BANK INDONESIA

FREQUENTLY ASKED QUESTIONS (FAQ)

STRENGTHENING THE MONETARY POLICY FRAMEWORK

1. **Is it correct that Bank Indonesia plans to abandon its policy rate?**
   Bank Indonesia will not ditch its policy rate. Bank Indonesia does, however, plan to introduce a new policy rate, namely the seven-day reverse repurchase rate, replacing the BI Rate as the benchmark rate. What is the difference? The BI Rate currently stands at 6.75% (equivalent to the 12-month interest rate in the term structure of monetary operations). Conversely, the seven-day reverse repurchase rate is currently 5.50% (equivalent to the 7-day interest rate of monetary operations). Until 19th August 2016, the BI Rate shall remain the benchmark rate, thereafter being replaced by the BI 7-Day Repo Rate as the policy rate. Consequently, concerning the term structure of monetary operations, the policy rate will change from one year (360 days) to a shorter term of just seven days.

2. **Will the BI Rate still be used as the policy rate?**
   Through to 19th August 2016, the BI Rate shall remain the monetary policy rate. Concurrently, however, Bank Indonesia will also announce the BI 7-Day Repo Rate as part of the term structure of monetary operations.

3. **It has been reported that Bank Indonesia will significantly lower the BI Rate, is that correct? Will lending and deposit rates also be reduced drastically?**
   That is not correct. Bank Indonesia is strengthening its monetary policy framework, not changing its monetary policy stance. Bank Indonesia will strengthen its monetary policy framework by introducing a new benchmark rate, namely the Bank Indonesia 7-Day Repo Rate, to replace the BI Rate. Bank Indonesia will not change the level of the policy rate, merely change the term of the policy rate from the BI Rate that is 360 days and currently stands at 6.75% to a tenor of 7 days that is now 5.50%. The change aims to improve the effectiveness of monetary policy transmission to money market rates and bank rates, both lending and funding rates.

4. **Why is it necessary to change the BI Rate as the policy rate?**
   The deluge of foreign capital inflows since the global crisis in 2010-2012 has prompted significant disparity between the BI Rate and interbank rate, in particular since the middle of 2010. Excess liquidity on the interbank money market from the influx of foreign capital triggered a very low short-term interbank rate, approaching the DF rate, well below the BI Rate that is consistent with attaining the inflation target. Furthermore, the underdeveloped interbank money market has failed to establish an interest structure on the interbank money market, most notably for tenors of 3 months to 12 months. Consequently, monetary policy transmission has remained ineffective in terms of money market rates. To that end, Bank Indonesia is seeking to bring the policy rate closer to the shorter tenors referred to by the money market.

5. **Why did Bank Indonesia select the 7-Day Repo Rate as the policy rate?**
   When determining the policy rate, Bank Indonesia utilises a number of transactional criteria (between Bank Indonesia and the banking industry), has relatively deep financial markets and strong correlation with the operational targets of monetary policy. The BI Rate, as the policy rate, does not refer to any money market instruments. In contrast, the BI 7-Day Repo Rate refers to monetary instruments actively transacted daily between Bank Indonesia and the banking industry. In

addition, the repo instrument was selected to further support financial market deepening, particularly in terms of repo instruments.

6. **With the change to the BI Rate, will Bank Indonesia still target inflation as the overarching goal?**
   Yes, pursuant to Bank Indonesia's mandate in accordance with prevailing laws, Bank Indonesia will continue to adhere to an inflation targeting framework (ITF). Replacing the policy rate aims to strengthen the monetary policy framework by enhancing the effectiveness of monetary policy transmission and, ultimately, achieve the predetermined inflation target.

7. **What is the desired outcome of strengthening the monetary policy framework?**
   Three main outcomes are expected. *Firstly,* to strengthen monetary policy signals using the 7-Day (Reverse) Repo Rate as the benchmark rate on financial markets. *Secondly,* to enhance the efficacy of monetary policy transmission through its influence on money market rates and banking rates. *Third,* to establish deeper financial markets, especially in terms of transactions, and determining the interbank rate structure for tenors of 3-12 months. To that end, strengthening monetary operations will be accompanied by measures to accelerate financial market deepening.

8. **Have other central banks adopted similar measures to strengthen the monetary policy framework?**
   Similar measures have been taken in Malaysia (2004), Thailand (2006), New Zealand (2006), South Korea (2008) and the Philippines (2015).