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Macroeconomic Analysis Series

Bank Indonesia Board of Governor Meeting

February 2025

Highlights

- Bank Indonesia should maintain the BI Rate unchanged at 5,75%.
- Headline inflation in January 2025 marked the lowest level since 2000 and fell below Bank Indonesia's target range, mainly driven by sizable electricity bills discount.
- The combinations of Trump's policy stance development, the Fed's rate hold, and Bank Indonesia's rate cut has influenced the Rupiah's fluctuation in the past few weeks.

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Headline inflation in January 2025 was 0.76% (y.o.y), hitting its lowest since 2000 and fell below Bank Indonesia's target range. This was mainly driven by the 50% discount on electricity bills for certain household groups. During last month, the Fed expectedly kept its policy rate unchanged and Bank Indonesia unexpectedly cut its policy rate despite massive pressure on Rupiah. In addition, the newly inaugurated President Trump has launched a mix of policies, including stricter immigration measures that tighten the labour market, corporate tax rate cuts, and various tariff hikes, which potentially could cause higher inflation rate in the US and affect global uncertainties. These three factors played a massive role in the dynamic of capital flows in Indonesia and the movement of Rupiah in the past few weeks. Going forward, the upcoming Ramadan period might trigger domestic inflationary pressures. Furthermore, the shift of gear by the Fed towards a less aggressive monetary easing and rapidly evolving policy stance of President Trump might affect investors' perceptions unpredictably. In addition, despite gradually appreciating, Rupiah is still relatively volatile. Considering all these aspect and that Rupiah is still relatively volatile, Bank Indonesia should keep its BI Rate unchanged at 5.75% in its Board of Governors meeting in February 2025.

Lowest Inflation Since 2000 Due to Electricity Bill Discounts

Inflation in January 2025 marked the lowest level since 2000, recorded at 0.76% (y.o.y), down from 1.57% (y.o.y) in December 2024 (**Figure 1**), and falling below Bank Indonesia's target range of 1.5%–3.5%. The largest contributor to the deflationary trend in January 2025 was the housing, water, electricity, and other fuel group, which saw a deflation of 8.75% (y.o.y), compared to an inflation rate of 0.59% (y.o.y) in December 2024. This deflationary pressure was primarily driven by a 22.77% (y.o.y) decline in the electricity, gas, and other fuel subgroup price, resulting from a 50% discount on electricity bills for certain household groups, as per the Ministry of Energy and Mineral Resources' decision. The discount applied to PT PLN (Persero) customers with power capacities of 450 VA, 900 VA, 1,300 VA, and 2,200 VA and is in effect for January and February 2025. On the other hand, the largest contributor to annual upward inflationary pressure in January 2025 was the food, beverage, and tobacco group, which contributed 1.07 percentage points to headline inflation. This group saw an inflation of 3.69% (y.o.y.) in January 2025, up from 1.90% (y.o.y.) in December 2024. Key contributors to food, beverage, and tobacco group inflation included the average price rise of packaged cooking oil by 13.65% (y.o.y) in January 2025 compared to January 2024 due to the rise in crude palm oil (CPO) prices, a

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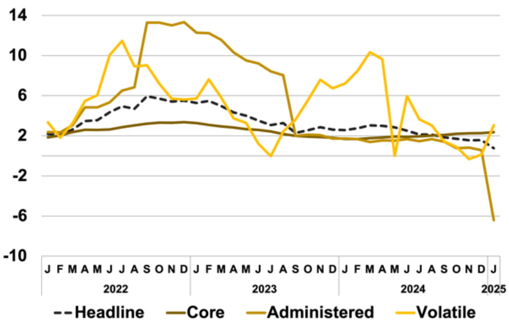
price increase of 5–8% in machine-made clove cigarettes (*sigaret kretek mesin*/SKM) due to adjustments in the retail selling price (*harga jual eceran*/HJE) of domestically produced tobacco products, and the price rise in bird's eye chili and ground coffee due to production disruptions caused by heavy rainfall in several major production areas.

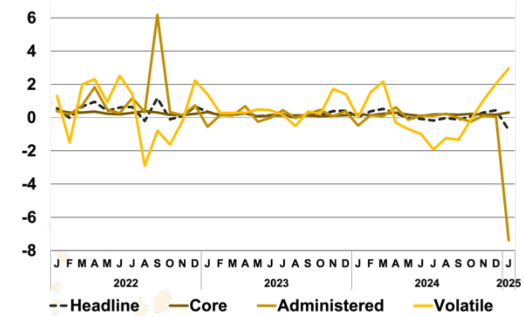
Monthly headline inflation in January 2025 recorded a deflation of 0.76% (m.t.m), reversing the inflation of 0.44% (m.t.m) seen in December 2024 (**Figure 2**). This deflationary trend was mainly attributed to the housing, water, electricity, and other fuel group, which experienced a significant deflation of 9.16% (m.t.m) in January 2025, down from a slight inflation of 0.01% (m.t.m) in December 2024. On the other hand, the food, beverage, and tobacco group contributed to the monthly inflationary pressure, recording a 1.94% (m.t.m) inflation in January 2025, up from 1.33% (m.t.m) in December 2024. This rise was higher than in previous years, where inflation for this group in January typically remained lower than in December of the previous year. Key commodities driving the monthly inflation in the food, beverage, and tobacco group included the price increase in red and bird's eye chilies, as well as other horticultural crops, due to a decrease in supply caused by production disruptions in several major production areas affected by higher rainfall in January 2025.

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



Source: CEIC

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



Source: CEIC

Core inflation increased to 2.36% (y.o.y) in January 2025 from 2.26% (y.o.y) in December 2024. The monthly trend followed the same direction, with core inflation rising to 0.30% (m.t.m) in January 2025 from 0.17% (m.t.m) in the previous month. This inflationary trend was driven by key commodities such as gold jewellery, cooking oil, ground coffee, and rice with side dishes. Gold jewellery contributed to inflation due to an increase in global prices amid geopolitical uncertainties driven by U.S. President Donald Trump's economic policies. The rise in CPO and global coffee prices was mainly driven by reduced supply from major producing countries (Indonesia for CPO, and Vietnam and Brazil for coffee) due to extreme weather conditions in those regions. Administered prices saw a deflation of 6.41% (y.o.y) in

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January 2025, a drop from 0.56% (y.o.y) in December 2024, and a significant deflation of 7.38% (m.t.m) compared to an inflation of 0.03% (m.t.m) in December 2024. Deflation in administered prices was primarily due to reductions in electricity tariffs. Furthermore, volatile goods inflation surged to 3.07% (y.o.y) in January 2025, up from 0.12% (y.o.y) in December 2024, and the monthly trend also increased to 2.95% (m.t.m) in January 2025 from 2.04% (m.t.m) in the previous month. The increase in volatile goods inflation was primarily driven by price increase in various types of chili due to production disruptions caused by heavy rainfall in several major production areas.

The decline in inflation in January 2025 was primarily driven by temporary factors, particularly the adjustment of electricity tariffs. Looking ahead, inflation in the coming months is expected to be shaped by both inflationary and deflationary pressures. On the deflationary side, it is anticipated that annual inflation in February 2025 will be lower than in January 2025, driven by the ongoing effects of electricity tariff discounts. Inflationary pressures are expected to rise in the coming months due to two key factors. First, the approach of Ramadan is likely to drive up demand and push prices higher. The General Price Expectations Index (IEH) for March 2025 stands at 179.0, up from 160.2 in the previous period. In response, the government has implemented precautionary measures, including imports of essential goods such as sugar, beef, and buffalo meat. Second, price increases could stem from adjustments in global commodity prices following U.S. import tariff policies on China, Mexico, and Canada. Additionally, the strengthening U.S. dollar poses a further risk to the Rupiah, heightening the threat of imported inflation.

Barely Growing 5% and Unproductive Trade Surplus

Indonesian economy expanded by 5.02% (y.o.y) in the last quarter of 2024, resulting in an overall growth of 5.03% (y.o.y) in 2024. The GDP growth in 2024 was slightly lower than 5.05% (y.o.y) in 2023. Household consumption, the primary driver of Indonesia's GDP, grew by 4.98% (y.o.y) in Q4-2024 and 4.94% (y.o.y) for FY2024. Growth in household consumption in Q4-2024 was driven by increased mobility during the Christmas and New Year festive period. However, the lower growth of household consumption in FY2024 compared to overall GDP growth could suggest a decline in purchasing power, reflected in the shrinking middle class, which decreased to 47.85 million people in 2024 from 48.27 million in 2023. Government expenditure rose by 4.17% in Q4-2024 or 6.61% (y.o.y) in FY2024. This growth was supported by increased capital expenditure for infrastructure improvements, procurement of defence equipment, and spending on goods to stabilize food supply and the 2024 election. The slower annual growth compared to GDP growth was also observed in Gross Fixed Capital Formation (GFCF), which grew by 5.03% (y.o.y) in

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Q4-2024 and 4.61% (y.o.y) for FY2024. The growth in GFCF was driven by both government and private sector infrastructure projects, particularly the ongoing development of Nusantara Capital City (IKN) and other projects such as toll roads. The moderate GFCF growth was partly due to a negative annual growth in vehicle investments, with national car sales declining by 13.9% (y.o.y) in 2024. Exports still recorded positive growth of 7.63% (y.o.y) in Q4-2024, resulting in 6.51% (y.o.y) growth in FY2024. In Q4-2024, exports were driven by increased value and volume in commodities such as electrical machinery and equipment, nickel, and footwear. Service exports also grew, partly due to increased foreign tourist arrivals. However, export growth in FY2024 was lower than import growth, driven by a slowdown in manufacturing activity. From July to November, Indonesia's Manufacturing Purchasing Managers' Index (PMI) remained below 50, marking its first contraction since the sharp decline during the COVID-19 period in July and August 2021 (40.1 and 43.7, respectively), indicating that the manufacturing sector was not in expansion territory. Imports showed stronger growth, increasing by 10.36% (y.o.y) in Q4-2024, leading to overall import growth of 7.95% (y.o.y) for FY2024.

Besides prolonging its surplus for 57 consecutive months since May 2020, Indonesia's trade balance also expanded by USD1.21 billion, rising from USD2.24 billion in December 2024 to USD3.45 in January 2025. However, the higher trade surplus might not signal higher productivity as both export and import declined, and the rising surplus stems from a bigger drop in import value relative to export value. In January 2025, Indonesia's exports were recorded at USD21.45 billion, down by USD2.01 billion (-8.56%, m.t.m) from the previous month's figure of USD23.46 billion, despite still increasing by 4.68% (y.o.y) compared to January 2024. The main contributors to export decline can be attributed to the export value of various commodities. Relative to December 2024, export value of crude oil dropped by 69.33% (m.t.m), refined oil by 14.92% (m.t.m), natural gas by 30.06% (m.t.m), coal by 19.33% (m.t.m), iron and steel by 10.41% (m.t.m), and CPO by 24.10% (m.t.m). The drop in various commodities export was driven by lower demand from main trading partners, such as China, US, India, and ASEAN countries due to heightened global uncertainties and low demand season. In addition, lower commodity prices also play a role in the decrease of export value, such as the prices of coal, metal ore, CPO, and oil.

Furthermore, import value declined by USD3.22 billion from USD21.22 billion in December 2024 to USD18.00 billion in January 2025, recorded as the biggest monthly decline of import value since June 2023. Specifically, Indonesia's import value grew by -2.67% (y.o.y) or -15.18% (m.t.m). Based on imported types of goods, import of consumption goods decreased by 28.65% (m.t.m) and 7.16% (y.o.y), which might suggest declining purchasing power and low season demand period. Similarly, import of intermediary inputs also grew negatively by 13.11% (m.t.m) and 3.15%

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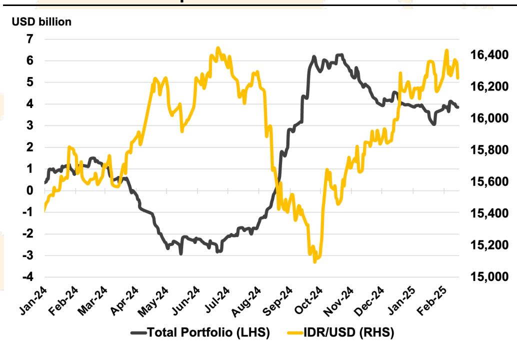
(y.o.y). On the other hand, capital goods imports grew annually by 1.74% (y.o.y), although shrank by 15.19% (m.t.m). The decrease in monthly import of capital goods was reflected by the decline in machinery and equipment which dropped by 15.04% (m.t.m). The fall in capital goods and intermediary input imports could be driven by lengthy holiday periods in January which limit the production activity. In addition, similar to export, import value of oil and gas commodities also contracted due to lower global prices and shrank by USD0.81 billion or 15.81% (m.t.m).

Rupiah Remains Volatile despite Slightly Appreciating

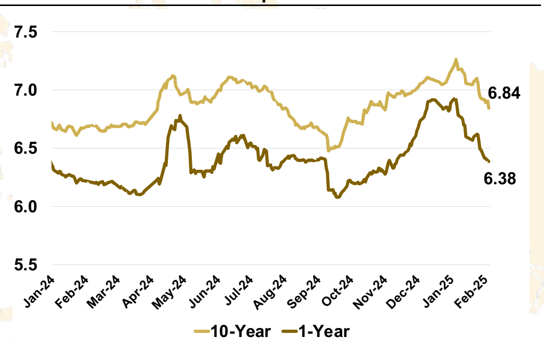
After three consecutive rate cuts in the previous Federal Open Market Committee (FOMC) meetings, the Fed held Fed Funds Rate (FFR) unchanged in the FOMC meeting last month at 4.25% - 4.50%. The decision by the Fed to keep its policy rate steady was mainly motivated by the current trend of US inflation. Since the Fed began its monetary policy easing stance last September, US inflation has consistently hiked from 2.4% (y.o.y) in September 2024 to 3.0% (y.o.y) in January 2025, shifting further away from the Fed's inflation target of 2% over the long run. Furthermore, despite a slight decrease in December 2024 to 3.2% (y.o.y) from a stable level of 3.3% (y.o.y) since September 2024, core inflation in the US rebounded to 3.3% (y.o.y) in January 2025. The latest development of US inflation has strengthened the view that the Fed will be less aggressive in cutting its policy rate throughout 2025. While the Fed's stance was widely anticipated, Bank Indonesia made an unexpected move of cutting its policy rate by 25bps during its Board of Governors meeting last month despite massive pressure on Rupiah. In addition, the newly inaugurated President Trump has launched a mix of policies, including stricter immigration measures that tighten the labour market, corporate tax rate cuts, and various tariff hikes, which potentially could cause higher inflation rate in the US and affect global uncertainties. These three factors played a massive role in the dynamic of capital flows in Indonesia and the movement of Rupiah in the past few weeks.

Figure 3: IDR/USD and Accumulated Portfolio Capital Inflow (since Jan-24)



Source: CEIC

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



Source: CEIC

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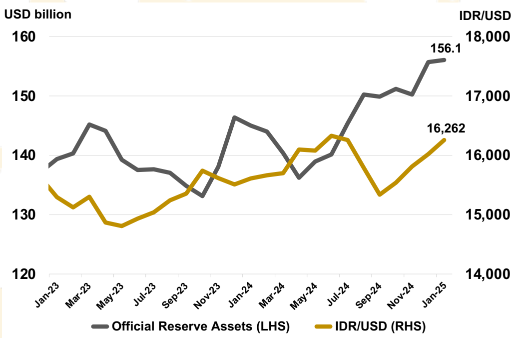
Following the inauguration of President Trump on January 20th, there has been more clarity on the potential scope of tariff war and this might reduce investors' perception of uncertainty as the risks of trade war can be better-calculated. This spurs capital flows into emerging markets, including Indonesia. Consequently, Rupiah strengthened from IDR16,360/USD on January 17th to IDR16,170/USD on January 24th. However, after the Fed's decision to hold its rate steady, Rupiah depreciated to IDR16,430/USD in early February. The ongoing escalation and negotiation of Trump's tariff imposition with various countries during the first few weeks of February has weakened the USD, consequently strengthening Rupiah to around IDR16,255/USD on February 14th. Overall, Rupiah depreciated on a year-to-date basis by 1.03% (y.t.d) and performed relatively worse compared to most of its peers' currencies, including the Russian Ruble, Brazilian Real, South African Rand, Thai Baht, Malaysian Ringgit, Chinese Yuan, and Philippine Peso, all of which recorded smaller depreciations or even gains.

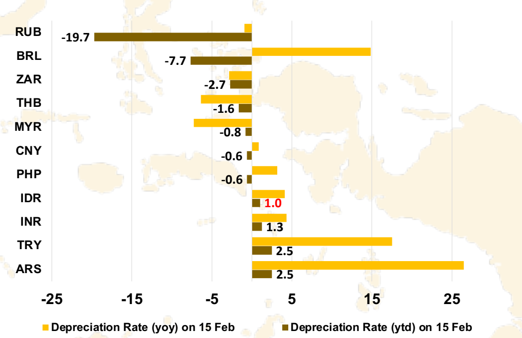
On the other hand, Indonesia recorded a positive inflow towards the bond market of around USD1.23 billion in the past four weeks. This was driven by relatively lower uncertainties perceived by investors' after Trump inauguration that spurs capital flows into emerging markets and investors' move to switch from stocks to bonds instruments in Indonesia due to relatively poor performance of domestic stock market. This is reflected by a net outflow of around USD0.45 billion in the stock market during the same period. A combination of inflow to bond market, Bank Indonesia's policy rate cut, and the action of Bank Indonesia to lower of Bank Indonesia's Rupiah Securities (Sekuritas Rupiah Bank Indonesia/SRBI) yield drove down overall government bonds yields. Specifically, 1-year government bond yield dropped by 53bps from 6.91% on January 15th to 6.38% on February 14th. During the same period, 10-year government bond yield also declined by 42bps from 7.26% to 6.84%.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (15 February 2025)



Source: Investing.com

Amidst recent fluctuation of Rupiah, official reserve assets prolonged its all-time high level after a slight increase of USD0.37 billion from USD155.7 billion in December

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2024 to USD156.1 billion in the first month of 2025. The increase was partly contributed by the government's global bond issuance as well as tax and service receipts. Furthermore, BI's effort to stabilize Rupiah by using a share of its official reserve assets might play a part in a relatively small rise in January official reserve assets figure. The current level of official reserve assets is equivalent to 6.7 months of import or 6.5 months of import and servicing the government's external debt, which is well above the international reserve adequacy standard of around three months of import and should equip Bank Indonesia with adequate resources to implement Rupiah stabilization effort through open market intervention, shall needed.

With the latest developments of global and domestic economy, uncertainty remains high. Domestically, inflation is still edging towards the lower bound of BI's target range. However, Indonesia will soon enter the period of Ramadhan and Eid Al-Fitr, which will pose inflationary pressures. Furthermore, the shift of gear by the Fed towards a less aggressive monetary easing and rapidly evolving policy stance of President Trump might affect investors' perceptions in an unpredictable manner. In addition, despite gradually appreciating, Rupiah is still relatively volatile. All things considered, we view that Bank Indonesia should keep its BI Rate unchanged at 5.75% in its Board of Governors meeting in February 2025.