Mizuho Brief: Macro Policy Preview

Economics & Strategy | Asia ex-Japan

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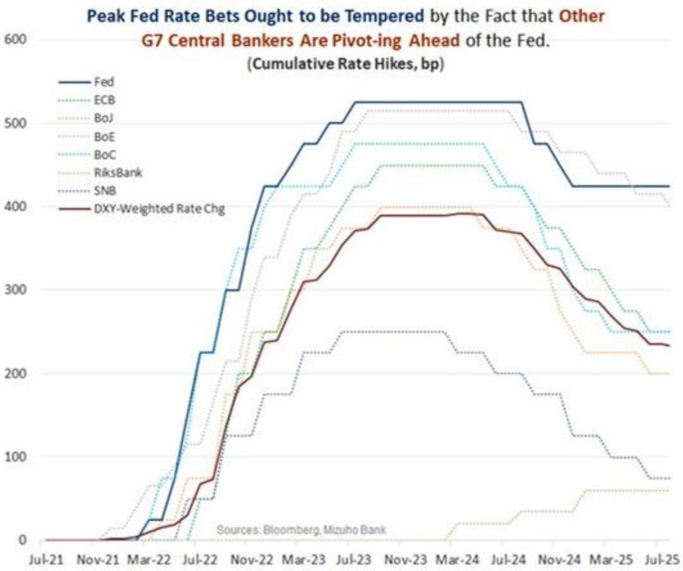
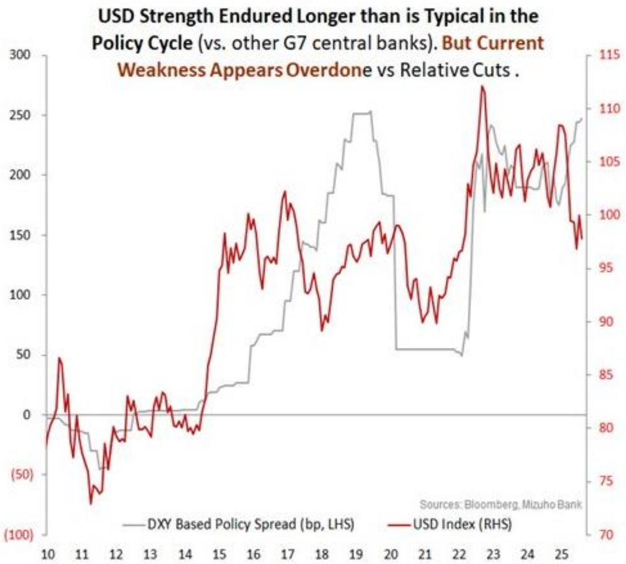
MIZUHO

Caution, Conditionality & Catch-Down

In a Nutshell:

- In the Majors space, **FOMC** (Wed), **BoJ** (Fri), **BoE** (Thu) and **BoC** (Wed) meetings are underway whilst in Asia, **Bank Indonesia** (Wed) and the **CBC** (Thu) are watched.
- **Despite overwhelming expectations of a Fed rate cut**, probably resuming an easing cycle even, the **mood is likely to remain somewhat cautious**.
- For one, *even if the Fed' cut presumably underwrites* an environment of *further easing,* **the Fed is by and far only just catching down**.
- Hence, **scope for unbridled optimism** (and attendant ***market exuberance***) premised on global rate cuts are **likely to be checked**.
- What's more, **further Fed cuts** are likely to be **conditional** on "dual mandate" balance *as inflation risks linger amid elevated tariff/immigration uncertainty.*
- Point being, the ***bar for a dovish Fed cut is high*** as the FOMC is **split on increasingly opposing inflation-jobs risk**.
- Hence, **USD bears** are **likely to be reined in as will scope for further pullback in UST yields** being **checked**.
- And if the BoE **hold**s as expected (after the cut in August), but backs that up *with rhetoric inflation concerns*, Gilts yields could lend to backstop in UST/global yields.
- Admittedly, BoC is set to cut by 25bp, but may have little sway in softening global yields. And insofar that reflects **economic risks**, it may **dampen** the **CAD**.
- The BoJ is **expected to stand pat** as the **BoJ's scope to hike** is ***necessarily not*** **urgency to tighten** amid near-term *trade* and *political uncertainties.*
- Crucially, the **BoJ risks adverse shocks** *from sharp and unwelcome JPY surge if* **should the BoJ's tightening be** *caught wrong-footed by deeper-than-expected Fed cuts* **into 2026**.
- Elsewhere in Asia, the CBC is expected to stand pat as semiconductor-related boost underpins the economy.
- In contrast to Taiwan's hold based on economic strength, Bank Indonesia's **expected rate hold** may be ascribed to *efforts to unequivocally insure against macro-/rupiah-stability risks.*
- Especially **given confidence gaps after the departure of ex-FinMin Sri Mulyani Indrawati**, resulting in underlying rupiah pressures.
- All said, the **Fed's rate cut** this week, insofar as it is **restrained and conditional**, **underscores dilemma amid uncertainty** and **attendant caution**.
- And **while the Fed is starting to catch-down**, the *USD and UST yields need not (pullback emphatically in tandem)*, given rate cuts already priced in.



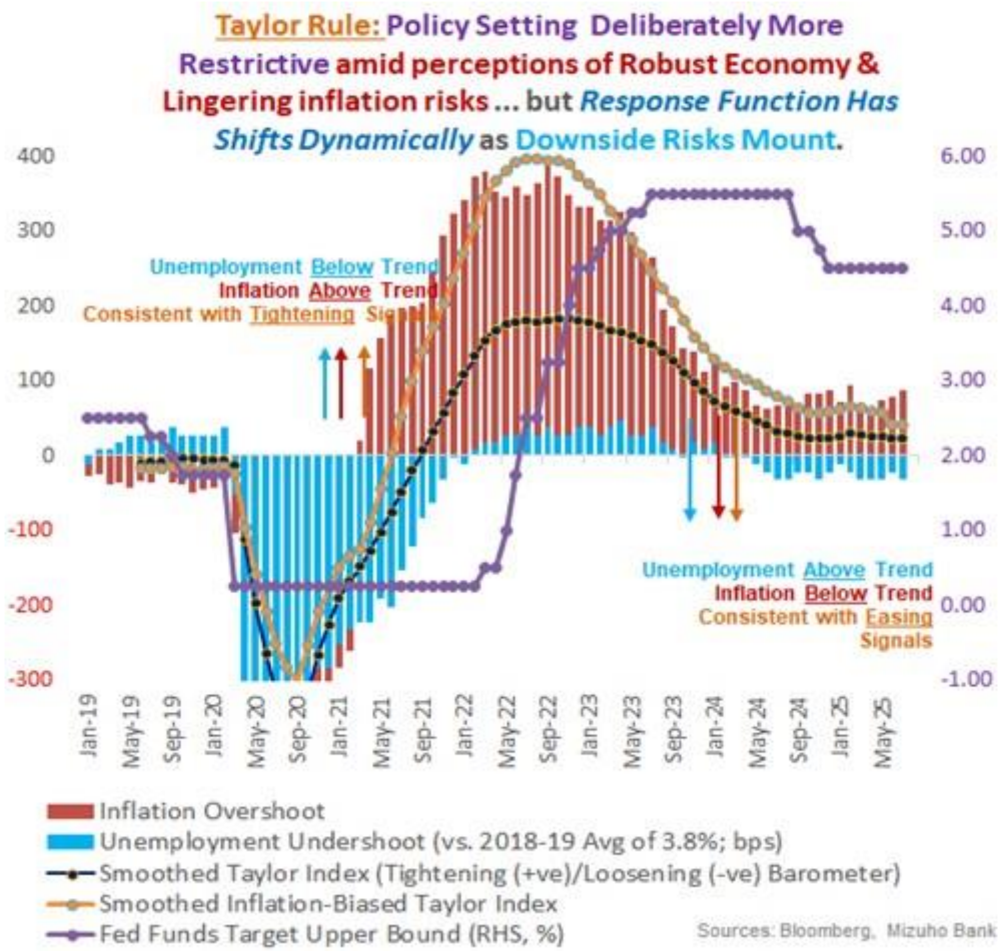


FOMC – 17th September

FOMC: High Bar for Dovish Cut

- Our **baseline** (and the sweeping market consensus) is **for** the **September** (17th) FOMC is **a 25bp cut.**
- But this is *subject to a high threshold for deviation either way* (no cut or a 50bp cut as argued for by Treasury Secretary Bessent).
- *Pointedly,* what's worth noting is that the **bar is high for a dovish cut**, **which entails Fed guidance turning unequivocally dovish**.
- Point being, views within the **FOMC** are **still distinctly split**, and in some instances **further complicated by threats of stagflation-like forces in the works**.
- The **hawks** *warn of* **inflation risks**, and in particular threats of *unmooring inflation expectations* as tariffs threaten to hijack sustained dis-inflation.
- The **fear** is that **reversion to the 2% inflation target is upended**. And so, the policy **bias** is **to maintain "high enough for long enough"**.
- But **doves** *are backed by compelling evidence of troubling softening in the job market,* **arguing for cuts sooner rather than later**. Perhaps even *front-loading upsized cuts.*
- **Especially *given* that *job market downturns* are *notorious for* the *lags* and *non-linear, abrupt deterioration*.**
- Which in turn **exacerbate the inherent risks of "too little, too late**" easing **given inherent policy lags**.
- Trouble is, **unpredictable interactions between**, *evolving tariffs, immigration* and **wider** *geoeconomic shocks,* **give rise to conflicting inflation and adverse demand shocks**.
- *And crucially, one does not harmlessly necessarily negate the other*. **So**, necessarily the **Fed may be unduly restrained** for now. Whereas this is not a stable equilibrium.
- Instead, the Fed's **policy tension may be poised to give way to pronounced binary risks that force an emphatic, compensatory, response further out**.
- As such, *sudden* and *sharp pullback in front-end UST yields* and accompanying *bearish bout in the USD,* ought **to be watched for into early-2026**.

- But for now, a **measured 25bp cut** with the accompanying balanced rhetoric **conditioning scope for further easing on evidence of jobs/economic stress**.
- The **interim adherence to dual-mandate restraints** on rate cuts, *despite the shifting balance of risks* (to downside jobs risks), will **likely rein in USD bears** and **check the depth of front-end yield pullback**.

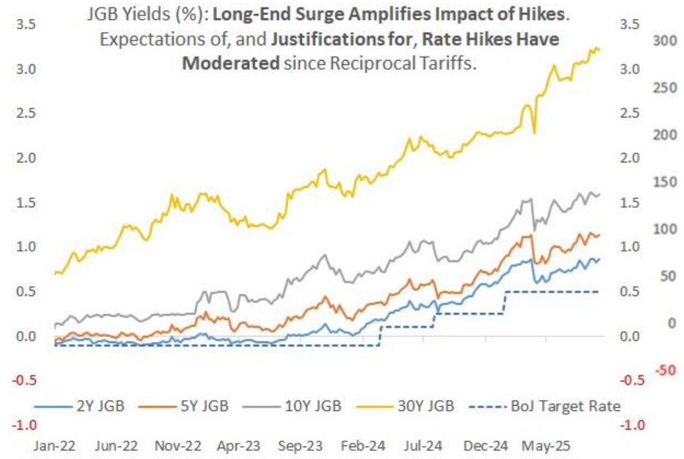


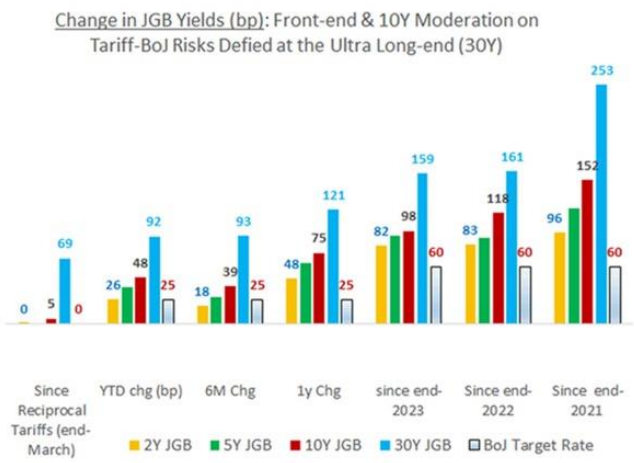
BoJ – 19th September

BoJ: Scope, Not Urgency

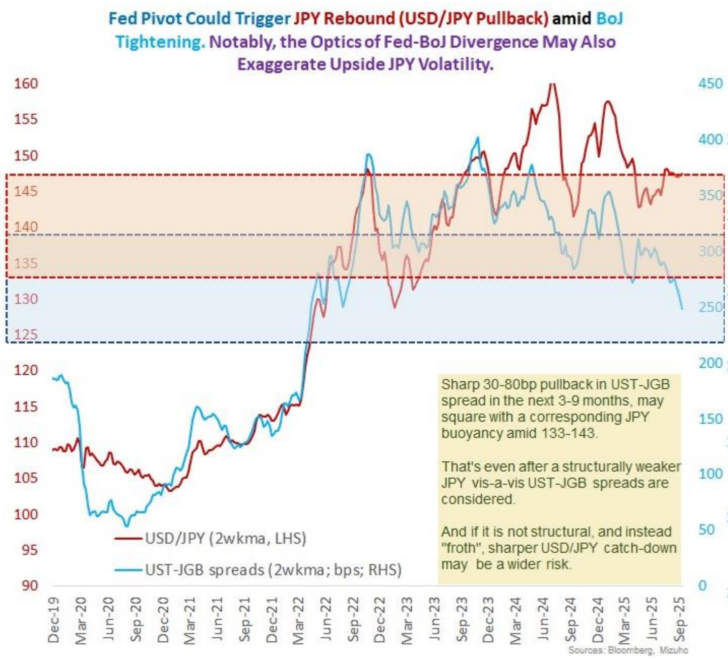
- At the September meet, **BoJ is not set to hike** just yet, choosing to stand pat *as more evidence is assessed,* although the **rhetoric** could **still** be **tilted to the hawkish side**.
- Admittedly, the **BoJ will still be inclined to express scope for rate hikes**, based on its **prevailing assessment of higher longer-term neutral rates**.
- *But* there will surely be **no urgency** for these hikes to be effected for three key reasons.

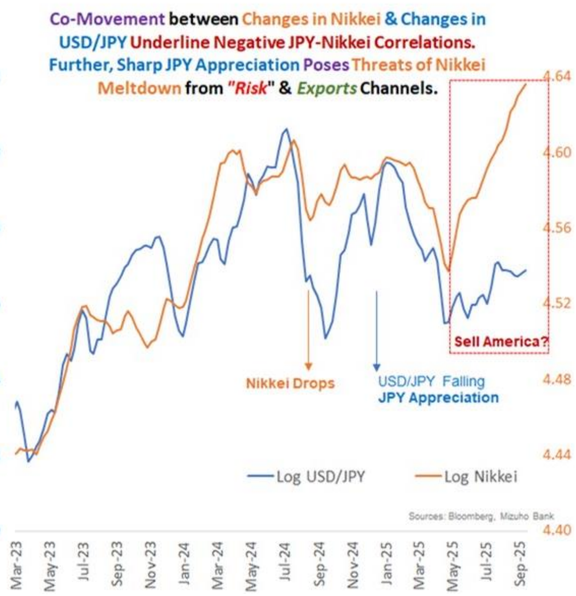
- <u>First</u>, the limited 60bp of hikes have already delivered *outsized tightening in the transmission to longer yields.*





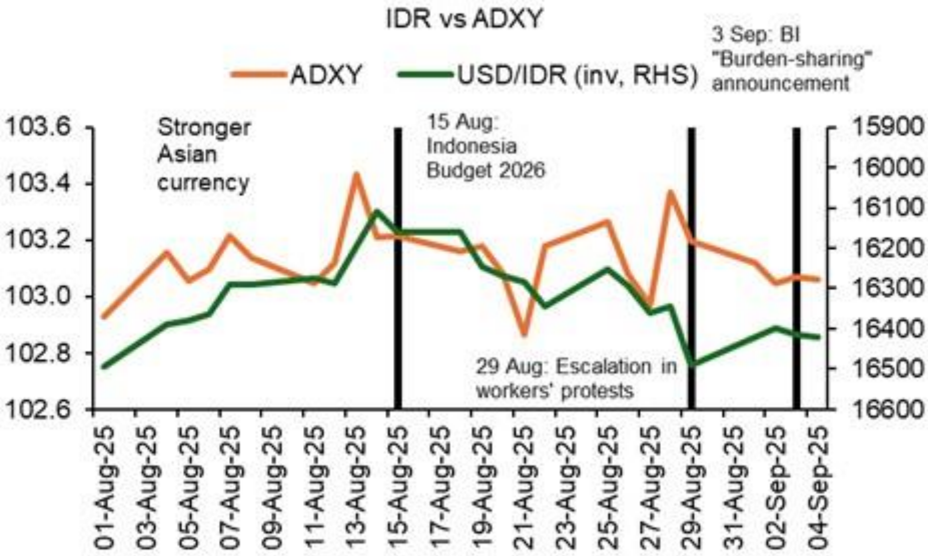
- 30Y (10) yields are up a staggering 135-140bp (80bp) since hikes started in March 2024. Hence, the BoJ *ought to be careful not to overly constrict the economy.*
- <u>Second</u>, with the *demand-destruction impact of tariffs yet to be determined,* whilst household confidence is still fragile, the *BoJ risks aborting nascent (positive) reflation dynamics with excessive hikes.*
- <u>Finally</u>, *JPY appreciation accentuated by Fed-BoJ divergence*, poses underappreciated but **significant threats of exacerbating economic pain** – *via adverse exports and asset market shocks.*
- And so, **with Fed rate cuts coming into view** the **BoJ has more reasons to be measured**.
- All said, the structural case for higher rates is being assessed, and contingent on durable recovery.
- Meanwhile, **geoeconomic/cyclical threats counsel patience**, if not cautious reassessment.





Bank Indonesia – 17th September

Bank Indonesia: (In)Stability



Sources: Bloomberg; Mizuho

- BI is expected to hold following two back-to-back cuts, as recent events have arguably accentuated downside risks to the beleaguered rupiah.
- First, the protests in Jakarta and beyond on demands for higher wages contrasts against the apparent resiliency of domestic consumption in Q2 GDP print.
- Second, increasing expenditures on President Prabowo's flagship programmes at the cost of steep cuts in regional transfers risks compromising local programmes.
- Third, Bank Indonesia's "burden-sharing" agreement with the government on perceptions of QE/"debt monetization" fears* may be exacerbated by (ex-)FinMin Sri Mulyani's departure* (below for more details).
- Amid the triple whammy, BI had stated that it aims to bring IDR to 16,300 levels.
- With USD/IDR current buoyant above 16,400, BI is unlikely to add fuel to fire by proceeding with another cut, even as it is still looking for room to ease.
- The IDR has underperformed regional currencies since the last meeting, and on a YTD basis, is one of the few currencies that remains softer than the USD, alongside INR and TWD.
- Even as BI hold rates, we do not expect any relief rally given that easing bias is retained and with growth/fiscal/debt woes intact.

* **Indonesia's Mounting Risks**

In a Nutshell: The abrupt **removal of Finance Minister Sri Mulyani Indrawati risks dangerously eroding fiscal-monetary policy credibility**. Especially given the *optics of political expedience* to side-step binding fiscal constraints. And **Bank Indonesia's "burden sharing" amplifies risks** as the *threat of monetary policy subordination to fiscal dominance* further compromise macro-stability. **Wider credit spreads** *exacerbated by rising global term premium* suggest **higher cost of capital**. **Rupiah debasement risks** also mount as investor assess debt monetization. And in any case, *Bank Indonesia's easing may impose sharper IDR stability trade-offs.*

- **Risks to Indonesian assets are mounting as fiscal** and **monetary policy threats conspire to undermine credibility**.
- The *latest assault on confidence* stems from abrupt **removal of internationally respected Finance Minister (FinMin) Sri Mulyani Indrawati**.
- To be sure, her replacement **Purbaya Yudhi Sadewa is accomplished** in both finance and public service.
- So, this is not about suitability or qualifications. He is amply qualified and **would ordinarily feature very favourably as a successor**.
- ***But these are not ordinary times***. In fact, the **timing and abruptness** of the move is **extraordinary** and **very inconvenient**.
- An abrupt and presumably unplanned removal **creates optics of political expedience** *at the expense of fiscal/macro stability.*
- Especially given FinMin Indrawati's pushback to overly-aggressive/unrealistic fiscal plans/projections put forward by the President.
- Upshot being, given *President Prabowo's aggressive populist policies that sometimes bend fiscal feasibility it is* **critical to project fiscal credibility** to temper risks and assure investors.
- And (ex-)**FinMin Indrawati did precisely that**. As an independent figure with **a track record of objectivity,** *and when required,* **objections**.
- Whereas the onus may be on in-coming FinMin Prubaya to reassure investors that fiscal integrity will not be compromised.
- *Making matters worse,* that this **follows hot on the heels of Bank Indonesia's "burden sharing" arrangement,** which we warned* was problematic of policy/macro stability even with FinMin Indrawati's backing.
- Specifically, "burden sharing" **undermines monetary policy** by *potentially subordinating it to fiscal objectives.*
- Consequently, the worse-case iterations **threaten to subject rupiah to debasement** from *debt monetization risks* (perceived or real).
- This **feeds off, and into, mounting risks of wider credit spreads** *exacerbated by rising global term premium* to d**rive up Indonesia's yields** (pressuring bond prices).
- That will inevitably present itself as a **higher effective cost of capital** burdening growth. And more so as "crowding out" pressures also rise.
- For now, Bank Indonesia will have to watch macro/FX-stability closely and lean against capital outflows risks.
- As a corollary, this might **compromise scope to ease** as the ***trade-off with rupiah stability sharpens***.

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