

Bank Indonesia Embarks On Policy Normalisation

***In a nutshell:** BI raised its policy rate by 25bp, taking it to 3.75%, finally embarking on its journey of policy normalisation, in line with our expectations but against market consensus. The decision reflected BI's recognition of building price pressures, not only on the core inflation front but also with regard to elevated food prices. The switch in BI's focus from growth to inflation implies that it will remain steadfast in hiking rates for the rest of the year.*

The pace and magnitude of policy rate normalisation will, however, be more measured compared to other global central banks such as the US Fed. That said, BI has prudently left the door open for upsized hikes should it be necessary. As such, we maintain our forecast for end-2022 policy rates to settle at 4.50% implying another 75bp in rate hikes.

BI Makes a Timely Shift in Focus from Growth to Inflation

In line with our expectations, but against consensus, BI raised its policy rate by 25bp taking it to 3.75%. The decision reflects a shift in BI's focus from growth to inflation. **We had argued for some time now that the need for crisis level policy rate support has passed** (see [Mizuho Insights: 8 August 2022: Bank Indonesia's Fast Fading Mirage of Stability](#)) and **that BI needed to shift gears to inflation containment.** This has indeed materialised. With BI acknowledging that 2022 GDP growth will likely settle at the top end of its 4.5-5.3% forecast band, the build-up in inflationary pressures took precedence. In fact, BI expects domestic demand to remain strong and for the Q3 GDP growth to rise to 5.5% (Q2: 5.4%).

BI characterised its raising of the policy rate as “pre-emptive” and “forward looking” to mitigate risks around rising food prices and core inflation. It expects headline inflation to settle at 5.24% by end-2022 from 4.5-4.6% previously, with core inflation rising to 4.15% (from 2-4% earlier). **These estimates will rise further, compounding inflationary pressures, if the government decides to pull the trigger on retail fuel price hikes** to reduce energy subsidies (as was hinted at by President Jokowi during the 2023 Budget announcement).

BI's also aims to check inflationary pressures by enhancing FX stabilisation efforts. With the Jackson Hole symposium looming, and the Fed expected to double down on its hawkish intentions, **BI embarking on policy normalisation signals greater stability for IDR in the near-term, with continued outperformance compared to regional peers.**

Looking ahead, the pace and magnitude of policy rate normalisation by BI will likely be more measured compared to other global central banks such as the US Fed. That said, **BI has prudently left the door open for upsized hikes** should it be necessary. As such, **we maintain our forecast for end-2022 policy rates to settle at 4.50%, implying another 75bp in rate hikes.**

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