

Indonesia: Two key risks for the central bank

Indonesia's central bank (BI) is likely to keep its policy rate steady at next Thursday's meeting but could it be forced to tighten later in the year?



Source: istock

4.25%

BI 7-day repo rate

Likely steady policy rate this year

Policy rate steady, for now

Inflation will likely remain within the central bank's target range of 2.5% to 4.5% over the forecast horizon. The Jokowi government is expected to moderate price increases in administered or subsidised commodities or increase the budget for subsidies, which would keep headline inflation at moderate levels.

Pressure on the budget has increased due to oil prices and the level of the Indonesian rupiah, both

of which are significantly higher than this year's budget assumptions. Oil prices in the past three months have averaged \$63/bl, more than 30% higher than this year's assumption. The IDR has traded at an average of 13580 in the last three months and is trading around IDR13765 in March, almost 2% weaker than this year's budget assumption of IDR13500.

Leeway for keeping energy prices steady with higher subsidies is available with this year's deficit target at 2.2% of GDP. Higher oil prices at between \$55 and \$60/bl would cost the government an additional IDR8tr or 0.05% of GDP in subsidies. BI remains vigilant in moderating currency moves. The first action is to keep policy settings steady for now while directly intervening in the USD/IDR market. But excessive IDR weakness may challenge the steady policy rate view for this year.