FX Reserves:

Navigating the turbulence ahead

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Executive Summary

- BI's FX reserves position declined to USD 130.2 Bn by the end of October 2022 mainly due to FX interventions, but the scale of intervention has been more limited compared to the past or to other countries at the moment.
- FX liquidity within the domestic banking remains tight due to increased demand for FX loans and capital outflows that outstrip FX third party fund growth
- The Fed's more hawkish monetary policy is likely to increase pressure on BI to hike rates even further, especially amid declining commodity prices, although the possibility of a Fed pivot may be growing.

- Bank Indonesia's official reserves asset position stood at USD 130.2 Bn by the end of October 2022, a slight decline from USD 130.8 Bn in September 2022. As of this month's position, BI's FX reserves is enough to cover 5.8 months of imports, the lowest in recent years.

- As has been the case in recent months, there are three main suspects of the cause of the decline: declining value of BI's foreign assets, payment of the government's FX debt and FX intervention in the market. The first has been an underrated source of reserves decline thus far, as the value of US treasury securities have slumped by approximately 15% since the start of the year (Chart 1) – versus the decline in Indonesia's FX reserves of 10%. For October, however, the decline was relatively minor at ~1%.

- Meanwhile, data from the Ministry of Finance show no change in the value of outstanding FX bonds in October. This means that the decline related to debt repayment was probably limited to loans or interest payment.

- The main culprit, then, is still FX interventions. However, if we compare the current situation to past cycles of interventions e.g. in 2013 or 2018 – and also to current interventions by other central banks such as the BoJ (Japan) or RBI (India) – it is clear that BI has been much more prudent and strategic with the way it is utilizing its reserves.

- Indeed, the Rupiah's rather rapid depreciation since August was caused by external causes which are clearly not going to be solved by FX intervention. First of all, it is about rate differentials between Indonesia and the US caused by the Fed's ever-tightening policy. BI's operation twist – trying to raise short-term yields while lowering long-term yields – is a clever bit of monetary policy, but its impact have been limited as capital outflows still accelerated in the past month due to rising global rate expectations.

- Another big factor causing Rupiah depreciation is the increasingly tight FX availability within the domestic financial system. Deposits of FX funds has been declining with FX third party funds growing only 7.4% YoY in July, lower than at the start of the year. This is likely due to much lower guaranteed rate of returns on FX deposits compared to banks abroad, enticing exporters to place funds overseas. Meanwhile growth of FX credit has been accelerating, driven by SOEs and private sector demand for investment (Chart 3).
- The outlook for the Rupiah, then, is still full of uncertainty. The "default" scenario for the Fed is now likely to slow down the pace of its rate hikes but towards a higher terminal rate of 5.00%-5.25% (or even higher). This would continue to push the Dollar upwards and drain global liquidity.
- An alternative and far more preferable scenario, of course, is that the Fed could pivot into a loose monetary policy if there is a deeper recession than expected or a financial crisis which could lead to further (and prolonged) output loss. In this case BI – which is facing a more modest inflationary pressure compared to peer countries – may find itself with significant leeway to stimulate the economy given the return of capital inflows.
- Nonetheless, it is far more likely that BI would stay prudent and assume the default scenario, to try to maintain the real yield differentials. This could mean further hikes by 125-175 bps into the first half of 2023. This is especially necessary if global commodity boom moderates significantly, as seen by the recent drop in coal prices due to an oversupply of gas in Europe. Foreign reserves will continue to be critical to moderate the peaks and valleys of global liquidity ahead.

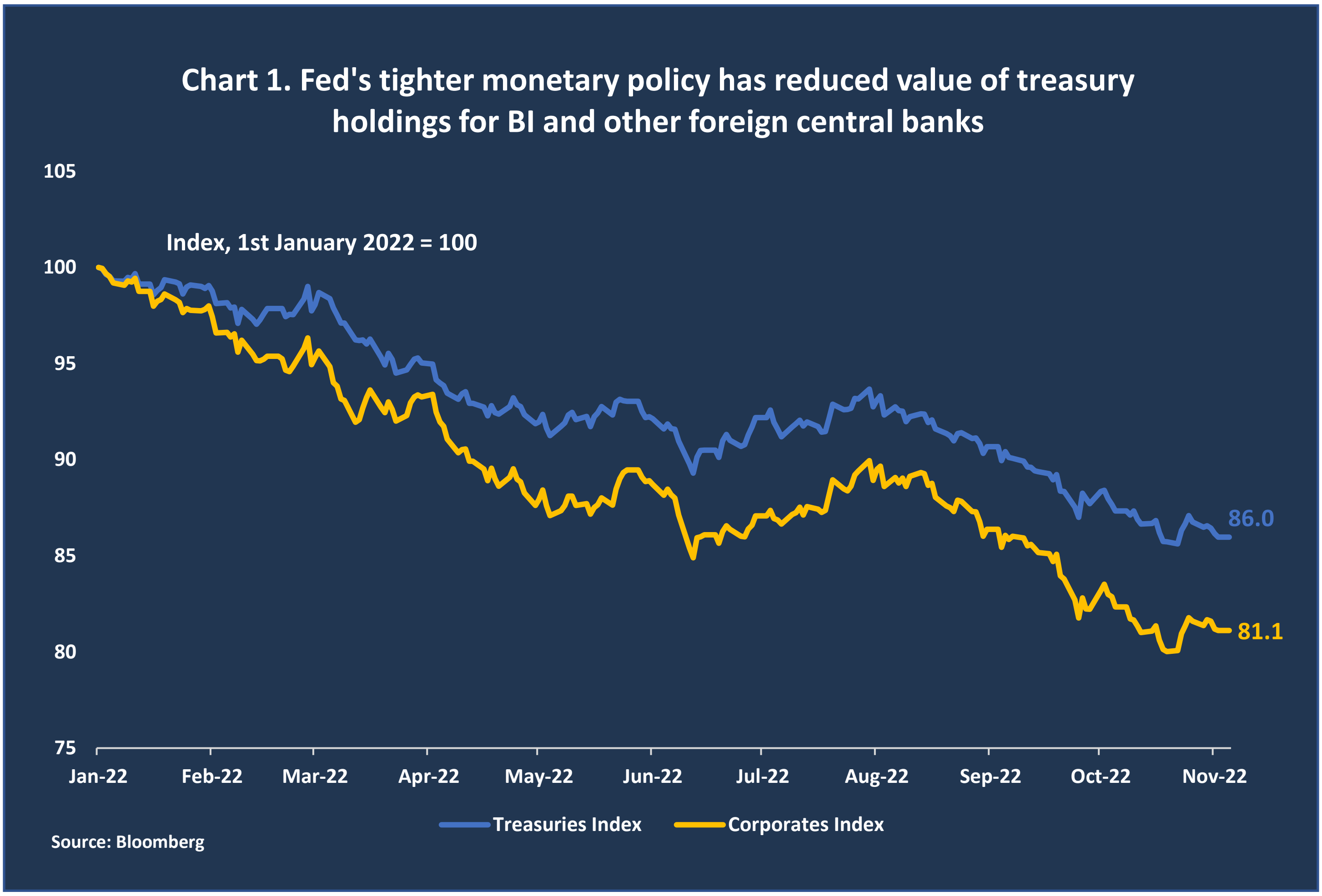
Chart 1. Fed's tighter monetary policy has reduced value of treasury holdings for BI and other foreign central banks
Index, 1st January 2022 = 100
105
100
95
90
85
80
75
Jan-22
Feb-22
Mar-22
Apr-22
May-22
Jun-22
Jul-22
Aug-22
Sep-22
Oct-22
Nov-22
86.0
81.1
Treasuries Index
Corporates Index
Source: Bloomberg

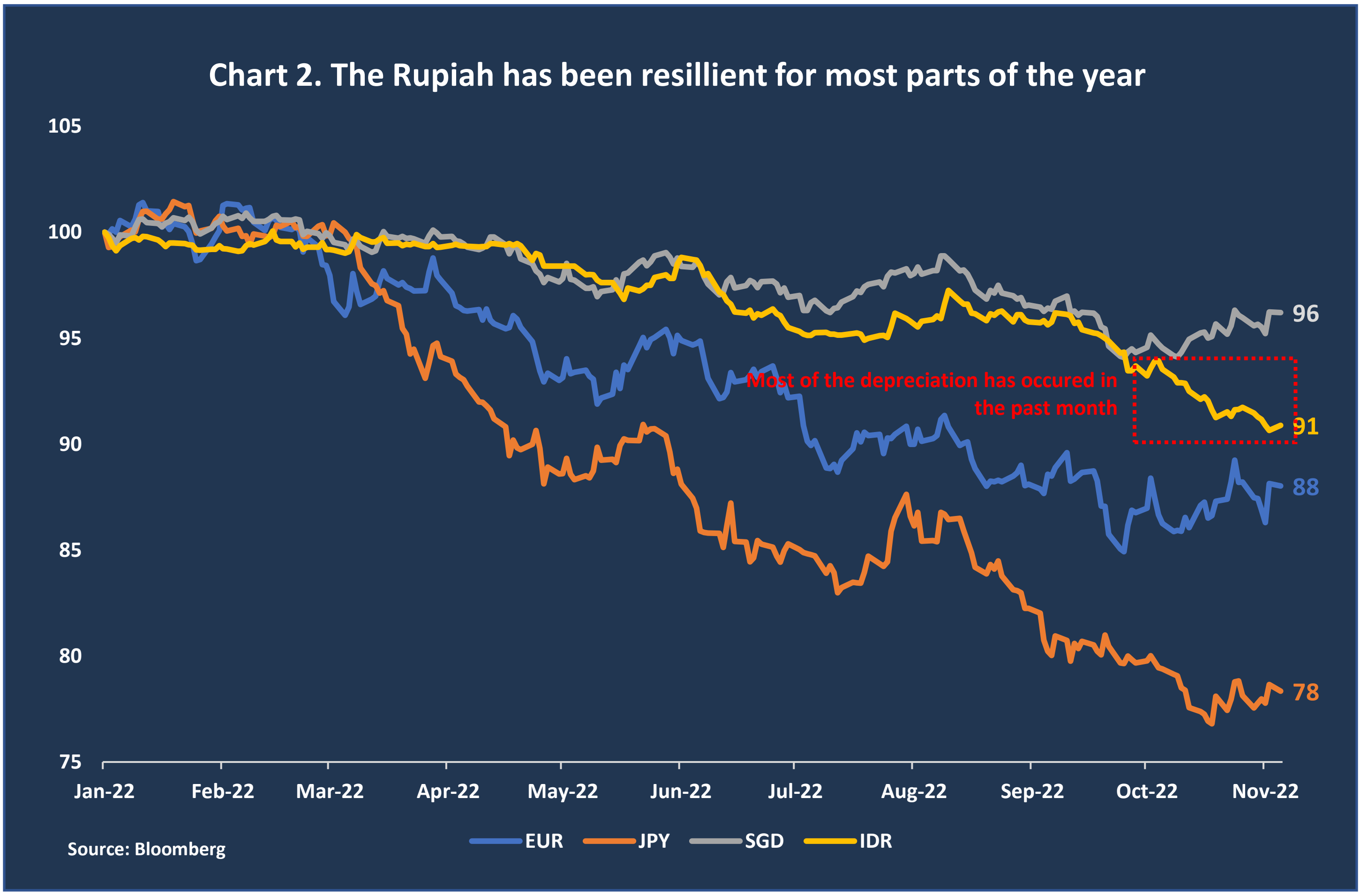
Chart 2. The Rupiah has been resillient for most parts of the year
105
100
95
90
85
80
75
Jan-22
Feb-22
Mar-22
Apr-22
May-22
Jun-22
Jul-22
Aug-22
Sep-22
Oct-22
Nov-22
Most of the depreciation has occured in the past month
96
91
88
78
EUR
JPY
SGD
IDR
Source: Bloomberg

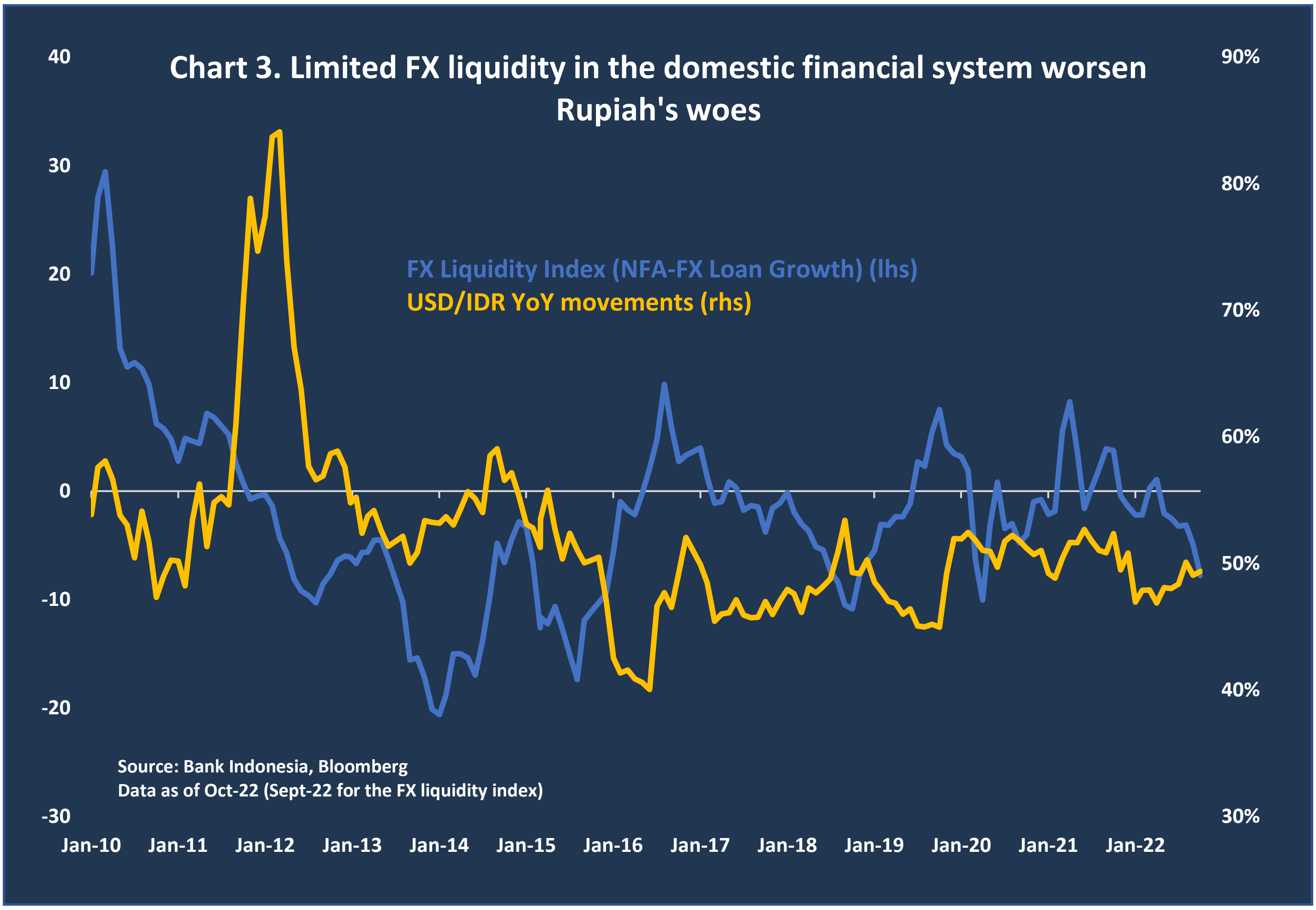
Chart 3. Limited FX liquidity in the domestic financial system worsen Rupiah's woes
FX Liquidity Index (NFA-FX Loan Growth) (lhs)
USD/IDR YoY movements (rhs)
Source: Bank Indonesia, Bloomberg
Data as of Oct-22 (Sept-22 for the FX liquidity index)
40
30
20
10
0
-10
-20
-30
90%
80%
70%
60%
50%
40%
30%
Jan-10
Jan-11
Jan-12
Jan-13
Jan-14
Jan-15
Jan-16
Jan-17
Jan-18
Jan-19
Jan-20
Jan-21
Jan-22

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	3.25	Oct-22	-4.95
UK	2.25	Oct-22	-7.85
EU	2.00	Oct-22	-8.70
Japan	-0.10	Jan-16	-3.10
China (lending)	4.35	Oct-22	1.55
Korea	3.00	Oct-22	-2.70
India	5.90	Sep-22	-1.51
Indonesia	4.75	Oct-22	-0.96

Money Mkt Rates	4-Nov	-1 mth	Chg (bps)
SPN (1M)	4.96	4.25	71.7
SUN (10Y)	7.44	7.25	19.7
INDONIA (O/N, Rp)	4.30	3.84	45.8
JIBOR 1M (Rp)	5.43	4.88	55.2

Bank Rates (Rp)	Jul	Jun	Chg (bps)
Lending (WC)	8.42	8.40	1.37
Deposit 1M	2.83	2.84	-1.02
Savings	0.64	0.62	1.50

Currency/USD	4-Nov	-1 mth	Chg (%)
UK Pound	0.879	0.871	-0.85
Euro	1.004	1.001	-0.29
Japanese Yen	146.6	144.1	-1.70
Chinese RMB	7.185	7.116	-0.96
Indonesia Rupiah	15,738	15,245	-3.13

Capital Mkt	4-Nov	-1 mth	Chg (%)
JCI	7,045.5	7,072.3	-0.38
DJIA	32,403.2	30,316.3	6.88
FTSE	7,334.8	7,086.5	3.50
Nikkei 225	27,199.7	26,992.2	0.77
Hang Seng	16,161.1	17,079.5	-5.38

Foreign portfolio ownership (Rp Tn)	Oct	Sep	Chg (Rp Tn)
Stock	2,630.5	2,526.7	103.76
Govt. Bond	713.2	730.3	-17.02
Corp. Bond	15.4	15.5	-0.12

Trade & Commodities	4-Nov	-1 mth	Chg (%)
Baltic Dry Index	1,323.0	1,865.0	-29.1
S&P GSCI Index	665.9	642.0	3.7
Oil (Brent, $/brl)	98.6	91.8	7.4
Coal ($/MT)	349.0	408.0	-14.5
Gas ($/MMBtu)	4.45	5.41	-17.7
Gold ($/oz.)	1,681.9	1,726.1	-2.6
Copper ($/MT)	8,136.0	7,800.0	4.3
Nickel ($/MT)	23,721.0	21,934.0	8.1
CPO ($/MT)	884.3	744.4	18.8
Rubber ($/kg)	1.24	1.34	-7.5

External Sector	Sep	Aug	Chg (%)
Export ($ bn)	24.80	27.86	-11.0
Import ($ bn)	19.81	22.15	-10.6
Trade bal. ($ bn)	4.99	5.71	-12.6
Central bank reserves ($ bn)*	130.2	132.2	-1.52

Prompt Indicators	Sep	Aug	Jul
Consumer confidence index (CCI)	117.2	124.7	123.2
Car sales (%YoY)	18.9	16.4	29.4
Motorcycle sales (%YoY)	10.7	11.6	-13.3

Manufacturing PMI	Oct	Sep	Chg (bps)
USA	50.2	50.9	-70
Eurozone	46.4	48.4	-200
Japan	50.7	50.8	-10
China	49.2	48.1	110
Korea	48.2	47.3	90
Indonesia	51.8	53.7	-190

Source: Bloomberg, BI, BPS
Notes:
^Data for January 2022
*Data from an earlier period
For changes in currency: **Black indicates appreciation against USD, **Red** otherwise
***For PMI, **>50** indicates economic expansion, **<50** otherwise

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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$)	3877	3927	4175	3912	4350	4564
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	6.4
BI 7-day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	5.5
USD/IDR Exchange Rate (end of the year)**	13,433	14,390	13,866	14,050	14,262	15,584
Trade Balance (US$ 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 the Rupiah's fundamental exchange rate

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