Not leaping over a narrowing gap

03 March 2025

Lazuardin Thariq Hamzah
lazuardin_hamzah@bca.co.id

Barra Kukuh Mamia
barra_mamia@bca.co.id

Scan for the link to our report depository

Summary

- Despite their similarly downward growth trajectory, inflationary pressures seem to be returning to the US, threatening the economy with stagflation while China's production overcapacity continues to breathe disinflation into the economy and the global south.
- Indonesia's more inflation outlook explains the narrowing UST-SBN yield spread, lessening the adverse impact of the US' volatile rate outlook on the SBN market.
- Alas, Indonesia may not benefit from the narrowing yield spread, given investors' adverse reaction to signals of loosening fiscal control in Indonesia.

- Geopolitics and international relations continued to dominate the news flow last week, with the US government once again demonstrating the futility for analysts to predict its policy decisions and objectives. What initially seemed like a swift progress toward a US-sponsored Ukraine-Russia peace deal now appears uncertain, as disagreements (or misinterpretations) over what a US security guarantee would mean devolved into a 15-minute high-profile brouhaha between the US and Ukrainian leaders.
- Not long after that, the White House announced that tariffs on imports from Mexico and Canada would re-commence as planned, although the Canadian and Mexican governments' decision to comply with some of the US' demand may have earned them some discount to the import tariff.
- While the market appreciates the Trump administration's use of import tariffs to force its trade partners to negotiate, this strategy appears to harm the economy's growth trajectory. Anticipation of higher import tariffs encourages US businesses to front-load their imports, which explains the record-high US trade deficit in January 2025 (-USD 153.3 Bn) and the resulting drop in Atlanta Fed's GDPNow model (-1.5% SAAR for Q1-2025, 2.3% before the January 2025 US trade data release).
- Indeed, there is an argument to be made that the US economy may not be as strong as it seems–or at least not as strong as in previous quarters. Many have noted the rising delinquency rates for both mortgage and consumer loans, indicating stress on consumers' purchasing power, particularly for the lower half of the income population.

Letting a chance go by

- It is possible, then, for the US economy to join the long list of economies expected to experience weaker growth momentum in 2025–a trend that has so far been more synonymous with European economies (excluding Spain) or countries in Asia and the Global South, such as China. The latter, of course, is the primary casualty of the Trump administration's trade rhetoric, given that expectations of weaker Chinese economic growth in 2025 (4.5% YoY GDP growth forecast in 2025 vs. 5.0% YoY actual in 2024) are largely due to the projected decline in demand for its exports.
- The slowing growth momentum raises questions on whether the two governments will employ some form of fiscal intervention to steer the two largest economies back on track. Reports prior to China's "Two Sessions[1]" suggest that a fiscal stimulus package by the Chinese government is increasingly likely, highlighted by the relatively high GDP growth target (5.0% YoY, vs. 4.5% YoY expected by analysts).
- Meanwhile, the index tracking US economic policy uncertainties remains close to its all-time high, as the still-going debt ceiling debate (and general concerns with public sector debt) limits the Trump administration's ability to intervene fiscally. If anything, the ongoing review process led by the Department of Government Efficiency (DOGE) may slow down fiscal spending realisation in the US, further dampening growth momentum.
- Another factor that may complicate the US government's effort to expand its fiscal posture and turn the corner on its increasingly bearish growth outlook is the returning inflationary pressure ***(see Chart 1)***. As we have noted in a previous report ***(see here)***, domestic fuel prices in the US have been rising lately, weakening consumers' confidence in the economy. However, the current administration's seemingly monetarist view on economic policies may lead to the US government curbing money supply growth to restrict inflation. This policy dilemma–balancing slowing growth with returning inflation–mirrors the spectre of stagflation now looming over the US economy, in contrast to the outright (though arguably more structural) slowdown currently affecting the Chinese economy.
- Meanwhile, inflationary pressure is a non-issue for the Chinese government, which is expected to set the inflation target at 2% in 2025–a tall task given the 0.2% YoY inflation currently. As we have argued repeatedly, China's chronic manufacturing oversupply and sluggish domestic demand explain the deflationary pressures facing its economy–a problem that many analysts believe could be resolved through substantial demand-side fiscal interventions.

"UST securities seem to command lower premiums than Asian sovereign bonds, thanks to the US more volatile inflation outlook"

[1] Annual plenary sessions held by the National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC)

- Another popular argument we have made is how China's deflationary spiral has rippled through its trade partners ***(see Chart 2)***. Many economies, including Indonesia, are now experiencing a drop in inflation expectations, partly a product of Chinese exporters' increasing dominance in their import markets. In contrast, the US-led bloc is attempting to reverse the trend, and the additional costs associated with higher tariffs (to restrict access for Chinese and other low-cost producers) or reshoring efforts may factor into inflation calculations in the coming periods.
- Despite its adverse impact on local manufacturers, this China import-driven disinflationary trend in Indonesia and other economies may yield some benefits for local bond markets. A more stable (or at least muted) inflation outlook in Indonesia relative to the US may explain the narrowing yield spread between SBN and UST securities ***(see Chart 3)***, a trend also observable in other ASEAN sovereign bond markets. Conversely, the yield spread appears to be widening between UST and sovereign bonds of countries facing the spectre of stagflation, such as the UK gilt and the German bund markets.
- Indonesia, however, has not been able to take advantage of this narrowing yield spread. Normally, this situation would call for greater borrowing by the public and private sectors to bolster growth. However, while there is evidence that the private sector is looking to issue more debt, the public sector remains constrained by the deficit cap, self-limiting its ability to expand borrowing and tying it to the ongoing budget relocation effort to meet the funding needs of priority programmes. The government's adherence to the 3% deficit rule may be influenced by events throughout 2024 when any indication of a higher deficit was met with a spike in SBN yields and CDS premiums.
- At the same time, Bank Indonesia also finds it hard to reduce its policy rate, which is arguably too high at the moment given the -0.09% YoY inflation. Depreciation pressures facing the Rupiah (IDR 16,540/USD, -2.72% YTD as of writing) so far obscure BI's path towards further policy normalisation, which appears to carry more idiosyncratic risk at the moment given the stable (although still high) USD index. President Trump's rolling threat of tariffs did not help bring the USD to a more favourable level for the Rupiah and other currencies, nor did the Fed's policy signals amid returning inflationary pressures.

"Episodes of bond market tantrum in 2024 seems to have led to the government treating the 3% deficit cap as sacrosanct"

- It is fair to say, then, that the Eastern deflation forces the Indonesian economy to jump higher to break the deflationary spiral, but the Western stagflation lowers the ceiling for the economy to do so. The current situation highlights the challenge for policymakers, who may need to think outside of the box to force the Indonesian economy to break the mould. The government may be trying to do so through Danantara, whose ability to issue quasi-public bonds could help solve its funding problem. However, more out-of-the-box thinking is highly needed, lest the Indonesian economy may continue to exist within this narrowing space.

Chart 1

Going on different paths

Despite its similarly uncertain growth outlook, price level in the US (and most economies within its bloc) is trending towards a different direction than in China (and its bloc)

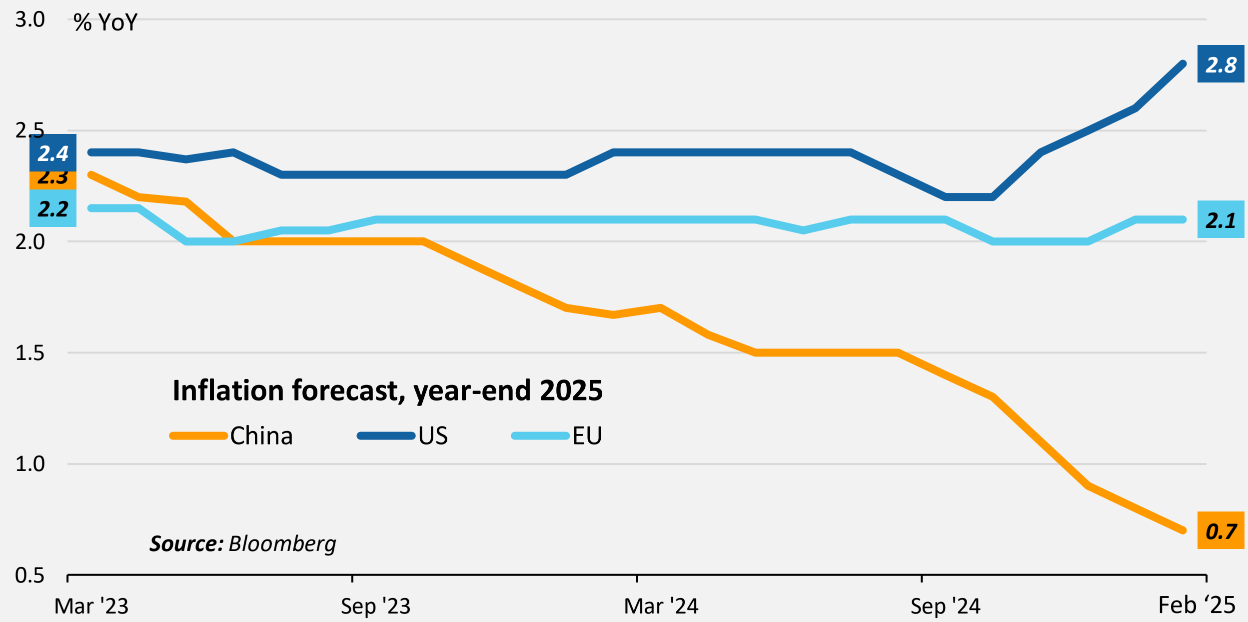


Chart 2

Go south

Apart from domestic macro condition, higher share of imports from China may also explain the lower inflation outlook in some (mostly southern) economies

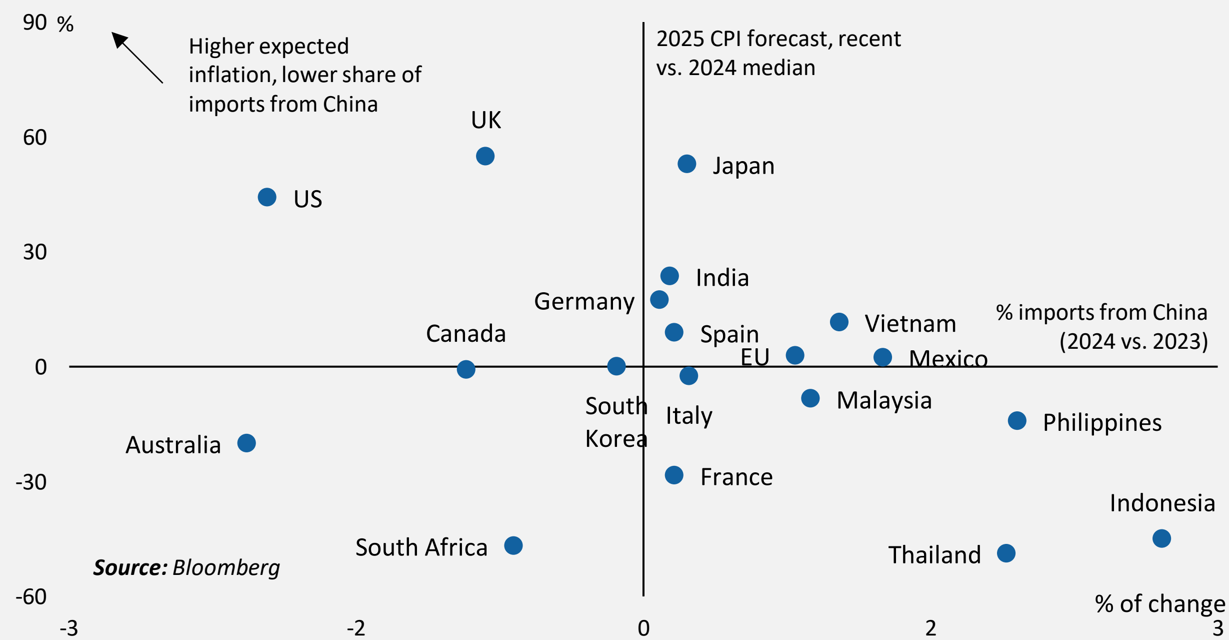
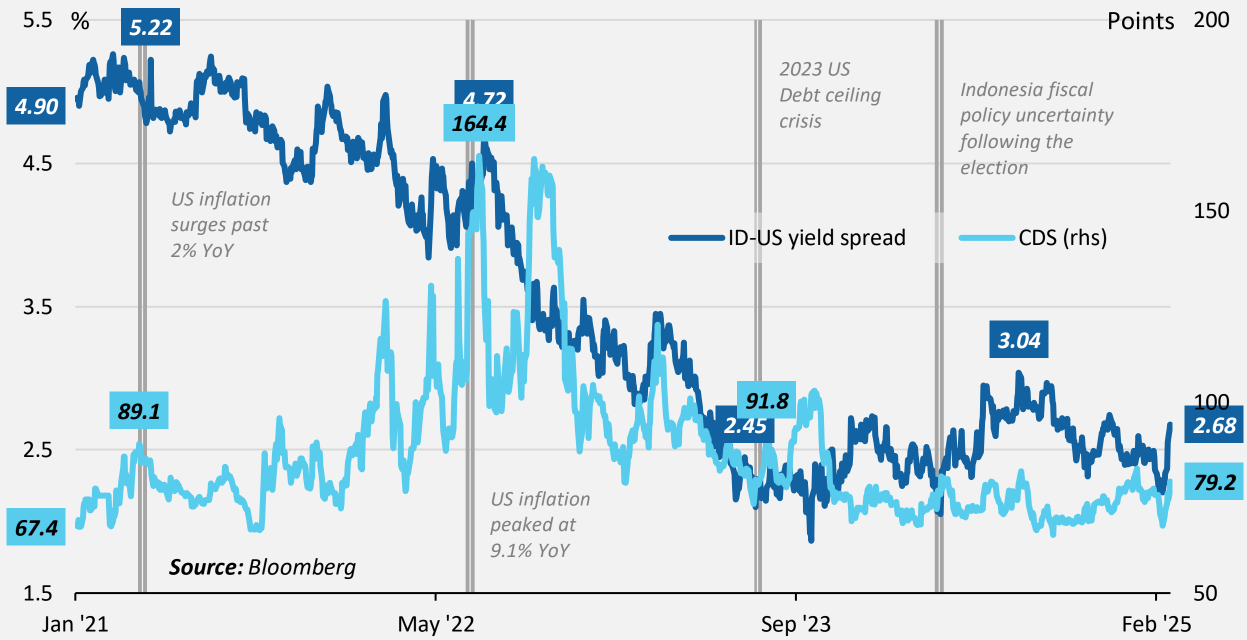


Chart 3

Narrowing the gap

Relatively stable inflation and fiscal outlook explains the narrowing nominal yield spread between the UST and SBN market



Source: *Bloomberg*

Economic Calendar

		Actual	Previous	Forecast*
03 March 2025				
ID	S&P Global Manufacturing PMI	53.6	51.9	52.3
ID	**Inflation Rate YoY, %**	**-0.09**	**0.76**	**0.5**
US	S&P Global Manufacturing PMI		51.2	51.6
06 March 2025				
EA	Retail Sales YoY, %		1.9	2
US	Balance of Trade, (Bn)		-98.4	-123
07 March 2025				
CN	Balance of Trade, (Bn)		104.84	120.0
ID	**Foreign Exchange Reserves, USD Bn**		**156.1**	**156.0**
US	Non-Farm Payrolls, th		143	150.0
09 March 2025				
CN	Inflation Rate YoY, %		0.5	0.1
10 March 2025				
ID	Car Sales YoY, %		-11.3	-
11 March 2025				
ID	Consumer Confidence		127.2	127.5
ID	Motorbike Sales YoY, %		-6.0	-
12 March 2025				
ID	Retail Sales YoY, %		1.8	0.4
US	Inflation Rate YoY, %		3	3.0
17 March 2025				
ID	**Balance of Trade, USD Bn**		**3.45**	**-**
CN	Retail Sales YoY, %		3.7	-
US	Retail Sales YoY, %		4.2	3.5
18 March 2025				
EA	Balance of Trade, (Bn)		15.5	**-**
19 March 2025				
ID	**Interest Rate Decision, %**		**5.75**	**-**
20 March 2025				
US	**Fed Interest Rate Decision, %**		**4.5**	**4.5**
ID	M2 Money Supply YoY, %		5.9	-
ID	Loan Growth YoY, %		10.27	-
ID	Tourist Arrival YoY, %		8.72	-
28 March 2025				
US	PCE Price Index YoY, %		2.5	-

*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	4.50	Dec-24	1.50
UK	4.50	Feb-25	1.50
EU	2.90	Jan-25	0.40
Japan	0.50	Jan-25	-4.10
China (lending)	2.00	Sep-24	3.85
Korea	2.75	Feb-25	0.55
India	6.25	Feb-25	1.94
Indonesia	5.75	Jan-25	5.84
Money Mkt Rates	**28-Feb**	**-1 mth**	**Chg (bps)**
SPN (1Y)	6.08	6.70	-62.3
SUN (10Y)	6.90	7.03	-13.5
INDONIA (O/N, Rp)	5.73	5.92	-19.1
JIBOR 1M (Rp)	6.38	6.39	-1.1
Bank Rates (Rp)	**Dec**	**Nov**	**Chg (bps)**
Lending (WC)	8.62	8.68	-5.92
Deposit 1M	4.92	4.78	14.17
Savings	0.68	0.67	1.19
Currency/USD	**28-Feb**	**-1 mth**	**Chg (%)**
UK Pound	0.795	0.804	1.08
Euro	0.964	0.959	-0.53
Japanese Yen	150.6	155.5	3.26
Chinese RMB	7.278	7.245	-0.46
Indonesia Rupiah	16,580	16,173	-2.45
Capital Mkt	**28-Feb**	**-1 mth**	**Chg (%)**
JCI	6,270.6	7,166.1	-12.50
DJIA	43,840.9	44,850.4	-2.25
FTSE	8,809.7	8,533.9	3.23
Nikkei 225	37,155.5	39,016.9	-4.77
Hang Seng	22,941.3	20,225.1	13.43
Foreign portfolio ownership (Rp Tn)	**Jan**	**Dec**	**Chg (Rp Tn)**
Stock	3,531.1	3,521.3	9.76
Govt. Bond	881.3	876.6	4.65
Corp. Bond	6.0	5.9	0.10

Trade & Commodities	28-Feb	-1 mth	Chg (%)
Baltic Dry Index	1,229.0	746.0	64.7
S&P GSCI Index	553.6	564.3	-1.9
Oil (Brent, $/brl)	73.2	77.5	-5.6
Coal ($/MT)	101.9	120.3	-15.3
Gas ($/MMBtu)	3.91	3.40	15.0
Gold ($/oz.)	2,857.8	2,763.5	3.4
Copper ($/MT)	9,338.1	8,861.3	5.4
Nickel ($/MT)	15,266.9	15,221.4	0.3
CPO ($/MT)	1,055.3	1,037.5	1.7
Rubber ($/kg)	2.05	2.02	1.5
External Sector	**Jan**	**Dec**	**Chg (%)**
Export ($ bn)	21.45	23.46	-8.56
Import ($ bn)	18.00	21.22	-15.18
Trade bal. ($ bn)	3.45	2.24	54.17
Central bank reserves ($ bn)*	156.1	155.7	0.23
Prompt Indicators	**Jan**	**Dec**	**Oct**
Consumer confidence index (CCI)	127.2	127.7	121.1
Car sales (%YoY)	-11.3	-6.4	-3.7
Motorcycle sales (%YoY)	-6.0	-5.5	5.4
Manufacturing PMI	**Jan**	**Dec**	**Chg (bps)**
USA	51.2	49.4	180
Eurozone	46.6	45.1	150
Japan	48.7	49.6	-90
China	50.1	50.5	-40
Korea	50.3	49.0	130
Indonesia	51.9	51.2	70

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	2024	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	6.0	7.6
GDP per capita (USD)	4175	3912	4350	4784	4920	4960	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	6.97	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	31.0	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*

Economic, Banking & Industry Research Team

David E.Sumual
Chief Economist
david_sumual@bca.co.id
+6221 2358 8000 Ext:1051352

Agus Salim Hardjodinoto
Head of Industry and Regional Research
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Barra Kukuh Mamia
Head of Macroeconomic Research
barra_mamia@bca.co.id
+6221 2358 8000 Ext: 1053819

Victor George Petrus Matindas
Head of Banking Research and Analytics
victor_matindas@bca.co.id
+6221 2358 8000 Ext: 1058408

Gabriella Yolivia
Industry Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Lazuardin Thariq Hamzah
Economist / Analyst
lazuardin_hamzah@bca.co.id
+6221 2358 8000 Ext: 1071724

Keely Julia Hasim
Economist / Analyst
keely_hasim@bca.co.id
+6221 2358 8000 Ext: 1071535

Elbert Timothy Lasiman
Economist / Analyst
Elbert_lasiman@bca.co.id
+6221 2358 8000 Ext: 1074310

Thierris Nora Kusuma
Economist / Analyst
thierris_kusuma@bca.co.id
+6221 2358 8000 Ext: 1071930

Nicholas Husni
Economist / Analyst
nicholas_husni@bca.co.id
+6221 2358 8000 Ext: 1079839

Samuel Theophilus Artha
Economist / Analyst
samuel_artha@bca.co.id
+6221 2358 8000 Ext: 1080373

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group

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