Three potholes on Main Street

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Summary

- US consumer demand remains strong. However, the loosening labour market, the threat of re-escalating energy inflation, and tighter financing conditions mean that a drop in consumption level may be inevitable.
- A slowing US economy would be a net loss on Indonesia's book as reduced external demand would hit the domestic real sector while the prospect of capital inflow appears to be limited considering the "no cuts" outlook in 2023.
- Bank Indonesia may continue to use its dual tools of policy rate spread to protect the Rupiah's value and accommodative macroprudential policies to provide support for the domestic real economy.

- Consistent with the theme in 2023, multiple macroeconomic data released last week again sent out mixed signals. **On the strong side, demand from US consumers remains quite resilient**, as shown by the 7.6% YoY in PCE growth which is significantly higher than the data's 3.8% pre-pandemic average. The US economy's deepening goods trade balance last month (-92.9 Bn, -83.0 Bn in the previous month) also shows that US consumers' unyielding appetite to consume continues to benefit the global economy.

- US economic resilience is further underpinned by its hot labour market. The Mar-23 non-farm payroll data may run below expectation, nevertheless, the unemployment rate in the US continues to move southward to 3.5% (3.6% in Feb-23) albeit with a slight nudge in the labour force participation rate. The slight increase in the quits rate (2.9%, 2.8% in Jan-23) also indicates that workers in the US remain comfortable trading their job for something new, a trend especially apparent in the client-facing service sector.

- However, **despite this apparent resiliency, the US economy does not exactly have much upward potential.** Indeed, US consumers could be facing all three vices that characterise the Carterian economic malaise. The first one is the slow U-turn in the labour market. Low retention rates may continue to fuel nominal wage growth, but the downward trending weekly working hours show that employers are no longer shorthanded, suppressing workers' bar-gaining powers that may limit the prospect of further wage growth ***(see Chart 1)***. Indeed, the 0.3 decline in working hours demanded from workers had erased the March-23 wage growth by around 0.9%, a hit to US consumers' income.

- The second one is the persistently high inflation, driven by a spike in energy prices. Just like in the 1970s, OPEC is once again the thorn in the US

side, as evident from production cuts to the tune of 1.6 mn bbl/day announced last week. Granted, the now-weaker global oil demand means that production cuts may not send oil prices to the triple-digit level. But gasoline prices hovering above USD 3/gallon for a longer period is a scary sight for American consumers, who rely mostly on ICE-powered private vehicles for mobility. The creation of strategic petroleum reserves (SPR) is intended to limit the risk of this problem from ever occurring. However, considering the now-depleted SPR, **US consumers may continue to face a "higher-for-longer" outlook for gasoline prices, depressing disposable income for periods to come.**

- The third factor is a product of the second one, namely the higher interest rate. The present Fed rate may not be as high as it was in the 1970s. However, the 2022-2023 tightening episode marks the fastest transmission from the increase in the Fed rate to interest paid by *consumers* ***(see Chart 2)***. Indeed, a higher Fed rate dictates lending rates from mortgages to auto loans, eating a bigger portion of households' disposable income. This scenario is especially true for mortgages, in which payment is often a priority given residential property' unique role in a typical household's assets. Higher mortgage rates, then, mean that US consumers may need to look for another way to maintain their basic consumption basket, either through downtrading (opting for cheaper goods) or drawing their savings. Alas, **the dwindling saving rate shows that US customers are already leaving no stone unturned to finance even the most basic of their consumption basket**, which is also getting more expensive by the day thanks to persistent food inflation and the resurgent spectre of energy inflation.

"The higher-for-longer outlook may apply to interest rates and gasoline prices"

- Some economic commentators have noted that consumer loans (credit cards) may help consumers in the US maintain their consumption, especially during the recent high-spending season. Alas, this strategy may prove to be increasingly untenable, even outright dangerous. Interest rates on credit card plans in the US have already breached the 20% high-water mark in Feb-23, and **the need for banks to offer more attractive deposit rates while also maintaining profitability may translate to further tightening in financing conditions, completing the whole three sets of 70's-style malaise that may doom US consumers in periods to come.**

- Economic analysts often refer to the adage that the Fed will continue hiking rates until something breaks. The imploding banking sector may not be not enough to force FOMC members to follow this adage ***(see Chart 3)***, but **the wrecked Main Street may finally compel FOMC members to hang their hiking gear.** Deteriorating conditions in Main Street are often taken as good news for Wall Street, as the prospect of a re-opened liquidity faucet may propel the market back to the bull territory. However, such a prospect may not be the case for 2023. For one, **the labour market is still too tight to the Fed's liking** (FOMC members projected the year-end unemployment rate at 4.50%), opening the path for another 25bps rate hike in the upcoming meeting followed by a pause throughout the rest of the year. The bond market was also quick to downplay the prospect of FFR cuts in 2023, as evidenced by the short-lived post-FOMC meeting bull steepener ***(see Chart 4)***.

- The Fed may have signalled an end to its rate hiking campaign, but as shown during the 2023 banking crisis, the central bank is under no urgency to halt its policy normalisation campaign through QT (as seen in Chart 3). **The upcoming US economic slowdown, then, may have a limited impact on those in the financial market, especially in more peripheral markets such as Indonesia.** Indeed, inflows to Indonesia's domestic financial market have been dictated by the dominating sentiment in Wall Street, first by the soft Dec-22 CPI reading that gave birth to the "Fed pivot" sentiment early in the year and then by the imploding banking sector that revived such a sentiment.

- Now, **the prospect of a lower terminal rate for the FFR may limit the risk of capital flight, although the "no-cuts" outlook would also limit the potential for capital inflow** into the Indonesian economy. However, the Indonesian capital market is still facing net capital outflow risks, especially in the short term. Indeed, as is often the case in any other year, foreign investors tend to realise their gains in Q2, taking the profit elsewhere. Normalising commodity prices, and hence commodity exporters' revenue in 2023, may strengthen this temporal sell-off dynamics, or at the very least, trigger a rebalancing to other sectors listed in the market.

- **It is the domestic real sector that would be worst affected by the US economic slowdown.** Indonesian manufacturers often rely on American consumers (and European consumers, which is also in a bad shape) to export their products. Dwindling external demand, then, means that domestic manufacturers may be increasingly reliant on domestic consumers. Here**, the problem for Indonesian manufacturers is two-fold. First, the weakening USD would make imported goods cheaper for Indonesian consumers**, **erasing the attractive-ness of domestically-produced goods. Second, Indonesian consumers' demand also turns out to be rather underwhelming, as noted in our consumer transaction index (Intrabel BCA, *see Chart 5*).**

- **Bank Indonesia's policy option, then, is rather straightforward**. On the one side, despite the ebbing depreciation threat to the Rupiah, capital outflows risks may require BI to maintain a healthy policy rate differential against the Fed (which is expected not to cut rates in 2023). Meanwhile, the risk of slowing domestic consumption means that the central bank may not be afford to withdraw its policy support. Luckily, central bankers, including BI officials, are now adept at simultaneously using two policy tools. Hence, BI may need to maintain the BI7DRR at the present level for a prolonged period to provide a cushion for the IDR, while directing other tools such as macroprudential policies (or even the still-going operation twist) to encourage lending and thus consumption in the Real sector.

> ***"Domestic demand during the 2023 Ramadan period appears to be underwhelming so far"***

Chart 1

No overtime necessary

A tight labour market continues to fuel wage growth but lower demand for working hours limits the increase in US workers' disposable income

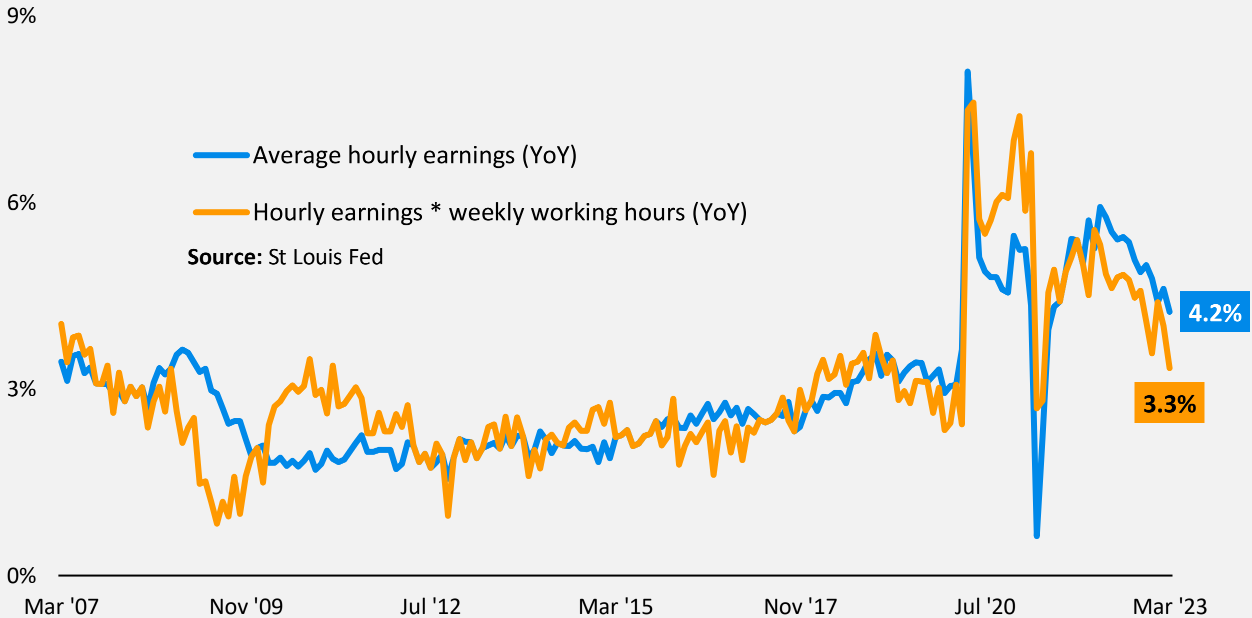


Chart 2

When interest comes due

A drop in consumption level may be inevitable amidst the tighter lending condition and higher interest payments as consumers prioritise loan repayment (especially mortgages) over other goods

Chart 3

An ebb after the flow

Fed balance sheet fell by USD 101.4 Bn as receding panics in the banking system and penalty rates discouraged further usage of the discount window while QT keeps marching on

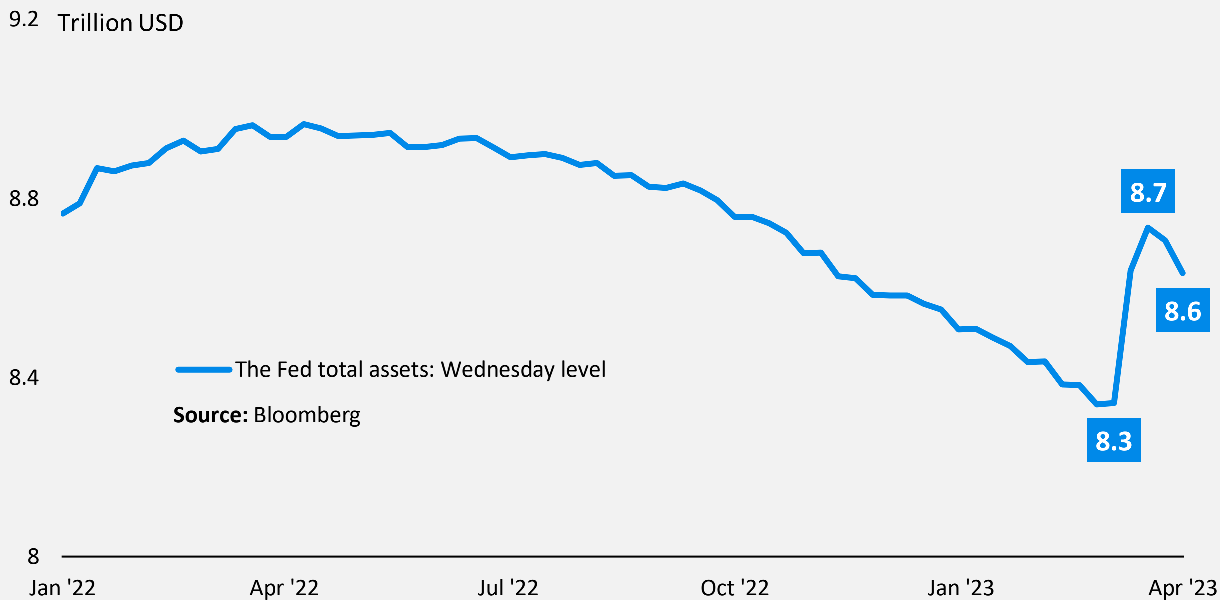


Chart 4

Bond traders say no cuts

The short-lived bull steepener means that the bond market remains sceptical about the prospect of a lower Fed rate in 2023

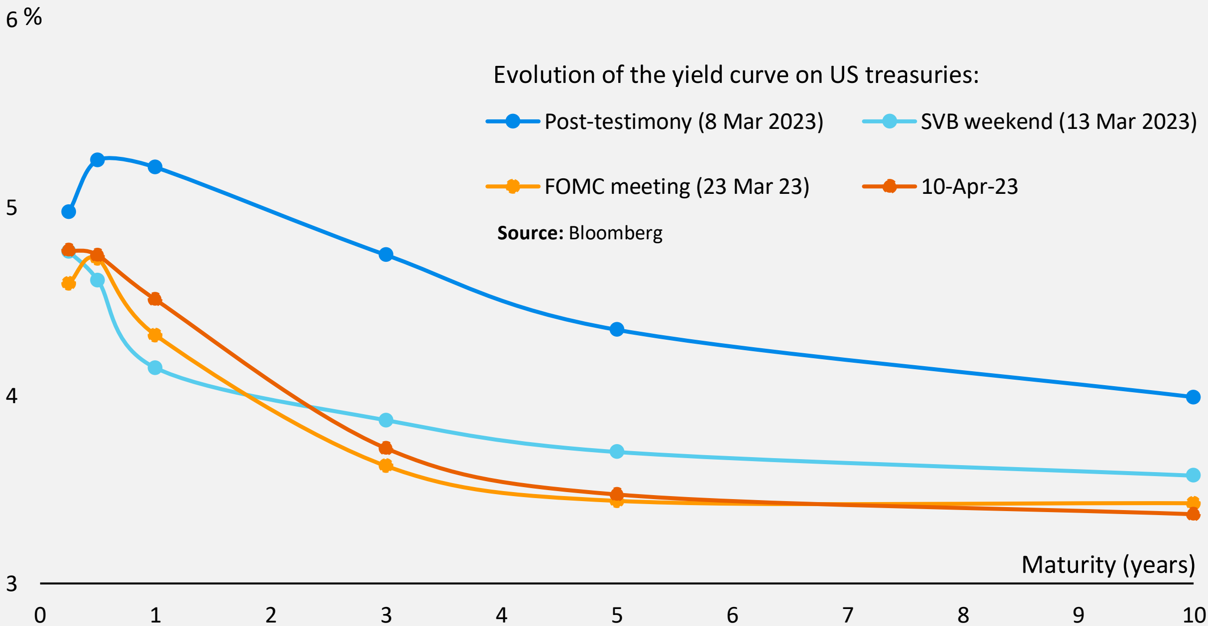
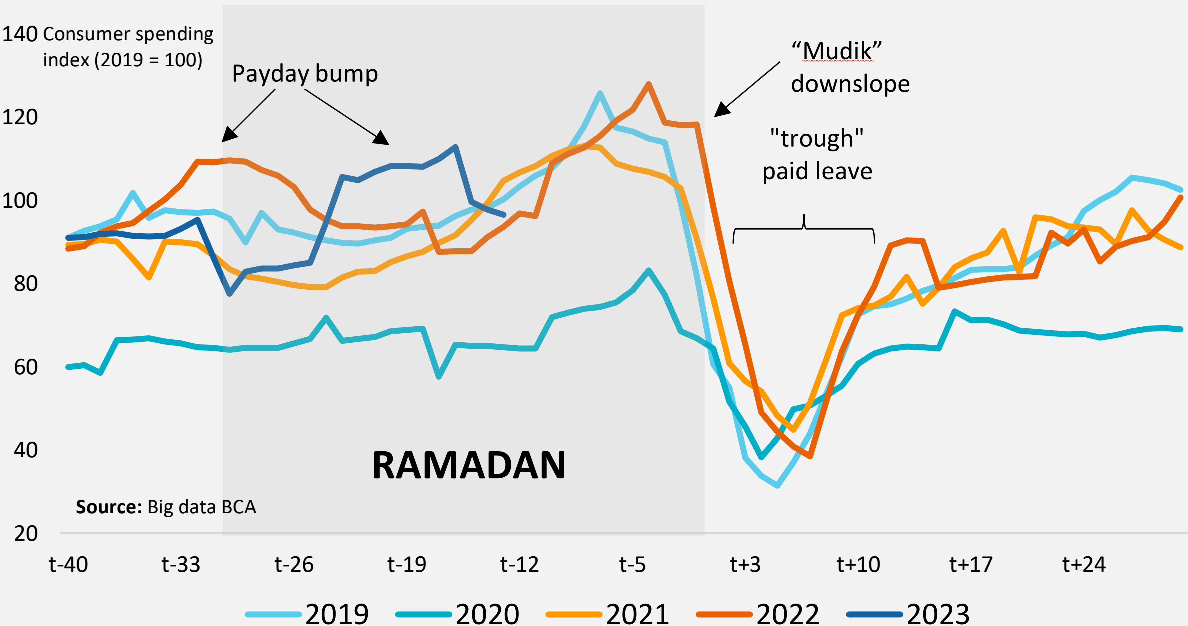


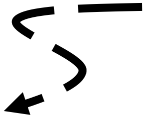
Chart 5

Fasting means managing appetites

Ramadan in 2023 appears to be less busy shopping-wise compared to the last year as normalising commodity prices and higher inflation deflate purchasing power



Source: Big data BCA



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Economic Calendar

		Actual	Previous	Forecast*
3 April 2023				
ID	S&P Global Manufacturing PMI	51.9	51.2	50
ID	**Inflation Rate (YoY)**	**4.97%**	**5.47%**	**5.3%**
US	ISM Manufacturing PMI	46.3	47.7	49
5 April 2023				
US	Balance of Trade (USD Bn)	-70.5	-68.7	-69.0
US	ISM Non-Manufacturing PMI	51.2	55.1	54
7 April 2023				
ID	**Foreign Exchance Reserves (USD Bn)**	**145.2**	**140.3**	**141.0**
11 April 2023				
CN	Inflation rate YoY	-	1%	2.0%
12 April 2023				
US	Inflation rate YoY	-	6%	5.8%
13 April 2023				
US	FOMC Minutes			
US	PPI YoY	-	4.6%	4.2%
CN	Balance of Trade (USD Dn)	-	116.88	49
ID	Car Sales YoY	-	7.4%	-
17 April				
ID	**Balance of trade (USD Bn)**	**-**	**5.48**	**2.9**
18 April				
CN	GDP Growth Rate YoY	-	2.9%	3.2%
EA	Balance of Trade (EUR Bn)	-	-	-11.9
28 April				
ID	M2 Money Supply YoY	-	7.9%	-
EA	GDP Growth Rate YoY Flash	-	-1.8%	1.0%

*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	5.00	Apr-23	-1.00
UK	4.25	Apr-23	-6.15
EU	3.50	Apr-23	-3.40
Japan	-0.10	Jan-16	-3.40
China (lending)	4.35	Apr-23	3.35
Korea	3.50	Feb-23	-0.70
India	6.50	Feb-23	0.06
Indonesia	5.75	Mar-23	0.78

Money Mkt Rates	6-Apr	-1 mth	Chg (bps)
SPN (1M)	3.43	4.44	-101.4
SUN (10Y)	6.65	6.91	-26.6
INDONIA (O/N, Rp)	5.57	5.61	-3.8
JIBOR 1M (Rp)	6.40	6.40	0.0

Bank Rates (Rp)	Jan	Dec	Chg (bps)
Lending (WC)	8.75	8.60	14.94
Deposit 1M	4.00	3.95	5.05
Savings	0.67	0.67	0.03

Currency/USD	6-Apr	-1 mth	Chg (%)
UK Pound	0.804	0.832	3.45
Euro	0.916	0.936	2.26
Japanese Yen	131.8	135.9	3.15
Chinese RMB	6.873	6.932	0.86
Indonesia Rupiah	14,913	15,295	2.56

Capital Mkt	6-Apr	-1 mth	Chg (%)
JCI	6,792.8	6,807.0	-0.21
DJIA	33,485.3	33,431.4	0.16
FTSE	7,741.6	7,929.8	-2.37
Nikkei 225	27,472.6	28,237.8	-2.71
Hang Seng	20,331.2	20,603.2	-1.32

Foreign portfolio ownership (Rp Tn)	Mar	Feb	Chg (Rp Tn)
Stock	2,726.8	2,730.0	-3.23
Govt. Bond	818.5	804.3	14.21
Corp. Bond	12.0	12.4	-0.40

Trade & Commodities	6-Apr	-1 mth	Chg (%)
Baltic Dry Index	1,560.0	1,258.0	24.0
S&P GSCI Index	588.7	594.2	-0.9
Oil (Brent, $/brl)	85.1	86.2	-1.2
Coal ($/MT)	211.2	198.0	6.7
Gas ($/MMBtu)	2.18	2.46	-11.4
Gold ($/oz.)	2,007.9	1,846.9	8.7
Copper ($/MT)	8,806.8	8,893.3	-1.0
Nickel ($/MT)	22,657.0	24,204.0	-6.4
CPO ($/MT)	964.5	950.9	1.4
Rubber ($/kg)	1.32	1.38	-4.3

External Sector	Feb	Jan	Chg (%)
Export ($ bn)	21.40	22.32	-4.15
Import ($ bn)	15.92	18.44	-13.68
Trade bal. ($ bn)	5.48	3.88	41.15
Central bank reserves ($ bn)*	140.3	139.4	0.65

Prompt Indicators	Feb	Jan	Dec
Consumer confidence index (CCI)	122.4	123.0	119.9
Car sales (%YoY)	7.4	11.9	9.0
Motorcycle sales (%YoY)	56.3	38.6	24.6

Manufacturing PMI	Mar	Feb	Chg (bps)
USA	46.3	47.7	-140
Eurozone	47.3	48.5	-120
Japan	49.2	47.7	150
China	50.0	51.6	-160
Korea	47.6	48.5	-90
Indonesia	51.9	51.2	70

Source: Bloomberg, BI, BPS
Notes:
^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

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3	4.7
GDP per Capita (US$)	3927	4175	3912	4350	4784	5011
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	4.3
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,647
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	19.8
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-1.2

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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