FX Reserves:

War bolsters Indonesia's commodity buffers

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Executive Summary

- Indonesia's foreign exchange reserves increased by USD 0.1 Bn, closing the month at USD 141.4 Bn, driven by the government's limited global bond issuance and tax receipts, as well as capital inflows to Indonesia's equity market.
- High oil prices as a result of the on-going Russo-Ukrainian conflict has the potential to push inflation up in the near term, which could lower real yields and trigger even more capital outflows from the bond market.
- However, Indonesia's robust trade surplus buffer and a potentially less hawkish Fed would help maintain Rupiah's stability. As such, BI has room to only raise its policy rate by 50 bps this year.

- Bank Indonesia's foreign exchange reserves stood at USD 141.4 Bn by the end of February 2022, an increase of USD 0.1 Bn from the previous month's figures. This limited increase was driven by a small amount of the government's global bond issuance and tax receipts, augmented by capital inflows to Indonesia's equity market **(Chart 1)**.

- However the increase in FX reserves was still very limited in part due a decline in banks' FX placements in BI **(Chart 2)**. As economic recovery continues and demand for foreign goods and services grow, so does the private sector's (and banks') need for foreign currency. Soaring oil prices, especially in the aftermath of the Russia-Ukraine war, would also contribute to an increase in imports, and as a result, demand for FX by Indonesian importers. The impact of rising commodity prices then, will play a significant role in determining the outlook of Rupiah in the coming months.

- Firstly, how inflation develops will influence the attractiveness of Indonesia's investments. Sanctions on Russian exports will squeeze global supplies of several commodities, particularly wheat, oil, and gas -- but also coal, of which Russia in fact controls a larger share of global exports (16%) relative to oil or gas (roughly 10% each). As discussed in our previous report ("CPI: A temporary respite?"), there is a good chance that domestic energy prices would need to be adjusted if global fuel prices were at their pre-war levels, let alone now. The impact of these is surely rising inflation, by 5.7% or even higher. The question, then, is how Rupiah's stability and Indonesia's capital account would be affected by the declining (or even potentially negative) real yields, and what kind of response should we expect from BI?

- There are, fortunately, several mitigating factors for those risks. Firstly, the sharp increase in coal prices should more than offset the rising oil imports. At the same time, military unrest in Ukraine has also halted the export of Ukrainian sunflower oil, which has driven up the prices of CPO -- Indonesia's other top export. In fact, we are revising (again) our forecast for Indonesia's current account in the light of the recent shock, and now think that a trade surplus of USD 35.7 Bn and a CA surplus of 0.5% is now quite probable. Additionally, foreign investors may be more inclined to invest in the Indonesian stock market as a result of the recent geopolitical conflict since high commodity prices have boosted the earnings outlook of several publicly traded energy companies. This may help soften the blow from capital outflows in the bond market.

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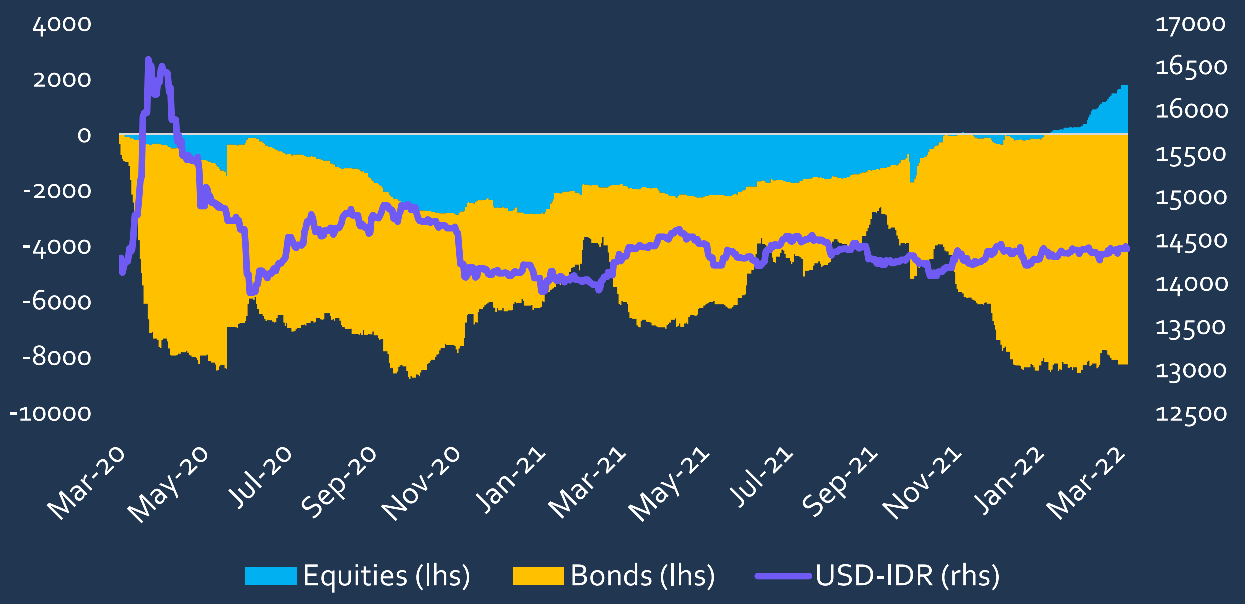
- Finally, the potential of an economic slowdown in the US and especially Europe may deter the Fed from tightening monetary policy too quickly. Indeed, the continued inversion of the US' yield curve has investors worrying of a forthcoming recession. As a result, markets have recently revised their expectations downward from seven rate hikes to six by the end of 2022 **(Chart 3)**. Further bolstering the notion of a less aggressive monetary tightening is the recent congress meeting, in which Powell is generally only leaning to a 25 bps rate hike in March. The slower pace of the Fed's monetary tightening then, will help slow down capital outflows from Indonesia.

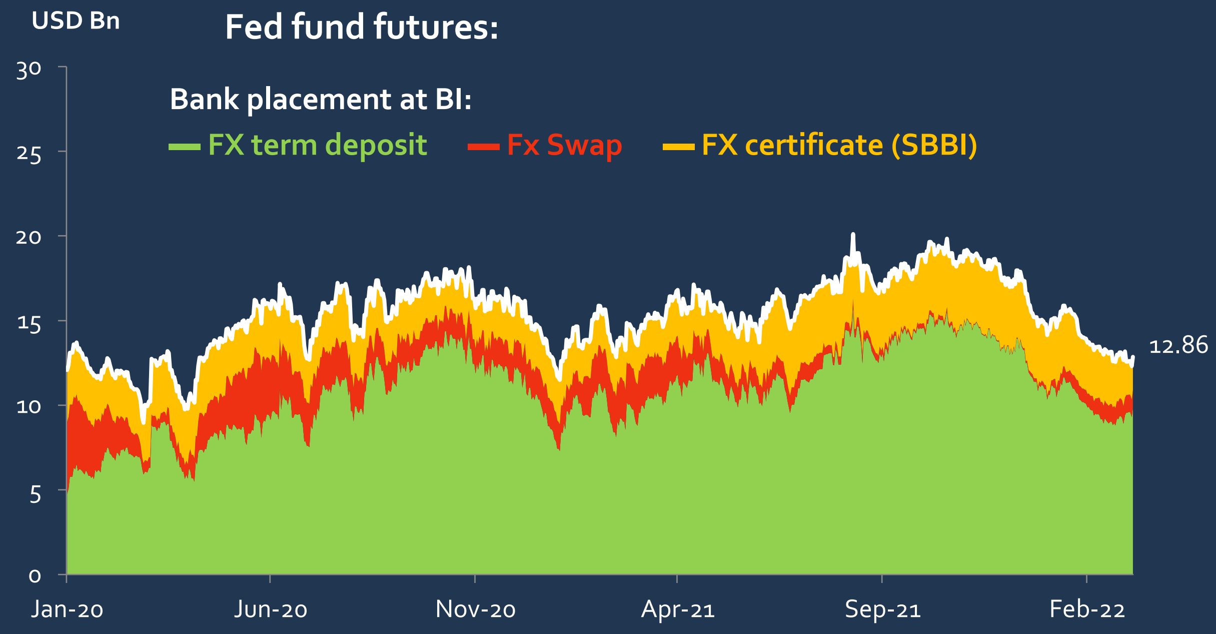
- Due to all of these favorable factors, we would argue that BI still has the room to increase interest rates by only 50 bps, despite the above-mentioned risks threatening the Rupiah. The ball is clearly on the government's court, since a substantial relaxation of the current price control regime on energy (and some food staples) could raise inflation to such extent where the benchmark rate would have to be increased.

Chart 1. Indonesian equity markets have experienced net capital inflows throughout February



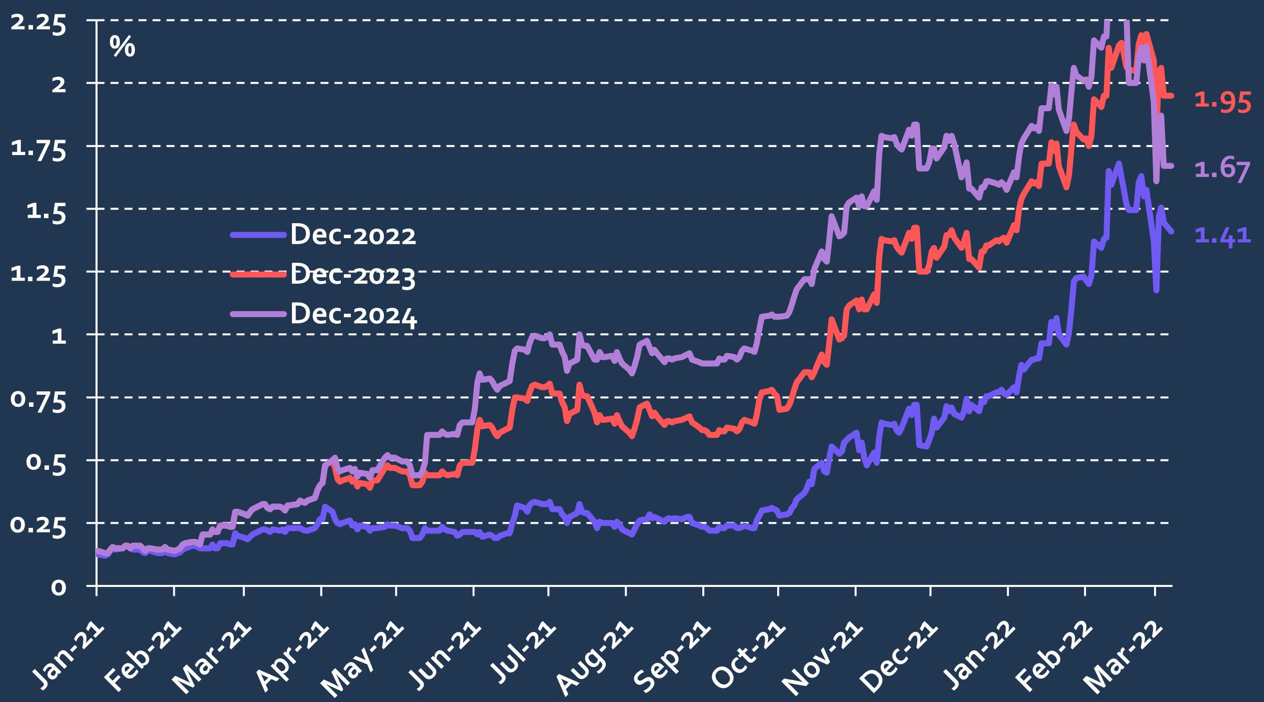
Source: Bank Indonesia, BCA Economist

Chart 2. The increase in FX reserves has been limited due to decline in banks' FX placements in BI



Source: Bank Indonesia, BCA Economist

Chart 3. Markets have recently revised their expectations downward



Source: Bloomberg (last update: 07 Mar 2022)

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	0.25	Mar-20	-7.25
UK	0.50	Feb-22	-5.00
EU	0.00	Mar-16	-5.80
Japan	-0.10	Jan-16	-0.60
China (lending)	4.35	Oct-15	3.45
Korea	1.25	Jan-22	-2.45
India	4.00	May-20	-2.01
Indonesia	3.50	Feb-21	1.44

Money Mkt Rates	7-Mar	-1 mth	Chg (bps)
SPN (1M)	2.48	3.38	-90.5
SUN (10Y)	6.75	6.45	30.2
INDONIA (O/N, Rp)	2.79	2.78	0.4
JIBOR 1M (Rp)	3.55	3.55	0.0

Bank Rates (Rp)	Dec	Nov	Chg (bps)
Lending (WC)	8.63	8.76	-13.02
Deposit 1M	2.92	3.02	-9.83
Savings	0.69	0.71	-2.65

Currency/USD	7-Mar	-1 mth	Chg (%)
UK Pound	0.763	0.739	-3.16
Euro	0.921	0.873	-5.20
Japanese Yen	115.3	115.3	-0.05
Chinese RMB	6.321	6.361	0.64
Indonesia Rupiah	14,415	14,380	-0.24

Capital Mkt	7-Mar	-1 mth	Chg (%)
JCI	6,869.1	6,731.4	2.05
DJIA	32,817.4	35,089.7	-6.48
FTSE	6,959.5	7,516.4	-7.41
Nikkei 225	25,221.4	27,440.0	-8.09
Hang Seng	21,057.6	24,573.3	-14.31

Foreign portfolio ownership (Rp Tn)	Feb	Jan	Chg (Rp Tn)
Stock	2,405.8	2,314.3	91.55
Govt. Bond	896.6	887.3	9.35
Corp. Bond	20.3	23.0	-2.67

Trade & Commodities	7-Mar	-1 mth	Chg (%)
Baltic Dry Index	2,235.0	1,423.0	57.1
S&P GSCI Index	803.7	643.0	25.0
Oil (Brent, $/brl)	123.2	93.3	32.1
Coal ($/MT)	427.0	177.1	141.1
Gas ($/MMBtu)	4.93	5.34	-7.7
Gold ($/oz.)	1,998.1	1,808.3	10.5
Copper ($/MT)	10,255.5	9,870.5	3.9
Nickel ($/MT)	48,201.0	23,390.0	106.1
CPO ($/MT)	1,674.7	1,374.8	21.8
Rubber ($/kg)	1.76	1.73	1.7

External Sector	Jan	Dec	Chg (%)
Export ($ bn)	19.16	22.36	-14.3
Import ($ bn)	18.23	21.35	-14.6
Trade bal. ($ bn)	0.93	1.01	-7.4
Central bank reserves ($ bn)*	141.4	141.3	0.04

Prompt Indicators	Jan	Dec	Nov
Consumer confidence index (CCI)	119.6	118.3	118.5
Car sales (%YoY)	58.9	68.1	62.4
Motorcycle sales (%YoY)	12.5	67.4	95.6
Cement sales (%YoY)	7.8	-0.9	-2.6

Manufacturing PMI	Feb	Jan	Chg (bps)
USA	58.6	57.6	100
Eurozone	58.2	58.7	-50
Japan	52.7	55.4	-270
China	50.4	49.1	130
Korea	53.8	52.8	100
Indonesia	51.2	53.7	-250

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

Indonesia – Economic Indicators Projection

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	5.2
GDP per Capita (US$)	3877	3927	4175	3912	4350	4640
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	3.7
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.0
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	14,660
Trade Balance (US$ billion)	11.8	-8.5	-3.2	21.7	35.3	35.7
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.3	0.5

** Estimation of Rupiah's fundamental exchange rate

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