Macroeconomic Analysis Series

# BI Board of Governor Meeting

## April 2024

LPEM FEB UI
Institute for Economic and Social Research

### Highlights

- BI should maintain BI Rate at 6.00% this month.
- Headline inflation increased to 3.05% (y.o.y), driven increasing food prices by El-Nino and increased demand for food commodities during Ramadan.
- Indonesia has been facing an enormous currency pressure and surge in capital outflow in the past two weeks, triggered by Middle East geopolitical tension and the *'high-for-longer'* sentiment by the Fed.


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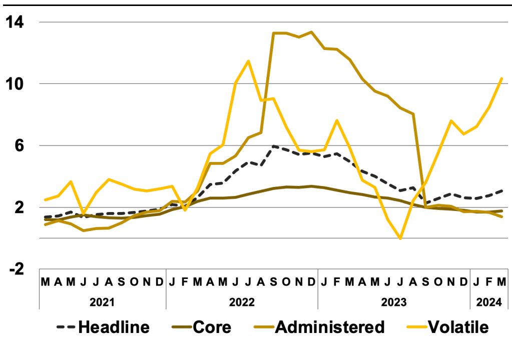
Headline inflation accelerated to 3.05% (y.o.y) in March 2024. For the past six months, rising food prices have been the primary driver of annual inflation, influenced by a delayed harvest season, which has shifted to late March 2024 to April 2024. This month, increasing food prices were further exacerbated by increased demand for food commodities during Ramadan. Rupiah has been facing an enormous currency pressure and surge in capital outflow in the past two weeks, triggered by Middle East geopolitical tension and the 'high-for-longer' sentiment by the Fed. However, increasing policy rate might be costly to the real sector and BI has several policy options that can be utilized further supported by ample amount of reserves. Thus, we are in the view that BI should hold its policy rate at 6.00% for now.

### Inflation Reached The Fastest Pace in Seven Months During Ramadan

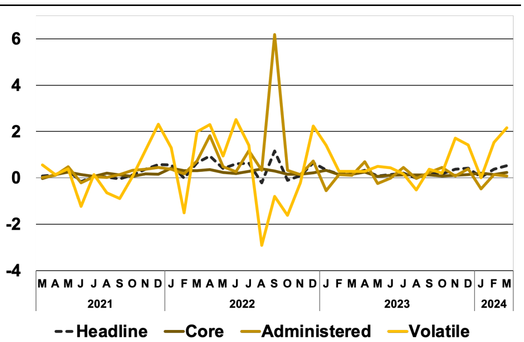
Headline inflation accelerated to 3.05% (y.o.y) in March 2024, up from 2.75% (y.o.y) a month earlier, continuing the upward trend since January 2024. Although the latest inflation figure is the highest in seven months, it remains within BI's target range of 2.5% to 3.5%. For the past six months, rising food prices have been the primary driver of annual inflation, influenced by a delayed harvest season, which has shifted to late March 2024 to April 2024. This month, increasing food prices were further exacerbated by increased demand for food commodities during Ramadan. Food price increases is reflected in the inflation rate for the food, beverage, and tobacco expenditure group, which rose 7.43% (y.o.y) in March 2024, up from 6.36% (y.o.y) in February 2024, contributing 2.09% to March's annual inflation.

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




Source: CEIC

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




Source: CEIC

By component, it is not surprising that the primary driver of inflation in March 2024 is the volatile price component, which registered an inflation rate of 10.33% (y.o.y) in March 2024, up from 8.47% (y.o.y) the previous month, contributing 1.64 percentage

## Key Figures

BI-Rate (March '24)
**6.00%**
GDP Growth (y.o.y, Q4 '23)
**5.04%**
Inflation (y.o.y, March '24)
**3.05%**
Core Inflation (y.o.y, March '24)
**1.77%**
Inflation (m.t.m, March '24)
**0.52%**
Core Inflation (m.t.m, March '24)
**0.23%**
FX Reserve (March '24)
**USD140.4 billion**

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points to this month's headline inflation. The rising prices of purebred chicken eggs, purebred chicken meat, and rice led to the increase in the volatile price component's inflation rate. Core inflation in March 2024 was recorded at 1.77% (y.o.y), an increase from 1.68% (y.o.y) in February 2024. This marks the first increase in core inflation after a declining trend that began in December 2022. The rise in core inflation is attributed to increased demand during the Ramadan festivities. Administered prices recorded an inflation rate of 1.39% (y.o.y) in March 2024, down from 1.67% (y.o.y) a month earlier. This decrease in administered price inflation was due to lower airfares throughout March 2024. While airfares typically increase during the Ramadan season, this year was an exception, with airfare prices decreasing as many airlines chose not to raise their prices and instead increased the number of flight routes. During March 2024, the number of passengers traveling by plane was limited. Additionally, the GoI decided to reduce airfare prices by up to 20% in three Super Priority Tourism Destinations (*Destinasi Pariwisata Super Prioritas* (DPSP)).

On a monthly basis, headline inflation reached 0.52% (m.t.m) in March 2024, higher than the 0.37% (m.t.m) recorded in February 2024. This increase in monthly headline inflation was driven by all components. Core inflation accelerated to 0.23% (m.t.m) in March 2024, up from 0.14% (m.t.m) the previous month. The rise in core inflation was attributed to increasing prices for gold jewellery, cooking oil, and rice with side dishes. Additionally, the seasonal effects of the Ramadan season and the upcoming Eid Al-Fitr festival led to heightened demand. The volatile price component inflated by 2.16% (m.t.m) in March 2024, up from 1.53% (m.t.m) in February 2024. Although the prices of purebred chicken eggs, purebred chicken meat, and rice rose, a decrease in the prices of chili and tomato helped prevent the volatile price component from inflating further. Administered prices recorded an inflation rate of 0.08% (m.t.m) in March 2024, lower than the 0.15% (m.t.m) rate in February 2024. As mentioned earlier, the reduction in airfares caused a decrease in administered prices. However, an increase in the price of machine-made kretek cigarettes prevented a further decline in administered prices. Although the harvest season occurred in April 2024, headline inflation is expected to remain above 3% (y.o.y) due to the extended Eid Al-Fitr holiday, which led to increased mobility and spending. The distribution of the religious holiday allowance (Tunjangan Hari Raya, or THR) for Eid Al-Fitr, along with the 13th salary for civil servants, has boosted the public's purchasing power and stimulated spending. The heightened demand for transportation due to homecoming activities (or *mudik*) to celebrate Eid Al-Fitr, is also expected to contribute to rising inflation. Externally, the Government of Indonesia (GoI) should anticipate a potential increase in oil prices due to the escalating conflict between Iran and Israel, which might impact prices of other commodities. Additionally, a weakening Rupiah is likely to exert upward price pressure through imported inflation.

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FX Reserve (March '24)
**USD140.4 billion**



## Massive Pressure on Rupiah triggered by Global Events

Indonesia's trade balance recorded a widening surplus of USD4.47 billion in March 2024, a significant increase, more than four times the February 2024 surplus of USD 0.87 billion. This is the first increase in the surplus since January 2024. The widening surplus was driven by a larger drop in imports, which fell by 12.76% (y.o.y) in March 2024, compared to a 4.19% (y.o.y) contraction in exports during the same period.

Focusing on exports, the contraction showed signs of improvement, with a smaller drop of 4.19% (y.o.y) in March 2024, compared to a 9.45% (y.o.y) drop in February 2024. The decrease in exports was due to a decline in both oil and gas and non-oil and gas exports, which fell by 3.95% and 4.21% (y.o.y), respectively. Breaking down non-oil and gas commodities, the ten that contributed to more than 60% of non-oil and gas exports saw a decline of 7.81% (y.o.y) in March 2024, with the steepest drop in mineral fuels at 26.63% (y.o.y), followed by chemical products, which fell by 19.20% (y.o.y). Weakening demand from China and ASEAN, two major Indonesian trading partners, contributed to the drop in exports, with each contracting by 16.27% (y.o.y) and 7.43% (y.o.y), respectively, in March 2024. On a monthly basis, exports grew by 16.40% (m.t.m) in March 2024 compared to 0.89% (m.t.m) growth in the previous month. The monthly growth in exports was driven by increases in both oil and gas and non-oil and gas exports, by 5.62% (m.t.m) and 17.12% (m.t.m), respectively. By commodity, the monthly growth in exports was driven by all major commodities, with the highest growth in precious metal, which saw a 206.58% (m.t.m) increase in March 2024. This growth is attributed to climbing gold prices due to expectations of a Fed rate cut delay.

On the imports front, in March 2024, it decreases by the 12.76% (y.o.y) after an increase of 18.76% (y.o.y) in February 2024. The decline in imports was caused by a drop in non-oil and gas imports, which fell by 16.72% (y.o.y), while oil and gas imports increased by 10.34% (y.o.y) in March 2024. The decrease in imports was driven by a decline in raw materials and capital goods, which fell by 12.63% (y.o.y) and 21.72% (y.o.y), respectively. This can be explained by weakening industrial demand in trading partner countries, including China. Moreover, sluggish domestic manufacturing activity, demonstrated by a 33.93% (y.o.y) decrease in motor vehicle production in March 2024, also contributed to the decline in imports of raw materials and capital goods. On the other hand, imports of consumption goods increased by 4.97% (y.o.y) in March 2024, driven by a significant increase in cereal imports (including rice, wheat, and corn) by 144.02% (y.o.y) due to rising demand during Ramadan. On a monthly basis, imports fell by 2.60% (m.t.m) in March 2024, a sharper drop compared to the 0.89% (m.t.m) decrease in February 2024. The monthly decline in major non-oil and gas imports was attributable to lower imports in machinery and mechanical appliances (17.18% (m.t.m)), plastics and articles thereof (27.75% (m.t.m)), vehicles (19.71% (m.t.m)), organic chemicals (5.59% (m.t.m)),

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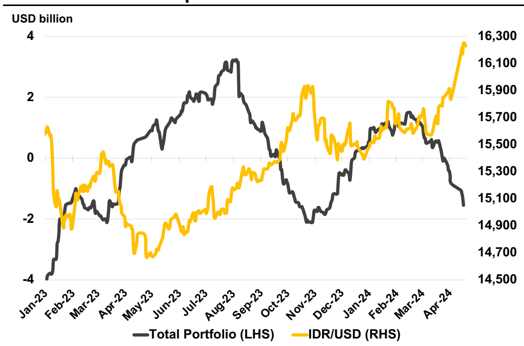
residues and waste from the food industries (2.64% (m.t.m)), and mineral fuels (16.7% (m.t.m)).

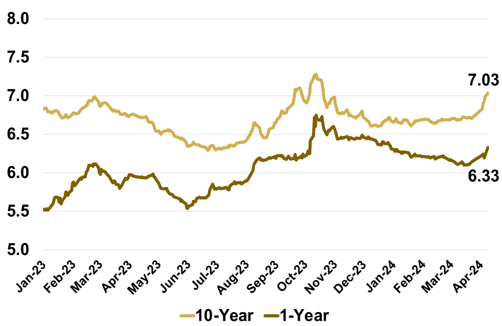
In the last two weeks, global economic situation has been quite eventful. Released on April 10th, the US inflation surprisingly rose to 3.5% (y.o.y) in March 2024 from 3.2% (y.o.y) in the previous month, boosted by gas, rents, auto insurance and other items. Higher-than-expected figures for US consumer price index inflation led markets to row back expectations that the Fed would cut rates as soon as June. Investors now forecast the first move will come by September, with a growing minority betting that there will be one or fewer cuts this year. The release of US inflation data created a turmoil in the financial market and triggered series of flight-to-safety capital movement away from Emerging Markets. Only a few days later, global economy was hit by another major event. On April 13th, Iran launched hundreds of drones and missiles towards Israel as a response of Israel attacking the Iranian Consulate in Damascus on April 1st. This escalation of geopolitical tension has caused another shockwave on global financial market and amplify the capital movement towards safe haven assets.

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




Source: CEIC

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

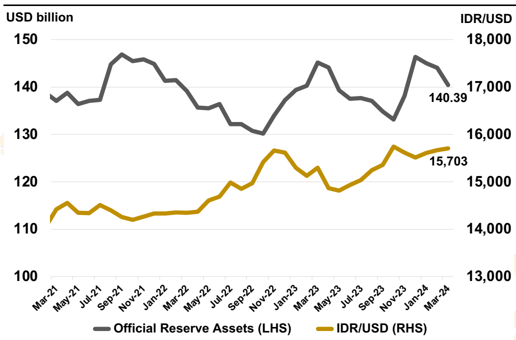



Source: CEIC

Even before the release of lates US inflation data and heightening Iran-Israel conflict, Indonesia financial market already experienced a massive pressure. There a was considerable capital outflow from Indonesia in the period of late March until early April, driven by market sentiment that US might hold its rate high-for-longer and investors decided to move its capital before the period of Indonesia's market closing due to long holiday of Eid Al-Fitr. When Indonesia's financial market reopened on April 16th, Rupiah was already at above IDR16,000/USD and immediately hit by another round of capital outflow. During the first week after Eid-Al Fitr long-holiday, capital outflow from Indonesia was amounted to around USD0.49 billion. Moreover, in the past month the accumulated capital outflow recorded at USD2.11 billion (March 18th to April 18th), making it the highest monthly capital outflow from Indonesia since last September. Consequently, 10-year Indonesian government bond yield spiked to 7.03% from 6.67% a month earlier, reaching its highest level in more than five months. Similarly, 1-year government bond yield also increased to 6.33% from 6.19% during the same period. As a response, BI has intensified its 'triple intervention' strategy through active purchase in currency spot market, domestic non-delivery forward (DNDF), and government bonds purchase. Interventions taken by BI in the past week has been able to stabilize Rupiah. However, due to immense external pressure, these interventions have only managed to stabilize Rupiah at the level of around IDR16,200/USD. Rupiah has now depreciated around 2.98% (m.t.m) or 5.5% (y.t.d) against USD, making it one of the worst performers compared to its peers and only performed better relative to Brazilian Lira in the past month.

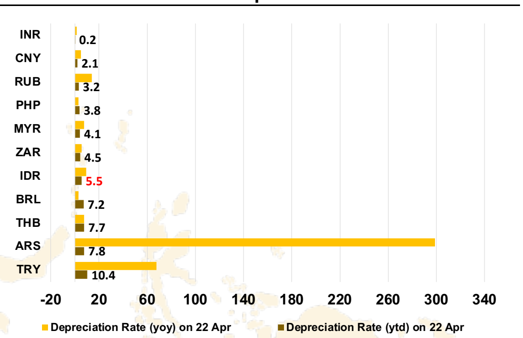
The latest figure for foreign exchange reserves is only available until March 2024; thus, not capturing the most recent development of global financial market. Regardless, foreign exchange reserves have been depleted by about USD3.6 billion, from USD144.0 billion in February to USD140.4 billion in March 2024, influenced by government's external debt payments, anticipation of corporate liquidity needs, and the need for Rupiah stabilization amid persistently high global financial market uncertainty. Nonetheless, Indonesia's foreign exchange reserves remain adequate. The current amount of foreign reserve assets is equivalent to 6.4 months of imports or 6.2 months of imports and government external debt payments, well above the international adequacy standard of 3 months of imports. This should provide BI with more room to stabilize Rupiah, especially during the current massive pressure on domestic currency.

**Figure 5: IDR/USD and Official Reserve Assets**




Source: CEIC

**Figure 6: Depreciation Rates of Selected EMs (22 April 2024)**




Source: Investing.com

Indonesia has been facing an enormous currency pressure and surge in capital outflow in the past two weeks. While there is a room to increase policy rate, higher policy rate might not be the most ideal measure to be taken now. In the past few days, Rupiah has been rather stable in its 'new normal' level of around 16,200 per USD as the sentiment of "high-for-longer" by the Fed has been materialized and the Middle-East geopolitical tension might not be escalated further. Furthermore, BI has several policy options that can be utilized further supported by ample amount of

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reserves. On the other hand, rising policy rate comes with the cost of heightened borrowing cost and negatively affect real sector. Thus, increasing BI rate should be considered as the last-resort policy option considering its potential domestic risks. Considering these factors, we are in the view that BI should hold its policy rate at 6.00% for now.

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