Economics

BI Holds Rate At 5.75% Amid “Goldilocks” Global And Domestic Conditions

Highlights

- Rates held steady amid "goldilocks" conditions. BI maintained the BI Rate at 5.75% as easing US inflation weakened the dollar, boosted foreign capital inflows into Indonesian bonds, and reduced market risk perception (CDS dropping to 80 bps). Domestically, moderating GDP growth (5.29%) and declining inflation gave the central bank room to pause, while new Governor Destry Damayanti signalled policy continuity.
- Complementary measures and positive market reaction. Alongside the rate hold, BI increased swap discount provisioning for foreign-currency debt and FDI to sustain foreign investment flows. These steps, combined with improved global sentiment, drove rupiah appreciation and lower government bond yields, though part of the rally also reflects easing Middle East tensions and Fed expectations.
- Tightening cycles are expected to resume in late-26 to early-27. While BI's current strategy prudently supports growth and currency stability, risks remain from geopolitical volatility and potential dollar strength. With US inflation still above target, the Fed is expected to deliver a 25bps hike in Q4 2026 or early-27, prompting BI to follow with two 25bps hikes to preserve its interest rate spread.

Analysis

- Bank Indonesia maintained its policy rate, the BI Rate, at 5.75% during its Board of Governors meeting on Aug 26, in line with both our estimate and market consensus. This was the first Board of Governors meeting under Destry Damayanti's leadership following the sudden resignation of Perry Warjiyo as BI Governor. During the press conference, Destry preserved the structure established by Perry, signalling a degree of policy continuity from the central bank.
- The decision to hold was driven by increasingly "goldilocks" conditions on both the global and domestic fronts. Globally, waning US inflation has diminished market expectations of further Fed rate hikes, weakening the dollar and drawing foreign inflows into Indonesia's bond market and SRBI instrument.
- In response to improving market sentiment, BI has also reduced SRBI issuance, pushing awarded yields and bond market yields lower. Furthermore, the government's decision to appoint long-time Deputy Governor Destry Damayanti as acting governor, alongside its reduced deficit target for 2027, has lowered market risk perception, driving Indonesia's CDS back into the 80 bps range from the 90bps range.
- Domestically, slowing but still relatively strong GDP growth of 5.29% in 2Q26 (down from 5.61% in the prior quarter) and declining inflation have given BI some reprieve from the need for an immediate policy rate increase. Consequently, the rupiah has appreciated over the past month, along with other emerging market currencies, aided by a weaker US dollar amid diminishing expectations of Fed hikes in the short term.
- Alongside the rate hold, BI increased the swap discount provisioning for foreign currency debt held by the banking sector and for foreign direct investment (FDI). These measures should aid in encouraging – or at least maintaining – the flow of foreign investment and foreign currency denominated debt into Indonesia. Market reaction was relatively positive, with the rupiah continuing its strengthening rally and Indonesian government bond yields declining. However, part of this rally is also driven by

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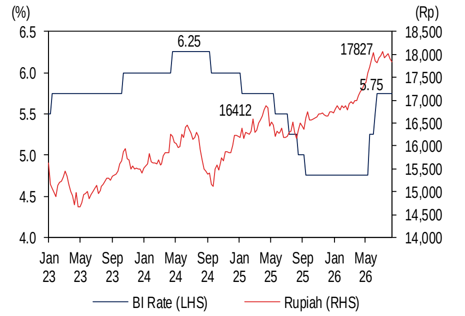
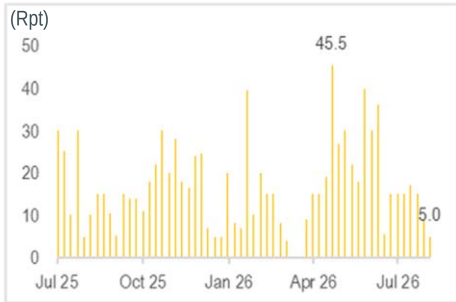
BI Rate And Indonesia Rupiah Exchange Rate



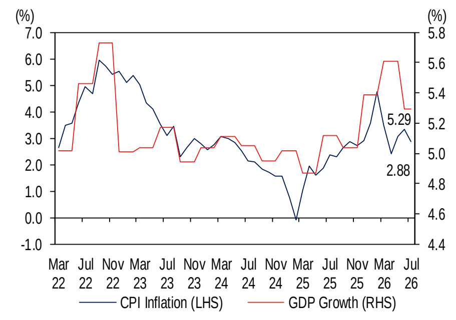
Source: Bloomberg

Issuance Of SRBI (Rpt)



Source: Bloomberg

Indonesia CPI Inflation And GDP Growth (% yoy)



Source: Bloomberg

improvements in global sentiment, particularly regarding the Fed rate outlook and the conflict in the Middle East.

Outlook

- We view BI's policy approach – leveraging foreign capital inflows to avert a further domestic slowdown while supporting rupiah stability – as a laudable move. Nevertheless, this strategy is not without risks, notably the persistently volatile geopolitical landscape, which could significantly impact foreign appetite for Indonesian assets.
- Further geopolitical deterioration or renewed dollar strength could force another round of market repricing, demanding higher spread premiums to hold Indonesian assets. Other important factors to watch include monetary policy under Destry Damayanti's leadership and further details of the 2027 state budget – particularly how the government will pursue its highly ambitious revenue growth target.
- An improving geopolitical situation in the Middle East and weaker-than-expected Chinese growth prospects have contributed to a stabilisation of global oil prices within the US$80-US$100 per barrel range. This has also allowed US inflation to ease somewhat, although it remains above the Fed's 2% target. Consequently, we still expect the Fed to raise its policy rate – the Fed Funds rate – by 25bps, perhaps in 4Q26 or early-27.
- Following the Fed, we expect BI to eventually resume its tightening cycle, delivering two 25bps rate hikes in 4Q26 or 1Q27 to preserve its spread over US policy rates.

Brent Oil Price

Source: U.S. Energy Information Administration