

Bank Indonesia surprises with 25bp rate cut

Indonesia's central bank is back in an easing cycle as it cut rates for the second consecutive month



Source: istock

4.25% Policy rate
cut by 25bp

Taking advantage of slowing inflation to support economic activity, Bank Indonesia's (BI) easing continues. For a second straight policy rate meeting, BI surprised the market with a 25bp cut of its policy rate late last Friday bringing the policy rate to 4.25%.

How low can inflation go?

Moderating inflation continues to allow BI to take advantage of this leeway to support growth. Inflation eased to below 4% in July (at 3.9%) and further to 3.8% in August. Inflation estimates of BI as of the second week of September pointed to a 0.04% MoM increase which implies inflation is

slowing further to 3.6% to 3.7% in September. This downtrend would see inflation within the target range of 3% to 5% in 2017 and also likely within the 2.5% to 4.5% target range in 2018.

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Monetary indicators of economic activity have been anaemic. Bloomberg reported last week that loan growth, also an indicator of moderate economic activity, slowed further with only an 8.2% YoY increase in July. Loan growth in Q1 and Q2 averaged 8.6% and 8.5% respectively. Also, July M2 growth remained anaemic at 9.2% after a stronger May-June growth of 11.3%.

The future

There is scope for further easing in the fourth quarter. This easing cycle is likely to be more measured and not as aggressive as the early phase of monetary easing in 2016. BI seems confident that inflation will slow further from around 4% average this year to around the point target inflation rate of 3.5% in 2018. BI would also likely consider US monetary policy with a December rate hike likely. We believe that BI would take advantage of any window to support growth.

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