

BI Board of Governor Meeting July 2024



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Highlights

- BI should maintain BI Rate at 6.25% this month.
- Headline inflation continued to slow to 2.51% (y.o.y) in June 2024 from 2.84% (y.o.y) in May 2024.
- Sentiments about dovish stance by the Fed triggered capital inflows to emerging markets and contributed to a 2.23% (m.t.m) Rupiah appreciation between mid-June and mid-July.
- Indonesia's foreign exchange reserves rose by USD1.2 billion, providing a buffer against currency pressure.

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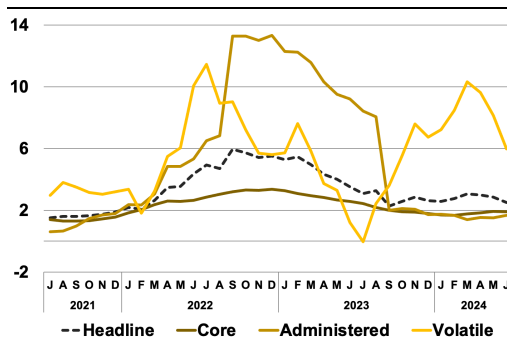
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Sitting near the middle of BI's target range, headline inflation currently stood at 2.51% (y.o.y) in June 2024, slowing from May 2024 figure at 2.84% (y.o.y). Slowing headline inflation can be attributed to easing food prices following harvest season and low demand after Eid al-Fitr celebrations ended in April 2024. As the Fed is currently engaging in a more dovish stance, capital flows have spurred into emerging markets and Rupiah has appreciated considerably over the past few weeks, currently at approximately IDR 16,110/USD, marking a 2.23% increase over the past month. Additionally, Indonesia's official reserve assets rose by about USD1.2 billion, from USD138.97 billion in May to USD140.18 billion in June 2024. Given these conditions, Bank Indonesia should maintain its policy rate at 6.25% this month.

Slowing Inflation Continues

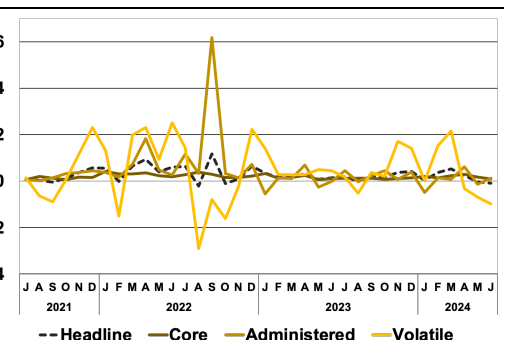
Six months into 2024, headline inflation slowed to 2.51% (y.o.y) in June 2024, down from 2.84% (y.o.y) in May 2024. This marks the lowest headline inflation level in nine months and sitting near the middle of BI's target range of 1.5% to 3.5%. The decline in headline inflation can be attributed primarily to easing food prices following the harvest season and the low-demand period after the Eid al-Fitr celebrations in April. Inflation for food, beverages, and tobacco eased to 4.95% (y.o.y) in June 2024 from 6.18% (y.o.y) in May, reaching the lowest level in eight months. Inflation also eased in other expenditure groups, such as food and beverage provision/restaurants (2.51% (y.o.y) in June 2024 vs. 2.31% (y.o.y) in May 2024) and education (1.71% (y.o.y) in June 2024 vs. 1.69% (y.o.y) in May 2024). Conversely, transportation prices accelerated in June 2024, rising to 1.61% (y.o.y) from 1.34% (y.o.y) in May. This increase was driven by higher transportation fares during the Eid al-Adha holiday and increased mobility during the long holidays in June.

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



Source: CEIC

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



Source: CEIC

Key Figures

BI-Rate (Jun '24)

6.25%

GDP Growth (y.o.y, Q1 '24)

5.11%

Inflation (y.o.y, Jun '24)

2.15%

Core Inflation (y.o.y, Jun '24)

1.90%

Inflation (m.t.m, Jun '24)

-0.08%

Core Inflation (m.t.m, Jun '24)

0.10%

FX Reserve (Jun '24)

USD140.2 billion

On a month-to-month basis, headline inflation recorded its second deflation in 2024, with a deeper deflation of 0.08% (m.t.m) in June 2024 compared to 0.03% (m.t.m) in May 2024. Similar to the annual figure, the largest contributor to June's monthly deflation was the food, beverage, and tobacco group, which indicated a deflation of 0.49% (m.t.m), contributing 0.14% to June's overall deflation.

By component, the volatile price component was the primary driver of June's inflation. This component recorded an annual inflation of 5.96% (y.o.y) in June 2024, down from 8.14% (y.o.y) in May 2024, marking the lowest level since November 2023. On a month-to-month basis, the volatile price component recorded its third deflation of the year, reaching -0.98% (m.t.m) in June 2024 from -0.69% (m.t.m) in May 2024. The decline in annual inflation and the deeper monthly deflation were driven by price decreases in shallots, tomatoes, and purebred chicken meat. These price decreases resulted from increased supply due to the harvest season and lower feed prices for chickens, which led to lower prices for purebred chicken meat. Administered price component posted an annual inflation of 1.68% (y.o.y) in June 2024, inching up from 1.52% (y.o.y) in May 2024. On a monthly basis, this component recorded an inflation of 0.12% (m.t.m) in June 2024, following a deflation of 0.13% (m.t.m) in May. The main contributors to the administered price inflation were machine-made kretek cigarettes, as producers passed higher excise duties on tobacco products to consumers, and airfares, which increased during the heightened mobility of the Eid al-Adha period.

Core inflation in June 2024 was reported at 1.90% (y.o.y), slightly down from 1.93% (y.o.y) in May 2024, marking the end of an upward trend observed since February 2024. On a monthly basis, core inflation was 0.10% (m.t.m) in June 2024, down from 0.17% (m.t.m) in May 2024. Core inflation remains manageable due to stable inflation expectations during the Eid al-Adha holiday. The primary contributors to June's core inflation were gold jewellery and ground coffee prices. Gold prices have seen notable gains this year as investors shift to safe haven assets, driven by expectations surrounding the Federal Reserve's potential rate cuts, geopolitical uncertainties, and gold purchase by most central banks. Meanwhile, ground coffee prices have increased due to a decline in coffee production, which has been adversely affected by climate change. Looking ahead, aside from the pressures of imported inflation resulting from the weakening Rupiah and the anticipated impact of the La Niña season, the most imminent inflationary pressure in July 2024 is expected to stem from seasonal increases in educational spending due to the start of new academic year.

Trade Surplus Narrows due to Decline in Exports and Imports

In June 2024, Indonesia recorded a trade surplus of USD2.39 billion, marking the 50th consecutive month of trade surplus. However, this represents an 18.30% (m.t.m)

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decrease compared to the USD2.93 billion surplus in May 2024. The decline in the trade balance is attributed to a simultaneous decrease in both exports and imports, with exports experiencing a more significant drop than imports. Exports were valued at USD20.84 billion in June 2024, representing a 6.65% (m.t.m) drop compared to the previous month and a 1.17% (y.o.y) increase from the same period last year. The decrease in exports was driven by reductions in both oil and gas and non-oil and gas exports. Oil and gas exports dropped by 13.24% (m.t.m) to USD1.23 billion, while non-oil and gas exports fell by 6.21% (m.t.m) to USD19.61 billion. The decline in oil and gas exports is attributed to lower oil lifting, which averaged 561 thousand barrels per day in the first semester of 2024, a 7.27% decrease compared to the same period last year. Among the top ten contributors to non-oil and gas exports in June 2024, eight recorded a monthly decline. Mineral fuels dropped by 1.86% (m.t.m) to USD3.24 billion, while iron and steel decreased by 4.32% (m.t.m) to USD2.70 billion. The decrease in non-oil and gas exports can be attributed to lower demand from Indonesia's main trading partners. Exports to China, ASEAN, the US, the EU, and Japan all experienced monthly declines of 1.72% (m.t.m), 4.47% (m.t.m), 9.99% (m.t.m), 24.87% (m.t.m), and 30.14% (m.t.m), respectively.

Imports stood at USD18.45 billion in June 2024, reflecting a 4.89% (m.t.m) decrease from USD19.40 billion in the previous month and a 7.58% (y.o.y) increase from a year earlier. The monthly decrease in imports was driven by reductions in input materials and capital goods imports, partly due to the depreciation of the Rupiah, which made imported goods relatively more expensive. Imports of input materials decreased by 3.41% (m.t.m) to USD12.36 billion, while imports of capital goods fell by 14.51% (m.t.m) to USD3.20 billion. Conversely, imports of consumption goods increased by 2.48% (m.t.m) in June 2024, reaching USD1.59 billion. The lower imports of input materials and capital goods is reflected in the decline of Indonesia's Purchasing Managers' Index (PMI), which fell to 50.7 in June 2024 from 52.1 in May 2024. Although still in expansionary territory, this marks the lowest index in thirteen months. The decline in the PMI was driven by slowing global demand, leading to reduced domestic production activity in Indonesia. The President of the Confederation of Indonesian Workers' Unions (KSPN) reported that in the first semester of 2024, six textile factories ceased operations, and four others reduced their workforce due to efficiency concerns.

Capital Flow Reversal into Emerging Markets

Despite no change in the Fed's policy rate since last June, sentiment towards the Fed's policy stance for the rest of 2024 has shifted substantially from last month. One of the main reasons for the change in expectation is the US inflation figure. In June 2024, US inflation was down to 3.0% (y.o.y) from 3.3% (y.o.y) a month earlier due to cheaper gasoline and moderating rents, marking its lowest level since March 2021. In addition, the monthly inflation figure also recorded a deflation of 0.1% (m.t.m),

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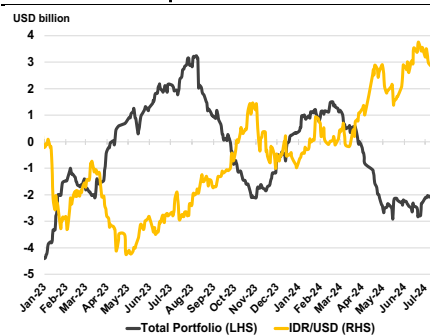
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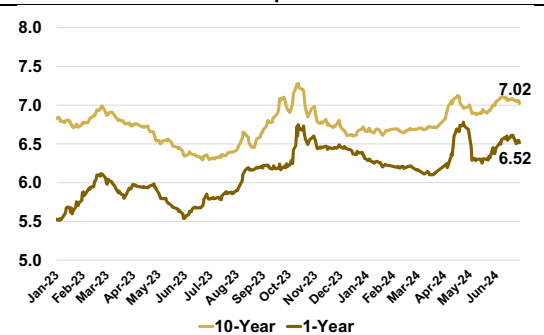
the first deflation since April 2020. The US labour market showed signs of cooling, with the unemployment rate rising in June and the pace of jobs growth in recent months shown to have been lower than previously expected. US economy added 206,000 jobs last month, exceeding 190,000 jobs the consensus had forecasted. However, increase in the unemployment rate is attributed to a rise in labor supply rather than job losses. Thus, non-farm payrolls data showed that the unemployment rate was at 4.1% in June 2024, slightly increased from 4.0% in the previous month. The release of latest US inflation and unemployment data roughly suggested a coherent narrative of the US economic pressure is cooling down. This has led to convince investors that a policy rate cut by the Fed by next September is close to certain. Furthermore, US central bankers spoke with a newfound assurance during several public appearances last week about their grip on inflation and readiness to embark on a policy pivot.

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



Source: CEIC

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



Source: Investing.com

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As the Fed are currently engaging in a more dovish stance after the inflation data release on July 11th, capital flows have spurred into emerging markets since then. Total portfolio flows into Indonesia's capital market increased by USD1.06 billion in the past three weeks, making the accumulated capital flows reached its highest level since mid-April. Out of USD1.06 billion inflows, USD0.74 billion flew into equity instruments and USD0.32 billion entered bond market. However, inflows toward bond instruments were dominated by long-term government bonds as 10-Year government bond yield decreased from 7.8% on June 19th to 7.02% on July 12th. In contrast, 1-Year government bond yield was relatively unchanged and stood at 6.52% during the same period. Less appetite of investors to invest in short-term government bonds might reflect their jitter towards Indonesia's economic situation in the short run as there has been growing uncertainty about future public spending and potential of fiscal imprudence by the next administration. Nevertheless, overall investors' increase of appetite towards Indonesia's financial market is reflected in Indonesia's 5-Year credit default swap (CDS) premium as it went down to 71.72 on July 12th from its recent peak of 78.17 at the end of last month.

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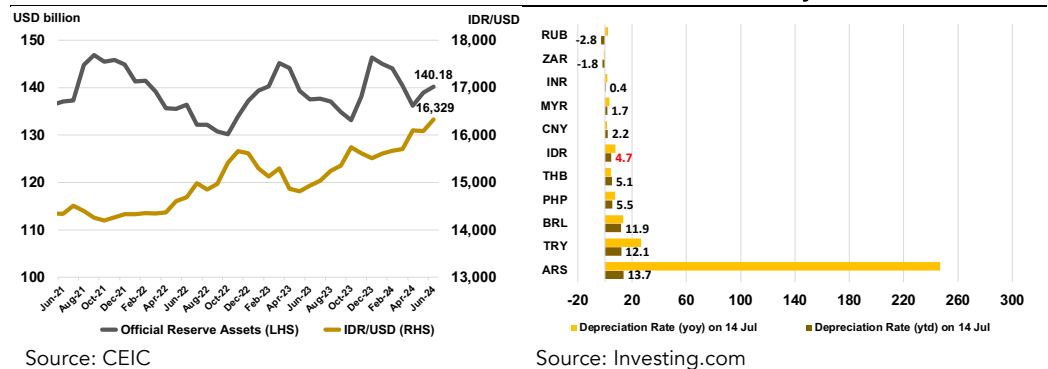
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FX Reserve (Jun '24)
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Furthermore, the surge of capital inflows has benefitted Indonesia as it eased downward pressures on Rupiah. As the US Dollar Index (DXY) dropped to a three-week low, Rupiah has appreciated rather considerably in the past few weeks. Currently stood around IDR16,110/USD, Rupiah has appreciated around 2.23% in the past month. Furthermore, on a year-to-date basis, Rupiah has depreciated by 4.65% (y.t.d) and performing better compared to its peers' currency, including Argentine Peso, Turkish Lira, Brazilian Real, Philippines Peso, and Thailand Baht. Moreover, Indonesia also experienced a positive note on its official reserve asset as it rose by around USD1.2 billion, from USD138.97 billion in May to USD140.18 in June 2024. Higher official reserve asset was attributable to tax and services receipts as well as government's foreign loan withdrawals due to Rupiah stabilization needs amidst enormous depreciation pressure during last month. As a result, Indonesia's reserve assets were equivalent to 6.3 months of import or 6.1 months of import and servicing government's external debt, well above the international reserve adequacy standard of around three months of import value.

Figure 5: IDR/USD and Official Reserve Assets **Figure 6: Depreciation Rates of Selected EMs (14 July 2024)**



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Indonesia is entering the second half of 2024 with a more benign situation on the inflation and external fronts. Regardless, recent history indicates that global financial situation is highly dependent on market perception towards the Fed's potential stance and the perception has been very capricious. On the inflation aspect, Indonesia has passed the massive price pressure stemming from various seasonal domestic events and the occurrence of El-Nino. However, several climate institutes predicts potential occurrence of La Nina phenomenon in Q3-2024 and could pose another threat on food prices due to its capacity to disrupt food production. Therefore, BI should remain vigilant formulating its policy mix to manage Rupiah and domestic price stability. For now, we view that inflation is relatively not an issue and the current rate differential remains relatively attractive to maintain capital inflows and exchange rate stability. Given these situation, BI should keep its policy rate at 6.25% this month.