CPI Inflation:

Deeper into the deflationary spiral

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Executive Summary

- Inflation declined to 1.84% YoY in September (-0.12% MoM), due to a combination of foodstuffs deflation, weak consumer demand, and a global deflationary trend driven by oversupply in China.
- Despite the food deflation, there remain live concerns over rice supplies, while impact on rural welfare has been ambiguous and limited.
- Food deflation could continue amid Oct-Nov harvest season, but inflation may pick up again next year from tax increases and a potential rebound of commodity (especially energy) prices. Accordingly, while rate cuts are likely to continue into early 2025, the outlook for further cuts might be murkier.

- Inflation continued to slide to 1.84% YoY in September (from 2.12% YoY in August), on the back of a 0.12% MoM deflation. Prices of foodstuffs – already on a deflationary roll since April – continued to decline (-0.59% MoM) particularly from poultry and chilis, while there was also slight deflation from transportation (-0.16% MoM), largely due to lower prices of non-subsidized fuels.

- A handful of items that still saw strong price increase such as university tuition fee and airline fares, but these are one-offs. The only consistent inflationary force, as we saw in recent months, were gold jewelry (which is categorized under "personal care"). Excluding gold, inflation would have been far lower both for headline (1.54% YoY, from 1.84% YoY) and core inflation (1.62% YoY, from 2.09% YoY).

- The story behind this deflation remains the same. **Weak aggregate demand continues to be an issue, as indeed we see a probable further weakening in our big data indices in September.** However, the picture would be incomplete without considering the supply-side situation from imported goods and foodstuffs.

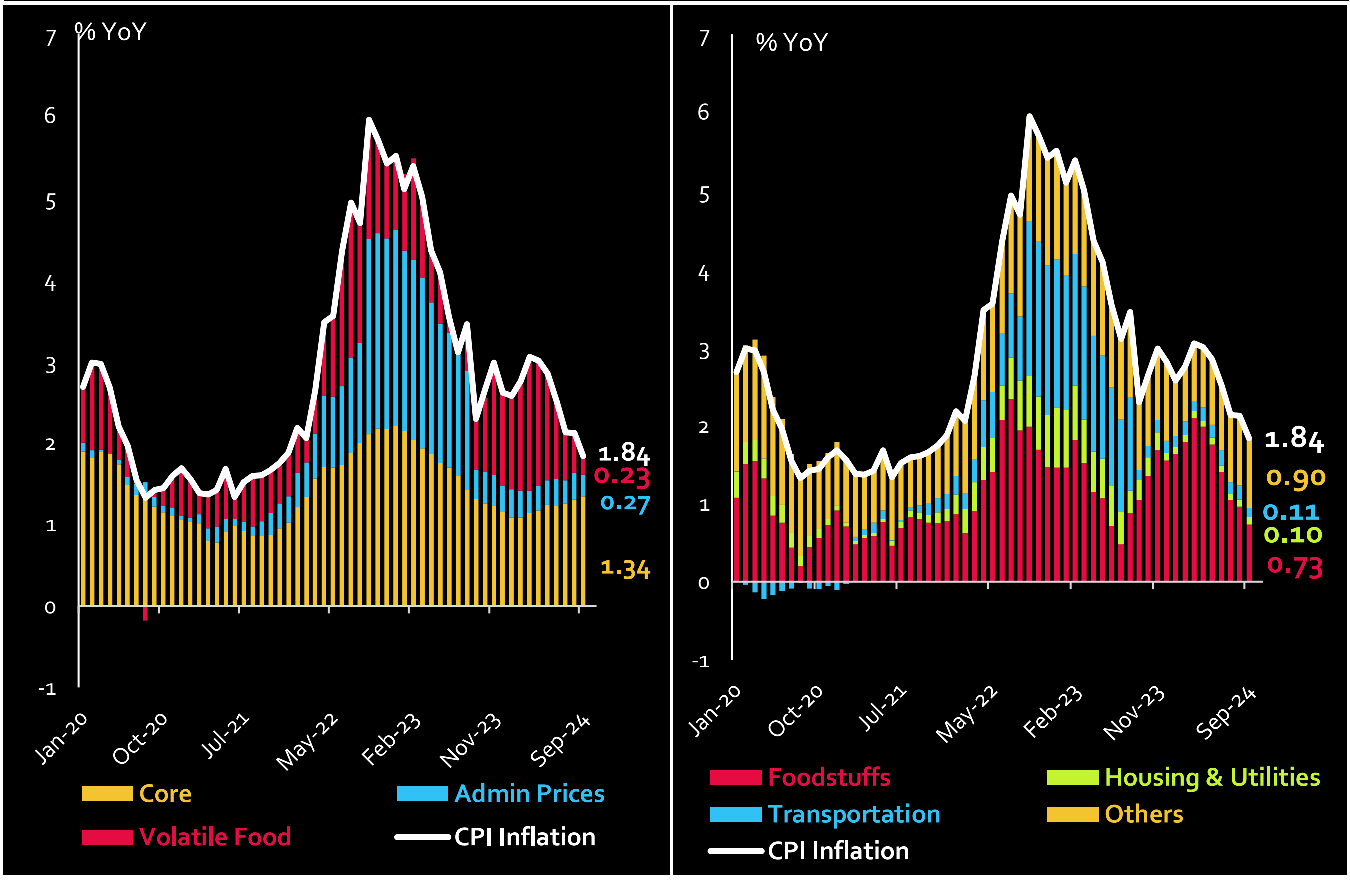
- After a brief imported inflation between April and July (largely due to IDR depreciation), imported prices returned to deflationary territory in August (-1.15% YoY). While stronger IDR clearly drove this shift, it is clear from inflation data in other countries that manufactured goods in general are experiencing a deflation, as a result of the widening gap between industrial production (supply) and retail consumption (demand) in China.

- As for foodstuffs, we noted last month that cereal imports have risen again despite the apparent deflation, which might signal the government's worry about food availability amid a politically-sensitive period – with the Prabowo administration succeeding this month, and

Regional Elections the next. Interestingly, the worry about rice is quite well-justified (rice prices remain elevated YTD), while most of the food deflation was driven by sharp price declines (by 30-40% YTD) for spices.

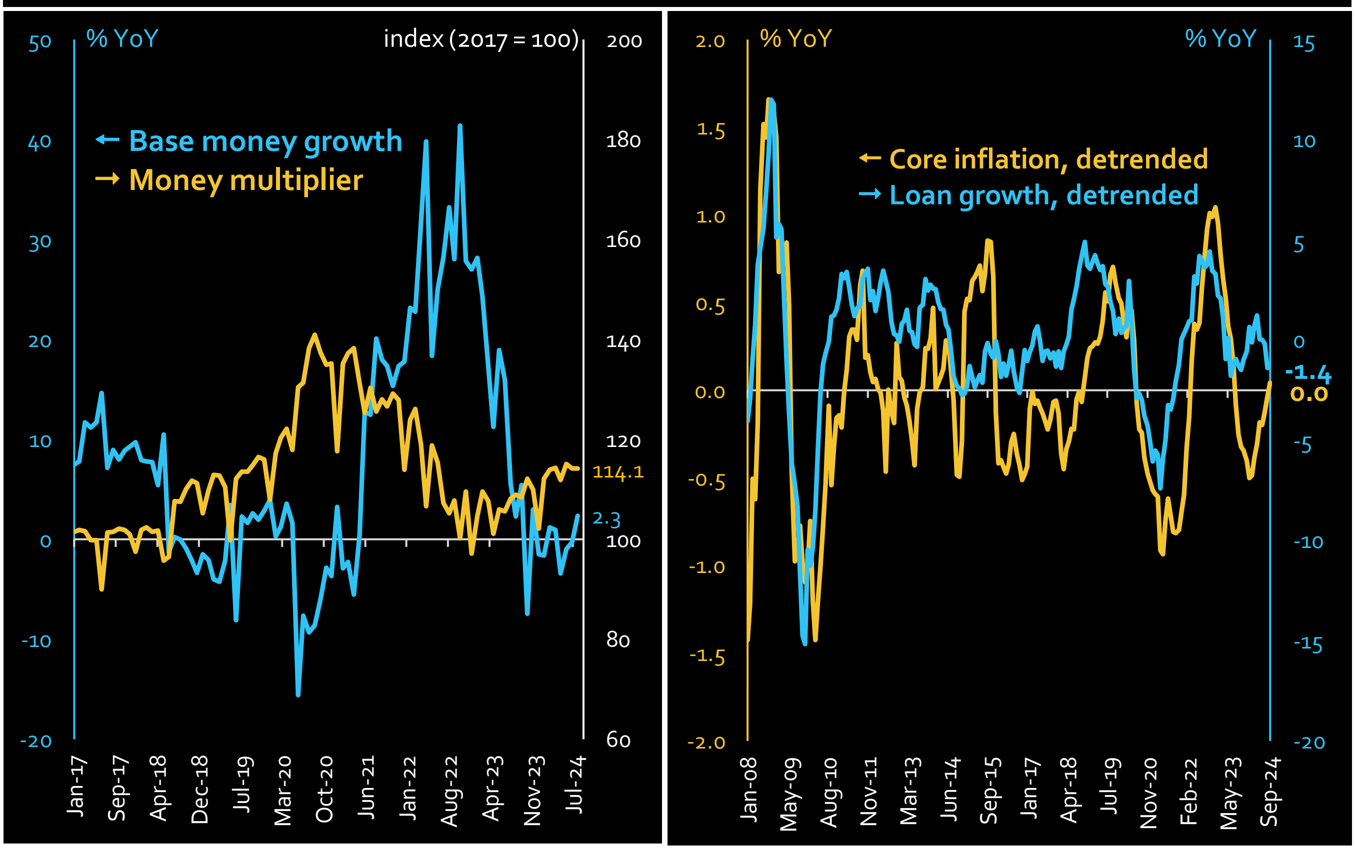
- In theory, food deflation transfers income away from rural areas towards urban areas, and indeed this was what we saw between April and June, when farmers' purchasing power (nilai tukar petani, NTP) declined by as much as 8.9% after the rice harvests. The situation in the past two months, however, is more ambiguous, as NTP begins to recover.
- To be sure, NTP could decline again in the short-term during the next harvest season (October-November), which would also be when we expect the deflationary trend to bottom out. From that point, inflation may return, although its speed is very uncertain. Some government policies, notably higher VAT rates (from 11% to 12%) and a new excise tax on sugary drinks, would raise inflation by about 0.3 – 0.5% YoY. Others, like the free lunch program and food estates, have more ambiguous effects, although the latter – if successful – should suppress food inflation in the long-run.
- But the global drivers are even less predictable. The glut of Chinese goods is currently drowning the world in deflation, but a successful demand-side stimulus and/or renewed tariff war in the event of a Trump victory could change the landscape drastically in a short period. Likewise, the subdued oil price in recent weeks could change upon geopolitical escalation – of which the Israel-Iran conflict is currently the hottest, but not the only, flashpoint. Freed from the burden of high Fed rates, it is not impossible that commodity prices could rally by early next year, in a manner similar to "Trump reflation trade" in 2016-17.
- Which brings us to the issue of interest rates. As we stated in a previous report, the ineffectiveness of rate cuts should, ironically, imply faster rate cuts in the short-term (until Q1 or Q2-25). It is far from given, however, that the trend of slowing growth and lower inflation would persist past that point, putting our medium-term rate outlook in murkier waters.

Panel 1. **Food inflation experienced another slowdown, while core inflation remains stable**



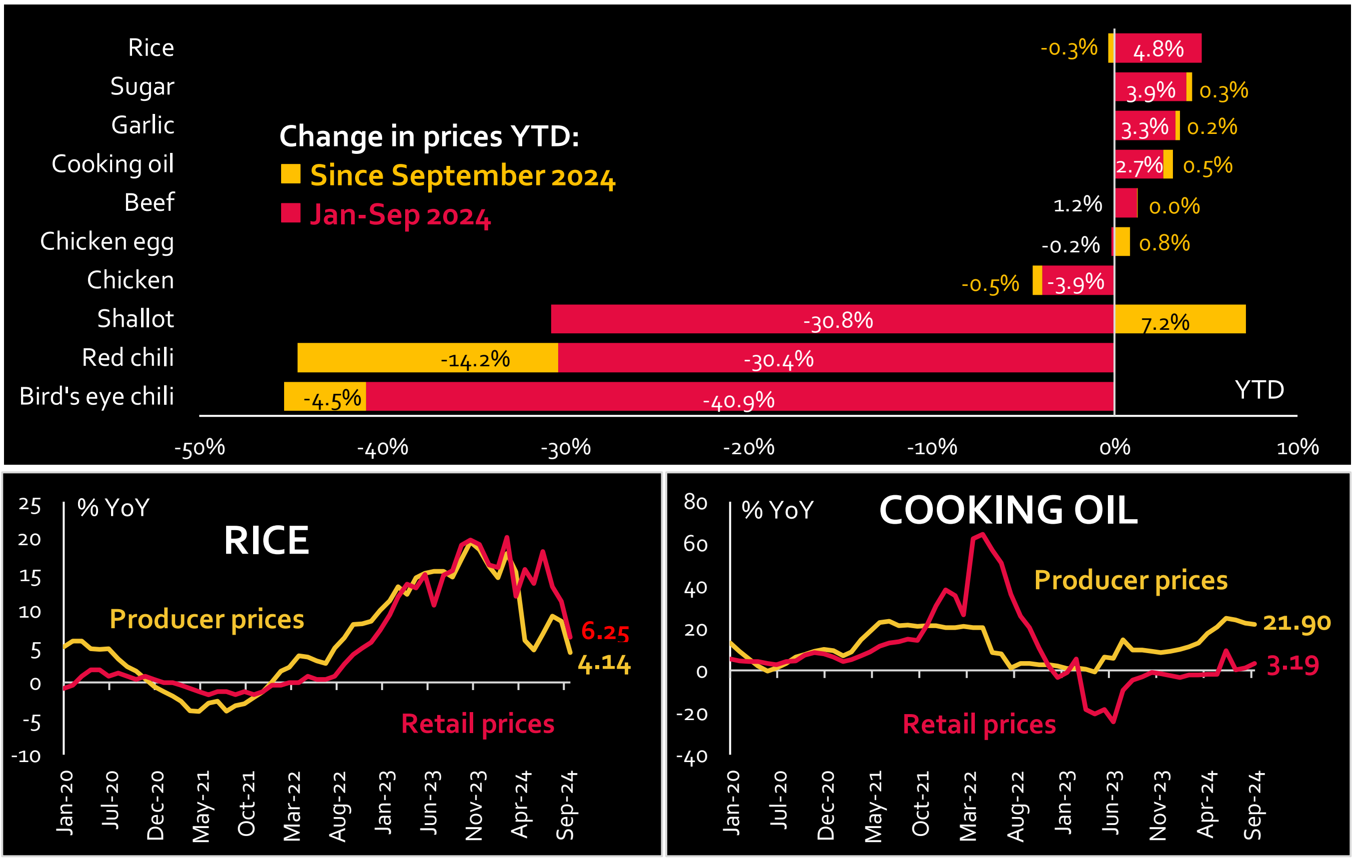
Source: BPS, calculation by BCA Economic Research

Panel 2. **Strong loan growth may indicate higher core inflation in periods ahead**



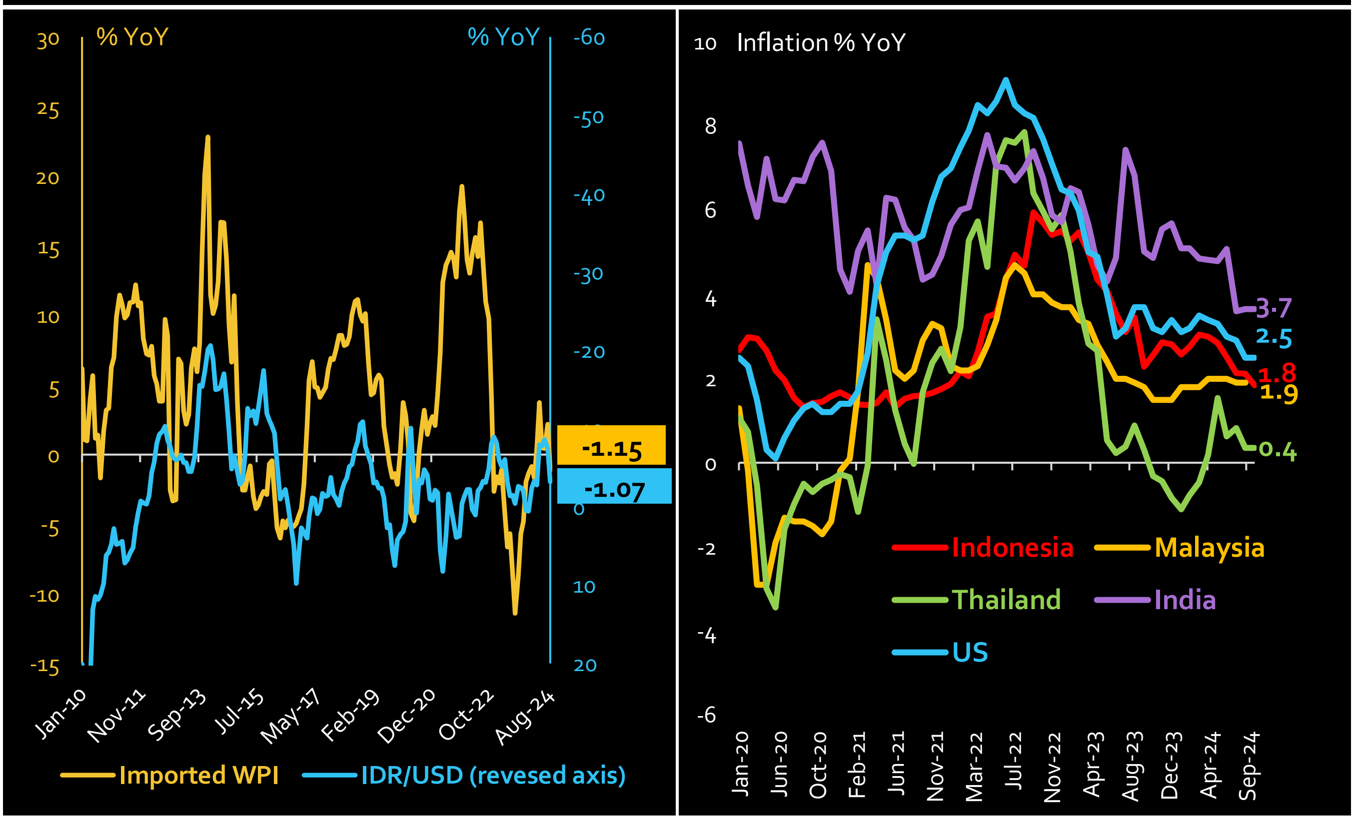
Source: BI, OJK, BCA big data, calculation by BCA Economic Research

Panel 3. Rice prices remain stable while chicken and shallots saw a decrease



Source: Ministry of Trade, BPS

Panel 4. Strong Rupiah and Chinese oversupply pushed down imported inflation.



Source: BI, Bloomberg

Selected Macroeconomic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	5.00	Jul-23	2.50
UK	5.00	Aug-23	2.80
EU	3.65	Jul-23	1.85
Japan	-0.10	Jan-16	-3.10
China (lending)	2.00	Aug-23	3.75
Korea	3.50	Jan-23	1.90
India	6.50	Feb-23	2.85
Indonesia	6.00	Sep-24	4.16

Money Mkt Rates	1-Oct	-1 mth	Chg (bps)
SPN (3M)	5.87	5.91	-4.3
SUN (10Y)	6.45	6.62	-16.7
INDONIA (O/N, Rp)	6.21	6.35	-13.9
JIBOR 1M (Rp)	6.65	6.90	-24.6

Bank Rates (Rp)	Jul	Jun	Chg (bps)
Lending (WC)	8.81	8.82	-1.72
Deposit 1M	4.78	4.70	7.49
Savings	0.65	0.67	-1.66

Currency/USD	1-Oct	-1 mth	Chg (%)
UK Pound	0.753	0.762	1.21
Euro	0.904	0.905	0.18
Japanese Yen	143.6	146.2	1.81
Chinese RMB	7.019	7.091	1.03
Indonesia Rupiah	15,200	15,455	1.68

Capital Mkt	1-Oct	-1 mth	Chg (%)
JCI	7,642.1	7,670.7	-0.37
DJIA	42,157.0	41,563.1	1.43
FTSE	8,276.7	8,376.6	-1.19
Nikkei 225	38,652.0	38,647.8	0.01
Hang Seng	21,133.7	17,989.1	17.48

Foreign portfolio ownership (Rp Tn)	Sep	Aug	Chg (Rp Tn)
Stock	3,558.2	3,684.6	-126.37
Govt. Bond	870.6	852.3	18.28
Corp. Bond	6.9	7.0	-0.02

Trade & Commodities	1-Oct	-1 mth	Chg (%)
Baltic Dry Index	2,030.0	1,814.0	11.9
S&P GSCI Index	540.9	536.7	0.8
Oil (Brent, $/brl)	73.6	78.8	-6.6
Coal ($/MT)	142.7	146.8	-2.8
Gas ($/MMBtu)	2.67	1.99	34.4
Gold ($/oz.)	2,663.2	2,503.4	6.4
Copper ($/MT)	9,840.2	9,118.1	7.9
Nickel ($/MT)	17,449.2	16,538.7	5.5
CPO ($/MT)	1,005.1	942.4	6.7
Rubber ($/kg)	2.19	1.84	19.0

External Sector	Aug	Jul	Chg (%)
Export ($ bn)	23.56	22.24	5.97
Import ($ bn)	20.67	21.74	-4.93
Trade bal. ($ bn)	2.90	0.50	478.90
Central bank reserves ($ bn)*	150.2	145.4	3.32

Prompt Indicators	Aug	Jul	Jun
Consumer confidence index (CCI)	124.4	123.4	123.3
Car sales (%YoY)	-14.2	-7.8	-9.7
Motorcycle sales (%YoY)	7.4	24.1	3.5

Manufacturing PMI	Sep	Aug	Chg (bps)
USA	47.3	47.9	-60
Eurozone	45.0	45.8	-80
Japan	49.7	49.8	-10
China	49.3	50.4	-110
Korea	48.3	51.9	-360
Indonesia	49.2	48.9	30

Source: Bloomberg, BI, BPS

Notes:

*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

	2019	2020	2021	2022	2023	2024E
Gross Domestic Product (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0
GDP per Capita (US$)	4175	3912	4350	4784	4920	5149
Consumer Price Index Inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	1.9
BI 7 day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	5.50
USD/IDR Exchange Rate (end of year)**	13,866	14,050	14,262	15,568	15,397	15,650
Trade Balance (US$ billion)	-3.2	21.7	35.3	54.5	37.0	32.6
Current Account Balance (% GDP)	-2.7	-0.4	0.3	1.0	-0.1	-0.5

* Estimated Number

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