FX Reserves:
Under pressure, fork in the road for BI?

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Executive Summary

- Bank Indonesia's FX reserves declined sharply by USD 3.6 Bn to USD 140.4 Bn in March 2024 due to ongoing pressure on the rupiah.
- The depreciation in the rupiah is caused by global factors, mainly the waning expectation of Fed rate cuts and the depreciation in both Yuan and Yen. This results in outflows, especially in the bond market. In addition, the pressure on the rupiah also comes from the increased FX demand from the domestic economy.
- BI is still quite likely to hold the interest rate in April and continue FX interventions, but there might be a rate hike with more KLM incentives at some point in the upcoming months, with the incentives offsetting the hawkish move with pro-growth policy.

- Bank Indonesia's FX reserves stood at USD 140.4 Bn in March 2024, a sharp decline of USD 3.6 Bn from the previous month. This comes as little surprise given the pressure on the Rupiah during March, which continues into the first week of April and at times threatens to cross the round-number psychological threshold of 16,000. The decline, as such, reflected a heavy use of FX interventions by BI.

- The root causes of the Rupiah's weakness are mostly global. Expectations of Fed rate cuts are fading fast, especially as the recent oil price spike (and overall robust data from the US) finally convince the market that moderately-high inflation could be more persistent than it had expected earlier.

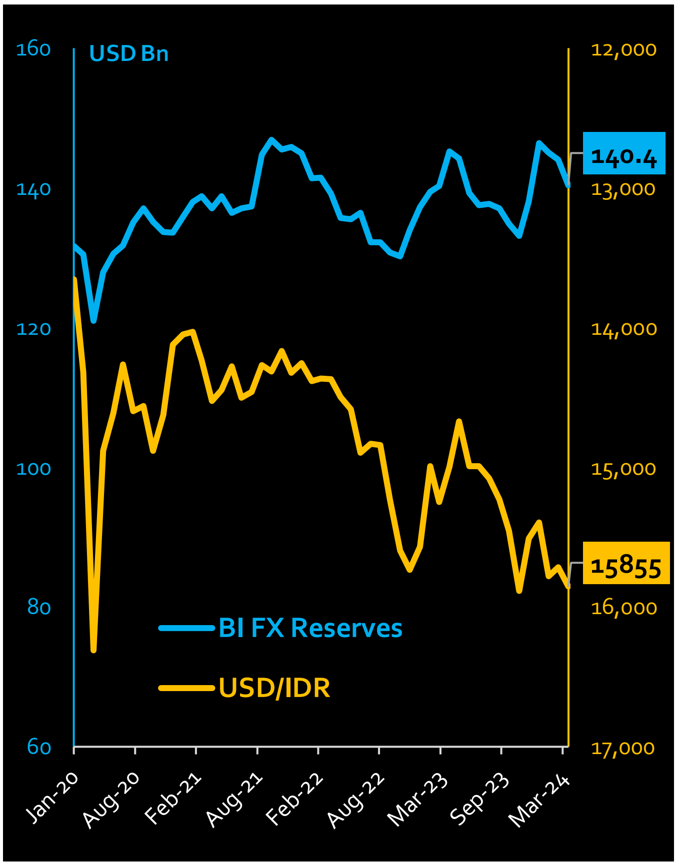
- This has pushed the Dollar index upwards, especially against Asian currencies. The BoJ's exit from negative interest rate policy has failed to stem Yen depreciation, while the Yuan spot rate has been weakening vis-à-vis the PBoC's fixing rate. As these two "anchor currencies" go, so does other Asian currencies – and the outlook for Rupiah, accordingly, could get worse before it gets better.

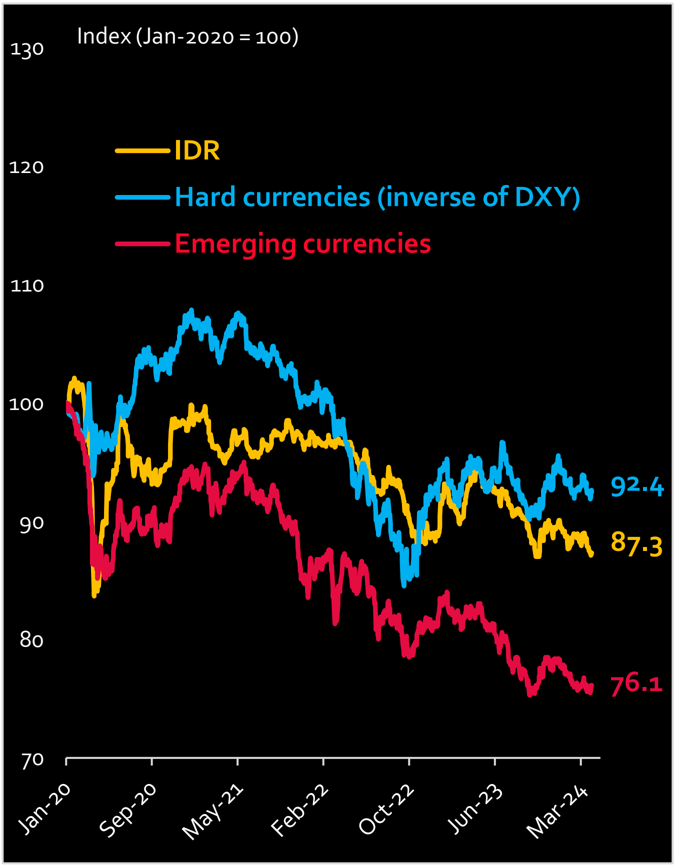
- We can see, for instance, how Indonesia saw a whopping USD 1.3 Bn outflows from sovereign bonds in March, in addition to around IDR 5 Tn (~USD 0.3 Bn) of foreign exit from SRBI. Stocks saw rather healthy-looking inflows at USD 0.5 Bn throughout March, but we need to keep in mind that foreign flows have been moving in the opposite direction more recently – especially after dismal earning reports for Q4-23.

- This external pressure is compounded by an apparent increase in FX demand by the domestic economy. Banks' placement at BI ***(see Panel 2)*** declined by USD 2 Bn, and – unlike the previous month – this is not simply a case of banks shifting towards SVBI/SUVBI. Instead, there seems to be a genuine shift in banks' allocation of its FX liquidity, from BI to loans, as corporations face greater FX needs. This may reflect a (probably temporary) spike in imports, driven by heightened consumption during Ramadan/Lebaran, but it can also reflect a gaping gap between declining FX earnings and continued appetite to invest in certain sectors (energy/commodities and government/SOE-related areas).

- Does the situation, then, warrant another hike by BI? Or should it continue to rely more on intervention or, even, let the Rupiah depreciate and let go of the 16,000 threshold? In our view, the last option may not be as bad as it sounds. Keep in mind that while weakening, the Rupiah remains stronger than most EM currencies amid the present Fed rate hike cycle, and particularly compared to our Asian trading partners. The robust import growth may be a sign that Indonesia needs a slightly weaker currency, in order to restore its previously-hefty trade surplus.
- Meanwhile, the efficacy of BI's interventions depends in part on the adequacy of its reserves versus potential short-term outflows. For the past few months – and even after the sharp increase in FX reserves in Dec-23 – this ratio has been quite low ***(see Panel 5)***, which could be a sign that further intervention may only further undercut the "deterrent effect" of BI's interventions in the first place.
- Still, we may recall that when BI made its surprise hike in October, the Rupiah also nearly breached 16,000 but FX reserves were just under USD 135 Bn. This latter number may well reflect BI's internal guidance (or its tolerance level) before undertaking another rate hike. We also need to keep in mind recent fears about slowing consumption – which, we argued, mostly reflects weaker "animal spirit" among high-income households – which might render BI more reluctant to hike lest it further undermines growth.
- One could argue, however, that BI's plan to broaden its macroprudential incentives (KLM) would dovetail nicely with a rate hike – providing one dovish move for domestic lending to offset its hawkish move with respect to the capital market. So while our base case for April remains that BI would stay put and continue FX interventions, we would not be surprised if it goes for the "rate hike + more KLM incentives" combo at some point in the upcoming months.

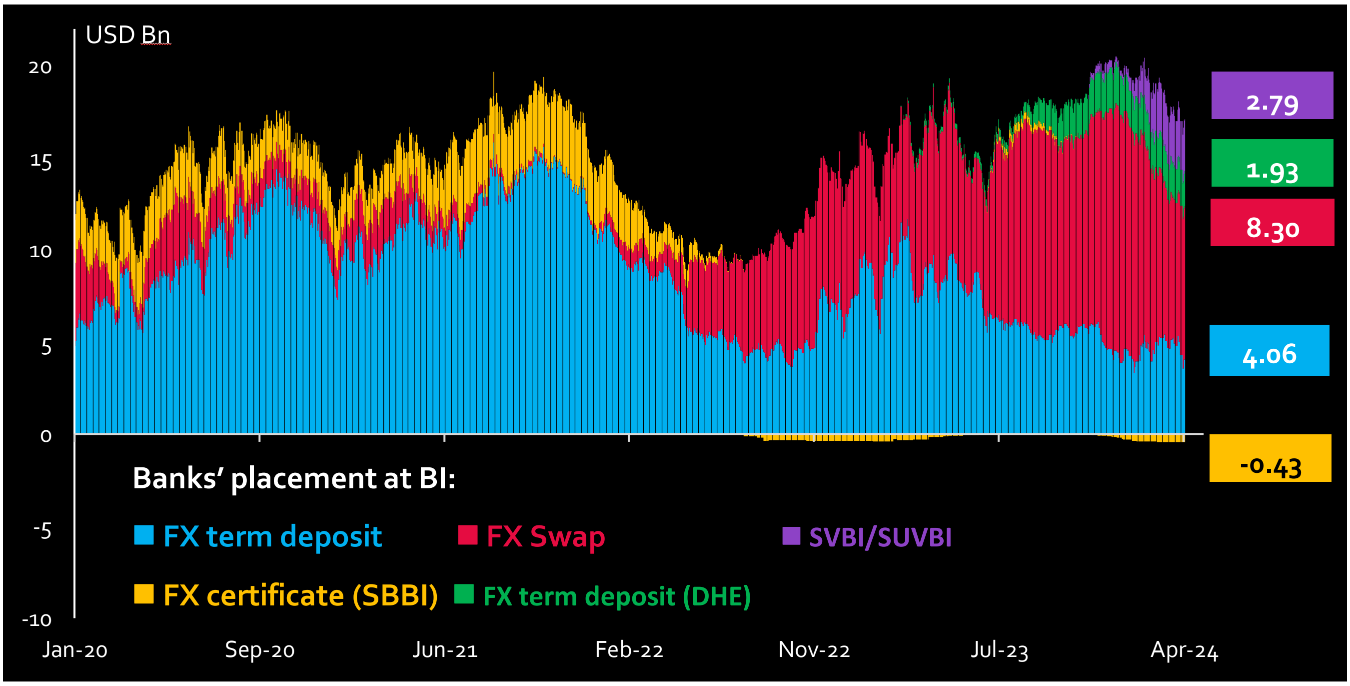
Panel 1. FX reserves declined, partly due to BI intervention to stabilize the Rupiah





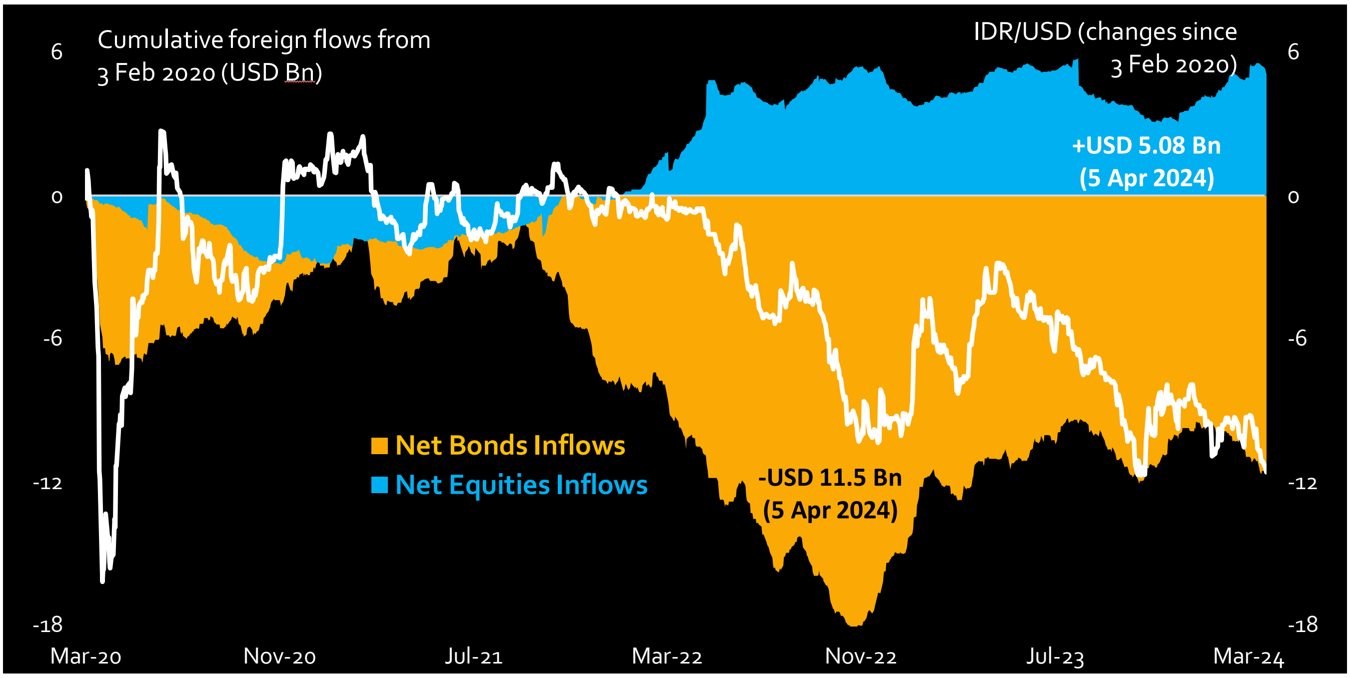
Source: Bloomberg

Panel 2. A big decline in the banks' placement at BI may be an indication of a need of FX loans for corporations



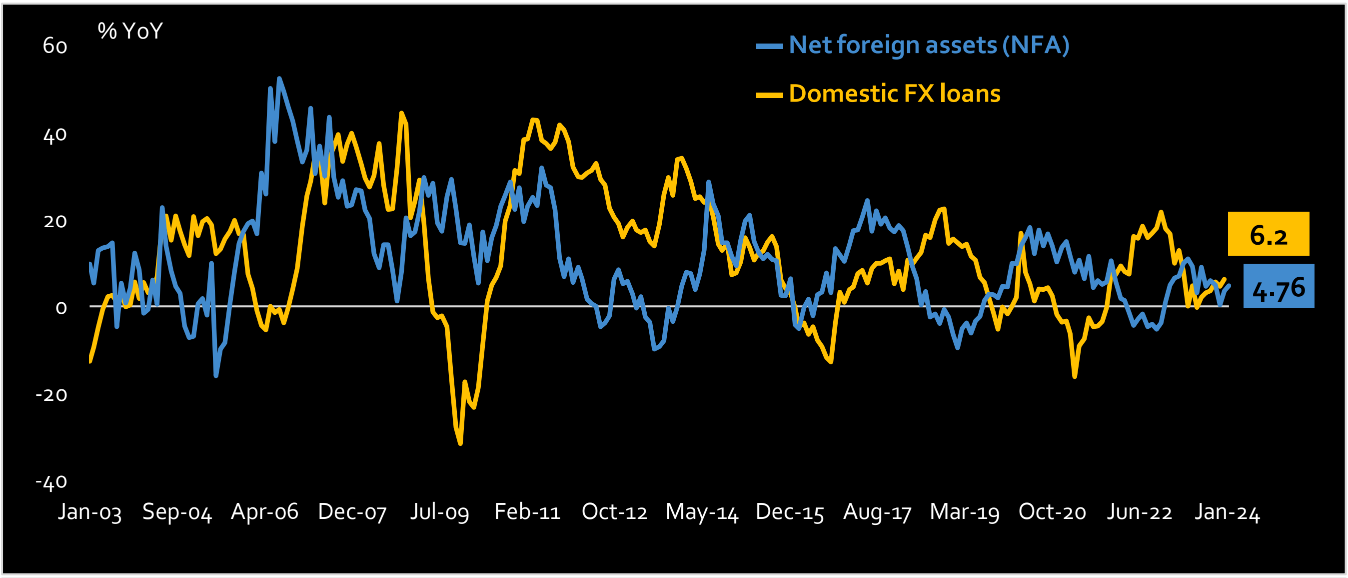
Source: BI

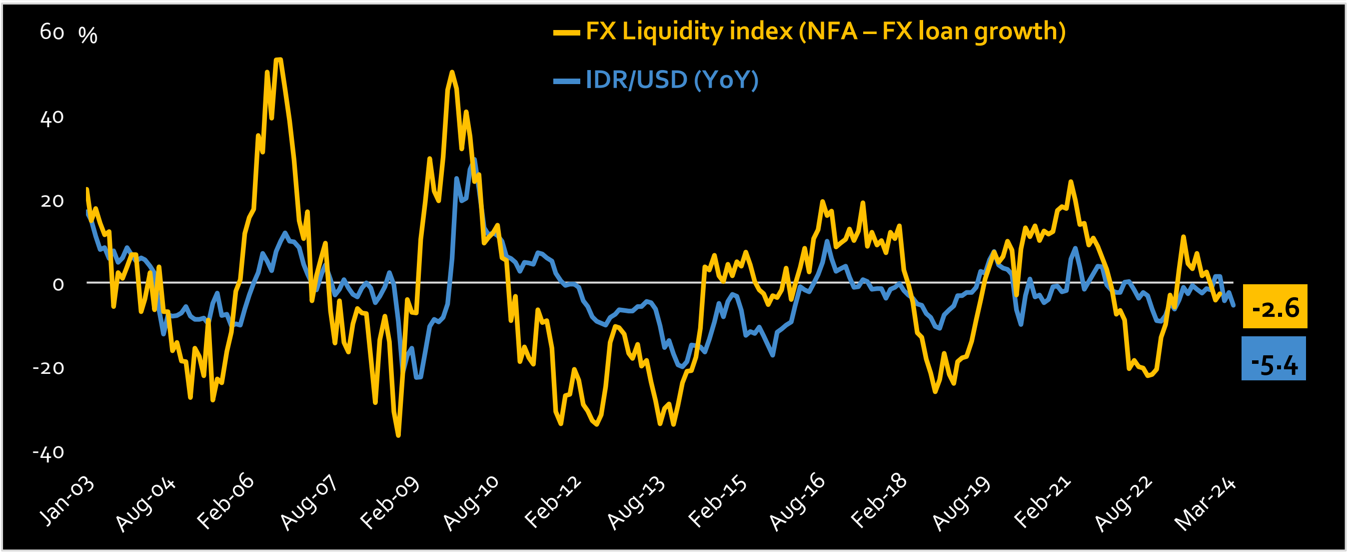
Panel 3. **Bond market suffered from outflows due to a gradual shift on future rate outlook**



Source: Bloomberg

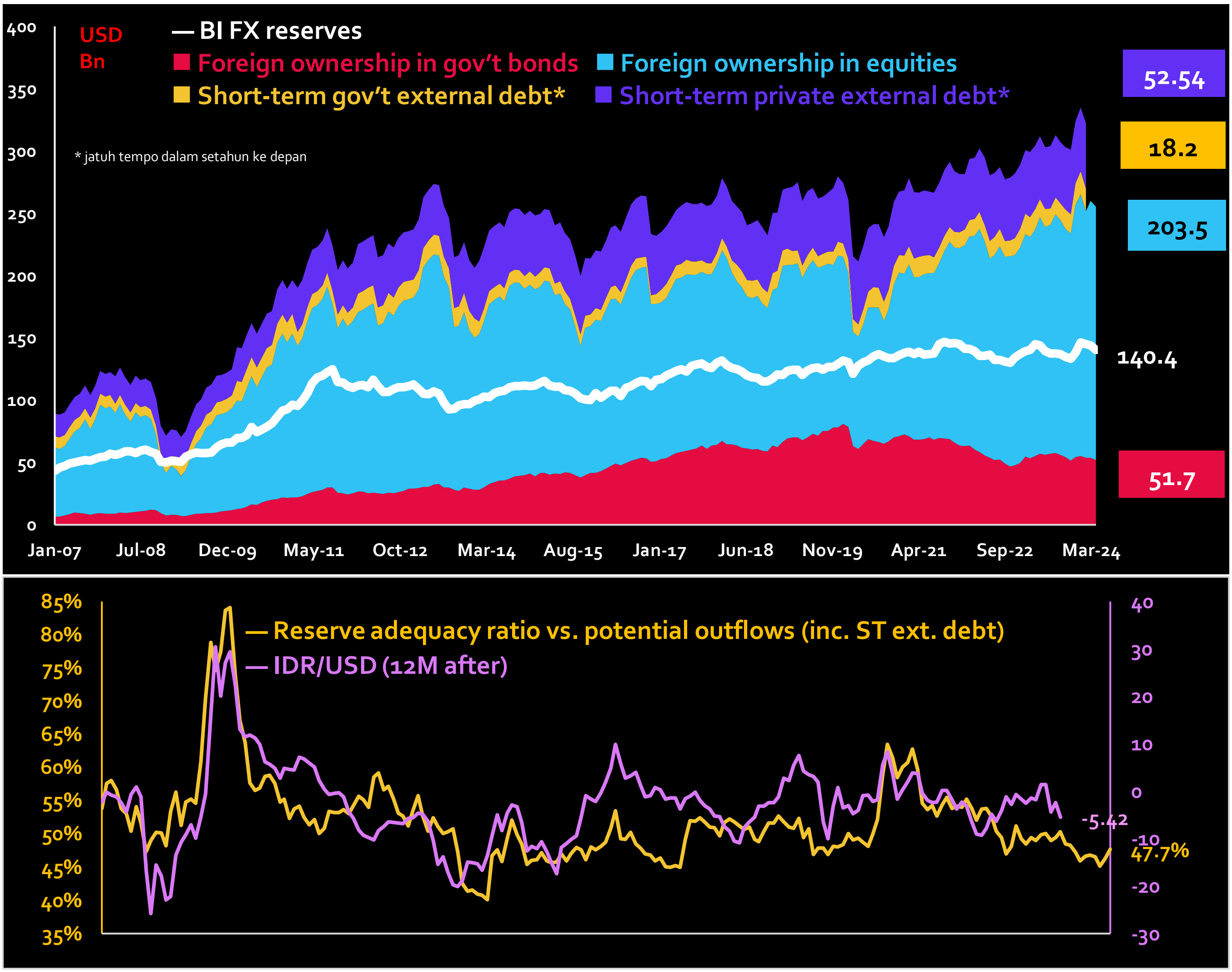
Panel 4. **Demand for FX liquidity is picking up in recent months**





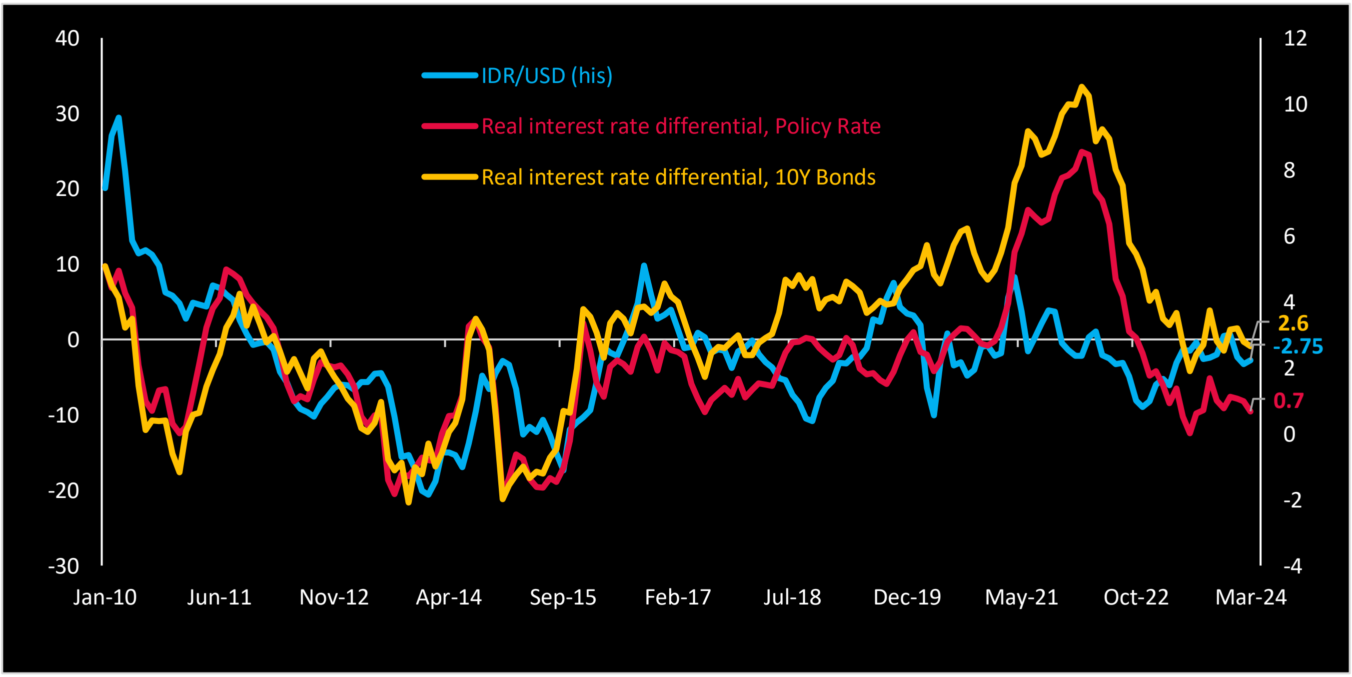
Source: BI, Bloomberg

Panel 5. Reserves adequacy ratio might be worsening in the coming months



Source: BI, Bloomberg

Panel 6. Narrowing real rate differentials outlook might add another pressure on the Rupiah



Source: Bloomberg

Selected Macroeconomic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Dec-23	2.30
UK	5.25	Dec-23	1.85
EU	4.50	Dec-23	2.10
Japan	-0.10	Jan-16	-2.90
China (lending)	2.50	Dec-23	3.65
Korea	3.50	Nov-23	0.40
India	6.50	Dec-23	1.41
Indonesia	6.00	Nov-23	2.95

Money Mkt Rates	4-Apr	-1 mth	Chg (bps)
SPN (1M)	5.88	5.80	7.6
SUN (10Y)	6.67	6.63	3.5
INDONIA (O/N, Rp)	5.85	5.95	-10.2
JIBOR 1M (Rp)	6.65	6.64	0.9

Bank Rates (Rp)	Dec	Nov	Chg (bps)
Lending (WC)	8.86	8.91	-4.93
Deposit 1M	4.76	4.52	24.61
Savings	0.69	0.67	1.94

Currency/USD	4-Apr	-1 mth	Chg (%)
UK Pound	0.791	0.788	-0.39
Euro	0.923	0.921	-0.18
Japanese Yen	151.3	150.5	-0.54
Chinese RMB	7.233	7.199	-0.47
Indonesia Rupiah	15,893	15,740	-0.96

Capital Mkt	4-Apr	-1 mth	Chg (%)
JCI	7,254.4	7,276.7	-0.31
DJIA	38,597.0	38,989.8	-1.01
FTSE	7,975.9	7,640.3	4.39
Nikkei 225	39,773.1	40,109.2	-0.84
Hang Seng	16,725.1	16,596.0	0.78

Foreign portfolio ownership (Rp Tn)	Mar	Feb	Chg (Rp Tn)
Stock	3,226.6	3,236.2	-9.67
Govt. Bond	810.7	837.1	-26.42
Corp. Bond	9.4	9.5	-0.10

Trade & Commodities	4-Apr	-1 mth	Chg (%)
Baltic Dry Index	1,669.0	2,297.0	-27.3
S&P GSCI Index	599.2	561.2	6.8
Oil (Brent, $/brl)	90.7	82.8	9.5
Coal ($/MT)	130.3	138.9	-6.2
Gas ($/MMBtu)	1.78	1.48	20.3
Gold ($/oz.)	2,290.9	2,114.5	8.3
Copper ($/MT)	9,242.1	8,455.9	9.3
Nickel ($/MT)	17,543.4	17,713.5	-1.0
CPO ($/MT)	952.3	852.9	11.7
Rubber ($/kg)	1.61	1.60	0.6

External Sector	Feb	Jan	Chg (%)
Export ($ bn)	19.31	20.49	-5.79
Import ($ bn)	18.44	18.49	-0.29
Trade bal. ($ bn)	0.87	2.00	-56.64
Central bank reserves ($ bn)*	144.0	145.1	-0.70

Prompt Indicators	Feb	Jan	Nov
Consumer confidence index (CCI)	123.1	125.0	123.6
Car sales (%YoY)	-18.8	-26.1	-7.5
Motorcycle sales (%YoY)	-2.9	-3.7	-2.8

Manufacturing PMI	Feb	Jan	Chg (bps)
USA	52.2	50.7	150
Eurozone	46.5	46.6	-10
Japan	47.2	48.0	-80
China	50.9	50.8	10
Korea	50.7	51.2	-50
Indonesia	52.7	52.9	-20

Source: Bloomberg, BI, BPS
Notes:
*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

	2019	2020	2021	2022	2023	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0
GDP per Capita (US$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	3.2
BI 7 day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	5.50
USD/IDR Exchange Rate (end of year)**	13,866	14,050	14,262	15,568	15,397	16,119
Trade Balance (US$ billion)	-3.2	21.7	35.3	54.5	37.0	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	-0.1	-0.5

** Estimation of Rupiah's fundamental exchange rate

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