FX loans: towards the fast lane

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Summary

- The demand for FX loans has been increasing since Q3 2023, a trend that seems to be encouraged by the widening rate differentials and the low USDIDR hedging cost during the period.
- However, further increases in FX loans may be driven more by the decreasing FX liquidity condition in the domestic market, as diminishing trade and other FX revenue could compel businesses to seek FX financing.
- The accelerating demand for FX loans presents another challenge for the Rupiah, but the still-ample FX reserves and healthy FX LDR condition may soften the blow on the Rupiah.

- The sentiment regarding the global economy may have taken a turn for the worse as news about the recently confirmed recession in Germany bubbled up throughout the past week. However, despite the gloomier global outlook, the momentum in the US economy continued unabated. Driven by solid earnings from the AI sector, the S&P 500 continues to set new all-time highs in the past week, potentially fuelling US consumption growth thanks to the positive wealth effect.
- This rally, however, does not seem to be driven by the risk-on sentiment typical amidst the strengthening expectations for FFR cuts. Quite the contrary, many in the market have pushed their timeline for an FFR cut to H2 2024, while concerns have also arisen that robust payrolls and CPI data in February 2024 may further delay the initial rate cut until after the June FOMC meeting. Some analysts have also expressed concerns about a rate cut in the July or September meeting, given the heightened political sensitivity before the US election.
- Despite the earnings-driven rally in the US stock market, the Fed's victory in the staring contest against the dovish camp in the market may negatively affect the demand for other risky assets. Indeed, foreign inflows to Indonesia's stock market have slowed down quite substantially in the past week, as foreign investors only recorded around USD 11.58 Mn of net buys in the market while the domestic bond market suffered from foreign capital outflows to the tune of USD 205.57 Mn.

When necessity trumps prices

- The slowing demand for Rupiah-denominated assets amidst the seemingly moderating expectation for monetary policy loosening in the US echo our concerns regarding Indonesia's balance of payment (BoP) posture in the upcoming period. As we noted in the previous report on the Q4 2023 BoP number, strong demand for Rupiah assets is one of the determining factors that tip Indonesia's BoP number back into a surplus. Meanwhile, the still-strong appetite for expansions (both fiscal and private consumptions) is likely to tether the current account to a deficit, forcing the economy to finance the deficit with debts as portfolio and foreign direct investments decelerate.
- It is fair to say, then, that the prospect of improving the domestic FX liquidity conditions seems to be limited in the short term. The slowing net trade revenue and declining foreign investments would limit the avenue in which the Indonesian economy could improve its domestic FX liquidity condition through external debt, a trend that was also captured on the Q4 2023 BoP number.
- **The upward trend in the demand for external loans mirrors the situation in the domestic Eurodollar market *(see Chart 1).*** The demand for FX loans has been increasing in recent periods, following the largely unabated upward trend in Rupiah loans after the downward trend in Q3 2022 – Q2 2023.
- The boom-and-bust cycle in FX loan growth deserves further discussion, particularly in periods coinciding with a commodity supercycle. Given Indonesia's bad history with FX loans (the overextension period that precludes the 1998 crisis), the demand for FX loans is often driven by an urgent shortfall in FX liquidity rather than other, more opportunistic motives. Indeed, the distribution of FX loans is often skewed to the SOE sector and more concentrated on working capital loans, as SOEs seek bridging loans to finance their imports.

"The demand for FX loans is often driven by an urgent shortfall in FX liquidity rather than other, more opportunistic motives."

- The upswing in FX loans in 2021-2022 largely follows this more traditional dynamic. The surge in energy prices first increases SOEs' demand for working capital loans, which translates to higher USDIDR hedging costs as the demand for FX loans outpaced that of supply. However, **the positive correlation between the accelerating FX loans and USDIDR hedging did not last throughout the boom cycle, a condition only seen in periods coinciding with a commodity supercycle *(see Chart 2)*.**
- During a commodity supercycle, abundant trade surpluses, along with CA surpluses, contributed to lower volatility in the Rupiah's exchange rate. This condition enabled debtors to opt for FX loans as a more affordable financing option for their expansion projects. However, this trend was reversed when the Fed started its 2022-2023 policy-tightening campaign, narrowing the rate differentials between the USD- and IDR-denominated loans. More opportunistic debtors, then, found themselves priced out of the market, while at the same time, the declining commodity prices

brought back volatility to the Rupiah's exchange rate and, thus higher hedging costs.

- Now that the demand for FX loans is on the rise again, it might be worthwhile to explore what sort of reasoning hitherto drives this renewed spike in FX loans. **When it first started, the increase in FX loan growth may have been driven by speculative intentions**, given the widening USDIDR real rate differentials in Q3 2023 and the still-low hedging costs (around 0.764 bps above the spot rate vs. 3.736 2019-2023 average) that may make FX loans cheaper than IDR loans.
- The acceleration of FX loan growth in Q3 2023, predominantly propelled by non-bank financial institutions, reinforces the argument that the initial surge in FX loans was driven by speculative motives, as the heightened demand for FX loans was concentrated on non-bank financial institutions. However, these speculative intentions may not yield many results at the moment. Despite the still-low hedging costs, the narrowing USDIDR real interest rate differential may have made the relative price of USD financing more expensive than it was in Q3 2023 (by around 68.86 bps using 2Y bonds as a basis), diminishing the allure of USD financing as indicated by the increasing cost of carry.
- Therefore, **it is the demand from non-financial sectors that may sustain the ongoing rally in the demand for FX loans**. Indeed, despite the now-higher cost of FX loans, the declining domestic FX liquidity condition may leave some in the private sector with no option but to continue asking for FX loans ***(see Chart 3)***. As mentioned in the opening, the slowing global demand for commodities means that Indonesia is unlikely to increase its FX revenue either through trade or investments, while the still-going expansion projects continue to absorb FX liquidity from the domestic Eurodollar market. Indeed, FX loan growth in the private sector continues to accelerate in Q4 2023, while NBFIs and the financial sector already slowed their demand for FX financing. What started as a bet to seek cheaper financing, then, may increasingly become a necessity as the domestic FX liquidity further dwindles.

"The declining FX liquidity condition may sustain the demand for FX loans despite the now-higher hedging cost"

- The accelerating demand for FX loans, however, may be better interpreted as a natural result of the still-strong growth impulses in Indonesia rather than the pressing FX liquidity shortage of yesteryears. The government's more regular energy compensation schedule has also reduced the demand for urgent FX bridging loans from import intensive SOEs, which may ensure more productive utilisations of domestic FX liquidity. **The accelerated FX loans, of course, often come as a harbinger of Rupiah's depreciation. However, the healthy FX LDR ratio within the domestic banking system and the still-ample FX reserves mean that the pressure will be manageable.**

Chart 1

Bouncing back

Domestic demand for FX loans slowed down in 2022 but is already bottoming out following its nadir in Q2 2023

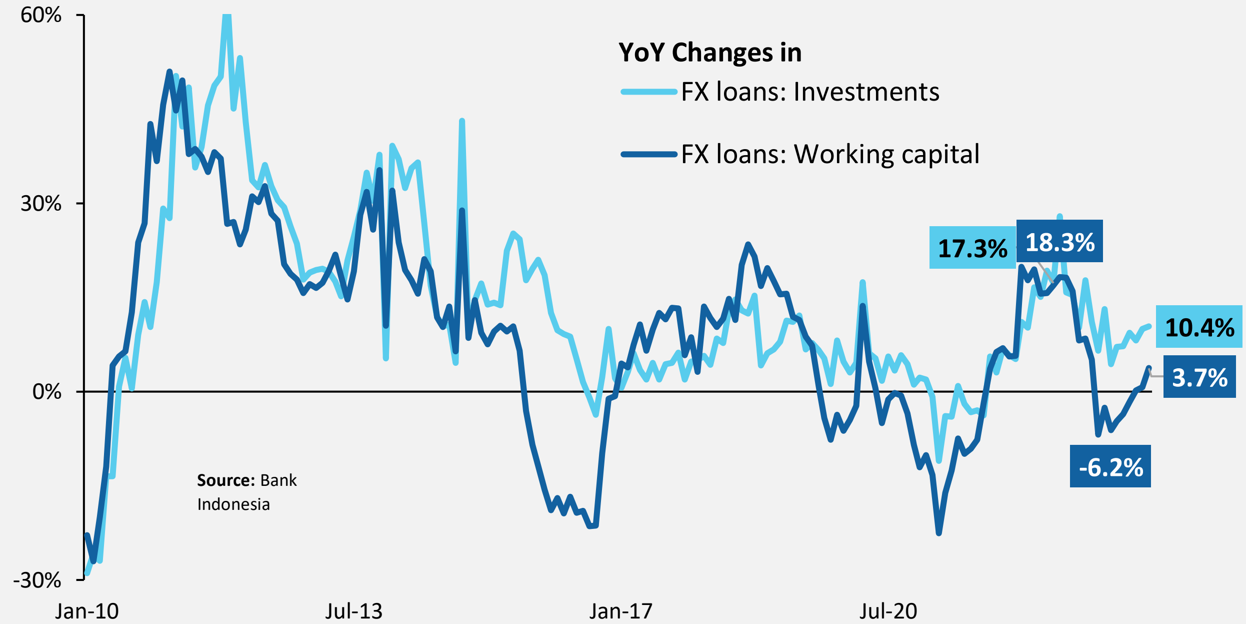


Chart 2

Higher demand, higher prices

Unlike in 2021-2022, the accelerating FX loan growth since H2 2023 leads to an increase in the USD-IDR hedging cost as the higher demand for FX loans may be increasingly driven by necessity rather than hedging.

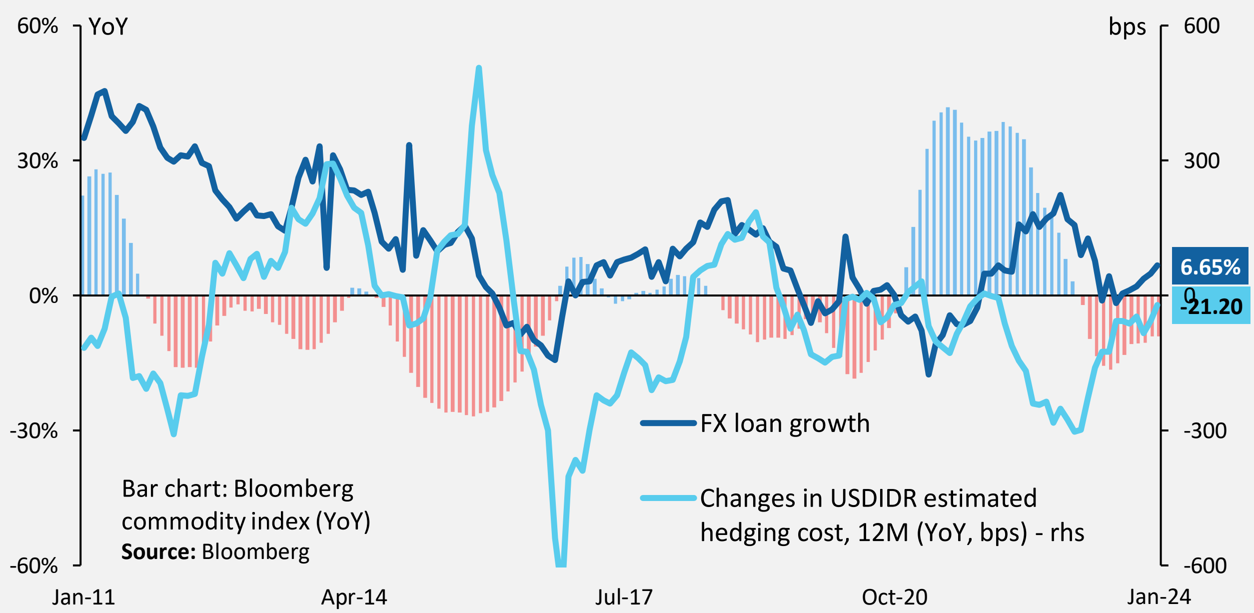
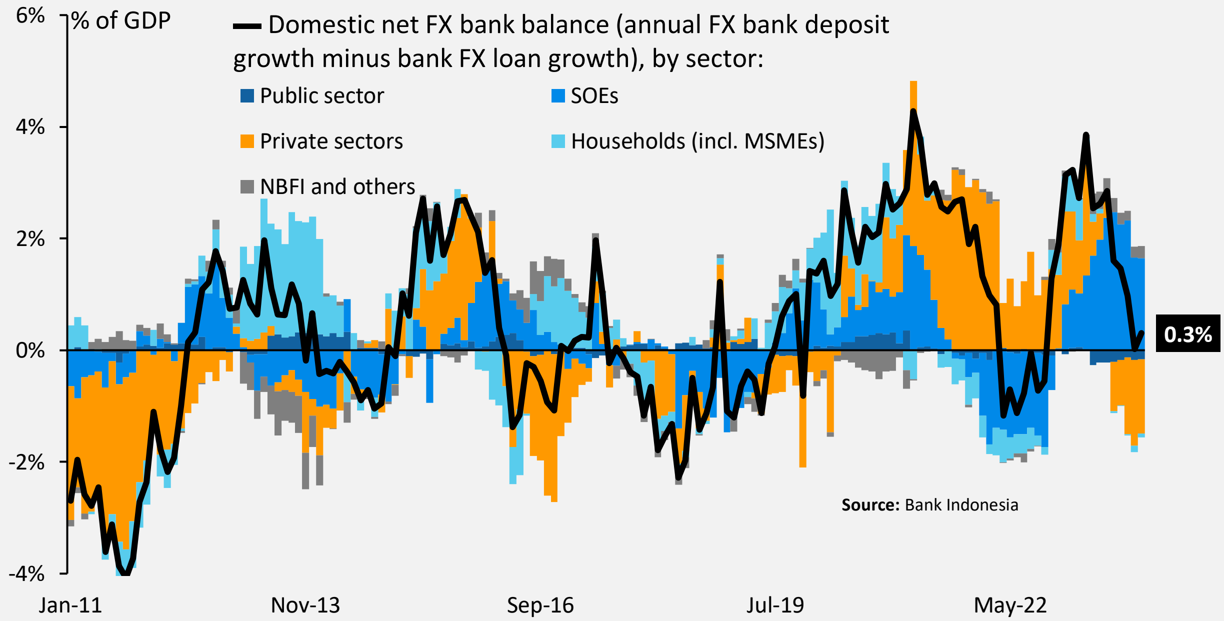


Chart 3

USD back in demand?

The now-lower domestic FX liquidity condition amidst the slowdown in export revenue growth may continue to fuel the demand for FX loans.



Source: Bank Indonesia

Economic Calendar

		Actual	Previous	Forecast*
7 February 2024				
ID	**Foreign Exchange Reserves (USD Bn)**	**145.1**	**146.4**	**-**
US	Balance of Trade (USD Bn)	-	-63.2	-63
8 February 2024				
CN	Inflation Rate YoY, %	-0.8	-0.3	-0.4
9 February 2024				
ID	Motorbike Sales YoY, %	-3.7	-11.6	-
13 February 2024				
US	Inflation Rate YoY, %	3.1	3.4	3.1
ID	Consumer Confident	125.0	123.8	123.9
ID	Car Sales YoY, %	-26.1	-19.1	-
14 February 2024				
ID	2024 Presidential and General Election			
15 February 2024				
EU	Balance of Trade (EUR Bn)	16.8	20.3	15.4
ID	**Balance of Trade (USD Bn)**	**2.01**	**3.3**	**3.1**
16 February 2024				
ID	Retail Sales YoY, %	0.2	2.1	2.6
21 February 2024				
ID	**BI Rate Announcement**, %	**6.0**	**6.0**	**6.0**
ID	Loan Growth YoY, %	11.83	10.38	-
22 February 2024				
ID	**Balance of Payment (USD Bn)**	**-1.3**	**-1.0**	**-0.8**
1 March 2024				
ID	**Inflation rate YoY,** %		**2. 57**	**2.50**
ID	S&P Global Manufacturing PMI		52.9	52.8
CN	Caixin Manufacturing PMI		50.8	50.9
US	ISM Manufacturing PMI		49.1	49.5
6 March 2024				
ID	JOLTs Job Openings (USD Mn)		9026	-
7 March 2024				
ID	**Foreign Exchange Reserves (USD Bn)**		**145.1**	**-**
CN	Balance of Trade (USD Bn)		75.34	-
US	Balance of Trade (USD Bn)		-62.20	-

*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	Dec-23	2.40
UK	5.25	Dec-23	1.25
EU	4.50	Dec-23	1.70
Japan	-0.10	Jan-16	-2.70
China (lending)	2.50	Dec-23	5.15
Korea	3.50	Nov-23	0.70
India	6.50	Dec-23	1.40
Indonesia	6.00	Nov-23	3.43

Money Mkt Rates	23-Feb	-1 mth	Chg (bps)
SPN (1M)	5.88	5.80	7.6
SUN (10Y)	6.56	6.59	-2.9
INDONIA (O/N, Rp)	5.79	5.79	0.9
JIBOR 1M (Rp)	6.64	6.64	-0.5

Bank Rates (Rp)	Dec	Nov	Chg (bps)
Lending (WC)	8.86	8.91	-4.93
Deposit 1M	4.76	4.52	24.61
Savings	0.69	0.67	1.94

Currency/USD	23-Feb	-1 mth	Chg (%)
UK Pound	0.789	0.788	-0.12
Euro	0.924	0.921	-0.30
Japanese Yen	150.5	148.4	-1.44
Chinese RMB	7.196	7.172	-0.34
Indonesia Rupiah	15,595	15,630	0.22

Capital Mkt	23-Feb	-1 mth	Chg (%)
JCI	7,295.1	7,256.2	0.54
DJIA	39,131.5	37,905.5	3.23
FTSE	7,706.3	7,485.7	2.95
Nikkei 225	39,098.7	36,517.6	7.07
Hang Seng	16,725.9	15,354.0	8.94

Foreign portfolio ownership (Rp Tn)	Jan	Dec	Chg (Rp Tn)
Stock	3,115.8	3,226.3	-110.54
Govt. Bond	841.9	842.1	-0.17
Corp. Bond	10.4	10.6	-0.19

Trade & Commodities	23-Feb	-1 mth	Chg (%)
Baltic Dry Index	1,866.0	1,473.0	26.7
S&P GSCI Index	550.9	545.4	1.0
Oil (Brent, $/brl)	81.6	79.6	2.6
Coal ($/MT)	125.3	120.0	4.4
Gas ($/MMBtu)	1.52	2.15	-29.3
Gold ($/oz.)	2,035.4	2,029.3	0.3
Copper ($/MT)	8,475.0	8,312.0	2.0
Nickel ($/MT)	17,271.5	16,070.0	7.5
CPO ($/MT)	828.4	837.4	-1.1
Rubber ($/kg)	1.59	1.51	5.3

External Sector	Jan	Dec	Chg (%)
Export ($ bn)	20.52	22.39	-8.34
Import ($ bn)	18.51	19.11	-3.13
Trade bal. ($ bn)	2.02	3.29	-38.67
Central bank reserves ($ bn)*	145.1	146.4	-0.88

Prompt Indicators	Jan	Dec	Nov
Consumer confidence index (CCI)	125.0	123.8	123.6
Car sales (%YoY)	-26.1	-19.1	-7.5
Motorcycle sales (%YoY)	-3.7	-11.6	-2.8

Manufacturing PMI	Jan	Dec	Chg (bps)
USA	50.7	47.9	280
Eurozone	46.6	44.4	220
Japan	48.0	47.9	10
China	50.8	50.8	0
Korea	51.2	49.9	130
Indonesia	52.9	52.2	70

Source: Bloomberg, BI, BPS
Notes:
*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

	2019	2020	2021	2022	2023E	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0
GDP per Capita (US$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	5.50
USD/IDR Exchange Rate (end of the year)**	13,866	14,050	14,262	15,568	15,397	16.037
Trade Balance (US$ 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	-0.4	-0.5

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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