Be careful now that the punchbowl is out

26 August 2024

Lazuardin Thariq Hamzah
lazuardin_hamzah@bca.co.id

Barra Kukuh Mamia
barra_mamia@bca.co.id

Scan for the link to our report depository

Summary

- Excerpts from the Jackson Hole Conference show that the Fed is more likely than not to start cutting the FFR in the next FOMC meeting, bolstering sentiment in risky markets as USD liquidity is widely anticipated to improve.
- However, the Fed may execute its rate-cut campaign gradually, given the risk of returning inflation that may arise from the fiscal cycle and the commodity price channel.
- The ongoing rally in the domestic market opens up space for BI to adjust its policy rate, but the central bank may remain prudent as a marked improvement in the Rupiah's fundamentals remain scant.

- The Fed and other global central bankers hunkered down at the Jackson Lake Lodge last week, and the result was just what the market expected. Fed chairman Jerome Powell delivered his outlook on the economy following the conference, noting that the US job market has cooled considerably and that the tome for the Fed to lower its policy rate is already at hand.
- Many analysts have also noted Chairman Powell's failure to signal the pace of the upcoming rate cut cycle, which some in the market interpreted as the Fed keeping the door open for more aggressive rate cuts. At last, it seems, the Fed caves into the market's demand; the S&P 500 index is only a stone's throw away from its all-time high, and the USD index shredded its YTD gains as the market closed last week.
- Adding to the market's optimism is that there are forces besides the much-anticipated FFR cut that are also expected to contribute to driving up liquidity conditions. The Fed's balance sheet position presents a treasure trove of liquidity, **with the still-ample balances in the RRP and the Treasury General Account (TGA) reflecting the sizable amount of cash in the Fed's vault that is ready to flood the market at some point in the future (*see Chart 1*).**
- Emerging financial markets, including in Indonesia, stand to benefit from this two-pronged liquidity-boosting scenario in the US. **The improving global sentiment has accelerated foreign inflows to Indonesia's capital market**, with foreign investors recording net purchases to the tune of USD 1 Bn in the last week (excluding SRBI) – the highest since mid-March 2024. It is unsurprising, then, that the 10Y benchmark SBN yield falls to its 6-month low of 6.59%, as

foreign investors are now competing with Bank Indonesia to increase its SBN holdings.

- While foreign capital inflows to the domestic stock market remain relatively limited compared to the SBN market (USD 0.26 Bn vs USD 0.74 Bn inflows to the SBN market in the last week), **the rising optimistic fervour also appears to have spread to the domestic stock market *(see Chart 3)***. Indeed, the expected improvement in liquidity conditions and the declining discount rate have encouraged investors to seek higher returns in the domestic equities market. Reports of some mutual funds pivoting from the SBN to the equities market (slowing SBN purchases by domestic mutual funds in the past month backed this report) further highlight the risk-on sentiment now gripping the Indonesian financial market, as the still-low (albeit rising) multiple offers considerable upside potential for investors.

> ***"Apart from FFR cuts, a potential TGA drawdown following the US election could also be expected to boost liquidity in the US market"***

Hiking down slowly

- It might be worthwhile to note, however, that **the recent rally in the domestic financial market does not seem to be followed by a marked improvement in macro fundamentals.** For instance, anaemic demand for commodities (due to slowing manufacturing activities in China) means that the earnings outlook for the domestic corporate sector remains limited, while the widely-lauded draft 2025 state budget (which seems to have eased concerns over fiscal deficit) is still subject to change.
- The now-improving global sentiment does seem to be the only factor that has thus far fuelled the recent across-the-board appreciation of IDR-denominated assets. Alas, market sentiment is rarely set in stone, and its exuberant fervour often hides the prevailing conditions in the market. For instance, **much of the optimism that now drives the US equity market rests on the still-positive growth outlook for some AI-related companies**, an optimism that may turn sour should the number presented in upcoming earnings calls move anywhere but northwards.
- Meanwhile, **Chairman Powell's explicit signal of an incoming FFR cut in the next FOMC meeting did not seem to have loosened the liquidity condition within the US financial market**, with indicators such as the 10Y US corporate spread widened by 10.91 bps to 1.78% (nearing its YTD high of 1.84% when the abysmal July 2024 non-farm payroll data spooked the market) as the Jackson Hole Conference comes to a close (***see Chart 2***). The relatively tighter financing conditions in the US reflect the JPY carry trade position that has since been unwounded, and the strengthening JPY means that carry traders may not rebuild their position anytime soon.
- As mentioned earlier, the ample balance in the RRP and TGA account may provide another source of liquidity that may fuel the ongoing rally in the US financial market. However, it should be noted that the RRP account has underwritten the 'stealth' loosening in the US

market over the past year (by encouraging MMFs to pivot to T-bills, thus refilling the TGA account), but the balance has dwindled since then. Hence, **the still-ample TGA account may provide a more significant boost to system-wide liquidity in the US (apart from the incoming FFR cuts)**, regardless of who wins the Election in November. Nonetheless, such a scenario will require the US monetary and fiscal policy to work in tandem in the upcoming months.

- **A monetary-fiscal coordination do not seem to be in line with the Fed's expectation for a soft landing and normalising (read: back to 2%) inflation.** Indeed, expanding fiscal expenditures (i.e. drawing down the TGA balance) in tandem with loosening monetary policy when the economy is still showing positive growth momentum may bring back inflationary pressures that initially forced the Fed to tighten its policy rate.

- Furthermore, **the long anticipation of the Fed's upcoming rate-cutting campaign may also limit how far the central bank could actually cut its policy rate.** One study has found that the Fed's rate signal works mainly through the commodity price channel, as commodity traders start to adjust their position in anticipation of the Fed's next policy action. The sharp increase in the gold-to-oil price ratio in the past couple of months illustrates commodity traders' anticipation of higher commodity prices in the upcoming period, a situation that may also bring back the spectre of inflationary pressures that may check the Fed's rate cut action.

- **Our outlook, then, is still that the Fed will enact gradual, cautious cuts until year-end while evaluating the situation.** The central bank may expedite its rate cut campaign should the US (and global) economy shows further sign of a slowdown, but any sign of a rebound in inflationary momentum may force it to refrain from further cuts, similar to what happened in 1996.

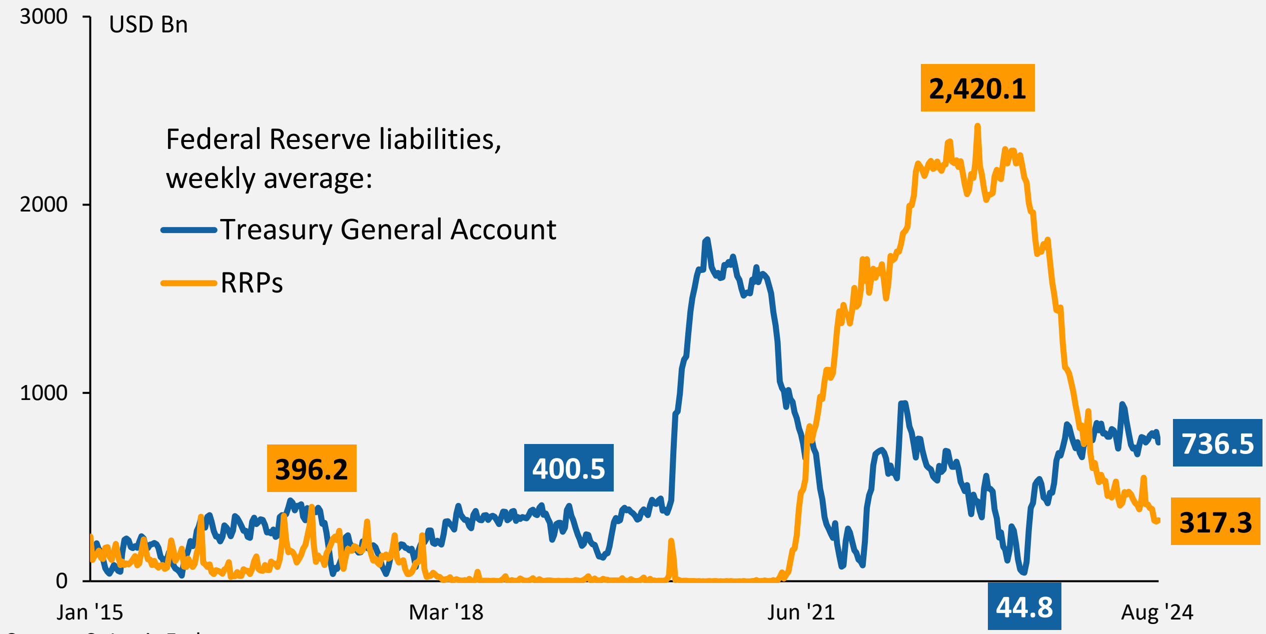
> ***"BI may still need to maintain a prudent posture, as the recent rally in the domestic financial market is primarily driven by sentiment rather than fundamentals"***

- The market, of course, is increasingly quick to respond to any shortfall in their expectations, as we have seen numerous times throughout the past year. Hence, while the now-improving sentiment has opened up room for BI to loosen its policy rate, it is arguably more prudent for BI to wait for the dust to settle before starting its rate-loosening campaign. After all, **there is more than one option available for BI to improve domestic liquidity conditions without resorting too soon to rate cuts**, with instruments such as SRBI having now surpassed their usefulness as the IDR has found a more stable footing at the moment.

Chart 1

Three chests full of liquidity

Apart from the anticipated FFR cut, a potential liquidity drawdown from the TGA (and a further RRP drawdown) may further boost the liquidity condition in the US market.

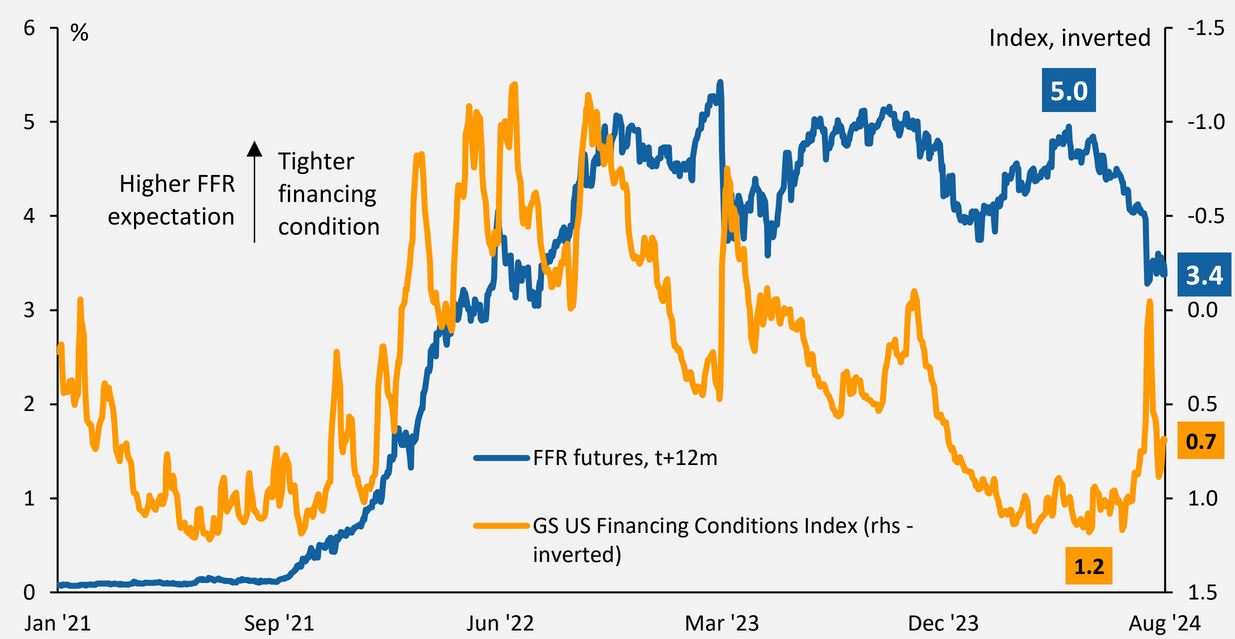


Source: St Louis Fed

Chart 2

Not as loose as it was

The financing condition in the US has not been as loose as before, although the market expects the Fed to cut the FFR aggressively in the upcoming periods.



Source: Bloomberg

Chart 3

Changing tactics

Investors in the Indonesian market seem to have started adopting a more risk-on sentiment, given the expected loosening in the liquidity condition

Economic Calendar

		Actual	Previous	Forecast*
1 August 2024				
ID	**CPI Inflation YoY, %**	**2.13**	**2.51**	**2.17**
US	**FOMC meeting, %**	**5.5**	**5.5**	**5.5**
UK	BoE meeting, %	5.00	5.25	5.00
02 August 2024				
US	Non Farm Payrolls	114	179	4.1
US	Unemployment Rate, %	4.3	4.1	4.1
05 August 2024				
ID	**GDP Growth Rate, %**	**5.05**	**5.11**	**4.5**
06 August 2024				
US	Balance of Trade, USD Bn	-73.1	-75.1	-72
07 August 2024				
ID	**Foreign Exchange Reserves, Bn**	**145.4**	**140.2**	**-**
08 August 2024				
ID	Consumer Confidence	123.4	123.3	122
09 August 2024				
CN	Inflation Rate YoY, %	0.5	0.2	0.3
ID	Retail Sales YoY, %	2.7	2.1	1.7
15 August 2024				
ID	**Balance of Trade, Bn**	**0.47**	**2.39**	**2.2**
CN	Retail Sales YoY, %	2.7	2.0	3.0
16 August 2024				
ID	**2025 RAPBN announcement**			
21 August 2024				
ID	**Interest Rate Decision, %**	**6.25**	**6.25**	**6.25**
22 August 2024				
US	FOMC Minutes			
ID	**Q2-2024 Balance of Payment, USD Bn**	**-3.0**	**-2.4**	**-0.97**
27 August 2024				
US	S&P/Case-Shiller Home Price, YoY %		6.8	6.5
30 August 2024				
US	PCE Price Index, YoY %		2.5	2.5

*Forecasts of some indicators are simply based on market consensus
Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Jul-23	2.60
UK	5.00	Aug-23	2.80
EU	4.25	Jul-23	1.65
Japan	-0.10	Jan-16	-2.90
China (lending)	2.30	Aug-23	3.85
Korea	3.50	Jan-23	0.90
India	6.50	Feb-23	2.96
Indonesia	6.25	Jul-24	4.12

Money Mkt Rates	23-Aug	-1 mth	Chg (bps)
SPN (3M)	6.42	6.56	-13.6
SUN (10Y)	6.63	6.99	-36.0
INDONIA (O/N, Rp)	6.29	6.20	9.7
JIBOR 1M (Rp)	6.90	6.90	-0.1

Bank Rates (Rp)	Jun	May	Chg (bps)
Lending (WC)	8.82	8.86	-3.79
Deposit 1M	4.70	4.68	2.60
Savings	0.67	0.67	0.02

Currency/USD	23-Aug	-1 mth	Chg (%)
UK Pound	0.757	0.775	2.37
Euro	0.893	0.921	3.11
Japanese Yen	144.4	155.6	7.77
Chinese RMB	7.121	7.275	2.16
Indonesia Rupiah	15,490	16,210	4.65

Capital Mkt	23-Aug	-1 mth	Chg (%)
JCI	7,544.3	7,313.9	3.15
DJIA	41,175.1	40,358.1	2.02
FTSE	8,327.8	8,167.4	1.96
Nikkei 225	38,364.3	39,594.4	-3.11
Hang Seng	17,612.1	17,469.4	0.82

Foreign portfolio ownership (Rp Tn)	Jul	Jun	Chg (Rp Tn)
Stock	3,322.0	3,273.1	48.98
Govt. Bond	813.1	808.1	4.97
Corp. Bond	7.6	8.2	-0.60

Trade & Commodities	23-Aug	-1 mth	Chg (%)
Baltic Dry Index	1,762.0	1,869.0	-5.7
S&P GSCI Index	540.5	551.4	-2.0
Oil (Brent, $/brl)	79.0	81.0	-2.5
Coal ($/MT)	147.2	138.4	6.3
Gas ($/MMBtu)	1.93	2.13	-9.4
Gold ($/oz.)	2,512.6	2,409.6	4.3
Copper ($/MT)	9,173.4	9,046.7	1.4
Nickel ($/MT)	16,537.9	15,741.8	5.1
CPO ($/MT)	902.5	859.7	5.0
Rubber ($/kg)	1.81	1.64	10.4

External Sector	Jul	Jun	Chg (%)
Export ($ bn)	22.21	20.85	6.55
Import ($ bn)	21.74	18.45	17.82
Trade bal. ($ bn)	0.47	2.39	-80.29
Central bank reserves ($ bn)*	145.4	140.2	3.74

Prompt Indicators	Jul	Jun	Apr
Consumer confidence index (CCI)	123.4	123.3	127.7
Car sales (%YoY)	-7.9	-11.8	-17.4
Motorcycle sales (%YoY)	26.0	3.5	18.3

Manufacturing PMI	Jul	Jun	Chg (bps)
USA	49.6	51.6	-200
Eurozone	45.8	45.8	0
Japan	49.1	50.0	-90
China	49.8	51.8	-200
Korea	51.4	52.0	-60
Indonesia	49.3	50.7	-140

Source: Bloomberg, BI, BPS
Notes:
*Data from an earlier period
For changes in currency: **Black indicates appreciation against USD, **Red** otherwise
***For PMI, **>50** indicates economic expansion, **<50** otherwise

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$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	2.87
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00
USD/IDR Exchange Rate (end of the year)**	13,866	14,050	14,262	15,568	15,397	16,172
Trade Balance (US$ 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 the Rupiah's fundamental exchange rate

Economic, Banking & Industry Research Team

Agus Salim Hardjodinoto
Head of Industry and Regional Research
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Gabriella Yolivia
Industry Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Elbert Timothy Lasiman
Economist / Analyst
Elbert_lasiman@bca.co.id
+6221 2358 8000 Ext: 1074310

Agus Salim Hardjodinoto
Head of Industry and Regional Research
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Gabriella Yolivia
Industry Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Elbert Timothy Lasiman
Economist / Analyst
Elbert_lasiman@bca.co.id
+6221 2358 8000 Ext: 1074310

Nicholas Husni
Economist / Analyst
nicholas_husni@bca.co.id
+6221 2358 8000 Ext: 1079839

Agus Salim Hardjodinoto
Head of Industry and Regional Research
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Gabriella Yolivia
Industry Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Elbert Timothy Lasiman
Economist / Analyst
Elbert_lasiman@bca.co.id
+6221 2358 8000 Ext: 1074310

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group

20th Grand Indonesia, Menara BCA
Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia
Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343