Bank Indonesia holds rates steady, with easing on the horizon

Bank Indonesia (BI) held its policy rate at 5.5%, taking a cautious stance amid ongoing global uncertainties. Despite tariff uncertainties and geopolitical tensions, we expect BI to rate cuts later this year to boost growth

Bank of Indonesia Governor Perry Warjiyo (right)

Policy rates left unchanged

Bank Indonesia held its policy rate steady at 5.5%, in line with both our expectations and the Bloomberg consensus. In the accompanying statement, BI emphasised that global economic conditions and the stability of the Indonesian rupiah (IDR) remain key considerations for the future path of interest rates.

As anticipated, the central bank maintained a cautious stance amid ongoing tariff uncertainties and rising geopolitical tensions in the Middle East, which could trigger a risk-off for emerging market currencies like the IDR.

However, the overall stance remained dovish as the governor repeatedly highlighted that the domestic economy needs support and bank lending rates need to come down.

Growth and inflation dynamics support further rate cuts

We believe the macro environment remains well-positioned for BI to cut rates later this year to support economic growth, following a slowdown in first quarter GDP to 4.9% year-on-year, down from 5.0% in the previous quarter. The deceleration was primarily driven by weaker investment activity, reflecting heightened uncertainty surrounding tariff policies.

To cushion the economy, the government has rolled out a fiscal stimulus package worth US$1.5bn, including doubled wage subsidies, transport fare discounts, and direct cash and food assistance. While these measures may help stabilise near-term consumption, they are unlikely to spur a meaningful recovery in capital expenditure.

Meanwhile, CPI inflation has eased toward the lower end of BI's target range and is expected to hover around 2% for the year, primarily driven by lower food prices and weaker growth. While higher crude oil prices are a risk to CPI inflation, the magnitude of impact is relatively low when compared to the rest of the region. A 15% increase in oil prices could add about 0.2% to CPI inflation, leaving enough room still within BI's target of 1.5-3.5%

With real policy rates still close to 4%, BI is still likely to deliver considerable easing of 75bp by the first quarter of 2026. Rising risks to growth from tariffs and an uncertain investment climate, combined with domestic policy uncertainty, increase the risks of higher-than-expected rate cuts.

BI may use windows of currency strength to cut rates more opportunistically

We remain less concerned about Indonesia's current account balance, even as export growth slows, given that import demand is also likely to weaken. While FDI inflows remain subdued, portfolio investments – particularly in the bond market – picked up pace in May.

The recent appreciation in the IDR appears to be less driven by direct BI intervention, as FX reserves remained largely unchanged, suggesting the central bank is comfortable with current levels – provided depreciation pressures are contained by positive foreign inflows and a weaker USD backdrop.

Looking ahead, while the sustainability of large inflows into Indonesian bonds remains uncertain due to persistent fiscal risks, the broader USD weakening trend should offer support. In this context, BI may use windows of currency strength to cut rates more opportunistically.

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