FX Reserves:

Staying resilient in the heat of battle

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Executive Summary

- Bank Indonesia's foreign exchange reserves declined by a minor USD 0.1 Bn in May 2022, closing the month at USD 135.6 Bn as higher revenue from coal and gas exports counteract external debt payments and rising imports despite the temporary ban on CPO exports.
- Despite considerable inflows in the stock market, foreign capital still flows out of the domestic bond market as a negative real rate may exacerbate the risk of capital flight.
- Ample FX reserves and easing short-term inflationary pressures provide some room for Bank Indonesia to maintain its accommodative policy. However, rate hikes might be needed in 2H 2022 as pressures against the IDR may continue to emerge.

- Bank Indonesia's foreign exchange reserves position stood at USD 135.6 Bn in May 2022, a rather negligible decrease from USD 135.7 Bn in the previous month. Despite being at its 18-month-low, the current FX reserves position is still well above the international adequacy standard, equivalent to 6.8 months of imports or 6.6 months of both imports and the government's external debt servicing.
- Although the FX reserves position continues to move southbound, the recent figure's negligible decline is much better than what some analysts might have predicted, considering that the month-long CPO exports hiatus deprived Indonesia of one of its hard-currencies spigot. However, the loss in revenue appears to be offset by higher coal and gas exports (which prices had gone up by 17.6-21.7% MoM), keeping the tap open for Indonesia. Stratospheric commodity prices, coupled with the resumption of CPO exports, would help to fill Indonesia's FX buffer. However, several factors remain that could drain Indonesia's FX reserves position.
- The first threat to Indonesia's FX reserves position is an unfortunate by-product of the government's policy stance, which is leaning towards quick mobilisation of commodity windfall to shield domestic consumers from the raging global inflation. Indeed, stable domestic energy prices due to a higher subsidy budget played an instrumental role in boosting consumption. However, this situation is complicated by stratospherically high oil prices, which are trending upward following the gradual reopening of China's economy and heightened supply scare due to the intensifying geopolitical tension in the Hormuz strait on top of the protracted Ukraine-Russia war – exposing oil importers such as Indonesia to higher prices that drive up the imports bill. Higher imports may increase the FX demand, which often correlates with Rupiah's

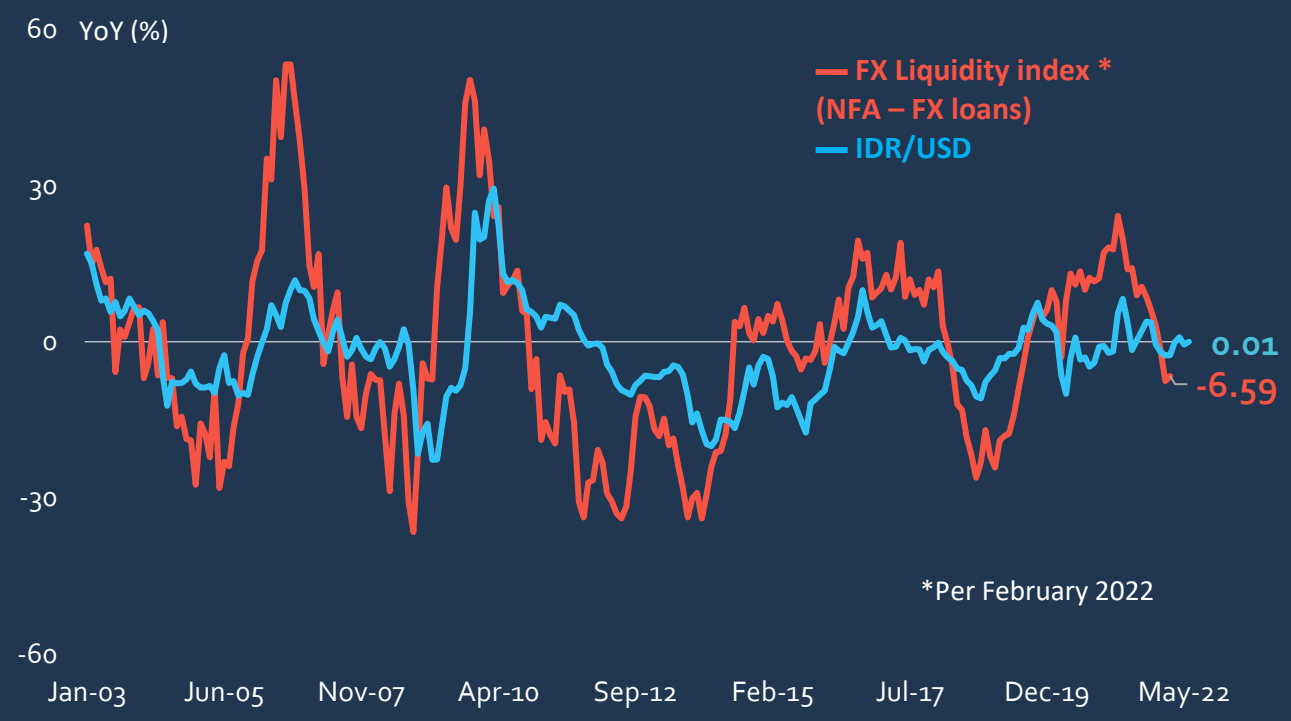
value **(Chart 1)**. While unyielding trade surpluses continue to support Rupiah to outperform its fundamental, a quick inspection of the FX liquidity index shows that FX deficits would eventually drag Rupiah closer to its fundamental value; a replay of the 2012-2013 period when the Rupiah's value plummeted in 2013 (despite bountiful trade surpluses in 2012) which exacerbated the painful period of the taper tantrum.

- Unrelenting capital outflows are another factor that could suppress Indonesia's coffers in the coming months **(Chart 2)**. Despite considerable inflows in the stock market throughout 2022, foreign capital is still bleeding out of the domestic bond market –with a tighter global monetary environment intensifying the scale of EM bonds' sell-off. The global bond market's rather peculiar movement further complicates the picture, as investors might be looking for higher yields during inflationary periods but the current yields may still be too high for a recession scenario. Market-wide price action might be necessary to push investors closer to either the inflation or recession camp, providing investors with clearer direction out of the presently disconcerting market.

"Stratospheric commodity prices, coupled with the resumption of CPO exports, would help to fill Indonesia's FX buffer"

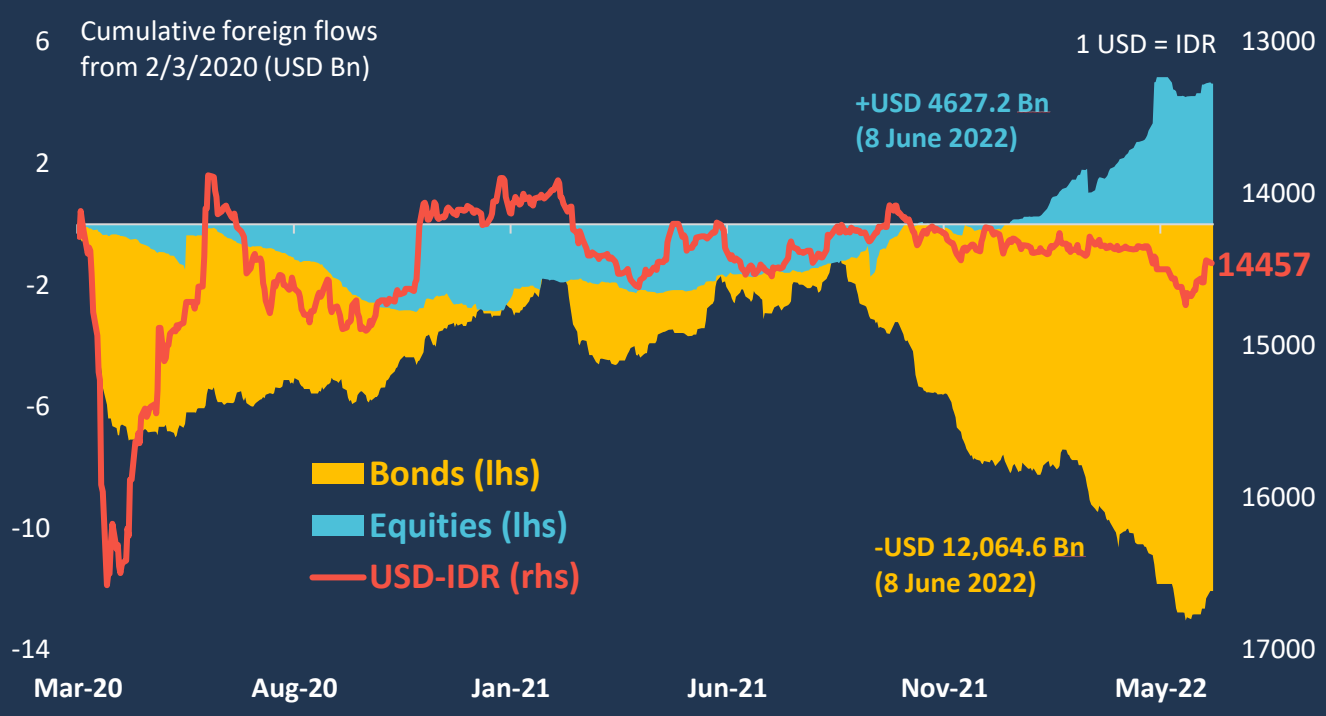
- Finally, negative real rate return may exacerbate capital flight risks – tilting the playing field in which Bank Indonesia had to protect Rupiah's value against the stronger US Dollar. However, despite the downside risks laid above, it's worth noting that Rupiah is still performing better relative to other EM currencies. The present FX reserves position still left a sizable manoeuvering space for Bank Indonesia, while the government's heightened fiscal spending took the onus of managing inflation from Bank Indonesia. Thus, Bank Indonesia may still have some breathing space to keep its tried-and-true policy in place, while policy rate hikes to the tune of 50-150 bps could be on the card in 2H 2022 as pressures against the Rupiah may continue to emerge.

Chart 1. The IDR's exchange rate tends to mirror domestic FX liquidity, albeit sometimes with a time lag



Source: OJK, Bloomberg

Chart 2. A negative real rate return may exacerbates the risk of capital outflows, especially in a tighter global liquidity environment



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	1.00	May-22	-7.30
UK	1.00	May-22	-8.00
EU	0.00	Mar-16	-8.10
Japan	-0.10	Jan-16	-2.60
China (lending)	4.35	Oct-15	2.25
Korea	1.75	May-22	-3.65
India	4.90	May-22	-2.89
Indonesia	3.50	Feb-21	-0.05
Money Mkt Rates	**7-Jun**	**-1 mth**	**Chg (bps)**
SPN (1M)	2.71	2.65	6.6
SUN (10Y)	7.00	6.97	3.7
INDONIA (O/N, Rp)	2.79	3.49	-70.8
JIBOR 1M (Rp)	3.54	3.55	-0.8
Bank Rates (Rp)	**Feb**	**Jan**	**Chg (bps)**
Lending (WC)	8.62	8.66	-3.55
Deposit 1M	2.85	2.88	-3.49
Savings	0.63	0.69	-6.27
Currency/USD	**7-Jun**	**-1 mth**	**Chg (%)**
UK Pound	0.794	0.810	1.98
Euro	0.934	0.948	1.44
Japanese Yen	132.6	130.6	-1.53
Chinese RMB	6.671	6.667	-0.06
Indonesia Rupiah	14,457	14,497	0.28
Capital Mkt	**7-Jun**	**-1 mth**	**Chg (%)**
JCI	7,141.0	7,228.9	-1.22
DJIA	33,180.1	32,899.4	0.85
FTSE	7,598.9	7,387.9	2.86
Nikkei 225	27,944.0	27,003.6	3.48
Hang Seng	21,531.7	20,002.0	7.65
Foreign portfolio ownership (Rp Tn)	**May**	**Apr**	**Chg (Rp Tn)**
Stock	2,503.9	2,599.7	-95.79
Govt. Bond	795.7	827.9	-32.12
Corp. Bond	18.1	18.5	-0.47

Trade & Commodities	7-Jun	-1 mth	Chg (%)
Baltic Dry Index	2,514.0	2,718.0	-7.5
S&P GSCI Index	814.3	769.4	5.8
Oil (Brent, $/brl)	120.6	112.4	7.3
Coal ($/MT)	369.0	347.7	6.1
Gas ($/MMBtu)	9.28	8.41	10.3
Gold ($/oz.)	1,852.4	1,883.8	-1.7
Copper ($/MT)	9,699.3	9,411.0	3.1
Nickel ($/MT)	29,401.5	29,971.5	-1.9
CPO ($/MT)	1,541.6	1,628.4	-5.3
Rubber ($/kg)	1.64	1.58	3.8
External Sector	**Apr**	**Mar**	**Chg (%)**
Export ($ bn)	27.32	26.50	3.1
Import ($ bn)	19.76	21.96	-10.0
Trade bal. ($ bn)	7.56	4.54	
Central bank reserves ($ bn)*	135.6	139.1	-2.54
Prompt Indicators	**Apr**	**Mar**	**Feb**
Consumer confidence index (CCI)	113.1	111.0	113.1
Car sales (%YoY)	5.0	16.1	65.2
Motorcycle sales (%YoY)	-7.1	-13.6	-2.6
Cement sales (%YoY)	-10.0	23.2	13.6
Manufacturing PMI	**May**	**Apr**	**Chg (bps)**
USA	56.1	55.4	70
Eurozone	54.6	55.5	-90
Japan	53.3	53.5	-20
China	48.1	46.0	210
Korea	51.8	52.1	-30
Indonesia	50.8	51.9	-110

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$)	3877	3927	4175	3912	4350	4615
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	4.2
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.0
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	14,660
Trade Balance (US$ 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

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