Assessing Policy Response – Stability over Growth (?)

Key Takeaways

- M2 money supply continued to expand in May 2024, reaching IDR8,965.9 trillion, reflecting a +7.6% YoY increase.
- Bank Indonesia's Board of Governors (RDG) opted to hold the BI-Rate steady at 6.25% during their meeting on June 19-20.
- The recent IDR depreciation is due to global financial market volatility, foreign capital outflows, and heightened perception on future fiscal sustainability.
- During March and April, foreign investors engaged in shifting funds from the domestic market to other EMDE's in Asia, like India, Thailand, and South Korea.
- As of June 14, 2024, SRBI totaled IDR 666.53 trillion, with foreign ownership at IDR 179.86 trillion (~27%).
- Until 2H24, the government through the MoF appeared to withhold the issuance of SBN amidst high cost of funds to maintain a controlled debt position.

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Taming the inflation tide

Since 2021 until the present, heightened inflation across many countries has prompted central banks to raise their policy interest rates. The Fed increased its benchmark rate from 0.25% in January 2021 to 5.50% in May-24, while the European Central Bank (ECB) raised its key rate by 450 bps by Apr-24. Domestically, Bank Indonesia (BI) has raised interest rates by 275 bps, from 3.50% in Feb-21 to 6.25% in May-24. Additionally, BI tightened monetary policy by increasing the minimum reserve requirement from 5.0 percent in Jun-22 to 9.0 percent in Sep-22.

BI's reserve requirement hikes are meant to control money volume by impacting bank balance sheets. This drives banks to place excess liquidity in safer instruments, ensuring prudent financial management since government securities are less risky than loans. Such policy contributed to a slowdown in broad money supply growth (M2) in 2022 and 2023. However, M2 managed to grow higher in 2024, with M2 reaching IDR8,965.9 trillion in May 2024, reflecting a +7.6% YoY increase.

BI stands firm on rates despite weakening rupiah

The Bank Indonesia's Board of Governors (RDG) meeting on June 19-20 decided to maintain the BI-Rate at 6.25%, even though the Rupiah exchange rate has weakened by more than 6% YtD to IDR16,430/USD. This decision is likely based on the following factors: 1) Inflation remains below BI's target, 2) the differential rate between Indonesia and other countries remains attractive to investors, and 3) foreign exchange reserves stood at USD139 billion in May-24, providing a buffer for short-term rupiah stability. In contrast, in April 2024, BI raised the interest rate to 6.25% when the Rupiah weakened to IDR16,200/USD. We anticipate BI will maintain the benchmark rate at the next meeting, as triple intervention strategy effectively stabilizes the rupiah, bolstered by ample foreign exchange reserves and strong domestic fundamentals.

Foreign capital outflows weigh on rupiah

Foreign investors remain engaged in shifting funds out of the domestic financial market to other EMDE's in Asia, such as India, Thailand, and South Korea. During the second week of June, foreign investors recorded a net sell position of approximately IDR0.75 trillion in the SBN market, followed by a net sell of approximately IDR1.42 trillion in the stock market the following week. This outflow of foreign capital is attributed to global market sentiment regarding the uncertain direction of the Fed's interest rate policy. Additionally, the high demand for USD by corporations for dividend payments has contributed to the weakening of the rupiah. Concerns surrounding the new government's initiatives, which is perceived as potentially widening the deficit, have also triggered sell-offs in both the stock and SBN markets, further weakening the rupiah.

A rugged drive into the vale

Bank Indonesia is actively engaged in foreign exchange interventions in both the spot and forward markets to strengthen the rupiah. While this policy is expected to deplete existing foreign exchange reserves, BI's latest release shows that foreign exchange reserves actually increased from USD139 billion in May-24 to USD140.2 billion in Jun-24. BI's involvement extends to the SBN market, as evidenced by their increased ownership this month to 22.74%, up from 22.25% in the previous month.

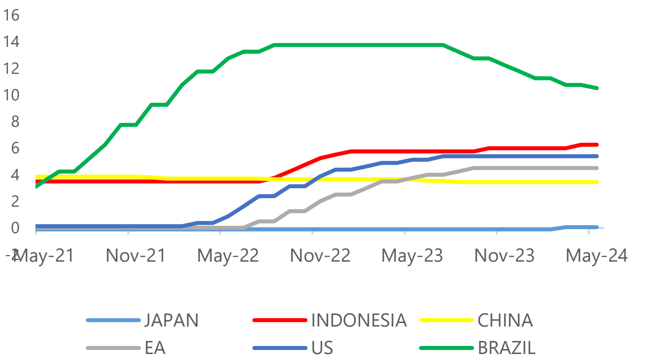
Additionally, BI employed the SRBI instrument, offering significantly higher interest rates of 7.28-7.52% in last week's auction, exceeding both the BI rate and the 30-year SBN yield of 7.12%. This strategy attracted renewed foreign inflows, with foreign ownership at IDR179.86 trillion (27% of total SRBI) as of June 14, 2024. Nevertheless, higher SRBI rates could invert the yield curve, causing Short-Term yields to rise above Long-Term yields. Furthermore, high borrowing cost might potentially impede economic growth and undermine fundamentals in the real sector. Should the IDR depreciate beyond IDR16,500 due to persistent outflows, Bank Indonesia may be compelled to raise interest rates to stabilize the currency.

A measured policy to soothe the fever

As of May-24, budget financing through new debt issuance reached IDR132.2 trillion, down 12.2% YoY compared to the same period last year. This debt financing was primarily derived from the sale of SBN amounting to IDR141.6 trillion, down 2% YoY and equivalent to 21.3% of GDP. The government, through the Ministry of Finance, chose to hold off on additional new debt due to rising cost of funds, which would make state budget financing more expensive. The policy to restrain new SBN issuance is an anticipatory step amid global financial market turmoil in an era of high interest rates. This measure is backed by the Excess Budget Balance (SAL) at the end of 2023, which reached IDR459.5 trillion and can be used as a fiscal buffer for any potential disruptions in 2024.

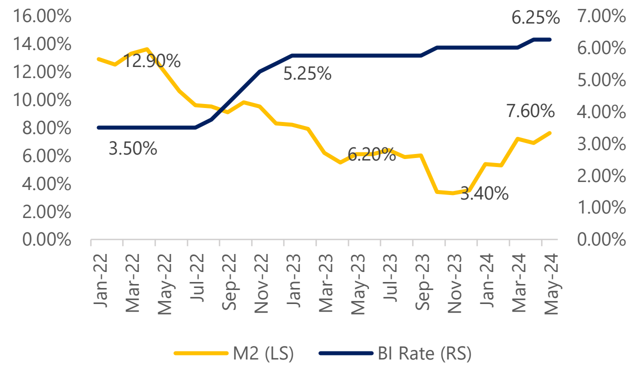
To address rising spending needs in the second half of 2024, the Indonesian government intends to resume the issuance of Indonesian government bonds in the 3Q24. However, the government's SBN issuance strategy must navigate market dynamics and consider external factors: 1) The recent surge in market demand for high-yielding SRBI could lead to an upward shift in the SBN yield curve as well, 2) SBN issuance will face direct competition from UST offerings in the 4Q24, 3) The spread between SBN and UST yields is expected to narrow further as the approaching US presidential election in November could trigger a rise in UST yields.

Exhibit 1. Global monetary policy divergence (in %)



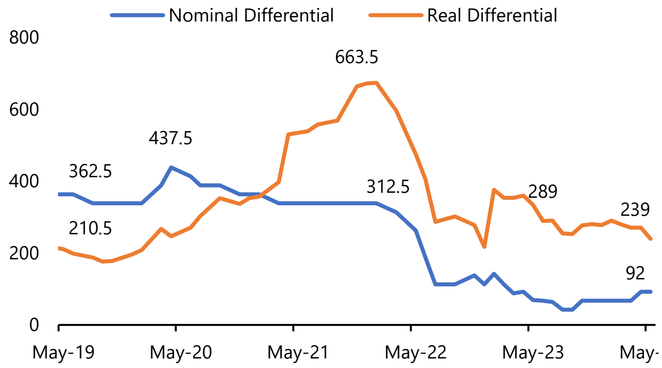
Sources : Bloomberg, MNCS Research

Exhibit 2. M2 growth on BI rate hikes (in %)



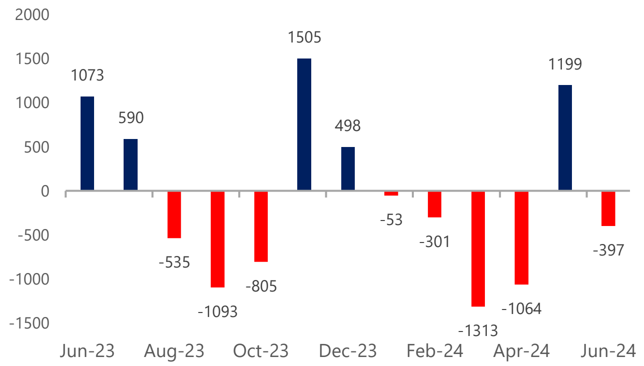
Sources : Bank Indonesia, MNCS Research

Exhibit 3. US-Indo rate differential narrows (in bps)



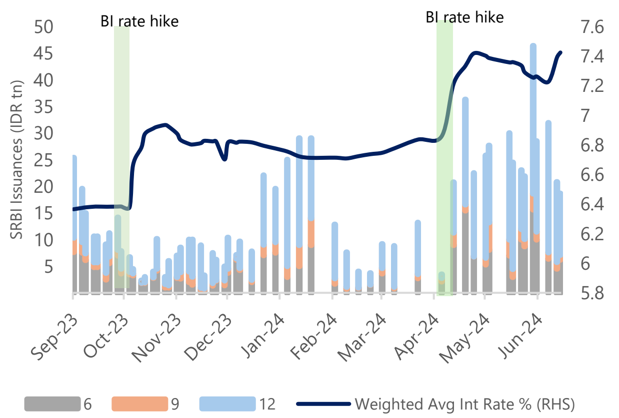
Sources : Bloomberg, MNCS Research

Exhibit 4. SBN monthly fund flows (USD mn)



Sources : Bloomberg, MNCS Research

Exhibit 5. SRBI yields surged following BI's rate hike



Sources : Bank Indonesia, MNCS Research

Exhibit 6. Narrowing yield spread : 10-yr Indo GB vs. 10-yr UST

Sources : Bloomberg, MNCS Research

MNC Research Industry Ratings Guidance

- **OVERWEIGHT :** Stock's total return is estimated to be above the average total return of our industry coverage universe over next 6-12 months
- **NEUTRAL :** Stock's total return is estimated to be in line with the average total return of our industry coverage universe over next 6-12 months
- **UNDERWEIGHT :** Stock's total return is estimated to be below the average total return of our industry coverage universe over next 6-12 months

MNC Research Investment Ratings Guidance

- **BUY** : Share price may exceed 10% over the next 12 months
- **HOLD** : Share price may fall within the range of +/- 10% of the next 12 months
- **SELL** : Share price may fall by more than 10% over the next 12 months
- **Not Rated** : Stock is not within regular research coverage

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