CPI:
Food prices jump higher but watch out for core inflation

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Executive Summary

- The consumer price index increased by 4.94% YoY (0.64% MoM) in July 2022, faster than the previous months as supply concerns continue to increase food and energy prices.
- Cratering demand in the commodity market may alleviate some of inflation risks currently faced by the Indonesian economy. Core inflation, however, may continue to increase as businesses would look to pass-on costs onto consumers while continued money supply expansion heightened the risk of monetary inflation.
- The decline in imported commodity prices and lower currency depreciation risks may tempt BI not to increase the BI 7DRR as other policies have insofar shown promising results in draining excess liquidity out of the banking sector.

- Inflation ran hot once more in Jul-22 as consumer price index (CPI) increased by 4.94% YoY (0.64% MoM), the highest since Oct-15. The headline number was largely food-driven, with items such as chili and shallots driving foodstuffs inflation by 10.88% YoY (1.35% MoM). Meanwhile, items in the 'administered price' basket also increased by 6.51% YoY (1.17% MoM), courtesy of some price adjustments in the domestic energy market (albeit still limited to higher-end consumers).

- Substantial spikes in foodstuffs and AP inflation shows inflation in Indonesia remains commodity-driven ***(Chart 1).*** The good news, however, is that the cooling off of global commodity prices will start to ease this pressure in the coming months. For instance, lower CPO prices has reduced cooking oil prices to an extent that was difficult to do even with various market interventions (domestic market obligations, export ban). At the same time, the decline in fertiliser prices should help agricultural producers increase their yields.

- Of course, government continues to play a sizable role here, for instance by subsidising fertiliser prices for staple food production. But the biggest intervention – and therefore the biggest wildcard – is still its fuel subsidies, which is set to continue for the remainder of the year. However, August will see two developments which could decide energy price inflation in 2023: (1) the introduction of myPertamina mobile app to limit subsidized fuel use for certain class of vehicles, and (2) the announcement of the 2023 Budget, which may see some changes to the subsidy allocation in a bid to reduce fiscal deficit. While oil price has cooled down recently, it has not fallen by enough as to eliminate the role of government intervention in setting prices – that would require oil falling to USD 60-70/barrel or lower.

- Setting fuel subsidies aside, the remaining threat this year might have to do with core inflation – the central banker's favourite gauge. While it remains at a low level of 2.86% YoY, this number has been trending upward over the last ten months, with a growth rate that is also accelerating compared to the previous month (0.28% MoM vs. 0.19% MoM in JUN-2022). Is the role of commodity inflation about to be usurped by core inflation?

- We noted earlier in the year that concerns over consumer demand discourage manufacturers from passing on the extra cost to the still-vulnerable consumers. However, it is evident from both our big data and from recent indices such as consumer confidence and retail sales that consumer demand is actually quite robust – to an extent that domestic demand could offset weak export demand in the latest PMI survey. This demand was further bolstered by the aforementioned subsidies.

- Per our "starting gun" hypothesis, what sellers need was signal(s) that it is okay to start raising prices, and it is clear that this has happened in recent months. And with imported wholesale price index still up by double-digits, the pass-through effect would probably continue for imported goods and items with imported components.

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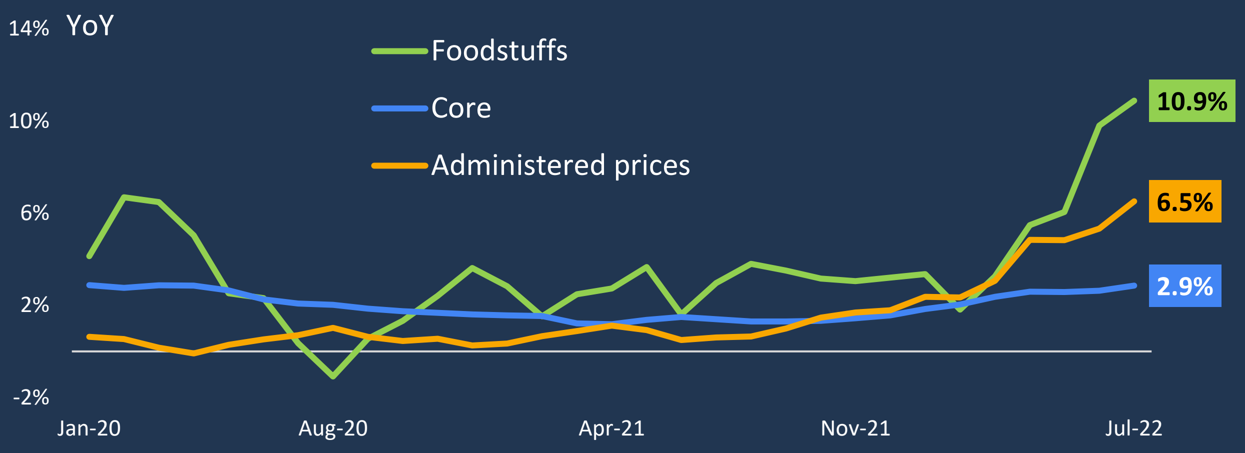
- The recent tumult in China, on the other hand, could potentially help dampen core inflation in the medium term. Anaemic domestic demand in China throughout the early part of 2022 led to an "export boom" of sorts, which means that China is essentially exporting deflation across the world. This may continue amid the current real-estate sector turbulence, and the lack of demand-side stimulus by the Chinese authorities. Furthermore, China's unexpected PMI decline to 49.0 in Jul-22 might signal continued softness in the demand for key industrial inputs such as copper, "locking in" lower prices for the manufacturing sector.

- Finally, there is the risk of monetary inflation, as the money supply expands courtesy of (1) base money expansion to support the government's deficit spending, and (2) robust loan growth in recent months. On top of that, the economic recovery is also stimulating faster circulation of money (higher velocity), which could foster inflation further ***(Chart 2)***.

- This provides a rationale for BI's policies to drain liquidity from the banking system, which includes the RRR hike – in order to reduce money multiplier – and the gradual sell-off of government bonds in the secondary market – to curb base money growth. The liquidity-draining operation, as discussed in our previous report on FOMC, has succeeded in absorbing excess liquidity from the banking sector.

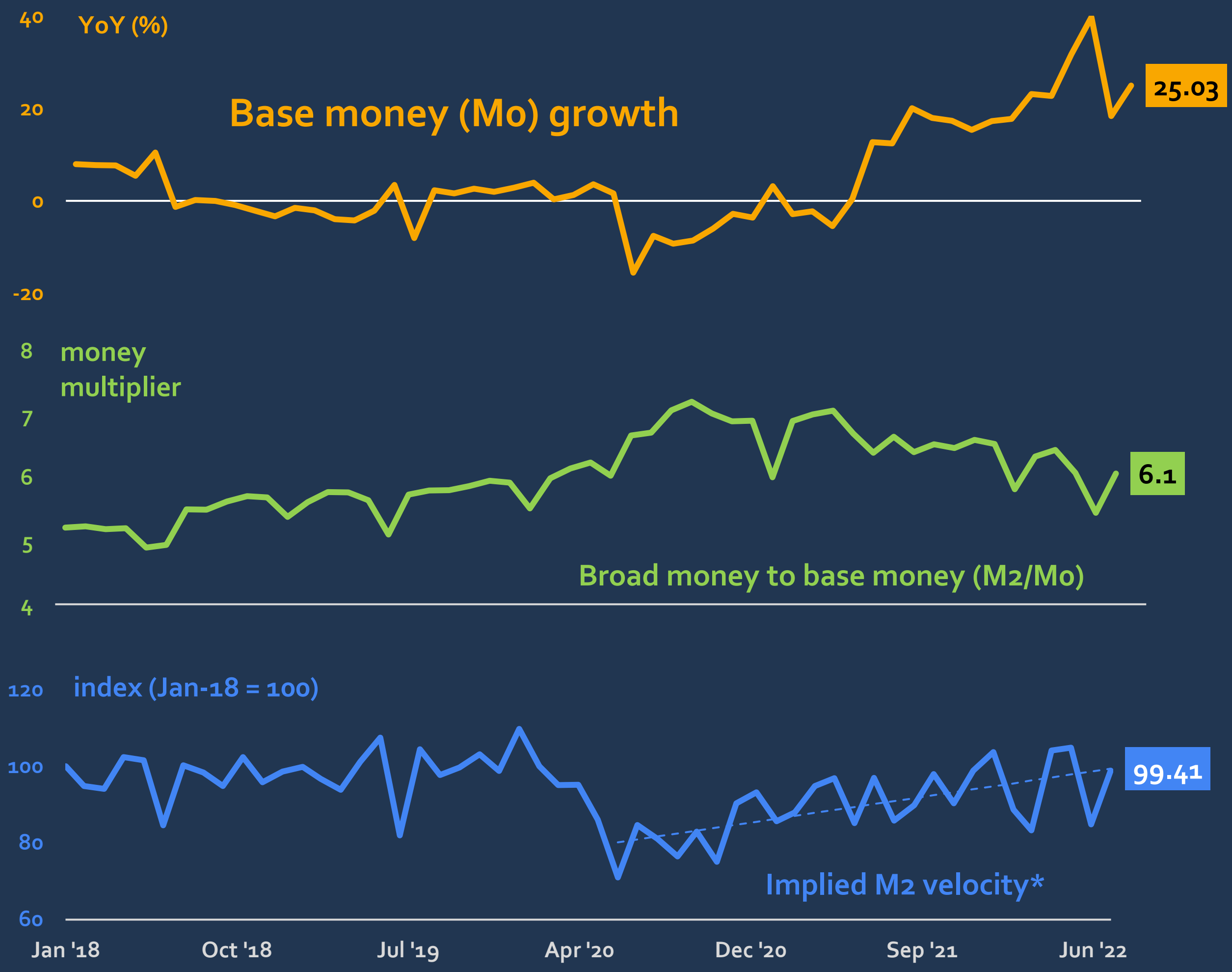
- Meanwhile, the threat of depreciation – where BI may truly need to bring the big gun, i.e. BI7DRR hike – are receding as the market expects the Fed to pivot in a more dovish direction. For the moment, then, it appears that BI may not need to hike the BI7DRR while its other policies are working. Nonetheless, there is a decent probability that the market may be misjudging the Fed's intention, while there is a good potential that the global growth outlook is darkening for H2-22 and 2023. The latter means weaker commodity prices, and considering Indonesia has been a beneficiary of foreign inflows into its equity sector courtesy of the commodity boom narrative, the risk of reversal needs to be taken into consideration going forward.

Chart 1. Inflation remains commodity-driven while core inflation creeps upward as consumer demand strengthens.



Source: BPS

Chart 2. BI's liquidity-draining operation would be essential to combat inflation as higher money velocity would add to the monetary inflation risk.



Source: BI, BCA Big Data

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	2.50	Jul-22	-6.60
UK	1.25	Jun-22	-8.15
EU	0.50	Jul-22	-8.40
Japan	-0.10	Jan-16	-2.50
China (lending)	4.35	Oct-15	1.85
Korea	2.25	Jul-22	-3.75
India	4.90	Jun-22	-2.11
Indonesia	3.50	Feb-21	-1.44

Money Mkt Rates	29-Jul	-1 mth	Chg (bps)
SPN (1M)	2.48	2.49	-0.9
SUN (10Y)	7.11	7.29	-18.7
INDONIA (O/N, Rp)	2.80	2.79	0.8
JIBOR 1M (Rp)	3.69	3.54	14.4

Bank Rates (Rp)	Mar	Feb	Chg (bps)
Lending (WC)	8.59	8.62	-2.97
Deposit 1M	2.85	2.85	0.57
Savings	0.63	0.63	-0.23

Currency/USD	29-Jul	-1 mth	Chg (%)
UK Pound	0.822	0.821	-0.11
Euro	0.978	0.951	-2.84
Japanese Yen	133.3	136.1	2.15
Chinese RMB	6.745	6.708	-0.54
Indonesia Rupiah	14,833	14,837	0.03

Capital Mkt	29-Jul	-1 mth	Chg (%)
JCI	6,951.1	6,996.5	-0.65
DJIA	32,845.1	30,947.0	6.13
FTSE	7,423.4	7,323.4	1.37
Nikkei 225	27,801.6	27,049.5	2.78
Hang Seng	20,156.5	22,419.0	-10.09

Foreign portfolio ownership (Rp Tn)	Jul	Jun	Chg (Rp Tn)
Stock	2,442.4	2,388.2	54.28
Govt. Bond	749.6	780.2	-30.66
Corp. Bond	16.7	17.9	-1.14

Trade & Commodities	29-Jul	-1 mth	Chg (%)
Baltic Dry Index	1,895.0	2,204.0	-14.0
S&P GSCI Index	692.6	744.9	-7.0
Oil (Brent, $/brl)	110.0	118.0	-6.8
Coal ($/MT)	384.8	355.5	8.2
Gas ($/MMBtu)	8.33	6.54	27.4
Gold ($/oz.)	1,765.9	1,820.0	-3.0
Copper ($/MT)	7,931.3	8,360.0	-5.1
Nickel ($/MT)	23,579.0	23,119.0	2.0
CPO ($/MT)	966.2	1,155.6	-16.4
Rubber ($/kg)	1.52	1.61	-5.6

External Sector	Jun	May	Chg (%)
Export ($ bn)	26.09	21.51	21.3
Import ($ bn)	21.00	18.61	12.9
Trade bal. ($ bn)	5.09	2.90	
Central bank reserves ($ bn)*	136.4	135.6	0.63

Prompt Indicators	Jun	May	Apr
Consumer confidence index (CCI)	128.2	128.9	113.1
Car sales (%YoY)	8.9	-9.8	5.0
Motorcycle sales (%YoY)	-30.9	-2.5	-7.1
Cement sales (%YoY)	#N/A	7.6	-10.0

Manufacturing PMI	Jul	Jun	Chg (bps)
USA	N/A	53.0	0
Eurozone	49.6	52.1	-250
Japan	52.1	52.7	-60
China	50.4	51.7	-130
Korea	49.8	51.3	-150
Indonesia	51.3	50.2	110

Source: Bloomberg, BI, BPS
Notes:
^Data for January 2022
*Data from earlier period
For changes in currency: **Black indicates appreciation against USD, **Red** otherwise
***For PMI, **>50** indicates economic expansion, **<50** otherwise

Indonesia – Economic Indicators Projection

	2017	2018	2019	2020	2021	2022E
Gross Domestic Product (% YoY)	5.1	5.2	5.0	-2.1	3.7	4.8
GDP per Capita (US$)	3877	3927	4175	3912	4350	4615
Consumer Price Index Inflation (% YoY)	3.6	3.1	2.7	1.7	1.9	5.2
BI 7 day Repo Rate (%)	4.25	6.00	5.00	3.75	3.50	4.50
USD/IDR Exchange Rate (end of year)**	13,433	14,390	13,866	14,050	14,262	15,070
Trade Balance (US$ billion)	11.8	-8.5	-3.2	21.7	35.3	39.2
Current Account Balance (% GDP)	-1.6	-3.0	-2.7	-0.4	0.3	0.9

** Estimation of Rupiah's fundamental exchange rate

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