Indonesia Outlook

BI hikes by 25bps amid IDR pressure

Wednesday, August 15, 2018

Highlights

- **Bank Indonesia (BI) has chosen to hike the benchmark rate by another 25bps bringing it to 5.50%.** This means that to date for this year, the central bank has cumulatively raised rates by 125 bps. This came as the pressure on the Turkish Lira also receded. The current account for 2Q 2018 had also widened to 3.0% of GDP whilst the trade balance also turned negative for July 2018 at -US$2030m (June 2018: US$1743m). The central bank said in its press release that this is consistent with the efforts to maintain the attractiveness of the domestic financial market and control the current account deficit within a safe limit. BI believes that the Fed will continue to gradually raise the fed fund rate amid what they believe will be a strengthening US economy. The central bank also believes that growth will be at 5.0% - 5.4% for 2018. BI also said that its policy in increasing the effectiveness of providing foreign currency swaps with lower prices was able to increase the interest of bidders in various tenors and reduce market swap premiums, for example from 4.85% to 4.62% for 1-month tenors and from 5.18% to 4.96% for a 1-year tenor. They expect that inflation would be maintained in their target range of 3.5%+1% yoy for this year.
- **This rate hike comes as the government itself has also implemented other policies to try to stem the IDR decline.** Just yesterday, President Jokowi had held a cabinet meeting to discuss on the forex reserves. Finance Minister Sri Mulyani then announced that the government "will take firm and drastic measures to control imports" and that they "have identified consumption goods and raw materials that can be substituted with domestic products". The government plans to impose a 7.5% tax on imports of select products deemed as not strategic for the economy. The government will also ask state-owned refiner PT Pertamina and electricity producer to review imports of capital goods. The two companies will also need to postpone infrastructure projects that are yet to tie up funds, according to Sri Mulyani. All request for capital goods imports by these companies will be suspended for the next six month or until the balance of payment is improved. The government is also working to mandate the use of 20% percent blended palm biodiesel in more sectors. This is estimated to cut crude oil imports by about US$2.3bn for this year.
- **Going forward, we expect that BI could still further raise rates this year.** The central bank itself has already recognized the possibility of the Fed further raising rates and this could come to put pressure on BI to also further raise rates. The prospect of further trade tensions between the US and China or the US with other countries could further dampened sentiment towards the currency. In other parts of the economy, our expectation is for growth to come out at 5.1% yoy, which is at the lower end of the official central bank forecast.

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