

Balance of payments:

No glory in FA surplus, no shame in CA deficits

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Executive Summary

- Indonesia recorded a USD 8.62 Bn balance of payments (BoP) surplus in Q4 2023, a significant recovery from the USD 1.10 deficits in the previous quarter thanks to the sharp increase in the financial account (FA).
- Foreign investors' appetite for Indonesian financial assets and the bottoming external debt deleveraging trend explains the increase in FA. However, this trend may not extend to the upcoming period given the moderating global rate cuts expectation.
- The deepening services account deficit and continuous increase in dividend payments tipped Indonesia's current account (CA) to another deficit despite the increase in goods account surplus. The widening CA deficit could be interpreted as a sign of the still-vibrant Indonesian economy amidst the slowing global demand.

- The writings may have been on the wall for some time, but the scale of Indonesia's balance of payment surplus in Q4 2023 may have come as a pleasant surprise to many. Indonesia recorded a USD 8.62 Bn (2.63% GDP) in Q4 2023, almost doubling the USD 4.73 Bn recorded in the same quarter last year. This significant BoP surplus explains the USD 13.24 Bn increase in Bank Indonesia's FX reserves position between October and December 2023, equipping BI with ample dry powders should the urgency come for the central bank to stabilise the Rupiah in the open market in months ahead.
- The bulk of Indonesia's Q4 2024 BoP surplus comes from the financial account, which recorded a surplus of USD 8.70 Bn (2.63% GDP) in FY 2023 – much higher than the USD -9.16 Bn deficits recorded in the previous year. **The deficit-to-surplus flip is particularly striking in the portfolio investments account.** The loosened financial condition in the US (which has since reversed) encouraged foreign investors to flock to the Indonesian financial market in the previous quarter, as indicated by the USD 6.10 Bn in foreign capital inflows recorded in the BoP data.
- This watershed of foreign capital inflows, however, is not limited to the SBN market. Atypical of the historical data, **most foreign inflows into the domestic bond market in the past quarter were recorded on BI's side of the ledger (USD 3.68 Bn vs. USD 2.41 of SBN), signalling investors' preference for short-dated SVBI/SUVBI rather than longer-dated SBN.** This financial account data, then, confirms our suspicion of FX liquidity sitting on the sideline, as foreign investors continue to see a potential for alpha in the Indonesian financial market but are discouraged by the build-up of short-term uncertainty typical of a pre-election period.

- Another driver behind the surge in financial account surpluses is the USD 1.55 Bn increase in the other investments account. Indeed, **the balance sheet deleveraging trend appears to be winding down in Indonesia, as both the public and private sectors starting to increase their exposure to external debt in Q4 2023.** The loosening financial condition in the US during the quarter again offers a likely explanation for the scenario, although the increase in the private sector's other investment liabilities is driven more by lower debt repayment rather than higher utilisation of non-rupiah loan facilities.
 - It is quite clear, then, that the sizable increase in Indonesia's FA balance is more of a product of the economy's increasing exposure to the global financial market, thanks to the improving demand for riskier and higher-yielding assets amidst the loosening global financial conditions. Alas, **this dynamic may not hold on for too long, given that the pendulum of global interest rate expectation is swinging in the other direction now.**
 - While the expectation remains for the Fed to cut its policy rate by 75-100bps in 2024, minutes from the January 2024 FOMC meeting show that many FOMC members remain wary about the prospect of cutting rates too soon or deep, lest replaying the double-peak inflation of the 1970s. A lower-than-expected rate cuts campaign may thus negatively affect market sentiments, potentially leading to the reversal of foreign capital hitherto flowing to the domestic financial market.
 - The risk of another round of financial conditions tightening in the US (and globally) may also lead to the domestic economy being priced out from external financing, impacting Indonesia's foreign capital inflow outlook not only through the portfolio but also via other investments (external loan) channels. The ongoing slowdown in the global economy, particularly in China, could also potentially hinder the influx of foreign capital into Indonesia through the FDI channel. Consequently, **BI may face a more challenging period in stabilising the Rupiah's value in the months ahead, although the ample FX reserves may provide some leeway for the central bank to maintain its current interest rate policy guidelines.**
- "The moderating Fed funds rate cuts expectation and the slowing global economy may limit foreign capital inflows to Indonesia in the upcoming period".*
- Alas, the Q4 2023 current account balance seems to be antithetical to the bountiful surplus in the FA balance. Despite the 11.52% QoQ increase in surplus on the goods account, the Indonesian economy recorded CA deficits to the tune of USD 1.29 Bn (-0.40% GDP) in Q4 2023, a slightly deeper deficit than the previous quarter.
 - Given the welcome increase in the goods account surplus, it might be worthwhile to start our discussion on the Q4 2023 CA balance from the goods account. The Indonesian economy may benefit from an improvement in its terms-of-trade in November – December 2023, but this improvement only came after an abrupt decline in the previous month. Hence, **rather than improving export prices, the higher goods account surplus should be attributed to the higher volume of exports during the quarter**, most notably to China whose manufacturing sectors continue to be in an expansionary mode.
 - The question, then, is whether this volume-driven (or perhaps, China-driven) goods surplus will continue in the upcoming period. While multiple data still point to an expansion in China's

industrial output, the intensifying production activities appear to be concentrated in the mid-stream sectors (such as metal smelting), headbutting the expansion in Indonesia's domestic metal processing sector. It is not surprising, then, that Indonesia's HS 75 (nickel and derivatives) export volume is on a downward trend at present, limiting the export volume expansion to mineral fuels such as coal.

- Indonesia's volume-driven goods surplus model also appears to weigh heavily on the service account. **Higher export volumes increase the domestic demand for shipping services, leading to the USD 2.03 Bn deficits in the goods transport services account.** Falling coal export volume to China may limit Indonesia's demand for shipping in the current period, although the surging shipping prices following the disrupted global shipping lines mean that a significant drop in the deficit remains unlikely.

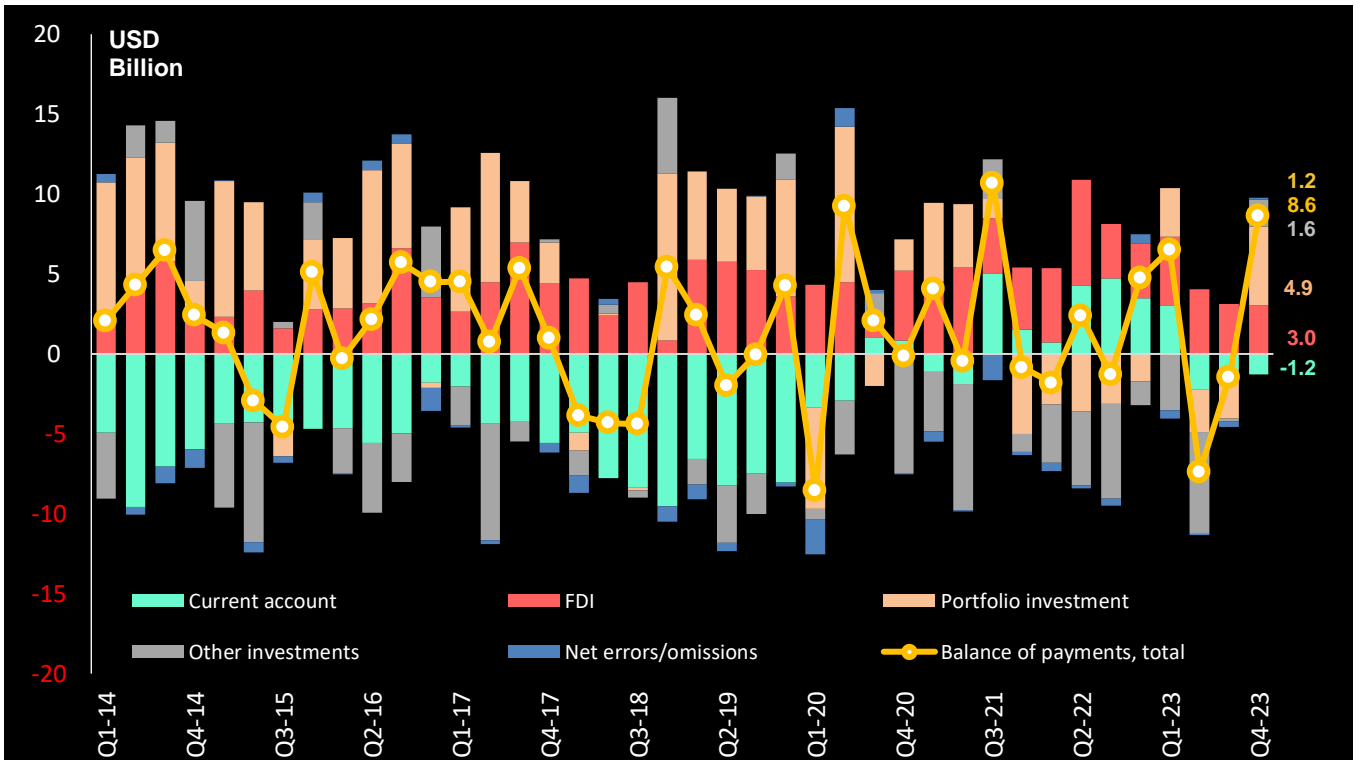
"The widening CA deficit reflects Indonesia's success in attracting foreign businesses to invest while also indicating the still-robust prospect for aggregate demand growth in the domestic economy".

- The widening deficit in Indonesia's service account in Q4 2023 is made worse by the drop in travel exports (tourism). The number of foreign tourist arrivals (1.144 Mn in December 2023) may continue to move closer to its pre-pandemic peak. However, the number of deep-pocketed tourists (typically from East Asian countries) seems to be declining. The general

economic slowdown in the region (Japan's technical recession and China's slowing growth) may thus limit the prospect of East Asian tourists flocking to Indonesian beaches anytime soon, meaning that Indonesia may not look at the tourism sector to halt the widening deficit in its services account.

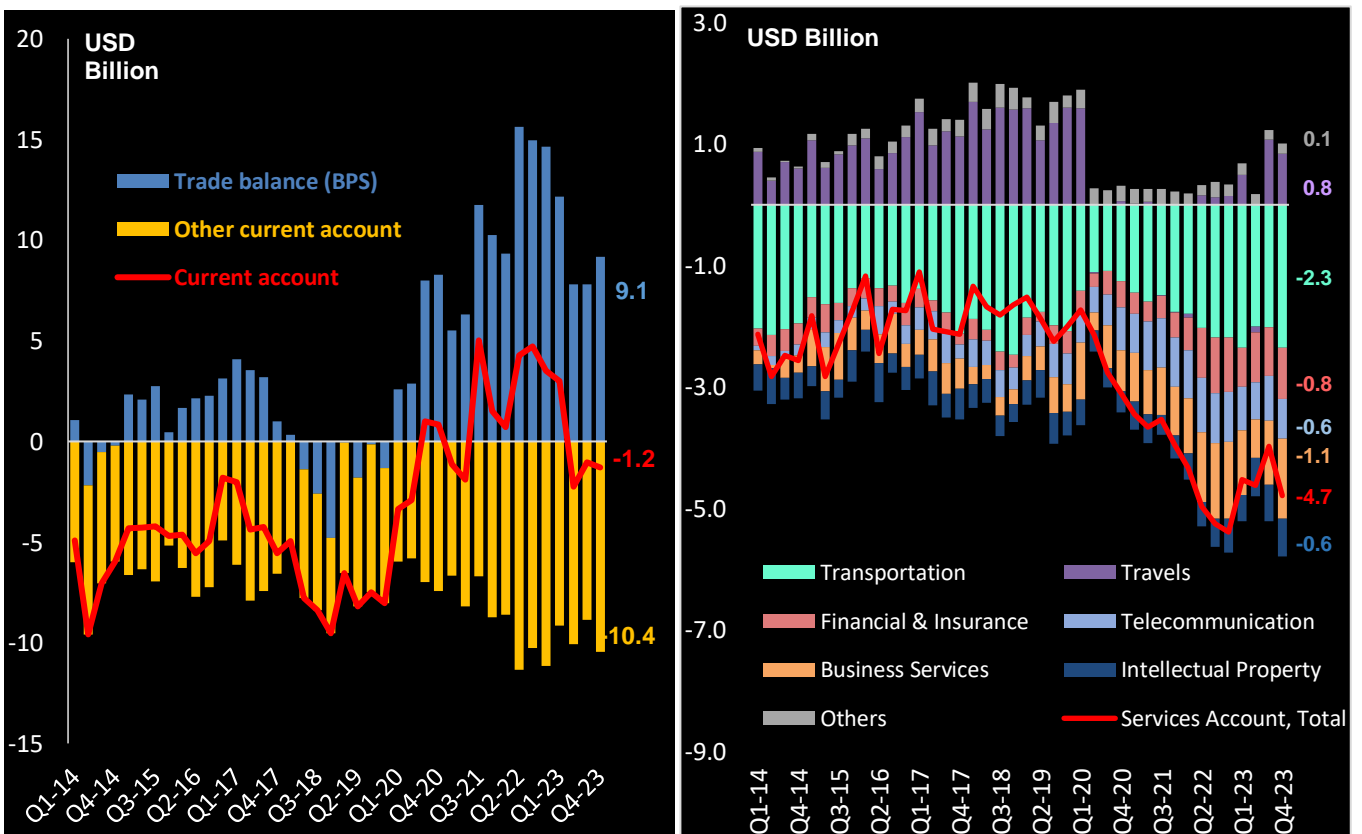
- It is the primary income account, however, that dealt the final blow to Indonesia's CA balance. Despite the lower net interest payments during the quarter, dividend payments on direct investments are rising, totalling USD 6.39 Bn in Q4 2023. **The more significant growth in dividend payment (relative to exports) indicates that a sizable chunk of the revenue is still booked domestically and then shipped abroad, translating to a net loss in Indonesia's CA book.**
- Considering the arguments presented above, we maintain our expectation that the CA deficit trend in Indonesia will worsen before showing signs of improvement. However, it is important to note that the continued deficit trend, now spanning three quarters, does not necessarily indicate weakness in the economy.
- For instance, the deepening goods transport services may be more palatable rather than a sharp decline in Indonesia's export volumes. The limited -1.64% YoY decline in imports also points to a stable domestic aggregate demand despite the global slowdown. Additionally, the continuous increase in the dividend repayment bills could also indicate Indonesia's success in attracting foreign companies to invest in the economy. Therefore, **the projected deepening of CA deficits in FY 2024 could be viewed as a sign of a still-humming economic growth engine**, although whether this spending power will be directed towards more productive or consumptive means remains to be seen throughout the year.

Chart 1. Surging foreign capital inflows tipped Indonesia's BoP to a surplus in Q4 2023 despite the deepening current account deficit.



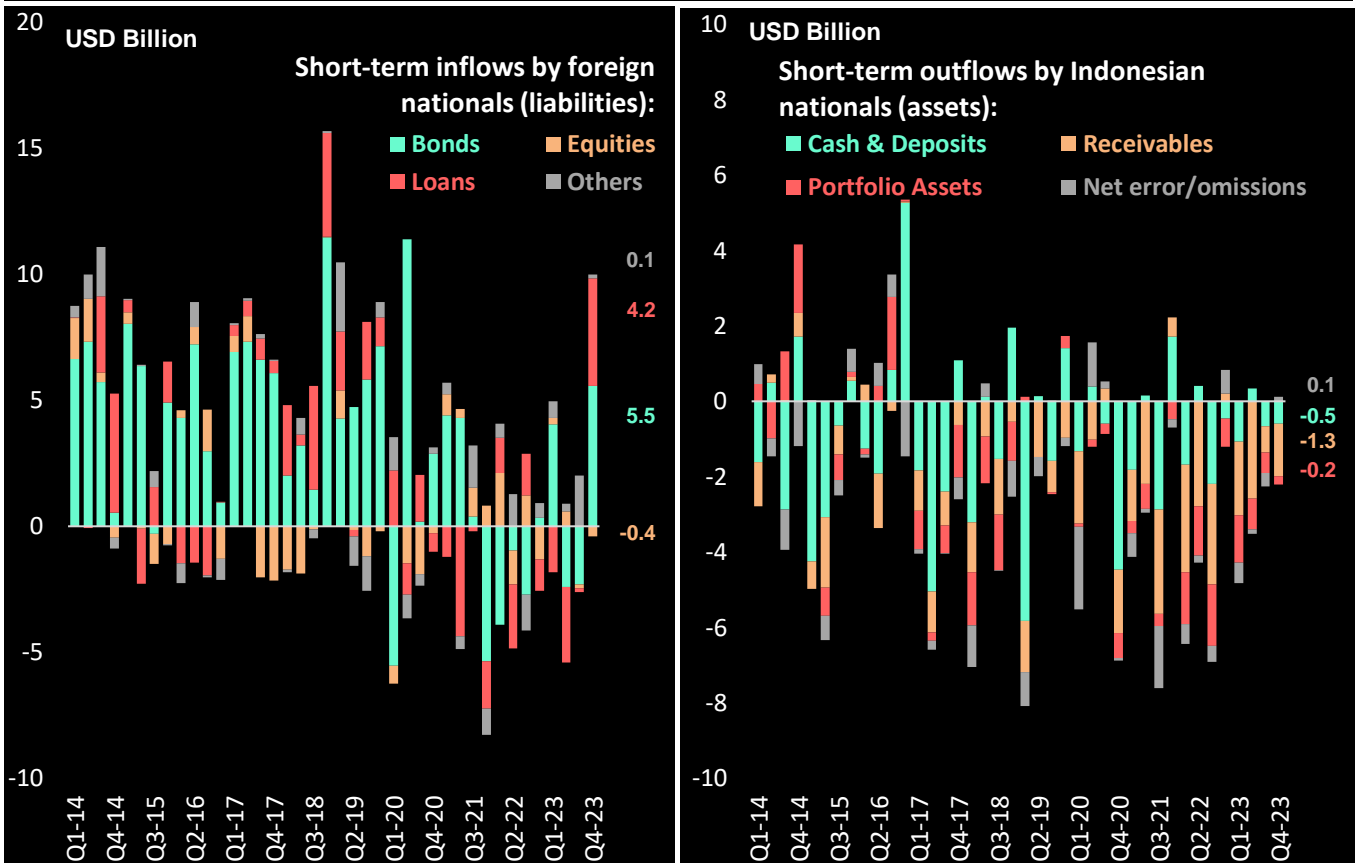
Source: Bank Indonesia

Panel 1. Indonesia's volume-driven trade surplus is a boon to the goods account but puts a burden on the service account.



Source: Bank Indonesia, BPS

Panel 2. The loosening financial condition in the US translates to a significant foreign capital inflow in Q4 2023



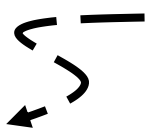
Source: Bank Indonesia

Selected Macroeconomic Indicators

Table 1. Balance of payments (current USD Million)

	Q4-22	Q1-23	Q2-23	Q3-24	Q4-23	2020	2021	2022	2023
CURRENT ACCOUNT	3,499	3,009	-2,247	-1,039	-1,290	-4,433	3,511	13,215	-1,567
<i>(as % of GDP)</i>	<i>1.06</i>	<i>0.90</i>	<i>-0.64</i>	<i>-0.30</i>	<i>5.90</i>	<i>-1.72</i>	<i>1.09</i>	<i>3.95</i>	<i>-0.41</i>
A. Goods	16,951	14,718	10,133	10,162	11,333	28,301	43,806	62,672	46,347
- Non-Oil/Gas	22,958	19,013	15,164	15,868	17,588	29,954	57,804	89,773	67,633
- Oil/Gas	-5,415	-3,959	-4,547	-5,284	-5,869	-5,386	-12,965	-24,777	-19,658
B. Services	-5,391	-4,526	-4,624	-3,981	-4,788	-9,755	-14,599	-19,957	-17,919
C. Income	-9,634	-8,629	-9,183	-8,472	-9,075	-28,911	-31,961	-35,303	-35,360
D. Current Transfers	1,573	1,447	1,427	1,252	1,239	5,932	6,264	5,803	5,365
CAPITAL TRANSACTIONS	428.64	2.78	4.86	8.40	27.25	36.91	80.15	476.19	43.28
FINANCIAL TRANSACTIONS	177	4,037	-5,018	-74	9,757	7,884	12,492	-9,157	8,703
A. Direct Investment	3,383	4,321	4,053	3,129	3,054	14,142	17,286	18,067	14,558
B. Portfolio Investment	-1,716	3,031	-2,629	-3,014	4,918	3,369	5,086	-11,631	2,307
C. Derivative Instruments	-10.90	204.92	-83.16	-53.21	98.74	17.73	332.71	48.36	167.29
D. Other Investment	-1,479	-3,520	-6,359	-136	1,686	-9,645	-10,212	-15,642	-8,330
NET ERRORS AND OMISSIONS	626.14	-531.74	-111.54	-357.73	123.18	-891.30	-2,622.30	-535.12	-877.82
BALANCE OF PAYMENT <i>(= change in BI international reserves)</i>	4,730	6,517	-7,372	-1,462	8,617	2,597	13,461	3,999	6,301

Source: Bank Indonesia



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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	5.50
USD/IDR Exchange Rate (end of year)**	13,866	14,050	14,262	15,568	15,397	16,037
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	-0.4	-0.5

** Estimation of Rupiah's fundamental exchange rate

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