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FX & Interest Rate

Debt ceiling dispute resolved, at least for now. After several unavailing talks between the US Government and Senate, a bill has finally been ratified on June 3rd to suspend the current debt limit until January 2025, averting risk of default. The measure came with spending caps and cuts. The discretionary spending which includes law enforcement, forest management, scientific research, and more would be reduced for the 2024 fiscal year. Meanwhile, discretionary spending growth would be limited to 1% in 2025. The white house estimated that the arrangement will save USD 1 trillion in spending and help improve fiscal structure before the deadline expires.

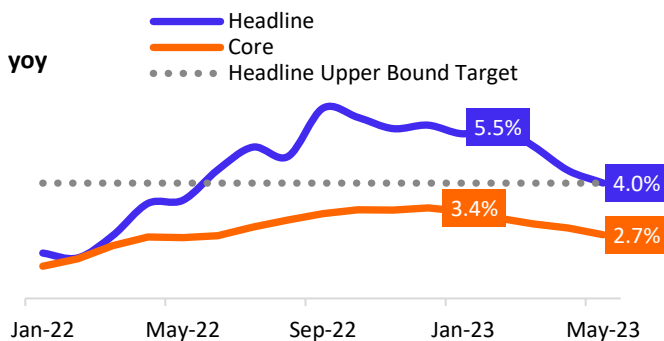
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Still expecting a pause. After a sticky inflation in the US at 4.9% yoy last month, which slid from 5.0% yoy a month prior, nonfarm payroll appeared higher than consensus. Nonfarm payroll in May increased by 339 thousand, well above the 190 thousand of expectation. Nevertheless, we think that the Fed will sidestep policy rate and pay more attention to fundamental factors -i.e. tighter financial condition and potential decline in economic growth-. The collapse of several US banks and fiscal spending cuts might help the Fed to achieve its 2% inflation target next year. As mentioned in the FOMC press release, the Fed will cautiously reassess impacts of previous 500 bps rate hike before deciding its next policy measures.

Domestic inflation returned to BI's upper bound target. Indonesia's statistics office released inflation result for May-23 at 4.0% yoy, down from 4.3% yoy in Apr-23. The disinflation was broad based across segments. Volatile food inflation moderated further to 3.3% yoy from 3.7% yoy, as successful harvest season continued amid favorable weather. A closely monitored component, core inflation, also eased from 2.8% yoy to 2.7% yoy, driven by prices of apparels as well as a deflation in information and communication. The headline inflation was lower than market's expectation of 4.2% yoy.

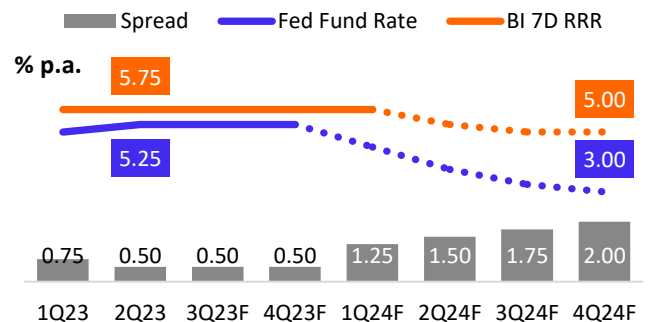
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Chart 1. Indonesia's Inflation



Source: Indonesia's Statistics Office

Chart 2. Policy Rate Outlook



Source: Bloomberg, Danamon

Approaching pivot? Since the disinflation path is faster than expected, call for a policy rate cut gets louder. According to the latest Bloomberg survey, 8 out of 31 analysts expect BI to cut policy rate in 2H23. However, we remain on the view that BI will leave its benchmark rate at current level throughout the year. Despite favorable inflation, external risks could lead to higher volatility of Rupiah. Such condition was seen during the discussion of US debt limit, sticky inflation, and uncertainties from global oil market. It is too risky for BI to cut policy rate, especially when the balance of risk for Fed Fund Rate is leaning more to the upside. Recent deal over the suspension of debt limit requires fiscal caps and cuts that will significantly impact the US economy next year. Therefore, we expect a potential pivot by the Fed in 1Q23, followed by BI a quarter later.

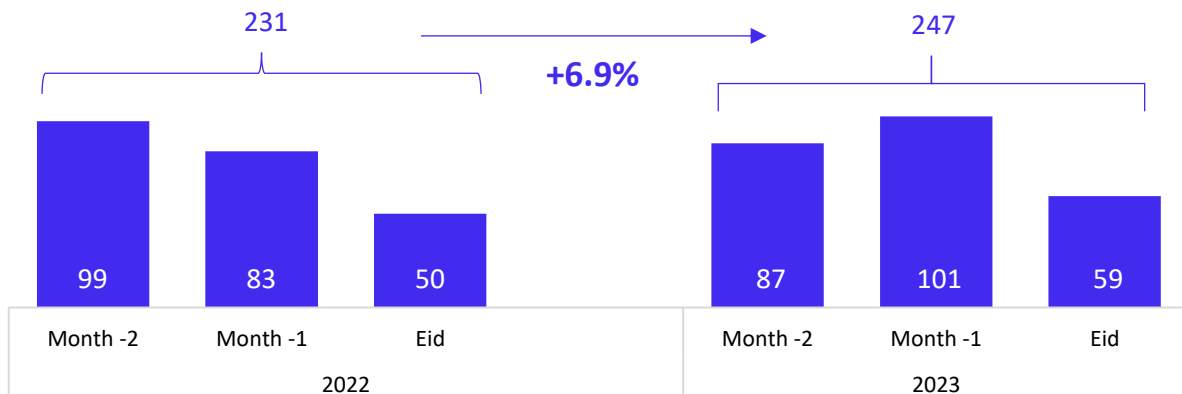
Automotive Industry

Remains attractive during festivity. During the 2023 Eid season, the Indonesian automotive industry grew stronger than last year as car sales increased by 6.9% yoy. Sales were dominated by Passenger Vehicles (PV), growing by 9.1% yoy and mainly driven by affordable energy saving cars (4x2 type) as it contributed around 10.5% to PV sales growth. On the other hand, commercial vehicles experienced lower sales which resulted in slower growth of 0.8% yoy. Until April 2023, Indonesia has recorded a total of 341,311 units, equivalent to 32.5% of this year’s sales target.

Hybrid over EVs? Strong growth was also reflected in electric vehicles sales, shooting up by 15.5% mom to 1,285 units in Apr-23. The surge in this segment is also supported by government incentives to cut VAT from 11% to 1%. Despite increasing demand and government incentives, electric vehicles are still behind hybrid cars, whose sales growth reached 32.4% mom. Furthermore, in terms of cumulative sales (Jan to Apr-23), EV only accounted for 0.9% whereas hybrid cars partake 2.7% of the market share. These indicate people’s preference towards hybrid cars as they are considered more reliable in the transition era of future vehicles. Many are still contemplating and reluctant in switching to an electric vehicle due to price, availability, and supporting infrastructure (e.g., charging station). A rise in hybrid cars is in line with the strategy from various producers but could potentially hinder the government’s target of having 15 mn EVs in 2030.

Chart 3. Auto sales during Eid season

Tho Units



Source: Gaikindo

Indonesia's Selected Economic Indicators

	2020	2021	2022	2023E
National Accounts				
Real GDP (% y-o-y)	-2.1	3.7	5.3	5.3
Domestic demand ex. inventory (% y-o-y)	-3.1	2.8	3.8	5.2
Real Consumption: Private (% y-o-y)	-2.7	2.0	4.9	6.1
Real Gross Fixed Capital Formation (% y-o-y)	-4.9	3.8	3.9	3.5
GDP (USD bn) — nominal	1,059	1,186	1,391	1,475
GDP per capita (USD) — nominal	3,917	4,350	4,783	5,267
Open Unemployment Rate (%)	7.1	6.0	5.9	5.5
External Sector				
Exports (% y-o-y, BoP Basis)	-3.0	42.5	25.6	8.5
Imports (% y-o-y, BoP Basis)	-18.1	39.9	21.6	17.2
Trade balance (USD bn, BoP Basis)	28.2	43.8	62.7	47.9
Current account (% of GDP)	-0.4	0.3	1.0	-0.4
Central government debt (% of GDP)	38.1	41.0	39.6	37.3
International Reserves –IRFCL (USD bn)	135.9	144.9	137.2	143.8
Reserve Cover (Months of imports & ext. debt)	9.8	7.8	5.9	6.8
Currency/USD (Year-end)	14,050	14,253	15,573	14,890
Currency/USD (Average)	14,529	14,296	14,855	14,983
Other				
BI 7-Day Reverse Repo rate (% year end)	3.75	3.50	5.50	5.75
Consumer prices (% year end)	1.68	1.87	5.51	3.82
Fiscal balance (% of GDP; FY)	-6.09	-4.65	-2.38	-2.18
S&P's Rating – FCY	BBB	BBB	BBB	BBB

Source: CEIC, E= Danamon Estimates

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