

FOMC:

Keeping all options open

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Executive Summary

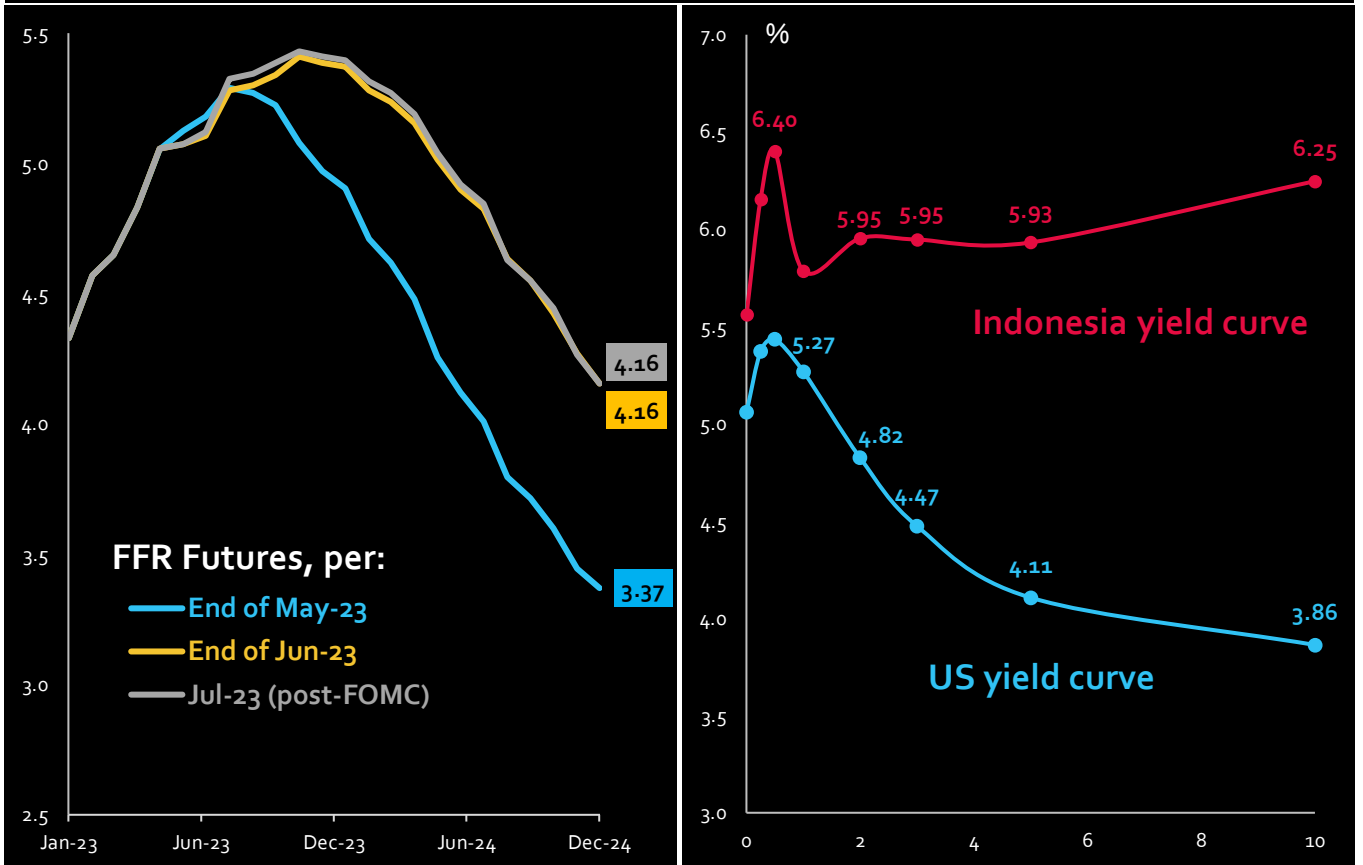
- The Fed delivered a 25 bps hike to the Fed Funds Rate, bringing the target range up to 5.25% - 5.5%. Forward guidance introduces uncertainty; market leans toward a “hawkish hold” with a near 50:50 bet that the Fed would start cutting rates in Mar-24.
- Market optimism fuels a weakening of the Dollar index. Weaker USD correlates with faster economic activities and higher commodity prices, likely the reason why the Fed is sounding more sanguine about the prospect of the US avoiding recession.
- However, there are a number of obstacles that would make it prudent for BI to avoid cutting rates prematurely, including the revival of cost-push inflation and the potential reversal of the current bull market. As such, other strategies to boost growth (fiscal/pre-election spending, macroprudential policies, even RRR cut) would have to take precedence in the near-term.

- The latest FOMC meeting delivered a much anticipated 25 bps hike to the Fed Funds Rate, bringing the target range up to 5.25% - 5.5%. But the Fed’s forward guidance adds a fresh dollop of uncertainty to rate outlook. While it remains highly committed to its 2% inflation target, Chairman Powell said that officials will be increasingly more data-dependent on their decision, starting with the September meeting.
- As such, while the dot plot from last June shows one additional hike this year, the market is increasingly embracing the concept of a prolonged “hawkish hold”, with the futures market now implying only a 20% chance of a hike in September. There is even growing speculation that the Fed will pivot earlier than it indicates, with about 50% implied probability of a cut beginning in Mar-24.
- Small wonder, then, that the market reacted rather positively to Powell’s presser. One sign of optimism is the weaker Dollar index, which finally resumed its downward trend after a small rebound during pre-FOMC jitters. Weaker USD, of course, correlates with both faster economic activities and higher commodity prices, and this is why the Fed is also sounding more sanguine about the prospect of the US avoiding recession.
- But as we remarked in our report on BI policy last Tuesday, there are still many obstacles along the way before we get from point A (now) to the supposed point B (safe pivot after a soft landing) – and this is why BI cannot afford to cut rates prematurely.
- The first obstacle, as we noted yesterday, is the revival of cost-push inflation, be it from oil or food prices. The latter is now increasingly likely given the potential of extreme drought due to El Niño, India’s export rice ban, and Russia’s withdrawal from the Black Sea grain deal. The

Fed could, once again, choose to respond to these supply disruptions by constraining demand, i.e. either more hikes or delaying its pivot.

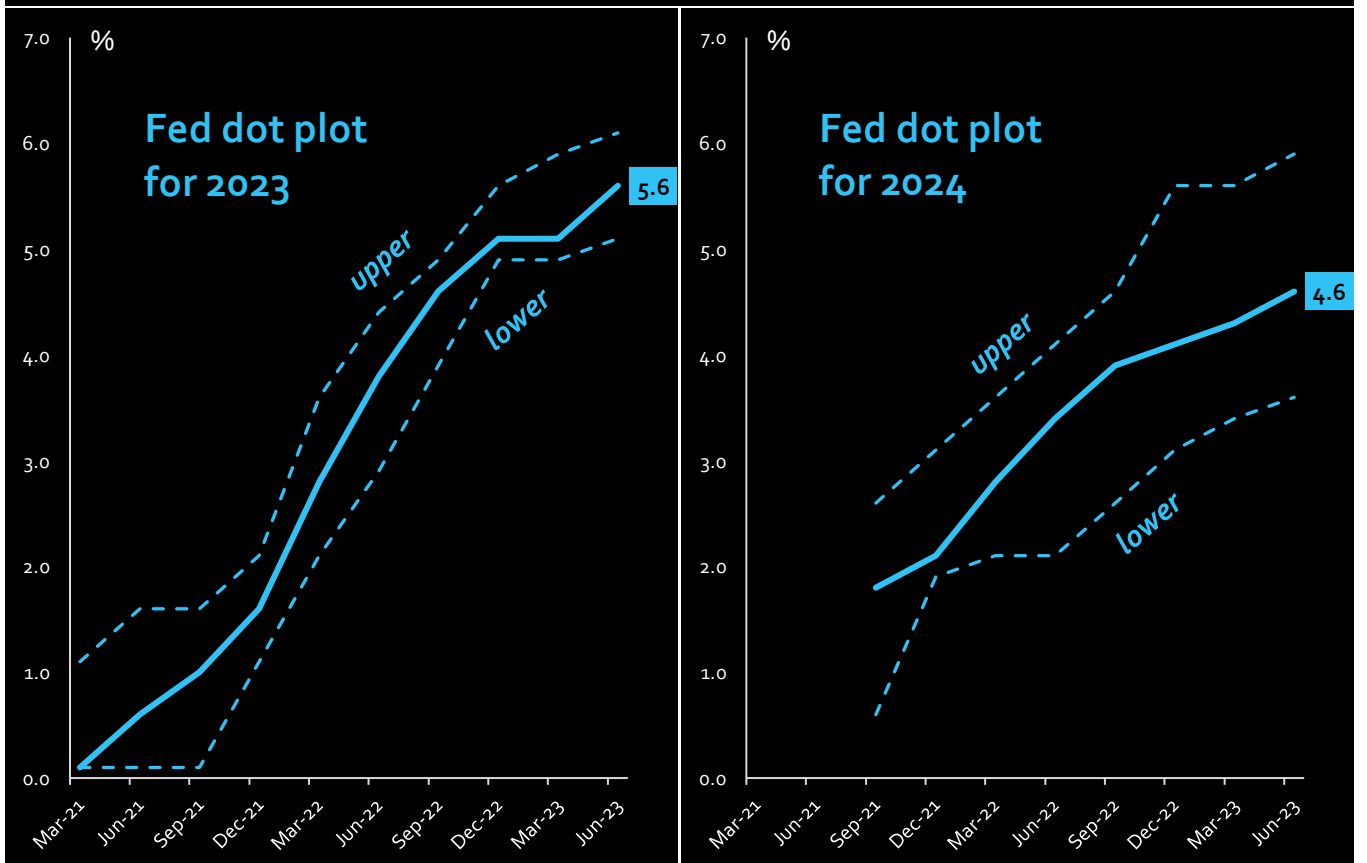
- The second obstacle is a potential reversal of the current bull market, which could reverse the hitherto-healthy foreign inflows into Indonesia. Indeed, recent market strength seems to defy gravity. While usually there is a close and positive correlation between central bank balance sheets and the stock market, for the past two months the S&P 500 has been gaining strength against the backdrop of declining balance sheets of the Fed and ECB.
- For this, we could probably thank the relentless pivot speculations, but there are a few other factors that might be in play. One is the Bank Term Funding Program (BTFP), the Fed's response to the earlier banking crisis. By allowing banks to repo their US Treasury holdings at their full notional value, it effectively adds liquidity to the market and make USTs a near-equal to cash – at least until Mar-24.
- And then there is also the US Treasury Department's tactics to refill its coffers, post-debt ceiling. The choice to offer shorter-duration T-bills at higher rates prevents a drain from bank reserves and instead pulls money from the Fed's overnight reverse repo facility (O/N RRP).
- All these drivers – inflation, BTFP, shorter-duration USTs – could change between now and the expected pivot date, meaning that a weaker USD (and a stronger/stable Rupiah) is not the assured one-way ticket that it seems. Add to that the fact that the market seems to "punish" currencies with positive real yield differentials to the US due to their expected more dovish policy going forward. To keep the IDR steady, then, BI will likely refrain from cutting rates prematurely, and other strategies to boost growth (fiscal/pre-election spending, macroprudential policies, even RRR cut) would have to take precedence in the near-term.

Panel 1. Market leans toward a “hawkish hold” with the first rate cut expected to happen around Q2-24



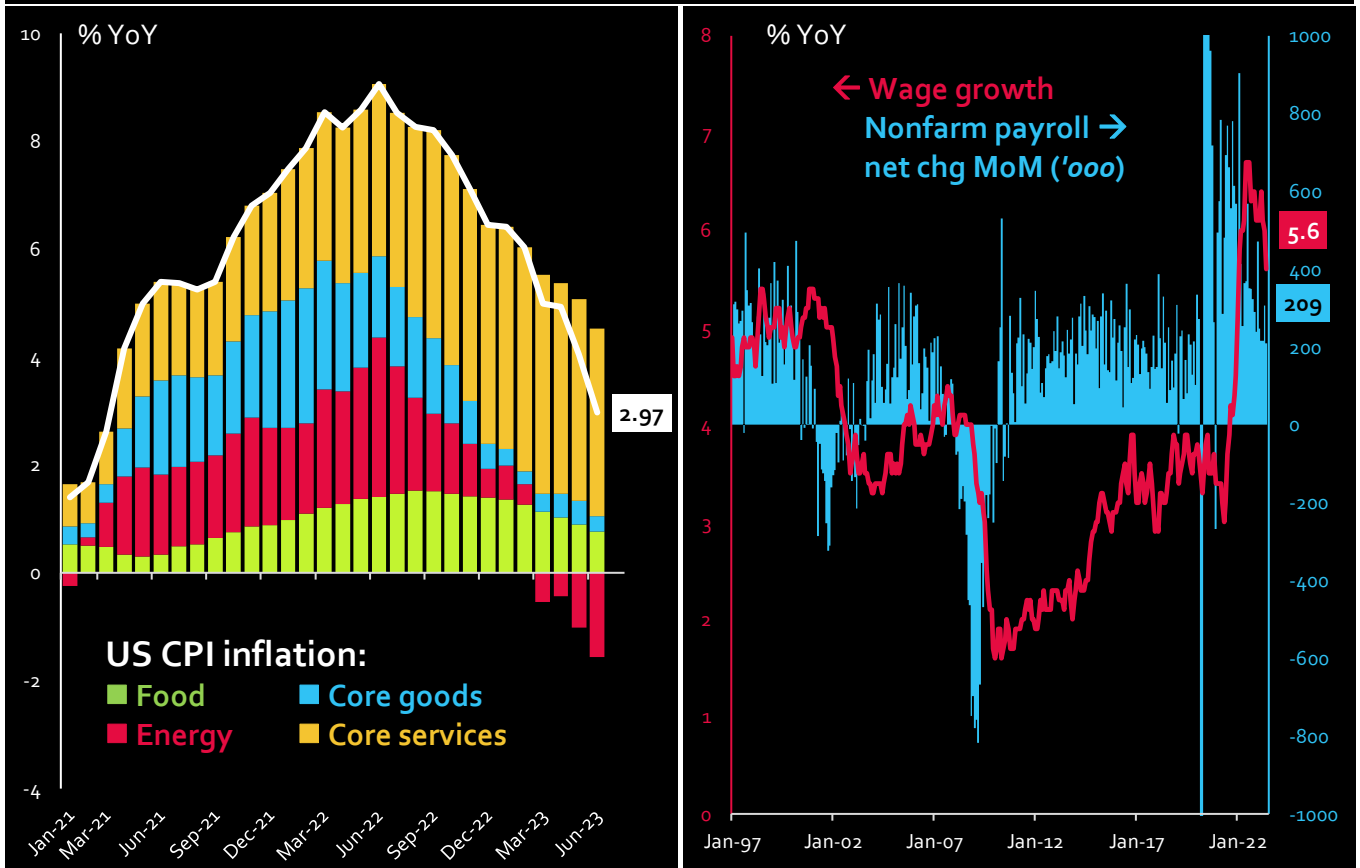
Source: Bloomberg, BI

Panel 2. Fed pencils in another 25 bps hike for 2023, but baseline expectations of a pivot next year remains intact



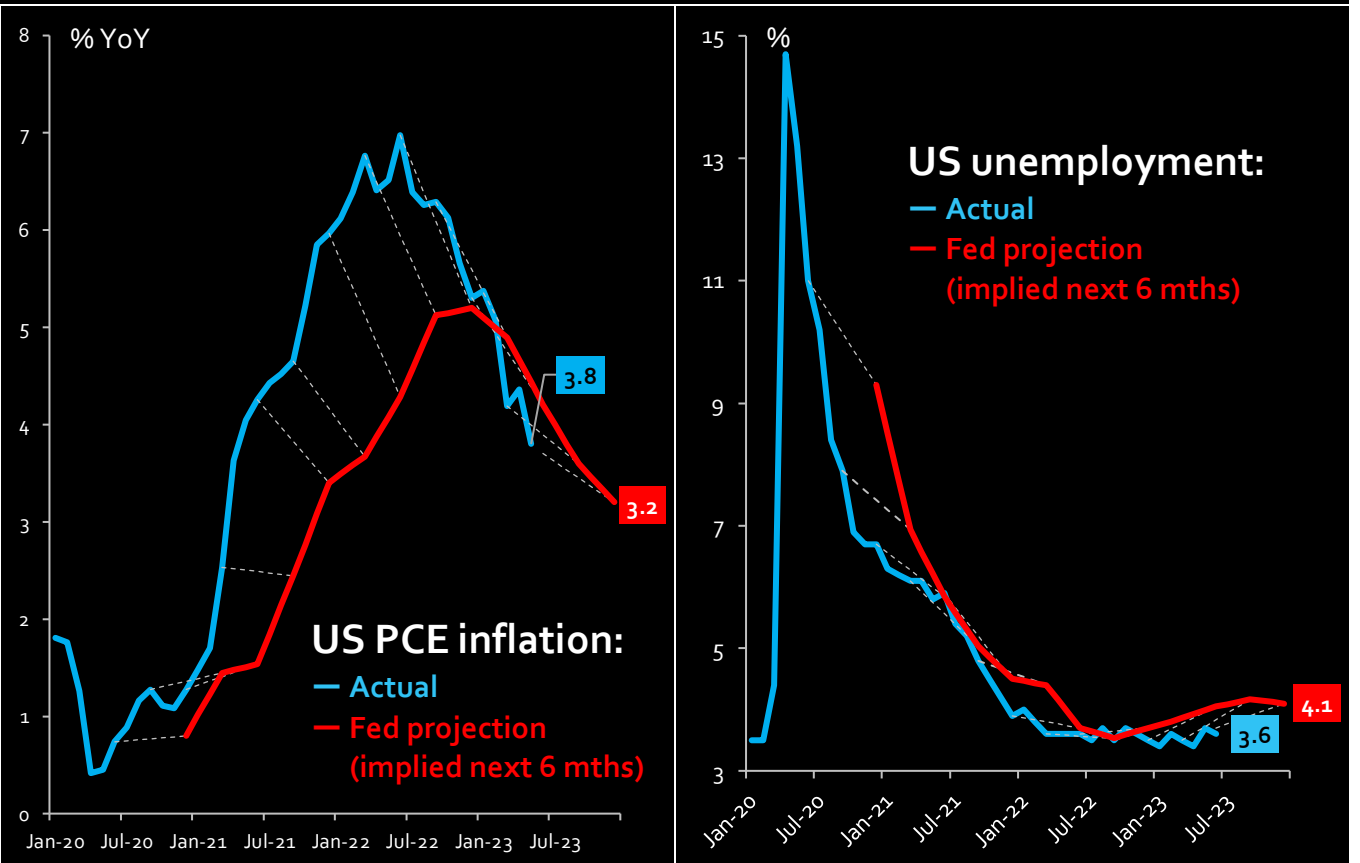
Source: Federal Reserve

Panel 3. US inflation has declined rapidly, but supply problems could reignite cost-push inflation in the coming months



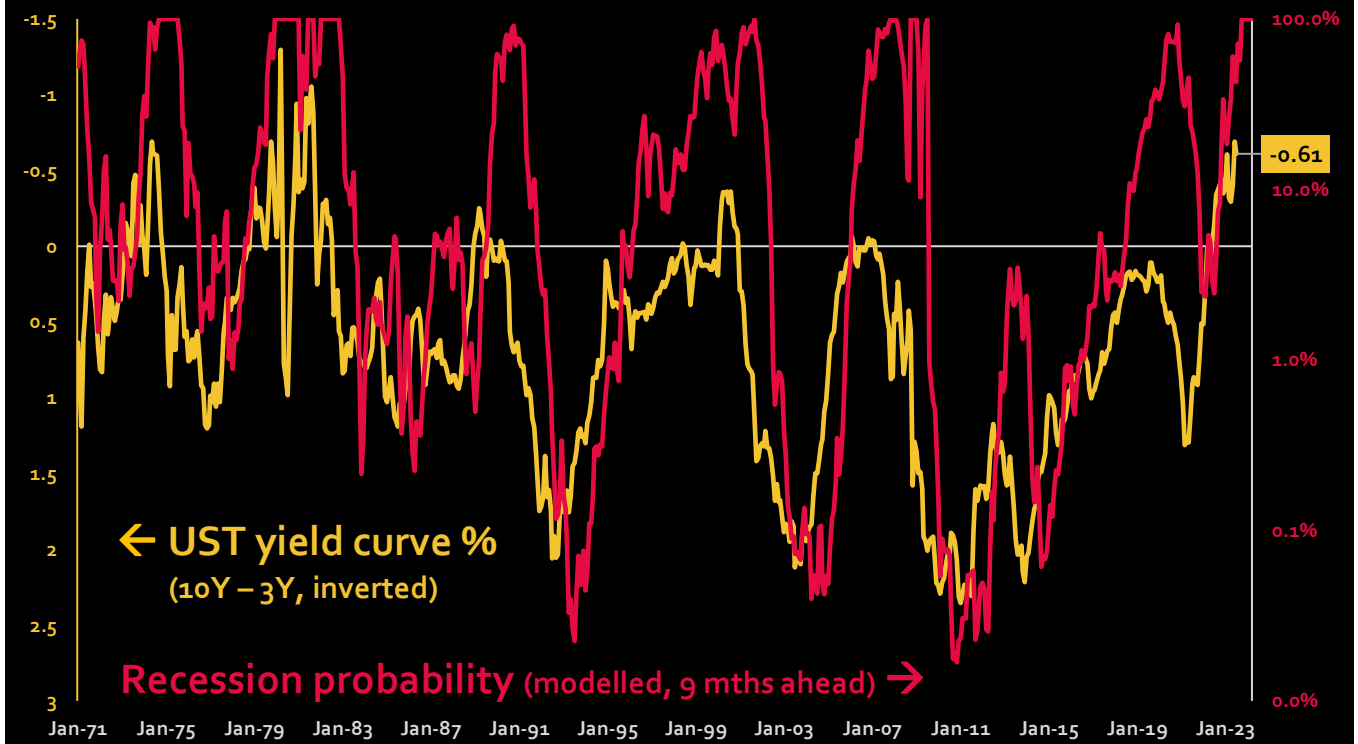
Source: US BLS, Bloomberg

Panel 4. Both PCE inflation and US unemployment rate appear to be even lower than the Fed's projections



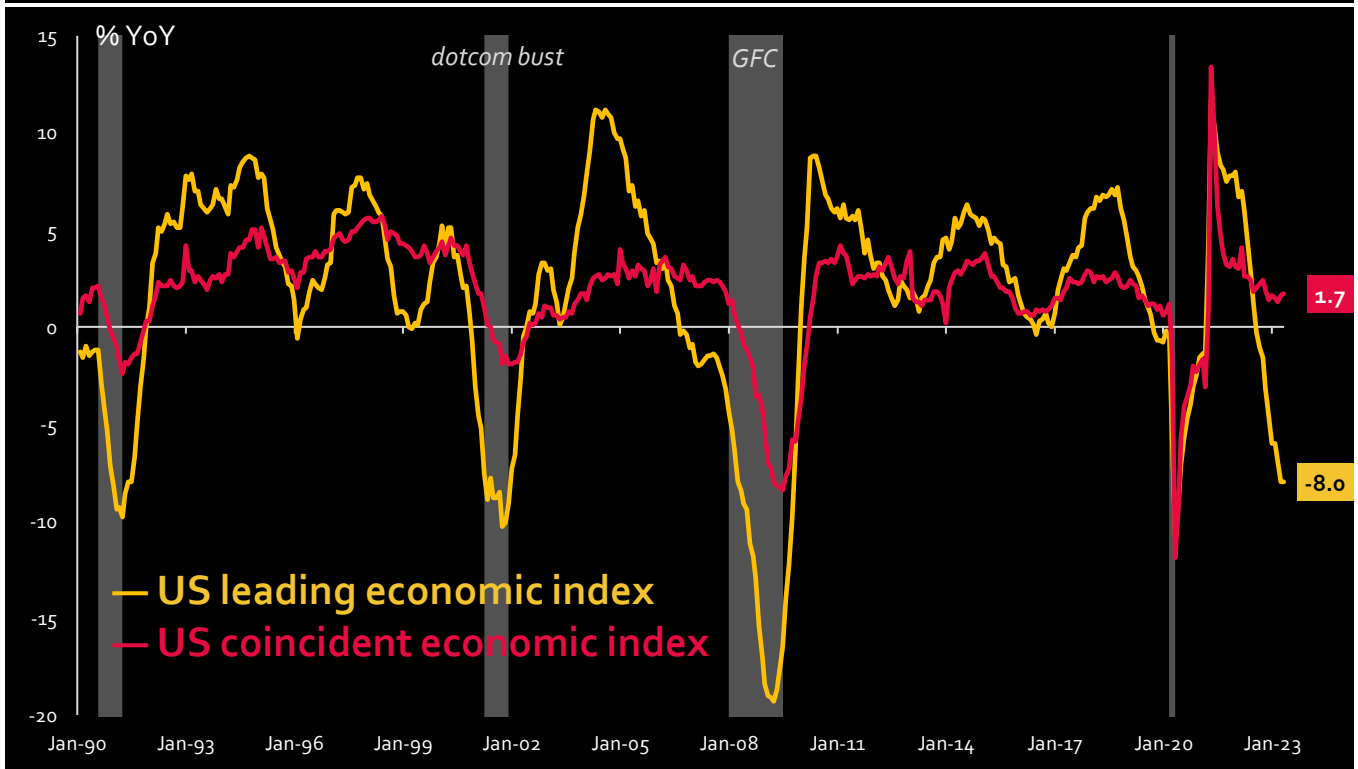
Source: Bloomberg, Federal Reserve

Chart 1. The traditional yield curve indicator projects US recession with near-certainty by Q4-23 ...



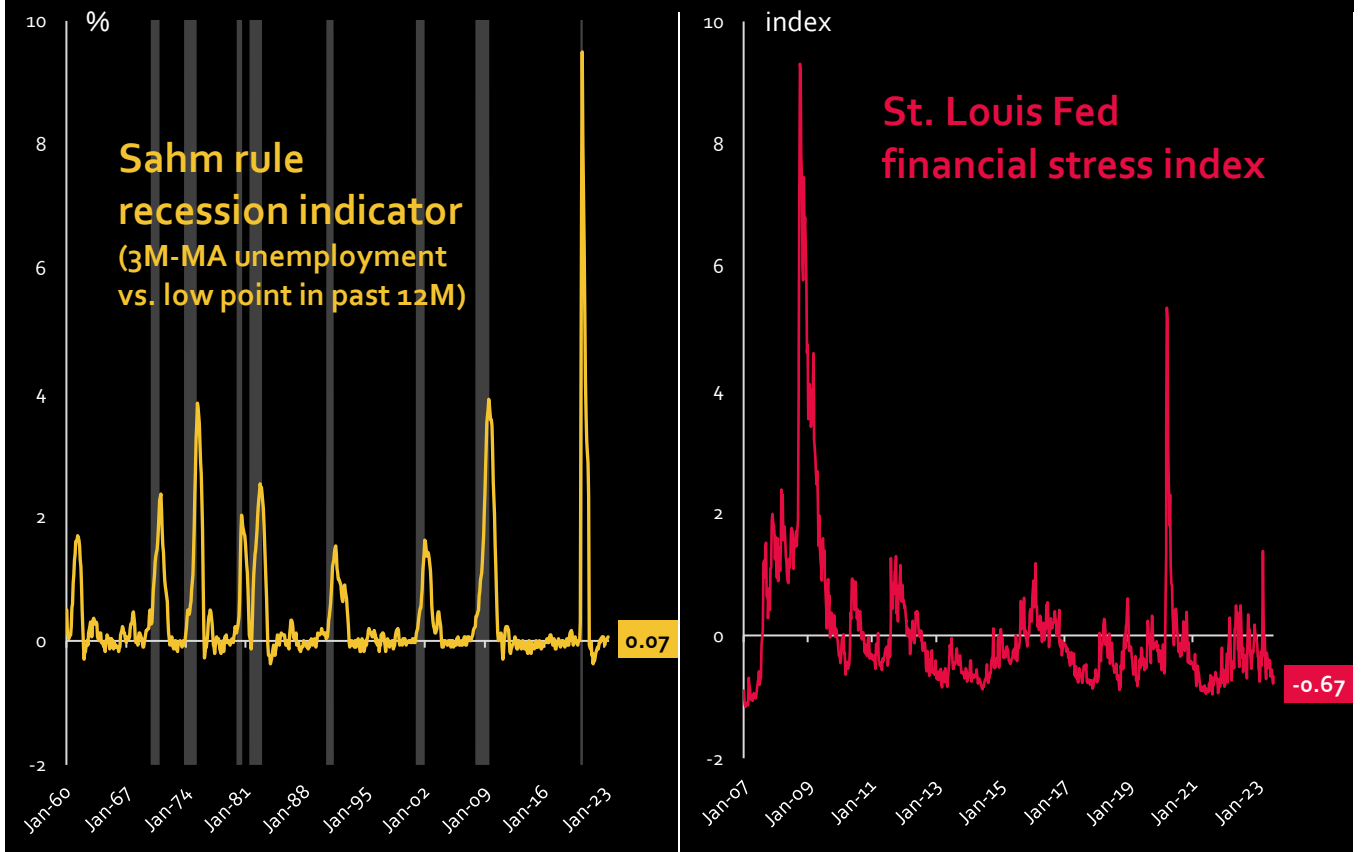
Source: Bloomberg, calculations by BCA Economist

Chart 2. ... while a composite of leading economic indicators suggests a "dotcom bust"-sized recession to arrive by year-end ...



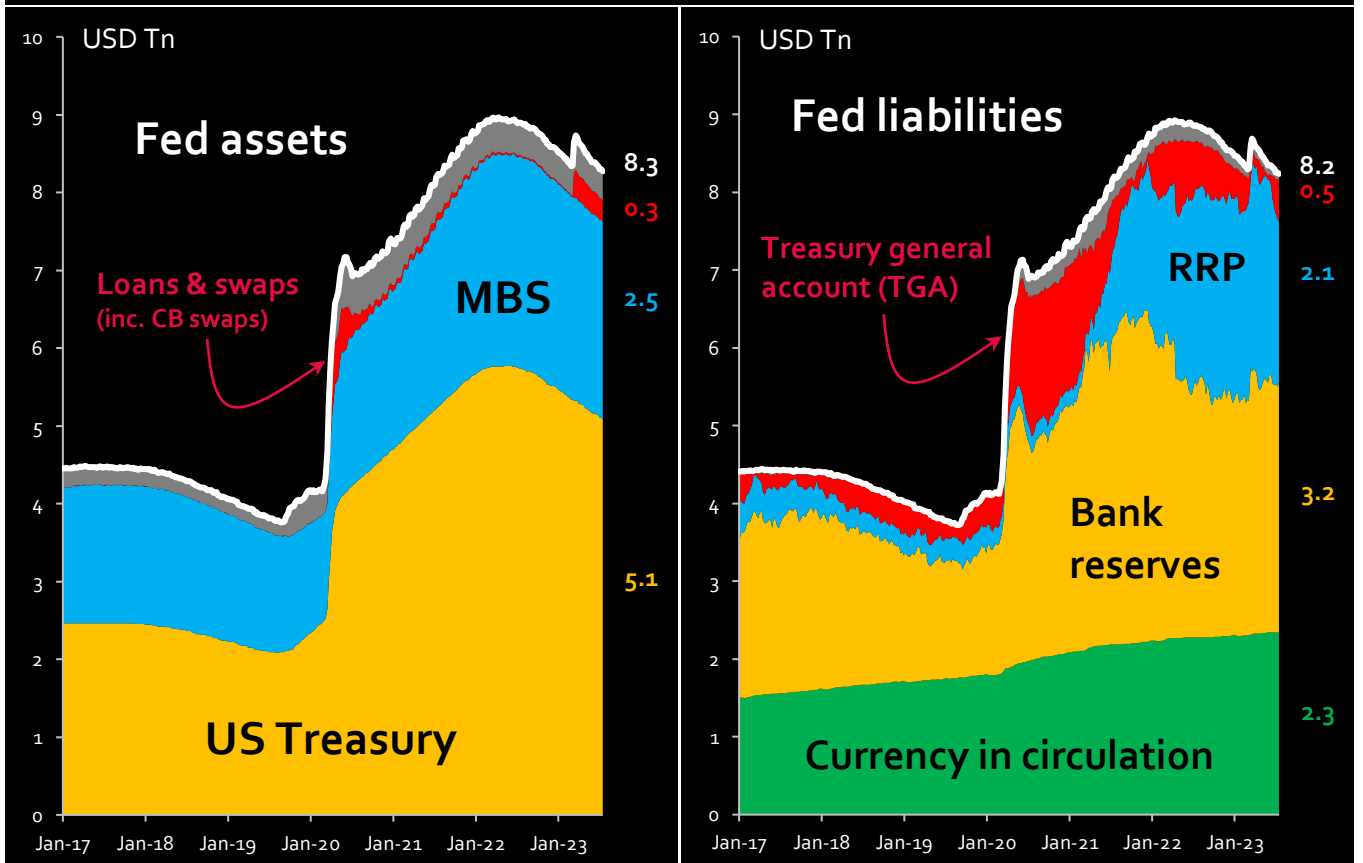
Source: Conference Board

Panel 5. ... but financial stress has actually moderated following recent banking crises



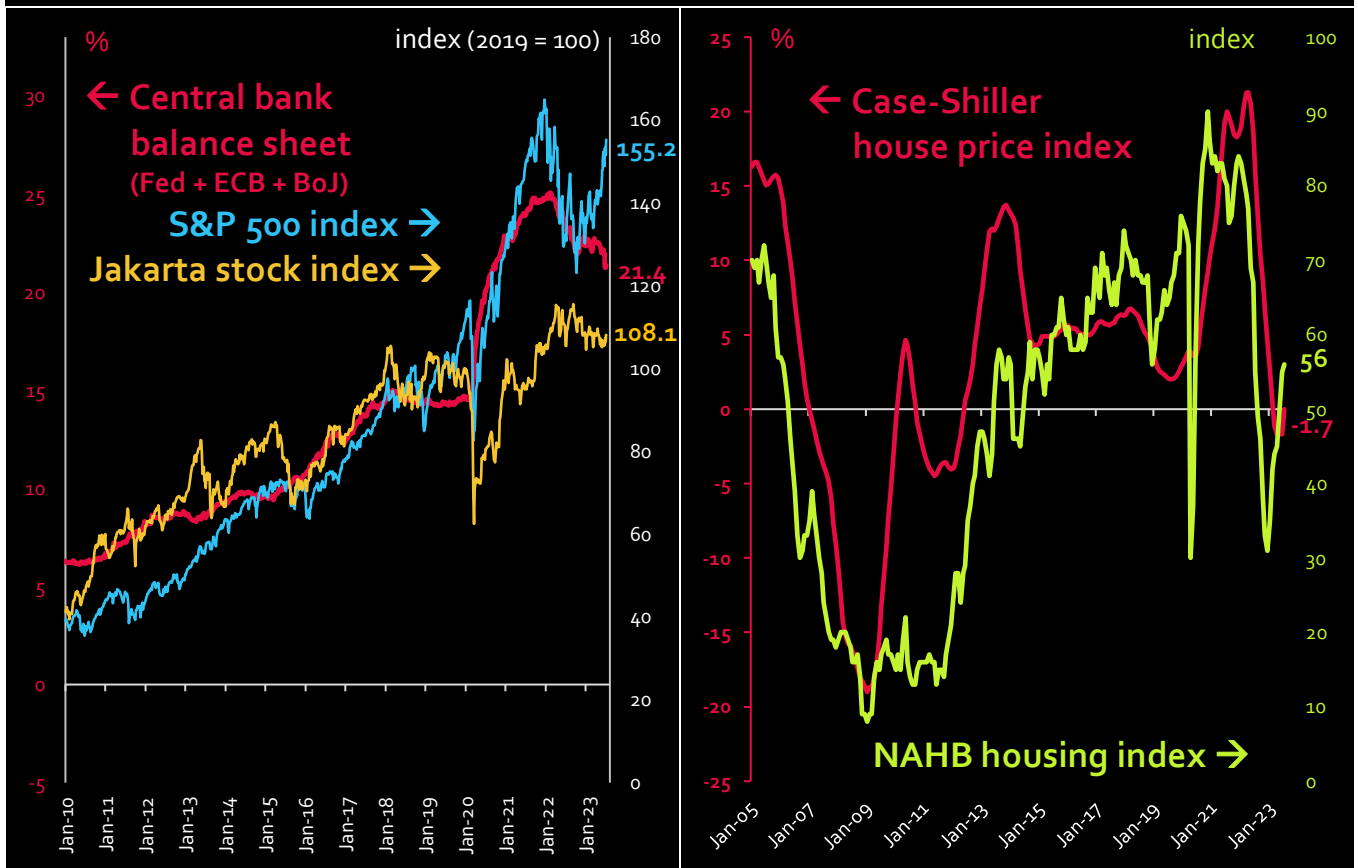
Source: St. Louis Fed

Panel 6. Issuance of shorter duration T-bills prevents a drain from bank reserves and instead pulls money from the Fed's overnight reverse repo facility



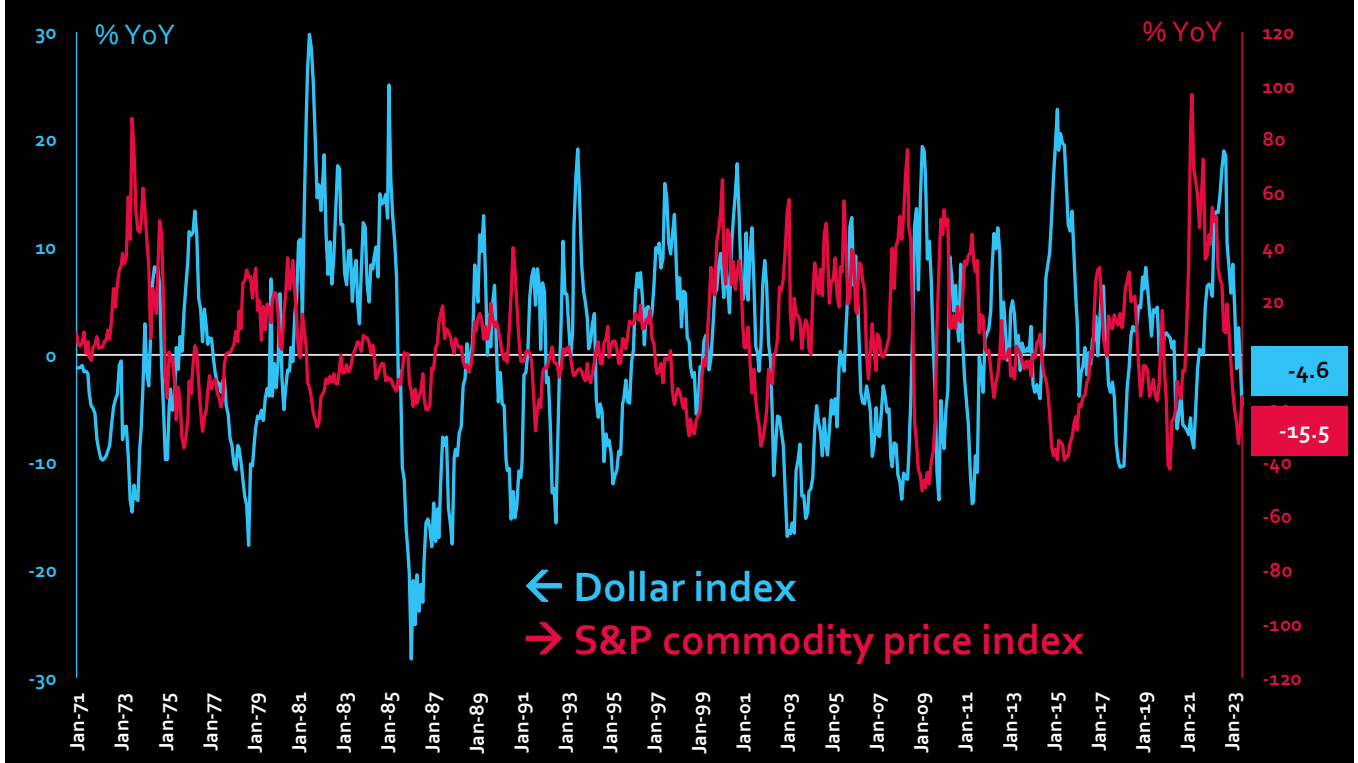
Source: St. Louis Fed

Panel 7. US equities and housing continue to strengthen despite falling CB balance sheets – a deviation from historical trends



Source: Bloomberg, calculations by BCA Economist

Chart 3. The recent weakening of the dollar index is associated with a slight rally in commodity prices



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	26-Jul	-1 mth	Chg (%)
US	5.50	Jul-23	2.50	Baltic Dry Index	1,067.0	1,240.0	-14.0
UK	5.00	Jul-23	-2.90	S&P GSCI Index	585.2	541.6	8.1
EU	4.00	Jul-23	-1.50	Oil (Brent, \$/bbl)	82.9	73.9	12.3
Japan	-0.10	Jan-16	-3.40	Coal (\$/MT)	160.2	147.0	9.0
China (lending)	4.35	Jul-23	4.35	Gas (\$/MMBtu)	2.66	2.22	19.8
Korea	3.50	Jul-23	0.80	Gold (\$/oz.)	1,972.1	1,921.2	2.6
India	6.50	Jun-23	1.69	Copper (\$/MT)	8,577.3	8,409.2	2.0
Indonesia	5.75	Jul-23	2.23	Nickel (\$/MT)	21,340.0	21,117.0	1.1
Money Mkt Rates	26-Jul	-1 mth	Chg (bps)	CPO (\$/MT)	887.4	779.7	13.8
SPN (1M)	4.74	4.46	28.3	Rubber (\$/kg)	1.29	1.31	-1.5
SUN (10Y)	6.24	6.28	-3.5	External Sector	Jun	May	Chg (%)
INDONIA (O/N, Rp)	5.56	5.61	-4.4	Export (\$ bn)	20.61	21.71	-5.08
JIBOR 1M (Rp)	6.40	6.39	1.3	Import (\$ bn)	17.15	21.28	-19.40
Bank Rates (Rp)	Apr	Mar	Chg (bps)	Trade bal. (\$ bn)	3.45	0.43	708.66
Lending (WC)	8.92	8.95	-2.71	Central bank reserves (\$ bn)*	137.5	139.3	-1.28
Deposit 1M	4.18	4.20	-2.70	Prompt Indicators	Jun	May	Apr
Savings	0.67	0.69	-1.70	Consumer confidence index (CCI)	127.1	128.3	126.1
Currency/USD	26-Jul	-1 mth	Chg (%)	Car sales (%YoY)	4.7	65.2	-28.8
UK Pound	0.773	0.787	1.79	Motorcycle sales (%YoY)	66.6	113.4	-19.4
Euro	0.902	0.918	1.76	Manufacturing PMI	Jun	May	Chg (bps)
Japanese Yen	140.2	143.7	2.47	USA	46.0	46.9	-90
Chinese RMB	7.143	7.179	0.51	Eurozone	43.4	44.8	-140
Indonesia Rupiah	15,018	14,994	-0.16	Japan	49.8	50.6	-80
Capital Mkt	26-Jul	-1 mth	Chg (%)	China	50.5	50.9	-40
JCI	6,948.3	6,639.7	4.65	Korea	47.8	48.4	-60
DJIA	35,520.1	33,727.4	5.32	Indonesia	52.5	50.3	220
FTSE	7,676.9	7,461.9	2.88				
Nikkei 225	32,668.3	32,781.5	-0.35				
Hang Seng	19,365.1	18,890.0	2.52				
Foreign portfolio ownership (Rp Tn)	Jun	May	Chg (Rp Tn)				
Stock	2,755.0	2,738.1	16.95				
Govt. Bond	846.9	829.4	17.53				
Corp. Bond	11.3	11.8	-0.47				

Source: Bloomberg, BI, BPS

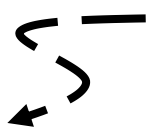
Notes:

^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	5.0
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	2.3
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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