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Global Economics & Market Strategy

Indonesia: The First & Last Hike in 2024

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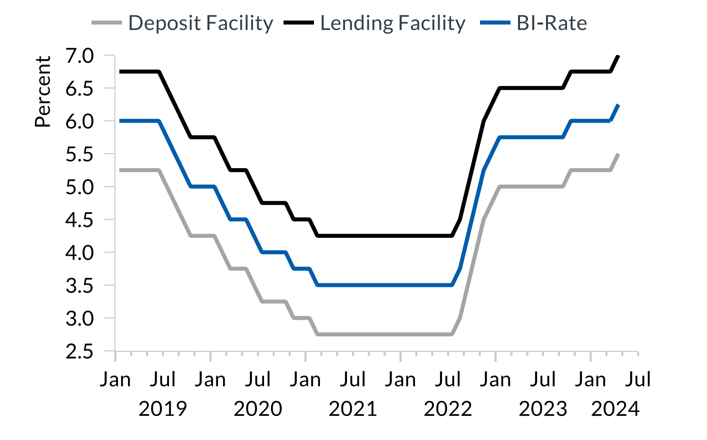
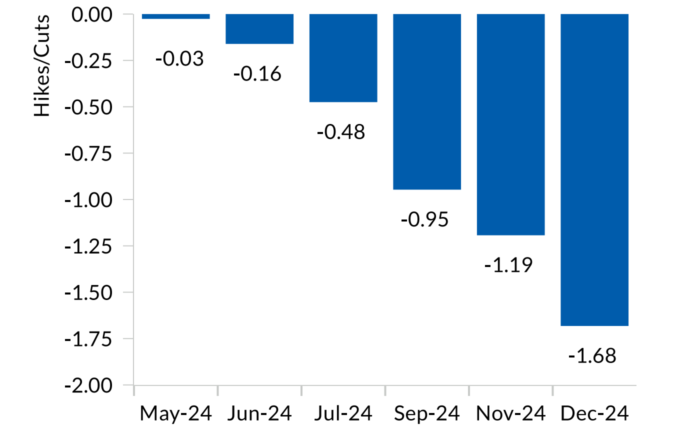
- **We see downside risks for our base case Indonesia's GDP growth to below 5.0% in 2024, against our prior outlook of 5.0%. We keep our inflation forecast unchanged at 3.3% this year.**
- **Bank Indonesia's (BI) hike to 6.25% will likely be the first and last for the year. Higher rates will tamper consumption demand, albeit it may cushion the weakness in the IDR into the year.**
- **BI unexpectedly hiked its benchmark rate to 6.25% in its April 2024 MPC meeting, against market consensus (and ours) view for no change. BI now views US Fed Funds Rate to see only one cut in December, against the previous view for cuts to happen in 2H24.**

Figure 1: Bank Indonesia hike its policy rate to 6.25% in the April Meeting...



Source: Macrobond, RHB Economics & Market Strategy.

Figure 2: ...as the market is continued to price out the FFR cuts



Source: Macrobond, RHB Economics & Market Strategy.

We See No Rate Cuts for Rest of The Year

We see downside risks for our base case Indonesia's GDP growth to below 5.0% in 2024, against our prior outlook of 5.0%. Our inflation forecast is kept unchanged at 3.3% this year, with inflation pressures within BI's inflation target at latest data. Our thematic study suggests (1) Indonesia's consumption patterns to potentially slow in 2H24 as Lebaran-fuelled seasonal demand dissipates, (2) with consumption demand fueled primarily by loans growth. Private consumptions remain to be a primary driver for Indonesia's GDP (>50% of total GDP), whereby we think GDP growth potential must be supported by robust retail sales patterns over the same period.

Today's rate hike, we opine, is likely driven by the need to stabilise the IDR, especially given recent market pricing-out of US Fed Funds Rate (FFR) cuts. Latest swap pricing suggests that market is expecting between one to two rate cuts towards 2H24, against our view for only one rate cut towards year-end. We believe that the high-for-longer US rates is a pertinent driver for further DXY appreciation towards the 110 handle in 2Q24, thus suggesting IDR's potential weakness over the same period. BI's rate, however, may also be preemptive against potential inflationary pressures, given the ongoing appreciation in commodity prices, thus underlining the need to cushion Indonesia's imported inflation given the structural energy net-imports.

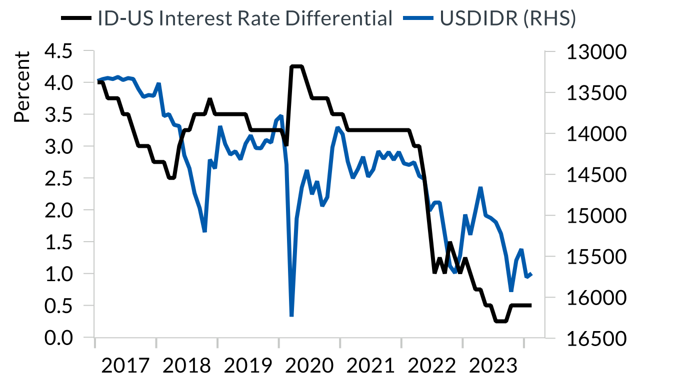
Notwithstanding our aforementioned view, according to Bank Indonesia, the rate hike today is due to three key reasons: (1) IDR stability likely from the revised BI view on the US FFR trajectory, whereby (2) the need to ensure IDR stability is made pertinent from recent geopolitical tensions, while (3) higher rates can help cushion imported inflation in the year ahead.

In that vein, we think Bank Indonesia's (BI) hike to 6.25% will likely be the first and last for the year. Our view was for BI to keep rates unchanged, as (1) Indonesia's inflation remains tame with headline prices within the 1.5 – 3.5% target for 2024, (2) while higher rates may depress loans growth, and consequently, consumer demand, and (3) a weaker IDR may help support Indonesia's trade surplus, especially with trade surplus seeing a -40% YoY in 1Q24. Despite today's hike, these factors remain to be important reasons why BI will not hike rates further in 2024. Thus, we see BI rate to peak at 6.25% and expect no cuts for the rest of the year. We recognise tail-end risks for further hikes only if global inflation pressures or geopolitical tensions exacerbate unexpectedly into 2H24.

We note initial market reaction has been muted, suggesting that a single 25bps rate hike may be insufficient to stem IDR weakness. Thus, today's hike may merely cushion IDR's weakness, and should not be regarded as evidence for a persistent strengthening of the IDR into 2024. IDR was little changed at around 16150 per USD after the hike announcement. BI view IDR at 16200 per USD for 2Q24, before strengthening to 15800 into 4Q24, a view we do not subscribe to. We keep to our view for market participants to price out FFR cuts into 2H24, suggesting that DXY strength may persist over the said period. Beyond, JCI was also muted at its 7170 handle.

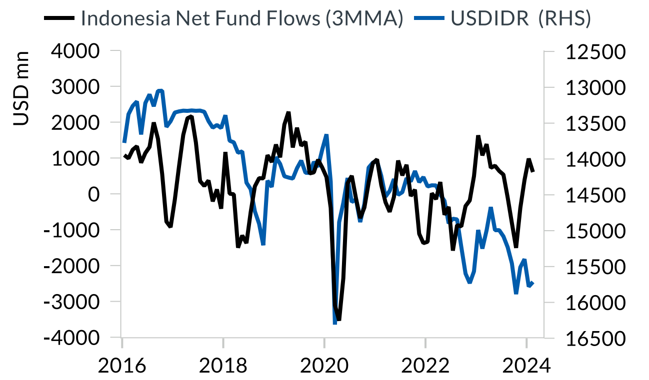
BI unexpectedly hiked its benchmark rate to 6.25% in its April 2024 MPC meeting, against market consensus (and ours) view for no change. BI now views US Fed Funds Rate to see only one cut in December. BI kept its GDP growth forecast unchanged at 4.7% - 5.5%, while maintaining its CPI outlook at 1.5 – 3.5% in the year ahead. In a virtual briefing, BI governor Warjiyo commented that the rate hike is in response with dollar resurgence and the conflict in the Middle East, thus requiring an "anticipatory, forward-looking, and preemptive" policy response.

Figure 3: The BI rate hike should widen ID-US rate differentials and cushion IDR's weakness...



Source: Macrobond, RHB Economics & Market Strategy.

Figure 4: ... while it may too soon to tell if the rate hike is effective to garner net inflows into ID shores



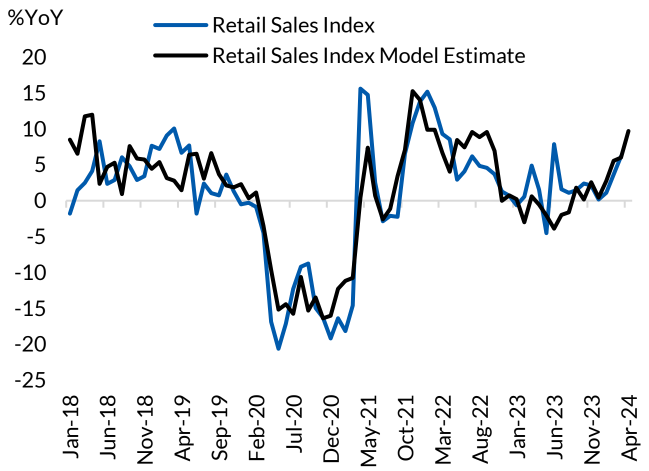
Source: Macrobond, RHB Economics & Market Strategy.

Figure 5: Retail sales (MoM %) is usually strong during Lebaran festivities, and thereafter, slow into the year

	Mean	Median	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Jan	-5.03	-4.38	-8.82	-2.60	-1.24	-4.93	-7.29	-7.70	-7.47	-4.26	-3.11	-4.38	-3.52
Feb	-2.39	-2.47	-4.85	-0.40	-2.47	-4.86	-1.71	0.03	-0.54	-2.66	-4.55	-3.38	-0.94
Mar	3.87	3.48	-0.62	2.51	2.97	3.48	4.54	5.48	1.64	6.07	2.64	7.04	6.86
Apr	3.76	1.22	-1.73	1.10	1.22	1.22	2.83	-0.35	-13.29	*17.32*	*16.52*	*12.81*	
May	2.65	3.68	3.68	1.50	3.67	3.76	*7.88*	*8.91*	4.00	3.22	-2.14	-7.99	
Jun	-0.96	1.13	2.52	4.03	*6.51*	*8.47*	2.53	-6.49	-2.38	-12.75	-11.75	-0.26	
Jul	-1.05	-4.08	*22.46*	*8.57*	-0.74	-9.67	-9.16	-5.29	0.25	-5.05	-3.12	-8.79	
Aug	-3.50	-1.46	-10.93	-13.10	-8.93	-3.76	-0.81	-2.11	1.33	2.11	0.83	0.36	
Sep	-1.03	-1.46	-0.53	0.62	-0.10	-0.43	-1.62	-1.94	-1.43	-1.54	-1.82	-1.48	
Oct	0.79	1.28	0.99	2.53	0.19	0.56	-1.27	1.58	-5.34	3.15	2.31	3.22	
Nov	0.89	0.41	-0.69	0.24	1.89	2.16	2.69	0.40	-1.16	2.82	0.41	0.16	
Dec	7.12	7.25	5.90	7.52	8.08	6.21	10.57	8.55	4.81	7.61	6.99	4.94	

Source: CEIC, RHB Economics & Market Strategy. Blue coloured figure indicates the month of Lebaran Celebrations

Figure 6: Retail sales may slow into 2H24 as Lebaran-fueled consumption dissipates



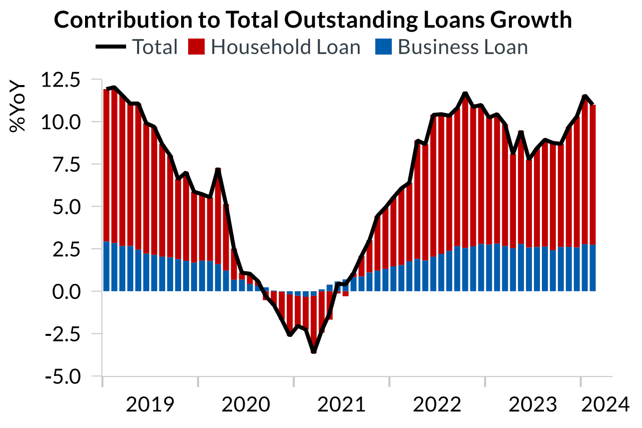
Source: RHB Economics & Market Strategy.

Figure 7: Our model suggests loan outstanding drives retail sales…

Dependent Variable	Retail Sales Index			
Independent Variables	Coefficient	Std. Error	t-Statistic	P-value
Total Loan Outstanding (-3)	0.964	0.197	4.897	0.000
Jakarta Composite Index (-2)	0.346	0.073	4.773	0.000
Consumer Confidence Index (-1)	0.103	0.049	2.098	0.040
Import of Consumer Goods (-2)	0.090	0.032	2.828	0.006
Car Sales (-2)	-0.008	0.003	-2.441	0.018
Consumer Price Index (-2)	-1.942	0.717	-2.710	0.009
Constant	-2.011	1.807	-1.113	0.270
R-Square	0.758			
Adjusted R-Square	0.733			
Standard Error	4.609			
Observation	60			

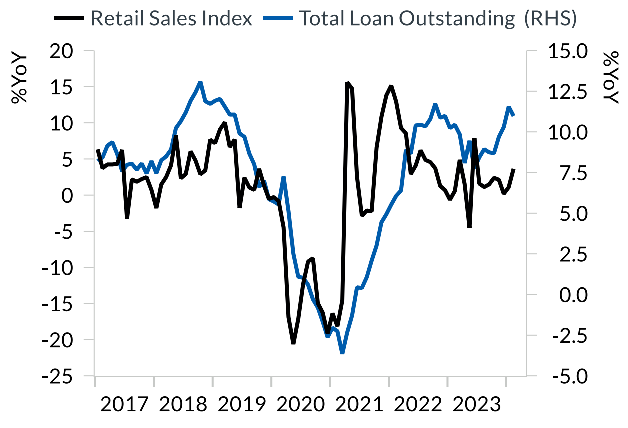
Source: RHB Economics & Market Strategy.
(-x) represent the (t-x) lag of the variables.

Figure 8: … which suggests today's BI rate hike may lift cost of borrowing…



Source: Macrobond, RHB Economics & Market Strategy.

Figure 9: … and depress loans growth and by consequence, retail sales spending into 2H24



Source: Macrobond, RHB Economics & Market Strategy.

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