Same but Different

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Indonesia starts to normalize, while Malaysia opts for patience

- Coincidentally, both central banks of Indonesia and Malaysia opted to announce their respective monetary policy decisions today, at the same time to boot – as if to test the multitasking ability of the covering analysts. To some extent, the task of analysing their stance is made easier by the fact that both decided to keep their policy rates unchanged today.
- However, the differences do stick out. For one, BI has started to withdraw its monetary policy accommodation by gradually nudging up the RRR starting from March 1st by an aggregate of 150bps, laying the groundwork for rate hikes soon. Indeed, we see a good chance that the first BI rate hike might follow right on the tail of the Fed's likely lift-off in March.
- In contrast, BNM is less committal. It still holds the view that 2022 inflation will stay largely moderate, and that the risks to the growth outlook remain tilted to the downside, signalling that patience is still the guiding philosophy when it comes to hiking rate. The dichotomy ultimately derives from how Malaysia is relatively more buffered than Indonesia to the Fed hawkish turn.

New Year, New Reality

From the market perspective, the year 2022 thus far has been all about the Fed, the Fed and the Fed, as we discussed at length last week. The fact that the US central bank has turned hawkish – potentially squeezing the trifecta of tapering, rates lift-off, and quantitative tightening all within the span of this year if not the next few months – has inadvertently featured strongly in today's deliberations by Bank Indonesia (BI) and Bank Negara Malaysia (BNM), as well.

Indeed, the effects of the Fed's policy tightening could be felt concretely in BI's actions today. Even though BI, just like BNM, kept the policy rate unchanged at record-low levels, as widely expected, the Indonesian central bank started to adjust to the new reality of a tougher global landscape by announcing a series of hikes in the reserve requirement ratios for its banks.

Starting from March 1st, the RRR will be upped by 150bps to 5.0%. Thereafter, it will be raised by 100bps in June, and then by 50bps in September to a rate of 6.5%. BI Governor Perry Warjiyo mentioned that the aggregate 300bps RRR hike would withdraw as much as IDR200tn (~USD13.9bn).

Given the fact that all the quantitative easing that BI undertook in the whole of 2021 amounted to IDR147.83tn, the liquidity withdrawal from the RRR hike is a sizable one, even if the latter is via the banking sector conduits rather than directly. Still, BI is keen to portray its macroprudential stance as remaining broadly accommodative, introducing a series of incentives

including a 100bps RRR 'discounts' for banks that fulfil certain inclusive lending criteria to priority sectors, for instance.

From the standpoint that BI has highlighted that it would prioritize liquidity withdrawal before undertaking rate hikes, the RRR uptick announcement today can be seen as preparing the ground for policy rate move soon. To us, the drumbeat of Fed's hawkishness has become so loud of late that BI can no longer ignore it and retain a low-rates-for-longer stance domestically.

Indeed, from the press conference, BI is open about how it now sees as many as 4 hikes coming from the Fed this year, with the first hike to come in March. Interestingly enough, it even murmured the potential for a 50bps move by the Fed at that pivotal meeting. Hence, we now see a good chance that BI will start its rate hike cycle on March 17th, hours after the FOMC announcement.

For the year as a whole, BI is likely to undertake two more hikes thereafter to try and anchor FX sentiment. To limit the 'shock' impact on the economy – not least on the loans growth that is just picking up speed to a growth of 5.24% in Dec 2021 – it will ideally want to spread the hiking cycle out on a quarterly basis. The risk, of course, is that even with a relatively early lift-off move, BI might have to front-load these increases more, especially if the market moves on to the idea of even faster removal of Fed's policy accommodation.

Ultimately, one metric to judge the speed and scale of BI's policy rate hike will be the USDIDR. Thus far, despite more tell-tale gyrations of late, it has stayed rather well-anchored, not least because of the lack of large USD movement. BI would hope that it stays that way so that it can continue its gingerly and calibrated dance of exiting from the extraordinary monetary policy accommodation of the pandemic era.

That's for Indonesia. Now, in the case of Malaysia, we continue to detect a wait-and-see attitude overall in the central bank's monetary policy statement and its tone from the analyst call thereafter.

For one, BNM appears to be unperturbed about inflation risk – and hence limiting the need to hike rate to contain the price pressures. It highlighted its view of how 2022 average inflation is still going to be largely moderate, broadly ascribing the recent uptick in headline prints to base effect of fuel inflation. Even as it acknowledges that core inflation will nudge up due to economic recovery, the BNM pointed out that it is "expected to be modest, with upside risks contained by the continued slack in the monetary and labour market."

On the growth front, its statement remains constructive about the prospects of recovery, noting how 2022 growth will be supported by external demand expansion as well as higher private consumption due to "improvements in the labour market and continued policy support." Still, it continued to strike

a cautious tone, pointing out how "Risks to the growth outlook remain tilted to the downside," listing factors such as global growth dip, supply chain issues and Covid-19 strains, for example.

Overall, it does not look like a central bank that is preparing the market for a rate hike in the immediate future. To be sure, there is no obligation for BNM to do so, but the overall comfort about domestic inflation outlook and its lingering tentative tone on growth outturn signal that policy rate may stay at this level for a while longer.

On a relative basis, compared to its counterparts in Indonesia, the Malaysia's central bank does have more leeway on this front because it stands less exposed to the ebbs and flows of Fed-driven global market sentiment.

Fundamentally, even as Indonesia's fundamentals have strengthened markedly from the 2013 Taper Tantrum scare, with its current account deficit projected to be averaging 1.5% of GDP this year compared to over 3% back then, for instance, a deficit is unfortunately still a deficit. This is unlike Malaysia's outright current account surplus, which allows it the luxury of being less dependent on foreign fund flows to plug the gap – and hence less vulnerable to their sudden outflows.

Hence, while we do see that the new reality of a tighter global policy landscape resulting in the prospect of BNM joining the rate hike gang too this year (from our earlier view of no hike), the OPR is likely to remain unchanged in H1, with a potential for one 25bps hike in Q3 largely due to a shift in domestic inflation and growth dynamics.

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