

Indonesia: Surprise policy rate hike

Bank Indonesia (BI) continues to try tame factors that weaken the rupiah (IDR). The surprise 25bps policy rate hike and a higher bank reserve requirement follow a worse than expected trade gap in October



Perry Warjiyo,
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Source: IMF/Flickr

6%

BI policy rate

Surprise 25 bps hike brings total to 175 bps this year

Higher than expected

IDR remains BI's focus by addressing the weak external payments fundamentals.

Bank Indonesia's (BI's) surprise two-pronged tightening addresses a key factor of IDR's weakness this year, the current account deficit. BI surprised the market with not only a 25bps policy rate hike but also tightened liquidity by raising banks' reserve requirements. The rate hike brings the total increase to 175bps this year. The tightening should eventually work through a slowing economy

and moderation of domestic demand that has been powering imports and worsened not only the trade balance but also the current account.

Indonesia reported earlier today a trade deficit in October that is the second worse since April 2014. We fear that the worse than expected trade deficit of \$1.8bn would result in a current account deficit of around -3% of GDP for 2018. The monetary tightening would likely moderate the deterioration of the external balances. Meanwhile, IDR is benefiting from the BI's tightening. We expect that BI's support for IDR will continue while offsetting the negative impact of the current account deficit on the currency. We expect BI to hike policy rates by at least another 50bps over the policy horizon.