Monthly Economic & Finance Briefing

Economic, Banking & Industry Research of BCA Group - DKP

Inflation: Rational spirits, or animal spirits?

Executive Summary:

- **Indonesia's Consumer Price Index grew by 1.38% YoY (+0.10% MoM) on February, as continued social restrictions weighed down on economic activity.**
- Mass vaccinations remain a prerequisite to the large spikes in economic activity that a sharp uptick in inflation would presage. Markets' expectations of high inflation then, appear to driven more by US-focused concerns.
- While bond yield differentials remain stable, **the potential divergence in US and emerging market economic recovery (most likely due to the different pace of vaccinations) may have adverse effects on the Rupiah.**

- **Indonesia's Consumer Price Index grew by 1.38% YoY (+0.10% MoM) on February, largely in line with analysts' expectations.** These figures seem to portray what appears to be a still-sluggish domestic economy. Nowhere is this better reflected than in core inflation, which has been in chronic decline ever since the early days of the pandemic **(*Chart 1*)**. In a sense, these sluggish numbers aren't too surprising. **The re-imposition of some social restrictions as well as the spike in Covid cases since early January were expected to put some pressure on economic activity in the coming months.**

- There are encouraging signs however. While still trending downwards, the pace of decline for core inflation has been steadily slowing, and appears to be bottoming out already **(*Chart 1*)**. **Daily new Covid-19 cases in Indonesia have also fallen dramatically, which bodes well for the return of mobility, particularly as Ramadan approaches.**

- With demand-pull inflation always seemingly trending downwards yet always seemingly on the cusp of a recovery as well, one is compelled to ask: whence the reflation? Indeed, the dramatic rise in bond yields over the past few weeks was at least partly driven by expectations of higher inflation in the coming months. Naysayers could very well draw a link between the recent turmoil in markets with the gulf between Indonesia's still weak inflation data and what may be markets' overly rosy expectations of inflation and recovery.

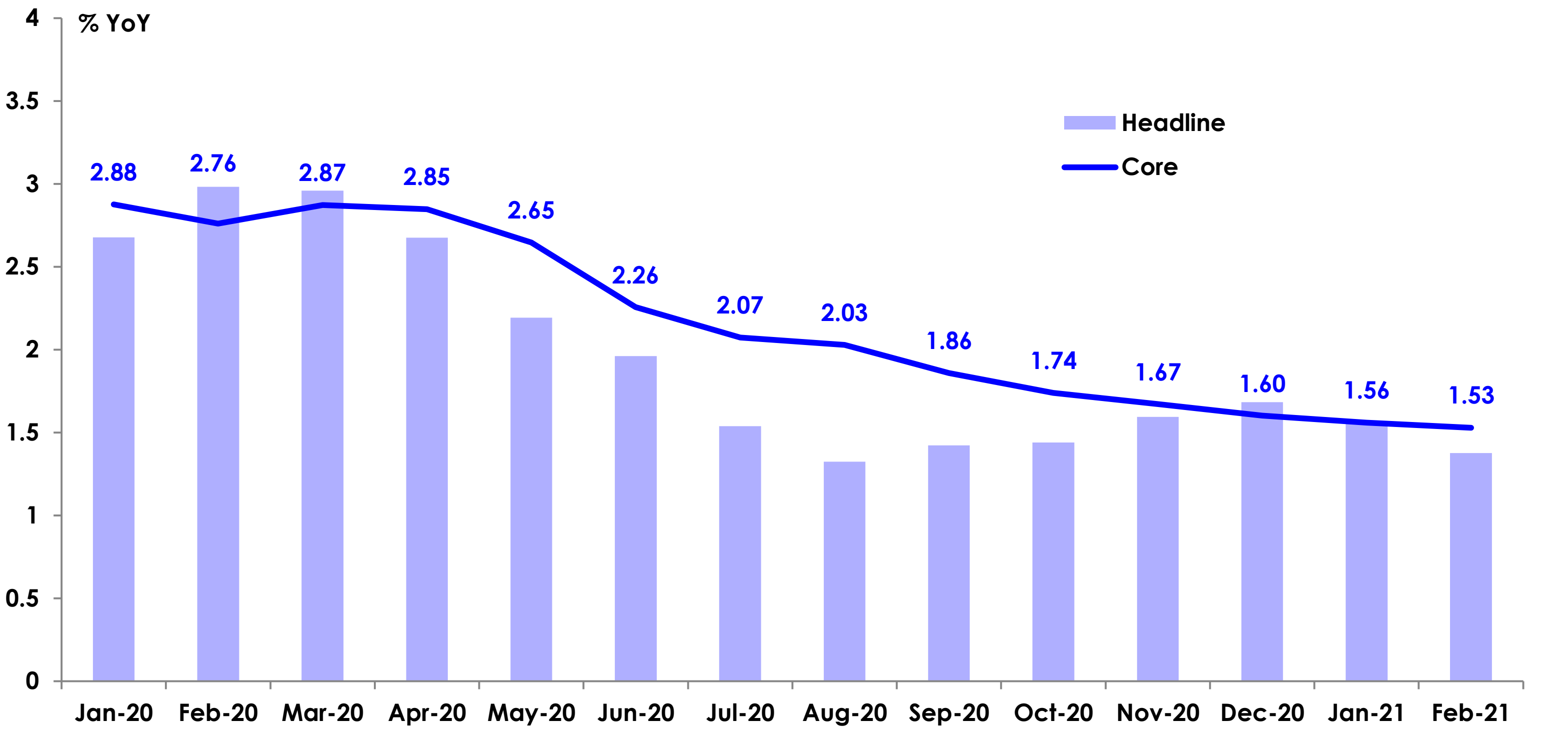
- In the case of Indonesia at least, mass vaccinations remain the key factor. As long as vaccinations remain minimal and mobility suppressed, economic recovery is unlikely to go beyond the slow and steady pace it is currently moving at. Mass vaccinations, in other words, is a prerequisite to the large spikes in economic activity that a sharp uptick in inflation presages. **With even the most generous projections expecting full inoculations only by early next year, a dramatic return of inflation in Indonesia is by no means a given this year.**

- None of this means however, that market expectations are entirely irrational. **While inflation may not rear its head as quickly as expected in Indonesia, the same case may not apply in the US, which is where most of the market's inflationary concerns seems to be focused on.** Indeed, the spike in bond yields appears to be primarily motivated by US inflation expectations – something reflected in the near synchronous movement of US and domestic bond yields **(*Chart 2*)** - and not necessarily an increase in risk perceptions of Indonesia **(*Chart 3*)**.

- With its relatively rapid pace of vaccination, it is not unreasonable to see the entire US population fully inoculated by H2-2021. The timeline for economic recovery then, appears to be much shorter for the US compared to emerging markets such as Indonesia. Add to this the Biden administration's new round of fiscal stimulus, as well as concerns of the fact that much of the fiscal stimulus disbursed in 2020 remains intact as savings, and the market's inflation expectations suddenly take on a character potentially more real than the mere cavorting of complacent animal spirits.

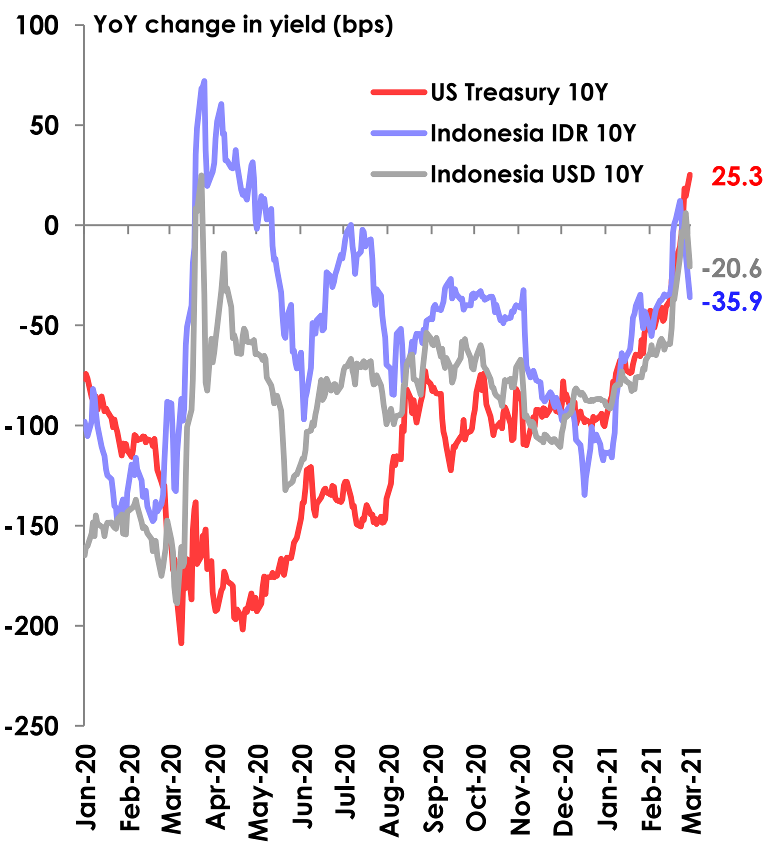
- What does all of this bode for the Rupiah? Indonesian and US bond yield differentials have remained steady, and have even increased for USD-denominated bonds. On this front then, there appears to be no major immediate threat to the Rupiah **(*Chart 3*)**. On a more fundamental level however, **the potential divergence between US and emerging market economic recovery may push markets to disfavor emerging market currencies.** Should the Fed respond by cutting back on the pace of its asset purchases, this risk would be exacerbated. Additionally, pressures from imported inflation may also further weigh down the Rupiah.

Chart 1. Core inflation continues to decline, though it appears to have already bottomed out



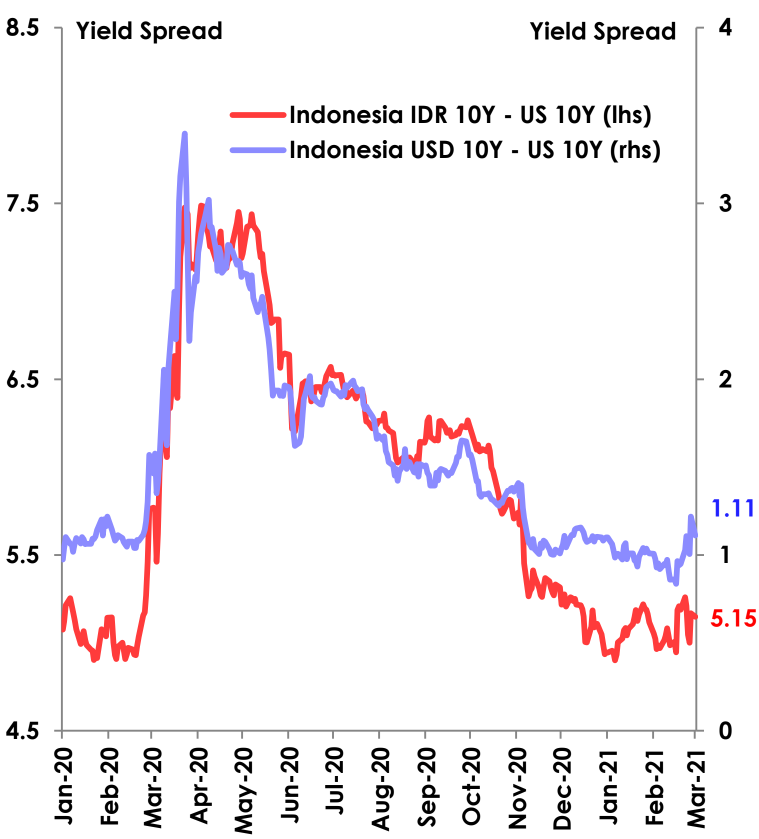
Source: BPS

Chart 2. The spike in US treasury yields is mirrored by a similar uptick in Indonesian bond yields…



Source: Bloomberg (last update: 01 Mar 2021)

Chart 3. …although US and Indonesian bond yield spreads have remained largely stable, if not higher



Source: Bloomberg (last update: 01 Mar 2021)

Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	0.25	Mar-20	-1.15
UK	0.10	Mar-20	-0.60
EU	0.00	Mar-16	-0.90
Japan	-0.10	Jan-16	0.50
China (lending)	4.35	Oct-15	4.65
Korea	0.50	May-20	-0.10
India	4.00	May-20	-0.06
Indonesia	3.50	Feb-21	2.12
Money Mkt Rates	**26-Feb**	**-1 mth**	**Chg (bps)**
SPN (1M)	6.61	2.65	395.8
SUN (10Y)	6.58	6.23	34.3
INDONIA (O/N, Rp)	2.80	3.04	-23.6
JIBOR 1M (Rp)	3.56	3.80	-24.3
Bank Rates (Rp)	**Dec**	**Nov**	**Chg (bps)**
Lending (WC)	9.21	9.32	-10.54
Deposit 1M	4.22	4.45	-23.28
Savings	0.86	0.87	-0.66
Currency/USD	**26-Feb**	**-1 mth**	**Chg (%)**
UK Pound	0.718	0.728	1.43
Euro	0.828	0.822	-0.70
Japanese Yen	106.6	103.6	-2.77
Chinese RMB	6.474	6.465	-0.13
Indonesia Rupiah	14,235	14,065	-1.19
Capital Mkt	**26-Feb**	**-1 mth**	**Chg (%)**
JCI	6,241.8	6,140.2	1.66
DJIA	30,932.4	30,937.0	-0.02
FTSE	6,483.4	6,654.0	-2.56
Nikkei 225	28,966.0	28,546.2	1.47
Hang Seng	28,980.2	29,391.3	-1.40
Foreign portfolio ownership (Rp Tn)	**Feb**	**Jan**	**Chg (Rp Tn)**
Stock	1,930.8	1,811.4	119.42
Govt. Bond	971.4	987.3	-15.92
Corp. Bond	28.4	29.3	-0.92

Trade & Commodities	26-Feb	-1 mth	Chg (%)
Baltic Dry Index	1,675.0	1,659.0	1.0
S&P GSCI Index	477.0	433.8	9.9
Oil (Brent, $/brl)	66.1	55.9	18.3
Coal ($/MT)	81.5	86.0	-5.3
Gas ($/MMBtu)	2.63	2.67	-1.6
Gold ($/oz.)	1,734.0	1,850.9	-6.3
Copper ($/MT)	9,139.3	8,007.3	14.1
Nickel ($/MT)	18,532.0	18,010.5	2.9
CPO ($/MT)	987.8	887.4	11.3
Rubber ($/kg)	1.81	1.55	16.8
External Sector	**Jan**	**Dec**	**Chg (%)**
Export ($ bn)	15.30	16.54	-7.5
Import ($ bn)	13.34	14.44	-7.6
Trade bal. ($ bn)	1.96	2.10	-6.7
Central bank reserves ($ bn)	138.0	135.9	1.55
Prompt Indicators	**Jan**	**Dec**	**Nov**
Consumer confidence index (CCI)	84.9	96.5	92.0
Car sales (%YoY)	-34.2	-34.4	-41.0
Motorcycle sales (%YoY)	#N/A	-45.1	-56.7
Cement sales (%YoY)	-5.9	-12.6	-14.0
Manufacturing PMI	**Jan**	**Dec**	**Chg (bps)**
USA	58.7	60.5	-180
Eurozone	54.8	55.2	-40
Japan	49.8	50.0	-20
China	51.5	53.0	-150
Korea	53.2	52.9	30
Indonesia	52.2	51.3	90

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$)	3605	3877	3927	4175	3912	4055
Consumer Price Index Inflation (% YoY)	3.0	3.6	3.1	2.7	1.7	3.1
BI 7 day Repo Rate (%)	4.75	4.25	6.00	5.00	3.75	3.75
USD/IDR Exchange Rate (end of year)**	13,473	13,433	14,390	13,866	14.050	14.460
Trade Balance (US$ 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

Economic, Banking & Industry Research Team

David E. Sumual
Chief Economist
david_sumual@bca.co.id
+6221 2358 8000 Ext: 1051352

Agus Salim Hardjodinoto
Industry Analyst
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

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

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

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

Derrick Gozal
Economist / Analyst
derrick_gozal@bca.co.id
+6221 2358 8000 Ext: 1066722

Livia Angelica Thamsir
Economist / Analyst
livia_thamsir@bca.co.id
+6221 2358 8000 Ext: 1069933

Ahmad Aprilian Rizki
Research Assistant
ahmad_rizki@bca.co.id
+6221 2358 8000 Ext: 20378

Arief Darmawan
Research Assistant
arief_darmawan@bca.co.id
+6221 2358 8000 Ext: 20364

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group - DKP
20th Grand Indonesia, Menara BCA
Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia
Ph : (62-21) 2358-8000 Fax : (62-21) 2358-8343