Shedding a light on the looming shadow of commodity reflation

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Summary

- Frequent changes in global interest rate expectations continue to present a challenge for the financial market, underscoring the importance of Indonesia's trade performance for the stability of the Rupiah in the coming periods.
- Despite the deteriorating sentiment, the Chinese government's efforts to revive its economy from the ongoing downturn might stabilise the demand for Indonesian commodities as the impact could go as far as sparking another rally in the global commodity market.
- The potential for commodity reflation, along with other supply-side risks, might constrain the magnitude of the expected FFR cuts. This, in turn, poses additional risks to the financial market.

- The release of minutes from the latest FOMC meeting, along with the hot December 2023 US non-farm payroll data (216,000 in Dec-23 vs 170,000 expected) seems to slow down the FFR cut expectation that has dominated market sentiments in recent months. The FFR futures now point to up to 125 bps of rate cuts in 2024, 25 bps less than prior expectations in the first week of January, albeit still considerably higher than the 75 bps rate cuts communicated by the Fed. It is no wonder, then, that the US stock market tumbled by -1.79 % by the end of last week.
- Meanwhile, the Indonesian stock market has continued to march northward in the past week. Foreign capital inflows to the tune of USD 185.09 Mn helped the JCI to start trading from the 7,402.14 high last Friday, although the JCI fell again slightly as the hot December 2023 NFP number forced some investors to retreat. On the other side of the market, it is a tad unclear how foreign investors position themselves in the domestic bond market throughout the first week of the year, although the increasing bid-ask spread for the benchmark 10Y SBN may point to a less optimistic picture in the SBN market.
- Looking back, strong capital inflows to the domestic bond market throughout the last month have helped to improve the domestic FX supply condition, as indicated by the USD 8.3 Bn increase in Bank Indonesia's FX reserves position (more of this on our dedicated report on the December 2023 FX reserves position). The still-mercurial global

interest rate expectation, as discussed above, means that it might not be too prudent to assume that the Indonesian economy would benefit from an endless stream of foreign capital inflows in 2024. Therefore, how the economy performs in the export market remains crucial for the Rupiah's stability in the upcoming period, a condition which may point to another source of optimism given Indonesia's ongoing streak of higher-than-expected trade surpluses.

- One of our main observations from the previous year is that the Indonesian economy has considerably been lucky with its trade surpluses. While commodity prices continued to decline from their peak around Q3 2022, Indonesia's trade balance still managed to record a sizable surplus of around USD 3 Bn per month ***(see Chart 1)***. Lower import prices, especially for fuel and manufactured goods, may play a part in keeping a check on Indonesia's imports. However, the 11.87 % increase in the volume of Indonesia's exports seems to play the lead role in keeping the bountiful trade surplus, which helped to stabilise the domestic FX supply condition amidst the outpouring of foreign capital in Q3 2023.

"The higher volume of exports to China seems to be the product of the government's rather than the recovery in its economy"

- Identifying the force behind this "lower price, higher volume" model that has played a role in sustaining Indonesia's substantial trade surpluses leads to an unsurprising answer. The Chinese economy, of course, is the one that contributed significantly to the increase in Indonesia's trade volume ***(see Chart 2)***. This finding, however, leads to another two questions that may dictate Indonesia's trade performance and, thus, the stability of the Rupiah in the New Year.

- The first question, of course, is the rationale behind this increase in export volume. First, we should note that China is not the only economy that demands more exports from Indonesia. Indonesia benefits from higher demand from its ASEAN partners, thanks to a robust growth outlook throughout the region. But the story is different for China. While some indicators may point to a rebound in China's growth potential, the YoY reading of much of China's economic data is unsurprising given the low base effect.

- The higher volume of Indonesia's exports to China seems to be the product of policies taken by the Chinese government to lift its economy from the ongoing slump rather than the dramatic recovery in China's growth potential. The torrent of stimulus directed mainly towards the manufacturing sector has kept the expansion momentum alive, which would increase the demand for raw materials that benefit commodity producers. The condition may especially be true for industrial minerals and energy producers, as the expansion in China's manufacturing activity seems to be concentrated on the mineral-heavy EV sector and energy-intensive chemical industry. The Chinese government's bid to improve its energy security also continues to fan the demand for coal from Chinese consumers, which is good news for the Indonesian economy.

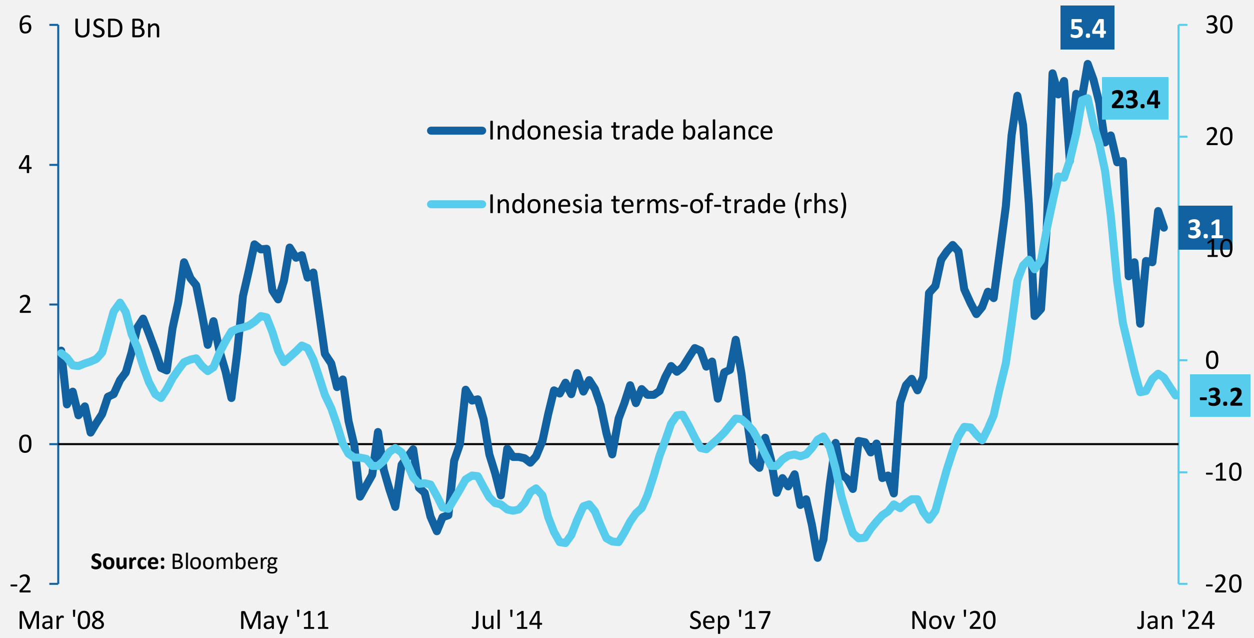
- The second question is whether this theme will continue in the upcoming period. In hindsight, the current conditions do not point to a favourable outcome for the Indonesian economy. For instance, consistent improvement in China's domestic coal production and the already-high inventory level may limit the demand for imported coal ***(see Chart 3)***. Continued manufacturing expansions may also worsen China's lingering oversupply problem, considering the slowing global demand, as many expected in 2024.
- However, we should not underestimate China's ability to kick recession down the road. The central government's low debt level may allow them to continue flushing stimulus towards the manufacturing sector, allowing them to continue producing (and thus, absorbing more industrial and energy commodities) despite the suppressed margin. Combined with recent signs of still-robust economic activity in the US and commodity traders' already net-short position, the prospect of stable commodity demand from China could result in another rally in the global commodity market, akin to what happened in the copper market throughout December 2023.
- It is difficult to fathom, then, that the Fed would aggressively cut the policy rate as anticipated by the market given the still-looming risk of commodity reflation (among other supply-side risks, such as the now-elevated shipping costs). Ergo, rather than rigid forward guidance, we see the FOMC's decision to telegraphed an additional 25 bps in its rate cut outlook as a bid to extend their policy optionality. A no-shock scenario for the Fed's current projection, as we discussed in the previous week, already amounts to a considerable negative shock for the market's interest rate expectation. A commodity reflation scenario, then, would translate to an even greater shock to the market, which may spark more significant outflows from more peripheral markets including the Indonesian financial market.
- While the still-probable commodity reflation scenario is indeed good news for commodity producers and Indonesia's trade surpluses, such a scenario may turn out to be neutral for BI's policy decision. While the bountiful trade surplus would help to improve the domestic FX supply condition, the spectre of expectations shock in the market may force the central bank to stand guard against the risk of foreign capital outflows. BI's room to loosen its policy rate, then, seems to be limited to 50-75 bps as signalled by the Fed and will likely come in the second half as BI has mentioned – meaning that the job to stimulate the economy, at least in H1 2024, would fall squarely on fiscal policies.

> ***"Stable demand from China, combined with the still-robust US economy, may spark another rally in the global commodity market"***

Chart 1

Little on price, big on volume

Higher trade volume helped Indonesia's trade surplus to rebound in Q3 2023 despite the continued downturn in commodity prices.

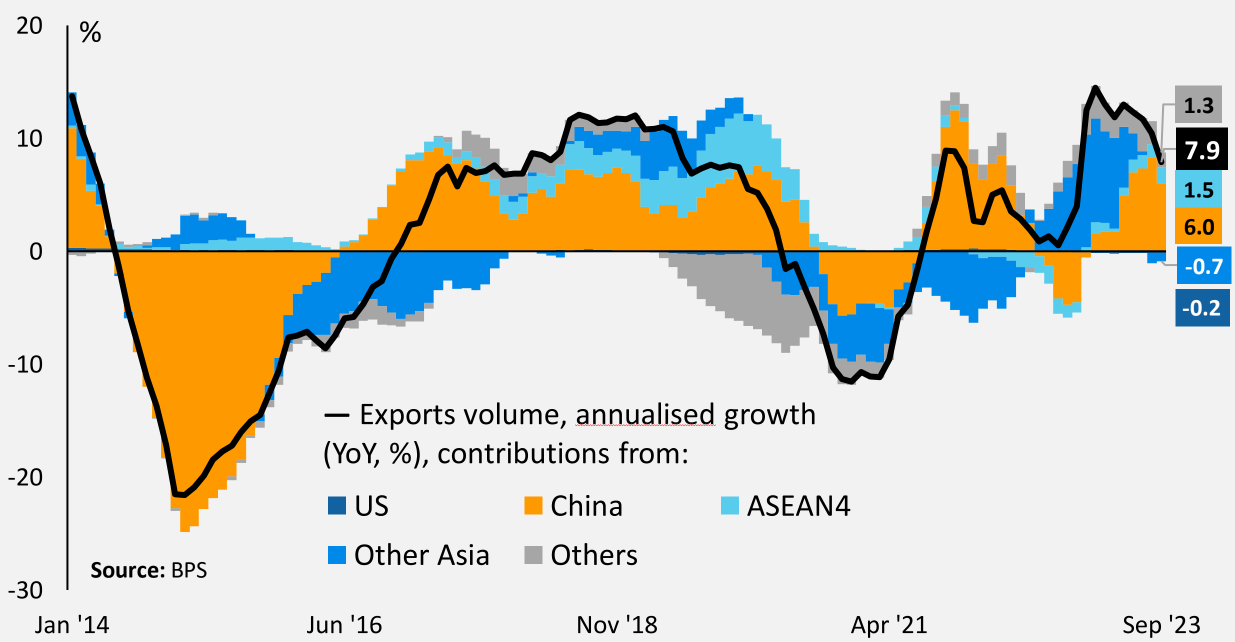


Source: Bloomberg

Chart 2

Monopsony-like

Indonesia's higher trade volume seems to be primarily driven by China, while demand from other Asian and Western markets declined.



Source: BPS

Chart 3

No room left?

China continue to import more coal in 2023, but the constant improvement in its domestic production and the already high coal inventory may limit China's coal demand in the upcoming period

Source: Bloomberg

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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**
9 January 2024				
ID	Consumer Confidence		123.6	-
US	Balance of Trade (USD Bn)		-64.3	-64.8
10 January 2024				
ID	Retail Sales YoY		2.4%	-
11 January 2024				
US	Inflation Rate YoY		3.1%	3.0%
ID	Motorbike Sales YoY		-2.8%	-
12 January 2024				
CN	Inflation Rate YoY		-0.5	-0.7
13 January 2024				
CN	Balance of Trade (USD Bn)		68.3	46
15 January 2024				
EU	Balance of Trade (EUR Bn)		11.1	-
ID	**Balance of Trade (USD Bn)**		**2.41**	**5**
16 January 2024				
ID	**Interest Rate Decision**		**6%**	**-**
19 January 2024				
ID	Loan Growth YoY		9.74%	-
24 January 2024				
ID	**Foreign Direct Investment YoY**		**-**	**-**

*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	1.35
EU	4.50	Dec-23	1.60
Japan	-0.10	Jan-16	-2.90
China (lending)	2.50	Dec-23	4.85
Korea	3.50	Nov-23	0.30
India	6.50	Dec-23	0.95
Indonesia	6.00	Nov-23	3.39

Money Mkt Rates	5-Jan	-1 mth	Chg (bps)
SPN (1M)	5.88	5.80	7.6
SUN (10Y)	6.68	6.57	10.4
INDONIA (O/N, Rp)	5.80	5.94	-13.7
JIBOR 1M (Rp)	6.64	6.65	-0.4

Bank Rates (Rp)	Oct	Sep	Chg (bps)
Lending (WC)	9.05	9.02	2.79
Deposit 1M	4.43	4.33	10.10
Savings	0.67	0.66	0.19

Currency/USD	5-Jan	-1 mth	Chg (%)
UK Pound	0.786	0.794	0.99
Euro	0.914	0.926	1.35
Japanese Yen	144.6	147.2	1.74
Chinese RMB	7.147	7.147	0.00
Indonesia Rupiah	15,515	15,505	-0.06

Capital Mkt	5-Jan	-1 mth	Chg (%)
JCI	7,350.6	7,100.9	3.52
DJIA	37,466.1	36,124.6	3.71
FTSE	7,689.6	7,489.8	2.67
Nikkei 225	33,377.4	32,775.8	1.84
Hang Seng	16,535.3	16,327.9	1.27

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

Trade & Commodities	5-Jan	-1 mth	Chg (%)
Baltic Dry Index	2,110.0	3,143.0	-32.9
S&P GSCI Index	541.8	539.9	0.3
Oil (Brent, $/brl)	78.8	77.2	2.0
Coal ($/MT)	130.5	135.1	-3.4
Gas ($/MMBtu)	2.75	2.73	0.7
Gold ($/oz.)	2,045.5	2,019.4	1.3
Copper ($/MT)	8,361.0	8,252.8	1.3
Nickel ($/MT)	16,151.5	15,940.0	1.3
CPO ($/MT)	791.1	783.1	1.0
Rubber ($/kg)	1.51	1.40	7.9

External Sector	Nov	Oct	Chg (%)
Export ($ bn)	22.00	22.15	-0.67
Import ($ bn)	19.59	18.67	4.89
Trade bal. ($ bn)	2.41	3.47	-30.56
Central bank reserves ($ bn)*	138.1	133.1	3.73

Prompt Indicators	Nov	Oct	Sep
Consumer confidence index (CCI)	123.6	124.3	121.7
Car sales (%YoY)	-7.5	-13.8	-20.1
Motorcycle sales (%YoY)	-2.8	-4.0	-0.9

Manufacturing PMI	Nov	Oct	Chg (bps)
USA	46.7	46.7	0
Eurozone	44.2	43.1	110
Japan	48.3	48.7	-40
China	50.7	49.5	120
Korea	50.0	49.8	20
Indonesia	51.7	51.5	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

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	34.9	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	-0.4	-0.5

*Actual number

** Estimation of the Rupiah's fundamental exchange rate

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