Cruise Control

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Bank Indonesia signals rate to be unchanged for a long while more

- The decision by Indonesia's central bank to keep its policy rate unchanged again today was widely expected, given the propensity by BI to strike a balance between anchoring currency stability and boosting growth.
- By now, it has paused for the 8th month running. Moreover, if the global conditions and domestic inflation allow for it, BI may well hit cruise control and keep its policy rate unchanged for much of next year. With inflation drumbeat echoing more and more loudly globally – and the spectre of Fed funds rate lift-off by H2 now a distinct possibility – BI might be left with little choice but start to tighten by then, however minutely.
- For now, there is not much more that BI can and will do, although it has helpfully extended the round of easier macroprudential measures including 0% down-payment for auto and home loans into end-2022 today. Loans growth has started to inch up, with property loans spurting up nicely in particular – signalling a nascent return of confidence as Indonesia appears to have gotten the better of the recent pandemic bout.

A softer globe

In an extensive press briefing involving not just Governor Perry Warjiyo but many of the other MPC members, Bank Indonesia covered many grounds today. One aspect that received much attention was the recent combination of softer global growth prospects at a time of rising inflationary concerns.

For good measure, BI has trimmed its 2021 global growth forecast from 5.8% to 5.7%, acknowledging that growth prospects in major economies ranging from the US to Japan and China are likely to be softer than they had anticipated previously. As it rightly emphasized, however, despite the softer global growth, Indonesia's exports are likely to stay supported, courtesy of robust demand and price uplift in commodities ranging from palm oil and coal to iron ore and more, as we detailed in an earlier report.

Indeed, the exports strength is enough for Indonesia to swing back to current account surplus territory again, at least for Q3, going by the central bank's view. For the year as a whole, it anticipates current account deficit to stay largely curtailed, at 0.0 to 0.8% of GDP.

On that note, BI hammered home the point that, should there be lingering concerns about how Indonesia – which was once slapped with the unfriendly label of "Fragile Five" during the tumultuous days of Taper Tantrum in 2013 – can cope with the soon-to-arrive eventuality of Fed tapering, its much thinner current account deficit should help to limit the impact a lot more.

Domestic help

Switching its focus on to domestic growth, BI has kept its 2021 growth forecast of 3.5-4.3% unchanged for now, even as it struck a congratulatory note on how the pandemic resurgence has by and large subsided on the ground and consumer confidence has started to return nascently. To us, our forecast of 3.7% for the full year might see some slight upside bias if the domestic confidence returns more forcefully in the coming weeks, alongside the uptick in commodities complex.

Tellingly, loans growth has started to see a more convincing uptick, signalling a recovery in demand for credit. Compared to 1.16% yoy growth in August, loans growth picked up some speed to grow at 2.21% yoy in September. In particular, Indonesia's property sector has enjoyed quite an uplift of late, with home loans posting a sizable growth of 8.67% in September.

As if to egg on such an uptick further, BI has rolled over its existing easy macroprudential measures – whereby there is a 0% down-payment requirement since March – all the way to end-2022. The same goes for automotive loans.

For a central bank which has been badgering the domestic banking players to pass on its rate cuts and extend more loans, the recent loans growth uptick would be most welcomed. Apart from the hope that such movement would be indicative and adds to the growth recovery prospects, it would also help BI in swatting away any nagging call for it to ease policy rate further in the name of growth.

Price pressure?

During the Q&A session, domestic press was replete with questions about the impact of global supply chain concerns and energy crunch on Indonesia, to which the governor offered a series of professorial answers that essentially say, "We are watchful of such global price pressures, but do not expect Indonesia's inflation to tick up because of them." Indeed, thus far, Indonesia's inflation has been undershooting the 2-4% central bank target range, and we continue to see it staying broadly curtailed into next year.

Hence, unlike some of its central bank peers globally and in the region (including the MAS), which have started to tighten their monetary policies due to inflation concerns, Bank Indonesia is likely to chart its own path in that regard.

If anything, we do not think BI will be compelled to raise its policy rate to combat domestic inflation risks anytime soon. In part, this is because, despite the favourable momentum of recovery that we are indeed expecting going into year-end, there remains much slack in the economy that would keep any secondary price pass-through still contained.

There is, however, a scenario of BI rate hike that looks a lot more likely to us: that is, the overhanging prospect of a Fed funds rate lift-off by the end of

2022. Even as the near-term focus remains when and how the Fed would taper, the continual drumbeat of inflation in the US is likely to result in a corresponding uptick in Fed funds rate hike possibility. BI will try all that it can to limit the passthrough, but if its domestic economy continues to strengthen as it hopes for, consumption will return and so would imports, resulting in a likely return of a fatter current account deficit which would tie Indonesia's fortunes more closely with the ebbs and flows of global market sentiment once again.

To cut a long story short, BI will be on pause for good measure still for now. However, by H2 2022, as and when the Fed starts to posture towards hiking its policy rate there more forcefully, BI will have not much choice but to play along. The degree to which it needs to adjust its own policy rate will be dependent on the incline that the Fed has in mind as well. We see a good chance that BI may have to hike at least twice by the end of 2022 in a fairly benign baseline scenario.

Overall, as much as BI is comfortable hitting the cruise control now because the path for the immediate period ahead appears to be smooth and easy-going, the road further out is likely to be a lot more sinuous and bumpier such that it will take deft and very much hands-on handling.

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