Indonesia: Rates on hold but risks remain

Inflation within the target range over the policy horizon allows Bank Indonesia to continue supporting growth. But the central bank recognises some risks that require caution

4.25%

As expected

BI 7-day Reverse Repo Rate

No reason to change policy rate

Steady policy rate decision keeps support for economic activity. But there is a hidden risk

Bank Indonesia (BI) left the policy rate steady with inflation remaining within the target range of 2.5% to 4.5% over the policy horizon. External developments argued for caution. These include higher oil prices and geopolitical risks, trade war fears and tightening US monetary policy. In addition, inflation is seen remaining within the target range of 2.5% to 4.5%. Bloomberg consensus sees inflation at 3.7% in 2018 and 3.9% in 2019. Government efforts to rein in price pressures aided BI's decision. This is where the risks lie. Efforts to stabilise prices include keeping prices of subsidised fuels steady despite rising benchmark oil prices, which we believe will have moderate fiscal repercussions. The government also requires companies supplying non-subsidised fuels to

seek approval for any changes in prices while mandating a cut in coal prices for the power industry. These moves are made to encourage faster household spending, which has been adversely affected by the reduction of energy subsidies in the past and high inflation. The risk of increased regulation over pricing may affect the financial strength of energy companies. The two-year period of such a pricing regime hopefully does not compromise these companies. With inflation at moderate levels and within the target range over the policy horizon, growth remains the focus. A steady policy rate regime is likely to keep financing costs moderate and spur greater economic activity. We believe that steady BI policy rates are likely in 2018. But a hawkish tone may surface later this year.