

BI Policy:

A more delicate balancing act

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Executive Summary

- BI raised its policy rate to 5.25% following the November meeting. The 50 bps hike came as no surprise given the IDR's lacklustre performance despite the weakening USD. BI maintain its accommodative macroprudential policies, announcing the issuance of SME loans-backed securities to promote its inclusive financing goal.
 - Improving global outlook did little to support the IDR's value as the plummeting coal prices weaken investors' sentiment on the IDR.
 - A flatter yield curve would help BI in its effort to stabilise the IDR's value. As such, we expect that BI would hike the BI 7DRR by another 25-50 bps in the December meeting to widen the yield spread on short-term bonds.
- Bank Indonesia raised the BI7DRR by 50 bps to 5.25% during its November meeting, the same call as the previous two meetings which brings the total rate hike in 2022 to 175 bps. As before, BI tempers its rate hike with accommodative macroprudential policies, this time by announcing the issuance of new securities (SBPI) backed by SME loans. A liquid market in SBPI would facilitate BI's policy goal of raising the ratio of SME loans in banks' portfolio to 30% by 2024.
 - Returning to the rate policy, the decision comes amidst intensifying debates over whether the Fed should start considering slowing the pace of interest rate hikes, as evident from the recent rally in riskier markets. A slew of good news that comes out throughout the month strengthen investors' risk-on sentiment. For one, the softening US inflation number shows that the Fed's policy mix had gone some way in deflating excess demand and suppressing inflation. And the encouraging outcome from the 2022 US midterm election also erases the spectre of a debt-ceiling debacle, adding more certainty regarding the US Government's fiscal programme.
 - Moreover, the apparent détente between the US and Chinese governments in the G20 meeting – held, of course, in Indonesia – also help to cool geopolitical tensions. China's decision to unwind some of its pandemic measures add to the realm of good news we had received throughout the month.
 - These positive news, unfortunately, have mixed impact for the Indonesian economy. For one, foreign capital has started to return into the domestic bond market as investors rediscover its risk-on sentiment. However, such a positive development did little to support the IDR's

value. Indeed, the IDR continued to weaken in November, in contrast to other currencies which have been able to recover some of its value as the USD starts to normalise.

- The key factor here is commodity prices. As the fear of gas shortage in Europe is alleviated, the price of coal and gas both plummeted, weakening the prospects of Indonesia's exports – although this has been counterbalanced by slowing import growth. Meanwhile, the inflows into the bond market have been matched by outflows from equities as foreign investors pull away from the domestic energy sector. So while the current situation comes as a relief for the Euro and global inflation prospects, it is putting the IDR under renewed pressure.
- It is crucial, then, for BI to maintain significant yield spreads to protect the IDR's value against the still-strong US Dollar. The deeper inversion of the US yield curve further highlights the urgency behind BI's rate hike and 'operation twist'. The fact that Indonesia's yield curve still looks normal versus the US actually complicates the issue of IDR stability, as yield differentials are widest where bond market liquidity is drying fast – i.e. on the longer end – and narrowest where the liquidity is relatively more ample – i.e. on the shorter end. A flatter yield curve should support bond inflows while keeping longer loan rates relatively undisturbed.
- The global economic slowdown has forced BI to perform a more delicate balancing act. The central bank cannot completely revoke its accommodative policy stance, for domestic demand has normalised while the corporate sector has remained quite conservative. At the same time, still-high inflation figures coupled with the IDR's not-so-stellar performance throughout the month would force the BI to continue tightening its policy. Luckily for BI, the government's present fiscal position portends more spending throughout the rest of the year, providing a substantial boost for economic growth. The division of labour, then, would allow BI to turn its full attention on the presently ailing IDR, at least for now. As such, we expect BI to continue to raise the BI 7DRR to the tune of 25-50 bps in the next meeting, closing the year at around 5.5-5.75%.

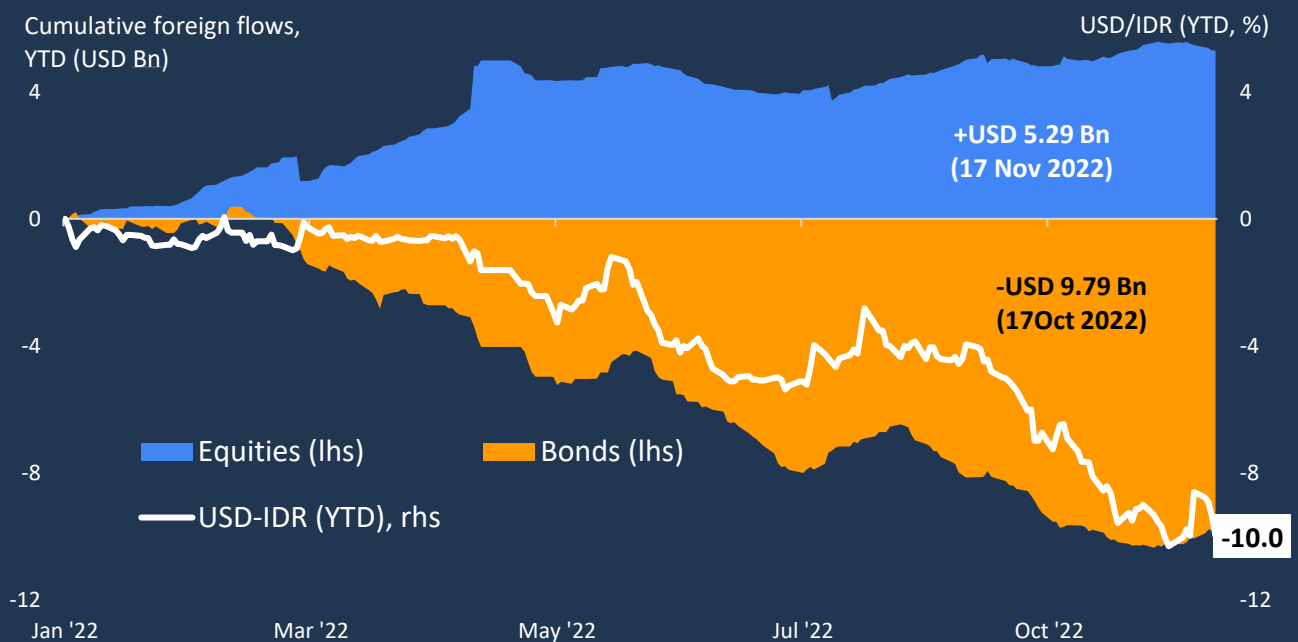
"The deeper inversion of the US yield curve further highlights the urgency behind BI's rate hike and 'operation twist' "

Chart 1. Plummeting coal prices put a strain on the IDR's value despite still-substantial trade surplus



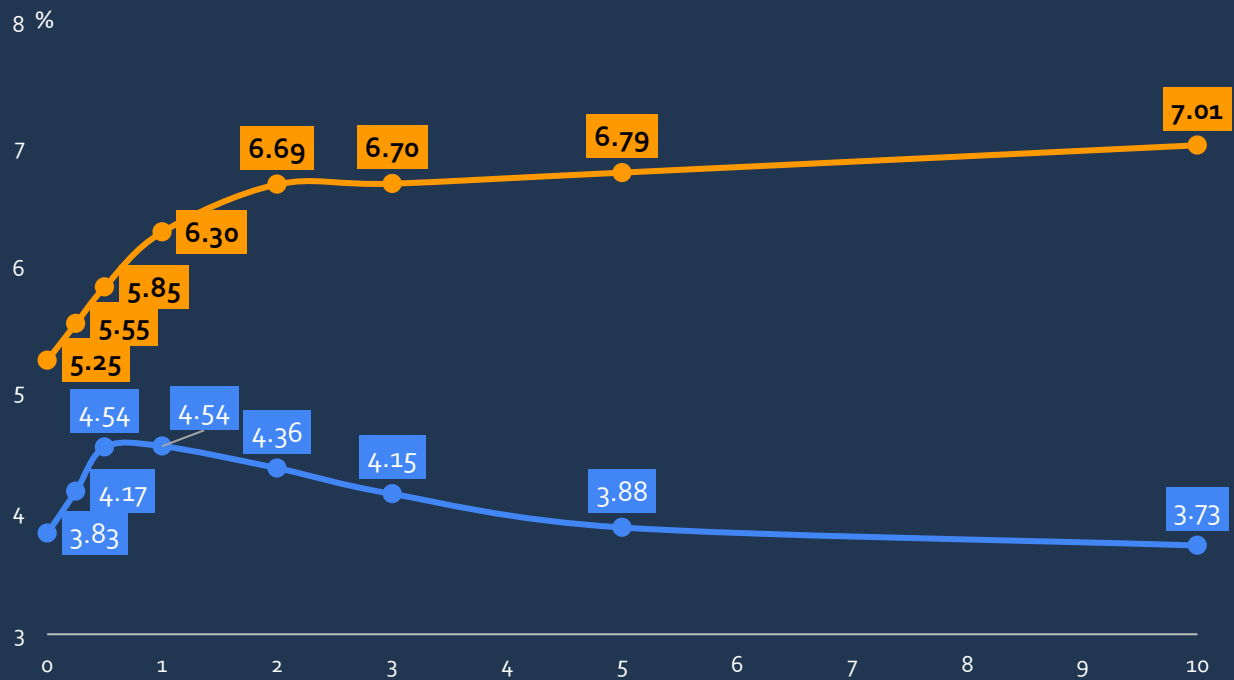
Source: Bloomberg

Chart 2. The seemingly improving global outlook push bond investors back to the Indonesian market while stock investors retract as coal prices starts to normalise



Source: Bloomberg

Chart 3. Indonesia's still-normal yield curve might complicate the issue of IDR's stability as it provides little incentives for investors to start collecting Indonesian bonds



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	16-Nov	-1 mth	Chg (%)
US	3.25	Oct-22	-4.45	Baltic Dry Index	1,288.0	1,838.0	-29.9
UK	2.25	Oct-22	-8.85	S&P GSCI Index	638.5	631.9	1.0
EU	2.00	Oct-22	-8.70	Oil (Brent, \$/bbl)	92.9	91.6	1.3
Japan	-0.10	Jan-16	-3.10	Coal (\$/MT)	316.1	397.0	-20.4
China (lending)	4.35	Oct-22	2.25	Gas (\$/MMBtu)	5.92	5.80	2.1
Korea	3.00	Oct-22	-2.70	Gold (\$/oz.)	1,773.9	1,644.5	7.9
India	5.90	Sep-22	-0.87	Copper (\$/MT)	8,260.8	7,652.8	7.9
Indonesia	4.75	Oct-22	-0.96	Nickel (\$/MT)	27,438.0	21,660.8	26.7
Money Mkt Rates	16-Nov	-1 mth	Chg (bps)	CPO (\$/MT)	871.7	791.1	10.2
				Rubber (\$/kg)	1.28	1.31	-2.3
SPN (1M)	4.14	3.46	67.3	External Sector	Oct	Sep	Chg (%)
SUN (10Y)	7.00	7.35	-34.9	Export (\$ bn)	24.81	24.78	0.1
INDONIA (O/N, Rp)	4.30	3.81	48.5	Import (\$ bn)	19.14	19.81	-3.4
JIBOR 1M (Rp)	5.45	4.94	51.5	Trade bal. (\$ bn)	5.67	4.97	14.2
Bank Rates (Rp)	Jul	Jun	Chg (bps)	Central bank reserves (\$ bn)*	130.2	130.8	-0.45
Lending (WC)	8.42	8.40	1.37	Prompt Indicators	Oct	Sep	Aug
Deposit 1M	2.83	2.84	-1.02	Consumer confidence index (CCI)	120.3	117.2	124.7
Savings	0.64	0.62	1.50	Car sales (%YoY)	23.3	18.9	16.4
Currency /USD	16-Nov	-1 mth	Chg (%)	Motorcycle sales (%YoY)	20.9	10.7	11.6
UK Pound	0.839	0.895	6.64	Manufacturing PMI	Oct	Sep	Chg (bps)
Euro	0.962	1.029	6.92	USA	50.2	50.9	-70
Japanese Yen	139.5	148.7	6.57	Eurozone	46.4	48.4	-200
Chinese RMB	7.098	7.193	1.33	Japan	50.7	50.8	-10
Indonesia Rupiah	15,603	15,423	-1.15	China	49.2	48.1	110
Capital Mkt	16-Nov	-1 mth	Chg (%)	Korea	48.2	47.3	90
JCI	7,014.4	6,814.5	2.93	Indonesia	51.8	53.7	-190
DJIA	33,553.8	29,634.8	13.22				
FTSE	7,351.2	6,858.8	7.18				
Nikkei 225	28,028.3	27,090.8	3.46				
Hang Seng	18,256.5	16,587.7	10.06				
Foreign portfolio ownership (Rp Tn)	Oct	Sep	Chg (Rp Tn)				
Stock	2,630.5	2,526.7	103.76				
Govt. Bond	713.2	730.3	-17.02				
Corp. Bond	15.4	15.5	-0.12				

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



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Indonesia – Economic Indicators Projection

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	5.1
GDP per Capita (US\$)	3877	3927	4175	3912	4350	4564
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	6.4
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	5.5
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	15,584
Trade Balance (US\$ billion)	11.8	-8.5	-3.2	21.7	35.3	45.5
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.3	1.4

** Estimation of Rupiah's fundamental exchange rate

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