# The 2023 debt ceiling negotiation: The epilogue

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**Summary**

- The US government reached an agreement to lift the debt ceiling without a nominal cap until 2025. Despite the lack of a nominal cap, the US government's ability to expand its fiscal commitments appears to be limited, suppressing the outlook for aggregate demand in the US.
- A potential increase in UST issuance may reveal the liquidity problem in the UST market and the banking sector, given the dwindling demand for UST from non-bank investors while UST bill issuance may crowd out liquidity from banks.
- The continued robustness in headline economic indicators appears to strengthen the DXY. However, the Rupiah may continue to be stable thanks to foreign investors' appetite for Indonesian financial assets.

- Discussions surrounding the X-date, which signifies the day at which the US government may exhaust its coffers to support its operations, remained a key focus for investors and macroeconomic observers during the past week. Fortunately, progress has been made in the negotiation to lift the US debt ceiling, with US President Biden and House Speaker Kevin McCarthy announcing a compromise agreement that would allow the US government to raise debt without a nominal limit until 1 January 2025.
- The Biden-McCarthy deal remains contingent on a congressional vote, which poses challenges considering the current landscape of American politics. However, despite the uncertainty surrounding the congressional vote, the news of a potential deal to address the ongoing debt ceiling debacle still reverberates well in the market, as evident from the rally in the S&P 500 observed last Thursday and Friday.
- Unfortunately, the uncertainty surrounding the debt ceiling deal extends beyond the question of whether it will pass Congress. **The potential consequences of the deal on the real and financial sectors (apart from the short-term oscillation in asset prices) remain unclear.** For instance, while the Biden-McCarthy deal will only reduce government spending by USD 50 Bn in this fiscal year, the debt ceiling agreement would restrict the ability of the US government to expand its discretionary spending in subsequent years, which may hit the disposable income of some households.
- Liquidity is another source of concern. The debt ceiling deal would allow the US

government to issue up to USD 1 Tn in new debt before the end of Q1 2023, which is important given the severely-depleted US treasury general account (TGA). **However, the size of the new debt pie may be too big for the market to swallow.** At present, demand for US treasuries appears to be on a decline. For instance, The Fed is actively seeking to reduce its balance sheet through quantitative tightening (QT), which reduces the demand for US treasuries although the central bank still refrained from selling the IOUs acquired during the QE period.

- The Demand for US treasuries from foreign holders has also shown some weakness ***(see Chart 1)***. The US government's tendency to use the USD as a tool in geopolitical conflicts has diminished demand for US treasuries from countries that are often seen as hostile to the US. Additionally, the Bank of Japan's potential exit from the yield curve control (YCC) policy could lead to an outflow from the US treasury market, given Japan's status as one of the largest foreign holders of US treasuries (Japan holds 14.36% of total foreign UST holdings in Mar-23, down from 16.16% in Mar-22).

- Granted, demand for UST from offshore financial centres (BBLUICS countries) remains considerably robust, up to 33.01% of total UST holding in Mar-23 compared to the pre-pandemic average of 17.28%. However, it is worth noting that demand from BBLUICS countries is often driven by yield considerations, meaning that the US treasury market may need to offer higher yields (relative to historical levels) to continue attracting demand from these offshore financial centres.

- As demand for US treasuries hit the speedbump, the US treasury market may become more reliant on banks to absorb the potential increase in supply. However, it is uncertain to what extent banks will be able and willing to absorb a larger amount of US treasuries. While US treasury bills currently offer slightly higher yields compared to the IORB (interest rate on reserve balances) paid by the Fed, banks may prioritise the safety and liquidity of holding reserves at the Fed. Banks may also prefer shorter-tailed treasury bills over longer-tailed treasury notes and bonds despite the same HQLA (high quality liquid asset) Level 1 classification, given the urgency to limit duration risks amidst the continued decline in bank deposits that threaten the liability side of a bank's balance sheet.

***"Banks may prefer UST bills over other treasuries despite the same HQLA classification"***

- Currently, UST bills are indeed an appealing option for banks. Not only does its short duration limit banks' exposure to duration risks, higher yields on UST bills compared to longer-tailed treasuries following the yield curve inversion further highlight UST bills' attraction. However, if the US government proceeds with issuing USD 1 Tn worth of treasuries within such a short period, this situation may change. **The substantial issuance amount of USD 1 Tn could exceed the capacity of the market for UST bills, prompting the US**

**government to issue debt with less-preferable maturities.**

- Moreover, the scenario where UST bills could continue to offer an attractive yield spread compared to other HQLA alternatives would not be cost-free either. Such a scenario may give rise to another liquidity concern, as the still-attractive yield on UST bills may crowd out liquidity from bank reserves towards the government's coffers ***(see Chart 2).*** This scenario may exacerbate the liquidity crunch within the US banking system, damaging the outlook for US aggregate demand that may hasten the coming of the next recession.

- Tighter financing conditions that may arise from the lifting of the debt ceiling are not entirely unfortunate. For instance, minutes from the latest FOMC meeting reveal that the prospect of a slowdown in consumer demand following the recent banking stress has allowed the Fed to take a more measured and data-dependent approach to monetary policymaking. But defeating inflation remains the Fed's primary target, and new research by Fed economists shows that **tighter financing conditions tend to generate less disinflationary effects compared to an outright tightening in monetary policy (Bundick et al., 2023).** Some FOMC officials remain keen on further interest rate hikes, with one FOMC member even communicating his preference for another 50 bps rate hike to confidently quell inflation.

***"Outright policy tightening generates more disinflationary effect compared to a tighter financing condition"***

- Apart from FOMC members' hawkish remarks, economic data released last week also provide little leeway for policy doves. The US labour market continues to display resilience, as demonstrated by the latest initial jobless claims data (229,000) that runs below economist expectations of 245,000. The most recent PCE data also highlight the strength of US consumer demand, with PCE inflation recorded a slight uptick to 4.4% YoY in Apr-23 (4.2% YoY previously).

- The uptick in PCE data may turn out to be a fluke, given the declining goods prices and the retreat in consumption for *services* ***(see Chart 3)***. But the combination of hawkish statements from Fed officials and the general robustness of headline economic indicators seem to have tempered the "Fed pivot" sentiment, as the market now assigns a 59.9% probability for a 25 bps rate hike in the upcoming Jun-23 FOMC meeting, followed by a 40.5% probability for another 25 bps rate hike in the subsequent meeting.

- Support for the "Fed pivot" sentiment may appear to diminish lately, but demand for risky assets (including Indonesian assets) remains quite robust. Foreign investors made a net purchase of USD 205.36 Mn last week, with USD 133.8 Mn flowing into the stock market thanks to its now-attractive valuations relative to other Asian stocks. The continued downturn in CDS and yield of Indonesian sovereign bonds also illustrate foreign investors' eagerness in buying into the "fortress Indonesia" story.

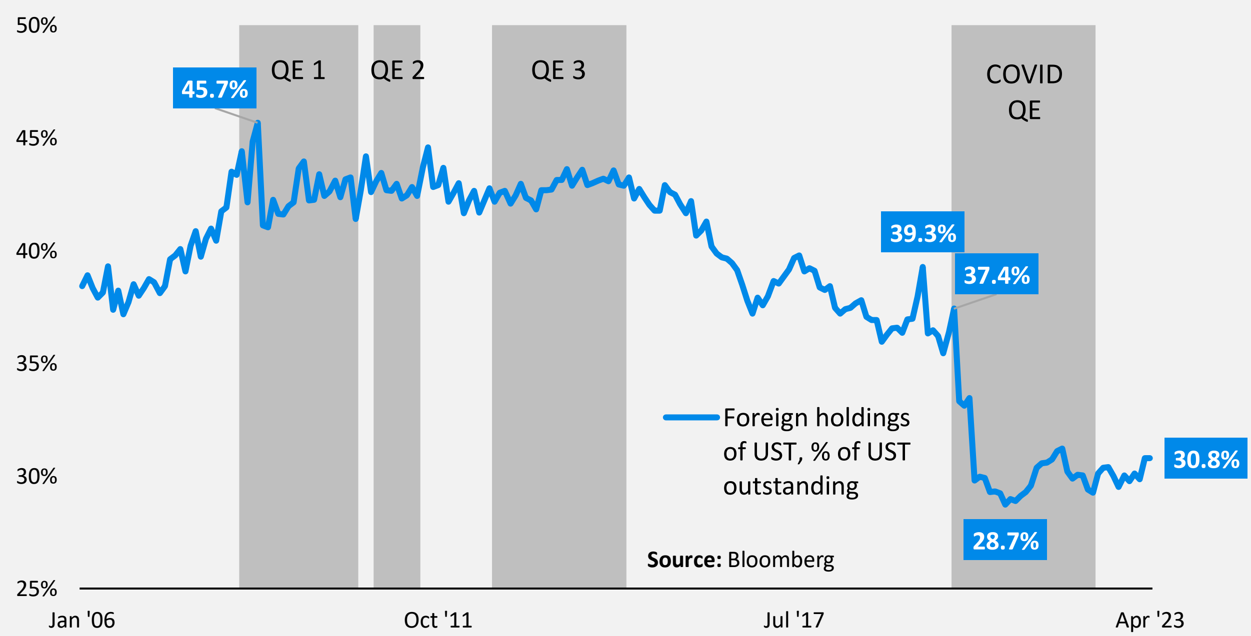
- Despite the notable inflow of foreign capital, the Rupiah continues to decline against the USD, which is quite atypical throughout the first four months of 2023 ***(see Chart 4)***. Currently, the currency is trading closer to its physical barrier of 15,000/USD rather than its 2023 peak of 14,670/USD recorded in early May-23. However, it is important to consider that this depreciation seems to follow the recent moderation in the "Fed pivot" sentiment, as the DXY also strengthens during the same period. The IDR's weakening value may also simply be a product of seasonal patterns, limiting the concern of underlying weaknesses in the IDR's fundamentals.
- Indeed, historical data indicates that Indonesia's external payments tend to increase in the middle of the year, which may lead to a higher demand for foreign currencies in Q2-2023. Fortunately, Bank Indonesia still have enough resources to stabilise the IDR's value, as demonstrated by the healthy level of FX reserves in Apr-2023. Thus, we maintain our stable outlook for the Rupiah, with BI maintaining its policy rate although some tinkering to macroprudential policies may be necessary to safeguard the outlook for domestic consumption.

***"The IDR's downward trend in may seem to be a product of strengthening DXY and seasonal pattern rather than underlying weaknesses"***

**Chart 1**

**Less diversity, less demand?**

The Fed's QT and lower demand from foreign investors mean that the US treasury market would be increasingly reliant on banks to absorb the supply of treasuries




**Source:** Bloomberg

Chart 2

**From one hole to another**

Higher yields on UST bills may crowd out liquidity from banks' reserve balance to the government's TGA, ending the government's cash crunch by exacerbating banks' liquidity crisis

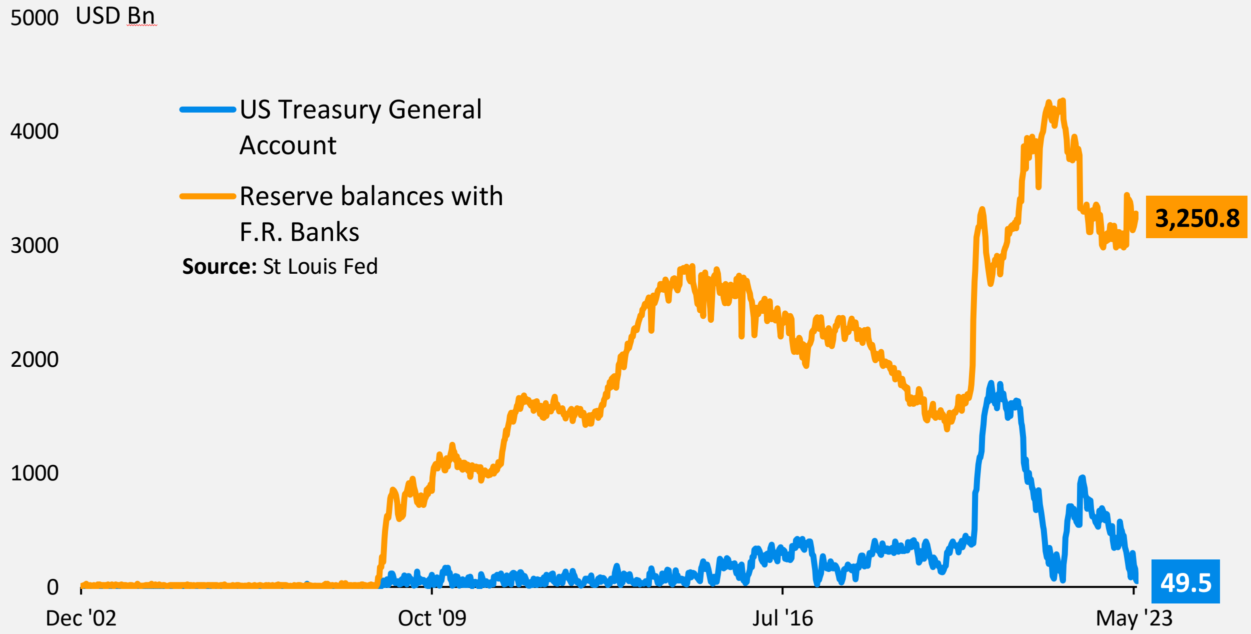



Chart 3

**General retreat**

Cheaper imports help to maintain consumption on durable goods but lower service consumption portends the general decline in US household consumptions

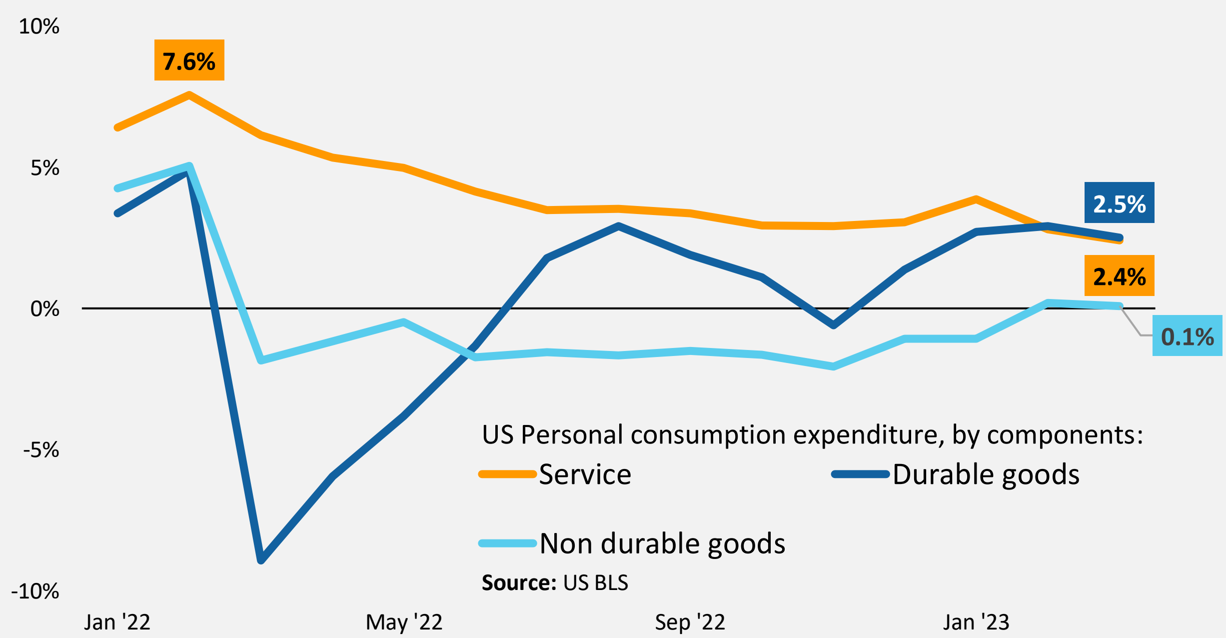
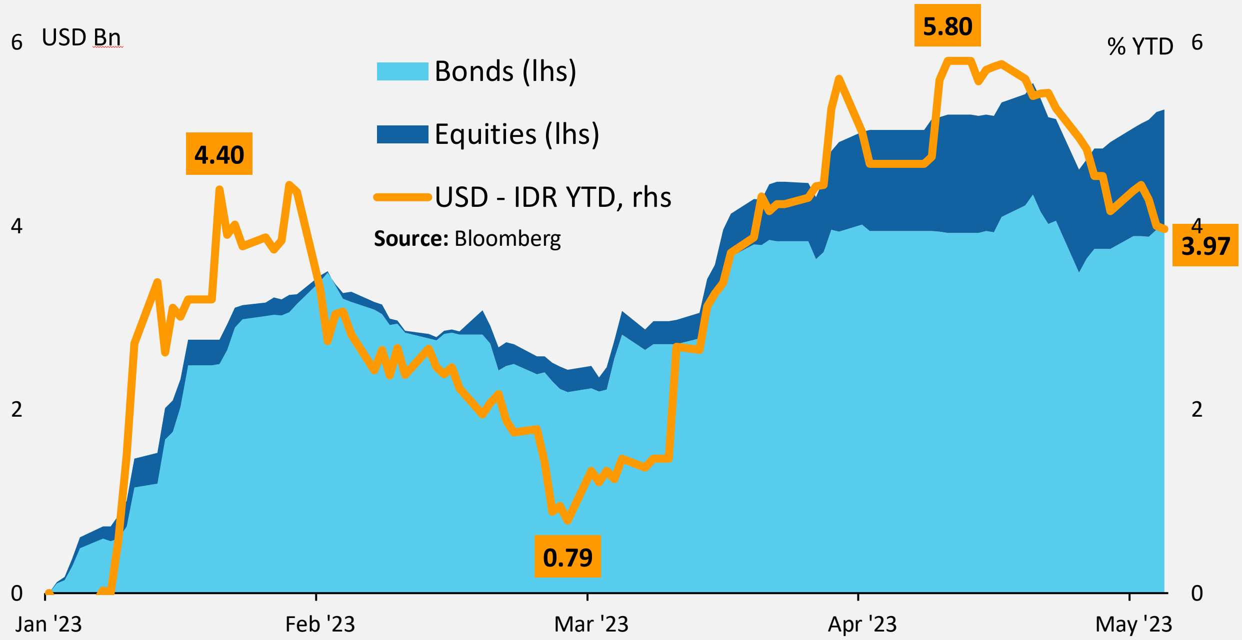


**Chart 4**

**A diverging trend**

The Rupiah continue to lose its steam despite substantial capital inflows, which may be attributed to the recent strengthening in DXY amidst increasing external payments.

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## 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% |
| 7 May 2023 | | | | |
| CN | Foreign Exchange Reserves (USD Bn) | 3.205 | 3.184 | 3.19 |
| 8 May 2023 | | | | |
| ID | Motorbike Sales YoY | -19.4% | 40.5% | - |
| **ID** | **Foreign Exchange Reserves (USD Bn)** | **144.2** | **145.2** | **146.0** |
| 9 May 2023 | | | | |
| CN | Balance of Trade (USD Bn) | 90.21 | 88.19 | 76.0 |
| ID | Consumer Confidence | 126.1 | 123.3 | 123 |
| 10 May 2023 | | | | |
| US | Inflation rate YoY | 4.9 | 5% | 4.9% |
| ID | Retail Sales | 4.9% | 0.6% | 1.4% |
| 11 May 2023 | | | | |
| CN | Inflation rate YoY | 0.1% | 0.7% | 0.4% |
| 15 May 2023 | | | | |
| **ID** | **Balance of trade (USD Bn)** | **3.94** | **2.83** | **3.2** |
| 16 May 2023 | | | | |
| CN | Industrial Production YoY | 5.6% | 3.9% | 9.8% |
| EA | Balance of Trade (EUR Bn) | 25.6 | 4.6 | -12.7 |
| 17 May 2023 | | | | |
| ID | Property Price Index YoY | 1.79% | 2.00% | 2.2% |
| 19 May 2023 | | | | |
| ID | Car Sales YoY | -28.8% | 2.6% | - |
| 25 May 2023 | | | | |
| ID | Loan Growth YoY | 8.08% | 9.93% | - |
| 29 May 2023 | | | | |
| ID | M2 Money Supply YoY | 5.5% | 6.2% | - |

*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 | 5.25 | May-23 | 0.35 |
| UK | 4.50 | May-23 | -4.20 |
| EU | 3.75 | May-23 | -3.25 |
| Japan | -0.10 | Jan-16 | -3.60 |
| China (lending) | 4.35 | May-23 | 4.25 |
| Korea | 3.50 | May-23 | -0.20 |
| India | 6.50 | Apr-23 | 1.80 |
| Indonesia | 5.75 | May-23 | 1.42 |
| **Money Mkt Rates** | **29-May** | **-1 mth** | **Chg (bps)** |
| SPN (1M) | 4.72 | 5.37 | -64.7 |
| SUN (10Y) | 6.38 | 6.51 | -13.3 |
| INDONIA (O/N, Rp) | 5.55 | 5.71 | -15.7 |
| JIBOR 1M (Rp) | 6.40 | 6.40 | 0.1 |
| **Bank Rates (Rp)** | **Mar** | **Feb** | **Chg (bps)** |
| Lending (WC) | 8.95 | 8.89 | 6.13 |
| Deposit 1M | 4.20 | 4.18 | 2.24 |
| Savings | 0.69 | 0.67 | 1.92 |
| **Currency/USD** | **29-May** | **-1 mth** | **Chg (%)** |
| UK Pound | 0.809 | 0.796 | -1.69 |
| Euro | 0.934 | 0.908 | -2.82 |
| Japanese Yen | 140.5 | 136.3 | -2.95 |
| Chinese RMB | 7.071 | 6.913 | -2.24 |
| Indonesia Rupiah | 14,970 | 14,670 | -2.00 |
| **Capital Mkt** | **29-May** | **-1 mth** | **Chg (%)** |
| JCI | 6,681.1 | 6,915.7 | -3.39 |
| DJIA | 33,093.3 | 34,098.2 | -2.95 |
| FTSE | 7,627.2 | 7,870.6 | -3.09 |
| Nikkei 225 | 31,233.5 | 28,856.4 | 8.24 |
| Hang Seng | 18,551.1 | 19,894.6 | -6.75 |
| **Foreign portfolio ownership (Rp Tn)** | **Apr** | **Mar** | **Chg (Rp Tn)** |
| Stock | 2,789.1 | 2,726.8 | 62.33 |
| Govt. Bond | 818.5 | 818.5 | 0.00 |
| Corp. Bond | 11.8 | 12.0 | -0.20 |

| Trade & Commodities | 29-May | -1 mth | Chg (%) |
|---|---|---|---|
| Baltic Dry Index | 1,172.0 | 1,576.0 | -25.6 |
| S&P GSCI Index | 546.9 | 565.0 | -3.2 |
| Oil (Brent, $/brl) | 77.1 | 79.5 | -3.1 |
| Coal ($/MT) | 140.7 | 187.6 | -25.0 |
| Gas ($/MMBtu) | 1.88 | 2.27 | -17.2 |
| Gold ($/oz.) | 1,943.2 | 1,990.0 | -2.4 |
| Copper ($/MT) | 8,106.0 | 8,577.0 | -5.5 |
| Nickel ($/MT) | 21,034.5 | 24,210.5 | -13.1 |
| CPO ($/MT) | 776.9 | 941.5 | -17.5 |
| Rubber ($/kg) | 1.32 | 1.34 | -1.5 |
| **External Sector** | **Apr** | **Mar** | **Chg (%)** |
| Export ($ bn) | 19.29 | 23.42 | -17.62 |
| Import ($ bn) | 15.35 | 20.59 | -25.45 |
| Trade bal. ($ bn) | 3.94 | 2.83 | 39.43 |
| Central bank reserves ($ bn)* | 144.2 | 145.2 | -0.68 |
| **Prompt Indicators** | **Apr** | **Mar** | **Dec** |
| Consumer confidence index (CCI) | 126.1 | 123.3 | 119.9 |
| Car sales (%YoY) | -28.8 | 2.7 | 9.0 |
| Motorcycle sales (%YoY) | -19.4 | 40.5 | 24.6 |
| **Manufacturing PMI** | **Apr** | **Mar** | **Chg (bps)** |
| USA | 47.1 | 46.3 | 80 |
| Eurozone | 45.8 | 47.3 | -150 |
| Japan | 49.5 | 49.2 | 30 |
| China | 49.5 | 50.0 | -50 |
| Korea | 48.1 | 47.6 | 50 |
| Indonesia | 52.7 | 51.9 | 80 |

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$) | 3927 | 4175 | 3912 | 4350 | 4784 | 5285 |
| Consumer Price Index Inflation (% YoY) | 3.1 | 2.7 | 1.7 | 1.9 | 5.5 | 3.4 |
| BI 7-day Repo Rate (%) | 6.00 | 5.00 | 3.75 | 3.50 | 5.50 | 5.75 |
| USD/IDR Exchange Rate (end of the year)** | 14,390 | 13,866 | 14,050 | 14,262 | 15,568 | 15,173 |
| Trade Balance (US$ billion) | -8.5 | -3.2 | 21.7 | 35.3 | 54.5 | 35.3 |
| Current Account Balance (% GDP) | -3.0 | -2.7 | -0.4 | 0.3 | 1.0 | -0.7 |

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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