# Indonesia: Central Bank turns hawkish

Bank Indonesia has turned hawkish and is now open to a rate hike, like other Asian central banks which have seen their currencies weaken substantially


4% IDR weakness year-to-date

## BI policy rate hike is likelier as direct intervention in IDR spot market may not be enough.

We have warned in earlier notes that a weakening Indonesian rupiah could see Bank Indonesia (BI) turn more hawkish. BI, like the Philippine and Indian central banks (BSP and RBI), indeed turned hawkish. BI declared its openness to hike policy rates yesterday, earlier than we had expected. The IDR has weakened by as much as 4% year-to-date while the Indian rupee and Philippine peso have lost as much as 5% against the US dollar. Prolonged currency weakness, especially when it comes with higher commodity prices, leads to higher-than-expected inflation and raises the risk of lower household spending, moderate economic growth and a less stable financial sector.

Perceived central banks' complacency in the previous weeks added to the currency woes, which already reflect current account deficits, higher oil prices, increased risk of slower growth and US monetary policy tightening. Direct intervention in the spot market has moderated the recent weakness but this is unsustainable and could eventually exacerbate the weakness of the currencies as FX reserves dip. The market sees monetary policy hawkishness as a way to protect the economy, inflation targets and the financial sector. BI targets inflation between 2.5% and 4.5%. However, inflation is already expected to increase in the coming months with the consensus forecast at 3.7% this year from the actual 1Q average of 3.3%. We expect inflation to average 3.6-3.7% for the rest of the year. Markets fear that the sustained weakening of IDR may yet lead to higher inflation expectations. BI's recent openness to a rate hike coupled with sustained IDR weakness could see a policy rate hike as early as this quarter or in 3Q.