

BI Policy:

Staying the course for now

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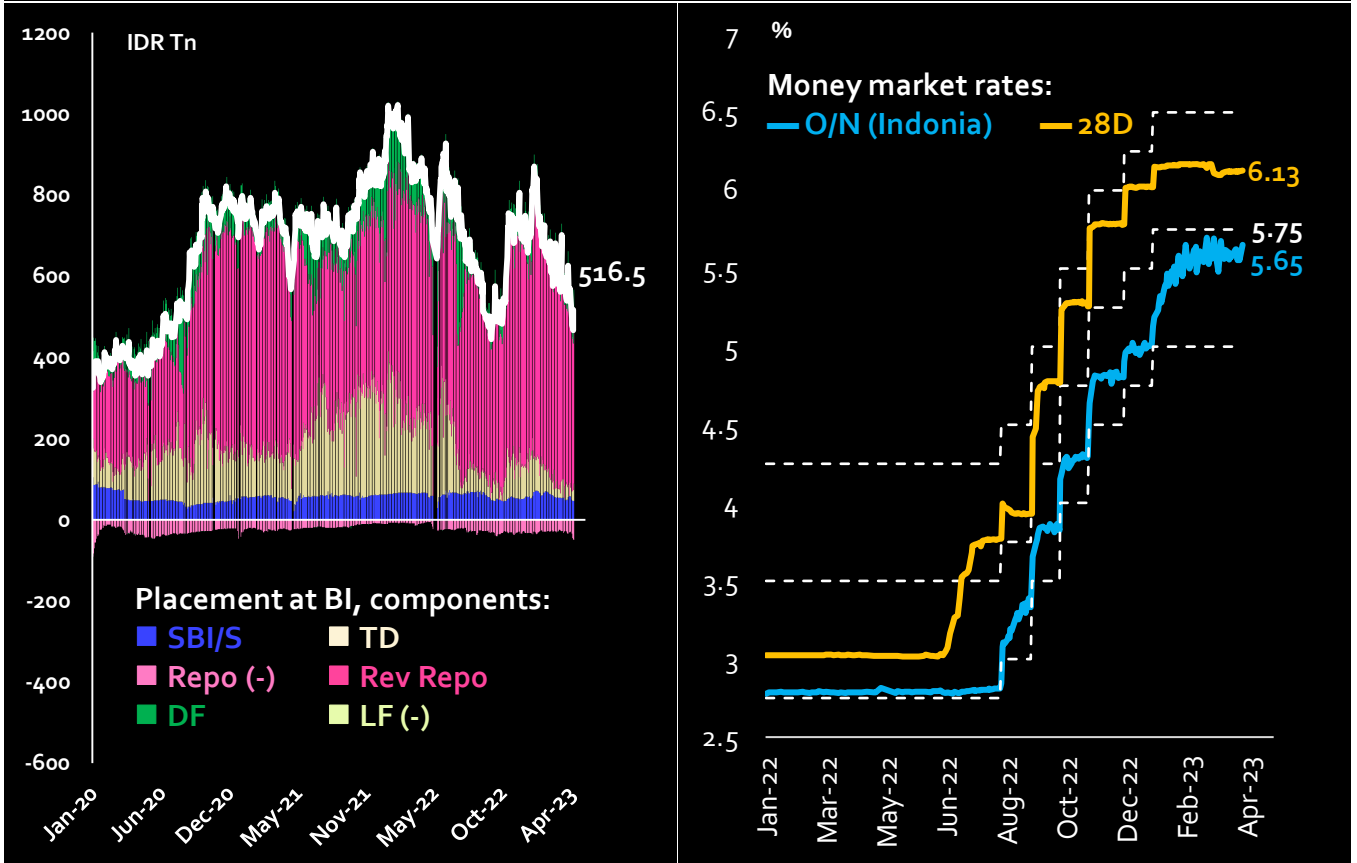
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Executive Summary

- BI maintained the BI7DRR at 5.75%, set against a strong Rupiah and slowing inflation.
 - Instead of cutting rates, BI is using other means to stimulate the economy, such as the “operation twist”.
 - Since the Fed would probably wait for clearer signs of a deflationary recession before pivoting, which might not happen until Q3-23 or later – or might not arrive at all, BI will mostly limited to tinker on the margins.
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- To no one’s surprise, Bank Indonesia (BI) held its benchmark 7-Day Repo Rate at 5.75%. The decision was made against the backdrop of firming expectations of one-and-done Fed (i.e. one final 25 bps FFR hike in May) and concerning albeit limited signs of slowdown of domestic demand amid Ramadan. Most importantly, it was also set against a strong Rupiah, which has appreciated by 4.8% YTD – outperforming many of its peers among emerging and commodity-producing nations. The sharp increase in FX reserves last month has virtually eliminated depreciation concerns, at least in the short-term.
 - The decision also came amid slowing inflation as a result of normalizing price pressures from fuel and rice as well as slowing imported inflation due to China’s reopening. The current economic climate then, is giving BI room to maintain its interest rates in the near-term to facilitate economic growth.
 - However, the question arises as to why BI is not cutting interest rates, especially since slowing inflation, a robust Rupiah, and declining domestic demand may indicate a need for BI to loosen policy. But as we have argued in previous reports, the likelihood of BI doing so before the Fed pivots is still very limited. So as has been the case for the past year, BI combines its stability-oriented rate and reserve requirement policies with other means to stimulate the economy.
 - One such measure is BI’s version of “operation twist”, which has successfully flattened the yield curve. As yield curve determines bank margins – while long-term yields are typically used as benchmark for long-term bank loans such as mortgages, the “twist” essentially forces bank to trade their margins for higher volumes. This complements BI’s other policies which are also geared to spur loan volumes, such as the 100% LTV policy (which has been extended until the end of this year) and the Macroprudential Inclusive Financing Ratio (RPIM) requirement (which has increased from 20% in 2022 to 25% in 2023).

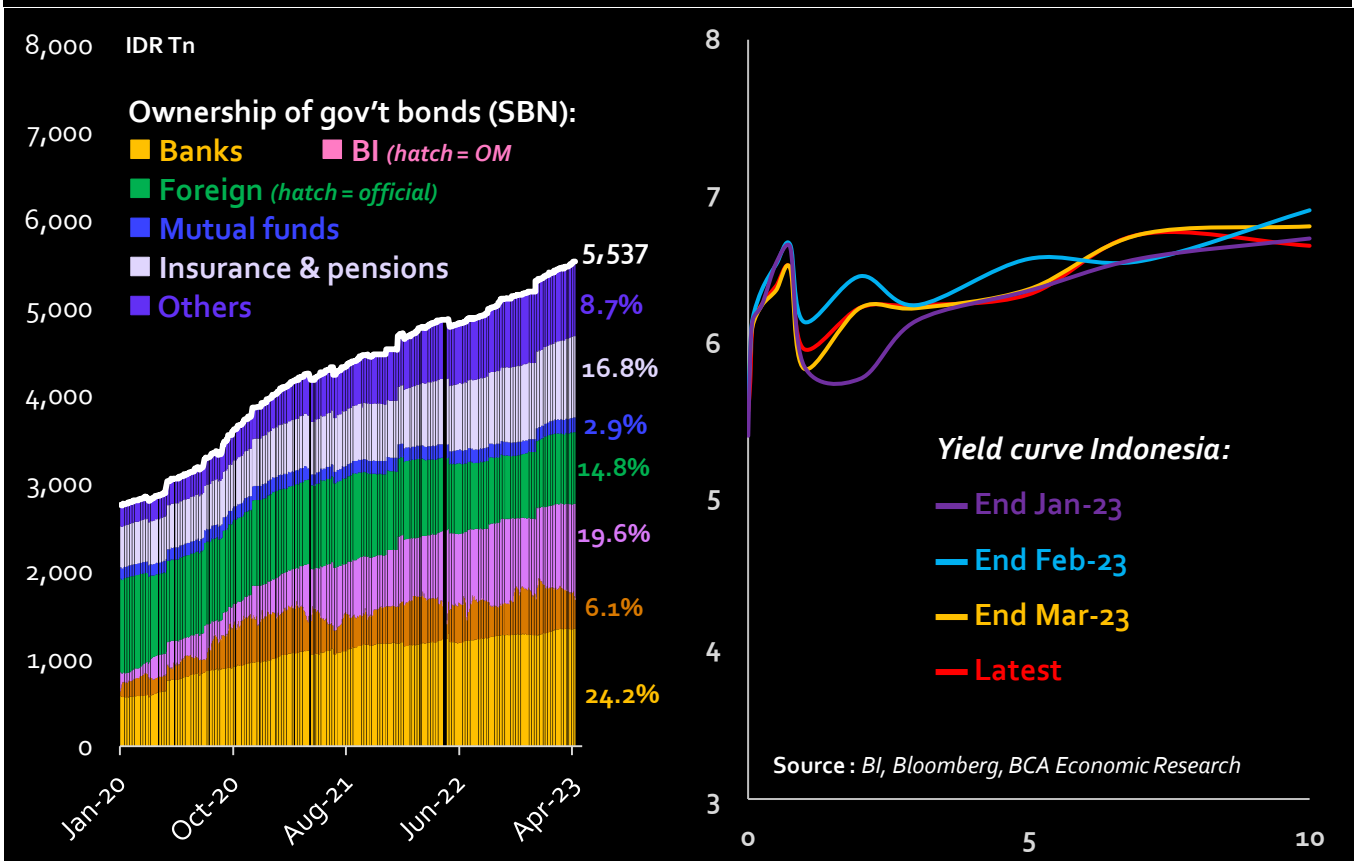
- Despite all these policy tools, however, loan growth has been slowing down to 9.93% by Mar-23. This decline has been most visible for working capital loans, which indicates some cooling of economic activities. Interestingly, investment and consumer loans seem to retain forward momentum – the former thanks the expansive investment especially in Indonesia’s red-hot “nickel-industrial complex”, and the latter probably proving the effectiveness of the LTV relaxation. The overall loan slowdown probably spurs BI to introduce new incentives this month – this time targeting “green loans” and KUR (a type of small business loans).
- Notwithstanding its impact on loans, BI’s operation twist could have other effects. By vacating short-dated bonds to buy longer-dated ones, BI essentially forces domestic banks to shorten their maturity. This is a positive development in the light of the Silicon Valley Bank (SVB) collapse recently. However, this could have less sanguine impact on foreign flows, as these investors prefer the more liquid long-term instruments, primarily the 5Y and 10Y bonds. This may put a cap on bond inflows and therefore on Rupiah’s appreciation. But this is not necessarily a bad thing in the current environment, if it also dampens the transmission of global volatility towards the domestic market.
- Circling back, this very volatility is the reason why we do not expect a significant change in BI’s policy mix in the short-term. Just as the market narrative moved swiftly from a “higher-for-longer” Fed to a Fed pivot following the US banking crisis, there is still a possibility that the Fed will not stop its war on inflation for longer than previously anticipated, despite signals of an impending US recession. The Fed would probably wait for clearer signs of a deflationary recession before pivoting, which might not happen until Q3-23 or later – or might not arrive at all, if we get global stagflation instead. Until then, BI will mostly limited to tinker on the margins.

Panel 1. BI remains put amid ample domestic liquidity



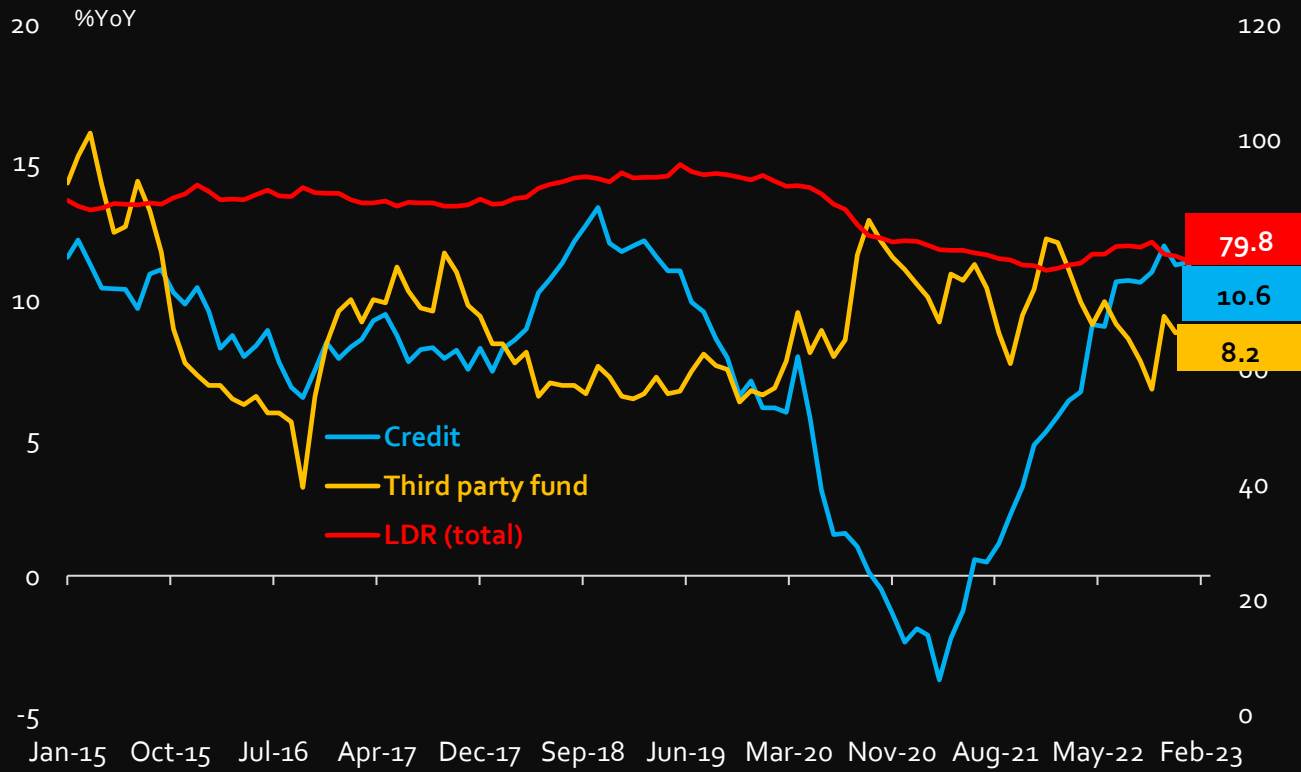
Source: BI, Bloomberg, BCA Economist

Panel 2. Foreign capital still flowing in, maintaining stable Indonesian yields



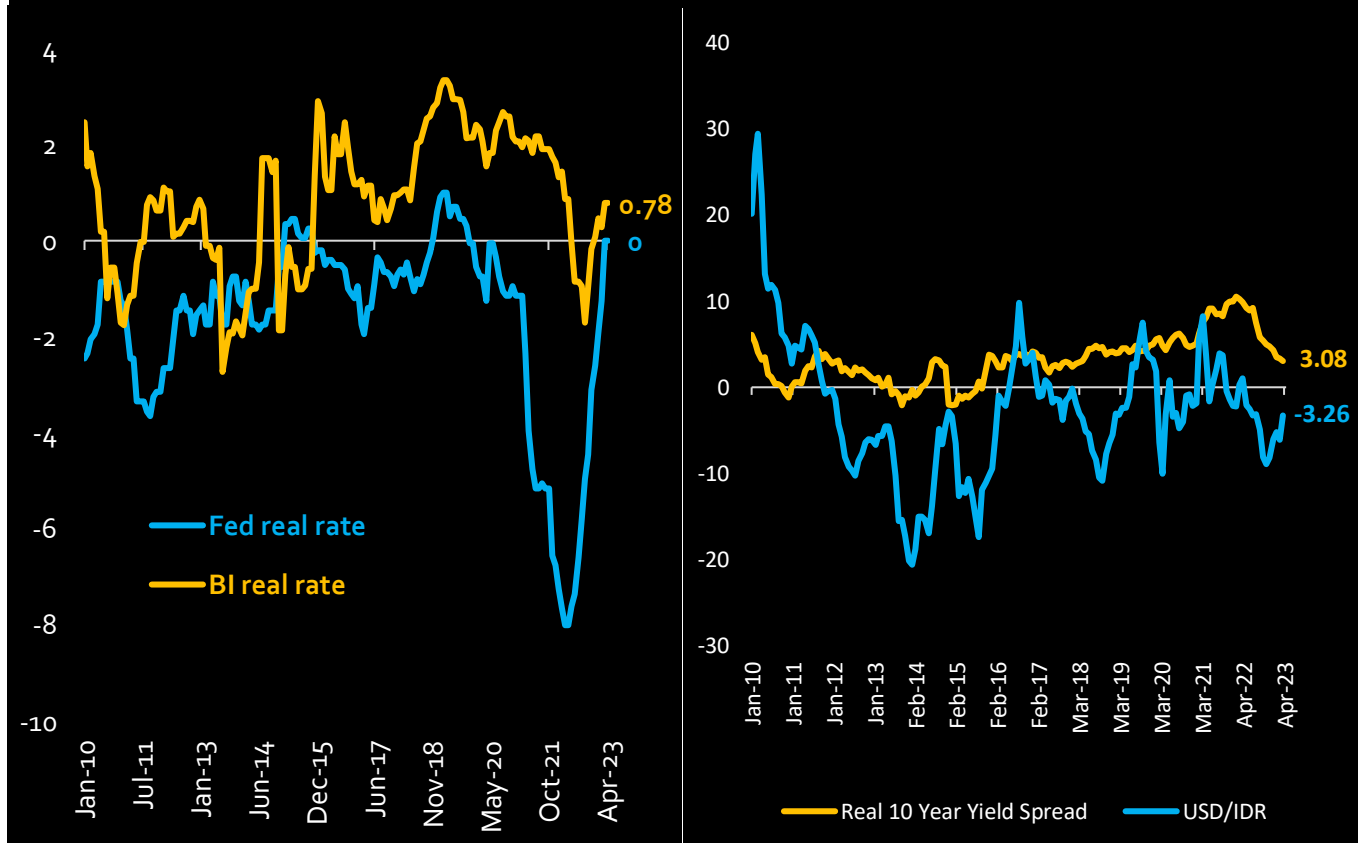
Source: BI, Bloomberg

Panel 3. Third-party fund and credit growth has moderated somewhat from 2022 pace



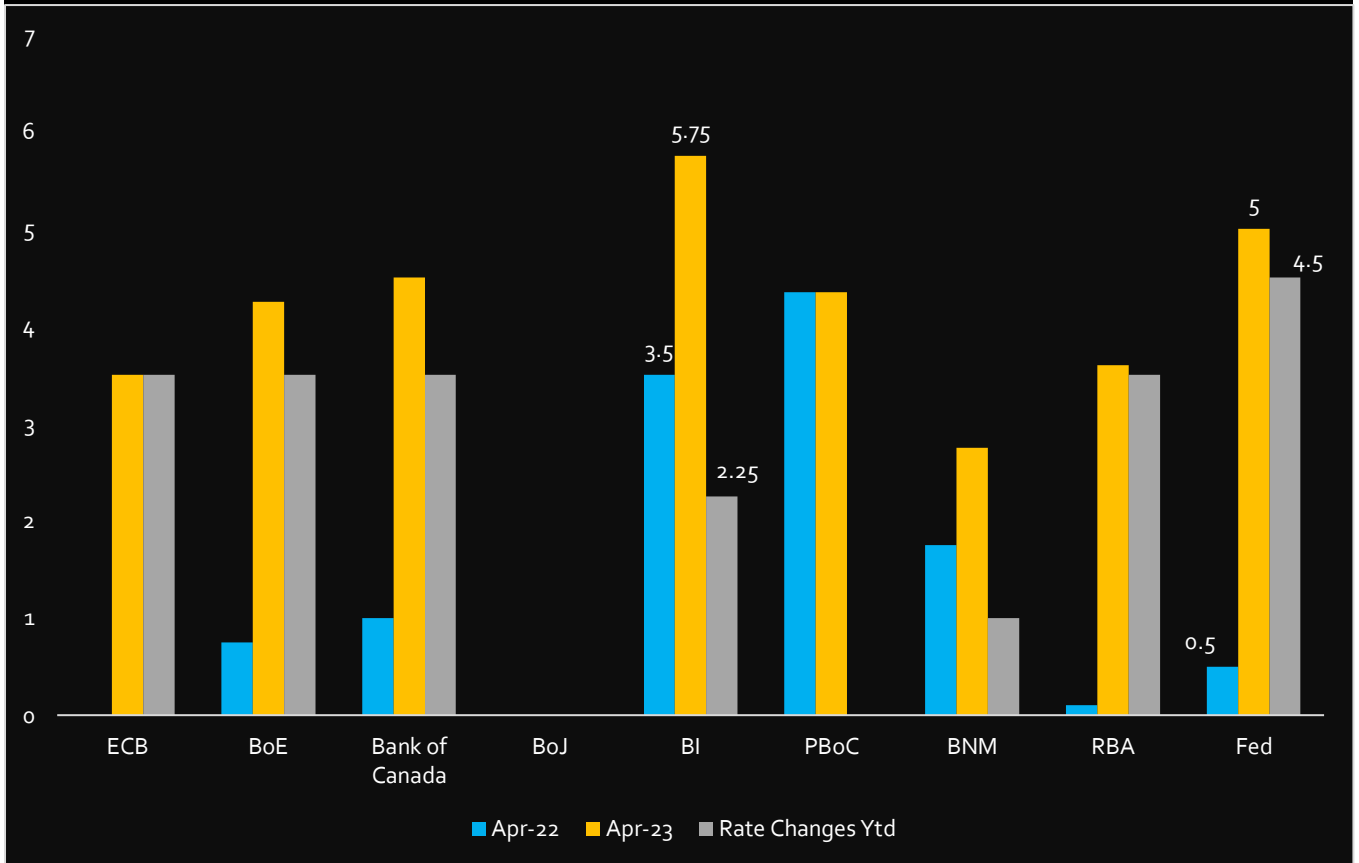
Source: BI, OJK, Bloomberg

Panel 4. The spread of ID-US assets narrowed, but the Fed pivot sentiment has drove IDR appreciation



Source: BI, Bloomberg

Panel 5. BI's total rate hikes of 225 bps is relatively modest compared to other central banks



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	17-Apr	-1 mth	Chg (%)
US	5.00	Apr-23	0.00	Baltic Dry Index	1,412.0	1,535.0	-8.0
UK	4.25	Apr-23	-6.15	S&P GSCI Index	591.4	541.6	9.2
EU	3.50	Apr-23	-3.40	Oil (Brent, \$/bbl)	84.8	73.0	16.2
Japan	-0.10	Jan-16	-3.40	Coal (\$/MT)	183.0	179.1	2.2
China (lending)	4.35	Apr-23	3.65	Gas (\$/MMBtu)	2.21	2.42	-8.7
Korea	3.50	Apr-23	-0.70	Gold (\$/oz.)	1,995.2	1,989.3	0.3
India	6.50	Apr-23	0.84	Copper (\$/MT)	8,963.0	8,573.3	4.5
Indonesia	5.75	Apr-23	0.78	Nickel (\$/MT)	24,635.0	23,147.0	6.4
				CPO (\$/MT)	936.0	937.3	-0.1
				Rubber (\$/kg)	1.36	1.29	5.4
Money Mkt Rates	17-Apr	-1 mth	Chg (bps)	External Sector	Mar	Feb	Chg (%)
SPN (1M)	4.56	4.41	15.6	Export (\$ bn)	23.50	21.38	9.89
SUN (10Y)	6.64	6.88	-23.4	Import (\$ bn)	20.59	15.92	29.33
INDONIA (O/N, Rp)	5.65	5.56	9.2	Trade bal. (\$ bn)	2.91	5.46	-46.78
JIBOR 1M (Rp)	6.40	6.40	0.0	Central bank reserves (\$ bn)*	145.2	140.3	3.48
Bank Rates (Rp)	Feb	Jan	Chg (bps)	Prompt Indicators	Mar	Feb	Dec
Lending (WC)	8.89	8.75	13.80	Consumer confidence index (CCI)	123.3	122.4	119.9
Deposit 1M	4.18	4.00	17.94	Car sales (%YoY)	2.6	7.4	9.0
Savings	0.67	0.67	0.25	Motorcycle sales (%YoY)	40.5	56.3	24.6
Currency/USD	17-Apr	-1 mth	Chg (%)	Manufacturing PMI	Mar	Feb	Chg (bps)
UK Pound	0.808	0.821	1.67	USA	46.3	47.7	-140
Euro	0.915	0.937	2.40	Eurozone	47.3	48.5	-120
Japanese Yen	134.5	131.9	-1.95	Japan	49.2	47.7	150
Chinese RMB	6.880	6.887	0.10	China	50.0	51.6	-160
Indonesia Rupiah	14,790	15,345	3.75	Korea	47.6	48.5	-90
				Indonesia	51.9	51.2	70
Capital Mkt	17-Apr	-1 mth	Chg (%)				
JCI	6,787.6	6,678.2	1.64				
DJIA	33,987.2	31,862.0	6.67				
FTSE	7,879.5	7,335.4	7.42				
Nikkei 225	28,514.8	27,333.8	4.32				
Hang Seng	20,782.5	19,518.6	6.48				
Foreign portfolio ownership (Rp Tn)	Mar	Feb	Chg (Rp Tn)				
Stock	2,726.8	2,730.0	-3.23				
Govt. Bond	818.5	804.3	14.21				
Corp. Bond	12.0	12.4	-0.40				

Source: Bloomberg, BI, BPS

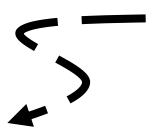
Notes:

^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	4.7
GDP per Capita (US\$)	3927	4175	3912	4350	4784	5011
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.3
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	54.5	28.4
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-1.02

*Estimated number

** Estimation of Rupiah's fundamental exchange rate

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