

BI Policy:

The full-time whistle may have been blown, but no victory lap

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Executive Summary

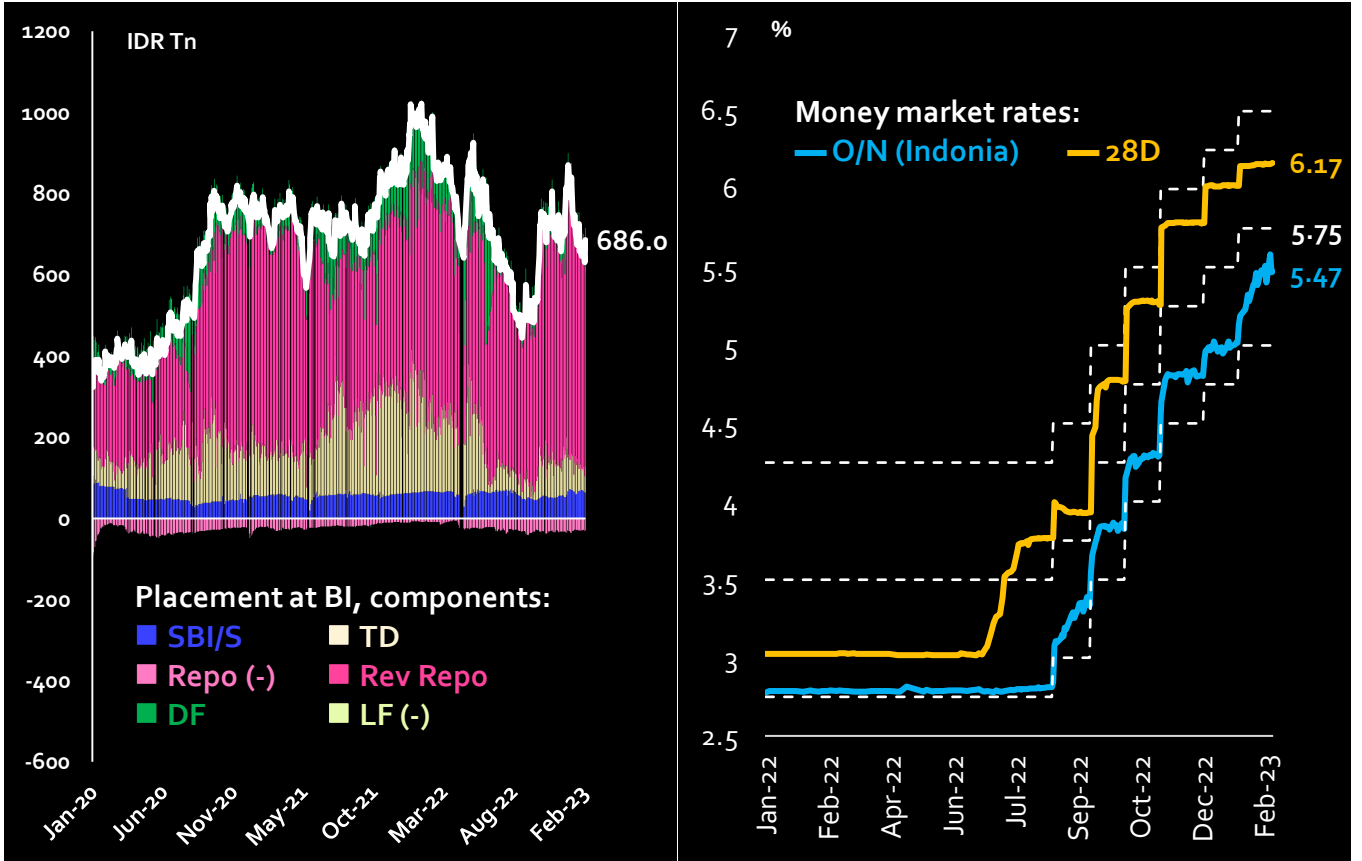
- BI kept the BI 7DRR at 5.75%. Stable inflation and continuous FX inflows, either from net exports or foreign investments (direct and portfolio), fuel the widespread optimism regarding the IDR's continued resiliency in 2023.
- Despite the short-term optimism, investors' shifting expectations, narrowing real yield spread between Rupiah-denominated and safe haven assets, and lower trade surplus may threaten the Rupiah's value in periods ahead.
- Medium-to-long-term risks may push BI to follow the Fed's "tighter-for-longer" policy outlook. However, still-accommodative macroprudential policies and the continuation of "operation twist" means that the central bank may continue to provide some support to the domestic economy.

- Bank Indonesia broke the airwaves today with two announcements. First, the special FX term deposit (TD) facility that would support the implementation of the DHE policy will come into effect early next month. The second, more prime announcement is the central bank's decision to keep the BI 7DRR at 5.75%, unchanged from the previous meeting.
- This policy rate decision came as no surprise, reflecting the market and BI's confidence in the hitherto stable Rupiah. This widespread confidence, of course, is not a Hail-Mary pass. For one, the Rupiah continue to show resiliency in 2023, thanks to the steady dose of foreign inflows. Moreover, inflation in Indonesia also remains stable, moving steadily southwards as BI's pre-emptive tightening strategy helps the economy to avoid the full brunt of inflationary pressures arising from last September's upward adjustments to subsidised fuel prices.
- Indeed, nearly all of the short-term dynamics point to a resilient Rupiah. From the financial sector, foreign investors continue to show their confidence in the Indonesian market, as evident from the substantial USD 3.14 Bn YTD capital inflows. This trend may hold for some time, thanks to the still-ample global liquidity and anticipation of the ongoing upcoming dividend cycle. Indonesian assets' perceived lower risks relative to other emerging economies also help to smoothen the deal, as evident from the peak in the Rupiah's value in 2023 (14,880/USD on 2 Feb 2023, now 15,119/USD) which coincides with the trough in the CDS for Indonesian assets (78.9 on 2 Feb 2023 from peak of 97.2 on 3 Jan 2023, now 89.3).

- Support also comes from the domestic real sector, which continues to generate FX proceeds either through FDI or net gains from trade. This trend, it seems, may prove to be longer-lasting. For one, the heightened demand for minerals amid the green energy revolution would continue to fuel Indonesia's FDI attractiveness, while the still-uncertain global energy supplies (at least in the short term) may keep energy commodities such as coal and gas at a supernormal price range, if not compared to 2022 then at least relative to the average prices in recent years.
- However, the phalanx that hitherto protects the Rupiah may wither away in the long term. We should not forget that BI's decision to hold its policy rate comes amid a shift in investors' expectations, as the still-robust US economic data lead more investors to make the switch from the "Fed-pivot" to "tighter-for-longer" camp, reducing the appetite for riskier assets such as Rupiah-denominated assets. Many in the market also expect the Fed to raise its policy rate by a total of 50 bps in the next two FOMC meetings, which will coincide with the high-spending (thus inflationary) season of Ramadan and Eid in Indonesia. The narrowing (real) yield spread may further limit the demand for Indonesian assets in periods ahead, posing depreciation risks for the IDR.
- Further rate hikes by the Fed may slow private consumption, weakening the demand for commodities. This reflects the second, long-term threat for the Rupiah, which has been shielded by stratospheric coal prices throughout 2021–2022. Granted, coal prices may still be high enough to prolong Indonesia's streak of trade surplus. But the narrowing trade surplus would limit the potential of the recently rejuvenated DHE policy, while also may already be enough to plunge Indonesia's current account into the deficit territory. This situation, of course, points to a gap between the domestic FX demand and supply, which could undermine the Rupiah's fundamentals in periods ahead.
- All these medium-to-long-term threats mean that despite the decision not to hike rates, BI may not afford to sound dovish anytime soon. After all, the central bank may not need to sing a dovish tune. Indeed, the domestic economy remains largely stable, and the central bank may continue to provide some boost to the economy, either through its still-ongoing "operation twist" or its largely accommodative macroprudential policies. BI, of course, may continue to look at data to chart its path going forward. However, if the current situation holds, it seems likely that the central bank would keep the BI 7DRR at 5.75% for the rest of the year, signalling an end to BI's post-pandemic tightening campaign.

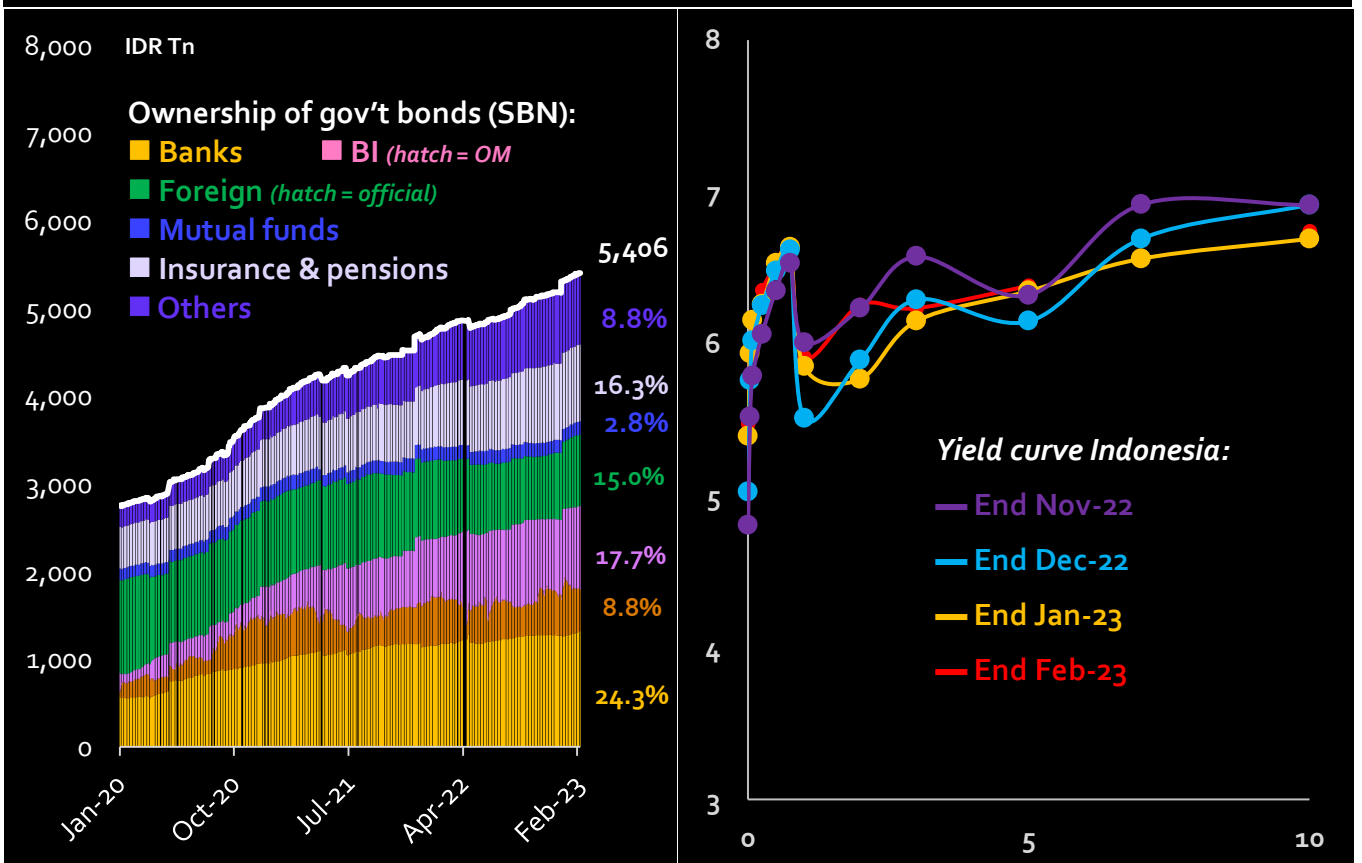
"BI cannot afford to sound dovish anytime soon, although the central bank may not need to do so"

Panel 1. BI's tightening cycle has not significantly reduce domestic liquidity



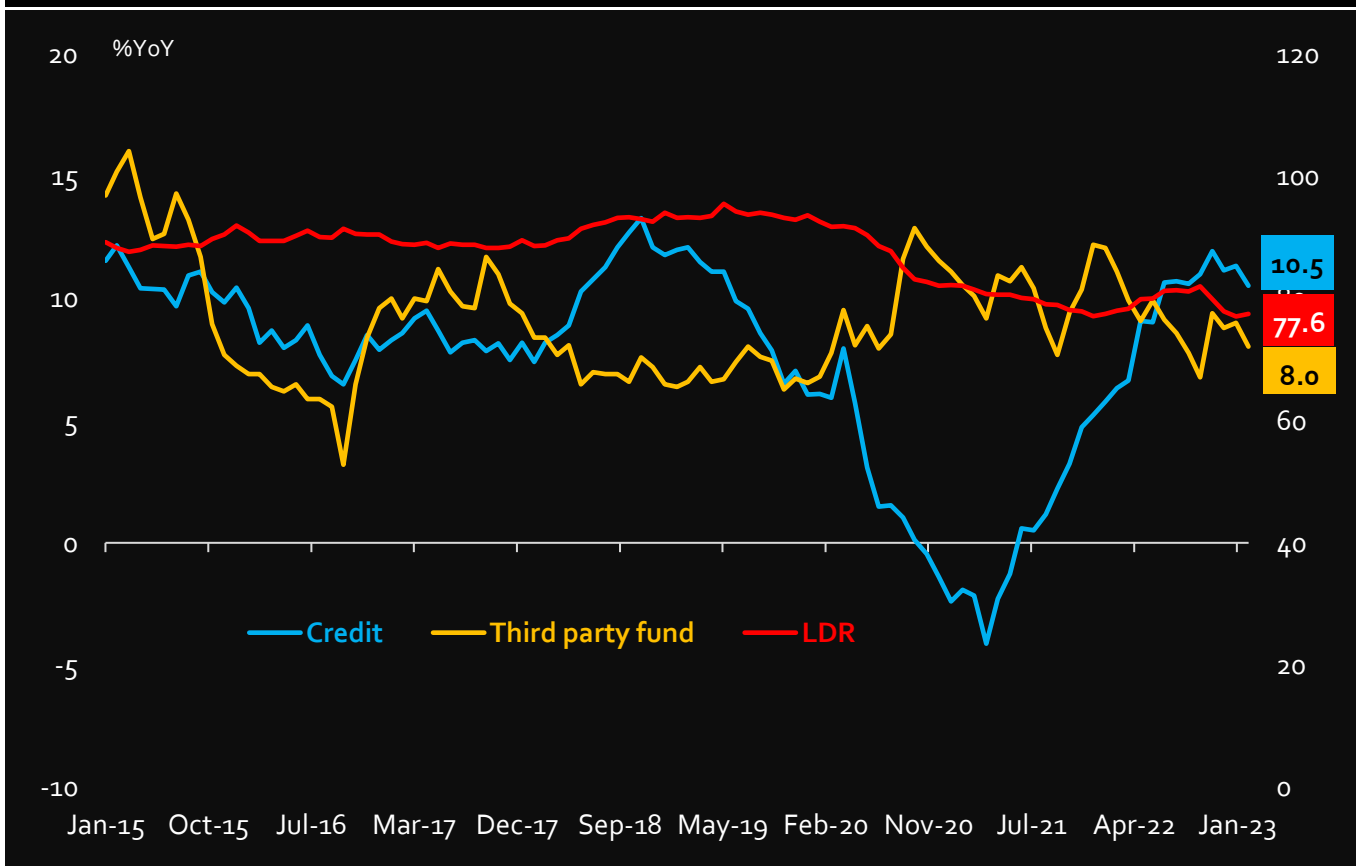
Source: BI, Bloomberg, BCA Economist

Panel 2. Increased foreign inflows push Indonesian yields lower



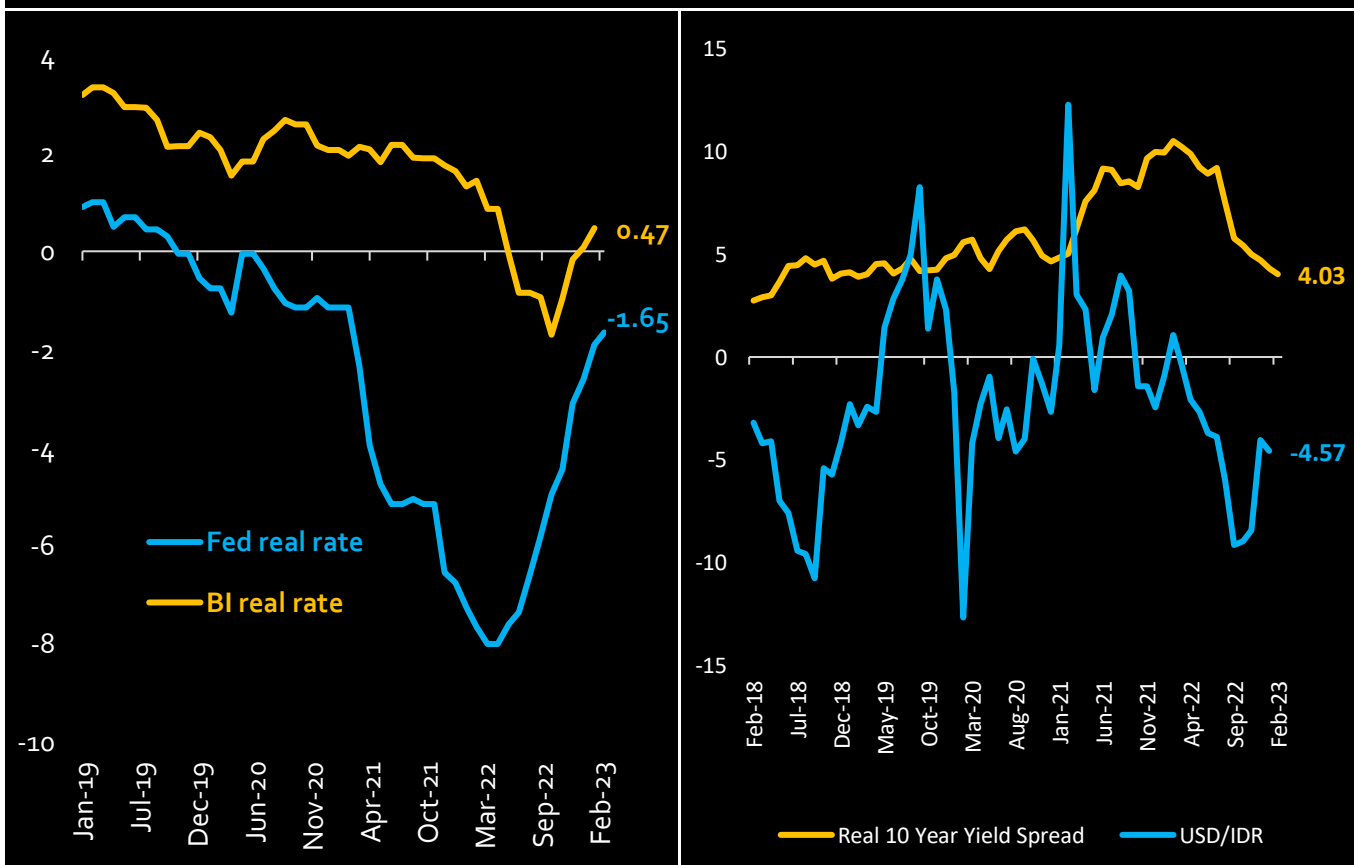
Source: BI, Bloomberg

Chart 1. BI's accommodative macroprudential policies may continue to support credit growth



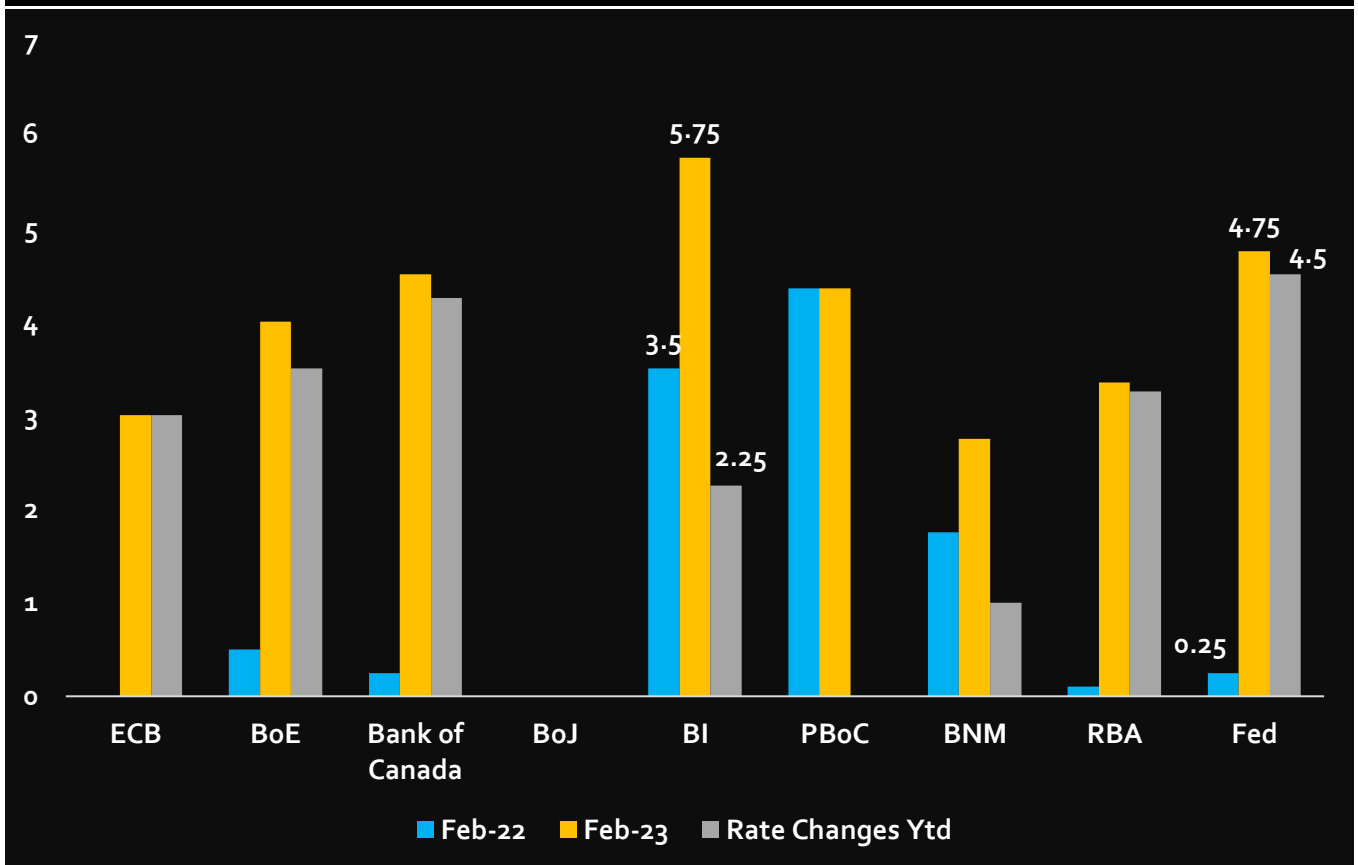
Source: BI, Bloomberg

Panel 3. The Fed's still-hawkish posture may narrow the spread between ID-US assets



Source: BI, Bloomberg

Chart 2. BI's total rate hikes of 250 bps is relatively modest compared to other central banks



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	15-Feb	-1 mth	Chg (%)
US	4.75	Feb-23	-1.65	Baltic Dry Index	541.0	946.0	-42.8
UK	4.00	Feb-23	-6.10	S&P GSCI Index	591.8	605.8	-2.3
EU	3.00	Feb-23	-5.50	Oil (Brent, \$/bbl)	85.4	85.3	0.1
Japan	-0.10	Jan-16	-4.10	Coal (\$/MT)	196.0	309.0	-36.6
China (lending)	4.35	Feb-23	2.25	Gas (\$/MMBtu)	2.45	3.50	-30.0
Korea	3.50	Jan-23	-1.70	Gold (\$/oz.)	1,836.0	1,920.2	-4.4
India	6.50	Feb-23	-0.02	Copper (\$/MT)	8,826.8	9,168.6	-3.7
Indonesia	5.75	Feb-23	0.47	Nickel (\$/MT)	25,908.0	26,599.0	-2.6
Money Mkt Rates	15-Feb	-1 mth	Chg (bps)	CPO (\$/MT)	891.5	884.7	0.8
SPN (1M)	2.63	4.01	-138.1	Rubber (\$/kg)	1.36	1.35	0.7
SUN (10Y)	6.74	6.67	7.3	External Sector	Jan	Dec	Chg (%)
INDONIA (O/N, Rp)	5.47	5.00	47.5	Export (\$ bn)	22.31	23.83	-6.36
JIBOR 1M (Rp)	6.37	6.20	16.5	Import (\$ bn)	18.44	19.86	-7.15
Bank Rates (Rp)	Oct	Sep	Chg (bps)	Trade bal. (\$ bn)	3.87	3.97	-2.39
Lending (WC)	8.58	8.46	12.35	Central bank reserves (\$ bn)*	139.4	137.2	1.58
Deposit 1M	3.36	2.97	38.77	Prompt Indicators	Jan	Dec	Nov
Savings	0.67	0.66	1.10	Consumer confidence index (CCI)	123.0	119.9	119.1
Currency/USD	15-Feb	-1 mth	Chg (%)	Car sales (%YoY)	11.8	9.0	4.4
UK Pound	0.831	0.818	-1.61	Motorcycle sales (%YoY)	37.0	24.6	26.9
Euro	0.936	0.923	-1.30	Manufacturing PMI	Jan	Dec	Chg (bps)
Japanese Yen	134.2	127.9	-4.69	USA	47.4	48.4	-100
Chinese RMB	6.855	6.701	-2.25	Eurozone	48.8	47.8	100
Indonesia Rupiah	15,204	15,150	-0.36	Japan	48.9	48.9	0
Capital Mkt	15-Feb	-1 mth	Chg (%)	China	49.2	49.0	20
JCI	6,914.5	6,641.8	4.11	Korea	48.5	48.2	30
DJIA	34,128.1	34,302.6	-0.51	Indonesia	51.3	50.9	40
FTSE	7,997.8	7,844.1	1.96				
Nikkei 225	27,501.9	26,119.5	5.29				
Hang Seng	20,812.2	21,738.7	-4.26				
Foreign portfolio ownership (Rp Tn)	Jan	Dec	Chg (Rp Tn)				
Stock	2,700.6	2,699.4	1.22				
Govt. Bond	811.9	762.2	49.70				
Corp. Bond	12.4	12.5	-0.02				

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



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Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3	4.7
GDP per Capita (US\$)	3927	4175	3912	4350	4784	5011
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.3
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,647
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	54.5	43.2
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	0.9*	-0.2

*Estimated number

** Estimation of Rupiah's fundamental exchange rate

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