

**BI Policy: A preliminary strike****Executive Summary:**

- **Bank Indonesia (BI) maintained its 7-Day Reverse Repo Rate (BI7DRR) at 3.50%, in line with market consensus. But in lieu of policy rate hikes, BI will start increasing the minimum reserve requirement ratio (RRR) in stages.**
- **The question, then, is why use RRR instead of BI7DRR? It could be argued that RRR hikes narrowly targets the banking sector, while policy rate hikes can affect the broader asset pricing and market sentiment.**
- **BI may also feel more comfortable raising RRR in instead of BI7DRR since loan growth has bounced back quite close to its expected loan growth rate for 2022.**
- **While BI is not immune to the Fed's hawkish behavior, Indonesia's economic condition allows it to wait until the second half of 2022 to start raising rates.**

- **Bank Indonesia (BI) maintained its 7-Day Reverse Repo Rate (BI7DRR) at 3.50%, in line with market consensus.** But in lieu of policy rate hikes, BI will start increasing the minimum statutory reserve requirement ratio (RRR), at first from 3.5% to 5% effective from March 1, 2022, then to 6% by June 1, 2022, and finally to 6.5% by September 1, 2022.
- The planned RRR hike certainly constitutes monetary tightening, seeing as it is one of the most potent tool in BI's arsenal. The question, then, is why use RRR instead of BI7DRR? It could be argued that RRR hikes narrowly targets the banking sector, **while the effects of policy rate hikes can reverberate towards the longer end of the yield curve and affect the broader asset pricing and market sentiment.**
- Can the RRR hikes replace, or at least forestall, BI7DRR hikes? RRR hikes might not seem like much of a sop for global bond investors amid the Fed's tightening cycle, but it does affect the money multiplier and thereby curtail inflationary risks - which helps maintain Indonesia's real interest rate differentials (**Chart 1**). **BI may feel more comfortable raising RRR in lieu of BI7DRR since loan growth has bounced back rather quickly to 5.24% YoY by Dec-21, which is already quite close to its expected loan growth rate for 2022 at 6-8%.**
- BI's first policy meeting of the year also introduced a few other tweaks to its tried-and-true policy mix. These include a slight relaxation of the rules regarding underlying documentation for FX transactions (whereby the lower limit is raised from USD 25,000 to USD 100,000). This is apparently intended to stimulate FX transaction volumes, in order to bolster Indonesia's rather shallow FX market. BI also plans to use RRR as an additional tool to direct loan growth, specifically towards small and medium enterprises (SMEs), as the RRR is lowered by 100 bps for banks that have fulfilled its so-called inclusive financing macro-prudential ratio (RPIM).
- BI's decision to hike RRR rather than BI7DRR appears quite judicious set against the backdrop of turmoil in the global bond market. The last few days have seen 10Y UST yields soaring above 1.8% as the market prices in the Fed's increasingly aggressive stance, while geopolitical concerns regarding oil supply resurfaced.
- Overall, we maintain our position that BI does not need to follow the Fed's interest rate decisions quite as closely as in the past - and the planned RRR hikes may buy it even more time in that regard. It is indeed notable that even though recent capital outflows almost add up to the same amount of outflows as during the early months of the pandemic, the Rupiah did not plunge as much as it did back then. The key difference, as ever, is the trade surplus and the positive real rate differentials - both rarities among EMs at the moment. Additionally, the current proportion of foreign bond ownership hovers a little below 20% compared to around 40% before the pandemic began, which suggests that Indonesia might be less vulnerable even as foreign capital flows out (**Chart 2**). **While BI is not immune to the Fed's hawkish behavior, Indonesia's clean macro bill of health allows it to wait until the second half of 2022 to start raising rates.**

Chart 1. RRR affects the money multiplier and thereby curtail inflationary risks

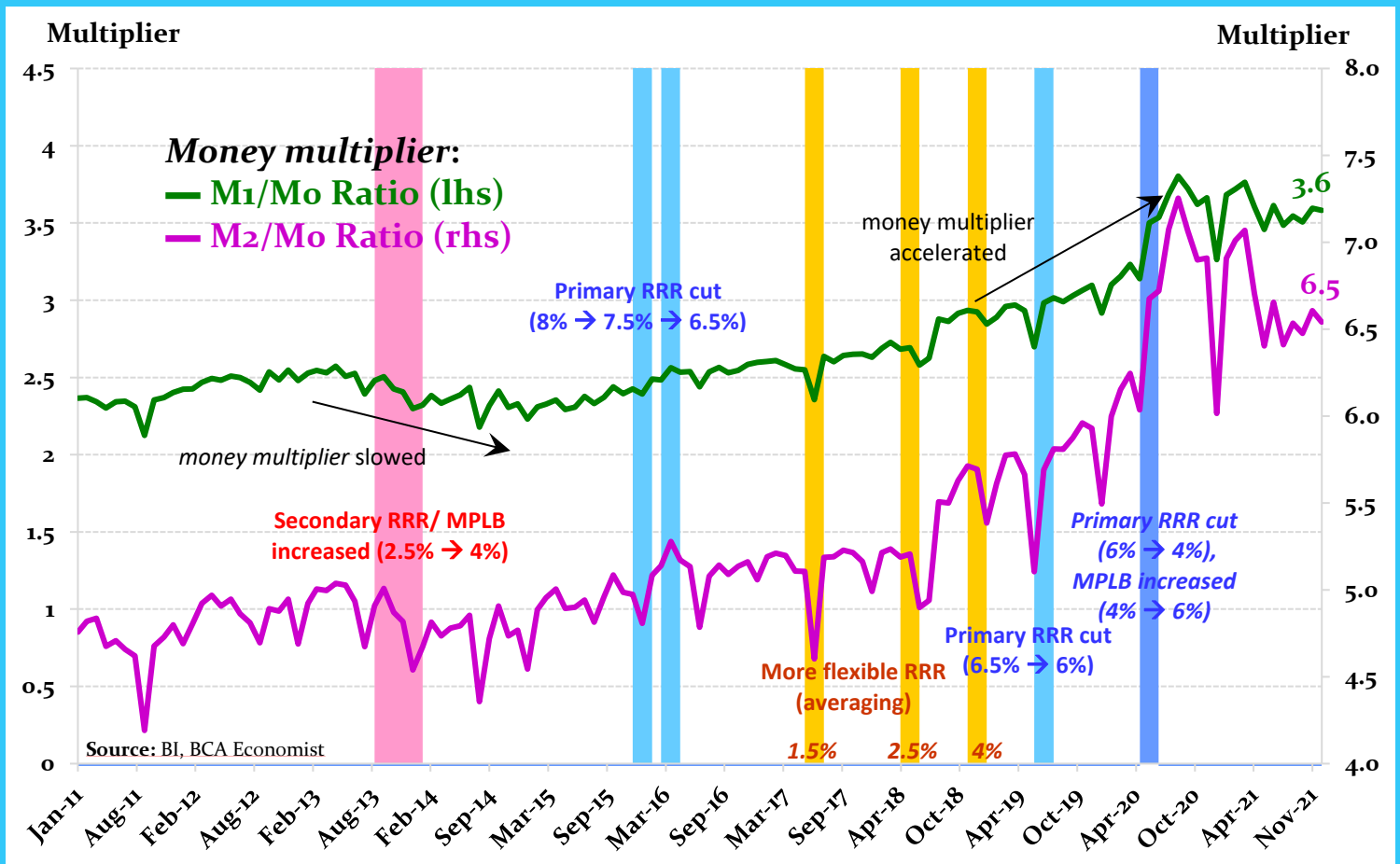
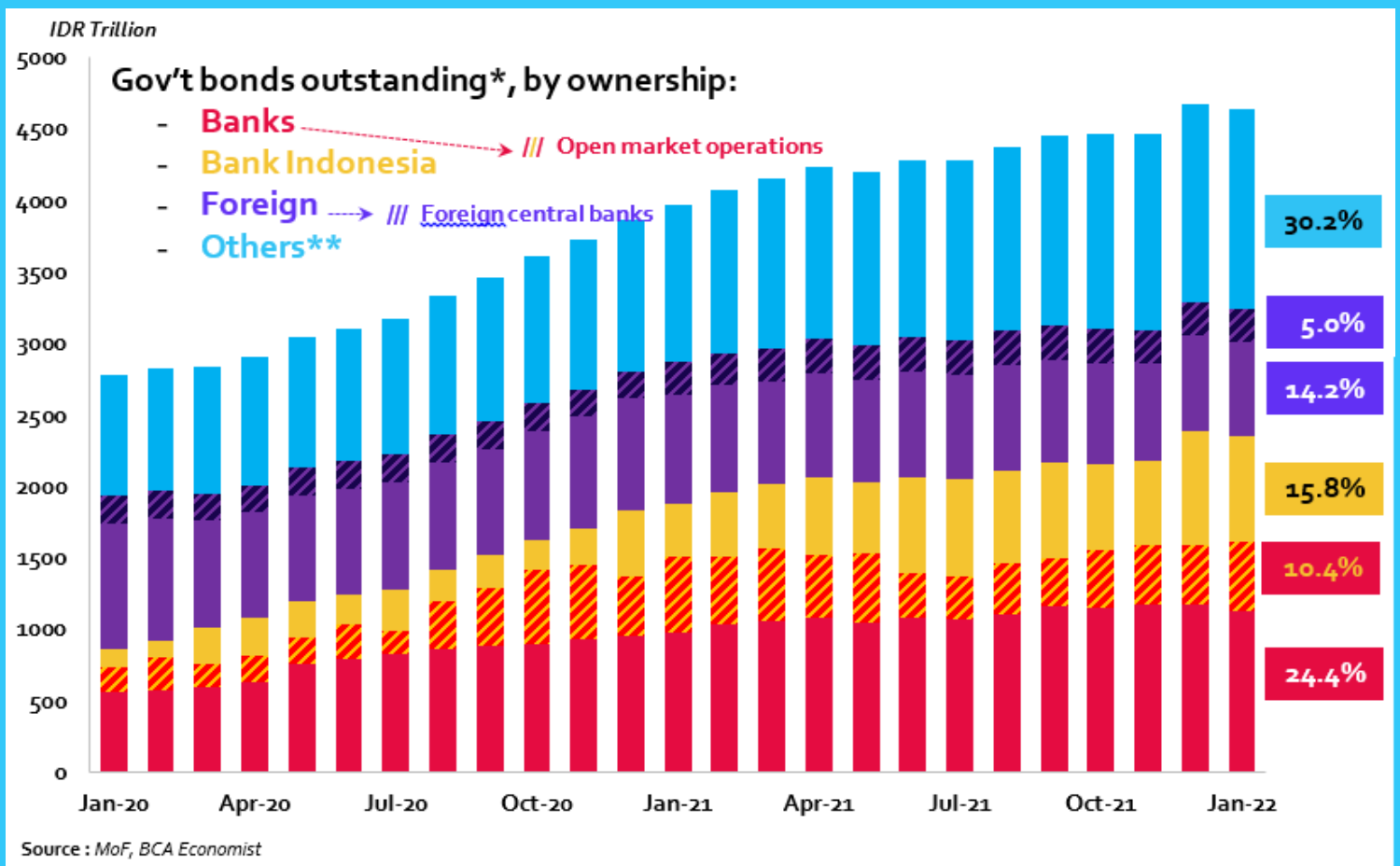


Chart 2. The proportion of foreign bond ownership has declined, which suggests that Indonesia might be less vulnerable to foreign outflows.



## Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	20-Jan	-1 mth	Chg (%)
US	0.25	Mar-20	-6.75	Baltic Dry Index	1,474.0	2,371.0	-37.8
UK	0.25	Dec-21	-5.15	S&P GSCI Index	611.4	530.7	15.2
EU	0.00	Mar-16	-5.00	Oil (Brent, \$/brl)	88.4	71.5	23.6
Japan	-0.10	Jan-16	-0.90	Coal (\$/MT)	187.4	166.7	12.5
China (lending)	4.35	Oct-15	2.85	Gas (\$/MMBtu)	4.17	3.89	7.2
Korea	1.25	Jan-22	-2.45	Gold (\$/oz.)	1,839.3	1,790.9	2.7
India	4.00	May-20	-1.59	Copper (\$/MT)	10,018.3	9,463.0	5.9
Indonesia	3.50	Feb-21	1.63	Nickel (\$/MT)	24,076.0	19,422.0	24.0
Money Mkt Rates	20-Jan	-1 mth	Chg (bps)	CPO (\$/MT)	1,294.5	1,150.3	12.5
SPN (1M)	2.78	3.11	-33.2	Rubber (\$/kg)	1.79	1.64	9.1
SUN (10Y)	6.40	6.39	1.2	External Sector	Dec	Nov	Chg (%)
INDONIA (O/N, Rp)	2.79	2.79	0.0	Export (\$ bn)	22.38	22.84	-2.0
JIBOR 1M (Rp)	3.55	3.55	0.0	Import (\$ bn)	21.36	19.33	10.5
Bank Rates (Rp)	Oct	Sep	Chg (bps)	Trade bal. (\$ bn)	1.02	3.52	-71.0
Lending (WC)	8.78	8.85	-6.86	Central bank reserves (\$ bn)	144.9	145.9	-0.66
Deposit 1M	3.13	3.24	-10.58	Prompt Indicators	Dec	Nov	Oct
Savings	0.72	0.73	-1.87	Consumer confidence index (CCI)	118.3	118.5	113.4
Currency/USD	20-Jan	-1 mth	Chg (%)	Car sales (%YoY)	68.1	62.4	54.1
UK Pound	0.735	0.757	2.98	Motorcycle sales (%YoY)	67.4	95.6	39.9
Euro	0.884	0.887	0.29	Cement sales (%YoY)	N/A	-2.6	5.3
Japanese Yen	114.1	113.6	-0.44	Manufacturing PMI	Dec	Nov	Chg (bps)
Chinese RMB	6.341	6.376	0.55	USA	58.8	60.6	-180
Indonesia Rupiah	14,341	14,402	0.43	Eurozone	58.0	58.4	-40
Capital Mkt	20-Jan	-1 mth	Chg (%)	Japan	54.3	54.5	-20
JCI	6,626.9	6,547.1	1.22	China	50.9	49.9	100
DJIA	34,715.4	34,932.2	-0.62	Korea	51.9	50.9	100
FTSE	7,585.0	7,198.0	5.38	Indonesia	53.5	53.9	-40
Nikkei 225	27,772.9	27,937.8	-0.59				
Hang Seng	24,952.4	22,744.9	9.71				
Foreign portfolio ownership (Rp Tn)	Dec	Nov	Chg (Rp Tn)				
Stock	2,286.1	2,233.2	52.91				
Govt. Bond	891.3	918.5	-27.11				
Corp. Bond	22.9	22.4	0.47				

Source: Bloomberg, BI, BPS

Notes:

\*Previous data

\*\*For change in currency: **Black** indicates appreciation against USD, **Red** indicates depreciation

\*\*\*For PMI, &gt; 50 indicates economic expansion, &lt; 50 indicates contraction

## Indonesia – Economic Indicators Projection

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	4.0*	5.2
GDP per Capita (US\$)	3877	3927	4175	3912	4350*	4640
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	3.3
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.0
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	14,660
Trade Balance (US\$ billion)	11.8	-8.5	-3.2	21.7	35.3	30.6
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.6*	0.1

\* Provisional numbers for 2021

\*\* Estimation of Rupiah's fundamental exchange rate

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