

No surprises in the plummeting Rupiah

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Summary

- The Rupiah has weakened rapidly over the past week, erasing all of its year-to-date gains as it edges closer to its fundamental value.
- The recent drop in the Rupiah's value may not drastically alter BI's rate cut outlook, though the central bank may need to adopt a more pragmatic approach in implementing further cuts.
- The still-ample FX reserves position suggests that BI can continue to rely on money market interventions to manage the Rupiah's decline while awaiting further FFR cuts from the Fed.

- The global financial market shifted its tone again last week. The "hard landing" scenario once again fades away from the headline, as the US labour market added 254k new jobs in September 2024, surpassing market expectations of 147k and bringing the unemployment rate back down to 4.1% (from 4.3% previously). **The 8.75% WoW increase in oil prices amidst the tussle in Lebanon has also led to some economists calling for the Fed to be more pragmatic with its rate cut timeline** (despite the 100-bps telegraphed in the rest of 2024 and 2025), given the risk of returning inflationary pressures in the US and globally.
- As always, bond traders in the UST market were the quickest to react to the new environment. The 2Y UST yield surged above 3.9% following the NFP data announcement, its highest level since Fed Chairman Powell

confirmed that the central bank will cut its policy rate in the upcoming meeting. The result, of course, was another tightening in US financing conditions (*see Chart 1*), causing the USD to reverse course and head north once again.

- **The renewed rally in the USD index is especially unpleasant for the Asian financial market.** The Asia Dollar Index (which tracks a basket of Asian currencies against the USD) declined by 1.02 % WoW in the past week, its biggest weekly decline since mid-August 2023 when the Fed hiked the FFR to its post-pandemic peak of 5.50-5.75%. **Unfortunately, the Rupiah has been one of the biggest casualties of the recent USD rally**, as the currency depreciates by 2.38% WoW compared to -0.34% to -2.28% for other ASEAN currencies.

What goes up, comes down

- The Rupiah’s fall from grace is not entirely surprising. We previously argued that the Rupiah had overshot its fundamental value in recent weeks, cautioning against more optimistic forecasts. However, the rapid depreciation in the USDIDR exchange rate (from IDR 15,140/USD when the market opened last week to IDR 15,663/USD at the time of writing) may look as somewhat concerning, particularly as economists begin to revive warnings of a potential soft- or no-landing scenario in the US.
- Our less optimistic outlook on the Rupiah largely stems from two considerations. First, **we are sceptical that the strong trend of foreign capital inflows into the Indonesian financial market since mid-August 2024 can continue for a while longer (see Chart 2),** which could ultimately cap the Rupiah’s appreciation. Indeed, foreign investors’ demand for Indonesian stocks soon dissipated as the PBoC’s monetary stimulus sparked a world-beating rally in the Chinese stock market.
- Meanwhile, **the still-healthy demand for Indonesian government bonds (SBN) appeared to be more of a product of foreign investors rotating away from SRBI back to the SBN market rather than fresh FX liquidity flowing into the Indonesian market,** which is evident from the slim USD 0.3 Bn decline in Bank Indonesia’s FX reserves position despite the USD 1.34 Bn inflows to the SBN market throughout September 2024.

“While the sharp drop in the Rupiah’s value may look concerning, it may not warrant a significant policy action from BI as the currency corrected closer to its fundamental value”

- Second, **we continue to voice our concerns that the fundamentals supporting the Rupiah have not meaningfully improved in recent months.** From the perspective of banks, the continued divergence between accelerating loan growth (11.7% YoY in July 2024, 11.4% YoY previously) and stagnant savings growth (7.7% YoY in July 2024, 8.2% YoY previously) points to a liquidity gap within the domestic banking sector (*see Chart 3*). This gap (which also indicates Indonesia’s CA balance) will likely need to be covered by external financing (which reflects the financial account side of the balance of payment), which often correlates negatively with the Rupiah’s value. This relationship was not observed during the Rupiah’s recent rally, which explains why the currency has fallen quite expeditiously from its YTD peak as the rally, after all, lacked fundamental support.
- In the meantime, **the sharp drop in the USDIDR exchange rate over the past week should not prompt BI to alter its course regarding monetary policy.** BI has already decided to hasten its rate-cutting timeline to before Q4 2024, and flip-flopping between exchange rate stability and growth potential may introduce additional monetary policy uncertainty, compounding the fiscal and policy uncertainties that are currently affecting the Indonesian economy. **Allowing the Rupiah to hover around its fundamental value could even provide some much-needed support for the domestic manufacturing sector,** as a weaker currency would shift demand away

from the import market and toward local manufacturers.

- Hence, the path remains open for BI to proceed with its rate-cutting campaign, though recent conditions show that the central bank still needs to look at exchange rate stability with both eyes. To achieve this, **BI may revert to its earlier strategy from the start of the year, relying primarily on vanilla money market interventions to smooth out the Rupiah’s decline, given the still ample FX reserves position.** Refinancing a larger portion of maturing SRBI could also be on the table, especially given the surge in maturing SRBI (around IDR 336.72 Tn) between now and January 2025.
- While BI’s FX market interventions in Q1 2024 proved untenable (as BI raised the policy rate

to 6.25% following a USD 7.82 Bn decline in its FX reserves position before the April 2024 policy meeting), the central bank may find more success with a similar strategy in the coming months. Unlike early in the year, the global rate-cutting campaign has started, with the Fed expected to continue lowering the FFR between now and December 2025, albeit at a more tactical pace and with less magnitude than previously thought by the market before the September 2024 NFP data release.

- Finally, the expected higher SBN yield in the next year (as telegraphed by the government in its macro assumptions for the 2025 state budget) also means that the real rate spread between the Rupiah and USD assets could be expected to continue to widen (*see Chart 4*), thus providing some support for the currency.

Chart 1

Another shift in the wind

The still-robust labour market data brings back the soft- and no-landing expectation back to the headline, tightening US financing conditions as UST yields rose higher

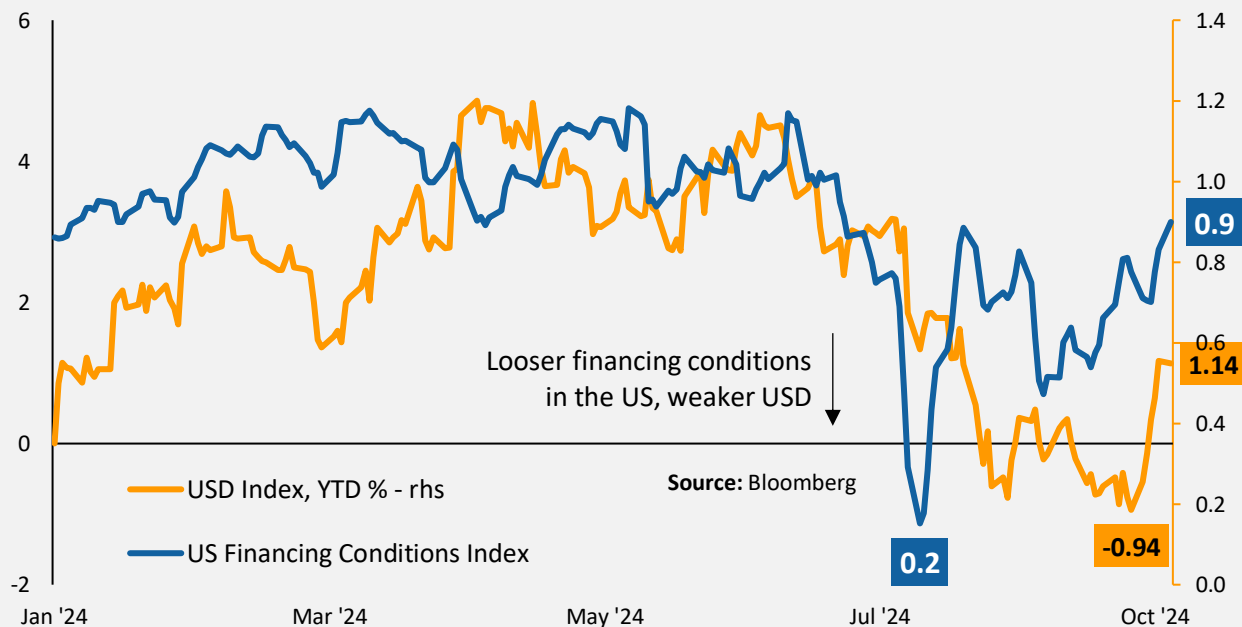


Chart 2

Falling from grace

The Rupiah shredded all of its YTD gains in the past week as the foreign capital inflows trend slowed down to a halt amidst investors' renewed interest in the Chinese market

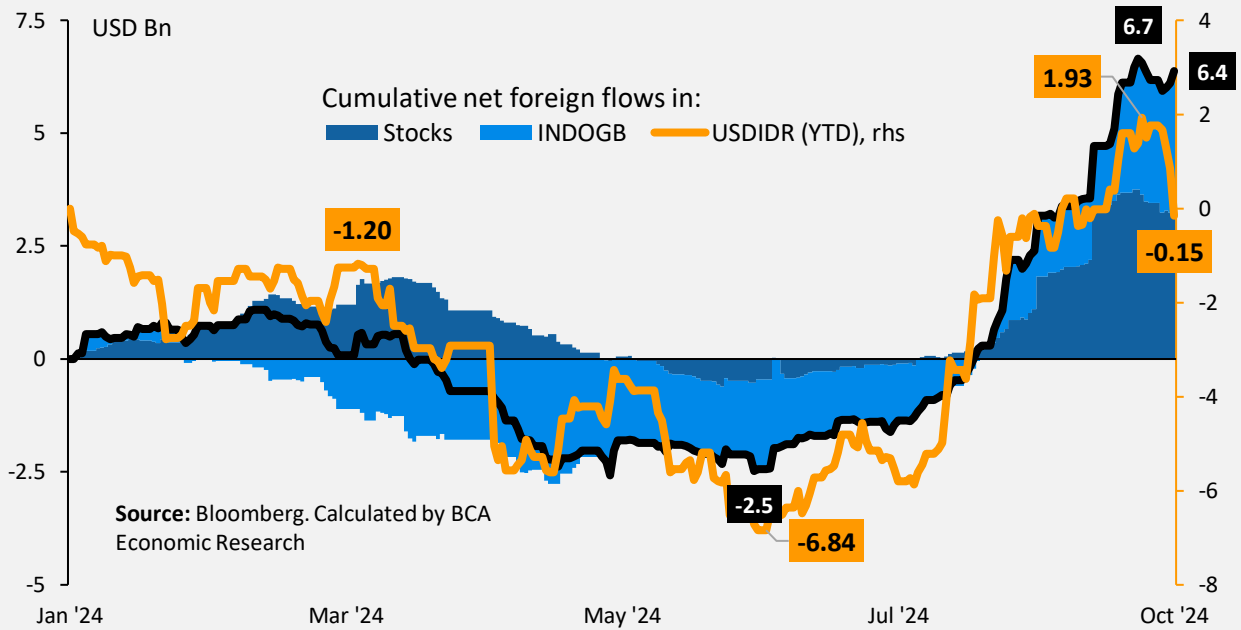


Chart 3

Now comes the hangover

The Rupiah may continue to normalise in the coming months, as the currency has shot past its fundamental value in previous weeks

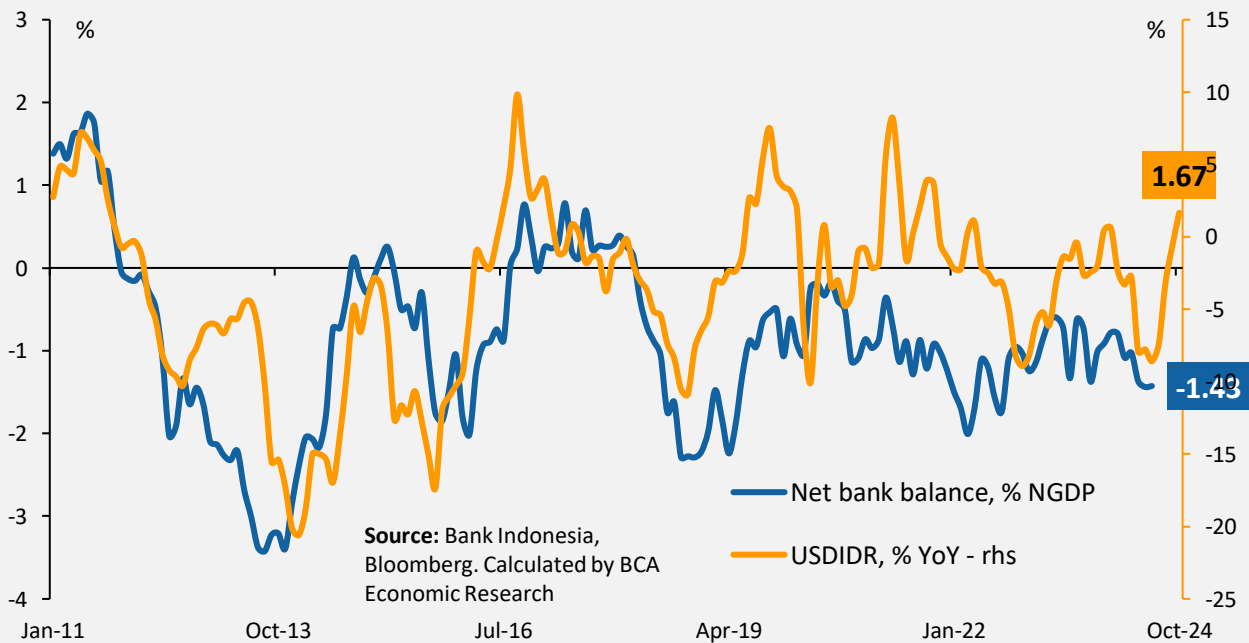


Chart 4

Improvements down the line

The widening IDR-USD real rate spread may help to improve the Rupiah’s fundamental, although the relationship has weakened recently amid the wild swing in market sentiments.

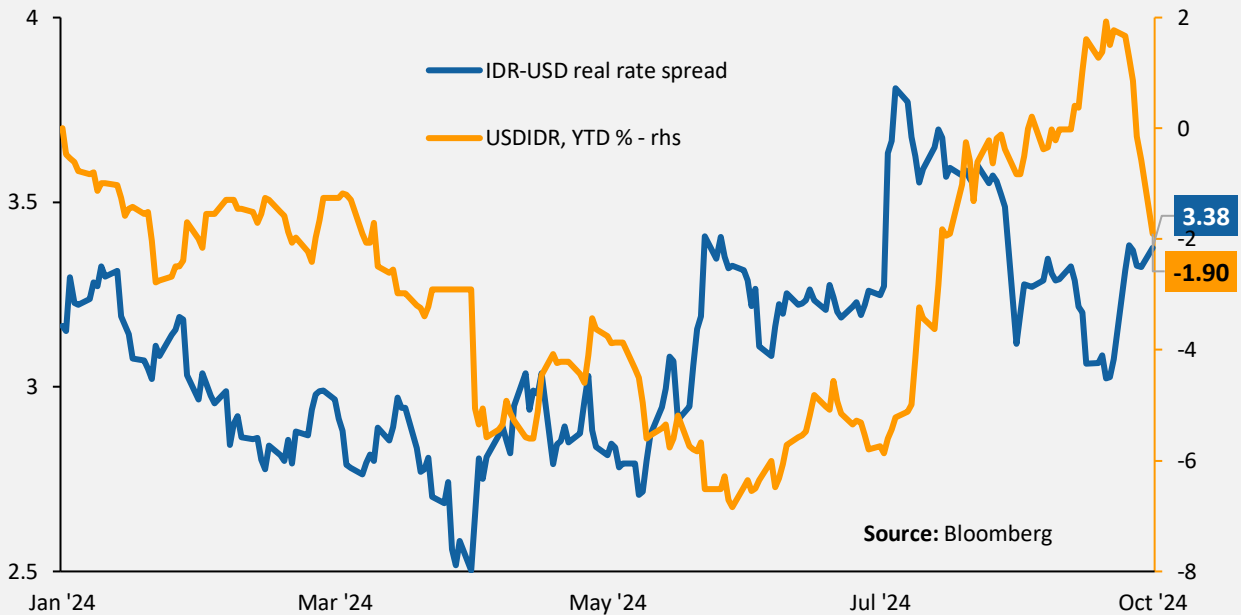
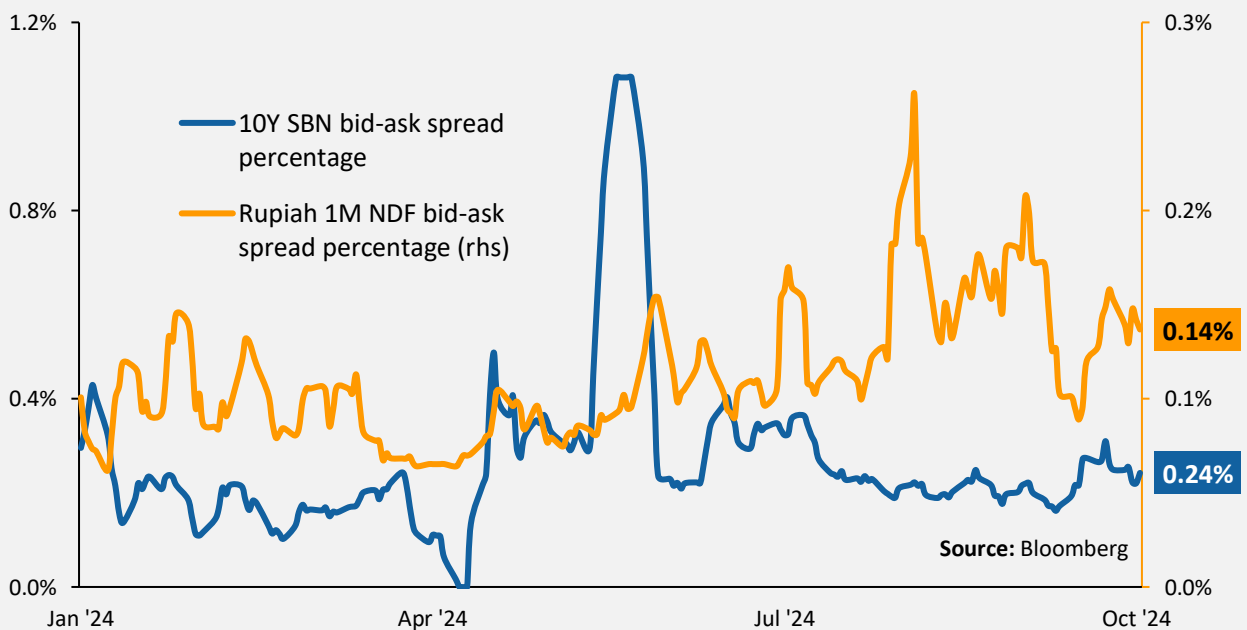


Chart 5

All remains fine

The bid-ask spread for the Rupiah is trending lower despite the weakening exchange rate, indicating an improving liquidity condition that limits the urgency for BI to react



Economic Calendar				
		Actual	Previous	Forecast*
01 October 2024				
ID	CPI Inflation YoY, %	1.84	2.12	2.1
ID	S&P Global Manufacturing PMI	49.2	48.9	49.5
US	S&P Global Manufacturing PMI	47.3	47.9	47
04 October 2024				
US	Non Farm Payrolls, K	254	159	130
07 October 2024				
ID	Foreign Exchange Reserves, USD Bn	149.9	150.2	149.0
08 October 2024				
US	Balance of Trade, USD Bn		-78.8	-72
09 October 2024				
ID	Retail Sales YoY, %		4.5	3.2
10 October 2024				
US	Inflation Rate YoY, %		2.5	2.3
ID	Motorbike Sales YoY, %		7.4	-
11 October 2024				
ID	Car Sales YoY, %		-14.2	-
13 October 2024				
CN	Inflation Rate YoY, %		0.6	0.4
CN	Balance of Trade, USD Bn		91.02	82
15 October 2024				
ID	Balance of Trade, USD Bn		2.89	2.3
16 October 2024				
ID	Loan Growth YoY, %		11.4	-
ID	Interest Rate Decision, %		6.0	-
18 October 2024				
CN	Retail Sales YoY, %		2.1	2.9
21 October 2024				
ID	Foreign Direct Investment YoY, %		16.6	-
22 October 2024				
ID	M2 Money Supply YoY, %		7.3	-
31 October 2024				
US	PCE Price Index YoY, %		2.2	2.4

*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	4-Oct	-1 mth	Chg (%)
US	5.00	Jul-23	2.50	Baltic Dry Index	1,928.0	1,947.0	-1.0
UK	5.00	Aug-23	2.80	S&P GSCI Index	557.4	524.8	6.2
EU	3.65	Jul-23	1.85	Oil (Brent, \$/brl)	78.1	73.8	5.8
Japan	-0.10	Jan-16	-3.10	Coal (\$/MT)	149.6	142.7	4.9
China (lending)	2.00	Aug-23	3.75	Gas (\$/MMBtu)	2.75	2.01	36.8
Korea	3.50	Jan-23	1.90	Gold (\$/oz.)	2,653.6	2,492.9	6.4
India	6.50	Feb-23	2.85	Copper (\$/MT)	9,796.4	8,829.9	10.9
Indonesia	6.00	Sep-24	4.16	Nickel (\$/MT)	17,743.3	16,208.4	9.5
				CPO (\$/MT)	1,033.2	926.6	11.5
				Rubber (\$/kg)	2.07	1.80	15.0
Money Mkt Rates	4-Oct	-1 mth	Chg (bps)	External Sector	Aug	Jul	Chg (%)
SPN (3M)	5.60	5.91	-31.5	Export (\$ bn)	23.56	22.24	5.97
SUN (10Y)	6.63	6.65	-1.7	Import (\$ bn)	20.67	21.74	-4.93
INDONIA (O/N, Rp)	6.11	6.45	-33.8	Trade bal. (\$ bn)	2.90	0.50	478.90
JIBOR 1M (Rp)	6.65	6.90	-25.3	Central bank reserves (\$ bn)*	150.2	145.4	3.32
Bank Rates (Rp)	Jul	Jun	Chg (bps)	Prompt Indicators	Aug	Jul	Jun
Lending (WC)	8.81	8.82	-1.72	Consumer confidence index (CCI)	124.4	123.4	123.3
Deposit 1M	4.78	4.70	7.49	Car sales (%YoY)	-14.2	-7.8	-9.7
Savings	0.65	0.67	-1.66	Motorcycle sales (%YoY)	7.4	24.1	3.5
Currency/USD	4-Oct	-1 mth	Chg (%)	Manufacturing PMI	Sep	Aug	Chg (bps)
UK Pound	0.762	0.763	0.06	USA	47.3	47.9	-60
Euro	0.911	0.906	-0.62	Eurozone	45.0	45.8	-80
Japanese Yen	148.7	145.5	-2.17	Japan	49.7	49.8	-10
Chinese RMB	7.019	7.122	1.47	China	49.3	50.4	-110
Indonesia Rupiah	15,485	15,525	0.26	Korea	48.3	51.9	-360
				Indonesia	49.2	48.9	30
Capital Mkt	4-Oct	-1 mth	Chg (%)				
JCI	7,496.1	7,616.5	-1.58				
DJIA	42,352.8	40,936.9	3.46				
FTSE	8,280.6	8,298.5	-0.21				
Nikkei 225	38,635.6	38,686.3	-0.13				
Hang Seng	22,736.9	17,651.5	28.81				
Foreign portfolio ownership (Rp Tn)	Sep	Aug	Chg (Rp Tn)				
Stock	3,558.2	3,684.6	-126.37				
Govt. Bond	870.6	852.3	18.28				
Corp. Bond	6.9	7.0	-0.02				

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	1.9
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	15,650
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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