Inside Indonesia

OCBC Bank

Happy Anniversary!

Indonesia cuts rate as Jokowi marks his two years in office

Oct 20, 2016

- **Bank Indonesia slashed its policy rate today, surprising some in the market though thankfully not us. The room given by low inflation and tame current account was too tempting, plus it's either now or never this year given year-end global event risks.**
- **Today's move happens to coincide with the 2nd anniversary of Jokowi's inauguration, and should help his government's desire for higher lending growth – which is unhelpfully plumbing new lows now.**
- **Still, rate cut cannot be a gift that BI can keep on giving. Even as it will speak dovish, we are much nearer to the end of the cycle by virtue of how much it has eased already. One to two more cuts early next year if growth doesn't pick up is possible, but that's about it.**

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Watch what they watch

For a while now, it is apparent to us that Bank Indonesia is paying attention to loans growth data.

It played a key role in the spurt of easing movement by the central bank early this year, when it cut rates back-to-back for three months straight. It was probably one important consideration in its decision to tweak its monetary policy framework to adopt the 7-day reverse repo rate as its key benchmark rate too. (See our April 14th report, Toolkit Tinkering for details).

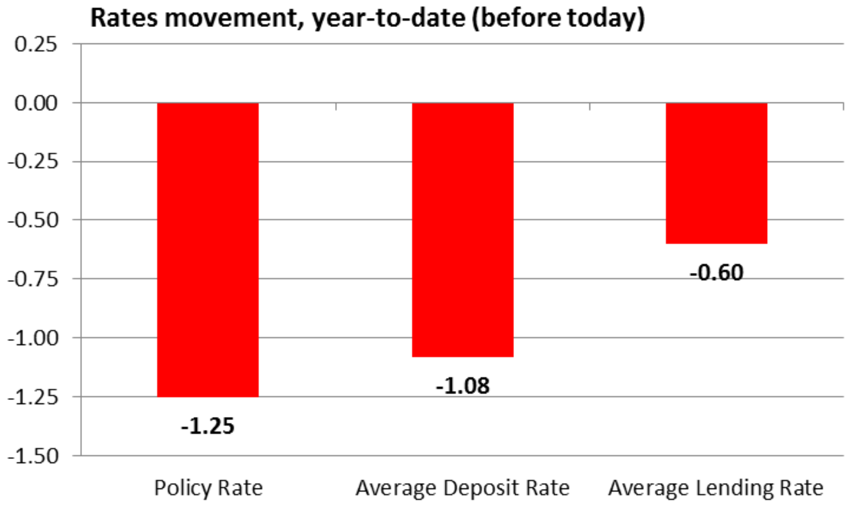
This time round, loans growth – or rather the lack of it, given that August's 6.8% yoy print is the lowest since 2009 – remains the key driver in the monetary policy decision. For good measure, its policy statement today (as we see from the Bahasa version) notes that even as "transmission of monetary policy loosening is ongoing", "transmission through the credit channel remains not optimal, judging from the credit growth that remains limited."

Source: Bloomberg, OCBC.

For good measure, it ends the statement with this line: "Bank Indonesia is confident that the re-easing of monetary policy and the loosening of macroprudential measures thus far would drive credit growth in order to support higher economic growth going forward."

In its communication with the press post-decision today, BI also lingers on about how much of the policy rate cuts it has done has been passed through by the banks or not.

Bloomberg, for instance, notes that BI mentioned that year-to-date, average deposit rate has declined by 108bps while lending rate dropped by 60bps. Notably, deposit rate has closely tracked the 125bps drop in policy rate year-to-date (prior to today's decision to cut it down by a further 25bps to a total of 150bps). This is much more so than the contemporaneous drop in lending rate, of course, and would remain a point of contention that the authorities would have with the banking folks in Indonesia. For what it's worth, BI told the press that it expects lending rate to drop by 15-20bps further by year-end.

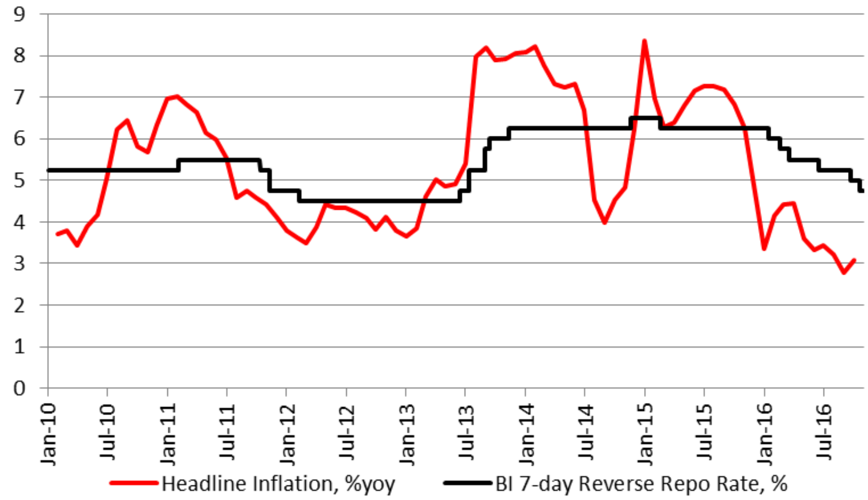


Source: Bloomberg, OCBC.

In many ways, BI has been playing it smart by cutting its policy rate largely in instalments thus far. That helps to save its not-unlimited bullets over time. It has also been talking dovish talks. Even after slashing rates 6 out of 10 meetings already this year, it is still talking about how it "sees room to lower monetary policy", albeit with a requisite caveat of "if data supports it." The whole game is to persuade the banks that "Hey guys, we are serious about cutting our policy rate, so why don't you go ahead and ease yours already!".

While we do think that lending rates would indeed drop further, we cannot help but think that it will take a lot more than just policy rate easing carrots alone, whether those that are already on the plate or just merely dangled in front. As BI itself has repeatedly acknowledged, demand for credit – especially from the corporate side – has been dismal. If someone has little appetite, even if BI cooks up a storm and fills the room with the most enticingly aromatic dishes (with promises of more to come, to boot), he wouldn't bite it much.

As to why there is so little appetite for credit to begin with, global uncertainties play a big role, and there's not much Indonesian authority can do on that front. The fact that newly enthusiastic taxpayers – individuals and corporates alike – had to fork out money in the last few months for tax penalty payments, as they participate in the successful tax amnesty program is also another, thankfully one-off, factor.



Source: Bloomberg, OCBC.
Note: Historical 7-day reverse repo imputed from the previous 12-month BI policy rate.

From BI's end, what it can do would be increasingly limited. Its heroic talks about having room to lower rate further might be true, given that inflation is low and current account deficit is less concerning now, but it is also a reality that there is going to be less and less space for them to manoeuver going ahead. Given where oil price might be heading, it needs to build in potential of an inflation uptick next year. The Fed's move up on its policy rate would also become a consideration. Hence, we think BI is done with rate easing this year, opting to leave the increasingly limited space for next year just in case its help might be needed again.