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FX Insight

What Indonesia's Export Proceeds Possible Rule Revision Implies?

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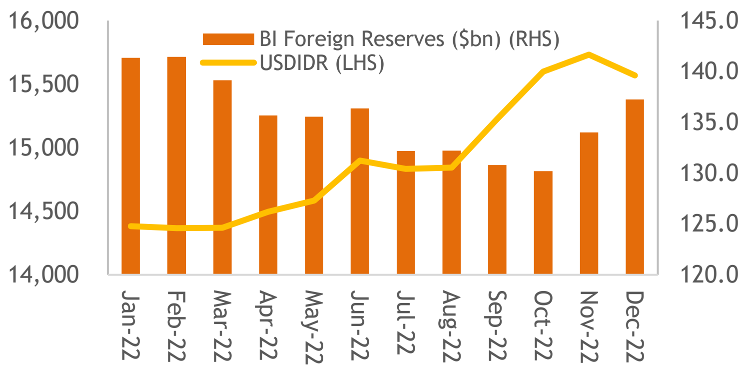
Export Proceeds Rule Revision being Considered

Recently, Indonesia announced the potential of rule revisions related to requiring exporters to keep proceeds locally. The government has argued that the revisions are needed to prevent a drying up of the FX reserves. Indonesia already has an existing regulation that requires exporters of natural resources to repatriate income back home although there is no time limit to keep it locally nor any mandatory conversion. However, the government is now looking to expand the number of sectors covered by the rule in addition to creating requirements on time limits and the amount of money to be kept. Based on our investigation, the rule revision looks to put Indonesia at a similar position to Malaysia and Thailand – two other peer countries in ASEAN that have such regulations. To date, the government has started with an incentive driven approach rather than any hard rule revision by providing higher term deposit rates for USD kept onshore. Take up so far looks rather low but this could be due to exporters still trying to sense the direction of the government.

What would the Impact be on the IDR?

Concerns regarding the FX proceeds rule revision is whether it risks hurting FDI if it creates challenges to doing business. However, the decision for a company to invest in a country is driven by more than just one regulation. Over the years, FDI (% of GDP) has actually been fairly steady despite the introduction of the current set of FX proceeds rules in 2019. Based on our fair value estimation model, we found that a 1% decrease in FDI (% of GDP) can lead to a 0.06% increase in the USDIDR, which implies the currency is somewhat sensitive to FDI. Aside that, another area of impact is on FX reserves where Economic Affairs Minister Airlangga Hartarto has said it could rise by $40-$50bn. However, FX reserves are mainly effectively used to stabilize a currency in the short-run. As a note, our fair value estimates for the USDIDR stands ~13300, implying the IDR being currently undervalued.

Chart 1: BI Foreign Reserves and USDIDR 2022



Source: Bloomberg, Maybank FX Research and Strategy

Background and Current Developments
Recently, the Indonesian government has spoken about a plan to review a regulation on the retention of export earnings onshore in Indonesia. Coordinating Minister for Economic Affairs Airlangga Hartarto has said that a revision in the regulation could help bump up the country's FX reserves by $40bn - $50bn. He has also noted that "the government is also looking at what needs to be done so that Indonesia's FX does not run dry".

The current regulation which had taken effect in 2019 requires companies in the natural resources industries (e.g. coal, minerals, oil, gas, etc) to keep their export proceeds locally in either IDR or special accounts available in USD, EUR, JPY and CNY. The proceeds must be deposited locally by the third month latest following the customs export notification. There is also no time limit on how long the proceeds have to be kept onshore.

Proposed revisions or additions as implied are possibly looking at expanding the number of industries (to include manufacturing) that would be covered and requiring exporters to keep their proceeds onshore for at least three months. Airlangga Hartarto had also talked that only exporters with proceeds of at least $250,000 would be subject to the rules. Regarding whether exporters would be required to undertake mandatory conversion to IDR, Bank Indonesia (BI) Governor Perry Warjiyo has said that the new rules were still being discussed including "the pros and cons" of such a requirement.

As of now, it still seems that Indonesia is starting off with a more incentive driven approach rather than immediately jumping into implementing any hard rule. The central bank has recently just unveiled new USD term deposits onshore rates (see table 1). At the inaugural offer, it appears that exporters had only placed $15m of deposits and all in the one month tenor. In another statement on 7 Mar 2023, BI mentioned that they received another $21.75m and whilst it was higher than the initial amount received, it all continued to still be placed in the shorter one month tenor.

Table 1: New Term Deposit Facility for USD

Tenor	$1m - $5m	$5m - $10m	≥$10m	USD Certificate of Deposit*
1 - month	4.54%	4.59%	4.64%	4.79%
3 - month	4.82%	4.87%	4.92%	4.96%
6 - month	5.10%	5.15%	5.20%	5.26%

Source: Bank Indonesia, Maybank FX Research and Strategy
**As of 10 March 2023*

What could be Driving this Move by the Government?
There are a few factors that could be driving the government's push for exporters to keep their USD proceeds onshore. Among them include:

1) **The decline of BI's reserves in 2022:** Despite the IDR holding up well for much of the year, in addition to a strong trade performance, the foreign reserves actually fell. The need to pay government external debt and limited repatriation and FX intervention later in the year undertaken by BI to stabilize the IDR may have resulting in the draining of the reserves. The reserves would only recover in the final two months of 2022 when US inflation fear subsided slightly and income from other sources had come in such as state oil and gas revenue, receivables in tax and service fees.

2) **IDR's performance subdued despite trade surplus:** Whilst initially the IDR held up, it later on saw a substantial decline towards the final months of 2022 despite the country continuing to hold up a trade surplus. Even in 2023, the country still recently saw a trade surplus in Jan and yet the IDR is now seeing heavy weakening (though there was some stability for the currency in Feb). For certain, external factors such as the Fed hawkishness and the aggressive pace of tightening have been weighing on the IDR but the government may wish to realize more of the benefits from the trade surplus to offset the negative factors.

Comparison with other South East Asian countries

Out of the five major South East Asian economies (Singapore, Malaysia, Thailand, Indonesia and The Philippines), only two others have regulations related to keeping export proceeds – Malaysia and Thailand. Compared to Malaysia, Indonesia's current regime is seen as less restrictive given that it only covers certain industries, namely natural resources. In comparison to Thailand, Indonesia's current rules on the one hand can be seen as tighter given that the full amount of money has to be repatriated (versus Thailand's $1,000,000 or more threshold). On the other though it is less comprehensive than Thailand as it only covers certain industries, namely natural resources. Despite both Malaysia and Thailand having such rules, FDI for both countries has generally actually held up quite well. Malaysia in fact saw a pick-up in FDI in 2022. This may appear to imply that FDI inflows can be determined by more than just one regulation.

Should Indonesia implement all the rule revisions and additions that the government has so far been known to have talked about, it would result in the country having a regulatory regime that can be seen as more similar to those two in terms of its tightness. The others may not have a time limit on proceeds retention like Indonesia is looking to introduce but Indonesia is also looking at applying the rule to a threshold of $250,000 or more and possibly expand it only to certain industries. Malaysia requires the full amount to be repatriated and both Thailand and Malaysia applies their rules to goods related industries.

Table 2: Regulations related to Repatriation of Export Proceeds for Malaysia, Thailand and Indonesia

Country	Amount	Currency	Time Limit on Retention	Applicable Industries
Indonesia (Current)	Full	IDR or Foreign Currency but note the special account available in USD, EUR, JPY and CNY	None	Natural Resources
Indonesia (Known Proposed Revisions/Additions)	≥$250,000 (30% of their earnings)	USD	3 months	Not fully specified yet but may include natural resources and manufacturing
Malaysia	Full	MYR or Foreign Currency	None	Goods Related Industries
Thailand	≥$1,000,000	THB or Foreign Currency	None	Goods Related Industries

Source: Respective Government Websites, Maybank FX Research and Strategy

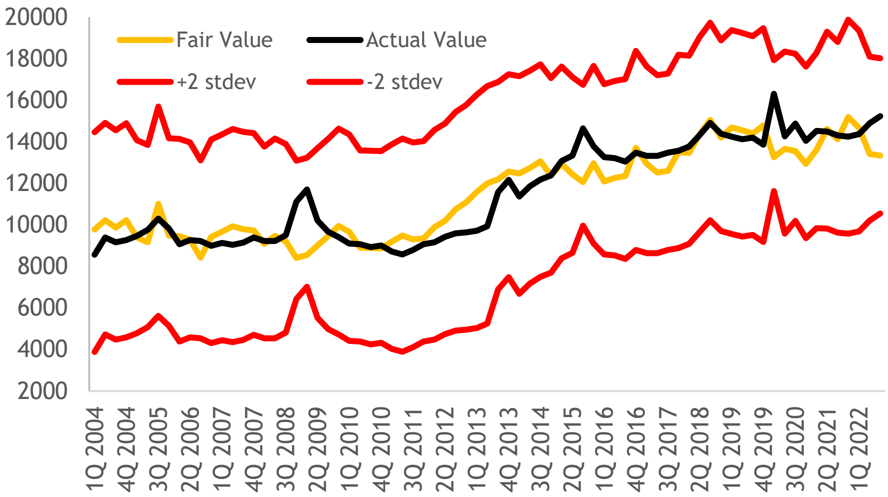
What would the Impact be on the IDR?

Concerns regarding the FX proceeds rule revision is whether it could risk making it more challenging to do business in the country, hurting FDI inflows. However, the decision for a company to invest in a country can be determined by more than just one regulation. Other positive factors such as access to raw materials or the market can outweigh other cons of doing business in a particular country. Over the years, FDI (% of GDP) as a whole has actually been fairly steady despite the introduction of the current set of FX proceeds rules back in 2019. Back to the currency, based on our fair value estimation model, we found that a 1% increase in FDI (% of GDP) can lead to a 0.06% decrease in the USDIDR pair, which implies the currency is somewhat sensitive to FDI.

Aside that, Coordinating Minister for Economic Affairs Airlangga Hartarto has said that the revision could help bump up the country's FX reserves by $40bn - $50bn. If we take the upper end of the figure of $50bn, that would mean a 36% increase from the current levels of reserves that stood at about $140.30bn as of Feb 2023. The increase would also imply 8.4 months of imports or 8.1 months of imports and servicing government's external debt would then be covered versus the current amount of 6.2 months of imports or 6.0 months of imports and servicing government's external debt. The IMF has stated that the traditional "rule of thumb" that has been used to guide reserve adequacy suggests FX reserves should cover 3 months' worth of imports. However, foreign reserves are usually mainly effectively used to stabilize a currency during periods of high pressure in the short-run. Furthermore, we also have to take into account that the initial take up of the current USD deposit offers has been rather low. However, that could also be due to exporters still trying the sense the policy direction of the government. Long run strength of a currency would still mainly be determined by its fundamentals as a whole.

As a note, our current fair value estimates of the USDIDR finds that the pair should be around 13300. Based on this calculation, this would imply that the IDR is undervalued versus the USD given it was last seen trading around 15380.

Chart 2: Estimated Fair Value of USDIDR



Source: Bloomberg, Maybank FX Research and Strategy
Note: Fair value is estimated based on an OLS regression with USDIDR against real 10 year yield differential (UST - IGB), current account (% of GDP) differential (US - Indonesia), Reflation Proxy (MSCI World Index/Bloomberg Global-Aggregate Total Return Index), FDI (% of GDP) and Peninsular Malaysian Palm Oil Board Crude Palm Oil fob Spot Price.

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