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BI's Accommodative Rate Cut: A Pro-Growth Strategy in Support of Asta Cita

Bank Indonesia (BI) has once again moved to ease its monetary stance, lowering the benchmark BI Rate by 25 bps to 5.00% (Cons: 5.25%; KBVS; 5.25%; Prev: 5.25%). In tandem, the Deposit Facility rate was reduced to 4.25% and the Lending Facility rate to 5.75%. The central bank positioned this decision as part of its broader strategy to maintain stability, ensure sufficient liquidity, and accelerate monetary transmission into both the banking sector and the real economy—ultimately supporting economic growth in line with its Asta Cita's mandate.

Yet, the immediate challenge confronting BI is the sluggish pace of domestic credit expansion. As of Jul '25, bank lending grew by only 7.03% YoY, down from 7.77% in the previous month. Despite ample liquidity in the financial system, banks have remained cautious in extending credit. This caution reflects both subdued demand from the corporate sector and persistent risk aversion among financial institutions. Compounding this is the slow adjustment in lending rates, which averaged 9.18% at the end of Jul '25. The transmission of lower policy rates to borrowing costs has thus far been limited, underscoring structural rigidities in Indonesia's credit market.

At the core of BI's decision lies a favorable inflation outlook. Governor Perry Warjiyo emphasized that inflation remains firmly within the central bank's target range, with headline inflation expected to remain stable over the next two years. Recent data reinforces this view: headline inflation eased from 2.50% in Apr to 2.40% in May, 2.37% in Jun, and further to 2.32% by the end of Jul '25. This stability has been underpinned by coordinated efforts of the Regional Inflation Control Teams (TPID) and the National Inflation Control Team (TPIP), which have maintained stable food prices alongside policies bolstering energy and food security. A decline in global geopolitical tensions has further helped ease energy costs and improve distribution channels, thereby reducing imported inflationary pressures. Nonetheless, BI remains cautious of potential headwinds, including reciprocal tariffs stemming from U.S. trade policy, which could pose fresh challenges to price stability.

Another key factor enabling BI's rate cut is the resilience of capital inflows, coupled with expectations that the Federal Reserve may cut its policy rate twice—by 25 bps each—before the end of 2025. To reinforce its stance, BI has paired its rate cuts with a "*triple intervention*" framework: intervening simultaneously in the spot foreign exchange market, domestic non-deliverable forwards (DNDF), and the government bond market. This multi-layered approach is designed to smooth Rupiah volatility, provide liquidity assurance, and stabilize the broader financial system. By doing so, BI aims to anchor market expectations and safeguard currency stability, even as it shifts toward a more growth-supportive monetary policy.

Looking ahead, the cumulative 100 bps of rate cuts delivered this year is expected to gradually filter through the financial system. Lower interbank money market rates should translate into more competitive deposit rates, which in turn create room for banks to reduce lending rates. If successful, this chain reaction could reinvigorate credit demand, stimulate investment, and support consumption. A more dynamic flow of credit to the real sector would provide the much-needed boost for Indonesia's economic growth trajectory, which has been facing headwinds from softer household spending and external demand pressures.

Positive sentiment is also likely to emerge across several capital-intensive industries, particularly the telecommunications and tower sectors. Likewise, credit-sensitive segments such as multifinance and housing could benefit from stronger lending flows. Meanwhile, banks with funding structures anchored by low-cost deposits may enjoy an improved net interest margin, given the stickiness of lending rate adjustments. That said, the cautious stance of investors and the slow pace of private-sector investment remain critical variables—factors that ultimately influence job creation, household income, and overall economic momentum. For this reason, monetary stimulus must be reinforced by fiscal measures—such as streamlined regulations and more effective investment incentives—to maximize its pro-growth potential.

From a broader macroeconomic perspective, BI's policy shift highlights the classic trade-off facing emerging market central banks. On one hand, the urgency to bolster domestic demand is pressing, especially given uneven global growth and external vulnerabilities. On the other, maintaining currency stability remains critical. This is particularly relevant as BI's easing has already been aggressive this year, while the U.S. Federal Reserve has yet to begin its own rate-cutting cycle. As a result, the interest rate differential between the BI Rate and the Fed Funds Rate has narrowed to just 50 bps. This narrowing spread could constrain portfolio inflows, exert further depreciation pressure on the Rupiah, and potentially reignite imported inflation—risks that could weigh on investor confidence.

In the bond market, Bank Indonesia's aggressive easing is expected to lend immediate support to short-tenor SUN and short-duration corporate bonds. We project the SUN2Y yield to move toward 5.25%, reflecting a decline of about 25 bps from current levels, while the SUN10Y yield is likely to converge around 5.30% ahead of the next BI Board of Governors' meeting. The near-term adjustment in yields reflects improved market confidence in the policy stance, with expectations that easing will anchor short-term funding costs and provide greater liquidity to the system.

If effectively transmitted to the real economy, this momentum could generate broader benefits by stimulating corporate activity, improving tax revenues, and narrowing fiscal deficits through reduced reliance on future debt issuance. Over time, such dynamics would place downward pressure on longer-term yields, contributing to a structurally lower cost of funding for Indonesia. Sustained progress in this trajectory could strengthen the sovereign credit rating outlook, reinforcing investor confidence and providing a more stable platform for long-term growth.

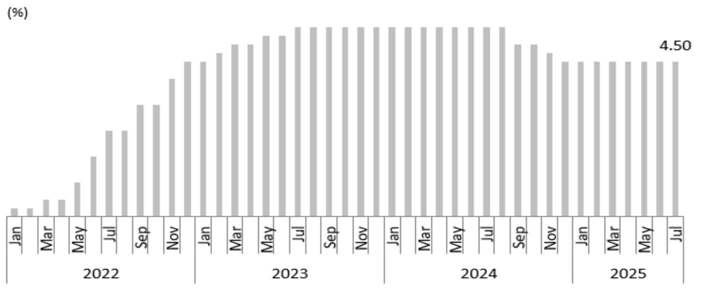
We believe the months ahead will serve as a crucial test of Bank Indonesia's ability not only to maintain price and currency stability, but also to stimulate credit growth that can translate monetary easing into stronger momentum in the real sector. The challenge lies as much in structural constraints as in cyclical factors, making the careful management of this balance a key determinant of Indonesia's monetary trajectory through the remainder of 2025. This takes on added significance with the Board of Governors Meeting scheduled for 17 Sep, just one day before the U.S. Federal Reserve's FOMC meeting on 18 Sep '25. **Our expectation is that BI will deliver another 25 bps rate cut at its upcoming meeting.**

Table 1. Interest Rate Data

Indicators	20-Aug-25		Monthly Changes (in bps)	Ytd Changes (in bps)
	Latest	M-1		
Policy Rate (in %)				
United States	4.50	4.50	0.0	(100.0)
European Union	2.15	2.15	0.0	(235.0)
United Kingdom	4.00	4.25	(25.0)	(125.0)
Japan	0.50	0.50	0.0	60.0
China	3.00	3.00	0.0	(45.0)
India	5.50	5.50	0.0	(100.0)
Thailand	1.50	1.75	(25.0)	(100.0)
Philippines	5.25	5.25	0.0	(125.0)
Indonesia	5.00	5.25	(25.0)	(100.0)
Global Monetary Policy Change (in number of countries)				
Easing	0	0		
Unchanged	6	9		
Tightening	3	7		
Average International Interest Rate (in %)				
USD LIBOR -1 Month	4.96	4.96	0.0	(45.0)
USD LIBOR -3 Months	4.85	4.85	0.0	(75.6)
USD LIBOR -6 Months	4.68	4.68	0.0	(117.8)
Domestic Interbank Money Market (in %)				
INDONIA	4.97	5.38	(40.9)	(102.9)
JIBOR - 1 Month	6.02	6.16	(14.4)	(37.4)
JIBOR - 3 Months	6.31	6.44	(13.0)	(44.0)
JIBOR - 6 Months	6.41	6.54	(13.3)	(46.3)
JIBOR - 12 Months	6.60	6.74	(14.2)	(45.2)

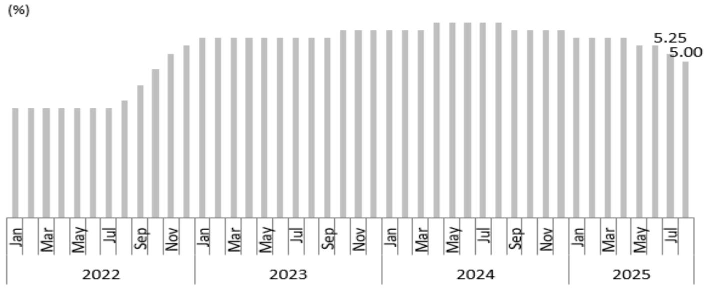
Sources: Each Central Bank and GlobalRates – treated (2025)

Fig 1. Fed Rate



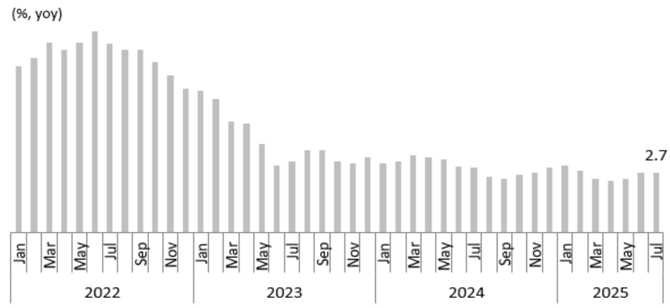
Source: The Fed – treated (2025)

Fig 2. BI Rate



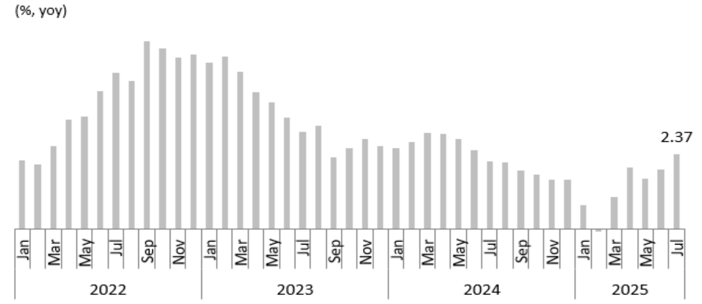
Source: Bank Indonesia – treated (2025)

Fig 3. US CPI Inflation



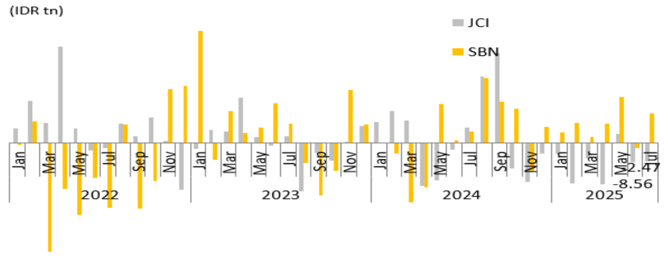
Source: US BLS– treated (2025)

Fig 4. Indonesia CPI Inflation



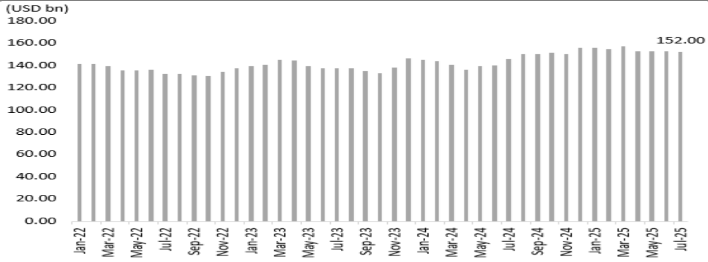
Source: BPS – treated (2025)

Fig 5. Indonesia Portofolio Flow



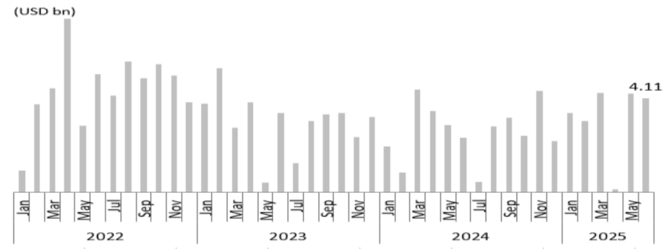
Source: Bloomberg – treated (2025)

Fig 6. Indonesia FX Reserves



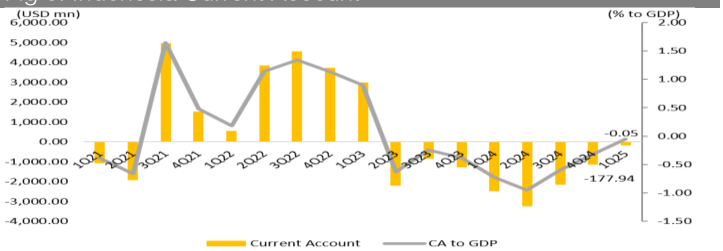
Source: BI – treated (2025)

Fig 7. Indonesia Trade Balance



Source: BI – treated (2025)

Fig 8. Indonesia Current Account



Source: BI – treated (2025)

Table 2. Fed Rate Probabilities, as of 20 Aug '25

MEETING DATE	225-250	250-275	275-300	330-325	325-350	350-375	375-400	400-425	425-450
17-Sep-25	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	84.9%	15.1%
29-Oct-25	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	47.2%	46.1%	6.7%
10-Dec-25	0.0%	0.0%	0.0%	0.0%	0.0%	36.8%	46.3%	15.4%	1.5%
28-Jan-26	0.0%	0.0%	0.0%	0.0%	15.5%	40.8%	33.3%	9.5%	0.9%
18-Mar-26	0.0%	0.0%	0.0%	7.9%	28.4%	37.0%	21.2%	5.1%	0.4%
29-Apr-26	0.0%	0.0%	2.4%	14.0%	31.0%	32.3%	16.4%	3.7%	0.3%
17-Jun-26	0.0%	1.3%	8.8%	23.4%	31.7%	23.5%	9.4%	1.8%	0.1%
29-Jul-26	0.4%	3.5%	13.2%	25.9%	29.2%	19.3%	7.1%	1.3%	0.1%

Source: CME Group – treated (2025)

Disclaimer

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