

1999

Banking deregulation, banking/monetary aggregates and monetary policy

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**BANKING DEREGULATION, BANKING/MONETARY
AGGREGATES AND MONETARY POLICY**

Darsono, SE (Indonesia), MA (USA)

**A thesis submitted in total fulfillment
of the requirement for the degree of
Doctor of Philosophy**

**Department of Economics
Wollongong University
Australia.**

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LIST OF ACRONYMS

ADRL	: Auto Distributive Regression Lag
BPR	: Bank Perkreditan Rakyat (Rural Banks)
CAR	: Capital Adequacy Ratio
ECM	: Error Correction Mechanism
GDP	: Gross Domestic Product
GNP	: Gross National Product
IFS	: International Financial Statistics
KUK	: Kredit Usaha Kecil (Small Scale Credit)
LLL	: Legal Lending Limits
LLR	: Lender of Last Resort
NCG	: Net Claims on Central Government
NDC	: Net Domestic Credit
NFA	: Net Foreign Assets
NOP	: Net open Position
OLS	: Ordinary Least Square
OMO	: Open Market Operation
Pakjan 90	: Paket 29 Januari 1990 (The 29 January Package)
Pakjun 83	: Paket Juni 1983 (The 1 June 1983 Deregulation Package)
PAKTO 88	: Paket Oktober 1988 (The 28 October 1988 Deregulation Package)
PELITA	: Pembangunan Lima Tahun (Five Year Development Plan)
SBI	: Sertifikat Bank Indonesia (Bank Indonesia Certificates)

SBPU : Surat Berharga Pasar Uang (Money Market Securities)

TABANAS : Tabungan Nasional (Saving deposits)

TASKA : Tabungan Asuransi Berjangka (Time Deposits)

VAR : Vector Auto-regression

SUMMARY

The objective of this study is to evaluate the reliability of banking and monetary aggregates as guide to the conduct of monetary policy. Banking aggregates i.e. savings mobilized through the banking system and credit aggregates are analyzed in accordance with searching alternative variables and providing more information needed to facilitate monetary policy.

This study found that the possible presence of structural breaks for banking and monetary aggregates occurred in response to the second phase of banking deregulation. With regard to the long run relationships, this study confirmed the existence of stable long run equilibrium for all banking and monetary aggregates. However, for interest bearing aggregates i.e. savings, credit, modified narrow money and broad money, the stable equilibrium could only be achieved when applying the test procedures which allow for the presence of possible structural breaks. It implies that banking deregulation had more impact on interest bearing aggregates than on non interest ones. The latter, particularly currency and narrow money, are needed mainly to support transactions, therefore they are less responsive to changes in interest rates which under a deregulated system were allowed to reach their market clearing levels.

The short run relationships particularly with respect to changes in interest rates display an interesting result. Even though interest rates were statistically significant in explaining the short run variations of some interest bearing aggregates, however their magnitudes were considered too low to warrant a policy recommendation. In line with savings mobilization which has received considerable attention in the banking

deregulation, since interest rates were not effective enough as a measure to stimulate savings, the policy should be more focused on building and maintaining public confidence in the domestic banks. With regard to the implementation of monetary policy, it suggests that indirect monetary instruments which work through affecting the price i.e. interest rates were not effective. Clearly, under a deregulated system, banking and monetary aggregates are less controllable.

Banking and monetary aggregates mostly did not perform well in predicting the future course of variables regarded to be the objectives of monetary policy particularly inflation and real income. Nominal currency performs more consistently and statistically significant in explaining the future course of inflation, both in the full sample and sub sample period. Meanwhile none of the banking and monetary aggregates could perform well in explaining real income, particularly in the post banking deregulation sub sample period.

Briefly, in the long run banking and monetary aggregates are mostly still reliable as a guide to undertaking monetary policy in Indonesia, provided that stable long run equilibrium for those aggregates and the specified variables still exist regardless of the impact of banking deregulation. However, in terms of relationship with the variables presumed to be the objectives of monetary policy or predictability and controllability aspects, currency and narrow money and modified narrow money emerge as the most sensible variables to guide for the conduct of monetary policy.

STATEMENT OF AUTHORSHIP

Except where reference is made in the text of this thesis, this thesis contains no material published elsewhere or extracted in whole or part from a thesis presented by me for another degree or diploma.

No other person's work has been used without due to acknowledgement in the main text of the thesis.

This thesis has not been submitted for the award of any degree or diploma in any other tertiary institution.

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