Mizuho Chart Speak: Bank Indonesia

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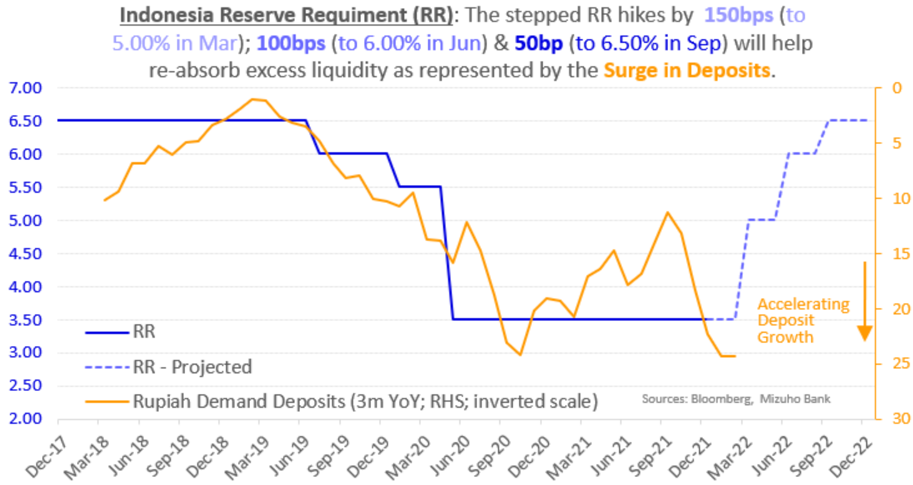
"Pro-Stability" RR Hike is Backstop, Not Bullet-Proofing, for Rupiah



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**.