

FOMC:

A rave spoiler for a (potential) box-office bomb

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Executive Summary

- The Fed keeps its policy rate at 5.25-5.50%, opening the door for a possibility of a Sep-2024 rate cut. However, the still-wide gap between the Fed's rate cut signal and the market's expectation may fuel volatility in periods ahead.
- The ongoing rotation to safe assets and peak FFR cut expectation shields the US market from the reversing Yen carry trade, but the same thing cannot be said about the Asian market.
- Limited foreign inflows and the Rupiah's worsening fundamental means that it might be better for BI to prioritise exchange rate stability over more growth.

- The Fed Funds Rate (FFR) remains at 5.25-5.50%, the Fed introduced no changes to its policy mix (QT continues while the 2% inflation target remains the Fed's lodestar), yet there is no denying that Mr Market is walking out of yesterday's FOMC meeting with a spring on his heels.
- In his official statement, **Fed Chair Jerome Powell has toned down the central bank's singular focus on fighting inflation**, highlighting recent developments in the US labour market as a risk to the "maximum employment" part of its dual mandate. The four-paragraph official statement puts a smile on the market, leading to them sending the S&P 500 1.6% higher following the meeting (2.6% for the tech-heavy Nasdaq composite).
- During the Q&A session, Chairman Powell also declared that it is apolitical for the Fed to use its tool before the US presidential election – a statement which shifted the question circulating in the market from "whether" the Fed will cut the FFR in September 2024 to "how much". The FFR futures market is now indicating a 118.1% chance for a 25-bps FFT cut in September 2024 (as of writing), with numbers higher than 100% indicating that the betting is now on for a 50-bps rate cut for the next FOMC meeting.
- However, just as the rise of review aggregators aggravates one's perceptions of a film, **the increasingly popular FFR futures market also intensifies the swing in the market's interest rate expectation**, as many analysts look to the FFR futures market to satisfy their confirmation bias. The FFR futures market, as widely known, projected a 150-175 bps rate cut early in the year when the Fed was still signalling a 75-bps rate cut for 2024. And now, FFR futures are projecting a 50-75 bps rate cut, while the Fed is yet to change its 25-bps rate cut call. **Mr Market, as it seems, could face another disappointment.**
- Alas, **it is unclear that the Fed needs to signal faster rate cuts.** While growth momentum slows, the US is still some ways away from a recession, while the 206k nonfarm payroll number in June 2024 (vs. 190k forecast) suggests that a cooling US labour market remains an implausible risk despite recent upticks in the unemployment level.

- **The most convincing argument against a 50-75 bps FFR cut scenario, of course, is the 0.6% gap between the Fed's favourite inflation measure (the PCE inflation) and its 2.0% YoY inflation target** – a gap that FOMC members themselves (according to the latest summary of economic projections) do not expect to dissipate in the short term. Powell had, of course, signalled that the Fed does not need to wait for 2.0% inflation to start cutting, but there is reasonable doubt if that remains a reasonable inflation rate in the long-term, under current circumstances.
- Sustained domestic demand, along with inflationary consequences of the recalibrating global supply chain and import tariffs (which may move even higher, depending on the election outcome) have raised the neutral rate of interest in the US, limiting the floor in which the Fed could lower its policy rate, unless, the central bank decided to shift its goalpost (that is if the Fed somehow announce that a 2% inflation target is no longer suitable in the current global macro condition, which is unlikely to happen under the current administration).
- Apart from the sizable expectation gap between the Fed and the market, there are more reasons to add to our scepticism that US financing conditions will ease significantly over the remainder of the year compared to its current levels. Less than 24 hours before Chairman Powell hit the airwaves, the Bank of Japan decided to increase its policy rate by another 15 bps to 0.25%, sending the JPY/USD below 150 for the first time since the end of Q1 2024 (+1.83% following the BoJ meeting). **Governor Ueda's policy normalisation agenda could prompt further unwinding of the Yen carry trade**, potentially keeping yields on the UST market elevated.
- This vicious Yen carry trade unwinding scenario may not yet be evident outside of the academic realm. Indeed, the benchmark UST yield has continued to decline despite the BoJ's surprise tightening, with the 2Y UST yield now at levels unseen since early January 2024. However, this does not mean that the risk of Japanese investors selling off their assets can safely be ignored. **The market is currently in a peak rate cut mania, and the uncertain global growth outlook is also driving up the demand for safe-haven assets**, including gold and UST. Coupled with the subdued Q3 2024 Treasury refunding announcement (QRA), **the current conditions are sparking demand for US treasuries, outweighing the risk of Japanese investors returning home.**
- **None of these yield-suppressing factors, however, are present in financial markets across Asia.** The Japanese government bond market is arguably still the only safe-haven market in Asia, excluding the Asian market from the ongoing risk-off rotation at the same time when Japanese investors are selling their foreign assets. Luckily, **the rise of the global semiconductor trade and the relocation of supply chains out of China are sustaining growth momentum in some Asian economies, granting their central bankers the degree of policy independence needed to attract foreign inflows to their economies.**
- Unfortunately, the reality now facing Bank Indonesia seems to look a tad different than its Asian counterparts. **Despite the peaking expectations of easing global financial conditions, foreign portfolio inflows into domestic bond and stock markets remain**

"Sustained domestic demand and entrenched inflation risks may reduce the Fed's urgency to signal faster rate cuts"

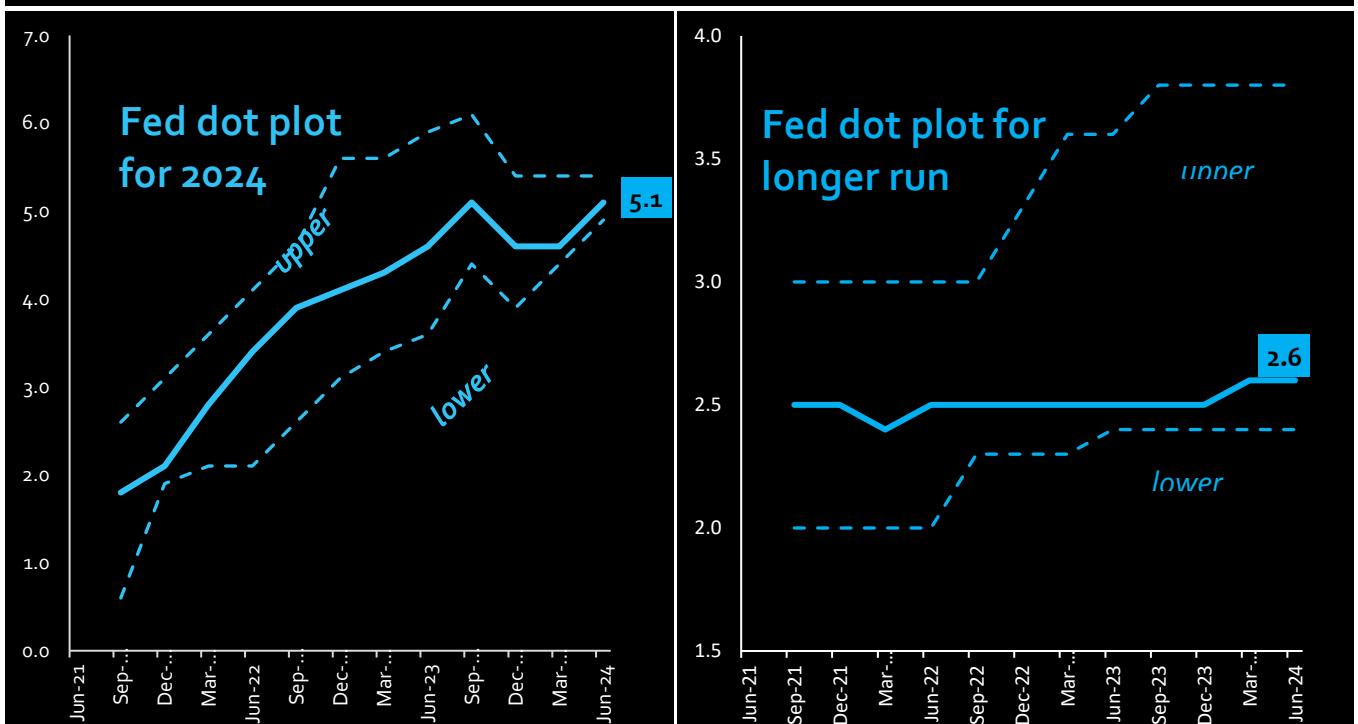
limited, while foreign inflows to SRBI have also weakened in the last two weeks as BI tries to lower yields at the latest auction.

- At the same time, **the reportedly slowing manufacturing activities in China are bad news for the outlook on Indonesia's CA balance**, while the higher demand for external financing due to the sizable gap in the domestic net bank balance may also pose a threat to the Rupiah's value. **It is fair to say, then, that the Indonesian financial market may still face rainy days in the months ahead.**

"Limited foreign inflows and worsening CA outlook means that it might be better for BI to err on the side of exchange rate stability"

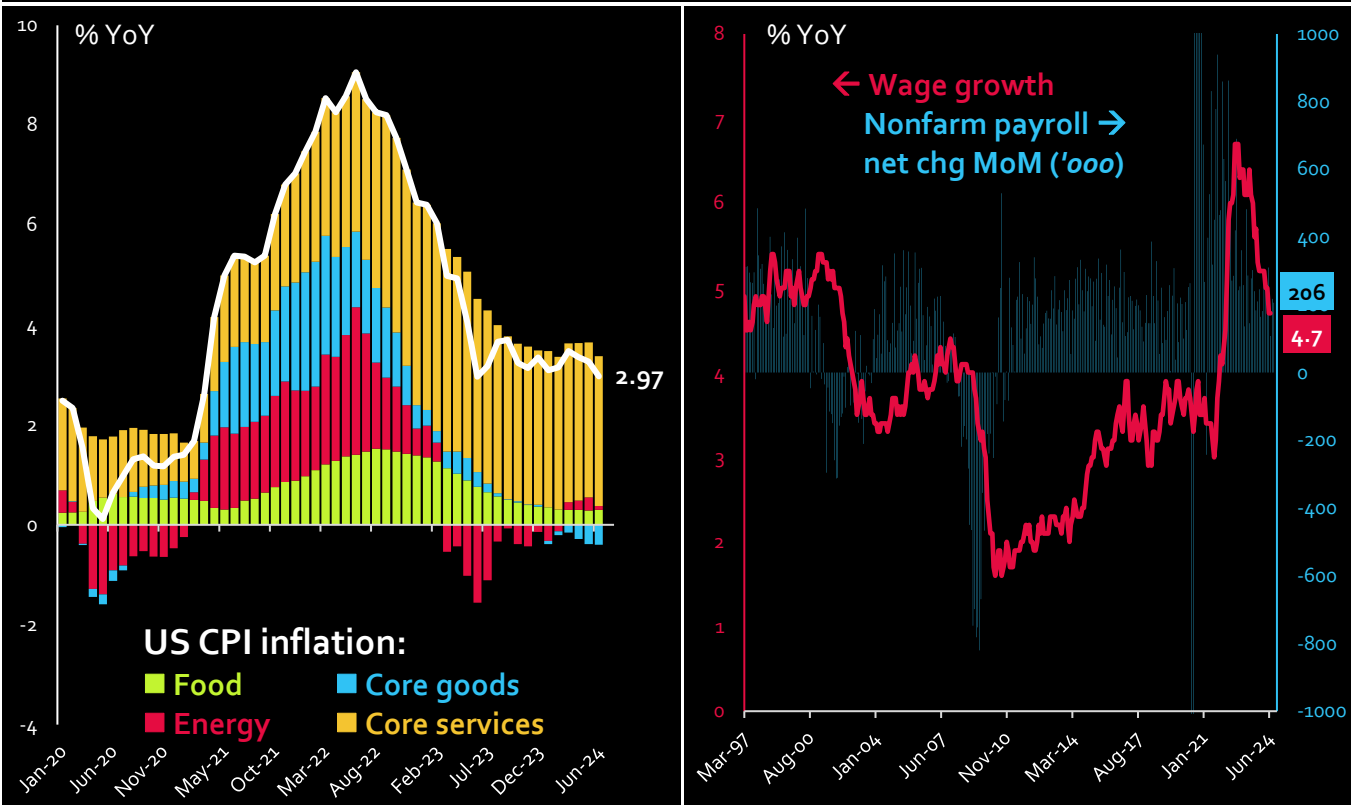
- Ergo, despite the equally justifiable need to cut its policy rate (such as the slowing household consumption and the soft 2.13% YoY inflation in July 2024), **the Rupiah's currently worsening fundamental means that it might be better for BI to err on the side of exchange rate stability.**
- The government's decision to lower SBN issuance in H2 2024 will also keep SBN yields stable, lessening the urgency for BI to lower its policy rate to mitigate the risk that may come from an increase in the government's debt burden. After all, the Fed's long-awaited rate cut action may turn out to be the lesser version of what the market expected, which underlines our call for a limited 0-25 bps BI-rate cut in 2024.

Panel 1. The FFR futures market is pointing to a 50-75 bps rate cut, but it might be better to wait for the Fed to provide another signal after the Jackson Hole conference



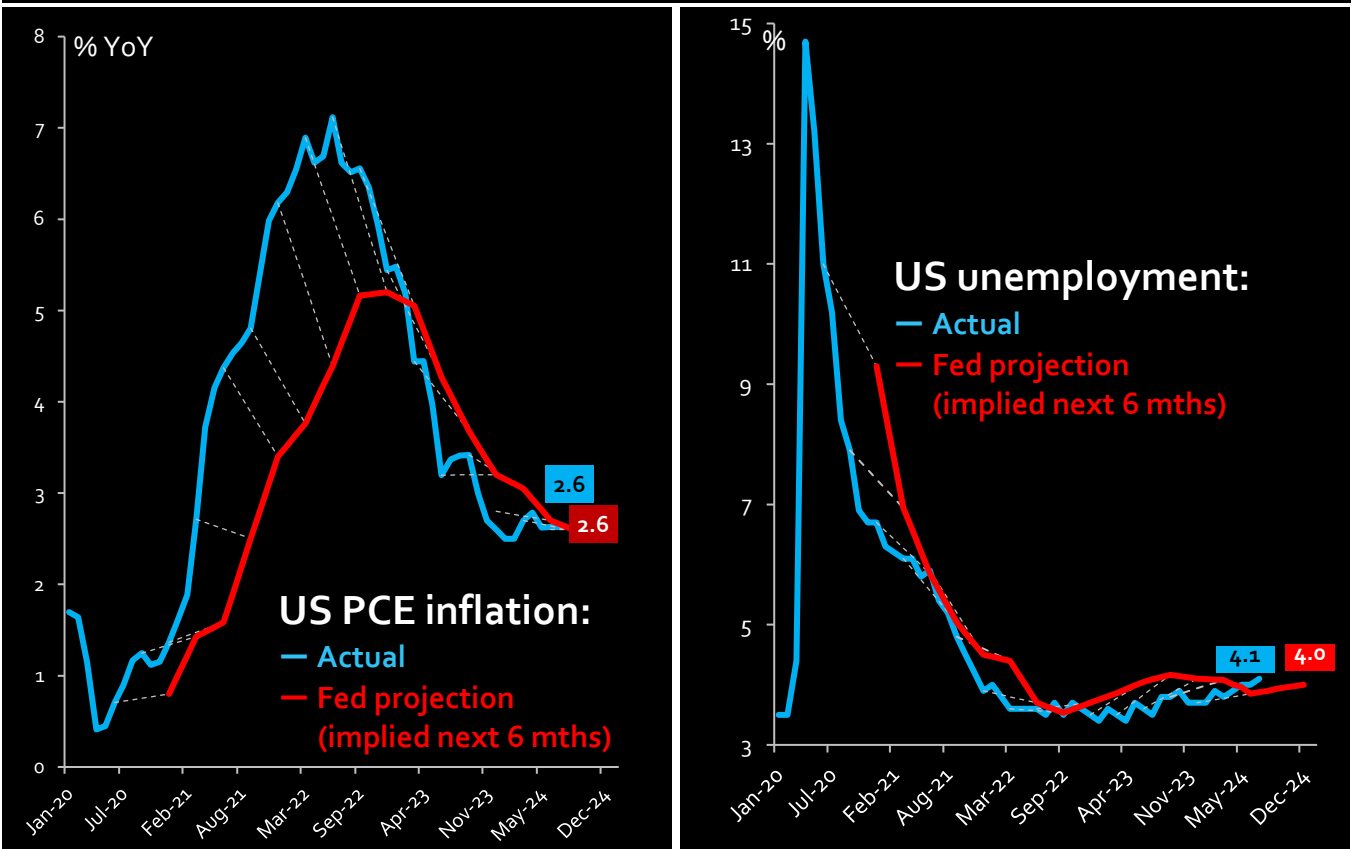
Source: Federal Reserve

Panel 2. FOMC officials are changing their views on the US labour market as it stopped driving inflation upwards



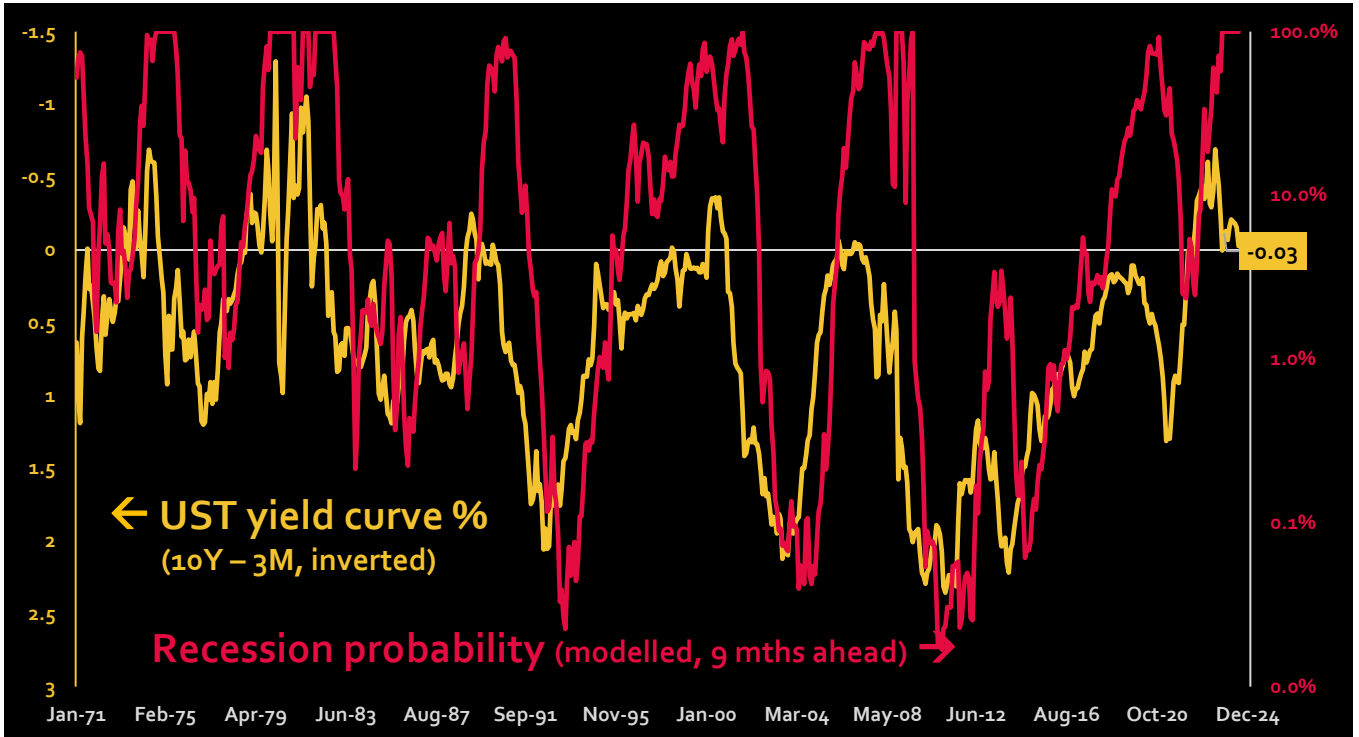
Source: US BLS, Bloomberg

Panel 3. The Fed was caught flat-footed in 2021-22, but recently its projections for inflation and unemployment have been closer to the mark



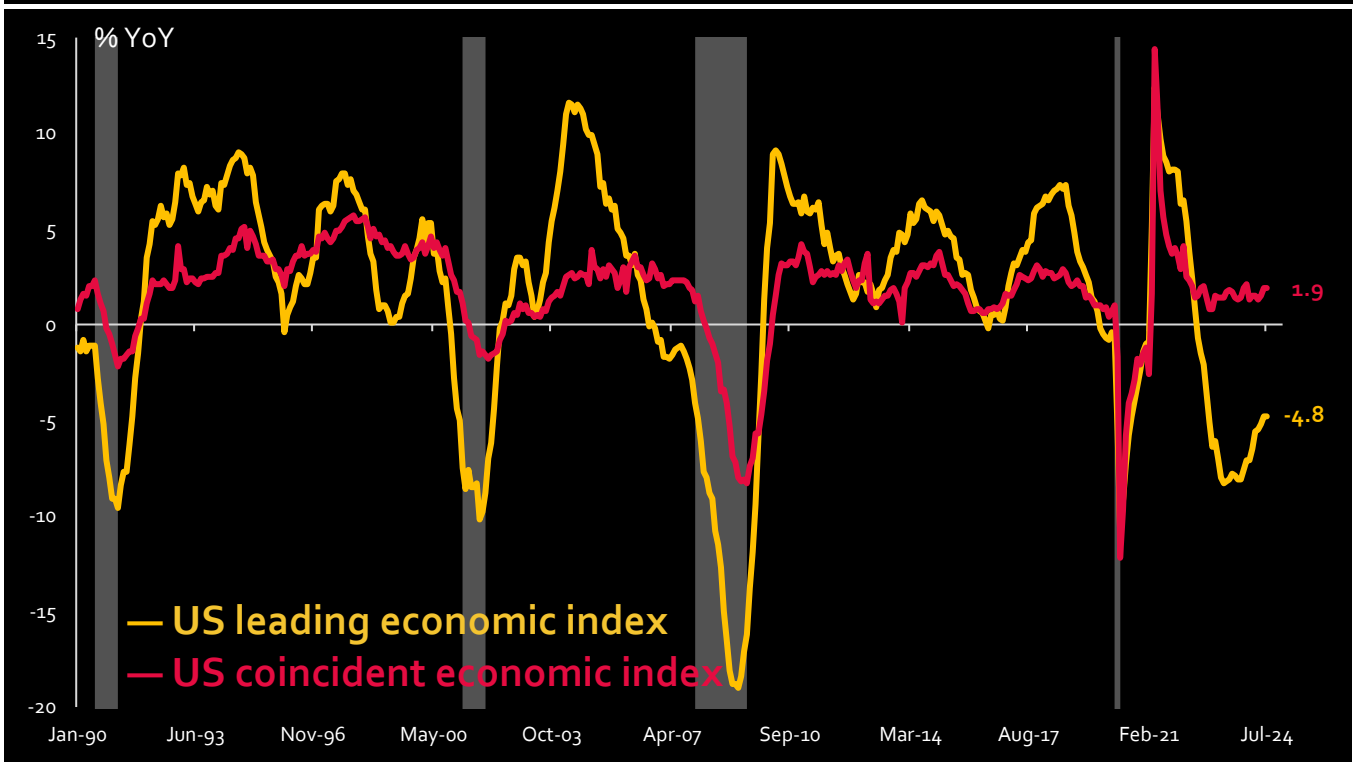
Source: Bloomberg, Federal Reserve

Chart 3. Normalising T-bills issuance and the higher demand for safe-haven assets pushed the yield on short-term US treasuries



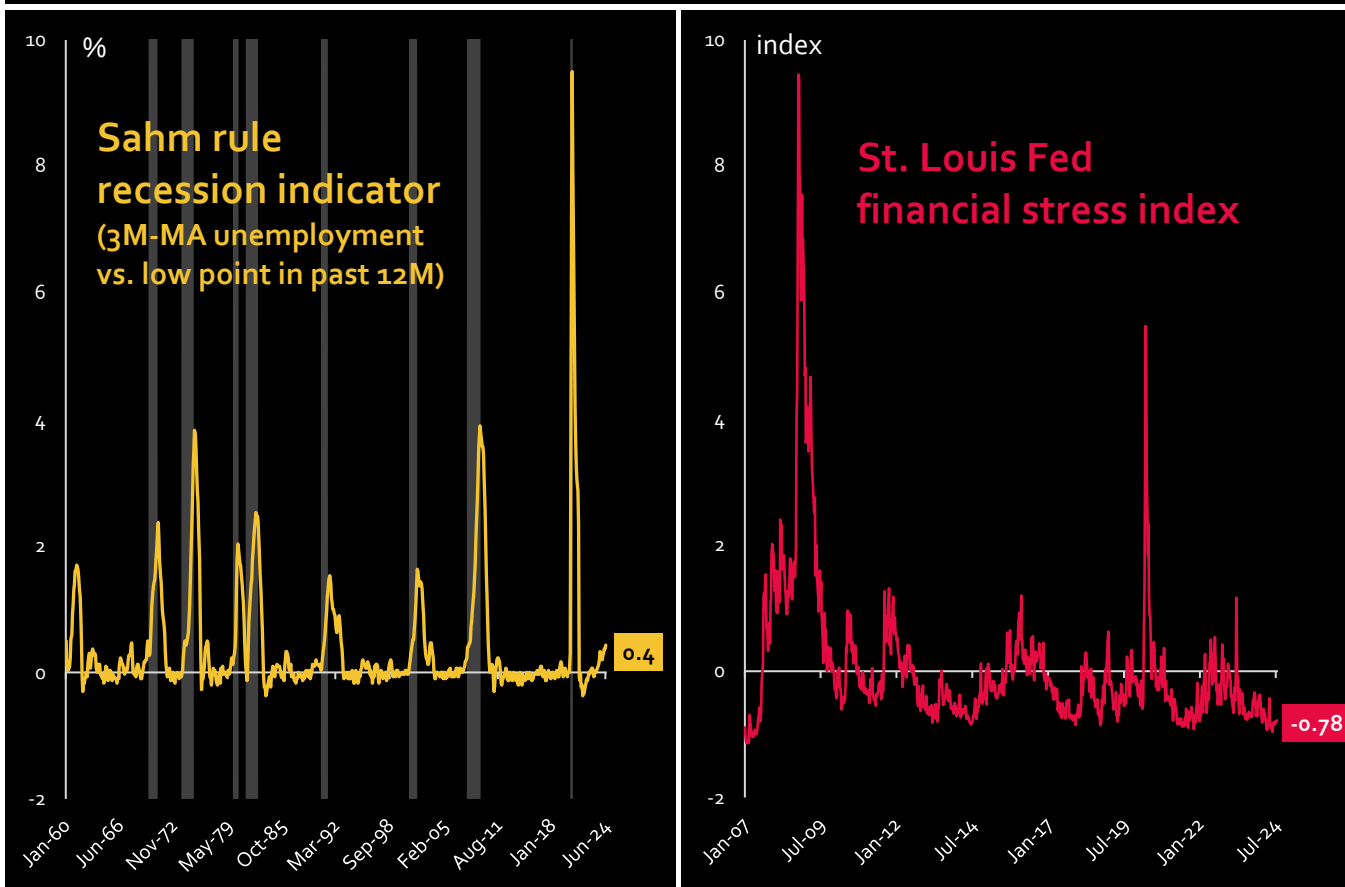
Source: Bloomberg, calculations by BCA Economist

Chart 4. Recession fears are somehow creeping in in the US despite the improving LEI index



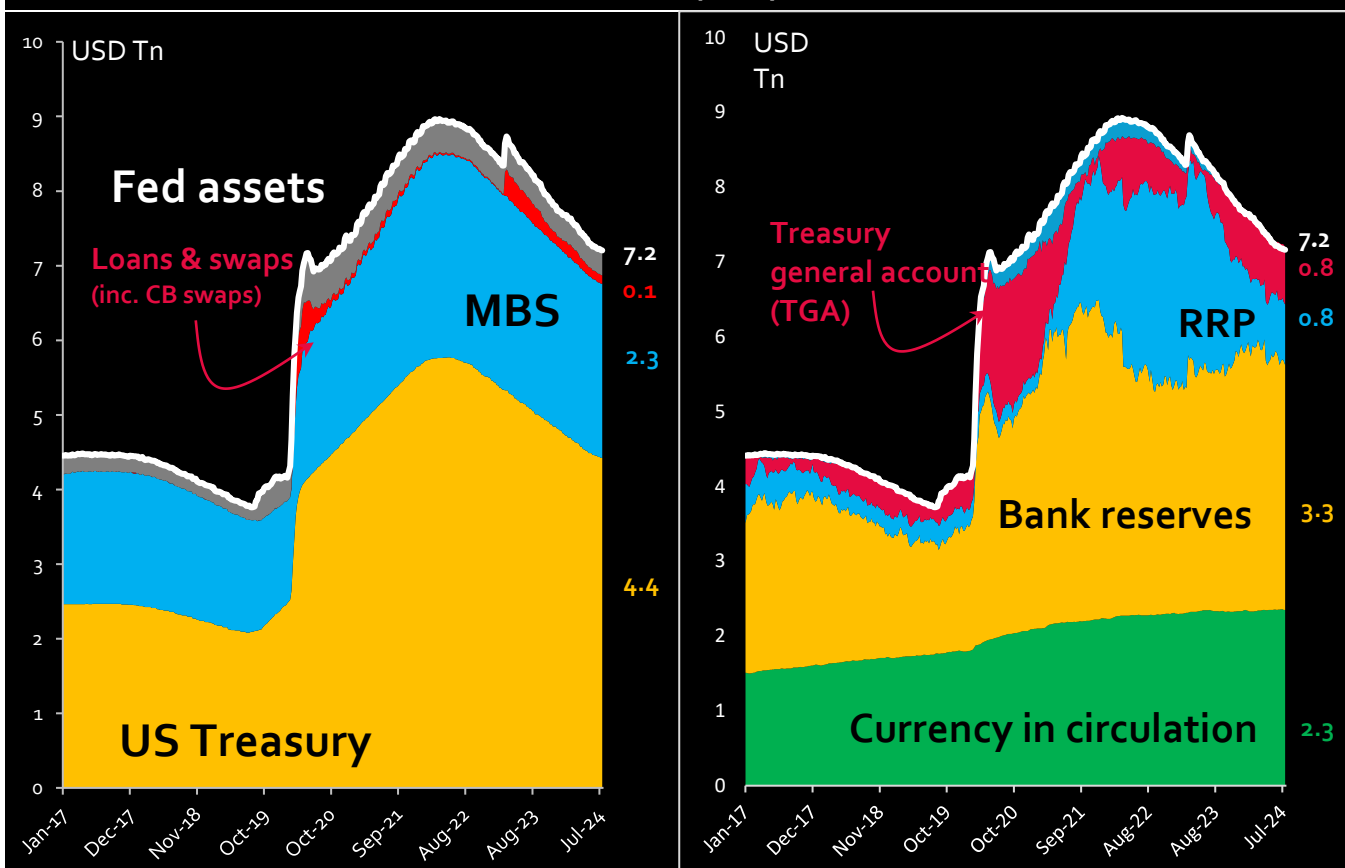
Source: Conference Board

Panel 4. Signs of impending recession are still limited, job loss momentum has not accelerated



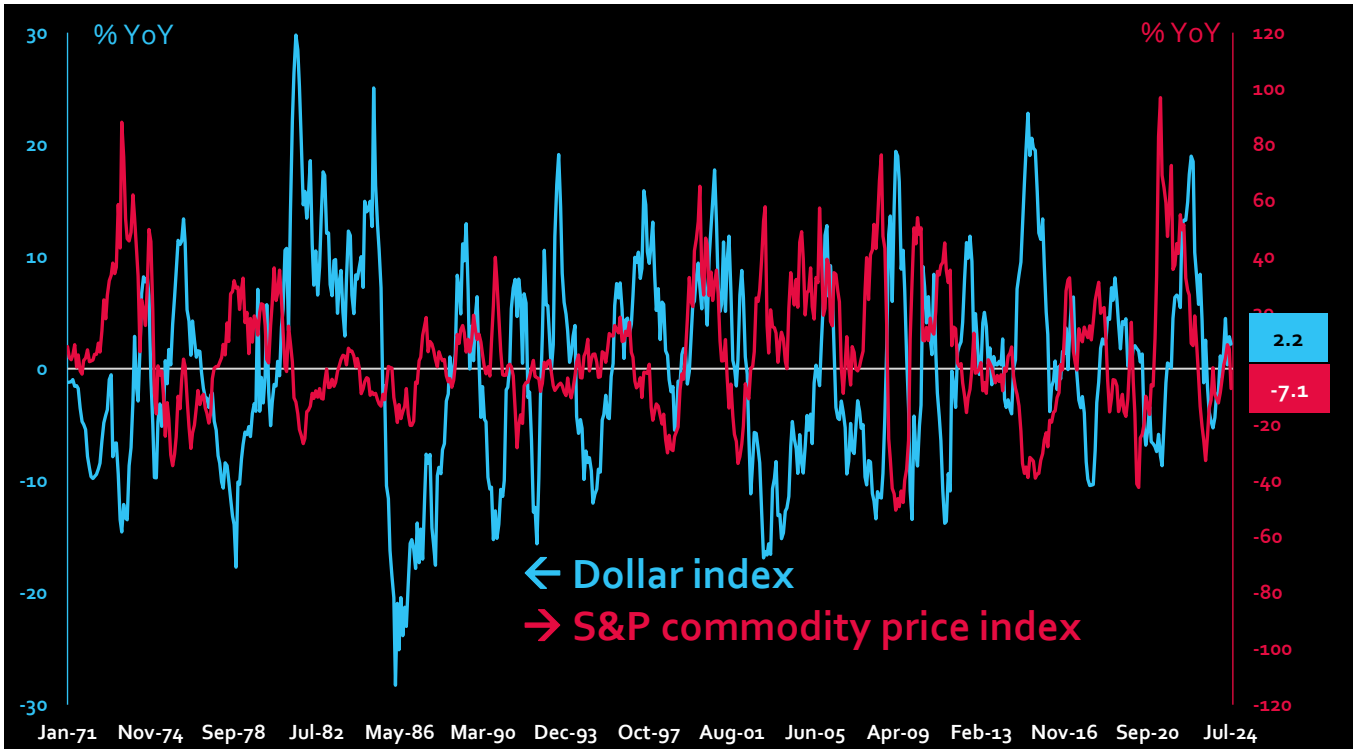
Source: St. Louis Fed

Panel 5. The Fed is slowing down its quantitative tightening (QT) with the still-enlarged balance sheet, but sufficient liquidity buffers are all around



Source: St. Louis Fed

Chart 5. The USD is moving out of its peak, but the global commodity market remains soft due to slowing manufacturing activities in China



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	1-Aug	-1 mth	Chg (%)
US	5.50	Jul-23	2.50	Baltic Dry Index	1,668.0	2,158.0	-22.7
UK	5.00	Aug-23	3.00	S&P GSCI Index	544.4	584.6	-6.9
EU	4.25	Jul-23	1.65	Oil (Brent, \$/brl)	79.5	86.6	-8.2
Japan	-0.10	Jan-16	-2.90	Coal (\$/MT)	150.4	139.2	8.0
China (lending)	2.30	Aug-23	4.15	Gas (\$/MMBtu)	1.93	2.21	-12.5
Korea	3.50	Jan-23	0.90	Gold (\$/oz.)	2,446.3	2,331.9	4.9
India	6.50	Feb-23	1.42	Copper (\$/MT)	8,923.9	9,482.8	-5.9
Indonesia	6.25	Apr-24	4.12	Nickel (\$/MT)	16,022.9	17,096.0	-6.3
Money Mkt Rates	1-Aug	-1 mth	Chg (bps)	CPO (\$/MT)	875.3	856.9	2.1
SPN (1M)	5.88	5.80	7.6	Rubber (\$/kg)	1.68	1.66	1.2
SUN (10Y)	6.87	7.06	-18.3	External Sector	Jun	May	Chg (%)
INDONIA (O/N, Rp)	6.25	6.15	9.3	Export (\$ bn)	20.84	22.32	-6.65
JIBOR 1M (Rp)	6.90	6.90	0.0	Import (\$ bn)	18.45	19.40	-4.89
Bank Rates (Rp)	May	Apr	Chg (bps)	Trade bal. (\$ bn)	2.39	2.92	-18.30
Lending (WC)	8.86	8.85	1.37	Central bank reserves (\$ bn)*	140.2	139.0	0.87
Deposit 1M	4.68	4.65	2.54	Prompt Indicators	Jun	May	Apr
Savings	0.67	0.68	-1.07	Consumer confidence index (CCI)	123.3	125.2	127.7
Currency/USD	1-Aug	-1 mth	Chg (%)	UK Pound	0.785	0.791	0.70
UK Pound	0.785	0.791	0.70	Euro	0.927	0.931	0.47
Euro	0.927	0.931	0.47	Japanese Yen	149.4	161.5	8.10
Japanese Yen	149.4	161.5	8.10	Chinese RMB	7.245	7.268	0.32
Chinese RMB	7.245	7.268	0.32	Indonesia Rupiah	16,235	16,322	0.54
Indonesia Rupiah	16,235	16,322	0.54	Capital Mkt	1-Aug	-1 mth	Chg (%)
Capital Mkt	1-Aug	-1 mth	Chg (%)	Manufacturing PMI	Jul	Jun	Chg (bps)
JCI	7,326.0	7,139.6	2.61	USA	49.6	51.6	-200
DJIA	40,348.0	39,169.5	3.01	Eurozone	45.8	45.8	0
FTSE	8,283.4	8,166.8	1.43	Japan	49.1	50.0	-90
Nikkei 225	38,126.3	39,631.1	-3.80	China	49.8	51.8	-200
Hang Seng	17,305.0	17,718.6	-2.33	Korea	51.4	52.0	-60
Foreign portfolio ownership (Rp Tn)	Jun	May	Chg (Rp Tn)	Indonesia	49.3	50.7	-140
Stock	3,273.1	3,115.0	158.05				
Govt. Bond	805.6	807.0	-1.38				
Corp. Bond	8.2	8.2	-0.06				

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	2.87
BI 7 day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00
USD/IDR Exchange Rate (end of year)**	13,866	14,050	14,262	15,568	15,397	16,172
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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