

BI Policy:

Facing challenges that keep on challenging

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Executive Summary

- The BI rate is left unchanged at 6.00%, in line with Bank Indonesia's pro-stability stance despite some calls from the market for the central bank to tone down its cautious signals given the now-favourable external condition.
- A pro-stability monetary policy posture remains instrumental for BI, given the risk of seasonal liquidity outflows in H1 2024 and uncertainties relating to the upcoming election.
- The disrupted global shipping, spillover effects from the weakening sentiment on other Asian currencies, and the risk of tightening US financial conditions following the upcoming US Treasury Quarterly Refunding Announcement (QRA) highlight the challenges that may complicate BI's effort to stabilise the Rupiah.

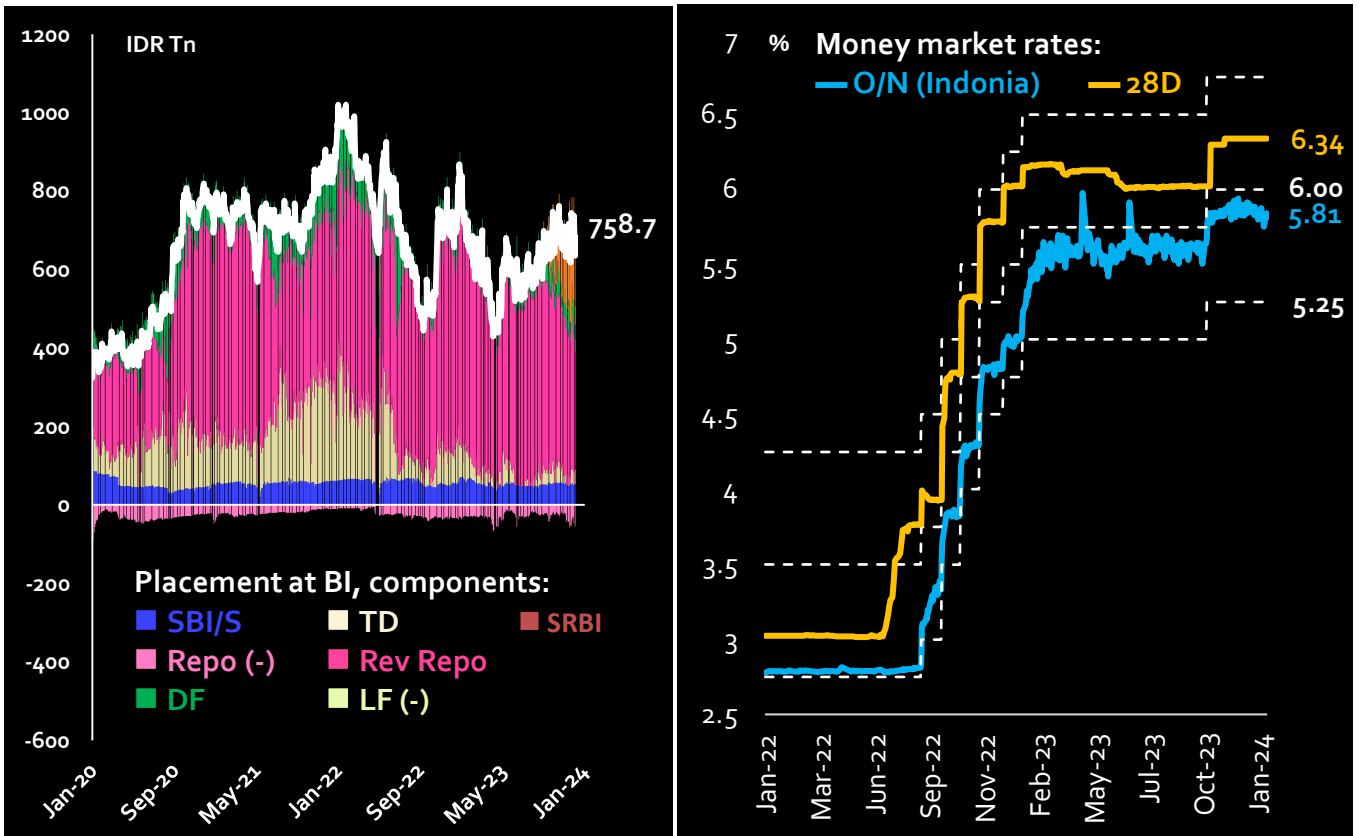
- Bank Indonesia Governor Perry Warjiyo opened the first post-policy meeting announcement of the year by remarking on the decelerating global economy and the expected FFR cuts in 2024. That said, the central bank keeps its policy rate (BI Rate) unchanged at 6.00%, in line with analysts' consensus and is consistent with its pro-stability messages since the "surprise" rate hike in October 2023.
- Despite the unsurprising rate announcement, the ongoing decline in the Rupiah's value (-1.60% YTD) indicates that some segments of the market are already anticipating a more dovish statement from the January 2024 meeting. After all, the Indonesian financial market benefits from a steady stream of capital inflows, while the low headline CPI inflation print in December 2023 implies more positive real rates. Still-robust trade gains in the past three months would also help to fill Indonesia's FX coffers. Surely the central bank has room to provide more stimulus to arrest the slowing aggregate demand growth?
- However, as made clear in recent meetings, the stability of the Rupiah remains the central bank's primary focus. Keeping the stability of the Rupiah is especially paramount at the moment, given the substantial refinancing needs in the SBN market. The upcoming dividend payment and repatriation window, which is likely to coincide with the lull between the two elections should the presidential election go to a run-off, would add to the challenges that BI could face in its mission to keep the Rupiah stable.
- BI officials also offer their baseline scenario for the FFR this year, which they believe will see around 75 bps cut in H2-24. Nevertheless, BI officials still expressed their optimism that the Rupiah would remain stable in the coming periods (and even strengthen should the economy continue to register above-normal trade gains). This policy signal, of course, acts as a balance for BI's more hawkish remarks on the FFR cuts scenario and other challenges that the central

bank would face in the short-term. Recent developments, however, have moved us to a question; what if the front-loaded challenges that BI officials already stated become even more challenging?

- We count at least three recent developments that present new hurdles in BI and other central banks' path towards policy loosening. The first hurdle is the re-emergence of global inflation, predominantly influenced by (but not limited to) recent shipping disruptions in the Bab-el-Mandeb Strait. Elevated shipping costs would function as a kind of tax for both producers and consumers, potentially driving up prices for goods. This scenario could, in turn, reignite the now-dormant core inflation, without substantially improving the outlook on business revenues.
- This initial challenge would feed into another obstacle—the risk of a persistently strong USD value. Some FOMC officials have hit the airwaves early this week, trying to cool down the market's expectation for 100-150 bps rate cuts in 2024. Several prominent central bankers in Europe have also spoken to the public in a hawkish tune, remarking that it is still too early to even talk about cutting rates.
- Meanwhile, monetary policy discussions between Asian central bankers are markedly different compared to their Western counterparts. China's unspectacular economic data (5.2% GDP growth with uneven recovery, especially in the property sector), along with its many structural problems (China's population fell in the past two years), would strengthen the urgency for the PBoC to keep an accommodative policy stance. The BoJ rate hike expectations have also waned recently, as indicated by the rally in the Japanese stock market. This monetary policy gap between Asian and Western central banks may pose downward pressure on Asian currencies, especially ones with considerably high economic linkages with China, such as Indonesia.
- Despite the clear signal from the Fed that the central bank has already seen it as appropriate to lower its policy rate later in the year, the extent to which the actual rate cuts would loosen the financing condition in the US beyond the current level is debatable. Monetary policy, of course, works through expectations, and the expectations that the Fed would cut rates have largely been priced in.
- And this is not even the sole determinant of US financing conditions in the coming periods. We also set our eyes on the upcoming Treasury Quarterly Refunding Announcement (QRA), when the US Treasury is expected to add duration to the UST market. Longer duration, of course, would increase the maturity risk premium in the UST market, possibly tightening the market condition beyond the current level.
- A tightening UST market would be bad news for riskier markets, including the Indonesian financial market. Such a scenario may halt the steady stream of foreign capital now flowing into the Indonesian market, complicating BI's effort to keep the Rupiah stable. It remains prudent, then, for the central bank to maintain a healthy rate premium for Rupiah-denominated assets. This entails preserving the existing mix of pro-stability monetary policies and pro-growth macroprudential policies, at least until the anticipated summer of FFR cuts came.

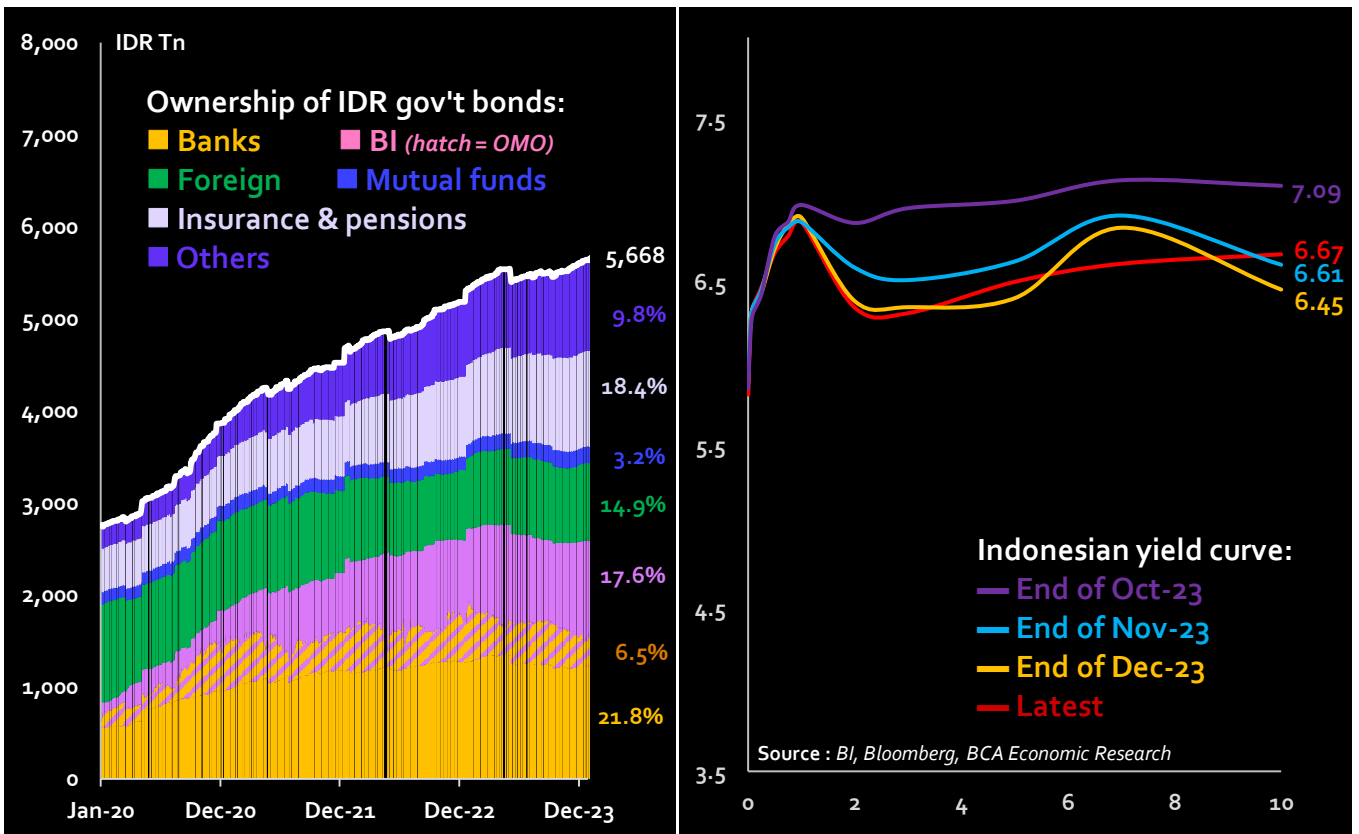
"Despite the now-favourable external conditions, multiple challenges still require Bank Indonesia to maintain its pro-stability policies"

Panel 1. Domestic banks' liquidity condition is improving, but its placement is increasingly skewed towards SRBI than other, more traditional instruments



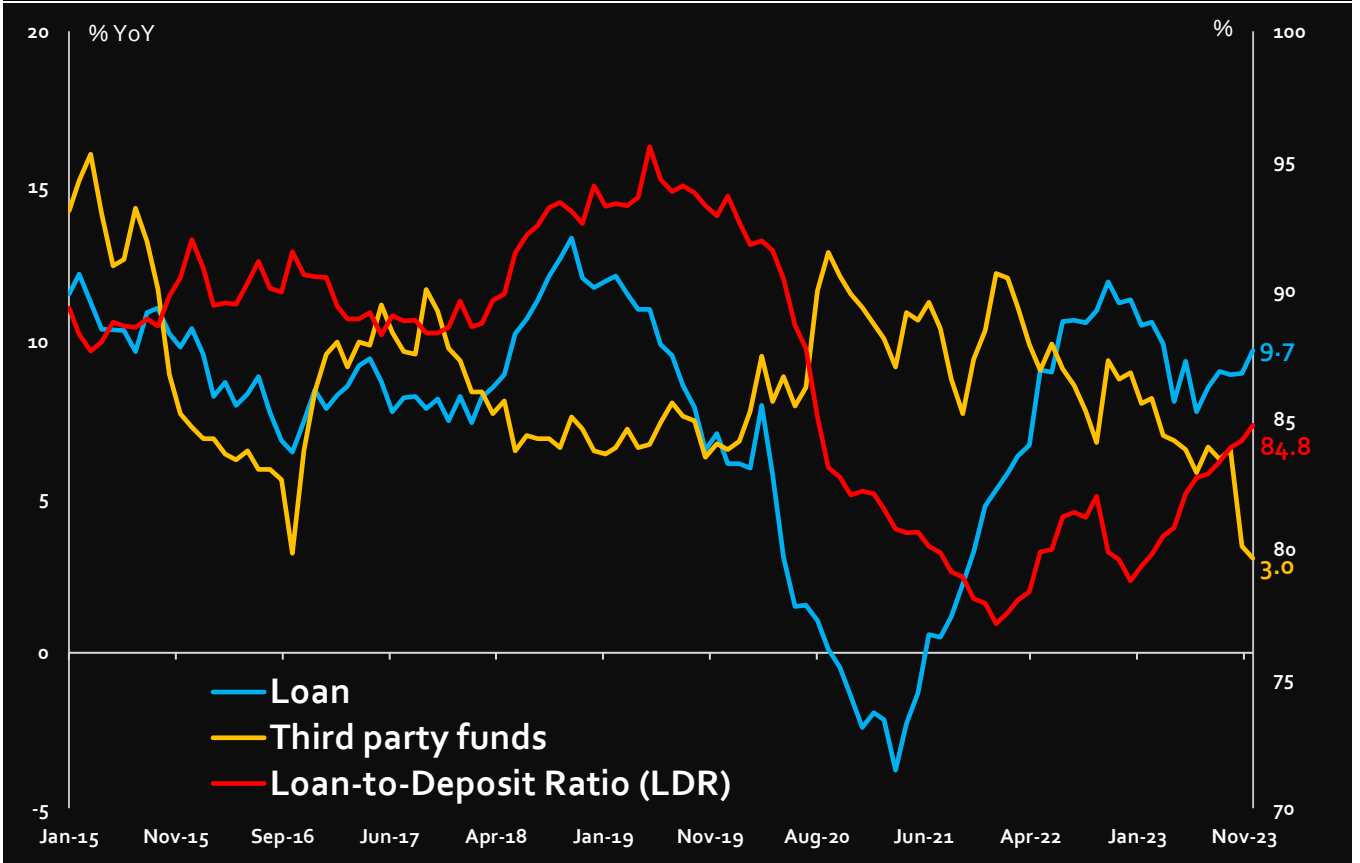
Source: BI, Bloomberg, BCA Economist

Panel 2. The yield on the SBN market rose slightly as much of the foreign capital inflows observed in January 2024 went to the stock market



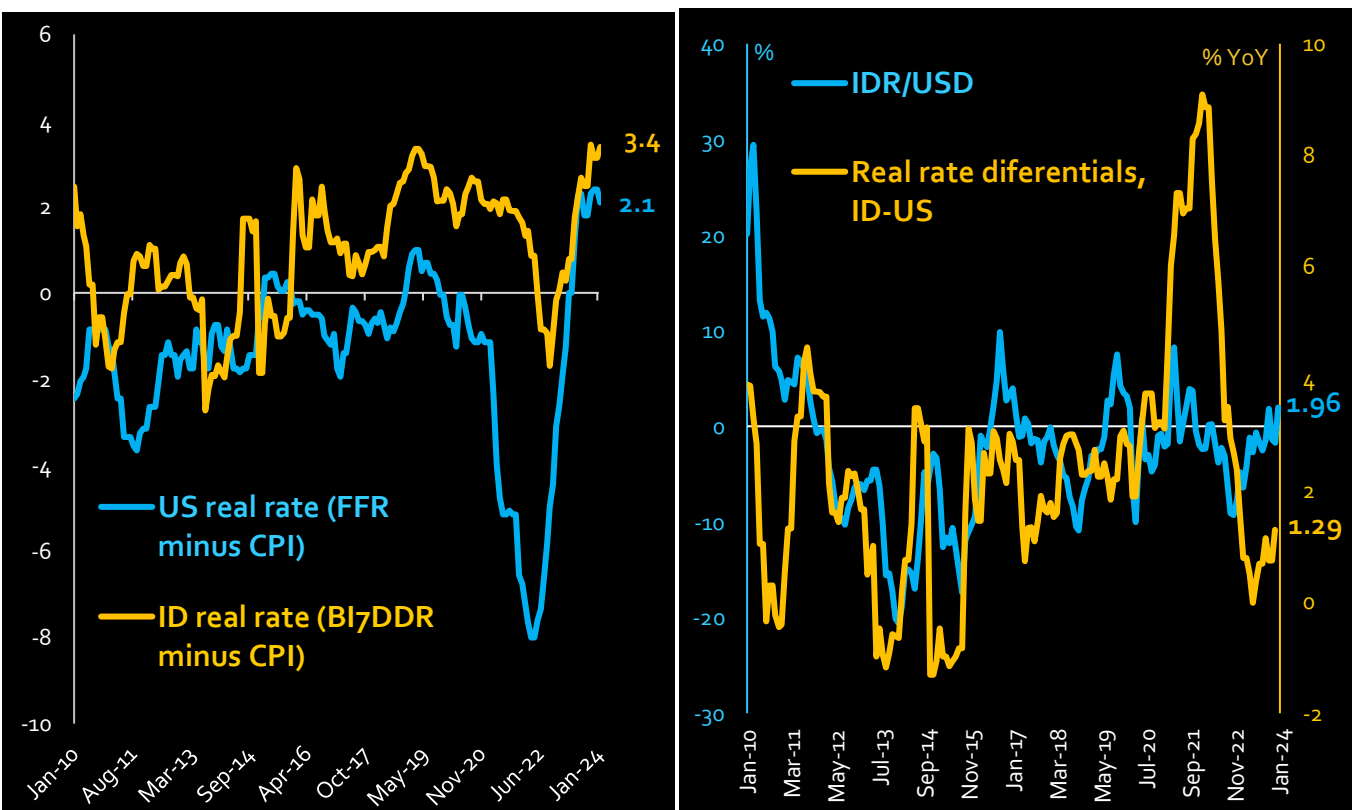
Source: MoF, BI, Bloomberg, BCA Economist

Panel 3. Loan growth continues to accelerate despite the more restricted deposit growth



Source: OJK, BI, BCA Economist

Panel 4. The now-subdued inflationary pressures widen Indonesia's real rate differentials, but BI would need to stay vigilant given the still apparent risk of food inflation



Source: BI, Bloomberg, BCA Economist

Selected Macroeconomic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	16-Jan	-1 mth	Chg (%)
US	5.50	Dec-23	2.10	Baltic Dry Index	1,324.0	2,348.0	-43.6
UK	5.25	Dec-23	1.25	S&P GSCI Index	537.0	537.6	-0.1
EU	4.50	Dec-23	1.60	Oil (Brent, \$/brl)	78.4	76.6	2.4
Japan	-0.10	Jan-16	-2.90	Coal (\$/MT)	127.4	139.9	-8.9
China (lending)	2.50	Dec-23	4.65	Gas (\$/MMBtu)	3.25	2.44	33.2
Korea	3.50	Nov-23	0.30	Gold (\$/oz.)	2,028.4	2,019.6	0.4
India	6.50	Dec-23	0.81	Copper (\$/MT)	8,268.0	8,454.7	-2.2
Indonesia	6.00	Nov-23	3.39	Nickel (\$/MT)	15,901.0	16,923.0	-6.0
Money Mkt Rates	16-Jan	-1 mth	Chg (bps)	CPO (\$/MT)	826.2	777.6	6.2
SPN (1M)	5.88	5.80	7.6	Rubber (\$/kg)	1.53	1.44	6.3
SUN (10Y)	6.66	6.54	12.0	External Sector	Dec	Nov	Chg (%)
INDONIA (O/N, Rp)	5.81	5.83	-2.3	Export (\$ bn)	22.41	22.00	1.89
JIBOR 1M (Rp)	6.64	6.65	-0.8	Import (\$ bn)	19.11	19.59	-2.45
Bank Rates (Rp)	Oct	Sep	Chg (bps)	Trade bal. (\$ bn)	3.31	2.41	37.10
Lending (WC)	9.05	9.02	2.79	Central bank reserves (\$ bn)*	146.4	138.1	6.01
Deposit 1M	4.43	4.33	10.10	Prompt Indicators	Dec	Nov	Oct
Savings	0.67	0.66	0.19	Consumer confidence index (CCI)	123.8	123.6	124.3
Currency/USD	16-Jan	-1 mth	Chg (%)	Car sales (%YoY)	-19.1	-7.5	-13.8
UK Pound	0.791	0.789	-0.35	Motorcycle sales (%YoY)	-11.6	-2.8	-4.0
Euro	0.920	0.918	-0.18	Manufacturing PMI	Nov	Oct	Chg (bps)
Japanese Yen	147.2	142.2	-3.42	USA	46.7	46.7	0
Chinese RMB	7.188	7.122	-0.92	Eurozone	44.2	43.1	110
Indonesia Rupiah	15,591	15,493	-0.63	Japan	48.3	48.7	-40
Capital Mkt	16-Jan	-1 mth	Chg (%)	China	50.7	49.5	120
JCI	7,242.8	7,191.0	0.72	Korea	50.0	49.8	20
DJIA	37,361.1	37,305.2	0.15	Indonesia	51.7	51.5	20
FTSE	7,558.3	7,576.4	-0.24	Foreign portfolio ownership (Rp Tn)	Dec	Nov	Chg (Rp Tn)
Nikkei 225	35,619.2	32,970.6	8.03	Stock	3,226.3	3,136.1	90.27
Hang Seng	15,865.9	16,792.2	-5.52	Govt. Bond	841.0	833.9	7.17
				Corp. Bond	10.6	11.2	-0.59

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

	2019	2020	2021	2022	2023E	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.1	5.0
GDP per Capita (US\$)	4175	3912	4350	4784	4982	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6*	3.2
BI 7 day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00*	5.50
USD/IDR Exchange Rate (end of year)**	13,866	14,050	14,262	15,568	15,397*	16.037
Trade Balance (US\$ billion)	-3.2	21.7	35.3	54.5	37.0*	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	0.1	-0.5

*Actual number

** Estimation of Rupiah's fundamental exchange rate

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