Indonesia Economic Briefing

BI Rate: stay as CAD improving

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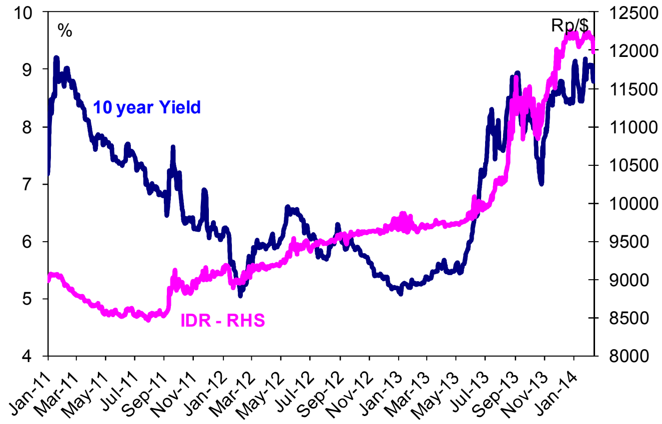
BI Rate maintained at 7.5%

- **Today, as expected, BI decided to maintain the benchmark policy rate at 7.5%,** on the back of positive fundamental economic data and improving external environment. However, this year, BI will maintain tight monetary stance and will remain vigilant as uncertainties lingers particularly on the normalization of Fed's policy and China's slowdown. **The deposit facility rate unchanged at 5.75% while the lending facility rate stayed at 7.5%.**
- Economic data continued to show positive result. BI seemed quite confident on the pace of adjusment in the external balance, as the CA deficit showed a favorable improvement in Q4. GDP growth slowed moderately and particularly driven by slowdown in investment while consumption is still relatively strong. The growth slowdown was better than expectation, and was more apparent on the investment, that was partly reflected in the contraction of the capital goods imports. This has brought a significant adjustment in the CA deficit in Q4.
- In 2013, overall imports was down by -2.6%yoy (particularly driven by the contraction in the capital goods), while exports contracted deeper at -3.9%yoy (the statistics office data). However **the trade performance was better than expected particularly in Q4, where exports grew quite strong and led to a significant improvement in the CA deficit to -1.98% of GDP (from previously at 3.9% of GDP in Q3, and 4.4% of GDP in Q2).** BI underlined the improvement in the manufacture exports that showed a greater improvement supported from the increasing demand from the US and Japan. BI confident that the continued improvement in this sector should be able to offset the impact of the raw mineral exports ban this year.
- **This led to an overall full year CA deficit at 3.26% of GDP (details to be released tomorrow), better than our previous expectation at 3.5% of GDP.** On the investor's conference call held this afternoon, BI share some details on the balance of payment data that will be released tomorrow. The 4Q CA deficit reached around USD4bn which was covered by the significant surplus in the financial account at around USD9.2bn, thus resulted in a overall balance of payment surplus of around USD4.4bn. Financial account surplus was still supported by inflows of FDI, portfolio and overseas deposits coming to Indonesia. **BI also quite confident that the improvement of the CA deficit will continue this year and expect the CA deficit will fall further to its sustainable level at around 2.5% of GDP.**
- **BI sees the GDP growth in 2014 will likely be at the lower end of 5.8-6.2%**, as interest rate hike impact is usually lasts around 6-12 months after. Credit growth was seen slowing down to 21.4%yoy in Dec (from prev. month at 21.9%yoy) or equal to 17.4%yoy if excluding the impact of the rupiah depreciation. **BI expects credit growth to come down further to around 15-16%yoy in 2014** while noting that credit growth in the annual business bank's plan this year was still higher than BI's expectation. Thus BI will coordinate with the financial services authority (OJK) to direct the credit growth to be in line with the growth moderation.
- **Meanwhile BI sees inflation remained on track 3.5-5.5% in 2014 and 3-5% in 2015**, despite the upside risk from the recent floods disaster. BI expects year-end forecast to be below 5%, broadly in line with our expectation at 4.9%yoy.

Market and Policy Implications

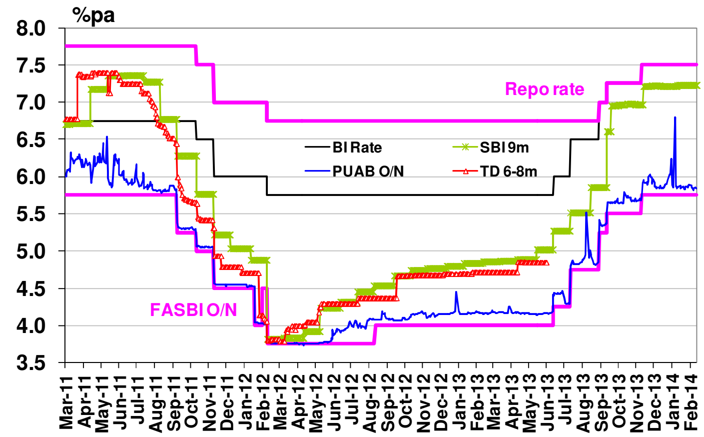
- **The positive outcome in the CA deficit brought positive impact on the rupiah.** The rupiah already gained 1.8% and reached below Rp12,000/USD ahead of BI rate decision today, and may continue to strengthen as confidence improved. Bond yield (10-yr benchmark) has declined to 8.8% (from as high as 9.1% this month). External environment was also supportive after Fed's chair Janet Yellen's positive tone on her first testimony yesterday. However we are still cautious on some downside risk on the rupiah i.e. the development of the trade data, particularly on the exports side and the remaining fluctuative data on US and China's economy. We may see some impact of the partial ore exports ban on the January-February trade data (released in March and April), though we think the impact would be relatively low, as ore exports only accounted of around 3.5% of total exports. Although the impact may not be very large, a swing in the trade balance could affect confidence and bring back pressure on the rupiah. Meanwhile risk of fund outflows is still there as US and China economic data are still fluctuating.
- **Inflation should still be on track in the central bank's target at 3.5-5.5% this year, even though we noted some upside risks** i.e. impact of disruption on distributions due to floods in many regions and potential impact of possible electricity rate hike this year. We still maintain the inflation forecast to reach 4.9%yoy by year end.
- Therefore, we think BI will still be focusing on stabilizing the rupiah amid subdued inflation. This year's policy direction will still be tight, thus we have not rule out the chance of a rate hike, and still expect another 25bps rate hike, especially if external sentiments worsen and affect the rupiah. Nevertheless, we are still optimistic that sentiments will improve in the second half as we expect positive result on the election and continued improvement in the economic data (CA deficit). **We maintain our forecast that the rupiah could strengthen to around Rp11,058/USD by year end.**
- BI continued its efforts to deepen the domestic financial market and improve liquidity. This afternoon, BI extends the mini MRA to include 38 more banks to push further the domestic repo market. Since the mini MRA issued, BI stated that there has been an increase in the size of repo market transaction to around Rp25tn.

Chart 1. Rupiah (IDR) vs 10 Yr Bond Yield



Source: Bloomberg

Chart 2. Interest Rate



Source: Bloomberg

Indonesia: Selected Economic Indicators

	2010	2011	2012	2013E	2014E	2015E
National Accounts						
Real GDP (% y-o-y)	6.2	6.5	6.2	5.8	5.7	6.2
Domestic demand ex. inventory (% y-o-y)	5.3	5.7	6.2	5.1	5.5	5.7
Real Consumption: Private (% y-o-y)	4.7	4.7	5.3	5.3	5.2	5.4
Real Gross Fixed Capital Formation (% y-o-y)	8.5	8.8	9.8	4.7	4.0	6.8
GDP (US$bn) — nominal	710	845	879	871	925	1,086
GDP per capita (US$) — nominal	2,986	3,509	3,596	3,490	3,640	4,215
Open Unemployment Rate (%)	7.1	6.6	6.1	6.3	6.1	6.1
External Sector						
Exports, fob (% y-o-y, US$ bn)	32.1	27.0	-6.1	-4.6	4.2	6.0
Imports, fob (% y-o-y, US$ bn)	43.7	30.3	8.4	-1.1	3.5	4.2
Trade balance (US$ bn)	30.6	34.8	8.6	2.0	3.3	6.8
Current account (% of GDP)	0.7	0.2	-2.7	-3.5	-2.9	-2.4
Central government debt (% of GDP)	26.1	24.6	23.1	22.0	21.2	22.2
International Reserves –IRFCL (US$ bn)	96.2	110.1	112.8	99.4	100.0	103.5
Reserve Cover (Months of imports & ext. debt)	7.1	6.3	6.1	5.4	5.6	5.8
Currency/US$ (Year-end)	8,991	9,068	9,670	12,189	11,058	10,754
Currency/US$ (Average)	9,085	8,779	9,380	10,428	11,605	10,770
Other						
BI policy rate (% year end)	6.50	6.00	5.75	7.50	7.75	8.00
Consumer prices (% year end)	6.96	3.79	4.30	8.38	4.94	4.61
Fiscal balance (% of GDP; FY)	-0.73	-1.14	-1.77	-2.24	-1.80	-2.00
S&P's Rating – FCY	BB	BB+	BB+	BB+	BB+	BB+

Source: CEIC, *Danamon Estimates

Economic and Market Research

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