All Signal, No Noise

MARKET ANALYSIS

MNI Bank Indonesia – May 2022

Announcement Date: Tuesday, 24 May 2022

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

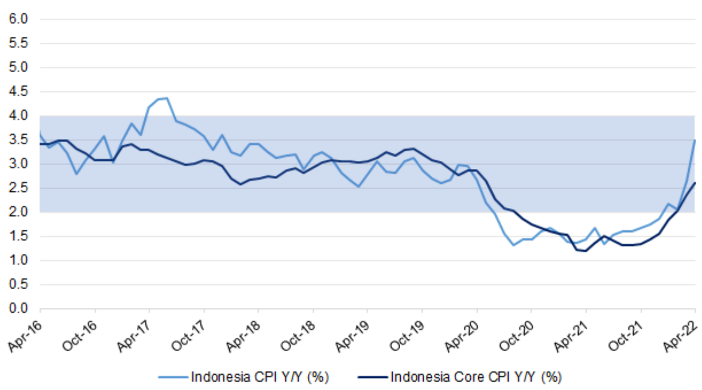
Link To Rate Decision: https://www.bi.go.id/en/statistik/indikator/bi-7day-rr.aspx

MNI Point of View: Governors To Stand Pat, But Tightening Risk Grows

Bank Indonesia meets this week against the backdrop of global inflationary shocks which have encouraged a growing flock of policymakers to start withdrawing pandemic-era monetary stimulus. While sharp rupiah depreciation and bubbling inflationary pressures breathe into policymakers' necks, there is a good chance that the Board of Governors delays tightening policy in a bid to make sure economic recovery does not lose steam.

Rupiah stability is a known key focus of Bank Indonesia. It is measured across a range of indicators, which include the rupiah's exchange rate to the U.S. dollar, 10-year government bond yield spread with the U.S., 5-year credit default swap premium and foreign capital flows. In parallel, Bank Indonesia is tasked with guarding the stability of domestic prices and keeping inflation in check.

After a period of generally rangebound price action in the first few months of the year, spot USD/IDR rallied sharply in the weeks after Bank Indonesia's April meet, reaching levels not seen since October 2020. The move was facilitated by broader demand for the greenback amid the Fed's continued signalling of resolve in fighting inflation. Meanwhile, the rupiah has faced some headwinds from on-and-off restrictions on shipments of crude palm oil and processed products, Indonesia's key export commodities. And the broader environment has not been favourable to Asia EM currencies, as China's COVID-19 outbreak, Russia's invasion of Ukraine and the prospect of further aggressive hikes from U.S. Fed have discouraged investors from exploring opportunities in developing economies.



The shaded region represents Bank Indonesia's target range.

With regard to domestic prices, the situation seems to be under control, at least on the surface. Inflation remains within the target range (+2.0%-4.0% Y/Y). Headline CPI growth printed at +3.47% Y/Y in April, while core prices rose 2.60% Y/Y, staying below the target mid-point. It is the trend, not the most recent reading, that might be worrying from Bank Indonesia's perspective. The rate of consumer price growth has picked up substantially over the last few months, reaching the fastest pace since December 2017, narrowing the scope for Bank Indonesia to keep monetary settings accommodative. In addition, the central bank's survey data flags potential for further acceleration this month.

Comments from Bank Indonesia officials were indicative of a general inclination to avoid rushed rate hikes if possible. Deputy Governor Destry Damayanti told a G20 forum last month that the central bank could further increase the RRR, using interest rate hikes "at the end of all our instruments (…) if all our instruments are not enough to handle the inflation problem." These remarks came virtually on the heels of Bank Indonesia's "on hold" decision, justified by the assessment that inflation remained "manageable." After that decision, Governor Warjiyo told investors that another RRR hike might be enough to fend off inflationary pressures and put core inflation in the spotlight, noting that its sharp acceleration this year could lead to an eventual rate hike.

Rhetoric pointing to preference for liquidity management over interest-rate action would complicate Bank Indonesia's task when it comes to communicating a rate hike, especially that core inflation remains below the mid-point of the target range. We believe that a stand-pat decision is more likely this week, but we expect the Board of Governors to lay the groundwork for a potential rate hike in June. At the same time, a pre-emptive rate hike as soon as this week cannot be entirely ruled out, although we perceive such a scenario as hawkish.

Bank Indonesia April Monetary Policy Statement:

The BI Board of Governors Meeting agreed on 18th and 19th April 2022 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 stability and control inflation, together with efforts to revive economic growth despite a build-up of external pressure, particularly the geopolitical tensions between Russia and Ukraine as well as sooner-than-expected monetary policy normalisation in advanced economies. Bank Indonesia continues to optimise its policy mix strategy to maintain stability and safeguard economic recovery momentum through the following policy measures:

1. Strengthening exchange rate policy to maintain rupiah stability in line with market mechanisms and economic fundamentals.
2. Maintaining an accommodative macroprudential policy stance by holding: (i) the Countercyclical Capital Buffer (CCyB) at 0%, (ii) Macroprudential Intermediation Ratio (MIR) in the 84-94% range, (iii) Macroprudential Liquidity Buffer (MPLB) at 6% with 6% repo flexibility and the Sharia Macroprudential Liquidity Buffer at 4.5% with 4.5% repo flexibility.
3. Maintaining prime lending rate transparency in the banking industry with a focus on sources of operating income in the banking industry.
4. Ensuring adequate availability of currency fit for circulation, maintaining seamless currency distribution and prime cash services, while preparing BI-FAST implementation during the holy fasting month of Ramadan and Eid-ul-Fitr 1443H.
5. Raising the maximum deposit limit for registered electronic money from Rp10 million to Rp20 million and the monthly transaction limit from Rp20 million to Rp40 million, effective from 1st July 2022.
6. Strengthening international policy by expanding cooperation with other central banks and international organisations, promoting trade and investment in conjunction with the relevant institutions as well as ensuring the success of the six priority agendas in the Finance Track of Indonesia's G20 Presidency in 2022 in conjunction with the Ministry of Finance.

Bank Indonesia also remains committed to strengthening policy synergy with the Government and Financial System Stability Committee to control inflation, maintain monetary and financial system stability as well as revive lending to the corporate sector and other priority sectors to foster economic growth, stimulate exports and increase economic and financial inclusion.

Click here to see the full statement.

Sell-side comments:

ANZ: Recent economic and financial market developments support the case for Bank Indonesia's rate lift-off to come as soon as this week. First quarter GDP data show the economy is on track to achieve the central bank's 4.5–5.3% growth forecast this year, and high frequency data suggest that economic activity picked up in Q2 amid further economic reopening. Headline inflation surprised to the upside in April and has now breached the midpoint of BI's 2–4% target band for the first time since 2019. The breakdown also points to broadening price pressures. Admittedly, BI's policy messaging has signalled that core inflation will be the key trigger for a rate hike. While inflation has been picking up, the latest April print of 2.60% y/y suggests scope for a little more patience. However, we note that recent surveys point to a further rise in price pressures in May, adding to the case for a pre-emptive move. The external environment has become even more challenging. The rate-hiking trend is accelerating both at the global and regional levels, with the central banks of India and Malaysia among the latest to join the bandwagon since BI's last meeting. While the IDR has been pretty stable in the first four months of the year, it has since started to come under material pressure. These developments add impetus for BI to move sooner rather than later given its priority on stability. Even if BI opts to hold the trigger in May, its policy messaging is likely to turn more hawkish. The absence of a change in stance and a prolonged delayed to its rate lift-off could risk undermining investor confidence.

Barclays: While the recent weakening of the IDR has raised the risk of a 25bp rate hike at the upcoming 24 May monetary policy meeting, our base case is for Bank Indonesia (BI) to leave its policy rate unchanged – such an increase is more likely in June, in our view. Instead, we expect the central bank to announce additional hikes to the reserve requirement ratio (RRR), taking it to 8.0% by the end of this year – BI has so far announced that the RRR will rise to 6.5% by September.

Goldman Sachs: We expect Bank Indonesia (BI) to keep the 7-day reverse repo rate unchanged at 3.5% in its meeting next week, in line with consensus. While growth has started to show firmer recovery and inflation accelerating, the core inflation – which is BI's preferred metric— remained within the central bank target range of 2-4% in April. We expect BI to hike 50bp in Q3 and 75bp in Q4 for a total of 125bp of hikes this year and another 100bp of hikes in H1 2023. However, we acknowledge some risk that BI may start to normalize policy earlier than our expectation (i.e. hike by 25bp this coming week), given the ~2% depreciation point-to-point in USDIDR since the April meeting, although this is not our base case.

ING: Bank Indonesia (BI) will likely keep rates unchanged at the 24 May meeting although expect BI Governor Perry Warjiyo to whip out a "hawkish pause". A blowout trade surplus recorded in April gave BI some breathing room but the central bank may need to consider tightening in the near term. Expect BI to keep rates unchanged while setting the table Economic and Financial Analysis 20 May 2022 Article for a rate hike at the June meeting.

Scotiabank: A minority of forecasters expect Bank Indonesia to hike its 7-day reverse repo rate by another 25bps on Tuesday. Most expect a hold at 3.5%. Headline inflation is running at 3 ½% y/y and core CPI inflation is at 2.6% y/y, both well within the 2–4% headline target range. As such, there is no pressing urgency to adjust policy, right? Maybe not so fast. As the Federal Reserve has turned increasingly hawkish, the effect has been to depreciate the rupiah that has lost almost 3% over about the past month. Concern over financial stability and imported inflation may prompt earlier tightening than it had guided at its prior meeting.

Société Générale: We expect BI to keep the policy rate at 3.5% at its May meeting but to embark on a tightening cycle from June, when inflation will likely be within touching distance of BI's upper tolerance level of 4.0% after having hit 3.5% yoy in April, a 52-month high. Importantly, the WPI already crossed 4.0% in April. Worryingly for Indonesia, food prices apart, rising transportation costs reflecting sharp upward adjustments in administered fuel prices indicate a long runway for second-round effects. We now bring forward our BI rate hike expectation from 3Q22 to 2Q22 and expect a 25bp hike in the 7-day reverse repo rate during the June meeting. Also, with average headline CPI growth likely to print at 4.6% yoy for 2H22, we expect two more rate hikes (50bp in 3Q22 and 25bp in 4Q22), taking the cumulative hike in 2022 to 100bp versus our earlier expectation of 50bp. We expect a more aggressive BI, especially during 2H22, as it needs to prepare the economy for the consequences of it exiting its debt monetisation programme from 2023 and commodity prices turning around - the programme and commodity prices have provided major support to the currency and bond yields in 2022.

TD Securities: We expect BI to hike by 25bps next week contrary to consensus expectations. Given its focus on FX stability, we think the rapid weakening of IDR against the USD, albeit partially attributed to the recent strength of the USD, could warrant a response from BI. Coupled with a worsening inflation outlook, we think BI will kickstart the hiking cycle with a pre-emptive hike.

UOB: We are with the majority and continue to hold our forecast that BI will hold its benchmark rate unchanged in 1H22 and to start hiking only in Jul 2022.