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UNIVERSITAS INDONESIA

BI Board of Governor Meeting

August 2021

Highlights

- BI should continue to hold its policy rate at 3.50% this month.
- Despite recorded at a notable rate in Q2 2021, economic performance will most likely decline in Q3 2021 with surge in Covid-19 daily case and strict lockdown.
- Rupiah depreciates as the domestic uncertainty prevails.

Macroeconomics & Political Economy Policy Research

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Indonesia's GDP rose by 7.07% (y.o.y) in the second quarter and after exactly one year, we are now officially out of economic recession that started in Q2-2020. Despite the better-than-expected growth of the economy, the pace of recovery will be limited due to the emergence of Delta variant that has a high transmission rate and causes mobility restrictions to be imposed since last July. Hence, economic indicators, such as Consumer's Confidence Index (CCI), and Manufacturing Purchasing Managers' Index (PMI) continued to plunge. From external conditions, the improvement of the U.S. economy resulted in investors moving their capital from emerging markets which caused Rupiah to depreciate against the USD. Therefore, amidst these uncertain circumstances, we see that BI needs to hold its policy rate at 3.50% while maintaining the exchange rate and financial stability.

Slight Increase in Inflation Rate Amid the Ongoing Health Crisis

July's headline inflation was recorded at 1.52% (y.o.y), up from 1.33% (y.o.y) in the previous month. This was driven by increase in administered and volatile prices components. Administered prices inflation accelerated from 0.49% (y.o.y) in June to 0.61% (y.o.y) in July, while volatile prices inflation jumped to 2.97% (y.o.y) from 1.60% (y.o.y) in June 2021. Otherwise, core inflation slightly weakened from 1.49% (y.o.y) to 1.40% (y.o.y) this month.

On a monthly basis, inflation in July started to pick up again after previously experiencing deflation. It was recorded at 0.08% (mtm), up from -0.16% (mtm) in June 2021 and -0.10% (mtm) in the same period last year. This was triggered by an increase in the administered and volatile prices inflation component. Administered prices inflation was recorded at 0.05% (mtm), strengthened compared to the previous month which experienced deflation of 0.21% (mtm). One of the reasons is the increase in tobacco excise which has resulted in an increase in cigarette prices. At the same time, volatile goods inflation increased to 0.14% (mtm) from -1.23% (mtm) in the previous month due to an increase in commodity prices such as chilies, tomatoes, and onions. This is an improvement compared to the same period in the previous year, where all inflation components other than core inflation experienced deflation due to sluggish purchasing power as the social restriction was implemented. Meanwhile, core inflation has continued to slow down since last May, recorded at 0.07% (mtm) in July 2021. It was also lower compared to July 2020 with 0.16% (mtm). This is an indication that demand recovery is still very limited given the partial lockdown imposed by President Jokowi at the beginning of last month.

In terms of sectoral aspects, health sector is the main contributor for this month's inflation due to the ongoing health crisis because the number of new confirmed cases

Key Figures

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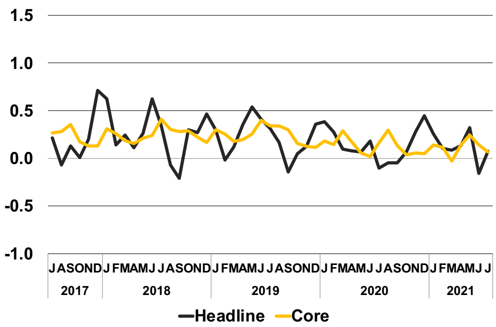
USD137.3 billion

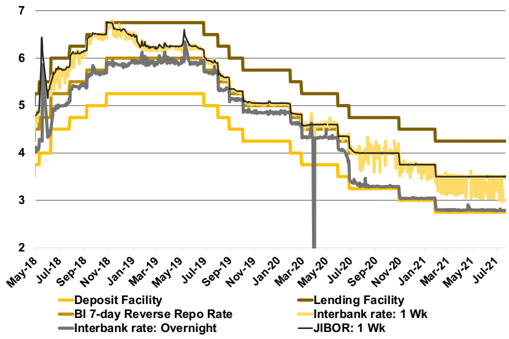
encourages people to take more vitamins and medicines. Additionally, medical oxygen shortage due to high demand contributed to an increase in health sector's prices. All in all, we see that this slight improvement in the inflation rate shows the dynamics caused by the Covid-19 pandemic crisis which peaked in early July 2021. However, we expect the inflation rate to remain low in August as the partial lockdown remains in place at least until 23rd August.

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



Source: CEIC

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



Source: CEIC

Notable Economic Performance before Another Wave of Pandemic

Indonesia's GDP rose by 7.07% (y.o.y) in the second quarter and after exactly one year, we are now officially out of economic recession that started in Q2-2020. The positive growth was driven by two factors, namely the economic recovery and a low base effect from the second quarter of 2020, where economic growth at that time contracted by -5.32% (y.o.y). This positive growth cannot be separated from the global economy which also grew in the same period. The economic growth of Indonesia's trading partners also contributed to the growth of the export of Indonesian goods and services by 31.78% (y.o.y) as a component of GDP. An increase also occurred in Indonesia's imports by 31.22% (y.o.y) as a result of an increase in imports of components of consumer goods, raw materials, and capital goods. Beside being driven by the economic recovery of trading partners, positive growth was also driven by the increase in commodity prices, such as coal and CPO. However, there may be challenges faced by the GoI in the next quarter which may restrain the recovery path, where the economic performance will depend on how long the partial lockdown is in effect and our success in controlling Covid-19 cases.

After being in the optimistic area (>100) in the April-June 2021 period, Indonesia's Consumer's Confidenece Index (CCI) fell to 80.2 from 107.4 in the previous month following the implementation of the partial lockdown in early July. This indicates that consumer expectations for the economic conditions in the next 6 months are still limited, both in terms of business activities and the jobs availability. CCI decreases across all spending levels and all age brackets especially for respondents between 41 and 50 years old and respondents with expenses of IDR 1-2 million per month.

Along with CCI, the second wave of Covid-19 also hit Indonesia's manufacturing sector hard in July 2021, causing Indonesia's Manufacturing Purchasing Managers' Index (PMI) to drop drastically to 40.1 compared to the previous month at 53.5. This marks the first contraction in Indonesia's manufacturing sector in nine months, with the fastest rate of decline since June 2020. Meanwhile, output and demand declined at the fastest pace since May 2020, ending an eight-month streak of growth. The increase in disruption stems from the second wave of Covid-19, which has hampered production and demand.

Since 19th July, the number of new daily confirmed cases (7-day moving average) has started to slow down, recorded at 27,704 cases as of 14th August. However, there is still a long way to go because the number of cases is still above 10,000 with more than 1,000 deaths per day. The event indicates that the partial lockdown, which has been extended several times by the government, is starting to show results. Since it was first implemented on 3rd July, this policy has been adjusted several times. Last time, the GoI relaxed the public activity restriction (Pemberlakuan Pembatasan Kegiatan Masyarakat/PPKM) level 4 policy by allowing malls and restaurants to open under certain conditions, such as visitors must have been vaccinated and indoor restaurants can only accept take away/delivery. The GoI will continue to monitor Covid-19 cases and carefully issuing policies that are adapted to the developments of the pandemic by extending PPKM at least until August 23rd.

Looking into vaccine rollout data, up to 14th August, at least 53.6 million people have received a single dose of the vaccine, while more than 27.8 million people have been fully vaccinated. This figure is still below the target of more than 208 million people to be fully vaccinated. As of 27th July, Indonesia has secured 173.1 million doses of Covid-19 vaccine, consisting of 144.7 million doses from Sinovac and 28.6 million doses in the form of finished products from AstraZeneca, Sinopharm, and Moderna. Throughout August 2021, Indonesia is expected to receive 45 million more doses from three pharmaceutical companies, 50% of which will be distributed to seven regions in Java and Bali.

Capital Reversal driven by US Economic Recovery

After experiencing capital inflow due to the release of the Q2 2021 GDP data, there is a slight outflow from USD7.81 million to USD7.62 million in the second week of August 2021 as investors move their capital from emerging markets. This is because the U.S. jobs report in July 2021 showed an unexpectedly sharp drop in the unemployment rate to 5.4%, which caused an increase in U.S. treasury yields and turn the market sentiment and expectation that the Fed will announce a taper of its asset purchases, at least, at its September meeting. There are indications that the outflow will continue if the domestic situation is still uncertain in terms of the

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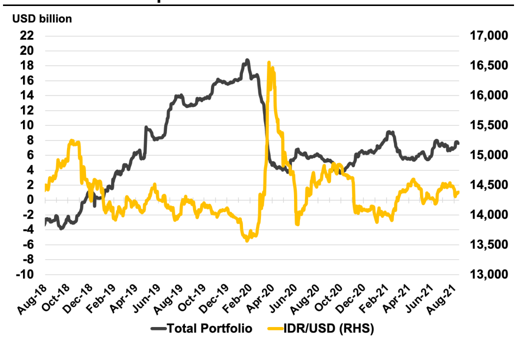
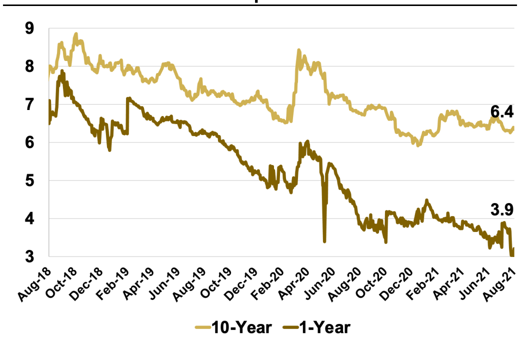
implementation of PPKM policy and the number of Covid-19 domestic cases. The recent outflow has driven yields of 10-year and 1-year government bond higher to 6.4% and 3.9% compared to 6.3% and 3.0% in the previous week, respectively. Likewise, the impact of the portfolio reversal brought Rupiah slowly back to depreciate against USD to around IDR14,380.

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



Source: CEIC

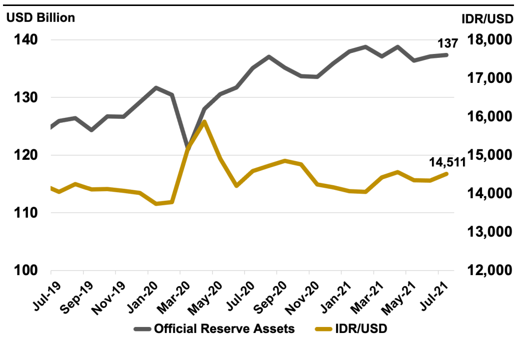
Figure 4: Government Bonds Yield (% pa)



Source: Investing.com

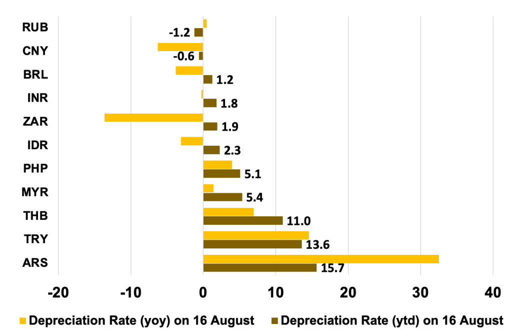
Compared to its peers, Rupiah recorded a depreciation of 2.29% (ytd) against USD. However, it surpassed Malaysian Ringgit and Thailand Baht's performance with a lower year-to-date depreciation. Foreign reserves assets slightly increased to USD137.3 billion in July 2021 from USD137.1 billion in the previous month and was influenced by the Government's global bond issuance as well as tax and services receipts. The latest reserve figure is equivalent to finance 8.9 months of imports or 8.6 months of imports and servicing government's external debt, and well above the international adequacy standard of three months imports.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

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



Source: Investing.com

Despite the better-than-expected growth of the Indonesian economy in Q2 2021, the pace of recovery will be limited due to the emergence of Delta variant that has a high transmission rate and causes mobility restrictions to be imposed since last July. Indonesia recorded a grim milestone of more than 100,000 deaths from Covid-19 on 14th August, with 3.83 million people infected. GoI needs to not compromise

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any efforts to save public health as the failure to do so would be detrimental to health and economic aspect. From the external side, markets are currently watching closely how the Delta variant reshapes the Covid-19 crisis around the world while monitoring how policymakers around the world, especially The Fed, will react. Therefore, amidst these uncertain circumstances, we see that BI needs to hold its policy rate at 3.50% while maintaining the exchange rate and financial stability.