

## Looking at the REER view mirror

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### Summary

- The foreign capital inflow momentum that followed the BI and the Fed policy meeting in late October 2023 may seem to be weakening recently. However, the recovering IDR's value may reduce the urgency for BI to further adjust its policy in 2023.
- The improvement in domestic FX liquidity conditions and Indonesia's stable inflation outlook may continue to offer fundamental support for the Rupiah.
- A more controlled weakening of the IDR's value should not unsettle BI, given the Rupiah's still relatively high real effective exchange rate (REER).

- The Indonesian financial market remains in a state of relative quiescent throughout the third week of November 2023. The Rupiah appreciated regained its YTD appreciation, as the currency traded at 15,493/USD when the market closed last week. Despite the rally in the money market, however, the domestic capital market continues to show mixed results. Foreign investors may record a net buy to the tune of USD 45.69 Mn throughout the last week, but the increase in foreign capital stock in the domestic stock market is not enough to fill the gap left by the USD 114.38 Mn outflows from the domestic bond market.
- Despite the increasing (although, still manageable) capital outflows, the Indonesian capital and money markets are still floating in a calmer global financial market environment. While outflows from the domestic bond market once again push

Indonesia's benchmark 10Y yield to around the 7.0% level, the consistent appreciation of the Rupiah over the past three weeks has lessened the urgency for Bank Indonesia to follow up its surprise rate hike in the October 2023 meeting with another increase in the next session.

- While the favourable improvement in the global rate expectation is undoubtedly the main factor that might allow BI not to further increase the policy rate in 2023, multiple internal factors may also justify the reasoning behind BI's "stop-go" policy. First, the liquidity condition in the domestic Eurodollar market seems to be improving. Alas, the driving factor behind this improvement does not seem to be the renewed surge in capital inflows. As we mentioned earlier, recent trends show that the influx of foreign capital into the Indonesian financial market seems to be

already losing its momentum, meaning that it may not be wise to count on a continuous stream of foreign capital inflows to bolster Indonesia's FX coffers in the upcoming period.

- Neither is the improvement in the domestic Eurodollar market supply condition fully dictated by the strengthened export proceeds (DHE) rule. Our previous report on BI's FX reserves shows that the strengthened DHE regulation does not translate to much improvement in the domestic FX liquidity supply, while the decline in global commodity prices further signals that exporters' ability to generate more hard currencies for the economy may remain limited.
- **The improvement in the domestic FX liquidity condition, then, arrives primarily from the decline in the demand for FX loans (see Chart 1).** Despite the recent shift in USD rate expectation, the benchmark yield on dollar lending remains at a sufficiently restrictive level, limiting the demand for financing in the Eurodollar market. Changes in the government's energy compensation repayment schedule may also play a role in limiting the demand for foreign currency-denominated bridging loans, reducing the risk of urgent demand for FX-denominated bridging loans in Indonesia's Eurodollar market.
- **The healthy real interest rate outlook for the Rupiah is another idiosyncratic factor that may allow BI not to increase the policy rate in the next meeting.** Despite its above-

*"The domestic FX liquidity condition seems to be improving, thanks to the weaker demand for FX loans"*

normal nominal rates and slowing inflation numbers, the stable energy (oil) consumption outlook vis-à-vis the production outlook means that the US economy remains haunted by the spectre of energy inflation.

- *Au contraire*, Indonesia's inflation (and hence, real rates) outlook seems to be more stable. Emerging news about disappointing crop yield due to the challenging weather conditions in the past three months may continue to feed into the CPI number through the volatile food component. However, the risk of food-driven inflation in Indonesia seems to be manageable, partly thanks to the swift effort to secure several rice import commitments, including the agreement with China to import up to 1 mn tonnes of rice that Indonesian importers could trigger in 2024.
- China's role as a disinflationary force in the Indonesian economy stretches beyond the volatile food component. Indonesian consumers continue to benefit from cheap imported goods from China, a role which the "Middle Kingdom" is only happy to play given their strategy to export themselves out of stagnation and the need to replace their weakening market share in the Western market. **The real interest rate on Rupiah-denominated assets, then, may remain separated by quite a gap from its USD-denominated counterpart**, with BI's limited dovish signal providing the cherry on top for yield-seeking investors.

- We also point to the Rupiah’s relatively expensive valuation as a possible signal for BI’s limited urgency to hike the policy rate in the upcoming meeting (*see Chart 3*). Indonesia’s still-going streak of trade surplus has boosted the Rupiah’s real valuation relative to its trading partners, keeping the IDR somewhat stable in real terms despite its volatile IDR/USD nominal terms (which is still relatively stable compared to other emerging markets or Asian currencies). **The diminishing threat to the domestic money market has enabled Indonesia’s Real Effective Exchange Rate (REER) to inch back into overvaluation territory**, which contrasts with the trend observed in other Asian manufacturing hubs, such as China.
- **The impact of the Rupiah’s expensive valuation, at least relative to its trading partners, extends beyond the financial side of the economy.** As mentioned earlier, the availability of cheap imported goods is instrumental in keeping a stable inflation outlook in Indonesia, and an expensive IDR would further add to the allure of imported goods for Indonesian customers. Indonesian customers have been enjoying the twin benefits of falling prices of imported goods and the Rupiah’s stable valuation, allowing them to maintain their consumption basket despite the lack of improvement in the household liquidity condition.
- An overvalued Rupiah also benefits certain segments within the domestic corporate sector. Our observations of the financial performance of domestically listed companies in Q3 2023 reveal that companies

in inward-looking sectors, such as the consumer discretionary sector, were able to increase their revenue in the past quarter (*see Chart 4*), despite their typically higher dependence on imports. The expensive IDR, coupled with China’s still-going inventory fire sale, means that corporate Indonesia in Q3 2023 may report an improvement in revenue thanks to, rather than despite, their higher imports.

- Finally, we conclude the discussion by bringing up one of our long-held concerns about the Indonesian economy: the risk of a “Dutch disease”. Indeed, the overvalued IDR due to Indonesia’s increasingly lucrative commodity business and the limited expansion in manufacturing new export orders points to the classic Dutch disease symptom – a condition when an improvement in one sector (in this case, the commodity-exporting and consumer goods-importing sectors) leads to the decline in another (the goods-exporting sector). Fortunately, the stable manufacturing PMI number indicates that the domestic market remains big enough for both importers and local manufacturers, although the expensive IDR may continue to tie the manufacturing new export orders index in the contraction zone.

*“Despite its volatile nominal exchange rate, the Rupiah retains its premium valuation compared to its trading partners”*

Chart 1

### A necessary step back

The domestic FX liquidity condition seems to be improving but only due to the weakening demand for FX loans

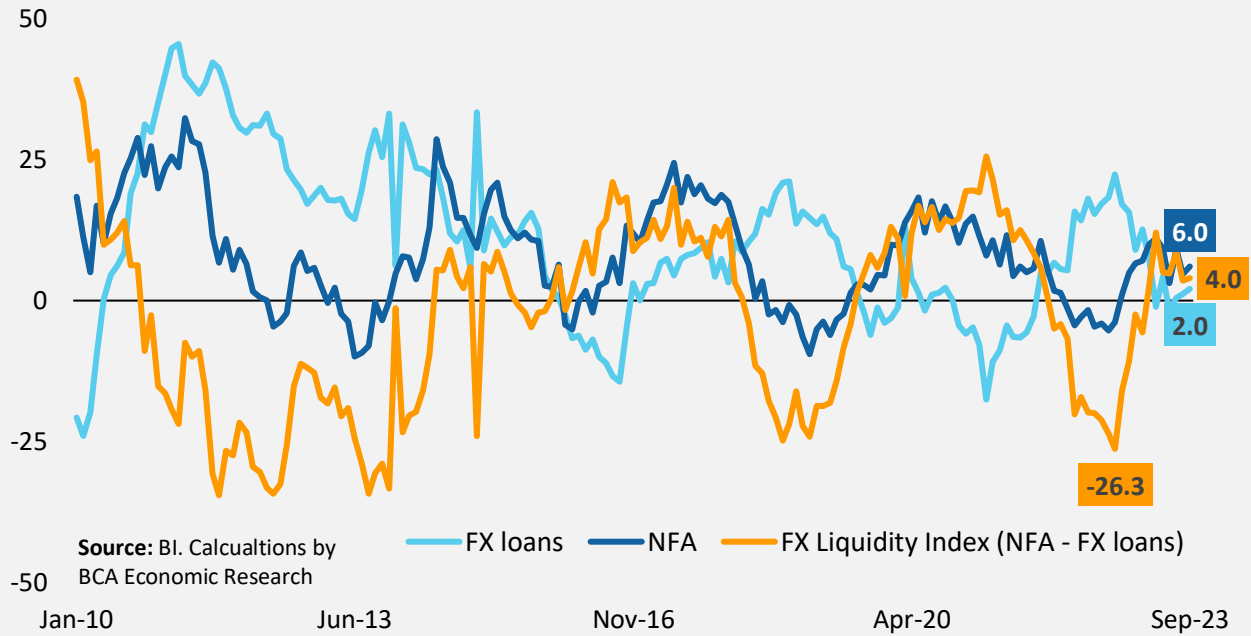


Chart 2

### Minding the gap

Indonesia's stable inflation outlook may continue to provide some succour for the Rupiah as the global oil market could still come back and haunt the US inflation dynamic

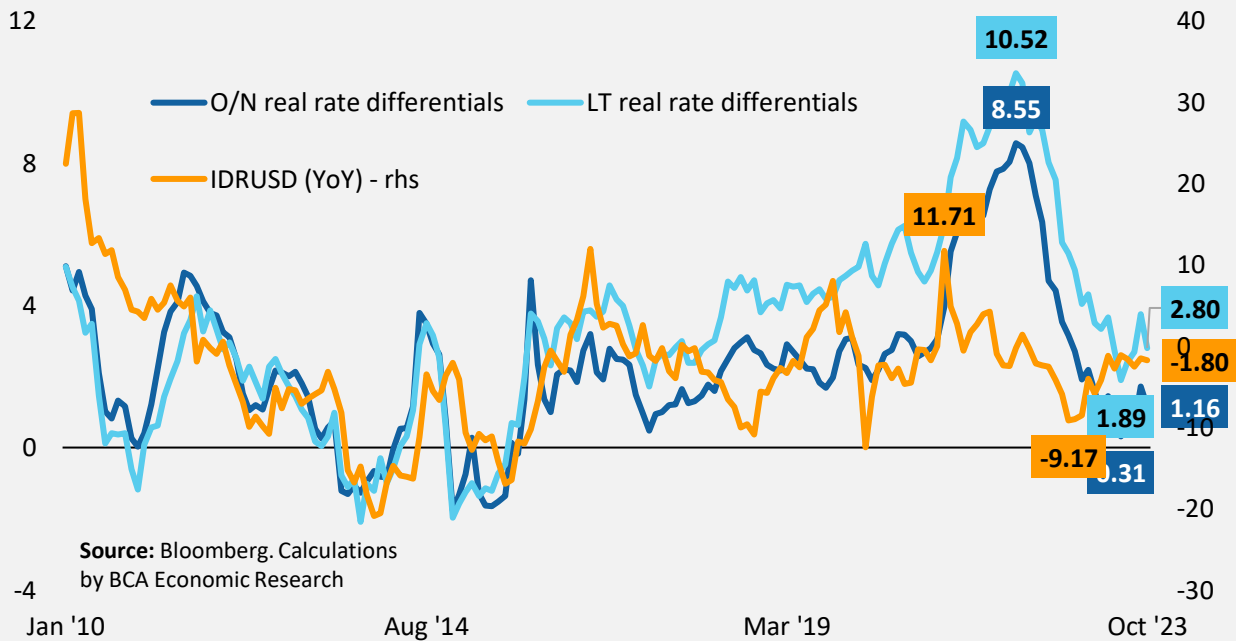


Chart 3

### Going Dutch?

The Rupiah's expensive valuation relative to other Asian currencies may benefit local importers but could be detrimental to manufacturers

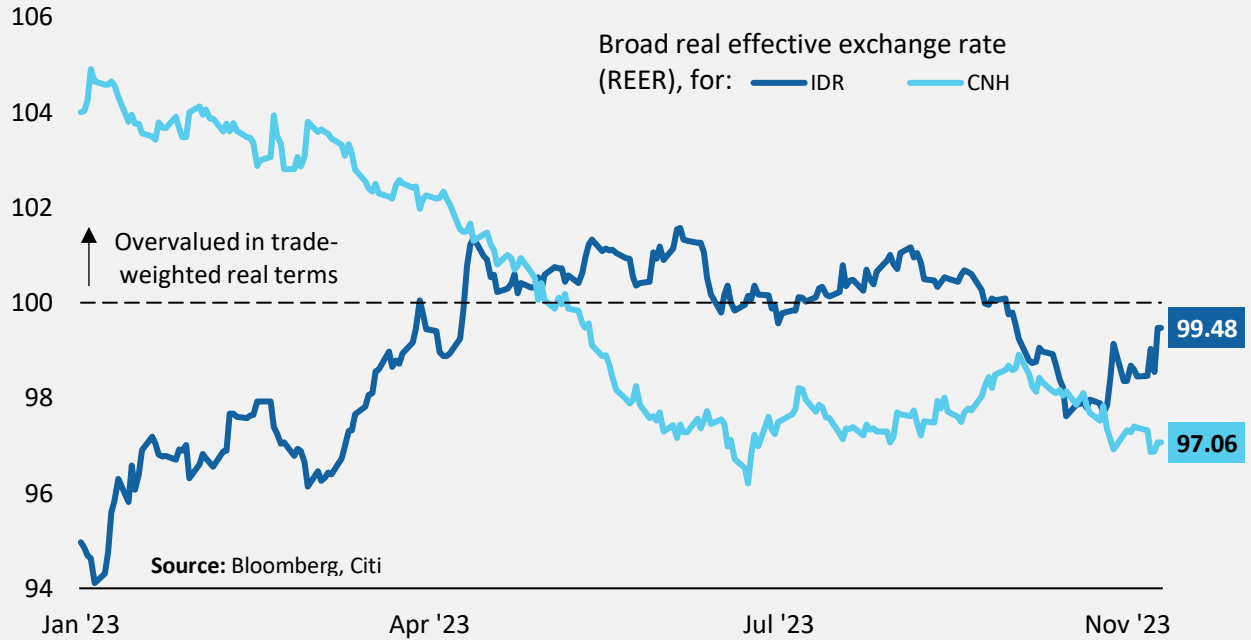
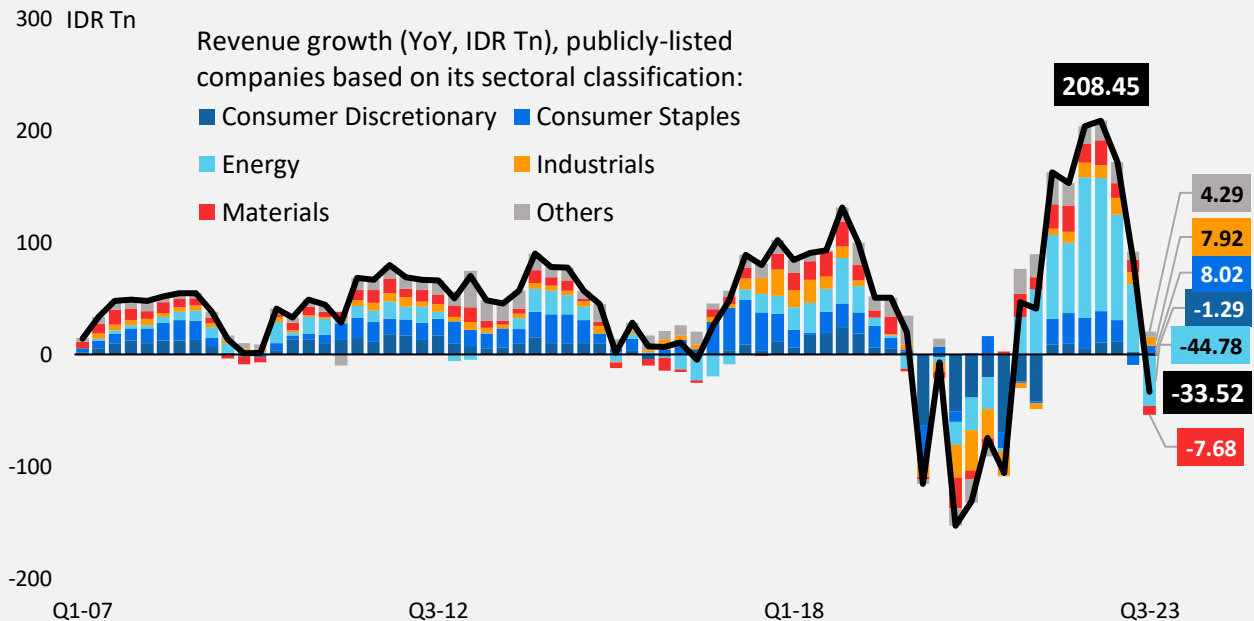


Table 4

### Inner strength

Unlike their exporting and outward-looking counterparts, companies in the importing and inward-looking sectors enjoyed an increase in their revenue in Q3 2023



Source: Bloomberg. Calculations by BCA Economic Research

Economic Calendar				
		Actual	Previous	Forecast*
1 November 2023				
ID	S&P Global Manufacturing PMI	51.5	52.3	52
CN	Caixin Manufacturing PMI	49.5	50.6	50.7
<b>ID</b>	<b>Inflation rate YoY</b>	<b>2.56%</b>	<b>2.28%</b>	<b>2.4%</b>
US	ISM Manufacturing PMI	46.7	49	49.5
US	JOLTs Job Openings (USD Mn)	9.55	9.6	9.2
2 November 2023				
<b>US</b>	<b>Fed Interest Rate Decision</b>	<b>5.5%</b>	<b>5.5%</b>	<b>5.5%</b>
3 November 2023				
US	Unemployment Rate	6.5%	3.8%	3.8%
US	Non-Farm Payroll ('000)	150	336	190
6 November 2023				
<b>ID</b>	<b>GDP Growth Rate YoY</b>	<b>4.94%</b>	<b>5.17%</b>	<b>5.1%</b>
7 November 2023				
CN	Balance of Trade (USD Bn)	56.53	77.7	81.0
US	Balance of Trade (USD Bn)	-61.5	-58.3	-59.5
<b>ID</b>	<b>Foreign Exchange Reserves (USD Bn)</b>	<b>133.1</b>	<b>134.9</b>	<b>133.0</b>
8 November 2023				
ID	Consumer Confidence	124.3	121.7	-
ID	Motorbike Sales YoY	-4%	-0.9%	-
ID	Car Sales YoY	-13.9	-20.1%	-
9 November 2023				
CN	Inflation Rate YoY	-0.2%	0.0%	0.0%
ID	Retail Sales YoY	1.5%	1.1%	2.9%
14 November 2023				
US	Inflation Rate YoY	3.2%	3.7%	3.3%
15 November 2023				
<b>ID</b>	<b>Balance of Trade (USD Bn)</b>	<b>3.48</b>	<b>3.41</b>	<b>3.8</b>
EU	Balance of Trade (EUR Bn)	10	6.7	22.3
16 November 2023				
ID	Property Price Index YoY	1.96%	1.92%	2.4%
21 November 2023				
<b>ID</b>	<b>Current Account (USD Bn)</b>	<b>-</b>	<b>-1.9</b>	<b>-0.9</b>
23 November 2023				
ID	Loan Growth YoY	-	<b>8.9%</b>	-
<b>ID</b>	<b>Interest Rate Decision</b>	<b>-</b>	<b>6%</b>	<b>6%</b>

\*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	17-Nov	-1 mth	Chg (%)
US	5.50	Nov-23	2.30	Baltic Dry Index	1,820.0	2,058.0	-11.6
UK	5.25	Nov-23	0.65	S&P GSCI Index	556.7	591.4	-5.9
EU	4.50	Nov-23	1.60	Oil (Brent, \$/brl)	80.6	89.9	-10.3
Japan	-0.10	Jan-16	-3.10	Coal (\$/MT)	127.6	155.0	-17.7
China (lending)	2.50	Nov-23	4.55	Gas (\$/MMBtu)	2.62	2.94	-10.9
Korea	3.50	Oct-23	-0.30	Gold (\$/oz.)	1,980.8	1,923.2	3.0
India	6.50	Oct-23	1.63	Copper (\$/MT)	8,168.2	7,902.8	3.4
Indonesia	6.00	Oct-23	3.44	Nickel (\$/MT)	16,672.5	18,333.0	-9.1
				CPO (\$/MT)	820.0	785.5	4.4
				Rubber (\$/kg)	1.47	1.49	-1.3
Money Mkt Rates	17-Nov	-1 mth	Chg (bps)	External Sector	Oct	Sep	Chg (%)
SPN (1M)	6.42	5.86	56.5	Export (\$ bn)	22.15	20.75	6.76
SUN (10Y)	6.94	6.75	18.6	Import (\$ bn)	18.67	17.34	7.68
INDONIA (O/N, Rp)	5.85	5.64	20.6	Trade bal. (\$ bn)	3.48	3.41	2.08
JIBOR 1M (Rp)	6.66	6.40	25.7	Central bank reserves (\$ bn)*	133.1	134.9	-1.30
Bank Rates (Rp)	Aug	Jul	Chg (bps)	Prompt Indicators	Oct	Sep	Aug
Lending (WC)	8.96	8.95	0.65	Consumer confidence index (CCI)	124.3	121.7	125.2
Deposit 1M	4.29	4.24	5.00	Car sales (%YoY)	-13.9	-20.1	-8.3
Savings	0.66	0.67	-0.53	Motorcycle sales (%YoY)	-4.0	-0.9	1.8
Currency/USD	17-Nov	-1 mth	Chg (%)	Manufacturing PMI	Oct	Sep	Chg (bps)
UK Pound	0.802	0.821	2.29	USA	46.7	49.0	-230
Euro	0.916	0.945	3.20	Eurozone	43.1	43.4	-30
Japanese Yen	149.6	149.8	0.12	Japan	48.7	48.5	20
Chinese RMB	7.214	7.316	1.41	China	49.5	50.6	-110
Indonesia Rupiah	15,493	15,715	1.43	Korea	49.8	49.9	-10
				Indonesia	51.5	52.3	-80
Capital Mkt	17-Nov	-1 mth	Chg (%)				
JCI	6,977.7	6,939.6	0.55				
DJIA	34,947.3	33,997.7	2.79				
FTSE	7,504.3	7,675.2	-2.23				
Nikkei 225	33,585.2	32,040.3	4.82				
Hang Seng	17,454.2	17,773.3	-1.80				
Foreign portfolio ownership (Rp Tn)	Oct	Sep	Chg (Rp Tn)				
Stock	2,895.1	2,833.3	61.89				
Govt. Bond	810.4	823.0	-12.62				
Corp. Bond	11.3	10.8	0.52				

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



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## Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3	5.1
GDP per Capita (US\$)	3927	4175	3912	4350	4784	4982
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.8
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	6.00
USD/IDR Exchange Rate (end of the year)**	14,390	13,866	14,050	14,262	15,568	15,728
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	54.5	34.9
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.4

\*Estimated number

\*\* Estimation of the Rupiah's fundamental exchange rate

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