OPENING REMARKS

By

Dr. Hendar
Deputy Governor, Bank Indonesia

Mr. Hookyu RHU, Executive Director of The SEACEN Centre,

Distinguished Speakers,

All Participants,

Ladies and Gentlemen.

Assalamu’alaikum Warahmatullahi wabarakatuh,

A very good morning to you all,

It is indeed my honor and pleasure to welcome Mr. Hookyu RHU and colleagues from The SEACEN Centre, honorable speakers, 1) Prof. Masahiro Kawai, from University of Tokyo; 2) Prof. Tu Yonghong from Renmin University of China; 3) Dr. Kenneth Coates from University of Montevideo Uruguay; 4) Ms. Emily Poole from Reserve Bank of Australia; 5) Dr. Ilhyock Shim from BIS; 6) Dr. Rizki Wimanda from Indonesia; 7) Dr. Herbert Poenisch; and 8) Dr. Hans Genberg as Consultant and Advisor of SEACEN; and all delegates from SEACEN member countries. Welcome to the Seminar on “Global Liquidity and Impact of Capital Flows on Exchange Rates in Emerging Asia.”

I would like to also welcome you to Bandung, and for those of you who are here in Indonesia for the first time, I hope you will have a great time discovering the country and especially the city of Bandung. Welcome, Selamat Datang, to the “Parijs van Java.”

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2 His remarks were delivered by Mr. Made Sadguna, Senior Director, Senior Advisor, Center for CB Research & Education, Bank Indonesia.
Allow me first to acknowledge SEACEN, whose seminar series have provided an excellent opportunity for member central banks to exchange knowledge and experiences and to foster closer ties among central bankers in Southeast Asia. It is my personal belief that interactions nurtured in this kind of event contribute positively to our successful collaboration at work and other official arrangements.

I hope that you will walk away from this Seminar with greater awareness on the causes of global liquidity phenomenon and the impact of capital flows on exchange rates in emerging Asia. I also hope that, when you return home, you will be better equipped to deal with the issues and challenges we discuss here.

Ladies and Gentlemen,

The aftermath of the Global Financial Crisis saw the implementation of large scale unconventional monetary policy in the advanced countries. This unusual policy approach has somewhat helped to ease “tail risks”, thus encouraged global resumption of capital flows. However, these flows have added a new dimension to global liquidity. It has resulted in the large surge of volatile capital inflows to emerging Asia.

The resurgence of capital flows to emerging economies took on renewed importance with the growing attractiveness of investment in Asia compared to that of in advanced industrial economies.

Successful management of capital flows promises a great deal of benefits for the economic development. However, failure in such effort can jeopardize both internal and external stability. From the perspective of a central bank, a surge in capital inflows poses a range of policy challenges, especially in terms of macroeconomic risks such as excessive credit expansion, an overheating economy and an overvalued real exchange rate. There is also risk of currency crisis and financial instability if such inflows suddenly reversed.

Ladies and Gentlemen,

There is no single recipe for success in reaping the rewards and avoiding the risks of capital flows. But allow me to discuss here our very own experiences in dealing with this issue.

Since 2009, the onset of the resurgence of capital inflows, Bank Indonesia has implemented a range of policies and utilized a variety of instruments available at hand. Our first priority was to preserve a sound and sustainable macroeconomic stability conducive to capital flows. Bank Indonesia also pursued prudent monetary policy under its Inflation Targeting Framework. At the same time, the Government maintained a sustainable fiscal policy by keeping budget deficit below 2 per cent of GDP and monitoring closely its debt.
Strong fundamentals are necessary, though not sufficient to manage a surge in capital flows. That calls for other measures that together help maintain stability. In Indonesia, these measures do not aim to control the volume of portfolio flows. Rather, they are designed to reduce volatility and sustain financial stability by maintaining a flexible exchange rate through selective foreign exchange intervention and by targeted macroprudential measures.

The role of exchange rate flexibility in managing capital flows is critical. Exchange rate flexibility can serve as a shock absorber that eventually helps to lessen the chance of overheating and dampen pressure on other asset prices. But an excessive appreciation of the rupiah during a period of capital inflows also has potential to disrupt the economy more generally. Against this background, Bank Indonesia conducted a sterilized intervention in the foreign exchange (forex) market. This helped to contain excessive exchange rate volatility, while allowing the rupiah to move in line with Indonesia’s economic fundamentals. Yet this strategy cannot be used to cushion against large and persistent capital flows. It is just one aspect of the broader policy mix.

Ladies and Gentlemen,

Bank Indonesia also undertook a parallel intervention in the government bond market. During a period of capital flow reversal caused by foreign holders selling off government bonds, Bank Indonesia used some of the rupiah absorbed from its intervention in the forex market to purchase these government bonds in the secondary market. Thus far, the intervention has successfully stabilized markets and avoided a further drop in the rupiah and government bond prices.

Bank Indonesia then tightened its money market operations to sterilize the liquidity generated from its intervention in the forex market and to prevent undue impact from short-term capital inflows. These policies have improved the ability of the central bank to absorb excess liquidity, and have also helped to eliminate carry trade and arbitrage.

In some circumstances a purely macroeconomic policy response is simply not adequate. For this reason Bank Indonesia also introduced its capital flow management scheme and a series of macroprudential measures (MPMs).

As part of its capital flow management strategy, Bank Indonesia issued a month-long holding period for SBIs. Besides preventing a sudden, large-scale reversal of capital, the policy was also designed to channel capital flows from these certificates into more productive portfolios, such as government bonds and equities. Macro-prudential measures included a policy on reserve requirements to absorb undue liquidity stemming from substantial capital inflows and excess liquidity in the banking system. Bank Indonesia also implemented other measures to manage excessive credit growth in certain sectors by strengthening the loan-to-value ratio. This policy is expected to shift funds into more productive lending and could also strengthen the banking sector.
Ladies and Gentlemen,

Having realized on what are the challenges, I do believe that the deliberations of this Seminar will improve our knowledge on ways and means of global liquidity and changing capital flows in particular the impact on exchange rates.

Finally, I wish for a fruitful discussion and a successful Seminar. I do encourage all participants to be actively involved in this event. Don’t be afraid to ask tough questions. As the old adage says, “If you don’t ask the right questions, you don’t get the right answers….”

Thank you.

Wassalamu’alaikum Warahmatullahi Wabarakatuh.