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Economics | Indonesia

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Economics

Indonesia’s Reserves Rise, But Rupiah Faces Renewed Pressure Amid Global Uncertainty

Highlights

- **Reserves continue upward trend.** Indonesia's foreign exchange reserves increased to US$146.5b in Aug 26, driven by capital inflows into bonds, equities, and SRBI, as well as foreign currency-denominated debt issuance. The buildup was supported by reduced intervention needs as the rupiah appreciated 1.58% mom in line with other emerging-market currencies.
- **Rupiah reverses gains on strong US jobs data.** Despite the positive reserves news, robust US non-farm payrolls (162,000 vs 55,000 expected) raised the likelihood of a Fed rate hike in September, causing the rupiah to reverse its earlier appreciation and Indonesian bond yields to rise. Ytd, the rupiah remains one of the worst-performing EM currencies, down 5.81%.
- Outlook remains cautious with wildcards. The rupiah is expected to face renewed depreciation pressure in September-October due to seasonal patterns, rising oil prices, and the US-Iran conflict. A potential Fed rate hike (25 bps to 4.00%) could trigger BI intervention via SRBI issuance and a further rate hike, pushing the rupiah to Rp18,000-18,200 by year-end. However, a wildcard remains: Global capital flows into emerging markets are unexpectedly counteracting higher US yields, and it is uncertain whether this trend will persist.

Analysis

- Indonesia’s foreign exchange reserves edged up to US$146.5b in Aug 26, from US$145.3b in Jul 26, continuing an upward trend since the May low of US$144.9b. The modest increase was primarily driven by capital inflows into the bond, equity, and SRBI markets, alongside the issuance of foreign currency-denominated debt.
- The reserve buildup was further supported by a reduced need for central bank intervention, as the rupiah appreciated 1.58% during the month. This gain mirrored the performance of other emerging-market currencies, such as the Malaysian ringgit and Mexican peso, and was largely attributed to global factors – specifically a weaker US dollar index amid a deepening US bond market crisis. On a ytd basis, however, the rupiah has depreciated 5.81%, placing it among the worst performing emerging market currencies.
- Despite the mildly positive reserves announcement, market sentiment was quickly overshadowed by robust US jobs data. August non-farm payrolls came in at 162,000 – well above market expectations of 55,000 – raising the probability of a Federal Reserve rate hike in September. Consequently, the rupiah reversed its earlier gains and depreciated, while Indonesian government bond yields moved higher.

Outlook

- Following the rupiah's positive movement in August, which aligned with seasonal patterns, we expect mild depreciation pressure to re-emerge in September and October, consistent with historical trends. This weakening is likely to be exacerbated by worsening global conditions, particularly the escalation of the US-Iran conflict and the resulting rise in oil prices. We project the rupiah to depreciate by approximately 0.5%-1.0%, ending the month around Rp17,800 per USD.
- Furthermore, we note a significant probability that the US Federal Reserve will raise its policy rate by 25bps to 4.00%, which would further strengthen the US dollar. Under this scenario, we expect Bank Indonesia to respond by

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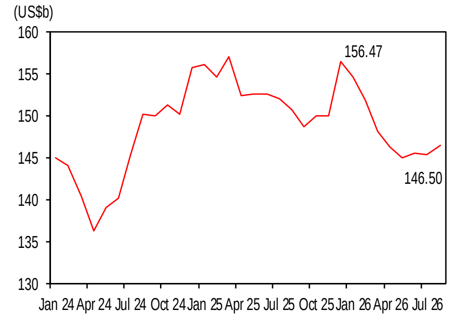
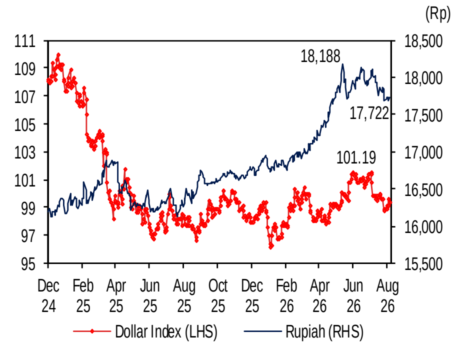
Indonesia Foreign Exchange Reserves



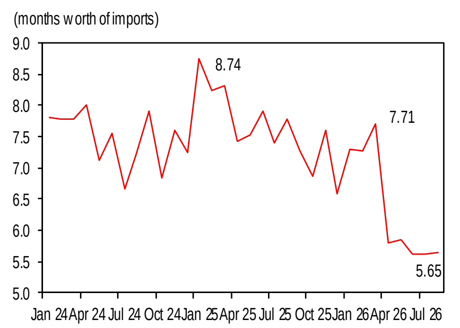
Source: BI

Rupiah Exchange Rate And US Dollar Index



Source: Bloomberg, UOB Kay Hian

Ratio Of Foreign Reserve To Imports



Source: Bloomberg

increasing the issuance of short-term SRBI to attract foreign capital and raising its policy rate by 50bps to preserve the interest rate spread against the Fed. BI's intervention is justified by the relatively low foreign reserve adequacy, which currently stands at 5.6 months of imports – the weakest level since 2024. As a result of the more hawkish Fed stance and volatile global geopolitical conditions, although partially offset by BI's policy interventions, the rupiah is expected to depreciate toward a range of Rp18,000-18,200 per USD by the end of the year.

- However, there remains a wildcard: Global capital flows into emerging markets appear to be counteracting higher US Treasury yields, defying conventional expectations. It remains to be seen whether this trend will continue or prove to be a short-term phenomenon, and this dynamic warrants close monitoring in the coming months.