MNI Bank Indonesia Preview – September 2021

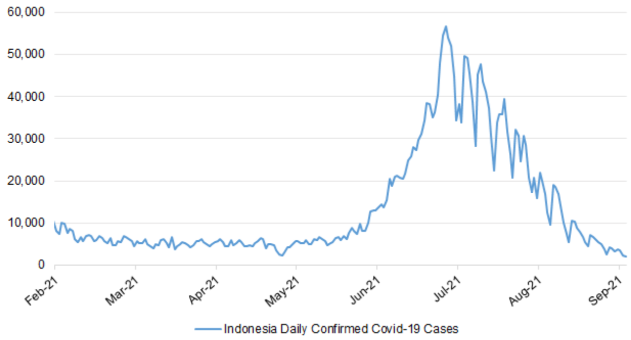
Announcement Date: Tuesday, 21 September 2021

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: Stabilisation Gives BI Some Breathing Space

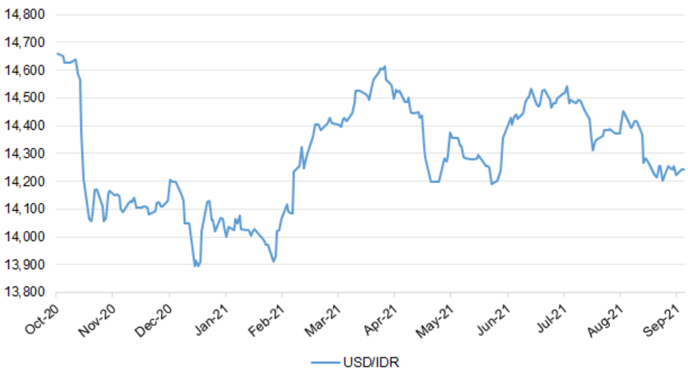
Bank Indonesia are expected to keep the 7-Day Reverse Repo Rate unchanged at 3.50% and the next move will likely be up but not quite yet. Governor Warjiyo has recently reiterated that the central bank has an exit strategy to gradually reduce liquidity through 2022 and then perhaps raise the policy rate "as early as the end of next year," leaving virtually all analysts expecting policy parameters to remain on hold for now.



Indonesia's once dramatic flare-up in Covid-19 cases has come under control, although questions surrounding the nation's underwhelming testing capacity remain. Nonetheless, the wave of infections which briefly made Indonesia a global epicentre of the pandemic has abated, opening the potential for easing restrictions. The government recently announced that Covid-19 rules in Bali will be relaxed, while Indonesian Health Minister flagged a planned opening of borders to foreigners in November.

The latest trade report was encouraging as exports rose to an all-time high, generating a record-breaking trade surplus. This surge in outbound shipments fuelled optimism about recovery prospects, as foreign appetite for Indonesian goods may help offset the drag on domestic consumption created by restrictions on activity imposed in response to the latest wave of Covid-19 infections. It may also help promote rupiah stability, taking some pressure off the central bank, who are known for paying close attention to foreign exchange.

The rupiah has indeed stabilised since the previous monetary policy meeting. The recent MNI INSIGHT piece (see the bottom of this document) noted that "BI sees the rupiah, which has travelled above the 14,000 level to the USD since February, as more stable than in 2013, when foreign investors stampeded out of the local share market and the currency plummeted". The relative calm on the foreign exchange front gives Indonesia's central bank some breathing space.



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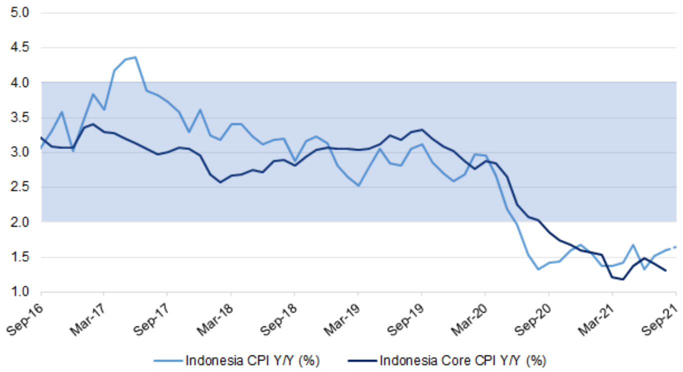

However, consumer-price inflation remains stuck below Bank Indonesia's target range. Difficulties with promoting acceleration in price growth warrants keeping monetary policy settings accommodative. In addition, high-frequency indicators suggest that the economy is struggling, as the latest reading of Markit Manufacturing PMI showed continued contraction in the sector, while the official gauge of consumer confidence deteriorated.

Nonetheless, Bank Indonesia's room for manoeuvre is limited by the talk of upcoming stimulus tapering from the U.S. Fed. In the current environment, policymakers can be expected to leave the 7-Day Reverse Repo Rate at its current accommodative level, while retaining preference for using macroprudential tools rather than outright interest-rate action if needed. Meanwhile, they will look to fiscal policy to do the heavy lifting, following an extension to the "burden-sharing" deal with the government through next year.

Going forward, much still depends on the trajectory of the global pandemic and factors including the potential emergence of more transmissible or vaccine-resistant variants. Should Indonesia manage to advance its inoculation campaign and work out an effective way of living with the virus, the local central bank will be able to proceed with their gradual exit strategy in 2022.

Bank Indonesia August Monetary Policy Decision:

The BI Board of Governors Meeting agreed on 18th and 19th August 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 exchange rate and financial system stability amid projected low inflation and efforts to revive economic growth. In addition, Bank Indonesia continues to optimise its policy mix towards maintaining macroeconomic and financial system stability, while supporting efforts to improve the national economy through the following policy measures:

1. Maintaining rupiah exchange rate policy to preserve stability in line with the currency's fundamental value and market mechanisms.
2. Continuing the strengthening strategy for monetary operations to reinforce the effectiveness of the accommodative monetary policy stance.
3. Nurturing intermediation by strengthening prime lending rate (PLR) transparency with an emphasis on PLR transmission to interest rates on new loans, particularly housing loans (Appendix).
4. Accelerating Quick Response Code Indonesia Standard (QRIS) uptake, including cross-border QRIS, and implementing the National Open API Payment Standard (SNAP) towards broader digital economic and financial integration.
5. Maintaining a seamless and reliable payment system, while supporting government programs through collaborative trials of social aid program (bansos) digitalisation and the Government Transaction Electronification program.
6. Promoting trade and investment as well as continuing to socialise the use of local currency settlement (LCS) in conjunction with other relevant institutions. In August and September 2021, Bank Indonesia will promote trade and investment in the United Arab Emirates, China, Australia, Sweden, UK, Singapore and Malaysia.

Bank Indonesia continues to strengthen policy synergy with the Financial System Stability Committee in terms of optimising implementation of the Integrated Policy Package to maintain financial system stability and stimulate lending to the corporate sector and other priority sectors, including micro, small and medium enterprises (MSMEs). Bank Indonesia will also strengthen policy coordination with the Government and other relevant authorities to revive economic growth, including monetary-fiscal policy coordination, export stimuli as well as economic and financial inclusion.

Sell-side comments:

ANZ: With the growth outlook improving, the pressure on the central bank to cut the policy rate has diminished. The domestic virus outbreak has eased significantly, giving the government scope to relax containment measures. This bodes well for economic activity, and mobility indicators are already picking up. Still, with growth risks still elevated, BI will want to maintain a “pro-growth” stance. Weak bank lending remains a concern, and BI’s focus is on improving the transmission of earlier policy rate cuts and turning to macroprudential tools. Notably, to improve lending for MSMEs and related entities, BI recently issued an inclusive financing rule that requires banks to allocate at least 20% of their loans to MSMEs in 2022, 25% in 2023 and 30% in 2024. Meanwhile, benign price pressures will give BI scope to keep policy accommodative for longer. Headline inflation in August remained weak at 1.59% y/y, and available survey data for September points to inflation staying below the central bank’s 2-4% target. With slack in the economy still significant, price pressures will remain benign for some time yet. A strengthening external position also reduces the urgency for BI to hike rates despite the anticipated tapering by the US Federal Reserve. Notably, Indonesia’s current account deficit fell to 0.1% of GDP in Q2 2021 on a four-quarter rolling basis from a peak of 3.1% of GDP in Q1 2019, and large trade surpluses in July and August suggest the current account deficit will remain very modest. Recent commodity price trends also continue to bode well for Indonesia’s external position, as do other structural tailwinds. Overall, our baseline scenario remains for BI to keep its policy rate unchanged at its current record low through 2021, with a firmer domestic economic recovery paving the way for a gradual rate normalisation cycle to kick off in the latter half of 2022

Barclays: Bank Indonesia is unlikely to adjust its policy rate in the near term, having pledged to keep its policy settings accommodative but being constrained from implementing further rate cuts by the more hawkish FOMC.

Goldman Sachs: We expect Bank Indonesia (BI) to keep policy rates unchanged at 3.50% at its meeting next week. A weak activity rebound despite some loosening in movement restrictions in August, subdued inflation pressures and IDR stability over the past few months have seen policymaker commentary begin to shift away from an emphasis on external stability and towards supporting growth. However, we do not expect BI to cut policy rates given the emphasis on other tools including renewed asset purchases to support the COVID fiscal response, macro-prudential policy easing and targeted efforts to encourage credit growth to businesses in priority sectors. Given our baseline of slower growth in the second half of 2021, still muted inflation and a conducive external environment, we recently pushed back our expectations for BI tightening, and do not expect BI to begin normalizing policy settings until Q2 2022 (from Q1 2022 earlier). Thereafter, we expect BI to start tightening liquidity conditions first, pushing effective rates back up towards the policy rate, from 75bp below the policy rate currently. Then as liquidity conditions return to neutral, we expect BI to start hiking policy rates – with a hike each in Q3 and Q4 2022.

Morgan Stanley: With the policy rate already at a record low, we expect BI to keep the policy rate on hold at 3.5% at the upcoming MPC meeting next week. Instead, what BI will likely focus more on, in our view, is improving the transmission mechanism of its monetary policy to allow previous policy rate cuts to be passed through to market-oriented interest rates. Besides, further policy rate cuts are also likely not required to the extent that current social distancing measures are already helping the domestic Covid situation stabilize, and vaccination rates could possibly reach ~82% of the adult population by year-end. In this context, and given the improving global backdrop and rising commodity prices, we expect the economy to show a more evident cyclical recovery towards year-end. On a separate note, the Fed’s impending policy normalisation may raise concerns about Indonesia, especially given Indonesia’s debt burden scheme for 2021/2022. However, disruptive rate hikes are not in our base case, as Indonesia’s macro stability indicators have mostly improved vs 2013, with the current account deficit less stretched, inflation lower, and real rate differentials vs. the US more comfortable. In our base case, we expect BI to be on hold through 2021, with a gradual lift-off in rates only in 2Q22as the growth recovery firms out.

NatWest: On Tuesday, we see Bank Indonesia unchanged rates at 3.50%, in line with consensus. BI will likely continue to emphasise support for the economy, after a sizeable hit to the economy over the middle of the year from COVID. Falling COVID cases and some progress with vaccinations are a silver lining. Gov Warjiyo has emphasised that rates are likely to stay unchanged until after the Fed hikes.

Société Générale: We believe that Bank Indonesia (BI) is done with its rate easing stance and will keep the policy rate unchanged at 3.5% while retaining accommodative stance. While supportive monetary policy prevented a precipitous drop in economic activity, the inadequate fiscal response failed to prevent weakening of the economic foundation. Luckily for the central bank, extremely benign inflation (thanks in main to official spending on subsidies, especially on energy) means that monetary policy normalisation is not on the cards, at least for now. However, we do expect the policy rate to rise next year as base effect-driven inflation perks up. We in fact are less constructive on Indonesia's medium-term growth prospects as monetary policy tightens (by end 2022) and Indonesia reverts to the 3% (of GDP) budget deficit limit in 2023.

TD Securities: We expect Bank Indonesia (BI) to continue with its accommodative stance, leaving the 7-day reverse repo rate unchanged at 3.5% on Tuesday, 21 September. Given the strict lockdowns in July and Aug, sentiment remains soft with the manufacturing PMI staying in contractionary territory (<50) while consumer confidence declined again in August. Encouragingly, daily COVID cases (7dma) continue to decline and are at YTD lows. This could translate to further easing in restriction measures and facilitate a quicker rebound in economic activity. Indeed, Google mobility data already point to activity recovering to around pre-lockdown levels (May'21). Given that state spending is likely to stay elevated into 2022, we think BI has reached the end of its easing cycle as fiscal policy takes center stage in supporting recovery.

UOB: With the current global developments, we are of the view BI has little room to trim its benchmark rate further. Nonetheless, BI will keep its accommodative monetary policy via other monetary, macroprudential, liquidity supporting measures to effectively transmit the lowering of benchmark interest rate so far into the economy.

MNI STATE OF PLAY: Stable Rupiah Reassures Bank Indonesia

By Lachlan Colquhoun

Bank Indonesia's Board of Governors are likely confident on a stable rupiah as a two-day monetary policy meeting starts on Monday that is expected to to hold the benchmark interest rate at the 3.5% level it has been for most of this year.

With the Indonesian economy beginning to open up after the pandemic, the central bank, or BI, is under little pressure to move on rates this month.

The rate decision will be announced late Tuesday local time.

The current settings are seen as accommodative and supportive for the economic recovery, and BI is unlikely to undermine the currency with another rate cut. The benchmark rate was cut by 150 basis points in 2020.

--GROWTH FORECAST CUT, INFLATION BENIGN

BI has cut its growth forecasts for 2021 several times this year and is now forecasting 3.5% to 4.3% growth for the year.

Inflation pressures continue to be benign, with the August print at 1.59% against BI's target of 2-4%.

BI has purchased another USD30 billion in Indonesian bonds direct from the government in August, has now purchased a total of USD87 billion in bonds since the pandemic began.

After these measures, the focus is now on transmitting the easy monetary policy through to the economy through financial inclusion, prudential measures and digital innovation.

BI Governor Perry Warjiyo has effectively ruled out a rate rise this year, which also suggests the bank has no intention of cutting rates further. While the next move in Indonesian interest rates is likely to be up, that is not likely to be considered until 2022.

MNI INSIGHT: Little Choice For Bank Indonesia In Funding Gov't

By Lachlan Colquhoun

Indonesia's central bank is confident that its recent direct purchase of another USD30 billion of government bonds will both support domestic economic recovery and also reduce the risk of a debt sell-off by foreign investors which would weaken the currency, MNI understands.

Last week, Bank Indonesia and the Finance Ministry announced the purchase of another USD30 billion in government bonds, the third time the central bank has bought debt directly during the pandemic period. The Bank purchased USD57 billion in bonds last year in what it said was a one-off move.

The purchases have been called "burden sharing" by Bank Indonesia and the Finance Ministry but have raised concerns about policy credibility and the monetisation of debt.

MNI understands that the Bank recognises that the increasing scale of direct bond purchases has the potential to undermine confidence in Indonesia's sovereign debt, but points to high levels of foreign ownership of government bonds - at over 30% - as a sign that investors understand and have confidence in the market.

Bank Indonesia also calculates that the bond purchases will limit the impact of any tapering of U.S. bond purchases and so stabilise the rupiah. It sees the impact on inflation as muted, or delayed until 2023, with the 2021 forecast at between 2% and 4%.

--BANK AWARE OF INDEPENDENCE CONCERNS

This eases pressure for any rise in the benchmark interest rate, which has been held at the record low of 3.5% after 150 basis points in cuts last year.

Governor Perry Warjiyo has said policy is likely to remain accommodative this year, effectively ruling out a rate rise.

With the Indonesian economy re-opening slowly after being closed since June, the central bank has revised its 2021 growth forecast down on several occasions. It is now at 3.5%.

The central bank sees an economic recovery as the ultimate test of the "burden sharing" policy, but it is aware of perceptions that its independence is being eroded by the direct bond purchases, as well as potentially by a bill before the Indonesian Parliament which would give the government more control over the central bank. Debate on that bill has been postponed and is not likely to resume until next year.

With the government's ambitious USD400 billion infrastructure plan and recovering interest from foreign investors in local equities, Bank Indonesia believes that it has little choice now but to play a role in funding fiscal policy at low interest rates while it hopes for no further resurgence of the pandemic.

MNI INSIGHT: Bank Indonesia Is Confident On Pandemic Recovery

Lachlan Colquhoun

Indonesia's central bank is becoming increasingly confident that the economy can navigate its way out of the pandemic lockdowns and into the recovery phase without any significant changes to existing monetary policy, MNI understands.

Key to the optimism is the view that Bank Indonesia, or BI, can avoid a shock from any "taper tantrum" as the Federal Reserve tightens monetary policy, although U.S. inflation has yet to gather great momentum.

MNI understands that BI sees the rupiah, which has travelled above the 14000 level to the USD since February, as more stable than in 2013, when foreign investors stampeded out of the local share market and the currency plummeted.

BI's benchmark interest rate was held steady at the last meeting at 3.5%, after cuts of 150 basis points last year, and there is currently little pressure for change.

Governor Perry Warjiyo has said that policy was likely to remain accommodative this year, effectively ruling out a rate rise, a view supported by the current relative stability of the currency.

With the economy opening, there is also little immediate pressure for further cuts, with the likely result that BI is likely to maintain its current settings in the expectation that the recovery will kick in and take the economy into a brighter 2022.

--INFLATION, GROWTH

Adding to the positive outlook is low inflation, which printed at 1.59% in August well under the BI tolerance level of 2% to 4%.

GDP figures for the second quarter showed a return to growth of 7.07% after contracting by 0.71% in the first quarter, and while Bank Indonesia has revised its annualized growth forecast lower this year down to between 3.5% to 4.3% the bank would be satisfied with this result.

Also helping the economy has been BI's program of quantitative easing, with the bank purchasing another USD30 billion directly from the Government in August, after purchasing USD57 billion last year.

BI is aware that direct purchases may be seen as controversial, but believes the benefits of supporting the nation's economic recovery during the pandemic are necessary to prevent economic scarring.

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