Flushed out of the UST market

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Summary

- Imploding leveraged positions appear to largely explain the spike in UST yields, as inflation expectations have not changed materially while selling by tariff-impacted countries remains orderly.
- Policy uncertainty and heavy debt issuance may continue to breathe volatility into the UST market, especially with the Fed continuing to insist that the reserves position remains ample.
- Indonesia continues to be on the wrong side of the US market implosion, but continuous outflows and the weakening Rupiah may not force BI to abandon its dovish bias.

- Easter festivities were up in the air last week, but that does not seem to take the heat away from financial markets in Indonesia and globally. While the Indonesian stock market seemed relatively calm in the past week, the 1.1% WoW increase in the index masked the continued foreign capital outflow from the market, which amounted to around USD 1.26 Bn last week alone. The USD 76.7 Mn foreign outflows from the SBN market did not help to ease the pressure, plunging the Rupiah below the IDR 16,800/USD level as the market closed last Friday.
- What is interesting is that another bad week for the Rupiah comes just as the DXY index (a proxy for the USD's value against a basket of other hard currencies) slid below 100 for the first time since late July 2023, courtesy of the raging policy uncertainties that hitherto wreak havoc in the US financial market. The spiking UST yields (with the benchmark 10Y UST yield up 15.6 bps MTD to 4.32%) add to the sense of volatility, strengthening opposition to President Trump's trade policies.
- More casual macroeconomic observers are by now familiar with the list of detrimental impacts that Trump's tariffs may have on the US and global economy. The rhetoric around tariff-induced inflationary pressures is gaining traction, as more people begin connecting the dots between higher US import tariffs and retail prices; seemingly without pausing to consider whether US consumers will baulk at the higher prices. The recent spike in UST yields may appear to validate these popular concerns. However, bond traders do not seem to subscribe to such a view, as the stable inflation expectation (10Y TIPS dipping below 2% in the latest auction) indicates that the rising yield is driven by factors more technical than returning inflation expectation.

A series of implosions

- Despite growing public concern, the flip-flopping tariff threats have not materially altered US inflation expectations, particularly as energy prices continue to decline amid expectations of slowing economic growth ***(see Chart 1)***. Rather than the returning spectre of inflation, bond market watchers appear to be leaning on one of two arguments explaining the recent spike in UST yields: (1) the loss of the UST's safe-haven status, and (2) the unwinding of intricate trades that had previously supported the UST market.

- The first argument stems from a qualitative assessment of what President Trump's mercurial policy-making might mean for the US and global economy, as the constant threat-making and policy U-turns have rendered efforts to predict US policymaking nearly futile – thus threatening the smooth functioning of the market. **While it is true that US policymaking has since been hard to predict, it may be too soon to assume that foreign demand for USTs and other USD assets has dried up to nothing**, with mixed results from recent UST auctions further showing that the demand profile for the UST market is still too early to tell.

"The recent UST yields spike seems to be driven by the unwinding of trade positions that have previously supported the market"

- The second argument appears to be more convincing, especially considering the strong capital inflows and more optimistic outlook that the UST market benefited from before the recent shocks ***(see Chart 2)***. Despite the heavy debt issuance, the more dovish inflation outlook has driven up the demand for UST. **The increasingly popular support to wind down Basel III has also encouraged traders to build a considerable position in the longer end of the UST market *(see Chart 3)***, committing themselves to a SLR trade position as the market anticipates the COVID-era regulation that exempts treasuries from the Supplementary Leverage Ratio (SLR) calculation to return.

- The previous widespread optimism in the UST market even led some bolder traders to leverage up and arbitrage the basis between cash Treasuries (whose value was expected to rise) and the corresponding futures (which were anticipated to fall in price), giving rise to the popularity of the Treasury basis trade.

- Alas, **the recent tariff-induced volatility seems to have thrown these traders' positions into disarray.** The Fed has yet to give the green light on the SLR exemption, forcing traders to maintain their positions longer and exposing them to paper losses amidst the 'post-Liberation Day' market turbulence. The sustained volatility has also driven a sharp increase in the cost of swapping variable- and fixed-interest payments ***(see Chart 4)***, making Treasury basis trade positions increasingly expensive to maintain—and possibly prompting traders to exit the UST market altogether.

- What makes both trade positions untenable, of course, is the level of leverage needed to make both trades economical. Basis trade is considered a highly safe but low-margin strategy, which encourages traders to take on significant leverage – up to 20 times or more, according to some estimates – to justify the returns. **What is happening in the UST market, then, may be better described as a series of imploding leveraged positions rather than a sea change in investors' attitude toward the UST or concerted selling by motivated malign actors (such as China as often argued).** A similar dynamic could be traced to the UK Gilt crisis of 2022 when PM Truss' mini-budget announcement sparked a sell-off in the Gilt market, which quickly escalated into a more chaotic period of liquidations as margin calls forced pension funds to frantically unwind their highly leveraged long positions.

- Some tweaks could be done to help stabilise the UST market from the ongoing implosion. For instance, a Fed QT stop is still expected to be on the near horizon, and Treasury Secretary Bessent also continues to push for the SLR exemption. However, Fed chairman Jerome Powell's recent remark that reserves are still ample may lower the likelihood of such a scenario, **while the heart of the issue – the heavy debt issuance – is still expected to linger given the stunted progress at increasing the efficiency of the US budget posture.**
- The global financial market, then, may remain sharply divided, with developed markets such as Europe and Japan now enjoying a steady stream of foreign inflows thanks to a boost in their safe haven credentials, while emerging markets, including Indonesia, continue to grapple with persistent foreign outflows.
- However, as we continue to argue, Indonesia may benefit from Bank Indonesia's heightened pain tolerance for global volatility and IDR weakening. For instance, the plummeting oil prices dampen the pass-on costs from the weakening Rupiah to the fiscal condition. Indonesia has also managed to record a substantial increase in its March 2025 trade surplus (USD 4.3 Bn, USD 3.1 Bn in Feb 2025), partly driven by a bump in merchandise exports.
- **While the tariff front-running effect seems to be significant, the period also coincides with the time when the Rupiah depreciates more in real terms (against its trading partners, -2.51% MTD) than against the USD (-1.75% MTD)**, thus making made-in-Indonesia goods more attractive on the exports market. BI, then, may still have the flexibility to maintain its dovish bias, with the ample FX reserves allowing the central bank to intervene should global market-induced short-term liquidity stress arise.

> ***"The Rupiah continue to be on the wrong end of US volatility, but BI may still afford to maintain its dovish bias"***

Chart 1

Don't blame it all on inflation

UST yields are rising despite the lower inflationary pressure, signalling other factors that might be at play in causing the recent UST selloffs

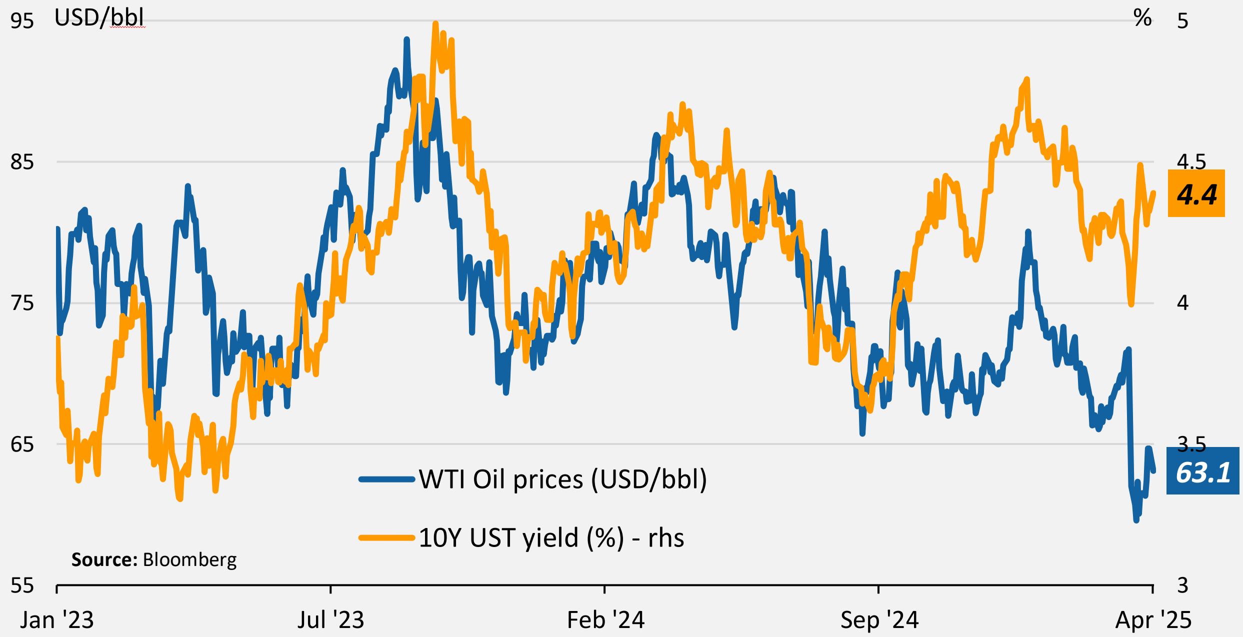


Chart 2

Still good a couple of months ago

The UST market enjoys a steady stream of foreign inflows in 2024, a trend that may have begun to revert as volatility steer investors away from the US market

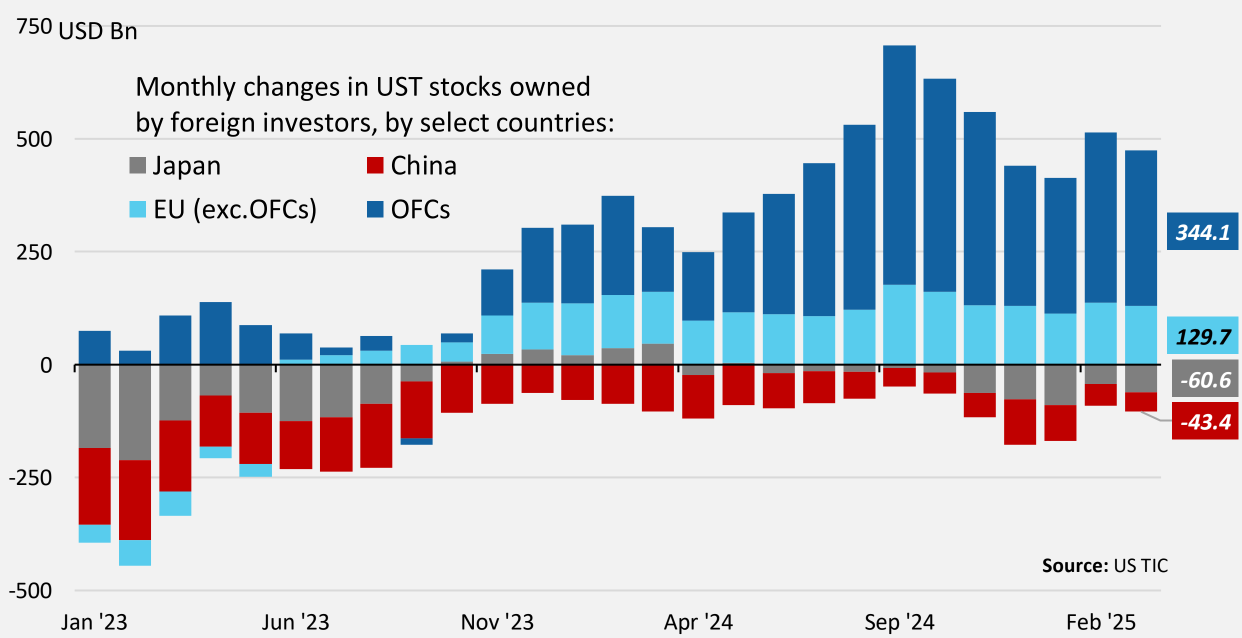
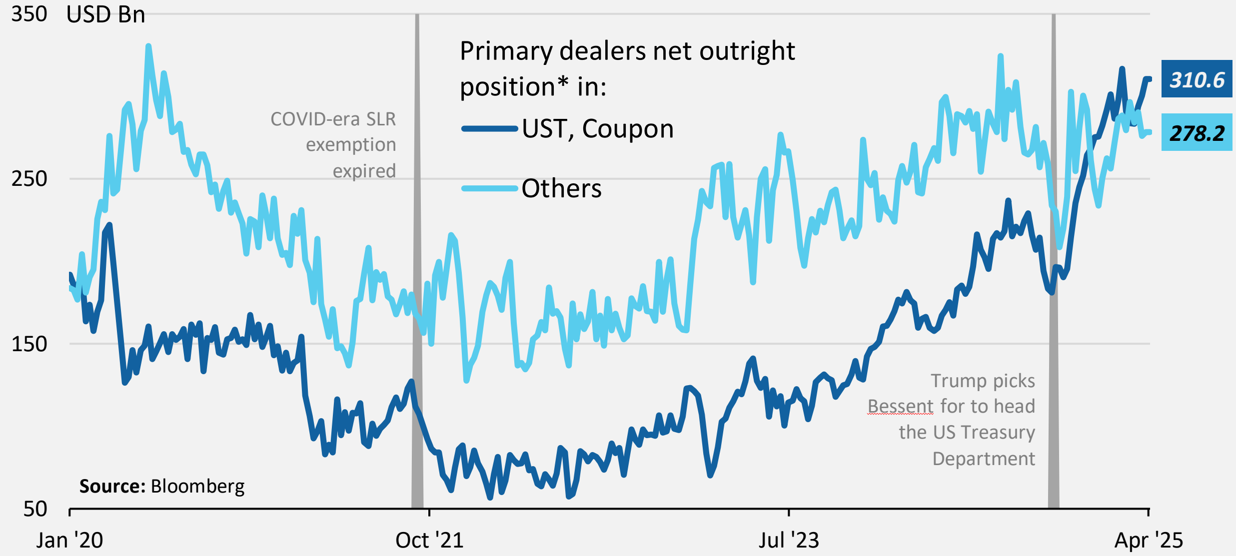


Chart 3

Blown by the volatility wind

Traders has been building position in the longer end of the UST market amid expectations of banking deregulation, a position that is increasingly untenable given the recent volatility

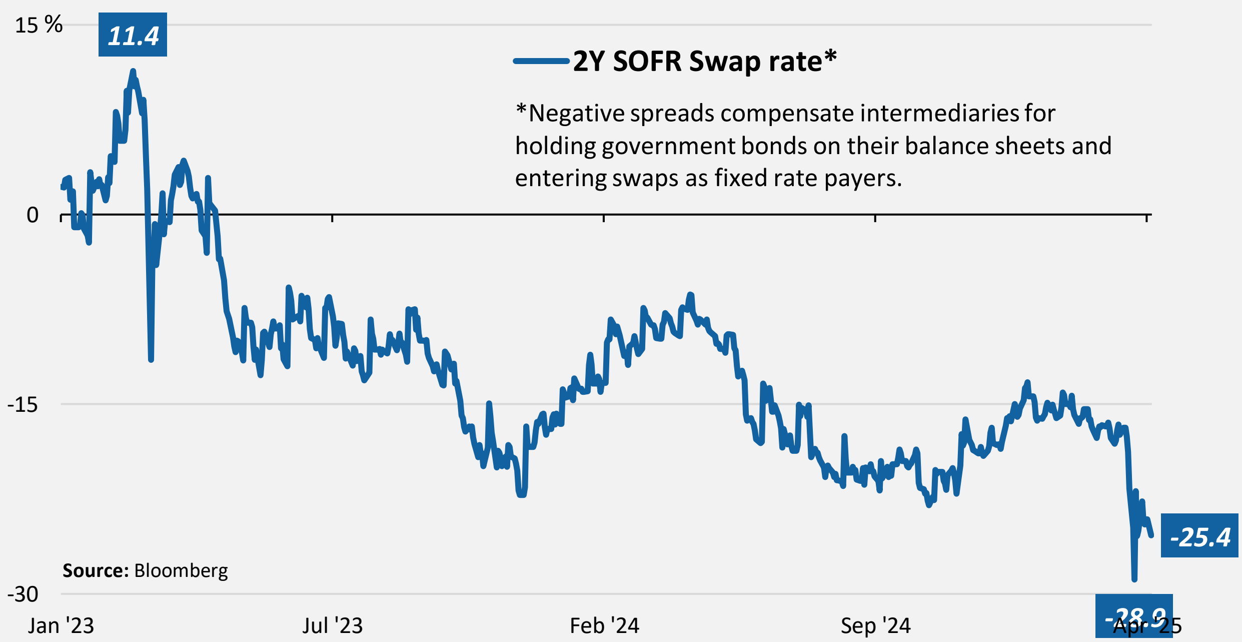


*excl. USTs allotted to dealers. Used as proxy for UST demand from prime broker's customers

Chart 4

It costs more to keep things fixed

The recent tariff-induced volatility has increased the cost for traders to maintain their basis trade position, even possibly forcing some traders to abandon their position



Economic Calendar

		Actual	Previous	Forecast*
03 April 2025				
US	Balance of Trade, (Bn)	-122.7	-130.7	-122
04 April 2025				
US	Non-Farm Payrolls, th	228	117	100.0
07 April 2025				
EA	Retail Sales YoY, %	2.3	1.8	2.1
08 April 2025				
ID	**Inflation Rate YoY, %**	**1.03**	**-0.09**	**1.3**
10 April 2025				
CN	Inflation Rate YoY, %	-0.1	-0.7	0.0
US	Inflation Rate YoY, %	2.4	2.8	2.5
14 April 2025				
ID	Motorbike Sales YoY, %	-7.2	4.0	-
CN	Balance of Trade, (Bn)	102.64	170.52	84
ID	**Foreign Exchange Reserves, USD Bn**	**157.1**	**154.5**	**155.0**
15 April 2025				
ID	Consumer Confidence	121.1	126.4	127.3
ID	Car Sales YoY, %	-5.1	2.2	-
16 April 2025				
CN	Retail Sales YoY, %	5.9	4	4.4
ID	Retail Sales YoY, %	2.0	0.5	1.0
US	Retail Sales YoY, %	4.6	3.5	2.6
21 April 2025				
ID	**Balance of Trade, USD Bn**	**4.33**	**3.12**	**4.2**
23 April 2025				
ID	**Interest Rate Decision, %**		**5.75**	**-**
EA	Balance of Trade, (Bn)		1	-
24 April 2025				
ID	Loan Growth YoY, %		10.3	12
25 April 2025				
ID	M2 Money Supply YoY, %		5.7	-
29 April 2025				
ID	**Foreign Direct Investment YoY, %**		**33.3**	**-**
30 April 2025				
US	PCE Price Index YoY, %		-	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	2.10
UK	4.50	Feb-25	1.90
EU	2.40	Mar-25	0.20
Japan	0.50	Jan-25	-3.10
China (lending)	2.00	Sep-24	4.45
Korea	2.75	Feb-25	0.65
India	6.00	Apr-25	2.66
Indonesia	5.75	Jan-25	4.72

Money Mkt Rates	21-Apr	-1 mth	Chg (bps)
SPN (1Y)	6.17	6.01	15.7
SUN (10Y)	6.94	7.17	-22.4
INDONIA (O/N, Rp)	5.77	5.80	-3.7
JIBOR 1M (Rp)	6.38	6.38	0.0

Bank Rates (Rp)	Jan	Dec	Chg (bps)
Lending (WC)	8.62	8.62	0.57
Deposit 1M	4.87	4.92	-4.27
Savings	0.68	0.68	-0.18

Currency/USD	21-Apr	-1 mth	Chg (%)
UK Pound	0.747	0.774	3.56
Euro	0.868	0.924	6.44
Japanese Yen	140.9	149.3	6.01
Chinese RMB	7.292	7.252	-0.55
Indonesia Rupiah	16,805	16,500	-1.81

Capital Mkt	21-Apr	-1 mth	Chg (%)
JCI	6,446.0	6,258.2	3.00
DJIA	38,170.4	41,985.4	-9.09
FTSE	8,275.7	8,646.8	-4.29
Nikkei 225	34,279.9	37,677.1	-9.02
Hang Seng	21,395.1	23,689.7	-9.69

Foreign portfolio ownership (Rp Tn)	Mar	Feb	Chg (Rp Tn)
Stock	3,144.7	3,083.7	61.05
Govt. Bond	891.9	890.2	1.72
Corp. Bond	5.2	5.1	0.06

Trade & Commodities	21-Apr	-1 mth	Chg (%)
Baltic Dry Index	1,261.0	1,643.0	-23.3
S&P GSCI Index	532.0	558.2	-4.7
Oil (Brent, $/brl)	66.3	72.2	-8.2
Coal ($/MT)	97.1	104.0	-6.6
Gas ($/MMBtu)	3.16	3.94	-19.8
Gold ($/oz.)	3,424.0	3,022.2	13.3
Copper ($/MT)	9,161.0	9,813.5	-6.6
Nickel ($/MT)	15,420.2	15,833.3	-2.6
CPO ($/MT)	948.5	1,068.0	-11.2
Rubber ($/kg)	1.74	1.99	-12.6

External Sector	Mar	Feb	Chg (%)
Export ($ bn)	23.25	21.94	5.95
Import ($ bn)	18.92	18.86	0.30
Trade bal. ($ bn)	4.33	3.08	40.56
Central bank reserves ($ bn)*	157.1	154.5	1.67

Prompt Indicators	Mar	Feb	Jan
Consumer confidence index (CCI)	121.1	126.4	127.2
Car sales (%YoY)	-5.1	2.2	-11.3
Motorcycle sales (%YoY)	-7.2	4.0	-5.5

Manufacturing PMI	Mar	Feb	Chg (bps)
USA	50.2	52.7	-250
Eurozone	48.6	47.6	100
Japan	48.4	49.0	-60
China	51.2	50.8	40
Korea	49.1	49.9	-80
Indonesia	52.4	53.6	-120

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	4.8
Nominal GDP growth (% YoY)	6.7	-2.5	9.9	15.4	6.7	6.0	5.7
GDP per capita (USD)	4175	3912	4350	4784	4920	4960	4996
CPI inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	1.6	2.1
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	7.68
USD/IDR exchange rate (end of year)	13,866	14,050	14,262	15,568	15,397	16,102	16,943
Trade balance (USD Bn)	-3.2	21.7	35.3	54.5	37.0	31.0	26.0
Current account balance (% of GDP)	-2.7	-0.4	0.3	1.0	-0.1	-0.6	-1.0

Notes:

- *USD/IDR exchange rate projections are for fundamental values; market values may diverge significantly at any moment in time*

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