

US property sector: A different spectre

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Summary

- Higher interest rates and vacancies continue to drive delinquencies in the commercial real estate sector. The crisis in the CRE sector does not reflect the situation in the property sector as demand for CRE spaces shifts into demand for other types of property.
 - The US housing market may not suffer from a significant devaluation given the low supply of residential properties. Relatively-stable house values may help US consumers to sustain their consumption level.
 - Low housing supply may reverberate into the rental market, risking a rebound in rental prices that would strengthen the Fed's hawkish signal
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- The Indonesian manufacturing sector continued to expand in Jun-23, as indicated by the increase in the manufacturing PMI from 50.3 in May-23 to 52.5. This expansion, similar to previous months, was driven by domestic orders, while external demand continue to decline. Additionally, the Indonesian economy recorded a 3.52% inflation last month, lower than analysts' consensus of 3.62% YoY and will be discussed in detail in our monthly inflation report.
 - Meanwhile, the global economy continue to twist and turn over the past week. For instance, the third revision to the US GDP data (2.0% SAAR, previously 1.3%) revealed that the US economy was in much better shape than previously thought. This positive outcome could be attributed to resilient US consumers, who increased their consumption of services in Q1 2023, although consumption of goods (and consequently imports) continued to decline.
 - The unexpectedly strong performance of the US economy aligns well with the Fed's policy outlook, as the central bank continues to signal a further 50 bps increase to the policy rate in 2023. However, there are still sceptics who believe that the Fed's renewed hawkish signal is more rhetoric than action. They point to the increase in BTFP outstanding, which may signal the ongoing instability in the US banking system. However, it is important to note that this increase in BTFP outstanding happens at the same time as the decline in other credit facilities (**see Chart 1**), which suggests that the rise in BTFP balances is more reflective of the programme's attractiveness relative to other lending facility, rather than indicative of a deteriorating banking sector.

Bedlam in the property sector: A redux for GFC, or rental inflation?

- Another factor that contributes to concerns about ongoing stress in the US banking system is the downturn in the US property sector. The argument is straightforward: Higher interest rates decrease demand for property, which in turn suppresses property values (*see Chart 2*). The declining property values, of course, hold an emotional value for many in the market, as the memory of the 2007-2008 financial crisis is still fresh in the memory of many central bankers and market participants.
- Adding to the fear is the perfect storm facing the US commercial real estate (CRE) sub-sector. The widespread adoption of remote work (WFH) has diminished the demand for office spaces, while the rapid expansion of E-Commerce platforms turned off the lights in many retail spaces. Many CRE investors even opted to default on their bonds, projecting a bleak long-term outlook for office and retail spaces.
- However, **the downturn in the CRE sub-sector should not be interpreted as a precursor to an imminent economic meltdown similar to the one in 2008**. While the challenges faced by the CRE industry are significant, it is important to note that this situation can benefit other parts of the property market (*see Chart 6 – REITs' price-to-FFO ratio*). For instance, the shift to online shopping has reduced demand for retail spaces but increased the need for warehouses, benefiting industrial REITs.

"The downturn in the CRE sub-sector should not be interpreted as a precursor to an imminent economic meltdown"

Thus, while delinquencies in the CRE sector may continue rising, the stress is unlikely to spill over to the banking sector. As shown in Chart 3, REITs are generally well positioned, while many property analysts suggest that office properties make up only a small portion of the US (and global) REIT market.

- The question, then, is whether the trend in the US housing sector would mimic the trend in the CRE sector or those in industrial REITs. There is no denying that demand in the US housing market is cooling, given the higher mortgage rates and dwindling household liquidity. Fortunately, unlike in 2008, **the US**

housing market may fall on a shallow floor. Well aware of the experience in 2007-2008, the decade of ultra-easy policies in 2009-2019 has not translated into a construction boom (*see Chart 3*), which stands in

contrast to the boom in residential construction in the lead up to the global financial crisis.

- The supply conditions in the US property market are further constrained by the Fed's actions (*see Chart 5*). Rock-bottom interest rates during the pandemic allowed homeowners to refinance their mortgages (*see Chart 4*), helping them avoid foreclosures during the bleak COVID days. As a result, **many homeowners are now hesitant to sell their properties, given the opportunity costs of separating from their low-rate mortgages to take on a new, more-expensive mortgage.** The prevalence of

mortgage refinancing, of course, has made it difficult for banks to raise their lending rates to recover their NIM following the increase in deposit rates. However, **the prevalence of still-cheap mortgages may prevent US banks from entering a death spiral of declining property values and increased foreclosures that led to the crisis in 2007-2008.**

- The dearth of housing supply may strengthen the Fed's conviction to further tighten the financing condition in the US. **Relatively-stable residential property prices would allow US consumers to tap into their home equity, increasing their ability to sustain consumption.** A limited decline in housing prices is also unlikely to translate to a significant negative wealth effect that may entice US consumers to stop consuming and start saving.
- Another, more direct argument is **that the limited housing supply could reverberate into the rental market**, which is a significant component of US CPI inflation. The shelter component of the US CPI has finally shown a decline in recent months, dropping to a YoY rate of 8.0% in May-23 from a peak of 8.2% YoY in Mar-23 as renters negotiate new contracts amidst weakening economic sentiment. However, as US economic indicators continue to deliver positive surprises, landlords may become more bullish and begin charging higher rates, or

even selling their rental units to take advantage of limited supply in the housing market. **The risk of rebounding rental prices could complicate the Fed's efforts to yank inflation back to the 2% level**, leaving the central bank with limited room to reduce its hawkish stance.

- Robust performance in the US housing sector and limited risks of the cooling CRE sector to banks show that unless something is breaking in 2023, the coast is rather clear for the Fed to deliver another 50 bps increase in the policy rate. Meanwhile in Indonesia, recent developments such as the inflation rate which has now fallen within Bank Indonesia's target range, slowing domestic aggregate demand growth, and the watershed of imported manufactured products show that **the circumstances are increasingly in favour of the central bank not to match the Fed's hawkish signal.** The growing divergence between BI's signals vis-à-vis the Fed, then, may add to depreciation pressures facing the Rupiah in the short term, particularly given the weakening sentiment surrounding major Asian currencies.

"The risk of rebounding rental prices could complicate the Fed's efforts to yank inflation back to the 2% level"

Chart 1

A better deal

The shift from the Fed's primary credit facility to BTFP shows that the increase in BTFP outstanding reflects the facility's attractiveness to banks rather than continued uncertainty within the US banking system

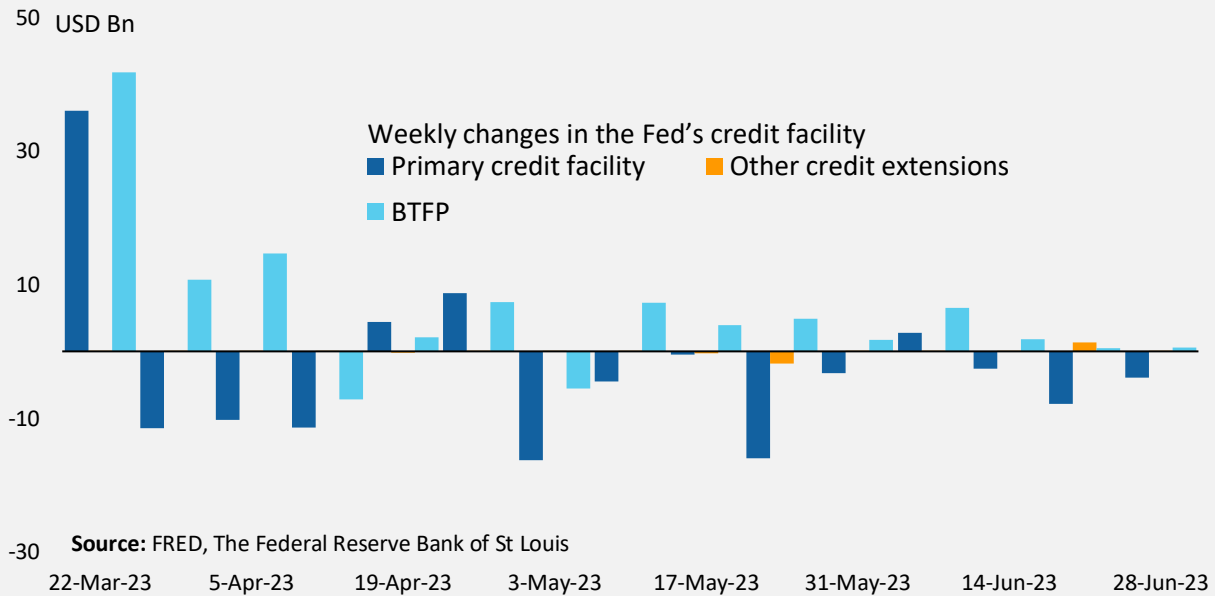
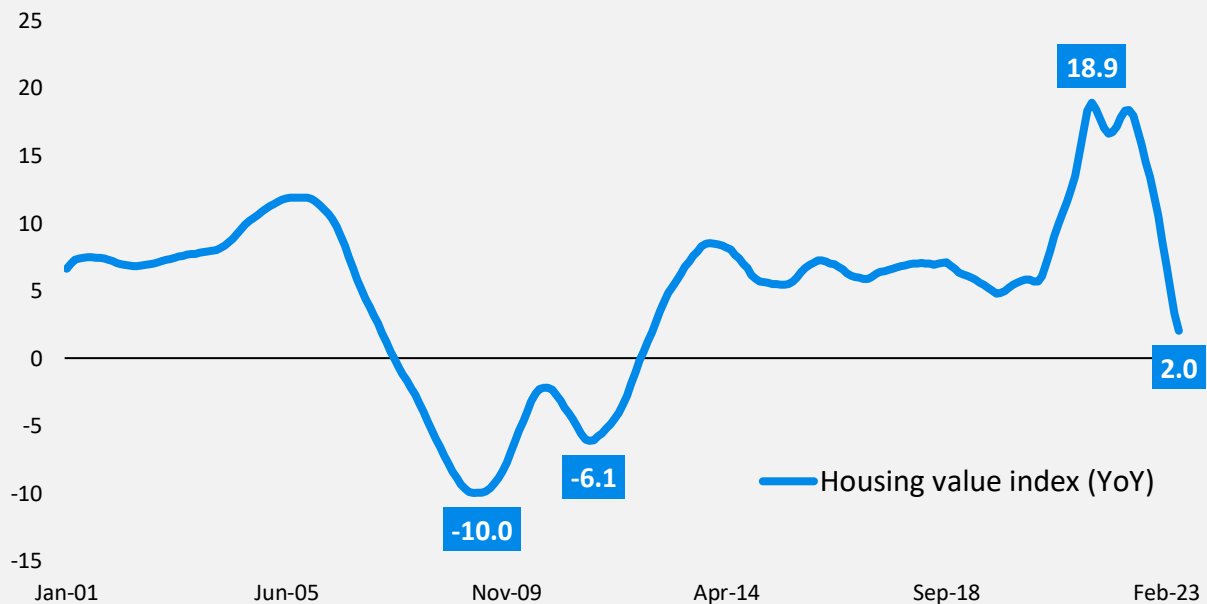


Chart 2

A limited slump

Demand for residential property declined amidst the high-rate environment, but the decline in prices may not be too severe given the tight supply in the housing market



Source: Zillow

Chart 3

Mistakes learned

The decade of ultra-easy monetary policy that follows the GFC has not translated to an excessive construction boom, keeping the US housing inventory on a healthy level

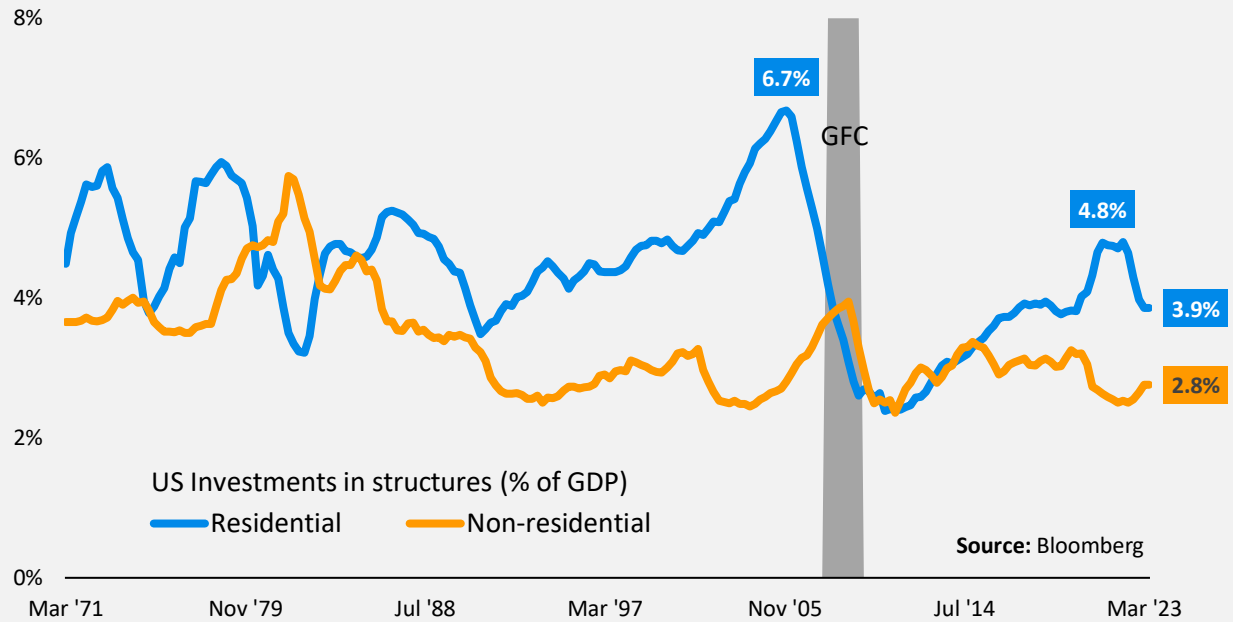


Chart 4

Bargains are hard to let go

Cheap mortgages following refinancing during the pandemic may discourage homeowners to sell their properties, further restricting the supply condition in the US housing market

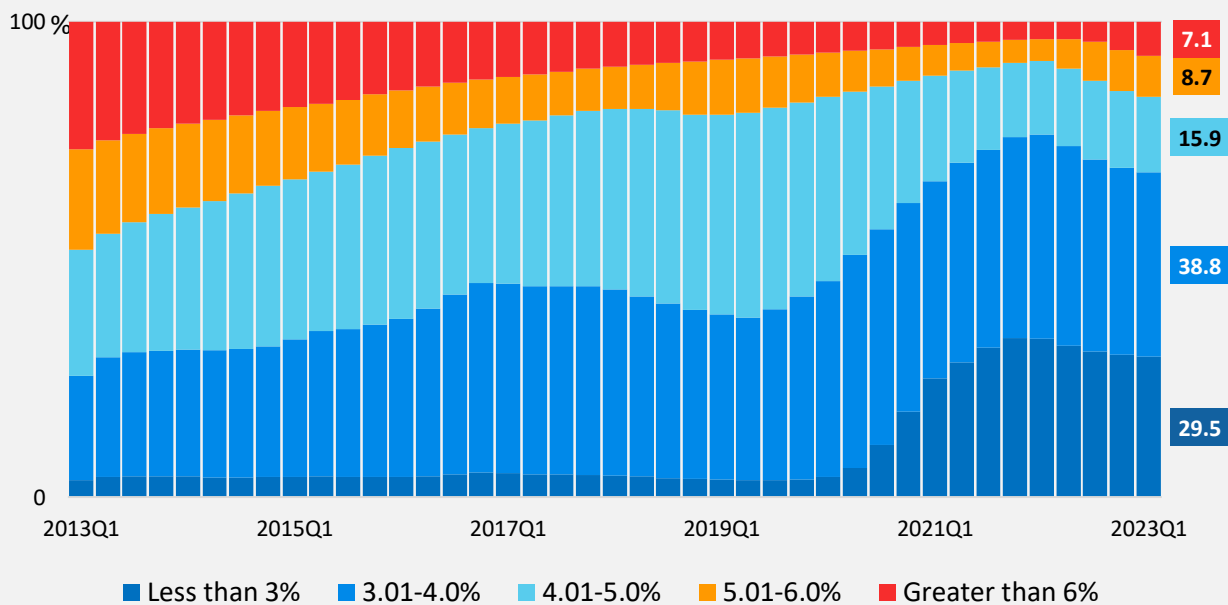
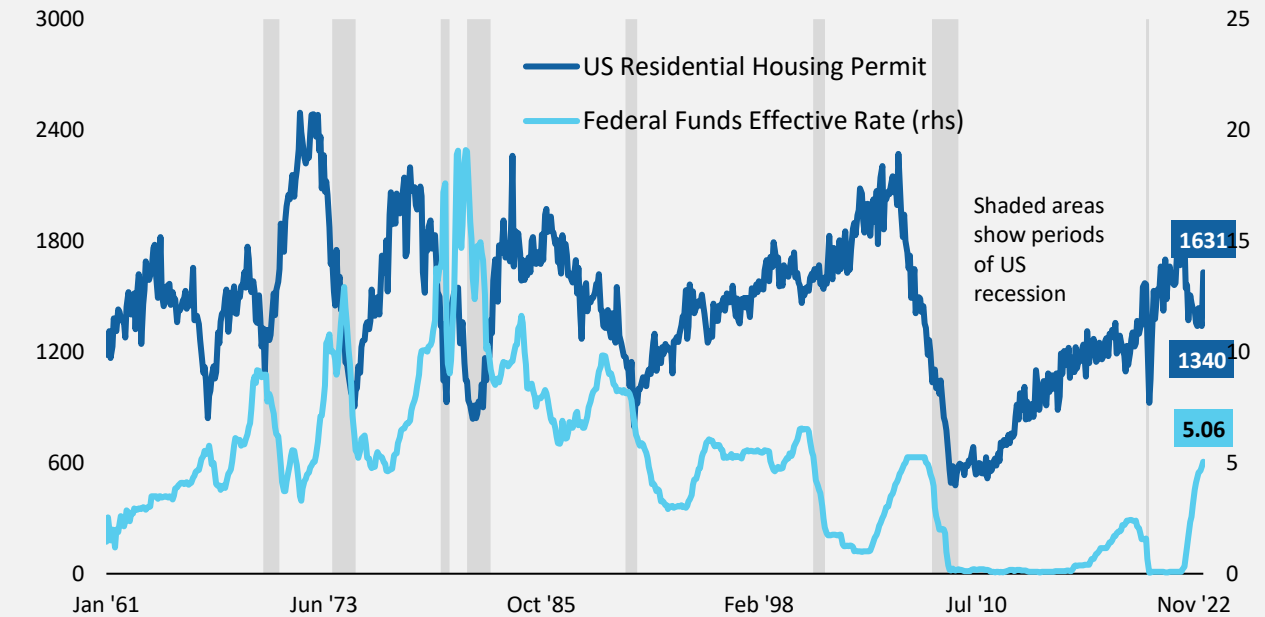


Chart 5

Build back better more

Residential construction activities in the US is increasing in recent months, but the expansion may be limited given the now-high interest rate

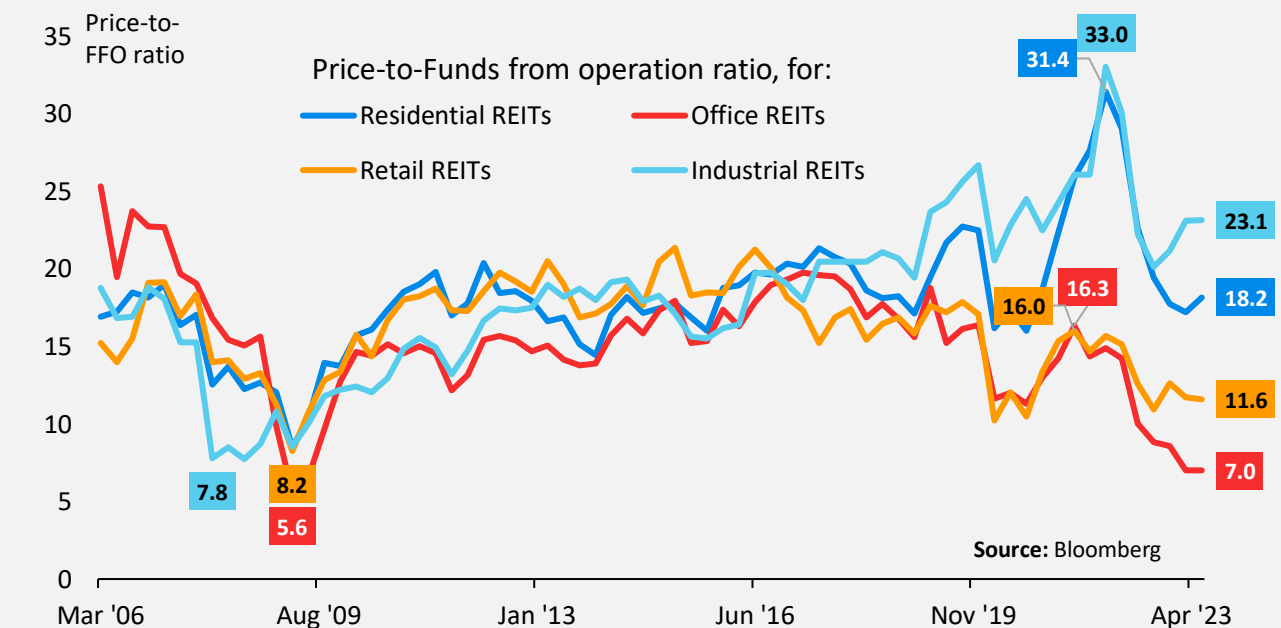


Source: Bloomberg

Chart 6

Beaten but holding on

High vacancies amidst the high interest rate environment pummel office and retail REITs, the balance sheet of REITs are in a better shape compared to 2007-2008



Source: Bloomberg

Economic Calendar				
		Actual	Previous	Forecast*
3 July 2023				
ID	S&P Global Manufacturing PMI	52.5	50.3	50.6
ID	Inflation Rate YoY	3.52%	4.0%	3.6%
US	ISM Manufacturing PMI	-	46.9	46.3
6 July 2023				
US	Balance of Trade (USD Bn)	-	-74.6	-68.7
7 July 2023				
ID	Foreign Exchange Reserves (USD Bn)	-	139.3	139.0
10 July 2023				
CN	Inflation rate YoY	-	0.2%	0.5%
ID	Consumer Confidence	-	128.3	128
12 July 2023				
US	Inflation rate YoY	-	4.0%	3.6%
13 July 2023				
CN	Balance of Trade (USD Bn)	-	65.81	68.0
ID	Car Sales YoY	-	65.2%	-
14 July 2023				
EA	Balance of Trade (USD Bn)	-	-11.7	-16.4
ID	Motorbike Sales YoY	-	113.4%	-
17 July 2023				
CN	GDP Growth Rate YoY	-	4.5%	5.8%
ID	Balance of Trade (USD Bn)	-	0.44	1.1
20 July 2023				
ID	Retail Sales YoY	-	1.5%	-
ID	Foreign Direct Investment YoY	-	20.2%	-
25 July 2023				
ID	Loan Growth YoY	-	9.39%	-
ID	Bank Indonesia policy announcement	-	5.75%	5.75%
27 July 2023				
US	Fed Interest Rate Decision	-	5.25%	5.5%
ID	M2 Money Supply YoY	-	6.1%	-
EA	Deposit Facility Rate	-	3.5%	3.75%
31 July 2023				
EA	Inflation Rate YoY Flash	-	-	-

*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 (%)	Trade & Commodities	27-Jun	-1 mth	Chg (%)
US	5.25	Jun-23	1.25	Baltic Dry Index	1,183.0	1,172.0	0.9
UK	5.00	Jun-23	-3.70	S&P GSCI Index	533.7	546.9	-2.4
EU	4.00	Jun-23	-1.50	Oil (Brent, \$/bbl)	72.3	77.0	-6.1
Japan	-0.10	Jan-16	-3.30	Coal (\$/MT)	151.2	146.0	3.6
China (lending)	4.35	Jul-23	4.15	Gas (\$/MMBtu)	2.67	1.88	42.0
Korea	3.50	May-23	0.20	Gold (\$/oz.)	1,913.7	1,946.5	-1.7
India	6.50	Jun-23	2.25	Copper (\$/MT)	8,382.0	8,106.0	3.4
Indonesia	5.75	Jun-23	2.23	Nickel (\$/MT)	20,581.0	21,034.5	-2.2
Money Mkt Rates	27-Jun	-1 mth	Chg (bps)	CPO (\$/MT)	797.5	779.1	2.4
SPN (1M)	4.57	4.70	-13.5	Rubber (\$/kg)	1.29	1.34	-3.7
SUN (10Y)	6.24	6.41	-16.8	External Sector	May	Apr	Chg (%)
INDONIA (O/N, Rp)	5.91	5.42	49.6	Export (\$ bn)	21.72	19.28	12.61
JIBOR 1M (Rp)	6.40	6.40	-0.5	Import (\$ bn)	21.28	15.35	38.65
Bank Rates (Rp)	Apr	Mar	Chg (bps)	Trade bal. (\$ bn)	0.44	3.94	-88.91
Lending (WC)	8.92	8.95	-2.71	Central bank reserves (\$ bn)*	139.3	144.2	-3.38
Deposit 1M	4.18	4.20	-2.70	Prompt Indicators	May	Apr	Mar
Savings	0.67	0.69	-1.70	Consumer confidence index (CCI)	128.3	126.1	123.3
Currency/USD	27-Jun	-1 mth	Chg (%)	Car sales (%YoY)	65.2	-28.8	2.7
UK Pound	0.784	0.810	3.28	Motorcycle sales (%YoY)	113.4	-19.4	40.5
Euro	0.912	0.933	2.22	Manufacturing PMI	Jun	May	Chg (bps)
Japanese Yen	144.1	140.6	-2.41	USA	N/A	46.9	0
Chinese RMB	7.224	7.064	-2.22	Eurozone	43.4	44.8	-140
Indonesia Rupiah	14,993	14,955	-0.25	Japan	49.8	50.6	-80
Capital Mkt	27-Jun	-1 mth	Chg (%)	China	50.5	50.9	-40
JCI	6,661.9	6,687.0	-0.38	Korea	47.8	48.4	-60
DJIA	33,926.7	33,093.3	2.52	Indonesia	52.5	50.3	220
FTSE	7,461.5	7,627.2	-2.17				
Nikkei 225	32,538.3	30,916.3	5.25				
Hang Seng	19,148.1	18,746.9	2.14				
Foreign portfolio ownership (Rp Tn)	Jun	May	Chg (Rp Tn)				
Stock	2,755.0	2,738.1	16.95				
Govt. Bond	846.9	829.4	17.53				
Corp. Bond	11.3	11.8	-0.47				

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



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Indonesia – Economic Indicators Projections

	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	2.3
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	15,173
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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