LPEM FEB UI
UNIVERSITAS INDONESIA

Macroeconomic Analysis Series

BI Board of Governor Meeting

September 2021

Highlights

- BI should continue to hold its policy rate at 3.50% this month.
- The new academic year partially contributed to a slight pick-up in inflation.
- Several recent developments, including the addition of reserves from SDR to LCS implementation strengthen the external resiliency of financial sector.

Lower trend of Covid-19 daily cases has brought some positive signals to the macroeconomic and financial indicators. This was marked by the mild improvement in Manufacturing Purchasing Managers' Index (PMI). On the external side, support from IMF also eases the instability in the near future. However, since partial lockdown (PPKM) is still in place, the recovery plans are becoming rather limited. This is shown by *softer-than-expected* inflation as well as the Consumer Confidence Index (CCI) that continues to drown. The mutation of Covid-19 virus to several variants ranging from MU, Lambda, and C.1.2 also put another jeopardy and uncertainty to the health condition in particular and future economic stability in general. Therefore, given the circumstances we see that BI should hold its policy rate at 3.50% while carefully observing the trend of Covid-19 development and maintaining a stable financial condition.

Slight Increase of Inflation as the Improvement in Health Aspect Emerges

Continuing the upward trend since last month, this month inflation experienced a slight pickup from 1.52% (y.o.y) in July to 1.59% (y.o.y), which was partially supported by the beginning of 2021/2022 academic year that started in late July to early August. Looking at the expenditure group, education is surprisingly accelerated to 2.26% (y.o.y) compared to 1.63% (y.o.y) in the previous month. Food, beverage, and tobacco expenditure group also shows the same trend with a higher level of inflation from 2.74% (y.o.y) in July to 3.31% (y.o.y). The main reason for this higher level of inflation is mostly caused by the remaining impact of tobacco excise that has risen the price of cigarette. Furthermore, higher CPO price also contributed to a higher level of inflation in the sector. Personal care and other services, on the other hand, continued to show a decelerating movement with a slower performance of 0.62% (y.o.y) compared to 2.50% (y.o.y) in a prior month. To conclude, the second outbreak of Covid-19 has slowed down consumption and led the inflation level to remain below the central bank's target. The vaccination program combined with the lower trend of confirmed cases of Covid-19 are expected to gradually bolster the inflation figure for the rest of this year as the economic activity is set in motion.

Macroeconomics & Political Economy Policy Research

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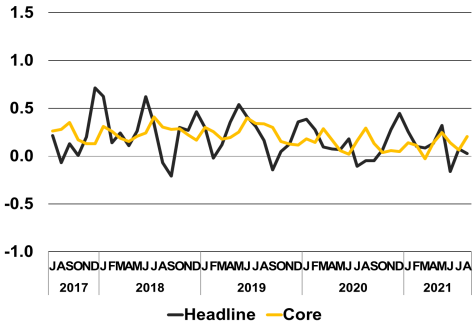
Key Figures

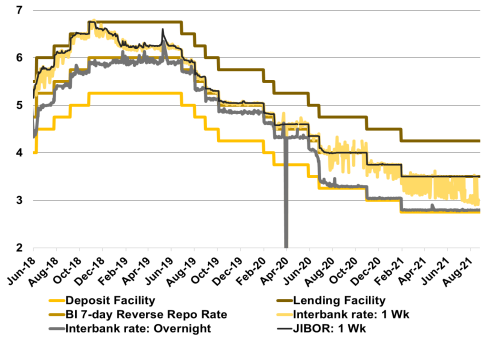
BI Repo Rate (7-day, August '21)
3.50%
GDP Growth (y.o.y, Q2 '21)
7.07%
Inflation (y.o.y, August '21)
1.59%
Core Inflation (y.o.y, August '21)
1.31%
Inflation (m.t.m, August '21)
0.03%
Core Inflation (m.t.m, August '21)
0.21%
FX Reserve (August '21)
USD144.8 billion

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



Source: CEIC

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



Source: CEIC

On a monthly basis, the food, beverage, and tobacco marked a significant deflation at -0.32% (mtm) compared to 0.15% (mtm) inflation in the preceding month due to the harvest season for several commodities, such as vegetables and chicken, that strengthened the supply side. Likewise, both clothing and footwear, as well as recreation, sport, and culture also showed a similar tendency with a -0.07% (mtm) deflation compared to 0.08% (mtm) and 0.05% (mtm) inflation last month, respectively. The deflation is mainly driven by the implementation of partial lockdown (PPKM) that has materialized its impact. On the other hand, health sector continued the last month's trend from 0.24% (mtm) to 0.32% (mtm) this month as the surge of Covid-19 cases persisted. The immense number of confirmed cases leads to higher demand of health-related products ranging from medicine to oxygen.

Core inflation was recorded lower at 1.31% (y.o.y) from 1.40% (y.o.y) in July as the sluggish demand remained. On a monthly basis, however, core inflation marked a significant increase from 0.07% (mtm) in July to 0.21% (mtm) in August. The higher number of monthly core inflation was mostly driven by the relaxation of partial lockdown (PPKM) combined with the new academic year that started in the early August. However, since the partial lockdown has not been fully lifted up and the number of confirmed cases was still high, the transportation sector continued to slump. The curtailing movement of transportation sector is also reflected in administered prices that recorded lower inflation of 0.02% (mtm) compared to 0.05% (mtm) in July. Volatile price also showed an unfavourable deflation at -0.64% (mtm) due to the harvest season of several commodities. All in all, the three components of inflation posed a rather unfavourable outcome and generated monthly inflation of 0.03% (mtm) in August compared to inflation level in July that recorded at 0.08% (mtm).

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Potential Economic Rebound after Recent Delta-Driven Cases Peak

In August, the impact of second wave outbreak on the economy remains as the partial lockdown is still being implemented in almost all regions. The Consumer's Confidence Index (CCI), which captures people's confidence in their income and future spending, continued to drop from 80.2 last month to 77.3 by August. The decreasing trend from last month persisted after the index settled in the optimistic area of 107.4 by June 2021. The worsened index implies that consumer expectations upon spending and business activities in the near future are still narrow. The fall in CCI was mostly shared by expenditure group of 2.1-3 million and 3.1-4 million per month. On the contrary, the lowest expenditure group reported a slight increase amid the second wave chaos. On the other hand, since the peak of the second wave outbreak has passed, we shall see some improvement ahead.

The Manufacturing Purchasing Managers' Index (PMI), recorded a mild increase of 43.7 this month after bearing the unfavourable fall from 53.5 to 40.1 in the previous month. The better performance of PMI was resulted from the relaxation of partial lockdown that took place in late July. As an implication of the policy, several sectors are allowed to re-open under strict health protocols. Following the PMI's trend, trade balance also marked a pleasing surplus of USD4.74 billion compared to USD2.60 billion in the preceding month. The faster growth of export than import was supporting the surplus in trade balance. The rising trend of commodity prices, such as CPO and coal, heavily contributed to the positive amount of export as the commodity goods still hold a significant role in Indonesia's export profile.

The slight pick-up showed by several aspects combined with lower trend of cases, are expected to be the sign of recovery after the second wave crashed the economic and social condition. However, as it is probably the calm before another storm, several firm plans have to be executed as the new variants has started to take the stage. Although the health impacts are not as severe as Delta variant that has brought the condition upside down for the last three months, the MU variant is confirmed to have resistant against the Covid-19 vaccines. Apart from MU variant, other variants, such as Lambda and C.1.2, are also currently under further observation. As new mutations arise, both government and society have to be well-prepared to prevent the condition from going out of control. Several countries have started Covid-19 booster shots and others are planning to do so as the effect slowly fades over time. The UK and US are now preparing for the distribution of 3rd dose of Covid-19 vaccine, whereas Israel is preparing for the 4th dose as the public health condition has become worsened caused by the Delta variant. In Indonesia, the Ministry of Health predicted that the presence of new variants will multiply the

confirmed cases by more than double in 2022. Looking in the same direction as the other countries, the Ministry of Health is now starting to provide boosters for public in order to avoid the upsurge of Covid-19 cases. Looking into vaccine rollout data, by 17th September 2021, 77.42 million people have received the first dose and 44.12 million people have been fully vaccinated. This means, only 21.21% of 208 million people target had received full vaccination. Data by the same period also reported that approximately 834 thousand people have obtained the third dose of Covid-19 vaccine, that mostly dominated by health workers. However, since the new variants are suspected to have immunity against vaccines, other scenarios must urgently be planned including provide enough health facilities and apply strict measures in terms of health protocols.

Several Major Events puts Rupiah in Appreciation Trend

The lower trend of Covid-19 daily cases since July that continue up until now, presented a rather good impact as capital inflow recorded an upward trend since then. At the beginning of September, there was an aggressive inflow from USD8.39 million to USD9.06 million. The flow of capital implies that the investor's sentiment has begun to increase, especially after the second wave hit that cause more than 1,000 deaths daily ends. The capital inflow was also following the reduction of partial lockdown levels in several regions, especially Jakarta and the rest of Java-Bali. Since the level of partial lockdown has become lower, several business activities were allowed to re-open, leading to better market sentiment. The capital inflow also supported the Rupiah to appreciate against USD to IDR14,210 in the similar period. Looking at the different aspects, the announcement of BI and MoF further burden sharing scheme affected the performance of government bonds yield. The event was marked by lower trend of 10-year yield at the beginning of September. In the current scheme, BI acts as the main buyer, particularly to cover all the interest expenses in this year and 2022. On the other side, with BI-dominated ownership, the banking sector is only able and should compete with others to get a relatively small proportion of SBN. As a result, they will use their liquidity to channel credit.

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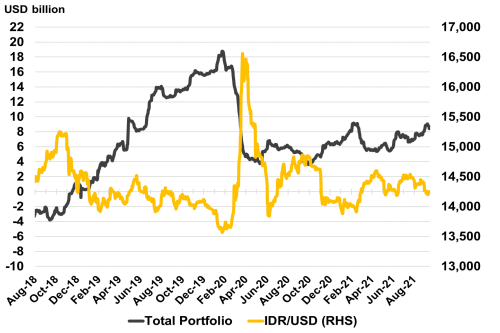
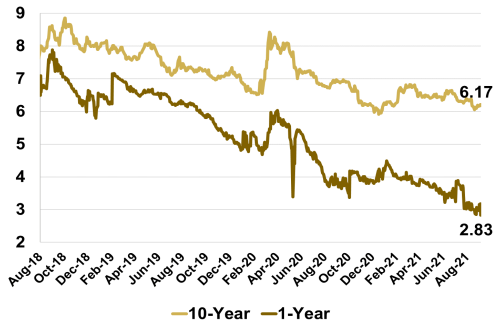
Figure 3: IDR/USD and Accumulated Portfolio Capital Inflow (Last 36 Months)



Source: CEIC

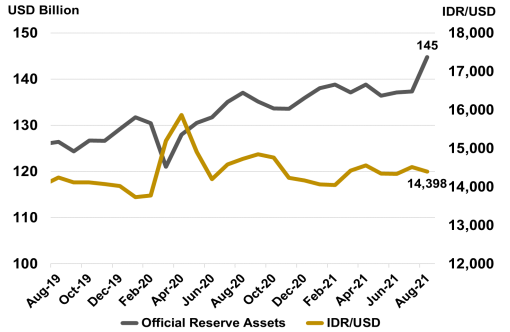
Figure 4: Government Bonds Yield (% pa)



Source: Investing.com

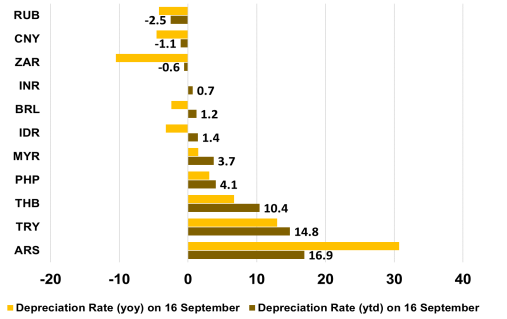
While the solid trend of Rupiah is only momentary as it depreciated by 1.44% (ytd) against USD a week after, the value was considered better compared to other EM's rates including Malaysian Ringgit and Thailand Baht's that recorded respective depreciation rates of 3.73% (ytd) and 10.40% (ytd). On the other hand, several central banks, such as in Russia and Brazil, have implemented an aggressive policy rate hike (Russia by 2.25% and Brazil by 3.25%) to curb inflation pressure. Such move consequentially appreciates their respective currencies. Moreover, despite the depreciation rate, Rupiah and other currencies are expected to be more stable as investors and markets are now shifting their observation to the upcoming FOMC that will be held next week. On the other hand, foreign reserves assets continue its rising trend from last month and reported an ambitious increase of USD145 billion. The value was determined as the highest record of foreign reserve this year. The achievement was mainly driven by Special Drawing Rights (SDR), which was given by the IMF to their member, including Indonesia. Higher foreign reserve in August is equal to finance 8.7 months of imports and government's external debt. As the reserve reported a greater value, we expect the central bank to have adequate tools in their arsenal to weather any future turbulence in the currency value.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

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



Source: Investing.com

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This month was marked by several positive signs from the market and external side ranging from capital inflow to an increase in foreign reserve. Following the persistence of lower Covid-19 cases that lead to the lift of several restrictions, the manufacturing sector, as well as other businesses activities, have started to re-operate under certain health protocol. However, since the condition is still circled by uncertainty added by the sluggish movement of demand, we expect the recovery plan will be limited. The presence of new variants also establishes another dark tunnel to a public health system that is suspected to give another hit if there aren't any firm plans and preparations. Fortunately, the implementation of Local Currency Settlement between BI and PBOC blows a serene breeze to the sustainability of industries as China has been a major trading partner for Indonesia. Moreover, the policy is also in parallel with BI's attempt to maintain the stability of currency and macroprudential in general. Therefore, given the current circumstances, we see that BI should hold its policy rate at 3.50% while carefully observe the trend of Covid-19 development and maintaining a stable financial condition.