Indonesian central bank cuts policy rates as growth momentum fades

Bank Indonesia cut its key rate by another 25 basis points after downgrading growth projections

Perry Warjiyo, Governor of Bank Indonesia

Source: IMF/Flickr

3.5% 7-day reverse repurchase rate

As expected

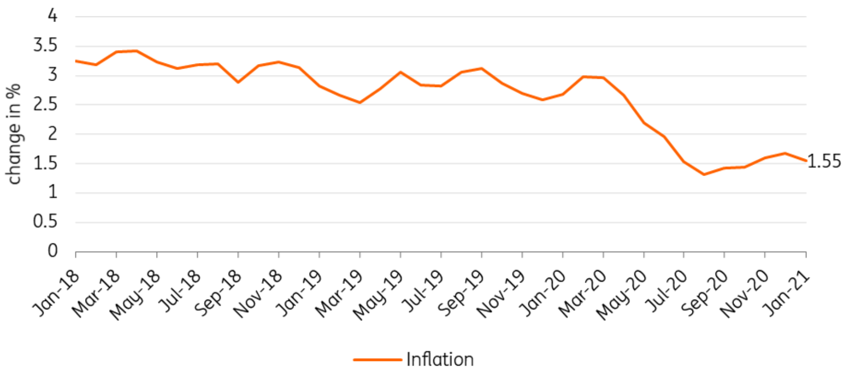
Bank Indonesia moved quickly to support sagging growth momentum

Indonesia' central bank cut the policy rate by 25 basis point to 3.5% in a bid to revive fading growth momentum.

With inflation below the central bank’s 2-4% target and the economic recovery faltering, Governor Perry Warjiyo pulled the trigger to deliver another round of easing.

Days after finance minister Indrawati downgraded official growth projections, the central bank also tempered its GDP forecast to 4.3-5.3%, which was previously at 4.8-5.8%. But the central bank remains hopeful for domestic economic activity to recover supported by more fiscal stimulus and vaccination efforts.

Low inflation and fading growth momentum gave BI space to cut rates



Source: Badan Pusat Statistik

Lost in transmission? BI steps up efforts to bolster lending

It's worth noting that the emphasis on ensuring that the string of rate cuts delivered by the central bank would eventually transmit to lower borrowing costs and faster bank lending. Warjiyo highlighted the slow transmission of the central bank's easing, citing that banks had lowered borrowing rates by roughly 83 bps compared to the 125 bps cumulative rate reduction in 2020.

Nonetheless, the central bank hoped that banks would pass on the lower borrowing costs to consumers with bank lending now expected to grow between 5-7%.

On top of the rate cut, the Bank also unveiled new rules on lending to the automotive and property sector, with loans for automobiles now no longer requiring a down payment, in a bid to bolster demand for credit.

Easy on the easing

One other interesting development was the shift in tone.

After months of indicating the central bank's willingness to provide monetary stimulus and support the economic recovery, the central bank hinted that the scope for further rate reductions was now "more limited". The sudden shift in tone may hint at a more measured pace of rate cuts in the near term with the Governor suggesting that the central bank would select the proper tool to support the recovery.

Going forward, we now expect the Bank to pause in the near term as they monitor the recent pickup and global bond yields and what it could mean for both inflation and IDR stability in the coming months.