

## FX Reserves:

# A costly deal

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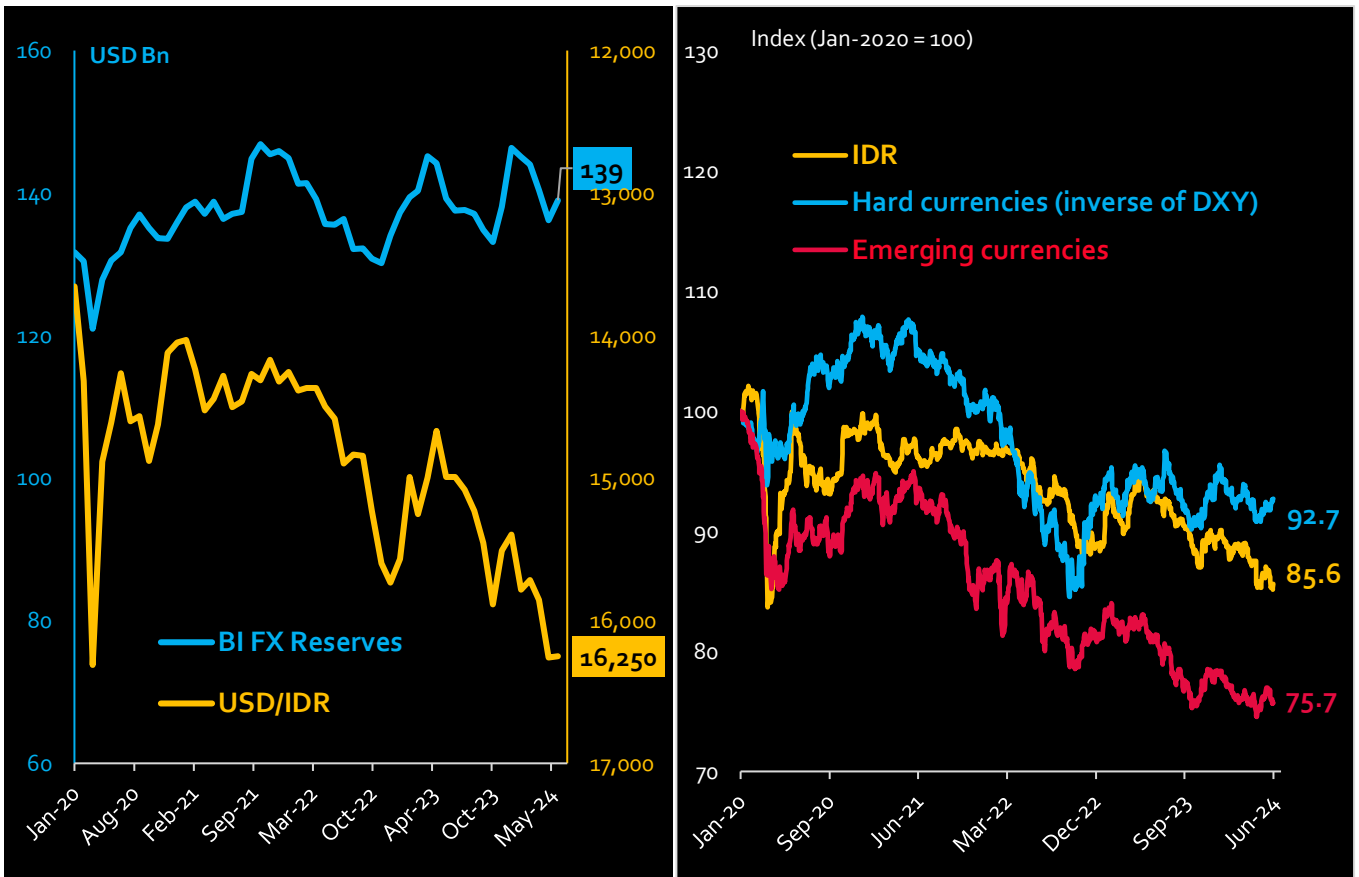
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### Executive Summary

- Bank Indonesia's FX reserves stood at USD 139 Bn in May-24, increasing by USD 2.8 Bn from the previous month. The increase can be attributed to global bond issuance, inflows into bonds, and SRBI.
  - Inflows in capital inflows may be unsustainable given the uncertainty over the Fed rate outlook, as would be inflows from trade surplus considering the outlook of metal prices.
  - Global bond issuance and SRBI are more sustainable drivers of FX reserves. SRBI is drawing foreign investors back, but it is costly as BI needs to pay investors higher yields for short-term instruments while buying longer-dated SBN at a premium.
  - There is still a chance for another 25 – 50 bps hike, considering the ~1% gap between the BI Rate and SRBI. However, it will still be decided on a month-to-month basis.
- Bank Indonesia's FX reserves increased by USD 2.8 Bn in May 2024 to USD 139 Bn, following a decline of USD 7.8 Bn in the previous 2 months. This increase can largely be explained by JPY bond issuance and inflows into government bonds/SBN (USD 1.2 Bn) and SRBI (USD 4.5 Bn), while abating pressure on the Rupiah in May allowed BI to conserve its ammo.
  - But was the increase temporary, or sustainable? Portfolio flows ex-SRBI have already reversed in the first week of June, as investors continue to withdraw from the stock market amid concerns over higher credit risks, weaker demand, and generally slowing growth in the short-term. In general, uncertainty over the Fed rate outlook and the next administration's policies would continue to drive further volatility in capital flows over the next 1-2 quarters.
  - FX inflows from trade surplus, meanwhile, may be similarly unsustainable. In the last few months, our trade balance has benefited from the rally in metal (and coal) prices. But we cannot expect the rally to last forever, especially considering China's apparent high inventory of coal, nickel, and copper. Indeed, prices have begun to fall over the past two weeks, which further compounds investors' pessimism regarding companies' earnings outlook.
  - The other two drivers of FX reserves (global bond issuance and SRBI), however, are more reliable. In May, the net issuance of JPY bonds amounted to 90.8 billion (roughly USD 0.58 billion), and the government is yet to make a net issuance of USD or EUR bonds. Meanwhile, the government's excess cash reserve in Bank Indonesia has been declining rapidly, which suggests the need for more debt issuance in the coming months.

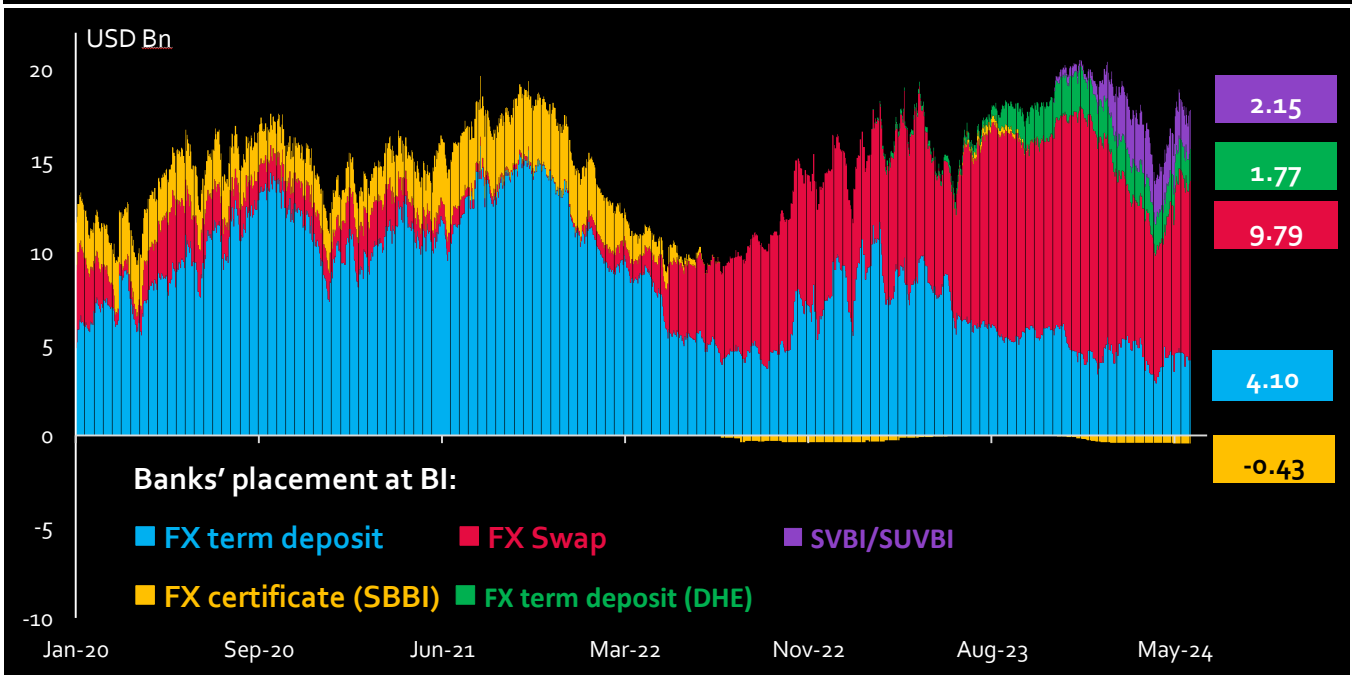
- SRBI, meanwhile, has proven to be BI's trump card in stabilizing the Rupiah, with foreign holdings having doubled in May. The high-return, low-risk instrument (with a yield of 7.2% for 6M at the latest auction) is of course an attractive choice in the current situation, and it has proven successful in drawing foreign investors back to Indonesia.
- Relying on SRBI, however, is a rather costly choice. BI is paying investors higher yields to hold a short-term instrument, while buying up longer-dated SBN at a premium (lower yields). This keeps the government's borrowing costs low, but at substantial costs to BI – not unlike its experience with “burden sharing” during the pandemic. SRBI may also tighten domestic liquidity if banks snap up too much of it, which means that BI can only limit issuance up to a certain level.
- SRBI seems to be a more favorable choice than hiking the BI Rate outright, but it is also true that higher SRBI yields, in practice, reflect foreign investors' cravings for higher rates. The question, then, is whether the ~1% gap between BI Rate and SRBI yields tenable? This is something that BI will probably have to decide on a month-to-month basis for the next few months, balancing the consideration of cost, domestic liquidity, and exchange-rate risks. For this reason, we still see a chance for 25-50 bps rate hike this year, barring a quick turnaround in the Fed rate outlook.

**Panel 1. FX reserves increased mainly due to inflow, global bond issuance, and SRBI**



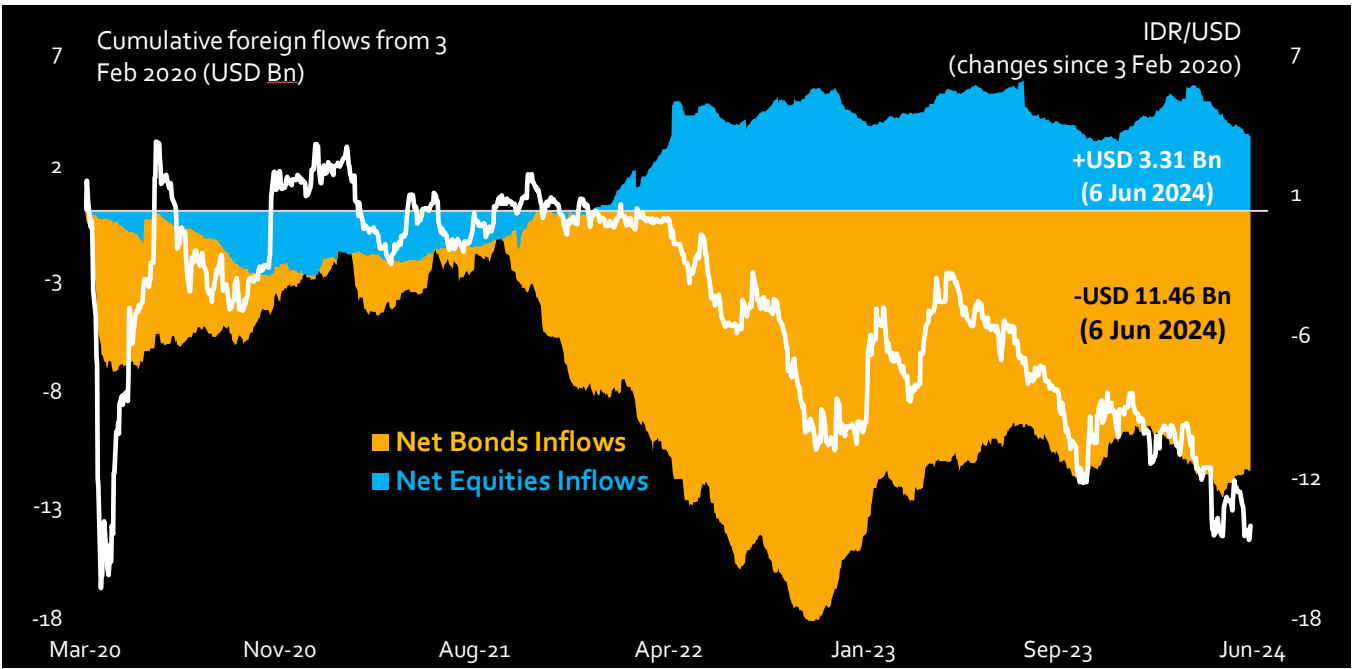
Source: Bloomberg

**Panel 2. Banks' placement at BI increased, driven mainly by FX swap and not the newer SVBI/SUVBI**



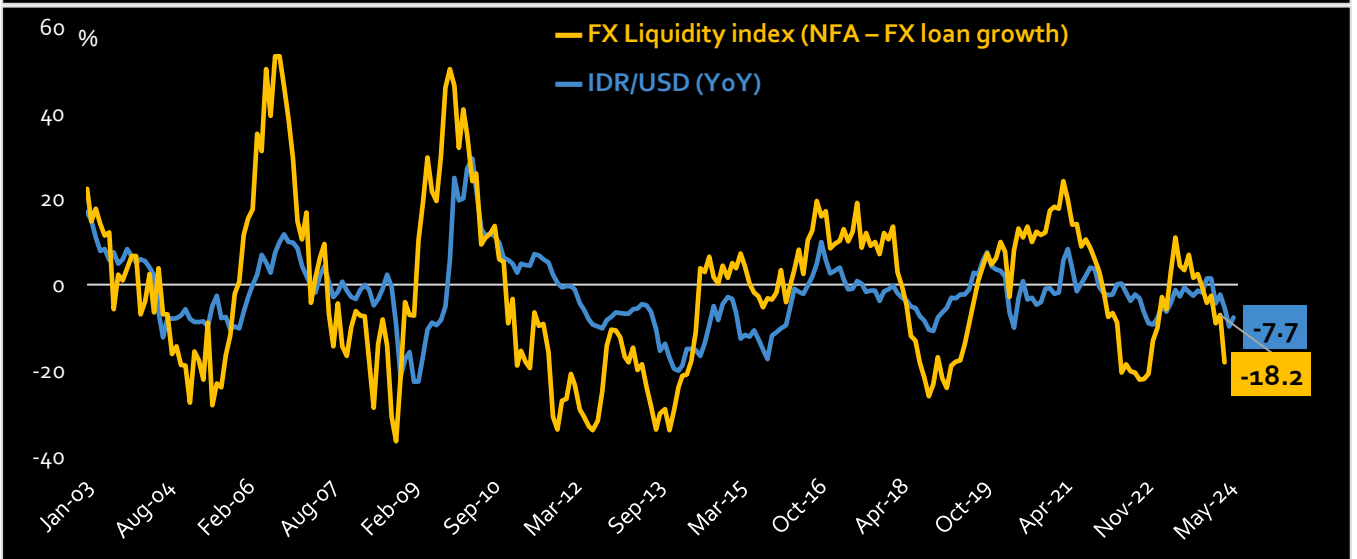
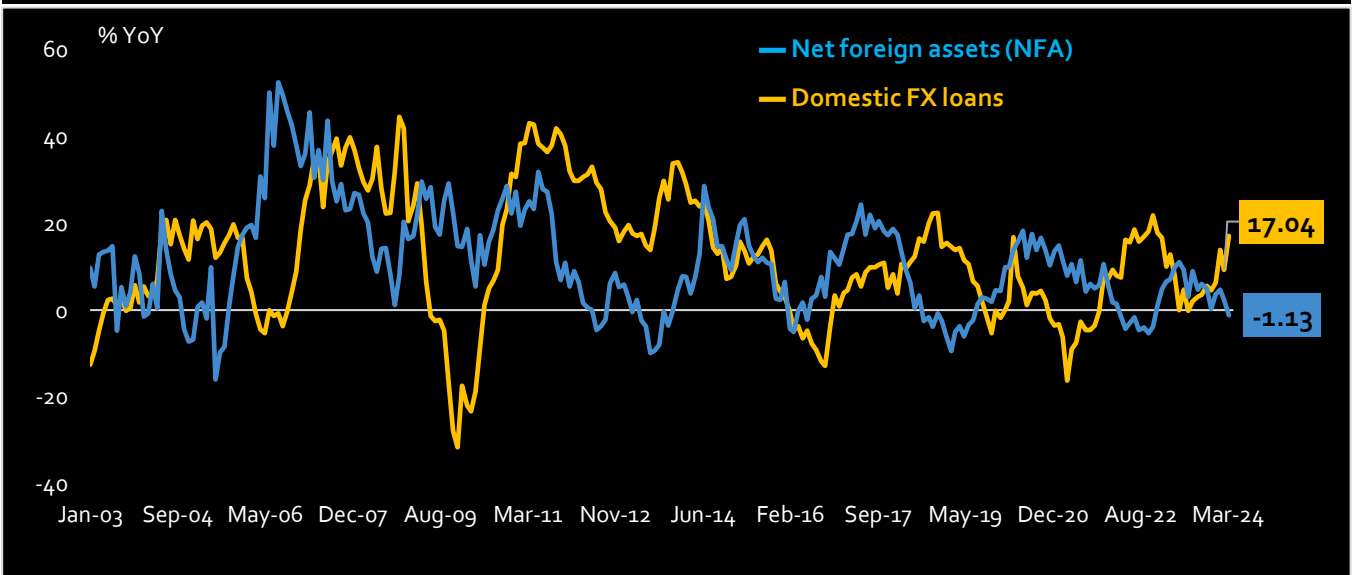
Source: BI

**Panel 3. Investors withdrew from equities while bonds still recorded a net inflow**



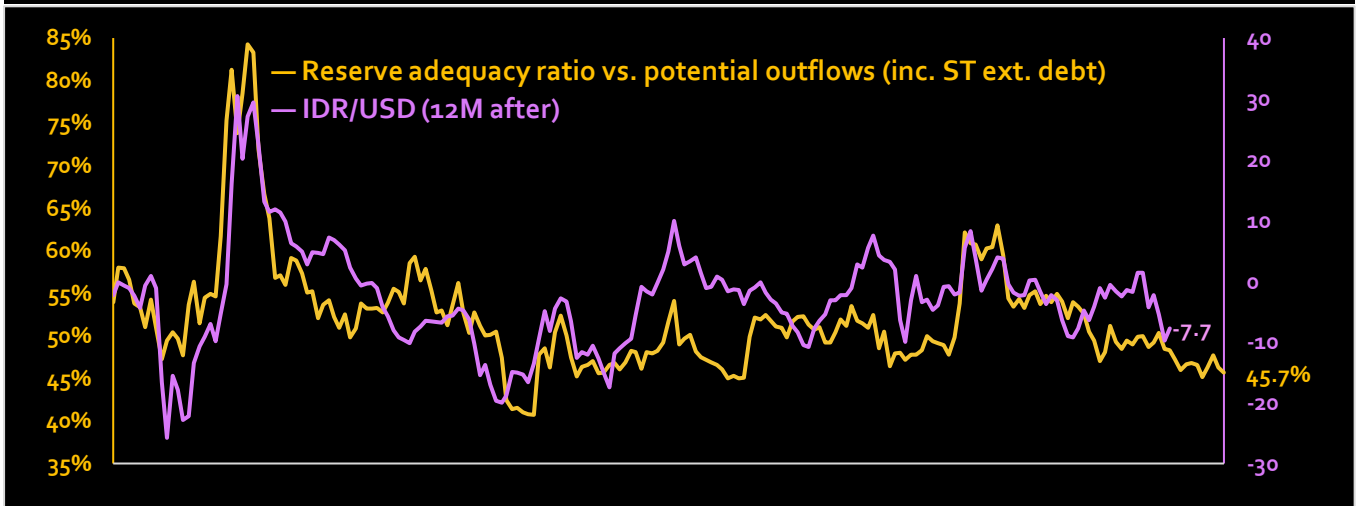
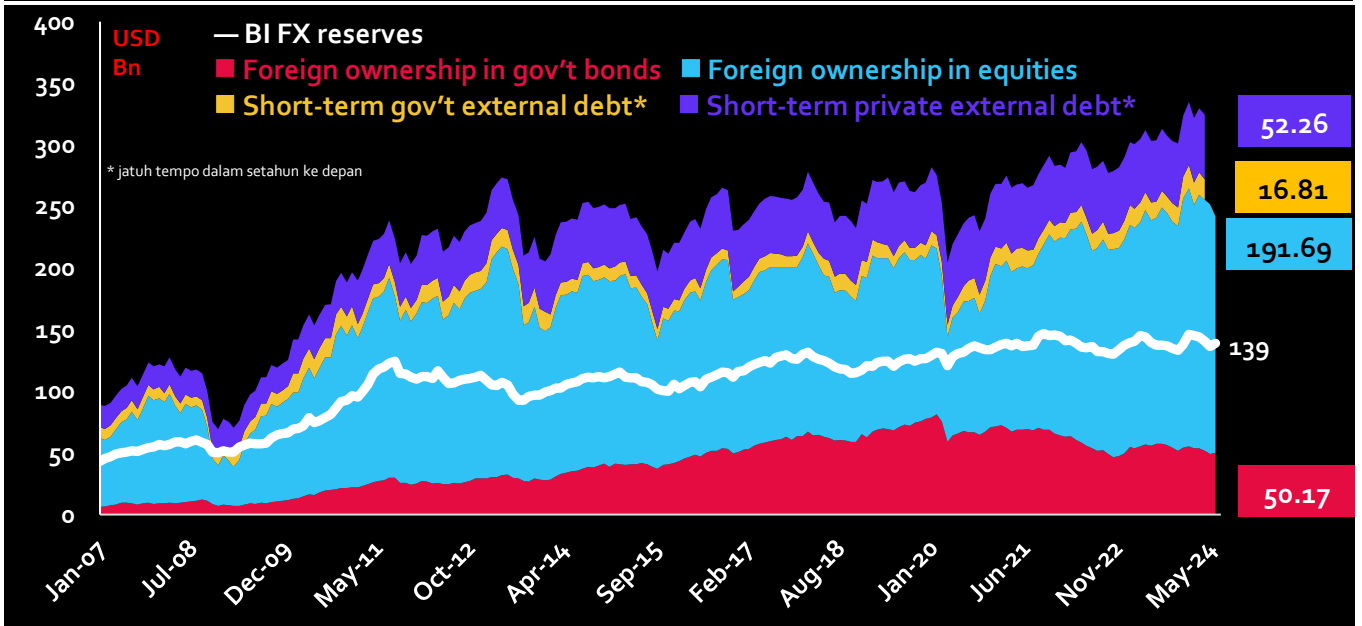
Source: Bloomberg

**Panel 4. Demand for FX liquidity continue to pick up**

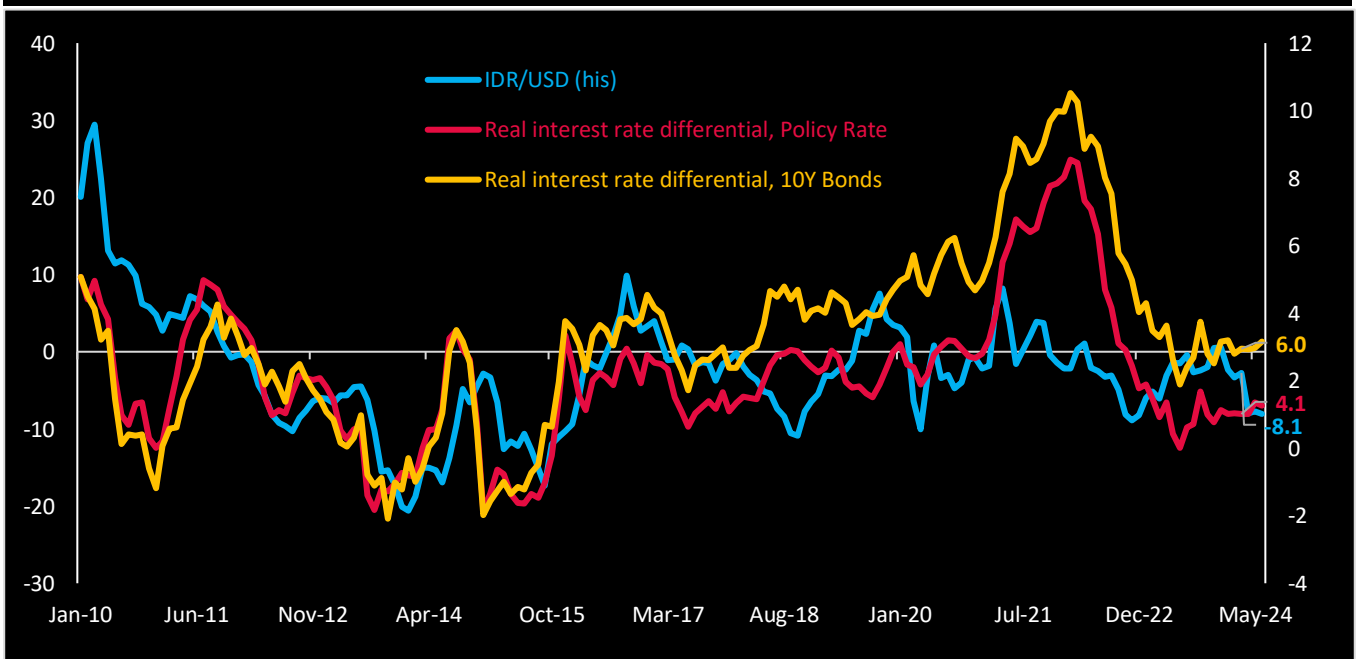


Source: BI, Bloomberg

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



**Panel 6. Still narrow real rate differentials may add pressure on the Rupiah**



Source: Bloomberg

## Selected Macroeconomic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	6-Jun	-1 mth	Chg (%)
US	5.50	Jul-23	2.10	Baltic Dry Index	1,869.0	1,876.0	-0.4
UK	5.25	Aug-23	2.95	S&P GSCI Index	569.1	576.9	-1.4
EU	4.25	Jul-23	1.65	Oil (Brent, \$/brl)	79.9	83.3	-4.2
Japan	-0.10	Jan-16	-2.60	Coal (\$/MT)	135.9	146.1	-7.0
China (lending)	2.50	Aug-23	4.05	Gas (\$/MMBtu)	2.30	1.88	22.3
Korea	3.50	Jan-23	0.80	Gold (\$/oz.)	2,376.1	2,324.0	2.2
India	6.50	Feb-23	1.67	Copper (\$/MT)	10,036.5	9,790.1	2.5
Indonesia	6.25	Apr-24	3.41	Nickel (\$/MT)	18,301.6	19,047.0	-3.9
Money Mkt Rates	6-Jun	-1 mth	Chg (bps)	CPO (\$/MT)	839.7	823.4	2.0
				Rubber (\$/kg)	1.78	1.60	11.3
Bank Rates (Rp)	Mar	Feb	Chg (bps)	External Sector	Apr	Mar	Chg (%)
SPN (1M)	5.88	5.80	7.6	Export (\$ bn)	19.62	22.54	-12.97
SUN (10Y)	6.90	6.88	1.9	Import (\$ bn)	16.07	17.96	-10.55
INDONIA (O/N, Rp)	5.97	6.18	-20.7	Trade bal. (\$ bn)	3.55	4.58	-22.46
JIBOR 1M (Rp)	6.90	6.90	0.0	Central bank reserves (\$ bn)*	136.2	140.4	-2.97
Lending (WC)	8.83	8.84	-1.69	Prompt Indicators	Apr	Mar	Feb
Deposit 1M	4.62	4.62	-0.76	Consumer confidence index (CCI)	127.7	123.8	123.1
Savings	0.68	0.67	0.26	UK Pound	0.782	0.796	1.82
Currency/USD	6-Jun	-1 mth	Chg (%)	Euro	0.918	0.929	1.12
				Japanese Yen	155.6	153.9	-1.09
				Chinese RMB	7.245	7.209	-0.50
				Indonesia Rupiah	16,260	16,025	-1.45
				Car sales (%YoY)	-17.5	-26.2	-18.8
Capital Mkt	6-Jun	-1 mth	Chg (%)	Motorcycle sales (%YoY)	18.3	-7.8	-2.9
JCI	6,974.9	7,135.9	-2.26	Manufacturing PMI	May	Apr	Chg (bps)
DJIA	38,886.2	38,852.3	0.09	USA	51.3	50.0	130
FTSE	8,285.3	8,213.5	0.87	Eurozone	47.3	45.7	160
Nikkei 225	38,703.5	38,236.1	1.22	Japan	50.4	49.6	80
Hang Seng	18,476.8	18,578.3	-0.55	China	51.7	51.4	30
Foreign portfolio ownership (Rp Tn)	May	Apr	Chg (Rp Tn)	Korea	51.6	49.4	220
Stock	3,115.0	3,294.9	-179.85	Indonesia	52.1	52.9	-80
Govt. Bond	807.0	789.9	17.11				
Corp. Bond	8.2	8.4	-0.20				

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	6.50
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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