

Indonesia: Inflation inches higher in July

Inflation mildly accelerated to 3.18% from the 18-month low of 3.1% in June. The central bank's policy action can continue to focus on currency stability



Source: Shutterstock

3.18%

July inflation rate

Moderate inflation likely in 2018 and 2019

As expected

Inflation in 2018 will come close the BI's target rate of 3.5%

Inflation gradually accelerated to 3.18% in July from June's 3.1%. Base effects continue to keep inflation moderate. Inflation in July 2017 was 3.9%. Favourable base effects will continue until this quarter, likely keeping inflation in the coming months below the central bank's point inflation target of 3.5% this year. Non-food inflation such as utilities, transport, communication and finance as well as administered prices moderate the higher non-processed and processed food inflation. The government's favourable fiscal position in the first half allows further increases of subsidies for energy. The government's fiscal balance is less than 1% of GDP and significantly below this year's

fiscal deficit programme of 2.1% of GDP. In an election environment, the utilisation of the fiscal leeway to moderate inflation would be important for the re-election bid of President Jokowi. As a result, the weak Indonesian rupiah (IDR) has not had a significant impact on inflation. IDR has weakened by 6% year-to-date. We expect inflation to remain near Bank Indonesia's (BI's) point inflation target of 3.5% this year and next. We expect average inflation of 3.4% and 3.8% in 2018 and 2019, respectively. Under normal circumstances, BI would have little reason to adjust policy rates further. But the Bank remains vigilant about a weakening IDR which may generate financial sector instability. With recent IDR stability, the chances for BI to retain current policy rate settings at the 16 August meeting are high. However, we still expect another 25 basis point rate hike before the year ends.

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