Fed Rate Meeting: 19 December 2024

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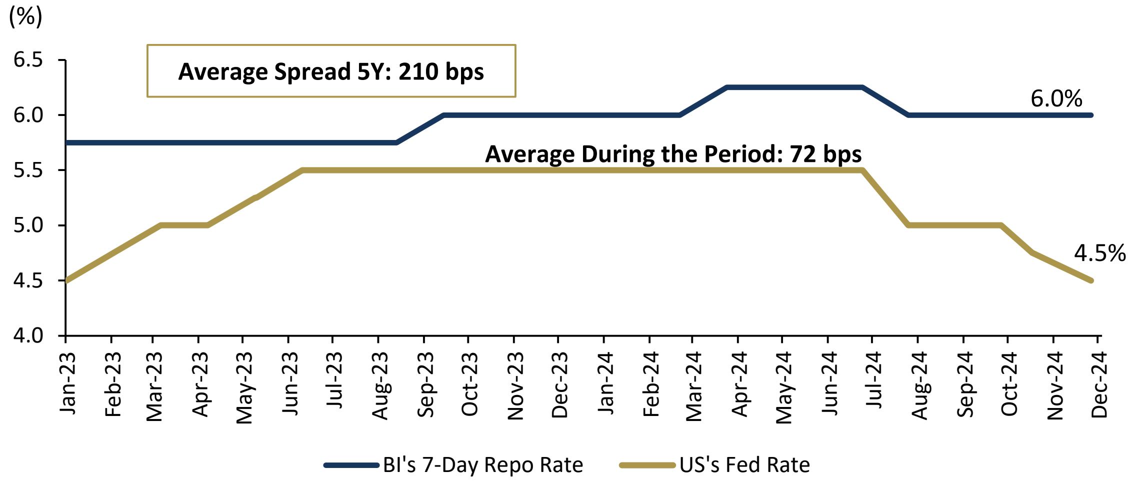
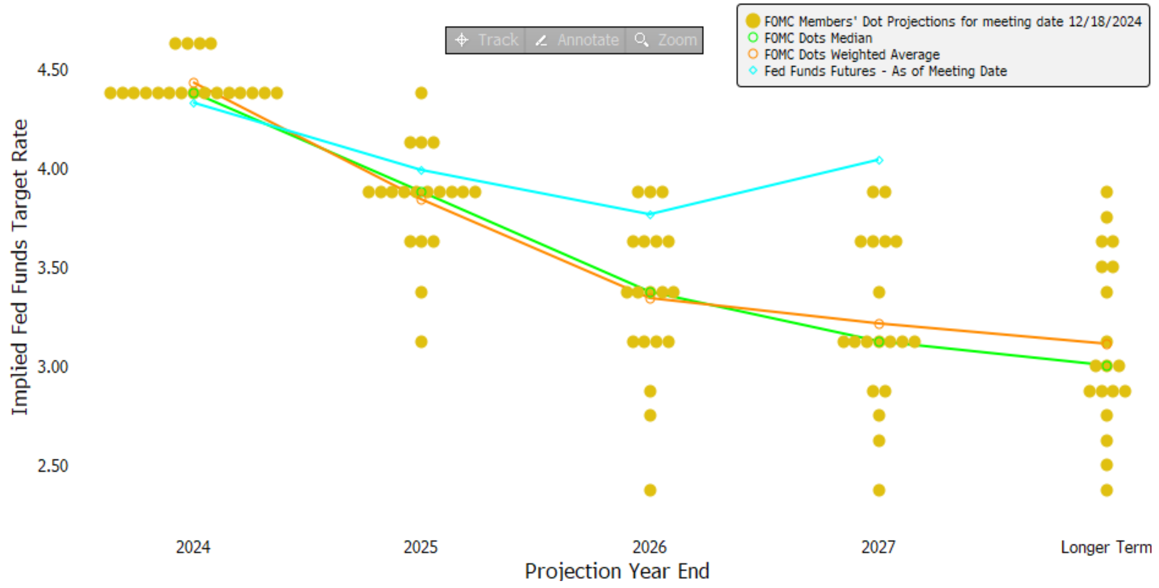
- The Federal Reserve's December 2024 decision to implement a 25-basis-point cut, reducing the federal funds rate to the 4.25%-4.5% range, highlights a nuanced approach to balancing economic growth with inflation management. This marks the third consecutive rate cut this year, signalling a shift towards a more accommodative monetary stance amid evolving economic conditions. The Fed's updated guidance, reflected in its dot plot, suggests that policymakers anticipate only two rate cuts in 2025—totalling 50 basis points—down from the 100 basis points previously expected. This adjustment underscores the Fed's recognition of persistent inflationary pressures and solid economic activity.
- Revised GDP growth forecasts further cement the Fed's optimism about the economy's resilience. The upward revision for 2024 (from 2% to 2.5%) and 2025 (from 2% to 2.1%) reflects sustained consumer spending and labor market strength. Concurrently, inflation projections have been raised, with PCE inflation now expected to reach 2.4% in 2024, 2.5% in 2025, and 2.1% in 2026, signalling the Fed's expectation of prolonged periods with above-target price pressures. Core PCE inflation estimates follow similar trajectory, reflecting sticky underlying inflationary drivers. The downward adjustments to unemployment projections for 2024 (4.2% vs. 4.4%) and 2025 (4.3% vs. 4.4%) further highlight labor market tightness as contributing factor to sustained inflation.
- For Indonesia, these developments carry significant macroeconomic implications. While the Fed's dovish pivot, albeit moderate, may provide relief, emerging markets like Indonesia appear to have suffered from potentially stronger dollar for longer as the US central bank expects fewer rate cuts leading up to 2025. This expectation spells bad news for our IDR despite Bank Indonesia's prudent move of maintaining its benchmark rate at 6% to support the local currency and ensure external stability.
- The upward revisions to U.S. growth and inflation forecasts may also prolong the period of elevated global commodity prices, benefiting Indonesia's export revenues in sectors like palm oil, coal, and nickel. However, higher global inflation could lead to imported inflationary pressures, complicating Indonesia's inflation management. In this context, Bank Indonesia's policy focus on maintaining macroeconomic stability, particularly through measures to stabilize the IDR and manage inflation expectations, will remain critical.
- At this stage of the market cycle, we see five factors that would weigh on the IDR: 1. weaker commodity prices on global economic slow down; 2. higher imports as the new president attempts to accelerate Indonesia's economic growth; 3. widening budget deficit on the back of tax potential shortfall; 4. Yuan depreciation caused by US-China trade war to drag down regional currencies including the IDR; 5. stronger USD for longer on the Fed's limited ability to cut rates next year. That said, Bank Indonesia's recent unchanged rate decision reflects a proactive stance to support the IDR amid both local and global challenges.

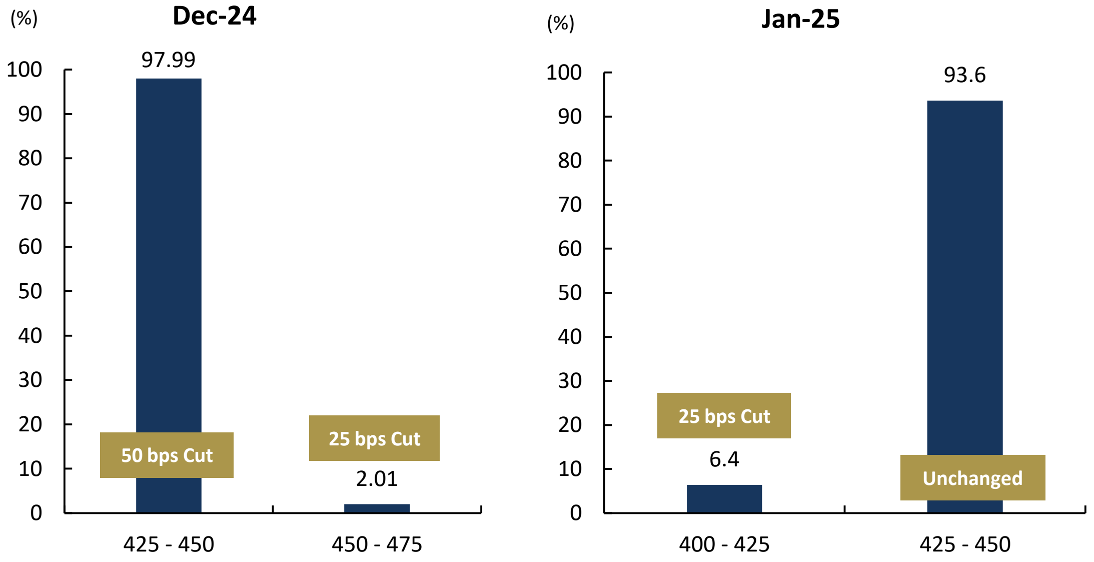
US' Fed Rate and BI's 7-Day Repo Rate



FOMC Dot Plot



Target Rate Probabilities for Dec-24 & Jan-25 Fed Meeting



Sources: Bloomberg, SSI Research

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