May-24 FOMC Meeting: The Fed has dismissed the possibility of a policy rate hike

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Statement from the Fed

The risk of 'higher-for-longer' materialized.

- During its May-24 FOMC meeting, the Fed opted to maintain the Fed Funds rate (FFR) target range at 5.25%-5.50% for the sixth consecutive time. This decision reflected concerns about persistent inflationary pressures and a tight labor market, suggesting a slowdown in progress towards meeting the 2% inflation target for this year.
- Inflation remains elevated and achieving further reduction is uncertain with an unclear path ahead. The Fed indicated it would not be appropriate to consider lowering FFR target range until there is greater confidence that inflation is moving sustainably towards 2%.
- The data this year have not yet instilled this confidence in the Fed. The Fed is prepared to maintain the current FFR target range for as long as necessary, aware that premature or excessive policy easing could reverse progress made on inflation. Conversely, delaying such easing could unnecessarily weaken economic activity and employment.

The Fed ruled out policy rate hike, giving less-hawkish signal.

- The Fed acknowledged that while inflation has moderated somewhat over the past year, it remains elevated, and recent months have shown limited advancement towards the Fed's objectives.
- Nonetheless, Chair Powell indicated that he does not anticipate a rate hike in the near term and believes that current policy measures are sufficiently restrictive to achieve the desired 2% inflation target.

Quantitative Tightening is scheduled to be eased.

- Furthermore, the Fed announced plans to decrease the pace of Quantitative Tightening (QT) starting 1-Jun-24, reducing the monthly reduction in Treasury securities from USD60 billion to USD25 billion, marking a significant adjustment in its balance sheet management strategy.
- The Fed explained that slowing the pace of runoff does not imply that the balance sheet will ultimately shrink less than planned, but rather allows the Fed to approach its intended level more gradually. Specifically, this adjustment will aid in ensuring a smooth transition, reducing the risk of stress in money markets, and thereby facilitating the ongoing reduction in securities holdings needed to achieve an appropriate level of ample reserves.

As the US economic outlook is unclear, the Fed stated it will be closely monitoring the potential risks of inflation going forward.

- Recent indicators suggest that economic activity has continued to expand steadily. While GDP growth eased from 3.4%qoq in 4Q23 to 1.6%qoq in 1Q24, Private Domestic Final Purchases—which excludes inventory investment, government spending, and net exports, and typically provides a clearer signal of underlying demand—stood at 3.1%qoq in 1Q24, matching the strength seen in the second half of 2023. Consumer spending has remained robust over the past few quarters, despite the dampening effect of high interest rates on housing and equipment investment. Improved supply conditions have bolstered resilient demand, contributing to the strong performance of the US economy over the past year.
- The labor market remains tight, with supply and demand conditions moving toward better balance.
- Inflation has shown limited progress toward the 2% objective in recent months. The inflation data received so far this year have exceeded expectations. The Fed noted that although some measures of short-term inflation expectations have risen in recent months, longer-term inflation expectations appear to be well anchored.

Market Implication

Market implication: The Fed's less-hawkish tones eased the concern over the possibility of more tightening policy.

- Previously, market expected that the Fed might shift their stance into more hawkish tone during the FOMC announcement because of solid inflation and labor market condition. Due to affirmation that Fed would not consider policy rate hike in 2024, investors' concern was relieved, pushing US Dollar to depreciate. After May-24 FOMC announcement, US Dollar weakened until closed lower by 0.44% to 105.76. US Dollar depreciation was trimmed slightly because the Fed also admitted that disinflation progress already stalled and future policy rate decision will be highly dependent on the US economic indicator development.
- Simultaneously, US Treasury (UST) yields decreased after the FOMC meeting announcement, mainly because of certainty regarding the slowdown of QT policy. The QT policy boosted expectation that bond supply in market would not increase significantly. As a result, demand for UST increased, lowering yield of UST yield. The 10-year UST yield fell by 5bps to 4.63%.

Our PIERspective:

- Due to persistent core inflation trend, we expect that US inflation level for full year 2024 could be above the Fed's economic projection in the Mar-24 FOMC. We see that extended duration for inflation to return to the target will force the Fed to maintain the current level of policy rate longer towards the end of 2024, thus maintaining 'higher-for-longer' stance. The inflationary risk for US inflation is also come from the geopolitical uncertainty in Middle East, prone to boost energy prices in the US. The pressure from demand in the US is also reflected by stronger US labor market. The US labor market remained tight until end of 1Q24, especially because of stronger demand labor in construction and service sector. Due to that condition, we revise down our expectation of our projection in FFR from previously 4.50%-4.75% to 5.00%-5.25%. We expected that Fed will only cut FFR once this year in Dec-24 by 25bps.
- In line with change in our expectation toward 'higher-for-longer' stance from the Fed, we also revised our expectation of Bi-rate and Rupiah. After expectation of the Fed's rate cut changed, Rupiah depreciated by 2.49%mom in Apr-24 until reached above Rp16,000 per USD. We expect Rupiah to move around Rp16,150 – 16,450 per USD in 2Q24 and 3Q24, because global uncertainty is still looming. Rupiah tends to strengthen ahead of 4Q24, after the Fed already signal the policy rate cut, mostly supported by foreign capital inflow in the bond market. *We now expect that BI will hold BI-rate at 6.25% until the end of 2024, and the Rupiah exchange rate will be around Rp16,000 – 16,400 per USD by the end of 2024, with the 10-year IDR bond yield hovering around 7.00 – 7.30%.*
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PIER Snapshot: May-24 FOMC Meeting

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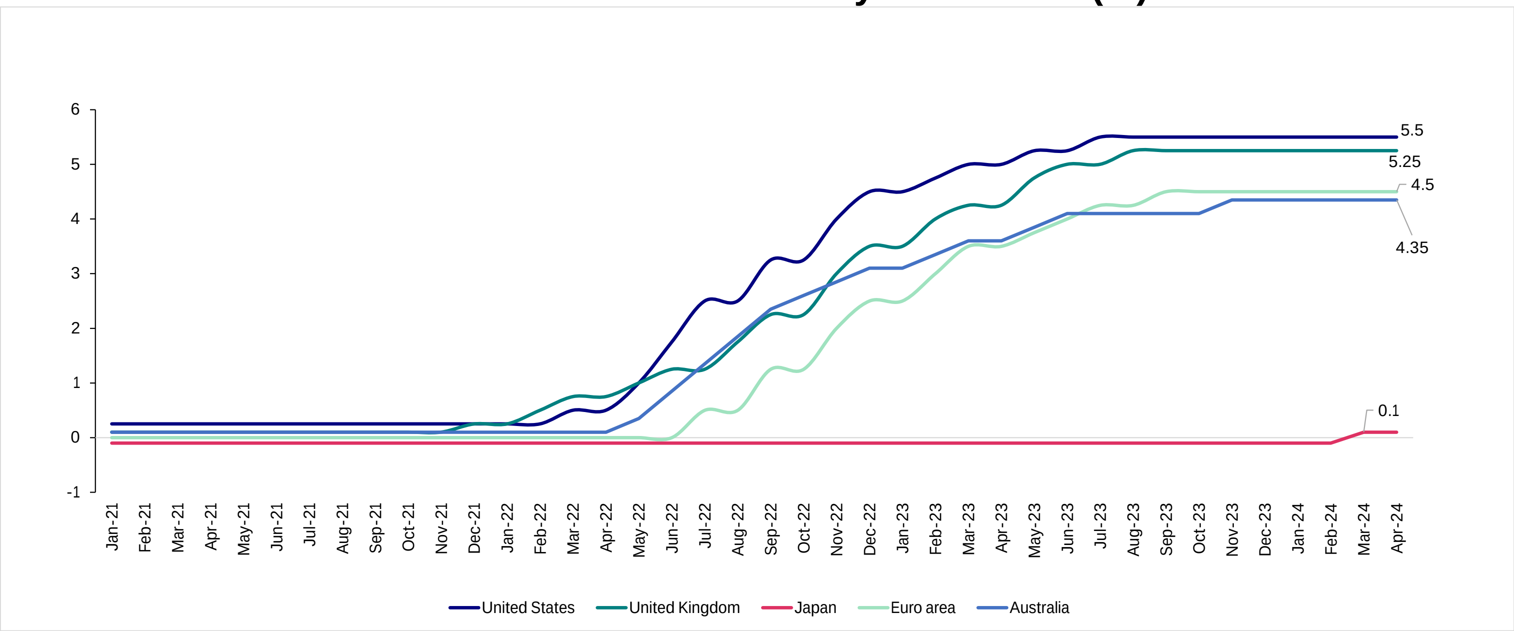
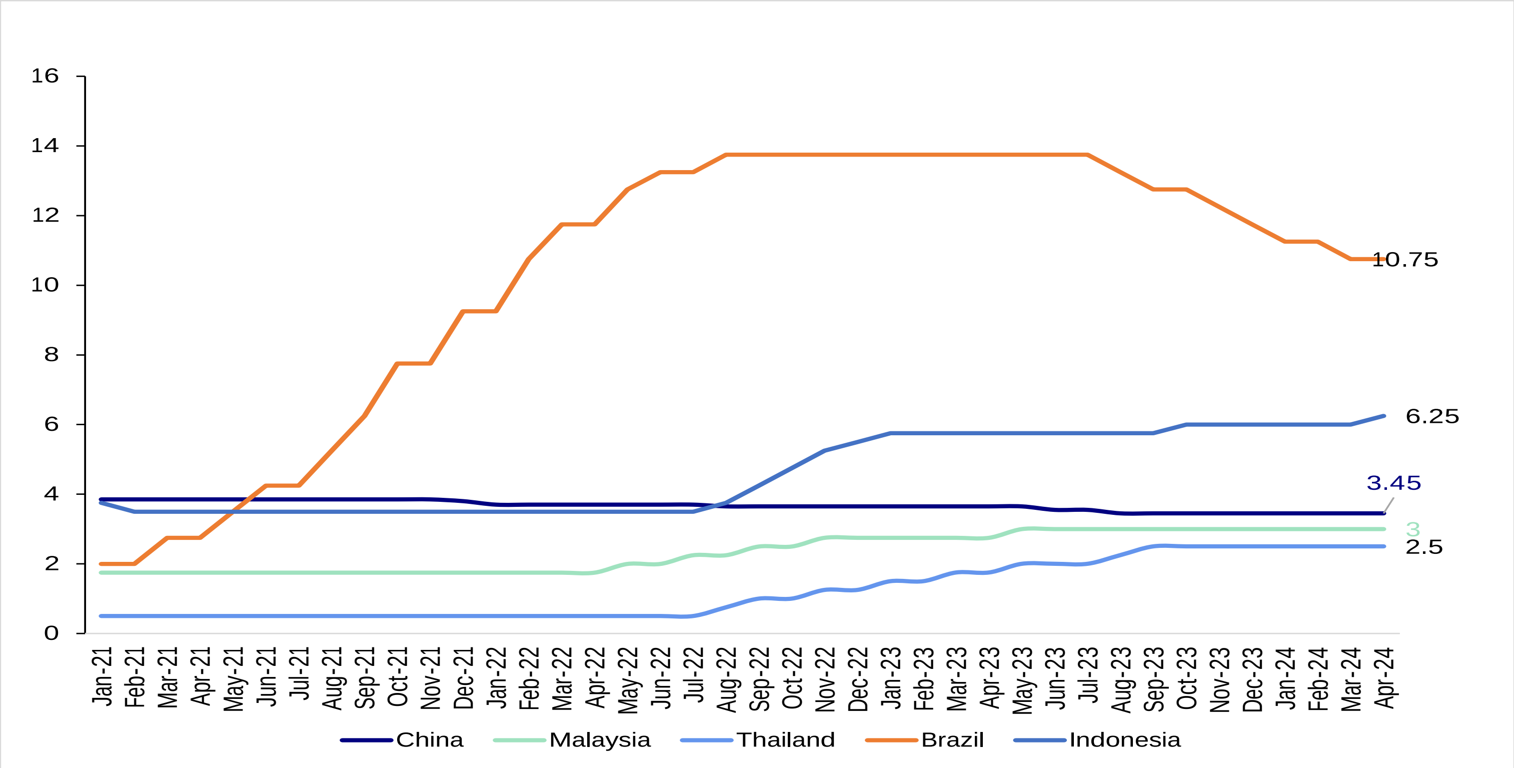
Global Central Banks' Policy Rate Trend (%)



Source: Bloomberg & PIER



Source: Bloomberg & PIER

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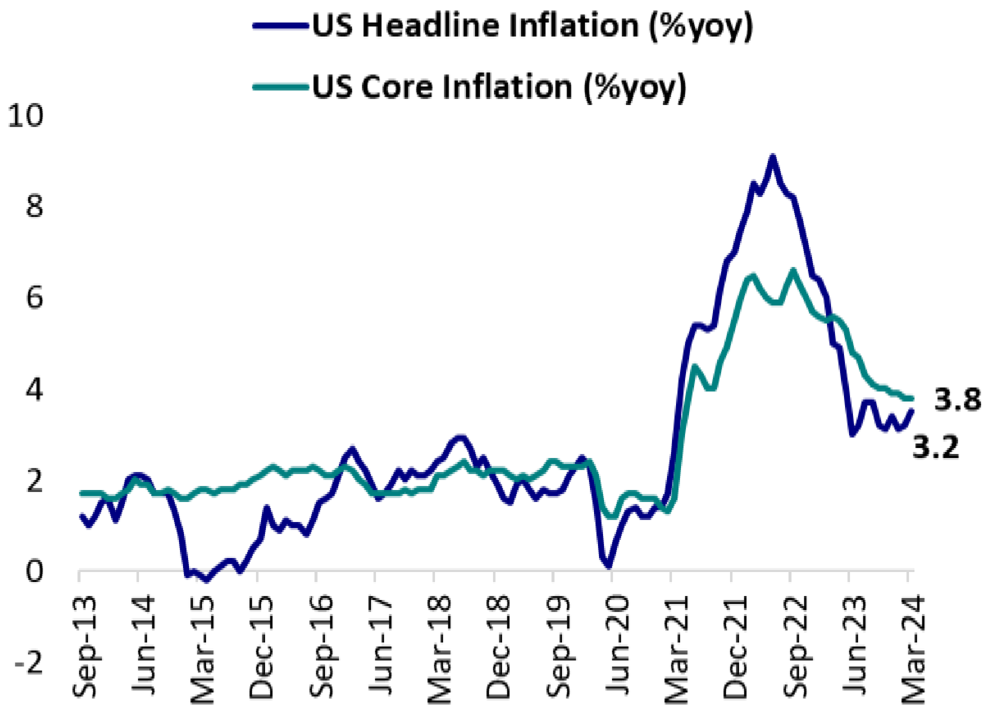
Probability of FFR Path

CME FEDWATCH TOOL - CONDITIONAL MEETING PROBABILITIES							
MEETING DATE	375-400	400-425	425-450	450-475	475-500	500-525	525-550
Jun-24		0.00%	0.00%	0.00%	0.00%	9.10%	90.90%
Jul-24	0.00%	0.00%	0.00%	0.00%	1.90%	26.00%	72.10%
Sep-24	0.00%	0.00%	0.00%	0.70%	11.00%	43.50%	44.70%
Nov-24	0.00%	0.00%	0.20%	3.30%	19.30%	43.80%	33.40%
Dec-24	0.00%	0.10%	1.60%	10.30%	30.00%	39.30%	18.80%
Jan-25	0.00%	0.60%	4.40%	16.60%	33.00%	32.70%	12.80%
Mar-25	0.30%	2.20%	9.70%	23.80%	32.90%	23.90%	7.20%
Apr-25	0.80%	4.40%	13.80%	26.40%	30.30%	19.10%	5.10%

Source: CME Fed Watch Tools

US Core Inflation Still Recorded High, Reflecting Inflationary Pressure from Demand



Source: Bloomberg & PIER

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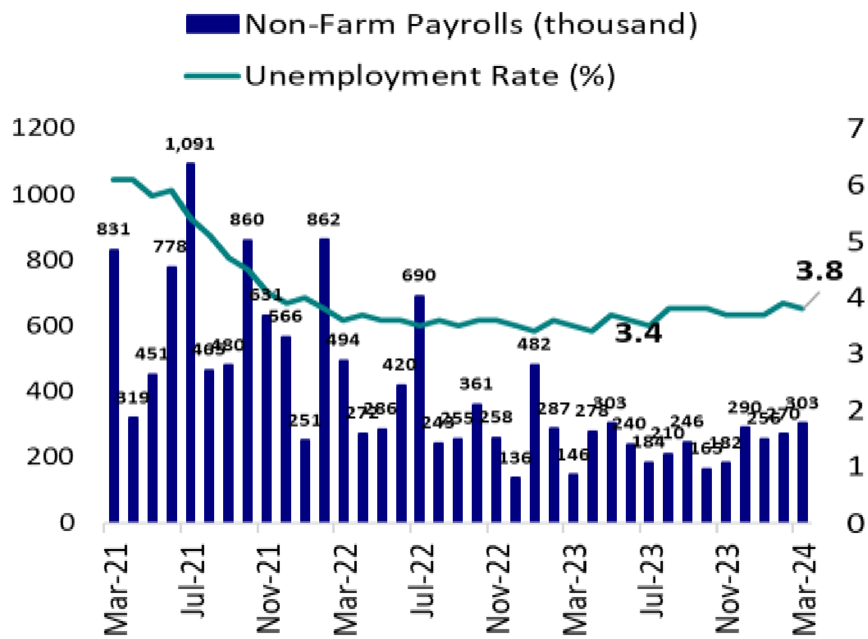
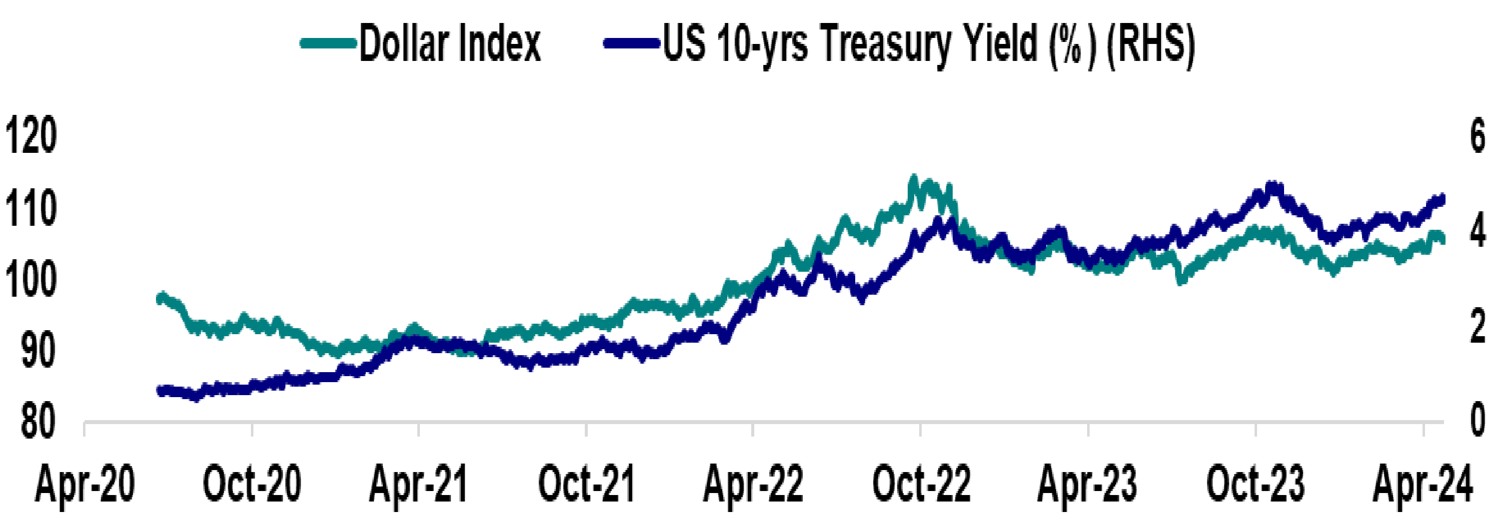
Unemployment Rate Fell in Mar-24, Affirming Tight Labor Market



Source: Bloomberg & PIER

Tighter Labor Market and Stronger Inflation Supported US Dollar Appreciation



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PIER's Economic & Market Forecast

	2019	2020	2021	2022	2023	1Q24F	2Q24F	3Q24F	4Q24F	2024F	2025F	2026F
National Account												
Real GDP (% yoy)	5.02	-2.07	3.70	5.31	5.05	5.10	5.11	5.05	5.00	5.07	5.15	5.26
Real Consumption: Private (% yoy)	5.04	-2.63	2.02	4.93	4.82	5.18	5.20	5.15	5.05	5.14	5.10	5.12
Real Consumption: Government (% yoy)	3.27	2.12	4.24	-4.51	2.95	5.05	4.79	4.81	5.05	4.93	5.52	6.09
Real Gross Fixed Capital Formation (% yoy)	4.45	-4.96	3.80	3.87	4.40	4.58	4.23	5.13	5.11	4.78	5.83	6.62
Real Export (% yoy)	-0.48	-8.42	17.95	16.28	1.32	-5.23	-2.39	1.27	4.95	-0.29	9.62	10.41
Real Import (% yoy)	-7.13	-17.60	24.87	14.75	-1.65	-4.63	-2.95	2.88	6.36	0.57	11.82	12.65
Nominal GDP (IDR tn) - nominal	15,832.66	15,443.35	16,976.75	19,588.09	20,892.38	5,485.18	5,656.44	5,727.52	5,731.41	22,600.55	24,479.95	26,548.14
Nominal GDP (USD bn) - nominal	1,119.10	1,059.93	1,186.29	1,318.68	1,371.47	355.01	366.11	374.25	378.60	1,473.98	1,641.11	1,807.17
Inflation & Unemployment												
Headline Inflation Rate (2022=100, % yoy, avg)	2.82	2.04	1.56	4.14	3.73	2.79	3.10	3.15	3.07	3.03	3.15	3.18
Headline Inflation Rate (2022=100, % yoy, eop)	2.59	1.68	1.87	5.41	2.81	3.05	3.18	3.12	3.08	3.08	3.25	3.15
Unemployment Rate (%)	5.18	7.07	6.49	5.86	5.32	5.14	5.14	5.28	5.28	5.28	5.14	4.91
Fiscal Condition												
Fiscal Balance (% of GDP)	-2.20	-6.14	-4.57	-2.35	-1.65	0.25	0.05	-0.75	-2.14	-2.14	-2.00	-2.04
IDR 10-year Bond Yield (%)	7.06	5.89	6.38	6.94	6.48	6.73	7.25	7.16	7.10	7.10	6.39	5.87
External Sector												
Trade Balance (USD bn)	-3.59	21.62	35.42	54.46	36.91	7.31	6.11	5.44	6.52	25.38	23.41	17.22
Goods Balance (USD bn)	3.51	28.30	43.81	62.67	46.35	9.57	8.13	7.44	8.54	33.68	31.44	25.24
Current Account (USD bn)	-30.28	-4.43	3.51	13.22	-1.57	-1.35	-3.37	-3.31	-2.36	-10.38	-18.67	-26.63
Current Account (% of GDP)	-2.71	-0.42	0.30	1.00	-0.11	-0.38	-0.92	-0.88	-0.60	-0.70	-1.13	-1.46
Foreign Reserves (USD bn)	129.18	135.90	144.91	137.23	146.38	140.39	131.79	132.41	140.72	140.72	141.07	144.51
USD/IDR (avg)	14,141	14,529	14,297	14,874	15,248	15,783	16,325	16,208	16,158	16,119	15,817	15,201
USD/IDR (eop)	13,866	14,050	14,253	15,568	15,397	15,855	16,235	16,245	16,121	16,121	15,595	14,897
Commodity Price												
Coal Price (USD/MT)	66.2	83.0	169.7	379.2	141.8	133.1	124.4	121.0	117.5	117.5	103.8	90.3
CPO Price (USD/MT)	763.7	1,016.4	1,270.3	940.4	797.8	805.8	813.7	821.7	829.6	829.6	818.0	808.3
Oil Price (USD/BBL)	65.85	49.87	74.31	80.90	77.9	77.8	77.7	79.0	80.3	80.3	84.1	85.4
Interest Rate												
Fed Funds Rate (%)	1.75	0.25	0.25	4.50	5.50	5.50	5.50	5.25	4.75	4.75	3.75	2.75
BI Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00	6.00	6.00	5.50	5.50	4.50	4.00
Average Lending Rate (%)	10.52	9.67	9.16	9.16	9.27	9.28	9.23	9.21	9.15	9.15	8.55	8.00
Banking Sector												
Loan (% yoy)	6.08	-2.40	5.24	11.35	10.38	10.48	10.58	10.69	10.79	10.79	11.34	11.78
TPF (% yoy)	6.54	11.11	12.21	9.01	3.73	4.84	6.28	8.15	10.57	10.57	9.39	9.22
LDR (%)	94.8	83.2	77.8	79.7	83.8	84.8	86.1	85.9	84.0	84.0	85.5	87.5
Real Sector												
Car Sales (Unit)	1,030,126	532,027	887,202	1,048,040	1,005,802	313,529	202,128	252,240	279,733	1,047,630	1,071,763	1,144,675
Car Sales (% yoy)	-10.5	-48.4	66.8	18.1	-4.0	-1.0	-9.7	1.2	25.4	4.2	2.3	6.8
Motorcycles Sales (Unit)	6,487,460	3,660,616	5,057,516	5,221,470	6,236,992	2,144,597	1,026,925	1,604,918	1,502,065	6,278,505	6,300,894	6,436,790
Motorcycles Sales (% yoy)	1.6	-43.6	38.2	3.2	19.4	17.6	-25.5	5.6	-0.9	0.7	0.4	2.2

Source: Permata Institute for Economic Research (PIER)

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Permata Institute for Economic Research (PIER)

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