

BI and Fed policy:

Neither puts nor U-turns

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Executive Summary

- BI and the Fed opted to leave its policy rates unchanged in the March 2025 meeting, highlighting both central banks' policy independence despite recent short-term shocks.
- The growing stagflation concern compels the Fed to play down the market's dovish expectations. Meanwhile, its slowing economy may compel the US government to reopen its fiscal spigot, possibly keeping the UST yields elevated.
- While the loose macroprudential policy may allow BI to maintain its dovish bias, the still-unfavourable global condition may continue to limit its policy options.

- **Bank Indonesia kept the BI rate at 5.75% in its March 2025 meeting**, highlighting the central bank's conservative approach to policymaking which is in line with our expectations. The recent bedlam in the domestic financial market – a product of the liquidity problem that hitherto hamstrung the Indonesian market – may have led some (mostly foreign) analysts to start calling for another BI rate cut in yesterday's meeting. However, BI's decision to leave the policy rate unchanged shows that the central bank could remain focused on its policy goals, despite headwinds and strong signals from the financial market.
- **Slightly hidden beneath this conservative attitude, however, is BI's seemingly increasing dovish bias**, as signalled by the governor's multiple remarks on the need to support the real sector. Indeed, BI has been doing whatever it takes to provide more liquidity for the real sector, bar adjusting its policy rate lower. For instance, the central bank has purchased IDR 70.74 Tn worth of government debt to date, expeditiously running through the allotted IDR 150 Tn budget for the debt-buying programme. BI's recent success in lowering the SRBI yield (to 6.3% for 9M SRBI) has also pushed banks to switch their liquidity back to the SBN market, helping to keep nominal long-term interest rates relatively stable, at least before the recent selloffs.
- Recent data may further encourage BI to maintain this tight-rate-loose-macroprudential policy mix. Loan growth clocked in at 10.3% YoY in February 2025, matching the 10.2% YoY expectation. This slight rebound in loan growth, we shall note, occurred despite the enhanced macroprudential liquidity incentives (KLM) policy only kicking in early next month, with the central bank projecting an additional IDR 80 Tn in liquidity injections through the strengthened policy initiative.
- **While the enhanced KLM incentives could lower the RRR to as low as 4% (compared to the record low of 3.5% during the pandemic), it should be noted that the**

additional liquidity will not be broadly accessible to the private sector. As signalled by the governor's remarks, BI's macroprudential policies are increasingly tailored to support the government's fiscal priorities, with the latest iteration specifically targeting the property sector.

- **Be that as it may, the domestic liquidity condition may see a better day (to a degree) in the coming period.** For instance, the government has seemingly front-loaded its debt issuance, meaning that the public sector may not need to absorb much more central bank and private liquidity in the coming months. We are also hopeful that the government's spending realisation will start to normalise soon, which will unlock liquidity previously trapped in the public sector and boost the aggregate demand condition as well.
- The Indonesian economy will also be hoping for foreign capital flows to normalise, as foreign investors appear to have priced in emerging risks in the Indonesian market (such as fiscal risks, which have led to some foreign analysts increasing their 2025 fiscal deficit forecast to 2.8-2.9% of GDP). **Alas, the prospect of foreign investors returning to the Indonesian financial market does not seem to be too likely at the moment.** Higher government spending has led to rising yields in Europe and China, highlighting the intensifying global competition for money.
- **Meanwhile, the Fed has also decided to keep its policy rate at the 4.25-4.50% range,** possibly reverting the dovish expectation that previously allowed liquidity to flow to markets outside of the US. While the decision to maintain the FFR is unsurprising, and FOMC officials have responded to the growing liquidity concern in the UST market by signalling a further slowdown in the pace of its QT (to USD 5 Bn from USD 25 Bn per month for US treasuries), Chairman Powell's rather hawkish remarks may have caught some in the market off guard, halting the downward trend in the USD index (DXY).
- Rather than plain vanilla inflation, the first summary of economic projections of the year revealed FOMC members' wariness over the growing stagflation risk looming over the US economy. This is indicated by the committee raising its 2025 PCE inflation forecast by 200 bps to 2.7%, while sharply lowering its 2025 GDP growth expectation from 2.1% to 1.7%. **Chairman Powell's remarks following the FOMC meeting explicitly pointed to shifting US trade policies as the main driver behind the stagflation risk, which may prompt the Fed to keep the USD expensive to counteract the inflationary impact of the galloping US import tariff through the exchange rate channel.** This may explain the FOMC members' decision to maintain their projection of a maximum of 50 bps in FFR cuts for 2025, against the market's prior expectations of 50-75 bps of rate cuts.
- This policy outlook is particularly problematic for the US government's agenda. As we have previously argued, an expensive USD hampers efforts to rebuild the US manufacturing sector, which is a central part of President Trump's campaign platform. **The slow progress of the reindustrialisation agenda, may, in turn, push the Trump administration to double down on its tariff threats, starting over this maligned policy cycle.**
- The slowing growth momentum may also encourage the Trump administration to reopen its fiscal spigot, despite the widely reported budget optimisation effort spearheaded by the

"Potentially lower SBN issuance and normalising public sector spending realisation may help to improve the domestic liquidity condition in the upcoming months"

Department of Government Efficiency (DOGE). Populist thoughts are never far from President Trump's laundry list of policy ideas, as evidenced by his hinting at a potential stimulus check using funds saved by the DOGE to promote the quasi-public institution. Senate minority leader Chuck Schumer's decision to play down the shutdown threat has also opened the room for an agreement to lift the US debt ceiling, which will allow the sitting administration to further increase the UST supply.

- It is quite clear, then, that policy options available to BI (and other central banks) will remain constrained. The USD is unlikely to slide much from its now-elevated position, while still high UST yield (despite the tapered QT) indicating that maintaining a high Rupiah real interest rate remains crucial to keeping foreign investors engaged.

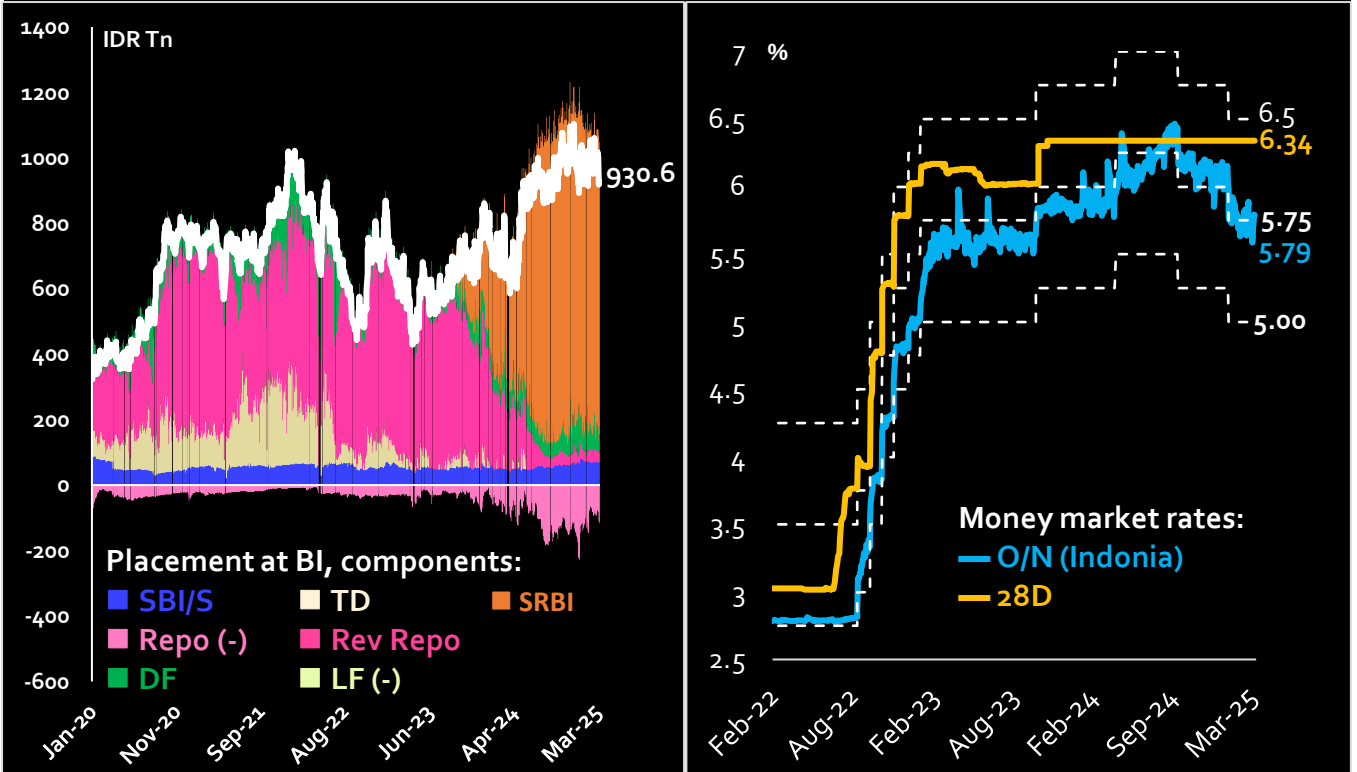
"The elevated UST yield and the intensifying global competition for liquidity may continue to limit Bank Indonesia's policy options"

- BI may continue its dovish bias, but whether this will materialize in the form of rate cut is not yet clear in the short-term. **One thing to keep in mind is the seasonal effect due to the ongoing Ramadan festivities (plus the recent sharp drop in the administered prices component of CPI inflation), which muddles the picture with**

respect to aggregate demand growth. Data coming after the Ramadhan may provide a clearer picture of the domestic demand condition, especially if government spending starts to normalise.

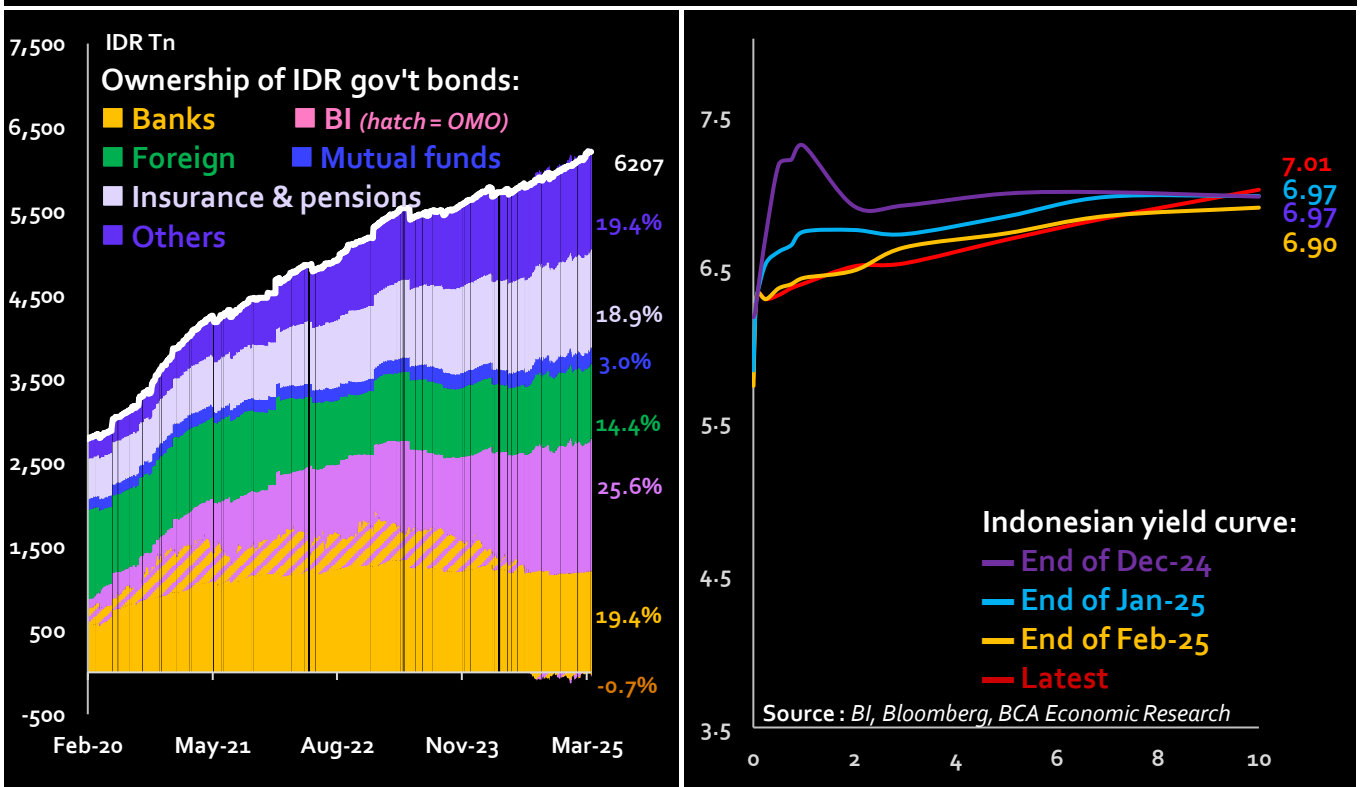
- Indeed, BI may need to tread carefully with its policy easing, as any signals hinting at a more broad-based easing may reignite pressure on the Rupiah. The central bank, then, may continue its selective approach to policy easing for a while, benefitting some sectors that are central to the government's fiscal priorities, while other sectors remain parched of liquidity. This needs to engineer a more broad-based liquidity injection underlines our expectation of another 25 bps BI rate cut this year, although the muddled signalling means that the timing remains uncertain.

Panel 1. Decreasing SRBI issuance allows BI to lower the SRBI yield, forcing banks to switch back to the SBN market



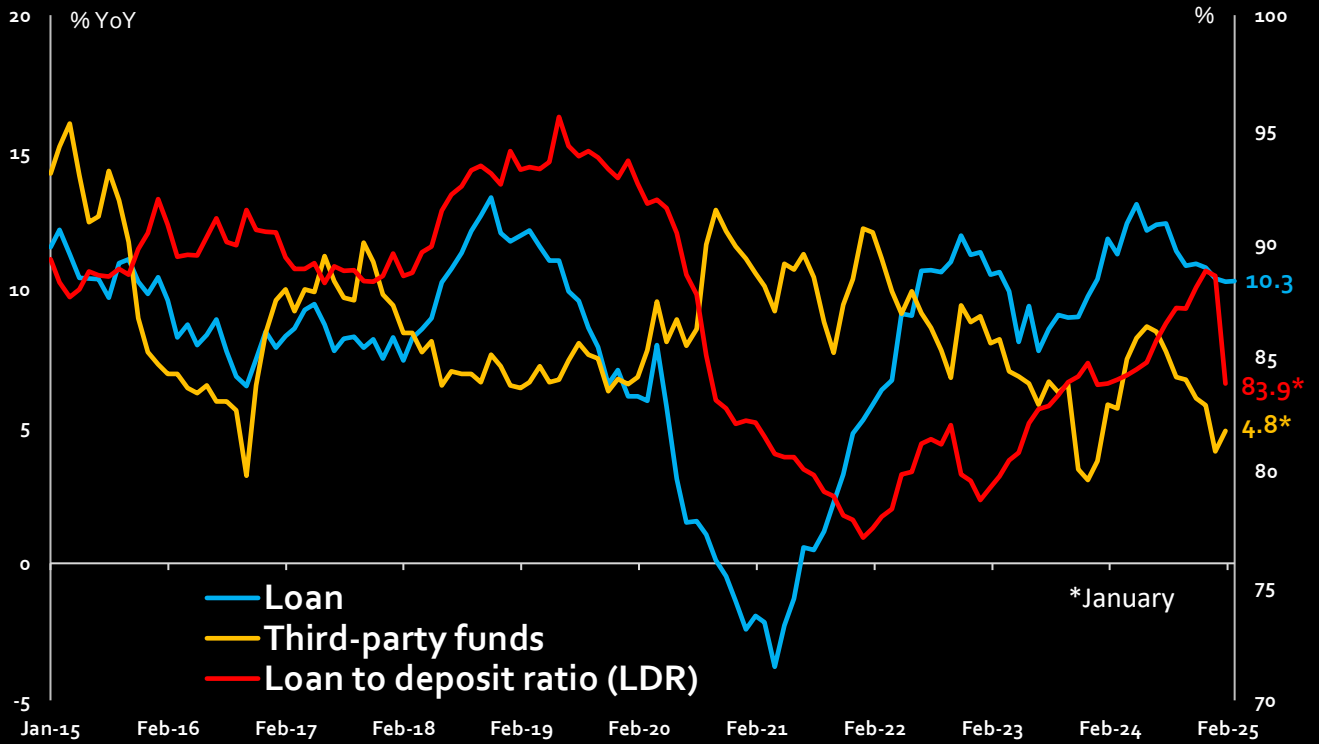
Source: BI, Bloomberg, BCA Economist

Panel 2. The recent market selloffs send SBN yields northwards, but lower issuance and rising private liquidity may help to balance the market condition



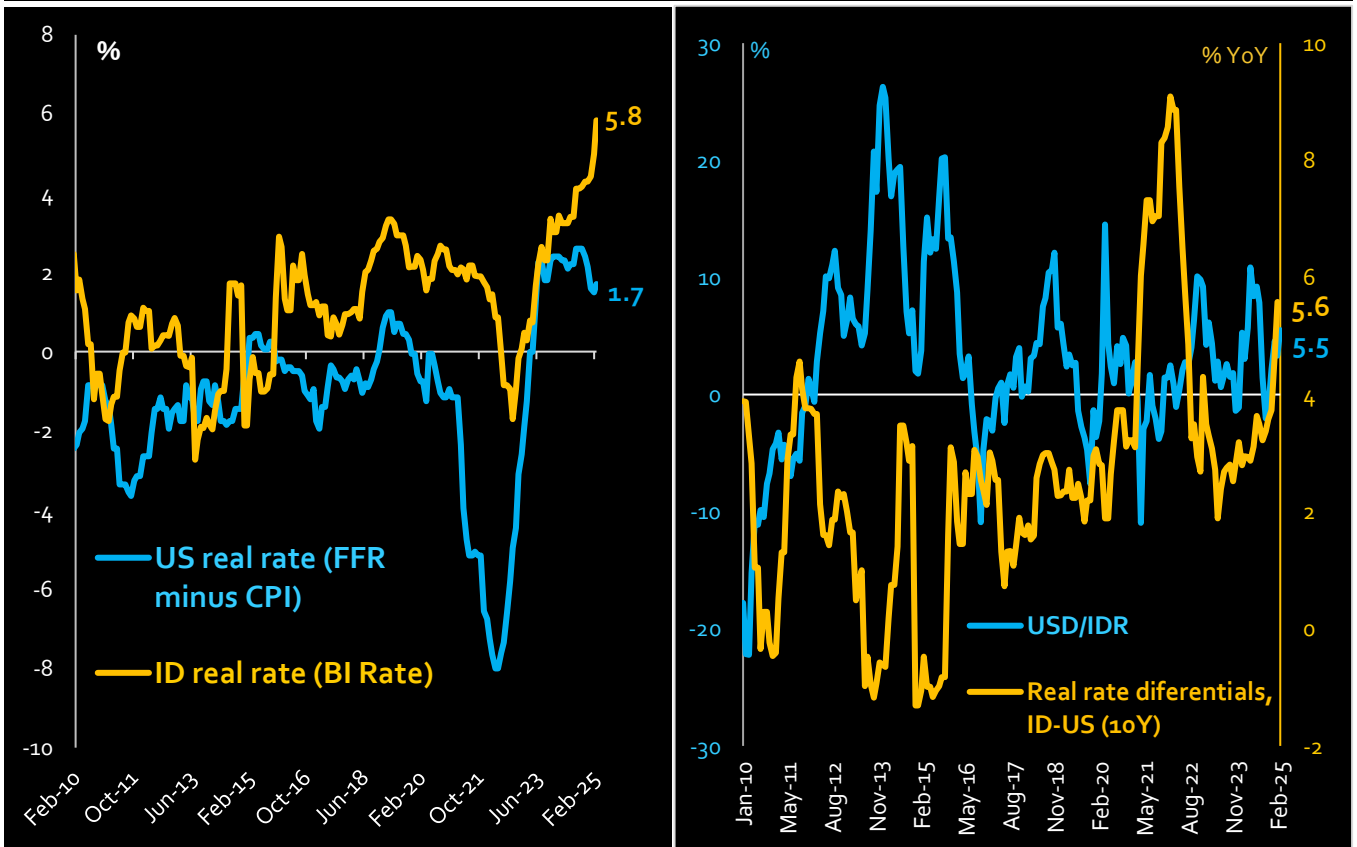
Source: MoF, BI, Bloomberg, BCA Economist

Panel 3. Loose macroprudential policies help to keep the loan growth momentum going, but the growth potential may be limited to some government-favoured sectors



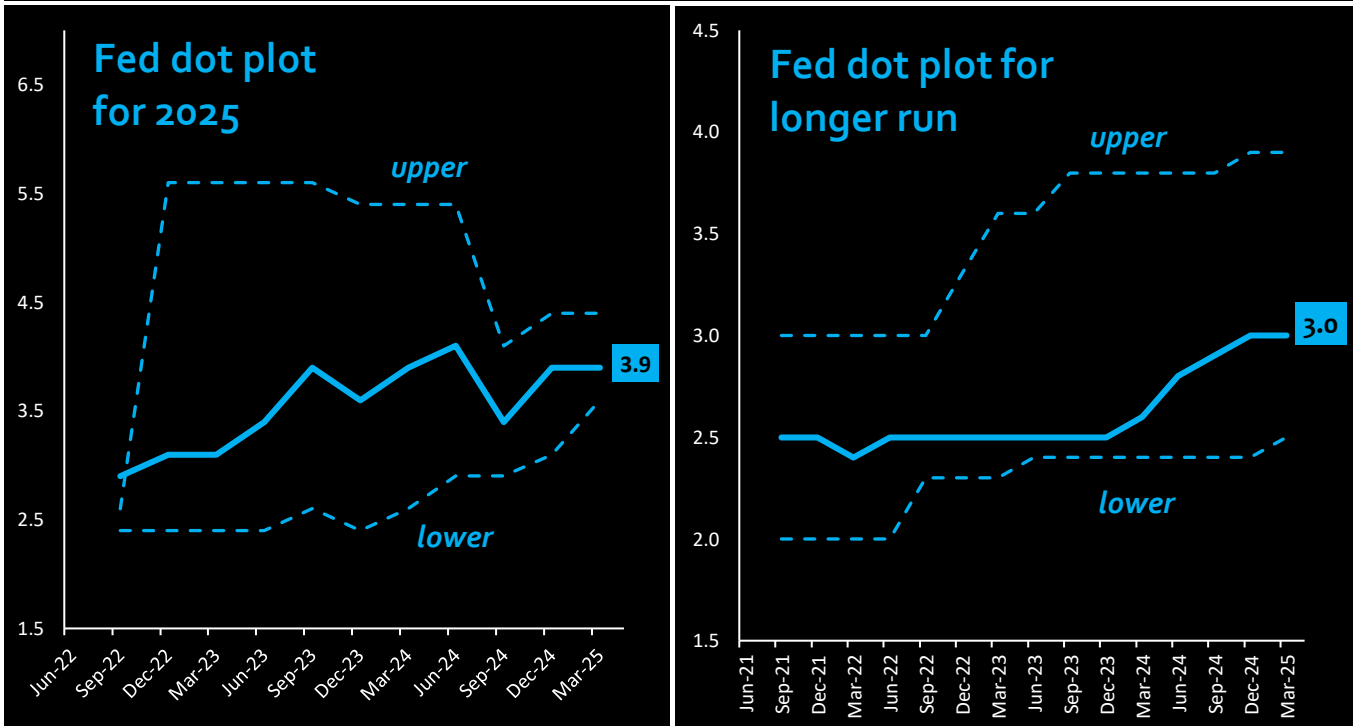
Source: MoF, Bloomberg, BCA Economist

Panel 4. The recent market selloffs and IDR weakening highlight the need to maintain an attractive real interest rate



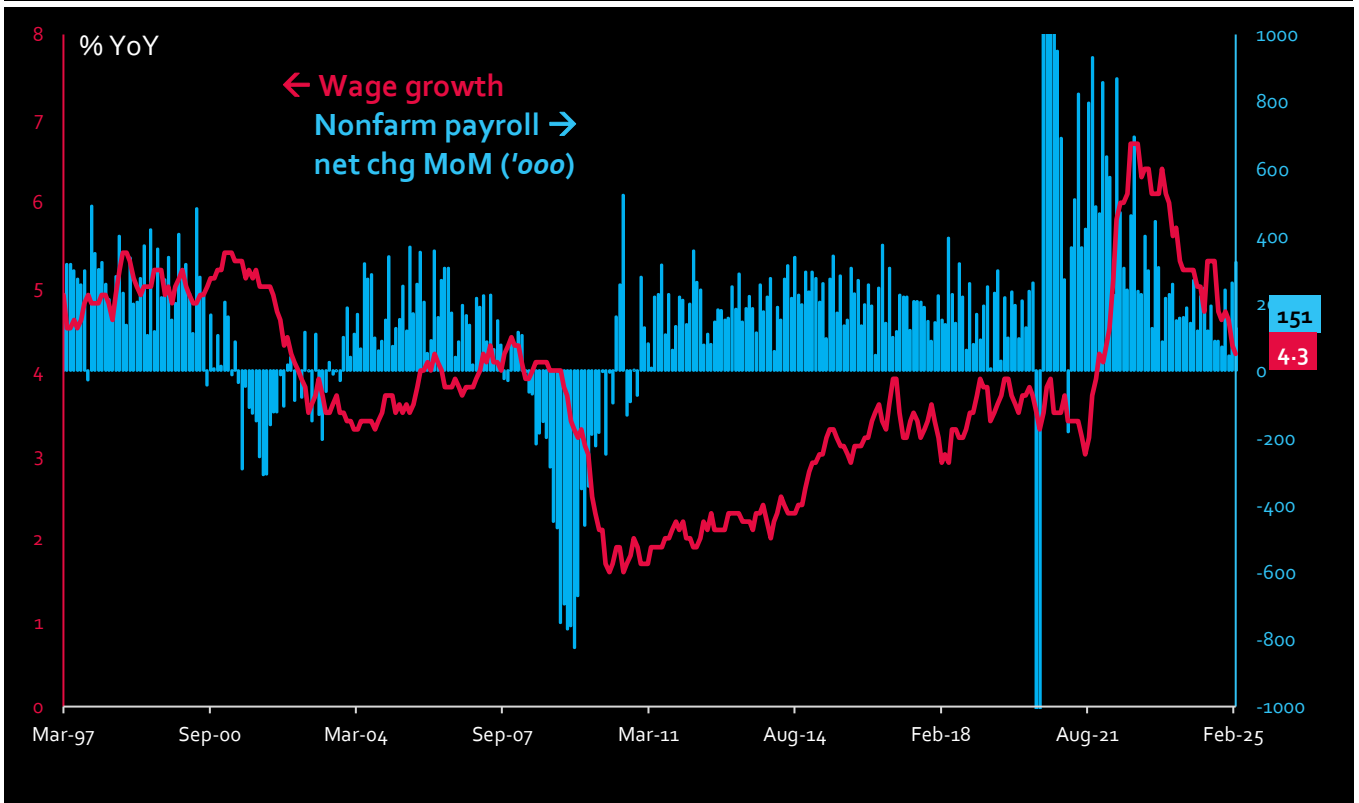
Source: BI, Bloomberg, BCA Economist

Panel 1. Stagflation risks compel FOMC members to maintain their 50 bps rate cut signal, playing down the market's dovish expectations



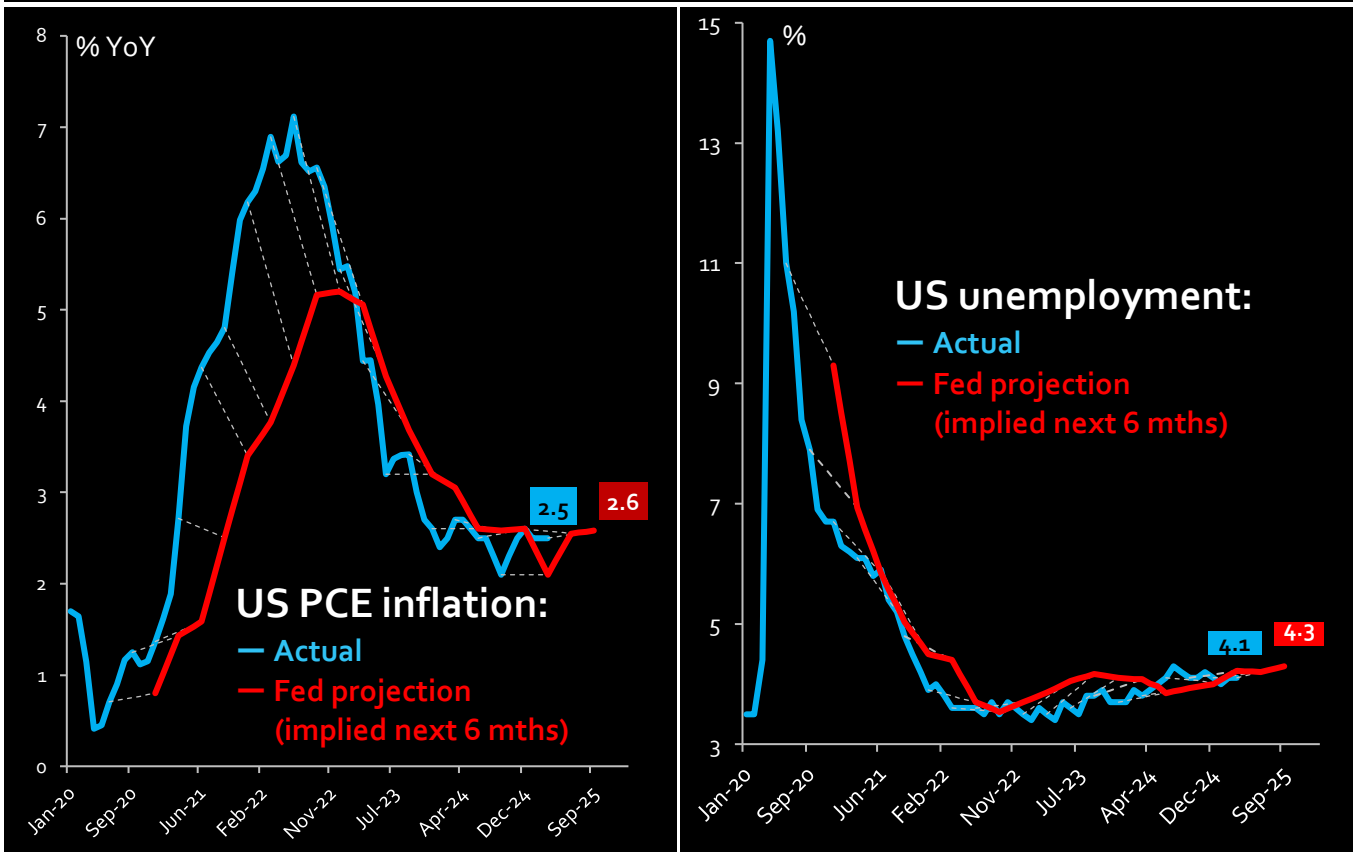
Source: Federal Reserve

Chart 1. Rather than the labour market, the galloping US import tariffs is more of a concern for the Fed



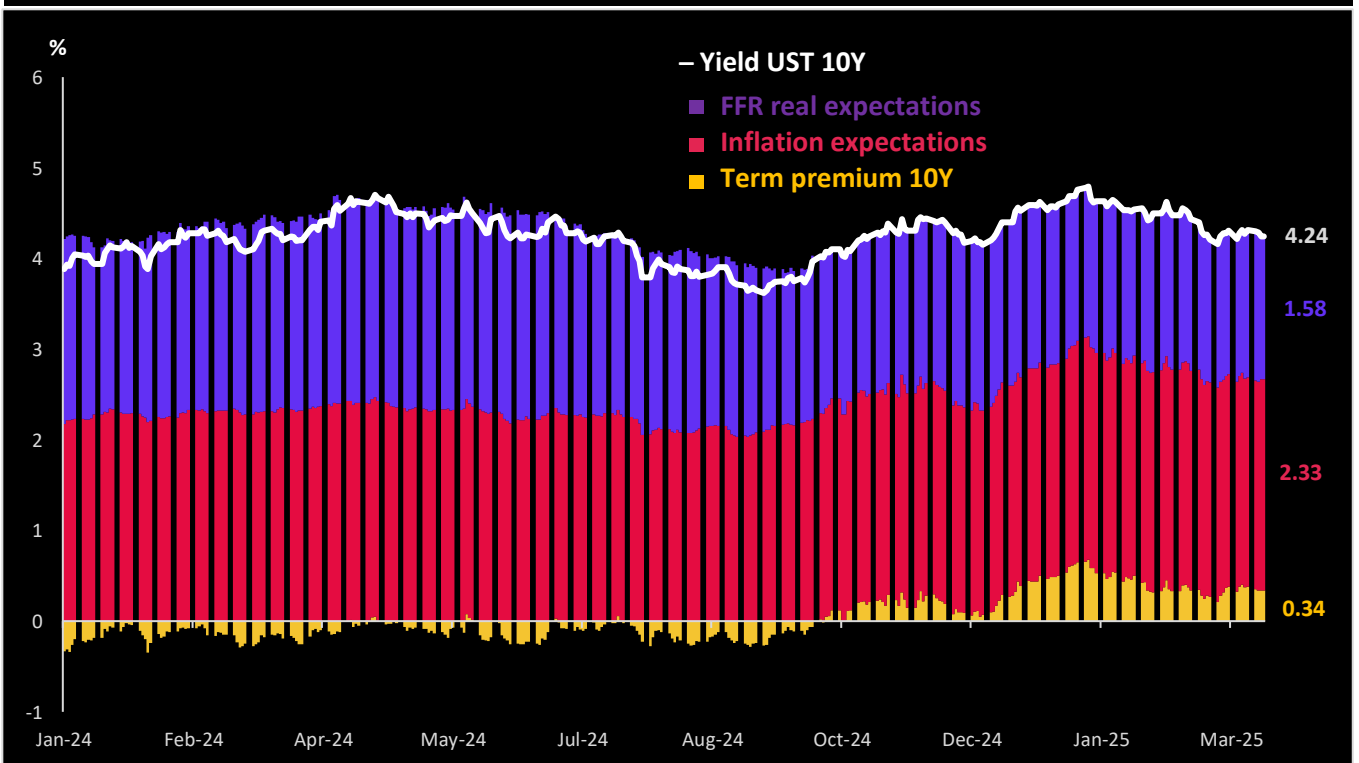
Source: US BLS, Bloomberg

Panel 2. The Fed was caught flat-footed in 2021-22, but recently its projections for inflation and unemployment have been closer to the mark



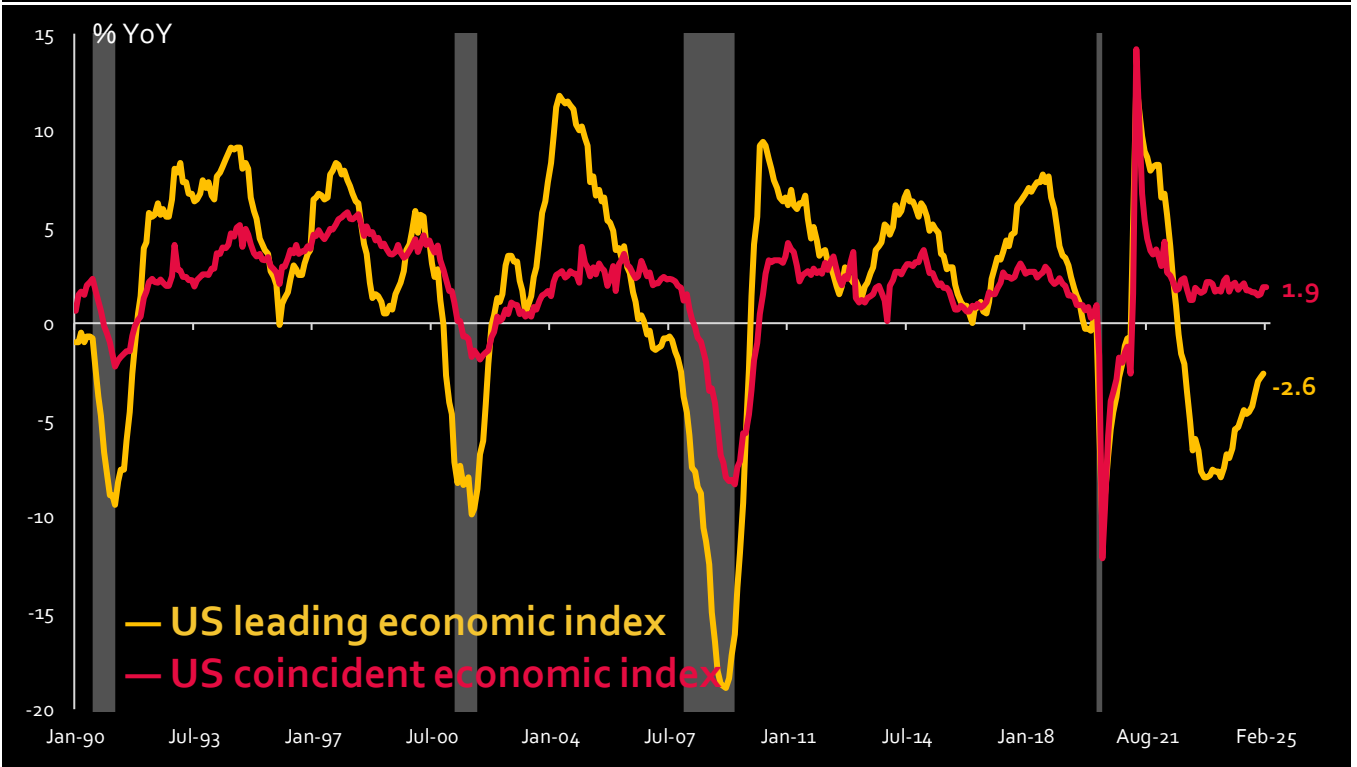
Source: Bloomberg, Federal Reserve

Chart 2. The returning inflation expectation and supply risks may keep the benchmark UST yield elevated



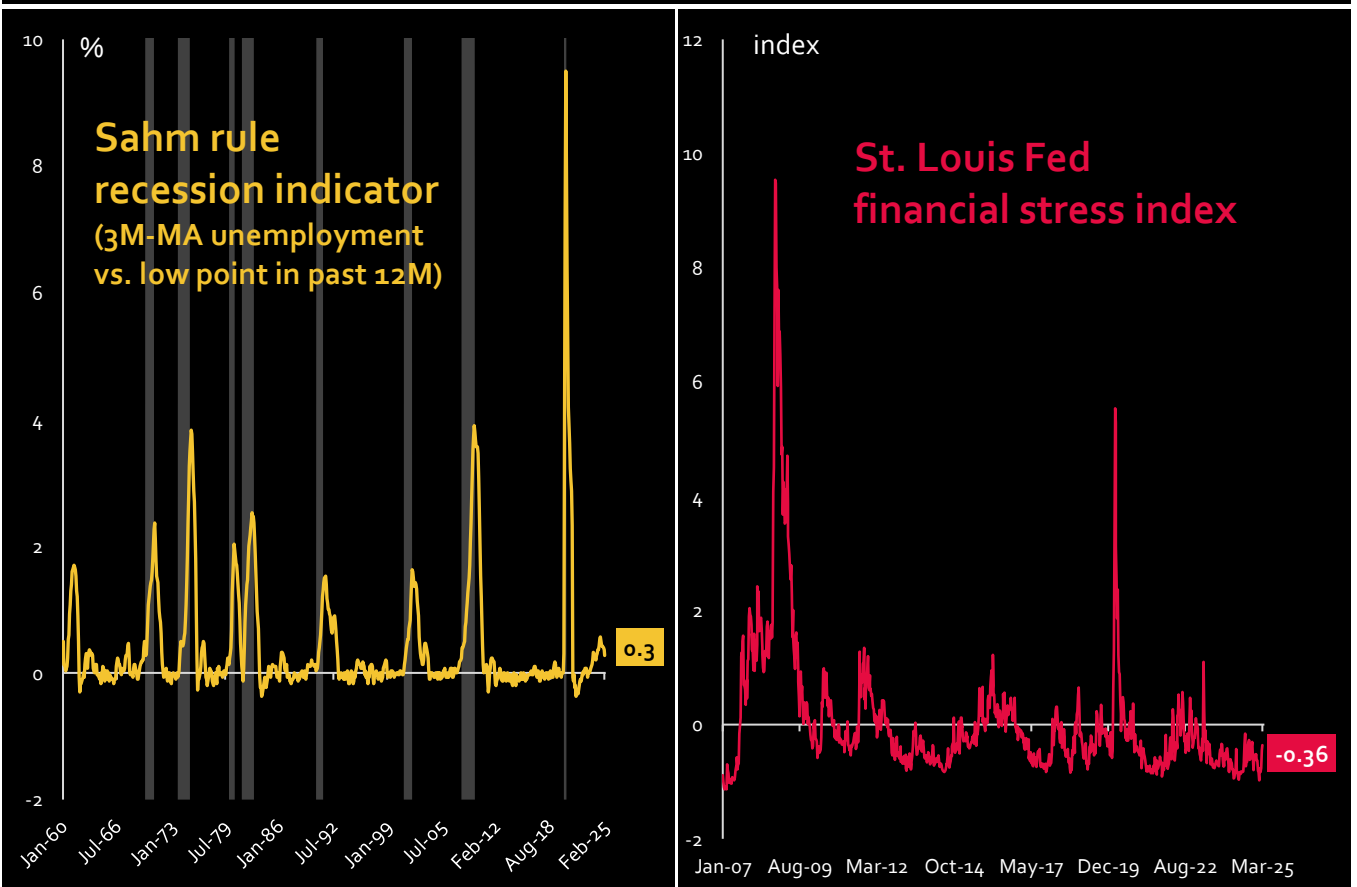
Source: Bloomberg, calculations by BCA Economist

Chart 3. Recession fears are somehow creeping in in the US despite the improving LEI index



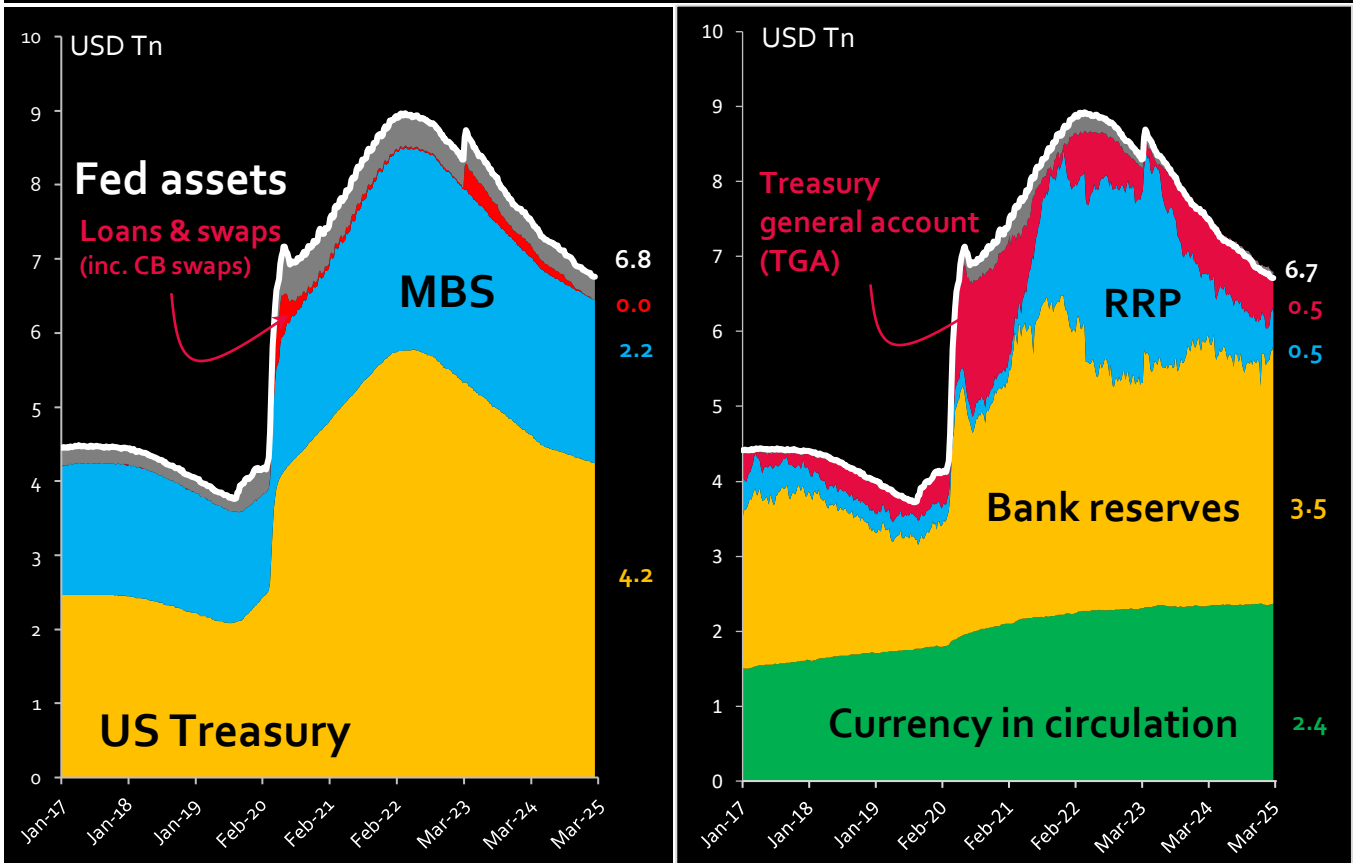
Source: Conference Board

Panel 3. Signs of impending recession are rising together with inflation expectations



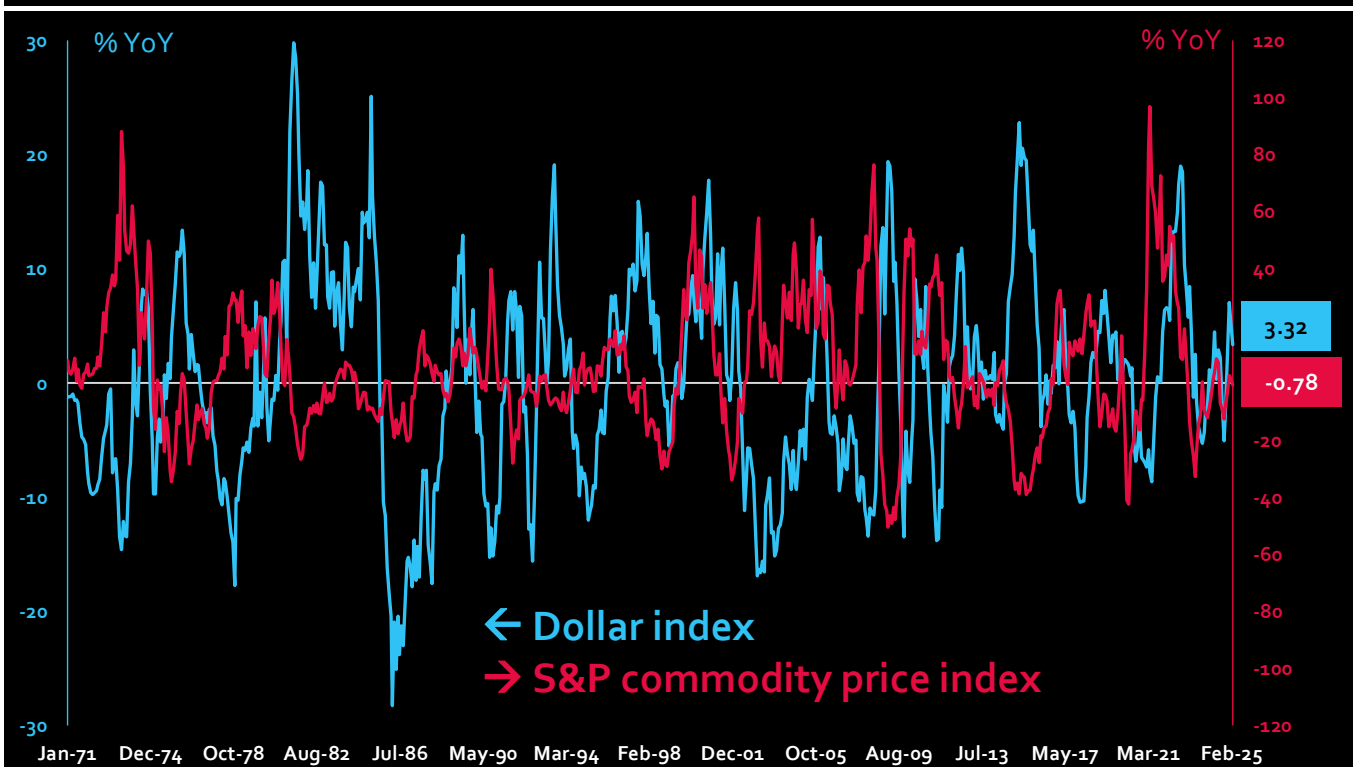
Source: St. Louis Fed

Panel 4. The Fed signal its intention to taper the QT to USD 5 Bn per month, reflecting liquidity concerns in the UST market and the dwindling liquidity buffer (RRP) within its balance sheet



Source: St. Louis Fed

Chart 4. The USD is slowly moving out of its peak, but the global commodity market remains soft due to slowing manufacturing activities in China



Source: Bloomberg

Selected Macroeconomic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	19-Mar	-1 mth	Chg (%)
US	4.50	Dec-24	1.70	Baltic Dry Index	1,650.0	792.0	108.3
UK	4.50	Feb-25	1.50	S&P GSCI Index	556.9	569.4	-2.2
EU	2.65	Mar-25	0.35	Oil (Brent, \$/bbl)	70.8	74.7	-5.3
Japan	0.50	Jan-25	-3.50	Coal (\$/MT)	105.4	111.0	-5.0
China (lending)	2.00	Sep-24	5.05	Gas (\$/MMBtu)	4.21	4.60	-8.5
Korea	2.75	Feb-25	0.75	Gold (\$/oz.)	3,047.8	2,882.5	5.7
India	6.25	Feb-25	2.64	Copper (\$/MT)	9,951.8	9,490.4	4.9
Indonesia	5.75	Jan-25	5.84	Nickel (\$/MT)	16,169.7	15,259.3	6.0
				CPO (\$/MT)	1,058.3	1,074.7	-1.5
				Rubber (\$/kg)	1.96	2.08	-5.8
Money Mkt Rates	19-Mar	-1 mth	Chg (bps)	External Sector	Feb	Jan	Chg (%)
SPN (1Y)	6.02	6.12	-10.5	Export (\$ bn)	21.98	21.43	2.58
SUN (10Y)	7.08	6.76	32.1	Import (\$ bn)	18.86	17.94	5.18
INDONIA (O/N, Rp)	5.76	5.64	12.1	Trade bal. (\$ bn)	3.12	3.49	-10.75
JIBOR 1M (Rp)	6.38	6.38	-0.2	Central bank reserves (\$ bn)*	154.5	156.1	-1.01
Bank Rates (Rp)	Dec	Nov	Chg (bps)	Prompt Indicators	Feb	Jan	Oct
Lending (WC)	8.62	8.68	-5.92	Consumer confidence index (CCI)	126.4	127.2	121.1
Deposit 1M	4.92	4.78	14.17	Car sales (%YoY)	0.0	-11.3	-3.7
Savings	0.68	0.67	1.19	Motorcycle sales (%YoY)	0.0	-6.0	5.4
Currency/USD	19-Mar	-1 mth	Chg (%)	Manufacturing PMI	Feb	Jan	Chg (bps)
UK Pound	0.769	0.795	3.31	USA	52.7	51.2	150
Euro	0.917	0.953	3.92	Eurozone	47.6	46.6	100
Japanese Yen	148.7	152.3	2.43	Japan	49.0	48.7	30
Chinese RMB	7.229	7.257	0.38	China	50.8	50.1	70
Indonesia Rupiah	16,525	16,260	-1.60	Korea	49.9	50.3	-40
				Indonesia	53.6	51.9	170
Capital Mkt	19-Mar	-1 mth	Chg (%)				
JCI	6,311.7	6,638.5	-4.92				
DJIA	41,964.6	44,546.1	-5.80				
FTSE	8,706.7	8,732.5	-0.30				
Nikkei 225	37,751.9	39,149.4	-3.57				
Hang Seng	24,771.1	22,620.3	9.51				
Foreign portfolio ownership (Rp Tn)	Feb	Jan	Chg (Rp Tn)				
Stock	3,083.7	3,531.1	-447.42				
Govt. Bond	890.2	881.3	8.86				
Corp. Bond	5.1	6.0	-0.89				

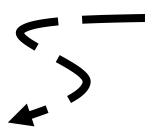
Source: Bloomberg, BI, BPS

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	2024	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	6.0	7.6
GDP per capita (USD)	4175	3912	4350	4784	4920	4960	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

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