BI Policy:
A scalpel for these delicate times

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Executive Summary

- BI maintained BI7DRR at 5.75%, as expected, amid the recent IDR depreciation.
- The ongoing repricing in the global bond markets, driven by the reassessment of the Fed's policy outlook, affects most currencies, including IDR.
- Asian currencies currently are in a weak position against the USD, but IDR stands out as the best-performing major currency in Asia.
- BI possesses two additional tools to counteract IDR's depreciation: DHE regulation and the newer Sekuritas Rupiah Bank Indonesia (SRBI). The latter allows BI to intervene via money quantity instead of adjusting rates.

- Bank Indonesia (BI) maintained its policy rate (BI7DRR) at 5.75%, as widely expected, and in spite of a few calls to start hiking again. There are indeed good reasons why BI is far from panic mode in dealing with the latest bout of IDR depreciation.

- Firstly, the depreciation is not unique to the Rupiah, being rather a direct corollary of the ongoing repricing in the global bond markets. Apart from well-publicized issues regarding the supply versus demand balance for the UST, this repricing is also driven by a reassessment of the Fed's policy outlook.

- Jerome Powell is widely expected to unveil a high (but not necessarily higher) for longer rate trajectory at the Jackson Hole retreat, in stark contrast to the market's pivot expectations which prevailed until recently. The Fed seems to fear that a premature pivot would cost its credibility, when supply shocks (most notably from energy price) may yet revive inflation despite its recent decline.

- As such, the market is adopting a very risk-off stance, which leads to a sharp (more than 2% MoM) gain in the USD. Asian currencies are uniquely badly-positioned against this USD juggernaut, as the ever-more evident weakness in China's economy has forced it to cut lending rates – and likely to cause downward revision in growth outlook across the region.

- The IDR can take heart, nonetheless, in being the best-performing major currency in Asia to-date. It is also true that the USD rally is not yet as extreme as last year (the DXY is slightly below 104, versus 108-114 in the latter half of last year). As long as both of these remains true, we think it makes little sense for BI to hike the BI7DRR.

- The comparative strength vis-à-vis other Asian currencies may instead be a worrisome fact in the light of last quarter's current account deficit (CAD). Earlier this week, we wrote of an increase in consumer goods imports and outbound tourism, which might be early symptoms of a too-strong Rupiah.

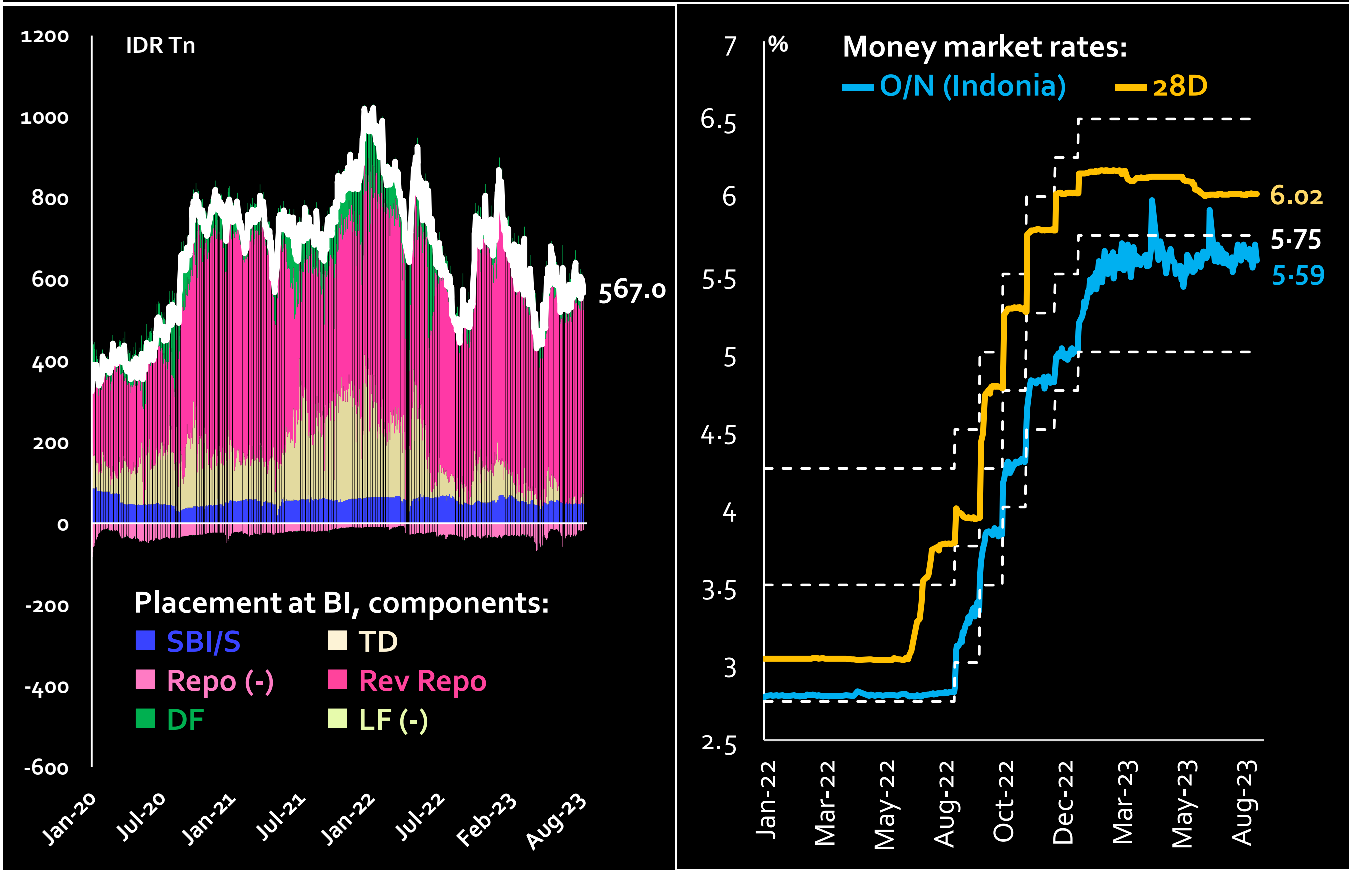
- Furthermore, BI has two extra tools it could hope to wield against further IDR depreciation. The first, which we have mentioned frequently, is of course the requirement for commodity exporters to put 30% of their export receipts (*devisa hasil ekspor*/DHE) domestically, which should bolster FX reserves in the long-run.

- The second, and newer, instrument is the SRBI (*Sekuritas Rupiah Bank Indonesia*), which will be first issued on September 15th. SRBI is a securitization of government bonds (SBN) held by BI, and as such allows BI to absorb IDR liquidity from the banking system. As of now, BI possesses a substantial amount of SBN (~IDR 900 Tn), far more than banks' excess liquidity (~IDR 570 Tn) – which means it could, in theory, tighten liquidity very rapidly and effectively if needed without resorting to rate hikes.

- But why would BI prefer to act on money quantity instead of rates? Recall that it had also increased the reserve requirement ratio (RRR) last year before it began to hike the BI7DRR. We could argue that in the post-Covid environment – with excess liquidity both on the private and public sides – quantity is the more appropriate target, whereas the transmission of rate hikes has been slow and incomplete.

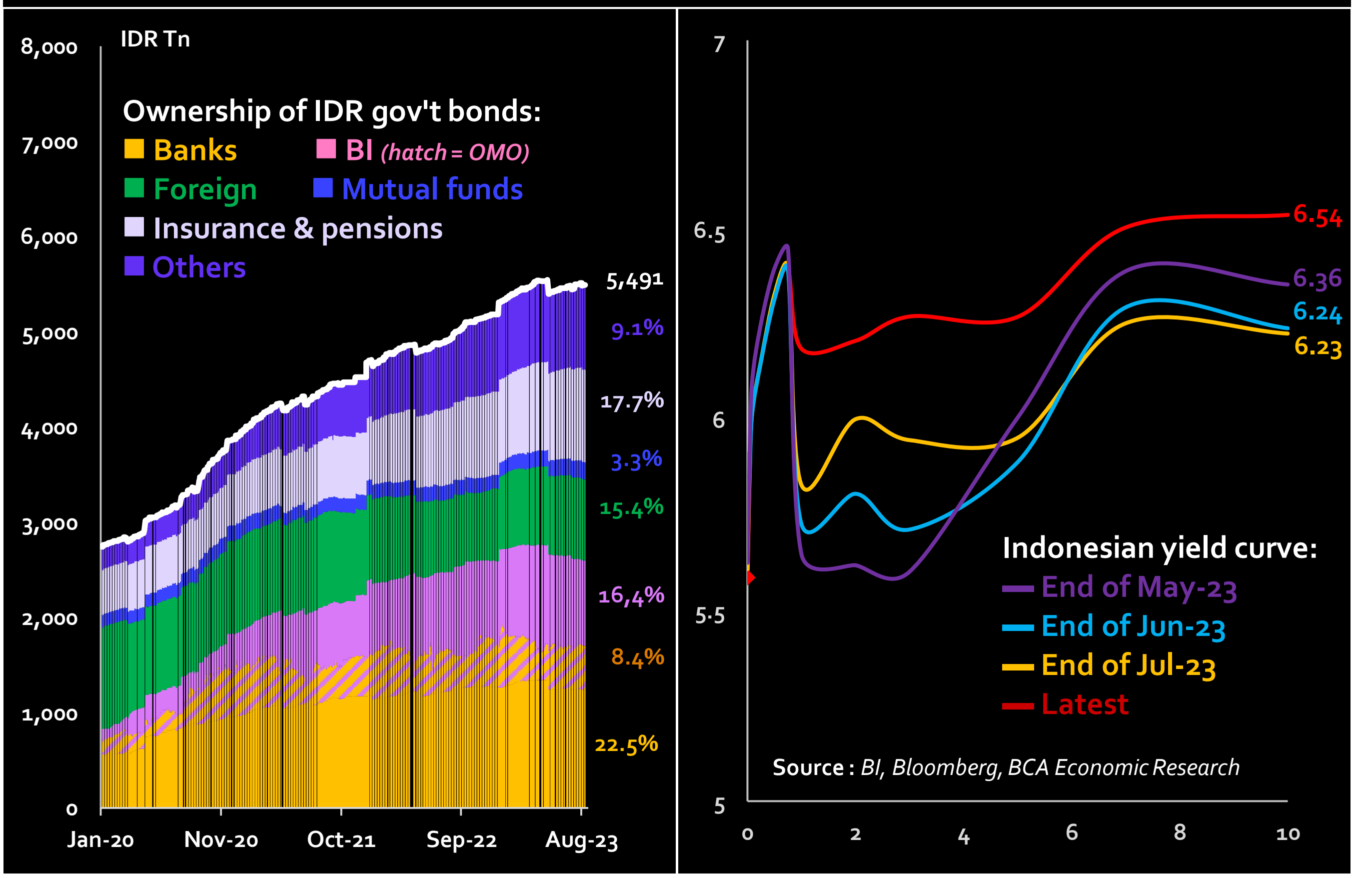
- Rate hike, then, is more useful as a kind of signaling tool, to be used sparingly and in case of more pressing emergencies. We also cannot help but think that credit rationing by quantity rather than by price would be preferred by a government that wishes to allocate relatively cheap financing to certain sectors (SMEs, industries recovering from the pandemic, metals downstreaming, etc.). A scalpel is more suited in these delicate operations than a hammer.

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



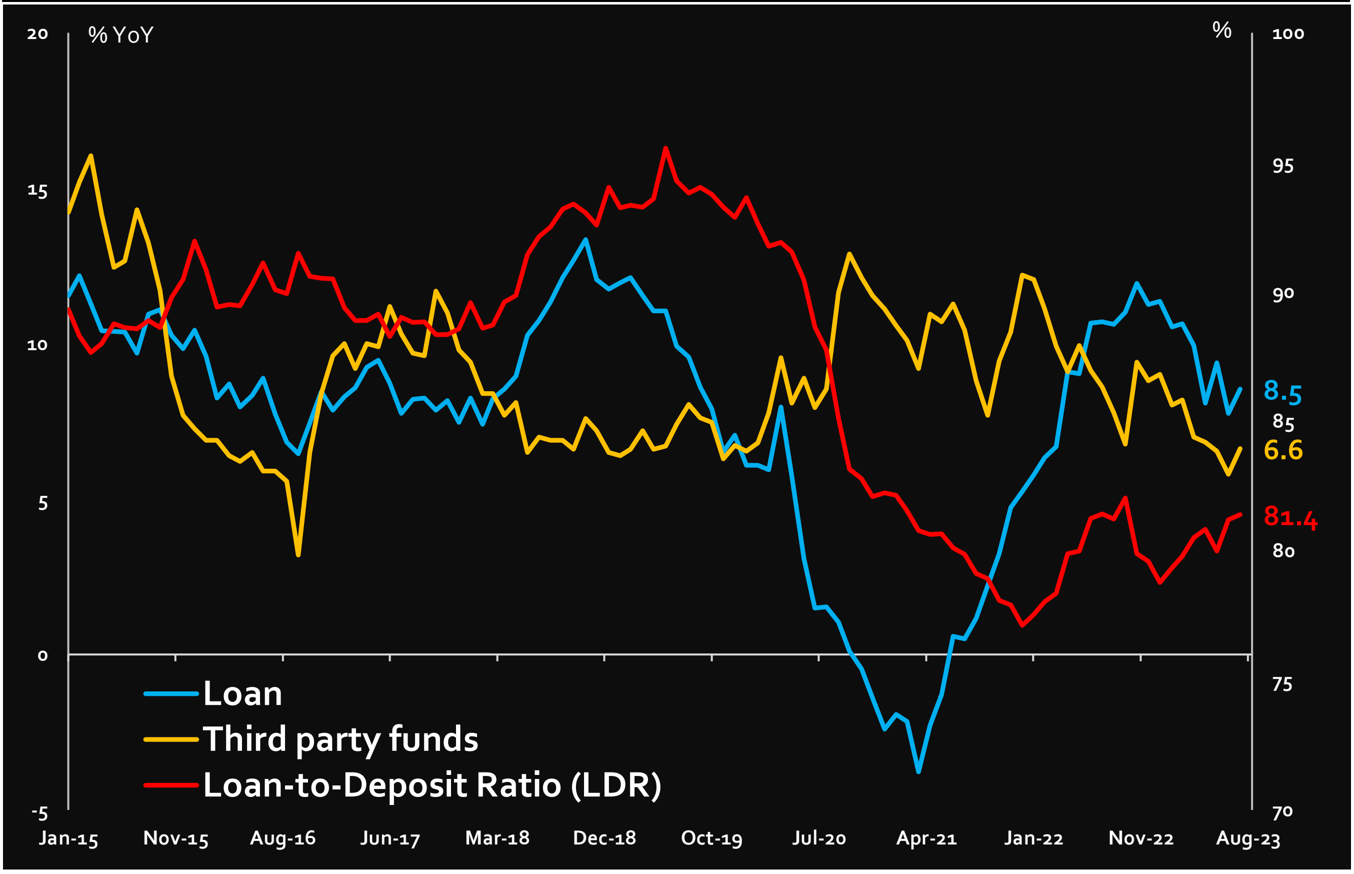
Source: BI, Bloomberg, BCA Economist

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



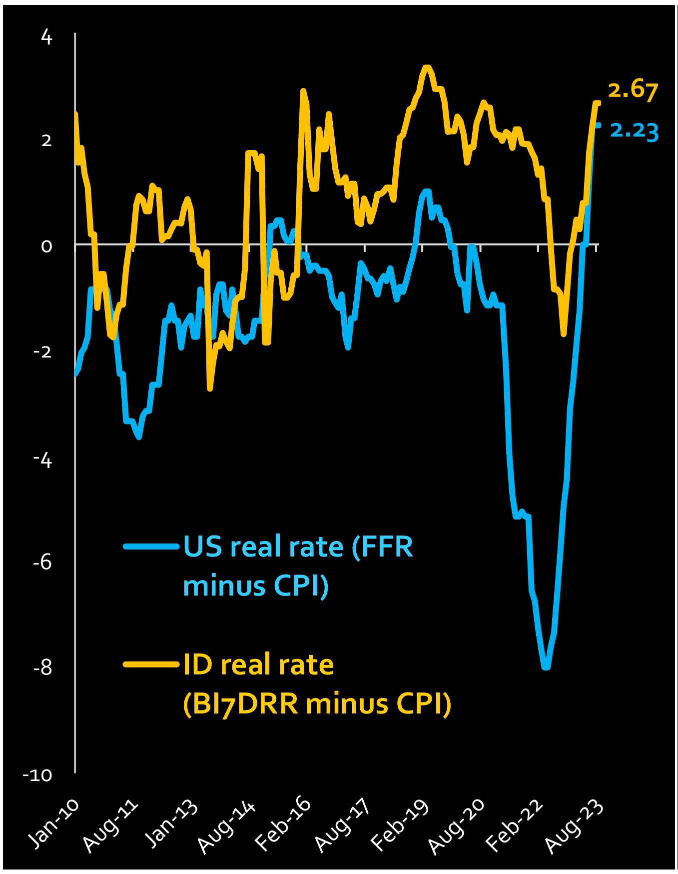
Source: MoF, BI, Bloomberg, BCA Economist

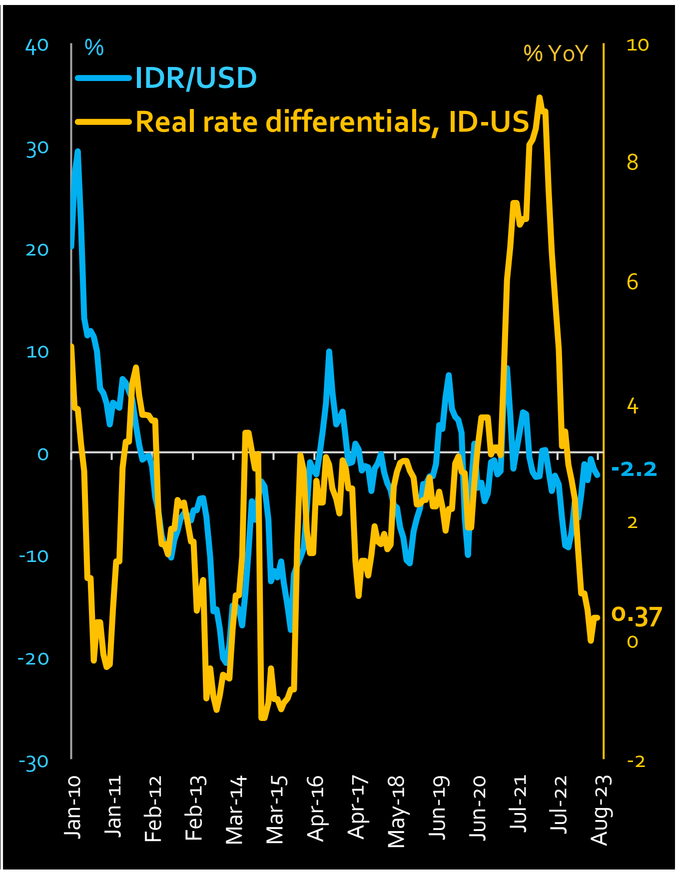
Panel 3. Loan growth have been moderating, but deposits have slowed even further



Source: OJK, BI, BCA Economist

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





Source: BI, Bloomberg, BCA Economist

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Aug-23	2.30
UK	5.25	Aug-23	-1.55
EU	4.25	Aug-23	-1.05
Japan	-0.10	Jan-16	-3.40
China (lending)	2.50	Aug-23	4.65
Korea	3.50	Jul-23	1.20
India	6.50	Aug-23	-0.94
Indonesia	5.75	Aug-23	2.67

Money Mkt Rates	23-Aug	-1 mth	Chg (bps)
SPN (1M)	5.09	4.88	21.0
SUN (10Y)	6.59	6.23	36.1
INDONIA (O/N, Rp)	5.59	5.55	3.3
JIBOR 1M (Rp)	6.40	6.40	-0.1

Bank Rates (Rp)	May	Apr	Chg (bps)
Lending (WC)	8.93	8.92	0.35
Deposit 1M	4.19	4.18	1.37
Savings	0.67	0.67	0.00

Currency/USD	23-Aug	-1 mth	Chg (%)
UK Pound	0.786	0.778	-0.99
Euro	0.921	0.899	-2.35
Japanese Yen	144.8	141.7	-2.15
Chinese RMB	7.279	7.188	-1.25
Indonesia Rupiah	15,295	15,025	-1.77

Capital Mkt	23-Aug	-1 mth	Chg (%)
JCI	6,921.4	6,880.8	0.59
DJIA	34,473.0	35,227.7	-2.14
FTSE	7,320.5	7,663.7	-4.48
Nikkei 225	32,010.3	32,304.3	-0.91
Hang Seng	17,845.9	19,075.3	-6.44

Foreign portfolio ownership (Rp Tn)	Jul	Jun	Chg (Rp Tn)
Stock	2,892.9	2,755.0	137.88
Govt. Bond	846.9	846.9	0.00
Corp. Bond	11.3	11.3	-0.03

Trade & Commodities	23-Aug	-1 mth	Chg (%)
Baltic Dry Index	1,151.0	978.0	17.7
S&P GSCI Index	577.7	574.7	0.5
Oil (Brent, $/brl)	83.2	81.1	2.6
Coal ($/MT)	161.3	147.7	9.2
Gas ($/MMBtu)	2.60	2.61	-0.4
Gold ($/oz.)	1,915.5	1,961.9	-2.4
Copper ($/MT)	8,424.3	8,422.5	0.0
Nickel ($/MT)	20,722.0	20,538.5	0.9
CPO ($/MT)	817.7	875.4	-6.6
Rubber ($/kg)	1.29	1.26	2.4

External Sector	Jul	Jun	Chg (%)
Export ($ bn)	20.88	20.60	1.36
Import ($ bn)	19.57	17.15	14.10
Trade bal. ($ bn)	1.31	3.45	-61.96
Central bank reserves ($ bn)*	137.7	137.5	0.12

Prompt Indicators	Jul	Jun	May
Consumer confidence index (CCI)	123.5	127.1	128.3
Car sales (%YoY)	-6.8	4.7	65.2
Motorcycle sales (%YoY)	45.6	66.6	113.4

Manufacturing PMI	Jul	Jun	Chg (bps)
USA	46.4	46.0	40
Eurozone	42.7	43.4	-70
Japan	49.6	49.8	-20
China	49.2	50.5	-130
Korea	49.4	47.8	160
Indonesia	53.3	52.5	80

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	5.2
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.7
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US$ 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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