

**ECONOMIC REPORT | Indonesia Monetary Policy****Fed's Inaction and Subdued Inflation Gave Green Light to Indonesia Central Bank to Ease Further**

- *Bank of Indonesia cut the 7-day repo rate to 5.0% amid subdued inflation rate and Fed's inaction. The new benchmark interest rate was cut by 25bps to 5.0% yesterday by the central bank. This was first time the bank cut the 7-day repo rate and it as was fifth time of easing (including the old policy rate) this year. Recall that the Bank of Indonesia was rather aggressive earlier this year, cutting as much as 100bps within the January to July period. Headline inflation was at the lowest level since 2009 in July with consumer prices were only 2.7% higher than the year earlier.*
- *The central bank maintained its economic growth forecast at 4.9% - 5.3% while hinted 3Q expansion was rather robust, supported by largely strong private consumption. Indonesia's GDP grew 5.2% in 2Q16, higher than the 4.9% recorded in the first quarter of this year.*
- *The central bank of Indonesia has hinted for further easing in the future hence we believe there would be at least one more rate cut this year.*

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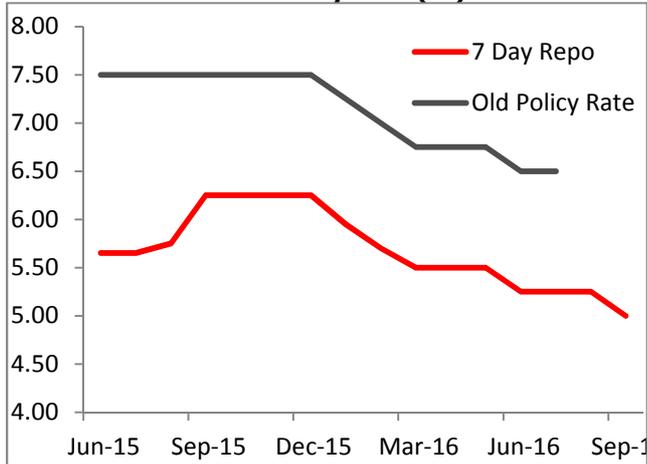
**The central bank maintained its economic growth forecast at 4.9% - 5.3%** while hinted 3Q expansion was rather robust, supported by largely strong private consumption. Indonesia's GDP grew 5.2% in 2Q16, higher than the 4.9% recorded in the first quarter of this year. Hence, the country has achieved an average of 5.0% growth in the first half, well within the central bank's forecast. However, despite the steady economic expansion, this was still lower than the long-term average economic growth (10-year trend) which stood at 5.8%.

**Loan growth grew at the weakest pace since 2009, expanding only 7.7% in July.** Loan growth was recorded at 7.7% in July, down from 8.9% rise in June. This was the slowest pace of loan growth since November 2009 amidst contraction of loans to the mining and transport sectors. Loan to the mining sector formed a rather significant amount to the total outstanding loan at 17.4% but shrunk 15.4% year-on-year in July. Loan to the transport segment was back in the red in July, shrinking by 0.2%yoy. This proved the rebound in June was probably supported by rush buying due to Eid festive month.

**The central bank of Indonesia has hinted for further easing in the future** hence we believe there would be at least one more rate cut this year. The Fed's inaction and inflation was at the lowest level since December 2009 have given rooms to the central bank to conduct more accommodative monetary policy. Plus, it would be the better options as well in the face of tighter fiscal condition. The budget deficit to GDP ratio reached 2.5% last

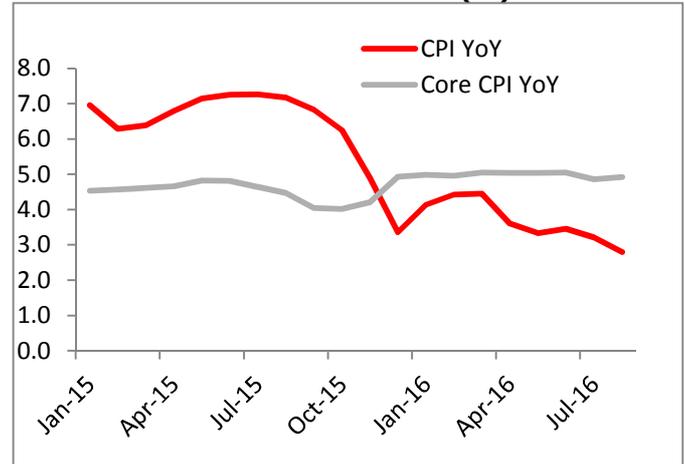
year and the Indonesian president Jokowi has called for a curb in government spending to curb the budget deficit.

**Chart 1: New and Old Policy Rate (%)**



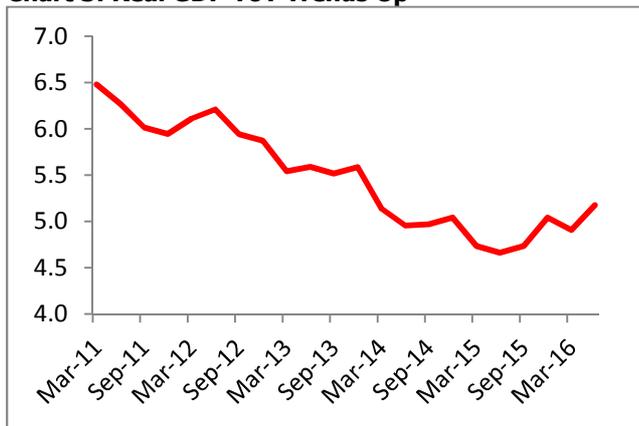
Source: Bank of Indonesia; MIDF Research

**Chart 2: Headline and Core Inflation (%)**



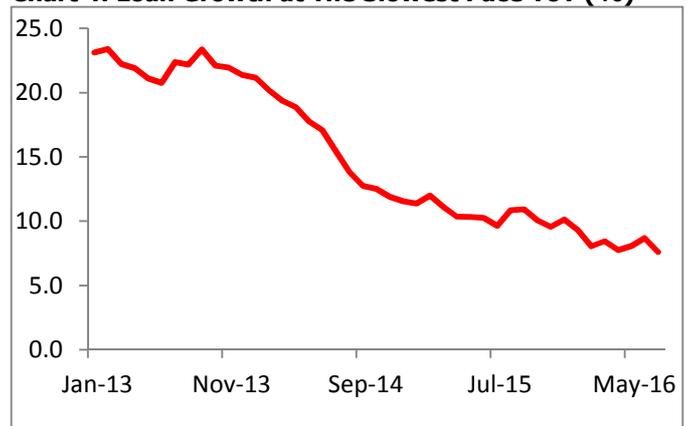
Source: Central Bureau of Statistics; MIDF Research

**Chart 3: Real GDP YoY Trends Up**



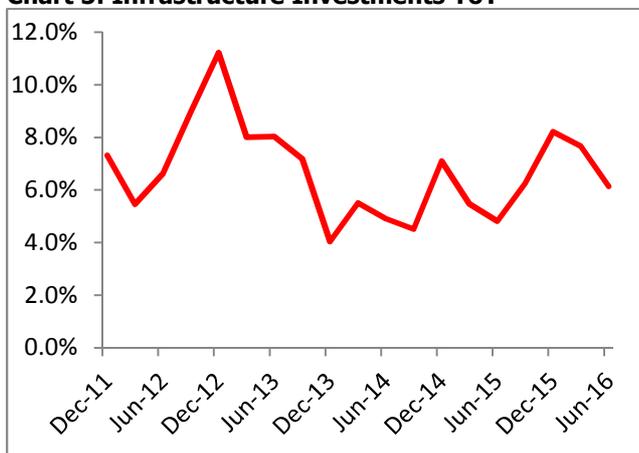
Source: Central Bureau of Statistics; MIDF Research

**Chart 4: Loan Growth at The Slowest Pace YoY (%)**



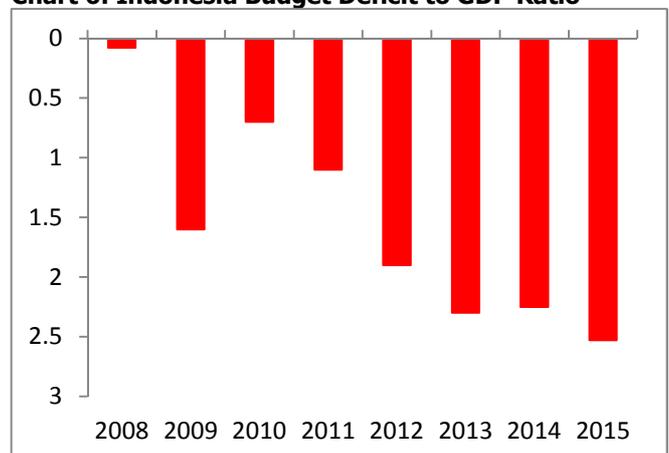
Source: Bank of Indonesia; MIDF Research

**Chart 5: Infrastructure Investments YoY**



Source: Central Bureau of Statistics; MIDF Research

**Chart 6: Indonesia Budget Deficit to GDP Ratio**



Source: Ministry of Finance Indonesia; MIDF Research

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