

FOMC:

## No time for premature celebrations

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02 Nov 2023

### Executive Summary

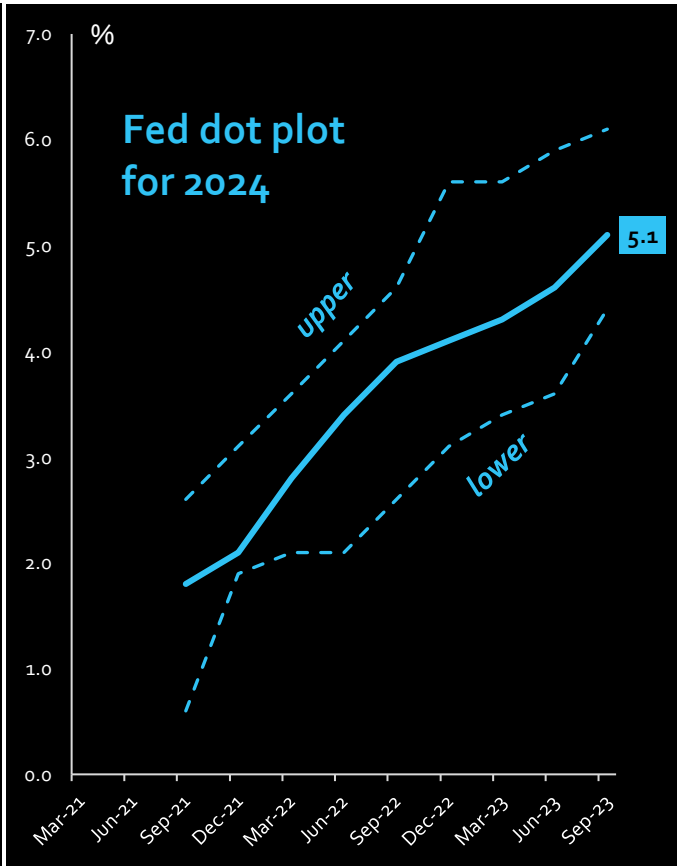
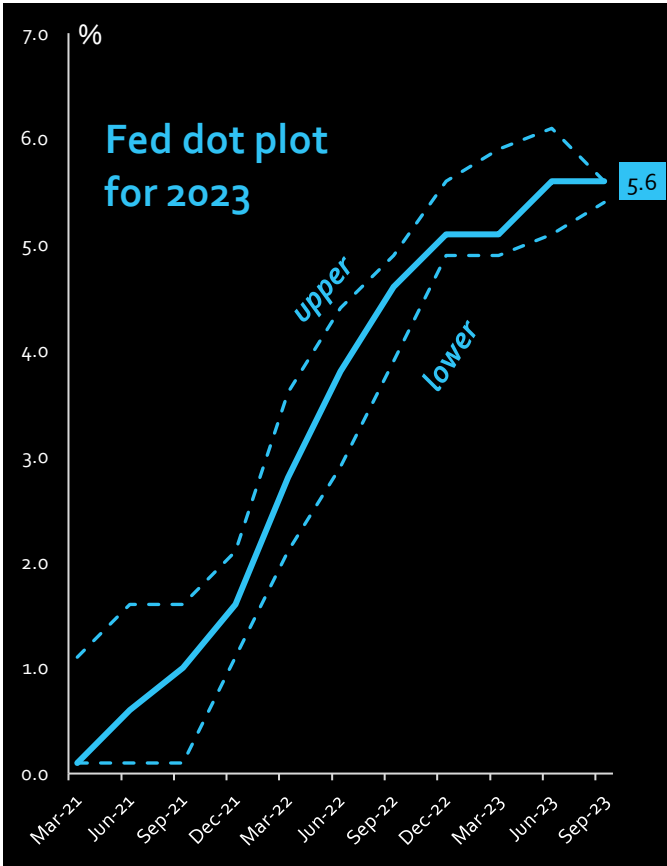
- The Fed maintained its benchmark rate at 5.25-5.50% in its recent FOMC meeting, leading to market speculation that the rate hike cycle may have ended.
- US continues to grapple with inflation, making it challenging for the Fed to pivot soon, which leans toward a “high (but probably not higher) for longer” situation.
- The rise in the US yield curve has triggered capital flight from Indonesia, affecting the Rupiah. Pressure on the Rupiah intensified in October, possibly due to the government bond issuance in Q4.
- Authorities in Indonesia have three options to stabilize the Rupiah: use government savings in place of bond issuance, cut government spending, or balance bond issuance with private sector savings induced by BI rate hikes. The last option may be preferred amid El Nino and the upcoming Elections.

- In its most recent FOMC meeting (November 1st), the Fed opted for another pause as expected, holding the benchmark Fed Funds Rate (FFR) steady at the range of 5.25% to 5.50%. This was accompanied by statements that sounded bullish on US economic growth and inflation, but cautious at the consequences of tightening financial and credit conditions in the future.
- The ambiguous messaging seems to be taken by the market as a sign that the Fed may have concluded its rate hike cycle – and even, perhaps, that the vaunted pivot is back on the table. Less than 20% of investors now expect a rate hike in December, as Bloomberg calculates. This interpretation is bolstered by slower growth in Q4-23, after an unexpectedly strong pace of 4.9% in Q3. The Atlanta Fed’s GDPNow “nowcast” has recently declined from 2.3% to 1.2%, which is attributed to underwhelming data from manufacturing and construction spending.
- But this may prove to be a premature celebration, and the battle against inflation in the US is still very much ongoing. Jay Powell’s favorite inflation benchmark – service inflation excluding housing – is still hovering around 0.4% MoM, both in the PCE and CPI versions. This translates to an annual pace of more than 4% inflation, which is probably not where the Fed prefers it to be when it starts pivoting.
- The situation, then, still leans towards a “high (but probably not higher) for longer” scenario, which is hardly a relief for peripheral countries like Indonesia, as it is the rising long-end of the US yield curve that has led to capital flight in recent months. This is plainly evident from

the decline in YTD capital inflows, from USD 7.14 Bn in August to USD 2.86 Bn barely two months later. Naturally, this has taken a toll on the Rupiah, although it did experience a slight rebound after the Fed's meeting.

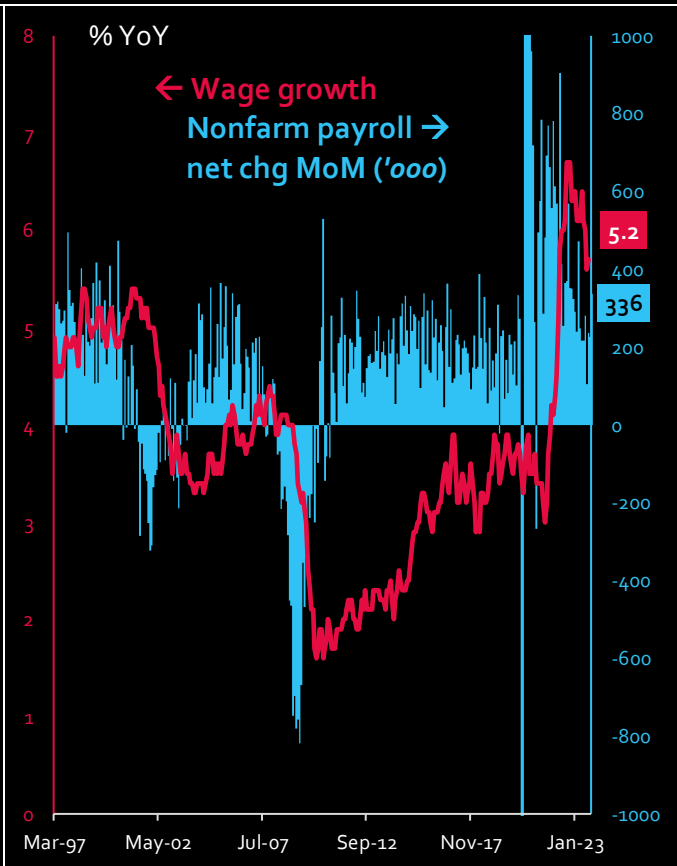
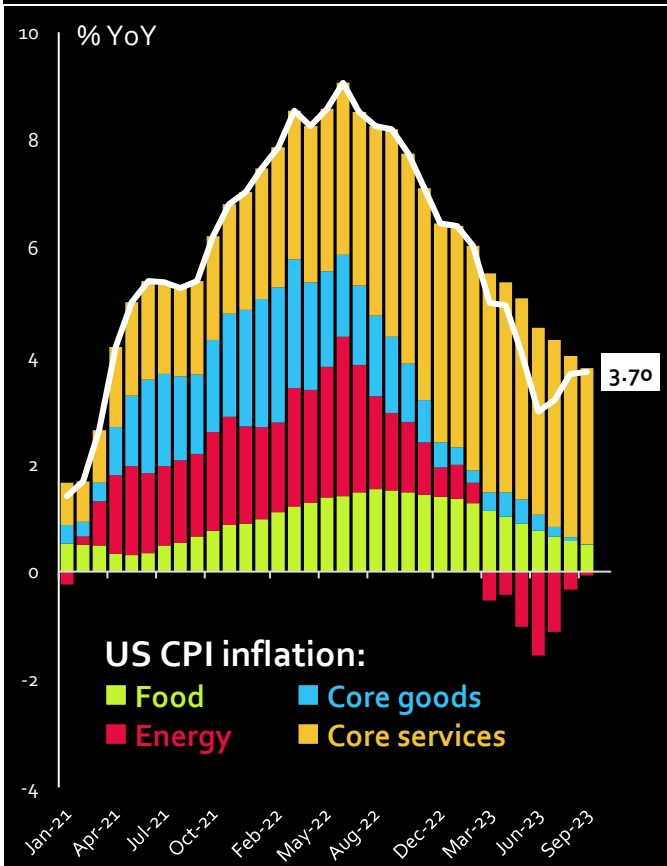
- One thing we should notice about the Rupiah, however, is the almost idiosyncratic nature of the recent pressure. IDR held up better against the USD compared to many other Asian currencies early on amid the "bear steepening", but it really faltered in October when the Dollar's rise was actually slowing down. The bid-ask spreads in the FX forward market confirms that pressures on the Rupiah really heightened only in October – which begs the question: why?
- The usual answer to this was to point out BI's FX intervention, which might have masked the currency volatility in September. But the close correlation between pressures on FX and on Indonesian sovereign bonds (SBN), and the exact point when the pressures picked up steam (at the very start of Q4, and before Israel-Palestine hostilities) may point to another culprit, namely government bond issuance.
- As it turns out, the Indonesian MoF planned to issue IDR 168 Tn worth of bonds in Q4-23, which is substantially larger than what is typically issued this late in the year. This unexpected excess supply, coming into a choppy global market, is probably a decisive factor behind the Rupiah's underperformance and BI's decision to hike the 7-day Repo Rate in October.
- If we are correct in our assessment, then there are essentially three options for the authorities to stabilize the Rupiah. First, the MoF can reduce its SBN issuance and instead mobilize its substantial savings in BI (IDR 658 Tn, Sep-23) and commercial banks (IDR 314 Tn, Aug-23). The problem with this is that the government cannot solely rely on its savings, as it will need to refinance a significant amount of maturing bonds (IDR 194.2 Tn plus USD 2.2 Bn) in Q1-24 – draining the savings would simply lead to much bigger issuance in the next quarter.
- The second option is obviously to cut spending, which could reduce the need for SBN issuance quite substantially given the amount of spending still to be done in Q4 (around IDR 1093 Tn). Of course, this move could come at the expense of growth and especially bank liquidity, which often depends on the seasonal burst of government spending in Q4.
- The final course of action is to continue issuing bonds (government spending), but counteract it with a strong dose of private sector saving induced by BI rate hikes. This might well be the preferred course of action amid El Nino and in the run up to the Elections, given the distributional implications. Savings take away spending power mainly from the upper classes, while government expenditures (cash transfers or rice price interventions) shifts that purchasing power to the lower classes.
- The caveat, however, is that private sector savings often lag the rate hikes, which could result in a brief period where the Rupiah remains under pressure (government spending not countered by private saving). BI, then, may choose to hike out of an abundance of caution – and for this reason, we expect them to raise the 7dRR by at least another 25 bps before year-end. Finally, given the still-robust government spending and the lagged effect to private savings, we are actually rather sanguine about growth prospects in the coming quarters, global headwinds aside.

**Panel 1. Despite FFR hold, the Fed's forward guidance continues to inch higher**



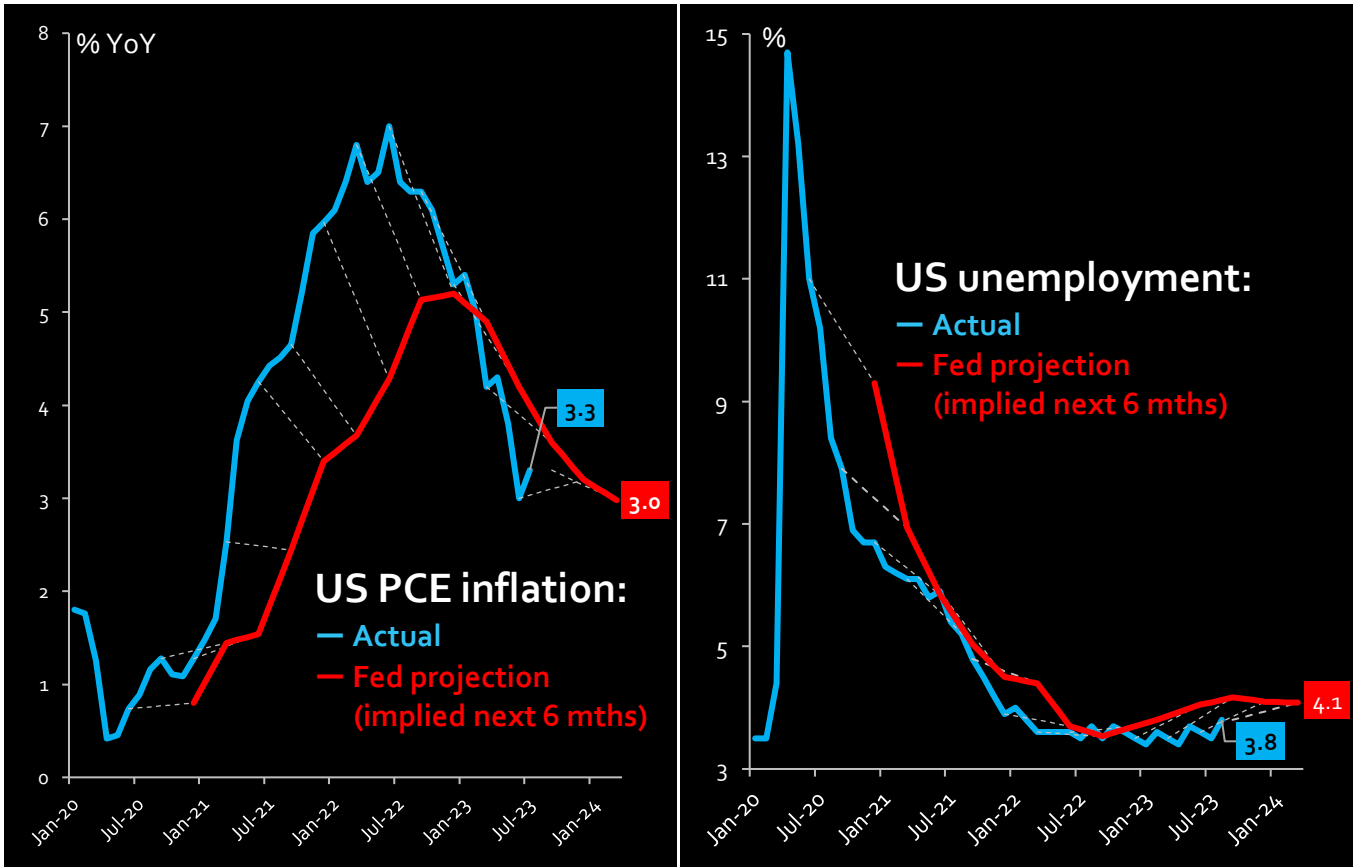
Source: Federal Reserve

**Panel 2. Rising oil price presents a tough dilemma for the Fed, reducing the chance of pivot?**



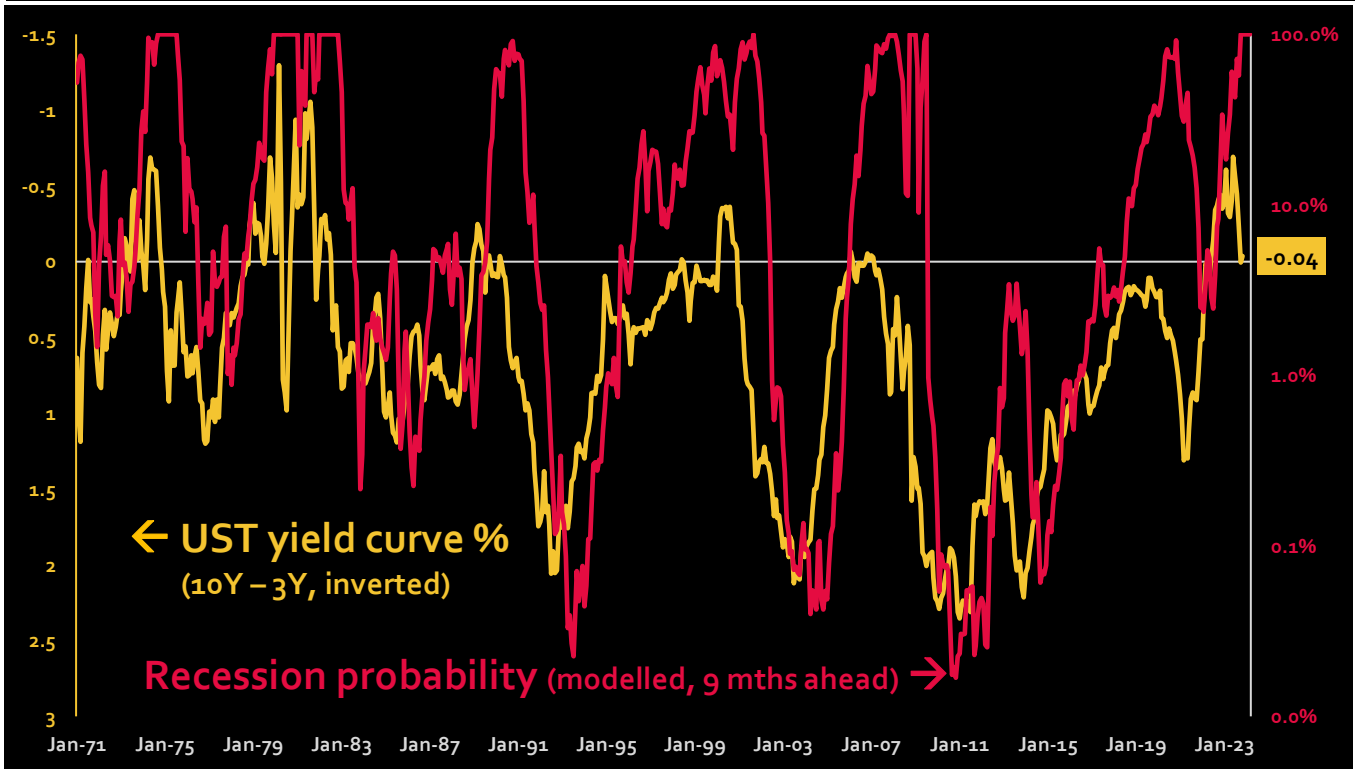
Source: US BLS, Bloomberg

**Panel 3. The Fed's forecast has remained rather more cautious than the actual data**



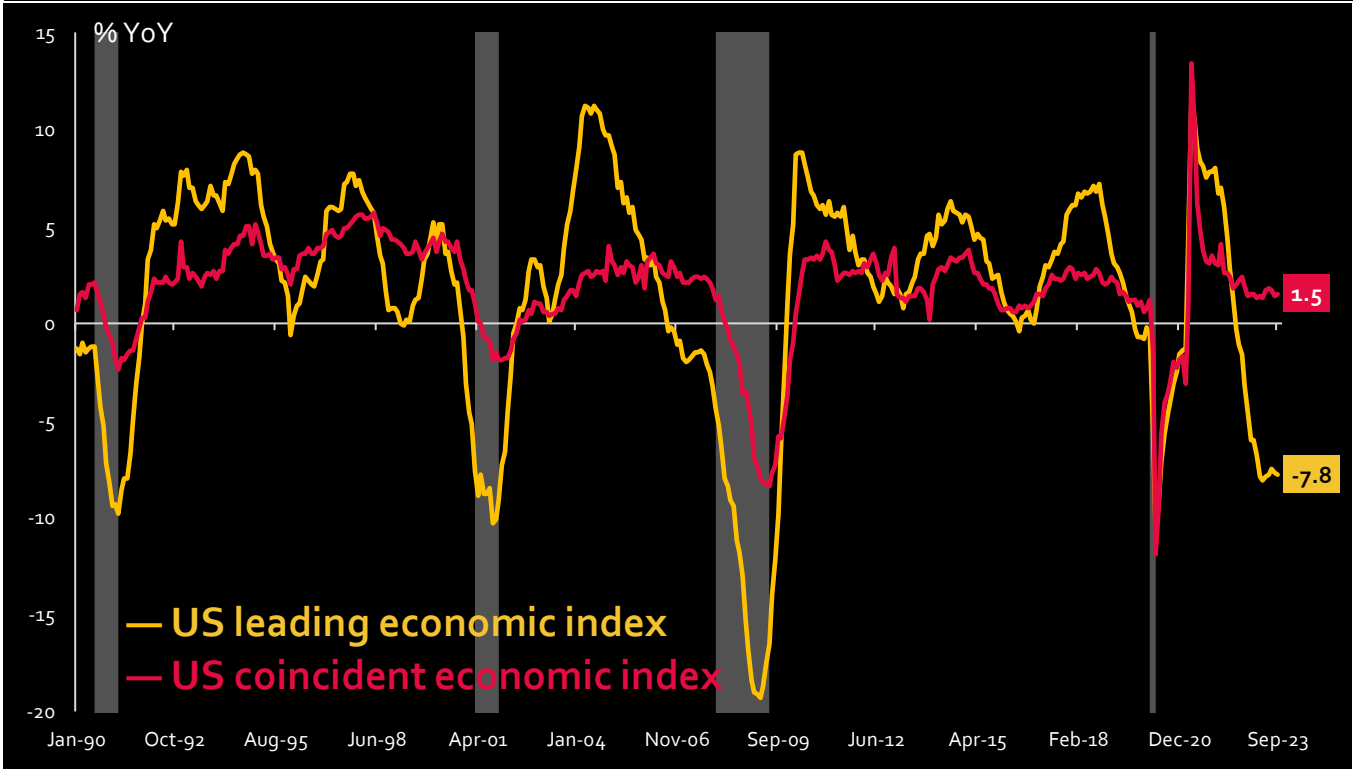
Source: Bloomberg, Federal Reserve

**Panel 4. Despite recent bear steepening, the yield curve has remained highly inverted**



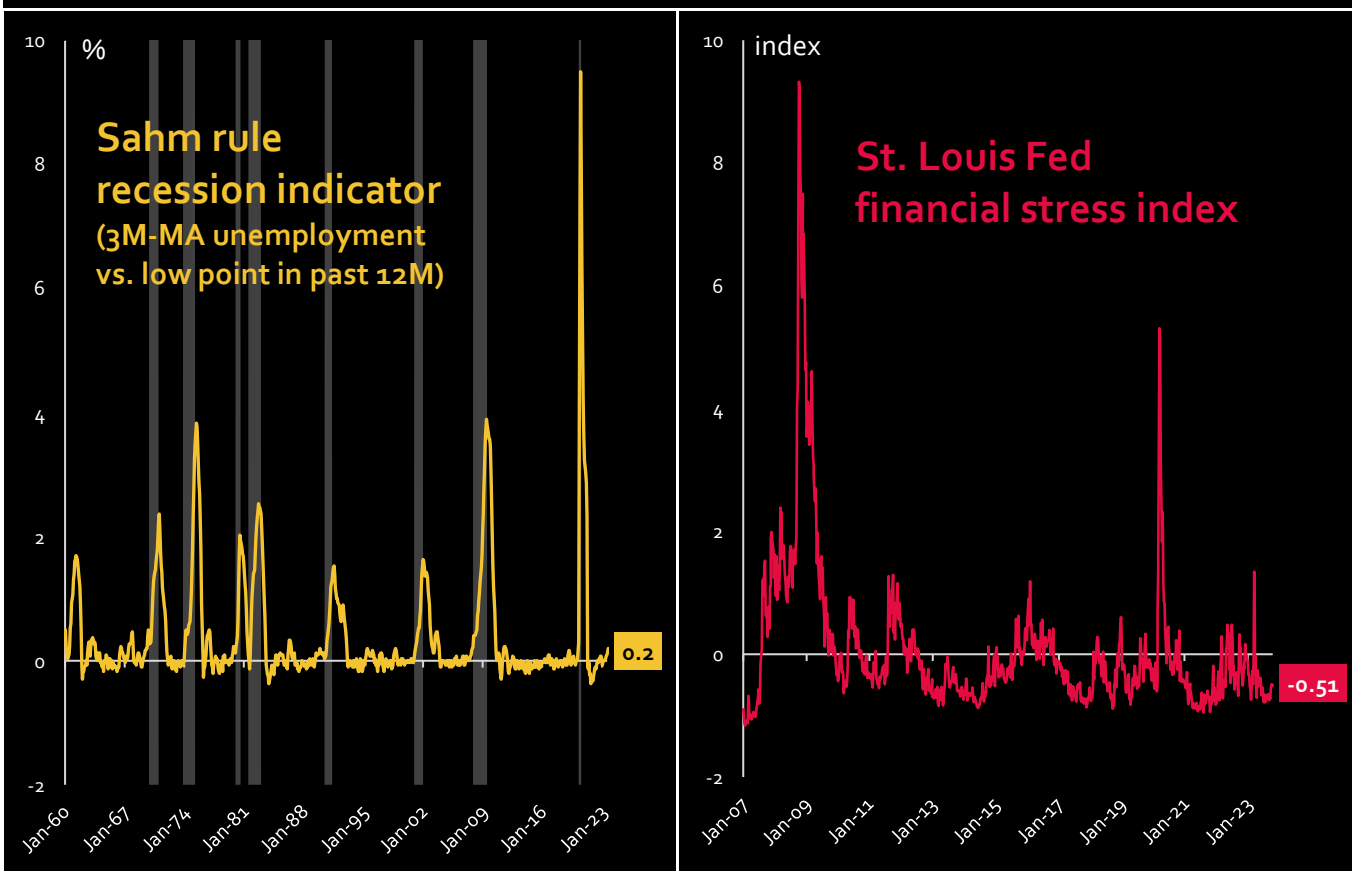
Source: Bloomberg, calculations by BCA Economist

**Panel 5. US leading index bottoms out, implying a "dotcom-sized" not "GFC-sized" recession?**



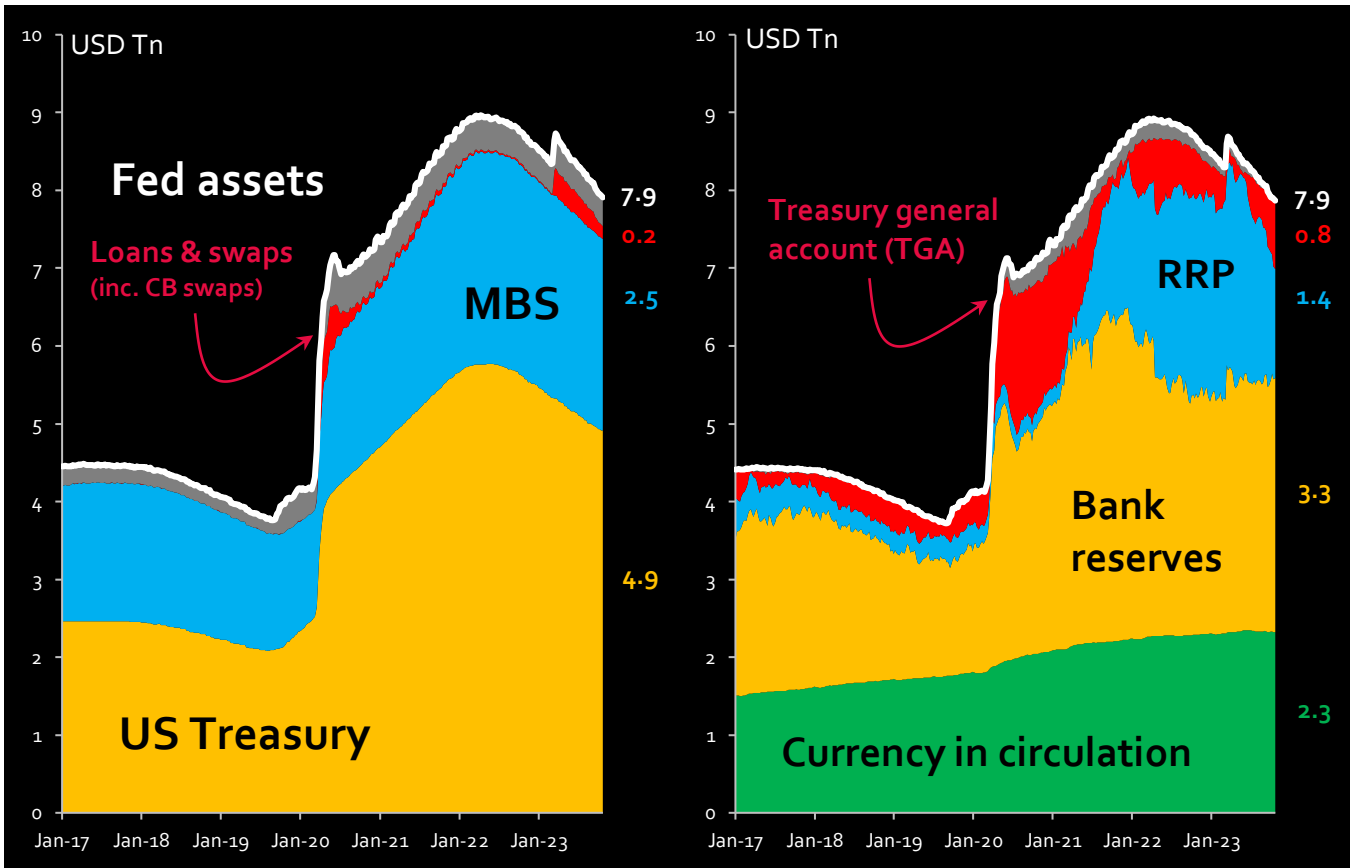
Source: Conference Board

**Panel 6. Both in the real and financial sides, signs of impending US recession remain limited**



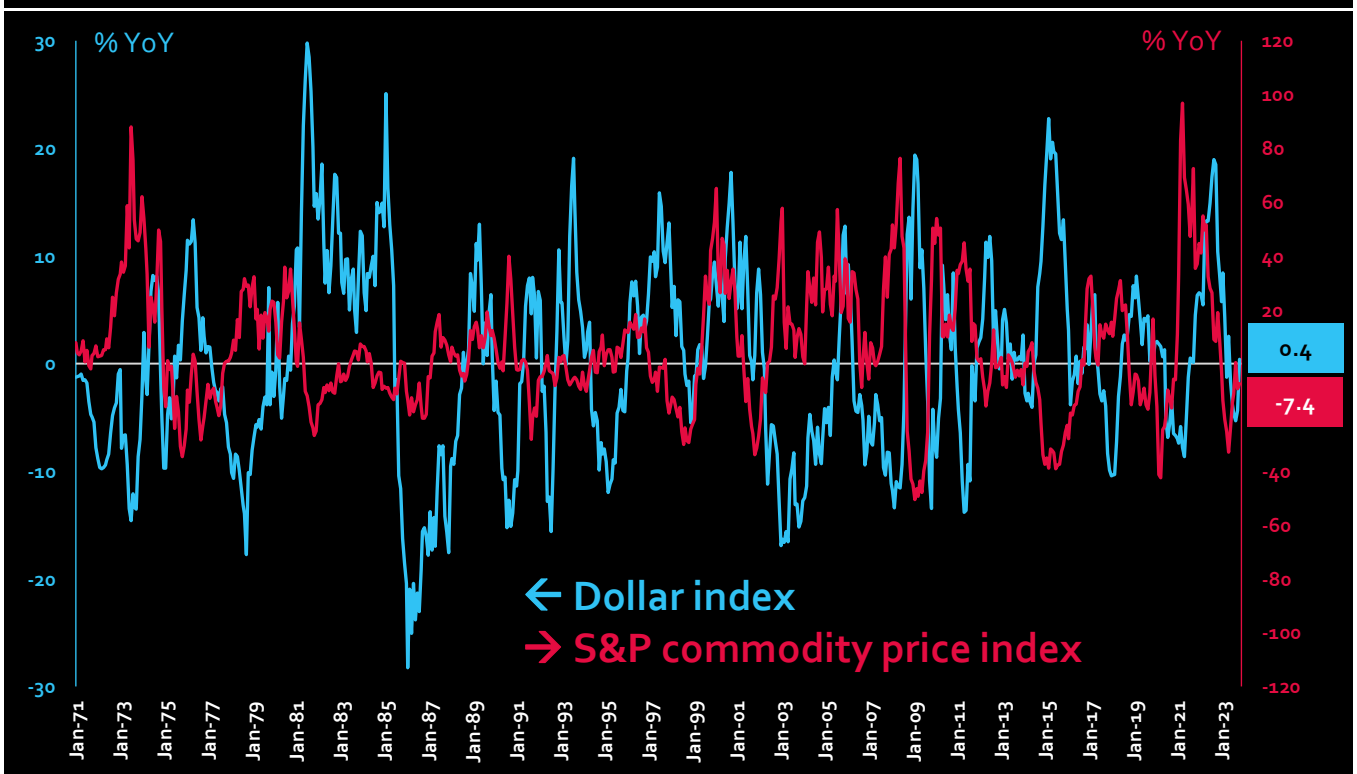
Source: St. Louis Fed

Panel 7. 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	1-Nov	-1 mth	Chg (%)
US	5.50	Nov-23	1.80	Baltic Dry Index	1,401.0	1,701.0	-17.6
UK	5.25	Nov-23	-1.45	S&P GSCI Index	575.3	609.7	-5.6
EU	4.50	Nov-23	1.60	Oil (Brent, \$/bbl)	84.6	95.3	-11.2
Japan	-0.10	Jan-16	-3.10	Coal (\$/MT)	126.5	162.5	-22.2
China (lending)	2.50	Oct-23	4.35	Gas (\$/MMBtu)	3.19	2.68	19.0
Korea	3.50	Oct-23	-0.30	Gold (\$/oz.)	1,982.5	1,848.6	7.2
India	6.50	Oct-23	1.48	Copper (\$/MT)	8,030.0	8,212.5	-2.2
Indonesia	6.00	Oct-23	3.44	Nickel (\$/MT)	17,789.0	18,440.0	-3.5
Money Mkt Rates	1-Nov	-1 mth	Chg (bps)	CPO (\$/MT)	754.7	785.3	-3.9
SPN (1M)	6.38	5.44	94.6	Rubber (\$/kg)	1.43	1.39	2.9
SUN (10Y)	7.06	6.89	16.1	External Sector	Sep	Aug	Chg (%)
INDONIA (O/N, Rp)	5.83	5.63	20.5	Export (\$ bn)	20.76	22.00	-5.63
JIBOR 1M (Rp)	6.65	6.40	25.4	Import (\$ bn)	17.34	18.88	-8.15
Bank Rates (Rp)	Jul	Jun	Chg (bps)	Trade bal. (\$ bn)	3.42	3.12	9.61
Lending (WC)	8.95	8.93	2.84	Central bank reserves (\$ bn)*	134.9	137.1	-1.60
Deposit 1M	4.24	4.19	4.92	Prompt Indicators	Sep	Aug	Jul
Savings	0.67	0.67	-0.41	Consumer confidence index (CCI)	121.7	125.2	123.5
Currency/USD	1-Nov	-1 mth	Chg (%)	Car sales (%YoY)	-20.1	-8.3	-6.7
UK Pound	0.823	0.820	-0.39	Motorcycle sales (%YoY)	-0.9	1.8	45.6
Euro	0.946	0.946	-0.03	Manufacturing PMI	Oct	Sep	Chg (bps)
Japanese Yen	151.0	149.4	-1.05	USA	46.7	49.0	-230
Chinese RMB	7.316	7.298	-0.25	Eurozone	43.0	43.4	-40
Indonesia Rupiah	15,935	15,455	-3.01	Japan	48.7	48.5	20
Capital Mkt	1-Nov	-1 mth	Chg (%)	China	49.5	50.6	-110
JCI	6,642.4	6,939.9	-4.29	Korea	49.8	49.9	-10
DJIA	33,274.6	33,507.5	-0.70	Indonesia	51.5	52.3	-80
FTSE	7,342.4	7,608.1	-3.49	Foreign portfolio ownership (Rp Tn)	Oct	Sep	Chg (Rp Tn)
Nikkei 225	31,601.7	31,857.6	-0.80	Stock	2,895.1	2,833.3	61.89
Hang Seng	17,101.8	17,809.7	-3.97	Govt. Bond	809.3	823.0	-13.66
				Corp. Bond	11.3	10.8	0.52

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	5.1
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	2.6
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.25
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	16,114
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	54.5	32.8
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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