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IndonesiaPulse: The limits of oil shock buffers for the rupiah

Key Points

- The pace of rupiah depreciation might moderate, but the broader depreciation trend is unlikely to be over. USDIDR has retraced nearly 500 points from its peak as crowded long USDIDR positioning unwinds and some foreign inflows return. However, headwinds from elevated US yields and higher oil prices remain in place. We maintain our forecast for USDIDR at 18,350 by end-2026.

- Indonesia's trade balance remains under pressure. While the goods trade balance returned to a modest surplus in July after deficits in the prior two months, it remains well below the monthly average surplus recorded in 2025. Surpluses in coal, palm oil, and base metals are only partially offsetting the oil shock impact. Our estimates suggest Indonesia's commodity trade balance is negatively impacted once Brent rises above US$82/bbl. With Brent currently above US$90/bbl, trade-balance pressures are likely to persist, limiting the scope for sustained rupiah appreciation.

- The government’s B50 biodiesel programme is primarily an energy-security strategy rather than a near-term trade-balance windfall. While lower diesel imports could save roughly US$1.5-2.0bn in H2, much of the benefit is offset by palm oil being diverted from exports towards biodiesel production. The key test is whether Indonesia can raise CPO production sufficiently to support both domestic biodiesel demand and exports.

- The stronger support for IDR in the near term is portfolio inflows, but this buffer may be approaching maturity. Foreign ownership of SRBI has risen back to around 27%, close to late-2024 highs, while SRBI yields have started to moderate from their June peak. BI's strategy of raising the return on portfolio capital has been effective in stabilising USDIDR, but its ability to drive further sustained rupiah gains may be diminishing amidst rising US yields and oil prices.

- Several macro and market risks continue to argue against a structurally bullish rupiah view. MSCI's removal of GoTo from the Indonesia index highlights ongoing concerns around market accessibility and liquidity, while uncertainty remains over the future direction of state-led commodity export reforms under Danantara Sumber Daya Indonesia (DSI). At the same time, headline inflation has accelerated to 3.19%yoy and core inflation continues to trend higher, raising the possibility of further BI rate hikes if energy and food price pressures persist.

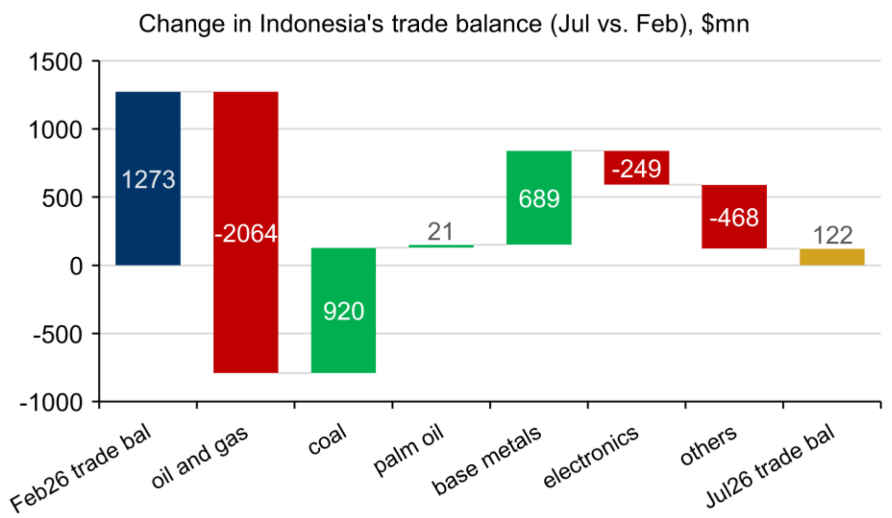
The recent decline in USDIDR from its peak near 18,190 to around 17,700 may appear inconsistent with Indonesia's weaker trade fundamentals. Higher oil prices, rising US yields, and Middle East tensions would normally be expected to generate sustained pressure on the rupiah. Instead, USDIDR has fallen nearly 500 points as crowded long USDIDR positioning unwinds and some foreign inflows return. We believe this reflects the effectiveness of Indonesia's three buffers against the oil shock: commodity exports consisting of coal, palm oil, and base metals, the B50 biodiesel programme that started in July, and Bank Indonesia's ability to attract some portfolio inflows through elevated SRBI yields and lower hedging swap costs. However, these buffers are helping to slow the rupiah's depreciation rather than creating the necessary conditions for a sustained appreciation cycle. We maintain our forecast for USDIDR to reach 18,350 by end-2026.

Buffer 1: Commodity exports are only partially cushioning the oil shock

Commodity exports remain Indonesia's first line of defence against higher oil prices. Coal continues to act as a natural hedge against rising Brent prices, while the government's mineral downstreaming strategy has led to rising base metal surpluses. Trade balances for copper and aluminium have also improved steadily, partly helped by higher prices, highlighting the growing importance of Indonesia's broader metals complex and providing an additional source of FX earnings.

The rise in trade surpluses from coal (+US$920mn), base metals (+US$689mn), and animal and vegetable oils (+US$21mn) between February and July has provided an important buffer against the widening oil and gas deficit.

CHART 1: COMMODITY BUFFER CAN ONLY PARTIALLY CUSHION THE OIL SHOCK



Source: CEIC, MUFG GMR

However, the commodity cushion still remains insufficient to fully neutralise the impact of the current oil shock. Our estimates suggest Indonesia's commodity trade balance (considering coal, palm oil, base metal, and oil and gas) is negatively impacted once Brent rises above US$82/bbl. With Brent currently trading above US$90/bbl, surpluses from coal, palm oil, and base metal can only partially cushion the oil shock rather than offsetting it entirely. Importantly, coal prices are far less supportive than during the 2022 Russia-Ukraine energy shock. This makes the base metal story increasingly important. Broadly widening surpluses from base metals have become a key source of support for the trade balance and also underscoring the growing contribution of Indonesia's downstreaming strategy.

Amidst the ongoing Middle East conflict and higher Brent prices, trade-balance pressures are likely to persist and constrain the scope for a structurally stronger rupiah. Notably, Indonesia's current account deficit widened significantly to 3.3% of GDP in Q2, from a 1% deficit in Q1.

Buffer 2: B50 Is an energy security strategy, not yet a trade-balance windfall

The second buffer is Indonesia's B50 biodiesel programme, which came into effect in July. According to GAPKI estimates, B50 could reduce palm oil exports by around 2 million metric tonnes in H2. At current CPO prices, this implies approximately US$2.3bn of export revenues being redirected toward domestic biodiesel production. At the same time, this could reduce imported diesel by around US$1.5-2.0bn.

As a result, we view B50 primarily as an energy-security and import-substitution strategy rather than a trade-balance story. The B50 programme's main benefit is lower structural dependence on imported diesel and the rupiah's sensitivity to future oil shocks.

The key litmus test will be whether Indonesia can raise palm oil production sufficiently to support domestic biodiesel demand while keeping exports broadly stable. If production rises enough to achieve both objectives, B50 could become structurally positive for the trade balance and the rupiah. If not, the programme may improve energy resilience without generating a meaningful improvement in external balances.

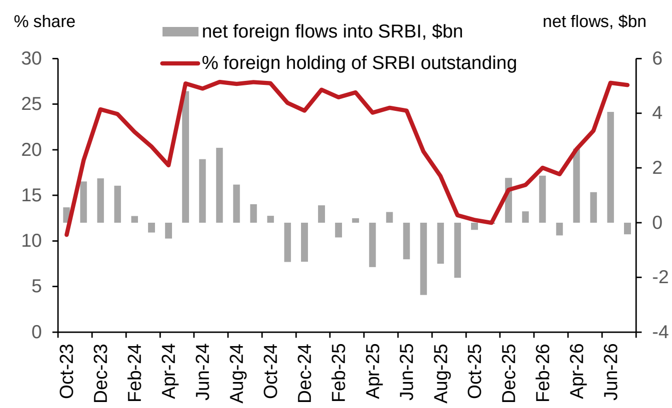
Buffer 3: BI raised the return on portfolio capital

The third and currently a strong buffer is portfolio inflows.

Despite weaker trade fundamentals, onshore dollar liquidity conditions have eased noticeably in recent months. Demand for USD protection through the options market has also moderated, reducing depreciation pressures on the rupiah.

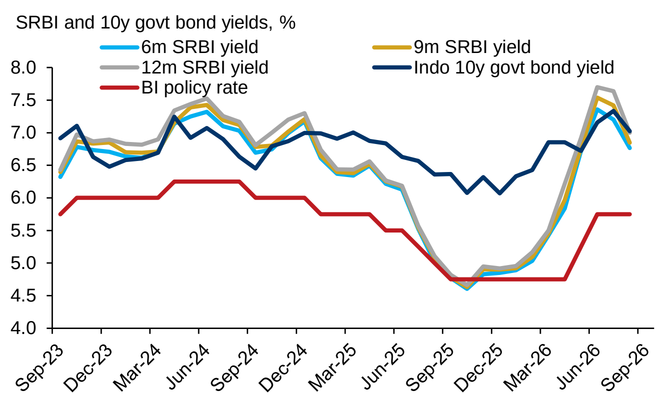
At the same time, BI has substantially increased the attractiveness of rupiah assets. Twelve-month SRBI yields remain close to 7%, even after moderating from a peak of around 7.7% in June. Combined with lower hedging costs, this has helped attract foreign participation, with foreign ownership of SRBI rising to around 27%, close to previous highs reached in late 2024.

CHART 2: FOREIGN HOLDING OF SRBI HAS RISEN CLOSE TO PREVIOUS HIGHS IN LATE 2024



Source: Bank Indonesia, Bloomberg, MUFG GMR

CHART 3: HIGHER RETURN ON PORTFOLIO CAPITAL HELPS BRING BACK SOME FOREIGN INFLOWS



Source: Bloomberg, MUFG GMR

The challenge is sustainability. Foreign ownership has already returned close to previous highs, suggesting the pace of incremental inflows could moderate going forward. At the same time, SRBI yields have begun to roll over, undercutting the potential returns on holding SRBI.

More importantly, there is a growing policy trade-off. BI cannot indefinitely rely on elevated SRBI yields to attract foreign capital while simultaneously encouraging stronger domestic lending and supporting the government's growth ambitions. The SRBI strategy has been effective in stabilising the rupiah, but its ability to deliver further substantial currency gains may be fading.

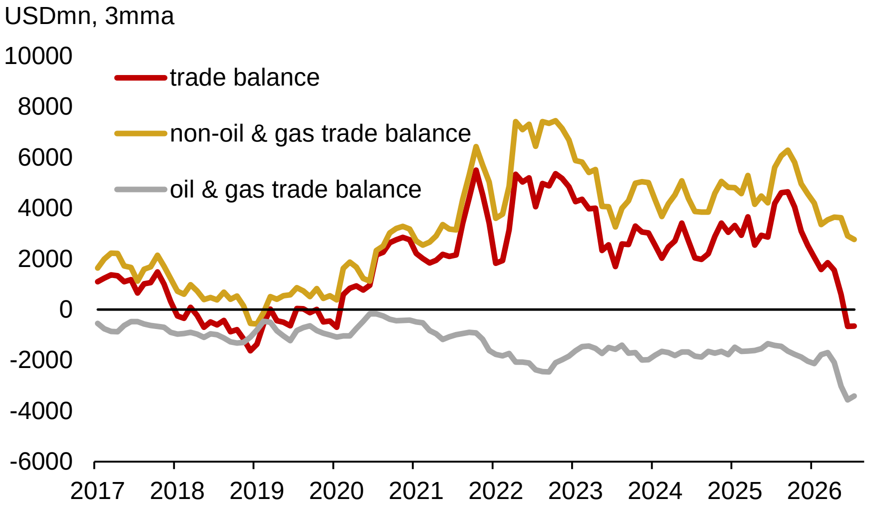
USDIDR: Tactical Stabilisation, Structural Caution

The existing buffers help partly explain why USDIDR has fallen nearly 500 points despite higher oil prices and rising US yields. Commodity exports have softened the blow from the oil shock, B50 offers a pathway toward lower diesel-import dependence, and SRBI inflows have provided meaningful support to the currency.

However, we remain cautious about extrapolating recent rupiah strength into a sustained appreciation cycle.

Indonesia's trade balance is already weakening with Brent above the estimated US$82/bbl breakeven level. Commodity exports are cushioning the shock, but not reversing it. B50 remains promising but has yet to prove it can improve external balances without sacrificing exports. Meanwhile, the stronger support for the rupiah today, namely portfolio inflows into SRBI and government bonds, appears closer to maturity than acceleration.

CHART 4: TRADE BALANCE HURT BY OIL SHOCK AND NARROWING NON-OIL AND GAS TRADE SURPLUS



Source: CEIC, MUFG GMR

Additional risks remain. MSCI's decision to remove GoTo from the Indonesia index in August highlights ongoing concerns around market accessibility and liquidity. GoTo shares have remained at the Rp50/share minimum price floor for several months, reflecting subdued trading activity and liquidity. That said, the local authorities have proposed lowering the minimum price floor to Rp1/share in an effort to improve market liquidity and support trading activity.

Policy uncertainty surrounding state-led commodity export reforms also remains a source of concern. For now, Danatara Sumber Daya Indonesia (DSI) has largely assumed a monitoring role, overseeing commodity export transactions and enforcing compliance with the new export proceeds framework. However, uncertainty persists over whether DSI could eventually evolve into a more active intermediary, potentially playing a role in brokering transactions between domestic producers and international buyers. Such a shift could have implications for commodity trade flows, investor perceptions, and Indonesia's broader export ecosystem.

Inflation risks are also beginning to re-emerge. August CPI inflation accelerated to 3.19%yoy, remaining within BI's target range, while core inflation was at 2.9%yoy, continuing its upward trend. With GDP growth holding above 5%, alongside rising energy and food prices, inflation risks appear skewed to the upside. A combination of strong domestic demand and higher imported inflation could lead to the need for further BI-rate hikes.

CHART 5: CORE INFLATION CONTINUES ITS UPWARD TREND

Source: Bloomberg, MUFG GMR

Taken together, these factors represent headwinds to market sentiment and reinforce our view that the recent strength in IDR is better characterised as a tactical stabilisation rather than the start of a sustained appreciation cycle.

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