IFG Progress Digest

When Trillions Nap in Banks: The Limits of Indonesia's Liquidity Push

October 6th 2025 - Issue 25, 2025

Ibrahim Khollilul Rohman, Acting Head of IFG Progress and Lecturer at Universitas Indonesia
Ibrahim.kholilul@ifg.id
Mohammad Alvin Prabowosunu, Junior Lead Research Associate, alvin.prabowosunu@ifg.id
Erin Glory Pavayosa Br Ginting, Junior Research Associate, erin.glory@ifg.id

Summary Result

- This paper takes a closer look at the government's decision to place two hundred trillion rupiah in state-owned banks, noting that while the policy may prevent funds from remaining idle at the central bank and strengthen banks' balance sheets, it does not necessarily lead to stronger credit growth nor faster economic recovery.
- Empirical evidence shows that lending rate movements have only a limited impact on credit volumes, suggesting that high lending rates in Indonesia are not solely the result of liquidity shortages. Firm survey data further indicate that complex procedures and high collateral requirements remain key obstacles preventing firms from accessing credit.
- To ensure success, the current liquidity injection should target borrowers with higher probabilities of success, drawing on lessons from the KUR program, where optimal success rate was limited to certain groups
- Unfavorable conditions amid weakening credit demand pose a significant challenge, further amplified by the sharp decline in working capital loans as the main indicator of productive lending alongside persistent weakness in household sentiment.

Introduction

In developing economies such as Indonesia, the bank lending channel constitutes the most critical conduit through which monetary and fiscal policies affect real economic activity. In contrast to advanced economies where firms may rely on well-developed bond or equity markets, Indonesian enterprises (particularly small and medium-sized enterprises/SMEs) remain heavily dependent on bank credit as their primary source of financing. This dependence is further reinforced by pervasive information asymmetries and the relatively shallow development of domestic capital markets.

Earlier empirical research by Agung (2000)[1] highlighted this structural feature, showing that monetary policy shocks in Indonesia exerted limited influence on the balance sheets of large banks. Instead, the transmission mechanism of policy has historically operated more strongly through credit availability than through interest rate adjustments. Moreover, smaller banks, lacking access to offshore funding sources, have exhibited greater sensitivity to domestic liquidity conditions, underscoring the fragility of the credit channel in the Indonesian financial system.

Against this backdrop, the Ministry of Finance recently reallocated approximately IDR 200 trillion in idle government funds from Bank Indonesia to state-owned commercial banks namely Bank Mandiri, BNI, BRI, BTN, and BSI. The underlying assumption is straightforward: an injection of liquidity into the banking system should expand lending capacity, which in turn would stimulate output growth. However, Indonesia's historical experience shows that the transmission mechanism has been less straightforward than what theory would predict. Factors such as risk aversion among banks, weak credit demand, and structural rigidities in the economy often attenuate the effectiveness of liquidity injections, thereby limiting their ultimate impact on real sector performance.

Weak Responsiveness of Credit Volume to Lending Rates

A central reason why liquidity injections into banks do not necessarily translate into higher lending in Indonesia lies in the limited role of interest rates as a clearing mechanism in the credit market. Our analysis demonstrates that lending rates are statistically insignificant predictors of credit dynamics, (IFG Progress Analysis, *forthcoming 2025*). Disaggregated results from a Vector Autoregression (VAR) framework further underscore this point: the impulse response of credit volumes to lending rates is muted, particularly among micro, small, and medium-sized enterprises (MSMEs). These borrowers exhibit little responsiveness to changes in lending costs (Exhibit 1).

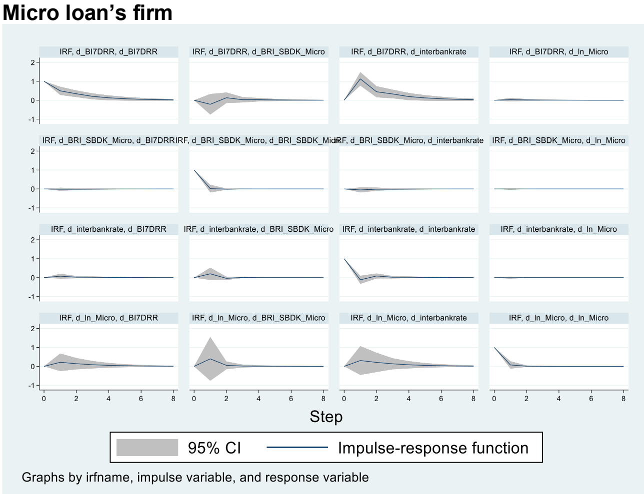
Even among large corporations, responsiveness of rates-lending transmission is limited, with credit demand shaped more by internal financing capacity or access to capital markets than by marginal movements in borrowing costs. This suggests

[1] Agung, Juda (2000) "Finacial Deregulation and Lending Channel in Developing Countries: Case of Indonesia," Bulletin of Monetary Economics and Banking: Vol. 3: No. 1, Article 2.

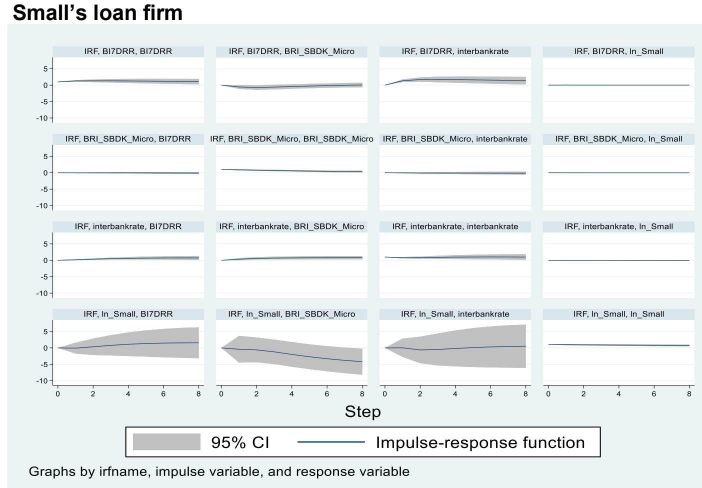
that high lending rates in Indonesia are not merely a reflection of liquidity shortages. Instead, they embody a combination of risk premiums, prudential regulatory requirements, and heightened risk aversion among banks in periods of economic uncertainty. This is further supported by the World Bank's enterprise survey, which finds that the main challenges preventing firms from applying for loans are not only unfavorable interest rates but also the complexity of procedures. In addition, high collateral requirements represent another major constraint faced by firms (see Exhibit 2 for details). In this context, additional liquidity in the banking system does not necessarily translate into greater intermediation to the real sector, as credit expansion itself continues to face numerous challenges.

Exhibit 1. Impulse Reaction Function of Credit Channel, by Firm Size

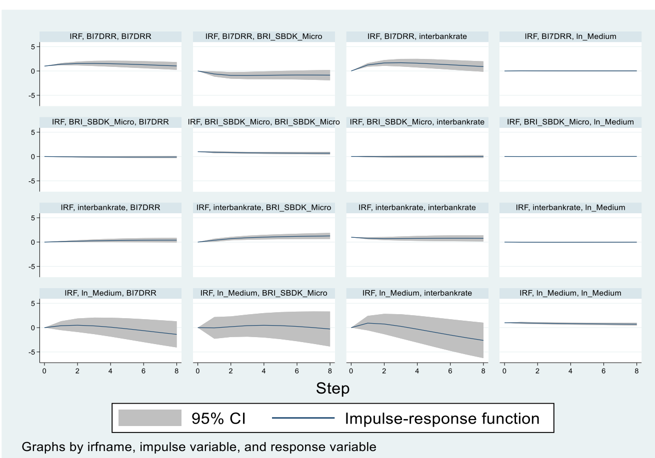
Micro loan's firm



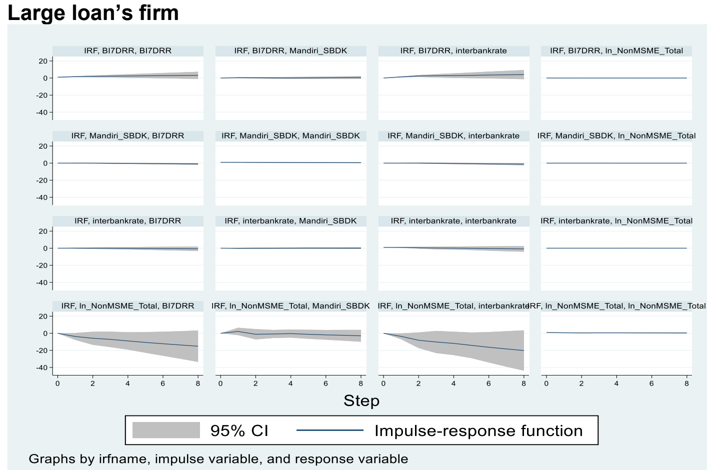
Small's loan firm



Medium loan's firm



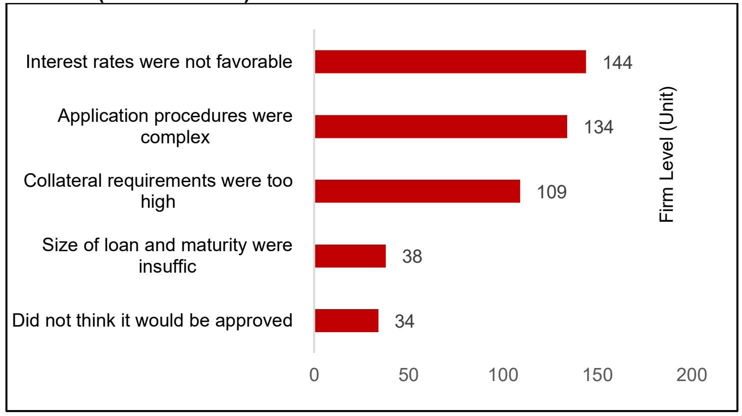
Large loan's firm



*Source: IFG Progress Analysis (2025)**

This insight is critical for assessing the recent IDR 200 trillion liquidity injection. Without a corresponding increase in real-sector demand and absent mechanisms to incentivize or mandate lending to riskier but productive segments, the newly injected liquidity risks remain idle. Banks may rationally choose to allocate surplus funds toward safer alternatives such as government securities or to strengthen their liquidity coverage ratios, rather than extending credit to SMEs. Our simple regression analysis supports this behavior: banks demonstrate a clear substitution effect; whereby incremental liquidity is more likely to be absorbed into securities portfolios than into loan expansion (Exhibit 3). These dynamic highlights the structural preference of banks for safe assets, thereby attenuating the policy's intended stimulative impact on productive investment.

Exhibit 2. Main reasons why firms refrained from applying for any line of credit (firm-level unit) as of 2023



*Source: World Bank Enterprise Survey (2023) (Processed)**

Lessons from Targeted Liquidity Programs and Possible Alternatives

The government expects the injected liquidity to be directed toward productive sectors such as infrastructure, renewable energy, and green financing. This mandate is outlined in Minister of Finance Decree (KMK) No. 276 of 2025 on the Placement of State Funds for Managing Cash Surpluses and Shortfalls to Support Government Programs in Promoting Economic Growth. By tying liquidity to programs such as *Kredit Usaha Rakyat (KUR)* or channeling it through cooperatives, the government aims to ensure that the funds generate more targeted and tangible impacts.

Kredit Usaha Rakyat (KUR), launched in 2007, has long served as Indonesia's flagship microcredit initiative. Its scale has grown dramatically from about fifty thousand recipients in its early years to over ten million today, while the average loan size has risen from less than six million rupiah per borrower to nearly forty million by 2023. Despite this impressive expansion, the program's macroeconomic impact remains limited. As highlighted in our previous study on the Economic Impact of KUR (*IFGP Economic Bulletin Issue-50, 2024*), a one percent increase in KUR disbursement is associated with only a 0.2 percent rise in the MSME contribution to gross regional domestic product (IFG Progress, 2024). Theoretically, since SMEs generate around sixty percent of national GDP, such an increase in financing should deliver a much stronger growth effect. In practice, however, the actual impact falls far short of that potential suggesting that while KUR plays an important role in supporting individual households and businesses, it has yet to deliver transformative change at the broader economic level.

Exhibit 3. Ordinary Least Square Regression Results on Banks' Preference for Securities over Lending

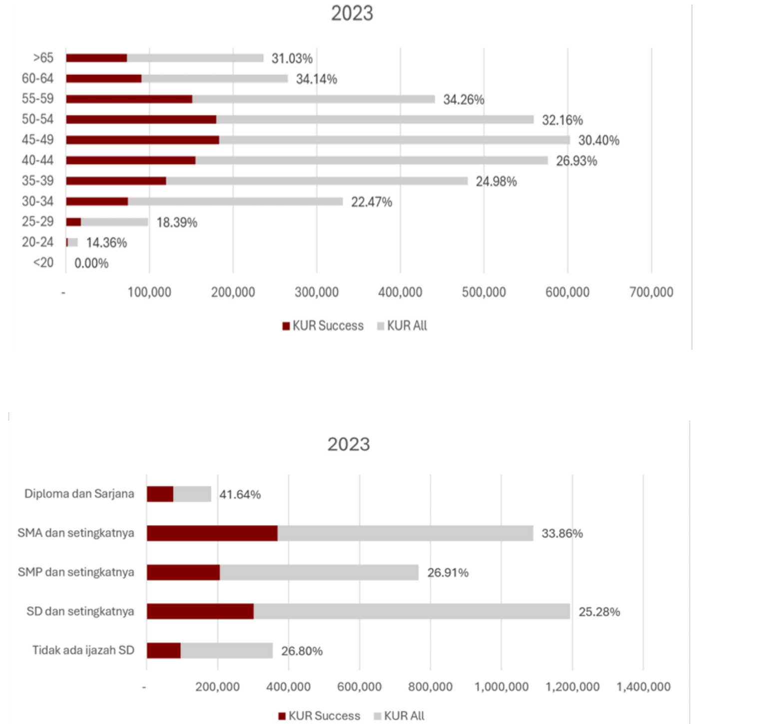
VARIABLES	(1) ln_Credit	(2) ln_Credit
ln_SBNOwnership	-0.121***	
	(0.0237)	
BIRate	0.0867***	0.0740***
	(0.00304)	(0.00357)
LendingRate	-0.225***	-0.207***
	(0.0126)	(0.00578)
SBN_AssetRatio		-0.0134***
		(0.00162)
Constant	18.96***	17.33***
	(0.440)	(0.0782)
Observations	83	83
R-squared	0.939	0.955

Source: IFG Progress Analysis, 2025

Our findings indicate that each additional one million rupiah of KUR financing raises household expenditure among beneficiaries by roughly 0.3 to 1 percent. For families living near the poverty line, such an increase is significant. However, once year and district fixed effects are taken into account, the magnitude of the impact diminishes, and in many cases the results lose statistical significance. At the district level, the mechanical calculation suggests that a one million rupiah rise in KUR disbursement translates into less than a 0.01% increase in average household expenditure. This helps clarify why, despite the disbursement of trillions of rupiah, the overall impact on aggregate GDP remains modest.

Our study also shows that KUR produces uneven outcomes, with success rates [2]varying across different groups of beneficiaries. The highest rates are recorded among borrowers aged forty to forty-nine, who are more likely to operate stable businesses (Exhibit 4). By contrast, younger recipients aged twenty to thirty exhibit lower success rates, highlighting the importance of experience and networks in translating credit into sustainable growth. Education also plays a role: higher levels of schooling increase the likelihood of success, yet the success rate among tertiary-educated borrowers has declined—from more than half during the program's early years to roughly forty percent in recent cohorts. These patterns suggest that as KUR expands its reach to a broader set of borrowers, the program faces diminishing returns.

Exhibit 4. Successful Rate of KUR based on Age Group (Top) and Education Level (Bottom) (Labels designate the Success Rate)



*Source: IFG Progress Analysis, 2024**
**IFGP Economic Bulletin Series-50*

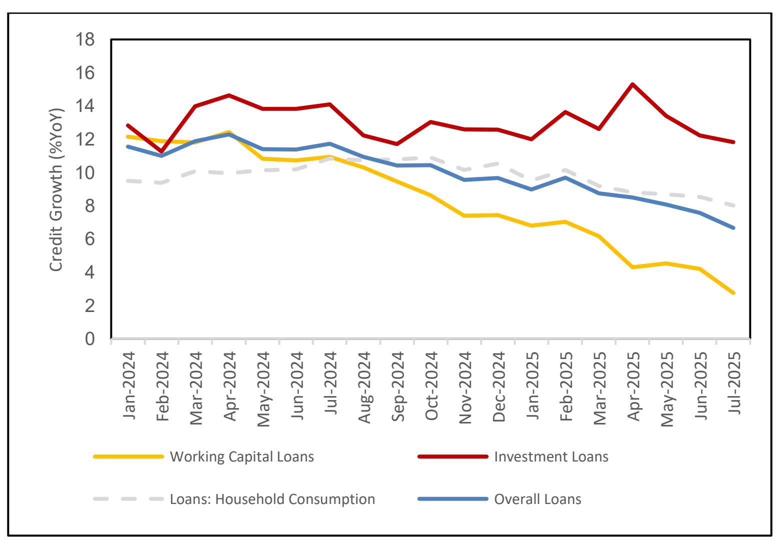
If the two hundred trillion-rupiah liquidity injection is allocated in a similar fashion, the outcome is likely to mirror that of KUR: meaningful but modest gains at the household level, without generating broad economic transformation. The real significance of KUR lies in its ability to deliver targeted welfare benefits, enabling vulnerable households to sustain their consumption. Should the liquidity injection adopt a comparable approach directing funds toward borrowers with higher probabilities of success, the overall impact could be far more substantial. Without such targeting, however, much of the capital may simply flow back into low-risk financial instruments, with little effect on stimulating real economic activity.

The cooperative sector presents another potential channel. Evidence from our earlier study, Unpacking the Myth of Cooperatives (IFGP Economic Bulletin Series-35), shows that the presence of cooperatives is not consistently associated with higher regional GDP or household consumption. However, cooperative-based lending, particularly through savings and loans, has a measurable impact on reducing unemployment. By supporting micro-entrepreneurs and self-employed workers in sustaining their businesses, these institutions help to lower joblessness (IFG Progress, 2025). Thus, channeling part of the liquidity through cooperatives could contribute to reducing unemployment, even if it does not translate into significant gains in aggregate output.

Unfavorable Conditions Amid Low Credit Demand

On the demand side, credit growth has slowed notably since late 2024, dropping from 9.55% (YoY) in November 2024 to 7.03% in August 2025. The steepest decline has been in working capital loans, an important proxy for productive financing that sustains firms' day-to-day operations. Growth in this category fell consistently, from 9.45% (YoY) in September 2024 to just 3.01% by August 2025. In contrast, overall credit expansion has been propped up by investment loans, whose contribution to economic activity tends to materialize only over the longer term (Exhibit 5). This weakening trajectory in working capital lending deserves close monitoring, particularly given that the government's IDR 200 trillion liquidity injection is

Exhibit 5. Low Credit Demand 2025



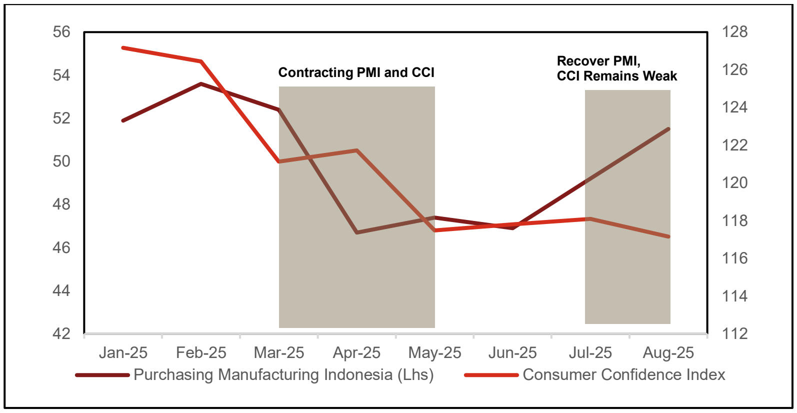
Source :CEIC, 2025

[2] A successful KUR is defined as a household recipient whose expenditure exceeds the 70th percentile of commercial credit recipients, based on tabulations from the 2014 and 2023 household data level from National Household Survey Data. [See the detail on IFG Progress Economic Bulletion Series-50, 2024](#)

intended to stimulate the real sector.

Equally important, the issue of timing presents a major challenge. While headline GDP grew by just over five percent year-on-year in the second quarter of 2025, this expansion was concentrated in capital-intensive sectors such as basic metals and chemicals. Besides, the consumer confidence index fell to 121 in July 2025 (the lowest level in nearly a year). As of August 2025, the consumer confidence index has yet to recover and continues to trend downward, underscoring persistent weakness in household sentiment. Besides, there is still faint signal of rebound as Purchasing Manager Index (PMI), returned above the contraction threshold of 50 in August 2025, however it has been staying below the threshold for four consecutive months since Aprill (Exhibit 6). This may suggest an early sign of recovery in business activity, which could eventually translate into stronger production and, in turn, greater financing needs in the near future. What this implies is that while the real sector, particularly households, remains reluctant to take on new credit, the business sector shows potential due to improving sentiment. Therefore, the key focus should be on how liquidity injections into banks can genuinely stimulate stronger credit demand, especially from businesses.

Exhibit 6. Trends in PMI and CCI Throughout 2025



Source :CEIC, 2025

Conclusion: The Uphill Task of Expanding Credit Growth

In summary, the decision to place two hundred trillion rupiah of government funds into state-owned banks may prevent idle money from sitting at the central bank and may bolster bank balance sheets, but it is not by itself a guarantee of stronger credit growth or faster economic recovery. Indonesian experience demonstrates that liquidity and interest rates are not the most binding constraints. What matters more is how funds are targeted and whether they reach borrowers capable of turning them into productive financing. The lesson from KUR is that targeted credit can improve household welfare but has limited macroeconomic impact. Unless the new injection is carefully directed toward high-success borrowers and productive sectors, it risks becoming another example of fiscal liquidity support that strengthens financial indicators but leaves the real sector stagnant.

Indonesia Financial Group (Persero)
Gedung Graha CIMB Niaga, 7th Floor
Jl. Jendral Sudirman Kav. 58
RT.5/RW.3, Senayan, Kebayoran Baru
Kota Jakarta Selatan, DKI Jakarta 12190
(+62) 021 2505080
Indonesia Financial Group
PT. Bahana Pembinaan Usaha Indonesia – Persero
@indonesiafinancialgroup
@ifg_id

Indonesia Financial Group (IFG)
Indonesia Financial Group (IFG) adalah BUMN Holding Perasuransian dan Penjaminan yang beranggotakan PT Asuransi Kerugian Jasa Raharja, PT Jaminan Kredit Indonesia (Jamkrindo), PT Asuransi Kredit Indonesia (Askrindo), PT Jasa Asuransi Indonesia (Jasindo), PT Bahana Sekuritas, PT Bahana TCW Investment Management, PT Bahana Artha Ventura, PT Bahana Kapital Investa, PT Graha Niaga Tata Utama, dan PT Asuransi Jiwa IFG. IFG merupakan holding yang dibentuk untuk berperan dalam pembangunan nasional melalui pengembangan industri keuangan lengkap dan inovatif melalui layanan investasi, perasuransian dan penjaminan. IFG berkomitmen menghadirkan perubahan di bidang keuangan khususnya asuransi, investasi, dan penjaminan yang akuntabel, prudent, dan transparan dengan tata kelola perusahaan yang baik dan penuh integritas. Semangat kolaboratif dengan tata kelola perusahaan yang transparan menjadi landasan IFG dalam bergerak untuk menjadi penyedia jasa asuransi, penjaminan, investasi yang terdepan, terpercaya, dan terintegrasi. IFG adalah masa depan industri keuangan di Indonesia. Saatnya maju bersama IFG sebagai motor penggerak ekosistem yang inklusif dan berkelanjutan.

Indonesia Financial Group (IFG) Progress
The Indonesia Financial Group (IFG) Progress adalah sebuah *Think Tank* terkemuka yang didirikan oleh Indonesia Financial Group sebagai sumber penghasil pemikiran-pemikiran progresif untuk pemangku kebijakan, akademisi, maupun pelaku industri dalam memajukan industri jasa keuangan.