LPEM FEB UI
Institute for Economic and Social Research

Macroeconomic Analysis Series

BI Board of Governor Meeting

December 2023

Highlights

- BI should hold its policy rate at 6.00% this month.
- Higher inflation is still attributed to food prices component, although the source of inflationary pressure has shifted from rice to other food commodities.
- Rupiah appreciated considerably to around IDR15,500 from around IDR15,650 during last month due to Fed's policy rate stance and DHE SDA regulation.

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El-Nino still plays a major part in pushing inflation upward. Headline annual inflation climbed up to 2.86% (y.o.y) in November 2023. Contrary to the previous months, source of pressure of food prices shifted in November from rice to other commodities, such as red chili pepper, cayenne pepper, and onion. While GoI has done a rather excellent job in managing rice price through import, further prompt policy response is urgently needed as El-Nino is disrupting other food ingredients supply adequacy. Energy price decrease also helped in managing the overall inflation rate of November 2023. On the external factor, the Fed's decision to hold its FFR and additional foreign currency supply spurred by export proceeds from natural resources (*Devisa Hasil Ekspor Sumber Daya Alam*/DHE SDA) policy has bolstered the value of Rupiah, which was recorded at around IDR15,500 per USD in mid-December 2023. Currently, Rupiah is among the least affected currencies by global shocks throughout 2023. A rather manageable inflation figure and excellent performance of Rupiah during the last month put us in a view that BI should leave its policy rate steady at 6.00% in December 2023.

Lingering Impact of El-Nino

November's headline inflation is recorded at 2.86% (y.o.y), a considerable increase from the previous month's inflation figure of 2.56% (y.o.y). Higher inflation rate is even more pronounced on monthly basis as headline inflation rate reached 0.38% (m.t.m) in November 2023, reaching its highest rate during 2023. Continuing its previous trend since last August, driver of higher inflation rate is mostly contributed by food prices. Besides having the highest weight on the inflation component, food, beverage, and tobacco expenditure group inflation is on a very high level and recorded a substantial increase to 6.71% (y.o.y) last month from 5.41% (y.o.y) in October 2023. Annual inflation rate of this expenditure group has reached its highest since October 2022. Similarly, monthly inflation rate of food, beverage, and tobacco expenditure group was 1.23% (m.t.m) in November 2023 from only 0.20% (m.t.m) in the previous month, suggesting the continuation of rising food prices. Strips out the beverages and tobacco parts, food ingredients inflation recorded a spike from 5.33% (y.o.y) in October 2023 to 7.19% (y.o.y) in November 2023. This is the highest annual inflation increase for food ingredients since April 2022. Similarly, massive surge in food prices is also reflected in the volatile food component as its inflation is recorded at 7.59% (y.o.y) in November 2023, a considerable increase from 5.54% (y.o.y) in the previous month.

Rapid increase of food prices is attributed to the El-Nino phenomenon that has been occurring in the past few months. Since November 2023, the ENSO Index, an index

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6.00%
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2.86%
Core Inflation (y.o.y, November '23)
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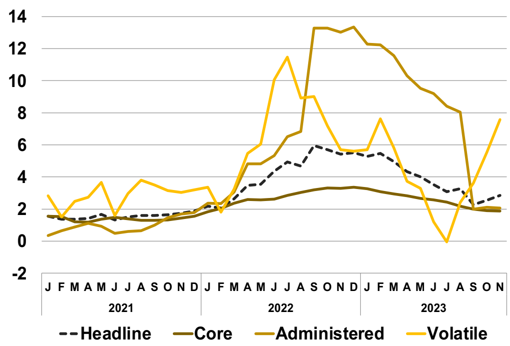
Core Inflation (m.t.m, November '23)
0.12%
FX Reserve (November '23)
USD138.1 billion

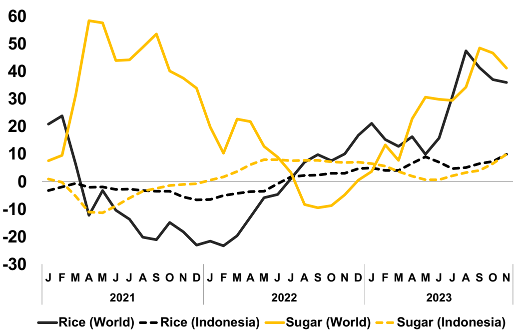
measuring the scale of El-Nino, has reached a strong scale of El-Nino 2.21 (above 2 indicates strong El-Nino), suggesting that the phenomenon might have brought its biggest impact so far to the commodity prices. Contrary to the previous months, in November 2023, source of upward pressure of food prices has changed from rice to other commodities such as red chili pepper, cayenne pepper, and onion in November 2023. These increases were also related to supply disruption due to El-Nino. Based on a survey conducted by BI in November 2023, average retail prices in traditional market of red chili pepper have increased by 37.99% (m.t.m), cayenne pepper by 35.22% (m.t.m), and onion by 13.46% (m.t.m), a record-high monthly price increase of those commodities since last year.

Figure 1: Inflation Rate (%, y.o.y)



Source: CEIC

Figure 2: Global and Domestic Food Prices (%, y.o.y)



Source: CEIC, World Bank Pink Sheet

Decreasing contribution of rice price to the overall inflation hike and moderated rice price increase are driven by higher rice supply security through imports. As of last month, GoI has imported 2.53 million tons of rice, which has been successful in tampering the price. Thanks to government intervention through imports, domestic rice price increase in November 2023 is only 19.71% (y.o.y), way below global rice price increase of 35.91% (y.o.y). Similarly, the domestic price of sugar 'only' increased by 12.63% (y.o.y), substantially lower than 41.13% (y.o.y) increase of global sugar price in November 2023. Moreover, big force of food prices on the overall inflation figure was also moderated by the decrease in energy prices. Due to lower oil prices, energy inflation has recorded deflation in both its annual and monthly basis figure. In November 2023, energy price inflation was recorded at -0.24% (y.o.y) compared to 0.11% (y.o.y) in the previous month. Similarly, its monthly inflation was recorded at -0.37% (m.t.m) from 0.45% (m.t.m) in October 2023. Lower energy prices also has consequences on the administered price component. Inflation of administered price component decreased from 2.12% (y.o.y) in October 2023 to 2.07% (y.o.y) in November 2023 as the GoI adjusted the basic retail selling price of nonsubsidized fuel.

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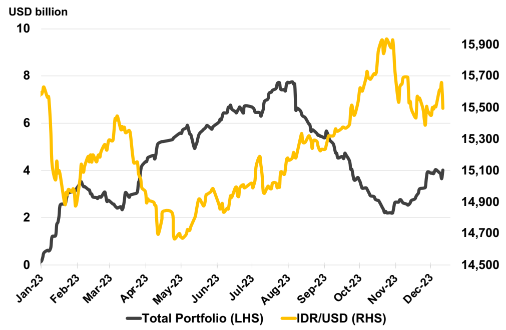
Currently, inflation rate has been successfully kept within BI's target range of 2% - 4%. In general, purchasing power remains manageable as core inflation is recorded at 1.87% (y.o.y) in November 2023, despite slightly decreased from 1.91% (y.o.y) in the previous month. However, mounting pressure from El-Nino on food prices in Indonesia might pose a threat to households' purchasing power. While GoI has done a rather excellent job in managing rice price through imports, further prompt policy response is urgently needed as El-Nino is disrupting other food ingredients supply adequacy. This might be a challenge in the upcoming inflation management as El-Nino expects to linger until early next year. Considering all aspects, we expect inflation will be within BI's target range for the overall year of 2023 and could reach 3% by the end of this year due to the cyclical trend of rising consumption during the end-of-year holiday season.

Rapid Appreciation of Rupiah

On the external condition, trade surplus shrank considerably to USD2.41 billion in November 2023 from USD3.48 billion in the previous month. The narrowing trade surplus is driven by the combination of lower exports and rising imports throughout last month. Exports were down by 8.56% (y.o.y) or 0.67% (m.t.m) due to decline in demand for iron and steel following the weak purchasing power for property and industry in China causing a decline in non-oil and gas export of around USD167 million. In addition, weakening global demand and oil price decrease also contributed to lower oil products export, reducing overall oil and gas export by USD895 million. Besides, Indonesia's imports in November increased by 3.29% (y.o.y) or 4.89% (m.t.m), driven by increase in oil and gas sector due to preparations to accommodate the mobility of the year-end and new year holidays. Oil and gas imports grew by USD281 million or 24.41% (y.o.y) in November 2023. Iron and steel products also recorded a spike in imports of around USD138.7 million to meet the needs of steel consumption, which in 2023 is estimated to reach 17.9 million tons while domestic production only reaches 14.4 million tons.

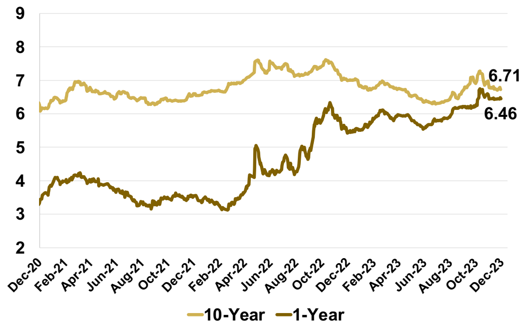
The Fed concluded its last FOMC meeting in 2023 last week by leaving the Fed Funds Rate (FFR) unchanged at 5.25% - 5.50%. This marks the third consecutive meeting in which the Fed holds FFR. US's inflation rate continued to decrease to 3.14% (y.o.y) in November 2023 from 3.24% (y.o.y) in the previous month. Furthermore, latest core inflation in the US was recorded at 4.01% (y.o.y) in November 2023, hitting its lowest level since September 2022. The trend of inflation in the US has been consistently edging towards its target of 2% inflation rate, albeit slowly. In addition, the labor market in the US remained resilient as the unemployment rate fell to 3.7% in November from 3.9% in the previous month. The latest FOMC meeting also signaled the possibility of three policy rate cuts for next year, which came as a surprise as it is more than most investors initially expected. Shortly after the Fed made its policy rate decision, ECB announced its decision to maintain the current key interest rates unchanged. This decision marks the second consecutive meeting where the ECB has opted for unchanged interest rates, possibly signaling the conclusion of the hiking cycle initiated in July 2022.

Figure 3: IDR/USD and Accumulated Portfolio Capital Inflow (y.t.d)



Source: CEIC

Figure 4: Government Bonds Yield (% p.a.)



Source: CEIC

The decision made by the Fed has immediately spurred capital flows into emerging markets and weakened USD. As a repercussion, USD index fell to 101.96 shortly after the announcement of FFR, hitting its lowest level since July 2023. Indonesia experienced a surge of capital inflow of around USD360 million in one day after FOMC meeting (December 14th) and rapidly strengthening Rupiah from IDR15,655 to IDR15,495 during the same period. Following the capital inflow triggered by FOMC meeting decision, bond yield for Indonesian government bonds, both 10-year and 1-year, decreased by nine percentage points and three percentage points in just two days (until December 15th). In addition, Indonesia has recorded a rather massive capital inflow during the past month. Until mid-December, capital inflow from bonds and stock increased by USD1.48 billion to USD4.02 billion from USD2.54 billion in mid-November. However, the flow of incoming capital towards Indonesia's financial market has favored long-term assets as suggested by the 10-year Indonesian government bond yield fell by 27 percentage points from 6.98% in mid-November to 6.71% in mid-December. Meanwhile, 1-year Indonesian government bond yield 'only' decreased by 12 percentage points during the same period. The lower surge of capital inflow towards short-term assets might be driven by BI's decision to hold policy rate mostly unchanged relative to FFR. On the other hand, the higher surge of capital inflow towards long-term assets might suggest investor's confidence in Indonesia's long-term economic prospect as it is currently able to keep inflation in check, low current account deficit, and robust economic growth relative to global economic growth. However, the narrowing yield difference between long- and short-term Indonesian government bonds could serve as an indication of investors' uncertainty, albeit rather slightly, over the short-term economic situation in Indonesia due to various factors, including lower trade surplus, slower economic growth, and upcoming election period.

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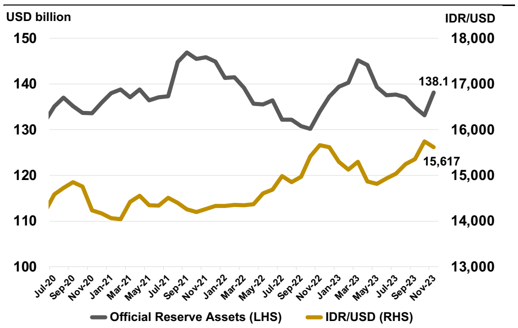
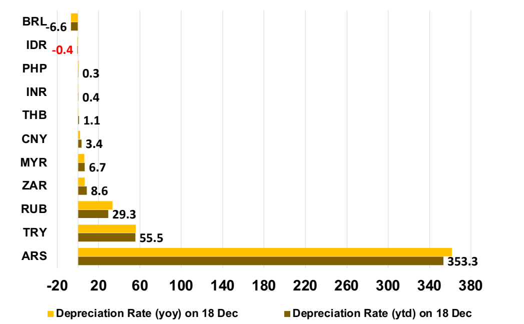
Besides massive capital inflows resulting from the Fed's decision to hold its policy rate, another factor has contributed to the rally of Rupiah in the past few weeks. The revision of government regulation concerning the proceeds from natural resources export (*Devisa Hasil Ekspor*/DHE), which now covers a wider range of natural resources products, has recently come into fruition. As of November 2023, the amount of export proceeds in foreign exchange that is deposited in domestic financial market reached USD1.3 trillion. This regulation has boosted the supply of foreign currency in domestic market and consequently increased official foreign exchange reserve assets by USD5 billion from USD133.1 billion in October 2023 to USD138.1 billion in November 2023. This marks the highest monthly increase of foreign exchange reserves in the last 25 months. The combination of capital inflows and significant increase in foreign currency supply has strengthened Rupiah considerably. Per December 18th, Rupiah is recorded at around IDR15,500 per USD, performing quite excellently against its peers' currency. On a year-to-date basis, Rupiah recorded an appreciation of 0.4%, substantially better than other emerging currencies that are mostly still on depreciation territory.

Figure 5: IDR/USD and Official Reserve Assets



Source: CEIC

Figure 6: Depreciation Rates of Selected EMs (18 December 2023)



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8 DECENT WORK AND ECONOMIC GROWTH

Considering the latest developments discussed above, we view that BI should hold its policy rate unchanged at 6.00% in the last Board of Governors meeting this year. Going forward, the era of 'high-for-longer' might persist despite the indication that the Fed might cut its rate next year. Considering this, BI should remain vigilant especially on the Fed's movement in 2024. The current BI's policy rate is at its highest in the last 4.5 years, providing BI with ample room for rate cut in 2024. However, the timing of rate cut is also crucial. Too soon of a rate cut might spur unnecessary capital outflow and weakening Rupiah and too late of rate cut could depress purchasing power and halt the real sector growth. Besides the potential of Fed rate cut in 2024, other things to watch for from BI's perspective include inflationary pressure due to election period and the persistence of El-Nino, lower trade flows due to prolonged global demand weakening, and potential capital outflow due to global economic and geopolitical uncertainty.