

A one-way liquidity pipeline

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Summary

- The external conditions remain uncertain, yet the Indonesian financial market has been stabilising as insurance and pension funds are looking to purchase more equities while banks are returning to the SBN market.
- The higher demand for SBN from banks likely reflects the weakening demand for financing in the real sector rather than an improvement in banks' liquidity condition.
- The currently stable market may encourage BI to tune up its dovish signal, but the onus to improve the liquidity condition rests primarily on the public sector.

- The bad news continued to stack up against the US and global financial markets over the past week. First, Fed chairman Jerome Powell announced a review of the Fed's monetary policy framework, as the central bank does not appear to put much faith in FAIT (flexible average inflation targeting) anymore. Chairman Powell's warning that more frequent supply shocks could skew inflation expectations upward dampens the market's expectation for rate cuts in 2025; the market now anticipates a total of 50 bps in FFR cuts, down from 75 bps before Powell's remarks last Thursday.
- Another troubling development is the recent downgrade of US treasuries, stripping the UST of its last remaining AAA rating among the major credit rating agencies. Luckily, market reaction has been relatively muted so far, with the benchmark 10Y UST yield easing slightly, from 4.53% after Chairman Powell's remarks to 4.51% following the downgrade.
- Alas, the highly politicised nature of the de-rating (with Senate Minority Leader Schumer and President Trump quickly trading blame) adds a new layer of uncertainty to the ongoing debt ceiling negotiations. This could, in turn, constrain the US government's fiscal flexibility at a time when the broader economy is already beginning to show signs of fatigue, although the US government's cash reserves remain ample at USD 562.43 Bn (compared to the low of USD 48.51 Bn during the 2023 debt ceiling crisis).
- Indeed, while much attention has been given to the 34.86 bps MTD rise in the benchmark 10Y UST yield, our deeper concern lies in the more palpable upward movement at the shorter end of the yield curve. The recent bear-flattening episode reinforces our view that stagnation concerns are becoming more urgent in the US, while the market sees the Fed as still "fighting the last fight" against inflation.

- Fortunately, the Fed's bias on the inflation side of the stagflationary concerns has not significantly impacted Asian (and Indonesian) financial markets over the past week. The Asia Dollar Index remained stable, while the Rupiah

appreciated by 0.25% WoW, breaking below the 16,500/USD threshold. Last week also proved to be a good one for the Indonesia stock market, with the JCI rallying 4.01% WoW – far outpacing most regional peers.

No need to sweat over the insurance money

- While we remain sceptical that the ongoing stock market recovery is underpinned by improving fundamentals in the domestic corporate sector, the recent stock market rally is not entirely surprising. **In addition to local securities firms (as discussed in last week's report), domestic insurance and pension funds are expected to inject more liquidity into the market,** with government-linked insurance and pension

funds having signalled their intention to increase the share of equities in their investment portfolios.

- However, it should be noted that **the effort by domestic insurance and pension funds to expand their equity holdings are not preceded by a meaningful expansion of their balance sheets.** Asset growth has continued to dwindle, reaching a post-COVID low of 3.82% YoY in February 2025 – a trend that may persist amidst declining participation rates reported in the domestic insurance and pension sectors. **Ergo, expanding the equity holdings may be achieved through a process of asset reallocation rather than an outright expansion,** which may pose a threat to other parts of the Indonesian financial market.

“The slowing assets growth means that insurance and pension funds’ bid to purchase more equities will be finance by asset reallocation”

- The question, then, is how the domestic insurance and pension funds will finance its purchase of equities. At first glance, the answer appears to point toward bank deposits, particularly time deposits, given the improved net bank balance positions of domestic insurance, pension funds, and other non-bank financial institutions. While this may impact some banks, the liquidity condition within the

banking sector may not change much should this reading prove to be true, given the relative size of non-bank financial institutions' cash stash to the overall banking system.

- However, historical precedent does not appear to bother the banking sector at all (*see Chart 1*). **The share of time deposits in domestic insurance and pension fund portfolios has remained relatively stable over time,** while equities have gradually ceded ground to SBNs since peaking in December 2017. Apart from its record-high share in insurance and pension funds' portfolios, the static SBN yield (relative to the interest rate on TDs, *see Chart 2*), may reduce portfolio managers' incentive to maintain their SBN holdings, meaning that the reported higher demand for equities may be financed by the displacement of liquidity from the SBN market.

Giving the market what the real sector direly needs

- Hence, what initially appeared to be a threat to the banking sector may pose a more pressing challenge for the SBN market. Since 2022, domestic insurance and pension funds, alongside Bank Indonesia, have played a crucial role in stabilising the demand for SBNs, helping to anchor the benchmark 10Y yield tightly contained around the 7% mark.
- While domestic insurance and pension funds may not be showing the same level of appetite for SBNs as in the previous months, this does not necessarily spell the end of the robust demand for SBNs (*see Chart 3*). BI, for one, remains committed to its bond-buying programme, while the Indonesian government's commitment to keep the deficit target at 2.53% seems to be successful in attracting foreign investors back to the market. **Domestic banks are another class of investors that we could expect to play a greater role in driving the demand for SBN**, as the gradual unwinding of the SRBI market seems to be forcing banks to rotate back to the SBN market.
- **It is important to note, however, that banks' higher demand for SBNs seems to be happening as the liquidity condition is taking a turn for the worse.** The outstanding on BI's repo facility has surged recently, highlighting mounting liquidity pressures within the banking system (*see Chart 4*). Ergo, apart from the shrinking of the SRBI market, banks' return to the SBN market also underscores the weakening demand for bank financing, as the uncertain growth outlook has led to a broad

"While BI may tune up its dovish signal, Better fiscal spending realisation remains the surest way to improve the domestic liquidity condition"

pause in real sector investment, and with it, a decline in the demand for credit.

- **The domestic liquidity pipeline, then, appears to be increasingly channelled towards the equities and bond markets, instead of loans.** Indeed, the real sector remains in consolidation mode amidst tight liquidity conditions, subdued domestic demand, and intensifying competition from imports. **There are a few measures the Indonesian government could take to remedy this imbalance. First, the government could look to mitigate the crowding-out effect on the private sector by rethinking its reliance on the SBN market,** looking instead for alternative financing sources such as external loans. This could be done by tapping more aggressively into bilateral or multilateral financing facilities, which may ease the government's pressing financing needs without adding the burden on the private sector.
- **Second, and arguably more crucial, is the need to improve fiscal spending realisation for the rest of the year.** Indeed, government expenditures have been contributing negatively to the GDP growth number in Q1-2025, influenced by temporal disruptions amidst the previous budget review and reallocation process. Better fiscal spending realisation in the rest of the year would help to send some of the liquidity hitherto trapped in the public sector back to the private sector, which may also re-energise activities as the public sector assumes a greater role in driving the aggregate demand.

- Another institution that may play a role in remedying the situation, of course, is BI itself. Despite the evident slowdown in domestic demand, Bank Indonesia has been compelled to tone down its dovish stance, as the Rupiah came under pressure amidst persistent foreign

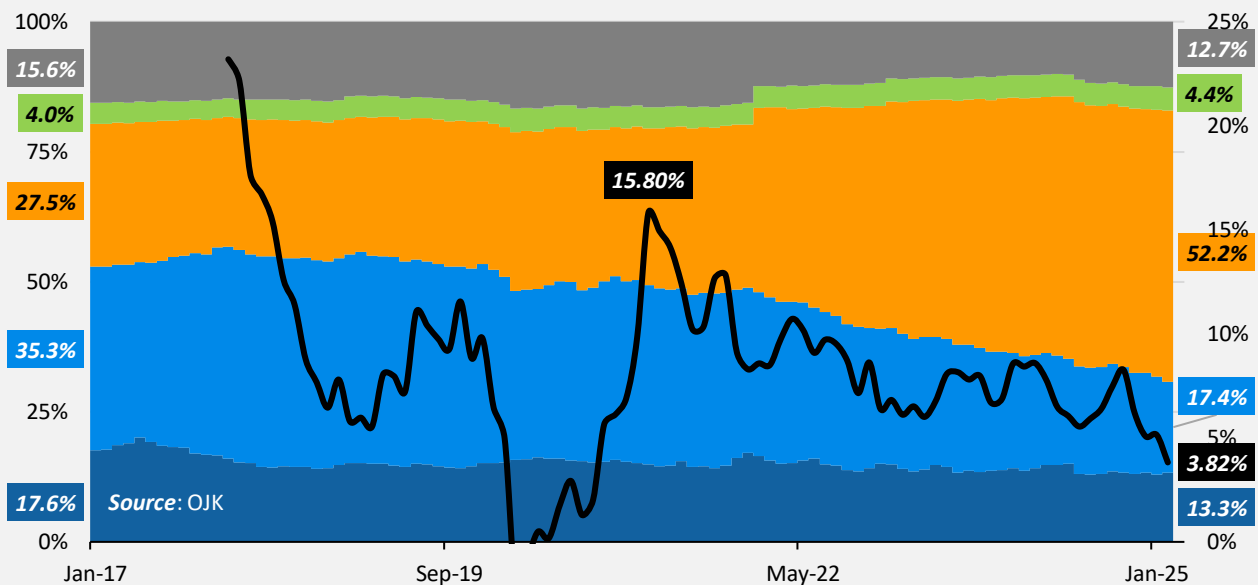
capital outflows and deteriorating external conditions. The stabilising domestic market condition may provide a leeway for BI to be more accommodative, although doing so may re-escalate the pressure on the Rupiah as the Fed remains steady in its fight against inflation.

Chart 1

A possible return to 2017?

The stable share of TDs means that domestic insurance and pension funds' signal to expand their stock portfolios may see them reducing their demand for SBN instead.

Domestic insurance and pension funds, share of investment portfolio



Black line: YoY assets growth (%), invested in:

■ TD ■ Stocks & MFs ■ Sovereign bonds ■ Property & Other direct investments ■ Others

Chart 2

Narrowing spread

Rates on TDs are increasingly attractive relative to the stable SBN yield, underscoring the high opportunity cost of reducing TDs in one's portfolio of assets.

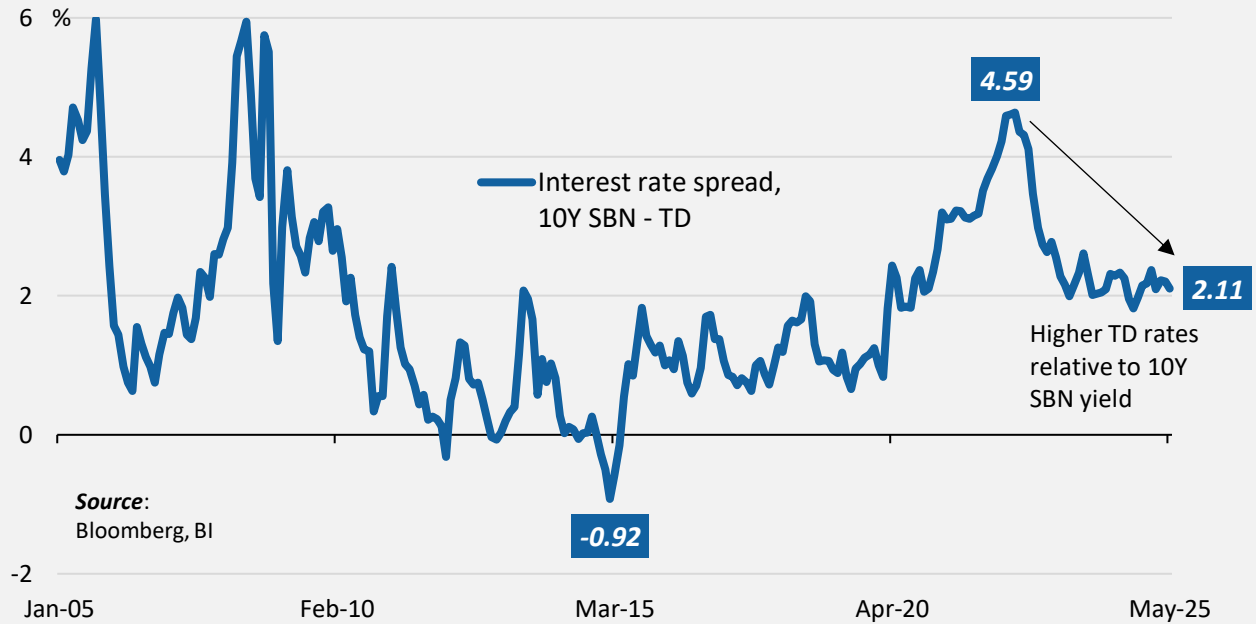


Chart 3

Drained pool

Liquidity constraints in the banking sector are flaring up again whereas non-bank financial institutions have signalled their intention to provide liquidity for the market.

YoY changes in the ownership of marketable SBNs

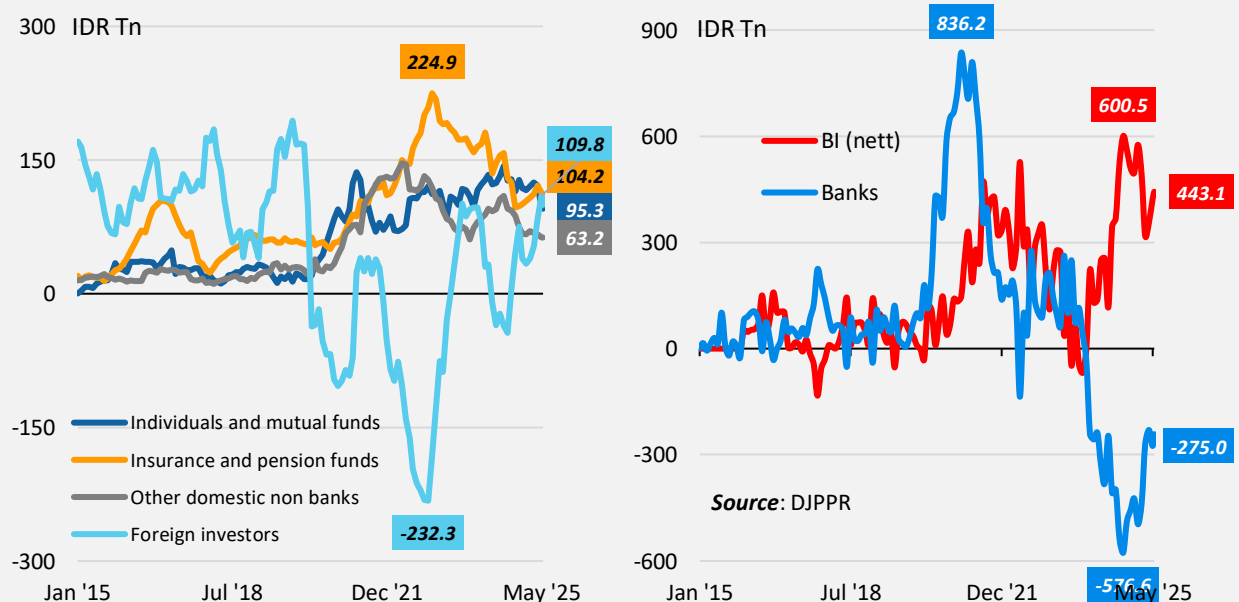
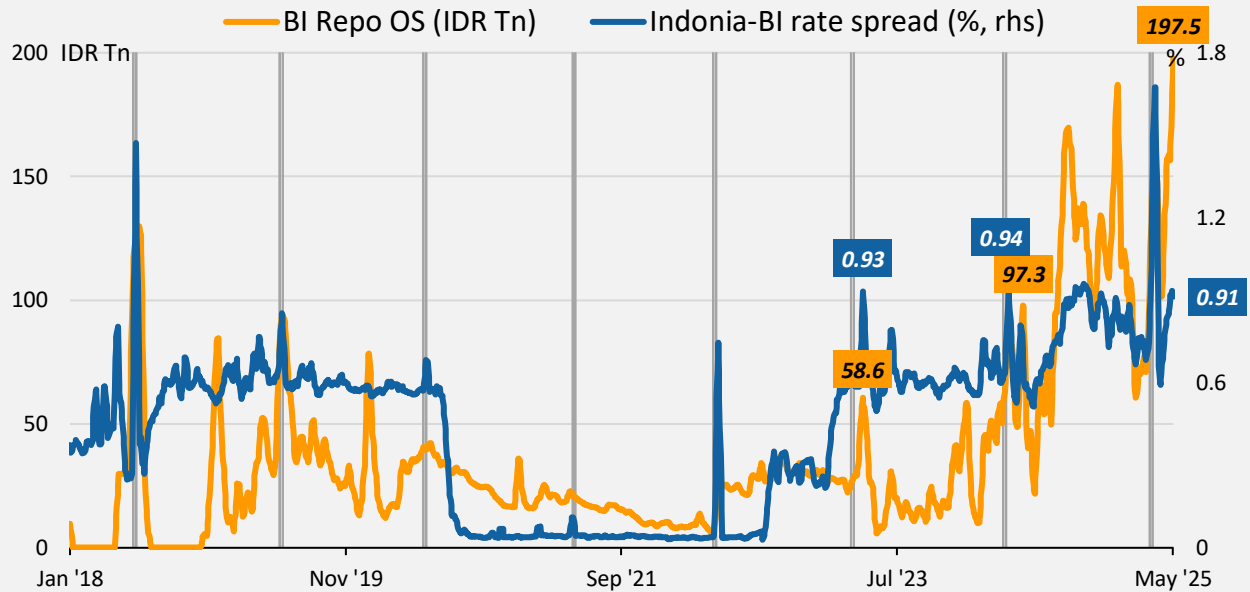


Chart 4

Drained pool

Liquidity constraints in the banking sector are flaring up again whereas non-bank financial institutions have signalled their intention to provide liquidity for the market.



Source: Bloomberg. Shaded areas reflect the Eid holiday

Economic Calendar				
		Actual	Previous	Forecast*
05 May 2025				
ID	GDP Growth Rate YoY, %	4.87	5.02	4.9
06 May 2025				
US	Balance of Trade, USD Bn	-140.5	-123.2	-137.1
07 May 2025				
EA	Retail Sales YoY, %	1.5	1.9	1.9
ID	Property Price Index YoY, %	1.07	1.39	1.6
08 May 2025				
US	Fed Interest Rate Decision, %	4.5	4.5	4.5
ID	Foreign Exchange Reserves, USD Bn	152.5	157.1	-
ID	Motorbike Sales YoY, %	3	-7.2	-
09 May 2025				
CN	Balance of Trade, (Bn)	96.18	102.64	70.0
ID	Consumer Confidence	121.7	121.1	119.8
10 May 2025				
CN	Inflation Rate YoY, %	-0.1	-0.1	0.0
ID	Car Sales YoY, %	5.0	-5.1	-
13 May 2025				
US	Inflation Rate YoY, %	2.3	2.4	2.5
14 May 2025				
ID	Retail Sales YoY, %	5.5	2	3.3
15 May 2025				
US	Retail Sales YoY, %	5.2	5.2	1.1
16 May 2025				
EA	Balance of Trade, (Bn)	36.8	24.8	25
19 May 2025				
CN	Retail Sales YoY, %	5.1	5.9	5.6
20 May 2025				
ID	Loan Growth YoY, %		9.16	9.0
21 May 2025				
ID	Interest Rate Decision, %		5.75	5.75
22 May 2025				
ID	Current Account, (USD Bn)		-1.1	-1.2
23 May 2025				
ID	M2 Money Supply YoY, %		6.1	-

*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	16-May	-1 mth	Chg (%)
US	4.50	Dec-24	2.20	Baltic Dry Index	1,388.0	1,263.0	9.9
UK	4.25	May-25	1.65	S&P GSCI Index	533.1	524.1	1.7
EU	2.40	Apr-25	0.20	Oil (Brent, \$/bbl)	65.4	64.7	1.1
Japan	0.50	Jan-25	-3.10	Coal (\$/MT)	116.6	121.2	-3.8
China (lending)	2.00	Sep-24	4.45	Gas (\$/MMBtu)	3.20	3.26	-1.8
Korea	2.75	Feb-25	0.65	Gold (\$/oz.)	3,203.7	3,230.7	-0.8
India	6.00	Apr-25	2.84	Copper (\$/MT)	9,479.0	9,119.3	3.9
Indonesia	5.75	Jan-25	3.80	Nickel (\$/MT)	15,454.4	15,344.9	0.7
Money Mkt Rates	16-May	-1 mth	Chg (bps)	CPO (\$/MT)	903.4	985.8	-8.4
SPN (1Y)	6.00	6.18	-18.5	Rubber (\$/kg)	1.77	1.72	2.9
SUN (10Y)	6.87	6.95	-8.2	External Sector	Mar	Feb	Chg (%)
INDONIA (O/N, Rp)	5.86	5.57	28.8	Export (\$ bn)	23.25	21.94	5.95
JIBOR 1M (Rp)	6.38	6.38	0.3	Import (\$ bn)	18.92	18.86	0.30
Bank Rates (Rp)	Feb	Jan	Chg (bps)	Trade bal. (\$ bn)	4.33	3.08	40.56
Lending (WC)	8.67	8.62	5.00	Central bank reserves (\$ bn)*	157.1	154.5	1.67
Deposit 1M	5.02	4.87	15.00	Prompt Indicators	Apr	Mar	Feb
Savings	0.68	0.68	0.00	Consumer confidence index (CCI)	121.7	121.1	126.4
Currency/USD	16-May	-1 mth	Chg (%)	Car sales (%YoY)	0.0	-5.1	2.2
UK Pound	0.753	0.756	0.39	Motorcycle sales (%YoY)	0.0	-7.2	4.0
Euro	0.896	0.886	-1.05	Manufacturing PMI	Apr	Mar	Chg (bps)
Japanese Yen	145.7	143.2	-1.71	USA	50.2	50.2	0
Chinese RMB	7.214	7.316	1.42	Eurozone	49.0	48.6	40
Indonesia Rupiah	16,440	16,815	2.28	Japan	48.7	48.4	30
Capital Mkt	16-May	-1 mth	Chg (%)	China	50.4	51.2	-80
JCI	7,106.5	6,441.7	10.32	Korea	47.5	49.1	-160
DJIA	42,654.7	40,369.0	5.66	Indonesia	46.7	52.4	-570
FTSE	8,684.6	8,249.1	5.28				
Nikkei 225	37,753.7	34,267.5	10.17				
Hang Seng	23,345.1	21,466.3	8.75				
Foreign portfolio ownership (Rp Tn)	Apr	Mar	Chg (Rp Tn)				
Stock	3,244.2	3,144.7	99.51				
Govt. Bond	899.7	1,071.4	-171.73				
Corp. Bond	5.1	5.2	-0.05				

Source: Bloomberg, BI, BPS

Notes:

Car and motorcycle sales data to be released on the third week of January 2022

^Data for January 2022

*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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