FX reserves: The precarious edge of Powell's boot

Executive Summary:

- **Bank Indonesia's foreign reserves stood at USD 136.4 Bn by the end of last month, a decline of USD 2.4 Bn from April,** primarily driven by government debt payments.
- **Capital markets remain precariously balanced on concerns of tapering by the Fed, of which uncertainties remain due to the mixed signals coming out of the US labor market.**
- Combined with risks associated with a recovery in imports as well as maturing government and SOE debt for the year, **BI is likely to continue holding a wait and see posture for the coming months.**

- **Bank Indonesia's (BI) foreign reserves stood at USD 136.4 Bn by the end of last month, a decline of USD 2.4 Bn from the historical high recorded in April.** The lion's share of this decline was driven by the USD 5.9 Bn worth of FX-denominated government bonds maturing by the end of May.

- **The deluge of government debt payments however, obscures the stealthy return of foreign inflows that began in late April,** the first since rising yields sparked off large outflows earlier in the year **(*Chart 1*)**. This doesn't seem to be unique to Indonesia, emerging market bond and currency indices have both steadily crept up in the past few months, accompanied by a weakening USD **(*Chart 2*)**. A combination of steady US Treasury yields, continuing economic recovery across the globe, as well as continued monetary easing by the Fed have converged to create a rather favorable environment for capital market operators in the recent months.

- This state of being however, remains precariously perched upon the whims of the Fed. **Indeed, markets remain wary of when tapering – or rather, serious nods towards the impending arrival of tapering – will take place.** Although the Fed's tone has remained strongly dovish up to this point, the very fundamental fact remains that economic recovery in the US is proceeding at quite a robust speed. So long as economic indicators continue to tick upwards in the US, nervous prognostications of how long it will take before Powell decides enough is enough are likely to continue.

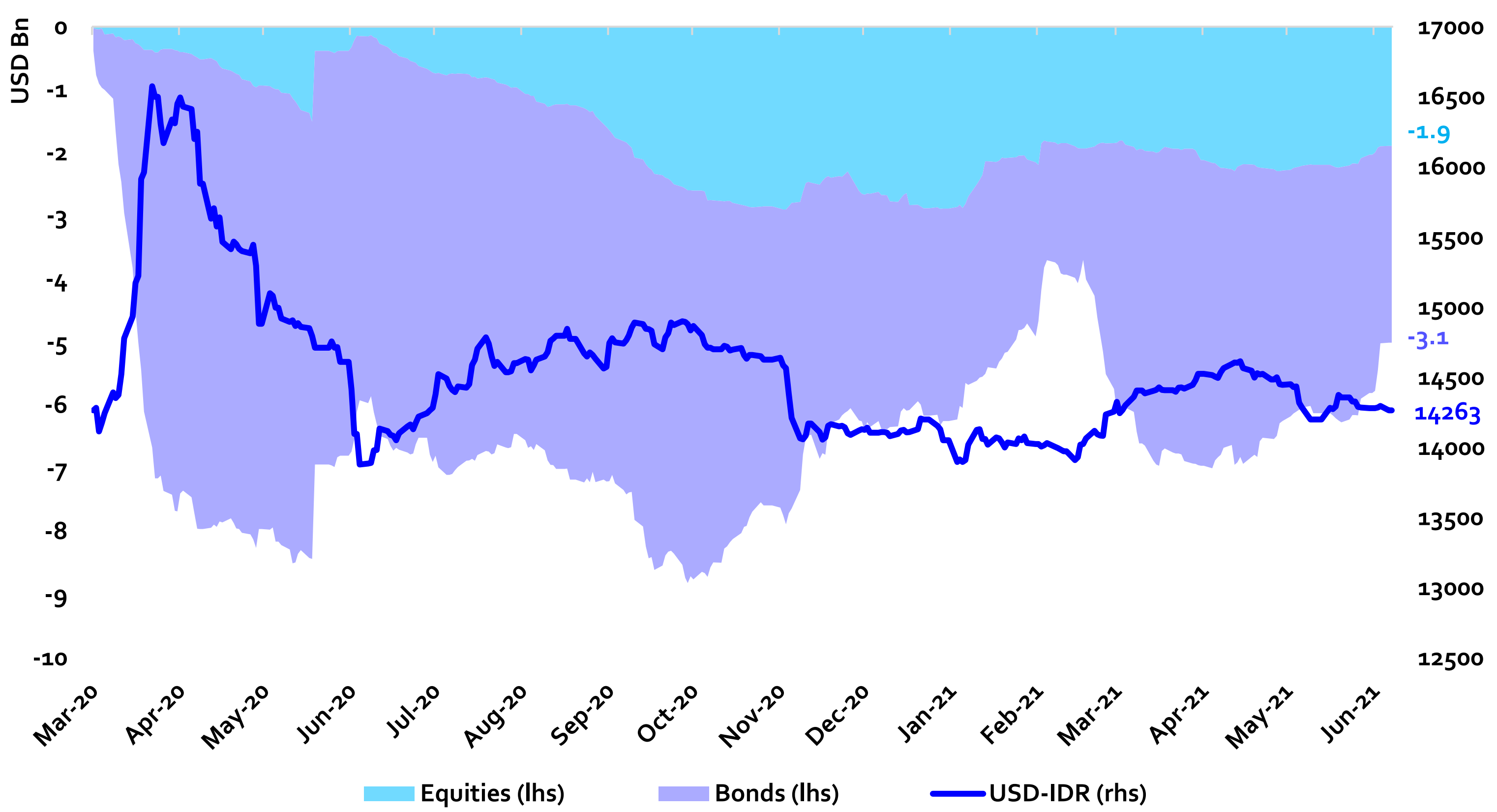
- How long the current state of affairs in the market can last then, rests on the pace of the US' economic recovery. There are two criteria by which we can evaluate this. The first is inflation. **While both the CPI and PPI have skyrocketed in the US over the past few months, much of these figures remain distorted by the extremely low-base of last year, and the sharp increase may very well be temporary in nature.** This at least, appears to be the view of the Fed.

- **A second thing to consider is employment, which the Fed itself has proclaimed to be one of the primary metrics by which it will dictate the direction of its policy.** Where then, does the US labor market stand? While vast strides have been made since the bleak depths plumbed last year, employment figures still remain quite a ways below pre-pandemic levels. Progress then, but still not quite the ideal level of progress.

- Ultimately, the accumulating picture we have of the US' economic recovery – particularly with respect to the Fed's own stated goals – remains very much mixed. **In other words, markets are confused precisely because the picture of recovery remains so confusing.** That the pace of recovery is robust can hardly be denied. The fact that employment figures remain behind the Fed's target however, complicates the picture by a fair bit **(*Chart 3*)**.

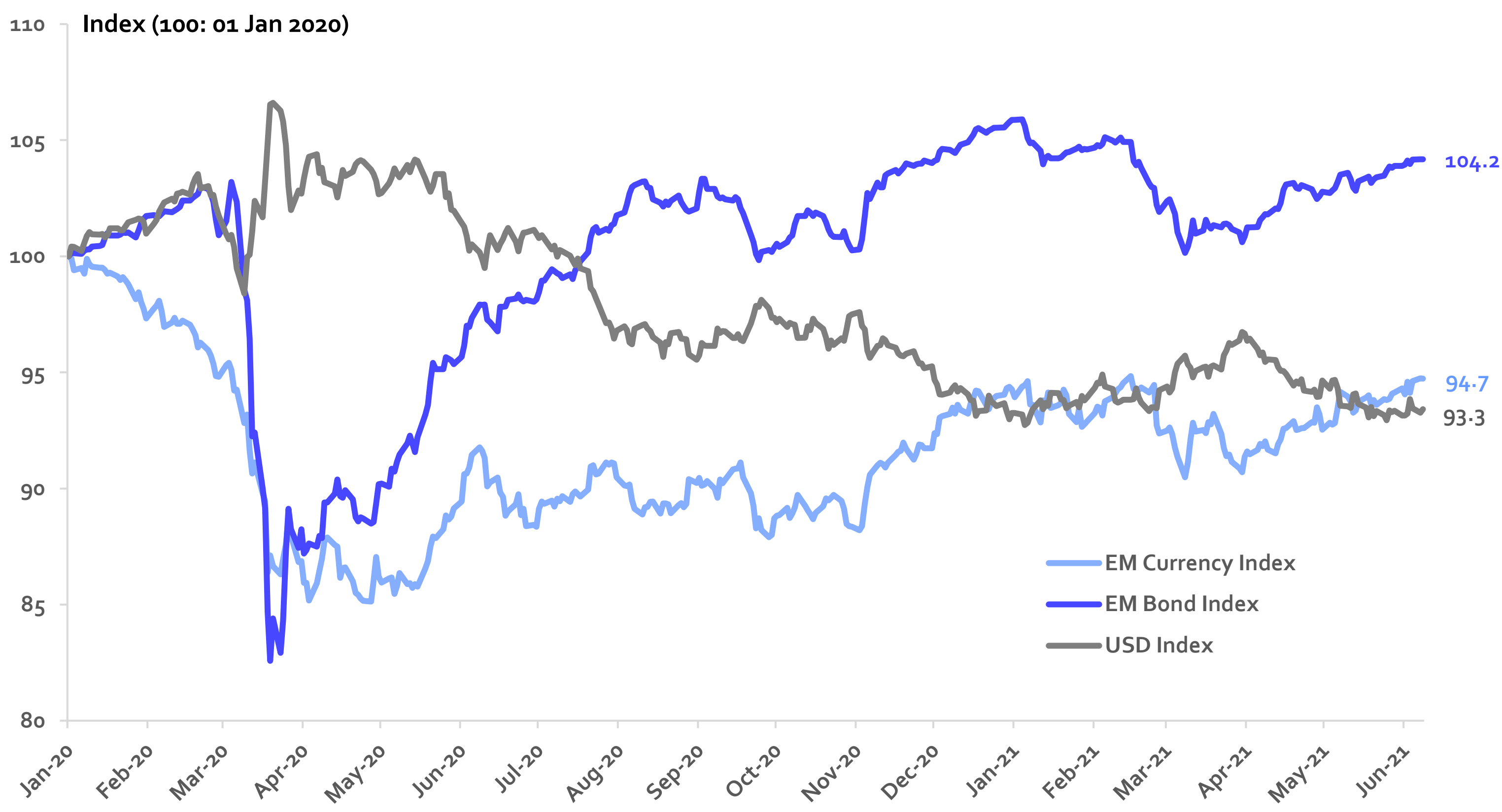
- There are other concerns as well. While the current commodity boom has so far helped maintain Indonesia's trade surplus, continuing recovery may very well push imports further up, potentially putting pressure on the current account. The picture for the capital account, excluding the uncertainties concerning the Fed, remains similarly mixed. While upcoming financial developments concerning Indonesian big tech (eg. the double listing of the Gojek-Tokopedia behemoth) may spur fresh capital inflows, there is also a risk concerning the large amounts of government and SOE debt maturing this year, particularly those related to Pertamina, PLN and Inalum. As long as the current account deficit remains below the 2% generally forecast however, much of this should remain manageable. **With all these combined uncertainties, we expect BI to continue adopting a wait and see posture for the coming months.**

Chart 1. Foreign capital inflows began trickling back in on late April



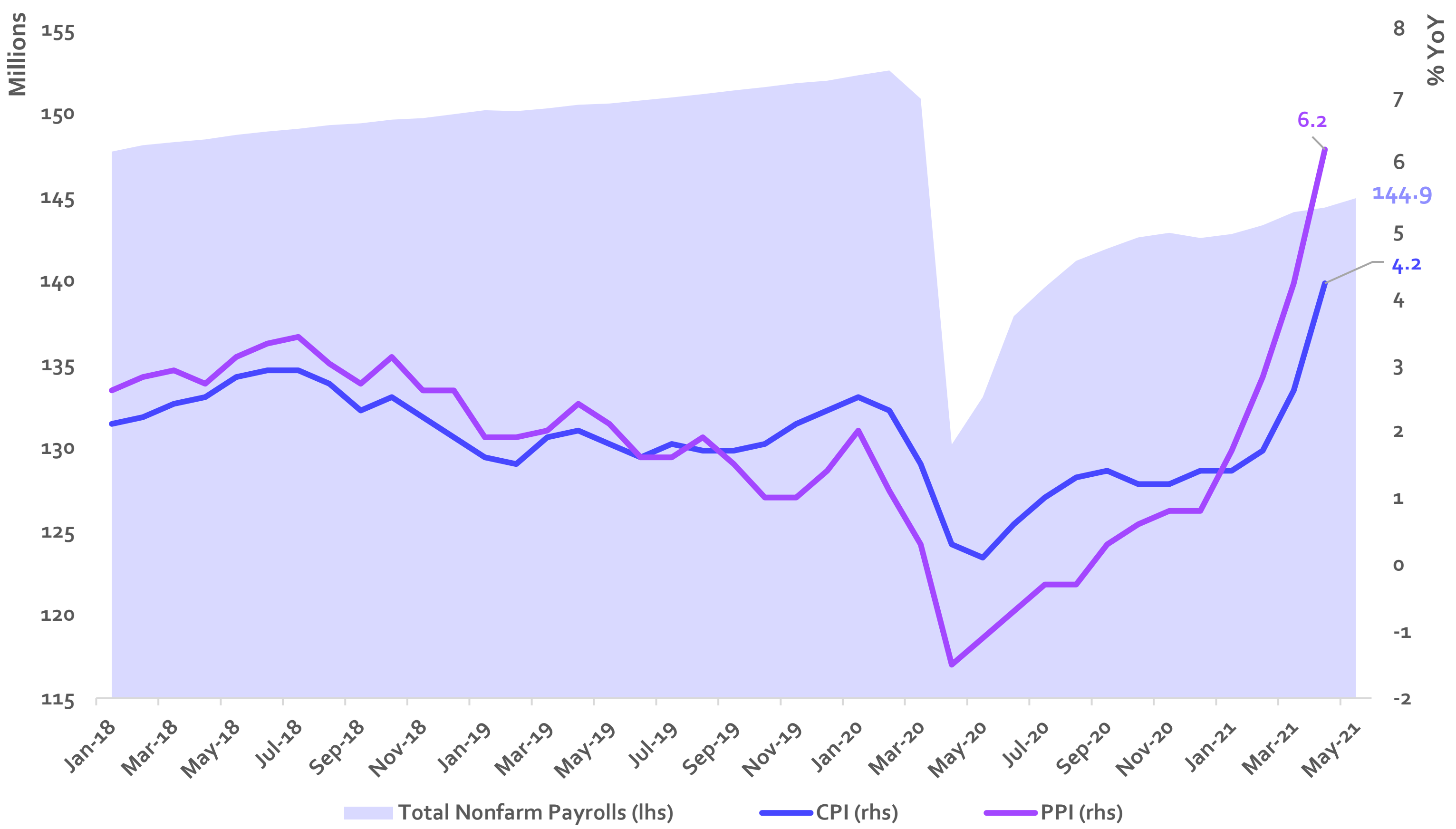
Source: Bloomberg (last update: 08 Jun 2021)

Chart 2. Emerging market assets have recorded steady increases in recent months, accompanied by a softening USD



Source: Bloomberg (last update: 08 Jun 2021)

Chart 3. US inflation has skyrocketed in recent months, even as employment remains well below pre-pandemic levels



Source: Bloomberg

Indonesia – Economic Indicators Projection

	2016	2017	2018	2019	2020	2021E
Gross Domestic Product (% YoY)	5.0	5.1	5.2	5.0	-2.1	4.5
GDP per Capita (US$)	3605	3877	3927	4175	3912	4055
Consumer Price Index Inflation (% YoY)	3.0	3.6	3.1	2.7	1.7	3.1
BI 7 day Repo Rate (%)	4.75	4.25	6.00	5.00	3.75	3.50
USD/IDR Exchange Rate (end of year)**	13,473	13,433	14,390	13,866	14.050	14.460
Trade Balance (US$ billion)	8.8	11.8	-8.5	-3.2	21.7	10.1
Current Account Balance (% GDP)	-1.8	-1.6	-3.0	-2.7	-0.4	-1.8

** Estimation of Rupiah's fundamental exchange rate

Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	0.25	Mar-20	-3.95
UK	0.10	Mar-20	-1.40
EU	0.00	Mar-16	-2.00
Japan	-0.10	Jan-16	0.30
China (lending)	4.35	Oct-15	3.45
Korea	0.50	May-20	-2.10
India	4.00	May-20	-0.29
Indonesia	3.50	Feb-21	1.82
Money Mkt Rates	**7-Jun**	**-1 mth**	**Chg (bps)**
SPN (1M)	2.57	2.63	-6.2
SUN (10Y)	6.40	6.40	0.5
INDONIA (O/N, Rp)	2.80	2.80	-0.1
JIBOR 1M (Rp)	3.56	3.56	0.3
Bank Rates (Rp)	**Mar**	**Feb**	**Chg (bps)**
Lending (WC)	9.12	9.23	-10.55
Deposit 1M	3.74	3.88	-14.01
Savings	0.83	0.83	0.13
Currency/USD	**7-Jun**	**-1 mth**	**Chg (%)**
UK Pound	0.705	0.715	1.42
Euro	0.820	0.822	0.20
Japanese Yen	109.3	108.6	-0.59
Chinese RMB	6.397	6.433	0.56
Indonesia Rupiah	14,265	14,285	0.14
Capital Mkt	**7-Jun**	**-1 mth**	**Chg (%)**
JCI	6,069.9	5,928.3	2.39
DJIA	34,630.2	34,777.8	-0.42
FTSE	7,077.2	7,129.7	-0.74
Nikkei 225	29,019.2	29,357.8	-1.15
Hang Seng	28,787.3	28,610.7	0.62
Foreign portfolio ownership (Rp Tn)	**May**	**Apr**	**Chg (Rp Tn)**
Stock	1,892.8	1,892.9	-0.11
Govt. Bond	957.5	964.6	-7.14
Corp. Bond	27.5	28.5	-1.00

Trade & Commodities	7-Jun	-1 mth	Chg (%)
Baltic Dry Index	2,428.0	3,183.0	-23.7
S&P GSCI Index	529.6	523.0	1.3
Oil (Brent, $/brl)	71.5	68.3	4.7
Coal ($/MT)	115.6	93.9	23.1
Gas ($/MMBtu)	2.98	2.90	2.8
Gold ($/oz.)	1,899.2	1,831.2	3.7
Copper ($/MT)	9,881.3	10,420.0	-5.2
Nickel ($/MT)	17,863.0	18,052.5	-1.0
CPO ($/MT)	1,027.7	1,159.0	-11.3
Rubber ($/kg)	1.65	1.71	-3.5
External Sector	**Apr**	**Mar**	**Chg (%)**
Export ($ bn)	18.48	18.35	0.7
Import ($ bn)	16.29	16.79	-3.0
Trade bal. ($ bn)	2.19	1.57	40.0
Central bank reserves ($ bn)	138.8	137.1	1.24
Prompt Indicators	**Apr**	**Mar**	**Feb**
Consumer confidence index (CCI)	101.5	93.4	85.8
Car sales (%YoY)	902.9	10.5	-38.2
Motorcycle sales (%YoY)	282.0	-7.2	-30.8
Cement sales (%YoY)	8.3	10.9	0.7
Manufacturing PMI	**May**	**Apr**	**Chg (bps)**
USA	61.2	60.7	50
Eurozone	63.1	62.9	20
Japan	53.0	53.6	-60
China	52.0	51.9	10
Korea	53.7	54.6	-90
Indonesia	55.3	54.6	70

Source: Bloomberg, BI, BPS
Notes:
*Previous data
For change in currency: **Black indicates appreciation against USD, **Red** indicates depreciation
***For PMI, **> 50** indicates economic expansion, **< 50** indicates contraction

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