Fed and BI Policy:
Raising the heat

Keely Julia Hasim
Economist/Analyst

Suryaputra Wijaksana
Economist/Analyst

Barra Kukuh Mamia
Senior Economist

22 September 2022

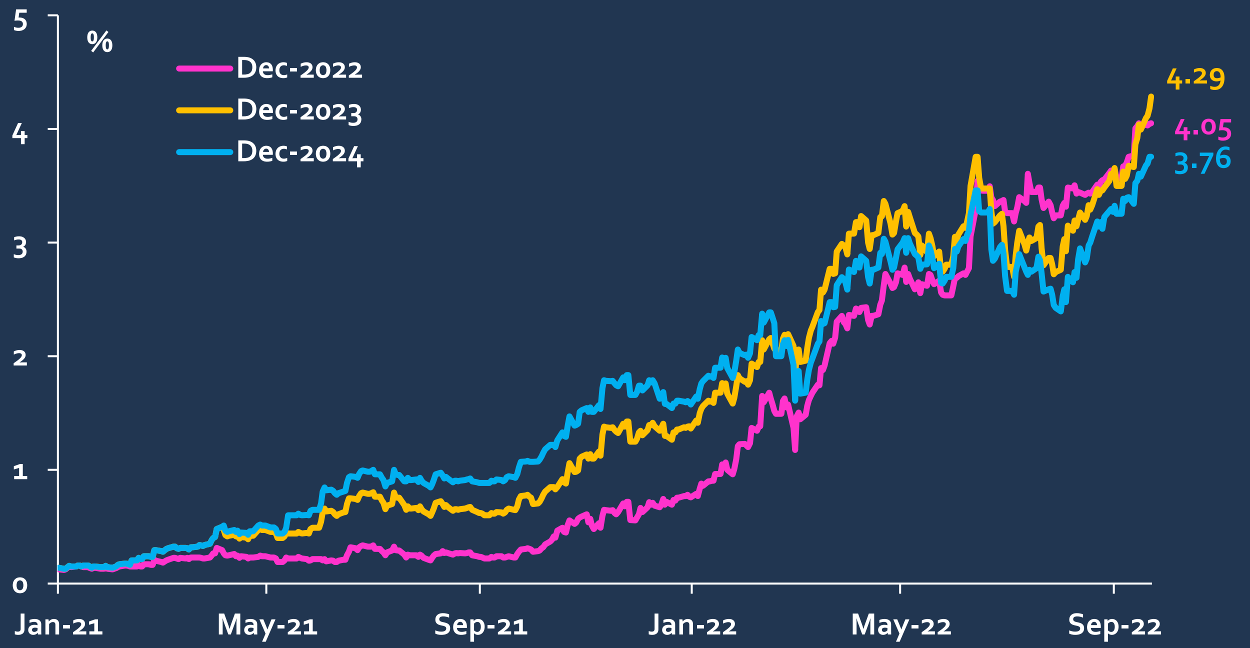
Executive Summary

- The Fed raised the federal funds rate by another 75 bps to a range of 3 – 3.25% during the September FOMC meeting. Additionally, the Fed's dot plot shows that officials plan on hiking rates by another 125 bps by the end of this year.
- Despite the Fed's efforts to tame inflation, several factors complicate the picture, including Russia's threats to escalate the war in Ukraine and hot US labor market conditions. And even if the Fed manages to bring down inflation, it is likely to bring the US economy into recession.
- Bank Indonesia's (BI) decision to raise its BI7DRR by 50 bps to 4.25% then should be seen in the light of the Dollar's all-conquering strength. The hike is also a pre-emptive strike against rising inflation after the fuel price hike earlier this month. As we mentioned before, BI's rate hikes are likely not designed to match the increase in headline inflation, but rather that of core inflation. This means the year-end BI7DRR will probably end up between 4.75 - 5.25%, depending on the extent of further pressure from the Dollar.

- The Fed raised the federal funds rate by another 75 bps to a range of 3 - 3.25% during the September FOMC meeting. While the rate hike is in line with most analysts' expectations, the markets' less than splendid reaction to the interest rate decision suggests that the Fed's forward guidance may be more hawkish than some had originally anticipated **(Chart 1)**. Indeed, projections from the meeting indicated that the Fed is planning to hike rates by another 125 bps in the last two FOMC meetings this year, followed by another 25 bps hike until the benchmark rate reaches a terminal rate of 4.6% in 2023. The dot plot of Fed officials' expectations also suggest that rate cuts will unlikely occur until 2024, despite the expected slowdown in economic growth.
- The Fed's efforts to tame US inflation however is complicated by numerous factors. For one, Russia threaten to escalate its war in Ukraine, again possibly hampering oil and gas supply to global market. Meanwhile, the hot US labor market conditions is pushing up wages and service sector inflation.
- Finally, even if the Fed manages to bring down inflation - a tall order at this point - it is likely to come at the cost of recession. This is something that we can glean from both the inverted yield curve and the Fed's own unemployment projections, which keep increasing from meetings to meetings.

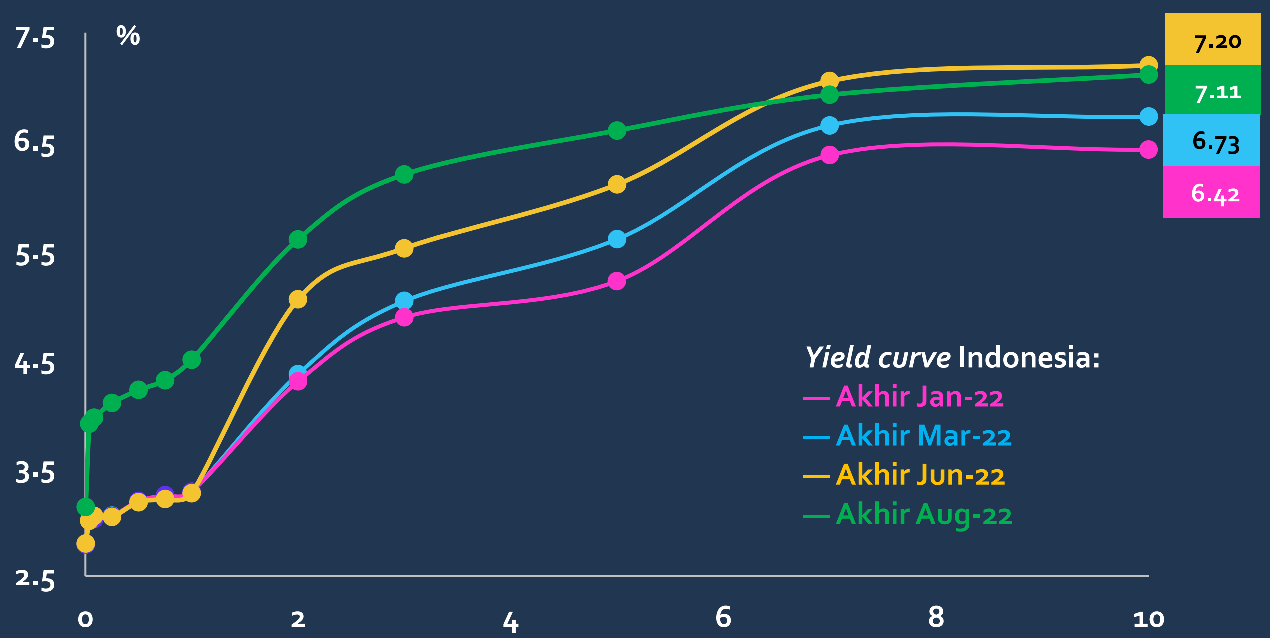
- Amid the Fed's hawkish announcement, the central bank is easing in at least one dimension: stopping its mortgage-backed securities (MBS) sell-off starting September 15. But while this move could help prevent mortgage rates from rising further and therefore slow the crunch in the US property sector, it may have unfortunate side effects for emerging markets as the Fed will have to sell US Treasury at a faster pace. Furthermore, with less risk of its housing market "breaking", the Fed might be encouraged to hike more aggressively, leading to stronger Dollar and therefore effectively "offloading" the risks overseas.
- Bank Indonesia’s (BI) decision to raise its BI7DRR by 50 bps to 4.25%, then, should be seen in the light of the Dollar's all-conquering strength. Indonesian Rupiah remains one of the best-performing currencies YTD, but the performance of some of its peers such as the Indian Rupee following the Fed rate hike serves as a warning sign. BI's decision also parallels that of other central banks today such as the BoE (50 bps) and SNB (75 bps), which are similarly responding to the Fed.
- The hike is also a pre-emptive strike against rising inflation after the fuel price hike earlier this month. BI is expecting inflation to increase by about 1% MoM in September, which would translate to 5.78% in YoY terms. As we mentioned before, BI's rate hikes are likely not designed to match the increase in headline inflation, but rather that of core inflation. This means the year-end BI7DRR will probably end up between 4.75 - 5.25%, depending on the extent of further pressure from the Dollar.
- This is, of course, still quite a moderate course by this year's standards (a total of 125 - 175 bps hike). There are still many factors that work in Indonesia's favor, particularly the current account surplus - which we deem likely to exceed 1% of GDP even before Russia's latest escalation. In addition, BI is also still letting the shorter-end of the yield curve rise in a bid to attract foreign bond investors **(Chart 2)**, while the worsening outlook for many other EMs such as India could pique some interest towards Indonesia, which has been a winner albeit somewhat overlooked in the current situation.

Chart 2. Markets have expected the fed funds rate (FFR) to reach 4.29% by Dec 2023, even though the Fed is planning to bring the FFR up to 4.6% with no intentions of cutting until 2024



Source: Bloomberg

Chart 2. BI's operation twist is driving short-term yields and increase attractiveness of Indonesian assets



Source: BI, Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	2.50	Jul-22	-5.80
UK	1.75	Aug-22	-8.15
EU	0.50	Jul-22	-8.60
Japan	-0.10	Jan-16	-3.10
China (lending)	4.35	Oct-15	1.85
Korea	2.50	Aug-22	-3.20
India	5.40	Aug-22	-1.60
Indonesia	4.25	Sep-22	-0.44

Money Mkt Rates	21-Sep	-1 mth	Chg (bps)
SPN (1M)	1.96	2.17	-21.8
SUN (10Y)	7.18	7.09	9.2
INDONIA (O/N, Rp)	3.33	2.81	52.2
JIBOR 1M (Rp)	4.33	3.77	55.7

Bank Rates (Rp)	May	Apr	Chg (bps)
Lending (WC)	8.48	8.49	-1.13
Deposit 1M	2.79	2.84	-4.96
Savings	0.64	0.62	1.17

Currency/USD	21-Sep	-1 mth	Chg (%)
UK Pound	0.887	0.845	-4.73
Euro	1.017	0.996	-1.99
Japanese Yen	144.1	137.0	-4.92
Chinese RMB	7.050	6.818	-3.30
Indonesia Rupiah	14,998	14,838	-1.07

Capital Mkt	21-Sep	-1 mth	Chg (%)
JCI	7,188.3	7,172.4	0.22
DJIA	30,183.8	33,706.7	-10.45
FTSE	7,237.6	7,550.4	-4.14
Nikkei 225	27,313.1	28,930.3	-5.59
Hang Seng	18,444.6	19,773.0	-6.72

Foreign portfolio ownership (Rp Tn)	Aug	Jul	Chg (Rp Tn)
Stock	2,541.6	2,442.4	99.11
Govt. Bond	759.5	751.2	8.27
Corp. Bond	15.2	16.7	-1.50

Trade & Commodities	21-Sep	-1 mth	Chg (%)
Baltic Dry Index	1,746.0	1,279.0	36.5
S&P GSCI Index	630.0	670.1	-6.0
Oil (Brent, $/brl)	89.8	96.7	-7.1
Coal ($/MT)	448.0	434.9	3.0
Gas ($/MMBtu)	8.00	9.11	-12.2
Gold ($/oz.)	1,673.9	1,747.1	-4.2
Copper ($/MT)	7,749.0	8,100.9	-4.3
Nickel ($/MT)	24,882.0	22,176.5	12.2
CPO ($/MT)	824.4	930.7	-11.4
Rubber ($/kg)	1.33	1.46	-8.9

External Sector	Aug	Jul	Chg (%)
Export ($ bn)	27.91	25.56	9.2
Import ($ bn)	22.15	21.35	3.8
Trade bal. ($ bn)	5.76	4.22	
Central bank reserves ($ bn)*	132.2	132.2	0.02

Prompt Indicators	Aug	Jul	Jun
Consumer confidence index (CCI)	124.7	123.2	128.2
Car sales (%YoY)	16.4	29.4	8.5
Motorcycle sales (%YoY)	11.6	-13.3	-30.9
Cement sales (%YoY)	#N/A	#N/A	-41.1

Manufacturing PMI	Aug	Jul	Chg (bps)
USA	52.8	52.8	0
Eurozone	49.6	49.8	-20
Japan	51.5	52.1	-60
China	49.5	50.4	-90
Korea	47.6	49.8	-220
Indonesia	51.7	51.3	40

Source: Bloomberg, BI, BPS

Notes:

^Data for January 2022

*Data from earlier period

For changes in currency: **Black indicates appreciation against USD, **Red** otherwise

***For PMI, **>50** indicates economic expansion, **<50** otherwise

Scan for the link to our report depository or **click**:

https://s.id/1fMOq

Indonesia – Economic Indicators Projection

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	5.1
GDP per Capita (US$)	3877	3927	4175	3912	4350	4564
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	7.1
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.75
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	15,293
Trade Balance (US$ billion)	11.8	-8.5	-3.2	21.7	35.3	45.5
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.3	1.4

** Estimation of Rupiah's fundamental exchange rate

Economic, Banking & Industry Research Team

David E.Sumual
Chief Economist
david_sumual@bca.co.id
+6221 2358 8000 Ext:1051352

Agus Salim Hardjodinoto
Senior Industry Analyst
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Barra Kukuh Mamia
Senior Economist
barra_mamia@bca.co.id
+6221 2358 8000 Ext: 1053819

Victor George Petrus Matindas
Senior Economist
victor_matindas@bca.co.id
+6221 2358 8000 Ext: 1058408

Gabriella Yolivia
Industry Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Suryaputra Wijaksana
Economist / Analyst
suryaputra_wijaksana@bca.co.id
+6221 2358 8000 Ext: 1065752

Livia Angelica Thamsir
Economist / Analyst
livia_thamsir@bca.co.id
+6221 2358 8000 Ext: 1069933

Lazuardin Thariq Hamzah
Economist / Analyst
lazuardin_hamzah@bca.co.id
+6221 2358 8000 Ext: -

Keely Julia Hasim
Economist / Analyst
keely_hasim@bca.co.id
+6221 2358 8000 Ext: -

Ahmad Aprilian Rizki
Research Assistant
ahmad_rizki@bca.co.id
+6221 2358 8000 Ext: 20378

Arief Darmawan
Research Assistant
arief_darmawan@bca.co.id
+6221 2358 8000 Ext: 20364

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group

20th Grand Indonesia, Menara BCA

Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia

Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343