Inflation Outlook 2024

LPEM FEB UI
UNIVERSITAS INDONESIA

Key Figures

Inflation (2023)

2.61%

Core Inflation (2023)

1.80%

Inflation* (2024)

2.5 – 3.5%

Core inflation* (2024)

1.7 – 2.5%

Economic Growth (Q3 2023)

4.94%

% Current Account of GDP (Q3 2023)

0.2%

*) Forecast

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Apparent Economic Recovery: Optimism Towards 2024

Summary

We observe a declining inflation rate trend throughout 2023, back to the Bank Indonesia's inflation target. It hit the highest level in February 2023 at 5.47% and steadily decreased afterward, reaching 2.61% in December 2023. This is the lowest inflation rate in two decades outside the pandemic period 2020-2021.

The decrease in the inflation rate from February to December 2023 was mainly contributed by volatile inflation and administered inflation, which sharply declined in 2023. Volatile inflation recovered from August to December 2023 after a deflation rate in June 2023 (-0.03%). Administered inflation fell from 12.28% in January 2023 to 1.72% in December 2023. In 2023, administered inflation only increased in February and October 2023. Nevertheless, the low inflation rate does not always give a good signal to the economy since core inflation also faced a slightly decreasing trend in 2023.

By the consumption types, energy and transportation have the highest spikes in 2023. Energy prices decreased due to geopolitical tensions in various regions and concerns about production levels from major producers worldwide. The Government of Indonesia (GoI) also came up with a policy of reducing the price of fuel oil from Q4 2023. Transportation declined because of a decreasing trend in global oil prices in 2023. Although, there was a slight increase at the end of 2023 due to the high demand for transportation associated with Christmas and New Year festivities.

Table 1: Inflation Rate (Forecast LPEM FEB UI)

Dec 2022		Jan 2023 Forecast	
Headline	Core	Headline	Core
2.61%	1.80%	2.5-3.5%	1.7-2.5%

The exchange rate market marked both a jump and a decline in 2023. In Q1 2023, the exchange rate appeared to weaken, following the global investor's attention on the outlook for the interest rates of the US Federal Reserve in 2023. In October 2023, the exchange rate level market was the highest one in the year, caused by the escalating geopolitical situation in the Middle East, leading to caution about risky assets.

We forecast inflation to stabilize at 2.50-3.50% at the beginning of 2024 and decrease toward the end of the year. In Q1 of the upcoming year, it is expected that the effect of fuel price

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adjustment will still exist, and the exchange rate will still be high due to global financial uncertainty. However, inflation may decrease in the subsequent quarter due to the global economic slowdown and decrease in import prices, given that the government manages to control prices of commodities through energy and food subsidies.

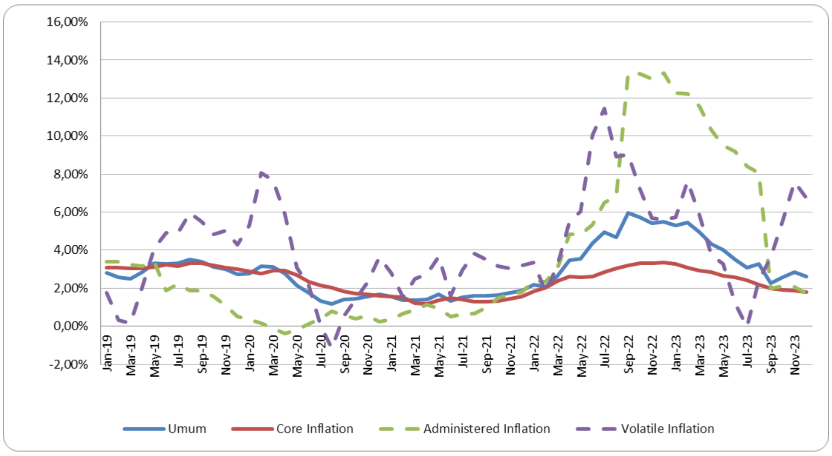
Lower Inflation Rate, Yet Increasing Rice Price

Overall, we saw a relatively low inflation rate throughout 2023. We saw a decrease in every aspect of inflation. The volatile inflation experienced a substantial decline, reaching a deflation of -0.03% in June 2023. It is the first time volatile inflation has reached a negative number since 2020 after the pandemic hit. Moreover, the inflation of the volatile group bounced back in the past six months, remarking at 6.73% YoY inflation in December 2023.

We also saw a massive decrease in the rate of inflation for administered goods, which peaked at the end of 2022 with double-digit YoY inflation. The high number of administered inflation remained in double digits until May 2023 and decreased substantially to 1.72% in December 2023. We argue that this decrease phenomenon resulted from the drop in fuel prices in 2023.

The fall in inflation rates for administered and volatile goods is driving the overall inflation back to the Bank of Indonesia's inflation target of 3±1 percent, as stated in the Regulation of The Minister of Finance No. 124/PMK.010/2017, after facing a short rise in 2022. On the other hand, core inflation faced a slight decrease in 2023.

Figure 1: Inflation Rate (Headline, Core, Volatile, Administered Goods), 2019-2023



Source: CEIC

Next, we analyze the inflation rate based on consumption types (**Figure 2**). We observe several spikes starting from the second quarter for several consumption types. The two most significant ones were in energy and then followed by transportation. Energy prices surged due to the global energy crisis, initiated by supply shortages and fuel price increases that occurred after the COVID-19 pandemic and worsened by the Russian invasion of Ukraine in February 2022. The proxy war between NATO and Russia involved sanctions against Russia, which then responded by limiting gas exports to the EU. Oil prices continued to soar in 2022,

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reaching a peak of US$122 per barrel in March 2022. Disruptions in global oil prices also led several countries to experience energy crises and increased debt and inflation. Indonesia faced similar pressures, prompting the government to improve energy subsidies from around Rp170 trillion to over Rp400 trillion. Oil prices fluctuated throughout 2023, predominantly sideways or in a "holding pattern." This was due to the Russian invasion of Ukraine and oil production cuts by OPEC. By the end of 2023, crude oil prices declined by more than 10 percent, driven by geopolitical tensions in various regions and concerns about production levels from major producers worldwide. Indonesia also followed this decline with a policy of reducing the prices of Motor Fuel Oil (BBM) from September 2023 to January 2024.

In addition to energy prices, the government's easing travel restrictions influenced inflation in the transportation sector. As a result, some people started to live as before the pandemic, commuting and traveling, leading transportation service providers to revert prices to their original levels. Inflation in the transportation sector in September 2022 also aligned with the increase in energy prices due to the global energy crisis, impacting various urban and inter-provincial transportation fares, including online transportation services, which adjusted their fares in response to the rise in fuel prices. However, a decline also continued, considering the decreasing trend in global oil prices. However, there was a slight increase at the end of 2023 due to the demand patterns associated with the Christmas and New Year festivities.

Post-pandemic, the government also facilitated the public's attendance at recreational events. The return of music concerts, galleries, and playgrounds could also explain the recorded inflation increase in recreation, sports, and culture. We also observed a rise in food ingredients, food, beverages, and tobacco products, although not as extreme as in energy and transportation. The hikes began in early 2022 due to nationwide crop failures, imports of food ingredients, a ban on CPO exports, and a shortage of cooking oil, all of which were responsible for the surge in food prices in Q2-Q3. Fortunately, food prices started to decline in the latter part of 2022. However, increases occurred again in the first quarter of 2023, influenced by tobacco tax hikes and some commodity types affected by disrupted harvests due to high rainfall. In the second quarter, inflation in food ingredients continued to decline due to an increase in supply resulting from an extended harvest season for horticultural commodities. However, throughout the second semester, food ingredients and food, beverages, and tobacco also increased due to the impact of the El Niño weather phenomenon. The increase in cigarette taxes, not to mention the rise in rice prices since October 2023, has become a worrisome issue. The Indonesian government must pay attention to the increase in domestic food production and the capacity of farmers in terms of food security. Sometimes, the Indonesian government overlooks the prices of rice and other staple foods because it is too focused on energy prices.

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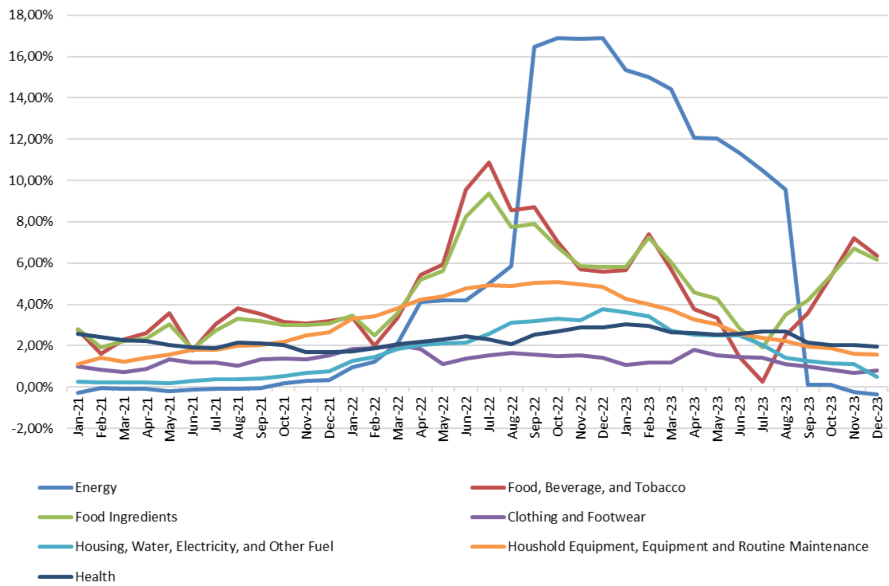
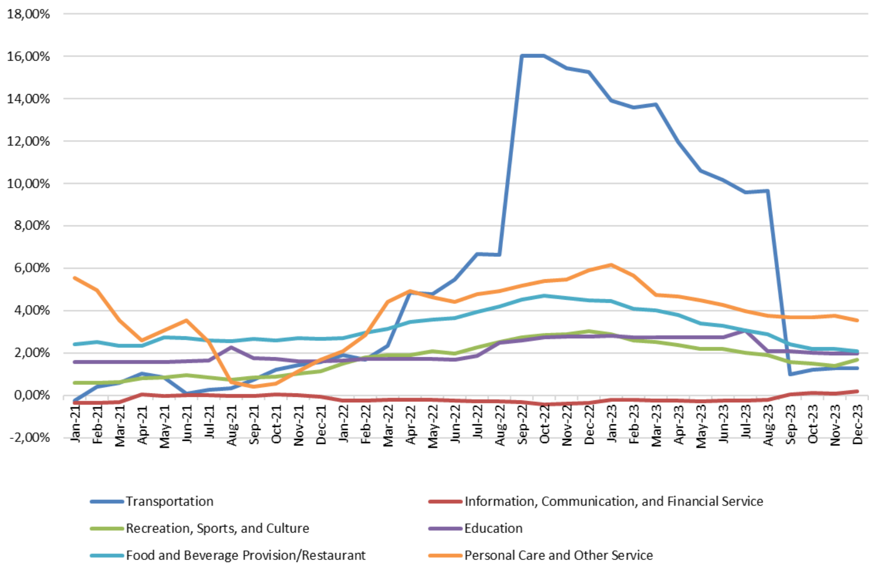
Figure 2: Inflation Rate by Consumption Type, 2021-2023 (YoY)





Source: CEIC

After analyzing the inflation rate based on consumption types, it is evident that the impact of health and economic recovery is noticeable throughout 2022 and 2023. It can be concluded from the fact that several sectors are returning to normal levels. People have started traveling both domestically and internationally, recreational events are making a comeback, and the wave of people returning to work from offices is also driving economic activities. The slow and steady inflation rate in the health sector also implies lower concerns about health risks due to COVID-19. The abundance of COVID-19 vaccines, easily accessible for those in need (especially in major cities), and the lower service fees for COVID-19 testing can be interpreted as positive signs for the future.

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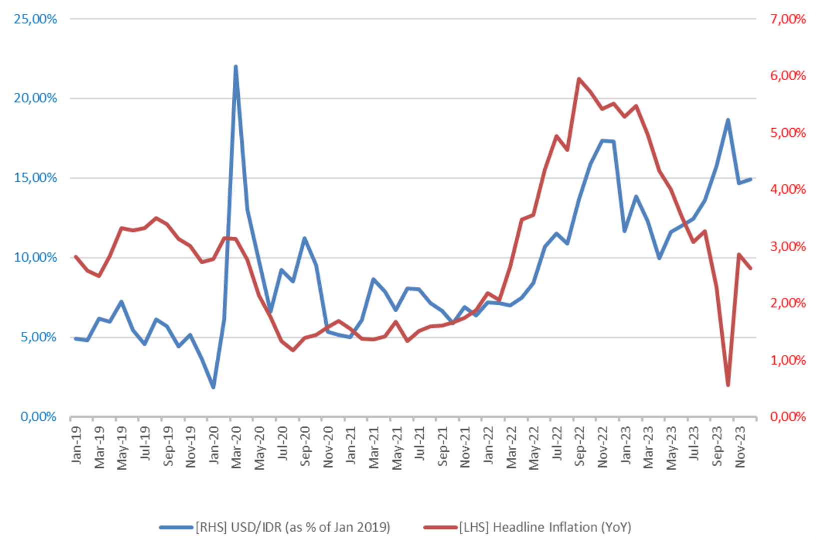
The exchange rate market experienced a roller-coaster journey in 2023 (**Figure 3**). The exchange rate in Q1-2023 appeared to fluctuate. It tended to weaken, in line with global investor attention on the outlook for the interest rates of the US Federal Reserve in 2023 and concerns about the unsuccessful easing of COVID-19 restrictions in China. However, it briefly strengthened in February 2023, aligning with the strengthening of the US dollar index. In July, the Federal Reserve decided to raise the benchmark interest rate to 5.25%-5.5%, marking the highest interest rate hike in the US in the last 22 years.

Meanwhile, Bank Indonesia chose to maintain the interest rate at 5.75%. In October, the rupiah exchange rate breached Rp15,916 per US dollar, reaching the highest exchange rate throughout 2023. It was caused by the escalating geopolitical situation in the Middle East, leading many businesses to be cautious about risky assets. The rupiah depreciation increased the prices of some imported commodities, such as soybeans and sugar. Despite the increased global risks, Indonesia's trade balance remained in surplus until November 2023, extending Indonesia's trade surplus streak to 43 consecutive months.

At the same time, the global crypto industry, which had faced setbacks since 2022 due to the collapse of FTX, encountered a new blow in early 2023 with the collapse of Silvergate Capital, Signature Bank, and Silicon Valley Bank (SVB). It sent shockwaves through the global financial system, including the crypto industry. However, the market capitalization of the crypto market managed to experience an increase by the end of 2023, even reaching USD 1.67 trillion in December 2023. This position was the highest since early May 2022, or approximately the last 1.5 years. In Indonesia, the trading volume of crypto assets experienced a significant decline in September 2023, dropping by 224% annually (YoY) due to high taxation. Despite this decrease, Indonesia's number of crypto investors increased by 10.1%, reaching 16.4 million people in October 2022. Additionally, crypto transactions in Indonesia showed strong momentum, with a transaction value of Rp10.5 trillion at the end of 2023, driven by the influx of new investors into the market due to the rise in prices of major crypto assets such as Bitcoin.

Figure 3: Inflation Rate and Relative Change in USD/IDR, 2019-2023



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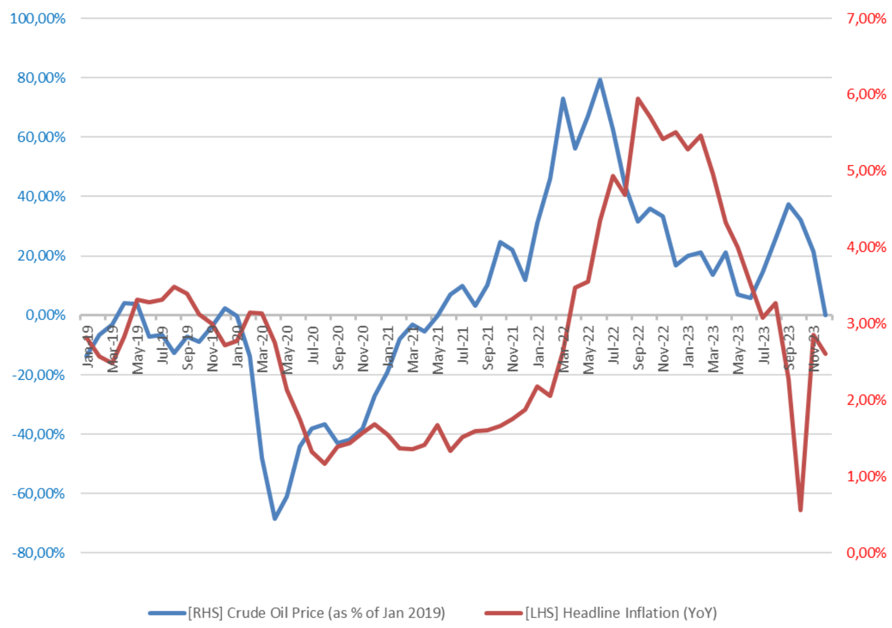
The global crude oil prices experienced fluctuations, making them rise and fall throughout the year 2023, although they consistently remained above the prices in January 2019 (**Figure 4**). The year 2021 was marked by increasing crude oil prices due to continuously growing global demand outpacing supply, while fluctuations in crude oil prices characterized 2022 due to the global energy crisis following oil supply disruptions due to the conflict between Russia and Ukraine. In early 2023, the movement of oil prices was influenced by the policy of easing social restrictions in China, leading to an increase in crude oil purchases from that country. The weight on oil prices increased with the global recession threats from the US and China and the interest rate hikes by The Fed, impacting global oil demand in mid-2023. This led to OPEC's policy on production cuts, resulting in supply deficits until Q4-2023. The oil price in September reached the highest level this year, triggered by the tensions between Israel and Palestine, raising concerns about potential disruptions in oil supply from that region.

Consequently, the government raised non-subsidized fuel prices in early October. Until the end of 2023, crude oil prices experienced a decline influenced by diverse economic data from China, production growth in the US and Brazil, and increased OPEC exports. Indonesia also followed this decline, reducing non-subsidized fuel prices starting November 1, 2023.

Figure 4: Inflation Rate and Relative Change in Oil Price (Brent), 2019-2023



Source: CEIC

Economic growth was constantly positive at around 4-5% YoY in 2023 despite the global economic uncertainty caused by the Fed and the Israel-Hamas conflict (**Figure 5**). Indonesia's economic growth marked positive trends in the first and second quarters of 2023. Indonesia's economic growth in Q1 2023 is driven by improvements in all aspects of the economy, especially export performance, which is supported by demand from strong trading

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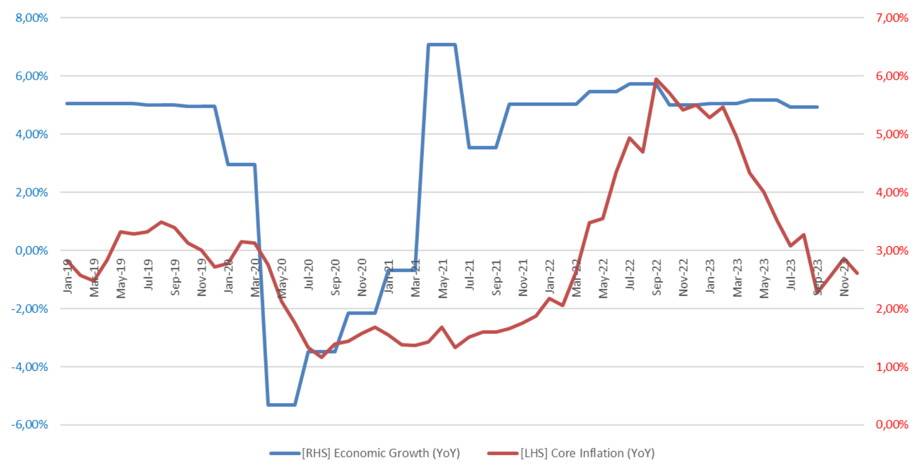
partners and household consumption, increased mobility, and increased purchasing power. In Q2 2023, there is a significant increase in Indonesia's economic growth, marking the highest one since Q3 2022. Positive trends were found in household consumption, government expenditure, and investment. Specific to investment, there is an enhancement in construction and non-construction, reflected by increased capital and infrastructure development growth across Indonesia. Economic growth in Q3 2023 decreased to 4,94%, the first economic growth below 5% since Q3 2021, mainly caused by the decrease in export due to the global economic retardation. Employment conditions also continued to improve following the recovery of economic conditions. According to Statistics Indonesia (BPS), the labor force participation rate (LFPR) was reported at 69.48% in August 2023, the highest LFPR since 1986.

Figure 5: Core Inflation Rate and Economic Growth, 2019-2023



Source: CEIC

2024 Inflation Forecast: Lingering Risk from The War, Energy Prices, and High Inflation

We estimate that the inflation rate in 2024 will still be above the average inflation of the previous year, around 2.5% to 3.5%, but still within the target range. These underlying estimates stem from a combination of increasing global energy and food prices, domestic demand growth returning to normal levels after post-pandemic recovery, the potential inflationary impact of the upcoming elections, and new government policies such as a 10% tax imposition on electronic cigarette products like vapes or pods, a 10% increase in cigarette excise tax, adjustments to the excise tax rates for alcoholic beverages, and the imposition of taxes on sweetened beverages in packaging and plastic containers. However, the inflation trend is predicted to slow down due to low food inflation, a decline in oil prices, and the potential strengthening of the rupiah exchange rate. Therefore, maintaining food availability and inter-regional distribution needs attention, especially during the rainy season. Domestic inflation rates are expected to start increasing from the middle to the end of 2024, possibly caused by the end of the harvest season leading to an increase in food commodity prices.

Although the value of the US dollar is strengthening daily, we expect the Rupiah to remain stable or even strengthen. The movement of the exchange rate of the Rupiah against the US

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Dollar in early 2024 will still be influenced by the risk of capital outflow, which can occur due to the high benchmark interest rates set by the Fed, moderate investment pace in the election year, and the waning increase in global commodity prices that can affect exports. Additionally, the movement of the Rupiah against the US Dollar also depends on issues related to ongoing geopolitical tensions in several countries and concerns about global economic slowdown, as seen in the US, Europe, and China.

Moving forward, despite the surge in crude oil prices in 2023, we anticipate more stable prices in 2024. The economic slowdown in China, excess supply in US oil reserves despite the onset of winter, and the lower cost of natural gas as a crude oil substitute could contribute to keeping crude oil prices in 2024 at relatively moderate levels. Additionally, geopolitical tensions among several countries, such as the Israel-Hamas conflict and the Ukraine-Russia war, possibly reaching ceasefire points, may ease pressure on oil prices compared to the past year. Even though we expect that inflation will be 2.5-3.5% in 2024, GoI needs to keep food prices, especially rice prices, stable as their main priority next year.