LPEM FEB UI
Institute for Economic and Social Research

Macroeconomic Analysis Series

BI Board of Governor Meeting

October, 2023

Highlights

- BI should maintain the policy rate at the current level of 5.75% this month.
- Indonesia's inflation fell to 2.28% (y.o.y) due to high-base effect.
- Rupiah continued to depreciate, reaching IDR15,354 per dollar, following the Fed's indication of maintaining higher interest rates in the foreseeable future and China's run-off-the-mill economic indicators.

Macroeconomics, Finance & Political Economy Research Group

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Indonesia's inflation figure fell below 3% in September due to the high-base effect from the same period last year. However, the inflation trends underscore the ongoing efforts to preserve price stability amid diverse challenges, most notably the El Nino weather phenomenon, which is expected to peak in September. Indonesia also maintained a higher trade surplus in September 2023, which marks the 41st consecutive month of surplus. However, the dynamics in the US market regarding potential rate hikes in the upcoming months have translated into an outflow spree of capital from the Indonesian market in recent weeks, as noted in the selloff in stocks and bonds assets amounting to USD1.35 billion between mid-September and mid-October. It is worth emphasizing that the pressures on the Rupiah are expected to persist for a while, which will likely pose challenges for the central bank in the coming months. In light of the pressures on the Rupiah and the necessity to uphold the interest rate differential with the Fed, we are in the view that BI shall maintain its policy rate at the existing level of 5.75% while continuing its macroprudential effort to stabilize any short-term pressure on price and exchange rate level.

Inflation Falls Below 3% in September 2023 due to High-Base Effect

September headline inflation was the lowest in the last 19 months and recorded at 2.28% (y.o.y), which fell from 3.27% (y.o.y) in August 2023. The decrease was mainly caused by the high-base effect of the subsidized fuel price adjustment in September 2022. However, monthly inflation increased slightly to 0.19% (m.t.m) after experiencing deflation in the previous month of 0.02% (m.t.m). The increase in monthly inflation was mainly driven by the volatile price component, which increased to 0.37% (m.t.m) this month and the administered prices component, which also increased to 0.23% (m.t.m). The increase in administered prices inflation was driven by clove cigarette commodities and fuel prices, including Pertamax, Pertamax Turbo, Pertamina Dex, and Pertamax Green. Meanwhile, the increase in the volatile food component was strongly driven by the rice price increase due to El Nino weather phenomenon, which was starting to show its impact as well as jump in beef prices. However, further increases in inflation were restrained by deflation in purebred chicken eggs, various onions, and various chilies. Core inflation in September 2023 was recorded at 0.12% (m.t.m), mainly attributed to inflation in cell phone credit prices and academic tuition fees and relatively stable compared to inflation in the previous month of 0.13% (m.t.m).

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Key Figures

BI Repo Rate (7-day, September '23)
5.75%
GDP Growth (y.o.y, Q2 '23)
5.17%
Inflation (y.o.y, September '23)
2.28%
Core Inflation (y.o.y, September '23)
2.00%
Inflation (m.t.m, September '23)
0.19%
Core Inflation (m.t.m, September '23)
0.12%
FX Reserve (September '23)
USD134.9 billion

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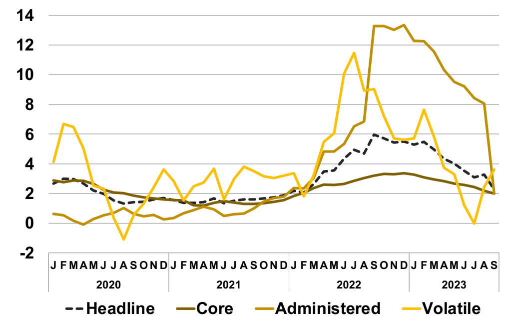
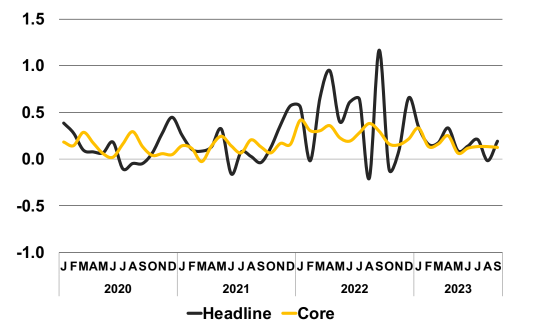
Figure 1: Inflation Rate (%, y.o.y)



Source: CEIC

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



Source: CEIC

On an annual basis, core inflation was recorded at 2.00% (y.o.y) in September 2023, a decrease of 0.18 percentage points compared to the previous month. The administered prices inflation has also decreased to 1.99% (y.o.y) in September 2023 compared to 8.05% (y.o.y) in August 2023. The drastic decline in the administered prices component was caused by the high-base effect of the increase in subsidized fuel prices in September 2022. On the other hand, the volatile price component increased to 3.62% (y.o.y) in September 2023, inched up from 2.42% (y.o.y) in August 2023.

All in all, the persistent implementation of prudent monetary policy measures and coordination between GoI and BI in implementing various price control initiatives effectively have kept inflation in September 2023 within BI's target range of 3.0±1%. September's inflation trends also underscore the ongoing efforts to preserve price stability amid diverse challenges, most notably the El Nino weather phenomenon. By strengthening BI's policy mix in maintaining stability and supporting economic growth by coordinating with the government, it is even likely for the inflation rate to be around 3% at the end of 2023. However, BI still needs to be vigilant in the final months of 2023 with the increase in fuel prices in early October due to the increase in crude oil prices and the potential effects of El Nino which may still be felt in the coming months, as well as the potential for higher imported prices due to the depreciation of the Rupiah exchange rate.

Trade Surplus in 41 Consecutive Months

In latest developments, Indonesia's CCI declined to 121.7 in September 2023 from 125.2 in the previous month, pointing to the lowest level since last December, as almost all components of CCI decreased. The decline was mainly attributed to a decrease in the Current Economic Conditions Index and the Consumer Expectations Index, namely for the components of job availability and current income contained in the Current Economic Conditions Index, as well as all components of the

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Consumer Expectations Index. Nonetheless, the overall CCI in September 2023 is still maintained in the optimistic zone (>100), which shows that consumer confidence in economic conditions is still quite strong.

Indonesia's trade surplus in September 2023 reached USD3.42 billion, a notable increase of USD300 million from the surplus recorded a month earlier. This marks the 41st consecutive month of surplus, a streak that commenced in May 2020. The trade balance surplus as of September 2023 was mainly supported by non-oil and gas trade surplus of USD5.34 billion, with the main commodities being mineral fuels, animal fats and vegetable oils, and steel. However, Indonesia's export value in September 2023, which reached USD20.76 billion, decreased by 5.63% (m.t.m) compared to exports in August 2023, contributed by declining commodity prices and weakening global demand. Meanwhile, compared to September 2022, the export value decreased by 16.17% (y.o.y). Specifically, the drop in the export figure was driven by lower demand for CPO from India, as the largest importer from Indonesia, due to high stockpile. In addition, declining coal prices in comparison to last year's high base also amplified the export decrease. This marks the fourth consecutive month of export contraction. In detail, non-oil and gas exports in September 2023 reached USD19.35 billion, down 6.41% (m.t.m) compared to August 2023, and down 17.66% (y.o.y) compared to September 2022. The largest destination country for non-oil and gas exports in September 2023 was China, the United States, and India, with the value recorded at USD5.17 billion, USD1.84 billion, and USD1.50 billion, respectively. The value of Indonesia's exports to these three countries contributed to 43.97% of total non-oil and gas exports. Meanwhile, exports to ASEAN and the European Union amounted to USD3.49 billion and USD1.33 billion, respectively.

On the import front, Indonesia's imports shrank by 8.15% (m.t.m) in September 2023 compared to the previous month. It was due to the contraction in non-oil and gas imports (-13.60% (m.t.m)). This decline indicates lower demand for domestic production inputs, partially due to lower export demand following the muted global demand. This is reflected in imports of electrical equipment and spare parts as one of the main factors driving the decline in imports of non-oil and gas goods in September 2023 worth USD401.7 million (17.95% (m.tm.)). Meanwhile, the most significant increase was evident for salt, sulphur, stone, and cement at USD33.3 million (43.27% (m.t.m)). On the other hand, oil and gas imports in September 2023 rose 25.04% (m.t.m) compared to August 2023. Going forward, the trade surplus is projected to be on a downward trajectory as commodity prices modulate and the global economy slows down.

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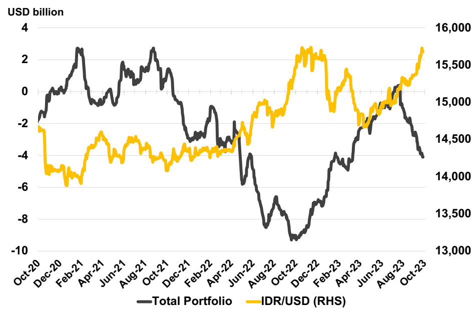
Higher for Longer: Interest Rate to Remain High

In September 2023, the US saw a decline in inflation, dropping to 0.6% (m.t.m), slightly higher than expected at 0.4% after seasonal adjustments. However, the unadjusted annual inflation rate remained steady at 3.7% (y.o.y). In contrast, annual core inflation decreased from 4.3% in August 2023 to 4.1% in September 2023. While shelter costs continued to rise at a steady pace, growing by 7.2% annually, there were signs of relief in a number of sectors, notably in used cars, trucks, and utility (piped) gas services, which saw deflation of 8.0% (y.o.y) and 19.9% (y.o.y), respectively. September marked robust job growth, with the addition of 336,000 jobs, keeping the unemployment rate stable at 3.8%, mirroring the situation in August.

Amid these developments, there appears to be a shift in the Fed's stance regarding potential rate hikes for the remainder of the year. After deciding to maintain interest rates in September, most participants initially indicated one more rate hike before year-end, suggesting a "higher-for-longer" policy. However, recent changes in the job and bond markets, where US 10-year Treasury yields reached their highest levels since 2007, have prompted Fed officials to adopt a more cautious approach. Recent statements by the Fed officials now indicate a highly plausible continued pause on rate hikes, at least until November.

Such dynamics in the US market have translated into an outflow spree of capital from the Indonesian market in recent weeks, as noted in the selloff in stocks and bonds assets amounting to USD1.35 billion between mid-September 2023 and mid-October 2023. The total portfolio decline was reflected in Indonesia's 10-year and 1-year government bond yields increase to 6.97% and 6.24% in mid-October 2023 from 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

In September 2023, Rupiah continued to depreciate, reaching IDR15,354 per US dollar, following the Fed's indication of maintaining higher interest rates in the foreseeable future and China's run-off-the-mill economic indicators. Nonetheless, Key Figures

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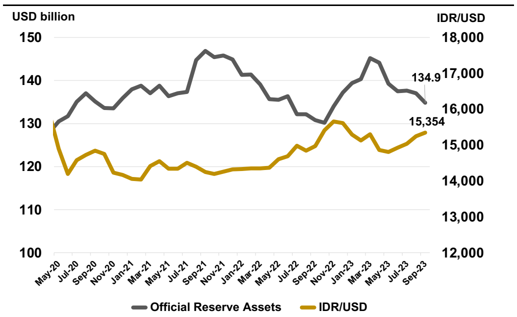
Rupiah remained among the top-performing currencies in emerging markets, second only to Brazilian Real, which has consistently shown strength against the US Dollar due to robust global demand for Brazilian commodities.

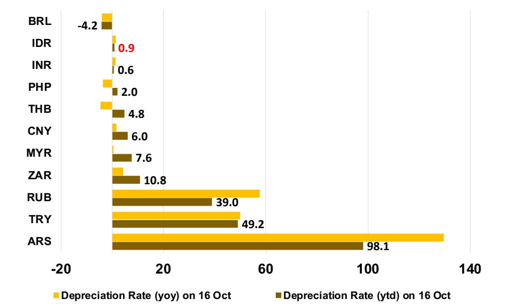
In the meantime, Indonesia's official reserves declined from USD137.1 billion in August 2023 to USD134.9 billion in September 2023, primarily due to stabilization efforts by the central bank to navigate external uncertainties and the government's foreign debt servicing. With this latest announcement, Indonesia's reserves now amount to the equivalent of 6.1 months of imports and 6.0 months of import and servicing government's external debt.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (16 October 2023)



Source: Investing.com

Although we anticipate continued capital outflows in the foreseeable future, several key economic indicators are displaying encouraging trends, showcasing the nation's domestic resilience in the face of external uncertainties. The latest trade surplus data has provided the economy some support to withstand the Rupiah’s depreciation. Furthermore, inflation figures have been showing increasingly positive trends, reducing the immediate need for further tightening. Nonetheless, it is worth emphasizing that the pressures on the Rupiah are expected to persist for a while, which will likely pose challenges for the central bank in the coming months. Given these factors and the need to maintain the interest rate differential with the Fed’s, we are in the view that BI shall maintain its policy rate at the existing level of 5.75% while continuing its macroprudential effort to stabilize any short-term pressure on price and exchange rate level.

8 DECENT WORK AND ECONOMIC GROWTH