

“The bull”, “the boy”, and the still-limited risk of food inflation

25 July 2023

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Summary

- Improving short-term inflation and interest rate expectations explains the recent increase in foreign capital inflows into Indonesia and other emerging markets.
- The impact of rising wheat prices following the cancelled Black Sea grain deal on inflation expectations in the US may be limited. However, the increase in wheat consumption in the US and the worsening global production outlook indicate increasing competition among wheat importers to secure physical supplies.
- Significant increases in rice imports in 2023 and ample liquidity in the public sector would help the Indonesian government to stabilise rice prices in the domestic market amidst the threat of El Nino and export bans.

- We spent the last two weeks on a two-parter that paints our expectation for the trajectory of inflation and the state of the global economy in upcoming quarters. This week, we shifted our focus back to a shorter time horizon. The most seismic recent development, in our view, is the growing support for the “soft landing” camp (or perhaps, the return of the “Fed pivot” crowds) as sticky inflation components become unstuck in Jun-2023 without a severe downturn in aggregate demand.
- While we still have to wait for the Jun-23 PCE data, various FedSpeaks following the release of Jun-23 CPI data reveal that some FOMC members have entertained the idea that the Fed may not need to increase the policy rate beyond the Jul-23 FOMC meeting. Some in the market now expect that the Fed may begin cutting the interest rate in late Q1-2023, adding to the animal spirit that insofar fuels the market in 2023.
- The bullish sentiment that derives from the weakening USD also benefits riskier markets outside the US, including Indonesia. Net foreign capital inflows to the domestic financial market amounted to around USD 502.5 Mn last week, with the bulk of it (USD 361.9 Mn) flowing into the bond market. The Rupiah is also stable despite the narrowing real yield spread, as interest rate expectations continue to guide investors into emerging markets (*see Chart 1*).

- It is therefore quite clear that the recent market optimism in both Dollar and non-dollar markets lies primarily in the improving outlook for interest rates (and hence, inflation) in the US and globally. However, recent developments signal that this expectation may be too premature. As discussed in last week's report, dwindling supply outlook especially for energy commodities may translate into another commodity cycle, leading to a sustained inflationary pressure that could force the Fed to hold the terminal rate for longer.
- Alas, Russia's decision to pull out of the Black Sea grain deal means that the risk of reflation has spread from energy to food commodities (*see Chart 2*). While the present condition in the global wheat market is not as panicky as the opening weeks of the Russo-Ukraine invasion, the ~USD 94/bushel increase in wheat prices and the commodity's flattening forward curve (rather than a clear contango in weeks before the cancellation of the Black Sea grain deal) indicates the heightened competition to secure physical supplies of wheat.
- Fortunately, the risk of food reflation due to an increase in wheat prices appears to be limited in the US. A recent report by the US Department of Agriculture (USDA) shows that American customers could expect an increase in supplies in 2023-2024, thanks to an increase in harvested areas and higher yields. Unfortunately, the condition in the US

"A flattening forward curve indicates an increasing competition in the global wheat market to secure physical supplies of wheat"

may not be shared by the global economy. Despite the increase in supplies, USDA also expects an increase in the domestic use of wheat in the US, leaving exports unchanged.

- Meanwhile, the combination of an increase in feed and residual use of wheat in China, lower yields due to dry weather and multiple strikes in Europe, and higher financing costs for farmers reduce the supply of wheat available in the export market. This outlook, of course, is particularly troubling for import-dependent Indonesia, which, despite the lack of domestic production, still adopts wheat as a staple food.

- Another recent development that could pose a more direct threat to the inflation outlook in Indonesia is the upward trend in rice prices (*see Chart 4*), which could be exacerbated by India's planned rice export ban. India, of course, commands around 40% of the supply in the global wheat market, rivalled only by the rice-producing triangle of Thailand, Vietnam, and Myanmar. Fortunately for Indonesia (and other rice importers), India's export ban (starting on 1 August 2023) has yet to translate into inflationary pressure for global rice prices. Indeed, still-favourable weather conditions during the May-Jun 2023 growing season in Southeast Asia (especially in Myanmar and Vietnam) would help to stabilise prices throughout the Sep-Oct 2023 harvesting season that coincided with India's export ban.

- Alas, recent calls by Vietnamese politicians to boost their domestic food security may lead to Vietnam following India's path to restrict supply in the export market. Fortunately, the Indonesian government has some tools to help stabilise prices in the domestic market. One of the tools that the government has used tactically throughout H1 2023 is the manifold increase in rice imports (**see Chart 3**). President Widodo's recent remarks for the government to organise more 'cheap markets' indicates the improvement in the government's grain reserves following the supply shock in Nov-2022.
- Considering the ample liquidity in the public sector, another tool that the government might consider using is transfer payments to consumers to purchase staple foodstuffs, including rice. A transfer payment programme would help the economy in three ways. The most important one, of course, is that a transfer payment programme would help consumers maintain their rice consumption without jeopardising the consumption of other goods. The second positive take from such a programme is that the programme would not harm farmers' margins amidst the rising input cost. Any fiscal expenditures programme would also help to unlock liquidity in the public sector,

leading to an improvement in private sector liquidity. The programme's political allure also cannot be understated, which is particularly relevant given the ongoing election cycle.

- Finally, while we remain cautious about the impact of dry El Nino weather on food supply and headline inflation in Indonesia and globally, the threat of food inflation arising from India's export ban and the ill-fated Black Sea grain deal may not greatly impact short-term inflation expectations in Indonesia. The positive inflation outlook, of course, would feed positively to the demand for Indonesian assets. The stable inflation and exchange rate outlook thus provides no urgency for Bank Indonesia to tweak its policy stance, allowing the central bank not to change its policy rate perhaps throughout 2023.

"The increase in government's grain supplies and ample liquidity in the public sector should help to stabilise domestic rice prices amidst the decline in global supply"



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Chart 1

Guiding interests

Fluctuations in US interest rate and inflation expectations dictate the demand for IDR-denominated assets and thus changes in the IDR's exchange rate

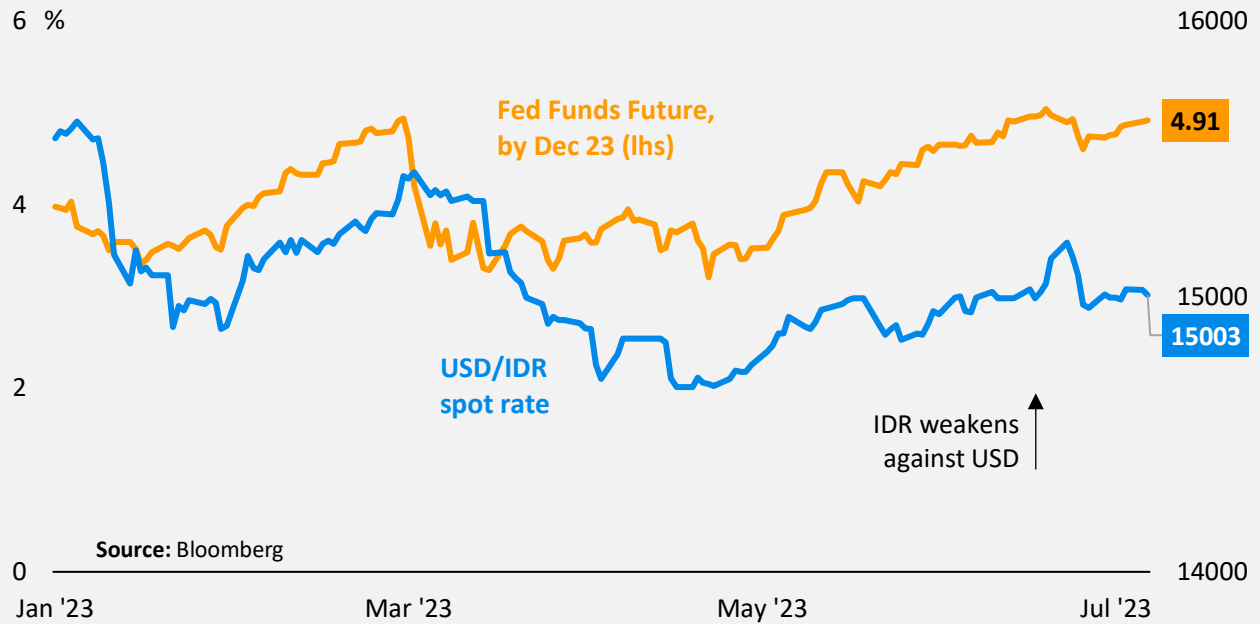


Chart 2

Show me the goodies

The flattening forward curve indicates commodity traders' unwillingness to extend carry, signalling an increase in demand for physical deliveries.

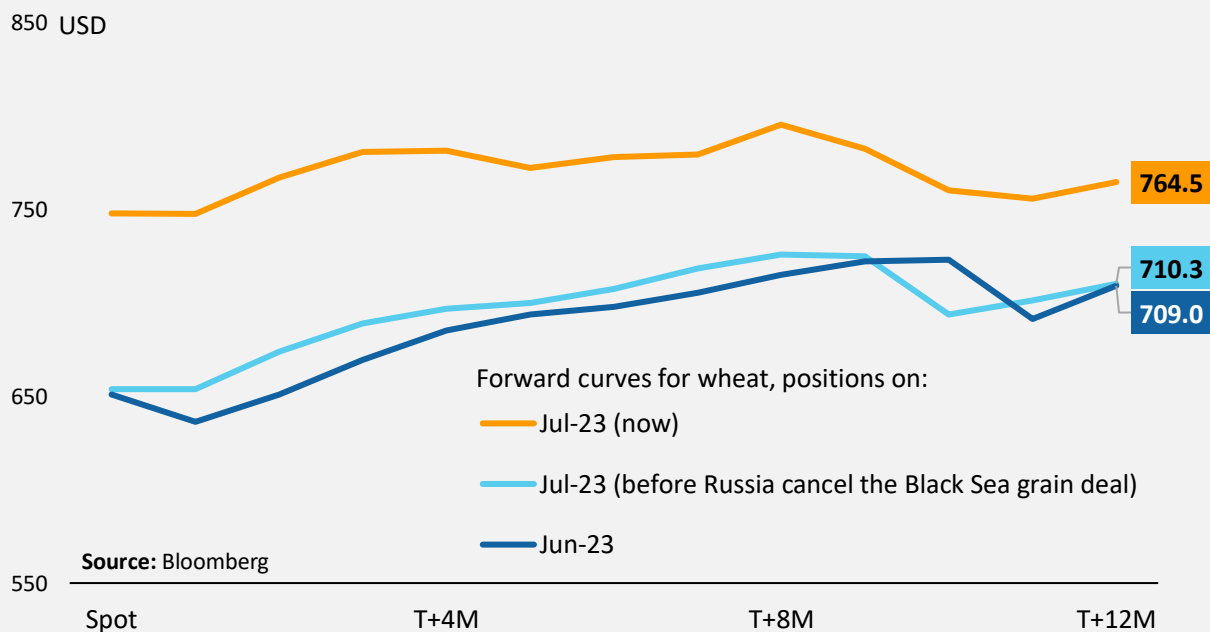


Chart 3

Rainy-day inventories

The significant increase in rice imports would help the government to launch market operations needed to stabilise domestic rice prices amidst the prospect of declining supplies.

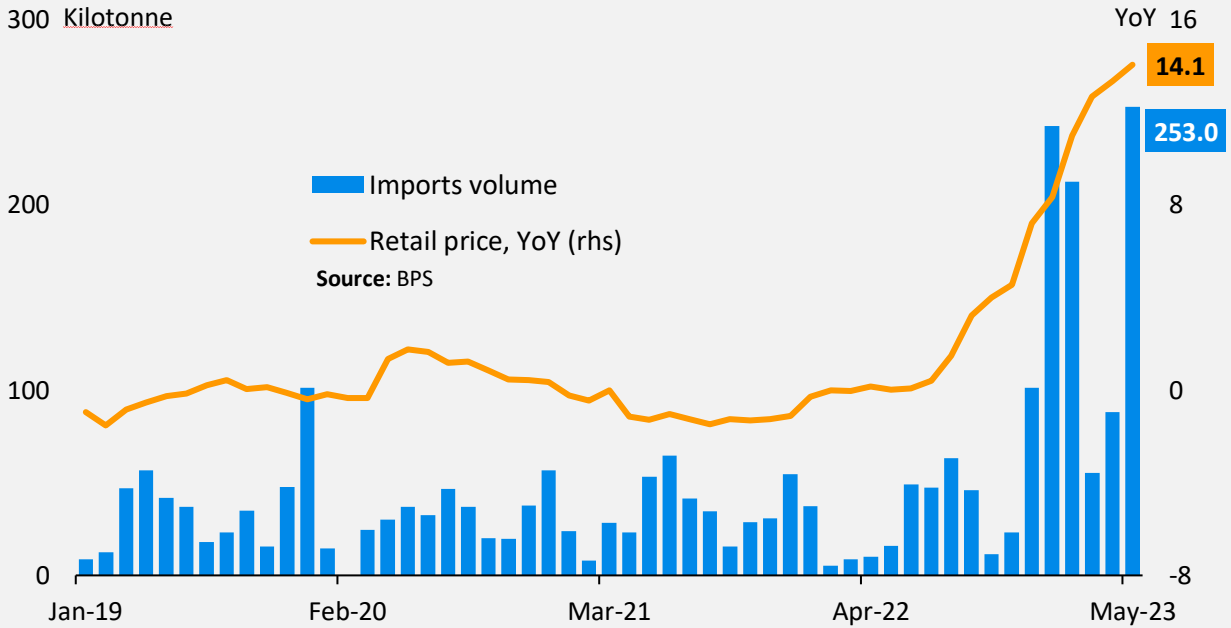
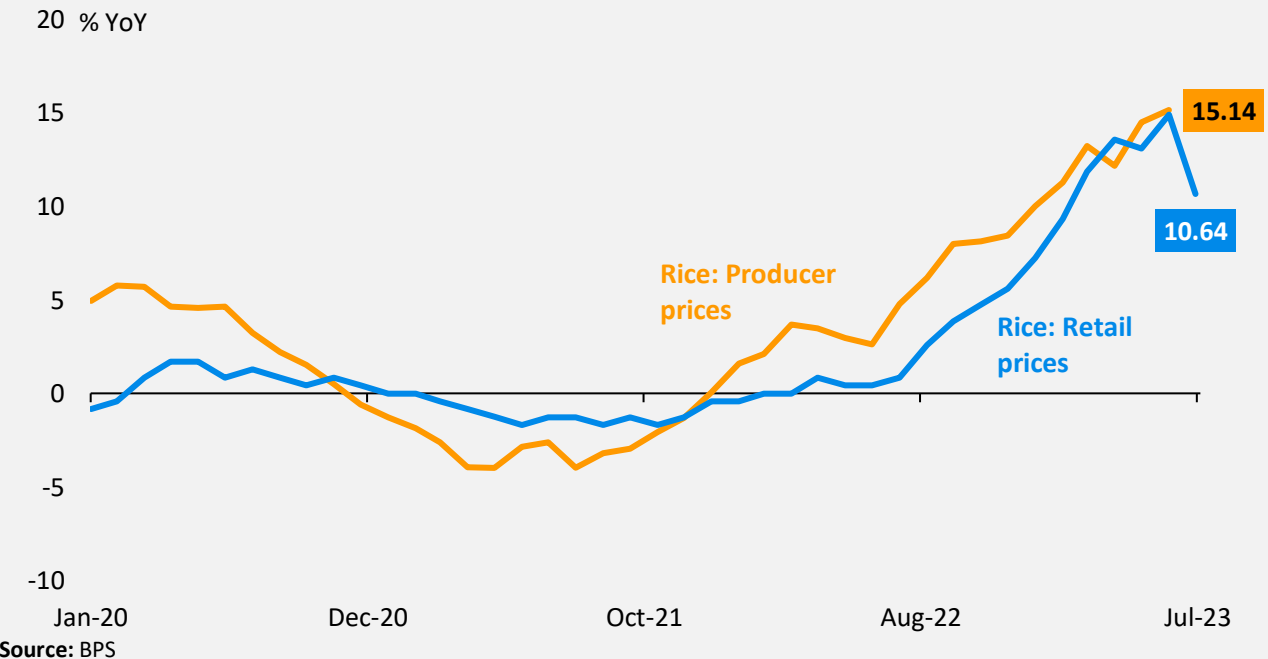


Chart 4

Don't blame the farmer

Transfer payments are favourable compared to price controls as farmers currently suffer from the increase in input costs



Economic Calendar				
		Actual	Previous	Forecast*
3 July 2023				
ID	S&P Global Manufacturing PMI	52.5	50.3	50.6
ID	Inflation Rate YoY	3.52%	4.0%	3.6%
US	ISM Manufacturing PMI	46	46.9	46.3
6 July 2023				
US	Balance of Trade (USD Bn)	-69.0	-74.6	-68.7
7 July 2023				
ID	Foreign Exchange Reserves (USD Bn)	137.5	139.3	139.0
CN	Foreign Exchange Reserves (USD Tn)	3.19	3.18	3.1
10 July 2023				
CN	Inflation rate YoY	0%	0.2%	0.1%
ID	Consumer Confidence	127.1	128.3	128
ID	Motorbike Sales YoY	66.6%	113.4%	-
12 July 2023				
US	Inflation rate YoY	3.0%	4.0%	3.6%
13 July 2023				
CN	Balance of Trade (USD Bn)	70.6	65.8	68.0
ID	Car Sales YoY	4.6%	65.2%	-
14 July 2023				
EA	Balance of Trade (USD Eur)	-0.3	-11.7	-16.4
ID	Retail Sales YoY	-4.5%	1.5%	-
17 July 2023				
CN	GDP Growth Rate YoY	6.3%	4.5%	5.8%
ID	Balance of Trade (USD Bn)	3.46	0.44	1.2
21 July 2023				
ID	Foreign Direct Investment YoY	14.2%	20.2%	-
25 July 2023				
ID	Loan Growth YoY	7.76	9.39%	-
ID	Bank Indonesia policy announcement	5.75%	5.75%	5.75%
27 July 2023				
US	Fed Interest Rate Decision	-	5.25%	5.5%
ID	M2 Money Supply YoY	-	6.1%	-
EA	Deposit Facility Rate	-	3.5%	3.75%

*Forecasts of some indicators are simply based on market consensus
 Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	24-Jul	-1 mth	Chg (%)
US	5.25	Jul-23	2.25	Baltic Dry Index	967.0	1,240.0	-22.0
UK	5.00	Jul-23	-2.90	S&P GSCI Index	586.0	541.6	8.2
EU	4.00	Jul-23	-1.50	Oil (Brent, \$/brl)	82.7	73.9	12.0
Japan	-0.10	Jan-16	-3.40	Coal (\$/MT)	148.2	142.7	3.9
China (lending)	4.35	Jul-23	4.35	Gas (\$/MMBtu)	2.67	2.22	20.3
Korea	3.50	Jul-23	0.80	Gold (\$/oz.)	1,954.7	1,921.2	1.7
India	6.50	Jun-23	1.69	Copper (\$/MT)	8,487.8	8,409.2	0.9
Indonesia	5.75	Jul-23	2.23	Nickel (\$/MT)	21,199.0	21,117.0	0.4
Money Mkt Rates	24-Jul	-1 mth	Chg (bps)				
SPN (1M)	4.88	4.80	8.2	CPO (\$/MT)	874.3	779.7	12.1
SUN (10Y)	6.22	6.28	-5.8	Rubber (\$/kg)	1.27	1.31	-3.1
INDONIA (O/N, Rp)	5.61	5.61	0.4	External Sector	Jun	May	Chg (%)
JIBOR 1M (Rp)	6.40	6.39	1.3	Export (\$ bn)	20.61	21.71	-5.08
Bank Rates (Rp)	Apr	Mar	Chg (bps)	Import (\$ bn)	17.15	21.28	-19.40
Lending (WC)	8.92	8.95	-2.71	Trade bal. (\$ bn)	3.45	0.43	708.66
Deposit 1M	4.18	4.20	-2.70	Central bank reserves (\$ bn)*	137.5	139.3	-1.28
Savings	0.67	0.69	-1.70	Prompt Indicators	Jun	May	Apr
Currency/USD	24-Jul	-1 mth	Chg (%)	Consumer confidence index (CCI)	127.1	128.3	126.1
UK Pound	0.779	0.787	0.90	Car sales (%YoY)	4.7	65.2	-28.8
Euro	0.904	0.918	1.56	Motorcycle sales (%YoY)	66.6	113.4	-19.4
Japanese Yen	141.5	143.7	1.57	Manufacturing PMI	Jun	May	Chg (bps)
Chinese RMB	7.187	7.179	-0.11	USA	46.0	46.9	-90
Indonesia Rupiah	15,023	14,994	-0.19	Eurozone	43.4	44.8	-140
Capital Mkt	24-Jul	-1 mth	Chg (%)	Japan	49.8	50.6	-80
JCI	6,899.4	6,639.7	3.91	China	50.5	50.9	-40
DJIA	35,411.2	33,727.4	4.99	Korea	47.8	48.4	-60
FTSE	7,678.6	7,461.9	2.90	Indonesia	52.5	50.3	220
Nikkei 225	32,700.9	32,781.5	-0.25				
Hang Seng	18,668.2	18,890.0	-1.17				
Foreign portfolio ownership (Rp Tn)	Jun	May	Chg (Rp Tn)				
Stock	2,755.0	2,738.1	16.95				
Govt. Bond	846.9	829.4	17.53				
Corp. Bond	11.3	11.8	-0.47				

Source: Bloomberg, BI, BPS

Notes:

^Data for January 2022

*Data from an 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

	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	2.3
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of the 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 the Rupiah's fundamental exchange rate

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