



# BI Board of Governor Meeting

March 2021

## Highlights

- BI should keep its policy rate at 3.50% this month.
- The rise of inflation expectation in the U.S. has triggered capital outflows from Emerging Markets, including Indonesia.
- Despite ongoing muted inflation, improvement in daily Covid-19 cases, CCI, and trade balance might indicate a start of recovery.

## Macroeconomics & Political Economy Policy Research

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The performance of Indonesia's macroeconomic indicators is currently showing an improvement, as recorded by higher CCI, trade balance, and decrease in daily Covid-19 cases. The improvement is fueled by better expectations of economic activity after the first rollout of Covid-19 vaccines. However, the positive sentiment from domestic side is vanished since the late of February due to the high pressure from external condition. The rout in the U.S. market following the higher-than-expected inflation figure which is reflecting the optimistic prospect of economic recovery has hit all emerging economies' markets, including Indonesia. Rupiah has been depreciated by 3.70% (ytd) in mid-March. The depreciation was driven by the massive capital outflow due to the narrowed yield differential between U.S. and emerging market's assets. In this uncertain time, we see that BI should be more vigilant against any increases in external risks. Despite the continuation of low inflation that is signaling muted aggregate demand, BI should prioritize the stability of Rupiah this month. Any expansionary monetary policy will be too costly for BI right now as the performance of economic condition is also far from recover. Thus, we see that BI needs to hold its policy rate at 3.50% this month as the preemptive measure to stabilize Rupiah.

## Muted Inflation Pressure

Considering lingering demand weakness together with the end of holiday season festivity, it is no surprise that inflation in February 2021 is still below BI's target range, which stood at 1.38% (y.o.y), easing from 1.55% (y.o.y) in January 2021. This is the lowest annual headline inflation in seven months or since August 2020. Maintaining our views from last month, we do not expect a sharp increase in inflation in the near future because of dwindling purchasing power.

On a monthly basis, the headline inflation declines from 0.26% (mtm) in the first month 2021 to 0.10% (mtm) in February 2021. Lower headline inflation is due to the combination of subdued core inflation and volatile food deflation, offsetting administered price inflation. Monthly core inflation was at 0.11% (mtm) in February 2021, lower than the same period last year at 0.14% (mtm). Apart from muted, drop in gold price by 6.71% in February 2021 may account for decline in core inflation. Gold price has dipped throughout 2021 after surge in 2020 because of rise in USD and treasury yield and increasing confidence as multiple vaccine rollout. Volatile food recorded a deflation of 0.01% (mtm), significantly lower than January level at 1.15% (mtm). This deflation is caused by price drop in several commodities, such as chilli, tomato, egg, and chicken meat. In terms of administered price, inflation was recorded at 0.21 % (mtm) in February 2021, creeping higher from previous deflation

## Key Figures

BI Repo Rate (7-day, Feb '21)  
**3.50%**

GDP Growth (y.o.y, Q4 '20)  
**-2.19%**

Inflation (y.o.y, Feb '21)  
**1.38%**

Core Inflation (y.o.y, Feb '21)  
**1.53%**

Inflation (m.t.m, Feb '21)  
**0.10%**

Core Inflation (m.t.m, Feb '21)  
**0.11%**

FX Reserve (Feb '21)  
**USD138.8 billion**

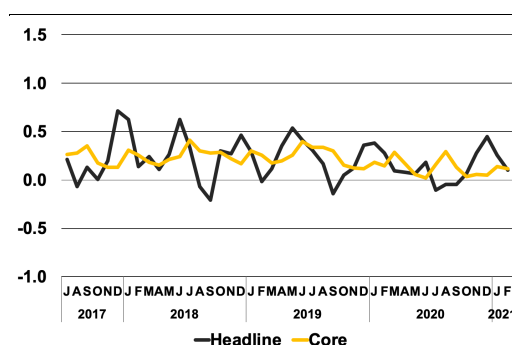
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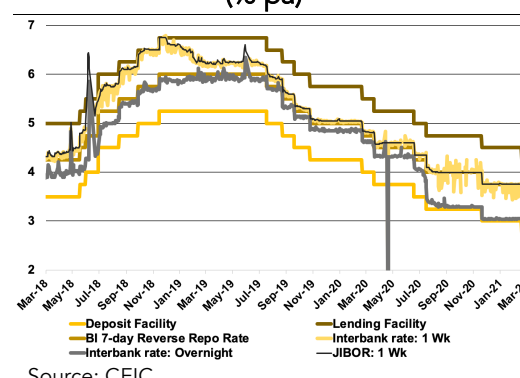
at 0.19% (mtm). This is due to airline fares starting to bounce back to its normal level after year-end period and the government adjust toll tariff for several segments.

Figure 1: inflation Rate



Source: CEIC

Figure 2: Interest Rate Policy and Interbank Money Market Interest Rate (% pa)



Source: CEIC

## Gradual Domestic Economic Recovery

Following various measures to speed up economic recovery, Consumer Confidence Index (CCI) showed an improvement in its latest figure at 85.8, a slight increase from 84.9 in January. CCI is recorded stronger for respondents with expenditure levels between IDR1 million to IDR 3 million per month. Small improvement in CCI was attributable to perception of current economic conditions, job availability, income, and timeliness of durable goods purchase. To boost consumer confidence and to restore purchasing power, The MoF issued two tax break on car and property sales. Value added tax on certain luxury vehicles and landed house or apartment below IDR 5 billion will get tax discount ranging from 100% to 25%. Bank Indonesia also drop the down payment requirement for new vehicle loans and mortgages last month in an attempt to stimulate aggregate demand. This regulation is planned to be in effect until the end of this year.

Progress on economic recovery is also visible in our trade balance, which recorded a surplus of USD2 billion in February 2021, a modest increase of 1.89% from January surplus of USD1.96 billion. While oil and gas records a lower trade deficit of USD0.44 million compared to January 2021, non-oil and gas trade continues posting trade surplus of USD2.4 billion, although lower by 7.1% from January level. On export side, we see an increase in iron and steel export by USD240.7 million, or 24.2% compared to the previous month, which suggest our trade partners are recovering. Looking into import, the highest increase is seen in machinery and electrical equipment by USD172.8 million or 10.03% increase from January level. This indicates manufacturing starts to pick up, a good sign of recovery.

Another indicative measure of recovery is shown by the daily Covid-19 cases. Our daily confirmed cases is showing a downward trend since January 2021. As of 16

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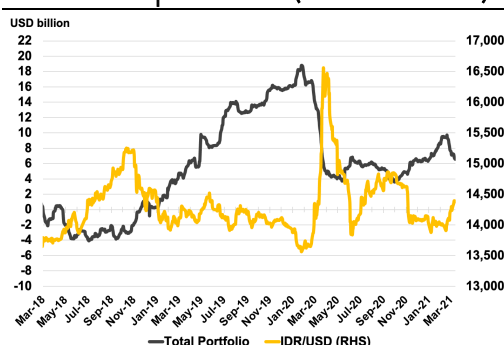
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March 2021, there are 5,414 confirmed cases. However, our mortality rate remains stood at 2.7%, higher than global fatality rate at 2.2%. This suggest that the government need to stay vigilant to suppress the spread rate. Vaccine rollout together with massive stimulus are expected to help gradually return consumer and business confidence back to normal.

## Rising External Pressures

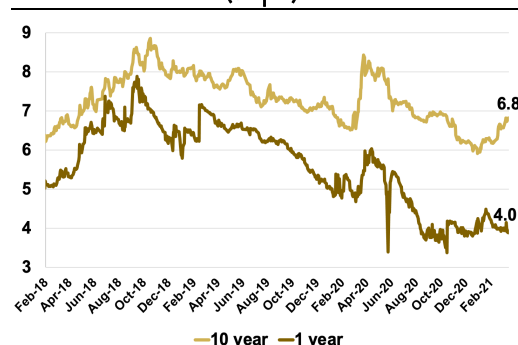
After period of appreciation since November last year, Rupiah unexpectedly began depreciating again to IDR14,400 in the fourth week of February from around IDR14,000 in the previous week. The weakened condition of Rupiah was mainly driven by the unexpected condition of the U.S. market. The market was in a surprise in the late February as better-than-expected inflation figure in U.S. reflects the optimistic recovery prospects from the Covid-19 pandemic. The higher inflation coupled with the upcoming Biden's stimulus package, which is amounted to USD1.9 trillion, has created immense turbulence in the U.S. bonds market. Despite the sign of faster economic recovery in U.S, the market fear of further surge in inflation due to the better economic condition has triggered massive selloff in U.S. bonds market since February. The condition has prompted investors to move their assets out of bonds into other assets that are less prone to inflation and debt borrowing cost. As a result, the average of 10-year U.S. treasury bond yields has climbed to its pre-pandemic level at 1.6% in mid-March. The rising U.S. bond yields led dollar to a higher level and hit investors' interest for emerging markets as the yield differential was narrowed. In turn, the local-currency bonds in emerging markets are experienced the first most volatile week in 2021.

Figure 3: IDR/USD and Accumulated Portfolio Capital Inflow (Last 36 Months)



Source: CEIC

Figure 4: Government Bonds Yield (% pa)



Source: Investing.com

Despite the positive sentiment of Indonesia's economy, perceived by the improvement of CCI and daily Covid-19 cases, the impact is rather overturned by massive capital outflow. The trend of capital outflow that has happened in Indonesia is reflected in the government bonds yield, where 10-Year bond yield has increased to 6.6% by the end of February. The continuation of enormous pressure on first week

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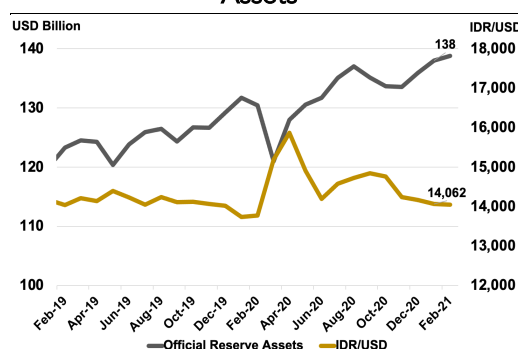


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of March drove this figure higher to 6.8% in mid-March. In line with the increased 10-Year bonds yield, the value of credit default swap (CDS) for 10-Year government bond has also surged from only 67 in mid-February to 79 in mid-March, reflecting increased perceived risks among investors in the last one month.

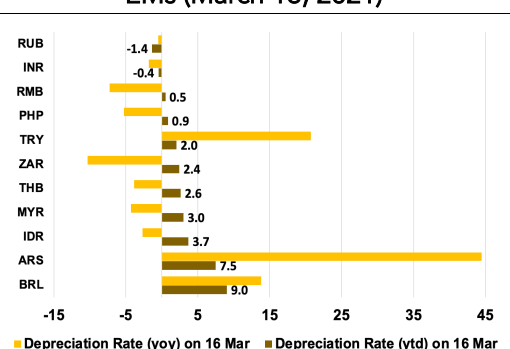
The uncertainty in domestic capital market which is fueled by external pressures has held back the episodes of high accumulation of forex reserves throughout this year. BI foreign exchange reserves in February is only increased by around USD800 million to USD138.8 billion. However, the foreign exchange reserves are ample to equip BI with enough liquidity to support Rupiah stabilization for the upcoming external pressures. The stability of Rupiah should be the highest priority of BI's attention this upcoming month as Rupiah has been one of the the hardest hit currency during the U.S. market uncertainty. The depreciation rate of Rupiah, which is recorded at 3.70% (ytd), is the highest among other emerging market peers in Asia.

**Figure 5: IDR/USD and Official Reserve Assets**



Source: CEIC

**Figure 6: Depreciation Rates of Selected EMs (March 16, 2021)**



Source: CEIC

The external pressures from U.S. market is most likely to persist until the end of this week as the market are waiting for The Fed's meeting. The higher U.S.' inflation last month has prompted investors to believe that The Fed will hike its interest rate in order to mute the inflation. However, The Fed has tried to calm down the market by signalling that there will be no hike in interest rate at any time soon. In turn, the market is currently firm in cautious movement before the meeting. In this uncertain time, we see that BI should be more vigilant against any increases in external volatility. On the other hand, any expansionary monetary policy will be too costly for BI right now as the performance of economic condition is still far from recover. Despite the continuation of low inflation that is signaling muted aggregate demand, BI should prioritize the stability of Rupiah to mitigate further depreciation risks this month. Along with the utilization of foreign exchange reserves to dampen the volatility in Rupiah, we see that BI needs to hold its policy rate at 3.50% this month as the preemptive measure to stabilize Rupiah.