Bank Indonesia Dares to Make the Interest Rate Gapwith America Smaller

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Abstract

According to Milton Friedman, inflation is an "old disease" that is always and everywhere in a monetary phenomenon. He also added that monetary policy has notto be backed up by fiscal policy to curb inflation. This means that monetary policy is an appropriate and proper tool when directed at achieving price stability or at the desired rate of price. Hence, the Fed through FOMC (Federal Open Market Committee) focuses on monetary policy to control inflation, either through the interestrate mechanism or reducing the Fed's balance sheet. The results do show a decline in inflation, but it is still above the set target. Very much different from Indonesia, BankIndonesia, as the central bank, not only uses monetary policy to manage inflation, butalso applies a fiscal approach, by forming a National Inflation Control Team, which collaborates with the government via the Finance Department. Inflation Control Teams were also established in every province, district and city throughout Indonesia. The result is that the reduction in inflation figures is more effective, faster, and with very low persistence, without being completely dependent on the benchmark interest rate. In the end, the disparity between Indonesian and American interest rates narrowed. BankIndonesia is not worried that there will be a capital outflow from the investment portfolioto America, as long as Indonesia's real interest rate is still greater than America's.

Keywords: Inflation, Monetary Policy, Fiscal Policy, Inflation Control Teams, Low Persistence Inflation, Narrow Gap Interest Rates