

# Monthly Economic & Finance Briefing

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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

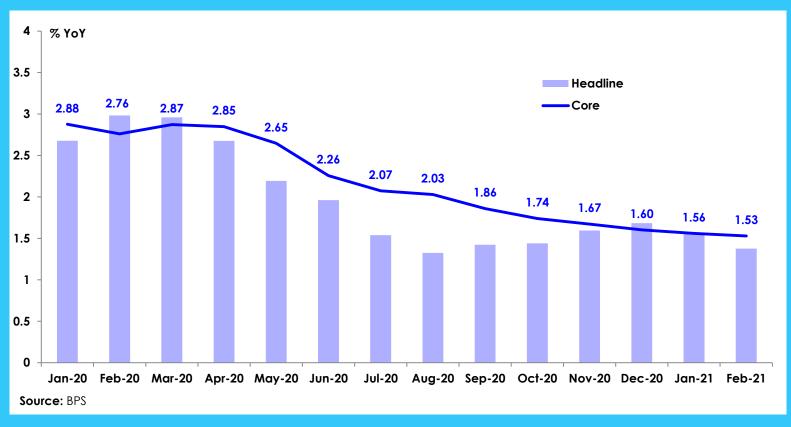


Chart 2. The spike in US treasury yields is mirrored by a similar uptick in Indonesian bond yields...

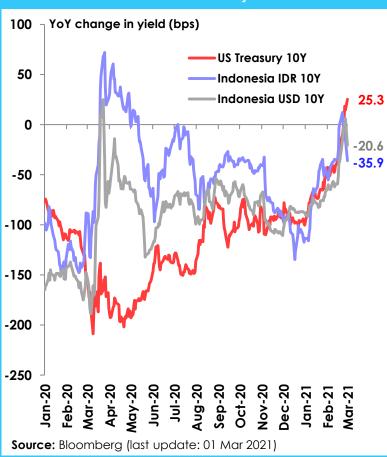


Chart 3. ...although US and Indonesian bond yield spreads have remained largely stable, if not higher



# **Selected Recent Economic Indicators**

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	26-Feb	-1 mth	Chg (%)			
US	0.25	Mar-20	-1.15 Baltic Dry Index		1,675.0	1,659.0	1.0			
UK	0.10	Mar-20	-0.60 S&P GSCI Index		477.0	433.8	9.9			
EU	0.00	Mar-16	-0.90	Oil (Brent, \$/brl)	66.1	55.9	18.3			
Japan	-0.10	Jan-16	0.50	Coal (\$/MT)	81.5	86.0	-5.3			
China (lending)	4.35	Oct-15	4.65	Gas (\$/MMBtu)	2.63	2.67	-1.6			
Korea	0.50	May-20	-0.10	Gold (\$/oz.)	1,734.0	1,850.9	-6.3			
India	4.00	May-20	- <mark>0.06</mark> Copper (\$/MT)		9,139.3	8,007.3	14.1			
Indonesia	3.50	Feb-21	2.12	2.12 Nickel (\$/MT)		18,010.5	2.9			
Money Mkt Rates	26-Feb	-1 mth	Chg	CPO (\$/MT)	987.8	887.4	11.3			
			(bps)	Rubber (\$/kg)	1.81	1.55	16.8			
SPN (1M)	6.61	2.65	395.8	External Sector	Jan	Dec	Chg (%)			
SUN (10Y)	6.58	6.23	34.3	External Sector						
INDONIA (O/N, Rp)	2.80	3.04	-23.6	Export (\$ bn)	15.30	16.54	-7.5			
JIBOR 1M (Rp)	3.56	3.80	-24.3	Import (\$ bn)	13.34	14.44	-7.6			
Bank Rates (Rp)	Dec	Nov	Chg	Trade bal. (\$ bn)	1.96	2.10	-6.7			
			(bps)	Central bank reserves	138.0	135.9	1.55			
Lending (WC)	9.21	9.32	-10.54	(\$ bn)						
Deposit 1M	4.22	4.45	-23.28	Prompt Indicators	Jan	Dec	Nov			
Savings	0.86	0.87	-0.66	Trompt Indicators						
Currency/USD	26-Feb	-1 mth	Chg (%)	Consumer confidence index (CCI)	84.9	96.5	92.0			
UK Pound	0.718	0.728	1.43	Car calos (0/ VoV)	-34.2	-34.4	-41.0			
Euro	0.828	0.822	-0.70	Car sales (%YoY)						
Japanese Yen	106.6	103.6	-2.77	Motorcycle sales	#N/A	-45.1	-56.7			
Chinese RMB	6.474	6.465	-0.13	(%YoY)						
Indonesia Rupiah	14,235	14,065	-1.19	Coment cales (0/ VeV)	-5.9	-12.6	-14.0			
Capital Mkt	26-Feb	-1 mth	Chg (%)	Cement sales (%YoY)						
JCI	6,241.8	6,140.2	1.66	Manufacturing PMI	Jan	Dec	Chg			
DJIA	30,932.4	30,937.0	-0.02	Manufacturing PM1			(bps)			
FTSE	6,483.4	6,654.0	-2.56	USA	58.7	60.5	-180			
Nikkei 225	28,966.0	28,546.2	1.47	Eurozone	54.8	55.2	-40			
Hang Seng	28,980.2	29,391.3	-1.40	Japan	49.8	50.0	-20			
Foreign portfolio	Feb	Jan	Chg	China	51.5	53.0	-150			
ownership (Rp Tn)			(Rp Tn)	Korea	53.2	52.9	30			
Stock	1,930.8	1,811.4	119.42	Indonesia	52.2	51.3	90			
Govt. Bond	971.4	987.3	-15.92							
Corp. Bond	28.4	29.3	-0.92							

Source: Bloomberg, BI, BPS

Notes:

<sup>\*</sup>Previous data

<sup>\*\*</sup>For change in currency: **Black** indicates appreciation against USD, **Red** indicates depreciation

<sup>\*\*\*</sup>For PMI, > 50 indicates economic expansion, < 50 indicates contraction

# **Indonesia - Economic Indicators Projection**

	2016	2017	2018	2019	2020	2021E
Gross Domestic Product (% YoY)		5.1	5.2	5.0	-2.1	4.8
GDP per Capita (US\$)		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

<sup>\*</sup> Estimation of Rupiah's fundamental exchange rate

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