

Slotting It In **Bank Indonesia eases ahead of potential global jitters**

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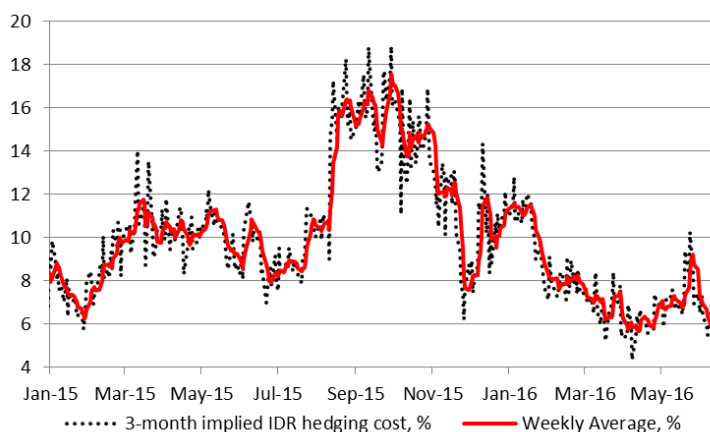
- BI decided to trim its policy rate – current and future ones – by 25bps today, as we expected. Pushing for loans growth amid still-sluggish economic momentum remains at the forefront of its policy focus.
- As if to signal its seriousness in helping growth along, apart from rate cuts, it has also loosened its macroprudential measures that should aid the property sector in particular.
- The relative stability in its currency in recent weeks has allowed BI the space to move today. With Brexit and other global risks on the horizon, it made sense to slot one in now – just in case.

On the Wall

Bank Indonesia decided to cut its policy rate by 25bps. The existing 12-month rate is slashed from 6.5% to now 6.25%, while its successor, the 7-day reverse repo rate is also cut by 25bps, from 5.5% to 5.25%.

It may be billed as a surprise cut, but to us, the writings were already on the wall. Prior to today's decision, Bank Indonesia has repeatedly offered clues about easing. For one, in last month's monetary policy statement, it wrote that "Provided that the macroeconomic stability maintained in a stable condition, rooms for monetary easing that has been opened may be used at an earlier time."

Obviously, there is the sense that stability has been maintained thus far – enough for the central bank to do what it said it would do. Even as the idea of 'stability' is in itself a relative and subjective term, as we mentioned in our May 19th report, "*Holding Buddies*", it boils down to Rupiah's volatility – or rather the lack of it. Essentially, how the Rupiah fares against the USD, and how much fluctuations there are, might have been the key gauge of whether the situation is stable enough for it to cut rate. To that end, as the chart below suggests, while the USDIDR implied volatility has indeed picked up somewhat, it is hardly in a territory worthy of alarm bells just yet.



Source: Bloomberg, OCBC.

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For that, Bank Indonesia would have the Federal Reserve to thank. The dovish stance of the US central bank has underpinned a relatively weak USD of late. And, judging from the overnight tilt in its statement and dot plot, it does look like the Fed remains queasy about hiking rates for a while more, hence paving the way for BI to do what it deems necessary for its own domestic economy.

On that front, BI has deemed the Indonesian economy to be in greater need of support than before. For one, while it said that Q2's GDP growth should improve, it mentioned that the data would be softer than expected, indicating that the economy is going to grow at just 4.9-5.0% yoy in Q2. Even as it put on a brave face and noted that higher government spending and investment pick-up should provide enough lift for the economy to grow at a rate of 5.0-5.4% this year, there are nonetheless enough concerns about weak economic momentum for it to cut rates today. This is especially so, given that credit growth has remained lacklustre. Today's statement, for instance, noted that "transmission via credit channel is not yet optimal", credit growth dropping back again from March's 8.7%yoy to 8.0% in April.



Source: Bloomberg, OCBC.

Its bid to egg credit growth on has also been supplemented with easing on macroprudential measures, as well. The relaxation is focused on the property sector for now, with friendlier loan-to-value and financing-to-value ratios for banks that have NPLs of less than 5%. To get banks to play ball in extending more loans, the central bank has also raised the lower limit of loan-to-financing ratios for banks, from 78% to 80% starting from August this year.

Going forward, it appears that BI is still keen to ease further. We think that it will cut rate by at least one more time, by 25bps, this year. When? It will all depend on how the global factors play out once more. Our sense is that BI remains worried that the Fed may still hike rate in July. If that were to happen against a market that is not expecting it – futures showing a puny 5.9% chance of a July 27th hike now – then any resurgence in USD because of that would obviously make it rather tricky for Bank Indonesia to continue the course of easing. Hence, BI may wait until August when things look clearer to cut rate again.

In case it cannot enjoy the space to cut policy rate because of global factors, we believe that BI will nevertheless continue to signal an easing bias to further prod the banking sector in extending credit more. It has already talked about broadening today's loosening of macroprudential measures to vehicle financing, for instance. There is also a potential slashing of reserve requirement ratio that it can utilize.

The bottom-line is this: Here's a central bank that is determined to play its part in giving the domestic economic momentum more push. At a time when the 3% budget deficit limit curtails how much the fiscal policy can do to help, that is especially helpful.

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