Recent development on growth prospect, stability & policy responses

Key Takeaways

- IMF cut global growth prospect by -40 bps while revised up world inflation outlook by +90 bps for FY22E.
- World economy is welcoming more rate hikes in the near future, but policy response may have a huge cost.
- US case : taming inflation through aggressive rate hikes could cause US economy to fall into recession.
- Recent IDR depreciation is associated with lowering real rates & US-Indo nominal rate differential. However continued trade balance surplus should favor IDR fundamentals and justified IDR depreciation is more manageable than peers.
- In spite of keeping interest rate unchanged, BI actually already set the course of policy normalization through raising banking RR and selling GB in secondary market.
- BI policy responses have been focused on influencing banks balance sheet to control the volume of money as well as risk management.
- In addition, to reduce currency volatility and promoting stability, BI plans to sell GB in the secondary market, creating a more attractive valuation that could invite capital inflows.

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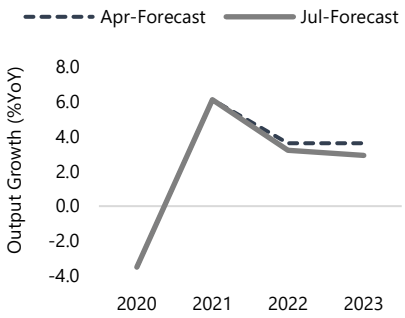
IMF WEO Jul-22 : bleak outlook awaits

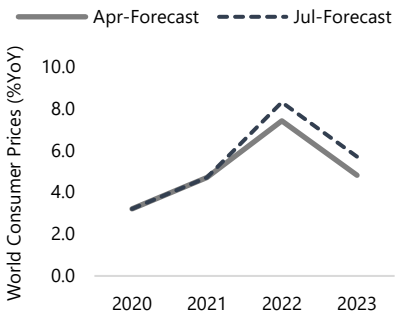
With the upside risk of inflationary pressure stemming on world's economy, global growth prospect is revised down. Recently, on its flagship report : World Economic Output (WEO) Jul-22 Edition, IMF cut FY22E global/AEs/EMDEs GDP growth outlook by -40/-80/-20 bps from previous projection to 3.2%/2.5%/3.6%. On the other hand, IMF raised its world's/AEs/EMDEs inflation rate forecast by +90/+90/+80 bps to 8.3%/6.6%/9.5% for FY22E. The slump in output along with increasing consumer prices have reminded us on a stagflation period nearly 5 decades ago which we think to remain dictating financial assets behavior for some time to come.

Exhibit 1. Global stagflation risk haunting

Global growth is revised down...



...yet inflation outlook is is revised up



Period	World	AEs	EMDEs
2020	-3.5	-4.5	-2.0
2021	6.1	5.2	6.8
2022	3.2	2.5	3.6
2023	2.9	1.4	3.9

Period	World	AEs	EMDEs
2020	3.2	0.7	5.2
2021	4.7	3.1	5.9
2022	8.3	6.6	9.5
2023	5.7	3.3	7.3

Sources : IMF World Economic Outlook, MNCS Research

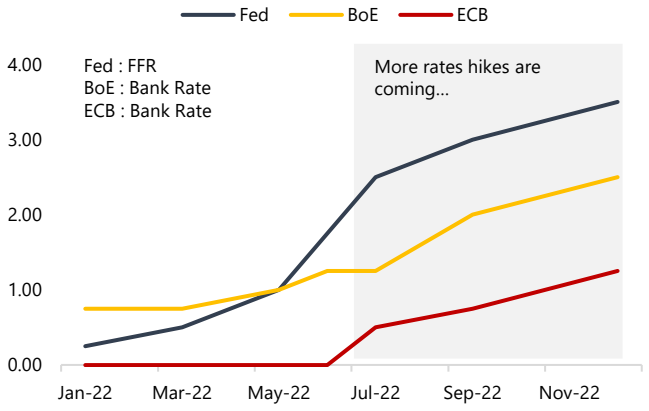
Aggressive policy response to bring back stability seems to have a huge cost

To contain the pressure from rising consumer prices, CBs in AEs, particularly Fed, BoE, & ECB have been aggressively tightening so far. First, they began with tapering to normalize liquidity in the financial system, and now they tighten further with an interest rate hikes. Fed has raised FFR by +150 bps YTD, while BoE increased +50 bps YTD. However, BoE has started its tightening cycle since Dec-21 and becoming the first G4 CB to pull the trigger. Meanwhile, on the other hand, ECB made the last move. On Jul-22 policy meeting, ECB hiked its main refinancing rate by +50 bps, higher than consensus estimate of +25 bps and ending their ZLB era.

Now, market participants keep their eyes on Jul-22 FOMC meeting this week. Based on CME Fed Watch tools, there is a 75% probability of Fed to raise FFR by +75 bps while 25% expect +100 bps hike. Note that market expectation on +100 bps hike is gradually declining and reaching the highest level post US Jun-22 CPI data release. We foresee US CB to raise another +75 bps bringing the target rate at 225-250 bps this time in-line with majority forecast as Fed's policymakers said that too aggressive tightening would only cause more harms than goods to economy and triggering financial distress.

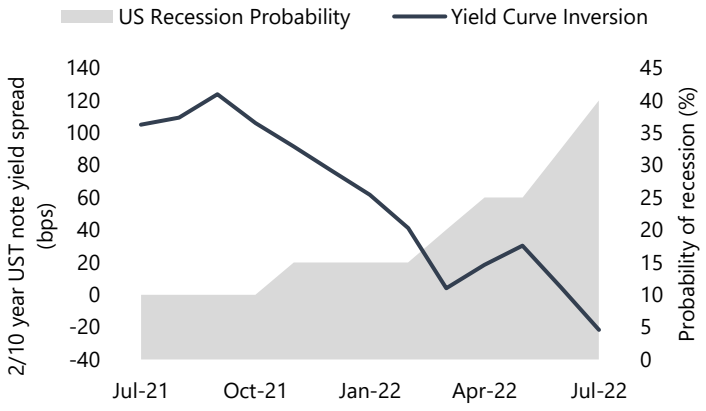
In spite of Fed's active communication to bring clear guidance on future policy rates and affirmation that monetary policy is not aimed to hurt economy, markets reacted negatively. Spread between shorter & longer term (2/10 year UST note) turned negative indicating a yield curve inversion as a leading indicator that signal US economy to fall into a recession. Along with the yield curve inversion that began in Apr-22, US probability of recession has risen from 15% in Mar-22 to 40% on Jul-22.

Exhibit 2. Welcoming more rate hikes to come



Sources : CME Fed Watch, Trading Economics, MNCS Research

Exhibit 3. US yield curve inversion & recession probability

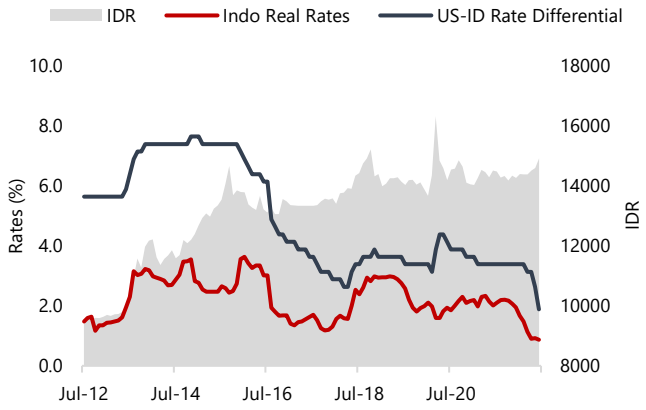


Sources : Bloomberg, MNCS Research

BI's reluctancy to raise policy rate put pressure on IDR (?)

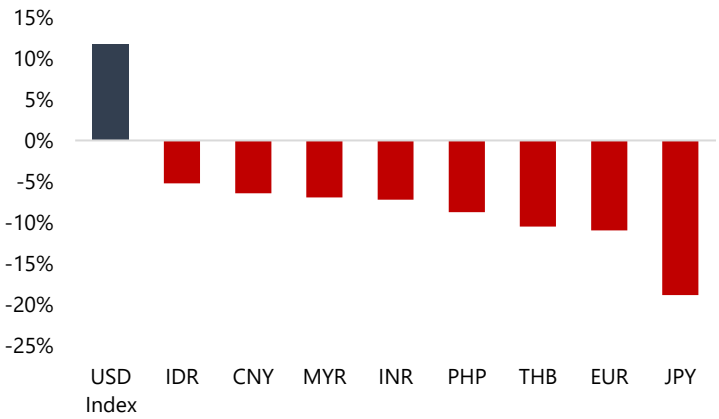
Some argue that recent IDR depreciation is due to lower real rates and US-Indo nominal rates as : 1) Fed aggressively tighten; 2) rising domestic inflation and 3) BI kept 7-day reverse repo rate unchanged at the lowest level in history. Indeed, interest rate parity also affect IDR fundamentals, yet, we need to look at a broader sense of currency valuation, as rates differential is not solely indicator to depict the value of a currency against others. It is also worth noting that 1) 26-month straight trade balance surplus; 2) current account surplus 3) inflows to equity market and 4) lower ownership of foreign investors in GB should also favor IDR fundamentals. Such condition also justify that IDR depreciation is considerably manageable compared to other EM currencies, let alone USD index also strengthening to a two-decade high levels.

Exhibit 4. IDR movement vs real rates & US-Indo rate diff



Sources : Bloomberg, MNCS Research

Exhibit 5. YTD currencies performance against USD



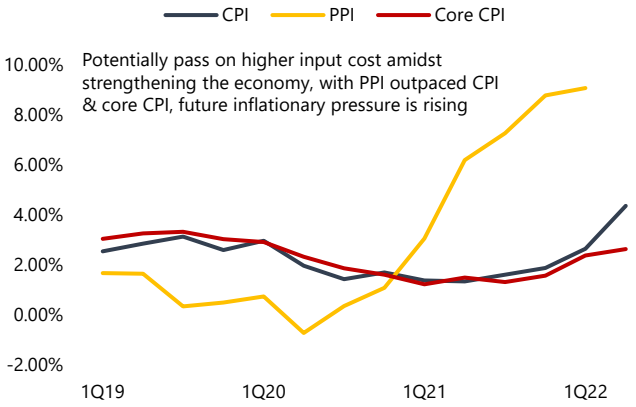
Sources : Bloomberg, MNCS Research

What we need to understand from BI policy responses

Indeed, BI has been reluctant so far to raise as core inflation remains in-line with ITF at 2-4% albeit the jump in headline inflation. However, worth noting that BI actually already started to adjust monetary policy through raising statutory reserves. Note that BI raised banking reserves requirement from 3.5% by the end of Dec-21 to 9% in Sep-22. We estimated, the increase in reserves requirement would reduce banking liquidity by IDR234-315tn. Such number is expected would not affect banks capability to perform its intermediary function as LDR remains below 80% and long term average level of 88%. Furthermore, BI also announced its plan to sell short term government bond in the secondary market. Through reserves requirement hikes and selling government bond, BI actually try to control the volume of money, particularly by influencing banks balance sheet. The impact channel would be indirectly. First, banks would place their excess liquidity on a safer instrument making a financial system management remaining prudent as government provide lower risk compared to loan. On a macro level this would also limit money supply (M2) growth that could trigger higher inflation if it keeps flowing to the real sectors.

Secondly, by selling government bond, it could push up yield and making valuation becoming more attractive and potentially inviting inflows to support IDR stability. In addition, rising yield would also help BI to ensure market keep functioning properly while helping monetary authority to give forward guidance on interest rate corridor. Such condition reflects that BI still have policy room before finally raising interest rate to complete its pre-emptive strategy to anchor inflation. We expect BI to raise 7-day reverse repo anytime soon by early on Aug/Sep-22.

Exhibit 6. Urgency of pre-emptive policy to anchor inflation



Sources : Statistics Indonesia, MNCS Research

Exhibit 5. Need more attractive valuation from GB market

Sources : Bloomberg, MNCS Research

MNC Research Industry Ratings Guidance

OVERWEIGHT: Stock's total return is estimated to be above the average total return of our industry coverage universe over next 6-12 months

NEUTRAL: Stock's total return is estimated to be in line with the average total return of our industry coverage universe over next 6-12 months

UNDERWEIGHT: Stock's total return is estimated to be below the average total return of our industry coverage universe over next 6-12 months

MNC Research Investment Ratings Guidance

BUY : Share price may exceed 10% over the next 12 months

HOLD : Share price may fall within the range of +/- 10% of the next 12 months

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