Macroeconomic Analysis Series

BI Board of Governor Meeting

March 2024

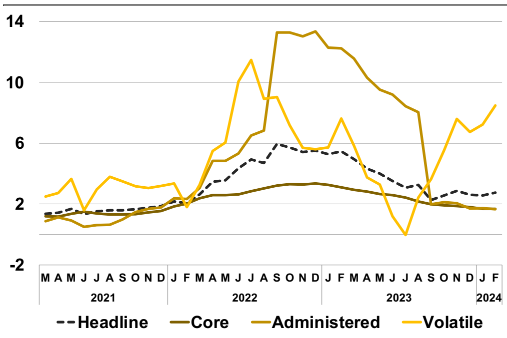
LPEM FEB UI
Institute for Economic and Social Research

Headline inflation spiked up to 2.75% (y.o.y) in February 2024 as the pressure from food prices were mounting due to the combination of supply-side and demand-side pressure. Increasing intensity of El-Nino disrupt the supply adequacy of food commodities while Ramadhan period drove up demand for food commodities. Furthermore, the surprising rise of the US inflation triggered a sentiment that the Fed might have to wait longer than previously expected to cut down policy rate from its current 23-year high. This has partially caused capital outflow from Indonesian bond market. Despite the mounting pressure on Rupiah, Rupiah has been rather stable in the past few weeks. Thus, we view that BI should hold its policy rate at 6.00%.

Food Price Management Become of Utmost Importance

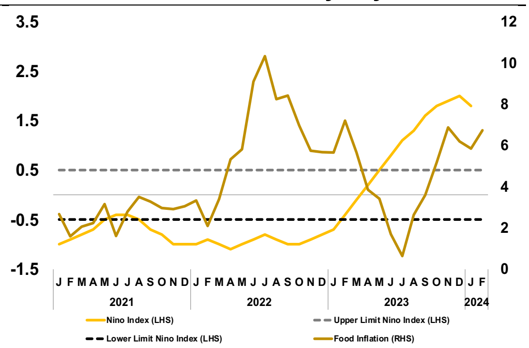
Headline inflation spiked up to 2.75% (y.o.y) in the second month of 2024, rose considerably from 2.57% (y.o.y) in January 2024. The dynamic of food prices has been the main driver of overall inflation rate in the past five months, following the widespread crop failures due to intensifying impact of natural phenomenon, namely El-Nino. As food component is the biggest contributor to headline inflation, managing its prices has been the main concerns in inflation management lately. Since last September, Nino Index has reached the point beyond 0.5 (indicating the occurrence of El-Nino) and currently stood at 1.80. The occurrence of El-Nino has disrupted the supply adequacy of rice supply as it delayed harvest period. Additionally, demand for food commodities, including rice, increases as Indonesia enters the Ramadan period. The combination of supply shortage and rising demand of food commodities drove up food inflation in Indonesia to 6.73% (y.o.y) in February 2024 from 5.84% (y.o.y) in the previous month.

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



Source: CEIC

Figure 2: El-Nino Index and Food Inflation (%, y.o.y)



Source: CEIC

Highlights

- BI should maintain BI Rate at 6.00% this month.
- Headline inflation increased to 2.75% (y.o.y), mostly influenced by the rising food prices due to the combination of supply and demand price pressure.
- The surprising rise of US inflation triggered a sentiment that the Fed might have to wait longer than previously expected to cut down policy rate.

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Key Figures

BI-Rate (February '24)
6.00%
GDP Growth (y.o.y, Q4 '23)
5.04%
Inflation (y.o.y, February '24)
2.75%
Core Inflation (y.o.y, February '24)
1.68%
Inflation (m.t.m, February '24)
0.37%
Core Inflation (m.t.m, February '24)
0.14%
FX Reserve (February '24)
USD144.04 billion

Analysing by its component, the effect of rising food prices was most apparent in the volatile food prices. In February 2024, volatile food inflation was recorded at 8.47% (y.o.y), substantially hiked from 7.22% (y.o.y) in the previous month and reached its highest level since October 2022. Similarly, monthly volatile food inflation jumped from 0.01% (m.t.m) in January 2024 to 1.53% (y.o.y) in the following month. The escalating volatile food inflation was contributed by several main commodities. In February 2024, rice price rose by 17.53% (y.o.y), garlic price inched up by 33.40% (y.o.y), and red chili pepper price increased by 47.37% (y.o.y), among other commodities.

Furthermore, core inflation was stable at 1.68% (y.o.y) in February 2024, relatively unchanged from January 2024. Core inflation has reached its lowest annual growth since January 2022, suggesting a prolonged trend of moderating household purchasing power. Meanwhile, its monthly rate also suggested a moderating trend as core inflation decreased from 0.20% (m.t.m) in January 2024 to 0.14% (m.t.m) in February 2024. Regardless, the downward pressure on purchasing power has somewhat been partly cushioned by subsidies and social assistance disbursement from GoI and political parties before the national election. On the other hand, administered price increased on a monthly basis to 0.15% (m.t.m) in February 2024 from -0.48% (m.t.m) in the previous month. This is mainly driven by machine-rolled clove cigarettes component, following the gradual price pass-through by the producers as an adjustment for higher cigarettes excise implementation few months ago. However, as there is no substantial administered price adjustment in the last month, annual administered prices slightly decreased to 1.67% (y.o.y) in February 2024 from 1.74% (y.o.y) in the previous month.

Lately, the skyrocketing food prices has become a national issue besides mounting demand for food commodities following the Ramadan season. In addition, rising food prices has been eroding purchasing power and managing food prices became the most urgent agenda within inflation issue. While the short-term solution in the form of raising imports to narrow the supply shortage and active inflation management through National Movement for Food Inflation Control (*Gerakan Nasional Pengendalian Inflasi Pangan*/GNPIP) in various regions has been incorporated, a longer-term and more sustainable strategy is needed. On the other hand, on a bright side, El-Nino is expected to moderate soon and main harvest season is expected to occur at the end of April until May this year, possibly narrow the gap of supply shortage. Regardless, the rising threat of climate change might increase the occurrence of natural disruption, such as El-Nino, in the future and necessitates a more concrete policy actions to ensure food security, which is crucial in overall effort of inflation management in the future.

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Another Potential Delay of the Fed Rate Cut

Indonesia recorded a trade surplus of 'only' USD0.87 billion in February 2024. This is the lowest level of trade balance in the last nine months and prolonged a downward trend of trade surplus for the consecutive third month. Narrowing trade balance is mostly driven by the decline in exports figure. Indonesia's exports shrunk by 9.45% (y.o.y) in February 2024, deeper than the decline in January 2024 of 8.06% (y.o.y). On a monthly basis, exports also fell by 5.79% (m.t.m) in the second month of 2024, although moderated from a decline of 8.48% (m.t.m) in the previous month. The main contributors of the decline came from iron and steel exports. Contributing to 9.27% of Indonesia's total exports, iron and steel exports decreased by 22.14% (y.o.y) on annual basis and 27.08% (m.t.m) on a monthly basis. The drop in iron and steel exports might be driven by weakening economic activities of Indonesia's main trading partner, such as China. Similarly, with the export share of 6.63%, exports of CPO products dropped by 39.58% (y.o.y) on annual basis and 30.39% (m.t.m) on a monthly basis. The decline in CPO export might be caused by the lower demand from China and India as those countries are currently possessing relatively high stocks of CPO products. Based on trading partners, slowdown in Indonesia's export performance was driven by lower demand from China and ASEAN, which contributes to around 40% of Indonesia's export demand. In February 2024, Indonesia's exports to China dropped by 19.26% (y.o.y) and 10.75% (m.t.m) while export to ASEAN countries declined by 20.84% (y.o.y) and 5.06% (m.t.m). However, the lower exports value in February 2024 was cushioned by rising export to the US (contributing to 11.01% of Indonesia export) by 10.02% (y.o.y) and 5.68% (m.t.m).

From imports perspective, despite being rather stable on a monthly basis, it increased considerably on annual basis by 15.84% (y.o.y) ahead of the Ramadan period. The highest imports growth came from consumption goods rising by 36.49% (y.o.y) in February 2024. This is driven by substantial rise of rice and wheat imports (164.1%, y.o.y) following the GoI's effort to maintain domestic supply and stabilize price. Similarly, importsof raw materials increased by 12.82% (y.o.y) and capital goods by 18.52% (y.o.y). The increase of all importscomponents suggested an increase of production activity to accommodate the rising consumer's demand in Ramadan period.

The latest US inflation data unexpectedly rose to 3.2% (y.o.y) in February 2024, proving a more stubborn challenge faced by the Fed in the "last mile" of its year-long fight to bring down inflation. In addition, unemployment rate also increased to 3.9% in February 2024 from 3.7% in the previous month. The surprising rise of inflation triggered a sentiment that the Fed might have to wait longer than previously expected to cut down policy rate from its current 23-year high. Before the release of latest inflation data, the indication was leaning towards the Fed to cut its interest rate in June 2024. However, rising inflation might suggest that the best time to cut

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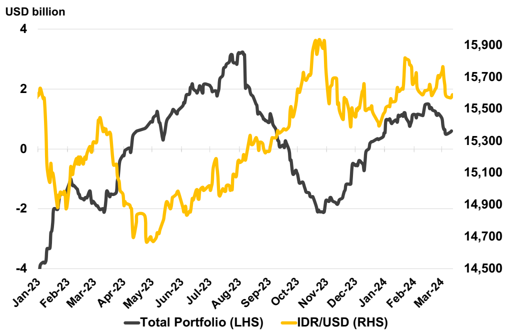
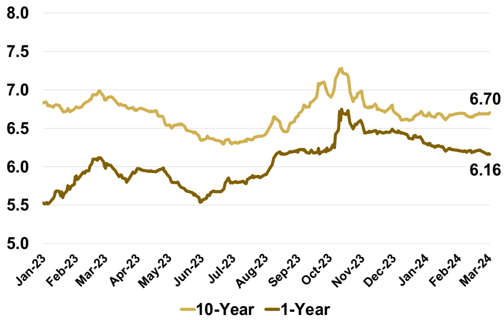
rate is to be postponed until September this year. This might complicate matters as Biden administration is keen for borrowing costs to fall to pre-pandemic levels sooner rather than later, especially ahead of the US election period.

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



Source: CEIC

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



Source: CEIC

The shifting sentiment towards rate cuts delay by the Fed has spurred capital flows outside emerging economies, including Indonesia. Since mid-February, Indonesia experienced an outflow of USD1.39 billion in bond market. However, an ever-decreasing share of foreign ownership, BI's active intervention, and solid domestic demand for Indonesian government bonds has somewhat cushioned the impact of net foreign sell in bonds market towards its yield. Currently, foreign ownership of Indonesian outstanding government bonds is only 14.4%, substantially lower compared to its level in 2019 that almost reached 40%. Between the period of second week of February to second week of March 2024, 10-year Indonesian government bond yield is relatively unchanged at 6.70%, while 1-year yield even decreased from 6.21% to 6.16%. On the other hand, there was a recorded capital inflow of around USD0.50 billion towards domestic equity market during the same period. As investors maintain a positive growth projection towards Indonesia and reduced uncertainty after projected Presidential election quick-count results, capital inflow towards equity has reduced the overall net capital outflow. Cumulatively, Indonesia 'only' experienced capital outflow of USD0.89 billion during Mid-February to Mid-March 2024.

Indonesia's foreign reserves mildly decreased to USD144.04 billion in February 2024, from USD145.05 billion in the previous month. The decline of foreign reserves is influenced by BI's active intervention to maintain Rupiah stability and payment of GoI's foreign debt, among others. Despite active intervention by BI, the pressure on Rupiah is rather considerable in the past few weeks as global financial uncertainty looms following the timing of first rate cut by major central banks, especially the Fed. Until March 17th, Rupiah has depreciated by 1.6% (y.t.d), performing worse than some of its peers', including Indian Rupee, Philippines Peso, and Chinese Yuan. Nevertheless, current level of foreign reserves remains ample and provide adequate

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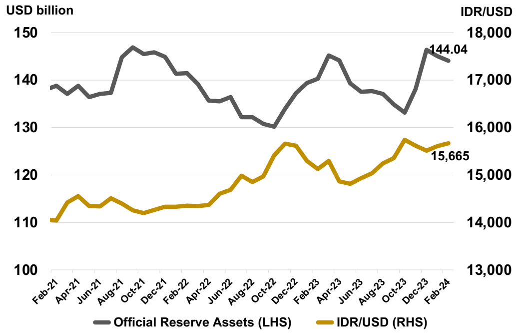
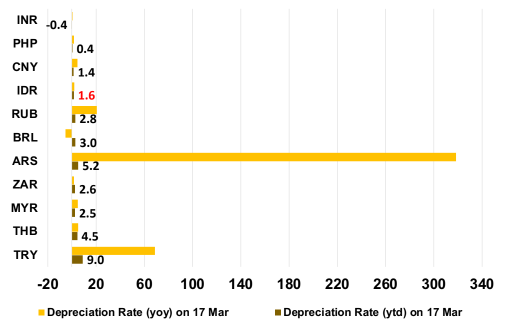
absorbing capacity for any potential market and currency shock. Currently, the foreign reserves level is equivalent to 6.5 months of imports or 6.3 months of imports and servicing government's external debt, which is well above the international adequacy standard of around three months of imports.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (17 March 2024)



Source: Investing.com

All in all, the current stance of policy rate trajectory in emerging markets are rather dictated by the Fed movement. In order not to risk a massive round of capital outflow, central banks of emerging economies might not cut its rate before the Fed cut theirs. Indonesia is no exception. On the other hand, Rupiah is rather stable in the past few weeks after depreciated slightly and domestic inflation is well within BI's target range. The current state of inflation and exchange rate pose no urgency for BI to change its policy rate anytime soon. Thus, we are in view that BI should hold its policy rate at 6.00% in March Board of Governors' meeting.