Macroeconomic Analysis Series

BI Board of Governor Meeting

January 2024

LPEM FEB UI
Institute for Economic and Social Research

Highlights

- BI should hold its policy rate at 6.00% this month.
- Successfully navigating the threat of El-Nino on food supply through combinations of import policy and active stabilization effort by GNPIP, inflation in December decelerated to 2.61% (y.o.y).
- The slowdown of capital flows towards emerging economies, including Indonesia, is partly driven by investors uphold view that there is around 70% probability the Fed would likely to cut its policy rate by first quarter of 2024.

Macroeconomics, Finance & Political Economy Research Group

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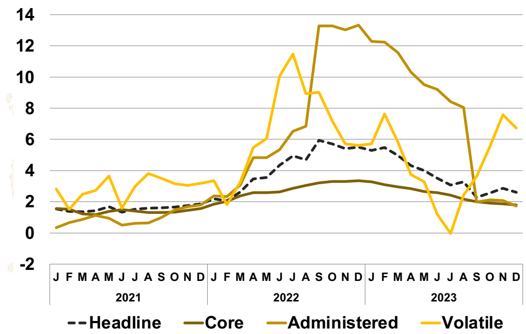
Stood at 2.61% (y.o.y) in December, Indonesia's inflation rate throughout 2023 has shown a downward trend and been successfully kept within BI's target range. The 2023 inflation realization is substantially below 2022 full-year inflation figure that reached a staggering level of 5.51% (y.o.y) due to skyrocketed commodity and energy prices. Before 2022, full-year inflation always fell short of 2% lower-band BI's target range due to muted aggregate demand during Covid-19 period (1.68% (y.o.y) in 2020 and 1.87% (y.o.y) in 2021). On external front, Indonesia consistently maintained trade surplus throughout 2023; it was recorded at USD3.3 billion in December 2023. Relative to its peers' currency, Rupiah performed rather unimpressive in the first two weeks of 2024 despite being rather stable. Considering these factors, we view that BI should hold its policy rate at 6.00% this month.

Target's Achieved

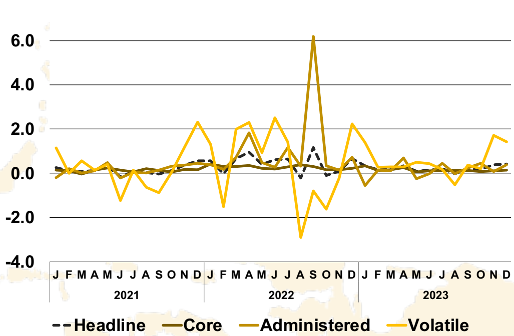
Indonesia's annual inflation rate in December 2023, or the realization of full-year 2023 inflation, stood at 2.61% (y.o.y),. This marked the first success of reaching inflation within BI's target range since 2019. The 2023 inflation realization is substantially below 2022 full-year inflation figure that reached a staggering level of 5.51% (y.o.y) due to skyrocketed commodity and energy prices. Before 2022, inflation always fell short of 2% lower-band BI's target range due to muted aggregate demand during Covid-19 period (1.68% (y.o.y) in 2020 and 1.87% (y.o.y) in 2021).

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



Source: CEIC

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



Source: CEIC

December 2023 annual headline inflation rate decelerated from 2.86% (y.o.y) in the previous month. This is driven by a rather manageable food prices and high-base effect from the same period last year. Bearing the biggest weight in the inflation measurement, food, beverages, and tobacco component inflation decreased to 6.18% (y.o.y) in December 2023 from 6.71% (y.o.y) in November 2023. Historically, this component experienced a rising inflation rate in December compared to

Key Figures

BI Repo Rate (7-day, December '23)
6.00%
GDP Growth (y.o.y, Q3 '23)
4.94%
Inflation (y.o.y, December'23)
2.61%
Core Inflation (y.o.y, December '23)
1.80%
Inflation (m.t.m, December '23)
0.41%
Core Inflation (m.t.m, December '23)
0.14%
FX Reserve (December '23)
USD146.4 billion

November following the Christmas and New Year celebration period. However, this does not happen in December 2023 when food, beverages, and tobacco component demonstrated a lower inflation figure as GoI successfully contained the food prices. As a result, monthly food, beverages, and tobacco inflation rate slumped from 1.23% (m.t.m) in November 2023 to 1.07% (m.t.m) in the last month of 2023. Being the major source of inflationary pressure in the previous months, the price of rice have moderated and actually experienced a price decrease of around 0.39% (m.t.m) in December 2023. Other food commodities, such as red chili pepper and cayenne pepper, have moderated during last month as the GoI ensured the supplies were maintained during December 2023. While the food price components deviated from its end-of-year trend and ease the pressure on headline inflation rate, transportation and consumer goods were in-line with its seasonal trend. Putting upward inflationary pressure, transportation group recorded a spike in monthly inflation from 0.07% (m.t.m) in November 2023 to 0.45% (m.t.m) in December 2023 as public mobility increased amid Christmas and New Year holiday period. Similarly, clothing and footwear inflation increased to 0.18% (m.t.m) in last month from -0.04% (m.t.m) in November 2023 due to rising consumer demand.

Successfully navigating the threat of El-Nino on food supply through combinations of import policy and active stabilization effort by National Movement for Food Inflation Control (*Gerakan National Pengendalian Inflasi Pangan*/GNPIP), volatile price component experienced a rather considerable decrease of inflation from 7.59% (y.o.y) in November 2023 to 6.73% (y.o.y) in December 2023. In addition, administered price component also declined from 2.07% (y.o.y) to 1.72% (y.o.y) during the same period as the need for adjusting commodity prices by the GoI was quite minimum in December 2023. Core inflation was recorded at 1.80% (y.o.y) in December 2023, moderated slightly from 1.87% (y.o.y) in November 2023 and has been consistently on a downward trend since December 2022. Slowing core inflation might indicate moderating domestic aggregate demand.

Overall, Indonesia's inflation rate throughout 2023 has shown a downward trend and been successfully kept within BI's target range. In 2024, there are two major changes in the domestic inflation development. First, consumer price index will use the new 2022 base with various changes, including expansion of regional coverage from 90 to 150 regions, renewed component weights, addition of digital economic activities, and adjustment to consumption pattern in the post-Covid-19 era. Second, BI will adjust its inflation target range from 2%-4% to 2.5%-3.5%. Considering its achievement in 2023, we are in optimist view that GoI and BI are in capacity to achieve the inflation target for 2024.

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Weakening Capital Inflows to Emerging Markets

On the external front, Indonesia consistently maintained trade surplus throughout 2023 as December trade balance is recorded at USD3.3 billion, increased considerably from USD2.41 billion in the previous month. This surplus contributed to the full-year trade surplus of USD36.93 billion, despite notably declined from USD54.46 billion in 2022 as we enjoyed a massive commodity windfall during last year. During the last month of 2023, Indonesia's exports dropped by 5.76% (y.o.y), moderating from a contraction of 8.56% (y.o.y) in the previous month. This is driven by weakening global demand and decline of commodity prices which consequently dampen the export of animal/vegetable fats & oils, mineral fuels, and automotive components. On the other hand, oil and gas export substantially increased by 1.45% (y.o.y) or 15.28% (m.t.m) driven by export of oil products that spiked by 91.15% (y.o.y) or 78.67% (m.t.m). Thanks to this, monthly export in December 2023 increased by 1.89% (m.t.m) from USD21.99 billion in November 2023 to USD22.41 billion in December 2023. On the other hand, import prolonged to fell and recorded at USD19.11 billion in December 2023, a decline of 2.45% (m.t.m) from the previous month or 3.81% (y.o.y). The main contributor of import decline came from slower capital goods imports, which decreased by 9.91% (y.o.y) or 10.51% (m.t.m). Similarly, raw materials import also decline by 4.43% (y.o.y) or 0.97% (m.t.m) Slower import of capital goods and raw materials suggested an emerging trend of weakening domestic production activity. Entering 2024, maintaining trade surplus could be challenging as global demand weakening, particularly Indonesia's main trading partners (i.e., China and the US), remains as a persistent risk. Moreover, there is a potential of import increase throughout 2024 due to increasing domestic activity following election period.

The release of US inflation data surprised the market as it increased above forecasts. Annual US inflation hiked to 3.4% (y.o.y) in December 2023 from a five-month low of 3.1% (y.o.y) in the previous month, defying a smooth path down to normal levels. The rise in the US inflation owed primarily to a rise in housing and energy costs. Previously, the Fed was expected to dial back its inflation fighting regime by soon cutting interest rate. However, latest inflation data could complicate this plan. On the other hand, US labor market remained resilient as the December's unemployment rate is at 3.7%, reaching its lowest level since 2020. This granted some optimism that the US could safely avoid recession and eventually achieve "soft landing" with price increase return to normal level while the economy continue to grow. However, averting economic downturn remains to be seen as inflation stands well below last summer's peak of over 9%, but remains well short of the Fed's target rate of 2%.

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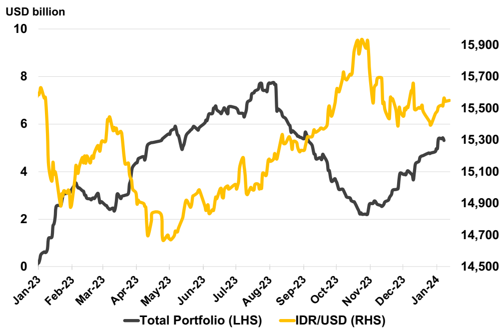
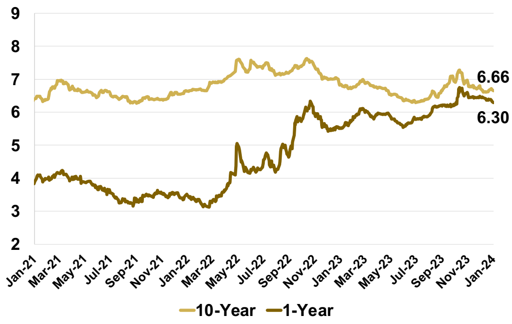
Figure 3: IDR/USD and Accumulated Portfolio Capital Inflow (Last 12 Months)



Source: CEIC

Figure 4: Government Bonds Yield (% p.a.)



Source: CEIC

During the past few weeks, there was a mild surge of capital inflows towards Indonesia. Until second week of January, accumulated capital inflows are recorded at USD0.97 billion since mid-December. The slowdown of capital flows towards emerging economies, including Indonesia, is partly driven by investors uphold view that there is around 70% probability the Fed would likely to cut its policy rate by first quarter of 2024, despite after US inflation uptick during December 2023. The inflows have resulted in Indonesia's government bond's yield decrease. 10-year government bond yield is down to 6.66% in second week of January from around 6.80% a month earlier and 1-year government bond yield declined to 6.30% from around 6.46% during the same period. The widening yield differential between short- and long-term government bonds might suggest the effect of Rupiah Securities of Bank Indonesia (*Sekuritas Rupiah Bank Indonesia*/SRBI) to shift the bond yield has taken place as SRBI is only issued on the short-term tenor.

Indonesia's official reserve assets stood at USD146.38 billion in December 2023, increased substantially by USD8.3 billion from USD138.10 in November 2023. Monthly increase of reserve assets in December 2023 reached its historical high, driven by revenue from tax and services, and GoI's foreign loan withdrawal. Current level of reserve assets is equivalent to finance 6.7 months of import or 6.5 months of imports and external debt servicing, well above the international adequacy standard of three months of imports. Latest position of official reserve assets might provide an ample support to cushion potential shock to Rupiah down the road. On January 15th, Rupiah exchange rate to USD hovered at around IDR15,550, depreciated slightly by 1.06% (y.t.d) since beginning of the year. Relative to its peers' currency, Rupiah performed rather unimpressive in the first two weeks of the year as it performed worse than Russian Ruble, Indian Rupee, Brazilian Lira, Philippines Peso, and Argentine Peso. However, Rupiah is relatively stable in the past few weeks and current level of foreign reserve assets is rather adequate in its capacity to minimize any potential pressure on Rupiah, shall be needed.

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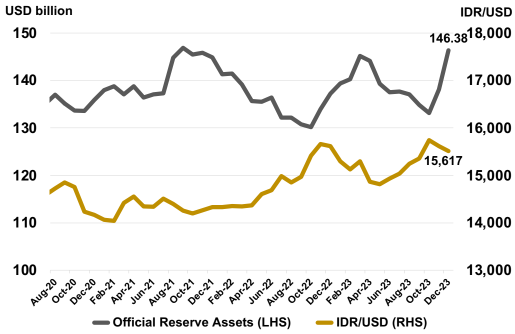
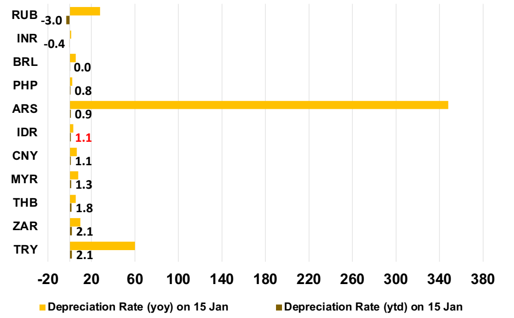
Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (15 January 2024)



Source: Investing.com

Indonesia is entering 2024 with a positive note on various fronts. Inflation has been manageable throughout 2023 amidst ongoing pressure on food prices stemming from El-Nino. Moreover, trade balance has been consistently on a surplus territory despite the weakening global demand and commodity prices. On the other hand, the expectations of the Fed to cut rates as early as first quarter of 2024 is rising and prolongs the capital flows toward Indonesia, albeit moderating in the past few weeks. With Rupiah mildly depreciating since beginning of the year and inflation is not currently being an issue, we view that cutting policy rate prematurely might not be wise for BI as it will puts pressure on Rupiah. BI might anchor its rate cut timeline to the Fed's decision accordingly. Therefore, in its first Board of Governors' meeting after changing policy rate's name from BI 7-days reverse repo rate (BI 7DRR) to BI rate, BI should hold its policy rate at 6.00%.

8 DECENT WORK AND ECONOMIC GROWTH