

Indonesia Economic Briefing

A Full Cycle



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- As expected, **Bank Indonesia raised its key policy rates by 25bps at their MPC meeting yesterday**. 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 marked as a full cycle for Governor Agus, whom had chaired his last Monetary Policy meeting, as he also started off with an interest rate hike back in 2013. BI's stance of monetary policy remained neutral yet "ready to implement stronger measures to maintain macroeconomic stability", which we believe translates to further monetary tightening.
- Reiterating from our report dated April 20th on *Indonesia Economic Briefing: What Can Expedite a Shift in Monetary Stance?*, we had been on the view that **the central bank will only utilize interest rate as a back-stop plan if the following condition arises simultaneously**: 1) inflation pushed above the targeted range of 4.5% with core inflation trailing close, 2) the Rupiah breaks outside BI's target range of 10% volatility, and 3) FX reserve depleting close to its highest comfortable threshold, which by our calculation is USD 76bn. These fundamental thresholds may differ from market psychological threshold that usually denotes in rounded big figures. As such, a breach in each one of these variables could have the potential to expedite the others.
- Revising our YE18 forecast for BI 7D RRR to 4.75% and the preceding currency variable to close around IDR13,800/USD**. Although we do not expect such aggressive import that was revealed these past 9 months to continue on 2H18, our concern over global financial volatility post European Central Bank's Quantitative Easing remains. And by infusing the abovementioned revisions into our model, we estimate that the benchmark IDR government bond yield may close around 7.78% (10Y) and 8.34% (20Y) by year end.
- In the short run, we think it's important to manage the liquidity and volatility of foreign exchange within the system amid times of productive import. The central bank had taken a first-aid measure in the form of active market operations -e.g. more FX swap auctions-. **Equally important is to start building up a medium-term solution for USD supply**. The banking industry's loan to deposit ratio had surged rapidly from 86.3% in Mar-17 to 95.1% in Mar-18. If we cross-reference these data with Indonesia's external account, the contraction in FX deposit due to capital outflows had outweighed the deterioration in FX loan from international trade.

Indonesia: Selected Economic Indicators

	2014	2015	2016	2017	2018E
National Accounts					
Real GDP (% y-o-y)	5.0	4.9	5.0	5.1	5.3
Domestic demand ex. inventory (% y-o-y)	5.3	4.0	5.0	4.8	5.4
Real Consumption: Private (% y-o-y)	5.1	5.0	5.0	4.9	5.0
Real Gross Fixed Capital Formation (% y-o-y)	4.4	5.0	4.5	6.2	6.0
GDP (USD bn) — nominal	891	861	933	1,016	1,115
GDP per capita (USD) — nominal	3,532	3,370	3,603	3,878	4,198
Open Unemployment Rate (%)	5.9	6.2	5.6	5.5	5.5
External Sector					
Exports (% y-o-y, BoP Basis)	-3.7	-14.9	-3.1	16.9	6.0
Imports (% y-o-y, BoP Basis)	-4.5	-19.7	-4.5	16.2	11.8
Trade balance (USD bn, BoP Basis)	6.9	14.1	15.4	18.9	17.6
Current account (% of GDP)	-3.2	-2.1	-1.8	-1.7	-2.0
Central government debt (% of GDP)	24.7	27.4	27.8	28.6 (E)	28.7
International Reserves –IRFCL (USD bn)	111.9	105.9	116.4	130.2	136.8
Reserve Cover (Months of imports & ext. debt)	6.5	7.4	8.4	8.3	8.5
Currency/US\$ (Year-end)	12,440	13,795	13,436	13,548	13,800
Currency/US\$ (Average)	11,878	13,392	13,308	13,383	13,874
Other					
BI policy rate (% year end)	7.75	7.50	6.50*	N/A	N/A
BI 7-Day Reverse Repo rate (% year end)	N/A	6.25	4.75	4.25	4.75
Consumer prices (% year end)	8.36	3.35	3.02	3.61	3.64
Fiscal balance (% of GDP; FY)	-2.26	-2.70	-2.46	-2.60 (E)	-2.52
S&P's Rating – FCY	BB+	BB+	BB+	BBB-	BBB-

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

Economic and Market Research

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