Indonesia Outlook

OCBC Bank

A hold but it is a matter of time

Thursday, June 20, 2019

Highlights

- **Bank Indonesia held the benchmark rate at 6.0% in line with our expectations.**
- **BI did cut the reserve ratio requirement (RRR) by 50bps to 6.0% for commercial banks and 4.5% for Shahriah banks in order to ensure sufficient liquidity in the system and support loan growth.**
- **Commercial banks loan growth though has recently come off in 2019 even as commercial banks average lending rates has actually trended downwards.**
- **Going forward, we see that BI may likely still cut by at least 50bps for 2019 and a first cut of 25bps may even come as early as 3Q 2019 as long as market conditions remain favorable.**

Treasury Research
Tel: 6530-8384

Bank Indonesia (BI) held the benchmark rate at 6.0% in line with our expectations. However, they appeared to turn more dovish as according to Bloomberg, Governor Perry Warjiyo was quoted as saying that a rate cut is a "matter of timing" now. He again emphasized that the central bank will "keep monitoring the global financial market conditions and the external stability of Indonesia's economy in considering a cut in the key policy rate in line with low inflation and the need to push domestic economic growth". The central bank's decision to still keep rates on hold even as conditions appear favorable with a firmer IDR in June amid global expectations of a Fed cut may have raised eyebrows. However, in its statement, BI highlighted that current global conditions are resulting in a "flight to quality".

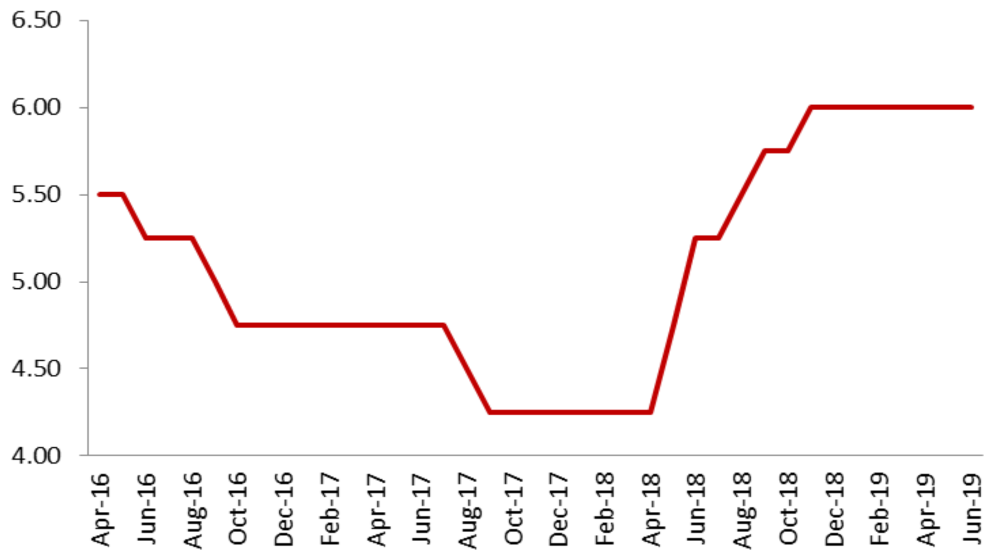
BI though did cut the reserve ratio requirement (RRR) by 50bps to 6.0% for commercial banks and 4.5% for Shahriah banks in order to ensure sufficient liquidity in the system. According to Bloomberg, Warjiyo himself had said that the RRR cut was also simply meant to boost lending. **Commercial banks loan growth has recently come off in 2019 (see chart 2) but the commercial banks average lending rate (see chart 3) has in fact been trending downwards for 2019** even as the liquid asset ratio may remain at levels much lower than the highs seen in 2017. It is therefore difficult to judge the cause of this fall off.

On the domestic front, BI did highlight a "softening" of growth has occurred during the second quarter of 2019". BI attributed this to "declining export performance". They also see the inflation will be kept under control and that it is projected to come out below the midpoint of the target corridor of 2.5% - 4.5%. They expect the current account deficit to be in the range of 2.5% - 3.5% in 2019 whilst the balance of payments for 2Q 2019 should remain positive.

Alan Lau
Tel: 6530-5949
AlanLau@ocbc.com

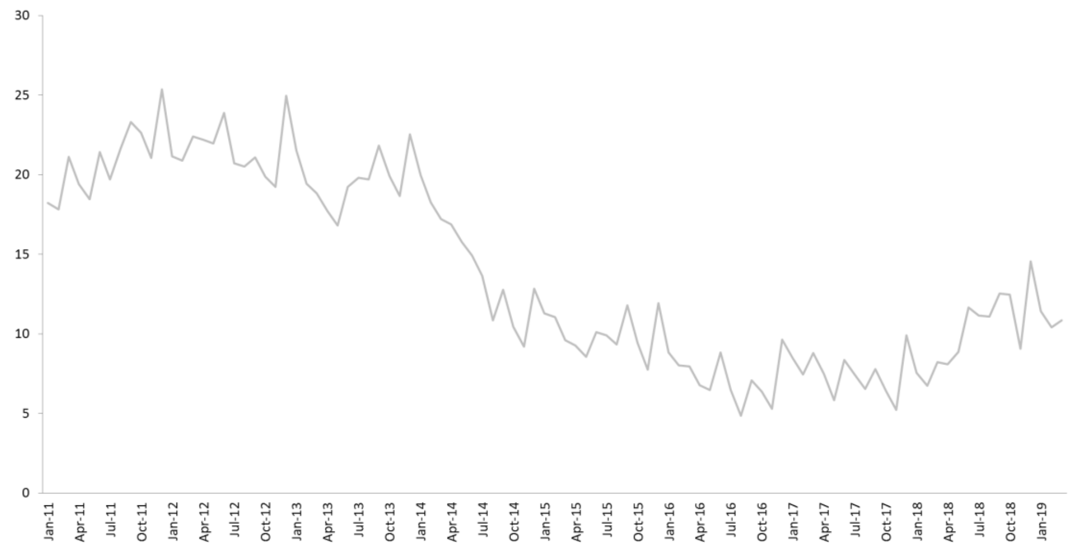
Going forward, we see that BI may likely still cut by at least 50bps for 2019. We see a first cut of 25bps may even come as early as 3Q 2019 as long as market conditions continue to be favorable. Favorable market conditions include the global trend of rate cuts continuing ahead which provides more support to the IDR. This we believe can also help raise BI's confidence of a reduced risk of capital outflows in the case of a cut. Whilst there may be a concern of the current account deficit, we see that in the level of 2.5% – 3.0%, it simply continues to just highlight the IDR's short term vulnerability to external factors. There is also the risk of an outflow of the first phase (ended September 2016) of the repatriated tax amnesty funds when its three year lock period expires this year. However, if the external environment remains sufficiently favorable, a decent amount of these funds may still remain in the country or inflows may be able to offset any outflows. Even if a cut may boost liquidity, which in turn may not necessarily see a marked increase in lending, it is still not ideal that the benchmark rate remains high for long period of times especially as BI continues to highlight a "softening of national economic growth".

Chart 1: Bank Indonesia 7 – Day Reverse Repo Rate, %



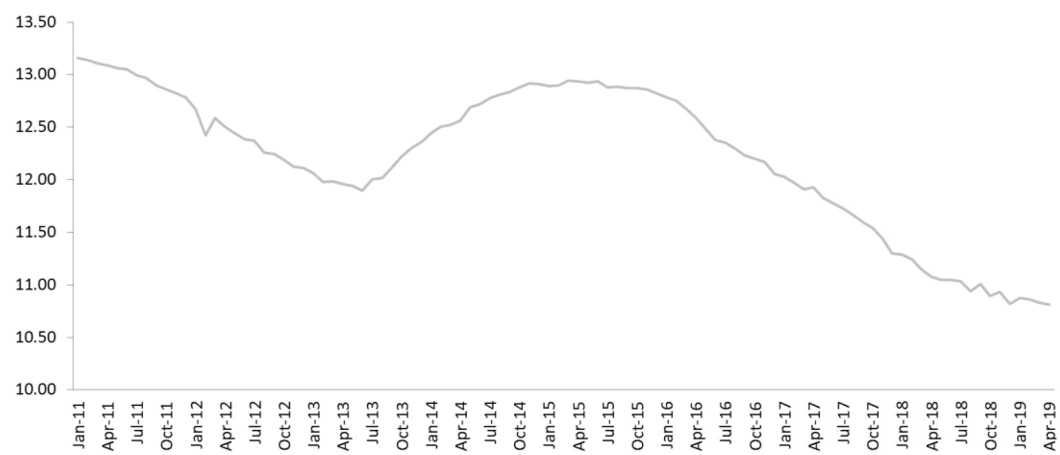
Source: CEIC, Bloomberg and OCBC

Chart 2: Commercial Banks Loan Growth, % yoy



Source: CEIC, Bloomberg and OCBC

Chart 3: Commercial Banks Average Lending Rate, %



Source: CEIC, Bloomberg and OCBC

Co.Reg.no.:193200032W