Three cheers for the Rupiah, but threats remain

16 January 2023

Lazuardin Thariq Hamzah
lazuardin_hamzah@bca.co.id

Barra Kukuh Mamia
barra_mamia@bca.co.id

Summary

- The 'Fed pivot' sentiment appears to be on strong foot, given the US inflation number that continue to weaken. However, still-ample liquidity in the US private sector compel the Fed to continue its tightening campaign via QT.
- The weakening USD and inflows to the domestic bond market explain the IDR's ongoing rally. But such a rally could be snapped ahead of the FOMC meeting in early February as the Fed may look to continue tightening its policy.
- The DHE regulation may help to stabilise the IDR's value by improving FX liquidity conditions in the domestic economy and strengthening BI's monetary authority. Emerging economies' concerted move to restrict capital mobility limit the regulation's detrimental impact on Indonesia's FDI attractiveness.

- Some important data points emerged in the third week of 2023, thankfully, to no one's surprise. One of the most consequential should be the Dec-22 US CPI inflation figure (6.45% YoY, 7.11% YoY previously), which continues to track southward. The weakening price movements in the US (and globally) may indicate an ominous sign that aggregate demand is plummeting and the global economy is inching closer towards another recession. Many in the market have been vigilant of signs of global economic winter, hoping that the terminal rate would be no more than 25 – 50 bps hikes away (if not an outright pivot in the second half of 2023 as indicated by FFR futures). Indeed, the "Fed pivot" mania seems to be on strong foot now, as evident from the yet-to-be-broken New Year's rally in the stock market while the USD (DXY) has been shredded by around 173.4 bps in the five last trading day.
- At the same time, markets in Indonesia are continuing with the same story from last week; stocks were mostly going down while yields on Indonesian government bonds continue to fall. **It is the energetic Rupiah, however, that stole the limelight**. We noted three channels behind the IDR's upward momentum. First, as mentioned above, **the USD has been moving lower for some time, a trend that continues after the US inflation data**. **Second, the domestic bond market also provides a boost to the IDR's value,** thanks to foreign capital inflow to the tune of

USD 1.0 Bn. These two positive sentiments, of course, are a by-product of the developing expectation that the Fed may not need to hike its policy rate above 5% in 2023.

- It may be too soon, however, to conclude that the Fed has already given the market a green light to continue rallying. We should recall that the developing expectation does not match the outlooks of many (if not all) FOMC members for 2023 and inflationary risks are still present. For instance, the global energy market remains a question mark for now, considering that commodity demand (especially for energy) from China remains muted despite the re-opening, courtesy of the ongoing COVID-19 outbreaks. There is also concern about the Fed's ongoing quantitative tightening campaign. Despite the alacrity to raise rates, the Fed hasn't followed its QT game plan **(*see* Chart 1)**. Instead of reducing USD 95 Bn per month as announced in the Aug-22 FOMC meeting, the Fed only managed to wind down around USD 16.3 Bn per week from its balance sheet, most of which was on the government's account. All of this means that **the Fed may perceive that there is still significant amount of excess private liquidity to unwind, and thus we may see more liquidity tightening to come, which would once again put depreciating pressure on the IDR.**
- Luckily, the third channel may provide support for the IDR in the coming periods. The government has instructed commodity exporters to keep their proceeds (*Devisa Hasil Ekspor*/DHE) within the Indonesian banking system, improving foreign exchange liquidity conditions in the domestic economy. Indeed, growth in demand for FX loans has outpaced growth in FX deposits throughout much of 2021 - 2022, creating a gap that could undermine the IDR's fundamental value **(*see* Chart 2)**. By ensuring the steady flow of foreign currencies within the domestic banking system, **the DHE regulation may also strengthen Bank Indonesia's monetary sovereignty, making the IDR less vulnerable to fluctuations in the Fed's policy, while also allowing the central bank to maintain its relatively accommodative policy mix** (especially on the macroprudential side) and support the weakening growth outlook in 2023.

"The DHE regulation doesn't make Indonesia's currency flows regime more restrictive than peer economies such as India"

- The potential deluge of FX deposits that might ensue could increase banks' interest expense, especially if demand for FX loans also weakens as imports decline. Luckily, BI is quick to smooth this wrinkle, with an upcoming FX liquidity instrument that would offer banks an attractive return on their FX deposits. This in turn would allow banks to offer attractive rates on FX deposits.
- In theory, this new constraint could be costly, as foreign investors may be none too pleased about their inability to repatriate their gains. This could be especially problematic as the new regulation would extend to the manufacturing sector, and not just primary sectors. However, Indonesia is arguably in a strong position to dictate terms on would-be investors, and the authorities may think that the green energy revolution means that opportunities to invest in Indonesia's

mineral-related sectors are too sumptuous for investors to pass on.

- At the same time, **Indonesia's currency flows regime, as it is, are not notably more restrictive than peers (*see* Chart 3), especially as many emerging markets have been moving towards reduced capital mobility as a way to preserve their monetary independence and exchange-rate stability.** It appears that abandoning that particular vertex of the famous 'impossible trilemma' is the favored choice amid the turbulent cycle of global liquidity expansions and contractions in the past decade and a half. As such, we remain cautiously optimistic for the IDR's stability, while maintaining our view that part of its latest comeback story may be 'froth' that a simple comment from Jerome Powell could 'dissipates'.

Chart 1

Slowly going down the hill

The still-mounting private sector liquidity may strengthen the Fed's fortitude to continue its liquidity-tightening campaign

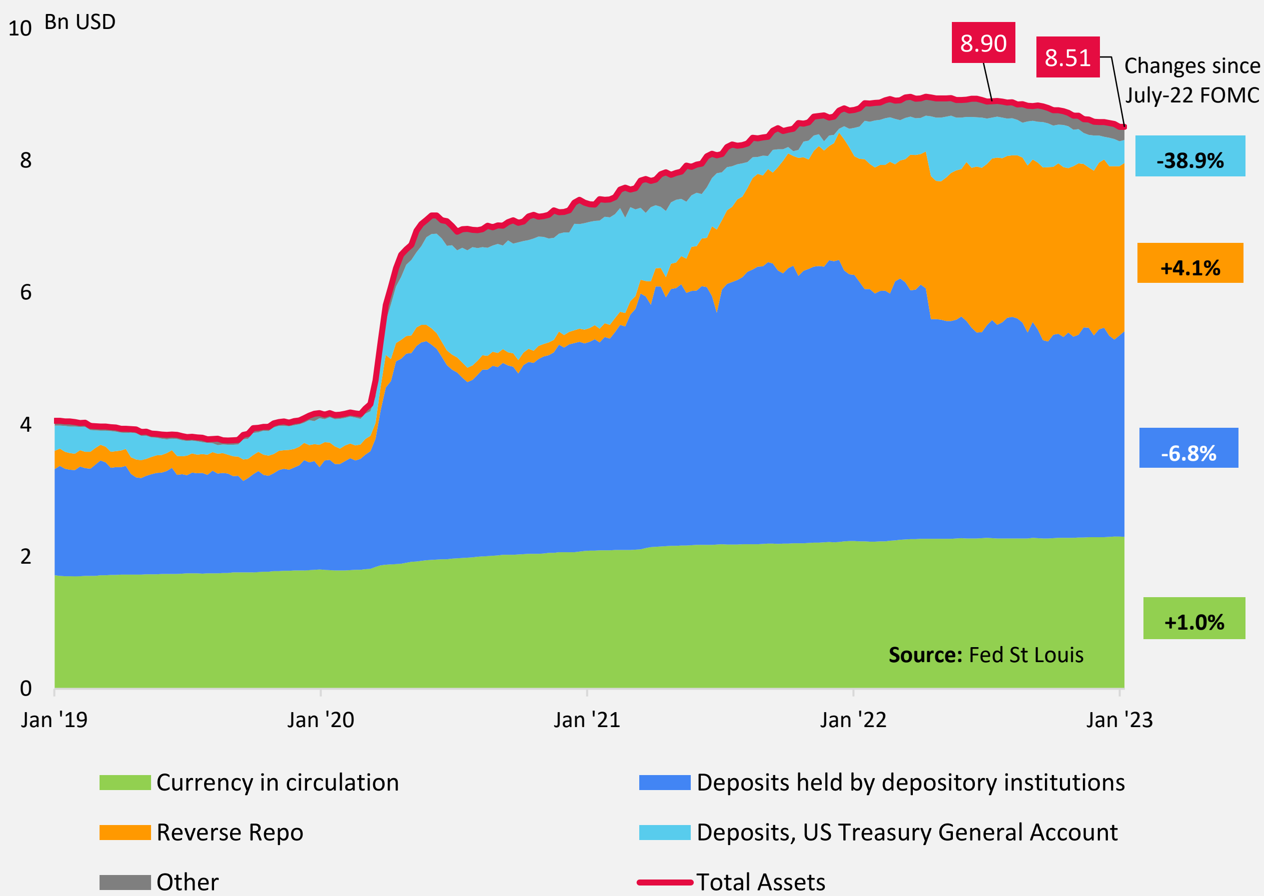
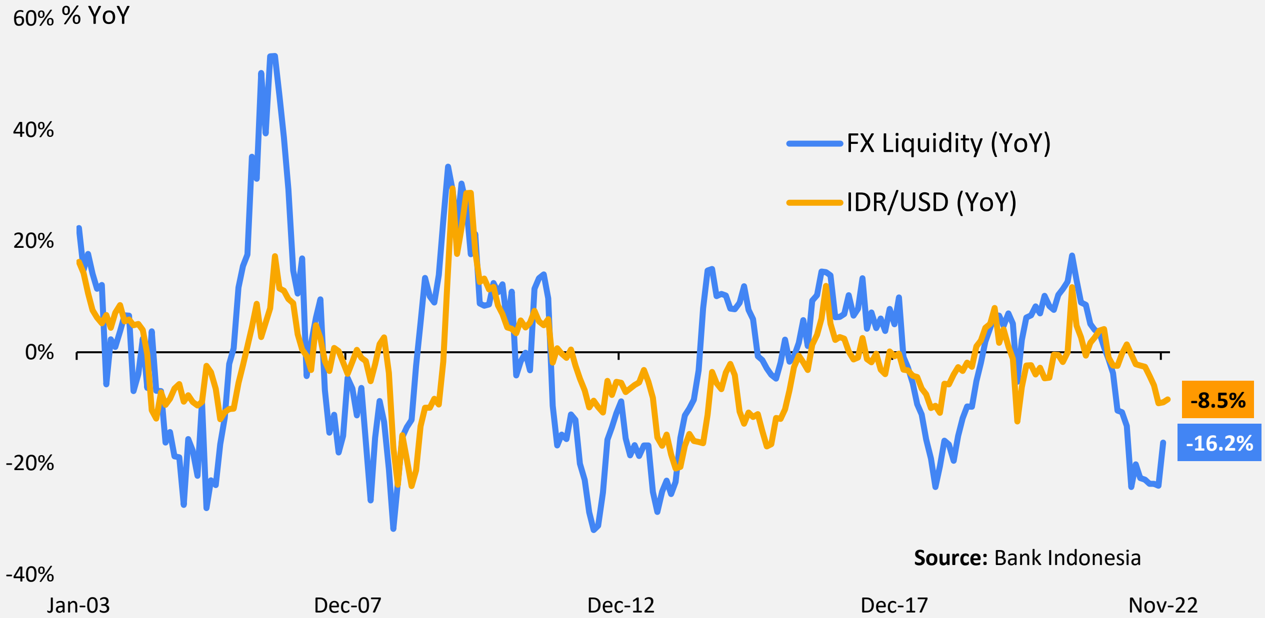


Chart 2

Mind the gap

The DHE regulation may help to close the FX funding gap that often precipitates a decline in the IDR's fundamental value

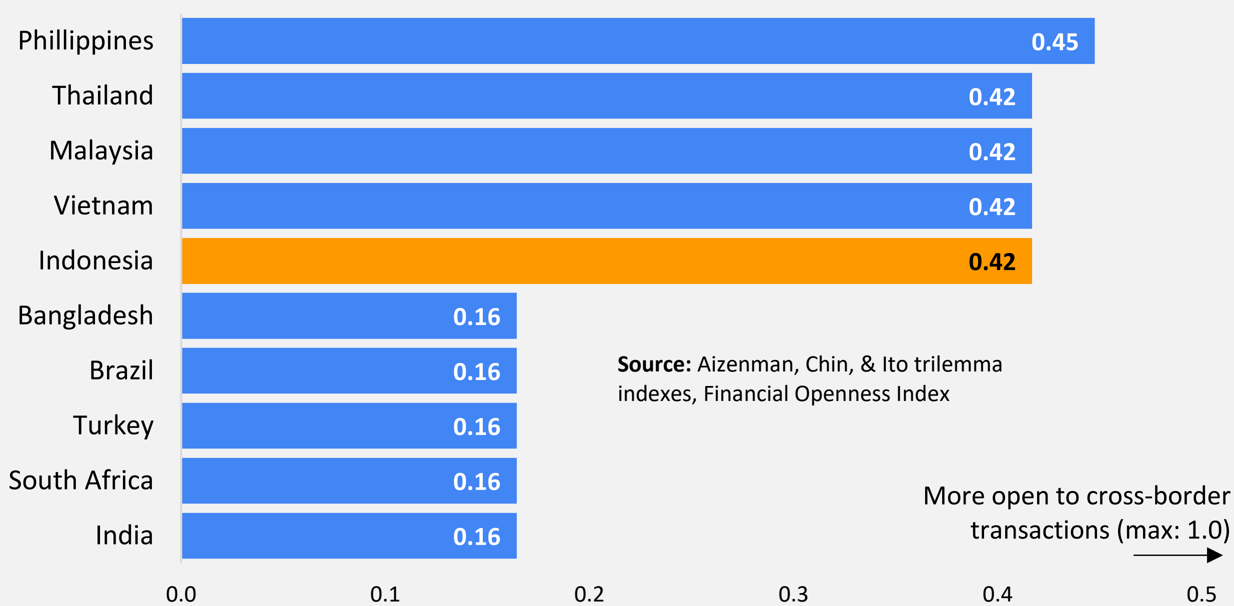


Source: Bank Indonesia

Chart 3

Land of the free

Indonesia's currency flow regime remains relatively open compared to peers, which may help to boost Indonesia's attractiveness to inventors



Source: Aizenman, Chin, & Ito trilemma indexes, Financial Openness Index

Economic Calendar

		Actual	Previous	Forecast*
9 January 2023				
ID	Consumer confidence	119.9	119.1	115
10 January 2023				
ID	Retail sales YoY	1.3%	3.7%	-
12 January 2023				
CN	CPI Inflation YoY	1.8%	1.6%	2%
US	CPI Inflation YoY	6.45%	7.1%	6.7%
13 January 2023				
CN	Balance of trade (USD Bn)	78.0	69.8	80
16 January 2023				
ID	External debt (USD Bn)	392.6	390.2	-
ID	**Balance of trade** (USD Bn)	3.89	**5.1**	**3.57**
17 January 2023				
CN	Industrial Production	-	2.2%	3.8%
18 January 2023				
US	Producer Price Index	-	0.3%	0.3%
US	Retail sales	-	-0.6%	0.3%
19 January 2023				
ID	**Bank Indonesia policy announcement**	-	**5.5%**	-
27 January 2023				
US	Personal income MoM	-	0.4%	0.3%
US	Personal spending MoM	-	0.1%	0.1%

*Forecasts of some indicators are simply based on market consensus
Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Scan for the link to our report depository or **click**:

https://s.id/1fMOq

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	4.50	Jan-23	-2.00
UK	3.50	Jan-23	-7.20
EU	2.50	Jan-23	-6.70
Japan	-0.10	Jan-16	-3.90
China (lending)	4.35	Jan-23	2.55
Korea	3.50	Jan-23	-1.50
India	6.25	Dec-22	0.53
Indonesia	5.50	Dec-22	-0.01
Money Mkt Rates	**13-Jan**	**-1 mth**	**Chg (bps)**
SPN (1M)	3.80	4.23	-42.4
SUN (10Y)	6.67	6.93	-26.0
INDONIA (O/N, Rp)	5.00	4.84	16.1
JIBOR 1M (Rp)	6.20	5.95	25.1
Bank Rates (Rp)	**Aug**	**Jul**	**Chg (bps)**
Lending (WC)	8.42	8.42	-0.03
Deposit 1M	2.87	2.83	3.57
Savings	0.65	0.64	0.98
Currency/USD	**13-Jan**	**-1 mth**	**Chg (%)**
UK Pound	0.818	0.809	-1.12
Euro	0.923	0.940	1.85
Japanese Yen	127.9	135.6	6.04
Chinese RMB	6.701	6.952	3.74
Indonesia Rupiah	15,150	15,657	3.35
Capital Mkt	**13-Jan**	**-1 mth**	**Chg (%)**
JCI	6,641.8	6,810.3	-2.47
DJIA	34,302.6	34,108.6	0.57
FTSE	7,844.1	7,502.9	4.55
Nikkei 225	26,119.5	27,954.9	-6.57
Hang Seng	21,738.7	19,596.2	10.93
Foreign portfolio ownership (Rp Tn)	**Dec**	**Nov**	**Chg (Rp Tn)**
Stock	2,699.4	2,656.0	43.37
Govt. Bond	762.2	736.9	25.26
Corp. Bond	12.5	14.5	-2.05

Trade & Commodities	13-Jan	-1 mth	Chg (%)
Baltic Dry Index	946.0	1,357.0	-30.3
S&P GSCI Index	605.8	596.4	1.6
Oil (Brent, $/brl)	85.3	80.7	5.7
Coal ($/MT)	334.0	363.7	-8.2
Gas ($/MMBtu)	3.50	7.17	-51.2
Gold ($/oz.)	1,920.2	1,810.8	6.0
Copper ($/MT)	9,168.6	8,449.3	8.5
Nickel ($/MT)	26,599.0	28,007.0	-5.0
CPO ($/MT)	880.3	880.9	-0.1
Rubber ($/kg)	1.35	1.34	0.7
External Sector	**Dec**	**Nov**	**Chg (%)**
Export ($ bn)	23.83	24.12	-1.2
Import ($ bn)	19.94	18.96	5.2
Trade bal. ($ bn)	3.89	5.16	-24.6
Central bank reserves ($ bn)*	137.2	134.0	2.39
Prompt Indicators	**Dec**	**Nov**	**Oct**
Consumer confidence index (CCI)	119.9	119.1	120.3
Car sales (%YoY)	9.0	4.4	23.3
Motorcycle sales (%YoY)	24.6	26.9	20.9
Manufacturing PMI	**Dec**	**Nov**	**Chg (bps)**
USA	48.4	49.0	-60
Eurozone	47.8	47.1	70
Japan	48.9	49.0	-10
China	49.0	49.4	-40
Korea	48.2	49.0	-80
Indonesia	50.9	50.3	60

Source: Bloomberg, BI, BPS
Notes:
^Data for January 2022
*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

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3*	4.6
GDP per Capita (US$)	3927	4175	3912	4350	4564*	4525
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.4
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.00
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	16,292
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	55.8*	43.2
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	0.9*	-0.2

*Estimated number

** Estimation of the 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
Senior Industry Analyst
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

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

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

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

Suryaputra Wijaksana
Economist / Analyst
suryaputra_wijaksana@bca.co.id
+6221 2358 8000 Ext: 1065752

Lazuardin Thariq Hamzah
Economist / Analyst
lazuardin_hamzah@bca.co.id
+6221 2358 8000 Ext: 1071724

Keely Julia Hasim
Economist / Analyst
keely_hasim@bca.co.id
+6221 2358 8000 Ext: 1071535

Elbert Timothy Lasiman
Economist / Analyst
Elbert_lasiman@bca.co.id
+6221 2358 8000 Ext: 1074310

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

Firman Yosep Tember
Research Assistant
firman_tember@bca.co.id
+6221 2358 8000 Ext: 20378

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group

20th Grand Indonesia, Menara BCA

Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia

Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343