Balance of payments:

Will the line hold?

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Executive Summary

- Indonesia's balance of payments registered a slight deficit of USD 0.8 Bn in Q4-2021, as capital outflows pushed the financial account into negative territory despite the continued current account surplus.
- Continued uncertainties over inflation and the Fed's tightening cycle mean that the threat to the financial account persists. At the same time however, the current account is set to decline as continued recovery and rising oil prices drive up imports, while the potential normalization of commodity prices casts a cloud over exports.
- With these risks in mind, we have lowered our projections for 2022's current account down to a 0.5% deficit relative to GDP. As this line of defense weakens, we expect BI to respond by raising rates by 50-100 bps this year.

- **Indonesia's balance of payments (BoP) registered a slight deficit of USD 0.8 Bn in Q4-2021.** While Indonesia's current account continued to post a surplus (albeit one slightly diminished from Q3's), it was the deterioration of the financial account over the final few months of 2021 that pushed Indonesia's BoP back to a deficit ***(Chart 1)***.
- This of course, merely confirms what trade statistics and market indicators have been telling us over the previous months. It lines up with the large foreign capital outflows observed during Q4-21, triggered by market panic over the uncertainty of the Fed's monetary tightening timeline. It is also in line with the theory that the effects of these outflows have been largely offset by Indonesia's trade surpluses, which have remained strong amidst the current high in commodity prices. **Indonesia's current account then, is its thin line of defense against the reverberating waves of a mercurial financial account. Will it continue to hold however, as we move further into 2022?**
- **On the financial account side, uncertainties are likely to persist.** It is true that foreign portfolio outflows have begun to ebb over the past few weeks, and that a reasonable amount of foreign capital has even made its way into Indonesian equities. These equity inflows however, still pale in comparison to the large outflows observed in the bond market.
- Additionally, the global outlook for inflation remains as uncertain as ever. While there have been quite a few predictions of supply chain disruptions beginning to ease in H2-2022; recent events, such as the geopolitical tensions driving up oil prices close to the USD 100/bbl mark, have only added more fuel to the fire. Add to this the lingering threat of

further supply chain disruptions due to prolonged lockdowns in China, and inflation remains a persistent source of anxiety. **Markets certainly seem to be operating in line with these apprehensions, and have been increasingly willing to price in ever more hawkish bets over the past weeks.**

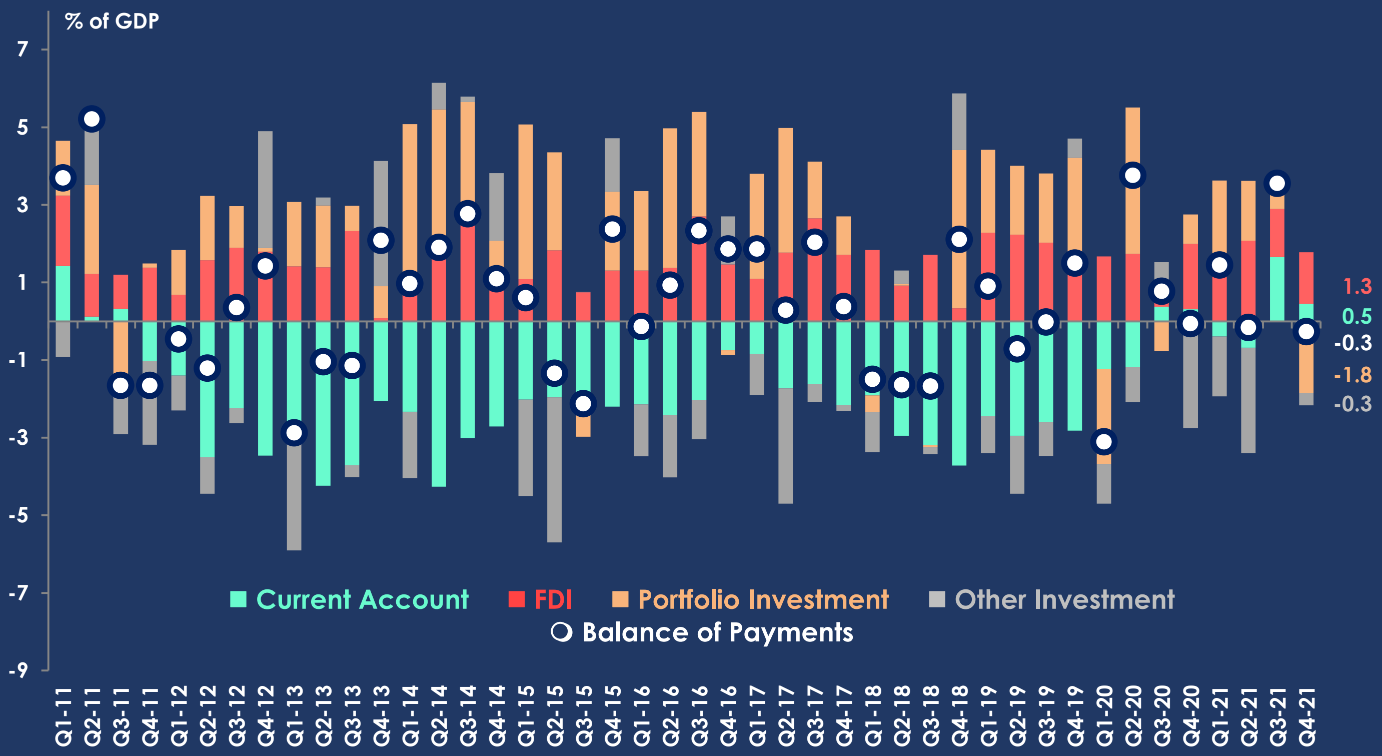
- The main threat to Indonesia's BoP then, is not likely to fade away in the coming months. What of its primary defense then, its current account surplus? Q4's BoP data offers a few glimpses of what the future might hold in this regard. Of particular concern is the trajectory of Indonesia's services balance. **Indeed, Q4 data shows that the deterioration in the services balance that began during the onset of the pandemic continues unabated,** as export earnings from tourism wither away while imports related to freight and other services (particularly those related to ICT) continue to climb ***(Chart 2)***. There is a glimmer of hope with regards to tourism, as countries begin to move more decisively towards scrapping quarantine requirements and reopening borders as they shrug off Omicron's effects. Whether and how quickly this will herald the return of foreign visitors however, remains to be seen. Much less uncertain is the threat posed by swelling service imports. Freight costs remain high, and the post-Covid structural trends (such as "Zoom-ification") that are the likely culprits behind the rise in ICT service imports are likely here to stay. The services balance, in short, is more likely to be a liability rather than an asset going forward.

- **For much of the past year, the swelling services deficit has been more than compensated for by the remarkable strength of the goods balance. As discussed in our previous report *("Trade: A temporary slump")* however, concerns have been mounting here too.** Imports are set to rise as the domestic economy continues to recover. Indeed, Indonesia's FX liquidity has been gradually eroded down over the past year, driven primarily by increased FX demand for imports ***(Chart 3)***. Additionally, rising oil prices are also likely to take a chunk out of the trade surplus, something reflected in the worsening oil and gas deficit in the BoP data as well. Export growth, on the other hand, may be set to begin cooling down as commodity prices potentially begin normalizing and the government attempts to strike a balance between maintaining its high commodity export earnings and keeping domestic supply and prices under control (as evidenced by its recent ban on coal exports). **In line with the above mentioned risks, particularly the thinning of the trade surplus, our forecast for 2022's current account have been revised downwards to a 0.5% deficit relative to GDP.**

> ***"The swelling services balance, as well as risks arising from the financial account, have been largely offset by Indonesia's large trade goods surplus. The potential thinning of this surplus then, poses a risk to exchange rate stability in the coming months."***

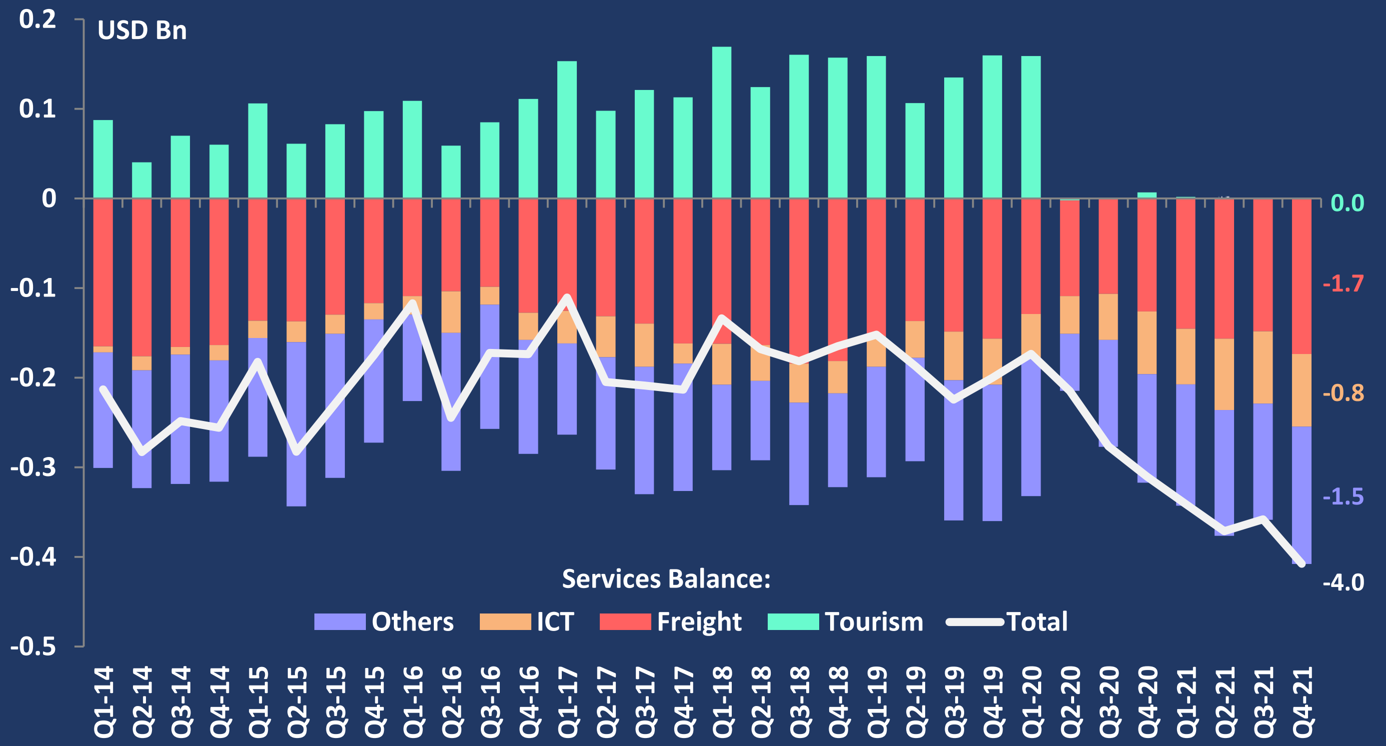
- The Rupiah's outlook for 2022 then, appears to be fraught with uncertainty as the current account comes under pressure amidst a risk-averse atmosphere in markets. If the historical correlation between FX liquidity and the Rupiah's strength is of any indication, current trends pointing to declining FX liquidity are likely to eventually make a mark on the exchange rate ***(Chart 3)***. With this line of defense weakening, Bank Indonesia will likely have to put up several defensive barriers of its own. The increase in the primary reserve requirement ratio was one such move, one that will likely be complemented by several upcoming policy rate hikes. **Overall, we maintain our view that the BI rate is likely to end up 50-100 bps higher than where it stands now by the end of 2022.**

Chart 1. The balance of payments slid back into a deficit as capital outflows pushed the financial account into negative territory



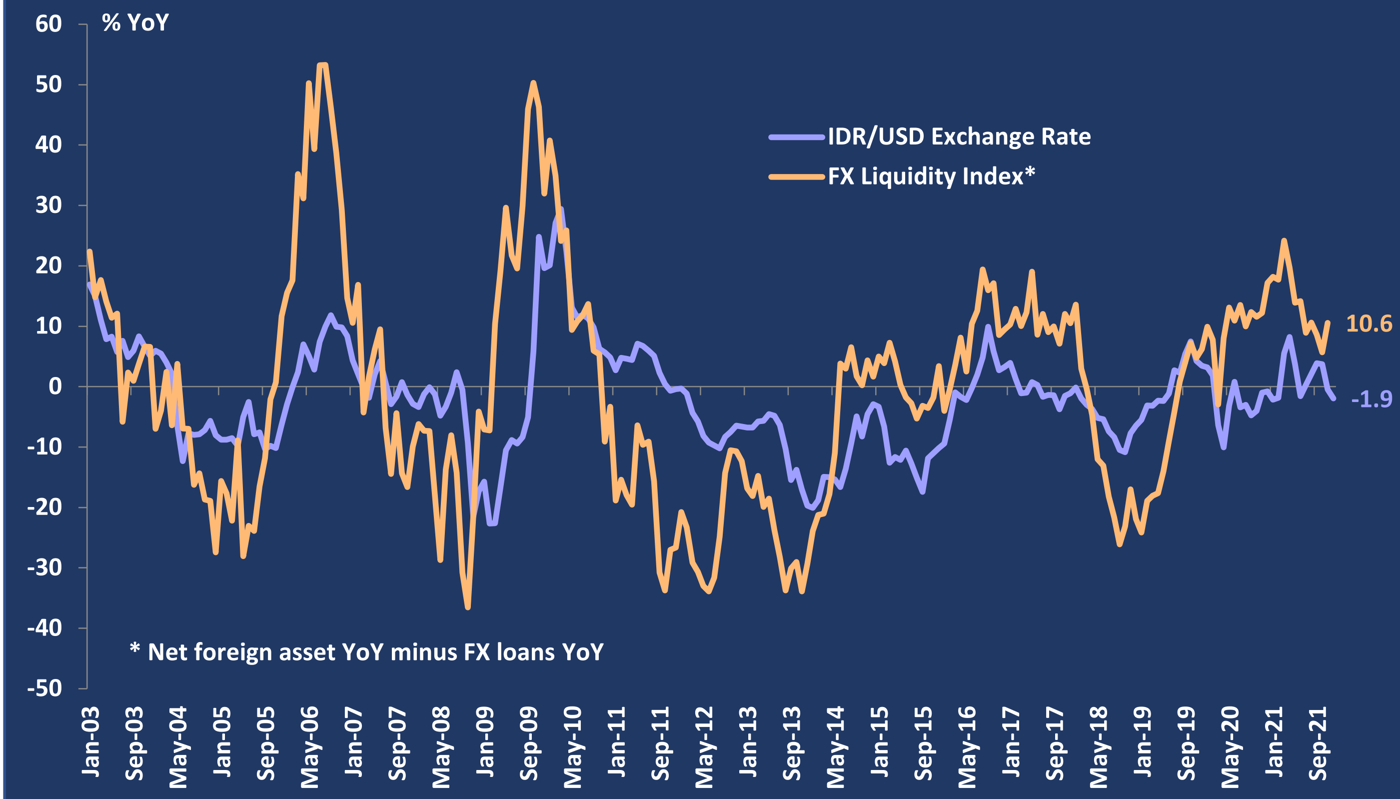
Source: Bank Indonesia
Last update: Q4-2021

Chart 2. The services balance continues to deteriorate as tourism earnings remain near zero while other service imports rise



Source: Bank Indonesia
Last update: Q4-2021

Chart 3. Declining FX liquidity has a high historical correlation with IDR depreciation



Source: Bloomberg
Last update: Nov-2021

Selected Macroeconomic Indicators

Table 1. Balance of payments (current USD Million)

	Q4-20	Q1-21	Q2-21	Q3-21	Q4-21	2019	2020	2021
CURRENT ACCOUNT	***850***	***-1,095***	***-1,964***	***4,970***	***1,415***	***-30,279***	***-4,433***	***3,326***
(as % of GDP)	***0.31***	***-0.39***	***-0.68***	***1.65***	***0.45***	***-2.71***	***-0.42***	***0.28***
A. Goods	9,969	7,628	8,337	15,408	12,433	3,508	28,301	43,806
- Non-Oil/Gas	11,332	9,976	11,581	18,120	18,128	11,965	29,954	57,804
- Oil/Gas	-1,233	-2,269	-3,144	-2,508	-5,045	-10,319	-5,386	-12,965
B. Services	-3,105	-3,411	-3,714	-3,581	-4,078	-7,641	-9,755	-14,784
C. Income	-7,442	-6,744	-8,052	-8,274	-8,889	-33,775	-28,911	-31,960
D. Current Transfers	1,428	1,432	1,465	1,417	1,950	7,629	5,932	6,264
CAPITAL TRANSACTIONS	**23.79**	**2.21**	**4.91**	**9.96**	**63.00**	**39.06**	**36.91**	**80.08**
FINANCIAL TRANSACTIONS	**-958**	**5,734**	**1,655**	**6,699**	**-2,417**	**36,564**	**7,884**	**11,670**
A. Direct Investment	4,350	4,474	5,372	3,197	3,443	20,531	14,142	16,486
B. Portfolio Investment	1,952	4,904	3,990	1,193	-4,761	21,990	3,369	5,326
C. Derivative Instruments	201.46	110.06	23.75	172.24	26.65	186.40	17.73	332.71
D. Other Investment	-7,462	-3,754	-7,730	2,136	-1,125	-6,144	-9,645	-10,474
NET ERRORS AND OMISSIONS	**-72.40**	**-576.33**	**-145.39**	**-988.52**	**95.21**	**-1,647.91**	**-891.30**	**-1,615.04**
BALANCE OF PAYMENT ***(= change in BI international reserves)***	**-156**	**4,065**	**-450**	**10,690**	**-844**	**4,676**	**2,597**	**13,461**

Indonesia – Economic Projections Table

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	5.2
GDP per Capita (US$)	3877	3927	4175	3912	4350	4640
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	3.3
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.0
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	14,660
Trade Balance (US$ billion)	11.8	-8.5	-3.2	21.7	35.3	22.4
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.3	-0.5

** Estimation of Rupiah's fundamental exchange rate

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