

## Profits to take, costs to burden

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### Summary

- Inflation in Indonesia may continue to run higher in the next couple of months as the domestic economy enters the high-spending season of Ramadan and Lebaran (Eid). Thus, the narrowing real rate differentials may put the Rupiah under depreciation pressures.
- BI launched the FX term deposit for export proceeds (DHE) at an attractive rate. The policy would help to improve the domestic FX liquidity condition but at a cost that would be borne by BI alone.
- Interest payments on DHE FX term deposits would limit BI's ability to generate profits. Dwindling profitability would not impact BI's ability to fulfil its mandate, but the DHE policy's costliness may discourage the central bank to maintain the market instrument over the longer term.

- Last week was a quite busy one for watchers of the Indonesian economy. First, we have the February – 2023 CPI inflation data, which ran hotter than expected. However, unlike the same observation in the US or Europe, a slight nudge in Indonesia's YoY CPI number should not awaken the policy hawks. Inflationary pressures in Indonesia may continue to weaken, as evident from the continuous drop in the core CPI number (unlike in the US or Europe). The deluge of cheap, imported goods may also help to further reduce the inflationary risk, especially amid the prospect of rising consumption in the coming period (*see Chart 1*).
- The passage above, however, is just one side of Indonesia's multifaceted inflation dynamics. At present, Indonesian customers are bracing themselves for the upcoming

month-long (Ramadan and Lebaran) spending bonanza, especially for the food component. This will take place against the backdrop of further monetary policy tightening by the Fed and other developed economies' central banks. It is clear to see, then, that the real policy rate between Indonesia and those developed economies is soon to narrow, explaining foreign investors' declining appetite for Indonesian assets in the past couple of (*see Chart 2*).

- The narrowing real rate differential and resulting capital outflows may create depreciation pressure on the Rupiah. Fortunately, last week's second major announcement can help alleviate this risk. Indeed, Bank Indonesia introduced FX term deposits for export proceeds (DHE) last week, with rates that are close to our liking (4.54-5.20% for 1-6 months terms). These

attractive rates may help to encourage the still-high (albeit continuously normalising) export profits to return to the Indonesian financial system, enhancing domestic FX liquidity and strengthening the Rupiah's fundamentals (*see Chart 3*). Additionally, the policy offers benefits for banks (through agent fees/spread) without inflating the appointed bank's balance sheet.

- It is quite clear that the DHE FX term deposit is an attractive instrument for everyone involved. However, we have to remember that many corners of the financial sector do not operate on a positive-sum basis, meaning that one's gains must be another's losses. Thus, since the bolstered DHE policy would not inflict losses on either the banks or the exporters, BI appears to be the one left to carry the burden of the policy's costs. The question, then, is how long the central bank can carry this burden alone.
- Granted, the rejuvenated DHE policy comes with a high cost, although profit generation is never central bankers' priority. Nor that it should be one. A central bank, of course, should be judged on its ability to fulfil its mandate. However, it may be worth discussing the policy's impact on BI's (and the government's) budget balance. The (ongoing) global monetary policy tightening has suppressed the bond market's value, translating to paper losses for central banks (including BI) that launched asset purchase

***“The DHE FX term deposit’s costliness may discourage BI to maintain the instrument over the long term to complement the government’s DHE policy”***

programmes throughout the pandemic years. BI's pandemic era fire-fighting has also added to its balance sheet, translating to lower capital vis-à-vis assets. Soaring interest expenditures, to pay for the DHE FX term deposit, will add to BI's paper losses, limiting the central bank's ability to generate profits.

- We should consider, however, whether or not Bank Indonesia could return a profit is of little importance to the wider economy. The central bank has not returned any surpluses for the government in more than a decade, and SOEs' stellar performance in 2022 means that the government could expect a sumptuous dividend payment this year. Higher interest payments may force BI to operate at a loss, or at least with much-reduced profits.
- However, as illustrated by a plethora of other central banks, losses or negative equity have not been known to directly affect central banks' ability to operate effectively. Many of them, in fact, are suffering from large losses in the past year, with as yet little impact on monetary outcome. However, we should not turn a blind eye to the policy's costliness, and the high-interest costs may eventually discourage the central bank to maintain the instrument over the long term to complement the government's DHE policy.
- Is the cost worth it? Certainly. The more funds that are flowing in, the more costly it is, but also the more helpful it is for BI to stabilise the Rupiah. Note that the DHE

repatriation requirement still does not include the obligation to convert export proceeds in any currencies into the Rupiah, so **what the policy does is add to BI reserves (which could be crucial for BI to deal with the pile of bonds maturing in Q2 2023) and the stock of FX available for SOEs (especially energy and infrastructure SOEs) to borrow from.** Higher FX liquidity, of course, would help to guard against Rupiah volatility, particularly in the short term as real policy rate differentials further narrow.

- Cost consideration aside, the DHE programme would help BI in its effort to achieve the best of both worlds; a stable currency (which would help importers and the government to manage its spending) and a pro-growth outlook. However, as we noted in previous reports, the higher-for-longer

monetary policy outlook in developed economies may force Indonesian policy works to settle for a lower ground (compared to the government’s 2023 macro-economic assumptions) on both fronts.

- On the GDP front, it is rather clear that it would be hard for the Indonesian economy to emulate last year’s performance, and the downward trend in prices of mainstay commodities would complicate the government’s effort to achieve its 5.3% growth target. On the exchange rate front, we maintain the view that further weakening in the Rupiah’s value might be too hard to avoid, but the improving FX liquidity thanks to the DHE programme may help to brake the fall, perhaps to the range of 15,300 – 15,400, in H1 2023.

Chart 1

**On sale**

Cheaper imported goods, some of which came from China, may help to suppress Indonesia’s core CPI component amid the prospect of higher consumption in March – April 2023.

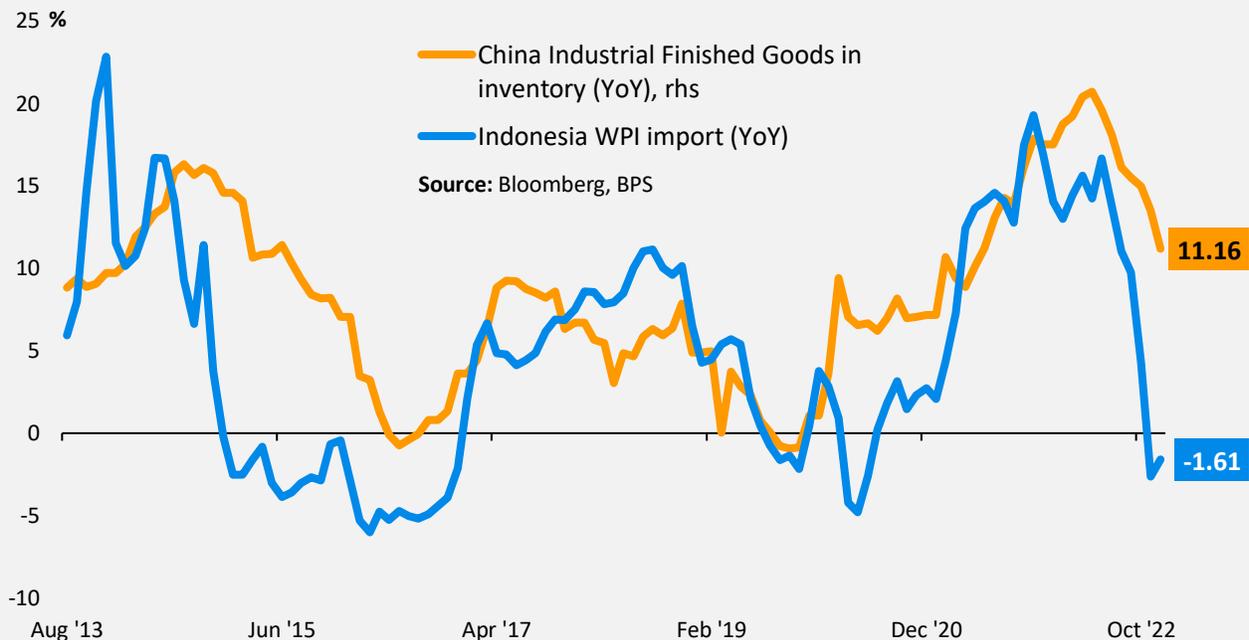


Chart 2

**Keeping it real**

The prospect of rising inflation in the next two months may suppress the real yield on Indonesia's assets, lowering foreign investors' investment appetite.

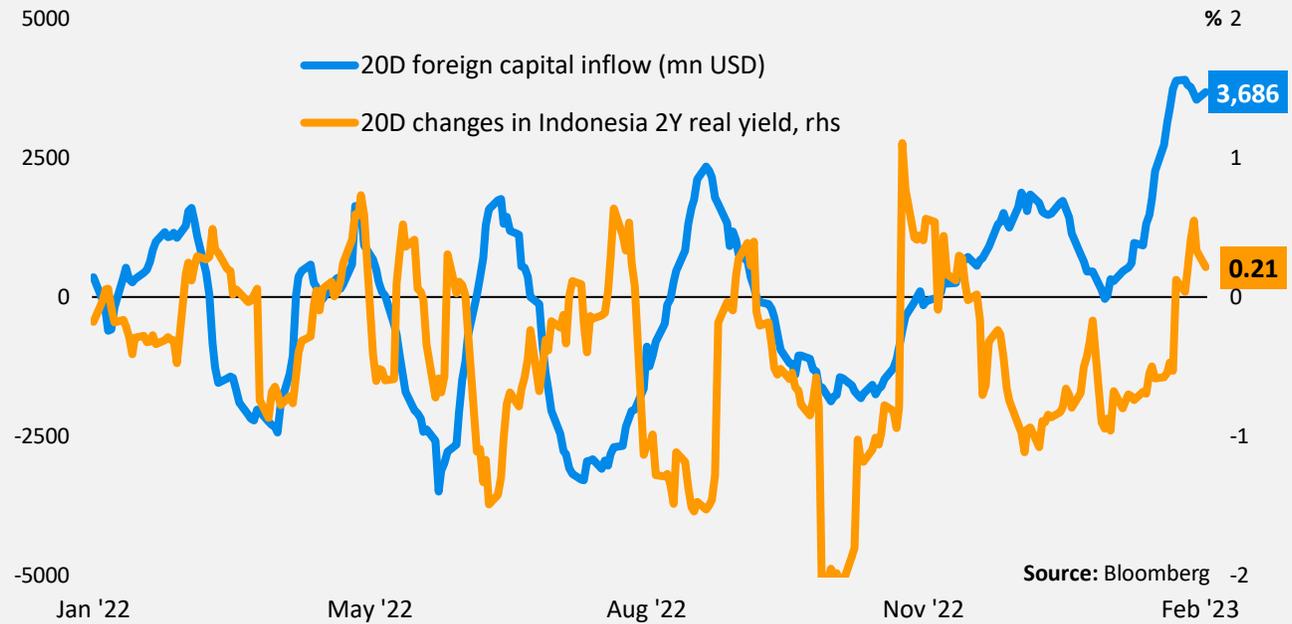
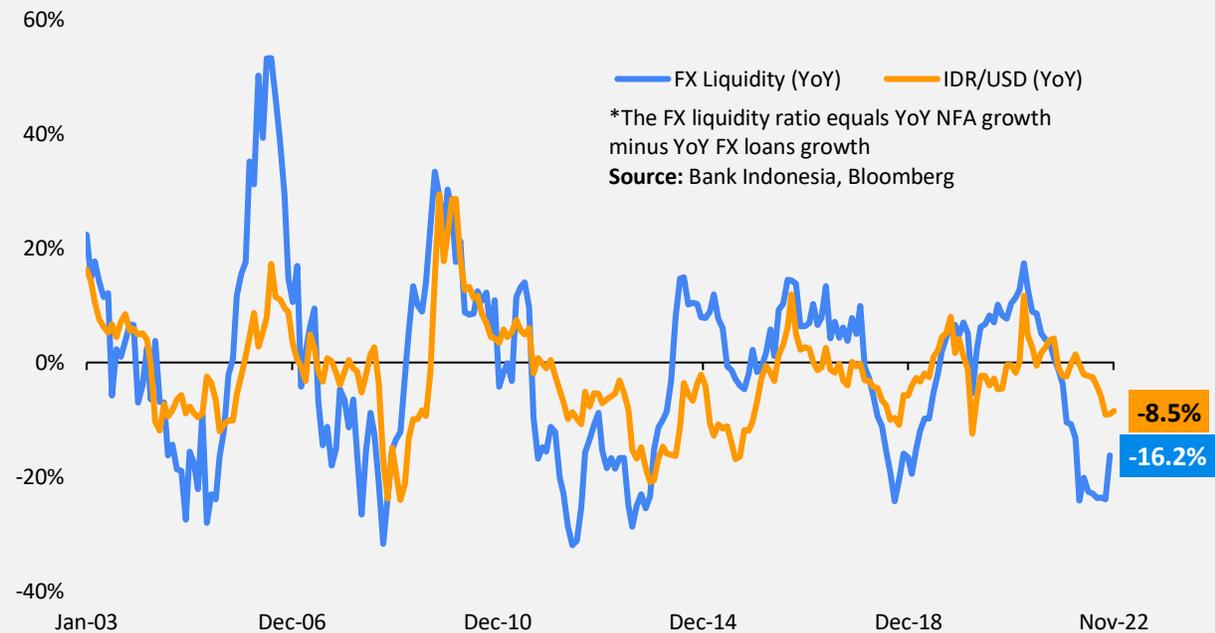


Chart 3

**Sticking to fundamentals**

Improving FX liquidity in the domestic economy would help to stabilise the Rupiah's value amid the still-high demand for FX financing.



Economic Calendar				
		Actual	Previous	Forecast*
1 March 2023				
ID	S&P Global Manufacturing PMI	52.6	49.2	50.3
CN	NBS Manufacturing PMI	51.6	49.2	50.3
<b>ID</b>	<b>Inflation Rate (YoY)</b>	<b>5.47%</b>	<b>5.28%</b>	<b>5.3%</b>
US	ISM Manufacturing PMI	47.7	47.4	48
2 March 2023				
EU	Inflation Rate (YoY)	8.5%	8.6%	8.4%
7 March 2023				
CN	Balance of Trade (USD Bn)	-	78	78.2
<b>ID</b>	<b>Foreign Exchange Reserves (USD Bn)</b>	<b>-</b>	<b>139.4</b>	<b>139.0</b>
8 March 2023				
US	Balance of Trade (USD Bn)	-	-67.4	-69.0
9 March 2023				
CN	Inflation rate YoY	-	2.1%	2.3%
CN	PPI YoY	-	-0.8%	-0.5%
US	Initial Jobless Claims	-	190K	192.0K
14 March 2023				
US	Inflation Rate YoY	-	6.4%	6.2%
15 March				
<b>ID</b>	<b>Balance of trade (USD Bn)</b>	<b>-</b>	<b>3.87</b>	<b>tba</b>
US	PPI YoY	-	6	-
16 March				
<b>ID</b>	<b>BI 7DRR decision</b>	<b>-</b>	<b>5.75%</b>	<b>5.75%</b>
ID	Retail Sales YoY	-	0.7%	-
CN	House price index YoY	-	-1.5%	-0.4%
23 March				
<b>US</b>	<b>FOMC/Fed Rate Decision</b>	<b>-</b>	<b>4.75%</b>	<b>5.0%</b>
24 February				
CN	NBS Manufacturing PMI	-	52.6	51.2
EU	Inflation Rate YoY	-	-	8.3%

\*Forecasts of some indicators are simply based on market consensus  
 Bold indicates indicators covered by the BCA Monthly Economic Briefing report

### Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	3-Mar	-1 mth	Chg (%)
US	4.75	Mar-23	-1.65	Baltic Dry Index	1,211.0	681.0	77.8
UK	4.00	Mar-23	-6.10	S&P GSCI Index	595.9	606.1	-1.7
EU	3.00	Mar-23	-5.50	Oil (Brent, \$/brl)	85.8	84.5	1.6
Japan	-0.10	Jan-16	-4.40	Coal (\$/MT)	188.9	244.2	-22.6
China (lending)	4.35	Mar-23	2.25	Gas (\$/MMBtu)	2.66	2.66	0.0
Korea	3.50	Feb-23	-1.30	Gold (\$/oz.)	1,856.5	1,928.4	-3.7
India	6.50	Feb-23	-0.02	Copper (\$/MT)	8,954.5	9,199.6	-2.7
Indonesia	5.75	Feb-23	0.28	Nickel (\$/MT)	24,384.9	30,153.0	-19.1
Money Mkt Rates	3-Mar	-1 mth	Chg (bps)	CPO (\$/MT)	938.7	891.6	5.3
SPN (1M)	3.62	4.93	-130.7	Rubber (\$/kg)	1.41	1.42	-0.7
SUN (10Y)	6.96	6.69	27.3	External Sector	Jan	Dec	Chg (%)
INDONIA (O/N, Rp)	5.47	5.39	8.2	Export (\$ bn)	22.31	23.83	-6.36
JIBOR 1M (Rp)	6.40	6.41	-1.3	Import (\$ bn)	18.44	19.86	-7.15
Bank Rates (Rp)	Nov	Oct	Chg (bps)	Trade bal. (\$ bn)	3.87	3.97	-2.39
Lending (WC)	8.60	8.58	1.67	Central bank reserves (\$ bn)*	139.4	137.2	1.58
Deposit 1M	3.69	3.36	32.89	Prompt Indicators	Jan	Dec	Nov
Savings	0.67	0.67	0.00	Consumer confidence index (CCI)	123.0	119.9	119.1
Currency/USD	3-Mar	-1 mth	Chg (%)	Car sales (%YoY)	11.8	9.0	4.4
UK Pound	0.831	0.812	-2.31	Motorcycle sales (%YoY)	38.6	24.6	26.9
Euro	0.940	0.921	-2.10	Manufacturing PMI	Feb	Jan	Chg (bps)
Japanese Yen	135.9	130.1	-4.25	USA	47.7	47.4	30
Chinese RMB	6.904	6.755	-2.16	Eurozone	48.5	48.8	-30
Indonesia Rupiah	15,300	14,990	-2.03	Japan	47.7	48.9	-120
Capital Mkt	3-Mar	-1 mth	Chg (%)	China	51.6	49.2	240
JCI	6,813.6	6,839.3	-0.38	Korea	48.5	48.5	0
DJIA	33,391.0	34,086.0	-2.04	Indonesia	51.2	51.3	-10
FTSE	7,947.1	7,771.7	2.26				
Nikkei 225	27,927.5	27,327.1	2.20				
Hang Seng	20,567.5	21,842.3	-5.84				
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 an 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 the 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	19.8
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-1.2

\*Estimated number

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

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