LPEM FEB UI
UNIVERSITAS INDONESIA

MACROECONOMIC ANALYSIS SERIES

Inflation Outlook 2025

Historic Low Inflation: Positive Supply Shock and Weak Demand

Summary

We observed a declining inflation rate trend throughout 2024, returning to Bank Indonesia's inflation target. Inflation reached its highest point in March 2024 at 3.05% and steadily decreased, hitting 1.57% in December 2024. This is the lowest inflation rate in two decades, excluding the pandemic period of 2020-2021 and the post-pandemic years of 2022-2023.

The decrease in the inflation rate from February to December 2024 was primarily driven by a sharp decline in volatile inflation and administered inflation. Volatile inflation rose during the early months of January to March 2024 but then declined continuously, culminating in deflation in November 2024 (-0.32%). Administered inflation also dropped significantly, from 1.74% in January 2024 to 0.56% in December 2024. Throughout 2024, administered inflation only recorded increases in June and August. However, a low inflation rate does not always signal a healthy economy, as core inflation experienced a slight decline in 2024.

By consumption types, food ingredients, and food, beverages, and tobacco recorded the highest inflation spikes in 2024. Rising rice prices, a staple food for Indonesian households, primarily drove inflation in food ingredients. The increase in rice prices was linked to several challenges in agricultural production. Meanwhile, the food, beverages, and tobacco inflation was driven by various factors, most notably the rising costs of cooking oil and tobacco.

Table 1: Inflation Rate YoY (Forecast LPEM FEB UI)

Dec 2024		Jan 2025 Forecast	
Headline	Core	Headline	Core
1.57%	2.26%	1.6-2.1%	2.2-2.5%

Indonesia's exchange rate market in 2024 experienced significant depreciation. The pressure on the Rupiah was driven by global factors, including the Federal Reserve's decision to maintain its Fund Rate and the strengthening of the United States (US) dollar, which led to foreign capital outflows from Indonesia's financial market. Furthermore, inflation realization throughout 2024 was lower than targeted, with headline inflation recorded at 1.57% year-on-year (YoY), compared to the government's target of 2.8% YoY.

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2.26%
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Core Inflation* (2025)
2.2%-2.5%
Economic Growth (Q3 2024)
4,95%
% Current Account of GDP (Q3 2024)
0,6%

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*) *Forecast*

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Regarding the rupiah exchange rate, we estimate that the Rupiah will remain under pressure from the strong US dollar until the first half of 2025. Additionally, global uncertainties are expected to continue impacting exchange rate stability and economic growth, which will likely slow down.

Declining Energy Prices, yet Increasing Imported Inflation

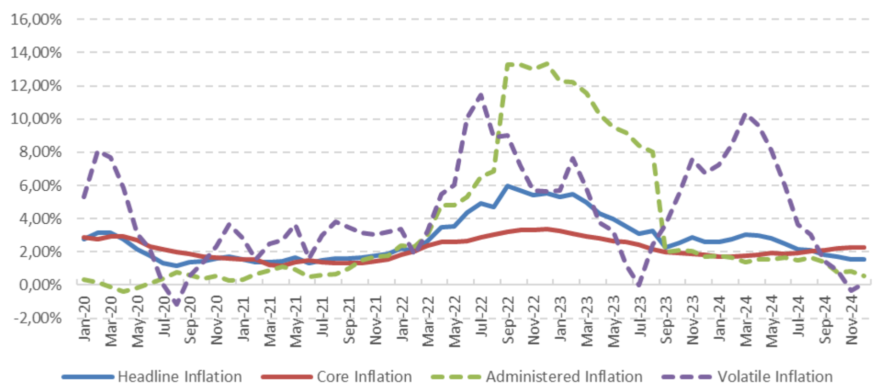
We observed a low inflation rate throughout 2024. In January 2024, inflation decreased to 2.57%, compared to 5.28% in the previous year. This downward trend continued through December 2024, reaching 1.57%, a reduction from 2.61% in the same month of 2023. The volatile goods inflation component experienced its most significant decline since the pandemic, with deflation of -0.32% in November 2024. However, prices of volatile goods rebounded slightly, recording an inflation rate of 0.12% in December 2024. Commodities driving the decline in volatile goods inflation included bird's eye chilli, red chilli, shallots, and broiler chicken.

Unlike the double-digit inflation trend for administered prices in 2023, this year, this component significantly declined. In January 2024, inflation for administered prices stood at 1.72%, decreasing further to 0.56% in December 2024. Adjustments to non-subsidized fuel prices and airline ticket fares implemented by the government contributed to reducing this inflation component.

Furthermore, core inflation declined during the first six months of 2024 but rose in subsequent months. Gold, as a safe-haven asset, was one of the commodities contributing to inflation in this component. The weakening of core inflation throughout 2024 also indicates pressure on demand and consumer purchasing power, contributing to monthly deflation.

The decline in inflation rates for volatile goods, administered prices, and core inflation helped bring overall inflation back to Bank Indonesia's target of 2.5±1 percent, as stated in the Regulation of the Minister of Finance No. 101/PMK.010/2021. This target was lower than the previous year's target of 3±1 percent.

Figure 1: Inflation Rate by Categories 2020-2024 (%, YoY)



Source: CEIC

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Next, based on Figure 2, the commodities that experienced the most significant price spikes in the second quarter compared to others were food ingredients and food, beverages, and tobacco. The increase in rice prices primarily drove inflation in this group. Generally, this price increase was caused by the rise in Harvested Dry Grain (GKP) and Milled Dry Grain (GKG) prices. Statistics Indonesia (BPS) reported that GKP prices rose by 4.8%. The Farmer's Price Index (IB) also increased from 119.12 in January 2024 to 121.04 in November 2024. The peak rice harvest shifted from March in 2023 to April in 2024. The estimated rice harvest area in 2024 also declined by 1.54% compared to 2023.

Meanwhile, palm oil prices 2024 also increased on average by 7.47% compared to 2023. This rise was further reinforced by Trade Minister Regulation No. 18 of 2024, which mandated that the Domestic Market Obligation (DMO) be entirely in the form of MINYAKKITA and no longer in bulk or crude palm oil (CPO). Consequently, the Highest Retail Price (HET) for subsidized cooking oil increased to Rp 15,700 per liter in August 2024.

The food, beverages, and tobacco inflation was also influenced by the continued transmission of tobacco excise tariffs to consumer selling prices by producers. On average, there was a 12% increase throughout 2024, based on Finance Minister Regulation No. 191/PMK.010/2022. However, the increasing distribution of illegal cigarettes and a shift in consumer preference toward more affordable cigarette types (downtrading) still limited the transmission of tobacco excise tariffs. Another reason for the increase in tobacco excise rates was to maintain the workforce in the agricultural and tobacco industries.

In contrast to 2023, which experienced inflation, energy was the commodity that recorded the most significant inflation decline this year. The types of gasoline experiencing price drops were non-subsidized fuel types (Pertamax, Pertamax Turbo, Pertamina Green 95, Pertamina Dex, and Dexlite). This price reduction was due to adjustments in the average global oil price trends and considerations of the Rupiah's exchange rate against the US Dollar, which had depreciated. Pertamina was noted to have adjusted fuel prices in January, August, September, October, November, and December 2024. Furthermore, crude oil prices in 2024 fell by 2.61% compared to the average in 2023.

Aside from energy prices, the government's relaxation of travel restrictions also impacted inflation in the transportation sector. As a result, many people resumed pre-pandemic activities such as commuting and traveling, prompting transportation service providers to revert their prices to pre-pandemic levels. However, declining inflation persisted as global oil price reductions influenced lower aviation fuel prices. The decline continued even during the Christmas and New Year holidays due to government adjustments in airline ticket prices.

Furthermore, the only sector that did not experience a decline in inflation throughout 2024 was personal care and other services. This sector recorded an inflation rate of 3.01% in January, steadily increasing to 7.02% by December 2024. Gold jewelry, which experienced 15 consecutive months of inflationary growth, was a major contributor to this inflation. The rise in gold prices was driven by global price increases, fueled by international uncertainties caused by wars, political and economic instability, and crises. Gold is considered a haven asset, leading to higher demand and rising prices in global markets.

Additionally, gold is susceptible to changes in global interest rates. When interest rates are low, or there is an expectation of rate cuts, gold prices rise because the opportunity cost of

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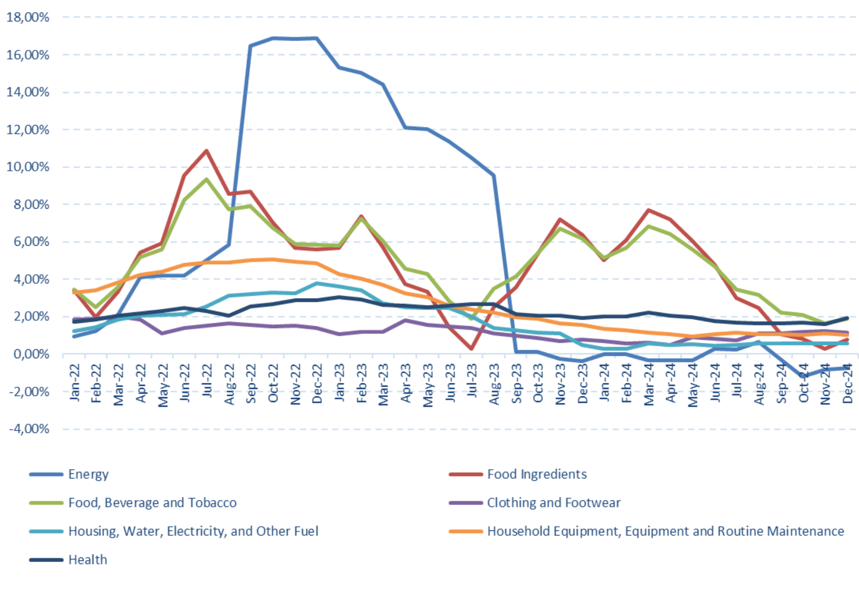
holding non-yielding assets like gold becomes low. Conversely, gold prices may be pressured when interest rates increase as investors shift to interest-bearing assets like bonds.

In 2024, global uncertainties and monetary policies from the Federal Reserve contributed to the volatility in gold prices. The growing demand for gold as a hedge against global risks drove significant inflation in gold jewelry in Indonesia, which played an essential role in the imported inflation observed in the personal care and other services sectors, marked by rising luxury and intermediate goods costs and increased reliance on imported materials. This sector also saw a rise in inflation, particularly during the festive seasons (Ramadan, Eid al-Fitr, and Christmas), due to changes in consumer spending patterns. During these periods, there was a significant increase in expenditure on personal care services, driven by the high demand for related products and services.

After analyzing the inflation trends by consumption type, it is clear that Indonesia's economy is beginning to recover despite threats of external instability (marked by an increase in imported inflation) throughout 2024. The largest decline in energy and fuel prices, supported by effective subsidy policies, has positively impacted distribution costs and consumer purchasing power. On the other hand, although the food sector experienced fluctuations due to weather phenomena like El Niño, increased horticultural harvests in mid-2024 helped stabilize food prices. In other words, the personal care and other services sectors experience an increasing pattern of inflation.

Meanwhile, the momentum from the general election also boosted market confidence in political stability and the direction of economic policy. Domestic and foreign investments showed growth, particularly in the manufacturing and infrastructure sectors, which the government has prioritized. This reflects optimism about Indonesia's potential for future economic growth.

Figure 2: Inflation Rate by Consumption Type, 2022-2024 (YoY)



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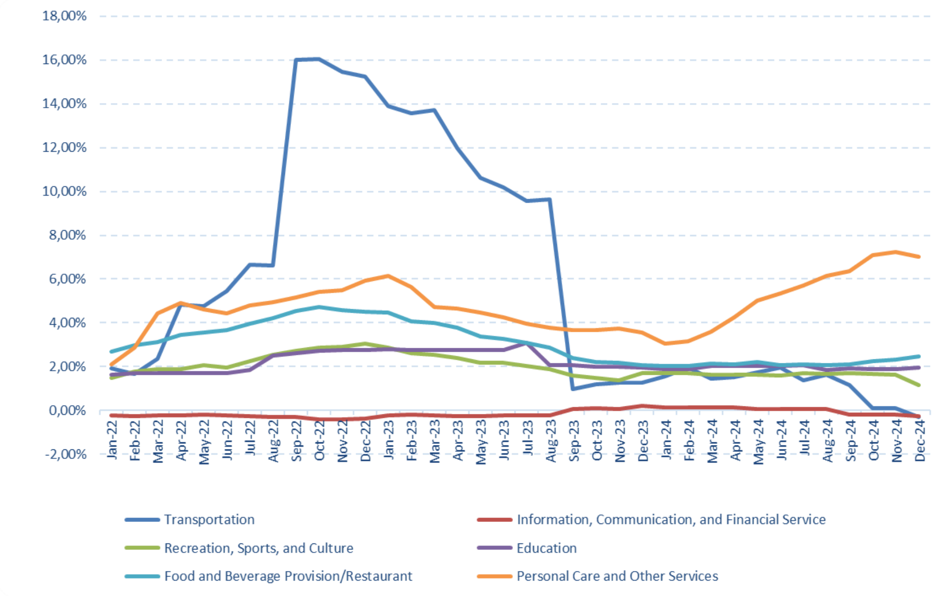

Source: CEIC

Slower Growth of Purchasing Power and Unprecedented Low Logistics Disturbance

From 2022 to 2024, household purchasing power remained stable and did not experience a significant decline. However, its growth showed signs of slowing down, mainly when observed through the core inflation trend. In 2022, core inflation recorded a considerable increase, exceeding 2%, which indicated pressure on purchasing power. However, core inflation began to level off by the end of 2023 and into 2024, although it remained in the positive zone.

This situation coincided with a significant increase in gold prices, particularly in late 2023 and early 2024. Gold, often considered a hedge against inflation, experienced a sharper surge compared to 2022. However, despite the spike in gold prices, core inflation remained under control, indicating that household purchasing power was still relatively well-maintained, albeit with slower growth than in the previous year. It is also important to note that increases in international prices primarily drove the rise in gold prices. Therefore, the rise in core inflation due to higher gold prices can be regarded as imported inflation rather than inflation stemming from domestic demand pressures.

Core inflation did not decrease significantly despite the sharp rise in gold prices, indicating that purchasing power remained resilient. However, the slowdown in core inflation growth may suggest that household consumption is stabilizing and not growing as rapidly as before. This highlights a potential transition from a phase of purchasing power expansion to a normalization phase.

The weak demand is simultaneously supported by better supply conditions, mainly through improvements in logistics infrastructure. The Central Statistics Agency (BPS) recorded an addition of 204.5 kilometers of operational toll roads constructed between January and December 2024, which boosted efficiency in the distribution of goods and services. Furthermore, 2024 was marked by relatively stable weather and a decline in natural

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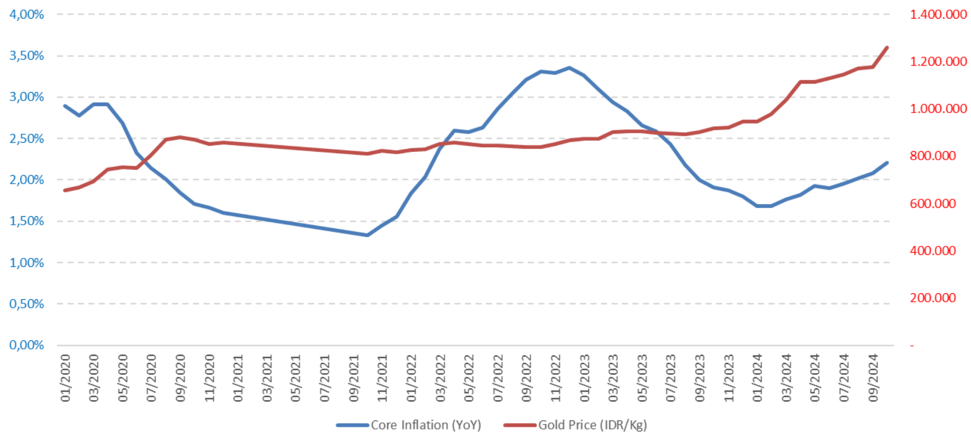
disasters, especially in Java production centers and distribution routes. A decrease in fertilizer prices and the adoption of new technologies in the agricultural sector also contributed to improvements in supply conditions.

The slowdown in purchasing power can also be linked to the rising inflation in the personal care and other services sector (as discussed in the previous section). The lipstick effect suggests that when purchasing power weakens, consumers shift their spending from expensive luxury goods to smaller items or services that still provide satisfaction or luxury (MacDonald & Dildar, 2020; Hayes, 2024). In this context, personal care products and services such as cosmetics, skincare, and beauty treatments serve as "substitutes" for luxury goods perceived as more affordable. Thus, consumers' purchasing power has not entirely declined but has only slowed, as people do not eliminate their spending on non-essential goods. Instead, they continue to seek ways to feel comfortable and satisfied, even in economic challenges.

Figure 3: Core Inflation Rate and Gold Price, 2020-2024



Source: CEIC

Economic Dynamics in Indonesia 2024: Rupiah Exchange Rate Fluctuations, Interest Rate Stability, and the Rise of Crypto Trading

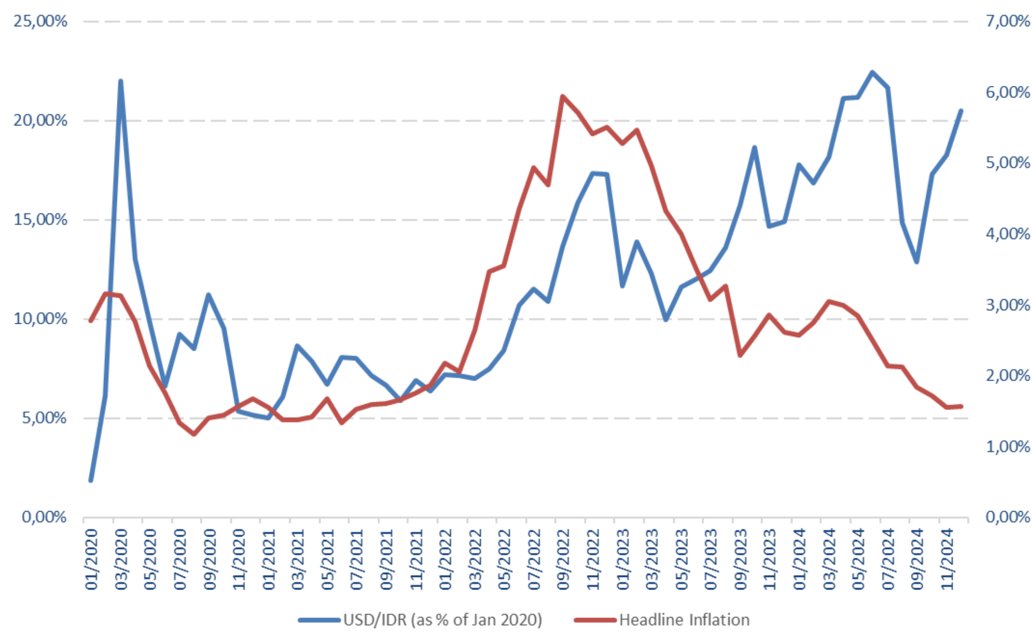
In terms of the rupiah exchange rate, fluctuations in the rupiah exchange rate occurred in Indonesia during 2024 (Figure 3). The rupiah exchange rate fluctuations occur due to uncertain global economic conditions and unstable geopolitical conditions in various regions. The weakening of the rupiah exchange rate in 2024 is caused by the higher uncertainty of global direction, especially in the direction of US policy, the widespread strengthening of the US dollar, and the lower FFR. In terms of unstable geopolitical conditions, especially in the Middle East and Ukraine, it has its influence and indirectly affects investors' preferences to move their investments back to the US. Global economic uncertainty is a significant challenge in this period.

Meanwhile, regarding interest rates, Bank Indonesia is expected to maintain its benchmark interest rate at 6% in December 2024 to control inflation. The inflation rate targeted by Bank Indonesia, classified as controlled inflation, falls within the range of 2.5% ± 1% for

2024. This policy aligns with Bank Indonesia's broader efforts to stabilize the rupiah exchange rate.

At the same time, a breath of fresh air has also emerged in Indonesia's crypto asset trading sector. Bappebti reported a significant increase in crypto asset transactions during 2024, with a total transaction value of IDR 556.53 trillion recorded from January to November 2024. This growth in transaction value aligns with the rising number of customers transacting through Prospective Crypto Asset Physical Traders (CPFAK) and Crypto Asset Physical Traders (PFAK). As a result of these developments, state revenue from crypto transaction taxes reached IDR 914.2 billion between 2022 and September 2024. Crypto trading in Indonesia is further supported by regulatory certainty, as outlined in the Financial Services Authority Regulation of the Republic of Indonesia Number 27 of 2024 concerning implementing Digital Financial Asset Trading, Including Crypto Assets.

Figure 4: Inflation Rate and Relative Change in USD/IDR, 2020-2024



Source: CEIC

The downward trend in global oil prices also impacted Indonesia from 2022 to 2024. This decline was driven by several factors, including the recovery of global economic conditions following the COVID-19 pandemic, the state of the world economy—particularly in China—and an increase in crude oil production by non-OPEC producers, resulting in sufficient global supply.

In addition, global oil prices in 2024 were influenced by demand fluctuations from China and the effects of tensions arising from the Middle East conflict. The average price of Indonesian crude oil in November 2024 fell by 2.3%, declining from US$73.53 per barrel in October 2024 to US$71.83 per barrel in November 2024. According to the OPEC 2024 Publication Report, the decline in global oil demand growth for 2024 amounted to 107 thousand barrels daily. Another factor contributing to the decrease in crude oil prices was

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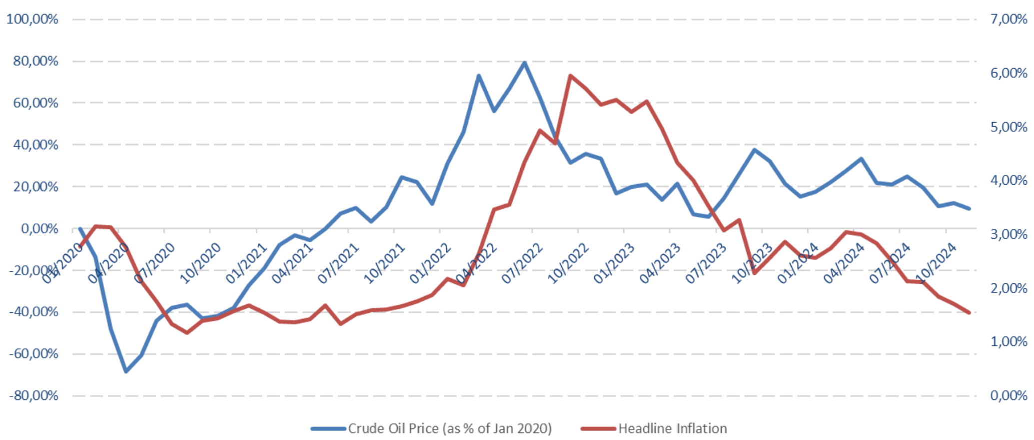
the US dollar exchange rate surge, which made commodities traded in US dollars more expensive.

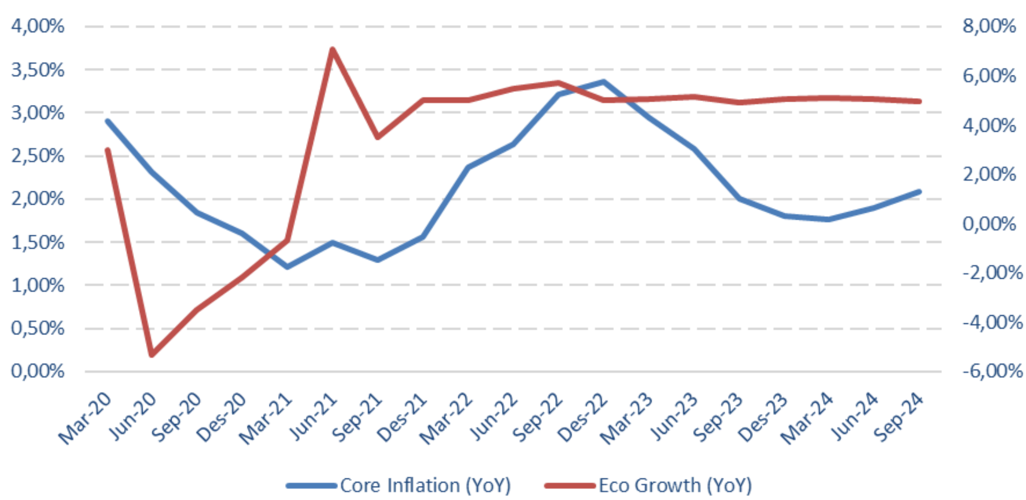
Figure 5: Inflation Rate and Relative Change in Oil Price (Brent), 2019-2023



Source: CEIC

In Q3-2024, Indonesia's economy, measured by Gross Domestic Product (GDP) at current prices, reached IDR 5,638.9 trillion, while at constant 2010 prices, it amounted to IDR 3,279.6 trillion. The construction, mining and quarrying, and manufacturing sectors primarily drove economic growth in Q3-2024. From the expenditure perspective, Q3-2024 economic growth was supported by the strong performance of the gross fixed capital formation (PMTB) component, which grew by 8.44%, followed by the export of goods and services sector, which expanded by 8.10%. Overall, the complex economic conditions in 2024 have significantly impacted both economic growth and the inflation rate.

Figure 5: Core Inflation Rate and Economic Growth, 2020-2024



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2025 Inflation Forecast: Lingering Risk from The War, Rupiah Depreciation, and New Government Policy

We forecast that the inflation rate 2025 will remain slightly above the previous year's average, around 1.6% to 2.1%, but still within the target range. This figure stems from ongoing trends driven by rising prices of goods and services in the core inflation component and the growth of the middle class. A combination of domestic and global factors will influence inflation risks in 2025. On the domestic side, new government policies, such as imposing a 12% tax, are projected to increase the cost of luxury goods and services. The increase in the minimum wage is also expected to raise production costs, which will ultimately be passed on to consumers in the form of higher prices. Implementing an excise tax on sugary beverages (MBDK) is also anticipated to drive up prices in the food and beverage sector. The global risk of rising imported inflation is becoming more evident, supported by the trend of a weakening Rupiah due to market anticipation of policies from the newly elected US President, Donald Trump, particularly regarding import tariffs. Therefore, Bank Indonesia must maintain effective monetary policies to manage inflation expectations and exchange rate stability. Measures such as interest rate adjustments, foreign exchange market interventions, and coordination in managing fiscal policies will be key to keeping inflation within the target range.

However, the risk of slowing inflation remains present due to fiscal policies such as food and electricity assistance, incentives for MSMEs, and VAT subsidies for home purchases (PPN DTP). The food estate program, which has been initiated to support the free lunch plan, can potentially create a multiplier effect in slowing inflation. The improvement in logistics infrastructure can enhance the efficiency of distribution processes. Additionally, the Indonesian Meteorological, Climatological, and Geophysical Agency (BMKG) predicts that rainfall in 2025 will fall within the standard category, with temperature anomalies ranging between +0.3°C and +0.6°C. Meanwhile, a slowdown in household purchasing power may also contribute to a decline in inflation, as demand for goods and services tends to weaken. That said, the slowdown in purchasing power also needs to be monitored carefully, as prolonged weakening could impact overall economic growth. In this context, the government must balance policies aimed at curbing inflation and those designed to stimulate domestic consumption. This can be achieved through targeted subsidies, programs to strengthen household incomes, and incentive policies to support strategic business sectors. These measures are critical to ensuring that inflation stabilization does not come at the expense of economic growth momentum.

With the US dollar strengthening daily, we estimate that the rupiah exchange rate will remain under pressure from the dollar until the first half of 2025. The continued strengthening of the US Dollar Index supports this condition. Despite the weakening of the Rupiah at the beginning of the year, it is expected to strengthen in the future. Global pressures are also contributing to the Rupiah's current weakness.

Regarding global inflation, we estimate that the rate of decline will slow down. This risk has emerged following Donald Trump's re-election as the US president. Furthermore, oil prices are expected to average around USD 70 per barrel in 2025 due to weakening demand from

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China and an increasing global crude oil supply. Additionally, inflation in 2025 is projected to remain under control at 2.5% ± 1%. This condition underscores the need for consistent monetary policy and enhanced synergy between central and regional governments in managing the inflation rate.

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