SAMUEL SEKURITAS INDONESIA

# Macro Strategy and Fixed Income

# Economic Outlook June 2023

Lionel Priyadi

Your Lifelong
**Investment Partner**

www.samuel.co.id

# Global Macro Fundamentals

Lionel Priyadi

# What's Our View?

## We expect Asia's economy to outperform both the US and Europe in 2H23

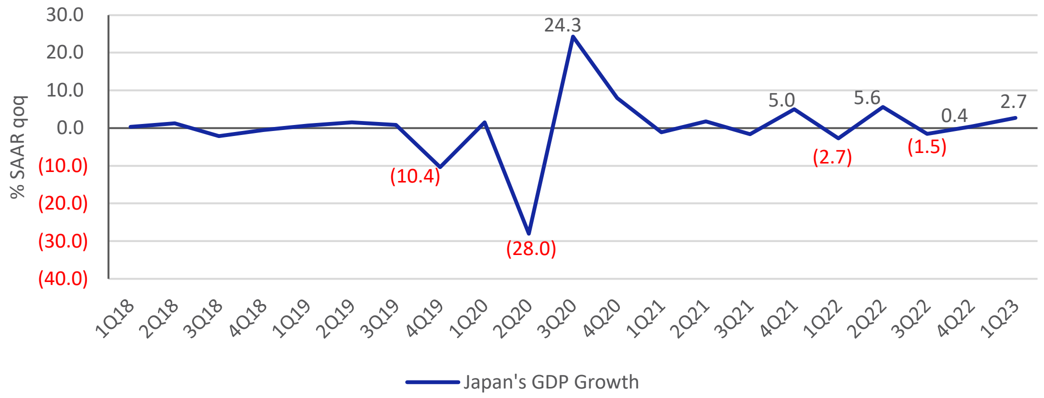
- As a result, we might see foreign capital flow from both the US and Europe to Asia

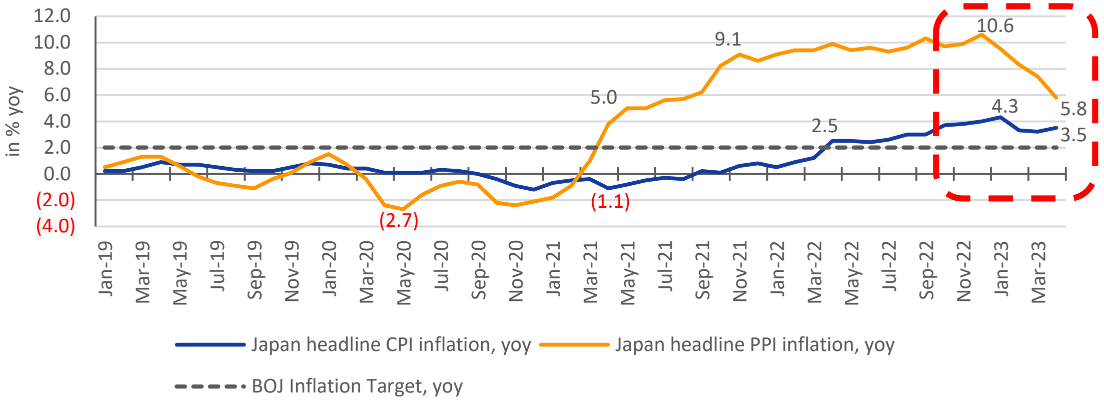
- Some of the factors expected to drive Asia's economy in 2H23 including:
    a) Japan managed to break the deflation chain for the first time since the 1990s,
    b) PBOC's decision to stimulate Chinese economy through policy rate cuts
    c) Soft landing in Southeast Asia

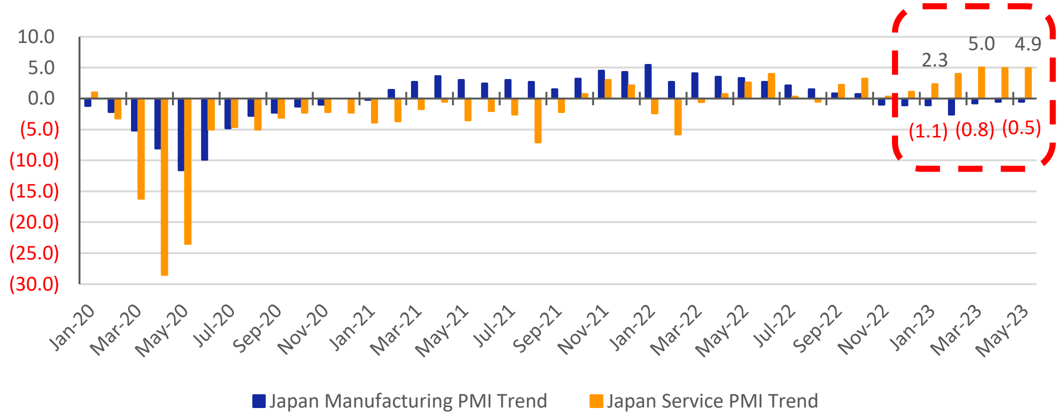
- However, the terminal rate hike In the US and Europe might somewhat hamper the capital inflow into Asia, at least for a little while.

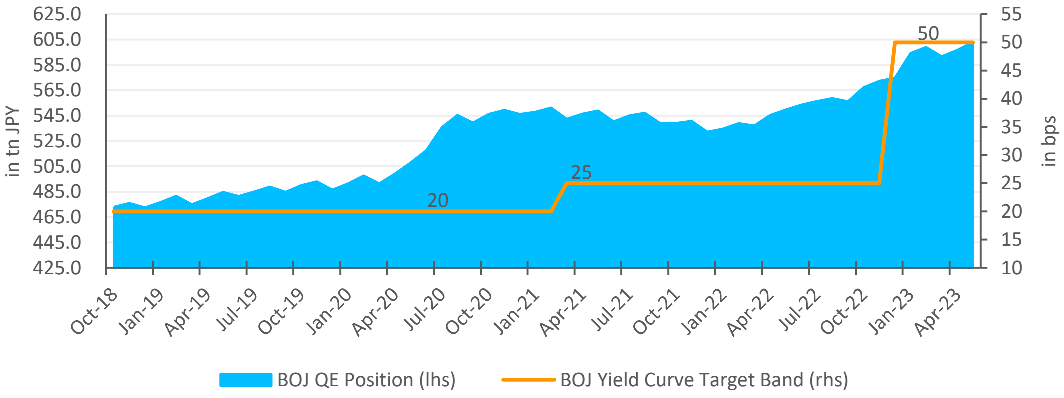
# Japan managed to break the deflation chain, with the services sector as the main driver

Thanks to BOJ's expertise in balancing its yield curve control policy with quantitative easing



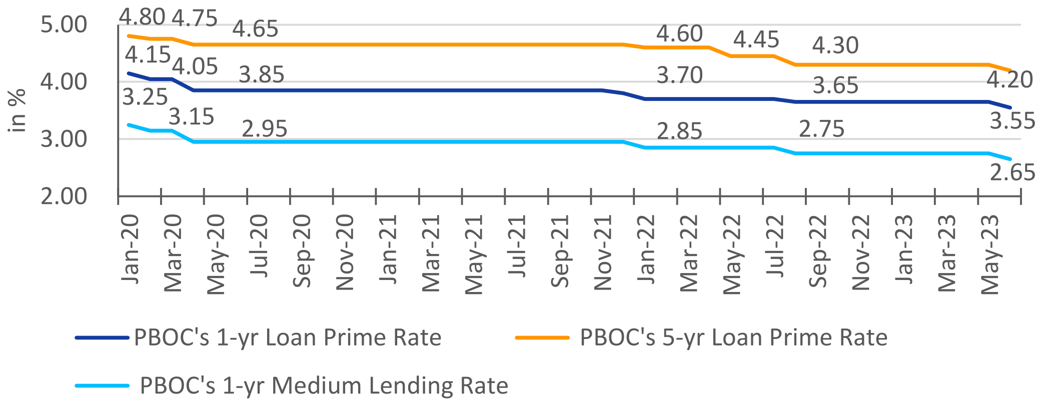



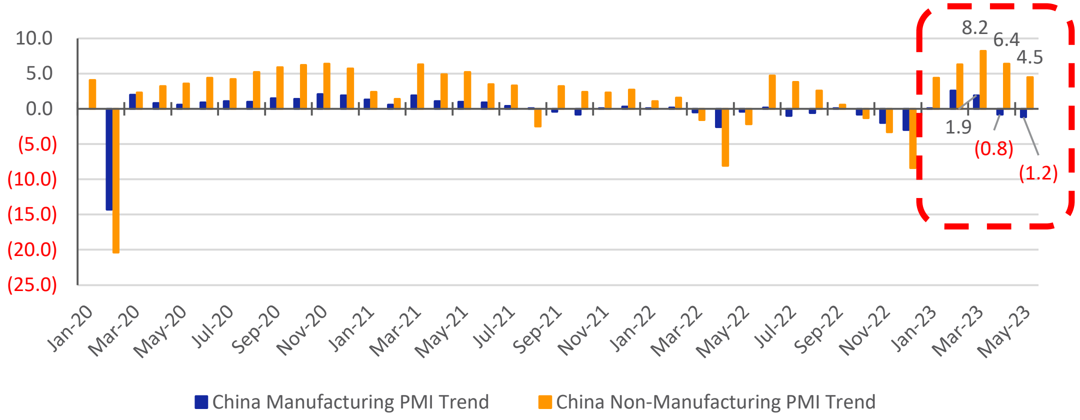



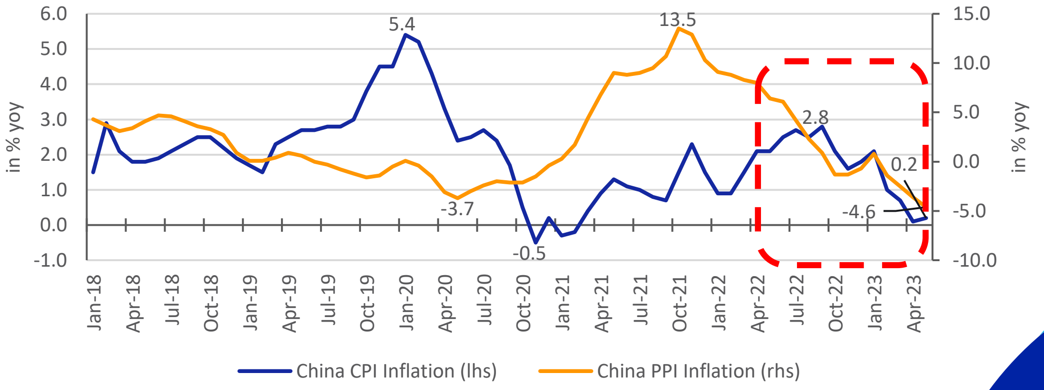

Source: Bank of Japan, Japan Statistics Bureau, S&P, Bloomberg, SSI Research

SAMUEL SEKURITAS INDONESIA

# China's economic slowdown in 2Q23 was a blessing in disguise, because it ‘forced’ the PBOC to cut its policy rate

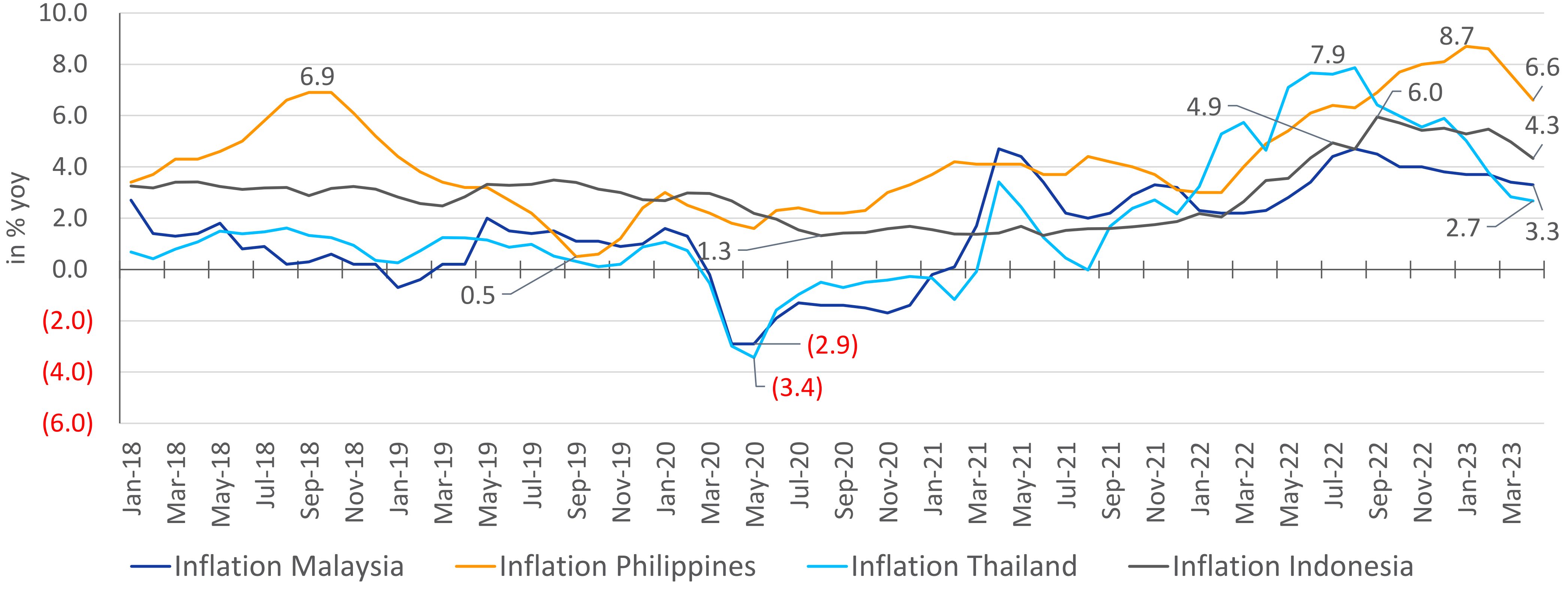




Source: NBSC, S&P, Bloomberg, SSI Research

# Soft landing in Southeast Asia (1)

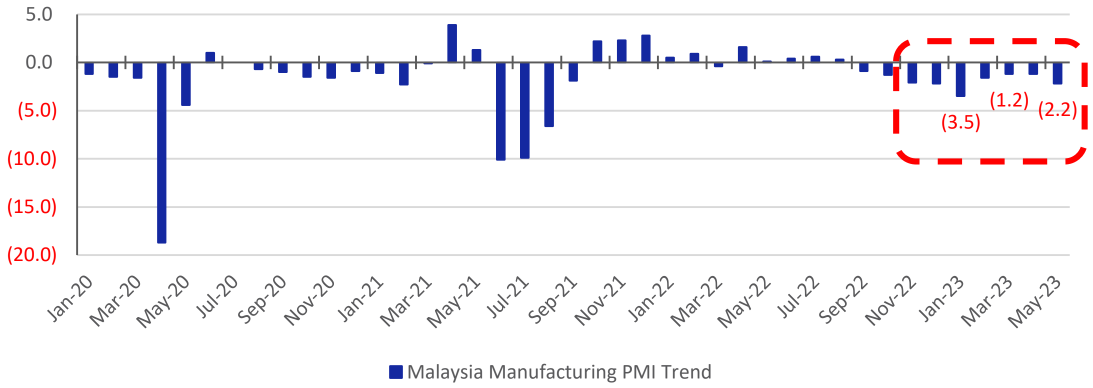
Slow, stable inflation allows for earlier rate cuts …



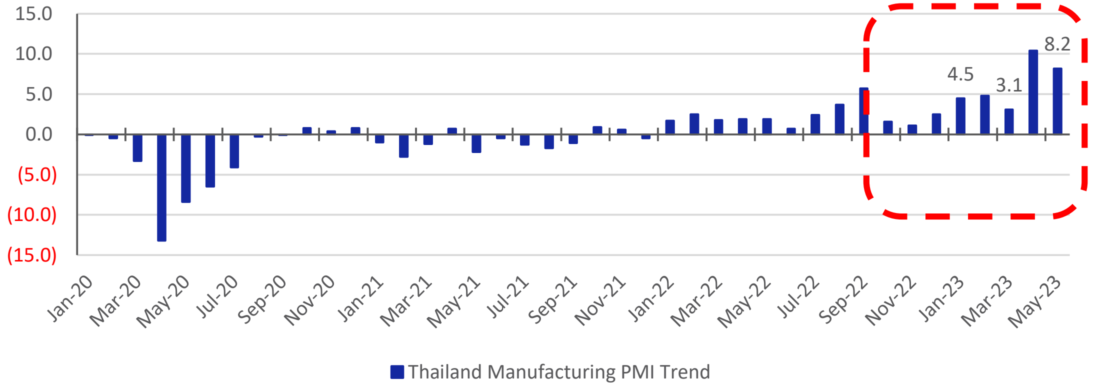

Source: S&P, Bloomberg, SSI Research

# Soft landing in Southeast Asia (2)

…especially in Malaysia and Indonesia, which experienced an economic slowdown

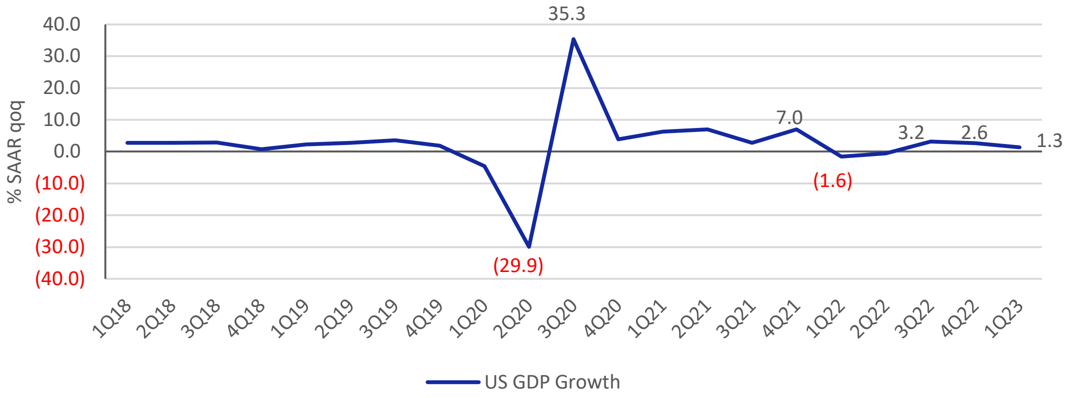



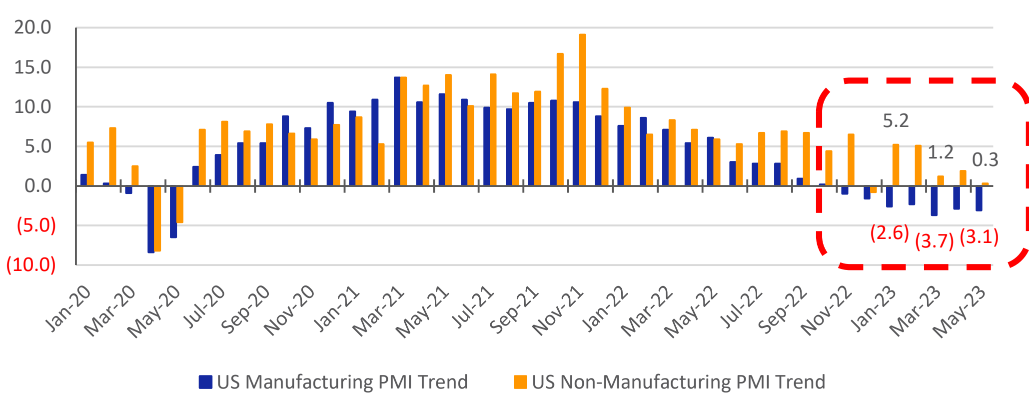


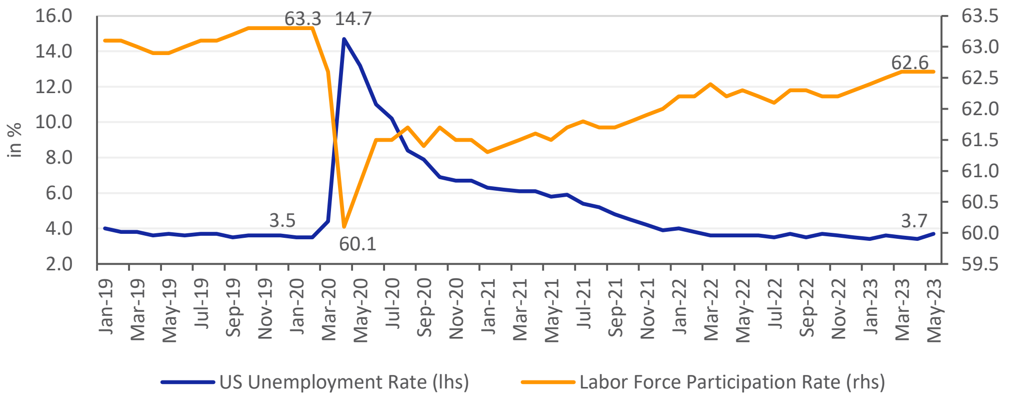


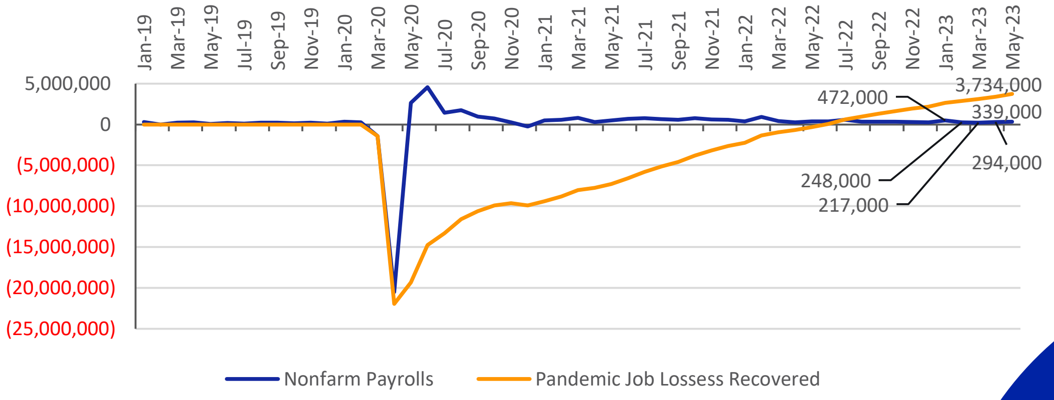

Source: S&P, Bloomberg, SSI Research

# US market participants are still waiting for a recession to trigger the Phillips Curve trade-off



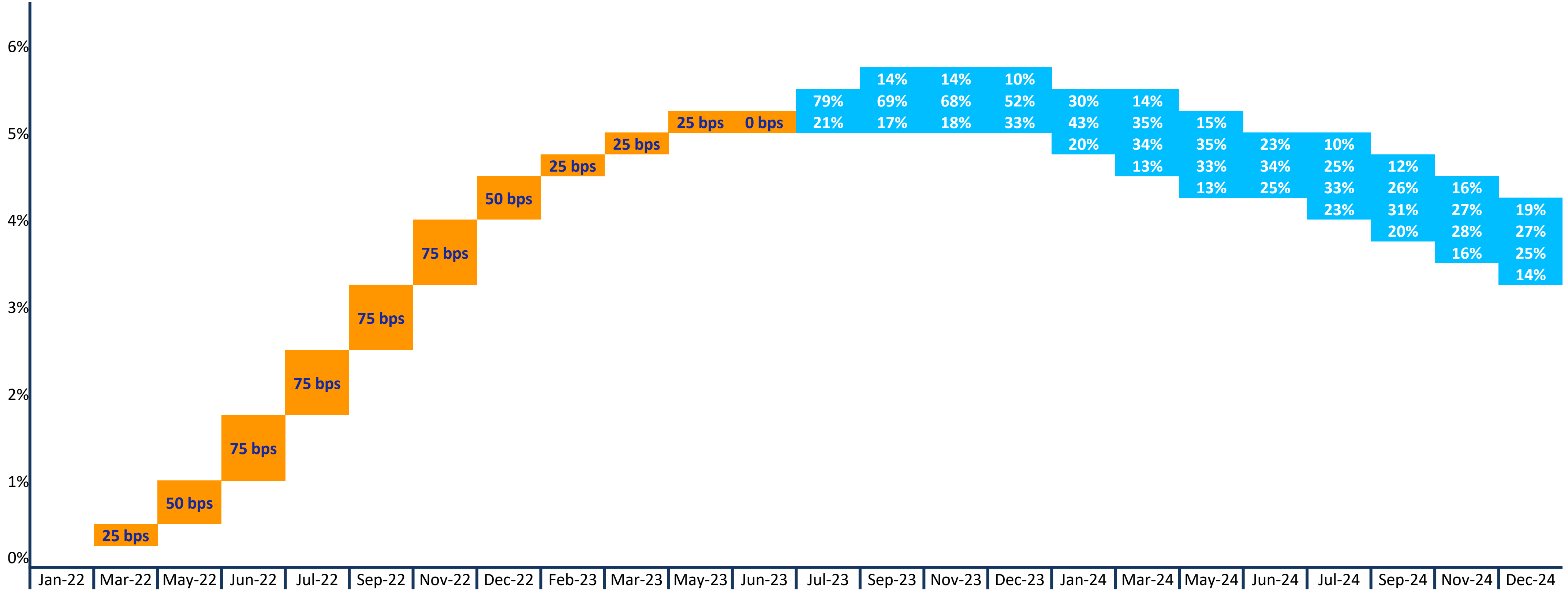




Source: BEA, BLS, S&P, Bloomberg, SSI Research

# According to the consensus, a hard landing is unavoidable since a terminal rate hike is necessary to trigger the Phillips Curve trade-off

We have three potential scenarios: a) a 25 bps terminal rate hike, with Fed rate cuts starting in 1Q24 …




Source: CME Group, Federal Research, SSI Research

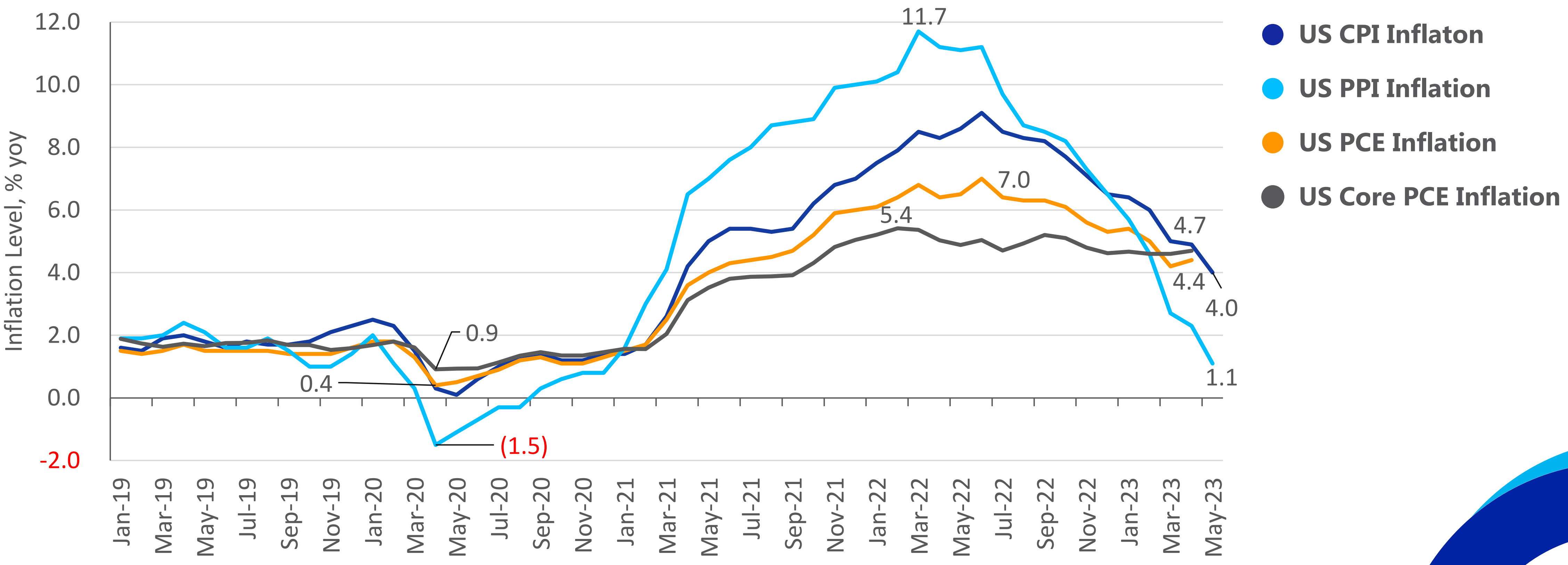
# … b) 50 bps rate hike, and …

…due to the Fed's concern over the possibility of a slower-than-expected core disinflation

| | | 2023 | 2024 | 2025 | Longer-run |
|---|---|---|---|---|---|
| GDP Growth | June Forecast | ↑1.0 | ↓1.1 | ↓1.8 | 1.8 |
| | March Forecast | 0.4 | 1.2 | 1.9 | 1.8 |
| Unemployment Rate | June Forecast | ↓4.1 | ↓4.5 | ↓4.5 | 4.0 |
| | March Forecast | 4.5 | 4.6 | 4.6 | 4.0 |
| PCE Inflation | June Forecast | ↓3.2 | 2.5 | 2.1 | 2.0 |
| | March Forecast | 3.3 | 2.5 | 2.1 | 2.0 |
| Core PCE Inflation | June Forecast | ↑3.9 | 2.6 | ↑2.2 | |
| | March Forecast | 3.6 | 2.6 | 2.1 | |
| Fed Terminal Rate | June Forecast | ↑5.6 | ↑4.6 | ↑3.4 | 2.5 |
| | March Forecast | 5.1 | 4.3 | 3.1 | 2.5 |

Source: Federal Research, SSI Research

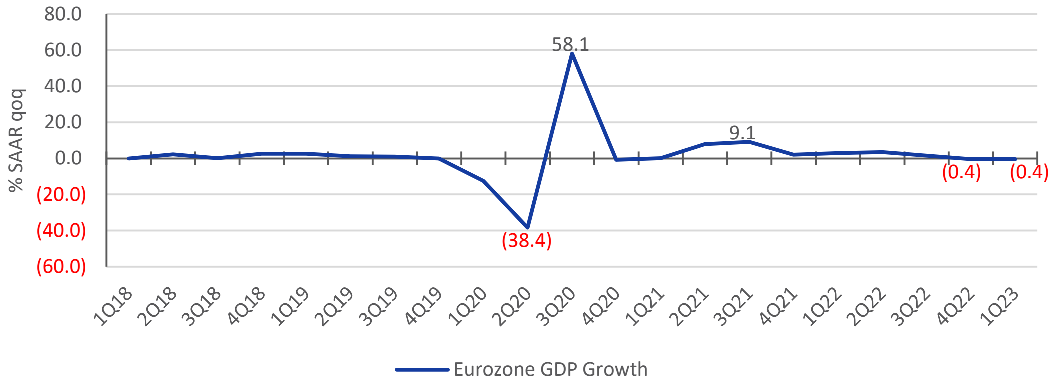
# ... c) no terminal rate hike in July, especially if June CPI inflation < 3.5% yoy

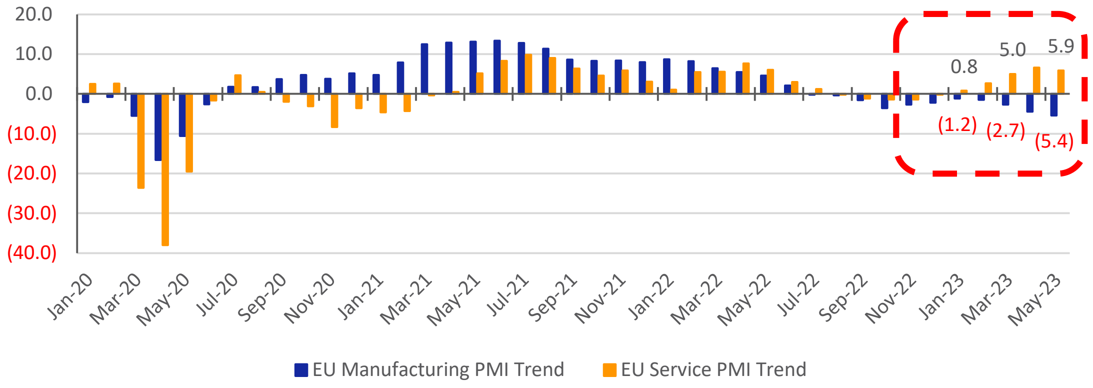


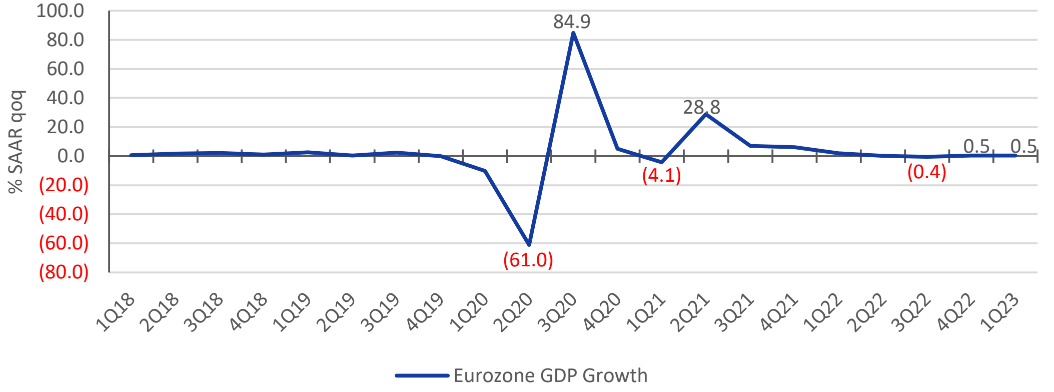

Source: BEA, BLS, Bloomberg, SSI Research

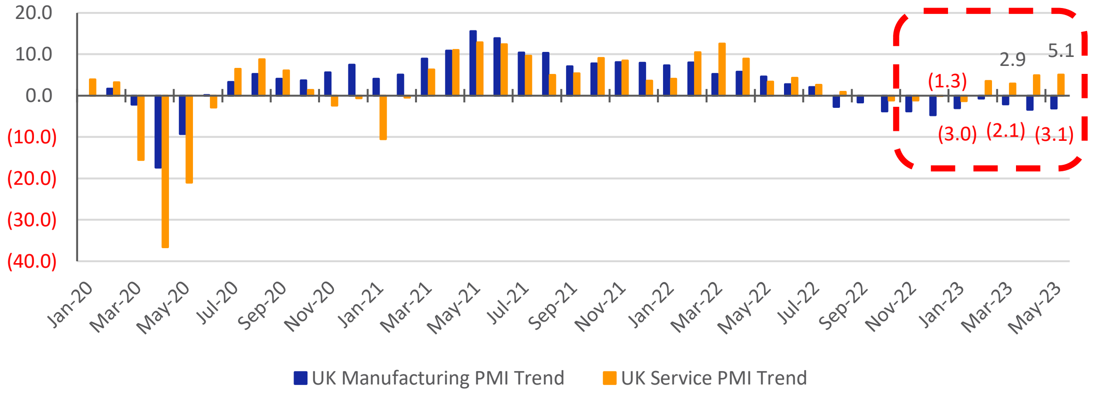
# Recession came sooner to Europe, though it might not last

## Thanks to stronger services PMI rebound in 2Q23



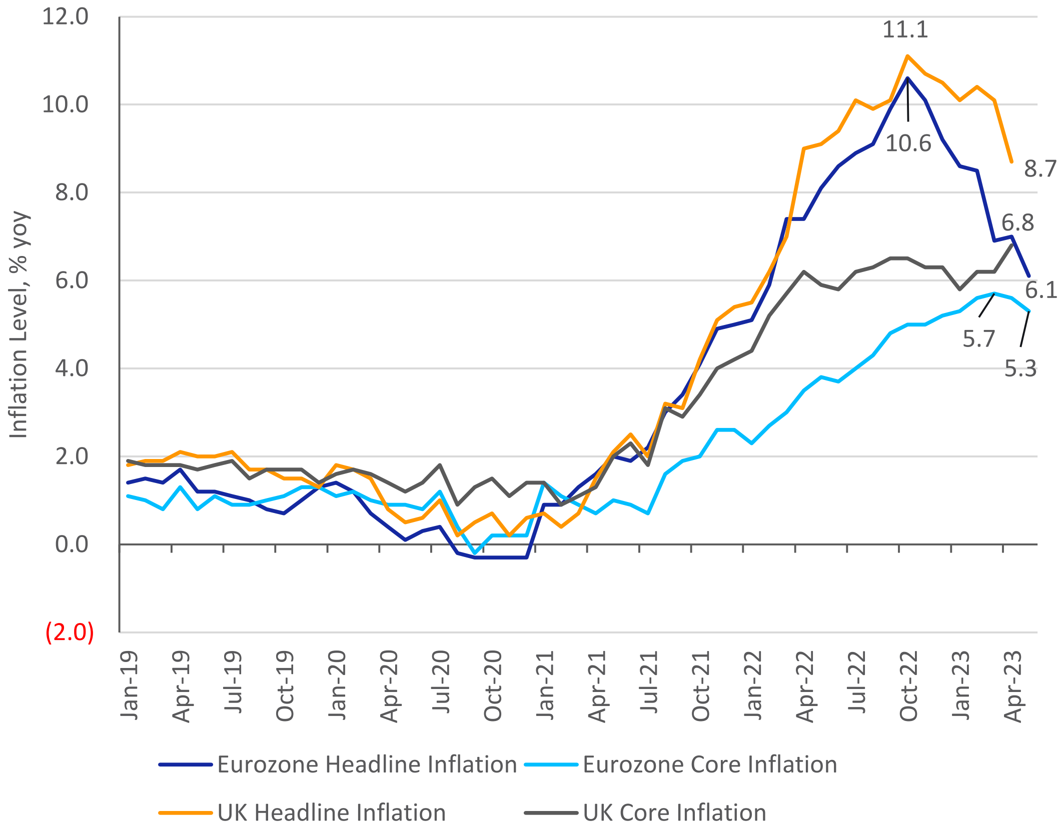



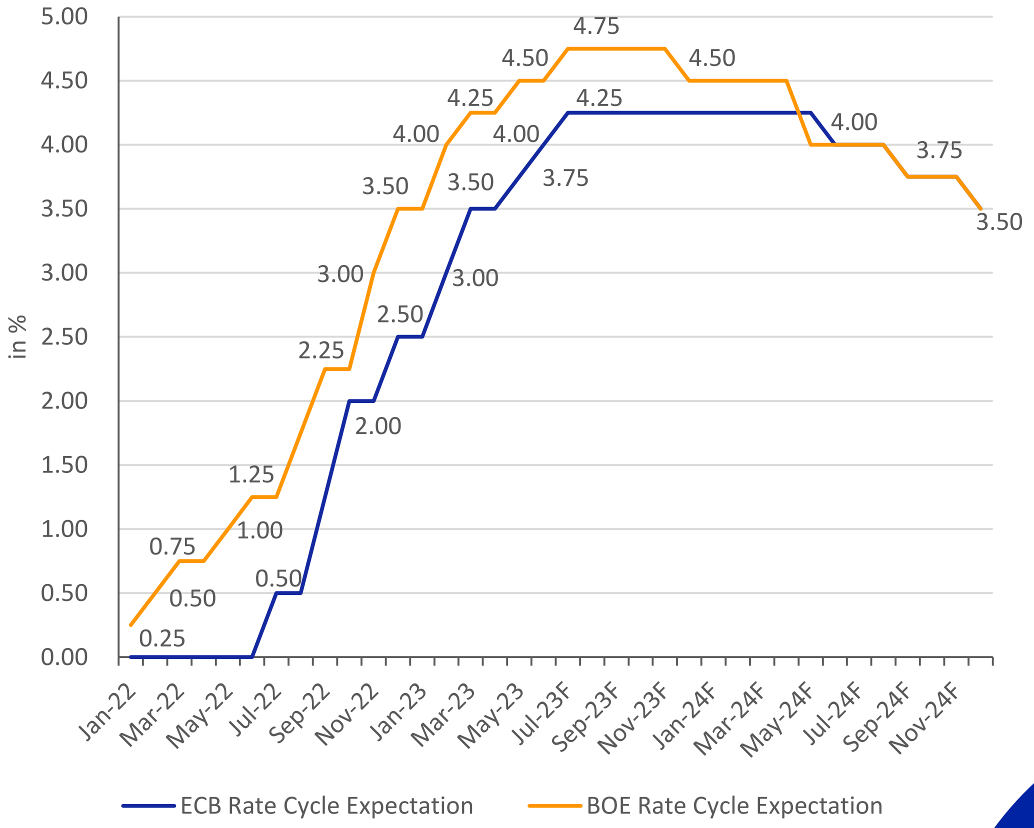




Source: Eurostat, ONS, S&P, Bloomberg, SSI Research

SAMUEL SEKURITAS INDONESIA

# The probability of a recession in Europe is still relatively high, mainly due to a) persistent inflation, b) ongoing rate hike cycle, and…




Source: BOE, ECB, SSI Research

# ...c) Russia-Ukraine war

## The US plans to 'weaken' Russia

"The United States should … seek to erode its (Russia) power over time in the military, diplomatic, and economic spheres." Prof. John Deni – US Army War College (FP)

## Fighting the far-rights

The Russia-Ukraine war gives a chance for politicians from various parties in the US and Europe to 'attack' far-right populist politicians in the public (DGAP)

## EU's energy geopolitical changes

The Russia-Ukraine conflict opens the door for the EU to execute its energy union policy that unites all European energy policies from the perspective of security, market control, and competitiveness. (EC)

## NATO's expansion

The Russia-Ukraine war has made NATO relevant again, and even opened up opportunities for the military organization to expand its wings through partnerships with Japan and Australia in the Asia-Pacific.(NATO)


## Ukraine reconstruction

Various parties in the United States and Europe have sensed the economic and business opportunities from the Ukraine reconstruction program; economists from both continents have prepared the blueprint. (CEPR)


## Opening the door for the US to Central Asia

The United States uses the Russia-Ukraine conflict to fight Russia and China by infiltrating Central Asia using USAID (ANKASAM)

# Indonesia’s Macro Fundamentals

# What's Our View?

Even though the signs of an economic slowdown are getting stronger in Indonesia, we see that as a positive thing, since it might persuade BI to start its rate cut sooner

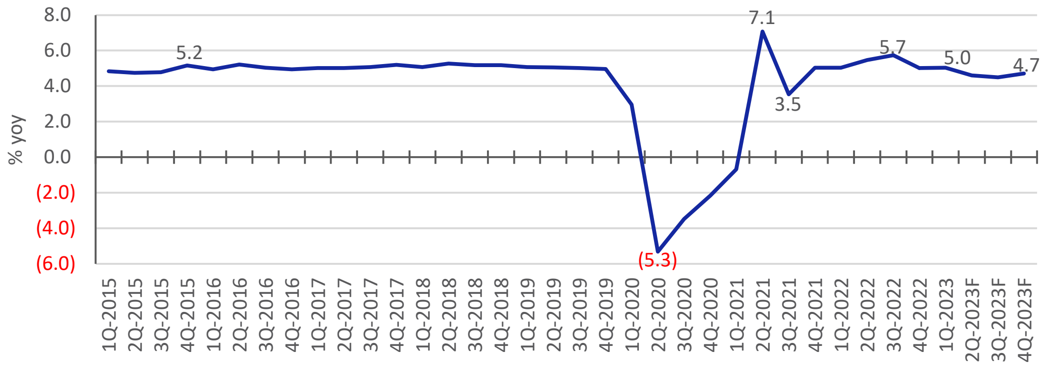
- Strong disinflation and the small chance for twin deficit (fiscal deficit and current account deficit at the same time) become positive catalysts for BI rate cut.

- However, Bank Indonesia may postpone the rate cut until October (4Q23) if rupiah depreciation continues into 3Q23, since it will force BI to keep doing its currency intervention.

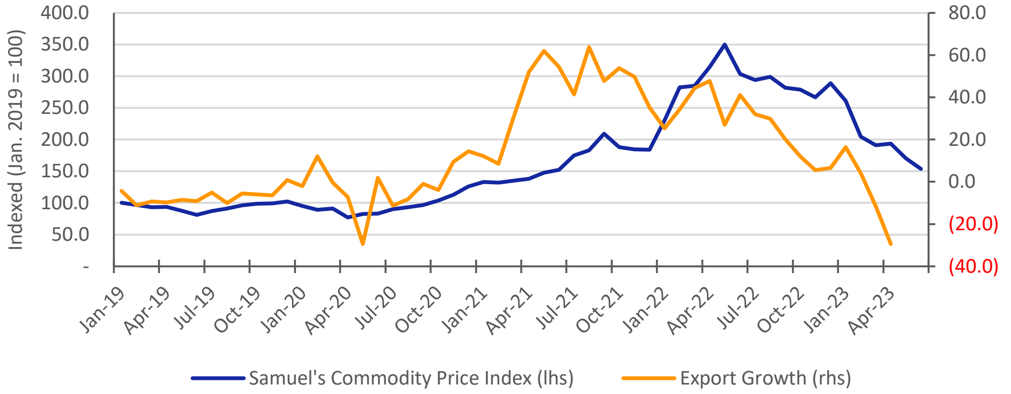
- We maintain our 2023 exchange rate projection at IDR 14,900 per USD, with the following assumptions: a) 0 bps policy rate spread between BI and the Fed, and b) negative current account-to-GDP ratio.

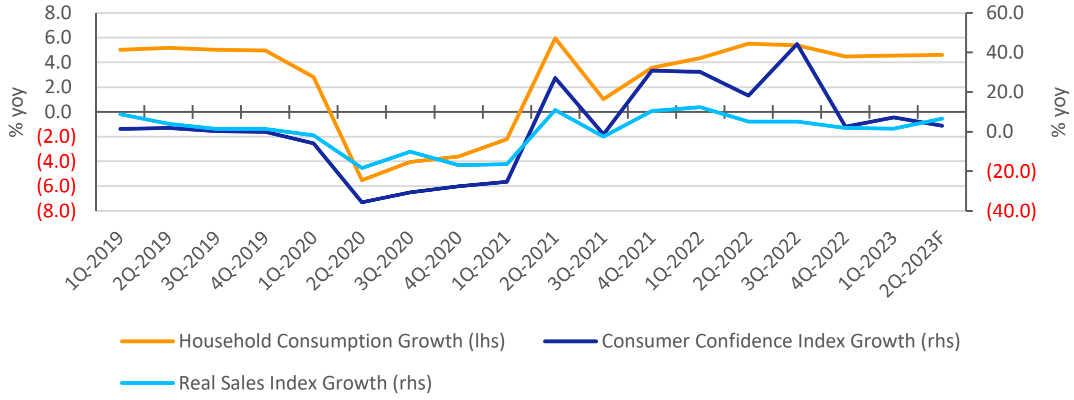
# We expect Indonesia’s GDP growth to slow down to 4.7% (MOF: 5.3%; Cons: 4.9%)

## Domestic consumption remained stable; however, manufacturing activities slowed down and export fell due to commodity slump





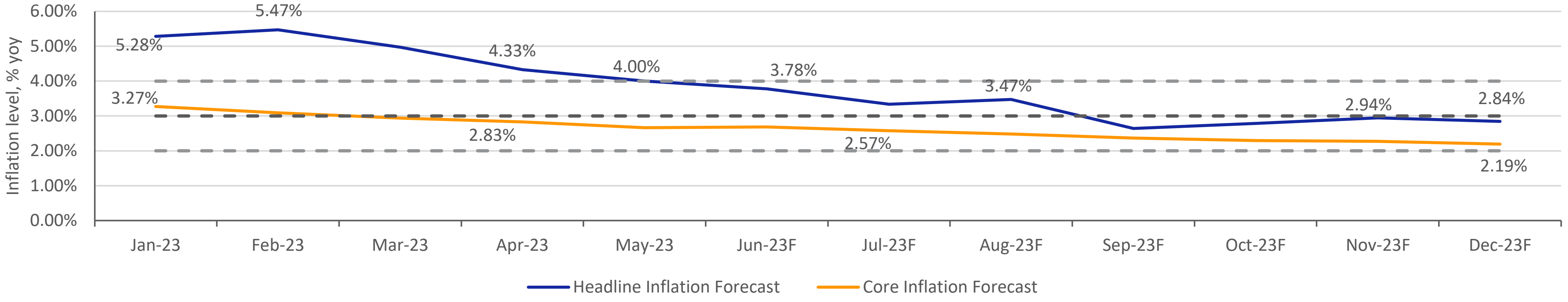


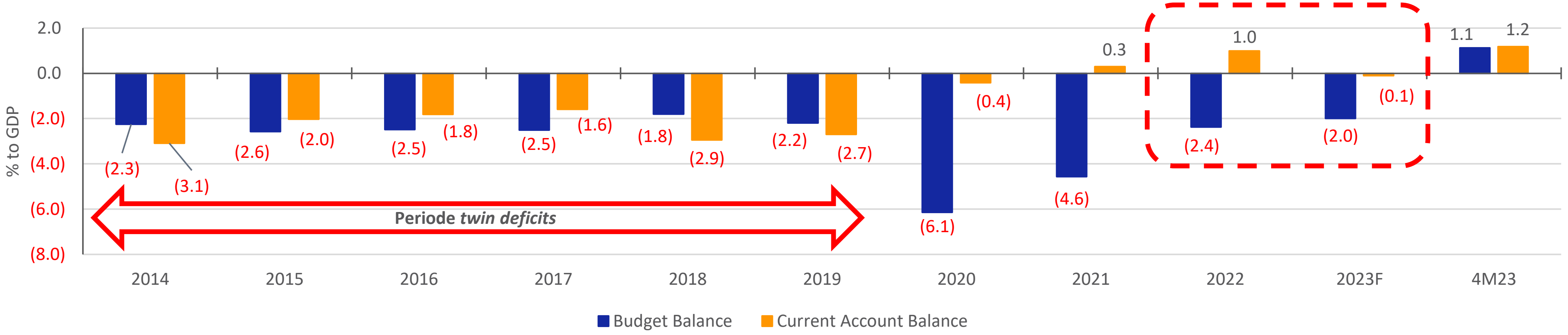




Source: BPS, S&P, Bloomberg, SSI Research

SAMUEL SEKURITAS INDONESIA

# Economic slowdown + stable inflation + No twin deficits = Perfect rate cut scenario

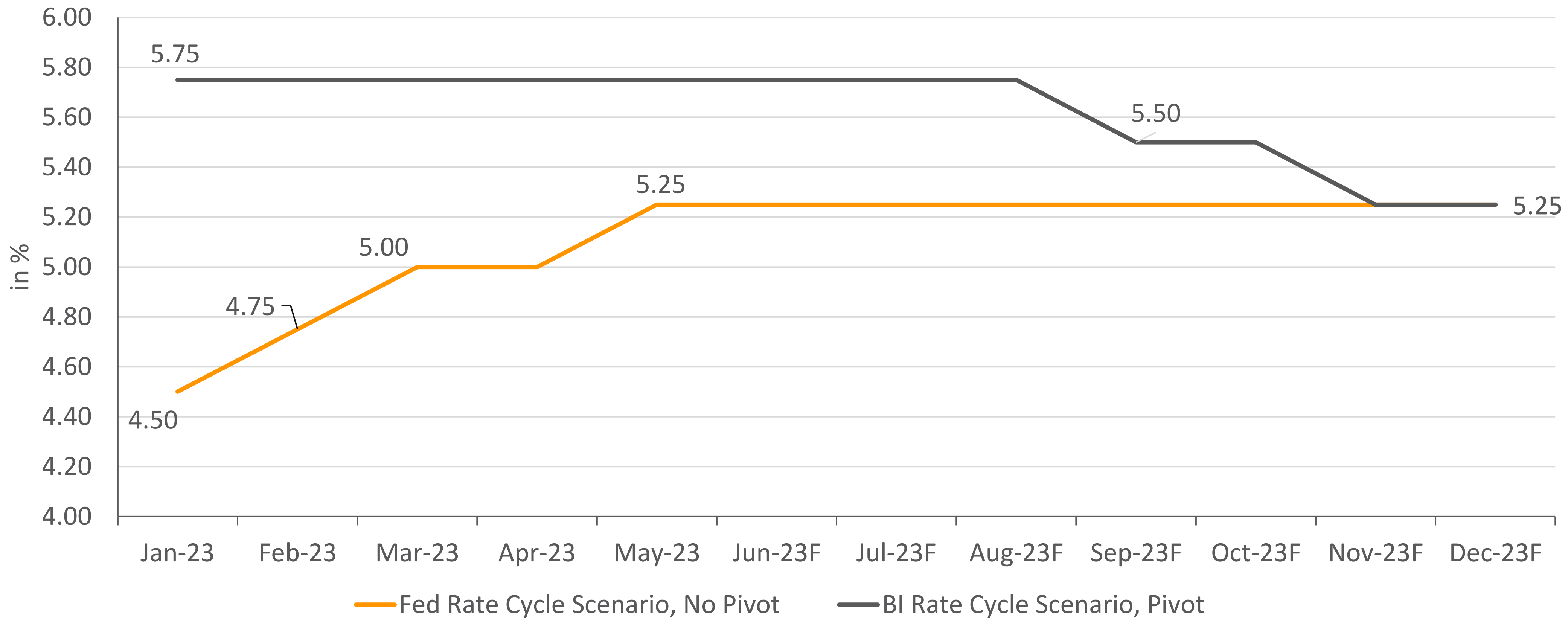



Source: Bank Indonesia, BPS, Bloomberg, SSI Research

# Our BI rate cut scenario: 2X25 bps in September & November

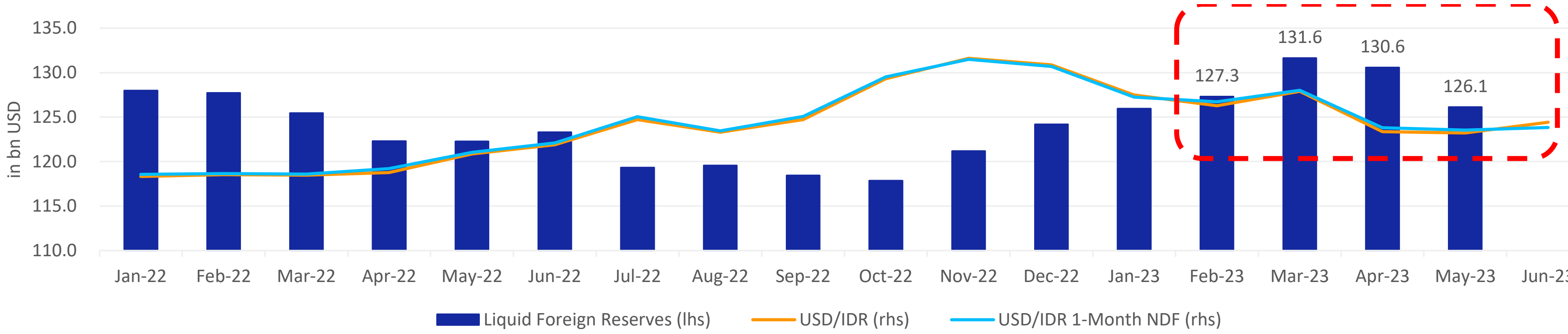
Scenario C: no Fed terminal rate hikes

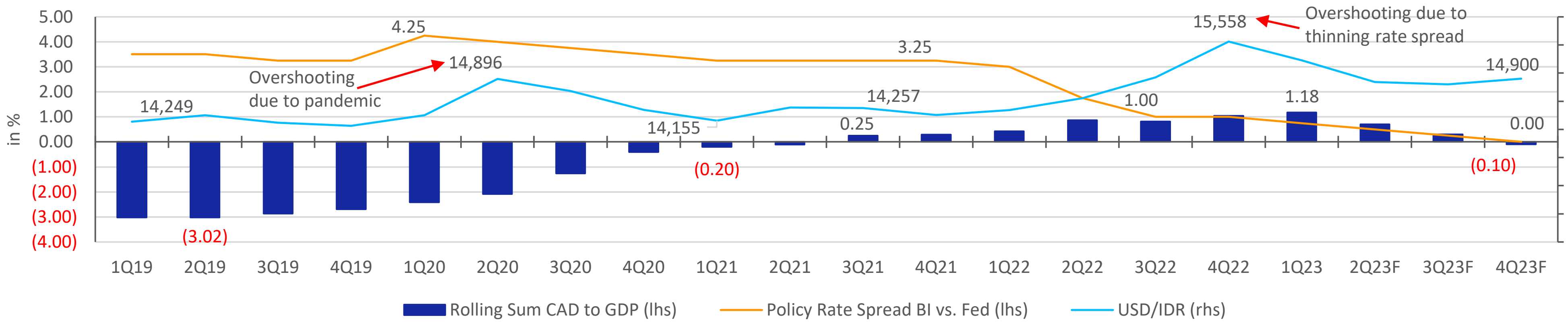



Source: BPS, S&P, Bloomberg, SSI Research

SAMUEL SEKURITAS INDONESIA

# The factor that might prevent our BI rate cut scenario is rupiah deprecation, which is likely to trigger more interventions from BI




Source: Bank Indonesia, Bloomberg, SSI Research

# SSI Forecast Table

| Indicators (% yoy) | 1Q21 | 2Q21 | 3Q21 | 4Q21 | 1Q22 | 2Q22 | 3Q22 | 4Q22 | 1Q23 | 2Q23F | 3Q23F | 4Q23F | FY21 | FY22 | FY23F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Real GDP (NSA % qoq) | (0.9) | 3.3 | 1.5 | 1.1 | (1.0) | 3.7 | 1.8 | 4.0 | (0.9) | 3.4 | 1.7 | 0.6 | | | |
| Real GDP | (0.7) | 7.1 | 3.5 | 5.0 | 5.0 | 5.4 | 5.7 | 5.0 | 5.0 | 4.6 | 4.5 | 4.7 | 3.7 | 5.3 | 4.7 |
| Unemployment rate (% nsa) | 6.3 | 6.3 | 6.5 | 6.5 | 5.8 | 5.8 | 5.9 | 5.9 | 5.5 | 5.5 | 5.4 | 5.3 | 6.5 | 5.9 | 5.3 |
| Consumer price | 1.4 | 1.3 | 1.6 | 1.9 | 2.6 | 4.4 | 6.0 | 5.5 | 5.0 | 3.8 | 2.6 | 2.8 | 1.9 | 5.5 | 2.8 |
| Current account balance (% to GDP) | (0.4) | (0.7) | 1.7 | 0.5 | 0.2 | 1.1 | 1.3 | 1.3 | 0.9 | (0.6) | (0.3) | (0.4) | 0.3 | 1.0 | (0.1) |
| 12M rolling sum | (0.2) | (0.1) | 0.3 | 0.3 | 0.4 | 0.9 | 0.8 | 1.0 | 1.2 | 0.7 | 0.3 | (0.1) | | | |
| Fiscal balance (% to GDP) | (0.8) | (1.7) | (2.7) | (4.6) | 0.1 | 0.4 | 0.3 | (2.4) | 0.6 | (1.1) | (1.8) | (2.8) | (4.6) | (2.4) | (2.8) |
| Policy rate, 7DRRR (%) | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 | 4.25 | 5.50 | 5.75 | 5.75 | 5.50 | 5.25 | 3.75 | 5.50 | 5.25 |
| 10-year government bond yield (%) | 6.78 | 6.59 | 6.26 | 6.38 | 6.74 | 7.22 | 7.37 | 6.94 | 6.79 | 6.40 | 6.20 | 6.00 | 6.38 | 6.94 | 6.00 |
| Exchange rate (USD/IDR) | 14,525 | 14,500 | 14,313 | 14,253 | 14,369 | 14,898 | 15,228 | 15,568 | 14,995 | 14,600 | 14,700 | 14,900 | 14,253 | 15,568 | 14,900 |

Source: Bank Indonesia, BPS, Bloomberg, SSI Research

# Intermarket Analysis

# What’s Our View?

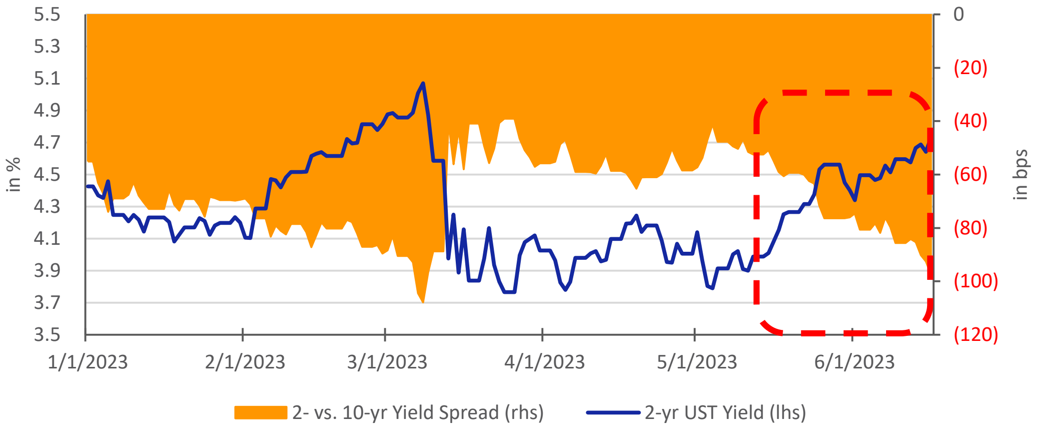
## We advise investors to **overweight** on **2Y, 10Y, and 15Y INDOGB as a strategy to face BI pivot in 2H23**

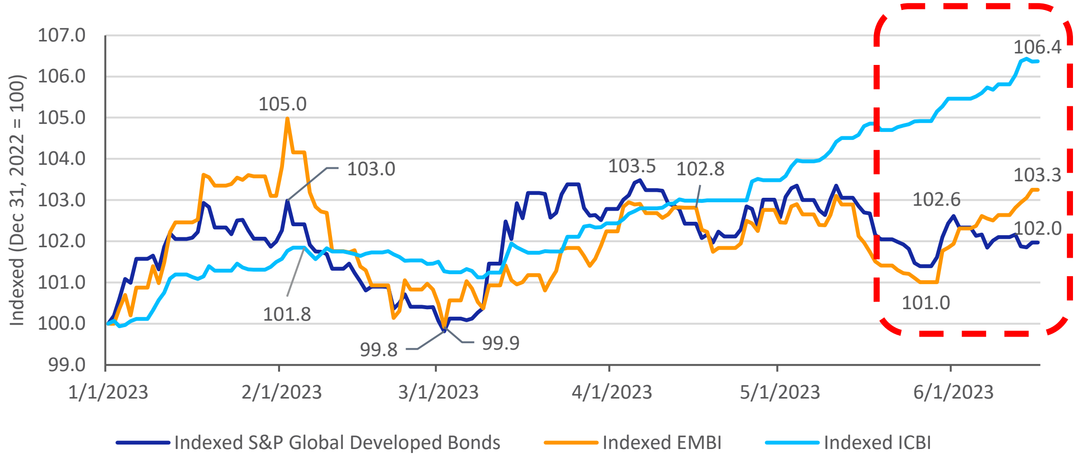
- Aside from the BI pivot, some factors leading to the recommendation are: :
    a) UST yield curve that has become more and more inverted due to speculations regarding Fed terminal rate hike and the announcement of FOMC’s projections.
    b) Shift in capital inflow from developed market to emerging market (including Indonesia),
    c) The government’s decision to limit the supply of new SUNs to the primary market, and
    d) Bullish steepening in the INDOGB market.

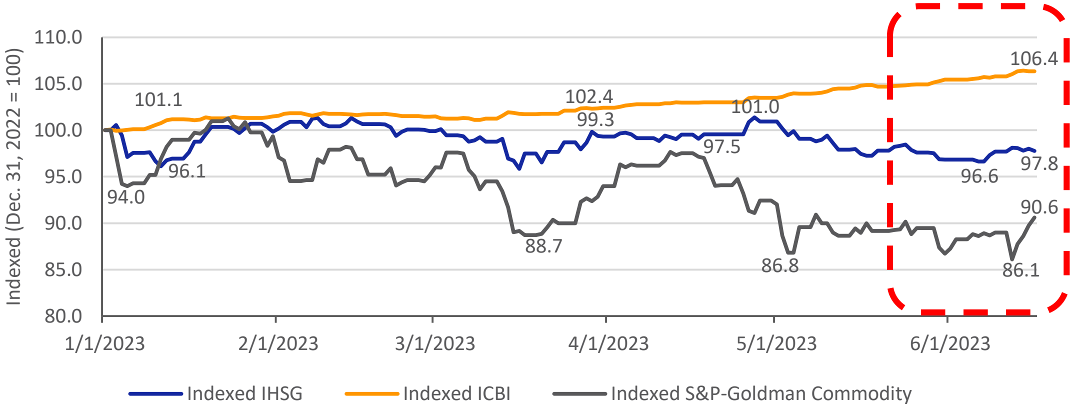
- In our opinion, the best conservative buying momentum is started in the **second week of July**

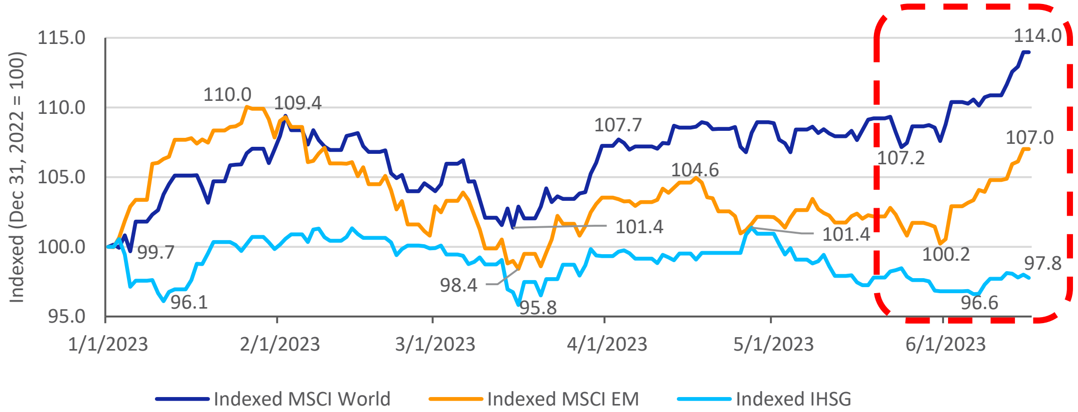
# Fed’s terminal rate hike leads to changes in capital flow in the bond market

## However, there are no significant changes in global stock markets



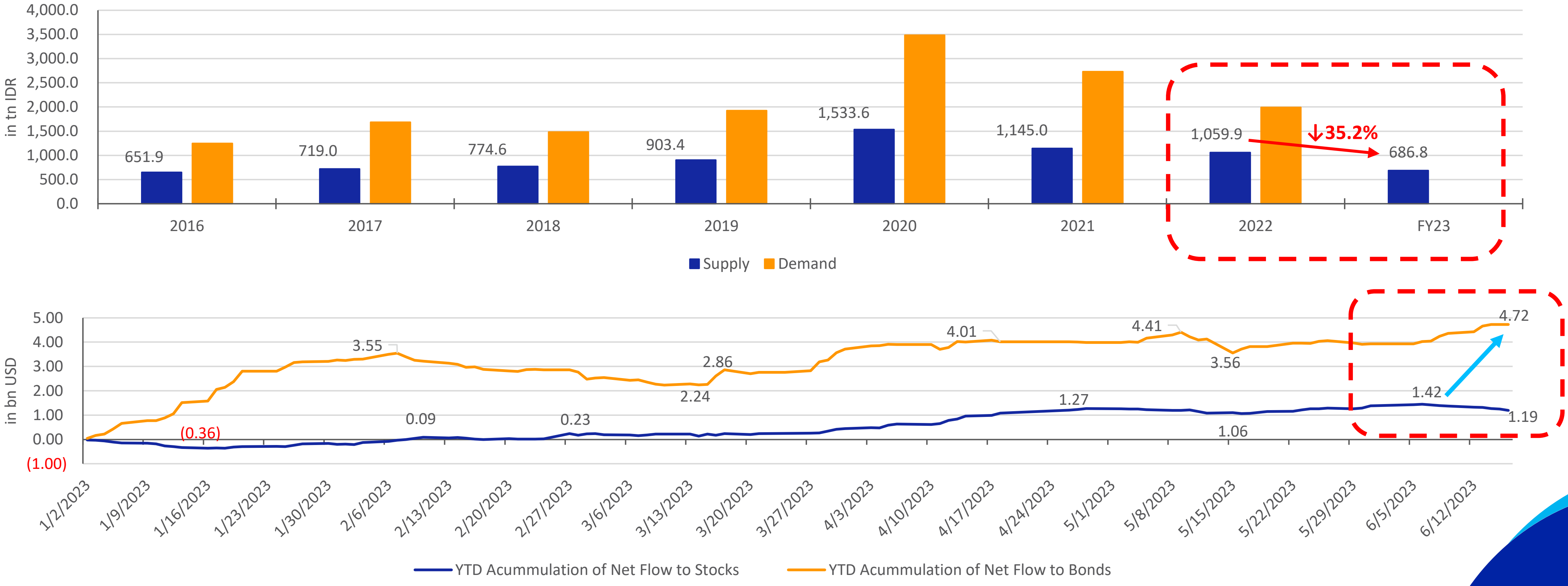




Source: Bloomberg, SSI Research

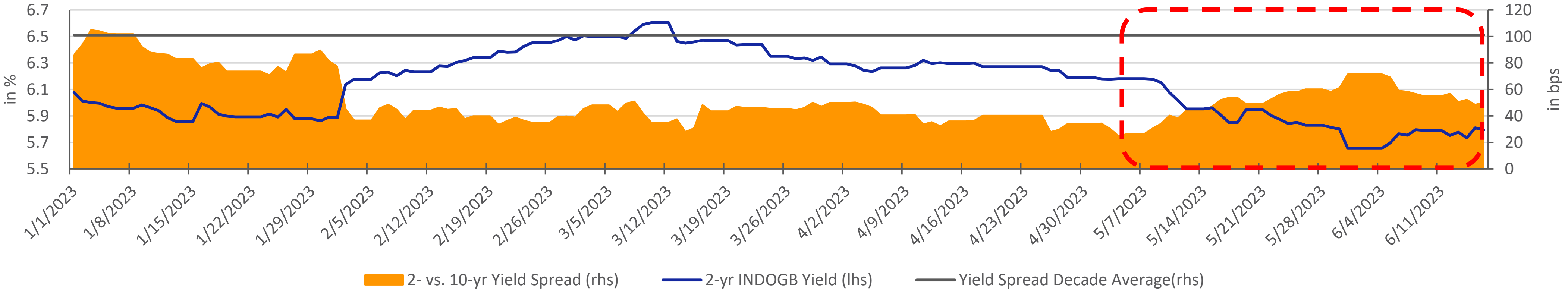
# Foreign investors shift their portfolios from stocks to bonds in anticipation of the decline in the supply of new bonds in FY23 (-35.2%)

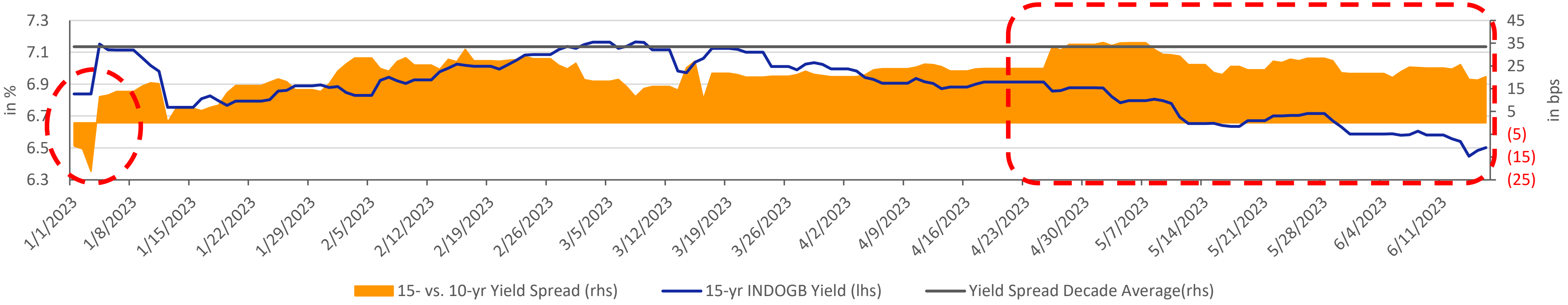



Source: DJPPR, IDX, Bloomberg, SSI Research

# Strategy: Overweight on 2Y, 10Y, and 15Y

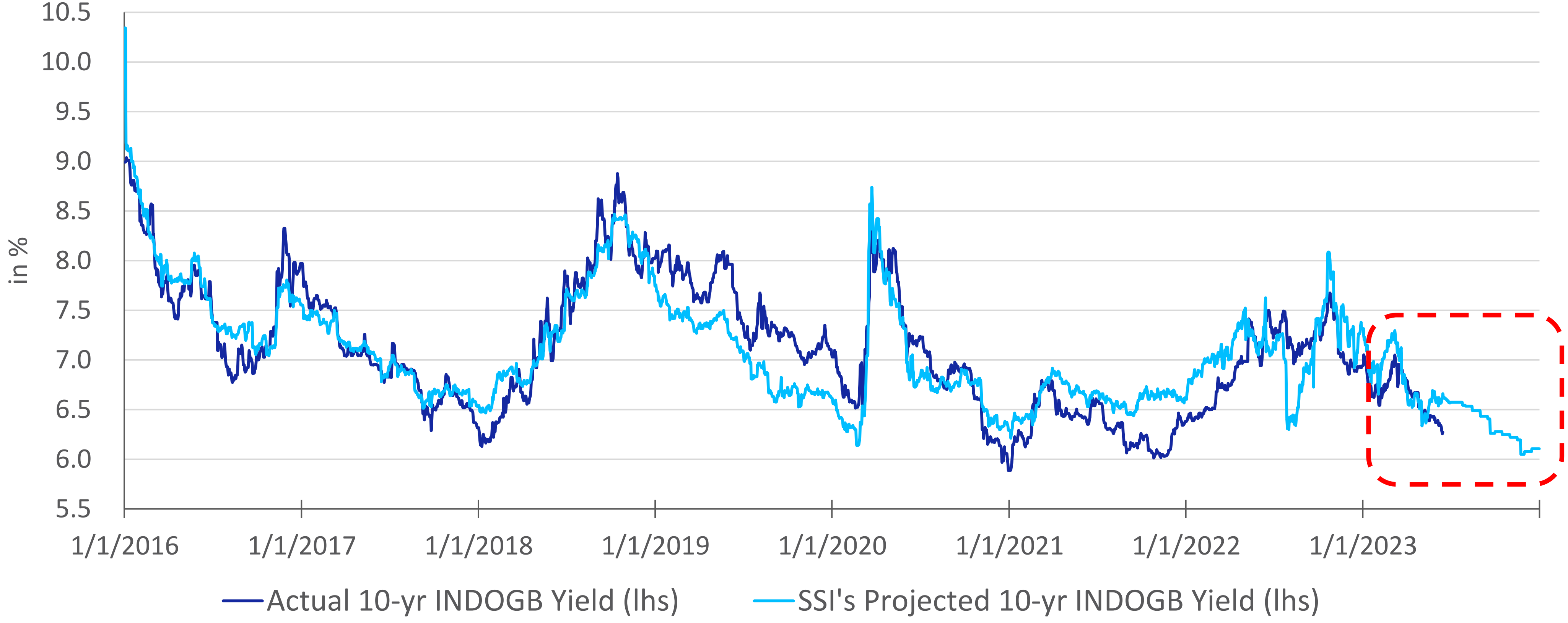
2Y & 10Y: Bullish steepening (though the issue of the Fed's terminal rate should not be ignored);
15Y: Normalization of yield spread between 15Y and 10Y (getting closer to its 10-yr historical average)




Source: Bloomberg, SSI Research

# Our INDOGB 10Y model shows that the bond market might fluctuate for the next 3 weeks




Source: IDX, Bloomberg, SSI Research

# Looking into 2024

# Our scenarios for 2024


## Continuity vs. changes

Two presidential candidates, Prabowo Subianto and Ganjar Pranowo, carry the theme of ‘continuity’. Meanwhile, another presidential candidate, Anies Baswedan, carries the theme of ‘change’.

## The era of rate cuts

We expect central banks around the world to start cutting rates (Fed: 100 bps; ECB: 75 bps; BOE: 125 bps; BI: 50-75 bps)

## Will Trump return?

Low public satisfaction towards Joseph "Joe" Biden opens up opportunities for former President Donald Trump to compete in the 2024 US Presidential Election

## US vs. China conflict

Geopolitical rivalry between the United States and China will influence state investments in transportation, energy transition, smelters, batteries, and digital devices


## Global economic growth acceleration

The global economy is expected to experience better growth in 2024, supported by rate cuts in developed countries; we project Indonesia to book GDP growth of 5.1% yoy.

## Current account deficit

Current account deficit management will be a major issue in 2024, since commodity prices are expected to decline, and without proper measures, it might trigger USD/IDR turmoil.

# Thank You

Your Lifelong
**Investment Partner**

Lionel Priyadi
PT Samuel Sekuritas Indonesia
Menara Imperium, 21st Floor, Jl. HR. Rasuna Said Kav. 1
Jakarta 12980, Indonesia
Tel. +62 21 2854 8100 | www.samuel.co.id

samuelsekuritasindonesia
samuelsekuritas
SamuelSekuritasIndonesia