

Indonesia holds rates steady after Covid-19 spike threatens recovery

Bank Indonesia kept rates unchanged as expected with Governor Warjiyo hoping to provide monetary support for a little longer



Perry Warjiyo,
Governor of Bank
Indonesia

Source: IMF/Flickr

3.5%

Policy rate

7-day reverse repurchase rate

As expected

Indonesia's central bank held its policy rate at 3.5% - a move widely expected by market participants even as inflation remains below the official central bank target band of 2-4%.

The central bank maintained its GDP growth projections (4.1-5.1%) and its expectations for the current account deficit for the year (1-2%). Governor Warjiyo pledged to provide monetary support for the fledgling economic recovery; however, he had made it clear in early 2021 that additional stimulus is unlikely via additional rate cuts.

Comments from the May meeting suggest that Governor Warjiyo is preparing for the eventual reversal in stance. However, he clarified that any such reversal would be at least a year away as BI stays accommodative for now. However, what was clear from today's meeting was Warjiyo's intent to support growth while also ensuring FX stability.

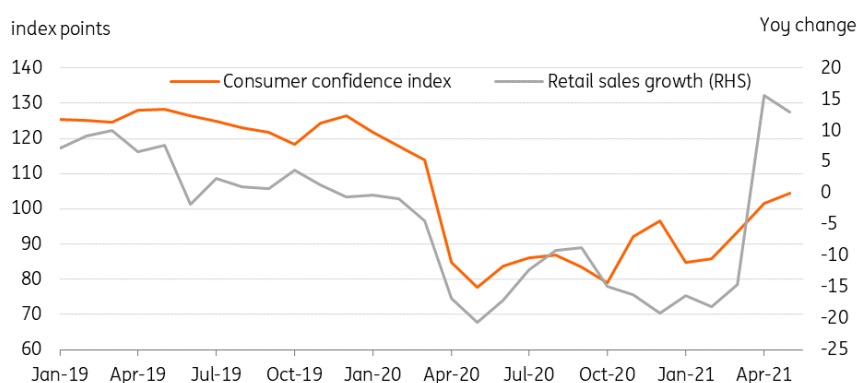
The IDR was weaker by 0.15% throughout the week ahead of the Fed policy meeting before retreating further after the Fed's announcement to dip by more than 1% for the week.

Monetary support but rate cuts off the table

Warjiyo was clear that today's decision to hold rates steady was designed to help support the nascent economic recovery, which is now under threat after the recent spike in Covid-19 cases (7-day moving average at 8,657 from 6,468 last week). Warjiyo however also suggested his preference for FX stability, which limits the scope for any further reductions in the policy rate.

With the likelihood of additional rate cuts off the table given recent currency weakness, the central bank has once again exhorted banks to deploy loans in a bid to reverse the current contraction in bank loans with the latest report showing a 1.3% drop in May.

Indonesia's recovery notching some early gains



Source: Bank Indonesia

FX stability and the Fed's hawkish hints

We expect the central bank to remain on hold in the near term.

Still, Governor Warjiyo could consider a potential reversal in his current accommodative stance if his objective of FX stability comes under threat. IDR has remained resilient for most of 2021, outside a few bouts of depreciation during episodes of uncertainty, and BI could extend its pause for as long as this trend holds. However, with the Fed taking on a hawkish slant last night, we could foresee a potential reversal in stance by the central bank if IDR comes under significant pressure for a protracted period of time.

The Indonesian economy made modest headway in its recovery efforts with retail sales and consumer confidence improving before the recent spike, which could lessen pressure on the central bank to provide monetary stimulus if Warjiyo did indeed need to shift gears for additional support to the currency. If the Fed stays hawkish and global rates move higher, the probability of an accelerated reversal of BI's stance will increase as well.

