

Some risks to the government's long-game

22 January 2024

Lazuardin Thariq Hamzah
lazuardin_hamzah@bca.co.id

Barra Kukul Mamia
barra_mamia@bca.co.id

Summary

- The demand for SRBI seems to be on the rise early in the year, suggesting foreign investors' willingness to hold Rupiah-denominated assets despite some short-term risks.
 - The government maintained its tight control over net SBN issuance thus far in January 2024, leading to lower risk premiums and higher demand that help stabilise SBN yields.
 - The anticipated decline in global interest rates might tempt the government to postpone its SBN issuance, but this back-loading strategy remains vulnerable to the negative rate shock risk.
-
- The US capital market (S&P 500) reached its new all-time high of 4,839.81 on Friday last week, eclipsing its January 2022 high following the broad-based rally since November 2023. This record-breaking development, however, further illustrates the disconnect between markets' expectations of a slowdown-induced Fed rate cuts and the actual US economic data: three US economic data released last week, retail sales (0.6 % MoM in Dec-2023), new building permits (1.495 Mn in Dec-2023), and the consumer confidence index (78.8, jump from 69.7 in Dec-23) all ended higher than market analysts first expected. As emphasised by a stream of FOMC officials in the past two weeks, the data is yet to show that it is time for the Fed to cut its policy rate finally.
 - The Indonesian market continues to benefit from this disconnect. Bank Indonesia reported that the domestic financial market recorded foreign capital inflows to the tune of IDR 7.66 Tn during 15-18 January 2024, which includes IDR 5.52 Tn (USD 353 Mn) into government bonds and IDR 0.65 Tn (USD 41.7 Mn) to the stock market. However, market transactions data show much less buying by foreign investors, as net foreign inflows to the domestic stock market slowed down to USD 3.57 Mn. Meanwhile, the build-up of foreign capital stocks in the Indonesian bond market appears to continue lagging behind the stock market, as foreign capital is observed to be flowing out of the SBN market to the tune of USD 46.9 Mn during 15-16 January 2024.

Chasing the SBN

- The disconnect between BI's reporting and the market data is something that we have observed previously from time to time, and is understandable, given the different methodologies used to produce the data. However, the gap between the two data is the

widest one in recent times and thus warrants some explanations. One of the main differences between BI's flow of funds data and the market data is that BI also takes into account foreign capital inflows to the SRBI market. Indeed, BI reporting reveals that foreign investors purchased around IDR 1.50 Tn of SRBI in last week's auction, which adds to the IDR 62.17 Tn of SRBI outstanding held by foreign investors in December 2023.

- The demand for SRBI does appear to experience a sharp increase in the first three auctions of the year (*See Chart 1*). The heightened demand for SRBI is not surprising. First, SRBI offers lower duration risk relative to SBN, which is particularly attractive for investors given the relative uncertainty in both Indonesia's politics (due to the upcoming Elections) and the global rate outlook. The higher yield on SRBI (as Indonesia's yield curve essentially inverts) puts the cherry on top, encouraging foreign and domestic institutional investors to look more at the SRBI market and, perhaps, less at the SBN market at the moment.
- Be that as it may, we should be careful not to paint the SRBI market as a competition to the SBN market. Similar to the government, BI has shown careful control over SRBI issuances, and the amount awarded has remained relatively limited especially compared to the large increase in bids from the market. **Instead of competing with SBN, then, SRBI has fulfilled its role by offering an alternative for foreign or other institutional investors to manage their IDR liquidity in the short term while**

“The government is still benefitting from the now-loosening global financial conditions despite keeping its tight control over net SBN issuance ”

looking for other long-term opportunities, such as SBN or equities, should the opportunity arise.

- Alas, the opportunity to enter the SBN market may be relatively limited too at the moment. **Despite strong demand for Rupiah-denominated securities, net issuance in the SBN market has been declining since Q4 2023 (see Chart 2)**, increasing the competition for SBN which helped to suppress the lending rate for the government below the 6.7% target.
- The government, of course, is not facing any urgency to issue more SBNs, at least for the moment. The sizable piles of cash still available within the public sector enable the government to meet its substantial fiscal commitments in H1 2024. As hinted in last week's BI policy meeting, **Indonesian policymakers appear to be banking for the Fed to start cutting its policy rate in the second half of the year, a scenario that may allow the government to backload SBN issuances on a lower yield.** It could also be said that the government is still benefitting from the now-loosening global financial conditions despite maintaining tight control over net SBN issuance, as indicated by the reported drawing of FX loan facilities in December 2023.
- The decision to take out external loans (or to utilise the excess budget balance) rather than issuing new SBNs may indicate the government's de-risking effort amidst the still-volatile global and domestic economic and political landscape in the short term. The government's de-risking effort may run in parallel with a similar effort by the market.

Indeed, investors may be on the lookout for a safer bond market at the moment, given the worsening fiscal profile in many economies as governments look to ramp up their spending. **Indonesia’s more prudent approach to debt issuance may reduce the economy’s risk premium and consequently, the demand for Rupiah-denominated assets**, as reflected by the declining trend of the bid-ask spread in the benchmark 10Y SBN market and Indonesia’s CDS premium.

- Unfortunately for foreign investors, the same fiscal prudence that improves Indonesia’s risk perception and helps stabilise the yield on SBN complicates their effort to enter the SBN market. The limited supply growth seems to heighten the competition between foreign and domestic investors to acquire some amount of SBN in their portfolios, as investors from the domestic non-bank sectors do not seem eager to sell their SBN holdings while domestic banks are returning to the SBN market (*see Chart 3*). Fierce competition against domestic investors may also explain the lagging foreign capital inflows into the SBN market, forcing them to look for other alternatives such as SRBI.
- The still-loose global financing conditions, coupled with a large number of liquidity sitting on the shorter and safer end of Indonesia’s financial market, may add to the confidence that the upcoming development in the SBN market would play out as intended by the government’s back-loading strategy. However,

it is important to note that **the successful execution of this back-loading strategy is contingent on multiple factors not controlled by the government**. From the domestic side, how soon the pre- and post-election uncertainty would resolve would be instrumental in keeping the risk premium on the government’s IoU low.

- Another deciding factor, of course, is the financing condition in the US (*see Chart 4*). While it is still early to call, recent updates do not seem to be favourable for Indonesia and other risky markets. The gap between the Fed’s policy signal and the market’s interest rate expectation remains considerably wide, while the upcoming QRA may also play a role in unwinding the loose financing conditions currently evident in the market. A sudden U-turn in the global interest rate expectation may prompt the high amount of liquidity in the shorter end of Indonesia’s financial markets to flow out again rather than moving deeper into the longer end of Indonesia’s market – a potential threat to the government’s back-loading strategy.

“The success of the government’s back-loading strategy remains contingent on external factors such as the probable U-turn on global rate expectations”

Chart 1

Looking for (better) alternatives

Interests for BI's SRBI instrument have been increasing lately amidst the short supply in the SBN market

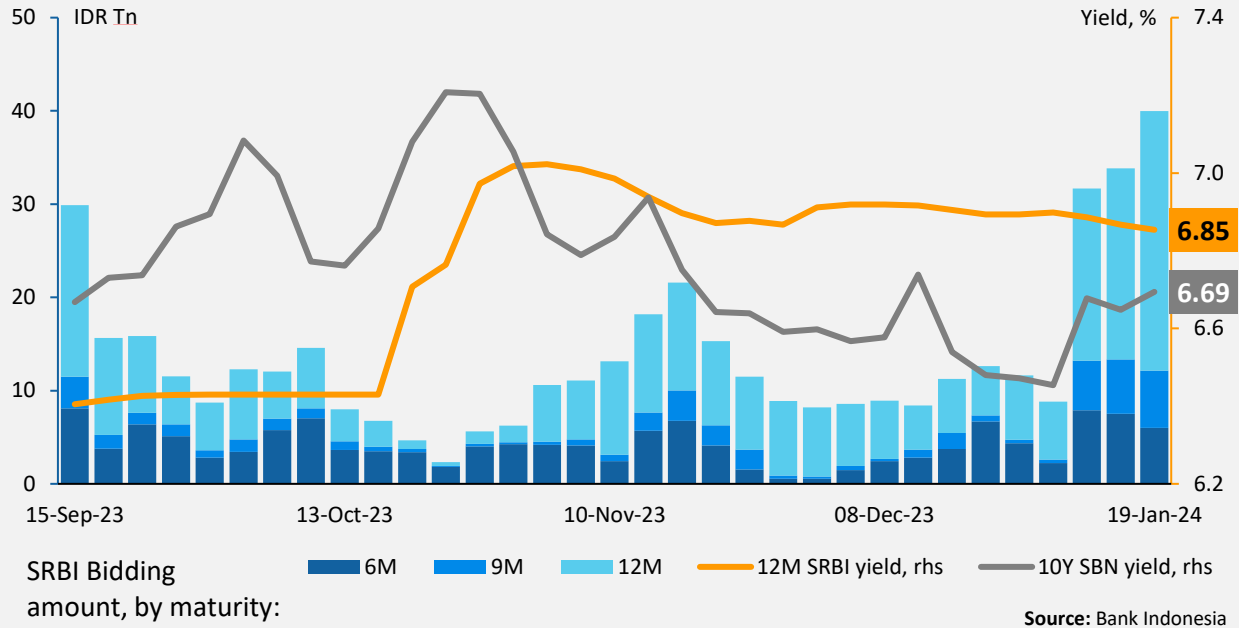


Chart 2

Dried-up

SBN issuance has been declining since Q4-2023 despite investors' still-strong appetite for Rupiah-denominated debt

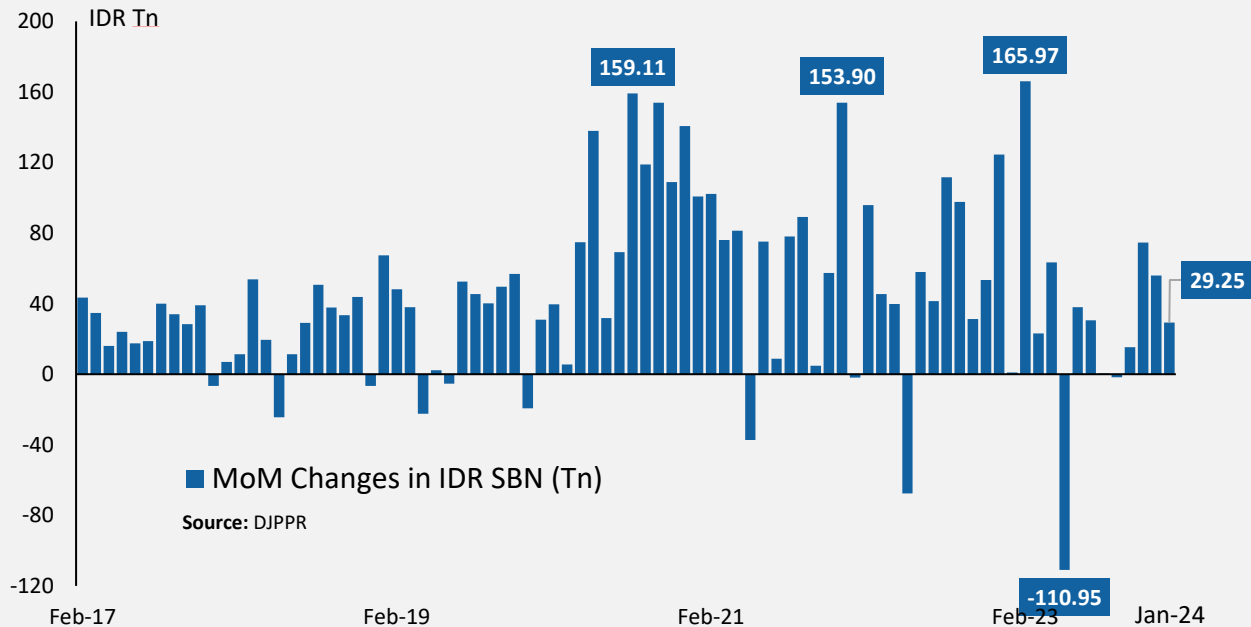


Chart 3

Ticket SBN War

Foreign investors find itself competing with domestic investors and banks in the SBN market as the government maintain its tight leash on the SBN supply in January 2024

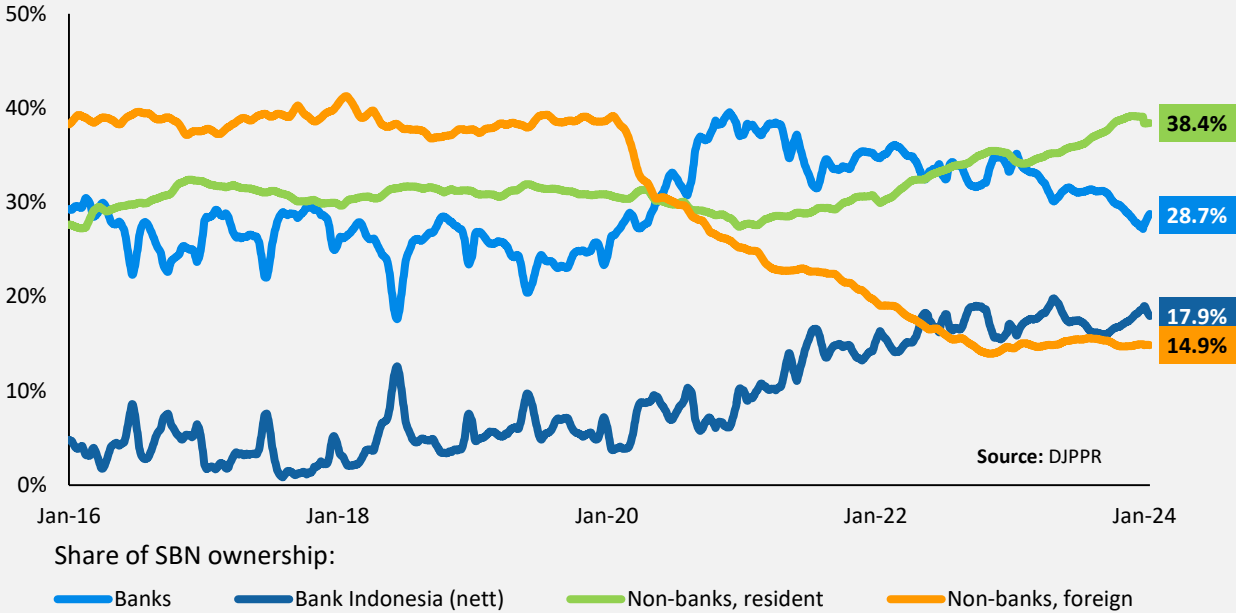
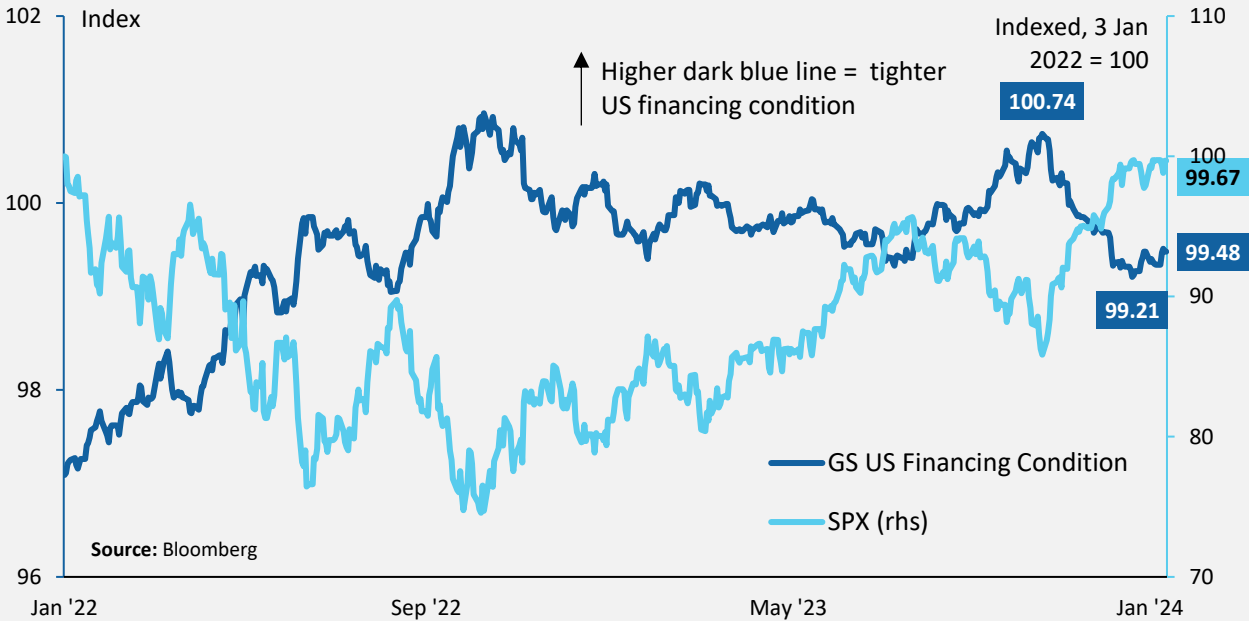


Chart 4

Getting too hot for Goldilocks

The financing condition in the US may continue to tighten in the upcoming months, given the slew of robust macroeconomic data and the anticipation of the upcoming QRA



Economic Calendar				
		Actual	Previous	Forecast*
2 January 2024				
ID	S&P Global Manufacturing PMI	52.2	51.7	51.9
CN	Caixin Manufacturing PMI	50.8	50.7	50.7
ID	Inflation rate YoY	2.61%	2.86%	2.6%
3 January 2024				
US	JOLTs Job Openings (USD Mn)	8.79	8.73	8.75
US	ISM Manufacturing PMI	47.4	46.7	47.3
5 January 2024				
US	Non-Farm Payroll ('000)	216	199	150
8 January 2024				
ID	Foreign Exchange Reserves (USD Bn)	146.4	3.17	3.18
ID	Motorbike Sales YoY	-11.6%	-2.8%	-
9 January 2024				
ID	Consumer Confidence	123.8	123.6	-
US	Balance of Trade (USD Bn)	\$-63.2B	-64.3	-64.8
10 January 2024				
ID	Retail Sales YoY	2.1%	2.4%	-
11 January 2024				
US	Inflation Rate YoY	3.4%	3.1%	3.0%
12 January 2024				
CN	Inflation Rate YoY	-0.3%	-0.5	-0.7
CN	Balance of Trade (USD Bn)	\$75.34B	68.3	46
15 January 2024				
EU	Balance of Trade (EUR Bn)	€20.3B	11.1	-
ID	Balance of Trade (USD Bn)	\$3.3B	2.41	5
17 January 2024				
ID	Interest Rate Decision	6%	6.00%	6.00%
ID	Loan Growth YoY	10.38%	9.74%	-
24 January 2024				
ID	Foreign Direct Investment (USD Bn)	-	13.26	-

*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	19-Jan	-1 mth	Chg (%)
US	5.50	Dec-23	2.10	Baltic Dry Index	1,503.0	2,219.0	-32.3
UK	5.25	Dec-23	1.25	S&P GSCI Index	538.8	546.3	-1.4
EU	4.50	Dec-23	1.60	Oil (Brent, \$/brl)	78.6	79.2	-0.8
Japan	-0.10	Jan-16	-2.70	Coal (\$/MT)	122.0	136.3	-10.5
China (lending)	2.50	Dec-23	4.65	Gas (\$/MMBtu)	2.69	2.44	10.2
Korea	3.50	Nov-23	0.30	Gold (\$/oz.)	2,029.5	2,040.4	-0.5
India	6.50	Dec-23	0.81	Copper (\$/MT)	8,271.8	8,500.5	-2.7
Indonesia	6.00	Nov-23	3.39	Nickel (\$/MT)	15,799.0	16,517.0	-4.3
Money Mkt Rates	19-Jan	-1 mth	Chg (bps)	CPO (\$/MT)	836.2	791.2	5.7
SPN (1M)	5.88	5.80	7.6	Rubber (\$/kg)	1.53	1.44	6.3
SUN (10Y)	6.61	6.49	12.5	External Sector	Dec	Nov	Chg (%)
INDONIA (O/N, Rp)	5.78	5.89	-10.5	Export (\$ bn)	22.41	22.00	1.89
JIBOR 1M (Rp)	6.64	6.65	-0.9	Import (\$ bn)	19.11	19.59	-2.45
Bank Rates (Rp)	Oct	Sep	Chg (bps)	Trade bal. (\$ bn)	3.31	2.41	37.10
Lending (WC)	9.05	9.02	2.79	Central bank reserves (\$ bn)*	146.4	138.1	6.01
Deposit 1M	4.43	4.33	10.10	Prompt Indicators	Dec	Nov	Oct
Savings	0.67	0.66	0.19	Consumer confidence index (CCI)	123.8	123.6	124.3
Currency/USD	19-Jan	-1 mth	Chg (%)	Car sales (%YoY)	-19.1	-7.5	-13.8
UK Pound	0.787	0.785	-0.23	Motorcycle sales (%YoY)	-11.6	-2.8	-4.0
Euro	0.918	0.911	-0.76	Manufacturing PMI	Dec	Nov	Chg (bps)
Japanese Yen	148.1	143.8	-2.89	USA	47.4	46.7	70
Chinese RMB	7.193	7.119	-1.04	Eurozone	44.4	44.2	20
Indonesia Rupiah	15,615	15,505	-0.70	Japan	47.9	48.3	-40
Capital Mkt	19-Jan	-1 mth	Chg (%)	China	50.8	50.7	10
JCI	7,227.4	7,187.8	0.55	Korea	49.9	50.0	-10
DJIA	37,863.8	37,557.9	0.81	Indonesia	52.2	51.7	50
FTSE	7,461.9	7,638.0	-2.31				
Nikkei 225	35,963.3	33,219.4	8.26				
Hang Seng	15,308.7	16,505.0	-7.25				
Foreign portfolio ownership (Rp Tn)	Dec	Nov	Chg (Rp Tn)				
Stock	3,226.3	3,136.1	90.27				
Govt. Bond	841.0	833.9	7.17				
Corp. Bond	10.6	11.2	-0.59				

Source: Bloomberg, BI, BPS

Notes:

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



Scan for the link to our report depository or click:

<https://s.id/1fM>

Indonesia – Economic Indicators Projection

	2019	2020	2021	2022	2023E	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.1	5.0
GDP per Capita (US\$)	4175	3912	4350	4784	4982	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6*	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00*	5.50
USD/IDR Exchange Rate (end of the year)**	13,866	14,050	14,262	15,568	15,397*	16.037
Trade Balance (US\$ billion)	-3.2	21.7	35.3	54.5	37.0*	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	0.1	-0.5

*Actual 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

Aldi Rizaldi

Research Assistant
aldi_yanto@bca.co.id
+6221 2358 8000 Ext: 1020451

Agus Salim Hardjodino

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

Fikri Adam Zaqi

Research Assistant
-
+6221 2358 8000 Ext: -

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

20th Grand Indonesia, Menara BCA
Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia
Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343

DISCLAIMER

This report is for information only, and is not intended as an offer or solicitation with respect to the purchase or sale of a security. We deem that the information contained in this report has been taken from sources which we deem reliable. However, we do not guarantee their accuracy, and any such information may be incomplete or condensed. None of PT. Bank Central Asia Tbk, and/or its affiliated companies and/or their respective employees and/or agents makes any representation or warranty (express or implied) or accepts any responsibility or liability as to, or in relation to, the accuracy or completeness of the information and opinions contained in this report or as to any information contained in this report or any other such information or opinions remaining unchanged after the issue thereof. The Company, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Company or any other person has been advised of the possibility thereof. Opinion expressed is the analysts' current personal views as of the date appearing on this material only, and subject to change without notice. It is intended for the use by recipient only and may not be reproduced or copied/photocopied or duplicated or made available in any form, by any means, or redist ed to others without written permission of PT Bank Central Asia Tbk.

All opinions and estimates included in this report are based on certain assumptions. Actual results may differ materially. In considering any investments you should make your own independent assessment and seek your own professional financial and legal advice. For further information please contact: (62-21) 2358 8000, Ext: 20364 or fax to: (62-21) 2358 8343 or email: aldi_yanto@bca.co.id