

## Indonesia: BI Cut by 25bps, Probably Reached the End of its Easing Cycle

The BI cut its benchmark overnight rate by 25bps to 6.50% as expected on Wed and signalled that monetary policy will be guided by inflation expectation in the coming meetings, citing target next year at 5%. Since Dec 2008, the BI has already brought rates down by 300bps and we do not see the necessity for the central bank to continue cutting interest rates given the resilience in the domestic economy. This was despite headline inflation falling to 2.7%/y/y in July from double-digit levels in 2H08. While the inflation rate will likely remain below 3% in the next three months as a result of basis effect, we expect 2010 average inflation to surpass the BI's target of 5% which should stay the BI's hands at the upcoming monetary policy meetings. In particular, the inflation rate is likely to rise above 5%/y/y by early part of 2010. Recovery in domestic demand and rebound in commodities prices pose some upside risk to inflation. While we think the rate cut on Wed is likely the last in the current easing cycle, present low inflation rate does temporarily provide some room for further monetary easing should the economic conditions deteriorate. Note that President Yudhoyono has mentioned the possibility of the rate falling to 6% recently.

The IDR ended weaker at 9,910/USD on Wed vs 9,860 on Tue as domestic equity market pulled back. The monetary policy decision which was already priced in did not have much impact on the currency. We expect USD/IDR to trade within a range of 9,800-10,000 in the near-term. While the stable domestic political environment will keep the IDR supported, further upside will be capped by the uncertainties surrounding the global economic recovery.