

## FX Reserves:

# Slight rebound, challenges still ahead

Keely Julia Hasim  
Economist/Analyst

Barra Kukuh Mamia  
Senior Economist

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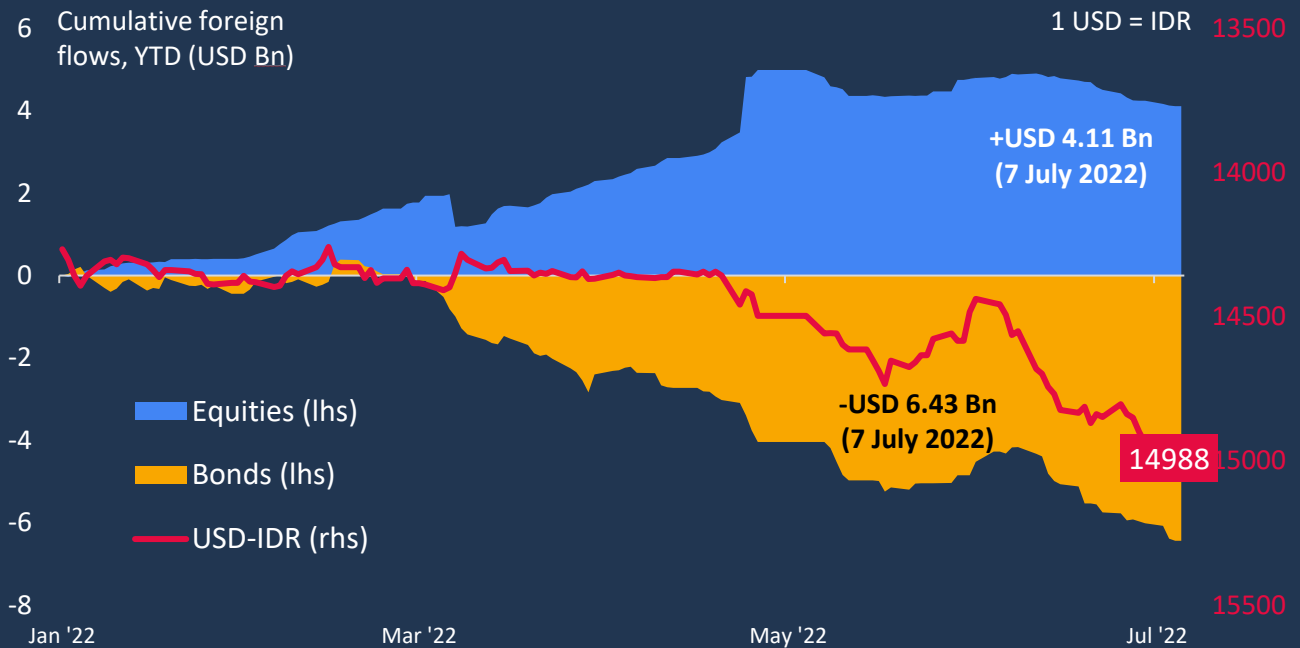
### Executive Summary

- Bank Indonesia's FX reserves stood at USD 136.4 Bn at the end of June 2022, a slight increase of USD 0.8 Bn from the previous month's figures. The increase in reserves however is a good sign, but it is a rather modest one given that the government's net global bond issuance totaled around USD 3.5 Bn during the month.
  - A tighter global liquidity environment, falling commodity prices, and slowing growth prospects have led to considerable capital outflows from both the Indonesian stock and bond markets.
  - In order to prevent further IDR depreciation, we expect that BI will raise the BI7DRR by 75-175 bps by the year-end, with the first hike likely to start this month.
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- Bank Indonesia's FX reserves stood at USD 136.4 Bn at the end of June 2022, a slight increase of USD 0.8 Bn from the previous month's figures. The increase in reserves however is a good sign, but it is a rather modest one given that the government's net global bond issuance totaled around USD 3.5 Bn during the month.
  - This discrepancy is understandable considering that there were considerable outflows from both the stock and bond markets, amounting to more than USD 1.5 Bn in total. This is not at all surprising considering that the Fed's aggressive monetary tightening have led to massive sell-offs in emerging market bonds. Unfortunately, this resolve to fight inflation is not going away any time soon as the Fed's latest minutes suggest that officials are much more concerned over inflation rather than recession. This means that the Indonesian bond markets is still at the mercy of perhaps two more 75 bps Fed rate hikes – with the market expecting a Fed Funds Rate of 3.3% by the end of this year.
  - Recent declines in PMIs and multiple other economic indicators across the world suggest that business activity appear to be slowing down – which in turn have suppressed demand (and prices) for industrial commodities such as copper, rubber, and CPO. Slowing growth prospects and especially the fall in commodities have led to outflows from the stock market (**Chart 1**) since the earnings prospects of some of Indonesia's top exporters in the first half of 2022 was what drew foreign investors to the Indonesian stock market in the first place.
  - To be sure, there are two silver linings to the decline in commodity prices. For one, the price of coal – one of Indonesia's major exports – has held up, due to strong demand as substitute

for oil and gas, the supplies of which remain highly uncertain despite their falling prices. In addition, Indonesia is also a net importer of oil, meaning that declining oil price lightens the government's subsidy burden. But we are not fully out of the woods, since (1) oil prices may quickly recover if the recent fall was in fact triggered by financial incidents, perhaps a wave of forced liquidations, rather than genuine improvements that relieve physical market tightness; and (2) weakening IDR also increases subsidy burden regardless of oil price.

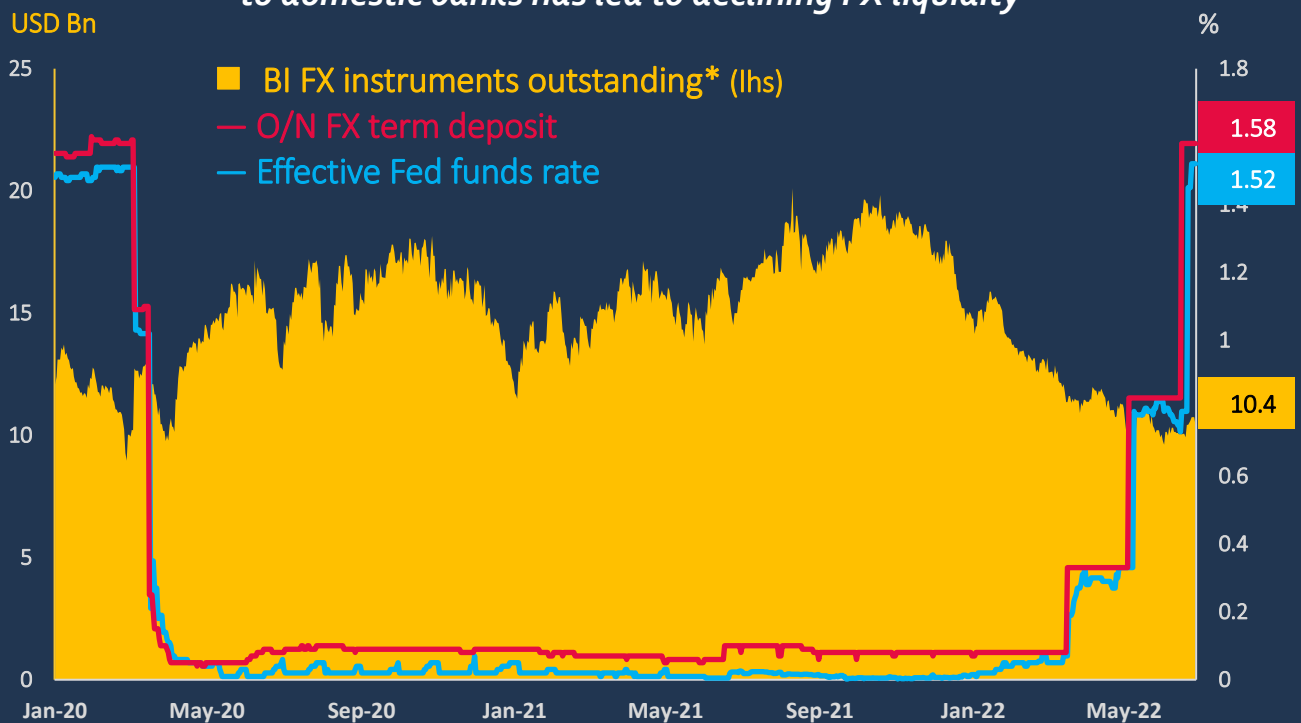
- We have mentioned a few times that expansive fiscal policy (subsidies) to fight inflation also necessitate tighter monetary policy, and this remains the case especially as USD/IDR flirts with the psychological barrier of 15,000. BI's earlier move to raise banks' reserve requirement ratio (RRR) is probably not the ideal tool to stanch this trend, even though it is an excellent one to curtail inflation and cool down loan growth. RRR hike works primarily by raising yields in the long-end of the curve, which should in theory attract inflows into government bonds. Unfortunately, the uncertainty over Fed policy and the overall investor aversion to EM assets seem to hinder this promise at the moment.
- The main tonic for IDR will have to be a raise on the short-end of the curve, i.e. policy rate. A substantial amount of Indonesia's export receipts is retained abroad, both due to (1) pre-existing arrangements, and (2) higher interest on FX deposits in foreign as opposed to domestic banks (**Chart 2**). These foreign banks have generally danced to the Fed's tune in raising interest rates, while local banks have not. As such, the policy rate hike would have to involve more than just the BI 7-Day Repo Rate (BI7DRR), but also the LPS rate – i.e. the maximum interest rate that is still covered by deposit insurance – especially for FX deposits. We reiterate our expectations that BI will raise the BI7DRR by 75-175 bps by the year-end, with the first hike likely to start this month.

**Chart 1. Aggressive Fed tightening have led to sizeable capital outflows from Indonesia**



Source: Bloomberg, BCA Research Team

**Chart 2. Higher interest on FX deposits in foreign as opposed to domestic banks has led to declining FX liquidity**



Source: St. Louis Fed, BI

## Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	6-Jul	-1 mth	Chg (%)
US	1.75	Jun-22	-6.85	Baltic Dry Index	2,043.0	2,633.0	-22.4
UK	1.25	Jun-22	-7.85	S&P GSCI Index	664.1	808.3	-17.8
EU	0.00	Mar-16	-8.60	Oil (Brent, \$/bbl)	100.7	119.7	-15.9
Japan	-0.10	Jan-16	-2.60	Coal (\$/MT)	397.0	376.5	5.5
China (lending)	4.35	Oct-15	2.25	Gas (\$/MMBtu)	5.65	8.34	-32.3
Korea	1.75	May-22	-4.25	Gold (\$/oz.)	1,738.9	1,851.2	-6.1
India	4.90	Jun-22	-2.14	Copper (\$/MT)	7,506.3	9,498.5	-21.0
Indonesia	3.50	Feb-21	-0.85	Nickel (\$/MT)	21,776.0	28,061.5	-22.4
Money Mkt Rates	6-Jul	-1 mth	Chg (bps)	CPO (\$/MT)	885.1	1,539.0	-42.5
SUN (10Y)	7.25	6.92	32.9	Rubber (\$/kg)	1.59	1.65	-3.6
INDONIA (O/N, Rp)	2.78	2.79	-0.9	External Sector	May	Apr	Chg (%)
JIBOR 1M (Rp)	3.54	3.54	-0.1	Export (\$ bn)	21.51	27.32	-21.3
Bank Rates (Rp)	Mar	Feb	Chg (bps)	Import (\$ bn)	18.61	19.76	-5.8
Lending (WC)	8.59	8.62	-2.97	Trade bal. (\$ bn)	2.90	7.56	-61.7
Deposit 1M	2.85	2.85	0.57	Central bank reserves (\$ bn)*	136.4	135.7	0.55
Savings	0.63	0.63	-0.23	Prompt Indicators	May	Apr	Mar
Currency/USD	6-Jul	-1 mth	Chg (%)	Consumer confidence index (CCI)	128.9	113.1	111.0
UK Pound	0.839	0.801	-4.50	Car sales (%YoY)	-9.8	5.0	16.0
Euro	0.982	0.933	-5.01	Motorcycle sales (%YoY)	-2.5	-7.1	-13.6
Japanese Yen	136.0	130.9	-3.73	Cement sales (%YoY)	7.6	-10.0	23.2
Chinese RMB	6.708	6.660	-0.71	Manufacturing PMI	Jun	May	Chg (bps)
Indonesia Rupiah	14,997	14,438	-3.73	USA	53.0	56.1	-310
Capital Mkt	6-Jul	-1 mth	Chg (%)	Eurozone	52.1	54.6	-250
JCI	6,646.4	7,183.0	-7.47	Japan	52.7	53.3	-60
DJIA	31,037.7	32,899.7	-5.66	China	51.7	48.1	360
FTSE	7,107.8	7,533.0	-5.64	Korea	51.3	51.8	-50
Nikkei 225	26,107.7	27,761.6	-5.96	Indonesia	50.2	50.8	-60
Hang Seng	21,586.7	21,082.1	2.39				
Foreign portfolio ownership (Rp Tn)	Jun	May	Chg (Rp Tn)				
Stock	2,388.2	2,503.9	-115.73				
Govt. Bond	780.2	795.7	-15.51				
Corp. Bond	17.9	18.1	-0.16				

Source: Bloomberg, BI, BPS

Notes:

^Data for January 2022

\*Data from 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

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	4.8
GDP per Capita (US\$)	3877	3927	4175	3912	4350	4615
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	4.7
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.50
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	15,070
Trade Balance (US\$ billion)	11.8	-8.5	-3.2	21.7	35.3	48.5
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.3	1.4

\*\* Estimation of Rupiah's fundamental exchange rate

### Economic, Banking & Industry Research Team

**David E.Sumual**

*Chief Economist*

david\_sumual@bca.co.id

+6221 2358 8000 Ext:1051352

**Victor George Petrus Matindas**

*Senior Economist*

victor\_matindas@bca.co.id

+6221 2358 8000 Ext: 1058408

**Livia Angelica Thamsir**

*Economist / Analyst*

livia\_thamsir@bca.co.id

+6221 2358 8000 Ext: 1069933

**Ahmad Aprilian Rizki**

*Research Assistant*

ahmad\_rizki@bca.co.id

+6221 2358 8000 Ext: 20378

**Agus Salim Hardjodinto**

*Senior Industry Analyst*

agus\_lim@bca.co.id

+6221 2358 8000 Ext: 1005314

**Gabriella Yolivia**

*Industry Analyst*

gabriella\_yolivia@bca.co.id

+6221 2358 8000 Ext: 1063933

**Lazuardin Thariq Hamzah**

*Economist / Analyst*

lazuardin\_hamzah@bca.co.id

+6221 2358 8000 Ext: -

**Arief Darmawan**

*Research Assistant*

arief\_darmawan@bca.co.id

+6221 2358 8000 Ext: 20364

**Barra Kukuh Mamia**

*Senior Economist*

barra\_mamia@bca.co.id

+6221 2358 8000 Ext: 1053819

**Derrick Gozal**

*Economist / Analyst*

derrick\_gozal@bca.co.id

+6221 2358 8000 Ext: 1066122

**Keely Julia Hasim**

*Economist / Analyst*

keely\_hasim@bca.co.id

+6221 2358 8000 Ext: -

### PT Bank Central Asia Tbk

#### Economic, Banking & Industry Research of BCA Group

20<sup>th</sup> Grand Indonesia, Menara BCA

Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia

Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343

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