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Monthly Economic & Finance Briefing

Economic, Banking & Industry Research of BCA Group - DKP

BI and Fed policy: The market cheers, the periphery fidgets

Executive Summary:

- **Markets roiled by recent yield spikes were largely calmed by the Fed's assertion that monetary conditions would remain loose for a reasonably long period, and that it was willing to accept a higher degree of inflation for a longer period of time.**
- However, the steady rise of rate expectations as per the Fed's dot plot does raise concerns over how well Powell's "loose inflation" commitments hold up with the other members of the board.
- These concerns are more pronounced outside the US, where the general pace of vaccinations and economic recovery tend to be slower. **BI's decision to hold rates steady at 3.50% is likely to reflect such concerns, and portends the great degree of cautious with which it must enact its policies in the coming months.**

- As it prepared to deliver its monthly press conference, the Fed was faced with the unenviable task of calming markets roiled in the midst of a "yield tantrum." Fortunately, it largely succeeded. Markets rallied and tempers cooled as Powell stepped off the podium. **The Fed Funds Rate remained near the zero bound, but as ever, the key elements here were the Fed's messaging and economic projections.**

- In line with the high expectations that drove yields up in the past few weeks, the Fed projected the US economy to grow by a remarkable 6.5% this year, a substantial jump from the 4.2% growth predicted in December (to put this into perspective, these projections rival China's 6% and above growth target for 2021). Additionally, core inflation is also expected to exceed 2% this year, right at the upper margins of the Fed's inflation target. **With these numbers in mind, markets' fears of the Fed tightening policy much faster in anticipation of inflation do not seem so unreasonable.**

- What ultimately calmed markets however, was Powell's assertion that easy monetary conditions – namely, zero interest rates and continued quantitative easing – will continue for a reasonably long time despite these growth numbers. This was, in many ways, a remarkably dovish statement to make. Where such numbers may have compelled the old Fed to pull back on its policy support as it sought to pre-empt the merest sign of a potential inflationary tide, **Powell has sent a very clear signal that the Fed is now ready to accept a certain degree of higher inflation for a longer period of time.**

- All this of course, is perfectly in line with the new inflation guidance scheme the Fed first announced last year. The recent turmoil with bond markets then, may be interpreted as the first true test of the Fed's commitment to its new inflation strategy, a commitment that it tried very hard to display at the recent FOMC.

- And yet, there remain a few disconcerting signs. Despite Powell's remarkably dovish statements, general rate expectations as reflected by the Fed's dot plot have continued to trend ever upwards (***Table 1***). **Although a clear majority of the Fed's board still expects rates to remain near zero through 2023, this does raise concerns over how well Powell's "loose inflation" commitments hold up with the other members of the board.** These concerns will become only more pressing as the US' continuing economic recovery makes it more and more difficult to justify extra-loose monetary policy in the coming months.

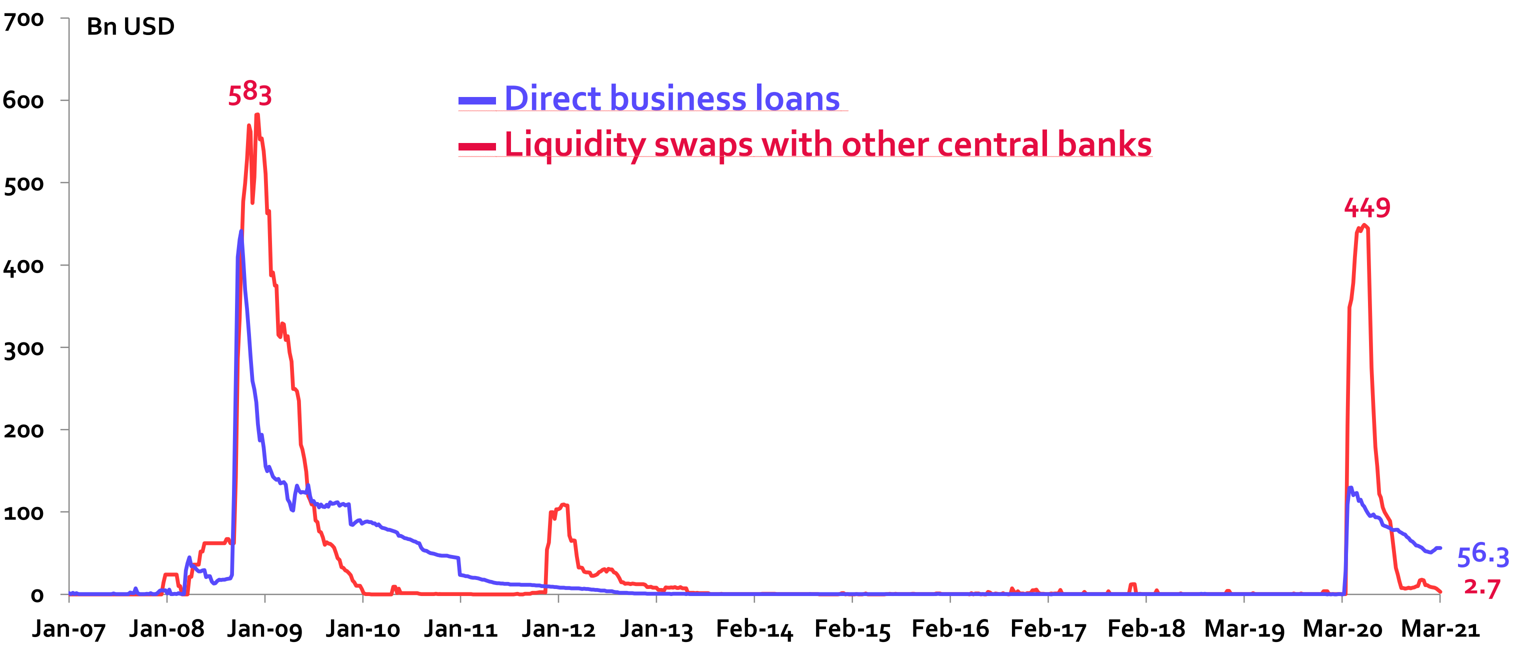
- **These concerns of course, are even more pressing for the peripheral provinces of the Fed's vast domains: in other words, the rest of the world.** Indeed, concerns over a premature tightening by the Fed had already animated other central bankers in the previous weeks. With vaccinations and projections of recovery in the rest of the world generally lagging behind that of the US, tightening dollar liquidity threatens to add another speed bump to a still fragile recovery. Additionally, the Fed's FX swap lines with other central banks are set to expire at the end of this month. The closing off of this invaluable backstop of dollar liquidity will only further complicate things in the coming months (***Chart 1***).

- It is the context of these developments that we must view BI's decision to hold rates steady, a decision that analysts unanimously expected. With the path of

Indonesia's recovery still by no means certain (see our recent report, **"Trade: A recovery, but with strings attached"**), BI itself is likely to remain dovish in its posture, as attested to by the fact that it cut rates as recently as last month. However, concerns over the Fed's possibly accelerated monetary policy cycle as well as the risks of tightening global dollar liquidity means that BI must remain very cautious. **This means, in effect, that BI is likely to maintain the strategy it has followed in the past year whenever market conditions sour: pursuing monetary expansion without fiddling too much with rates.**

- This philosophy was in full display in BI's policy announcements. Even as it was constrained from further lowering rates, BI also enacted a series of macro-prudential policies to boost liquidity by other means. The most conspicuous of these was its decision to double down on financing-to-funding ratios (RIM). Penalties for banks failing to meet their RIM requirements – previously waived due to Covid – are now to be gradually re-imposed in an attempt to spur bank lending. Running concurrently with this "offensive" is also a bolstering of BI's "defenses"; namely, its intensified "triple intervention" in the market as a means to alleviate some of the pressure on the Rupiah.

Chart 1. The Fed's liquidity swap lines have proven to be an invaluable tool for maintaining dollar liquidity during periods of crisis



Source: The Federal Reserve (last update: 10 Mar 2021)

Table 1. Based on the Fed's dot plot, the number of Fed board members expecting rate hikes in 2022 and 2023 continue to rise over time

		Per Dec-2020		
		2021	2022	2023
Fed Funds Rate	0.00 – 0.25	18	17	13
	0.25 – 0.50	-	1	3
	0.50 – 0.75	-	-	1
	0.75 – 1.00	-	-	-
	1.00 – 1.25	-	-	1

		Per Mar-2021		
		2021	2022	2023
Fed Funds Rate	0.00 – 0.25	18	14 (-3)	11 (-2)
	0.25 – 0.50	-	3 (+2)	1 (-2)
	0.50 – 0.75	-	1 (+1)	1
	0.75 – 1.00	-	-	3 (+3)
	1.00 – 1.25	-	-	2 (+1)

Source: The Federal Reserve

Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	0.25	Mar-20	-1.45
UK	0.10	Mar-20	-0.60
EU	0.00	Mar-16	-0.90
Japan	-0.10	Jan-16	0.50
China (lending)	4.35	Oct-15	4.55
Korea	0.50	May-20	-0.60
India	4.00	May-20	-1.03
Indonesia	3.50	Feb-21	2.12
Money Mkt Rates	**17-Mar**	**-1 mth**	**Chg (bps)**
SPN (1M)	2.71	2.43	27.5
SUN (10Y)	6.73	6.20	53.6
INDONIA (O/N, Rp)	2.79	3.04	-25.5
JIBOR 1M (Rp)	3.56	3.80	-24.1
Bank Rates (Rp)	**Dec**	**Nov**	**Chg (bps)**
Lending (WC)	9.21	9.32	-10.54
Deposit 1M	4.22	4.45	-23.28
Savings	0.86	0.87	-0.66
Currency/USD	**17-Mar**	**-1 mth**	**Chg (%)**
UK Pound	0.716	0.722	0.84
Euro	0.835	0.825	-1.16
Japanese Yen	108.8	104.9	-3.58
Chinese RMB	6.504	6.458	-0.70
Indonesia Rupiah	14,428	13,973	-3.15
Capital Mkt	**17-Mar**	**-1 mth**	**Chg (%)**
JCI	6,277.2	6,222.5	0.88
DJIA	33,015.4	31,458.4	4.95
FTSE	6,762.7	6,589.8	2.62
Nikkei 225	29,914.3	29,520.1	1.34
Hang Seng	29,034.1	30,173.6	-3.78
Foreign portfolio ownership (Rp Tn)	**Feb**	**Jan**	**Chg (Rp Tn)**
Stock	1,930.8	1,811.4	119.42
Govt. Bond	971.4	987.3	-15.92
Corp. Bond	28.4	29.3	-0.92

Trade & Commodities	17-Mar	-1 mth	Chg (%)
Baltic Dry Index	2,105.0	1,339.0	57.2
S&P GSCI Index	488.6	464.0	5.3
Oil (Brent, $/brl)	68.0	62.4	8.9
Coal ($/MT)	86.9	81.0	7.2
Gas ($/MMBtu)	2.50	6.61	-62.2
Gold ($/oz.)	1,745.3	1,824.2	-4.3
Copper ($/MT)	9,070.8	8,352.3	8.6
Nickel ($/MT)	16,027.3	18,525.3	-13.5
CPO ($/MT)	1,018.7	968.0	5.2
Rubber ($/kg)	1.78	1.60	11.3
External Sector	**Feb**	**Jan**	**Chg (%)**
Export ($ bn)	15.27	15.29	-0.2
Import ($ bn)	13.26	13.33	-0.5
Trade bal. ($ bn)	2.00	1.96	1.9
Central bank reserves ($ bn)	138.8	138.0	0.58
Prompt Indicators	**Feb**	**Jan**	**Dec**
Consumer confidence index (CCI)	85.8	84.9	96.5
Car sales (%YoY)	-38.2	-34.2	-34.4
Motorcycle sales (%YoY)	N/A	-14.7	-45.1
Cement sales (%YoY)	N/A	-5.9	-12.6
Manufacturing PMI	**Feb**	**Jan**	**Chg (bps)**
USA	60.8	58.7	210
Eurozone	57.9	54.8	310
Japan	51.4	49.8	160
China	50.9	51.5	-60
Korea	55.3	53.2	210
Indonesia	50.9	52.2	-130

Source: Bloomberg, BI, BPS
Notes:
*Previous data
For change in currency: **Black indicates appreciation against USD, **Red** indicates depreciation
***For PMI, **> 50** indicates economic expansion, **< 50** indicates contraction

Indonesia – Economic Indicators Projection

	2016	2017	2018	2019	2020	2021E
Gross Domestic Product (% YoY)	5.0	5.1	5.2	5.0	-2.1	4.8
GDP per Capita (US$)	3605	3877	3927	4175	3912	4055
Consumer Price Index Inflation (% YoY)	3.0	3.6	3.1	2.7	1.7	3.1
BI 7 day Repo Rate (%)	4.75	4.25	6.00	5.00	3.75	3.50
USD/IDR Exchange Rate (end of year)**	13,473	13,433	14,390	13,866	14.050	14.460
Trade Balance (US$ billion)	8.8	11.8	-8.5	-3.2	21.7	10.1
Current Account Balance (% GDP)	-1.8	-1.6	-3.0	-2.7	-0.4	-1.8

** Estimation of Rupiah's fundamental exchange rate

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