LPEM FEB UI
UNIVERSITAS INDONESIA

Macroeconomic Analysis Series

BI Board of Governor Meeting

May 2022

Highlights

- BI has room to hold its policy rate at 3.50% this month.
- The prices of FnB and transportation surged in April due to seasonal pattern of Ramadhan and the relaxation of physical and social restrictions' measures.
- Indonesia continued to record growth in Q1-2022, supported by persistent domestic consumption, recovery in investment, and higher exports due to soaring commodity prices.
- The robust economic performance and surging commodity prices help to manage the capital outflow during the Fed's monetary tightening.

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

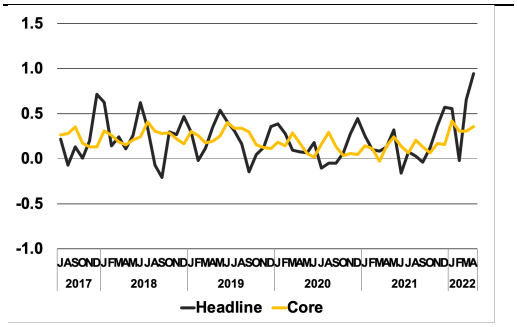
Faradina Alifia Maizar
faradina@lpem-feui.org

The higher consumption due to the fasting month of Ramadhan and ahead of Eid-al-Fitr celebration coupled with the soaring commodity prices during the inflationary pressures have contributed to high headline inflation in April, with the highest contribution coming from volatile and food ingredients components. In contrast, energy prices were still manageable as the GoI continued to implement the energy subsidy and compensation as well as social protection, thus, people's purchasing power maintained and core inflation remained relatively low. On domestic conditions, Indonesia continued to record positive growth in Q1-2022, supported by persistent domestic consumption, recovery in investment, and higher exports due to soaring commodity prices. The robust economic performance and surging commodity prices help manage the capital outflow during the Fed's monetary tightening to fight the inflationary pressures. The favorable economic growth and manageable core inflation provide room for BI to maintain its policy rate at 3.50% in this month's BI Board of Governor meeting.

Rising Inflation due to Seasonal Pattern and Covid-19 Measures Relaxation

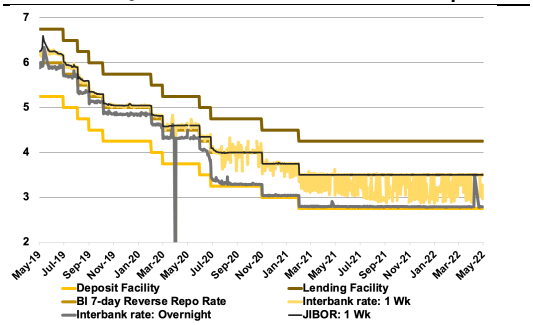
Inflation picked up to a new three-year high in April, supported by higher consumption due to the seasonal pattern of the fasting month of Ramadhan and ahead of Eid-al-Fitr celebration as well as steep increase in global commodity prices. On a yearly basis, the headline inflation stood at 3.47% (y.o.y), with the highest price increase recorded in food, beverage, and tobacco, as well as transportation. The rise in demand for these goods was inseparable from the GoI's effort to relax the physical restrictions last month. GoI has allowed people to celebrate Ramadhan Iftar and perform evening Ramadhan prayers at the mosque as long as they have received a full dose of vaccination and vaccine booster. The GoI also allowed people to go back to their hometowns to celebrate Eid festive (*Mudik*) for the first time since the Covid-19 pandemic began. The disbursement of Religious Holiday Allowance (Tunjangan Hari Raya or THR) for workers also contributed to the higher spending in April. As a result, overall prices accelerated 0.95% (m.t.m) compared to a month earlier.

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



Source: CEIC

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



Source: CEIC

Key Figures

BI Repo Rate (7-day, Apr '22)
3.50%
GDP Growth (y.o.y, Q1 '22)
5.01%
Inflation (y.o.y, Apr '22)
3.47%
Core Inflation (y.o.y, Apr '22)
2.60%
Inflation (m.t.m, Apr '22)
0.95%
Core Inflation (m.t.m, Apr '22)
0.36%
FX Reserve (Apr '22)
USD135.7 billion

Looking into its components, inflation in April was influenced mainly by higher prices for volatile and food ingredients due to the soaring global commodity prices during the economic recovery. The energy prices also escalated after the adjustment of the Pertamax price made by GoI last month. However, the increase in energy prices was still manageable and lower than the inflation in volatile and food ingredients as the GoI maintained to implement energy subsidies, particularly in fuel prices. In turn, the core inflation in April remained relatively low, with a yearly increase of 2.60% (y.o.y) and a monthly difference of 0.36% (mtm). It reflects that people's purchasing power gradually recovered from the Covid-19 pandemic amid the external pressures of global price volatility in commodity and energy prices.

Considering the high energy prices at the global level, which includes fuel, gas, and electricity, due to the economic recovery and geopolitical tension between Russia and Ukraine, the GoI was left with a limited option but to protect the purchasing power to maintain the momentum of economic recovery. The GoI maintained the energy subsidy and compensation and planned to increase the amount of subsidies by IDR74.9 trillion and compensation by IDR216.1 trillion for overall 2022 to prevent further increases in energy prices. The effort is expected to subdue the pressures of soaring inflation and accelerate the economic recovery plan this year. In fiscal position, the higher spending for subsidies will be covered by the additional revenues from a windfall of commodities export. Therefore, the effort is not expected to dampen the fiscal space. Nevertheless, the energy prices will be manageable amid the external inflation pressures as long as the GoI also strengthens their coordination with all related policymakers, including BI, in managing inflation expectations.

Better-than-expected Performance Amid the Omicron Wave

Indonesia continued to record robust performance for the fourth time in Q1-2022, with an economic growth of 5.01% (y.o.y). Aside from the low-base effect due to weaker economic performance in the same period a year earlier, the economic growth surprisingly surpassed market expectations, thanks to GoI's ability to limit the risk of the Omicron wave. The rising positive cases of Covid-19 from January to mid-February have not prompted the GoI to tighten the physical and social restrictions, given that most of the patients were only self-quarantined at home. Thus, the people with no Covid-19 infections kept their spending unaffected, as captured by the growth of household consumption at 4.34% (y.o.y) in Q1-2022; higher than 3.55% (y.o.y) growth in Q4-2021. The figure reflects that household spending continued to gradually recover, considering that the pandemic threat declines with the acceleration of vaccination rates. The consumer survey conducted by BI also found that Consumer Confidence Index (CCI) increased to 113.1 in April from 111.0 in previous month due to a more robust consumer perception regarding economic conditions.

Key Figures

BI Repo Rate (7-day, Apr '22)
3.50%
GDP Growth (y.o.y, Q1 '22)
5.01%
Inflation (y.o.y, Apr '22)
3.47%
Core Inflation (y.o.y, Apr '22)
2.60%
Inflation (m.t.m, Apr '22)
0.95%
Core Inflation (m.t.m, Apr '22)
0.36%
FX Reserve (Apr '22)
USD135.7 billion

Further, positive economic growth in Q1-2022 was partly supported by the stronger export performance due to high commodity prices, particularly palm oil and coal. The exports figure in GDP grew by around 16% compared to the previous year. The gradual recovery in investment due to better market expectations on domestic conditions, as the Covid-19 positive cases were relatively manageable, also promoted economic growth. Businesses in all sectors kept their activities to meet the recovery pace, with a high contribution to economic growth from the manufacturing, wholesale & retail trade, and construction sectors. It was in line with the Purchasing Manufacturing Index (PMI) figure, which continued to mark positive performance with its 8th consecutive increase in April at 51.9. The business activity is expected to improve further due to the easing restrictions measures. However, in the case that the GoI is unable to counteract the latest external pressures of increasing commodity prices, the progress of business recovery might be hampered due to the rising production costs in line with the soaring energy prices. Thus, the GoI needs to formulate the best policy responses to stimulate economic recovery amid the risks of commodity prices.

On the other hand, the higher exports and trade surpluses will likely persist in the near future. The trade balance recorded a new all-time high surplus of USD7.6 billion in April 2022. Amidst the ban on palm oil exports that has been in effect since April 28, the total exports increased 48% in April compared to the same period a year earlier, supported by the rising palm oil and coal prices. Gradual global demand recovery contributed to the value of Indonesia's exports. There is a concern that the ban on palm oil exports may affect the trade performance in May, which could hinder the recovery. However, the government has revoked the policy as of May 23. On the other hand, imports only increased by 22% (y.o.y), driven by soaring oil and gas prices. The higher growth of exports than imports has maintained monthly trade surpluses, marking the 24th consecutive trade surpluses since May 2020. Persistent trade surplus in goods has supported the positive current account balance which was marking the 3rd consecutive quarter surplus in Q1-2022 at USD0.22 billion or equal to 0.1% of GDP in Q1-2022. The soaring commodity prices has outperformed the widened deficit of trade in services and the balance in primary and secondary income, thus maintain the surplus in current account.

Relatively Manageable Capital Outflow Amid External Pressures

Since the Federal Open Market Committee (FOMC) meeting in April, the global capital market has deteriorated as the Fed has been more explicit in tackling the mounting inflation. While inflation in the US slowed to 8.3% (y.o.y) in April compared to 8.5% (y.o.y) in March, this figure is still far above the bank's target of 2%. The soaring inflation is due to the pent-up demand after the Covid-19 pandemic coupled with the Russia-Ukraine tension. The inflationary pressures have also been experienced by several other countries, such as Australia, the UK, and several

Key Figures

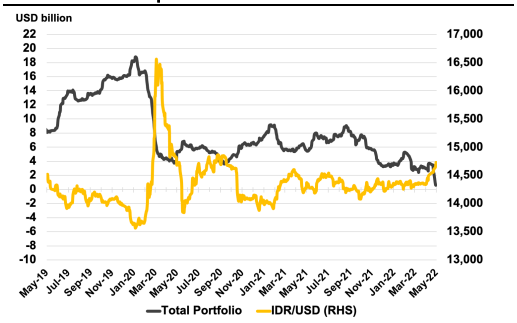
BI Repo Rate (7-day, Apr '22)
3.50%
GDP Growth (y.o.y, Q1 '22)
5.01%
Inflation (y.o.y, Apr '22)
3.47%
Core Inflation (y.o.y, Apr '22)
2.60%
Inflation (m.t.m, Apr '22)
0.95%
Core Inflation (m.t.m, Apr '22)
0.36%
FX Reserve (Apr '22)
USD135.7 billion

countries in the EU, with the inflation rate reaching double digits. To prevent inflation from rising further, the Fed and other central banks have decided to increase their benchmark rates. The Fed has raised its benchmark rate for the second time by 50 bps in early May. India has also increased their benchmark rates for the first time after two years by 40 bps, while the Bank of England has raised further the interest rate for the third time since the end of last year. The GCC, such as Saudi Arabia and Kuwait, have also increased their benchmark rates due to the soaring energy prices and following the Fed's decision to raise its benchmark rates.

The rising interest rate is expected to generate greater borrowing costs for households, businesses, and the government, thus reducing the demand as well as lowering the inflation. The cost of raising the interest rate, however, is the risk of economic slowdown. The economy is predicted to grow slower as borrowing costs rise. Households will hold back their consumption due to higher borrowing rates. The increasing cost of government borrowing is also expected to jeopardize the government's massive spending to support the economic recovery from the pandemic. Considering the high cost of raising the interest rate, the government must carefully weigh the need to lower the rising inflation while maintaining economic recovery momentum. Nevertheless, the inflationary pressure risks coupled with geopolitical tension have slashed the IMF's global economic growth forecast to 3.6% from 3.8%.

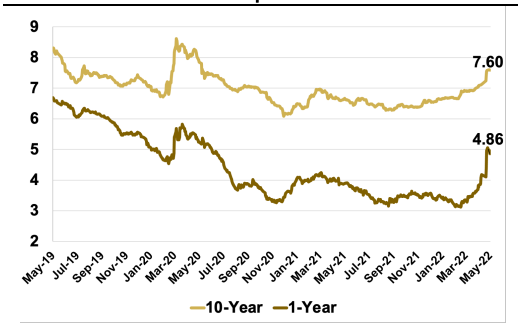
In the global capital market, the monetary tightening by the Fed has made widespread repercussions as investors tend to shift their assets from riskier investments to safer markets. As a result, capital outflow and currency volatility were unavoidable in developing countries, including Indonesia. The net capital flows have been decreasing since mid-April, with the total capital outflow reaching more than USD2 billion in a month. It was also reflected in the rising yields of 10-Year government bonds and 1-Year government bonds from only 7.07% and 3.69% in April to 7.60% and 1-Year 4.86% in May, respectively. Moreover, the decline in the yield difference of long- and short-term tenors suggests that the short-term risk has been increasing.

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



Source: CEIC

Figure 4: Government Bonds Yield (% pa)



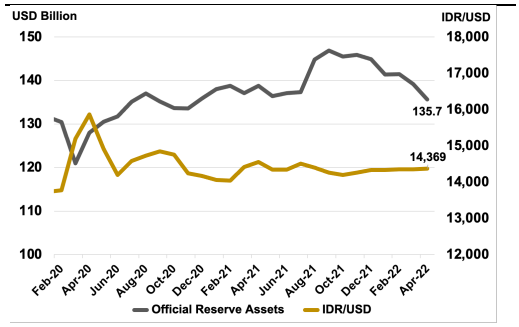
Source: CEIC

Key Figures

BI Repo Rate (7-day, Apr '22)
3.50%
GDP Growth (y.o.y, Q1 '22)
5.01%
Inflation (y.o.y, Apr '22)
3.47%
Core Inflation (y.o.y, Apr '22)
2.60%
Inflation (m.t.m, Apr '22)
0.95%
Core Inflation (m.t.m, Apr '22)
0.36%
FX Reserve (Apr '22)
USD135.7 billion

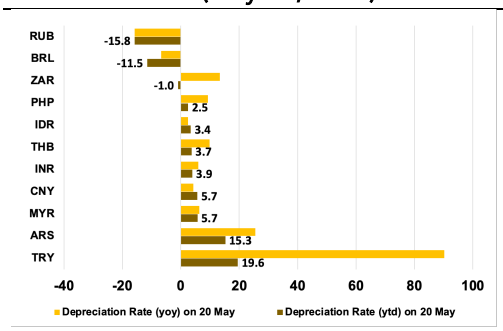
The period of capital outflow and the need for foreign currency to maintain the support for economic recovery in the last month have brought foreign exchange reserves in a declining trend to USD135.7 billion in April from USD139.1 billion in the previous month. Even though reserves have been declining since September 2021, the amount remained ample to cover 6.7 months of imports and the government's foreign debt. It remained well above the international adequacy standard of around three months of imports. The robust foreign exchange reserves were in line with the relatively maintained Rupiah as it was the second-best performing currency compared to other ASEAN peers. Rupiah only depreciated by 3.4% (ytd), lower than the depreciation in Thailand Bath (3.7%) and Malaysian Ringgit (5.7%). The stable Rupiah and adequate foreign exchange reserves, owing to the robust domestic economic outlook and policy responses to boost economic recovery. Aside from that, the soaring commodity prices have increased the national exports, which suggests the exports have been contributing to foreign capital inflows in Indonesia's market amid the monetary tightening.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (May 20, 2022)



Source: Investing.com

BI has kept the policy rate unchanged at 3.50% since February 2021 in order to support the economic recovery during the period of muted inflation and relatively stable Rupiah. Although headline inflation has risen considerably in the last month, core inflation remains low. The relatively manageable inflation was supported by the GoI's efforts to maintain people's purchasing power by continuing to implement energy subsidies and compensation, and expanding the budget for social protection. Meanwhile, BI still maintains an accommodative stance to keep maintaining rupiah stability amidst the monetary tightening by several central banks to fight the inflationary pressures. Considering the quite manageable domestic economic condition and slight external pressures, BI still has room to maintain its policy rates at 3.50% this month to not interrupt the economic recovery just yet while maintaining the inflation and exchange rate stability.