

Monetary Watch

DANAREKSA RESEARCH INSTITUTE

June 5, 2018

MONETARY WATCH: Another 25bps Hike in May

DRI Forecast for 2018

| | |
|-------------------|-------------|
| 7D Reserve R. (%) | 4.50 - 4.75 |
| Inflation (%) | 3.00 - 3.50 |
| GDP Growth (%) | 5.20 - 5.30 |

- In an unscheduled meeting on 30 May, BI raised its benchmark 7-Day RR rate by 25bps to 4.75 percent, with the deposits and lending facility rates also increased by 25 bps to 4.00 percent and 5.50 percent, respectively. This comes after BI hiked the 7-Day RR rate by 25 bps at the most recent scheduled monthly meeting on 16 – 17 May, meaning that the benchmark interest rate was raised by a total of 50bps in May.
- The interbank interest rate as proxied by the JIBOR O/N rate remained in its uptrend. Compared to April when the JIBOR O/N rate averaged 4.05 percent, the JIBOR O/N rate averaged 4.11 percent in May.
- In next month's governors' meeting, BI is likely to hold the benchmark rate steady after the two hikes in consecutive meetings in May. Meanwhile, the expectation of aggressive FFR hike and Fed's policy of balance sheet normalization amidst expectations of brighter US economic performance may continue to create rupiah volatility. Potential higher trend of US Treasury yield due to wider budget deficit can also absorb liquidity in global market. Lastly, Trump's protectionism and geopolitical risk may add some burden to market stability. Against this backdrop, BI will closely scrutinize economic indicators to decide whether further rate hikes are needed in the future.

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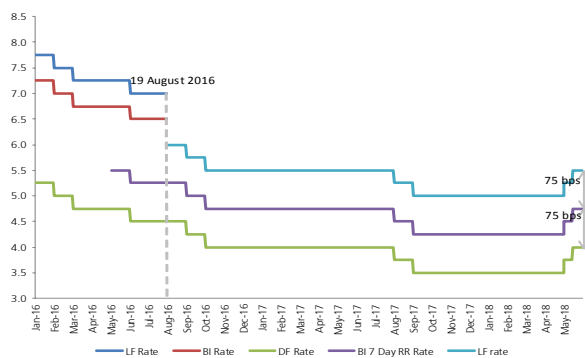
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BI 7-Day RR Rate: Another 25bps Hike

- In an unscheduled meeting on 30 May, BI raised its benchmark 7-Day RR rate by 25bps to 4.75 percent, with the deposits and lending facility rates also increased by 25 bps to 4.00 percent and 5.50 percent, respectively. This comes after BI hiked the 7-Day RR rate by 25 bps at the most recent scheduled monthly meeting on 16 – 17 May, meaning that the benchmark interest rate was raised by a total of 50bps in May.
- The 25 bps hike in the 7-Day RR rate was part of BI’s short term policy to curtail capital outflows and defend the embattled rupiah, which has come under heavy pressure in recent months in the face of high US treasury yields, global monetary tightening (especially in the US), in addition to concerns over a China-US trade war and several geopolitical risks. BI’s move - which was pre-emptive, front-loading, and ahead-of-the-curve – demonstrates its willingness to take preventive measures prior to the next Fed meeting in mid-June in which the FFR is expected to be raised for the second time this year. Furthermore, BI also continues to optimize its dual intervention policy in the foreign exchange and bonds markets to ensure plenty of liquidity. Besides this additional meeting, BI will also hold its regular monthly meeting on June 28.

BI Reference Rates

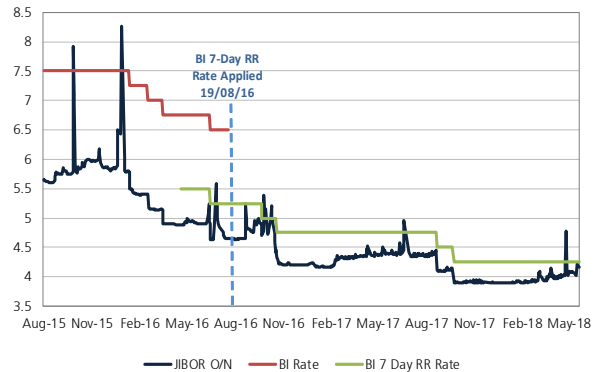


Source: Bank Indonesia

Interbank Interest Rate: Still in an Increasing Trend

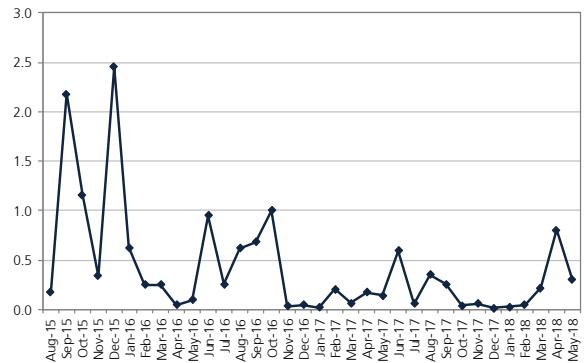
- The interbank interest rate as proxied by the JIBOR O/N rate remained in its uptrend. Compared to April when the JIBOR O/N rate averaged 4.05 percent, the JIBOR O/N rate averaged 4.11 percent in May. The volatility (as shown by the difference between the highest and lowest levels of the JIBOR O/N rate) in May, however, was much lower than in April. The volatility in April - which reached 80 bps - eased to 31 bps in May, albeit still a relatively high level.
- Looking ahead to June, the JIBOR O/N rate may remain in its uptrend, especially following BI’s two benchmark rate hikes in May. And as global volatility remains high, the volatility of the JIBOR O/N rate is still expected to stay high, although not as high as in April.

JIBOR O/N Rate



Source: Bloomberg

JIBOR O/N Spread



Source: Bloomberg, DRI

June BI Governors' Meeting: The US Treasury Yield Peaked at 3.11 percent

- On 17 May, the 10-year U.S. Treasury yield reached a peak of 3.11 percent. Foreign net selling in stock market continued and reached around 7 trillion IDR in May, despite being much less than in either March or April. Even though the beleaguered rupiah surpassed Rp14,000/USD in early May, it then managed to appreciate to Rp13,896/USD as of 31 May.
- Despite these developments, the Indonesian economy is quite strong fundamentally. The current account deficit, for example, narrowed to USD5.5 billion (2.1% of GDP) in the first quarter of 2018 compared to a USD6.0 billion deficit (2.3% of GDP) in the last quarter of 2017. Moreover, inflation was subdued in May 2018 at only 3.21 percent (yoy) – still far below May 2017's inflation rate of 4.33 percent. Currently, inflation is still within the targeted range set by BI. With inflation likely to remain benign, BI still has some room to navigate through the financial market headwinds.
- In next month's governors' meeting, BI is likely to hold the benchmark rate steady after the two hikes in consecutive meetings in May. Meanwhile, the expectation of aggressive FFR hike and Fed's policy of balance sheet normalization amidst expectations of brighter US economic performance may continue to create rupiah volatility. Potential higher trend of US Treasury yield due to wider budget deficit can also absorb liquidity in global market. Lastly, Trump's protectionism and geopolitical risk may add some burden to market stability. Against this backdrop, BI will closely scrutinize economic indicators to decide whether further rate hikes are needed in the future.

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