Brought Forward

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Bank Indonesia frontloaded its rate cut with Covid-19 in mind

- In what is quite a sea change from the optimistic tone of the previous MPC statement, BI's decision to cut rate today by 25bps to 4.75% is colored by a less sanguine outlook, driven by the ongoing Covid-19 outbreak in the region.
- Growth forecasts for global and domestic economies have been revised down by 0.1ppt in 2020, but BI expects a fairly quick rebound thereafter in 2021. Indeed, by our quick count, the Governor mentioned "V-shaped" at least 15 times in the press conference.
- For good measure, macroprudential policy was loosened too, allowing banks to count funding from overseas branches in regulatory ratio calculation, as well. Overall, BI still retains an easing bias, but may have to be increasingly conscious of using its limited ammunition.

Non-Zero Impact

While much has been said about whether or how Indonesia has managed to have zero case of Covid-19 within its shores, one thing that is for certain is that the virus has had non-negligible impact on its central bank's assessment of the economic outlook.

Compared to the rosy picture it painted last month (see our Jan 23 report for details), Bank Indonesia's post-decision press conference and monetary policy statement alike detailed a series of negative impact.

To begin with, it has revised down its expectation for 2020 global growth forecast to 3.0% from 3.1% previously. Its read on the domestic economy has been similarly revised down, from 5.1-5.5% to 5.0-5.4% now. Overall, however, the hit is expected to be relatively short-lived, with a V-shaped recovery being bandied about – repeatedly – during the press conference, backed by its expectation of 5.2-5.6% growth for next year.

When asked about the details of the Covid-19 impact, the Governor mentioned tourism receipt losses of up to USD1.3bn, logistical issues affecting exports and imports that are estimated to cost USD1bn collectively, as well as delayed investment activities worth USD0.4bn. These numbers are non-negligible but would unlikely be moving the needle much on market expectations of the current account outlook.

Overall, even as the central bank has stepped back from its previous optimistic assessment of the global and domestic economies, the new growth range expected might still be quite a stretch to reach, especially if the virus outbreak drags on. It would also have been predicated on the notion that luck remains on Indonesia's side when it comes to escaping the clutches of the Covid-19 virus.

To be sure, today's statement and press conference – not to mention the act of cutting rate itself – shows that the central bank is very much still retaining a dovish bias. For good measure, it has also loosened its macroprudential measures a tad bit, by allowing banks to include funding from its overseas branches in fulfilling the Macroprudential Intermediation Ratio.

Going forward, however, the space which BI can utilize to trim rates further will naturally be more limited than before. With today's rate cut, for instance, it has walked back 125bps' worth of the 175bps rate hike it did to battle EM jitters. Purely by this measure alone, there are but two rate cuts left to go before breaking even.

Our sense is that BI would be most comfortable with rate settling at 4.5% -i.e. just one more 25bps cut – by year-end, to leave itself some wiggle room. Hence, as much it has shown its willingness to frontload the rate movement this year, it would be more cautious in cutting back-to-back. If the situation worsens and the impact on domestic economy proves to be greater than they have anticipated, it might use that bullet even in the next meeting, but that should hopefully not be the case.

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