

BI Policy:

Reading two maps at once

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Executive Summary

- Bank Indonesia raised its policy rate by 25 bps to 6.25% in response to the recent global market turmoil and weakening of the Rupiah.
- As expected, BI paired the hike with an expansion of the macroprudential liquidity incentives (KLM) policy, to enhance banks' liquidity and facilitate loan growth.
- Going forward, global asset repricing and potential bear steepening in the US yield curve may continue, potentially setting the stage for further policy tweaks by BI.
- The tighter rates and looser macroprudential policy could collide, as higher loan growth relative to deposit growth could still translate to wider current account deficits, potentially affecting the Rupiah's value.

- Many things happened in the global monetary space while Indonesians went on their long holiday between late May and early March 2024, with most of it coming to the Rupiah's disadvantage. The sound of missiles darting across the Middle East has awakened the market from their soft landing fantasy, leading to a heightened USD (DXY) value as the risk of returning inflationary pressures in the US once again becomes the talk of the town. Against this backdrop, **Bank Indonesia has decided to increase its policy rate by 25 bps in today's meeting, bringing the BI rate to 6.25%** – its highest level since 2016.
- BI's decision to increase the policy rate by another 25bps echoes the situation in October 2023, when the central bank decided to bring the BI-Rate to 6.00%. Persistent external pressures and foreign capital outflows have rendered FX interventions too costly (as indicated by the USD 3.6 Bn decline in the FX reserves position, despite the higher-than-expected USD 4.47 Bn trade surplus), compelling the central bank to go on the hiking trail again after a considerable hiatus.
- However, unlike in October 2023, BI is not putting its weight squarely on FX stability this time around. **The central bank also announced its decision to expand the macroprudential liquidity incentives (KLM) policy, which could now discount banks' required reserves by a maximum of 4% (RRR is set at 9%)**, potentially unearthing around IDR 81 trillion of fresh liquidity into banks' loanable funds coffers.
- **The recent policy decision further highlights BI's "tight monetary, loose macroprudential" policy mix.** The higher short-term rate, along with the more stable inflation outlook in Indonesia, shall widen the real rate differential that may help to increase the attractiveness of Rupiah-denominated assets. BI's continued presence in the FX market,

along with SRBI issuances, may also help to absorb IDR liquidity in the market, which could strengthen the bulwark for the Rupiah amidst the challenging external backdrop.

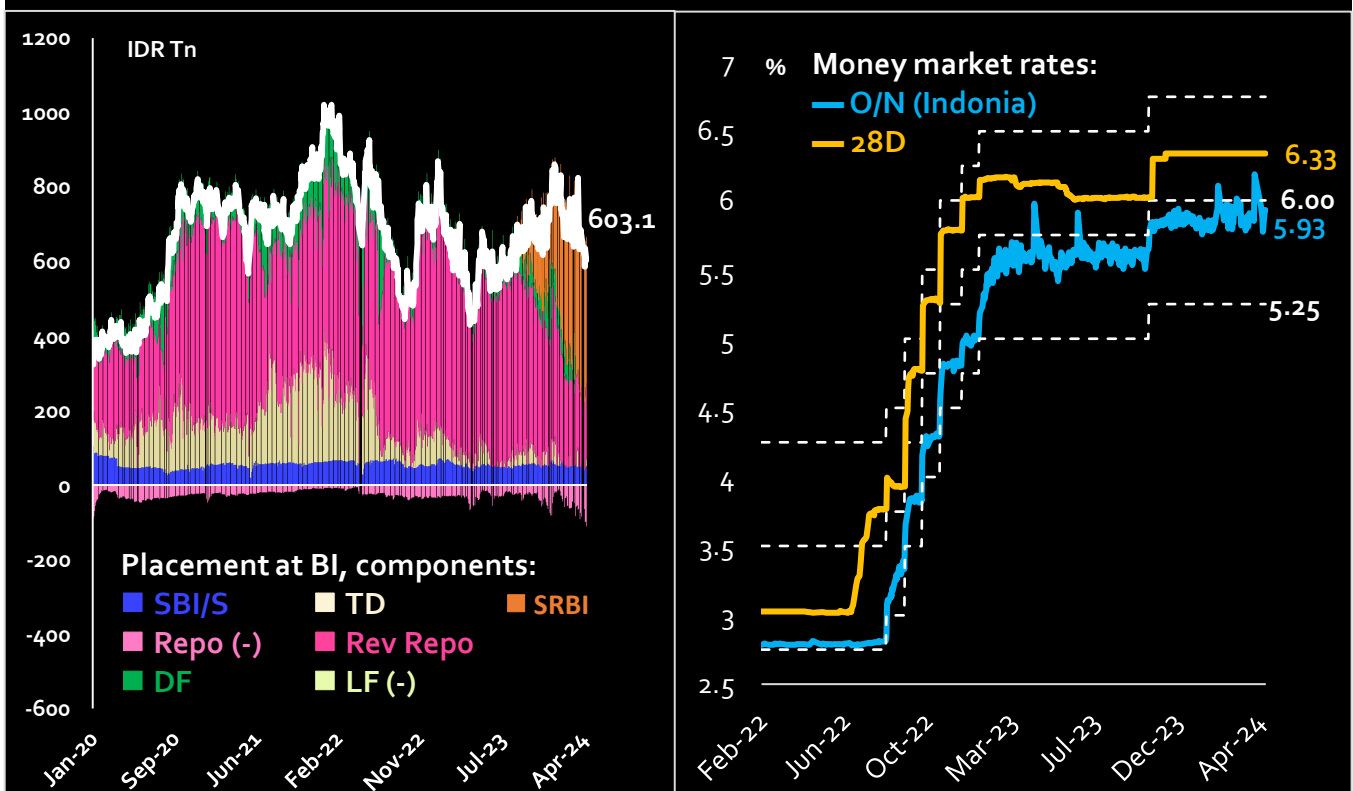
- Meanwhile, the loosened macroprudential policy through the expanded KLM incentives is good news for the domestic banking industry. The wide range of industries listed as targets will help banks qualify for the incentive, especially given the low loan growth threshold set by the central bank (as low as 1% for loans to the automotive, trade, and social service industries, relative to 12.4% YoY loan growth in March 2024). **The expanded KLM incentives thus answer banks' need for a looser liquidity condition, while also ensuring a fresh supply of credits to a wide range of industries in the real sector.**
- The effort to channel liquidity and maintain the growth momentum in the real sector also compels BI to maintain its presence in the SBN market. The central bank has added around IDR 64.5 trillion (USD 3.98 Bn) worth of SBN to its balance sheet so far in the month, offsetting domestic banks' shift towards SRBI and loans. Alas, the continued salvo of SBN selloffs by foreign investors still managed to send the benchmark 10Y SBN to breach the 7.0% mark early this week, highlighting the challenge facing BI as bond prices continue to be dictated by the marginal buyers (despite a low foreign SBN ownership of 13.93% currently).
- Indeed, **the widened policy rate differentials may not help much in attracting foreign investors back to the Indonesian financial market in the short while.** Notwithstanding the inflationary sentiment that has recently flared up due to the rising uncertainty in the Middle East, the undersupply condition in the global oil market (despite Iran still exporting 1.56 Mn bl/d of oil in 2024) points to a more structural inflationary pressure in the US and globally. **Investors in the US Treasury market also remain wary of an expected higher issuance of long-term USTs, adding to the risk of a bear steepener (long-term rates increasing higher than short-term rates) happening in the US financial market.**
- Complications with BI's dual policy approach (pro-growth with an eye on FX rate stability) may further complicate the situation. Firstly, BI's last two policy rate hikes have been a response to the brewing external pressures, and the decision was only taken after it became clear that prolonged interventions would drain the central banks' FX coffers. This repeating pattern of rate hikes to complement FX interventions may diminish the deterrent effect of such interventions, as the central bank has twice shown that it could blink first in a staring contest against speculators in the FX market.
- Secondly, while BI have successfully managed to add variability to its policy arsenal, **the decision to tighten the monetary policy while at the same time loosening the macroprudential policy may deprive the market of a clearer policy signal from the central bank.** The current situation in the SBN market, where BI and government-linked institutions often act as a backstop against continued selloffs by foreign investors, could also add to the problem of distorted signals that may steer foreign investors away from the Indonesian market.
- Another currency depreciation risk that may stem from BI's "tight monetary, loose macroprudential" policy mix concerns Indonesia's less-than-stellar current account outlook. **The size of liquidity incentives awarded to banks will depend on the bank's success**

"The expanded KLM incentives answer banks' need for a looser liquidity condition, but the recent rate hike may not be the panacea for the Rupiah's woes"

in expanding its loan portfolio, potentially widening the saving-investment gap within the domestic banking system and signalling a continued CA deficit in the upcoming quarters. While investment by the private sector have slowed down recently, the demand for capital goods imports may remain significant due to still-going government-sponsored infrastructure projects. At the same time, the short-lived commodity price rally may continue to constrain domestic banks' deposit growth potential, which improved to 7.44% YoY in March 2024 but still lag the 12.40% loan growth.

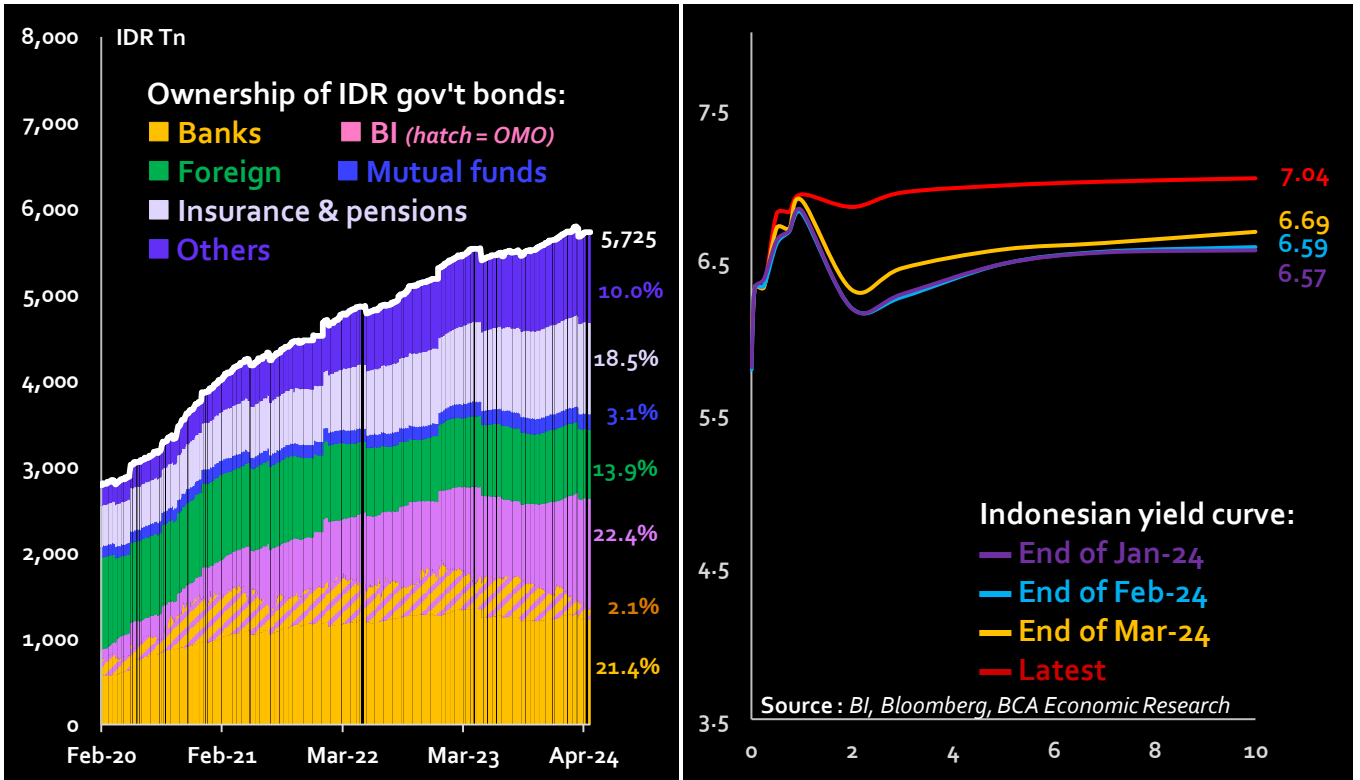
- **Hence, the recent policy tweak may not be the panacea for the Rupiah's current woes.** BI's best chance, it appears, remains for the market to find firmer ground regarding their Fed funds rate expectations, which have now swung fully to the hawkish side after months of dovish exuberance. Thus, we maintain our call that BI would synchronise its future rate adjustments with the projected timeline outlined by the Fed, although the still-robust US economy and the risk of more structural inflationary pressure means that the Rupiah may hover in the 16,000-16,300 level a tad longer.
- Luckily, **the Indonesian economy may be able to make do with a weaker currency for the time being.** Continued manufacturing oversupply condition in China helps to keep imported inflation low and stable, meaning that inflationary pressures are likely to stem from domestic conditions. Meanwhile, a weakened currency may also help domestic manufacturers maintain their competitiveness, especially in the regional market given more significant YTD depreciation recorded in other Asian manufacturing centres (such as the -8.01% YTD drop in Thai Baht value). However, a weakened currency may continue to be an item of concern for the government, while [some in the market are already pondering the implication of the weakened Rupiah to the government's fiscal posture.](#)

Panel 1. A loosened reserve requirement is long overdue, considering the continued decline in banks' IDR placements at BI and more frequent spikes in the O/N money market rate.



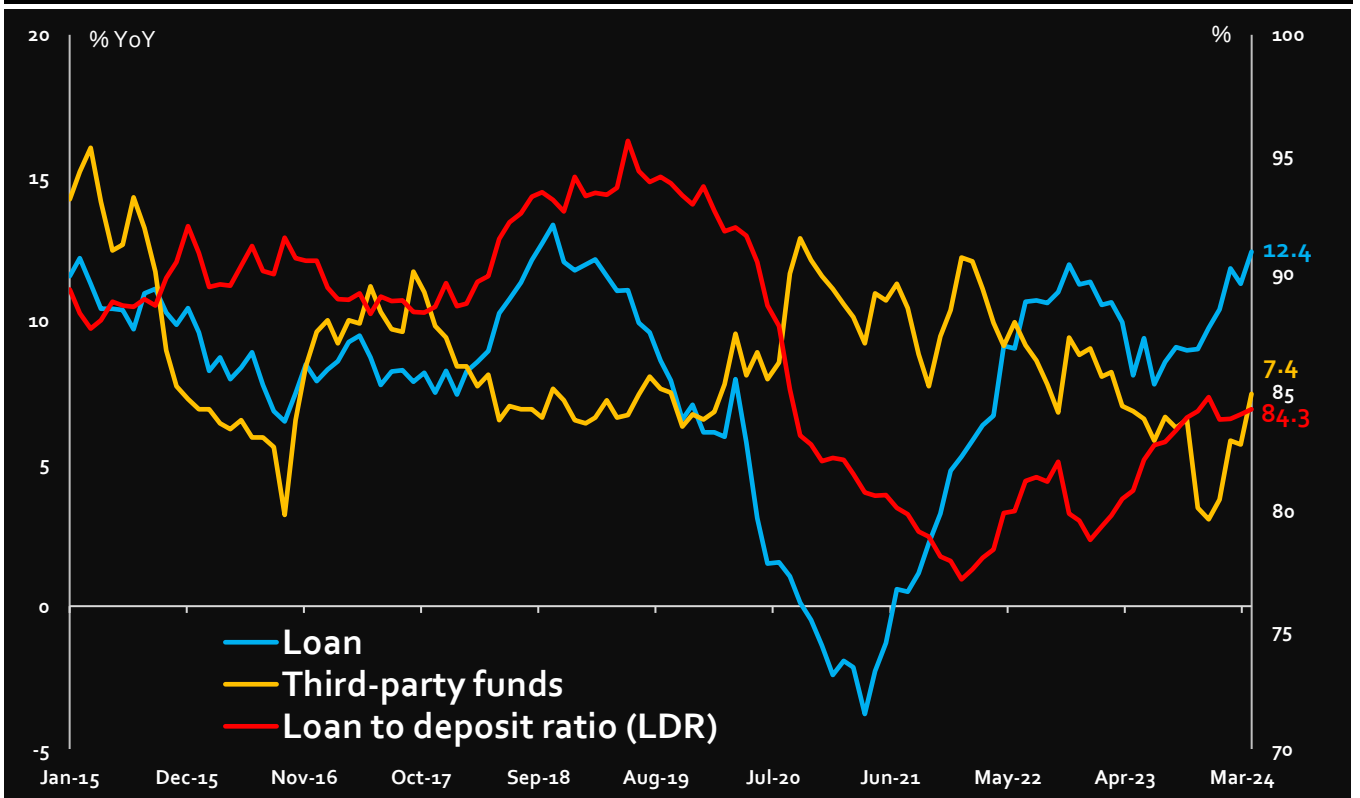
Source: BI, Bloomberg, BCA Economist

Panel 2. The benchmark SBN yield breached above the 7.0% level despite BI's continued presence in the SBN market.



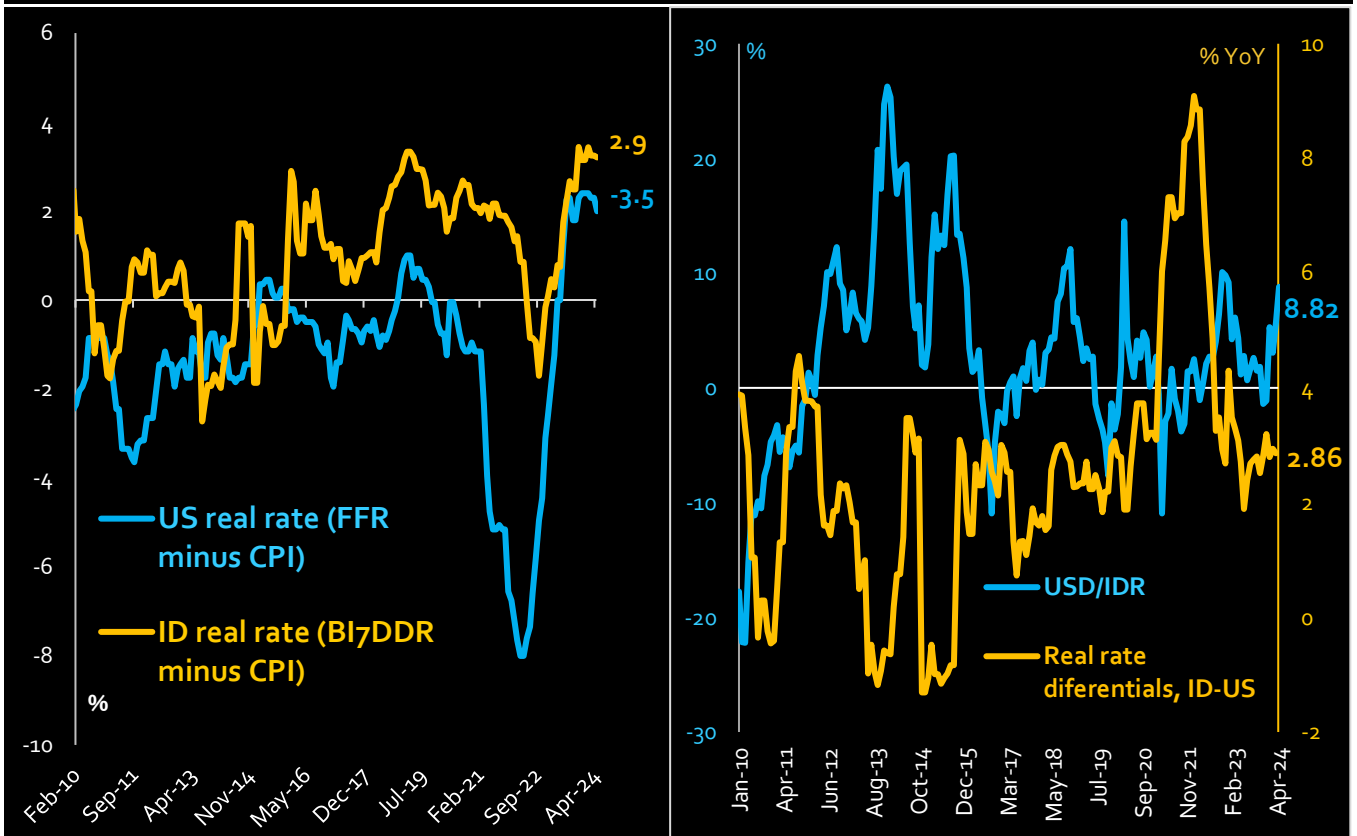
Source: MoF, BI, Bloomberg, BCA Economist

Panel 3. The expanded KLM incentives may continue to boost loan growth higher than deposit growth.



Source: MoF, Bloomberg, BCA Economist

Panel 4. BI's rate hike should widen the real rate differential vis-à-vis the Fed, especially given the risk of more structural inflationary pressure in the US.



Source: BI, Bloomberg, BCA Economist

Selected Macroeconomic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	23-Apr	-1 mth	Chg (%)
US	5.50	Dec-23	2.00	Baltic Dry Index	1,804.0	2,196.0	-17.9
UK	5.25	Dec-23	2.05	S&P GSCI Index	593.8	574.4	3.4
EU	4.50	Dec-23	2.10	Oil (Brent, \$/bbl)	88.4	85.4	3.5
Japan	-0.10	Jan-16	-2.80	Coal (\$/MT)	140.0	126.9	10.4
China (lending)	2.50	Dec-23	4.25	Gas (\$/MMBtu)	1.59	1.51	5.5
Korea	3.50	Nov-23	0.40	Gold (\$/oz.)	2,322.0	2,165.4	7.2
India	6.50	Dec-23	1.65	Copper (\$/MT)	9,602.1	8,756.0	9.7
Indonesia	6.25	Nov-23	3.20	Nickel (\$/MT)	18,846.1	17,044.6	10.6
Money Mkt Rates	23-Apr	-1 mth	Chg (bps)	CPO (\$/MT)	862.8	916.5	-5.9
				Rubber (\$/kg)	1.59	1.64	-3.0
SPN (1M)	5.88	5.80	7.6	External Sector	Mar	Feb	Chg (%)
SUN (10Y)	7.04	6.64	40.7	Export (\$ bn)	22.43	19.27	16.40
INDONIA (O/N, Rp)	5.93	5.78	14.9	Import (\$ bn)	17.96	18.44	-2.60
JIBOR 1M (Rp)	6.65	6.65	0.5	Trade bal. (\$ bn)	4.47	0.83	436.66
Bank Rates (Rp)	Jan	Dec	Chg (bps)	Central bank reserves (\$ bn)*	140.4	144.0	-2.53
Lending (WC)	8.87	8.86	1.70	Prompt Indicators	Mar	Feb	Jan
Deposit 1M	4.68	4.76	-7.90	Consumer confidence index (CCI)	123.8	123.1	125.0
Savings	0.68	0.69	-1.30	Car sales (%YoY)	-26.2	-18.8	-26.1
Currency/USD	23-Apr	-1 mth	Chg (%)	Motorcycle sales (%YoY)	-7.8	-2.9	-3.7
UK Pound	0.803	0.794	-1.21	Manufacturing PMI	Mar	Feb	Chg (bps)
Euro	0.934	0.925	-0.99	USA	51.9	52.2	-30
Japanese Yen	154.8	151.4	-2.21	Eurozone	46.1	46.5	-40
Chinese RMB	7.245	7.229	-0.22	Japan	48.2	47.2	100
Indonesia Rupiah	16,220	15,780	-2.71	China	51.1	50.9	20
Capital Mkt	23-Apr	-1 mth	Chg (%)	Korea	49.8	50.7	-90
JCI	7,110.8	7,350.2	-3.26	Indonesia	54.2	52.7	150
DJIA	38,503.7	39,475.9	-2.46				
FTSE	8,044.8	7,930.9	1.44				
Nikkei 225	37,552.2	40,888.4	-8.16				
Hang Seng	16,828.9	16,499.5	2.00				
Foreign portfolio ownership (Rp Tn)	Mar	Feb	Chg (Rp Tn)				
Stock	3,226.6	3,236.2	-9.67				
Govt. Bond	810.7	837.1	-26.42				
Corp. Bond	9.4	9.5	-0.10				

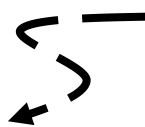
Source: Bloomberg, BI, BPS

Notes:

*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

	2019	2020	2021	2022	2023	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0
GDP per Capita (US\$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00
USD/IDR Exchange Rate (end of the year)*	13,866	14,050	14,262	15,568	15,397	16,119
Trade Balance (US\$ billion)	-3.2	21.7	35.3	54.5	37.0	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	-0.1	-0.5

*Actual number

** Estimation of Rupiah's fundamental exchange rate

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