Macroeconomic Analysis Series

# BI Board of Governor Meeting

## October 2024

LPEM FEB UI
Institute for Economic and Social Research

### Highlights

- Bank Indonesia should maintain the BI Rate at 6.00% despite deflationary trends observed in the last five months.
- Headline inflation decreased to 1.84% (y.o.y) in September 2024, down from 2.12% in August 2024.
- Trade balance recorded a surplus of USD3.26 billion in September 2024, indicating a sharper decline in imports compared to exports.
- Rupiah depreciated by 1.20% (m.t.m) by early October 2024; foreign exchange reserves stood at USD149.9 billion, a slight decline of USD0.3 billion from an all-time-high of USD150.2 billion the previous month.

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In September 2024, Indonesia's headline inflation dropped to 1.84% (y.o.y) from 2.12% in August 2024, marking the lowest level since December 2021, mainly driven by a decline in volatile food prices. Core inflation edged up to 2.09% (y.o.y), fueled by rising costs of ground coffee and education. Furthermore, the Fed begun its monetary easing cycle by cutting policy rate 50bps last month, almost concurrently with BI cutting its rate by 25bps. The latest development suggested that Rupiah was stable around IDR15,660/USD, despite experiencing depreciation amid capital outflows influenced by geopolitical tensions and uncertainties surrounding the upcoming US elections. Although official reserves dipped to USD149.9 billion, Bank Indonesia is expected to maintain the BI rate at 6.00% during its October meeting. Any potential room for further policy cuts should be reserved to address the risk of a prolonged deflationary trend.

### Five Months of Deflationary Winds

Headline inflation in September 2024 decreased to 1.84% (y.o.y) from 2.12% (y.o.y) in August 2024 (Figure 1), marking the lowest level since December 2021. Although it fell below 2%, it remains within Bank Indonesia's target range of 1.5% to 3.5%. The decline in headline inflation was largely driven by supply-side factors, particularly the drop in volatile food prices following several initiatives by the GoI, namely food distribution facilitation, development of food kiosks, and interregional cooperation. Moreover, inflation for food, beverages, and tobacco group weakened further to 2.57% (y.o.y) in September 2024, down from 3.39% (y.o.y) in August 2024, reaching its lowest level since July 2023. Inflation also eased in other expenditure groups, such as transportation (0.92% (y.o.y) in September 2024 vs 1.42% (y.o.y) in August 2024), information, communication, and financial services (-0.28% (y.o.y) in September 2024 vs -0.16% (y.o.y) in August 2024), and health (1.69% (y.o.y) in September 2024 vs 1.72% (y.o.y) in August 2024).

On a month-to-month basis, headline inflation registered its fifth consecutive month of deflation in 2024 (Figure 2), the first such occurrence since early 1999 after the 1998 economic crisis. The deflation deepened to 0.12% (m.t.m) in September 2024 from 0.03% (m.t.m) in August 2024. Similar to the annual price trends, the primary driver of September's monthly deflation was the food, beverage, and tobacco group, which indicated a deflation of 0.59% (m.t.m), contributing 0.17 percentage points to the overall deflation for the month. However, demand-side factors also played a role. Monthly core inflation has decreased three times in the past six months, signaling reduced demand pressure and weakening consumer purchasing power. While the

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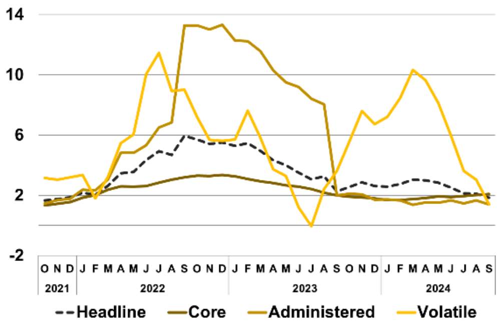
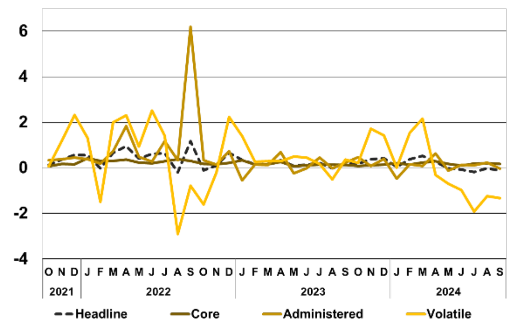
impact from the demand side may not be as significant as that from the supply side, it nonetheless contributed to the overall inflation slowdown and should not be overlooked.

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




Source: CEIC

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




Source: CEIC

Core inflation was the key factor sustaining inflation in September 2024. It edged up slightly to 2.09% (y.o.y) from 2.02% (y.o.y) in August 2024 (Figure 1). On a monthly basis, core inflation was 0.16% (m.t.m) in September 2024, declining moderately from 0.20% (m.t.m) in August 2024 (Figure 2). The main drivers behind September's core inflation were rising prices for ground coffee and higher education expenses. Global coffee prices continued to climb due to strong consumer demand and logistical disruptions caused by climate-related issues, while higher education costs increased with the start of new academic year. Furthermore, global gold prices continued to spike in September 2024, driven by its status as a safe-haven asset amid the Fed's interest rate cuts.

Volatile and administered prices saw a significant drop in September 2024. The Volatile price component recorded an annual inflation rate of 1.43% (y.o.y) in September 2024, down from 3.04% (y.o.y) in August 2024 (Figure 1), marking its lowest level since August 2023. On a month-to-month basis, the volatile price component recorded its sixth deflation of the year, slightly down to 1.34% (m.t.m) in September 2024 from 1.24% (m.t.m) in August 2024 (Figure 2). The decline in annual inflation and continued monthly deflation were driven by price decreases in red chilies, bird's eye chilies, and broiler eggs, due to increased supply following the chili harvest season and reduced input costs for chicken broiler. Meanwhile, the administered price component posted an annual inflation of 1.40% (y.o.y) in September 2024, slightly decreased from 1.68% (y.o.y) in August 2024 (Figure 1). On a monthly basis, it recorded a deflation of 0.04% (m.t.m) in September 2024, a downturn from last month's 0.23% (m.t.m) inflation rate (Figure 2). The main contributors to the decline in administered prices were gasoline commodities, following adjustments in non-subsidized fuel prices.

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**USD149.9 billion**



Consumer optimism showed a slight decline in September 2024 compared to the previous month, as reflected in the Bank Indonesia Consumer Confidence Index, which fell to 123.5 in September 2024 from 124.4 in August 2024. This decrease can be attributed to the ongoing deflation observed over the past five months. Nevertheless, BI remains confident that inflation will remain within the target range of 1.5% to 3.5%. However, BI should be mindful of the potential for weakening demand. Although a rate cut was implemented last month, BI should prioritize stimulating aggregate demand if the current trend continues. Looking ahead, inflationary pressure in October 2024 is expected to stem from imported inflation, driven by Rupiah's continued decline since early October.

## Trade Surplus Continues to Thrive Despite Global Demand Weakening

In September 2024, Indonesia's trade balance recorded its 53rd consecutive surplus of USD3.26 billion, up from USD2.75 billion in August 2024, a 17.37% (m.t.m) increase, though down by 4.30% (y.o.y) compared to the September 2023 figure. The growing trade surplus in September 2024 was driven by a sharper decline in imports than in exports. Exports in September 2024 were valued at USD22.08 billion, down 5.80% (m.t.m) from USD23.44 billion in the previous month. Meanwhile, imports fell by 8.90% (m.t.m), from USD18.02 billion in August to USD16.30 billion in September 2024.

In terms of exports, both oil and gas and non-oil and gas exports experienced a monthly decline. Oil and gas exports were recorded at USD1.17 billion in September 2024, down from USD1.20 billion in August 2024, marking a 2.80% (m.t.m) decrease. Similarly, non-oil and gas exports dropped from USD22.24 billion in August 2024 to USD20.91 billion in September 2024, a 5.96% (m.t.m) decline. Among the top ten export commodities, six saw monthly declines, with the steepest drops occurring in ores, slag, and ash (HS26, 32% (m.t.m) decline), animal or vegetable fats and oils (HS15, 16.91% (m.t.m) decline), and electrical machinery and equipment, and parts thereof (HS85, 12.39% (m.t.m) decline), all affected by weakening global demand. Exports to China, Indonesia's largest trading partner, grew only marginally by 0.34% (m.t.m), while exports to the U.S., the second-largest market, saw a steep decline of 15.00% (m.t.m), further exacerbating the overall export contraction.

Similar to exports, both oil and gas and non-oil and gas imports saw a decline in September 2024. Oil and gas imports decreased by 4.53% (m.t.m), falling from USD2.64 billion in August 2024 to USD2.53 billion in September 2024. Non-oil and gas imports experienced a more significant drop of 10.56% (m.t.m), decreasing from USD18.02 billion to USD16.30 billion during the same period. Of the ten major import commodities, only two showed no monthly decline in September 2024.

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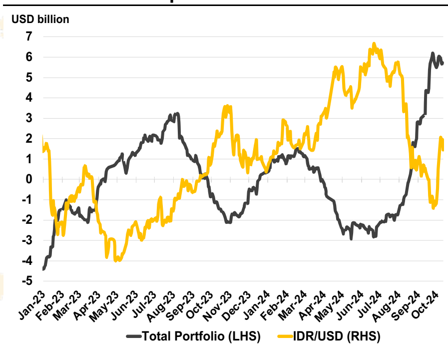
Monthly declines were evident across all categories, with consumption goods down 6.37% (m.t.m), raw materials declining by 9.69% (m.t.m), and capital goods decreasing by 7.15% (m.t.m). This trend aligns with the current Purchasing Managers' Index (PMI) of 49.2 in September 2024. While this reflects a slight improvement from the August level of 48.9, it remains within contraction territory, indicating ongoing challenges in the manufacturing sector and reduced demand.

## A New Era of Monetary Easing

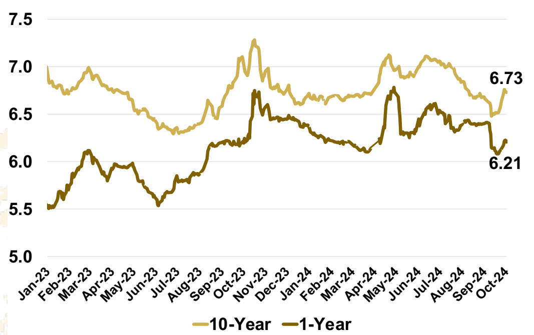
The latest FOMC meeting marked a major shift in the global monetary policy toward an easing era as the Fed cut its policy rate for the first time in the last 4.5 years. However, the Fed's 50bps rate cut last September was larger than many analysts had expected. With the mandate to sustain inflation at an average rate of 2% (y.o.y) over the longer run, the Fed certainly took a significant move in the policy rate stance as the latest US inflation rate was 2.4% (y.o.y) in September, above economists' consensus of 2.3% (y.o.y). The US inflation figure marked the sixth consecutive month the annual headline rate has fallen. However, once volatile items, such as food and energy were stripped out, "core" inflation rose faster than expected and recorded at 3.3% (y.o.y) in September 2024. In addition, US jobless claims in the second week of this month hit 258,000, around 30,000 more than forecast, marking the highest weekly increase since August 2023. The relatively higher-than-expected inflation rate and jobless claims painted a rather mixed picture of the current state of the largest economy in the world. Regardless, the Fed might still have a room of 25bps to 50bps rate cut for the rest of 2024.

**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 Fed rate cut spurred a flow of capital towards emerging markets, including Indonesia. During the first week after rate cut by the Fed, Indonesia experienced an inflow of foreign capital of around USD1.93 billion (Figure 3), dominated mainly by an inflow towards the bond market that amounted to USD1.51 billion. As a result,

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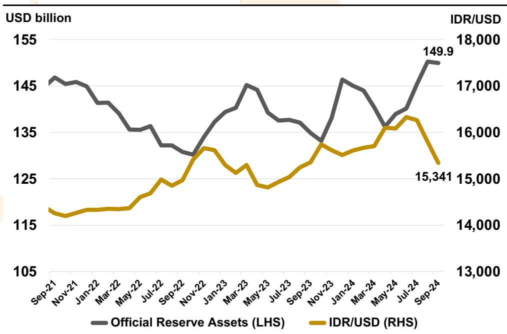
the 10-year government bond yield decreased by 26bps from 6.62% on September 18th to 6.51% on September 30th, and the 1-year government bond yield declined by 35bps from 6.43% to 6.08% during the same period (Figure 4). However, this trend has been reversed during the last week as foreign capital flew out from Indonesia, which was triggered by rising geopolitical tension and uncertainties preceding the upcoming US election. Cumulatively, as of October 11th, the 10-year government bond yield has risen by 21bps to 6.73% and the 1-year government bond yield by 13bps to 6.21% since the end of last month.

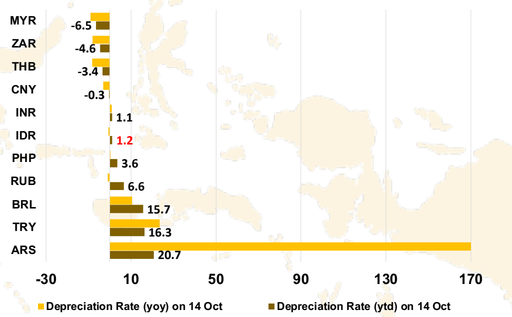
The recent capital outflow from Indonesia in the past two weeks has been reflected in the fluctuation of Rupiah. On a monthly basis, Rupiah depreciated by 1.20% (m.t.m) from around IDR15,330 per USD in mid-September to around IDR15,660 at the end of second week of October. This recent depreciation might indicate a normalization trend after appreciating significantly (around 7%) in less than a month, from the end of July to mid-August. On a year-to-date basis, Rupiah performance has been relatively average relative to its peers (Figure 6). Since the beginning of this year, Rupiah has depreciated by 1.20% (y.t.d), performing worse compared to Malaysian Ringgit, South African Rand, Thailand Baht, and Indian Rupee (Figure 6). These currencies have appreciated by 6.47% (y.t.d), 4.62% (y.t.d), 3.38% (y.t.d), and depreciated by 1.06% (y.t.d), consecutively. Meanwhile, Indonesia's official reserve asset recorded its first decline in the last five months. Official reserves asset in September 2024 stood at USD149.9 billion, a slight decline of USD0.3 billion from an all-time-high of USD150.2 billion the previous month (Figure 5). The shrinking of Indonesia's reverse asset was partially contributed by the payment of GoI's external debt. Despite shrinking, the current level of official reserve assets is rather ample as it is equivalent to 6.6 months of import of 6.4 months of import and GoI's external debt service payment, suggesting external resiliency for the upcoming months.

Figure 5: IDR/USD and Official Reserve Assets




Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (14 October 2024)




Source: Investing.com

In September 2024, the Fed and BI both initiated their monetary easing era almost concurrently. Additionally, rising geopolitical tension, China's stimulus program, and

US election are contributing to factors influencing the capital flows toward Indonesia and fluctuations of Rupiah in the near future. Domestically, Indonesia has been facing a persistent deflation trend in the past five months, driven by both supply- and demand-side factors, although inflation remains within BI's target range. Fortunately, Rupiah has started to stabilize in the past week. With less than three months left in 2024, we consider BI still has some room for some rate cut. This might be a useful policy tool in the future to revive aggregate demand in the real sector should the trend of deflation prolong. However, there is no urgency for BI to execute another round of rate cuts in the October Board of Governors meeting. Thus, we are in view that BI should keep its policy rate unchanged at 6.00% for now.

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