

Turning the tide

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Summary

- The normalising CA outlook following the seasonal spike in Q2 2024 and the returning foreign capital inflows may help the Rupiah to be more stable in the months ahead.
- The improving bank liquidity condition may further strengthen the Rupiah's fundamentals, albeit the improvement is more driven by lower consumption.
- The now-stable Rupiah lowers the urgency for BI to adjust its policy rate, but efforts to prematurely loosen the financing condition may again expose the Rupiah to higher volatility.

- The global financial market has been a relatively serene place in recent times. It's been three weeks since a repricing event hit the US financial market (measured by shocks to the 12M FFR futures), as the recently released FOMC minutes delivered almost nothing besides things that the market already knew of (FOMC members already saw a pathway towards a lower policy rate environment, but the risk remains on the side of inflation). The DXY index may remain elevated, up 3.54% since the start of the year, but the USD's recent strength may be driven more by other major central banks' more dovish stance rather than the Fed's increasingly hawkish signal.

- The relatively tranquil global condition translates positively to Indonesia's financial market. Bank Indonesia reported USD 0.51 Bn in net foreign capital inflows throughout the past week, with USD 0.13 Bn inflows to the stock market covering the USD 0.12 outflows from the INDOGB market while net purchases of SRBI by foreign investors accounting for the rest. Foreign interest for Rupiah-denominated assets may remain limited to SRBI and a handful of stocks (with the four 'big banks' accounting for an estimated USD 0.11 Bn of the USD 0.13 Bn total foreign inflows in the past week), but, given the Rupiah's positive trend in the past week, it looks like the Rupiah will enjoy its time in the sun in the next couple of months.

Stabilising power comes from within

- Before arriving at our improving outlook on the Rupiah, it might be best to list the negative factors that have plunged the Rupiah into its May-June 2024 malaise. First, the financing

conditions in the US are visibly tighter during the period, thanks to the series of hotter-than-expected US economic data that culminates

with the Fed revising its rate cut signal from a total of 75bps to merely 25bps in mid-June.

- This re-pricing event in the US prolonged the longer-running factor that had brought the Rupiah to its knees since late March 2024, the continuous foreign outflows from the domestic financial market. The limited rally in the global commodity market and the slowing household consumption lowers the allure of Indonesian stocks, while the uncertain fiscal outlook spurred investors in the INDOGB market to the exit door (with some of them moving to the SRBI market).
- Further complicating the situation is the seasonal spike in Indonesia's external payments. The dividend repatriation season, combined with high imports of travel services (driven by the Hajj season and other events such as long weekends and the end of the school year holidays) fuels the demand for foreign currencies, adding to the pressure that suppresses the IDR to its 16,450/USD nadir on 21 June 2024.
- The toxic mix of tight dollar-funding conditions, foreign capital outflows, and higher payments abroad leads us to speculate that BI may need to increase the BI rate by another 25 bps should this challenging environment persist. Fortunately, **events in the past week indicate that the tide might already be turning for the Rupiah.** For instance, downside surprises to recently released US economic data have been taken by the market as some sort of 'confirmation' that the Fed will need to cut its policy rate at least by 25 bps in 2024, leading to the expectation that the 0.93%

“The Rupiah may depend mostly on internal factors to ward-off volatilities as FFR cut scenario is already priced-in by the market”

WoW depreciation against the USD recorded in the last week may mark the start of a longer trend (*see Chart 1*).

- However, **we are less sanguine that the highly anticipated FFR cut will significantly boost the Rupiah.** First, it is important to notice that while the FFR has not changed, the financing conditions in the US are already looser than at almost any other point in the past two years (*see Chart 2*). Ergo, the uncertainty now lies on the side of the next QRA (when the US Treasury Department will announce the size of UST issuance in Q3-2024) rather than the Fed's next policy rate action. **The market, it seems, has already positioned itself in anticipation of the 25 bps FFR cut scenario,** meaning that the actual FFR cut is not likely to unlock more demand for Rupiah-denominated assets (among other risky assets).
 - Meanwhile, the growing support for a 25-50 bps FFR cut scenario may also not be taken as a positive sign. As mentioned time and again by FOMC officials, inflationary pressures facing the US economy have become more structural, leading to the new normal of a higher long-term interest rate (as indicated by the FOMC's recent summary of economic projections). A more aggressive FFR cut, then, may not be possible without a significant downside shock to the US economy, which often leads to tighter financing conditions (at least in the early stage of the shock).
- The Rupiah may need to rely on domestic conditions to find its way towards the warm summer sun – which, fortunately, the economy should have no problem finding in the upcoming months. Despite our more

careful reading on the positive impact a 5.00-5.25% FFR will have on the demand for the Rupiah, **there are still reasons to be confident that the returning net foreign inflows trend will continue (see Chart 3)**. The recently announced 2025 state budget proposal (fiscal deficit will be kept between 2.29-2.82% in 2025) dismisses concerns that the upcoming government will adopt a more expansive fiscal budget, encouraging foreign investors to return to the domestic bond market (despite the limited outflows in the last week).

- The expectedly higher INDOGB (and FX-denominated INDON) issuance may further spur foreign investors to set their sights on the Indonesian market, although **yields on the sovereign bond market may need to be allowed to move higher (or at least, closer to SRBI yields) to prevent the trend of funds switching from SBN to the SRBI market to continue**. Apart from the portfolio side of the BoP, the Indonesian economy is likely to face a lower external payments bill in H2 2024, given that almost all the annual events (dividend repatriation, Hajj pilgrimage, holiday seasons) that naturally drive current account deficits are concentrated in Q2 2024.
- **The Rupiah's fundamental may also be strengthened by the seemingly improving savings condition**. Our net bank balance indicator detects an improvement in May 2024, albeit still limited to the corporate sector (see Chart 4). Apart from pointing to a more balanced CA condition, a higher saving rate will help to slow down the money supply growth, bringing the Rupiah's supply closer to a condition that will allow the currency to regain its value vis-à-vis other currencies.
- Alas, **it remains uncertain whether the now-higher savings rate is a product of a higher**

revenue or lower consumption (and investments), which will translate negatively to the GDP growth momentum. Unfortunately, the early signal is pointing to the latter, given the limited improvement in Indonesia's export prices. **More specifically, the improvement in banks' liquidity condition seems to be indicative of slowing investment in the corporate sector**, given that the increase in the net bank balance is concentrated in the corporate and SOE sectors (their net bank balance increased by around IDR 79.3 Tn in May 2024) while the household sector continues to find it hard to reign in consumption and increase their saving balance.

- Given this reading, **the time might be ripe to see the possibility of BI raising the policy rate by another 25 bps with less conviction**. Indeed, BI has shown that the combination of SRBI-driven inflows and FX market interventions is enough to keep the Rupiah stable amidst the short-term volatility. However, **efforts to step on the accelerator towards higher GDP growth may shepherd the exchange rate volatility to return**, meaning that a prolonged period of a high-and-dry BI rate remains the base scenario for now.

"The trade-off between a higher GDP growth or a stable currency seems to be unavoidable given the uncertain global condition"

Chart 1

Defying the gravity

The widening policy rate gap between the Fed and other major central banks explains the USD's stably high value despite the series of downside surprises in recent US economic data

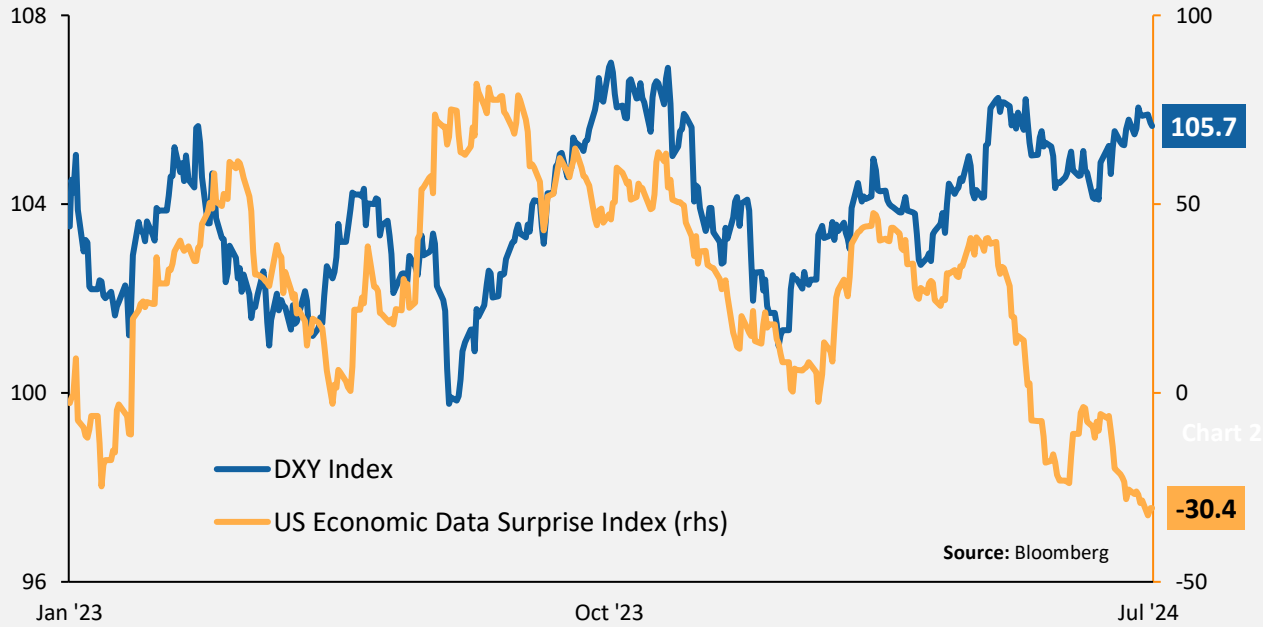


Chart 2

Loosest in years

The US stock market continues to appreciate on the back of the looser financing condition, while a negative shock to the economy may move the financing condition to re-tighten

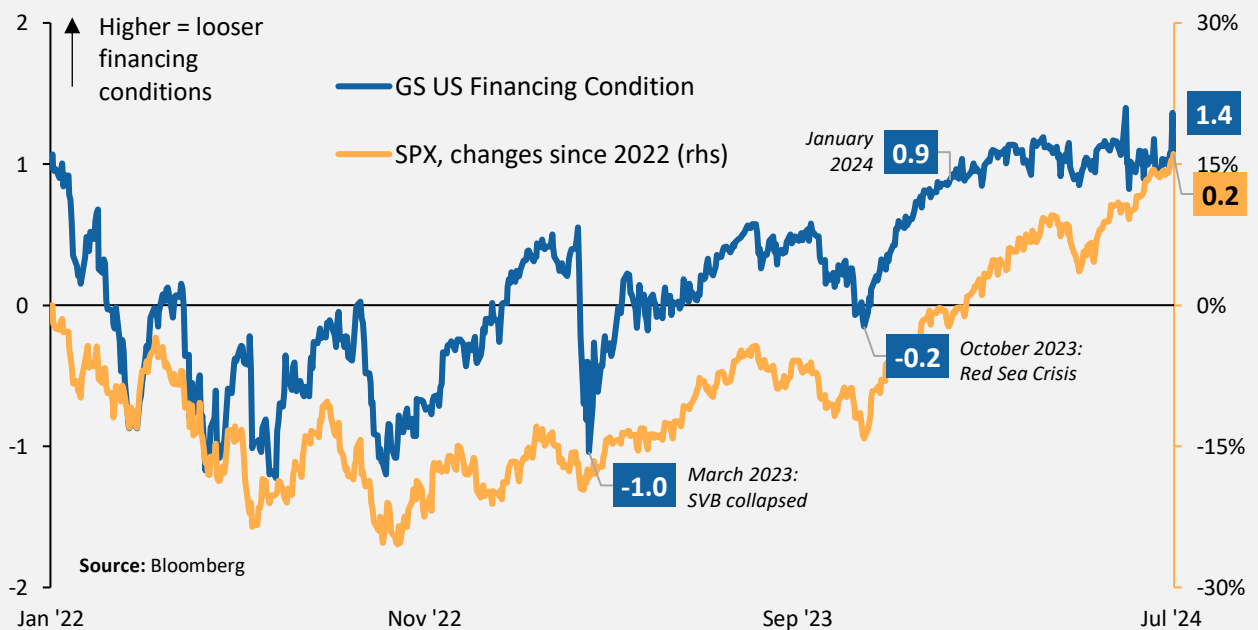


Chart 3

Inward and upward

The IDR moves upward as foreign investors are returning to the domestic market following more clarity about Indonesia's fiscal posture in 2025

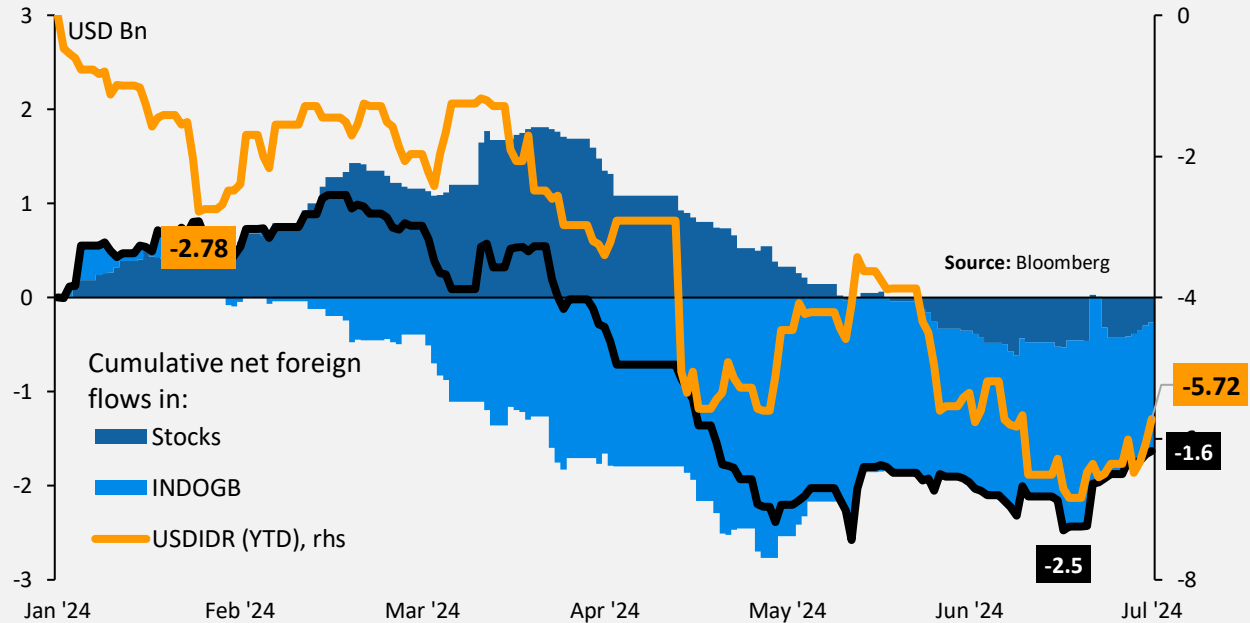
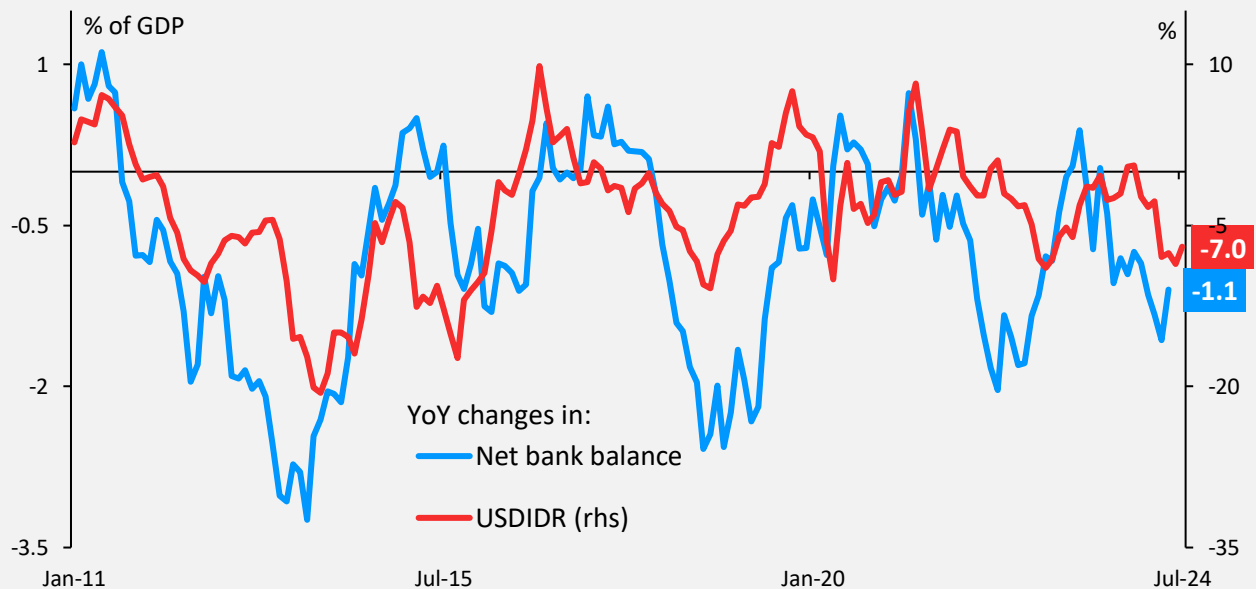


Chart 4

A game of trade-offs

The improving net bank balance provides a foundation for the Rupiah to regain its value, but the need to conserve liquidity highlights the trade-off between a more stable Rupiah and a higher GDP growth



Source: BI. Calculated by BCA Economic Research

Economic Calendar				
		Actual	Previous	Forecast*
01 July 2024				
ID	S&P Global Manufacturing PMI (Bn)	50.7	52.1	51
ID	Inflation rate YoY, %	2.51	2.84	2.96
02 July 2024				
US	JOLTs Job Openings, (Mn)	18.14	8.05	7.9
EU	Inflation rate YoY, %	2.5	2.6	2.5
EU	Unemployment Rate, %	6.4	6.4	6.5
03 July 2024				
US	Balance of Trade, (Bn)	-75.1	-74.5	-76
05 July 2024				
ID	Foreign Exchange Reserves, (Bn)	140	139	148
US	Unemployment Rate, %	4.1	4	4
US	Non Farm Payrolls, (Th)	206	218	160
07 July 2024				
CN	Foreign Exchange Reserves, (Tn)	3.222	3.232	3.25
08 July 2024				
ID	Consumer Confidence	123.3	125.2	125.5
09 July 2024				
ID	Retail Sales YoY, %		-2.7	-0.5
10 July 2024				
CN	Inflation Rate YoY, %		0.3	0.3
ID	Motorbike Sales, %		-4.5	-
11 July 2024				
US	Inflation Rate YoY, %		3.3	3.1
12 July 2024				
CN	Balance Of Trade, (Bn)		82.62	85
ID	Car Sales YoY, %		-13.3	-
15 July 2024				
ID	Balance Of Trade, (Bn)		2.93	-
CN	Retail Sales YoY, %		3.7	3.2
16 July 2024				
EA	Balance Of Trade, (Bn)		15	-

*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	7-Jul	-1 mth	Chg (%)
US	5.50	Jul-23	2.20	Baltic Dry Index	1,966.0	1,869.0	5.2
UK	5.25	Aug-23	3.25	S&P GSCI Index	587.1	569.1	3.2
EU	4.25	Jul-23	1.75	Oil (Brent, \$/brl)	86.5	79.9	8.4
Japan	-0.10	Jan-16	-2.90	Coal (\$/MT)	138.6	139.7	-0.8
China (lending)	2.50	Aug-23	4.05	Gas (\$/MMBtu)	2.02	2.30	-12.2
Korea	3.50	Jan-23	1.10	Gold (\$/oz.)	2,392.2	2,376.1	0.7
India	6.50	Feb-23	1.75	Copper (\$/MT)	9,795.2	10,036.5	-2.4
Indonesia	6.25	Apr-24	3.74	Nickel (\$/MT)	17,082.2	18,301.6	-6.7
				CPO (\$/MT)	876.8	839.7	4.4
				Rubber (\$/kg)	1.64	1.78	-7.9
Money Mkt Rates	7-Jul	-1 mth	Chg (bps)	External Sector	May	Apr	Chg (%)
SPN (1M)	5.88	5.80	7.6	Export (\$ bn)	22.33	19.62	13.82
SUN (10Y)	7.04	6.90	14.5	Import (\$ bn)	19.40	16.90	14.82
INDONIA (O/N, Rp)	6.13	5.97	16.3	Trade bal. (\$ bn)	2.93	2.72	7.61
JIBOR 1M (Rp)	6.90	6.90	0.0	Central bank reserves (\$ bn)*	139.0	136.2	2.02
Bank Rates (Rp)	Apr	Mar	Chg (bps)	Prompt Indicators	May	Apr	Mar
Lending (WC)	8.85	8.83	2.01	Consumer confidence index (CCI)	125.2	127.7	123.8
Deposit 1M	4.65	4.62	3.47	Car sales (%YoY)	-13.3	-17.5	-26.2
Savings	0.68	0.68	0.22	Motorcycle sales (%YoY)	-4.5	18.3	-7.8
Currency/USD	7-Jul	-1 mth	Chg (%)	Manufacturing PMI	Jun	May	Chg (bps)
UK Pound	0.780	0.782	0.19	USA	51.6	51.3	30
Euro	0.923	0.918	-0.46	Eurozone	45.8	47.3	-150
Japanese Yen	160.8	155.6	-3.20	Japan	50.0	50.4	-40
Chinese RMB	7.268	7.245	-0.32	China	51.8	51.7	10
Indonesia Rupiah	16,278	16,260	-0.11	Korea	52.0	51.6	40
				Indonesia	50.7	52.1	-140
Capital Mkt	7-Jul	-1 mth	Chg (%)				
JCI	7,253.4	6,974.9	3.99				
DJIA	39,375.9	38,886.2	1.26				
FTSE	8,203.9	8,285.3	-0.98				
Nikkei 225	40,912.4	38,703.5	5.71				
Hang Seng	17,799.6	18,476.8	-3.67				
Foreign portfolio ownership (Rp Tn)	Jun	May	Chg (Rp Tn)				
Stock	3,273.1	3,115.0	158.05				
Govt. Bond	805.6	807.0	-1.38				
Corp. Bond	8.2	8.2	-0.06				

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	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	6.50
USD/IDR Exchange Rate (end of the year)*	13,866	14,050	14,262	15,568	15,397	16,304
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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