BI Board of Governor Meeting

November 2019

Highlights

- BI should cut its policy rates by 25 bps this month
- Inflation is low and stable. Exchange rate is stable at around IDR14,000 while capital inflow continues
- Improving CAD could continue, better commodity price will help

Recent macro indicators suggest that the slowing down trend of Indonesian economy, both in demand and production, still continues. BI has started its accommodative stance in July 2019 and has cut its policy rates four times. Relatively improving external conditions and the potential risk of slowing down economic growth below its potential justify the easing stance.

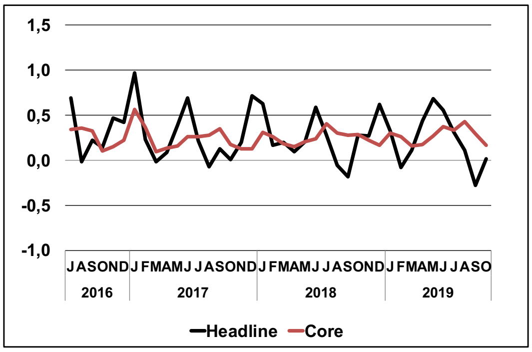
Domestically, consistent with the weakening demand, the inflation rate continues to be lower than BI's target. Externally, the slight improvement in CAD in Q3 2019 to 2.7% of GDP is supported by some adjustments that happen in imports especially by lower deficit in oil. On the other hand, portfolio capital inflow continues, supported by the attractiveness of real yields offered by IDR bonds relative to its other emerging peers. Rupiah has been stable as BI continues accumulating international reserves. With the overall current domestic and external circumstances, we view that BI should cut its policy rates by 25bps this month.

Benign Pattern of Inflation

Overall inflation performance has been stable, as headline and core inflation in October remained within BI's target range of 2.5-4.5%. On a monthly basis, consumer price index increased 0.02% (mtm), after deflation recorded of -0.27% (mtm) in the previous month. Meanwhile, annual inflation stood at 3.13% (yoy) last month; slowed from 3.39% (yoy) in September. Benign inflation in October was due to increasing foodstuff prices at a slower pace. Volatile food prices experienced another period of deflation, decreased to -0.47% (mtm) in October from -2.26% (mtm) in the prior month, mainly caused by declining prices of red chilli as the commodity was in the harvesting season as well as by declining prices of eggs.

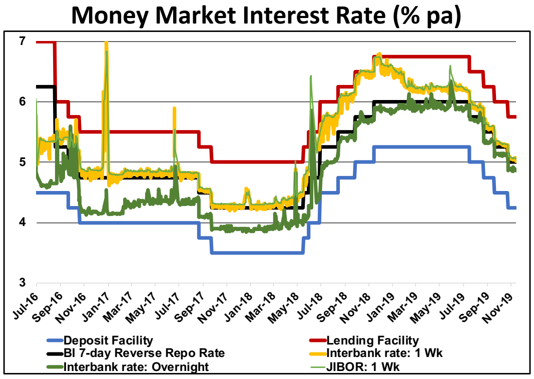
Furthermore, administered prices inflation has remained stable, recorded at 0.03% (mtm), relatively unchanged compared to 0.01% (mtm) in September. Monthly core inflation slowed down to 0.17% (mtm) from 0.29% (mtm) a month earlier. Likewise, annual core inflation eased to 3.20% (yoy) signalling stable private consumption.

Figure 1: Inflation Rate (%, mtm)



Source: CEIC

Figure 2: Interest Rate Policy and Interbank Money Market Interest Rate (% pa)



Source: CEIC

Better Picture of CAD Amid Modest Growth

The GDP growth continues its slightly slowing down trend, recording a 5.0% growth rate in Q3 2019. Indonesian economy stands at its lowest growth rate in more than last two years, driven by relatively limited government spending, suboptimal investment performance, and depressed trade performance. Government spending has slowed down significantly at 0.98% (yoy) responding to weakening tax revenue while focusing on achieving manageable budget deficit for

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Key Figures

- BI Repo Rate (7-day, Okt ‘19)
  5.00%
- GDP Growth (y.o.y, Q3 ‘19)
  5.02%
- Inflation (y.o.y, Okt ‘19)
  3.13%
- Core Inflation (y.o.y, Okt ‘19)
  3.20%
- Inflation (mtm, Okt ‘19)
  0.02%
- Core Inflation (mtm, Okt ‘19)
  0.17%
- FX Reserve (Okt ‘19)
  USD126.7 billion

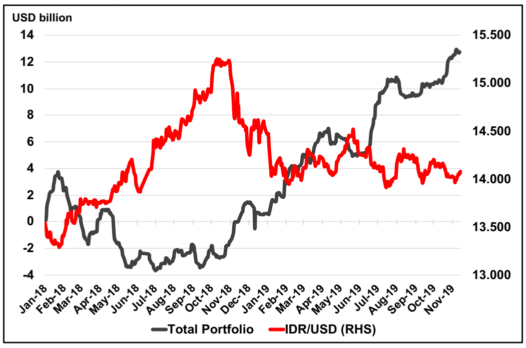
the 2019 fiscal year. Meanwhile, investment performance remains disappointing, recorded at 4.21% (yoy). Rising downside risk on economic growth could be seen from the slower-than-expected domestic demand, with the growth rate of household consumption decreased to 5.01% (yoy). In terms of production, the manufacturing industry as the largest contributor in the economy, does not show significant progress. Manufacturing industry recorded 4.15% (yoy) of growth.

CAD narrowed to 2.7% of GDP in Q3 2019 (USD7.7 billion) from 2.9% of GDP in Q2 2019 (USD8.2 billion), supported by lower oil and gas trade deficit due to the implementation of the B-20 policy amidst a stable non-oil and gas trade surplus. Export performance in Q4 2019 will be helped by higher price of palm oil as a result of potentially easing US-China tensions which has increased the price of soybean. Going forward, this relatively manageable current account balance could become one of the fundamental helpers of Indonesia's external resilience against global economic moderation, thereby maintaining IDR volatility in the near future.

Keeping Up Stability to Cushion External Risk

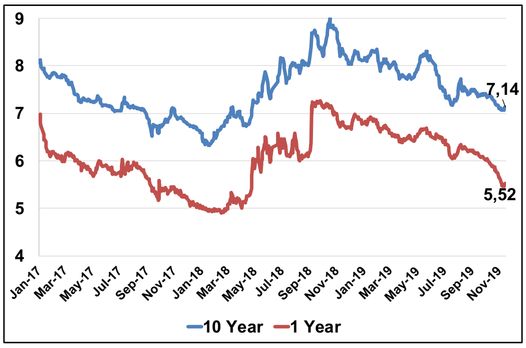
On the external condition, global growth continues to weaken despite a slight decline in financial market uncertainty following the US and China trade agreements in October 2019. IMF slashed the global growth by 20 bps to 3.0% for this year. In the absence of inflationary pressures and facing weakened manufacture and trade activity, major central banks have appropriately eased its monetary stance to reduce downside risks of growth. The Fed cut the FFR by 25bps last month. Meanwhile, ECB announced it would conduct additional effective Quantitative Easing in November 2019 and indicated further negative interest rate cuts. Bank Indonesia also has cut the policy rate by 25 bps to 5.00% for the fourth time in 2019 as the pre-emptive move to stimulate growth amid the global slowdown.

Figure 3: IDR/USD and Accumulated Portfolio Capital Inflow (Since Jan-2018)



Source: CEIC

Figure 4: Government Bonds Yield (% pa)



Source: CEIC

Overall, Rupiah remained stable at around IDR14,000, appreciated by -3.0% (ytd) as of November 18, 2019; better than its emerging market counterparts (Figure 6). The strengthening of Rupiah is influenced by reduced external pressure and stability in domestic conditions that are quite conducive. The slight easing of uncertainty in the global financial markets has pushed capital inflows into developing countries. Investors remained confident of Indonesia’s fundamental, reflected from the total accumulated capital inflow until mid-November 2019 which has reached USD12,7 billion and is also fully reflected in the lower yields of 10-year and 1-year government bonds to 7.1% and 5.5% in November. In general, relatively high real yields offered by Indonesia bonds market remains attractive to lure foreign investors, compared to other Asian markets.

Key Figures

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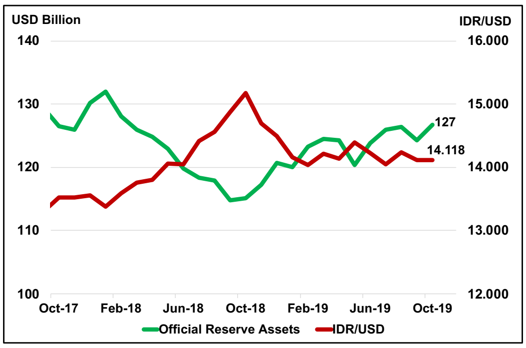
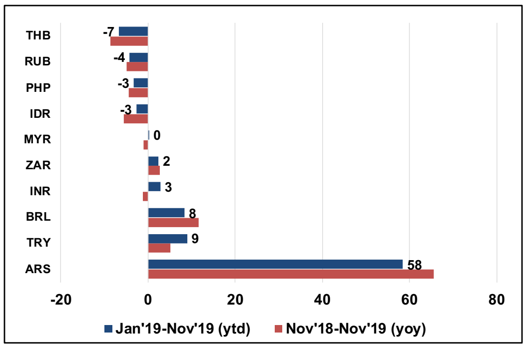
Besides cutting the policy rate four times in consecutive periods, BI loosened several macroprudential measures, including loan-to-value ratio to help the deteriorating credit growth. In the meantime, BI has collected more of foreign exchange reserves to USD126.7 billion, from USD124.3 last month. The reserves will be needed as a buffer to weather the risk of external shocks. For this month, considering the developments we discussed above, we view that Bank Indonesia needs to cut the policy rate by another 25 bps to 4.75%.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs



Source: CEIC