

Fed Policy: Dovish, but whence the tapering?

Executive Summary:

- The Fed maintained its policy outlook, despite its more upbeat assessment of the US economy. In particular, it sees the recent increase in inflation as transitory, suggesting that it will wait for a more sustained inflation before changing course.
 - The two stimulus plans from the Biden administration, worth a total of USD 4.1 T, could – if approved by Congress – pave the way for such inflation.
 - The US fiscal-monetary combo could dampen market volatility in the short-run, but also increase the risk of “tantrum”-like dynamics as 2022 approaches.
-
- Heading into last night’s FOMC press conference, the market expected a perfectly sleepy and predictable affirmation of the mantras that the Fed has reiterated in the last few months – that it is “committed [...] to support the US economy”, or that it “will aim [for] inflation moderately above 2% for some time”. Overall, this is exactly what it got from Jerome Powell and company.
 - But the tension between the Fed’s policies and its increasingly sunnier assessment of the US economy is hard to miss. To wit, the Fed has removed references to the pandemic’s effects on unemployment and inflation, and added notes about vaccination progress and strong policy support – presumably from the fiscal side.
 - Inflation, the bogeyman during the bear steepening in March, seems to be relegated to a side concern for the time being. While the US headline inflation stands at 2.6% YoY, the Fed regards the rise as transitory, stemming from low base effect, oil price increase, and short-term bottlenecks in the global supply chains. **In effect, the Fed intends to wait for a more sustained increase in inflation before curtailing its monetary support.**
 - All these gave the Fed’s policy statements a clear dovish tinge, paving the way for the market to resume the risk-on posture that it has assumed since early April. It may also ease the concern a few analysts raised prior to the FOMC that the Fed might announce “tapering” as early as June, following in the footsteps of the Bank of Canada last week.
 - From the perspective of EMs like Indonesia, this is undoubtedly a positive development, especially heading into May which – as the saying goes – might be a moment for market selloffs. **In particular, a**

continuing weakness of the USD could act as a balm given the gaping divergence in health outcome between developed countries and EMs.

- However, the risk in the medium- to longer-term might just grow bigger, especially amid the backdrop of President Biden’s fiscal bazooka: the USD 2.3 T American Jobs Plan and the USD 1.8 T American Families Plan. If approved, these stimuli could provide additional fuel to the commodity price rally (**Chart 1**), lifting inflation and forcing more drastic actions by the Fed at some point.
- The divergence in Fed fund futures, with 2022 outlook flat-lining and 2023-24 spiking upwards (**Chart 2**), illustrates the kind of scenario prevalent in current market thinking, i.e. that the Fed might not be ready to lift off in 2022, but could start tapering in advance of the upcoming rate hikes.
- **And it is tapering, not inflation, that will be the main threat going forward.** If we decompose the US Treasury yield into an expected inflation component and a real yield component, we can see that expected inflation has climbed to historically high levels and is starting to plateau – while real yields are still near historic lows (**Chart 3**). It was precisely this real yield component that jumped during the original “taper tantrum” in 2013.
- **So while the waters should stay sufficiently calm for BI to maintain its current policies for the year, tapering speculations may start to be an issue as 2022 approaches.** Fortunately, the vicious cycle between rising yields and weaker Rupiah – an ever present specter during prior crises – might be softened by the reduced foreign ownership in Indonesian sovereign bonds (**Chart 4**).

Chart 1. Biden's massive stimulus could fuel a new commodity supercycle

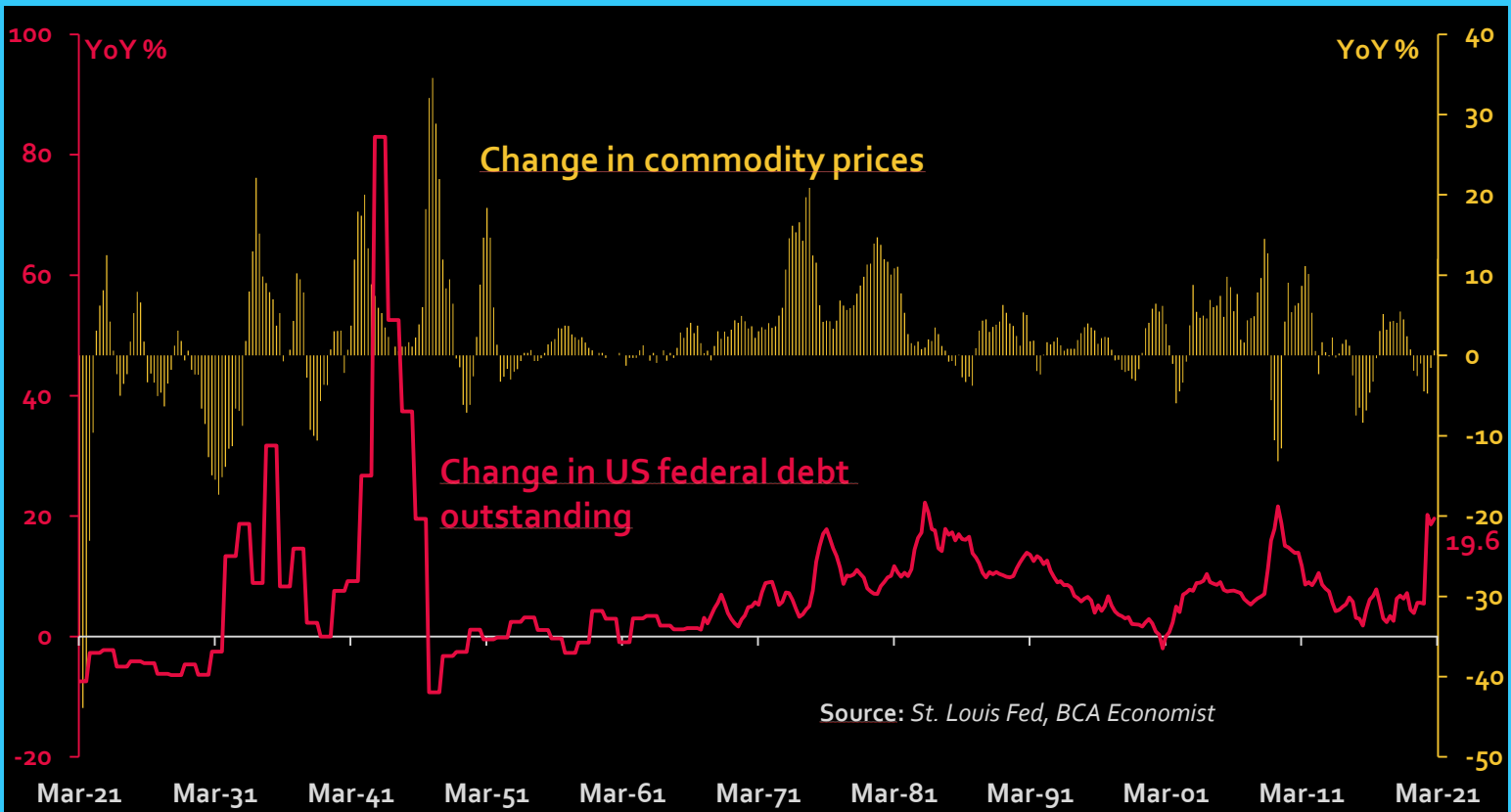


Chart 2. Fed rate hike by 2023 is increasingly viewed as a sure thing by the market, 2022 to be the year of tapering?

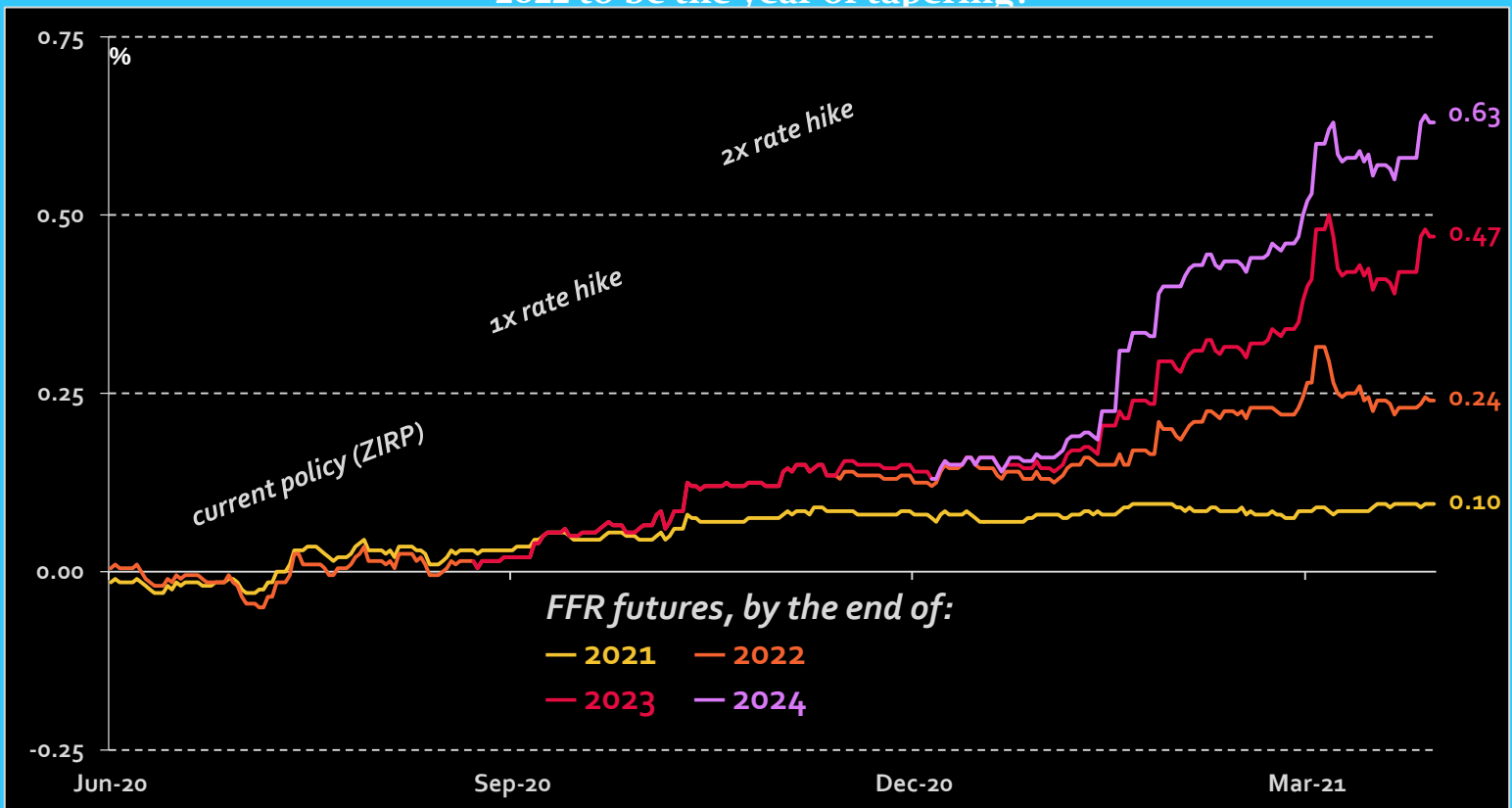


Chart 3. Inflation expectations have begun to slow after a prolonged increase, but rumors of tapering could raise real yields

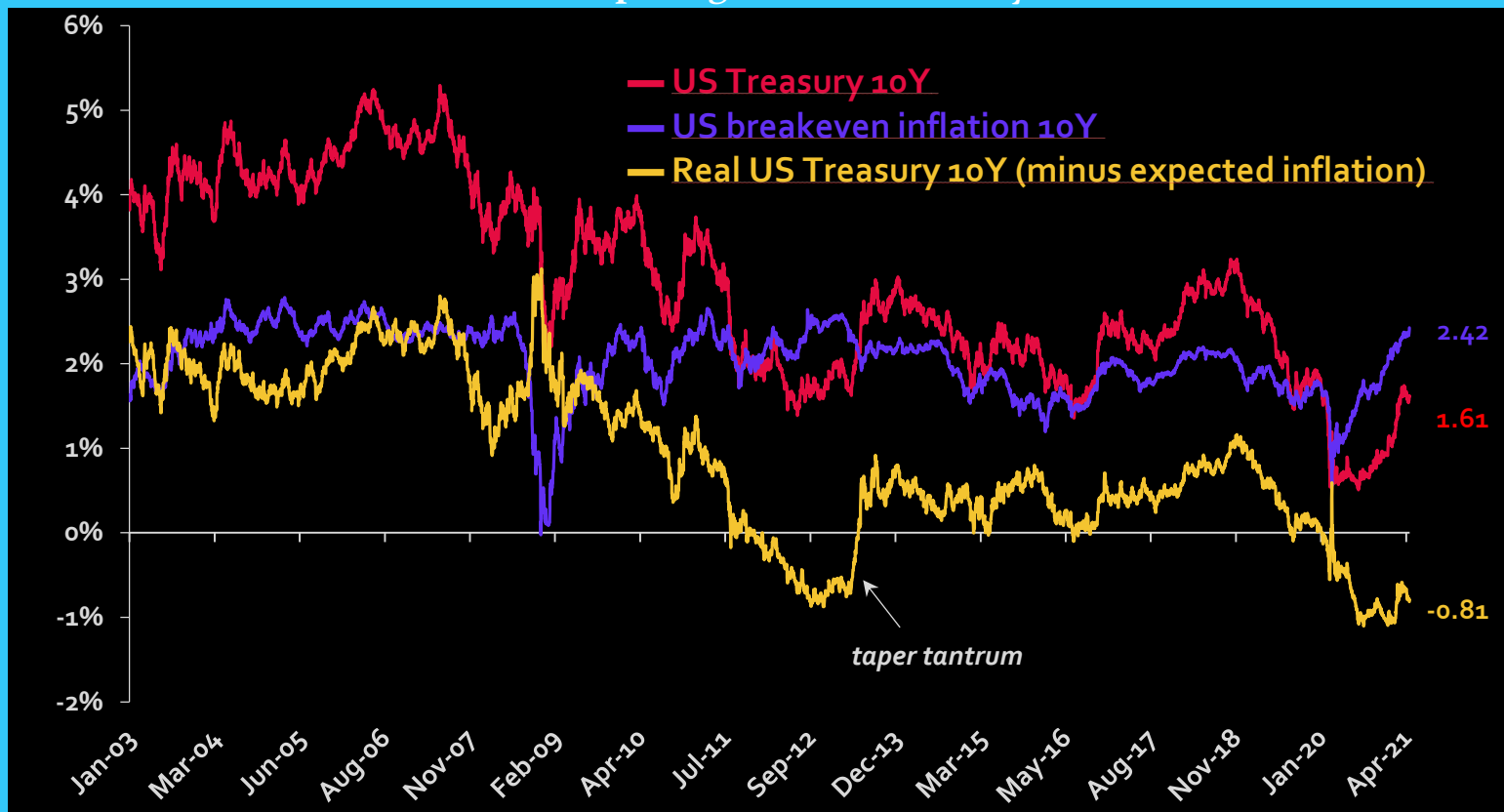
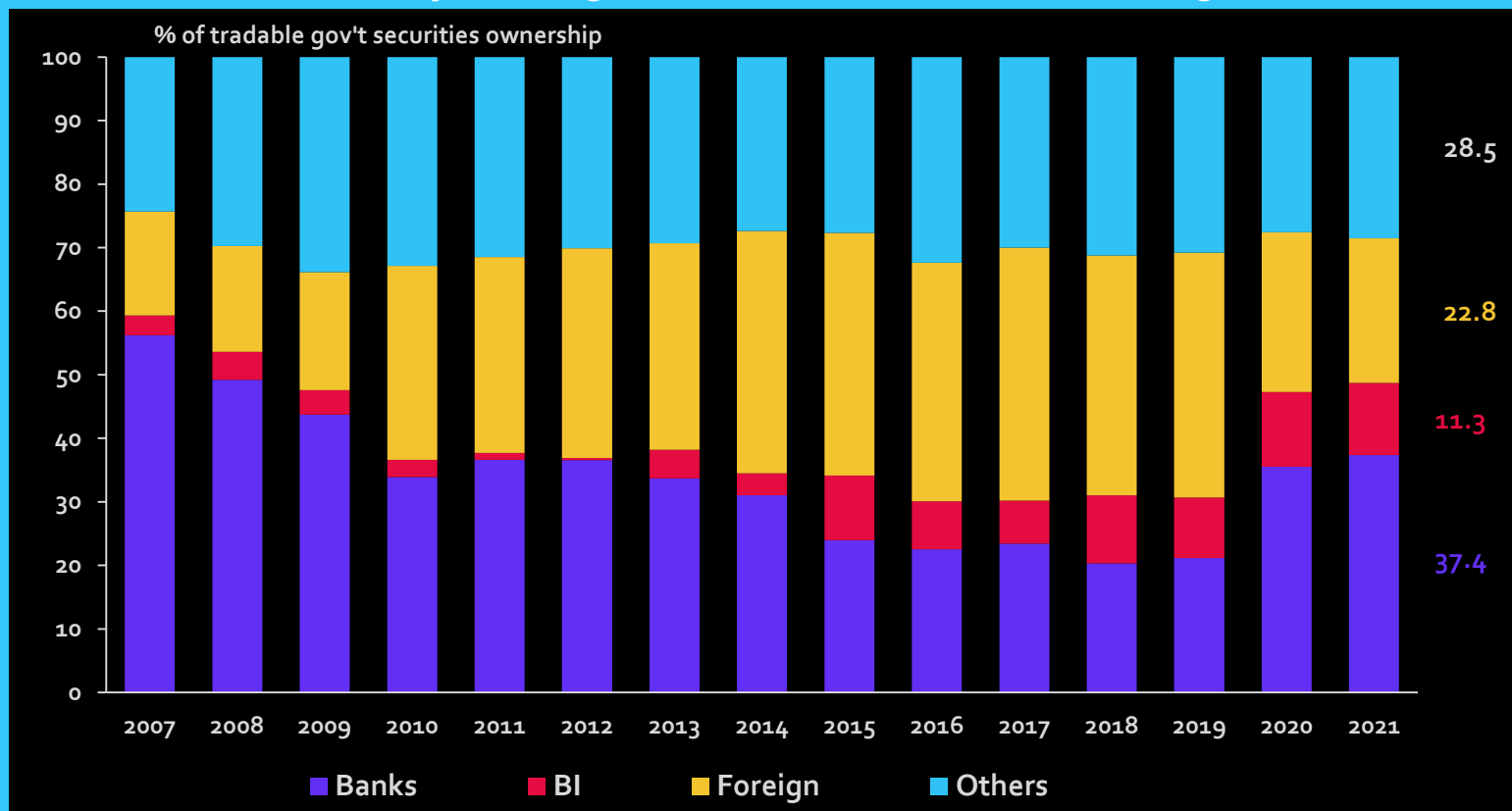


Chart 4. The shift of sovereign bond ownership to domestic banks should reduce vulnerability to foreign outflows, at the cost of “crowding out”



Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	28-Apr	-1 mth	Chg (%)
US	0.25	Mar-20	-2.35	Baltic Dry Index	2,957.0	2,178.0	35.8
UK	0.10	Mar-20	-0.60	S&P GSCI Index	504.9	474.0	6.5
EU	0.00	Mar-16	-1.30	Oil (Brent, \$/bbl)	67.3	64.6	4.2
Japan	-0.10	Jan-16	0.10	Coal (\$/MT)	88.0	88.4	-0.5
China (lending)	4.35	Oct-15	3.95	Gas (\$/MMBtu)	2.92	2.44	19.6
Korea	0.50	May-20	-1.00	Gold (\$/oz.)	1,781.7	1,732.5	2.8
India	4.00	May-20	-1.52	Copper (\$/MT)	9,880.3	8,967.0	10.2
Indonesia	3.50	Feb-21	2.13	Nickel (\$/MT)	17,410.0	16,342.3	6.5
Money Mkt Rates	28-Apr	-1 mth	Chg (bps)	CPO (\$/MT)	1,081.1	968.8	11.6
SPN (1M)	1.73	2.11	-37.7	Rubber (\$/kg)	1.65	1.69	-2.4
SUN (10Y)	6.49	6.69	-20.3	External Sector	Mar	Feb	Chg (%)
INDONIA (O/N, Rp)	2.79	2.79	-0.1	Export (\$ bn)	18.35	15.26	20.3
JIBOR 1M (Rp)	3.56	3.56	0.3	Import (\$ bn)	16.79	13.27	26.6
Bank Rates (Rp)	Jan	Dec	Chg (bps)	Trade bal. (\$ bn)	1.57	1.99	-21.3
Lending (WC)	9.27	9.21	6.15	Central bank reserves (\$ bn)	137.1	138.8	-1.23
Deposit 1M	4.05	4.22	-17.18	Prompt Indicators	Mar	Feb	Jan
Savings	0.84	0.86	-2.39	Consumer confidence index (CCI)	93.4	85.8	84.9
Currency /USD	28-Apr	-1 mth	Chg (%)	Car sales (%YoY)	10.5	-38.2	-34.2
UK Pound	0.718	0.725	1.06	Motorcycle sales (%YoY)	-7.2	-30.8	-14.7
Euro	0.825	0.848	2.81	Cement sales (%YoY)	10.9	0.7	-5.9
Japanese Yen	108.6	109.6	0.96	Capital Mkt	28-Apr	-1 mth	Chg (%)
Chinese RMB	6.479	6.541	0.96	JCI	5,974.5	6,195.6	-3.57
Indonesia Rupiah	14,500	14,418	-0.57	DJIA	33,820.4	33,072.9	2.26
Capital Mkt	28-Apr	-1 mth	Chg (%)	FTSE	6,963.7	6,740.6	3.31
JCI	5,974.5	6,195.6	-3.57	Nikkei 225	29,054.0	29,176.7	-0.42
DJIA	33,820.4	33,072.9	2.26	Hang Seng	29,071.3	28,336.4	2.59
FTSE	6,963.7	6,740.6	3.31	Foreign portfolio ownership (Rp Tn)	Mar	Feb	Chg (Rp Tn)
Nikkei 225	29,054.0	29,176.7	-0.42	Stock	1,878.6	1,930.8	-52.25
Hang Seng	29,071.3	28,336.4	2.59	Govt. Bond	951.4	971.4	-20.00
Foreign portfolio ownership (Rp Tn)	Mar	Feb	Chg (Rp Tn)	Corp. Bond	28.9	28.4	0.52
Stock	1,878.6	1,930.8	-52.25				
Govt. Bond	951.4	971.4	-20.00				
Corp. Bond	28.9	28.4	0.52				

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

Economic, Banking & Industry Research Team

David E. Sumual

Chief Economist

david_sumual@bca.co.id

+6221 2358 8000 Ext: 1051352

Agus Salim Hardjodinoto

Industry Analyst

agus_lim@bca.co.id

+6221 2358 8000 Ext: 1005314

Barra Kukuh Mamia

Economist / Analyst

barra_mamia@bca.co.id

+6221 2358 8000 Ext: 1053819

Victor George Petrus Matindas

Industry Analyst

victor_matindas@bca.co.id

+6221 2358 8000 Ext: 1058408

Gabriella Yolivia

Economist / Analyst

gabriella_yolivia@bca.co.id

+6221 2358 8000 Ext: 1063933

Derrick Gozal

Economist / Analyst

derrick_gozal@bca.co.id

+6221 2358 8000 Ext: 1066722

Livia Angelica Thamsir

Economist / Analyst

livia_thamsir@bca.co.id

+6221 2358 8000 Ext: 1069933

Ahmad Aprilian Rizki

Research Assistant

ahmad_rizki@bca.co.id

+6221 2358 8000 Ext: 20378

Arief Darmawan

Research Assistant

arief_darmawan@bca.co.id

+6221 2358 8000 Ext: 20364

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group - DKP

20th Grand Indonesia, Menara BCA

Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia

Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343

DISCLAIMER

This report is for information only, and is not intended as an offer or solicitation with respect to the purchase or sale of a security. We deem that the information contained in this report has been taken from sources which we deem reliable. However, we do not guarantee their accuracy, and any such information may be incomplete or condensed. None of PT. Bank Central Asia Tbk, and/or its affiliated companies and/or their respective employees and/or agents makes any representation or warranty (express or implied) or accepts any responsibility or liability as to, or in relation to, the accuracy or completeness of the information and opinions contained in this report or as to any information contained in this report or any other such information or opinions remaining unchanged after the issue thereof. The Company, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Company or any other person has been advised of the possibility thereof. Opinion expressed is the analysts' current personal views as of the date appearing on this material only, and subject to change without notice. It is intended for the use by recipient only and may not be reproduced or copied/photocopied or duplicated or made available in any form, by any means, or redistributed to others without written permission of PT Bank Central Asia Tbk.

All opinions and estimates included in this report are based on certain assumptions. Actual results may differ materially. In considering any investments you should make your own independent assessment and seek your own professional financial and legal advice. For further information please contact: (62-21) 2358 8000, Ext: 20364 or fax to: (62-21) 2358 8343 or email: ahmad_rizki@bca.co.id