

CPI:

Supply-side conditions: Friend now, enemy later?

Lazuardin Thariq Hamzah Barra Kukuh Mamia
Economist/Analyst Senior Economist

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Executive Summary

- Inflation declined to 3.08% YoY in July 2023, largely influenced by the decrease in prices of staple foods despite the increase in spice prices.
- The current disinflation process in Indonesia is primarily driven by supply-side improvements. However, the anticipated improvement in demand, coupled with the projected decline in supply, could potentially reverse these supply-side improvements.
- While Indonesia is not immune to supply shocks, the government could intervene effectively and stabilise food prices in the domestic market in the forthcoming periods.

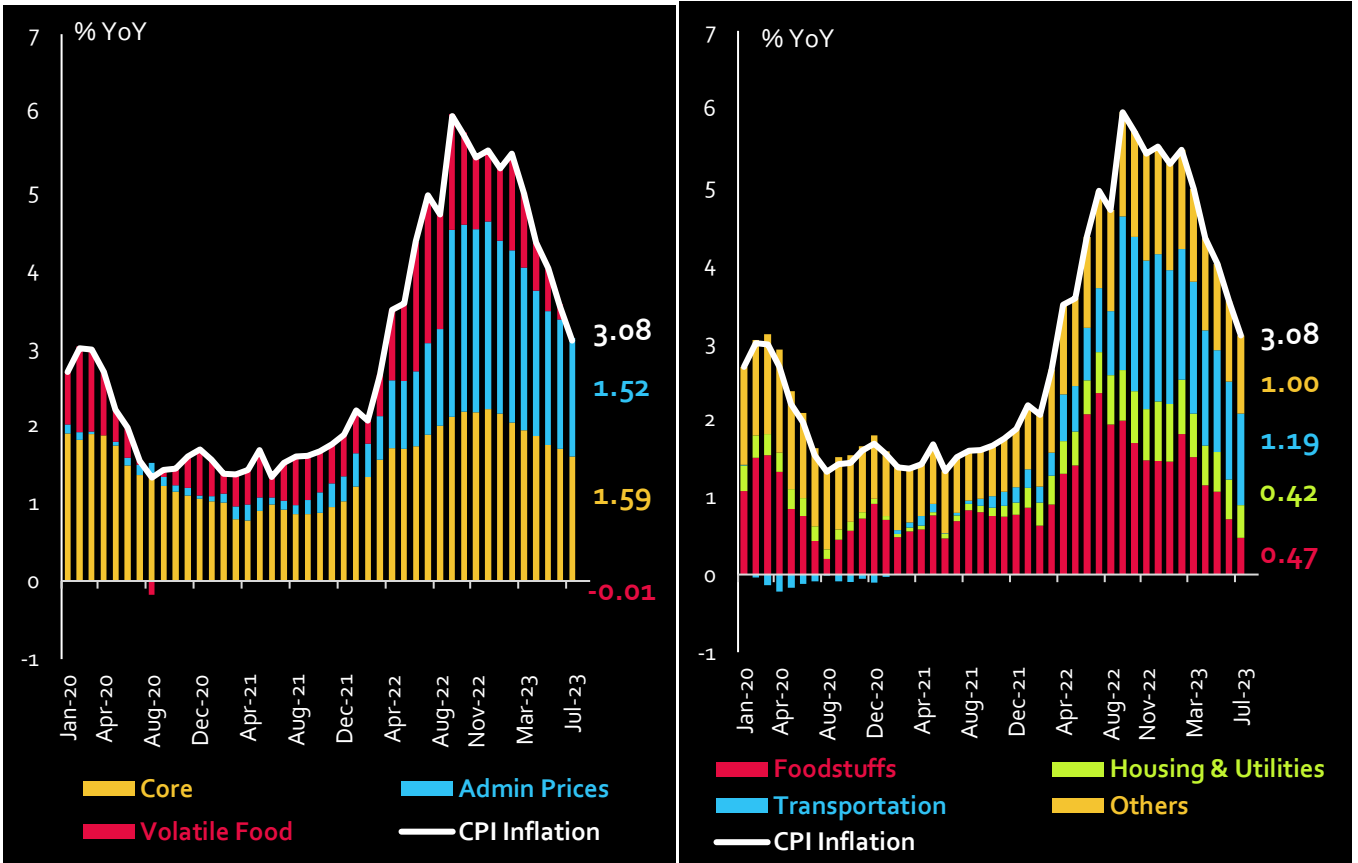
- Indonesia's CPI inflation dropped to a 16-month low of 3.08% in Jul-23 from 3.52% YoY in the previous month, lower than earlier estimates of 3.10% YoY. The story continues where it left off last month; the disinflation process was observed across the board, including the administered prices component, which fell to 8.42% YoY from 9.21% YoY in the previous month despite the adjustment in non-subsidised fuel prices last month. The administered price component contributes around 1.51% to the headline inflation number, but this may continue to decline as the economy shakes off the base effect from the increase in subsidised fuel prices in September last year.
- It is the volatile food component, however, that continues to lead the disinflation process in Indonesia. Prices for staple foodstuffs such as rice (0.6% MoM), edible oils (-0.54% MoM), and poultry (-5.00% MoM) have mostly remained stable or declined in the past month, resulting in inflation in the volatile foodstuffs component to decelerate to 0.17% MoM from 0.44% MoM in the previous month. However, the decline in food prices throughout last month appears to have been capped by the increase in prices for important spices such as chilli (7.05% MoM) and garlic (9.15% MoM), reflecting the low availability of these commodities in government inventories.
- The disinflation process in Indonesia is in line with the global trend, where the headline inflation numbers in major economies continue to move southward due to either the improvement in supply conditions (such as in the US) or anaemic aggregate demand (as in the case of China and the EU). Granted, the decline in loan growth (especially for consumption loans) indicates some of the disinflationary pressure in Indonesia comes from the decline in aggregate demand. However, given the still-positive (albeit weakening) domestic consumption growth, it could be said that the disinflation process in Indonesia thus far largely follows a similar supply-improvement pattern as in the US. This supply improvement argument is true even in the case of core inflation. Core inflation in Indonesia also continues

to slow down (2.43% YoY in Jul-23, 2.58% previously), which is congruent with our analysis on China-driven global goods disinflation.

- The current supply-driven disinflationary process in Indonesia (and globally) has translated to an improvement in short-term economic expectations. Indeed, many analysts now project another above 5.0% annual growth for the Indonesian economy in 2023, while the argument for the 'soft landing' scenario in the US is also gaining support. Despite this apparent optimism, however, it might be worth the time to ponder how long the ongoing disinflationary process could continue to rely on supply-side improvements, especially against the backdrop of rising oil prices throughout the past quarter.
- Several arguments point to the risk of oil (and other commodities) reflation in the upcoming period. The first one is the 'soft landing' expectation itself. For one, the improving short-term economic expectation, which shall lead to an increase in economic activities, would translate positively to the demand for energy commodities. Thus, the improving demand outlook may coincide with the decline in supply, given the plan by OPEC+ to cut production quotas by at least 1.4 Mn bl/d by 2024. Meanwhile, the current high-rate environment may also hamstrung swing producers such as shale oil producers, while the eventual need for the US government to refill their strategic petroleum reserves (SPR) may further tip the balance in the global oil market into that of undersupply.
- We also saw a limit in how far Chinese manufacturers could continue to export disinflation to the global economy. Low margins have forced some Chinese manufacturers to close shops, as indicated by the contraction in manufacturing activities (NBS PMI) over the past four months. The slowing manufacturing activities have also contributed to the declining level of manufactured goods inventory in China, which exports helped start the global goods disinflation since China's economic reopening last year. The reduced availability of imported goods may be good news for domestic manufacturers. However, the potential increase in input prices, especially if commodity prices start rising again, may eventually force producers to pass on the extra costs to customers, leading to higher retail prices.
- Recent events, such as Russia's cancellation of the Black Sea grain deal and the restrictions on rice exports by India and Vietnam (and the looming spectre of El Nino, of course), have further heightened concerns regarding the risk of supply shocks that could re-fuel global inflationary pressures in the coming periods. Fortunately, the risk of food inflation in the short term may not be too acute in Indonesia. As mentioned in our previous report, the Indonesian government possesses certain tools to help stabilise food prices in the domestic market. These include the hitherto healthy level of food stockpiles (particularly for staples such as rice and maize), and the still-ample liquidity in the public sector that could be utilised for price interventions via market operations or transfer payments.
- The still-positive inflation outlook in Indonesia separates the economy from its peers. Indeed, the stable inflation outlook partly explains the continued trend of capital inflows to Indonesia (especially for bonds), providing a buffer against pressures currently facing the Rupiah. This condition, of course, reflects our view that Bank Indonesia is under no urgency to move from its pro-growth policy outlook in 2023, although further monetary stimulus may not be worthwhile at the moment given the relatively untapped dry powder of fiscal expansions.

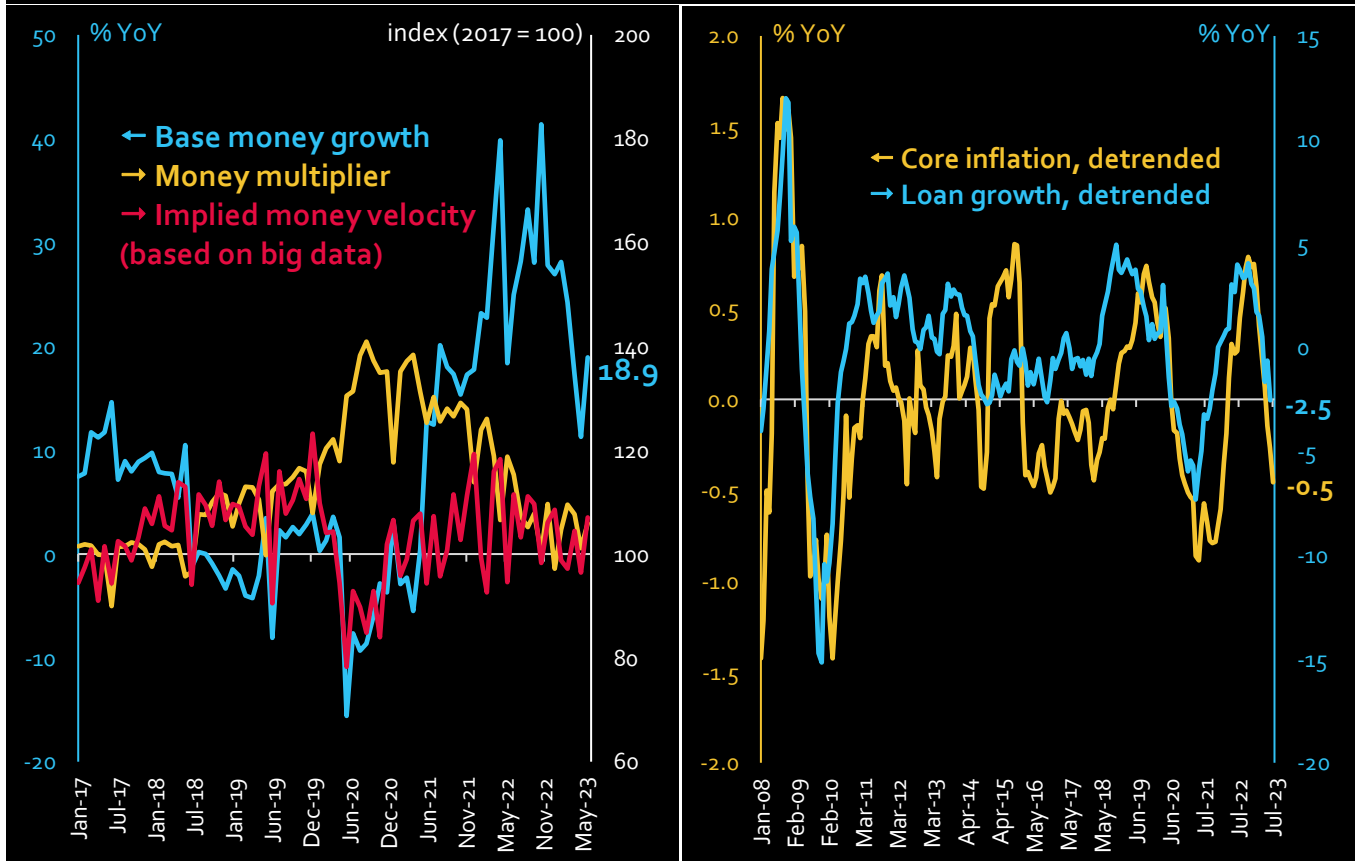
"Supply-side improvements that hitherto contribute to the global disinflationary process may start to weaken in the upcoming periods"

Panel 1. Inflation is declining across the board, but food (especially staples) continues to lead the way



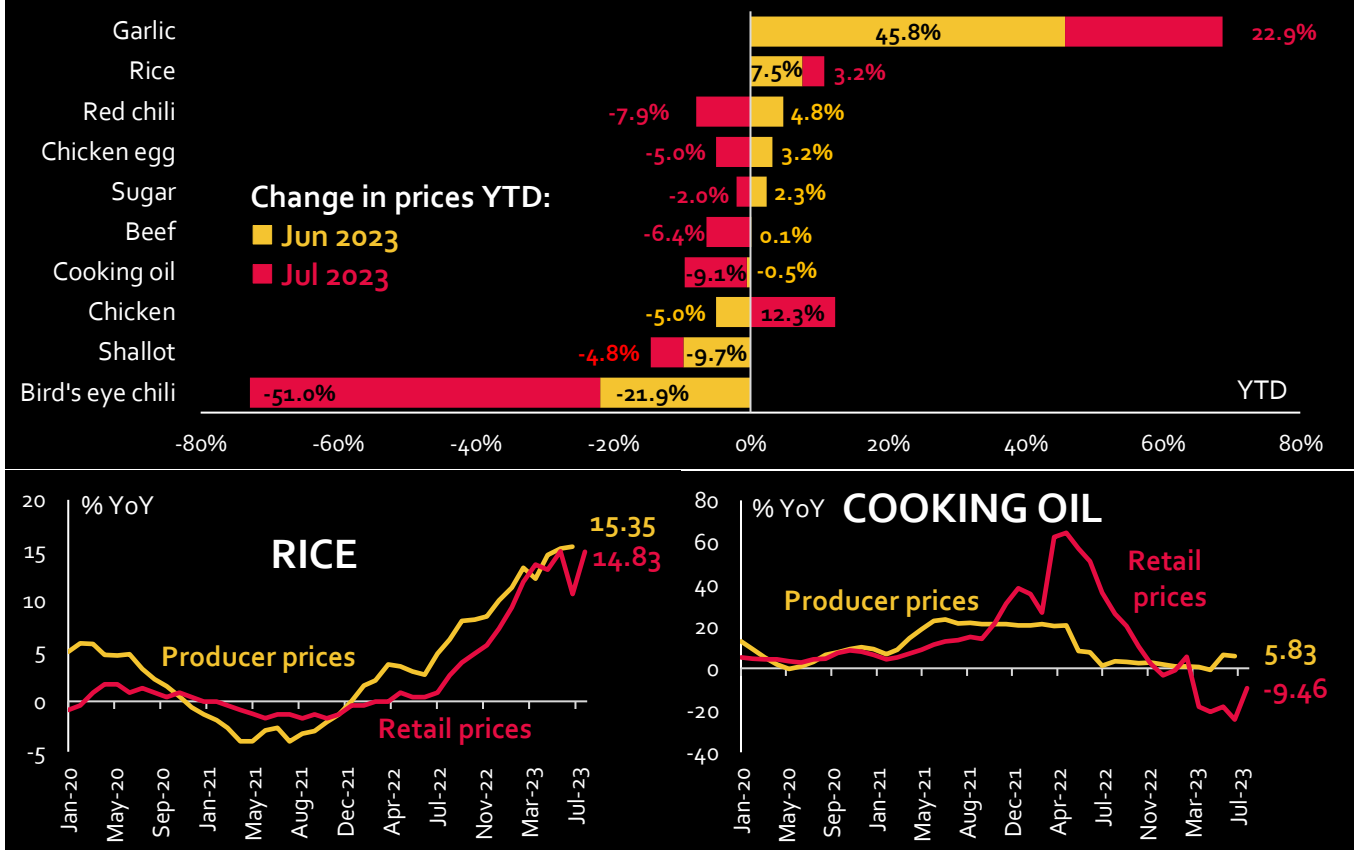
Source: BPS, calculation by BCA Economic Research

Panel 2. Core inflation continues to decline, but lower availability of cheap imported goods could halt the disinflation trend



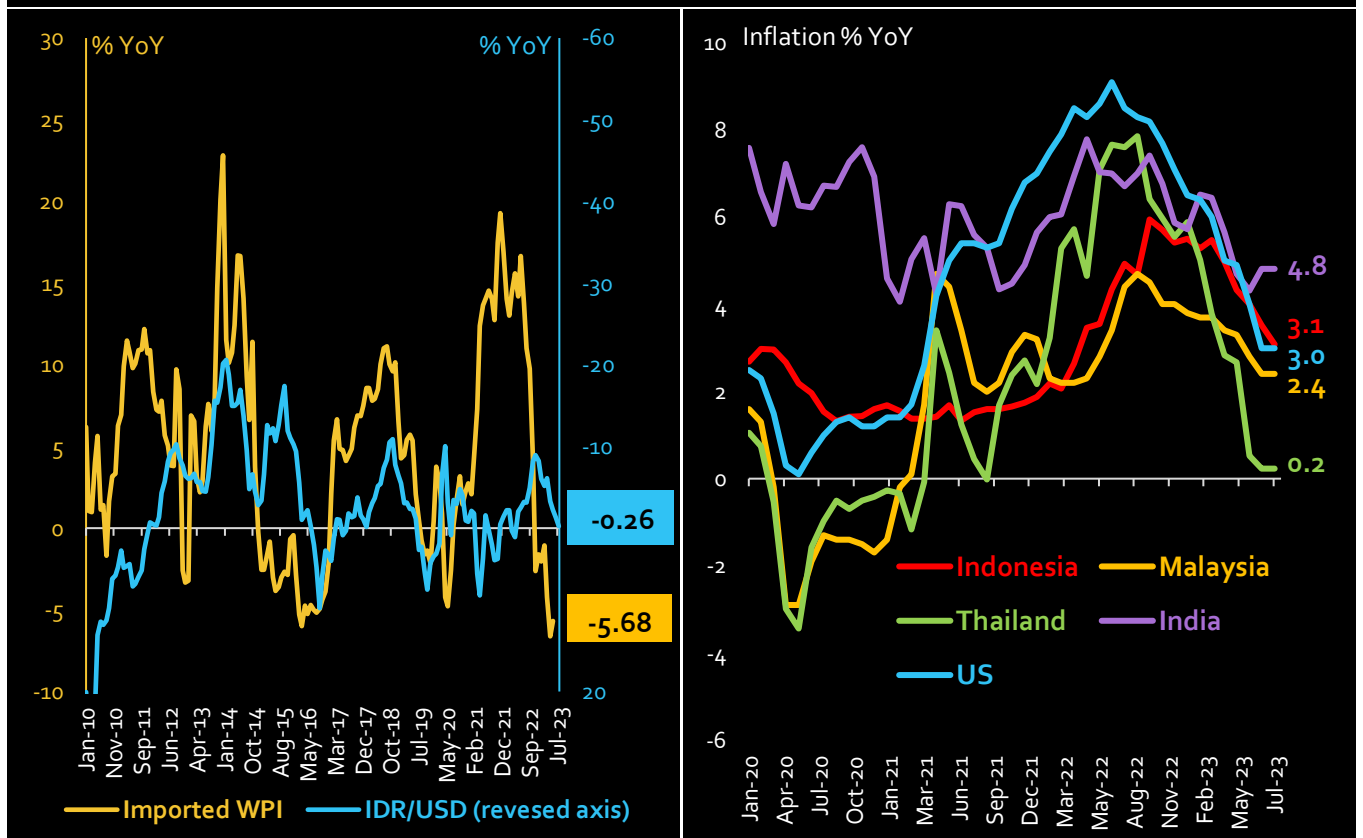
Source: BI, OJK, BCA big data, calculation by BCA Economic Research

Panel 3. Except for some imported-dependent commodities, food prices remained relatively stable or even decline



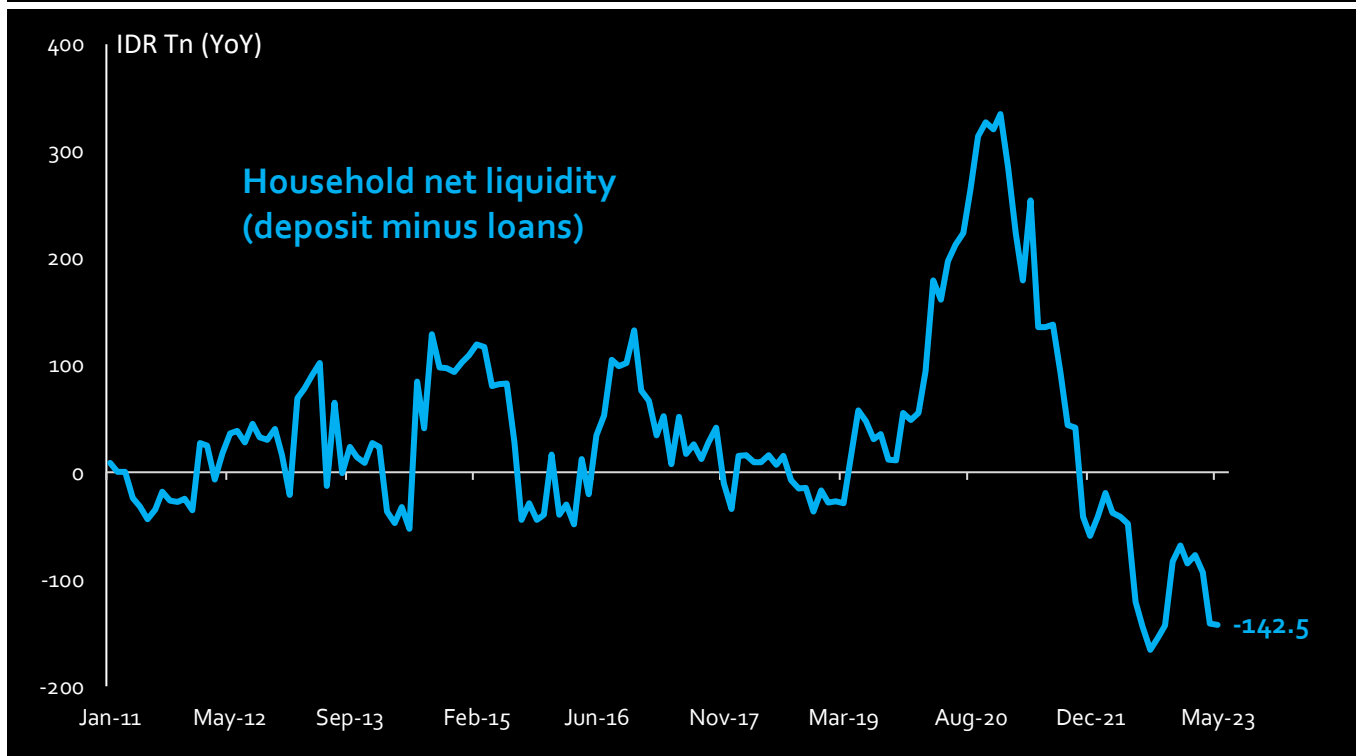
Source: Ministry of Trade, BPS

Panel 4. The China-driven disinflation story that mainly impacts Asian economies may start to weaken given the decline in China's output



Source: BI, Bloomberg

Chart 1. Further disinflation would be increasingly important to maintain consumption levels given that households have exhausted their accumulated savings from Covid



Source: BI

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	31-Jul	-1 mth	Chg (%)
US	5.50	Jul-23	2.50	Baltic Dry Index	1,127.0	1,091.0	3.3
UK	5.00	Jul-23	-2.90	S&P GSCI Index	593.4	540.5	9.8
EU	4.25	Jul-23	-1.05	Oil (Brent, \$/bbl)	85.6	74.9	14.2
Japan	-0.10	Jan-16	-3.40	Coal (\$/MT)	137.3	156.3	-12.2
China (lending)	4.35	Aug-23	4.35	Gas (\$/MMBtu)	2.58	2.48	4.0
Korea	3.50	Jul-23	0.80	Gold (\$/oz.)	1,965.1	1,919.4	2.4
India	6.50	Jun-23	1.69	Copper (\$/MT)	8,800.0	8,322.1	5.7
Indonesia	5.75	Jul-23	2.67	Nickel (\$/MT)	22,076.0	20,346.1	8.5
Money Mkt Rates	31-Jul	-1 mth	Chg (bps)	CPO (\$/MT)	845.4	798.5	5.9
SPN (1M)	4.82	4.57	25.1	Rubber (\$/kg)	1.31	1.31	0.0
SUN (10Y)	6.23	6.24	-1.4	External Sector	Jun	May	Chg (%)
INDONIA (O/N, Rp)	5.69	5.91	-22.1	Export (\$ bn)	20.61	21.71	-5.08
JIBOR 1M (Rp)	6.40	6.40	0.5	Import (\$ bn)	17.15	21.28	-19.40
Bank Rates (Rp)	May	Apr	Chg (bps)	Trade bal. (\$ bn)	3.45	0.43	708.66
Lending (WC)	8.93	8.92	0.35	Central bank reserves (\$ bn)*	137.5	139.3	-1.28
Deposit 1M	4.19	4.18	1.37	Prompt Indicators	Jun	May	Apr
Savings	0.67	0.67	0.00	Consumer confidence index (CCI)	127.1	128.3	126.1
Currency/USD	31-Jul	-1 mth	Chg (%)	Car sales (%YoY)	4.7	65.2	-28.8
UK Pound	0.779	0.787	1.04	Motorcycle sales (%YoY)	66.6	113.4	-19.4
Euro	0.909	0.917	0.81	Manufacturing PMI	Jul	Jun	Chg (bps)
Japanese Yen	142.3	144.3	1.42	USA	N/A	46.0	0
Chinese RMB	7.143	7.254	1.55	Eurozone	42.7	43.4	-70
Indonesia Rupiah	15,080	14,993	-0.58	Japan	49.6	49.8	-20
Capital Mkt	31-Jul	-1 mth	Chg (%)	China	49.2	50.5	-130
JCI	6,931.4	6,661.9	4.05	Korea	49.4	47.8	160
DJIA	35,559.5	34,407.6	3.35	Indonesia	53.3	52.5	80
FTSE	7,699.4	7,531.5	2.23				
Nikkei 225	33,172.2	33,189.0	-0.05				
Hang Seng	20,078.9	18,916.4	6.15				
Foreign portfolio ownership (Rp Tn)	Jul	Jun	Chg (Rp Tn)				
Stock	2,892.9	2,755.0	137.88				
Govt. Bond	854.0	846.9	7.15				
Corp. Bond	11.3	11.3	-0.03				

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	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 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

Economic, Banking & Industry Research Team

David E.Sumual

Chief Economist

david_sumual@bca.co.id

+6221 2358 8000 Ext:1051352

Victor George Petrus Matindas

Senior Economist

victor_matindas@bca.co.id

+6221 2358 8000 Ext: 1058408

Keely Julia Hasim

Economist / Analyst

keely_hasim@bca.co.id

+6221 2358 8000 Ext: 1071535

Firman Yosep Tember

Research Assistant

firman_tember@bca.co.id

+6221 2358 8000 Ext: 20378

Agus Salim Hardjodinato

Head of Industry and Regional Research

agus_lim@bca.co.id

+6221 2358 8000 Ext: 1005314

Gabriella Yolivia

Industry Analyst

gabriella_yolivia@bca.co.id

+6221 2358 8000 Ext: 1063933

Elbert Timothy Lasiman

Economist / Analyst

elbert_lasiman@bca.co.id

+6221 2358 8000 Ext: 1074310

Barra Kukuh Mamia

Senior Economist

barra_mamia@bca.co.id

+6221 2358 8000 Ext: 1053819

Lazuardin Thariq Hamzah

Economist / Analyst

lazuardin_hamzah@bca.co.id

+6221 2358 8000 Ext: 1071724

Thierris Nora Kusuma

Economist / Analyst

thierris_kusuma@bca.co.id

+6221 2358 8000 Ext: 1071930

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group

20th Grand Indonesia, Menara BCA

Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia

Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343

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