BI Policy:
# A game of two halves

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**Executive Summary**

- Bank Indonesia maintained the BI 7DRR at 3.50%, consistent with its recent accommodative posture to keep the momentum for economic recovery.
- The policy mix have so far been successful in keeping inflation in check. However, tighter Fed policy poses a two-pronged risk to the exchange rate considering that lower commodity demand will dampen Indonesia's windfall while foreign capital may begin to flow back into the core market.
- Some measure of BI 7DRR hikes may be needed to provide additional mechanisms to maintain the IDR's value, as the risks from further depreciation (fiscal and external debt) outweigh potential gains in export competitiveness.

- The shaking of the tree almost certainly shakes its branches; unsurprisingly the same observation holds in the global economy. It's started with a higher-than-expected May inflation reading, which has forced the Federal Reserve to accelerate its tightening plans; causing central banks from Europe to the Gulf to move in the same motion. However, such a sentiment is yet to make ground among Indonesian policymakers, which for now continues to stroll on its diverging path. Consistent with its dovish signals in recent weeks, Bank Indonesia (BI) maintained its 7-Day Repo Rate (BI-7DRR) at 3.50% while the reserve requirement ratio (RRR) is sitting at 6% with another 300-bps hike coming until September as planned.

- BI's relative equanimity is best explained as a product of "division of labor" between it and the government in dealing with inflation, which was strengthened by new sets of policies in May. On one hand, the expansion of government subsidies take care of energy inflation, while on the other hand, BI's RRR hike is aimed at curbing monetary growth – and therefore core inflation. Amid fiscal expansion and burgeoning trade surplus, there appears to be a need to cool down credit growth to the private sector (9.1% per Apr-22) ***(Chart 1)***.

- So far, the combination of commodity windfall (current account surplus) and positive real yields (which benefits from the stringent inflation control) has become the main buffer against external risks. However, the weakening of the IDR value in the past week surely begs some questions as to how long that these buffers would hold. As we have shown in previous reports, EM currencies' performance is more correlated with real policy rates, and countries that have hiked rates at earlier dates (mostly Latin American countries) has seen rising or at least more stable currency moves throughout the first half of 2022.

- Unfortunately, BI's job may not get easier going forward. The Fed's signal for further rate hikes would further tighten US Dollar liquidity, increasing outflows from Indonesian domestic capital market that could put further pressure on Indonesia's FX coffers ***(Chart 2)***. More specific to commodity exporters, lower demand due to global recession may also reduce Indonesia's commodity windfall, as apparent among some agriculture commodities (CPO included) which have been affected of late. Per our previous reports, stratospheric prices in the global commodity market are the primary determinant behind Indonesia's outsized trade surplus. Whether through a decline in trade volume or price normalisation (or both), Indonesia's outsized trade surplus could take a hit, taking away one primary buffer.

- Complicating the situation is the fact that inflation stability is itself dependent on IDR's value, as weakening IDR would enlarge the government's (already substantial) energy subsidies budget. And then there is the issue that rising RRR would limit banks' capacity to finance both government deficit and private financing needs, resulting in higher yield on the long-end even in the absence of rate hikes on the short-end.

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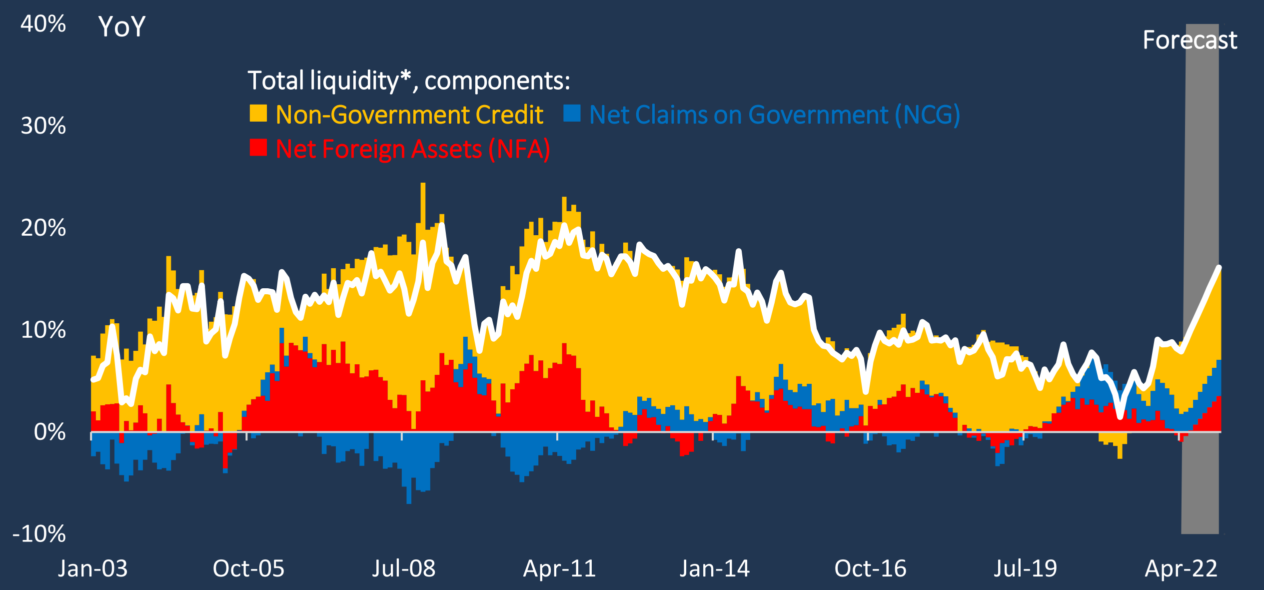
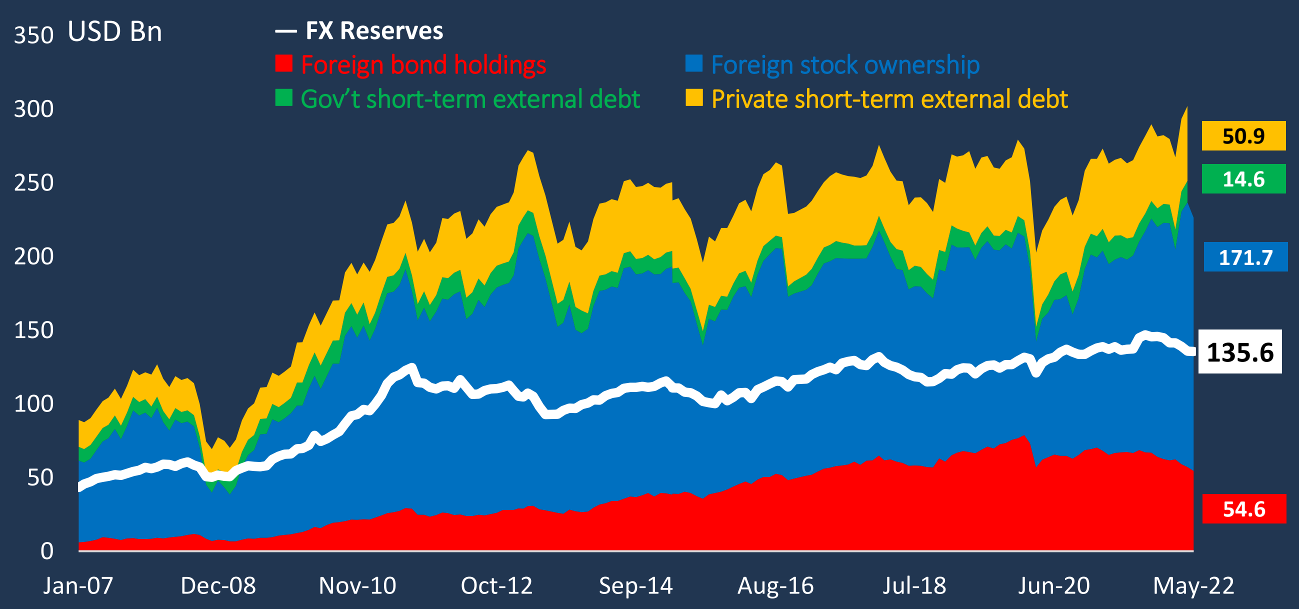
- There is an argument to be made that the Rupiah does need to be taken down a notch to maintain Indonesia's export competitiveness (i.e. avoiding Dutch disease amid the commodity boom). However, the benefits of such depreciation might be limited in the short term, considering that the increasingly probable global economic slowdown would lower demand for all sorts of tradable goods. Despite BI's current posture, then, the risk-reward calculus thus remains tilted toward a modest amount of rate hikes. Indeed, 2022 may look like a game of two halves, as BI is pouring all it could manage to maintain growth momentum throughout the first half while the second half might be all about securing the win (it is 1-0 to economic growth for now but the Fed's accelerated tightening is controlling the ball now) by keeping both inflation and the IDR's value in check. It is with this basic calculus in mind that we maintain our call that the BI 7DRR may end the year at a level 50-150 bps higher than the present.

***Chart 1. NCG and NFA are boosting liquidity while higher RRR should slow down credit growth to suppress core and monetary inflation***




**Source:** Bank Indonesia
Last Update: Apr-2022 (May-Dec 2022 data is a forecast)

***Chart 2. FX reserves remain strong but it can provide limited defence in the event of massive capital outflow***




**Source:** BI
*Feb-Dec 2022 are forecasts

## Selected Macroeconomic Indicator

| Key Policy Rates | Rate (%) | Last Change | Real Rate (%) |
|---|---|---|---|
| US | 1.00 | May-22 | -7.60 |
| UK | 1.00 | May-22 | -8.10 |
| EU | 0.00 | Mar-16 | -8.10 |
| Japan | -0.10 | Jan-16 | -2.60 |
| China (lending) | 4.35 | Oct-15 | 2.25 |
| Korea | 1.75 | May-22 | -3.65 |
| India | 4.90 | Jun-22 | -2.14 |
| Indonesia | 3.50 | Feb-21 | -0.05 |
| **Money Mkt Rates** | **22-Jun** | **-1 mth** | **Chg (bps)** |
| SPN (1M) | 1.53 | 1.12 | 40.7 |
| SUN (10Y) | 7.46 | 7.20 | 26.5 |
| INDONIA (O/N, Rp) | 2.80 | 2.79 | 0.8 |
| JIBOR 1M (Rp) | 3.54 | 3.54 | -0.4 |
| **Bank Rates (Rp)** | **Feb** | **Jan** | **Chg (bps)** |
| Lending (WC) | 8.62 | 8.66 | -3.55 |
| Deposit 1M | 2.85 | 2.88 | -3.49 |
| Savings | 0.63 | 0.69 | -6.27 |
| **Currency/USD** | **22-Jun** | **-1 mth** | **Chg (%)** |
| UK Pound | 0.815 | 0.801 | -1.71 |
| Euro | 0.946 | 0.947 | 0.02 |
| Japanese Yen | 136.3 | 127.9 | -6.15 |
| Chinese RMB | 6.702 | 6.693 | -0.14 |
| Indonesia Rupiah | 14,868 | 14,652 | -1.45 |
| **Capital Mkt** | **22-Jun** | **-1 mth** | **Chg (%)** |
| JCI | 6,984.3 | 6,918.1 | 0.96 |
| DJIA | 30,483.1 | 31,261.9 | -2.49 |
| FTSE | 7,089.2 | 7,390.0 | -4.07 |
| Nikkei 225 | 26,149.6 | 26,739.0 | -2.20 |
| Hang Seng | 21,008.3 | 20,717.2 | 1.41 |
| **Foreign portfolio ownership (Rp Tn)** | **May** | **Apr** | **Chg (Rp Tn)** |
| Stock | 2,503.9 | 2,599.7 | -95.79 |
| Govt. Bond | 795.7 | 827.9 | -32.12 |
| Corp. Bond | 18.1 | 18.5 | -0.47 |

| Trade & Commodities | 22-Jun | -1 mth | Chg (%) |
|---|---|---|---|
| Baltic Dry Index | 2,349.0 | 3,344.0 | -29.8 |
| S&P GSCI Index | 742.0 | 765.8 | -3.1 |
| Oil (Brent, $/brl) | 111.7 | 112.6 | -0.7 |
| Coal ($/MT) | 366.3 | 365.9 | 0.1 |
| Gas ($/MMBtu) | 6.60 | 7.97 | -17.2 |
| Gold ($/oz.) | 1,837.7 | 1,846.5 | -0.5 |
| Copper ($/MT) | 8,773.5 | 9,451.0 | -7.2 |
| Nickel ($/MT) | 24,389.0 | 27,941.0 | -12.7 |
| CPO ($/MT) | 1,150.1 | 1,537.3 | -25.2 |
| Rubber ($/kg) | 1.57 | 1.61 | -2.5 |
| **External Sector** | **May** | **Apr** | **Chg (%)** |
| Export ($ bn) | 21.51 | 27.32 | -21.3 |
| Import ($ bn) | 18.61 | 19.76 | -5.8 |
| Trade bal. ($ bn) | 2.90 | 7.56 | |
| Central bank reserves ($ bn)* | 135.6 | 135.7 | -0.04 |
| **Prompt Indicators** | **May** | **Apr** | **Mar** |
| Consumer confidence index (CCI) | 128.9 | 113.1 | 111.0 |
| Car sales (%YoY) | -9.8 | 5.0 | 16.0 |
| Motorcycle sales (%YoY) | -2.5 | -7.1 | -13.6 |
| Cement sales (%YoY) | N/A | -10.0 | 23.2 |
| **Manufacturing PMI** | **May** | **Apr** | **Chg (bps)** |
| USA | 56.1 | 55.4 | 70 |
| Eurozone | 54.6 | 55.5 | -90 |
| Japan | 53.3 | 53.5 | -20 |
| China | 48.1 | 46.0 | 210 |
| Korea | 51.8 | 52.1 | -30 |
| Indonesia | 50.8 | 51.9 | -110 |

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 | 4.8 |
| GDP per Capita (US$) | 3877 | 3927 | 4175 | 3912 | 4350 | 4615 |
| Consumer Price Index Inflation (% YoY) | 3.6 | 3.1 | 2.7 | 1.7 | 1.9 | 4.2 |
| BI 7 day Repo Rate (%) | 4.25 | 6.00 | 5.00 | 3.75 | 3.50 | 4.0 |
| USD/IDR Exchange Rate (end of year)** | 13,433 | 14,390 | 13,866 | 14,050 | 14,262 | 14,660 |
| Trade Balance (US$ billion) | 11.8 | -8.5 | -3.2 | 21.7 | 35.3 | 48.5 |
| Current Account Balance (% GDP) | -1.6 | -3.0 | -2.7 | -0.4 | 0.3 | 1.4 |

* Provisional numbers for 2021

** Estimation of Rupiah's fundamental exchange rate

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