The price is right

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Samuel Theophilus Artha
samuel_artha@bca.co.id
Barra Kukuh Mamia
barra_mamia@bca.co.id
Lazuardin Thariq Hamzah
lazuardin_hamzah@bca.co.id

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Summary

- Covered Interest Rate Parity suggests that SBN yields are not currently overvalued, even as they approach historic lows.
- SBN valuation can be justified by low NDF premia, which in turn can be traced to decreased foreign ownership in bonds and successful BI intervention in the forward market.
- Low SBN yields may not benefit loan growth, as it comes at the cost of higher absorption of domestic liquidity into SBN.

- Investors around the world breathed a sigh of relief last week, as the surprise US bombing run into Iran's nuclear facilities did not materialize into another protracted war in the Middle East. Other than a small and symbolic attack on Al Udeid Air base, Iran's retaliation has been relatively muted. This prompted Trump to hastily announce a ceasefire between both sides, which so far has held up tenuously.
- This de-escalation was quickly followed by a sharp downturn in oil prices to a level even lower than on June 12 (with Brent crude down to USD 67.9/bbl). This crude decline combined with news of another Trump meddling into the Fed to push for lower rates led to perhaps one of the more risk-on mood in the markets since "Liberation Day".
- But therein lies the rub. The market now must turn its attention to the messy matter of tariffs, as the deadline of reciprocal tariff suspension looms on July 9. So far, Trump has failed to secure any trade deals other than with the UK and China. Instead, he has threatened to halt trade talks with Canada over Digital Services Tax, leading to its eventual scrapping, while other vague tariff threats and rumours swirl ominously. Still, there is a faint possibility of "flash deals" or another round of pause especially with major trading partners, as the deadline zooms closer.
- Another source of anxiety are the negotiations over the "Big Beautiful Bill", which has been modified by the Senate and will be subject to another House vote. While the oft-talked 'Section 899 tax' was removed from the bill; the still-high projected increase in fiscal deficit along with a potentially more dovish Fed Chairman in 2026 still adds a degree of uncertainty to longer-term Treasuries.

Theory vs. practice

- While the Indonesian stock market has had a difficult run during Trump's presidency with USD 3.2 Bn net outflow YTD, the SBN market has seen the opposite, helped by steady inflow of foreign investors amid the so-called "sell America" trade. Even more amazing was the fact that yields have been at an all-time low outside of the pandemic, with 10Y SBN at 6.6% as of this writing. In effect, Indonesian yield differentials against the UST has narrowed more compared to many other countries (see Chart 1).

- This narrow yield gap, however, might mean that SBN valuation are becoming unattractive — and that there is a risk of yields shooting upwards in the next few months. One possible way to tease out this risk is to test current SBN yields against Interest Rate Parity (IRP), which theorizes that any difference in nominal yields should be fully explained by the magnitude of expected currency movements. Although the strong version of this hypothesis — Uncovered Interest Rate Parity (UIP) — generally does not hold empirically, the weak version — Covered Interest Rate Parity (CIP) — does hold in real-world markets.
- Since CIP holds that hedging costs (which we can derive from the non-deliverable forwards/ NDF market) aligns with yield differentials, we can try to estimate "fair" SBN yields using NDF premia against the spot Rupiah (see Chart 2). The result shows, interestingly, that current yields align with currency hedging cost — that is, SBN are not being overvalued.
- More surprisingly, the result implies that SBN was undervalued prior to Sep-24 — at times, even suggesting that its yield should be almost equal to the corresponding UST. But while this would be welcome news for the government, this may jar with the common market sense that there is substantial risk premium attached to holding the SBN. What gives?
- Recall, of course, that CIP relies only on a single variable: NDF premia. This was usually 3% or higher (for 12M) prior to 2021 but has fallen sharply since. A possible driver of this decline was the reduced foreign ownership in SBN (see Chart 3), which implies lower volumes of carry trade and thus lower demand for IDR-USD hedging.
- This decline in NDF also coincided with its decoupling from the spot market. Historically, NDF premia are often extrapolations of recent movement in spot prices, as market participants may be spooked by recent volatility and thus sees greater value in hedging, at least temporarily (see Chart 4). However, starting in 2022, NDF premia have become far less sensitive to recent spot movements — even having a slight negative correlation.
- This structural break could be a sign that the market is now less jittery over the Rupiah — having more "rational" instead of "adaptive" expectations, so to speak — and expect the Rupiah to mean-revert after a period of depreciation. Absent this abrupt shift in market perceptions, however, a more likely explanation is BI's growing intervention in the forward markets.
- Recall that BI has become more assertive in recent years in its "triple intervention", i.e. on the spot, forward, and bond (SBN) markets. If this is true, then, the FX market interventions have the inadvertent effect of boosting SBN valuation, much more than would be expected in markets that are still spooked by Rupiah depreciation risks.

Price vs. volume

- Where does this leave Indonesia's bond market, then? For now, lingering anxieties on the Dollar combined with BI's May rate cut has left the SBN market in a strong footing, with a lower yield compared to budgetary assumption of 7%, which is quite impressive considering the frontloaded issuance early on this year. Moreover, the risk of a sudden spike in SBN yields (or a sudden outflow from SBN) remains low so long as BI maintain its current set of policies and interventions.

- The low SBN yields, unfortunately, may not directly translate to easier financial conditions in the banking sector. If low foreign ownership is a precondition to low NDF premia (and thus low yields), then it is achieved by transferring some of the SBN onto the balance sheets of domestic banks, households, and corporates. Consequently, this limits the volume of funds available for credit/money creation, even as it suppresses the price of these funds. In the big picture, then, this would limit the transmission of BI's recent rate cuts and delay its positive impact on GDP growth.

Glossary

- Non-Deliverable Forward = a contract between two parties to exchange the difference between actual and agreed upon price of a pair of currencies on a future date.
- Interest Rate Parity = a theory that the interest rate differential between two countries is equal to the difference between current exchange rate and future exchange rate.
- Uncovered Interest Rate Parity = a 'strong' version of IRP that suggests future currency movement aligns with interest rate differential between two countries.
- Covered Interest Rate Parity = a 'weak' version of IRP that suggests forward rate aligns with interest rate differential between two countries.

Chart 1

Rooting for the underdogs

Emerging markets have had a sharper yield differential drop post 'Liberation Day' compared to developed markets even as their currencies does not experience the same degree of appreciation.

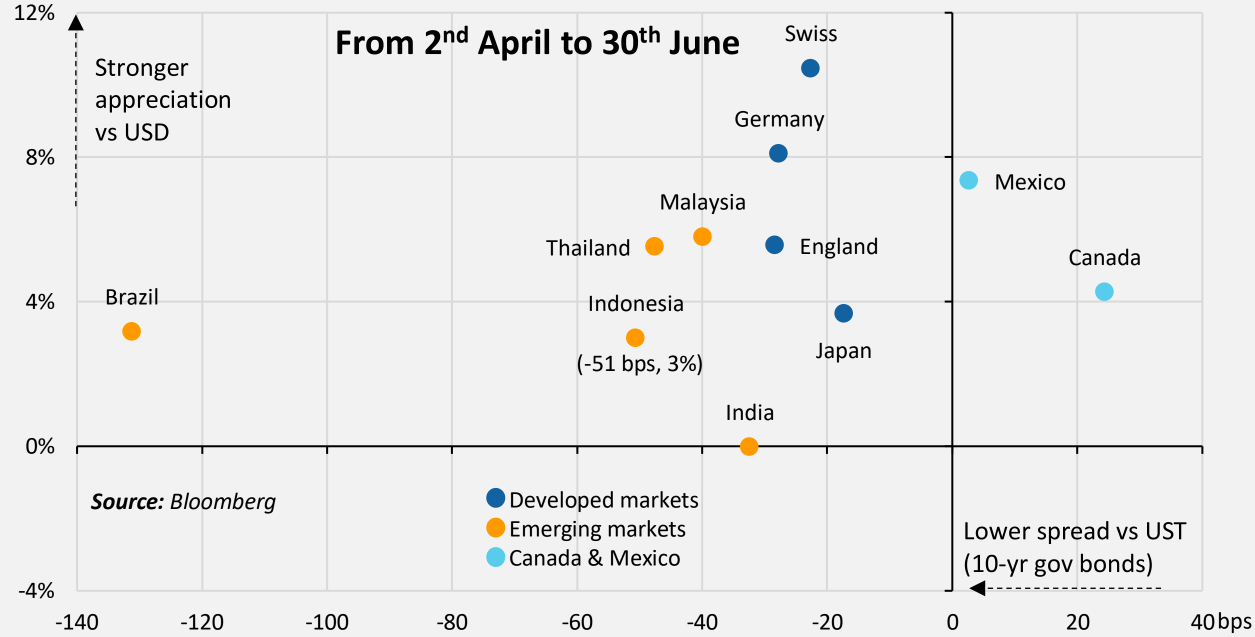


Chart 2

Correctly priced?

SBN might have been undervalued during 2022-24 but current yields are in line with Covered Interest Rate Parity.

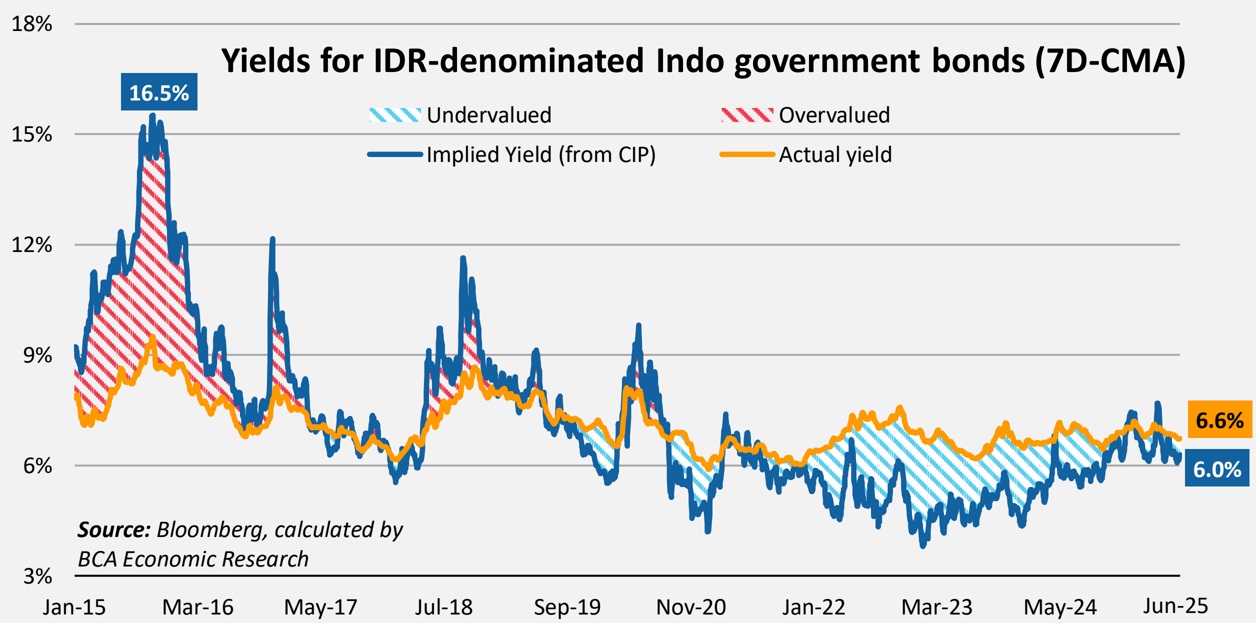


Chart 3

Running out of customers

Significant decrease in foreign ownership since 2020 may have dampened the demand for currency hedging, pushing down NDF spread.

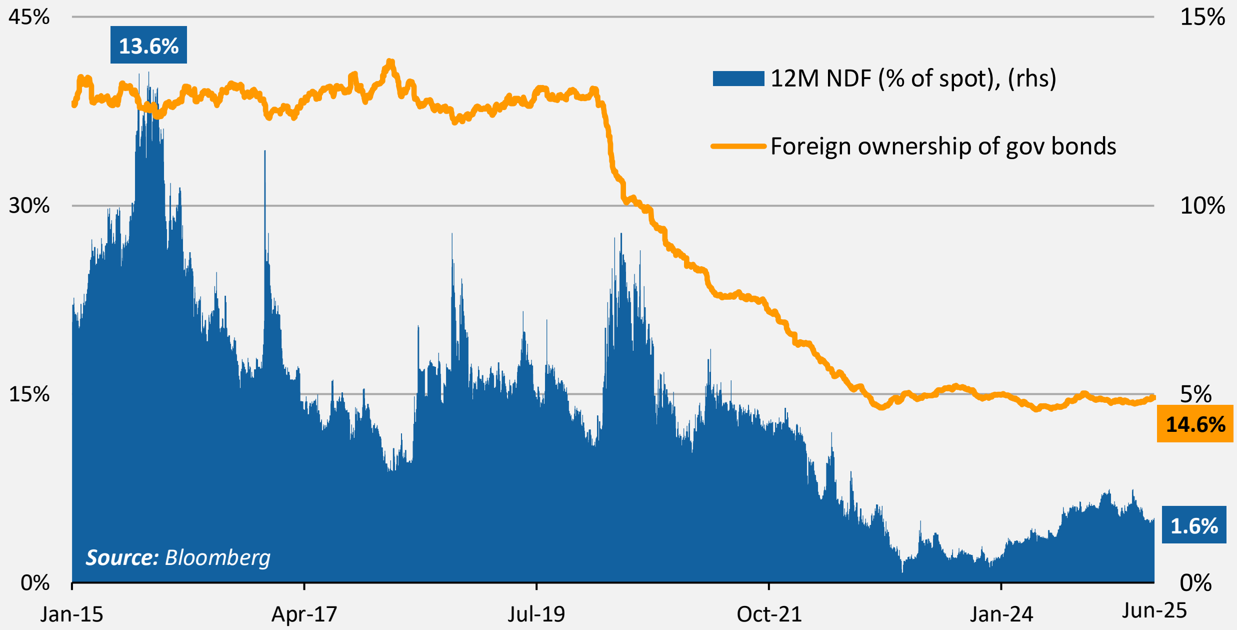
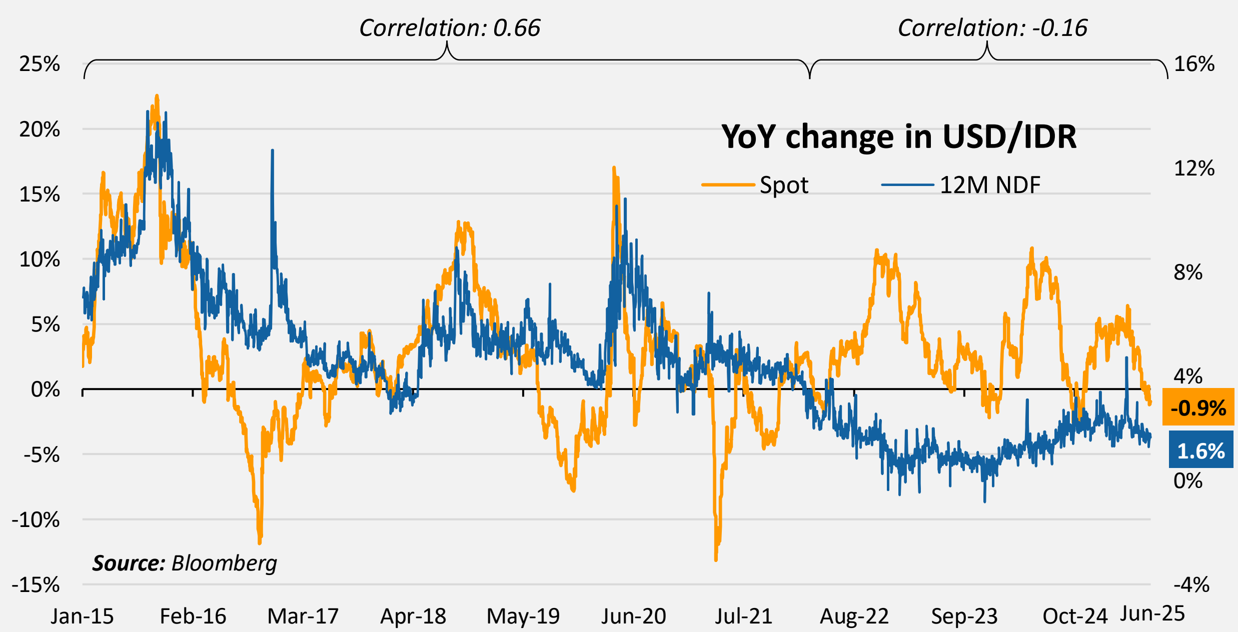


Chart 4

Conscious uncoupling

NDF premium used to be sensitive to spot depreciation, but has decoupled since 2022 perhaps in part due to BI intervention in the forward market



Economic Calendar

		Actual	Previous	Forecast*
02 June 2025				
ID	S&P Global Manufacturing PMI	47.7	46.7	48.3
ID	**Trade balance (Apr-25), USD Bn**	**0.15**	**4.33**	**3.1**
ID	**Inflation Rate YoY, %**	**1.6**	**1.95**	**1.9**
US	S&P Global Manufacturing PMI	52	50.2	52.3
05 June 2025				
US	Trade balance, USD Bn	-61.6	-138.3	-66.6
06 June 2025				
EA	Retail Sales YoY, %	2.3	1.9	1.1
US	Non Farm Payrolls, th	139	147	130.0
09 June 2025				
CN	Inflation Rate YoY, %	-0.1	-0.1	-0.2
CN	Trade balance, USD Bn	103.22	96.18	100.0
10 June 2025				
ID	**Foreign Exchange Reserves, USD Bn**	**152.5**	**152.5**	**-**
11 June 2025				
US	Inflation Rate YoY, %	2.4	2.3	2.5
ID	Car Sales YoY, %	-15.1	5.0	-
ID	Motorbike Sales YoY, %	-0.1	3	-
12 June 2025				
ID	Consumer Confidence	117.5	121.7	122.2
13 June 2025				
ID	Retail Sales YoY, %	-0.3	5.5	2.1
16 June 2025				
CN	Retail Sales YoY, %	6.4	5.1	4.7
17 June 2025				
US	Retail Sales YoY, %	3.3	5	4.9
18 June 2025				
ID	**BI-Rate Decision, %**	**5.5**	**5.5**	**5.5**
ID	Loan Growth YoY, %	8.43	8.88	8.8
19 June 2025				
US	**Fed Rate Decision, %**	**4.5**	**4.5**	**4.5**
23 June 2025				
ID	M2 Money Supply YoY, %	4.9	5.2	-
27 June 2025				
US	PCE Price Index YoY, %	2.3	2.2	2.2

*Some forecasts 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	4.25	May-25	0.85
EU	2.15	Jun-25	0.25
Japan	0.50	Jan-25	-3.00
China (lending)	2.00	Sep-24	4.45
Korea	2.50	May-25	0.60
India	5.50	Jun-25	2.68
Indonesia	5.50	May-25	3.90
Money Mkt Rates	**27-Jun**	**-1 mth**	**Chg (bps)**
SPN (1Y)	5.88	6.02	-13.6
SUN (10Y)	6.64	6.82	-17.1
INDONIA (O/N, Rp)	5.17	5.70	-53.6
JIBOR 1M (Rp)	6.15	6.15	0.0
Bank Rates (Rp)	**Mar**	**Feb**	**Chg (bps)**
Lending (WC)	8.66	8.67	-0.75
Deposit 1M	5.01	5.02	-0.47
Savings	0.68	0.68	0.16
Currency/USD	**27-Jun**	**-1 mth**	**Chg (%)**
UK Pound	0.729	0.740	1.55
Euro	0.853	0.883	3.44
Japanese Yen	144.7	144.3	-0.22
Chinese RMB	7.173	7.195	0.32
Indonesia Rupiah	16,205	16,273	0.42
Capital Mkt	**27-Jun**	**-1 mth**	**Chg (%)**
JCI	6,897.4	7,199.0	-4.19
DJIA	43,819.3	42,343.7	3.48
FTSE	8,798.9	8,778.1	0.24
Nikkei 225	40,150.8	37,724.1	6.43
Hang Seng	24,284.2	23,382.0	3.86
Foreign portfolio ownership (Rp Tn)	**May**	**Apr**	**Chg (Rp Tn)**
Stock	3,435.7	3,244.2	191.47
Govt. Bond	926.3	995.6	-69.37
Corp. Bond	5.2	5.1	0.08

Trade & Commodities	27-Jun	-1 mth	Chg (%)
Baltic Dry Index	1,521.0	1,296.0	17.4
S&P GSCI Index	545.7	531.0	2.8
Oil (Brent, $/brl)	67.8	64.1	5.7
Coal ($/MT)	109.0	113.3	-3.8
Gas ($/MMBtu)	3.23	3.21	0.6
Gold ($/oz.)	3,274.3	3,300.9	-0.8
Copper ($/MT)	10,118.7	9,636.6	5.0
Nickel ($/MT)	15,059.7	15,214.2	-1.0
CPO ($/MT)	938.2	906.0	3.5
Rubber ($/kg)	1.66	1.74	-4.6
External Sector	**Apr**	**Mar**	**Chg (%)**
Export ($ bn)	20.74	23.25	-10.77
Import ($ bn)	20.59	18.92	8.80
Trade bal. ($ bn)	0.16	4.33	-96.33
Central bank reserves ($ bn)*	152.5	157.1	-2.94
Prompt Indicators	**May**	**Apr**	**Mar**
Consumer confidence index (CCI)	117.5	121.7	121.1
Car sales (%YoY)	-15.1	5.0	-5.1
Motorcycle sales (%YoY)	-0.1	-3.0	-7.2
Manufacturing PMI	**May**	**Apr**	**Chg (bps)**
USA	52.0	50.2	180
Eurozone	49.4	49.0	40
Japan	49.4	48.7	70
China	48.3	50.4	-210
Korea	47.7	47.5	20
Indonesia	47.4	46.7	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	4.8
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	2.0
BI Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00	5.00
SBN 10Y yield (%)	7.04	5.86	6.36	6.92	6.45	6.97	7.02
USD/IDR exchange rate (average)	14,141	14,529	14,297	14,874	15,248	15,841	16,350
USD/IDR exchange rate (end of year)	13,866	14,050	14,262	15,568	15,397	16,102	16,625
Trade balance (USD Bn)	-3.2	21.7	35.3	54.5	37.0	31.0	26.0

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

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

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

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

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

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

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

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

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

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

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