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UNIVERSITAS INDONESIA

Macroeconomic Analysis Series

BI Board of Governor Meeting

April 2021

Highlights

- BI should hold its policy rate steady at 3.50% this month.
- Developments in the US, such as improving labour market and better-than-expected inflation, posses risks for Rupiah.
- Major indicators, such as trade balance, vaccine rollout, PMI, and CCI, are on the track of recovery, despite inflation remains muted.

Macroeconomics & Political Economy Policy Research

Jahen F. Rezki, Ph.D.
jahen@lpem-feui.org

Syahda Sabrina
syahda.sabrina@lpem-feui.org

Nauli A. Desdiani
nauli.desdiani@lpem-feui.org

Teuku Riefky
teuku.riefky@lpem-feui.org

Amalia Cesarina
amalia.cesarina@lpem-feui.org

Meila Husna
meila.husna@lpem-feui.org

Faradina Alifia Maizar
faradina@lpem-feui.org

Continuation of domestic recovery trend is gaining traction. These achievements are driven by accelerating vaccination program and government stimulus, such as tax discount on luxury goods. Despite these figures, unlike the usual, inflation remains muted during the start of Ramadhan. On the external side, uncertainty mostly comes from the US developments. Massive progress on vaccination, stronger labor market, and better-than-expected inflation indicate very good news on the economy, prompting investors to put their assets to safe haven instruments. This put pressure on Rupiah as we see it depreciates against USD to IDR14,572 at the end of March. This month, we see The US 10-year treasury yield then gradually went down and capital starts to move to emerging markets, including Indonesia. Despite low inflation, to continue anchoring Rupiah and to support recovery, BI should hold its policy rate steady at 3.50% this month.

Inflation Hasn't Been Showing Any Real Progress

Resuming economic performance during the first quarter of 2021, inflation has continuously reflected a rather unfavorable pattern. The impact of the pandemic that persisted along with the end of the holiday season has heftily affected the consumption pattern of the considerably high-income group. The issue was reflected by a lower inflation rate in March 2021 that continues after a notable decrease in February 2021. Annual headline inflation stood at 1.37% (y.o.y) compared to 1.38% (y.o.y) in February 2021. On the same basis, core inflation also recorded a lower rate of 1.21% (y.o.y) from 1.53% (y.o.y) in the previous month. Several events that may put an inflationary pressure such as any preparation to welcome Ramadhan festive have not been translated into a higher inflation rate. However, we may expect an accelerated inflation rate for next month as the Ramadhan will officially begin and people will also prepare for the Eid-al-Fitr celebration.

Monthly inflation stood at 0.08% (mtm) compared to 0.10% (mtm) in preceding month. The declining headline inflation is partly driven by deflation in core value recorded at -0.03% (mtm) compared to 0.11% (mtm) in the previous month. The lower core inflation rate is especially triggered by several events such as tax incentives for vehicle and luxurious goods and a persistent decline in gold price. On the other hand, volatile food fortunately recorded an upward pressure from -0.01% (mtm) deflation in February 2021 to 0.56% (mtm) in March 2021. The increase of several commodities prices such as onion and chili has become the main driver for the higher inflation rate in volatile food amid the harvest season for other vital commodities such as rice. However, several declines in administered price inflation and energy price deflation offset the volatile food performance and therefore failed to manage a rather pleasant performance in headline monthly inflation. Further, we

Key Figures

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

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

Inflation (y.o.y, Mar '21)
1.37%

Core Inflation (y.o.y, Mar '21)
1.21%

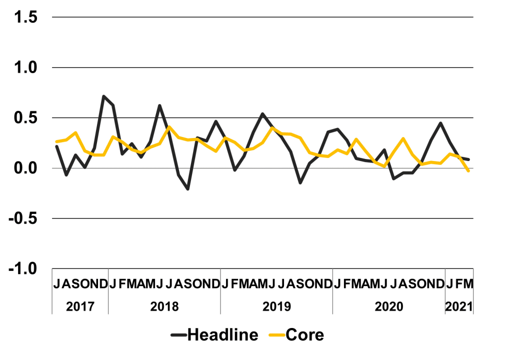
Inflation (m.t.m, Mar '21)
0.08%

Core Inflation (m.t.m, Mar '21)
-0.03%

FX Reserve (Mar '21)
USD137.1 billion

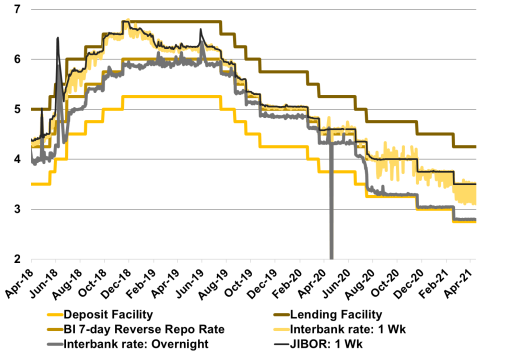
expect better coordination between GoI, BI, and other stakeholders in order to elevate the purchasing power and to put the inflation within the BI's target range of 2%-4%.

Figure 1: Inflation Rate (m.t.m)



Source: CEIC

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



Source: CEIC

Recovery Is On Track

Following various measures to speed up economic recovery, Consumer Confidence Index (CCI) continued to increase in March 2021 to a level of 93.4 from 85.8 in February. Respondents across all expenditure and education groups were more optimistic during this reporting period. The improvement in CCI was attributable to the perception of current economic conditions, job availability, income, and timeliness of durable goods purchase. To boost consumer confidence and restore purchasing power, GoI has issued several policies that support the national economic recovery, ranging from tax breaks on car and property sales to encouraging banks to lower loan interest rates.

The implementation of sales tax incentives on luxury goods (PPnBM) for new cars has proven to be effective in boosting sales of automotive manufacturers throughout March 2021. Based on data from the Indonesian Automotive Industry Association (Gaikindo), sales from factories to four-wheeled dealers or wholesales in March 2021 reached 84,910 units, an increase of 72.6% compared to the previous month. BI also relaxed the Loan to Value/Financing To Value (LTV/FTV) ratio for loans and property financing to a maximum of 100%. These policies have been implemented since March 2021 and are 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 USD1.57 billion in March 2021. Despite the lower realization than the surplus of USD2 billion in February 2021, the March surplus is driven by both increase export and import, which suggest a stronger sign of recovery. The value of exports reached USD18.35 billion in March 2021, an increase of 20.31% (mtm) from

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USD15.27 billion in February 2021. In detail, the export performance supported by oil and gas reached USD910 million, an increase of 5.28% (mtm) in the previous month. Meanwhile, non-oil and gas exports amounted to USD17.45 billion, an increase of 21.21% (mtm). The export increases was mainly due to an increase in demand and commodity prices, besides a depreciation of Rupiah. Based on the HS code, the increase in exports on a monthly basis occurred in edible animal fats & oils, metal ores & ash, iron & steel, electronic machinery & equipment, and mineral fuels. Meanwhile, the increase in imports came from iron & steel commodities, machinery & mechanical equipment, ships, boats & floating structures, and mineral fuels, which all are mainly useful as inputs for production. Higher imports of raw materials and capital goods suggests that manufacturing and investment are starting to recover, which is also supported by Indonesia's PMI, which stood at its highest for the last 10 years with 53.2.

Strong External Pressures Despite Domestic Improvement

At the end of March 2021, Rupiah depreciated against USD to IDR14,572, down by 2.41% compared to the previous month and hit its lowest level since November 2020. The weakening of Rupiah is mainly driven by external sector, as President Biden signed a fiscal stimulus of USD1.9 trillion in the last month. On top of that, earlier this month, he unveiled an infrastructure package of USD2 trillion, which will mostly be financed by an increase in corporate tax. There are also higher expectations on economic growth as a result of rapid progress on The US vaccination program with about 39% of the population has received at least one vaccination and higher-than-expected inflation of 0.6% (m.t.m) in March 2021. Generally, very good news on the economy would have increased investors' risk appetite, which triggered a major Treasuries sell-off and yields would hold at a higher level or rise further. This is true during the second half of March 2021 when The US 10-year treasury yield climbed towards 1.8%, the highest level since January 2020. Mid-April 2021, despite the announcement of strong retail sales, which increases by 9.8% in March 2021, and lower-than expected initial claims for unemployment insurance, the US 10-year treasury yield then gradually went down and eventually reached 1.59% on April 16th. There are two reasons of why this happens. Firstly, the market already priced in strong expectations for the US' economic growth in March. Secondly, the market is currently self-correcting after pricing in an accelerated Fed rate hikes as a result of solid economic performance.

Focusing on Indonesia, the surge in the US 10-year treasury yield shifts investors' appetite for safe-haven instruments, prompting investors to pull capital out of emerging markets. As a result, the USD strengthens and we saw an increase in government bond yields with 10-year bond yields up by 22bps to 6.81% at the end of March 2021 compared to 6.59% at the end of February 2021. Domestic recovery progress on the real sector, combined with a decrease in domestic bond yields currently to 6.59% in mid-April result in lower credit default swap (CDS) at 148.74 in

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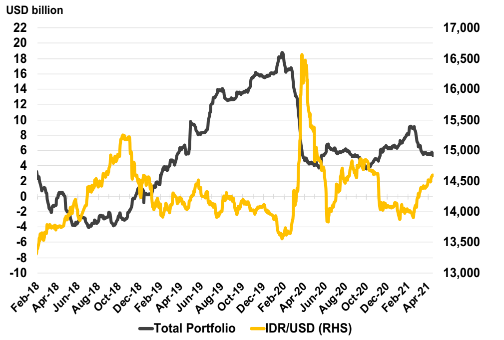
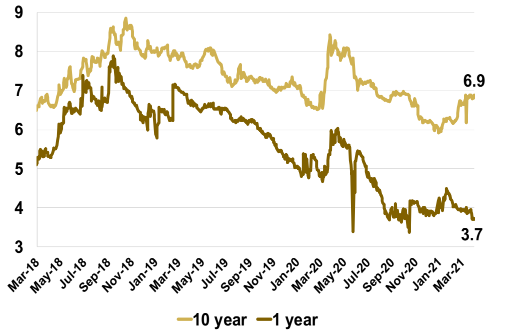
mid-April from 153.89 at the end of March, suggesting lower perceived risk by global investors.

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



Source: CEIC

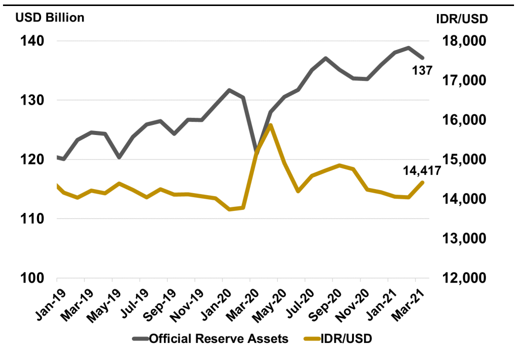
Figure 4: Government Bonds Yield (% pa)



Source: Investing.com

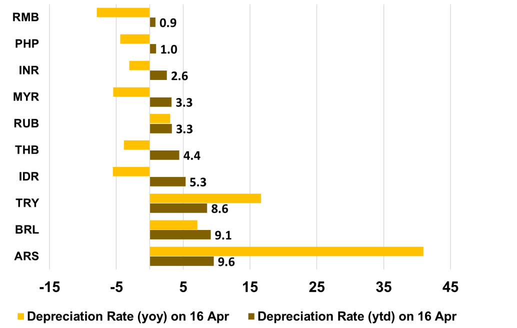
At the end of March 2021, foreign exchange reserves slightly fell to USD137.1 billion, down by USD1.7 billion from February 2021 at USD138.8 billion. This decline was mainly influenced by external debt payments. Despite a slight decrease, the current level of foreign exchange reserves is considered strong enough to weather current external pressures, which are equivalent to finance 10.1 months of imports or 9.7 months of imports and government debts. Amid external uncertainty, Rupiah depreciated by 5.3% (ytd), the worst among its ASEAN peers.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

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



Source: CEIC

Despite an emerging sign of recent domestic economic recovery, the external factors have imposed some degree of volatility in Rupiah. The robust prospect of US economic recovery has shifted investors' appetite, creating a flight of capital flows from EMs, including Indonesia. While there is still a substantial need to bolster domestic purchasing power and aggregate demand, we are in a view of BI needs to hold its policy rate steady at 3.50% to maintain the financial and exchange rate stability while supporting economic recovery.