The Fed's coming but no need to run

31 January 2023

Lazuardin Thariq Hamzah
lazuardin_hamzah@bca.co.id

Barra Kukuh Mamia
barra_mamia@bca.co.id

Summary

- Markets continue to rally ahead of the February 2023 FOMC meeting, courtesy of the still-present Fed pivot sentiment and the rather colourful earnings season. However, weakening consumer demand amid continued policy tightening may force investors to downgrade their expectations for the periods ahead.
- The upcoming earnings season would also provide some boosts for the Indonesian stock market, considering the still-strong domestic consumption and the weakening inflation that would help to sustain aggregate demand growth.

- US economic data releases from last week did little to bring market commentators closer to a consensus on the state of the US economy. On the one hand, the US economy expanded by 2.9% YoY in Q4 2022, beating market expectations of 2.6% YoY. On the other hand, consumer spending continues to weaken, contracting by 0.2% MoM in December 2022 (–0.1% MoM in Nov-22). We are also getting closer to the first FOMC meeting in 2023, where the Fed is widely expected to hike its policy rate by 25 bps. Against this backdrop, however, the market remains relatively sanguine. Indeed, volatility indices continue to move lower, while the S&P 500 recorded a robust 2.44% WoW gain last week.
- The reason behind this relatively buoyant mood should be quite obvious now; the market has priced in the 25 bps rate hike in the upcoming FOMC meeting and many remain sceptical that the Fed could "walk" its hawkish "talk" **(*see* Chart 1)**. We do acknowledge that inflationary pressures have receded in the US (and globally), but the spectre of inflation remains close. China's re-opening would (eventually) translate to a surge in commodity demand, potentially renewing global inflationary pressures in periods ahead. Chairman Powell's reported emphasis on the stickier component of the PCE inflation (core service inflation, excluding housing) further underlines the Fed's singular focus on fighting inflation. We also noted that absent mortal threats to the economy or the financial sector, the Fed may have little incentive to call a win on inflation and cut (or at least, stop hiking) rates. With US GDP continuing to beat expectations in Q4 2022, then, **we maintain our thesis that it is still too premature to assume that the**

Fed would wrap up its tightening campaign anytime soon.

- The other factor that continues to sustain the rally in the stock market is the ongoing earnings season. Indeed, many companies deliver colourful numbers in their Q4 2022 financial reports, with 69% of 29% of US companies that have reported their earnings delivering positive EPS surprises. Indeed, the US corporate sector enjoyed an astronomical level of demand in 2022, courtesy of excess savings that had piled up throughout the pandemic days. This effervescent demand, of course, allows US corporates to assume greater control of prices, as indicated by the record-breaking margin in 2022 despite substantial cost pressures. However, now the excess liquidity is spent and many American households find no options but to moderate their spending, leading us to question whether or not this exuberant corporate earnings trend would continue in 2023**.**
- It is quite clear that the US corporate sector has performed splendidly in 2022, and it would be a Herculean task to emulate the last year's performance. China's re-opening, and the flurry of cheap imports that entail, may help to deflate cost pressures faced by US corporates while also providing some support to US consumers' purchasing power. But this dynamic will eventually boil down to the Fed. Indeed, the Fed's still-going tightening campaign would attack inflation by first suppressing demand, quite technically turning consumers away from the market **(*see* Chart 2).** However, as indicated by the still robust US GDP projections, US consumers may still have some fuels in their tank, which may translate to quite substantial (despite softening) corporate earnings. Rather than a Fed pivot, then, we may see a market pivot when the Fed continue its crusade against inflation while investors revise its expect-ations slightly downward.

"Expectation of continued strong earnings would also act as a rebuttal to the Fed pivot sentiment"

- But what about the Indonesian market? Fortunately, foreign investors continue to show their confidence in the domestic bond market, continuing the trend which started in late October 2022. Indeed, Indonesia continues to benefit from risk-off sentiment driven by the "Fed pivot" sentiment amid the still-ample liquidity in the global market. Apart from sentiment play, however, the upcoming earnings season may also provide some boosts for the domestic stock market. We've only seen two earnings announcements so far, both from the banking sector and largely in line with market consensus. However, we do have reasons to believe that the fruit is ripe not only in the banking sector but throughout the Indonesian market, both in Q4 2022 and the quarter ahead.
- For the export-oriented mining sector, heightened energy demand during the winter period has undoubtedly bolstered the earning prospects of Indonesia's many coal producers. Coal demand may be trending downward at the moment, but improving manufacturing activities in China may help to restore the sentiment for coal producers, although this scenario is rather heavily reliant on the Chinese demand. For those in the real sector, however, the signals appear to be rather mixed. Just like US consumers,

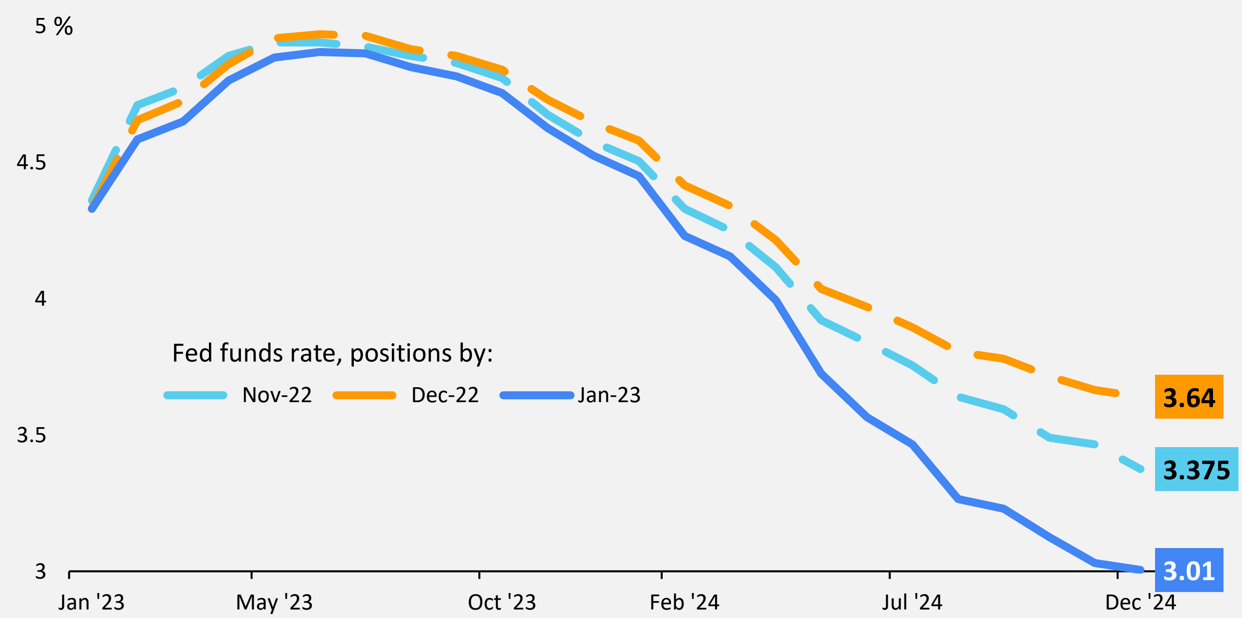
Indonesian consumers have spent much of its pandemic-era liquidity pile up **(*see* Chart 3)**, and news regarding layoffs and the impending global recession throughout the much part of Q4 2022 may help to worsen public confidence. Nevertheless, our spending (*Intrabel*) and business transaction (*Intrabiz*) indices indicated continued consumption growth in Q4 2022 despite the lack of clear stimuli. This reading underlines our optimism ahead of earnings announcements of those companies in the real sector, especially those companies that dwell in the mid-to-high market that may better capture the profile of transactions captured by our indices.

- We are also quite optimistic about the earnings prospects of Indonesian companies going forward, at least for this quarter. The increase in real wages (minimum growth minus yearly inflation) would provide some help in stimulating aggregate demand in the periods ahead, with the high-spending season of Ramadan set to put domestic aggregate demand on steroids on the closing days of Q1 2023. The anticipated surge in demand by the end of Q1 2023 would also help the domestic corporate sector to improve their margin, bolstering the prospects for periods ahead. It is important to note, however, that continued growth in consumer spending (and hence, corporate earnings) would depend on developments in domestic prices during the interregnum period between the end-of-year spending season and the upcoming Ramadan. In this regard, we expect inflation to continue trending downward, with inflation in Jan-2023 weakening to (albeit still relatively high) 5.42% YoY.

Chart 1

Strongly convinced

Markets remain sceptical that the Fed could deliver its “tighter-for-longer” policy outlook despite the still robust economic projections



Source: Bloomberg

Chart 2

The only game in town

The Fed's still-ongoing tightening campaign may limit US corporate earnings as aggregate demand (and transaction) dwindles

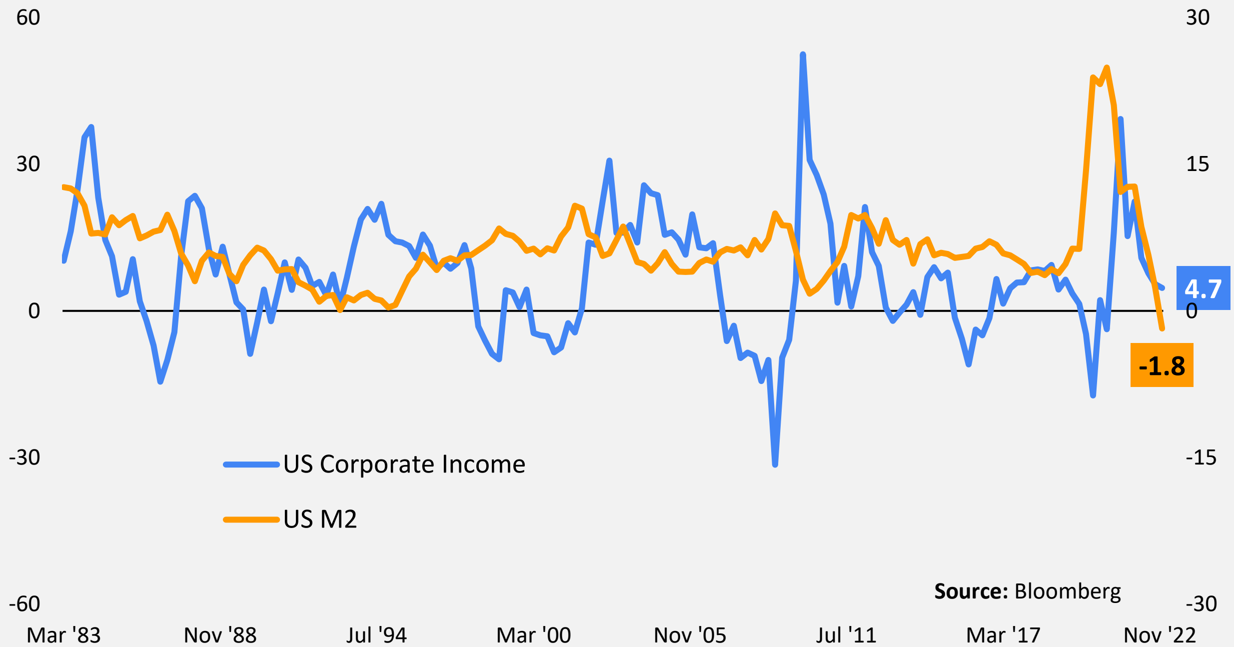
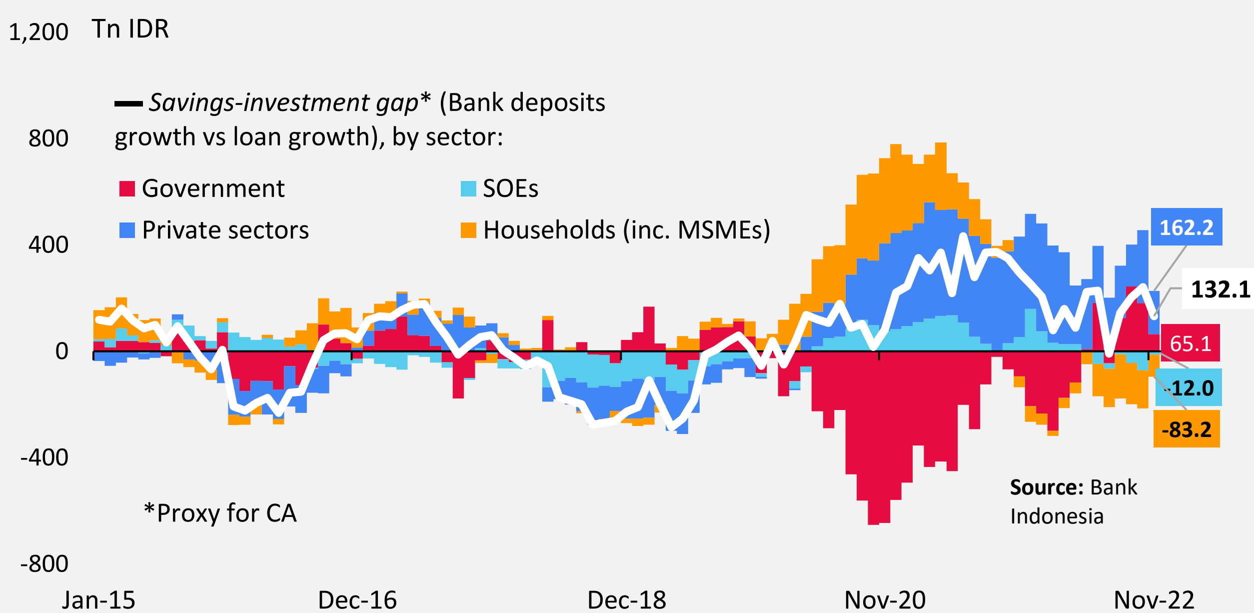


Chart 3

Dwindling munitions

Lower liquidity in the domestic households sector may limit the ceiling in which aggregate demand could continue to grow



Economic Calendar

		Actual	Previous	Forecast*
9 January 2023				
ID	Consumer confidence	119.9	119.1	115
10 January 2023				
ID	Retail sales YoY	1.3%	3.7%	-
12 January 2023				
CN	CPI Inflation YoY	1.8%	1.6%	2%
US	CPI Inflation YoY	6.45%	7.1%	6.7%
13 January 2023				
CN	Balance of trade (USD Bn)	78.0	69.8	80
16 January 2023				
ID	External debt (USD Bn)	392.6	390.2	-
ID	**Balance of trade** (USD Bn)	**3.89**	**5.1**	**3.57**
17 January 2023				
CN	Industrial Production	1.3%	2.2%	3.8%
CN	GDP Growth Q4 2022 (YoY)	2.9%	3.9%	1.8%
18 January 2023				
US	Producer Price Index (YoY)	6.2%	7.3%	6.8%
US	Retail Sales (YoY)	6.0%	6.0%	5.0%
19 January 2023				
ID	**Bank Indonesia policy announcement**	**5.75%**	**5.5%**	**5.75%**
24 January 2023				
ID	**Foreign and Domestic Direct Investments Q4 2022 (YoY)**	**43.3%**	**63.6%**	-
ID	M2 Money Supply (YoY)	8.3%	9.5%	-
26 January 2023				
US	GDP Growth Q4 2022 (YoY), Adv	2.9%	3.2%	2.6%
27 January 2023				
US	Personal income MoM	0.2%	0.4%	0.3%
US	Personal spending MoM	-0.2%	-0.1%	0.1%

*Forecasts of some indicators are simply based on market consensus
*Forecasts of some indicators are simply based on market consensus
Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	4.50	Jan-23	-2.00
UK	3.50	Jan-23	-7.00
EU	2.50	Jan-23	-6.70
Japan	-0.10	Jan-16	-4.10
China (lending)	4.35	Jan-23	2.55
Korea	3.50	Jan-23	-1.50
India	6.25	Dec-22	0.53
Indonesia	5.75	Jan-23	0.24

Money Mkt Rates	30-Jan	-1 mth	Chg (bps)
SPN (1M)	3.43	4.44	-100.4
SUN (10Y)	6.74	6.92	-17.8
INDONIA (O/N, Rp)	5.36	5.02	33.8
JIBOR 1M (Rp)	6.42	6.20	21.8

Bank Rates (Rp)	Sep	Aug	Chg (bps)
Lending (WC)	8.46	8.42	3.71
Deposit 1M	2.97	2.87	10.38
Savings	0.66	0.65	0.76

Currency/USD	30-Jan	-1 mth	Chg (%)
UK Pound	0.810	0.828	2.23
Euro	0.922	0.934	1.36
Japanese Yen	130.4	131.1	0.56
Chinese RMB	6.752	6.899	2.17
Indonesia Rupiah	14,970	15,568	3.99

Capital Mkt	30-Jan	-1 mth	Chg (%)
JCI	6,872.5	6,850.6	0.32
DJIA	33,717.1	33,147.3	1.72
FTSE	7,784.9	7,451.7	4.47
Nikkei 225	27,433.4	26,094.5	5.13
Hang Seng	22,069.7	19,781.4	11.57

Foreign portfolio ownership (Rp Tn)	Dec	Nov	Chg (Rp Tn)
Stock	2,699.4	2,656.0	43.37
Govt. Bond	762.2	736.9	25.26
Corp. Bond	12.5	14.5	-2.05

Trade & Commodities	30-Jan	-1 mth	Chg (%)
Baltic Dry Index	676.0	1,515.0	-55.4
S&P GSCI Index	599.9	610.1	-1.7
Oil (Brent, $/brl)	84.9	85.9	-1.2
Coal ($/MT)	257.0	339.6	-24.3
Gas ($/MMBtu)	2.85	3.52	-19.0
Gold ($/oz.)	1,923.2	1,824.0	5.4
Copper ($/MT)	9,188.4	8,364.8	9.8
Nickel ($/MT)	29,017.3	29,886.0	-2.9
CPO ($/MT)	924.6	915.4	1.0
Rubber ($/kg)	1.44	1.27	13.4

External Sector	Dec	Nov	Chg (%)
Export ($ bn)	23.83	24.09	-1.1
Import ($ bn)	19.94	18.96	5.2
Trade bal. ($ bn)	3.89	5.13	-24.2
Central bank reserves ($ bn)*	137.2	134.0	2.39

Prompt Indicators	Dec	Nov	Oct
Consumer confidence index (CCI)	119.9	119.1	120.3
Car sales (%YoY)	9.0	4.4	23.3
Motorcycle sales (%YoY)	24.6	26.9	20.9

Manufacturing PMI	Dec	Nov	Chg (bps)
USA	48.4	49.0	-60
Eurozone	47.8	47.1	70
Japan	48.9	49.0	-10
China	49.0	49.4	-40
Korea	48.2	49.0	-80
Indonesia	50.9	50.3	60

Source: Bloomberg, BI, BPS
Notes:
^Data for January 2022
*Data from an 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/1fMO

Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3*	4.6
GDP per Capita (US$)	3927	4175	3912	4350	4564*	4525
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.4
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.00
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	16,292
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	55.8*	43.2
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	0.9*	-0.2

*Estimated number

** Estimation of the 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

Lazuardin Thariq Hamzah
Economist / Analyst
lazuardin_hamzah@bca.co.id
+6221 2358 8000 Ext: 1071724

Keely Julia Hasim
Economist / Analyst
keely_hasim@bca.co.id
+6221 2358 8000 Ext: 1071535

Elbert Timothy Lasiman
Economist / Analyst
Elbert_lasiman@bca.co.id
+6221 2358 8000 Ext: 1074310

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

Firman Yosep Tember
Research Assistant
firman_tember@bca.co.id
+6221 2358 8000 Ext: 20378

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