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Monthly Economic & Finance Briefing

Economic, Banking & Industry Research of BCA Group - DKP

Fed Policy: Dovish, but whence the tapering?

Executive Summary:

- The Fed maintained its policy outlook, despite its more upbeat assessment of the US economy. In particular, it sees the recent increase in inflation as transitory, suggesting that it will wait for a more sustained inflation before changing course.
- The two stimulus plans from the Biden administration, worth a total of USD 4.1 T, could – if approved by Congress – pave the way for such inflation.
- The US fiscal-monetary combo could dampen market volatility in the short-run, but also increase the risk of "tantrum"-like dynamics as 2022 approaches.

- Heading into last night's FOMC press conference, the market expected a perfectly sleepy and predictable affirmation of the mantras that the Fed has reiterated in the last few months – that it is "committed […] to support the US economy", or that it "will aim [for] inflation moderately above 2% for some time". Overall, this is exactly what it got from Jerome Powell and company.

- But the tension between the Fed's policies and its increasingly sunnier assessment of the US economy is hard to miss. To wit, the Fed has removed references to the pandemic's effects on unemployment and inflation, and added notes about vaccination progress and strong policy support – presumably from the fiscal side.

- Inflation, the bogeyman during the bear steepening in March, seems to be relegated to a side concern for the time being. While the US headline inflation stands at 2.6% YoY, the Fed regards the rise as transitory, stemming from low base effect, oil price increase, and short-term bottlenecks in the global supply chains. **In effect, the Fed intends to wait for a more sustained increase in inflation before curtailing its monetary support.**

- All these gave the Fed's policy statements a clear dovish tinge, paving the way for the market to resume the risk-on posture that it has assumed since early April. It may also ease the concern a few analysts raised prior to the FOMC that the Fed might announce "tapering" as early as June, following in the footsteps of the Bank of Canada last week.

- From the perspective of EMs like Indonesia, this is undoubtedly a positive development, especially heading into May which – as the saying goes – might be a moment for market selloffs. **In particular, a continuing weakness of the USD could act as a balm given the gaping divergence in health outcome between developed countries and EMs.**

- However, the risk in the medium- to longer-term might just grow bigger, especially amid the backdrop of President Biden's fiscal bazooka: the USD 2.3 T American Jobs Plan and the USD 1.8 T American Families Plan. If approved, these stimuli could provide additional fuel to the commodity price rally (***Chart 1***), lifting inflation and forcing more drastic actions by the Fed at some point.

- The divergence in Fed fund futures, with 2022 outlook flat-lining and 2023-24 spiking upwards (***Chart 2***), illustrates the kind of scenario prevalent in current market thinking, i.e. that the Fed might not be ready to lift off in 2022, but could start tapering in advance of the upcoming rate hikes.

- **And it is tapering, not inflation, that will be the main threat going forward.** If we decompose the US Treasury yield into an expected inflation component and a real yield component, we can see that expected inflation has climbed to historically high levels and is starting to plateau – while real yields are still near historic lows (***Chart 3***). It was precisely this real yield component that jumped during the original "taper tantrum" in 2013.

- **So while the waters should stay sufficiently calm for BI to maintain its current policies for the year, tapering speculations may start to be an issue as 2022 approaches.** Fortunately, the vicious cycle between rising yields and weaker Rupiah – an ever present specter during prior crises – might be softened by the reduced foreign ownership in Indonesian sovereign bonds (***Chart 4***).

Chart 1. Biden's massive stimulus could fuel a new commodity supercycle

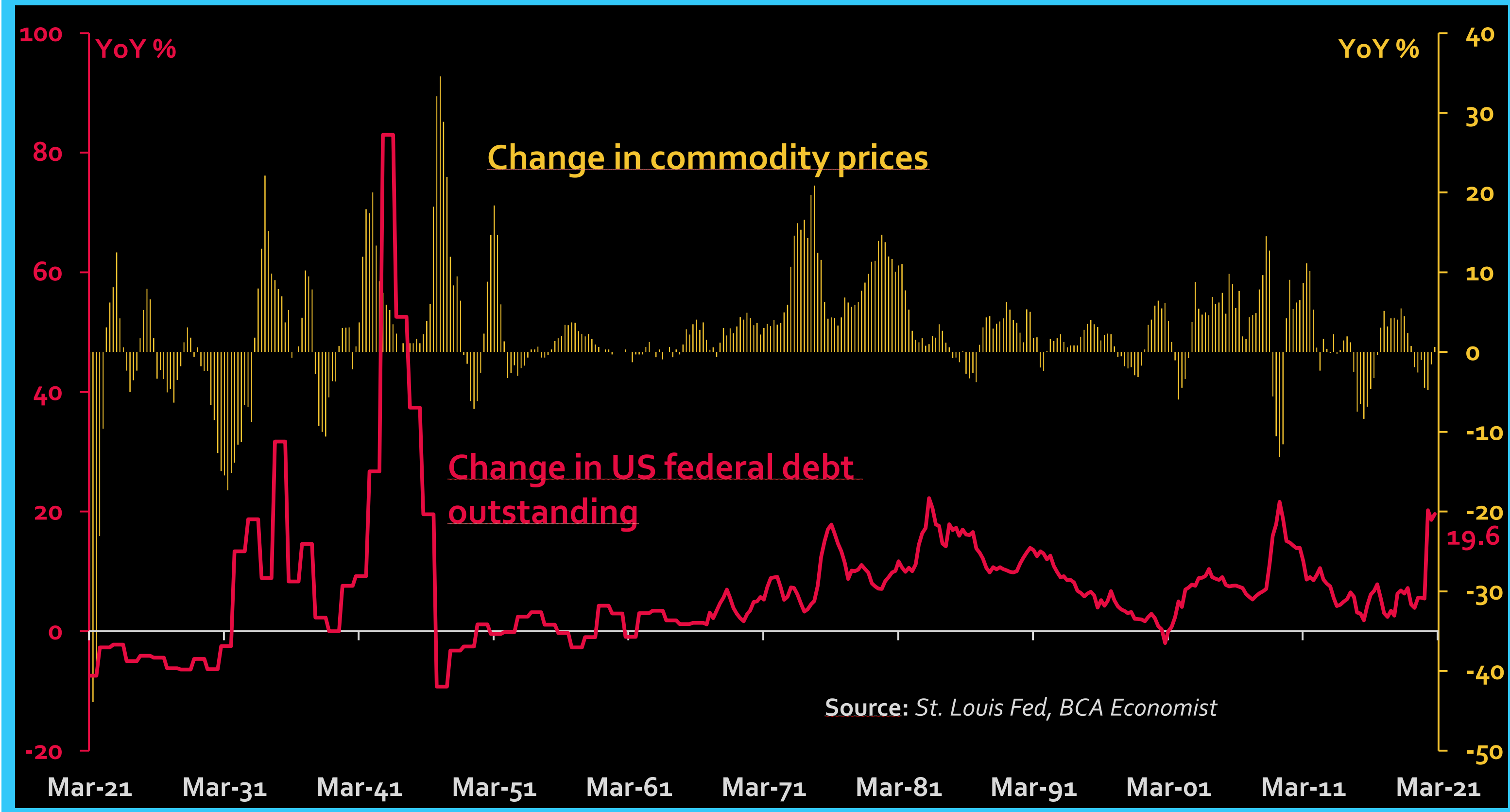


Chart 2. Fed rate hike by 2023 is increasingly viewed as a sure thing by the market, 2022 to be the year of tapering?

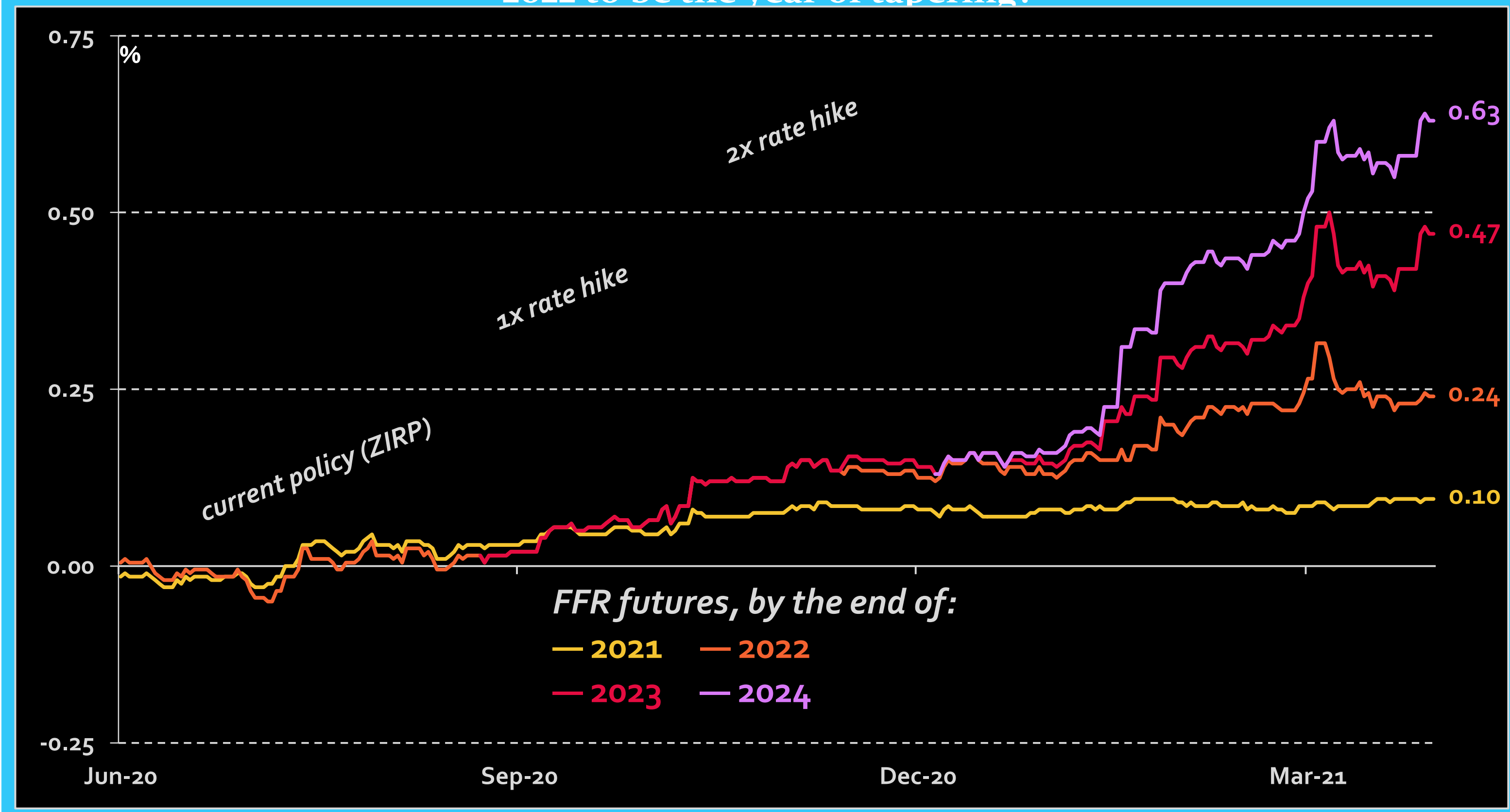


Chart 3. Inflation expectations have begun to slow after a prolonged increase, but rumors of tapering could raise real yields

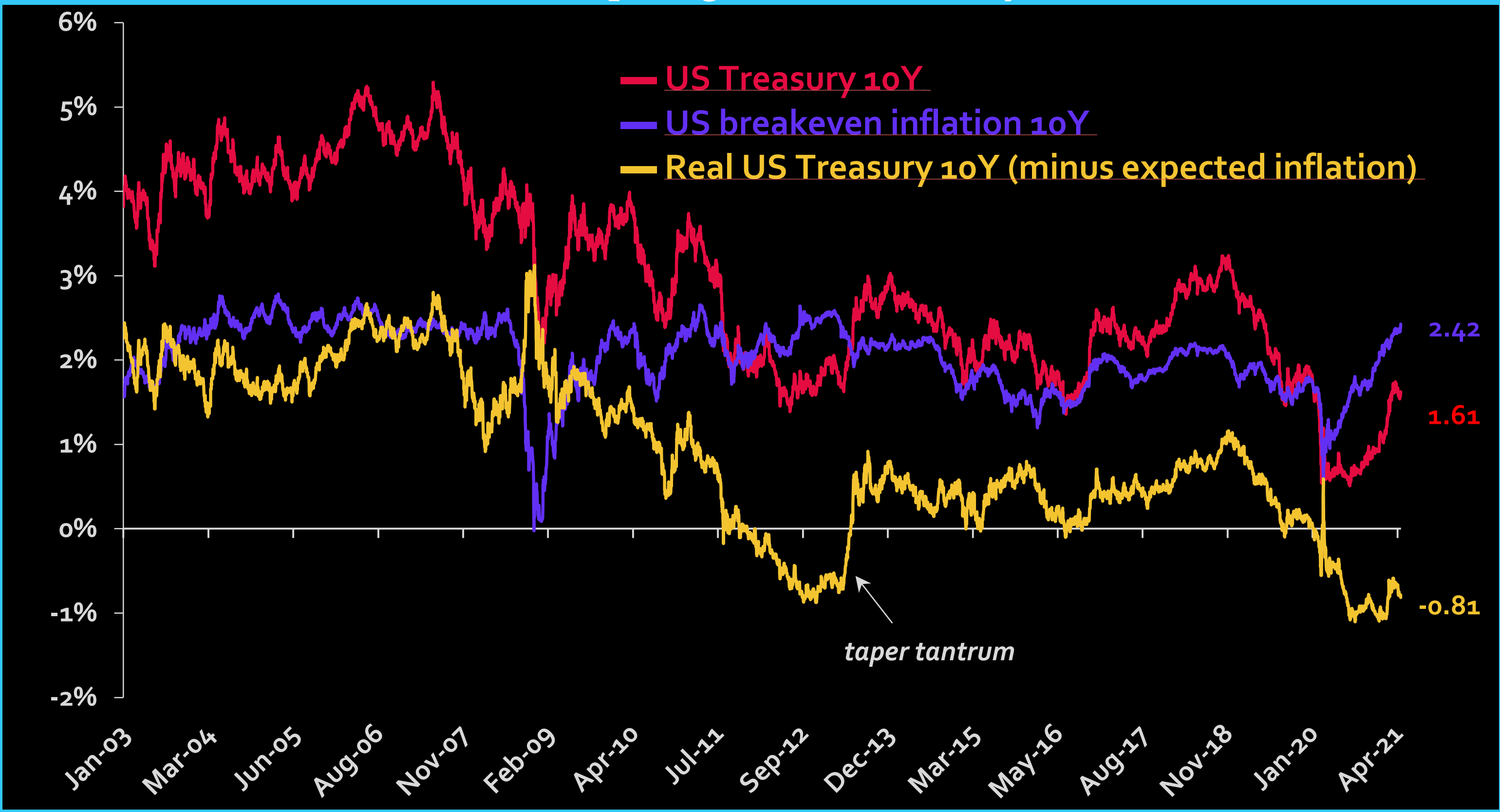
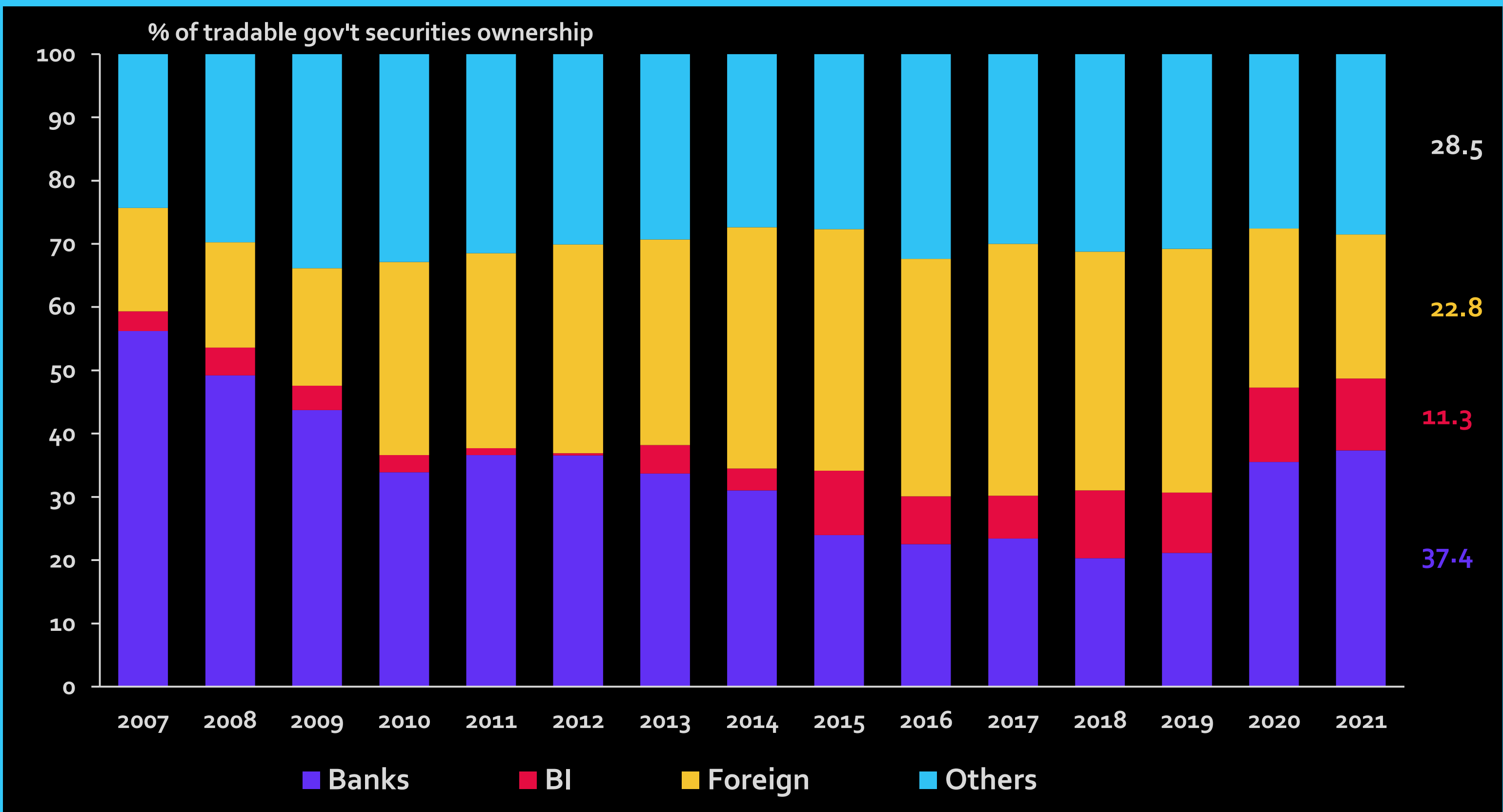


Chart 4. The shift of sovereign bond ownership to domestic banks should reduce vulnerability to foreign outflows, at the cost of “crowding out”



Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	0.25	Mar-20	-2.35
UK	0.10	Mar-20	-0.60
EU	0.00	Mar-16	-1.30
Japan	-0.10	Jan-16	0.10
China (lending)	4.35	Oct-15	3.95
Korea	0.50	May-20	-1.00
India	4.00	May-20	-1.52
Indonesia	3.50	Feb-21	2.13
Money Mkt Rates	**28-Apr**	**-1 mth**	**Chg (bps)**
SPN (1M)	1.73	2.11	-37.7
SUN (10Y)	6.49	6.69	-20.3
INDONIA (O/N, Rp)	2.79	2.79	-0.1
JIBOR 1M (Rp)	3.56	3.56	0.3
Bank Rates (Rp)	**Jan**	**Dec**	**Chg (bps)**
Lending (WC)	9.27	9.21	6.15
Deposit 1M	4.05	4.22	-17.18
Savings	0.84	0.86	-2.39
Currency/USD	**28-Apr**	**-1 mth**	**Chg (%)**
UK Pound	0.718	0.725	1.06
Euro	0.825	0.848	2.81
Japanese Yen	108.6	109.6	0.96
Chinese RMB	6.479	6.541	0.96
Indonesia Rupiah	14,500	14,418	-0.57
Capital Mkt	**28-Apr**	**-1 mth**	**Chg (%)**
JCI	5,974.5	6,195.6	-3.57
DJIA	33,820.4	33,072.9	2.26
FTSE	6,963.7	6,740.6	3.31
Nikkei 225	29,054.0	29,176.7	-0.42
Hang Seng	29,071.3	28,336.4	2.59
Foreign portfolio ownership (Rp Tn)	**Mar**	**Feb**	**Chg (Rp Tn)**
Stock	1,878.6	1,930.8	-52.25
Govt. Bond	951.4	971.4	-20.00
Corp. Bond	28.9	28.4	0.52

Trade & Commodities	28-Apr	-1 mth	Chg (%)
Baltic Dry Index	2,957.0	2,178.0	35.8
S&P GSCI Index	504.9	474.0	6.5
Oil (Brent, $/brl)	67.3	64.6	4.2
Coal ($/MT)	88.0	88.4	-0.5
Gas ($/MMBtu)	2.92	2.44	19.6
Gold ($/oz.)	1,781.7	1,732.5	2.8
Copper ($/MT)	9,880.3	8,967.0	10.2
Nickel ($/MT)	17,410.0	16,342.3	6.5
CPO ($/MT)	1,081.1	968.8	11.6
Rubber ($/kg)	1.65	1.69	-2.4
External Sector	**Mar**	**Feb**	**Chg (%)**
Export ($ bn)	18.35	15.26	20.3
Import ($ bn)	16.79	13.27	26.6
Trade bal. ($ bn)	1.57	1.99	-21.3
Central bank reserves ($ bn)	137.1	138.8	-1.23
Prompt Indicators	**Mar**	**Feb**	**Jan**
Consumer confidence index (CCI)	93.4	85.8	84.9
Car sales (%YoY)	10.5	-38.2	-34.2
Motorcycle sales (%YoY)	-7.2	-30.8	-14.7
Cement sales (%YoY)	10.9	0.7	-5.9
Manufacturing PMI	**Apr**	**Mar**	**Chg (bps)**
USA	N/A	64.7	0
Eurozone	63.3	62.5	80
Japan	53.3	52.7	60
China	50.6	50.6	0
Korea	55.3	55.3	0
Indonesia	53.2	53.2	0

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	4.8
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	10.1
Current Account Balance (% GDP)	-1.8	-1.6	-3.0	-2.7	-0.4	-1.8

** Estimation of Rupiah's fundamental exchange rate

Economic, Banking & Industry Research Team

David E. Sumual
Chief Economist
david_sumual@bca.co.id
+6221 2358 8000 Ext: 1051352

Agus Salim Hardjodinoto
Industry Analyst
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Barra Kukuh Mamia
Economist / Analyst
barra_mamia@bca.co.id
+6221 2358 8000 Ext: 1053819

Victor George Petrus Matindas
Industry Analyst
victor_matindas@bca.co.id
+6221 2358 8000 Ext: 1058408

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

Derrick Gozal
Economist / Analyst
derrick_gozal@bca.co.id
+6221 2358 8000 Ext: 1066722

Livia Angelica Thamsir
Economist / Analyst
livia_thamsir@bca.co.id
+6221 2358 8000 Ext: 1069933

Ahmad Aprilian Rizki
Research Assistant
ahmad_rizki@bca.co.id
+6221 2358 8000 Ext: 20378

Arief Darmawan
Research Assistant
arief_darmawan@bca.co.id
+6221 2358 8000 Ext: 20364

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group - DKP
20th Grand Indonesia, Menara BCA
Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia
Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343