Less hawks but no doves amidst the Swiss affair

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Summary

- SNB's many interventions would help to restore stability to the banking system. However, such interventions may not be too productive to restore confidence in financial sector, which may translate into a flight-to-safety dynamic that could strengthen the USD's value.
- The decision to expand the central bank liquidity swap operations would help to avoid unwanted strengthening to the USD while also providing a guarantee to USD liquidity that would help to suppress panic in the Eurodollar market.
- A healthy tier 1 capital to risk-weighted assets ratio means that Indonesian banks remain shielded from downturns in asset valuations which may arise due to the flight-to-safety dynamic.

- We had a glimpse at US and EU Feb-2023 CPI inflation data last week, which is still a problem. But last week is all about financial stability concerns. The first concern arose from the continued siege on US regional banks by its depositors, which seems to be contained within the regional banking sector as depositors look to move their funds away to bigger, more-regulated systemically-important banks (SIBs). **This flight-to-safety pattern in the US banking sector may reveal a rather calming truth – that trusts in the banking sector remains strong, especially in these SIBs.** The Fed's emergency lending facility would bolster the public's trust in the banking sector **(*see* Chart 1)**, guarding US banks against liquidity risks that last week spells the end for banks such as SVB and Signature bank.
- The second concern, however, is bigger and arguably more complicated. The problematic bank in question, of course, is Credit Suisse – whose role as a primary dealer in the US treasuries market cemented its position among the G-SIBs crowd. Unlike regional banks, **there are no arguments about the severity of counterparty risks and contagion effect that may ensue if G-SIBs of Credit Suisse's stature are allowed to go under.** Central banks' playbook, then, is quite clear. Liquidity should be provided, either by providing a liquidity backstop (á la AIG bailout) or finding a white knight that would acquire the troubled bank (á la JP Morgan acquisition of Bear Stearns).
- The Swiss National Bank (SNB) is quick to deploy these post-2008 monetary policy innovations to slow down the pace of the Credit Suisse crisis. First, the SNB provides an emergency loan to the tune of USD 54 Bn to the bank. Alas, the liquidity backstop is quickly run-over, highlighting the confidence crisis that curses the bank. The bank is also in the process of being acquired by its

hometown rival UBS, leading to a concentration risk on top of the mark-to-market risks that may cast a shadow on the Swiss (and European) banking sector. **Solutions by the SNB may help to mitigate the pressing liquidity problem faced by Credit Suisse, but such solutions may not solve the confidence problem that befell the Swiss and European banking sectors.**

- Dwindling confidence in the Swiss (and/or European) banking sector may translate to another flight-to-safety pattern, this one from the distressed Europe to a relatively safer US. Such inflows may strengthen the US Dollar, further complicating the global financial stability effort. It is clear, then, that the Fed should throw its hat in the ring. The recent announcement by the Fed, SNB, and four other central banks to change the frequency of the central bank liquidity swap facility from a weekly to daily basis shows that the Credit Suisse stabilisation effort is a team effort, marshalled and paid for by the Fed.

- More frequent central bank liquidity swap transactions would kill two birds with one stone. First, it would act as a counterbalance for liquidity inflows coming from Europe (or other places), allowing the Fed to avoid wanton strengthening of the US Dollar as the facility would allow the Fed to quickly recycle the repatriated US Dollar back offshore. **The more important function, of course, is that the expanded swap facility would ensure USD liquidity in the Eurodollar market, avoiding panic (and sell-off it ensued) in distressed markets.** However, financial stabilisation measure, either through emergency lending to domestic banks or more frequent central bank liquidity swap transactions necessitates a re-enlargement of the Fed's balance sheet ***(see Chart 2)***, complicating the Fed's policy normalisation effort.

"Improving stigma on the discount window allows the Fed to lend precisely to those banks in need"

- Despite this laid-out plan to restore stability and confidence in the global financial sector**, the Fed (and other central banks) may not afford to abandon their crusade against inflation**. Indeed, with core CPI still at 5.5% YoY in Feb-2023 (down from 5.6% YoY last month), the fight against inflation is far from over for the Fed. The inflation situation, of course, is not better in Europe (although it is much better in Switzerland) prompting the ECB to hike its policy rate by another 50bps.

- The ECB's decision to hike its policy rate amidst still-high inflation and cracks in the financial sector provides a model that the Fed could follow. Indeed, **The Fed has been trying to separate inflation-countering monetary policy from its financial sector stabilisation policy**, as evident from the central bank's greater focus on expanding the discount window (by announcing the BTFP). The now-improving stigma on distressed banks' lining up on the Fed's discount window would help the Fed to lend precisely to those banks in need, unlike the unsolicited "helicopter money" approach of QE. The Fed's decision to intensify the use of the central bank liquidity swap facility is also separated from its monetary policy, as liquidity generated from inter-central bank swaps would circulate outside of the US economy, reducing the risk of inflation that may arise from an increase in the domestic money stocks. The Fed, then, may opt to hike its policy rate by another 25bps in the FOMC meeting this week, with the terminal rate edging above 5% as indicated by Fed chair Powell's testimony.

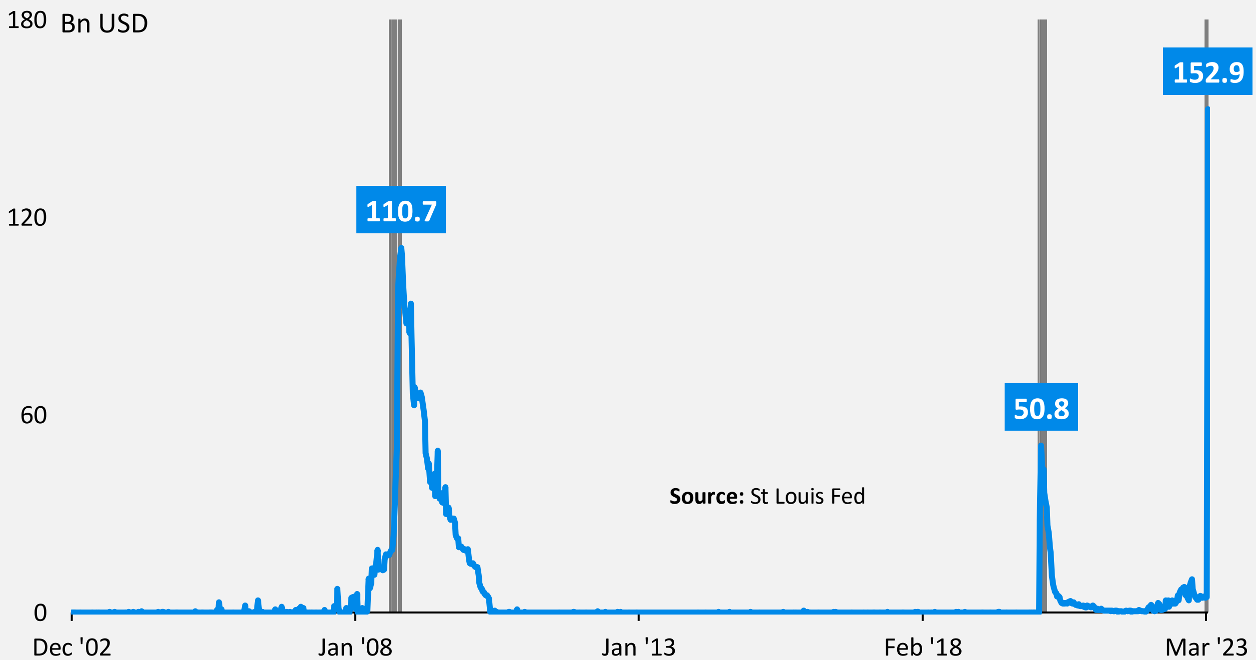
- The Fed's policy outlook may seem like a win-win solution for the Fed and its European counterparts. The picture, however, may not look too colourful for emerging economies. Considering the greater perceived risks on the Emerging Asia market vis-à-vis the European market, there is no guarantee that the flight-to-safety pattern that may hit the European economies will not infect emerging Asian economies, further deflating asset valuations in already-distressed markets. **For Indonesian banks, however, this is not a source of worry. Indonesian banks remain properly capitalised, and the healthy ~22.3% tier 1 capital to risk-weighted-assets ratio (average of top 4 publicly-listed banks) would help Indonesian banks weather all but the most severe downturn in asset valuations.** Unlike Credit Suisse, profitability is not known as an issue for Indonesian banks, and the still-robust domestic outlook would help to bring more stability to the domestic banking sector.

- With that being said, the Fed's policy outlook, still poses a problem for the real sector, mainly through its impact on the Rupiah's valuations. More-intensive utilisation of central bank liquidity swaps may help to ensure USD liquidity, but Indonesia is not exactly on the receiving end of the facility (although access to the Fed's repo facility and the BoJ may help to weather the pain). Moreover, **the separation between the Fed's monetary and financial stabilisation policy also means that the risk of narrowing real rate differentials is still present**, posing depreciation risks for the IDR. Finally, capital inflows in domestic financial markets and FX inflows from TD on export proceeds (DHE) may help to stabilise the Rupiah's value **(*see* Chart 3).** But the policy's high cost may tempt Bank Indonesia to revisit its policy rate decision should depreciation risks against the Rupiah intensify.

Chart 1

Smooth operator

The Fed has been using the discount window more extensively in an effort to separate the financial stability policy with the inflation-busting monetary policy



Source: St Louis Fed

Chart 2

It happen again (though not quite the same)

The Fed's QT campaign, which started amidst the inflation crisis, may not be ended yet but the re-enlargement of the central bank's balance sheet may be unavoidable considering the intensifying central bank liquidity swap

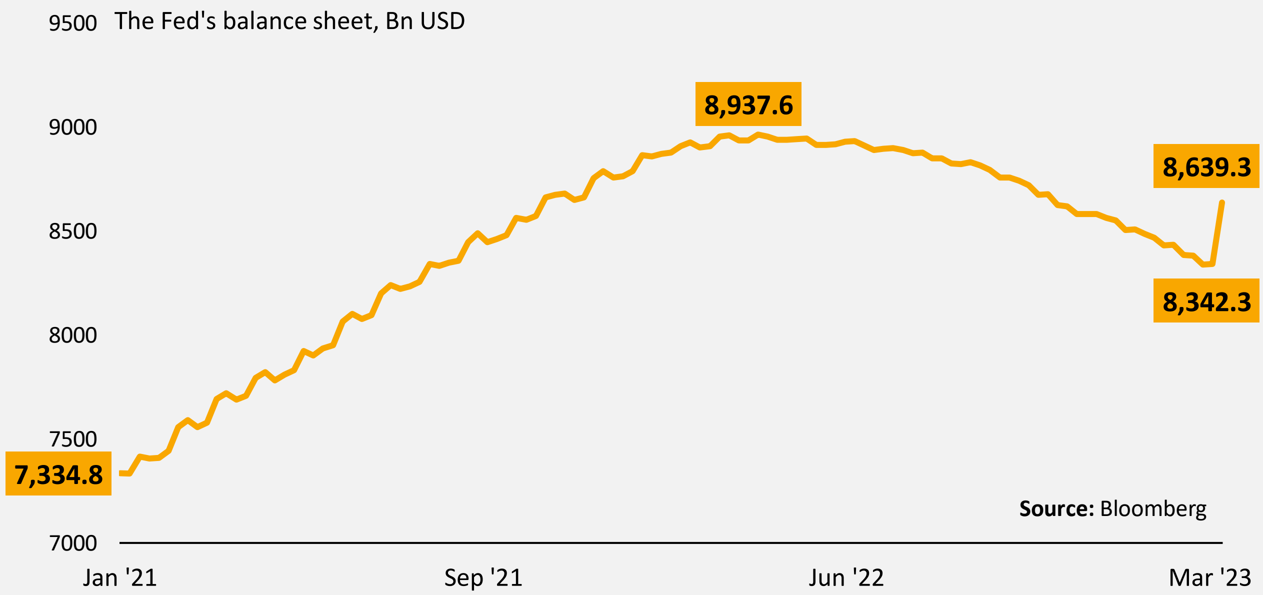
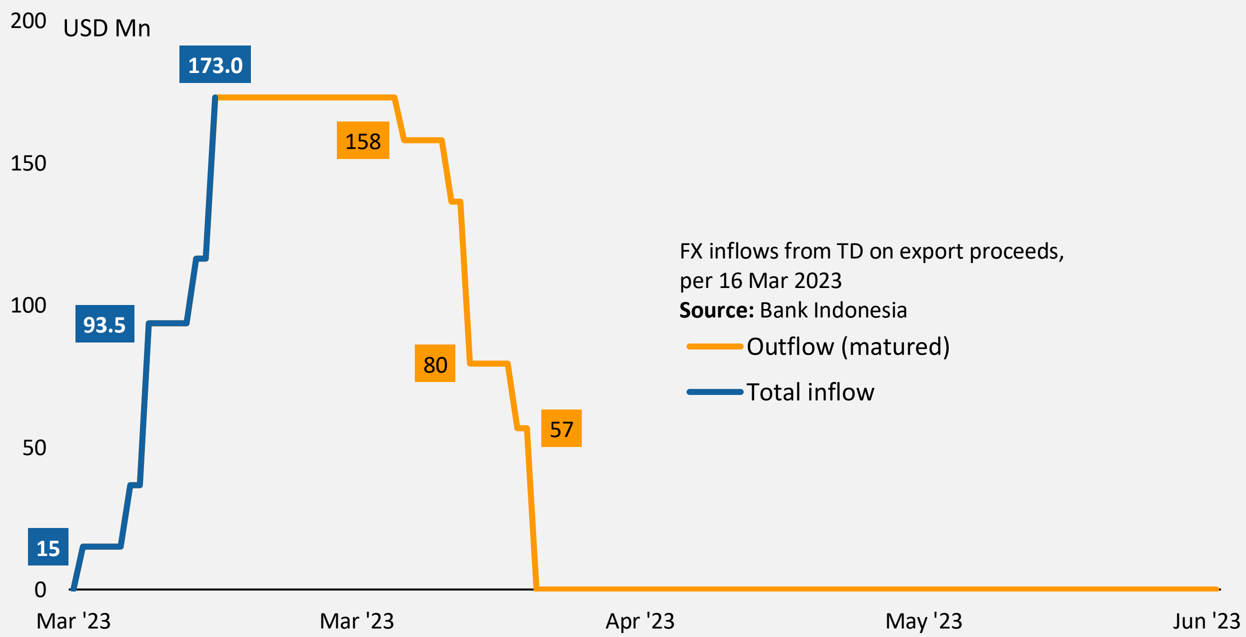


Chart 3

A last line of defense

BI's DHE policy would be crucial to provide stability for the Rupiah amidst the still-present risks of narrowing real rate differential and the emerging risk of capital flight-to-safety



Economic Calendar

		Actual	Previous	Forecast*
1 March 2023				
ID	S&P Global Manufacturing PMI	52.6	49.2	50.3
CN	NBS Manufacturing PMI	51.6	49.2	50.3
ID	**Inflation Rate (YoY)**	**5.47%**	**5.28%**	**5.3%**
US	ISM Manufacturing PMI	47.7	47.4	48
2 March 2023				
EU	Inflation Rate (YoY)	8.5%	8.6%	8.4%
7 March 2023				
CN	Balance of Trade (USD Bn)	116.88	78	78.2
ID	**Foreign Exchance Reserves (USD Bn)**	**140.3**	**139.4**	**139.0**
8 March 2023				
US	Balance of Trade (USD Bn)	-68.3	-67.4	-69.0
9 March 2023				
CN	Inflation rate YoY	1%	2.1%	2.3%
ID	Retail Sales YoY	-0.6%	0.7%	-
CN	PPI YoY	-1.4%	-0.8%	-0.5%
US	Initial Jobless Claims	211K	190K	192.0K
14 March 2023				
US	Inflation Rate YoY	6%	6.4%	6.2%
15 March				
ID	**Balance of trade (USD Bn)**	**5.48**	**3.87**	**3.5**
US	PPI YoY	4.6	6	5.7
16 March				
ID	**BI 7DRR decision**	**5.75%**	**5.75%**	**5.75%**
CN	House price index YoY	-1.2%	-1.5%	-0.4%
23 March				
US	**FOMC/Fed Rate Decision**	**-**	**4.75%**	**5.0%**

*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	Mar-23	-1.25
UK	4.00	Mar-23	-6.10
EU	3.50	Mar-23	-5.00
Japan	-0.10	Jan-16	-4.40
China (lending)	4.35	Mar-23	3.35
Korea	3.50	Feb-23	-1.30
India	6.50	Feb-23	0.06
Indonesia	5.75	Mar-23	0.28

Money Mkt Rates	17-Mar	-1 mth	Chg (bps)
SPN (1M)	2.56	4.46	-190.0
SUN (10Y)	6.88	6.70	17.3
INDONIA (O/N, Rp)	5.56	5.47	9.2
JIBOR 1M (Rp)	6.40	6.37	3.2

Bank Rates (Rp)	Dec	Nov	Chg (bps)
Lending (WC)	8.60	8.60	0.46
Deposit 1M	3.95	3.69	26.18
Savings	0.67	0.67	0.02

Currency/USD	17-Mar	-1 mth	Chg (%)
UK Pound	0.821	0.821	0.00
Euro	0.937	0.931	-0.63
Japanese Yen	131.9	133.2	0.99
Chinese RMB	6.887	6.828	-0.85
Indonesia Rupiah	15,345	15,160	-1.21

Capital Mkt	17-Mar	-1 mth	Chg (%)
JCI	6,678.2	6,941.9	-3.80
DJIA	31,862.0	34,089.3	-6.53
FTSE	7,335.4	7,953.9	-7.78
Nikkei 225	27,333.8	27,602.8	-0.97
Hang Seng	19,518.6	21,113.8	-7.56

Foreign portfolio ownership (Rp Tn)	Feb	Jan	Chg (Rp Tn)
Stock	2,730.0	2,700.6	29.43
Govt. Bond	804.3	811.9	-7.57
Corp. Bond	12.4	12.4	-0.06

Trade & Commodities	17-Mar	-1 mth	Chg (%)
Baltic Dry Index	1,535.0	563.0	172.6
S&P GSCI Index	541.6	597.6	-9.4
Oil (Brent, $/brl)	73.0	85.6	-14.7
Coal ($/MT)	175.1	192.9	-9.3
Gas ($/MMBtu)	2.42	2.42	0.0
Gold ($/oz.)	1,989.3	1,854.3	7.3
Copper ($/MT)	8,573.3	8,921.0	-3.9
Nickel ($/MT)	23,147.0	26,227.0	-11.7
CPO ($/MT)	937.3	896.7	4.5
Rubber ($/kg)	1.29	1.37	-5.8

External Sector	Feb	Jan	Chg (%)
Export ($ bn)	21.40	22.32	-4.15
Import ($ bn)	15.92	18.44	-13.68
Trade bal. ($ bn)	5.48	3.88	41.15
Central bank reserves ($ bn)*	140.3	139.4	0.64

Prompt Indicators	Feb	Jan	Dec
Consumer confidence index (CCI)	122.4	123.0	119.9
Car sales (%YoY)	7.4	11.9	9.0
Motorcycle sales (%YoY)	56.3	38.6	24.6

Manufacturing PMI	Feb	Jan	Chg (bps)
USA	47.7	47.4	30
Eurozone	48.5	48.8	-30
Japan	47.7	48.9	-120
China	51.6	49.2	240
Korea	48.5	48.5	0
Indonesia	51.2	51.3	-10

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

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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$)	3927	4175	3912	4350	4784	5011
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.3
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,647
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	19.8
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-1.2

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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