Balance of payments:

Flipping the script, temporarily

Keely Julia Hasim
Economist/Analyst

Barra Kukuh Mamia
Senior Economist

23 May 2022

Executive Summary

- Indonesia's balance of payments (BoP) registered a deficit of USD 1.8 Bn in Q1-2022, driven by a decline in the current account (CA).
- While we would likely see improvements in the CA, the government's efforts to control domestic inflation would limit the potential gains from high commodities prices.
- At the same time, the Fed's hawkish stance would hasten capital outflows and cause the financial account to deteriorate further over the coming months.
- As a result, BI would likely need to raise its policy rate anywhere from 50 to 150 bps to preserve real yield differentials between Indonesia and the US.

- Indonesia's balance of payments (BoP) registered a deficit of USD 1.8 Bn in Q1-2022. The financial account continued to post a deficit, but it was the current account's deterioration that drove the decline in BoP ***(Chart 1)***.

- In turn, the worsening current account (CA) was caused primarily by three main factors. The first, as we have mentioned often in the past, was repressed commodity exports relative to the global price and demand levels, courtesy of the government's coal export ban in January. A similar effect will likely be seen for Q2 as well, due to a ban in CPO (and other palm oil products) exports, which similarly lasted for only less than a month after last week's announcement to re-allow exports. This on/off export control dynamics may well appear again if local inventories run low, which is probable given that local prices for these commodities continue to run below their global levels. This seems particularly true for coal, where the partial adjustment of DMO prices (in March, for cement and fertilizer industries) and electricity prices (upcoming, for large-wattage households only) still has not kept up with surging global prices.

- The second was rising imports, mainly due to elevated oil prices but also – particularly in March – due to restocking by local wholesalers and retailers. And just like the first factor, this may come up again over the next few quarters, considering the persistent global inflation as well as the robust domestic demand that was evident from our transaction data during Ramadan. Given the government's recent decision to increase fuel subsidies in lieu of raising domestic fuel prices, it is inevitable that some of this consumer surplus will be used on imported goods, leading to further increase in imports.

- The third factor was the widening services deficit ***(Chart 2)***, especially for travels. While Indonesia has scrapped its quarantine requirements for fully-vaccinated foreign visitors and increased the number of countries eligible for Visa on Arrival (VoA), the tourism sector remained far below its usual capacity – and the Omicron outbreak in Q1 did not help either. Interestingly, outbound travel expenses seemed to have rebounded more strongly, a function both of earlier relaxation of travel restrictions in many other countries as well as pent-up demand for religious pilgrimage.

- While all these seem to suggest that the CA is set to deteriorate further in the future, we think that the Q1 figure (a 0.07% surplus relative to GDP) was probably a low point, simply because rising commodity prices – as we saw in April – managed to produce bumper exports for Indonesia. We concur, however, that the CA is likely to disappoint compared to the gaudy expectations (2% or more) that some analysts have predicted based on commodity prices alone, and it will likely be closer to 0.5 – 1.2% of GDP. This is largely the function of the aforementioned export bans and subsidies, i.e. sacrificing CA surplus in order to control domestic inflation.

- In contrast, the financial account side saw an improvement in Q1 that would probably not be sustained for the rest of the year. In particular, there was a surge in equity inflows primarily into energy/commodity stocks, as well as additional inflows coming from the government's global bond issuance and foreign loan uptake. Unfortunately, the situation is reversing in Q2, with the Fed's hawkish policies – coupled with earnings uncertainty engendered by the export bans – would likely hasten outflows from both bonds and equities. The one bright spot that is set to continue is FDI, where we expect further investments into the primary sectors as well as manufacturing and logistics, amid the backdrop of supply-chain disruptions.

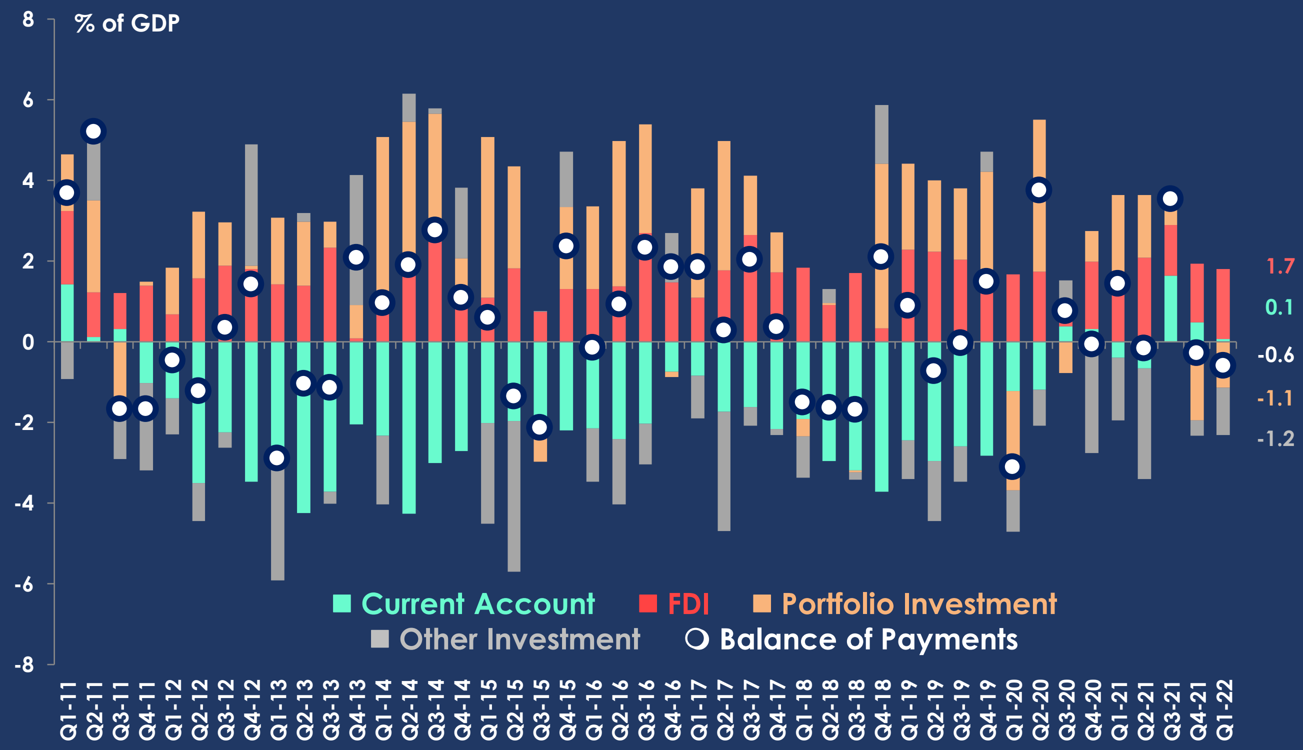
- The question, then, is whether CA or the financial account is more influential in determining the exchange rate – given that we expect improvement in the former, but more pressure for the latter. Using data from several EMs ***(Charts 3 and 4)***, it appears that recent exchange rate change vs. the USD is not particularly correlated with CA balance. On the other hand, it is more closely correlated (albeit still rather weakly) with real policy rates, which could be a determinant of portfolio inflows.

"While all these seem to suggest that the CA is set to deteriorate further in the future, we think that the Q1 figure was probably a low point, simply because rising commodity prices – as we saw in April – managed to produce bumper exports for Indonesia."

- Since inflation obviously reduces real rates, this justifies the government's choice to sacrifice part of the CA surplus to curb inflation. However, we would argue that inflation may still exceed 4% YoY even without energy price adjustments, simply because global inflation may start to affect food and fertilizer prices in the coming months. In addition, strong investment growth would lead to strong demand in financing, and when combined with diminished private savings (due to narrow CA) could result in a big financing gap ***(Chart 5)***. Historically, such a large financing gap is associated with higher real interest rates ***(Chart 6)***.

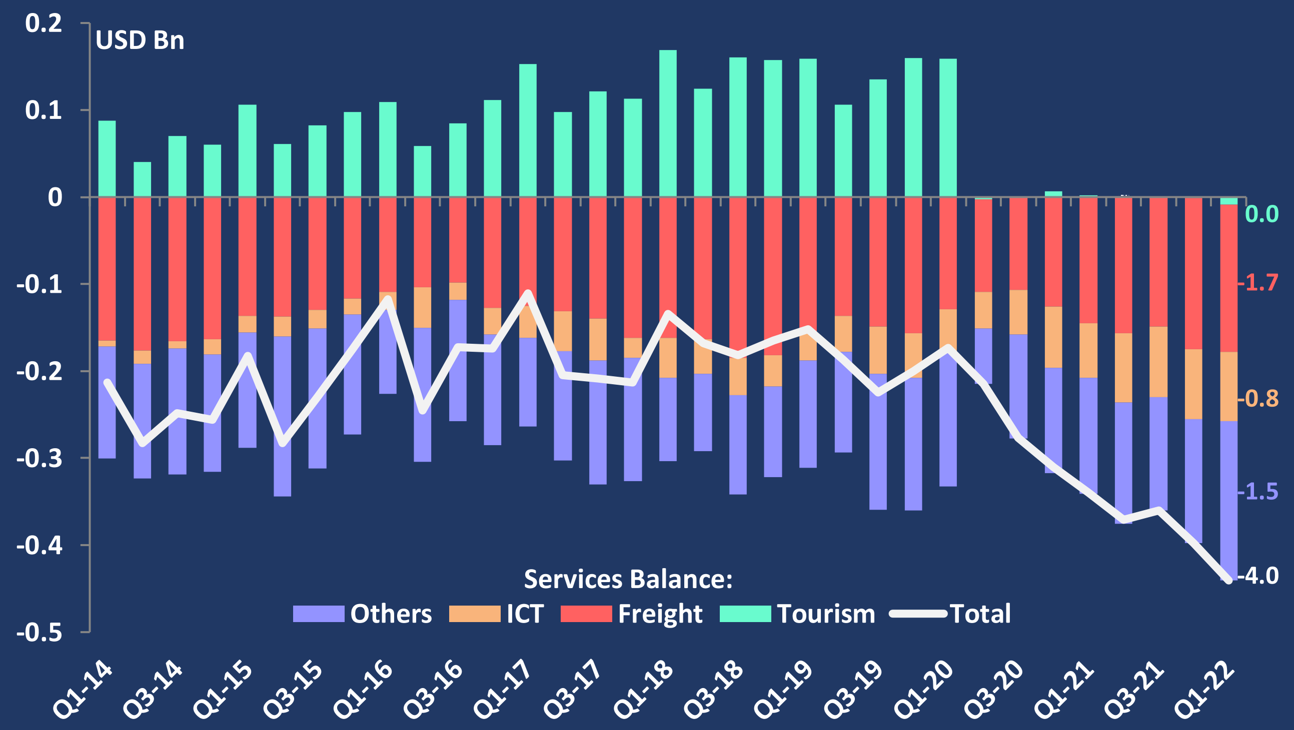
- As such, we maintain our view that BI could hike by anywhere between 50 – 150 bps this year, owing to the need to maintain real yield differentials against rising UST yields. With fuel hikes likely off the table for the year, however, the timing of the initial hike would be largely determined by external shocks, both pertaining to inflation and Fed policy tightening.

Chart 1. The financial account continued to post a deficit, but it was the current account's deterioration that drove the decline in BoP



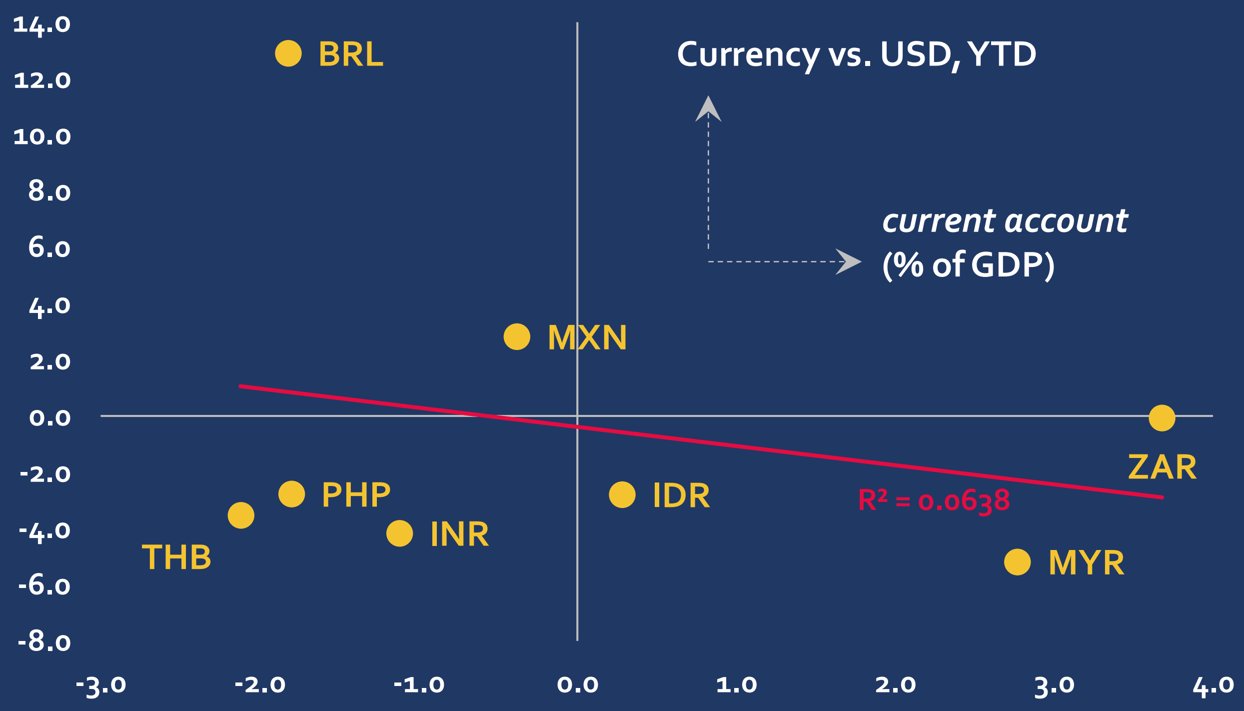
Source: Bank Indonesia
Last update: Q1-2022

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



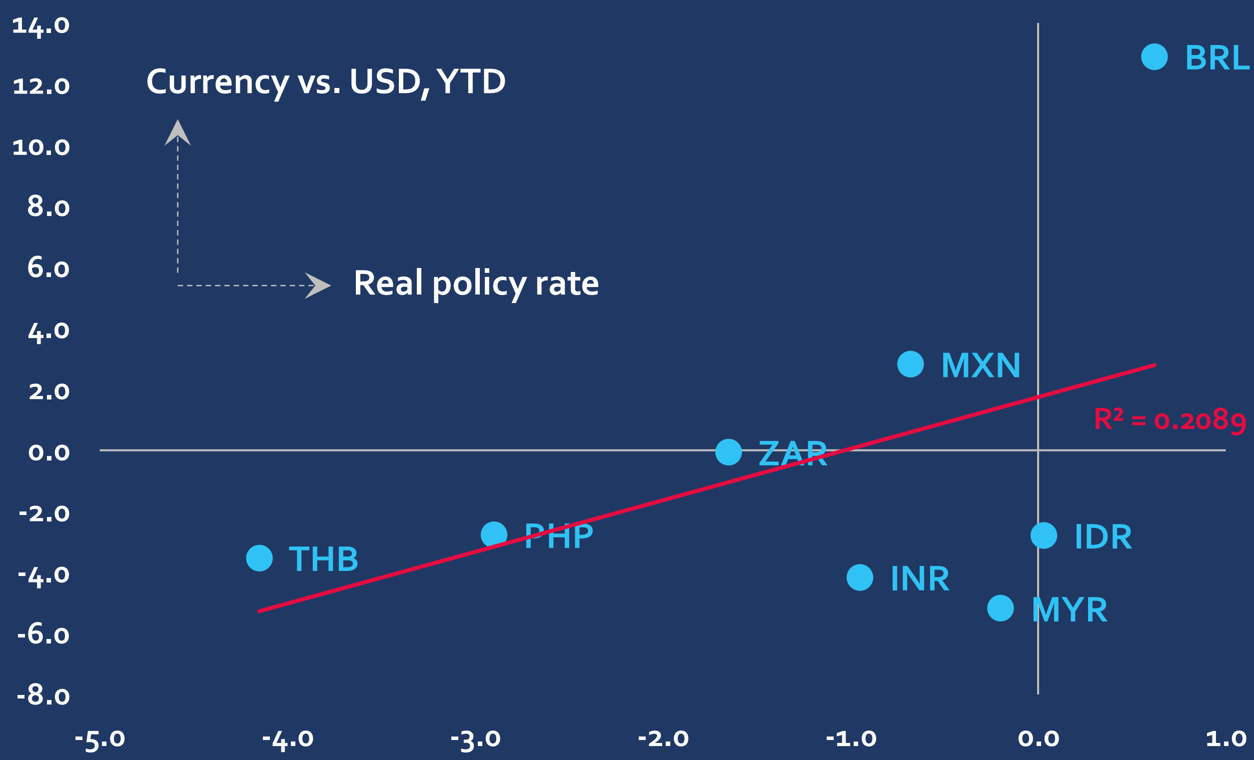
Source: Bank Indonesia
Last update: Q1-2022

Chart 3. The YTD change of EM currencies vs. the USD is not strongly correlated with CA balance



Source: Bloomberg, BCA Economist calculations

Chart 4. The YTD change of EM currencies vs. the USD is more closely correlated with real policy rates, albeit still rather weakly.



Source: Bloomberg, BCA Economist calculations

Chart 5. Strong financing demand combined with diminished private sector savings could result in a big financing gap

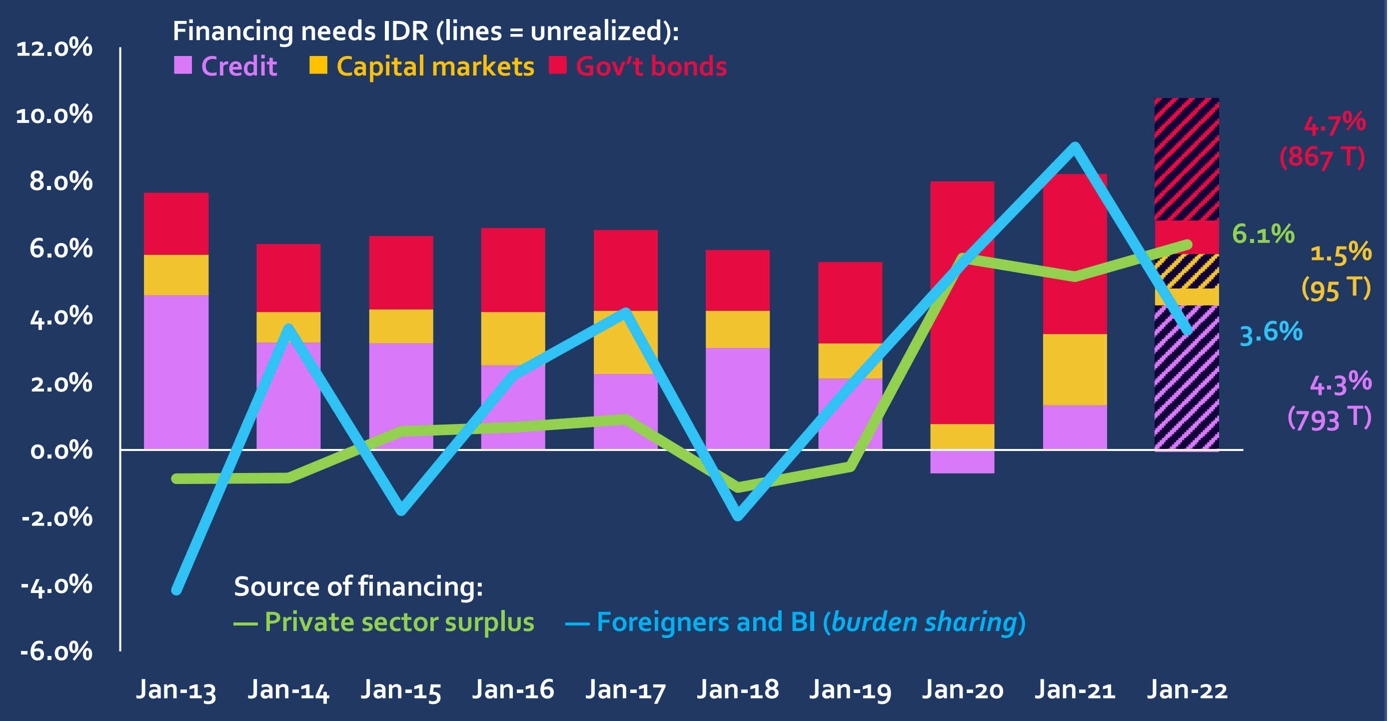
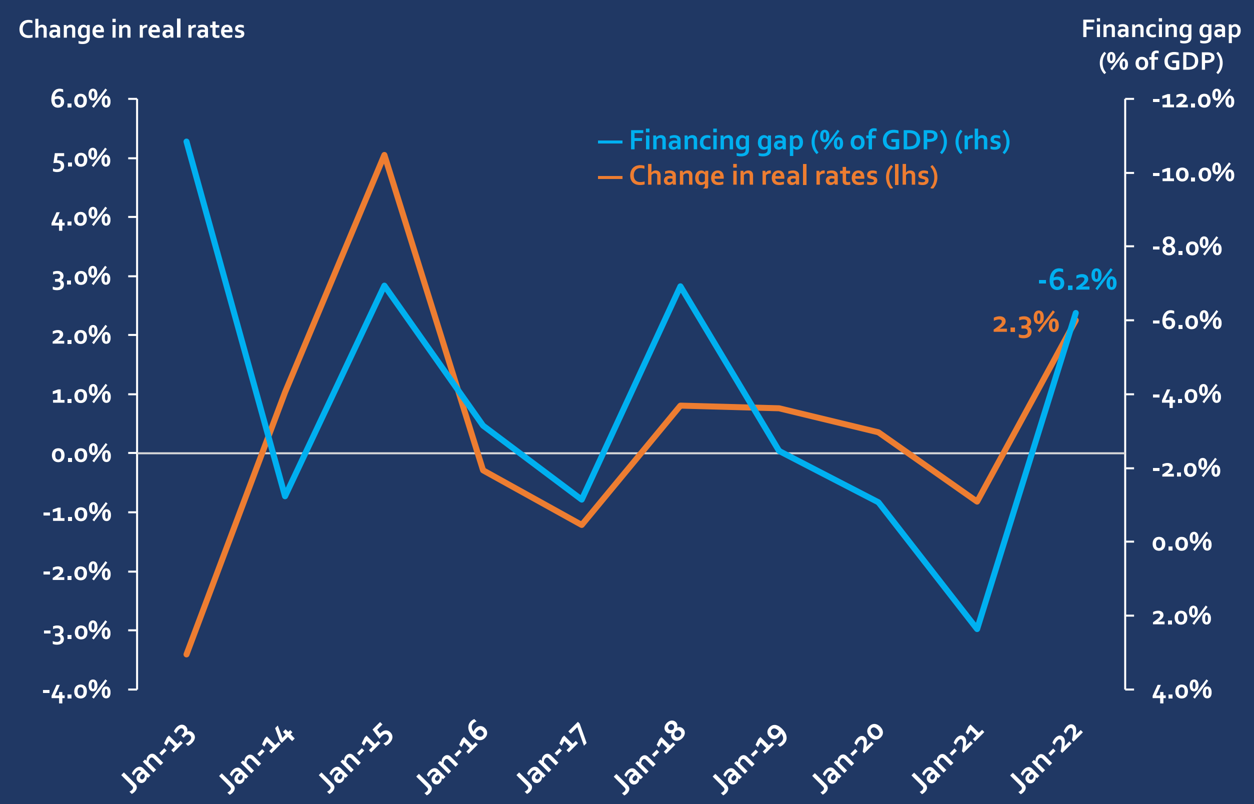


Chart 6. Large financing gaps are associated with higher real interest rates



Selected Macroeconomic Indicators

Table 1. Balance of payments (current USD Million)

	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22	2019	2020	2021
CURRENT ACCOUNT	***-1,087***	***-1,929***	***4,950***	***1,496***	***221***	***-30,279***	***-4,433***	***3,430***
(as % of GDP)	**9.66**	**8.77**	**8.64**	**7.76**	**6.96**	**-2.71**	**-0.42**	**7.76**
A. Goods	7,628	8,337	15,408	12,433	11,140	3,508	28,301	43,806
- Non-Oil/Gas	9,976	11,581	18,120	18,128	17,210	11,965	29,954	57,804
- Oil/Gas	-2,269	-3,144	-2,508	-5,045	-5,855	-10,319	-5,386	-12,965
B. Services	-3,394	-3,707	-3,601	-3,976	-4,407	-7,641	-9,755	-14,678
C. Income	-6,753	-8,023	-8,274	-8,910	-8,007	-33,775	-28,911	-31,961
D. Current Transfers	1,432	1,465	1,417	1,950	1,494	7,629	5,932	6,264
CAPITAL TRANSACTIONS	**2.21**	**4.91**	**9.96**	**63.00**	**0.88**	**39.06**	**36.91**	**80.08**
FINANCIAL TRANSACTIONS	**5,757**	**1,671**	**6,717**	**-2,250**	**-1,704**	**36,564**	**7,884**	**11,895**
A. Direct Investment	4,492	5,392	3,235	3,785	4,467	20,531	14,142	16,904
B. Portfolio Investment	4,903	3,998	1,198	-5,024	-2,944	21,990	3,369	5,076
C. Derivative Instruments	110.06	23.75	172.24	26.65	136.76	186.40	17.73	332.71
D. Other Investment	-3,748	-7,743	2,111	-1,038	-3,364	-6,144	-9,645	-10,418
NET ERRORS AND OMISSIONS	**-607.50**	**-196.64**	**-987.38**	**-152.74**	**-334.59**	**-1,647.91**	**-891.30**	**-1,944.26**
BALANCE OF PAYMENT *(= change in BI international reserves)*	**4,065**	**-450**	**10,690**	**-844**	**-1,817**	**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	4.8
GDP per Capita (US$)	3877	3927	4175	3912	4350	4615
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	4.2
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.0
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	14,660
Trade Balance (US$ billion)	11.8	-8.5	-3.2	21.7	35.3	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: 1066722

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

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

Lazuardin Thariq Hamzah
Economist / Analyst
Lazuardin_hamzah@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