



Highlights

- Inflation started to rise, but mostly due to seasonal factors
- Q3 2018 GDP growth beats market expectation
- Net capital inflow has turned positive again and is likely to continue in the next two months
- Bank Indonesia can afford to hold its policy rates for this month

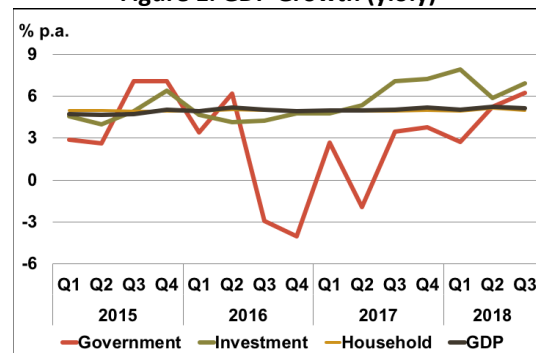
Inflation rate seems to follow its seasonal pattern in general; after two months of consecutive deflation, month-to-month inflation rate has started to climb in anticipation of seasonal increase in consumption around Christmas and New Year. Impact of the increase in non-subsidized fuel prices have also started to materialize in the inflation rate. Stronger domestic demand, along with receding external pressures following announcement of trade talks between China and US, are among the reasons to be rather optimistic about general trend in financial market. This more sanguine outlook is reflected by recent upward movement of Rupiah. Bank Indonesia can afford to hold its interest rate this Thursday; BI should increase its policy rates again in December.

Inflation Follows Seasonal Pattern

After two consecutive deflation, headline and core October inflation on month-to-month basis recorded at 0.28% and 0.29%. This movement more or less follows the seasonal pattern of inflation which will continue to even higher inflation in November and December related to the shopping season for Christmas and New Year.

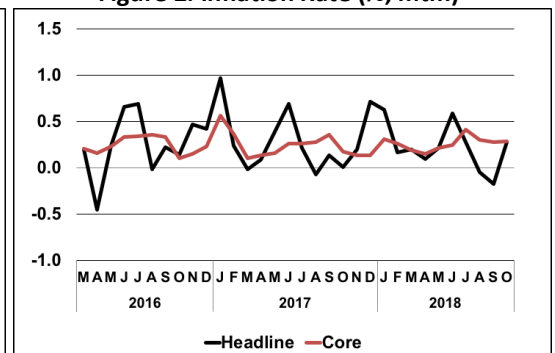
Meanwhile, on year-on-year basis, after experiencing decline last month, headline and core inflation slightly increase in October 2018 to 3.15% and 2.94% from 2.88% and 2.82% in September 2018. It is mainly related to higher price of non-subsidized fuel which directly or indirectly affects inflation. For the most part, the effect of higher fuel prices on inflations is transmitted through the rise in transportation costs.

Figure 1: GDP Growth (y.o.y)



Source: CEIC

Figure 2: Inflation Rate (% mtm)



Source: CEIC

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GDP Beats Expectations

GDP growth at 5.17% (y.o.y) in Q3 2018 is slightly above market expectation of 5.1%. Q3 growth was mainly driven by increases in investment and government expenditure, which has reached to 6.96% and 6.28% (y.o.y), respectively. The growth of government spending hits the highest record since 2016. This increase in expenditure cannot be separated from the economic impact of Asian Games 2018 event, which is reflected in the surge of DKI Jakarta and Palembang GDRP growth to 6.41% and 5.56% (y.o.y) respectively.

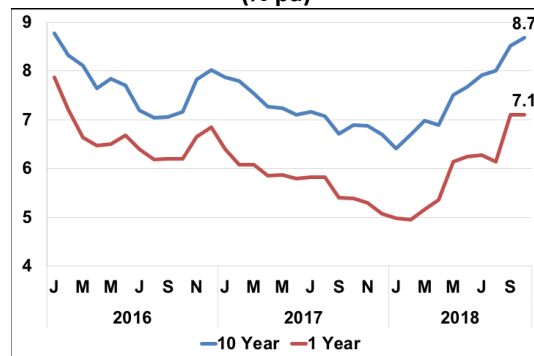
Key Figures

- BI Repo Rate (7-day, Oct '18)
5.75%
- GDP Growth (y.o.y, Q3 '17)
5.17%
- Inflation (y.o.y, Oct '18)
3.15%
- Core Inflation (y.o.y, Oct '18)
2.94%
- Inflation (mtm, Oct '18)
0.28%
- Core Inflation (mtm, Oct '18)
0.29%
- FX Reserve (Oct '18)
USD115.2 billion

Trade War Fears Recede, Foreign Exchange Reserves Increase

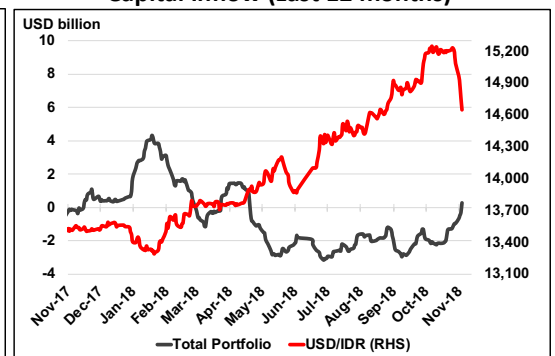
Investors' behavior since early November is interesting to follow as Rupiah suddenly appreciated to 14,700 per USD; the highest weekly gain since 2016. USD depreciation, largely driven by the result of midterm election and the possibility of resolution to the trade war after an announcement of potential trade talk between US and China, accounts for most of the behavior of capital inflow to emerging markets in the last two weeks. Rupiah led the appreciation among emerging market currencies, particularly after Q3 GDP growth rate beat market expectation. Cumulative net capital inflow at the end of last week is recorded at positive territory after being consistently at negative territory in the last 6 months; 10-year government bonds yield fell by 35 bps. What currently happens in the financial market is the exact opposite of what happened three months earlier; liquidity in the foreign exchange market has somewhat increased.

Figure 3: Government Bonds Yield (% pa)



Source: CEIC

Figure 4: IDR/USD and Accumulated Portfolio Capital Inflow (Last 12 months)



Source: CEIC

Aside from the strength of domestic macroeconomic indicators, with GDP growth of more than 5% and stable inflation at around 3% level, recent Bank Indonesia's decision to introduce Domestic Non-Deliverable Forward (DNDF) has also played part in attracting market participants to buy Rupiah at least in the short term; demand for short-term Rupiah bonds gains in the last two weeks.

Current Account Deficit and December FOMC

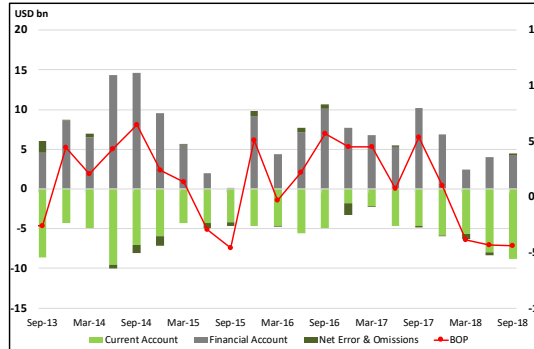
Current account deficit in Q3 2018, which reached the 3.4% level, has become a source of concern and tapered the appreciation of Rupiah back to Rp14,700 in the last few days. However, we see that the current account condition will improve in Q4 2018 and 2019 due to higher costs of importing goods or the result of various policy mix. Price of crude oil, while still difficult to predict, seems to stabilize at current level and has fallen from where it was several months earlier.

Increase in domestic demand along with reduction in external pressures, particularly driven by receding fears of trade war, are two key reasons to be optimistic in current market outlook. Taking these factors and Rupiah movement in the last few weeks into consideration, we view that Bank Indonesia has room to hold its policy rate unchanged in Thursday meeting. Indeed, there is still one more Fed rate hike in December. In response, we see that BI will need to raise its policy rates in December.

Key Figures

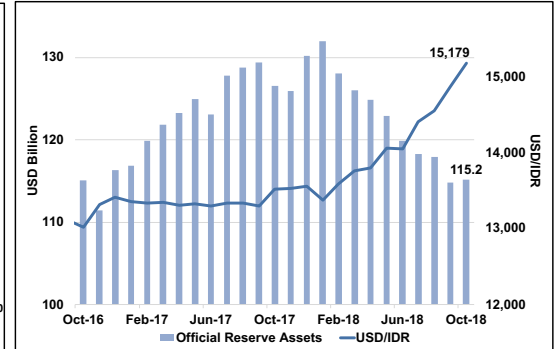
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Figure 5: Balance of Payment
Q3 2013 – Q3 2018



Sumber: CEIC

Figure 6: IDR/USD Official Reserve Assets
(Last 24 months)



Sumber: CEIC