Indonesia

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Bank Indonesia: To Hike Or Not To Hike?

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- Market speculation/expectations are rising for BI to hike its policy rate by 25bp at its 24 April meeting in support of the currency, after the USD/IDR exchange rate broke 16,200 levels.
- Our base case is for BI to keep its policy rate unchanged at 6.00% as a 25bp hike is unlikely sufficient to stem IDR depreciation pressures.
- Importantly, we believe the trade-off between higher policy rates and growth is becoming sharper. We expect GDP growth to slow to 4.8% in 2024 (2023: 5.0%).

We noted in our recent ASEAN central banks update (see *ASEAN-5: Changing Out Policy Rate Forecast*s, 16 April 2024) that the balancing act for regional central banks is becoming more delicate. This has become more obvious for BI in recent days. The USD/IDR exchange rate abruptly broke 16,200 levels over the past week, as the Indonesian markets returned from the Eid holidays. The global market backdrop has remained volatile as the markets continue to re-price US Federal Reserve rate cut expectations (currently at 40bp cuts for 2024 versus 67bp at the end of March) and geopolitical tensions persist.

BI's focus on managing IDR volatility has been steadfast. BI executive director for monetary and security asset management Edi Susianto, as quoted to *Bloomberg* on 19 April, said that BI has entered "the market more boldly to maintain market confidence." Adding to this, Finance Minister Sri Mulyani and BI Governor Perry Warijyo have also added to the chorus of being proactive in signalling strong IDR support.

Recent Statement/Quotes		
Perry Warjiyo *Bank Indonesia Governor*	"Bank Indonesia will continue to ensure rupiah stability is maintained with FX intervention and other necessary measures."	Date: 19 April 2024, Source: Bank Indonesia
Sri Mulyani *Finance Minister*	"We have to be careful at this very moment, especially the movement coming from US policy, then EM countries have to be very very vigilant with this development."	Date: 19 April 2024 Source: Bloomberg
Airlangga Hartarto *Coordinating Minister for Economic Affairs*	"It's not wise to keep buying dollars during this time when the rupiah is depreciating," "We encourage state-owned enterprises to restrain huge dollar purchases, especially for imports of consumer goods.	Date: 18 April 2024, Source: Bloomberg
Erick Thohir *SOEs Minister*	"My directive to state-owned enterprises is to optimize the purchase of dollars, meaning it should be measured and in line with needs, not hoarding. The key is to avoid excess; we must be wise in addressing the current rise in the dollar."	Date: 19 April 2024 Source: Pertamina
Edi Susianto *Executive Director for monetary and security asset management*	"We enter the market more boldly to maintain market confidence"	Date: 19 April 2024 Source: Bloomberg

The authorities' proactive response is expected to be extended into rate hikes from BI at its 24 April meeting. *Bloomberg* consensus survey shows 7 out of 22 polled economists expect BI to hike by 25bp while the majority expects no change.

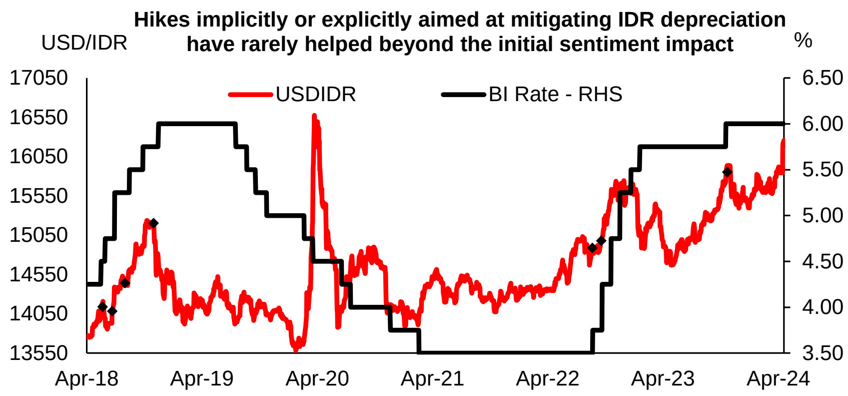
Our baseline is for no change from BI for the following reasons:

1) **If IDR stability is the aim, then one 25bp hike is likely insufficient to help IDR buck the trend of EM Asia FX depreciation.** BI, by our count, has surprised consensus on seven occasions since 2018 by raising its policy rate, in an attempt (implicit and explicit) to mitigate IDR depreciation pressures. While these actions have provided some support to sentiment immediately after the hike, the impact has not been sustainable, particularly when the external backdrop stayed volatile. This was evident in BI's latest effort in October 2023 when it implemented a 'surprise' 25bp rate hike, only to see the currency (IDR) come under renewed depreciation pressure approximately 12 days later, influenced by hawkish US rate repricing.

Previous MPC decisions that were higher than consensus expectations

Date	Magnitude	End-of-month Rate
May-18*	50	4.75
Jun-18	50	5.25
Aug-18	25	5.50
Nov-18	25	6.00
Aug-22	25	3.75
Sep-22	50	4.25
Oct-23	25	6.00

Note: "Magnitude" refers to the total hike in the specified month. *Bank Indonesia raised policy rates by a cumulative 50bp in May 2018, including an off-cycle 25 bp hike on May 30, 2018. Source: Bank Indonesia, OCBC.



Source: Bloomberg; OCBC.

2) **Growth concerns will soon start to take precedence.** We expect 2024 GDP growth to slow to 4.8% YoY versus 5.0% in 2023. Based on incoming activity data, we estimate that 1Q24 GDP growth slowed to 4.7% YoY versus 5.0% in 4Q23, with exports underperforming regional peers. Indeed, BI is already implicitly supporting growth through macroprudential tools, such as lowering reserve requirement ratios for priority lending sectors.

3) **Although inflationary pressures have been volatile in 1Q24, it is not at a stage to warrant tighter monetary policy conditions.** Headline and core inflation are likely to ease in the coming months as seasonal festivities driven price increases subside. Furthermore, better coordination between the government and BI to manage prices of key commodities is bearing fruit. Higher rice importation and a build-up in rice stocks will help mitigate sharp increases in rice prices in the coming months. To that end, the government has previously raised the rice import quota by 1.6mn tonnes

in February, bringing the 2024 quota to a record 3.6mn tonnes. On net, we continue to expect headline inflation to average 3.1% YoY in 2024 (2023: 3.7%), and ending the year at 2.9%, within BI's 1.5%-3.5% target.

The bottom-line is that the trade-off for BI is sharper in terms of IDR versus economic growth. Moreover, the effectiveness of raising the policy rate to credibly support the currency against a volatile global markets backdrop is likely to still be low.

As such, our view remains that BI's next move is likely to be cut rather than a hike. BI will not, however, throw caution to wind. For BI to make the shift in its stance, from maintaining macro stability to growth support, the coast needs to be clear in terms of a more favourable external backdrop. This requires that the US Federal Reserve embark on its easing cycle. BI's rate cutting cycle beyond the starting point, however, does not need to move in lock step with US rates as domestic considerations (namely growth) take precedence. Hence, we expect a cumulative 100bps in rate cuts from BI versus 75bps from the US Fed in 2024.

We see merit in BI front-loading rate cuts in 2024 rather than delaying it into 2025, given a shift in the domestic policy bias. Fiscal policies under incoming President Prabowo will become more expansionary, warranting a more conservative monetary policy stance next year. The 2025 fiscal deficit is forecasted to be wider up to 2.8% of GDP versus 2.3% in 2024. Indeed, fiscal deficits over the medium-term are expected to be wider under President Prabowo.

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