Inside Indonesia

Path of Least Resistance

Indonesia holds rate, as expected

May 18, 2017

- **Another month marks another hold for Bank Indonesia's monetary policy decision. Its 7-day reverse repo policy rate remains stuck at 4.75% for now.**
- **That should not come as a surprise. Facing recalcitrant domestic inflation pressure and a hint of global risk aversion, cutting rate today would have been feckless. Given that growth is doing alright, there is little need for such act too.**
- **On the flip side, there is hardly any case for a rate hike anytime soon, as well. Its currency is stable. Relatedly, the Fed looks to have even less gumption to hike more than anticipated now than before, with all the drama in Washington.**

Steady does it

If it's not broken, why fix it? That seems to be the spirit that is guiding Bank Indonesia's monetary policy decision over the past few months, and it looks set to remain so for the rest of the year from the current vantage point.

For the seventh consecutive month now, BI kept its 7-day reverse repo policy rate unchanged at 4.75%, and our sense is that it will remain stuck at the same level for the rest of this year.

To understand why there is such an apparent inertia, it is easiest to think of it less as a result of casual indifference than of an active consideration because of two equal but opposing forces.

First, as alluded to at the start, a number of factors keep BI from easing its monetary policy. The most in-your-face one has to be the recent uptick in inflation. April saw headline prices picking up by 4.17% yoy, when it was below 3% just half a year back. This wave has been driven by a motley crew of adjustments in electricity prices, dearer airline tickets, petrol prices and cigarettes.

With just weeks to go before the Ramadan fasting month, we are likely to see further uptick in food- and transport-driven prices for the next few prints. While the one-off and seasonal factors are hardly a reason to freak out over more generalized inflation risks, they would nonetheless minimize the chances of a rate cut in the near term.

Meanwhile, while Q1 GDP growth was not much to write home about at 5.01%yoy – a barely noticeable uptick from 4.94% of the previous quarter – the momentum remains positive enough for the central bank to refrain from easing. This is especially so given that there appears to be relatively low chances of a fiscal pullback by the government, unlike the same period last year.

On the flip side, there is not much impetus for the central bank to nudge its policy rate upward. For one, as mentioned earlier, even as inflation remains something to look out for, there is little sign that price upticks are spreading broadly enough to warrant a classic monetary policy reaction just yet.

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On top of that, Rupiah has also been trading around a comfortably narrow range, which means BI is unlikely to be forced to come in forcefully to support the currency via rate hikes.

This relatively dormant situation, of course, remains in large part a function of global factors, as well.

Overnight, we saw a whiff of risk aversion because of a roster of captivating developments in the US domestic politics. Thus far, this has translated more into USD weakness – which is, narrowly defined, a boon to EM currencies including Rupiah. To be sure, in what remains a rapidly evolving situation, Bank Indonesia is probably not alone in being cognizant that, if the risk aversion deepens further, EM currencies may well come under pressure as well. However, the likelihood of BI having to tighten primarily to stabilize its currency remains low at this point.

For now, the lack of compelling reasons to hike rate, or to ease it, will keep BI on hold. Overall, steady rates look to us to remain the path of least resistance for now.

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