Relative resiliency amid shifting expectations

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Summary

- Shifting expectations in the market pose a depreciation pressure for the IDR. However, this problem is not unique to Indonesia as a stronger USD would suppress the value of other currencies as well.
- The resilient labour market, still-loose liquidity conditions, and the prospect of higher oil prices may strengthen the Fed's conviction in delivering its "tighter-for-longer" policy outlook.
- The IDR remains stable for now but the dwindling trade surplus and narrowing real yield spread between ID – US bonds would continue to test the Rupiah's resiliency in periods ahead.

- The most recent US labour market data, followed by a series of hawkish remarks by Fed officials last week, has duly removed any doubts about the Fed's resolve to do what it takes to hammer down inflation back to the 2% benchmark. **The FOMC seems willing to err on the over-tightening side and hence, the debate now shifted to how long the Fed will maintain the Federal Funds Rate (FFR) at its peak level.** At the present, no Fed officials seem to be outside of the "tighter-for-longer" camp, as indicated in the summary of economic projections and multiple statements that follows. On the other side of the debate, however, many in the market are still convinced that the Fed would eventually need to cut the interest rates, perhaps later in Q3 2023 compared to Q2 2022 as projected earlier **(*see* Chart 1).** Indeed, the slowdown in US consumer demand may tempt the Fed to cut its policy rate. But the still-resilient US labour market and two other factors may reduce the probability of this scenario rolling out.
- The first factor lies in the US financial sector itself. Despite the widely reported increase in mortgage costs, the Fed's tightening campaign has not significantly affected liquidity conditions in the US financial sector **(*see* Chart 2).** Granted, the FFR is now standing near its peak level (as projected by FOMC members' summary of economic projections) and the increasingly apparent slowdown in consumption may complicate further increase past the projected 5.00 – 5.25% level. Nevertheless, the Fed still have a lot of tightening to do, and keeping the policy rate at its peak level for a prolonged period would surely help to shake off pandemic-era excess stimulus from the US financial system.
- The other factor that may keep the FFR at its peak level for a while is the commodity market. The slowdown in global manu-

facturing activities may have reduced the prices of industrial commodities, and the demand for energy commodities such as natural gas and coal may have decreased as winter passes. However, the US government appears to have done little to replenish the declining Strategic Petroleum Reserve (SPR) inventory, even though the energy demand is expected to shift from electricity to fuel as the weather warms up during spring. Petroleum prices are often cited as the Svengali behind the US inflation, and President Biden's statements regarding oil producers during his State of the Union speech indicate that **there are still concerns among US policymakers that the global oil market may come back and halt a more expeditious decline in the US inflation.**

"The warmer spring weather may shift energy demand from electricity to fuel, putting coal exporters at a disadvantage"

- The shift in demand for energy commodities could have a detrimental impact on the Indonesian economy. The rapid decline in coal and gas prices, as well as several industrial commodity prices like copper, CPO, and nickel, would limit Indonesia's export gains. The rising oil prices, or at least stability at a high level, would also add to imports; further reducing Indonesia's trade surplus which has supported the IDR's value throughout 2022. The declining exports could also reduce the effectiveness of the DHE (Exports Proceeds) policy, at the same time when increasing imports would increase demand for foreign currencies, a condition that often precedes a decline in the IDR's value **(*see* Chart 4).**

- However, it's important to note that this current challenge is not unique to Indonesia. The DXY has strengthened again as investors reassess their positions in light of the expectations for increasing and higher-for-longer discount rate, causing the Rupiah to decline along with other currencies rates **(*see* Chart 3)**. Despite this change in market expectations, the IDX still recorded inflows of around USD 118.2 million last week, despite the USD 245.8 decrease in the domestic bond market. If anything, this shift from the domestic bond market to the stock market may indicate foreign investors' growing appetite for the riskier side of the Indonesian financial market, reflecting the confidence for the Indonesian economy's relative strength in the year ahead.

- The main question for the domestic economy, then, is how BI would react against the shifting market expectation. The Rupiah seems stable for now, but declining trade surplus and weaker capital inflows may expose it to more depreciation pressures going forward. Real yield differentials between ID-US bonds, which in 2021-2022 had been propped up largely by high inflation in the US, may also be turning around **(*see* Chart 5)**; although there's still a possibility that rising global demand for oil might slowdown the pace of disinflation in the US. Consequently, there could still be an outside chance for the central bank to hike its policy rate by 25 bps in the February meeting, although the possibility for BI holding the BI 7DRR seems more probable for now.

Chart 1

Jobs not finished

The market still convinced that the Fed would cut interest rates in 2023, although only after a higher terminal rate. Meanwhile, FOMC officials seems set to deliver on their "tighter-for-longer" policy outlook

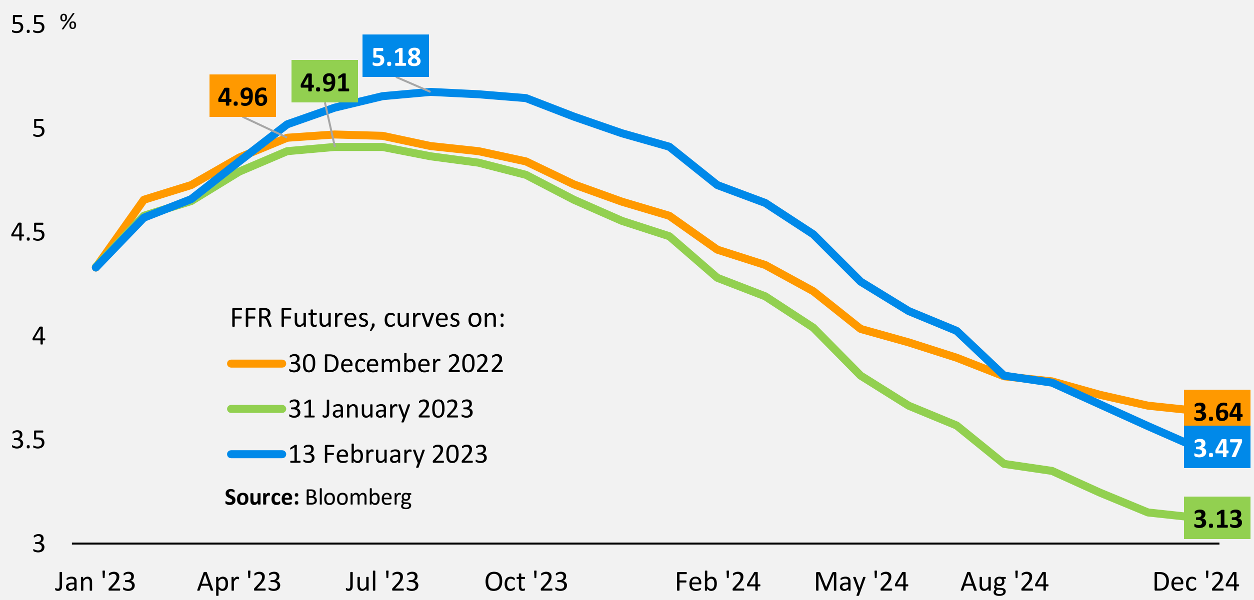


Chart 2

Still loose

Financial conditions in the US remain loose despite the aggressive tightening campaign in 2022. Still-ample liquidity conditions would strengthen the Fed's case to keep the FFR on the peak level for a prolonged period

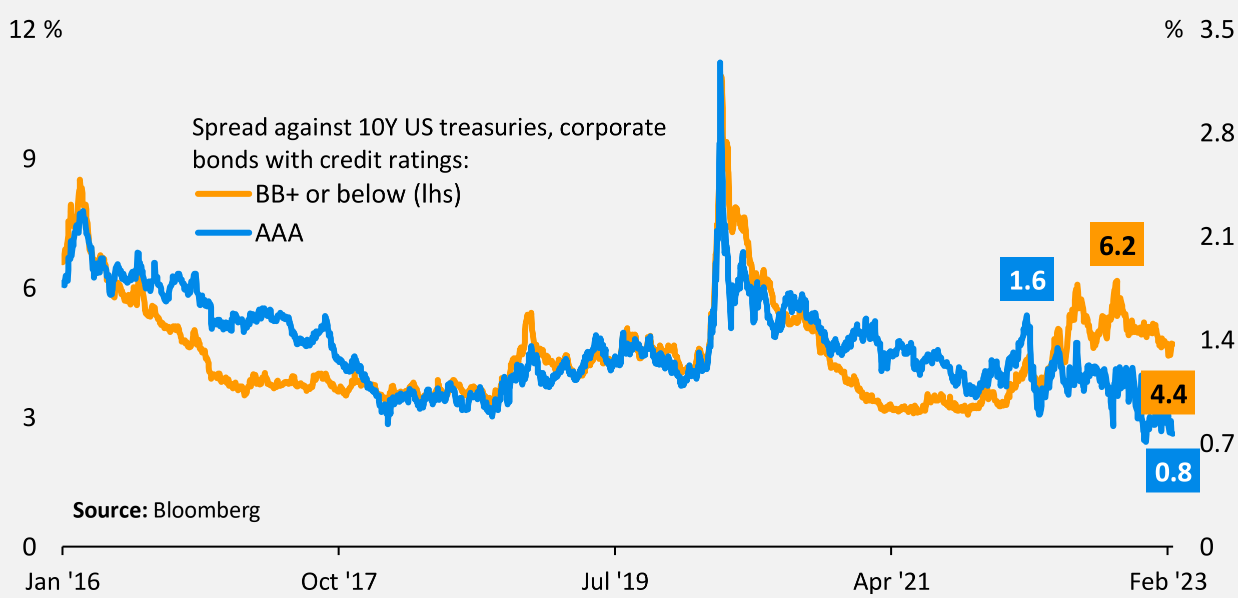
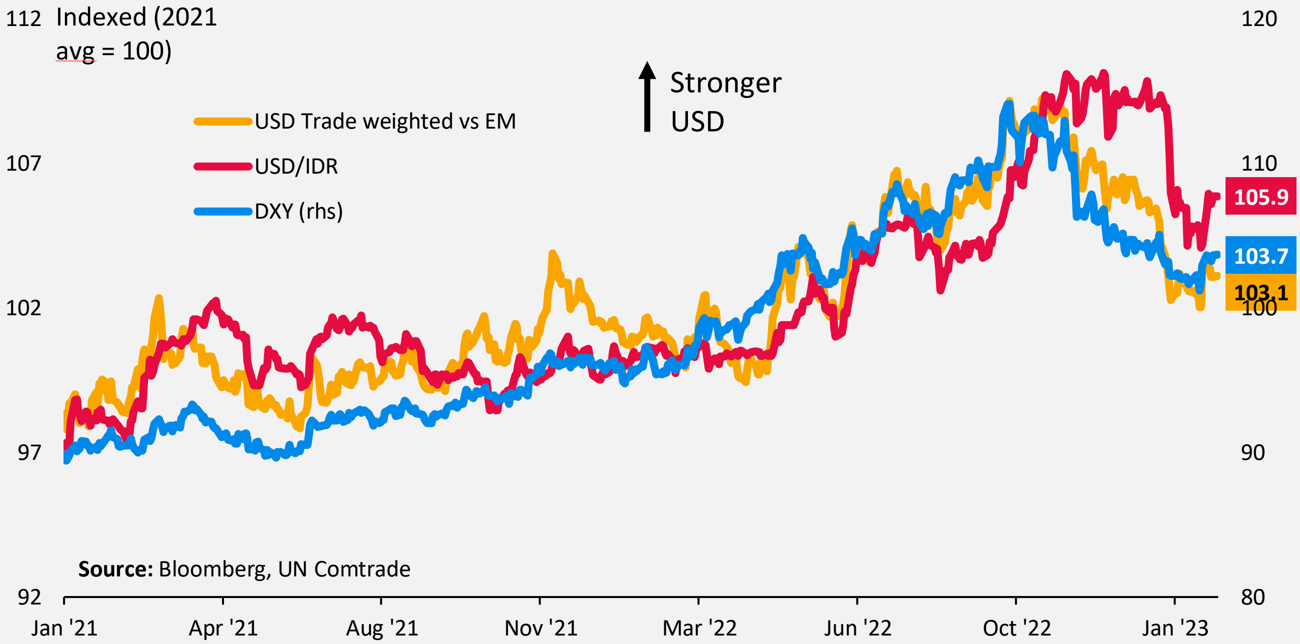


Chart 3

A problem for all

The shift towards a "tighter-for-longer" outlook presents a depreciation risk for other currencies including the IDR as the USD strengthens.

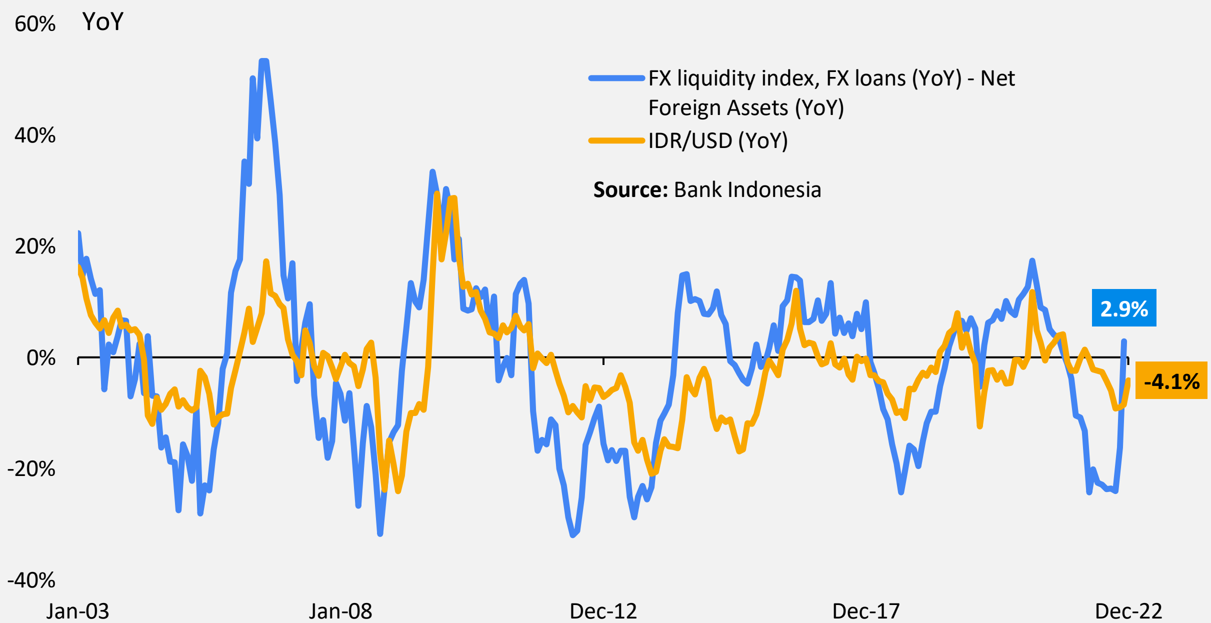


Source: Bloomberg, UN Comtrade

Chart 4

Mind the gap

Higher oil prices may increase domestic demand for foreign currencies, but lower coal prices may limit the DHE policy's effectiveness in bolstering domestic FX liquidity.

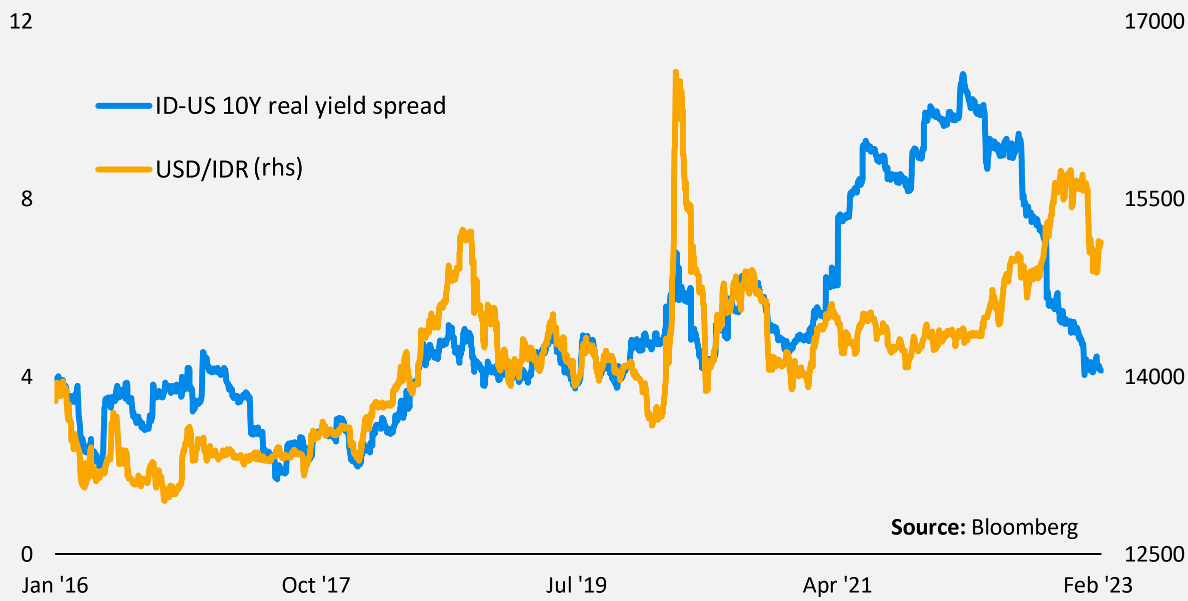


Source: Bank Indonesia

Chart 5

Show me the yield

The narrowing real yield spread between Indonesia and the US government bonds may expose the IDR to depreciation pressures in the periods ahead



Source: Bloomberg

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Economic Calendar

		Actual	Previous	Forecast*
1 February 2023				
ID	Manufacturing PMI	**51.3**	50.9	50.8
ID	**CPI Inflation YoY**	**5.28%**	5.51%	5.43%
2 February 2023				
US	**Fed rate decision**	**4.75%**	4.50%	4.75%
EU	ECB deposit rate decision	**2.50%**	2.00%	2.50%
3 February 2023				
US	Non-farm payrolls (thousands)	**517**	260	185
US	Unemployment rate	**3.4%**	3.5%	3.6%
6 February 2023				
ID	**GDP Growth Q4 2022 (YoY)**	**5.01%**	**5.72%**	**4.8%**
7 February 2023				
ID	**Foreign exchange reserve (USD Bn)**	**139.4**	**137.2**	**138.0**
US	Balance of trade (USD Bn)	-67.4	-61.5	-68.8
8 February 2023				
ID	Consumer confidence index	123.0	119.9	120
9 February 2023				
ID	Retail sales (YoY)	0.7%	1.3%	3.0%
US	Initial jobless claims	196K	183K	189.0K
10 February 2023				
CN	Inflation rate YoY	2.1	1.8	2
14 February 2023				
US	CPI Inflation YoY	-	6.5%	6.3%
15 February				
ID	**Balance of trade (USD Bn)**	**-**	**3.89**	**3.1**
US	Retail sales YoY	-	6%	4.5%
16 February				
CN	House price index YoY	-	-1.5%	-1.3
US	PPI YoY	-	6.2%	6.0%
ID	**BI 7DRR decision**	-	5.75%	6.00%
20 February				
ID	**Current account Q4 2022 (USD Bn)**	-	4.4	3.5
23 February				
EU	Inflation rate YoY	-	9.2	8.5
ID	Property price index Q4 2022 (YoY)	-	1.94%	

*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	4.75	Feb-23	-1.75
UK	4.00	Feb-23	-6.50
EU	3.00	Feb-23	-5.50
Japan	-0.10	Jan-16	-4.10
China (lending)	4.35	Feb-23	2.25
Korea	3.50	Jan-23	-1.70
India	6.50	Feb-23	0.78
Indonesia	5.75	Jan-23	0.47

Money Mkt Rates	10-Feb	-1 mth	Chg (bps)
SPN (1M)	2.41	4.42	-201.0
SUN (10Y)	6.65	6.83	-17.2
INDONIA (O/N, Rp)	5.40	5.02	38.6
JIBOR 1M (Rp)	6.37	6.20	17.6

Bank Rates (Rp)	Sep	Aug	Chg (bps)
Lending (WC)	8.46	8.42	3.71
Deposit 1M	2.97	2.87	10.38
Savings	0.66	0.65	0.76

Currency/USD	10-Feb	-1 mth	Chg (%)
UK Pound	0.829	0.823	-0.76
Euro	0.937	0.932	-0.51
Japanese Yen	131.4	132.3	0.69
Chinese RMB	6.815	6.780	-0.51
Indonesia Rupiah	15,134	15,573	2.90

Capital Mkt	10-Feb	-1 mth	Chg (%)
JCI	6,880.3	6,622.5	3.89
DJIA	33,869.3	33,704.1	0.49
FTSE	7,882.5	7,694.5	2.44
Nikkei 225	27,671.0	26,175.6	5.71
Hang Seng	21,190.4	21,331.5	-0.66

Foreign portfolio ownership (Rp Tn)	Jan	Dec	Chg (Rp Tn)
Stock	2,700.6	2,699.4	1.22
Govt. Bond	811.9	762.2	49.70
Corp. Bond	12.4	12.5	-0.02

Trade & Commodities	10-Feb	-1 mth	Chg (%)
Baltic Dry Index	602.0	1,096.0	-45.1
S&P GSCI Index	597.6	581.1	2.8
Oil (Brent, $/brl)	86.4	80.1	7.9
Coal ($/MT)	206.0	334.7	-38.4
Gas ($/MMBtu)	2.42	3.32	-27.1
Gold ($/oz.)	1,865.6	1,877.0	-0.6
Copper ($/MT)	8,828.8	8,890.5	-0.7
Nickel ($/MT)	27,575.5	27,234.0	1.3
CPO ($/MT)	896.1	881.8	1.6
Rubber ($/kg)	1.36	1.33	2.3

External Sector	Dec	Nov	Chg (%)
Export ($ bn)	23.83	24.09	-1.10
Import ($ bn)	19.94	18.96	5.16
Trade bal. ($ bn)	3.89	5.13	-24.23
Central bank reserves ($ bn)*	137.2	134.0	2.42

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	Jan	Dec	Chg (bps)
USA	47.4	48.4	-100
Eurozone	48.8	47.8	100
Japan	48.9	48.9	0
China	49.2	49.0	20
Korea	48.5	48.2	30
Indonesia	51.3	50.9	40

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	4.7
GDP per Capita (US$)	3927	4175	3912	4350	4784	5011
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.3
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.00
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,647
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	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

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