

## FOMC and BI Policy:

# Rebalancing pirouette between two wrecking balls

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### Executive Summary

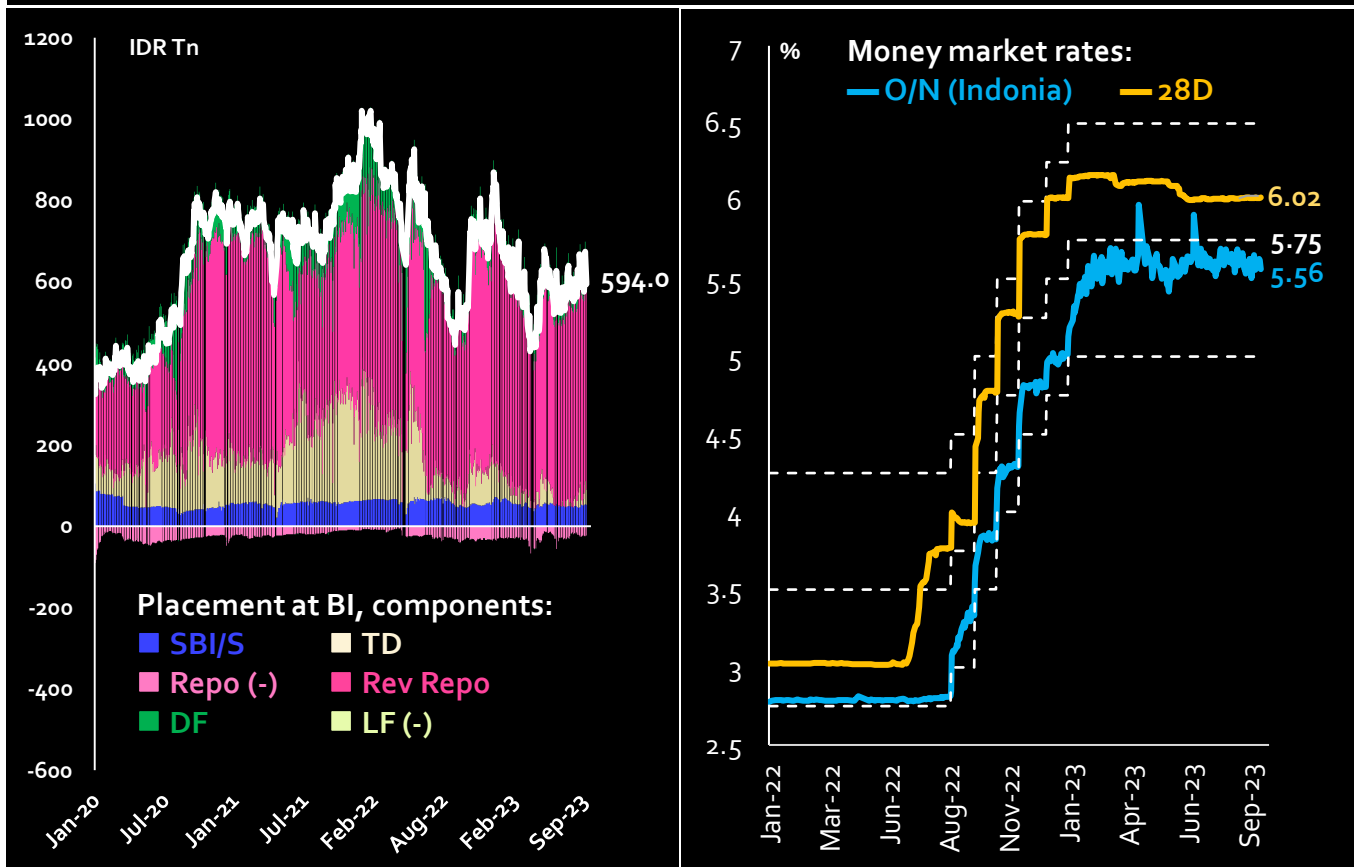
- The Fed maintained its benchmark rate at 5.25 – 5.50%, but indicated more hawkish future stance which led to higher US Treasury yields and stronger USD.
- The combination of a strong Dollar and oil price ascent may make “soft landing” scenario less likely for the US economy. It leaves BI with limited options, and a neutral stance will likely continue.
- BI continues to stand guard in the FX and bond markets, heavily using quantity-based interventions such as the recently launched SRBI.
- Balancing public spending with private savings will be important to stabilize the CA deficit, especially ahead of the upcoming big public spending and in the runup to the 2024 General Elections.

- The latest FOMC meeting saw the Fed keeping its benchmark Fed funds rate (FFR) at 5.25 – 5.50% – as was expected. But it was the changes in its future projections that stole the headline, showing a likely 25 bps hike in Q4, only 50 bps cuts in 2024 (as opposed to 100 bps projected in June), and mostly positive revisions about US macro conditions.
- The market’s reaction to this more hawkish stance was, predictably, negative. At the heart of this was the US Treasury, with 10Y yields moving to 4.5%, and the Dollar index which is now at its highest level since the Silicon Valley Bank (SVB) collapse.
- “King” Dollar’s surge is likely to continue at least in the short-term, given what seems to be happening elsewhere – BoE and SNB finally ending their rate hike cycle, while ECB’s latest hike is widely seen as their last. Among global central banks, then, the Fed will probably be the last to keep hiking – setting aside inflationary outliers like Turkey. And given the relative resilience of the US economy to date, it might also be less compelled to cut at an early date.
- And the Dollar may have an unwitting accomplice in the form of rising oil prices. With OPEC+ cut in place and a global supply shortage projected in Q4, the recent price rally may not be ending just yet. At a glance, this may not seem to be a big deal for the Fed, whose benchmark tends to be the core PCE inflation. But oil is a special commodity given its potential knock-on effect on supply chains, and – particularly in the light of recent labor strikes in the US – it could have salient effect on cost of living and therefore on future wage growth.

- Oil's ascent is also likely to push the vaunted "soft landing" scenario into a harder one, as we indeed saw in 2008 – when it helped turn a slow-moving money market crisis into a much deeper recession. And since the US now lack the tool to bring down oil in short order – having spent its SPR ammo arguably too early – the only sure-fire cure would be declining demand, whether from China in particular or from a more globalized crisis.
- Thus in a 2x2 matrix of scenarios, with "pivot" or "higher for longer" as the Fed policy outlook, and "soft landing" or "hard landing" as the macro outcome, we think that the most optimistic "pivot X soft landing" scenario is now almost completely off the table. In bond market-speak, any re-steepening of the UST yield curve would have to come from more "bear steepening" first (higher long-term yields) before we can eventually get to the "bull" phase (lower short-term yields).
- Caught now between the two wrecking balls (USD and oil), BI's chances of easing policy any time soon is now very limited indeed. But neither is it likely to hike with inflation being as low as it is. BI's cautious, tempered neutrality in its latest meeting is thus pretty much what we could expect for the time being, absent a significantly more intense pressure on the Rupiah.
- But neutral does not mean idle – far from it. BI continues to stand guard in the FX and bond markets, and – as we mentioned last month – BI is now heavily using quantity-based (instead of rate-based) interventions, most recently with the introduction of the SRBI to "mop up" excess Rupiah liquidity if needed. This instrument has accumulated an impressive IDR 37.7 Tn in just two auctions, which highlights both the scale of the liquidity overhang and the strong demand for highly liquid short-term securities in the local money market.
- Between this effort to absorb liquidity and the higher real interest rates, the recent revival in loan growth (up 9.6% YoY per August) may prove to be short-lived. This seems quite adverse from a private sector perspective, but there is arguably quite a clear-headed logic here.
- Remember that the current account (CA) is a reflection of the saving-investment (S-I) gap, as much as it is an imprint of global trade. The CA deficit in Q2, then, was the result of a decline in corporate savings (due to declining commodity exports) simultaneously with an increase in government spending (early disbursement of social assistance and civil servant bonuses).
- Now keep in mind that the government still has about IDR 1,400 Tn to spend in the last four months of the year, which is more than 6% of the GDP. Should this massive public spending be disbursed while the private sector (corporates, SMEs, and households) is also still spending big, it would likely widen the CA deficit – which is a risky proposition in a strong-USD environment. The public spending, as such, has to be offset at least to some extent by private savings.
- This would certainly have negative repercussions on growth. In an upcoming report, we estimate that at current commodity prices, Indonesia can only grow at around 4.7-4.8% YoY if it wants to keep its CA neutral. The authorities would likely not go to that extreme, but some reconfiguration and scaling back in short-term growth (perhaps to 5.0-5.1%) could help reduce the risk.

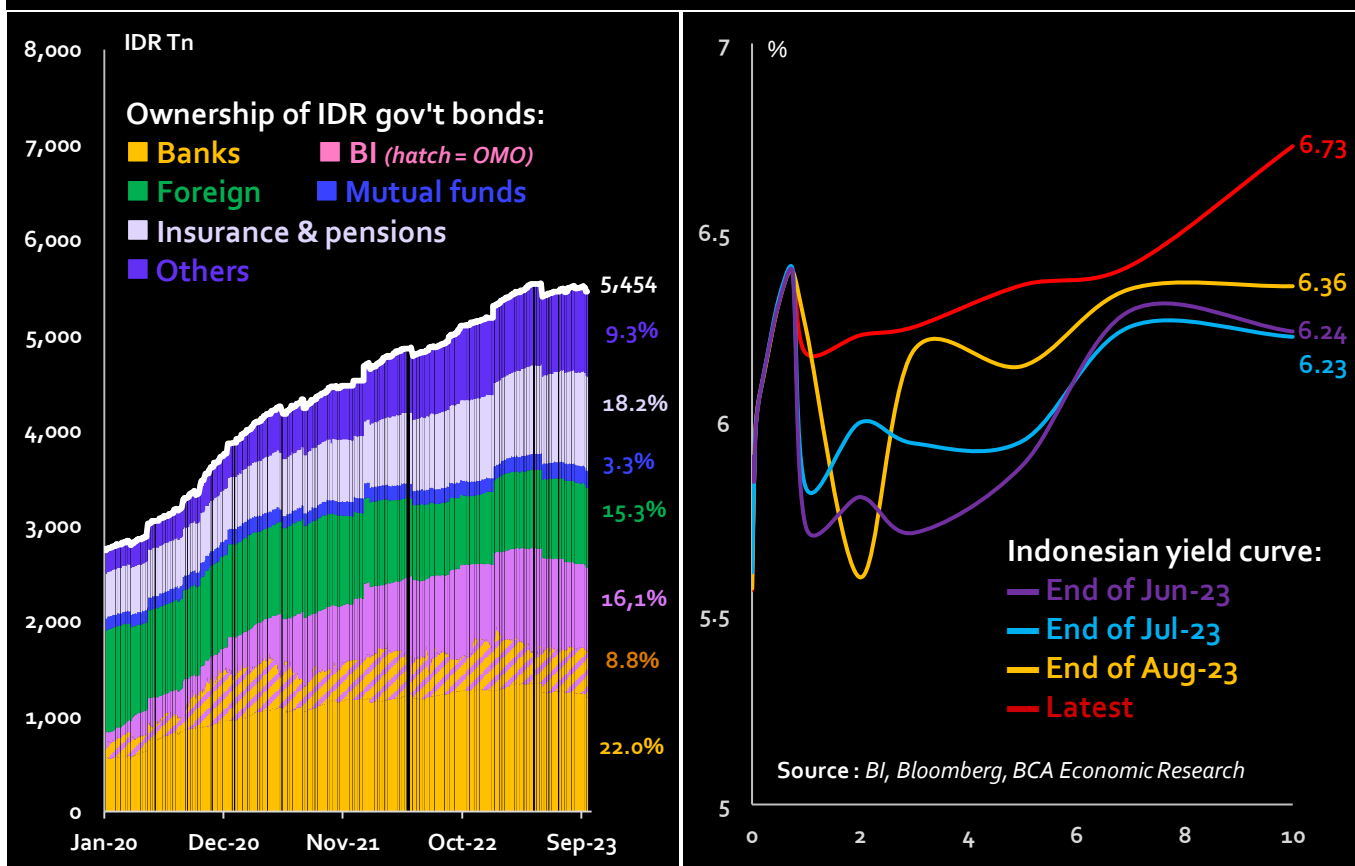
- The kind of growth that we will get in a “public spending, private saving” situation will also be somewhat different, qualitatively and distributionally. Bear in mind that household dis-saving after the pandemic has been driven largely by pent-up demand from the upper/middle classes, while corporate CAPEX has also been robust despite recent decline in revenue.
- If these expenditures are now scaled back in favor of government spending, we may see a rebalancing away from mining, manufacturing, and discretionary consumption towards construction, services, and basic (staples) consumption. A large part of the spending will also be targeted towards the low-income masses, in the form of social assistance and subsidies/market interventions to keep food prices affordable. We cannot help but think that this is a necessary shift in focus ahead of a General Election in a year (2024) when the global situation could become even more challenging.

**Panel 1. BI stays put, pivots to quantitative measures amid ample liquidity in the system**



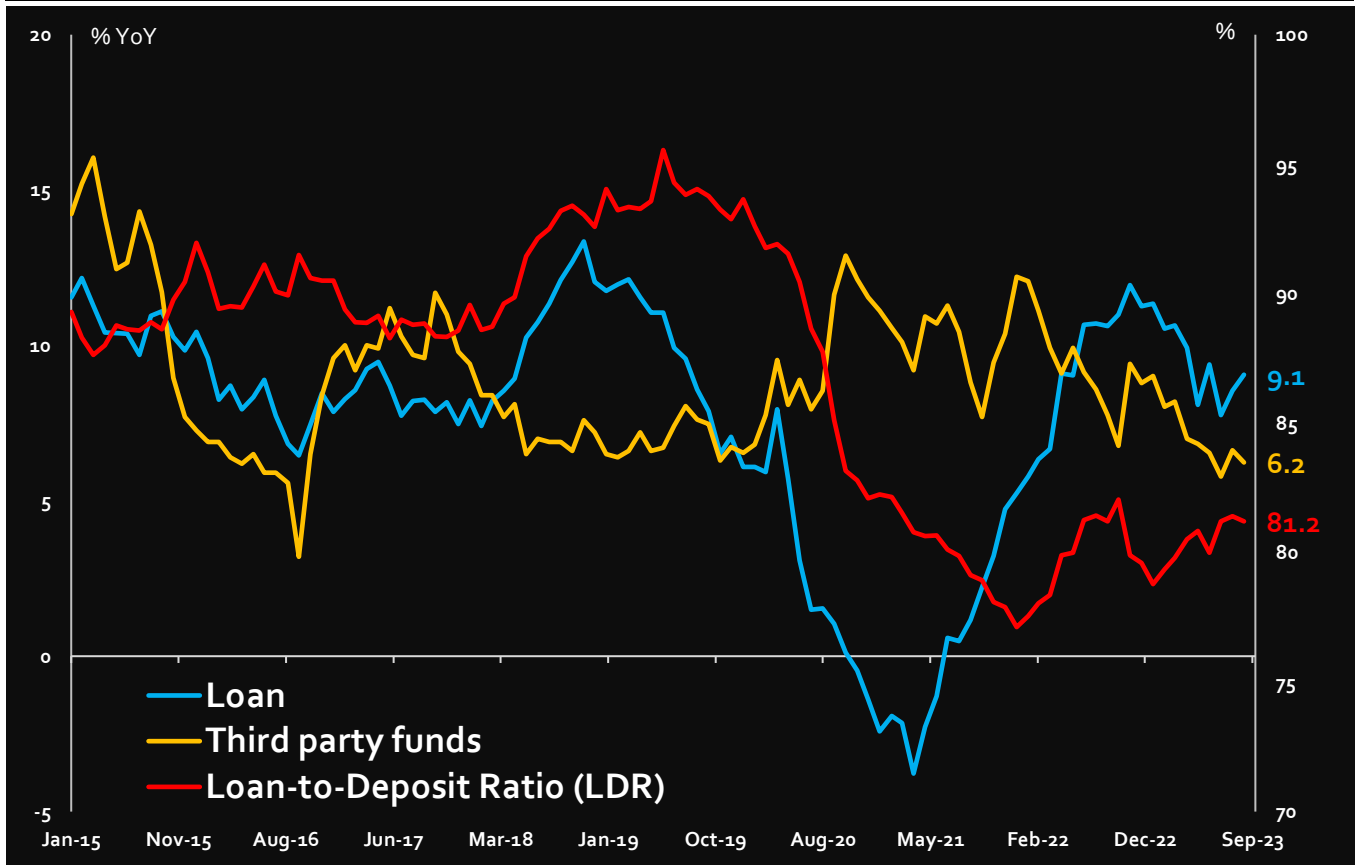
Source: BI, Bloomberg, BCA Economist

**Panel 2. Bear steepening in UST puts similar pressure on long-dated Indonesian bonds**



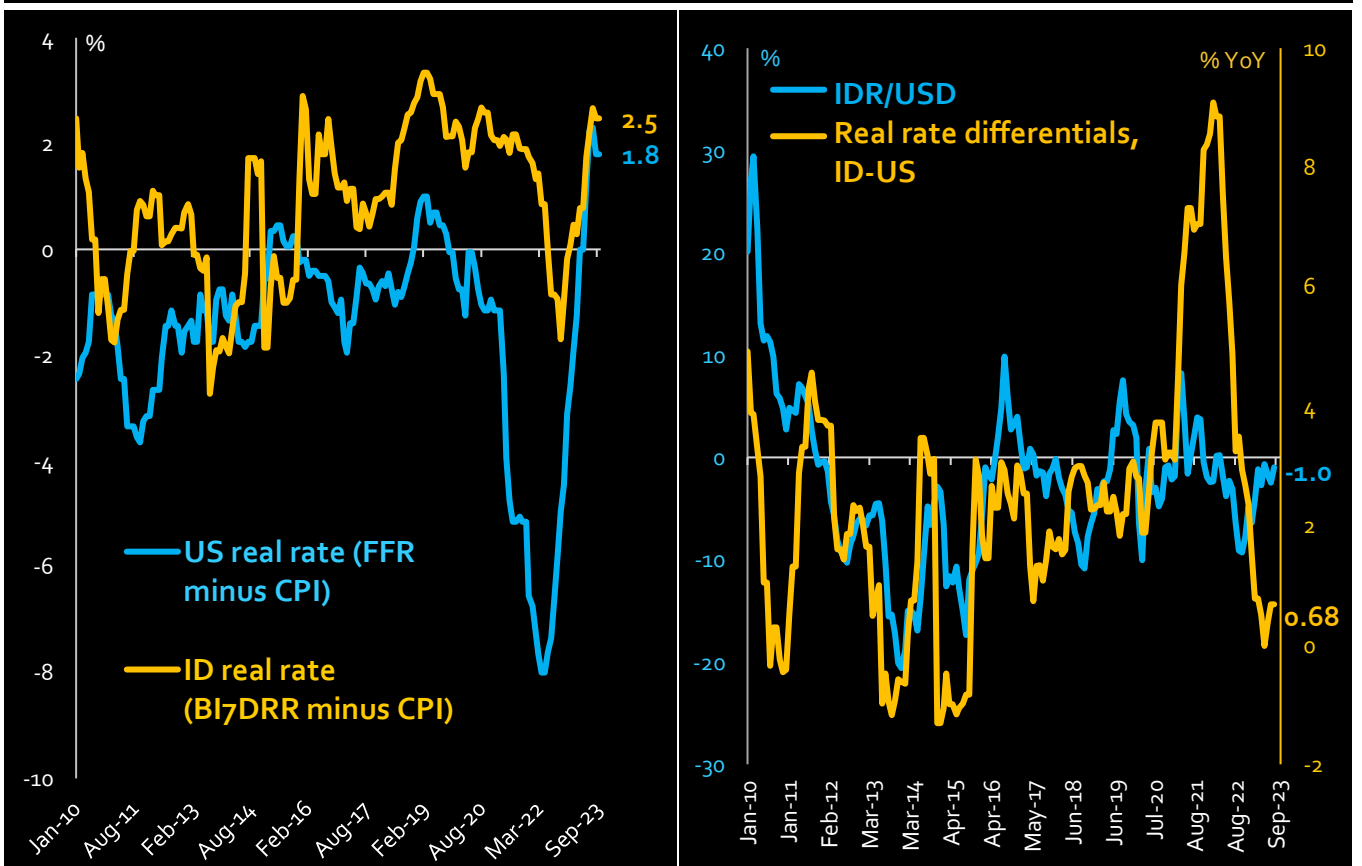
Source: MoF, BI, Bloomberg, BCA Economist

**Panel 3. Loan growth staging a mini-revival, but could be limited by BI's quantitative measures**



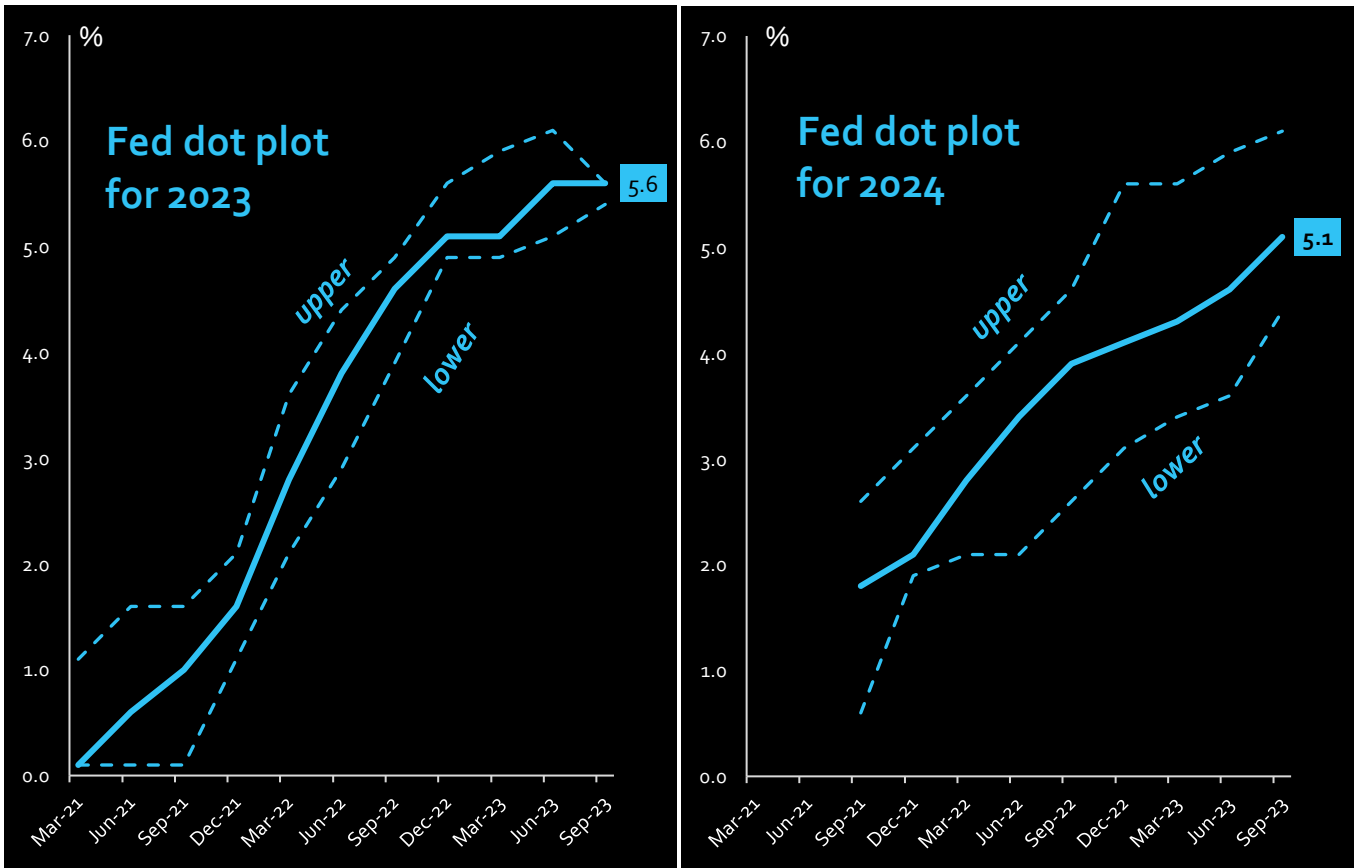
Source: OJK, BI, BCA Economist

**Panel 4. Real rate differentials remain narrow, although not (yet) as predictive for USD/IDR**



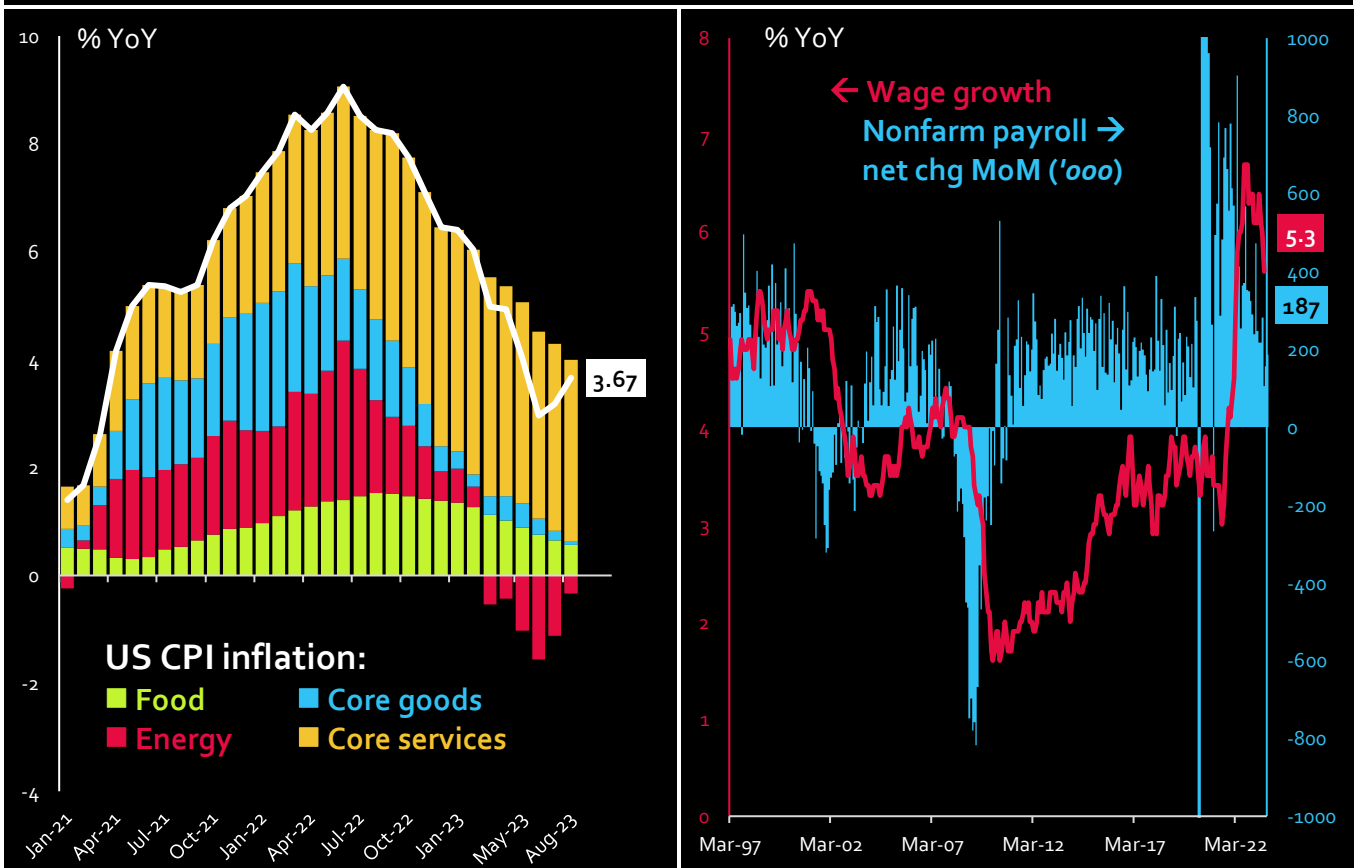
Source: BI, Bloomberg, BCA Economist

**Panel 5. Despite FFR hold, the Fed's forward guidance continues to inch higher**



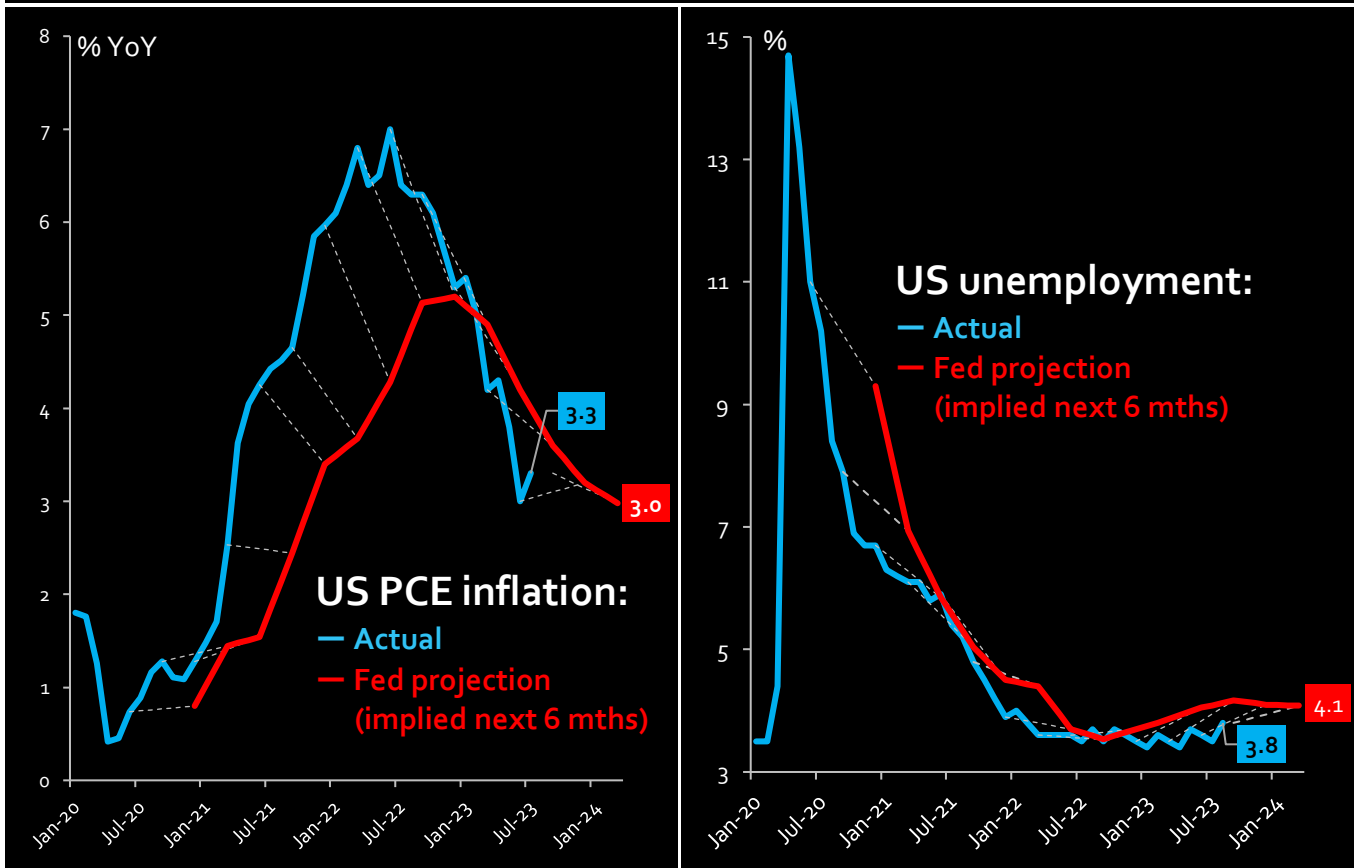
Source: Federal Reserve

**Panel 6. Rising oil price presents a tough dilemma for the Fed, reducing the chance of pivot?**



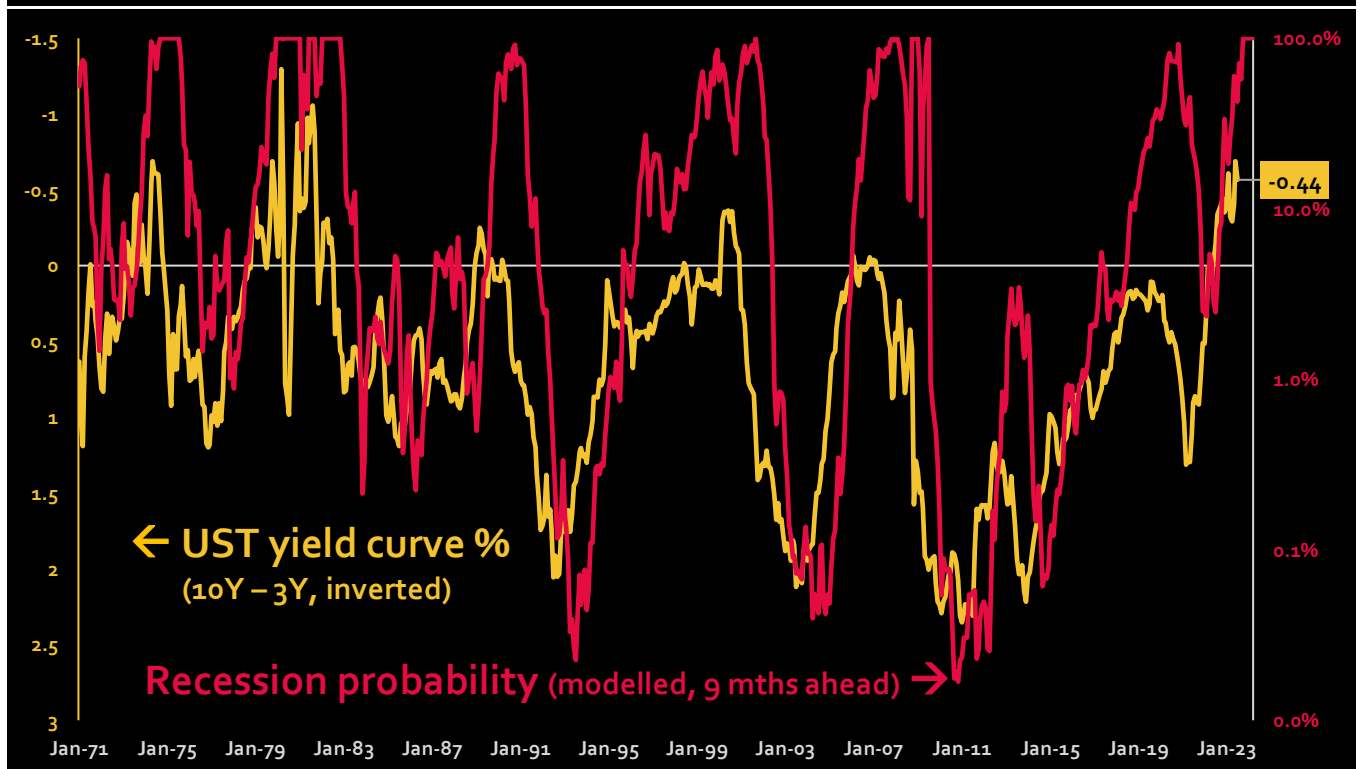
Source: US BLS, Bloomberg

**Panel 7. The Fed's forecast has remained rather more cautious than the actual data**



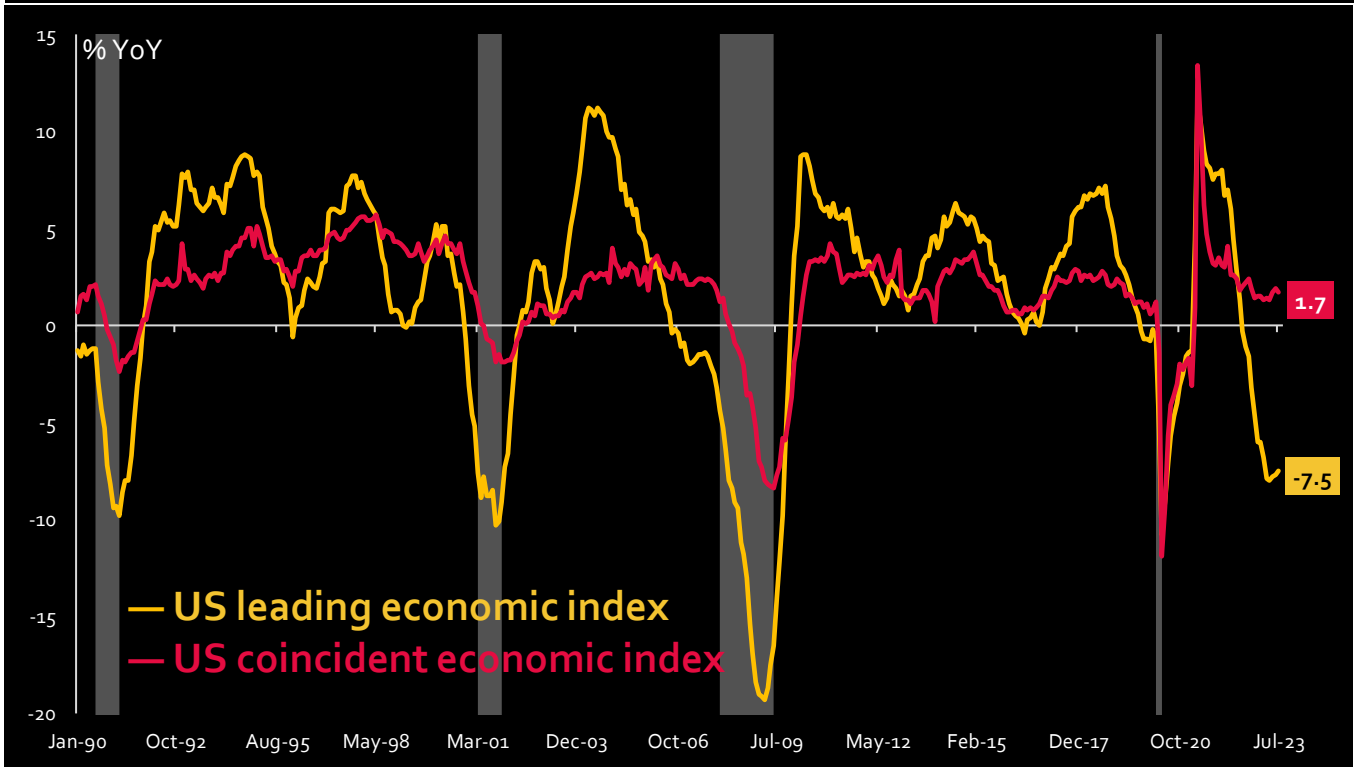
Source: Bloomberg, Federal Reserve

**Panel 8. Despite recent bear steepening, the yield curve has remained highly inverted**



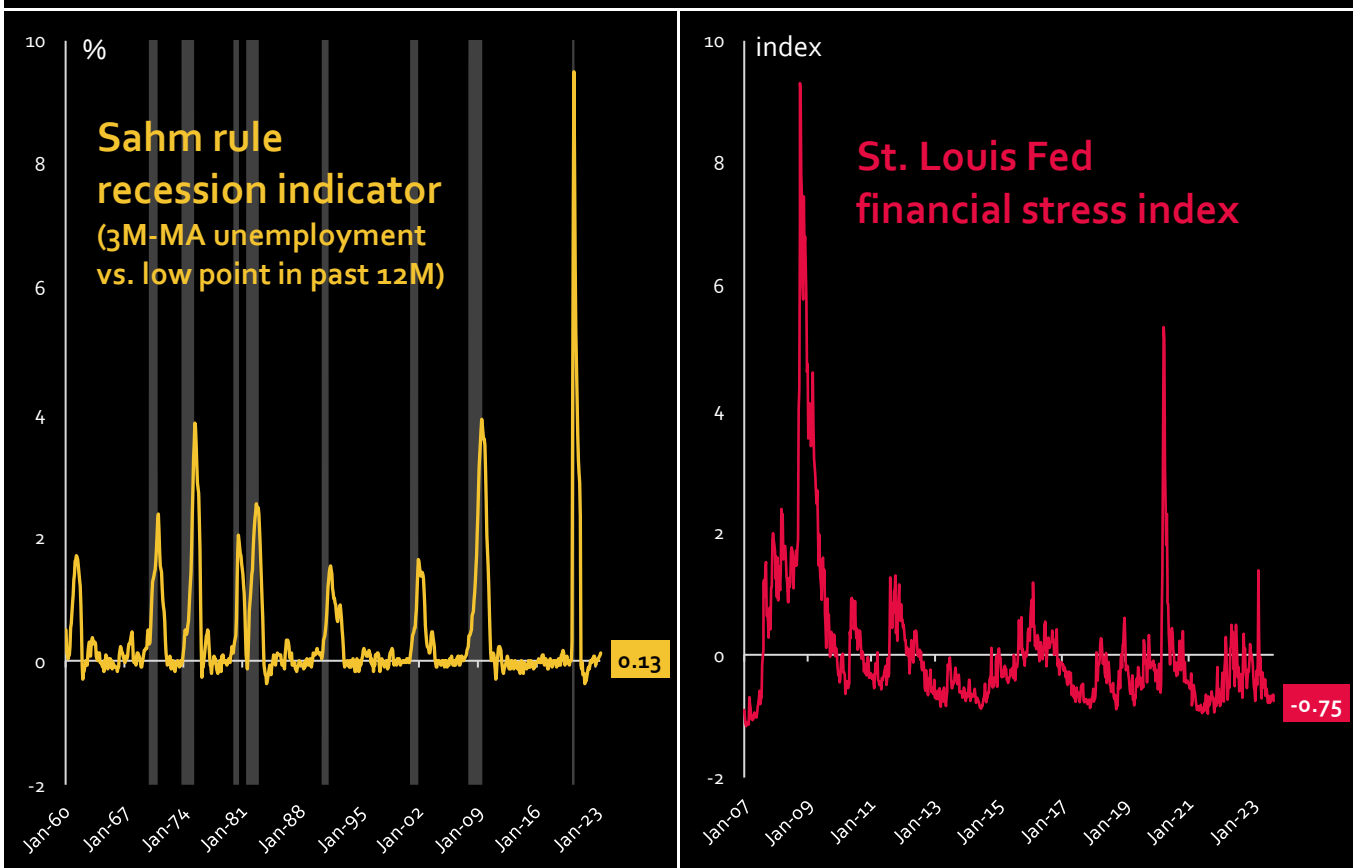
Source: Bloomberg, calculations by BCA Economist

**Panel 9. US leading index bottoms out, implying a “dotcom-sized” not “GFC-sized” recession?**



Source: Conference Board

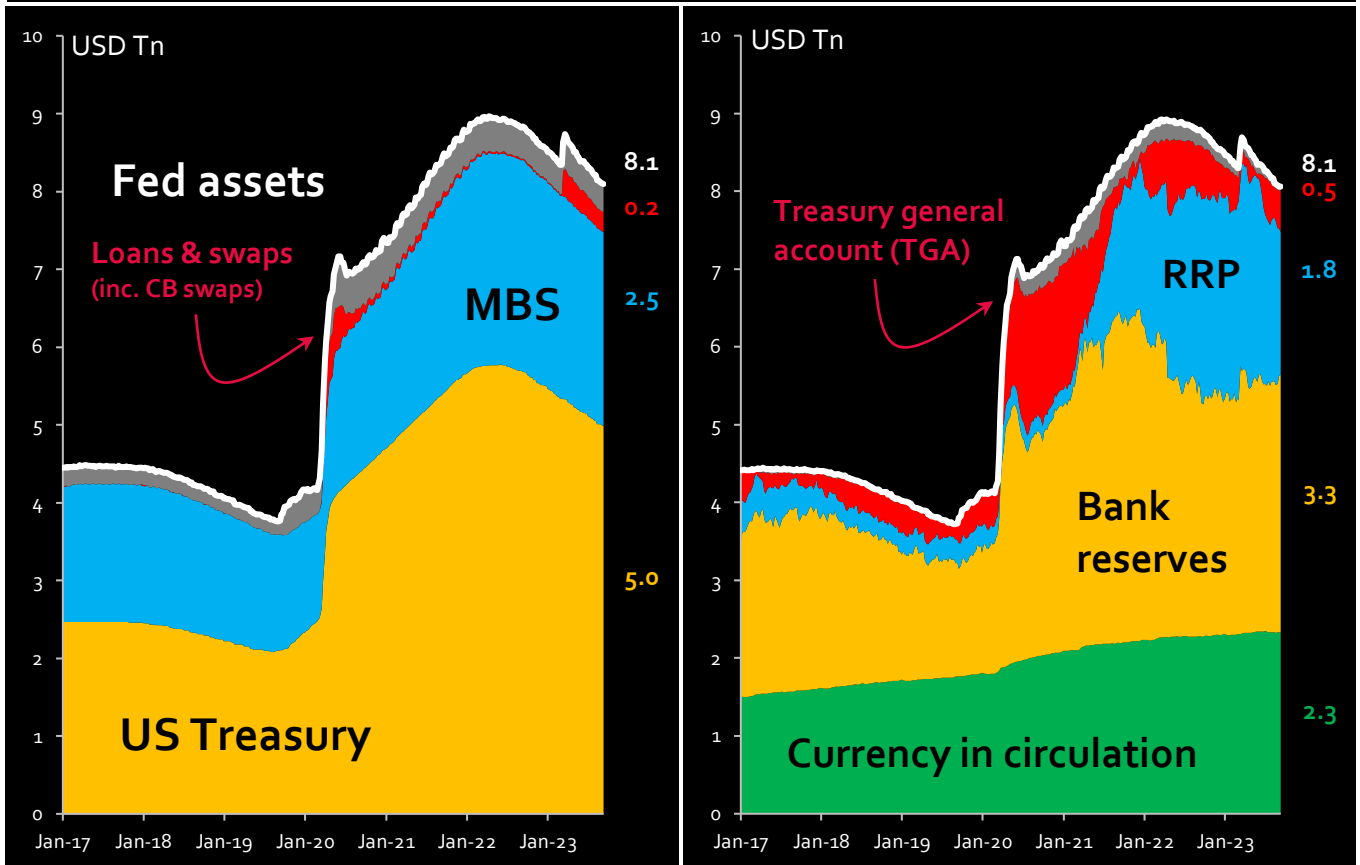
**Panel 10. Both in the real and financial sides, signs of impending US recession remain limited**



Source: St. Louis Fed

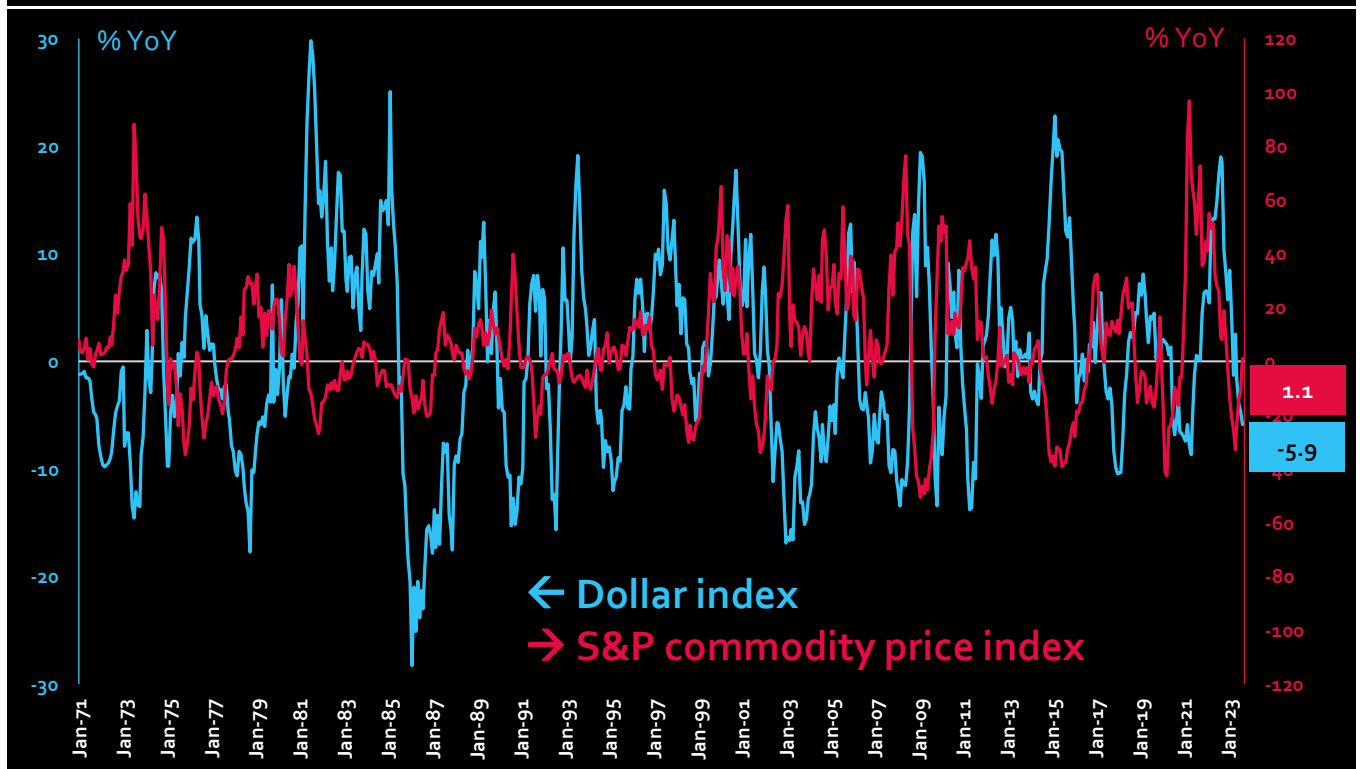


**Panel 11.** Despite QT and large UST issuance, US bank reserves have remained stable



Source: St. Louis Fed

**Chart 1.** Both the Dollar and oil climbing back up, troubling sign for the world economy?



Source: Bloomberg

## Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	20-Sep	-1 mth	Chg (%)
US	5.50	Sep-23	1.80	Baltic Dry Index	1,584.0	1,237.0	28.1
UK	5.25	Sep-23	-1.45	S&P GSCI Index	614.5	582.0	5.6
EU	4.50	Sep-23	-0.70	Oil (Brent, \$/bbl)	93.5	84.8	10.3
Japan	-0.10	Jan-16	-3.40	Coal (\$/MT)	167.9	164.4	2.1
China (lending)	2.50	Sep-23	4.25	Gas (\$/MMBtu)	2.78	2.44	13.9
Korea	3.50	Aug-23	0.10	Gold (\$/oz.)	1,930.3	1,889.3	2.2
India	6.50	Aug-23	-0.33	Copper (\$/MT)	8,281.5	8,213.8	0.8
Indonesia	5.75	Sep-23	2.48	Nickel (\$/MT)	19,326.0	19,907.0	-2.9
Money Mkt Rates	20-Sep	-1 mth	Chg (bps)	CPO (\$/MT)	787.3	834.0	-5.6
SPN (1M)	5.64	5.52	11.4	Rubber (\$/kg)	1.40	1.27	10.2
SUN (10Y)	6.73	6.49	24.1	External Sector	Aug	Jul	Chg (%)
INDONIA (O/N, Rp)	5.56	5.54	2.3	Export (\$ bn)	22.00	20.86	5.47
JIBOR 1M (Rp)	6.40	6.40	0.0	Import (\$ bn)	18.88	19.57	-3.53
Bank Rates (Rp)	Jun	May	Chg (bps)	Trade bal. (\$ bn)	3.12	1.29	141.85
Lending (WC)	8.93	8.93	0.00	Central bank reserves (\$ bn)*	137.1	137.7	-0.42
Deposit 1M	4.19	4.19	0.10	Prompt Indicators	Aug	Jul	Jun
Savings	0.67	0.67	-0.20	Consumer confidence index (CCI)	125.2	123.5	127.1
Currency/USD	20-Sep	-1 mth	Chg (%)	Car sales (%YoY)	-8.3	-6.7	4.7
UK Pound	0.810	0.785	-3.06	Motorcycle sales (%YoY)	1.8	45.6	66.6
Euro	0.938	0.920	-1.95	Manufacturing PMI	Aug	Jul	Chg (bps)
Japanese Yen	148.3	145.4	-1.99	USA	47.6	46.4	120
Chinese RMB	7.286	7.285	-0.02	Eurozone	43.5	42.7	80
Indonesia Rupiah	15,384	15,285	-0.64	Japan	49.6	49.6	0
Capital Mkt	20-Sep	-1 mth	Chg (%)	China	51.0	49.2	180
JCI	7,011.7	6,859.9	2.21	Korea	48.9	49.4	-50
DJIA	34,440.9	34,500.7	-0.17	Indonesia	53.9	53.3	60
FTSE	7,731.7	7,262.4	6.46				
Nikkei 225	33,023.8	31,450.8	5.00				
Hang Seng	17,885.6	17,950.9	-0.36				
Foreign portfolio ownership (Rp Tn)	Aug	Jul	Chg (Rp Tn)				
Stock	2,869.7	2,892.9	-23.21				
Govt. Bond	846.3	855.2	-8.89				
Corp. Bond	11.1	11.3	-0.20				

Source: Bloomberg, BI, BPS

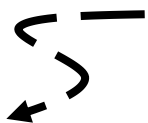
Notes:

^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	5.2
GDP per Capita (US\$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.7
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	54.5	35.3
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.7

\*Estimated number

\*\* Estimation of Rupiah's fundamental exchange rate

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