Macroeconomic Analysis Series

BI Board of Governor Meeting
September 2024

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Highlights

- Bank Indonesia should keep the BI Rate at 6.25% to prevent currency volatility and manage risks from sudden capital outflows.
- Headline inflation eased to 2.12% year-over-year in August 2024 from 2.13% in July 2024, with core inflation rising to 2.02% year-over-year.
- Rupiah strengthened to IDR 15,395/USD by mid-September 2024, appreciating by 2.75% over the past month due to significant capital inflows.
- Indonesia's foreign exchange reserves increased to a record USD 150.2 billion in August 2024, the highest monthly increase since December 2023.

Macroeconomics, Finance & Political Economy Research Group

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August 2024 saw Indonesia's headline inflation ease slightly to 2.12% (y.o.y) from 2.13% in July 2024, primarily due to lower food prices. Core inflation rose to 2.02% (y.o.y), driven by higher costs for gold jewellery, coffee, and education. Rupiah strengthened to IDR 15,395/USD in mid-September, supported by robust capital inflows, and official reserves hit a record USD 150.2 billion. Although current inflation rates, the strengthening Rupiah, and expectations of the Fed rate cut in September 2024 create a favourable backdrop, Bank Indonesia should hold BI rate at 6.25% during its September meeting. This approach will help preventing potential currency volatility and managing risks associated with sudden capital outflows.

August Inflation Drops to 30-Month Low

In August 2024, headline inflation eased slightly to 2.12% (y.o.y), down from 2.13% (y.o.y) in July 2024, marking the lowest rate since February 2022 but remaining within BI's target range of 1.5% to 3.5%. This slight decline was primarily diven by supply-side factors, notably falling volatile food prices due to harvest season for horticultural crops. Inflation for the food, beverages, and tobacco group further weakened to 3.39% (y.o.y) in August 2024 from 3.66% (y.o.y) in July 2024, the lowest level since July 2023. Inflation also moderated in other expenditure groups, such as education (1.83% (y.o.y) in August 2024 vs 1.90% (y.o.y) in July 2024). The easing in these expenditure groups was partly due to the fading impact of new academic year, which began in July 2024. On a month-to-month basis, headline inflation recorded its fourth consecutive deflation in 2024, with a deflation of 0.03% (m.t.m) in August 2024 compared to 0.18% (m.t.m) in July 2024. Similar to the annual price trends, the primary driver of August's monthly deflation was the food, beverage, and tobacco group, which indicated a deflation of 0.52% (m.t.m), contributing 0.15 percentage points to the overall deflation for the month.

Based on its component, the volatile food price component was the primary driver of August's inflation figure. This component recorded an annual inflation of 3.04% (y.o.y) in August 2024, down from 3.63% (y.o.y) in July 2024, marking the lowest level since September 2023. On a month-to-month basis, the volatile price component recorded its fifth deflation of the year, reaching 1.24% (m.t.m) in August 2024 from 1.92% (m.t.m) in July 2024. The decline in annual inflation and the continuation monthly deflation were driven by price decreases in shallots, broiler chicken meat, and tomatoes. Meanwhile, the administered price component posted an annual inflation of 1.68% (y.o.y) in August 2024, slightly increased from 1.47% (y.o.y) in July

Key Figures

BI-Rate (Aug '24)
6.25%
GDP Growth (y.o.y, Q2 '24)
5.05%
Inflation (y.o.y, Aug '24)
2.12%
Core Inflation (y.o.y, Aug '24)
2.02%
Inflation (m.t.m, Aug '24)
-0.03%
Core Inflation (m.t.m, Aug '24)
0.20%
FX Reserve (Aug '24)
USD150.2 billion

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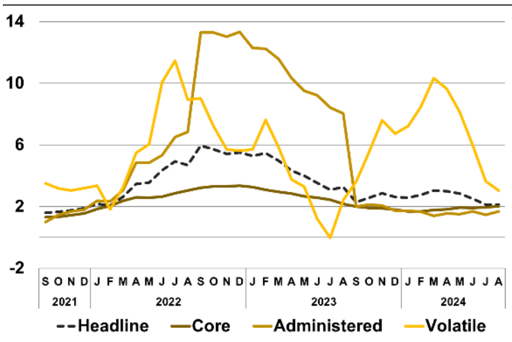
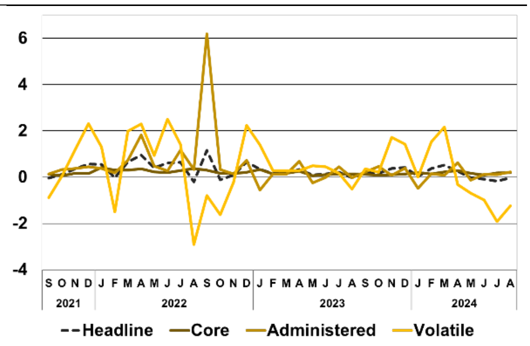
2024. On a monthly basis, it recorded an inflation of 0.23% (m.t.m) in August 2024, rising from last month's rate of 0.11% (m.t.m). The main contributors to the administered price hike were gasoline prices and machine-made kretek cigarettes, following adjustments in non-subsidized fuel prices and the continued transmission of higher tobacco excise taxes.

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



Source: CEIC

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



Source: CEIC

Core inflation in August 2024 edged up slightly to 2.02% (y.o.y) from 1.95% (y.o.y) in July 2024. On a monthly basis, core inflation was 0.20% (m.t.m) in August 2024, rose moderately from 0.18% (m.t.m) in July 2024. The key drivers of August's core inflation were ground coffee, gold jewellery, and education expenses. The inflation was affected by the continued rise of global price commodities. Coffee prices have continued to rise, wherein robusta coffee has reached a new historic high and arabica coffee has climbed to its highest level in 2.5 months. The decline in production and increase in demand exacerbates the condition of global coffee market. Global gold commodity prices continued to climb due to heightened expectations for an interest rate cuts by the Fed, anticipated to take place this September. Moreover, the increase in core inflation was also contributed by rising education costs, as tuition fees are typically paid in July and August.

Looking ahead, inflationary pressures are expected to ease in September 2024, with inflation projected to remain within the target range of 1.5% to 3.5%. This is supported by a slight decline in the General Price Expectations Index (IEH) from August. The early September reduction in non-subsidized fuel prices is also likely to help alleviate overall inflation. However, pressures may persist in the volatile food price sector, with rice production anticipated to decline until October 2024 due to the forthcoming La Niña season.

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Trade Surplus Quadruples: Exports Surge on CPO Prices, Imports Plummet with Falling Oil Prices

Indonesia recorded its 52nd consecutive trade surplus in August 2024, reaching USD2.90 billion, up significantly from USD0.47 billion in July 2024. This represents a fourfold increase from the previous month, although the trade balance declined by 6.96% (y.o.y) from August 2023. The sharp rise in the trade surplus was driven by higher exports and a decline in imports. Exports in August 2024 amounted to USD23.56 billion, a 5.97% (m.t.m) increase from July 2024, continuing an upward trend since April 2024. In contrast, imports fell by 4.93% (m.t.m) to USD20.67 billion in August 2024, down from USD21.74 billion in July 2024.

Breaking down the export data, non-oil and gas exports saw a notable increase, rising to USD22.36 billion in August 2024 from USD20.81 billion in July 2024, a 7.43% (m.t.m) growth. This growth was partly driven by a strong performance in animal and vegetable fats and oils exports, which surged 24.50% (m.t.m) to USD2.39 billion, fueled by a rise in palm oil prices in late August. Between 16 and 30 August 2024, Malaysian palm oil prices rose by 8.10%. However, oil and gas exports declined by 15.41% (m.t.m), from USD1.42 billion in July 2024 to USD1.20 billion in August 2024, due to lower global oil prices. The average WTI and Brent crude prices fell by 6.26% (m.t.m) and 5.63% (m.t.m), respectively.

On the import side, the decline in August 2024 was driven by decreases in both oil and gas and non-oil and gas imports. Oil and gas imports dropped sharply by 25.56% (m.t.m), falling from USD3.56 billion in July 2024 to USD2.65 billion in August 2024. This sharp drop reflects the impact of declining global oil prices, driven in part by negative market sentiment. The primary factors behind this sentiment include concerns over weaker oil demand from China, as well as lower oil demand forecasts from OPEC and lower output growth forecast by EIA. Additionally, the appreciation of the Rupiah by 2.88% (m.t.m) in August 2024 further contributed to the decrease in imports by making foreign goods relatively cheaper.

Non-oil and gas imports also edged down by 0.89% (m.t.m), from USD18.18 billion in July 2024 to USD18.02 billion in August 2024. This modest decline was primarily due to a 6.30% (m.t.m) reduction in imports of machinery, mechanical appliances, and parts, which suggests a possible slowdown in industrial production as manufacturers scaled back on purchasing production inputs. This trend is further evidenced by the drop in imports of raw materials (down 7.16% m.t.m) and consumption goods (down 4.58% m.t.m). The contraction in imports aligns with the falling Manufacturing PMI, which declined to 48.9 in August 2024, marking its second consecutive month of contraction. The deeper contraction in Indonesia's manufacturing sector reflects a sharper decline in both output and new orders, signaling weaker domestic and external demand.

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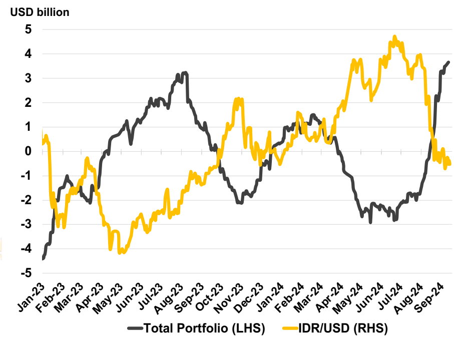
Prolonged Capital Inflows Toward Emerging Markets

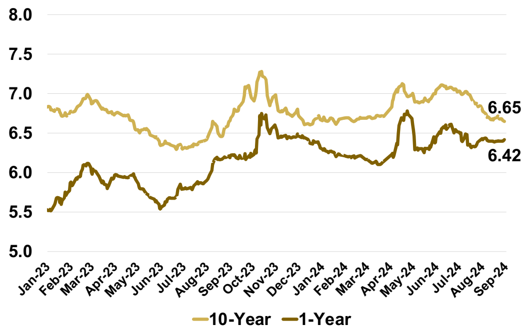
The latest US inflation data set the stage for the Fed to start cutting interest rates gradually at the FOMC meeting this week. US inflation rate in August considerably decelerated to 2.5% (y.o.y) from 2.9% (y.o.y) in July 2024 and marginally below the estimate of 2.6% (y.o.y) from economists polled by Reuters. In addition, the US current inflation rate has fallen to its lowest in over three years due to a persistent disinflation trend in the past five consecutive months. Based on its drivers, price pressure is fading for key household items, such as grocery prices and the cost of petrol. However, core inflation in the US remained unchanged at 3.2% (y.o.y) from July to August as the disinflationary pressure was counterbalanced by the rise in the prices of airline tickets, car insurance, rent, and other housing costs. The higher costs for housing and other services indicate some stickiness in various prices, which should serve as a primary motivation for the Fed not to cut rates at an aggressive pace. Furthermore, the development in the US labour market also confirms the possibility of an immediate rate cut by the Fed. The unemployment rate fell to 4.2% in August 2024 from 4.3% in the previous month, with increased jobs added from 89,000 in July to 142,000 last August. Despite rising, the added jobs figure was lower than expected, suggesting a slowing momentum in labour market and might serve as an additional motivation for the rate cut by the Fed.

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



Source: CEIC

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

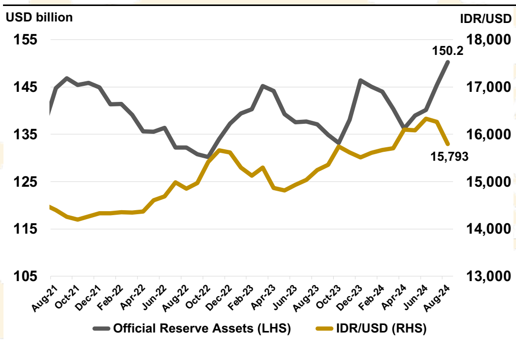


Source: Investing.com

The trend of massive capital flows from developed economies to emerging markets since early August has continued. From August 15th to September 11th, Indonesia experienced a surge in capital inflow of around USD3.37 billion. The flood of foreign capital towards the domestic financial market has bolstered the exchange rate of Rupiah. During that period, Rupiah appreciated by 2.75% and currently stood at around IDR15,395/USD. Furthermore, foreign capital inflows towards the bond market in Indonesia have driven down Indonesia's government bond yield. Currently stood at 6.65%, the 10-Year government bond yield decreased by more than ten percentage points from 6.78% on August 15th. On the other hand, while fluctuating in the past 30 days, the 1-year government bond yield is now at 6.42% and is relatively similar to its level on August 15th. The differences in movement of 10-Year and 1-Year government bond yields amidst immense foreign capital inflow could be explained by various factors. Generally, 10-year government bond is more liquid which enables its yield to be more fluctuating. Also, short-term tenor of government bonds is usually anchored to BI rate and the presence of a more attractive alternative of short-term instruments, such as SRBI, keeps the 1-year government bond yield relatively stable.

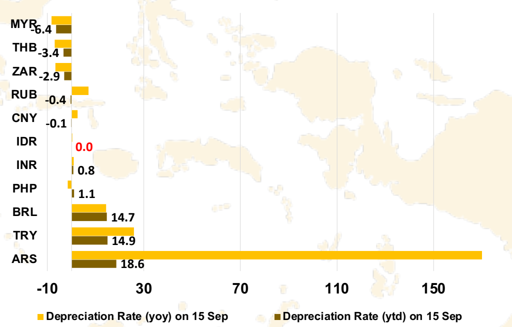
As the possibility of the Fed starting its monetary easing era is over the horizon, the momentum of capital flows toward emerging markets is prolonged. As a consequence, the US Dollar Index (DXY) reached 100.67 on the third week of September 2024, marking its lowest level since September 2023. In the past 30 days, the majority of emerging markets' currencies have been strengthening, except Brazilian Real, Turkiye Lira, and Argentine Peso. Despite the episode of appreciation in the past few weeks, the value of Rupiah is relatively unchanged on a year-to-date basis. While performing better than several of its peers' currencies, such as Indian Rupee and Philippines Peso, Rupiah's performance is relatively behind other peers' currencies, such as Malaysian Ringgit, Thailand Baht, and South African Rand. On the other hand, Indonesia's official reserve asset was recorded at USD150.2 billion in August 2024, a rapid increase of around USD4.8 billion from USD145.4 billion in the previous month. A considerable increase in official reserve asset was supported by tax and services receipts, oil and gas income receipt, and withdrawal of foreign loans by the GoI. The latest figure of official reserve asset marked its highest level in history and bolstered Indonesia's external resilience. Currently, Indonesia's reserve asset is equivalent to of 6.7 months of import or 6.5 months of import and servicing GoI'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



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (15 September 2024)



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With a rate cut by the Federal Reserve now almost certain, Indonesia and other emerging markets are experiencing the benefit of capital inflows and stronger currency. In addition, the domestic price level in Indonesia is currently in a disinflationary trend. The combination of prolonged appreciation of Rupiah and deceleration of inflation rate creates a certain room for BI to cut interest rate in order to boost aggregate demand and the growth of the real sector. However, the inflation rate is generally still within BI's target range and there is a potential of capital flow reversal out of Indonesia. Considering these aspects, there is no urgency for BI to cut its policy rate this month. Delaying the rate cut might also be beneficial for BI as it provides more room for monetary easing for the rest of the year if needed. Therefore, we are in view that BI should maintain its policy rate at 6.25% during the September Board of Governors meeting.

8 DECENT WORK AND ECONOMIC GROWTH