

Bank Indonesia Still Biding Its Time On Rate Hikes

In a nutshell: BI kept its policy rate unchanged at 3.50%, as expected. It did, however, double down on its liquidity management agenda by raising the magnitude of Rupiah Reserve Requirement (RRR) hikes. The RRR rate will now be hiked incrementally to 9% by September instead of 6.5%, previously. Overall, BI did sound more cautious around domestic inflation risks than at its 19 April meeting; but it does seem that the bar to hike rates is still high. Even so, IDR stability, a key focus for BI, will be hard to sustain given the regional divergence with other EM Asia central banks taking more timely cues from the US Fed. As such, we expect BI maybe forced to join suit in June rather than in Q3.

- **BI kept its policy rate unchanged at 3.50% but double downed on its liquidity management agenda by raising the magnitude of RRR hikes** by 2.50%. The RRR rate will now be hiked to 9% by end September instead of 6.50% earlier. BI's focus on liquidity management is part of its multi-pronged approach to maintaining growth support while keeping an eye on IDR stability.
- **This, however, may no longer be sufficient. As the announcement effect of the RRR hikes showed, with USD/IDR moving higher**, liquidity management to backstop currency depreciation is meek in the face of aggressive rate hikes from the Fed, ECB and other EM Asia central banks.
- That said, BI does seem to be setting the stage for future rate hikes: which have now become more a matter of when rather than if.
- **BI acknowledged that FX inflows will slow while headline inflation will breach the upper band of its 2-4% target range**, even if temporarily in 2022, by its forecast.
- Simultaneously, BI acknowledged that **growth was on more stable footing**, implicitly setting the stage for reduced growth support.
- **It is increasingly becoming more challenging for BI to swim against the tide of aggressive global central bank tightening**. Even if begrudgingly, we expect BI to join begin hiking rates in June rather than in Q3.
- To balance out BI's many objectives, it could opt for a more modest tightening cycle. However, to defer rate hikes into Q3 would mean that IDR stability, one of BI's stated objectives, is at risk.

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