



Highlights

- BI should continue to hold its policy rate steady at 3.50%.
- Inflation continues to accelerate, in-line with higher public confidence in economic activity.
- Global market volatility due to the threat of faster monetary tightening and the spread of the Omicron variant requires vigilance to maintain Rupiah stability amid the economic recovery agenda.
- Throughout 2021, BI managed persistent vigilant measures in maintaining domestic prices and stabilizing Rupiah while supporting economic recovery agenda during the pandemic.

Macroeconomics & Political Economy Policy Research

Jahen F. Rezki, Ph.D.

jahen@lpem-feui.org

Syahda Sabrina

syahda.sabrina@lpem-feui.org

Nauli A. Desdiani

nauli.desdiani@lpem-feui.org

Teuku Riefky

teuku.riefky@lpem-feui.org

Amalia Cesarina

amalia.cesarina@lpem-feui.org

Meila Husna

meila.husna@lpem-feui.org

Faradina Alifia Maizar

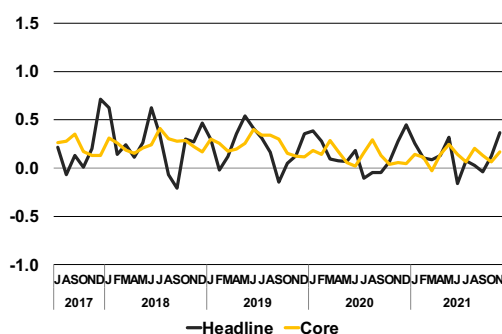
faradina@lpem-feui.org

Domestic economic activity continues to improve, in line with improving public confidence as captured by rising inflation as well as the CCI and PMI. However, the rise in Covid-19 new cases in several countries due to the novel Omicron variant that appears to be spreading faster poses a very high global risk, which could triggering a new wave. The retightening of government-imposed social restriction and lockdown are becoming inevitable, and these jeopardize any recovery that global supply chains have made around the world. Global market risks have also risen in the last month as a result of earlier monetary policy tightening due to the trend of rising inflation. Government's effort to prevent massive spike in Omicron cases is critical in order to maintain the economic recovery momentum. Meanwhile, BI needs to maintain Rupiah amid economic recovery by holding the benchmark interest rate at 3.50% this month.

Inflation Continues to Rise Into Christmas and New Year's Holidays

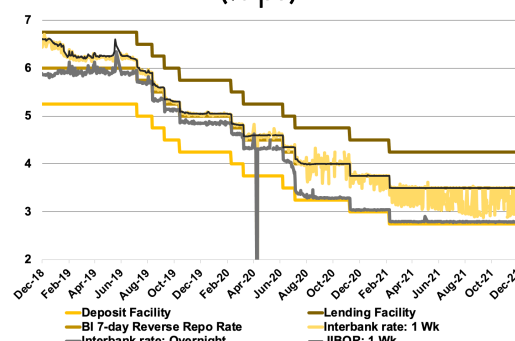
People's mobility are increasing following the end of the Delta-variant wave. The government has relaxed containment measures as the number of new Covid-19 cases remains stable. The seven-day average of new cases in mid-December was only about 200 per day, which was close to the number of new cases during the first occurrence of Covid-19 in March 2020. The improved condition of Covid-19 in Indonesia, at least so far, has led to a greater demand in the economy which is fully reflected in inflation rate. November's annual inflation reached 1.75% (y.o.y), recorded as the highest inflation since July 2020. The inflation rate also increased from October 2021 figure with the highest monthly inflation of 0.37% (m.t.m) throughout 2021. The recovery of people's confidence in carrying out activities boosts overall purchasing power as reflected by 1.44% (y.o.y) and 0.17% (m.t.m) increases in core inflation.

Figure 1: Inflation Rate (m.t.m)



Source: CEIC

Figure 2: Interest Rate Policy and Interbank Money Market Interest Rate (% pa)



Source: CEIC



Key Figures

BI Repo Rate (7-day, November'21)

3.50%

GDP Growth (y.o.y, Q3 '21)

3.51%

Inflation (y.o.y, November'21)

1.75%

Core Inflation (y.o.y, November'21)

1.44%

Inflation (m.t.m, November'21)

0.37%

Core Inflation (m.t.m, November'21)

0.17%

FX Reserve (November '21)

USD145.9 billion

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Annual inflation in all expenditure categories increased compared to November 2020. The components of food and volatile prices increased by 3.07% (y.o.y) and 3.05% (y.o.y), respectively. Aside from improved demand, the rise in food prices could be explained partly by the high possibility of crop failures and disruptions in food distribution channels as a result of weather factors. Food prices are expected to rise as a result of increased rainfall and the return of La Nina from the end of this year to the beginning of next year. This condition is also at risk of causing natural disasters, such as the huge floods that hit Indonesia in early 2020.

Furthermore, administered prices rose sharply by 1.69% (y.o.y) in November 2021, the highest level in the last two years. The increase was driven by the soaring price of airline tickets driven by the gradual rebound in travel activities. The relaxation of mobility restrictions combined with the momentum of the Christmas and New Year holidays boosted service sector activities related to travel, particularly tourism. The price recorded in recreation, sports, and culture expenditure also jumped to the highest level during the pandemic. The surging demand for restaurants also lifted overall November inflation. Inflation is expected to rise further by the end of the year along with the gradual improvement in economic activity. However, the GoI must implement prevention and countermeasures to deal with the potentially perilous impact of flood disaster at the beginning of next year in order to maintain the momentum of economic recovery.

Consumer Confidence Increases Due to Improved Job Opportunities and Personal Income

The rise in domestic economic activity is reflected in the improved Purchasing Manager's Index (PMI) and Consumer Confidence Index (CCI) indicators. The relatively well-managed Covid-19 condition and the relaxation of social restrictions have increased public confidence to resume economic activities. The CCI jumped to 118.5 in November 2021 from 113.4 in October 2021. According to BI survey, increased public perception is primarily driven by improvements in job availability and personal income. People are also becoming more confident in purchasing durable goods. The increase in public demand is also consistent with the strong growth in factory production, as measured by the PMI indicator in November 2021 of 53.9. The number is slightly lower than October 2021 figure, but still reflects an improvement in demand and output produced during the pandemic. A slight decrease in PMI was caused by rising raw material and transportation prices due to the combination of higher demand and fewer suppliers compared to the pre-pandemic level. However, Indonesia's PMI figures in November 2021 remain higher than other developing countries, such as Malaysia (52.3), Vietnam (52.5) the Philippines (51.7), and Thailand (50.6). This demonstrates that business growth in Indonesia is still robust and promising.

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International trade activity also supports the momentum of recovery with the trade surplus hits record of USD 5.7 billion in October 2021. The sign of improvement in economic activity was reflected in all-time high export growth, which increased by 53.5% (y.o.y). Non-oil and gas exports increased significantly due to higher prices, particularly in mineral goods and palm oil commodities. On the other hand, some other export goods, such as machinery and equipment, fell due to slightly lower global demand. On the import side, imports accelerated to 51.1% (y.o.y) with the annual growth of major contributors, such as machinery equipment, electrical equipment, as well as iron and steel, continues to rise. The overall growth in imports, however, is still slower than exports which resulted in trade surpluses for 18 consecutive months. The surpluses coupled with positive growth in imports indicate that the economy is improving, but the pace is likely to be gradual.

Omicron Variant Increases Market Uncertainty

Despite the pleasing condition in domestic economy, external conditions are quite concerning. The discovery of Omicron variant in several countries has forced countries to take drastic measures by tightening their social restriction policies. The increasing number of new infection cases in Europe has caused huge market uncertainty, which led to lower investor confidence. The spread of Omicron cases also exacerbate disruptions in supply chains that have not fully recovered. Global supply chain disruptions along with rising commodity prices have put countries at risk of overall price level spikes. Inflation has rose sharply in some advanced and emerging countries, such as US, UK, Turkey, and India. The higher-than-expected surge in US inflation has put market worrying that it will force the Fed to accelerate the end of quantitative easing by doubling the reduction purchases of bonds and raise interest rate sooner than expected. The expectations of a more hawkish stance from the Fed has led to lower longer-term bonds yield, resulting in flattened spread between 2-year and 10-year US treasury note. However, the market is currently becoming more certain that the interest rate hike will take place as planned in early 2022, while the expectations of taper acceleration at the end of this year are still high.

Inflationary pressures coupled with the speculation of faster monetary policy tightening and expected future rate hikes in the US prompted an earlier monetary policy tightening across the globe. Several central banks in other countries, including South Korea, South Africa, and Mexico, have responded to the threat of soaring inflation by increasing short-term interest rates to lessen the monetary policy. The high uncertainty in the global market due to the threat of faster monetary policy tightening combined with the spread of a new variant of the Covid-19 was reflected in the VIX indicator, which jumped to 31.1 in early December 2021.

The recently high level of uncertainty has pushed global investors into a more risk-averse stance and it limited capital inflows into developing countries. Investors' expectations also failed to pick up after several geopolitical events, such as President

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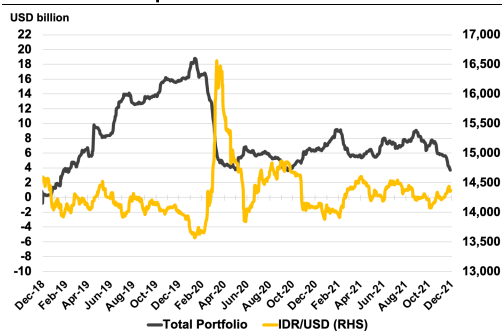
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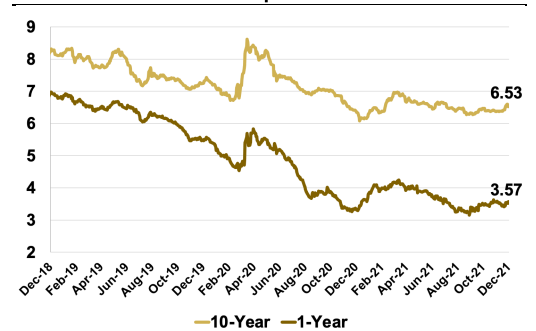
Biden and Xi's recent virtual meeting which did not conclude with any prospective deal on important issues. On the other hand, the attractiveness of China's bonds has decreased after the government recently announced stricter regulations for the property and technology industries. This condition risks increasing market volatility due to expected lower investment in China, and it could lead to negative sentiment in the global market. Market volatility, which is still dominated by tightening monetary policy and uncertainty over the new variant spread, has resulted in capital outflows in Indonesia amounting to USD2.3 billion in a month. The capital outflows were reflected in higher government bonds yields for 10-year and 1-year tenors, which were recorded at 6.53% and 3.57% respectively in mid-December 2021.

Figure 3: IDR/USD and Accumulated Portfolio Capital Inflow (Last 36 Months)



Source: CEIC

Figure 4: Government Bonds Yield (% pa)



Source: CEIC

A series of global market challenges led almost all currencies in developing countries to depreciate, including Rupiah. The depreciation of the Rupiah, however, was lower when compared to other developing countries thanks to the strong and well-maintained domestic economy and Covid-19 condition. BI's efforts to maintain Rupiah despite increasing market volatility have contributed to the stabilization of Rupiah. Despite global market turbulence, BI's accommodative monetary policy managed to maintain a safe foreign exchange reserve position of USD145.9 billion in November 2021. The reserves are adequate as it is equal to finance 8.1 months of imports plus the government's external debt, which is significantly higher than international adequacy standard of only around three months of imports.

For overall 2021, the performance of Indonesian currency is relatively well-managed with Rupiah is expected to become the best-performing currency in Asia at the end of year. The achievement was boosted by persistent vigilant measures by BI in maintaining domestic prices and stabilizing Rupiah while supporting economic recovery agenda during the pandemic. BI has actively implemented triple intervention in stabilizing Rupiah in spot and domestic non-deliverable forward (DNDF) markets, along with buying the government bonds in secondary market throughout 2021. The expansion of local currency settlement (LCS) and the agenda of investment and trade promotion in Indonesia's main trading partner countries

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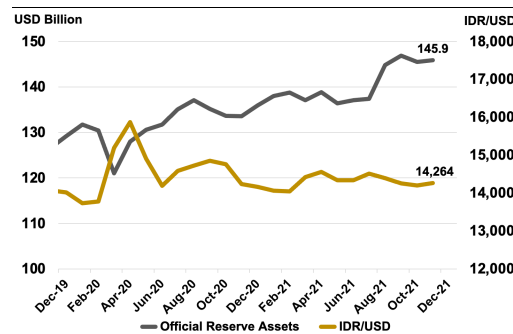
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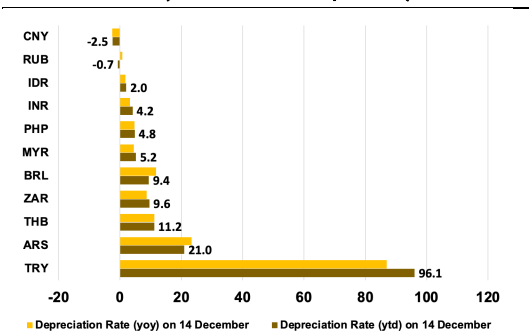
could also attract more bilateral trade and investment flows, which are promising for the future stability of Rupiah.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (December 14, 2021)



Source: Investing.com

The upward trend in global inflation that prompts faster monetary policy tightening has remained the dominant factor in the market turmoil over the last month. This condition is exacerbated by the increasing panic due to the discovery of the new Covid-19 variant in several countries. Despite the rapid spread of the new variant, the possible outcomes from the current contagion to the economy remain uncertain. The governments around the world still do not know whether it will pose severe risks to the health condition or how effective the vaccines are against the new variant. Thus, it is still premature to predict how long the containment measures will be required or how hard the next fiasco is in the economy. However, with the rapidly increasing vaccination rate and lessons learned from containing the second wave pandemic, the economy is expected to be better prepared to deal with Covid-19. Government of Indonesia needs to maintain economic recovery momentum by strengthening anticipative measures to prevent possible new Covid-19 wave at the end of this year. The Ministry of Finance (MoF)'s plan of expanding government bonds issuance next year will continue to support the economic recovery and carry out precautionary measures to anticipate any turbulence in 2022. Given higher global uncertainty recently, BI needs to hold its benchmark interest rate at 3.50% in order to support the economic recovery agenda and maintain Rupiah stability.