

Indonesia Inflation Indicators

| Inflation by Expenditure Category, yoy | May | June |
|---|-------|-------|
| Headline inflation | 4.0% | 3.5% |
| Headline inflation, mom | 0.09% | 0.14% |
| Food, beverages and tobacco | 4.3% | 2.9% |
| Clothing and footwears | 1.5% | 1.5% |
| Housing, utilities and household fuels | 2.5% | 2.5% |
| Equipment and household maintenance | 3.0% | 2.6% |
| Health | 2.5% | 2.6% |
| Transportations | 10.6% | 10.2% |
| Telecommunication and financial Service | -0.3% | -0.2% |
| Recreation, sport and culture | 2.2% | 2.2% |
| Education | 2.8% | 2.8% |
| Accommodations and restaurants | 3.4% | 3.3% |
| Personal care and other services | 4.5% | 4.3% |
| Inflation by Volatility Level, yoy | | |
| Core inflation | 2.7% | 2.6% |
| Administered price inflation | 9.5% | 9.2% |
| Volatile good inflation | 3.3% | 1.2% |
| - Energy | 12.0% | 11.4% |
| - Foods | 3.3% | 1.5% |
| Inflation by Sector, yoy | | |
| Wholesale price Inflation | 4.4% | 3.9% |
| - Agriculture | 4.0% | 2.8% |
| - Mining and Quarrying | 9.8% | 8.2% |
| - Manufacturing | 4.5% | 4.1% |
| Manufacturing PMI | 50.3 | 52.5 |

Source: BPS, SSI Research

Inflation slowdown in June supports rate cuts, though rupiah depreciation might deter BI

Indonesia's CPI inflation slowed down to 3.5% yoy in June, slightly lower than consensus. The slowdown was mainly caused by the drop in food price inflation to 1.5% yoy (May: 3.3% yoy), which should help reduce the inflationary impact of El Niño in 2H23. In light of the current conditions, we decided to lower our headline and core inflation projections for 3Q23 to 2.4% and 2.3% (Prev: 2.6% and 2.4%) and for FY23 to 2.6% and 2.1% (Prev: 2.8% and 2.1%), respectively, with a food price inflation estimate of 3-5% (Prev: 5-7%). We believe the current conditions are ideal for Bank Indonesia to start cutting its 7DRRR. However, it is very likely that BI will still hold its 7DRRR at 5.75% due to strong depreciation pressure on the rupiah following rampant market speculation regarding Fed rate hike in 2H23.

Consumer price index (CPI) inflation slowed down to 3.5% yoy In June, slightly lower than consensus (May: 4% yoy; Cons Jun: 3.6% yoy; SSI: 3.8% yoy). Meanwhile, core CPI inflation slipped to 2.6% yoy (May: 2.7% yoy; Cons Jun: 2.6% yoy; SSI: 2.7% yoy). The decline in headline inflation was mainly caused by the drop in food price inflation to less than half of the previous month's rate, standing at 1.5% yoy in June (May: 3.3% yoy). We believe that the drop in food price inflation in June will help reduce the inflationary impact of El Niño in 2H23. Previously, we predicted that food price inflation may reach 5-7%. In light of the current conditions, we project food price inflation to reach 3-5% at the end of the year, prompting us to lower our FY23 headline and core inflation projections to 2.6% and 2.1%, respectively (Prev: 2.8% and 2.2%). We also reduce our headline and core inflation projections for 3Q23 to 2.4% and 2.3% (Prev: 2.6% and 2.4%, see Chart 1 and Table 1).

Even though the inflation slowdown provides an ideal situation for Bank Indonesia to start cutting its 7DRRR, we believe Bank Indonesia will still hold the rate at 5.75% until next September or October, due to strong depreciation pressure on the rupiah following rampant market speculation regarding Fed rate hike in 2H23. Today, 87% of market analysts expect a Fed terminal rate hike in July of 25 bps to 5.5%, and 29% of market analysts project another terminal rate hike in November or December of 25 bps to 5.75%. This projection is made based on the US core PCE inflation data, which remained at 4.6% yoy in May (Apr: 4.7% yoy, see Chart 2). In our view, the core PCE inflation data for May still need to be confirmed by US labor market data (which will be released this week) and US consumer inflation data (CPI) (which will be released next week). If the US CPI inflation rate drops below 3.5% yoy, followed by a drop in core CPI inflation to 4.5% yoy or lower, then we expect the Fed to delay its July terminal rate hike. Considering these conditions, we predict that depreciation pressure against the rupiah will continue for the next two weeks.

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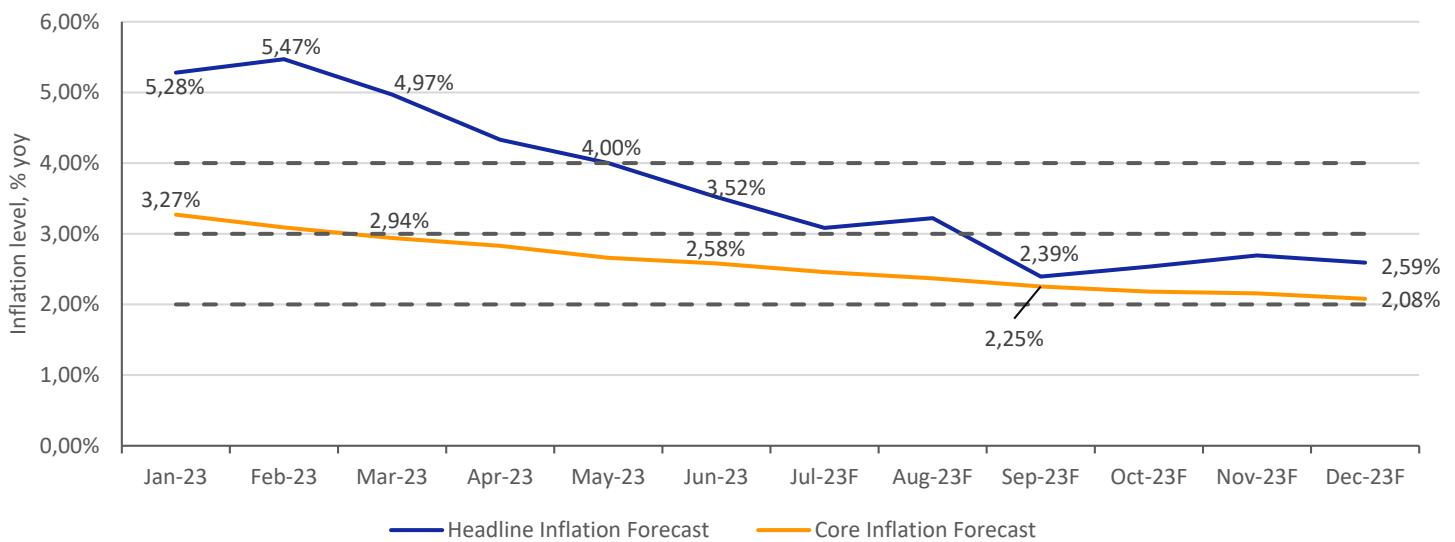
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Table 1. SSI Macroeconomic Forecast Table

| Indicators (% yoy) | 1Q21 | 2Q21 | 3Q21 | 4Q21 | 1Q22 | 2Q22 | 3Q22 | 4Q22 | 1Q23 | 2Q23F | 3Q23F | 4Q23F | FY21 | FY22 | FY23F |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Real GDP (NSA % qoq) | (0.9) | 3.3 | 1.5 | 1.1 | (1.0) | 3.7 | 1.8 | 4.0 | (0.9) | 3.4 | 1.7 | 0.6 | | | |
| Real GDP | (0.7) | 7.1 | 3.5 | 5.0 | 5.0 | 5.4 | 5.7 | 5.0 | 5.0 | 4.6 | 4.5 | 4.7 | 3.7 | 5.3 | 4.7 |
| Unemployment rate (% nsa) | 6.3 | 6.3 | 6.5 | 6.5 | 5.8 | 5.8 | 5.9 | 5.9 | 5.5 | 5.5 | 5.4 | 5.3 | 6.5 | 5.9 | 5.3 |
| Consumer price | 1.4 | 1.3 | 1.6 | 1.9 | 2.6 | 4.4 | 6.0 | 5.5 | 5.0 | 3.5 | 2.4 | 2.6 | 1.9 | 5.5 | 2.6 |
| Current account balance (% to GDP) | (0.4) | (0.7) | 1.7 | 0.5 | 0.2 | 1.1 | 1.3 | 1.3 | 0.9 | (0.6) | (0.3) | (0.4) | 0.3 | 1.0 | (0.1) |
| 12M rolling sum | (0.2) | (0.1) | 0.3 | 0.3 | 0.4 | 0.9 | 0.8 | 1.0 | 1.2 | 0.7 | 0.3 | (0.1) | | | |
| Fiscal balance (% to GDP) | (0.8) | (1.7) | (2.7) | (4.6) | 0.1 | 0.4 | 0.3 | (2.4) | 0.6 | (1.1) | (1.8) | (2.8) | (4.6) | (2.4) | (2.8) |
| Policy rate, 7 day reverse repo rate (%) | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 | 4.25 | 5.50 | 5.75 | 5.75 | 5.50 | 5.25 | 3.75 | 5.50 | 5.25 |
| 10-year government bond yield (%) | 6.78 | 6.59 | 6.26 | 6.38 | 6.74 | 7.22 | 7.37 | 6.94 | 6.79 | 6.26 | 6.20 | 6.00 | 6.38 | 6.94 | 6.00 |
| Exchange rate (USD/IDR) | 14,525 | 14,500 | 14,313 | 14,253 | 14,369 | 14,898 | 15,228 | 15,568 | 14,995 | 14,993 | 14,700 | 14,900 | 14,253 | 15,568 | 14,900 |

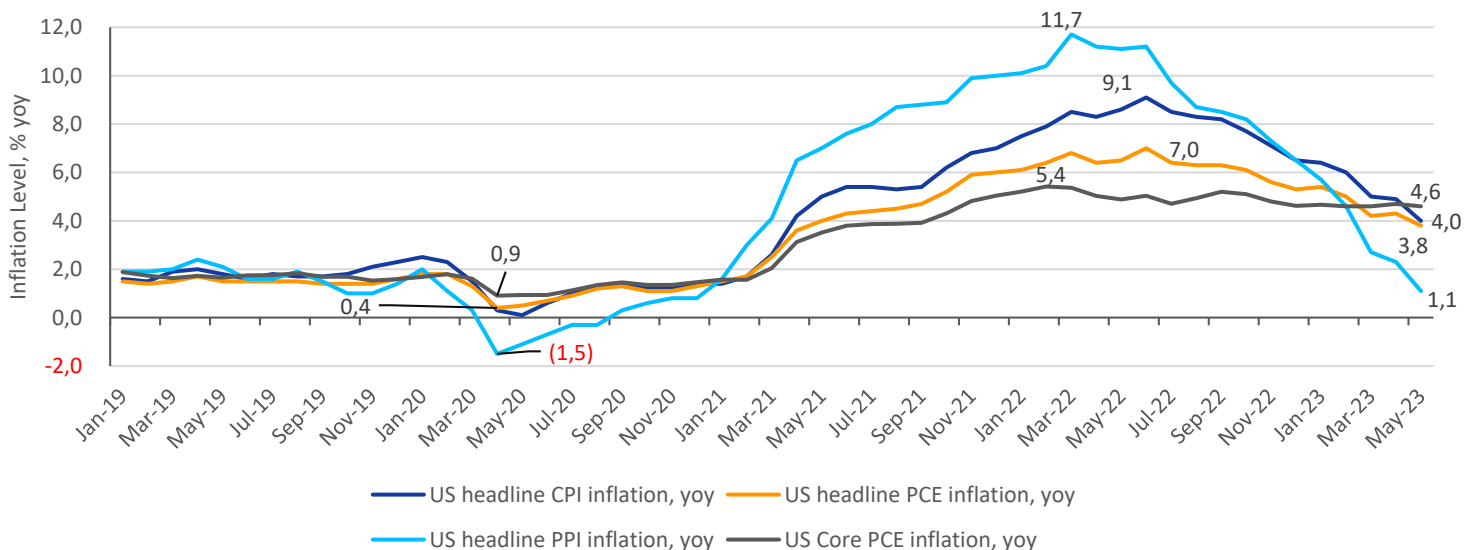
Source: SSI Research.

Chart 1. SSI's Inflation Projection



Source: Bank Indonesia, SSI Research

Chart 2. Inflation Trend in the United States



Source: BEA, BLS, Bloomberg, SSI Research

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