

Indonesia Macro View

Looking Closer into Indonesia's Foreign Reserves

- **Short term borrowings of BI from onshore banks has been on the rise** — In recent quarters, BI has increased short term FX borrowings from onshore commercial banks, mainly through its USD TD and FX swap auction facilities. Altogether, the balances of these facilities almost reached \$10bn as of mid-October, by our calculation.
- **Accordingly market participants have been increasingly looking at foreign reserves net of short term liabilities** — BI's reserves are commonly subtracted with short term net drains e.g. BI's USD TD and FX swap balances. Thus many now increasingly pay attention to BI's International Reserves / Foreign Currency Liquidity (IRFCL) reporting template. The aim is to get a more forward looking picture of reserve dynamics. The simple logic being that as the short term liabilities mature in the next 1, 3, 6 or 12 months, the level of reserve assets can drop.
- **Potential for data misinterpretations, due to limited comprehension of BI's IRFCL data, has also grown** — This is why in this report we highlight several key points to mind when analyzing the IRFCL template. We show where the USD TDs and swaps are accounted for in the data. We also discuss why it could be misleading to subtract reserves with all the components of short term drains. For example scheduled government foreign debt repayments should not be wholly used to subtract reserves because a big chunk is usually rolled over. Liabilities to commercial banks in the form of statutory reserves also should not be used to subtract reserves.
- **In our view, the gross foreign assets (GFA) of commercial banks is now an increasingly relevant indicator** — Whenever commercial banks place funds in BI's USD TD facility or participates in the swap auction, the GFA of the banks decline while foreign reserves of BI rises equivalently. The GFA of commercial banks represents the pool of funds which BI can borrow from thus should be monitored alongside the IRFCL, in our view.
- **Beefing up swap lines is good, but FX policy sustainability is now more important** — BI has renewed and modified bilateral swap arrangements with a number of countries: Japan (\$12bn), China (eq. \$15bn) and Korea (eq. \$10bn), which we believe is a commendable step to build a second line of defense. However any draw-down of these swaps would raise both reserve assets and short term drains in the IRFCL template, which market participants could use to discount BI's reserve assets. In this regard, we believe it is now more important than ever for FX policy sustainability to be perceived as credible and sustainable.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Looking Closer into BI's Foreign Reserves

Bank Indonesia's short term borrowings from onshore banks have risen in recent quarters. Therefore market participants are increasingly looking beyond the headline foreign reserve numbers. Attention has grown on foreign reserves net of short term liabilities. This is often done through subtracting foreign reserve assets with BI's USD term deposits and FX swap balances. Many also subtract reserve assets with short term drains detailed in BI's IRFCL template. Such adjusted indicators are meant to give a more forward looking picture of foreign reserve dynamics. In this report we discuss in more detail the recent developments of BI's short term liabilities. We also guide through the BI's IRFCL reporting template to gain better understanding of the components of the various sections.

Analysing Indonesia's IRFCL template

BI's short term borrowings have increased in recent quarters. Since mid-2012, BI has started borrowing USD from onshore banks through its USD term deposit facility. And in July this year BI also introduced the swap auction facility, whereby banks can sell and then buy-back their dollars to BI in exchange for IDR. The total outstanding balance of these facilities by our calculation sums up to about \$9.6bn as of mid-October, consisting of \$3.3bn in the TD and \$6.3bn in the swap.

Market participants have been looking beyond the headline: BI's reserve assets are subtracted with short term liabilities. One simple exercise is to simply subtract BI's reserves with the outstanding TD and swap balances. For example using the Sep-13 reserve number of \$96bn, subtracting the TD and swaps would lead to a "net" figure of around \$86bn. This is a relatively straightforward exercise that could make use of the most recent foreign reserves data.

Many also increasingly pay attention to BI's International Reserves / Foreign Currency Liquidity (IRFCL) reporting template. Official reserves are often subtracted by short term drains as defined in BI's IRFCL template, which is available on BI's website and consists of 3 sections:

- I) Official reserve assets;
- II) *Predetermined* short term net drains on foreign currency assets;
- III) *Contingent* short-term net drains on foreign currency assets.

The template gives a more holistic picture of BI's short term liabilities and gives details of liabilities by tenor. However the drawback is that the data is usually less recent; i.e. lagged one month compared to the latest headline foreign reserve publication.

Why care about these adjusted measures at all? The aim is to get a more forward looking picture of reserve dynamics. The simple logic being that as the short term liabilities mature in the next 1, 3, 6 or 12 months, the level of reserve assets can drop. As early as 2-years ago, market participants did not pay much attention to BI's short term liabilities as they were relatively small in size. Now as they have grown bigger, more attention seems warranted. However the potential for data misinterpretations, due to a lack of understanding of BI's IRFCL data, has also grown.

We list below key points to mind when analyzing the IRFCL template.

Firstly, BI's USD TD and swap balances outstanding are already reflected in section II of the IRFCL template. Therefore it is not correct to subtract the USD TD and swap balances from the reserve assets and then also subtract the short term drains in the IRFCL template. The TDs are included in Section II.1 (Foreign

currency loans, securities and deposits) of the IRFCL template. Meanwhile the short USD forward legs of BI's swap positions are recorded in Section (II.2). In fact, nearly the whole balance of the latter post (i.e. \$7.5bn as of Aug-13) consists of the forward legs from the FX swap transactions. Based on our observation, BI has been doing very few outright forward transactions with onshore banks.

With regard to section II.1, most of it comprises of government debt repayments which also have clear roll-over / draw-down plans. As mentioned earlier in the text, the TD's are just a small portion. Out of the Aug-13 reading of \$11.2bn in projected principal repayments and \$3.1bn interest payments, most of it accrues to government foreign debt. Therefore using this headline number to discount reserve assets would also be misleading, in our view. This is because a big chunk of the government's foreign debt repayment is usually rolled over. For example in the 2014 government budget, scheduled repayments amount to Rp57tn but scheduled drawdowns amount to Rp43tn (i.e. a roll-over ratio of 75%).

BI's contingent short term drains should not be used to subtract reserve assets, in our view. Based on the IMF's IRFCL guideline, contingent flows refer to contractual obligations that give rise to potential or possible future changes in reserve assets.¹ Some market participants have thus used this post to subtract reserve assets, along with section II. The result is an alarmingly low "net" figure. However in our view, section III should not be used to subtract reserve assets. This is because the bulk of the balance (\$5.7bn in Aug-13) reflects commercial banks' statutory foreign currency (FCY) reserve requirements. Commercial banks have to surrender 8% of FCY deposits to BI. This balance is hence almost totally within the central bank's control, although it is defined 'contingent' and has no clear maturity.

Figure 1. Section II of BI's IRFCL template: Predetermined short term net drains of foreign currency assets in US\$m (as of Aug-13)

		Maturity breakdown			
		Total	Up to 1 month up to 3 months	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits		(14,319)	(3,106)	(1,330)	(9,883)
—outflows (-)	Principal	(11,222)	(2,741)	(823)	(7,658)
	Interest	(3,098)	(365)	(507)	(2,226)
—inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)		(7,474)	(2,976)	(1,928)	(2,570)
(a) Short positions (-)		(7,944)	(3,446)	(1,928)	(2,570)
(b) Long positions (+)		470	470	0	0

Source: Bank Indonesia, Citi Research

Figure 2. Section III of BI's IRFCL template: Contingent short term net drains on foreign currency assets in US\$m (as of Aug-13)

		Maturity breakdown		
		Total	Up to 1 month	More than 1 and up to 3 months
1. Contingent liabilities in foreign currency		(5,728.47)	(5,728.47)	More than 3 months and up to 1 year
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities		(5,728.47)	(5,728.47)	

Source: Bank Indonesia, Citi Research

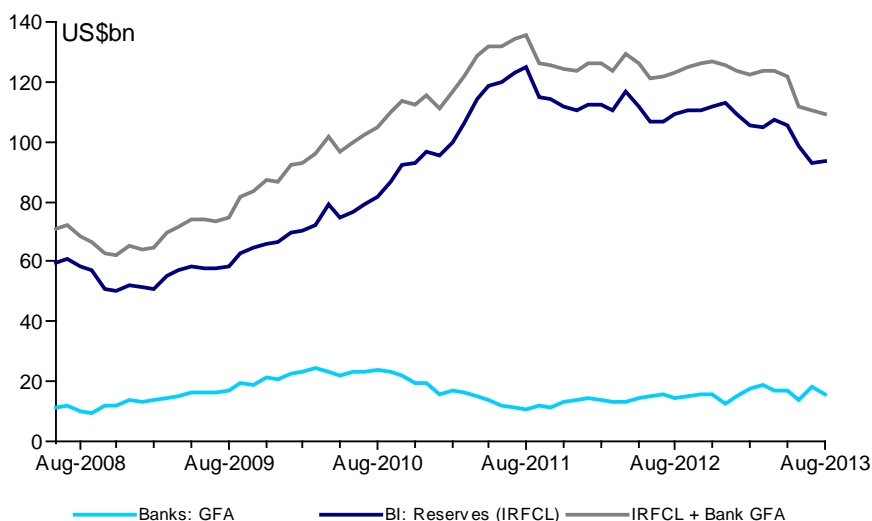
¹ See "International Reserves and Foreign Currency Liquidity, Guidelines for a Data Template", International Monetary Fund (2013)

Subtracting reserves with the TD and swap balances seems the most straightforward exercise for now, although this is also not free from caveats.

Out of the nearly \$10bn in the TD and swaps outstanding, there is likely to be a portion of this balance which is sticky (i.e. a core balance). Given the declining trend of IDR excess liquidity, a number of banks have been utilizing the swap facility as a source of IDR funding.

In our view, gross foreign assets (GFA) of commercial banks should be monitored alongside. Whenever commercial banks place funds in BI's USD TD facility or utilizes the swap facility, the GFA of the banks decline while foreign reserves of BI increases equivalently. The GFA of commercial banks thus represents the pool of funds which BI can borrow from. Accordingly, it may also be useful to track the GFA of the whole banking system (banks + BI), as it is not affected by changes in BI's short term borrowings to onshore banks.

Figure 3. BI foreign reserve assets and commercial bank gross foreign assets (GFA)

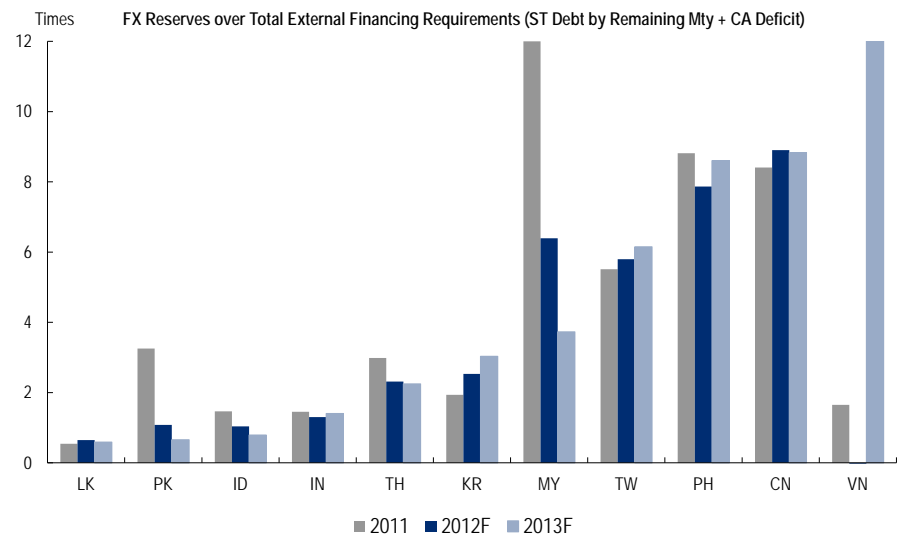


Source: CEIC, Citi Research

Perception of policy sustainability has become more important than bilateral swap facilities, in our view. BI has renewed and modified bilateral swap arrangements with a number of countries: Japan (\$12bn), China (eq. \$15bn) and Korea (eq. \$10bn), which we believe is a commendable step to build a second line of defense.² However any draw-down of these swaps will raise both reserve assets and short term drains in the IRFCL template (particularly section II.2), which market participants could use to discount BI's reserve assets. So as attention is focused on reserve measures excluding short term liabilities, we believe it is now very important for FX policy sustainability to be perceived as sustainable. Policymakers now have very little room to "manage volatility" using their FX reserves as frequently done in the past.

² The swap line with Japan is for IDR-USD but has 80% IMF linked portion; the swap with China is for IDR-CNY but can have a certain IDR-USD portion; meanwhile the swap with Korea is purely IDR-KRW.

Figure 4. Comparison of reserve adequacy



Source: Citi Research

Appendix A-1

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