

Indonesia: Inflation remains subdued in August

Inflation inched higher to 3.2% from July's rate of 3.18%. Bank Indonesia remains focused on stabilising the rupiah, which could mean another rate hike at the September 27 meeting



3.2%

August inflation rate

8-month average of 3.25% - well within target inflation range

Lower than expected

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

August inflation inched higher to 3.2% while the eight-month 2018 average of 3.25% is below Bank Indonesia's (BI's) 3.5% target. Moderating food, transportation and clothing prices have kept headline inflation well within BI's inflation target range of 2.5% to 4.5%. Inflation is likely to inch higher over the monetary policy horizon, with the Bloomberg consensus forecasting an average inflation rate of 3.5% this year and 3.9% next year. We are more optimistic and expect an average

inflation rate of 3.3% this year and 3.6% in 2019.

With a favourable inflation rate outlook, the central bank continues to grapple with IDR's stability. The recent emerging market risk-off sentiment has weakened IDR by 1.5% in two weeks and by 8.5% year-to-date. BI remains vigilant about a weakening currency, which could generate financial sector instability. The bank has raised interest rates by 125 basis points this year and continued monetary tightening is likely. This would not only help stabilise IDR but also moderate demand-pull inflation pressures which would keep inflation over the policy horizon well within the inflation target range. IDR's recent weakness has raised the likelihood of a follow-through tightening at the 27 September policy rate meeting. Government efforts to take corrective actions to moderate the deterioration of the trade and current account gaps would also help. But the burden to stabilise IDR is largely on BI in the short term.