

Indonesia: Inflation heats up further in June, Bank Indonesia rate hike in the pipeline

Headline inflation accelerated past target but core inflation remains relatively subdued



Inflation in Indonesia will likely pick up this year

4.4% June headline inflation

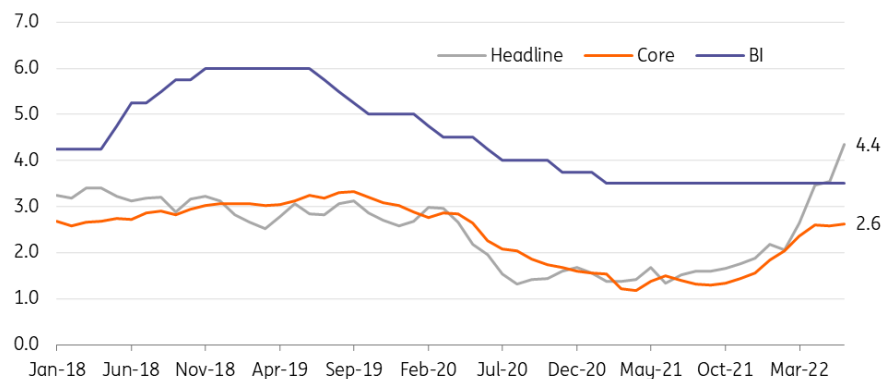
Higher than expected

June inflation accelerates faster than expected, settles at 4.4%

Price pressures pushed headline inflation to 4.4%, accelerating past market expectations for a 4.2% rise. Food inflation was the main driver for the upside surprise with food prices up 8.3%. Transportation was the other major contributor to faster inflation, rising 5.5% as the global energy price surge filtered through to the domestic economy. Despite the breach of the target by headline inflation, core inflation stayed relatively subdued at 2.6%.

The authorities believe that imported inflation has yet to manifest onshore but pressure on IDR in recent weeks will still likely fuel additional inflation pressure. We expect both headline and core inflation to continue to creep higher with core inflation likely cresting the 3% handle by August.

BI running out of room to keep rates unchanged



Source: Badan Pusat Statistik

Window to pause is closing

Bank Indonesia (BI) has refrained from hiking policy rates so far this year, citing the need to support the domestic economic recovery. Despite the pickup in headline inflation, BI has justified the reluctance to hike rates by pointing to well-behaved core inflation readings.

BI may still have some room to keep rates unchanged but we believe the eventual rise of core inflation will trigger a mild rate hike cycle from BI to help shore up currency stability. We believe the central bank will hike rates as early as August, although BI's hike path will not likely be as aggressive as others in the region.