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Indonesia’s Jokowi administration to face challenging tasks to curb rupiah volatility

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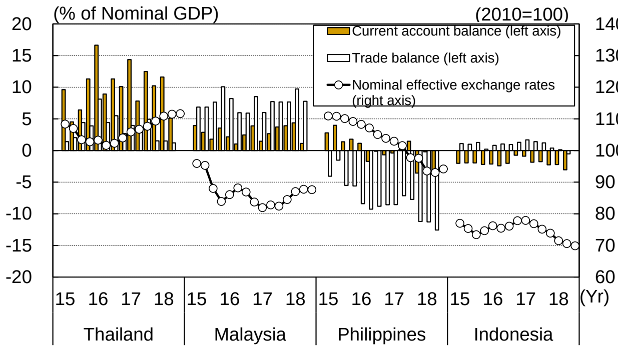
There has been growing concern about large capital outflow from emerging countries and weakness in local currencies owing to concerns over intensifying US-China trade tensions and Turkey issue, as well as higher interest rates in the US and USD appreciation. Compared to Turkey and Argentina who have uncertainties over the management of domestic policies as well as external balance vulnerabilities such as current account deficit and total reserves, decline in local currencies in ASEAN region are relatively limited. That being said, the Indonesian rupiah has declined more than other regional currencies (see chart 1).

Indonesia has run deficit in current account and its currency tends to be sold easily, but there has been growing concern over the Indonesian rupiah lately in foreign exchange market after the country’s current account deficit widened as trade balance fell into deficit for the first time in four and a half years on the back of import increase associated with solid domestic demand.

Looking at emerging countries, each country has a different degree of shock resistance for external balance. Indonesia is regarded relatively safer compared to Turkey and Argentina considering its level of external debts and total reserves, and there is little possibility of being hit by a currency crisis. However, the government and the central bank not only raised interest rates but also had no choice to try and curb imports to reduce current account deficit in order to stabilize its currency value. For example, the government adopted measures such as a biofuel mandate to promote the use of fuel blended with domestic palm biodiesel (from 1 September), and imposing higher corporate income taxes which are prepaid for imported consumer goods that can be produced locally (from 13 September). Furthermore, the government said it would review major development projects of state-owned companies which would require large-scale imports of capital goods. 2019 draft budget that was presented by the government to parliament in August also restrained infrastructure spending (see chart 2).

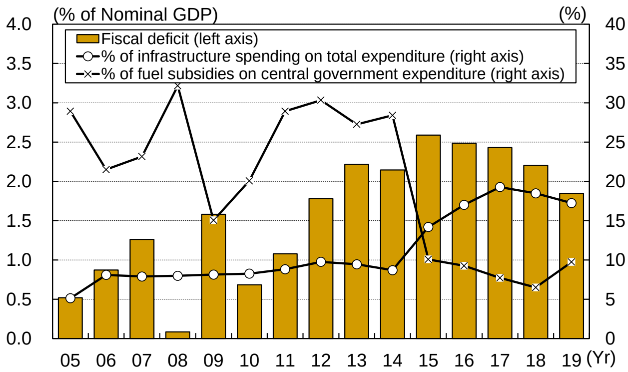
These measures to curb imports, however, could restrain domestic demand. The Jokowi administration needs to consider boosting the economy at the same time ahead of upcoming presidential election taking place in April 2019. In fact, some measures were implemented such as reintroducing fuel subsidies that were abolished in principle in 2015, and relaxing regulation on loan-to-value ratio (LTV) on housing loans (in August) under tightening monetary policy. Whether the administration will be able to implement stable policy management to balance stabilizing currency value and supporting domestic demand will bear watching.

Chart 1: Current Account and Effectgive Exchange Rates in main ASEAN countries



Note: 1. “Trade balance” on a customs clearance basis.
2. The latest figure of “Nominal effective exchange rates” represents the average of 2 July and 17 September.
Source: BIS, Individual country statistics,
MUFG Bank Economic Research Office

Chart 2: Fiscal balance in Indonesia



Note: 1. 2018 onwards are draft budget.
2. "Total expenditure" includes central government expenditure and transfer expenditure to local governments.
Source: Ministry of Finance Indonesia,
MUFG Bank Economic Research Office

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