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## Monthly Economic & Finance Briefing

**Economic, Banking & Industry Research of BCA Group** 

## FX reserves: Weathering the Fed's hawkish turn

## **Executive Summary:**

- Indonesia's FX reserves declined 0.7% MoM in December 2021, closing the year at USD 144.9 Bn. This decline was largely fuelled by capital outflows as markets became increasingly rattled by the Fed's hawkish tilt.
- The pace of monetary tightening in 2022 will depend on how inflation develops, the extent of market risks in the US, as well as how far the US' high leverage will constrain the Fed's hawks.
- Fortunately, despite these capital market risks, **BI will still have substantial breathing space as long as Indonesia** continues to enjoy a comfortable trade surplus.
- Indonesia's FX reserves stood at USD 144.9 Bn as 2021 came to a close, a decline of 0.7% from the previous month's figures. This decline was largely driven by foreign debt repayments and, more crucially, a significant amount of foreign capital outflows (Chart 1).
- The large outflows observed over the past few months is but one harbinger of capital markets' increasing turbulence. Emerging market currencies declined across the board as the dollar picked up strength and risky assets are sidelined, signaling the start of what appears to be a new risk-off cycle for markets.
- All these were signs of a market trying to adjust to a more uncertain tightening cycle as the Fed pivots to a decidedly more hawkish stance in response to inflation. Markets, initially holding out hope that shortterm economic risks such as Omicron may constrain the Fed from hiking rates too aggressively, recently revised their expectations upwards from two rate hikes to three in line with the Fed's dot plot in 2022 (Chart 2). Adding further fuel to the fire was the recently released minutes for December's FOMC, which explicitly floated the possibility of the Fed winding down its balance sheet not long after it starts hiking rates. 2022 then, appears to be a somewhat bumpy year as markets attempt to adjust to an ever-changing timeline for tightening. Several important variables will determine the severity of market risks in the coming months.
- Firstly, how inflation develops will influence the pace of monetary tightening. While most expect supply chain disruptions and inflation to begin easing this year, new Covid variants remain as wildcards. Indeed, with most countries showing a stiff reluctance against prolonged lockdowns in the face of Omicron, one could argue that new variants run a greater risk of worsening inflation (should China continue to be more

- lockdown-prone than the rest of the world) rather than triggering a global economic freeze.
- Secondly, rising asset valuations over the past two years have been largely underpinned by the Fed's generous largesse. There is a risk that should much of these gains prove to be "bubbly," monetary tightening by the Fed may trigger a broader market panic. Additionally, should inflation worsen and force the Fed into a much narrower timeline for monetary tightening, the trickier it becomes for the Fed to reduce liquidity rapidly enough without unleashing chaos in markets.
- Finally, there is also the issue of the US' large amount of debt, which may dis-incentivize the Fed from committing to monetary tightening too aggressively. Aside from the real economic and financial risks of higher debt servicing costs, households' sharply increased exposure to equities over the past two years also means that any financial or debt shocks would result in greater wealth effects, potentially putting the real economy at greater risk.
- Capital market risks then, look to be especially pronounced this year. Fortunately however, Indonesia still retains a significant defense in the form of its trade surplus. Indeed, while recent capital outflows almost add up to nearly the same amount of outflows observed during Covid's initial shock, the Rupiah did not plunge in the same dramatic fashion as it did back then (Chart 1). The primary difference of course, was that Indonesia's trade balance, which was running a deficit in early 2020, had flipped to a massive surplus by 2021.
- As long as Indonesia maintains a comfortable trade surplus then, BI still has room to maneuver despite capital market risks. This means that policies that could pare down this surplus, such as the recent ban on coal exports, are unlikely to last too long.

Chart 1. The Rupiah has remained remarkably resilient, despite significant outflows approximating those observed in the early days of the Covid pandemic

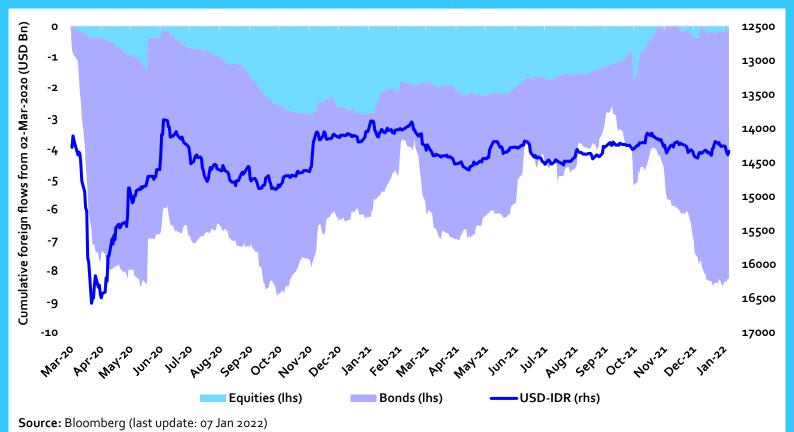
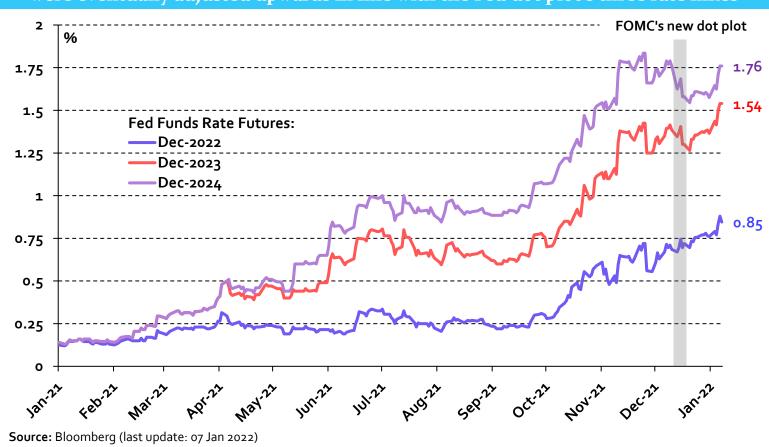


Chart 2. While markets initially only tabled in two rate hikes in 2022, expectations were eventually adjusted upwards in line with the Fed dot plot's three rate hikes



# **Selected Recent Economic Indicators**

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	6-Jan	-1 mth	Chg (%)			
US	0.25	Mar-20	-6.55	-6.55 Baltic Dry Index		3,235.0	-29.0			
UK	0.25	Mar-20	-4.85 S&P GSCI Index		578.0	534.3	8.2			
EU	0.00	Mar-16	-4.90 Oil (Brent, \$/brl)		82.0	73.1	12.2			
Japan	-0.10	Jan-16	-0.70	Coal (\$/MT)	168.0	135.6	23.9			
China (lending)	4.35	Oct-15	2.05	Gas (\$/MMBtu)	3.93	3.64	8.0			
Korea	1.00	Nov-21	-2.70	Gold (\$/oz.)	1,791.2	1,778.7	0.7			
India	4.00	May-20	-0.91 Copper (\$/MT)		9,542.8	9,558.3	-0.2			
Indonesia	3.50	Feb-21	1.63	Nickel (\$/MT)	20,498.8	19,961.5	2.7			
Marray Mit Batas	6-Jan	-1 mth	Chg	CPO (\$/MT)	1,259.7	1,236.4	1.9			
Money Mkt Rates			(bps)	Rubber (\$/kg)	1.70	1.69	0.6			
SPN (1M)	3.16	2.66	50.4	External Sector	Nov	Oct	Chg			
SUN (10Y)	6.39	6.28	10.9	External Sector			(%)			
INDONIA (O/N, Rp)	2.78	2.79	-0.5	Export (\$ bn)	22.84	22.03	3.7			
JIBOR 1M (Rp)	3.55	3.55	0.0	Import (\$ bn)	19.33	16.29	18.6			
Bank Rates (Rp)	Son	Aug	Chg	Trade bal. (\$ bn)	3.51	5.74	-38.7			
balik Kates (Kp)	Sep	Aug	(bps)	Central bank reserves	145.9	145.5	0.27			
Lending (WC)	8.85	8.92	-6.89	(\$ bn)	143.9	143.3	0.27			
Deposit 1M	3.24	3.31	-7.36	Prompt Indicators	Nov	Oct	Sep			
Savings	0.73	0.76	-2.84	Frompt Indicators						
Currency/USD	6-Jan	-1 mth	Chg (%)	Consumer confidence index (CCI)	118.5	113.4	95.5			
UK Pound	0.739	0.754	2.02	Car calos (0/ VoV)	62.4	54.1	73.2			
Euro	0.885	0.886	0.11	Car sales (%YoY)						
Japanese Yen	115.8	113.5	-2.03	Motorcycle sales	95.6	39.9	22.0			
Chinese RMB	6.383	6.376	-0.10	(%YoY)						
Indonesia Rupiah	14,391	14,442	0.35	Coment colos (0/ VeV)	-2.6	5.3	3.7			
Capital Mkt	6-Jan	-1 mth	Chg (%)	Cement sales (%YoY)						
JCI	6,653.4	6,547.1	1.62	Manufacturing PMI	Dec	Nov	Chg			
DJIA	36,236.5	35,227.0	2.87	Manufacturing PM1			(bps)			
FTSE	7,450.4	7,232.3	3.02	USA	58.7	61.1	-240			
Nikkei 225	28,487.9	27,927.4	2.01	Eurozone	58.0	58.4	-40			
Hang Seng	23,072.9	23,349.4	-1.18	Japan	54.3	54.5	-20			
Foreign portfolio	Dec	Nov	Chg	China	50.9	49.9	100			
ownership (Rp Tn)	ownership (Rp Tn)		Korea	51.9	50.9	100				
Stock	2,286.1	2,233.2	52.91	Indonesia	53.5	53.9	-40			
Govt. Bond	891.3	918.5	-27.11							
Corp. Bond	0.0	22.4	-22.42							

Source: Bloomberg, BI, BPS

Notes:

<sup>\*</sup>Previous data

<sup>\*\*</sup>For change in currency: **Black** indicates appreciation against USD, **Red** indicates depreciation

<sup>\*\*\*</sup>For PMI, > **50** indicates economic expansion, < **50** indicates contraction

## **Indonesia - Economic Indicators Projection**

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	4.0*	5.2
GDP per Capita (US\$)	3877	3927	4175	3912	4350*	4640
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	3.3
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.0
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	14,660
Trade Balance (US\$ billion)	11.8	-8.5	-3.2	21.7	36.1*	30.6
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.6*	0.1

<sup>\*</sup> Provisional numbers for 2021

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<sup>\*\*</sup> Estimation of Rupiah's fundamental exchange rate