Silently at the forefront of the race for higher yields

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Summary

- Indonesia has suffered from a sharper increase in bond yields compared to some other economies since the US election, underscoring the growing influence of bond vigilantes demanding higher returns on bonds.
- Indonesia faces a similar challenge to many European economies, as weakening domestic growth momentum and military spending hinder progress on fiscal consolidation.
- The increasingly active bond vigilantes could complicate the government's efforts to issue more debt and keep borrowing costs at manageable levels unless the government manage to meaningfully improve its spending efficiency.

- The global macro discussion has been relatively quiet over the past week. Black swan events such as the ongoing wildfire in LA County may have significant implications economically and financially, but the financial sector has yet to deliver any significant surprises this year. Meanwhile, the real sector continues to perform as anticipated. The higher-than-expected US non-farm payroll data in December 2024 (256k vs. 200k forecast) merely reinforced the market's suspicions of only a limited FFR cut in 2025, with some analysts starting to ponder a no-rate-cut scenario this year.
- Meanwhile, things appear to be moving more significantly in the Indonesian financial market over the past week. The domestic stock market may experience a net foreign sell-off to the tune of USD 130.9 Mn, and the Rupiah remains weak, trading below the 16,000 level. However, foreign investors have started returning to the domestic sovereign bond market, with foreign inflows totalling around USD 162.6 Mn recorded throughout the past week.
- Unfortunately, the recent inflow of foreign investors into the Indonesian financial market does not appear to be based on the assumption or observation of improving macroeconomic fundamentals. Instead, higher net buys from foreign investors seem to be driven by the higher yields now available in the SBN market, with the benchmark 10Y SBN yield surging as much as 14.1bps (compared to the Friday level) to reach 7.09% at its peak last week.

A shade of Indonesia in other country's problems

- The ongoing trend of rising bond yields is not unique to Indonesia. Anticipations of policy shifts under the second Trump administration have sent the UST yield northward while rising bond yields in Europe have also been a subject of discussion. Yields in the Indonesian bond market, however, seem to have increased the highest ***(see Chart 1)***, making this an intriguing topic for discussion, especially given Indonesia's relatively stable political and economic conditions.
- Much has been said about uncertainties in the US. Political conditions in Europe, however, are arguably more uncertain, with major economic powerhouses such as Germany and France grappling with domestic political crises since late 2024 ***(see Chart 2)***. Debates over the 2025 fiscal budget proved to be the final straw for the coalition governments in both European superpowers, as the previous governments' (the "traffic light" coalition in Germany and the centre-right minority government in France) fiscal ambition being rejected by the opposition.
- Meanwhile, the new Labour government in the UK have also rapidly lost popularity. Its spending plan has created what analysts called a fiscal black hole, prompting an upward revision of gilts issuance in the short term to GBP 296.9 Bn. The Labour government has also set the plan to raise GBP 40 Bn annually in new taxes, which is expected to push the UK's tax ratio to a record-high 38.2% by 2030 despite the campaign promises not to raise new taxes.

"Widespread rejection of fiscal expansion has led to political instability and higher borrowing costs in two out of three major European economies..."

- Looking beyond domestic contexts, **Europe's uncertainty can be distilled into a common theme: widespread resistance to expansionary fiscal policies.** Despite varying political spectrums, European governments appear committed to breaking economic stagnation by maintaining–or even doubling down on–their spending agendas, against the wishes of investors seeking fiscal consolidation after years of heavy spending due to the pandemic and the war in Ukraine. Indeed, despite facing similarly pressing domestic political challenges, South Korea's bond market has not experienced a comparable upward trend in yields, as debates over its 2025 budget proved to be relatively easier to bridge (although the political outcome is arguably the same).
- **Alas, the still-going cost of living crisis and President Trump's constant criticisms on NATO leave European governments with limited options to reduce their fiscal commitment**, given the dual challenge of maintaining military spending at 2% and the equally urgent need to sustain social benefit expenditures to protect household consumption.
- **The stagnating fiscal consolidation in Europe may find some semblance in the situation Indonesia is currently in.** It is no secret that the current administration favours a big government, as indicated by the massive expansion in the social spending programme and continued support for infrastructure development (through SOEs' spending and other extra-budgetary spending). The

government is also still in the process of modernising its weapon system, with the country's military spending expected to increase to 0.68% of GDP in 2025 (0.62% in 2024). What separates Indonesia and its European counterpart is that while governments in Europe have slashed their debt issuance guideline in 2025 (although not as much as first signalled), **the Indonesian government is still looking to issue more debt than in the previous year, highlighting the more significant supply risk that explains the more substantial increases in the Indonesian government's borrowing costs.**

- It is unsurprising, then, that the Indonesian bond market suffers from a more acute case of bond vigilantism, as indicated by the widening bid-ask spread in the SBN market ***(see Chart 3)***. While it should be noted that the bid-ask spread in the SBN market will be wider given its relative lack of depth, the widening bid-ask spread in the SBN market (and for the Rupiah) may continue until bond vigilantes are satisfied with the higher yield.
- The Indonesian government may still have some options. First, the government could maintain its spending commitment and accept the higher borrowing costs. Second, the government could reduce its spending commitment to reflect the volatile global condition. The first option, of course, is unpalatable as Indonesia already spent 2.21% of GDP on interest payments in 2024, and issuing more debt at rates exceeding 7% will only further constrain fiscal space. The other option is also unthinkable, given the frail domestic growth momentum at the moment.
- Akin to the UK government, the Indonesian government may also try to dig itself out of the ongoing fiscal dilemma by raising its tax revenue, either through a one-shot injection such as the tax amnesty programme (which ideas have been floated since last year) or higher tax rates (the ministerial law that effectively delays the VAT rate hike could be cancelled without lengthy legislative process). Alas, this option may also prove impractical, given the political costs of raising taxes or implementing another instalment of the tax amnesty programme.
- **The last option, then, is to copy the US and its so-called DOGE (Department of Government Efficiency)**. The USD 0.22 Bn cut in the budget for business trips is a positive step towards this option, but additional savings are urgently needed. A mere 10% reduction in the budget for the so-called management support programme (*program dukungan manajemen*), for instance, could save around USD 2.33 Bn of public money, potentially lowering Indonesia's fiscal deficit to around 2.37% of GDP in 2025.

> ***"…but Indonesia's bond yields rose higher given the shared problem of stalling fiscal consolidation and rising bond vigilantism in Indonesia and Europe"***

Chart 1

At least we are winning on something

Indonesian bond yields rose higher than most major economies since the US election, despite the seeming absent of crises that now beset governments in some major economies.

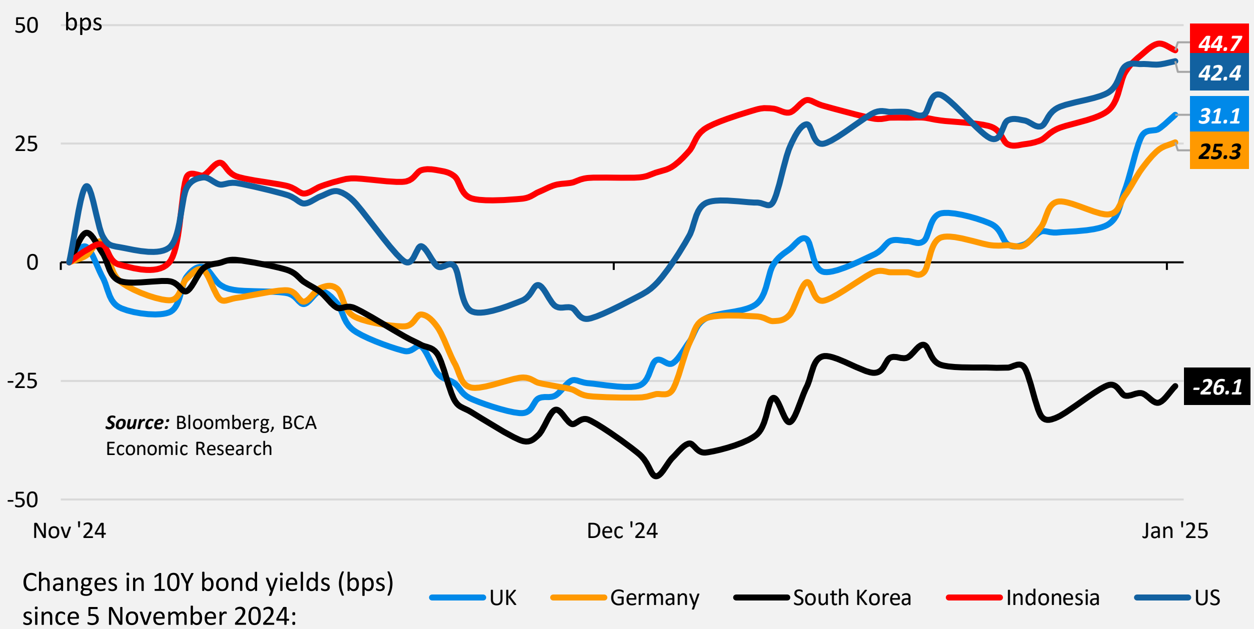


Chart 2

Euro crisis

Domestic political crises lead to higher policy uncertainties in some major economies, with conditions in Europe especially uncertain given the widespread dispute over budgets.

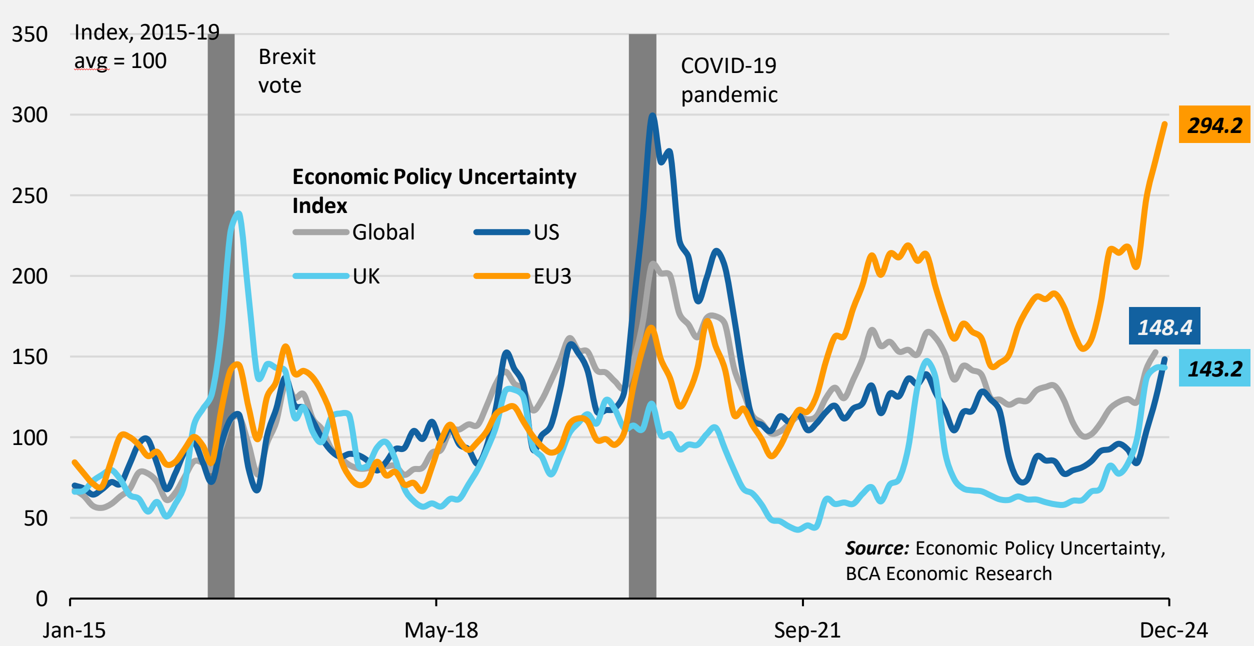
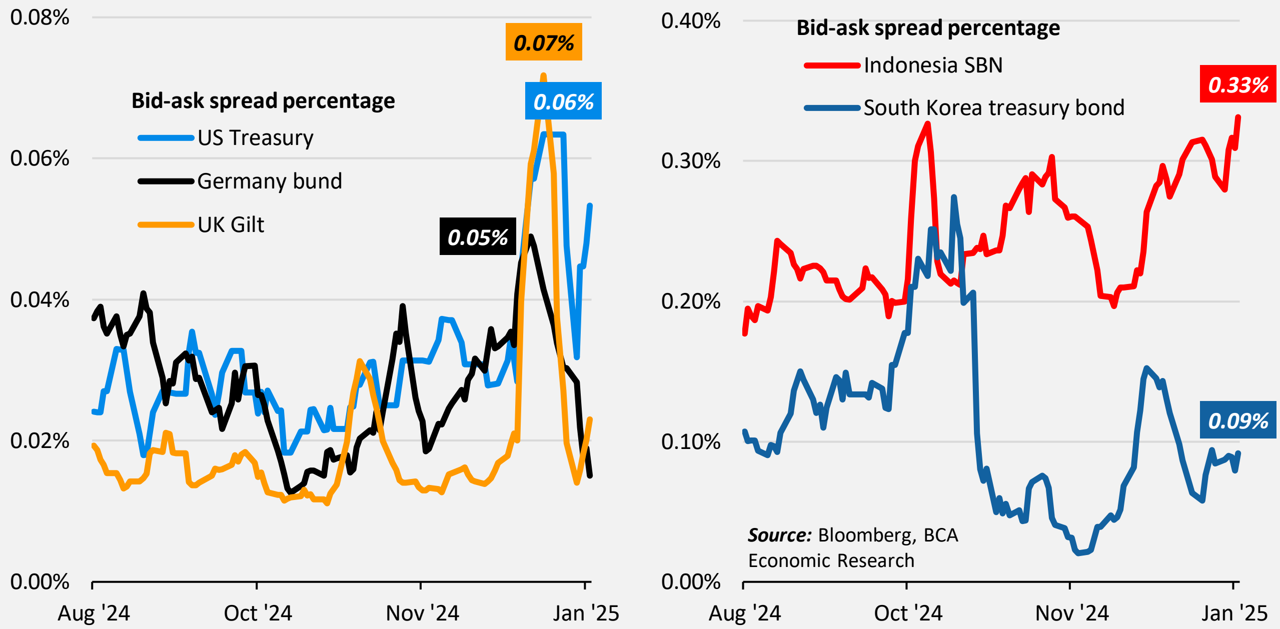


Chart 3

Stay vigilant when vigilantes are around

Bond vigilantism is on the rise lately, which run in contrast with governments trying to issue more debts.



Source: Bloomberg, BCA Economic Research

Economic Calendar

		Actual	Previous	Forecast*
02 January 2025				
ID	S&P Global Manufacturing PMI	51.2	49.6	50
ID	**Inflation Rate YoY, %**	**1.57**	**1.55**	**1.7**
US	S&P Global Manufacturing PMI	49.4	49.7	48.3
07 January 2025				
US	Balance of Trade, USD Bn	-78.2	-73.8	-70
08 January 2025				
ID	**Foreign Exchange Reserves, USD Bn**	**155.7**	**150.2**	**152.0**
09 January 2025				
ID	Consumer Confidence	127.7	125.9	120
CN	Inflation Rate YoY, %	0.1	0.2	0.2
EA	Retail Sales YoY, %	1.2	2.1	1.7
10 January 2025				
ID	Car Sales YoY, %	-6.4	-11.9	-
ID	Motorbike Sales YoY, %	-5.5	-10.3	-
ID	Retail Sales YoY, %	0.9	1.5	-
US	Non-Farm Payrolls, th	256	212	200
13 January 2025				
CN	Balance of Trade, USD Bn	104.84	97.44	85
15 January 2025				
ID	**Balance of Trade, USD Bn**		**4.42**	**2.8**
US	Inflation Rate YoY, %		3.3	3
16 January 2025				
EA	Balance of Trade, USD Bn		6.8	-
17 January 2025				
CN	Retail Sales YoY, %		3	2.8
CN	GDP Growth Rate YoY, %		4.6	5
ID	Loan Growth YoY, %		10.79	10
22 January 2025				
ID	M2 Money Supply YoY, %		7	-
24 January 2025				
ID	**Foreign direct investment, % YoY**		**18.55**	**-**
30 January 2025				
US	**Fed Interest Rate Decision, %**		**4.5**	-
31 January 2025				
US	PCE Price Index YoY, %		2.4	2.4

*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	4.50	Dec-24	1.80
UK	4.75	Nov-24	2.15
EU	3.15	Dec-24	0.75
Japan	0.25	Jul-24	-3.00
China (lending)	2.00	Sep-24	4.25
Korea	3.00	Nov-24	1.10
India	6.50	Feb-23	1.02
Indonesia	6.00	Sep-24	4.43
Money Mkt Rates	**10-Jan**	**-1 mth**	**Chg (bps)**
SPN (1Y)	6.84	6.88	-3.2
SUN (10Y)	7.16	6.91	25.4
INDONIA (O/N, Rp)	6.06	6.10	-3.9
JIBOR 1M (Rp)	6.62	6.63	-0.4
Bank Rates (Rp)	**Oct**	**Sep**	**Chg (bps)**
Lending (WC)	8.72	8.87	-15.48
Deposit 1M	4.78	4.81	-2.76
Savings	0.66	0.67	-0.14
Currency/USD	**10-Jan**	**-1 mth**	**Chg (%)**
UK Pound	0.819	0.783	-4.42
Euro	0.976	0.950	-2.69
Japanese Yen	157.7	152.0	-3.66
Chinese RMB	7.333	7.250	-1.13
Indonesia Rupiah	16,185	15,865	-1.98
Capital Mkt	**10-Jan**	**-1 mth**	**Chg (%)**
JCI	7,088.9	7,453.3	-4.89
DJIA	41,938.5	44,247.8	-5.22
FTSE	8,248.5	8,280.4	-0.38
Nikkei 225	39,190.4	39,367.6	-0.45
Hang Seng	19,064.3	20,311.3	-6.14
Foreign portfolio ownership (Rp Tn)	**Dec**	**Nov**	**Chg (Rp Tn)**
Stock	3,521.3	3,402.4	118.98
Govt. Bond	876.6	872.5	4.15
Corp. Bond	5.9	7.1	-1.18

Trade & Commodities	10-Jan	-1 mth	Chg (%)
Baltic Dry Index	1,048.0	1,156.0	-9.3
S&P GSCI Index	571.0	538.9	6.0
Oil (Brent, $/brl)	79.8	72.2	10.5
Coal ($/MT)	116.3	135.0	-13.9
Gas ($/MMBtu)	4.12	3.06	34.6
Gold ($/oz.)	2,689.8	2,694.3	-0.2
Copper ($/MT)	8,991.9	9,101.0	-1.2
Nickel ($/MT)	15,450.6	15,480.4	-0.2
CPO ($/MT)	1,050.0	1,194.6	-12.1
Rubber ($/kg)	1.95	2.03	-3.9
External Sector	**Nov**	**Oct**	**Chg (%)**
Export ($ bn)	24.01	24.41	-1.66
Import ($ bn)	19.59	21.94	-10.72
Trade bal. ($ bn)	4.42	2.48	78.56
Central bank reserves ($ bn)*	150.2	151.2	-0.66
Prompt Indicators	**Dec**	**Nov**	**Oct**
Consumer confidence index (CCI)	127.7	125.9	121.1
Car sales (%YoY)	-6.4	-11.9	-3.9
Motorcycle sales (%YoY)	-5.5	-10.3	5.4
Manufacturing PMI	**Dec**	**Nov**	**Chg (bps)**
USA	49.4	49.7	-30
Eurozone	45.1	45.2	-10
Japan	49.6	49.0	60
China	50.5	51.5	-100
Korea	49.0	50.6	-160
Indonesia	51.2	49.6	160

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	2025E
Real GDP growth (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0	4.9
Nominal GDP growth (% YoY)	6.7	-2.5	9.9	15.4	6.7	7.0	7.9
GDP per capita (USD)	4175	3912	4350	4784	4920	4975	5005
CPI inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	1.6#	2.3
BI Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00#	5.50
SBN 10Y yield (%)	7.04	5.86	6.36	6.92	6.45	7.04	7.47
USD/IDR exchange rate (end of year)	13,866	14,050	14,262	15,568	15,397	16,102#	16,887
Trade balance (USD Bn)	-3.2	21.7	35.3	54.5	37.0	31.4	26.2
Current account balance (% of GDP)	-2.7	-0.4	0.3	1.0	-0.1	-0.6	-0.9

Notes:

- *USD/IDR exchange rate projections are for fundamental values; market values may diverge significantly at any moment in time*
- *Numbers marked with (#) for 2024 are final; other numbers for 2024 are our projections*

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