SAMUEL SEKURITAS INDONESIA

Macro Strategy May 2023 Will We See Fed and BI Pivot Soon?

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Macroeconomic Fundamentals

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What's Our View?

We expect Bank Indonesia to proceed with rate cuts in 2H23, even with Fed pivot seems increasingly unlikely

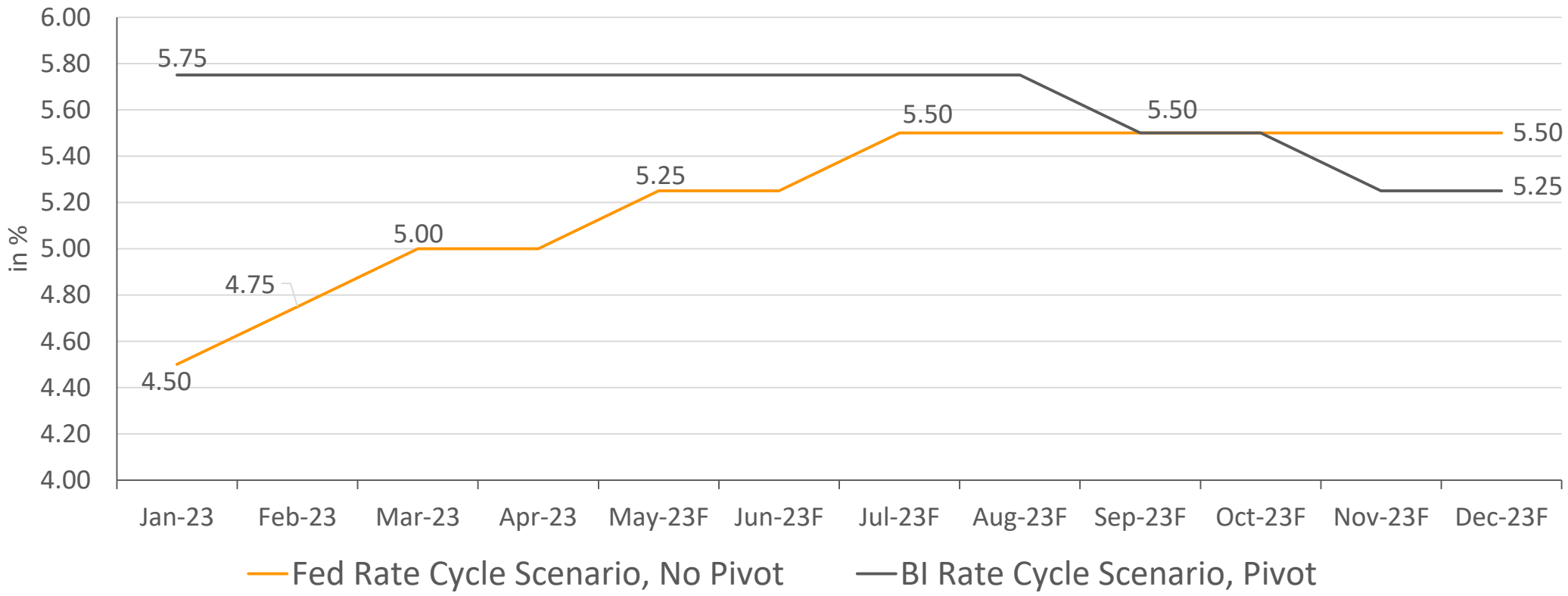
- Indonesia is backed by supportive macroeconomic situations, particularly with solid disinflation and stable rupiah exchange rate.

- Meanwhile, the reason behind the decline in Fed pivot probability was rampant speculation of the Fed's terminal rate, with many expecting a hike to 5.5% due to persistent expansion of the US labor market.

- European central banks (ECB and BoE) are also facing terminal rate hike expectations due to persistent inflation. We anticipate the possibility of BI's 7DRRR rate cuts amid further BOE and ECB rate hikes.

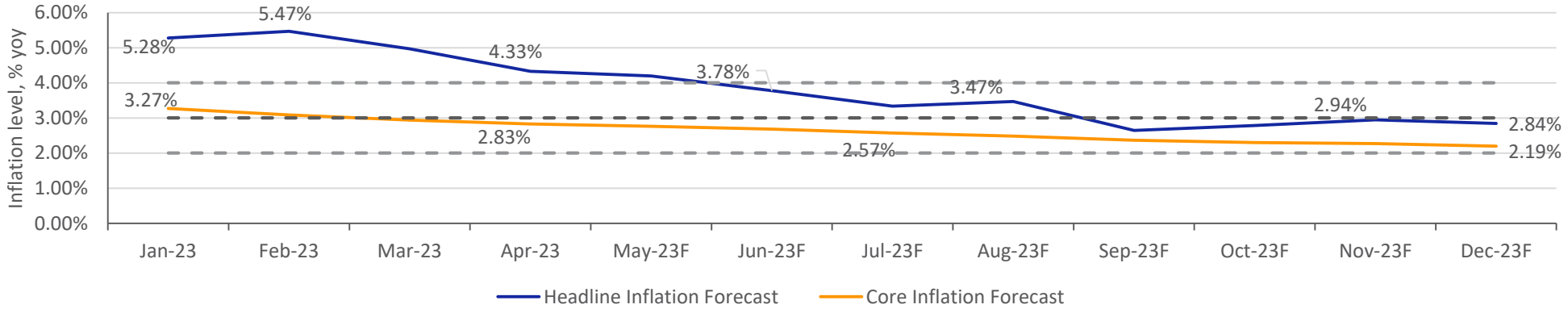
We project 50 bps cut of 7DRRR to 5.25%

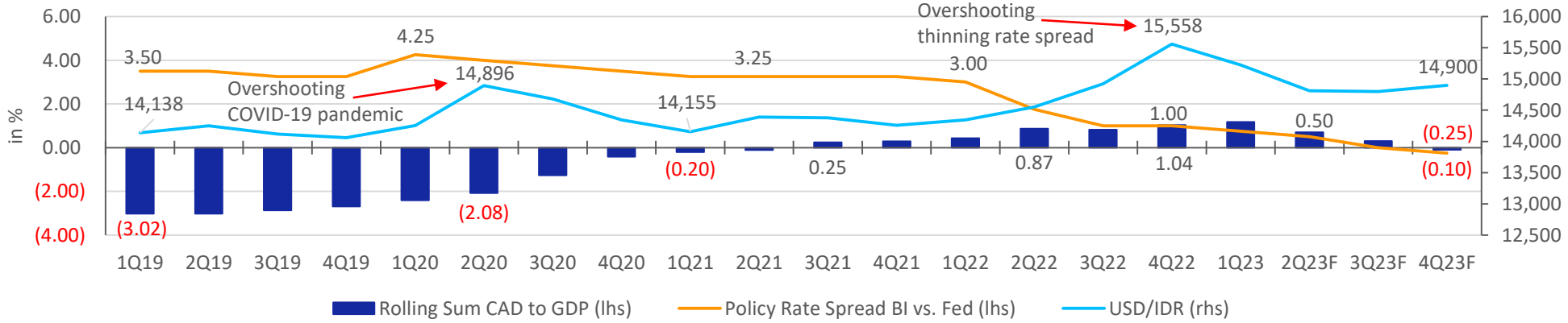
Assuming that the Fed will raise its terminal rate to 5.5%, with no pivot through the end of the year



Source: CME Group, Federal Reserve, Bank Indonesia, SSI Research

Two factors that support BI Pivot scenario: solid disinflation and stable exchange rate after the previous overshooting

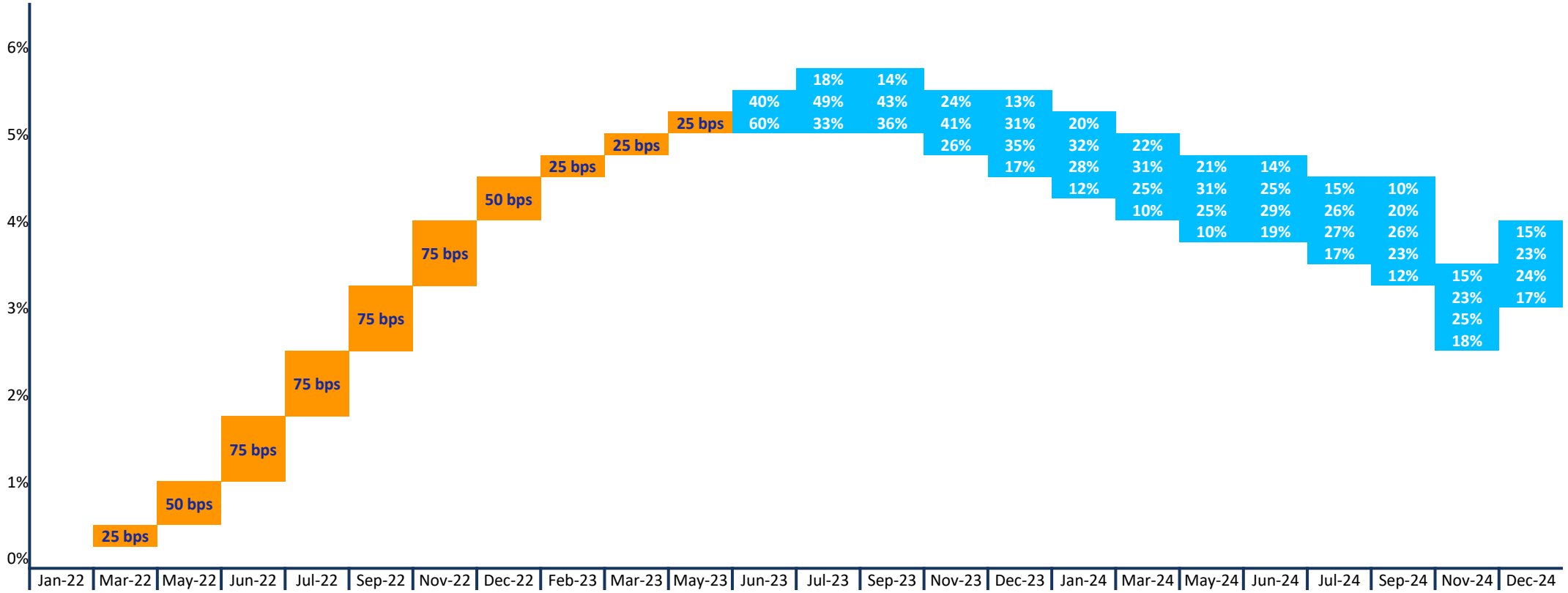




Source: Bank Indonesia, BPS, Bloomberg, SSI Research

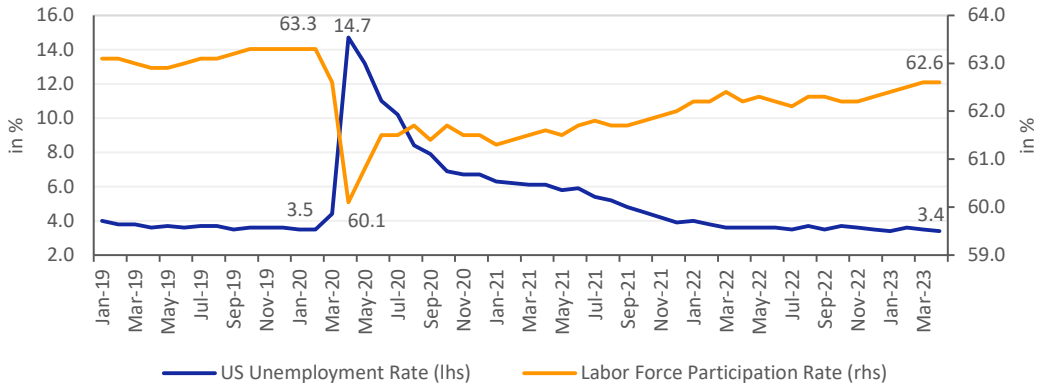
There's a change in market expectations, from a Fed pivot in 4Q23 to terminal rate hike in July

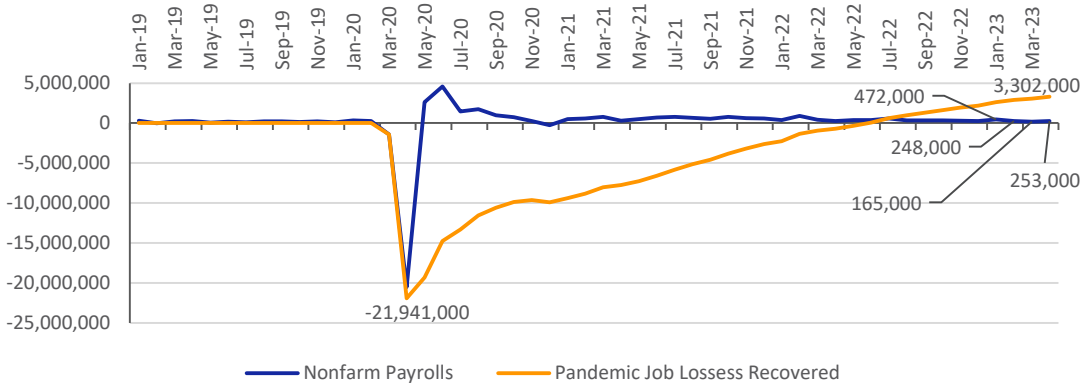
Even so, the market still believe that Fed pivot is coming, with expectation of FFR cuts to 5% by December

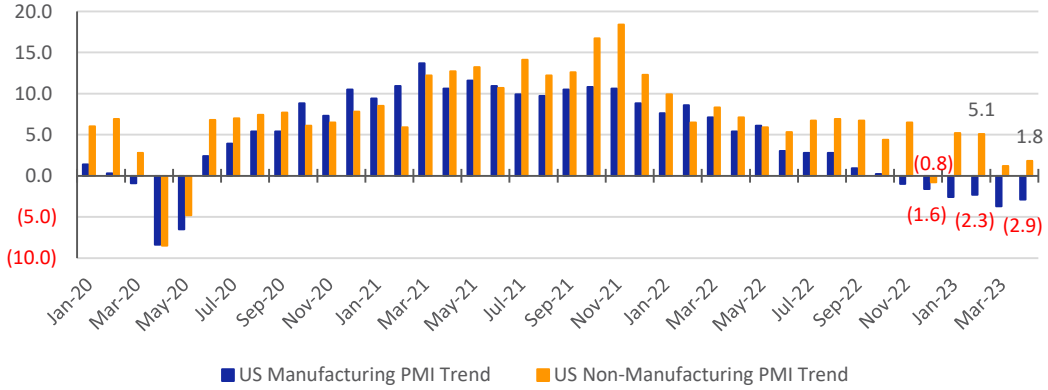


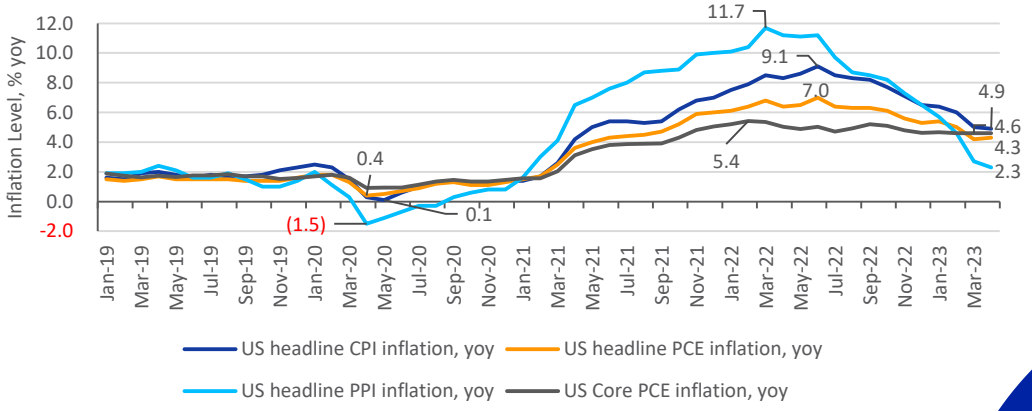
Source: CME Group, Federal Research, SSI Research

The Fed's terminal rate hike is expected to stop US labor market expansion by triggering services **recession**, which should help strengthen the disinflationary momentum





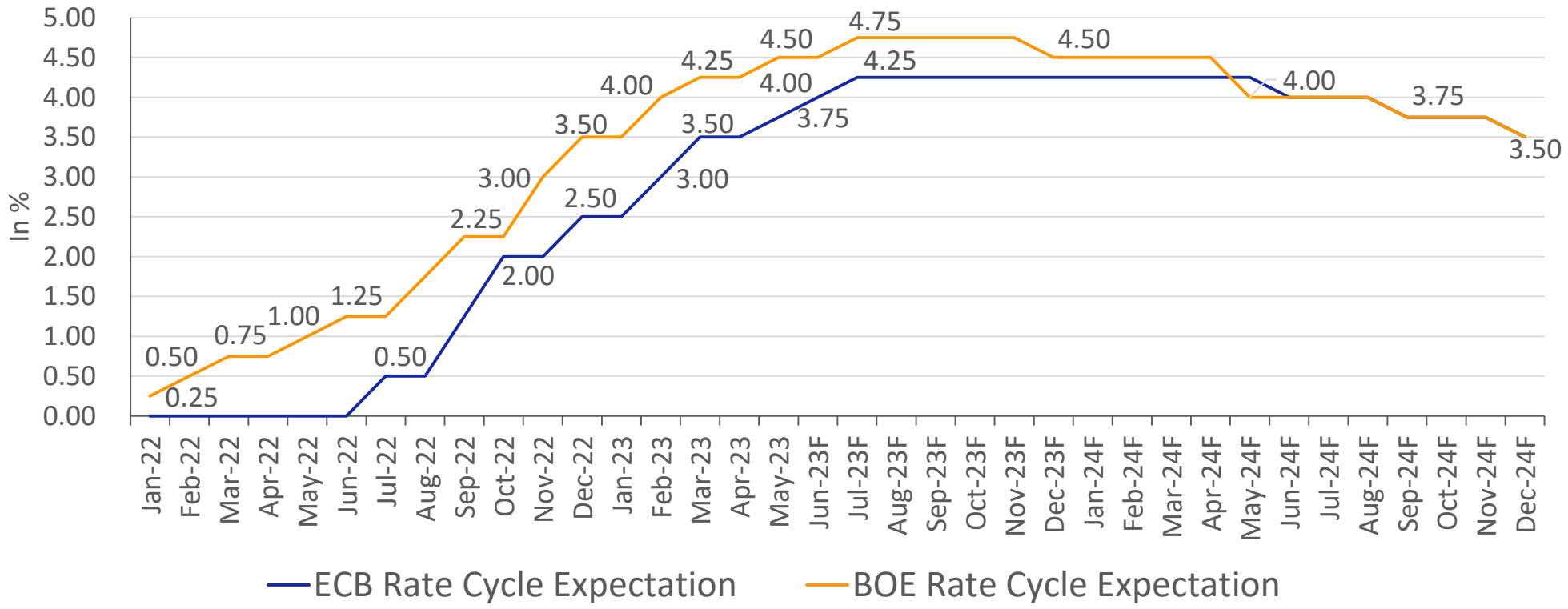




Source: BEA, BLS, S&P, Bloomberg, SSI Research

ECB and BoE are facing terminal rate hike expectations

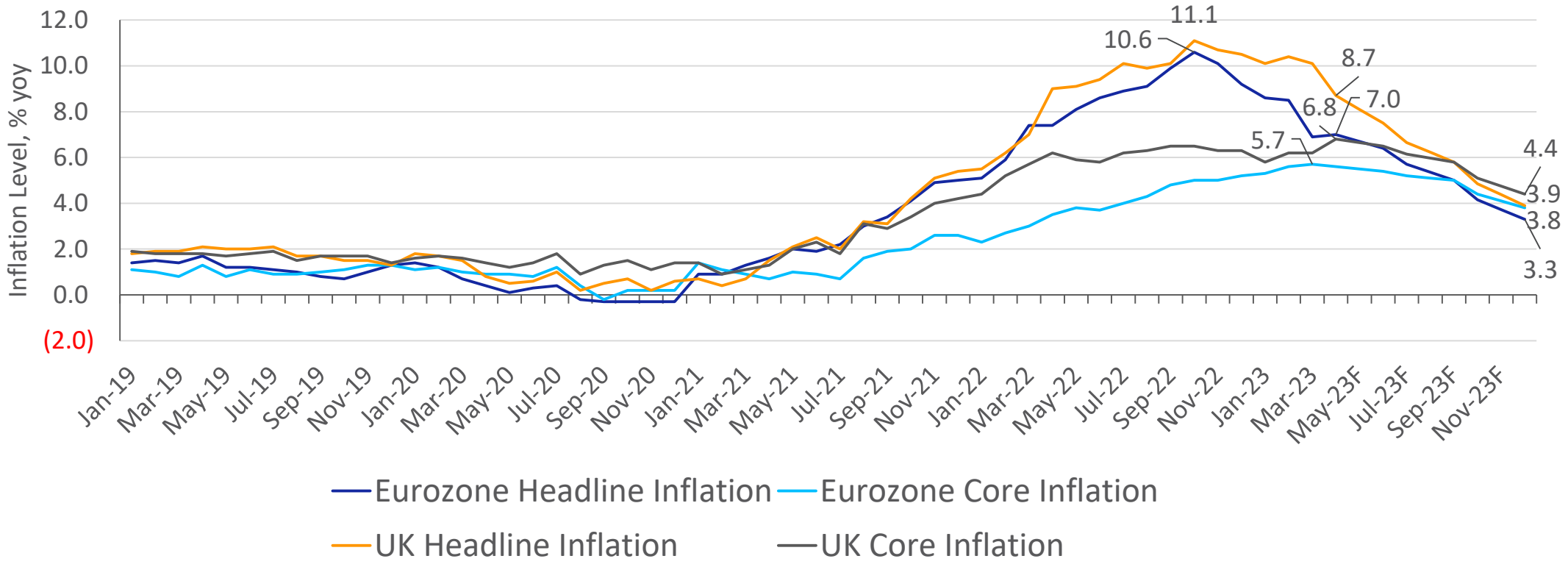
For BoE, the market also expects a pivot in December



Source: BOE, ECB, SSI Research

According to consensus, terminal rate hike is necessary to suppress inflation to ≤4% in FY23

The market expects that BoE pivot will bring UK inflation to 4.4% yoy at the end of 2023



Source: Eurostat, ONS, Bloomberg, SSI Research

Intermarket Analysis

What's Our View?

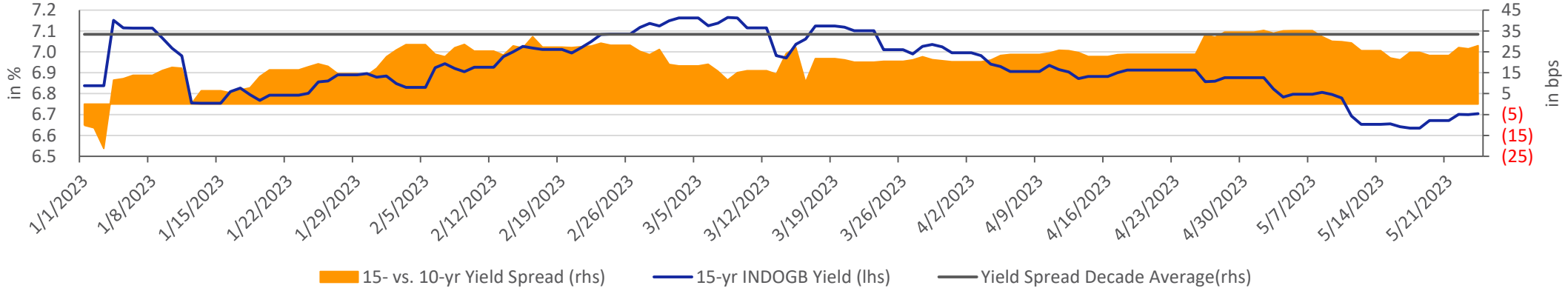
We recommend investors to **overweight 2-yr and 15-yr INDOGB as a strategy to face BI Pivot**

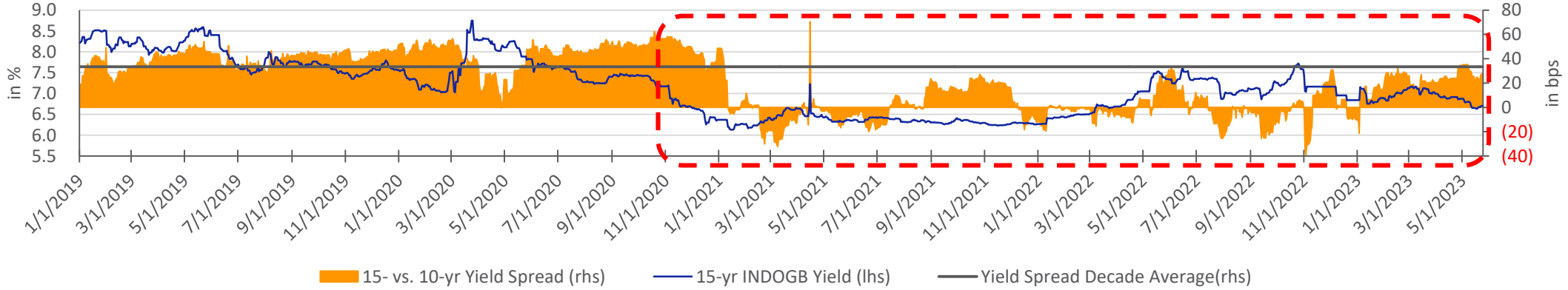
- The main factor supporting our recommendation is the possibility of the normalization of the yield spreads between the two instruments and the benchmark tenor (10-yr) to their historical average, particularly in the last decade.

- We recommend investors to **underweight all INDON instruments**, considering the relatively **inverted yield curve** due to the instruments' strong linkage with global macroeconomic situations.

The yield spread between 10-yr vs. 15-yr INDOGB has started to normalize after a turbulent period (due to the pandemic)

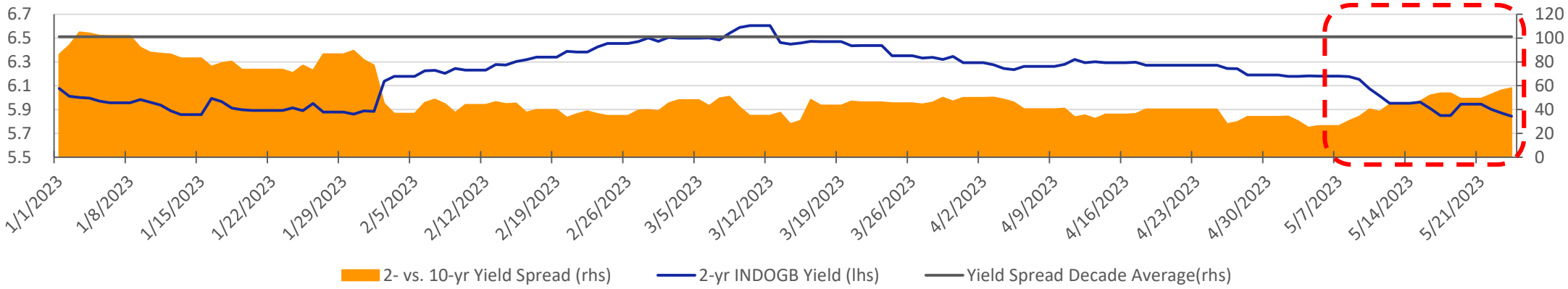
The yield spread is getting closer to the 10-yr average of 33 bps

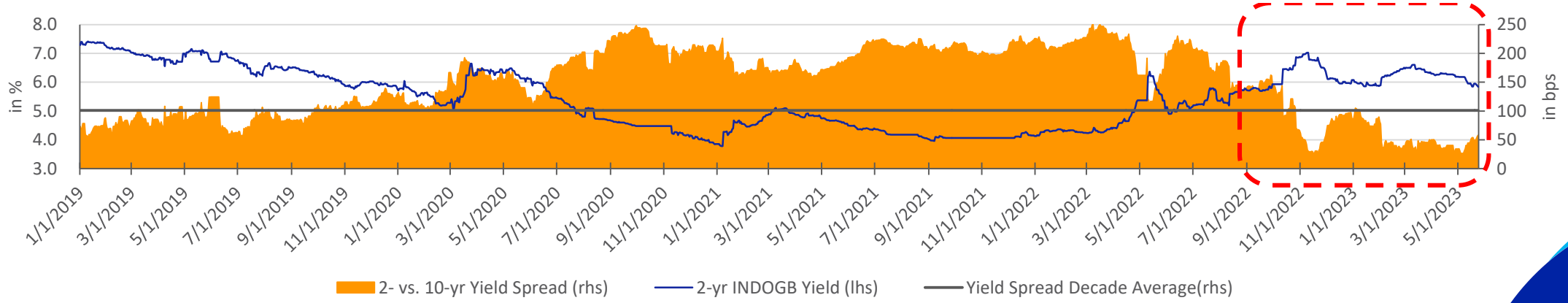




Source: Bloomberg, SSI Research

The yield spread of 2-yr INDOGB might also normalize, with its 10-yr average being 101 bps

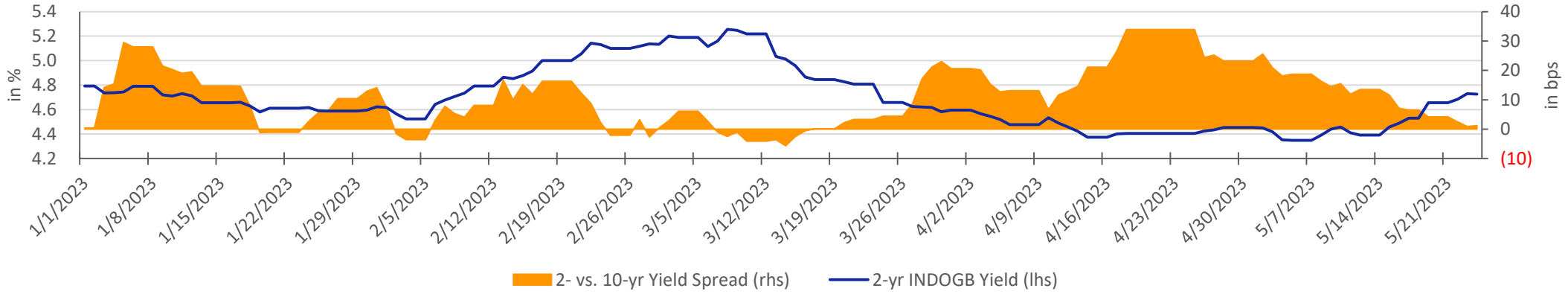


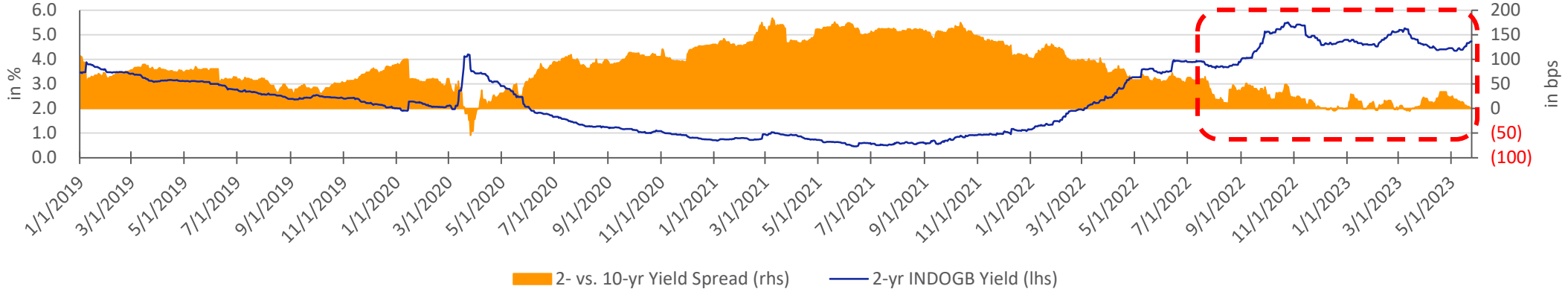


Source: Bloomberg, SSI Research

There's a huge chance for inverted INDON yield curve

Considering the instrument's strong linkage to the Fed's rate cycle





Source: Bloomberg, SSI Research

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Thank You

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