Oil swings, exchange rate jabs

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Summary

- The recent spike in oil prices may reflect a heightened conflict premium due to the Iran-Israel tensions, especially considering that the oil market was heading toward oversupply before the conflict.
- Even a modest increase in oil prices could significantly affect US inflation readings, potentially prompting the Fed to adopt a more hawkish stance in the upcoming FOMC meeting.
- Given the revenue shortfall and the weakening Rupiah, even a moderate rise in oil prices could still pose a threat to Indonesia's fiscal balance.

- There is a saying that there are decades when nothing happens, and there are weeks when decades happen. While nothing truly shocking occurred in the past week, it was certainly more eventful than in previous weeks. First, talks on the "big, beautiful" bill are still ongoing, leading to peculiar movements in both the USD and the US Treasury market that initially caught our attention. In the meantime, US Defence Secretary Pete Hegseth has also launched a review of US participation in the AUKUS security partnership, potentially forcing Asia-Pacific countries to boost their defence spending if the US withdraws its commitment from the region.
- Alas, something more eventful unfolded by the end of the week. Israel and Iran began trading missiles on Friday, with Israel expanding its airstrikes on Iranian energy facilities following Iran's retaliatory attacks targeting Tel Aviv. The unsurprising result is a 16.12% MTD increase in Brent oil prices to USD 75.05/bl, a trend many fears may persist as Israeli and Iranian officials continue to speak in a bellicose manner.

Oil and its finicky way towards the equilibrium

- For many, their concern has unfolded in line with textbook economics; higher oil prices are expected to lead to higher energy inflation, further undermining the Fed's rate cut outlook that could trigger another USD rally. For the Indonesian economy, this scenario is akin to being trapped between a rock and a hard place, as higher oil prices and a stronger USD will mostly undermine the government's fiscal capacity ***(see Figure 1)***.
- **Lower oil prices have helped the Indonesian government make do despite the shock to its revenues**. Spending on fuel and other subsidised items was recorded at around IDR 47.4 Tn as of April 2025, representing only 15.3% of its allotted FY 2025 budget. The

realisation of subsidy spending is much slower compared to other items such as goods (37.8% of the annual budget) and even capital expenditures (19.2% of the annual budget) – a condition that might not hold if oil prices return to their start-of-the-year level of USD 78.18/bl or beyond.

- **Using the figures provided in the 2025 macro assumptions and the prevailing USD/IDR exchange rate, oil prices would need to rise by another USD 20-25/bl from their current level for it to start becoming a problem for the government**. Hence, our view remains that the government is playing it safe by assuming oil prices will hover around USD 82/bl in 2025, providing a comfortable cushion in the fiscal space.

"Market balances may protect Indonesia and the global economy from a stratospheric rise in oil prices in the short term"

- Fortunately, we have reasons to expect that oil prices will not be breaking out above the level seen in the previous year (which is around USD 80/bl). For instance, the global oil market was heading toward an oversupply before the Israel-Iran conflict ***(see Chart 1)***, meaning that the added premium from the escalating conflict may be better viewed as a stabilising force that helps oil prices find a floor after the recent downturn.
- Moreover, rising oil prices may be neutralised by oil producers seeking to maintain their oil revenue amidst the slowing demand growth. Saudi Arabia has announced its intention to normalise oil production, which has been kept below 10 Mn bl/d since April 2023, as OPEC+ attempts to manage output amid slowing demand growth.
- Meanwhile, higher domestic oil production is a sensitive issue for the Trump administration, which, as a rule of thumb, needs to keep oil prices above USD 65/bl to encourage shale producers to maintain their production. Higher supply from the two biggest oil producers may keep oil prices stable, while Russia also continues to flood the global oil market to keep its war economy going.
- As with earlier conflicts in recent years, physical threats to Iran's or other Gulf countries' oil facilities due to the ongoing conflict may remain valid only in the speculative realm. For instance, some analysts have also noted that Iran's threat to block the Strait of Hormuz lacks credibility. China still relies on the strait for its oil supply, meaning that any disruption would likely provoke complaints from Iran's largest customer ***(see Chart 1)***. Iranian commando, however, may resume its operation on vessels suspected of being Israeli-linked, potentially increasing shipping premiums on Middle East-bound tankers.

Beware of the indirect exchange rate threat

- While market forces may shield Indonesia and the global economy from another sharp rise in oil prices in the short term, we must acknowledge that our long-term outlook remains obscured by the fog of war. For instance, changing political landscapes in the Middle East (such as further progress in the Arab-Israeli normalisation and successful neutralisation of al-Assad regime and Hezbollah) may embolden Israel to aim for maximalist war goals, complicating the ongoing nuclear peace agreement that may corner Iran to take more drastic action in the Hormuz. Indeed, the timeline of the current conflict remains open to speculation, and prolonged disruptions could eventually reverberate through the global oil market by negatively impacting market balance.

- **Another thing to consider is that there are more than two ways the ongoing Israel-Iran conflict could inflict volatility in the global economy.** For instance, the potential indirect impact of the event on FFR expectations and the USD may be equally significant. As we have noted in a previous report, the stable US inflation is largely attributable to the downturn in energy prices, while 'supercore' inflation, driven by tariffs, is beginning to take hold.
- If that is the case, then why does the FFR futures market continue to point to a total of 50 bps in rate cuts for 2025? The stability in FFR futures may simply reflect the Fed's earlier signal of a 50-bps cut, as communicated in the March 2025 Summary of Economic Projections. Since then, Fed Chairman Powell has begun publicly acknowledging the inflationary impact of tariffs. The Fed is expected to provide updated guidance in the upcoming June 2025 meeting, which may inject a more hawkish tone into market sentiment if FOMC members continue to signal another round in their fight against inflation.
- **The source of our concern for Indonesia, then, is not the rise in oil prices per se, but its spillover effect on the USD and, eventually, the Rupiah.** Given the lack of improvement in the domestic liquidity condition, the recent strengthening in the Rupiah's value could only be attributed to the weakening USD ***(see Chart 2)***, which may strengthen again if rising oil prices (even a modest one) lead to the Fed producing a more hawkish signal.
- **Along with the revenue shortfall (-12.4% as of April 2024), the depreciating Rupiah mean that oil prices may only need to increase to around USD 80-85/bl for the Indonesian government to start getting finicky over its fiscal balance**, as additional deficits due to oil prices rising to that level may push the fiscal balance uncomfortably close of the 3% of GDP limit. Given the limited fiscal room, we should not discount the possibility of fuel price adjustments if things start to develop following the worst-case scenario laid above, although the government may follow the familiar pattern of reallocating some of the freed-up budgets towards a stimulus package aimed at cushioning the blow on the purchasing power of lower-income segments of the population.

"Given the depreciating Rupiah and the revenue shortfall, a modest YTD oil price increase may bring the fiscal deficit uncomfortably close to the 3% target"

Figure 1

Fiscal squeeze

Given the sliding Rupiah, oil prices may not need to return to the 2022 price level before the government starts to rethink its fiscal posture

		USDIDR exchange rate						
		15000	15500	16000	16500	17000	17500	18000
Oil price levels (USD/bl)	70	-2.05	-2.12	-2.19	-2.26	-2.33	-2.39	-2.46
	75	-2.20	-2.26	-2.33	-2.40	-2.47	-2.53	-2.60
	80	-2.34	-2.41	-2.47	-2.54	-2.61	-2.68	-2.74
	85	-2.48	-2.55	-2.61	-2.68	-2.75	-2.82	-2.89
	90	-2.62	-2.69	-2.76	-2.82	-2.89	-2.96	-3.03
	95	-2.76	-2.83	-2.90	-2.97	-3.03	-3.10	-3.17
	100	-2.90	-2.97	-3.04	-3.11	-3.18	-3.24	-3.31
	105	-3.05	-3.11	-3.18	-3.25	-3.32	-3.38	-3.45
	110	-3.19	-3.26	-3.32	-3.39	-3.46	-3.53	-3.59
	115	-3.33	-3.40	-3.46	-3.53	-3.60	-3.67	-3.74
	120	-3.47	-3.54	-3.61	-3.67	-3.74	-3.81	-3.88

Source: *Indonesia MoF, BCA Economic Research*

Chart 1

Turning the corner

Premiums due to the Israel-Iran conflict help oil prices to turn the corner, as it previously suffers from a downturn given the oversupply condition

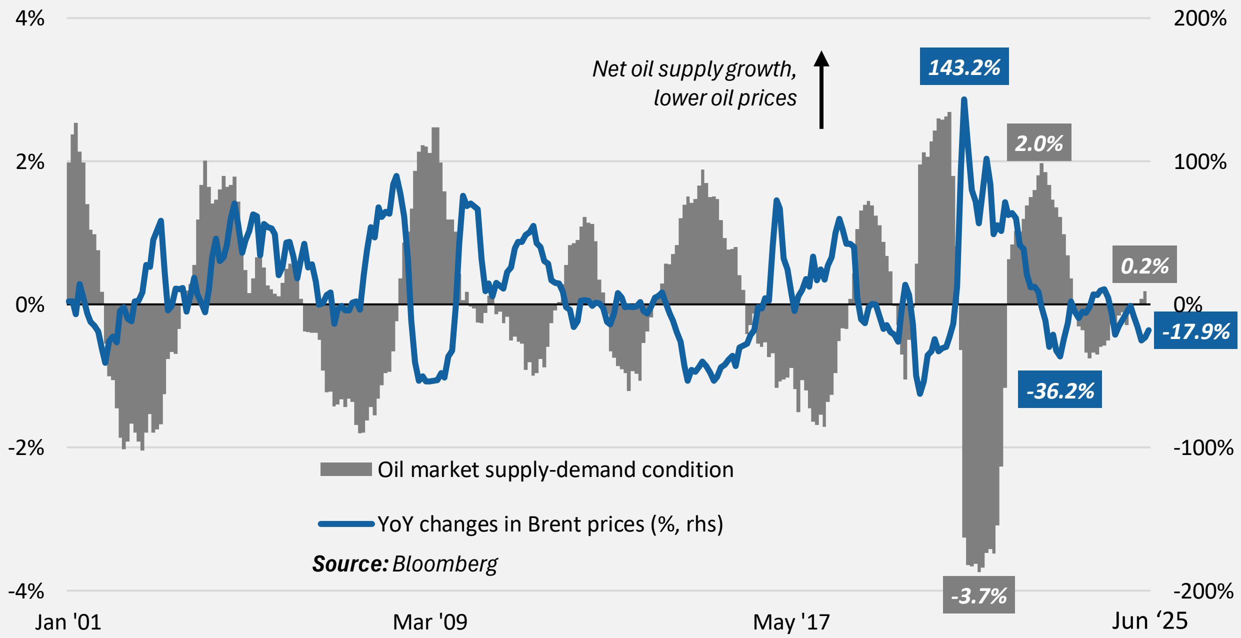
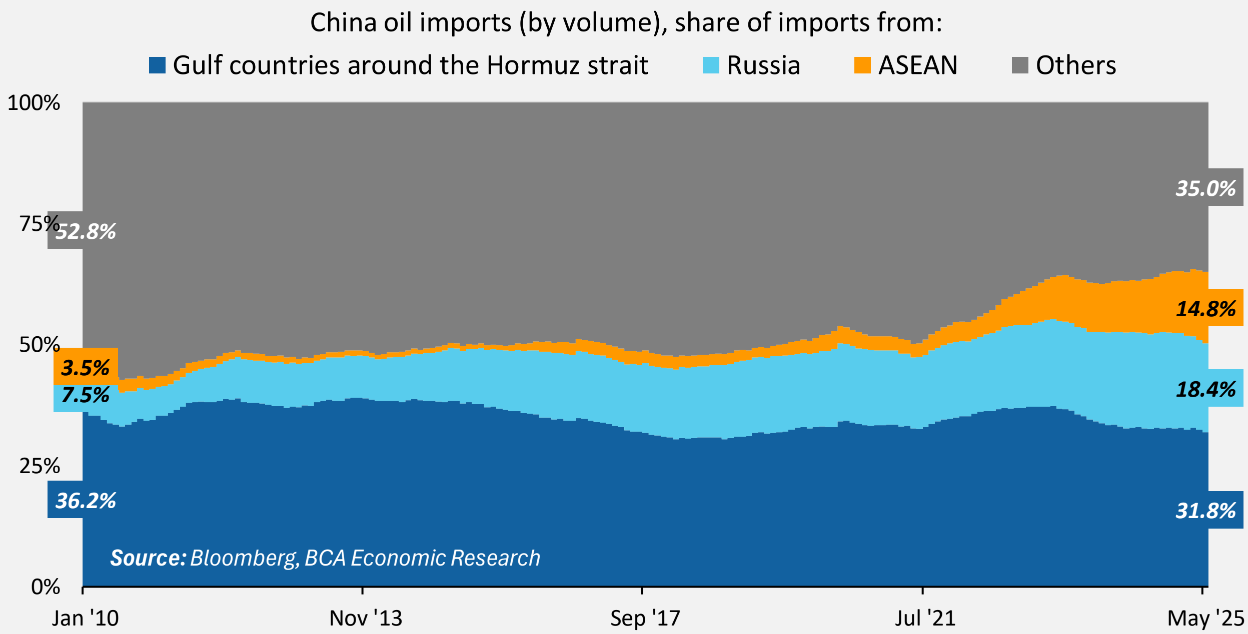


Chart 2

Do not bite the hand that feeds you

The Hormuz strait's strategic importance for China's energy supply chain may deter Iran from launching a drastic action, but the calculus may change in a prolonged conflict

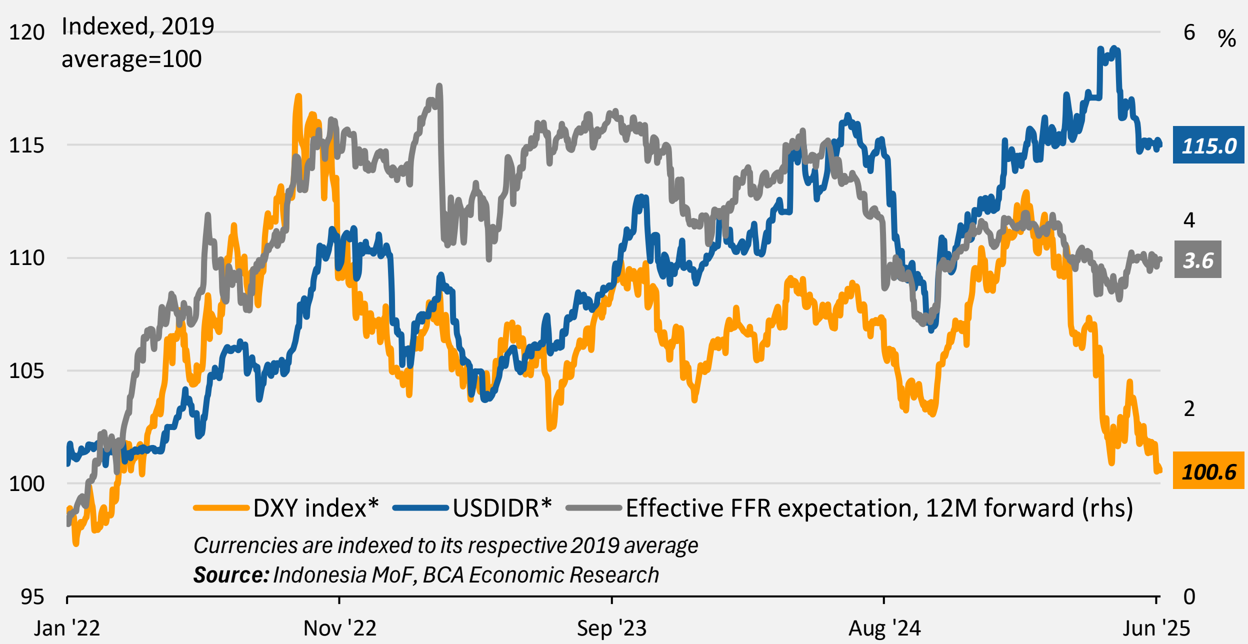


Source: Bloomberg, BCA Economic Research

Chart 3

Good time always comes to an end

The current USD condition may be as better as we may get as returning inflationary pressures due to rising oil prices may embolden the Fed to adopt a hawkish stance



Currencies are indexed to its respective 2019 average

***Source:** Indonesia MoF, BCA Economic Research*

Economic Calendar

		Actual	Previous	Forecast*
02 June 2025				
ID	S&P Global Manufacturing PMI	47.7	46.7	48.3
ID	**Trade balance (Apr-25), USD Bn**	**0.15**	**4.33**	**3.1**
ID	**Inflation Rate YoY, %**	**1.6**	**1.95**	**1.9**
US	S&P Global Manufacturing PMI	52	50.2	52.3
05 June 2025				
US	Balance of Trade, USD Bn	-61.6	-138.3	-66.6
06 June 2025				
EA	Retail Sales YoY, %	2.3	1.9	1.1
US	Non Farm Payrolls, th	139	147	130.0
09 June 2025				
CN	Inflation Rate YoY, %	-0.1	-0.1	-0.2
CN	Balance of Trade, USD Bn	103.22	96.18	100.0
10 June 2025				
ID	**Foreign Exchange Reserves, USD Bn**	**152.5**	**152.5**	**-**
11 June 2025				
US	Inflation Rate YoY, %	2.4	2.3	2.5
ID	Car Sales YoY, %	-15.1	5.0	-
ID	Motorbike Sales YoY, %	-0.1	3	-
12 June 2025				
ID	Consumer Confidence	117.5	121.7	122.2
13 June 2025				
ID	Retail Sales YoY, %	-0.3	5.5	2.1
16 June 2025				
CN	Retail Sales YoY, %	6.4	5.1	4.7
17 June 2025				
US	Retail Sales YoY, %		5.2	-
18 June 2025				
ID	**Interest Rate Decision, %**		**5.5**	**5.75**
19 June 2025				
US	**Fed Interest Rate Decision, %**		-	**-**
20 June 2025				
ID	M2 Money Supply YoY, %		5.2	-
ID	Loan Growth YoY, %		8.88	8.8
27 June 2025				
US	PCE Price Indeks YoY, %		2.1	-

*Forecasts of some indicators are simply based on market consensus
Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	4.50	Dec-24	2.10
UK	4.25	May-25	0.75
EU	2.15	Jun-25	0.25
Japan	0.50	Jan-25	-3.10
China (lending)	2.00	Sep-24	4.45
Korea	2.50	May-25	0.60
India	5.50	Jun-25	2.68
Indonesia	5.50	May-25	3.90

Money Mkt Rates	13-Jun	-1 mth	Chg (bps)
SPN (1Y)	5.99	6.02	-3.0
SUN (10Y)	6.71	6.84	-12.9
INDONIA (O/N, Rp)	5.28	5.98	-69.5
JIBOR 1M (Rp)	6.16	6.38	-22.6

Bank Rates (Rp)	Mar	Feb	Chg (bps)
Lending (WC)	8.66	8.67	-0.75
Deposit 1M	5.01	5.02	-0.47
Savings	0.68	0.68	0.16

Currency/USD	13-Jun	-1 mth	Chg (%)
UK Pound	0.737	0.752	1.99
Euro	0.866	0.894	3.25
Japanese Yen	144.1	147.5	2.37
Chinese RMB	7.183	7.205	0.30
Indonesia Rupiah	16,295	16,515	1.35

Capital Mkt	13-Jun	-1 mth	Chg (%)
JCI	7,166.1	6,832.8	4.88
DJIA	42,197.8	42,140.4	0.14
FTSE	8,850.6	8,602.9	2.88
Nikkei 225	37,834.3	38,183.3	-0.91
Hang Seng	23,892.6	23,108.3	3.39

Foreign portfolio ownership (Rp Tn)	May	Apr	Chg (Rp Tn)
Stock	3,435.7	3,244.2	191.47
Govt. Bond	926.3	995.6	-69.37
Corp. Bond	5.2	5.1	0.08

Trade & Commodities	13-Jun	-1 mth	Chg (%)
Baltic Dry Index	1,968.0	1,280.0	53.8
S&P GSCI Index	568.4	542.0	4.9
Oil (Brent, $/brl)	74.2	66.6	11.4
Coal ($/MT)	110.8	108.8	1.8
Gas ($/MMBtu)	2.65	3.27	-19.0
Gold ($/oz.)	3,432.3	3,250.3	5.6
Copper ($/MT)	9,718.4	9,618.7	1.0
Nickel ($/MT)	14,936.2	15,541.3	-3.9
CPO ($/MT)	921.2	899.9	2.4
Rubber ($/kg)	1.66	1.78	-6.7

External Sector	Apr	Mar	Chg (%)
Export ($ bn)	20.74	23.25	-10.77
Import ($ bn)	20.59	18.92	8.80
Trade bal. ($ bn)	0.16	4.33	-96.33
Central bank reserves ($ bn)*	152.5	157.1	-2.94

Prompt Indicators	May	Apr	Mar
Consumer confidence index (CCI)	117.5	121.7	121.1
Car sales (%YoY)	-15.1	5.0	-5.1
Motorcycle sales (%YoY)	-0.1	-3.0	-7.2

Manufacturing PMI	May	Apr	Chg (bps)
USA	52.0	50.2	180
Eurozone	49.4	49.0	40
Japan	49.4	48.7	70
China	48.3	50.4	-210
Korea	47.7	47.5	20
Indonesia	47.4	46.7	70

Source: Bloomberg, BI, BPS
Notes:
Car and motorcycle sales data to be released on the third week of January 2022
^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

Indonesia – Economic Indicators Projection

	2019	2020	2021	2022	2023	2024	2025E
Real GDP growth (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0	4.8
Nominal GDP growth (% YoY)	6.7	-2.5	9.9	15.4	6.7	6.0	5.7
GDP per capita (USD)	4175	3912	4350	4784	4920	4960	4996
CPI inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	1.6	2.0
BI Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00	5.00
SBN 10Y yield (%)	7.04	5.86	6.36	6.92	6.45	6.97	7.02
USD/IDR exchange rate (average)	14,141	14,529	14,297	14,874	15,248	15,841	16,350
USD/IDR exchange rate (end of year)	13,866	14,050	14,262	15,568	15,397	16,102	16,625
Trade balance (USD Bn)	-3.2	21.7	35.3	54.5	37.0	31.0	26.0

Notes:

- *USD/IDR exchange rate projections are for fundamental values; market values may diverge significantly at any moment in time*

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