Indonesia

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The Data Says No

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Bank Indonesia refrains from rate cuts on growth optimism

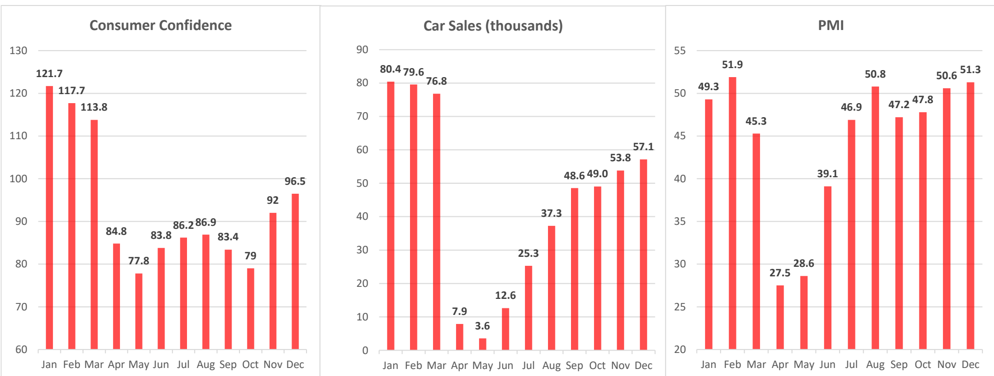
- Downside risks have been fermenting enough, we thought, that Bank Indonesia would reach for another rate cut today. As it turns out, BI remains sanguine on growth outlook enough to hold rate at 3.75% once more.
- BI's outlook is predicated on recent data – talking up the recent strength in trade due to uptick in demand from China and the US, as well as domestic spending due to faster fiscal disbursement. Such nascent strength may be subject to some speed bumps soon, however, since local pandemic spread remains prevalent enough for another extension of restrictions just today.
- We retain the view that further easing is coming, although the timing will now be pushed back to Q2 on account of BI's optimistic view. Thus far, BI appears to signal that the space for cuts is still there since, by its own accord, inflation remains under control and portfolio inflows would still be strong.

No need to ease?

Central banking decision making is a game of balance. One perennial balance to be had is to gauge how to use existing tools to support growth on one hand while keeping an eye on inflationary pressure that it might entail. A less apparent balance is between looking at data that we have on hand, reflecting how the economy has done in recent times, versus playing a game of anticipation for what may transpire next.

On that front, it appears that BI has placed the bulk of its faith on how recent data prints have improved – offering a signal that the economy was on a good turn in recent months.

To its point, we have indeed seen strength in trade numbers, for instance, with both exports and imports recovering strongly in December. Other recent indicators such as consumer confidence, vehicle sales and manufacturing PMI prints are also pointing up, not down.



Source: OCBC, Bloomberg, CEIC.

Still, we are less confidently assured that such strengths can persevere in the face of a recent uptick in coronavirus cases that have compelled the authorities to extend social restrictions in Java and Bali for another two weeks just today. Granted that the impact of such restrictions would be less than before – if they are indeed even followed and enforced much at all – but on a relative basis, one would have thought that the downside risks have risen on balance.

On the surface, from what we can gather from the press conference and the Bahasa monetary policy statement, such downside risks do not appear to feature prominently in the thinking at this point.

The statement, for instance, talks about how global economic activities would continue apace due to Covid -19 vaccination “in many countries” and continuing fiscal and monetary policy support. Indeed, the paragraph discussing its global outlook sounds like a roster of good news all around, pointing out anything from upticks in PMI, consumer confidence and trade flows readings to downticks in global financial market uncertainties.

This is echoed in the discussion for the domestic economy. While it allows for how the numbers “are a tad lower than previously anticipated”, the statement noted strengths in December 2020 indicators including trade, PMI and consumer confidence prints. Interestingly enough, it added that vaccination program and discipline in conforming to social restrictions can hopefully quicken the domestic economic recovery progress.

Overall, the conspicuous absence of discussion of downside risks to such a constructive outlook does not pave way for a rate cut in the very near term.

Still, if data turns south, BI might have to pivot – and pivot quickly – to offer more support.

As it stands, even though the existing roster of data is still supportive, there are other indicators that may paint a less rosy picture if one bothers to look. For one, the loans growth remains abysmal despite last year’s 125bps worth of rate cuts. Credit shrank by a hefty 2.41% yoy in December, perhaps signalling a lot less confidence, either by consumers and businesses or banks, or indeed both parties, in how growth would shape out in the near term.

Hence, while BI might continue to talk up growth prospects (and keep rates unchanged in tandem with that view), the possibility of growth turning softer than expected (and compelling it to cut rate) remains real.

It is helpful on that front, then, that BI’s space to move is there. Inflation, by its own telling, would remain under control this year. And, portfolio flows, whose stability is much needed to ensure the absence of overly volatile Rupiah fluctuations, are expected to remain solid.

Indeed, BI’s governor, Perry Warjiyo, noted in the press conference that the central bank sees an uptick in portfolio flows to the tune of USD19.1bn this year compared to around USD1.1bn of last year. He found it useful to say that, over the course of his interactions with major central bankers including the Fed's Chair Powell, there remain few signs of asset purchase tapering that might impede flows to EMs, as well.

Taken altogether, perhaps BI is trying to achieve the ultimate balance of all.

Even as it talks up growth prospects to help boost confidence – indeed, it has become a regular feature of the press conference now for the governor to end by appealing for help in building economic recovery optimism together – it wants to preserve space to act as well when that assumption/hope does not play out.

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