

Trouble in all four directions

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Summary

- The Fed is facing a quadrilemma as the central bank has to grapple with inflation, recession risks, financial sector instability, and the USD's weakening dominance in the global financial market.
- The USD's decreasing relevancy may not be an immediate source of concern for the Fed as the use of the Yuan is still limited on payments for trade with China's exporters.
- OPEC+ production re-introduces the fear of energy inflation in the US economy, which may encourage the Fed to refocus on its fight against inflation. However, the shifting AS curve means that the Fed may need to incur significant losses to force the CPI number back to the 2% target.

- We dedicated much of the time last month to discussing the brewing instability in banking sectors across both sides of the Atlantic. Today, the worst episode of the Q1-2023 banking sector turmoil may have passed. The Fed is quick to deploy its discount window to provide liquidity needs for distressed banks, while the debilitating flight-to-safety dynamic that could strengthen the USD is prevented thanks to the expanded central bank liquidity swap facility. Alas, depositors continue to flee bank deposits in favour of higher-yielding, equally liquid assets such as money market funds, showing that the cracks in the banking sector may not be repaired by anyone but the banks themselves by increasing deposit rates.
- Tighter credit conditions would make it hard for US consumers to fund their consumption,

which may hasten the coming of the next recession. **However, a recession is hardly America's only problem. Banks in the US still found themselves besieged by their depositors, prolonging the stress in the US banking system which may undermine the trust in the USD.** In normal times, the Fed may calm the banking sector as well as anticipate the coming of the next recession by cutting the policy rate and launching another round of QE at once. At the present, however, such a policy call is inapplicable considering the still-high inflation figure. The Fed, it appears, is trapped between four narrowing walls with a selection of incompatible tools to escape.

- The imploding regional banking sector took much of the attention from the inflation problem. Alas, **the inflation dynamic in the US is not exactly improving.** The Fed still

have to grapple with stubborn food prices, the still-tight labour market coupled with unanchored inflation expectations continue to fuel the wage-price spiral, and now, OPEC's surprise 1.149 mn b/d oil production cuts (1.649 mn b/d including Russia) could bring energy inflation back on the agenda. The fight against inflation just got trickier.

- **The US economy may have some cushions against the debilitating spike in global oil prices. Unfortunately, these cushions may already wear thin.** The first buffer against spiking oil prices, of course, is the strategic petroleum reserves (SPR). Indeed, the expeditious decline in gasoline prices (hence, inflation) between Q2-Q4 2022 cannot be separated from the US government's significant SPR drawdown. Unfortunately, the US government failed to take advantage of the low oil price window throughout Q1-2023 to replenish the now-depleted SPR, leading to renewed inflation scare that pushed market participants to quickly adjust their policy rate expectations amid the re-appearing spectre of energy inflation (*see Chart 1*).
- Shale oil producers' role as a counterweight to OPEC producers provides another buffer that may prevent OPEC-induced spikes in oil prices. Unfortunately, shale oil is not cheap to produce (compared to dirt-cheap Middle-eastern oil), and the short-cycle nature of its well requires continuous investments from shale producers. A higher policy rate, then,

would not help to improve the oil supply condition as tighter financing conditions may hamstring shale producers' much-needed investments. The Fed, then, may not be facing an inflation problem after all. Spiking oil prices, by claiming more share of disposable income, could limit demand for other goods. The US economy, then, may once again be haunted by the spectre of stagflation.

- **However, we remain sceptical that the OPEC+ cut introduced last week could significantly increase oil prices to a level worrying enough to spark the stagflation**

"Dwindling global demand means that the OPEC+ oil cuts may not translate to an outsized spike in oil prices"

problem (*see Chart 2*). For one, the impact of China's economic re-opening to the global energy demand has been rather underwhelming, while demand in the US market is not particularly springy either given the worsening short-term US economic outlook.

Production cuts as announced by OPEC+ members last week may lead to some increase in oil prices, perhaps around USD 10/bbl as reported by a research house, which would bring oil prices closer to our long-term outlook at USD 80-90/bbl. But without a substantial upward shock in demand energy prices may continue its slower jog along its disinflation path.

- The re-appearing spectre of energy inflation is only one of the US economy's many problems. On the Homefront, the US government's fiscal policy posture has been increasingly hard to predict, thanks to

intensifying partisanship that transformed the debt-ceiling debacle into a regular event. Economic policies taken by the US government have also grown to be more inward-looking, alienating even its staunchest allies. Academic economists have long discussed the mega-threat of the diminishing prestige of the USD in the global economy, and the uncertain and close-circuited US economy may help to hasten the downfall of the “King Dollar”.

- De-dollarisation efforts, once ridiculed as a hostile countries’ agenda to shield themselves from the US government’s tendency to weaponise its currency as a geo-political bargaining chip, are gaining momentum as more politically-neutral countries look to find an alternative deal from the presently expensive-yet-uncertain USD. Indeed, bilateral local currency swap agreement has been increasingly mainstream over the recent years, allowing countries to settle payments with their trade partners using currencies not coloured green.
- Last week, the global de-dollarisation effort reached a new milestone. China energy importers CNOOC struck a deal with France’s TotalEnergies to import around 65,000 tonnes of LNG paid in Yuan. The CNOOC-TotalEnergies deal is not the first deal settled in the Chinese Yuan, nor that it is the first energy deal settled in the CNY (assuming China’s deepening ties with Russian energy

“Without the emergence of a financial market that may rival the US treasury market, The USD may continue its rein as the global reserve currency for the foreseeable future”

producers). Yet the significance is clear to see. The CNOOC-TotalEnergies deal is the first CNY-settled deal between China and European power, opening the lane for the China-led de-globalisation effort to the northern hemisphere.

- **The US dwindling political and economic leadership may explain the accelerated momentum behind the de-dollarisation effort. But much of the infrastructure has been laid down by China,** which had expanded its bilateral currency swap agreement from a mere CNY 470 bn in 2009 to around CNY 4030 bn in 2023. However, it is important to note that despite the expanding swap agreements, the use of Yuan in cross-border settlements remains largely concentrated on payments for imports from China, and the still-developing Chinese financial market could make it hard for countries with net Yuan gains to reinvest their export revenues.
- Efforts by central banks to decrease their exposure to USD-denominated assets may also contribute to the recent hype in the China-led de-dollarisation effort. Indeed, many have reported that the USD’s share as global reserves has now stood at a “meagre” 59.8%, much lower than its 72.7% peak 20 years ago. This statistic, however, could be misleading. **The decline in the USD share in global FX reserves can be explained more by the increase in the IMF’s special drawing rights (see Chart 3),** although the share of

Chinese Yuan in the global FX reserve did increase from 0% before 2016 to 2.8% in Q3-2022.

- Moreover, US treasuries sell-off by foreign central banks also does not reduce the attractiveness of US financial assets. The US treasury market is still the only viable option for exporters (or people with excess capital in general) to reinvest their capital, as evidenced by the continuous inflows of private capital that constantly outweigh the much-reported outflows of official reserves (*see Chart 4*). Still, sky-high interest rates and the US government's inward-looking trade policy may continue to boost the relevancy of the CNY cross-border settlements in international trade (especially with China). **The Fed, then, may eventually need to cut their interest rates, ensuring the availability (and affordability) of the USD in the global market to limit the incentives to replace the greenbacks with other currencies to settle international transactions.** However, the Fed is not under immediate pressure to do so, considering that without the emergence of another non-US financial market big enough to rival that of the US treasury market, the “King Dollar” may continue to reign as the global reserve currency in the foreseeable future.
- Thus, it appears that the Fed would choose to focus itself on the year-long battle against inflation. Still, the increasingly-apparent threat of recession means that the Fed's inflation-combatting policy may become increasingly costly. Many have also voiced the argument **that the Fed may need to**

bring a more significant pain to pummel the inflation number back to the 2% target, considering the post-pandemic upward shift in the aggregate supply curve. The Fed, then, may eventually need to start cutting rates without seeing the YoY CPI number going back to the 2% target, considering the macroeconomic cost and political backlash that may come from a significant spike in the unemployment number.

- In contrast, the macroeconomic condition surrounding Bank Indonesia seems to be brighter. China's economic reopening appears to provide a floor for commodity prices, at a level higher than the pre-pandemic price level. Ongoing stress in banking sectors on both sides of the Atlantic would force the Fed to keep its liquidity swap open, ensuring the availability of the USD in overseas markets. **The depreciation threat against the Rupiah appears to be waning, while domestic consumptions continue to keep the labour-intensive manufacturing sector on its expansionary trend.** The Fed may not afford to keep its higher-for-longer policy outlook, but **BI could keep its BI7DRR at 5.75% over a longer term.**

“The shifting aggregate supply curve may force the Fed to incur more significant economic losses to bring inflation back to the 2% target”

Chart 1

Narrowing discrepancy

Many in the market now expect the terminal rate to be closer to the Fed's outlook as the OPEC+ oil cuts bring back the spectre of energy inflation

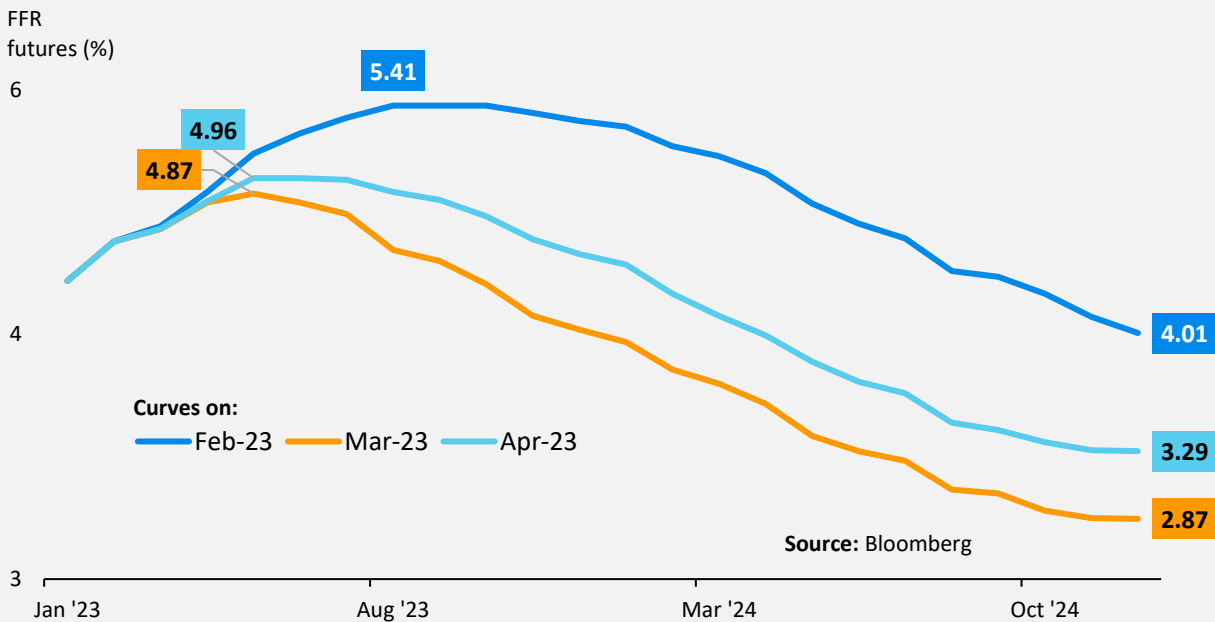


Chart 2

No spike

Dwindling energy demand amidst worsening short-term economic outlook may limit the increase in oil prices despite lower OPEC and shale output

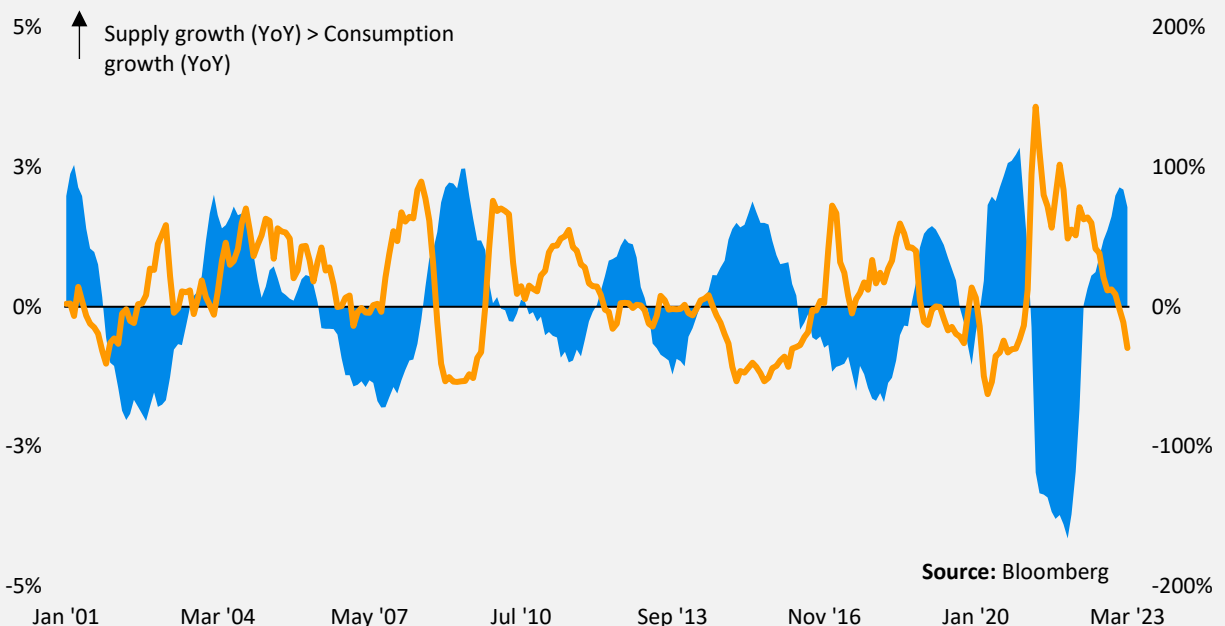


Chart 3

Different perpetrators

The CNY has made a significant gain in global FX shares but much of the shift from the USD could be better explained by the increase in IMF's SDR

15 USD Trillions

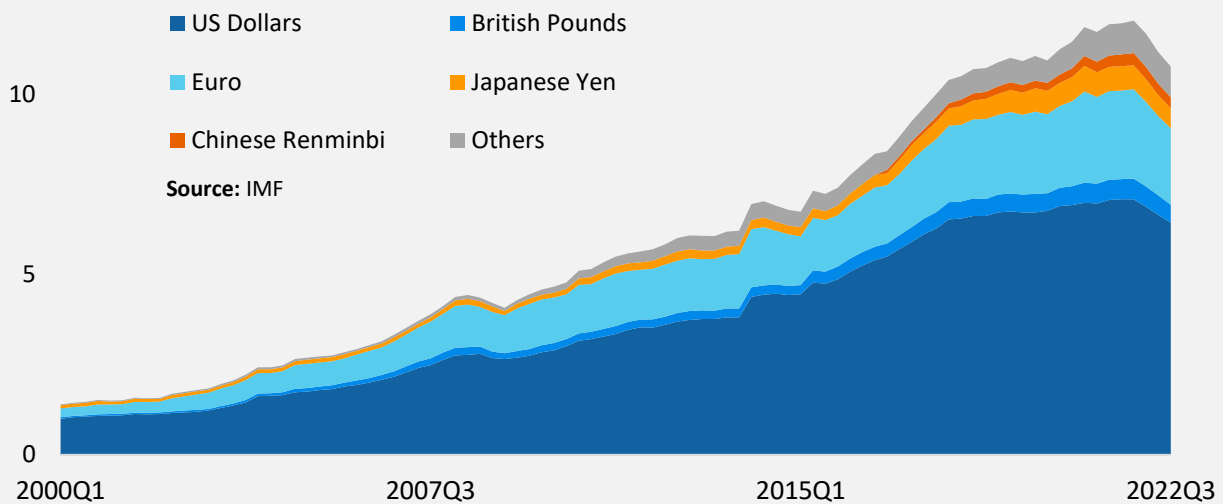
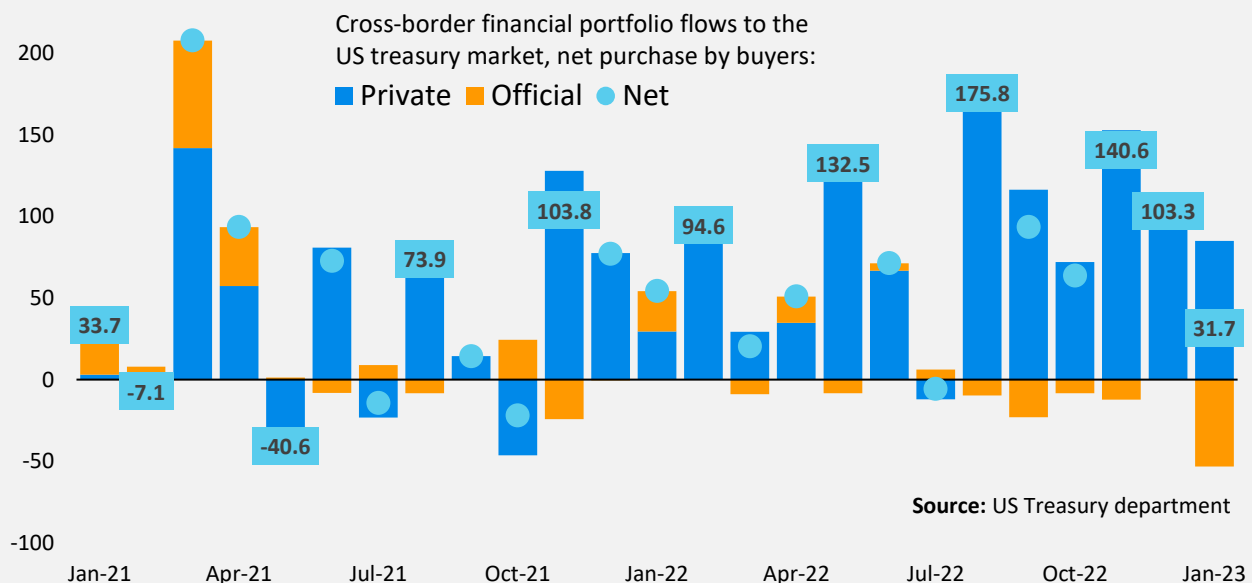


Chart 4

Coming and going

US treasuries sell-off by official reserves are constantly outweighed by private investors as the US treasury market remain as the only viable venue to reinvest excess capital

250 USD Bn



Economic Calendar				
		Actual	Previous	Forecast*
3 April 2023				
ID	S&P Global Manufacturing PMI	51.9	51.2	50
ID	Inflation Rate (YoY)	4.97%	5.47%	5.3%
US	ISM Manufacturing PMI	-	47.7	49
5 April 2023				
US	Balance of Trade (USD Bn)	-	-68.3	-69.0
US	ISM Non-Manufacturing PMI	-	55.1	54
7 April 2023				
ID	Foreign Exchange Reserves (USD Bn)	-	140.3	141.0
11 April 2023				
CN	Inflation rate YoY	-	1%	2.0%
12 April 2023				
US	Inflation rate YoY	-	6%	5.8%
13 April 2023				
US	FOMC Minutes			
US	PPI YoY	-	4.6%	4.2%
CN	Balance of Trade (USD Dn)	-	116.88	49
ID	Car Sales YoY	-	7.4%	-
17 April				
ID	Balance of trade (USD Bn)	-	5.48	2.9
18 April				
CN	GDP Growth Rate YoY	-	2.9%	3.2%
EA	Balance of Trade (EUR Bn)	-	-	-11.9
28 April				
ID	M2 Money Supply YoY	-	7.9%	-
EA	GDP Growth Rate YoY Flash	-	-1.8%	1.0%

*Forecasts of some indicators are simply based on market consensus

Bold indicates indicators covered by the BCA Monthly Economic Briefing report

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Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	31-Mar	-1 mth	Chg (%)
US	5.00	Mar-23	-1.00	Baltic Dry Index	1,389.0	990.0	40.3
UK	4.25	Mar-23	-6.15	S&P GSCI Index	574.0	581.9	-1.3
EU	3.50	Mar-23	-3.40	Oil (Brent, \$/bbl)	79.8	83.9	-4.9
Japan	-0.10	Jan-16	-3.40	Coal (\$/MT)	193.0	194.1	-0.6
China (lending)	4.35	Apr-23	3.35	Gas (\$/MMBtu)	2.10	2.50	-16.0
Korea	3.50	Feb-23	-1.30	Gold (\$/oz.)	1,969.3	1,826.9	7.8
India	6.50	Feb-23	0.06	Copper (\$/MT)	9,003.5	8,951.0	0.6
Indonesia	5.75	Mar-23	0.78	Nickel (\$/MT)	23,651.0	24,591.0	-3.8
Money Mkt Rates	31-Mar	-1 mth	Chg (bps)	CPO (\$/MT)	938.7	926.8	1.3
SPN (1M)	4.36	4.40	-3.6	Rubber (\$/kg)	1.34	1.36	-1.5
SUN (10Y)	6.77	6.88	-10.6	External Sector	Feb	Jan	Chg (%)
INDONESIA (O/N, Rp)	5.62	5.62	-0.1	Export (\$ bn)	21.40	22.32	-4.15
JIBOR 1M (Rp)	6.40	6.40	0.2	Import (\$ bn)	15.92	18.44	-13.68
Bank Rates (Rp)	Jan	Dec	Chg (bps)	Trade bal. (\$ bn)	5.48	3.88	41.15
Lending (WC)	8.75	8.60	14.94	Central bank reserves (\$ bn)*	140.3	139.4	0.64
Deposit 1M	4.00	3.95	5.05	Prompt Indicators	Feb	Jan	Dec
Savings	0.67	0.67	0.03	Consumer confidence index (CCI)	122.4	123.0	119.9
Currency/USD	31-Mar	-1 mth	Chg (%)	Car sales (%YoY)	7.4	11.9	9.0
UK Pound	0.811	0.832	2.62	Motorcycle sales (%YoY)	56.3	38.6	24.6
Euro	0.923	0.946	2.49	Manufacturing PMI	Mar	Feb	Chg (bps)
Japanese Yen	132.9	136.2	2.49	USA	N/A	N/A	N/A
Chinese RMB	6.874	6.936	0.90	Eurozone	47.3	48.5	-120
Indonesia Rupiah	14,995	15,250	1.70	Japan	49.2	47.7	150
Capital Mkt	31-Mar	-1 mth	Chg (%)	China	50.0	51.6	-160
JCI	6,805.3	6,843.2	-0.55	Korea	47.6	48.5	-90
DJIA	33,274.2	32,656.7	1.89	Indonesia	51.9	51.2	70
FTSE	7,631.7	7,876.3	-3.10				
Nikkei 225	28,041.5	27,445.6	2.17				
Hang Seng	20,400.1	19,785.9	3.10				
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				

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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