FOMC:
A smaller policy rate amid the bigger backdrop

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Executive Summary

- The Fed lowered the FFR to 4.50-4.75%, sparking a risk-on sentiment as US stocks rose following the meeting. However, long-term US interest rates continue to climb despite the lower FFR, driven by anticipated policy shifts following the US election.
- The rise in long-term UST yields underscores the risk of capital outflows from riskier markets, potentially restricting further policy rate cuts in 2025, particularly if increased import tariffs contribute to renewed inflationary pressures in the US.
- The improving FX liquidity condition in Indonesia may help to protect the Rupiah from short-term volatilities, creating a space for BI to consider a rate cut in the upcoming meeting.

- **The Fed lowered its policy rate by 25 bps to 4.50-4.75% last night, in line with market expectations.** Both labour market indicators (with the unemployment rate remaining stable at 4.1%) and inflation data (PCE inflation at 2.1%, in line with expectations) for October 2024 cleared the way for the Fed to continue its rate-cutting campaign. **This move confirms the continuation of the global rate-cut cycle**, with the ECB and BoE preceding the Fed in cutting their policy rates by a similar 25 bps.

- The market, as before, reacted positively to the November 2024 FFR cut, with the S&P 500 rallying by 0.74% as Fed Chairman Jerome Powell hit the airwaves. The ongoing risk-on mood is also evident in the declines of both the USD index (-0.55%) and gold prices (-0.24%) following the meeting, while a rally in the UST market (with the FFR-sensitive 2Y UST yield dropping by 6.23 bps yesterday) has helped roll back some of the recent increases in the US government's borrowing rate after the 2024 election results.

- Meanwhile, **Fed Chairman Jerome Powell continues to emphasise the committee's data-driven approach to policymaking**, despite market expectations that the central bank may further lower the policy rate at its upcoming FOMC meeting – bringing the projected total FFR cuts in 2024 to 100 bps. We have previously observed a close relationship between FOMC members' rate-cut signals and oil prices, suggesting that the currently low oil prices (USD 75.43/bl, -2.09% YTD) could encourage FOMC members to vote for another 25 bps rate cut in December 2024.

- **However, many in the market are sceptical that the Fed could maintain its rate-cutting pace in 2025.** The biggest boulder that blocks the road, of course, is the recent US election which saw President Donald Trump returning to the White House and potentially giving the Republican Party full control of both chambers of Congress. Tariff measures appear to be the first item on President Trump's agenda as he prepares to take office in 73 days.

- The proposed 60% tariff on imports from China is at the centre of the question, despite the decrease in the share of US imports from China over the past decade. **Indeed, American businesses and consumers remain heavily dependent on the Chinese supply chain, especially for consumer electronics, which account for a significant share of total US imports in 2024.** For instance, 28.21% of personal computers, 41.42% of smartphones, and a substantial 79.16% of various household appliances imported in 2024 come from China, suggesting a considerable pass-through effect from the proposed tariff hike to inflationary pressures. Other policy agendas, such as tracking down and mass deportation of illegal immigrants, will also impact the already tight US labour market, leading to **upward pressures on both the core goods and services sides of the price index.**

- Another consequential policy agenda, likely to be facilitated by the Republican Party's potential electoral trifecta, is the second round of Trump's tax cuts package. In addition to extending the 2017 tax cuts on personal income (set to expire in 2025), President Trump has also pledged to reduce the corporate tax rate from 21% to the global minimum of 15%, potentially encouraging a flow of funds returning from offshore financial centres.

> *"The market continues to expect for the Fed to lower its policy rate in 2024, but growing sceptical of further rate cuts in 2025"*

- In addition to obscuring the path toward lower inflation, **the recent US election has seemingly weakened the Fed's ability to influence both the exchange rate and interest rate conditions.** First, while the safe haven argument remains sound, the "preferable policy" argument (higher inflows due to tax cuts and deregulation) may also explain the higher demand for the USD amid President Trump's electoral success, explaining the continued depreciation pressure on other currencies despite the consensus on lower FFR in 2024-2025. Pressures due to the strengthening USD are particularly acute for Asian currencies, given the Trump tariff's detrimental impact on anchor currencies such as the CNY.

- Second, expectations of renewed inflationary pressures and higher deficit under the upcoming Trump presidency have driven the benchmark 10-year UST yield higher (now at 4.34%, up from 3.73% in early October 2024), seemingly unaffected by the FFR cut and offsetting the impact of the US Treasury Department's recent announcement of reduced UST issuance in Q4-2024 (borrowing estimates through marketable securities lowered by USD 19 Bn to USD 565 Bn).

- Meanwhile, some arguments are also pointing to the mutually reinforcing relationship between the higher USD index and UST yields, suggesting that a stronger USD could prompt other central banks (like the BoJ) to sell off their UST holdings to access the USD liquidity needed for currency market interventions. However, the lack of significant activity in the NY Fed's central bank liquidity swap operations indicates that this scenario is not the case at the moment.

- The Fed's waning influence over the longer end of the yield curve complicates its efforts to address mounting risks in the US labour market. Higher long-term rates have brought the UST yield curve closer to its uninversion event, with the 10Y-3M yield spread now around -0.17% (up from -1.35% in September 2024). For the US economy, though, it is often when the yield curve finally uninverts that the music stops, and **the ongoing bear-steepening**

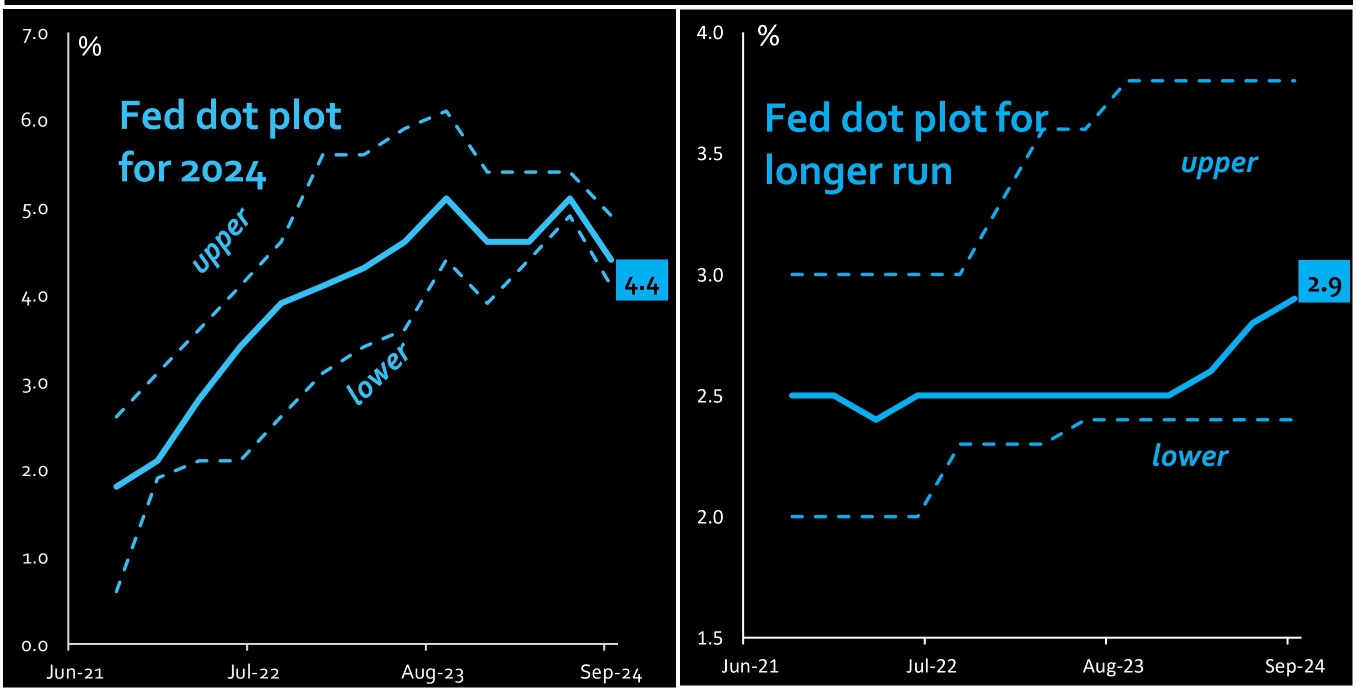
event (where long-term rates rise faster than short-term rates) does little to encourage the private sector money creation needed to sustain its now-robust growth.

- **Fortunately, the Fed does have something in its toolbox to calm the condition in the longer end of the UST market.** Debates have begun on whether the Fed should again reduce the pace of its QT campaign, which has been capped at USD 25 Bn since early June 2024. A QT halt (or even, a QE return?) will help to balance the condition in the UST market and improve the USD liquidity condition, while past experiences have shown little pass-through effect on inflation as the extra liquidity will be trapped in financial institutions' balance sheets.

- Therefore, despite the Trump trade's negative impact on demand for non-USD assets, the balance of risks appears to leave the door open for other central banks, including Bank Indonesia, to follow the Fed's path in reducing policy rates in 2024. Indeed, the improving but not stellar nominal GDP growth in Q3-2024 highlights the urgency for BI to tweak its monetary policy posture to a more accommodative tune, with the stagnating M2 (7.15% YoY, 7.28% YoY in August 2024) and loan growth (10.4% YoY, 12.3% peak in April 2024) strengthening the case.

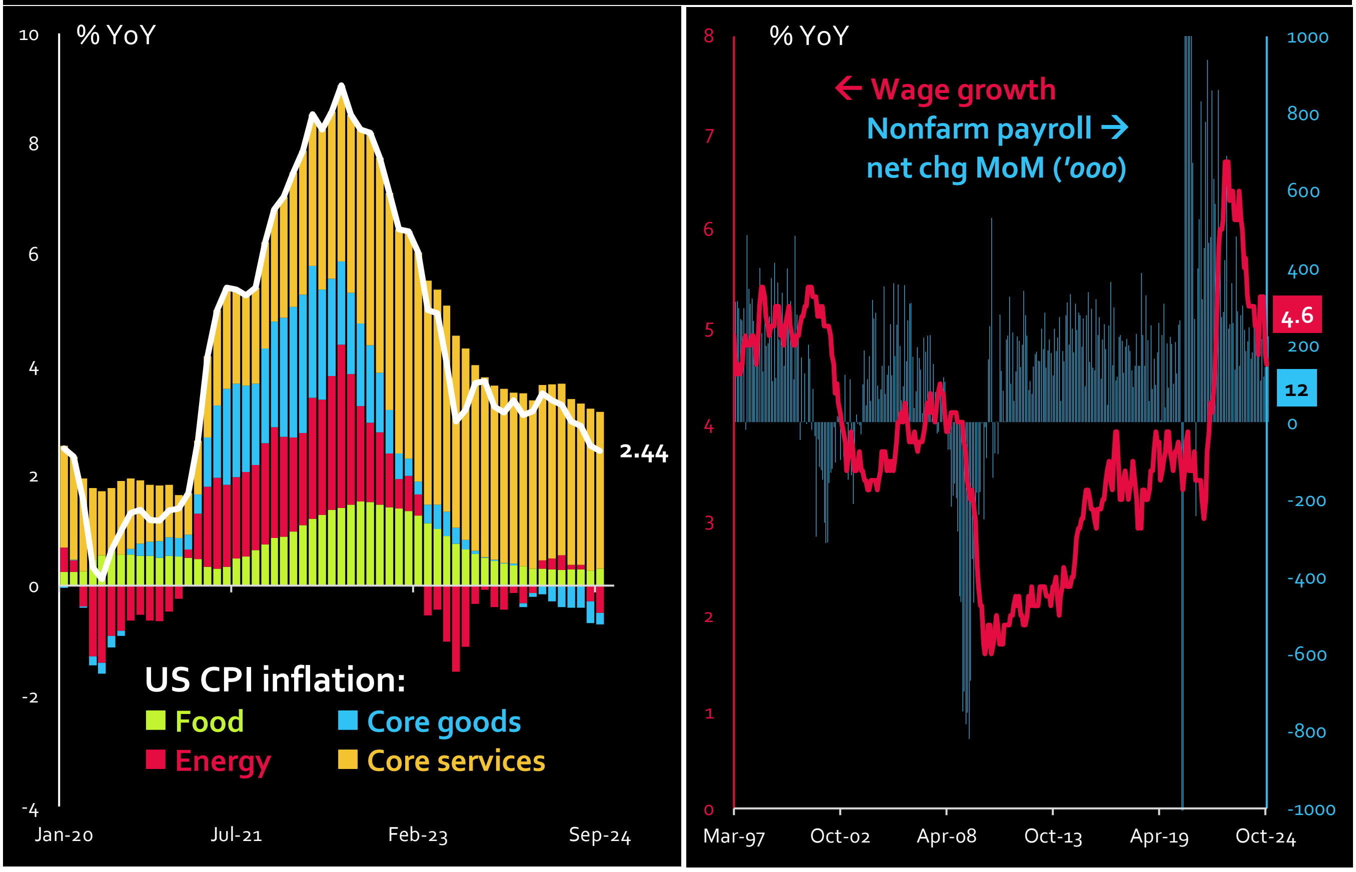
- **BI also has the tools to manage the risk of short-term volatility in the Rupiah's value, should it opt to lower the BI rate in the upcoming policy meeting.** As noted in our previous report, the domestic banking sector currently benefits from improved FX liquidity conditions, though this improvement seems more driven by lower demand for FX loans than increased revenue. The ample FX reserves should also enable the central bank to maintain its presence in the currency market, while yields on Indonesian government bonds remain stable, with foreign investors swapping SRBI for SBN. Ergo, the path remains open for BI to cut its policy rate by 25 bps in the upcoming meeting, even though the central bank may need to adjust its expectation on where the IDR's fundamental value should lie.

Panel 1. **The Fed is en route to realise its telegraphed 100 bps rate cuts in 2024, but the longer-term outlook for the FFR remains uncertain.**



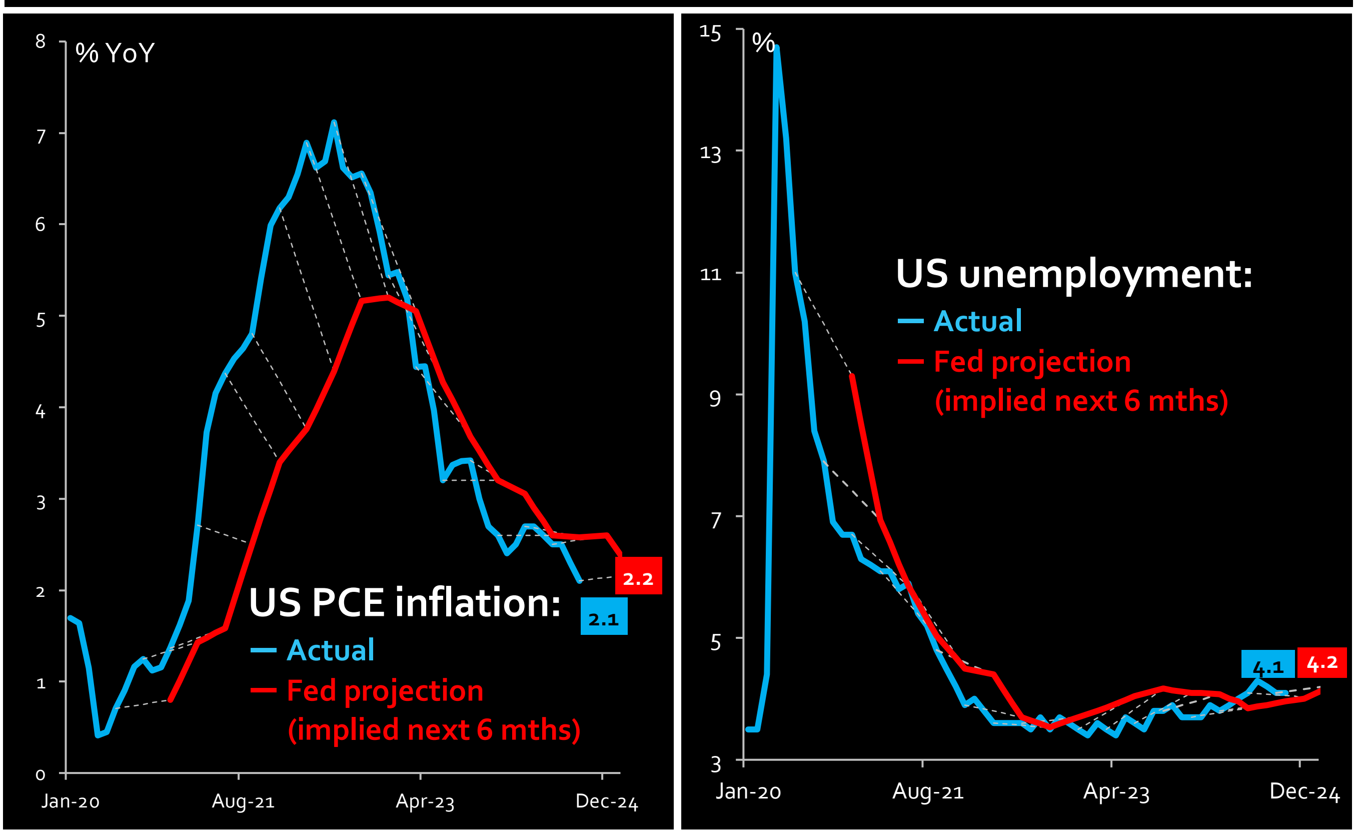
Source: Federal Reserve

***Panel 2*. The shift in government policies may return inflationary pressures to the US, especially for core goods and services components.**



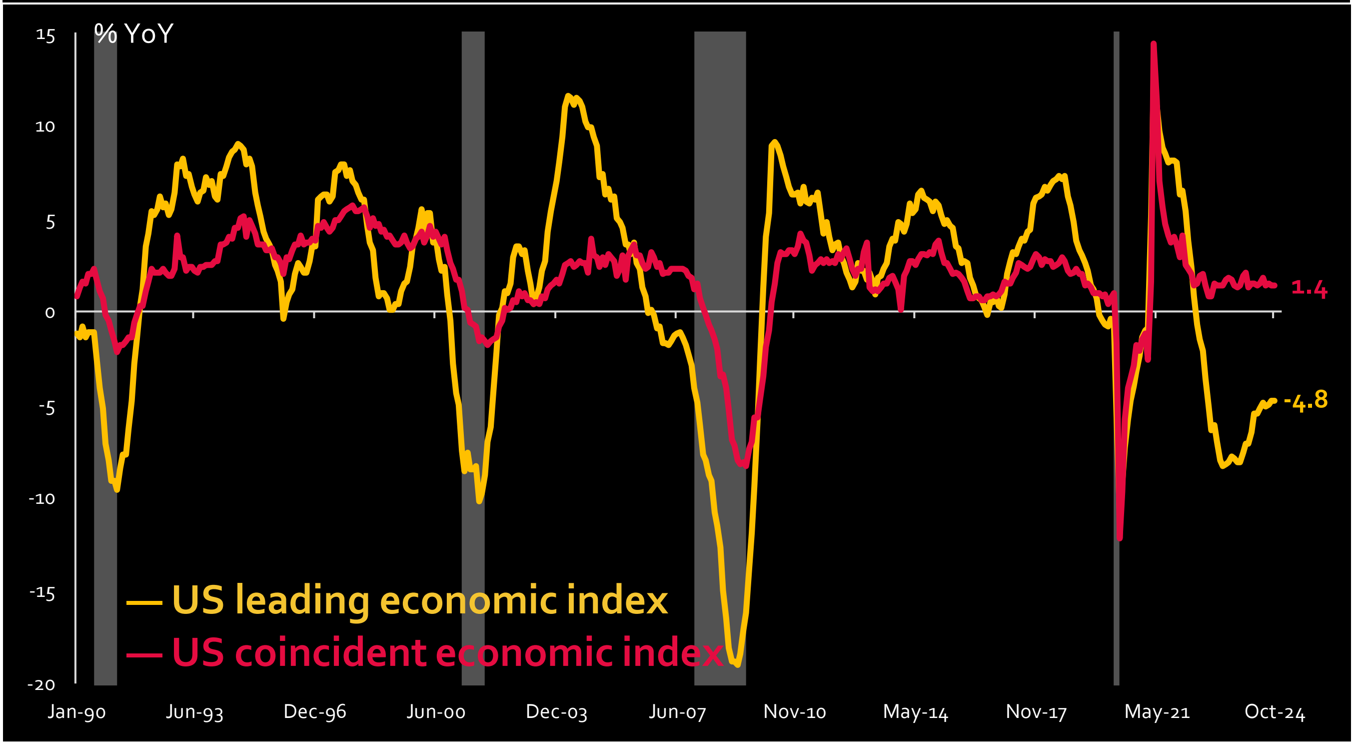
Source: US BLS, Bloomberg

***Panel 3*. The inflation and labour market conditions continue to develop per the Fed's scenario, but uncertainties arise following the US election**



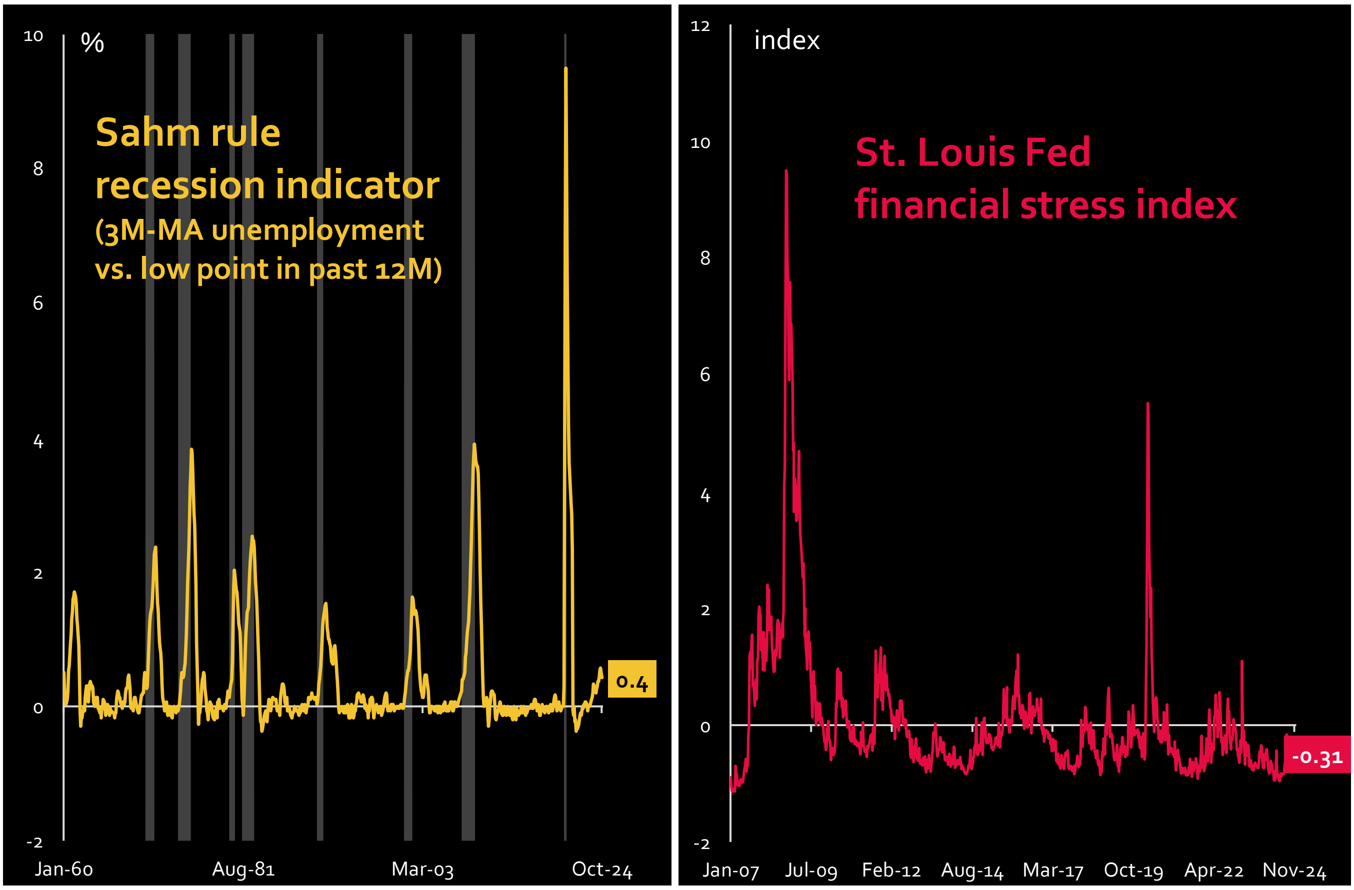
Source: Bloomberg, Federal Reserve

Chart 1. Optimisms are arising in the US, driven by the expectation of deficit-fuelled above-average growth under the second Trump administration



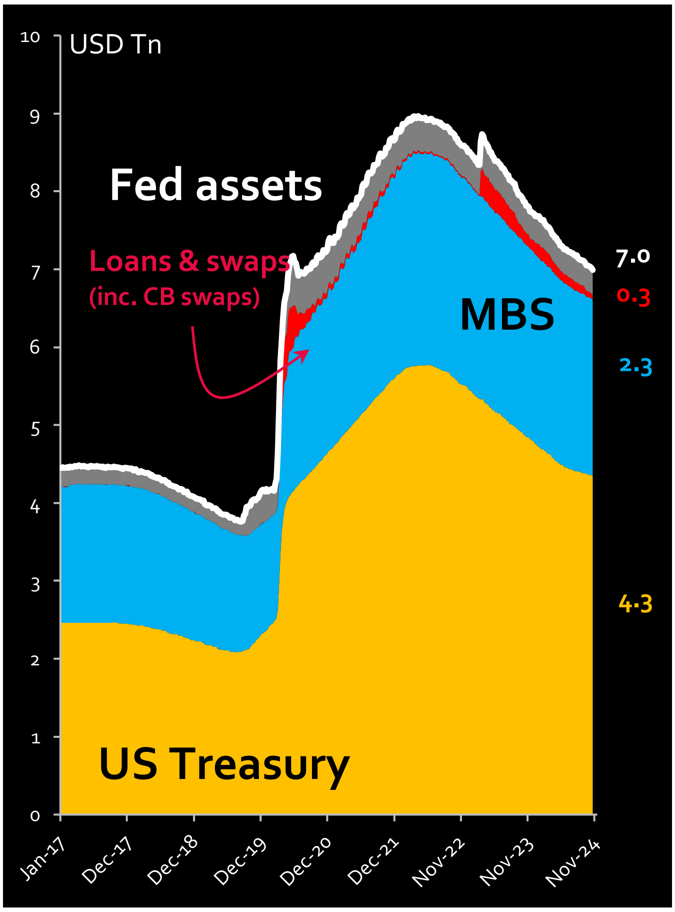
Source: Conference Board

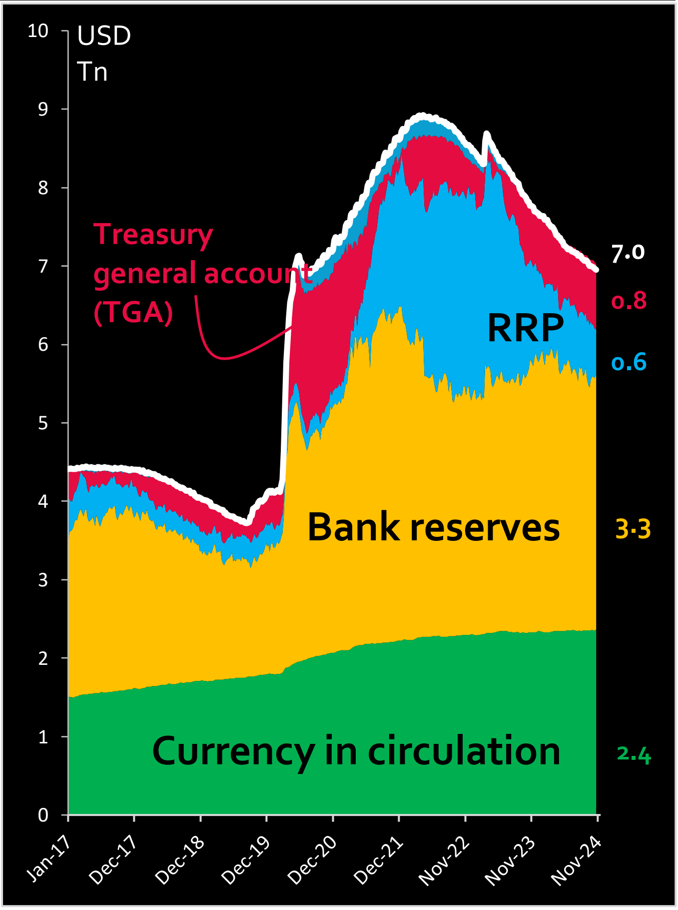
Panel 4. The job loss momentum accelerates, but signs of an impending recession remains limited



Source: St. Louis Fed

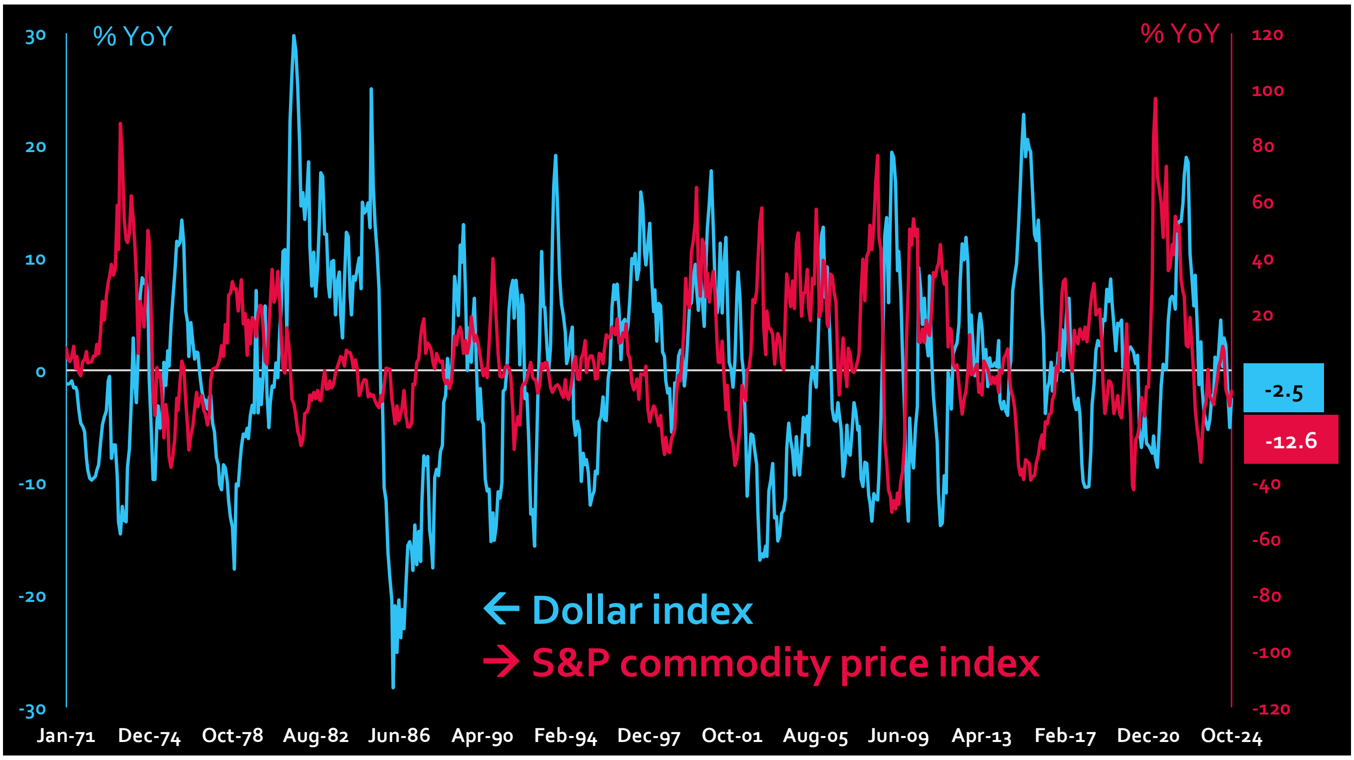
Panel 5. Continuously elevated long-term yields may compel the Fed to slow down the pace of its balance sheet run-off





Source: St. Louis Fed

Chart 2. The USD remains close to its peak, while commodity prices remain relatively muted as the market is awaiting news of China's expected fiscal stimulus



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	4.75	Sep-24	2.35
UK	4.75	Aug-24	3.05
EU	3.40	Oct-24	1.40
Japan	0.25	Jul-24	-2.60
China (lending)	2.00	Sep-24	3.95
Korea	3.25	Oct-24	1.95
India	6.50	Feb-23	1.01
Indonesia	6.00	Sep-24	4.29

Money Mkt Rates	7-Nov	-1 mth	Chg (bps)
SPN (1Y)	6.64	6.57	7.1
SUN (10Y)	6.76	6.71	4.7
INDONIA (O/N, Rp)	6.08	6.21	-13.0
JIBOR 1M (Rp)	6.63	6.65	-1.6

Bank Rates (Rp)	Aug	Jul	Chg (bps)
Lending (WC)	8.78	8.81	-2.51
Deposit 1M	4.79	4.78	1.00
Savings	0.65	0.65	-0.09

Currency/USD	7-Nov	-1 mth	Chg (%)
UK Pound	0.770	0.764	-0.73
Euro	0.925	0.911	-1.56
Japanese Yen	152.9	148.2	-3.11
Chinese RMB	7.143	7.019	-1.75
Indonesia Rupiah	15,735	15,680	-0.35

Capital Mkt	7-Nov	-1 mth	Chg (%)
JCI	7,243.9	7,504.1	-3.47
DJIA	43,729.3	41,954.2	4.23
FTSE	8,140.7	8,303.6	-1.96
Nikkei 225	39,381.4	39,332.7	0.12
Hang Seng	20,953.3	23,099.8	-9.29

Foreign portfolio ownership (Rp Tn)	Oct	Sep	Chg (Rp Tn)
Stock	3,573.9	3,558.2	15.66
Govt. Bond	885.6	870.6	14.98
Corp. Bond	6.9	6.9	-0.07

Trade & Commodities	7-Nov	-1 mth	Chg (%)
Baltic Dry Index	1,451.0	1,907.0	-23.9
S&P GSCI Index	547.2	566.6	-3.4
Oil (Brent, $/brl)	75.6	80.9	-6.5
Coal ($/MT)	143.1	154.5	-7.4
Gas ($/MMBtu)	1.49	2.51	-40.5
Gold ($/oz.)	2,706.7	2,642.6	2.4
Copper ($/MT)	9,527.1	9,777.7	-2.6
Nickel ($/MT)	16,343.6	17,792.9	-8.1
CPO ($/MT)	1,144.4	1,023.2	11.8
Rubber ($/kg)	2.02	2.10	-3.8

External Sector	Sep	Aug	Chg (%)
Export ($ bn)	22.08	23.44	-5.80
Import ($ bn)	18.82	20.67	-8.91
Trade bal. ($ bn)	3.26	2.78	17.37
Central bank reserves ($ bn)*	149.9	150.2	-0.21

Prompt Indicators	Sep	Aug	Jul
Consumer confidence index (CCI)	123.5	124.4	123.4
Car sales (%YoY)	-9.1	-14.2	-7.8
Motorcycle sales (%YoY)	3.7	7.4	24.1

Manufacturing PMI	Oct	Sep	Chg (bps)
USA	48.5	47.3	120
Eurozone	46.0	45.0	100
Japan	49.2	49.7	-50
China	50.3	49.3	100
Korea	48.3	48.3	0
Indonesia	49.2	49.2	0

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$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	1.9
BI 7 day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	5.50
USD/IDR Exchange Rate (end of year)**	13,866	14,050	14,262	15,568	15,397	15,650
Trade Balance (US$ 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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