

Indonesia: More rate hikes to come?

The central bank raised its policy rate by 25bps to 4.5% yesterday. Further tightening is likely, but we expect it to be more moderate than what we saw in 2013



Source: Shutterstock

4.5% 7-day reverse repo rate

As expected

Governor Perry Warjiyo is likely follow a more moderate path seen in 2H13

The central bank of Indonesia raised its policy rate by 25 bps yesterday. The pre-emptive move was to safeguard the inflation target and protect the economy.

In the last monetary policy tightening cycle way back in 2H13, the central bank raised policy rates by 175bps in five months with five policy rate decisions from June 2013. The aggressive tightening cycle started with a modest 25bps rate hike followed by two 50bps rate hike each in July and in August and 25bps rate hike at the September and November meetings.

The sustained weakness of the rupiah and rising benchmark oil price are risks that would need additional pre-emptive action

Back then, Bank Indonesia faced accelerating inflation with a peak at 8.8% in August from 4.6% at the start of 2013 which breached the inflation target range of 4.5% to 7.5%. During this period, benchmark crude oil price remained elevated at around \$112/bl. The Indonesia rupiah (IDR) played a role in the aggressive tightening cycle too as it lost value by 1.7% month on month in June and July. The weakness accelerated to a MoM loss of 6% in August and September. In total, the rupiah weakened by 16% in five months to September 2013.

But today, the central bank does not face an accelerating inflation environment as it remains within the target range of 2.5% to 4.5%, while May inflation is likely to remain between 3.2%-3.3%. But the sustained weakness of the rupiah and rising benchmark oil price are risks that will need additional pre-emptive action. The rupiah has weakened by an average of 1.2% MoM from February to May and by 5% since end January. Benchmark oil price have increased by 32% since March.

The task to protect the economy now shifts to incoming Governor Perry Warjiyo. With further weakening of the rupiah, more monetary action is likely and could be as early as the June meeting. With pre-emptive actions, a less aggressive tightening cycle is likely.