

## BI Policy:

## Stick to the plan

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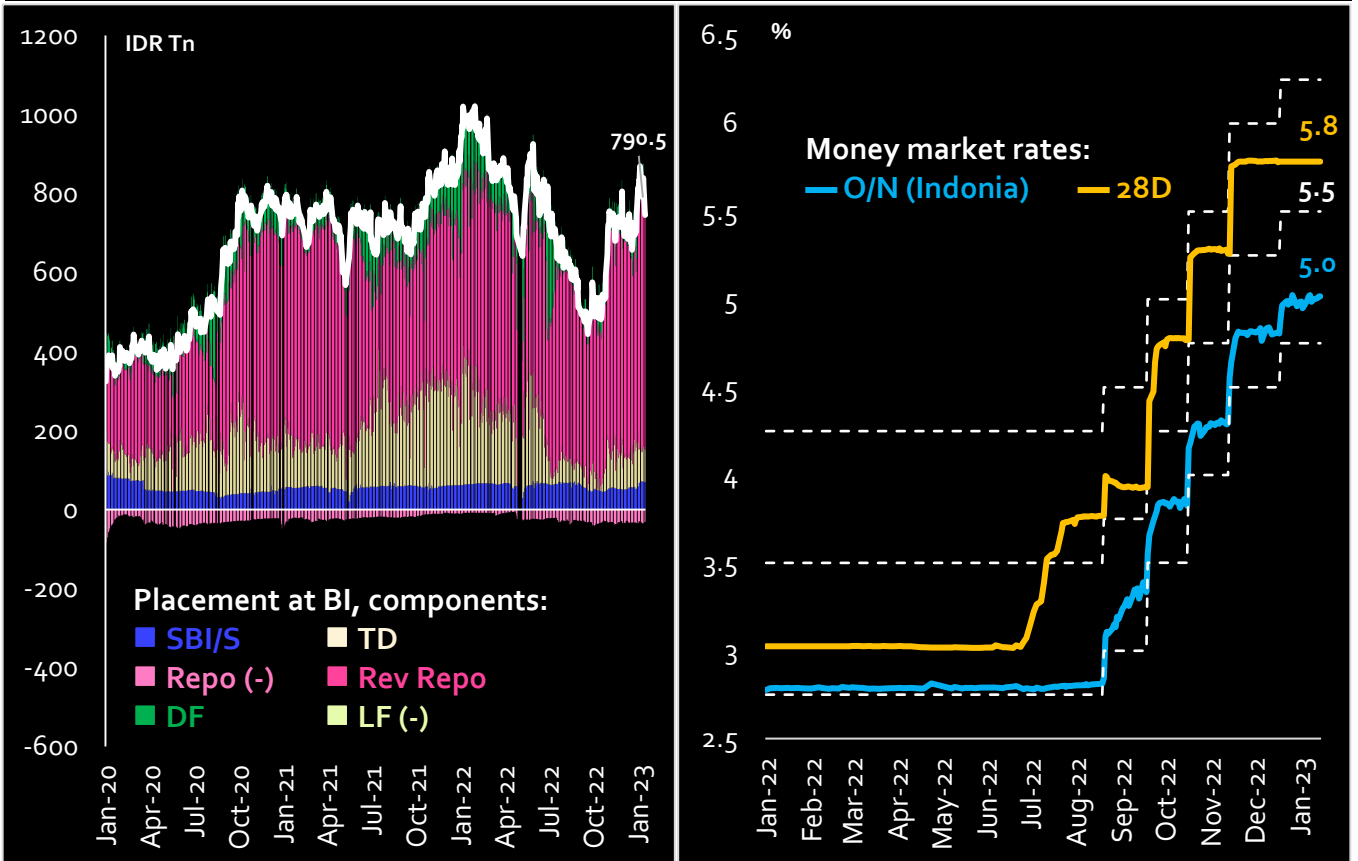
### Executive Summary

- BI delivered a second 25 bps rate hikes in January, settling the debate among economists on its tightening cycle. The debate also happen on the global stage as there was a stark divide between more dovish markets and the still aggressive Fed. The markets point out a looming global recession and declining US inflation. However the Fed is not taking any chances with some Fed officials even suggest Fed rates may end up higher than 5.5% by the end of the year.
  - Market's overconfidence has spilled out to emerging market assets, especially Indonesian bonds buoying the Rupiah. However it is likely to be a short term trend as it is caused by temporary strengthening of the Euro and the Yen. It is likely to be compounded by further weakness in global commodity prices. Aptly BI responded with new measures to bring export proceeds home.
  - BI is facing multiple risk factors in the short term: higher inflation in the fasting and Ramadan festivities, market volatility and Fed policy. It is likely the central bank would stay cautious hiking its policy rate by another 25 bps and stabilize at 6.00% for the rest of the year.
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- Recently there was some debate among Indonesian economists and market watchers whether Bank Indonesia would continue its tightening cycle at the start of the year. We correctly predict BI would deliver a 25 bps policy rate in January. Along with the policy rate hike, BI also announced a new special time deposit facility for exporters to increase absorption of foreign currency.
  - The divide is also paralleled in the global market between the aggressive Fed and the pivot-hungry market. Entering the year Fed still maintains a staunchly tighter monetary policy to keep the lid on inflationary pressures. So far it has partially worked. The US economy has slowed, signified with falling inflation although some of it is credited from easing of supply side constraints e.g energy and food prices. The Fed would like to hit the breaks on the economy further just in case inflationary pressures rebound. Fed officials even suggested Federal Funds Rate may end up higher than 5.5% by the end of 2023.
  - All the while financial markets-which also already priced in a shallow global recession – clamor for a Fed pivot some time by the end of 2023. This was reflected in the recent price surge of non-interest bearing gold and decline in commodity prices due to weaker global demand.

Unfortunately a shallow recession is unlikely to change the mind of the Fed as it would require a deeper recession – that drive unemployment higher- or some form of liquidity crunch.

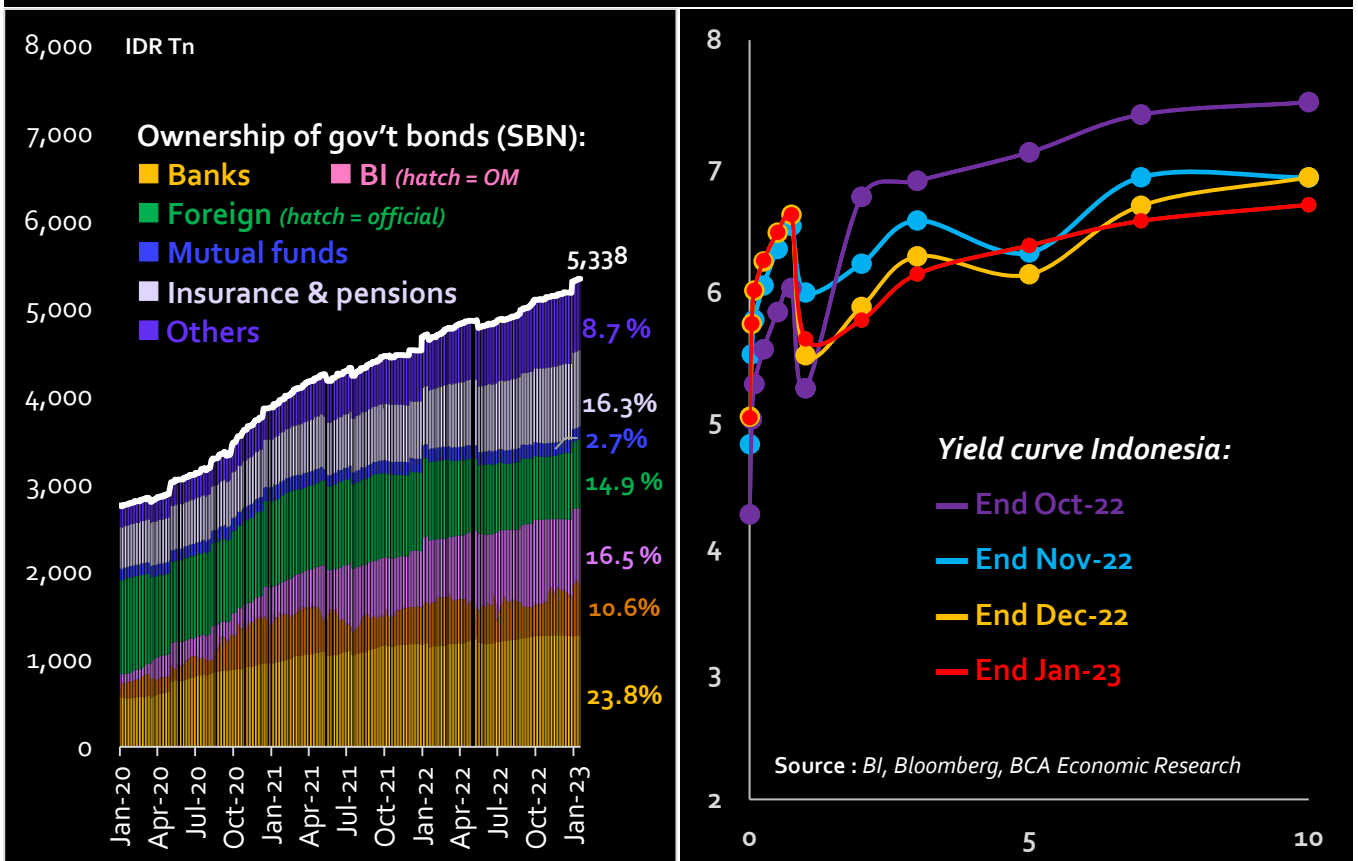
- The market's increasing overconfidence in the Fed pivot scenario has driven a broad increase in appetite for riskier assets, including emerging market. Indonesian bonds are especially interesting with lower inflation and better growth prospects than its emerging markets in general. Meanwhile equities have relatively languished due to outsized global attention on China.
- The Rupiah has strengthened sharply against the Dollar, driven partly by rising global appetite and speculation and a weaker US Dollar. The Dollar's malaise can be contributed by the Euro's (temporarily) better current account outlook and false hopes of a significant change in the Japanese yield control policy. However these factors should unwind soon, bringing back some strength for the Dollar. Therefore the Rupiah's appreciation is likely to be short lived especially as Indonesia's staple commodity prices is unlikely to improve soon, apparent from the narrowing trade surplus last month. Chinese rekindling of Australia, higher energy inventories in Europe and slowing Indian growth potentially reduce coal and CPO exports. Meanwhile global recessionary fears cut prices into CPO and coal futures.
- This makes BI's latest gambit to bring back export proceeds noteworthy. It aims to increase its stockpile of FX while also improving domestic growth conditions. Under the scheme, exporters would receive competitive returns for their FX deposits. For banks, this scheme is potentially lucrative as the exception of the export proceeds from both minimum reserve requirement ratio and intermediation ratio calculation would ease domestic FX credit disbursement. In addition banks would receive fiscal incentives from the government. We think this is good development, but the carrot has to be paired with the stick as well such as consistent enforcement of DHE rules.
- All in all, BI is facing multiple risk factors. In the short term, the fasting month and Ramadan festivities coupled with shortages of essential food stuffs could increase domestic inflationary pressures. Meanwhile continued Fed tightening and market volatility could bring spouts of capital outflows and increase pressure on the Rupiah. Therefore it is likely BI to stay cautious and will pick the safest path, hiking its policy rate by another 25 bps in February or March and stabilize at 6.00% for the rest of the year.

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



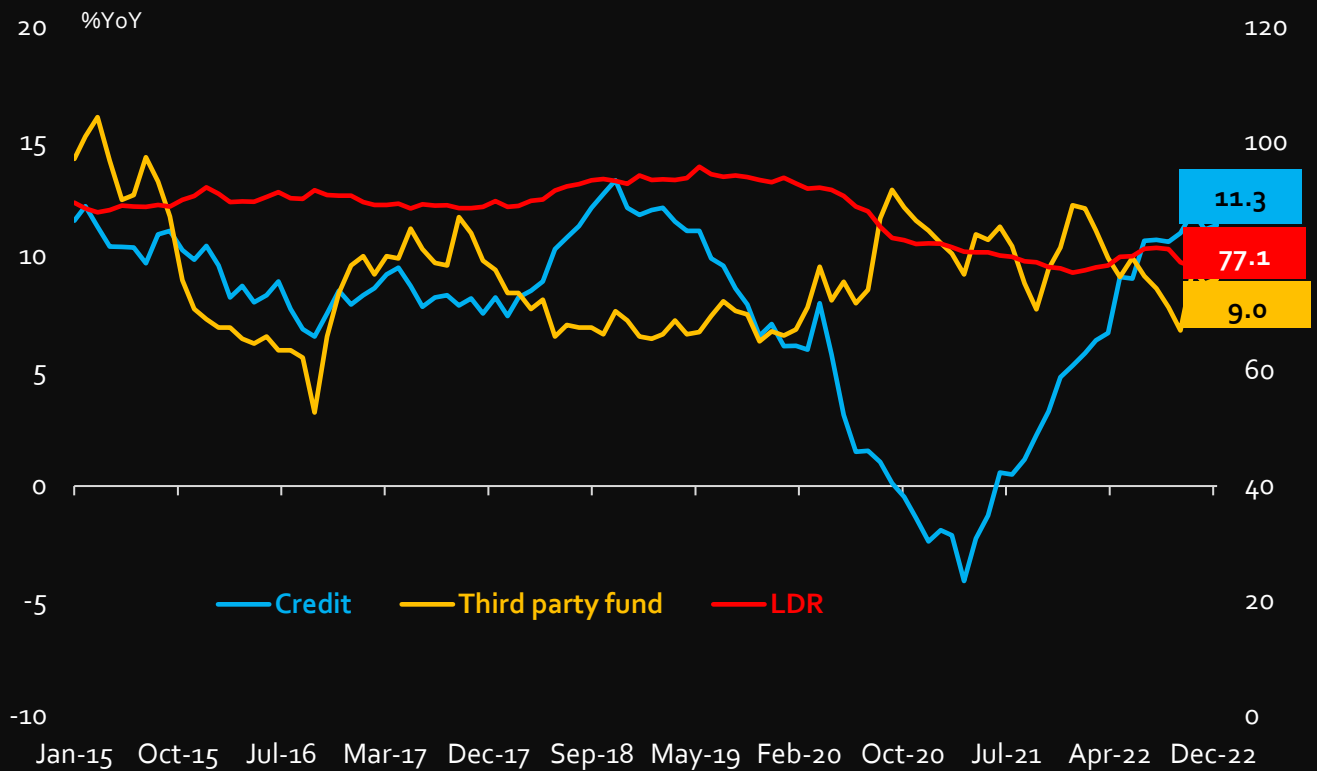
Source: BI, Bloomberg, BCA Economist

**Panel 2. Increased foreign inflows push Indonesian yields lower**



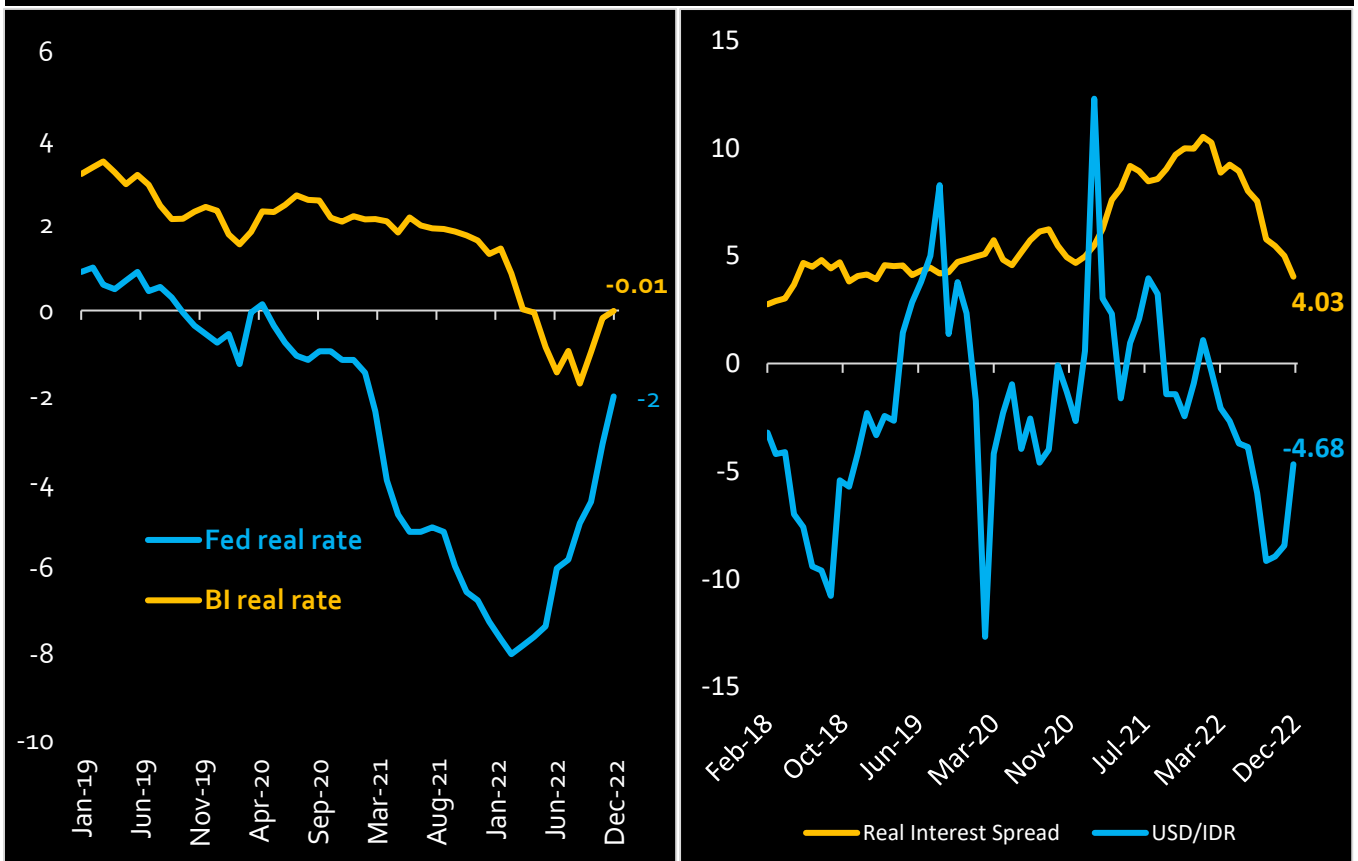
Source: BI, Bloomberg

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



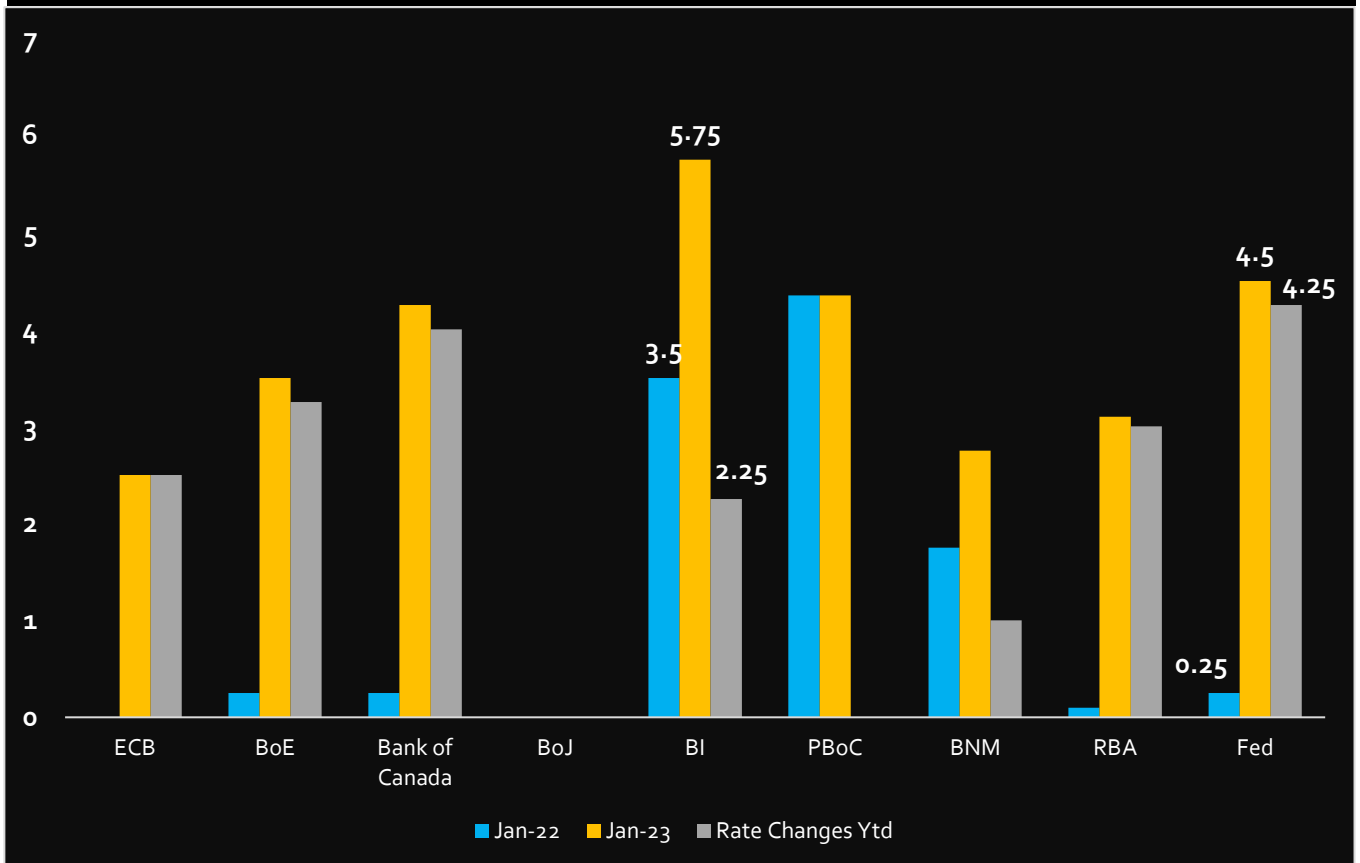
Source: BI, Bloomberg

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



Source: BI, Bloomberg

Chart 2. BI's rate hike of 225 bps relatively modest to other central banks



Source: Bloomberg

## Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	19-Jan	-1 mth	Chg (%)
US	4.50	Jan-23	-2.00	Baltic Dry Index	874.0	1,548.0	-43.5
UK	3.50	Jan-23	-7.00	S&P GSCI Index	606.7	586.5	3.4
EU	2.50	Jan-23	-6.70	Oil (Brent, \$/bbl)	84.3	79.8	5.7
Japan	-0.10	Jan-16	-3.90	Coal (\$/MT)	326.5	352.3	-7.3
China (lending)	4.35	Jan-23	2.55	Gas (\$/MMBtu)	3.20	5.87	-45.5
Korea	3.50	Jan-23	-1.50	Gold (\$/oz.)	1,910.8	1,787.6	6.9
India	6.25	Dec-22	0.53	Copper (\$/MT)	9,326.0	8,303.3	12.3
Indonesia	5.75	Jan-23	0.24	Nickel (\$/MT)	27,651.0	27,073.0	2.1
Money Mkt Rates	19-Jan	-1 mth	Chg (bps)	CPO (\$/MT)	892.1	885.0	0.8
				Rubber (\$/kg)	1.40	1.35	3.7
SPN (1M)	3.60	4.30	-70.7	External Sector	Dec	Nov	Chg (%)
SUN (10Y)	6.63	6.86	-22.3	Export (\$ bn)	23.83	24.09	-1.1
INDONIA (O/N, Rp)	5.02	4.81	20.7	Import (\$ bn)	19.94	18.96	5.2
JIBOR 1M (Rp)	6.20	5.95	25.0	Trade bal. (\$ bn)	3.89	5.13	-24.2
Bank Rates (Rp)	Aug	Jul	Chg (bps)	Central bank reserves (\$ bn)*	137.2	134.0	2.39
Lending (WC)	8.42	8.42	-0.03	Prompt Indicators	Dec	Nov	Oct
Deposit 1M	2.87	2.83	3.57	Consumer confidence index (CCI)	119.9	119.1	120.3
Savings	0.65	0.64	0.98	Car sales (%YoY)	9.0	4.4	23.3
Currency/USD	19-Jan	-1 mth	Chg (%)	Motorcycle sales (%YoY)	24.6	26.9	20.9
UK Pound	0.811	0.823	1.52	Manufacturing PMI	Dec	Nov	Chg (bps)
Euro	0.924	0.943	1.99	USA	48.4	49.0	-60
Japanese Yen	128.3	136.9	6.73	Eurozone	47.8	47.1	70
Chinese RMB	6.783	6.980	2.89	Japan	48.9	49.0	-10
Indonesia Rupiah	15,104	15,598	3.27	China	49.0	49.4	-40
Capital Mkt	19-Jan	-1 mth	Chg (%)	Korea	48.2	49.0	-80
JCI	6,819.9	6,779.7	0.59	Indonesia	50.9	50.3	60
DJIA	33,297.0	32,757.5	1.65				
FTSE	7,787.1	7,361.3	5.78				
Nikkei 225	26,405.2	27,237.6	-3.06				
Hang Seng	21,651.0	19,352.8	11.88				
Foreign portfolio ownership (Rp Tn)	Dec	Nov	Chg (Rp Tn)				
Stock	2,699.4	2,656.0	43.37				
Govt. Bond	762.2	736.9	25.26				
Corp. Bond	12.5	14.5	-2.05				

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

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3*	4.6
GDP per Capita (US\$)	3927	4175	3912	4350	4564*	4525
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.4
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.00
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	16,292
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	55.8*	43.2
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	0.9*	-0.2

\*Estimated number

\*\* Estimation of Rupiah's fundamental exchange rate

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