

Indonesia hikes interest rates to defend its falling currency

Thu, Aug 29 2013

By [Rieka Rahadiana](#) and [Randy Fabi](#)

JAKARTA (Reuters) - Indonesia's central bank raised its main interest rates on Thursday, the latest emerging economy forced into action to defend its currency from further hammering by investors who have pulled out funds in search of safer havens.

It is the third time in four months that Bank Indonesia has raised both its benchmark reference rate and the rate it pays banks for overnight deposits (FASBI). The benchmark rate is now its highest since June 2009 after it was raised 50 basis points to 7.0 percent.

Indonesia's 50-basis point increase in rates came right after a hike of the same magnitude by Brazil, which raised its benchmark interest rate to a 16-month high of 9 percent, trying to fight inflation and rebuild investors' confidence in Latin America's largest economy.

But some economists said Indonesia's move may still not be enough settle the rupiah currency, which has been pushed down sharply to more than four-year lows by concern over Southeast Asia's biggest economy and the broad retreat from emerging markets on expectations the U.S. Federal Reserve will soon start closing the tap on cheap money that has helped drive up their economies.

"We see the BI rate hike as a short-term positive for the (rupiah). However, in our view, it will not be sufficient to stabilise (it)," Standard Chartered Bank economists in Jakarta said in a note, predicting the currency would be at 12,000 to the dollar by the end of the third quarter.

It is currently trading at 10,920 per dollar, barely changed following the rate increase. It has slumped more than 11 percent this year, making it the second worst performing currency in Asia after the Indian rupee.

A big factor pushing down the rupiah in the past two weeks was Indonesia's announcement that its current account deficit was a much higher than expected 4.4 percent of gross domestic product during the second quarter.

In a statement Thursday, BI said that the deficit would narrow to 3.9 percent of GDP in the third quarter.

Thursday's hikes were announced after a rare extra board meeting, indicating the level of concern among authorities over the impact sliding investor confidence in the former emerging market star is having on already slowing economic growth.

A BI statement said the board felt the meeting was needed to thoroughly evaluate the macroeconomic and financial situation "which lately are experiencing higher intensity, in line with rising uncertainty in the global economy and high inflation expectation and perception to the sustainability of current account."

Gundy Cahyadi, economist at OCBC Bank in Singapore, said BI's decision "is meant to be (1) a signal that they are still on top of the situation to try and manage inflationary expectations in the country, (2) a bid to engineer a slowdown in the domestic economy to curb import growth, and (3) an attempt to boost U.S. dollar liquidity onshore."

Indonesia has been among the worst hit by the investor flight from emerging economies, along with other giants India and Brazil.

The concerns that have hit emerging markets in general have been compounded this week by expectations of Western military action in Syria, which has added encouragement to investors to head for shelter in dollar assets.

On Thursday, BI also renewed its swap arrangement with Japan for emergencies and in a move designed to attract investors, cut the holding period for investment in central bank paper, SBIs.

Indonesia's latest moves follow increases in June and July in the benchmark and FASBI rates by a total of 75 basis points.

At a meeting on August 15, the central bank held rates while changing some regulations to seek to contain commercial lending. That appeared to be to avoid any more impact on economic growth, which in the second quarter slipped below 6 percent for the first time since 2010.

FLIGHT FROM SHARES

However, the June and July hikes were not enough, given dwindling confidence in the country's outlook because of slowing growth, surging inflation and - to many the most troubling - the widening current-account deficit, now at one of its biggest levels on record.

The past two weeks has seen flight from Indonesian shares. At one point on Wednesday, the main index [JKSE](#) was down more than 18 percent from an August 14 peak. On Wednesday, stocks rebounded to rise 1.5 percent and on Thursday they were up 1.7 percent, with part of the gain coming after the rate-hike announcement. For the year, the benchmark index is down 4.9 percent.

The government last week announced a series of emergency fiscal and monetary measures but they have done little to dispel the short-term investor gloom over Indonesia though a number of economists say that the for emerging market star should start to shine again in a few months.

The central bank is also struggling to calm inflation, driven to 4-1/2 year high by a sharp increase in fuel prices in late June and repeated administrative stumbles over the supply of basic foods from garlic to beef.

The August inflation rate, which is expected to be around 9 percent, will be announced on Monday.

(Additional reporting by Adriana Nina Kusuma and Andjarsari Paramaditha in Jakarta and Jongwoo Cheon in Singapore; Writing by Jonathan Thatcher; Editing by Richard Borsuk)

© Thomson Reuters 2011. All rights reserved. Users may download and print extracts of content from this website for their own personal and non-commercial use only. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is expressly prohibited without the prior written consent of Thomson Reuters. Thomson Reuters and its logo are registered trademarks or trademarks of the Thomson Reuters group of companies around the world.