

Indonesia: BI is likely to keep policy rates steady

Bank Indonesia (BI), Indonesia's central bank, is likely to keep monetary policy settings steady at tomorrow's meeting



Source: istock

There are no compelling reasons to tweak policy settings

Recent factors that BI considers in deciding on monetary policy settings are quite favorable. Inflation is expected to remain within the 2018 target range of 2.5% to 4.5%. Growth is expected to moderately accelerate. The IDR has recently appreciated and is likely to achieve the target rate of Indonesia's fiscal program.

Inflation in 2018 is likely to remain within target.

We expect inflation to average 3.7% in 2018, a shade below the Bloomberg consensus forecast of 3.8% and near the government's 2018 point-target of 3.5% inflation. Nevertheless, the inflation forecasts are within the central bank's inflation target range of 2.5% to 4.5%. Preliminary January inflation forecast by BI is 0.6% MoM which translates to a 3.2% YoY inflation. The government continues to take steps to address some inflation pressures that led to the upside inflation surprise of 3.6% in December. Food inflation accelerated to 1.3% in December from November's YoY contraction of 0.5%. The government is allowing rice imports to augment local supplies from next

month. This year's energy subsidies will likely keep administered energy prices stable at least in the short-term. Fiscal leeway could allow this stability to continue in 2H as the country heads to regional elections by mid-year and national elections in 2019.

3.7%

2018 inflation forecast

Within BI's target range of 2.5% to 4.5%

Growth is likely to improve in 2018

Growth prospects are favorable this year. Bloomberg's consensus forecast shows a mild acceleration of growth to 5.3% in 2018 from the estimated 2017 GDP growth of 5.1%. We believe that there are reasons why GDP growth should achieve the government's target rate of 5.4%. Sustained infrastructure spending together with improvements in business spending will underpin overall economic activity. Household spending, a concern in 2017, is likely to also improve as inflation has moderated and is expected to stabilize. In addition, a mild push from election spending would contribute to a higher overall economic growth.

5.4%

GDP growth in 2018

Improvements in business and household spending

IDR strength would moderate inflation pressures

The IDR has appreciated by 1.8% in the past two weeks. Indonesia's local currency bond yields are one of the highest in the region. This has attracted investors to increase their local currency bond exposure. We estimate that investors have poured an additional \$1.9bn into local currency government bonds recently. We are in line with Bloomberg consensus of a year-end currency exchange rate of IDR13500. This is also in line with this year's government budget assumption of IDR13500. Trading of the IDR will likely range from the prevailing IDR13300 to IDR13500 this year. The stronger IDR recently and in the near term could help moderate import-related inflation pressures.