Demystifying SVBI's crowding out fears

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Summary

- Despite the negative current account balance in the past two quarters, the domestic foreign exchange (FX) liquidity condition seems to be improving in 2023 due to the dwindling demand for FX loans across multiple sectors of the economy.
- The growth in the domestic FX liquidity supply seems to be driven by the State-Owned Enterprises (SOE) sector, as the more regular reimbursement schedule provides a better mechanism to transfer FX liquidity from the public sector to SOEs.
- Domestic banks may benefit from the SVBI's success in the short term, given the anaemic demand for FX loans from both SOEs and the private sector.

- As we walk to the final week of the month, we could say that November 2023 has relatively been a good month for the global and domestic financial market. The absence of policy surprises led to the decline in USD (DXY) value throughout the month, providing relief for other currencies (including the Rupiah) from the long siege of the previous month. Last week, another financial tremor further strengthened the market's belief that the Fed is done hiking rates. The usage of the Fed's bank term funding programme (BTFP) surged in the past week, breaching USD 114 Bn as deposit outflows from US small banks reportedly reached USD 3.3 Bn last week.
- Any signs of continued stress in the US banking system are bad news for the prospect of the global economy. However, given the dramatic shift in the market's response function following the Fed's tightening campaign, it should come as no surprise that this sort of news turns out to jolt the market, including in Indonesia. The domestic financial market attracted considerable interest from foreign investors throughout the past week, as foreign capital to the tune of USD 303.36 Mn flowed into the domestic bond market while foreign investors in the domestic stock market recorded a net buy of around USD 80.09 Mn ***(see Chart 1)***.
- Apart from the quick shift in investors' sentiment, other macro-level data such as the Q3 2023 BoP number also paint a more optimistic picture regarding the FX supply condition within the Indonesian economy. Bank-level data also shows a substantial supply of FX liquidity within the domestic banking sector ***(see Chart 2)***, although our observations reveal that the hitherto abundant supply of foreign currencies is more of a product of the weakening demand

for FX loans rather than a significant inflow of foreign capitals.

- Given our reading on the limited prospect of an increase in hard currency revenues and the still-aggressive appetite for expansion, parroting the fact that domestic demand for FX loans has also been slowing may open the risk of inconsistency in our argument. It is important, then, to take note of how bank FX loans are distributed within the Indonesian economy. The government, of course, is not a big player in this market, given that it mainly borrows from the bond market rather than loans from banks. Instead, the ebb and flow in the demand for FX loans is often driven by demand from the SOE sector, which often finds the need to fill the gap in its balance sheet until the government makes good on its subsidy or compensation reimbursement.

- Throughout 2023, however, SOEs' demand for FX loans seems to be largely non-existent ***(see Chart 3)***. The government's better and more regular reimbursement schedule provides an efficient FX transfer mechanism from the public's purse to SOEs' balance sheet. This tweak in the government's fiscal reimbursement schedule reduces the urgency for SOEs' treasurers to try and find FX-denominated bridging loans, leaving banks with their corporate clients to absorb the excess FX liquidity supply.

- Alas, demand for FX loans from the private sector has been inconsistent in 2023. The upward trend in the private sector's FX loan growth has sputtered in Q3 2023, as higher USD real rates discourage debtors from taking more leverage. The slowing global demand outlook may also explain the declining demand for FX loans, as businesses in Indonesia may feel that there is less urgency in seeking export financing in recent periods.

- Given the declining demand for FX loans from the SOE and private sectors, it could be argued that Bank Indonesia has introduced its new FX instrument, the SVBI/SUVBI, with impeccable timing. Indeed, domestic banks are in need of other channels to distribute their FX liquidity, while it is also necessary for BI to keep the IDR's fundamentals by offering attractive market-driven rates and thus suppress the demand for FX financing. The SVBI, of course, enjoyed considerable success on its debut last week, raking in around USD 36.5 Mn more than its USD 200 Mn target for the central bank's FX coffers on a 5.49% interest.

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- SVBI's debut auction in the past week also did not appear to crowd out liquidity from BI's other FX instruments ***(see Chart 4)***. Interests in BI's other FX instruments remain considerably high, as indicated by the spike in FX swap outstanding and stable outflow to BI's FX term deposit instruments. Domestic banks' still-high FX liquidity situation, of course, explains the situation. However, as is also the case with BI's new Rupiah instrument (SRBI), the SVBI may help to fill the gap left by forgotten instruments such as BI's FX SBBI.

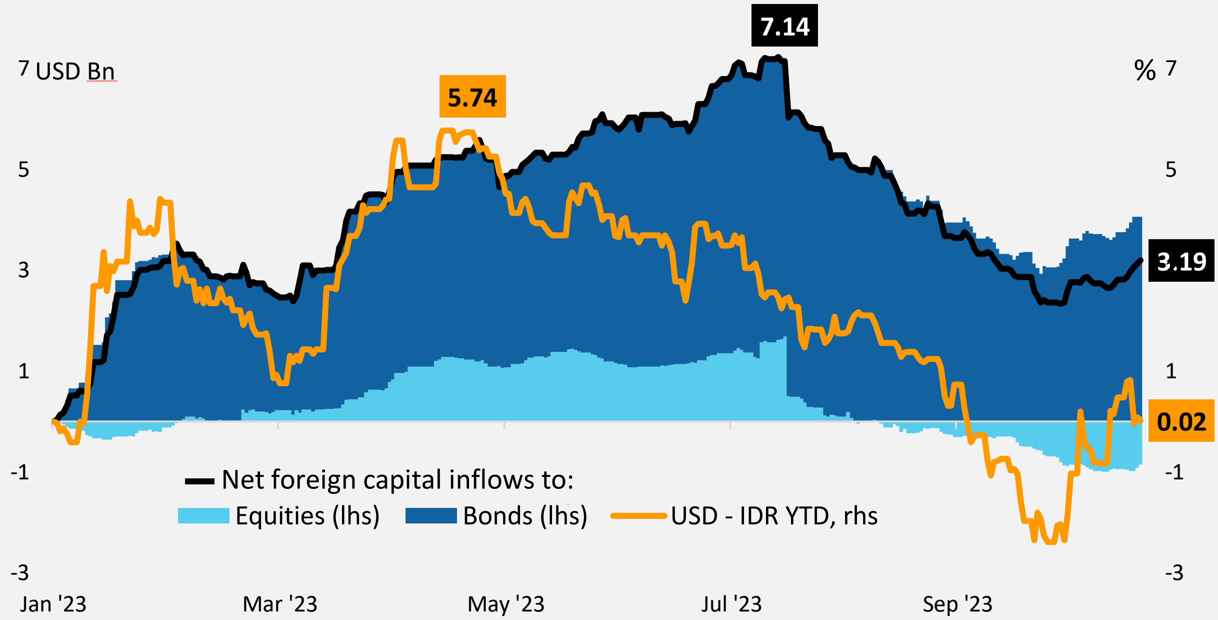
- Despite the hitherto mutualistic nature between BI's new instrument and banks' FX liquidity situation, however, there remains no guarantee that the SVBI/SUVBI instrument will not pose a problem for domestic banks in the future. As illustrated in Chart 1, domestic banks' FX LDR has been ticking upwards in Q3 2023, a condition that may expose banks to a scramble for FX liquidity should the trend continue.
- Unfortunately, the domestic banking sector often finds itself competing for FX liquidity against other institutions, such as foreign banks, at a disadvantageous position. Alas, this dynamic remains true in 2023, as domestic banks could only offer a median of 3.60% interest for FX deposits while their foreign counterparts are now offering as much as 5.19%. The strengthened export proceeds (DHE) rule may tip the competitive balance from foreign banks to the domestic banking sector. Alas, the 5.49% interest now offered by SVBI would still heat the competition for FX liquidity within the domestic banking sector, although the limited variability in SVBI's maturity may provide a fighting chance for domestic banks.
- However, hoping for BI to put a strict limit on rates offered during the SVBI auction would not be ideal either, especially in the short term. The limited prospect for another significant and consistent surge in FX inflows into the Indonesian economy also highlights the urgency for BI to continue offering a substantially high interest payout, given that efforts to strengthen the Rupiah fundamentals may continue to be restricted on keeping tight control over the supply-demand balance in the domestic Eurodollar market.
- Given banks' still-substantial FX liquidity, domestic banks may also benefit from the higher rate offered by SVBI at the moment. Moreover, our reading for a higher-for-longer global rate environment may prolong the mutualistic relationship between banks and BI's SVBI. This kind of relationship, however, may work only when banks are finding it harder to lend their excess FX supply. It is crucial, then, for BI to remain flexible when issuing SVBI, given that under different circumstances, higher issuance of SVBI (and its bountiful rates) could still crowd out the liquidity that would otherwise be available for banks' FX loans.

> ***"The purely mutualistic relationship between the SVBI and banks' FX loans may only hold as long as banks are finding it harder to lend their excess FX supply"***

Chart 1

Money pouring in

Foreign inflows are returning to the domestic bond and stock market, but the Rupiah continued to face considerable downward pressure in the past week.

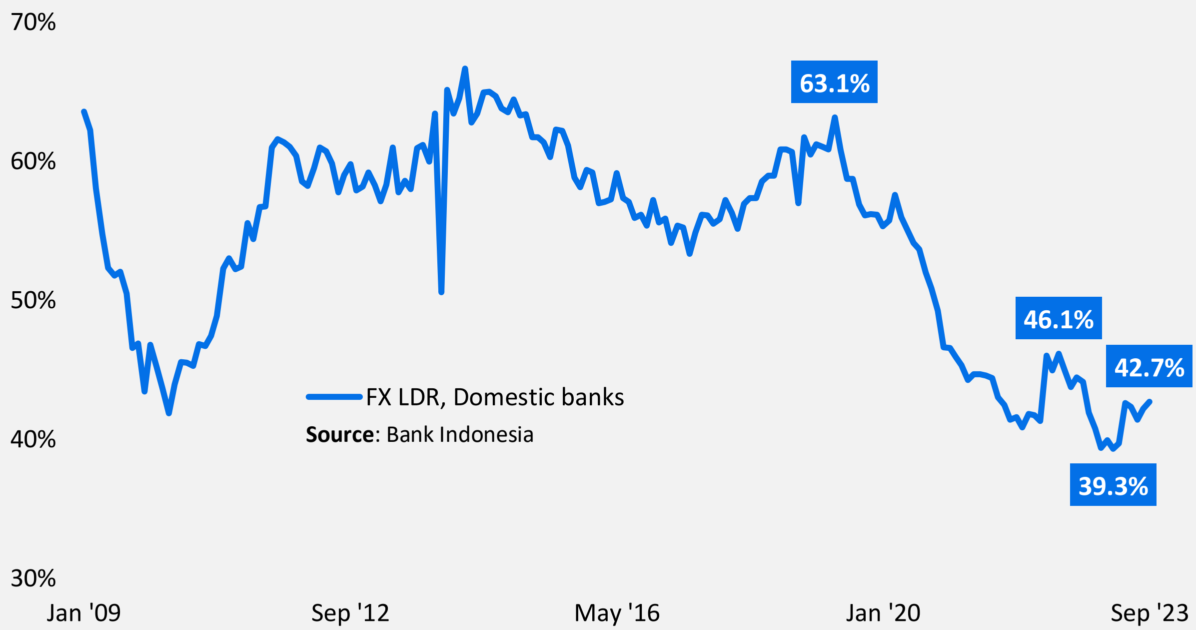


Source: Bloomberg

Chart 2

Flushed with cash

Domestic banks' FX liquidity condition is improving in 2023 compared to the last year, although it starts to tick up again in H2 2023.

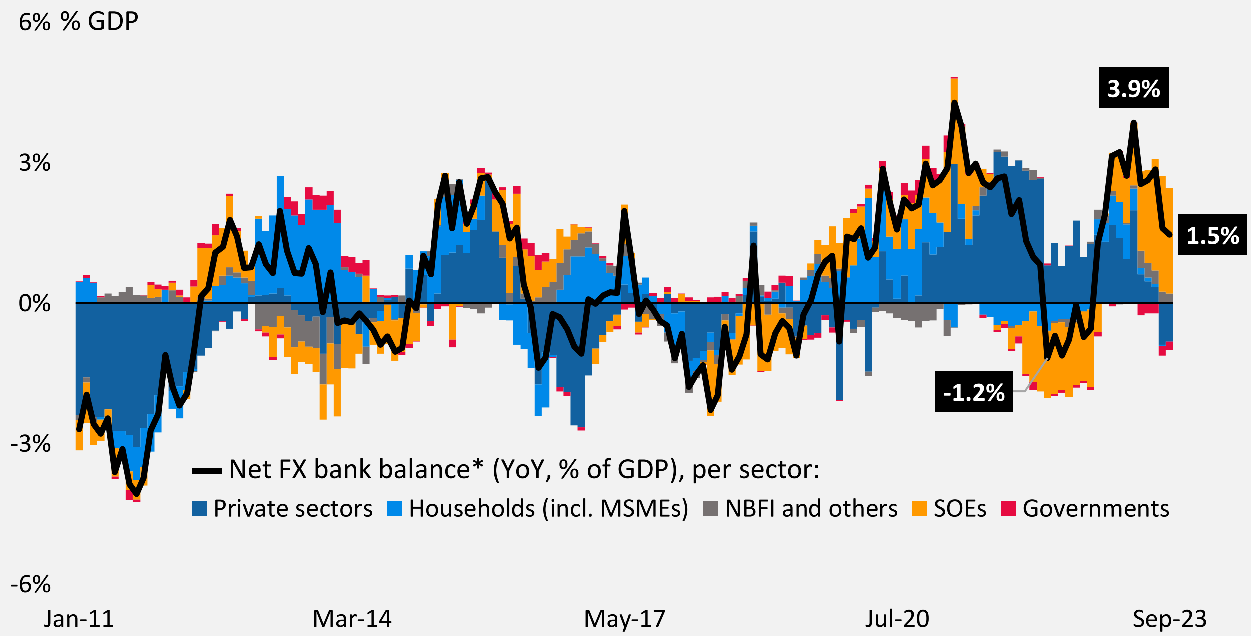


Source: Bank Indonesia

Chart 3

Unequal distribution

The domestic FX liquidity situation remains in good shape, although the FX liquidity supply is unevenly spread between the SOE and other sectors.

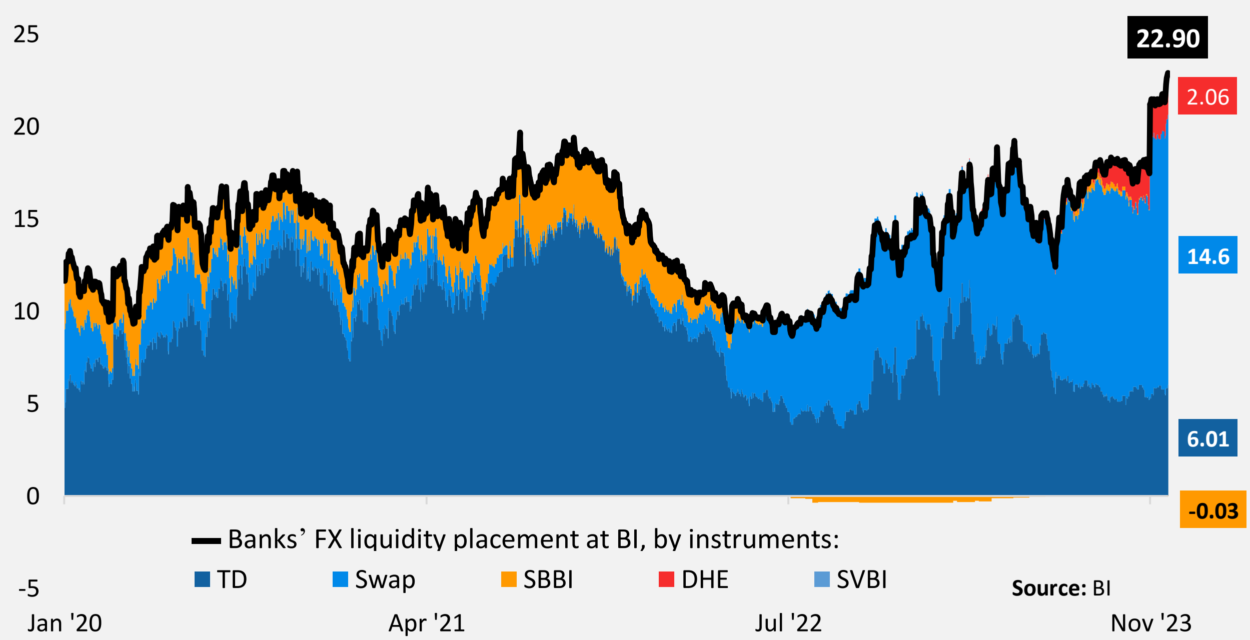


Source: BI. Calculations by BCA Economic Research. * excl. Bonds

Chart 4

Engaged crowds

SVBI's auction does not seem to draw liquidity from BI's other instruments given the still-ample FX liquidity condition within domestic banks.



Source: BI

Economic Calendar

		Actual	Previous	Forecast*
1 Desember 2023				
ID	S&P Global Manufacturing PMI		51.5	51.3
CN	Caixin Manufacturing PMI		49.5	50.2
ID	**Inflation rate YoY**		**2.56%**	**2.7%**
US	ISM Manufacturing PMI		46.7	47.2
5 Desember 2023				
US	JOLTs Job Openings (USD Mn)		9.55	9.4
6 Desember 2023				
US	Balance of Trade (USD Bn)		-61.5	-
7 Desember 2023				
CN	Balance of Trade (USD Bn)		56.53	51.0
ID	**Foreign Exchange Reserves (USD Bn)**		**133.1**	**132.0**
8 Desember 2023				
US	Unemployment Rate		3.9%	3.9%
US	Non-Farm Payroll ('000)		150	100
9 Desember 2023				
CN	Inflation Rate YoY		-0.2%	-0.3%
12 Desember 2023				
US	Inflation Rate YoY		3.2%	3.1%
14 Desember 2023				
US	**Fed Interest Rate Decision**		**5.5%**	**5.75%**
15 Desember 2023				
ID	**Balance of Trade (USD Bn)**		**3.48**	**-**
EU	Balance of Trade (USD Bn)		10	-
20 Desember 2023				
ID	Motorbike Sales YoY		-4%	-
ID	Car Sales YoY		-13.9	-
21 Desember 2023				
ID	Loan Growth YoY		8.9%	-
ID	**Interest Rate Decision**		**6.00%**	**6.00%**

*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	5.50	Nov-23	2.30
UK	5.25	Nov-23	0.65
EU	4.50	Nov-23	1.60
Japan	-0.10	Jan-16	-3.40
China (lending)	2.50	Nov-23	4.55
Korea	3.50	Oct-23	-0.30
India	6.50	Oct-23	1.63
Indonesia	6.00	Nov-23	3.44

Money Mkt Rates	24-Nov	-1 mth	Chg (bps)
SPN (1M)	6.30	6.83	-52.7
SUN (10Y)	6.64	7.22	-58.3
INDONIA (O/N, Rp)	5.80	5.83	-2.6
JIBOR 1M (Rp)	6.66	6.63	2.2

Bank Rates (Rp)	Aug	Jul	Chg (bps)
Lending (WC)	8.96	8.95	0.65
Deposit 1M	4.29	4.24	5.00
Savings	0.66	0.67	-0.53

Currency/USD	24-Nov	-1 mth	Chg (%)
UK Pound	0.793	0.822	3.64
Euro	0.914	0.944	3.30
Japanese Yen	149.4	149.9	0.31
Chinese RMB	7.149	7.311	2.27
Indonesia Rupiah	15,565	15,850	1.83

Capital Mkt	24-Nov	-1 mth	Chg (%)
JCI	7,009.6	6,806.8	2.98
DJIA	35,390.2	33,141.4	6.79
FTSE	7,488.2	7,389.7	1.33
Nikkei 225	33,625.5	31,062.4	8.25
Hang Seng	17,559.4	16,991.5	3.34

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

Trade & Commodities	24-Nov	-1 mth	Chg (%)
Baltic Dry Index	2,102.0	1,949.0	7.9
S&P GSCI Index	554.5	583.5	-5.0
Oil (Brent, $/brl)	80.6	88.1	-8.5
Coal ($/MT)	129.4	141.5	-8.6
Gas ($/MMBtu)	2.71	2.85	-4.9
Gold ($/oz.)	2,000.8	1,971.0	1.5
Copper ($/MT)	8,329.8	7,985.0	4.3
Nickel ($/MT)	15,907.0	18,042.0	-11.8
CPO ($/MT)	817.3	756.8	8.0
Rubber ($/kg)	1.46	1.45	0.7

External Sector	Oct	Sep	Chg (%)
Export ($ bn)	22.15	20.75	6.76
Import ($ bn)	18.67	17.34	7.68
Trade bal. ($ bn)	3.48	3.41	2.08
Central bank reserves ($ bn)*	133.1	134.9	-1.30

Prompt Indicators	Oct	Sep	Aug
Consumer confidence index (CCI)	124.3	121.7	125.2
Car sales (%YoY)	-13.9	-20.1	-8.3
Motorcycle sales (%YoY)	-4.0	-0.9	1.8

Manufacturing PMI	Oct	Sep	Chg (bps)
USA	46.7	49.0	-230
Eurozone	43.1	43.4	-30
Japan	48.7	48.5	20
China	49.5	50.6	-110
Korea	49.8	49.9	-10
Indonesia	51.5	52.3	-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

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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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