

# Countercyclical policies to support economic growth

*The anticipated monetary easing in 2025 presents a strategic opportunity that the banking sector should fully capitalize on.*

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Indonesia's economic conditions in the beginning of 2025 indicate a slowdown that must be addressed carefully.

Global challenges are rising with the tariff war between the United States and most of its trading partners, which has led to expectations of a global economic slowdown.

The International Monetary Fund in its latest projections revised Indonesia's economic growth forecast downward from 5.1 percent in January 2025 to 4.7 percent in April.

This adjustment reflects a broader global trend, as many other countries have also experienced downward revisions to their growth outlook.

Meanwhile, Indonesia's gross domestic product in the first quarter grew by 4.87 percent year-on-year (yoy), slowing from previous quarters that were consistently above 5 percent.

This deceleration is primarily caused by moderating fixed investment and government spending. Fixed investment grew by only 2.12 percent,

while government expenditure contracted by 1.38 percent.

Household consumption remains the main driver, yet its momentum is not strong enough to offset the drag from fiscal and investment sides, which highlights the urgency for more pro-growth policies to maintain the growth momentum.

In this situation, the key factor that can provide a cushion to the economy is a countercyclical approach, in both from fiscal and monetary policy. From the monetary side, an expansionary policy through lowering the Bank Indonesia (BI) Rate should provide support for credit growth.

Despite market volatility limiting the room to cut the benchmark rate, the recent low inflation and growth slowdown should justify such a move.

Core inflation remains within BI's target range, while global energy and food prices have been trending downward. At the same time, the rupiah has shown relatively stable appreciation after a period of market volatility when US President Donald Trump announced the reciprocal tariffs.

In mid-May 2025, the exchange rate was around Rp 16,430 per US dollar, strengthening from April 2025. Positive external sentiment has been reinforced by progress in global trade negotiations between the US and its trading partners, as evidenced by increased capital inflows and declining financial market risk premiums.

Moreover, Indonesia continues to maintain a positive interest rate differential relative to the US and even higher than several other ASEAN countries. Therefore, the potential for capital inflows should remain positive.

Additionally, with strong foreign exchange reserves and a relatively stable exchange rate, Indonesia's macroeconomic conditions provide sufficient space for a more accommodative monetary policy. Therefore, BI may have room to further cut the BI Rate by 25 bps, from 5.75 percent to 5.50 percent.

However, the effectiveness of interest rate cuts depends on how the policy is transmitted to the financial sector, particularly banking. Synergy between rate cuts and the macroprudential incentive liquidity policy (KLM) is key.

BI's KLM provides significant liquidity incentives to banks that channel credit to priority sectors, such as downstream industries, agriculture, micro, small and medium enterprises (MSMEs), manufacturing, the green economy and affordable housing.

A combination of accommodative monetary and macroprudential policy is expected to stimulate the productive sectors and restore domestic demand amid ongoing global uncertainties.

Based on BI data as of the second week of April, liquidity incentives distributed through the KLM have reached over Rp 370.6 trillion. Since April 1, 2025, the maximum KLM incentive threshold has also been relaxed from 4 percent to 5 percent of third-party funds (DPK).

These incentives are distributed across state-owned banks, national private banks, regional development banks and foreign bank branches, with an emphasis on strategic sectors that have high economic multiplier effects.

In the medium term, the synergy between the KLM and interest rate cuts can strengthen banking intermediation and promote healthy credit growth. Furthermore, the potential cut in the KLM incentives from 4 percent to 5 percent of DPK will provide banks with more ammunition

to expand funding and maintain sufficient liquidity while pushing credit into priority sectors.

Yet, efforts to boost credit must be balanced with prudential principles to avoid a spike in the nonperforming loans. Amid the rising risk of economic slowdown, banks must also cautiously monitor economic sectors specifically and selectively. In this context, strengthening credit risk management is essential.

Moreover, strong synergy between monetary, fiscal and financial regulators is crucial. Acceleration in government spending is essential to support liquidity and to provide stimulus for the private sector in driving economic activity.

The government must also continue structural reforms to build a more efficient and inclusive investment and financing ecosystem. The budget reallocation process may cause temporary delays in spending, but we believe government spending will accelerate in the second half of 2025.

Effective synergy and coordination between BI, the Financial Services Authority (OJK) and the government are essential to strengthening policy credibility and enhancing transmission to the real sector.

The anticipated monetary easing in 2025 presents a strategic opportunity that the banking sector should fully capitalize on. By aligning accommodative interest rate policies, macroprudential liquidity incentives and accelerated government spending, national banks can reinforce financial intermediation, ensure liquidity stability and expand financing to productive sectors.

Supported by prudent risk management and cohesive policy coordination, this approach can lay a strong foundation for a more resilient and sustainable Indonesian economy in the face of evolving global challenges.

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