

Indonesia Economic Briefing

Safe and Sound



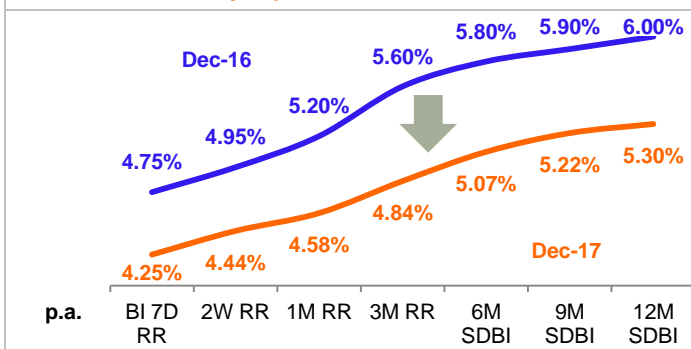
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- As expected, **Bank Indonesia left its key policy rates unchanged at their MPC meeting yesterday**. BI 7-Day Reverse Repo rate still stands at 4.25% whilst Deposit (FasBI) and Lending Facility at 3.50% and 5.00%, consecutively. There was a slight revision on the central banks' statement that followed the announcement, whereby last month it stated that the current policy rate *"is adequate to control inflation and current account deficit"* whilst now *"is sufficient to continue driving the economic recovery process"*. We take it as a sign that any possibility of another rate cut in the future has gotten thin, given the largest concern was on domestic demand.
- Earlier this week, **the US Federal Reserve had delivered its third 25bps benchmark rate hike for the year**. It was the last meeting and decision made by Janet Yellen as chairwoman, closed by a hint of dovish tone for future interest rate trajectory. Our house view has incorporated 2x25bps Fed Fund Rate hike in 2018, resulting in around 2.5% spread against local interest rate.
- Despite the narrowing interest rate spread between domestic and US, we have been on the view that the significance of Euro-zone to Indonesia's financial market has risen since 2014. This was contemplated from the following factors: 1) largest investor base in IDR government bond, 2) the movement of Rupiah had been switched from USD to Euro (*please see Chart 2*), and 3) the fund flow in global financial market mostly went out from Euro-zone to the US. Simple reasoning would suggest that money going out from Euro-zone due to QE would be retracted back upon tightening measures, which defers with the US since funds were actually coming in during easing measures. **As long as the ECB tapers through-out 2018, then domestic liquidity and capital market may still be stable.**
- Getting back to local monetary policy, we prefer macro-prudential measures instead. One policy that BI is finalizing was the **inclusion of corporate bond holding into banks' Loan-to-Funding calculation**. There will be different effects for each bank, depending on its current position. For banks with low LFR ratio, funds may be channeled to securities that potentially have higher yields than loan. While for banks with LFR at the margin or even above regulatory requirement, this inclusion may force them to take a more conservative position. Additional reserve may still be required for banks that could not meet regulator's targeted range. The then called Financing-to-Funding ratio will be released in early 2018, with stabilization and growth objectives on the forefront.

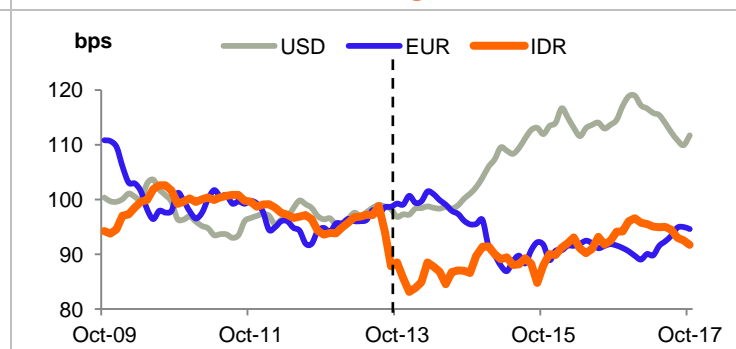
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Chart 1. Monetary Operation Term Structure



Source: Bank Indonesia

Chart 2. Real Effective Exchange Rate



Source: Bank for International Settlement

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	128.0
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	4.25
Consumer prices (% year end)	8.08	8.36	3.35	3.02	3.65
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

Economic and Market Research

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