Manufacturers' elegy amidst the banking sector turmoil

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Summary

- The ongoing banking sector turmoil may require US and European banks to increase their deposit rates, forcing banks to choose either to lower their margin or increase the lending rate.
- Tighter lending rates would be detrimental to US consumer demand, worsening the outlook for Indonesia's manufacturing sector which also has to grapple with intensifying competition from cheaper imported goods.
- The anaemic domestic manufacturing sector and lower depreciation risks amid improving global USD liquidity may incentivise BI to maintain its pro-growth posture.

- It's been three weeks since SVB (and a couple of other regional banks) went under. Yet despite the assortment of policy interventions launched in recent weeks, uncertainties continue to dominate discussions in the banking sector. This is particularly evident from the still-elevated CDS for some systemically important banks (SIBs) on both sides of the Atlantic. Now, anxious investors have turned their attention to another, arguably larger European-based SIB, with some calling for more action from central banks in the US and Europe to support the banking sector and neutralise the contagion risk from spreading further ***(see Chart 1: FFR Futures).***
- However**, policy support from central banks may not be sufficient to prevent ongoing financial sector volatility from developing into a more profound crisis.** The decreasing bond valuations are just the tip of the problem, hiding the crux of the matter that continues to undermine the credibility of US and European banks which is their unwillingness to adjust to changing interest rate conditions. As noted in our report on the FOMC meeting last week, **US banks' low deposit rates are herding customers to other liquid assets, such as money market funds, which may offer returns closer to the Fed rate *(see Chart 2).*** It may be inevitable, then, for US banks to increase their deposit rates. Banks are, therefore, caught between two unattractive options: they can either accept the higher interest cost, sacrificing their margin which explains the continued sell-off of US and European banking stocks, or they could try to maintain their NIM by

simultaneously increasing their lending rates.

- **The potential consequences of the second option, that banks opt to increase lending rates instead of sacrificing their margin, could be more significant**. Higher lending rates may hasten the arrival of the next recession, which would impact the real sector, both domestically and globally. We should remember that while disinflation in energy and goods may help restore some of US consumers' purchasing power, increase-ed use of consumer loans (typically through credit cards) also plays a significant role in supporting aggregate demand conditions in the US.

- Looking at the Indonesian context, such a scenario could prove to be particularly troubling, especially for export-oriented sectors such as textiles and chemicals. Indeed, Indonesian manufacturers often rely on American and European consumers to market their products ***(see Chart 3: ID goods exports)***, as evidenced by a series of layoffs in the textile industry after the normalisation of US consumer demand in 2022. **Tighter credit conditions in the US, then, followed by a decrease in the level of demand, could further harm the Indonesian manufacturing sector or at least make it more dependent on domestic demand.**

"Lower demand from US consumers would put Indonesian manufacturers deeper into the trouble"

- It is important to note that the prospect of cratering demand from American and European consumers may overlap the ongoing inventory downscaling efforts by manufacturers in China. Now, facing an anaemic demand from their domestic consumers, China-based manufacturers may be under more pressure to ship their goods to overseas markets, lowering prices which makes it more attractive for consumers to buy imported goods from China. The now-stronger Rupiah would further boost the price-attractiveness of imported goods, undermining demand for domestically-produced goods that drag Indonesian manufacturers deeper into the quagmire.

- The worsening condition in Indonesia's manufacturing sector leads to the decision by the ministry of labour to implement regulation no.5/2023, allowing labour-intensive, export-oriented manufacturers to adjust wages amidst the ongoing downturn in demand. This regulation would help to avoid a further series of layoffs, which may depress economy-wide confidence considering the labour-intensive nature of some industries. By lowering wages, however, the policy may prove to be counterproductive to boost the domestic demand condition, hardly a cure for domestic manufacturers crippled by plummeting demand.

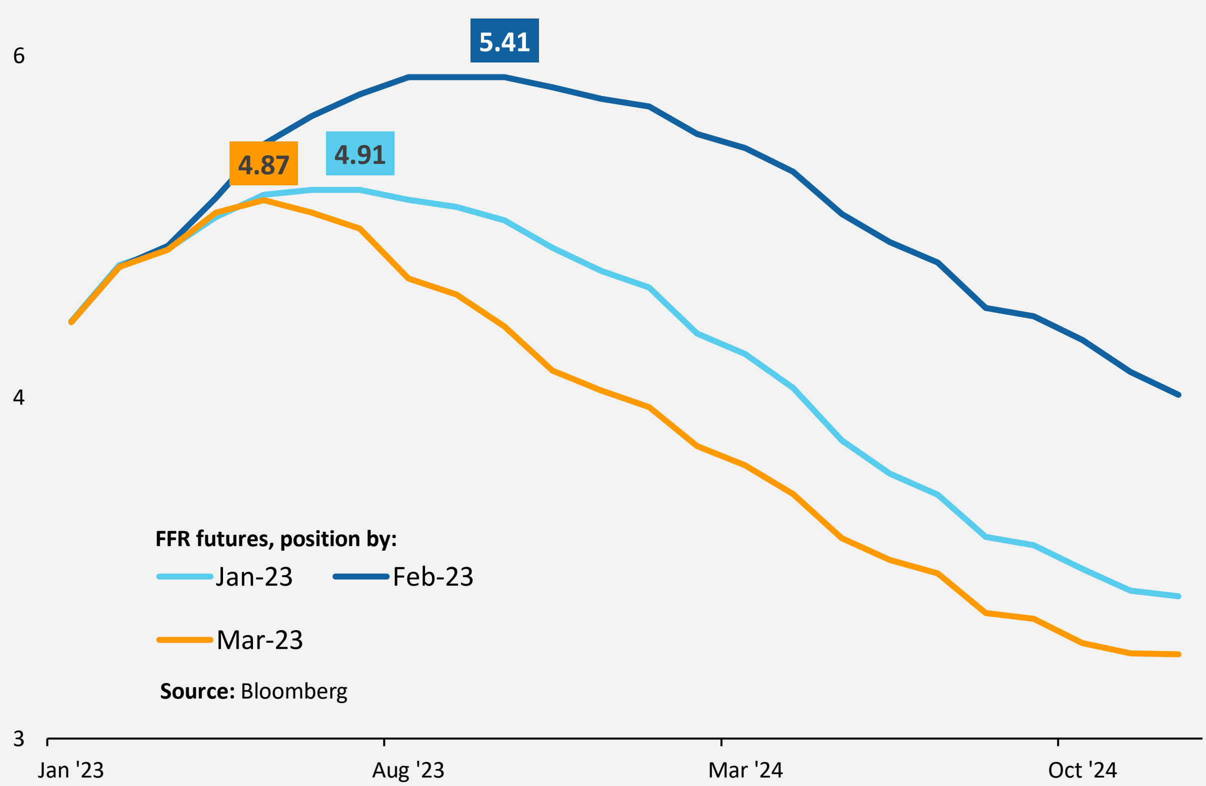
- As a whole, the situation in Indonesia's real sector is not completely doom and gloom. For instance, a stronger IDR would boost the prospect for import-intensive sectors. The clear winner, of course, is those in the retail sector, which would benefit from relatively lower import costs on top of the now-strong consumer demand following the seasonal pattern. However, **considering the wobbling manufacturing sector, it may become more difficult for the Indonesian economy to achieve the government's target of 5.3% growth.**

- The risk of slowing aggregate demand may increase Bank Indonesia's incentive to maintain its pro-growth posture. Fortunately for BI, the 2023 episode of banking sector turmoil appears to have had a positive impact on the domestic financial sector. Indonesian banks are in better shape compared to their European or American counterparts, and investors' confidence appears to have solidified in the past week, as evidenced by the approximately USD 102.8 million net purchase in Indonesia's financial assets. Capital inflows, especially through portfolio investments, will be crucial to safeguard the stability of the Rupiah in the future. **The present situation, therefore, does not seem to require BI to adjust its policy rate.**

Chart 1

Ever-changing expectations

The market expects no further rate hikes as tighter financing conditions may significantly depress demand conditions in the US



Source: Bloomberg

Chart 2

Yield-seekers

Unattractive deposit rates encourage depositors to move their funds to equally-liquid money market funds, which could offer returns closer to the Fed rate

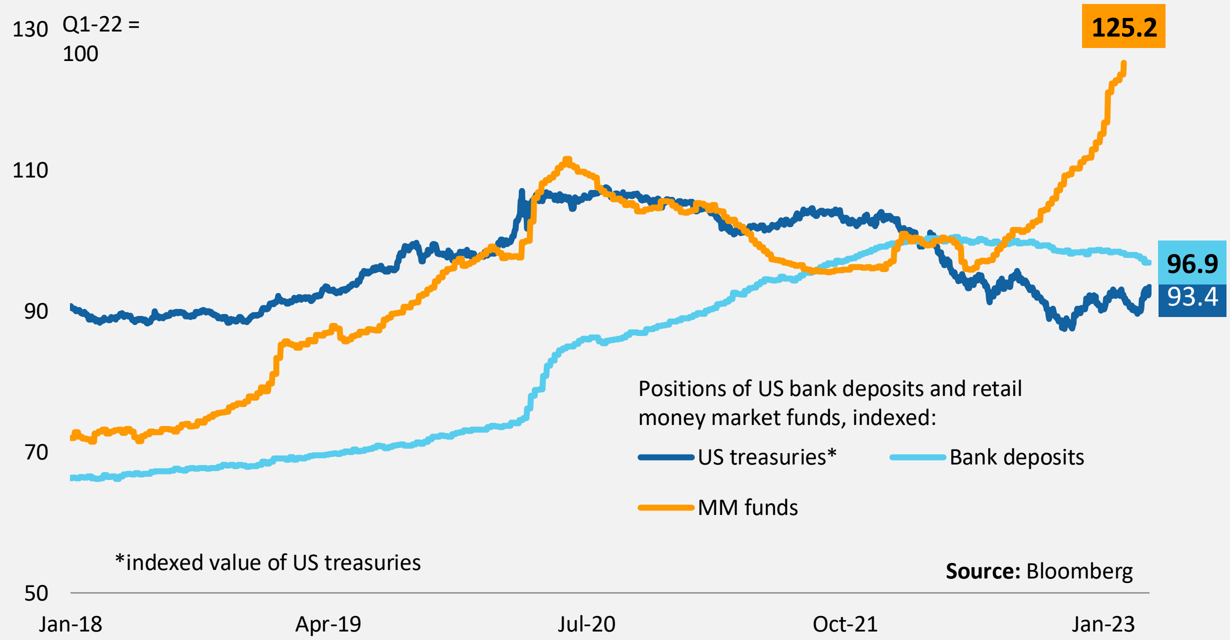
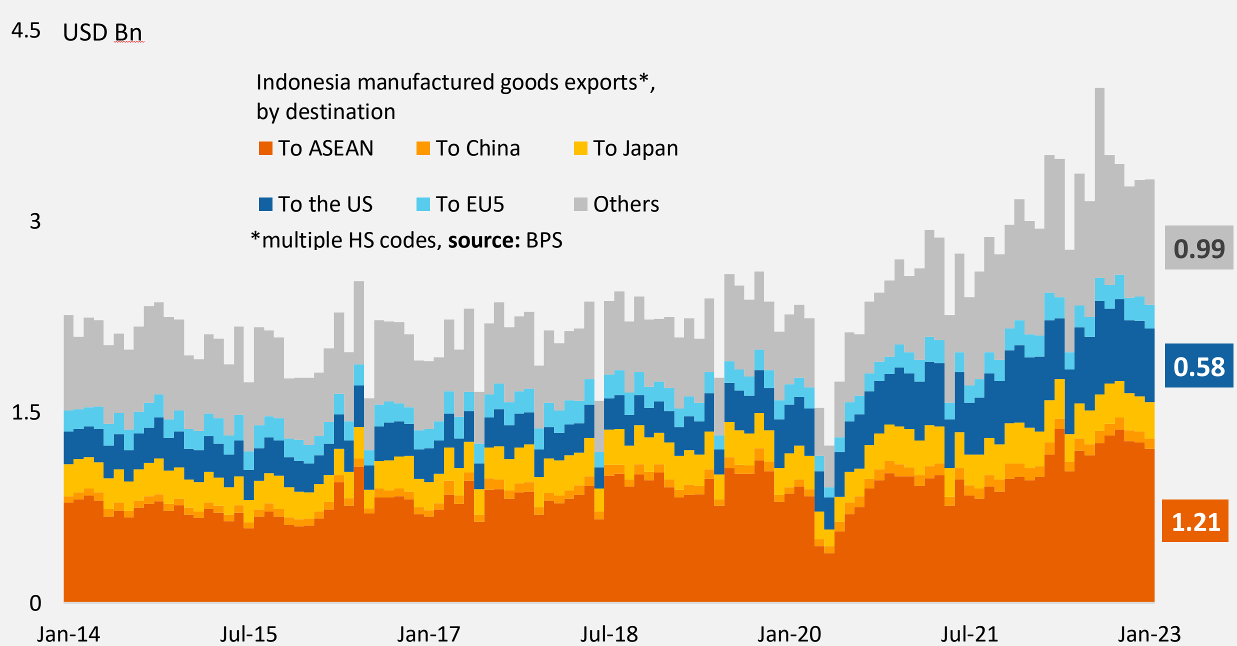


Chart 3

An American client

Domestic manufacturers may become increasingly dependent on domestic consumers if demand from US consumers continues to dwindle



		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**	**5.00**	**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	5.00	Mar-23	-1.00
UK	4.25	Mar-23	-6.15
EU	3.50	Mar-23	-5.00
Japan	-0.10	Jan-16	-3.40
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	24-Mar	-1 mth	Chg (bps)
SPN (1M)	4.28	4.25	3.0
SUN (10Y)	6.79	6.73	6.1
INDONIA (O/N, Rp)	5.48	5.61	-12.9
JIBOR 1M (Rp)	6.40	6.38	2.4

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	24-Mar	-1 mth	Chg (%)
UK Pound	0.817	0.826	1.00
Euro	0.929	0.939	1.05
Japanese Yen	130.7	135.0	3.27
Chinese RMB	6.867	6.880	0.18
Indonesia Rupiah	15,155	15,190	0.23

Capital Mkt	24-Mar	-1 mth	Chg (%)
JCI	6,762.3	6,873.4	-1.62
DJIA	32,237.5	33,129.6	-2.69
FTSE	7,405.5	7,977.8	-7.17
Nikkei 225	27,385.3	27,473.1	-0.32
Hang Seng	19,915.7	20,529.5	-2.99

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	24-Mar	-1 mth	Chg (%)
Baltic Dry Index	1,489.0	594.0	150.7
S&P GSCI Index	549.4	584.3	-6.0
Oil (Brent, $/brl)	75.0	83.1	-9.7
Coal ($/MT)	193.4	196.0	-1.4
Gas ($/MMBtu)	2.04	2.12	-3.8
Gold ($/oz.)	1,978.2	1,835.1	7.8
Copper ($/MT)	8,911.8	9,183.5	-3.0
Nickel ($/MT)	23,268.0	26,880.0	-13.4
CPO ($/MT)	882.8	933.3	-5.4
Rubber ($/kg)	1.29	1.38	-6.5

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

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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