Keeping tabs on the gold-hoarding Eastern dragon

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Summary

- The recent gold price rally has been driven by China, in part due to the PBoC's move to "de-risk" away from US Treasuries.
- However, there also appears to be a strong demand for gold from Chinese households, which underscores the scale of the capital outflow challenge confronting the PBoC, thus amplifying the depreciation risk facing the CNY and other Asian currencies.
- Lower demand for UST as China's surplus is shifted to gold may, in the medium term, force the Fed to loosen its policy and provide more liquidity support for the UST market.

- The Indonesian financial market seems to be reverting to its 2024 factory setting in the last week. The domestic stock market again benefitted from foreign capital inflows, albeit the nominal amount is limited to USD 67.04 Mn. Meanwhile, the SBN market continues to suffer from foreign capital outflows, which amounted to USD 318.49 Mn in the past week. uReduced concerns about political uncertainty and fiscal deterioration in the short term have not been able to attract foreign investors back to the SBN market, as lower SBN yields seem to send foreign investors away in search of better yields.
- Luckily, the Rupiah still managed to find its strength in the last week despite the ~USD 251.45 Mn in net foreign outflows. Given the lack of improvement in domestic circumstances (apart from the improving terms of trade), the Rupiah's strengthening value seems to be a product of the weakening USD. Indeed, the US unemployment rate reported last week turned out to be higher than analysts expected (3.9% vs. 3.7% forecast), adding to evidence of a loosening labour market in the US that could set the stage for the Fed's monetary policy easing.

Beware of the contagious gold-disease

- Given the increasingly stimulus-driven nature of the market, it is not surprising to see both the US Treasury and stock markets rallying in the same week that US unemployment figures are increasing. The recent broad asset price rally is particularly evident in the gold market, which appreciated by 3.05% over the past week. Once again, one may draw a straightforward connection between the rising gold price and the declining value of the USD in the last week, given the historically negative correlation between these two asset classes.

- However, there is evidence that **American investors may not have much to do with the recent rally in the gold market**. American investors have been dumping gold from their portfolios since 2022 ***(see Chart 1)***, possibly as a response to the increasing adoption of digital assets as an alternative to gold. It is quite surprising, then, that gold prices have been rallying despite the still-high short-term real interest rates in the US ***(see Chart 2)***, as the demand for gold appears to be increasingly detached from its traditional role as an inflation-hedging asset in the typical American investors' portfolio.

> ***"It is difficult to pin the recent gold price rally to the PBoC's gold-buying rally, given the limited growth in the central bank's foreign reserves"***

- **There is no denying that the recent rally in the gold market has been primarily driven not by the US or other Western economies, but by China.** We focus our discussion, then, on the debate on whether it is the People's Bank of China (PBoC) or Chinese households that play a larger role in driving the demand for gold.

- A common answer to the debate is that the demand for gold has been primarily driven by the PBoC, which has been adding gold to its FX reserves in the past 16 months. **PBoC's gold-buying streak is understood as part of its switch away from US Treasuries**, which started back around 2017-18 but has accelerated more recently for geopolitical reasons after the US froze Russia's UST holdings.

- However**, it is difficult to pin the recent gold price rally solely on the PBoC.** Despite China's huge CA surplus (USD 264.2 Bn in 2023, relative to the pre-pandemic average of around USD 160 Bn per year), its accumulation of FX reserves has been a good deal smaller (only about USD 50 Bn over the past year). This speaks to the challenge now confronting PBoC in stabilising the CNY, as foreign capital is flowing out of the Chinese economy as a part of their own de-risking effort.

- **This limited FX reserves growth provides less room for the PBoC to accumulate gold.** And even if some of the reserves that would otherwise be allocated to USTs are now being allotted for gold, it is unlikely that there is a one-to-one substitution. There are, for instance, indications that the PBoC has been shifting instead to higher-yielding financial assets (even including US agency bonds). Gold may continue to share space with these other assets in the PBoC's coffers, meaning that the likelihood that the recent surge in the demand for gold is solely due to the central bank's policy is quite low.

- **The increasing demand for gold in China, then, is likely to be primarily driven by its household sector**. Such a reading appears to be more consequential for the Chinese and the global economy, given the condition may portend three risks. First, **increasing demand for assets such as gold illustrates Chinese households' still-high savings rate**, meaning that domestic consumption growth remains unlikely to improve in the short term despite PBoC's multiple efforts to cut its policy rates. The sluggish growth in China's domestic aggregate demand could spell trouble for the global economy. However, continued stimulus to the manufacturing sector may still have positive impacts on economies situated upstream of China's supply chain, such as Indonesia.

- Second, **the increasing demand for gold from the household sector reflects Chinese investors' scepticism about the investability of China's domestic financial market** (or its still-imploding domestic real estate market). Given retail investors' traditionally outsized role in dictating China's domestic stock market (in contrast to the cluster of institutional investors in the Hong Kong stock market), **lower demand from Chinese households may discourage foreign investors from collecting more A-shares** – potentially exposing China's two domestic stock markets to further bouts of foreign capital outflows.

- Third, **households' increased demand for gold is practically a form of capital outflows from the Chinese economy**, thereby compounding the foreign capital outflow problem now facing the PBoC. The outflow of domestic capital in exchange for non-productive (albeit neutral) assets such as gold could reduce the private sector coffers that the government could tap to finance its stimulus, thus requiring the PBoC to play an active role in providing the liquidity needed to avert the feared stagnation.

- **China, of course, has already implemented its iterations of quantitative easing (QE), which took the form of a substantial increase in lending to domestic banks *(see Chart 4)***. Unlike expanding foreign assets through purchases of gold or other non-RMB financial assets, this more practical intervention would ensure the availability of cheap financing for the economy, enabling the Chinese manufacturing sector to sustain its expansion – especially in sectors crucial to the government's MIC2025 industrial policy.

"Chinese households' higher demand for gold reflects their still-high saving rate and scepticism of China's domestic financial market"

- The urgency for PBoC to maintain its loose stance may translate negatively to other, more peripheral Asian currencies, including the Rupiah. However, **Chinese investors' shift from financial assets, primarily US Treasuries, to gold may also present a risk for the USD and the Fed.**

- With UST holdings amounting to USD 816.1 Bn (as of December 2023), Chinese investors rank second only to their Japanese counterparts in terms of USD holdings. **The demand for UST, then, may become increasingly domestic, at the time when the US Treasury is projected to issue more debt while the Fed pledges to curb the USD**

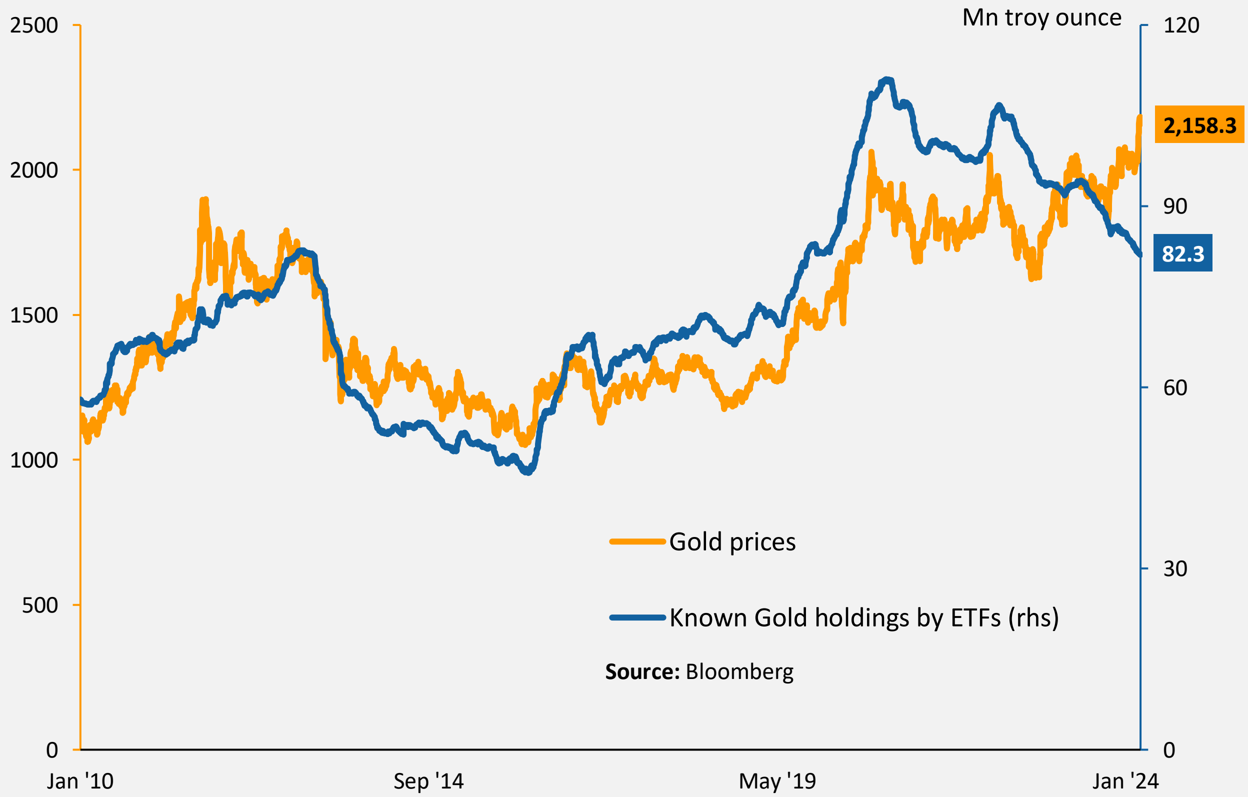
liquidity despite signalling 75 bps rate cuts in 2024. Ergo, declining Chinese and other foreign investors' demand for US Treasuries may still pose a liquidity risk for the UST market, which may compel the Fed to take a U-turn in its commitment to maintaining the Quantitative Tightening (QT) campaign.

- This reading, then, strengthens our expectation that the Fed is due to lower its policy rate sometime in H2 2024. In the meantime, Bank Indonesia may need to rely on another tool, such as FX market interventions, to stabilise the Rupiah's value amidst the contagion effect from China's accommodative monetary policy stance and the ebb-and-flow in the market's FFR expectations. However, the recent increase in commodity prices, which accompanied the rally in the gold market ***(see Chart 5)***, may help to improve Indonesia's FX revenue in the short term, while the gold rally boosts the value of BI's reserves on mark-to-market basis – thus minimising the blow to BI's FX coffers.

Chart 1

Un-American

Recent macro developments in the US may play a lesser role in the recent gold price rally as American investors continue to shift their portfolios away from gold



Source: Bloomberg

Chart 2

Unburdened by rates

The gold market is rallying in 2024 despite the still-high short-term real interest rate in the US, further signalling that the higher demand for gold is not coming from American investors

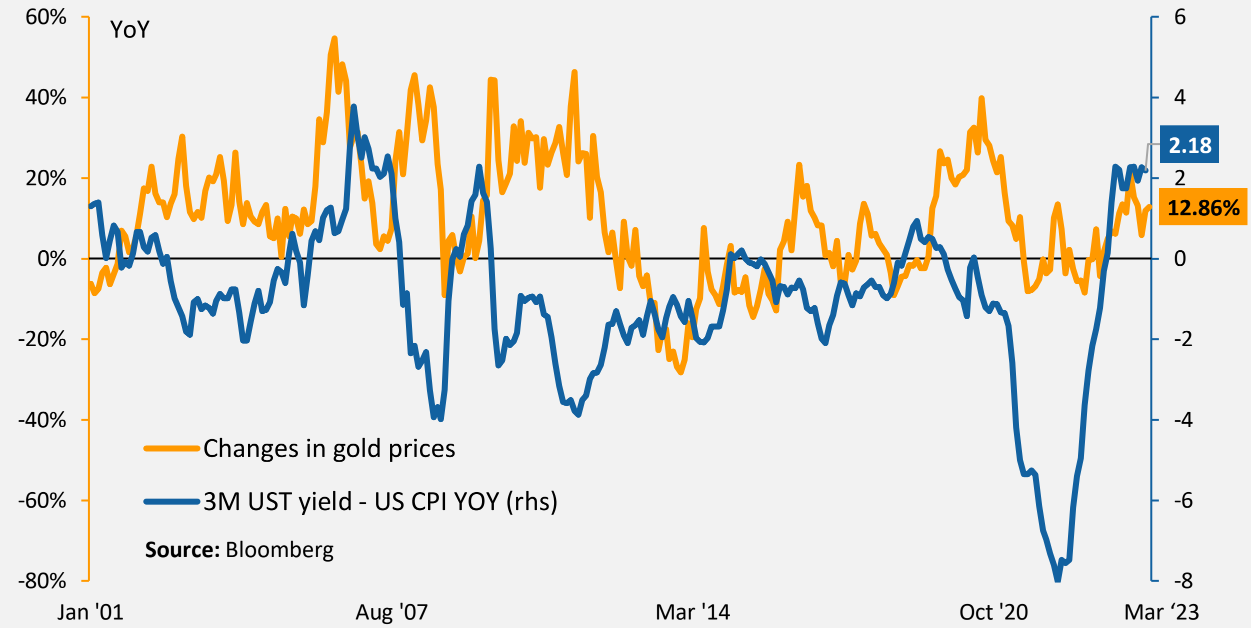


Chart 3

Constant siege

Continued pressure on the RMB spring the PBoC to intervene, reducing the central bank's FX reserves despite China's bountiful CA surplus

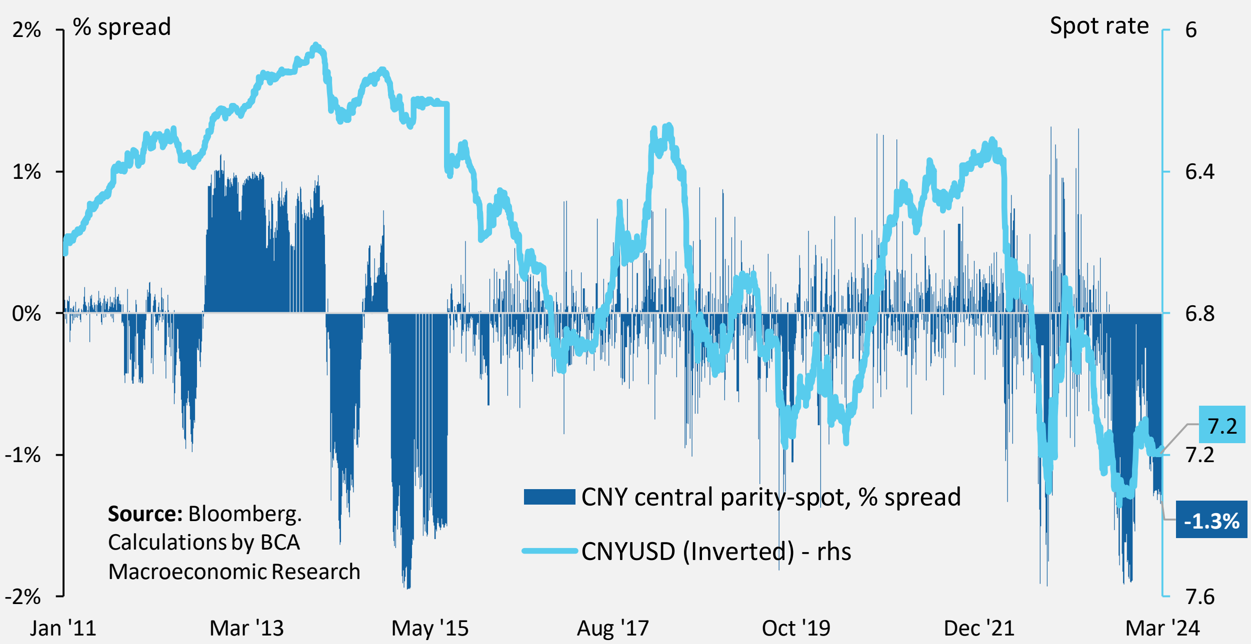


Chart 4

More loans than gold

The PBoC expanded its balance sheet by lending to domestic banks while the impact of the recent gold-buying streak on the central bank's balance sheet growth remains limited.

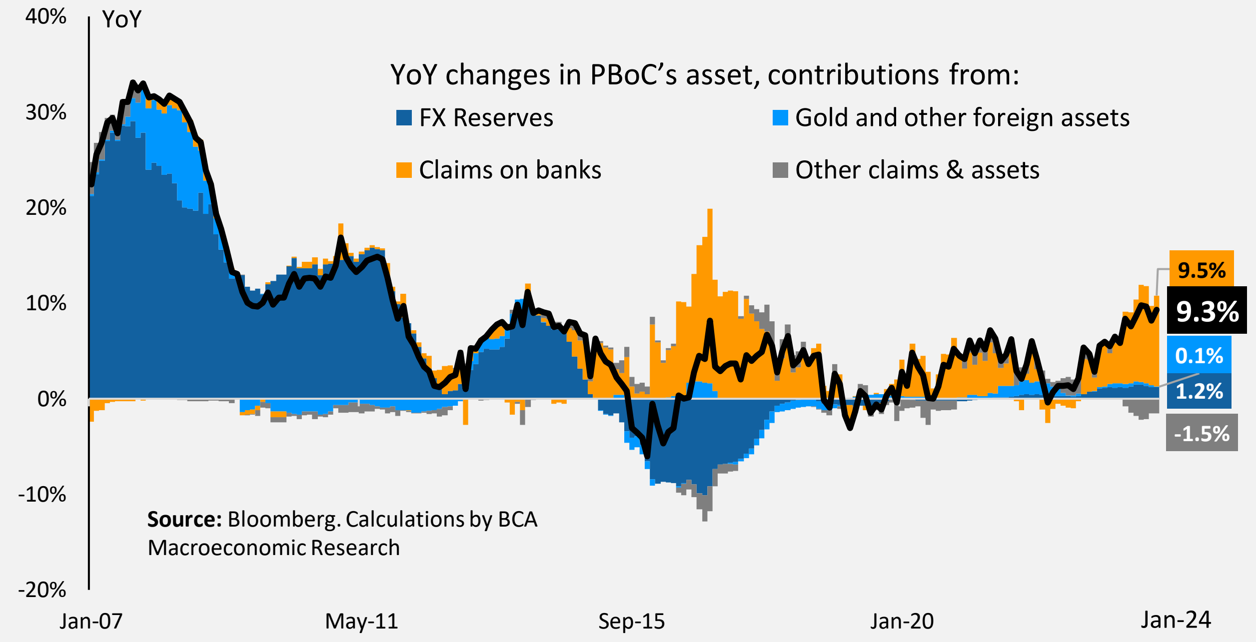
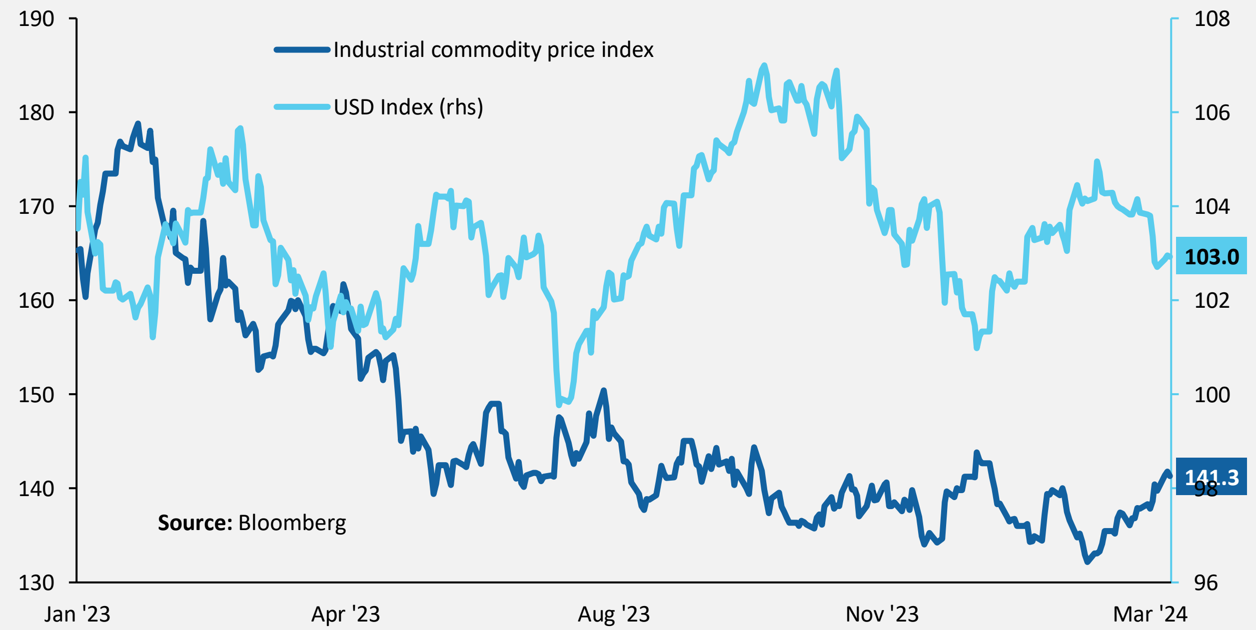


Chart 5

Additional dry powders

Recovering mineral prices may increase Indonesia's FX revenue in the short term, keeping BI's FX reserves on a healthy level amidst a potential increase in the need for FX market interventions.



Economic Calendar

		Actual	Previous	Forecast*
1 March 2024				
ID	**Inflation rate YoY**, %	**2.75**	**2. 57**	**2.50**
ID	S&P Global Manufacturing PMI	52.7	52.9	52.8
CN	Caixin Manufacturing PMI	50.9	50.8	50.9
US	ISM Manufacturing PMI	47.8	49.1	49.5
6 March 2024				
US	JOLTs Job Openings (Mn)		9.026	-
7 March 2024				
ID	**Foreign Exchange Reserves (USD Bn)**	144	**145.1**	**144**
CN	Balance of Trade (USD Bn)	125.1	75.3	106
US	Balance of Trade (USD Bn)	-67.4	-64.2	-63.5
8 Maret 2024				
US	Non Farm Payroll, (Th)	275	229	195
US	Unemployment Rate, %	3.9	3.7	3.7
9 Maret 2024				
CN	Inflation Rate YoY, %	0.7	-0.8	0.3
11 Maret 2024				
ID	Car Sales YoY, %	-18.8	-26.1	-
ID	Motorbike Sales YoY, %	-2.9	-3.7	-
12 Maret 2024				
US	Inflation Rate YoY, %	3.2	3.1	3.2
13 Maret 2024				
ID	Consumer Confidence	123.1	125.0	126
14 Maret 2024				
ID	Retail Sales YoY, %		0.2	-
15 Maret 2024				
ID	**Balance of Trade (USD Bn)**		**2.0**	**-**
20 Maret 2024				
ID	**BI Rate Announcement**, %		**6.0**	**6.0**
ID	Loan Growth YoY, %		11.8	-
21 Maret 2024				
US	**Fed Interest Rate Decision, %**		**5.5**	**5.5**

*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	Dec-23	2.30
UK	5.25	Dec-23	1.25
EU	4.50	Dec-23	1.90
Japan	-0.10	Jan-16	-2.30
China (lending)	2.50	Dec-23	3.65
Korea	3.50	Nov-23	0.40
India	6.50	Dec-23	1.41
Indonesia	6.00	Nov-23	3.25
Money Mkt Rates	**8-Mar**	**-1 mth**	**Chg (bps)**
SPN (1M)	5.88	5.80	7.6
SUN (10Y)	6.61	6.61	0.7
INDONIA (O/N, Rp)	6.01	5.94	7.7
JIBOR 1M (Rp)	6.64	6.63	1.0
Bank Rates (Rp)	**Dec**	**Nov**	**Chg (bps)**
Lending (WC)	8.86	8.91	-4.93
Deposit 1M	4.76	4.52	24.61
Savings	0.69	0.67	1.94
Currency/USD	**8-Mar**	**-1 mth**	**Chg (%)**
UK Pound	0.778	0.794	2.06
Euro	0.914	0.930	1.71
Japanese Yen	147.1	147.9	0.60
Chinese RMB	7.187	7.190	0.04
Indonesia Rupiah	15,590	15,730	0.90
Capital Mkt	**8-Mar**	**-1 mth**	**Chg (%)**
JCI	7,381.9	7,247.4	1.86
DJIA	38,722.7	38,521.4	0.52
FTSE	7,659.7	7,681.0	-0.28
Nikkei 225	39,688.9	36,160.7	9.76
Hang Seng	16,353.4	16,136.9	1.34
Foreign portfolio ownership (Rp Tn)	**Feb**	**Jan**	**Chg (Rp Tn)**
Stock	3,236.2	2,700.6	535.61
Govt. Bond	837.1	811.9	25.24
Corp. Bond	9.5	12.4	-2.94

Trade & Commodities	8-Mar	-1 mth	Chg (%)
Baltic Dry Index	2,345.0	1,516.0	54.7
S&P GSCI Index	559.5	544.7	2.7
Oil (Brent, $/brl)	82.1	78.6	4.4
Coal ($/MT)	136.5	122.3	11.7
Gas ($/MMBtu)	1.54	2.09	-26.3
Gold ($/oz.)	2,179.0	2,036.1	7.0
Copper ($/MT)	8,487.3	8,293.3	2.3
Nickel ($/MT)	17,803.0	15,660.0	13.7
CPO ($/MT)	894.4	812.1	10.1
Rubber ($/kg)	1.62	1.51	7.3
External Sector	**Jan**	**Dec**	**Chg (%)**
Export ($ bn)	20.52	22.39	-8.34
Import ($ bn)	18.51	19.11	-3.13
Trade bal. ($ bn)	2.02	3.29	-38.67
Central bank reserves ($ bn)*	145.1	146.4	-0.91
Prompt Indicators	**Jan**	**Dec**	**Nov**
Consumer confidence index (CCI)	125.0	123.8	123.6
Car sales (%YoY)	-26.1	-19.1	-7.5
Motorcycle sales (%YoY)	-3.7	-11.6	-2.8
Manufacturing PMI	**Jan**	**Dec**	**Chg (bps)**
USA	50.7	47.9	280
Eurozone	46.6	44.4	220
Japan	48.0	47.9	10
China	50.8	50.8	0
Korea	51.2	49.9	130
Indonesia	52.9	52.2	70

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	2023E	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0*	5.0
GDP per Capita (US$)	4175	3912	4350	4784	4920*	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6*	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00*	5.50
USD/IDR Exchange Rate (end of the year)**	13,866	14,050	14,262	15,568	15,397*	16.037
Trade Balance (US$ 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

*Actual number

** Estimation of the Rupiah's fundamental exchange rate

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