Distorted signals, aggressive loans, pressured banks

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Summary

- The speculation surrounding the end of BoJ's NIRP experiment, driven by higher-than-expected wage growth, has uncertain implications for the Rupiah due to the narrowing policy gap and the potential unwinding of the JPY carry trade.
- BI's bond-buying program helps to stabilise SBN yields, thereby encouraging banks to expand lending. However, this policy may distort market signals as low SBN yields could discourage investors from re-entering the market.
- The continued acceleration in loan growth poses a further threat to banks' liquidity conditions, as loans appear to be directed towards lower ROI projects.

- The US economy reported a 1.6% YoY increase in its PPI number in February 2024, strengthening the argument that inflationary pressures have returned to the US and policy doves have been driven back to the woods. However, changes in the USD's value remain limited. The announcement of several higher-than-expected economic indicators in the US seems to be counteracted by the more pivotal announcement by Japan's trade union RENGO, which reported that its members had secured a 5.8% increase in their wages (against 3.0% expected) in the latest *Shunto*[1].
- The higher-than-expected Shunto results drive speculation that the Bank of Japan will end its negative interest rate policy experiment at the upcoming meeting on Tuesday. The BoJ's expected move at its Tuesday meeting may narrow the policy gap between the Fed and the central bank, which should bode well for the JPY and other Asian currencies' value, including the Rupiah, despite the recent decline.
- However, **it might be better to hold our horses at the moment**. The BoJ has been experimenting with NIRP for years, which has led to a significant build-up of carry positions in the US financial market and beyond.

[1] annual wage negotiation between Japan's trade union and the *zaibatsu/*enterprise union concluded in Spring.

Hence, while it remains uncertain whether the BoJ will end its NIRP at the Tuesday meeting, what is certain is that the potential unwinding of JPY carry positions due to the expected BoJ policy normalisation will add a further layer of uncertainty.

- The current environment of heightened uncertainty may not bode well with the prospect of foreign capital flowing into the domestic financial market. Foreign investors may remain keen on Indonesian stocks, as evidenced by the USD 475.58 Mn net inflows recorded in the past week. However, given the limited outlook for corporate revenue growth in 2024, the persistent trend of capital inflows into the domestic stock market may be primarily driven by dividend play, meaning that foreign capital inflows to the stock market may slow down ahead of the upcoming earnings season. Alas, foreign inflows to the bond market are yet to pick up, as foreign investors again recorded a net sell to the tune of USD 86.9 Mn in the past week.

"Foreign investors seem to be uninterested in collecting more SBN, given external uncertainties and the distorted pricing signal in the SBN market"

Dangers hiding beneath calm water

- Foreign capital outflows from the SBN market may already be one of the longest trends in the Indonesian market so far in 2024. Selling pressures in the SBN market have also been exacerbated by domestic banks' reducing their SBN holdings. However, **despite these near-persistent selling pressures, the government's borrowing rates remain relatively stable *(see Chart 1)*** as SBN continue to find ready buyers from other crevices in the market.
- We have singled out domestic insurance and pension funds as the primary drivers for the demand for SBN in the second half of 2023, arguing that such a trend may not last for too long given the bubbling concentration risk in their asset portfolios (SBN accounts for a just shy of 62% of social insurances'2 total assets in December 2023). Indeed, SBN purchases by insurance and pension funds are slowing in 2024, accounting for IDR 19.4 Tn since the start of the year (relative to IDR 32.2 Bn in Q4 2023).
- The slowing demand from insurance and pension funds does not mean that domestic non-bank investors stop playing an important role in driving the demand for SBN. Individual investors, for instance, continue to collect more SBN in 2024 – explaining the limited trade volume in the domestic stock market despite a continuous stream of foreign capital inflows.
- **It is the central bank, however, that now plays a central role in driving the demand for SBN and thus keeping the SBN yield stable *(see Chart 2)*.** In part, this can be seen,

[2] BPJS and other government-controlled insurances

in part, as part of BI's open market operations, whereby it offsets banks' move away from SBN and into SRBI.

- Alas, BI's bond-buying programme may have unintentional negative results on investors' perception of the SBN market. **SBN purchases by BI may distort the price signal in the market, suppressing SBN yields to a level unattractive to yield-seeking foreign investors** (or even banks). Indonesia's yield curve is already inverted, which is not so much a prediction of recession as it is best understood as a reflection of BI's and banks' "twist and dance" (more on this later).

- Despite its negative effect on market signals, **the low SBN yield due to BI's intervention may yield more positive results for the real sector**, given that a stable and low SBN yield would help to signal banks to expand their loan portfolio – as reflected by the accelerating loan growth since October 2023.

> ***"The low and steady SBN yield encourage banks to distribute more loans, but the high short-term interest rate increases banks' cost of funds"***

- However, the ongoing acceleration in loan growth does not seem to be distributed equally between domestic banks ***(see Chart 3)***. State-controlled banks, as it seems, have been more aggressive in expanding their loan portfolio, although the same upward trend in loan growth could also be observed in commercial banks.

- Given the unequal distribution in loan growth, it might be worthwhile to investigate what sort of investments these new loans funded. Given the non-building fixed-asset investments' limited contribution to the YoY GDP growth in Q4 2023, **the accelerating loan growth during the period seems to be primarily channelled to fund infrastructure projects.** It is not surprising, then, that the YoY loan growth number is more aggressive for state-owned banks, given the government's heavier fingerprint in infrastructure projects.

- While higher investments are positive for the economy, the current pattern where investments primarily flow into infrastructure projects is not without consequences, especially given the increasing leverage needed to fund the projects. With few exceptions (such as toll roads), infrastructure projects seldom generate revenues, although their positive externalities and forward linkage potential are crucial in ensuring Indonesia's long-term growth potential.

- Nevertheless, infrastructure projects' limited revenue potential means that banks are unlikely to recoup the liquidity sunk to fund the project anytime soon. In contrast, more productive investments (such as investments in machinery) may translate to its investors' revenue potential in the short-term, which may improve banks' liquidity condition should investors opt to save their extra revenue. **The hitherto accelerating loan growth, then, may add more challenges for banks to improve their liquidity condition.**

- **Alas, BI's primary objective of keeping the Rupiah stable seems to limit their ability to**

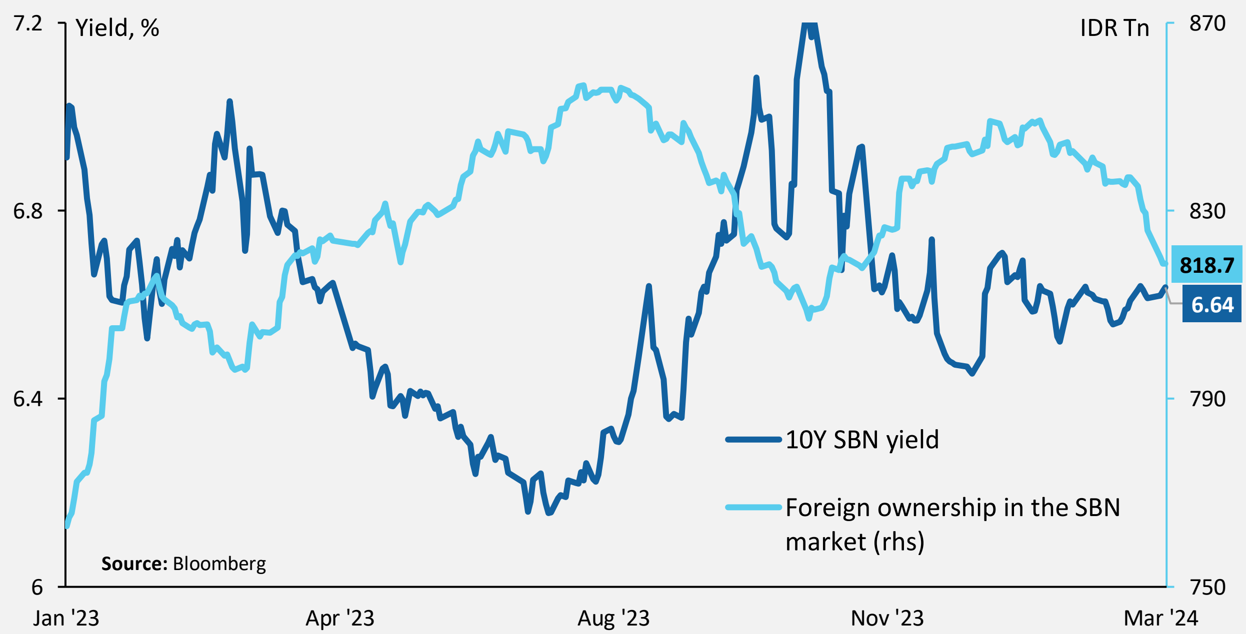
deploy other tools to alleviate the liquidity pressure now facing domestic banks. Depreciation pressures facing the Rupiah still force the central bank to maintain its policy tightening signal, especially on the shorter end of the Indonesian financial market ***(see Chart 4)***. **The introduction of higher-yielding and shorter-duration instruments such as SRBI has "inverted" Indonesia's yield curve, posing a challenge for smaller banks with higher LDR as the cost of funds rose while the lending rate remains stable.** To prevent this, BI may opt to issue SRBI with less volume and less regularity, returning the instrument to its role as essentially an additional tool in BI's arsenal to deal with the exigencies of the global market, as it was when the instrument is first introduced in the last year.

- The other policy that the central bank may start to consider is to adjust its reserves requirement ratio (RRR). Such a policy move is not without precedent, given that BI started tweaking its SRR in June 2022 (having announced it in early 2022) before lifting its policy rate from the pandemic low of 3.50% later in August 2022. **Such a "stealthy" policy loosening would help banks find the liquidity needed to fund the economic growth momentum**, without signalling to the market that the central bank has traded its exchange rate stability goal in search for a higher real economic growth.

Chart 1

Battered but holding on

The benchmark SBN yield remains stable despite near-constant foreign capital outflows in 2024, thus providing an impetus for banks to expand their lending portfolio.

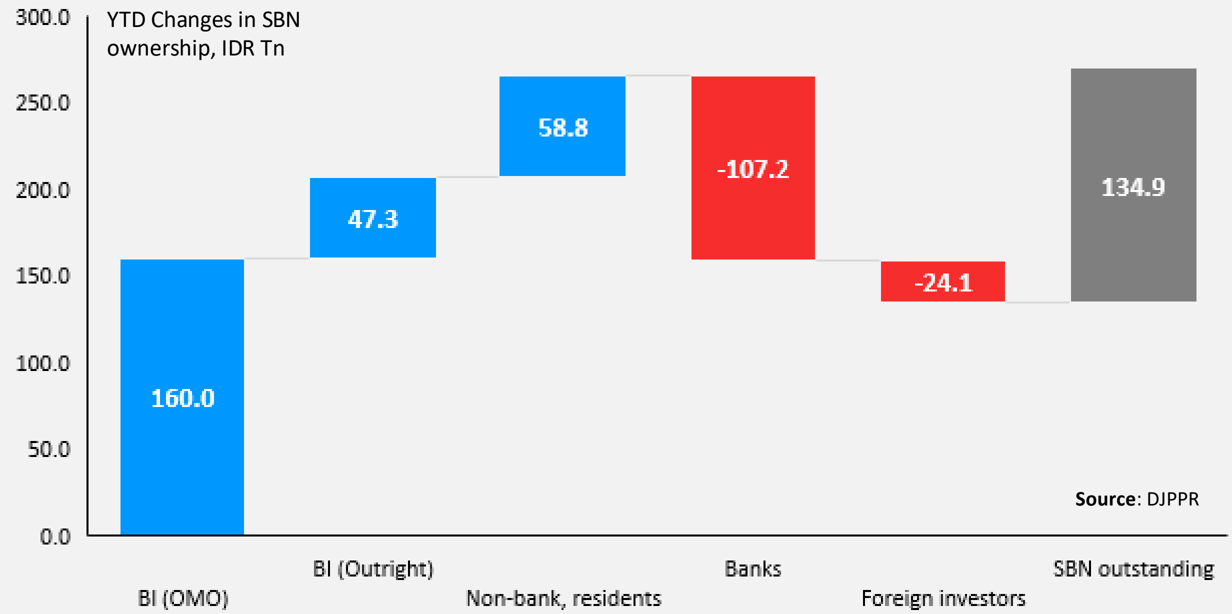


Source: Bloomberg

Chart 2

Keen bidder

BI's bond-buying programme helps to stabilise SBN yields while domestic banks look for other, higher-yielding and shorter-duration assets.

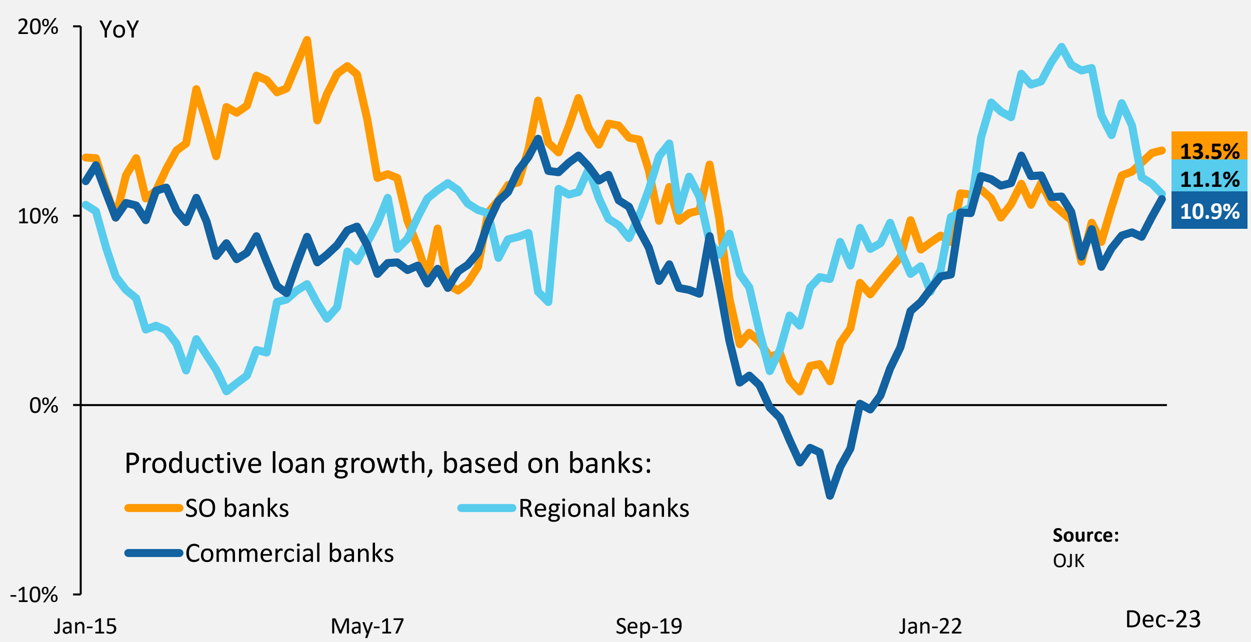


Source: DJPPR

Chart 3

Keener than others

State-owned banks are more aggressive in expanding their loan portfolio as investments are driven by government-sponsored infrastructure projects.

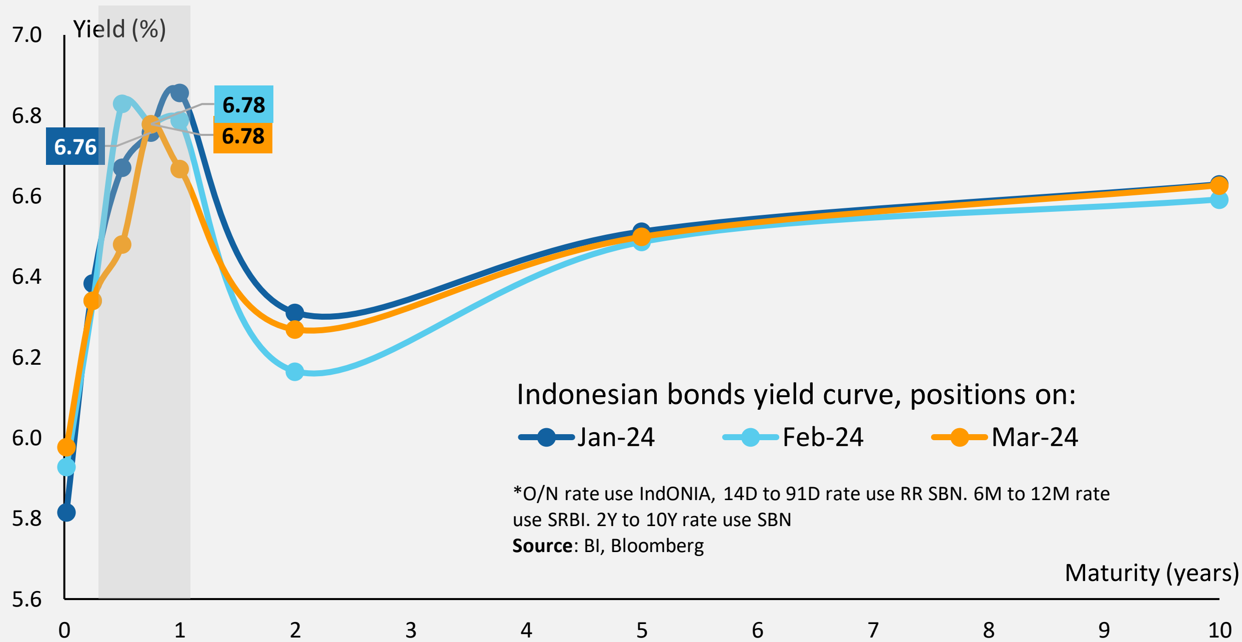


Source: OJK

Chart 4

Another case of inversion

Short-term interest rates have increased since SRBI's introduction while long-term rates remain stable, adding pressure to banks' liquidity conditions.



*O/N rate use IndONIA, 14D to 91D rate use RR SBN. 6M to 12M rate use SRBI. 2Y to 10Y rate use SBN

Source: BI, Bloomberg

Economic Calendar

		Actual	Previous	Forecast*
1 March 2024				
ID	**Inflation rate YoY, %**	**2.75**	**2. 57**	**2.50**
ID	S&P Global Manufacturing PMI	52.7	52.9	52.8
CN	Caixin Manufacturing PMI	50.9	50.8	50.9
US	ISM Manufacturing PMI	47.8	49.1	49.5
6 March 2024				
US	JOLTs Job Openings (Mn)	8,863	8,889	-
7 March 2024				
ID	**Foreign Exchange Reserves (USD Bn)**	**144.0**	**145.1**	**144**
CN	Balance of Trade (USD Bn)	125.1	75.3	106
US	Balance of Trade (USD Bn)	-67.4	-64.2	-63.5
8 Maret 2024				
US	Non-Farm Payroll, (Th)	275	229	195
US	Unemployment Rate, %	3.9	3.7	3.7
9 Maret 2024				
CN	Inflation Rate YoY, %	0.7	-0.8	0.3
11 Maret 2024				
ID	Car Sales YoY, %	-18.8	-26.1	-
ID	Motorbike Sales YoY, %	-2.9	-3.7	-
12 Maret 2024				
US	Inflation Rate YoY, %	3.2	3.1	3.2
13 Maret 2024				
ID	Consumer Confidence	123.1	125.0	126
14 Maret 2024				
ID	Retail Sales YoY, %	1.1	0.2	0.8
15 Maret 2024				
ID	**Balance of Trade (USD Bn)**	**0.87**	**2.0**	**2.5**
20 Maret 2024				
ID	**BI Rate Announcement**, %		**6.0**	**6.0**
ID	Loan Growth YoY, %		11.8	-
21 Maret 2024				
US	**Fed Interest Rate Decision, %**		**5.5**	**5.5**

*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	2.30
UK	5.25	Dec-23	1.25
EU	4.50	Dec-23	1.90
Japan	-0.10	Jan-16	-2.30
China (lending)	2.50	Dec-23	3.65
Korea	3.50	Nov-23	0.40
India	6.50	Dec-23	1.41
Indonesia	6.00	Nov-23	3.25

Money Mkt Rates	15-Mar	-1 mth	Chg (bps)
SPN (1M)	5.88	5.80	7.6
SUN (10Y)	6.64	6.63	1.1
INDONIA (O/N, Rp)	5.82	5.92	-10.4
JIBOR 1M (Rp)	6.65	6.63	1.2

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	15-Mar	-1 mth	Chg (%)
UK Pound	0.785	0.794	1.14
Euro	0.918	0.934	1.68
Japanese Yen	149.0	150.8	1.18
Chinese RMB	7.197	7.194	-0.05
Indonesia Rupiah	15,595	15,595	0.00

Capital Mkt	15-Mar	-1 mth	Chg (%)
JCI	7,328.1	7,209.7	1.64
DJIA	38,714.8	38,272.8	1.15
FTSE	7,727.4	7,512.3	2.86
Nikkei 225	38,707.6	37,964.0	1.96
Hang Seng	16,720.9	15,746.6	6.19

Foreign portfolio ownership (Rp Tn)	Feb	Jan	Chg (Rp Tn)
Stock	3,236.2	3,115.8	120.46
Govt. Bond	837.1	841.9	-4.76
Corp. Bond	9.5	10.4	-0.89

Trade & Commodities	15-Mar	-1 mth	Chg (%)
Baltic Dry Index	2,374.0	1,585.0	49.8
S&P GSCI Index	575.3	559.3	2.9
Oil (Brent, $/brl)	85.3	82.8	3.1
Coal ($/MT)	131.3	125.0	5.0
Gas ($/MMBtu)	1.38	1.61	-14.3
Gold ($/oz.)	2,155.9	1,993.2	8.2
Copper ($/MT)	8,968.5	8,155.5	10.0
Nickel ($/MT)	17,892.5	16,005.0	11.8
CPO ($/MT)	921.0	821.9	12.1
Rubber ($/kg)	1.67	1.51	10.6

External Sector	Feb	Jan	Chg (%)
Export ($ bn)	19.31	20.49	-5.79
Import ($ bn)	18.44	18.49	-0.29
Trade bal. ($ bn)	0.87	2.00	-56.64
Central bank reserves ($ bn)*	144.0	145.1	-0.72

Prompt Indicators	Feb	Jan	Nov
Consumer confidence index (CCI)	123.1	125.0	123.6
Car sales (%YoY)	-18.8	-26.1	-7.5
Motorcycle sales (%YoY)	-2.9	-3.7	-2.8

Manufacturing PMI	Feb	Jan	Chg (bps)
USA	52.2	50.7	150
Eurozone	46.5	46.6	-10
Japan	47.2	48.0	-80
China	50.9	50.8	10
Korea	50.7	51.2	-50
Indonesia	52.7	52.9	-20

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

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Indonesia – Economic Indicators Projection

	2019	2020	2021	2022	2023	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	-0.1	-0.5

* Estimation of the Rupiah's fundamental exchange rate

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