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Indonesia Economic Briefing

All Hands on Deck

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- Against expectation, today **Bank Indonesia cut its key policy rates by 25bps.** BI 7-Day Reverse Repo rate now stands at 4.50% whilst Deposit (FasBI) and Lending Facility at 3.75% and 5.25%, consecutively. The decision was made to support softer than anticipated economic growth, without changing their monetary stance from neutral position. The monetary operation term structure will follow suit, thus lowering the cap for banks' deposit rate, accordingly.

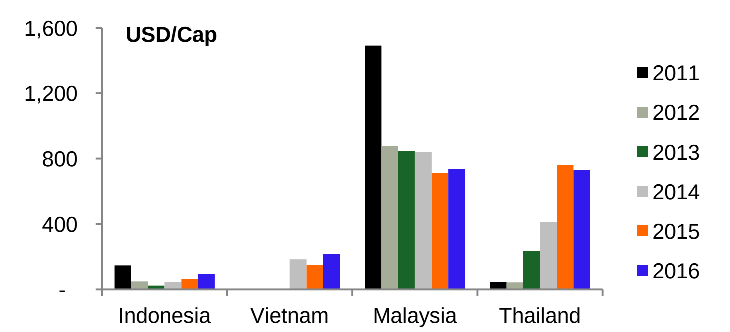
- Reasons behind the move were: 1) **subsiding inflation pressures** -the central bank expects that headline inflation will be around 4.0% in 2017 and below 3.5% in 2018-, 2) **manageable external account** with Current Account Deficit in the range of 1.5%-2.0% in 2017 and 2.0%-2.5% in 2018, 3) **milder than expected Fed Funds Rate hike**, and 4) **to stimulate loan growth** as the target was revised down from 10%-12% to 8%-10% for this year. Given the inflation outlook and current stance of policymakers, room for further easing lies ahead in the absence of global volatility.

- Aside from monetary easing, **BI is also in the midst of preparing other macro-prudential stimulus** that included: 1) submitting corporate bonds into banks' Loan-to-Funding calculation so that funds may be channeled to securities and not just through loan, 2) a spatial Loan to Value ratio for property and vehicles, depending on which region. Monetary policymakers have detected that economic laggards were in the Islands of Java, Borneo, and Celebes. As such, LTV ratio may vary within these regions to help spur demand.

- Our sense on today's announcement was more to address **what can be done rather than what needs to be done**. We've prepared two simple cases to indulge our statement. First of all from a banking perspective, the same argument from last year may still be valid in the case that lower interest rate may help consolidate NPLs through thicker margin. Yet it is worth mentioning that LDR has come down from 90.5% at end 2016 to 89.1% in Jun-17, implying less liquidity risk and demand. Should banks, hypothetically, lend out all the money that they can today then the additional loan growth is at a mere 3.5%.

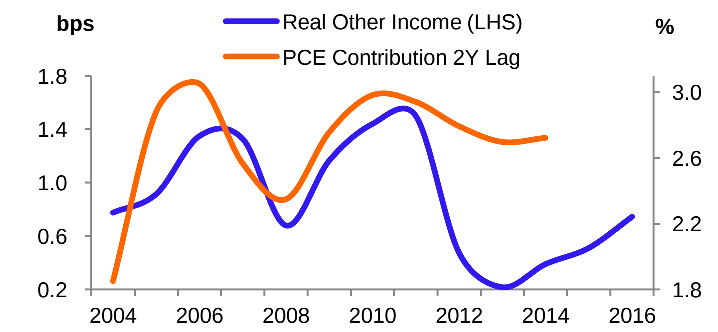
- Secondly, we've derived a back-of-the-envelope calculation by using a simple analogy from personal finance. If the domestic demand of an economy can be considered as one's wage, then the long-term external account -i.e. net export and FDI- can be used as a proxy of "other income". From the charts below, we can see the correlation to household consumption and comparables to other countries. **We think the focus needs to be on how to pour more water into the pool instead of stirring the water that's already inside the pool**.

Chart 1. Nominal Other Income per Capita - ASEAN



Source: Bank Indonesia, Central Bureau of Statistics (BPS), CEIC

Chart 2. Real Other Income & Household Consumption



Source: Bank Indonesia, Central Bureau of Statistics (BPS), CEIC

Indonesia: Selected Economic Indicators

	2013	2014	2015	2016	2017E
National Accounts					
Real GDP (% y-o-y)	5.6	5.0	4.9	5.0	5.0
Domestic demand ex. inventory (% y-o-y)	5.0	5.4	3.9	5.0	4.9
Real Consumption: Private (% y-o-y)	5.4	5.2	5.0	5.0	4.9
Real Gross Fixed Capital Formation (% y-o-y)	5.0	4.6	5.0	4.5	5.2
GDP (USD bn) — nominal	913	890	861	932	1,005
GDP per capita (USD) — nominal	3,648	3,529	3,371	3,604	3,838
Open Unemployment Rate (%)	6.3	5.9	6.2	5.6	5.5
External Sector					
Exports (% y-o-y, BoP Basis)	-2.8	-3.7	-15.4	-3.1	7.0
Imports (% y-o-y, BoP Basis)	-1.3	-4.5	-19.7	-4.5	6.6
Trade balance (USD bn, BoP Basis)	5.8	6.9	13.3	15.4	15.2
Current account (% of GDP)	-3.7	-3.2	-2.1	-1.8	-1.8
Central government debt (% of GDP)	21.3	23.5	26.6	27.7	30.2
International Reserves –IRFCL (USD bn)	99.4	111.9	105.9	116.4	114.0
Reserve Cover (Months of imports & ext. debt)	5.4	6.5	7.4	8.4	8.4
Currency/US$ (Year-end)	12,189	12,440	13,795	13,436	13,430
Currency/US$ (Average)	10,428	11,900	13,392	13.308	13,349
Other					
BI policy rate (% year end)	7.50	7.75	7.50	6.50*	N/A
BI 7-Day Reverse Repo rate (% year end)	N/A	N/A	6.25	4.75	4.50
Consumer prices (% year end)	8.08	8.36	3.35	3.02	4.57
Fiscal balance (% of GDP; FY)	-2.24	-2.26	-2.70	-2.46	-2.60
S&P's Rating – FCY	BB+	BB+	BB+	BB+	BBB-

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

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