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INDONESIA

Indonesia: Inflation surprises on the downside

September inflation slipped to 2.88% from 3.20% in August. The Bank of Indonesia is likely to focus on the stability of the rupiah as inflation remains within target

Source: t-bet

2.88%

September inflation rate

Second period of month-on-month disinflation

Lower than expected

Inflation in 2018 and 2019 likely within the central bank's target range of 2.5% to 4.5%

Inflation settled at 2.88% in September, a second month-on-month deceleration and well-within the Bank Indonesia's (BI's) 2.5-4.5% target. A moderation in prices of all major components contributed to the lower headline number while core inflation slid to 2.82%, despite a weaker currency. Despite a drought in central Java, food inflation (16.19% of the consumer basket) slowed to 3.75% from 4.9% as timely government rice imports helped to maintain a plentiful supply.

Inflation is likely to remain within-target over the monetary policy horizon, with the Bloomberg consensus forecasting an average inflation rate of 3.5% this year and 3.8% next year. BI Governor Perry Warjiyo remains confident that inflation will stay within target this year and next while we continue to expect an average inflation rate of 3.3% this year and 3.6% in 2019.

With inflation in check, BI will likely focus on maintaining financial market viability through a stable currency (IDR). Hawkish rhetoric from the central bank for "front-loaded and pre-emptive action" have helped limit the initial panic of emerging market contagion. BI hiked rates as expected on 27 September and looks to coordinate with the national government in deploying measures to provide IDR stability, which could in turn also keep a lid on inflation. IDR hit a high of 14,938 on 5 September and is currently down 9.8% year-to-date but recent moves of the BI appear to have calmed markets for the time being.

Monetary authorities have raised interest rates by 150 basis points this year and further monetary tightening is possible should volatility return to the IDR spot market. However, should both the IDR and Indonesia's inflation remain stable, this could afford the BI some breathing room to allow other measures, such as its various hedging facilities, to take root and keep the powder dry on rate hikes going into 2019.

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