FOMC and BI Policy:
Steadfast amid unyielding challenges

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21 March 2024

Executive Summary

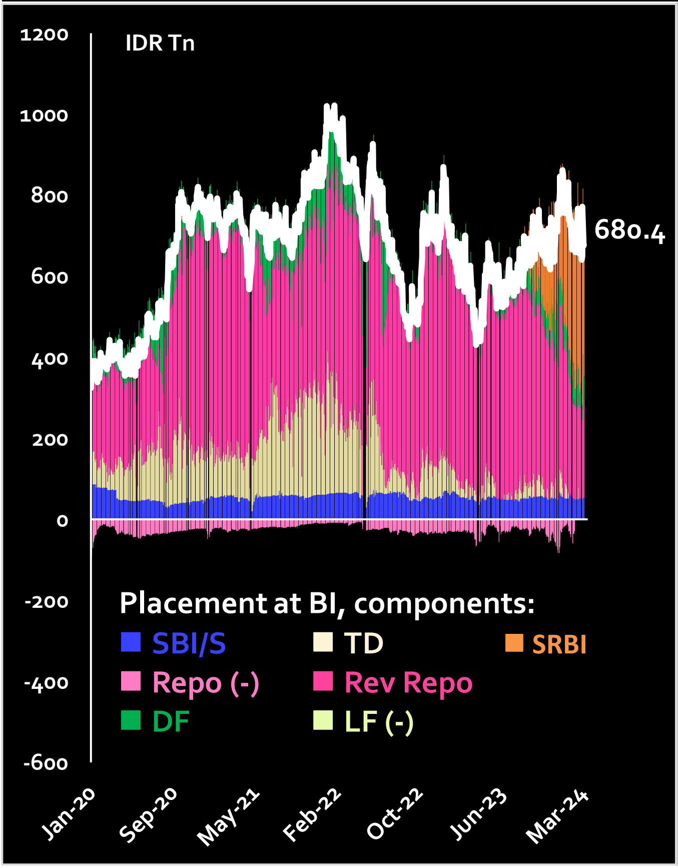
- The Fed maintained the Fed Funds Rate at 5.25 – 5.50% and upheld its expectation of a 75 bps rate cut in 2024, while adjusting 2025 rate cut projections to 75 bps primarily due to persistent inflation, contributing to the halved market expectations.
- The USD has not strengthened significantly due to subdued inflows and the "gold rush" in China, raising the prospect of "fiscal dominance" leading to negative real rates.
- Negative real rates may offer relief to Indonesia amid limited foreign appetite for SBN, while recent improvements in commodity prices provide temporary support for FX revenue, allowing BI to stay the course.
- Liquidity shortages persist and may escalate with the upcoming Lebaran festivities, alongside corporations' still-strong investment needs amid weak revenue due to commodity price declines.
- The liquidity shortage and narrow trade balance in February imply wider current account deficits, though mitigated by ample FX reserves and a stable Rupiah, prompting BI to likely postpone BI Rate cuts until the latter half of 2024.

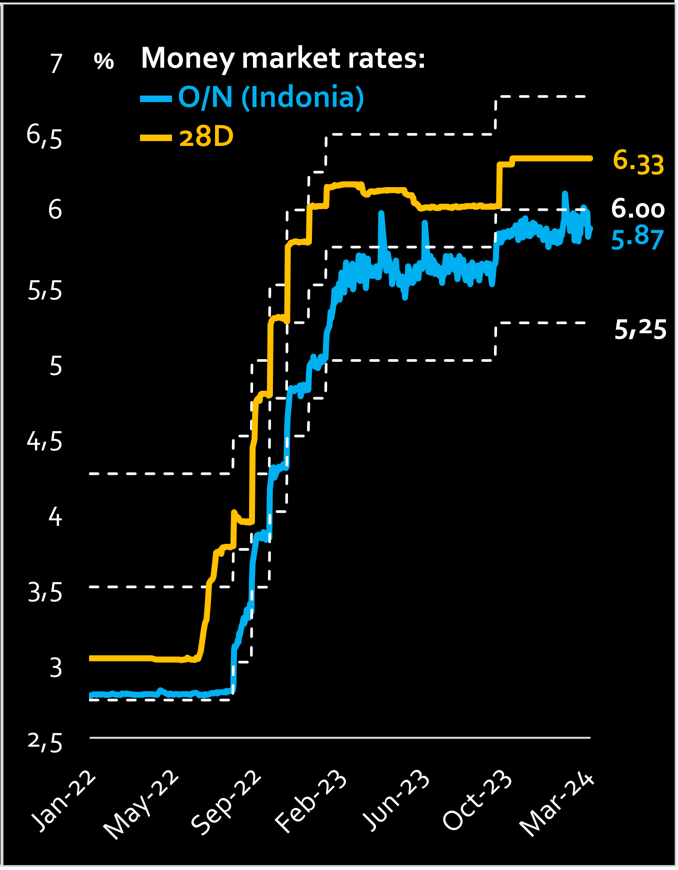
- The Fed has yet again opted to maintain the Fed Funds Rate at 5.25 – 5.50%, as expected. Despite the solid pace of economic expansion, with predominantly positive revisions regarding US macroeconomic conditions, the central bank has upheld its expectation of a 75 bps rate cut in 2024. However, it has slightly adjusted its rate cut projections for 2025, reducing expectations from a 100 bps cut to 75 bps, in light of the anticipated ongoing economic momentum.
- One of the primary factors influencing the Fed's decision is the persistent concern surrounding inflation. Despite the robust economic activity, there are fears that sustained growth may exacerbate inflationary pressures. In its latest projections, the Fed has revised upwards the core inflation figure from 2.4% to 2.6%, which could dampen the rationale for implementing rate cuts. This shift in the inflation outlook has also contributed to a decline in market expectations for future rate cuts, which have halved from 150 bps earlier in 2024.
- Interestingly despite the shift in rate outlook, the USD has not exhibited a significant strengthening. This is a curious phenomenon, which can be explained probably by relatively subdued inflows into the US. In our recent report, we examined a "gold rush" in China, whereby higher demand from both the PBoC (for geopolitical reasons) and retail investors (for safety reasons) have driven up the gold price. This is paralleled by an incipient increase

in other commodity prices, driven in part by similarly-rising demand (or expectations thereof) from China.

- This may provide a glimpse at a future scenario of "fiscal dominance", whereby the Fed is unable to sufficiently tighten policy to fight inflation, due to the need to finance US Treasury issuance. Rising commodity prices could provide renewed impetus to global inflation, while China's shift towards gold reduces the amount of surplus that is recycled to USTs. Under this situation, the Fed could be forced to start stabilizing the UST market again or, at least, frozen in stasis and eventually caused real rates to turn negative again.
- While this scenario is still uncertain, negative real rates could provide a tonic for emerging markets including Indonesia. This is particularly true given that foreign appetite for the government bonds (SBN) has been very limited, including after the Elections. In response to the outflows – and banks' shift towards higher-yielding SRBI – BI is now having to once again intervene and buy up SBN. This helps suppress yields, but at the same time the lower yields exacerbate the weak foreign demand for SBN.
- The recent improvements in commodity prices could also provide a temporary buffer for Indonesia's FX revenue, while the rally in the gold market has boosted the value of BI's reserves on a mark-to-market basis, mitigating potential strains on BI's FX reserves. All the same, the relatively flat trajectory of the USD also reduces the urgency for any immediate drastic measures from BI, affording the central bank the opportunity to monitor developments and respond prudently to unforeseen challenges in the future.
- However, concerns over liquidity shortages persist, evidenced by widening gap between loan growth and deposit growth (11.28% YoY vs 5.66% YoY, respectively), along with erratic movements in the Indonia money market benchmark rate over the last month. This pervasive liquidity shortage may escalate with the upcoming Lebaran festivities, posing (hopefully temporary) headwind to loan growth.
- The high and volatile Indonia rates probably reflect increased demand for cash, during the Elections and now the Muslim fasting month (Ramadan). Since a lot of the spending for low-income Indonesians are still conducted on a cash basis, this is probably a good sign for basic consumption in Q1-24. However, we are still doubtful about discretionary spending by the middle- and upper-classes, who seems intent on replenishing their savings instead of consuming.
- Corporations, both private and state-owned, continue to grapple with decreased revenue due to commodity price declines, though improvement could begin should the rebound in commodity prices continue. It is this weak revenue, coupled with still-strong investment needs, that explains the strong loan growth and the liquidity shortage.
- This liquidity shortage, as well as the narrow trade balance in February, would probably translate to wider current account (CA) deficits, although this is mitigated by the ample FX reserves and a relatively stable Rupiah. Given the heightened uncertainty surrounding Fed rate outlook, however, BI is likely to delay its plans to cut the BI Rate at least until the latter half of 2024. One quick fix, should the liquidity shortage continue, would probably be lowering the Reserve Requirement Ratio (RRR) – currently at 9% - although BI would also have to weigh it against the risk of inflation due to greater monetary circulation.

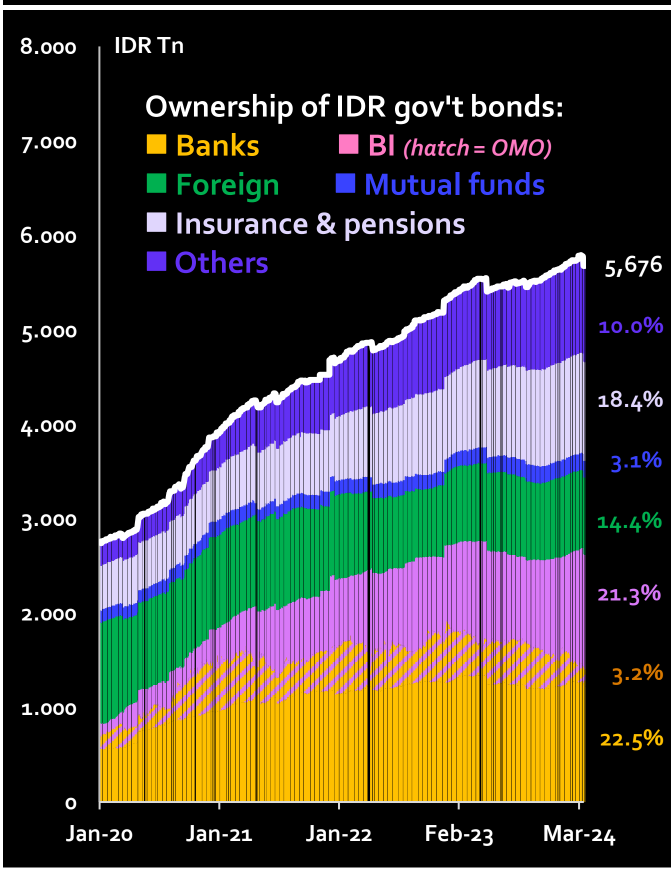
Panel 1. Domestic banks' placement is increasingly skewed towards SRBI than other, more traditional instruments

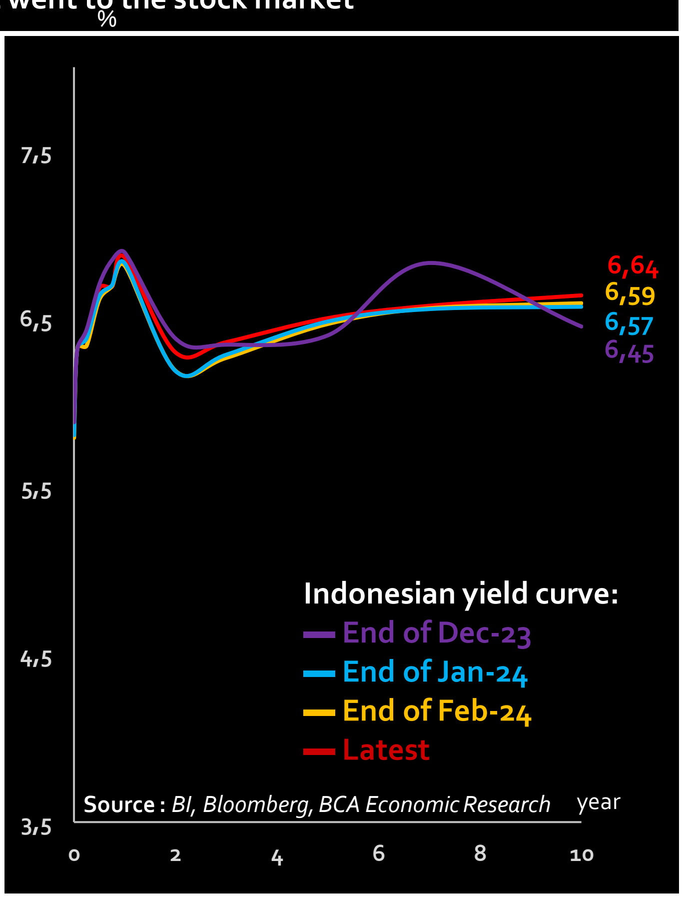




Source: BI, Bloomberg, BCA Economist

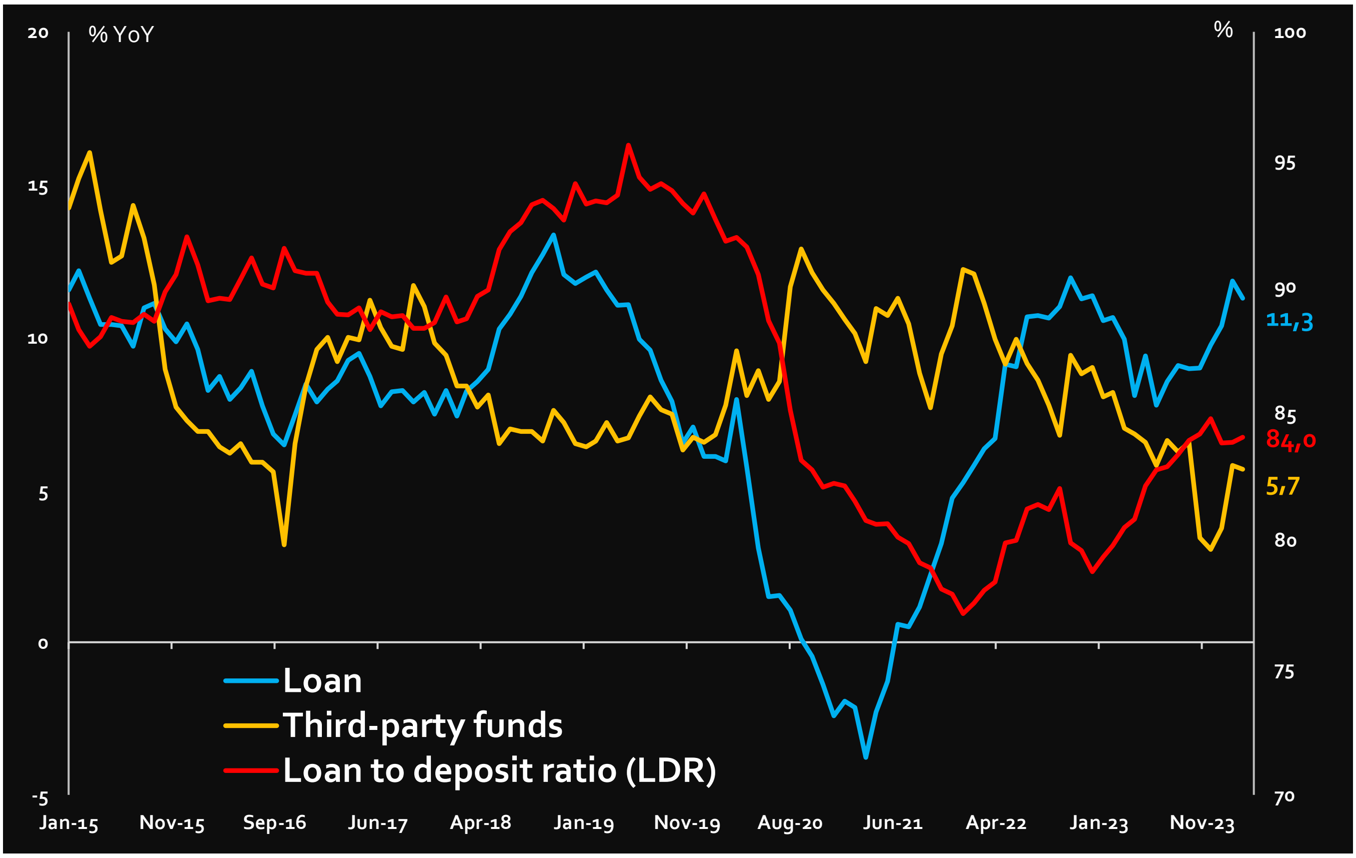
Panel 2. The yield on the SBN market rose slightly as much of the foreign capital inflows observed in January 2024 went to the stock market





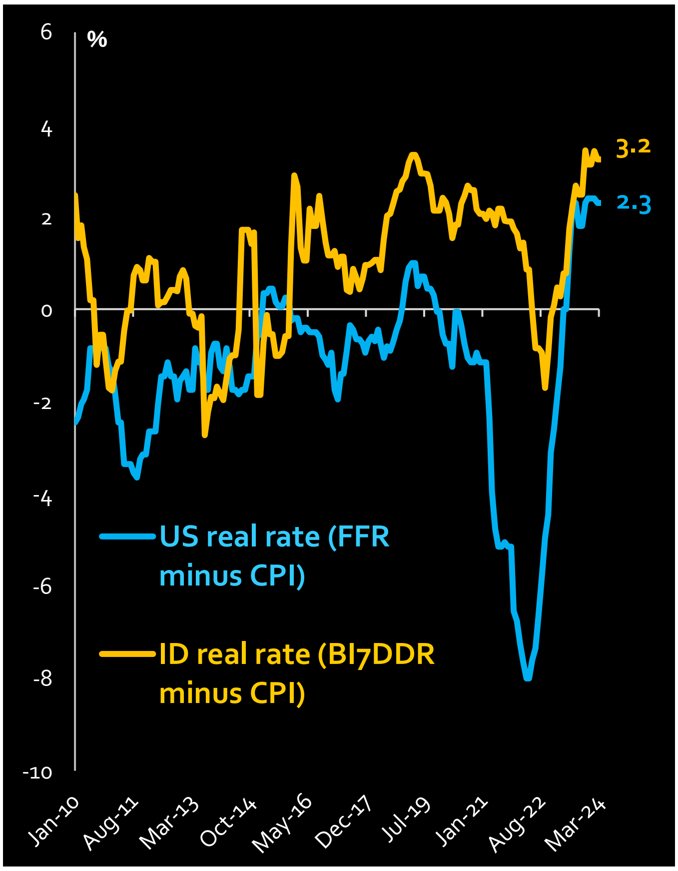
Source: MoF, BI, Bloomberg, BCA Economist

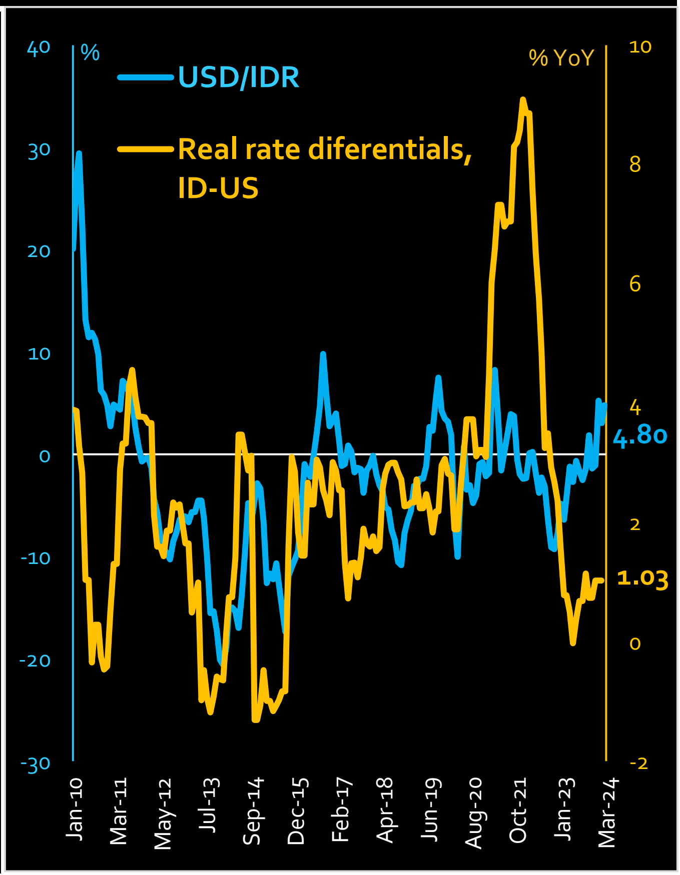
Panel 3. **Loan growth continues to accelerate despite the more restricted deposit growth**



Source: OJK, BI, BCA Economist

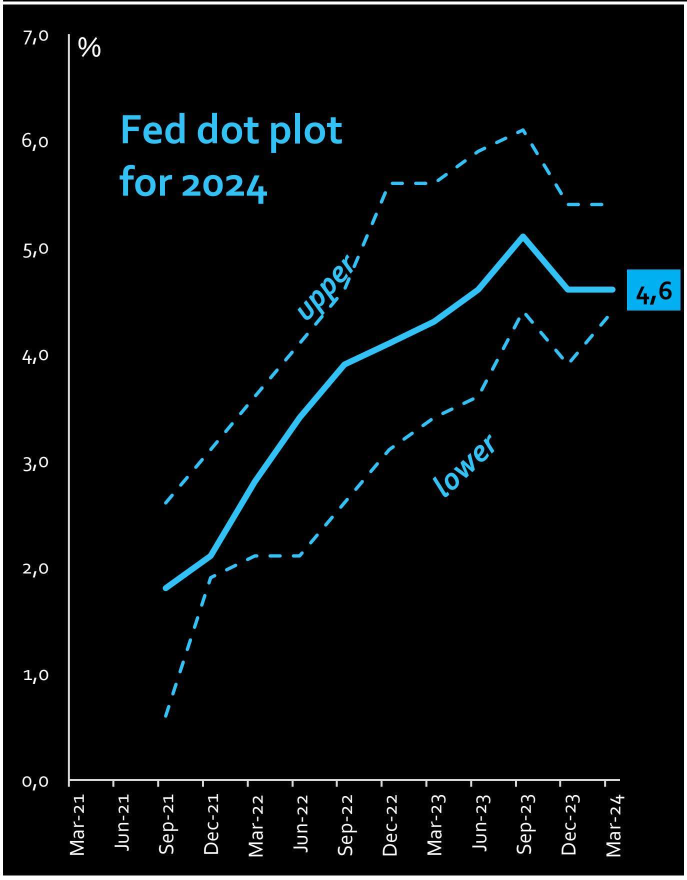
Panel 4. **The now-subdued inflationary pressures widen Indonesia's real rate differentials, but BI would need to stay vigilant given the still apparent risk of food inflation**

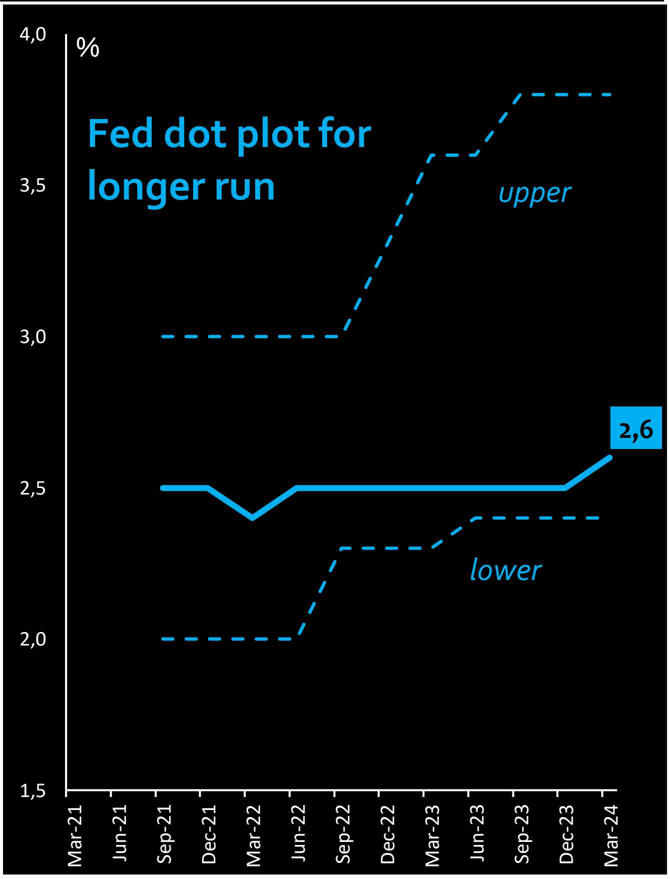




Source: BI, Bloomberg, BCA Economist

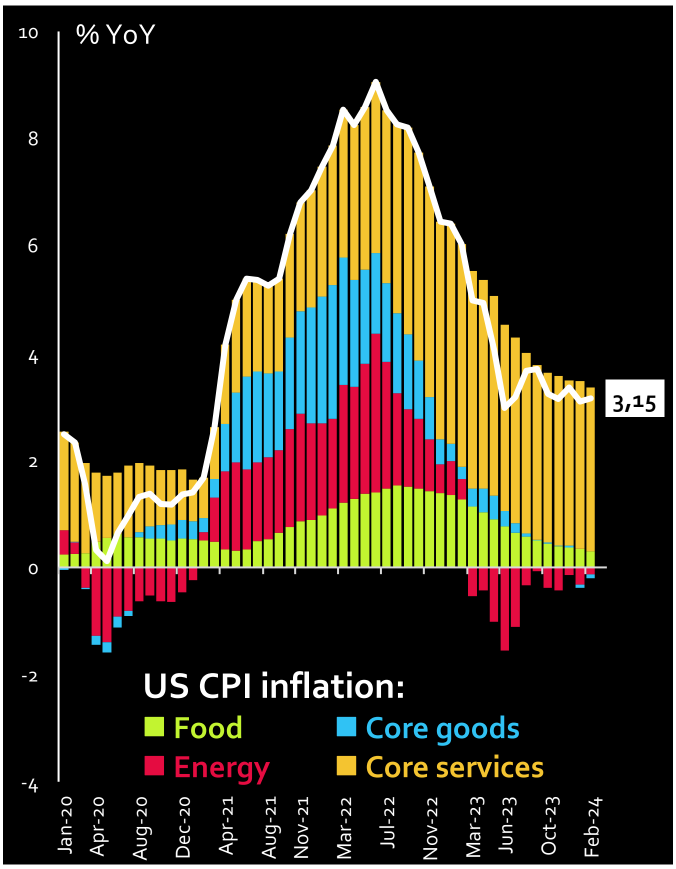
Panel 5. The Fed adopts a lower policy rate in its short-term outlook, but the widening spread in long-term rate expectation shows that the hawkish expectation remains in the picture

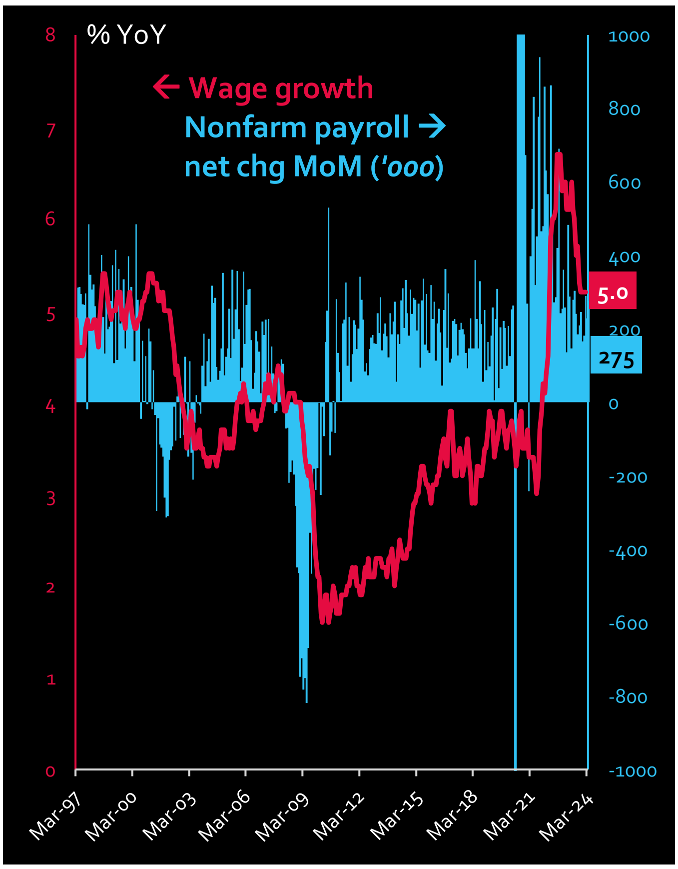




Source: Federal Reserve

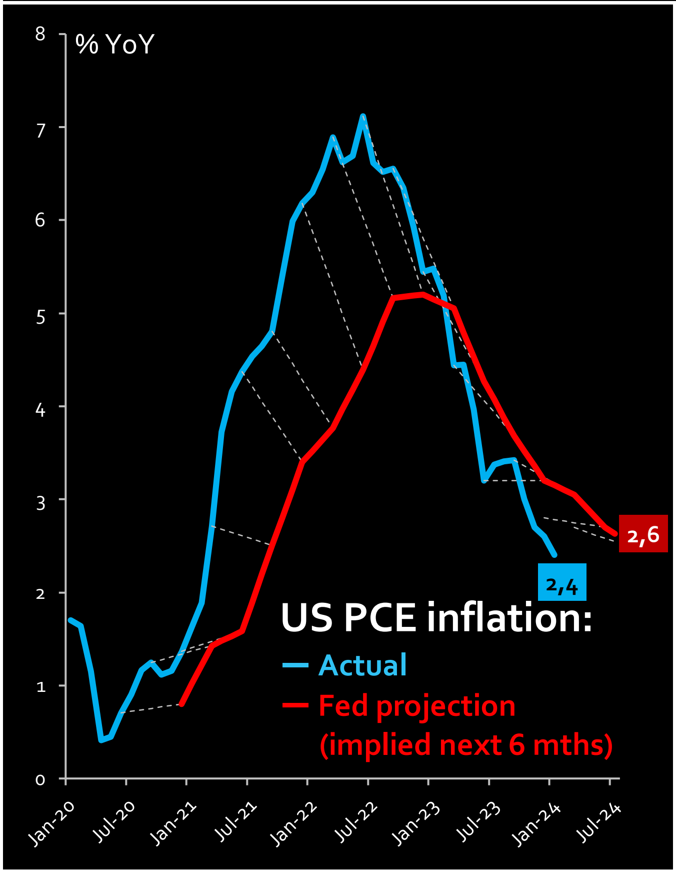
Panel 6. Energy has been the main source of US inflation volatility in recent months

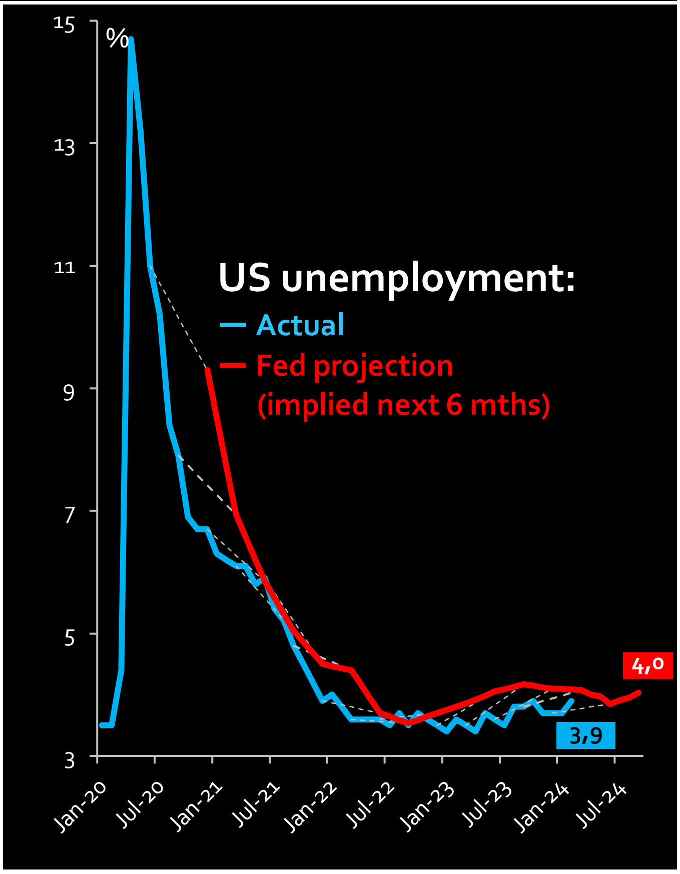




Source: US BLS, Bloomberg

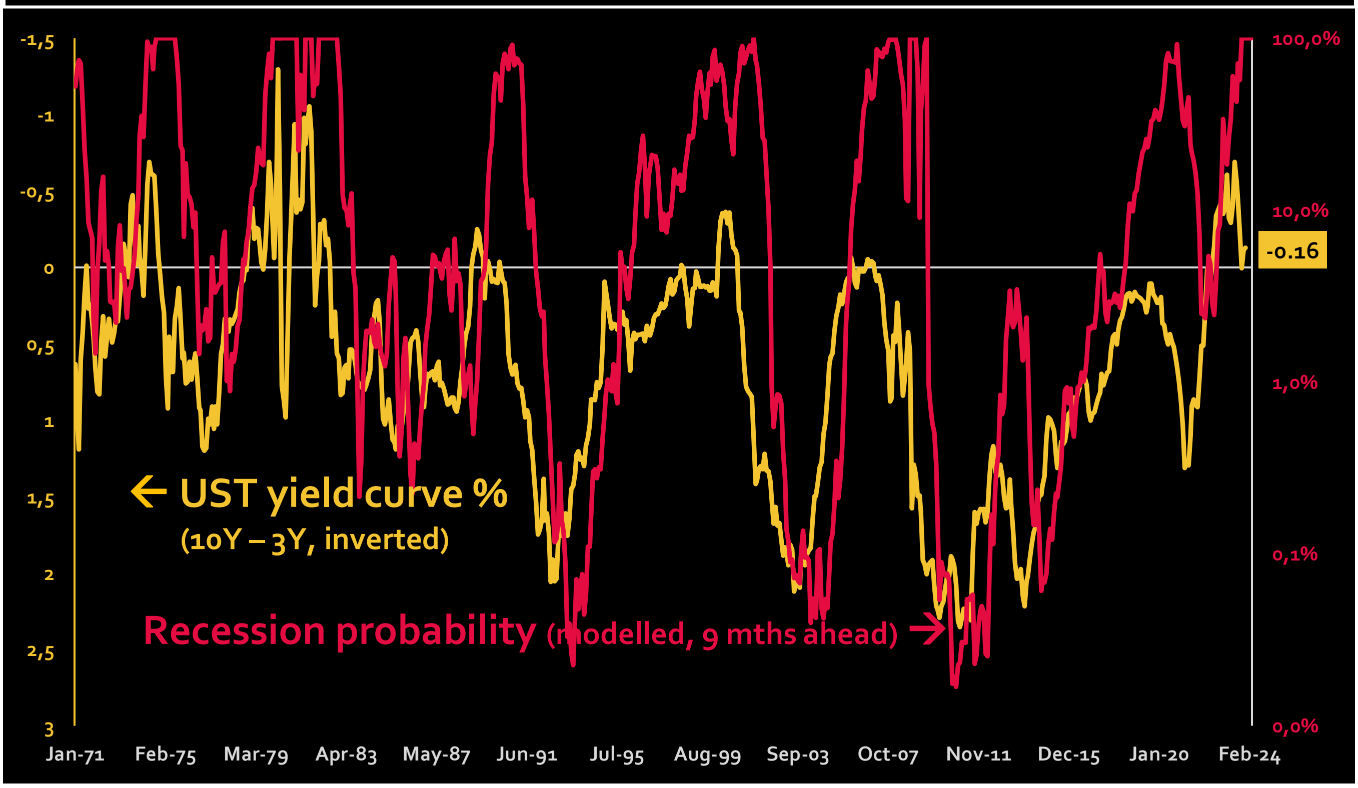
Panel 7. The Fed's recent forecast illustrates the central bank's growing confidence in its ability to deliver the "soft landing" scenario





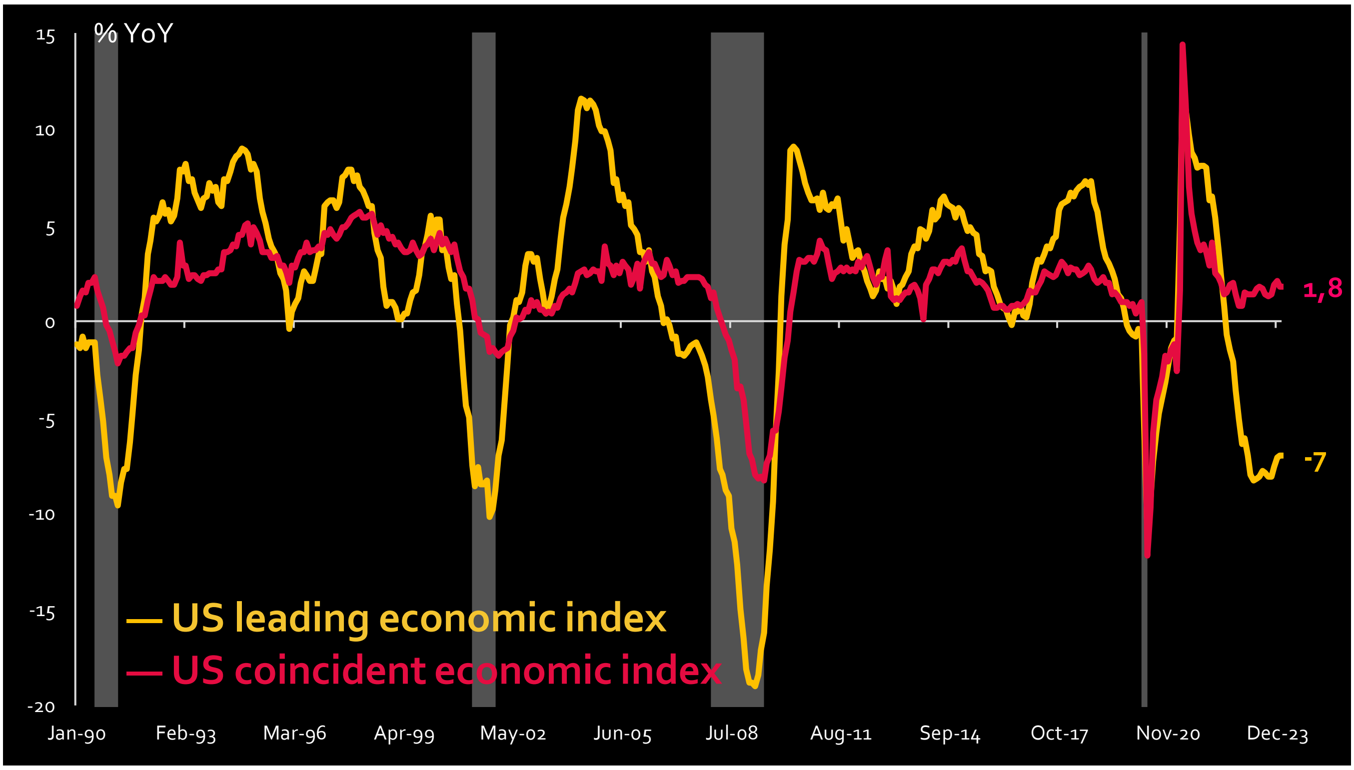
Source: Bloomberg, Federal Reserve

Panel 8. The inverted yield curve may be a product of higher T-bills issuance rather than weaker confidence in the US economic growth



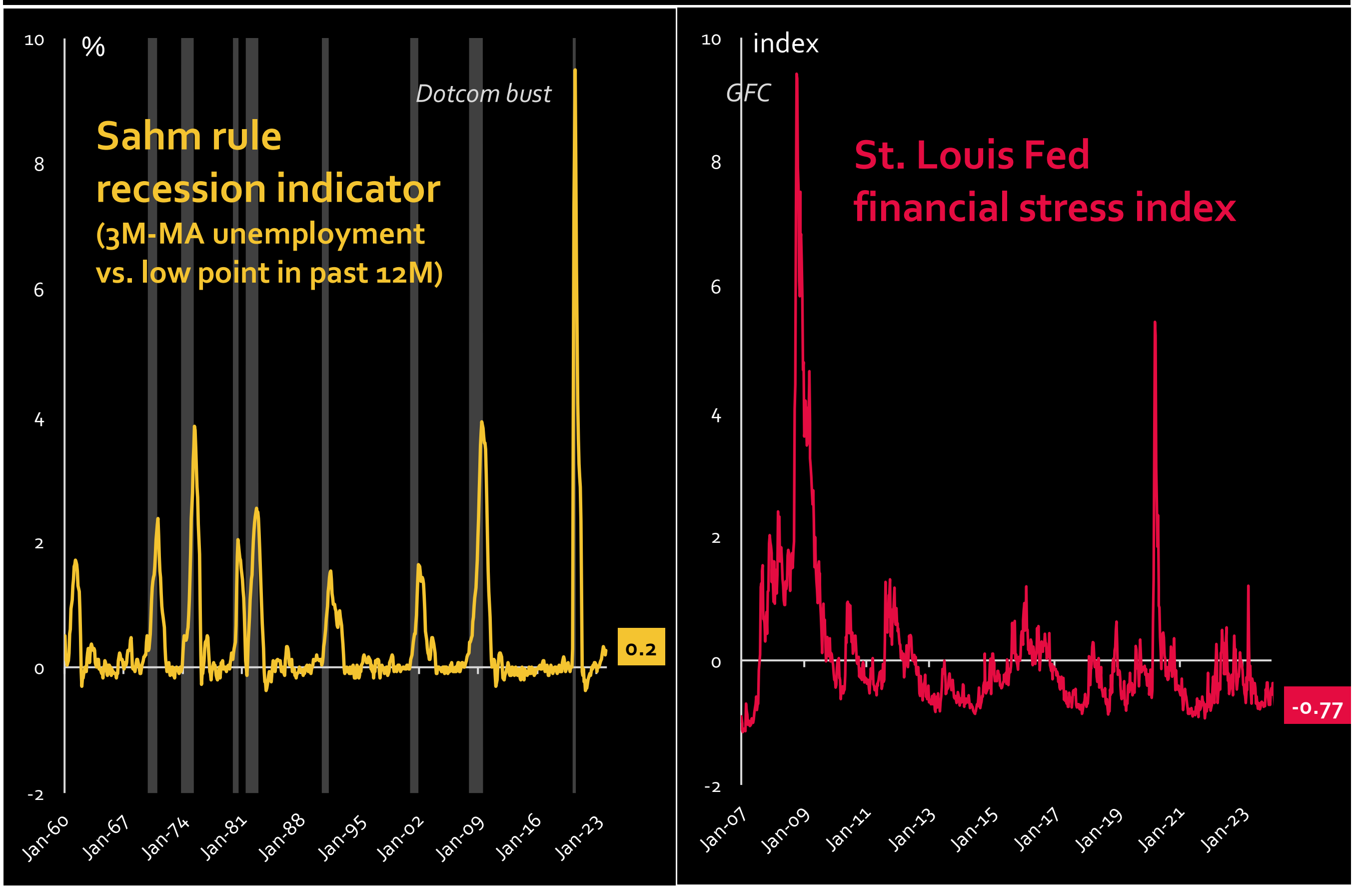
Source: Bloomberg, calculations by BCA Economist

Panel 9. US leading index remains near bottom, but recession still not in view



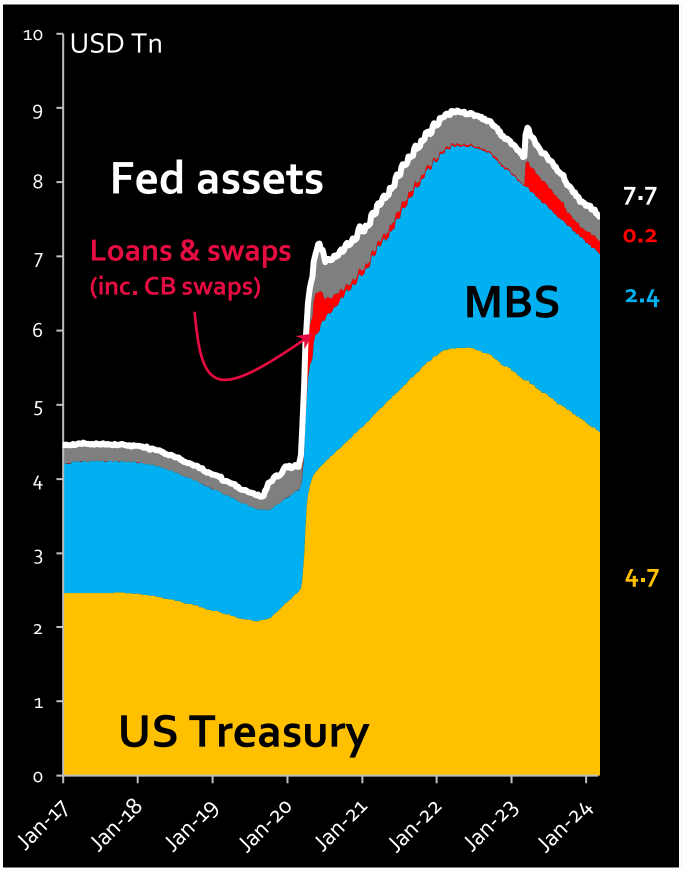
Source: Conference Board

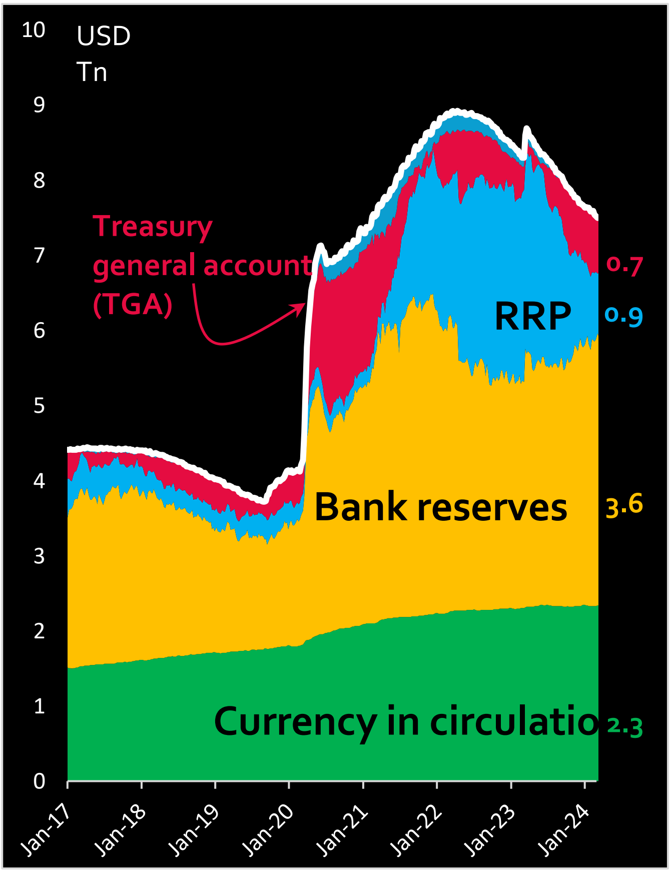
Panel 10. Both on the real and financial sides, signs of impending US recession remain limited



Source: St. Louis Fed

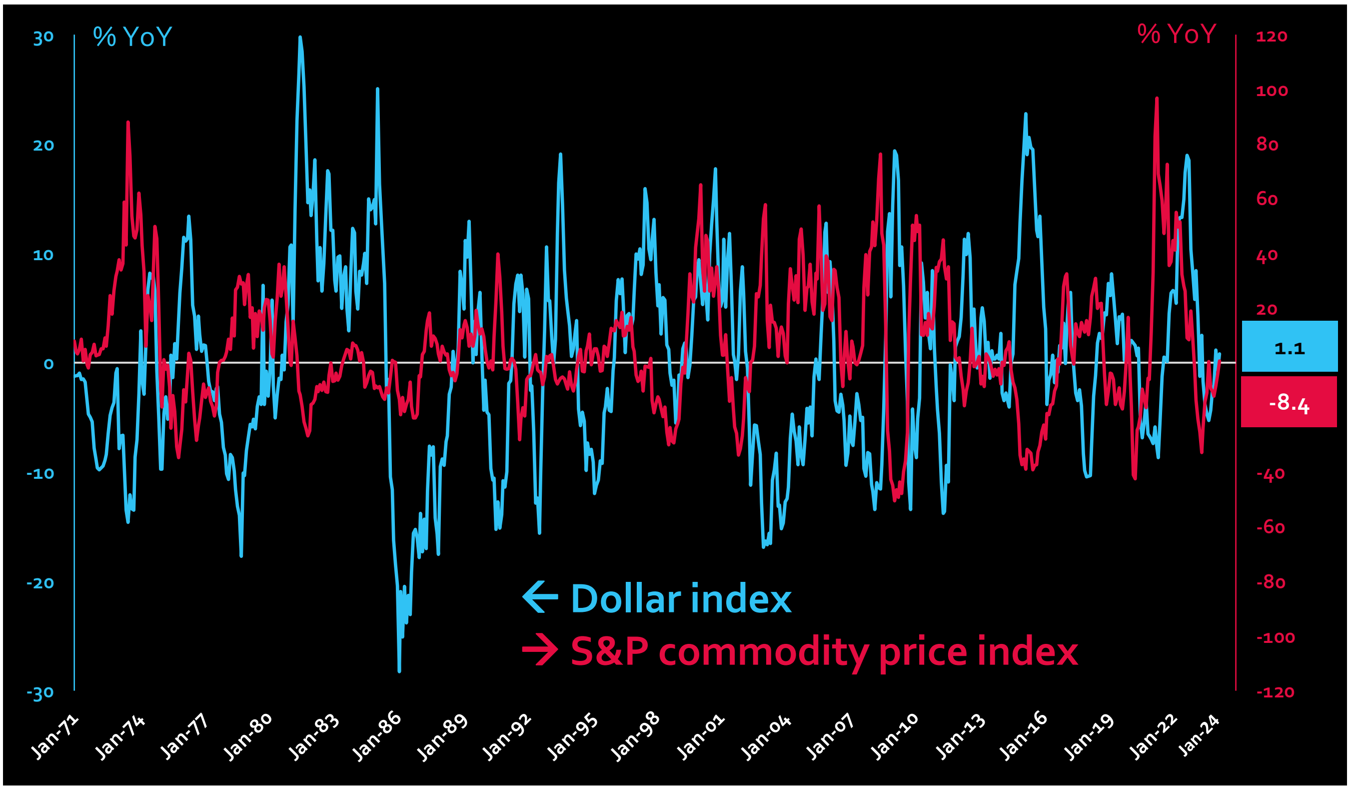
Panel 11. **Declining bill issuance in the upcoming months could help replenish the RRP and allow the Fed to continue QT**





Source: St. Louis Fed

Chart 1. **USD back on the uptrend, a sign of tightening liquidity?**



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Dec-23	2.30
UK	5.25	Dec-23	1.85
EU	4.50	Dec-23	1.90
Japan	-0.10	Jan-16	-2.30
China (lending)	2.50	Dec-23	3.65
Korea	3.50	Nov-23	0.40
India	6.50	Dec-23	1.41
Indonesia	6.00	Nov-23	3.25

Money Mkt Rates	20-Mar	-1 mth	Chg (bps)
SPN (1M)	5.88	5.80	7.6
SUN (10Y)	6.64	6.61	2.7
INDONIA (O/N, Rp)	5.87	5.86	1.4
JIBOR 1M (Rp)	6.65	6.64	1.0

Bank Rates (Rp)	Dec	Nov	Chg (bps)
Lending (WC)	8.86	8.91	-4.93
Deposit 1M	4.76	4.52	24.61
Savings	0.69	0.67	1.94

Currency/USD	20-Mar	-1 mth	Chg (%)
UK Pound	0.782	0.794	1.45
Euro	0.916	0.928	1.35
Japanese Yen	151.3	150.2	-0.69
Chinese RMB	7.198	7.194	-0.06
Indonesia Rupiah	15,715	15,620	-0.60

Capital Mkt	20-Mar	-1 mth	Chg (%)
JCI	7,331.1	7,335.5	-0.06
DJIA	39,512.1	38,628.0	2.29
FTSE	7,737.4	7,711.7	0.33
Nikkei 225	40,003.6	38,487.2	3.94
Hang Seng	16,543.1	16,340.0	1.24

Foreign portfolio ownership (Rp Tn)	Feb	Jan	Chg (Rp Tn)
Stock	3,236.2	3,115.8	120.46
Govt. Bond	837.1	841.9	-4.76
Corp. Bond	9.5	10.4	-0.89

Trade & Commodities	20-Mar	-1 mth	Chg (%)
Baltic Dry Index	2,284.0	1,610.0	41.9
S&P GSCI Index	577.1	559.0	3.3
Oil (Brent, $/brl)	86.0	83.5	3.0
Coal ($/MT)	126.6	123.4	2.6
Gas ($/MMBtu)	1.58	1.55	1.9
Gold ($/oz.)	2,186.4	2,013.6	8.6
Copper ($/MT)	8,818.8	8,409.2	4.9
Nickel ($/MT)	17,289.5	16,112.8	7.3
CPO ($/MT)	921.5	822.6	12.0
Rubber ($/kg)	1.70	1.53	11.1

External Sector	Feb	Jan	Chg (%)
Export ($ bn)	19.31	20.49	-5.79
Import ($ bn)	18.44	18.49	-0.29
Trade bal. ($ bn)	0.87	2.00	-56.64
Central bank reserves ($ bn)*	144.0	145.1	-0.72

Prompt Indicators	Feb	Jan	Nov
Consumer confidence index (CCI)	123.1	125.0	123.6
Car sales (%YoY)	-18.8	-26.1	-7.5
Motorcycle sales (%YoY)	-2.9	-3.7	-2.8

Manufacturing PMI	Feb	Jan	Chg (bps)
USA	52.2	50.7	150
Eurozone	46.5	46.6	-10
Japan	47.2	48.0	-80
China	50.9	50.8	10
Korea	50.7	51.2	-50
Indonesia	52.7	52.9	-20

Source: Bloomberg, BI, BPS
Notes:
*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

	2019	2020	2021	2022	2023	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0
GDP per Capita (US$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	5.50
USD/IDR Exchange Rate (end of the year)**	13,866	14,050	14,262	15,568	15,397	16.037
Trade Balance (US$ billion)	-3.2	21.7	35.3	54.5	37.0	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	-0.1	-0.5

*Estimated number

** Estimation of Rupiah's fundamental exchange rate

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