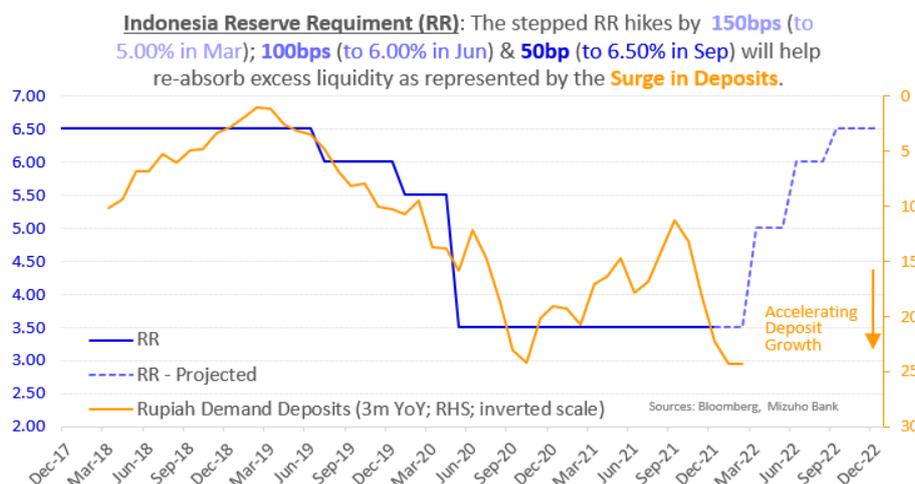


## “Pro-Stability” RR Hike is Backstop, Not Bullet-Proofing, for Rupiah



**In a Nutshell:** Bank Indonesia’s surprise hike to the reserve requirement by a total of 300bps over 9 months is **neither outright tightening nor a sure-fire bullet-proofing of rupiah**. Rather it **a calibrated normalization to absorb excess liquidity** so that it *may pre-empt and mitigate stability risks*; both price and currency. In particular, and more directly, the RR hike will help **check pipeline demand-pull inflation risks**. Admittedly, it may also **help backstop IDR insofar that anchoring inflation lower improves real returns and domestic supply-demand is augmented in favour of IDR** (vs. USD). But **rupiah backstop as a by-product of a liquidity calibration is a far cry from silver bullet to growing currency stability risks** in the context of a hawkish Fed; more so of coal windfall fades.

**Surprise, but Sensible, RR Hike:** While Bank Indonesia (BI) help policy rate steady as expected, it surprised with **reserve requirement (RR) hike**. This will be a **phased**, albeit in a *front-loaded* fashion, **300bps of reserve RR hike over the next 9 months**; which will raise RR from 3.50% currently to **5.00% (+150bp) in March**, **6.00% (+100bps) in June** and **6.50% (+50bps) in September**. Despite the timing surprise, this is a **sensible “pro-stability” calibration restoring RR to 2019 level amid flush liquidity in the system**. Specifically, it conveys intent to maintain growth-inflation stability, averting policy over-correction later. Upshot being, this is **liquidity calibration, not policy tightening per se**.

**The “Pro-Stability” Misconception:** But given BI enacted RR hike in the context of expressly cited hawkish shift in Fed rate hike assumptions (4 in 2022 and 3 in 2023) the **“pro-stability” RR hike** was **inferred as a defensive measure to guard against rupiah instability** that may result if a hawkish Fed incites capital outflows from Indonesia. This however **is a mis-conception**; as **RR tightening does not result in lasting currency strength**.

**Necessary Liquidity Calibration:** To be sure, this is a **necessary liquidity calibration** given the **sharp acceleration in deposit growth** (See Chart) suggests exceptional liquidity boost from RR cuts previously conspiring with exceptionally easy monetary policy (including balance sheet expansion) and sustained cost-push.

**Virtuous Inflation Anchoring:** Hence, the **liquidity calibration** is **critical to check pipeline demand-pull inflation risks** that may otherwise be **incited by excess liquidity** interacting with sustained cost-push pressures. **Admittedly, anchoring inflation will help to maintain the allure of real returns thereby helping to backstop the rupiah**.

**Backstopping, Not Bullet-Proofing, Rupiah:** But **rupiah support** derived *as a by-product of domestic liquidity calibration* (to maintain optimal growth-inflation balance) is **limited** by relative supply-demand shifts boosting the IDR over and above inflation anchor. **But this is not a guarantee of unqualified rupiah strength**. Especially *if a hawkish Fed incites capital outflows and windfall USD inflows from coal exports fade*; thereby **overriding rupiah benefits from low inflation and relatively tighter domestic rupiah liquidity conditions**.

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