Macro Strategy and Fixed Income September 2023 The Implications of ‘Higher for Longer’

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Global Macroeconomic Fundamentals

What’s Our View?

We noticed that global investors **have underweight stance** on Asia to prepare for the Fed, ECB, and BOE’s ‘higher for longer’ scenario.

- Officials of major central banks in developed countries (The Fed, European Central Bank, and Bank of England), except Japan, agreed to adopt 'higher for longer' scenario until 2H24, and the rate cut momentum will only reach its full height in 2025.

- We noticed that global market perceptions are increasingly in line with the Fed's 'policy guidance'.

- The ‘underweight’ stance might hurt Asian countries, especially China, as the driving force of the Asian economy, which currently suffers from a structural property crisis.

- Unclear direction of fiscal and monetary stimulus policies has also triggered capital outflows from China, which put pressure on the CNY and in turn Asian financial markets.

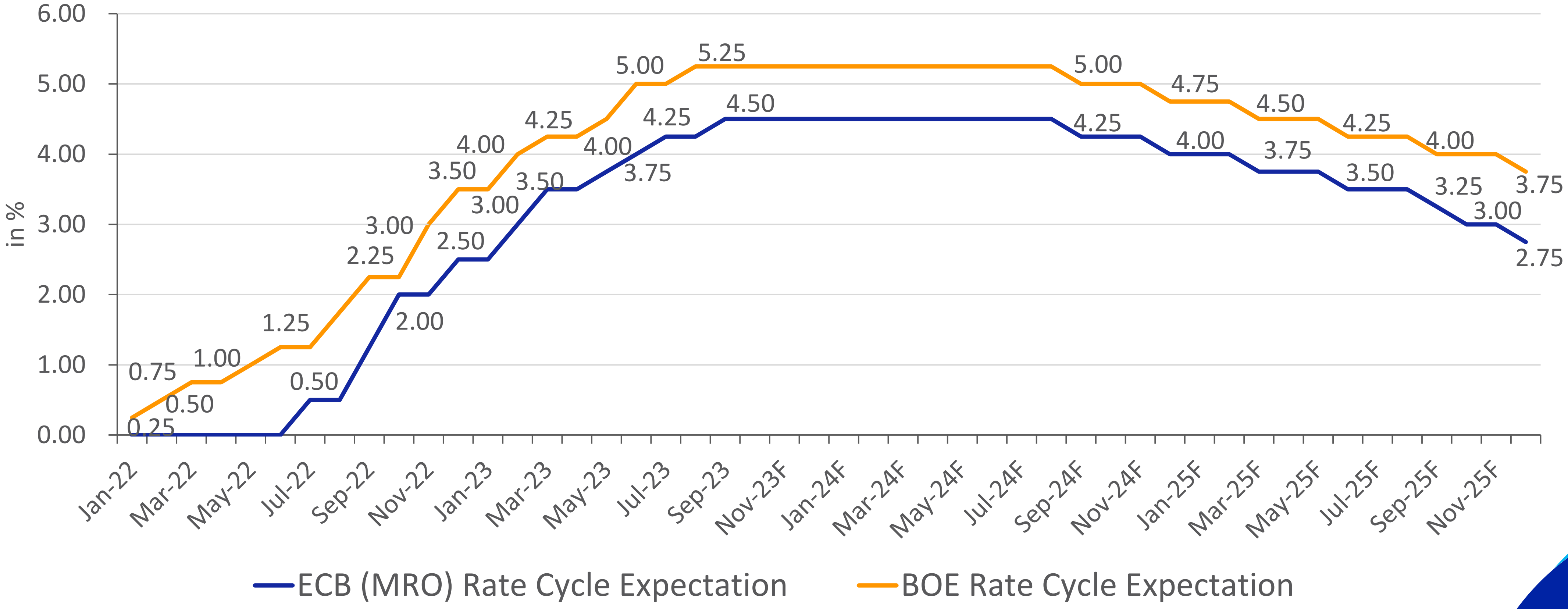
The ‘higher for longer’ scenario affects global rate cycle

The Fed has indicated that its rate cut cycle will begin in 2H24, and the momentum will reach its full height in 2025 and 2026. Also, a Fed rate hike in 4Q23 is conditional and will depend on ‘is there a chance for US economic growth in 2023 to exceed 2.1%?’.

		2023	2024	2025	2026	Longer-run
GDP Growth	September Forecast	↑2.1	↑1.5	1.8	1.8	1.8
	June Forecast	1.0	1.1	1.8		1.8
Unemployment Rate	September Forecast	↓3.8	↓4.1	↓4.1	4.0	4.0
	June Forecast	4.1	4.5	4.5		4.0
PCE Inflation	September Forecast	↑3.3	2.5	↑2.2	2.0	2.0
	June Forecast	3.2	2.5	2.1		2.0
Core PCE Inflation	September Forecast	↓3.7	2.6	↑2.3	2.0	
	June Forecast	3.9	2.6	2.2		
Fed Terminal Rate	September Forecast	5.6	↑5.1	↑3.9	2.9	2.5
	June Forecast	5.6	4.6	3.4		2.5

Source: Federal Reserve, SSI Research

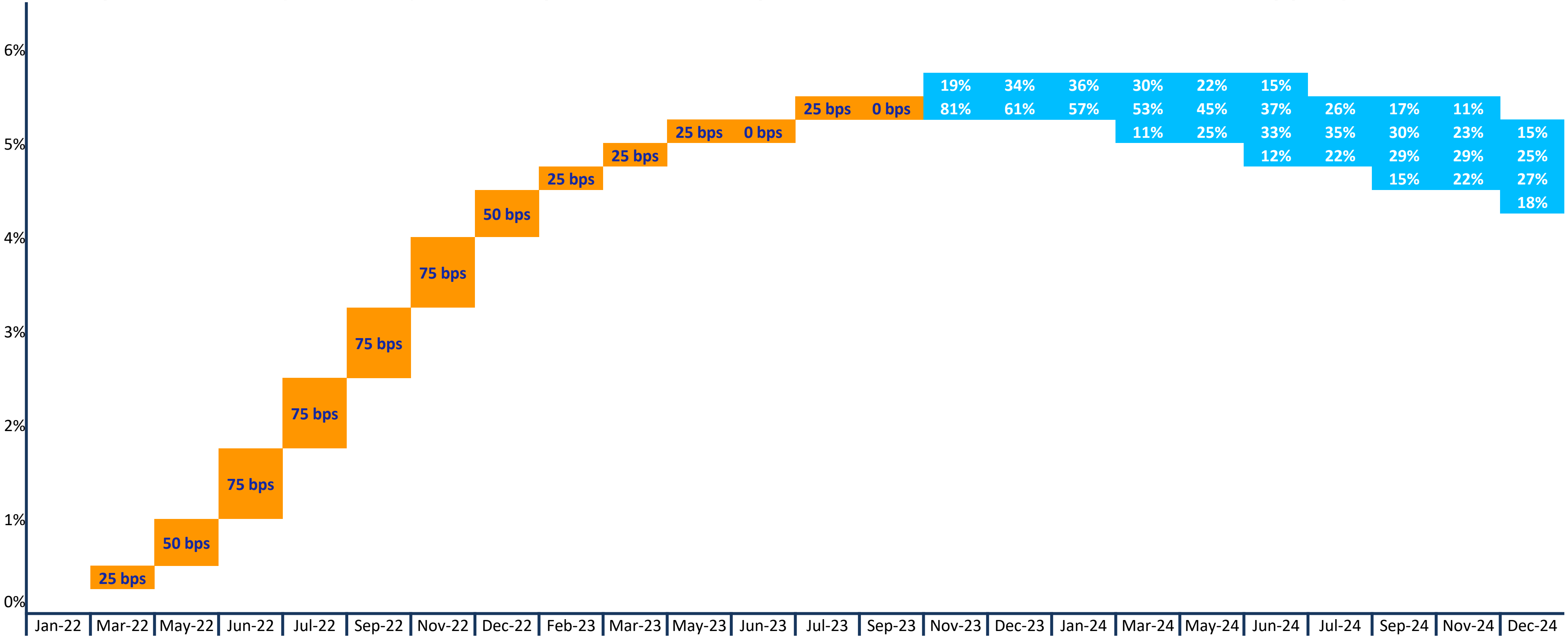
Rate cut expectations in Europe have started to shift as well, with many expecting the rate cut momentum to reach its full height in 2025



Source: BOE, ECB, Bloomberg, SSI Research

Market has the same view as The Fed's

Nevertheless, market players still hope that the Fed will cut its policy rate a little more aggressively in 2H24 by 3X25 bps to 4.75% (assuming that the planned 1x25 bps Fed rate hike in 4Q23 does not happen)



Source: CME Group, Federal Research, SSI Research

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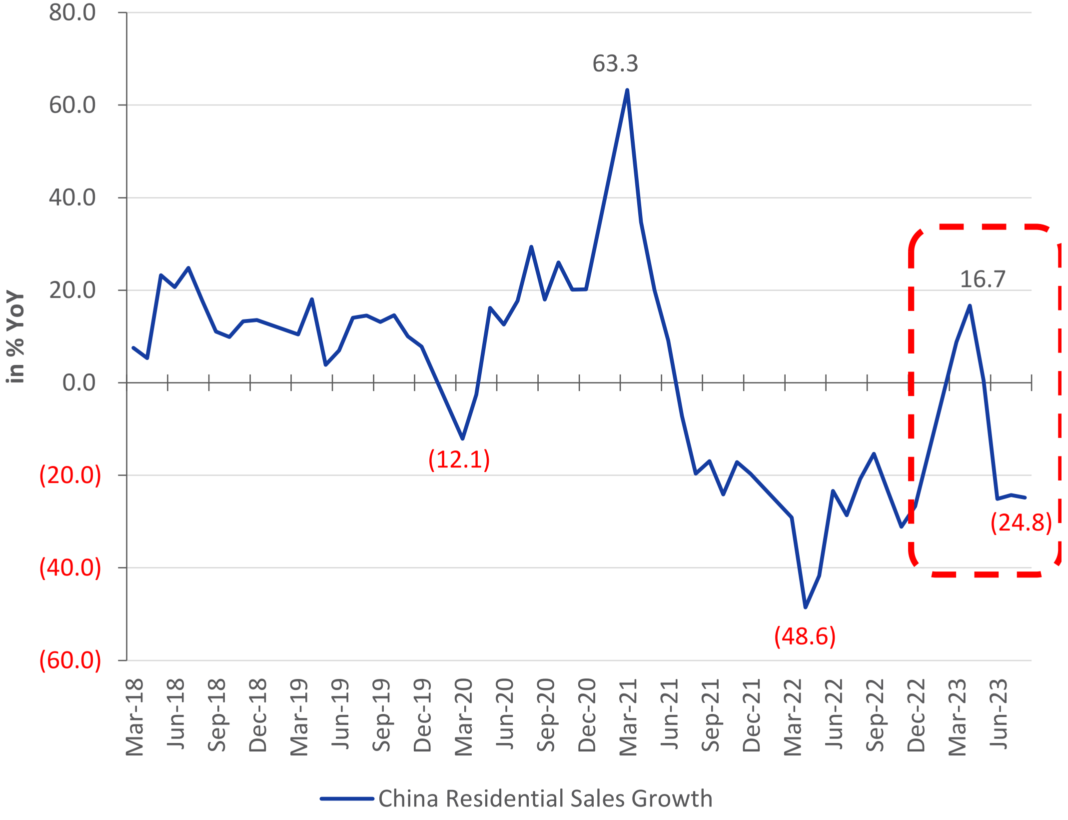
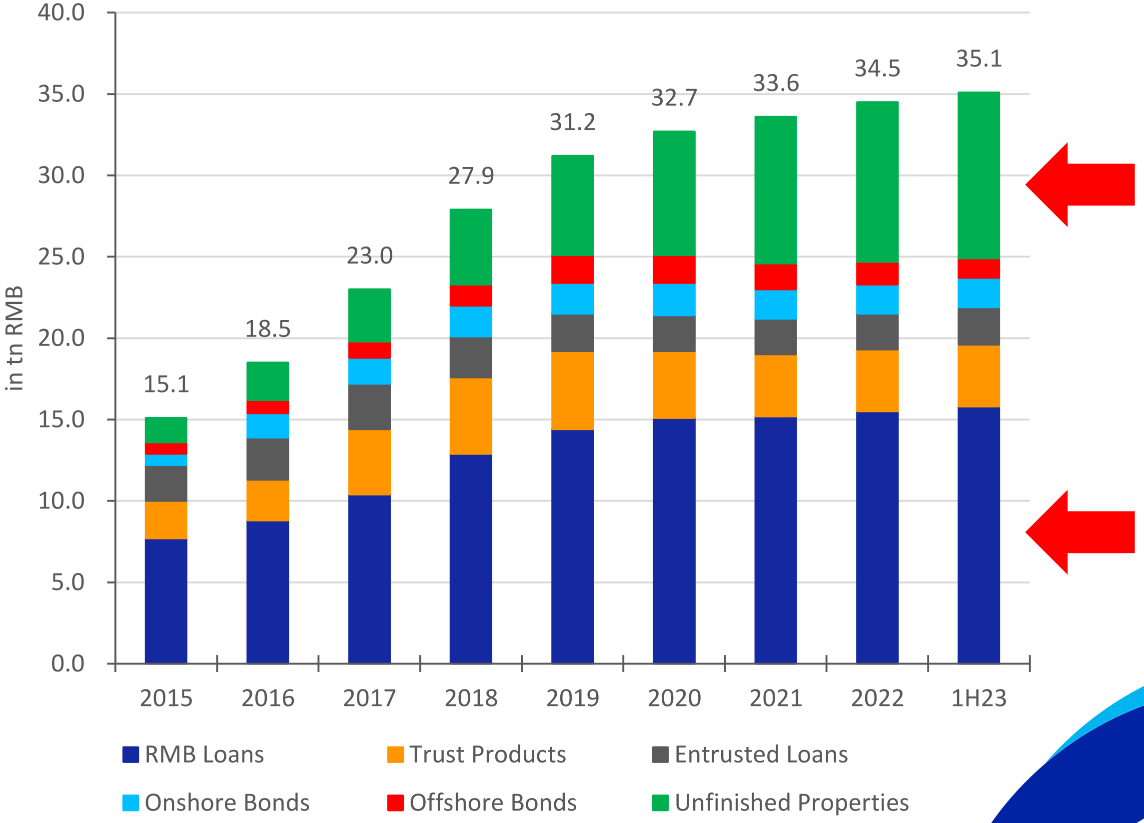
China's property crisis is a major stumbling block that hampers long-term economic recovery

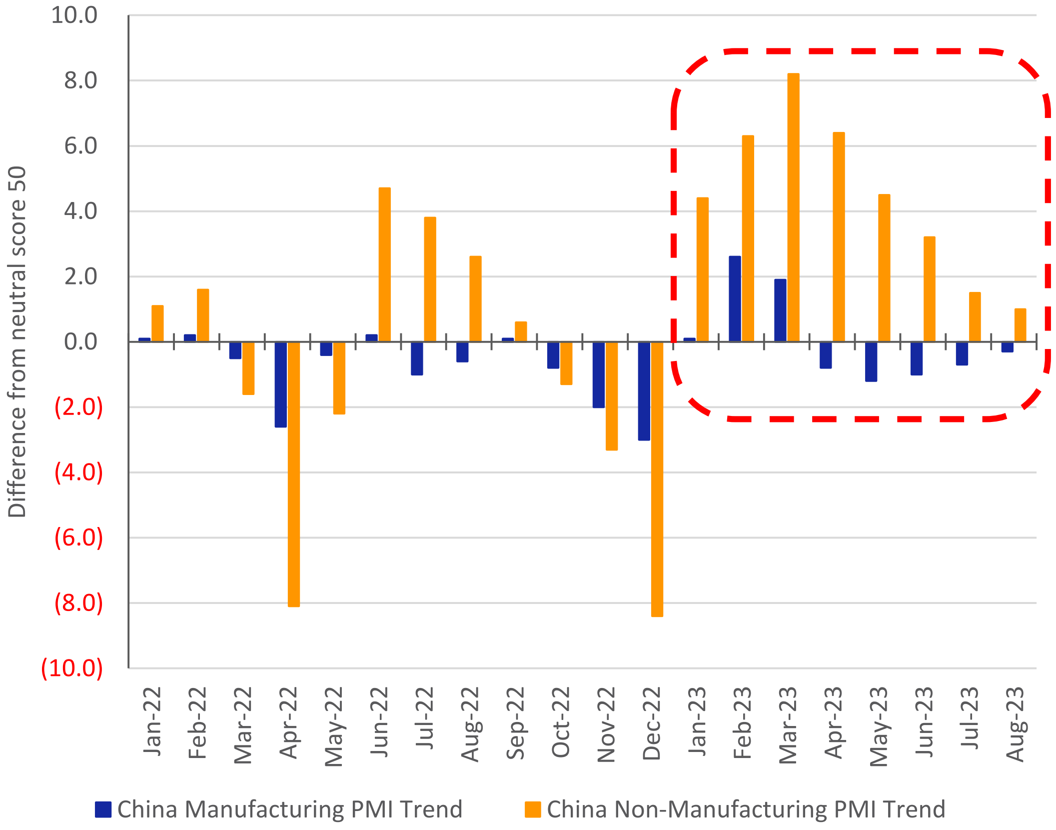


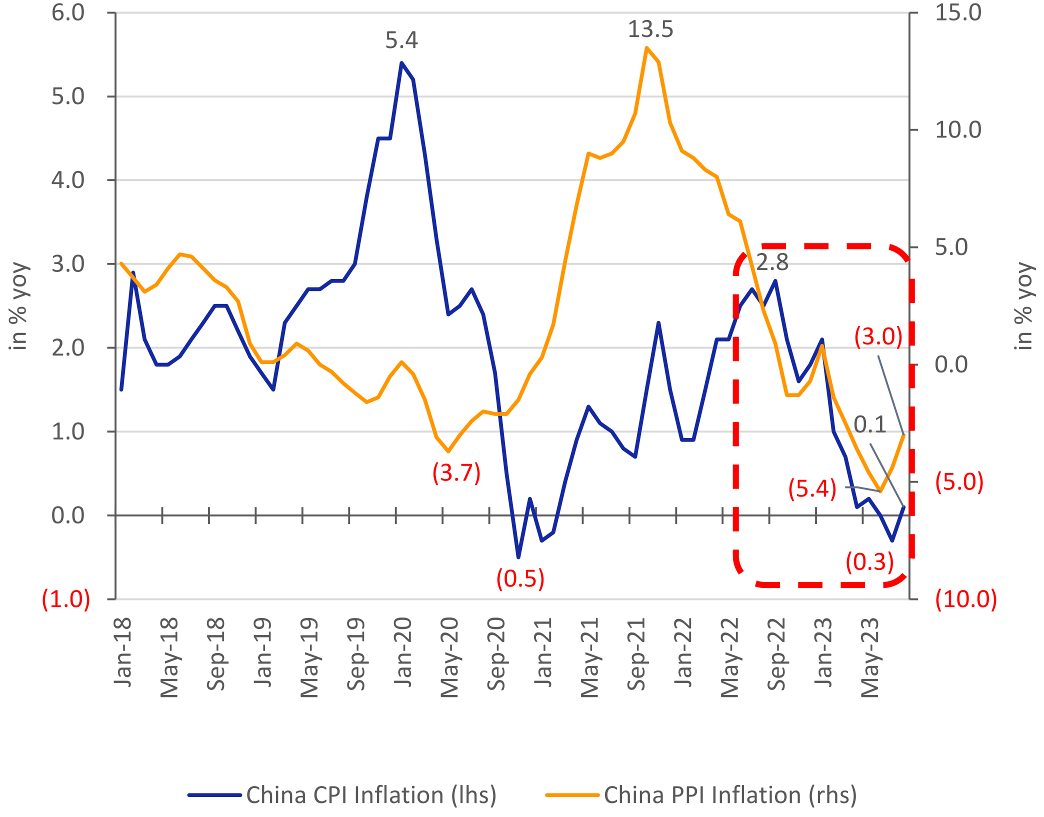


Source: PBOC, Bloomberg, SSI Research

As a result, China's economic activity continues to slow down, increasing the possibility of a deflationary spiral

Expansion of China's services sector has slowed down, while its manufacturing activity saw multiple contractions





Source: NBSC, PBOC, Bloomberg, SSI Research

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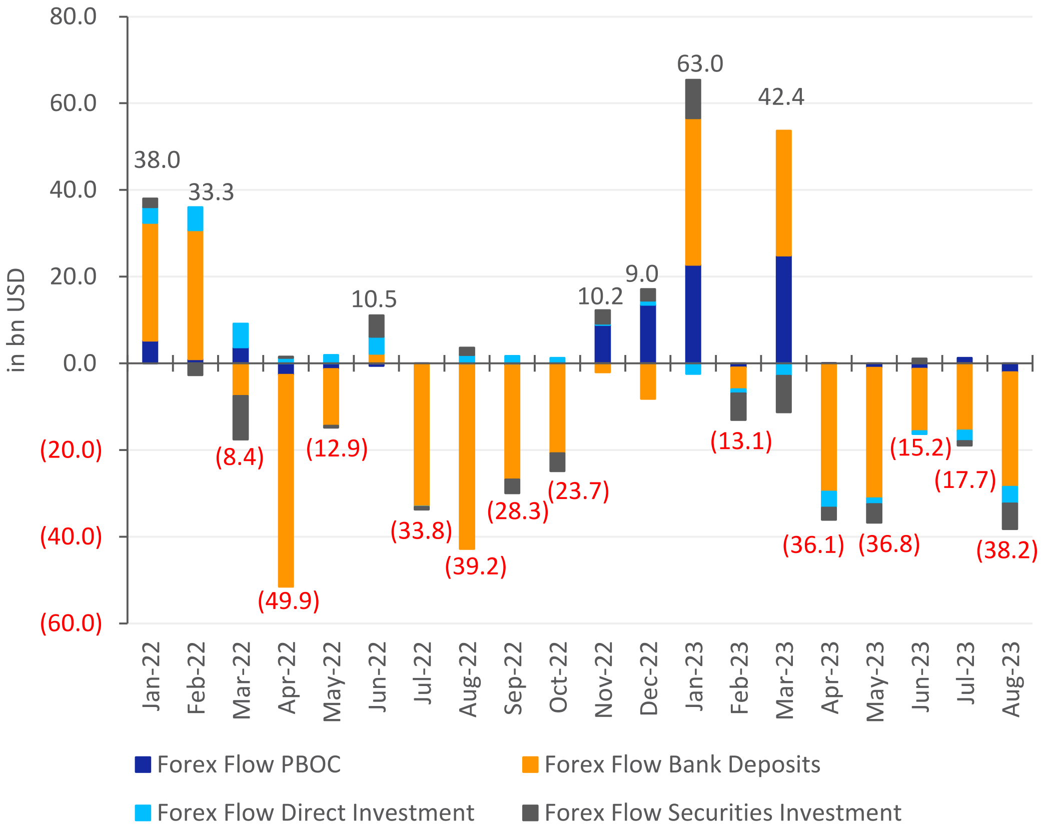
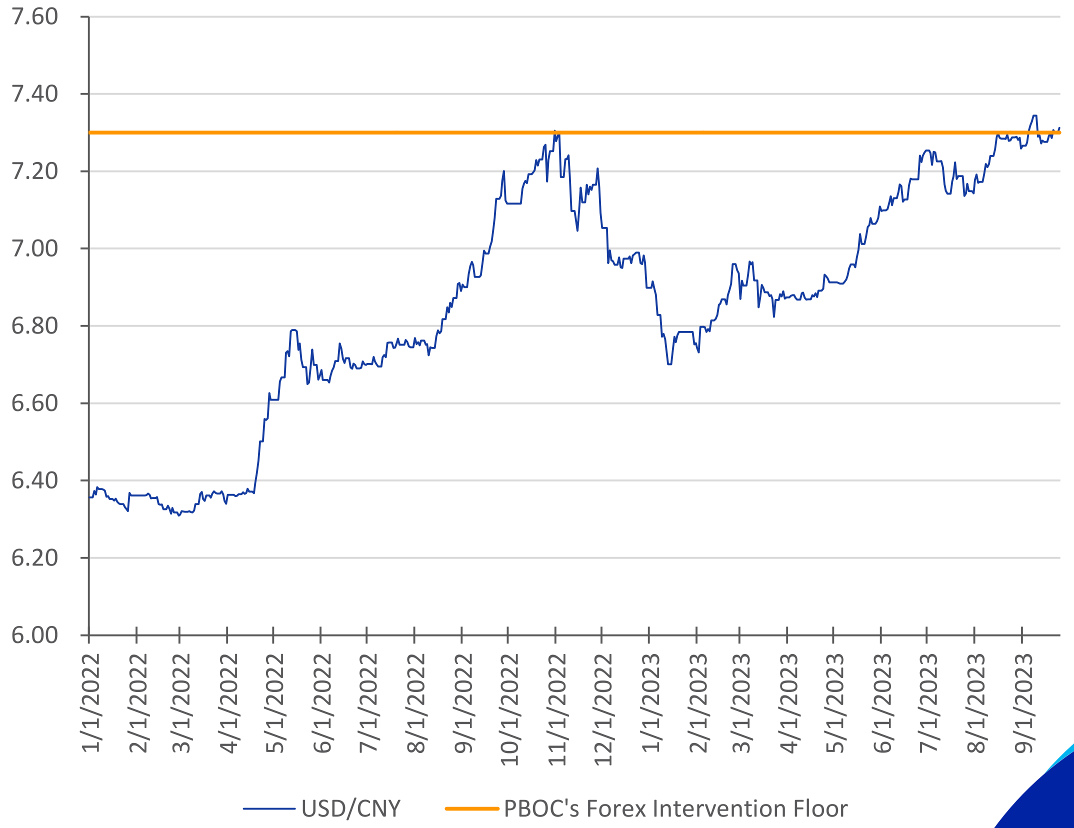
The lack of clarity on fiscal and monetary stimulus policies to stem the economic slowdown has caused investors to leave China





Source: PBOC, Bloomberg, SSI Research

Domestic Macroeconomic Fundamentals

What's Our View?

In our opinion, BI's rate policy direction will be highly influenced by the Fed's, considering Rupiah depreciation and the decline in the gap between Indonesia and US inflation rate in 2024 and 2025

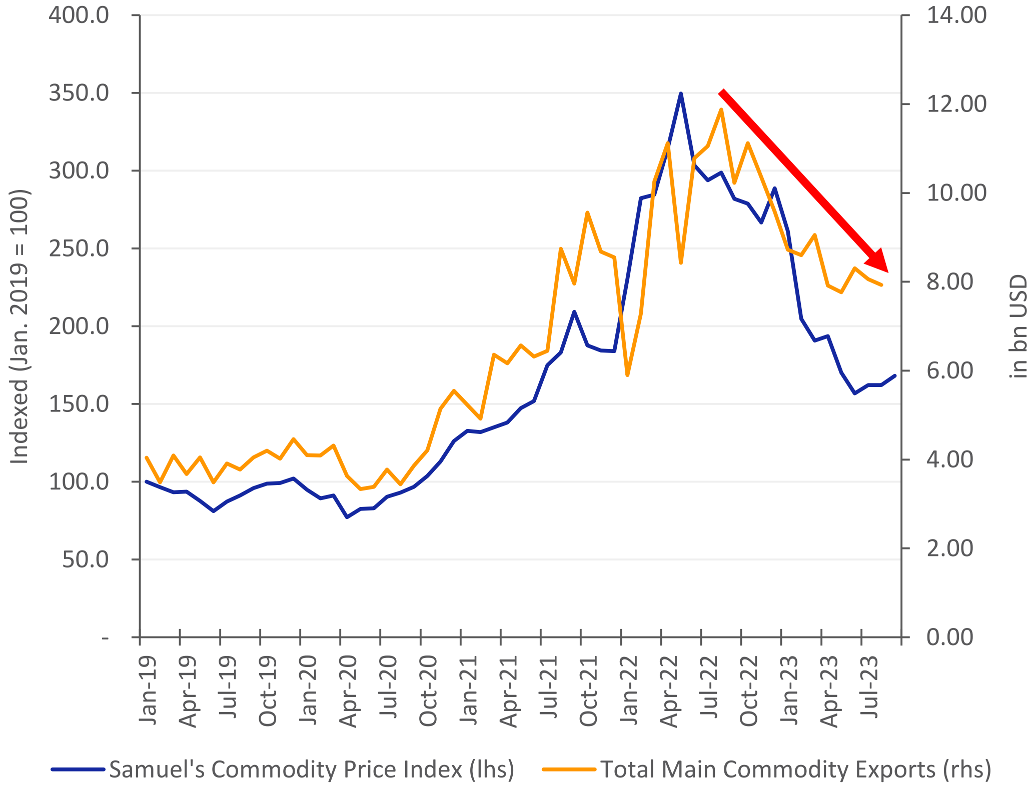
- Rupiah depreciation is driven by the possibility of another current account deficit due to commodity slump and foreign capital outflow from the Indonesian financial market due to the increasingly bearish perception of foreign investors towards emerging markets, especially Asian ones.

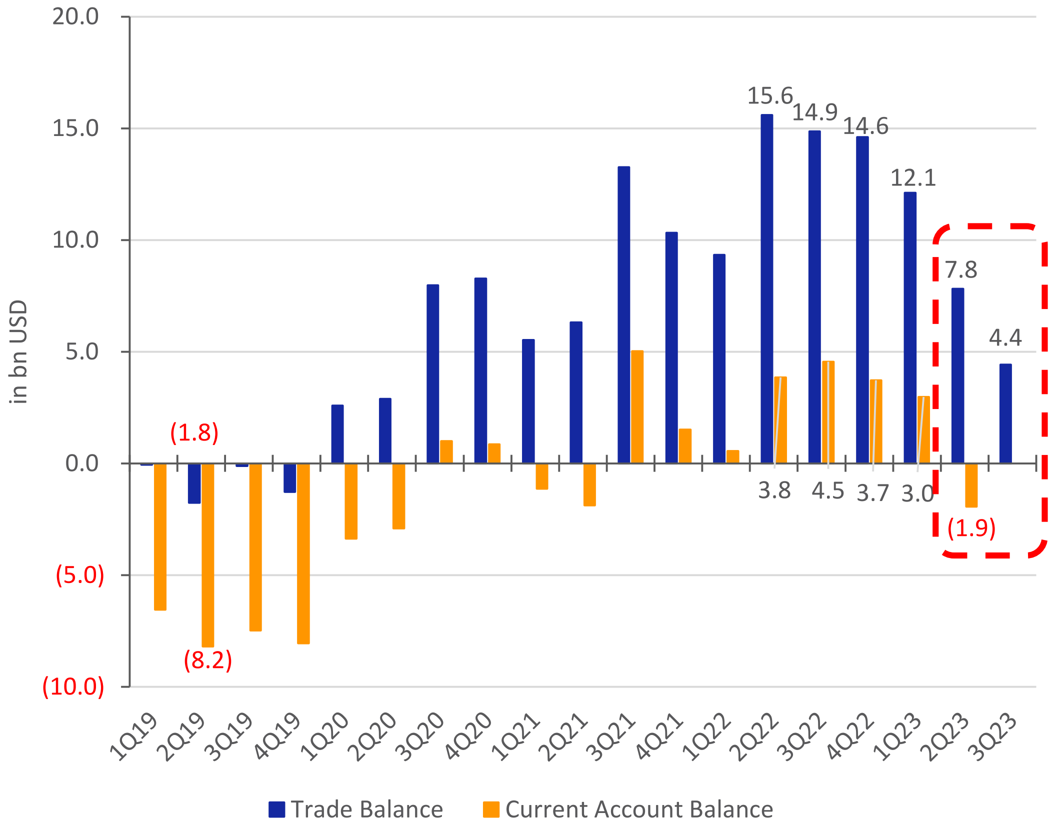
- The gap between Indonesia and US inflation rate is getting closer and closer, particularly their headline CPI inflation **(+0.4%)**, though the gap between the two countries' core CPI inflation is still quite large **(+2.2%)**.

- However, we expect the gap to close down in 2025, which will affect the real rate of return gap between Indonesia and the US.

Current account deficit may continue in 3Q23 and beyond

We estimated that Indonesia might book a current account deficit of USD (-1.6)bn in 3Q23 due to the drop in the value of commodity exports following the global commodity slump





Source: BI, BPS, Bloomberg, SSI Research

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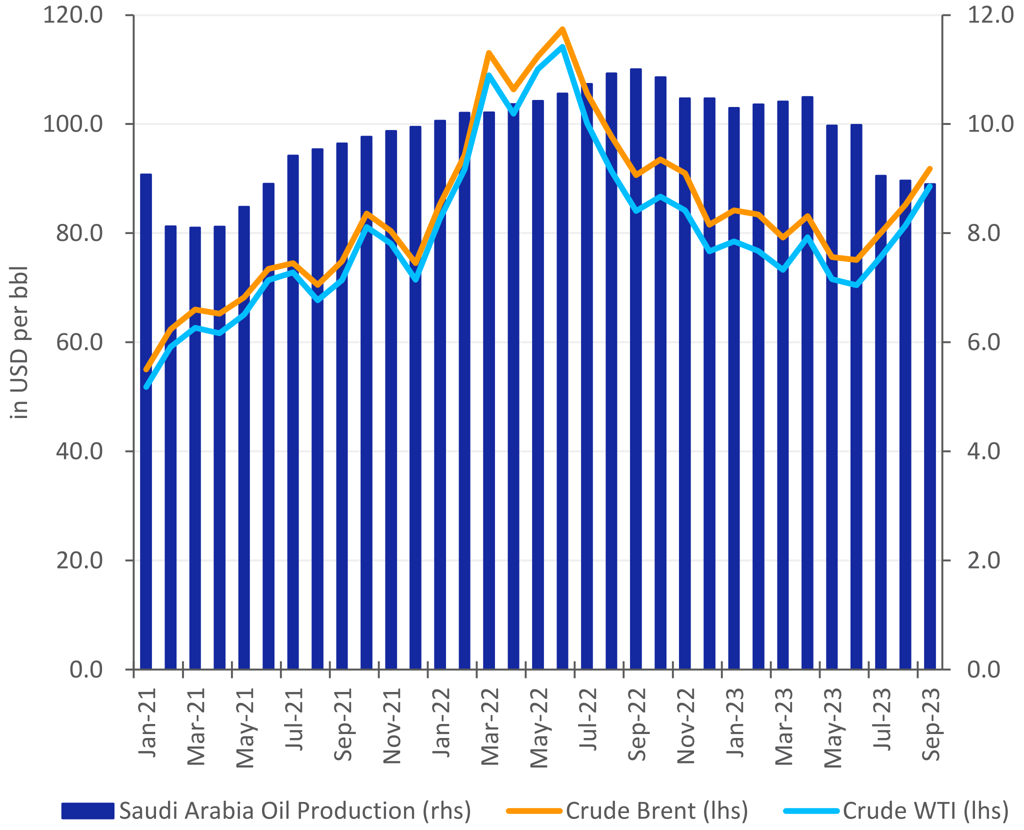
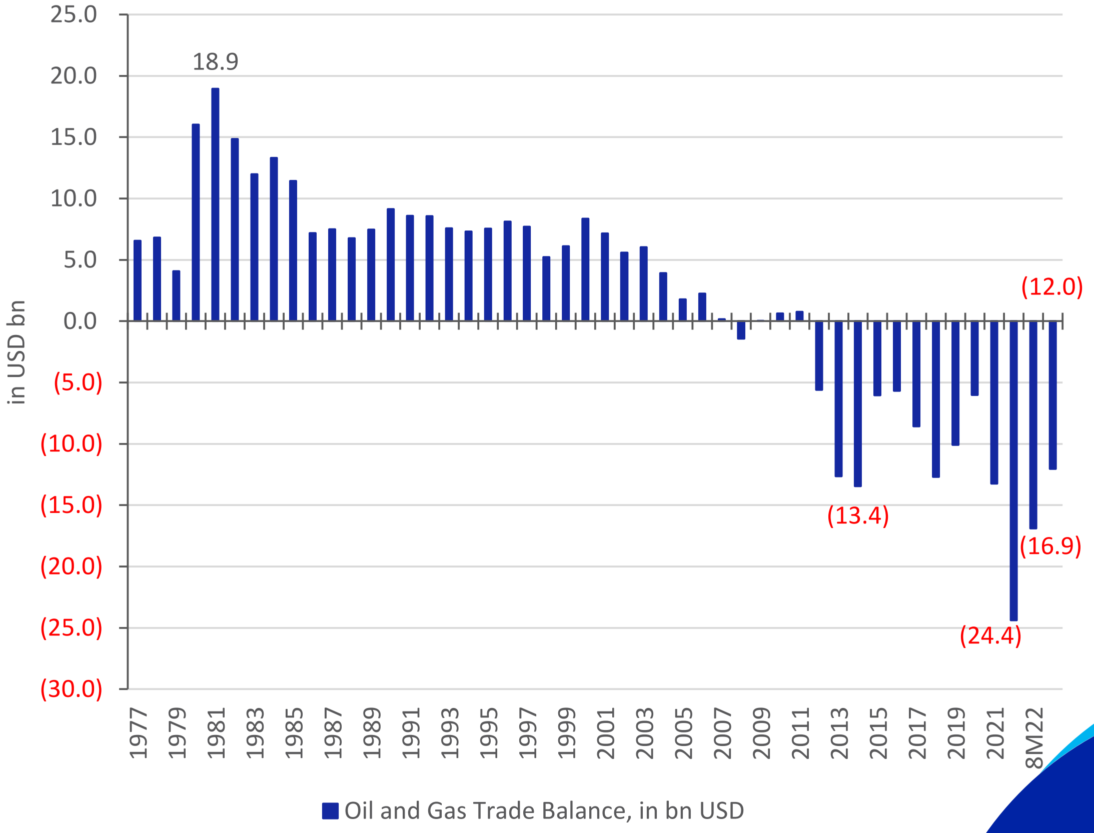
The current global oil price hike might lead to the second-highest oil and gas trade balance deficit in Indonesia's history [2022: USD (-24.4)bn]

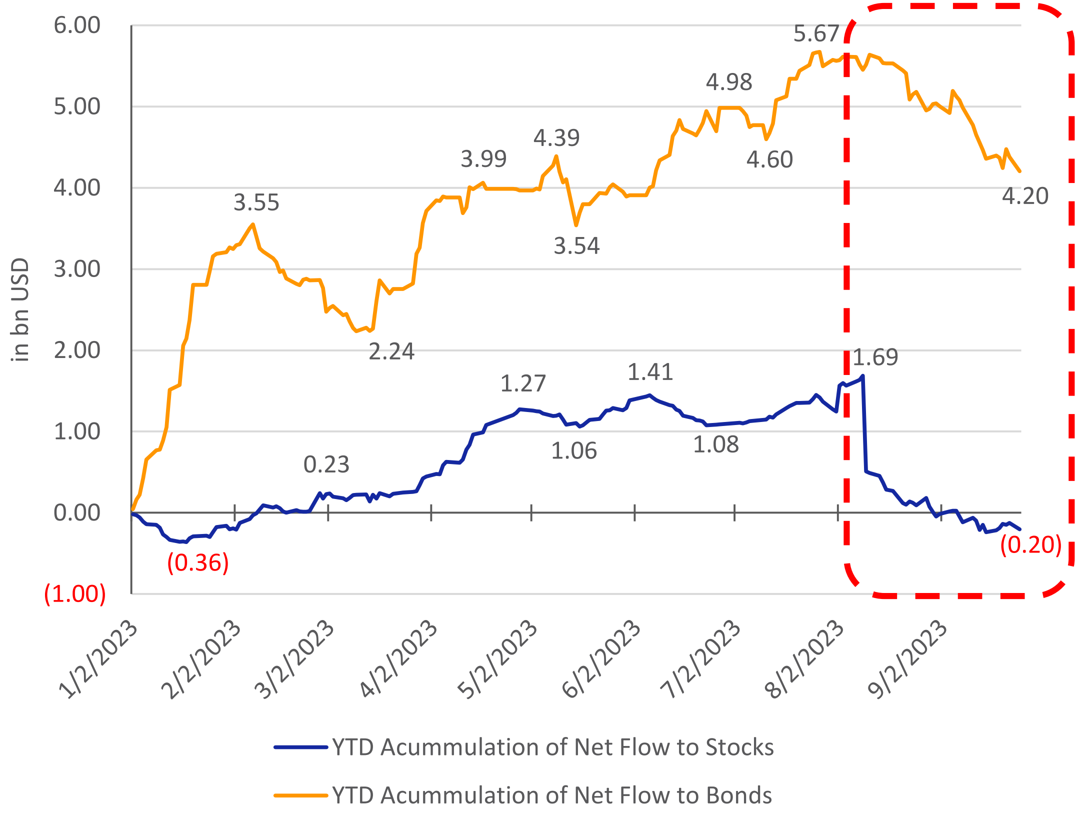


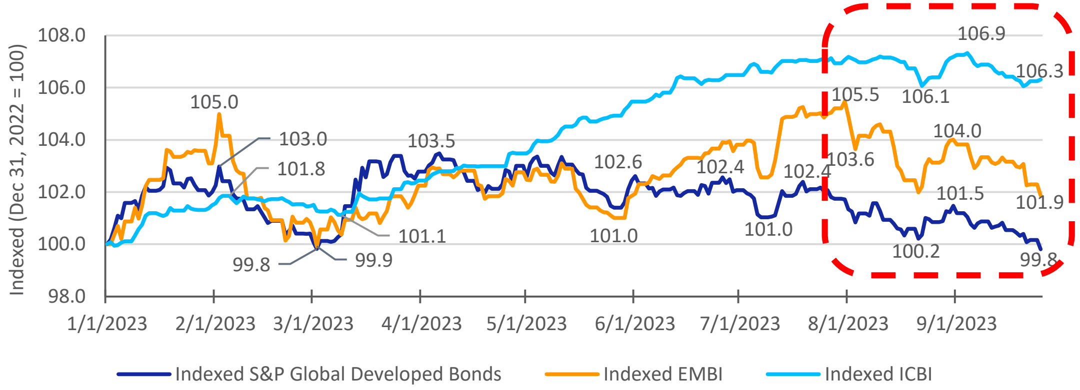


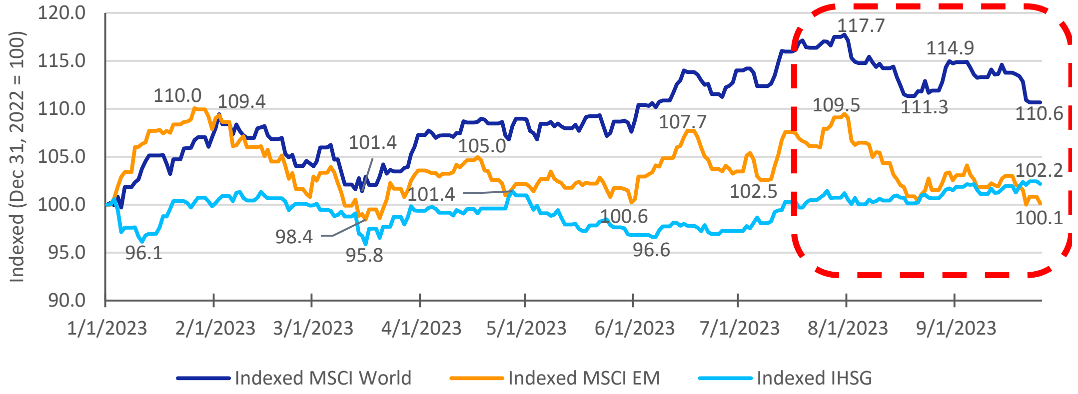
Source: BPS, OPEC, Bloomberg, SSI Research

Foreign capital outflow from the Indonesian financial market was mainly caused by changes in foreign investors' perceptions of emerging markets

Over the last 2 months, approx. USD 3.4bn of foreign capital left the Indonesian financial market (USD 1.9bn from the stock market and USD 1.5bn from the bond market)

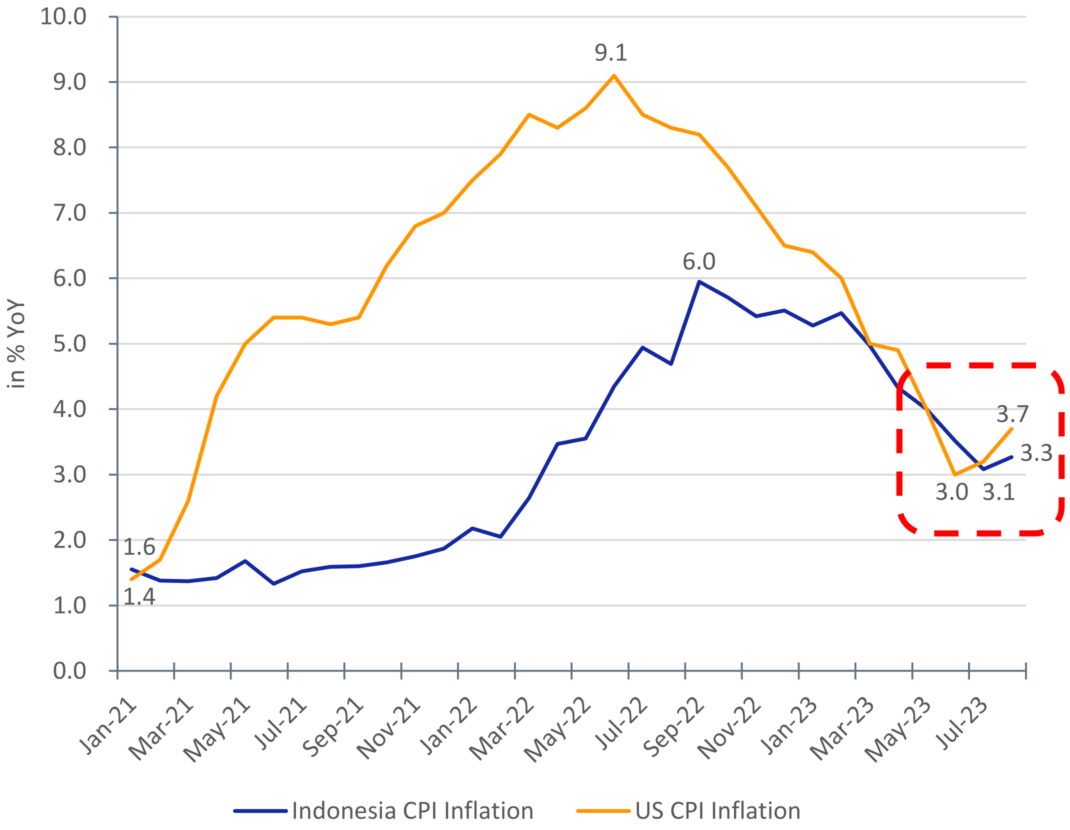


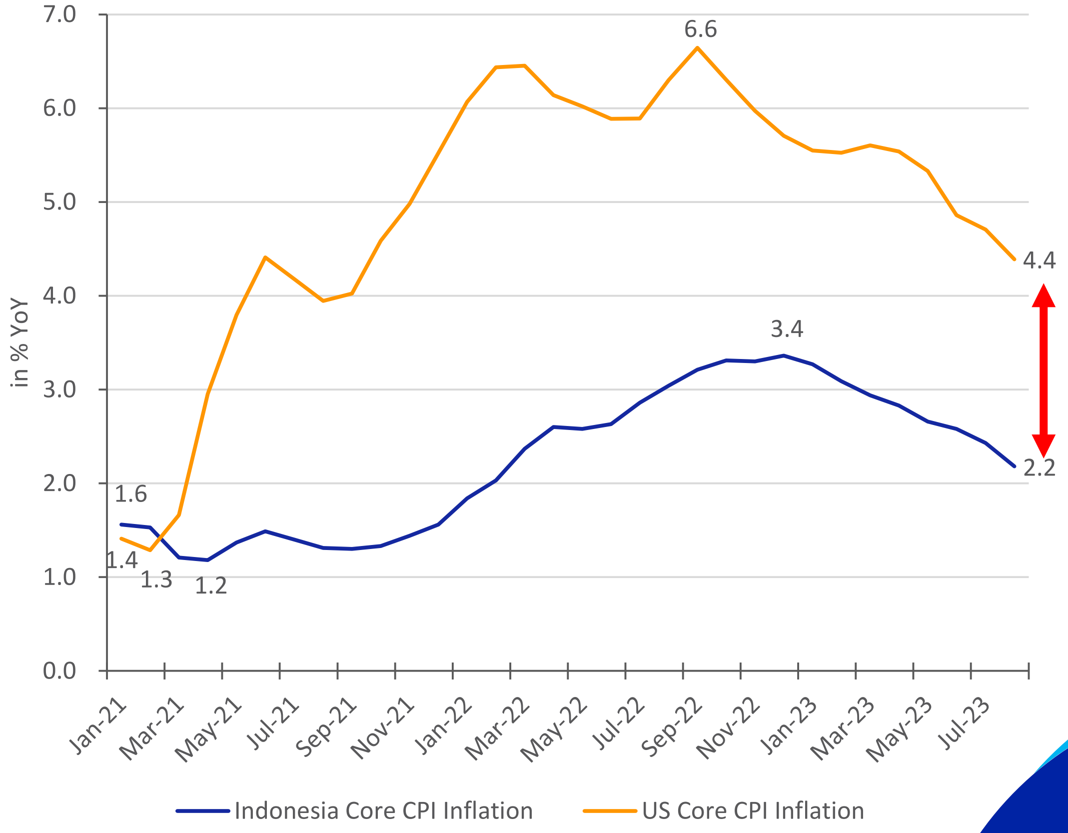




Source: BI, IDX, Bloomberg, SSI Research

Even though the inflation gap between the US and Indonesia's **core CPI** is still quite wide **(+2.2%),** the gap between the **headline CPI inflation** of the two countries is quite narrow **(+0.4%)**

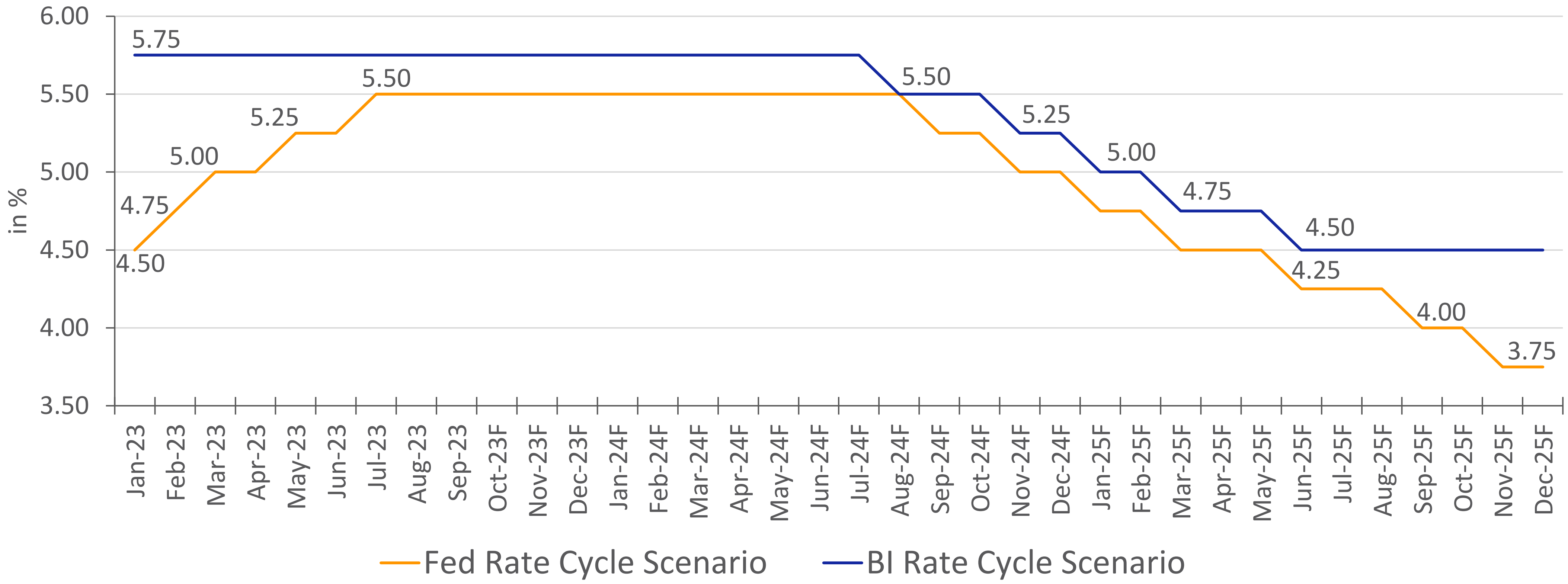




Source: BLS, BPS, Bloomberg, SSI Research

BI will start to normalize the gap between its policy rate and the Fed's in 2025

We expect BI to cut its 7DRRR by 50 bps in 2024 and 75 bps in 2025, and The Fed to cut its FFR by 50 bps in 2024 and 125 bps in 2025



Source: BI, CME Group, The Fed, Bloomberg, SSI Research

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SSI Forecast Table

Indicators (% yoy)	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	FY22	FY23F	FY24F
Real GDP (NSA % qoq)	(0.9)	3.7	1.8	0.4	(0.9)	3.9	1.8	0.3	(0.9)	3.6	1.7	0.6			
Real GDP	5.0	5.5	5.7	5.0	5.0	5.2	5.1	5.1	5.1	4.8	4.8	5.0	5.3	5.1	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	(0.6)	(1.5)	(1.2)	(1.2)	(1.3)	(1.5)	(1.7)	1.0	(0.6)	(1.4)
12M rolling sum	0.4	0.9	0.8	1.0	1.2	0.7	(0.1)	(0.6)	(1.1)	(1.3)	(1.3)	(1.4)			
Fiscal balance (% to GDP)	0.1	0.5	0.3	(2.4)	0.6	0.7	(0.1)	(2.3)	(0.4)	(1.0)	(1.5)	(2.3)	(2.4)	(2.3)	(2.3)
Policy rate, 7 day reverse repo rate (%)	3.50	3.50	4.25	5.50	5.75	5.75	5.75	5.75	5.75	5.75	5.50	5.25	5.50	5.75	5.25
10-year government bond yield (%)	6.74	7.22	7.37	6.94	6.79	6.26	6.77	6.60	6.60	6.50	6.50	6.40	6.94	6.50	6.40
Exchange rate (USD/IDR)	14,369	14,898	15,228	15,568	14,995	14,993	15,400	15,000	15,100	15,000	15,000	15,100	15,568	15,000	15,100

Source: SSI Research

Intermarket Analysis

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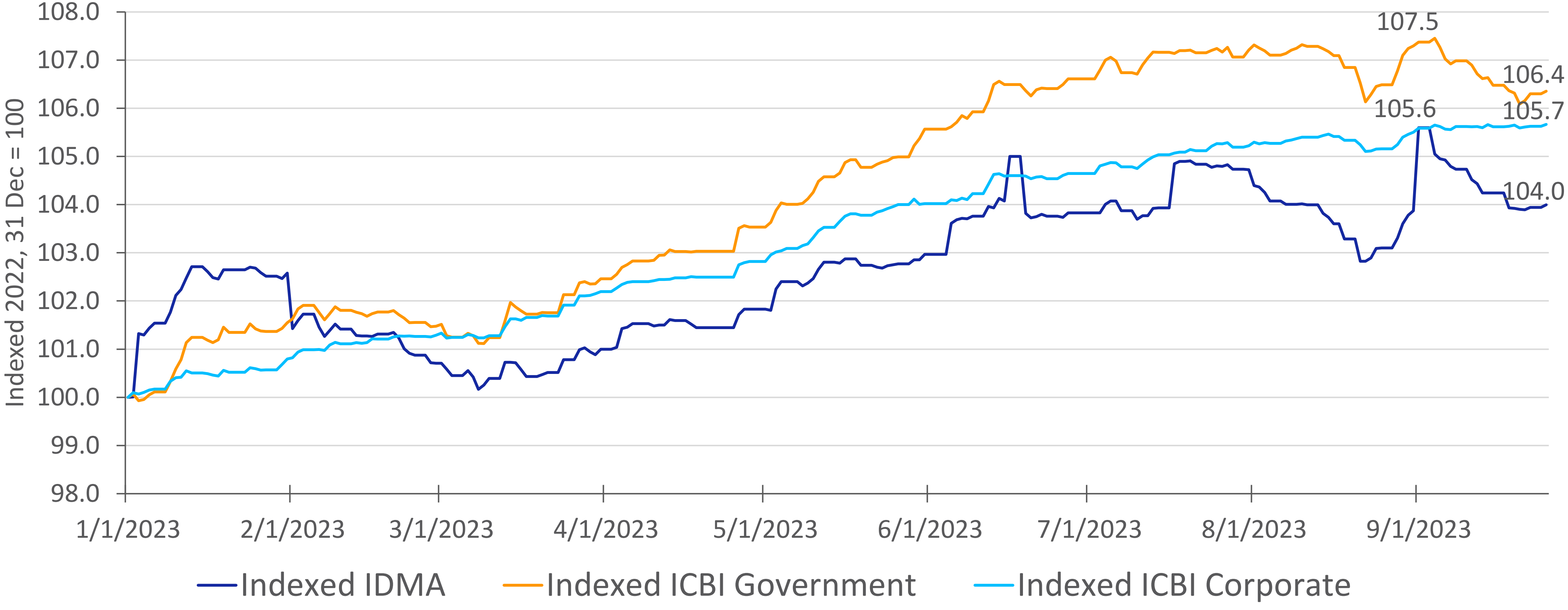
What's Our View?

We recommend investors to use a defensive buy and hold strategy, focusing on attractive coupon rates

- We advise investors to overweight on corporate bonds, especially those offering high interest.
- We also recommend overweighting high-coupon or short-term SBN as alternatives to corporate bonds.
- SRBI can also be considered for investors who have the flexibility to invest in the government bills market.

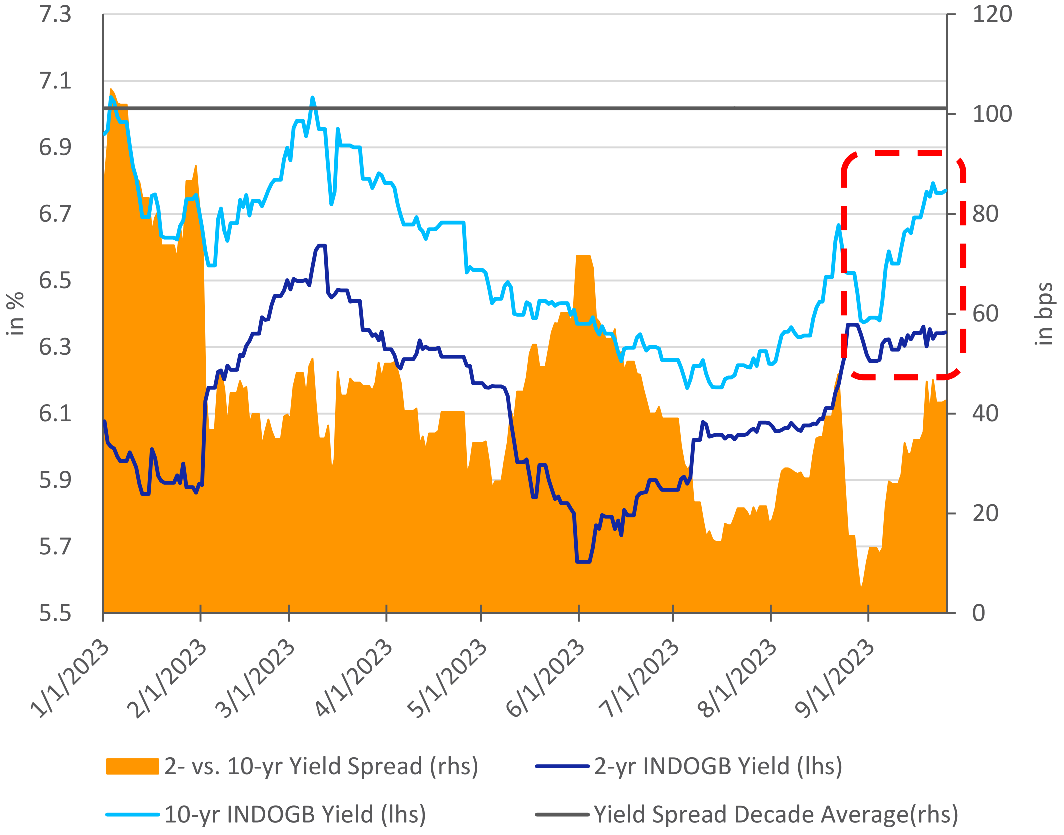
Overweight on high-interest corporate bonds

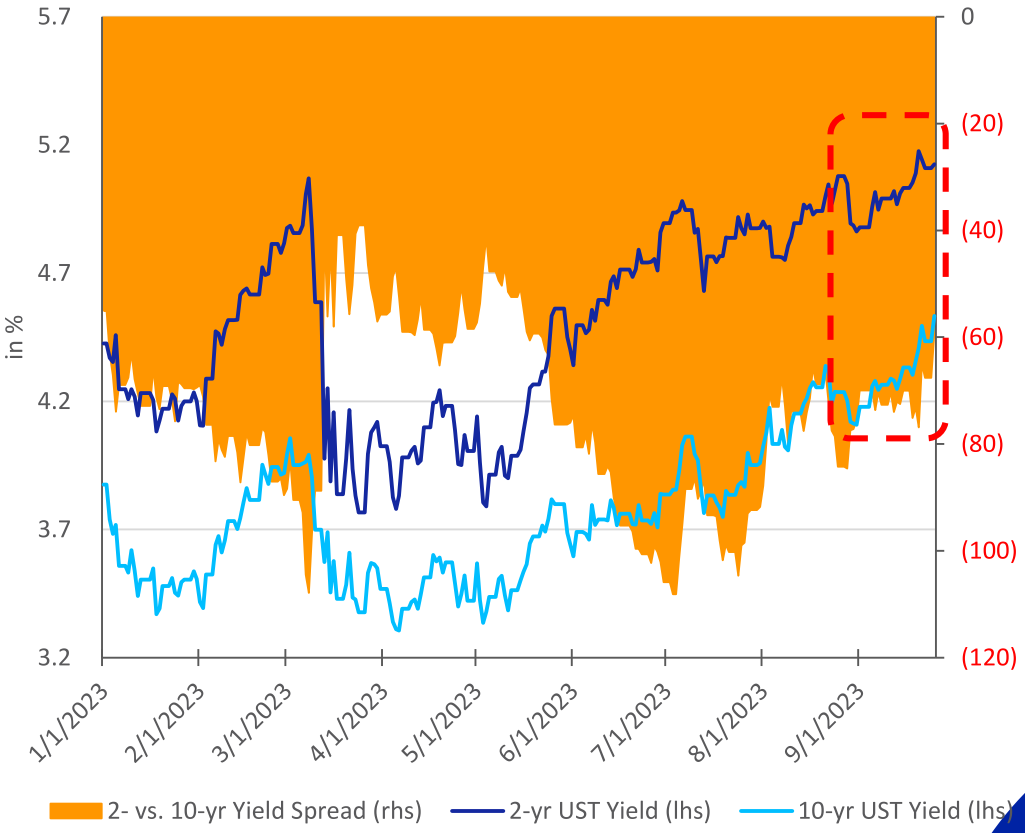
Corporate bonds are not as volatile as SBN and offer more attractive coupons; making them the perfect instrument to buy and hold until the Fed and BI start cutting their benchmark interest rates next year



Source: Bloomberg, SSI Research

The yields on long-term INDOGB and UST (10Y) are more prone to correction than the yields on short-term ones (2Y)

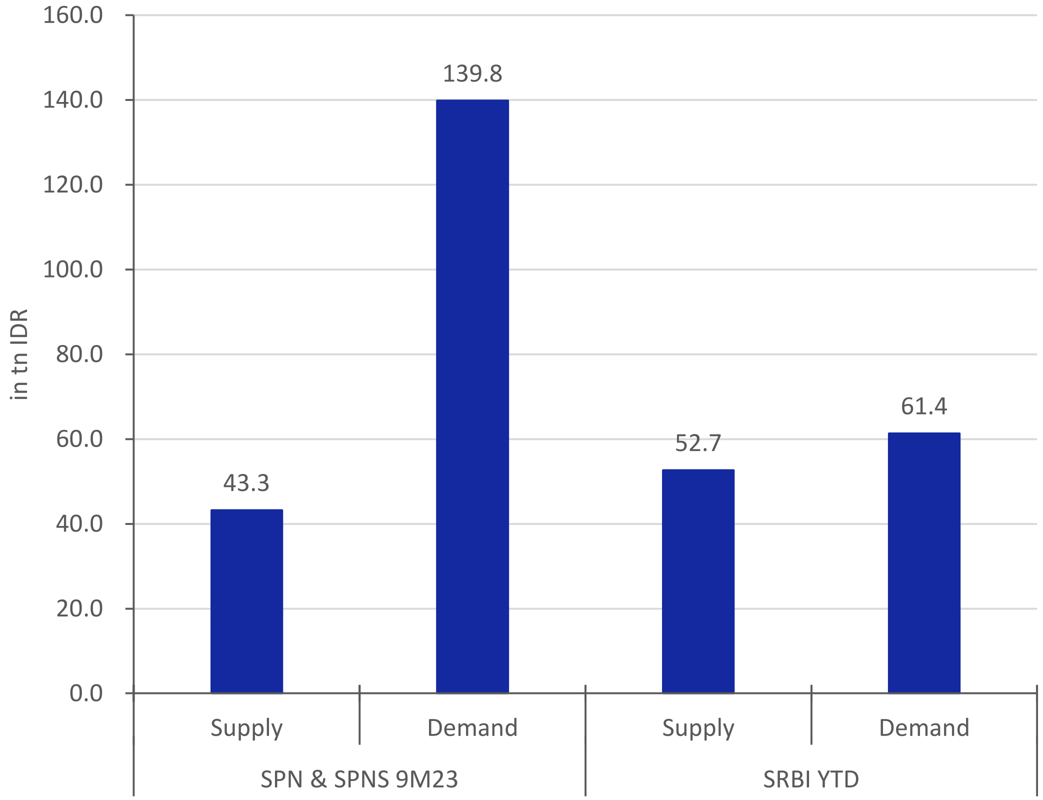




Source: BPS, OPEC, Bloomberg, SSI Research

SRBI makes the government bills market (SPN &SPNS) more attractive

The current SRBI outstanding comes in at IDR 96tn (and the figure will continue to increase), and it offers attractive returns (6.3-6.45%), the same as INDOGB 5Y yield



Asset Type	Incoming Bid, in tn IDR	Awarded Bid, in tn IDR	Discount/Yield
SRBI 6M (20/9)	3.8	2.2	6.31
SRBI 9M (20/9)	1.5	1.3	6.39
SRBI 12M (20/9)	10.4	9.8	6.42
SRBI 6M (22/9)	6.4	6.2	6.31
SRBI 9M (22/9)	1.3	1.3	6.40
SRBI 12M (22/9)	8.2	7.5	6.43
SPN (22/8)	1.0	0.7	5.59
SPNS (15/8)	3.1	1.8	4.91
FR0096 (10Y - 8/8)	9.6	2.3	6.35
FR0100 (New 10Y - 5/9)	9.0	5.8	6.45
FR0100 (New 10Y - 19/9)	11.8	7.9	6.73

Source: BI, IDX, Bloomberg, SSI Research

Thank You

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