Regional Dimensions of Monetary Policy in Indonesia

Ridhwan, M.H.A.

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Abstract

Monetary policy is structurally designed to address economic policy objectives of a country or a monetary union, but participating economies can have different economic structures and characteristics. As a consequence, monetary policies may have asymmetric effects amongst the participating economies and can have important distributional implications. For example, monetary policy tightening may provide a conducive macroeconomic environment in the core economy, while the periphery may suffer from higher interest rates and a tighter money supply. Based on literature and an empirical (econometrics) study, this dissertation focuses on the important role of geography in regional financial markets and the impact of national monetary policies on regional economic growth. A meta-analysis shows that the differential responses to monetary policy actions are primarily caused by regional differences in the sectoral composition and the financial structure of economies. This evidence is convincingly supported by a primary empirical analysis on the regional impact of monetary policy in Indonesia. It is furthermore shown that bank loan interest rates vary substantially across regions. These differences are partly explained by regional differences in risk factors, operating costs, economies of scale, and market concentration, but are also partly caused by regional characteristics. This latter result indicates that the Indonesian loan market is geographically segmented.