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Research Article

Monetary Policy Analysis on the Interest Rate Value of Indonesian Bank (Case Study of the Impact of the Fed's Policy in 2022)

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Abstract: This study examines the impact of Federal Reserve (Fed) monetary policy in 2022 on the Bank Indonesia (BI) benchmark interest rate and BI's responses to maintain national economic stability. In response to high inflation in the United States, the Fed raised interest rates aggressively from 0.25% to 4.25%. This policy resulted in the depreciation of the rupiah exchange rate, capital outflows, and an increase in imported inflation in Indonesia. In response, BI gradually increased the BI 7-Day Reverse Repo Rate from 3.50% to 5.75%, intervened in the foreign exchange (forex) market, and strengthened policy coordination with fiscal authorities. The results demonstrate that BI successfully maintained exchange rate stability and contained inflation. Economic growth remained positive at 5.72% year over year in the third quarter of 2022. These findings underscore the importance of adaptive, measured, and coordinated monetary policy in the face of global dynamics.

Keywords: Monetary Policy, The Fed, Bank Indonesia, Interest Rates, Economic Stability

1. Introduction

Monetary policy is the main instrument used by central banks to achieve macroeconomic stability, including inflation control, exchange rate stability, and sustainable economic growth. One of the important instruments in monetary policy is the benchmark interest rate, which can affect consumption behavior, investment, and capital flows in the economy.

In the era of globalization, the dynamics of monetary policy in developed countries, especially the United States through the Federal Reserve (The Fed), have a broad impact on developing countries such as Indonesia. When the Fed raises its benchmark interest rate, capital outflow tends to flow out of emerging markets to assets in the United States that are considered safer and more profitable. This condition causes depreciation of the domestic currency and triggers inflationary pressures through the mechanism of imported inflation.

In 2022, the Federal Reserve (The Fed) aggressively tightened its monetary policy in response to a surge in domestic inflation that reached 9.1 percent in June. The increase in the benchmark interest rate from almost 0 percent to a range of 5.25 to 5.50 percent created significant pressure on global financial markets. The United States Dollar (USD) strengthened significantly, triggering capital outflows from developing countries, including Indonesia, and weakening the Rupiah exchange rate.

Bank Indonesia (BI), as the domestic monetary authority, faces major challenges in maintaining exchange rate stability, curbing inflation, and maintaining the momentum of post-pandemic economic recovery. In response to the Fed's policy, BI has gradually raised its

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benchmark interest rate and taken stabilization measures through foreign exchange market intervention and policy coordination with fiscal authorities.

This study aims to analyze how the Fed's interest rate policy in 2022 affects Bank Indonesia's benchmark interest rate, the BI 7-Day Reverse Repo Rate (BI-7DRR), and to identify the strategies and responses implemented by BI to maintain national macroeconomic stability. Through this study, it is hoped that a more comprehensive understanding of the transmission of global monetary policy to the Indonesian domestic economy will be obtained.

2. Research Methods

This study uses a qualitative approach with a descriptive method through library research. This approach was chosen to gain an in-depth understanding of the dynamics of the Fed's monetary policy in 2022 and Bank Indonesia's policy response in maintaining national macroeconomic stability.

The qualitative approach in this study is complemented by descriptive analysis techniques, in which the author interprets secondary data from various relevant sources to describe the relationship between external monetary policy and changes in benchmark interest rates in Indonesia.

The data sources used are secondary data obtained from various official and trusted publications, including:

- Statistics of the Fed's benchmark interest rate (Federal Funds Rate) and the BI-7 Day Reverse Repo Rate from the official websites of the Federal Reserve and Bank Indonesia.
- Macroeconomic data such as exchange rates, inflation, and capital flows from the Central Bureau of Statistics (BPS) as well as reports from international institutions such as the IMF and AMRO.
- Scientific journal articles, annual reports, and other academic publications relevant to the research topic.

All collected data were analyzed descriptively to describe the relationship between external monetary policy (The Fed) and Bank Indonesia's (BI) domestic monetary response, as well as its implications for exchange rate stability, inflation, and Indonesia's economic growth.

3. Results And Discussion

The Fed's Policy in 2022

In 2022, the Federal Reserve (The Fed) implemented an aggressive monetary policy in response to a significant spike in inflation in the United States. Inflation in the country peaked at 9.1% (year-on-year) in June 2022, the highest in more than four decades. To curb the rate of inflation, the Fed raised its benchmark interest rate, the Federal Funds Rate (FFR), gradually from a range of 0.25% to 4.25% throughout 2022. This policy marked a phase of quite sharp monetary tightening after a period of massive stimulus following the COVID-19 pandemic.

The interest rate hike had a wide impact, not only on the domestic economy of the United States, but also on the global financial market. The strengthening of the US dollar as a direct result of the policy encouraged capital outflow from developing countries. Global investors shifted their investments from developing markets to assets in the United States that were considered safer and provided higher returns. This increased pressure on the exchange rates of developing countries' currencies, including the Rupiah, and increased volatility in the global financial market.

Many developing countries have been forced to adjust their monetary policies to maintain exchange rate stability and curb domestic inflation. Raising benchmark interest rates in these countries has become a common move to maintain the competitiveness of financial assets and avoid sharp currency depreciation. However, this response poses a policy dilemma, especially for countries with high levels of external debt denominated in US dollars. A stronger dollar increases the burden of debt servicing, which in turn limits fiscal space and slows domestic economic recovery.

The impact of the Fed's policy is also felt in the real sector of the United States. The increase in interest rates has increased borrowing costs for households and corporations, which has an impact on slowing consumption and investment. Concerns about the potential for economic recession have also increased, along with declining aggregate demand. The spill-over effect of this US economic slowdown also poses further risks to global trade and growth.

Overall, the Fed's monetary policy in 2022 reflects an effort to balance controlling inflation and maintaining economic stability. However, the policy also emphasizes the high interconnectedness of the global economy, as well as the need for developing countries to have adaptive and coordinated monetary policies in responding to external dynamics.

Direct Impact on Indonesia

The Fed's tightening monetary policy throughout 2022 has put significant pressure on Indonesia's macroeconomic stability. The impact is felt through various main channels, such as the depreciation of the Rupiah exchange rate, capital outflow, increased inflation, and adjustments to domestic interest rate policies by Bank Indonesia.

Pressure on the Rupiah Exchange Rate

The increase in the Federal Funds Rate from 0.25% to 4.25% strengthened the position of the US dollar globally. As a result, the Rupiah experienced a sharp depreciation, from around IDR 14,200 per USD at the beginning of the year to IDR 15,700 per USD at the end of 2022. This weakening exchange rate increased the cost of importing capital goods and raw materials, and drove inflation through the imported inflation mechanism.

The following is the average exchange rate of the Rupiah against the US Dollar:

The following is the average exchange rate of the Rupiah against the US Dollar:

- 2022 average: around Rp. 14,850
- 2023 average: around Rp. 15,250

The graphic visualization below shows the trend of Rupiah depreciation against the US Dollar during 2022 and 2023. In the first graph, it can be seen that the USD/IDR exchange rate has increased from IDR14,200 in January to IDR15,780 in December 2022. This reflects strong external pressure due to the Fed's monetary tightening, which has encouraged the strengthening of the dollar and the weakening of developing country currencies, including the Rupiah.

Meanwhile, the 2023 chart shows the exchange rate is still at a high level, with an average moving above IDR15,500 per USD until October, although there are fluctuations. This shows that external pressures due to the Fed's higher for longer policy continue, and domestic responses need to be adjusted continuously.

Both graphs make it clear how global monetary policy, particularly from the United States, has a direct impact on the Rupiah exchange rate. This trend is also an important indicator in determining the direction of Bank Indonesia's monetary policy throughout the period.

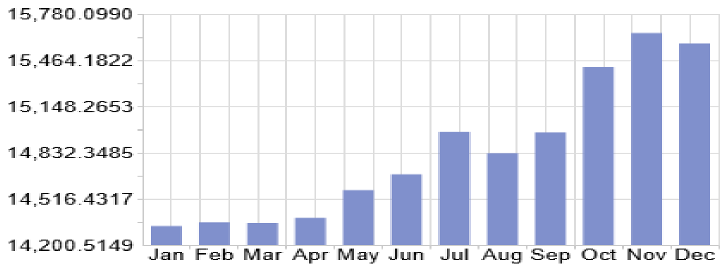

Figure 1. Average USD/IDR exchange rate per month in 2022

Source: X-Rates

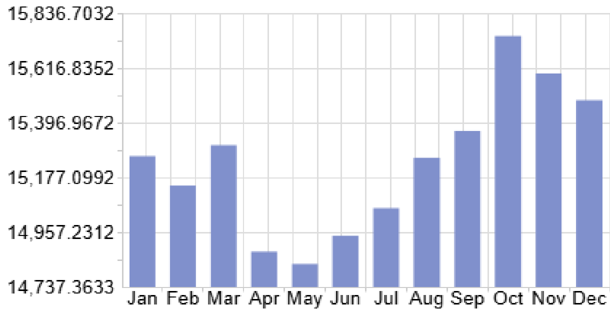

Figure 2. Average USD/IDR exchange rate per month in 2023
Source: X-Rates

Capital Outflow and Market Volatility

The Fed 's high interest rate policy has made dollar-based financial instruments more attractive to global investors. This has led to *capital outflows* from Indonesia, especially from the bond and stock markets. Foreign investors have withdrawn their funds from the domestic financial market, causing a decline in foreign ownership of Government Securities (SBN), especially in the second half of 2022.

This phenomenon has an impact on increasing volatility in domestic financial markets. The weakening exchange rate and rising domestic yields are a reflection of the increasing risks perceived by investors, as well as the market's efforts to balance investment incentives between Indonesia and the United States.

Increasing Inflationary Pressure

The sharp depreciation of the Rupiah exchange rate has increased import costs, especially for energy, food, and basic necessities. This has triggered significant domestic inflationary pressures. The Central Statistics Agency (BPS) noted that Indonesia's inflation at the end of 2022 reached 5.51% *year-on-year* , the highest figure in the last seven years.

This inflationary pressure comes from two main components, namely volatile foods *and* government-regulated prices *,* such as fuel oil (BBM). In addition, the depreciation of the Rupiah strengthens the effect of *imported inflation* , because most of Indonesia's industrial raw materials and consumer goods still depend on imports.

Adjustment of BI Interest Rate Policy

In the face of external pressures due to *the Fed's monetary policy* , Bank Indonesia made adjustments to its benchmark interest rate, namely the BI 7-Day Reverse Repo Rate (BI-7DRR). Although domestic inflationary pressures mostly come from the supply side (*supply shock*), BI continues to raise interest rates as a preventive measure to maintain exchange rate stability, control inflation expectations, and maintain the attractiveness of domestic financial portfolios.

This interest rate adjustment also reflects caution in responding to the risk of spillover *effects* from global monetary policy, as well as maintaining the credibility of monetary policy in the eyes of market players.

Summary of Transmission Channels

In general, the impact of *the Fed's monetary policy* on the Indonesian economy in 2022 can be classified into three main channels:

- The weakening of the Rupiah exchange rate, due to the strengthening of the US dollar, which causes an increase in import costs and pressure on the balance of payments.
- Increased *capital outflow* , which triggered financial market volatility and a decrease in foreign ownership of domestic financial instruments.
- *Imported inflation* pressures , which worsen the price stability of consumer goods and increase overall inflation.

These three channels interact with each other and reinforce each other's effects, creating pressure on Indonesia's macroeconomic stability. In this situation, Bank Indonesia responded with a careful and calibrated policy mix to maintain exchange rate stability, control inflation, and continue to support the economic recovery process after the COVID-19 pandemic.

Bank Indonesia's Policy Response to the Impact of The Fed's Policy in 2022

The Fed 's monetary tightening policy in 2022 has put significant pressure on the Indonesian economy, especially through the weakening of the Rupiah exchange rate, increasing inflation, and capital outflows from the domestic financial market. In response to these dynamics, Bank Indonesia (BI) has taken strategic steps through an adaptive, measured, and well-coordinated monetary policy mix to maintain national macroeconomic stability.

The first step taken by BI was to raise the benchmark interest rate, the BI 7-Day Reverse Repo Rate (BI-7DRR), gradually from August to December 2022. During this period, BI raised the interest rate five times, from 3.50% to 5.75%. This increase aims to contain inflation expectations, maintain the competitiveness of domestic financial assets, and stabilize the Rupiah exchange rate which has been strongly affected by the strengthening of the US dollar.

The details of BI's interest rate increases throughout 2022 are as follows:

- August 2022: 3.75%
- September 2022: 4.25%
- October 2022: 4.75%
- November 2022: 5.25%
- December 2022: 5.75%

In addition to interest rate adjustments, BI also actively intervened in the foreign exchange market to reduce exchange rate volatility. Interventions were carried out through spot market mechanisms, non-deliverable forward (DNDF) contracts, and operations in the secondary market for Government Securities (SBN). This policy has proven quite effective in maintaining the stability of the Rupiah compared to other developing country currencies that experienced sharper depreciation in the same period.

In order to strengthen the transmission of monetary policy to the real sector, BI also optimized open market operations to ensure adequate banking liquidity. These operations were carried out simultaneously with the issuance of short-term monetary instruments and adjustments to macroprudential policies to remain accommodative but prudent. The goal is that policy tightening does not hamper the ongoing domestic economic recovery after the pandemic.

Coordination with the government is an important part of BI's strategy in maintaining stability. Synergy is carried out through the Central and Regional Inflation Control Teams

(TPIP and TPID) and the *National Food Inflation Control Movement* (GNPIP) program, in order to reduce inflationary pressures from the supply side, especially food and energy. On the other hand, BI also supports the government's financing program through the purchase of SBN in the primary market in accordance with the *burden sharing framework* , as part of the strategy to maintain fiscal sustainability.

BI's policy response has shown quite positive results. Indonesia's inflation at the end of 2022, although it increased to 5.51% (*year-on-year*), remained more controlled compared to many other countries in the region. The Rupiah exchange rate also showed relative stability despite facing global pressures. In fact, Indonesia's economic growth remained at a positive level of 5.72% in the third quarter of 2022, indicating that the monetary policy response did not hinder the recovery process.

With a cautious yet responsive approach, BI has managed to dampen most of the external risks arising from *the Fed's policies* . This shows the importance of adaptive, flexible, and coordinated policies between monetary and fiscal authorities in the face of growing global uncertainty.

Impact of Bank Indonesia's Response on the Domestic Economy

The monetary policy implemented by Bank Indonesia throughout 2022, particularly through adjustments to the benchmark interest rate and stabilization of the foreign exchange market, has had a real impact on a number of domestic macroeconomic indicators. The impact is reflected in three main aspects, namely inflation, exchange rates, and economic growth.
In short, the impact of BI's policies can be summarized as follows:

- Inflation: Indonesia's inflation peaked at 5.95% (yoy) in September 2022, but declined to 5.71% in October. Although still above BI's target of 3.0 ± 1%, the downward trend shows the effectiveness of the policy response in curbing inflation.
- Exchange Rate: Rupiah depreciated from around Rp14,200/USD to Rp15,700/USD at the end of the year. However, the exchange rate remained relatively stable compared to other developing countries, thanks to BI's active intervention in the spot and DNDF markets.
- Economic Growth: Amid global pressures, the Indonesian economy continued to grow by 5.72% (yoy) in the third quarter of 2022. This growth was driven by solid household consumption and export performance, as well as a coordinated monetary-fiscal policy mix.

This positive impact shows that BI's monetary tightening does not completely hamper post-pandemic economic recovery. Instead, a careful and measured response is able to maintain a balance between macroeconomic stability and growth momentum .

4. Conclusion

This study aims to analyze the impact of monetary policy implemented by the Federal Reserve (The Fed) in 2022 on Bank Indonesia's (BI) benchmark interest rate, as well as to evaluate the monetary policy response taken by BI in maintaining national economic stability. The findings show that the Fed's aggressive policy in raising interest rates has put significant pressure on the Indonesian economy through three main channels, namely the weakening of the Rupiah exchange rate, increasing foreign capital outflows, and a spike in imported inflation.

In response to these pressures, Bank Indonesia raised its benchmark interest rate from 3.50% to 5.75% gradually, actively intervened in the foreign exchange market, and strengthened policy coordination with the government through various inflation control and financial sector stabilization programs.

The implications of these findings suggest that adaptive and coordinated monetary policy is critical in dealing with global economic dynamics. BI's responsive steps to external shocks have succeeded in maintaining exchange rate stability and curbing inflation, while maintaining the momentum of national economic recovery, as reflected in Indonesia's positive economic growth of 5.72% (yoy) in the third quarter of 2022. This underscores the important role of the monetary and fiscal policy mix in maintaining economic resilience amidst global pressures.

However, this study has several limitations. The method used is descriptive-qualitative with a literature study approach, so it has not been able to test causal relationships empirically. In addition, the focus of the study only covers the period of 2022, without evaluating the continuation of the impact of the "higher for longer" policy that is still ongoing in the following years.

Therefore, further research is suggested to use quantitative approaches or econometric models to measure the direct impact of external monetary policy on Indonesia's macroeconomic variables. Future research can also expand the focus on certain sectors that are most vulnerable to interest rate and exchange rate fluctuations, and consider the resilience factor of the national financial system in the long term.

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