OCBC TREASURY RESEARCH

Regional Snapshot

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Hurried Half

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Bank Indonesia raised rates by 50bps on hawkish Fed and inflation threat

- Indonesia's central bank opted to hike its rates by 50bps today from 3.75% to 4.25%, compared to the broader market expectation, including ours, for a more traditional 25bps move.
- The decision is a tell-tale sign of how the global monetary policy landscape has hardened. Against the spectre of the higher-for-longer Fed rates, it can no longer be assured that a slow and gingerly approach to its own monetary policy normalization can anchor exchange rate stability like before.
- On top of that, there is also the effect of fuel price hike to consider, with BI essentially saying that we'll have to wait until H2 2023 for any chance of inflation normalizing. Today's bigger-than-usual move heralds further rate hikes in the coming months and we might not see BI resting easy until rates hit 5%, to give it the necessary buffer by the end of this year.

Fifty to the Fight

The notion that Bank Indonesia would raise rates further today, after the inaugural 25bps hike in August, was more or less a given the uptick in domestic price pressures after the government's decision to rationalize fuel subsidies.

However, we had thought that the same gingerly pace of 25bps move would be par for the course today, in line with the broader market consensus, given that the central bank had only recently shed its dovish mantle.

Hence, BI's decision to raise by 50bps stood out.

The backdrop of the FOMC meeting overnight – which portrayed an overall sense that the Fed funds rate will not only go up further but stay there for longer – appears to have changed the game. The fact that USDIDR broke above 15,000 level this morning on broader dollar strength would have featured prominently in the decision-making process of the central bank too. After all, even as there are active discussions to broaden its mandate, BI's core KPI remains that of exchange rate stability.

Apart from the global considerations, domestic reality continues to bite, as well. It is telling, for instance, that BI has shifted up its forecast for the core inflation to 4.6% yoy by year-end, compared to 4.15% before. This signals a broadening of price pressures in the economy, as the effect from the fuel price hike continues to percolate through the system. Moreover, the core print is not expected to come down to below 4% until the second half of next year.

Taken together, the 50bps move today thus can be seen as BI's attempt to lay the anchor on both the external and internal fronts, to stabilize both the currency and inflation.

It is helpful that BI remains comfortable enough with the domestic growth momentum to act more forcefully, as well. Indeed, in the press conference, the governor noted that Q3 growth might come in at around 5.5% yoy, stronger than the 5.44% outturn in Q2 (which was itself a sizable upside surprise). It helps too that the banking sector liquidity remains ample enough to support continued recovery in loans growth, which posted a gain of 10.62% yoy in August.

Overall, the fact that it has moved relatively aggressively today suggests that BI is far from done with its rate hike cycle. Instead of waiting until early next year, it is likely to quicken the process and continue hiking for the rest of the year. Hence, we see BI hiking the policy rate by an aggregate of 75bps more in the remaining months of 2022, to end the year at 5.0%.

Our baseline is for BI to smooth out the hiking process by delivering 25bps hike in each of the 3 remaining meetings of the year. However, we will keep an eye on exchange rate volatility and cannot rule out another occasion of 50bps move.

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