

Monetary Watch

DANAREKSA RESEARCH INSTITUTE

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MONETARY WATCH: Rate Hike Aimed to Restore Stability

DRI Forecast for 2018

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

- Despite the economic growth that need to be supported, BI rose the 7-Day RR rate at the May monetary policy meeting, held on 16 – 17 May. The 7-Day RR rate was increased by 25bps to 4.50 percent, while both the deposits and lending facility rates were also hiked by 25 bps to 3.75 and 5.25 percent, respectively.
- As the global market volatility increased and liquidity is on the tighter trend, our interbank interest rate as proxied by the JIBOR O/N rate started to show an increasing trend as well. Its average rate in the first three weeks of April was 4.0 percent, and when rounded to the end of April, the average increased to 4.05 percent. The average of JIBOR O/N rate in the first three weeks of May kept on raising to 4.07 percent.
- In next month's governors' meeting, BI is likely to hike the benchmark rate given the high pressure on rupiah due to concerns over sentiment from expectations of the Fed intent on boosting interest rate and raising on US treasury yield in account of widen fiscal deficit. Moreover, The Fed's balance sheet normalization absorbs dollar from global financial market. Growing volatility on rupiah toward global uncertainty result in no room for BI to cut benchmark rate this year. Against this backdrop we expect BI to hike benchmark rate up to 4.75 percent ini 2018.

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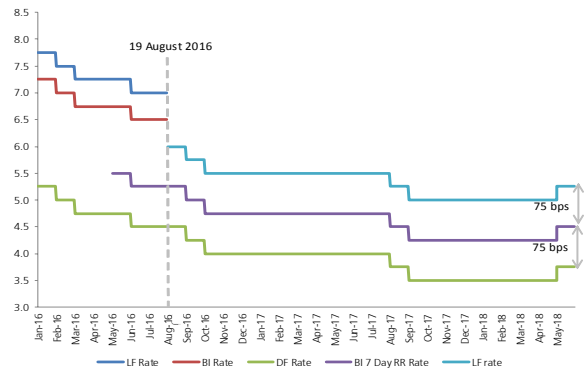
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BI 7-Day RR Rate: Rate Hike Aimed to Restore Stability

- Despite the economic growth that need to be supported, BI rose the 7-Day RR rate at the May monetary policy meeting, held on 16 – 17 May. The 7-Day RR rate was increased by 25bps to 4.50 percent, while both the deposits and lending facility rates were also hiked by 25 bps to 3.75 and 5.25 percent, respectively. The raise was the first time since November 2014, derailing from the easy money policy BI applied in the last several years in an attempt to push up economic growth. The recent hike, however, was expected to stabilize Rupiah necessary to support economic growth.
- Rupiah depreciated by around 3.50 percent (ytd) and traded above 14,000/USD since the second week of May, making it the weakest since December 2015. Global factors such as the rising US treasury yield, risk of further monetary tightening by the Fed, rising crude oil prices, potential break out of a global trade war (led by the USA and China), the geopolitical issues related to the cancellation of the US-Iran nuclear deal and in the Korean peninsula have put pressures on Rupiah steep depreciation. Meanwhile, domestic factors such as wider Q1 current account deficit, weaker than expected trade deficit in April, declining foreign exchange reserves and economic growth in Q1 that below expectation have added negative sentiments for capital outflow, thus weakening Rupiah. On the other hand, inflation rate rose just slightly to 3.41 percent in April from 3.40 percent in March. The April inflation rate, however, was still below market expectations of 3.5 percent.
- As on BI’s statement, for the time being, BI is aiming to protect Rupiah and ensure ample liquidity in the foreign exchange and money markets to overcome the current market volatility and to maintain economic growth stability.

BI Reference Rates

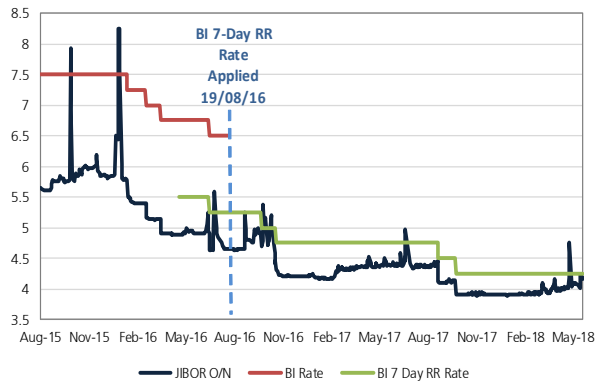


Source: Bank Indonesia

Interbank Interest Rate: On Increasing Trend

- As the global market volatility increased and liquidity is on the tighter trend, our interbank interest rate as proxied by the JIBOR O/N rate started to show an increasing trend as well. Its average rate in the first three weeks of April was 4.0 percent, and when rounded to the end of April, the average increased to 4.05 percent. The average of JIBOR O/N rate in the first three weeks of May kept on raising to 4.07 percent. The volatility (as shown by the difference between the highest and lowest levels of the JIBOR O/N rate) in the first three weeks of April was 8 bps. However, rounding to full weeks of April (by including the last week of April), the volatility jump ten times to 80 bps. The volatility in the first three weeks of May, however, dropped to 21 bps, although it is still considered high.
- Looking ahead to the rest of May and June, the JIBOR O/N rate may remain in an upward trend, as BI has just raised the benchmark rate. Global volatility, as mentioned above, remains high, therefore the volatility of the JIBOR O/N rate is still expected to stay high.

JIBOR O/N Rate

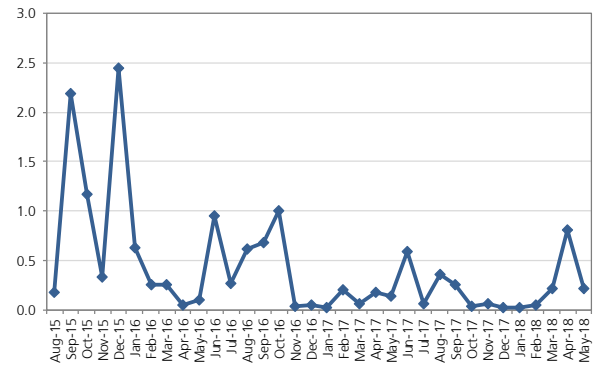


Source: Bloomberg

Deposit and Credit Rates: The End of Downward Trend

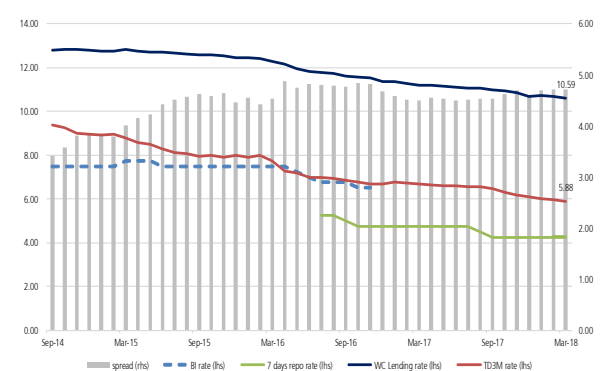
- In March, deposit rate declined by 9 bps to 5.8 percent. With last 25 bps benchmark rate hike, LPS rate will follow to increase its rate hence we can expect deposit rate will begin to tick up in the next two months. Credit rate recorded 10 bps declined in March, much higher that it did in February. More specifically, all credit rate components (working capital, investment and consumer credit rates) declined, although the declines have not yet led to a single-digit credit rate. Benchmark rate hike will end downward trend of credit rate in the past 2 years.
- According to Bank Indonesia, even though it is unlikely to cut benchmark rates this year, the central bank will still adopt certain macroprudential policies to achieve double-digit credit growth. In terms of credit quality, NPLs show improvement in March 2018 by decline to 2.75 percent from 2.90 percent in February.

JIBOR O/N Spread



Source: Bloomberg, DRI

The Interest Rate Spread of Banks



Source: Bank Indonesia

June BI Governors' Meeting: The External Uproar Continued

- In April 2018, Indonesia's inflation rate down 0.10 percent (MoM) from 0.20 percent in March. On an annual basis, inflation stood at 3.41 percent (yoy) – still far below April 2017's inflation rate of 4.71 percent. Looking at the position of Indonesia's current account deficit, it narrowed to USD5.5 billion deficit (2.1% of GDP) in the first quarter of 2018 compared with a USD6.0 billion deficit (2.3% of GDP) in the last quarter 2017. However, first quarter economic growth was below market expectation by grew 5.06 percent. We revised down our economy growth forecast to 5.2 percent up to 5.3 percent in 2018.
- Nevertheless, Indonesia's international reserves continued to drop to USD124 billion as of April 30, 2018, or down from USD126 billion in the previous month due to heightened external risks. In April, the 10-year U.S. Treasury yield rose above 3 percent for the first time since January 2014. This explains the IDR 10 trillion of net selling by foreign investors in the capital markets in April – continued its vast sell of 14 trillion in March. Given the heightened uncertainties, the rupiah depreciated by 3.6% (ytd).
- In next month's governors' meeting, BI is likely to hike the benchmark rate given the high pressure on rupiah due to concerns over sentiment from expectations of the Fed intent on boosting interest rate and raising on US treasury yield in account of widen fiscal deficit. Moreover, The Fed's balance sheet normalization absorbs dollar from global financial market. Growing volatility on rupiah toward global uncertainty result in no room for BI to cut benchmark rate this year. Against this backdrop we expect BI to hike benchmark rate up to 4.75 percent ini 2018.

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