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Bank Indonesia: "Burden-Sharing" Risks

- **Bank Indonesia's** announced **"burden-sharing" arrangement with the government**, **entailing debt servicing subsidy***, **risks being problematic for monetary policy** and the **rupiah** *unless it is managed very tightly*.
- Admittedly, **compellingly conservative limits to Bank Indonesia's debt servicing liabilities** could effectively mitigate adverse impacts on monetary policy/rupiah.
- But *unless* Bank Indonesia's *interest burden-sharing commitments are tightly defined and conservatively limited*, there are **three clear of risks**, with **inadvertent**, and **potentially adverse risks** to **policy**, **rupiah** and **rates**.

Risk 1 – Interest Rate Subsidy:

- First off, at the very least, **"burden sharing" will be recognized as interest rate subsidy**.
- To be sure. *within tight and pre-defined limits*, this could be **passed off as an operational^ revenue/profit transfers** (from BI to the government).
- But **beyond** the **usual dividend payment thresholds**, a more significant subsidy may be recognized as a **targeted, effective rate cut for the government**.
- Albeit one that comes **at the expense of the private sector**, potentially entailing *"crowding out" risks that is typically not growth positive.*

Risk 2 – Fiscal Dominance:

- **At a certain scale**, such a **"burden sharing"** arrangement **risks subordinating monetary policy**.
- In other words, **Indonesia may be confronted with** the **threat of "fiscal dominance"**, which **inadvertently undermines monetary policy**.
- To be fair, the MoF has stressed on Bank Indonesia's policy independence. And this is the case.
- But the **degree of policy flexibility** that Bank Indonesia could be *unintentionally* **constrained *if interest subsidy obligations turn significantly more burdensome***.

Risk 3 – QE & Debt Monetization:

- Without check, and ***in extreme iterations***, **"burden-sharing" could** be **construed as backdoor** (even if only partial) **debt monetization**.
- To be clear, overt debt monetization accusations are effectively deflected given Bank Indonesia not buying from primary markets (and only acquiring bonds via secondary markets).

- But insofar that bonds (on which interest subsidy is extended) are bought, **Bank Indonesia's expanding balance sheet** may **justifiably be conflated with defacto QE** (quantitative easing).
- Moreover, in **buying bonds outside of an economic crisis** (which may warrant QE/aggressive easing) *to subsidize debt servicing burden*, **Bank Indonesia is exposed to allegations of "debt monetization lite"** (justified or not).

Policy Impact: All else equal, "burden-sharing" will **sharpen rupiah stability-rate cut trades offs**. *Sharper rupiah falls from rate cuts is the risk*. So, for now, it **may constrain** (certainly impose greater caution around) **scope for further rate cuts**.

Rupiah Impact: **Rupiah pressures will also be increased** amid perceptions of QE/"debt monetization lite" hedging rupiah debasement risks as well as effectively lower real returns perceived.

Rates/Yield Impact: Yields may be nudged higher on perceptions of **wider risk premiums**. This ought to be more pronounced via **term premium impositions** at the longer-end *entailing uncertainty and debasement risks*. But **near-term bond buying by Bank Indonesia could still forcibly suppress yields albeit at the expense of the rupiah**.

* While a detailed plan has not been made available, the guidance suggests that Bank Indonesia at least partly subsidizes interest on bonds that it buys on the secondary market.

^ Central banks are known to pay dividends to respective Ministries of Finance

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