Living on a prayer

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Summary

- Spiking yields on UST securities limit the Fed's urgency to increase the FFR by another 25 bps. However, the situation might change given the recently observed bear-steepening situation.
- The worsening supply outlook in the global oil market may continue to fuel inflationary concerns in the US and global economy, highlighting the need for a stronger USD.
- The prolonged rally in the USD value could weaken the Rupiah's now-strong fundamental, which may tempt Bank Indonesia to restart its rate-tightening campaign.

- The Indonesian financial market continues to face considerable pressure throughout the first week of October 2023. The domestic financial market is haemorrhaging foreign capital to the tune of USD 329.32 Mn last week, as foreign investors sold around USD 308.49 Mn worth of Indonesian government bonds and foreign holdings in the domestic stock market fell below the level observed by the end of last year. The Rupiah, as we know, has fallen to the 15,600/USD level; erasing its gains in 2023 (-0.24% YTD recently, 5.80% YTD in April 2023).
- Much of these depreciatory pressures, of course, are due to the worsening external condition. As we described ad nauseam, the Rupiah and its Asian peers have been whipsawed by the rally in the USD's value since July 2023 and the weakening sentiment on the Asian economic powerhouses such as China and Japan. Alas, these prolonged pressures may already gnaw on some of the Rupiah's fundamentals. Indonesia's net FX liquidity index appears to be trending downward in September 2023, while FX liquidity within the domestic banking sector has not improved much despite the strengthened DHE rule ***(See Chart 1)***.
- Despite this continuous siege, BI and the Rupiah have not run out of defensive mechanisms. Stable domestic prices mean that the Rupiah may continue to benefit from a healthy real rate differential, while the seemingly attractive SRBI would help to siphon the Rupiah's liquidity in the market; reducing the supply of Rupiah and thus increasing its value. The still-ample FX reserves position, which now equals 6.0 months of imports and interest payments,

may also allow BI to extend its stabilising hand in the money market.

- Thus, BI may continue to rely on interventions in the money market to stabilise the Rupiah amidst the ongoing depreciatory challenge, as stated in the press release last Friday. The central bank's admission of active intervention in the FX market may indicate their optimistic view that these hitherto unfavourable conditions in the global market will prove to be cyclical; and that the Fed will soon call a day on its rate tightening cycle and thereby relieve BI of the pressure to widen its already high real interest rate differential.
- Indeed, many in the market are sceptical that the Fed would need to increase the FFR by another 25 bps in the November 2023 FOMC meeting; a scenario which shall spare BI from the risk of policy rate parity, at least for now. The market has been tightening the financing conditions on its own, as evident from the ceaseless rise in US mortgage rates and UST yields despite the absence of a more concrete tightening stance in the past two FOMC meetings. The worsening fiscal outlook in the US may also contribute to market participants' scepticism regarding the 5.50-5.75% terminal rate for the FFR, although the recently observed bear steepening[1] condition suggests that inflationary expectations may be bubbling up again in the US ***(see Chart 2)***.

"The recently observed bear steepening condition suggests that inflationary expectations may be bubbling up again in the US"

- The growing apprehensions about the resurgence of inflation, both in the US and globally, cannot be separated from the increasingly speculative sentiment surrounding the rally in the oil market. Indeed, the ongoing hot conflict in the Levant led oil prices to jump by 4.45% as the market opens today, which is significant given the lack of oil-producing activities in the region.
- It is interesting, then, to consider the source behind oil traders' apparent upward bias. We should look into the ebb-and-flow in the global oil market in 2022. Surging oil prices, which peaked at USD 122.27/bl in mid-June 2022, forced the Fed to tighten its policy at a faster pace compared to its counterpart, leading to the DXY reading of 144.1 on 27 September 2022. Oil prices, of course, were much lower by this time, settling at USD 86.27/bl when the USD (DXY) reached its two-decade high level in late September 2022. What also lies in the background, of course, is the US government's significant intervention in the oil market, as evident from the 42.51% decline in US SPR between January-September 2023 when oil prices peaked.
- Moreover, despite news regarding stagnating US shale oil productions and the reduction of OPEC+ oil production quotas, the global oil supply is still largely improving

[1] The widening of the yield curve due to long-term yields rising faster than short-term yields

in line with the resilient demand ***(see Chart 3)***. Many assumptions have been made regarding this development, including the effectiveness of the price cap on Russia's oil and the US government's more lenient attitude towards the sanction on Iran.

- Now, we compare the hitherto 'okayish' global oil supply condition with the widely expected future condition. First, the near rock-bottom SPR level means that the US government could not actively intervene in the supply condition in its domestic market, at least not to the same level as in 2022. Second, the now high-rate environment is detrimental to the US energy sector, given shale producers' short-cycle nature and dependency on junk bonds to finance their operations. The intensifying tension in the Levant may also force the US government to take stronger measures against its adversaries in the region, a move that would again shut the tap on the Iranian oil pipeline. It is clear, then, that the shallow oil wells have all been tapped out, leaving the Fed as the sole institution that may carry out the fight against the oil cartel.

- Alas, the Fed lacks the tools to target oil prices with surgical precision. The only tool available for the Fed, as we know, is the adverse relationship between the USD's value and commodity prices ***(see Chart 4)***. Higher oil prices, then, may necessitate a stronger US Dollar; a situation which should prompt the Fed and the market to keep the financial condition in a substantially tighter environment for an even longer period.

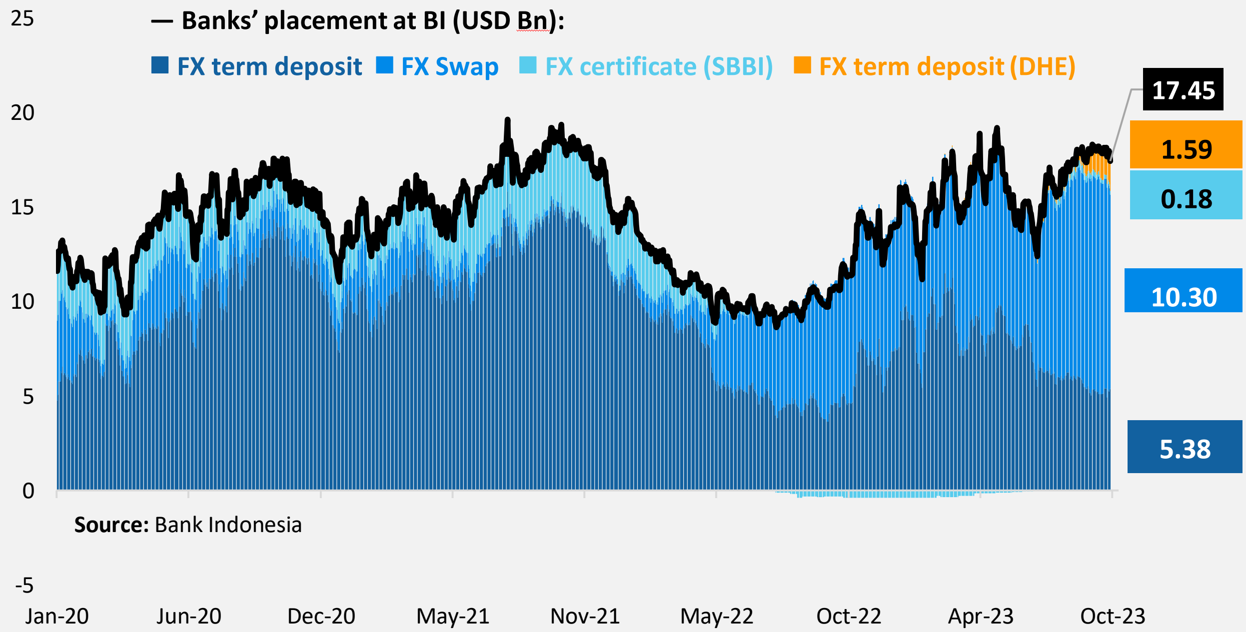
- This scenario, unfortunately, may show that BI's outlook of cyclical pressure on the IDR is increasingly looks like a Hail Mary. Despite the already limited outlook for a further US policy rate tightening, prolonged higher yields on the US treasury market may further reduce investors' demand for alternative assets, putting Indonesia and other peripheral markets in asphyxia. BI's current strategy of relying on market interventions to stabilise the Rupiah, then, may be increasingly costly – given the uncertainty regarding the duration of the ongoing rally in the USD's value. Hence, while BI (and us) may remain hopeful, the current situation may move the central bank to consider the possibility of restarting its interest rate increase campaign, especially if the Rupiah's fundamentals become increasingly weaker in the coming period.

"Prolonged higher yields on the US treasury market may further reduce investors' demand for alternative assets, putting Indonesia and other peripheral markets in asphyxia"

Chart 1

Little improvements

FX liquidity within the domestic banking sector has not improved much despite the strengthened DHE rule

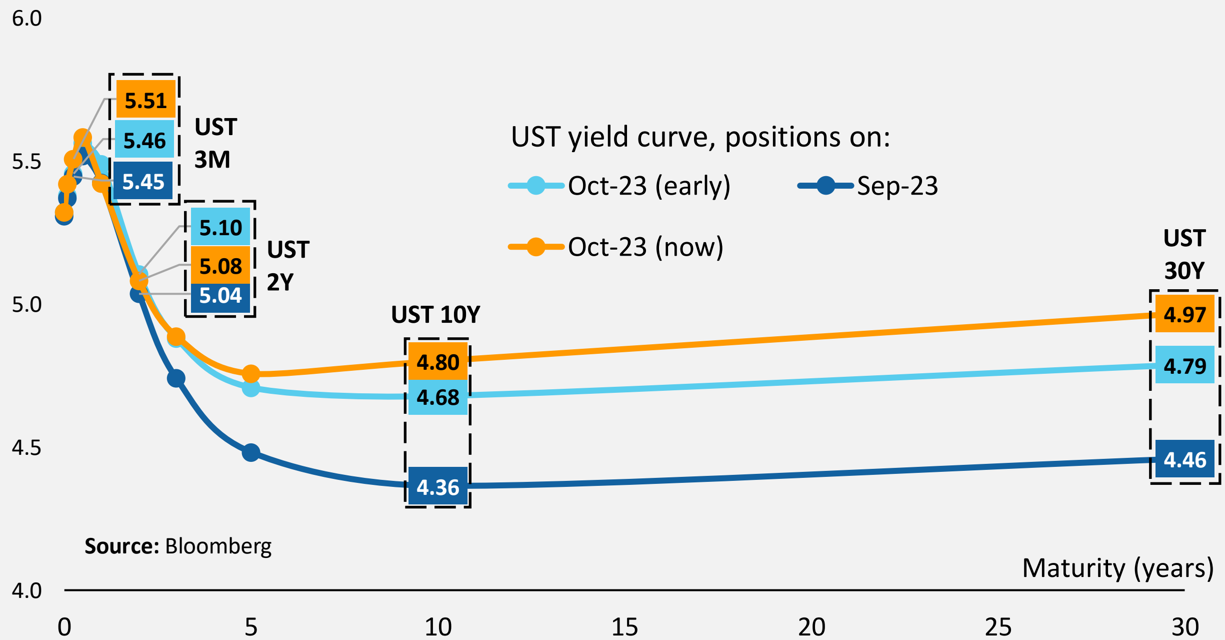


Source: Bank Indonesia

Chart 2

Beware the bear

The yield on longer-tailed UST securities has been increasing higher than US T-Bills, indicating the return of inflation expectations in the US

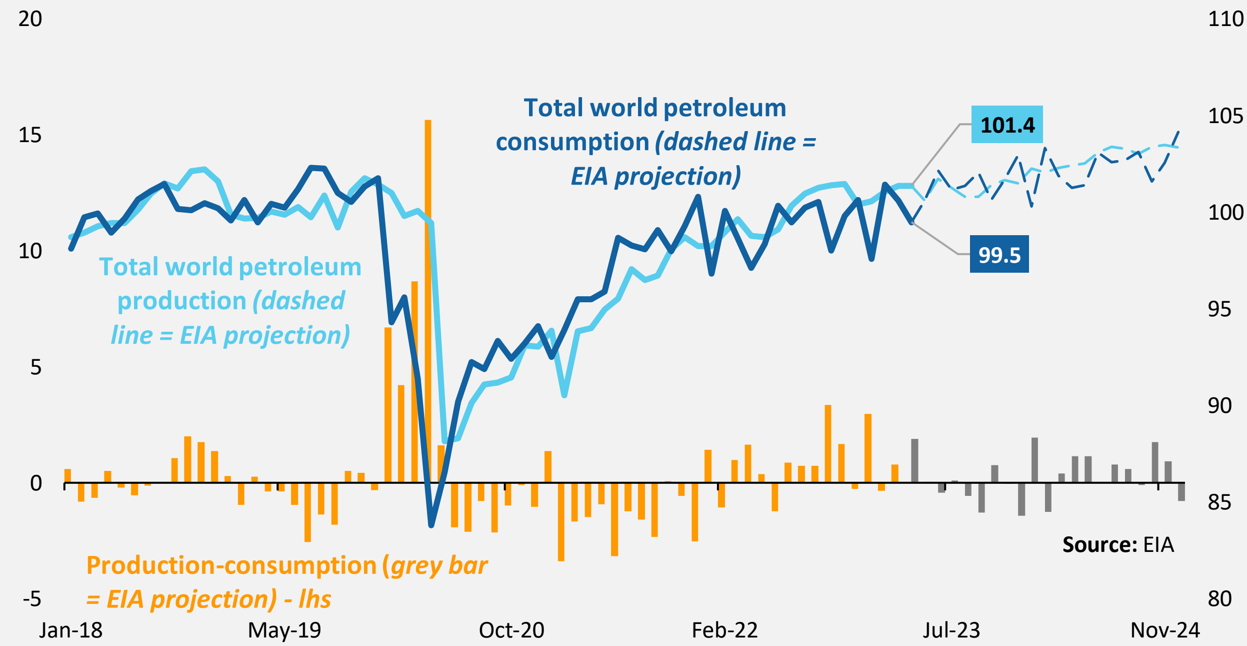


Source: Bloomberg

Chart 3

Stepping out of the goldilocks

The global oil supply is improving so far in 2023, but the situation may change in the upcoming period as the outlook for supply continues to worsen

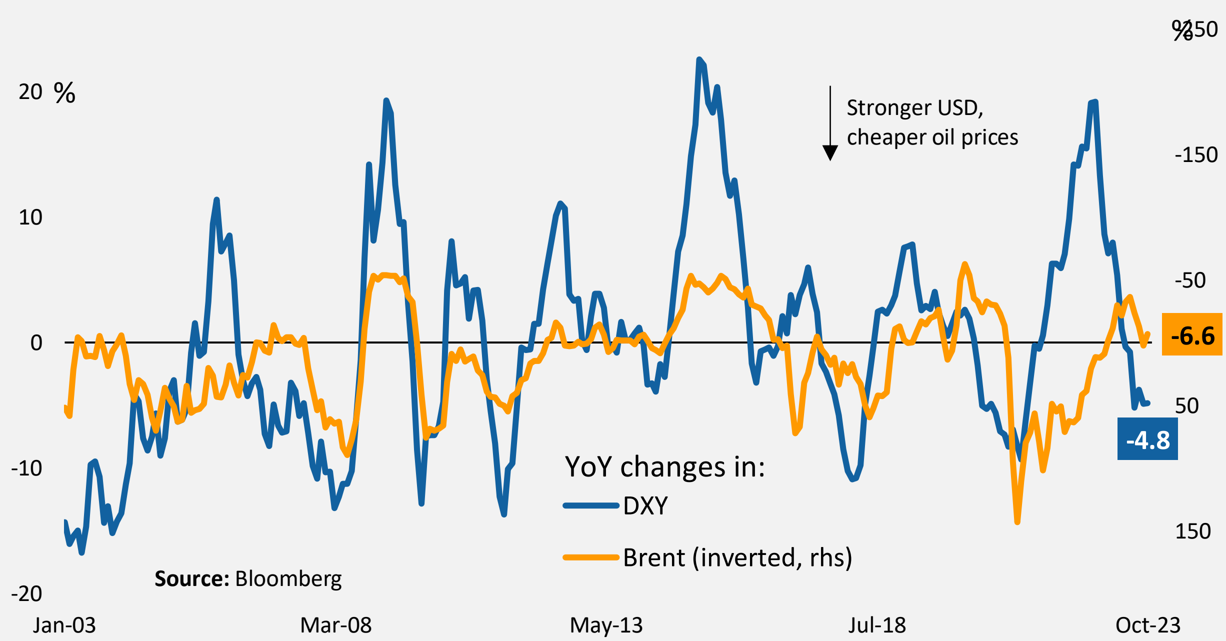


Source: EIA

Chart 4

Higher for way longer

Higher USD (and thus interest rates) may be increasingly necessary to suppress oil prices as the US government are running out of low-hanging fruits to intervene in the supply condition



Source: Bloomberg

Economic Calendar

		Actual	Previous	Forecast*
1 October 2023				
CN	Caixin Manufacturing PMI	50.6	51.0	51.2
2 October 2023				
ID	S&P Global Manufacturing PMI	52.3	53.9	53
ID	**Inflation rate YoY**	**2.28%**	**3.27%**	**2.23%**
US	ISM Manufacturing PMI	49	47.6	48.1
3 October 2023				
US	JOLTs Job Openings (USD Mn)	9.6	8.8	8.6
5 October 2023				
US	Balance of Trade (USD Bn)	-58.3	-65	-58.3
6 October 2023				
ID	**Foreign Exchange Reserves (USD Bn)**	**134.9**	**137.1**	**136.0**
US	Unemployment Rate	3.8%	3.8%	3.8%
7 October 2023				
CN	Foreign Exchange Reserves (USD Tn)	3.12	3.16	3.15
9 October 2023				
ID	Consumer Confidence	121.7	125.2	125
11 October 2023				
ID	Retail Sales YoY	-	1.6%	1.3%
12 October 2023				
US	Inflation rate YoY	-	3.7%	3.8%
ID	Motorbike Sales YoY	-	1.8%	-
13 October 2023				
CN	Inflation Rate YoY	-	0.1%	0.2%
CN	Balance of Trade (USD Bn)	-	68.36	64.0
ID	Car Sales YoY	-	-8.3%	-
16 October 2023				
ID	**Balance of Trade (USD Bn)**	**-**	**3.12**	**4.6**
EA	Balance of Trade (EUR Bn)	-	6.5	-
19 October 2023				
ID	Loan Growth YoY	-	9.06%	-
ID	**Interest Rate Decision**	**-**	**5.75%**	**5.75%**
24 October 2023				
ID	Foreign Direct Investment YoY	-	14.2%	-

*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	5.50	Oct-23	1.80
UK	5.25	Oct-23	-1.45
EU	4.50	Oct-23	0.20
Japan	-0.10	Jan-16	-3.30
China (lending)	2.50	Sep-23	4.25
Korea	3.50	Aug-23	-0.20
India	6.50	Oct-23	-0.33
Indonesia	5.75	Sep-23	3.47
Money Mkt Rates	**6-Oct**	**-1 mth**	**Chg (bps)**
SPN (1M)	5.70	5.67	3.0
SUN (10Y)	6.99	6.42	57.3
INDONIA (O/N, Rp)	5.58	5.59	-1.5
JIBOR 1M (Rp)	6.40	6.40	0.0
Bank Rates (Rp)	**Jun**	**May**	**Chg (bps)**
Lending (WC)	8.93	8.93	0.00
Deposit 1M	4.19	4.19	0.10
Savings	0.67	0.67	-0.20
Currency/USD	**6-Oct**	**-1 mth**	**Chg (%)**
UK Pound	0.817	0.796	-2.60
Euro	0.945	0.933	-1.27
Japanese Yen	149.3	147.7	-1.07
Chinese RMB	7.298	7.303	0.07
Indonesia Rupiah	15,610	15,265	-2.21
Capital Mkt	**6-Oct**	**-1 mth**	**Chg (%)**
JCI	6,888.5	6,991.7	-1.48
DJIA	33,407.6	34,642.0	-3.56
FTSE	7,494.6	7,437.9	0.76
Nikkei 225	30,994.7	33,036.8	-6.18
Hang Seng	17,486.0	18,456.9	-5.26
Foreign portfolio ownership (Rp Tn)	**Sep**	**Aug**	**Chg (Rp Tn)**
Stock	2,833.3	2,869.7	-36.44
Govt. Bond	823.0	846.3	-23.30
Corp. Bond	10.8	11.1	-0.26

Trade & Commodities	6-Oct	-1 mth	Chg (%)
Baltic Dry Index	1,929.0	1,063.0	81.5
S&P GSCI Index	575.7	604.2	-4.7
Oil (Brent, $/brl)	84.6	90.0	-6.1
Coal ($/MT)	141.6	169.5	-16.5
Gas ($/MMBtu)	3.13	2.60	20.4
Gold ($/oz.)	1,833.0	1,926.1	-4.8
Copper ($/MT)	7,971.3	8,482.5	-6.0
Nickel ($/MT)	18,310.3	20,840.5	-12.1
CPO ($/MT)	766.1	824.1	-7.0
Rubber ($/kg)	1.38	1.40	-1.4
External Sector	**Aug**	**Jul**	**Chg (%)**
Export ($ bn)	22.00	20.86	5.47
Import ($ bn)	18.88	19.57	-3.53
Trade bal. ($ bn)	3.12	1.29	141.85
Central bank reserves ($ bn)*	137.1	137.7	-0.42
Prompt Indicators	**Aug**	**Jul**	**Jun**
Consumer confidence index (CCI)	125.2	123.5	127.1
Car sales (%YoY)	-8.3	-6.7	4.7
Motorcycle sales (%YoY)	1.8	45.6	66.6
Manufacturing PMI	**Sep**	**Aug**	**Chg (bps)**
USA	49.0	47.6	140
Eurozone	43.4	43.5	-10
Japan	48.5	49.6	-110
China	50.6	51.0	-40
Korea	49.9	48.9	100
Indonesia	52.3	53.9	-160

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	5.1
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.6
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,535
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	32.8
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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