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Macroeconomic Analysis Series

BI Board of Governor Meeting

April 2023

Highlights

- BI should maintain its policy rate at 5.75% this month.
- The headline inflation moved in a favourable direction and stood at 4.97% (y.o.y) this month.
- Indonesia recorded an inflow of USD2.5 billion since mid-March 2023 following the pressure to delay monetary tightening by the US.
- Indonesia's foreign exchange reserve increased to USD145.2 billion, the highest record since February 2022.

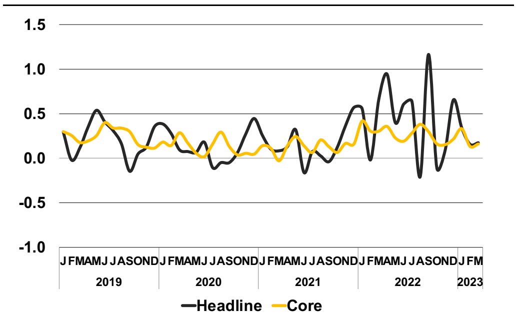
The inflation figure moved in a favourable direction as it decreased to 4.97% (y.o.y), getting closer to BI's target range of 3±1%. From the external side, the pressure to delay monetary tightening by the US has created momentum for flow of funds into emerging markets, including Indonesia, resulting in capital inflows of IDR8.21 trillion in the second week of April 2023. As a result, Rupiah strengthened to IDR14,750 on 13 April 2023, making it one of the best performers among emerging peers. Considering these factors, we view that BI should hold its policy rate at 5.75% this month while continuing to apply macroprudential measures to support the growth momentum.

Inflation Remained Under Control Ahead of Eid-al-Fitr

The annual headline inflation in March 2023 fell to 4.97% (y.o.y) from the previous month's figure of 5.47% (y.o.y) or decelerated by 50bps. This was driven by decline in all components of inflation, contributed by BI's monetary policy response in synergizing inflation control between BI and the GoI, regional governments, and other strategic partners in the Central and Regional Inflation Control Teams (TPIP and TPID) through the National Movement for Controlling Food Inflation (GNPIP) Program. The only expenditure group that experienced a price increase compared to the previous month's figure was transportation (13.72% (y.o.y)) following the upcoming Eid festive, while the expenditure group for clothing and footwear remained unchanged and other groups experienced slowdown in price hike.

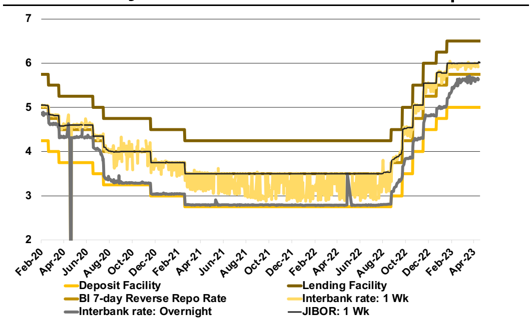
Core inflation was recorded at 2.94% (y.o.y) in March 2023, decreased from 3.09% (y.o.y) in the previous month. The slowdown in the annual inflation rate occurred after a massive increase at the end of the first quarter last year, following the increase in energy and food prices due to concerns over the impact of the Russian attack on Ukraine, which began at the end of February 2022. The administered prices inflation component has also decreased by 11.56% (y.o.y) in March 2023 compared to 12.24% (y.o.y) in February 2023. On the other hand, the volatile price component was also seen declining, with 5.83% (y.o.y) in March 2023 or a decrease from 7.62% (y.o.y) in the previous month.

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



Source: CEIC

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



Source: CEIC

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Key Figures

BI Repo Rate (7-day, March '23)
5.75%
GDP Growth (y.o.y, Q4 '22)
5.01%
Inflation (y.o.y, March '23)
4.97%
Core Inflation (y.o.y, March '23)
2.94%
Inflation (m.t.m, March '23)
0.18%
Core Inflation (m.t.m, March '23)
0.16%
FX Reserve (March '23)
USD145.2 billion

On the other hand, the monthly inflation trend actually showed an increase where the overall prices accelerated by 0.18% (m.t.m) compared to a month earlier. Observing its components, core inflation slightly increased to 0.16% (m.t.m) from 0.13% (m.t.m) in February 2023. This is in line with the gradual increase in demand partly due to declining global commodity prices. The highest price increases occurred in the transportation sector (0.54% (m.t.m)), the food, beverage and tobacco sector (0.35% (m.t.m)), and the energy sector (0.33% (m.t.m)). In contrast, two sectors experienced a decline in prices, namely the housing, water, electricity and other fuel sectors (-0.26% (m.t.m)) and the information, communication and financial services sector (-0.03% (m.t.m)).

Inflation in the volatile foods category remained under control. The volatile foods category recorded inflation of 0.29% (m.t.m), stable compared to inflation in the previous month of 0.28% (m.t.m). This development was mainly contributed by the deflation of red chili and shallot commodities. Meanwhile, rice, cayenne pepper, and garlic commodities contributed to inflation. In addition, administered prices inflation was recorded at 0.12% (m.t.m), down from 0.14% (m.t.m) in the previous month. Lower monthly inflation in this category was mainly due to reduced tariffs for regional drinking water companies (PAM), but was also restrained by inflation in air transport, gasoline and various cigarettes along with an increase in air mobility, price adjustments for non-subsidized gasoline, and tobacco excise rates. Despite the recent downward trend of inflation, GoI must remain vigilant because a reversal in the direction of the inflation rate in the latest data could occur due to Eid al-Fitr and the upcoming *mudik* season at the end of this month. If managed properly, returning inflation to BI's target range of 3±1% should be achievable in the first half of 2023.

Domestic Economy Remains Optimistic

Indonesia's Consumer Confidence Index (CCI) increased to 123.3 in March 2023 from 122.4 in the previous month, pointing to the highest level since last August. Households' assessment regarding the country's economic outlook strengthened (up by 1.0 points to 133.5), as did their views on the current economic conditions (up by 0.7 points to 113.1). At the same time, the job availability (up by 0.1 points to 113.9), the job availability compared to six months ago (up by 0.4 points to 131.1), and current income (up by 1.9 points to 120.4) improved. Meanwhile, income expectations for the next six months lowered (down by 2.2 points to 135.8). At the same time, Indonesia's Manufacturing Purchasing Managers Index (PMI) in March 2023 was at the level of 51.9, an increase of 0.7 points compared to the previous month, which was recorded at 51.2. This was the 19th straight month of growth in factory activity and the steepest pace since last September, with both output and new orders increasing at the fastest rate in six months and employment growing for the second straight month, while firms acquired inputs at a faster rate.

Observing the Indonesia trade performance, trade balance in March was still recorded in surplus territory after 35 consecutive months since May 2020. Indonesia's

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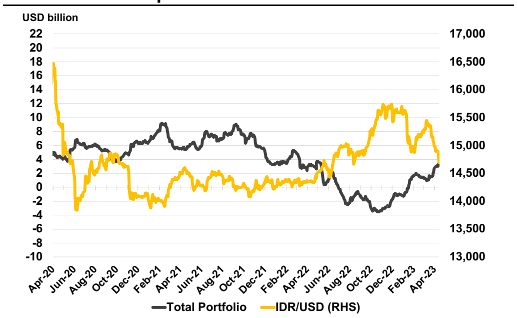
trade balance in March 2023 experienced a surplus of USD2.91 billion, mainly from the non-oil and gas sector of USD4.58 billion, but was reduced by a deficit in the oil and gas sector of USD1.67 billion. Although this month's surplus was weaker compared to the previous month and lower than March 2022, Indonesia's export value in March 2023 reached USD23.50 billion, an increase of 9.89% compared to February 2023. The largest increase in non-oil and gas exports in March 2023 compared to February 2023 occurred in mineral fuel commodities amounting to USD568.8 million (14.29%), while the largest decrease occurred in animal/vegetable fats and oils amounting to USD260.0 million (10.53%). On the other hand, Indonesia's import value in March 2023 reached USD20.59 billion, an increase of 29.33% compared to the previous month, suggesting a positive outlook towards domestic production activity.

Indonesia's Economy Remains Strong Amid the Market Turmoil

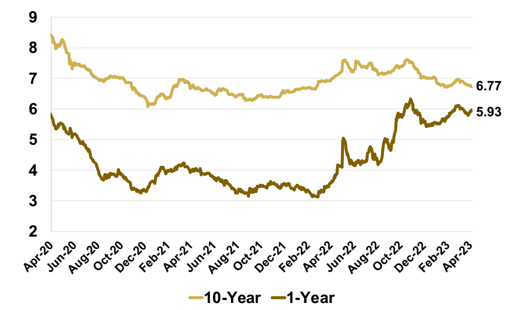
Interest rate hikes by the central bank have continued amid recent mayhem in the banking sector, albeit on a less aggressive basis. In the last FOMC meeting, the Fed surprised the market by continuing to rise their interest rate by 25bps to 4.75% - 5.00% as it attempts to fight stubbornly high inflation while addressing risks to financial stability. Similarly, ECB also raised its interest rate of 50bps, as inflation across their member region remains sharply above the targeted level of 2%. Meanwhile, PBoC left its interest rate unchanged for the seventh straight month, with the economy already benefiting from policy actions taken as it recovers from the pandemic.

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



Source: CEIC

Figure 4: Government Bonds Yield (% pa)



Source: CEIC

However, the banking chaos has stoked fears that the central bank could overcorrect the economy into recession and trigger more bank failures, so the market is not so convinced the Fed has more room to hike rates after its hike surprise in the latest FOMC meeting. Following this, Indonesia began experiencing capital inflows of USD2.5 billion since mid-March. This event has been translated into a substantial declines in the Indonesian government bond yield for 1-year and 10-year tenors. As for 1-year tenor, the yield went down from 6.12% in mid-March to 5.94% in mid-April 2023. A decreasing yield pattern was also seen in 10-year tenor, which started at 6.97% in mid-March and ended at 6.73% in mid-April 2023. The 5-year Indonesian

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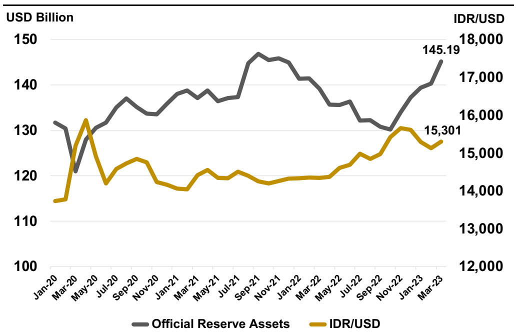
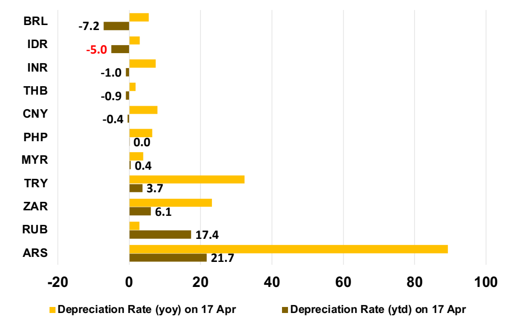
CDS premium also fell to 85.15bps as of April 13, 2023 from 93.35bps as of April 7, 2023. Furthermore, capital inflow also affected the movement of domestic currency, as Rupiah appreciated to IDR14,750 on 13 April 2023 relative to IDR15,360 in the same period last month. On a year-to-date basis, Rupiah marked an appreciation of 5.0% (ytd), making it the best performer among emerging peers after Brazil Lira.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (17 April 2023)



Source: Investing.com

Indonesia's official reserve assets position stood at USD145.2 billion in March 2023, which increased from USD140.3 billion in February 2023, making it the highest record since the similar period last year. The main drivers for the increasing reserve level were tax receipts and the government's foreign loan withdrawal. The position of current Indonesian forex reserve was equivalent to finance 6.4 months of imports or 6.2 months of imports and servicing government's external debt, and well above the international adequacy standard of three months of imports. As the reserve continues its upward trend, it is considered ample to support external resilience and maintain macroeconomic and financial system stability.

The latest condition indicates that Indonesia's economy has been getting stronger, with the inflation figure relatively manageable. From the external side, episodes of capital inflow and strengthening Rupiah have begun to be seen in the last few weeks due to recent developments in market sentiment in the US. In addition, with the increasing trend of reserves, Indonesia have ample room to cushion the ongoing and upcoming external shocks. Lastly, the yield differential between Indonesian Government Bonds and US Treasury Bonds seems adequate to be left as it is, following the recent case of SVB, which was followed by surprise hike of the latest FOMC meeting, leaving the Fed with very little room to pursue another rate hike in the future. Considering these factors, we view that BI should hold its policy rate at 5.75% this month to maintain price and exchange rate stability while continuing the macroprudential measures to support the growth momentum.