Monthly Economic & Finance Briefing

Economic, Banking & Industry Research of BCA Group - DKP

FX Reserves: Treasury yields take a breather

Executive Summary:

- **Bank Indonesia's FX reserves stood at USD 137.1 Bn on March,** a 1.2% decline from February that was mostly driven by capital outflows sparked by the steady rise of US treasury yields since February.
- Over the past few days however, markets appeared to have calmed somewhat, even as newly released indicators continue to point to a robust recovery in the US. **Overall, the signs seem to point to a market growing increasingly comfortable with the idea that the Fed won't withdraw their policy support prematurely.**
- It remains unclear however, how long the market will continue to give the Fed the benefit of the doubt. Additionally, the potential infusion of additional treasury bills to fund the US' new infrastructure bill may further drive up yields as well.

- **Bank Indonesia's FX reserves amounted to USD 137.1 Bn at the end of last month, a 1.2% decline from its peak in February.** Even though domestic FX liquidity actually rose on March, a combination of government debt payments and capital outflows also took their toll **(*Charts 1 & 2*)**. The steady rise of US treasury yields since February, and the market turmoil that followed growing fears of a premature tightening by the Fed, were the primary culprits behind these substantial outflows.

- **In the days following the FOMC in March however, the turmoil that had gripped markets in the past two months appears to have calmed somewhat.** Treasury yields seem to be plateauing **(*Chart 2*)**, the rout in emerging market assets winding down, and market projections of the FFR a few points lower than what they were at the end of March.

- **This seeming lull in the markets persisted even as newly released US economic data continued to beat market expectations.** Nonfarm payrolls were nearly 50% higher than market expectations, while PMI figures continued to record a significant expansion, and not just for the manufacturing sector, but for the pandemic-ravaged service sector as well **(*Chart 3*)**. The signs are stronger than ever that the US economy's rebound is proceeding with remarkable vigor.

- This economic vigor however, is precisely the thing that derailed bond markets in the first place. With the market mania of the past few weeks in mind then, the question arises: **how long will this calm last, especially if prevailing economic conditions seem to suggest a return to the turmoil of the past few weeks?** There are some technical factors at work here. The widening spread between long-term and short-term yields have made it cheaper for foreign investors to hedge against currency risks when purchasing long-term bonds. This has helped drive an influx of foreign purchases of US treasuries.

- It may also well be however, that current yields have already sufficiently priced in growth and inflation expectations. The market's current inflation expectations are hovering around 2.3-2.4%, which is roughly in line with the Fed's projections. **Additionally, there is a case to be made that markets seem to be growing more comfortable with the idea that the Fed won't withdraw their policy support prematurely.** Yields have remained generally stable since Powell reiterated his commitment to a "looser" inflation policy in March **(*Chart 2*)**, and employment figures – while rapidly improving – remain a ways below their pre-pandemic peak **(*Chart 3*)**. Given the Fed's insistence on the importance of supporting full employment, this does lend credence to the idea that the Fed will stick to Powell's "looser" trajectory. **Still, it is difficult to say whether the market's current faith in the Fed will prove long-lasting, or will prove to only be the fickle trappings of a momentary ceasefire.**

- Additionally, there is another curveball to watch out for: the Biden administration's new two trillion dollar infrastructure bill. A key development to watch out for here is the final proportion of the bill that will be funded by tax hikes. The greater the portion of the bill that must be funded through debt, the greater the upwards pressure on treasury yields. All in all, the current lull in the markets is a welcome break for BI. **With the potential infusion of up to USD 2.0 Tn of newly minted treasury bills in the coming months, as well as the uncertain duration of the ceasefire between the market and the Fed however, the coast is nowhere close to clear just yet.**

Chart 1. Domestic FX liquidity actually increased last month...

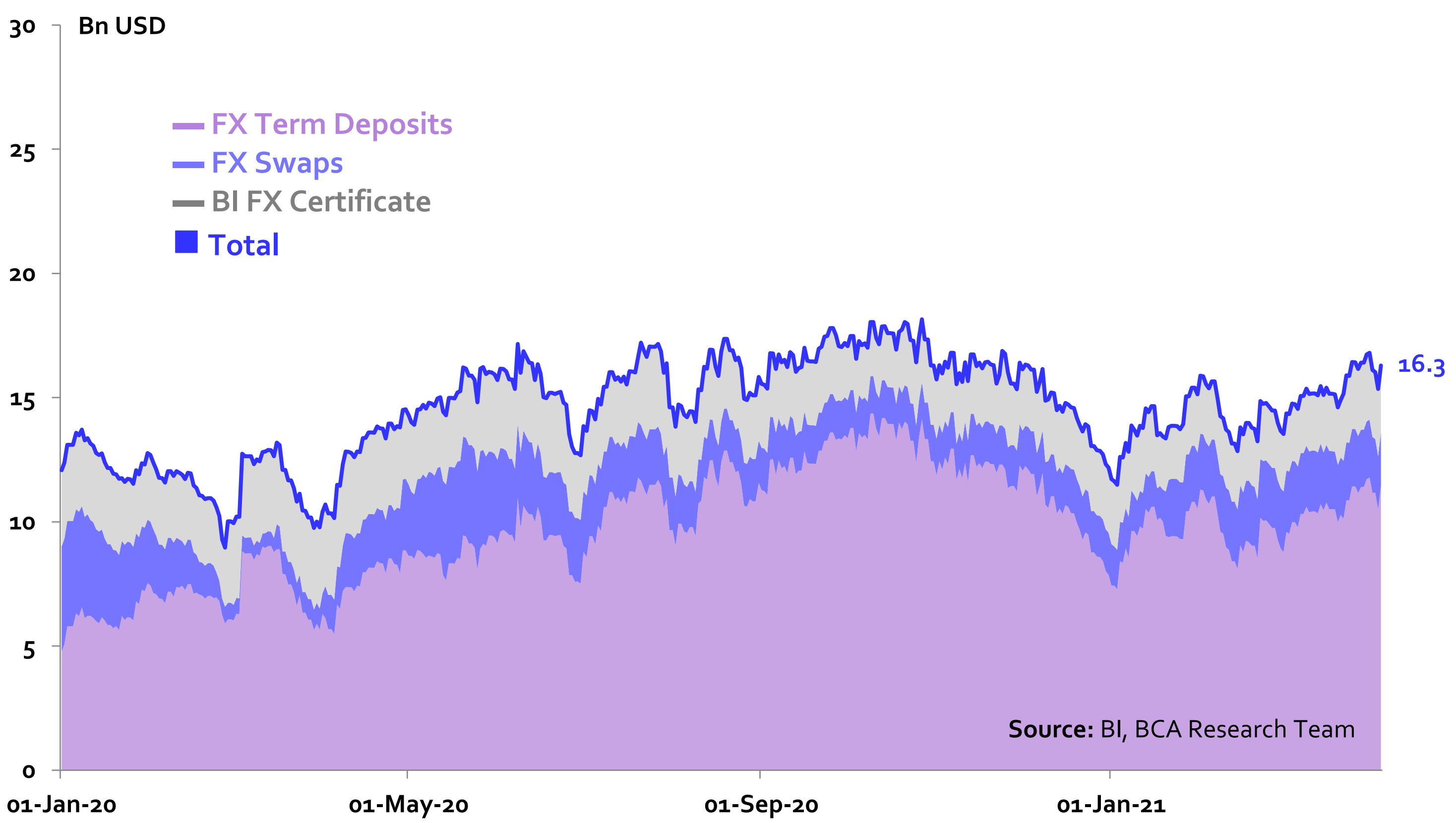
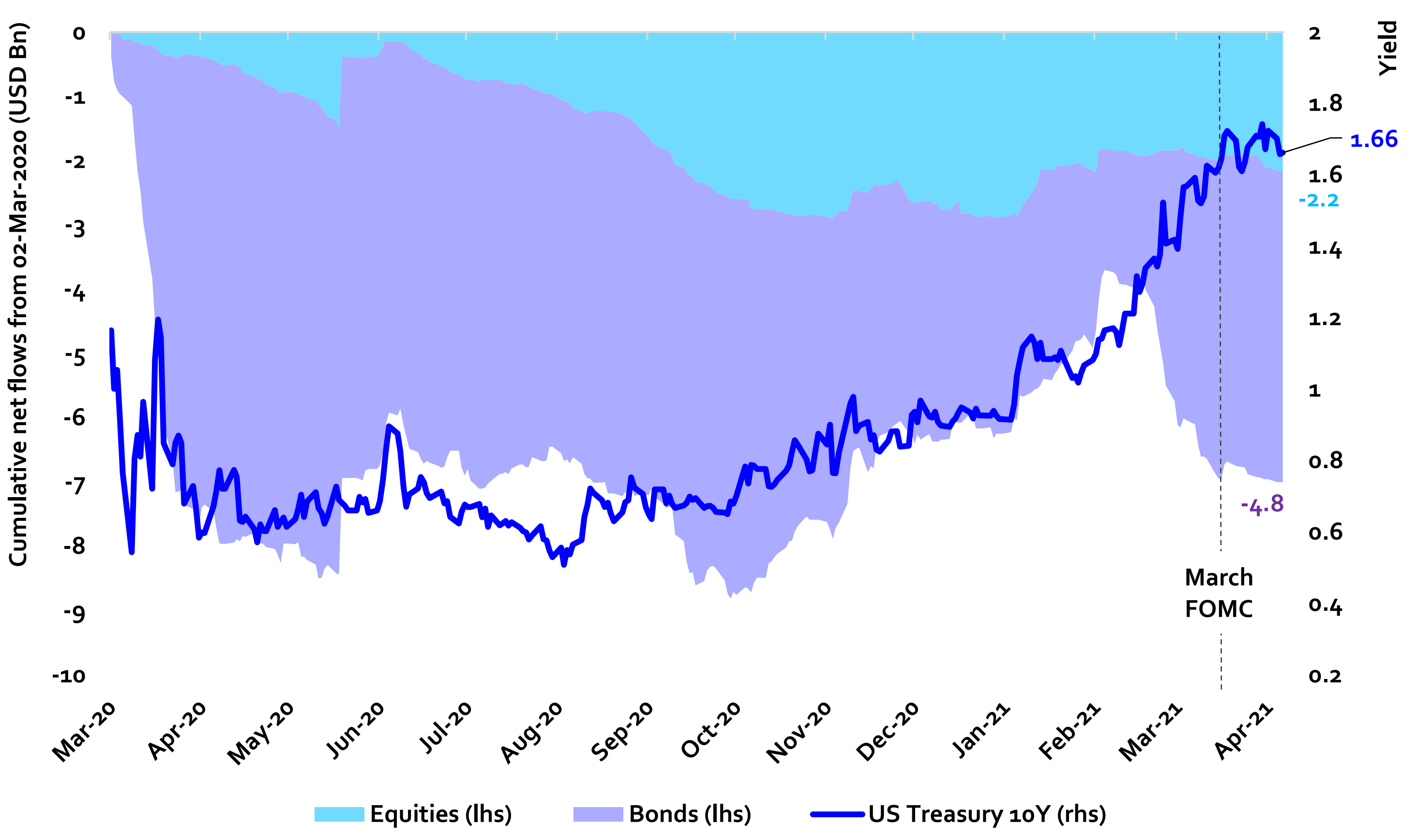
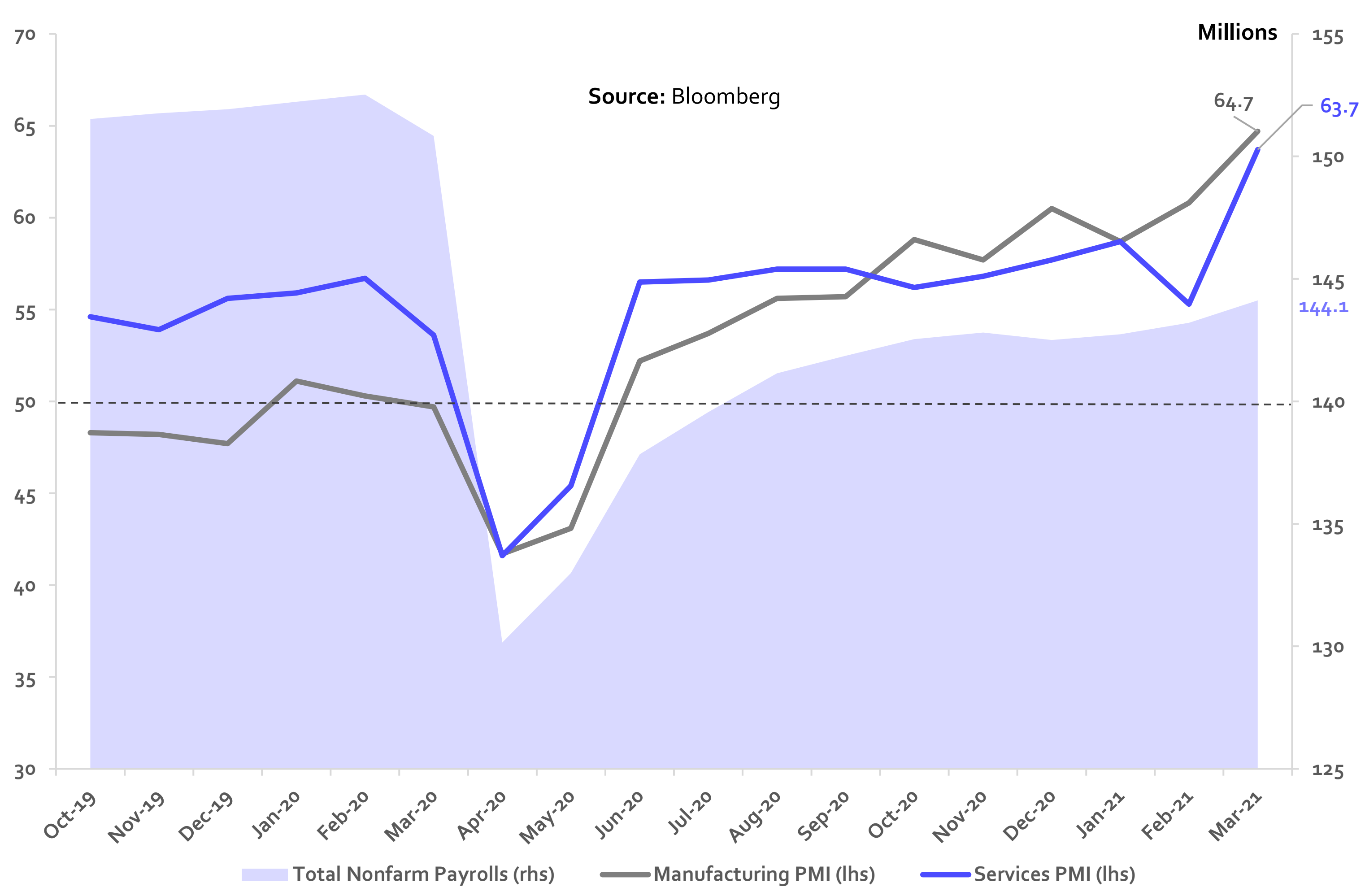


Chart 2. ...however, substantial capital outflows were triggered by rising treasury yields, which have flattened in the weeks following the recent FOMC



Source: Bloomberg (last update: 7 Apr 2021)

Chart 3. US PMI figures show continued expansion in the manufacturing and service sectors, while nonfarm payrolls continue to improve appreciably, although it remains far below pre-pandemic levels



Indonesia – Economic Indicators Projection

	2016	2017	2018	2019	2020	2021E
Gross Domestic Product (% YoY)	5.0	5.1	5.2	5.0	-2.1	4.8
GDP per Capita (US$)	3605	3877	3927	4175	3912	4055
Consumer Price Index Inflation (% YoY)	3.0	3.6	3.1	2.7	1.7	3.1
BI 7 day Repo Rate (%)	4.75	4.25	6.00	5.00	3.75	3.50
USD/IDR Exchange Rate (end of year)**	13,473	13,433	14,390	13,866	14.050	14.460
Trade Balance (US$ billion)	8.8	11.8	-8.5	-3.2	21.7	10.1
Current Account Balance (% GDP)	-1.8	-1.6	-3.0	-2.7	-0.4	-1.8

** Estimation of Rupiah's fundamental exchange rate

Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	0.25	Mar-20	-1.45
UK	0.10	Mar-20	-0.30
EU	0.00	Mar-16	-1.30
Japan	-0.10	Jan-16	0.30
China (lending)	4.35	Oct-15	4.55
Korea	0.50	May-20	-1.00
India	4.00	May-20	-1.03
Indonesia	3.50	Mar-21	2.13
Money Mkt Rates	**6-Apr**	**-1 mth**	**Chg (bps)**
SPN (1M)	2.57	2.53	4.3
SUN (10Y)	6.55	6.66	-11.3
INDONIA (O/N, Rp)	2.79	2.80	-0.6
JIBOR 1M (Rp)	3.56	3.56	0.0
Bank Rates (Rp)	**Jan**	**Dec**	**Chg (bps)**
Lending (WC)	9.27	9.21	6.15
Deposit 1M	4.05	4.22	-17.18
Savings	0.84	0.86	-2.39
Currency/USD	**6-Apr**	**-1 mth**	**Chg (%)**
UK Pound	0.723	0.722	-0.12
Euro	0.842	0.839	-0.33
Japanese Yen	109.8	108.3	-1.31
Chinese RMB	6.540	6.497	-0.65
Indonesia Rupiah	14,505	14,300	-1.41
Capital Mkt	**6-Apr**	**-1 mth**	**Chg (%)**
JCI	6,002.8	6,258.7	-4.09
DJIA	33,430.2	31,496.3	6.14
FTSE	6,823.6	6,630.5	2.91
Nikkei 225	29,696.6	28,864.3	2.88
Hang Seng	28,938.7	29,098.3	-0.55
Foreign portfolio ownership (Rp Tn)	**Mar**	**Feb**	**Chg (Rp Tn)**
Stock	1,930.8	1,811.4	119.42
Govt. Bond	971.4	971.4	0.00
Corp. Bond	28.9	28.4	0.52

Trade & Commodities	6-Apr	-1 mth	Chg (%)
Baltic Dry Index	2,092.0	1,829.0	14.4
S&P GSCI Index	468.6	491.4	-4.7
Oil (Brent, $/brl)	62.7	69.4	-9.5
Coal ($/MT)	90.1	80.9	11.4
Gas ($/MMBtu)	2.39	2.67	-10.5
Gold ($/oz.)	1,743.3	1,700.6	2.5
Copper ($/MT)	9,053.8	8,913.2	1.6
Nickel ($/MT)	16,691.0	16,393.0	1.8
CPO ($/MT)	1,008.6	966.5	4.4
Rubber ($/kg)	1.64	1.73	-5.2
External Sector	**Feb**	**Jan**	**Chg (%)**
Export ($ bn)	15.27	15.29	-0.2
Import ($ bn)	13.26	13.33	-0.5
Trade bal. ($ bn)	2.00	1.96	1.9
Central bank reserves ($ bn)	138.8	138.0	0.58
Prompt Indicators	**Feb**	**Jan**	**Dec**
Consumer confidence index (CCI)	85.8	84.9	96.5
Car sales (%YoY)	-38.2	-34.2	-34.4
Motorcycle sales (%YoY)	-30.8	-14.7	-45.1
Cement sales (%YoY)	0.7	-5.9	-12.6
Manufacturing PMI	**Mar**	**Feb**	**Chg (bps)**
USA	64.7	60.8	390
Eurozone	62.5	57.9	460
Japan	52.7	51.4	130
China	50.6	50.9	-30
Korea	55.3	55.3	0
Indonesia	53.2	50.9	230

Source: Bloomberg, BI, BPS
Notes:
*Previous data
For change in currency: **Black indicates appreciation against USD, **Red** indicates depreciation
***For PMI, **> 50** indicates economic expansion, **< 50** indicates contraction

Economic, Banking & Industry Research Team

David E. Sumual
Chief Economist
david_sumual@bca.co.id
+6221 2358 8000 Ext: 1051352

Agus Salim Hardjodinoto
Industry Analyst
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Barra Kukuh Mamia
Economist / Analyst
barra_mamia@bca.co.id
+6221 2358 8000 Ext: 1053819

Victor George Petrus Matindas
Industry Analyst
victor_matindas@bca.co.id
+6221 2358 8000 Ext: 1058408

Gabriella Yolivia
Economist / Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Derrick Gozal
Economist / Analyst
derrick_gozal@bca.co.id
+6221 2358 8000 Ext: 1066722

Livia Angelica Thamsir
Economist / Analyst
livia_thamsir@bca.co.id
+6221 2358 8000 Ext: 1069933

Ahmad Aprilian Rizki
Research Assistant
ahmad_rizki@bca.co.id
+6221 2358 8000 Ext: 20378

Arief Darmawan
Research Assistant
arief_darmawan@bca.co.id
+6221 2358 8000 Ext: 20364

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group - DKP

20th Grand Indonesia, Menara BCA

Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia

Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343