BI Policy:

China clouds over BI's placid waters

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Executive Summary

- BI kept the BI7DRR at 5.75%, amid recent IDR shakiness driven by narrowing trade surplus and weakening CNY.
- The global situation is pulling BI in two directions – Fed policy still implying tight policy while China's slowing momentum might necessitate some easing to support growth and avoid IDR overvaluation.
- For the time being, BI will likely keep the BI7DRR high while supporting growth through other means. RRR cuts and especially fiscal stimulus would also free up some "trapped liquidity", especially with deposits now growing much slower than loans.

- Bank Indonesia (BI) held the benchmark 7-day Repo Rate (BI7DRR) unchanged at 5.75%, in tune with expectations. There was little doubt that BI would stay put, even if – on one hand – chatters of an early rate cut has started, while on the other hand the IDR has been wobblier of late, briefly crossing the psychological barrier of 15,000 against the USD.

- Some of the wobbliness might have been attributed to the narrowing trade surplus, which surprisingly (but not too surprisingly) fell to 0.44 Bn in May. But a more immediate trigger may be found in China's recent rate cuts, which weakened the CNY and – by virtue of cross-correlation among Asian currencies – pressurized the IDR as well.

- Both of these are issues that we have discussed in recent reports, but it bears recapping. By itself, a smaller trade surplus is not a major threat to IDR, which has proven to be more sensitive to capital flows than to trade balance. The situation in China, however, could be more consequential for the IDR, through several different channels other than just the cross-correlation.

- Weaker demand from China has been weighing on commodity prices, and our export volumes are even starting to be affected. Meanwhile, the weakening Yuan shows that China could try to "export their way out of a slowdown", which entails more imports by their trade partners including Indonesia. As such, it is in itself a major contributor to the aforementioned decline in our trade surplus.

- Lower commodity prices could in turn dampen inflows into Indonesian equities, along with GDP growth. The latter might then boost speculations of an early BI7DRR cut, which might weaken the IDR further. Signs of slowing growth momentum are becoming clearer, including in our very own big data indices (*BCA Intrabiz* and *Intrabel*) which – apart from the seasonal flux during Ramadan/Lebaran – are in a downward trend.

- As such, the global backdrop that has allowed BI to keep calm during these last few months is turning into a dilemma. On one hand, the Fed is determined to go "higherer-for-longerer" (or at least jawboning to that effect) despite its recent pause, while UST issuance could suck up more liquidity from US banks – so BI better stays conservative.

- But on the other hand, China's economy could either slow down (and bring our GDP growth along with it) or it could export their way out of said slowdown. In the latter case, it might be wiser for BI to ease policy in order to prevent an overvalued IDR and the attendant "Dutch disease" which could afflict the local industries.

- The likely outcome, for the time being, is for BI to continue what it is doing: keep BI7DRR at 5.75% while supporting growth through other means. But there are limits to what BI could do within this framework. LTV relaxation and RPIM has been successful in driving loan growth (at 9.4% YoY in May) far ahead of deposit growth (6.6% YoY), but this is predicated on the fact that there is a good amount of excess liquidity left in the system.

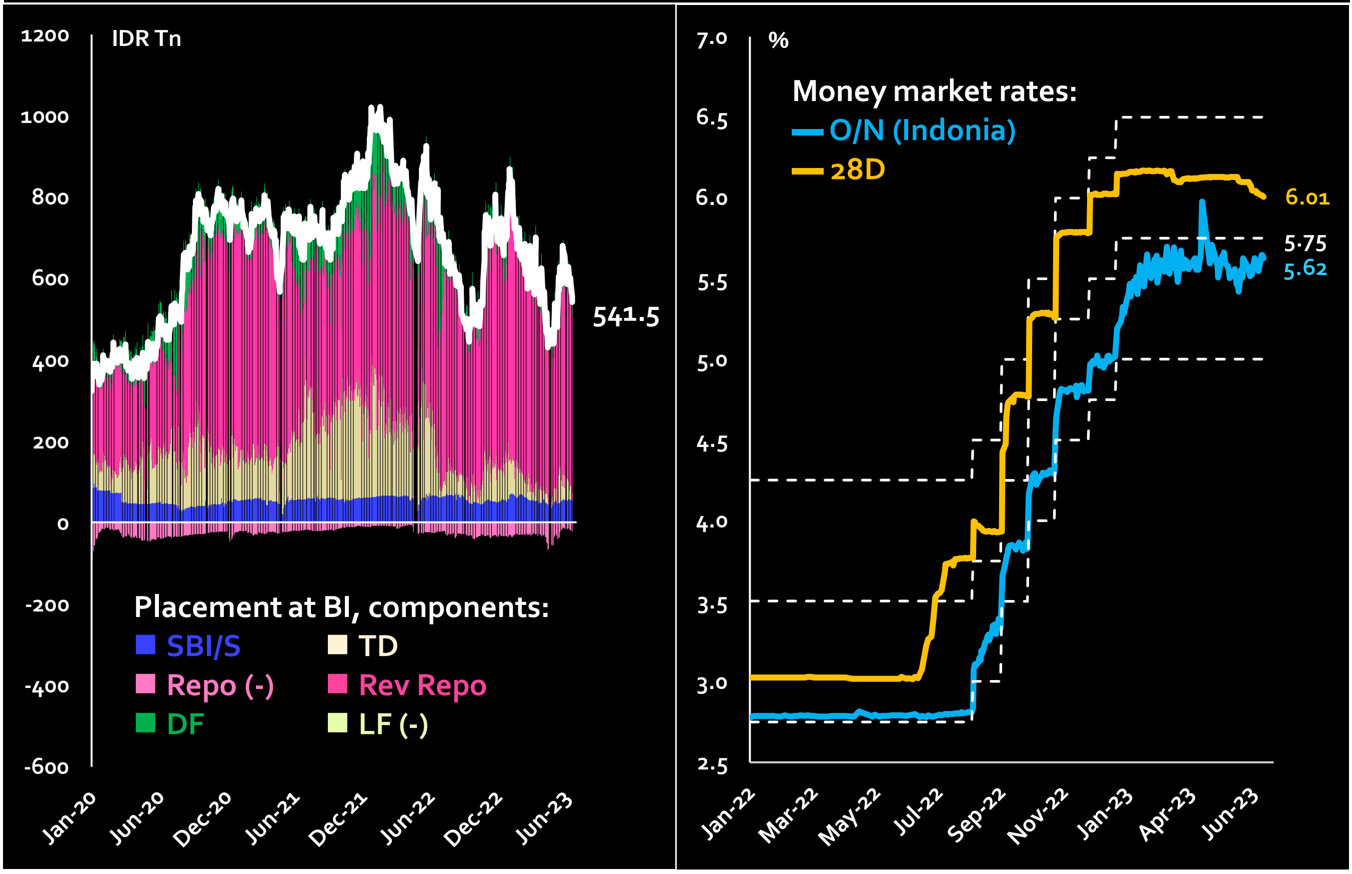
- Which, to be sure, there still is. But household excess savings seem almost depleted (which we will discuss in an upcoming special report), while corporate savings will be declining as trade surplus declines. The liquidity, then, will have to come from the two biggest sources of "trapped funding" at the moment: required reserves and government cash balance at BI.

- This is the point that we have been hammering on for the past month. BI has the room to cut early – much earlier than the Fed, even, thanks to China-driven disinflation – but the risk-reward calculus favors either fiscal stimulus or RRR cut first. Our current baseline scenario is for fiscal to be the main driver in H2-23, while monetary easing would probably start in early 2024.

- There is a further wrinkle. The ongoing or proposed stimulus measures (LTV relaxation, social assistance) are notably "consumerist" in orientation – and this probably includes RPIM, since local SMEs tend to be involved in trading more than manufacturing.

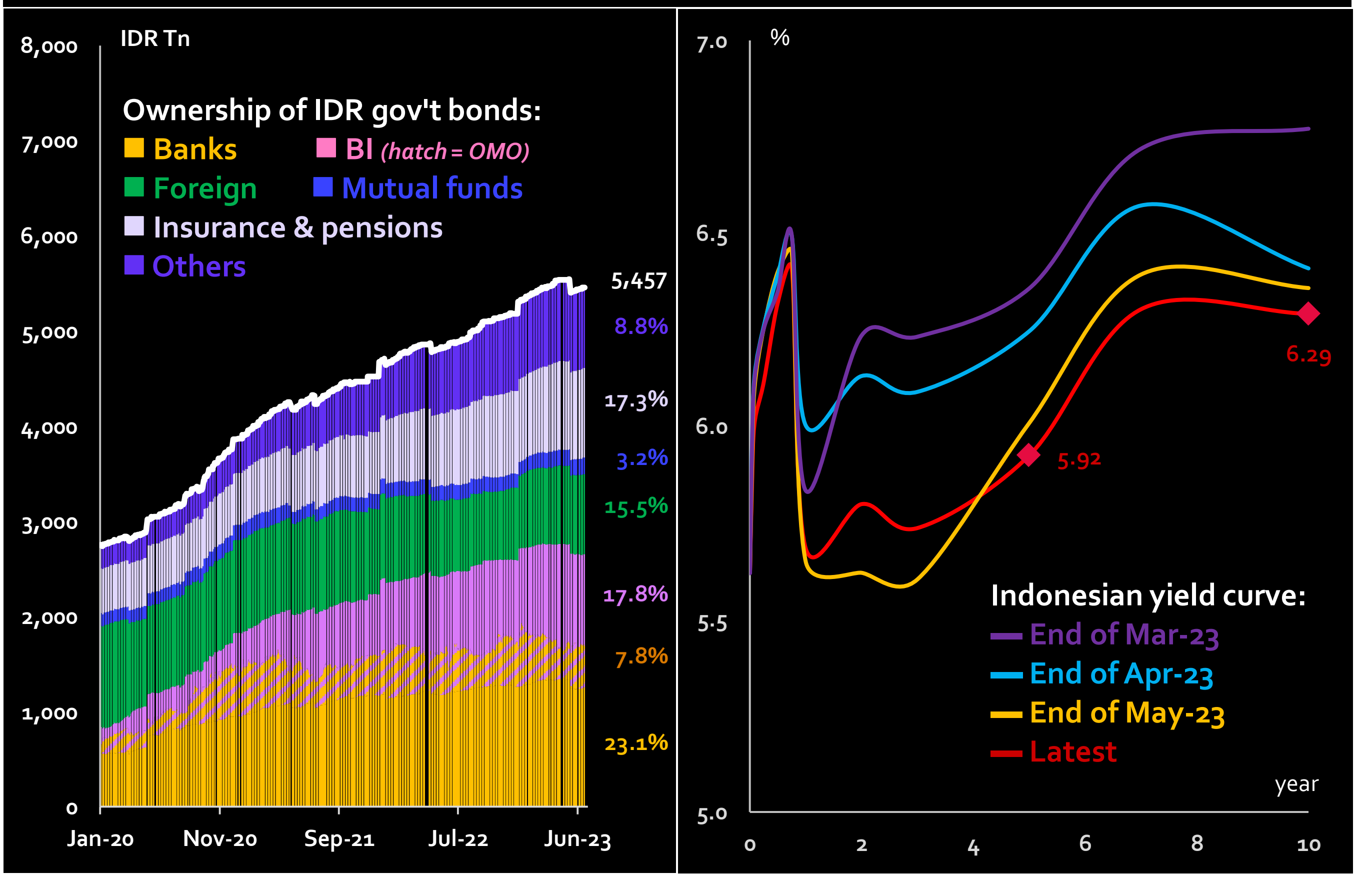
- There is little in the way of producer-oriented stimulus other than RRR incentives for banks to lend to certain industries (those greatly affected by Covid). If China does use its mercantilist playbook, however, the Indonesian authorities may need to step up its support for local industries – even though it seems like a less straightforward thing to do, especially in a "political year", than the usual consumer-oriented stimulus.

Panel 1. BI continues staying put as excess liquidity remains available in the system



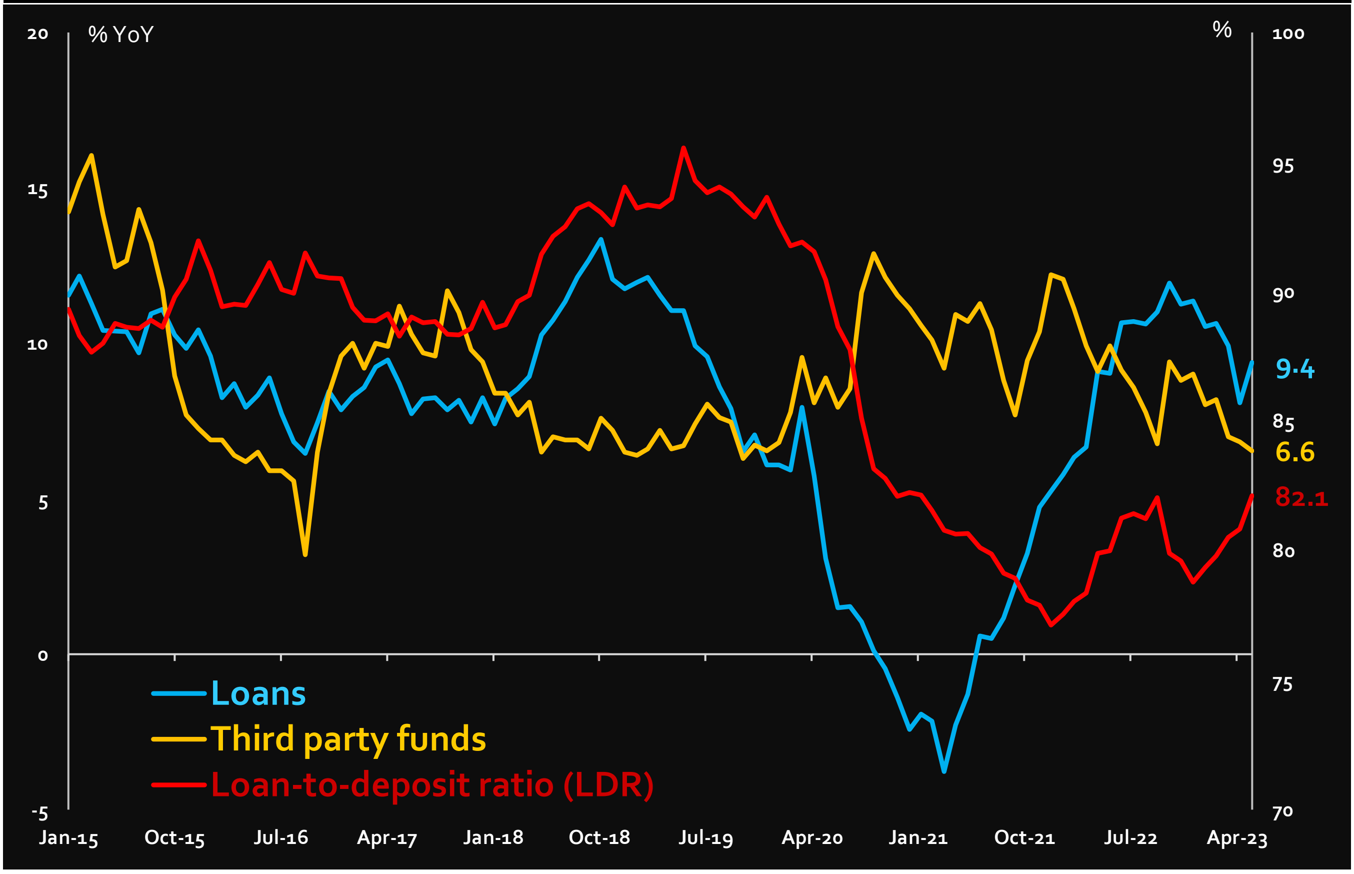
Source: BI, Bloomberg, BCA Economist

Panel 2. Yield curve has been flattening as net gov't bond issuance slows more recently



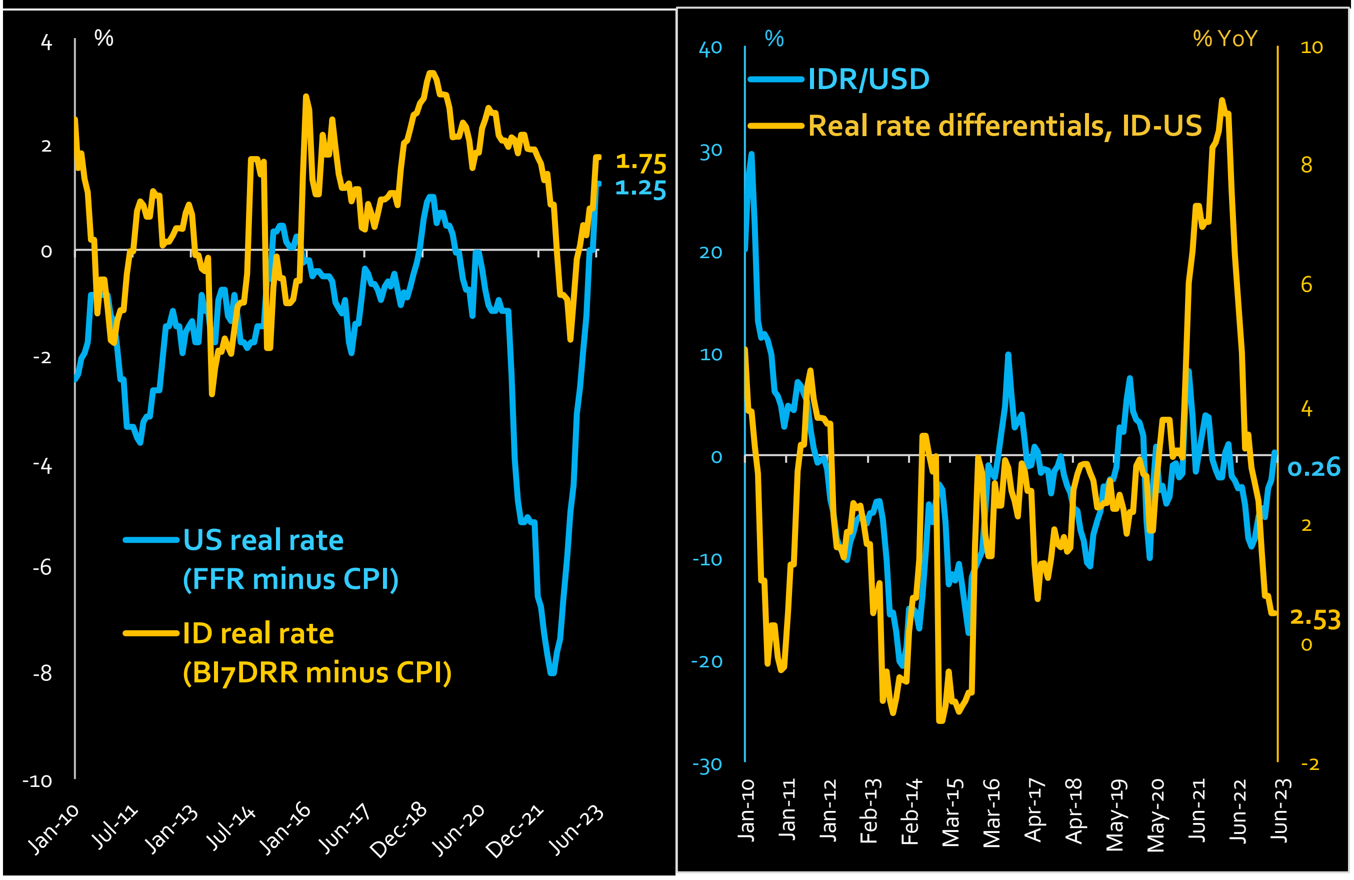
Source: MoF, BI, Bloomberg, BCA Economist

***Panel 3.* Loan growth have been moderating, but deposits have slowed even further**



Source: OJK, BI, BCA Economist

***Panel 4.* Rupiah exchange rate has somewhat decoupled from rate differentials in recent years**



Source: BI, Bloomberg, BCA Economist

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.25	Jun-23	1.25
UK	4.50	Jun-23	-4.20
EU	4.00	Jun-23	-2.10
Japan	-0.10	Jan-16	-3.60
China (lending)	4.35	Jun-23	4.15
Korea	3.50	May-23	0.20
India	6.50	Jun-23	2.25
Indonesia	5.75	Jun-23	1.75
Money Mkt Rates	**22-Jun**	**-1 mth**	**Chg (bps)**
SPN (1M)	4.82	5.33	-51.5
SUN (10Y)	6.28	6.41	-13.0
INDONIA (O/N, Rp)	5.62	5.56	6.8
JIBOR 1M (Rp)	6.39	6.40	-1.1
Bank Rates (Rp)	**Apr**	**Mar**	**Chg (bps)**
Lending (WC)	8.92	8.95	-2.71
Deposit 1M	4.18	4.20	-2.70
Savings	0.67	0.69	-1.70
Currency/USD	**22-Jun**	**-1 mth**	**Chg (%)**
UK Pound	0.783	0.804	2.63
Euro	0.909	0.925	1.69
Japanese Yen	141.8	138.6	-2.25
Chinese RMB	7.179	7.032	-2.05
Indonesia Rupiah	14,943	14,890	-0.35
Capital Mkt	**22-Jun**	**-1 mth**	**Chg (%)**
JCI	6,687.5	6,729.6	-0.63
DJIA	33,951.5	33,286.6	2.00
FTSE	7,463.8	7,771.0	-3.95
Nikkei 225	33,264.9	31,086.8	7.01
Hang Seng	19,218.4	19,678.2	-2.34
Foreign portfolio ownership (Rp Tn)	**May**	**Apr**	**Chg (Rp Tn)**
Stock	2,738.1	2,789.1	-51.06
Govt. Bond	822.7	822.7	0.00
Corp. Bond	11.8	11.8	-0.01

Trade & Commodities	22-Jun	-1 mth	Chg (%)
Baltic Dry Index	1,138.0	1,365.0	-16.6
S&P GSCI Index	559.9	544.4	2.8
Oil (Brent, $/brl)	76.9	76.0	1.1
Coal ($/MT)	133.7	160.8	-16.9
Gas ($/MMBtu)	2.22	2.30	-3.5
Gold ($/oz.)	1,930.2	1,971.9	-2.1
Copper ($/MT)	8,606.3	8,061.5	6.8
Nickel ($/MT)	21,066.0	21,273.0	-1.0
CPO ($/MT)	781.0	808.9	-3.5
Rubber ($/kg)	1.32	1.34	-1.5
External Sector	**May**	**Apr**	**Chg (%)**
Export ($ bn)	21.72	19.28	12.61
Import ($ bn)	21.28	15.35	38.65
Trade bal. ($ bn)	0.44	3.94	-88.91
Central bank reserves ($ bn)*	139.3	144.2	-3.38
Prompt Indicators	**May**	**Apr**	**Mar**
Consumer confidence index (CCI)	128.3	126.1	123.3
Car sales (%YoY)	65.2	-28.8	2.7
Motorcycle sales (%YoY)	113.4	-19.4	40.5
Manufacturing PMI	**May**	**Apr**	**Chg (bps)**
USA	46.9	47.1	-20
Eurozone	44.8	45.8	-100
Japan	50.6	49.5	110
China	50.9	49.5	140
Korea	48.4	48.1	30
Indonesia	50.3	52.7	-240

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	5.0
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	3.4
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	35.3
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.7

*Estimated number

** Estimation of Rupiah's fundamental exchange rate

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