Please Pass It On!

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Bank Indonesia urges banks to pass on previous rate cuts

- It would have been surprising if BI moved on its policy rate today, given the still-unsettled global interest rate environment that remains a weight on the currency. Indeed, as widely expected, it held its rate unchanged – and does not signal that there would be any shift from that stance anytime soon.
- Instead, it is evident that BI's focus is squarely on cajoling the banks to pass on its previous rate cuts. The governor spent considerable time focusing on the minutiae of how state-owned banks have started to dutifully trim their lending rates, including by trimming their margins – something that the private-sector banks have yet to do, apparently.
- Still, despite the valiant interest cuts by some banks, loans growth has remained abysmal, contracting by 4.1% yoy in March, putting into question whether it is the lack of demand, not supply, that is the ultimate culprit. With the economy yet to recover robustly – BI has just cut its 2021 GDP forecast by 20bps to 4.1-5.1% – resuscitating growth may thus need more than just guilt-tripping banks to cut their lending rates.

Supply and Demand

We've done our part, now please do yours. To us, that is the one-line summary of the press conference surrounding Bank Indonesia's monetary policy decision today.

The decision itself, to hold its policy rate again at 3.5%, is widely expected and should not be a surprise to the market. As we highlighted in our Mar 18th report, "End of the Cycle", we are likely to have seen the last of rate cuts from Bank Indonesia this year.

On the surface, the fact that further easing is no longer in the pipeline might seem a tad odd, given that the economic recovery momentum has yet to pick up robustly. As a case in point, BI has just revised down its 2021 GDP growth forecast to 4.1-5.1% from 4.3-5.3% previously.

When quizzed about the move by the press, the Governor was keen to point out that the economy is still growing – but just by less. The nuance, however, is that owing to continued pandemic concerns, the all-important private consumption has yet to recover strongly. While specific segments such as automotive sales have jumped in March due to the lure of tax incentives and 0% down-payment initiatives, the broader consumption has been a lot less gung-ho. Retail sales figure continued to be contracting at a hefty 17% yoy in March, not much of a recovery from 18.1% yoy drop of the month before, for instance.

However, if the need to ease has arguably gotten stronger because of the lack of energetic growth momentum, the space to do so has not become wider, unfortunately. The fact that the US Treasury yields have gone up present some challenges to Indonesian sovereign bonds attractiveness and hence the exchange rate movement. At a time when the situation remains far from settled, for BI to keep its policy rate unchanged despite the weaker growth outlook is thus a prudent choice.

If BI cannot ease policy rate further, what can it do to signal that it is doing its utmost to help the country's economy then, especially since it had already pulled the levers of macroprudential policy loosening quite forcefully earlier?

Here, BI appears to be adopting a policy of jaw-jaw in persuading and cajoling the banks to transmit its previous rate cuts more forcefully. In both the press conference and published statement thereafter, BI spent considerable time and effort detailing the breakdown of how some banks have dutifully started to trim their lending rates, while others have not.

The SOE banks, for instance, are said to have cut their base lending rate by 266bps yoy in February to 8.70% while the private-sector banks have only trimmed theirs by 88bps over the same period to 9.42%. As a measure of just how deeply BI cares about this, it further broke down how the SOE banks have selflessly cut their profit margins to help pull the credit rates down – something that is yet to be emulated by the private-sector financiers.

All in all, however, despite the system-wide decrease in lending rates, which declined by 171bps yoy overall, the fact of the matter is that credit growth remained stuck in the abyss, with a contraction of 4.13% yoy going by the March data.

Hence, one natural open question would therefore be: if the cost of loans supply has come down, but the level of completed transactions that is credit growth remains low, could we assume it is due to still-curtailed demand then? That indeed has been the long-time refrain of banks, which argued that there are simply fewer takers for their credit due to confidence issue.

If that is indeed the case, it begets a deeper conundrum. Confidence has a circuitous relationship with growth; the better the outlook, the more confident businesses will be to undertake new investments and the more ready consumers will be to buy that new shiny car – setting in motion where demand begets more demand. The dynamics work in the reverse too unfortunately, and until confidence returns more robustly to engender net increase in demand for credit, it might take a lot more than spirited prodding by the central bank for banks to pass on the rate cuts for loans growth and therefore broader economic growth to pick up.

To that end, we remain hopeful that despite the near-term challenges, the ongoing vaccination efforts by the authorities can start to tackle the root issue of the pandemic more fundamentally – to pave the way for a robust recovery. In the same breath, the news that the parallel vaccines import initiative by major companies might start to deliver shots next month should help too.

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