

BI Policy:

Gazing down the normalization path?

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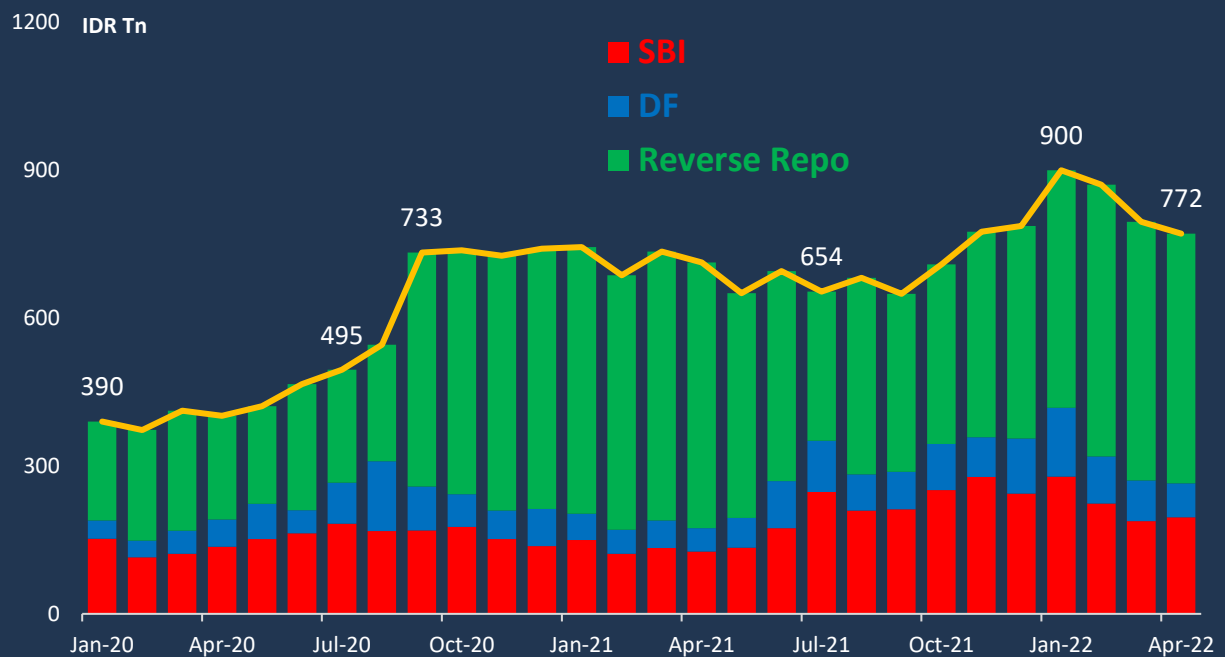
Executive Summary

- Bank Indonesia held the 7-Day Reverse Repo Rate (BI 7DRR) at 3.50% with overall policy shifting towards neutral, maintaining a somewhat accommodative policy stance while last month's reserve requirement ratio began to hike.
 - The Rupiah remained remarkably resilient despite continuing outflows thanks to Indonesia's cornucopia of trade surpluses. However, threats remain as global economic slowdown becomes increasingly probable.
 - Indonesia's clean bill of macroeconomic health helps Bank Indonesia to prolong its test-and-learn post-pandemic policy mix. However, increasing consumer spending and heightened risks of inflation could direct the central bank closer to the path of policy normalisation.
- Bank Indonesia maintained its 7 Day Reverse Repo Rate (BI 7DRR) at 3.50%, in line with analysts' consensus. BI policy thus continued to diverge from the Fed's trajectory, as well as many other EM's trajectory.
 - Low inflation remains one of the major factors that explain Bank Indonesia's gradualist approach. Inflation is indeed rising, albeit at a slower pace than most other EMs, driven mostly by foodstuffs for the time being. The main concern will be the mounting fiscal (and quasi-fiscal, i.e. SOE) cost of energy price control, which is likely to force the government to undertake larger price adjustments in the coming months. This is the main reason why we adjust our inflation expectation upwards (see **Table**), with the understanding that there is a great uncertainty with regards to the final number, which will depend greatly on the scale of those adjustments.
 - The other factor that works in BI's favor is Indonesia's trade surplus, which as we saw yesterday's exports data, was greatly bolstered by the rising commodity prices. The salvo of trade surpluses and inflows into the equity market have so far shielded Indonesia from the full impact of global monetary tightening on bonds (**Chart 2**), and we also adjust our trade balance and current account forecasts accordingly. However, we continue to see some downside risks in this area as well, both from the rising imports and especially from the slowdown in China and other trading partners as demand destruction increasingly becomes the consequence (as well as antidote) to the rising commodity prices.

- Despite the seemingly dovish policy, BI's policy stance is not fully accommodative, especially following the reserve requirement ratio (RRR) hike which began last March. The amount of liquidity placement by commercial banks at BI has receded by 18.8% since late February 2022 (**Chart 1**), and we expect subsequent rounds of RRR hikes to drain more liquidity from the market, which should neutralize the potential inflationary impact of BI's purchase of government debt.
- We also think that the economy may be edging closer to a full recovery, especially given that BI has also revised its growth outlook to 4.5 – 5.3% (down from 4.7 – 5.5%). BCA's internal big data, for instance, continues to show robust recovery in consumer spending and business revenues – the latter being particularly marked following the spike in commodity prices and also the relaxation of domestic market obligation (DMO) rules in March. Loan growth, meanwhile, has also bounced back to 6.1% in February 2022, well within the 6-8% target range set by BI.
- Overall, we could read BI's policy mix as starting to shift towards neutral, and rate hikes remain an open possibility in the second half of the year. We still maintain 4.00% at year-end (i.e. a total of 50 bps hike) as our baseline projection, but there is a great uncertainty here owing to the turmoil in the global bond markets. The saga of the 10Y-2Y yield curve in the past month – from inversion to steepening – is instructive in this regard. While inversion is associated with an upcoming recession, it also suggests a certain ceiling for Fed normalization, which reduces the uncertainty for EM bond prospects. The recent steepening, on the other hand, suggests that a higher-for-longer global interest rate regime is also quite probable, in spite of the darkening global growth outlook. While Indonesia is somewhat shielded from all these due to its status as a commodity exporter, it cannot fully escape the consequences.

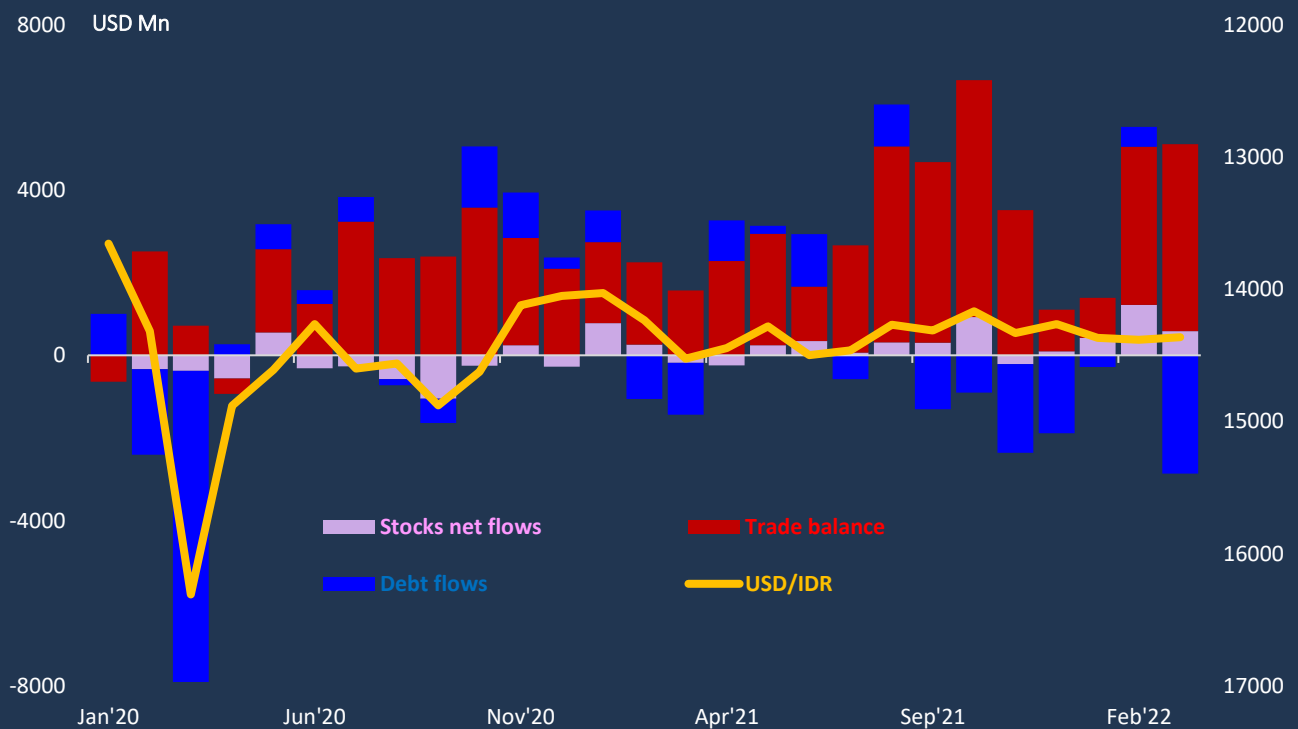
"While price pressures remain relatively tamed, it should be noted that the relative success in keeping inflation in check largely relies on the government's fiscal resilience."

Chart 1. Banks' excess liquidity has begun to decline following the first round of RRR hike in March



Source: Bank Indonesia

Chart 2. Trade surplus remains as the cornerstone of Rupiah's stability amid net outflows from government bonds



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	18-Apr	-1 mth	Chg (%)
US	0.50	Mar-22	-8.00	Baltic Dry Index	2,137.0	2,605.0	-18.0
UK	0.75	Mar-22	-6.25	S&P GSCI Index	776.3	725.6	7.0
EU	0.00	Mar-16	-7.50	Oil (Brent, \$/bbl)	113.2	107.9	4.8
Japan	-0.10	Jan-16	-1.00	Coal (\$/MT)	314.1	213.5	47.1
China (lending)	4.35	Oct-15	2.85	Gas (\$/MMBtu)	7.48	4.90	52.7
Korea	1.50	Apr-22	-2.60	Gold (\$/oz.)	1,978.9	1,921.6	3.0
India	4.00	May-20	-2.95	Copper (\$/MT)	10,297.5	10,327.0	-0.3
Indonesia	3.50	Feb-21	0.86	Nickel (\$/MT)	33,144.0	37,115.0	-10.7
Money Mkt Rates	18-Apr	-1 mth	Chg (bps)	CPO (\$/MT)	1,569.9	1,524.2	3.0
				Rubber (\$/kg)	1.71	1.70	0.6
SPN (1M)	3.73	2.45	128.0	External Sector	Mar	Feb	Chg (%)
SUN (10Y)	6.96	6.71	25.0	Export (\$ bn)	26.50	20.47	29.4
INDONIA (O/N, Rp)	2.79	2.78	0.2	Import (\$ bn)	21.97	16.64	32.0
JIBOR 1M (Rp)	3.55	3.55	0.0	Trade bal. (\$ bn)	4.53	3.83	
Bank Rates (Rp)	Jan	Dec	Chg (bps)	Central bank reserves (\$ bn)*	139.1	141.4	-1.65
Lending (WC)	8.66	8.63	2.97	Prompt Indicators	Mar	Feb	Jan
Deposit 1M	2.88	2.92	-3.51	Consumer confidence index (CCI)	111.0	113.1	119.6
Savings	0.69	0.69	0.87	Car sales (%YoY)	16.0	65.1	58.9
Currency/USD	16-Apr	-1 mth	Chg (%)	Motorcycle sales (%YoY)	-13.6	-2.6	12.5
UK Pound	0.766	0.759	-0.90	Cement sales (%YoY)	23.2	13.6	7.8
Euro	0.925	0.905	-2.18	Manufacturing PMI	Mar	Feb	Chg (bps)
Japanese Yen	126.5	119.2	-5.76	USA	57.1	58.6	-150
Chinese RMB	6.372	6.361	-0.16	Eurozone	56.5	58.2	-170
Indonesia Rupiah	14,381	14,340	-0.29	Japan	54.1	52.7	140
Capital Mkt	18-Apr	-1 mth	Chg (%)	China	48.1	50.4	-230
JCI	7,275.3	6,955.0	4.61	Korea	51.2	53.8	-260
DJIA	34,411.7	34,754.9	-0.99	Indonesia	51.3	51.2	10
FTSE	7,616.4	7,404.7	2.86				
Nikkei 225	26,799.7	26,827.4	-0.10				
Hang Seng	21,518.1	21,412.4	0.49				
Foreign portfolio ownership (Rp Tn)	Mar	Feb	Chg (Rp Tn)				
Stock	2,463.5	2,405.8	57.69				
Govt. Bond	848.3	896.6	-48.35				
Corp. Bond	19.4	20.3	-0.87				

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

Indonesia – Economic Indicators Projection

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	4.8
GDP per Capita (US\$)	3877	3927	4175	3912	4350	4615
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	4.2
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	48.5
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.3	1.4

* Estimation of Rupiah's fundamental exchange rate

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