Indonesia

During the 1990s, Indonesia operated a heavily managed FX regime – essentially a fixed conversion rate with pre-announced intervention bands (initially +/-0.25%) in a framework for creeping depreciation. But being too slow to move the market rate up, Bank Indonesia was forced to widen its intervention bands 6 times between January 1994 and September 1996. Then, as the Asian Financial Crisis took hold, and a further widening in July 1997 failed to stabilize the currency, IDR was allowed to float freely on August 14. The spot market spiked to 17,000, from 2,500.

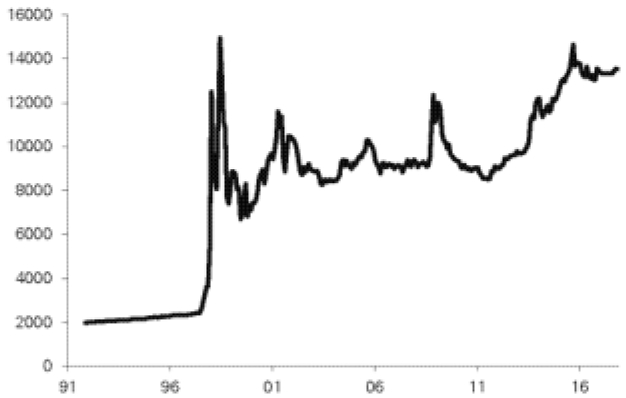
After the Asian Crisis – and under the supervision of an IMF program till 2003 – authorities sought to use FX policy – via higher interest rates, regulations over market access, direct intervention and moral suasion – to dampen market volatility and encourage a stronger rupiah. Today, the BI website notes prominently: *"Bank Indonesia has one single overarching objective: to establish and maintain rupiah stability."*

In the early 2000s and after the 2008 crisis, a stable to stronger rupiah contributed to lower inflation and reduced external debt servicing costs, while strong capital inflows and a stable current account allowed BI to fully repay IMF debt and build international reserves. However, things began to change in 2011 as the current account deteriorated and capital financing became more erratic. Illiquidity and multi-tiered FX prices were often a concern. Intervention led to significant drawdown in reserves over 2013 during the taper-tantrum. Market stress prompted authorities to tighten monetary and fiscal policy, and make efforts to improve FX liquidity.

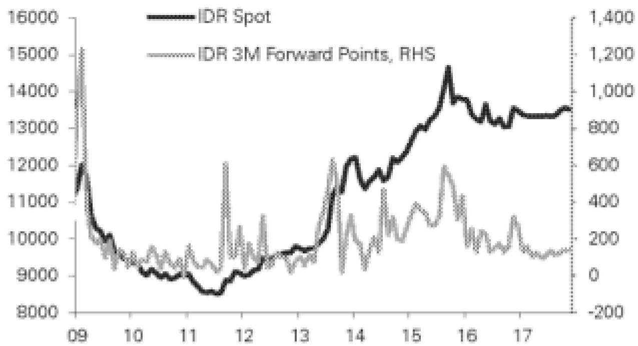
In the past few years, responsible macroeconomic policy-making from inflation management, fiscal prudence, reform focus, reserve rebuilding, improved price discovery and transparency appears to have paid off. A number of regulatory changes have also taken effect from the mandatory use of rupiah for domestic transaction to hedging requirements on private non-bank external debt in 2015, While exposure to offshore debt holdings is still among the highest in the region, the IDR spot market depth has improved, the current account deficit has moderated and become more sustainable, external debt has peaked, and reserves coverage looks more comfortable. From 2017 onwards, BI appears to have adopted a more apparent volatility management strategy for the rupiah, accumulating significant amount of reserves to keep the currency near fair value, and preventing large swings in FX.

The rupiah is convertible on the current account; while not open on the capital account, policies have accommodated increased FDI and portfolio flows.

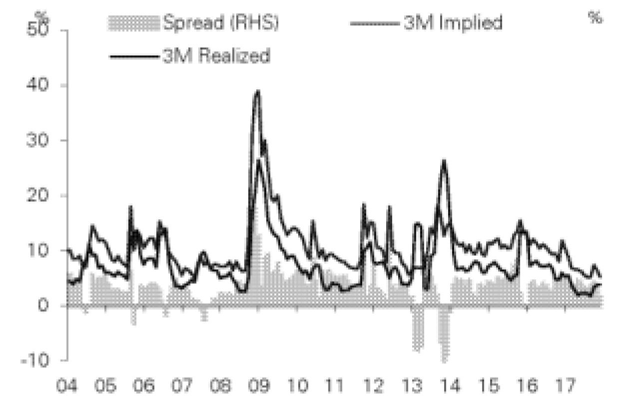
USD/IDR exchange rate



USD/IDR spot rate and 3M NDF premium



USD/IDR 3M historical vs. implied volatility



Source: DB Global Markets Research, Bloomberg Finance L.P.