Macroeconomic Analysis Series

BI Board of Governor Meeting

January 2022

LPEM FEB UI
UNIVERSITAS INDONESIA

Highlights

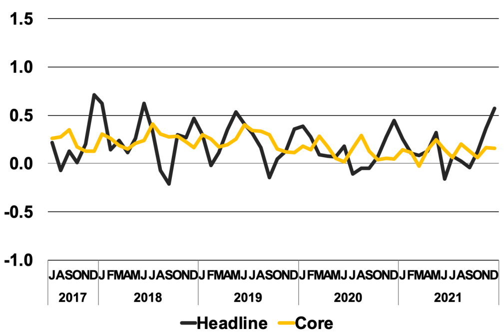
- BI needs to maintain its benchmark rate at 3.50%.
- Inflation was recorded at an 18-month high, but still below BI's target, indicating public confidence are slowly improving.
- The global market remains uncertain as The Fed is likely to increase interest rate and the Omicron case rises.
- Net capital inflows of around USD3.46 million is driven by improving market sentiment due to domestic recovery, despite rising global uncertainty.

Consumption and production activities gradually rebound and approaching normal level, as indicated by an increase in inflation and above-target tax revenue. However, public may not have full confidence yet as the GoI confirmed the first first recorded case of Omicron variant in December when daily confirmed cases were around 200 and it has been rising since then amid local transmission of the variant, as evidenced by a slight decrease in both CCI and PMI. Rising interest rates in several countries as well as the plan to hike interest rates in major economies pose risks, particularly to emerging economies. Additionally, global supply chain disruptions and rising inflation in many countries may force developing countries to begin raising interest rates sooner. However, considering below-the-target inflation and supporting the ongoing economic recovery, BI should continue to hold its policy rate at 3.50% this month.

Inflation Soars At 18-Month High but Still Below Target

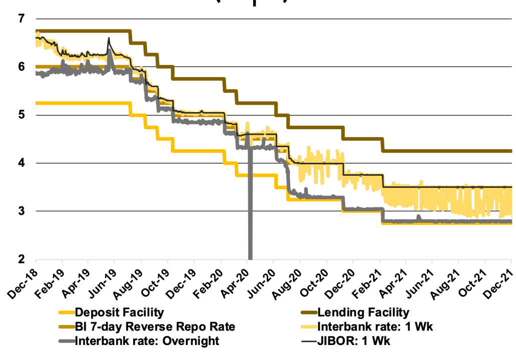
Despite having around 200 daily confirmed new cases (7-day moving average) in mid-December 2021 and the first recorded case of Omicron variant in 15 December 2021, the GoI decided not to enforce restrictions on public activities during the Christmas and New Year's holiday and instead adhered to its multi-tiered public activity restrictions (PPKM). As a consequence, inflation was recorded at 0.57% (mtm) in the last month of 2021, driven by increasing prices in food and transportation as mobility restriction was relaxed and consumption strengthened during the holiday season. Monthly inflation has started inching back up since September 2021, however, this was not enough to push inflation up to BI's target range of 2% to 4%. Full-year inflation was at 1.87% (y.o.y) in December 2021, the highest annual inflation since June 2020. Core inflation edged up to an 11-month high of 1.56% (y.o.y) in December 2021, from 1.44% (y.o.y) in the previous month, suggesting recovering demand as public's purchasing power gradually improves.

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



Source: CEIC

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



Source: CEIC

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

LPEM FEB UI
UNIVERSITAS INDONESIA

Key Figures

BI Repo Rate (7-day, Dec '21)
3.50%
GDP Growth (y.o.y, Q3 '21)
3.51%
Inflation (y.o.y, Dec '21)
1.87%
Core Inflation (y.o.y, Dec '21)
1.56%
Inflation (m.t.m, Dec '21)
0.57%
Core Inflation (m.t.m, Dec '21)
0.16%
FX Reserve (Dec '21)
USD144.9 billion

To keep you updated with our monthly and quarterly reports, please subscribe. Scan the QR code below

or go to http://bit.ly/LPEMCommentarySubscription

On the back of easing in pandemic curbs at the end of 2021, all expenditure groups demonstrated price increase compared to a year before. Food and volatile prices each jumped to 3.20% (y.o.y) compared to the same month of last year, reflecting higher demand. The biggest contributor of inflation in December 2021 is food, beverage, and tobacco basket where it contributed 0.41% to total inflation with 1.61% (m.t.m) and 3.09% (y.o.y). Looking into commodities, the most talked-about price increase was in cooking oil, which the Minister of Trade noted that the average price of palm oil based cooking oil at the end of 2021 was at IDR17,800 per litre, more than 40% higher than in 2020 and well above the reference price of IDR11,000. GoI intends to intervene by selling 11 million gallons at IDR14,000 per litre, but if market prices stay high, it may consider subsidizing using funds gathered from the palm export levy. Cooking oil has a contribution of 0.31% to the 2021 inflation.

As public mobility increases, it comes as no surprise that administered prices grew by 1.79% (y.o.y), continuing its upward trend since June 2021. The price increase was driven by rising airfares during the year-end festive period. Transportation basket reported a 1.58% (y.o.y) in December 2021 in comparison to 1.42% (y.o.y) a month earlier. On a monthly basis, the same basket reported 0.62% price increase, which contributed to 0.07% of December inflation. Moving forward, rise in value-added tax (VAT) and tobacco excise tax of 11% and 12%, respectively, combined with increase in cooking oil as well as cooking gas are expected to have an impact on inflation in 2022. On the supply side, producers and wholesalers have long faced rising costs due to supply disruptions that they may soon pass on to buyers. To keep inflation under control, GoI decided to scrap plans to phase out regular and medium-grade gasoline products with high carbon emissions, Premium and Pertalite, respectively. All things considered, the GoI together with Bank Indonesia should remain vigilant about inflationary pressure in 2022.

Omicron Outbreak May Dent the Confidence on the Current Recovery

In comparison to July 2021 when the Delta variant slammed the nation and reached its worst throughout 2021, Covid-19 cases were comparatively under control with about 200 daily confirmed new cases (7-day moving average) in mid-December 2021, indicating signs of recovery toward the end of 2021. The development has resulted in a progressive loosening of mobility restrictions, which resulted in higher people's mobility and economic activity. However, amidst fear of Omicron outbreak and rising inflation, Consumer Confidence Index (CCI) stood at 118.34 in December 2021, slightly weaker compared to 118.53 in the previous month but still in the optimistic territory. Consumers remain upbeat due to improving consumer perception of current economic conditions, driven by current incomes and job availability. Rebound in economic activity is also evident in tax revenue that exceeds

LPEM FEB UI
Universitas Indonesia

Key Figures

BI Repo Rate (7-day, Dec '21)
3.50%
GDP Growth (y.o.y, Q3 '21)
3.51%
Inflation (y.o.y, Dec '21)
1.87%
Core Inflation (y.o.y, Dec '21)
1.56%
Inflation (m.t.m, Dec '21)
0.57%
Core Inflation (m.t.m, Dec '21)
0.16%
FX Reserve (Dec '21)
USD144.9 billion

To keep you updated with our monthly and quarterly reports, please subscribe. Scan the QR code below

or go to http://bit.ly/LPEMCommentarySubscription

target for the first time in twelve years, reaching 103.9% of target. This was possible due to three reasons: impressive export performance due to high commodity prices, adjustment of several tax rate, for example increase in stamp duty tariff to IDR10,000, and most importantly, a low tax revenue target, the lowest since 2014. The low target certainly helped in meeting the target. In a similar fashion, Purchasing Manager's Index (PMI), measuring manufacturing activity, also displayed a slight decrease to 53.5 in December 2021 from 53.9 a month earlier. The PMI has been consistently above 50 since September 2021, indicating expansion is still in place but at a slower pace due to persistent supply constraints.

With previously surging commodity prices starting to normalize, Indonesia's trade surplus significantly narrowed to USD1.02 billion in December 2021 from USD3.5 billion in the previous month, reaching the lowest level since May 2020. The lower trade surplus can be attributed to two factors: slowing exports than the previous month which recorded at IDR22.38 billion, with a yearly growth of 35.3% (y.o.y) while imports hit an all-time high at IDR21.36 billion or 47.92% (y.o.y) growth, verifying the rebound in domestic production activities. Imports were significantly high due to increase in domestic purchase of international products from consumer items to raw materials for the manufacturing industry.

Resilience Amid Market Uncertainty

While the Delta variant is still wreaking havoc, Omicron, a new variant that spreads significantly faster, emerged. First reported in South Africa, surging cases of Omicron variant have been reported in many countries, including Europe, the US, Australia, and India. Despite uncertainty surrounding the new variant, the yield on 10-year US-Treasury ended 2021 at around 1.51% and has gained more than around 30 basis points in the first two weeks of the new year. The selling pressure is likely coming from investors to seem less indebted at the end of the year, known as window dressing. The depreciation of the JPY, another safe haven, of around 0.44% (m.t.m) in mid-January 2022 underscores a larger global shift away from secure assets and toward risky ones. Additionally, investors have learned to live with the virus, which now may have less and less of an impact on markets as they are quickly to price-in any economic fluctuations.

While Omicron cases may not pose a significant challenge to the capital market at this time, the looming Fed rate hikes may pose a major headwind for emerging economies. Recently published data on inflation and labour market provide justification for the Fed to continue its plan to tighten the monetary policy. US inflation soared to 7% (y.o.y) in December 2021, a step up from 6.8% (y.o.y) a month earlier, the fastest pace in nearly four decades. Wage has started to accelerate at 4.7% (y.o.y) due to tight labour market. Employers are reported to add 199,000 jobs in December 2021, down from November 2021 figure when 249,000 jobs were added to the economy, drove down further unemployment rate to 3.9% in December

Key Figures

BI Repo Rate (7-day, Dec '21)
3.50%
GDP Growth (y.o.y, Q3 '21)
3.51%
Inflation (y.o.y, Dec '21)
1.87%
Core Inflation (y.o.y, Dec '21)
1.56%
Inflation (m.t.m, Dec '21)
0.57%
Core Inflation (m.t.m, Dec '21)
0.16%
FX Reserve (Dec '21)
USD144.9 billion

To keep you updated with our monthly and quarterly reports, please subscribe. Scan the QR code below

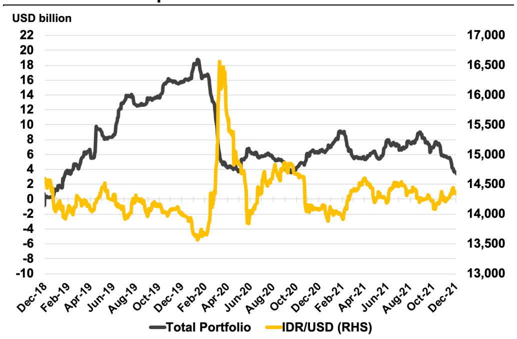
or go to http://bit.ly/LPEMCommentarySubscription

2021 compared to 4.2% a month earlier. However, the rising inflation indicates that there is still a shortage of labor supply compared to its demand despite more labor returning back to work. This could be driven by massive stimulus check to the unemployed, making them reluctant to return to the workforce. All in all, The Fed is forecasted to raise interest rate as early as March 2022 and trim its monthly amount of bond-buying to only USD60 billion, half the level it had been purchasing just a few months ago.

To keep the Omicron variant spread under control, especially in preparation to host the Winter Olympics next month, China maintains its strict zero-Covid policy, prolonging the global supply chain disruptions. The policy is predicted to choke the already stretched global supply chains, posing threats to all manufacturers in all nations who are already dealing with rising raw material and shipping costs as well as delivery delays and labour shortages. Severe shortages of both goods and labour in global supply chains are expected to cause global prices to soar even further.

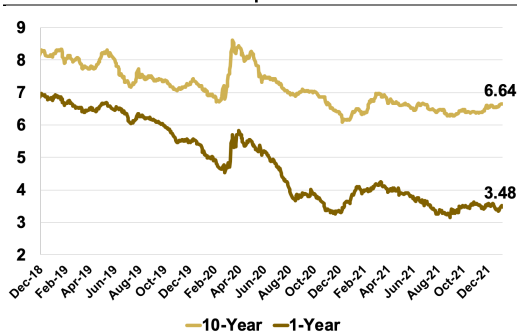
Taking into account the rising Omicron cases, imminent hike in the Fed Fund Rate (FFR), and threat of amplified global supply chain disruptions, while some investors move their assets from emerging markets, the others tap into riskier assets, resulting in net capital inflows of USD3.46 million in mid-January 2022. This then translates into decrease in 1-year bond yield to 3.5% in mid-January 2022 from 3.8% in mid-December 2022 while 10-year government bond yield remains stable at 6.4% between December 2021 and January 2022. The widening yield gap suggested that investors increase their net purchase of short-term bonds relative compared to the longer tenor, which indicates better prospect of short-term domestic condition.

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



Source: CEIC

Figure 4: Government Bonds Yield (% pa)



Source: CEIC

Riding high an export boom due to rising commodity prices, Rupiah has remained solid throughout 2021. With an annual depreciation of 2.05% in mid-January 2022, Rupiah was relatively stable compared to other emerging peers. Due to government's foreign debt payment, foreign exchange reserves stood at USD144.9 billion at the end of 2021, down USD1 billion from November 2021 level. The current level is sufficient to finance 8.0 months of imports or 7.8 months of imports and pay

Key Figures

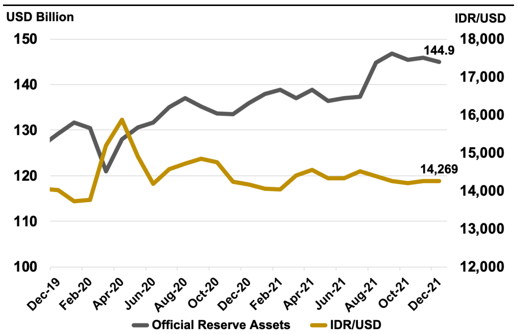
BI Repo Rate (7-day, Dec '21)
3.50%
GDP Growth (y.o.y, Q3 '21)
3.51%
Inflation (y.o.y, Dec '21)
1.87%
Core Inflation (y.o.y, Dec '21)
1.56%
Inflation (m.t.m, Dec '21)
0.57%
Core Inflation (m.t.m, Dec '21)
0.16%
FX Reserve (Dec '21)
USD144.9 billion

To keep you updated with our monthly and quarterly reports, please subscribe. Scan the QR code below

or go to http://bit.ly/LPEMCommentarySubscription

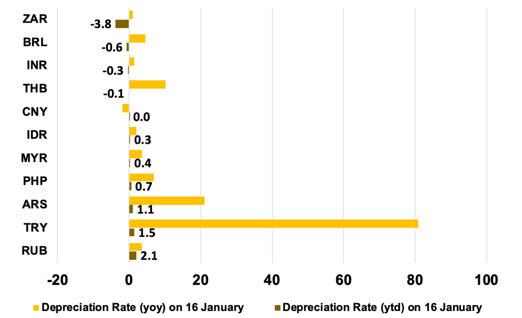
the government's foreign debt, which is well above the generally considered adequate threshold.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (January 16, 2022)



Source: Investing.com

Considering the persistent low inflation that has been below the central bank's target range of 2% to 4% for 19 consecutive months as well as to nurture recovery in economic performance, BI should hold its policy rate at 3.50% at its January meeting. While there are external factors, such as the Fed likelihood to tighten the monetary policy as early as March 2022, heightened risk of global supply chain disruptions, and rising inflation in many countries, that could force BI to raise its policy rate earlier than planned, BI is expected to keep the interest rate at records low until inflation starts to pick up. To maintain Rupiah stability, BI still needs to maintain its accommodative monetary policy stance; for now, providing support for pandemic recovery is critical, as it is unclear whether Omicron will cause more severe consequences than the previous variant.