Indonesia Market Color

4 September 2023

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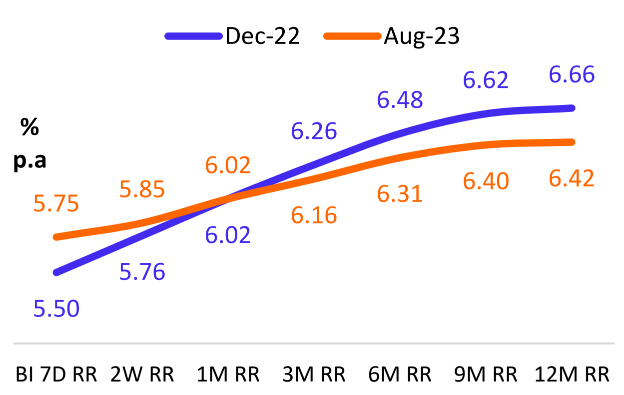
FX & Interest Rate

Taming down inflation at all costs. In the fourth week of Aug-23, Chairman Powell delivered his speech at Jackson Hole Symposium, where he emphasized the Fed's unwavering commitment to combating inflation. He cautioned that additional interest rate increases remain possible. However, he acknowledged that improvements have been achieved and underscored the Fed's cautious approach to future actions. Following the symposium, it is worth noting that Fed's preferred inflation measure accelerated to 3.3% yoy in Jul-23, up from 3.0% yoy in the previous month. Additionally, core PCE index climbed to 4.2% yoy in July, marking a slight uptick from 4.1% yoy in Jun-23. Meanwhile, the ratio of unemployed individuals to job vacancies remained consistently below 1, underscoring a persistent shortage in the labor supply. Considering all these figures, we still see Fed to hike another 1x25 bps in the coming September FOMC meeting.

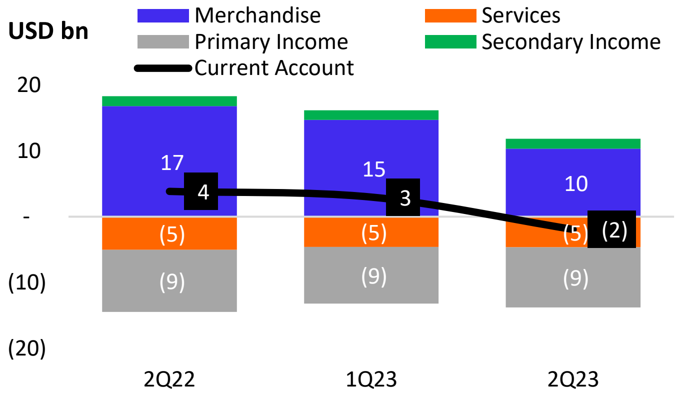
Domestic inflation's temporary uptick. Headline inflation exhibited a modest acceleration to 3.3% yoy in Aug-23, up from 3.1% yoy in the previous month. This uptick can be primarily attributed to the low base effect from the corresponding period in the previous year, particularly concerning volatile food items. The gain in headline inflation was a transient phenomenon, considering the adjustment on subsidized fuel price in September last year, providing high base effect going forward. Furthermore, S&P Global manufacturing index reported an improvement on supply chain efficiency, resulting in a moderation of input cost growth. Input cost inflation falling to the point weakest since October 2020. Going forward, China's deflationary pressure may further contribute to the moderation of input costs. China's official CPI fell by 0.3% yoy in Jul-23, the first time in more than two years. The trend is likely to continue as the economic slowdown is primarily attributed to structural issues such as property sector slump, the imbalance between consumption and investment, etc. We expect inflation to fall below 3.0% in 4Q23.

Chart 1. OMO Curve



Source: Bank Indonesia

Chart 2. Current Account



Source: Bank Indonesia

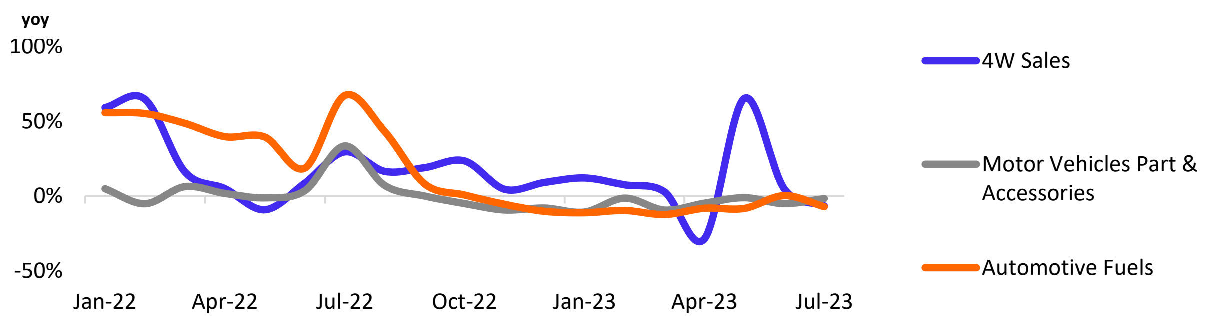
BI's new tool to stabilize IDR. During August MPC meeting, Governor Perry reaffirmed his view that policy rate should remain at its current level, even in the face of FFR hikes. To bolster IDR stability, BI introduced a new instrument, known as Sekuritas Rupiah Bank Indonesia (SRBI). SRBI is a tradable money market instrument accessible to both resident and non-resident investors in the secondary market. Its pricing will be closely aligned with BI's monetary policy stance, as reflected in the term structure of monetary operations (TSOM). With this new instrument, BI will no longer implement operation twist. The impact of SRBI is expected to be similar with operation twist, in which short term bond yield would rise, flattening the yield curve in bond market.

Chance to hike remains. Despite the introduction of this new instrument, external risks loom over IDR, along with deteriorating external resilience. At the end of Aug-23, IDR depreciated to IDR 15,230/USD, from IDR 15,116/USD at the end of Jul-23. External pressure for IDR intensified, driven by heightened US Treasury financing needs and uncertainties surrounding Fed's policy rate trajectory. On the domestic front, external resilience has weakened, primarily highlighted by the reversal of the current account into a deficit of USD 2 bn in 2Q23, while financial account booked net outflows of USD 5 bn during the same period. These figures increase the likelihood of BI's policy rate hike, should Fed opt for rate increase in September. September FOMC meeting assumes critical importance in this context, particularly in assessing the dot plot, which provides insight into the future direction of policy rate. In the event of more hawkish result, BI still has room for policy rate hike amid solid economic growth (2Q23: 5.2% yoy) and mild domestic inflation (Aug-23: 3.3% yoy).

Automotive Industry

The Indonesian automotive industry is showing a slowdown in Jul-23. In the realm of international trade, Indonesia's automotive exports experienced a setback, falling by 2.5% for Completely Built-Up (CBU) exports and a noticeable 33.8% yoy decline in export of component. The hampered export could be attributed to demand reduction from key export markets, especially amidst high interest rates that affected the Indonesian exchange rate; thus, making Indonesian products more expensive. In the domestic market, demand fell for new vehicles and replacement parts. From the wholesale market, cars sales dropped by 6.8% yoy as buyers anticipated the Gaikindo Indonesia International Auto Show (GIIAS), hoping for the promotional offers and discounts in Aug-23. Furthermore, the automotive components and fuels sales were also declining by 1.9% and 7.2% yoy, respectively. It is also worth mentioning that government projects, such as mass rapid transit (MRT) and light rail transit (LRT), may extend consumers' decision when it comes to purchasing cars.

Chart 3. Automotive Sales Growth



Source: Gaikindo

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Indonesia's Selected Economic Indicators

	2020	2021	2022	2023E	
				Forecast	Tracking
National Accounts					
Real GDP (% y-o-y)	-2.1	3.7	5.3	5.3	5.2
Domestic demand ex. inventory (% y-o-y)	-3.1	2.8	3.8	5.2	5.1
Real Consumption: Private (% y-o-y)	-2.7	2.0	4.9	6.1	5.1
Real Gross Fixed Capital Formation (% y-o-y)	-4.9	3.8	3.9	3.5	4.5
GDP (USD bn) — nominal	1,059	1,186	1,391	1,475	1,472
GDP per capita (USD) — nominal	3,917	4,350	4,783	5,267	5,256
Open Unemployment Rate (%)	7.1	6.0	5.9	5.3	5.3
External Sector					
Exports (% y-o-y, BoP Basis)	-3.0	42.5	25.6	8.5	8.5
Imports (% y-o-y, BoP Basis)	-18.1	39.9	21.6	17.2	17.2
Trade balance (USD bn, BoP Basis)	28.2	43.8	62.7	47.9	47.9
Current account (% of GDP)	-0.4	0.3	1.0	-0.4	-0.4
Central government debt (% of GDP)	38.1	41.0	39.6	37.3	37.3
International Reserves –IRFCL (USD bn)	135.9	144.9	137.2	141.2	139.1
Reserve Cover (Months of imports & ext. debt)	9.8	7.8	5.9	6.2	5.9
Currency/USD (Year-end)	14,050	14,253	15,573	14,839	14,839
Currency/USD (Average)	14,529	14,296	14,855	15,090	15,090
Other					
BI 7-Day Reverse Repo rate (% year end)	3.75	3.50	5.50	6.00	6.00
Consumer prices (% year end)	1.68	1.87	5.51	3.53	2.70
Fiscal balance (% of GDP; FY)	-6.09	-4.65	-2.38	-2.18	-2.18
S&P's Rating – FCY	BBB	BBB	BBB	BBB	BBB

Source: CEIC, E= Danamon Estimates

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