

Indonesia: Softer inflation - a reason to pause rate hikes?

Inflation eased to 3.23% in May from 3.41% in April. With a steadier Indonesian rupiah (IDR) and softer inflation rate, Bank Indonesia may find reason to pause



Source: t-bet

3.23%

May inflation rate

Moderates from April inflation rate

Lower than expected

Slower inflation in May and steadier IDR may be reasons for BI to pause after two preemptive policy rate hikes

Headline inflation remains moderate in Indonesia, slowing to 3.23% in May from April's 3.41%. The five-month 2018 average is 3.3%, which is below Bank Indonesia's (BI's) point target rate of 3.5% and well within the target range of 2.5% to 4.5%. Core inflation, however, moderately accelerated

to 2.75% from April's 2.69% and may be a cause for vigilance.

Inflation has not featured prominently in the recent BI tightening. Instead, officials have focused on the impact of a weakening IDR, which BI and the market see as a threat to economic and financial sector stability. IDR has appreciated and stabilised after two pre-emptive rate hikes of 25bps each in the regular BI policy rate meeting last 17 May and the emergency 30 May meeting.

IDR has consolidated at around IDR13,900 from IDR14,200 a week before the emergency policy rate meeting. We continue to expect BI's future action on monetary policy to be less influenced by inflation, even though inflation typically rises during the period of Ramadan- which started last month and ends in mid-June. IDR will remain a key driver of monetary policy in the short-term. The recent pre-emptive tightening takes into consideration the expected Federal Reserve rate hike next week. While a case can be made for the BI to pause its tightening cycle at the 28 June policy rate meeting, we have pencilled in a rate hike this month. A pause, however, cannot be ruled out but hawkish rhetoric after the June policy rate meeting may be needed to keep IDR in consolidation mode.