MNI Bank Indonesia Preview – May 2021

Announcement Date: Tuesday, 25 May 2021

Announcement Time: 08:20 BST/14:20 WIB

Link To Rate Decision: https://www.bi.go.id/en/statistik/indikator/bi-7day-rr.aspx

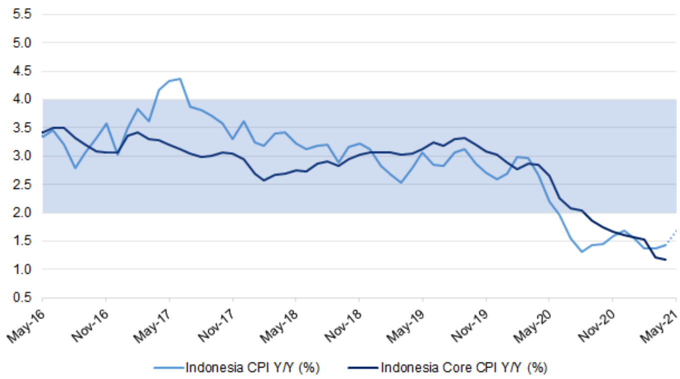
MNI Point of View: Keeping Foot On The Brake Pedal

This week's monetary policy meeting seems poised to be another non-event, with policymakers facing conflicting demands of their policy mandate. With inflation still subdued and the rupiah still vulnerable, the MPC will likely stand pat on the 7-day reverse repo rate. Elevated uncertainty around the local Covid-19 outbreak provides another reason for policymakers to hold fire this time.

The rupiah has net appreciated since the previous monetary policy meeting, yet the last two weeks have seen IDR give away the bulk of its earlier gains. This forced Bank Indonesia to intervene in FX spot and domestic NDF markets to stabilise the currency amid market musings surrounding the Fed's taper dilemma. The recent spell of renewed rupiah weakness gives the MPC a reason to wait with any further interest rate cuts for now, should policymakers be tempted to resume the easing cycle.

Meanwhile, despite accommodative monetary settings, price growth remains subdued. CPI missed expectations in April and remained comfortably below the central bank's target range of +2.0%-4.0% Y/Y, while the core metric registered at the lowest level in Bloomberg data series reaching to 2003. Headline consumer price inflation is expected to accelerate to 1.69% Y/Y in May, according to Bank Indonesia's survey for the first three weeks of the month, which suggests potential for another below-target reading.

Quarterly GDP print was also relatively underwhelming. The contraction was deeper than expected, as the economy shrank 0.74% Y/Y. The bitter release came with a sweetener, as Economic Affairs Minister Hartarto signalled that the government is preparing a suite of fresh stimulus measures and eyes a V-shaped recovery. In addition, higher-frequency data gave some reasons for optimism as Bank Indonesia's Consumer Confidence Index moved above the breakeven 100 level, while the latest Markit Manufacturing PMI reading printed at fresh all-time highs. All this came on top of a stellar exports reading, with Indonesian shipments reaching best levels in a decade.



Shaded region represents Bank Indonesia's target range. Dotted line represents projection based on Bank Indonesia's survey in the third week of May.

These days the epidemiological picture means as much as economic data. On the one hand, Indonesia has managed to keep a lid on infections relative to most of its regional peers, at a time when much of Southeast Asia battles a rapid resurgence of the virus. On the other hand, officials are on the watch for any signs of a looming spike in new cases after an estimated 1.5mn people travelled

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outside Jakarta to celebrate Eid al-Fitr in their hometowns, despite temporary travel restrictions imposed over the holiday period. For the MPC, this means that sitting pat on Tuesday would allow them to see if there are any epidemiological (and hence, by extension, economic) consequences of heightened mobility during the recent holidays.

With the rupiah back on a downward trajectory, Bank Indonesia are likely to leave monetary policy settings unchanged today, despite the fact that inflation remains below the target range. Preliminary signs that the economy is building momentum, while inflation is slowly picking up mean that the MPC are in no rush to cut interest rates. Furthermore, they may prefer to wait and see how the local Covid-19 situation unfolds. For now, the onus will remain on fiscal policy to keep economic recovery going.

Bank Indonesia April Monetary Policy Decision:

The BI Board of Governors Meeting agreed on 19th and 20th April 2021 to hold the BI 7-Day Reverse Repo Rate at 3.50%, while also maintaining the Deposit Facility (DF) rates at 2.75% and Lending Facility (LF) rates at 4.25%. The decision is consistent with the need to maintain rupiah exchange rate stability amidst persistently elevated global financial market uncertainty despite projected low inflation. Supporting the national economic recovery effort, Bank Indonesia has optimised its accommodative monetary and macroprudential policy mix and accelerated payment system digitalisation as follows:

1. Strengthening rupiah exchange rate policy by maintaining market presence through triple intervention policy to preserve exchange rate stability in line with the currency's fundamental value and market mechanisms.
2. Strengthening the monetary operations strategy to bolster the accommodative monetary policy stance.
3. Expanding the use of Bank Indonesia Sukuk (SukBI) for tenors of 1 week to 12 months to strengthen sharia monetary operations, effective from 16th April 2021.
4. Maintaining accommodative macroprudential policy by holding the countercyclical capital buffer (CCyB) at 0%, the Macroprudential Liquidity Buffer (MPLB) at 6% with repo flexibility at 6%, as well as the Sharia Macroprudential Liquidity Buffer at 4.5% with repo flexibility also at 4.5%.
5. Strengthening Prime Lending Rate (SBDK) transparency in the banking industry (Appendix), while coordinating with the Government and other relevant authorities to: (i) accelerate monetary policy transmission to lending rates in the banking industry; and (ii) stimulate lending/financing to the corporate sector.
6. Extending the National Clearing System (SKNBI) pricing policy of Rp1 from Bank Indonesia to banks and a maximum of Rp2,900 from banks to customers from 30th June 2021 previously until 31st December 2021 to accelerate national economic recovery momentum.
7. Strengthening QRIS policy to accelerate inclusive and efficient economic and financial digitalisation by:
    a. Raising the QRIS transaction limit from Rp2 million to Rp5 million, effective from 1st May 2021; and
    b. Lowering the Merchant Discount Rate (MDR) for Public Services Agencies (BLU) and Public Service Obligations (PSO) from 0.7% to 0.4%, effective from 1st June 2021.
8. Safeguarding the security, reliability and uninterrupted availability of payment system and rupiah currency management services during the Ramadan and Eid-ul-Fitr 1442 H festive period.
9. Facilitating trade and investment promotion as well as socialising the use of Local Currency Settlement (LCS) in conjunction with relevant institutions. In April and May 2021, promotional activities will be organised in Japan, Singapore, US, China, France and UK.

The measures outlined above, particularly points 4, 5, 7 and 9, are part of Bank Indonesia's ongoing commitment to policy synergy with the Financial System Stability Committee. Bank Indonesia will also continue to strengthen policy coordination with the Government and Financial System Stability Committee, including implementation of the Integrated Policy Package, to stimulate bank lending to the corporate and priority sectors, which will help catalyse economic growth and national economic recovery.

Click here to see the full press release.

Sell-side comments:

ANZ: There have been signs of improvement in Indonesia's economy, reducing the urgency for additional policy support. Mobility in Q2 has picked up relative to Q1. Consumer confidence has also risen. Meanwhile, high commodity prices are a boon for Indonesia, which is a major net exporter of coal and palm oil. However, given the slow vaccination progress, COVID-19 risks remain elevated, which would in turn cap the pace of recovery. Just over 5% of the population has received one dose of a COVID-19 vaccine, while a little more than 3% of the population has been fully vaccinated. While daily COVID-19 case numbers have declined recently, this may partly reflect lower testing during the recent holidays. The government is preparing for a spike in cases as an estimated 1.5million people left Jakarta for their hometowns during the Eid holidays, despite a travel ban. Social distancing restrictions have been extended. Mild price pressures also support the case for prolonged monetary accommodation. Headline inflation edged up slightly to 1.42% y/y in April, and BI's survey points to a mild increase in May so far. The inflation pick-up will be more pronounced in H2 as a materially lower base comes into play, but with a full economic recovery still some way off, demand-side price pressures are likely to be benign. It's worth noting that bank lending has remained very weak. Meanwhile, the IDR has regained some ground over the past month, which in turn gives BI more scope to keep its policy rate at its current low. In sum, we expect BI to keep its policy rate on hold through 2021 as it attempts to balance growth, inflation and external stability concerns.

Barclays: While we believe the Q1 GDP print fell short of the central bank's expectations, we expect Bank Indonesia (BI) to leave its policy rate unchanged at 3.50%. Though we note the risk that the central bank may come to view additional policy easing as warranted, we expect concerns over the volatility of the currency to stay BI's hand on the policy rate and divert its focus instead to other levers such as macroprudential policy.

Goldman Sachs: We expect Bank Indonesia (BI) to keep policy rates unchanged at 3.50% at its meeting next week. USDIDR has been drifting lower over the past month – which gives policymakers some room to maintain an accommodative stance given weak domestic fundamentals including below-target inflation and a slow growth recovery. However, policymakers remain cautious of spikes in global financial volatility, particularly with regards to risks around the US rates trajectory. Policymakers at our virtual tour conducted earlier this month, continue to place emphasis on external stability, citing it as the key policy priority. Given this focus on FX stability, we expect Bank Indonesia to keep the policy rate unchanged this year. Should exchange market pressures intensify driven by further rises in US rates on re-evaluation of the Fed policy stance, we would view risks around BI policy outcomes as being skewed to a hawkish direction.

Morgan Stanley: We expect BI to keep the policy rate on hold at 3.50% at the upcoming MPC meeting. Indeed, further rate cuts are unlikely as the economy is likely to show a cyclical recovery driven by both an external and domestic demand pick-up. On the external front, the improving global macro outlook and higher commodity prices provide a conducive backdrop for Indonesia's exports, which have already recovered above pre-COVID-19 levels. Meanwhile, with regards to domestic demand and the COVID-19 situation, policymakers are also adopting a more targeted/localised approach to stem transmission and the private sector has likely adapted to the new normal. These mean that the economic impact of any subsequent waves is likely to be less severe than before. Besides, a vaccine rollout is under way and will likely pick up pace in 2H21 as more supplies arrive. Meanwhile, disruptive rate hikes are not in our base case. This is because we expect the rise in US real rates to be gradual and orderly, given the Fed's dovish average inflation-targeting framework. Besides, Indonesia's macro stability indicators have also mostly improved versus 2013, with the current account deficit less stretched, inflation lower and real rate differentials versus the US more comfortable. The risk is if US inflation overshoots 2.5%, accompanied by lower unemployment rate and this prompts a disruptive tightening in financial conditions.

Scotiabank: Bank Indonesia is expected to stay on hold with a 7-day reverse repo rate of 3.5% on Tuesday. There had been a brief period of calm for the rupiah as it appreciated from mid-April onward, but renewed weakness set in more recently. Indonesia's economic growth rate has been moribund. The economy shrank by under 1% y/y in Q1. The latter is not seasonally adjusted, but it was the second worst first quarter growth rate—behind Q1 last year—over Q4 since the Global Financial Crisis broke out. With inflation resting at 1.4% y/y and core CPI at 1.2% y/y relative to an inflation target of 3.5% +/- 1%, Bank Indonesia has plenty of time to monitor currency risk.

SocGen: We believe that Bank Indonesia (BI) has no further room for an additional rate cut and therefore expect the central bank to keep the policy rate on hold at 3.5%. While the worst should be over for the economy, we expect a rather moderate bounceback in real GDP growth from last year's modest contraction. Nevertheless, we believe that the bank may continue to focus on non-interest rate policies with more targeted liquidity enhancement of macroprudential easing to support growth since the country cannot afford to have a lower bond yield, especially in the face of rising yields in the US. We expect BI to remain on hold at its meeting this week and continue to focus on the five major policy responses that it is banking on to cushion the economic impact of COVID-19: (1) accommodative monetary policy; (2) exchange rate stabilisation; (3) monetary stimulus in the form of quantitative easing; (4) burden sharing with the government to ensure fiscal sustainability; and (5) accommodative macroprudential policy.

TD Securities: We expect Bank Indonesia (BI) to keep its 7-day reverse repo rate unchanged at 3.50% at its meeting on Tuesday 25 May, in line with consensus. Since the last BI meeting on 20 April, IDR has firmed versus USD, notwithstanding weakness over recent days, while bond inflows have strengthened. Inflation remains low, with core CPI falling further in April. On the face of it, this gives more space for BI to cut, but we think there is limited impetus to do so. We continue to think BI will want to avoid provoking renewed pressure on IDR, while also wanting to maintain a relatively attractive yield to encourage inflows. On the data front, high frequency indicators are mixed while consumer confidence continues to improve. Separately, Indonesia has not seen a renewed surge in virus cases unlike some countries in Asia.

UOB: According to the Bloomberg poll (as of 21 May), it is a unanimous agreement among all the 13 economists polled for the central bank to keep the BI 7-Day Reverse Repo rate unchanged at 3.50%. We are of the view that BI has less room to trim its benchmark rate further. We keep our BI rate forecast to remain steady at 3.50% for the rest of the year.

MNI STATE OF PLAY: BI To Refrain From Cut As Rupiah Weakens

By Lachlan Colquhoun

SYDNEY (MNI) - Bank Indonesia is expected to leave the benchmark seven-day reverse repo rate unchanged at the record low of 3.5% despite economic weakness, with the volatile rupiah continuing to be a major factor in policy.

While accommodative monetary policy is needed to provide more stimulus for an economy still struggling to recover from the pandemic, BI is also seeking to protect the value of the rupiah, which it believes is still undervalued by around 10%, MNI understands.

A recent rally in the currency proved to be short-lived as the U.S. dollar appreciated. The rupiah has fallen more than 1.5% in recent weeks and is down over 3% so far this year, despite intervention from the central bank.

--GROWTH FORECAST

BI cut the benchmark rate by 25 basis points to 3.5% in February, after trimming it five times for a total of 125 basis points in 2020. The central bank also introduced a program of quantitative easing in 2020, buying government bonds direct on primary and also on secondary markets.

The bank has downgraded its growth forecast for 2021 to 4.1% from the previous 5.1%. GDP contracted by 0.74% in the first quarter of 2021, after shrinking 0.4% in the last quarter of 2020.

A decision from the Board of Governors' meeting is expected on Tuesday.