CPI:
Best of both worlds, but how much longer?

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Executive Summary

- Inflation continues to fall fast to 4.00% YoY (0.09% MoM), as transport costs normalized after Lebaran while excess inventory in China pushed down clothing and footwear prices.
- Consumption is starting to soften post-Lebaran, as households have spent their lockdown savings, and now may have spent the windfall from 2022's end-of-the-year fiscal spending too.
- Low inflation is not inherently incompatible with strong growth, but it probably is when the two largest global economies are either facing demand issues (China) or may soon be (US).
- China-driven disinflation may allow Asian central banks, including BI, to cut earlier than the Fed. However, fiscal stimulus and RRR cuts could deliver more immediate jolt than BI7DRR cut.
- CPI reading near or below 3% is quite likely this year, with the main spoiler being the probable emergence of El Niño over the next few months.

- Once again, consumer price inflation declined precipitously, to 4.00% YoY (0.09% MoM) in May-23. Transportation and clothing/footwear contributed to monthly deflation, at -0.07% and -0.02% apiece, but these were outweighed by food inflation which contributed +0.13%.

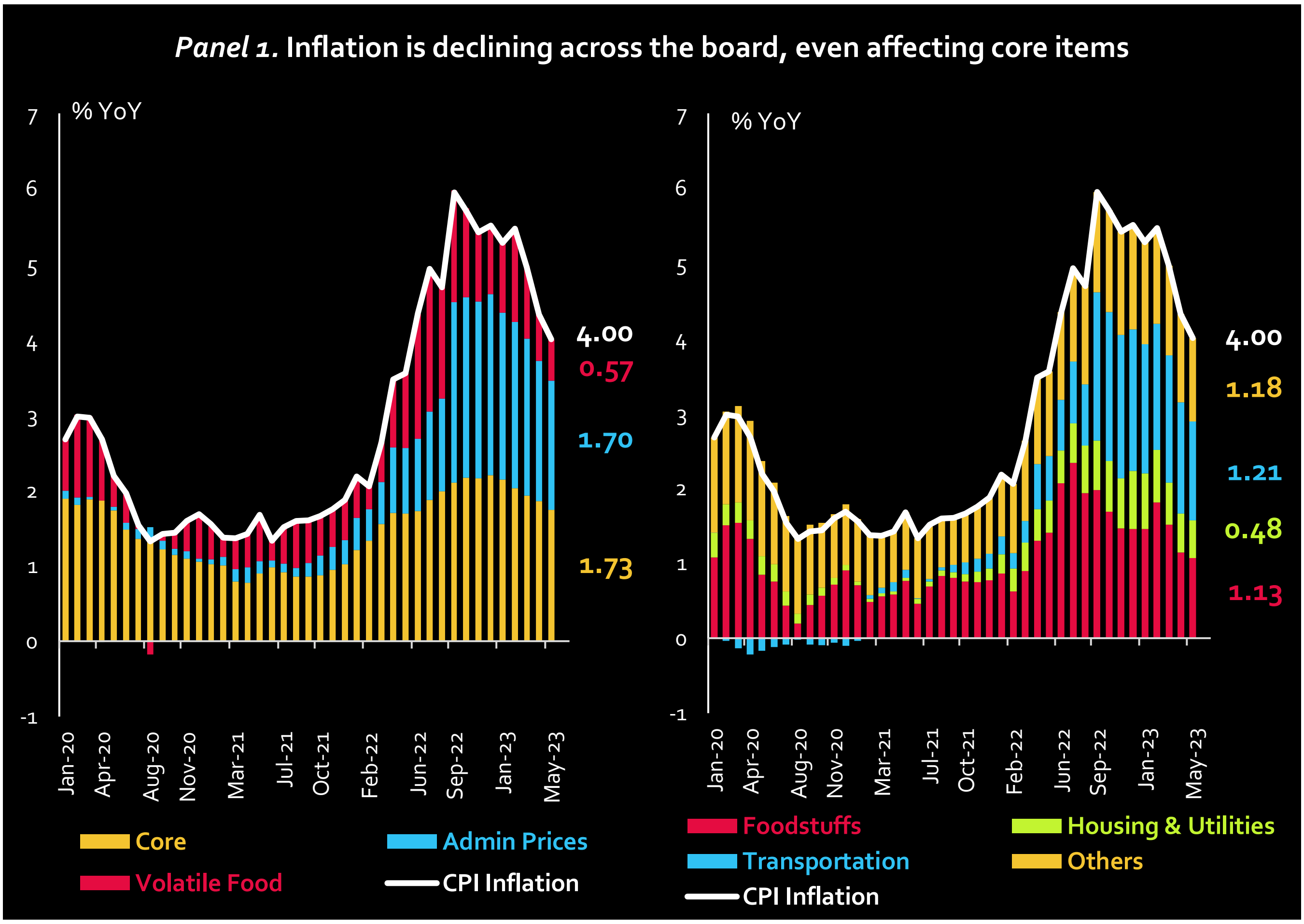
- Deflation in transportation was entirely expected in the month following Lebaran (Eid al-Fitr). For clothing, it is much less so, especially at such rapid clip (-0.46% MoM). It is, however, readily explained by an influx of excess inventory from China, an issue which we have delved into in a recent special report (see: Collideascope #1 – Full House). In the report, we showed that apparels are one category of goods which have seen an increase in import from China at much lower unit prices.

- We have also flagged this decline in imported inflation as a major factor behind the decline of core inflation, which – at just 2.66% YoY – is fast approaching its pre-Ukraine War, lockdown-era levels. Falling core inflation, then, might be as much a supply-side issue as it is a reflection of weaker demand.

- Still, it is hard to shake the suspicion that demand is weakening as we speak, especially with loan growth continuing to slow. The BCA Spending Index (Intrabel), based on our proprietary transaction data, also picks up a softening in consumer spending post-Lebaran versus the comparable period last year.

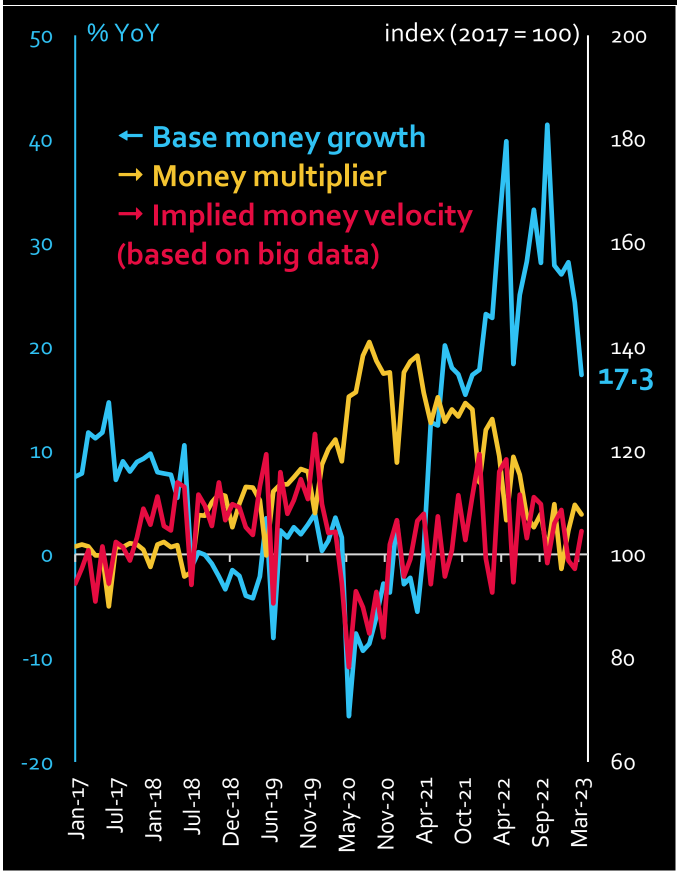
- So while the most recent headline data shows the best of both worlds (low inflation and strong growth at 5.03% YoY in Q1-23), this may not be the case for too long. The mounting oversupply in China and growing likelihood of a recession in the US could further suppress the demand for Indonesian commodities, which in turn further weaken the impetus for spending especially in commodity-dependent regions.
- Disinflation, then, could come at the expense of growth. This is our primary concern over the government's budget plans for 2024, which is set to be unveiled in August. None of the MoF's macro assumptions for next year are unrealistic by itself – including the growth target at 5.3-5.7% and inflation at 1.5-3.5%.
- Taken together, however, they might be incompatible. The former is a good bet in a year like 2022, when global supplies are constrained and commodities are at a premium – but it may imply inflation higher than 3.5%. Conversely, if the world is facing a demand deficit, inflation is likely to fall within the target range – but growth could fall short.
- Of course, the government does have ample fiscal resources to steer the economy towards its targets. The central and regional government's cash balance at BI and commercial banks was approaching IDR 1,300 Tn in March, and well-timed disbursement could counteract the softening demand.
- Fiscal support is even more critical since households have spent their excess savings during "the great revenge spending" between the end of the Delta wave (Aug or Sep-21) and the fuel price hike in Sep-22. The replenishment of these savings between Sep and Dec-22 was helped by a burst of fiscal stimulus, as the government spent 46% of its eventual expenditure during the last four months of the year (a total of IDR 1,434 Tn).
- This is why we have been arguing that fiscal spending and BI reserve requirement ratio (RRR) cuts could be the go-to policies in the next few months if growth falters. In contrast, cuts to the BI 7-day Repo Rate (BI7DRR) might be a riskier proposition with the Fed now seen as unlikely to pivot before the end of the year.
- Nonetheless, there are increasing bets that some Asian central banks could cut policy rates this year – Fed notwithstanding – and BI is among the top of that list along with the Korean and Philippine CBs. We now see this possibility as well, although we note that rate cuts tend to act with considerable lag compared to fiscal stimulus and RRR cuts – so it may not be the tool of choice to instantly "juice up" the economy.
- The likelihood that Asian CBs could cut earlier than the Fed is also supported by the Chinese inventory dynamics. While China is increasingly unloading the excess goods to the rest of Asia and the "Global South", its exports to the US is actually declining. As such, the US enjoys less of the China-driven goods disinflation compared to Asia – especially now that recalcitrant services inflation is the Fed's main headache.
- One thing that could also prevent monetary easing in Indonesia is one that we have not talked about since the first paragraph: food inflation. The price of some spices – garlic and bird's eye chili chief among them – has risen in May, and the same is true for poultry.

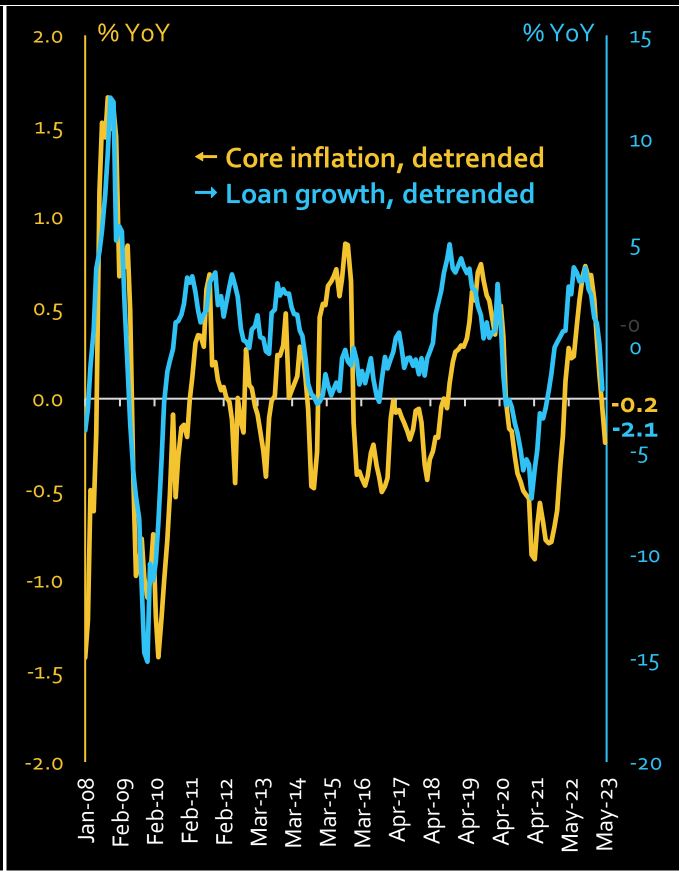
- There is an even bigger threat: strong El Niño-like ocean temperature anomaly is happening near the Americas, although not yet on the Asian side of the Pacific. If El Niño actually breaks out, the local food production could be negatively affected, which could become a pressing concern ahead of the 2024 Elections.
- Still, if these things do not materialize, there is a good chance that CPI inflation would continue to decline. A sub-3% reading is even plausible by the end of the year – quite probable, in fact. Recall that administered prices contribute 1.70% to inflation, mostly from the Sep-22 fuel hike. Once this effect is in the rear-view mirror (i.e. by Q4-23), we could be looking at a much lower headline inflation figure.



Source: BPS, calculation by BCA Economic Research

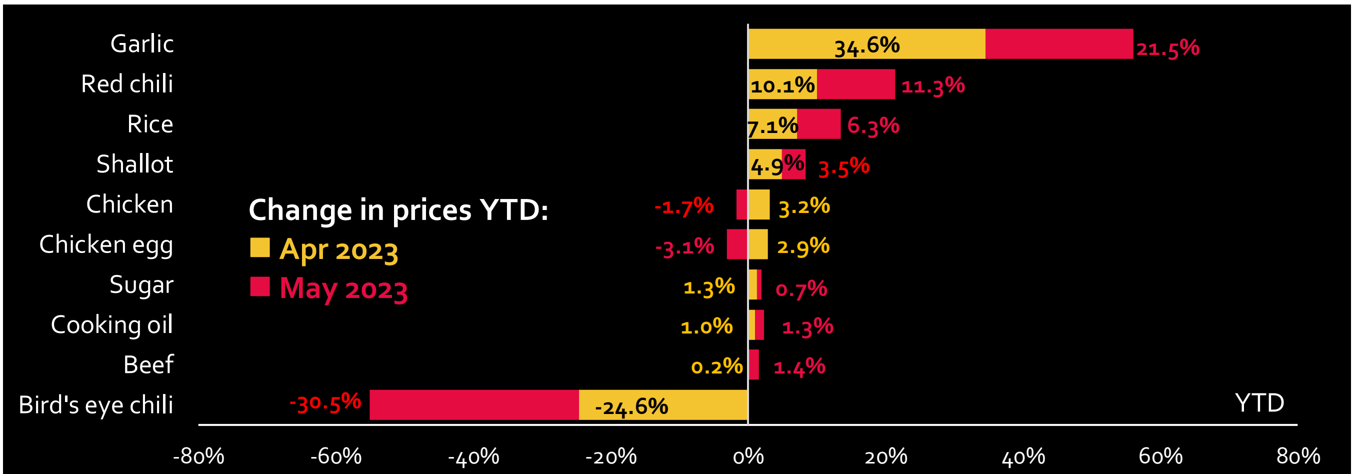
Panel 2. Slowing core inflation may reflect weaker demand and slowing loan growth

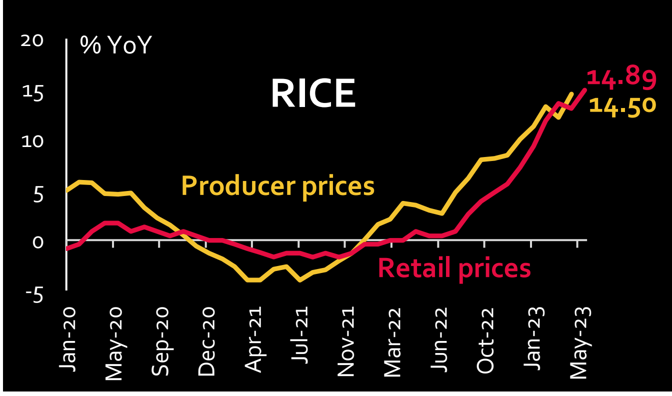


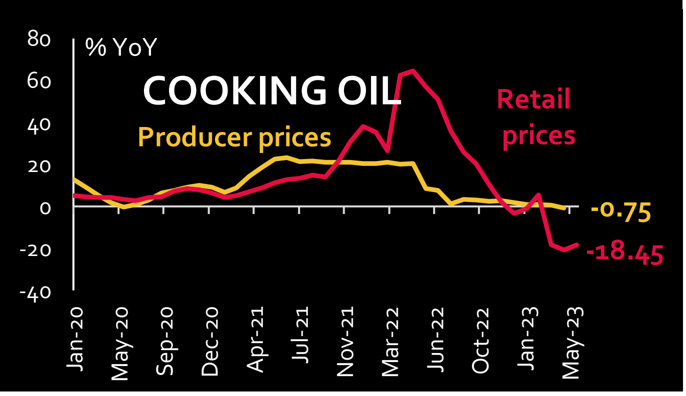


Source: BI, OJK, BCA big data, calculation by BCA Economic Research

Panel 3. Rice remains the main driver of food inflation, but spices are increasingly an issue

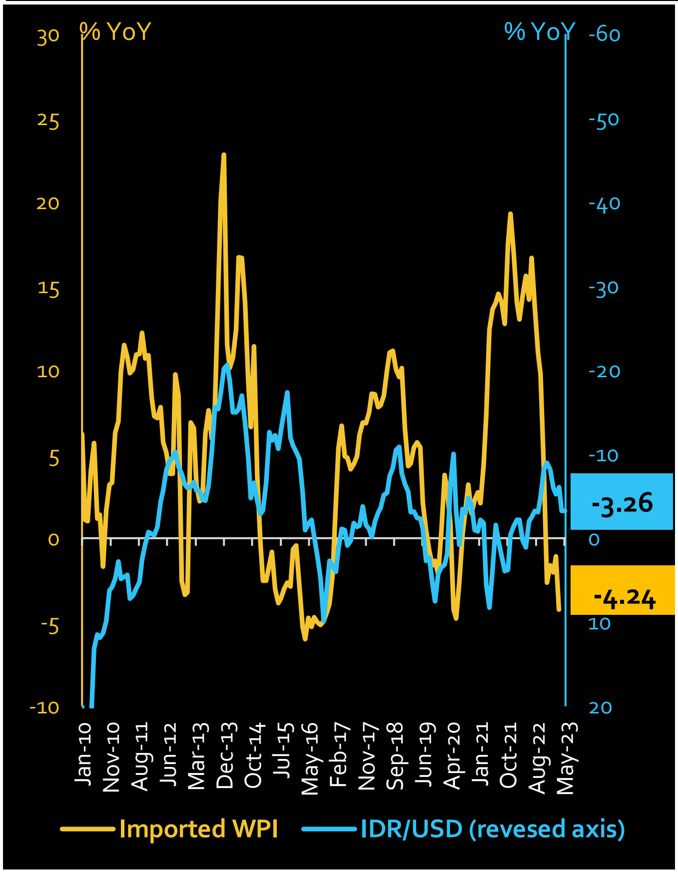






Source: Ministry of Trade, BPS

Panel 4. Inflation has slowed globally, but more noticeably in Asia thanks to Chinese imports



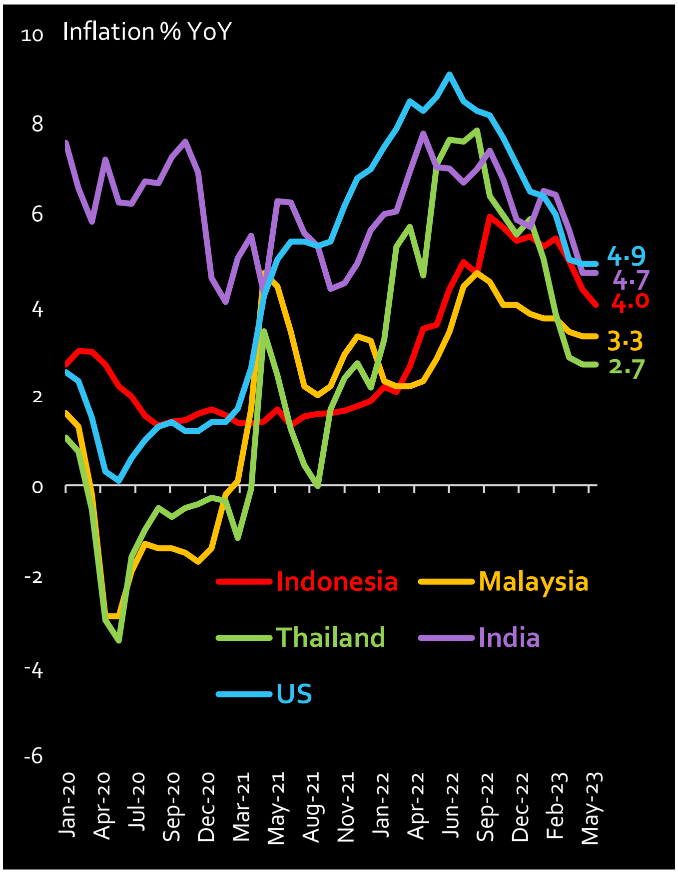
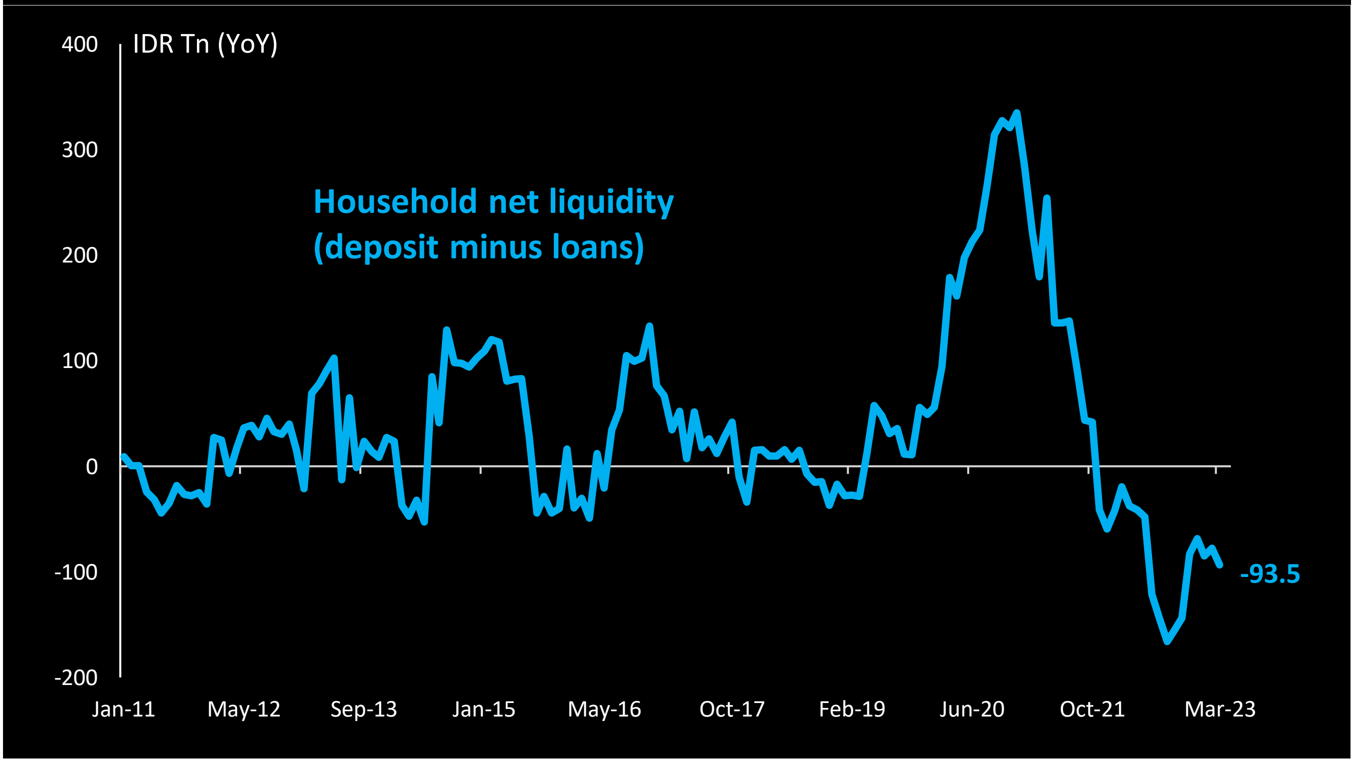


Chart 1. Households have spent their accumulated savings from Covid



Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.25	Jun-23	0.35
UK	4.50	Jun-23	-4.20
EU	3.75	Jun-23	-2.35
Japan	-0.10	Jan-16	-3.60
China (lending)	4.35	Jun-23	4.25
Korea	3.50	May-23	0.20
India	6.50	Apr-23	1.80
Indonesia	5.75	May-23	1.75

Money Mkt Rates	31-May	-1 mth	Chg (bps)
SPN (1M)	4.33	5.37	-104.1
SUN (10Y)	6.36	6.51	-15.4
INDONIA (O/N, Rp)	5.63	5.71	-8.4
JIBOR 1M (Rp)	6.40	6.40	0.1

Bank Rates (Rp)	Mar	Feb	Chg (bps)
Lending (WC)	8.95	8.89	6.13
Deposit 1M	4.20	4.18	2.24
Savings	0.69	0.67	1.92

Currency/USD	31-May	-1 mth	Chg (%)
UK Pound	0.804	0.796	-1.00
Euro	0.936	0.908	-2.99
Japanese Yen	139.3	136.3	-2.18
Chinese RMB	7.109	6.913	-2.76
Indonesia Rupiah	14,993	14,670	-2.15

Capital Mkt	31-May	-1 mth	Chg (%)
JCI	6,633.3	6,915.7	-4.08
DJIA	32,908.3	34,098.2	-3.49
FTSE	7,446.1	7,870.6	-5.39
Nikkei 225	30,887.9	28,856.4	7.04
Hang Seng	18,234.3	19,894.6	-8.35

Foreign portfolio ownership (Rp Tn)	May	Apr	Chg (Rp Tn)
Stock	2,738.1	2,789.1	-51.06
Govt. Bond	830.0	822.7	7.29
Corp. Bond	11.8	11.8	-0.01

Trade & Commodities	31-May	-1 mth	Chg (%)
Baltic Dry Index	977.0	1,576.0	-38.0
S&P GSCI Index	528.2	565.0	-6.5
Oil (Brent, $/brl)	72.7	79.5	-8.6
Coal ($/MT)	135.3	191.6	-29.4
Gas ($/MMBtu)	2.10	2.27	-7.5
Gold ($/oz.)	1,962.7	1,990.0	-1.4
Copper ($/MT)	8,070.0	8,577.0	-5.9
Nickel ($/MT)	20,433.0	24,210.5	-15.6
CPO ($/MT)	759.6	941.5	-19.3
Rubber ($/kg)	1.30	1.34	-3.0

External Sector	Apr	Mar	Chg (%)
Export ($ bn)	19.29	23.42	-17.62
Import ($ bn)	15.35	20.59	-25.45
Trade bal. ($ bn)	3.94	2.83	39.43
Central bank reserves ($ bn)*	144.2	145.2	-0.68

Prompt Indicators	Apr	Mar	Dec
Consumer confidence index (CCI)	126.1	123.3	119.9
Car sales (%YoY)	-28.8	2.7	9.0
Motorcycle sales (%YoY)	-19.4	40.5	24.6

Manufacturing PMI	May	Apr	Chg (bps)
USA	46.9	47.1	-20
Eurozone	44.8	45.8	-100
Japan	50.6	49.5	110
China	50.9	49.5	140
Korea	48.4	48.1	30
Indonesia	50.3	52.7	-240

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

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Indonesia – Economic Indicators Projection

	2018	2019	2020	2021	2022	2023E
Gross Domestic Product (% YoY)	5.2	5.0	-2.1	3.7	5.3	5.0
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	3.4
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US$ billion)	-8.5	-3.2	21.7	35.3	54.5	35.3
Current Account Balance (% GDP)	-3.0	-2.7	-0.4	0.3	1.0	-0.7

*Estimated number

** Estimation of Rupiah's fundamental exchange rate

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