

The Importance of Money Market Reconstruction in Indonesia

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Abstract— Money market is very important in order to provide the need of capital for public and private institution. Indonesian money market still need a strong, clean, efficient and effective structure in order to be able to perform its mission. A good money market structure will become a strong source for capital, especially short term capital for any form of business in Indonesia. A legal structure and construction of a money market is very important create an ideal money market in Indonesia. This paper will discuss two important matters, first is how the legal structure and construction of Indonesia money market today compare with international money market. The second matters, what is the ideal structure and construction of Indonesia money market. This research is a normative legal research, which analyze regulations in Indonesia money market, international money market and also to find the weakness of Indonesia money market in order to create a new structure and construction of a better Indonesia money market. Indonesia money market is quite different from international money market in its structure. Indonesia's central bank need to perform a strong legal policy in order to create a good money market.

Keywords— *Money market; Reconstruction; Sort-term Notes*

I. INTRODUCTION

What is the market? Market is a word that used to define a place where people can strictly exchange their needs. In markets, the seller offering their goods and services for the exchange of money from the buyer. Market facilitate trade and enable distribution of goods and services in the society, it also help distribution and allocation of resources in a society. There are many aspects involves in a market, the subject (seller, buyer, intermediate), the object or trade-able items (goods, services), product differentiation, places which exchanges are carried, who is the targeted buyers, the duration of selling process, the geographic boundaries. Those aspects will determine the form of a market. In financial institution, it also recognized a market, which is called the financial market or money market. Financial market is a market where people and business entities can sale or buy financial securities, commodities and other fungible items. Those items include securities in the form of stocks, bonds, commodities includes precious metals and agricultural goods. Financial markets will facilitate raising capital (in the capital market); transfer of risk; transfer of liquidity; international trade.¹

Every country in this world will try to maintain their financial market in shape, because the excellent financial market condition will give great benefit for the country itself. Those benefits are 1) public saving will be mobilized maximally into the financial market; 2) indirect investment from the financial market will be used maximally ; 3) national development will be back up by the financial market; 4)

entrepreneurship will growth rapidly based on financial market facility; 5) industrialization will also growth rapidly.²

Financial market in theory consist of 1) capital market which consist of stock market which provide financing for corporation who needs big amount of capital by issuing shares or common stock and enable the secondary market trading for it and bond market which provide financing for corporation or institution even a country by the issuance of bonds and enable the secondary market trading also. 2) commodity market to facilitate trading of commodities; 3) money market which provide short term debt financing and investment; 4) derivative market which provide securities instruments for the management of financial risk; 5) future market or forward market to provide forward contract in standard for trading products or commodities in the future date; 6) insurance market to facilitate the redistribution of various risk; 7) foreign exchange market to facilitate the trading of foreign exchange.³

This paper is about money market, especially money market in Indonesia. Indonesia's money market institution is solely control by the central bank of Indonesia, Bank Indonesia and in some part supervised by the OJK (Financial Service Authority). Money market instrument is developing really fast in its ability to provide fresh money for development. the main reason for money market developments are 1) the industrialization movement during 1951-1962; 2) the issuer of money market instruments are big corporation with good and wide networking to create market (buyer); 3) money market is an alternative besides banking for the source of debt; 4) money market instrument or securities are a liquid instruments, quite easy to negotiate in the

¹ Cook, "Determinants of the Spread between Treasury Bill and Private Sector Money Market Rates."

² Prananingtyas, "Laporan Penelitian Rekonstruksi Pasar Uang Indonesia Sebagai Lembaga Intermediasi Modal."

³ Bagehot, *The Project Gutenberg eBook of Lombard Street: A Description of the Money Market.*

secondary market.⁴ Many institution has a great hope on the potential of money market instrument. Money market instrument consist of short term note which issued by multinational corporation. That notes will help issuer to collect low cost debt from investors. From the investor point of view, the note will offer high returns, higher than bonds or other long term notes. Also these short term notes only give a low risk for the investors.

This is a research paper, based on a normative research. This paper will discuss two important matters, first is how the legal structure and construction of Indonesia money market today compare with international money market. The second matters, what is the ideal structure and construction of Indonesia money market.

This research is a normative legal research, which analyze regulations in Indonesia money market, international money market and also to find the weakness of Indonesia money market in order to create a new structure and construction of a better Indonesia money market.

II. RESEARCH METHOD

This paper was based on normative legal method of research. In this method the research was based on description of a positive law combined with a research on regulation and legal concept. This paper was also used a comparative research, to compare the money market action and regulation in other countries with Indonesia money market action and regulation.⁵ This paper analyzed several regulations in Indonesia that rules the issuing, offering and distributing of money market instruments.

According to Jovanovich this paper is a research paper which is an evaluative paper because this paper will see whether rules or regulation are working for the practices of the governance of the money market.⁶

III. LITERATURE REVIEW

Hartmann in his paper “*The Microstructure of The Euro Money Market*” emphasized that the money market institutionally can be divided into four element, first is the central bank, who has the task to decide on macro monetary policy, second for the operational framework, the central bank also has the important task, to decide the implementation of the monetary policy and liquidity management, including the monetary policy instruments, open market operation, standing facilities, reserve requirements. Third elements is more associated with the infrastructure such as the private trading environment including the different financial instrument traded in the money market, such as deposits, repos, derivatives, ; the trading facilities such as electronic brokering, electronic information systems,; and also the market

organization including the organized trading and over the counter trading.⁷

For a comparison, the European Union already created a new regulation to in order to shaped their money market. Based on the proposal for a regulation on money market funds, it showed that money market funds are an important source of short-term financing for financial institutions, corporates and governments. Money market funds on demand side offer short term cash management tools for the issuer, it will provide a high degree of liquidity, diversification, stability of value which is combined with a market-based yield.⁸

According to Cook and LaRoche , in the United States, the financial markets has its major purpose to transfer funds from lenders to borrowers. Money market is generally referring to borrowing and lending for periods of a year or less. It also said that money market is very efficient; it enables large sums of money to be transferred quickly and at a low cost from one economic unit such as business, government, and bank to another for short periods of time.⁹

According to Hanson, money market funds as the object of the money market have had some risk such as 1) the investors tend to withdrawn funds on demand, based on ex ante (forecast information) rather than ex post (actual information). The withdrawing of money market funds by the investor may destabilize the financial system and economy. 2) Investor expected government guarantee and intervention to stabilize money market which encourage money market funds managers and investors to take on excessive risk ex ante. 3) The practice of spillovers across funds, appears when the money market funds investors uninformed and have limited resources to process information on individual funds. 4) The formation of excessive short term funding of financial firms, because the high risk that appear from the excessive risk-taking by the money market funds.¹⁰

There are many changes into the financial market, according to Qoqiauri, in the journal paper “*Modern Trends of Development of Financial Market in Georgia*”, “...technological progress in computer and telecommunication technologies and globalization of banking and commercial domains conditioned reduction of the influence of governmental authorities upon economical processes and this gave rise to the activation of competition worldwide. Result to this is more effective market with global ties. However, the market became much more complex than it was several years ago. Notwithstanding numbers of important positive changes, leading financial institutions in many countries faced new difficulties...”¹¹

⁴ Kacperczyk and Schnabl, “When Safe Proved Risky : Commercial Paper During The Financial Crisis of 2007-2009.”

⁵ Prananingtyas, “Laporan Penelitian Rekonstruksi Pasar Uang Indonesia Sebagai Lembaga Intermediasi Modal.”

⁶ Jovanovic, “Legal Methodology & Legal Research and Writing Legal Research and Writing (Legal Methodic) Writing Writing in Law : Writing about Law :”

⁷ Hartmann, Manna, and Manzanares, “The Microstructure of the Euro Money Market,” 2001.

⁸ European Commission, Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Money Market Funds.

⁹ Cook, *Instruments of the Money Market*.

¹⁰ Hanson, Scharfstein, and Sunderam, “An Evaluation of Money Market Fund Reform Proposals.”

¹¹ Qoqiauri, “Modern Trends of Development of Financial Markets in Georgia.”

IV. RESULT AND DISCUSSION

A. THE LEGAL STRUCTURE AND CONSTRUCTION OF INDONESIA MONEY MARKET TODAY COMPARED WITH INTERNATIONAL MONEY MARKET

Money market in Indonesia is a place where the supply and demand of short-term instrument, one year tenor or less than a year is traded. The participants on money market in Indonesia are banks, individuals, insurance companies, pension fund companies, multinational corporations, state own corporations, government institutions, and other limited liability corporations. In 2001, there is a study held by Bank Indonesia, this study will guide Bank Indonesia in creating its regulation on financial market at large. The financial market in Indonesia for years is very vulnerable from “attack” both nationally or internationally. Because of these problems, it was deemed necessary to have a policy that would minimize the opportunity for non-residents to speculate against the rupiah. Therefore, Bank Indonesia issued Regulation no 3/3/2001 on 12 January 2001, which limited rupiah transactions between onshore banks and non-residents. Bank Indonesia designed policies to reduce the volatility of the rupiah exchange rate that originated from foreign exchange trading without underlying economic transactions, while maintaining our commitment to a free foreign exchange regime. The opportunity of non-residents to speculate on the rupiah would be curtailed through the limitation in accessing credits from the domestic banking system. Therefore, Bank Indonesia issued a regulation restricting rupiah transactions and foreign currency credit offered by banks to non-residents. The regulation consisted of two major parts, namely restrictions on certain transactions by banks with non-residents without any exception and limitations on derivative transactions with non-residents, with some exceptions.¹²

The coverage of the regulation is as follows: 1) Prohibits banks from extending loans and providing other sources of rupiah funding to non-residents including : Rupiah and foreign exchange loans to non-residents, including intraday overdrafts; Placement of rupiah in the form of deposits or other means in offshore banks; Investment in rupiah-denominated assets issued by non-residents; Inter-office transactions in rupiah (domestic branch lending to offshore branches); Equity participation in rupiah by non-residents. 2) Restricts banks from conducting derivative transactions without underlying transactions : Restricted derivative transactions encompass: Forward sales, including next day and spot currency transactions rolled over as synthetic transactions replicating foreign currency forward sales; Swap sales including overnight and next day swaps; Transactions involving the selling of foreign currency puts against the rupiah. 3) Prohibits banks from transferring rupiah to non-residents without underlying economic activities in Indonesia : Transferring rupiah from residents to non-residents is prohibited, except settlement of forex buying against the rupiah; settlement on Non-resident accounts with onshore

banks related to domestic economic activities such as equity participation, securities transactions, foreign debt repayment in rupiah, import L/Cs in rupiah, goods and services purchased in Indonesia, and Non-resident living costs in Indonesia. Transferring rupiah from non-residents to non-residents is prohibited, except: settlement of forex transactions; settlement on Non-resident accounts with onshore banks related to domestic economic activities such as equity participation, securities transactions, goods and services purchased in Indonesia, and Non-resident living costs in Indonesia.

This policy outset the Bank Central act, also what happened in the world which created turmoil in the world’s financial situation also tend to shape the regulation on Bank Indonesia and its policy towards financial market at large and specially money market.

Indonesia money market is regulated by the central bank , Bank Indonesia, because it has power and responsibility for the conduct of monetary policy. The Bank Indonesia action regarding money market policy is free from any interference from the government and or any other parties, as its defined in the Act Number 23 year 1999 on Bank Indonesia and it’s all amendment (*UU no 23 Tahun 1999 Tentang Bank Indonesia jo UU No 3 tahun 2004 tentang Perubahan Atas UU RI no 23 tahun 1999 tentang Bank Indonesia jo UU No 6 tahun 2009 tentang Penetapan Peraturan Pemerintah Pengganti UU no 2 tahun 2008 tentang Perubahan Kedua Atas UU no 23 tahun 1999 tentang Bank Indonesia Menjadi UU*).

The purpose of money market is to bridge the both sides of the participants in the money market, the investors or buyer and the issuer or seller. There are four main purpose of money market in Indonesia first is to help any corporations or institution which need raised capital for their companies. Second the money market act as the provider of short-term debt instruments or securities. Third as a distributor agency to facilitate Government intervention to distribute short term loan for local business. Fourth as a place where society as investors should by specified short term notes as SBI (*Sertifikat Bank Indonesia*) or other short term debt instrument.

The Bank of Indonesia as national central bank conducts monetary policy, supervises commercial and rural banks, and is responsible for the oversight of the payments system, it is an independent state institution. The Bank Indonesia Act explicitly safeguards the central bank against any government interference in the conduct of monetary policy, with the exception of emergency liquidity lending by Bank Indonesia to systemically important banks and the setting of inflation targets. In addition, Bank Indonesia’s operational budget is subject to the parliament approval.

The ultimate objective of Bank Indonesia is to achieve and maintain the stable value of the rupiah. The Bank Indonesia Act specifies that this objective has two key aspects: (i) a stable price of goods and services (internal price), and (ii) a stable exchange rate (external price). The priority of these two aspects of the objective is not explicitly stated in the Act. Bank Indonesia’s internal regulation explains that —price stability is the ultimate objective of monetary policy, while exchange rate stability is one of the prerequisite conditions for price stability, monetary stability and financial system stability.

¹² Sarwono, “Indonesian Policy on Non-Residents’ Participation in the Money Market: The Restriction of Rupiah Transactions by Non-Residents and Foreign Currency Credit Offered by Banks to Non-Residents - BIS Papers No 23, Part 14 May 2005.”

The Bank Indonesia, created many regulation to maintain the transaction in money market and foreign exchange market in Indonesia. There are four important regulation 1) electronic trading platform provider; 2) brokerage company; 3) systematic internalize and 4) money market institution. Indonesia money market instrument are SBI (*Sertifikat Bank Indonesia/* Bank Indonesia's Certificate; SBPU (*Surat Berharga Pasar Uang/Money Market Funds*); Interbank Call money; Commercial Paper; Repurchase Agreement; Banker's Acceptance; Promissory Notes; Certificate of Deposit.

Indonesia money market operational are heavily control by the Bank Indonesia. It is part of the Bank Indonesia main purpose, to control monetary operation in Indonesia, by conducted open market operations and standing facilities. According to Bank Indonesia source, open market operations are transaction conducted by Bank Indonesia on the money market with banks and or other parties within the framework of monetary operations. It also control the operational of lending, using standing facilities policy.

Bank Indonesia in order to improve monetary operations, will extend the maturity profile of SBI / Bank Indonesia Certificate. As part of Indonesia money market, the SBI auctions undergo an alteration, if its previously held weekly changed to monthly, additional 3 and 6 month SBI is created. Bank Indonesia in order to maintain adequate liquidity and interest rate stability will continue to optimize other monetary operations, namely FASBI, Repo O/N and Fine Tune Operations (Fine Tune Contraction and Expansion). For the sake of the structure, there is no big adjustment for the money market in Indonesia until recently.

For a comparative, according to Hartmann, in the European Union, has established policies regarding financial market and money market, it called the Eurosystem. Money market institutional environment can be divided into four elements, first is regarding the central bank. The central bank bodies deciding on macro monetary policy and their analytical strategy. Second regarding the framework operational for the implementation of the monetary policy and liquidity management by the central bank called the monetary policy instruments, such as open market operations, standing facilities, reserve requirements. Third is the private trading environment, including the different financial instruments traded (deposits, repos, derivatives, etc.), the trading facilities (electronic brokering, electronic information systems, etc.) and the market organization (organized exchange vs. over-the-counter market). Last is the payment and settlement infrastructure that shall be provided by the government and private sectors in money market and financial market in Europe such as large-value payment systems, securities settlement systems, clearing and netting facilities.¹³

The Eurosystem operational framework for monetary policy can be defined as the set of instruments that any member central bank uses to implement its monetary policy by managing the liquidity situation in the money market and steering money market interest rates. The money market is special insofar as the central bank sets the short-term interest

rate and acts as the only ultimate provider of liquidity in a given currency, thereby dominating the supply side. The former is done through its policy strategy and the latter through its operational framework, which can be used to either inject or withdraw liquidity from the banking sector. Apart from directly refinancing from the central bank, money market participants trade with each other to take positions in relation to their short-term interest rate expectations, to finance their securities trading portfolios (bonds, shares etc.), to hedge their more long-term positions with more short-term contracts and to square individual liquidity imbalances resulting from customer transactions or unsuccessful efforts in central bank refinancing operations. Funds (or securities in the case of secured markets) are ultimately transferred between the central bank and money market participants and among the participants themselves through payment (or settlement) systems. Depending on the financial instrument traded and the respective payment (or settlement) system used, the payment flows are not generally instantaneous, potentially happening on a day after the related trades, and have certain patterns during the day. In fact, all the four elements of the institutional environment of the money market can and do influence the evolution of prices and quantities in the money market. Therefore, the present section describes these four institutional elements for the euro money market, starting with a short introduction on the institutional framework for macro-economic monetary policy decisions.

B. THE IDEAL STRUCTURE AND CONSTRUCTION OF INDONESIA MONEY MARKET

After several years, Bank Indonesia revised its regulation regarding money market and also polished up its monetary policy on financial market and money market. The Indonesia Government realized that financial market is very important to preserve financial system stability. Financial deepening is one alternative choose by Bank Indonesia to increase financial service provision, it refer to wider choice of services and better access for many groups of investors or issuer in financial market. According to Bank Indonesia " ... Future strategic financial market development initiatives in Indonesia must be oriented towards achieving qualities of deep and globally competitive financial markets. Such qualities are: (i) ability to provide alternative sources of financing and investment; (ii) ability to facilitate risk mitigation; and (iii) ability to promote transaction efficiency by refining the quality of financial market infrastructure. ... "¹⁴

Open Market Operation is one of the most important decision that Indonesia Government take trough Bank Indonesia as the central bank, as part of monetary operation. Bank Indonesia Open Market Operation had been implemented since 1970s, it has been updated periodically by the Board of Governor of Bank Indonesia in-line with the Government's target. According to Bank Indonesia, the Open Market Operation is divided into two categories, first is Contractionary Open Market Operation, a special action done when the liquidity projection / the bank interest rate indicator

¹³ Hartmann, Manna, and Manzanares, "The Microstructure of the Euro Money Market," 2001.

¹⁴ Bank Indonesia, "Bank Indonesia."

points excess or overmuch the liquidity on the open market. It shown by the sharp drop in interbank money market rates. Bank Indonesia will used some instrument in contractionary open market operation such as SBI (Bank Indonesia Certificate) and SBIS (Bank Indonesia Sharia Certificate) issuance; Reverse Repo of Government Securities transaction; outright sale of Government Securities (SBN); term deposit and control of foreign exchange selling transactions against Rupiah.¹⁵ The second method is expansionary open market operation, which is launched when the liquidity projection or the interbank interest rate indicator points to a liquidity crunch on the money market, showed by the sharp rise in interbank money markets. Repo transactions, outright purchase of Government Securities (SBN) and foreign exchange buying transaction against Rupiah will be done to execute the expansionary open market operation.¹⁶

Another methods aside of open market operation are foreign exchange sterilization conducted actively by Bank Indonesia on foreign exchange market to safeguard the stability of the rupiah and application of statutory reserve requirement to maintain minimum amount of deposit percentage by banks stipulated by Bank Indonesia.¹⁷

For years those policies applied by Bank Indonesia to control financial market and money market in Indonesia, but those policies was shattered when world economy crashed on 2007/2008. Bank Indonesia was pushed to reevaluate its monetary policy.

National Strategy for Financial Market Development 2018-2024 Future strategic financial market development initiatives in Indonesia must be oriented towards achieving qualities of deep and globally competitive financial markets. Such qualities are: (i) ability to provide alternative sources of financing and investment; (ii) ability to facilitate risk mitigation; and (iii) ability to promote transaction efficiency by refining the quality of financial market infrastructure. It also develop a strong coordination among authorities, the FK PPPK (Coordination Forum on Development Financing), which consist of Bank Indonesia, the Ministry of Finance and also Financial Services Authority (OJK). This forum must formulating a National Financial Market Development and Deepening Strategy, a comprehensive and measurable single policy framework to create deep, liquid, efficient, inclusive and secure financial market. The coordination forum also success in creating a framework which called a three main pillars, 1) sources of economic financing and risk management; 2) market infrastructure development and 3) policy coordination, harmonization of regulation and education for society on financial and money market. The three pillars have been elaborated within seven development elements to be implemented in seven financial markets, namely the government bond market, corporate bond market, money market, foreign exchange market, stock market, structured products market and Islamic financial market.¹⁸

The forum also created timeline for implementation stages, 2018-2019 to strengthening the foundations; 2020-

2022 for acceleration period and 2023 -2024 to deepening the financial and money market.

In the form of regulation, some Bank Indonesia regulation already established to maintain a stronger and deep financial market and money market in Indonesia, such as Bank Indonesia Regulation Number 21/7/PBI/2019 Concerning Amendment To Bank Indonesia Regulation Number 20/10/PBI/2018 Concerning Domestic Non-Deliverable Forward Transactions.

But the most important thing that need to be done is the amendment of the Bank Central Act. It has been postponed for almost ten years, bypassed by the creation of OJK (Financial Services Authority). The old act of Bank Central or the Act number 23 year 1999 on Bank Indonesia, need a big and large reformation to backed up Bank Indonesia main task, one of them is in monetary policy.

A strong central bank with a huge back up from the Government (Ministry of Finance) will create a strong and health financial market which can be used by many institution in Indonesia, such as bank, insurance firm, pension fund firm, securities firm and multinational corporation to raise short term capital through financial market and money market.

V. CONCLUSION

Today, Indonesia money market regulation already exist and the financial market and money market is also actively exist. But compare with other countries, the existence of Indonesia financial market is not as active or interested by many investors. One of the main reason for that is because the skeptical from international investor towards Indonesia financial market.

Indonesia regulation on financial market and money market need a stronger umbrella, such as act. The lack of act on financial market burdened the fast motion of parties involved in financial market and money market. A new law to regulate central bank or Bank Indonesia and a new law to regulate financial market is a must.

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