

FX Reserves:

New tools to manage Rupiah's stability

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Executive Summary

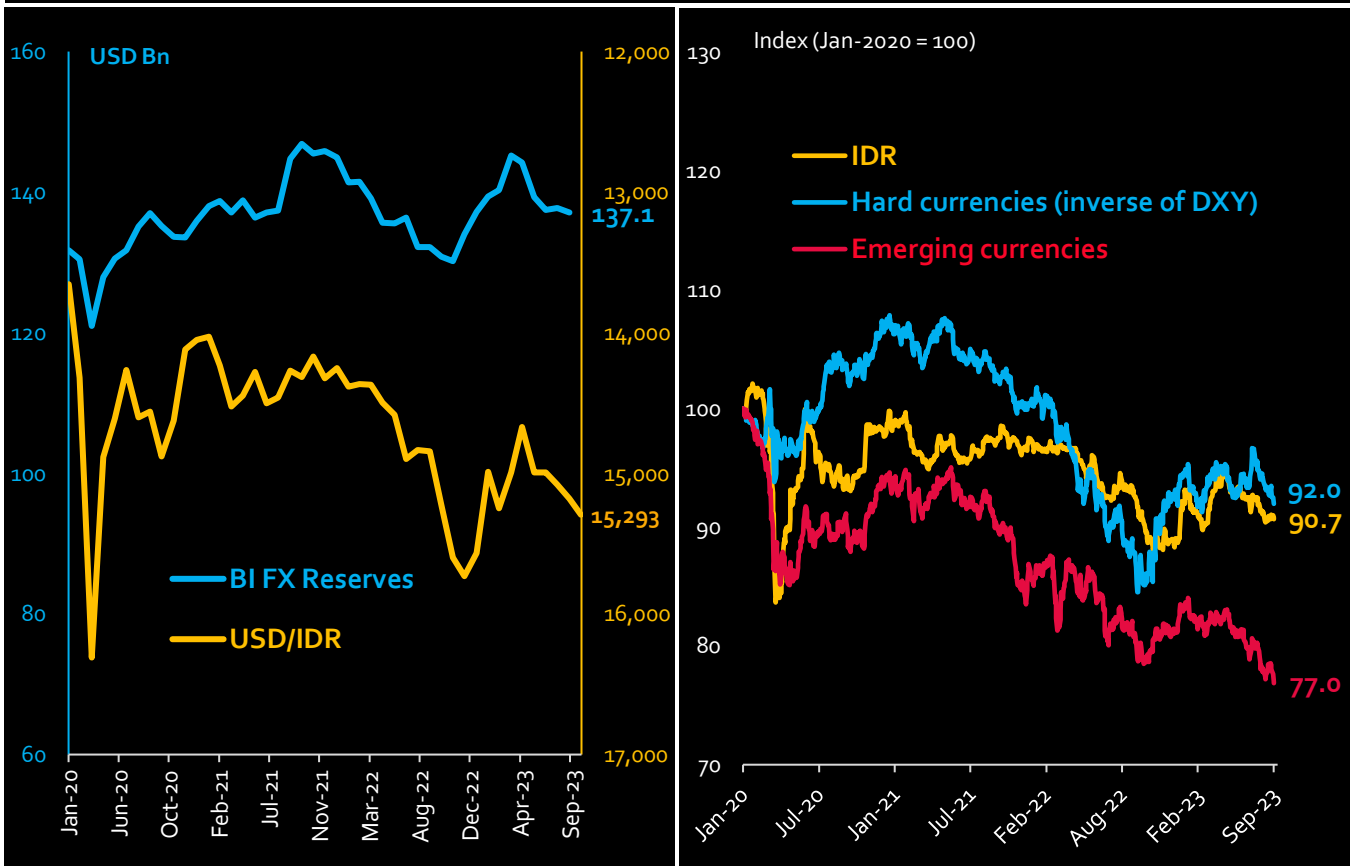
- BI FX reserves declined slightly to USD 137.1 Bn at the end of August, likely due to increasing pressures from rising USD and foreign capital outflows.
- Chinese economic troubles have put a strain on Indonesian exports and pressures on Asian currencies, including the IDR.
- Indonesian imports continue to rise due to rising oil prices and higher capital and consumer goods imports.
- BI would likely not use rate hikes to stabilize the Rupiah, considering the slow monetary transmission in the last rate-hike cycle.
- BI will likely use a combination of exchange-rate and bond market interventions, along with two new policy tools: requiring exports to place a minimum of 30% of their export receipts domestically and absorbing IDR liquidity with SRBI, to smooth out fluctuations in the IDR.

- Indonesia's FX reserves stood at USD 137.1 Bn at the end of Aug-23, representing a decline of USD 0.6 Bn compared to previous month's figures. Unlike in previous month, very little of this change could be attributed to either global bond maturity or issuance; instead, the decline seems largely to reflect the ongoing twin pressures of rising USD and foreign capital outflows (USD 1.32 Bn in equities and 0.54 Bn in bonds).
- But while the decline in August was much milder than those in May or June, the situation might be more concerning, as it seems to be driven by more persistent issues. To be sure, Indonesian fundamentals remains robust, and indicators of risk perception (the non-deliverable forward/NDF spread and CDS premium) has been remarkably stable. However, the current global economy is in a much less hospitable state, no less for Indonesia. Indeed, the IDR has depreciated by 1.4% MoM in Aug-23 amid a sharp gain (more than 2% MoM) in the DXY.
- The most troubling issue is of course China, whose economic malaise have put a huge strain on Indonesia's raw materials exports (particularly coal), while weak purchasing power of Chinese consumers has kept demand for e.g. tourism to Indonesia weak even after the reopening. The depreciation of the Yuan have also had contagion effect on other Asian currencies – to much more significant effect, perhaps, than the deflationary contagion that we have been hoping for.
- Meanwhile, the cut in oil production by OPEC+ spells trouble in two ways. Firstly, the renewed inflationary pressures make it less likely that the Fed is going to pivot anytime soon (the

market's median date for pivot has shifted from Q1-24 to mid-24). Secondly and more importantly, it is poised to significantly narrow down Indonesia's trade surplus, compounding the issue of weak commodity exports to China.

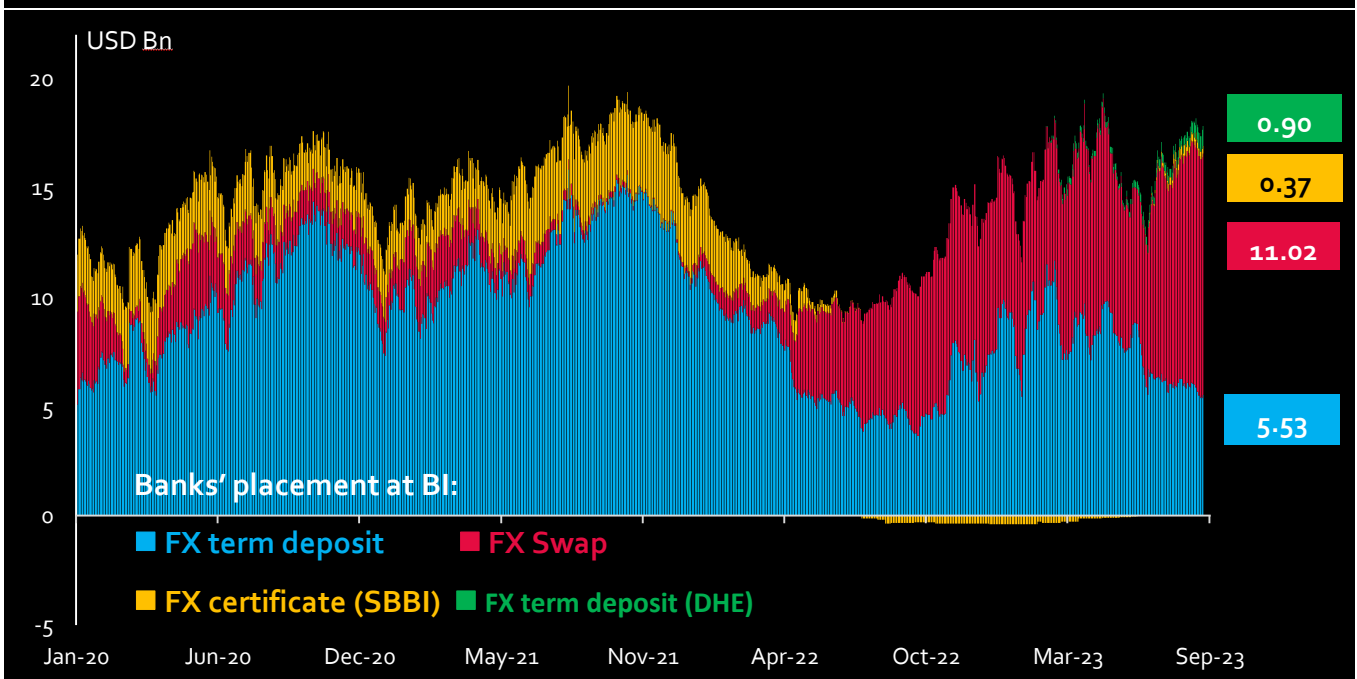
- Add these to Indonesian imports, which seems to be gaining strength not just for capital goods but now also for consumer goods, and we are getting the recipe for a sustained current account deficit in the next few quarters. Indeed, history suggests that when Indonesia gets into a CA deficit, it takes a minimum of one year to pull back into the black again. Without a quick Chinese turnaround or significant luck with regards to commodity prices, this will probably hold true this time around, too.
- The other way to quickly pull out of a CA hole is by what economists like to call, euphemistically, "demand adjustment" – through interest rate hikes, fuel hikes, cuts in fiscal spending, etc. But these are probably not a palatable buffet in an election year, and there is no guarantee either that rate hikes would deliver a sharp liquidity squeeze that would be needed to stabilize the Rupiah in a pinch, given the relatively slow monetary transmission that we have seen from BI's last hike cycle.
- At the moment, then, BI is likely to use a combination of exchange-rate and bond market interventions to smooth out the fluctuations of the Rupiah. However, BI is well aware of the danger of overusing the reserves, and fortunately it now has two new policies that could (a) top up and (b) conserve those reserves.
- Policy (a) is of course the requirement that commodity exporters place a minimum of 30% of their export receipts (devisa hasil ekspor/DHE) domestically. Effective on August 1st, it seems to have had some noticeable effect on FX liquidity, as proven by the sharp increase in BI's special term deposit facility for export receipts (TD-DHE), whose amount outstanding has gone up from USD 366 Mn at the end of July to USD 901 Mn by our latest reckoning. The stick, as such, has complemented the carrot.
- Meanwhile, policy (b) is the SRBI (Sekuritas Rupiah Bank Indonesia), which – as we have touched previously – allows BI to securitize its government bond (SBN) holdings and absorb liquidity. But unlike the typical reverse repo operation, SRBI can be traded in the secondary market, allowing an even wider absorption of IDR liquidity. This ability to rapidly drawing down IDR liquidity should help reduce the need for BI to add into FX liquidity (i.e. spend its FX reserves) in order to keep the exchange rate stable.

Panel 1. FX reserves are stabilizing, but the pressure on emerging currencies have remained significant



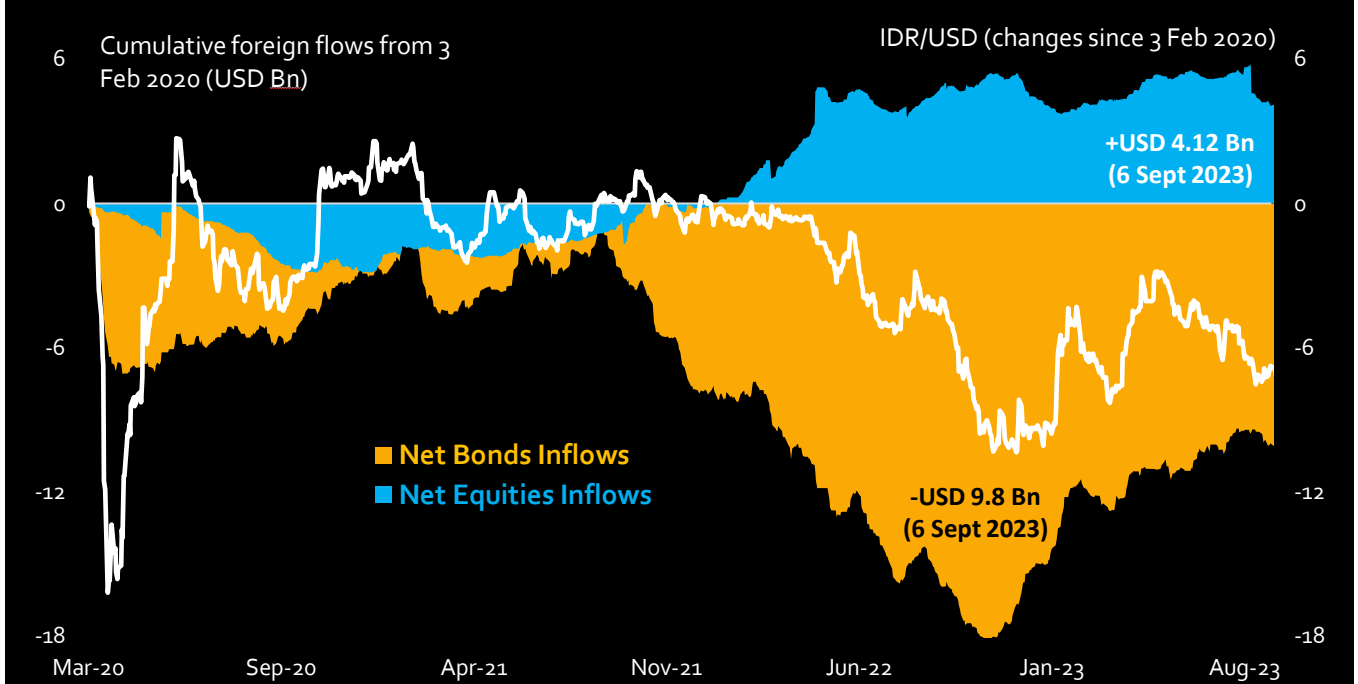
Source: Bloomberg

Chart 1. The value of export receipts (DHE)-linked instrument has increased since DHE rule-change in Aug 1st, but it is still a minor contributor to banks' overall FX liquidity

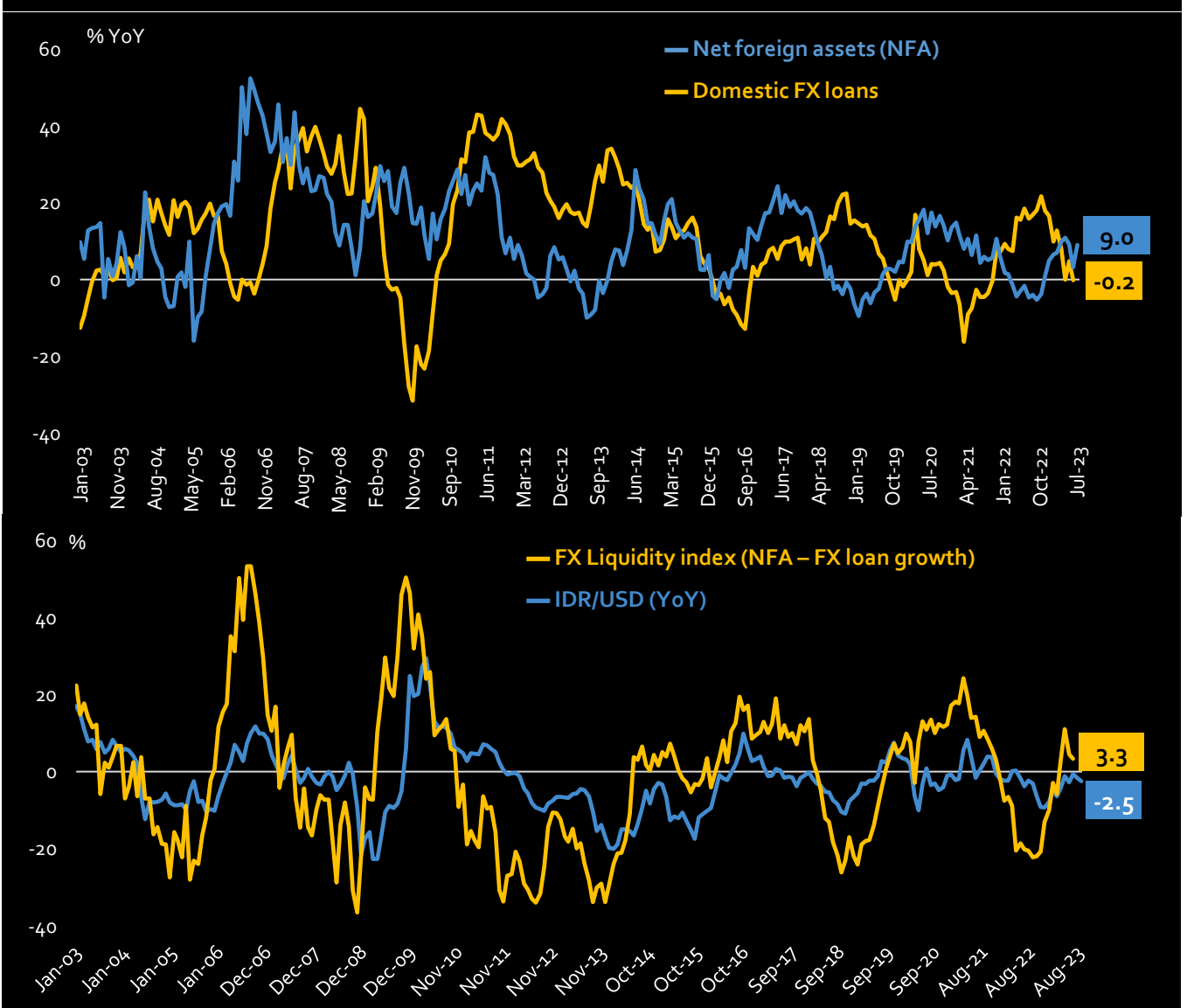


Source: BI

Chart 2. IDR depreciation further exacerbated by the outflow of foreign capital from both the bond and stock market in August

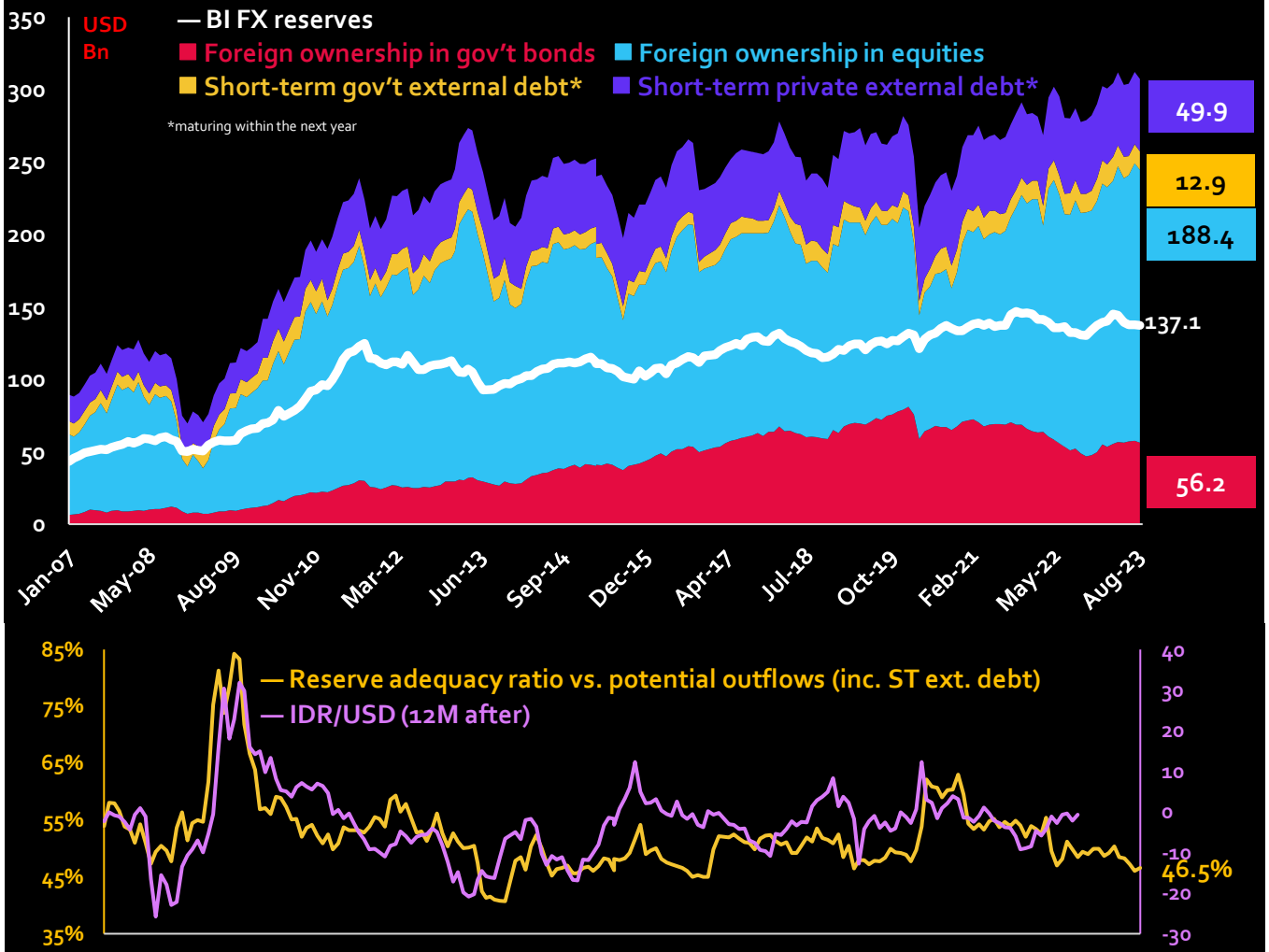


Panel 2. Domestic FX liquidity has slowed down slightly in recent months



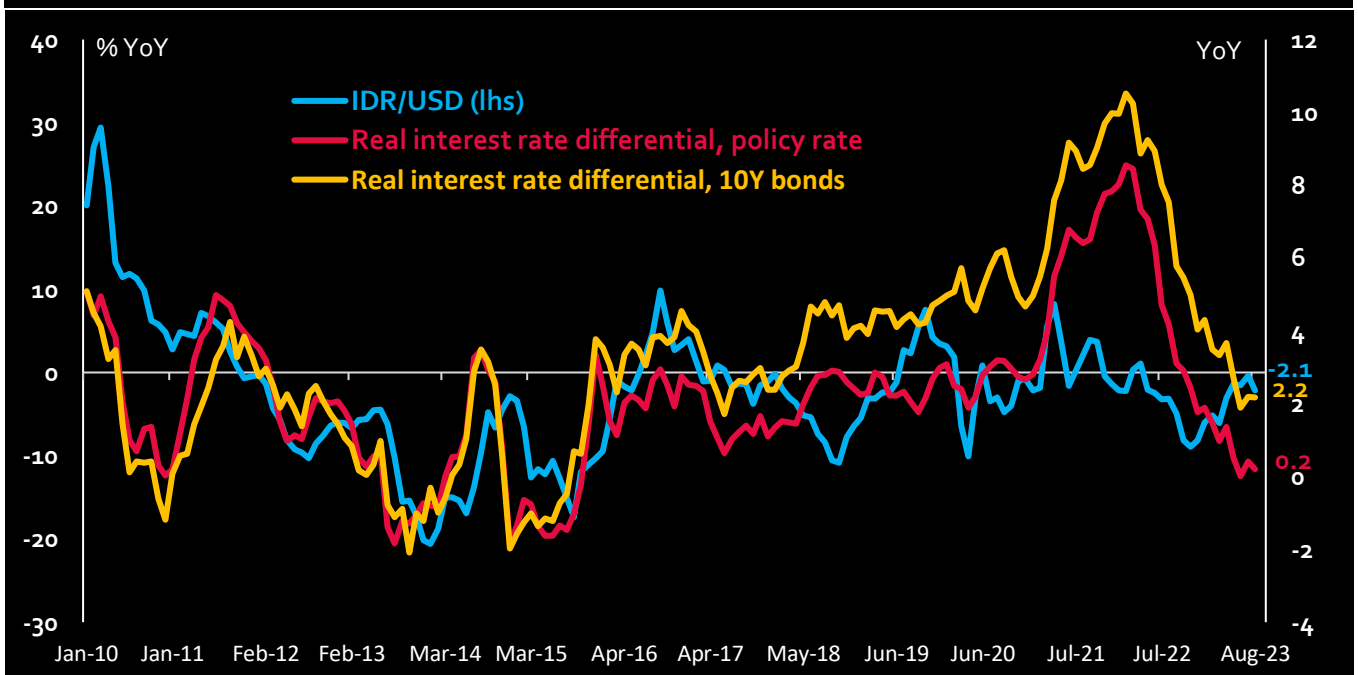
Source: BI, Bloomberg

Panel 3. FX reserve coverage has fallen slightly, partly also due to recent outflows



Source: BI, Bloomberg

Chart 3. IDR/USD has been much less dependent on ID-US real rate differentials



Source: Bloomberg

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	7-Aug	-1 mth	Chg (%)
US	5.50	Aug-23	2.50	Baltic Dry Index	1,145.0	1,009.0	13.5
UK	5.25	Aug-23	-2.65	S&P GSCI Index	588.3	551.8	6.6
EU	4.25	Aug-23	-1.05	Oil (Brent, \$/bbl)	85.3	78.5	8.8
Japan	-0.10	Jan-16	-3.40	Coal (\$/MT)	144.3	145.5	-0.8
China (lending)	4.35	Aug-23	4.35	Gas (\$/MMBtu)	2.65	2.48	6.9
Korea	3.50	Jul-23	1.20	Gold (\$/oz.)	1,936.6	1,925.1	0.6
India	6.50	Jun-23	1.69	Copper (\$/MT)	8,436.1	8,360.5	0.9
Indonesia	5.75	Jul-23	2.67	Nickel (\$/MT)	20,863.0	20,606.0	1.2
Money Mkt Rates	7-Aug	-1 mth	Chg (bps)	CPO (\$/MT)	834.2	812.9	2.6
				Rubber (\$/kg)	1.27	1.31	-3.1
SPN (1M)	5.24	4.93	30.7	External Sector	Jun	May	Chg (%)
SUN (10Y)	6.34	6.23	10.8	Export (\$ bn)	20.61	21.71	-5.08
INDONIA (O/N, Rp)	5.69	5.58	11.0	Import (\$ bn)	17.15	21.28	-19.40
JIBOR 1M (Rp)	6.40	6.39	0.8	Trade bal. (\$ bn)	3.45	0.43	708.66
Bank Rates (Rp)	May	Apr	Chg (bps)	Central bank reserves (\$ bn)*	137.5	139.3	-1.25
Lending (WC)	8.93	8.92	0.35	Prompt Indicators	Jun	May	Apr
Deposit 1M	4.19	4.18	1.37	Consumer confidence index (CCI)	127.1	128.3	126.1
Savings	0.67	0.67	0.00	Car sales (%YoY)	4.7	65.2	-28.8
Currency/USD	7-Aug	-1 mth	Chg (%)	Motorcycle sales (%YoY)	66.6	113.4	-19.4
UK Pound	0.782	0.779	-0.43	Manufacturing PMI	Jul	Jun	Chg (bps)
Euro	0.909	0.912	0.32	USA	46.4	46.0	40
Japanese Yen	142.5	142.2	-0.20	Eurozone	42.7	43.4	-70
Chinese RMB	7.193	7.225	0.45	Japan	49.6	49.8	-20
Indonesia Rupiah	15,185	15,135	-0.33	China	49.2	50.5	-130
Capital Mkt	7-Aug	-1 mth	Chg (%)	Korea	49.4	47.8	160
JCI	6,886.4	6,716.5	2.53	Indonesia	53.3	52.5	80
DJIA	35,473.1	33,734.9	5.15				
FTSE	7,554.5	7,256.9	4.10				
Nikkei 225	32,254.6	32,388.4	-0.41				
Hang Seng	19,537.9	18,365.7	6.38				
Foreign portfolio ownership (Rp Tn)	Jul	Jun	Chg (Rp Tn)				
Stock	2,892.9	2,755.0	137.88				
Govt. Bond	846.9	846.9	0.00				
Corp. Bond	11.3	11.3	-0.03				

Source: Bloomberg, BI, BPS

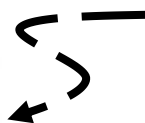
Notes:

^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



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Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3	5.2
GDP per Capita (US\$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.7
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US\$ billion)	-8.5	-3.2	21.7	35.3	54.5	35.3
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.7

*Estimated number

** Estimation of Rupiah's fundamental exchange rate

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