

Indonesia Inflation Indicators

Inflation by Expenditure Category, yoy	June	July
Headline inflation	3.5%	3.1%
Headline inflation, mom	0.14%	0.12%
Food, beverages and tobacco	2.9%	1.9%
Clothing and footwears	1.5%	1.4%
Housing, utilities and household fuels	2.5%	2.0%
Equipment and household maintenance	2.6%	2.4%
Health	2.6%	2.7%
Transportations	10.2%	9.6%
Telecommunication and financial Service	-0.2%	-0.2%
Recreation, sport and culture	2.2%	2.0%
Education	2.8%	3.1%
Accommodations and restaurants	3.3%	3.1%
Personal care and other services	4.3%	4.0%
Inflation by Volatility Level, yoy		
Core inflation	2.6%	2.4%
Administered price inflation	9.2%	8.4%
Volatile good inflation	1.2%	0.0%
- Energy	11.4%	10.5%
- Foods	1.5%	0.3%
Inflation by Sector, yoy		
Wholesale price Inflation	3.9%	3.6%
- Agriculture	2.8%	2.6%
- Mining and Quarrying	8.2%	6.4%
- Manufacturing	4.1%	3.7%
Manufacturing PMI	52.5	53.3

Source: BPS, SSI Research

Inflation slowdown in July supports October rate cut scenario

Indonesia's CPI inflation slowed down to 3.1% yoy in July (Jun: 3.5% yoy), driven mainly by a sharp decline in food price inflation to 0.3% yoy (Jun: 1.5% yoy), which itself was caused by the government's food price intervention amidst El Niño uncertainty. According to our El Niño indicator, Indonesia might face a weak El Niño with a food price inflation scenario of 1-4% at the end of the year. This will allow Bank Indonesia to cut BI 7DRRR by 2X25 bps in 4Q23 to 5.25% to reduce the floor limit of INDOGB 10Y and 3Y yields. In our opinion, 7DRRR cuts are necessary to maintain the momentum of foreign inflow into the bond market. Thus, the stability of the Rupiah exchange rate in 2H23 will be more secure amid the possibility of a current account reversal from surplus to a deficit of -0.6% of GDP.

CPI inflation fell to 3.1% yoy in July (Jun: 3.5% yoy; Cons: &SSI: 3.1% yoy). Meanwhile, core CPI inflation fell to 2.4% yoy (Jun: 2.6% yoy; Cons & SSI: 2.5% yoy). The decline in headline inflation (-0.44 percentage points), which was larger than core inflation (-0.15 percentage points) was caused by the slowdown in food price inflation to 0.3% yoy (Jun: 1.5% yoy).

The sharp decline in food price inflation was caused by two factors; the government's intervention to stabilize food prices in anticipation of El Niño, and uncertainty about when El Niño would come. Although the National Weather Service (NWS) had announced the formation of El Niño on June 8 ([NOAA declares the arrival of El Nino](#)), the Southern Oscillation index (SOI) shows a reversal in the indicator to the positive zone at the end of June (see Chart 1). Responding to this situation, the Australian Bureau of Methodology (BoM) maintained its El Niño outlook at 'alert' level with a probability of 70%. ([ENSO outlook](#)). **If the El Niño is relatively weak (just like in 2009-10) and the government continues its food price intervention, we project food price inflation to remain under pressure, staying within the range of 1-4% throughout the rest of the year (3-6% if the El Niño is moderate, just like in 2002-03).**

We are of the view that inflation will fall below 3% in September as the impact of energy inflation fades away (from ~10% yoy to 3% yoy), followed by a slowdown in transportation inflation, which is a 'derivative effect' of the subsidized fuel price hike in September 2022. Based on our observations, Bank Indonesia has anticipated this condition by announcing its FY24 inflation target of 2.5±1%. Taking this into account, we maintain our projections for 7DRRR cuts (starts in October) with a total cut of 2X25 bps to 5.25% (see Table 1 and Chart 2).

In our opinion, 7DRRR cuts are necessary to reduce the floor limit of INDOGB 10Y and 3Y yields. At the moment, the yields on these two instruments have touched their respective lower limits (JIBOR 1M for INDOGB 10Y and JIBOR 1W for 3Y) [see Chart 3 and 4]. If BI choose not to address this problem through interest rate cuts, it will be difficult to maintain foreign inflow momentum into the Indonesian bond market throughout 2H23, which may hurt rupiah exchange rate, particularly with the reversal of current account surplus to a deficit of -0.6% of GDP in 2H23 (see Table 1). We believe BI now holds the key to maintain foreign inflow momentum into the bond market (see Chart 5).

Lionel Priyadi

Macro Strategist

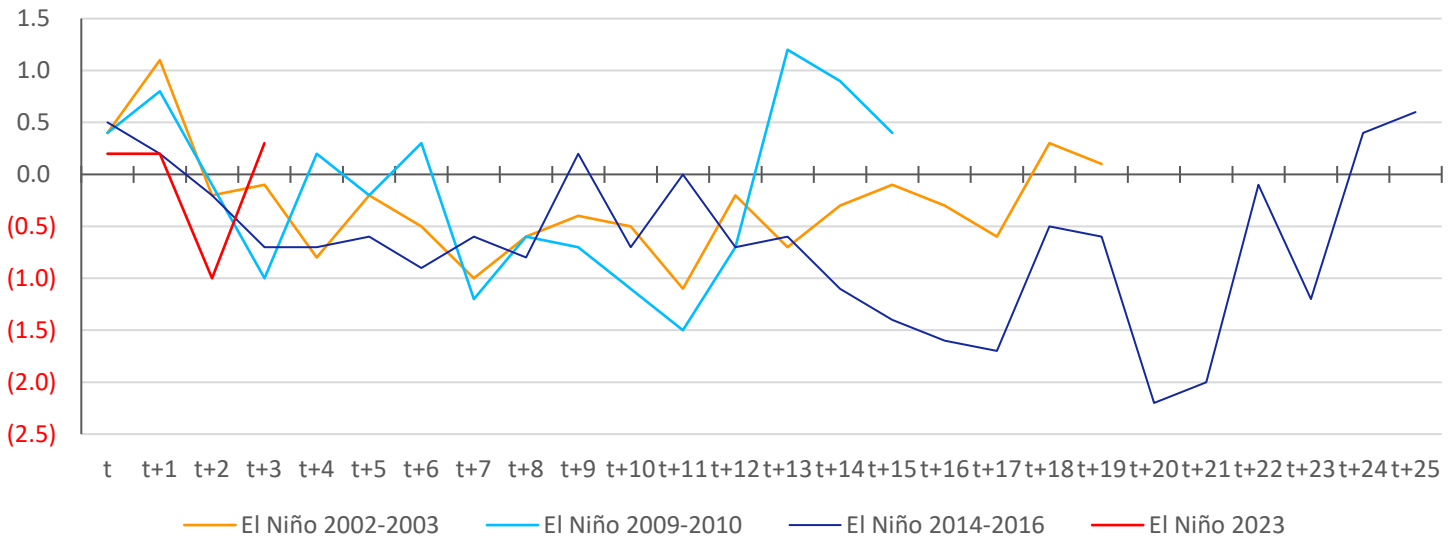
lionel.priyadi@samuel.co.id

+6221 2854 8854

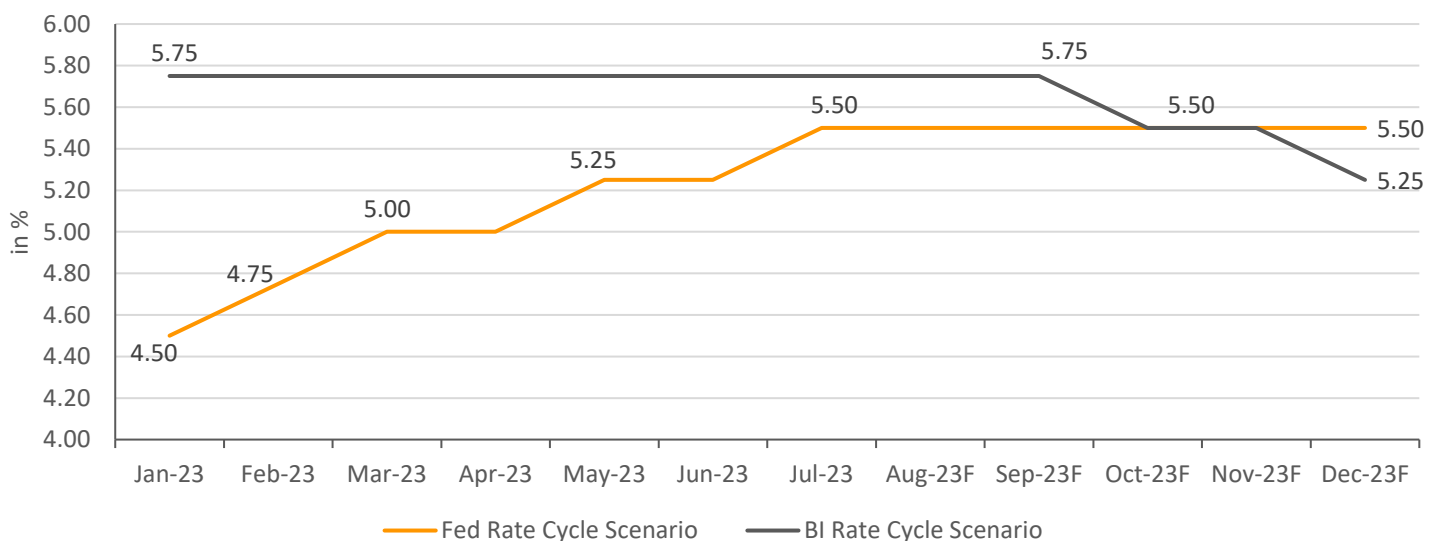
Table 1. SSI Macroeconomic Forecast Table

Indicators (% yoy)	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	FY22	FY23F	FY24F
Real GDP (NSA % qoq)	(1.0)	3.7	1.8	4.0	(0.9)	3.4	1.7	0.6	(0.8)	3.5	1.4	0.8			
Real GDP	5.0	5.4	5.7	5.0	5.0	4.6	4.5	4.7	4.8	5.0	4.7	5.0	5.3	4.7	4.9
Unemployment rate (% nsa)	5.8	5.8	5.9	5.9	5.5	5.5	5.4	5.3	5.2	5.1	5.1	5.0	5.9	5.3	5.0
Consumer price	2.6	4.4	6.0	5.5	5.0	3.5	2.4	2.6	2.7	3.1	3.3	3.3	5.5	2.6	3.3
Current account balance (% to GDP)	0.2	1.1	1.3	1.3	0.9	(1.3)	(0.9)	(1.1)	(0.7)	(1.9)	(1.3)	(1.6)	1.0	(0.6)	(1.4)
12M rolling sum	0.4	0.9	0.8	1.0	1.2	0.5	(0.1)	(0.6)	(1.1)	(1.2)	(1.3)	(1.4)			
Fiscal balance (% to GDP)	0.1	0.5	0.3	(2.4)	0.6	0.7	(1.3)	(2.5)	(0.7)	(1.3)	(1.9)	(2.6)	(2.4)	(2.5)	(2.6)
Policy rate, 7 day reverse repo rate (%)	3.50	3.50	4.25	5.50	5.75	5.75	5.75	5.25	4.75	4.25	4.25	4.25	5.50	5.25	4.25
10-year government bond yield (%)	6.74	7.22	7.37	6.94	6.79	6.26	6.20	6.00	5.80	5.50	5.70	5.60	6.94	6.00	5.60
Exchange rate (USD/IDR)	14,369	14,898	15,228	15,568	14,995	14,993	14,700	14,900	15,000	14,900	14,800	14,700	15,568	14,900	14,700

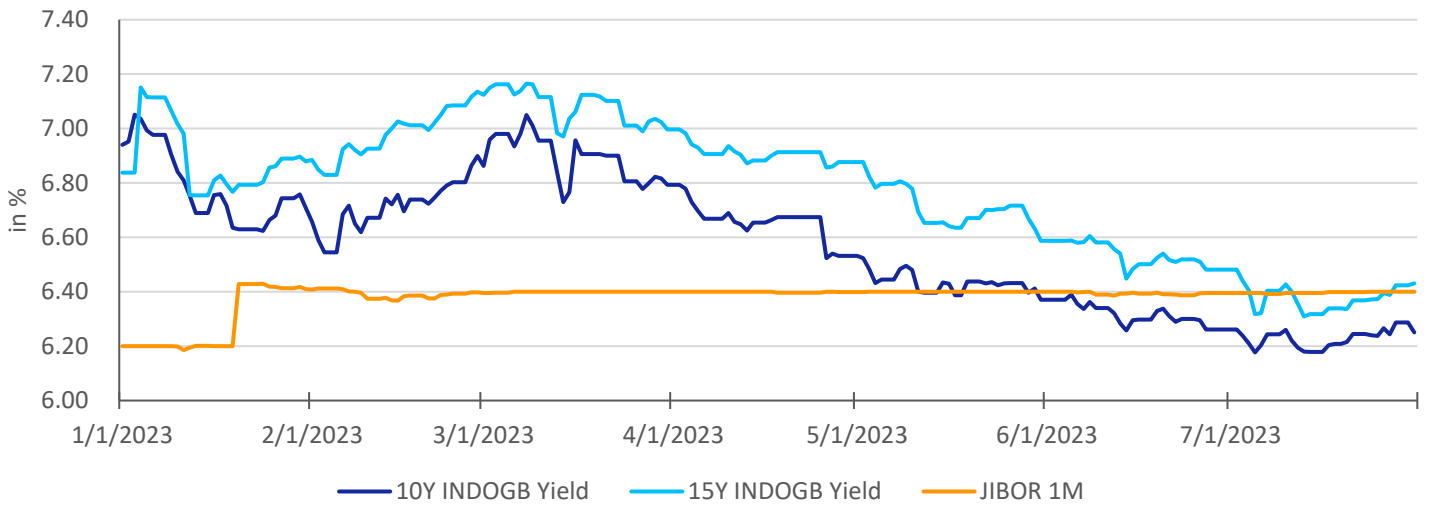
Source: SSI Research.

Chart 1. SSI's El Nino Watch


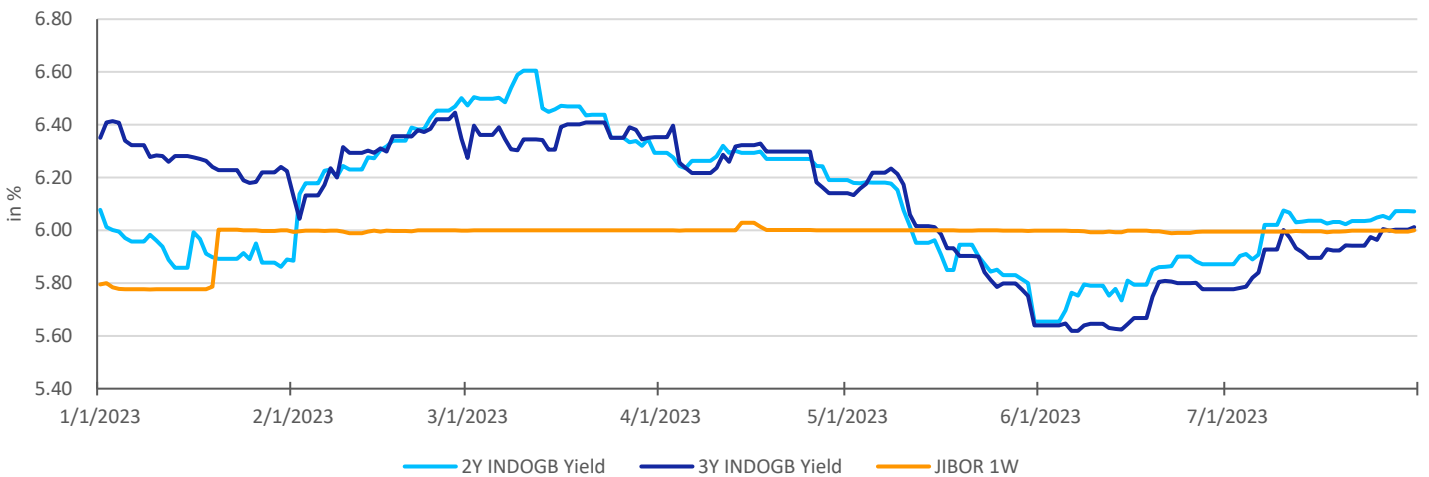
Source: NOAA, SSI Research

Chart 2. SSI's Fed Rate and BI's 7DRRR Projection


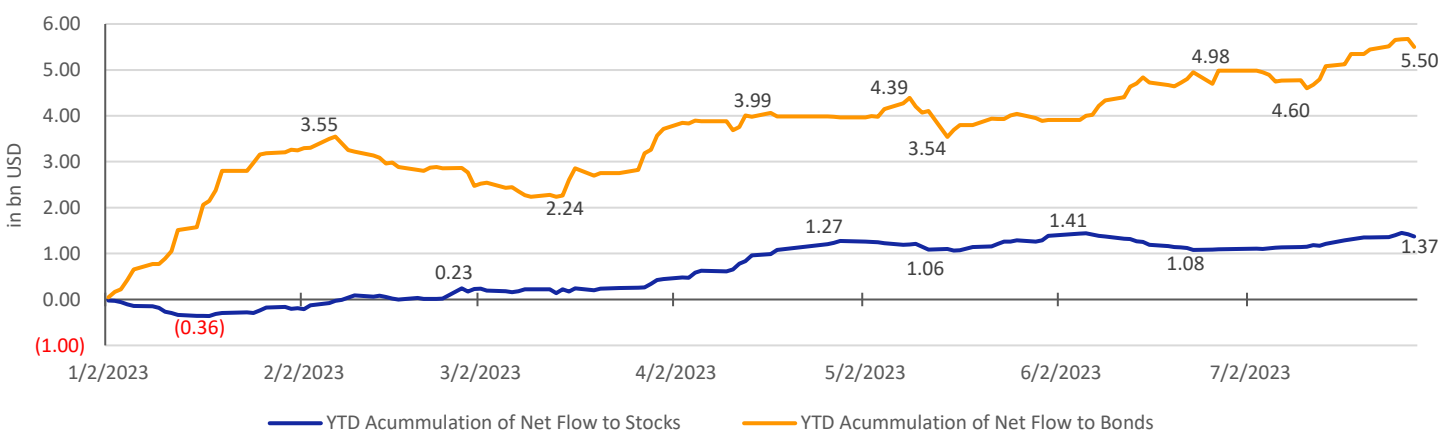
Source: BEA, BLS, Bloomberg, SSI Research

Chart 3. Samuel's Short-term SBN Yield Indicator


Source: Bank Indonesia, IDX, Bloomberg, SSI Research.

Chart 4. Samuel's Long-term SBN Yield Indicator


Source: Bank Indonesia, IDX, Bloomberg, SSI Research

Chart 5. YTD Accumulative Net Foreign Flow to Indonesia Capital Market


Source: BOE, Bloomberg, SSI Research

Research Team			
Prasetya Gunadi	Head of Equity Research, Strategy, Banking, Digital Banks	prasetya.gunadi@samuel.co.id	+6221 2854 8320
Lionel Priyadi	Macro Equity Strategist	lionel.priyadi@samuel.co.id	+6221 2854 8854
Muhamad Alfatih, CSA, CTA, CFTe	Senior Technical Analyst	m.alfatih@samuel.co.id	+6221 2854 8129
William Mamudi, CFTe, CMT, CCT	Senior Technical Analyst	william.mamudi@samuel.co.id	+6221 2854 8382
Yosua Zisokhi	Cement, Cigarette, Paper, Plantation, Telco Infra, Chemicals	yosua.zisokhi@samuel.co.id	+6221 2854 8387
M. Farras Farhan	Media, Poultry, Oil & Gas, Technology	farras.farhan@samuel.co.id	+6221 2854 8346
Pebe Peresia	Automotive, Consumer Staples, Retail	pebe.peresia@samuel.co.id	+6221 2854 8339
Juan Oktavianus Harahap	Coal, Metal Mining	juan.oktavianus@samuel.co.id	+6221 2854 8846
Jonathan Guyadi	Banking, Healthcare, Telco	jonathan.guyadi@samuel.co.id	+6221 2854 8321
Adolf Richardo	Editor	adolfrichardo@samuel.co.id	+6221 2864 8397
Ashalia Fitri Yuliana	Research Associate	ashalia.fitri@samuel.co.id	+6221 2854 8389
Daniel Aditya Widjaja	Research Associate	daniel.aditya@samuel.co.id	+6221 2854 8322
Laurencia Hiemas	Research Associate	laurencia.hiemas@samuel.co.id	+6221 2854 8392
Brandon Boedhiman	Research Associate	brandon.boedhiman@samuel.co.id	+6221 2854 8392

Equity Institutional Team			
Benny Bambang Soebagjo	Head of Institutional Equity Sales	benny.soebagjo@samuel.co.id	+6221 2854 8312
Ronny Ardianto	Institutional Equity Sales	ronny.ardianto@samuel.co.id	+6221 2854 8399
Anthony Yunus	Institutional Equity Sales	anthony.yunus@samuel.co.id	+6221 2854 8314
Widya Meidrianto	Institutional Equity Sales	widya.meidrianto@samuel.co.id	+6221 2854 8317
Fachruly Fiater	Institutional Sales Trader	fachruly.fiater@samuel.co.id	+6221 2854 8325
Lucia Irawati	Institutional Sales Trader	lucia.irawati@samuel.co.id	+6221 2854 8173
Alexander Tayus	Institutional Equity Dealer	alexander.tayus@samuel.co.id	+6221 2854 8319
Leonardo Christian	Institutional Equity Dealer	leonardo.christian@samuel.co.id	+6221 2854 8147

Equity Retail Team			
Joseph Soegandhi	Head of Equity	joseph.soegandhi@samuel.co.id	+6221 2854 8872
Damargumilang	Head of Equity Retail	damargumilang@samuel.co.id	+6221 2854 8309
Denzel Obaja	Head of Community & Partnership	denzel.obaja@samuel.co.id	+6221 2854 8342
Clarice Wijana	Head of Equity Sales Support	clarice.wijana@samuel.co.id	+6221 2854 8395
Gitta Wahyu Retnani	Equity Sales & Trainer	gitta.wahyu@samuel.co.id	+6221 2854 8365
Vincentius Darren	Equity Sales	darren@samuel.co.id	+6221 2854 8348
Michael Alexander	Equity Sales	michael.alexander@samuel.co.id	+6221 2854 8369
Sylviawati	Equity Sales	sylviawati@samuel.co.id	+6221 2854 8112
Wandha Ahmad	Equity Sales	wandha.ahmad@samuel.co.id	+6221 2854 8316
Handa Sandiawan	Equity Sales	handa.sandiawan@samuel.co.id	+6221 2854 8302
Wahyudi Budiyo	Dealer	wahyudi.budiyo@samuel.co.id	+6221 2854 8152

Fixed Income Sales Team			
R. Virine Tresna Sundari	Head of Fixed Income	virine.sundari@samuel.co.id	+6221 2854 8170
Rudianto Nugroho	Fixed Income Sales	rudianto.nugroho@samuel.co.id	+6221 2854 8306
Sany Rizal Keliobas	Fixed Income Sales	sany.rizal@samuel.co.id	+6221 2854 8337
Safitri	Fixed Income Sales	safitri@samuel.co.id	+6221 2854 8376
Khairanni	Fixed Income Sales	khairanni@samuel.co.id	+6221 28548104
Nadya Attahira	Fixed Income Sales	nadya.attahira@samuel.co.id	+6221 2854 8305

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