

## Fed and BI Policy: A hawkish signal, but no sharp turn

### Executive Summary:

- The Fed's dot plot indicates two rate hikes in 2023, affirming an upward trajectory for global interest rates.
  - The announcement is nonetheless not a great departure from market expectations, and most importantly only caused a modest (10-20 bps) increase in real yields instead of the sharp spike during 2013's taper tantrum.
  - Indonesia is better-placed to withstand any potential shock from tapering compared to 2013, with regards to inflation, current account, and foreign bond ownership.
  - The balance of macro factors still point to a gradual retreat by BI from its accommodative policy, and so the 7-Day Repo Rate might remain at 3.50% until a significant pullback in global liquidity (e.g. from tapering) is underway.
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- The June 2021 FOMC was always thought to be a "big deal", with the market expecting the Fed to clarify its timeline regarding tapering. And on this front, the Fed certainly delivered – and how! Its infamous dot plot showed two rate hikes in 2023, sending the global market into a significant, albeit modest, correction. The Fed also hiked the rate it pays on reserve balances, although this is largely a "housekeeping" measure in order to more finely target the effective funds rate (**Chart 1**).
  - The Fed's rate trajectory, nonetheless, does not represent that big of a departure from what the market has expected in the run up to this meeting – or from the Fed's previous policy stance, for that matter. By the start of June, the market has already priced in two rate hikes by 2023 (**Chart 2**). The Treasury yield curve in the immediate aftermath of the FOMC is also not too different from the one we saw in March (**Chart 3**), with only 5-10 bps steepening in the 2-5 years range.
  - Even more crucially, real yields (as shown by the Treasury Inflation-Protected Securities or TIPS) has only risen slightly (**Chart 4**) compared to the spike we saw in 2013. Such relative stillness underlines the Fed's success in shifting market expectations over the course of two (dovish) policy cycles. The market that threw a tantrum in 2013 was accustomed to strict inflation targeting of earlier eras, while the current market appears to have taken the Fed's mantra – that it will allow moderately high inflation for some time – to heart.
  - This FOMC decision, as such, does not unduly shift our timeline regarding the Fed's policy – namely, that tapering will probably begin in early 2022, and that speculations thereof would mount in H2-21. But it does shift our view regarding the effects of the upcoming (potential) market tantrum, and how it could differ from 2013.
  - The fault line between the "losers" (the so-called "Fragile Five") versus the other emerging markets that weathered the 2013 shock better was mostly about current account deficits (CAD). And since it came amid a downtrend in commodity prices and the "flipping" in Indonesia's current account, it should not have been surprising, in retrospect, that Indonesia should find itself among the "Fragile Five".
  - This time around, commodity prices are on an upswing, which has reduced Indonesia's balance-of-payment fragility (**Chart 5**). And even if tapering speculations – and policy tightening in China – could reverse some of the recent gains, the change in commodity terms of trade has been beneficial for Indonesia (see our recent report on trade, "**The great commodity rally continues**"), thanks to the bullish trend for industrial metals relative to oil.
  - The other big difference is the aforementioned calm in real Treasury yields. Given that Indonesia's CPI has stayed under control, especially compared to other EMs like Brazil or India, the Rupiah therefore has stronger fundamentals against the (potentially) appreciating USD, as seen by the moderate reaction in the non-deliverable forwards (NDF) market (**Chart 6**). Since part of the reason for this low inflation is the government's strong grip on food and energy prices, we might expect some inflationary pressure to eventually materialize in 2022-23 as the public sector deficits narrows – but this would give BI ample time to normalize its policy compared to the rapid yield hikes in 2013.

- Finally – and as we have mentioned plenty of times in this space – the fact that the lion’s share of sovereign bond ownership has shifted from foreigners to domestic banks means that the Rupiah is much less sensitive to changes in global liquidity, even if this comes at the cost of some form of “crowding out” in the financial system. As with inflation, this is an argument for a more orderly retreat by BI from its present stance, and that a sharper pullback in global liquidity (e.g. after tapering is well underway) might be needed to “cue” policy tightening.
- Accordingly, BI’s latest policy announcement – with the 7-Day Repo Rate staying at 3.5% and some tinkering at the margins (such as extending the reduction of credit card late fee) – is wholly expected. The stage may therefore be set for a relative calm on the monetary/liquidity front, at least until tapering speculations probably come back to the fore prior to the Fed’s Jackson Hole symposium in late August.

Chart 1. The increase in IOER was the first Fed rate hike since Covid, but represents “finetuning” of effective FFR rather than tightening per se

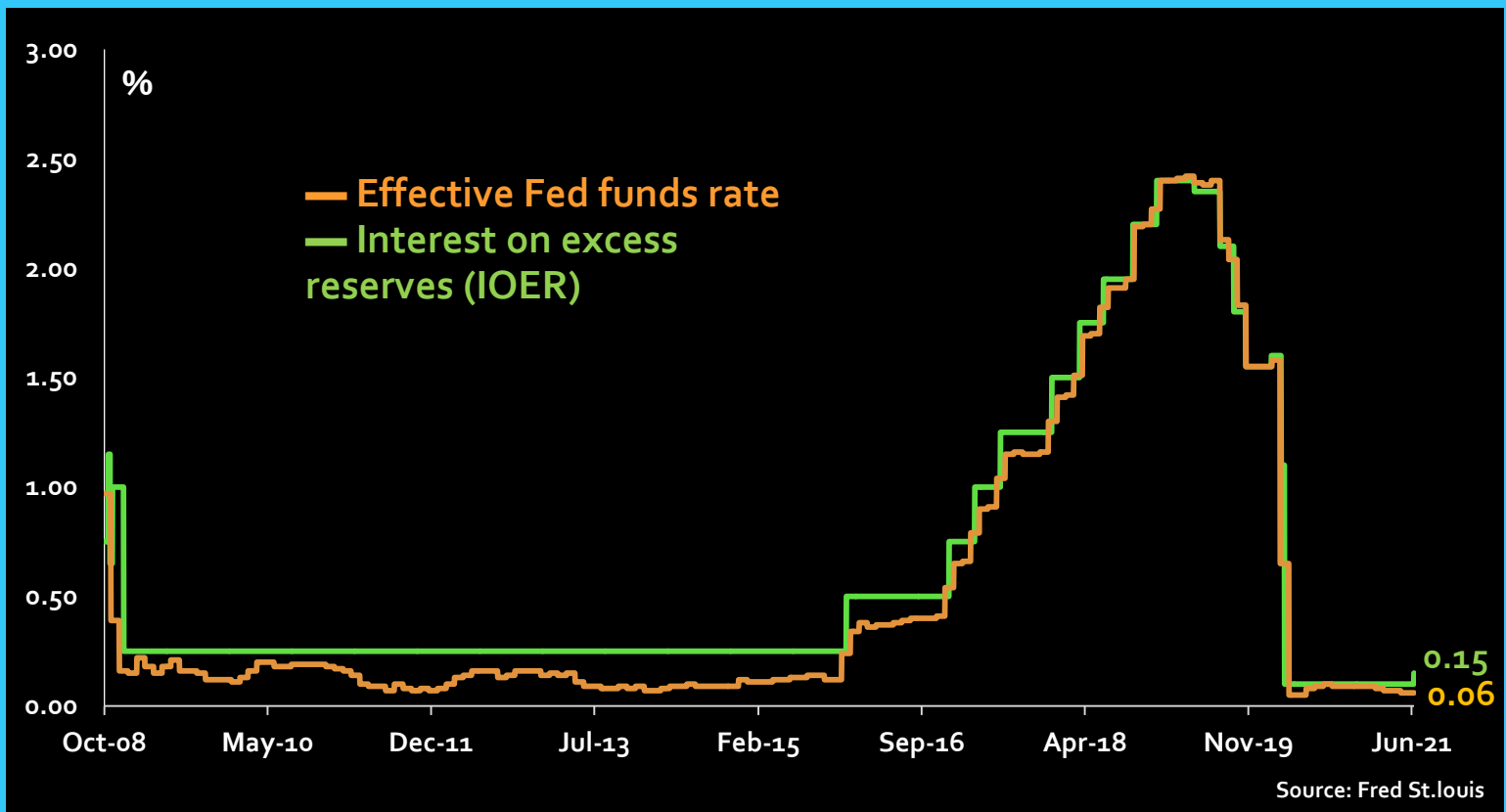


Chart 2. The market has priced in two rate hikes in 2023 for a few weeks prior to the FOMC meeting

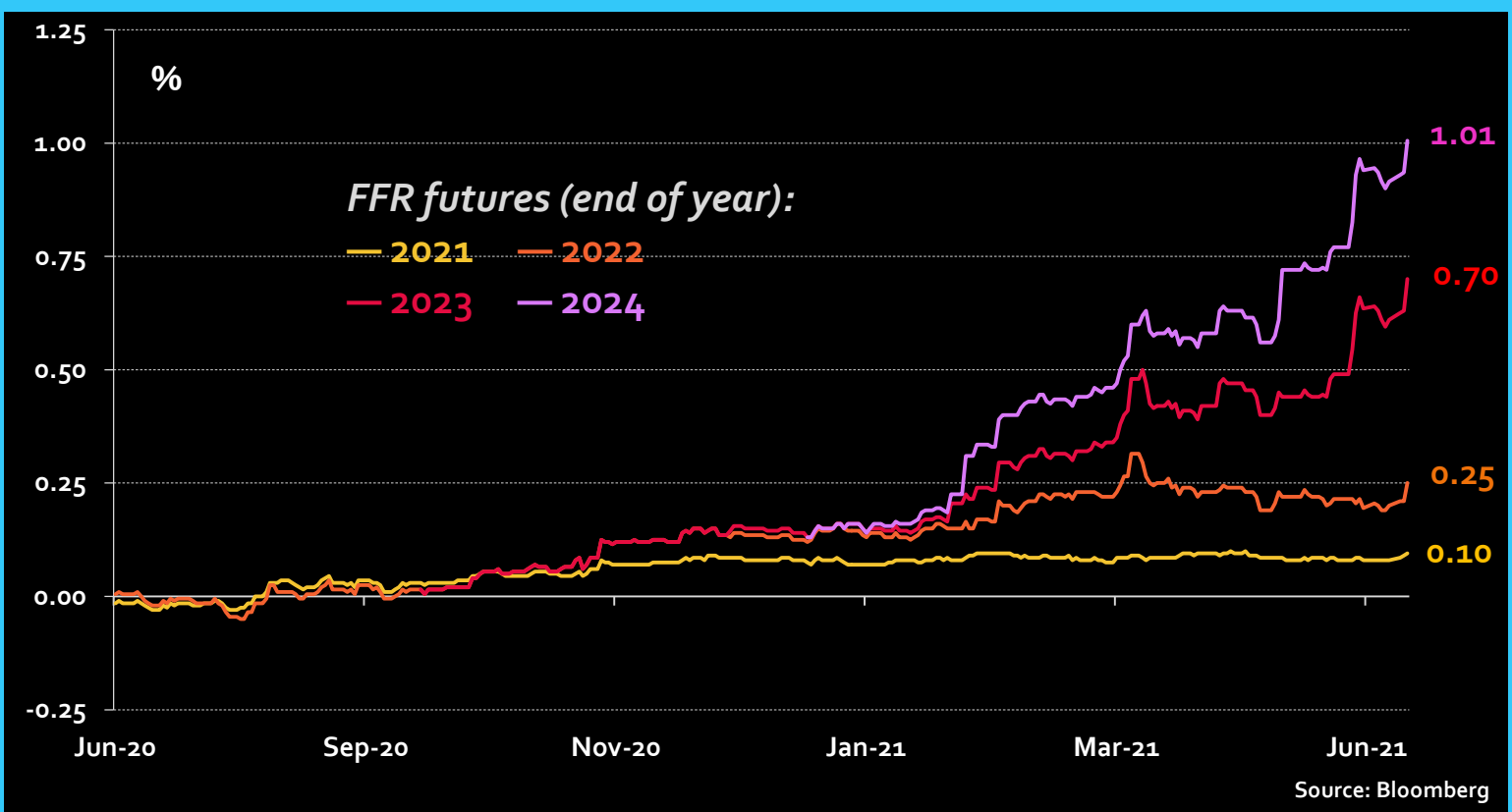


Chart 3. The rise in Treasury yields post-FOMC put the yield curve at (mostly) comparable levels to March

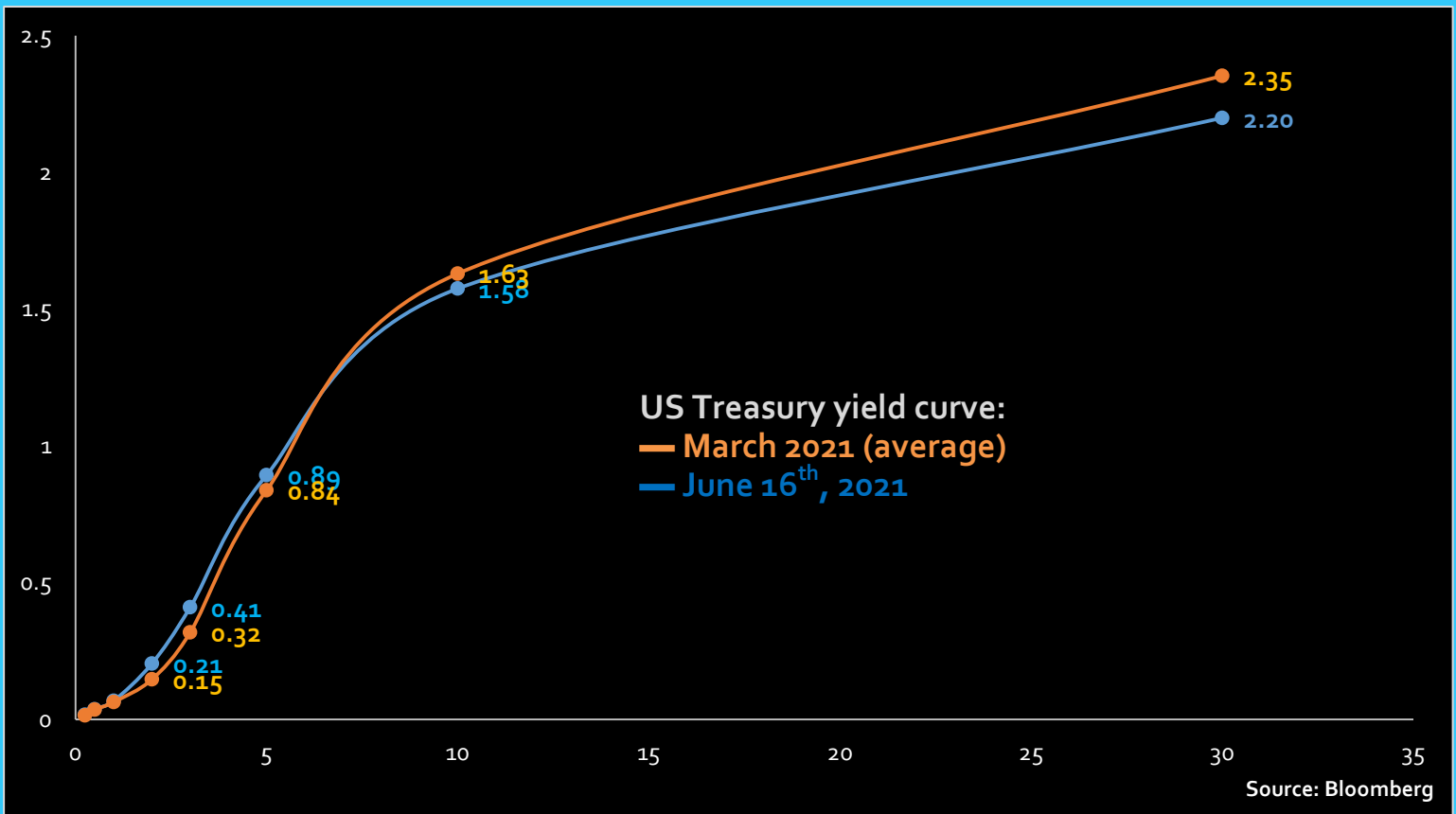


Chart 4. US real yields have not risen to similar extents as during taper tantrum in 2013



Chart 5. The strong trade surplus means Indonesian FX balance is in relatively safe territory even with limited portfolio inflows

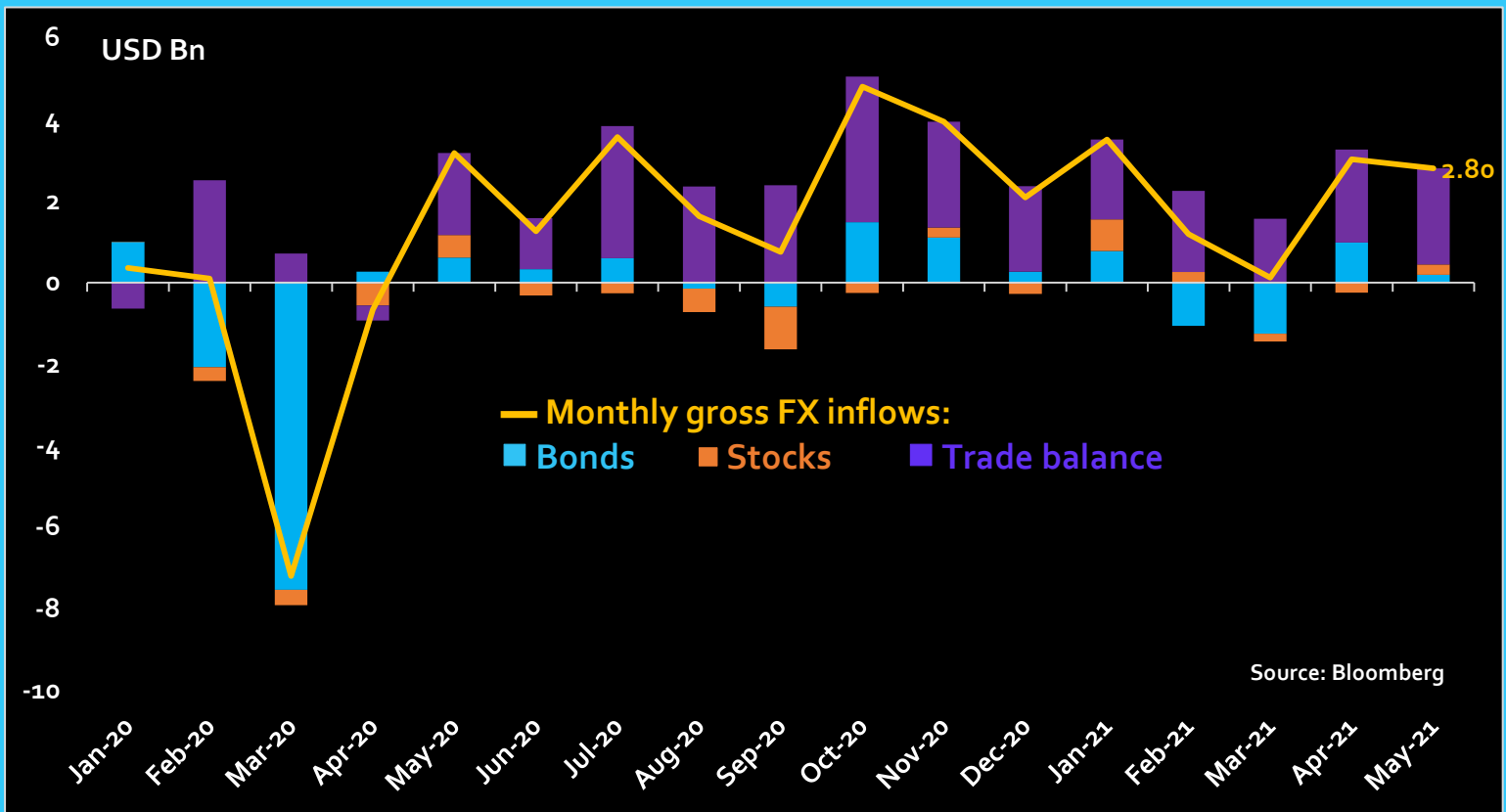
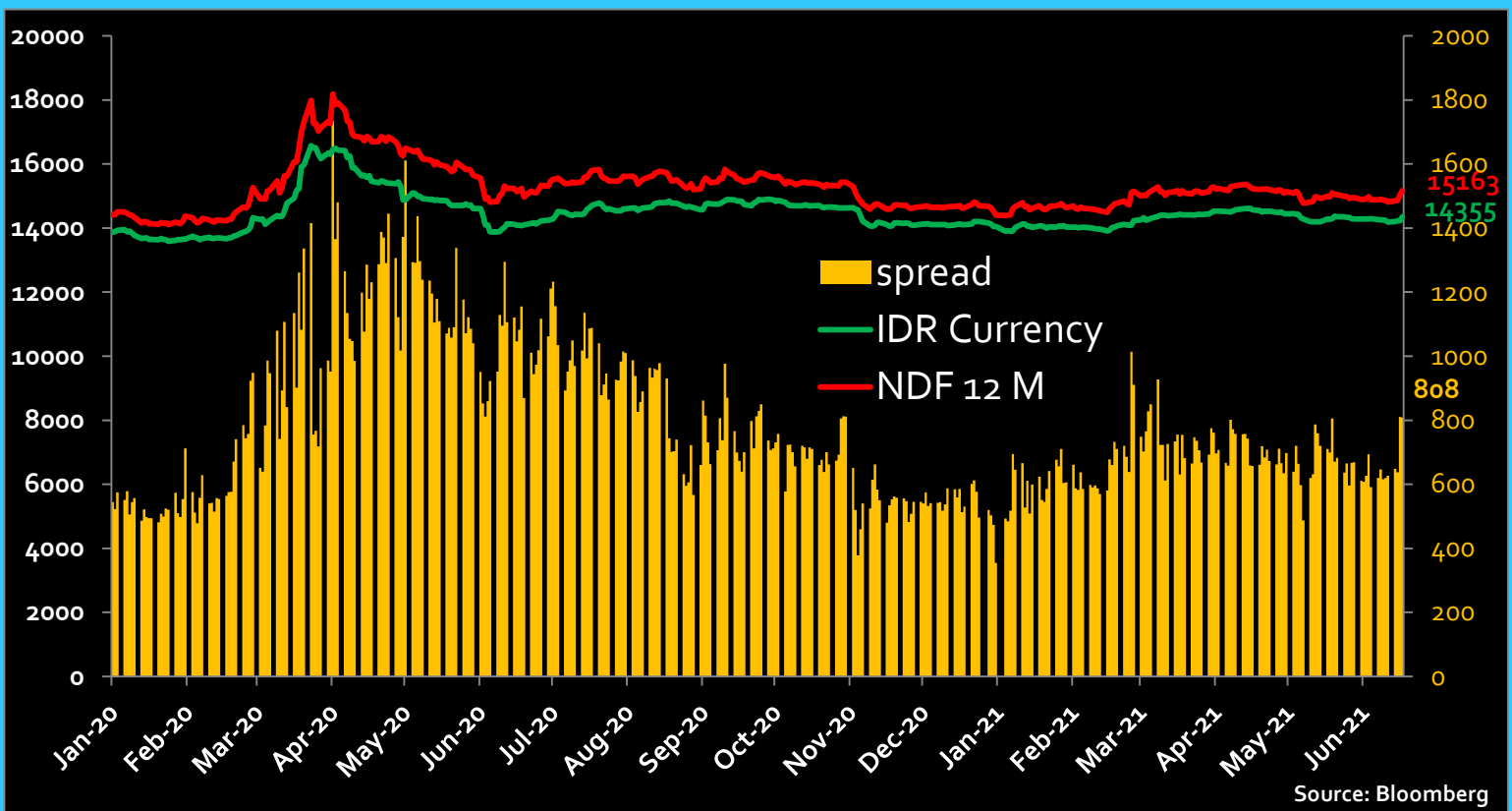


Chart 6. The forward rate for Rupiah rose after the latest FOMC, but the spread is still lower than March 2021



## Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	16-Jun	-1 mth	Chg (%)
US	0.25	Mar-20	-4.75	Baltic Dry Index	3,176.0	2,939.0	8.1
UK	0.10	Mar-20	-2.00	S&P GSCI Index	530.0	515.0	2.9
EU	0.00	Mar-16	-2.00	Oil (Brent, \$/bbl)	74.4	68.7	8.3
Japan	-0.10	Jan-16	0.30	Coal (\$/MT)	117.0	97.8	19.7
China (lending)	4.35	Oct-15	3.05	Gas (\$/MMBtu)	3.31	2.86	15.5
Korea	0.50	May-20	-2.10	Gold (\$/oz.)	1,811.5	1,843.4	-1.7
India	4.00	May-20	-2.30	Copper (\$/MT)	9,638.3	10,214.5	-5.6
Indonesia	3.50	Feb-21	1.82	Nickel (\$/MT)	17,619.0	17,516.0	0.6
				CPO (\$/MT)	865.3	1,160.6	-25.4
				Rubber (\$/kg)	1.60	1.70	-5.9
Money Mkt Rates	16-Jun	-1 mth	Chg (bps)	External Sector	May	Apr	Chg (%)
SPN (1M)	2.67	2.59	8.0	Export (\$ bn)	16.60	18.49	-10.3
SUN (10Y)	6.40	6.41	-1.6	Import (\$ bn)	14.23	16.20	-12.2
INDONIA (O/N, Rp)	2.79	2.91	-12.5	Trade bal. (\$ bn)	2.36	2.29	3.2
JIBOR 1M (Rp)	3.56	3.56	0.0	Central bank reserves (\$ bn)	136.4	138.8	-1.73
Bank Rates (Rp)	Mar	Feb	Chg (bps)	Prompt Indicators	May	Apr	Mar
Lending (WC)	9.12	9.23	-10.55	Consumer confidence index (CCI)	104.4	101.5	93.4
Deposit 1M	3.74	3.88	-14.01	Car sales (%YoY)	1,443.6	902.9	10.6
Savings	0.83	0.83	0.13	Motorcycle sales (%YoY)	N/A	282.0	-7.2
Currency/USD	16-Jun	-1 mth	Chg (%)	Cement sales (%YoY)	#N/A	8.3	10.9
UK Pound	0.715	0.709	-0.77				
Euro	0.834	0.824	-1.20				
Japanese Yen	110.7	109.4	-1.23				
Chinese RMB	6.398	6.437	0.61				
Indonesia Rupiah	14,238	14,198	-0.28				
Capital Mkt	16-Jun	-1 mth	Chg (%)	Manufacturing PMI	May	Apr	Chg (bps)
JCI	6,078.6	5,938.4	2.36	USA	61.2	60.7	50
DJIA	34,033.7	34,382.1	-1.01	Eurozone	63.1	62.9	20
FTSE	7,185.0	7,043.6	2.01	Japan	53.0	53.6	-60
Nikkei 225	29,291.0	28,084.5	4.30	China	52.0	51.9	10
Hang Seng	28,436.8	28,027.6	1.46	Korea	53.7	54.6	-90
Foreign portfolio ownership (Rp Tn)	May	Apr	Chg (Rp Tn)	Indonesia	55.3	54.6	70
Stock	1,892.8	1,892.9	-0.11				
Govt. Bond	957.5	964.6	-7.14				
Corp. Bond	27.5	28.5	-1.00				

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	4.5
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	15.0
Current Account Balance (% GDP)	-1.8	-1.6	-3.0	-2.7	-0.4	-1.3

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

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