

## Indonesia: No Trigger For A Resumption Of Rate Normalization Yet

Bank Indonesia kept its benchmark interest rate on hold at 6.75% for the fifth consecutive month on Tue, in line with market's expectation. The decision was supported by the easing headline inflation which fell to 5.5% y/y in June from as high as 7.0% in Jan and Dec. In its policy statement, Bank Indonesia said that it estimates that inflation will remain under control and could be lower than earlier estimates. Unless the government pulls the trigger to increase domestic fuel prices or implement the proposed restrictions on subsidized fuel purchase, we would expect the headline inflation rate to continue to trend lower to below 5% y/y in 3Q11 before rebounding in the last quarter of the year. If that is the case, Bank Indonesia will be tempted to maintain its interest rate levels for the rest of the year, even though we believe Indonesia's slow interest rate normalization could increase the inflation risk for the country in 1H12. As such, the uptrend in core inflation which crept to 4.6% y/y in the three preceding months has raised some concerns. We are still expecting a 25-50 bps hike before the end of the year.

### Impact on FX

USD/IDR was steady at 8,565 following the policy announcement. Although the interest rate normalization has stalled, investors are now expecting the IDR to be the main tool for the monetary policy tightening which implies more upside for IDR. We expect USD/IDR to drop to 8,400 by end-3Q and 8,350 by end-4Q.