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FX & Interest Rate

The Mighty Dollar. The DXY has displayed a noteworthy strengthening of 3.1% ytd, amidst the backdrop of prolonged monetary tightening. Although the US economy exhibits a robust performance, its financial market have shown signs of anxiety, exemplified by the 135 bps ytd increase in mortgage rates and the near 5.0% yield of 10Y UST. Consequently, we anticipate that the Fed takes a knee this month and monitors potential impact to the real economy. Building on insights from last FOMC, it's worth noting that members are projecting a terminal rate of 5.75% for FFR, leaving room for another 25 bps increase for the remainder of the year. Should economic data points to inflationary risk, it's reasonable to expect that the Federal Reserve will take advantage in December.

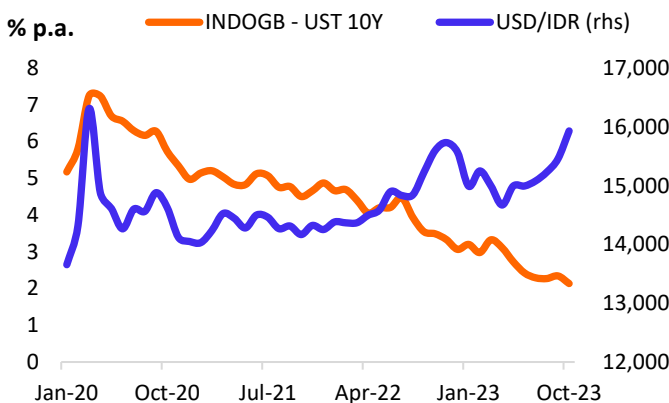
treasury.economist@danamon.co.id

Surging UST yields rattle INDOGB. Short-term UST yields have risen by approximately 80 bps ytd, while longer maturities have experienced even more significant increases. This was on the back of higher FFR coupled with widening fiscal requirements. The US Treasury is on the verge of unveiling its adjusted funding target, which is expected to surpass levels observed during the pandemic era. Consequently, we anticipate further increase in UST yields this quarter and trailed closely by INDOGB, exacerbated by a reversal from the initial expectation of supply cut. As a result, 10-year INDOGB yield surpassed the 7.0% mark, with future direction depending on policy rate.

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BI's response? Substantial movement in UST have significantly compressed the yield differentials between INDOGB and UST, reaching a historic low. This shift has prompted capital outflows from the bond market, subsequently putting pressure on IDR. Such pressure persisted despite BI's decision to raise policy rate by 25 bps last month.

Chart 1. Yield Differential vs USD/IDR



Source: Bloomberg

Chart 2. BI 7D RRR vs Fed Fund Rate

%	ΔFFR	ΔBI 7D RRR	Avg Spread	Current Account
2016	0.25	-0.75	4.58	-1.8
2017	0.75	-0.50	3.44	-1.6
2018	1.00	1.75	3.15	-2.9
2019	-0.75	-1.00	3.40	-2.7
2020	-1.50	-1.25	3.75	-0.4
2021	0.00	-0.25	3.27	0.3
2022	4.25	2.00	1.98	1.0

Source: Bloomberg, Danamon

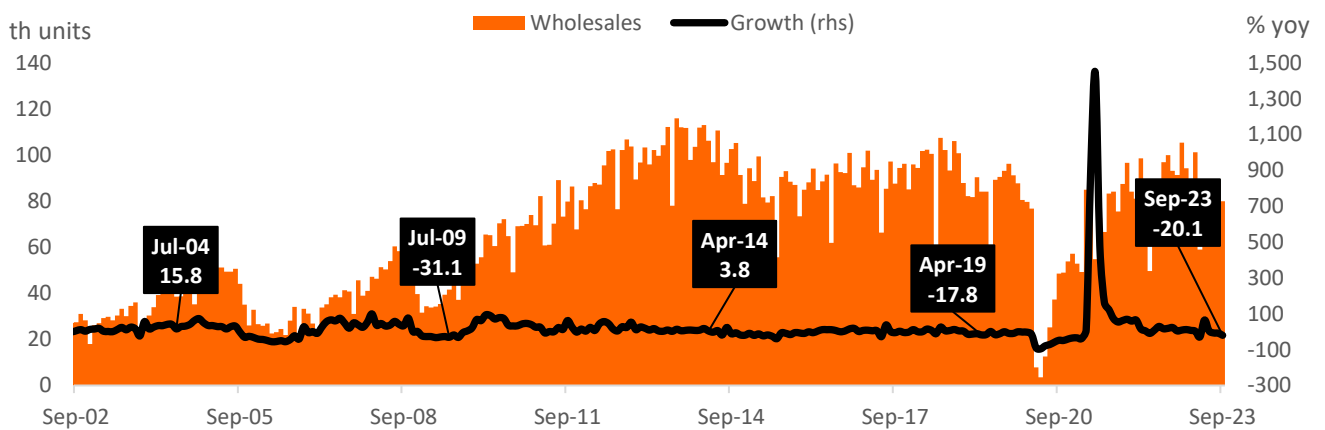
As highlighted in our last report (please see <https://bit.ly/MarketColorOctober23>), the current situation holds a striking resemblance with events back in 2018. On May-18, BI convened an off-cycle MPC meeting, raising policy rate by 25 bps in addition to the 25 bps increase during the monthly scheduled meeting. Given the ongoing pressure on IDR, a similar scenario could unfold amid dwindling foreign exchange reserves and limited options from unconventional instruments for stabilization. Our calculations suggest that, with a 1% current account deficit, the spread between BI 7D RRR and FFR should ideally be around 125 bps to help IDR withstand external volatility. With our expectation of a 0.4% current account deficit for this year, a spread of at least 50 basis points is required to maintain the attractiveness of IDR assets.

Automotive Industry

The performance of the automotive industry depends on several key factors, notably economic growth, government incentives, and major events within a country. During the second quarter of 2023, vehicle sales were affected by festivities such as Eid holidays, causing a temporary decline. However, in the third quarter of 2023, sales rebounded impressively, reaching 249,188 units. This represented an 11.4% increase qoq as post-Eid normalization took effect. Nevertheless, sales in this quarter faced a setback, declining by 12.0% yoy compared to the third quarter of 2022, when government incentives (PPnBM) that ended in October 2022 had driven sales up. On a monthly basis, 4W sales experienced a 10.1% mom decline in September 2023, coinciding with an automotive event that occurred in August 2023. Despite the subdued growth, sales for the first nine months of 2023 reached 755,173 units cumulatively, accounting for 72% of this year's target and mirroring last year's figures.

Another major event is the presidential election in 2024. The impact of an election year on vehicle sales can be intricate. As observed in Chart 3, the growth in 4W sales during election years from 2004 to 2019 displays variations. Hence, it is crucial to note that the exact nature of this correlation may differ from one election cycle to another, contingent upon the specific economic and political climate at the time. With Bank Indonesia raising policy rate to safeguard the IDR, there are concerns over the shift in marginal propensity to consume for loan-backed buyers that constitute around 70% of the market.

Chart 3. 4W Sales Growth



Source: GAIKINDO

Indonesia's Selected Economic Indicators

	2021	2022	2023E	2024E
National Accounts				
Real GDP (% y-o-y)	3.7	5.3	5.2	4.9
Domestic demand ex. inventory (% y-o-y)	2.8	3.8	5.1	5.0
Real Consumption: Private (% y-o-y)	2.0	4.9	5.1	5.0
Real Gross Fixed Capital Formation (% y-o-y)	3.8	3.9	4.5	4.2
GDP (USD bn) — nominal	1,186	1,391	1,472	1,553
GDP per capita (USD) — nominal	4,350	4,783	5,256	5,475
Open Unemployment Rate (%)	6.0	5.9	5.3	5.0
External Sector				
Exports (% y-o-y, BoP Basis)	42.5	25.6	8.5	-3.6%
Imports (% y-o-y, BoP Basis)	39.9	21.6	17.2	-1.6%
Trade balance (USD bn, BoP Basis)	43.8	62.7	47.9	40.9
Current account (% of GDP)	0.3	1.0	-0.4	-1.0
Central government debt (% of GDP)	41.0	39.6	37.3	36.8
International Reserves –IRFCL (USD bn)	144.9	137.2	139.1	142.5
Reserve Cover (Months of imports & ext. debt)	7.8	5.9	5.9	6.4
Currency/USD (Year-end)	14,253	15,573	15,240	15,120
Currency/USD (Average)	14,296	14,855	15,280	14,901
Other				
BI 7-Day Reverse Repo rate (% year end)	3.50	5.50	6.00	5.50
Consumer prices (% year end)	1.87	5.51	2.70	2.89
Fiscal balance (% of GDP; FY)	-4.65	-2.38	-2.18	-2.00
S&P's Rating – FCY	BBB	BBB	BBB	BBB

Source: CEIC, E= Danamon Estimates

Treasury Economist Team



Wisnu Wardana
Chief Economist
+62 21 8064-5000 ext. 8873
wisnu.wardana@danamon.co.id



Irman Faiz
Economist
+62 21 8064-5000 ext. 8875
irman.faiz@danamon.co.id



Amanda A. Joesoef
Industry Analyst
+62 21 8064-5000 ext. 8842
amanda.joesoef@danamon.co.id



A member of  MUFG, a global financial group

PT Bank Danamon Indonesia, Tbk.

Menara Bank Danamon
Jl. H.R. Rasuna Said Kav. C-10, Kuningan
Jakarta 12940
Indonesia

Email: treasury.economist@danamon.co.id

Fax: +62 21 80645263

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