We Are Done

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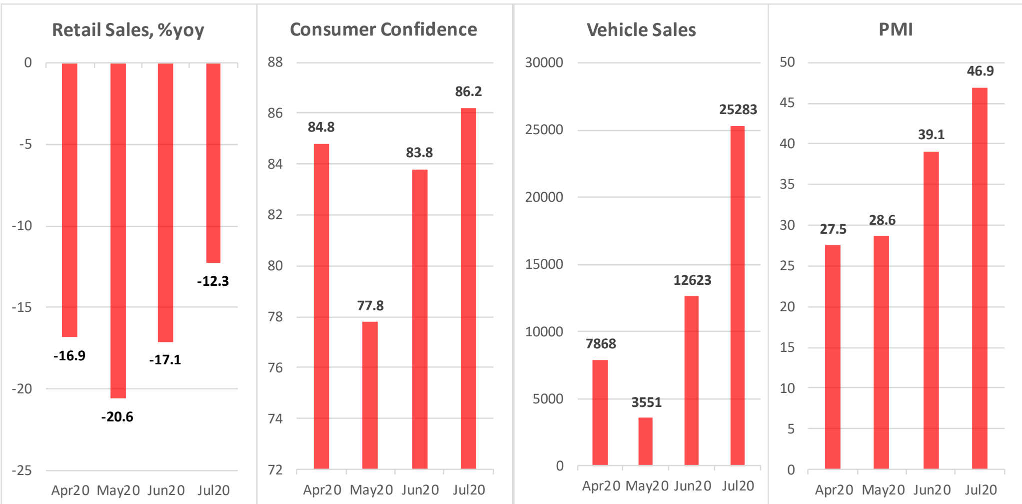
Bank Indonesia is done with its rate cut cycle

- Bank Indonesia kept its policy rate unchanged at 4.0% as we expected, and in line with majority of market anticipation. While the sharp downtick in Q2 GDP and still-tame inflation should technically give it room to ease further, the consideration for currency stability and yield attractiveness is paramount.
- Compared to previous rounds, the tone of the governor's press conference and the MPC statement are more optimistic now. While Q2 numbers were bad at home and abroad, things are seen to be picking up more encouragingly than before – offering BI air cover for a continued rate hold.
- BI will remain emphatic on how its quantitative policies will be a lot more effective in driving growth than further rate cuts from here. At the margin, it will tweak some of the macroprudential measures, as well, as evidenced by the reduction of down-payment for some vehicle purchases to 0%.

Anything but rate cut

When BI last cut its rate in July, we said that we hoped it would be the last rate cut. As it turns out, judging from the action and the tone of the announcement today, that should indeed prove to be the case for the remainder of the year.

In explaining its decision to hold rate unchanged at 4.0% today, BI's Governor Perry Warjiyo painted a more optimistic picture for the global economy. Even as Q2 GDP numbers for various economies, including Indonesia's own – which suffered the sharpest pullback since the Asian Financial Crisis – he pointed out the recovery in various higher-frequency indicators since, in the month of July.



Source: OCBC, CEIC, Bloomberg.

From retail sales overall to vehicle sales specifically, from confidence among consumers to manufacturers alike, the outturns in July have indeed seen a good continuation of recovery momentum from June, especially when compared with the deep slumps of April and May.

While the recovery remains nascent and subjected to a multitude of risk factors – BI highlighted second wave fear and US-China geopolitical tensions in its MPC statement, for instance – the recovery momentum itself has been encouraging enough to provide a good overarching reason for BI to refrain from cutting its policy rate further.

Still, BI remains keen to remind market (and perhaps the broader domestic policymaking circle) that it will continue to maintain an accommodative monetary policy stance. BI is just as quick, however, in pointing out that policy rate is already low and it is by no means the only tool it can tweak to continue to support growth. In a refrain that you would hear more and more, BI emphasized that it has been embarking on substantial quantitative easing – worth IDR651.54tn so far – and will continue to play a supportive role in financing the government stimulus spending.

On the last point, however, BI noted as well that its direct purchase of government bonds in 2021 will be limited to primary auctions via market mechanism instead of via another round of debt monetization.

There have been murmurs of market concerns since last Friday, after President Jokowi mentioned in his 2021 budget speech that BI would continue in its “burden sharing” of the government spending. While Finance Minister Sri Mulyani had come out to clarify things, and to re-emphasize that the current debt monetization is a one-off and will not be extended to 2021, it will take continued commitment by the government and Bank Indonesia alike to dampen such worries.

The episode would probably be a good reminder, as well, that as much as market players have given the benefit of the doubt on the recent debt monetization move, it is by no means unconditional and rests heavily on the credibility of the reassurance that it is indeed one-off in nature.

Outside of doing what it can to support the ongoing stimulus drive and aid the budget financing into 2021 as well (even if in a more reduced form), BI would be keen to loosen macroprudential policies in bits and pieces. Just today, even as it kept policy rate unchanged, it has loosened the rule on vehicle purchases, by cutting down-payment requirement to 0% from 5-10% currently.

Before you wonder why the clogged streets of Jakarta and other cities really need more vehicles, perhaps it is worth noting that the looser measure will only apply to environmentally-friendly vehicles. That is a fitting illustration that, as much as BI is keen on doing its best to boost growth, it remains cognizant of the need to do so in a way that is sustainable in the long run.

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