LPEM FEB UI
Institute for Economic and Social Research

Macroeconomic Analysis Series

BI Board of Governor Meeting

June 2024

Highlights

- BI should maintain BI Rate at 6.25% this month.
- Headline inflation slowed to 2.84% (y.o.y) in May 2024 from 3.00% (y.o.y) in April 2024, driven by reduced post-holiday consumer demand and stable food prices from the harvest season.
- The Fed's decision triggered capital outflows and contributed to a 2.79% (m.t.m) Rupiah depreciation between mid-May and mid-June.
- Indonesia's foreign exchange reserves rose by USD2.8 billion, providing a buffer against currency pressure.

Macroeconomics, Finance & Political Economy Research Group

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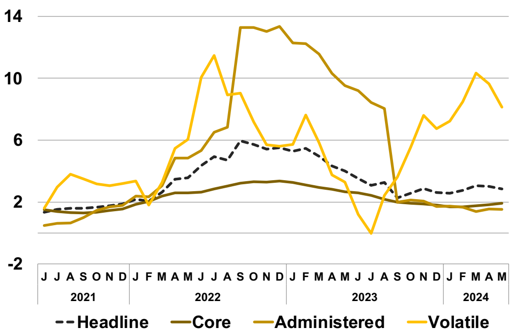
Following the Eid al-Fitr celebrations, headline inflation in Indonesia decreased to 2.84% (y.o.y) in May 2024, down from 3.00% (y.o.y) in April 2024, remaining within Bank Indonesia's target range due to reduced post-Eid consumer demand and stable food prices from the ongoing harvest season. Meanwhile, Rupiah depreciated by 2.79% (m.t.m) between mid-May and mid-June, reaching its lowest level since April 2020, primarily due to the strengthening US dollar. Despite this, the rising foreign exchange reserves in May 2024 provides a buffer against currency pressures. BI's triple intervention strategy is expected to help managed Rupiah's volatility. We view that BI should hold its policy rate at 6.25%

Inflation Drops Amid Post-Eid Holiday Calm

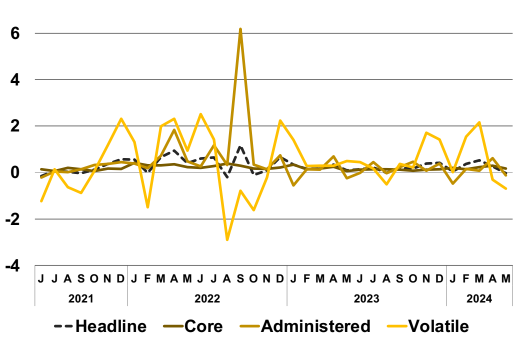
In May 2024, immediately following the Eid al-Fitr celebrations, headline inflation in Indonesia decreased to 2.84% (y.o.y), marking a reduction from the previous month's rate of 3.00% (y.o.y) and reaching the lowest level since March 2024. This current inflation rate remains comfortably within BI's target range of 1.5% to 3.5%. The decline in inflation is largely attributed to reduced consumer demand post-Eid al-Fitr, as evidenced by a drop in the inflation rate for the food, beverage, and tobacco expenditure group, which fell to 6.18% (y.o.y) in May 2024 from 7.04% (y.o.y) in April 2024.

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



Source: CEIC

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



Source: CEIC

On a month-to-month basis, headline inflation recorded a slight deflation of 0.03% (m.t.m) in May 2024, a shift from the inflation of 0.25% (m.t.m) in April 2024. This deflation was primarily driven by reduced demand following the Eid holiday season. This is highlighted by the food, beverage, and tobacco group experiencing a deflation of 0.29% (m.t.m) in May 2024, compared to a deflation of 0.03% (m.t.m) in April 2024, and the transportation group registering a deflation of 0.36% (m.t.m) in

May 2024, a significant turnaround from the inflation of 0.93% (m.t.m) in April 2024. Other expenditure groups, such as clothing and footwear along with information, communication, and financial services, also contributed to the overall monthly deflation observed in May 2024. Moreover, the harvest season continued into May 2024, which is evidenced by a decrease in the average retail price of rice in traditional markets by 1.84% (m.t.m) during the month. This drop in staple food prices also played a role in tempering inflationary pressures.

The dominant factor driving inflation in May 2024 was still the volatile price component, which recorded an annual inflation rate of 8.14% (y.o.y), though it was lower than the previous month's 9.63% (y.o.y). This component also experienced a deeper month-to-month (m.t.m) deflation of 0.69% in May 2024, compared to a deflation of 0.31% (m.t.m) in April 2024. The decline was influenced by decreases in the prices of rice, purebred chicken meat, and bird's eye chili, which all contributed to the monthly deflation and the reduced annual inflation rate in this volatile price component. Meanwhile, the administered price component posted a year-over-year inflation of 1.52% (y.o.y) for May 2024, a slight decrease from April 2024 figure at 1.54% (y.o.y). On a monthly basis, this component showed a deflation of 0.13% (m.t.m), a reversal from the inflation of 0.62% (m.t.m) seen in April. The decrease in administered price inflation was primarily due to price normalization in airfare, train tickets, and intercity transportation fares. However, an increase in the price of machine-made kretek cigarettes offset these reductions, limiting the fall in administered price inflation.

Core inflation in May 2024 was reported at 1.93% (y.o.y), marking an increase from the April 2024 figure of 1.82% (y.o.y) and continuing an upward trend that began in January 2024. The rise in annual core inflation this month can be attributed primarily to increased prices for housing contracts or rents and a notable rally in gold prices. The escalation in gold prices, especially betwen March to mid-April 2024, has been largely influenced by market expectations surrounding the Federal Reserve's interest rate policies, which have boosted global demand for gold. On a month-to-month basis, core inflation registered at 0.17% (m.t.m) in May 2024, down from 0.29% (m.t.m) in April 2024. This reduction in monthly core inflation indicates a return to normal demand levels after the Eid-al-Fitr celebrations, despite upward pressures from rising costs in gold, sugar, and housing rents. Looking ahead to June 2024, inflationary pressures are expected to be influenced by imported inflation as the Rupiah continues its decline against the US dollar. This weakening trend underscores the importance of vigilant monitoring of exchange rate fluctuations and their potential impact on overall price stability. Additionally, the forecasted arrival of La Nina in July and August poses another risk, potentially disrupting the agricultural sector. The expected higher rainfall could lead to flooding, inundating agricultural

Key Figures

BI-Rate (May '24)
6.25%
GDP Growth (y.o.y, Q1 '24)
5.11%
Inflation (y.o.y, May '24)
2.84%
Core Inflation (y.o.y, May '24)
1.93%
Inflation (m.t.m, May '24)
-0,03%
Core Inflation (m.t.m, May '24)
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FX Reserve (May '24)
USD139.0 billion

lands and damaging crops, which might further complicate inflationary trends and food security issues.

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Looming Risks Despite Robust Exports and Imports Growth

Indonesia experienced atrade surplus in May 2024 of USD2.93 billion, a 7.61% (m.t.m) increase of USD0.21 billion from USD2.72 billion in April 2024. Due to the low-base effect, May's trade surplus even grew by 585.10% (y.o.y) as the trade balance in May 2023 was at its lowest in the last four years. In May 2024, both export and import values grew compared to the previous month, and the uptick of the overall trade balance was driven by an increase in export values outpacing import values.

Exports value grew by 13.82% (m.t.m) or 2.86% (y.o.y) to USD22.33 billion in May 2024, mainly contributed by the surge in manufacturing exports. Based on groups of products, the main contributors are higher exports of machinery products, ores and slag, and nickel and its articles. Specifically, exports of machinery products increased by USD0.26 billion from USD0.99 billion in April 2024 to USD1.26 billion in May 2024, an increase of 26.66% (m.t.m) or 1.72% (y.o.y). Similarly, exports of ores and slag rose by USD0.21 billion (60.09% y.o.y, 25.96% m.t.m) from USD0.82 billion to USD1.04 billion, and nickel and its articles exports increased by USD0.18 billion (22.83% y.o.y, 26.77% m.t.m) from USD0.67 billion to USD0.85 billion during the same period. This surge in manufacturing exports can be attributed to rising demand from Indonesia's trading partners. In May 2024, the manufacturing PMI for key partners like the US and China indicated expansion. Consequently, Indonesia's exports to the US increased by 24.46% (m.t.m), and exports to China rose by 10.59% (m.t.m). Exports to EU countries also saw significant growth, up 30.11% (m.t.m) from April to May 2024.

Imports rose by USD2.50 billion from USD16.89 billion in April 2024 to USD19.40 billion in May 2024, an increase of 14.82% (m.t.m), though they were down 8.83% (y.o.y). The monthly rise in import value was driven by increased demand for input materials, which grew by USD1.57 billion. Imports of capital goods increased by USD0.64 billion, and consumption goods by USD0.29 billion from April to May 2024. Based on product groups, the highest import growth was seen in machinery products, which rose by USD0.67 billion, or 30.17% (m.t.m) in May 2024. However, on an annual basis, the value of imports of capital goods and input materials declined by 7.51% (y.o.y) and 10.13% (y.o.y), respectively. The decrease might be driven by the rapid weakening of the Rupiah, which could exacerbate the current slowing industrial expansion. If left unmitigated, there is a serious risk of potential export decline and domestic production slowdown in the upcoming months. This is

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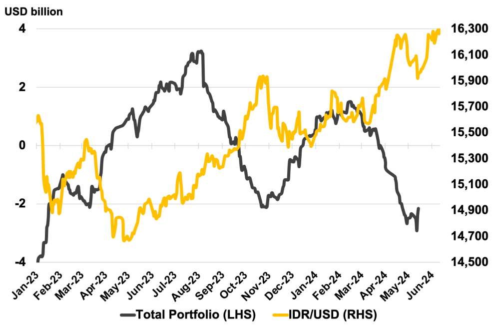
concerning as around 90% of Indonesian imports consist of capital goods and input materials, which are directly linked to domestic production activities.

Ripples from the Fed's Decision

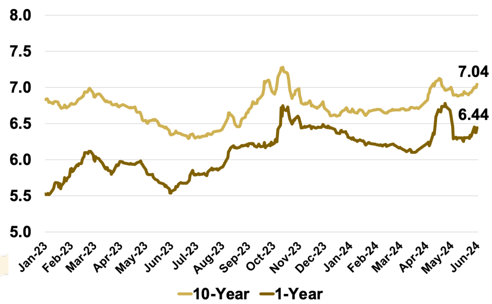
During its June meeting, the Fed opted to maintain its policy rate unchanged for the seventh consecutive time, holding steady between 5.25% and 5.75%. The Fed's stance shifted towards a more conservative outlook on rate cuts, with expectations tempered to just one potential cut before December 2024. This adjustment reflects their cautious approach in light of persistent inflation figures exceeding the 2% target. In May 2024, the US inflation moderated slightly to 3.3% (y.o.y), down from 3.4% (y.o.y) in April 2024, primarily due to a decline in gasoline prices. Although this represents a cooling trend, inflation remains notably above the Fed's target. Meanwhile, the labor market demonstrated resilience, evidenced by a robust increase of 272,000 jobs in nonfarm payroll employment, marking a notable acceleration from April's 165,000 gain. However, the unemployment rate in May 2024 saw a slight uptick to 4%, up from 2.9% in April 2024, driven by individuals re-entering the workforce without immediate job placement. Despite the positive momentum in job creation and recent inflation moderation, the Fed remains vigilant amid the uncertain economic landscape, particularly regarding potential inflationary risks.

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



Source: CEIC

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



Source: CEIC

As the Federal Reserve maintains its hawkish stance, capital has shifted away from emerging markets. Between 17 May and 14 June, the Indonesian bond and stock markets experienced net capital outflows totaling USD0.32 billion. This included a net foreign purchase of USD0.29 billion in the bond market, while the stock market saw capital outflows of US 0.61 billion during the same period. The yields on both 1-year and 10-year government bonds spiked by 0.15 percentage points, with the yield on the 1-year bond increasing from 6.29% to 6.44%, and the yield on the 10-year bond rising from 6.89% to 7.04%. This increase in bond yields between 17 May and

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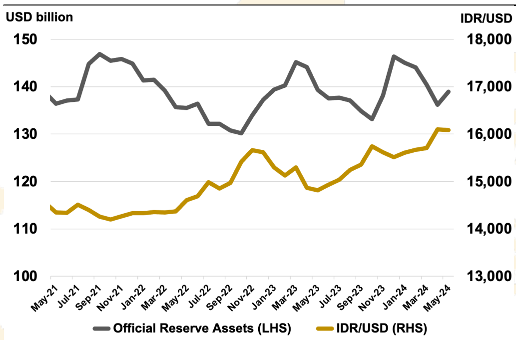
14 June can be attributed to expectations of tighter monetary policies in major economies. Despite net foreign buying in the bond market, the rise in both short-term and long-term government bond yields suggests that the influence of foreign investors on bond yields may be limited, as foreign investors account for only 14% of bond market participants. Additionally, expectations regarding the Fed's rate adjustments have contributed to foreign investors withdrawing from the Indonesian stock market, compounded by ongoing major sell-offs in the banking sector which indicate poor performance as of April 2024.

Between mid-May and mid-June, the Rupiah depreciated by 2.79% month-to-month, falling from IDR 15,950 per USD on May 17 to IDR 16,395 per USD on June 14. This rate marks the lowest level since April 2020, during the onset of the COVID-19 pandemic. The weakening of the Rupiah can primarily be attributed to the strengthening of the US dollar, which has been impacting currencies globally. This trend was not isolated to Indonesia; several other Asian currencies also showed similar patterns of depreciation. The Thai Baht, Malaysian Ringgit, and South Korean Won, for instance, all depreciated against the US dollar during the same period.

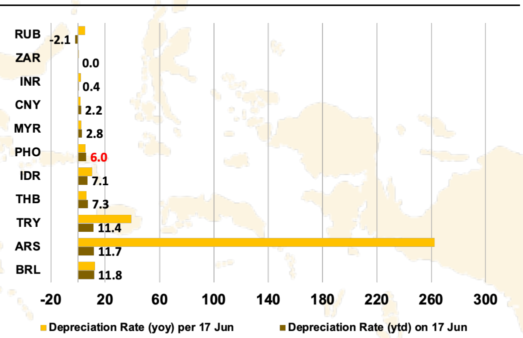
On a year-to-date basis, Rupiah has depreciated by 7.07% (y.t.d), showing moderate performance compared to its peers. Despite these challenges, Indonesia's foreign exchange reserves saw an increase of USD2.8 billion, rising from USD136.2 billion in April 2024 to USD138.97 billion in May 2024. This boost in reserves was supported by global bond issuances, inflows into the domestic bond market, and investments into SRBI Consequently, the country's reserve assets now cover 6.3 months of imports or 6.1 months of imports plus government external debt service, significantly exceeding the international standard for reserve adequacy, which is about three months of imports.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

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



Source: Investing.com

Inflation has continued to decline and remains comfortably within Bank Indonesia's target range due to reduced consumer demand post-Eid al-Fitr and stable food prices from the ongoing harvest season. Despite the Rupiah's depreciation over the past four weeks, the increasing foreign exchange reserves provide a significant buffer against this pressure. Furthermore, interest rate differential with the US is currently manageable while Bank Indonesia's triple intervention strategy further supports currency stability. Therefore, Bank Indonesia should hold its policy rate steady at 6.25% in the upcoming Board of Governors meeting.

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