

Indonesia: Central bank pauses after aggressive tightening

Bank Indonesia (BI) decided to keep policy rates steady at today's meeting. But the central bank may need to show it stands ready to be aggressive once again to support the currency



Source: Shutterstock

5.25%

As expected

BI 7-day reverse repurchase rate

Pause in the tightening cycle

The recent stability of IDR and funds inflows argued for a pause in the tightening cycle

The Indonesian rupiah (IDR) has traded between IDR14350 and IDR14480 since a 50 basis point rate hike late last month. And foreign funds amounting to \$650-\$670 million have flowed back into the local government bond market in the past two weeks. These developments supported BI's decision to keep policy rates unchanged at today's brief meeting. BI remains vigilant to protect the recent stability by also continuing to intervene directly in both the currency and local government

bond markets. The central bank also indicated its readiness to further tighten monetary policy. However, the market tested BI's resolve soon after the decision was announced, with IDR breaking above the upper end of the recent trading range and breaching IDR14500. One reason for the weakness is the central bank's view that the current account deficit would be less than 3% of GDP, which likely raised concerns. Previously, BI expected the current account deficit to be around 2.5% of GDP in 2018. We continue to expect BI to resume its tightening in the coming months with at least another 25 basis point hike this year and another 50 basis points in 2019. We cannot rule out BI turning aggressive again to support the IDR.