Is SRBI behind the tightening bank liquidity?

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Summary

- Unstable global interest rate expectations and domestic fiscal uncertainty explain investors' preference for SRBI over other long-term instruments, resulting in sell-off pressure in the SBN market but not the shorter end of the domestic debt market.
- Despite the lower demand from foreign investors and banks, the SBN market may find more ready buyers from the household sector, given retail investors' now higher sensitivity to nominal rates.
- Rather than the SRBI, retail investors' shift towards higher-yielding SBN may better explain banks' slowing deposit growth, which could be exacerbated if the government decides not to spend the proceeds from the SBN issuance.

- Episodes of Fedspeaks culminated with the release of FOMC minutes, making the situation in the past week a topsy-turvy one for the global economy. Several FOMC members, including Fed Chair Jerome Powell, continue to state that inflation has become entrenched, and the longer monetary policy lag may require the Fed to keep its policy rate high for an even longer period. Speculations mounted that the Fed may not cut the policy rate at all in 2024, but the release of FOMC minutes on Thursday suppressed that speculation and thus brought the USD index (DXY) back to the 104.6-104.7 range, where it started at the beginning of the week.
- The lack of seismic changes in the global interest rate expectation keeps the Indonesian financial sector relatively serene. The Rupiah remains relatively stable when the market opens today, only depreciating around 57 points at the time of writing (compared to 55 points when the market opens following the 9-10 May collective leave). The bid-ask spread percentage on a 10Y SBN also moves lower today, indicating that selling pressures in the Indonesian bond market have not intensified as the market opens following the long weekend.

Barking up the wrong tree

- Our discussions should then return to the recently released Q1 2024 BoP number. In line with our argument, the spiking cash placement abroad by the domestic private sector has moved the government to offer more incentives for its export proceeds (DHE) policy, slashing the income tax on TD DHE by 2.5%. However, business decisions by exporters to keep their proceeds abroad only explain one part of the problem, as the USD 2.29 Bn foreign outflow from the SBN market also plays an equal part in flipping the financial account to a deficit in Q1 2024.

- As we have argued in the previous report on Q1 2024 BoP data, the SBN market is unlikely to contribute much to the financial account in the upcoming quarter, given the continued foreign outflows from the market in Q2 2024 ***(see Chart 1)***. However, recurring outflows from the SBN market may not indicate a general unattractiveness of the Indonesian bond market. A quick look at the portfolio side of the financial account shows that **the short end of Indonesia's bond market is still recording foreign capital inflows** throughout the previous quarter, not only for BI-issued instru-ments such as SRBI but also for the more spe-culative corporate bills market.
- Indeed, The Q1 2024 QoQ changes in foreign investors' holding of SBN and SRBI are a near-perfect mirror image of each other, as SBN owned by private foreign investors fell by IDR 20.85 Tn while their SRBI holdings increased by IDR 20.18 Tn. One report even suggests that foreign investors' holdings of SRBI have shot up to IDR 142.90 Tn in the last week, indicating foreign net buys of around IDR 67.75 Tn since (compared to IDR 8.52 Tn in the SBN market) since the end of April 2024. Although the relatively low yield on the SBN market is an issue, **foreign investors' declining demand for SBN may be better understood as a change in appetite due to greater optionality**, rather than their worsening sentiment on the Indonesian debt market in general.

"Rather than its higher yield, SRBI's relative safety over SBN may better explains its allure on foreign investors and domestic banks"

- This behavioural change is not solely observed in foreign investors. The higher demand for SRBI (and the correspondingly lower demand for SBN) also characterises banks' paper investments in recent times; although, the IDR 283.5 Tn QoQ decline in their SBN holdings in Q1 2024 is greater than the IDR 122.44 Tn increase in SRBI holdings given the accelerating loan growth at the same time.
- Foreign investors and domestic banks' preference for SRBI over SBN stretches beyond SRBI's more attractive rates, which may translate to a neutral net return anyway given the 20% tax on its returns (compared to 10% of SBN). Despite being a derivative, **the higher demand for SRBI may stem from its relative safety compared to its underlying assets.** This is indicated by the yield on an off-the-run 12M SRBI, which has proven to be more stable during previous bouts of market volatility compared to the benchmark SBN yield.
- SRBI's apparent safety over its underlying assets does not only derive from its lower duration. First, the still-peculiar global interest rate situation still plays a significant role, as **the now flattish yield curve did not reward foreign investors to test the water on the longer end of the Indonesian debt market.**
- Second, **the upcoming administration's argument that Indonesia's debt-to-GDP ratio still has ample room to move higher also injects uncertainty into the government's future fiscal condition**, despite the current government's efforts to minimise SBN issuance

by utilising the excess budget balance ***(see Chart 2)***. **The SRBI market thus provides a space within the Indonesian financial market for investors to wait for global and domestic uncertainties to falter**, limiting the risk of capital outflows due to the risk of short-term volatilities.

- Another benefit that could be derived from the SRBI market may be more specific for BI and the domestic banking sector. **Domestic banks' attentiveness to the SRBI market may shorten BI's policy transmission lag**, as the central bank directly controls the supply of SRBI ***(see Chart 3)***. **A shorter monetary policy transmission may help BI to be more reactive in responding to the hitherto slowing business cycle in the real sector**; a role that has been increasingly dependent on fiscal measures in recent quarters.
- The SRBI market, of course, has received its fair share of concern. One concern that seems to be gaining currency within the domestic banking sector is that the higher yield offered by SRBI may draw liquidity from other parts of the financial sector apart from the SBN market, thus exacerbating the liquidity problems faced by the domestic banking sector.
- Proponents of this argument, however, seem to be running the risk of barking up the wrong tree. **Ownership of SRBI remains limited to banks and other non-bank financial institutions, unlike the SBN market which is gaining prominence among retail investors** (the percentage of SBN ownership by the household sector rose from 2.95% pre-COVID to 8.25% in May 2024). Ergo, domestic banks' slower deposit growth seems to be more accurately described as a consequence of retail investors' improving awareness of non-bank financial products ***(see Chart 4)***, which, in turn, may increase their sensitivity to nominal rate returns.
- The risk of retail funds leaking from the banking sector to the financial market (primarily the SBN market) may again become more acute in the upcoming period, as indicated by the slowing M2 growth in April 2024. The slowing M2 growth (6.9% YoY, 7.2% in March 2024) is not surprising, given the slowing fiscal spending since the end of Q1 2024.
- The slowing fiscal spending may thus signify more pressing concerns for the banking sector; **not only that the higher SBN issuance may crowd out retail funds but proceeds from the issuance may not find their way back to the domestic banking sector if the fiscal spending trend continues to normalise following the acceleration in Q1 2024**. Banks may continue to find themselves competing for a tighter pool of liquidity in the coming periods, but for the moment at least, the shadow on the other end of the ring may be those of the SBN market (and the government's higher financing needs) rather than BI and the SRBI market.

> ***"Banks may continue to face higher competition for liquidity, but the SBN market may emerge as a more relevant competitor rather than the SRBI market"***

Chart 1

Improving but still left behind

Foreign demand for Indonesian government bonds has been improving recently, but is still lacklustre compared to the demand for SRBI

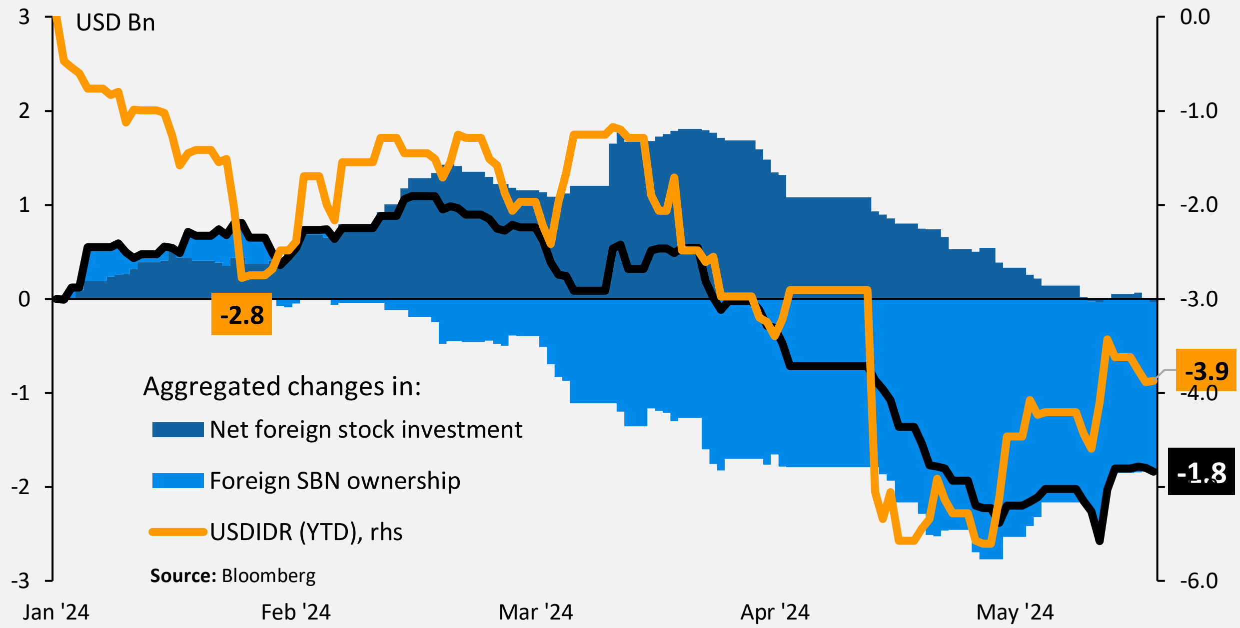


Chart 2

No such things as a bottomless coffer

Still-ample liquidity condition in the public sector allows the government to limit SBN issuance, but the government may eventually need to issue more SBN to refill their coffers

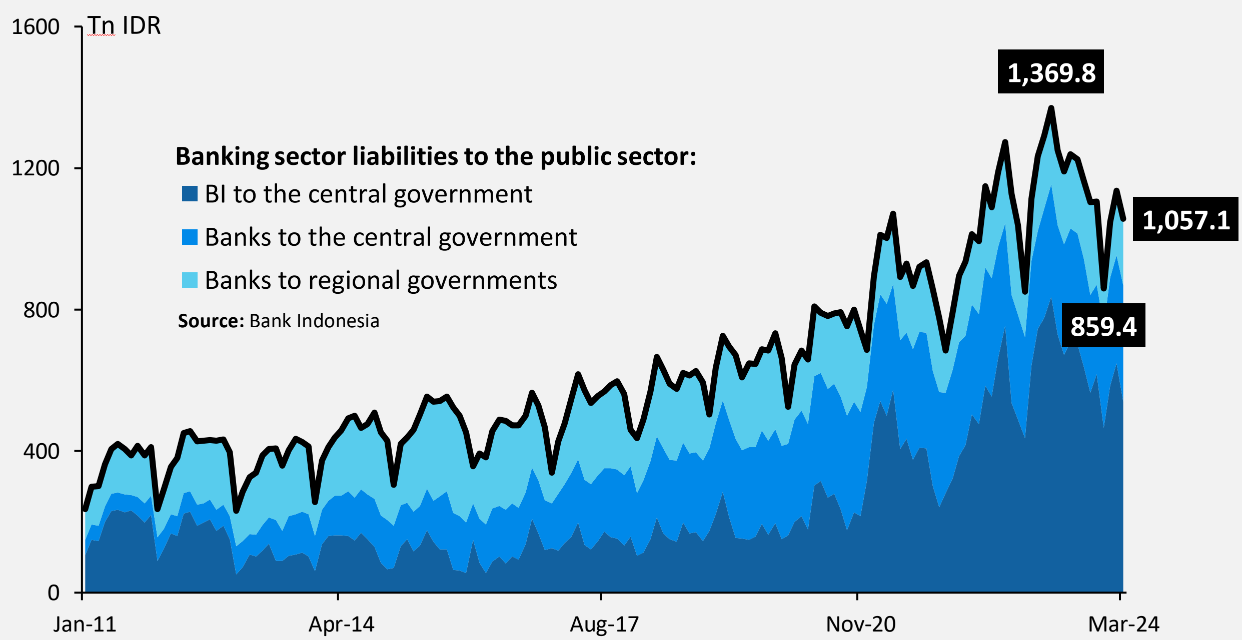


Chart 3

Proven stable despite the rough seas

The yield on SRBI appears to be solely driven by changes in the BI rate, while the benchmark SBN yield moves up and down following the shift in global interest rate expectations

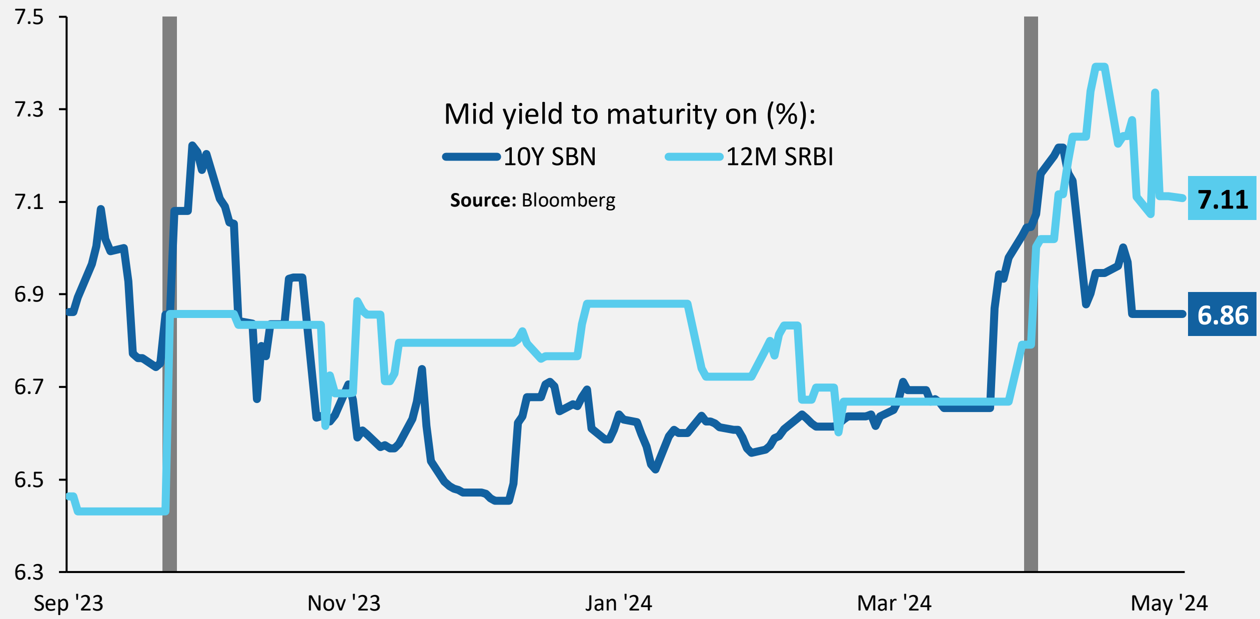
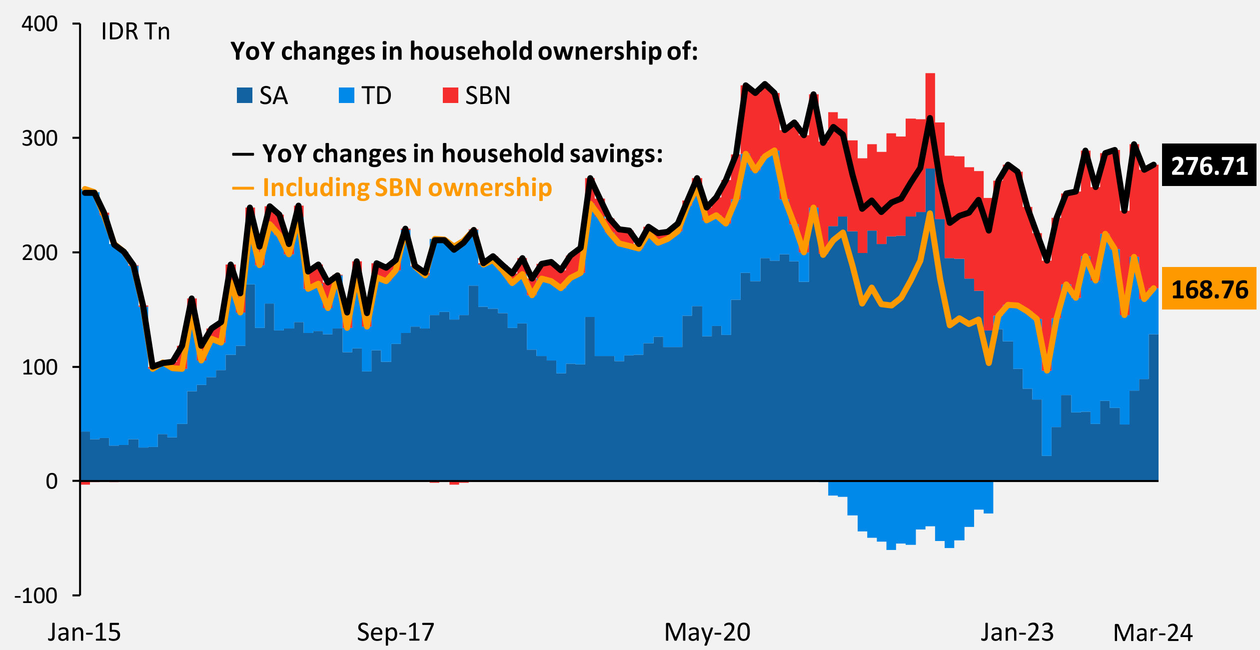


Chart 4

Yield seekers

Retail investors are flocking to the SBN market in search of higher yields, leaving banks to compete over a tightening pool of liquidity



Economic Calendar

		Actual	Previous	Forecast*
8 Mei 2024				
ID	**Foreign Exchange Reserves (USD Bn)**	**136.2**	**140.4**	**138.0**
9 Mei 2024				
ID	Motorbike Sales YoY, %	18.3	-7.8	-
13 Mei 2024				
ID	Consumer Confidence	127.7	123.8	123.1
14 Mei 2024				
ID	Retail Sales YoY, %	9.3%	6.4%	-
ID	Car Sales YoY, %	-17.5%	-26.2	-
15 Mei 2024				
ID	**Balance of Trade (USD Bn)**	**3.56**	**4.58**	**1.7**
US	Inflation rate YoY, %	3.4	3.5	3.5
17 Mei 2024				
EU	Inflation rate YoY, %	2.4	2.4	2.4
21 Mei 2024				
ID	**Current Account, (USD Bn)**	**-2.2**	**-1.1**	**-1.9**
22 Mei 2024				
ID	**Interest Rate Decision**	**6.25**	**6.25**	**6.25**
ID	Loan Growth YoY	13.09	12.4	-
3 June 2024				
ID	**Inflation rate YoY,** %		**3.00**	**2.94**
ID	S&P Global Manufacturing PMI		52.9	52.2
CN	Caixin Manufacturing PMI		51.4	-
US	ISM Manufacturing PMI		49.2	-
4 June 2024				
US	JOLTs Job Openings (Mn)		8.49	8.40
7 June 2024				
ID	**Foreign Exchange Reserves (USD Bn)**		**136.2**	**-**
CN	Balance of Trade (USD Bn)		72.3	-
US	Non-Farm Payroll, (Th)		175	151
US	Unemployment Rate, %		3.9	-
12 June 2024				
CN	Inflation rate YoY, %		0.3	-
US	Inflation rate YoY, %		3.4	-
13 June 2024				
US	**Fed Interest Rate Decision, %**		**5.5**	**5.5**

*Forecasts of some indicators are simply based on market consensus
Bold indicates indicators covered by the BCA Monthly Economic Briefing repor

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Jul-23	2.10
UK	5.25	Aug-23	2.95
EU	4.50	Jul-23	2.10
Japan	-0.10	Jan-16	-2.60
China (lending)	2.50	Aug-23	4.05
Korea	3.50	Jan-23	0.60
India	6.50	Feb-23	1.67
Indonesia	6.25	Apr-24	3.25

Money Mkt Rates	22-May	-1 mth	Chg (bps)
SPN (1M)	5.88	5.80	7.6
SUN (10Y)	6.86	6.98	-12.2
INDONIA (O/N, Rp)	6.11	5.77	34.1
JIBOR 1M (Rp)	6.90	6.65	25.0

Bank Rates (Rp)	Feb	Jan	Chg (bps)
Lending (WC)	8.84	8.87	-3.03
Deposit 1M	4.62	4.68	-5.80
Savings	0.67	0.68	-0.11

Currency/USD	22-May	-1 mth	Chg (%)
UK Pound	0.786	0.808	2.81
Euro	0.924	0.938	1.57
Japanese Yen	156.8	154.6	-1.38
Chinese RMB	7.241	7.239	-0.03
Indonesia Rupiah	15,993	16,255	1.64

Capital Mkt	22-May	-1 mth	Chg (%)
JCI	7,222.4	7,087.3	1.91
DJIA	39,671.0	37,986.4	4.43
FTSE	8,370.3	7,895.9	6.01
Nikkei 225	38,617.1	37,068.4	4.18
Hang Seng	19,195.6	16,224.1	18.32

Foreign portfolio ownership (Rp Tn)	Apr	Mar	Chg (Rp Tn)
Stock	3,294.9	3,226.6	68.31
Govt. Bond	791.0	810.7	-19.68
Corp. Bond	8.4	9.4	-0.97

Trade & Commodities	22-May	-1 mth	Chg (%)
Baltic Dry Index	1,804.0	1,919.0	-6.0
S&P GSCI Index	583.2	590.3	-1.2
Oil (Brent, $/brl)	81.9	87.3	-6.2
Coal ($/MT)	143.0	146.3	-2.3
Gas ($/MMBtu)	2.51	1.43	75.5
Gold ($/oz.)	2,378.9	2,391.9	-0.5
Copper ($/MT)	10,295.2	9,797.2	5.1
Nickel ($/MT)	20,101.0	19,161.2	4.9
CPO ($/MT)	836.0	857.0	-2.4
Rubber ($/kg)	1.69	1.61	5.0

External Sector	Apr	Mar	Chg (%)
Export ($ bn)	19.62	22.54	-12.97
Import ($ bn)	16.07	17.96	-10.55
Trade bal. ($ bn)	3.55	4.58	-22.46
Central bank reserves ($ bn)*	136.2	140.4	-2.98

Prompt Indicators	Apr	Mar	Feb
Consumer confidence index (CCI)	127.7	123.8	123.1
Car sales (%YoY)	-17.5	-26.2	-18.8
Motorcycle sales (%YoY)	18.3	-7.8	-2.9

Manufacturing PMI	Apr	Mar	Chg (bps)
USA	50.0	51.9	-190
Eurozone	45.7	46.1	-40
Japan	49.6	48.2	140
China	51.4	51.1	30
Korea	49.4	49.8	-40
Indonesia	52.9	54.2	-130

Source: Bloomberg, BI, BPS

Notes:

*Data from an earlier period

For changes in currency: **Black indicates appreciation against USD, **Red** otherwise

***For PMI, **>50** indicates economic expansion, **<50** otherwise

Indonesia – Economic Indicators Projection

	2019	2020	2021	2022	2023	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0
GDP per Capita (US$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	3.2
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	6.50
USD/IDR Exchange Rate (end of the year)*	13,866	14,050	14,262	15,568	15,397	16.119
Trade Balance (US$ billion)	-3.2	21.7	35.3	54.5	37.0	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	-0.1	-0.5

*Estimation of the Rupiah's fundamental exchange rate

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