYNERGISE TO BUILD OPTIMISM FOR ECONOMIC RECOVERY

Given the rapid, complexity, and multidimensional impact of Covid-19, the government and related authorities needed to synergise policies and not rely merely on one particular policy. For this reason, the government, Bank Indonesia, the Financial Services Authority (*Otoritas Jasa Keuangan*, or OJK), and the Deposit Insurance Corporation (*Lembaga Penjamin Simpanan*, or LPS), under the Financial System Stability Committee (*Komite Stabilitas Sistem Keuangan*, or KSSK), made a strong commitment to synergise supporting policies to mitigate the impact of the pandemic in Indonesia, as mandated in Law No. 2 of 2020. This law provided a strong legal foundation to take quick and accountable anticipatory measures to deal with the pandemic, so that the government, Bank Indonesia, OJK, and LPS could immediately take the necessary extraordinary measures. In this regard, Law No. 2 of 2020 gave the government the authority to undertake an expansionary fiscal policy by providing large amounts of stimulus to prevent a worsening in economic activity and to maintain financial system stability. This expansionary fiscal policy widened the fiscal deficit and raised the fiscal financing need for the 2020 State Budget. In terms of financing the fiscal deficit, Bank

Indonesia was given the authority to purchase long-term government securities (Surat Berharga Negara, or SBN) on the primary market. OJK was given authority related to mergers, consolidations, acquisitions, integration and conversion of financial service institutions. Meanwhile, LPS was given authority to strengthen its role in managing bank solvency, making decisions to save non-systemic banks, raising funds for handling failed banks, and formulating deposit insurance policies to support financial system stability.

ACCOMMODATIVE FISCAL POLICY: MASSIVE STIMULUS TO SUSTAIN THE ECONOMY

Throughout 2020, the government pursued an expansionary fiscal policy in order to overcome the impact of the pandemic – both the health and humanity aspects and the deteriorating economy. At the start of the pandemic, the government issued a stimulus for tax incentives, spending, as well as social assistance and food security. Law No. 2 of 2020 provided the legal basis for the government to pursue an expansionary fiscal policy, which allowed the fiscal deficit to exceed the limit of 3% of GDP until 2022. With this mandate, in 2020 the government issued two regulations to widen the deficit of 2020 State Budget. The first was through Presidential Decree No. 54 of 2020, dated 3 April 2020. This was later revised by Presidential Decree No. 72 of 2020, dated 25 June 2020, allowing the fiscal deficit to widen to 6.34% of GDP. With this widening of the fiscal deficit, government spending rose to Rp2,739.2 trillion (US$187.97 billion) due to additional spending on the National Economic Recovery (*Pemulihan Ekonomi Nasional*, or PEN) programme, for spending on both public goods and non-public goods, totalling Rp695.2 trillion ($47.71 billion), or 4.2% of GDP. The government continued to expand and made some adjustments to the PEN programme to make its implementation better and easier to execute, so as to effectively support economic recovery.

TABLE 1 POSTURE CHANGES AND 2020 STATE BUDGET REALISATION

	UU No.20/2019	Perpres No.54/2020	Perpres No.54/2020	Temporary realisation*
Government revenues	Rp2,232.2 trn	Rp1,760.9 trn	Rp1,699.9 trn	Rp1,633.6 trn
Government expenditures	Rp2,540.4 trn	Rp2,613.8 trn	Rp2,739.2 trn	Rp2,589.9 trn
Budget deficit	Rp307.2 trn	Rp852.9 trn	Rp 1,039.2 trn	Rp956.3 trn
Budget deficit (% GDP)	1.76%	5.07%	6.34%	6.09%
Financing from loans	Rp741.8 trn	Rp1,439.8 trn	Rp1,645,3 trn	

Note: * Press Conference 2020 State Budget Realization on 6 January 2021

Source: Ministry of Finance

The widening of the fiscal deficit raised the need for additional financing of the 2020 State Budget, which, among others, was met by Bank Indonesia as mandated by Law No. 2 of 2020. The contribution of Bank Indonesia to financing the fiscal deficit showed the strong coordination between fiscal and monetary policies in mitigating the impact of the Covid-19 pandemic in Indonesia. In this regard, the government was given the authority to issue SBN with a specific purpose related to the Covid-19 pandemic. Meanwhile, Bank Indonesia's authority was enhanced, enabling it to purchase long-term SBN – both on the primary market and through private placement – to support the financing of the stimulus.

THE CENTRAL BANK'S CONTRIBUTION: FINANCING THE DEFICIT

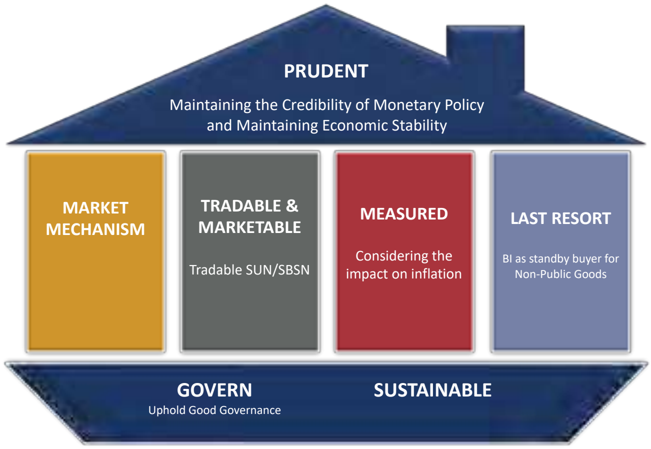
Bank Indonesia's commitment to funding and burden sharing in the 2020 State Budget was carried out while adhering to the principle of prudence in order to maintain economic stability, including its impact on inflation. The implementation of funding and burden sharing was carried out with due regard to the credibility and integrity of economic, fiscal and monetary management, as well as the financial sustainability of Bank Indonesia and the government, so as to promote sustainable economic growth. The scheme and mechanism for coordinating the purchase of SUN/SBSN was carried out through two Joint Decrees (*Keputusan Bersama*, or KB) between the Minister of Finance and the Governor of Bank Indonesia, the first dated 16 April 2020 (KB I) and the second dated 7 July 2020 (KB II), with the following details:

- In KB I, Bank Indonesia purchased long-term SUN/SBSN on the primary market, and Bank Indonesia also acted as the standby buyer in case the the issuance of SUN/SBSN could not be absorbed in the primary market. The role of Bank Indonesia in financing the fiscal deficit was carried out with prudence and adhering to four main principles: (i) market mechanisms were prioritised; (ii) the impact on inflation was considered; (iii) SUN/SBSN purchased were tradable and marketable; and (iv) Bank Indonesia was the last resort. KB I also stipulated that the issuance of SUN/SBSN by the government was carried out after prioritising other sources of financing, and also by taking into account the sustainability of the State Budget. Purchases of SUN/SBSN by Bank Indonesia were conducted based on sequence of priority: (i) an SUN/SBSN auction by submitting a non-competitive bid; (ii) a 'greenshoe' option if the SBN target is not met through an auction; and (iii) private placement in the event that the SBN target is not fulfilled through auctions and additional auction (the greenshoe option).

- In KB II, Bank Indonesia purchased SUN/SBSN directly through private placement for financing expenditure on public goods in the 2020 State Budget, amounting to Rp397.56 trillion ($27.28 billion). Public goods spending was related to health, social protection, and sectoral ministries/agencies and local governments, where Bank Indonesia bore all the costs of issuing the SBN. In addition, for the issuance of

SBN for funding non-public goods expenditures in the 2020 State Budget related to MSMEs and corporations, Bank Indonesia also contributed Rp177.03 trillion ($12.15 billion) towards burden sharing with the government.

FIGURE 1 PRINCIPLES OF FUNDING AND BURDEN SHARING



Large amounts of funding and burden sharing by Bank Indonesia for the 2020 State Budget provided assurance on the source of fiscal deficit financing, allowing the government to focus on accelerating the realisation of the budget for the national economic recovery. Under the KB I scheme, in 2020 Bank Indonesia purchased long-term SBN from the primary market through the market mechanism amounting to Rp75.85 trillion ($5.21 billion), consisting of Rp33.78 trillion in SBSN and Rp42.07 trillion in SUN. Meanwhile, the burden-sharing scheme funding for public goods by Bank Indonesia under KB II reached Rp397.56 trillion ($27.28 billion) by the end of 2020. The overall purchase of SBN by Bank Indonesia for funding and burden sharing of the 2020 State Budget in support of the economic recovery programme has reached Rp473.42 trillion ($32.49 billion). In addition, in the burden-sharing scheme for non-public goods, specifically for MSMEs, Bank Indonesia's contribution was Rp114.81 trillion ($7.88 billion) and for non-public goods for corporations it was Rp62.22 trillion ($4.27 billion). Bank Indonesia will continue to purchase SBN on the primary market in 2021 to support financing for the 2021 State Budget based on KB I, which was extended on 11 December 2020. The funding and burden-sharing scheme under KB II was implemented in 2020 only (as a one-off policy).

In addition to supporting government deficit financing, according to Law No.2 of 2020, Bank Indonesia can buy/repurchase securities owned by LPS to manage solvency problems in systemic and non-systemic banks. Bank Indonesia can also provide short-term liquidity loans or short-term liquidity financing based on *sharia* principles to systemic or non-systemic banks. In addition, Bank Indonesia has the authority to regulate the mandatory reception and usage of foreign exchange proceeds from exports by residents, including regulation regarding the transfer, repatriation and conversion of foreign exchange proceeds from exports by residents, in order to maintain macroeconomic and financial system stability. This measure is not intended as an effort to control foreign exchange movement, but rather as management of foreign exchange that only applies to residents (it does not apply to non-residents/foreign investors). Thus, external support for financing, both in the form of portfolio investment and foreign direct investment (FDI), is expected to remain supportive. Bank Indonesia can also provide access to funding for corporations/private companies by means of repurchase of SUN/SBSN owned by corporations/private companies through banking.

To strengthen financial system stability, OJK and LPS have also taken various policies in accordance with the mandate of Law No.2 of 2020. OJK has issued various forward-looking and countercyclical policies for banks, capital markets and non-bank financial institutions to mitigate the burden of the Covid-19 pandemic on the performance of the financial sector, which could eventually compromise the soundness of national economy and severely affect people's welfare. Policies have also been implemented to support the government's policy to accelerate national economic recovery, such as restructuring MSME and corporate loans. Regulation on relaxation of banking relating to credit restructuring was issued in the form of postponing principal and interest payments, to prevent the negative impact of increasing non-performing loans and weakening capital. Meanwhile, in addition to the policy of lowering the interest rate in its Deposit Guarantee Program, LPS also relaxed the penalty for late payment of premiums in order to reduce liquidity pressures and mitigate the impact of the worsening stability of the financial system amid the pandemic. In order to support the national economic recovery programme, LPS also prioritised the repayment of government funds placed in participating banks in the form of deposits.

BANK INDONESIA POLICY MIX

Bank Indonesia strengthened the policy mix to ensure economic stability and support recovery of the national economy, which was significantly affected by Covid-19 pandemic. Bank Indonesia's policy response was pursued through an accommodative monetary policy, the relaxation of macroprudential policies, and the strengthening of payment system policies to accelerate the digital economy and finance. Bank Indonesia continues to encourage synergy and coordination with related authorities, as well as various other supporting policies.

1. **Monetary policy**. Amid plummeting economic activity and rising uncertainty, necessary measures should be taken to prevent further economic deterioration, maintain exchange rate stability, and ensure the well-functioning of the financial system. Considering that inflationary pressure will remain benign, Bank Indonesia had opted to undertake a relaxation of monetary policy, in terms of both interest rates and liquidity, as well as strengthening the stabilisation of the rupiah.

First, **Bank Indonesia lowered the BI seven-day reverse repo rate (BI7DRR) policy rate**. BI7DRR was lowered five times in 2020, by 125 basis points in total, to 3.75% by the end of the year. This figure is the lowest in history. This interest rate reduction was carried out in a measured and gradual manner, taking into account inflation and the attractiveness of domestic financial assets, as well as external stability.

Second, **Bank Indonesia provided monetary stimulus through quantitative easing (QE).** As of 30 December 2020, Bank Indonesia had injected liquidity through QE amounting to Rp726.57 trillion ($49.86 billion), or around 4.7% of GDP. This is one of the largest amounts among developing countries, which have averaged around 1.7% GDP. This liquidity injection mainly came from a reduction in the reserve requirement (*Giro Wajib Minimum*, or GWM), with a value of around Rp155 trillion ($10.64 billion), and from monetary expansion from open market operations, with a value of around Rp555.77 trillion ($38.14 billion). In relation to the GWM policy,, Bank Indonesia reduced the GWM by 300 basis points in 2020, including relaxation of the GMW by 50 basis points as an incentive to banks that extend credit to MSMEs and export–import activities. The central bank also lowered the reserve requirement for foreign currency by 400 basis points in order to boost foreign exchange liquidity in the banking sector and to ease pressure on the foreign exchange market. Bank Indonesia also relaxed regulation on the macroprudential intermediation ratio (MIR) by removing the penalty for banks that do not comply with the regulation, resulting in additional liquidity to banks of around Rp15.8 trillion ($1.08 billion). In the second half of 2020, Bank Indonesia also paid interest of 1.5% per annum to banks that met the reserve requirement in rupiah, both on a daily and average basis.

Third, **Bank Indonesia stabilised the rupiah to keep it in line with fundamentals of the economy and market mechanisms**. This was aimed at maintaining the confidence of economic agents so that adjustments in the economy might take place without compromising macroeconomic and financial stability. Efforts to stabilise the rupiah were carried out through a triple intervention: interventions on the spot market, in domestic non-deliverable forwards (DNDFs), and in purchases of government securities (SBN) from the secondary market. The stabilisation of the rupiah was also supported by the adequacy of foreign reserves. To ensure this, Bank Indonesia has engaged with other authorities through bilateral swap cooperation (with China, Japan, Singapore, and Malaysia) and added repo line cooperation with several central banks and international institutions, including the Federal Reserve Bank of New York and the Bank for International Settlements (BIS). In the longer perspective, efforts to stabilise the rupiah have been carried out through the implementation of local currency settlements (LCSs) with a number of trade and investment partner countries order to reduce dependency on hard currencies. LCS cooperation through the Appointed Cross Currency Dealer (ACCD) scheme was carried out with Japan, Malaysia, Thailand, and China; LCS cooperation through the Bilateral Currency Swap Agreement (BCSA) scheme was carried out with China, South Korea, and Australia.

Fourth, **Bank Indonesia also strengthened its monetary operation strategy to maintain liquidity and enhance efficiency in the money market, with two-sided monetary operations: liquidity absorption and liquidity injection**. This was done by increasing the frequency of DNDF auctions (since 2 January 2020), repo auctions of up to 12-month tenor, and daily auctions (since 20 March 2020). Bank Indonesia also increased the frequency of FX swap auctions to daily (since 19 March 2020). In addition, Bank Indonesia strengthened the instrument for term deposits in foreign currency to improve liquidity management on the domestic foreign exchange market, and encouraged banks to use the liquidity from the reduction in GWM for domestic needs. Bank Indonesia strengthened monetary operations and deepened the Islamic financial market through the implementation of the Sharia Principles-Based Liquidity Facility (*Fasilitas Likuiditas Berdasarkan Prinsip Syariah*, or FLiSBI) and Sharia-based Liquidity Management (*Pengelolaan Likuiditas Berdasarkan Prinsip Syariah*, or PaSBI) (since 5 October 2020).

These policies have contributed to promoting the recovery of the national economy and also to maintaining stability in the financial system.

2. **Macroprudential policy**. Bank Indonesia continued to carry out accommodative macroprudential policies, especially to mitigate the widespread impact of the Covid-19 pandemic on the financial system and to support national economic recovery. Taking into account the stability of the financial system and also the financial cycle that is still below its long-term equilibrium, Bank Indonesia had pursued a number of macroprudential policies as follows:

   First, **Bank Indonesia relaxed its macroprudential policy by easing the macroprudential intermediation ratio** (*Rasio Intermediasi Makroprudensial*, or RIM/RIM Sharia – i.e. the ratio between financing and banking funding). The central bank did this by not imposing penalties on banks that have a RIM/RIM Sharia outside the target range of 84–94% (since 1 May 2020 and valid for one year). This was done considering the still limited demand for credit.

   Second, to ensure good quality and adequate bank liquidity, **Bank Indonesia made adjustments to the macroprudential liquidity buffer** (*Penyangga Likuiditas Makroprudensial*, or PLM/Sharia PLM) policy, which was carried out in conjunction with the policy to reduce the reserve requirement by 200 basis points. The PLM ratio – i.e. the ratio of liquid assets as a liquidity buffer in the form of SBN and SBI – was raised by 200 basis points for conventional commercial banks (*Bank Umum Konvensional*, or BUK) and 50 basis points for Sharia commercial banks/business units (*Bank Umum Syariah*, or BUS/Unit

Usaha Syariah, or UUS). The PLM ratio was strengthened from 4% to 6% against rupiah deposits for BUK, and to 4.5% against rupiah deposits for Islamic banks. This increase in the PLM was fulfilled through the purchase of SUN/SBSN issued by the government in the primary market. All portions of PLM can be used to underly repo transactions with Bank Indonesia.

Third, **Bank Indonesia maintained the countercyclical capital buffer (CCB) at around 0% to encourage credit growth**.

Fourth, **Bank Indonesia lowered the minimum downpayment limit for environmentally friendly motor vehicle loans** (*Kredit Kendaraan Bermotor*, or KB) from 5–10% to 0% (effective 1 October 2020) to support the acceleration of the government's battery-based electric motor vehicle programme (*Kendaraan Bermotor Listrik Berbasis Baterai*, or KBL BB).

We believe that the relaxation of our macroprudential policies will provide flexibility for banks in accelerating credit to support recovery of domestic economic growth while maintaining financial stability.

3. **Payment system policy** (*Sistem Pembayaran*, or SP). Bank Indonesia views the impact of the Covid-19 pandemic as part of the momentum to further accelerate the digitalisation of the payment system. To that end, **Bank Indonesia has accelerated the digitalisation of the payment system based on the 2025 Indonesian Payment System Blueprint** (*Blueprint Sistem Pembayaran Indonesia*, or BSPI) **to expand the digital economy and finance as part of economic recovery efforts and to strengthen the structural foundation for the Indonesian economy.**[1] The five main initiatives in BSPI 2025 are (i) open banking; (ii) the retail payment system; (iii) financial market infrastructure; (iv) data; and (v) regulatory, licensing and supervisory reforms.

   In addition, since Covid-19 first began to spread, Bank Indonesia has responded by relaxing various payment system policies.

   First, **Bank Indonesia lowered the ceiling for fees for fund transfers through the Bank Indonesia National Clearing System** (SKNBI) to encourage greater use and efficiency of non-cash transactions during the pandemic.

1 The Indonesia Payment Systems Blueprint (BSPI) 2025 presents the orientation of policy at Bank Indonesia in order to navigate the payment system industry in the era of the digital economy and finance. The Blueprint contains five payment system visions towards 2025 for implementation by five working groups: Open Banking; Retail Payment System; Large-Value (Wholesale) Payment System and Financial Market Infrastructure; Data and Digitalisation; and Regulatory, Licensing and Supervisory Reforms. BSPI 2025 will be realised through 23 key deliverables implemented in stages from 2019 to 2025. Details can be accessed at www.bi.go.id/en/fungsi-utama/sistem-pembayaran/blueprint-2025/default.aspx.

Second, in addition to the relaxation of credit card policies in the form of lowering the maximum interest rate limit, minimum payments, and late payment fines, **Bank Indonesia also eased the requirements in a package of credit card regulations**, including support for credit card issuers in lengthening repayment periods during the pandemic period.

Third, **Bank Indonesia continued to strive to support the expansion of digitisation by lowering the merchant discount rate (MDR) of the Quick Response Code Indonesia Standard** (QRIS). QRIS MDR was cut to 0% for merchants in the micro-business category.[2] This policy is aimed at promoting the digitalisation of MSMEs in line with the "Proud of Indonesian-made Products" movement (*Gerakan Nasional Bangga Buatan Indonesia*, or Gernas BBI).

Fourth, to improve cost efficiency and the tariff structure and to stimulate economic activity, **Bank Indonesia lowered the Bank Indonesia Real Time Gross Settlement (BI-RTGS) service fees**, starting from 1 December 2020.

Fifth, **Bank Indonesia continued to provide support to government programmes,** including through the electronification of non-cash social assistance payments. **Bank Indonesia also encouraged the electronification of regional government financial transactions,** which is also an effort to strengthen the governance of regional government budgets.

In 2020, in addition to pursuing a policy mix to mitigate the negative impact of the Covid-19 pandemic on the national economy, Bank Indonesia also moved forward with a reform agenda, including reform of the money market. In 2020, Bank Indonesia issued the Money Market Development Blueprint (BPPU) 2025 in an effort to accelerate the creation of a liquid, efficient, and deep financial market. The aims were to support monetary and financial system stability and to accelerate national economic development. BPPU 2025 is being implemented by encouraging the digitisation and strengthening of financial market infrastructure, strengthening the effectiveness of monetary policy, and developing sources of economic financing and risk management. Implementation of BPPU 2025 is supported by strengthening synergies between Bank Indonesia and the relevant authorities and players in the financial industry.

4. **Coordination between Bank Indonesia and the government**. Bank Indonesia consistently maintains and improves synergies and coordination with the government and other relevant authorities in maintaining economic stability and promoting economic recovery. Under the Financial System Stability Committee, which consists of Bank Indonesia, the Ministry of Finance, OJK, and LPS,

2 The Quick Response Code Indonesian Standard (QRIS) is the unification of various kinds of QR from various payment system service providers (*Penyelenggara Jasa Sistem Pembayaran*, or PJSP) using QR codes. QRIS was developed by the payment system industry together with Bank Indonesia so that the QR code transaction process would be easier, faster, and more secure.

coordination was primarily directed towards policies related to crisis prevention and resolution. Coordination was also conducted to promote economic recovery through various strategic steps, one of which is to synergise policies in fiscal, monetary, payment system, macroprudential, and deposit insurance areas, as well as other key areas.

In addition, to manage the positive perceptions of international stakeholders regarding the Indonesian economy, Bank Indonesia and the government have continued to work together in conducting more intensive communication with global investors and rating agencies to convey the authorities' policy responses to mitigate the impact of Covid-19 on the Indonesian economy, especially early on in the pandemic when uncertainty was at its highest. During that difficult time, to boost the confidence of stakeholders, communication by Bank Indonesia to the public was conducted more intensively and was delivered through a one-stop policy, directly by the Governor, using various communication channels. This strategy has succeeded in maintaining Indonesia's sovereign credit rating (SCR) with various major rating agencies at investment-grade level, amidst a decline in SCRs of other emerging market economies.

A series of coordination steps, as well as policy synergy between Bank Indonesia and related authorities, have been able to maintain Indonesia's economic resilience amidst the uncertainty and risk of crisis due to the Covid-19 pandemic. Going forward, Bank Indonesia will continue to strengthen coordination and synergies to accelerate national economic recovery towards strong, sustainable, balanced, and inclusive economic growth.

RECOVERY PROCESS IN PROGRESS

The synergy of policies pursued by the government, Bank Indonesia, and related authorities encouraged an improvement in the domestic economy in the second semester of 2020. Pressure on the economy gradually eased in the second semester. Economic growth began to improve in line with the easing of the PSBB, the impact of the greater realisation of fiscal stimulus, and the improvement in the global economy. Rupiah stabilisation measures undertaken by Bank Indonesia reduced pressure on the currency, which strengthened in the second semester of 2020 in line with increasing foreign capital inflows. Indonesia's balance of payments in the second semester also recorded a higher surplus than in the first semester of 2020. After previously falling to $121 billion in March 2020, foreign exchange reserves picked up to $135.9 billion at the end of 2020, equivalent to the financing of 9.8 months of imports and government foreign debt, which is above the international adequacy standard of around three months of imports. In line with weak domestic demand, the Consumer Price Index (CPI) inflation in 2020 was recorded at 1.68% (year-on-year), below the 3.0% ± 1% target and the lowest inflation level in the last 20 years.

Financial system stability continued to improve in line with the positive impact of easing macroeconomic policies and reduced uncertainty in global financial markets. The transmission of monetary easing continued, reflected in declining interest rates and a higher volume of interbank transactions. Cash and non-cash payment transactions also improved in the second semester as economic activity began to recover.

All of the positive developments in the national economy in the second semester of 2020 are inseparable from the successful synergy of policies pursued by the government, Bank Indonesia, and related authorities, which are supported by a strong legal foundation. Policy synergy has been the key to overcoming the impact of Covid-19 and supporting economic recovery.

OUTLOOK AND POLICY DIRECTION

The Indonesian economy is predicted to continue improving in 2021, supported by progress in the handling of Covid-19 (including vaccinations), global economic recovery, as well as stimulus and policy strengthening. Some early indicators by the end of December 2020 pointed towards optimism for global economic recovery, which was supported by increased mobility and policy stimulus in various countries. The speed of recovery will be heavily influenced by vaccination rollouts and public discipline in implementing Covid-19 protocols, which is a prerequisite for national economic recovery.

Going forward, strengthening policy synergy will continue to be pursued to build optimism for a better economic recovery. The prospect of domestic economic recovery is also supported by five policies: (i) the opening up productive and safe sectors nationally and in respective regions; (ii) the accelerated realisation of fiscal stimulus; (iii) increasing bank credit from the demand and supply side; (iv) continued monetary and macroprudential stimulus; and (v) accelerating economic and financial digitalisation, particularly related to the development of MSMEs. Bank Indonesia estimates that Indonesia's economic growth in 2021 will increase in the range of 4.3–5.3%, while inflation rate will be kept within the target of 3% ± 1% and the current account deficit will also be maintained at 1.0–2.0% of GDP.

In the medium term, the Indonesian economy is predicted to bounce back to an upward trajectory, bolstered by the improvement in the world economy and strengthening synergies in policy and structural reforms. The global economic outlook is predicted to improve further, in line with easing pressure from Covid-19 and the positive impact of policy stimuli in many countries. Global economic prospects will support the improvement of Indonesia's exports, which in turn will raise production, investment and consumption activities. Under these conditions, domestic economic growth is predicted to be in the range of 5.5–6.1% by 2025.

ABOUT THE AUTHOR

Dr. Perry Warjiyo was born in Sukoharjo, Indonesia in 1959. He received a bachelor degree in Accounting in 1982 from Gadjah Mada University, a master degree in 1989 and PhD degree in 1991 both in Monetary and International Finance from Iowa State University.

Dr. Perry has officially served as the Governor of Bank Indonesia since May 24th, 2018. Before serving as the Governor of Bank Indonesia, he was the Deputy Governor of Bank Indonesia from 2013-2018 for monetary policy, international policy, sharia economics and finance, and financial market deepening. Prior to this position, Dr. Perry served as the Assistant Governor for monetary, macroprudential, and international policy, the post he had held after the Executive Director of Economic Research and Monetary Policy Department, Bank Indonesia since 2009. Before re-joining Bank Indonesia since July 2009, he had served for two years as the Executive Director in the International Monetary Fund (IMF), representing the 13 member countries in the South-East Asia Voting Group (SEAVG). He has a long-standing career in Bank Indonesia in the areas of economic research and monetary policy, central banking studies and training, office of the Governors, monetary policy strategy and organization transformation, foreign exchange management, and international issues.

Dr. Perry is also an extramural lecturer in the post-graduate studies at the University of Indonesia, a distinguished lecturer on international economics and monetary economics at Gadjah Mada University, and a visiting lecturer at a number of reputable universities in Indonesia and abroad including University of Sydney. In addition, he has authored and published a number of books, journals, and papers on economy, monetary, and international issues. His latest book of Central Bank Policy: Theory and Practice was published by Emerald Publishing Limited in July 2019. He has also delivered numerous high-level keynote speeches that have influenced public policy around the globe.

ANNEX: CHRONOLOGY OF POLICY

No.	Date	Policy mix	Policy
1.	02.01.2020	Monetary	Reducing the GWM by 50 bps for BUK to 5.50% and BUS/UUS to 4.00% (press release for the Board of Governors Meeting (Rapat Dewan Gubernur, or RDG), November 2019)
2.	20.02.2020	Monetary	Lowering the BI7DRR by 25 bps to 4.75%, deposit facility to 4.00%, lending facility to 5.50% (RDG press release, February)
3.	16.03.2020	Monetary	Reducing the Forex GWM 400 bps to 4% (Bank Indonesia press release)
4.	19.03.2020	Monetary	Lowering BI7DRR by 25 bps to 4.50%, deposit facility to 3.75%, lending facility to 5.25% (RDG press release, March)
5.	19.03.2020	Monetary	Increasing the frequency of 1-, 3-, 6-, and 12-month FX swap auctions from three times per week to daily (RDG press release, March)
6.	20.03.2020	Monetary	Extending the SBN repo to 12 months and conducting daily auction (RDG press release, March)
7.	01.04.2020	Monetary	Extending incentives for easing daily statutory reserves in rupiah by 50 bps (originally only for export-import financing banks, expanded to MSME financing banks and priority sectors) valid up to December 31st, 2020 (RDG press release, March)
8.	01.04.2020	Payment system	Reducing SKNBI fees from banking to BI from Rp600 to Rp1 and from customers to banks from Rp4,500 to a maximum of Rp2,900 valid up to December 31st, 2020 (RDG press release, March
9.	01.04.2020	Payment system	Adjusting the QRIS MDR to 0% for the micro business category up to September 30th, 2020 (RDG press release, April)
10.	01.05.2020	Monetary	Reducing the Rupiah GWM by 200 bps for BUK and 50 bps for BUS/UUS (RDG press release, April)
11.	01.05.2020	Macroprudential	Increasing the PLM ratio by 200 bps to 6.00% of DPK in rupiah for BUK and 50 bps to 4.50% of DPK in Rupiah for BUS/UUS which must be fulfilled through the purchase of SUN/SBSN on the Primary market (RDG press release, April)
12.	01.05.2020	Macroprudential	Not imposing additional current account obligations to fulfil the RIM for BUK/BUS/UUS (RDG press release, April)

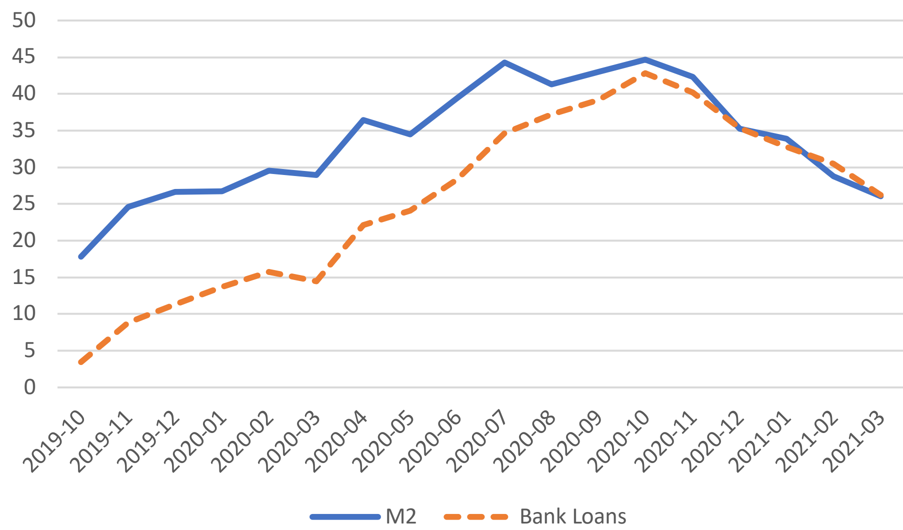
13.	01.05.2020	Payment system	• Lowering the maximum limit on credit card interest rates from 2.25% to 2.00% per month. • Temporarily reducing the minimum payment value for credit cards from 10% to 5% (up to December 31st, 2020) • Temporarily reducing late fees for credit card payments from 3% or max. Rp150,000 to 1% or max. Rp100,000 (up to December 31st, 2020) • Extending the term of credit card payments for customers affected by Covid-19 (the discretion of each issuer) (up to December 31st, 2020) • (RDG press release, April)
14.	18.06.2020	Monetary	Lowering BI7DRR by 25 bps to 4.25%, deposit facility to 3.50%, lending facility to 5.00% (RDG press release, June)
15.	16.07.2020	Monetary	Lowering BI7DRR by 25 bps to 4.00%, deposit facility to 3.25%, lending facility to 4.75% (RDG press release, July)
16.	01.08.2020	Monetary	Provision of current account services to banks that meet the Rupiah statutory reserve requirement (daily and average) of 1.5% per year with the proportion that is calculated to receive demand deposits of 3% of TPF (RDG press release, June)
17.	17.09.2020	Monetary	Extending the period of easing daily statutory reserves in Rupiah by 50 bps (originally only for export-import financing banks, expanded to MSME financing banks and priority sectors) up to June 30th, 2021 (originally until December 31st, 2020) (RDG press release, September)
18.	17.09.2020	Payment system	Extending the QRIS 0% Merchant Discount Rate (MDR) policy for Micro Enterprises up to December 31st, 2020 (previously September 30th, 2020) (RDG press release, September)
19.	29.09.2020	Monetary	Improving the provisions of the Short-Term Liquidity Loan for BUK and Short-Term Liquidity Financing for BUS (PLJPS) that strengthens BI's position as lender of the last resort (Bank Indonesia press release)
20.	01.10.2020	Macroprudential	Lowering the minimum downpayment limit from the range of 5-10% to 0% for environmentally friendly motor vehicles (RDG press release, August)
21.	19.11.2020	Monetary	Lowering BI7DRR by 25 bps to 3.75%, deposit facility to 3.00%, lending facility to 4.50% (RDG press release, November)
22.	19.11.2020	Macroprudential	Continuing the 0% Countercyclical Capital Buffer policy, RIM 84-94% with 0% disincentive parameters, 6% PLM with 6% repo flexibility (RDGB press release and RDG press release, November)

23.	19.11.2020	Payment system	Extending the period of reducing SKNBI fees up to June 30th, 2021 (previously December 31st, 2020) (RDG press release, November)
24.	19.11.2020	Payment system	Extending the period of easing late credit card payment fines up to December 31st, 2021 (previously up to December 31st, 2020) Extending the period of easing the minimum payment limit up to June 30th, 2021 (previously until December 31st, 2020) (RDG press release, November)
25.	01.12.2020	Payment system	Details of lowering RTGS costs: **Before** / **After** **Single transfer** Zone 1: Rp. 9,000 / Rp. 6,000 Zone 2: Rp. 18,000 / Rp. 15.000 Zone 3: Rp. 23,000 / Rp. 21,000 **Multiple transfer** Zone 1: Rp. 35,000 / Rp. 28,000 Zone 2: Rp. 35,000 / Rp. 28,000 Zone 3: Rp. 50,000 / Rp. 45,000 **Price capping**: Rp. 35,000 / Rp. 30,000 (RDG press release, November)
26.	17.12.2020	Payment system	Extending the 0% QRIS MDR policy for micro businesses up to March 31st, 2021 (previously December 31st, 2020) (RDG press release, November)
27.	2020	Monetary	Rupiah liquidity injection through monetary expansion of around Rp555.77 trillion ($38.14 billion) (Economic Report on Indonesia (*Laporan Perekonomian Indonesia*, or LPI) 2020)
28.	2020	Monetary	Rupiah liquidity injection from the decrease in GWM of around Rp155 trillion ($10.64 billion) (LPI 2020)
29.	2020	Monetary/fiscal	Purchasing long-term SBN from the primary market and / or through a market mechanism of around Rp473.42 trillion ($32.49 billion) for the realisation of funding and burden sharing for the 2020 State Budget for public goods (LPI 2020)
30.	2020	Monetary/fiscal	Realizing the burden sharing with the Government for the issuance of SBN to fund the 2020 State Budget for MSMEs non-public goods Rp114.81 trillion ($7.88 billion) and corporate non-public goods Rp62.22 trillion ($4.27 billion) (LPI 2020)

for banks conditional on credit growth. However, the constraints based on credit growth shortly became non-binding, as the banks quickly expanded their loan books with the other incentives provided by the authorities.

The carrot-and-stick approach of the asset ratio rule, the substantial boost in public banks' credit supply, and the vigorous loan demand driven by historically low real rates have fuelled credit growth and the broad money supply at an unprecedented pace. Accordingly, the annual rate of loan growth, which was 11% in 2019, reached 35% by the end of 2020 (Figure 4). The growth rate in broad money supply indicators also climbed to 35% during this period.

FIGURE 4 ANNUAL GROWTH IN MONEY AND CREDIT (%)



Source: CBRT

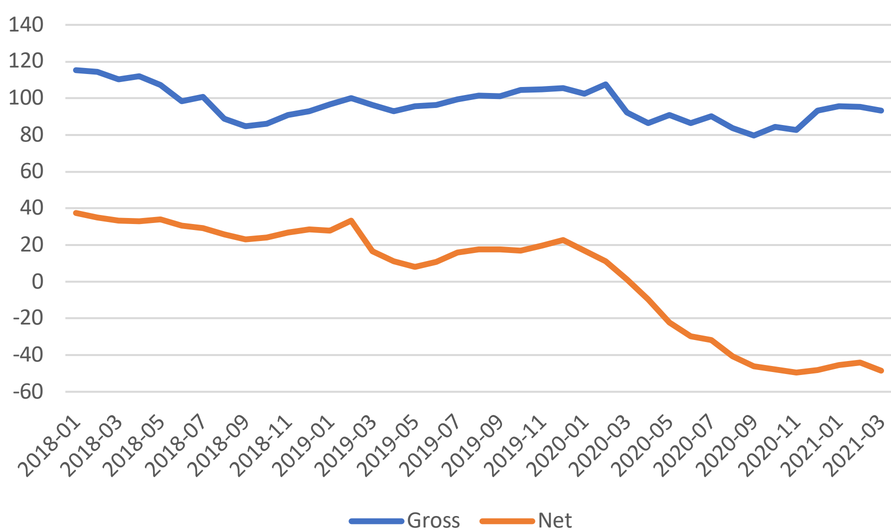
MACROECONOMIC IMPACT OF THE POLICY RESPONSE

Unlike the rest of the G20 countries and major EMEs, the Turkish authorities relied mostly on credit expansion rather than direct fiscal transfers to support the economic activity during the initial stages of the Covid era (IMF 2020). In that sense, Turkey became an outlier in terms of the design and composition of pandemic-related relief packages. The sizeable expansion in credit and money supply, coupled with the historically low real rates, stimulated domestic demand in a short period of time. After a brief collapse during the initial stages of the pandemic, consumption expenditures recovered swiftly and grew by 8.4% in the second half of 2020, becoming the main driver of economic activity. As a consequence, with a growth rate of 1.8% for the whole year, Turkey was one of the two G20 countries (along with China) that posted positive GDP growth in the year of the pandemic.

investors for hard currencies without creating FX open positions. The net effect of this operation on official international reserve holdings, *ceteris paribus*, was unchanged gross foreign reserves of the central bank, while net reserves declined considerably once the swaps are excluded. Meanwhile, the authorities were also engaged in cross-currency swap agreements with Qatar and China to mitigate the fall in international reserves.

Although the size and the timing of the interventions were not announced officially, the total amount of foreign reserves sold through this mechanism can be backed out by reverse engineering through the CBRT balance sheet items. Such calculations suggest that the total sales (excluding valuation effects) may have reached as high as $86 billion in 2020. This peculiar style of intervention strategy continued until November 2020, when the central bank governor and the Minister of Finance and Treasury were removed from their offices by presidential decree. As a consequence, the CBRT's net FX position moved into deeply negative territory (Figure 8).

FIGURE 8 CBRT INTERNATIONAL RESERVES (BILLION US DOLLARS)



Source: CBRT.

During the initial stages, FX interventions managed to stabilise the currency to some extent. Nevertheless, the strategy of using CBRT foreign assets to counteract currency pressures has backfired as domestic and foreign investors started noticing the substantial erosion in international reserves. Together with the sizeable external financing requirements due to short-term debt and the current account deficit, concerns over reserve adequacy and the sustainability of the balance of payments accounts have been increasingly highlighted by international institutions. With investors increasingly closing their Turkish lira long positions and domestic agents switching to dollar and gold deposits, the depreciation–inflation spiral took off. The whole scheme turned into sustainability of growth. This episode highlighted the typical damage posed by time-inconsistency problems, namely, creating substantial longer-term costs in exchange for short-term temporary benefits.

The interaction of the policy mix with policy credibility yields another important lesson from the pandemic period. The Turkish experience in the Covid era has demonstrated that credibility is the most precious asset for policymakers during challenging times. This may be even more the case for monetary policy, which, by nature, entails a forward-looking approach. Strong trust in monetary institutions and anchored expectations create more room for manoeuvre in smoothing business cycle fluctuations. In fact, Benigno et al. (2020) suggest that the effectiveness of quantitative easing in emerging markets depends on the degree of policy credibility. A good track record of inflation fighting allows the benefits of quantitative easing to be reaped without disrupting long-term expectations. On the contrary, quantitative easing under low policy credibility may raise inflation expectations and risk premia, leading to an undesirable tightening in financial conditions, which may eventually reverse the initial positive impact of the quantitative easing.

Encouraged by their past track record of low inflation and accumulated credibility buffers, many emerging market economies joined their advanced counterparts during the Covid era in pursuing quantitative easing. The Turkish authorities also conducted bond purchases and provided intensive credit stimulus close in spirit to quantitative easing. However, these attempts had significant side effects due to an unbalanced policy mix, weakly anchored inflation expectations, and imperfect institutional credibility.

Turkey is a case in point regarding the interaction between institutional reputation and the effectiveness of economic policies. Three central bank governors have been replaced in less than two years. The erosion in central bank independence and of checks and balances in the economic governance structure may not only have contributed to the design of an inefficient policy mix, but also weakened the transmission mechanism of such policies during the pandemic period.

Although Turkey became one of the rare countries to post positive GDP growth in 2020, the composition and the size of the policy mix have created sizeable macroeconomic imbalances. Excessively loose monetary and credit policies, coupled with an unsustainable foreign exchange intervention strategy, triggered capital outflows and raised risk spreads, eventually leading to tighter financial conditions. As a consequence, policymakers will not only have to deal with the economic challenges of the post-pandemic period, but will also have to cope with higher inflation, a wider current account deficit, and depleted reserves in the years ahead.