

Indonesia: A policy rate hike this week

A rate hike at the 17 May meeting is now likely after the governor of the central bank signalled the need to take pre-emptive action to support the currency



4.25%

Prevailing BI policy rate

Likely 25 bps higher at this week's meeting

The timing of our rate hike view has been accelerated with the bank governor's statement

Bank Indonesia (BI) Governor Agus Martowardojo signalled that BI has room to adjust its policy rate as a preemptive measure to ensure the stability of the currency and the economy. In our recent notes about monetary policy, inflation and the Indonesian rupiah (IDR), we had increasingly flagged a rate hike possibility this month or in June. However, we were then still leaning towards a June rate hike as the new BI governor takes the helm on 24 May. This implies that we were favouring a 28 June rate hike, which would also serve as a signal to the market about the change in the leadership. This expectation was in line with recent history when the then new BI Governor Martowardojo tweaked policy rate at the start of his governorship. The reason for the recent hawkishness is due to the likely impact of a significantly weaker IDR on the economy. Delaying

monetary tightening to June could bring about uncontrolled weakness of the currency, which has lost as much as 5.9% in the past three and a half months (despite a significant amount of central bank intervention in the FX spot market). If the depreciation continues, then inflation and inflation expectations could jump while economic growth would be at risk due to slower household spending. With the hawkish signal from the outgoing BI governor, we now expect a BI rate hike as early as this week.