

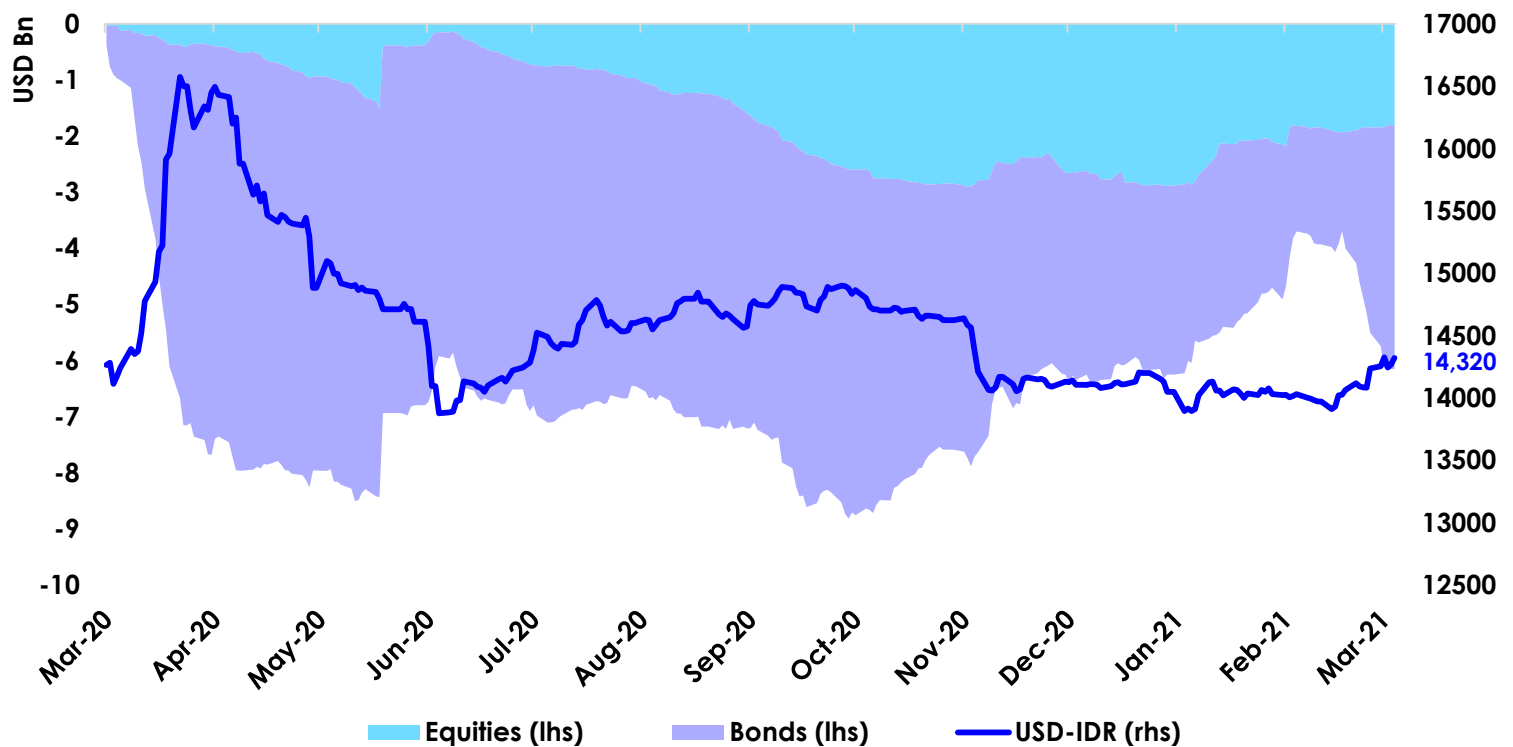
FX Reserves: US yield woes go international

Executive Summary:

- **Bank Indonesia's FX reserves were recorded at USD 138.8 Bn by the end of February, an increase of USD 0.8 Bn from January's figures.** This is a sharp decline from the USD 2.0 Bn increase in January, something driven by the recent spike in US Treasury yields and the market rout it triggered.
- While the inflation expectations undergirding the spike in yields may be appropriate for the US (with its relatively rapid vaccination rate), it may not hold true for other countries, where the timeline for recovery may be more drawn out.
- **These risks are particularly acute for emerging markets, where vaccinations are generally slower, and the possibility of an earlier than expected paring down of the Fed's policy measures.**

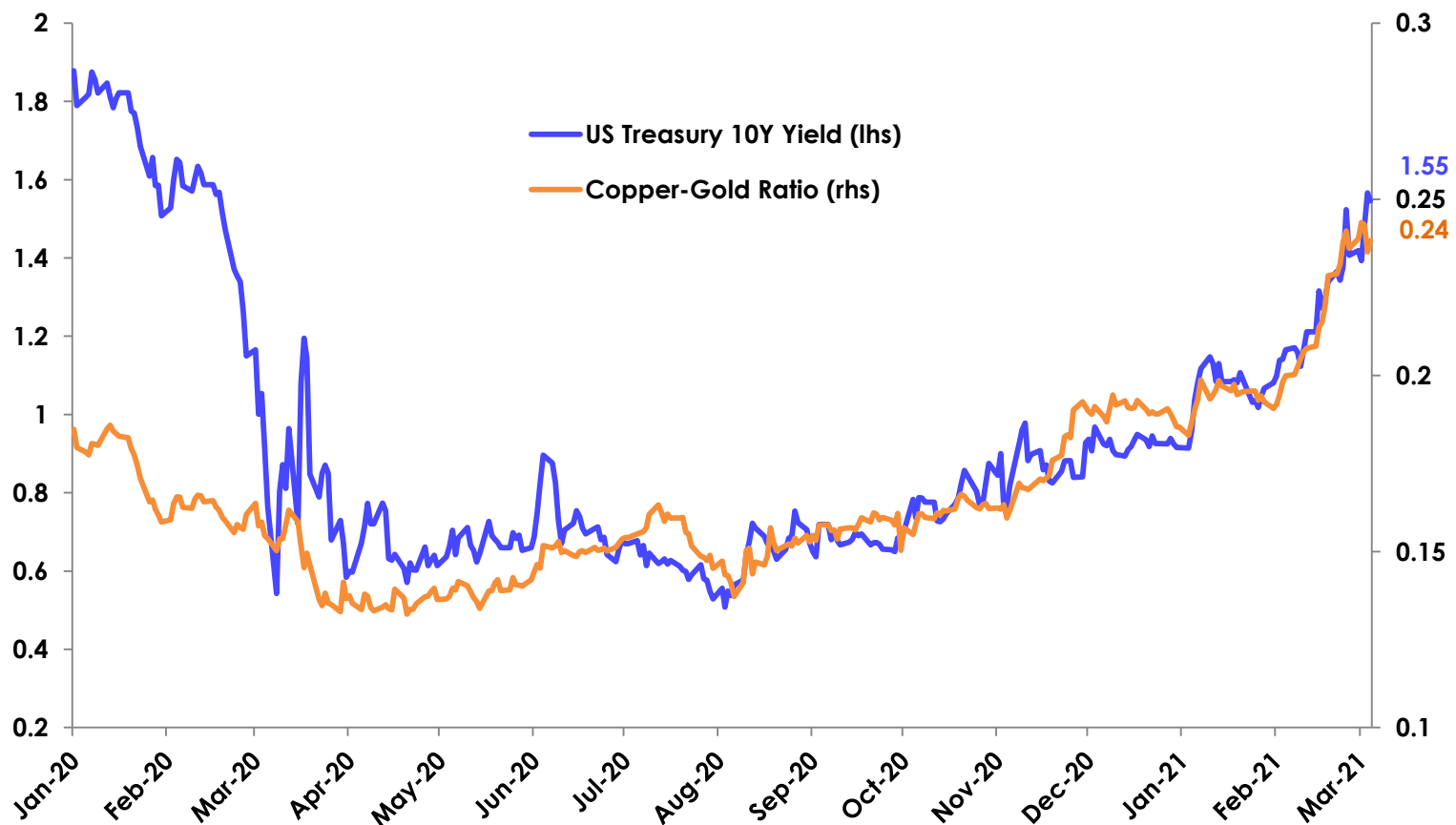
- **Bank Indonesia's FX reserves were recorded at USD 138.8 Bn by the end of February, an increase of USD 0.8 Bn from January's figures.**
- This however, is but a fraction of the large increases that took place over the past two months, where reserves rose over USD 2.0 Bn per month. **This decline comes as the vigorous market rally that had been underway for the past few months began to sputter out a few weeks ago.** The large capital inflows accumulated in January were almost entirely wiped out as foreign investors began to flee en masse in late February (**Chart 1**).
- **The key driver in all this of course, is the relentless rise in US Treasury yields over the past few weeks.** Rising inflation expectations, buoyed by projections of a post-vaccine surge in economic activity, was the primary impetus behind the sagging interest in US Treasuries (**Chart 2**). Add to this the fact that the supply of US Treasuries will likely get a significant boost with the Biden administration's looming 1.9 trillion dollar stimulus bill, and one is left with a market forced to juice up returns amidst expanding supply and sagging demand.
- In a way, rising yields were to be expected as the US economy begins to move out of its Covid slump. What appears to be giving markets the jitters however, is the rapid pace at which yields seem to be increasing. For its own part however, the Fed doesn't seem to see this as a problem just yet. **The current market rout, in its eyes, is nothing more than the healthy re-adjustment of various overvalued growth stocks which had reaped disproportionate gains during the pandemic.** As long as the current market correction doesn't spiral into a chaotic rout then, the Fed is likely to allow current market dynamics to play out naturally.
- This also partly explains why equities seem to be suffering even though broader confidence of economic recovery remains quite high (**Chart 2**). The sheer volume of funds that went into growth stocks during the pandemic far outweighs any reasonable number by which value stocks could reasonably go up by. Even as expectations of recovery boost appetite for value stocks, this is unlikely to compensate for the selloff in growth stocks.
- What may be nothing more than a natural re-adjustment for US markets however, could be something more malign for the rest of the world. Indeed, other central banks such as the ECB have sounded alarm over the relentless rise in Treasury yields, which have also driven up bond yields in other countries. **The key conundrum here is the fact that the US-centric expectations of inflation and recovery that are driving markets may not hold true for other countries.** A case in point is the divergence in the pace of vaccination between the US and other countries. And so while higher yields and inflation expectations may be appropriate for the US' timeline of vaccination and recovery, it risks driving up borrowing costs in those countries where mass vaccinations remain slow, recovery further off, and economic conditions still fragile.
- **These risks are particularly acute for emerging markets,** where the pace of vaccinations and the timeline for recovery appear to be generally lower than in their developed country peers. Where these risks may manifest most directly is in the form of capital outflows, as attested to by the recent outflows and weakening of the Rupiah in the past few weeks (**Chart 1**). Another risk factor for the Rupiah that must be borne in mind is the possibility of a shift in the Fed's policy timeline, particularly with regards to balance sheet tapering. Additionally, Fed Funds Rate Futures also suggest that the market's expectation of a rate hike sometime in 2023 has risen significantly (**Chart 3**). **And so while the broader sentiment over recovery remains strong, the possible incongruity in the US' and emerging market's timelines for economic recovery, and the emerging consternation in markets that these expectations are driving, is a key risk factor to look out for in the coming months.**

Chart 1. The recent market rout triggered foreign capital outflows that wiped out much of the inflows that occurred in January



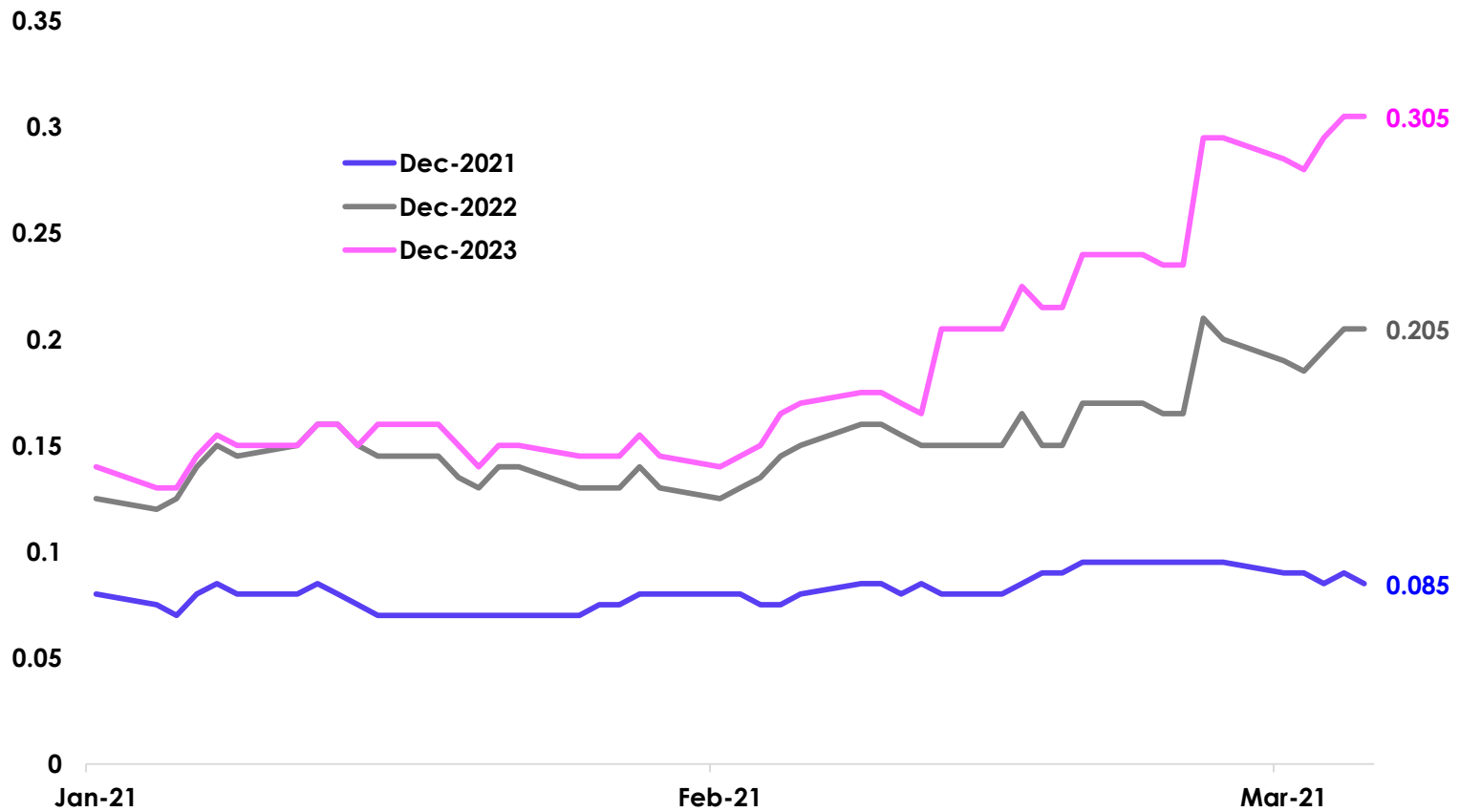
Source: Bloomberg (last update: 5 Mar 2021)

Chart 2. The concurrent increase in the copper-gold ratio indicates that the spike in US Treasury yields was driven by expectations of economic recovery and inflation



Source: Bloomberg (last update: 05 Mar 2021)

Chart 3. Fed Funds Rate Futures indicate that expectations of a rate hike sometime in 2023 has increased substantially



Source: Bloomberg (last update: 5 Mar 2021)

Indonesia – Economic Indicators Projection

	2016	2017	2018	2019	2020	2021E
Gross Domestic Product (% YoY)	5.0	5.1	5.2	5.0	-2.1	4.8
GDP per Capita (US\$)	3605	3877	3927	4175	3912	4055
Consumer Price Index Inflation (% YoY)	3.0	3.6	3.1	2.7	1.7	3.1
BI 7 day Repo Rate (%)	4.75	4.25	6.00	5.00	3.75	3.50
USD/IDR Exchange Rate (end of year)**	13,473	13,433	14,390	13,866	14,050	14,460
Trade Balance (US\$ billion)	8.8	11.8	-8.5	-3.2	21.7	10.1
Current Account Balance (% GDP)	-1.8	-1.6	-3.0	-2.7	-0.4	-1.8

** Estimation of Rupiah's fundamental exchange rate

Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	4-Mar	-1 mth	Chg (%)
US	0.25	Mar-20	-1.15	Baltic Dry Index	1,779.0	1,444.0	23.2
UK	0.10	Mar-20	-0.60	S&P GSCI Index	481.3	437.3	10.1
EU	0.00	Mar-16	-0.90	Oil (Brent, \$/bbl)	66.7	56.4	18.4
Japan	-0.10	Jan-16	0.50	Coal (\$/MT)	82.9	82.5	0.5
China (lending)	4.35	Oct-15	4.65	Gas (\$/MMBtu)	2.77	2.85	-2.8
Korea	0.50	May-20	-0.60	Gold (\$/oz.)	1,697.5	1,860.8	-8.8
India	4.00	May-20	-0.06	Copper (\$/MT)	8,932.8	7,805.6	14.4
Indonesia	3.50	Feb-21	2.12	Nickel (\$/MT)	16,088.5	17,816.3	-9.7
Money Mkt Rates	4-Mar	-1 mth	Chg (bps)	CPO (\$/MT)	964.5	964.2	0.0
SPN (1M)	2.52	2.65	-12.8	Rubber (\$/kg)	1.71	1.59	7.5
SUN (10Y)	6.56	6.13	42.2	External Sector	Jan	Dec	Chg (%)
INDONIA (O/N, Rp)	2.80	3.04	-24.1	Export (\$ bn)	15.30	16.54	-7.5
JIBOR 1M (Rp)	3.56	3.80	-24.1	Import (\$ bn)	13.34	14.44	-7.6
Bank Rates (Rp)	Dec	Nov	Chg (bps)	Trade bal. (\$ bn)	1.96	2.10	-6.7
Lending (WC)	9.21	9.32	-10.54	Central bank reserves (\$ bn)	138.0	135.9	1.55
Deposit 1M	4.22	4.45	-23.28	Prompt Indicators	Jan	Dec	Nov
Savings	0.86	0.87	-0.66	Consumer confidence index (CCI)	84.9	96.5	92.0
Currency /USD	4-Mar	-1 mth	Chg (%)	Car sales (%YoY)	-34.2	-34.4	-41.0
UK Pound	0.720	0.732	1.70	Motorcycle sales (%YoY)	-14.7	-45.1	-56.7
Euro	0.835	0.829	-0.75	Cement sales (%YoY)	-5.9	-12.6	-14.0
Japanese Yen	108.0	104.9	-2.82	Manufacturing PMI	Feb	Jan	Chg (bps)
Chinese RMB	6.470	6.468	-0.03	USA	60.8	58.7	210
Indonesia Rupiah	14,267	14,023	-1.71	Eurozone	57.9	54.8	310
Capital Mkt	4-Mar	-1 mth	Chg (%)	Japan	51.4	49.8	160
JCI	6,290.8	6,067.5	3.68	China	50.9	51.5	-60
DJIA	30,924.1	30,211.9	2.36	Korea	55.3	53.2	210
FTSE	6,650.9	6,466.4	2.85	Indonesia	50.9	52.2	-130
Nikkei 225	28,930.1	28,091.1	2.99				
Hang Seng	29,236.8	28,892.9	1.19				
Foreign portfolio ownership (Rp Tn)	Feb	Jan	Chg (Rp Tn)				
Stock	1,930.8	1,811.4	119.42				
Govt. Bond	971.4	987.3	-15.92				
Corp. Bond	28.4	29.3	-0.92				

Source: Bloomberg, BI, BPS

Notes:

*Previous data

For change in currency: **Black indicates appreciation against USD, **Red** indicates depreciation

***For PMI, > 50 indicates economic expansion, < 50 indicates contraction

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