FX Reserves:

Getting worse before it gets better

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Executive Summary

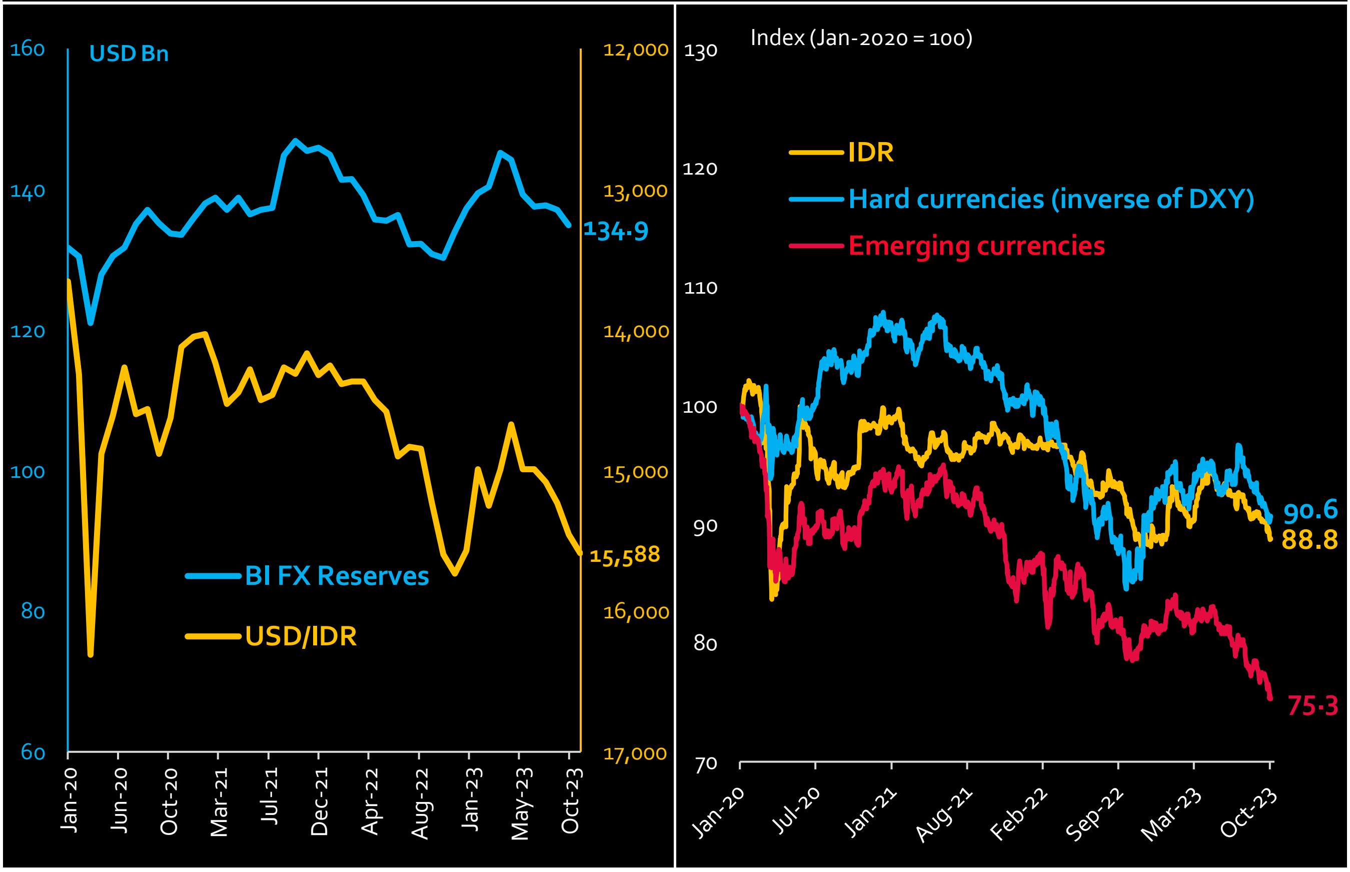
- Foreign exchange reserves decreased significantly to $134.9 billion in September 2023, as BI had to intervene amidst a bearish global market, strong US dollar, and capital outflows.
- Export receipt regulations and SRBI has been quite successful, but not enough to offset the capital outflows in recent weeks.
- The global market volatility might worsen before it gets better, and FX reserves remain key for Indonesia to weather the storm – although BI will probably aim to dampen the pace of depreciation rather than targeting a certain level of USD/IDR.
- In the short-term, the risk from IDR depreciation lies mainly in the upcoming maturity of FX debt, but there may also be benefits especially in restoring trade balance against China and other Asian countries and also supporting loan and deposit growth.

- Indonesia's foreign exchange reserves stood at USD 134.9 Bn at the end of Sept-23, a significant decrease of USD 2.2 Bn compared to the previous month. This month's hefty drop is consistent with the need for FX intervention, as the USD rallied and foreign capital flowed out of Indonesian markets (USD 1.1 Bn in bonds and USD 0.26 Bn in equities).
- All these are of course driven by a severely bearish turn in the global market, as investors increasingly lose faith in the "Fed pivot + soft landing" scenario, due in part to a resilient US economy and its job market in particular. And as the oil price become increasingly volatile – with the latest Israel-Hamas War providing the latest twist – it only adds fuel to the narrative of prolonged tight money policy from the Fed, resulting in a steeper UST yields and even stronger USD.
- We mentioned two weeks ago, in a report on Fed and BI policy, that pivot and soft landing is now nigh incompatible. A pivot will likely require a hard landing, otherwise the Fed will probably commit to a prolonged tight-money policy. In other words, things will have to get worse before it could get better.
- The question, then, is whether BI has sufficient resources left in its war chest to ride out the storm. On the surface, things does not appear promising – the Indonesian 10Y sovereign yields have been flirting with 7.00% in recent days, while the Rupiah performed worse than some of its peers such as the PHP and MYR in recent weeks despite BI's apparent intervention.
- The much-touted export receipts regulations have also been insufficient to offset the outflows. Since the requirement on commodity exporters to post 30% of their export receipts at home was effective on August 1st, we had seen around USD 2.3 Bn increase in banks' excess FX

liquidity – of which USD 1.3 Bn was placed directly in BI's special term deposit facility (TD-DHE). This was less than the USD 3.2 Bn in portfolio outflows during the same period.

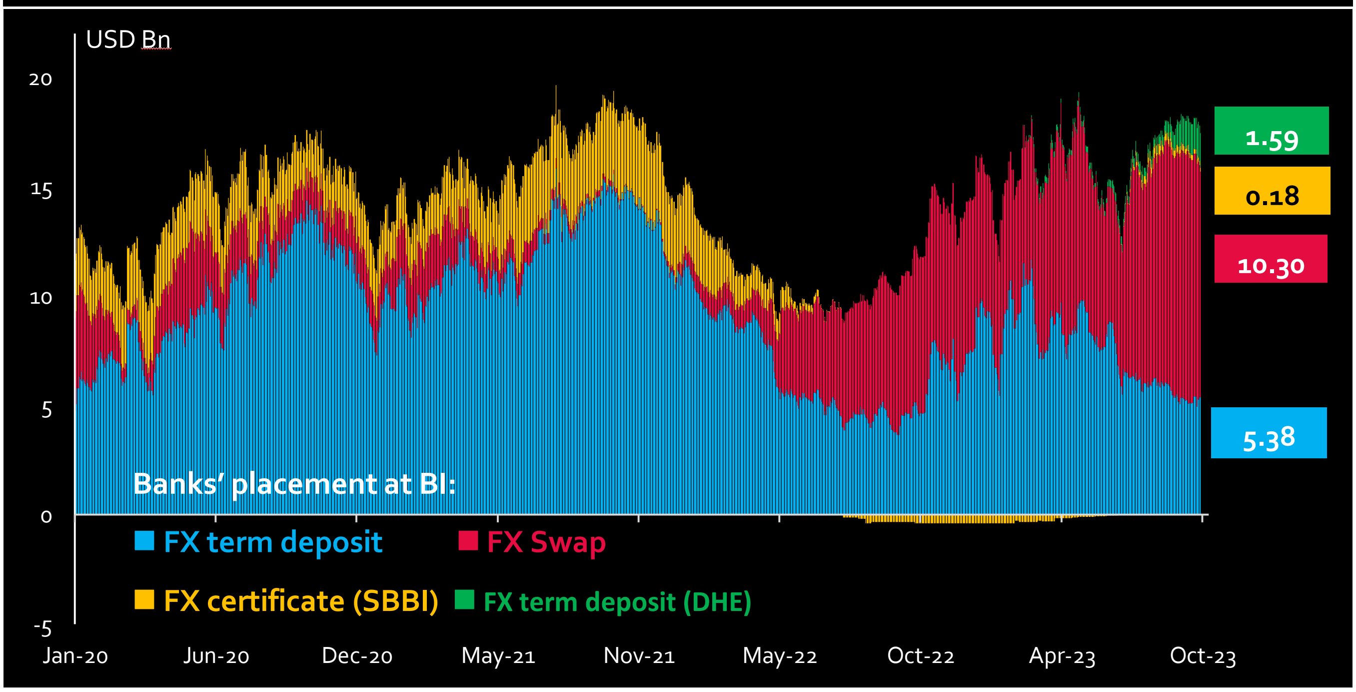
- BI can, of course, issue SRBI as a way to absorb IDR liquidity – and it works, given the amount of incoming bids in every SRBI auction so far. Still, any positive impact it has on exchange rate movements have been rather indirect, and is essentially a trade off against tighter liquidity and potentially weaker loan growth.
- For the time being, then, with "king Dollar" still reigning supreme, BI will probably continue to "step into the ring" from time to time in order to rein in the more extreme gyrations. We do not think that BI would (or should) target a particular level of IDR/USD, but rather its first difference – in other words, it matter less what level the Rupiah eventually lands on each day, but it matters how fast it gets there.
- Besides, it can be argued that at this point, the risk-reward calculus on IDR depreciation may be skewed towards the latter. Remember that the IDR remains one of the better-performing currencies in Asia – certainly compared to the CNY – and a weaker Rupiah may restore some of the trade imbalances that has happened in recent months. It can also translate to a larger money stock, which – during a time of low and declining core inflation – can arrest some of the deflationary trend with regards to transaction, bank loans, and deposits.
- On the other hand, the main danger that could arise from IDR depreciation lies in FX debt repayment. According to Bloomberg, about USD 9.1 Bn worth of FX sovereign bonds is coming due until the end of Q2-24, with USD 2.0 Bn more for SOE bonds and USD 1.1 Bn for private sector bonds. Given this outsized contribution of public sector debt, BI's reserves will still play a key role in managing the risk of depreciation – until things will, hopefully, get better.

***Panel 1.* FX reserves are deteriorating, and the pressure on IDR and emerging currencies have remained significant**



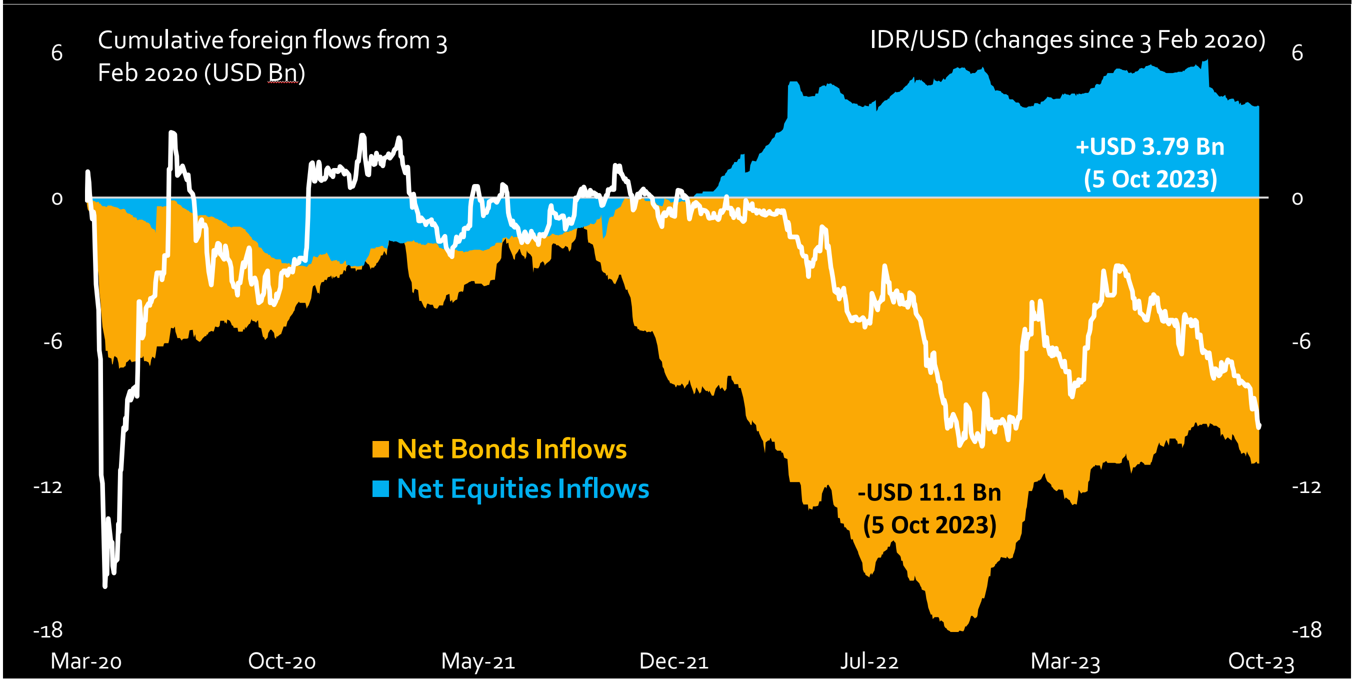
Source: Bloomberg

***Chart 1.* The value of export receipts (DHE)-linked instrument has increased since DHE rule-change in Aug 1st, contribute positively to the share of overall FX liquidity**



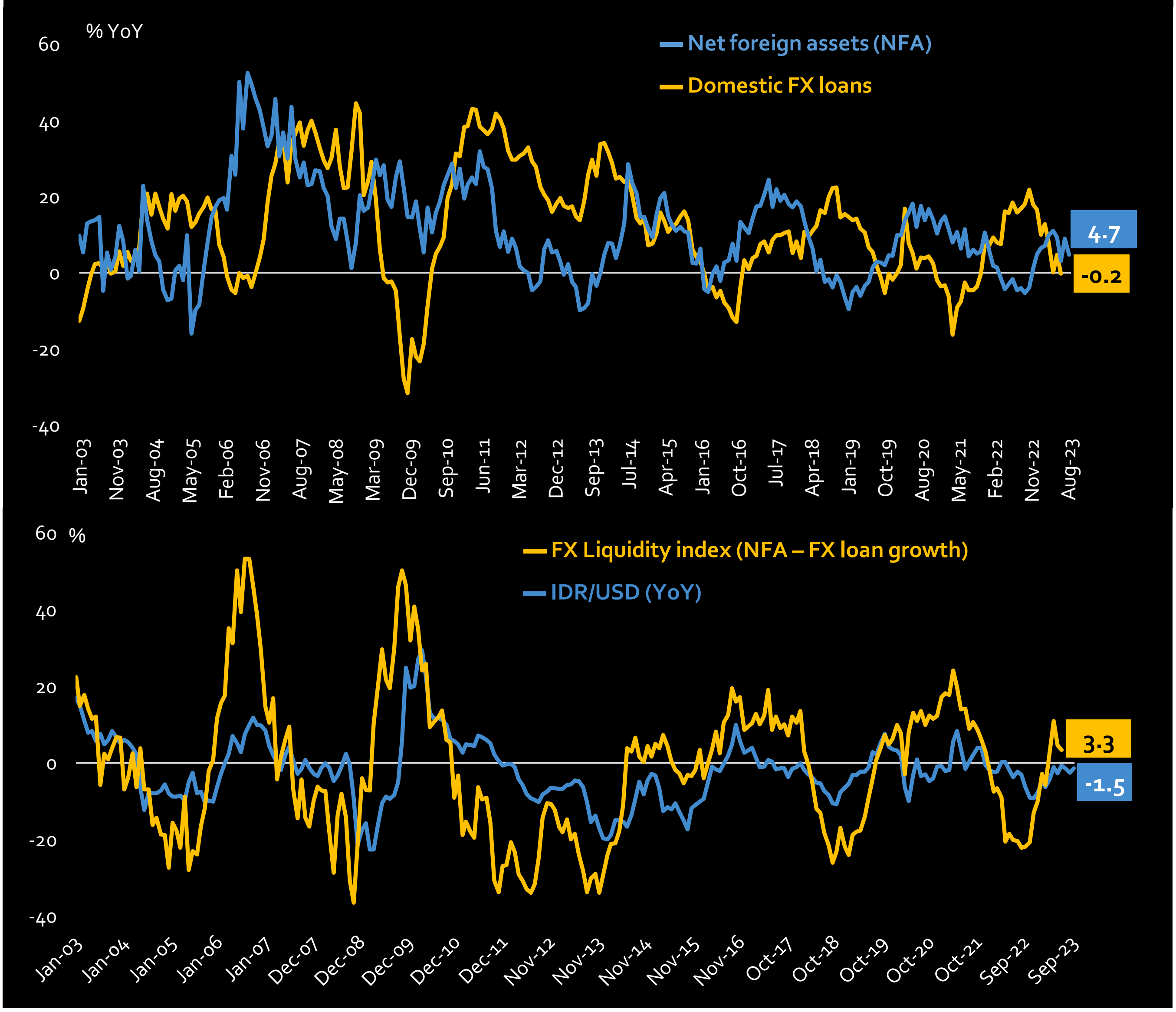
Source: BI

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



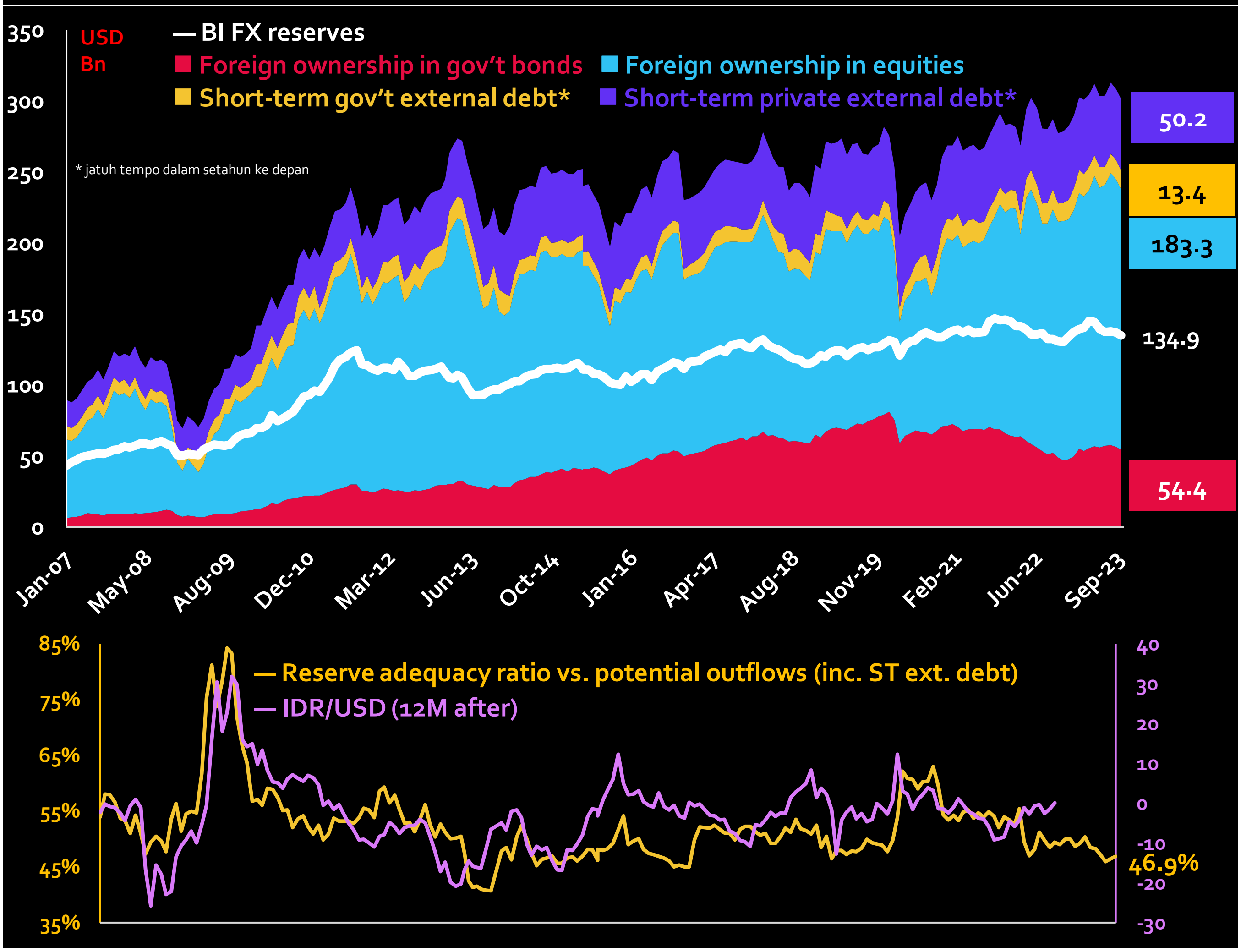
Source: Bloomberg

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



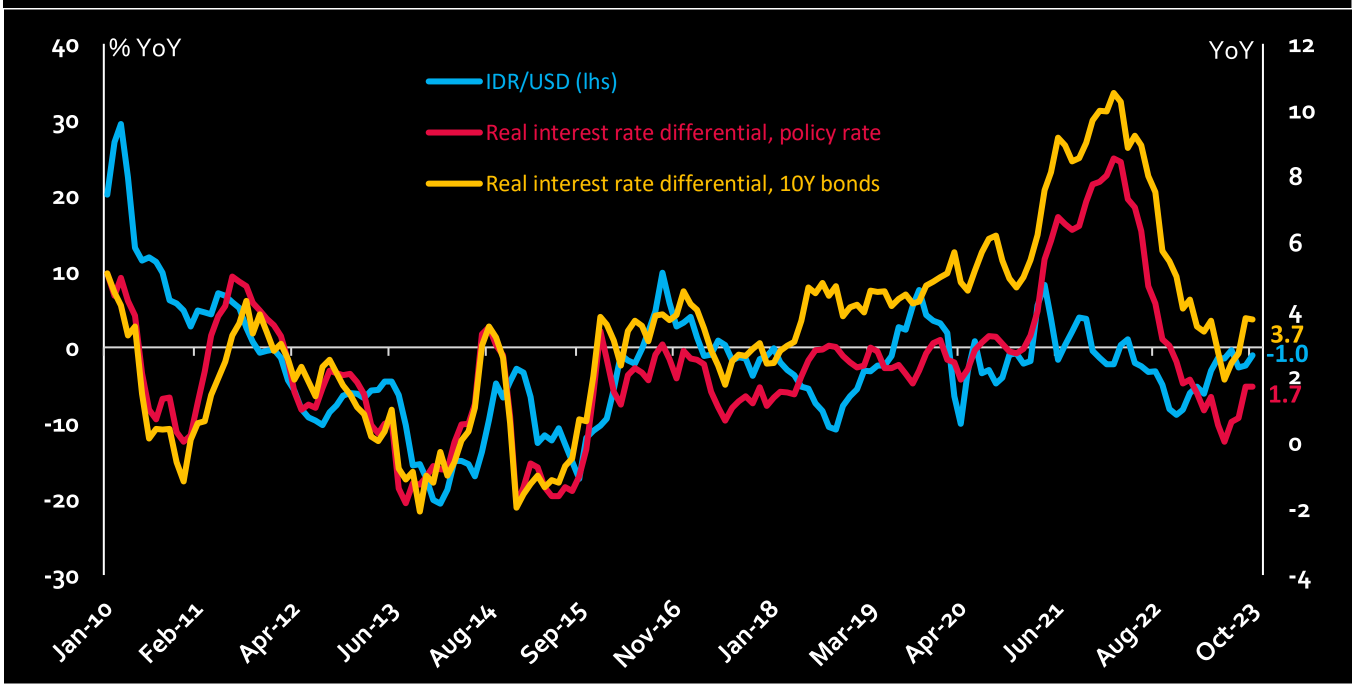
Source: BI, Bloomberg

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 (%)
US	5.50	Oct-23	1.80
UK	5.25	Oct-23	-1.45
EU	4.50	Oct-23	0.20
Japan	-0.10	Jan-16	-3.30
China (lending)	2.50	Sep-23	4.25
Korea	3.50	Aug-23	-0.20
India	6.50	Oct-23	-0.33
Indonesia	5.75	Sep-23	3.47

Money Mkt Rates	6-Oct	-1 mth	Chg (bps)
SPN (1M)	5.70	5.67	3.0
SUN (10Y)	6.99	6.42	57.3
INDONIA (O/N, Rp)	5.58	5.59	-1.5
JIBOR 1M (Rp)	6.40	6.40	0.0

Bank Rates (Rp)	Jun	May	Chg (bps)
Lending (WC)	8.93	8.93	0.00
Deposit 1M	4.19	4.19	0.10
Savings	0.67	0.67	-0.20

Currency/USD	6-Oct	-1 mth	Chg (%)
UK Pound	0.817	0.796	-2.60
Euro	0.945	0.933	-1.27
Japanese Yen	149.3	147.7	-1.07
Chinese RMB	7.298	7.303	0.07
Indonesia Rupiah	15,610	15,265	-2.21

Capital Mkt	6-Oct	-1 mth	Chg (%)
JCI	6,888.5	6,991.7	-1.48
DJIA	33,407.6	34,642.0	-3.56
FTSE	7,494.6	7,437.9	0.76
Nikkei 225	30,994.7	33,036.8	-6.18
Hang Seng	17,486.0	18,456.9	-5.26

Foreign portfolio ownership (Rp Tn)	Sep	Aug	Chg (Rp Tn)
Stock	2,833.3	2,869.7	-36.44
Govt. Bond	823.0	846.3	-23.30
Corp. Bond	10.8	11.1	-0.26

Trade & Commodities	6-Oct	-1 mth	Chg (%)
Baltic Dry Index	1,929.0	1,063.0	81.5
S&P GSCI Index	575.7	604.2	-4.7
Oil (Brent, $/brl)	84.6	90.0	-6.1
Coal ($/MT)	141.6	169.5	-16.5
Gas ($/MMBtu)	3.13	2.60	20.4
Gold ($/oz.)	1,833.0	1,926.1	-4.8
Copper ($/MT)	7,971.3	8,482.5	-6.0
Nickel ($/MT)	18,310.3	20,840.5	-12.1
CPO ($/MT)	766.1	824.1	-7.0
Rubber ($/kg)	1.38	1.40	-1.4

External Sector	Aug	Jul	Chg (%)
Export ($ bn)	22.00	20.86	5.47
Import ($ bn)	18.88	19.57	-3.53
Trade bal. ($ bn)	3.12	1.29	141.85
Central bank reserves ($ bn)*	137.1	137.7	-0.42

Prompt Indicators	Aug	Jul	Jun
Consumer confidence index (CCI)	125.2	123.5	127.1
Car sales (%YoY)	-8.3	-6.7	4.7
Motorcycle sales (%YoY)	1.8	45.6	66.6

Manufacturing PMI	Sep	Aug	Chg (bps)
USA	49.0	47.6	140
Eurozone	43.4	43.5	-10
Japan	48.5	49.6	-110
China	50.6	51.0	-40
Korea	49.9	48.9	100
Indonesia	52.3	53.9	-160

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	5.1
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.6
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,535
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	32.8
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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