FOMC:
Inching closer to the terminus

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Executive Summary

- The Fed delivered an expected 25 bps rate hike in January's FOMC. It also indicated that its current tighter monetary cycle could be close to the desired terminal rate, possibly converging with market expectations of a soft landing scenario.
- The soft landing scenario should benefit Indonesia as it would attract significant foreign inflow returns amidst thinning trade surplus. More importantly it would allow BI to pause its own rate hiking cycle albeit cautious of the return of global volatility.

- The Federal Reserve delivered a 25 bps rate hike in the first FOMC of the year, driving the Fed Funds rate to 4.5%-4.75% in line with market predictions. Along with rate hikes, there has been significant change in the Fed's wording stated in its implementation note. Firstly the Fed finally recognizes its previous tightening cycle has caused a significant slowdown in inflationary pressures. Secondly it also hinted significant change in its rate policy path, in which a pause in rate hiking maybe possible. On the side lines, the central bank plans to continue its purchase of US treasuries and mortgage backed securities up to $ 60 billion and $ 35 billion per month respectively.

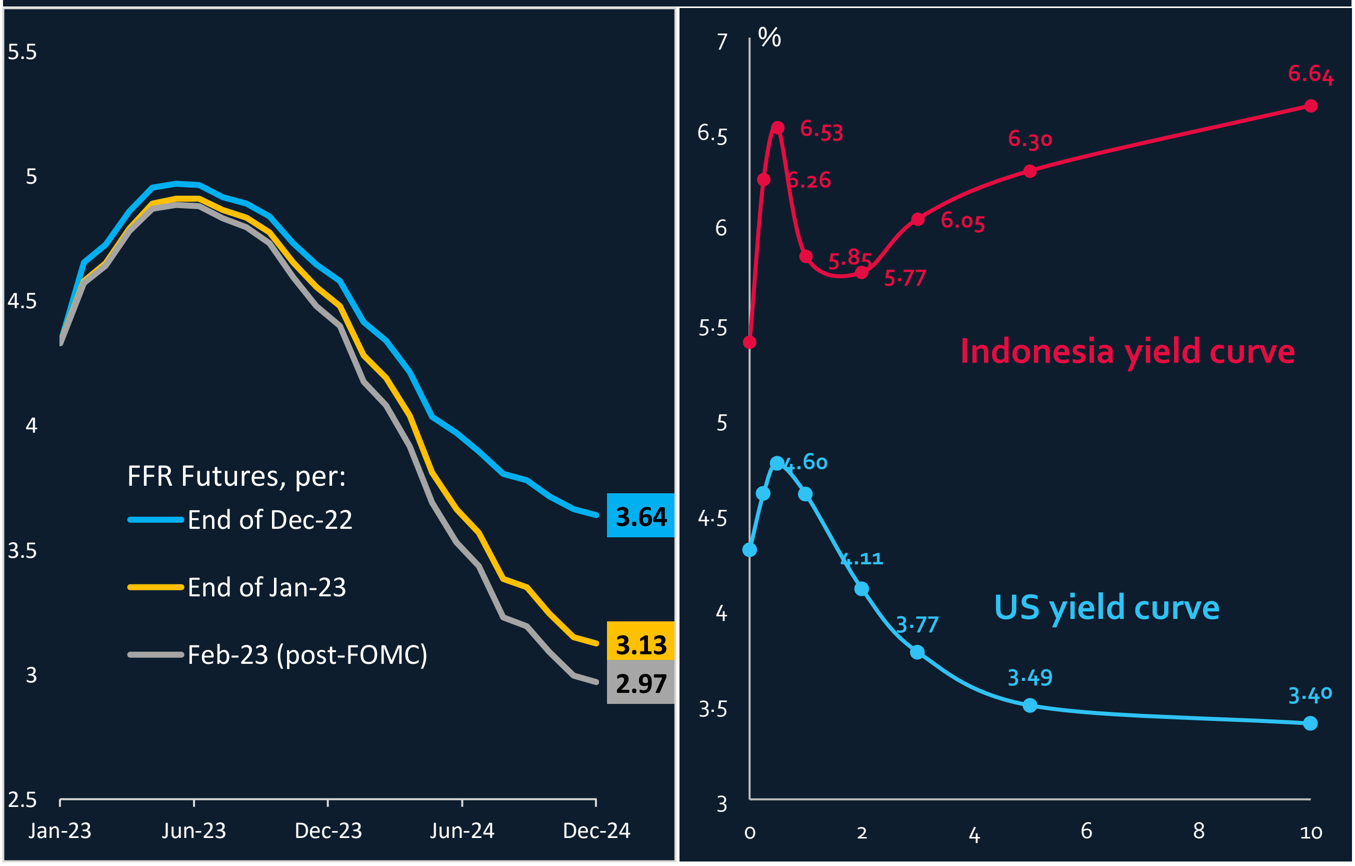
- Indeed US inflation has been rapidly dwindling thanks to mostly supply side factors: dropping global energy prices due to warmer weather in Europe and the relatively successful implementation of the G7 initiated oil price cap. Improving relations between US and China also reduce the risk of geopolitical flare ups for the time being.

- All the while the US demand remain relatively solid (for now) with core inflation remaining at elevated levels. Learning from history, the Fed also increasingly take notice of the lagging impact of its tighter monetary policy on the labor market. The still tighter labor market can be seen from the rapid rehiring of white collar workers laid off in the tech winter and still robust wage growth. However the real causes are likely to be structural demographic factors such as dwindling migration and aging population.

- Meanwhile the global outlook is also improving. Better than expected European adaptation of high gas prices and the alleviating Covid-19 wave in China could prevent a deeper global recession. Possible lifting of US sanctions on Venezuela could improve global oil supplies, reducing pressure on oil prices. These changes increasingly shift the needle from a "higher for longer" scenario to a "soft landing" scenario for the Fed, closing in the large difference between Fed and market expectations.

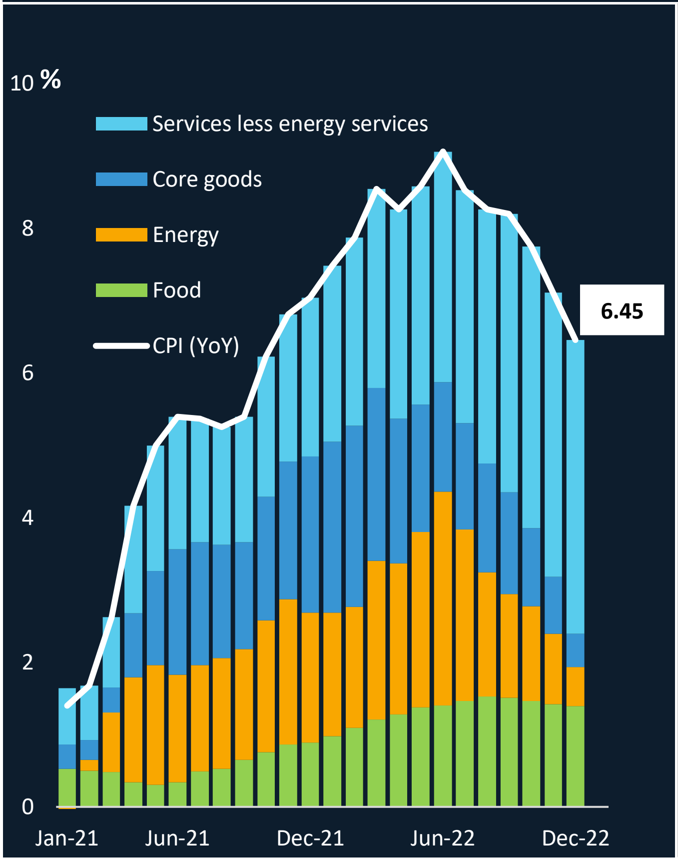
- Initially markets-which seem to favor a rapid Fed pivot- were disappointed by the Fed's change in policy path pushing equities lower. However it then quickly recovered -the Dollar sinking to multi month lows and bond yields tumbling- after grasping the softening inflation outlook and better than expected earnings of tech companies. Most notably investors saw increasing acceptance of a Fed pause as a significant sign of more dovish policy ahead, a vindication of its own prediction of Fed policy path of peaking in June and cutting by December of this year.
- For Indonesia specifically a soft landing scenario would be a sweet spot. Global commodity prices would remain moderate, sufficient enough to support domestic growth but unlikely to trigger further increases in retail fuel prices, critical for domestic consumption. An improved global outlook may not be enough to provide significant push for all important coal prices, thinning out Indonesia's trade surplus. Capital inflows should accelerate, buoying the nation's bond market and the Rupiah. More importantly for BI a soft landing scenario coupled with mild domestic inflation would provide it with some leeway to do its own pause in the short run and allow the domestic momentum to continue.

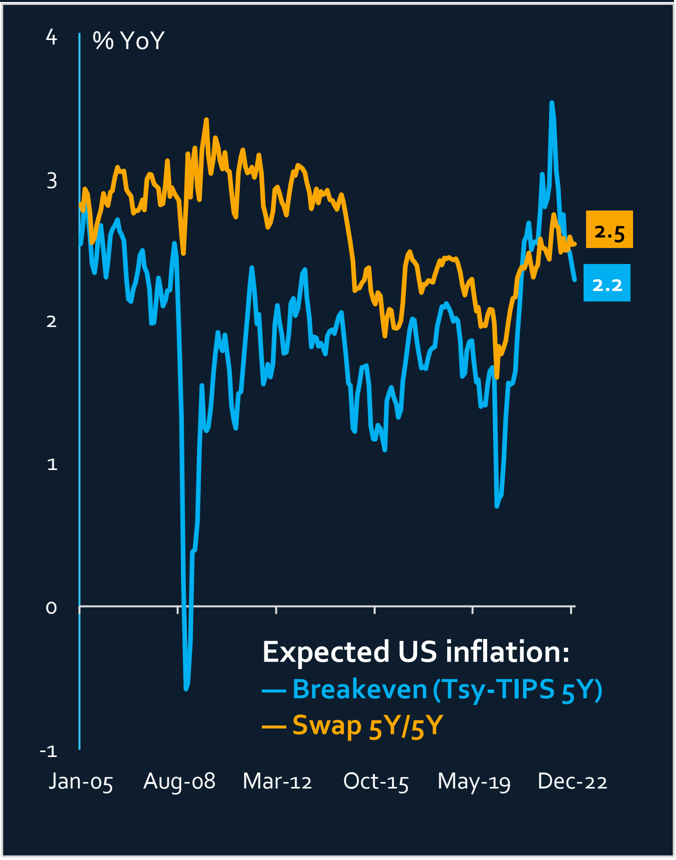
***Panel 1.* Fed hikes are expected to continue into 2023, but Indonesia maintains healthy nominal yield spreads versus the US especially in the longer end**



Source: Bloomberg, BI

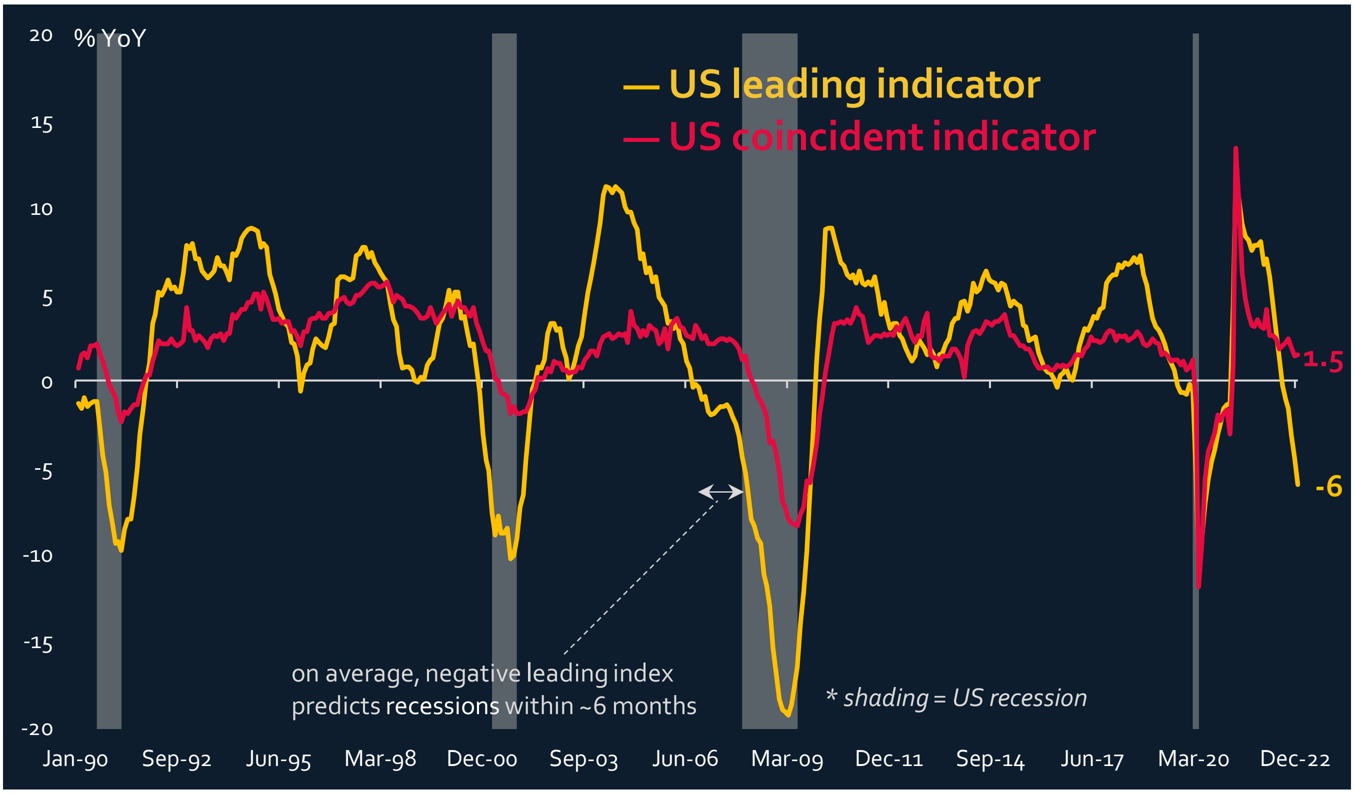
Panel 2. The long-run expectation of US inflation remains well-anchored but the inflation expectation remains stubbornly high due to some sticky components





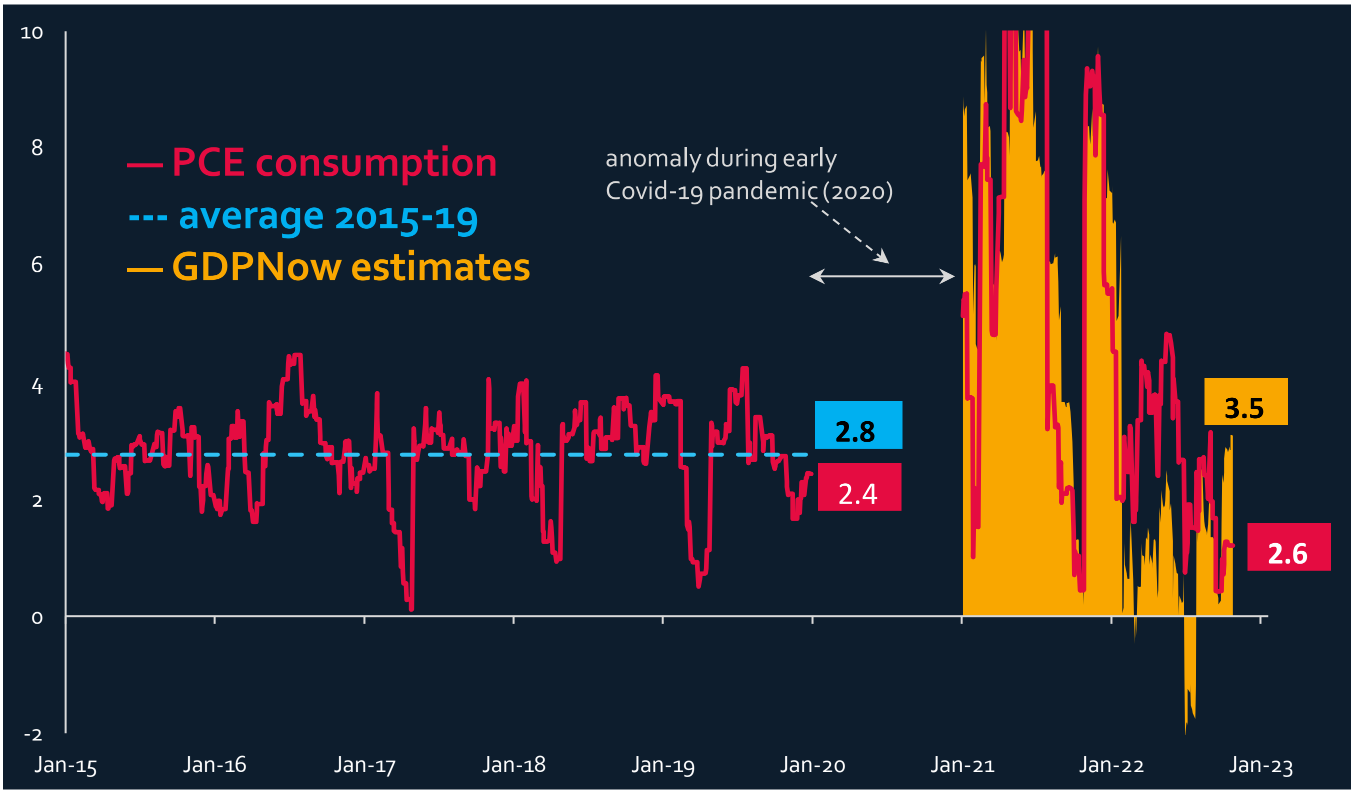
Source: US BLS, Bloomberg

Chart 1. The FOMC still expects a soft-landing scenario, but the spectre of recession has become more apparent



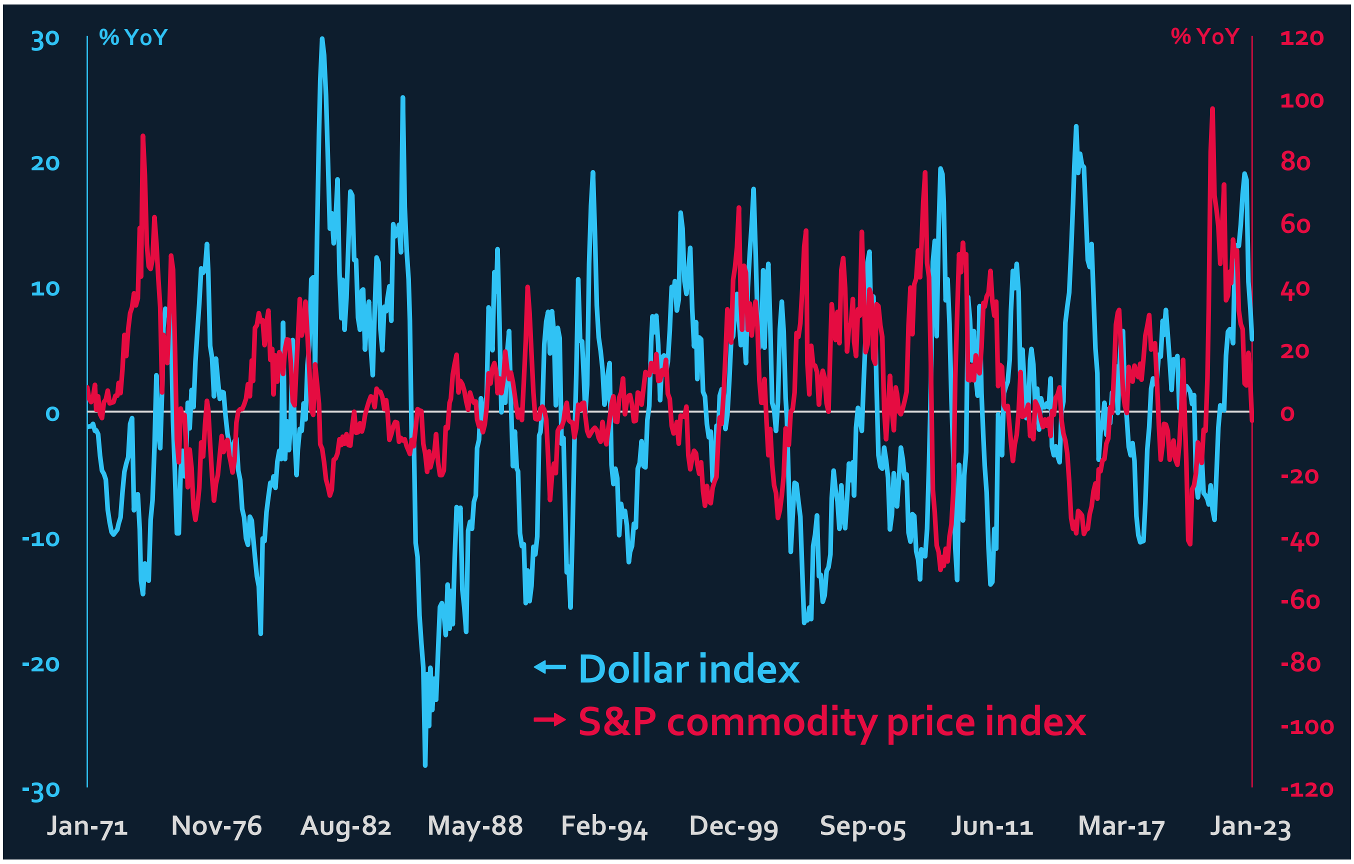
Source: Bloomberg

Chart 2. **GDP nowcast points to slowing demand amidst strong GDP print**



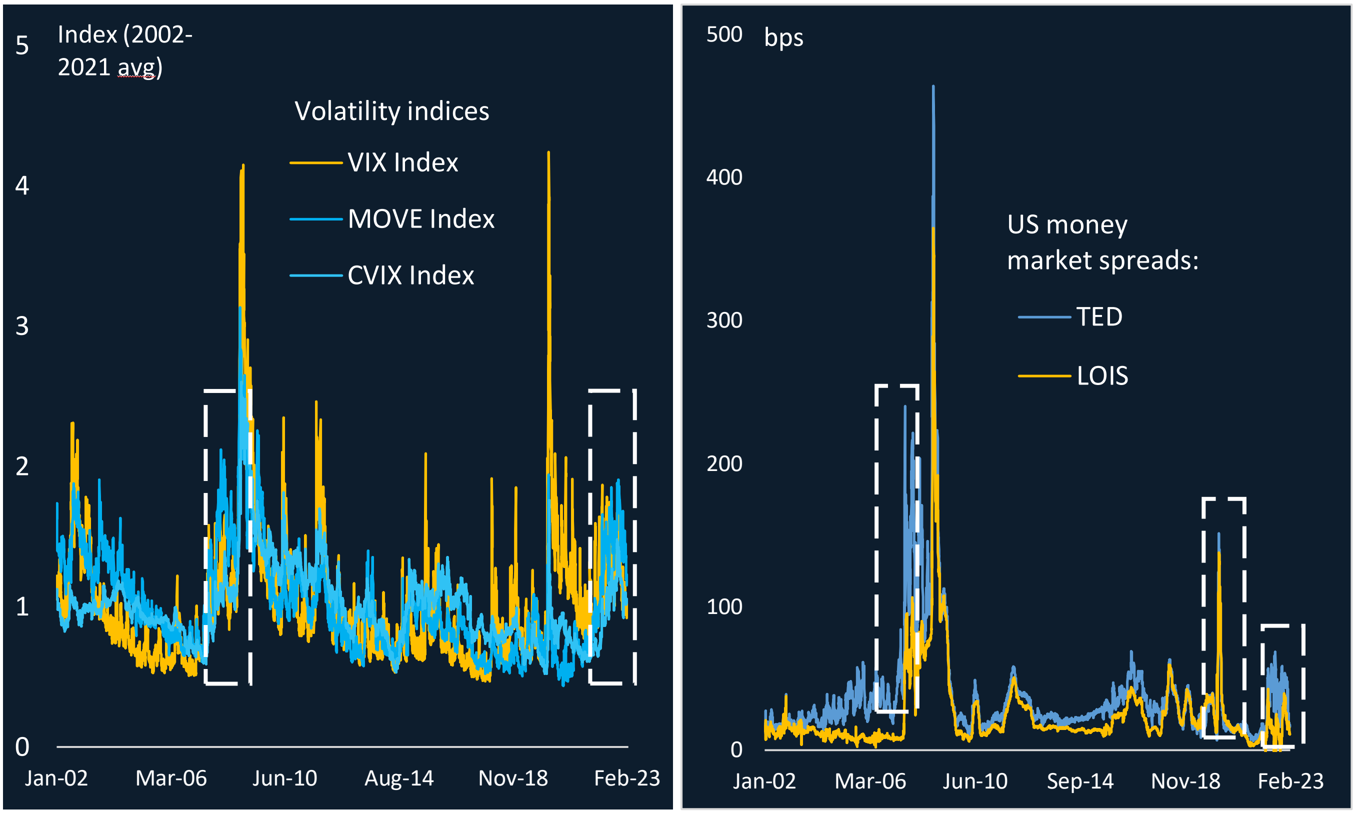
Source: Atlanta Fed

Chart 3. **Weakening demand has lowered commodity prices but a strong USD might still be needed to suppress prices even more**



Source: Bloomberg

Panel 3. Stress has risen in Treasury and FX markets while the US money market stays quiescent



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	4.75	Feb-23	-1.75
UK	3.50	Feb-23	-7.00
EU	2.50	Feb-23	-6.00
Japan	-0.10	Jan-16	-4.10
China (lending)	4.35	Feb-23	2.55
Korea	3.50	Jan-23	-1.70
India	6.25	Dec-22	0.53
Indonesia	5.75	Jan-23	0.47

Money Mkt Rates	1-Feb	-1 mth	Chg (bps)
SPN (1M)	3.92	4.44	-51.6
SUN (10Y)	6.64	6.92	-27.2
INDONIA (O/N, Rp)	5.40	5.02	37.9
JIBOR 1M (Rp)	6.41	6.20	20.8

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	1-Feb	-1 mth	Chg (%)
UK Pound	0.808	0.828	2.42
Euro	0.910	0.934	2.66
Japanese Yen	129.0	131.1	1.66
Chinese RMB	6.742	6.899	2.32
Indonesia Rupiah	14,975	15,568	3.96

Capital Mkt	1-Feb	-1 mth	Chg (%)
JCI	6,862.3	6,850.6	0.17
DJIA	34,093.0	33,147.3	2.85
FTSE	7,761.1	7,451.7	4.15
Nikkei 225	27,346.9	26,094.5	4.80
Hang Seng	22,072.2	19,781.4	11.58

Foreign portfolio ownership (Rp Tn)	Jan	Dec	Chg (Rp Tn)
Stock	2,700.6	2,699.4	1.22
Govt. Bond	811.9	762.2	49.70
Corp. Bond	12.4	12.5	-0.02

Trade & Commodities	1-Feb	-1 mth	Chg (%)
Baltic Dry Index	668.0	1,515.0	-55.9
S&P GSCI Index	591.0	610.1	-3.1
Oil (Brent, $/brl)	82.8	85.9	-3.6
Coal ($/MT)	240.8	339.6	-29.1
Gas ($/MMBtu)	2.65	3.52	-24.7
Gold ($/oz.)	1,950.5	1,824.0	6.9
Copper ($/MT)	9,060.5	8,364.8	8.3
Nickel ($/MT)	29,092.0	29,886.0	-2.7
CPO ($/MT)	891.6	915.4	-2.6
Rubber ($/kg)	1.42	1.27	11.8

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	Jan	Dec	Chg (bps)
USA	N/A	48.4	-100
Eurozone	48.8	47.8	100
Japan	48.9	48.9	0
China	49.2	49.0	20
Korea	48.5	48.2	30
Indonesia	51.3	50.9	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

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Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3*	4.7
GDP per Capita (US$)	3927	4175	3912	4350	4564*	5011
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.3
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.00
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,647
Trade Balance (US$ 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 Rupiah's fundamental exchange rate

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