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FX & Interest Rate

The escalation of the Middle East conflict is a game changer. The recent attacks between Israel and Iran have heightened tensions in the region, potentially destabilizing it. The Israel-Iran conflict could affect the global oil supply chain, especially around the Strait of Hormuz. It is the world's most important oil checkpoint due to the large volume of oil flowing through it (equivalent to 21% of global petroleum liquids consumption). With Iran indicating no immediate retaliation to Israel's latest attack, geopolitical tensions have slightly eased. Consequently, Brent prices have fallen below USD 90/b. However, uncertainties related to geopolitical risks remain high. The oil price could surge to above USD 100/b if the conflict escalates and affects activities in the Strait of Hormuz.

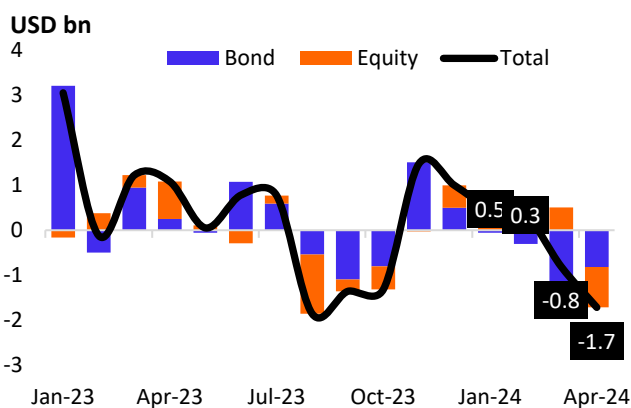
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Revisited the Fed Fund Rate (FFR) outlook. Not only is there the potential resurgence of a global inflation trend due to the recent escalation of conflicts, but also US inflation data has raised concerns in the market regarding the outlook for policy rate cuts. The US CPI accelerated above market expectations in Mar-24 to 3.5% yoy, up from 3.2% yoy the previous month. Meanwhile, core PCE inflation paused its downward trend at 2.8% yoy, lingering above the Fed's target. These two major events have pushed back market expectations for an FFR cut from Jul-24 to Sep-24, with only 2x25 bps cuts expected throughout the year, as reflected through implied fed fund rates. Our in-house calculation has priced in only 1x25 bps cut in Dec-24, as inflation risks tilt more to the upside, especially after the escalation of conflicts.

Please see the important disclaimer and information on the back of this report.

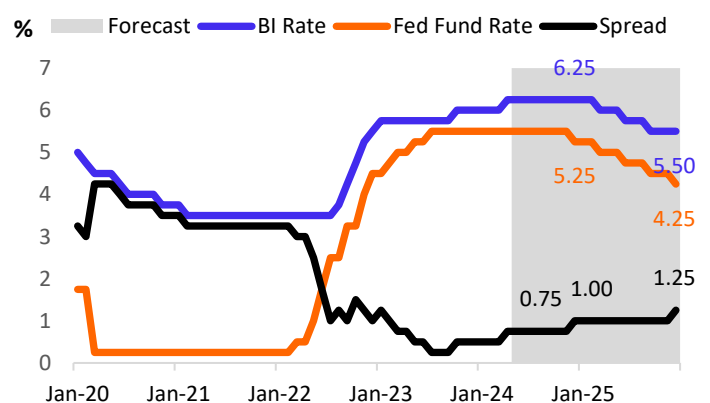
No BI rate cut for this year. The uncertainties surrounding the Middle East conflict, as well as the Fed's policy direction, have driven a global risk-off sentiment. The domestic equity market plunged amidst outflows of USD 0.9 bn in Apr-24, marking the first record of monthly outflows after persistent inflows since Dec-23.

Chart 1. Portfolio Flows



Source: Bloomberg as of 26 April 2024

Chart 2. Policy Rate Outlook



Source: Bloomberg, Danamon

Meanwhile, the bond market continued to experience outflows of USD 0.8 bn in Apr-24, resulting in total net outflows from domestic portfolio assets of USD 1.7 bn. Therefore, the IDR has depreciated by 5.3% YTD, indicating worse performance compared to the INR, CNY, MYR, PHP, and VND. As a pre-emptive measure against rising external uncertainties, BI hiked the policy rate by 25 bps to 6.25% in the April meeting. BI has also committed to attracting foreign flows to SRBI by significantly increasing SRBI yield by around 40 bps across tenors. With these multi-dimensional efforts and considering the lagging impact of policy rate transmission, we expect no cuts to the BI rate throughout 2024. BI will have room to cut after the Fed begins its rate cut cycle in Dec-24, meaning the BI rate cut cycle will commence in 1Q25 at the earliest, focusing on normalizing the rate differential between the BI rate and the FFR to ensure IDR stability amidst a widening current account deficit (*please see our report bit.ly/MarketColorNovember2023*).

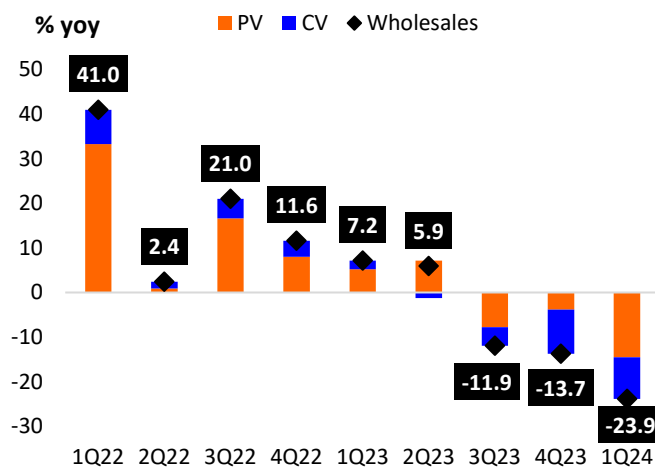
Automotive Industry

In the first quarter of 2024, Indonesia’s automotive industry continues to face a significant downturn. It was marked by a decline in four-wheel sales, which fell by 23.9% yoy compared to 1Q23. This decline was mainly driven by a sharp drop in passenger vehicle sales, particularly in the 4x2 type and affordable energy-saving cars segment, which together contributed 10.3% to the overall decrease. Such a downturn showcased a clear shift in consumer behavior and preferences within the automotive market.

Furthermore, external factors have worsened the challenges facing the industry. The geopolitical tensions subdued global demand, and the higher-for-longer interest rates are all weighing heavily on consumer sentiment and purchasing power. These external pressures have added to the high uncertainty already present, prompting consumers to adopt a more cautious approach towards taking new debts, especially for large purchases such as new vehicles.

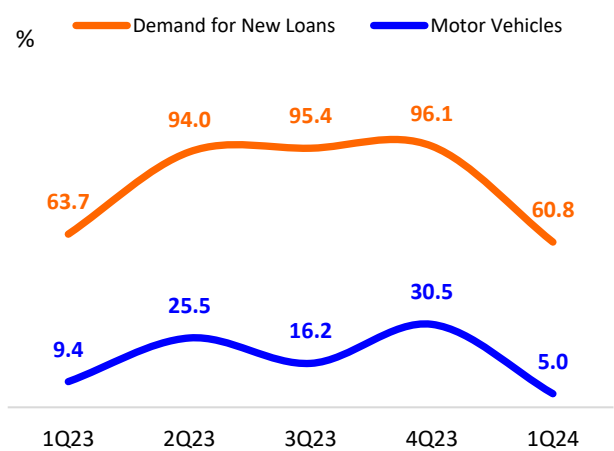
The latest banking survey highlighted a downward trend in loan demand expected for the second quarter of 2024. By component, the loan demand for motor vehicles is expected to drop in 2Q24, providing a glimpse into challenges faced by the automotive industry due to the uncertainty and tightening financial conditions.

Chart 3. 4W Sales Growth by Type



Source: GAIKINDO

Chart 4. Demand for New Loans



Source: Bank Indonesia

Indonesia's Selected Economic Indicators

	2021	2022	2023	2024E
National Accounts				
Real GDP (% y-o-y)	3.7	5.3	5.0	5.0
Domestic demand ex. inventory (% y-o-y)	2.8	3.8	4.6	5.0
Real Consumption: Private (% y-o-y)	2.0	4.9	4.9	5.0
Real Gross Fixed Capital Formation (% y-o-y)	3.8	3.9	4.4	4.2
GDP (USD bn) — nominal	1,186	1,391	1,371	1,553
GDP per capita (USD) — nominal	4,350	4,783	4,920	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	-11.3	-2.8%
Imports (% y-o-y, BoP Basis)	39.9	21.6	-7.3	-1.6%
Trade balance (USD bn, BoP Basis)	43.8	62.7	46.4	41.2
Current account (% of GDP)	0.3	1.0	-0.1	-0.8
Central government debt (% of GDP)	41.0	39.6	38.9	36.8
International Reserves –IRFCL (USD bn)	144.9	137.2	146.4	141.0
Reserve Cover (Months of imports & ext. debt)	7.8	5.9	6.5	6.2
Currency/USD (Year-end)	14,253	15,573	15,399	15,880
Currency/USD (Average)	14,296	14,855	15,244	15,970
Other				
BI 7-Day Reverse Repo rate (% year end)	3.50	5.50	6.00	6.25
Consumer prices (% year end)	1.87	5.51	2.61	2.89
Fiscal balance (% of GDP; FY)	-4.65	-2.38	-1.65	-2.2
S&P's Rating – FCY	BBB	BBB	BBB	BBB

Source: CEIC, E= Danamon Estimates

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