BI Board of Governor Meeting

September, 2023

Highlights

- BI should maintain the policy rate at the current level of 5.75% this month.
- Indonesia's inflation remained stable at 3.27% (y.o.y), aligned with BI's target range.
- Another interest rate hike by the Fed in the latest FOMC has triggered the capital outflow and led to Rupiah depreciation to around IDR15,300.

Macroeconomics, Finance & Political Economy Research Group

Jahen F. Rezki, Ph.D.
jahen@lpem-feui.org

Syahda Sabrina
syahda.sabrina@lpem-feui.org

Teuku Riefky
teuku.riefky@lpem-feui.org

Amalia Cesarina
amalia.cesarina@lpem-feui.org

Faradina Alifia Maizar
faradina@lpem-feui.org

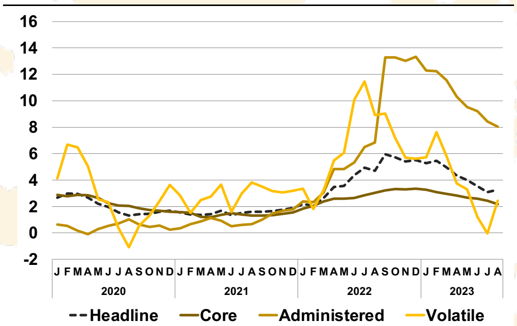
Yoshua Caesar Justinus
yoshua@lpem-feui.org

Indonesia's inflation remained stable and aligned with the BI's target range. August's trends in core inflation, administered prices, and the volatile food group underscore the ongoing efforts to preserve price stability amid diverse challenges, most notably the El Nino phenomenon—which is expected to peak in August until September—as well as Russia's suspension of Black Sea Grain Initiatives. The economy also grew stronger than expected in the second quarter of this year, thanks to robust domestic demand. Despite the capital outflows from Indonesia's financial market as the Fed raised interest rate again at the July FOMC, Indonesia maintained a higher trade surplus in August 2023 compared to its figure in July 2023. Rupiah is also recorded as one of the best performing EMs currencies. Therefore, foreign exchange adequacy should be higher and help stabilize the exchange rate without the urge for BI to adjust the policy rate. All in all, we see that BI should hold its policy rate at the current level of 5.75% while monitoring Rupiah stability and maintaining domestic prices.

Inflation Stable within Target Range

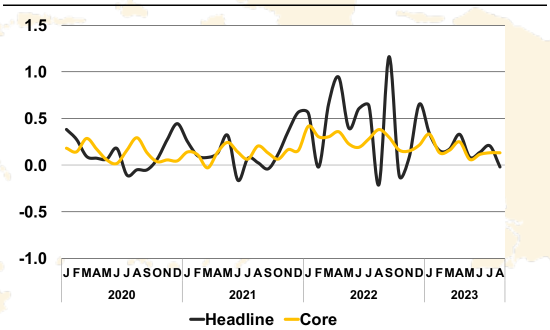
Recent release of inflation data by Statistics Indonesia for August 2023 indicated that Indonesia's annual inflation inched up after declining for five months in a row but still well within BI's target range. The country's year-on-year (y.o.y) inflation rate was reported at 3.27%, up by 0.19 percentage points relative to July's headline inflation at 3.08%. However, it is noteworthy that a slight month-to-month (m.t.m) deflation of 0.02% was recorded in August 2023, down from 0.21% (m.t.m) inflation a month earlier, due to the price moderation in almost all components, such as food, beverage, and tobacco; clothing and footwear; housing, water, electricity, and other fuel; household equipment and routine maintenance; health as well as transportation.

Figure 1: Inflation Rate (%, y.o.y)



Source: CEIC

Figure 2: Inflation Rate (%, m.t.m)



Source: CEIC

Key Figures

BI Repo Rate (7-day, August '23)
5.75%
GDP Growth (y.o.y, Q2 '23)
5.17%
Inflation (y.o.y, August '23)
3.27%
Core Inflation (y.o.y, August '23)
2.18%
Inflation (m.t.m, August '23)
-0.02%
Core Inflation (m.t.m, August '23)
0.13%
FX Reserve (August '23)
USD137.1 billion

Administered prices deflated by 0.02% (m.t.m) in August 2023 compared to July's 0.44% (m.t.m) inflation. This trend was influenced by factors such as decreased retail prices of nonsubsidized liquid petroleum gas and the normalization of air transportation tariffs following the school holiday period. Nonetheless, the deflationary effect was partly offset by price increases in filtered clove cigarettes (*rokok kretek filter*) and non-filtered white cigarettes (*rokok putih*), driven by ongoing adjustments to tobacco excise taxes. On an annual basis, this group expanded by 8.05% (y.o.y) in August 2023, but slower than July's reading at 8.42% (y.o.y).

Concurrently, the volatile food group also witnessed deflation on a monthly basis. In August 2023, this category experienced deflation of 0.51% (m.t.m), down from the previous month's inflation of 0.17% (m.t.m). Such decrease was primarily attributable to deflationary pressures on commodities such as chicken meat, shallots, and chicken eggs. However, inflationary pressures persisted for rice and various chili varieties. On an annual basis, the volatile food group recorded an inflation rate of 2.42% (y.o.y) in August 2023, marking an increase from the previous month when it experienced slight deflation of 0.03% (y.o.y).

In August 2023, core inflation exhibited a modest deceleration, registering at 2.18% (y.o.y) in August, down from the 2.43% (y.o.y) rate witnessed in July 2023. Meanwhile, core inflation remained unchanged compared to the preceding month, with a month-to-month (m.t.m) growth rate of 0.13%. This overall stability can be attributed to the persistent implementation of prudent monetary policy measures and the coordination between the Government of Indonesia (GoI) and BI in effectively executing various price control initiatives. Noteworthy among these are the National Movement for Food Inflation Control (GNPIP) and the establishment of Low-Priced Food Markets (GPM).

On balance, Indonesia's inflation remained stable and aligned with the target range. August's trends in core inflation, administered prices, and the volatile food group underscore the ongoing efforts to preserve price stability amid diverse challenges, most notably the El Nino phenomenon—which is expected to peak on August until September—as well as Russia's suspension of Black Sea Grain Initiatives.

Trade Surplus in 40 Consecutive Months

In recent economic developments, Indonesia demonstrates resilience and growth across key indicators. The Consumer Confidence Index (CCI) surged to 125.2 in August 2023, a significant improvement from the previous month's reading of 123.5. Accompanying the optimistic consumer sentiment is the Purchasing Managers' Index (PMI), which climbed from 53.3 in July 2023 to 53.9 in August 2023, marking the

Key Figures

BI Repo Rate (7-day, August '23)
5.75%
GDP Growth (y.o.y, Q2 '23)
5.17%
Inflation (y.o.y, August '23)
3.27%
Core Inflation (y.o.y, August '23)
2.18%
Inflation (m.t.m, August '23)
-0.02%
Core Inflation (m.t.m, August '23)
0.13%
FX Reserve (August '23)
USD137.1 billion

To keep you updated with our monthly and quarterly reports, please subscribe. Scan the QR code below

or go to http://bit.ly/LPEMCommentarySubscription

highest reading in the ASEAN region. This remarkable achievement represents two full years of expansive production, driven by robust foreign demand.

One of the standout achievements in the Indonesian economy is the continuous surplus in the trade balance. In August 2023, Indonesia's trade surplus reached USD3.12 billion, a notable increase compared to the USD1.29 billion surplus recorded a month earlier. Impressively, this marks the 40th consecutive month of surplus, a streak that commenced in May 2020. However, it is important to note that exports decreased by USD5 billion compared to the same period last year, primarily due to lower prices for Indonesia's top commodities.

The higher trade surplus in August 2023 compared to its figure in July 2023 was driven by a 3.53% (m.t.m) drop in imports while exports grew by 5.5% (m.t.m). The exports increased from USD19.64 billion in July 2023 to USD20.69 billion in August 2023, partly due to rising commodity prices on the global stage, particularly for Crude Palm Oil (CPO). In terms of non-oil and gas exports, the increase was mainly contributed by the jump in ores, slag, and ash exports (223.50%, m.t.m). It was attributable to the increase in foreign demand, notably the exports to key trading partners such as China, the United States (US), and India, which showed substantial improvements compared to the previous month. Non-oil and gas exports to China, the US, and India were read at USD5.38 billion (9.36%, m.t.m), USD2.13 billion (4.67%, m.t.m), and USD1.84 billion (1.07%, m.t.m) in August 2023, respectively.

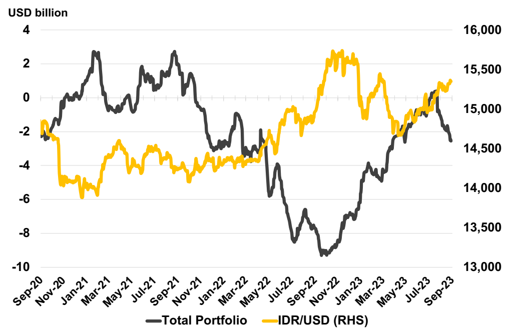
On the import front, Indonesia's imports shrank by 3.53% (m.t.m) in August 2023 compared to 14.11% (m.t.m) in July 2023. It was due to the contraction in oil and gas imports (-15.01%, m.t.m), which helped narrow the oil and gas trade deficit from USD1.91 billion to USD1.34 billion. This reduction signifies positive developments in the energy sector. Nevertheless, raw and auxiliary imported goods continued to be the main contributor to the lower imports in August 2023, following the trend that has taken shape since February 2023. Going forward, the trade surplus is projected to be on downward trajectory as commodity prices modulate and global economy slows down.

The Potential for Further Hikes Remains

In the second week of September 2023, the ECB hiked the benchmark rate to 4.00% in an effort to curb inflation. This figure rose drastically from minus 0.5% just a little more than a year ago and the highest since the Euro was established in 1999. US inflation also ticks upward to 3.7% (y.o.y) in August 2023 due to rising oil and gas prices. However, the core inflation actually decreased in August 2023 to 4.3% (y.o.y), down from 4.7% (y.o.y) in July 2023, reflecting the impact higher energy prices are having on the overall inflation rate. Therefore, even though the Fed continued its tightening cycle to fight inflation by raising interest rates by 25 bps to 5.22-5.50% at the Federal Open Market Committee (FOMC) meeting on July 25-26, it is predicted that the US central bank will maintain the federal funds rate in the current range until the end of the year.

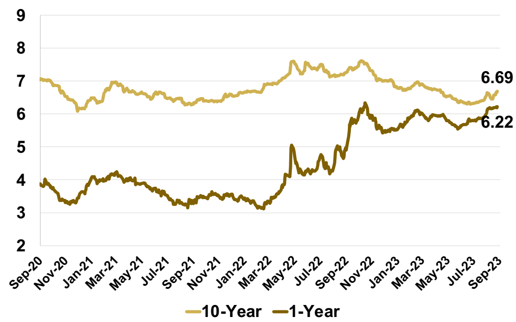
The higher interest rate in developed countries boosts the attractiveness of their assets compared to emerging countries, which at the same time lowered investors' appetite for Asia's assets. As a result, the capital outflow in Indonesia financial market was recorded at USD1.47 billion throughout mid-August 2023 until mid-September 2023. The decline in the total portfolio was contributed by the selloff in both stocks and bonds assets. It was reflected in the rising yields of Indonesia's 10-Year government bonds and 1-Year government bonds from 6.58% and 6.03% in mid-August 2023 to 6.69% and 6.22% in mid-September 2023, respectively.

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



Source: CEIC

Figure 4: Government Bonds Yield (% pa)



Source: CEIC

The Fed's latest increase in interest rates has also pushed Rupiah exchange rate down to IDR15,350 in mid-September. Even though Rupiah and Brazilian Lira continued to be the best currency performer relative to other emerging markets, the year-to-date appreciation rate of Rupiah was slashed to only 1.22% (ytd) from its peak at 5.03% (ytd) in mid-April. Furthermore, Indonesia's official foreign exchange reserve remained high at the end of August 2023, totalling USD137.1 billion, although it slightly weakened from USD137.7 billion at the end of July 2023. The decreasing amount is related to the GoI's obligation to pay for external debt and the need for Rupiah stabilization in response to increasing global financial market uncertainty. However, the reservxe amount is equivalent to 6.2 months of import or 6.0 of imports and government foreign debt payment, which is well above the international adequacy standard of three months of imports.

Key Figures

BI Repo Rate (7-day, August '23)
5.75%
GDP Growth (y.o.y, Q2 '23)
5.17%
Inflation (y.o.y, August '23)
3.27%
Core Inflation (y.o.y, August '23)
2.18%
Inflation (m.t.m, August '23)
-0.02%
Core Inflation (m.t.m, August '23)
0.13%
FX Reserve (August '23)
USD137.1 billion

To keep you updated with our monthly and quarterly reports, please subscribe. Scan the QR code below

or go to http://bit.ly/LPEMCommentarySubscription

Key Figures

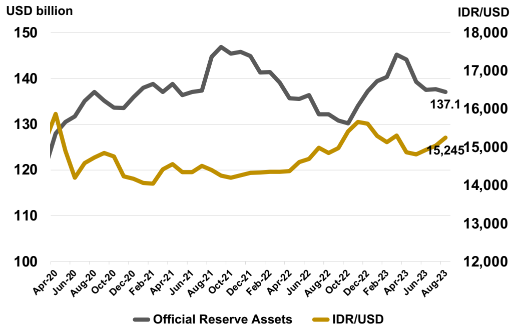
BI Repo Rate (7-day, August '23)
5.75%
GDP Growth (y.o.y, Q2 '23)
5.17%
Inflation (y.o.y, August '23)
3.27%
Core Inflation (y.o.y, August '23)
2.18%
Inflation (m.t.m, August '23)
-0.02%
Core Inflation (m.t.m, August '23)
0.13%
FX Reserve (August '23)
USD137.1 billion

To keep you updated with our monthly and quarterly reports, please subscribe. Scan the QR code below

or go to http://bit.ly/LPEMCommentarySubscription

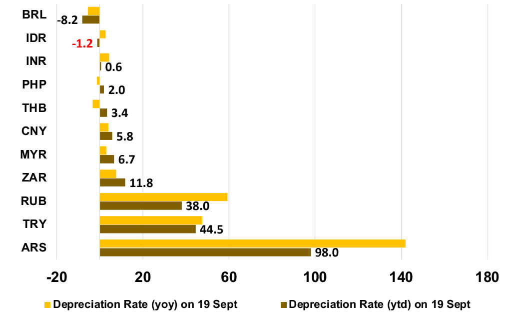
8 DECENT WORK AND ECONOMIC GROWTH

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (19 September 2023)



Source: Investing.com

Despite the capital outflows from Indonesia's financial market, domestic economic conditions are still robust as the inflation figure is expected to continue to move within BI's target range, with core inflation remains manageable. BI has also issued Bank Indonesia Rupiah Securities (SRBI) as a contractionary pro-market monetary operation instrument to strengthen IDR money market deepening efforts, attract foreign capital inflows in the form of portfolio investment, and optimize the SBN assets held by BI as underlying starting in mid-September. In addition, the latest trade balance surplus figure is also quite high so that foreign exchange adequacy should be higher and help stabilize the exchange rate without the urge for BI to adjust the policy rate. Not to mention that the reserve assets will remain ample to support external sector resilience as well as maintain macroeconomic and financial system stability. Therefore, we see that BI need to hold its policy rate at the current level of 5.75% while monitoring the Rupiah stability and maintaining the domestic prices.