

BI Policy:

Adapting to changing global conditions

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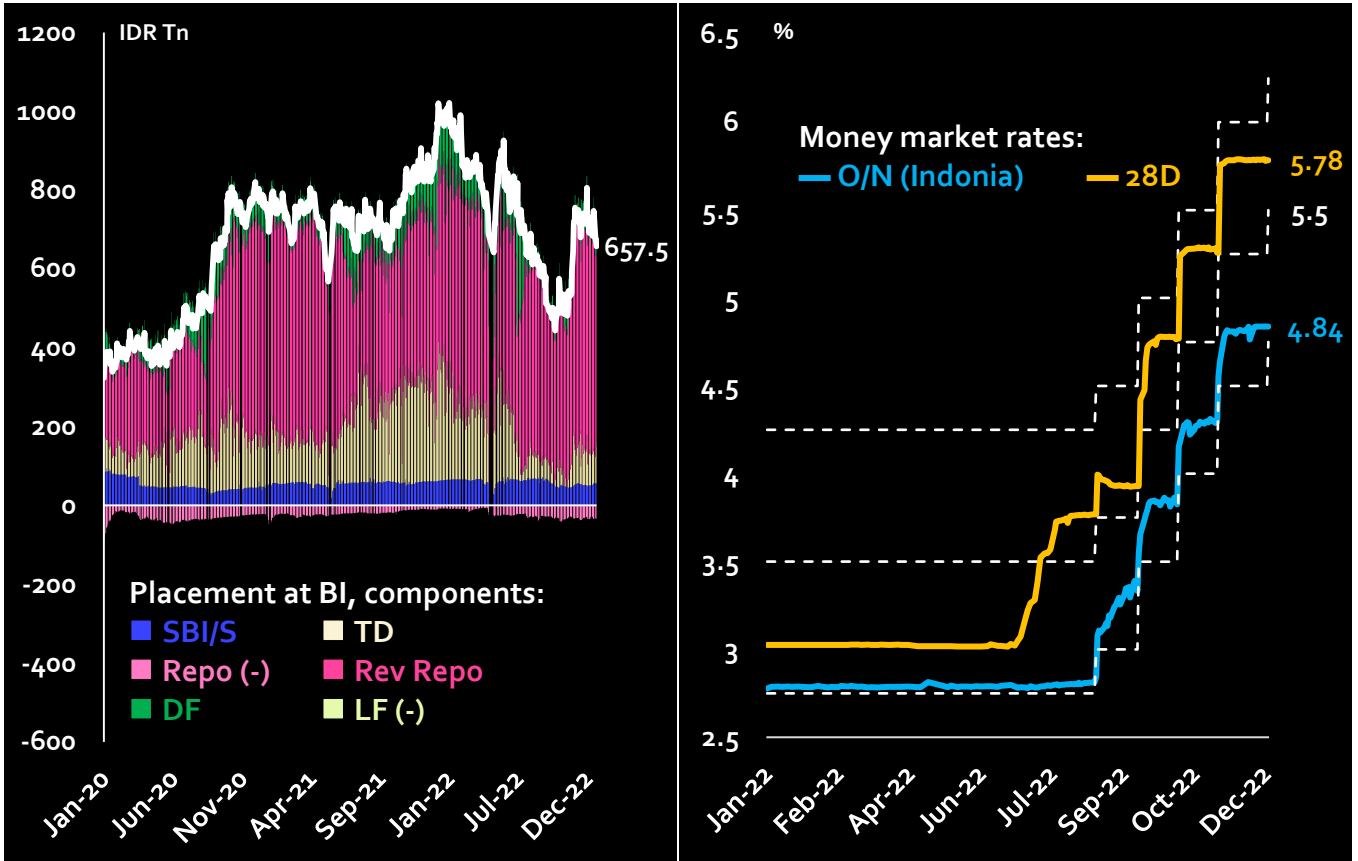
Executive Summary

- BI delivered a 25 bps policy hike for its December meeting. The rate hike was BI's response to the changing global conditions: less aggressive Fed coupled with rising recessionary risks and still elevated inflation above Fed's target.
- Increasingly fuzzy policy path coupled with thinning liquidity in the holiday season has baffled markets and reduce investor appetite. Commodity prices remain elevated but coupled with reduction in manufacturing demand, increasing urgency of bringing export receipts back home.
- The modest rate hike coupled with declining Indonesian and US inflation bring back interest rate differential to a stable 3%, attracting foreign inflows into the bond market while still maintaining domestic interest rates steady.
- BI's rate hike cycle should be ending soon but continued global uncertainty would force it to adapt a more conservative stance for the time being, pushing up its policy rate to 6.00% early next year.

- Bank Indonesia delivered a 25 bps policy rate hike for its December meeting, the first after three consecutive 50 bps rate hikes the months before. This reflects BI's adaptation with the changing global monetary environment and looming risk of global recession. The hike was also paired with some accommodative macro prudential policies (RRR incentives), and most importantly also new measures to drive export proceeds back home.
- BI's smaller policy rate was in line with the Fed's slowing monetary tightening due to lower US inflation and in preparation of the looming global recession. Latest PMI, new export orders and trade data have pointed out to worsening economic prospects, which may be signs of an upcoming recession. However on the other end inflation, while lower than before remains elevated due to stickier rent, services and wage prices. The Fed's own dot plot suggest its tightening campaign is not over yet as it envision a policy rate of 5% by the end of 2023, an increase of 50 bps from today's level.
- Therefore the main issue is whether demand destruction that follows easing inflation would worsen the labor market and create a deep recession. Data from the Philadelphia Fed already indicates worsening job creation in twenty seven states. Already latest global trade data has shown significant decline in volume and prices due to weakening demand. Meanwhile the situation in China rapidly deteriorates as spreading Covid-19 infections disrupt consumer and business activities, coupled with overstocking of inventories and declining manufacturing orders.

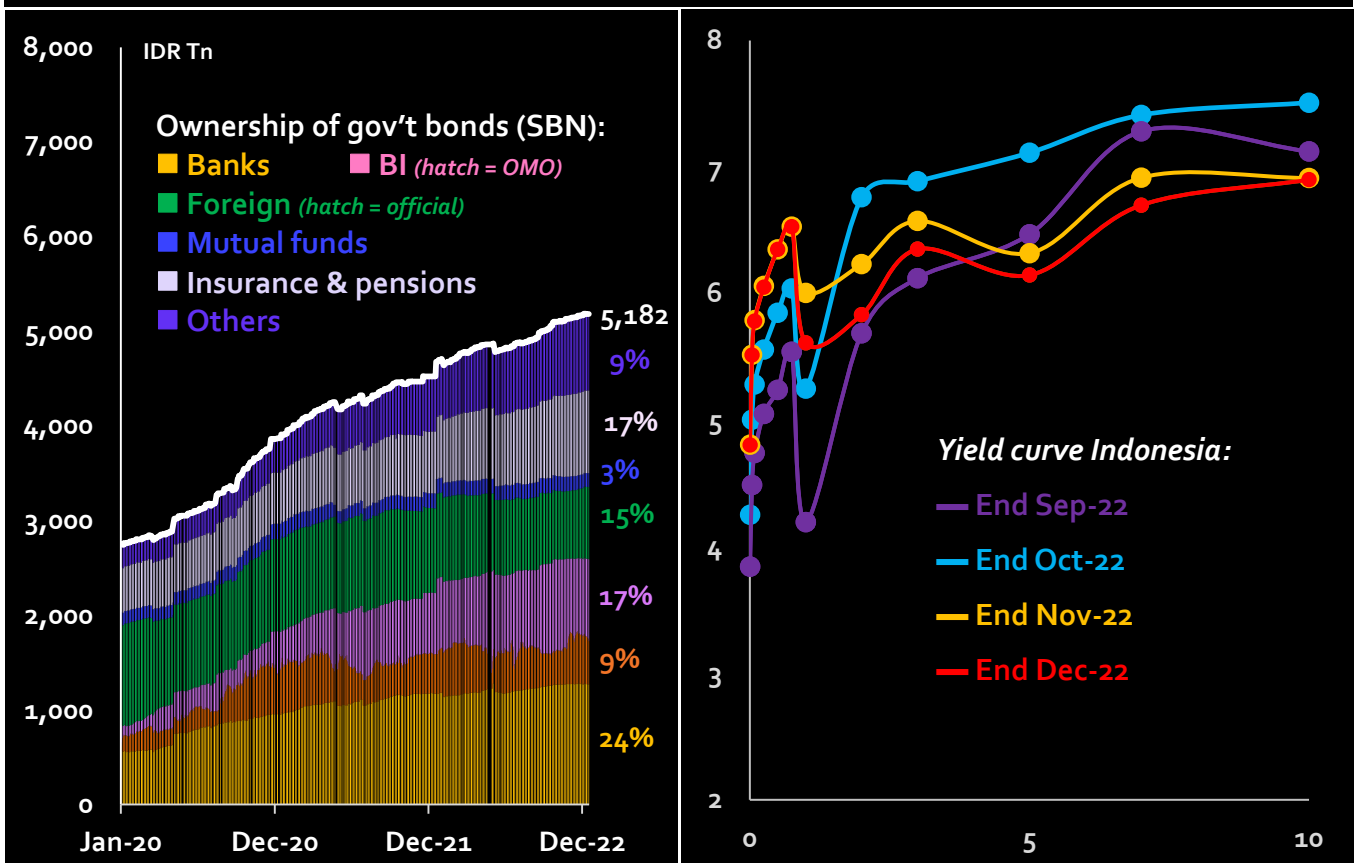
- Another noteworthy global development was The Japanese central bank (Bank of Japan) move to widen the range of its yield curve control by 25 bps while maintaining its policy overnight rate at -0.1%. There are two distinct probabilities. The first is that this is a technical move, where the BoJ increase its range and reduce the need for continuous bond market interventions. The second is that this is the start of a tightening cycle, in which the BoJ will continuously increase the range followed by increase in policy overnight rates to curb depreciating Yen. In the short run, it would increase attractiveness of Japanese assets, reducing demand for US treasuries and therefore pushing yields up and US Dollar down. For Indonesia, it would have mixed effects and weaker Dollar will reduce imported inflation but rising yields would increase capital outflows and thereby increase depreciation pressures on the IDR. We are in favor of the first option as the BoJ's decision did not increase its policy overnight policy rate.
- Increasingly fuzzy policy path coupled with thinning liquidity in the holiday season has baffled markets and dampen investor appetite into emerging market assets, resulting in spouts of foreign inflows and outflows and limited sideways Rupiah movements. Meanwhile usual defender, commodity prices remained elevated –coal prices increasing due to diminishing natural gas storage in Europe and palm oil prices rise due to expected shortages due to monsoon rains- while looming global recessionary risks reduce demand of manufactured and other commodities.
- This increases the urgency of bringing export receipts back home to support the Rupiah. Indeed, exporters have few incentives to bring back FX from export activities as the expected returns are well below equivalents in foreign markets. To do this, the central bank announced it would launch new instrument in the money market to attract FX liquidity, most likely launching higher interest open market tools to entice banks into depositing FX liquidity. However it will depend on a large part on bank's willingness to adjust rates on FX deposits without the important guarantee from LPS. Another more direct way to do it is to offer FX bonds directly to exporters.
- This month's BI rate hike would bring back the real rate differential to a stable 3% so ubiquitous in the past as US and Indonesian inflation decline. It would ease efforts to attract foreign inflows in the nation's bond markets. Declining domestic inflation has already cause the Indonesian yield curve to slightly flatten. This would also support the ongoing domestic momentum as it will not trigger higher rates on consumer loans such as mortgages, pushing the property sector.
- Entering a new year of 2023, BI will need to traverse global challenges-economic bifurcation, geopolitical tension and high energy prices- and navigate a changing global monetary environment. There is significant fuzziness on the "usual" savers: commodity prices, foreign inflows and low inflation. Therefore BI is likely to be conservative with its policy rate hover at 6.00% for next year.

Panel 1. BI's tightening cycle has not significantly reduce domestic liquidity



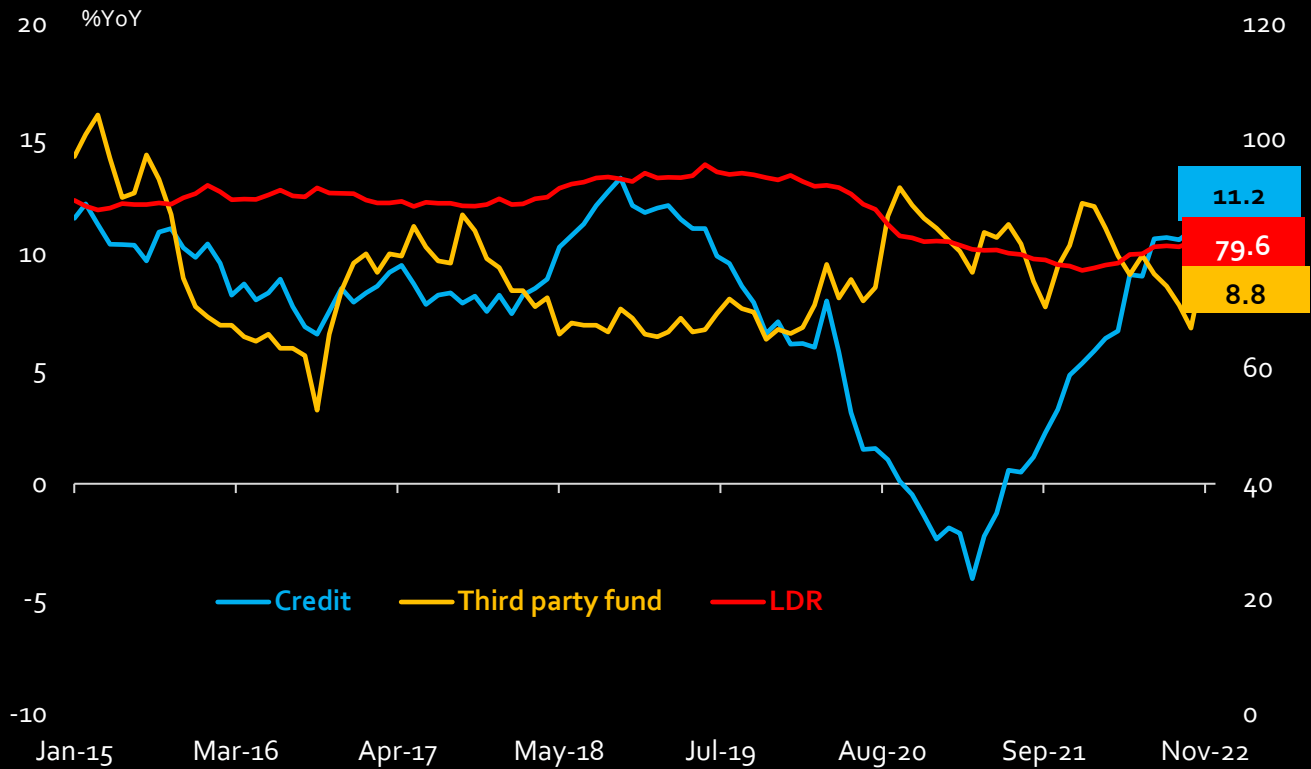
Source: BI, Bloomberg, BCA Economist

Panel 2. Lower domestic inflation reduce steepness of yield curve



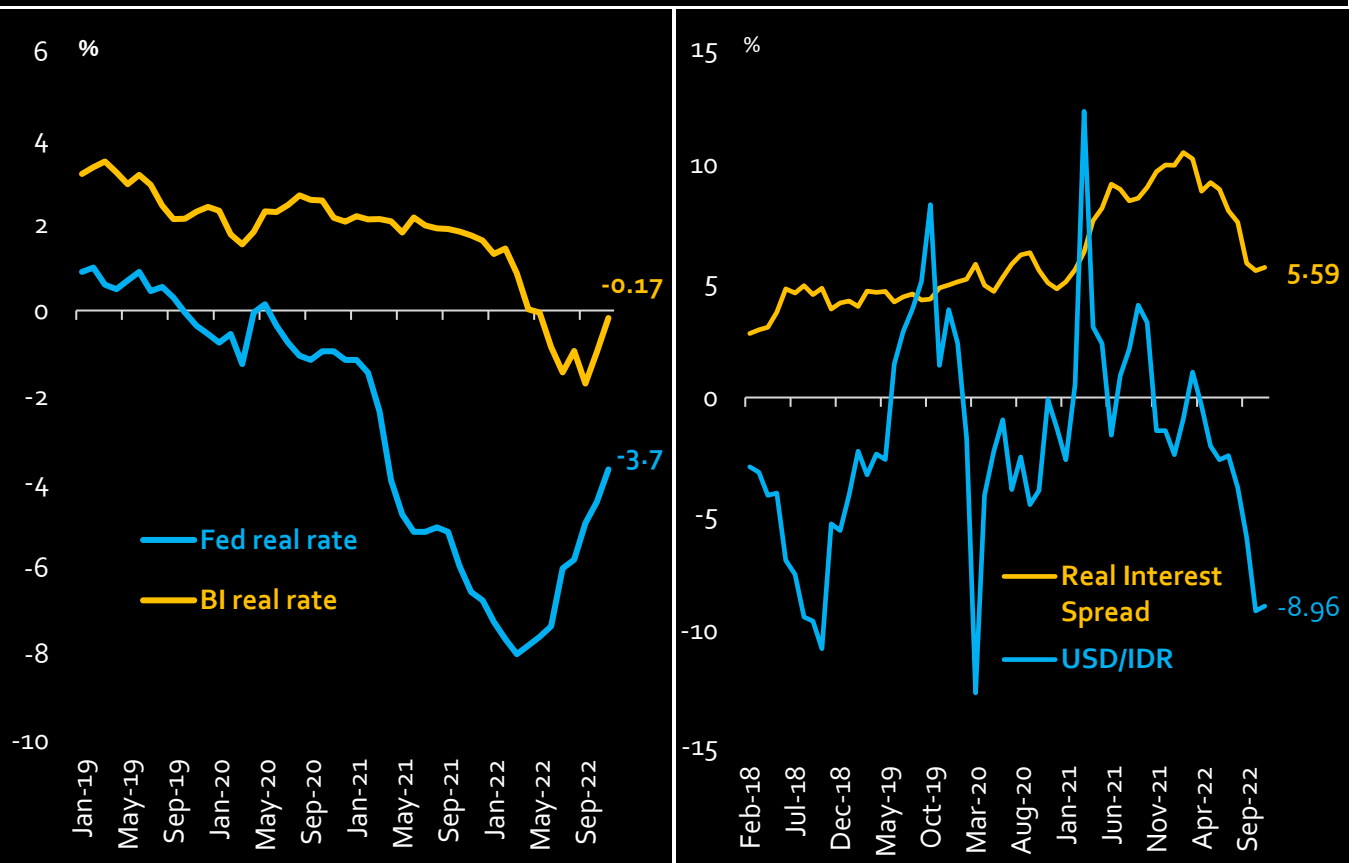
Source: BI, Bloomberg

Chart 1. BI's accommodative macroprudential policies would support credit growth



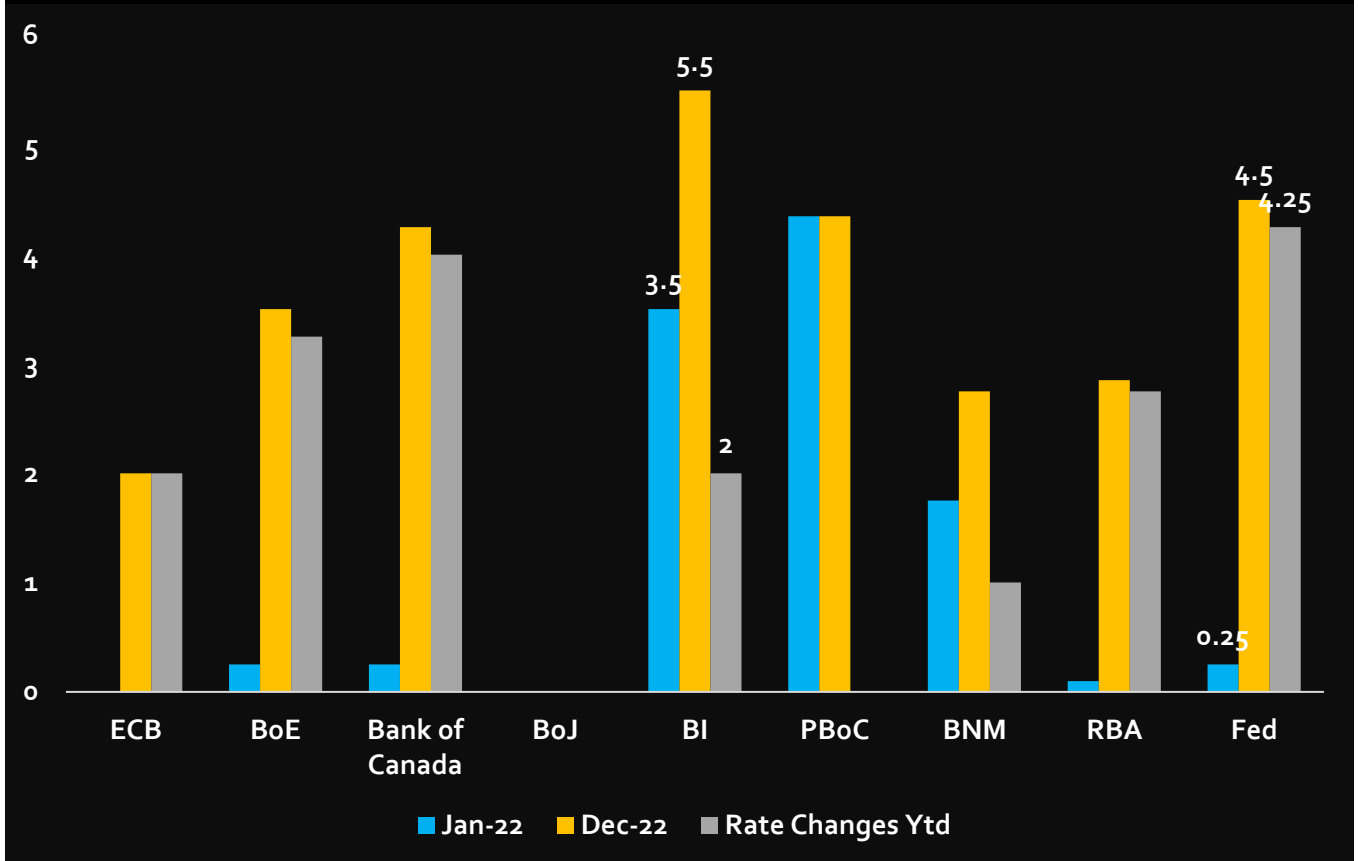
Source: BI, Bloomberg

Panel 3. Declining US and Indonesian inflation would stabilize real interest spreads



Source: BI, Bloomberg

Chart 2. BI's rate hike of 200 bps seem modest compared to other central banks



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	22-Dec	-1 mth	Chg (%)
US	4.50	Dec-22	-2.60	Baltic Dry Index	1,650.0	1,177.0	40.2
UK	3.50	Dec-22	-7.20	S&P GSCI Index	594.0	617.8	-3.9
EU	2.50	Dec-22	-7.60	Oil (Brent, \$/bbl)	81.0	87.5	-7.4
Japan	-0.10	Jan-16	-3.90	Coal (\$/MT)	326.4	326.5	-0.0
China (lending)	4.35	Nov-22	2.75	Gas (\$/MMBtu)	7.09	6.23	13.8
Korea	3.25	Nov-22	-1.75	Gold (\$/oz.)	1,792.5	1,738.1	3.1
India	6.25	Dec-22	0.37	Copper (\$/MT)	8,290.5	7,840.5	5.7
Indonesia	5.50	Dec-22	0.08	Nickel (\$/MT)	29,075.0	24,828.0	17.1
Money Mkt Rates	22-Dec	-1 mth	Chg (bps)	CPO (\$/MT)	875.9	840.0	4.3
				Rubber (\$/kg)	1.29	1.23	4.9
SPN (1M)	3.64	5.11	-146.6	External Sector	Nov	Oct	Chg (%)
SUN (10Y)	6.90	7.05	-15.5	Export (\$ bn)	24.12	24.73	-2.5
INDONIA (O/N, Rp)	4.91	4.78	12.8	Import (\$ bn)	18.96	19.14	-0.9
JIBOR 1M (Rp)	5.95	5.95	0.0	Trade bal. (\$ bn)	5.16	5.59	-7.8
Bank Rates (Rp)	Aug	Jul	Chg (bps)	Central bank reserves (\$ bn)*	134.0	130.2	2.92
Lending (WC)	8.42	8.42	-0.03	Prompt Indicators	Nov	Oct	Sep
Deposit 1M	2.87	2.83	3.57	Consumer confidence index (CCI)	119.1	120.3	117.2
Savings	0.65	0.64	0.98	Car sales (%YoY)	4.2	23.3	18.9
Currency/USD	22-Dec	-1 mth	Chg (%)	Motorcycle sales (%YoY)	26.9	20.9	10.7
UK Pound	0.831	0.846	1.82	Manufacturing PMI	Nov	Oct	Chg (bps)
Euro	0.944	0.976	3.46	USA	49.0	50.2	-120
Japanese Yen	132.4	142.1	7.40	Eurozone	47.1	46.4	70
Chinese RMB	6.985	7.165	2.58	Japan	49.0	50.7	-170
Indonesia Rupiah	15,583	15,713	0.83	China	49.4	49.2	20
Capital Mkt	22-Dec	-1 mth	Chg (%)	Korea	49.0	48.2	80
JCI	6,824.4	7,063.2	-3.38	Indonesia	50.3	51.8	-150
DJIA	33,027.5	33,700.3	-2.00				
FTSE	7,469.3	7,376.9	1.25				
Nikkei 225	26,507.9	27,944.8	-5.14				
Hang Seng	19,679.2	17,655.9	11.46				
Foreign portfolio ownership (Rp Tn)	Nov	Oct	Chg (Rp Tn)				
Stock	2,656.0	2,630.5	25.56				
Govt. Bond	736.9	713.2	23.70				
Corp. Bond	14.5	15.4	-0.86				

Source: Bloomberg, BI, BPS

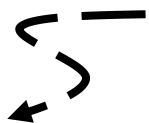
Notes:

^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	5.3
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	5.6
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	52.8
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.3	0.9

** Estimation of Rupiah's fundamental exchange rate

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