

Thursday, 04 December 2008

Flash Notes

BI Brought Forward Rate Cut

The BI surprised market with a 25bps cut to its benchmark overnight rate today (Dec 4) to 9.25%, marking the beginning of the monetary policy easing cycle in Indonesia. It has also lowered the overnight deposit rate to 50bps below the benchmark BI rate, from 100bps below previously and cut the overnight repo rate to 50bps above the BI rate from 100bps above the BI rate previously. These measures will help to boost liquidity in the market.

The last interest rate move was in Oct when the BI hiked its benchmark interest rate by 25bps, bringing the cumulative increase to 125bps in the tightening cycle from May 2008 after it raised the administered fuel prices in the country. We had expected the BI to stand pat today as CPI data earlier in the week pointed to a stubbornly high inflation rate of 11.68%/y/y in Nov compared with 11.77% in Oct and the peak of 12.14% in Sep. Inflation should start to ease more rapidly next year, especially if the government reduces the domestic energy prices in line with the fall in global oil and commodity prices. On the other hand, growth prospects for the country have weakened substantially as commodity prices plunged. We are expecting GDP to fall to just 3.6% next year from around 5.4% this year.

For now, we see the modest 25bps rate cut (vs more aggressive easing in countries such as Thailand, Australia and New Zealand this week) as a move to test the market's reaction. There is definitely concerns that aggressive rate cuts in Indonesia will exacerbate capital outflows which will be detrimental to the IDR. The IDR has already fallen by more than 20% against the USD YTD. Following the BI rate announcement, the IDR strengthened to 11,950/USD from around 12,100 in early trade today.

The 25bps rate cut today will build up expectation for further monetary easing in the next few meetings. Until the inflation rate in the country eases more meaningfully, the BI is likely to tread more carefully. We are now expecting the benchmark overnight rate to be cut by 100bps to 8.25% by end of 1Q09 and another 50bps to 7.75% by end of 2Q09.

Disclaimer: This analysis is based on information available to the public. Although the information contained herein is believed to be reliable, UOB Group makes no representation as to the accuracy or completeness. Also, opinions and predictions contained herein reflect our opinion as of date of the analysis and are subject to change without notice. UOB Group may have positions in, and may effect transactions in, currencies and financial products mentioned herein. Prior to entering into any proposed transaction, without reliance upon UOB Group or its affiliates, the reader should determine, the economic risks and merits, as well as the legal, tax and accounting characterizations and consequences, of the transaction and that the reader is able to assume these risks. This document and its contents are proprietary information and products of UOB Group and may not be reproduced or otherwise.
