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The Role of Financial Institutions in Controlling Inflation through Money Supply Policies in Indonesia in the Era of the COVID-19 Pandemic

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Abstract
The COVID-19 pandemic that has hit Indonesia since the beginning of 2020 has had a significant impact on national economic stability, especially in terms of controlling inflation and managing the money supply. This study aims to analyze the role of financial institutions, especially Bank Indonesia as a central bank and banking institution, in controlling inflation through money supply policies during the COVID-19 pandemic era. The research method used is a literature review study with empirical data analysis obtained from publications of Bank Indonesia, the Central Statistics Agency, and scientific journals for the period 2020-2024.The findings of the study indicate that Bank Indonesia has implemented a variety of accommodative monetary policy instruments, including the reduction of the BI 7-Day Reverse Repo Rate, the easing of the Minimum Mandatory Current Account, and the policy of purchasing Government Securities to maintain liquidity and stability of the financial system. Although the money supply has increased significantly during the pandemic period, inflation in Indonesia has remained under control within the set target range, even experiencing deflation in some periods. This shows the effectiveness of coordination between monetary and fiscal policies, as well as the active role of banking institutions in maintaining economic stability. The study concludes that financial institutions play a crucial role in controlling inflation through proper money supply management, although external challenges such as global price pressures and economic uncertainty remain to require continued vigilance.

Keywords: *Financial Institutions, Inflation, Money Supply, Monetary Policy, COVID-19 Pandemic, Bank Indonesia*

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INTRODUCTION

1 Indonesia's Economic Conditions During the COVID-19 Pandemic

Indonesia's economy has experienced a huge impact due to the COVID-19 pandemic since the announcement of the first case in early March 2020. The implementation of large-scale social restrictions by the government in an effort to stop the spread of the virus has caused severe disruptions to various economic sectors, especially tourism, hospitality, restaurants, retail, and transportation. On the other hand, the manufacturing sector is also facing pressure due to disruptions in the supply chain of raw materials, especially from China, resulting in scarcity and distribution delays.

Based on the analysis of the effectiveness of monetary policy (2025), Indonesia experienced a recession in 2020 with an economic contraction of 2.07 percent, although this figure is better than the initial projections and conditions in several other countries. This economic contraction is caused by a decline in public consumption, investment, and international trade due to restrictions on economic activity and high uncertainty (Mardiyani et al., 2025).

The impact of the pandemic on inflation shows interesting dynamics. Despite supply pressures due to supply chain disruptions and rising prices of some commodities, inflation in Indonesia in 2020 was at a low level of 1.68 percent, down from 2.72 percent in 2019. This low inflation rate reflects weak aggregate demand due to a decline in people's purchasing power and restrictions on economic activity.

2. Bank Indonesia's Monetary Policy Response

2.1 Reduction in the benchmark interest rate

In response to the impact of the COVID-19 pandemic, Bank Indonesia has implemented a series of accommodative monetary policies to support financial system stability and economic recovery, one of the prominent policy measures is the gradual adjustment of the BI 7-Day Reverse Repo Rate benchmark interest rate reduction. Referring to the findings of Ummah et al. (2024) regarding the response of monetary policy to inflation dynamics, in 2020 Bank Indonesia reduced the benchmark interest rate from an initial position of 5.00 percent to 3.75 percent to control inflation and support economic growth, with the aim of stimulating investment and consumption.

In 2021, Bank Indonesia maintained a low interest rate policy to support economic recovery amid uncertainty due to the COVID-19 pandemic. The BI 7-Day Reverse Repo Rate remains the main instrument in monetary policy used by BI to achieve balanced inflation and economic growth goals. According to Gading and Steven (2022) in their study of Bank Indonesia's monetary policy during the pandemic, it was stated that the BI 7-Day RR interest rate was maintained at 3.50 percent to maintain sufficient liquidity and encourage economic growth, with a focus on the domestic economic recovery affected by COVID-19. (Steven, 2022)

2.2 Easing of Minimum Mandatory Current Account

In addition to the reduction in the benchmark interest rate, Bank Indonesia also implemented a policy of easing the Minimum Mandatory Current Account as part of macroprudential policies to support the expansion of bank loans. This policy aims to provide greater flexibility for banks in managing liquidity and strengthen financial intermediation capacity. The easing of reserve requirements allows banks to allocate more funds for real sector

financing, especially useful for providing support to micro and small and medium-sized business sectors affected by the pandemic.

Based on research on monetary policy and its impact on lending rates (2025), significant structural changes were identified in 2020 during the pandemic, Bank Indonesia implemented a number of accommodative macroprudential policies to maintain the overall resilience of the financial sector in order to face risks arising from financial market failures that have the potential to trigger adverse economic crises. This policy has proven to be effective in maintaining the stability of the banking system and supporting the function of financial intermediation and current accounts

2.3 Government Securities Purchase Policy

The purchase of Government Securities in the primary market is one of the innovative steps implemented by Bank Indonesia during the pandemic. This step reflects the solid collaboration between Bank Indonesia and the government in addressing national economic problems. According to a study by Gading and Steven (2022), the purchase of Government Securities throughout 2020 on February 7, 2021 caused Indonesia's economic liquidity to become more expansive, which is reflected in the ratio of Liquid Instruments to Third-Party Funds which remained high at 31.64 percent and the growth of Third-Party Funds reached 10.57 percent on an annual basis.

This expansive liquidity supports the national economic recovery by opening up greater opportunities for banks to flow credit to the real sector. Bank Indonesia's coordination with the government's fiscal policy through the acquisition of SBN has proven to make a positive contribution to economic recovery and the maintenance of financial system stability amid pandemic pressures.

2.4 Exchange Rate Stability Policy

The rupiah faced significant pressure on the US dollar throughout the pandemic, which is a reflection of the combined influence of foreign and domestic factors. According to information from the Ministry of Trade (2024) reviewed by Situmorang et al. (2025), the US dollar exchange rate against the rupiah shows a tendency to increase from Rp13,901 in 2019 to Rp15,416 in 2023, although it had fluctuated in 2022 by reaching a high point of Rp15,731. This situation underscores the urgency of collaboration between monetary strategies and diplomacy in the economic field to maintain the stability of the rupiah exchange rate.

3. Dynamics of Money Supply During the Pandemic

The money supply in Indonesia has increased significantly during the COVID-19 pandemic period as a result of accommodative monetary policy. Based on Munawar's (2024) research on the influence of the money supply on inflation during the pandemic, data shows that the money supply fluctuates with an increasing trend from January 2020 to December 2020. In January 2020, the money supply was recorded at IDR 6,132,471 billion and increased to IDR 6,900,049 billion in December 2020.

This increase in the money supply is a logical consequence of various stimulus policies implemented, including the reduction of the benchmark interest rate, the easing of reserve requirements, and the purchase of SBN by Bank Indonesia. Despite the considerable increase

in the money supply, Bank Indonesia has managed to manage its impact on inflation through effective policy coordination and close monitoring of economic developments.

Further analysis shows that the growth of the money supply in a broad sense or M2 in 2020 reached 12.1 percent year on year, higher than the growth in 2019 which was 6.1 percent. This growth was driven by an increase in Third Party Funds in banking reflecting people's preference to store funds in liquid and safe instruments amid economic uncertainty, as well as the expansion of liquidity from accommodative monetary policy.

4 Inflation Developments During the COVID-19 Pandemic

4.1 Inflation in 2020

The development of inflation in Indonesia during the pandemic showed a unique pattern and was different from the initial predictions. In 2020, Indonesia's inflation was recorded very low, at 1.68 percent year on year, far below the inflation target set at 3.0 ± 1 percent. This low inflation rate is mainly due to weakening aggregate demand due to restrictions on economic activity and a decline in people's purchasing power.

Based on research by Ummah et al. (2024), low inflation in 2020 was recorded at 1.68 percent, down from 2.72 percent in 2019, with core inflation also low at 1.59 percent. This condition shows that inflationary pressures from the demand side are very weak, despite supply side disruptions due to mobility restrictions and supply chain disruptions. This low inflation provides ample room for Bank Indonesia to maintain an accommodative monetary policy without worrying about excessive inflationary pressures.

Even in certain periods, Indonesia experienced deflation or a decrease in the general price level. According to research on deflation in Indonesia (2024), deflation occurred consecutively for 5 months from May to September 2024, with deflation rates starting from 0.03 percent in May, 0.08 percent in June, 0.04 percent in July, 0.03 percent in August, and 0.12 percent in September. This deflationary condition is the worst since 1999, after a period of deflation during the COVID-19 pandemic.

4.2 Inflation in 2021-2023

In 2021, along with the start of the economic recovery process and the easing of activity restrictions, inflation began to show an increase although it remained under control. Inflation in 2021 was recorded at 1.87 percent, still below the lower limit of the inflation target. This condition shows that the economic recovery is taking place gradually and aggregate demand has not fully recovered to pre-pandemic conditions.

2022 will be a challenging year for inflation control in Indonesia. Based on research by Ummah et al. (2024), inflation in 2022 jumped to 5.51 percent, driven by rising global commodity prices, especially energy and food, as a result of the geopolitical conflict between Russia and Ukraine. This surge in inflation marks the end of a period of low inflation and prompted Bank Indonesia to start raising its benchmark interest rate in response to rising inflationary pressures.

In 2023, Bank Indonesia will continue its monetary tightening policy to control inflation that is still above target. Inflation in 2023 was recorded at 2.61 percent, showing the success of monetary policy in returning inflation to the set target range. The decline in inflation from 5.51 percent in 2022 to 2.61 percent in 2023 reflects the effectiveness of monetary policy implemented in a timely and measured manner.

4.3 The Relationship Between Money Supply and Inflation

An analysis of the relationship between the money supply and inflation during the pandemic period provides some interesting findings that enrich understanding of the transmission mechanism of monetary policy in Indonesia. Research by Ratri and Munawar (2022) using the Error Correction Model method found that in the long term, the money supply has a significant influence on the inflation rate in Indonesia during the COVID-19 pandemic, with a coefficient of 0.000016. These findings confirm the validity of the money quantity theory in the Indonesian context, where an increase in the money supply will ultimately encourage an increase in the general price level.

However, the same study also found that in the short term, the amount of money in circulation has no significant effect on inflation. This shows that there is a time lag or inaction in the transmission mechanism of monetary policy, where the impact of changes in the money supply on inflation takes time to fully manifest. This phenomenon is consistent with macroeconomic theory which states that monetary policy has an effect with a certain time lag.

Another interesting finding comes from the research of Iffatunnisa and Fisabilillah (2024) which found that an increase in the money supply does not necessarily lead to an increase in inflation. In their research, it was found that significant growth in money supply during the pandemic was followed by low inflation and even deflation in some periods. This is explained by the fact that the increase in the money supply is accompanied by an increase in demand and production of equivalent goods, so that prices remain stable.

This condition indicates that the relationship between the money supply and inflation is not mechanical and deterministic, but is influenced by various other factors such as the velocity of money, output gap, inflation expectations, and supply-side conditions of the economy. During the pandemic, although the money supply increased significantly, the velocity of money decreased as people tended to hold cash and increase the saving rate in response to uncertainty, so the impact on inflation was limited.

4.4 The Role of the Banking Sector in the Transmission of Monetary Policy

The banking sector plays a crucial role in the transmission of monetary policy to the real sector of the economy. As the main financial intermediation institution in Indonesia, banking functions as the main channel in distributing liquidity from Bank Indonesia's monetary policy to business actors and the public. Based on research by Gading and Steven (2022), the loose liquidity conditions due to various Bank Indonesia policies are reflected in the high ratio of Liquid Instruments to Third-Party Funds and positive deposit growth.

However, the effectiveness of monetary policy transmission through banking credit channels faced several challenges during the pandemic. Although liquidity in the banking sector has increased significantly, credit disbursement has not grown as rapidly as expected in the early phases of the pandemic. This is due to the increase in credit risk due to the decline in the quality of debtors affected by the pandemic, as well as banks' prudent attitude in disbursing loans amid high economic uncertainty.

To address these barriers, the government and Bank Indonesia have issued various supporting policies, including credit restructuring programs, relaxation of credit quality provisions, and various fiscal and monetary incentives to encourage credit disbursement to priority sectors. According to Hertinawati (2021), the OJK has issued a stimulus policy through

POJK No. 11/POJK.03/2020 which facilitates credit restructuring for debtors affected by the pandemic, both for conventional and sharia financial institutions.

4.5 Synergies between monetary policy and fiscal policy

The success of inflation control and economic stability during the pandemic is inseparable from effective coordination between Bank Indonesia's monetary policy and the government's fiscal policy. Hertinawati's research (2021) confirms the comprehensive harmonization between monetary and fiscal policies in the impact of the COVID-19 pandemic. The government has allocated a huge budget for the National Economic Recovery program which includes various fiscal stimulus, social assistance, and support for the health sector.

This coordination is manifested in various forms, one of which is the policy of purchasing SBN by Bank Indonesia in the primary market which allows the government to obtain cheaper and more certain financing for fiscal stimulus programs. This policy is a form of burden-sharing between monetary and fiscal authorities in the face of extraordinary crises, where the two collaborate to achieve the same goal, namely economic stability and sustainable recovery.

In addition, coordination is also seen in the synchronization of the timing and magnitude of policies. When Bank Indonesia implemented a very accommodative monetary policy at the beginning of the pandemic, the government also simultaneously launched a massive fiscal stimulus program. This coordination ensures that the two policies reinforce each other and do not work counterproductively, so that the combined impact of the two policies becomes greater and more effective.

4.6 Evaluation of the Effectiveness of Monetary Policy

An evaluation of the effectiveness of Bank Indonesia's monetary policy during the COVID-19 pandemic showed quite positive results despite several challenges. Based on research on the effectiveness of monetary policy (2025), although Indonesia's monetary policy has succeeded in maintaining macroeconomic stability, there are still challenges related to resilience to external turmoil such as the global financial crisis and the COVID-19 pandemic that require sustained attention.

From the aspect of inflation control, monetary policy can be considered effective because it has succeeded in keeping inflation within a controlled range despite various shocks both in terms of supply and demand. Low inflation in 2020-2021 suggests that accommodative monetary policy has not led to excessive inflationary pressures, while a rapid response in raising interest rates in 2022 has managed to bring inflation back into target in 2023.

In terms of economic growth, although Indonesia contracted in 2020, the depth of the recession was relatively milder compared to many other countries and the economic recovery took place faster. Indonesia's economic growth in 2021 reached 3.7 percent and continued to improve in the following years. This shows that accommodative monetary policy has contributed to supporting economic recovery despite the ongoing challenges from the pandemic.

From the aspect of stability in the financial system, various policies implemented by Bank Indonesia have succeeded in maintaining the stability of the banking sector and preventing financial crises. The bank's capital adequacy ratio remained above the minimum

requirement, the non-performing loan ratio, although it increased, remained within controlled limits, and there was no indication of bank runs or systemic panic in the financial sector.

4.7 Challenges and Limitations

While various monetary policies have been implemented effectively, there are some challenges and limitations that need to be acknowledged. First, the effectiveness of monetary policy transmission through banking credit channels was not fully optimal in the early phase of the pandemic due to the risk-averse attitude of banks. Second, the increasing money supply poses a long-term risk to price stability that requires a cautious policy normalization strategy.

Third, coordination between monetary and fiscal policies, although quite effective, raises debates about the independence of the central bank, especially related to the policy of buying SBN in the primary market, which under normal conditions is not a standard practice of the central bank. Fourth, the impact of monetary policy on various economic sectors is uneven, where certain sectors such as MSMEs and the informal sector are not fully reached by monetary policy transmitted through the formal banking system.

Fifth, external challenges such as the Federal Reserve's interest rate hikes, the Russia-Ukraine war, and global geopolitical tensions provide additional pressure on exchange rate stability and inflation that limit domestic monetary policy room for movement. According to Mardiyani et al. (2025), unstable global conditions underscore the urgency of collaboration between monetary policy and economic diplomacy in maintaining national economic stability.

CONCLUSION

Based on the analysis that has been conducted, this study has produced several important conclusions regarding the role of financial institutions in controlling inflation through money supply policies during the COVID-19 pandemic era in Indonesia. First, Bank Indonesia as the monetary authority has implemented a series of comprehensive and accommodative monetary policies to respond to the impact of the pandemic, including a reduction in the BI 7-Day Reverse Repo Rate from 5.00 percent to 3.50 percent, the easing of the Minimum Mandatory Current Account, and the implementation of the policy of purchasing Government Securities in the primary market.

Second, the money supply in Indonesia experienced a significant increase during the pandemic period as a consequence of expansionary monetary policy, with M2 growth reaching 12.1 percent in 2020. However, this increase in the money supply does not automatically lead to high inflation because it is offset by a decrease in the velocity of money and weak aggregate demand due to restrictions on economic activity.

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