

Keeping it cool amidst the heating debt-ceiling debacle

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Summary

- The Rupiah holds on to its strength despite the general decline in commodity prices last week, thanks to robust demand for Indonesian government bonds.
- The debt-ceiling alarm has led to a re-pricing in the market for short-tailed US Treasuries. But, the lack of similar price action in markets closer to the US shows that the US debt-ceiling crisis should have a neutral impact on faraway markets such as Indonesia.
- The Rupiah may be close to its ceiling given the expectation of sticky inflation in the US that may deflate the Fed pivot sentiment and the seasonal bump in external payments in the upcoming quarter.

- The Indonesian market continues to breeze along in the first week of May-2023. Slowing manufacturing activities in China may led to a retreat in commodity prices that sparked the sell-off in energy commodity stocks. But the USD 49.92 Mn outflow recorded last week is a soft blow, while the Rupiah's strengthening value portends a resilient foreign demand for Indonesian government bonds.
- Consistent with the theme in 2023, the relatively clear skies in the Indonesian market may be a special case given the gathering clouds in the global market, especially in the US market. US Treasury Secretary Janet Yellen again played the role of the messenger of bad news, breaking the news last week with a warning that the US government may run out of money by June 2023 (*see Chart 1*).
- Secretary Yellen's statement, of course, led to a re-pricing in the market for short-tailed treasury

securities. The most dramatic price action happened in the market for a 1-month treasury bill. Complications that may arise from a default event incentivise investors to put a premium on bonds that may mature before the dreaded X-date, resulting in a chimerical kinked inverted yield curve that has been a fixture in the past couple of months (*see Chart 2*). Now, the yield curve on US treasuries has returned to its familiar (in recessionary time) inverted form, as the prospect of the "June default" strips the 1-month US treasury bull out of its risk-free premium.

- Despite this rather dramatic price action in the US treasury market, many analysts remain adamant that the probability of a technical default is unlikely. Both parties have been open to the possibility of suspending the debt ceiling until 2024, effectively avoiding a default event in 2023 by extending the uncertainty to the next year. One analyst also cites that the bureaucratic process required to confirm a default may buy

time for US lawmakers to strike a deal. Still, inflows to money market funds show that the demand for risk-free assets remains urgent, which could force investors to look for alternatives outside the US treasury market. This development may explain the recent surge in gold prices, but gold's inelastic supply may force investors to look for other, relatively-safer bonds.

- The latter scenario may lead to the hype that the plight in the US bond market may benefit other markets, such as the Indonesian bond market. This hopeful scenario may draw legitimacy from two

“Despite its alarming headline, the 2023 episode of the debt-ceiling debacle may prove to be a non-event for the Indonesian market”

hypotheses. The first hypothesis is regarding Indonesia's growing status as an “emerging safe haven”. Indonesia's strong macroeconomic fundamentals may increase the attractiveness of Indonesian bonds amidst the uncertain US market, leading to inflows from foreign investors looking for relatively safe assets. However, as we argued in the earlier report on Q1 2023 GDP number, the weakening private sector impetus means that growth would be increasingly reliant on contribution from government spending. Higher government spending may translate to the expectation that the government would increase the supply of bonds, neutralising the prospect of lower yields through this safe haven channel.

- The other, equally hopeful hypothesis is derived from the portfolio substitution effect, which explains that outbidded investors may look for assets in other markets, which would eventually trickle down to Indonesia. However, we remain

sceptical that this argument would hold. For one, the portfolio substitution effect is famous during the QE period. Now, the Fed's QT campaign is ongoing, and despite the inflow to retail MMFs, the prospect of liquidity released from the US Treasury bill could match the downpours of QE could not be farther from the truth. Moreover, Secretary Yellen's statement also did not show any ripple effects on European short-term bonds,

signalling that Treasury bill investors are not rotating far from their home markets.

- The absence of significant price action in markets outside the US leads us to maintain the argument that the 2023 US debt-ceiling

episode is a non-event for the Indonesian market. Despite this conclusion, however, developments in Indonesia's debt market are not completely cut-off from the situation in the US market. The Indonesian market continues to benefit from the Fed pivot expectation, a trend that may continue for some other months as the prospect of a broader credit crunch in the US appears to widen the expectation gap between the market and the Fed (*see Chart 3*).

- Alas, the Fed pivot expectation may eventually taper off. The NY Fed's inflation expectation survey shows that consumers anticipate that inflation will remain sticky in the coming years, consistent with the Fed's “no-cut” outlook in 2023. Thus, the neutral outlook in the domestic bond market means that we may already see a ceiling in which the Rupiah would continue to appreciate, especially in Q2-2023 given the seasonal bump in external payments in the midpoint of the year.

Chart 1

Burning out cash

US Treasury continues to draw from its cash holdings as tax revenues dwindle amidst worsening real economic outlook

1200 USD Bn



Chart 2

Back to relative normalcy

The “June default” warning strips 1-month treasury bills’ risk-free status, normalising the yield curve as investors look for risk-free alternatives

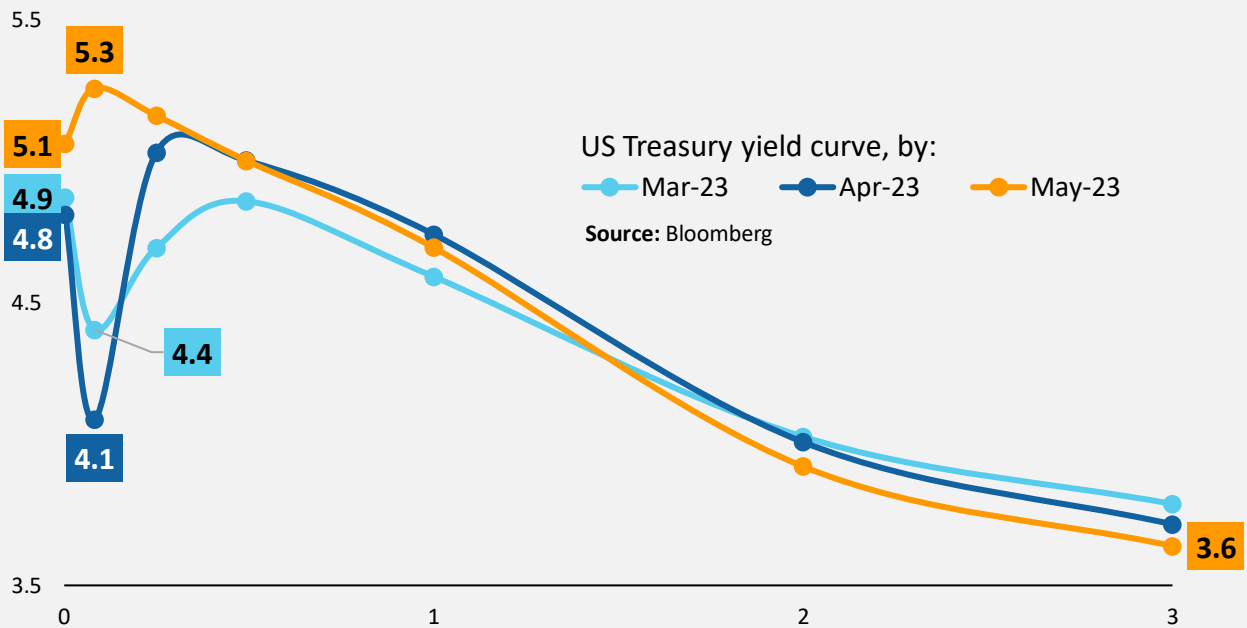
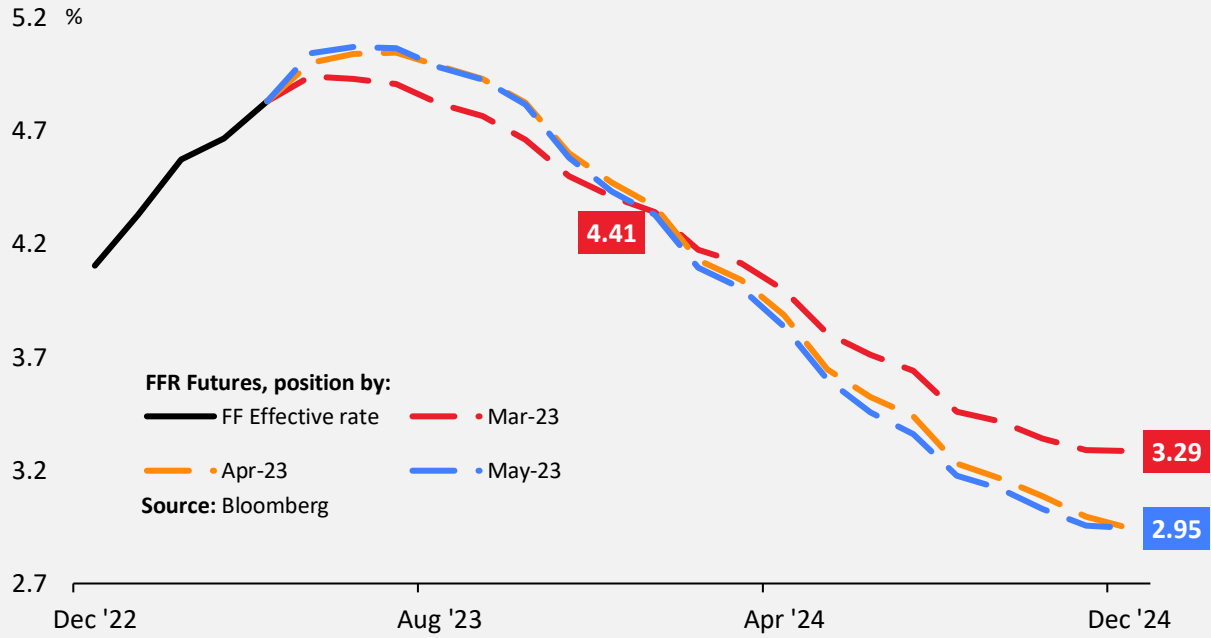


Chart 3

Battling expectations

Many in the market continue to price in a Fed pivot in 2023 as the banking crisis develops into a credit crunch. However, a sticky inflation reading may shift expectations closer to the Fed’s camp



Economic Calendar				
		Actual	Previous	Forecast*
1 May 2023				
US	ISM Manufacturing PMI	47.1	46.3	46.5
2 May 2023				
ID	S&P Global Manufacturing PMI	52.7	51.9	51.6
ID	Inflation Rate YoY	4.33%	4.97%	4.5%
EA	Inflation Rate YoY	7%	6.9%	6.9%
4 May 2023				
US	Fed Interest Rate Decision	5.25%	5%	5.25%
US	Balance of Trade (USD Bn)	-64.2	-70.5	-63.1
7 May 2023				
CN	Foreign Exchange Reserves (USD Bn)	3.205	3.184	3.19
8 May 2023				
ID	Foreign Exchange Reserves (USD Bn)	144.2	145.2	146.0
9 May 2023				
CN	Balance of Trade (USD Bn)	-	88.19	76.0
10 May 2023				
US	Inflation rate YoY	-	5%	4.9%
11 May 2023				
CN	Inflation rate YoY	-	0.7%	0.9%
15 May 2023				
ID	Balance of trade (USD Bn)	-	2.91	2.2
16 May 2023				
CN	Industrial Production YoY	-	3.9%	5.8%
EA	Balance of Trade (EUR Bn)	-	4.6	-12.7
18 May 2023				
ID	Motorbike Sales YoY	-	40.5%	-
19 May 2023				
ID	Car Sales YoY	-	2.6%	-
25 May 2023				
ID	Property Price Index YoY	-	2.0%	2.2%
ID	Loan Growth YoY	-	9.93%	1.0%

*Forecasts of some indicators are simply based on market consensus
 Bold indicates indicators covered by the BCA Monthly Economic Briefing report



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Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	5-May	-1 mth	Chg (%)
US	5.25	May-23	0.25	Baltic Dry Index	1,558.0	1,473.0	5.8
UK	4.25	May-23	-5.85	S&P GSCI Index	545.6	588.3	-7.3
EU	3.75	May-23	-3.25	Oil (Brent, \$/brl)	75.3	84.9	-11.3
Japan	-0.10	Jan-16	-3.30	Coal (\$/MT)	168.5	223.5	-24.6
China (lending)	4.35	May-23	3.65	Gas (\$/MMBtu)	1.85	2.13	-13.1
Korea	3.50	Apr-23	-0.20	Gold (\$/oz.)	2,016.8	2,020.4	-0.2
India	6.50	Apr-23	0.84	Copper (\$/MT)	8,560.3	8,740.3	-2.1
Indonesia	5.75	Apr-23	1.42	Nickel (\$/MT)	24,447.3	22,910.0	6.7
Money Mkt Rates	5-May	-1 mth	Chg (bps)	CPO (\$/MT)	914.9	964.6	-5.1
SPN (1M)	3.70	3.33	37.2	Rubber (\$/kg)	1.34	1.32	1.5
SUN (10Y)	6.42	6.71	-28.4	External Sector	Mar	Feb	Chg (%)
INDONIA (O/N, Rp)	5.51	5.56	-5.5	Export (\$ bn)	23.50	21.38	9.89
JIBOR 1M (Rp)	6.40	6.40	0.0	Import (\$ bn)	20.59	15.92	29.33
Bank Rates (Rp)	Feb	Jan	Chg (bps)	Trade bal. (\$ bn)	2.91	5.46	-46.78
Lending (WC)	8.89	8.75	13.80	Central bank reserves (\$ bn)*	145.2	140.3	3.48
Deposit 1M	4.18	4.00	17.94	Prompt Indicators	Mar	Feb	Dec
Savings	0.67	0.67	0.25	Consumer confidence index (CCI)	123.3	122.4	119.9
Currency/USD	5-May	-1 mth	Chg (%)	Car sales (%YoY)	2.6	7.4	9.0
UK Pound	0.791	0.800	1.08	Motorcycle sales (%YoY)	40.5	56.3	24.6
Euro	0.908	0.913	0.60	Manufacturing PMI	Apr	Mar	Chg (bps)
Japanese Yen	134.8	131.7	-2.29	USA	47.1	46.3	80
Chinese RMB	6.909	6.879	-0.44	Eurozone	45.8	47.3	-150
Indonesia Rupiah	14,675	14,900	1.53	Japan	49.5	49.2	30
Capital Mkt	5-May	-1 mth	Chg (%)	China	49.5	50.0	-50
JCI	6,787.6	6,833.2	-0.67	Korea	48.1	47.6	50
DJIA	33,674.4	33,402.4	0.81	Indonesia	52.7	51.9	80
FTSE	7,778.4	7,634.5	1.88				
Nikkei 225	29,158.0	28,287.4	3.08				
Hang Seng	20,049.3	20,274.6	-1.11				
Foreign portfolio ownership (Rp Tn)	Apr	Mar	Chg (Rp Tn)				
Stock	2,789.1	2,726.8	62.33				
Govt. Bond	822.9	818.5	4.38				
Corp. Bond	11.8	12.0	-0.20				

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	5.0
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	3.4
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	15,173
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	54.5	28.4
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-1.02

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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