

## A fiscal-driven monetary zugzwang

29 January 2024

Lazuardin Thariq Hamzah  
[lazuardin\\_hamzah@bca.co.id](mailto:lazuardin_hamzah@bca.co.id)

Barra Kukuh Mamia  
[barra\\_mamia@bca.co.id](mailto:barra_mamia@bca.co.id)



Scan for  
the link to  
our report  
depository

### Summary

- The potential change in US liquidity conditions may be more dictated by the US Treasury Department than the Federal Reserve in the upcoming days, as the Treasury is set to announce its financing needs and funding strategies.
- The Treasury is expected to re-balance its coupon issuance relative to T-bills in the upcoming QRA, as higher dependency on T-bills to finance its deficits would only postpone the deterioration in the US fiscal condition to the next couple of quarters.
- The Fed may need to react and accommodate continued fiscal expansion in the US while adhering to the limited room where the central bank could ease its policy.

- The Indonesian economy has enjoyed a string of good news for most of January 2024. Alas, events that transpired throughout the last week mark a break from that positive trend. First, despite the aggressive IDR 611.4 Tn (USD 39.43 Bn) of fiscal spending in December 2023, Indonesia's liquidity growth (M2) was recorded at 3.48% YoY, only marginally higher than the post-2008 low of 3.33% YoY in November 2023. Indonesia's FDI inflow growth in Q4 2023 also decelerates to around 5.2% YoY, in contrast, with the double-digit growth recorded since 2022.

### Fiscal sets the tune

- Many in the markets have based their expectation of liquidity conditions on signals coming out of the Eccles building (which is the Fed's headquarters). In the upcoming days, however, it might be better to focus our senses on signals coming out of the Treasury building.

- Meanwhile, the situation in the domestic financial market also did not show the same level of alacrity as shown in the preceding weeks. For instance, foreign investors in the stock market recorded USD 14.05 Mn in net sales between 22-26 January 2024, the first occurrence in 2024. Foreign purchases in the SBN market also remain limited, as indicated by the USD 15.17 Mn in foreign net buys last week. The 2.75% YTD decline in the Rupiah's value provides further indication that the domestic financial market is hurting from the dent in the FFR cuts expectation, which lowers investors' demand for risky assets such as Rupiah-denominated ones.

Indeed, **the US Treasury Department is about to conduct its first quarterly refunding announcement (QRA) of the year**, outlining the extent of the US government's financing needs and how the US Treasury Department looks to finance its deficit.

- Ever since the debt ceiling agreement, the US Treasury has relied on shorter-tailed Treasury bills (bills) to finance the US government's growing deficits (*see Chart 1*), which is itself driven in part by growing interest payment. This strategy works for two reasons: first, bills' "money-like" features would draw money market funds (MMFs) to enter the US treasury (UST) market, allowing the Treasury to tap into the ample liquidity in the Fed's repo facility (RRP) to refill its liquidity coffers. Second, since yields on bills present a risk-free rate, T-bills customers tend not to sell riskier securities to add more bills to their portfolios, thus keeping the liquidity condition in the market stable despite the Fed's ongoing quantitative tightening (QT) campaign.
- However, **despite the Treasury's hitherto success in refilling the treasury general account (TGA) by issuing more bills, the large size of the issuance – more so than its maturity structure - poses a risk of acute indigestion by the market.** The USD 984 Bn of debt that the Treasury is expected to issue in Q1 2024 represents the third consecutive quarter of mega-issuance, following the USD 1.007 Tn in Q3 2023 and USD 921 Bn in Q4. In particular, the QRA for Q3 on July 31st turned out to be a catalyst for a global bear market in subsequent months, although this was reversed somewhat by the slightly smaller (but still bills-heavy) QRA on November 1st.
- Other than the size, **the maturity structure of the debt poses another problem for the market and the Fed.** The strategy to raise debt by issuing more bills than coupons (treasury notes and bonds) may have worked well in the previous quarter, but such a strategy may only postpone the reckoning day for the US fiscal condition for another quarter rather than eliminate it

*“Despite its earlier success, continued reliance on bills may only postpone the reckoning day for the US fiscal situation”*

altogether. **Continuing to cut duration may strengthen the headwinds blowing against the US fiscal condition in the short term**, as the Treasury would need to issue even higher amounts of bills in subsequent QRAs to refinance bills maturing in the preceding months.

- The Treasury's strategy of adding more debt using bills could also add to the Fed's problem. A higher supply of bills may continue to drain the Fed's RRP facility, which has dwindled by around 63.39% from its peak (*see Chart 2*). The RRP facility acts as a buffer for the Fed in its quest to bring US banks' reserves to their lowest comfortable level (LCLoR). **Continued drawdown of the Fed's RRP facility amidst the higher supply of bills would thus remove the safety instrument for the Fed to carry on with its quantitative tightening (QT) campaign**, a condition which brings us to the memory of the September 2019 repo crisis when the liquidity condition in the banking sector drops to insufficient level and causing a stress in the interbank market.
- Another option, then, is for the Treasury to start issuing more coupons. Considering that the UST market duration has continued to decline since the debt ceiling agreement, some segments of the market have begun positioning themselves for higher supplies of coupons (*see Chart 3*), as the Treasury would eventually need to keep the balance between bills and coupon supplies in the UST market. **Given that term premiums in the UST market have been increasing before the QRA, the Treasury may concentrate its coupon issuance between 2Y and 10Y notes**, rather than longer-tailed bonds.
- Alas, concentrating issuance on the "belly" of the UST market may not eliminate the risk of tightening liquidity conditions. Unlike duration

risk-free bills, **term premiums imbued in longer-dated coupons would force coupon customers to reassess their risk profile, potentially leading to them selling other risky assets to absorb the newly issued coupons to balance the risk in their book.** The expiring bank terms funding programme (BTFFP) may also discourage banks from absorbing more coupons, potentially leading to an increase in yields on the longer-tailed segment of the UST market (*see Chart 4*).

- **Higher coupon issuance, then, may translate to a bear steepening condition** (when long-term interest rates rise higher than short-term interest rates) – potentially normalising the UST yield curve out of the hitherto inversion. Both a normalising yield curve and a bear steepening event are often marked as a harbinger of the upcoming economic slowdown, given that **higher long-term interest rates are detrimental to the demand for bank loans, and, thus, the US growth potential as credit creation dwindles.**
- Whichever instruments the Treasury would issue to finance its debt would hence trap the Fed in a zugzwang; **the central bank would need to move as higher T-bills issuance would make the QT campaign more risk-prone, while higher coupon issuance would push the US economy closer towards the maw of a recession.** Both strategies, then, should compel the Fed to loosen its policy stance – leading to concerns that the formulation of monetary policies in the US is teetering towards fiscal dominance.
- **The Fed, however, is also limited in its ability to loosen its monetary policy posture.** Some FOMC officials still worry about the danger of lowering

the policy rate too soon, lest there could be a repeat of the inflationary period of 1966-1983. Fortunately, the central bank might still be able to accommodate higher coupon issuance without making a U-turn on its rate signal. **Halting the QT campaign, which so far has managed to reduce the Fed's treasuries holding by an average of USD 51.48 Bn per month, springs as an option.** This would help banks digest a higher supply of coupons while preventing reserve levels from thinning out to a dangerously low level. Even a slowdown (or should we say "taper") on the pace of the QT campaign would help soften the blow from further Treasury issuance in the upcoming months.

- It would be best, then, to keep a more balanced expectation regarding the timing and the extent of the upcoming Fed funds rate loosening campaign. **The Fed still have some cards up its sleeve to keep the liquidity condition in the US stable,** while a substantial increase in (long-duration) Treasury yields may spark an inflow to the UST market that threatens other financial markets. **Hence, we see no change in our BI rate expectations,** especially amidst the risk of narrowing rate differentials between the UST and SBN markets and the mounting uncertainties that now colour Indonesia's financial market.

***"Whether bills or coupons, the Fed may need to react to the Treasury's continued fiscal expansions"***

Chart 1

### Additional durations

The US treasury department issued more long-term bonds in December 2023 as concerns over unbalanced T-bills supplies starts to emerge

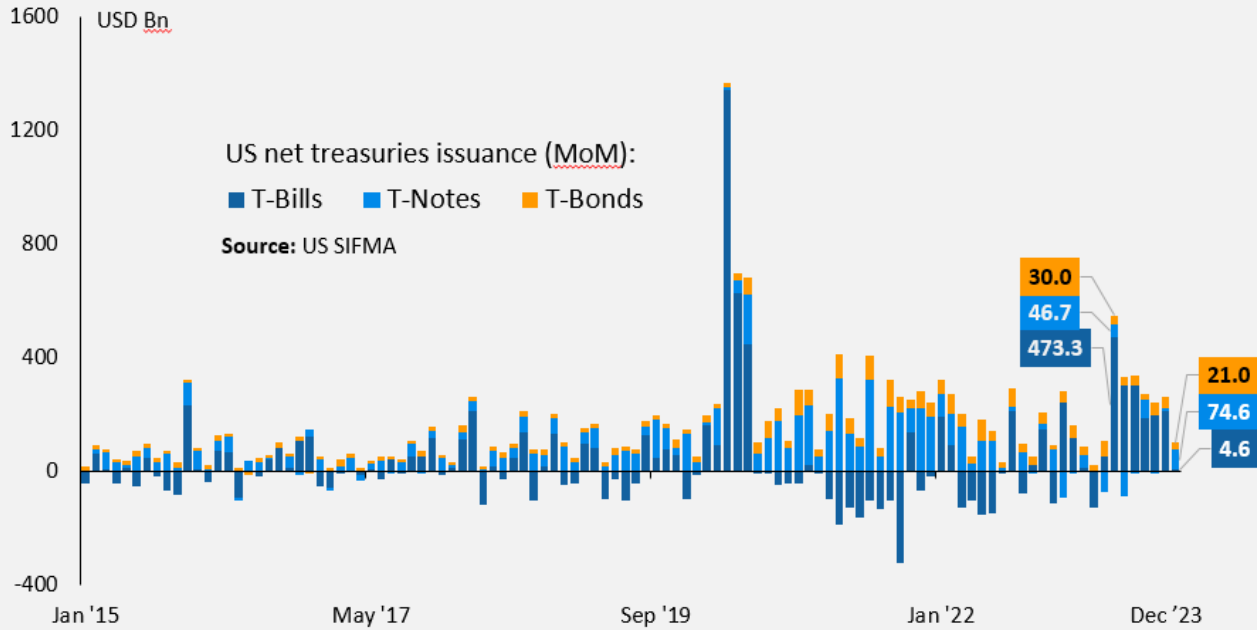


Chart 2

### Carrying on without a safety buffer

The outstanding on the Fed's RRP facility dwindles amidst the significant build-up of T-bills supplies in the UST market, potentially removing the safety buffer for the Fed's QT campaign

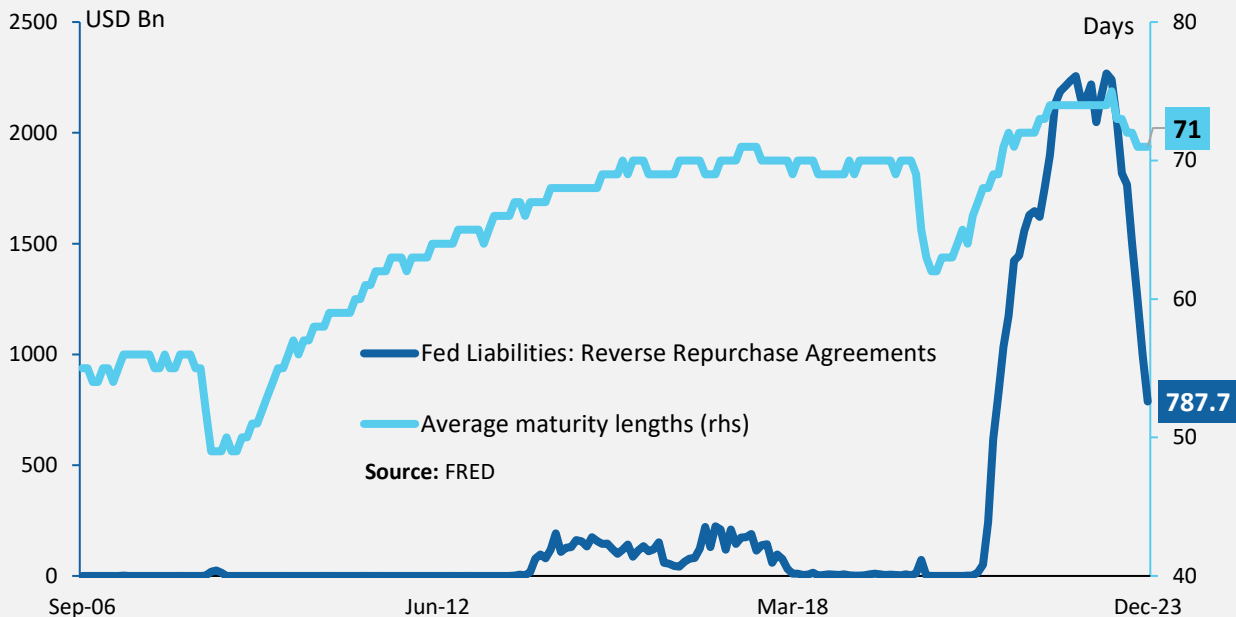


Chart 3

**Keeping an eye on the premium**

The market already positioning itself for higher Treasury notes and bonds issuances as the Treasury would eventually need to balance the maturity distribution in the UST market

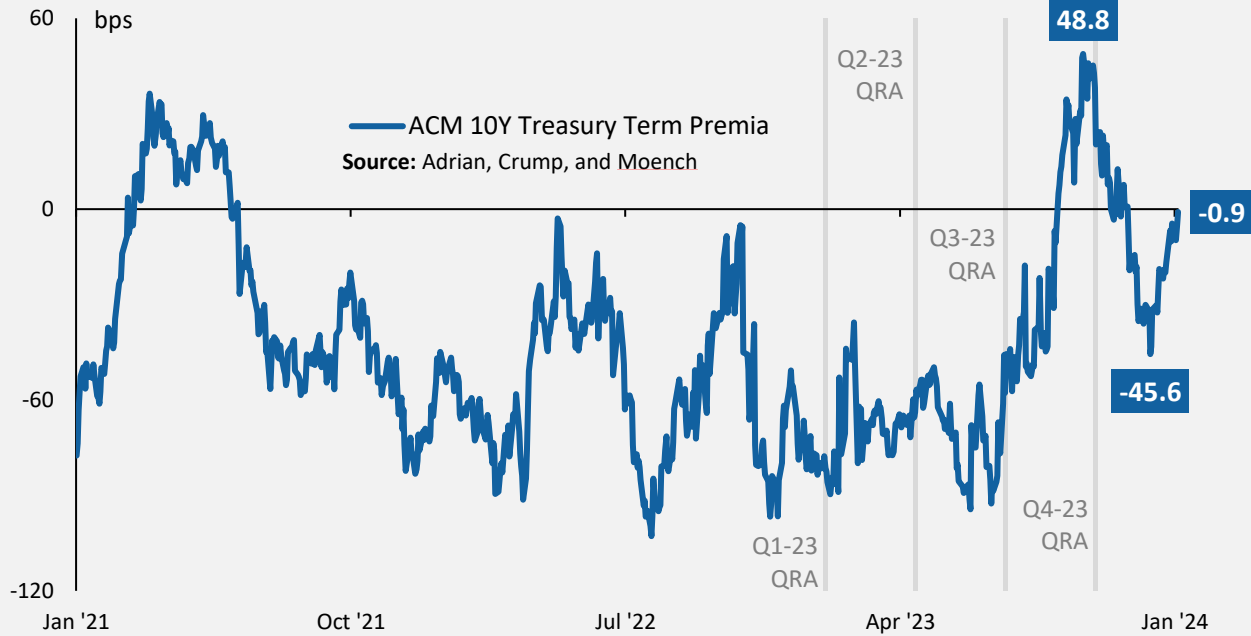
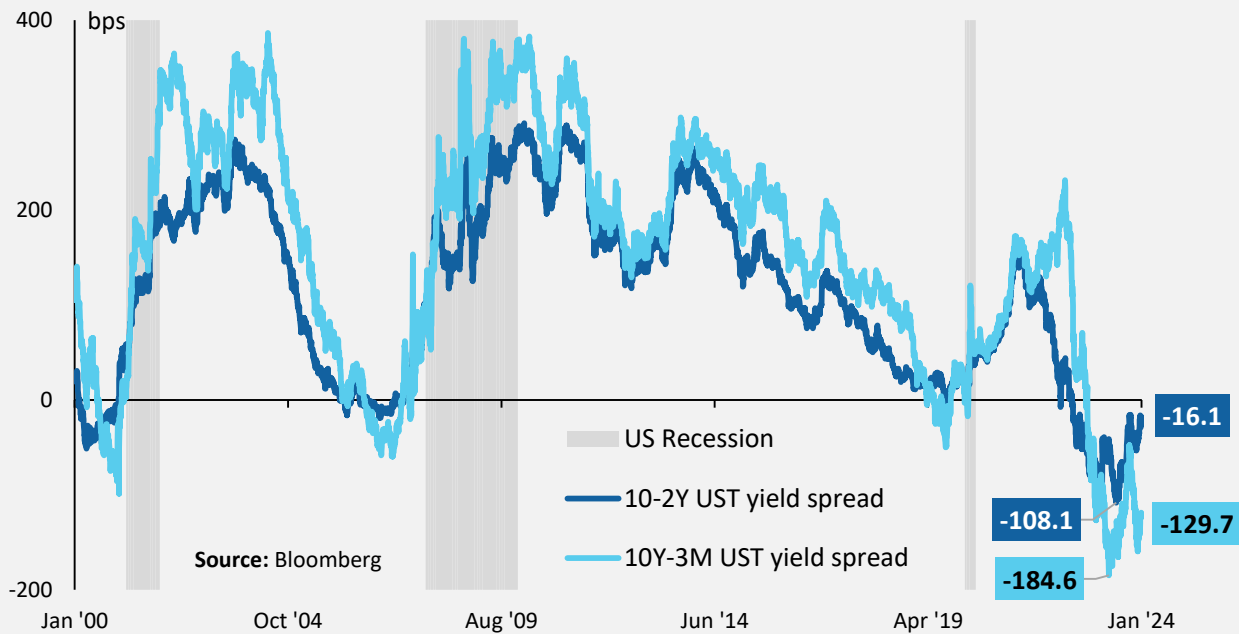


Chart 4

**Edging towards un-inversion**

The UST yield curve is close to be un-inverted as higher coupons issuance would push yields on long-term bonds more significantly than short-term bonds



## Economic Calendar

### Economic Calendar

		Actual	Previous	Forecast*
2 February 2024				
ID	S&P Global Manufacturing PMI	-	52.2	52.1
CN	Caixin Manufacturing PMI	-	50.8	50.8
<b>ID</b>	<b>Inflation rate YoY, %</b>	-	<b>2.61</b>	<b>2.42</b>
<b>US</b>	<b>Fed Interest Rate Decision, %</b>	-	<b>5.25-5.50</b>	<b>5.25-5.50</b>
US	ISM Manufacturing PMI	-	47.4	47.6
US	Non-Farm Payrolls ('000)	-	199	150
5 February 2024				
<b>ID</b>	<b>GDP Growth Rate YoY</b>	-	<b>4.94</b>	<b>4.96</b>
7 February 2024				
<b>ID</b>	<b>Foreign Exchange Reserves (USD Bn)</b>	-	<b>146.4</b>	-
US	Balance of Trade (USD Bn)	-	-63.2	-63
8 February 2024				
ID	Consumer Confidence	-	123.6	-
CN	Inflation Rate YoY, %	-	-0.3	-
9 February 2024				
ID	Retail Sales YoY, %	-	2.1	-
13 February 2024				
US	Inflation Rate YoY, %	-	3.4	-
ID	Motorbike Sales YoY, %	-	-11.6	-
ID	Car Sales YoY, %	-	-19.1	-
14 February 2024				
<b>ID</b>	<b>2024 Presidential and General Election</b>			
15 February 2024				
EU	Balance of Trade (EUR Bn)	-	20.3	15.4
<b>ID</b>	<b>Balance of Trade (USD Bn)</b>	-	<b>3.3</b>	-
20 February 2024				
<b>ID</b>	<b>Balance of Payment</b>	-	-	-
21 February 2024				
<b>ID</b>	<b>BI Rate Announcement, %</b>	-	<b>6.00</b>	-
ID	Loan Growth YoY, %	-	10.38	-

\*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 (%)	Trade & Commodities	26-Jan	-1 mth	Chg (%)
US	5.50	Dec-23	2.10	Baltic Dry Index	1,499.0	2,094.0	-28.4
UK	5.25	Dec-23	1.25	S&P GSCI Index	558.6	551.2	1.4
EU	4.50	Dec-23	1.60	Oil (Brent, \$/brl)	82.0	81.1	1.2
Japan	-0.10	Jan-16	-2.70	Coal (\$/MT)	118.1	136.8	-13.6
China (lending)	2.50	Dec-23	4.65	Gas (\$/MMBtu)	2.56	2.50	2.4
Korea	3.50	Nov-23	0.30	Gold (\$/oz.)	2,022.5	2,067.8	-2.2
India	6.50	Dec-23	0.81	Copper (\$/MT)	8,477.5	8,483.5	-0.1
Indonesia	6.00	Nov-23	3.39	Nickel (\$/MT)	16,469.0	16,279.0	1.2
Money Mkt Rates	26-Jan	-1 mth	Chg (bps)	CPO (\$/MT)	841.9	797.5	5.6
				Rubber (\$/kg)	1.53	1.48	3.4
Bank Rates (Rp)	Nov	Oct	Chg (bps)	External Sector	Dec	Nov	Chg (%)
SPN (1M)	5.88	5.80	7.6	Export (\$ bn)	22.41	22.00	1.89
SUN (10Y)	6.64	6.47	16.9	Import (\$ bn)	19.11	19.59	-2.45
INDONIA (O/N, Rp)	5.80	5.88	-8.4	Trade bal. (\$ bn)	3.31	2.41	37.13
JIBOR 1M (Rp)	6.64	6.65	-1.5	Central bank reserves (\$ bn)*	146.4	138.1	6.01
Bank Rates (Rp)	Nov	Oct	Chg (bps)	Prompt Indicators	Dec	Nov	Oct
Lending (WC)	8.91	9.05	-13.89	Consumer confidence index (CCI)	123.8	123.6	124.3
Deposit 1M	2.00	4.43	-243.26	Car sales (%YoY)	-19.1	-7.5	-13.8
Savings	0.67	0.67	0.34	Motorcycle sales (%YoY)	-11.6	-2.8	-4.0
Currency/USD	26-Jan	-1 mth	Chg (%)	Manufacturing PMI	Dec	Nov	Chg (bps)
UK Pound	0.787	0.786	-0.20	USA	47.2	46.6	60
Euro	0.923	0.906	-1.85	Eurozone	44.4	44.2	20
Japanese Yen	147.8	142.4	-3.65	Japan	47.9	48.3	-40
Chinese RMB	7.178	7.143	-0.50	China	50.8	50.7	10
Indonesia Rupiah	15,635	15,483	-0.97	Korea	49.9	50.0	-10
Capital Mkt	26-Jan	-1 mth	Chg (%)	Indonesia	52.2	51.7	50
JCI	7,111.8	7,237.5	-1.74				
DJIA	38,049.1	37,545.3	1.34				
FTSE	7,529.7	7,697.5	-2.18				
Nikkei 225	35,751.1	33,305.9	7.34				
Hang Seng	15,949.4	16,340.4	-2.39				
Foreign portfolio ownership (Rp Tn)	Dec	Nov	Chg (Rp Tn)				
Stock	3,226.3	3,136.1	90.27				
Govt. Bond	841.0	833.9	7.17				
Corp. Bond	10.6	11.2	-0.59				

Source: Bloomberg, BI, BPS

Notes:

\*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

	2019	2020	2021	2022	2023E	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.1	5.0
GDP per Capita (US\$)	4175	3912	4350	4784	4982	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6*	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00*	5.50
USD/IDR Exchange Rate (end of the year)**	13,866	14,050	14,262	15,568	15,397*	16.037
Trade Balance (US\$ billion)	-3.2	21.7	35.3	54.5	37.0*	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	0.1	-0.5

\*Actual number

\*\* Estimation of the Rupiah's fundamental exchange rate

### Economic, Banking & Industry Research Team

**David E.Sumual**

Chief Economist  
david\_sumual@bca.co.id  
+6221 2358 8000 Ext:1051352

**Victor George Petrus Matindas**

Senior Economist  
victor\_matindas@bca.co.id  
+6221 2358 8000 Ext: 1058408

**Keely Julia Hasim**

Economist / Analyst  
keely\_hasim@bca.co.id  
+6221 2358 8000 Ext: 1071535

**Aldi Rizaldi**

Research Assistant  
aldi\_yanto@bca.co.id  
+6221 2358 8000 Ext: 1020451

**Agus Salim Hardjodino**

Senior Industry Analyst  
agus\_lim@bca.co.id  
+6221 2358 8000 Ext: 1005314

**Gabriella Yolivia**

Industry Analyst  
gabriella\_yolivia@bca.co.id  
+6221 2358 8000 Ext: 1063933

**Elbert Timothy Lasiman**

Economist / Analyst  
Elbert\_lasiman@bca.co.id  
+6221 2358 8000 Ext: 1074310

**Fikri Adam Zaqi**

Research Assistant  
-  
+6221 2358 8000 Ext: -

**Barra Kukuh Mamia**

Senior Economist  
barra\_mamia@bca.co.id  
+6221 2358 8000 Ext: 1053819

**Lazuardin Thariq Hamzah**

Economist / Analyst  
lazuardin\_hamzah@bca.co.id  
+6221 2358 8000 Ext: 1071724

**Thierris Nora Kusuma**

Economist / Analyst  
thierris\_kusuma@bca.co.id  
+6221 2358 8000 Ext: 1071930

### PT Bank Central Asia Tbk

#### Economic, Banking & Industry Research of BCA Group

20<sup>th</sup> Grand Indonesia, Menara BCA  
Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia  
Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343

#### DISCLAIMER

This report is for information only, and is not intended as an offer or solicitation with respect to the purchase or sale of a security. We deem that the information contained in this report has been taken from sources which we deem reliable. However, we do not guarantee their accuracy, and any such information may be incomplete or condensed. None of PT. Bank Central Asia Tbk, and/or its affiliated companies and/or their respective employees and/or agents makes any representation or warranty (express or implied) or accepts any responsibility or liability as to, or in relation to, the accuracy or completeness of the information and opinions contained in this report or as to any information contained in this report or any other such information or opinions remaining unchanged after the issue thereof. The Company, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Company or any other person has been advised of the possibility thereof. Opinion expressed is the analysts' current personal views as of the date appearing on this material only, and subject to change without notice. It is intended for the use by recipient only and may not be reproduced or copied/photocopied or duplicated or made available in any form, by any means, or redist ted to others without written permission of PT Bank Central Asia Tbk.

All opinions and estimates included in this report are based on certain assumptions. Actual results may differ materially. In considering any investments you should make your own independent assessment and seek your own professional financial and legal advice. For further information please contact: (62-21) 2358 8000. Ext: 20364 or fax to: (62-21) 2358 8343 or email: