Balance of payments:

Lightning strikes at the start of a lingering rain

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Executive Summary

- Indonesia recorded the widest Q1 BoP deficits since the pandemic, as the financial account flipped to a deficit of USD 2.30 Bn (-0.68% of GDP) while the capital account deficit widened to USD 2.16 Bn (-0.64% GDP).
- Cash outflows and sell-offs in the SBN market explain the sharp drop in the financial account, which may not improve anytime soon given the still-weak demand for Indonesian financial assets.
- The increasing terms-of-trade index may improve the outlook on Indonesia's goods exports, but the CA deficit is expected to widen in Q2 2024 given the expectedly higher services imports and dividend payments abroad.

- The Indonesian economy is starting 2024 with a sharp drop in its balance of payment position, as the Q1 2024 BoP recorded a USD 5.97 Bn deficit against the USD 6.30 Bn surplus in the previous quarter. This BoP number holds some historical significance in a way. **The USD -5.97 Bn figure is the widest Q1 BoP deficit (excluding the COVID shock in Q1 2020) in recent times**, second only to the USD 6.61 Bn deficits in Q1 2013 when the Indonesian economy still found itself among the "Fragile Five" group ahead of the 2013 Taper Tantrum.

- The USD 14.59 Bn QoQ decline in the BoP number may have caused some jitters in the market, as the Rupiah weakened again above the 16,000/USD level shortly after the BoP data drops. However, it is important to consider the different contexts that shaped the BoP figures for this quarter and the previous quarter. The 6.30 Bn BoP surplus in Q4 2023 is largely thanks to the significant financial account (FA) surplus during the quarter, primarily driven by a higher amount of new foreign loans that flowed to the Indonesian economy. In contrast, **the more recent hawkish shift in the global interest rate expectation has reduced the public and private sector's appetite for new foreign loans (but not necessarily FX loans), leading to the USD 4.4 Bn deficit in the "other investment" side of the FA** that contributes to the USD 2.30 Bn FA deficit in Q1 2024.

- A lower foreign debt exposure may seem like a good thing, especially considering the upward trend in the expectation of the USD real interest rate in 2024. However, the USD 7.19 Bn QoQ decline in the "other investment" side of the FA does not leave much to cheer for. For instance, **cash placements abroad by the domestic private sector increased almost fivefold**, from USD 0.63 Bn in Q4 2023 to USD 3.05 Bn in Q1 2024. Financial outflows through this licit channel may reflect an uptick of similar activity in the more illicit channels, as indicated by the widening USD 1.51 Bn deficit accounted as net errors and omissions.

- The ebb-and-flow in the licit (and illicit) financial outflows from Indonesia is a regular occurrence, although the pattern is more haphazard rather than event-driven. This repeated spike of financial outflows from Indonesia, we should remember, is one of the factors that encourages the government to assert tighter control over FX proceeds from exports, which BI responded by launching the FX TD DHE instrument to ensure that investors will have a market-equivalent return for their domestic FX placement.

> ***"The spiking outbound cash placements show that Bank Indonesia may need to start offering more benefits to encourage exporters to keep their FX proceeds within the domestic economy"***

- Alas, **the surge in cash placements abroad by the domestic private sector, which still occurred in Q1 2024, illustrates that the instrument is yet to provide enough incentives for exporters to keep their FX proceeds within the domestic banking system.** Indeed, the yield on 3M FX TD DHE (its most liquid term) in 2024 is 10.2 bps less than the risk-free 3M UST yield, unlike the SVBI which offers 32.2 bps higher yield on average compared to the benchmark instrument. Further spikes in cash outflows from the Indonesian economy may thus compel BI to offer more carrots to exporters for them to utilise the FX TD DHE instrument better, although the possibility of the government again strengthening the stick (the DHE policy) is also not out of the question.

- The portfolio investment side of the FA also explains the sharp QoQ drawdown in Indonesia's financial account in Q1 2024. Foreign investors may have again recorded net purchases in Indonesia's stock market, as evidenced by the increase in the position of the private sector's stock liabilities to a surplus of USD 1.11 Bn in Q1 2024 from USD 0.41 Bn deficit prior. Alas, **foreign investors' demand for Indonesian stocks seems to be outmatched by the domestic private sector's interest in foreign financial assets** (especially for foreign bonds), while foreign investors' interest in the SBN market also recorded a sharp decline throughout the last quarter.

- Unfortunately, the outlook for the portfolio investment side of Indonesia's FA may get bleaker in the coming quarters. On the one hand, foreign investors have been reducing their exposure to the Indonesian stock market since the end of March 2024, which appears to exceed the net buy trend at the beginning of the year. On the other hand, **the higher yield on the US Treasury market does not help to lure foreign investors back to the SBN market**, leaving the SBN market exposed to changes in the fed rate expectation.

- **Foreign investors' feeble demand for SBN does not mean that the Indonesian debt market is not at all attractive to foreign investors.** Following the trend first started in Q3 2023, foreign inflows to BI's debt securities recorded a sizable sum, amounting to USD 1.29 Bn in Q1 2024. Continued foreign inflows to BI-issued debt securities prove that the central bank's effort to reinvigorate the short end of Indonesia's bond market has been quite successful, as the slowdown in foreign purchases of BI securities in Q1 2024 (USD 3.68 Bn in the previous quarter) is understandable as BI moves to reduce further SRBI/SVBI/SUVBI issuance during the quarter.

- The USD 2.30 Bn FA deficits and USD 1.51 Bn deficits in net errors and omissions only explain 63.81% of Indonesia's BoP picture in Q1 2024. **The current account side of the BoP is also netting USD -2.16 Bn in Q1 2024, extending its deficit from USD -1.12 Bn in the**

previous quarter. The underlying factor behind the USD 1.04 Bn decline in Indonesia's CA is clear to see. Exports fell by USD 3.83 Bn in Q1 2024, while imports only fell by USD 1.22 Bn during the same period. The 6.20% QoQ drop in Indonesia's exports is interesting given the 0.21% QoQ increase in Indonesia's terms-of-trade index, indicating a drop in the volume of external demand for made-in-Indonesia goods.

- Meanwhile, not much changed from the other side of the CA. Remittances from the Indonesian diaspora reached an all-time high of USD 3.82 Bn in Q1 2024, but this number is only USD 0.15 Bn higher than in the previous quarter. The services side of the CA also recorded a slimmer deficit in Q1 2024 (USD -4.42 Bn from USD 4.98 Bn in Q4 2023) as fewer Indonesians travelled abroad and slowing CAPEX trends allowed businesses to cut down their expenses on professional services, although the reduced services imports were offset by increases in dividend payments abroad.

- The outlook for Indonesia's CA may not improve much in the upcoming quarter. **A widening services account deficit in Q2 2024 is widely expected, given the Hajj pilgrimage that drives up the demand for FX in the domestic market. The Q2 2024 CA balance should also reflect the ongoing dividend payment and repatriation window**, a trend that may become increasingly structural given the increasing number of foreign-backed businesses (both brownfield and greenfield) within the Indonesian economy.

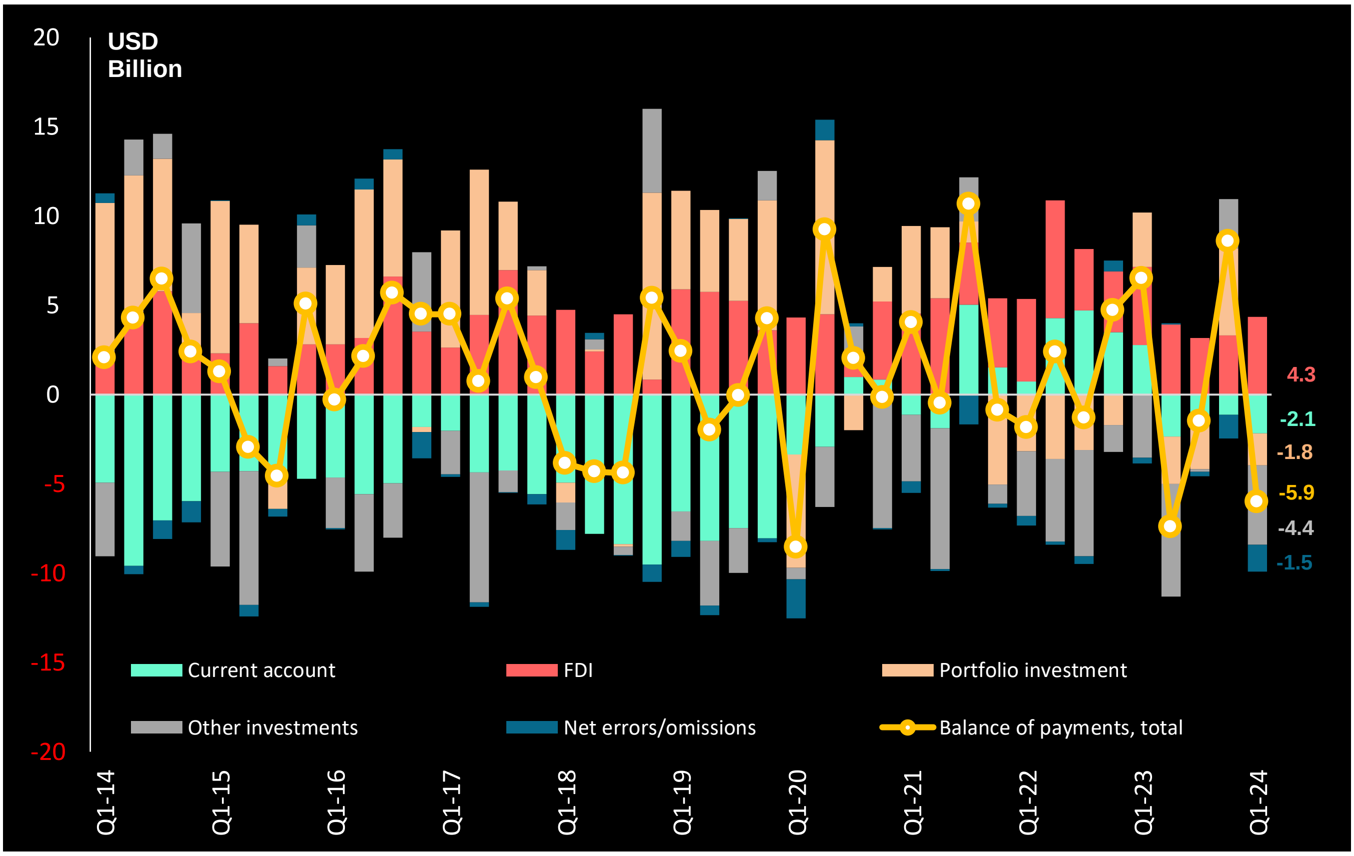
- Fortunately, there is a reason to hope that the CA deficit in the upcoming quarter may not be as deep as some might expected. **Indonesian traders now benefit from a 2.17% QoQ increase in their terms-of-trade index, improving the outlook on the trade balance despite the elevated oil and imported food prices.** Continued expansion in China's manufacturing sector may also buttress the demand for Indonesian exports, although the demand is likely to be concentrated on coal and some industrial minerals.

"Another BoP deficit in Q2 2024 may not significantly impact the sentiment on the Indonesian economy, but maintaining a hawkish policy signal may be more prudent given the uncertain global condition"

- As such, **the CA data in Q2 2024 may not significantly affect the sentiment on the Rupiah and the Indonesian financial market, given that a widening deficit to the CA balance is already priced-in with a potential surprise to the upside.** The improving terms-of-trade index may prove to be a positive surprise for the market, especially if the now-weakened Rupiah turns out to be significant in reducing the demand for imports.

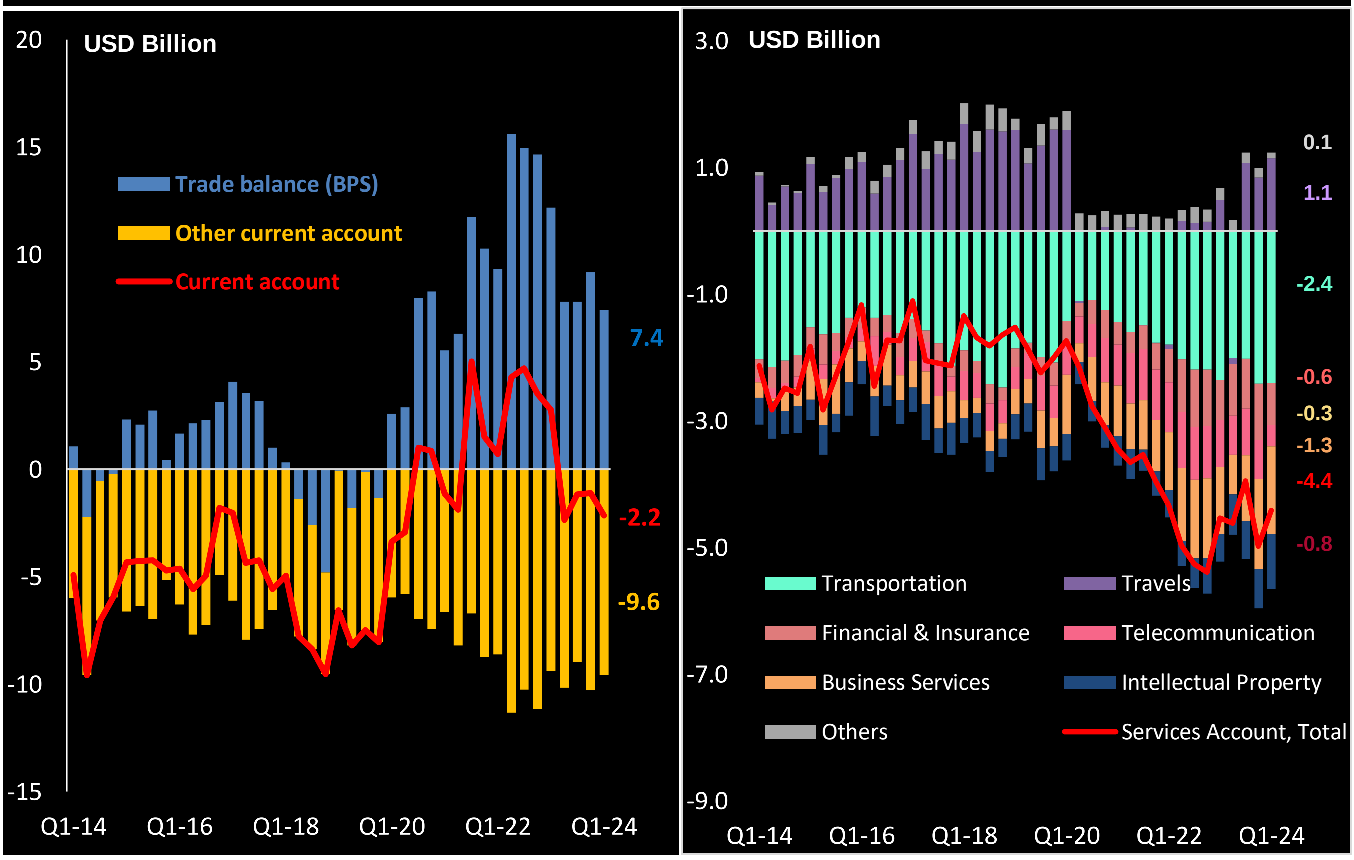
- Indeed, the case for another upward adjustment to the BI rate seems to be losing steam at the moment, although keeping the possibility of another 25-bps increase to the policy rate open may still serve as insurance given that uncertainties due to the heating geopolitical tension and the higher domestic demand for FX may continue to threaten the Rupiah and the domestic financial market.

Chart 1. **Foreign capital outflows and higher cash placements abroad tipped Indonesia's FA balance back to a deficit, while the CA side of the BoP extended its deficit in Q1 2024**



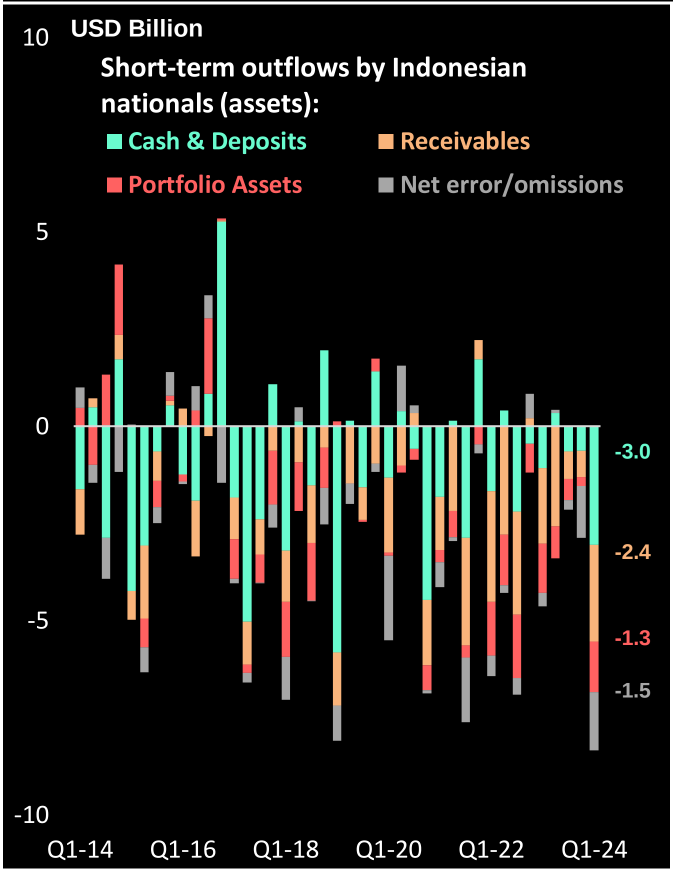
Source: Bank Indonesia

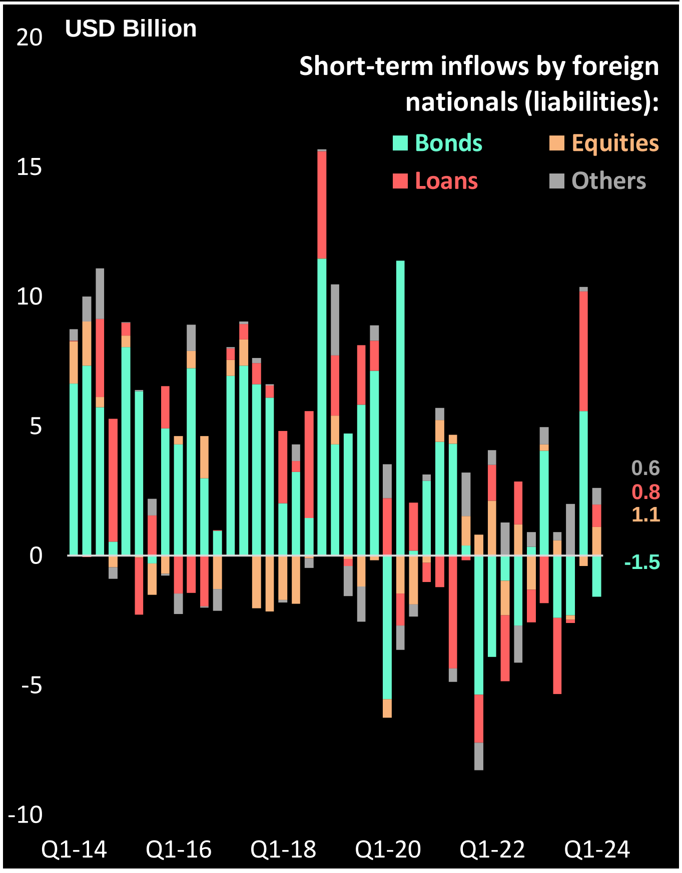
Panel 1. **The lower services deficit in Q1 2024 is not enough to cover the declining revenue from goods exports as volume plummeted**



Source: Bank Indonesia, BPS

Panel 2. The hawkish shift in global rate expectations negatively impacts the SBN market, but short-term Indonesian bonds remain in demand





Source: Bank Indonesia

Selected Macroeconomic Indicators

Table 1. Balance of payments (current USD Million)

	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	2021	2022	2023
CURRENT ACCOUNT	***2,775***	***-2,364***	***-1,171***	***-1,120***	***-2,161***	***3,511***	***13,215***	***-1,880***
(as % of GDP)	***0.83***	***-0.67***	***-0.34***	***-0.33***	***-0.64***	***0.30***	***1.00***	***-0.14***
A. Goods	14,718	10,133	10,162	11,440	9,823	43,806	62,672	46,453
- Non-Oil/Gas	19,013	15,164	15,867	17,694	15,077	57,804	89,773	67,738
- Oil/Gas	-3,959	-4,547	-5,284	-5,869	-4,969	-12,965	-24,777	-19,658
B. Services	-4,537	-4,621	-3,954	-4,976	-4,417	-14,599	-19,957	-18,089
C. Income	-8,853	-9,303	-8,631	-8,822	-8,944	-31,961	-35,303	-35,608
D. Current Transfers	1,447	1,427	1,252	1,239	1,378	6,264	5,803	5,365
CAPITAL TRANSACTIONS	**2.78**	**4.86**	**8.40**	**27.25**	**2.84**	**80.15**	**476.19**	**43.28**
FINANCIAL TRANSACTIONS	**4,089**	**-5,094**	**-40**	**11,039**	**-2,305**	**12,492**	**-9,157**	**9,994**
A. Direct Investment	4,376	3,925	3,157	3,308	4,347	17,286	18,067	14,766
B. Portfolio Investment	3,027	-2,637	-3,020	4,880	-1,791	5,086	-11,631	2,250
C. Derivative Instruments	204.92	-83.16	-53.21	98.74	-420.61	332.71	48.36	167.29
D. Other Investment	-3,519	-6,299	-124	2,752	-4,441	-10,212	-15,642	-7,190
NET ERRORS AND OMISSIONS	**-349.79**	**80.71**	**-259.02**	**-1,328.67**	**-1,507.00**	**-2,622.30**	**-535.12**	**-1,856.76**
BALANCE OF PAYMENT *(= change in BI international reserves)*	**6,517**	**-7,372**	**-1,462**	**8,617**	**-5,970**	**13,461**	**3,999**	**6,301**

Source: Bank Indonesia

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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$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	3.2
BI 7 day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	6.50
USD/IDR Exchange Rate (end of year)**	13,866	14,050	14,262	15,568	15,397	16,119
Trade Balance (US$ Bn)	-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

*Estimated number

** Estimation of Rupiah's fundamental exchange rate

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