Everyone's Doing It

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Bank Indonesia joins other central banks in easing further

- We had thought the unprecedented volatility in the currency markets – and many other asset classes – might compel Bank Indonesia to hold rates today. Alas, the need to offer whatever help it can to aid growth proves paramount.
- Growth expectation is slashed all around. It now sees growth potentially coming in at just 4.2% this year. Just last month, it was at 5.0%. The downward lurch prompted it to cut rate by 25bps today, with more to come.
- Indeed, it seems that BI had actually contemplated a larger cut of up to 50bps today, given the space given by Fed cuts and tamer domestic inflation, but wisely opted to be more cautious due to the global risk-off environment.

Gone with the Wind

Two months ago, Bank Indonesia was still painting a rosy picture of global growth. One month ago, it had started to dial down on the optimism due to the extent of the outbreak in China, and the resultant disruption to global supply chain. As a measure of how much things have shifted, any shade of jolly aura is now gone with the wind.

For good measure, the central bank shaved down its growth forecast for 2020. Instead of the 5.0-5.4% that it projects for just last month (itself downgraded by 0.1ppt from the month prior), Bank Indonesia now has 4.2-4.6% in mind, a hefty 0.8ppt downgrade. This is on the back of a 0.5ppt downward revision of global growth expectation for 2020, to 2.5%.

To be sure, it still alludes to the potential for a V-shaped recovery in 2021, with domestic growth seen picking up to a range of 5.2-5.6%. However, for investors who have been so whipsawed by global events and markets on a day-to-day – if not hour-to-hour basis – of late, that kind of time horizon is hard to envision at this point.

Overall, given the sharp degree of reversal in its growth outlook, Bank Indonesia looks to be looking for further opportunities to cut rate. Even though it would no doubt have Rupiah volatility in mind in its decision, other factors have dominated more. This is partly because BI appears to be looking at the recent market volatility with quite a bit of distant stoicism. When quizzed about the recent sharp IDR movement and its impact on rate decision deliberation during the press conference, Governor Perry Warjiyo suggested – not without justification – that the current market conditions no longer reflect economic fundamentals and are signalling more of a "cash is king" mentality.

Indeed, BI might have hinted that it is because of the overt risk premium in the current environment that it decided not to pursue a bigger cut, despite the space provided by the Fed's drastic rate cuts and tamer domestic inflation. (It now sees 2020 inflation at 3.0%yoy against 3.3% previously).

Nonetheless, given that Bank Indonesia's core mandate, its "single objective", is to achieve and maintain Rupiah stability, the ructions in currency market are never going to be very far off from its radar. To that end, it has tried to walk a fine balance between protecting Rupiah as best as it can from the overt market volatility and seeking space to cushion growth from Covid-19's impact.

Specifically, together with today's 25bps cuts, Bank Indonesia announced 7 steps to 7-step host of measures.

Top of the list is the by-now-very-familiar refrain of triple intervention in the spot FX, DNDF, and secondary bond market. These measures now be undertaken with a "stronger intensity", signalling a potential further ramping up of bond purchases for instance. Already, its ownership of government bonds through secondary market purchase has gone from 10% at the start of 2020, to over 14%. It is likely to go up even more from now, particularly as foreign holders exit. From the recent high of around 39.3%, foreign ownership has declined to 35.2%. Indeed, fund flows data show as much as USD5.5bn of bond market outflows year-to-date.

Elsewhere, with a nod to doing what it can to ensure USD liquidity onshore, point 3 announces the increased frequency of FX swap from 3 times a week to every day. Point 4 talks about the strengthening of the FX term deposit facility and encouraging banks to utilize the recent cut in FX RRR to 4% - slated to boost liquidity by USD3.2bn. Point 5 is about an earlier implementation of the measure to allow vostro accounts as the underlying in DNDF transactions. Originally slated to be effective April 1st, it's now going to come in place on March 23rd. Overall, such measures should help to bolster FX liquidity onshore. However, as discussed in length in our report yesterday, the issue of USD liquidity offshore everywhere might remain, as long as even the USD liquidity in the US itself remains unsettled.

In terms of interest rates path ahead, it is clear that BI is not done with easing yet and the next rate cut is likely to take place when its MPC meets next on April 14th. Our earlier thinking that a 'terminal' rate might be 4.25% - meaning just one more rate cut to go from here – has to be reassessed as well. It looks a lot more likely now that 4.0% - i.e. two more rate cuts – will be in place. This is due to the great degree of uncertainty in the economic outlook, on the back of not only the ongoing challenges from global growth, but also the potential for further pick-up in viral transmission on the ground that would challenge domestic growth even further.

Indicative of how the virus has changed daily life, the BI's board of governors itself is doing split team operations and announced the decision via split-screen teleconference. As a measure of how seriously the central bank wants to keep market updated about its views on the economy and market, the governor has also announced – laudably – that he will be conducting multiple press conferences twice a week.

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