BNY MELLON
iFlow
MACRO MORNING BRIEFING

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APAC On Alert To Safeguard FX Stability

Bank Indonesia (BI) on Wednesday delivered a surprise 25bp rate hike (BI rate now 6.25%). Governor Warjiyo said the hike was to strengthen the stability of the rupiah against geopolitical risks and serve as a pre-emptive move to prevent imported inflation. The unexpected move resembled action taken in October 2023 to counter IDR depreciation pressure from a reappraisal of Federal Reserve rate expectations, rising geopolitical risks, a correction in equities, and accelerated outflows from Indonesia fixed income.

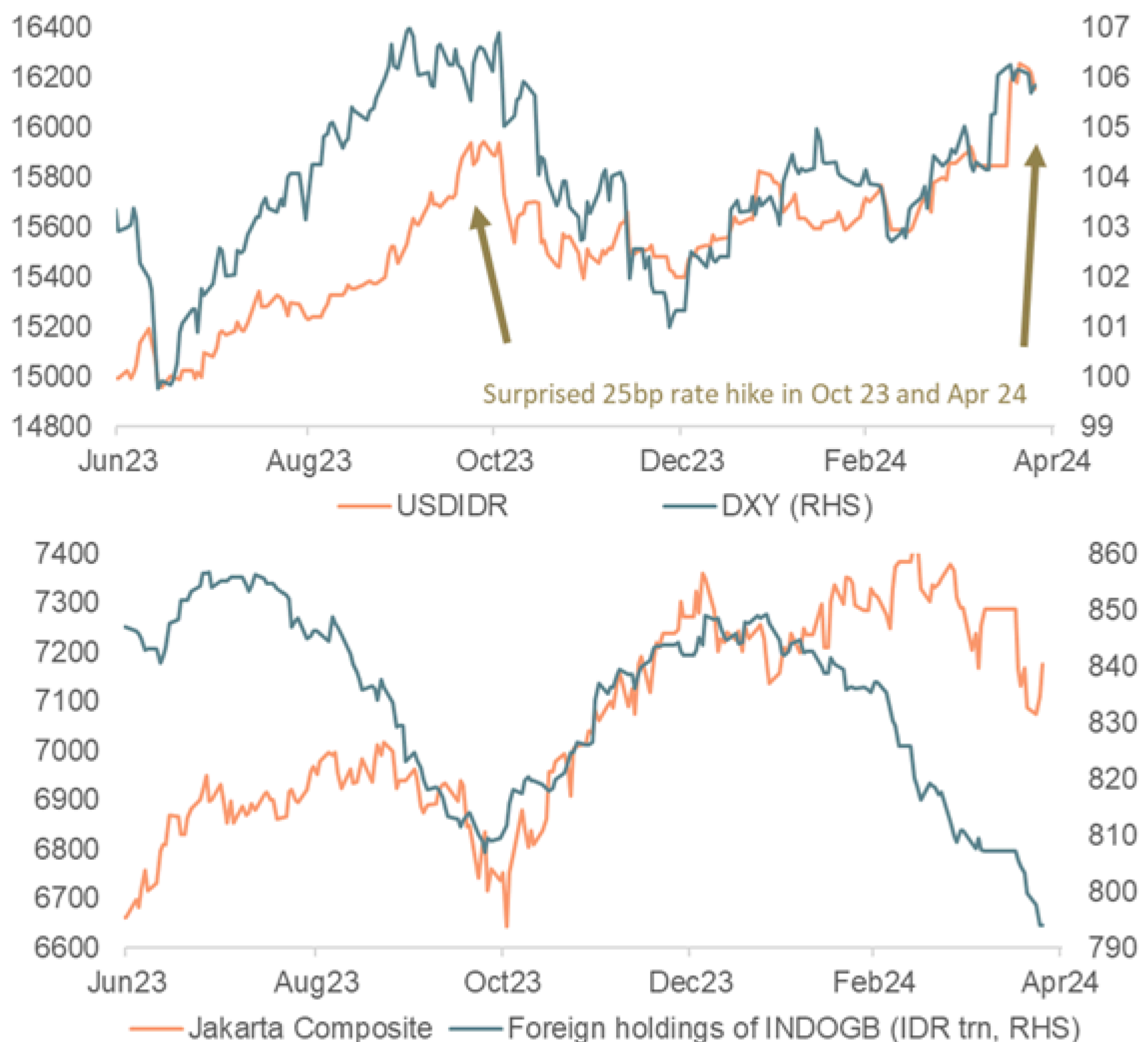
Indonesia's assets, along with others in wider APAC, have been under increasing pressure over the past few weeks. Rising global yields have apparently motivated investors to trim Indonesian sovereign bond (INDOGB) exposure, despite a stable valuation. The 10y INDOGB-US Treasury bond spread has traded in a 220-250bp range for most of the year. The magnitude of INDOGB selling in the recent "outflows" episode (February-April) totals IDR 55trn, exceeding the IDR 50trn net sold between August and October last year.

In reaction to the rate hike, the Jakarta Composite Index was down nearly 5% from the March high at one point, before going on to settle around -1.6% month-to-date. USDIDR broke above 16000 and hit year-to-date highs of 16255. The fast-paced rupiah depreciation so far this month measures nearly 2%, leaving it about 5% lower year-to-date. This has surely brought back unpleasant memories of 2022, when a 4% IDR selloff in H1 was followed by more losses that left it down 10% that year.

BI kept its key domestic forecasts, so we view the rate hike, just as in October 2023, primarily geared towards maintaining rupiah stability, and therefore overall financial stability. BI 2024 forecasts: GDP growth 4.7%-5.5%, current account deficit -0.1% to -0.9% of GDP, headline inflation staying in 2.5% ±1% target range, loan growth at 10-12%.

We caution against extrapolating currency depreciation as inevitably leading to economic stress and severe capital outflows. Vigilance is, however, warranted to guard against any untoward moves. For now, we think the weakness in APAC currencies is more a function of different monetary policies than reflective of any worsening of regional macro fundamentals.

Exhibit #1: BI Delivers Pre-emptive Hike To Support Rupiah



Source: BNY Mellon Markets, Bloomberg L.P.

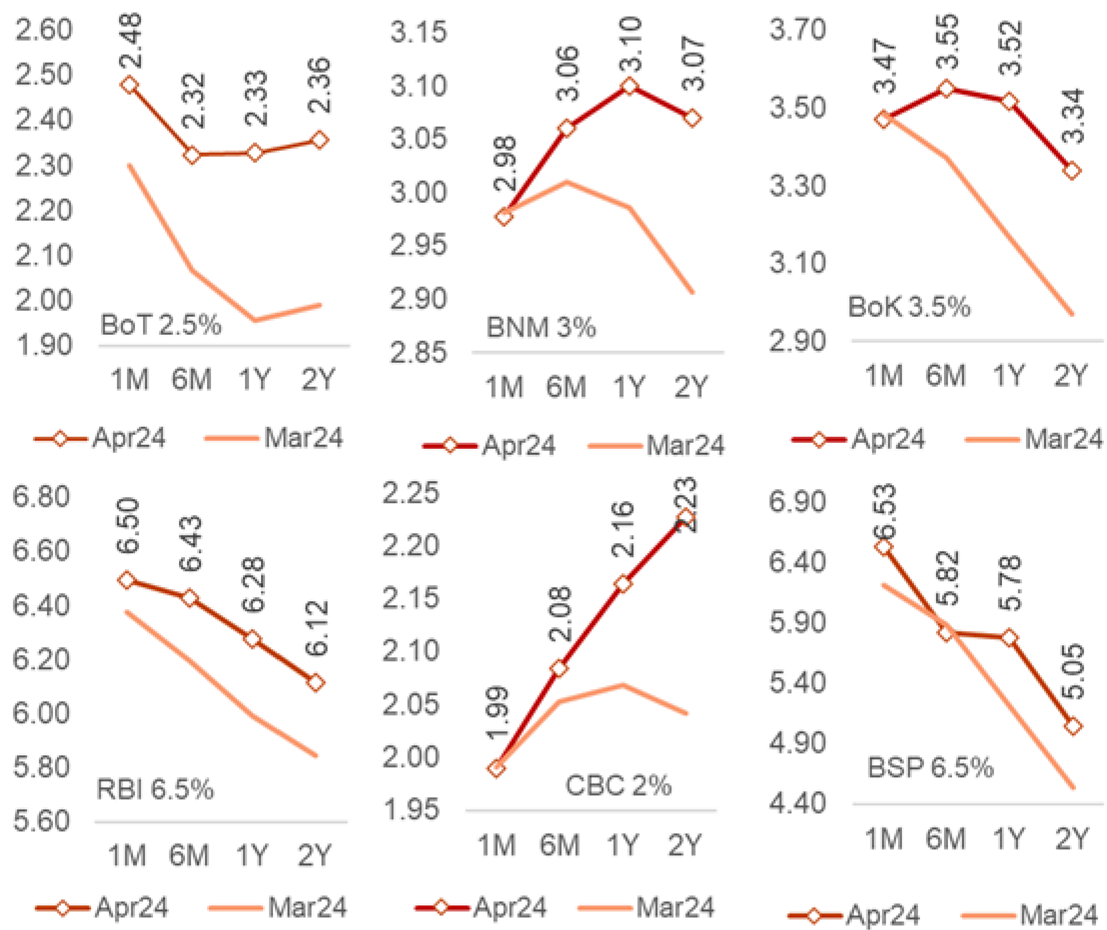
Is an interest rate hike an effective way to thwart depreciation pressure on a currency? There is no definitive answer, but a hike does make the subject currency more appealing from a perspective of real interest rates, assuming contained inflation expectations. Given overall-low inflation in APAC, excessively positive real interest rates might have knock-on effects on credit and growth, potentially leading to additional corporate refinancing stress.

As shown in exhibit #2 below, the market over the past month had been trimming expectations for interest-rate cuts – but not pricing any hikes. Unless inflation were to reverse course in the coming months, a scenario on which we place a low probability, we don't see interest rates resorted to as tools of choice. Intervention and so-called smoothing activities

might be more appropriate instead; those methods offer greater flexibility, too.

Using total reserves in months of imports as a measure of a country's ability to withstand a sudden decline in foreign inflows, export earnings or, worse, a financial crisis, APAC countries look in a comfortable place. For example, the Philippines, Indonesia and Thailand had an import cover ratio over 9 as of March. Malaysia has the lowest ratio, 6.7 months.

Exhibit #2: APAC Interest-Rate Expectations (OIS)

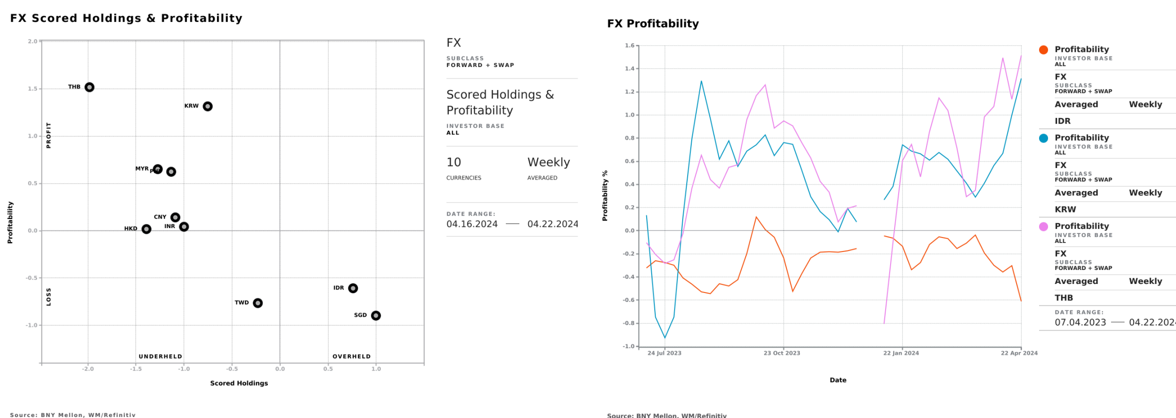


Source: BNY Mellon Markets, Bloomberg L.P.

A resumption of USD outflows per iFlow over the past week worked in favor of APAC currencies; LatAm and CEEMEA currencies had light outflows as well, especially MXN and PLN. MYR enjoyed the most inflows, weekly average scored flows of +0.72. CNY posted mild net inflows, further narrowing its underheld condition. TWD, by contrast, suffered outflows alongside selling in equities. There has been noticeable divergence in APAC scored holdings over the past few weeks: INR and PHP scored holdings dropping substantially to below -1; TWD and THB scored holdings improving the most. TWD holdings, at -0.23, are approaching neutral, compared to -1.30 at the beginning of the year. TWD is the only APAC currency underheld and unprofitable. Profitability in THB and KRW jumped. IDR's fall into deeper losses raises the prospect of short covering or position unwinding.

In APAC assets, buying momentum in South Korea equities continued. Buy flows in China equities the week prior proved short-lived, however, as investors were back in sell mode last week. Highlights in APAC bonds: large outflows from Indonesia sovereigns and renewed interest in China sovereigns after a long period of outflows (since late January 2024).

Exhibit #3: Overheld IDR Losses Deepen; THB & KRW Profitability Higher



Source: BNY Mellon Markets, Bloomberg L.P.

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