Break the mercantilist glass in case of emergency

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Summary

- The USD rally following last week's FOMC meeting turns out to be short-lived, but major Asian currencies such as the CNY continue to weaken as the PBoC seeks to provide more stimulus for its ailing economy
- China's stimulus may mainly benefit the supply side of the Chinese economy, given structural problems such as excess saving and the still-uncertain property sector that would continue to stifle domestic consumption
- China's effort to stimulate its economy could lead to a further dilemma for BI, as the need to slow the influx of Chinese imports clash with the fear of a weakening IDR alongside the CNY

- Last week is a significant one for the global economy, for we have to say goodbye to the "Fed pivot" sentiment that thus far had helped to balance the Fed's hawkishness. However, the Fed's continued hawkishness following last week's FOMC meeting did not translate into a prolonged rally in the USD's value. The DXY has already tumbled by 1.3% from its pre-FOMC peak, influenced by market participants' scepticism regarding the Fed's signalled policy action in 2023 in contrast to the European Central Bank's more convincing tightening signal.
- Alas, the short-lived rally in the DXY does not release Asian currencies from considerable depreciation pressure ***(see Chart 1)***. While the DXY is not exactly a perfect indicator to gauge the strength of Asian currencies, the weakening JPY and CNY amidst the decline in the DXY shows that the concerted decline in the two major Asian currencies is more consistent with both currencies' weakening fundamentals, which arises from the widening divergence between the Fed's posture compared to the Bank of Japan (BoJ) or the People's Bank of China (PBoC).
- While the BoJ has chosen to maintain its current monetary policies, the PBoC has taken more proactive steps. The central bank has cut the reserve requirement ratio (RRR) by 50bps since the post-pandemic re-opening, followed by two other rate cuts over the past two weeks. The first was a 10bps reduction in the repo rate, followed by another 10bps cut that lowered the medium term-lending rate from 2.75% to 2.65%. Although the headline number from this policy easing is not as visible as the Fed's hawkish signals, these moves remain significant as they reflect the PBoC's

increasing concerns about the ailing health of the economy.

- Now that the PBoC has demonstrated its determination to take necessary measures (albeit in contradiction to the global trend) to revitalise the Chinese economy, the question arises: Where the stimulus money will flow into China's economy? China's saving-intensive and export-driven economic model has resulted in excess capital, further inflated in recent times following the watershed of Chinese exports while the domestic demand remains anaemic. Indeed, China is not short of capital to spend, so the question is about its deployment. The best scenario, of course, is if these capitals make their way mainly to the household sector, encouraging consumers to increase consumption and take more debt as the interest rate goes lower.

- Unfortunately, increasing China's aggregate demand is not an easily achievable goal. Structural problems ranging from an ageing population and the absence of a robust social safety net have reduced consumers' propensity to consume, meaning that any rise in disposable income may only result in further accumulation in saving rather than consumption. The worsening condition in the property sector, as shown by the PBoC's property sector climate index ***(see Chart 2)***, further underscores the difficulty of boosting China's aggregate demand. The continued decline in property prices adds to the negative wealth effect, which may discourage Chinese consumers from increasing (or even maintaining) their spending.

"China's stimulus may eventually flow to the low-hanging fruit: supply-side interventions"

- In such a scenario, any stimulus package shall first address the challenges facing the property sector. There have been calls from many China watchers for a stimulus package targeted at the property sector, which could include measures such as fiscal backstop for property developers, lower LTV ratios for second-home purchases, and a further increase in liquidity injections to enable banks to lower mortgage rates. However, implementing such measures would run counter to the Chinese government's efforts to curb excesses in the residential property sector (under the common prosperity programme), which is reflected by the PBoC's decision to refrain from reducing the loan prime rate (LPR). Thus, it remains unlikely that the Chinese government would throw its weight on the property sector. Although, the stimulus for the property sector would still be made available on a piecemeal basis, as predicted by multiple China-based economists.

- The recent round of China's monetary stimulus, then, may again be directed towards the low-hanging fruit: support for the supply side of the economy. Indeed, higher availability of financing often increases China's manufacturing activity ***(see Chart 3)***, resulting in piling inventories as stimulus does not translate to an increase in domestic consumption.

- This strategy is not without its complications. In 2016, the combination of stimulus measures and the depreciation of CNY helped increase the demand for made-in-China products, thereby alleviating the manufacturing recession in China. However, the current geopolitical tensions and industrial competition pose challenges. Chinese producers cannot solely rely on a depreciating CNY (thus Say's law) to penetrate the US and Western markets ***(See Chart 4)***. China, then, would need to seek alternative partners such as the BRICS and other emerging economies to absorb their products.

- Economically speaking, such a scenario projects a zero-sum outcome for China and its trading partners, as importing countries would trade their manufacturing expansion in return for the increase in purchasing power and consumption. China's expanding manufacturing sector would also eventually translate to commodity prices, sustaining Indonesia's trade surplus that is crucial for the economy's post-pandemic growth model.
- However, holding on to Indonesia's tried-and-true growth model may result in long-term complications. Continued trade surplus may continue to fuel the Rupiah to the brink of overvaluation, resulting in an ossified manufacturing sector that would be detrimental to the government's long-term effort to expand the job market ahead of the explosion in the working-age population. The need to prevent this "Dutch disease", along with short-term concerns over the slowing aggregate demand growth, may move Bank Indonesia to get ahead of the curve and loosen its policy stance.
- Despite the growing "BI pivot" narrative, further considerations need to be taken before we are comfortable making such a call. Firstly, despite the strategy's success in 2016, lower demand from the US and Western markets means that the outcome of China's ongoing stimulus cycle remains uncertain.
- Secondly, weakening sentiments on Asian currencies following the depreciation of major Asian currencies such as the CNY (and the JPY) may also spread into the IDR, which could lower BI's resolve in cutting its policy rate ahead of the pack. Therefore, while a more accommodative policy appears increasingly favourable for BI and the Indonesian economy, there are reasons to remain sceptical about the need for immediate action in the short term.

"Holding on to Indonesia's tried-and-true growth model may result in long-term complications"

Chart 1

The fun in fundamental

Widening divergence between The Fed and major Asian central banks' policies explain the concerted weakening of the JPY and the CNY, while the IDR remain relatively robust thanks to its improving fundamentals

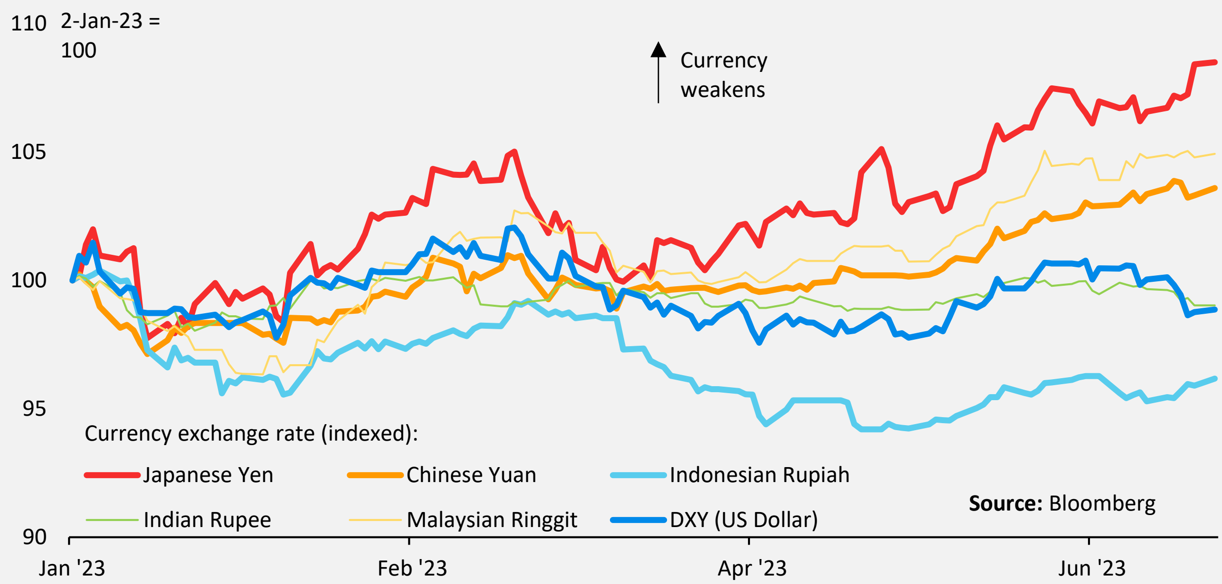


Chart 2

Hard times

Conditions in China's property sector remains precarious despite the monetary stimulus as the weakening CNY and higher USD rates add to property developers' debt burden

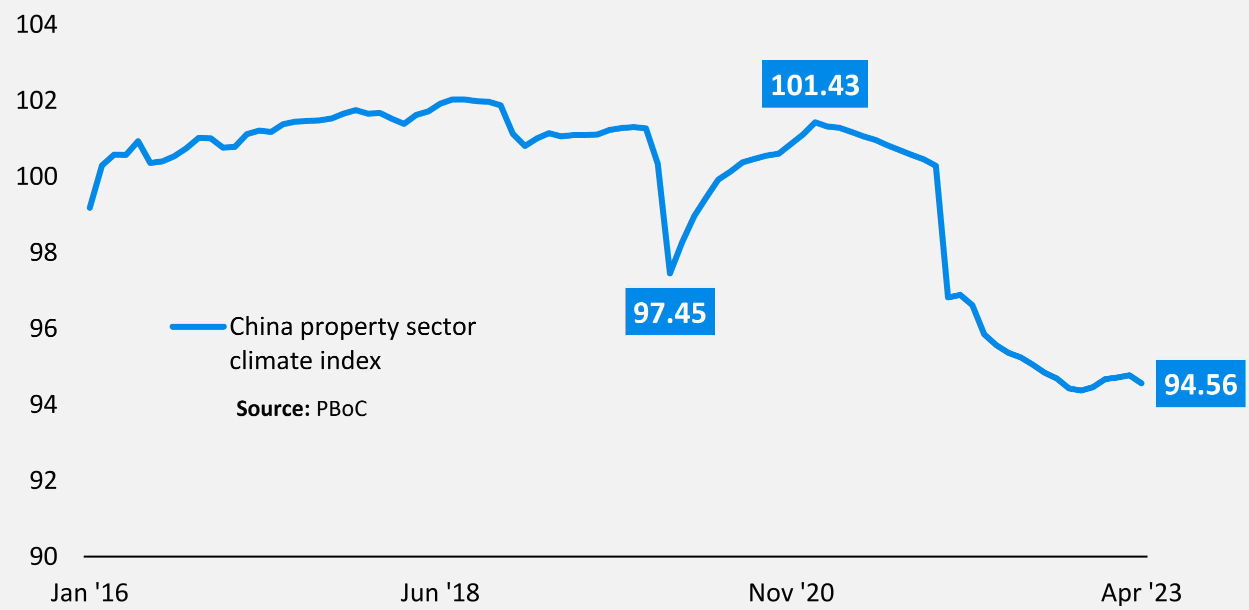
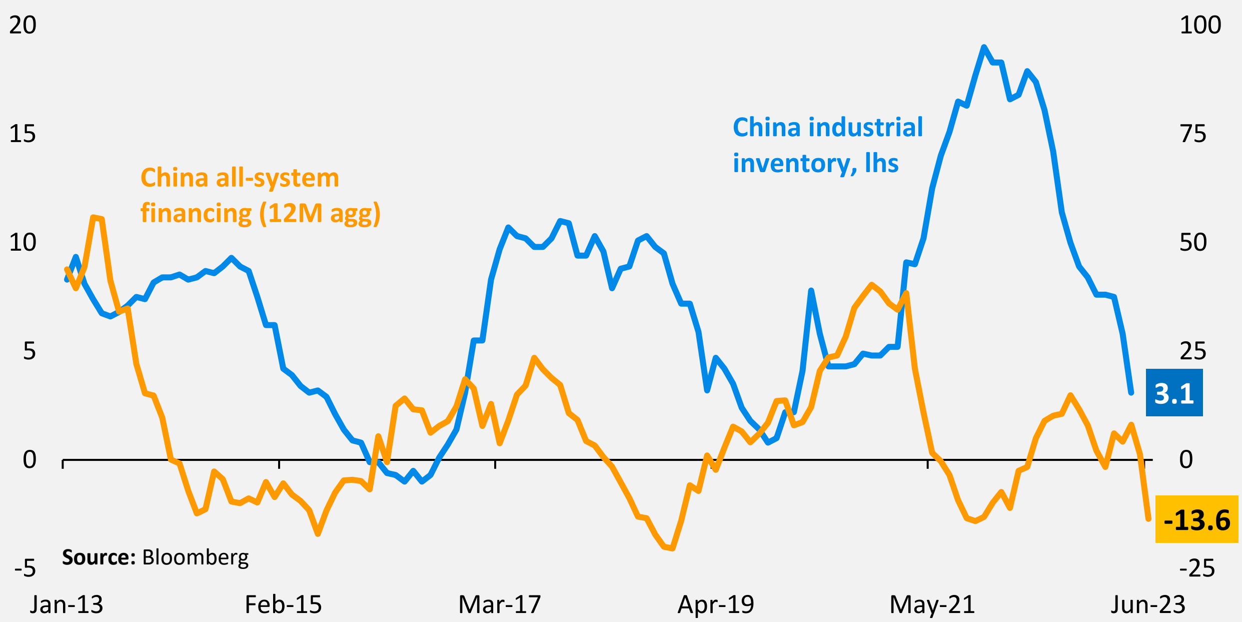


Chart 3

Walking along a more familiar path

The ongoing monetary stimulus may flow to supply side of the Chinese economy rather than demand-side, resulting in renewed inventory cycle that may benefit commodity producers

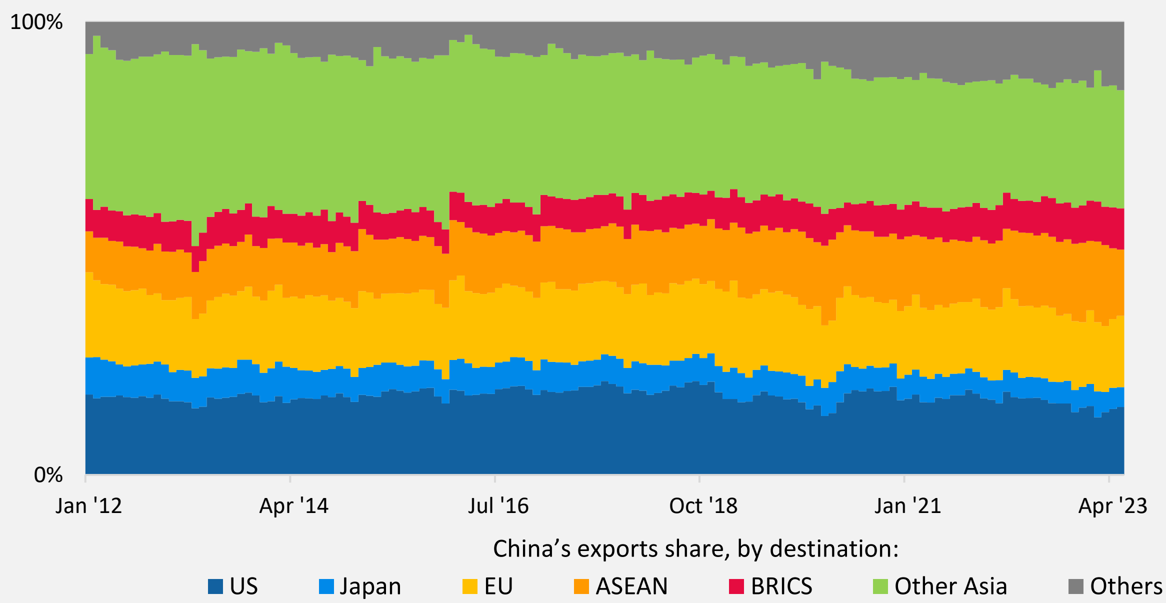


Source: Bloomberg

Chart 4

Same strategy, more difficult execution?

Supply-side stimulus and a weakening currency may not be enough to bail Chinese manufacturers out of a recession given the lower demand from the Western market following the weakening economic outlook and the decoupling agenda



Source: Bloomberg

Economic Calendar

		Actual	Previous	Forecast*
1 June 2023				
US	ISM Manufacturing PMI	46.9	47.1	48
5 June 2023				
ID	S&P Global Manufacturing PMI	50.3	52.7	52.3
ID	**Inflation Rate YoY**	**4.0%**	**4.33%**	**4.2%**
7 June 2023				
CN	Balance of Trade (USD Bn)	65.81	90.21	91.0
US	Balance of Trade (USD Bn)	-74.6	60.6	-78.2
9 June 2023				
CN	Inflation rate YoY	0.2%	0.1%	0.2%
ID	**Foreign Exchange Reserves (USD Bn)**	**139.3**	**144.2**	**144.0**
12 June 2023				
ID	Consumer Confidence	128.3	126.1	128
13 June 2023				
ID	Retail Sales	1.5%	4.9%	5.0%
US	Inflation rate YoY	4%	4.9%	4.3%
15 June 2023				
US	Fed Interest Rate Decision	5.25%	5.25%	5.25%
ID	**Balance of Trade (USD Bn)**	**0.44**	**3.94**	**3.2**
ID	Car Sales YoY	65.2	-28.8%	-
19 June 2023				
ID	Motorbike Sales YoY	113.4%	-19.4%	-
22 June 2023				
ID	Loan Growth YoY	-	8.08%	-
ID	**Bank Indonesia policy announcement**		**5.75%**	**5.75%**

*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 (%)
US	5.25	Jun-23	1.25
UK	4.50	Jun-23	-4.20
EU	4.00	Jun-23	-2.10
Japan	-0.10	Jan-16	-3.60
China (lending)	4.35	Jun-23	4.15
Korea	3.50	May-23	0.20
India	6.50	Jun-23	2.25
Indonesia	5.75	May-23	1.75
Money Mkt Rates	**16-Jun**	**-1 mth**	**Chg (bps)**
SPN (1M)	4.31	4.39	-7.7
SUN (10Y)	6.28	6.40	-12.2
INDONIA (O/N, Rp)	5.55	5.55	-0.1
JIBOR 1M (Rp)	6.39	6.40	-0.7
Bank Rates (Rp)	**Mar**	**Feb**	**Chg (bps)**
Lending (WC)	8.95	8.89	6.13
Deposit 1M	4.20	4.18	2.24
Savings	0.69	0.67	1.92
Currency/USD	**16-Jun**	**-1 mth**	**Chg (%)**
UK Pound	0.780	0.801	2.63
Euro	0.914	0.921	0.69
Japanese Yen	141.8	136.4	-3.83
Chinese RMB	7.127	6.977	-2.10
Indonesia Rupiah	14,935	14,820	-0.77
Capital Mkt	**16-Jun**	**-1 mth**	**Chg (%)**
JCI	6,698.5	6,676.6	0.33
DJIA	34,299.1	33,012.1	3.90
FTSE	7,642.7	7,751.1	-1.40
Nikkei 225	33,706.1	29,843.0	12.94
Hang Seng	20,040.4	19,978.3	0.31
Foreign portfolio ownership (Rp Tn)	**May**	**Apr**	**Chg (Rp Tn)**
Stock	2,738.1	2,789.1	-51.06
Govt. Bond	822.7	822.7	0.00
Corp. Bond	11.8	11.8	-0.01

Trade & Commodities	16-Jun	-1 mth	Chg (%)
Baltic Dry Index	1,076.0	1,476.0	-27.1
S&P GSCI Index	557.2	542.7	2.7
Oil (Brent, $/brl)	76.6	74.9	2.3
Coal ($/MT)	135.7	163.1	-16.8
Gas ($/MMBtu)	2.13	2.28	-6.6
Gold ($/oz.)	1,958.0	1,989.2	-1.6
Copper ($/MT)	8,555.0	8,074.2	6.0
Nickel ($/MT)	22,955.8	20,986.0	9.4
CPO ($/MT)	757.4	838.2	-9.6
Rubber ($/kg)	1.34	1.36	-1.5
External Sector	**May**	**Apr**	**Chg (%)**
Export ($ bn)	21.72	19.28	12.61
Import ($ bn)	21.28	15.35	38.65
Trade bal. ($ bn)	0.44	3.94	-88.91
Central bank reserves ($ bn)*	139.3	144.2	-3.38
Prompt Indicators	**May**	**Apr**	**Mar**
Consumer confidence index (CCI)	128.3	126.1	123.3
Car sales (%YoY)	65.2	-28.8	2.7
Motorcycle sales (%YoY)	113.4	-19.4	40.5
Manufacturing PMI	**May**	**Apr**	**Chg (bps)**
USA	46.9	47.1	-20
Eurozone	44.8	45.8	-100
Japan	50.6	49.5	110
China	50.9	49.5	140
Korea	48.4	48.1	30
Indonesia	50.3	52.7	-240

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	5.0
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	3.4
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	35.3
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.7

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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