

Indonesia Economic Briefing

Beefing Up Reserves



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- As expected, today **Bank Indonesia held its key policy rates at current levels**. BI 7-Day Reverse Repo rate stands at 4.75% whilst Deposit (FasBI) and Lending Facility at 4.00% and 5.50%, consecutively. The decision was made amid low volatility in financial markets and concern over future inflation risk.
- Earlier today, **the US Federal Reserve had delivered its second 25bps benchmark rate hike for the year**. Although the move was expected by participants, it was the inflation outlook for 2017 that rattled markets. Apparently market players were not expecting the core PCE inflation trajectory to be as low, -i.e. 1.6% to 1.8% from 1.7% to 2.0% previously-, and were bewildered by the hawkish tone in Fed's statement, with 3 hikes in the median dot-plot left unchanged. As a result, market sentiments became risk-on and funds flew elsewhere, including to Emerging Markets.
- On the Fed's balance sheet normalization plan, officials have stated that **"it will commence after interest rate normalization is well underway"**. At the first stage, which was said to be within this year, the Fed will stop reinvesting in USD 6bn of US Treasury Notes and USD 4bn of Mortgage Backed Securities they hold, per month. Then they will gradually raise the cap to USD 50bn per month, consisting of USD 30bn of UST and USD 20bn of MBS. In our view, the execution of both policies would largely depend on the US recovery momentum, which seems to have lost traction recently.
- Getting back to domestic affairs, the tone from Bank Indonesia appears to have been the same as previous month. Stability in inter-macro indicators as well as cross-market instruments has brought down a lot of the tension and fears of external headwinds. Meanwhile, we note that the central bank has been accumulating reserve assets, absorbing around USD 8.6bn ytd to USD 125bn as of May 2017. And we think **BI may keep on doing so in order to maintain macro stability**, for the time being.
- According to the International Monetary Fund, an international standard on reserve adequacy for a specific country like Indonesia can be determined through the following criteria: 1) how long can import payment be sustained in an event of shock, with a threshold of 3 months import coverage, 2) level of solvency during a crisis, with a threshold of 100% short-term debt coverage, and 3) can the reserve covers outflow of resident deposit during times of capital account crisis, with a threshold of 20% from money supply. Of these criteria, the latter posed as the highest FX reserve needs, which denotes at USD 76bn. Hence, current reserve asset is more than sufficient to cover it. Nevertheless, **in the event of minimizing currency crisis probability, BI may need to hold 1.5x its regional peers' reserves**. If we calculate the reserve of major ASEAN economies (ex-Singapore), the average is USD 100bn, thus BI may have to hold around USD 150bn just to keep it safe.
- **Monetary policy remains on neutral stance** for the time being due to global and domestic risks. Although BI officials had already stated that the easing cycle has ended, a shift towards more hawkish tone would depend on how global developments pan-out and how it would affect domestic financial market.

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	13,555
Currency/US\$ (Average)	10,428	11,900	13,392	13,308	13,504
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	5.00
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

Economic and Market Research

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