BI Policy:

The guns fall silent, but the anxiety remains

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Executive Summary

- Bank Indonesia has kept the BI7DRR at 6.00%, in line with expectations as the dovish shift in global interest rate expectations enables the Rupiah to significantly recover from its nadir in late October 2023.
- Despite the current favourable situation, the Indonesian financial market continues to experience some pressure, prompting BI to sustain its operations in the market.
- The interest rate condition may remain substantially restrictive, considering the limited improvements in the domestic liquidity condition and the potential risk of another shift in global interest rate expectations.

- Bank Indonesia has opted to maintain the 7-day reverse repo rate at 6.00%. In contrast to the previous meeting, the decision to keep the policy rate unchanged this month was widely anticipated. One indicator supporting this was the downward trend in yields awarded at SRBI auctions leading up to the November 2023 BI policy meeting, which suggests BI's expectation of a lower short-term interest rate than initially anticipated earlier in the month.
- The Rupiah's exceptional performance throughout the month serves as the primary driver behind BI's decision to hold its policy rate. The currency is performing superbly this time around, having recovered its YTD gains as the currency appreciates by 2.4% following its nadir in late October 2023. BI's decision last month may provide a clear signal that the central bank is unwilling to trade the Rupiah's stability to pursue other policy goals, but the now-stable Rupiah allows the central bank not to follow up on its policy decision from last month.
- **It is important to note that this currency recovery story is not exclusive to the Rupiah.** Other currencies have also been observed to appreciate considerably this month, indicating that the driving factor behind the Rupiah's (and other currencies) relative equanimity this month is mostly external. Indeed, the USD (DXY) is now suffering from the dovish shift in rate expectation, which has started to re-emerge following the cooling US CPI and labour market data announced early in November 2023.
- **Despite the calmer external situation, however, yield-seeking investors continue launching assaults on Indonesia's financial market**. For instance, the gap between bidding and awarded amounts in recent SRBI auctions has been widening, a sign that investors continue to demand higher rates for their investments in the Indonesian market. Foreign inflow to the domestic financial market has also been inconsistent throughout the month. Meanwhile, the pattern of intraday movements in the FX market also seems to indicate the central bank's continued intervention in the market, although the early success of SVBI's auction may help to soften the blow in BI's FX coffers.

- It is important, then, not to turn a blind eye to some risks that may continue to undermine the Rupiah's stability in the upcoming period. **The increasingly frequent shifts in global interest rate expectations point to the first, and perhaps the most significant, risk that may continue to affect the Rupiah in the short term.** The Fed's decision to shelve its "forward guidance" tool has intensified the data-driven nature of interest rate expectations in the market, as investors scour over every inch of data to predict the Fed's next move. For instance, below-expectation US jobless claims data has recently swung the pendulum of interest rate expectations slightly back to the hawkish territory, a condition which may translate negatively in the Indonesian financial market.
- Second, the limited improvement in the domestic liquidity condition provides no clear evidence that the Indonesian financial market is already out of the woods. While our observation of the domestic net FX liquidity index[1] does show some improvement, the recovery in the index is more due to a decrease in demand for FX financing while the domestic FX liquidity supply continues to stagnate. Alas, **inconsistent foreign capital flows and subdued global commodity prices show that the opportunity to refill Indonesia's FX coffers remains limited**, meaning that BI may need to maintain a sufficiently awarding real rate environment to keep domestic demand for FX financing on a short leash.

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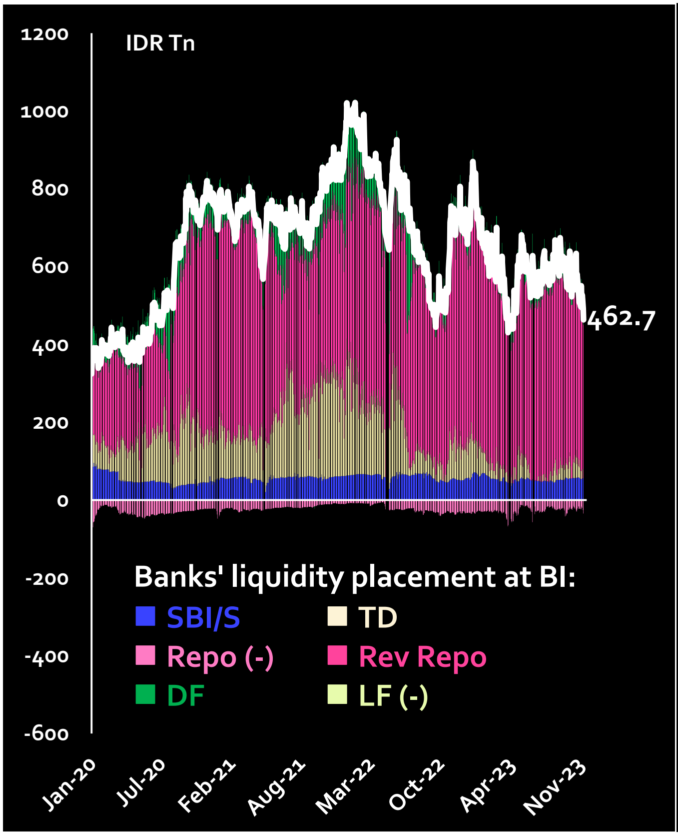
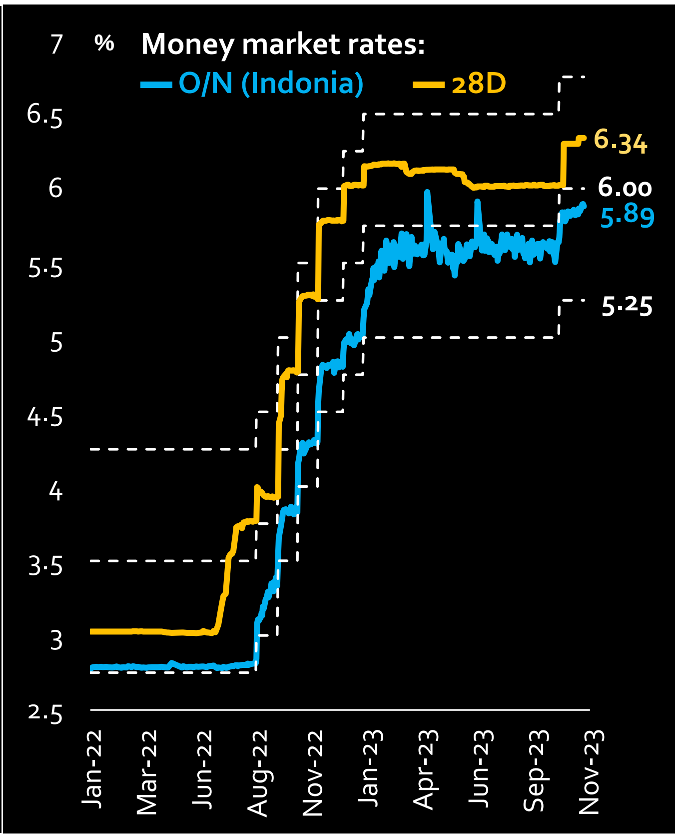
- Alas, the FX liquidity situation is not the only thing that saw limited improvements in the recent period. Given the 3.43% YoY increase in banks' third-party funds, the 8.99% YoY loan growth in October 2023 shows that the demand for lending remains quite aggressive. The increase in banks' LDR echoes our view on the Rupiah's stability amidst the prospect of continued CA deficits, as BI's singular focus to protect the Rupiah at some nominal level might require the central bank to maintain a substantially tight interest rate to put a brake to the still-aggressive demand for financing. BI's effort to stabilise the IDR, then, may prove to be increasingly complicated in the short term, as **the carnival of government expenses and household consumption that awaits in Q4 2024 up until H1 2024 may continue to suppress Indonesia's CA in a deficit, which may leads to a further deterioration in the fundamental strength now protecting the Rupiah.**
- With that being said, in the same way as we should not overreact to the IDR's strengthening, it might be wise for BI not to respond to any signs of the IDR's weakening. Continued downward pressure on the IDR could be understood as a natural corrective mechanism from Indonesia's now-deficit CA balance, which is only understandable given the vitality of Indonesia's aggregate demand.
- While the central bank has made it clear that a stable Rupiah remains the priority, the Rupiah's position might need to be assessed relative to its trading partners rather than its nominal level. Hence, even though various risks still lurk on the stability of the Rupiah value, **BI may continue to be relaxed by leaving the BI 7DRR at 6.00% in its last meeting of the year**; although keeping the door open for further adjustments to its policy rate might be necessary given the risk of another significant swing in the global rate expectations.

[1] Net foreign assets (YoY) – FX loans (YoY)

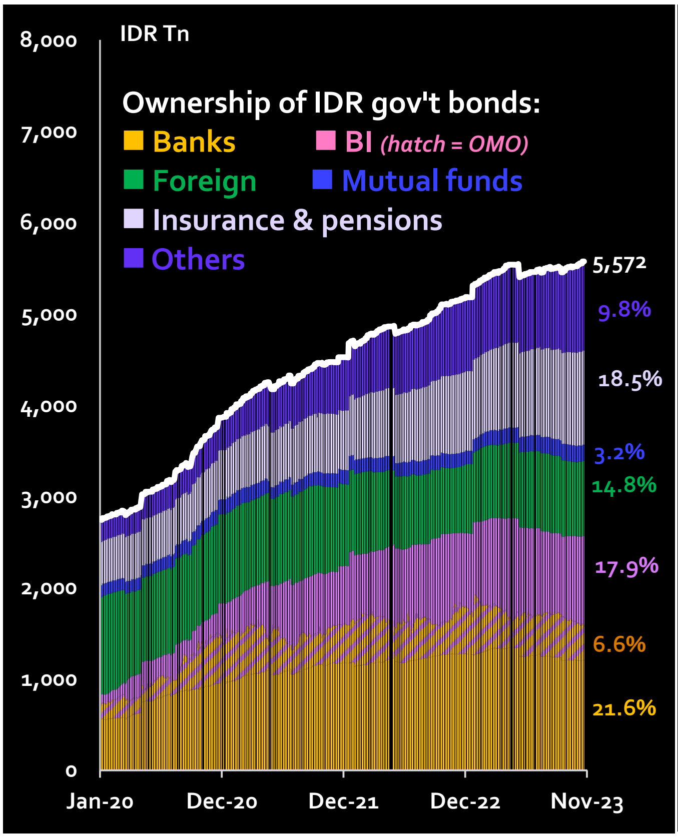
Panel 1. **The domestic liquidity supply is yet to improve as BI's last hike does not appear to significantly encourage foreign capital inflows**

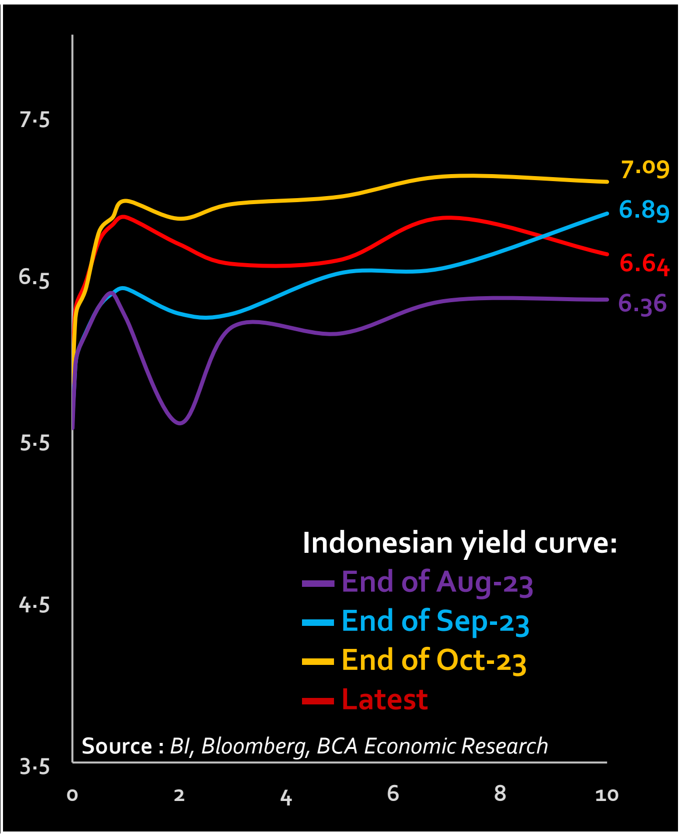




Source: BI, Bloomberg, BCA Economist

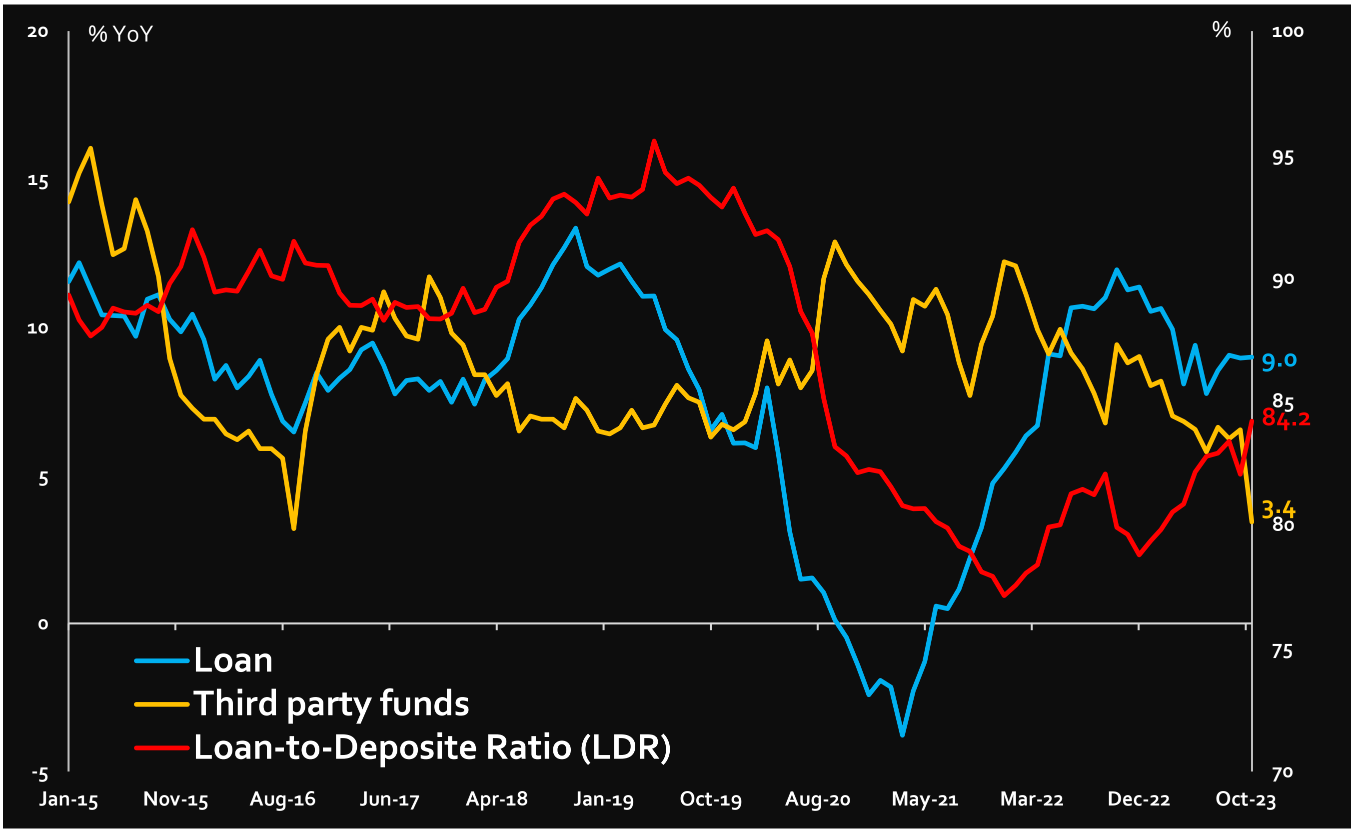
Panel 2. **The dovish shift in the US interest rate expectations alleviates some pressure facing the Indonesian bond market**





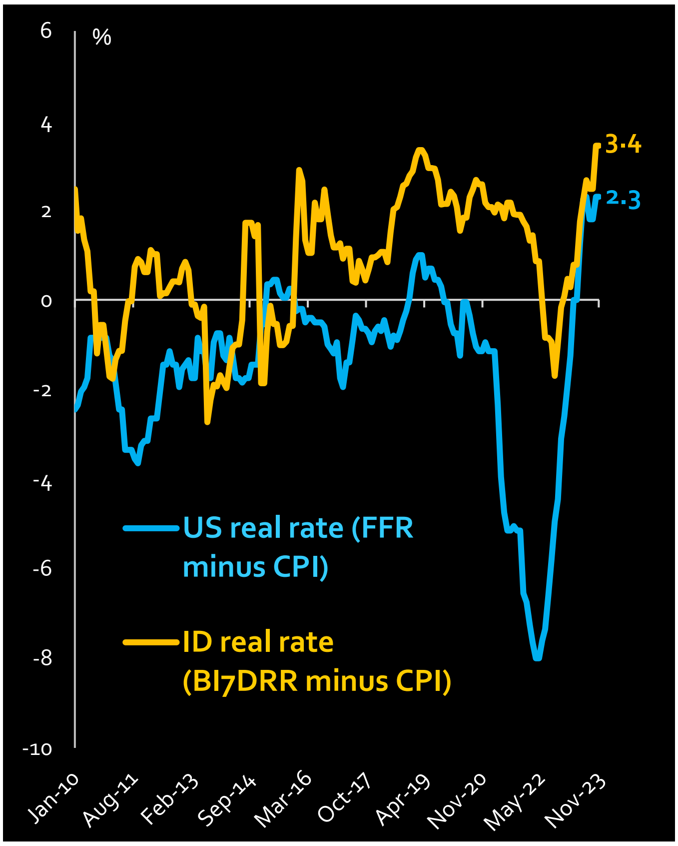
Source: MoF, BI, Bloomberg, BCA Economist

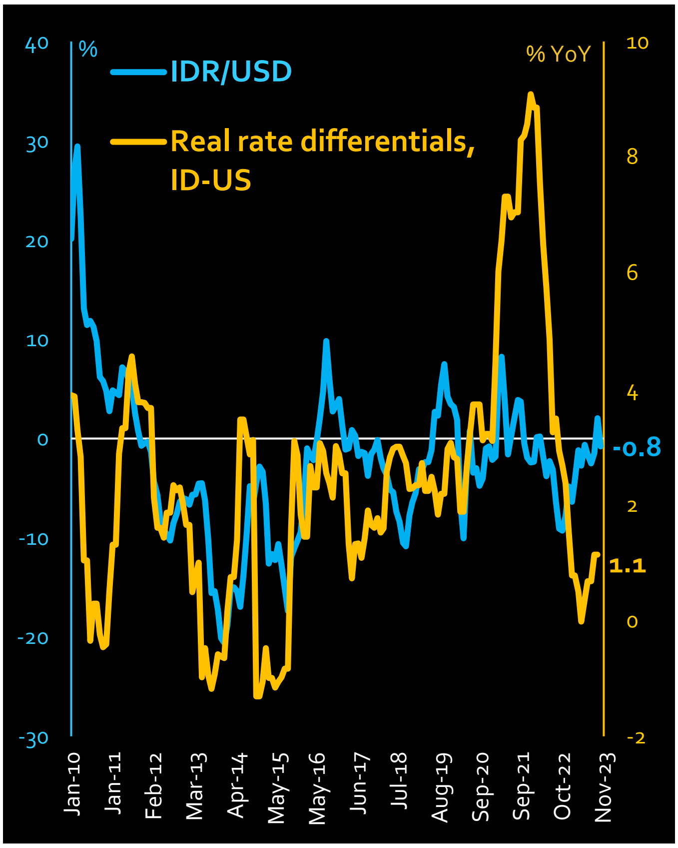
Panel 3. The still-aggressive demand for loans highlights the urgency for BI to maintain a substantially restrictive real rate environment in the upcoming period



Source: OJK, BI, BCA Economist

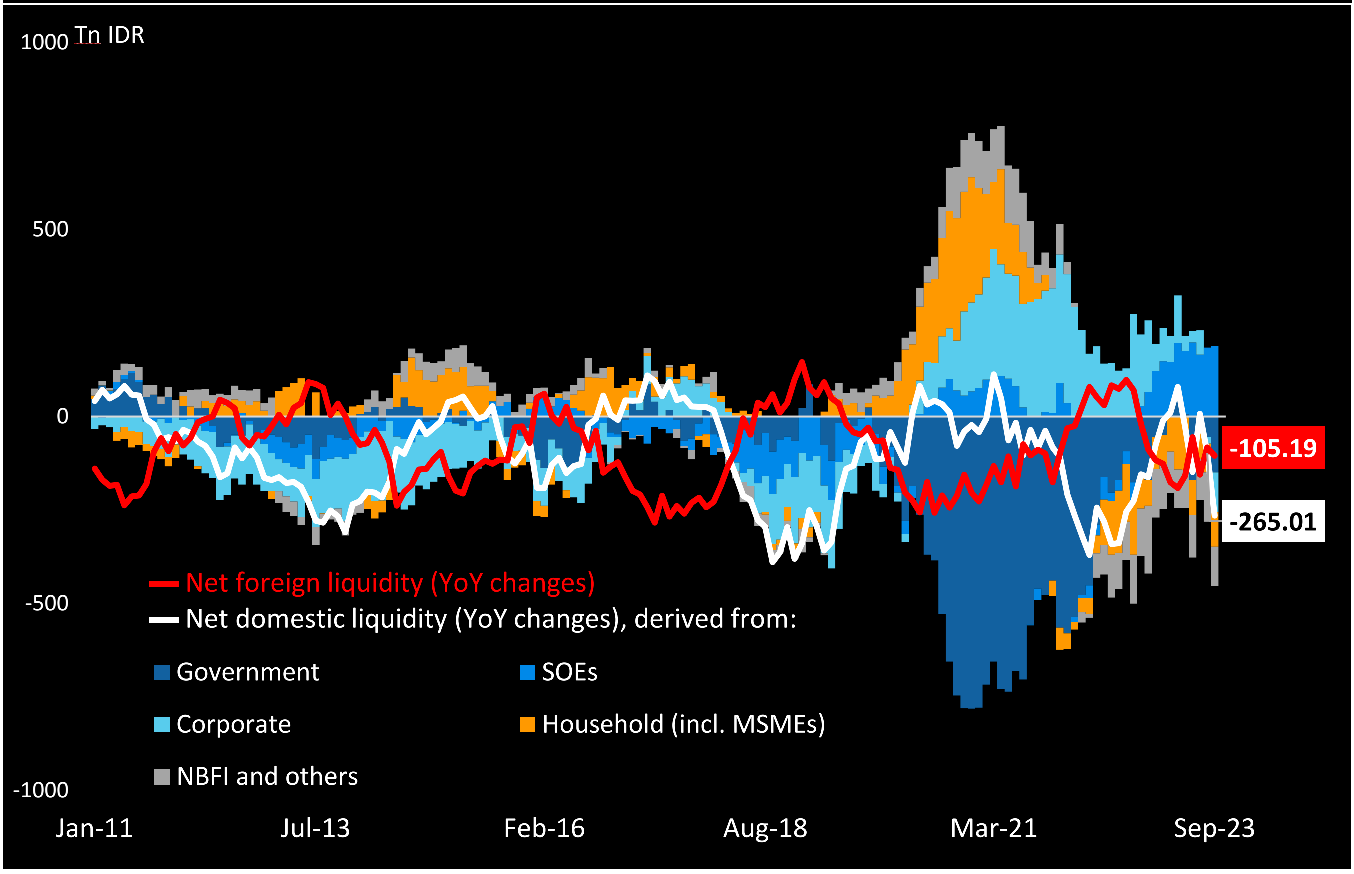
Panel 4. Changes to the Rupiah's value seem to be dictated by the ebb and flow in the global interest rate expectation rather than the Rupiah's real rate differentials





Source: BI, Bloomberg, BCA Economist

Panel 5. The projected increase in government spending may continue to put Indonesia's CA in a deficit, leading to a further deterioration in the Rupiah's fundamental



Source: BI, BCA Economist

Selected Macroeconomic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Nov-23	2.30
UK	5.25	Nov-23	0.65
EU	4.50	Nov-23	1.60
Japan	-0.10	Jan-16	-3.10
China (lending)	2.50	Nov-23	4.55
Korea	3.50	Oct-23	-0.30
India	6.50	Oct-23	1.63
Indonesia	6.00	Nov-23	3.44

Money Mkt Rates	22-Nov	-1 mth	Chg (bps)
SPN (1M)	6.29	6.19	10.1
SUN (10Y)	6.64	7.08	-43.8
INDONIA (O/N, Rp)	5.88	5.79	9.4
JIBOR 1M (Rp)	6.66	6.62	3.4

Bank Rates (Rp)	Aug	Jul	Chg (bps)
Lending (WC)	8.96	8.95	0.65
Deposit 1M	4.29	4.24	5.00
Savings	0.66	0.67	-0.53

Currency/USD	22-Nov	-1 mth	Chg (%)
UK Pound	0.800	0.822	2.71
Euro	0.918	0.944	2.78
Japanese Yen	149.5	149.9	0.21
Chinese RMB	7.165	7.315	2.10
Indonesia Rupiah	15,575	15,875	1.93

Capital Mkt	22-Nov	-1 mth	Chg (%)
JCI	6,907.0	6,849.2	0.84
DJIA	35,273.0	33,127.3	6.48
FTSE	7,469.5	7,402.1	0.91
Nikkei 225	33,451.8	31,259.4	7.01
Hang Seng	17,734.6	17,172.1	3.28

Foreign portfolio ownership (Rp Tn)	Oct	Sep	Chg (Rp Tn)
Stock	2,895.1	2,833.3	61.89
Govt. Bond	810.4	823.0	-12.62
Corp. Bond	11.3	10.8	0.52

Trade & Commodities	22-Nov	-1 mth	Chg (%)
Baltic Dry Index	1,755.0	2,046.0	-14.2
S&P GSCI Index	561.7	600.8	-6.5
Oil (Brent, $/brl)	82.0	92.2	-11.1
Coal ($/MT)	128.9	150.5	-14.4
Gas ($/MMBtu)	2.71	2.61	3.8
Gold ($/oz.)	1,990.2	1,981.4	0.4
Copper ($/MT)	8,253.0	7,879.8	4.7
Nickel ($/MT)	16,196.5	18,406.0	-12.0
CPO ($/MT)	821.6	774.1	6.1
Rubber ($/kg)	1.45	1.44	0.7

External Sector	Oct	Sep	Chg (%)
Export ($ bn)	22.15	20.75	6.76
Import ($ bn)	18.67	17.34	7.68
Trade bal. ($ bn)	3.48	3.41	2.08
Central bank reserves ($ bn)*	133.1	134.9	-1.30

Prompt Indicators	Oct	Sep	Aug
Consumer confidence index (CCI)	124.3	121.7	125.2
Car sales (%YoY)	-13.9	-20.1	-8.3
Motorcycle sales (%YoY)	-4.0	-0.9	1.8

Manufacturing PMI	Oct	Sep	Chg (bps)
USA	46.7	49.0	-230
Eurozone	43.1	43.4	-30
Japan	48.7	48.5	20
China	49.5	50.6	-110
Korea	49.8	49.9	-10
Indonesia	51.5	52.3	-80

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	5.1
GDP per Capita (US$)	3927	4175	3912	4350	4784	4982
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.8
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.00
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,728
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	34.9
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.4

*Estimated number

** Estimation of Rupiah's fundamental exchange rate

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