Balance of payments:
Mind the gap

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Executive Summary

- The current account surplus reached USD 4.4 Bn (1.3% of the GDP) in Q3-22, thanks to strong increase in commodity exports.
- In spite of this, the Rupiah remained quite vulnerable, due to a combination of: (1) portfolio outflows as Fed hikes rates; (2) declining FX reserves valuation; (3) export receipts not flowing into domestic banks; and (4) FDI realization not translating into actual FX inflows.

- At 1.3% of the GDP (USD 4.4 Bn), the current account (CA) surplus in Q3-22 was the largest since Q3-21, when initial pangs of the global energy crisis sparked a huge rally in commodity prices. Of course, the latest surplus was driven by similar dynamics, with the Nordstream 2 shutdown (and later detonation) causing a massive jump in the prices of gas and coal.

- However, this CA surplus failed to support the Rupiah nor translate into a balance-of-payments (BoP) surplus. Instead, BI's FX reserves fell by USD 5.6 Bn during the period, ostensibly to defend the Rupiah. **There is thus a wide gap (of about USD 10 Bn) between lofty expectations of a self-financing Indonesian economy that could power through the global crisis, and the cold reality of BI and the government having to hunker down and adopt more defensive policies.**

- So let's dissect this gap. The first and most obvious component is portfolio investment, as **the Fed's rapid tightening sparked outflows** from both government and corporate bonds. This could narrow as narratives of a potential Fed pivot gain steam, but at the same time weaker inflation and energy prices could deflate sentiment on Indonesian corporates, leading to equity outflows.

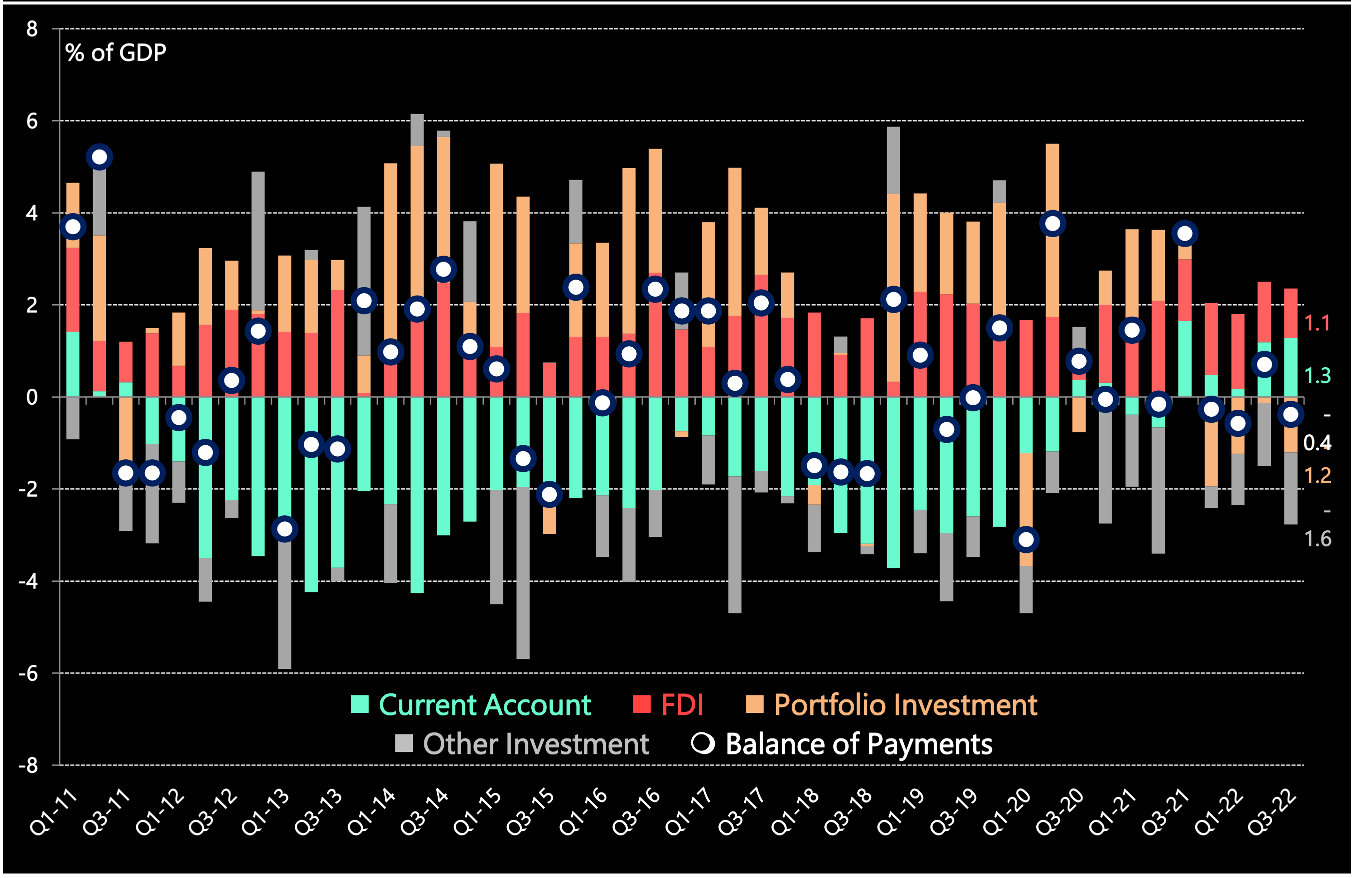
- The second gap is between the reported reserves drawdown to offset the BoP deficit (USD 1.7 Bn) and the aforementioned 5.6 Bn decline in FX reserves. **This could be a reflection of two things: (1) BI going "above and beyond" in its market interventions, or (2) valuation decline of the securities that BI hold as reserves.** Given the modest reserves decline in October, we think that BI could be adopting a less aggressive intervention strategy, while (2) should ease as the decline in global bond valuations has slowed down since September.

- The third gap is one that we have often highlighted: **export receipts not flowing into the domestic banking system due to widening yield gap in USD interest rates**. It manifests itself in outbound/nostro bank deposit, in "net errors and omissions" which may reflect illicit outflows, and most glaringly in outbound portfolio investment. The gap may narrow as BI cracks down on companies that fail to comply with its export receipts regulations, but part of it will likely persist along with the yield gap.

- Finally, there is a fourth gap: **that between reported FDI realization and actual monetary flows pertaining to FDI**, as we touched in a recent report ("Massive boom with some caveats", November 11 2022). This is a new problem, or at least one that was relatively minor prior to 2021. It may well be a temporary issue, as investors are slow in executing their projects amid current circumstances. However, it may also be a structural issue if the recent batch of investors – many of them metals-related – tend to negotiate tighter financial control which would leave much of their cash flow (whether operational or investment-related) in their home countries and outside of the Indonesian banking system.

- **All these help to explain why the Rupiah has been under pressure despite the healthy CA surplus.** Since there is likely to be only a modest narrowing in these gaps during Q4-22, it affirms our projections for the year which is still bullish on CA despite the recent decline in coal prices (0.9% of GDP for FY 2022), but rather less bullish on the Rupiah. It also means that BI could maintain a tighter stance even after the Fed finally signals a pause in rate hikes. Mind the gap, indeed.

***Chart 1.* Despite continued CA surplus, capital outflows pushed BoP into a deficit**



Source: Bank Indonesia

Last update: Q3-2022

Selected Macroeconomic Indicators

Table 1. Balance of payments (current USD Million)

	Q3-21	Q4-21	Q1-22	Q2-22	Q3-22	2019	2020	2021
CURRENT ACCOUNT	***4,963***	***1,510***	***569***	***4,023***	***4,376***	***-30,279***	***-4,433***	***3,465***
(as % of GDP)	***8.64***	***7.76***	***6.97***	***6.41***	***5.72***	***-2.71***	***-0.42***	***7.76***
A. Goods	15,408	12,433	11,301	16,797	17,515	3,508	28,301	43,806
- Non-Oil/Gas	18,120	18,128	17,210	24,445	25,160	11,965	29,954	57,804
- Oil/Gas	-2,508	-5,045	-5,694	-7,187	-6,589	-10,319	-5,386	-12,965
B. Services	-3,588	-3,963	-4,377	-4,942	-5,273	-7,641	-9,755	-14,644
C. Income	-8,274	-8,910	-7,849	-9,355	-9,275	-33,775	-28,911	-31,961
D. Current Transfers	1,417	1,950	1,494	1,523	1,408	7,629	5,932	6,264
CAPITAL TRANSACTIONS	**9.96**	**63.00**	**0.88**	**3.04**	**2.43**	**39.06**	**36.91**	**80.08**
FINANCIAL TRANSACTIONS	**7,293**	**-2,346**	**-1,991**	**-1,160**	**-6,073**	**36,564**	**7,884**	**12,423**
A. Direct Investment	3,465	4,050	4,194	3,401	2,779	20,531	14,142	17,423
B. Portfolio Investment	1,199	-5,023	-3,188	-347	-3,112	21,990	3,369	5,072
C. Derivative Instruments	172.24	26.65	136.76	-86.05	8.55	186.40	17.73	332.71
D. Other Investment	2,457	-1,400	-3,133	-4,128	-5,748	-6,144	-9,645	-10,405
NET ERRORS AND OMISSIONS	**-1,575.63**	**-71.36**	**-396.18**	**-476.92**	**390.64**	**-1,647.91**	**-891.30**	**-2,506.80**
BALANCE OF PAYMENT ***(= change in BI international reserves)***	**10,690**	**-844**	**-1,817**	**2,389**	**-1,304**	**4,676**	**2,597**	**13,461**

Source: Bank Indonesia

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Indonesia – Economic Indicators Projection

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	5.1
GDP per Capita (US$)	3877	3927	4175	3912	4350	4564
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	6.4
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	5.5
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	15,584
Trade Balance (US$ billion)	11.8	-8.5	-3.2	21.7	35.3	45.5
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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