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Indonesia Economic Briefing

Independency of Monetary Policy and Enhanced Cooperation

Danamon
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We attended a 1-day seminar of Central Banks in the Emerging Market East Asia Pacific region, held jointly by Bank Indonesia and the Federal Reserve Bank of New York. Discussion was mainly between governors of central banks in the region, with an addition of the Fed, IMF, and Switzerland. Below are the salient points of the conference:

- Background of this seminar was threefold: 1) how central banks **manage financial volatility and ripple effects in response to the helicopter money** that had been flushed, 2) how **monetary policy can help stimulate growth**, and 3) how do **monetary authorities keep their independency** while doing so. To better understand the issue, it is worth noting that the structure of an economy is limited to an "Impossible Trinity Trilema", basically stating that no one can have it all at the same time (*please see Chart 1*).

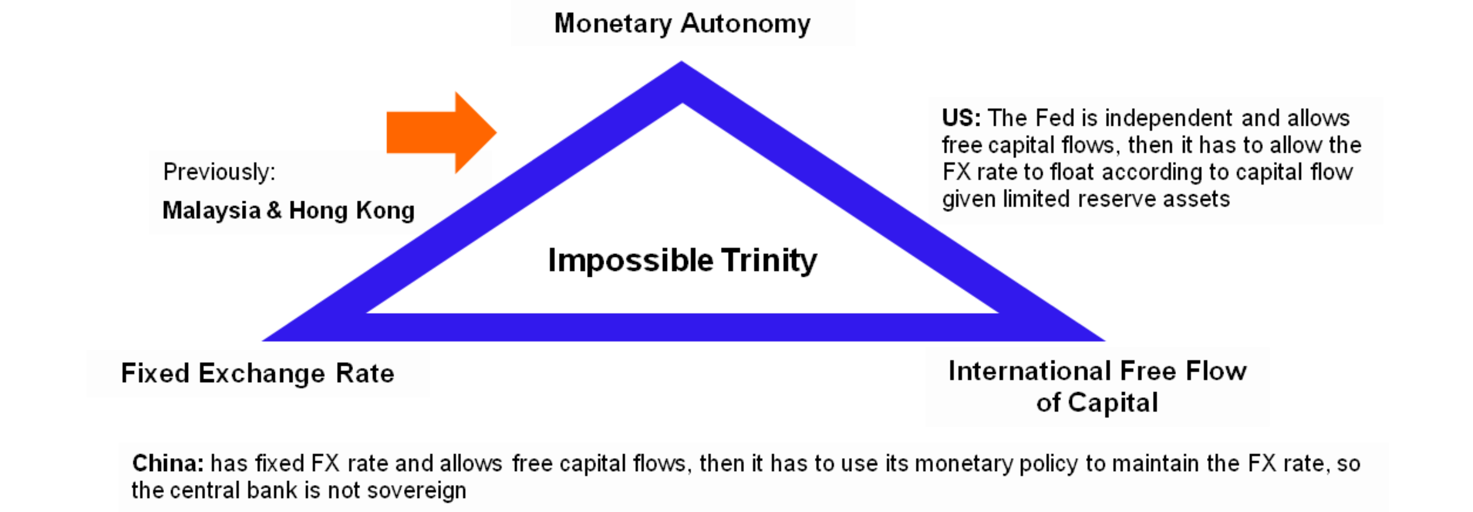
- **Major central banks in advanced economies decided for monetary easing** in response to the 2008 global financial crisis, with some topping it off with Quantitative Easing while others dare to go below zero interest. By traditional theory, this was supposed to cause capital outflows and currency depreciation due to narrowing interest rate spread, thus leading towards a more competitive export pricing. But the fact of the matter is, for some countries like Japan and Switzerland that has low foreign debt to GDP ratio, money has actually been coming in as funds seek for safe haven placements (*please see Chart 3*).

- Emerging Markets face a different kind of issue. With the sudden flood of capital and low interest rates post 2008, EM countries sought the opportunity to boost growth by tapping into the global financial pool. This leads to an **increasing corporate external debt and heavy potential of refinancing** for the next 4 years (*please see Chart 4*). Off course, now, global liquidity has tightened and US interest rate is on an uptrend.

- The central bankers intriguingly shared a common view whereby **spillover effects from global financial market turbulence has to be managed and taken into account in monetary policy decision making**. In spite of the common ground, proposal for a more coordinated policy between countries had raised concerns from several decision makers that domestic interest should and will be prioritized. Hence, they opt to enhance cooperation and share unique policy experiences that can be adopted by other members.

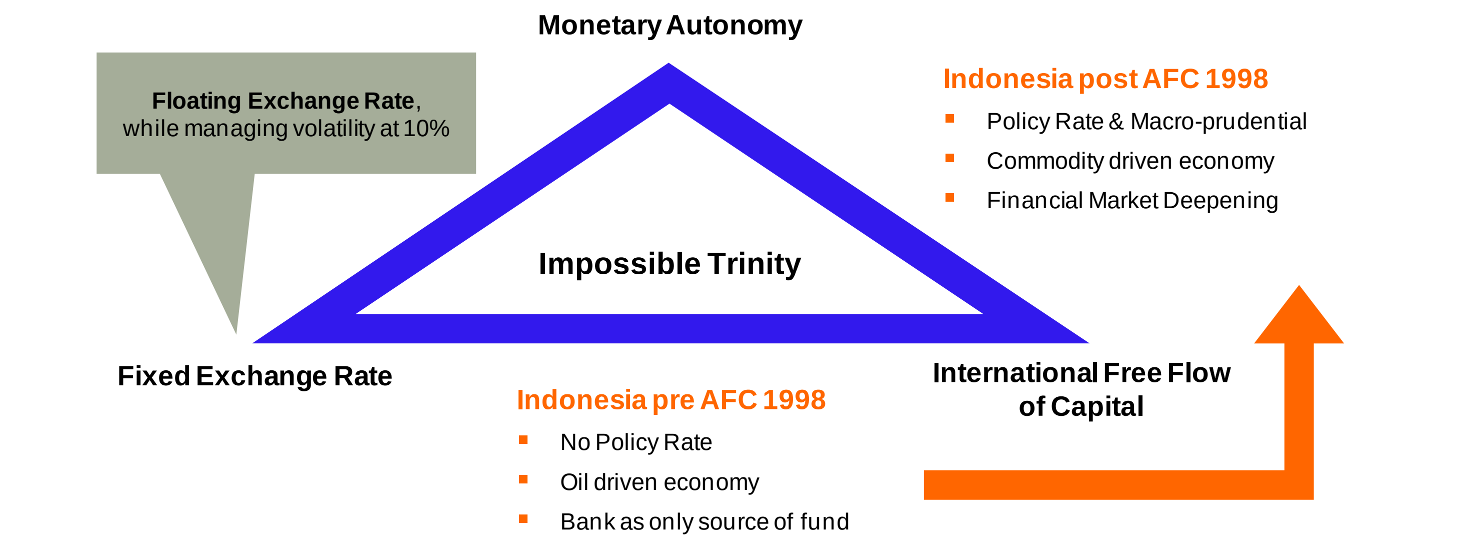
- What was interesting to see is that **the Fed and Bank Indonesia were considered as benchmarks of success** in terms of navigating the economy amid global uncertainty. The first succeeded to ramp up growth by lowering interest rate and quantitative easing in a demand-pulled inflation environment. Whilst the latter succeeded in an economy that has a supply-pushed inflation through a more conservative stance and macro-prudential measures (to keep the money within domestic borders with minimal excess to asset quality). This is despite both countries having similarity in economic drivers whereby domestic demand is larger than trade and service sectors over manufacturing. We believe it comes down to how much monetary policymakers understand the characteristics of the economy that they manage, including the behavior of each economic player.

Chart 1. The Impossible Trinity Trilema



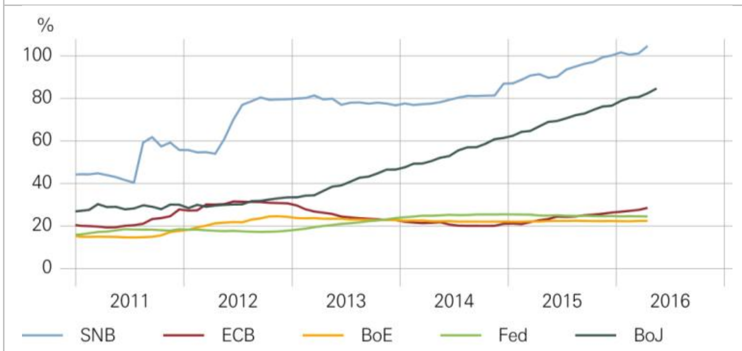
Source: Mundell-Fleming, Various Literatures

Chart 2. The Case of Indonesia: Economic Structure had Shifted Post AFC 1998



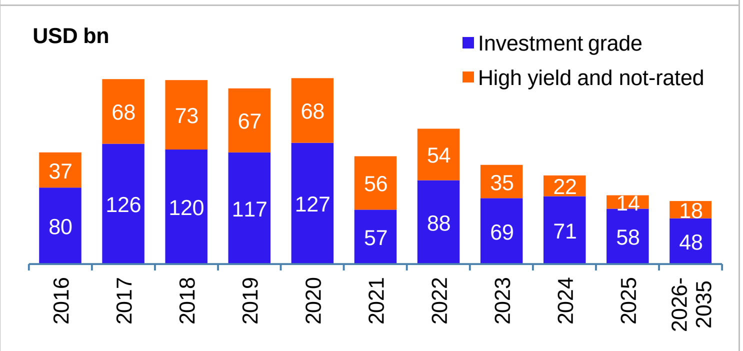
Source: Bank Indonesia, Various Literatures

Chart 3. Central Banks' Asset to GDP



Source: BIS, Bloomberg, Swiss National Bank

Chart 4. Maturity of Corporate External Bonds in EM



Source: IMF

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	6.25*
BI 7-Day Reverse Repo rate (% year end)	N/A	N/A	N/A	N/A	6.25	4.75
Consumer prices (% year end)	3.78	3.65	8.08	8.36	3.35	3.94
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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