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Macroeconomic Analysis Series

BI Board of Governor Meeting

February 2024

Highlights

- BI should maintain BI Rate at 6.00% this month.
- Headline inflation was recorded at 2.57% (y.o.y) as seasonal effect of year-end holidays declined and more controllable food prices.
- The Fed decided to keep its policy rate unchanged during January meeting and indicated rate cut would not happen in the next FOMC meeting (March 2024).

Macroeconomics, Finance & Political Economy Research Group

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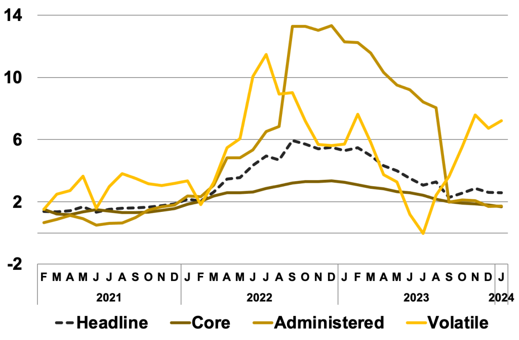
Headline inflation eased to 2.57% (y.o.y) in January 2024 approaching the new target mid-point of 2.5%. Diminishing impact of El-Nino weather phenomenon on food prices, distribution of social assistance to control food volatility, and lessen effect of year-end seasonal effect drove inflation down in the first month in 2024. Trade balance is still in positive territory although has been declining since April 2022. Considering the Fed will not lower its policy rate in the coming months, we view that BI should maintain BI Rate at 6.00% this month to maintain exchange rate stability.

Subdued Inflation, Results of Efforts to Tame Food Prices

In the first month of 2024, annual headline inflation edged down to 2.57% (y.o.y) from 2.61% (y.o.y) in December 2023. It is the lowest annual headline inflation in three months, approaching the mid-point of the new inflation target of 1.5% - 3.5% for 2024. Slowing inflation in January 2024 was driven by softer price increase in food, beverage, and tobacco expenditure group (5.87% (y.o.y) in January 2024 compared to 6.18% (y.o.y) in December 2023) and transportation expenditure group (1.11% (y.o.y) in January 2024 compared to 1.27% (y.o.y) in December 2023) as seasonal effect of Christmas and New Year holidays subsided. Although diminishing, El-Nino weather phenomenon still has impact on rice price. The average retail price of rice in traditional market increased by 15.82% (y.o.y) in January 2024, moderating from 16.64% (y.o.y) a month earlier. Increase in rice price contributed to 0.57 percentage point of this month's headline inflation. To manage impact of rice price increase, the 10-kilogram social aid rice distribution has been extended by the GoI until June 2024.

It is important to note that starting 2024, inflation calculation use 2022 cost of living (*Survei Biaya Hidup* (SBH)) as the new base replacing the 2018 SBH. The SBH update from 2018 to 2022 is expected to capture lifestyle change, particularly due to Covid-19 pandemic. The new inflation calculation now covers 150 cities compared to 90 cities in the previous calculation. Another notable change is in the consumption share where food commodities now accounts for 38.04% of total consumption, an increase from 33.68% of total consumption in the previous calculation. This increase is evident in how food, beverage, and tobacco now has higher contribution to headline inflation. In January 2024, food, beverage, and tobacco expenditure group recorded a 5.84% (y.o.y) inflation that contributed to 1.63 percentage point of overall inflation while in December 2023, this expenditure group recorded a 6.18% (y.o.y) price increase contributing to 1.60 percentage point of headline inflation.

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



Source: CEIC

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

Source: CEIC

Key Figures

BI-Rate (January '24)
6.00%
GDP Growth (y.o.y, Q4 '23)
5.04%
Inflation (y.o.y, January '24)
2.57%
Core Inflation (y.o.y, January '24)
1.68%
Inflation (m.t.m, January '24)
0.04%
Core Inflation (m.t.m, January '24)
0.20%
FX Reserve (January '24)
USD145.05 billion

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Breaking down its component, annual headline inflation in January 2024 was caused by price increase in all three components. Core inflation recorded a decelerating inflation of 1.68% (y.o.y) in January 2024 compared to 1.80% (y.o.y) in December 2023. Annual core inflation has consistently decreased since December 2022, suggesting moderating demand. Administered price reported an inflation of 1.74% (y.o.y) in January 2024, marginally higher compared to 1.72% (y.o.y) in December 2023 due to price adjustment in non-subsidized fuel, whose total consumption accounted to only around 15% of total fuel consumption, on 1 January 2024. Volatile price component indicated an increasing inflation of 7.22% (y.o.y) in January 2024 compared to 6.73% (y.o.y) in December 2023 and was a major contributor of this month's inflation accounted for 1.14 percentage point of headline inflation. Aside from rice, price increase in garlic and tomato contributed to increasing inflation of volatile price component.

On a monthly basis, headline inflation was reported at 0.04% (m.t.m) in January 2024, significantly lower compared to 0.41% (m.t.m) in the last month of 2023. Monthly core inflation increased from 0.14% (m.t.m) in December 2023 to 0.20% (m.t.m) in January 2024 due to increase in price of gold jewellery, house rental fees, and house contract fees. Increase in gold price is in accordance with rising global gold price while rising house rental and contract fees are attributable to surge in number of tourist. Volatile price component indicated a decelerating inflation from 1.42% (m.t.m) in December 2023 to 0.01% (m.t.m) in January 2024. While price of rice, garlic, and tomato increased in January 2024, price of various chilis declined restraining the volatile price to increase further this month. Administered price deflated by 0.48% (m.t.m) in January 2024 after experiencing 1.42% (m.t.m) inflation in December 2023, dampening the overall monthly inflation in January 2024. Decreasing administered price was due to lower air transportation rates after year-end holiday as well as the adjustment of non-subsidized fuel oil prices.

In the coming months, inflationary pressure will be exerted by increased spending during several long-weekend holidays in February 2024 and food prices ahead of

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Ramadan season as Indonesians consume more food during the period. In addition people will also spend more on clothing and travel during the Ramadan festivity and Eid Al-Fitr. Role of the Central Inflation Control Team (*Tim Pengendali Inflasi Pusat*/TPIP) and the Regional Inflation Control Teams (*Tim Pengendali Inflasi Daerah*/TPID) would be more crucial containing inflation, especially pressure from food commodities, given that food commodities currently make up a larger portion of total consumption in SBH.

Achieving 5% Growth amidst Global Turbulence

In line with market expectation, Indonesian economy expanded by 5.04% (y.o.y) in the last quarter of 2023, making the overall economy grew by 5.05% (y.o.y) in 2023. The GDP growth in 2023 was lower compared to 5.31% (y.o.y) growth in 2022 as Indonesia still enjoy a fair bit of low-base effect in 2022. However, considering China economic slowdown, rising geopolitical tension, declining commodity prices, and global monetary tightening, the growth level in 2023 is somewhat an achievement for Indonesia. By expenditure, growth in Q4-2023 was supported by positive growth in all expenditure components, except imports that recorded a negative annual growth in Q4-2023. Domestic consumption, main contributor of Indonesian GDP, grew by 4.47% (y.o.y) in Q4-2023 or 4.82% (y.o.y) in FY2023. Growth in household consumption in Q4-2023 was driven by greater mobility during the Christmas and New Year festive period and stable public purchasing power. Government expenditure also rose by 2.81% in Q4-2023 or 2.95% (y.o.y) in FY2023. Expedited expenditure at the end of the year as well as increase in election-related expenditure supported growth in government expenditure. Despite moderation in commodity prices, exports still recorded positive growth of 1.64% (y.o.y) in Q4-2023, resulted in 1.32% (y.o.y) growth in FY2023. Exports in Q4-2023 was driven by increase in exports volume of iron and steel coupled with improving services exports given the influx of inbound international travelers. On the other hand, imports declined by 0.15% (y.o.y) in Q4-2023, hence overall imports contracted by 1.65% (y.o.y) in FY2023

At the start of 2024, Indonesia posted a positive trade balance of USD2.01 billion in January 2024, the lowest level in six month declining from USD3.29 billion a month earlier. Exports declined by 8.06% (y.o.y) in January 2024 to USD20.52 billion, a larger contraction compared to 5.76% (y.o.y) drop a month earlier. Exports drop was due to muted global demand and falling global commodity prices resulting in shrinking oil and gas and non-oil and gas exports by 6.07% (y.o.y) (or 5.49% (m.t.m)) and 8.20% (y.o.y) (or 8.54% (m.t.m)), respectively. Zooming in on non-oil and gas commodities, almost all major commodities caused non-oil and gas exports to decline except for iron and steel and metal ores, slag, and ash that recorded a 9.62% (y.o.y) and 10.19% (y.o.y) growth, respectively, in January 2024. On a monthly basis, apart from iron and steel that rise by 1.21% (m.t.m), animal/vegetable fats & oils also

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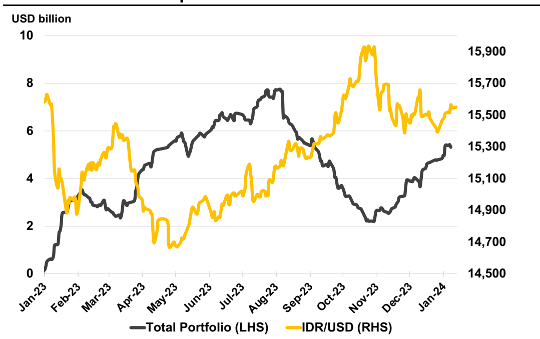
grew substantially by 10.36% (m.t.m), preventing non-oil and gas exports to decelerate further. On the other hand, imports increased slightly by 0.36% (y.o.y) to USD18.51 billion in January 2024 in January 2024 supported by increase in non-oil and gas imports by 1.76% (y.o.y) while oil and gas imports fell by 7.15% (y.o.y). On a monthly basis, imports contracted by 3.13% (m.t.m) mainly driven by reduction in oil and gas imports by 19.99% (m.t.m). Imports of consumer goods, raw materials, and capital goods declined by 13.54% (m.t.m), 2.25% (m.t.m), and 0.31% (m.t.m), respectively. Decline in imports may be related to how business pause their spending while waiting for election to be over. Overall, although has been in positive territory since May 2020, trade balance is on a downward trend for 22 consecutive months or since April 2022. Maintaining trade surplus in 2024 will be a challenge amidst global weakening demand, global rate cuts uncertainty, and in the wake of election.

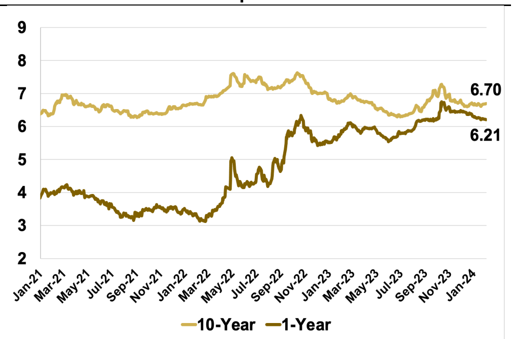
March Rate Cut by The Fed Is Unlikely

Figure 3: IDR/USD and Accumulated Portfolio Capital Inflow (since Jan-23)



Source: CEIC

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



Source: CEIC

After a brief disrupted pattern on decelerating inflation trend in December 2023, the annual inflation rate in the US fell to 3.1% (y.o.y) in January 2024 from 3.4% (y.o.y) a month earlier. Considering it is still above the 2% target, the Fed decided to keep its policy rate unchanged at 5.25% - 5.50% in January 2024 FOMC meeting. The Fed has maintained the policy rate unchanged for the four straight month on a trot. Shelter price that contributes to one third of CPI weighting edged up by 6% (y.o.y) in January 2024 slowing from 6.2% (y.o.y) in December 2023. In addition, food price increased by 2.6% (y.o.y) in January 2024, moderating slightly from 2.7% (y.o.y) in December 2023. On the labour market front, unemployment rate in the US was reported at 3.7% in January 2024, the same level for three consecutive months after adding 353,000 jobs in the first month of 2024. In addition, real average hourly earnings rose by 1.4% (y.o.y) between January 2023 and January 2024. While inflation is gradually declining, there is hope for a soft landing for the economy due

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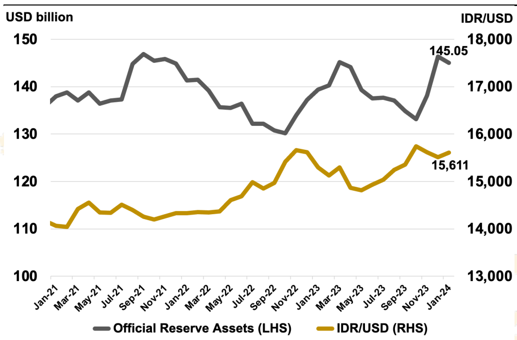
to the persistently robust labor market that has kept it afloat. During his press conference, the Fed chair, Jerome Powell, indicated that rate cut in March is unlikely unless sustainable path towards 2% inflation target is guaranteed. Other major central banks, such as European Central Bank (ECB) and Bank of England also decided to keep their policy rates at 4.5% and 5.25%, respectively. Flaring up inflation in both regions in recent months was the main cause for pending rate cuts.

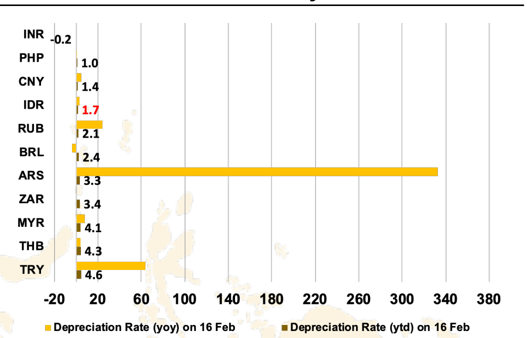
While election uncertainty clouds Indonesian markets and the Fed kept the interest rate unchanged and signaled no rush to cut interest rate, Indonesia still recorded capital inflows. Mild capital inflows to Indonesian market was recorded at USD540 million between mid-January 2024 and mid-February 2024, supported by inflows to stocks at USD770 million while outflows of bonds were recorded at USD230 million. With most quick counts projected one-round of presidential election, uncertainty is now reduced and triggered capital inflows to equity. Furthermore, mild capital outflow from domestic bond market has driven up yield of 10-year Indonesian government bond increased from 6.66% mid-January 2024 to 6.70% mid-February 2024. The slight outflow in 10-year Indonesian government bonds might be caused by shift of consensus in Fed cut rate expectation. On the other hand, sliding yield is seen 1-year Indonesian government bond from 6.30% to 6.21% during the same period as BI has been accumulating Indonesian government bond ownership, resulting in widening yield differential between short- and long-term government bonds.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (16 February 2024)



Source: Investing.com

In line with historical trend that Rupiah tends to weaken ahead of election coupled with a decrease probability of the Fed's interest rate cut in the coming months, Rupiah depreciated by 1.69% (y.t.d) to IDR15,655 per USD on 16 February 2024. As most peers' currencies depreciated against USD in mid-February 2024, Rupiah indicated mediocre performance, worse than Indian Rupee, the Philippines Peso, and Chinese Yuan. Indonesia's official reserve assets shrink by 0.87% (m.t.m) from USD146.38 billion at the end of 2023 to USD145.05 billion in January 2024. Decline

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in official reserve assets was driven by the GoI's external debt repayments. The current position of reserve assets is equivalent to finance 6.6 months of imports or 6.4 months of imports and servicing government's external debt, well above the international adequacy standards of three months imports. The latest reserve asset level is deemed adequate to provide cushion for Rupiah against any potential shock, including sudden reversal of capital inflows.

Judging from the latest dynamics, resilience of domestic economy and lower possibility of rate cuts by the Fed in the near future, we view that BI should maintain BI Rate at 6.00% during this month's BI governors' meeting. Inflation is maintained near the new target of 2.5% with the nearest inflationary pressure is from increasing spending during several long weekend holidays and rising prices ahead of Ramadan season. Although depreciating slightly during the last month, Rupiah now hovers around IDR15,650 per USD after the election. On the external front, the Fed decided to keep its policy rate unchanged and indicated lower probability of rate cuts in the near future. Although there is no pressure from inflation, maintaining adequate yield differential between Indonesian Government Bonds and US Treasury Bonds is crucial to prevent capital outflows and keep Rupiah manageable. Holding BI rate might be the wisest stance in the upcoming Board of Governors' meeting.