Agus D W Martowardojo: Managing stability and growth under economic and monetary divergence

Welcoming remarks by Mr Agus D W Martowardojo, Governor of Bank Indonesia, at the Bank Indonesia-Federal Reserve Bank of New York Joint International Seminar "Managing Stability and Growth under Economic and Monetary Divergence", Bali, 1 August 2016.

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Your Excellencies:

Central Bank Governors and Heads of Financial Services Authorities of the EMEAP Jurisdiction,

Mr. Boediono, Former Vice President of the Republic of Indonesia and also Former Governor of Bank Indonesia

Mr. Mitsuhiro Furusawa, Deputy Managing Director, IMF

Mr. William C. Dudley, President of Federal Reserve Bank of New York

Mr. Raghuram Rajan, Governor, Reserve Bank of India

Mr. Thomas Jordan, Chairman of the Swiss National Bank

Mrs. Zeti Akhtar Aziz, Former Governor of Bank Negara Malaysia

Distinguished Guests, Ladies and Gentlemen,

Good morning and warm welcome to all of you.

It is such a privilege for Bank Indonesia and Federal Reserve Bank of New York to welcome you all in this international seminar. Together with President William C. Dudley of Federal Reserve Bank of New York, I am very grateful to host this event here in Bali, Indonesia, where we can mix some meaningful discussions with the beauty of nature and culture of this island of Gods.

Today we have an excellent line of speakers, who will be deliberating a current and important issue in the global economy: an increasingly divergent global recovery paths in growth and policies, particularly from central bank perspectives. In particular, I would like to welcome Mr. Boediono, a former Vice President of the Republic of Indonesia who is also a former Governor of Bank Indonesia, for taking time to join us in this seminar. Later we will have an honor to learn from his vast experience and wisdom by listening to his luncheon speech.

Distinguished Guests, Ladies and Gentlemen,

This is a timely seminar given that we all acknowledge that the global economy is still in high uncertainty which influences its growth prospect. The divergence in economic recovery and monetary policy among major economies are still the focus of global issues. Normalization in US monetary policy has been underway, while the Euro area and Japan have been proceeding with monetary easing. At the same time, the development in China has seen gradual slowdown as a consequence of its economic rebalancing. Some countries have adopted negative interest rate policies, with some jurisdictions going even more negative.

The most recent UK's decision to leave the European Union adds another complication to the already bleak global economic outlook. Moreover, Brexit, which some said has produced a seismic political shock, has shifted the nature of global concerns from heightened vulnerabilities towards a new era of political uncertainty.

The previous episode of heightened vulnerabilities were characterized by rising risk of weakening growth, unresolved legacy issues in banks from Advanced Economies, leveraged and increasingly fragile corporates from Emerging Markets, and the existence of systemic liquidity. All of these urgently require more balanced and potent policy mix.

Now, in the new era of political uncertainty, there seems to a strong link between political uncertainty and market confidence. A political shock results in economic and financial fallout, and has tremendous financial stability implication. Therefore, in this new episode, apart from addressing vulnerability, we need also to strengthen the foundations of global financial system.

Otherwise, there is a likelihood that we will be trapped in a vicious circle, in a way that the policy uncertainty undermining confidence will instill slower and stagnant growth, which will erode political cohesion, making the crisis legacy challenges harder to resolve, which will later induce further increase in policy uncertainty.

Such new dynamics and concerns have given rise to a new set of policy challenges, not only on how to simultaneously maintain stability and revive growth, but also on how to strengthen the foundations of global financial system. Against this backdrop, Bank Indonesia and the Federal Reserve Bank of New York have decided to co-host a seminar that will look deeper and expand the boundaries of thinking, nurturing, and offering new insights pertaining to these challenges, with the spirit of putting both East and West perspectives on the table.

In our opinion, the boundaries would encapsulate three areas. First, pursuing growth objectives after the crisis, where factors impeding the global economy will be discussed, and initiatives to balance structural reform and support for growth will be deliberated. Topics surrounding challenges that are unique to small open economies, along with strategies to achieve sustained economic growth, hopefully will make this seminar very relevant and interesting.

Second, monetary policy tradeoffs in the open economy, where challenges stemming from divergent monetary policies, linkages between economic and financial cycles, dealing with capital flow reversal risks, and new roles of exchange rate in external adjustment, will be discussed.

Third, achieving financial stability in periods of monetary policy divergence, in which important issues such as policy responses to promote financial stability, tradeoffs between financial sector reform and growth, and country experiences with macroprudential tools, will be deliberated.

Distinguished Guests, Ladies and Gentlemen,

Recent global development has tested the creativity and innovation of central banks to the limit. A number of unconventional monetary policies were put forward. Acting boldly in the midst of a massive crisis, central banks have moved forward to prevent the world from a depression that would have far outreaching negative effect.

It turns out that such creativity and innovation did not stop with the success of central banks in calming a financial crisis that had brought the global economy to a virtual standstill. Subsequently, central banks have assumed the tasks to continue with the next stage of recovering the economy and maintaining its stability.

However, the challenges for central banks remain. The concern should not be about an upcoming inflation fueled by the expansion of central bank balance sheets and enormous liquidity injections. Instead, the real concern should be about stimulating economic momentum, unemployment and capacity, along with excessive financial risk taking, resource misallocations, and threats to the stability of markets. Moreover, in a new normal world today, central banks have not been able to completely resort to reliable insights and information from historical precedents, analytical models, or past policy experiences.

Courageously but prudently, central banks took the helmets on unprecedentedly large responsibilities for the economy as a whole. Central banks felt a moral and ethical obligation to expand their policy toolkits in responding to such challenges. In my opinion, there has come a time for central banks to move forward, by taking the role of institutional leadership, on top of the policy excellence they have always delivered.

Distinguished Guests, Ladies and Gentlemen,

Looking from a central banker perspective, to stay relevant, resilient, and agile, I agree that policy makers should be more inventive in tackling global challenges. The prime challenge has been how to nurture the sustainability of growth while keeping monetary and financial stability in check, including mitigating the risk of capital reversals.

Naturally, stability should serve as the basic foundation for growth to flourish. Having said that, focusing too much on stability could trade off the economic expansion, which in turn could risk a negative spillback through financial channel and hence the stability itself. In other words, we need to balance the long term objective of strong, sustainable and inclusive economic growth with the short term concerns of stability, in its many facets.

The situation truly explains many countries' challenges including Indonesia. In this regard, Bank Indonesia cannot solely rely on the policy rate as a single monetary policy instrument. In fact, we employ a variety of policy instruments which we call "the policy mix."

The "policy mix" consists of (a) policy rate to anchor inflation expectation complemented by (b) exchange rate flexibility to lessen pressure on external sector, (c) capital flows management to mitigate short-term excessive volatility, (d) macroprudential measures to manage pro-cyclicality, and (e) we also continue to strengthen policy coordination with the Government and ensure good communication to the public.

This year the policy mix focuses on maintaining macroeconomic and financial system stability, while stimulating economic momentum. In the monetary sector, gradual monetary easing remains consistent with efforts to maintain macroeconomic and financial system stability. Such policy is supported by measures to maintain exchange rates in line with economic fundamental, strengthen the position of reserve assets and manage flows of foreign capital. Bank Indonesia also maintains accommodative macroprudential policy, while continuing the effort of financial market deepening.

In terms of macroprudential policy, Bank Indonesia has been implementing a number of regulations, namely, the loan to deposits ratio (LDR) linked to the reserves requirement (RR) and loan-to-value (LTV) ratio on property loans and automotive loans. We adjust the rate according to the need of real sector.

Distinguished Guests, Ladies and Gentlemen,

In the midst of continuing global challenges, Bank Indonesia always strives to advance its central banking practices, particularly its policy frameworks. In order to improve the effectiveness of monetary policy transmission, Bank Indonesia has reformulated the policy rate from the BI Rate into the 7-day (Reverse) Repo Rate, which will become effective on August 19, 2016. Such enhancement does not imply a change in the prevailing monetary policy stance.

During the transition period prior to August 19, 2016, the BI Rate remains as Bank Indonesia's policy rate. Within that timeframe, BI has started to announce BI 7-day Repo Rate as part of the term structure. The enhancement of monetary operation framework has three objectives. First, to improve the policy signaling of policy rate as primary reference for interest rates in the financial market. Second, to strengthen the effectiveness of monetary policy transmission through its stronger impact on short term money market rates and bank rates. Third, to support financial market deepening, especially in encouraging transactions and developing interbank rate structure for 3 month to 12 month terms.

In line with the enhancement, Bank Indonesia also accelerates the implementation of financial market deepening program by pursuing the following steps: (i) strengthening the role of Jakarta Interbank Offered Rate (JIBOR) in shaping the interest rate structure of the money market across tenors from overnight to 12 months; (ii) accelerating the Repo transactions in the money market by promoting banks participation in General Master Repo Agreement (GMRA); and (iii) alleviating market segmentation and boosting the market's transaction capacity by encouraging banks to open more access to counterparty.

Distinguished Guests, Ladies and Gentlemen,

It seems that under the current global dynamics, the only certainty is the uncertainty itself. And therefore the focus of central banks should be on nurturing the economic growth, while maintaining stability. Across the globe, central banks are pressured to continuously pull a rabbit from a hat, offering a formula to tackle the important issues of economic slowdown. Nonetheless, we should be mindful that in an era of new normal with political uncertainty, all of us should relentlessly and collectively strengthen the foundations of global financial system.

In this spirit, we are bringing all the relevant stakeholders to the table to continue the policy dialogue. Hence, I am pleased to have the presence of the participants from east and west: central bankers, financial regulators, global policy makers, and market players. I sincerely believe that sharing perspectives and experiences among stakeholders will equip us with additional significant insights to enhance mutual understanding between authorities and industries towards sound policy responses and implementations. Moreover, the presence of all distinguished participants would strengthen communication and collective action commitments in facing the challenges of economic and monetary divergence.

Finally, once again I would like to express my appreciation to Honorable Governors, Heads of Financial Supervision Authorities, distinguished speakers and all guests for your participation in the seminar, and wish you an enjoyable and fruitful deliberation. I also hope that in the middle of the seminar's tight schedule, some of you are able to enjoy Bali and experience its picturesque view and unique cultural identity. After all, this is the place where the movie "Eat, Pray and Love" was taken. So please make your time.

Thank you.