BI Policy:
The horns of a trilemma

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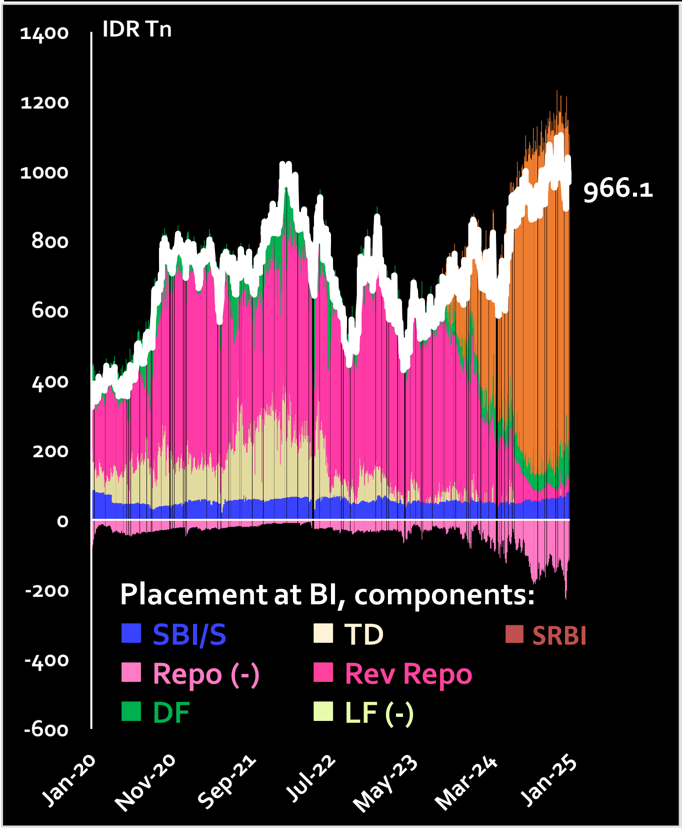
Executive Summary

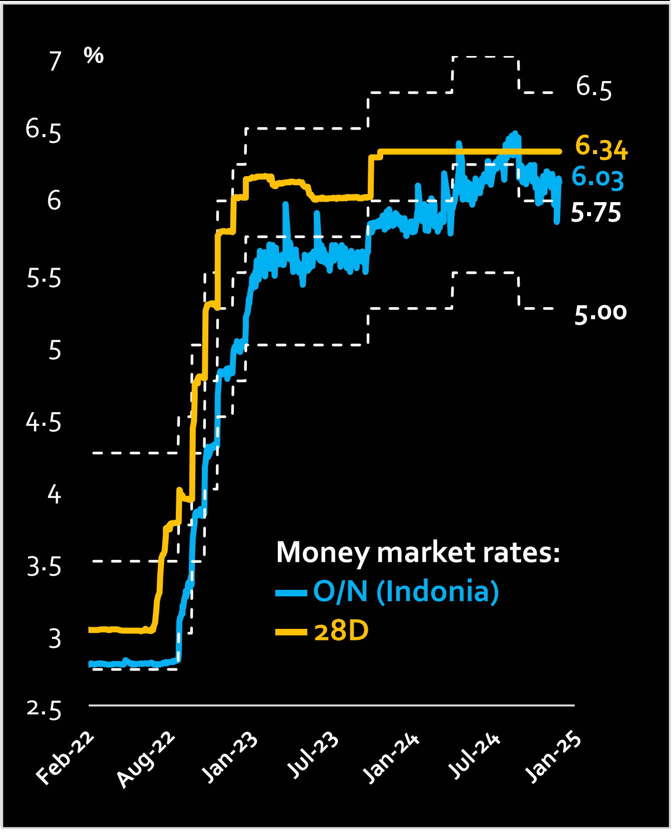
- BI unexpectedly cut its policy rate to 5.75% due to concerns over weak growth prospects even amidst worsening sentiment in the global market.
- Lower real rates can improve private liquidity and demand, albeit at the cost of a wider current account deficit and weaker Rupiah.
- BI will need to navigate between the risk of either disinflationary or depreciation spiral, meaning that it would take a tactical approach to its monetary policy.
- Increased minimum repatriation period on export proceeds from 3 months to 12 months can help bolster BI's ammunition against uncontrolled depreciation.
- Improved domestic liquidity and BI's secondary market purchase should reduce SBN yield volatility, crucial given high interest burden and increased bond vigilantism globally.

- BI unexpectedly cut its policy rate to 5.75% in its first meeting of 2025, citing concerns over weak growth prospects. This defied the consensus of all analysts which had expected caution from BI amid recent global uncertainty, and especially given BI's stance in Q4-24—when it refrained from following up its September rate cut largely to maintain Rupiah stability.
- Indeed, one could argue that the global situation has only become more hostile for the Rupiah compared to December when BI chose to hold. The market is now pricing in merely one cut for 2025 instead of two, while questions about Trump policies are becoming more acute the closer we get to his inauguration day.
- The change in BI's policy orientation is even clearer given its vague statements on "keeping Rupiah close to fundamental values". Previously, BI often clearly stated its belief that the Rupiah is undervalued, even going so far as to quoting a specific target price. It would not be a mistake, then, for the market to think that BI is now prepared to accept a slightly weaker exchange rate.
- BI's "January surprise" underscored the trilemma that we outlined in our 2025 Outlook. In short, given limited liquidity, policymakers can only choose two out of three between robust fiscal spending, robust private spending, and Rupiah stability. For most of 2024, the policies taken had essentially sacrificed private spending in favor of the other two goals, as liquidity was absorbed to SBN and SRBI while high real rates (vis-à-vis inflation) gradually depress consumer borrowing.
- Lower real rates should improve private liquidity, although of course, monetary policy works with long and variable lags. The flip side, of course, is that increased private spending—amid high fiscal spending—will add to our saving-investment (S-I) gap, i.e. our current account deficit. This, in turn, predicts a weaker Rupiah, in line with our forecast for 2025.

- In shifting its priorities, however, BI has to make sure it does not prevent one “vicious spiral” only to fall into another. The one that BI is trying to avoid could be called a “disinflationary spiral”, whereby weak consumption and falling inflation reduces businesses’ margins, thereby driving down business spending and recruitment, and so on. We have seen recently how the decline in our formal manufacturing sector has driven a decline in lower-middle class incomes, which reduced revenue for SMEs and made larger companies reluctant to spend (preferring to hold cash-like assets).
- Despite its costs, a controlled depreciation may help undercut the disinflationary spiral in a few ways by (1) re-routing demand away from imports and towards local goods; (2) making our exports more competitive; and (3) inflating the money supply, especially from commodity exports and FDI, in Rupiah terms.
- Nevertheless, an attempt at controlled depreciation could turn chaotic (“depreciation spiral”) and backfire if it causes a shift in expectations. Investors, expecting their Rupiah assets to always lose their value, suddenly expects higher premiums—while households seek refuge in gold, crypto, or FX assets. BI, then, will have to expertly steer the ship between Scylla and Charybdis.
- For this reason, we do not expect this latest decision to be part of a continuous rate cut cycle, but instead a tactical choice made on a month-to-month basis. BI also has plenty of room to intervene in the FX market, with its record-high reserves level further buttressed by a new regulation extending the period resource exporters are mandated to keep their FX revenue in domestic banks from three months to twelve. The latter, however, needs to be coupled with stricter enforcement, as a comparison between our resource exports and actual TD-DHE data still shows relatively low compliance.
- Fiscal spending—the third corner of our trilemma—remains the biggest X-factor. For now, we expect a wide fiscal deficit (around 2.8-2.9% of GDP) after the recent VAT hike cancellation, perhaps in addition to negative S-I gap among SOEs and other government-linked institutions. BI is supporting this spending, through debt switching (IDR 100 Tn) and higher SBN buying, which is crucial given the amount of maturing SBN (IDR 757 Tn) in 2025.
- The purchase of SBN should have a positive effect on private liquidity, as it will reduce the amount needed to be absorbed by banks, households, and corporates. Nonetheless, BI will have to strengthen its communication on this matter, given recent attention by the foreign business press on its high level of SBN ownership (25.3%, net). With bond vigilantism on the rise globally, Indonesia can ill-afford a spike in yields, especially with interest on government debt already expected to eat up 2.27% of the GDP.

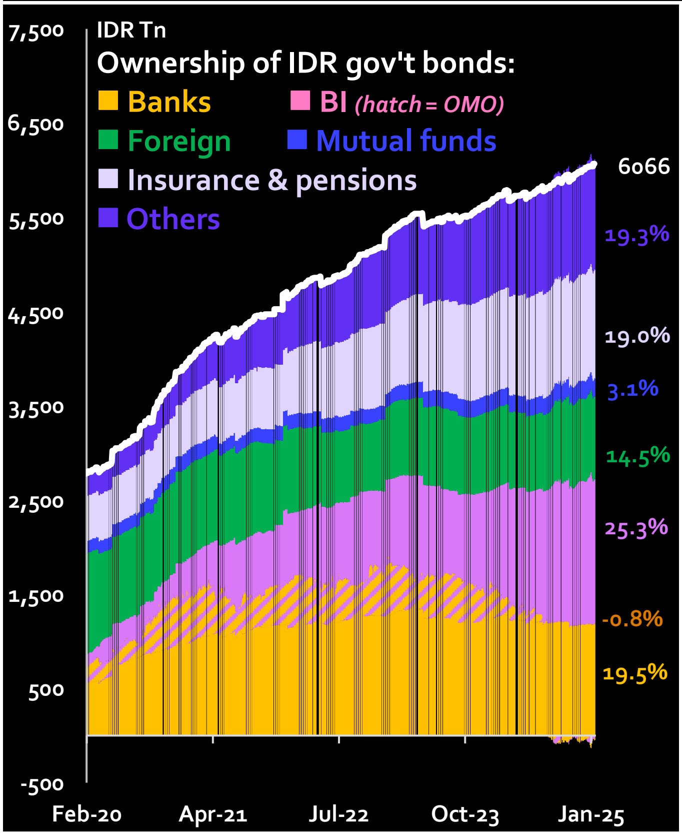
Panel 1. Declining SRBI outstanding is coupled with an unexpected rate cut this month

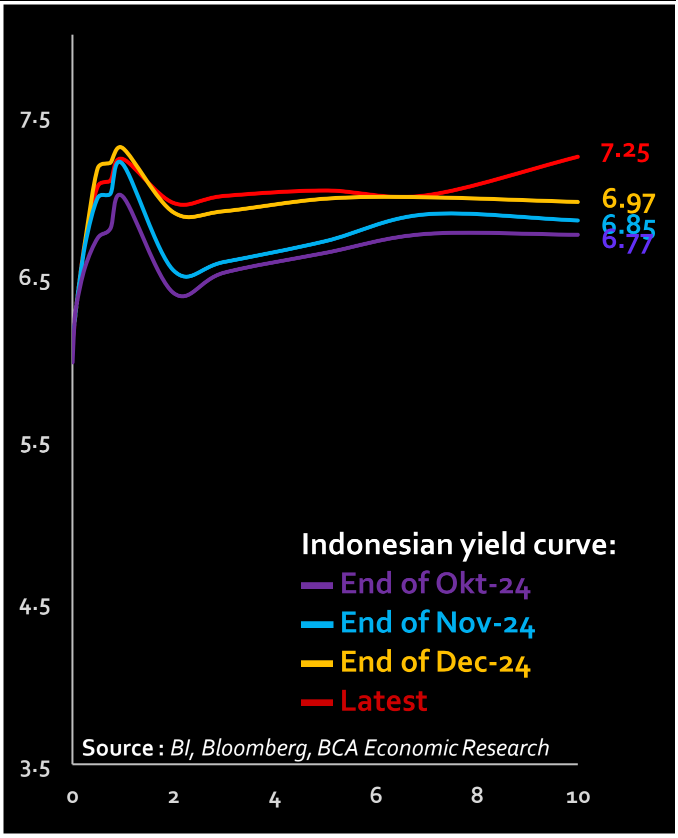




Source: BI, Bloomberg, BCA Economist

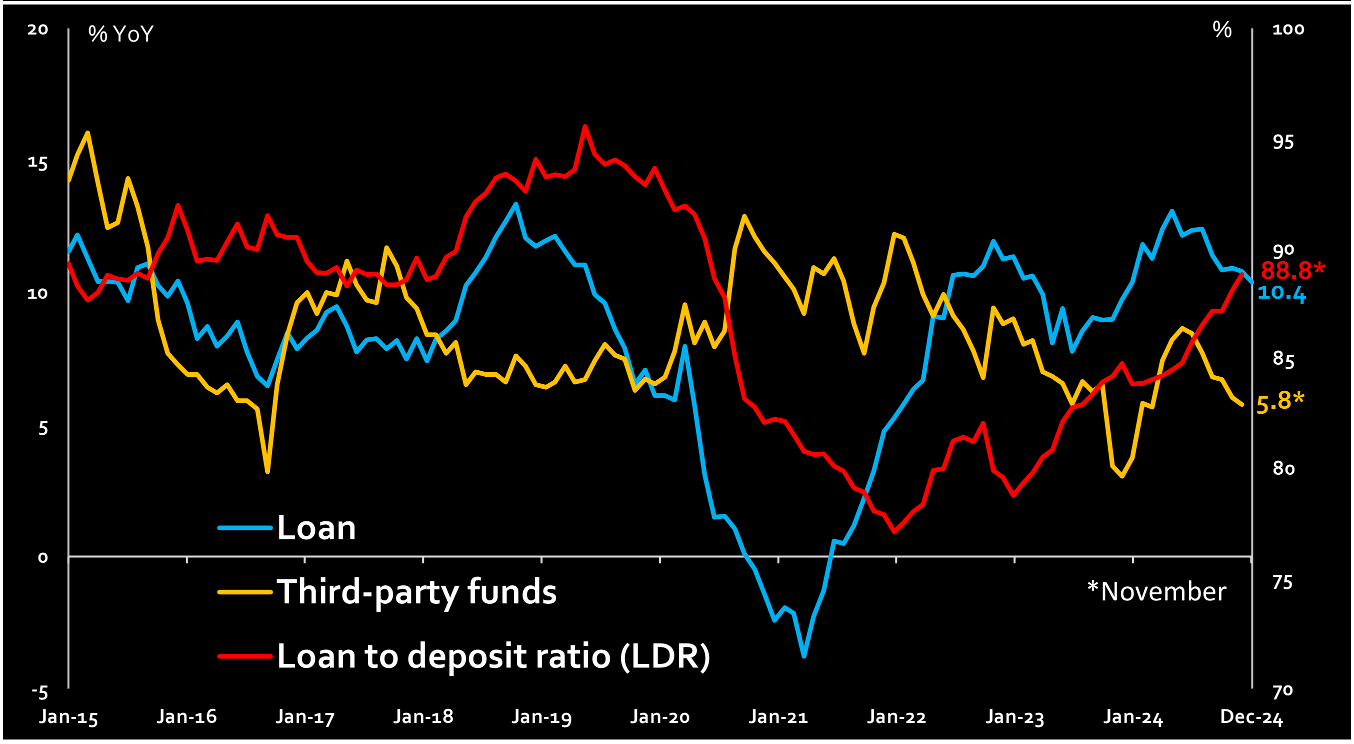
Panel 2. Indo's long term yield curve goes up in-line with global conditions





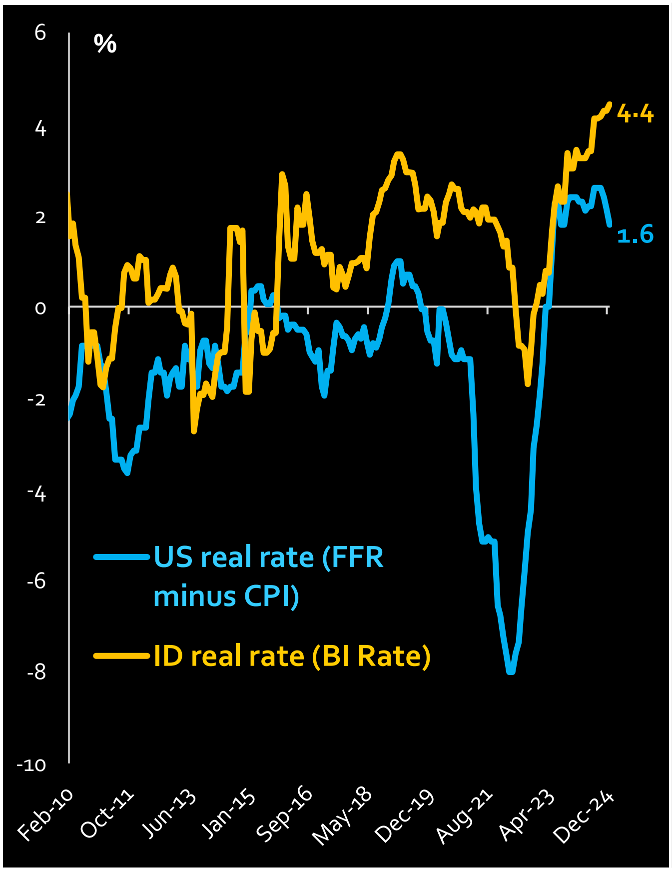
Source: MoF, BI, Bloomberg, BCA Economist

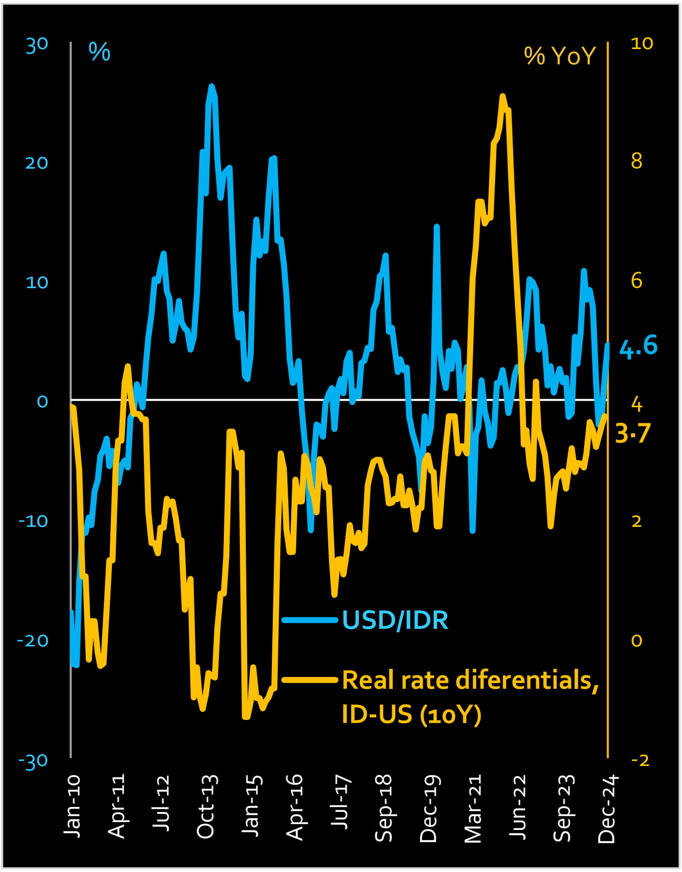
Panel 3. Drawdown in savings at 2nd half of 2024 constrained loan growth



Source: MoF, Bloomberg, BCA Economist

Panel 4. Narrowing real rate differentials may weaken Rupiah further





Source: BI, Bloomberg, BCA Economist

Selected Macroeconomic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	4.50	Dec-24	1.60
UK	4.75	Nov-24	2.25
EU	3.15	Dec-24	0.75
Japan	0.25	Jul-24	-3.00
China (lending)	2.00	Sep-24	4.25
Korea	3.00	Nov-24	1.10
India	6.50	Feb-23	1.28
Indonesia	5.75	Jan-25	4.18

Money Mkt Rates	15-Jan	-1 mth	Chg (bps)
SPN (1Y)	6.85	6.88	-2.3
SUN (10Y)	7.25	7.00	24.5
INDONIA (O/N, Rp)	5.99	5.92	6.8
JIBOR 1M (Rp)	6.62	6.63	-0.4

Bank Rates (Rp)	Oct	Sep	Chg (bps)
Lending (WC)	8.72	8.87	-15.48
Deposit 1M	4.78	4.81	-2.76
Savings	0.66	0.67	-0.14

Currency/USD	15-Jan	-1 mth	Chg (%)
UK Pound	0.817	0.792	-2.99
Euro	0.972	0.952	-2.02
Japanese Yen	156.5	153.7	-1.80
Chinese RMB	7.332	7.274	-0.80
Indonesia Rupiah	16,320	15,995	-1.99

Capital Mkt	15-Jan	-1 mth	Chg (%)
JCI	7,079.6	7,324.8	-3.35
DJIA	43,221.6	43,828.1	-1.38
FTSE	8,301.1	8,300.3	0.01
Nikkei 225	38,444.6	39,470.4	-2.60
Hang Seng	19,286.1	19,971.2	-3.43

Foreign portfolio ownership (Rp Tn)	Dec	Nov	Chg (Rp Tn)
Stock	3,521.3	3,402.4	118.98
Govt. Bond	876.6	872.5	4.15
Corp. Bond	5.9	7.1	-1.18

Trade & Commodities	15-Jan	-1 mth	Chg (%)
Baltic Dry Index	1,063.0	1,051.0	1.1
S&P GSCI Index	581.8	546.3	6.5
Oil (Brent, $/brl)	82.0	74.5	10.1
Coal ($/MT)	117.2	133.5	-12.2
Gas ($/MMBtu)	4.32	3.14	37.6
Gold ($/oz.)	2,696.3	2,648.2	1.8
Copper ($/MT)	9,053.4	8,940.5	1.3
Nickel ($/MT)	15,629.1	15,633.4	-0.0
CPO ($/MT)	1,029.4	1,157.5	-11.1
Rubber ($/kg)	1.98	2.02	-2.0

External Sector	Dec	Nov	Chg (%)
Export ($ bn)	23.46	24.00	-2.24
Import ($ bn)	21.22	19.63	8.10
Trade bal. ($ bn)	2.24	4.37	-48.73
Central bank reserves ($ bn)*	155.7	150.2	3.65

Prompt Indicators	Dec	Nov	Oct
Consumer confidence index (CCI)	127.7	125.9	121.1
Car sales (%YoY)	-6.4	-11.9	-3.9
Motorcycle sales (%YoY)	-5.5	-10.3	5.4

Manufacturing PMI	Dec	Nov	Chg (bps)
USA	49.4	49.7	-30
Eurozone	45.1	45.2	-10
Japan	49.6	49.0	60
China	50.5	51.5	-100
Korea	49.0	50.6	-160
Indonesia	51.2	49.6	160

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	2025E
Real GDP growth (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0	4.9
Nominal GDP growth (% YoY)	6.7	-2.5	9.9	15.4	6.7	7.0	7.9
GDP per capita (USD)	4175	3912	4350	4784	4920	4975	5005
CPI inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	1.6#	2.3
BI Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00#	5.50
SBN 10Y yield (%)	7.04	5.86	6.36	6.92	6.45	6.97#	7.47
USD/IDR exchange rate (end of year)	13,866	14,050	14,262	15,568	15,397	16,102#	16,887
Trade balance (USD Bn)	-3.2	21.7	35.3	54.5	37.0	31.0#	26.2
Current account balance (% of GDP)	-2.7	-0.4	0.3	1.0	-0.1	-0.6	-0.9

Notes:

- *USD/IDR exchange rate projections are for fundamental values; market values may diverge significantly at any moment in time*
- *Numbers marked with (#) for 2024 are final; other numbers for 2024 are our projections*

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