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Flash Notes

Indonesia: Weak Inflation Permits Low Rates

Bank Indonesia (BI) kept its benchmark overnight rate steady at 6.50% today in line with expectation. Low inflation rate in the country, partly due to the IDR strength has helped to rein in the price increase so far this year and the central bank has indicated its preference to keep rates steady at least until June in order to boost credit growth in the country. A steady benchmark rate is in line with calls for the commercial banks to cut their lending rates. This was in addition to BI's move to ease its rule on required reserves at the commercial banks, including revising the reserve requirement in Jan.

Although the BI was optimistic about Indonesia's growth prospects, it continued to suggest that the policy rate at 6.5% is consistent with the inflation rate within its forecast range of 4.0-6.0%. CPI was up 3.8%y/y in Feb. Although the inflation rate is likely to rise above 5%y/y during 2Q10, the central bank still has room to maintain a steady interest rate if it wants. Delays to fuel and electricity price hike in the country will keep inflation rate within manageable range this year. This means that the prospects for BI to hold its interest rates throughout 1H10 have increased. We have shifted our forecast for BI's first rate hike to 3Q10 from 2Q10 with the rate increase likely around 125bps still.

USD/IDR was fairly steady at 9,270 following the rate decision, similar to the close on Wed. We expect the currency pair to trade to 9,300 by end-1Q10 as the uncertain backdrop in the global environment should put a lid on the IDR's appreciation in the near-term. Domestically, the parliamentary probe into Bank Century's bailout in late-2008 could be something to watch out in the immediate period.