FX Reserves:
Slight rebound, challenges still ahead

Keely Julia Hasim
Economist/Analyst

Barra Kukuh Mamia
Senior Economist

7 Juli 2022

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.

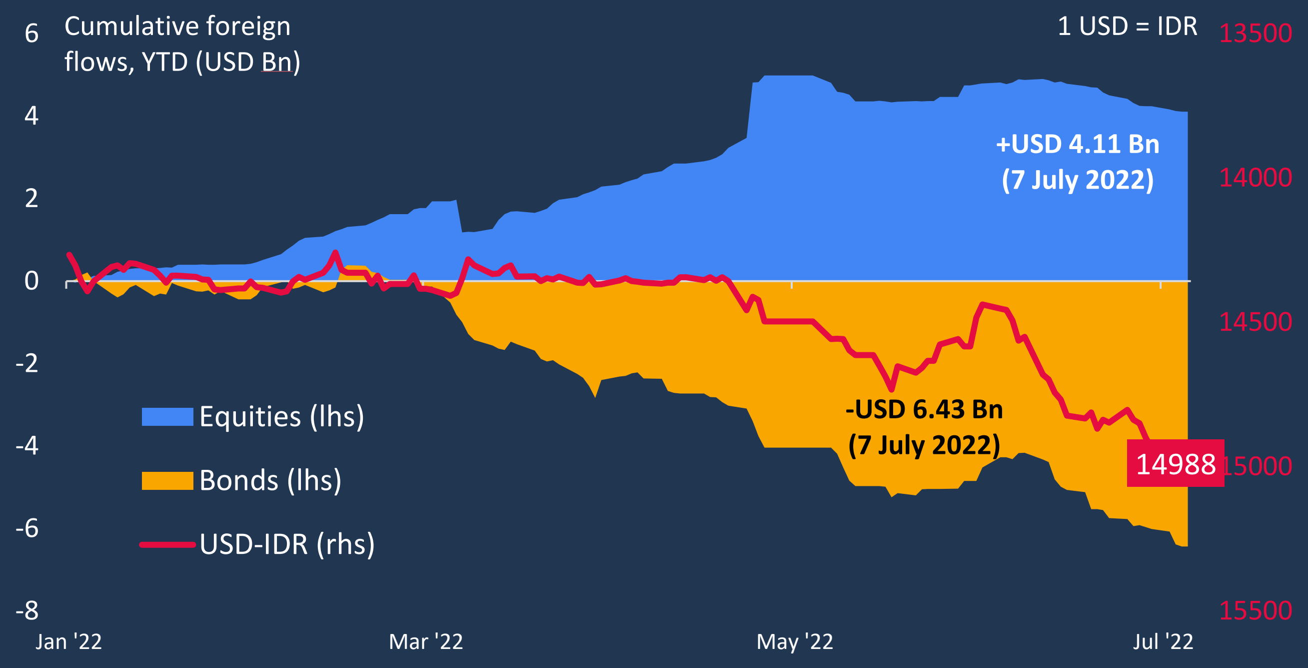
- Bank Indonesia's FX reserves stood at USD 136.4 Bn at the end of June 2022, a slight increase of USD 0.8 Bn from the previous month's figures. The increase in reserves however is a good sign, but it is a rather modest one given that the government's net global bond issuance totaled around USD 3.5 Bn 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.

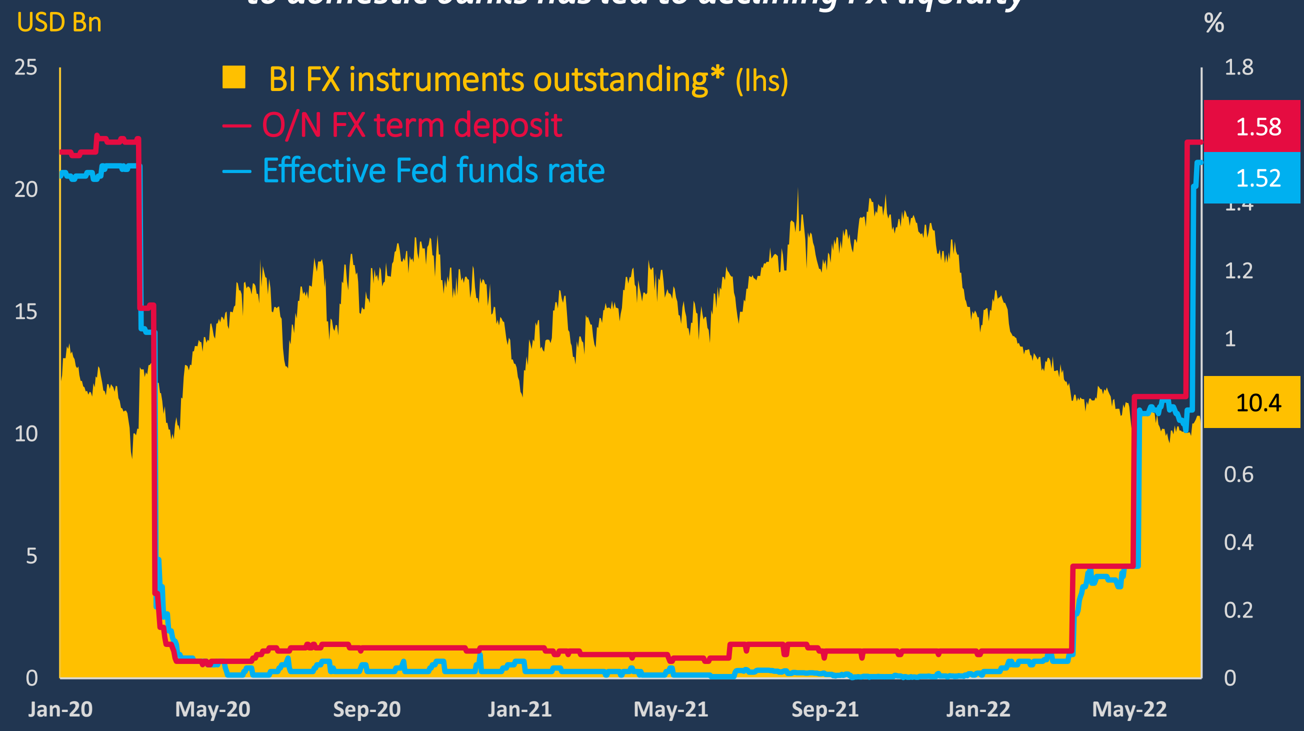
- The main tonic for IDR will have to be a raise on the short-end of the curve, i.e. policy rate. A substantial amount of Indonesia's export receipts is retained abroad, both due to (1) pre-existing arrangements, and (2) higher interest on FX deposits in foreign as opposed to domestic banks ***(Chart 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 (%)
US	1.75	Jun-22	-6.85
UK	1.25	Jun-22	-7.85
EU	0.00	Mar-16	-8.60
Japan	-0.10	Jan-16	-2.60
China (lending)	4.35	Oct-15	2.25
Korea	1.75	May-22	-4.25
India	4.90	Jun-22	-2.14
Indonesia	3.50	Feb-21	-0.85

Money Mkt Rates	6-Jul	-1 mth	Chg (bps)
SUN (10Y)	7.25	6.92	32.9
INDONIA (O/N, Rp)	2.78	2.79	-0.9
JIBOR 1M (Rp)	3.54	3.54	-0.1

Bank Rates (Rp)	Mar	Feb	Chg (bps)
Lending (WC)	8.59	8.62	-2.97
Deposit 1M	2.85	2.85	0.57
Savings	0.63	0.63	-0.23

Currency/USD	6-Jul	-1 mth	Chg (%)
UK Pound	0.839	0.801	-4.50
Euro	0.982	0.933	-5.01
Japanese Yen	136.0	130.9	-3.73
Chinese RMB	6.708	6.660	-0.71
Indonesia Rupiah	14,997	14,438	-3.73

Capital Mkt	6-Jul	-1 mth	Chg (%)
JCI	6,646.4	7,183.0	-7.47
DJIA	31,037.7	32,899.7	-5.66
FTSE	7,107.8	7,533.0	-5.64
Nikkei 225	26,107.7	27,761.6	-5.96
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

Trade & Commodities	6-Jul	-1 mth	Chg (%)
Baltic Dry Index	2,043.0	2,633.0	-22.4
S&P GSCI Index	664.1	808.3	-17.8
Oil (Brent, $/brl)	100.7	119.7	-15.9
Coal ($/MT)	397.0	376.5	5.5
Gas ($/MMBtu)	5.65	8.34	-32.3
Gold ($/oz.)	1,738.9	1,851.2	-6.1
Copper ($/MT)	7,506.3	9,498.5	-21.0
Nickel ($/MT)	21,776.0	28,061.5	-22.4
CPO ($/MT)	885.1	1,539.0	-42.5
Rubber ($/kg)	1.59	1.65	-3.6

External Sector	May	Apr	Chg (%)
Export ($ bn)	21.51	27.32	-21.3
Import ($ bn)	18.61	19.76	-5.8
Trade bal. ($ bn)	2.90	7.56	-61.7
Central bank reserves ($ bn)*	136.4	135.7	0.55

Prompt Indicators	May	Apr	Mar
Consumer confidence index (CCI)	128.9	113.1	111.0
Car sales (%YoY)	-9.8	5.0	16.0
Motorcycle sales (%YoY)	-2.5	-7.1	-13.6
Cement sales (%YoY)	7.6	-10.0	23.2

Manufacturing PMI	Jun	May	Chg (bps)
USA	53.0	56.1	-310
Eurozone	52.1	54.6	-250
Japan	52.7	53.3	-60
China	51.7	48.1	360
Korea	51.3	51.8	-50
Indonesia	50.2	50.8	-60

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

Agus Salim Hardjodinoto
Senior Industry Analyst
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Barra Kukuh Mamia
Senior Economist
barra_mamia@bca.co.id
+6221 2358 8000 Ext: 1053819

Victor George Petrus Matindas
Senior Economist
victor_matindas@bca.co.id
+6221 2358 8000 Ext: 1058408

Gabriella Yolivia
Industry Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Derrick Gozal
Economist / Analyst
derrick_gozal@bca.co.id
+6221 2358 8000 Ext: 1066122

Livia Angelica Thamsir
Economist / Analyst
livia_thamsir@bca.co.id
+6221 2358 8000 Ext: 1069933

Lazuardin Thariq Hamzah
Economist / Analyst
lazuardin_hamzah@bca.co.id
+6221 2358 8000 Ext: -

Keely Julia Hasim
Economist / Analyst
keely_hasim@bca.co.id
+6221 2358 8000 Ext: -

Ahmad Aprilian Rizki
Research Assistant
ahmad_rizki@bca.co.id
+6221 2358 8000 Ext: 20378

Arief Darmawan
Research Assistant
arief_darmawan@bca.co.id
+6221 2358 8000 Ext: 20364

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group

20th Grand Indonesia, Menara BCA
Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia
Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343