Wait a While More

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Bank Indonesia held rate unchanged to protect Rupiah

- The relative lull in global market stress and resultant Rupiah rebound in recent days have tipped our view towards a rate cut by BI. However, the central bank thinks that it is too early to relax – pointing out that exchange rate risk is the primary reason behind its decision to hold rate today.
- IDR stability reigns paramount. Even as BI wants to talk up Rupiah, it is fully cognizant of the fact that the forces of global sentiment may turn too quickly.
- Hence, as much as it remains dovish and highlighted that it still sees room for rate cuts, given low inflation and weakening growth momentum, the focus on exchange rate risk specifically has won the day. It opted to cut RRR by 200bps to release IDR102tn of liquidity instead, starting May 1st.

Not there yet

As we highlighted just this morning through our inaugural Market Stress Index reading, global market anxiety has more than halved from its peak in March. For EM currencies such as the Indonesian Rupiah, the decline in market risk has been a soothing balm, with the currency gaining about 5% against the USD since the start of April. Combined with a greater need to help growth – the government has recently downgraded its growth forecast to 2.3% from over 5% - we thought the balance will be tipped towards a rate cut today.

Alas, BI opted to see the glass of market normalcy as being half-empty. In his press briefing, Governor Perry Warjiyo pointed out for instance that, even though the VIX index has halved from the peak of last month, it remains highly elevated. Reading between the lines, it does not look like BI is convinced enough that the current market lull is entrenched enough for it to risk rocking the hard-won relative Rupiah stability with another cut today.

For good measure, in the opening paragraph of its Bahasa monetary policy statement today, BI notes that the rate decision was taken to "*preserve external stability in the midst of global market uncertainty that remains relatively high, even though BI continues to see the space for further rate cuts due to low inflation and the need to boost economic growth*."

That's as good a summary of why it kept rates unchanged as you can get, and also a clear indication that it is not done yet with rate cuts. Hence, if there is any sense that global market stress has declined enough – with IDR stability as the ultimate barometer – then the coast is clear for it to cut rate further. We continue to hold out the hope for such opportunities for BI to cut, by at least twice more in the coming months, to bring rate to 4.0%.

Until then, however, BI would continue to focus on non-policy rate measure. Indeed, the Governor has been cheerily touting the notion that BI has been engaging in quantitative easing despite not moving on policy rate. For one, it has been active in the secondary bond market purchase. Its ownership of outstanding government bonds now at 15% versus 10% at the start of the year, compared to foreign holdings which declined from over 38% to 32.5% over the same period. Moreover, BI has also received a mandate to purchase them on the primary market if necessary as well. (See "Wiggle Room" for details).

To bolster the "QE" and provide non-policy rate monetary policy support further, BI has announced extra measures today. To begin with, term repo operations for banks and corporations, with government bills and bonds as underlying and tenor of up to one year will be expanded. The RRR for conventional banks will also be lowered by 200bps and that for shariah-compliant institutions by 50bps, releasing up to IDR102tn of liquidity starting on May 1st. (In effect, the RRR for banks, conventional or shariah, will now be at either 3.0% or 3.5%, depending on whether they are deemed to be supporting export-import activities and SMEs, or otherwise.) Beginning May 1st, BI will also be suspending the additional requirement for Macroprudential Intermediation Ratio (RIM in local parlance) for one full year. The last measure is touted to release liquidity of up to IDR15.8tn.

Altogether, loosening everywhere but policy rate appears to be the near-term strategy that BI has in mind. It has to do its part to cushion the Indonesian economy from the seemingly relentless blows caused by the coronavirus, even as it faces the perennial constraint of having to protect the Rupiah by keeping its interest rates differential at an acceptably high level.

While an expansion of balance sheet would always carry some concerns about inflationary pressure down the road for any central bank anywhere, in Indonesia's case, the next-best solution to help growth has to stand in for a while for now.

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