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Monthly Economic & Finance Briefing

Economic, Banking & Industry Research of BCA Group - DKP

BI Policy: A protracted battle towards normalcy

Executive Summary:

- BI maintained the 7-Day Repo Rate at 3.50%, while tweaking several macroprudential policies in order to spur credit growth.
- Despite strong economic indicators thus far in Q2, there is a strong probability that GDP growth would begin to slow in H2-21.
- Aside from concerns regarding Covid cases and vaccination, there is a risk that the planned tax hikes and/or global monetary tightening could push the Indonesian economy towards a new post-Covid equilibrium characterized by higher savings, lower loan growth, and narrower CAD.

- To no one's surprise, Bank Indonesia (BI) held its benchmark 7-Day Repo Rate at 3.50%. The decision was made against the backdrop of growing concerns about Asian growth prospects, in particular due to rising Covid-19 caseloads in several Southeast Asian countries such as Malaysia and Thailand.

- The viral resurgence does not seem to make too large of an impact on the Indonesian economy thus far, particularly as case numbers in Indonesia has stayed quite low (***Chart 1***) despite fears of a post-Lebaran spike. Our transaction index ("Intrabiz") does show a massive downturn during the 3rd week of May (***Chart 3***), but it is as yet difficult to disentangle any potential slowdown from a normal post-Lebaran "hangover" in consumer spending.

- Nevertheless, all signs are pointing towards a protracted battle to restore economic normalcy – something which BI readily acknowledged despite its steady growth outlook for the year (at 4.1 – 5.1%). Vaccination is proceeding at a slower pace after a promising start in Q1 (***Chart 2***). Demand for loans, meanwhile, has remained weak – as shown by the -2.3% YoY decline in banking intermediation.

- **It is thus interesting to see how BI continues to enact dovish policies at the margins, despite its understandable reluctance to cut rates further.** One such tweak is the decision to cut maximum credit card rates from 2% to 1.75%. This move is clearly designed to spur consumer spending, but its impact will likely be limited given that credit card transactions account for only 2.6% (gross) of household consumption in 2020. BI also keeps its foot on the gas pedal for credit growth, with its continuing emphasis on lowering banks' prime lending rates (SBDK) as well as its plans to introduce a new "inclusive financing ratio" (RPIM) to spur lending to SMEs.

- **With BI digging deep into its toolbox for new measures to stimulate the economy, it becomes very clear that the fiscal side will have to do more of the heavy lifting.** But while there are encouraging signs on this front, especially regarding the disbursement of social assistance, the recent news cycle has instead been dominated by plans to raise VAT and income tax rates, as well as another round of tax amnesty.

- There are very good reasons why the government needs to raise revenue, given that the tax/GDP ratio, historically, has tended not to recover following crisis-induced declines (***Chart 4***). But the prospects of tax hikes could lower spending – especially for high-income household whose propensity to spend has declined the furthest during the pandemic. **So rather than becoming fuel for pent-up demand, "forced savings" could remain elevated for longer.**

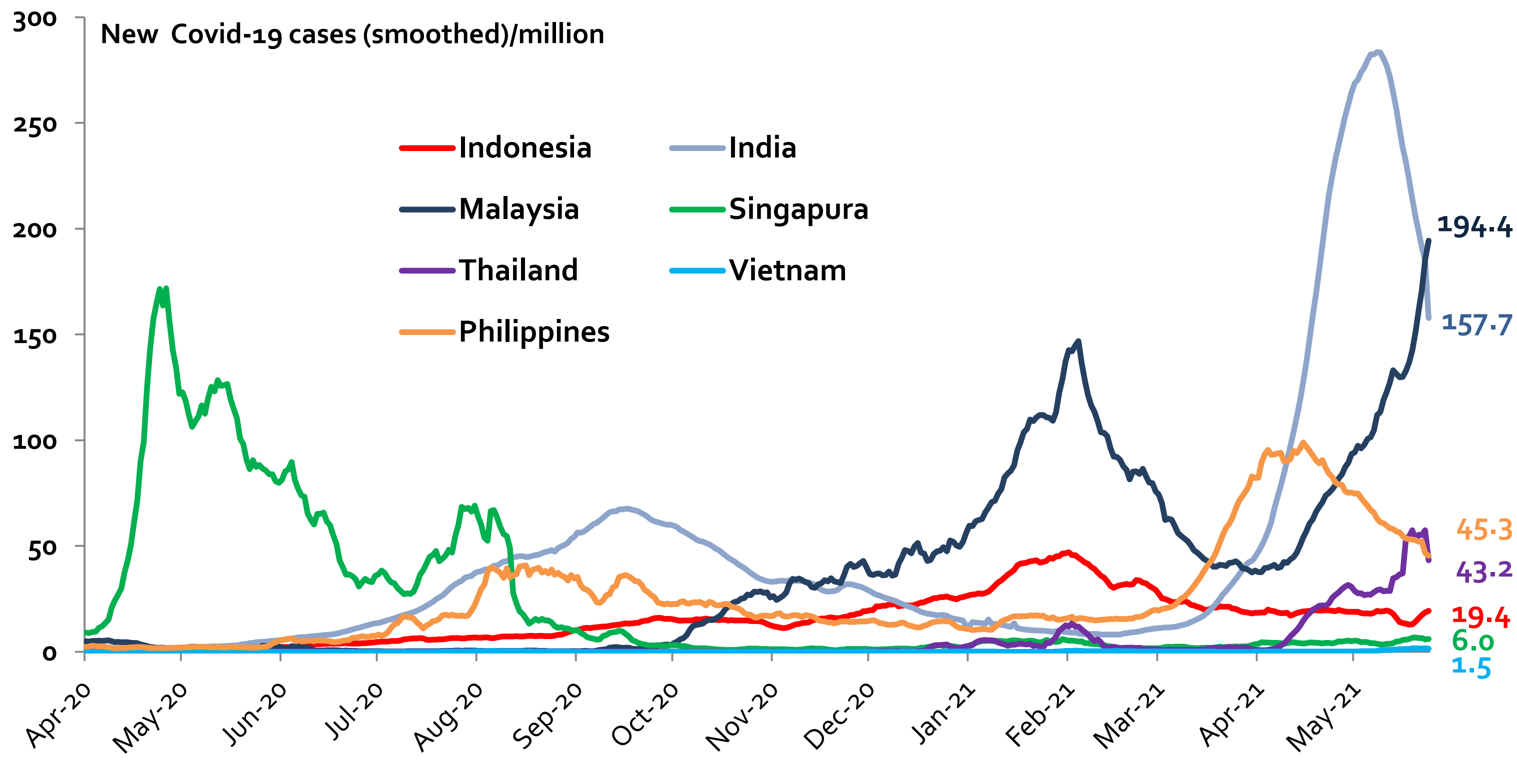
- Meanwhile, the dominant narrative in the global market – inflation (***Chart 5***) and the Fed's response to it – poses another set of challenges. As we mentioned in our last report (Trade: Living on the fast lane), these concerns are a bit premature, and the Fed's view that it is a temporary pressure is likely to prevail. Nonetheless, global rates remain on an upward trajectory, and it is quite inevitable that markets would try to pre-empt any future tightening by the Fed.

- **Whether the challenge will come from the taxes side or the bonds side, they may end up having similar effects in the medium-term – echoing the famous "Ricardian equivalence".** Bond yield hikes could deter capital inflows, which in turn force

Indonesian current account to adjust towards a smaller deficit. The flip side of having narrower CA deficit is higher savings rate vis-à-vis investment (i.e. "forced savings"), which translates to lower loan-to-deposit ratio (LDR). In turn, the "wedge" between bank loans and deposits will be filled by government bonds – at least until the tax hikes prove successful in raising revenue.

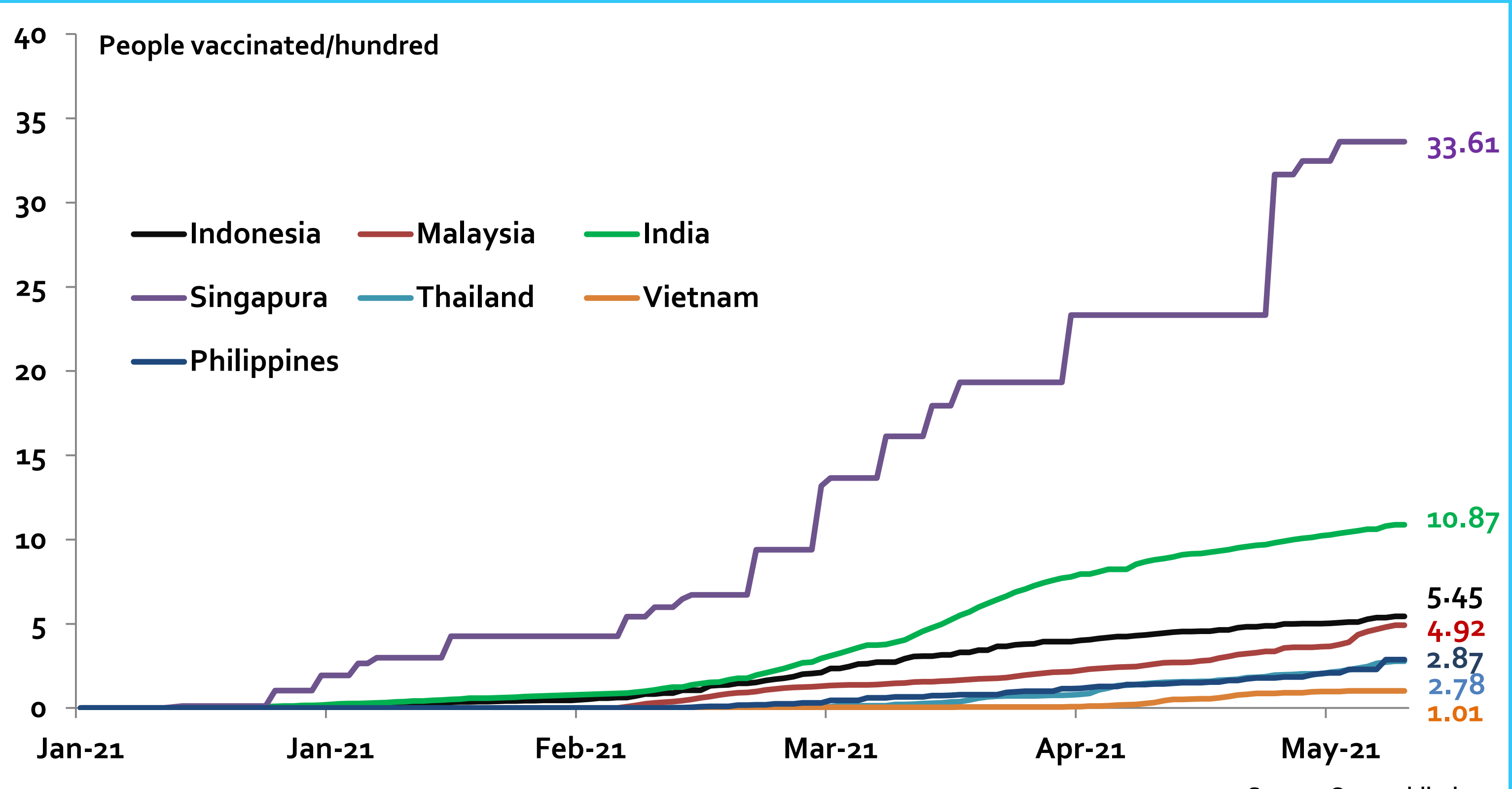
- Such potential post-Covid equilibrium is obviously not the optimal scenario, growth-wise, but is a distinct possibility that BI and the government are strenuously avoiding. There are still plenty of ways to avoid this fate, whether through luck (commodity supercycle) or hard work (post-Covid reforms). **Until then, however, it is reasonable to assume that the recovery would peak in Q2-21 – thanks to low-base and seasonal effects – and begin to slow down in H2-21.**

Chart 1. Indonesian caseloads ticked upwards after Lebaran, but still much lower than several countries in the region



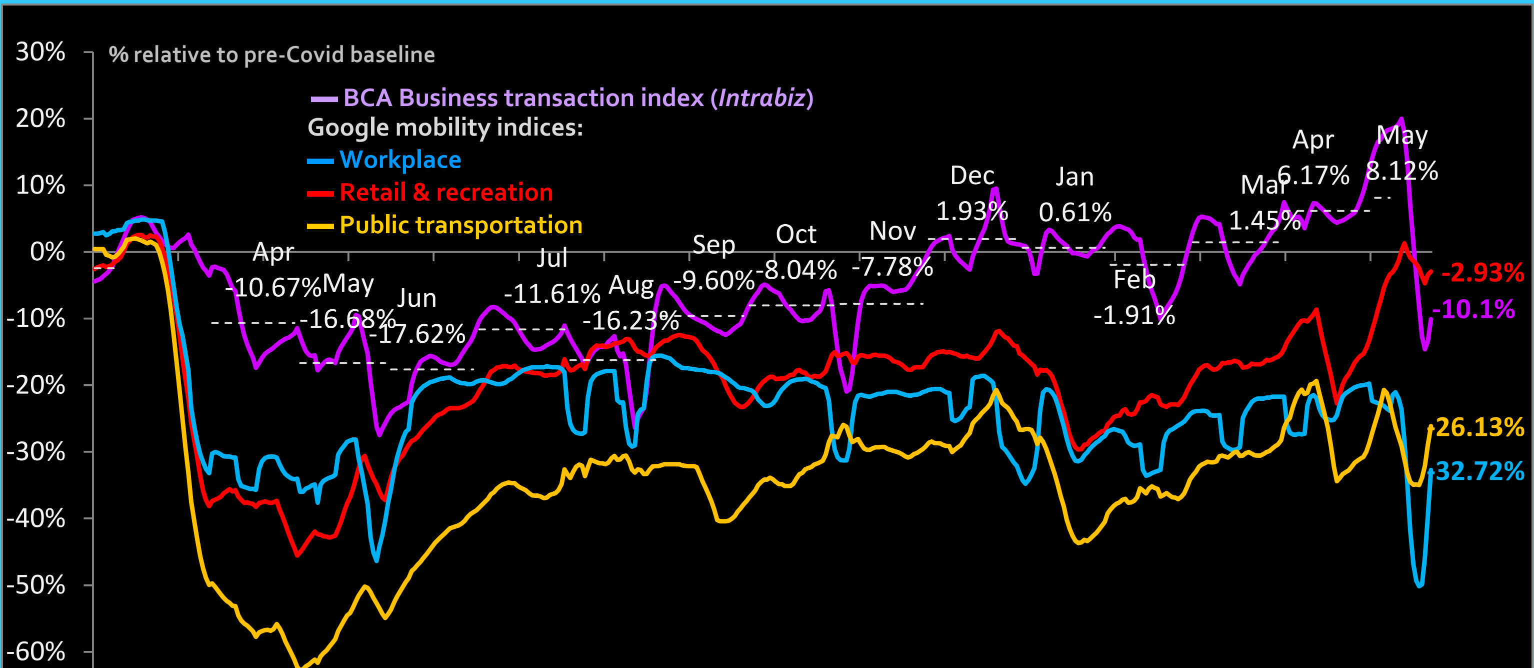
Source: Ourworldindata

Chart 2. After a strong start in Q1-21, Indonesian vaccination levels are gradually overtaken by other countries



Source: Ourworldindata

Chart 3. Economic activities peaked during Ramadan/Lebaran, the ensuing decline might be "hangover effect"



Source: *BCA Big Data, Google Covid-19 Mobility Reports*

Chart 4. Indonesian tax/GDP ratio has tended to decline following crises and did not recover

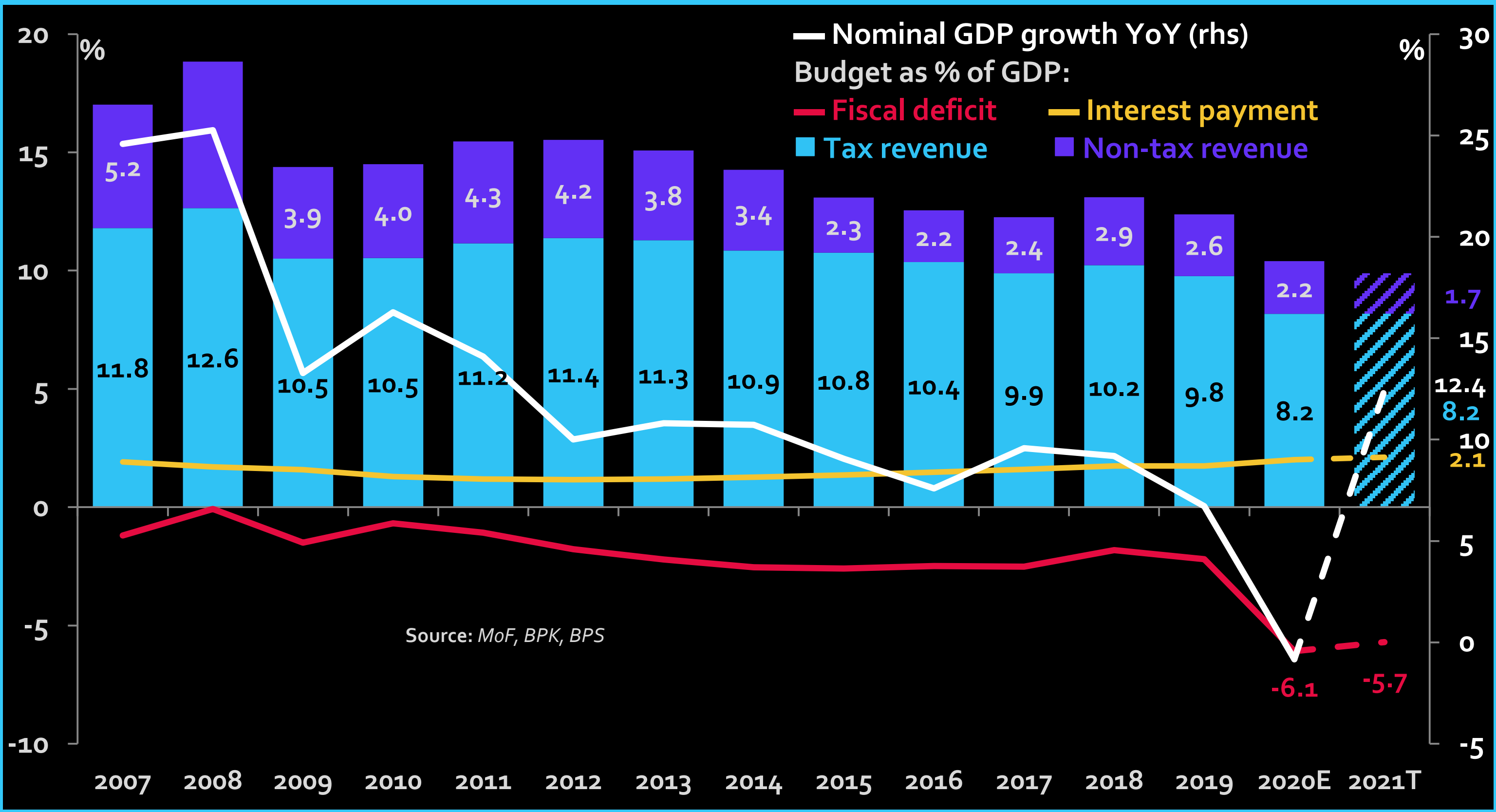
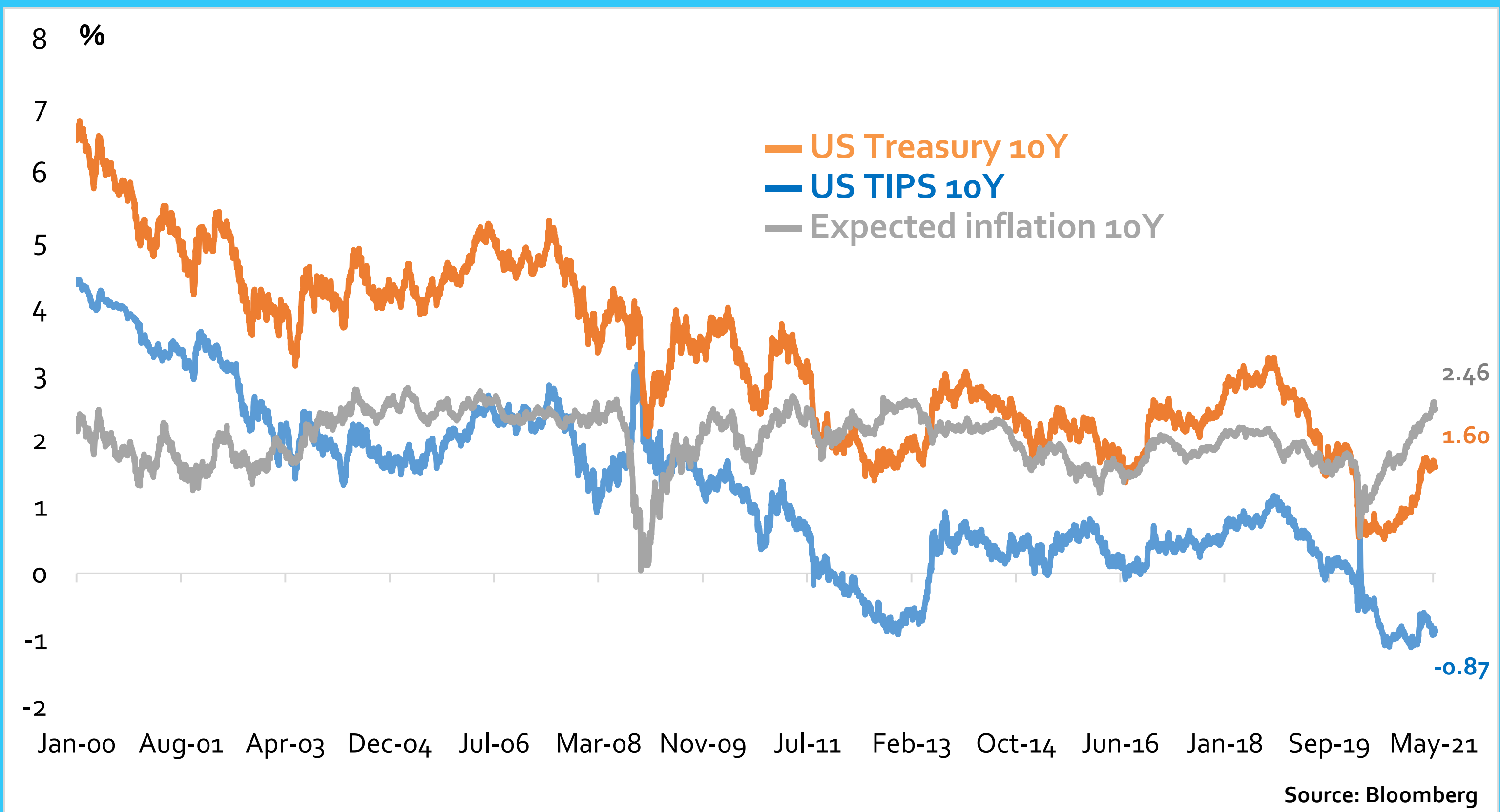


Chart 5. US expected inflation remains on an upward trend despite the Fed's attempts to play it down



Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	0.25	Mar-20	-3.95
UK	0.10	Mar-20	-1.40
EU	0.00	Mar-16	-1.60
Japan	-0.10	Jan-16	0.30
China (lending)	4.35	Oct-15	3.45
Korea	0.50	May-20	-1.80
India	4.00	May-20	-0.29
Indonesia	3.50	Feb-21	2.08

Money Mkt Rates	24-May	-1 mth	Chg (bps)
SPN (1M)	2.31	2.89	-58.4
SUN (10Y)	6.44	6.41	2.1
INDONIA (O/N, Rp)	2.79	2.79	0.5
JIBOR 1M (Rp)	3.56	3.56	-0.3

Bank Rates (Rp)	Feb	Jan	Chg (bps)
Lending (WC)	9.23	9.27	-4.29
Deposit 1M	3.88	4.05	-16.69
Savings	0.83	0.84	-0.97

Currency/USD	24-May	-1 mth	Chg (%)
UK Pound	0.706	0.721	2.03
Euro	0.819	0.827	0.98
Japanese Yen	108.8	107.9	-0.80
Chinese RMB	6.419	6.496	1.20
Indonesia Rupiah	14,355	14,525	1.18

Capital Mkt	24-May	-1 mth	Chg (%)
JCI	5,763.6	6,016.9	-4.21
DJIA	34,394.0	34,043.5	1.03
FTSE	7,051.6	6,938.6	1.63
Nikkei 225	28,364.6	29,020.6	-2.26
Hang Seng	28,412.3	29,078.8	-2.29

Foreign portfolio ownership (Rp Tn)	Apr	Mar	Chg (Rp Tn)
Stock	1,892.9	1,878.6	14.30
Govt. Bond	964.6	951.4	13.20
Corp. Bond	28.5	28.9	-0.37

Trade & Commodities	24-May	-1 mth	Chg (%)
Baltic Dry Index	2,881.0	2,788.0	3.3
S&P GSCI Index	514.3	494.1	4.1
Oil (Brent, $/brl)	68.5	66.1	3.6
Coal ($/MT)	106.7	85.2	25.3
Gas ($/MMBtu)	2.78	2.72	2.2
Gold ($/oz.)	1,881.0	1,777.2	5.8
Copper ($/MT)	9,928.8	9,581.5	3.6
Nickel ($/MT)	17,079.5	16,353.3	4.4
CPO ($/MT)	1,041.3	1,079.1	-3.5
Rubber ($/kg)	1.66	1.62	2.5

External Sector	Apr	Mar	Chg (%)
Export ($ bn)	18.48	18.35	0.7
Import ($ bn)	16.29	16.79	-3.0
Trade bal. ($ bn)	2.19	1.57	40.0
Central bank reserves ($ bn)	138.8	137.1	1.24

Prompt Indicators	Apr	Mar	Feb
Consumer confidence index (CCI)	101.5	93.4	85.8
Car sales (%YoY)	902.9	10.5	-38.2
Motorcycle sales (%YoY)	282.0	-7.2	-30.8
Cement sales (%YoY)	8.3	10.9	0.7

Manufacturing PMI	Apr	Mar	Chg (bps)
USA	60.7	64.7	-400
Eurozone	62.9	62.5	40
Japan	53.6	52.7	90
China	51.9	50.6	130
Korea	54.6	55.3	-70
Indonesia	54.6	53.2	140

Source: Bloomberg, BI, BPS
Notes:
*Previous data
For change in currency: **Black indicates appreciation against USD, **Red** indicates depreciation
***For PMI, **> 50** indicates economic expansion, **< 50** indicates contraction

Indonesia – Economic Indicators Projection

	2016	2017	2018	2019	2020	2021E
Gross Domestic Product (% YoY)	5.0	5.1	5.2	5.0	-2.1	4.5
GDP per Capita (US$)	3605	3877	3927	4175	3912	4055
Consumer Price Index Inflation (% YoY)	3.0	3.6	3.1	2.7	1.7	3.1
BI 7 day Repo Rate (%)	4.75	4.25	6.00	5.00	3.75	3.50
USD/IDR Exchange Rate (end of year)**	13,473	13,433	14,390	13,866	14.050	14.460
Trade Balance (US$ billion)	8.8	11.8	-8.5	-3.2	21.7	10.1
Current Account Balance (% GDP)	-1.8	-1.6	-3.0	-2.7	-0.4	-1.8

** Estimation of Rupiah's fundamental exchange rate

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