CPI:
Of Dust Bowls and Depressions

M Rifat Juniardo S
Economist/Analyst

Barra Kukuh Mamia
Senior Economist

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Executive Summary

- Inflation fell sharply to 2.28% YoY in Sep-23, largely due to high base effect from the previous year's fuel price increase. However, MoM still saw a significant inflation of 0.19%, due to rising rice prices.
- El Nino essentially robs us of seasonal disinflation in Sep-Oct, but Bulog rice stock should be sufficient to dampen price pressures in the near-term.
- Core inflation has continued to cool in Indonesia and across the globe, partly a sign of a global slowdown, but partly also the result of China doubling-down on supply-side measures and trying to export its way out of a slowdown. This may have some positive impact on Indonesian macro in the short-term, but with worrisome long-term implications.

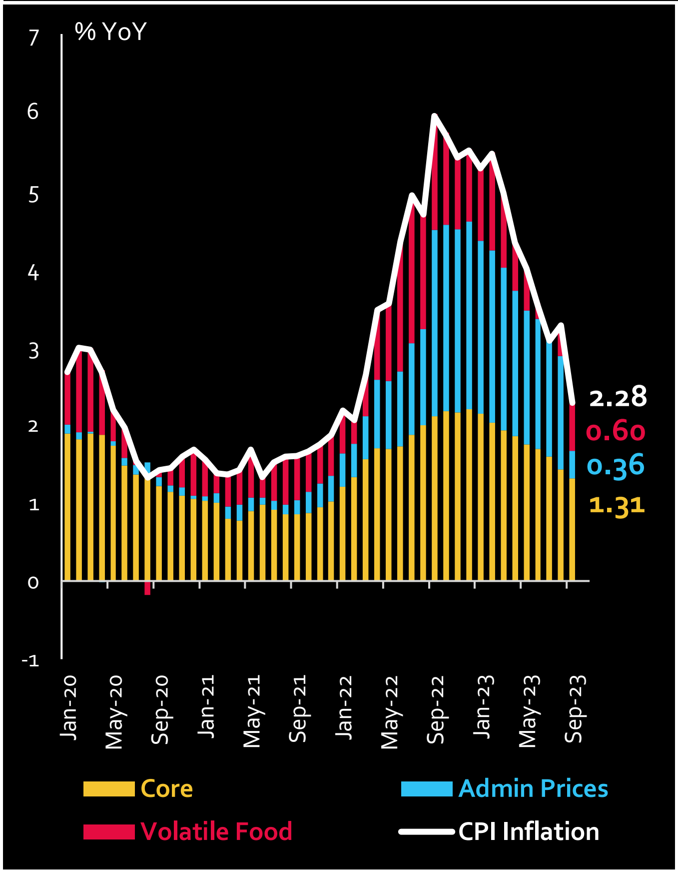
- Inflation fell sharply to 2.28% YoY in Sep-23, a decline that have been foretold long before given the high base effect from last year's fuel price hike. In MoM terms, however, there was still a significant inflation of 0.19%, which was largely down to food while other items recorded little to no inflation.
- And even among the foodstuffs, it was almost entirely down to one item – albeit the most important staple of all – rice. Indeed, the prices of eggs and several types of spices actually declined in September.
- We have noted in previous months how the government have prepared quite well for this situation, with its rice imports from India earlier in the year before that option was foreclosed. But with the end of El Nino nowhere in sight – some expecting the worst to continue well into H1-24 – and it already causing substantial damage (as much as 5% of the expected harvest) to the current crop, the government cannot be preparing enough.
- More recent news of rice import contracts with Cambodia (250,000 tons) and China (1 Mn tons) are therefore very welcome news to ensure affordable rice for lower-income consumers, while the private sector should be able to secure more imports albeit at elevated prices (premium price for the premium segment, so to speak).
- Amid recent worries over the price of rice and oil, the decline in core prices (now at 2.00%) may seem odd – but this is entirely in keeping with the global trend. Even inflationary hotbeds like the Eurozone have seen a sharp decline in core inflation in the past two months.
- There are two ways to interpret this: one as a sign of slowing global growth, but it may also be a symptom of China's unconventional way of dealing with its recent troubles. The country's

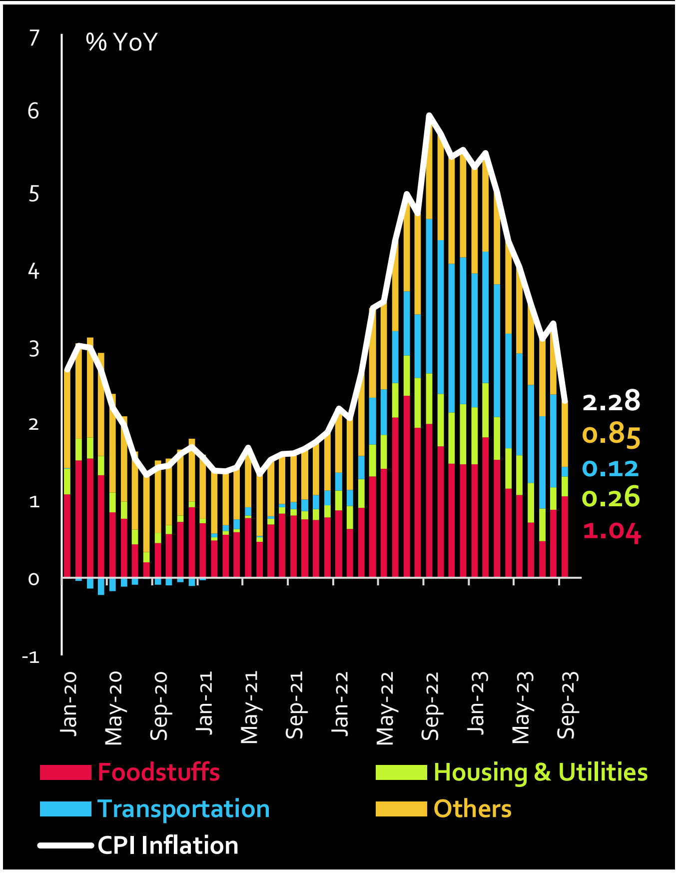
industries have seen much signs of life lately, not just its PMI but also its electricity consumption and its demand for raw materials – oil, copper, and iron ore among them. What gives?

- The Chinese authorities have been notably reluctant to "rebalance" its economy, i.e. trying to boost consumption amid the considerable fallout from its real estate woes. But instead, it seems to be "doubling down" on supply-side measures, especially on infrastructure and strategic industries of the futures such as EVs and renewables.
- In a way, this is not a bad deal for Indonesia as it provides support for our key commodity exports. Of course, this could also prop up oil prices. But with the price of "generic" fuels being fixed in Indonesia, the deflationary effects on core inflation might predominate instead – with China "dumping" even more cheap goods abroad.
- The long-run implications of this, however, is worrisome. China is essentially betting that it could export its way out of trouble, and that high corporate debt levels are not a pressing concern. And it may well be right – the US may fall into a recession and markets may destabilize. The Fed may then have to pivot, and the US forced to resume its role as the global buyer of last resort, which ultimately means buying from China.
- But with the US leadership – Democrats and Republicans alike – increasingly locked into a zero-sum worldview against China, this may only end up triggering more protective measures instead. With the two premiere world economies all wanting to be producers rather than consumers, we could be facing a "Smoot-Hawley scenario[1]" where protectionism is piled on top of financial issues. A rerun of the 1930s – the specter of Dust Bowls (food inflation, climate issues) and Depression – is the worst-case scenario that we could be sleepwalking into.
- Enough of the nightmare, then – what about the real world? While the US core PCE inflation has declined to 3.9% (Aug-23), the Fed is still far from declaring mission accomplished. The FFR and especially the long yields may still have room to increase, giving more impetus for the USD to rally.
- As we have mentioned in previous reports, quantitative measures (notably SRBI issuance) are key part of BI's arsenal in lieu of rate hikes. But fiscal policy is as much part of the story as we put forth in another recent report. The government may elect to reduce its spending for now, partly to prevent a widening of the CA deficit and partly to keep its powder dry for next year – when the pressure on borrowing costs, food, and fuel prices might grow even more.
- Overall, BI has not been eager to hike rates – and falling inflation might be doing some of the tightening job anyway – and as such we see minimal chance of it happening absent a sharper depreciation of the Rupiah. On the inflation front, El Nino essentially robs us of the seasonal disinflation during the Sep-Oct harvest season. Still, sufficient rice stock in the warehouses of Bulog (the government's food distribution agency) at 1.72 Mn tons should at least dampen the risk of further food inflation in the short-term.

[1] The Tariff Act of 1930, commonly known as the Smoot-Hawley Tariff, was a law that implemented high tariffs on over 20,000 goods into the US after the Wall Street crash of 1929. It led to retaliation by European countries and might have played significant role in increasing the severity of the Great Depression.

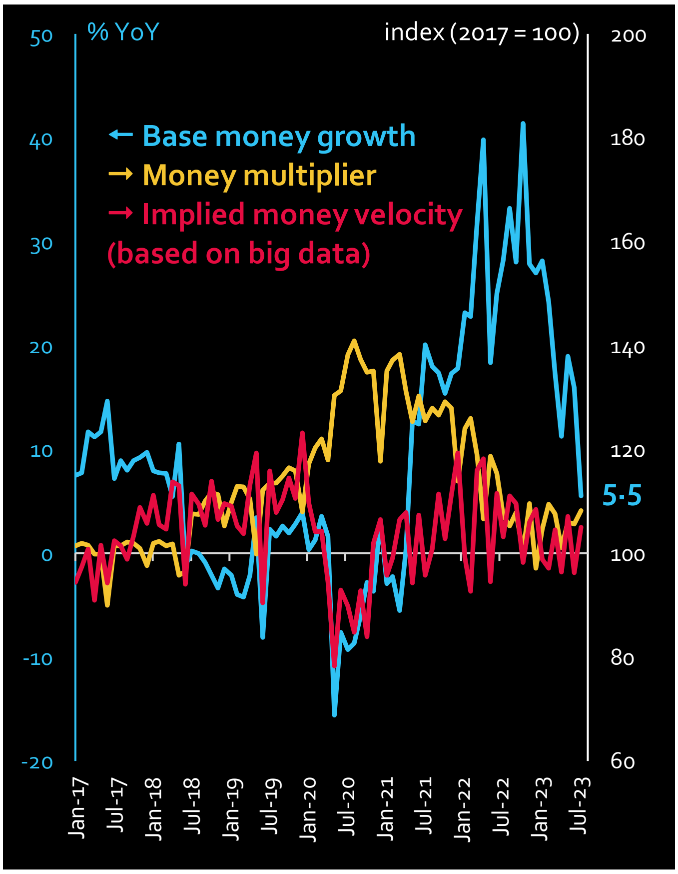
Panel 1. **Inflation is declining especially as fuel hike effects from last year were phased out, but food inflation has been an exception**

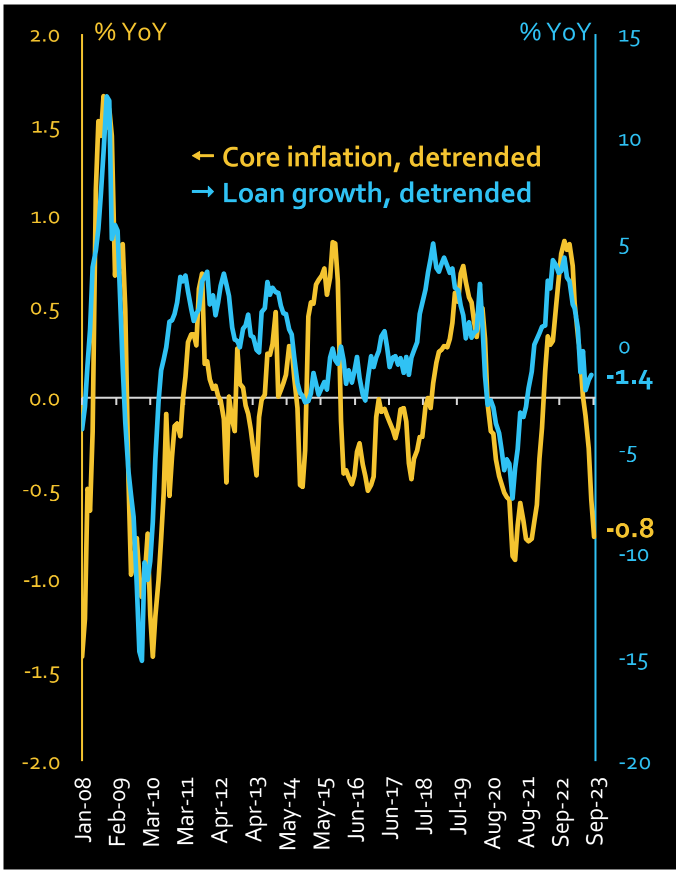




Source: BPS, calculation by BCA Economic Research

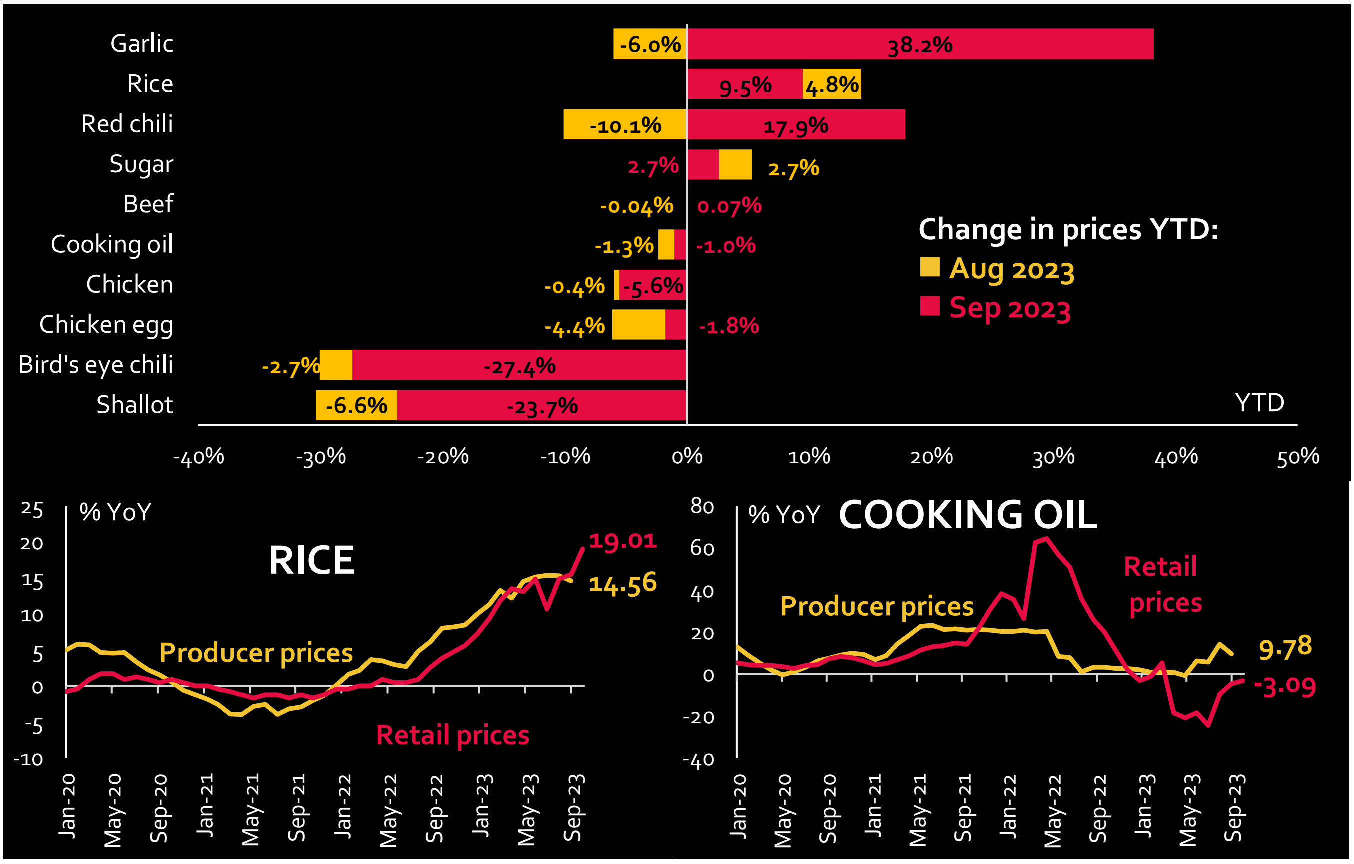
Panel 2. **Core inflation continues to decline, which may portend a continued slowdown in loan demand despite the apparent recovery last month**





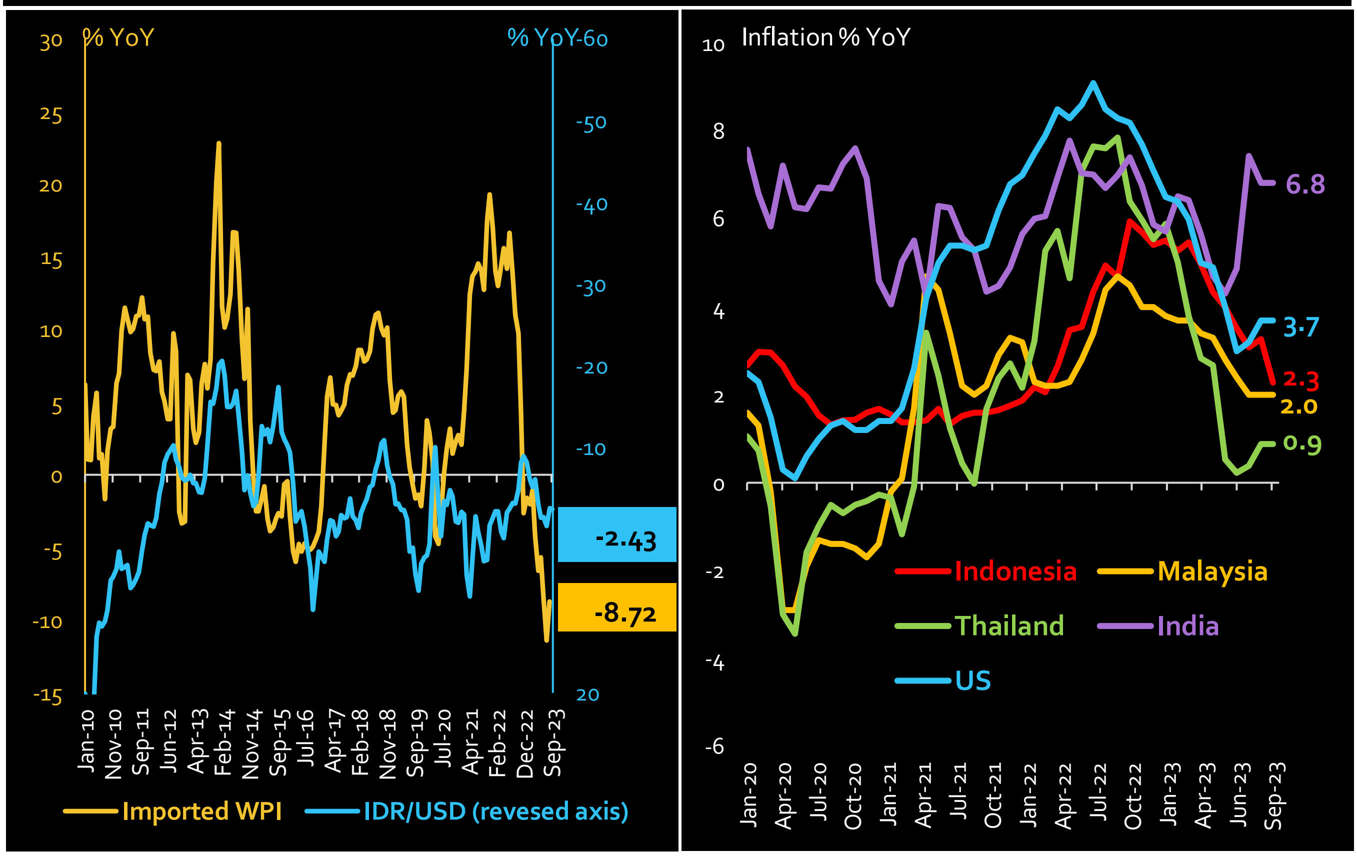
Source: BI, OJK, BCA big data, calculation by BCA Economic Research

Panel 3. The return of food inflation has been driven by just a handful of commodities, albeit some of the most crucial ones especially rice



Source: Ministry of Trade, BPS

Panel 4. Indonesia and its Asian counterparts continue to benefit from China's excess inventory



Source: BI, Bloomberg

Selected Macroeconomic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.50	Sep-23	1.80
UK	5.25	Sep-23	-1.45
EU	4.50	Sep-23	0.20
Japan	-0.10	Jan-16	-3.30
China (lending)	2.50	Sep-23	4.25
Korea	3.50	Aug-23	0.10
India	6.50	Aug-23	-0.33
Indonesia	5.75	Sep-23	3.47

Money Mkt Rates	2-Oct	-1 mth	Chg (bps)
SPN (1M)	5.44	5.67	-23.7
SUN (10Y)	6.97	6.37	59.8
INDONIA (O/N, Rp)	5.60	5.53	6.6
JIBOR 1M (Rp)	6.40	6.40	0.0

Bank Rates (Rp)	Jun	May	Chg (bps)
Lending (WC)	8.93	8.93	0.00
Deposit 1M	4.19	4.19	0.10
Savings	0.67	0.67	-0.20

Currency/USD	2-Oct	-1 mth	Chg (%)
UK Pound	0.827	0.794	-4.00
Euro	0.954	0.928	-2.81
Japanese Yen	149.9	146.2	-2.43
Chinese RMB	7.298	7.266	-0.43
Indonesia Rupiah	15,530	15,240	-1.87

Capital Mkt	2-Oct	-1 mth	Chg (%)
JCI	6,961.5	6,977.7	-0.23
DJIA	33,433.4	34,837.7	-4.03
FTSE	7,510.7	7,464.5	0.62
Nikkei 225	31,759.9	32,710.6	-2.91
Hang Seng	17,809.7	18,382.1	-3.11

Foreign portfolio ownership (Rp Tn)	Sep	Aug	Chg (Rp Tn)
Stock	2,833.3	2,869.7	-36.44
Govt. Bond	829.5	846.3	-16.83
Corp. Bond	10.8	11.1	-0.26

Trade & Commodities	2-Oct	-1 mth	Chg (%)
Baltic Dry Index	1,737.0	1,065.0	63.1
S&P GSCI Index	602.0	599.0	0.5
Oil (Brent, $/brl)	90.7	88.6	2.4
Coal ($/MT)	156.1	162.3	-3.8
Gas ($/MMBtu)	2.70	2.71	-0.3
Gold ($/oz.)	1,828.0	1,940.1	-5.8
Copper ($/MT)	7,978.0	8,479.3	-5.9
Nickel ($/MT)	18,486.0	20,891.0	-11.5
CPO ($/MT)	774.8	840.0	-7.8
Rubber ($/kg)	1.39	1.36	2.2

External Sector	Aug	Jul	Chg (%)
Export ($ bn)	22.00	20.86	5.47
Import ($ bn)	18.88	19.57	-3.53
Trade bal. ($ bn)	3.12	1.29	141.85
Central bank reserves ($ bn)*	137.1	137.7	-0.42

Prompt Indicators	Aug	Jul	Jun
Consumer confidence index (CCI)	125.2	123.5	127.1
Car sales (%YoY)	-8.3	-6.7	4.7
Motorcycle sales (%YoY)	1.8	45.6	66.6

Manufacturing PMI	Sep	Aug	Chg (bps)
USA	49.0	47.6	140
Eurozone	43.4	43.5	-10
Japan	48.5	49.6	-110
China	50.6	51.0	-40
Korea	N/A	48.9	0
Indonesia	52.3	53.9	-160

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	5.2
GDP per Capita (US$)	3927	4175	3912	4350	4784	5285
Consumer Price Index Inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	2.7
BI 7 day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
USD/IDR Exchange Rate (end of year)**	14,390	13,866	14,050	14,262	15,568	15,173
Trade Balance (US$ 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

Agus Salim Hardjodinoto
Head of Industry and Regional Research
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Barra Kukuh Mamia
Senior Economist
barra_mamia@bca.co.id
+6221 2358 8000 Ext: 1053819

Victor George Petrus Matindas
Senior Economist
victor_matindas@bca.co.id
+6221 2358 8000 Ext: 1058408

Gabriella Yolivia
Industry Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Lazuardin Thariq Hamzah
Economist / Analyst
lazuardin_hamzah@bca.co.id
+6221 2358 8000 Ext: 1071724

Keely Julia Hasim
Economist / Analyst
keely_hasim@bca.co.id
+6221 2358 8000 Ext: 1071535

Elbert Timothy Lasiman
Economist / Analyst
elbert_lasiman@bca.co.id
+6221 2358 8000 Ext: 1074310

Thierris Nora Kusuma
Economist / Analyst
thierris_kusuma@bca.co.id
+6221 2358 8000 Ext: 1071930

M Rifat Juniardo S
Economist / Analyst
rifat_juniardo@bca.co.id
+6221 2358 8000 Ext: -

Firman Yosep Tember
Research Assistant
firman_tember@bca.co.id
+6221 2358 8000 Ext: 20378

Aldi Rizaldi
Research Assistant
aldi_yanto@bca.co.id
+6221 2358 8000 Ext: -

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