Seri Analisis Makro

BI Board of Governor Meeting

July, 2023

LPEM FEB UI

Institute for Economic and Social Research

Highlights

- BI should maintain its policy rate of 5.75% this month.
- Inflation slowed and back to the BI's target.
- Indonesia enjoyed a subtle capital inflow, thus resulting in lower yield for the long-term bonds.
- The spike in trade surplus was triggered by the substantially lower import compared to the declining amount of export.

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The latest inflation figure eased and fell in the range of BI's target of 3±1%. Other indicators, such as CCI and PMI, also showed that the domestic economy remained solid, with optimistic consumer expectations and producers standing above the expansionary territory. On the external side, the Fed's decision to keep its rate unchanged has allowed Indonesia to maintain the yield spread between Indonesia Government Bonds and the US Treasury Bonds, which resulted in an adequate inflow to Indonesia and solid performance of Rupiah in comparison to other EM currencies. Given these considerations, BI should maintain its policy rate at 5.75% to stabilize Rupiah while observing the Fed's decision at the upcoming FOMC meeting.

Inflation is Back to BI's Target Range

The inflation rate moderated for four consecutive months since February 2023. June 2023 inflation was recorded at 3.52% (y.o.y), substantially lower than last month's inflation at 4.00% (y.o.y). With the current rate, domestic inflation has finally reached BI's target of 3±1% after overshooting above the upper threshold during the last twelve months. Compared to the same period last year, Indonesia experienced a high level of inflation of 4.35% (y.o.y) in June 2022, mainly triggered by disruption in the food and energy supply chain following the heightened tension between Russia and Ukraine. Consequently, the soaring Consumer Price Index (CPI) in June 2022 has succeeded in creating a high-base effect which partly influenced the controlled inflation rate in June this year. In addition, consistent monetary policy coupled with solid coordination between BI and GoI on inflation control programs, such as Central and Regional Inflation Control Teams (TPIP and TPID) through the National Movement for Controlling Food Inflation (GNPIP) Program and low-priced food markets or Gelar Pasar Pangan Murah (GPM), also continued to drive inflation rate down.

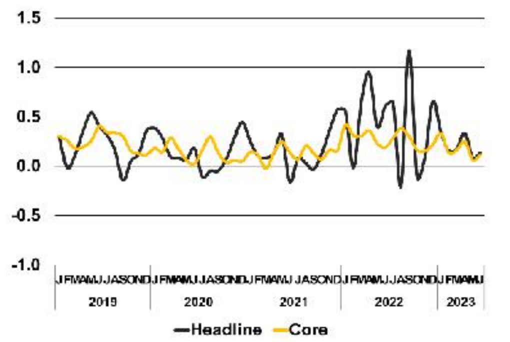
On a monthly basis, the June 2023 inflation rate increased to 0.14% (m.t.m) from 0.09% (m.t.m) in the preceding month due to a higher frequency of activities following the Eid Al-Adha festivities and school holiday season. Observing each expenditure group, the clothing and footwear price component inflated to 0.08% (m.t.m) after a deflation of 0.46% (m.t.m) last month caused by the normalization pattern during the Eid Al-Fitr festivities in April. The transportation group also experienced a substantial pick up, albeit still in deflation territory of 0.10% (m.t.m) this month relative to 0.56% (m.t.m) deflation in May. Conversely, the expenditure group of food, beverage, and tobacco moved slower, with an inflation rate of 0.39% (m.t.m) relative to 0.48% (m.t.m) in May. Although several commodities, for example chicken and egg, maintained their high prices due to the increasing trend of animal

Key Figures

BI Repo Rate (7-day, June '23)
5.75%
GDP Growth (y.o.y, Q1 '23)
5.03%
Inflation (y.o.y, June '23)
3.52%
Core Inflation (y.o.y, June '23)
2.58%
Inflation (m.t.m, June '23)
0.14%
Core Inflation (m.t.m, June '23)
0.12%
FX Reserve (June '23)
USD137.5 billion

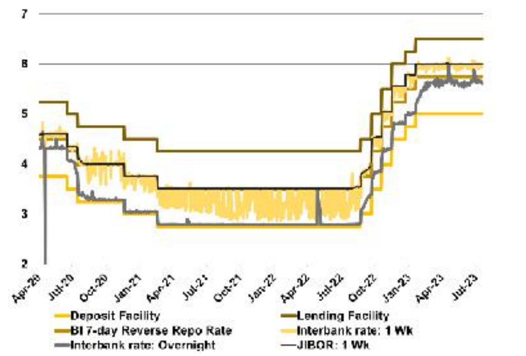
feed, other commodities like fish, onion, and cooking oil recorded deflation due to the adequate supply and lower global palm oil price.

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



Source: CEIC

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



Source: CEIC

Lower onion and cooking oil prices also contributed to subside volatile food inflation. In June 2023, volatile food posted an inflation rate of 0.44% (m.t.m), down from last month's rate of 0.49% (m.t.m). Likewise, annual volatile food inflation was also down substantially from 3.28% (y.o.y) in May 2023 to 1.20% (y.o.y) in June 2023. Furthermore, the administered price continued to record deflation from 0.25% (m.t.m) last month to 0.02% (m.t.m) this month. Deflation in administered prices was attributed to the adjustments in most fuel prices, including Pertamax, Pertamax Turbo, and Dexlite. On a yearly basis, administered price inflation was marked at a lower level from 9.52% (y.o.y) in May 2023 to 9.21% (y.o.y) in June 2023. While volatile food and administered prices recorded a downward trend, core inflation increased in June. The higher core inflation reflected the increase in society's demand following the higher frequency of social activities during the Eid Al-Adha festive and school holiday. Albeit historically, the inflation rate during the Eid al-Adha holidays was relatively lower compared to the Ramadan and Eid al-Fitr periods. On a monthly basis, core inflation slightly escalated to 0.12% (m.t.m) in June 2023 from 0.06% (m.t.m) a month earlier. House rent and school fees drove higher core prices due to the cyclical pattern of the payment maturity period.

Spike in Trade Surplus as Import Plunged

Indonesia's Consumer Confidence Index (CCI) decreased to 127.2 in June 2023 after reaching its peak in the previous month of 128.3. The lower CCI was driven by weakening of all index components, including the country's economic outlook (137.5 from 137.8) and current economic condition (116.8 from 118.9). Despite decreasing, Indonesia's CCI remained within the optimistic territory (>100) as Indonesia has gradually recovered from pandemic, which spurred domestic economic activity. On

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the other hand, Indonesia's Manufacturing Purchasing Managers Index (PMI) experienced a pleasant increase to 52.5 last June after recording a six-month low of 50.3 in May 2023. The latest PMI figure has strengthened Indonesia's PMI position in expansionary territory (>50) for 22 months straight. The favourable improvement in June PMI was influenced by various determinants, namely resilient domestic demand, higher production capacity, as well as the availability of production factors. Positive sentiment from producers amidst uncertain external demand also heavily influenced the PMI figure in June.

Looking at trade performance, Indonesia managed to record surplus of USD3.45 billion in June 2023, prolonged the trend of 38 consecutive months of trade surplus. The amount was substantially higher than the surplus in May 2023 of USD0.43 billion. Notwithstanding the spiked value of surplus, June exports was down 5.08% (m.t.m) to USD20.61 billion from USD21.71 billion last month. The declining exports value was caused by the substantial decrease in non-oil and gas components, especially mining products and mineral fuels such as coal. In June 2023, the exports of mineral fuel were down from USD3.83 billion to USD3.38 billion. Furthermore, the implementation of the export ban on bauxite since the beginning of June has also partly contributed to the lower amount of export. Similar to exports, imports also stood at a lower value with deeper decline relative to export. In June, import was recorded at USD17.15 billion compared to USD21.28 billion in the previous month. The component of non-oil and gas import was down 17.73% (m.t.m), with products such as machinery as well as iron and steel experiencing most of the downturn. Based on product type, raw and auxiliary materials as the largest component in import profile decreased 19.24% (m.t.m) from USD15.31 billion in May to USD12.36 billion in June 2023. Aside from non-oil and gas, oil and gas products also recorded a similar pattern, with import value decreasing 29.12% (m.t.m) from USD3.14 billion in May to USD2.22 billion in June 2023 due to the persistent lower trend in global oil price. Albeit the strong domestic demand, Indonesia should carefully monitor external factors such as more downward trends in commodity prices and muted demand from trading partners such as China and the US.

After a 'Hawkish Pause' by the Fed

At the last FOMC meeting, the Fed hold its Fed Funds Rate (FFR) at 5.00-5.25%, a first pause in the interest rate hike after ten consecutive periods of monetary tightening. While the Fed intended to give ample room for the prior hikes to has its effects on the economy, it also took into account other factors, such as the impact of tighter credit access due to the issue lingering around the US banking sector. In addition, the US inflation slowed to 3.0% (y.o.y) in June 2023, the lowest since March 2021. However, market expectations for the next FOMC meeting in July believe that

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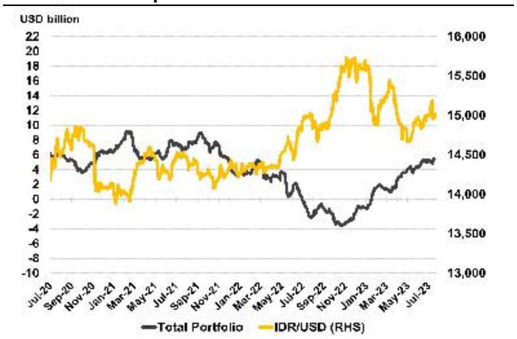
the Fed will resume its benchmark rate increases after a 'hawkish pause'. This suggests that even though inflation has moderated, it remains a concern.

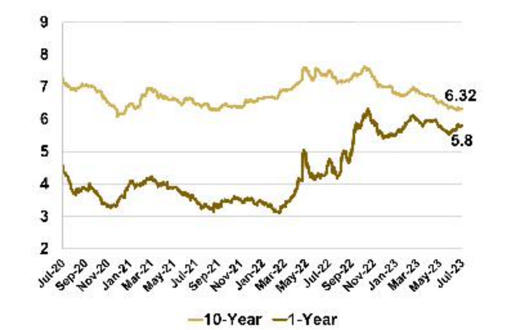
The Fed's decision to pause the interest rate hike has created enough room to keep the yield differential between Indonesia Government Bonds and US Treasury Bonds, thus, making it attractive enough to trigger capital inflow. During the mid-June to mid-July period, Indonesia recorded a moderate inflow of USD0.33 billion from USD5.15 to USD5.48. The inflow has resulted in the decline of 10-year government bonds from 6.37% in mid-June to 6.32% in mid-July. The trend was in-line with lower 5-year Credit Default Swap (CDS) from 86.16 in mid-June to 82.67 in mid-July. In addition, lower Dollar Index might contribute to the decrease in 10-year government bond yield as investor was seeking alternative instrument of USD denominated asset. On the other hand, the yield of 1-year government bond hiked during the similar period from 5.59% to 5.80%. The increase in the yield of 1-year government bond aligned with the increasing amount of inflow to stock asset during end of June to mid-July period as investor shift to alternative asset. Also, BI holding its policy rate also contributes to a rather stable 1-year government bond yield.

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



Source: CEIC

Figure 4: Government Bonds Yield (% pa)



Source: CEIC

Looking at the performance of Rupiah, it depreciated slightly to IDR15,000 on 17th July compared to IDR14,990 in mid-June. Albeit the promising flow of funds to Indonesia, the uncertainty against the Fed's decision of whether to resume its rate-hike campaign in the next FOMC meeting has recently put Rupiah under pressure. The pattern also happened in several emerging markets such as Malaysia, Philippines, and Argentina. On a year-to-date basis, however, Rupiah has appreciated by 3.35%, making it the best performer among developing countries together with Brazil Lira. Furthermore, Indonesia's official foreign exchange reserve remained high in June, with the amount marked at USD137.5 billion, although it slightly weakened from USD139.3 billion in May. The decreasing amount is related to the GoI's obligation to pay external debt. However, the reserve amount is equivalent to 6.1 months of import or six months plus government foreign debt payment, or beyond the international adequacy standard of three months of imports.

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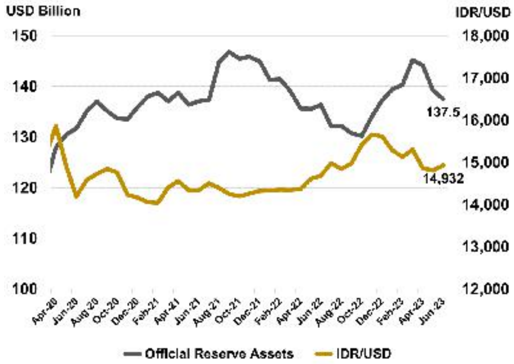
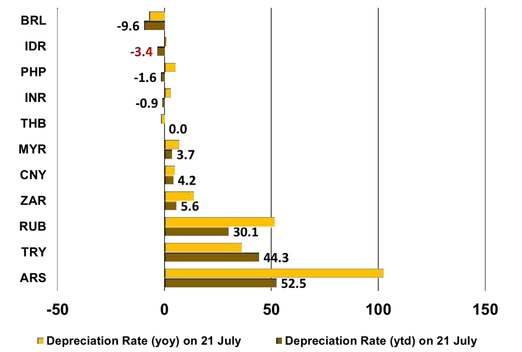
8 DECENT WORK AND ECONOMIC GROWTH

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (21 July 2023)



Source: Investing.com

The latest development in various determinants indicates that the domestic economy has improved. With a manageable inflation level, resilient consumption activity, and expansionary production activity, Indonesia is marching towards a promising outlook. From the external side, the Fed's decision to pause its hawkish stance has allowed Indonesia to maintain an adequate yield differential between Indonesian Government Bonds and the US Treasury Bonds, thus, contributing to the substantial inflow this month. On a year-to-date basis, Rupiah has shown a positive sign reflected in solid performance relative to other EMs. Considering these factors, we believe BI should hold its policy rate at 5.75%. At the same time, BI should monitor the Fed's move in the upcoming FOMC meeting as it may resume its prior stance to hiking its rate, while aiming to maintain exchange rate and domestic price stability.