



# Macro Strategy and Fixed Income July 2023

## Bond rally's biggest obstacle: inflation – BI rate mismatch

Lionel Priyadi

Your Lifelong  
**Investment Partner**

[www.samuel.co.id](http://www.samuel.co.id)



# Global Macroeconomic Fundamentals

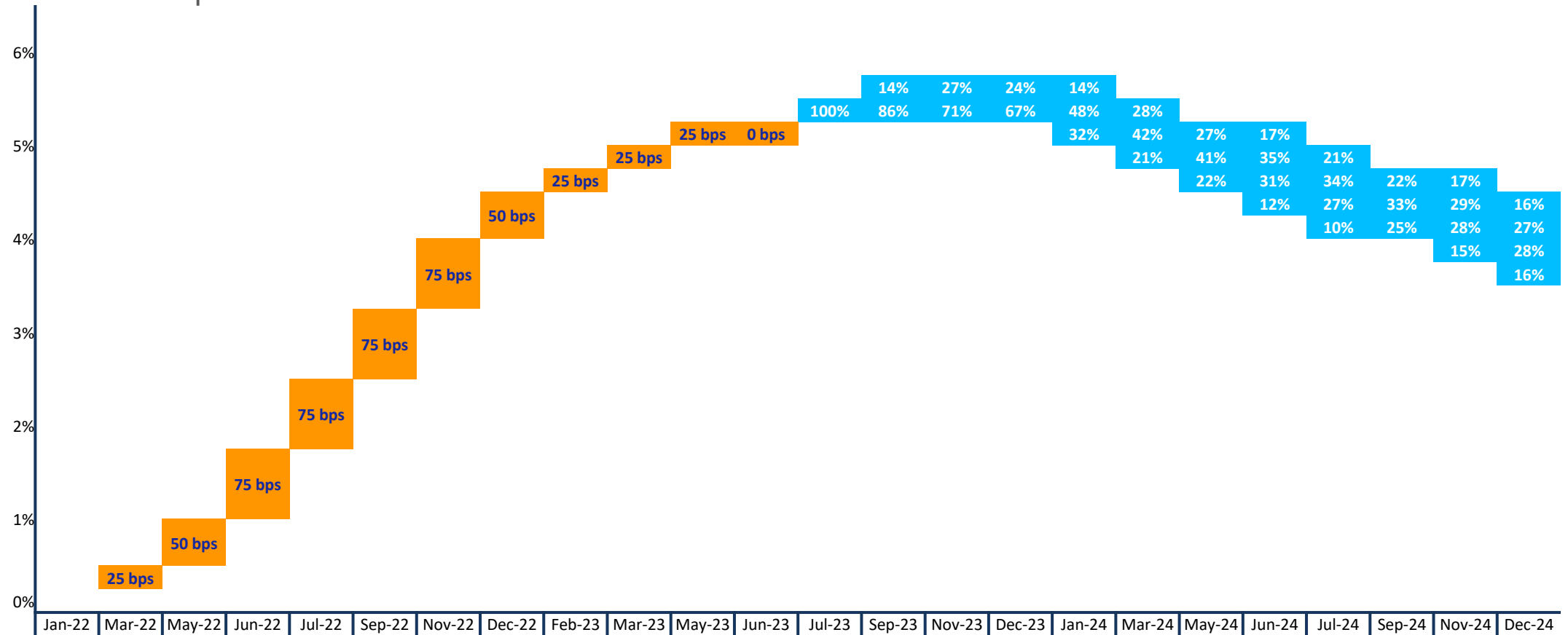
## What's Our View?

The slower-than-expected US core CPI inflation in June might persuade Asian central banks to start their rate cuts sooner than previously expected.

- We revised our main scenario from 'no rate hike' to '1X25 bps hike'.
- Though there's the possibility of another Fed rate hike in 4Q23, it is highly unlikely, given the sharp deceleration of US core CPI inflation in June.
- We believe that the 'fragile' economic recovery in China will lead to a faster rate cut cycle from PBOC, triggering rate cuts in East and Southeast Asia.
- We also see the possibility for more interventions from PBOC to keep USD/CNY stability at CNY 7-7.3 per USD, which should help support exchange rate stability in East and Southeast Asia.

## Market expectations are narrowing to a 1X25 bps terminal rate hike scenario

The Fed's rate cuts cycle is expected to start in March or May 2024, with a total cut of 6X25 bps to 4% for FY24



Source: CME Group, Federal Research, SSI Research

## Several Fed officials insist on more rate hikes (2X25 bps or more)

---



**Jerome Hayden Powell (Voting Member)**

A strong majority of committee participants expect that it will be appropriate to raise interest rates two or more times by the end of the year ([Bloomberg](#))



**Michelle White Bowman (Voting Member)**

I believe that additional policy rate increases will be necessary to bring inflation down to our target over time ([Reuters](#))



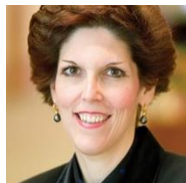
**Lorie K. Logan (Voting Member)**

In my view, it would have been entirely appropriate to raise the Federal funds target range at the FOMC's June meeting ([Dallas Fed](#))



**Christopher Waller (Voting Member)**

I see two more 25-basis point hikes in the target range over the four remaining meetings this year as necessary to keep inflation moving toward our target ([Bloomberg](#))



**Loretta J. Mester (Non-Voting Member)**

My view is that the funds rate will need to move up somewhat further from its current level and then hold there for a while ([Bloomberg](#))

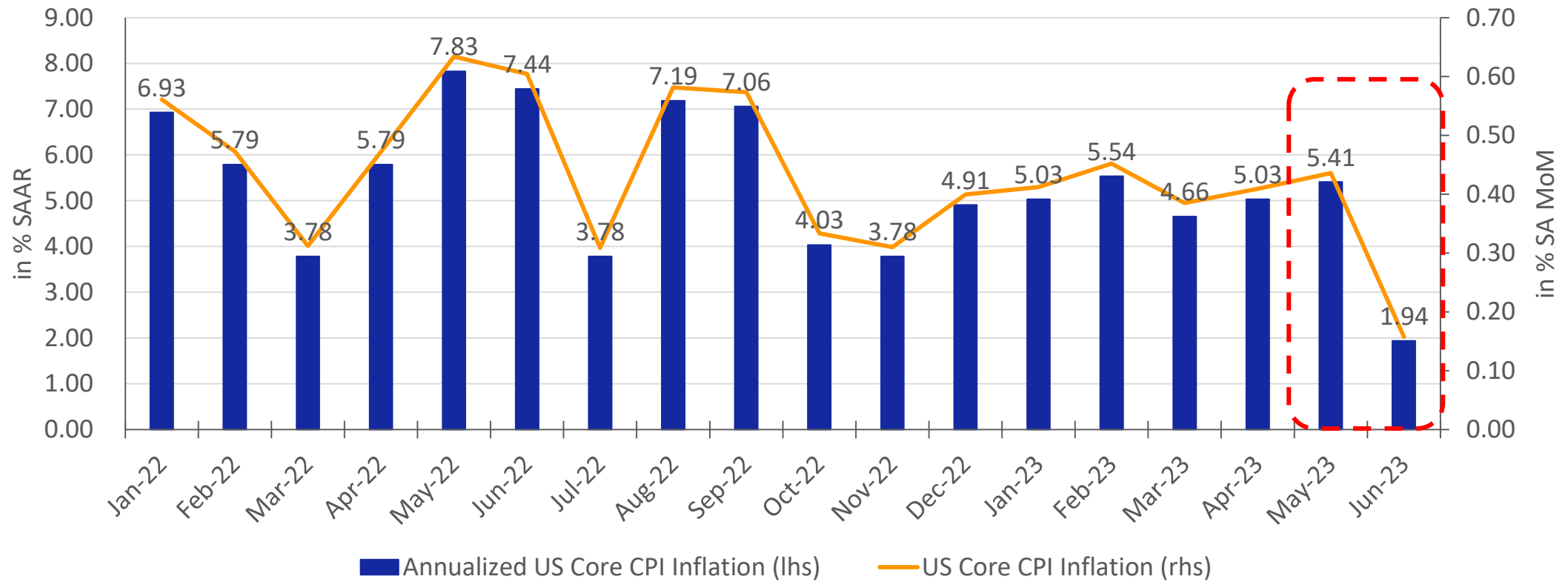


**Mary C. Daly (Non-Voting Member)**

It's really too early to say that we've declared victory on inflation ... we still have an economy that has a lot of momentum. This is why we continue to say we're going to keep working on rate hikes ([Bloomberg](#))

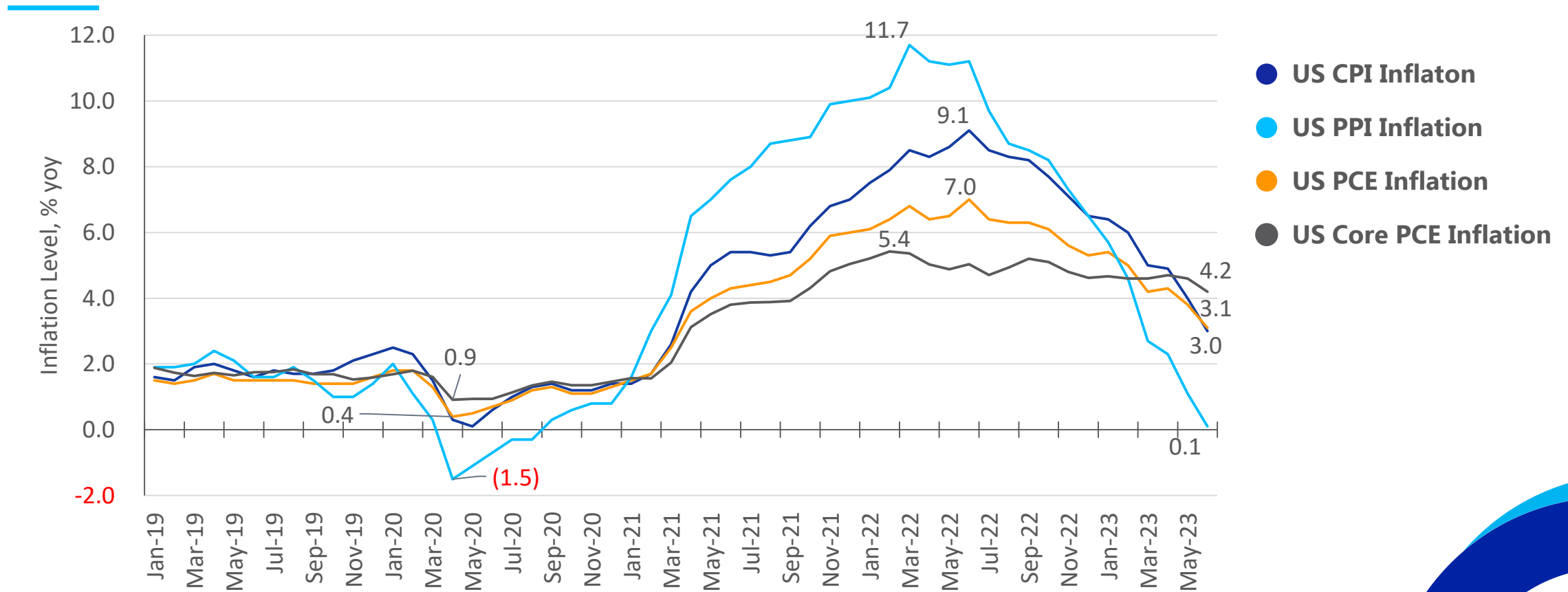
However, we believe that the probability of another 25 bps Fed rate hike in 4Q23 is **<10%**, given the strong disinflationary momentum in the US

As reflected in the decline of monthly core inflation rate (annualized) to 1.94% SAAR in June (May: 5.41% SAAR)



Source: BLS, Bloomberg, SSI Research

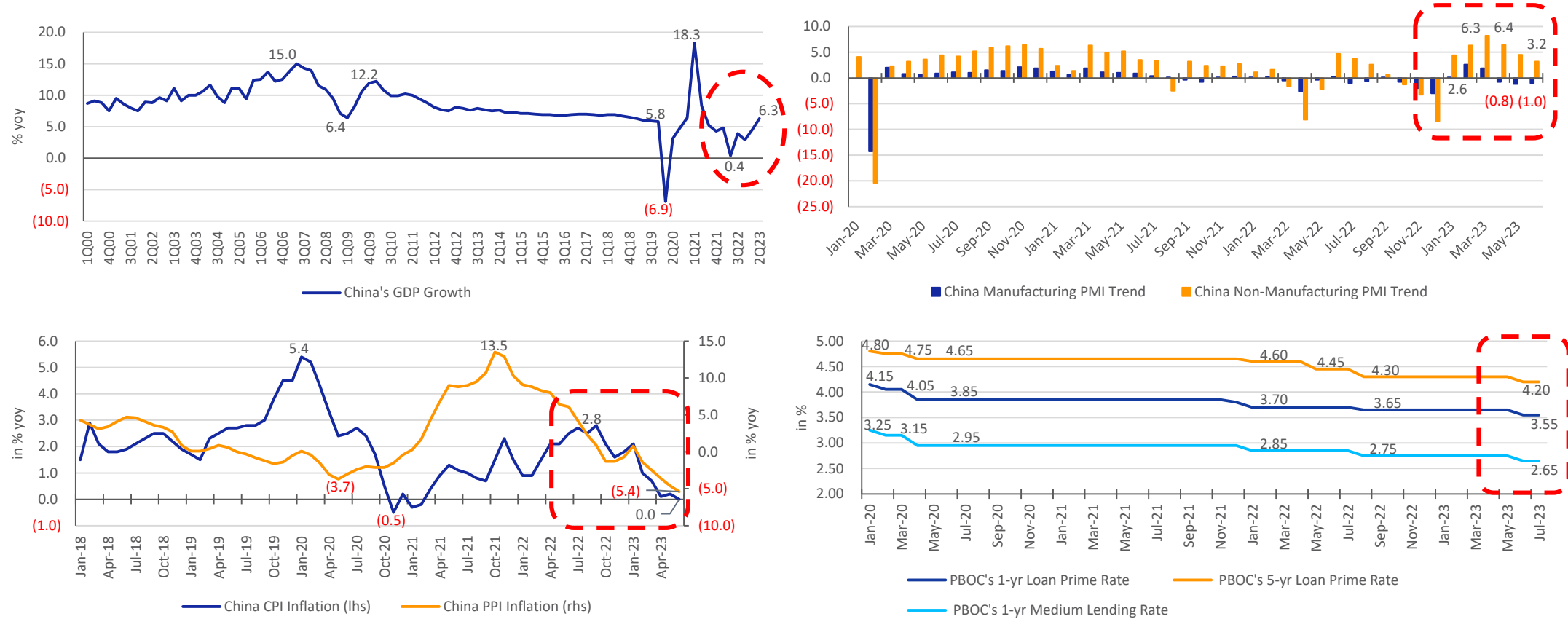
The momentum should help support the headline and core PCE disinflation; both are getting closer to the Fed's projection of 3.2% and 3.9% yoy



Source: BEA, BLS, Bloomberg, SSI Research

# Meanwhile, additional monetary stimulus is necessary to boost China's fragile economic recovery

The rise in GDP growth to 6.3% yoy was overshadowed by manufacturing contraction and deflationary spiral



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



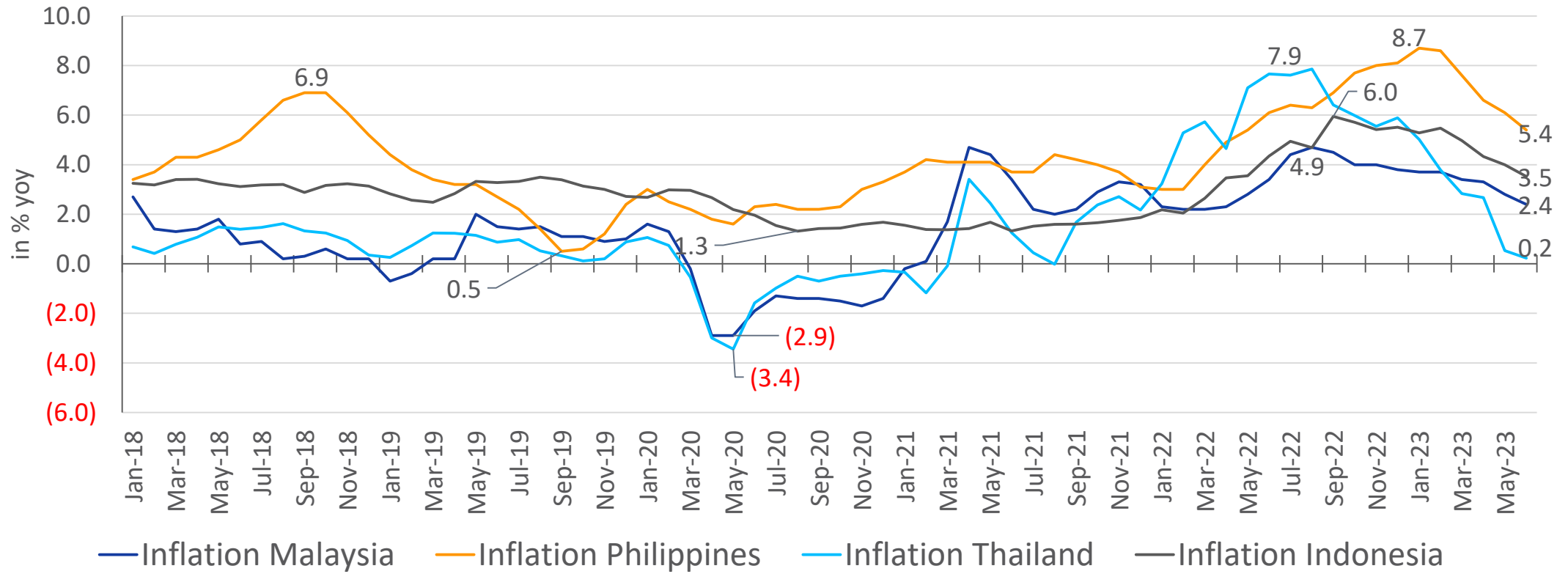
However, the risk of depreciation in Asian exchange rates (Including USD/IDR) due to PBOC's rate cuts is relatively under control, thanks to PBOC's intervention to limit USD/CNY depreciation at CNY 7.3 per USD



Source: Reuters, Bloomberg, SSI Research

## Inflation atmosphere in Southeast Asia is getting more and more conducive to start rate cuts

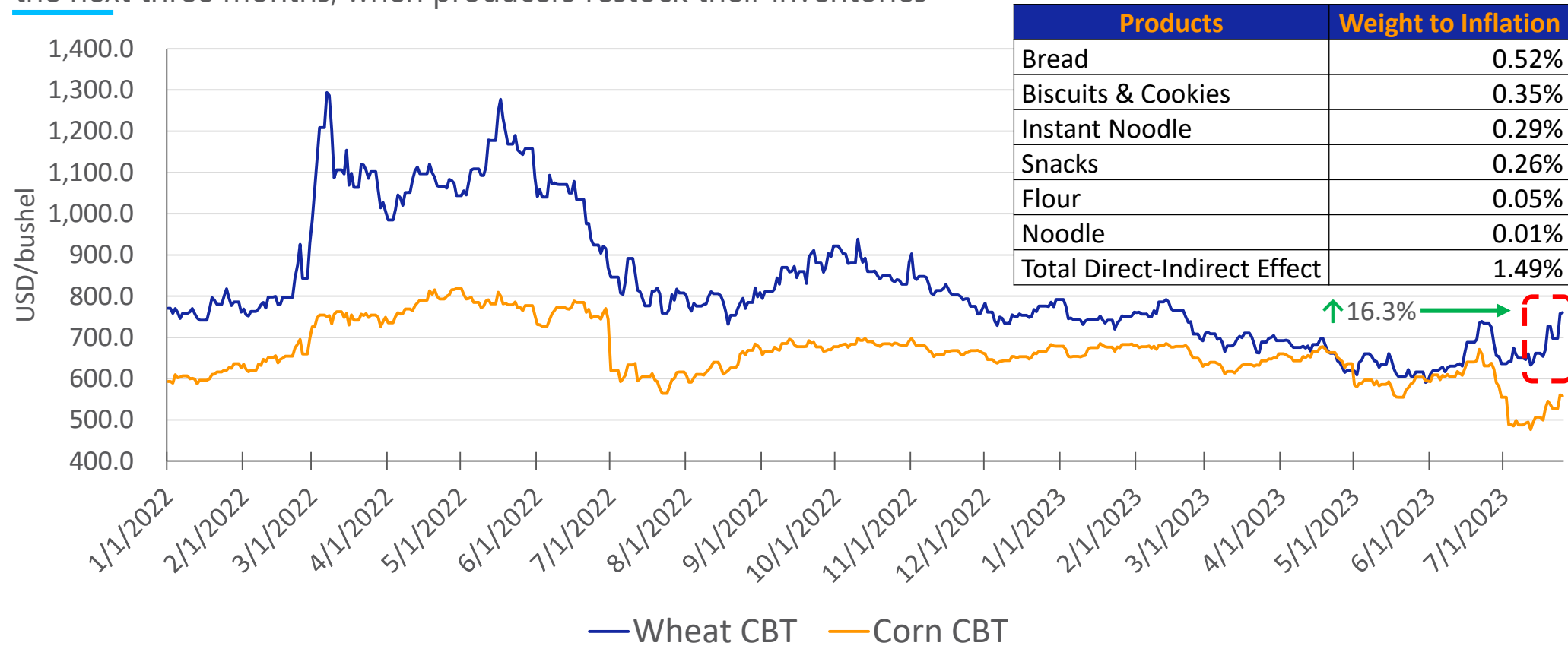
Indonesia, Malaysia and Thailand's inflation rate is already within their central bank's target range of 2-4% or even lower



Source: S&P, Bloomberg, SSI Research

# A risk of inflation spike due to the Russian military attack on Ukraine's grain facilities after its withdrawal from the Black Sea Grain Initiative

Though the impact on Indonesia and Asia will only be felt if global wheat prices remain elevated for at least the next three months, when producers restock their inventories



Source: Bloomberg, SSI Research

# Indonesia's Macroeconomic Fundamentals

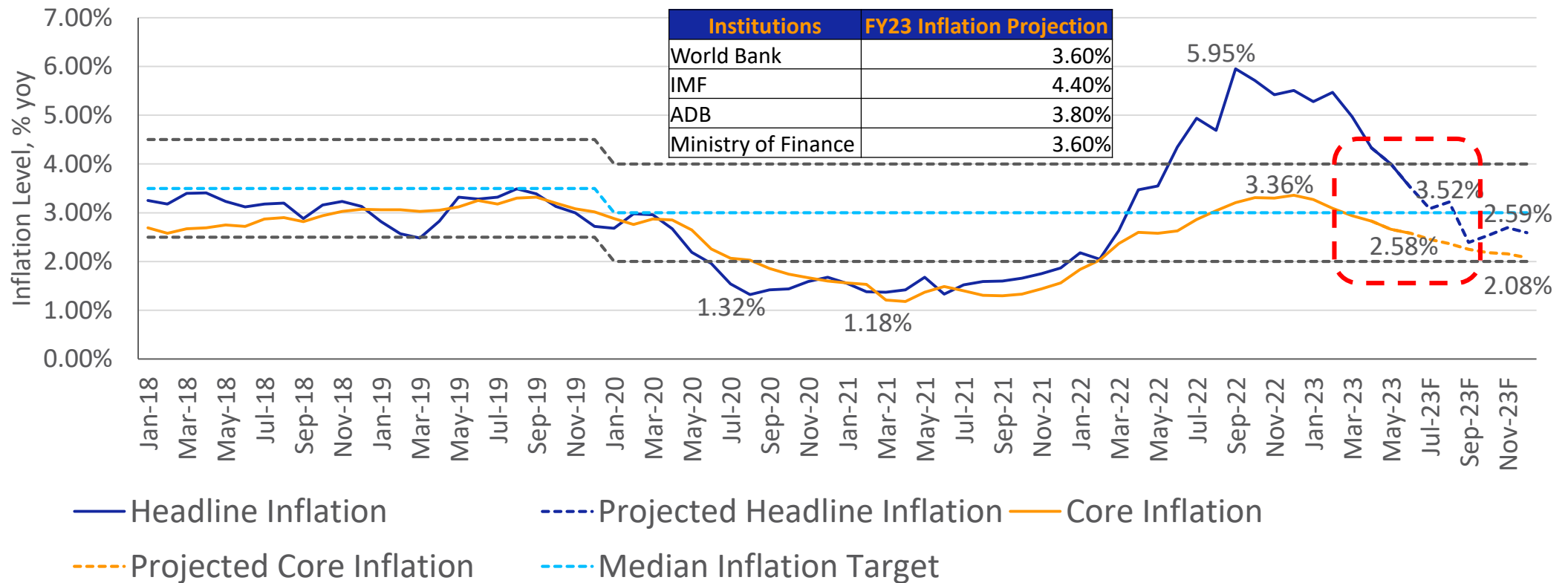
## What's Our View?

Rate cuts are necessary to 'fix' the mismatch between inflation and benchmark interest rates, which hurt the potential for a bullish rally in the bond market

- In our opinion, BI's hesitation to start its rate cuts is mainly caused by concerns regarding the possibility of a spike in inflation, as reflected in the projections of several international institutions.
- We see that the impact of the fear factor that emerged due to the depreciation of USD/IDR in the last two months has started to wear off after the release of US CPI inflation data.
- The interest rate vs. inflation mismatch created distortions in the bond market, as reflected in the drop in INDOGB 10Y yield, which now stands lower than the JIBOR 1M floor.
- Meanwhile, the fundamental of the State Budget and the balance of supply and demand for bonds indicate a bull market.

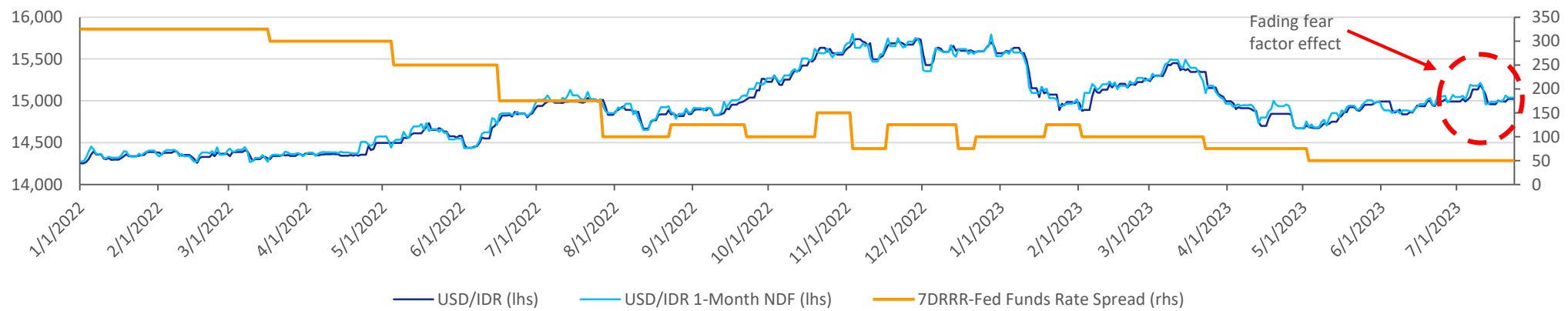
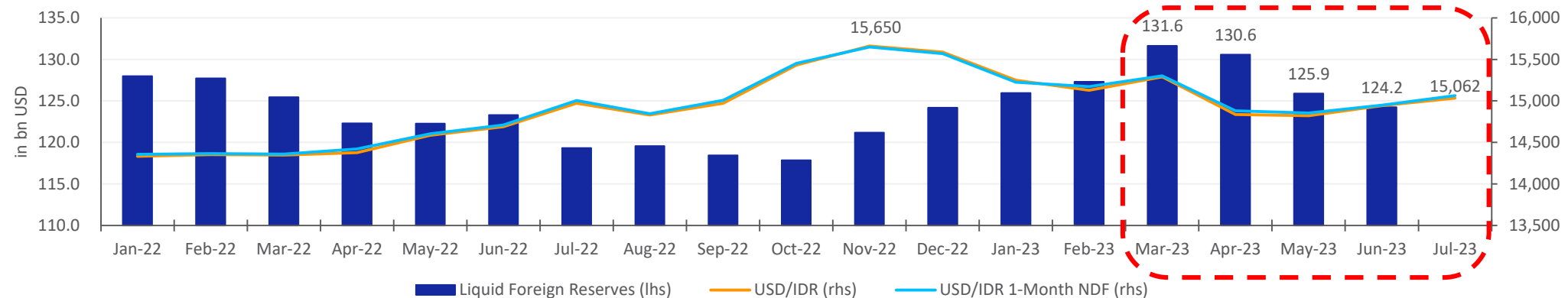
## High inflation expectations no longer match the latest inflation developments

The June inflation rate was lower than projections from the government and several international institutions, and it could fall even lower after September as the effect of last year's subsidized fuel price hike continues to fade away.



Source: BPS, MOF, IMF, WB, ADB, Bloomberg, SSI Research

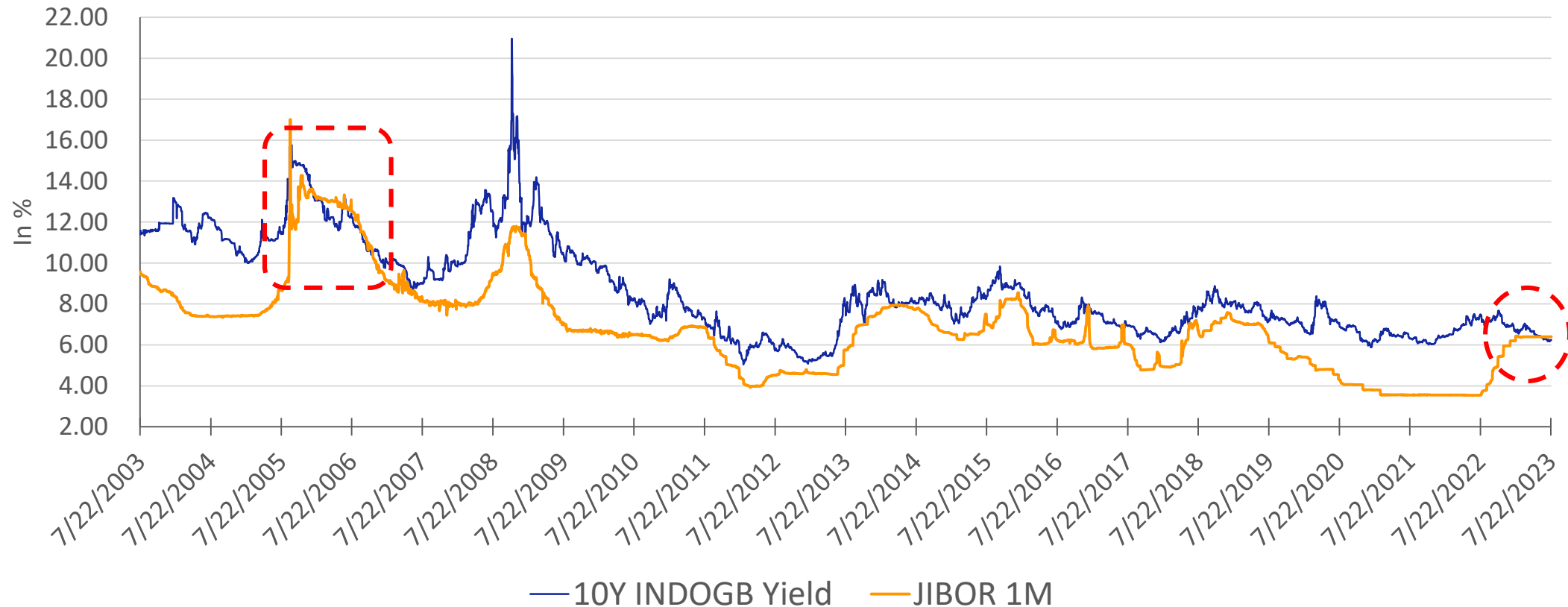
Though the impact of the fear factor from rupiah depreciation is still there, it has started to subside following the release of the US CPI inflation data for June



Source: Bank Indonesia, Federal Reserve, Bloomberg, SSI Research

## Rate cuts are necessary to 'fix' the INDOGB 10Y yield anomaly (which now stands lower than the JIBOR 1M floor).

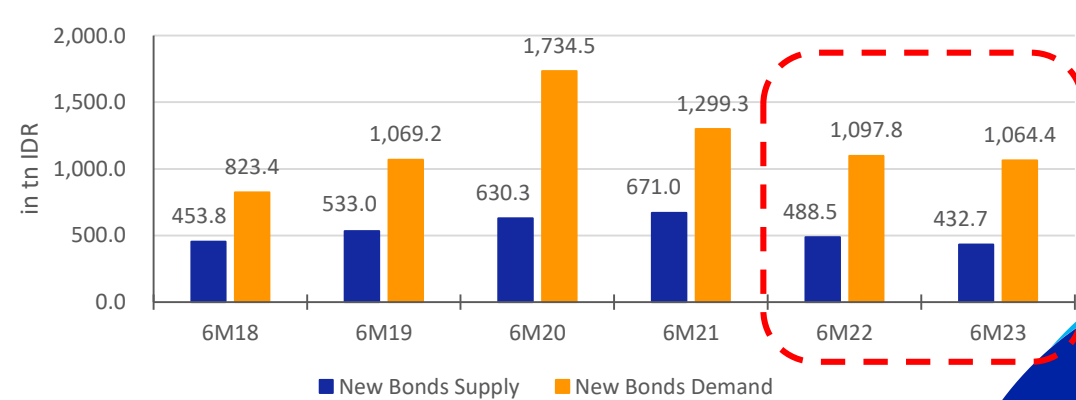
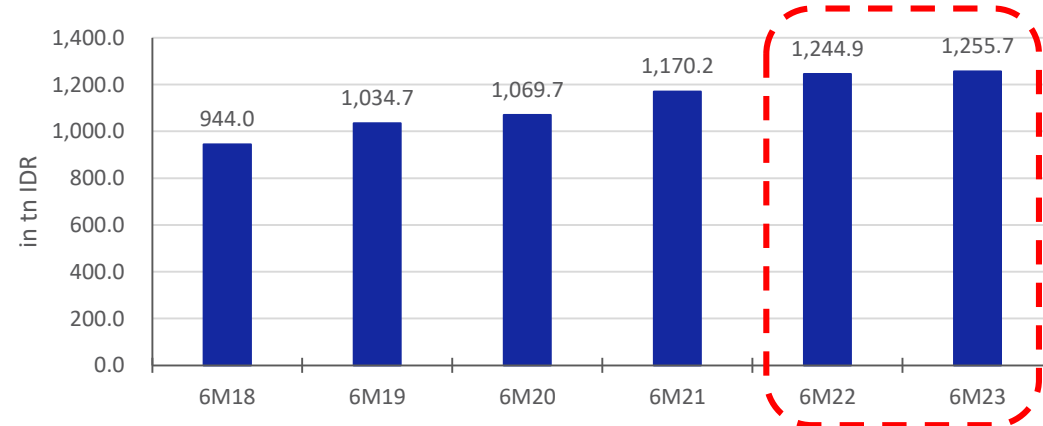
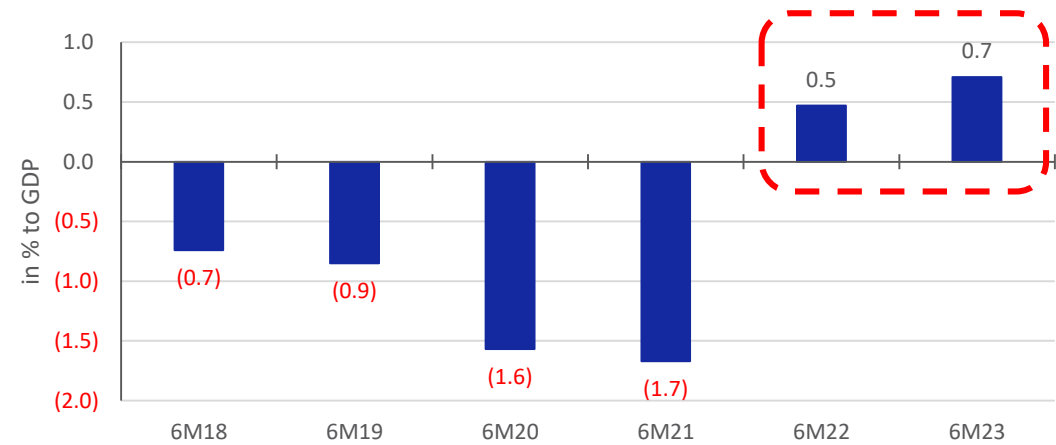
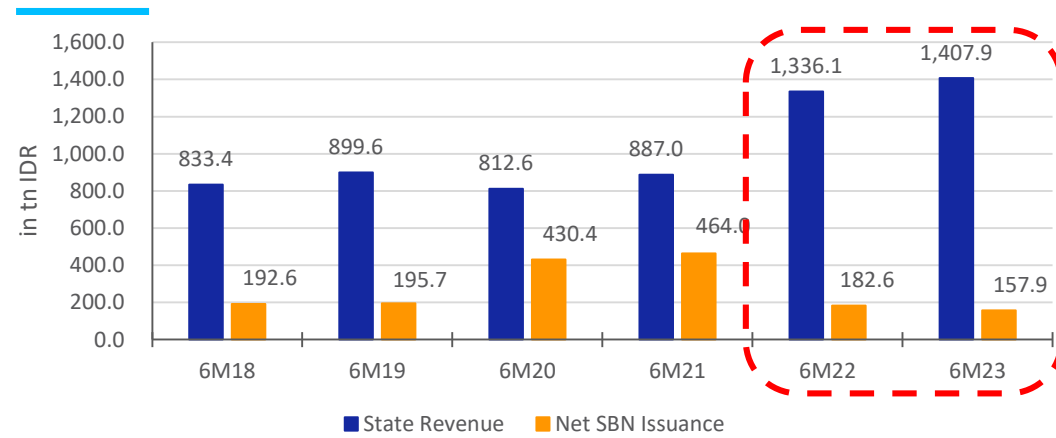
The anomaly has only occurred twice in the last 20 years, in January-November 2006 and for the last 2 months



Source: Bank Indonesia, IDX, Bloomberg, SSI Research



# State budget realization in 1H23 showed a strong bullish trend due to the high demand amid the declining need for government debt due to the commodity windfall



Source: MOF, Bloomberg, SSI Research

## SSI Forecast Table

Indicators (% yoy)	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	FY22	FY23F	FY24F
Real GDP (NSA % qoq)	(1.0)	3.7	1.8	4.0	(0.9)	3.4	1.7	0.6	(0.8)	3.5	1.4	0.8			
Real GDP	5.0	5.4	5.7	5.0	5.0	4.6	4.5	4.7	4.8	5.0	4.7	5.0	5.3	4.7	4.9
Unemployment rate (% nsa)	5.8	5.8	5.9	5.9	5.5	5.5	5.4	5.3	5.2	5.1	5.1	5.0	5.9	5.3	5.0
Consumer price	2.6	4.4	6.0	5.5	5.0	3.5	2.4	2.6	2.7	3.1	3.3	3.3	5.5	2.6	3.3
Current account balance (% to GDP)	0.2	1.1	1.3	1.3	0.9	(1.3)	(0.9)	(1.1)	(0.7)	(1.9)	(1.3)	(1.6)	1.0	(0.6)	(1.4)
12M rolling sum	0.4	0.9	0.8	1.0	1.2	0.5	(0.1)	(0.6)	(1.1)	(1.2)	(1.3)	(1.4)			
Fiscal balance (% to GDP)	0.1	0.5	0.3	(2.4)	0.6	0.7	(1.3)	(2.5)	(0.7)	(1.3)	(1.9)	(2.6)	(2.4)	(2.5)	(2.6)
Policy rate, 7 day reverse repo rate (%)	3.50	3.50	4.25	5.50	5.75	5.75	5.50	5.25	4.75	4.25	4.25	4.25	5.50	5.25	4.25
10-year government bond yield (%)	6.74	7.22	7.37	6.94	6.79	6.26	6.20	6.00	5.80	5.50	5.70	5.60	6.94	6.00	5.60
Exchange rate (USD/IDR)	14,369	14,898	15,228	15,568	14,995	14,993	14,700	14,900	15,000	14,900	14,800	14,700	15,568	14,900	14,700

Source: Bank Indonesia, BPS, Bloomberg, SSI Research

# Intermarket Analysis

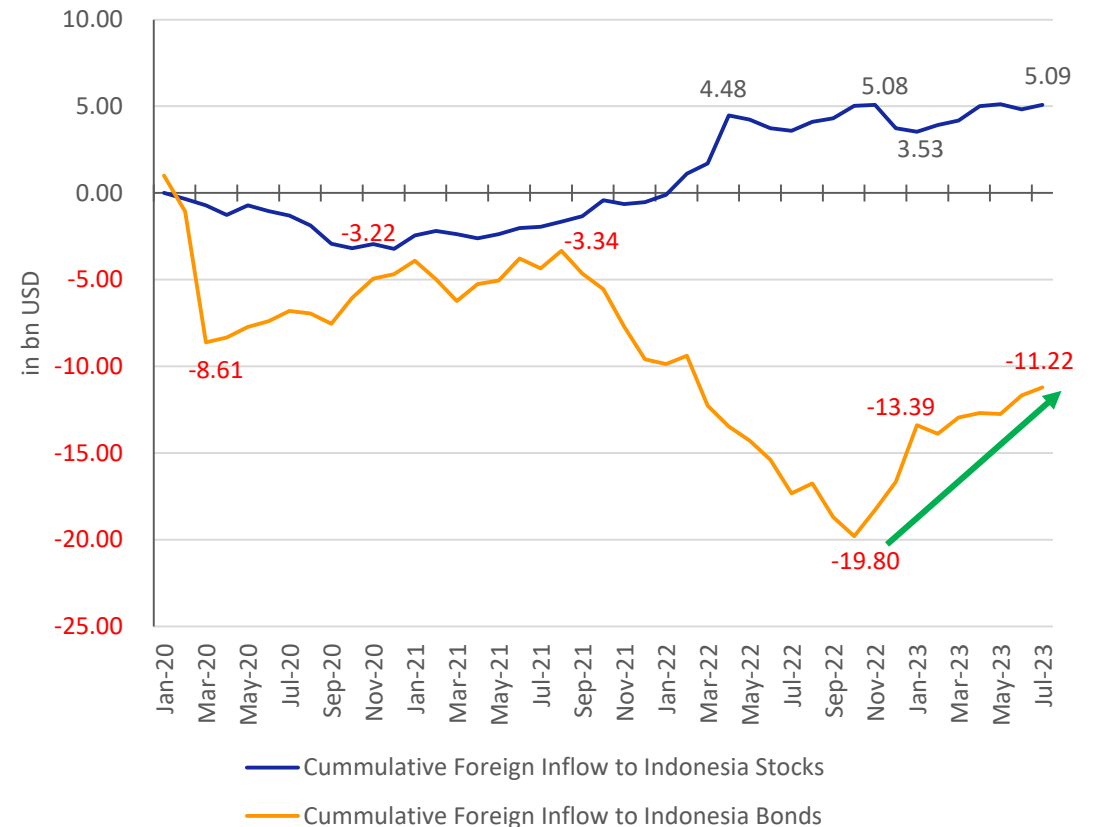
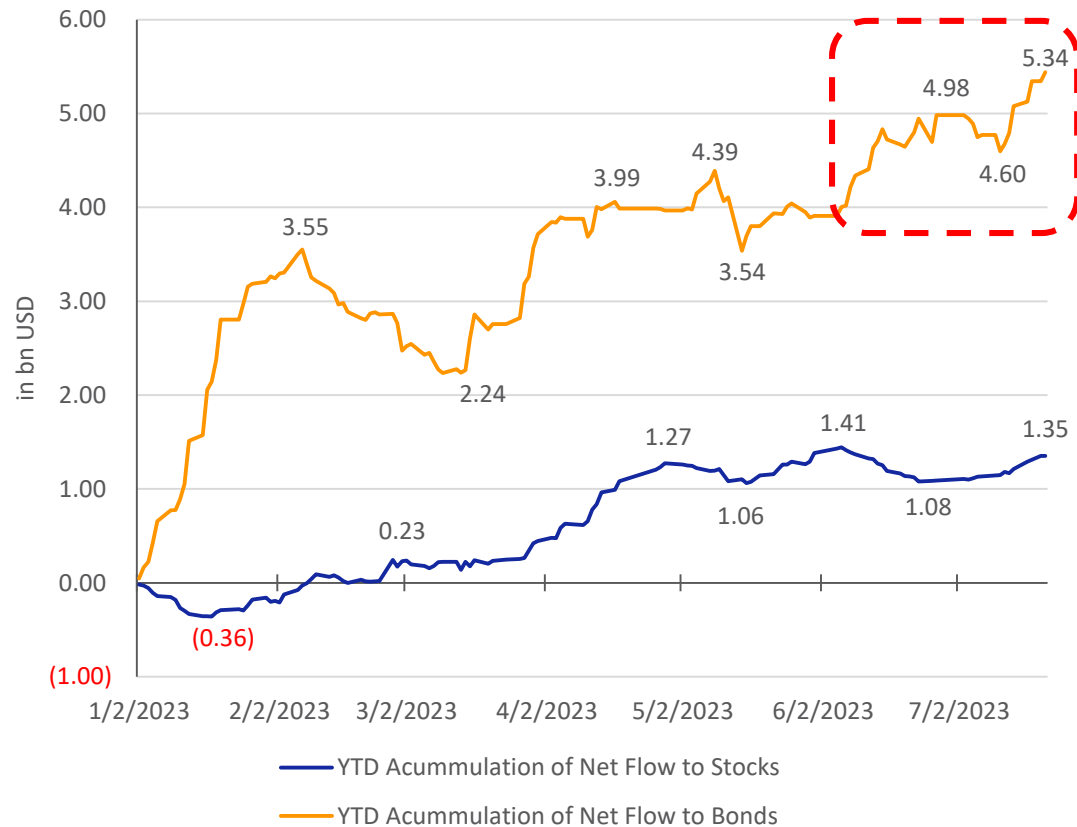
## What's Our View?

We reiterate our recommendation to **overweight** on **INDOGB 2Y, 10Y, and 15Y instruments** while adding the **INDON 2Y** in anticipation of BI rate cuts in 2H23

- Aside from anticipating the start of BI rate cuts, the recommendation was made by considering:
  - The strong foreign bullish sentiment on the prospects of the domestic bond market, despite the increase in the JIBOR 1M floor,
  - Positive correlation between INDOGB 15Y Vs. 10Y, and the position of INDOGB 15Y yield, which is now closer to the JIBOR 1M floor,
  - Potential reversal from bullish flattening to bullish steepening (INDOGB 2Y)
  - Potential reversal of the inverted yield curve to normal (INDON instruments).
- In our opinion, the market **has entered BUY momentum**

## Foreign investors' bullish sentiment towards the Indonesian bond market remains relatively strong

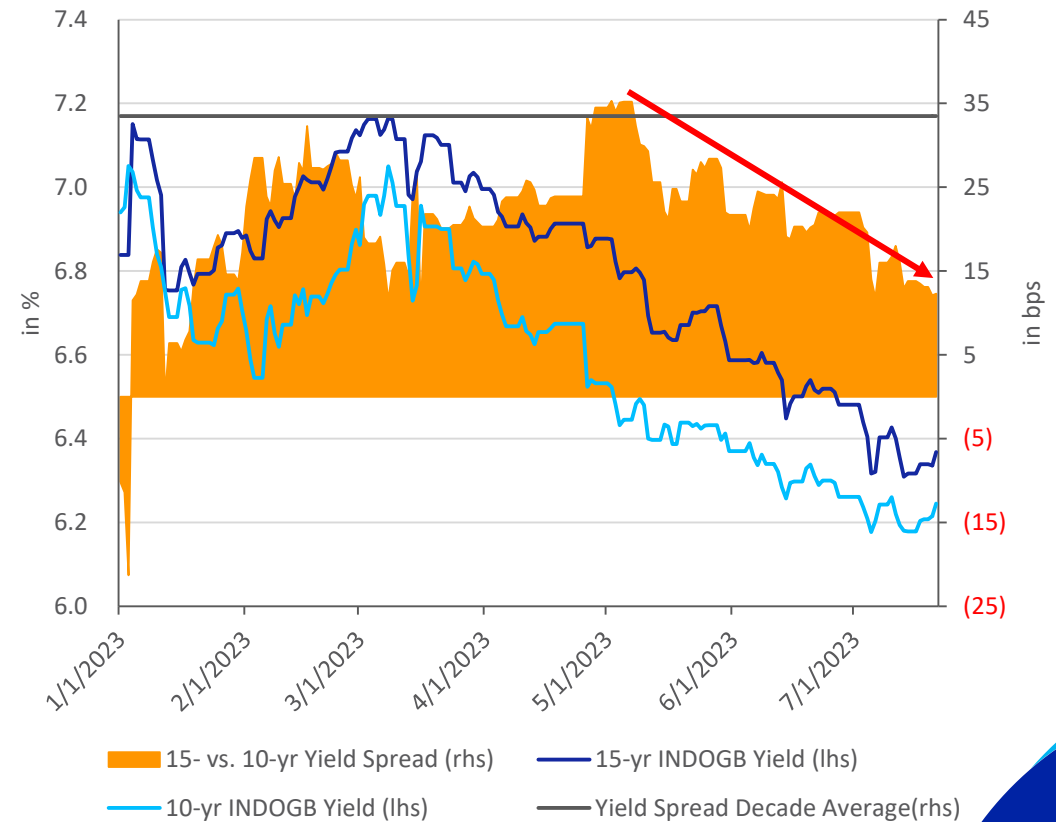
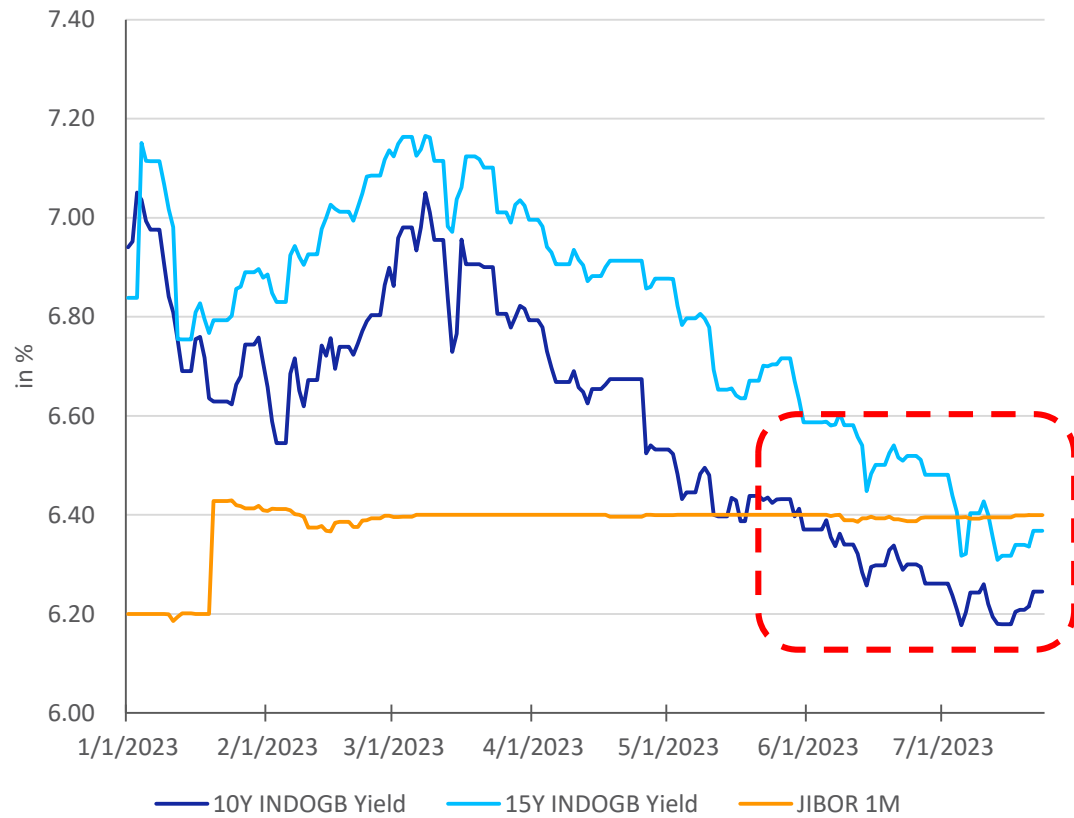
As reflected in foreign capital inflows in the last 2 months and since October 2022



Source: DJPPR, IDX, Bloomberg, SSI Research

# Overweight on INDOGB 10Y & 15Y

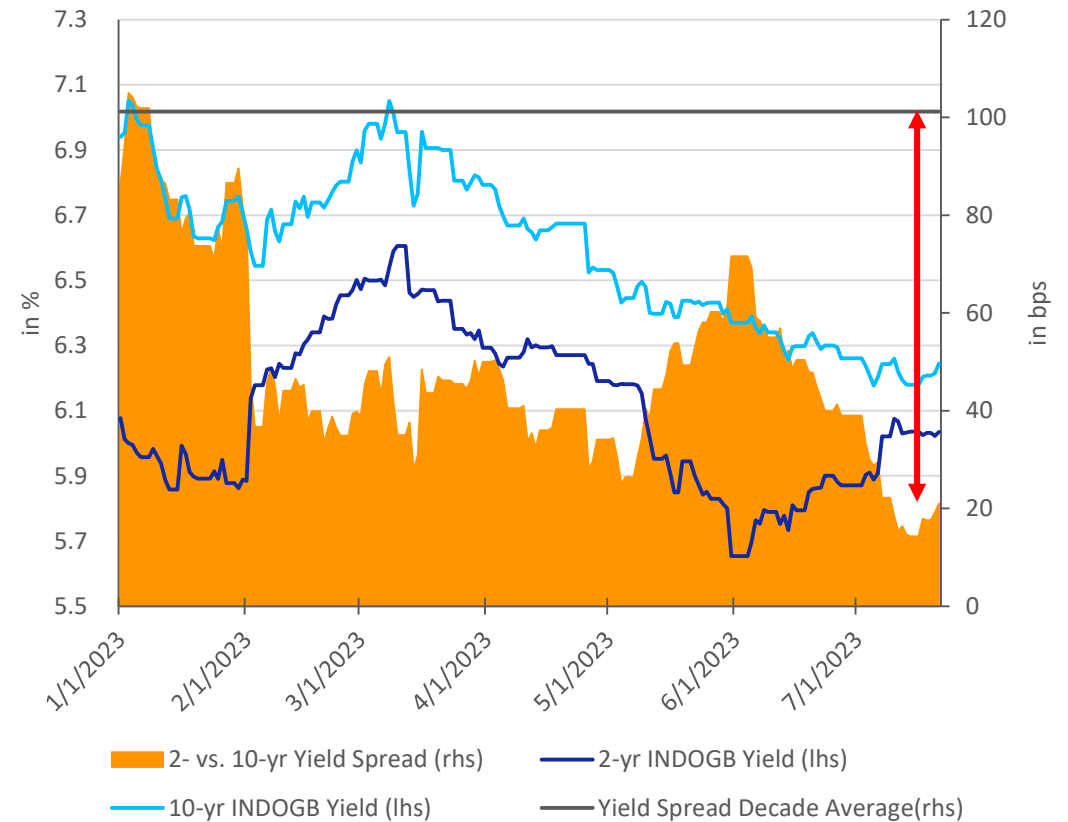
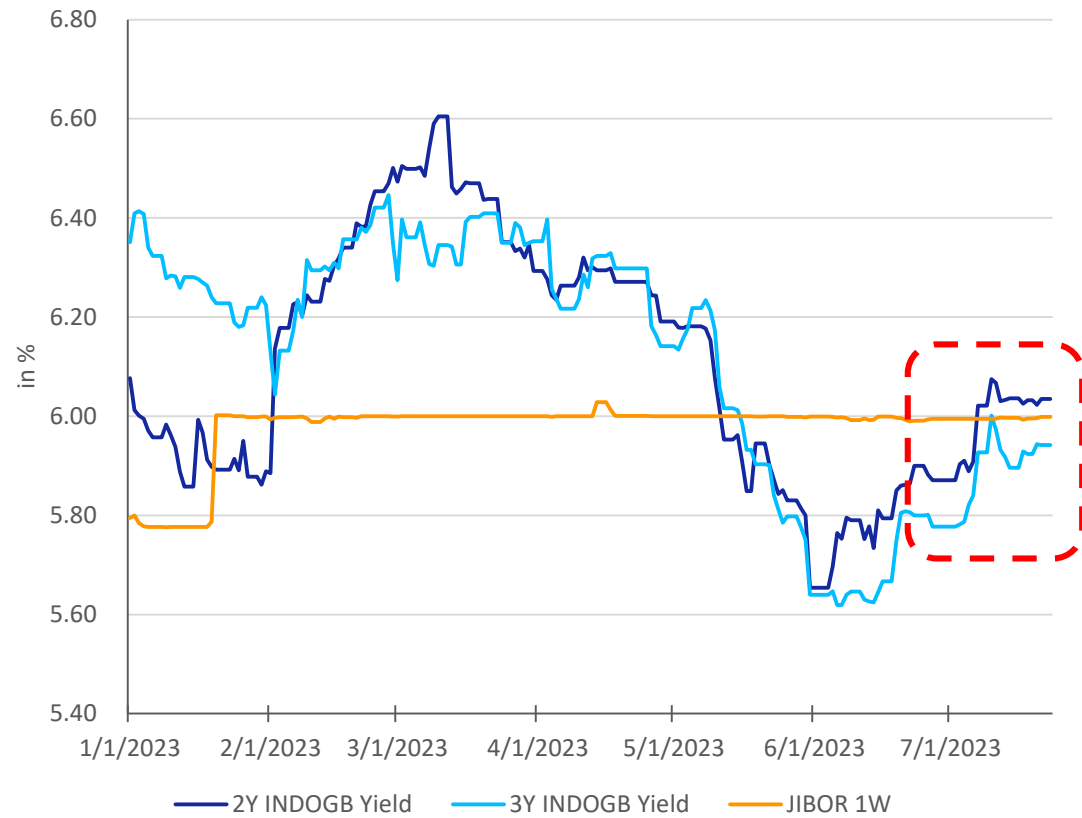
Considering the current yield spread and floor spread that benefit 15Y



Source: DJPPR, IDX, Bloomberg, SSI Research

## Overweight on INDOGB 2Y

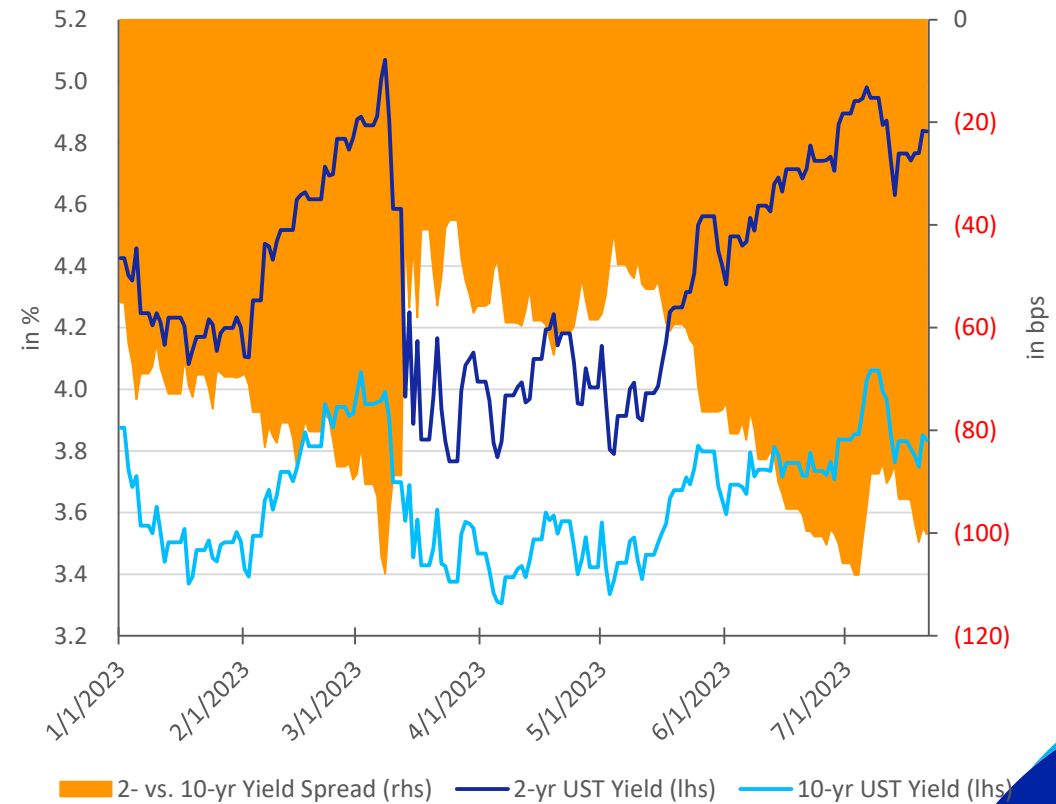
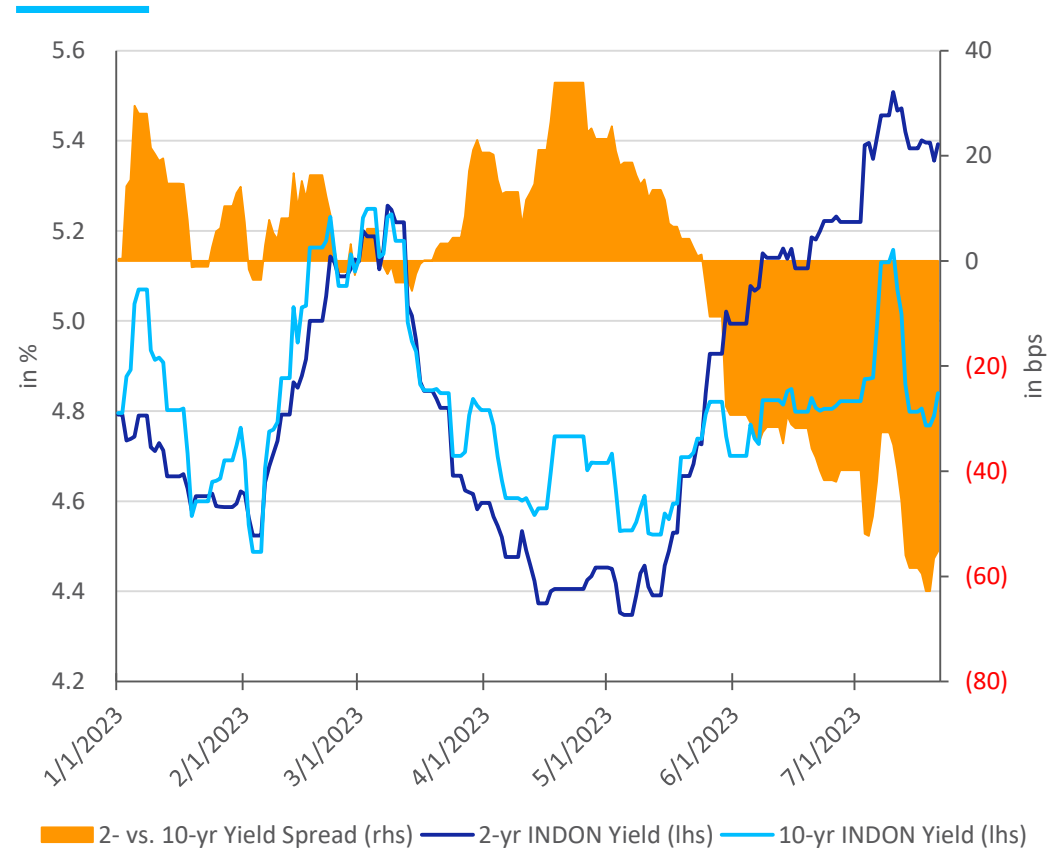
Despite the obstacle from the floor limit of the JIBOR 1W rate, there is a potential for a bullish steepening of 80 bps from the current yield spread to the historical average



Source: DJPPR, IDX, Bloomberg, SSI Research

# Overweight on INDON 2Y

Particularly after the yield spread of 2Y Vs. 10Y-INDON and UST touched their lowest inverted points this year



Source: DJPPR, IDX, Bloomberg, SSI Research





# 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](http://www.samuel.co.id)

 [samuelsekuritasindonesia](https://www.instagram.com/samuelsekuritasindonesia)

 [samuelsekuritas](https://twitter.com/samuelsekuritas)

 [SamuelSekuritasIndonesia](https://www.youtube.com/SamuelSekuritasIndonesia)