Indonesia Outlook

OCBC Bank

Bank Indonesia hikes by 25bps

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Highlights

- **Bank Indonesia (BI) raised rates by 25bps just as the Fed also hiked rates by 25bps earlier.**
- **BI also announced that it will allow lenders to offer non-deliverable rupiah forward contracts that can be settled in local currency.**
- **At this point, it appears that EM pressures may persist for a while.**
- **Going forward, we expect BI to raise rates by at least 25bps in Dec 2018.**

The central bank hiked rates by 25bps just as the Fed also hiked rates by 25bps earlier. This brings the benchmark rate up to 5.75% and cumulatively, that is an increase of 150bps so far this year. The central bank mentioned that this was in line with the effort to reduce the current account deficit. BI also noted that going forward, it will continue to undertake measures to stabilize the exchange rate in accordance with its fundamental values and to maintain the functioning of the market mechanisms. As expected, BI appears to be fully focused on IDR stability. Market reaction was generally quite muted as the IDR and 10 Year Govt Bond Generic Bid Yield changed little although the JCI did see a bit of increase.

BI also announced that it will allow lenders to offer non-deliverable rupiah forward contracts that can be settled in local currency. The contracts will be called the domestic non-deliverable forward (DNDF). They will be settled based on Bank Indonesia's spot dollar rate, known as the JISDOR. At the moment, full details on the DNDF is still pending. According to Nanang Hendarsah, executive director for monetary management at BI, the Indonesia Foreign Exchange Market Committee is drafting the framework for this at the moment and it may become operational in the coming weeks.

At this point, it looks like EM pressures may persist for a while. This pressure has been going on amid the US interest rate normalization and the Sino-US trade tensions. Fed dot plots indicate potential for at least three rate hikes next year whilst the US – China trade spat may be long drawn out. Indonesia's economic fundamentals though appear much stronger compared to the Asian financial crisis period of 1997 – 1998 (see table 1) where the IDR had hit levels as high as 16,650 against the USD. Regardless, Indonesia has run a persistent current account deficit since 2012 and foreign investors may be focusing on this now.

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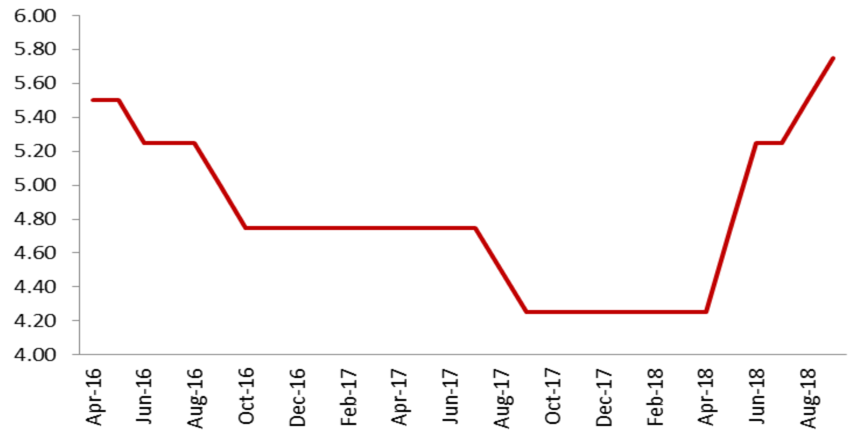
Going forward, we expect BI to further hike rates another time in December 2018 by at least 25bps. The central bank would probably want to ensure that they keep up with the fed increases with the next Fed hike of 25bps likely to come in December 2018. The government at the same time may continue to roll out other measures in their attempt to ensure the stability of the IDR. However, these measures may take a while to have an effect as they are gradually implemented and the local economy adapts to them.

Chart 1: Bank Indonesia Benchmark Rate, %



Source: OCBC staff calculations based on CEIC data

Table 1: Key economic indicators of Indonesia in 1996 and 2017

	1996	2017
Real GDP growth (% yoy)	7.8	5.1
CPI inflation (% yoy)	8.0	3.8
Current account balance (% of GDP)	-3.4	-1.7
International reserves, USDbn	19	130
International reserves, % of GDP	8.4	12.8
Import cover of FX reserves (no. of months imports)	5.3	10.0
External debt outstanding (% of GDP)	56.4	34.8
General government debt, % of GDP	30.8	28.9
Debt service ratio[1] (%)	13.7	4.2
Credit to private non-financial sector[2] (% of GDP)	63.1	39.4
Policy interest rate[3] (%)	12.75	4.25

Source: OCBC staff calculations based on CEIC and Bloomberg data

Note: 1. This refers to private non-financial sector and data is sourced from BIS.

2. Data sourced from BIS

3. The policy rate was changed to the BI 7-Day (Reverse) Repo Rate, effective from 19th August 2016. Prior to that, the policy rate was the 1 Month Bank Indonesia Certificates Auction Rate.

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