

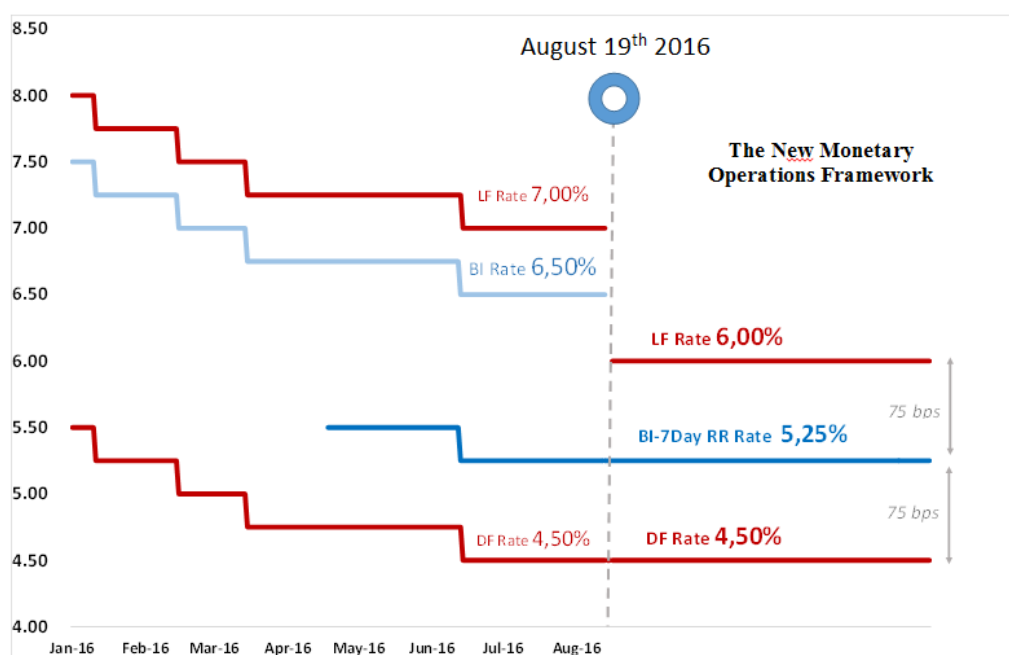
## Strengthening the Monetary Operations Framework

19<sup>th</sup> August 2016

### I. Features of the new Monetary Operations Framework (BI 7-Day Reverse Repo Rate and Interest Rate Corridor)

The BI 7-Day Reverse Repo Rate (BI 7-Day RR Rate) shall be used as the new policy rate, effective from 19<sup>th</sup> August 2016.

Implementation of the BI 7-Day Reverse Repo Rate shall be accompanied by normalisation of the interest rate corridor. The Lending Facility (LF) and Deposit Facility (DF) shall continue to act as the ceiling and floor of the interest rate corridor. Now, however, the LF and DF are positioned symmetrically from the BI 7-Day Reverse Repo Rate at a distance of 75bps respectively. Under the old monetary operations regime, the LF was slightly closer from the policy rate (BI Rate) than the DF, leading to an asymmetrical corridor.



	<b>Old Monetary Operations Framework</b>	<b>New Monetary Operations Framework</b>
Policy Rate	BI Rate	BI 7-Day Reverse Repo Rate
Reflected in the MO tenor	12 months	1 week
Standing Facilities	LF (Ceiling), DF (Floor)	LF (Ceiling), DF (Floor)
Corridor	Asymmetrical (50bps + 200bps)	Symmetrical (75bps + 75bps)

The BI 7-Day Reverse Repo Rate was selected as the new policy rate based on the following considerations:

1. The BI 7-Day Reverse Repo Rate refers to monetary operations actively transacted between Bank Indonesia and the banking sector.
2. BI 7-Day Reverse Repo monetary operation instruments benefit from a comparatively deep market.
3. The BI 7-Day Reverse Repo Rate correlates closely with the operational target of monetary policy, namely the overnight interbank rate.

Meanwhile, a symmetrical interest rate corridor was preferred in order to signal that the central bank maintains a neutral preference to bank liquidity and urges the banking industry to undertake optimal liquidity management in pursuance of economic dynamics/requirements. In addition, lowering the LF to create a symmetrical corridor shall also strengthen the position of LF instruments as liquidity support for banks requiring short-term liquidity. Reducing the cost of being liquid is expected to give the banks space to hold longer tenors on financial markets and, thus, support money market deepening efforts.

## **II. Goal of Strengthening the Monetary Operations Framework**

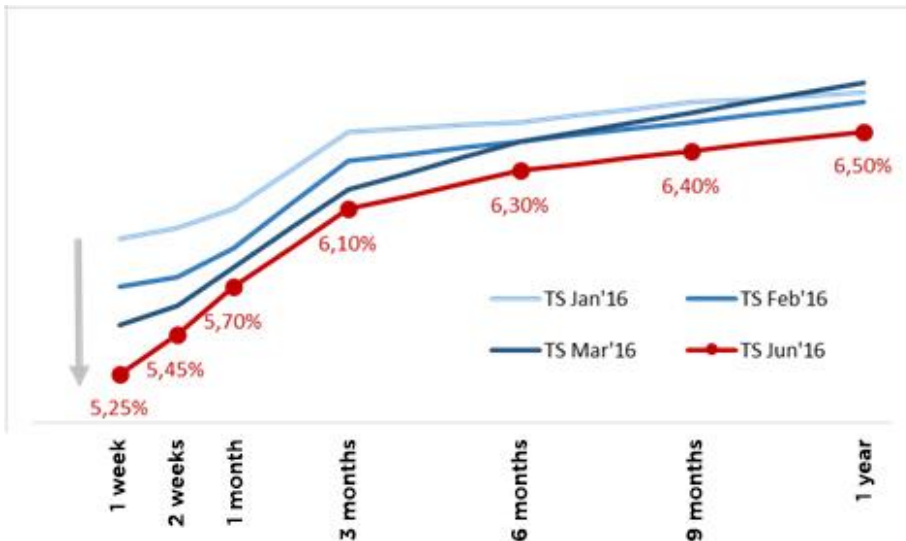
Strengthening the monetary operations framework has three salient goals as follows:

1. Strengthening the monetary policy signal using the BI 7-Day Reverse Repo Rate as the main reference rate on financial markets. Therefore, market players could utilise the BI 7-Day Reverse Repo Rate as a reference rate when setting other interest rates on financial markets.
2. Strengthening the effectiveness of monetary policy transmission through the influence on money market rates and banking rates.
3. Promoting financial market deepening, particularly transactions and setting the interest rate structure on the interbank money market for tenors from 3 to 12 months. To that end, strengthening monetary operations shall be accompanied by measures to accelerate financial market deepening.

## **III. Term Structure of Monetary Operations and Monetary Policy Stance**

The transition from the BI Rate as the policy rate with the BI 7-Day Reverse Repo Rate is done to strengthen the monetary operations. The change would not alter the monetary policy stance considering that the change remains within the same term structure of monetary operations. The policy rate has merely shifted from the BI Rate, equivalent to a 12-month tenor, to the BI 7-Day Reverse Repo Rate, with a 7-day tenor.

The new term structure will shift when BI changes its monetary policy stance, as was done in January, February, March and June 2016, periods when Bank Indonesia reduced its policy rate. On the contrary, when there is no change in the monetary policy stance, the term structure will not change (refer to the graph).



Consistent with the introduction of the BI 7-Day Reverse Repo Rate as the new policy rate at the August 2016 RDG, the term structure of monetary operations shall still be published, temporarily, in order to strengthen interest rate guidance on the markets. Furthermore, guidance shall also be strengthened through the application of a Fixed Rate Tender (FRT) for monetary instrument auctions of all tenors. The Fixed Rate Tender shall gradually be phased out and replaced with the Variable Rate Tender (VRT) mechanism.

#### **IV. Monetary Operations Post Implementation of the BI 7-Day Reverse Repo Rate**

To control fluctuations on the overnight interbank money market when surplus daily liquidity is present in the banking system, Bank Indonesia shall implement a reverse repo auction using 1-week SBN as the underlying, which is an instrument of open market operations (OMO).

Through such transactions, Bank Indonesia can mitigate O/N interbank rate fluctuations around the BI 7-Day Reverse Repo Rate without significantly influencing security prices. That is one of the advantages of using OMO instruments in the form of a repurchase agreement (repo) compared to utilising outright trade transactions.

Bank Indonesia shall routinely auction 1-week reverse repo SBN in order to strengthen the monetary policy stance. Therefore, the auction mechanism shall favour fixed rate tenders. Auctioning 1-week reverse repo SBN shall transmit the

policy rate (BI 7-Day Reverse Repo Rate) directly to OMO participants, in this case domestic banks, and is expected to be transmitted to longer term tenors. A transactional policy rate is expected to strengthen monetary policy transmission.