

Getting more by doing just enough

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Summary

- Returning optimism in the US financial market provided the landscape that allowed the Rupiah to significantly appreciate. However, the uncertain market expectation means that volatility is still lurking around.
- The time is nigh for the Fed to cut its policy rate, but more aggressive FFR cuts may do more harm to the market as the strengthening effect on the JPY and other currencies may exacerbate the sell-off due to the unwinding carry trade.
- The Rupiah is in a better position at the moment, but BI may still need to read the Fed's signal to chart its way to a rate cut.

- Optimism seems to have abounded in the Indonesian financial market in the past week. Jolted by the strong Q2 2024 GDP growth number (5.05% YoY, vs. 4.97% forecast) and the exceptional USD 5.2 Bn increase in the FX reserves position, the Rupiah swung sharply from 16,222/USD on Monday to finish the week at 15,949/USD – its lowest level since May 2024.
- The Indonesian financial market has also shown promising developments in the past week. Foreign investors' demand for Indonesian stocks may remain limited, as indicated by the slim USD 40.89 Mn foreign net buy the market, but the USD 140.92 Mn foreign inflows to the Indonesian sovereign bond market helped the market to continue moving from strength to strength. Similar to the exchange rate condition, the 6.76% yield for the benchmark 10Y SBN is also a level unseen since May 2024, while the lower bid for SRBI along with its lower yield reflects the calmer situation facing BI in its effort to stabilise the Rupiah at the moment.
- BI's recent success in keeping the Rupiah stable, of course, is partly underpinned by the situation unfolding in the US and global financial markets. Investors come to the realisation that the US economy is not in such a precarious state as the July 2024 non-farm payroll data suggested, as the dominant service sector continues to expand (ISM services PMI rose to 51.5 from 48.8 in July 2024) and the leading economic index (LEI) shut off its recession signal. Returning optimism recovers the financing condition in the US market to its previously loose condition following the flash tightening earlier in the month (*see Chart 1*), sending the US stock market (especially the tech-heavy NASDAQ) on a frantic move northward.
- Recent developments may have pointed to the anecdote that the US stock market is now

surrounded by perma-bulls, where investors cheer weak economic data as it bolsters their expectation of FFR cuts, while strong economic data justify their astronomical valuations, urging them to climb higher. But economic realities dictate that one cannot expect to get their cakes (still robust US growth) and eat it too (100 bps FFR cut in 2024), meaning that these two opposing arguments will eventually collide in favour of the strongest camp (*see Chart 2*).

- Recalling the swing in the US stock market over the past two weeks, it is quite clear that a sustained US economic growth momentum will work best for the US and global financial markets. As illustrated in Chart 2, the financing condition in the US is at its lowest (loose) level when the market remains confident about the economy and the market, whereas signals pointing to a recession may first spark a sell-off due to the dash for cash-like assets. Fortunately, the US government's expanding fiscal deficit is now helping to dampen the negative liquidity effect from the Fed's balance sheet tightening (as liquidity creation shifted from banks to the public sector), providing the market with enough liquidity to keep the US stock market floating near its record-high level.
- Alas, the return of the soft-landing scenario (or at least, a plain vanilla recession) is not without some hurdles. The downgraded earnings guidance for several mega-companies in the US consumer goods

"Recession or not, the mounting risk in the US treasury market may compel the Fed to lower its policy rate"

industry does serve as a warning signal for slowing consumption in the US and globally, although IT companies' in-line revenue seems to have allayed those concerns for now.

- Indeed, the market needs to be careful with what they have been wishing for regarding the FFR and the US economy. For the US financial market, a weaker USD may continue to fuel the appreciation trend of other currencies, most importantly the JPY. In turn, a further strengthening of the JPY may inflict more losses for Yen-funded carry traders, potentially forcing traders to liquidate their long positions in the US or other risk-asset markets.

- It is important to note, however, that if anything, the ongoing JPY carry trade fiasco may only complicate the Fed's exit plans from its current higher-for-longer stance. The Fed's intention

to cut the FFR is well-telegraphed, and the FOMC's decision to signal that the committee will start cutting the policy rate in the next meeting rather than executing it in the July meeting has already drawn criticism from several prominent analysts. The growing list of subpar Treasury bond auctions, taken in the context of the mounting government interest burden and the shortening duration, may eventually compel the Fed to "help" their Treasury colleagues and lower the rate condition. The time is nigh for the Fed to lower its policy rate, but a more aggressive rate cut made

urgent by an impending recession is a net loss for anyone involved.

- A slowing US economy will be bad news for the Indonesian economy, especially from a regional perspective. Lower US consumption will dampen manufacturing activity in China, and the falling domino will ultimately crush the global commodity market. We maintain our argument that the Rupiah's relative weakness compared to its Asian counterpart in 2024 stems from the lack of a positive catalyst for the CA balance, while the negative correlation between commodity prices and terms of trade of other commodity-importing industrial centres in the region (which also benefits from the rising integrated circuit trade and relocation-driven investments) may further separate the Rupiah and other ASEAN currencies.
- A severe US recession scenario, however, may resolve a big part of BI's pressing problem: the strong US Dollar. The Fed's re-expanding its balance sheet may create an asset displacement effect that may eventually cascade to the Indonesian market, boosting capital inflows that will help to strengthen the Rupiah. Alas, as

shown in the past two weeks, signs of an impending US recession may translate to a severe market pullback at first (which could be exacerbated by the unwinding carry trade), leading to a serious episode of market volatility.

- Therefore, it may be wiser for BI to take advantage of the currently calmer environment to strengthen the moat to support the Rupiah, rather than getting caught in the wave of the market's uncertain FFR cuts expectation. Indeed, the recent strengthening in the IDR's value seems to be preceded by the improving FX liquidity condition within the domestic banking sector (*see Chart 3*), indicating that BI may still need to choose between the growth outlook and the exchange rate stability.

“Aggressive but recession driven FFR cuts may solve BI’s exchange rate stability problem but worsen the economy’s CA balance problem”

Chart 1

Trampoline bounce

The financing condition in the US market starts to ease again as strong data released throughout the past week shrug-off recession fears.

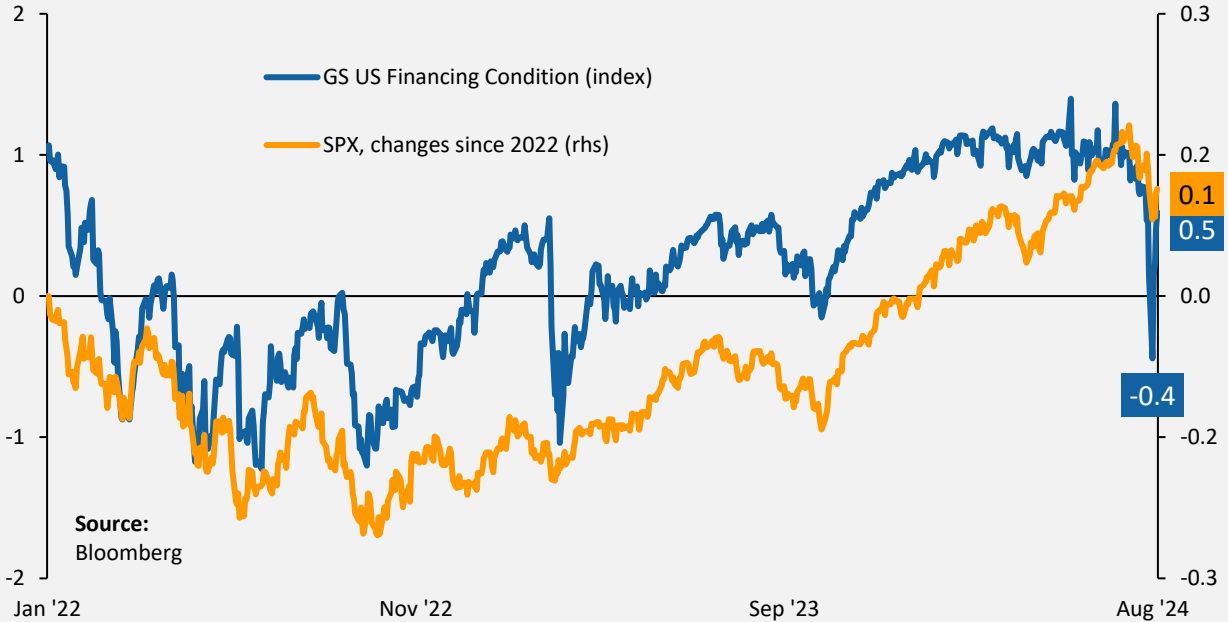


Chart 2

Trying to get the cake and eat it too

Better economic data recently cheered the market, but the bet is still on in the FFR market for 100-125bps rate cuts in 2024.

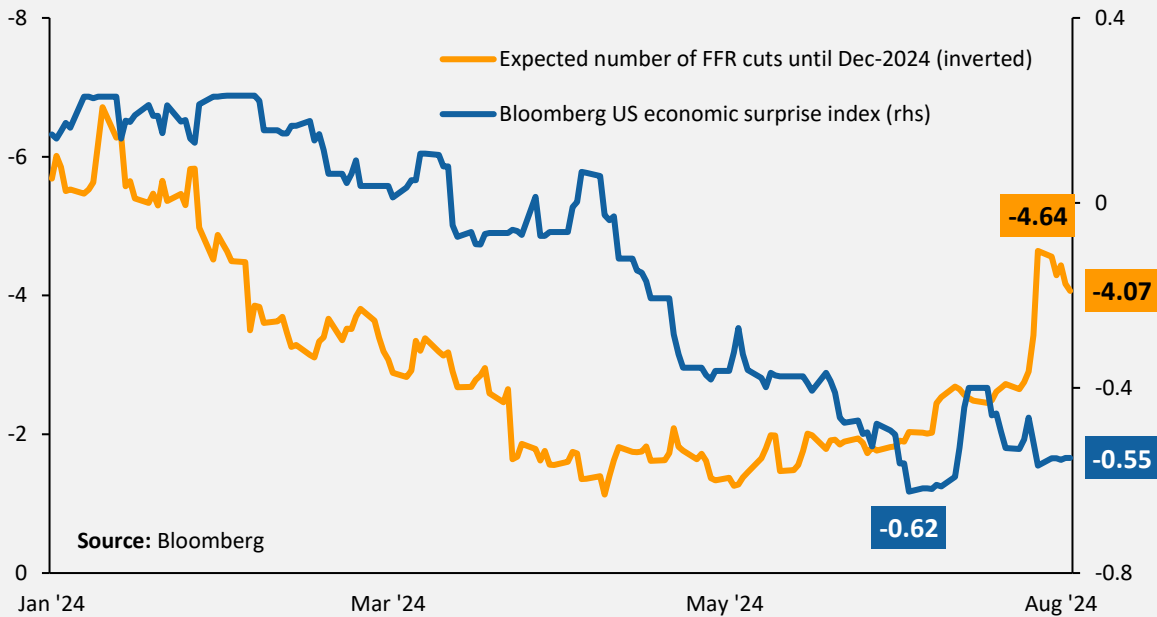
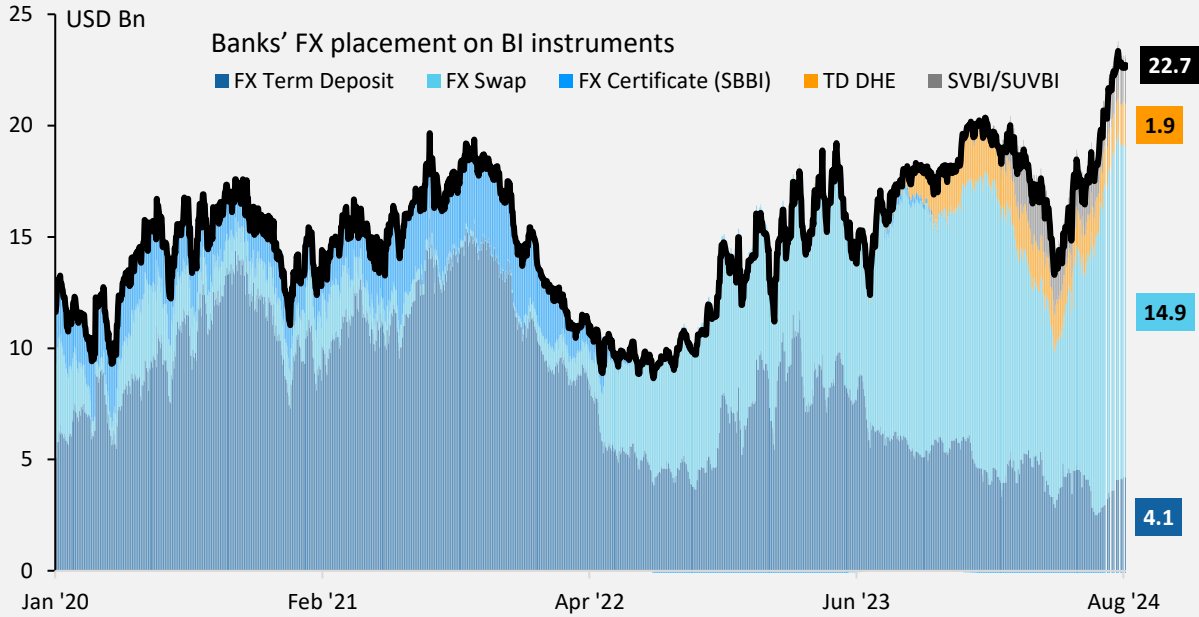


Chart 3

Conserving power

Companies' preserving their foreign currencies amidst the slowing CAPEX cycle helps the Rupiah to strengthen its value.



Source: Bank Indonesia

| Economic Calendar | | | | |
|-------------------|---|--------------|--------------|--------------|
| | | Actual | Previous | Forecast* |
| 1 August 2024 | | | | |
| ID | CPI Inflation YoY, % | 2.13 | 2.51 | 2.17 |
| US | FOMC meeting, % | 5.5 | 5.5 | 5.5 |
| UK | BoE meeting, % | 5.00 | 5.25 | 5.00 |
| 02 August 2024 | | | | |
| US | Non Farm Payrolls | 114 | 179 | 4.1 |
| US | Unemployment Rate, % | 4.3 | 4.1 | 4.1 |
| 05 August 2024 | | | | |
| ID | GDP Growth Rate, % | 5.05 | 5.11 | 4.5 |
| 06 August 2024 | | | | |
| US | Balance of Trade, USD Bn | -73.1 | -75.1 | -72 |
| 07 August 2024 | | | | |
| ID | Foreign Exchange Reserves, Bn | 145.4 | 140.2 | - |
| 08 August 2024 | | | | |
| ID | Consumer Confidence | 123.4 | 123.3 | 122 |
| 09 August 2024 | | | | |
| CN | Inflation Rate YoY, % | 0.5 | 0.2 | 0.3 |
| ID | Retail Sales YoY, % | 2.7 | 2.1 | 1.7 |
| 15 August 2024 | | | | |
| ID | Balance of Trade, Bn | | 2.39 | 2.2 |
| CN | Retail Sales YoY, % | | 2 | 3.0 |
| 16 August 2024 | | | | |
| ID | 2025 RAPBN announcement | | | |
| 21 August 2024 | | | | |
| ID | Interest Rate Decision, % | | 6.25 | - |
| 22 August 2024 | | | | |
| US | FOMC Minutes | | | |
| ID | Q2-2024 Balance of Payment, USD Bn | | -2.2 | -0.97 |
| 27 August 2024 | | | | |
| US | S&P/Case-Shiller Home Price, YoY % | | 6.8 | 6.5 |
| 30 August 2024 | | | | |
| US | PCE Price Index, YoY % | | 2.5 | 2.5 |

*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 (%) | Trade & Commodities | 9-Aug | -1 mth | Chg (%) |
|-------------------------------------|----------|-------------|---------------|---------------------------------|----------|----------|-----------|
| US | 5.50 | Jul-23 | 2.50 | Baltic Dry Index | 1,670.0 | 1,894.0 | -11.8 |
| UK | 5.00 | Aug-23 | 3.00 | S&P GSCI Index | 542.1 | 573.8 | -5.5 |
| EU | 4.25 | Jul-23 | 1.65 | Oil (Brent, \$/brl) | 79.7 | 84.7 | -5.9 |
| Japan | -0.10 | Jan-16 | -2.90 | Coal (\$/MT) | 150.5 | 136.6 | 10.2 |
| China (lending) | 2.30 | Aug-23 | 3.85 | Gas (\$/MMBtu) | 1.94 | 2.42 | -19.8 |
| Korea | 3.50 | Jan-23 | 0.90 | Gold (\$/oz.) | 2,431.3 | 2,364.1 | 2.8 |
| India | 6.50 | Feb-23 | 1.42 | Copper (\$/MT) | 8,747.3 | 9,711.0 | -9.9 |
| Indonesia | 6.25 | Apr-24 | 4.12 | Nickel (\$/MT) | 15,895.4 | 16,861.6 | -5.7 |
| | | | | CPO (\$/MT) | 870.9 | 852.8 | 2.1 |
| | | | | Rubber (\$/kg) | 1.76 | 1.66 | 6.0 |
| Money Mkt Rates | 9-Aug | -1 mth | Chg (bps) | External Sector | Jun | May | Chg (%) |
| SPN (3M) | 6.47 | 6.56 | -8.2 | Export (\$ bn) | 20.84 | 22.32 | -6.65 |
| SUN (10Y) | 6.76 | 7.03 | -27.1 | Import (\$ bn) | 18.45 | 19.40 | -4.89 |
| INDONIA (O/N, Rp) | 6.24 | 6.14 | 10.3 | Trade bal. (\$ bn) | 2.39 | 2.92 | -18.30 |
| JIBOR 1M (Rp) | 6.90 | 6.90 | -0.1 | Central bank reserves (\$ bn)* | 140.2 | 139.0 | 0.87 |
| Bank Rates (Rp) | May | Apr | Chg (bps) | Prompt Indicators | Jun | May | Apr |
| Lending (WC) | 8.86 | 8.85 | 1.37 | Consumer confidence index (CCI) | 123.3 | 125.2 | 127.7 |
| Deposit 1M | 4.68 | 4.65 | 2.54 | Car sales (%YoY) | -11.8 | -13.2 | -17.4 |
| Savings | 0.67 | 0.68 | -1.07 | Motorcycle sales (%YoY) | 3.5 | -4.5 | 18.3 |
| Currency/USD | 9-Aug | -1 mth | Chg (%) | Manufacturing PMI | Jul | Jun | Chg (bps) |
| UK Pound | 0.784 | 0.782 | -0.20 | USA | 49.6 | 51.6 | -200 |
| Euro | 0.916 | 0.925 | 0.96 | Eurozone | 45.8 | 45.8 | 0 |
| Japanese Yen | 146.6 | 161.3 | 10.04 | Japan | 49.1 | 50.0 | -90 |
| Chinese RMB | 7.168 | 7.273 | 1.46 | China | 49.8 | 51.8 | -200 |
| Indonesia Rupiah | 15,925 | 16,250 | 2.04 | Korea | 51.4 | 52.0 | -60 |
| Capital Mkt | 9-Aug | -1 mth | Chg (%) | Indonesia | 49.3 | 50.7 | -140 |
| JCI | 7,257.0 | 7,269.8 | -0.18 | | | | |
| DJIA | 39,497.5 | 39,292.0 | 0.52 | | | | |
| FTSE | 8,168.1 | 8,139.8 | 0.35 | | | | |
| Nikkei 225 | 35,025.0 | 41,580.2 | -15.77 | | | | |
| Hang Seng | 17,090.2 | 17,523.2 | -2.47 | | | | |
| Foreign portfolio ownership (Rp Tn) | Jul | Jun | Chg (Rp Tn) | | | | |
| Stock | 3,322.0 | 3,273.1 | 48.98 | | | | |
| Govt. Bond | 813.1 | 808.1 | 4.97 | | | | |
| Corp. Bond | 7.6 | 8.2 | -0.60 | | | | |

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 | 6.00 |
| USD/IDR Exchange Rate (end of the year)** | 13,866 | 14,050 | 14,262 | 15,568 | 15,397 | 16,172 |
| 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 |

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate

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