More debt is good news for some

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Summary

- The Chinese government decided to increase its ultra-long sovereign bond issuance in the past week, meeting the demand condition in China's domestic financial market.
- China's higher bond issuance may signal the government's commitment to providing cheap financing for the manufacturing sector, which will allow Chinese manufacturers to continue producing despite their low margins.
- Continued manufacturing expansion in China may improve the outlook for Indonesia's trade, which could help BI maintain its balanced policy mix.

- Conditions in the US economy have been trending favourably for the global financial sector in the past week. The headline US CPI inflation falls to 3.4% YoY in April 2024, breaking the uptrend since Q1 2024. The 1.36 Mn housing starts number also fell short of analysts' consensus, indicating slowing economic activities that run-in contrast with the market's Fed rate expectation. The USD index reasonably moves lower (-0.53% since last week), thus allowing other currencies to appreciate.
- The US Dollar's receding strength also helped the Rupiah's value, which pulled back below the 16,000/USD mark last week. Apart from the appreciating currency, the benchmark SBN yield also strengthens to 6.86% in the week before the next Bank Indonesia meeting; a condition which likely strengthens BI's conviction in its ability to balance between its pro-stability and pro-growth policy goals, and, thus, likely reduce the urgency to hike rates soon.
- However, the recent show of strength in Indonesia's currency and sovereign bond market may hide the weakness in the SBN market. The bid-ask spread for an active 10Y SBN shot up in the past week, reflecting foreign investors' decision to offload USD 371.49 Mn worth of SBN from their portfolio. In a way, the foreigners seem to mirror the domestic market tendency to switch away from longer-term SBN towards short-term SRBI. Amid this trend, BI maintains its role as a stabiliser in the SBN market, while the lack of SBN issuance in 2024 also helps keep the yield stable.

Different philosophy, different outcome

- Unlike in the SBN market, where tighter control over issuance remains instrumental in keeping the yield stable, circumstances in the Chinese bond market have allowed the Chinese government to flood the market with more debt ***(see Chart 1)***. Indeed, the Chinese government started to sell up to CNY 1 Tn (USD 140 Bn) worth of ultra-long (30 to 50-year) treasury bonds on Friday last week, seemingly responding to global calls for the Chinese government to leverage up to invigorate its slowing economy.

- It does not take long to understand why the market responded to the increase in the supply of Chinese sovereign bonds in a positive light. Looking from their domestic perspectives, **the closed-loop nature of China's financial market does not leave Chinese households with ample alternatives but the domestic sovereign bond market to park their excess savings**, especially amidst the downturn in China's stocks and residential property markets ***(see Chart 2)***. Chinese investors also tend to hold their bond portfolio to maturity, meaning higher issuance of ultra-long bonds might be more desirable given the higher coupon rate associated with longer bonds.
- China observers' approval of increased Chinese debt issuance is also not surprising. Years of regionalised debt-driven growth model have led to an over-leveraging issue in China's corporate sector and regional governments (through the LGFV[1] sector), while the central government's more conservative fiscal posture leaves some untapped fiscal space that the government could (or arguably, should) expand.
- It should be noted, however, that foreign observers' cheery reception to the news of higher sovereign bond issuance in China stems from their analysis of how China should pick up their slowing growth outlook. Western economists have long argued that the solution for the Chinese government lies at the bottom of the household sector's wallets, leading to the call for the government to invest in policies that could lower Chinese households' precautionary savings and thus increase their marginal propensity to consume. An ideal scenario for foreign economists, then, is for the Chinese government to spend more on social spending and rescuing its troubled real estate sector, thus un-tapping the consumption potential of Chinese households that may spill over to the global aggregate demand.
- But as often happens in economics, a different school of thought may approach the same problem from a different angle. While the slowing economic growth trend in China is clear for everyone to see, and everyone could agree that more central government debt would help to arrive at the solution, the Chinese authorities take a different perspective. Unlike the prevailing wisdom in more Western economies, the Chinese government's philo-sophical rejection of welfarism is well-documented. It is safe to say, then, that **China's recent sovereign debt issuance will not be the harbinger of more household consumption-driven growth in the Chinese economy.**

"Higher debt issuance may reflect a doubling in China's support for the manufacturing sector rather than a shift towards more consumption-led growth"

- The question, then, is two-fold. First, how will the Chinese government utilise the proceeds from their higher bond auction, and if not through higher domestic consumption, how will it translate to the global economy – particularly for the Indonesian economy? We should approach the first question through the lens of political economy. **The heating geopolitical contest emboldens China's bid to cement its position in the global supply chain of the future**, with the

[1] Local government financing vehicle

success of China's domestic EV manufacturing and renewable energies sector providing the blueprint for global expansions in other sectors ***(see Chart 3)***. The advanced semiconductor industry, for example, is of particular interest to the Chinese government, highlighting the endless pit of financing needed by the Chinese government to sponsor further development in chip manufacturing and other capital-intensive sectors.

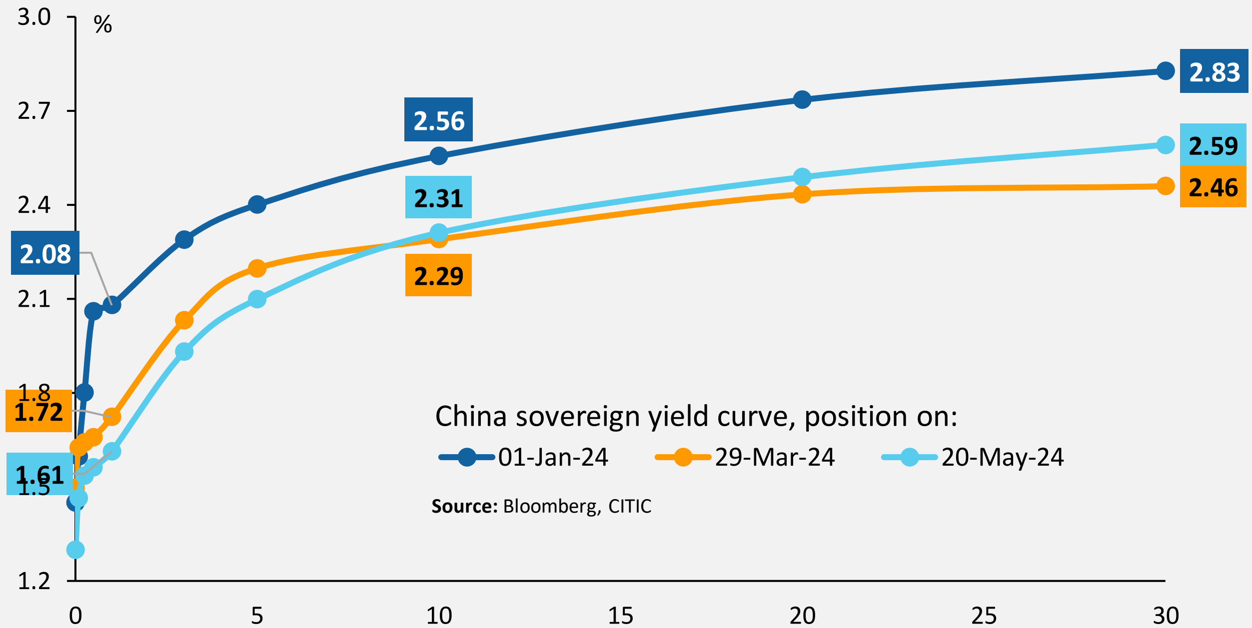
- Recent news on China's aircraft manufacturing sector provides another interesting case, as the recent tumult with US-based Boeing creates a lull in the industry (while the EU-based Airbus is booked up at least until the end of the decade). However, China's need for financing is not exclusive to the high-end of the manufacturing industry. **Businesses at the lower end of the manufacturing supply chain also continue to benefit from easy access to government-sponsored financing, which allows them to continue expanding their production capacity despite the plummeting revenue growth and mounting *inventories (see Chart 4).*** Indeed, these inventories may symbolise safety rather than excess capacity amidst the rolling threat of import bans and tariffs.
- China's higher bond issuance (and thus, spending) would clearly benefit its own growth, but it may not improve the outlook for global GDP growth. **Chinese manufacturers will continue to look for foreign markets to offload their products, exporting goods deflation the world over while also bringing competition to domestic manufacturers at the same time.**
- For commodity producers like Indonesia, however, the continuation of state-sponsored overcapacity in China's manufacturing sector is a good thing. **Higher demand from China may keep commodity prices stay high for longer, especially for minerals given China's interest in everything electronics.** Energy security is of another interest to the Chinese government, a condition which insofar have keep coal prices stably high despite reports of China's record-high domestic coal production.
- China's continued support for its manufacturing sector may thus continue to benefit the Indonesian economy. **Higher minerals and energy prices will translate positively to Indonesia's terms of trade, while the negative impact from the deluge of cheap manufactured goods imports may prove to be limited** given Indonesia's relatively smaller manufacturing base (the manufacturing sector accounts for 10.63% of GDP in Q1 2024 excluding the food and base metal sectors).
- Recalling the heyday of the commodity super-cycle in 2022, **the positive impact of higher commodity prices on the sentiment of the Indonesian economy could turn BI to be more flexible in determining its monetary policy posture.** Given the calmer external condition and the threat of slowing domestic consumption, a higher term of trade may strengthen BI's balanced now-balanced monetary policy posture. Hence, while we continue to believe that another rate hike is still the more prudent action amidst the mercurial global interest rate expectation, a 25-bps rate hike in the upcoming BI policy meeting does not seem to be likely at the moment.

"China may continue to export deflation, but its adverse impact on Indonesia may be limited given the small manufacturing base"

Chart 1

Higher demand warrants higher supply

Yields on Chinese sovereign bonds move lower as its demand rose and inflation expectation moves lower, creating an environment for the government to issue more long-term (and ultra long) bonds

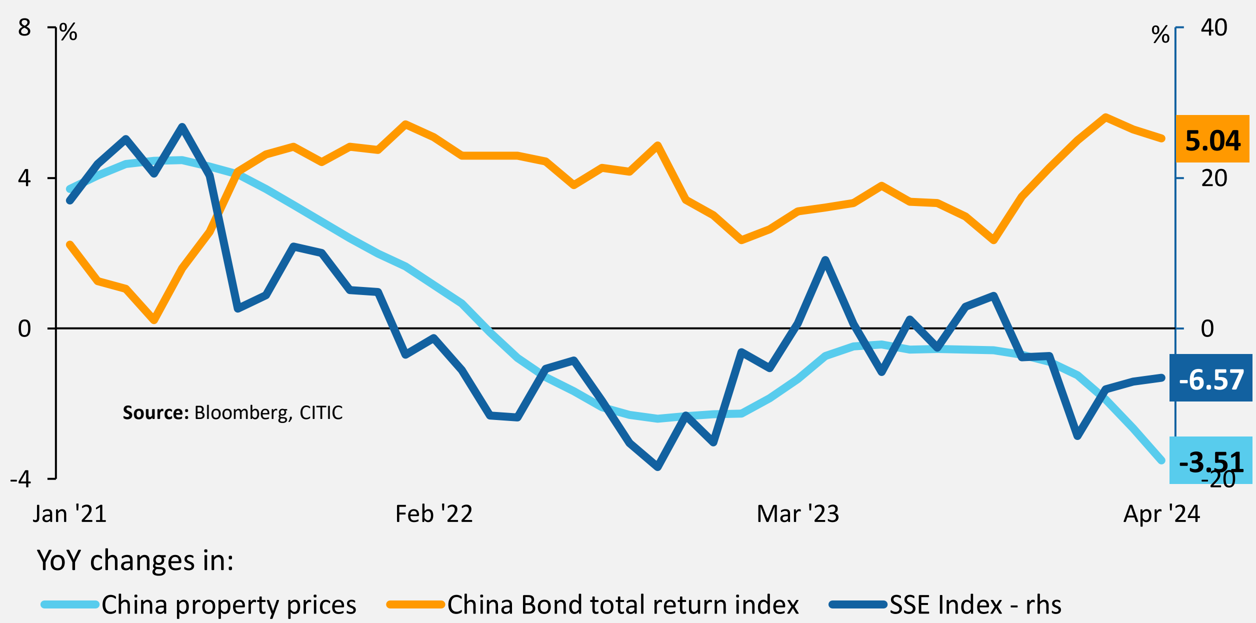


Source: Bloomberg, CITIC

Chart 2

Safer and sounder

The bond market continues to offer safety and returns for Chinese investors, while the stock market tracks the downturn in the property sector



Source: Bloomberg, CITIC

Chart 3

All chips on the manufacturing table

The Chinese government is unlikely to spend more to boost domestic consumption as cementing China's position in the global supply chain remains the government's chief concerns.

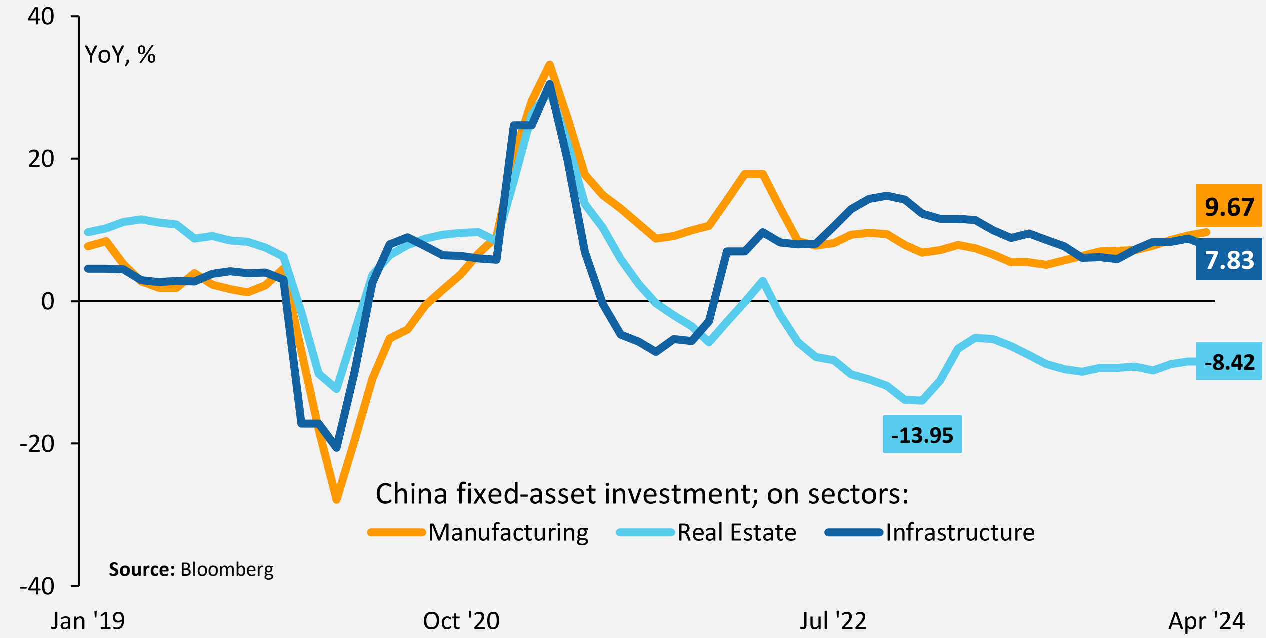
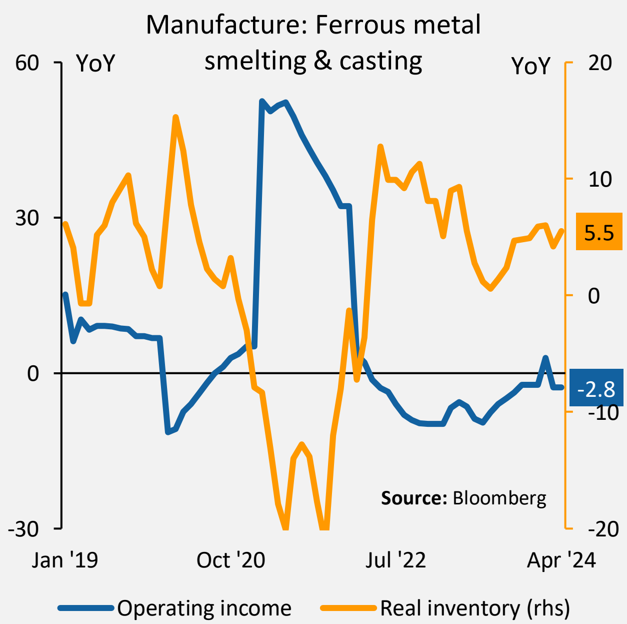


Chart 4

Lifeline supports

Continued state support for the manufacturing sector will help Chinese manufacturers to continue producing despite their cratering profits



Economic Calendar

		Actual	Previous	Forecast*
8 Mei 2024				
ID	**Foreign Exchange Reserves (USD Bn)**	**136.2**	**140.4**	**138.0**
9 Mei 2024				
ID	Motorbike Sales YoY, %	18.3	-7.8	-
13 Mei 2024				
ID	Consumer Confidence	127.7	123.8	123.1
14 Mei 2024				
ID	Retail Sales YoY, %	9.3%	6.4%	-
ID	Car Sales YoY, %	-17.5%	-26.2	-
15 Mei 2024				
ID	**Balance of Trade (USD Bn)**	**3.56**	**4.58**	**3.9**
US	Inflation rate YoY, %	3.4	3.5	3.5
17 Mei 2024				
EU	Inflation rate YoY, %	2.4	2.4	2.4
20 Mei 2024				
ID	**Current Account, (USD Bn)**	**-2.2**	**-1.3**	**-1.0**
22 Mei 2024				
ID	**Interest Rate Decision**		**6.25**	**6.25**
ID	Loan Growth YoY		12.4	-
3 June 2024				
ID	**Inflation rate YoY,** %		**3.00**	**-**
ID	S&P Global Manufacturing PMI		52.9	52.2
CN	Caixin Manufacturing PMI		51.4	-
US	ISM Manufacturing PMI		49.2	-
4 June 2024				
US	JOLTs Job Openings (Mn)		8.49	8.40
7 June 2024				
ID	**Foreign Exchange Reserves (USD Bn)**		**136.2**	**-**
CN	Balance of Trade (USD Bn)		72.3	-
US	Non-Farm Payroll, (Th)		175	151
US	Unemployment Rate, %		3.9	-
12 June 2024				
CN	Inflation rate YoY, %		0.3	-
US	Inflation rate YoY, %		3.4	-
13 June 2024				
US	**Fed Interest Rate Decision, %**		**5.5**	**5.5**

*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	Jul-23	2.10
UK	5.25	Aug-23	2.05
EU	4.50	Jul-23	2.10
Japan	-0.10	Jan-16	-2.80
China (lending)	2.50	Aug-23	4.05
Korea	3.50	Jan-23	0.60
India	6.50	Feb-23	1.67
Indonesia	6.25	Apr-24	3.25

Money Mkt Rates	20-May	-1 mth	Chg (bps)
SPN (1M)	5.88	5.80	7.6
SUN (10Y)	6.86	6.98	-12.2
INDONIA (O/N, Rp)	6.16	5.77	38.4
JIBOR 1M (Rp)	6.90	6.65	25.0

Bank Rates (Rp)	Feb	Jan	Chg (bps)
Lending (WC)	8.84	8.87	-3.03
Deposit 1M	4.62	4.68	-5.80
Savings	0.67	0.68	-0.11

Currency/USD	20-May	-1 mth	Chg (%)
UK Pound	0.787	0.808	2.72
Euro	0.921	0.938	1.89
Japanese Yen	156.3	154.6	-1.04
Chinese RMB	7.235	7.239	0.05
Indonesia Rupiah	15,975	16,255	1.75

Capital Mkt	20-May	-1 mth	Chg (%)
JCI	7,266.7	7,087.3	2.53
DJIA	39,806.8	37,986.4	4.79
FTSE	8,424.2	7,895.9	6.69
Nikkei 225	39,069.7	37,068.4	5.40
Hang Seng	19,636.2	16,224.1	21.03

Foreign portfolio ownership (Rp Tn)	Apr	Mar	Chg (Rp Tn)
Stock	3,294.9	3,226.6	68.31
Govt. Bond	791.0	810.7	-19.68
Corp. Bond	8.4	9.4	-0.97

Trade & Commodities	20-May	-1 mth	Chg (%)
Baltic Dry Index	1,847.0	1,919.0	-3.8
S&P GSCI Index	591.1	590.3	0.1
Oil (Brent, $/brl)	83.7	87.3	-4.1
Coal ($/MT)	140.0	144.4	-3.0
Gas ($/MMBtu)	2.52	1.43	76.2
Gold ($/oz.)	2,425.3	2,391.9	1.4
Copper ($/MT)	10,800.8	9,797.2	10.2
Nickel ($/MT)	21,339.0	19,161.2	11.4
CPO ($/MT)	832.3	857.0	-2.9
Rubber ($/kg)	1.69	1.61	5.0

External Sector	Apr	Mar	Chg (%)
Export ($ bn)	19.62	22.54	-12.97
Import ($ bn)	16.07	17.96	-10.55
Trade bal. ($ bn)	3.55	4.58	-22.46
Central bank reserves ($ bn)*	136.2	140.4	-2.98

Prompt Indicators	Apr	Mar	Feb
Consumer confidence index (CCI)	127.7	123.8	123.1
Car sales (%YoY)	-17.5	-26.2	-18.8
Motorcycle sales (%YoY)	18.3	-7.8	-2.9

Manufacturing PMI	Apr	Mar	Chg (bps)
USA	50.0	51.9	-190
Eurozone	45.7	46.1	-40
Japan	49.6	48.2	140
China	51.4	51.1	30
Korea	49.4	49.8	-40
Indonesia	52.9	54.2	-130

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	2023	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0
GDP per Capita (US$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	6.50
USD/IDR Exchange Rate (end of the year)*	13,866	14,050	14,262	15,568	15,397	16,119
Trade Balance (US$ 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

*Estimation of the Rupiah's fundamental exchange rate

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