

Indonesia Economic Briefing

Monetary Policy Review: How Low Can They Go?

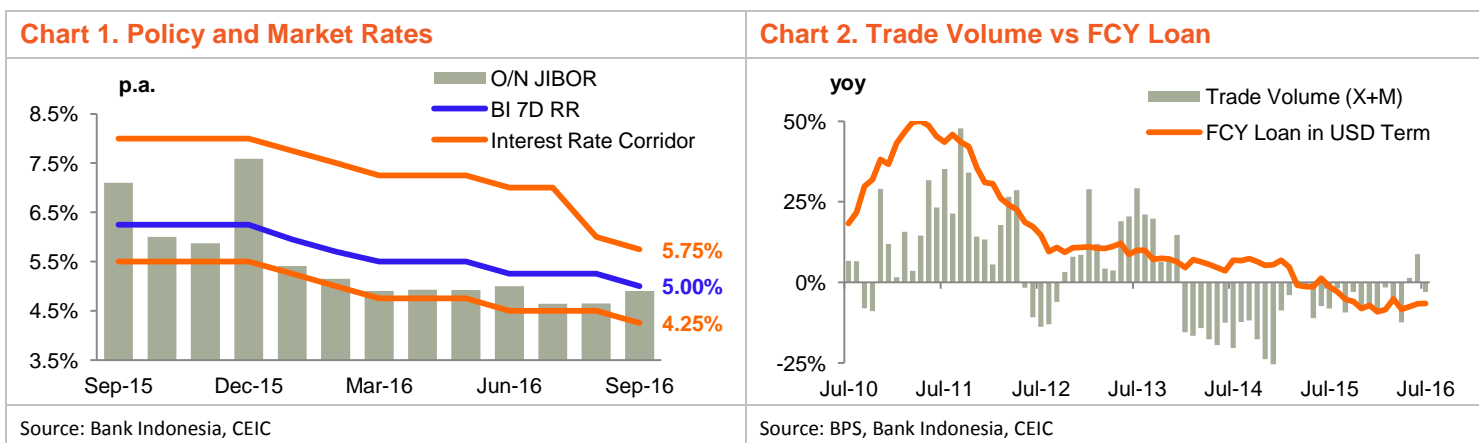


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- As expected, today **Bank Indonesia has decided to cut its key policy rates by 25bps**. BI 7-Day Reverse Repo rate now stands at 5.00% whilst Deposit and Lending Facility at 4.25% and 5.75%, consecutively. The move also narrowed the gap between one week reverse repo with overnight interbank, which currently yields 4.90%, as an effort to shift banks' access liquidity from the central bank to the market (*please see Chart 1*).
- Aside from the overall macro stability, we believe judgments behind the additional stimulus are twofold. Firstly, **global economic prospects are becoming less bright for this year and the next**. The central bank now sees global growth at around 2.9%-3.0% vs 3.1%, previously. With that in mind, then we can also expect that global trade volume may be dragged along with it, as indicated in our previous report on *Aug-16 Trade: A Delicate Balance*.
- Our second judgment refers to the impact of shrinking trade volume towards domestic economy. From Chart 2, we can comprehend that **less trading activities (export and import) leads to less demand for FCY loan**. It partially explains why there has been lack of credit demand in the banking sector, since LCY loan still grew at a modest pace of 3.4% ytd. The silver lining from both arguments is that future growth engines rely on domestic consumption and investment, which need to be supported by low interest rates. With a caveat lying in the undervaluation of Rupiah to keep current account in check.
- Now the-billion-dollar-question remains on: **how low can the benchmark rate go?** BI's rule of thumb is that policy rates should be around 50bps above inflation during expansion mode and 150bps during contraction mode (Danamon's inflation forecast for 2016 is 3.2% and 3.7% in 2017). Please note that the gap between FasBI rate and 12M inflation outlook have closed the target. Hence, our baseline scenario of maintained rates until the end of the year.
- Furthermore, given the urgency of both global and domestic situations, we believe the following alternate policies are worth to put forth: **1) flattening the belly and end of term structure, and or 2) narrowing the symmetrical interest rate corridor from currently 75bps to 50bps**. Either way, we're comfortable with the fact that monetary policymakers still have some tools reserved for a rainy day.

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Indonesia: Selected Economic Indicators

	2011	2012	2013	2014	2015	2016E
National Accounts						
Real GDP (% y-o-y)	6.2	6.0	5.6	5.0	4.8	5.0
Domestic demand ex. inventory (% y-o-y)	6.1	7.7	5.0	5.4	3.9	5.0
Real Consumption: Private (% y-o-y)	5.1	5.5	5.4	5.2	5.0	5.1
Real Gross Fixed Capital Formation (% y-o-y)	8.9	9.1	5.0	4.6	5.1	4.8
GDP (US\$bn) — nominal	893	918	915	890	862	893
GDP per capita (US\$) — nominal	3,688	3,741	3,668	3,530	3,374	3,453
Open Unemployment Rate (%)	6.6	6.1	6.3	5.9	6.2	6.0
External Sector						
Exports, fob (% y-o-y, US\$ bn)	29.0	-6.6	-3.9	-3.4	-14.8	-7.5
Imports, fob (% y-o-y, US\$ bn)	30.8	8.0	-2.6	-4.5	-19.9	-6.9
Trade balance (US\$ bn)	26.1	-1.7	-4.1	-1.9	7.6	6.1
Current account (% of GDP)	0.2	-2.7	-3.7	-3.2	-2.1	-2.3
Central government debt (% of GDP)	22.3	22.3	21.3	23.6	25.0	24.6
International Reserves –IRFCL (US\$ bn)	110.1	112.8	99.4	111.9	105.9	103.0
Reserve Cover (Months of imports & ext. debt)	6.3	6.1	5.4	6.5	7.4	7.0
Currency/US\$ (Year-end)	9,068	9,670	12,189	12,440	13,795	13,400
Currency/US\$ (Average)	8,779	9,380	10,428	11,900	13,392	13,360
Other						
BI policy rate (% year end)	6.00	5.75	7.50	7.75	7.50	6.50*
BI 7-Day Reverse Repo rate (% year end)	N/A	N/A	N/A	N/A	6.25	5.00
Consumer prices (% year end)	3.78	3.65	8.08	8.36	3.35	3.20
Fiscal balance (% of GDP; FY)	-1.14	-1.77	-2.24	-2.26	-2.70	-2.50
S&P's Rating – FCY	BB+	BB+	BB+	BB+	BB+	BB+

Source: CEIC, E = Danamon Estimates, *) Up to August 2016

Economic and Market Research

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