Indonesia

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Go, Fiscal, Go!

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Bank Indonesia held rate and – politely – urged for fiscal actions

- Indonesia's central bank kept its 7-day reverse repo policy rate unchanged at 4.0% for the third month in a row, in line with what we and the market had expected. It continued to emphasize that the quantitative easing channel that it has been pursuing is more effective than any interest rate cut now.
- Not much has changed in terms of BI's tone or overall economic outlook and it looks quite set on continuing this path of holding its policy rate. While it acknowledges that the economic recovery momentum remains beset with risks, BI appears to telegraph that it has already done whatever it could to help – and that a quicker fiscal disbursement is more crucial and effective.
- Given the abysmal loans growth rate of 0.12%, there is always going to be compulsion for BI to do just cut policy rate by a bit more. In a parallel universe where it is unbound by fund inflow and Rupiah consideration, it could. But in the reality of this world, it has achieved the right balance. Having pushed the envelope this much in terms of funding the government directly, it is really is up to the fiscal front to spend it fast and spend it well.

We do what we can

Given how often Bank Indonesia officials have telegraphed its intention to focus more on quantitative easing aspect of its monetary policy accommodation rather than the traditional interest rate channel, it would have been surprising to have anyone expecting a policy rate cut today. Indeed, as it turns out, BI opted to keep its policy rate unchanged at 4.0% for the third month running.

Parsing through the governor's press conference and looking through the monetary policy statement, there appears to be very little shift from its outlook assessment.

Indeed, translated from Bahasa, one opening sentence from the statement spells out as much, saying that "The global economic recovery continues as previously anticipated", citing how China's rapid pickup has helped Indonesia's exports of commodities and textile products, for instance. Domestic demand looks to BI to still stay resilient too, as signalled by early indicators such as retail and online sales, job vacancies and household income.

Meanwhile, inflation is expected to stay curtailed, as demand has yet to recover fully and food supplies remain ample.

Elsewhere, it is noteworthy that BI now sees a good chance of Indonesia posting an outright current account surplus in Q3, as exports start to recover even as imports remain lacklustre. If it turns out to be the case, it would mark the first current account surplus since late 2011. While this is likely to be temporary in nature – as any economic recovery will portend a rise in imports of consumer and intermediate goods alike – it is nevertheless a sign of near-term favourable external position.

Overall, the largely steady development in terms of growth, inflation and external fronts has allowed BI to keep its policy stance unchanged and focus on quantitative easing like before. By its account, BI has injected IDR667.6tn worth of quantitative easing into the system. This consists largely of IDR155tn worth of reserve requirement ratio cuts for the banking sector and an outright monetary expansion of IDR496.8tn.

In the press conference, Governor Perry Warjiyo repeatedly emphasized that BI would remain at the forefront of monetary policy accommodation by helping growth via the continued pursuit of quantitative easing measures.

With the word synergy being thrown around, it also marks a frequent reminder that BI is already working very closely with the government under the current arrangement. The conspicuously absent subtext may be that there is perhaps little need to change the setup radically, as some parliamentarians appear keen to do by pushing for a fundamental shift in the legislation governing BI's relationship with the government. (See our Sep 3 "Legally Blunt" report for details).

What's more, BI has highlighted the need for the government to ramp up its fiscal disbursement as well. As of end-September, the government has only disbursed 45.8% of its IDR695.2tn fiscal stimulus package. From one angle, it is rather ironic that a policy as radical (and unthinkable in pre-Covid days) as direct debt monetization has already been adopted to make sure the funding for fiscal injection is secured, only for the disbursement part to be largely disappointing still.

One consequence of the slow fiscal disbursement thus far has been the abysmal pace of the credit growth in the economy; it slumped to 0.12% yoy in September from an already low 1.04% in August. In its Q&A deliberation with the domestic press today on this issue, the governor pointed out that the supply side of credit remains abundant, supported by BI's QE expansion, but demand side would have to await more support from a faster fiscal disbursement.

While it is no longer new to hear central bankers urging governments to pursue more fiscal action to help growth, the multiple times in which BI emphasized that today is a reminder that it really has done what it can on its front. Long story short, do not expect BI to cut rate anytime soon.

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