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THE INFLUENCE OF MONETARY POLICY: THE INTEREST RATE CHANNEL ON THE DEVELOPMENT OF INDONESIA'S BANKING INDUSTRY

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Abstract - The Covid 19 pandemic caused various countries to implement expansionary monetary policies to prevent an economic crisis. The current economic problems stem from external factors and are detrimental to the internal economy in Indonesia. This condition requires special policies such as active monetary intervention. One of the effects of monetary policy in supporting development priorities and increasing welfare is the transmission of the interest rate channel. The interest rate channel monetary policy affects aggregate demand in the business world amid the economic slowdown. The analysis used is descriptive qualitative with data vulnerability for 2016-2020. The application of the interest transmission monetary policy has not been optimal. The central bank is still focused on inflation set by the government. Coordination with other regulators such as the Financial Services Authority and partners related to national banking needs improvement. This coordination is to support national economic recovery through the interest rate transmission line policy.

Keywords: Covid 19, monetary policies, internal economy

I. Introduction

The spread of Covid-19 disrupts global trade and impacts the cessation of economic activity in several countries. The biggest impact is the disruption of the concentration of rapid economic development, which mostly occurs in big cities [10] [11]. Global economic conditions throughout 2019 experienced dynamics in the financial sector. The Brexit process in Britain, the trade war with 10% US import tariffs against China, deteriorating relations between Japan and Korea, the G-20 meeting, and the Covid 19 pandemic impact the financial sector. Amid the state's vigilance in maintaining the momentum of sustainable economic growth in 2020, the global situation is experiencing a bigger problem that has never been anticipated, namely the spread of the Covid 19 virus. The current economic condition is experiencing a rapid decline due to the cessation of activities and services in several countries. The Covid-19 pandemic has caused turmoil on financial markets and global economic disruption. The pressure is also on the financial markets in each country, a decrease in the value of currencies, a decline in stock performance, and an increase in returns from financial market volatility, thereby increasing the risk of additional debt costs. The pandemic's significant impact has made various countries push for expansionary monetary policy and business stimulus to prevent an economic crisis [4]. This condition requires special policies such as active monetary intervention, in the context of monitoring the country's financial stability from financial market uncertainty and the "Cash his the king" phenomenon. Coronavirus makes global economic performance negative. The biggest decline in Indonesia occurred in the capital market. Other causes are external factors, namely the oil price war and the decline in interest rates by the Central Bank of the United States Federal Reserve (The Fed). Based on Figure 1, investors choose to attract investment from Indonesia and divert it to a country with stronger economic resilience. This can be seen from the significant decline in the Indonesian composite stock price index in 2020. in Figure 1 as follows:

Source: Trading Economics, 2020

Before the Covid 19 outbreak, the Indonesian economy was able to show its resilience amid global economic turmoil. Growth in the range of 5% with low inflation, controlled exchange rate, and lower government bond yields. The monetary sector performed well, namely supporting the central bank's monetary policy framework as a countercyclical instrument in maintaining positive economic growth momentum. One of the monetary policy mixes that receive priority in promoting development and social welfare is the transmission of the interest rate channel. The interest rate channel monetary policy affects the business world's aggregate demand amid pressures from the economic slowdown [3]. The effect of short-term interest rates is transmitted to medium-long-term interest rates by balancing the supply and demand sides of the money market. The development of cost interest rates will affect the agreed-upon demand component, namely the capital (capital) cost, which will affect investment and costs.

The monetary sector has also positively supported the economy with policy statements to reduce the BI 7-Day Repo Rate (BI7DRR), monetary policy, macroprudential policy, payment system, and financial market policies. When viewed from a monetary policy perspective, several countries adopted negative interest rates (Table 1). The Swiss National Bank's interest rate is -0.75%, while some interest rates in the Eurozone, Japan, and Sweden are also in the red zone. A decrease in interest rates will increase spending and borrowing. Offering the best interest rates will help improve the economy, respond positively to global financial markets and investment.

Table 1: Data on Bank Interest Rates in Countries Affected by the Covid Pandemic 19

No	Country	May 2020	June 2020	July 2020	August 2020
1	England	0,1%	0,1%	0,1%	0,1%
2	Swiss	- 0,75 %	- 0,75 %	- 0,75 %	- 0,75 %
3	Japan	- 0,1%	- 0,1%	- 0,1%	- 0,1%
4	AS	0,25%	0,25%	0,25%	0,25%
5	Indonesia	4,5%	4,25%	4%	4%

Source: Bloomberg and Trading Economics, 2020

Based on the series of economic changes, it can be seen that policies pay attention to the level of change, investment, and expenditure (1). The Board of Governors Meeting determines the policy on the number of interest rates by looking at economic indicators. The final target of reducing the BI7DRR interest rate to 4% is to reduce the inflation rate (Real sector). The interest setting policy is set monthly through a Board of Governor's decision based on an analysis of the latest economic developments and forecasts of future economic developments. Determination of the BI rate considers the information (Time lag) of monetary policy in influencing inflation. The decline in BI interest rates indicates that Bank Indonesia is responding to pressures on future inflation expectations lower than the inflation target. Economic problems that occur starting from external factors and are detrimental to Indonesia's internal economy [5]. There has been no research on interest rate transmission policy in driving the economy during the Covid 19 pandemic. The formulation of the problem that needs to be answered is whether monetary policy through the interest transmission channel in Indonesia can improve Indonesia's economic conditions during the Pandemic.

Monetary policy and transmission mechanisms can direct the economy to positive growth. A good economic indicator when the inflation rate is low, unemployment is low, and economic growth is high. Monetary policy is an important step that can be used to overcome macroeconomic problems [1]. The flow of money emerged because Keynes's theory failed to explain and solve the problems of stagnation and inflation in the 1970s. Monetary prioritizes three main references in overcoming economic problems. That development is an important element in employment opportunities and prices. Whereas an increase in the money supply greatly affects the development of monetary policy. The authority determines the increase in money, which is measured in waves.

To overcome unemployment, monetary flows use various monetary policies such as regulating the money supply or policy transmission. According to monetary flows, economic fluctuation is a surge in the money supply from the government's expansionary policy [7]. In the face of inflation, monetary flows consider increasing or decreasing the money supply. The monetary policy mechanism looks at the relationship between growth in the money supply (JUB) and inflation [8]. Changes in short-term and long-term interest rates will affect inflation. Price changes cannot occur immediately or are rigid [2]. Therefore, this price stickiness represents an expansionary monetary policy that will lower short-term interest rates, which will lower long-term real interest rates. The transmission mechanisms include Monetary policy changes the interest rate, Changes in the interest rate will change the investment, Changes in investment will change state spending, Changes in aggregate spending will change national income and the use of labor in the economy.

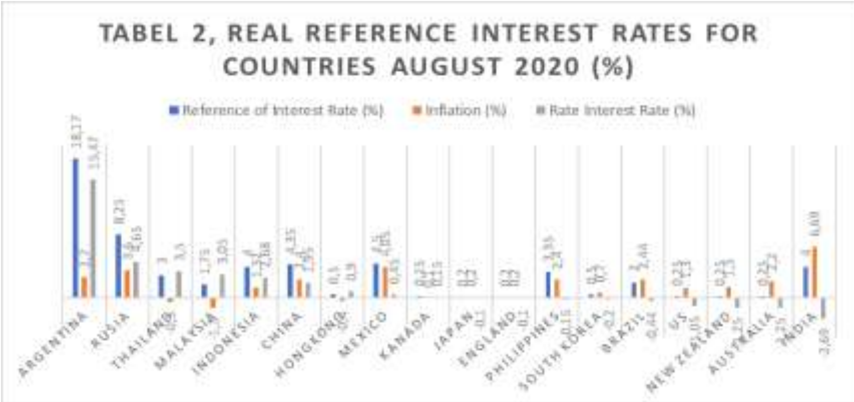
II. METHODS

The data used in this study are primary data and secondary data. The analysis used is descriptive qualitative with data from 2016-2020. The data used are interest rates, movement of the stock index, and bank lending. The data used comes from the website, the Financial Services Authority (OJK), Bank Indonesia (BI), research journals (library research). The theory used is monetary, to measure the transmission of interest rate channels in driving the economy during the Covid 19 pandemic. This research method uses a naturalistic research approach. The research used examines the current conditions, in which the researcher's analysis is the key instrument. Data collection techniques are carried out inductively, describe conclusions based on certain circumstances that will be treated in general. Qualitative research results emphasize meaning rather than generalization.

III. RESULTS AND DISCUSSION

The Government Regulation (PP) Policy on Large-Scale Social Restrictions (PSBB) was enforced in Indonesia to address the spread of Covid 19. The implementation of the PSBB made people choose to stay at home to reduce economic activity [6]. Indonesia is currently experiencing a recession due to the disruption of international and domestic trade activities. Indonesia's economic condition is experiencing negative growth due to global economic uncertainty, so monetary policy is needed to overcome this problem. The economic and financial crisis triggered investor panic and impacted capital outflows [9]. The current panic situation, namely the spread of Covid-19, continues to increase, and business activities are limited. Indonesia has good indicators of growth in liquidity, banking capital, credit, and savings. Bank Indonesia uses monetary policy instruments to maintain rupiah exchange rate stability and inflation by purchasing Government Securities (SBN), lowering interest rates, lowering statutory reserves, repositories, and others. Liquidity policies through various instruments have been prepared in large amounts, namely Rp. 300T. Even though these management efforts succeeded in maintaining the exchange rate, most of the community continued to reduce expenses. For the first time, an economic phenomenon occurred where the rich and the poor consumed primary goods simultaneously. This fact shows that the effectiveness of monetary policy in restoring the real economy has failed.

Monetary policy by lowering the BI rate is carried out to increase liquidity in the money market. The transmission of the interest rate path will affect total demand, the output gap, domestic inflationary pressures, and general inflation. A comparison of Indonesia's economic conditions with other countries can be seen in table 2. Monetary indicators such as inflation are relatively stable compared to other countries in the region; however, Indonesia's real benchmark interest rate was in the range of 2.68%. This figure is quite high compared to several other countries. This difference is due to differences in each bank's fund needs and the bank's profit target.



Source: BI and Trading Economics, 2020

The Monetary Authority implements an interest rate transmission mechanism by lowering the 7-day Repo Interest Rate (Reverse), Deposit Facility, and Loan Facility (Table 3). The policy is carried out to influence the cost of capital, which affects investment and consumption spending. Interest rate reduction policies did not have a major effect on lending. The community prioritizes precautionary motives than making transactions. At the same time, fund owners, business actors, and the banking sector are also cautious about credit distribution and prefer to look at market conditions. Business actors and the community prioritize the consumption of main food rather than business turnover. This will last until a vaccine is found for the Covid 19 pandemic problem.

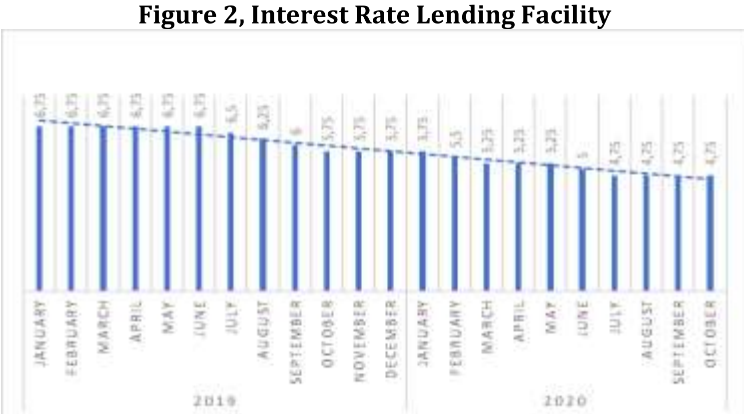
Table 3, The 7-day Repo Interest Rate (Reverse), Deposit Facility, and Loan Facility

Indonesia Monetary Indicator	2016	2017	2018	2019	2020
BI 7-day (Reverse) Repo Rate	4,75	4,25	6	5	4
Deposit Facility	4	3,5	5,25	4,25	3,25
Lending Facility	5,5	5	6,75	5,75	4,75

Source: BI, 2020

On the one hand, the decline in interest rates has encouraged business actors to take credit/financing from banks. On the other hand, real interest rates that are lower than those abroad will reduce people's interest in saving their funds in domestic banks, so that domestic banks will lack the funds needed to flow to the business world. If this condition continues, it will hamper investment in the industrial sector due to the slowing down of difficulties in obtaining funds. Analysis of changes in interest rates before the pandemic in 2019 and the pandemic period in 2020 experienced a downward trend so that predictions of lending have increased. The interest rate loan facility can be seen in Figure 2 as follows:

Figure 2, Interest Rate Lending Facility



Source: BI, 2020

A reduction in loan interest rates will have a positive impact on the economy. Entrepreneurs will take advantage of low-interest rates to develop their business. Based on table 4, it is known that there has been no increase in the nominal value of working capital, investment, and consumer credit. The current focus of banking is implementing the Financial Services Authority's policies by assisting debtors affected by the Pandemic. The policies provided were in the form of postponement of installment payments and credit reconstruction. Credit distribution experienced a slowdown in which working capital loans amounted to IDR 2.529 trillion, investment loans IDR 1.483 trillion, and consumption loans IDR 1.538 trillion. The decline in the credit interest rate did not positively impact investment and consumption because banks did not carry out intermediary functions. The bank restricted lending amidst the uncertain economic conditions during the Pandemic.

Table 4, Credit Development (Trillion Rupiah)

Year	Mount	Working capital loans	Investment loans	Consumption loans	Total Loans
2019	June	2.561	1.404	1.503	5.468
2019	July	2.533	1.411	1.509	5.453
2019	August	2.527	1.424	1.514	5.465
2019	September	2.568	1.430	1.527	5.525
2019	October	2.536	1.435	1.535	5.506
2019	November	2.534	1.447	1.543	5.524
2019	December	2.576	1.481	1.559	5.616
2020	January	2.473	1.472	1.558	5.503
2020	February	2.493	1.482	1.564	5.539
2020	March	2.603	1.541	1.568	5.712
2020	April	2.559	1.497	1.554	5.610
2020	May	2.546	1.502	1.538	5.586
2020	June	2.529	1.483	1.538	5.550

Source: BI, 2020

Based on data released by the Financial Services Authority in June 2020, total credit disbursement grew 1.49% (YoY), with details of working capital credit falling 1.25% (YoY), investment credit rising 5.61% (YoY), and credit consumers rose 1.47% (YoY). There was a decrease in working capital credit throughout 2020, namely experiencing negative growth of -1.25%. Many businesses have closed down due to policies implemented by several cities/districts. Consumptive credit has increased in 2020 because people use this credit as a bailout. Data on credit movements by type of credit can be seen in Figure 3 below:

Source: Financial Services Authority, 2020.

The Indonesian economy experienced a recession due to negative growth for 2 consecutive quarters or 6 months. The first quarter of 2020 is positive growth with 2.97%, the second quarter of -5.32%, and the third quarter of -3.49%. Monetary policy through interest rate channel transmission can help boost or revive an economy stalled during Large-Scale Social Restrictions. The current recession is fast, and its major repercussions are difficult to predict. This paradox shows that the money market has not entered the real sector. The decline in interest rates by Indonesia's central bank did not receive a positive response from banks and business players. Banks are holding back the lending rate, and business actors are asking for credit relaxation in the banking sector to sustain their business. The distribution of public consumption was disrupted, impacting businesses' running, and many companies failing to make credit payments at banks. The negative growth in working capital credit is because business actors consisting of subsistence, micro, small and medium enterprises are not in an economic balance where public consumption decreases and businesses experience excess output that is not absorbed by society. The circle of problems involving the banking sector, the business sector, and the community that took place simultaneously resulted in a slowdown in the Indonesian economy's movement.

IV. CONCLUSIONS

The application of the interest transmission monetary policy has not been optimal. The central bank is still focused on inflation set by the government. Operationally, monetary policy has shown a downward trend in interest rates (BI Rate). The current obstacle is the banking sector's response, which chose to hold liquidity during the Pandemic. Coordination with other regulators such as the Financial Services Authority and partners related to national banking needs improvement. This coordination is to support national economic recovery through the interest rate transmission line policy. Future research is expected to use a quantitative methodological approach.

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