

Inflation: Why are prices still low?

Executive Summary:

- **Indonesia's CPI increased by 1.42% YoY last month.**
- **Despite the robust recovery implied by other economic indicators, inflation itself remains relatively weak,** a reflection of government price controls, still large excess production capacities, as well as the predominantly export-oriented nature of Indonesia's recovery.
- **Indonesia's Consumer Price Index (CPI) increased by 1.42% YoY last month,** largely in line with our own projections, but still quite a ways below the more optimistic expectations of analysts' consensus.
- That there were significant expectations of an upside in inflation was not unreasonable. The narrative of continuing economic recovery – soon to receive a welcome shot in the arm from the Ramadan spending spree – appeared to be proceeding well enough. Recent data releases; including continued gains in our own internal business transactions index (**Chart 1**), as well as last month's historically high manufacturing PMI figure; **all appear to point towards an economic recovery gradually gaining in momentum.**
- **That these uniformly glowing indicators were accompanied by relatively tepid price increases then, may be somewhat puzzling.** Indeed, seemingly intransigent to the upwards trend in most other indicators of economic activity was core inflation, which dropped to its lowest point last month as it continued its steady decline.
- There are several possible explanations as to why Indonesia's ongoing recovery doesn't seem to have carried over to prices just yet. **One such factor is the government's efforts at maintaining price stability, particularly for food and oil prices.** At a time where oil prices are already nearly double than what they were last year, and where food prices continue to increase across the globe; the government's aggressive price control measures, such as its decision to import foodstuffs *en masse* over the past few months, appear to have been effective in helping keep inflationary pressures under control (**Charts 2 & 3**).
- This however, still doesn't explain why core inflation remains muted as well. While the robust figures seen elsewhere provides strong evidence that recovery is well and truly afoot, inflation's poor showing suggests that there are some nuances to the nature of this recovery that should be addressed. **The first thing to keep in mind is that demand is still recovering from the very low base set by the onset of the pandemic.** This means that many business are likely still saddled with substantial amounts of excess capacity. Wage increases may still be far from the minds of most employers as well, as many of those rendered jobless by the pandemic remain unabsorbed by the slow moving recovery. Under such conditions, it makes sense that the fruits of recovery have yet to pass themselves on to significant price hikes.
- **Additionally, the nature of the recovery we are currently seeing may also be predominantly export-driven.** March's import figures, which showed a disproportionate recovery in industrial over consumption-related imports, provides hints of this. This, as well as the remarkable recovery the manufacturing indicators over the past few months, may very well be driven predominantly by export-related manufacturers. Again, this would imply a weaker recovery in domestic demand than what these numbers may suggest at first glance.
- The partly seasonal nature of the current bout of economic activity also raises some questions. Will the pace of recovery wind down again once Ramadan is over? **These, as well as other factors that are likely to further draw out the Covid crisis, such as the rise of deadlier variants, or shortages in vaccine supply, paint an altogether murky picture of inflation.** Is economic recovery underway? Very likely so. Will we see a requisite spike in prices? Not necessarily, at least in the short to medium term.

Chart 1. Our internal business transaction index indicates a significant jump in economic activity last month

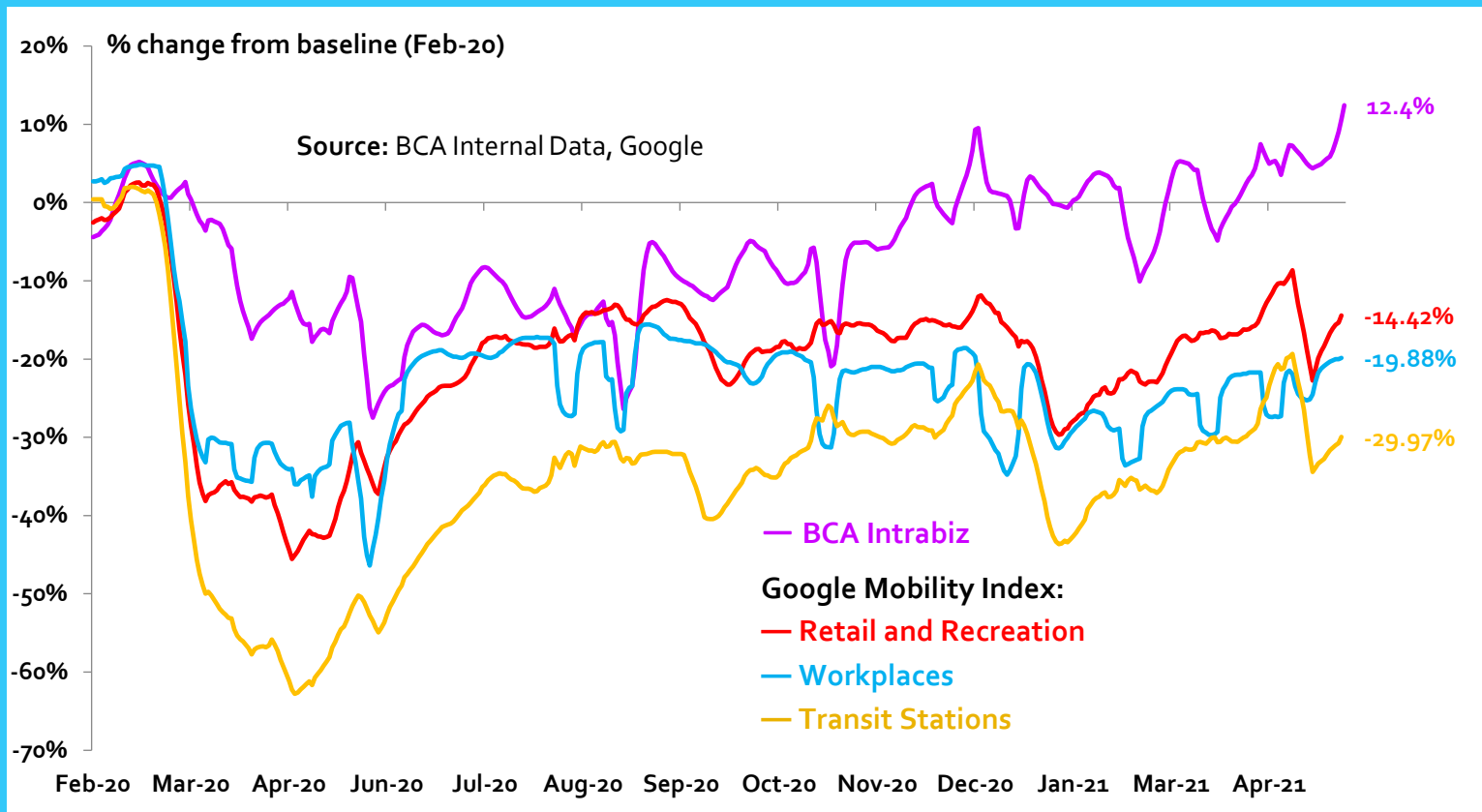


Chart 2. Food inflation remained muted in Indonesia, even as global food prices began to soar

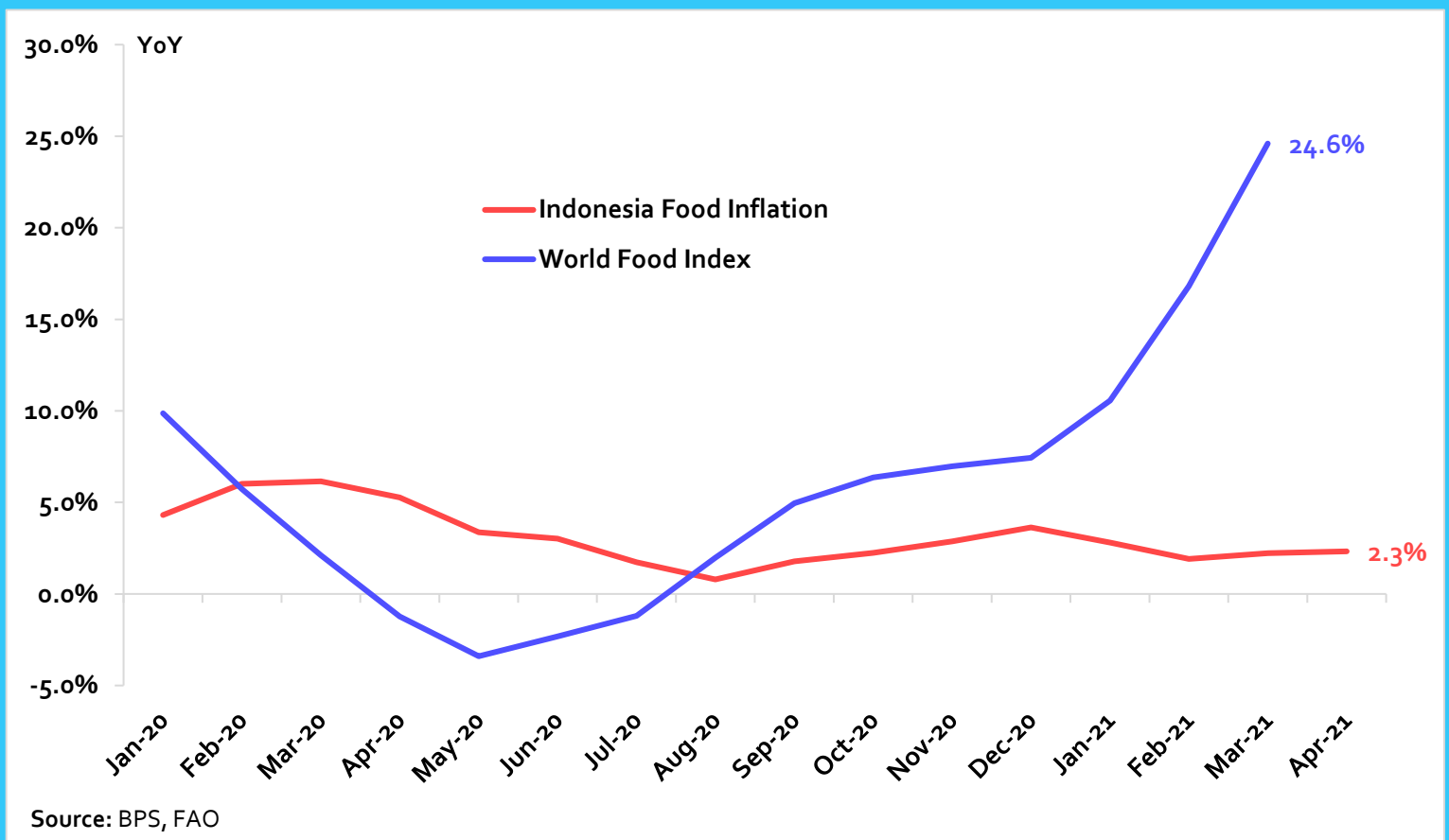
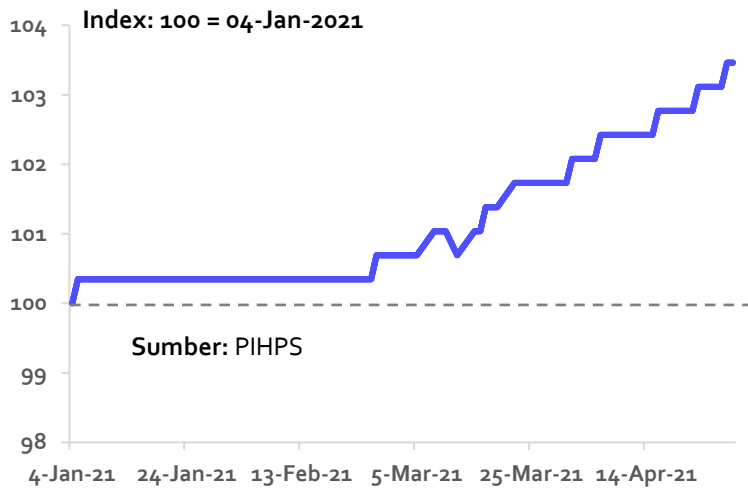
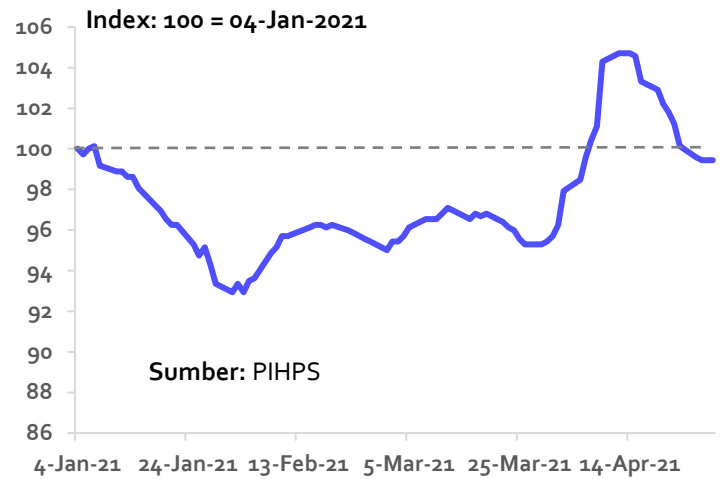


Chart 3. Aside from the prices of a few specific foodstuffs, most have remained stagnant or even declined despite the Ramadan effect

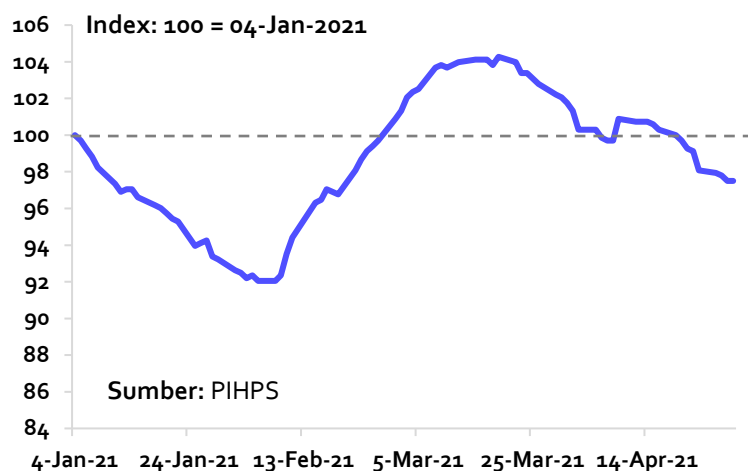
Cooking Oil



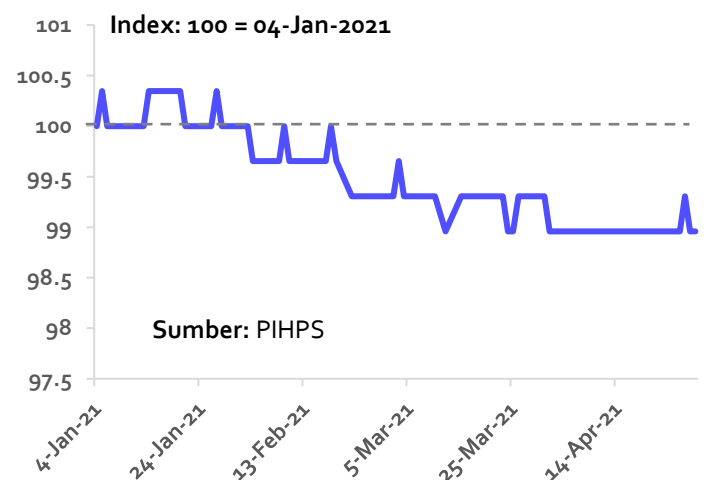
Poultry



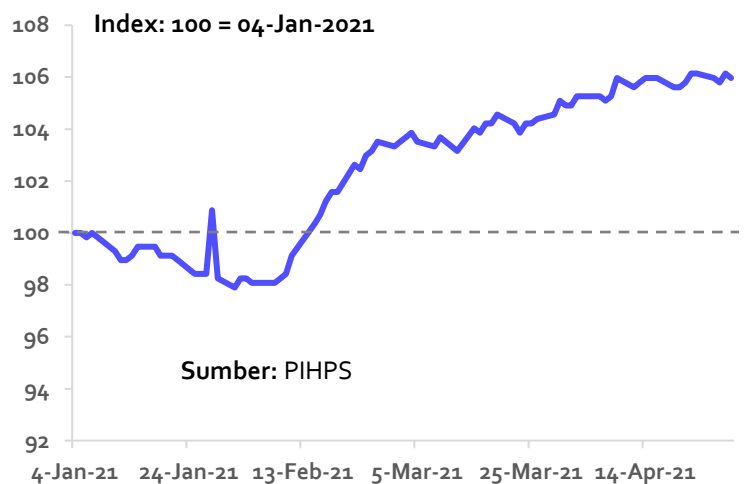
Shallots



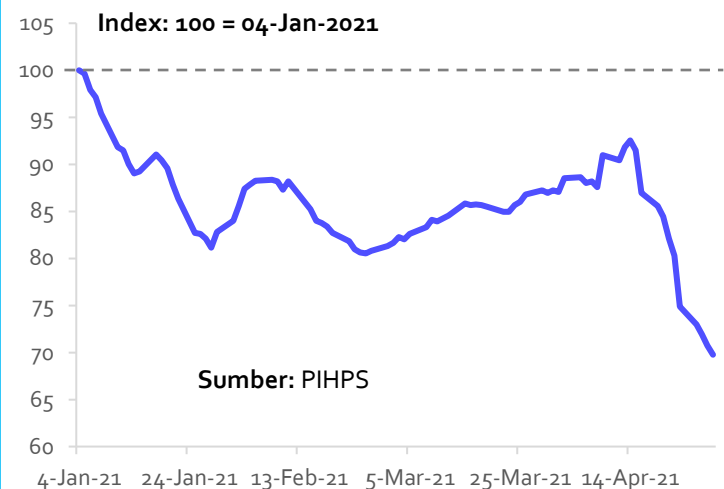
Sugar



Garlic



Chilis



Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	30-Apr	-1 mth	Chg (%)
US	0.25	Mar-20	-2.35	Baltic Dry Index	3,053.0	2,103.0	45.2
UK	0.10	Mar-20	-0.60	S&P GSCI Index	505.9	469.0	7.9
EU	0.00	Mar-16	-1.60	Oil (Brent, \$/bbl)	67.3	64.1	4.8
Japan	-0.10	Jan-16	0.10	Coal (\$/MT)	90.8	86.8	4.6
China (lending)	4.35	Oct-15	3.95	Gas (\$/MMBtu)	2.87	2.51	14.3
Korea	0.50	May-20	-1.00	Gold (\$/oz.)	1,769.1	1,685.2	5.0
India	4.00	May-20	-1.52	Copper (\$/MT)	9,829.0	8,770.3	12.1
Indonesia	3.50	Feb-21	2.08	Nickel (\$/MT)	17,653.0	15,897.4	11.0
Money Mkt Rates	30-Apr	-1 mth	Chg (bps)	CPO (\$/MT)	1,072.4	960.4	11.7
SPN (1M)	2.57	2.78	-20.5	Rubber (\$/kg)	1.67	1.65	1.2
SUN (10Y)	6.44	6.77	-32.9	External Sector	Mar	Feb	Chg (%)
INDONIA (O/N, Rp)	2.79	2.79	0.2	Export (\$ bn)	18.35	15.26	20.3
JIBOR 1M (Rp)	3.56	3.56	0.3	Import (\$ bn)	16.79	13.27	26.6
Bank Rates (Rp)	Feb	Jan	Chg (bps)	Trade bal. (\$ bn)	1.57	1.99	-21.3
Lending (WC)	9.23	9.27	-4.29	Central bank reserves (\$ bn)	137.1	138.8	-1.23
Deposit 1M	3.88	4.05	-16.69	Prompt Indicators	Mar	Feb	Jan
Savings	0.83	0.84	-0.97	Consumer confidence index (CCI)	93.4	85.8	84.9
Currency/USD	30-Apr	-1 mth	Chg (%)	Car sales (%YoY)	10.5	-38.2	-34.2
UK Pound	0.723	0.728	0.60	Motorcycle sales (%YoY)	-7.2	-30.8	-14.7
Euro	0.832	0.853	2.59	Cement sales (%YoY)	10.9	0.7	-5.9
Japanese Yen	109.3	110.4	0.96	Manufacturing PMI	Apr	Mar	Chg (bps)
Chinese RMB	6.475	6.572	1.50	USA	N/A	64.7	0
Indonesia Rupiah	14,445	14,480	0.24	Eurozone	63.3	62.5	80
Capital Mkt	30-Apr	-1 mth	Chg (%)	Japan	53.6	52.7	90
JCI	5,995.6	6,071.4	-1.25	China	51.9	50.6	130
DJIA	33,874.9	33,067.0	2.44	Korea	54.6	55.3	-70
FTSE	6,969.8	6,772.1	2.92	Indonesia	54.6	53.2	140
Nikkei 225	28,812.6	29,432.7	-2.11				
Hang Seng	28,724.9	28,577.5	0.52				
Foreign portfolio ownership (Rp Tn)	Apr	Mar	Chg (Rp Tn)				
Stock	1,892.9	1,878.6	14.30				
Govt. Bond	964.6	951.4	13.20				
Corp. Bond	28.5	28.9	-0.37				

Source: Bloomberg, BI, BPS

Notes:

*Previous data

For change in currency: **Black indicates appreciation against USD, **Red** indicates depreciation

***For PMI, > 50 indicates economic expansion, < 50 indicates contraction

Indonesia – Economic Indicators Projection

	2016	2017	2018	2019	2020	2021E
Gross Domestic Product (% YoY)	5.0	5.1	5.2	5.0	-2.1	4.8
GDP per Capita (US\$)	3605	3877	3927	4175	3912	4055
Consumer Price Index Inflation (% YoY)	3.0	3.6	3.1	2.7	1.7	3.1
BI 7 day Repo Rate (%)	4.75	4.25	6.00	5.00	3.75	3.50
USD/IDR Exchange Rate (end of year)**	13,473	13,433	14,390	13,866	14,050	14,460
Trade Balance (US\$ billion)	8.8	11.8	-8.5	-3.2	21.7	10.1
Current Account Balance (% GDP)	-1.8	-1.6	-3.0	-2.7	-0.4	-1.8

** Estimation of Rupiah's fundamental exchange rate

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