BI Policy:

Tradeoffs and balancing acts

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10 February 2022

Executive Summary

- BI7DRR remains at 3.50% for 12 consecutive months. Additionally, further details on the upcoming RRR hike has been released, showing that the amended RRR policy is still quite much accommodative due to its RPIM incentives.
- Despite the record-breaking capital outflows, Rupiah has remained stable thanks to the combination of relatively mild inflation and robust trade surplus.
- Indonesia's defense against global monetary tightening risks has so far relied on its low inflation rates and substantial trade surplus. Unfortunately, there is a tradeoff between low inflation and hefty trade surplus, which makes BI not entirely immune to the trend of increasing rates.

- Bank Indonesia reached the one-year anniversary of the lowest policy rate in its history as the BI7DRR remained at 3.50% in its latest meeting. **Additionally, BI provided further details on its strategy to use the reserve requirement ratio (RRR) – which it will start raising on a gradual basis – as a tool to induce more lending into SMEs and other prioritized sectors,** with provisions to cut the Rupiah-denominated ratio by a maximum of 0.5% for banks that have fulfilled the so-called inclusive financing macroprudential ratio (RPIM) and another 0.5% for those that disburse loans for certain priority sectors.
- The latest announcement shows that BI's policies remain a mix of accommodative and pro-stability policies. Despite the planned RRR hike, the RPIM should in the medium-term lead to faster credit growth, as banks will disburse more loans towards a traditionally underserved segment. As such, the RPIM scheme, along with LTV policy and the steady BI7DRR should help keep the recovery momentum going, especially as the economy dives into another round of Covid outbreak.
- BI remains rather coy about following in the footsteps of an aggressive Fed, despite the fact that markets – increasingly worried over inflationary risks – are currently projecting five rate hikes over the course of the year ***(Chart 1)***, a sharp increase from the two hikes predicted earlier in the year. So why does BI remain comfortable lagging behind the curve? One possible explanation is that unlike some emerging economies (such as Brazil, Russia, and Mexico among others), where central banks

have been forced to increase their policy rates to combat inflation, Indonesia still has the luxury of a relatively tame (albeit rising) inflation rate.

- Indeed, the government's arsenal of price control mechanisms has been successful so far in keeping domestic prices relatively stable, despite the constant downpour of inflationary pressures. This is in sharp contrast to the sky-high inflation rate observed in the US (with the latest number at 7.5% YoY), which has helped push real yields down to much lower levels relative to those in Indonesia ***(Chart 2)***. **As such**, **BI still has some wiggle room to withhold from raising rates, as domestic prices are still relatively low and real yield differentials between Indonesia and the US remain quite high.**

- BI's tranquil demeanor amid the Fed's hawkish pose is also justified by the Rupiah's relatively stable exchange rate, which is largely due to Indonesia's strong trade surplus. Indeed, it is the buffer of Indonesia's trade surplus that has allowed the Rupiah to remain stable even amidst record capital outflows (which have already exceeded the large outflows recorded during the onset of Covid), especially from the bond market.

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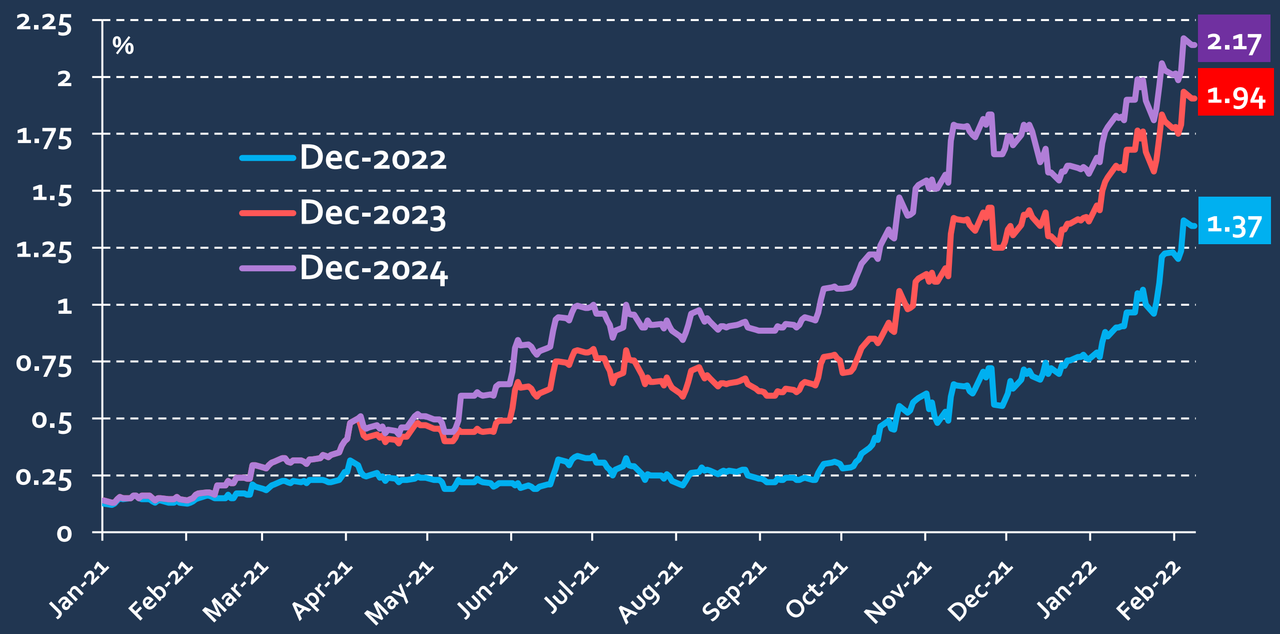
- Low rates of inflation, as well as a large trade surplus then, have so far made up the bulk of Indonesia's defense mechanism against the risks of global monetary tightening. **Unfortunately, maintaining these two buffers simultaneously could become more challenging going forward as there seem to be growing tradeoffs of maintaining one over the other**. For instance, the policy to maintain low coal prices domestically (Domestic Market Obligation/DMO) had led to a domestic coal shortage, which forced the government to temporarily ban coal exports in January – essentially taking a hit to its trade surplus in order to avoid a domestic energy shortage.

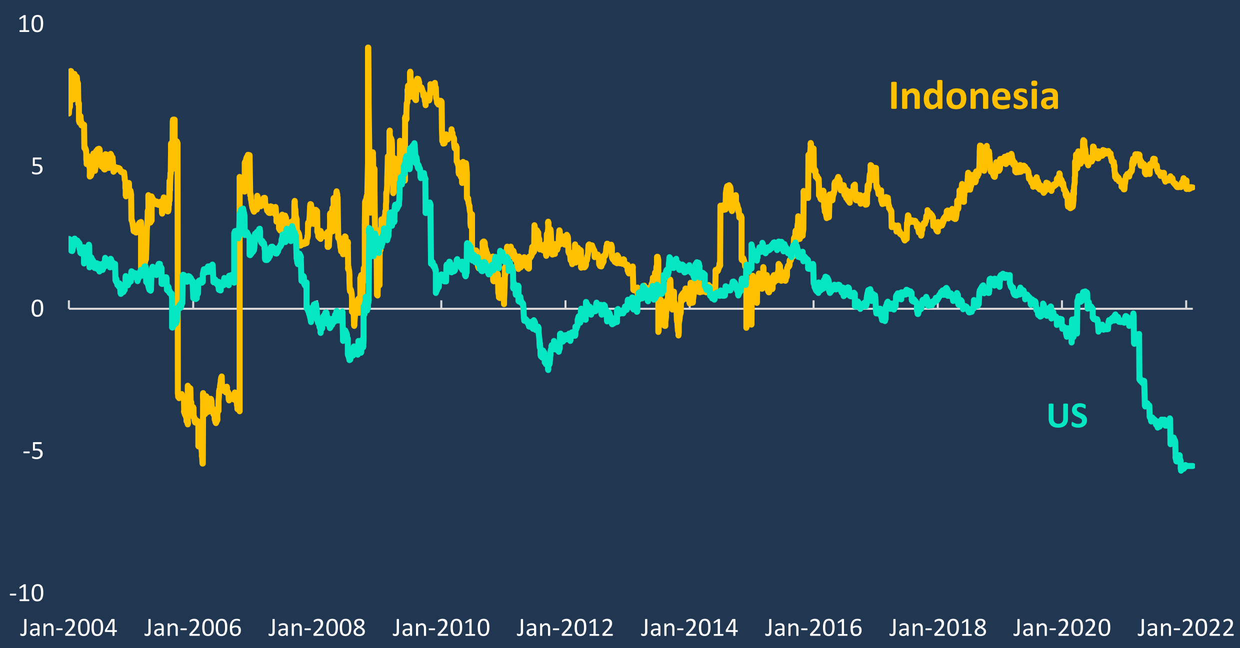
- A similar scenario may now be in play for CPO, as the government employs similar tactics to maintain low cooking oil prices in the domestic market. With global commodity prices continuing to climb upwards – at least in the short-term – it remains to be seen how the government proceeds with its balancing act of keeping inflation low and maintaining a healthy trade surplus. These policy limitations mean that Bank Indonesia is not entirely immune to the Fed's hawkish turn, despite Indonesia's impressive defenses. A series of projected rate hikes amounting to 50-100 bps in 2022 then, seems to be the most plausible scenario for now.

Chart 1. Fed has been increasingly aggressive on its hawkish signals…



Source: Bloomberg

Chart 2. …while Indonesia doesn't need to be as aggressive thanks to the expanding real yield differentials



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	0.25	Mar-20	-6.75
UK	0.25	Dec-21	-5.15
EU	0.00	Mar-16	-5.10
Japan	-0.10	Jan-16	-0.90
China (lending)	4.35	Oct-15	2.85
Korea	1.25	Jan-22	-2.35
India	4.00	May-20	-1.59
Indonesia	3.50	Feb-21	1.32
Money Mkt Rates	**7-Feb**	**-1 mth**	**Chg (bps)**
SPN (1M)	3.42	3.45	-3.2
SUN (10Y)	6.48	6.44	3.8
INDONIA (O/N, Rp)	2.79	2.79	0.3
JIBOR 1M (Rp)	3.55	3.55	0.0
Bank Rates (Rp)	**Oct**	**Sep**	**Chg (bps)**
Lending (WC)	8.78	8.85	-6.86
Deposit 1M	3.13	3.24	-10.58
Savings	0.72	0.73	-1.87
Currency/USD	**7-Feb**	**-1 mth**	**Chg (%)**
UK Pound	0.739	0.736	-0.38
Euro	0.874	0.880	0.72
Japanese Yen	115.1	115.6	0.40
Chinese RMB	6.362	6.378	0.24
Indonesia Rupiah	14,393	14,351	-0.29
Capital Mkt	**7-Feb**	**-1 mth**	**Chg (%)**
JCI	6,804.9	6,701.3	1.55
DJIA	35,091.1	36,231.7	-3.15
FTSE	7,573.5	7,485.3	1.18
Nikkei 225	27,248.9	28,478.6	-4.32
Hang Seng	24,579.6	23,493.4	4.62
Foreign portfolio ownership (Rp Tn)	**Jan**	**Dec**	**Chg (Rp Tn)**
Stock	2,314.3	2,286.1	28.23
Govt. Bond	887.3	891.3	-4.06
Corp. Bond	23.0	22.9	0.09

Trade & Commodities	7-Feb	-1 mth	Chg (%)
Baltic Dry Index	1,422.0	2,289.0	-37.9
S&P GSCI Index	639.9	578.1	10.7
Oil (Brent, $/brl)	92.7	81.8	13.4
Coal ($/MT)	193.6	149.6	29.5
Gas ($/MMBtu)	4.37	3.83	14.1
Gold ($/oz.)	1,820.5	1,796.6	1.3
Copper ($/MT)	9,806.8	9,692.0	1.2
Nickel ($/MT)	23,814.0	20,859.0	14.2
CPO ($/MT)	1,389.7	1,267.9	9.6
Rubber ($/kg)	1.75	1.74	0.6
External Sector	**Dec**	**Nov**	**Chg (%)**
Export ($ bn)	22.38	22.84	-2.0
Import ($ bn)	21.36	19.33	10.5
Trade bal. ($ bn)	1.02	3.52	-71.0
Central bank reserves ($ bn)^	141.3	144.9	-2.49
Prompt Indicators	**Dec**	**Nov**	**Oct**
Consumer confidence index (CCI)	118.3	118.5	113.4
Car sales (%YoY)	68.1	62.4	54.1
Motorcycle sales (%YoY)	67.4	95.6	39.9
Cement sales (%YoY)	-0.9	-2.6	5.3
Manufacturing PMI	**Jan**	**Dec**	**Chg (bps)**
USA	57.6	58.8	-120
Eurozone	58.7	58.0	70
Japan	55.4	54.3	110
China	49.1	50.9	-180
Korea	52.8	51.9	90
Indonesia	53.7	53.5	20

Source: Bloomberg, BI, BPS
Notes:
^Data for January 2022
*Data from earlier period
For changes in currency: **Black indicates appreciation against USD, **Red** otherwise
***For PMI, **>50** indicates economic expansion, **<50** otherwise

Indonesia – Economic Indicators Projection

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	5.2
GDP per Capita (US$)	3877	3927	4175	3912	4350	4640
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	3.3
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.0
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	14,660
Trade Balance (US$ billion)	11.8	-8.5	-3.2	21.7	35.3	30.6
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.6*	0.1

* Provisional numbers for 2021

** Estimation of Rupiah's fundamental exchange rate

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