Strategy

The Well-Anticipated 25 bps Rate Hike

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Bank Indonesia (BI) has just announced 25 bps rate hike on 7DRRR, bringing the policy rate to 4.5%. In addition, deposit and lending facility rate were increased to 3.75% and 5.25% respectively. Note that this is the first rate hike following the 100 bps cut since the introduction of 7DRRR and 200 bps cut since the beginning of the easing monetary policy introduced by Agus Martowardojo. In our view, this should be responded positively, since it has been long awaited by the market. Along with this, the rate increase is also expected to provide some defense for Rupiah, which recently has been volatile thus becoming a main concern for both economy and capital market.

What caused recent Rupiah volatility? Note that Rupiah has been depreciated by around 3.73% YTD to above IDR 14,000. The depreciation itself was on the back of external and internal factors. From external side, strengthening US economy and the increasing Fed Fund Rate (FFR) to 1.5% - 1.75% in March 2018 has led to higher US 10Y treasury yield (~3.1%) as well as dollar index (~93.5). This then has given some pressure on Rupiah. Meanwhile from internal, given 2Q18 is the dividend payment period for most companies, we notice a short term increase in USD. Furthermore, Indonesian companies' anticipation on imported raw materials before Eid Al-Fitr holiday added with potential foreign debt repayment in 2Q18 might have also boosted the needs for USD. Weakening Rupiah itself is believed to negatively impact the overall economy. It might result in higher imported inflation as well as disrupt purchasing power. While for companies which are heavily exposed to USD, it would potentially lead to margin compression.

What we see from BI's decision. At the time being, we remain doubtful that this rate hike could attract significant capital inflow into Indonesia. However, this could provide support to our currency, by withstanding foreign outflow. This is considering fed fund rate hike in June. Therefore, we believe another 25 bps rate hike will still be needed to maintain Rupiah in the medium term. On the other side, we believe this decision could boost up investor confidence, as it signals that BI also focuses on maintaining stability in addition to growth. **We maintain our guidance that there will be another rate hike of 25 bps this year.**

Our view on JCI. As this rate hike could slightly lift up the uncertainty of Rupiah, we expect this could be a relieve to Indonesian equity market. **Overall, our recommendation lies on big caps constituents which have been significantly punished due to the recent selloff. On sectoral view, we prefer consumer staples whose costs are highly related to USD.** As Rupiah is more stabilized, it could benefit the industry. In addition, our preference on staples is also backed up by upcoming festive seasons which could boost staples' performance this year. **We expect short term positive sentiment on banking sector, though we reiterate our NEUTRAL stance in the longer term.** Based on our channel check, banks still cast some doubt that they could reprice their existing loans with higher yield given the weak credit demand YTD.

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