

## Will Saudi's second strike haunts the US economy?

5 June 2023

Lazuardin Thariq Hamzah  
[lazuardin\\_hamzah@bca.co.id](mailto:lazuardin_hamzah@bca.co.id)

Barra Kuku Mamia  
[barra\\_mamia@bca.co.id](mailto:barra_mamia@bca.co.id)

### Summary

- Saudi Arabia announced the plan to cut oil production by 1 Mn bl/d in July 2023. No OPEC+ member follows the voluntary cut but the oil cartel looks set to reduce production quota by 3.34% in 2024.
- Saudi Arabia's production cut appears to have a limited impact on oil prices, given the declining global demand for oil prices. However, the further decline in oil supply may complicate the US government's effort to replenish the SPR.
- The dwindling SPR amidst the decline in the outlook for oil supply may results in another bout of energy inflation, exposing the US economy to a stagflation scenario.

- The Indonesian economy appears to be stepping into June 2023 on a strong footing. First, the financial market continued to breeze along last week, as evidenced by foreign capital inflows to the tune of USD 120.9 Mn recorded in the stock market despite the short trading week. These inflows into the Indonesian stock market reflect investors' confidence in the Indonesian economy, considering that the inflows occurred amidst the dissipating Fed pivot sentiment (**see Chart 1**) and the ossified global liquidity.
- Another early data release indicating the continued strength of the Indonesian economy is

the manufacturing PMI data, which was recorded at a still-expansionary 50.3 in May-2023, despite the decrease from 52.7 in the previous month. The key factor behind the drop in the PMI number is the weakening of new orders, which suggests a slowdown in domestic consumption. However, as noted in our previous reports, the potential slowdown in domestic consumption may not be too concerning, given the prospect of fiscal expansions in 2023-2023 and the still-open manoeuvring room for Bank Indonesia (BI) to stimulate the economy, perhaps through the relaxation of the reserve requirement ratio (RRR) policy.

### Oil prices and the reappearing spectre of a US stagflation

- The more eye-catching development, then, came from the energy-producing part of the global economy. Yesterday, Saudi Arabia made another

announcement regarding oil production cuts, this time amounting to 1 Mn bl/d. This reduction would result in the country's production falling

by 18.62% compared to the peak production level of 11.01 Mn bl/d recorded in September-2022.

- The news of another Saudi production cut did lead to an increase in oil prices. Brent prices, for instance, jumped by 3.14% to USD 74.23/bl following the announcement, before consolidating to around USD 73/bl. However, similar to the production cut in April-2023, Saudi's second voluntary production cut does not appear to be driven by an urgency to exert pressure or gain geopolitical advantages against oil-importing economies such as the US and Europe. Instead, it is mainly a response to the declining global demand (see Chart 2), which is consistent with expectations of an incoming global recession.
- Indeed, despite the still-strong headline economic indicators, the US (and global) economy appears to be edging closer to the brink of a slowdown (see Chart 3). The US economy may continue to showcase a robust labour market, as indicated by the non-farm payroll data of 339,000 in May-2023, which once again surpassed the consensus estimate of 190,000. But the tightening liquidity within the banking system, which have led to stricter lending standards that may hamper credit growth (see Chart 4), could eventually dampen the prospects for aggregate demand. The threat of slowing aggregate demand, of course, is significant given the consumer-driven structure of the US economy.
- Thus, despite the two rounds of voluntary production cuts by OPEC+ members in 2023, the weakening US (and global) demand, coupled with high inventories in China's warehouses, may contribute to a global deflationary slowdown in the short term. Economists are indeed forecasting that the US economy may officially

***"Despite the two rounds of OPEC+ production cuts, the global economy appears to be set on the path of a deflationary slowdown"***

enter a recession in late 2023 or early 2024, which could discourage FOMC members from introducing another 50bps rate hikes for the remainder of 2023.

- However, the "deflationary recession" scenario for the US economy may not hold for long. The US economy remains exposed to the spectre of stagflation, given the risk of spiking energy prices that have not completely disappeared. The main source of worry came from the dwindling strategic petroleum reserves (SPR), which are now down to the record low 355.44 Mn bl (equals 38.89 days of inventory) following the continued drawdown since November 2021. President Biden has announced the plan to replenish the SPR once prices fall within the range of USD 67-72/bl, which may reflect the new normal for oil prices in the current energy transition economy. However, OPEC+ members may have different plans.
  - Yesterday's announcement revealed OPEC+'s plan to cap production at 40.463 Mn bl/d in 2024, down from the current level of 41.866 million bl/d, signalling that supply tightening will indeed continue into next year. With the dwindling SPR and the tightening global oil supply, oil buyers may eventually need to compete with the US government to secure oil supplies. This competition could potentially lead to a spike in oil prices, resulting in renewed global energy inflation. The threat of stagflation may prompt FOMC members to consider adopting the playbook of former Fed Chair Volcker, which means the Fed may choose to prioritise tackling inflation first by significantly raising interest rates, crashing the economy to kill inflation.
- However, the outlook for oil prices remains highly uncertain. On the US side, the debt-ceiling agreement would make it easier for US shale

producers to obtain drilling permits. But the now-expensive funding costs may discourage them from expanding production. On the OPEC side, there is no guarantee that OPEC+ can sustain the level of cooperation needed to maintain tight control over oil prices, given the contrasting conditions between its two largest members, Saudi Arabia and Russia. We should note that much of the production cuts in 2023 were implemented by Saudi Arabia, while the USD 60/bl price cap on Russian oil provides no incentives for Russian oil producers to reduce output if oil prices continue to hover above the price cap. Thus, the breakdown in the relationship between OPEC+ members may help the US economy to avoid a stagflation scenario, which may allow the Fed to cut its policy rate once the US economy did fall into a “textbook” recession.

- The best scenario from the Indonesian perspective, however, is if the planned decline in OPEC+ production quota in 2024 aligns with the decrease in global demand, keeping oil prices within the USD 72-89/bl range observed throughout the first half of 2023. The government’s 2024 budget assumption, with oil prices assumed at USD 75-85/bl, appears to follow such a scenario. Indeed, oil prices moving

within the USD 75-85/bl range would reflect a goldilocks moment for the Indonesian economy. Firstly, the assumed oil price range reflects sustained demand for energy commodities, providing an important boost to the outlook of Indonesian exports and the government’s revenue.

- A stable oil price within the USD 75-85/bl range would also limit the risk of domestic energy inflation, as such a scenario would not significantly impact the government’s spending budget that may necessitate some adjustments to subsidised fuel prices. Consequently, such a scenario may not force the government to adjust its proposed 2.64% budget deficit for 2024, reflecting solid control over the government’s financing that should bode well for the outlook of Indonesian sovereign bonds.

***“Oil prices in the range of USD 75-85/bl present a goldilocks scenario for the Indonesian economy”***

Chart 1

### The market says no cut

The Fed pivot sentiment has now disappeared from the market following the strong headline inflation and labour market data in May 2023

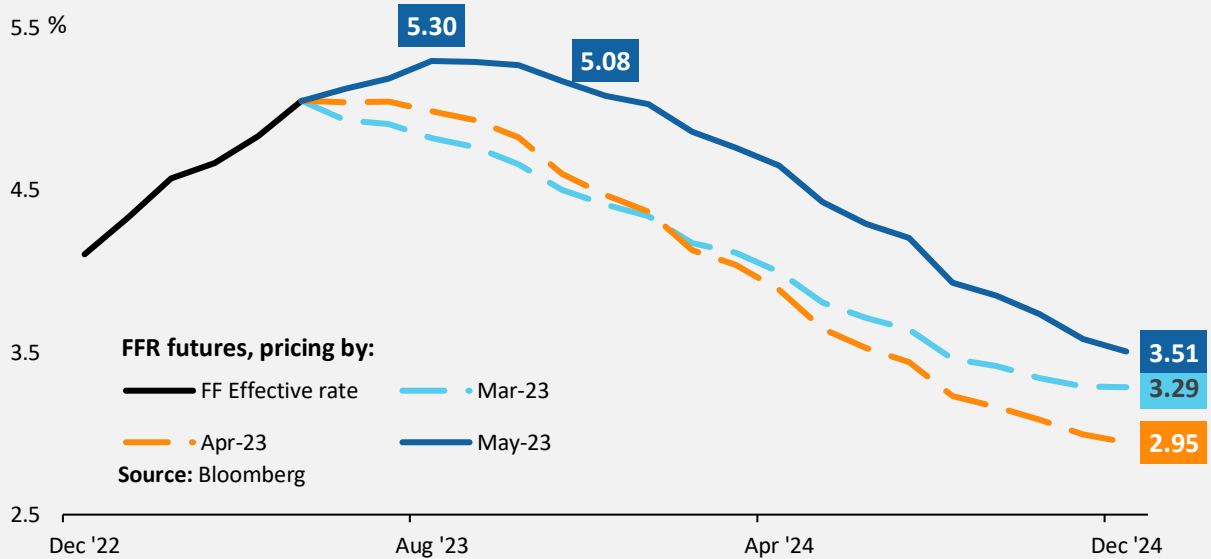


Chart 2

### Strictly business

Saudi Arabia's decision to voluntarily cuts oil production appears to be primarily driven by economic motives considering the supply glut in the global oil market

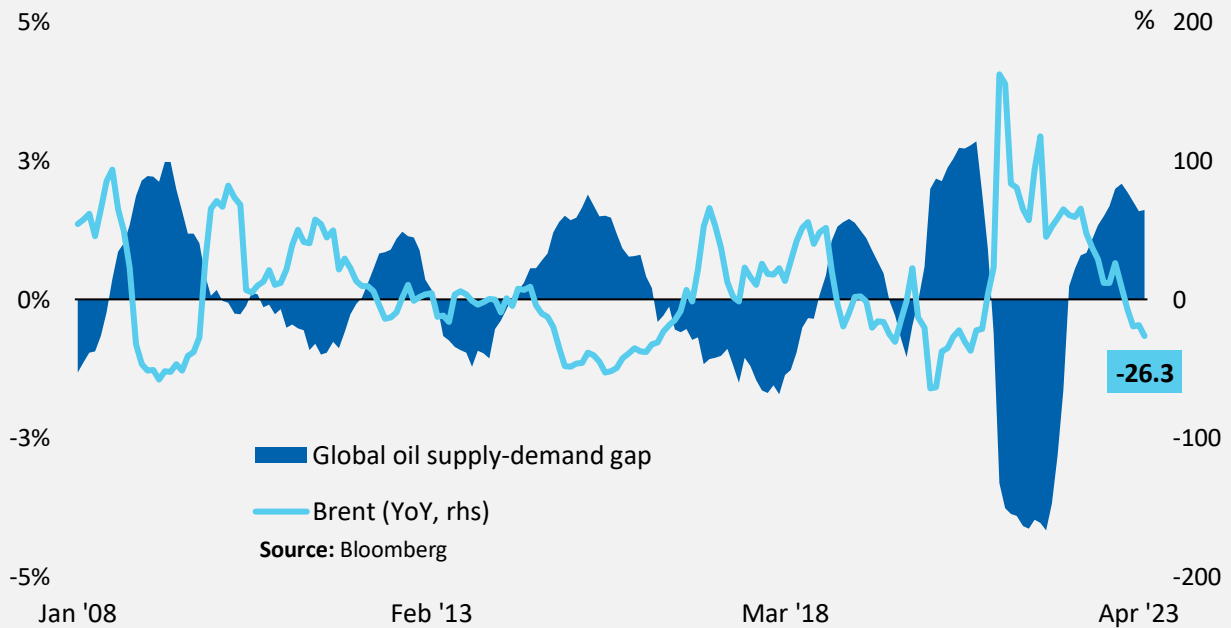


Chart 3

### Icebergs ahead

The declining global demand for oil reflects the expectation of an incoming US (and global) recession, which may come as soon as late-2023

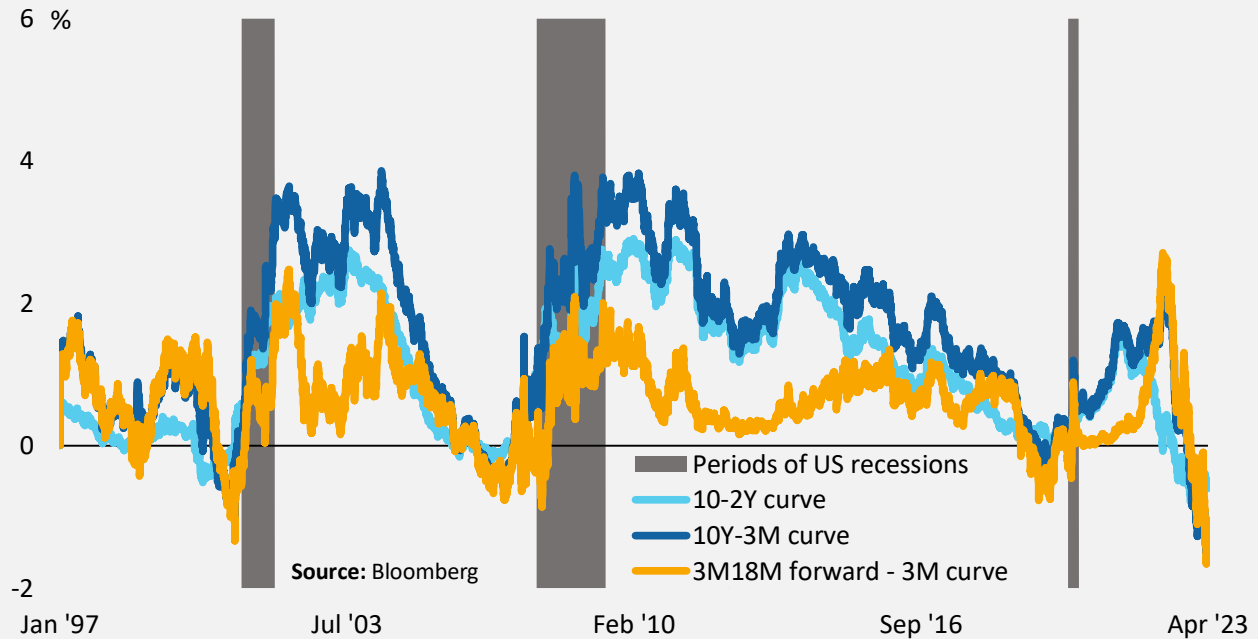
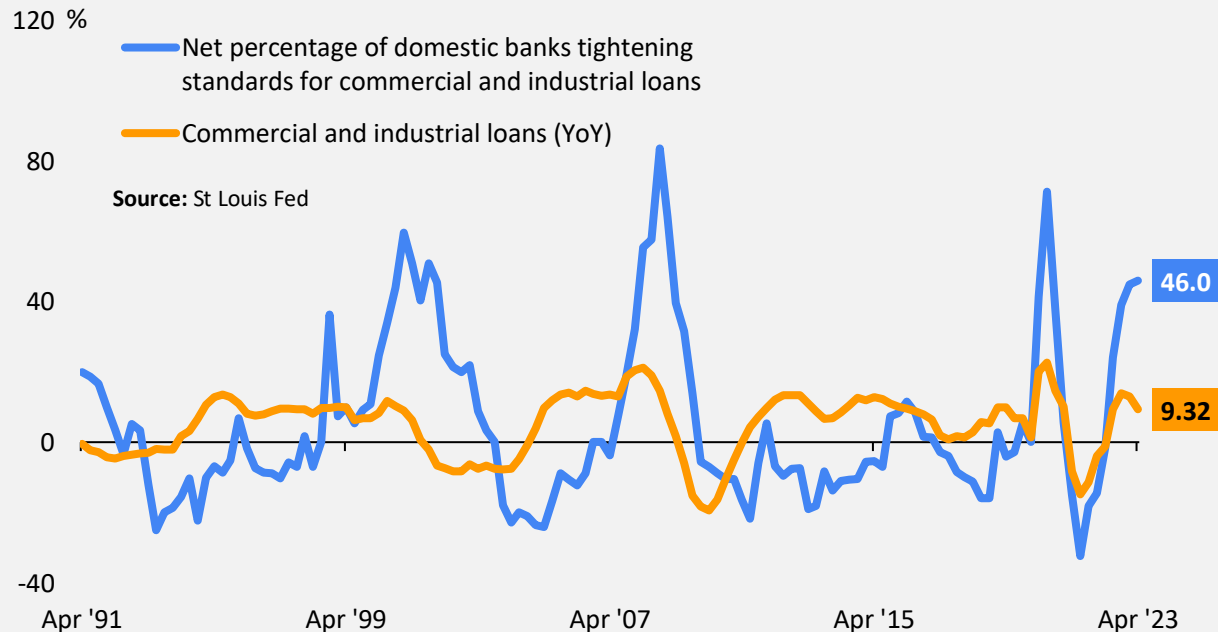


Chart 4

### Where the iceberg floats from

Despite the still-hot labour market, tightening credit conditions following the 2023 US banking crisis may curb US consumers' ability to maintain their consumption basket



Economic Calendar				
		Actual	Previous	Forecast*
1 June 2023				
US	ISM Manufacturing PMI	46.9	47.1	48
5 June 2023				
ID	S&P Global Manufacturing PMI	50.3	52.7	52.3
ID	<b>Inflation Rate YoY</b>	<b>4.0%</b>	<b>4.33%</b>	<b>4.2%</b>
7 June 2023				
CN	Balance of Trade (USD Bn)	-	90.21	91.0
ID	<b>Foreign Exchange Reserves (USD Bn)</b>	-	144.2	144.0
US	Balance of Trade (USD Bn)	-	-64.2	-78.2
9 June 2023				
CN	Inflation rate YoY	-	0.1%	0.2%
12 June 2023				
ID	Consumer Confidence	-	126.1	-
13 June 2023				
ID	Retail Sales	-	4.9%	-
US	Inflation rate YoY	-	4.9%	5.0%
14 June 2023				
ID	Car Sales YoY	-	-28.8%	-
15 June 2023				
US	Fed Interest Rate Decision	-	5.25%	5.25%
ID	<b>Balance of Trade (USD Bn)</b>	-	<b>3.94</b>	<b>3.2</b>
21 June 2023				
ID	Motorbike Sales YoY	-	-19.4%	-
22 June 2023				
ID	Loan Growth YoY	-	8.08%	-

\*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	31-May	-1 mth	Chg (%)
US	5.25	Jun-23	0.35	Baltic Dry Index	977.0	1,576.0	-38.0
UK	4.50	Jun-23	-4.20	S&P GSCI Index	528.2	565.0	-6.5
EU	3.75	Jun-23	-2.35	Oil (Brent, \$/brl)	72.7	79.5	-8.6
Japan	-0.10	Jan-16	-3.60	Coal (\$/MT)	135.3	191.6	-29.4
China (lending)	4.35	Jun-23	4.25	Gas (\$/MMBtu)	2.10	2.27	-7.5
Korea	3.50	May-23	0.20	Gold (\$/oz.)	1,962.7	1,990.0	-1.4
India	6.50	Apr-23	1.80	Copper (\$/MT)	8,070.0	8,577.0	-5.9
Indonesia	5.75	May-23	1.75	Nickel (\$/MT)	20,433.0	24,210.5	-15.6
Money Mkt Rates	31-May	-1 mth	Chg (bps)	CPO (\$/MT)	759.6	941.5	-19.3
SPN (1M)	4.33	5.37	-104.1	Rubber (\$/kg)	1.30	1.34	-3.0
SUN (10Y)	6.36	6.51	-15.4	External Sector	Apr	Mar	Chg (%)
INDONIA (O/N, Rp)	5.63	5.71	-8.4	Export (\$ bn)	19.29	23.42	-17.62
JIBOR 1M (Rp)	6.40	6.40	0.1	Import (\$ bn)	15.35	20.59	-25.45
Bank Rates (Rp)	Mar	Feb	Chg (bps)	Trade bal. (\$ bn)	3.94	2.83	39.43
Lending (WC)	8.95	8.89	6.13	Central bank reserves (\$ bn)*	144.2	145.2	-0.68
Deposit 1M	4.20	4.18	2.24	Prompt Indicators	Apr	Mar	Dec
Savings	0.69	0.67	1.92	Consumer confidence index (CCI)	126.1	123.3	119.9
Currency/USD	31-May	-1 mth	Chg (%)	Car sales (%YoY)	-28.8	2.7	9.0
UK Pound	0.804	0.796	-1.00	Motorcycle sales (%YoY)	-19.4	40.5	24.6
Euro	0.936	0.908	-2.99	Manufacturing PMI	May	Apr	Chg (bps)
Japanese Yen	139.3	136.3	-2.18	USA	46.9	47.1	-20
Chinese RMB	7.109	6.913	-2.76	Eurozone	44.8	45.8	-100
Indonesia Rupiah	14,993	14,670	-2.15	Japan	50.6	49.5	110
Capital Mkt	31-May	-1 mth	Chg (%)	China	50.9	49.5	140
JCI	6,633.3	6,915.7	-4.08	Korea	48.4	48.1	30
DJIA	32,908.3	34,098.2	-3.49	Indonesia	50.3	52.7	-240
FTSE	7,446.1	7,870.6	-5.39				
Nikkei 225	30,887.9	28,856.4	7.04				
Hang Seng	18,234.3	19,894.6	-8.35				
Foreign portfolio ownership (Rp Tn)	May	Apr	Chg (Rp Tn)				
Stock	2,738.1	2,789.1	-51.06				
Govt. Bond	830.0	822.7	7.29				
Corp. Bond	11.8	11.8	-0.01				

Source: Bloomberg, BI, BPS

Notes:

Car and motorcycle sales data to be released on the third week of January 2022

^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

### Economic, Banking & Industry Research Team

**David E.Sumual**

*Chief Economist*

david\_sumual@bca.co.id

+6221 2358 8000 Ext:1051352

**Victor George Petrus Matindas**

*Senior Economist*

victor\_matindas@bca.co.id

+6221 2358 8000 Ext: 1058408

**Keely Julia Hasim**

*Economist / Analyst*

keely\_hasim@bca.co.id

+6221 2358 8000 Ext: 1071535

**Arief Darmawan**

*Research Assistant*

arief\_darmawan@bca.co.id

+6221 2358 8000 Ext: 20364

**Agus Salim Hardjodinoto**

*Senior Industry Analyst*

agus\_lim@bca.co.id

+6221 2358 8000 Ext: 1005314

**Gabriella Yolivia**

*Industry Analyst*

gabriella\_yolivia@bca.co.id

+6221 2358 8000 Ext: 1063933

**Elbert Timothy Lasiman**

*Economist / Analyst*

Elbert\_lasiman@bca.co.id

+6221 2358 8000 Ext: 1074310

**Firman Yosep Tember**

*Research Assistant*

firman\_tember@bca.co.id

+6221 2358 8000 Ext: 20378

**Barra Kukuh Mamia**

*Senior Economist*

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

**Thierris Nora Kusuma**

*Economist / Analyst*

thierris\_kusuma@bca.co.id

+6221 2358 8000 Ext: 1071930

### PT Bank Central Asia Tbk

#### Economic, Banking & Industry Research of BCA Group

20<sup>th</sup> Grand Indonesia, Menara BCA

Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia

Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343

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