Indonesia Market Color

A member of MUFG, a global financial group

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FX & Interest Rate

Light at the end of the tunnel. The Fed has become less hawkish in the Feb-24 FOMC meeting, signaling that its policy rate has reached its peak. It left the FFR unchanged, after considering that the risks to achieving their inflation and employment targets are becoming more balanced. Recent inflation data has fallen below the Fed's expectations from Dec-23 meeting. In its projection, the Fed expected the core PCE inflation to close the year at 3.2% yoy, while the actual data was released at 2.9% yoy. However, Fed members appear to believe that a rate cut in March is unlikely. More data will probably be required to convince FOMC members that inflation will return to their target of 2%.

The persistence of global disinflationary trend continues. Despite the escalation of the Red Sea conflict, the rise in freight costs and oil prices remains at manageable levels. As global demand weakens, re-acceleration of global inflation is unlikely at this point. China, as a global manufacturing center, experienced negative growth in exports last year for the first time in five years, highlighting the weakness in global demand. Additionally, the global supply chain pressure index fell to -0.15 in Dec-23, indicating a much better state compared to 2021-2022 when disruptions occurred after economic reopening, inducing inflationary pressure.

Low domestic inflation, despite index rebase. Inflation remained steady at 2.6% yoy in Jan-24, as core components moderated to 1.7% yoy, down from 1.8% yoy the previous month. The prolonged slowdown in core inflation was primarily attributed to supply-side factors, related to a substantial moderation in input costs. The statistics office has rebased the consumer price index from the 2018 living cost survey to 2022. This change aims to accommodate shifts in consumption behavior post-COVID and expand regional coverage.

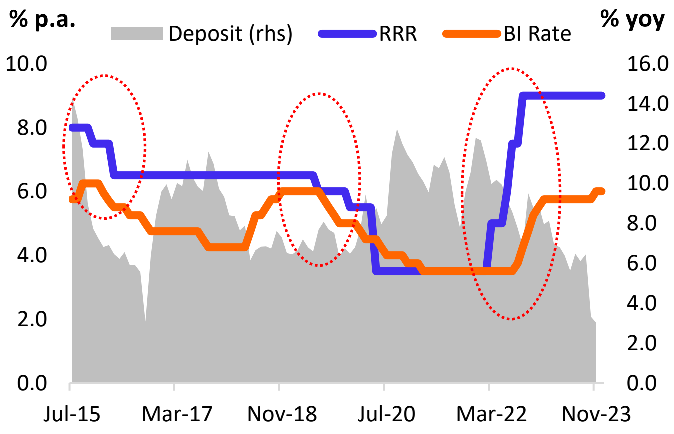
Chart 1. Consumer Price Index Rebase: Summary

	Index 2018	Index 2022
Total Commodities	835	847
Share of Consumption Value		
Food	34%	38%
Non-Food	66%	62%
Regional Coverage (Urban & Rural)	90	150

Top 5 larget increase in weight	Top 5 largest decrease in weight
Internet subscription fee	Rental
Electricity tarrif	House contract
Fuel	Mobile phone credit
Cooking Oil	Maid/Helper
Machine-rolled cigarette	Craftsman

Source: Indonesian Bureau of Statistics

Chart 2. Reserve Requirement Ratio & BI Rate



Source: Bank Indonesia

The current index will be more sensitive to food and energy commodity prices, given their increased weights. Despite the change in the base year, we maintain our view on 2024 inflation at 2.9% yoy. Risk factors related to the escalation of geopolitical conflicts in the Middle East remain benign, while input cost growth has continued to moderate since 2Q23.

Waiting for a signal from BI. With stable low inflation domestically, the clearer path of US monetary policy normalization has provided support for the appreciation of IDR this year. However, uncertainties remain high, driven by geopolitical tensions and elections in more than 40 countries worldwide. Therefore, BI is likely to await the Fed's first rate cut before considering adjustments to its own policy rate. In the meantime, BI might opt for a liquidity-focused approach, especially during the current period of liquidity normalization (similar to the 2015 case). In the last three policy rate adjustment cycles, a liquidity approach through Reserve Requirement Ratio (RRR) was taken prior to the policy rate adjustment.

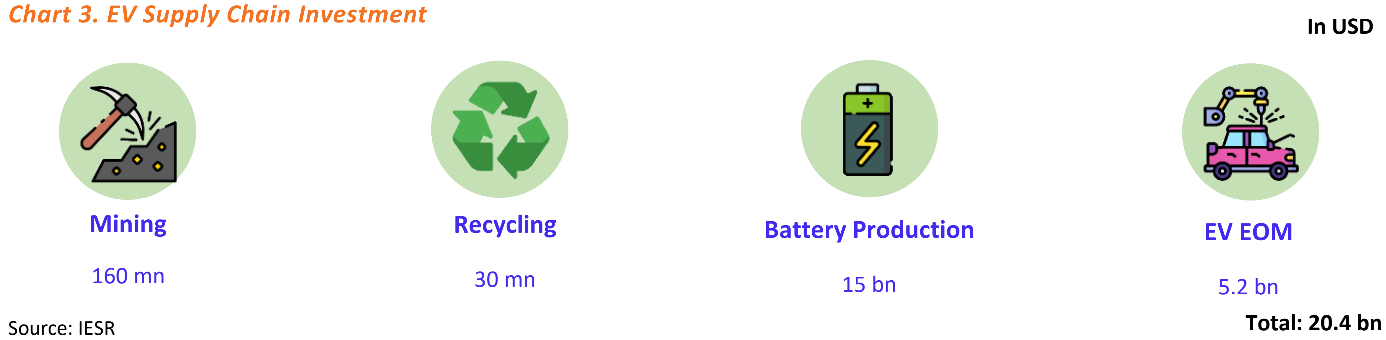
Automotive Industry

The adoption of electric vehicles (EVs) has seen a steady rise in recent years, 4W EV surging by 65.2% yoy in 2023. Recognizing the strategic importance of an integrated supply chain, the government is actively encouraging investment across all stages, from refining raw materials to manufacturing EVs within the country. This initiative has successfully attracted over USD 20 bn in investments from major multinational companies, with notable contributions from Korean firms LG Energy Solution and Hyundai, who invested USD 1.1 bn in the groundbreaking PT HKML Battery Indonesia.

In a significant development, Chinese investors have entered the scene, establishing themselves as formidable contenders in Indonesia’s EV industry, thereby intensifying market competition. BYD, a global leader in EVs, has garnered considerable attention. Outperforming even Tesla, BYD sold more EVs in 4Q23. BYD recently injected USD 1.3 bn to establish an EV plant with a substantial capacity of 150,000 units in Indonesia. What finally convinced BYD? Firstly, it aims to broaden its market reach, building on its successful market share gains in Singapore and Thailand. Secondly, the diminishing demand from China has prompted manufacturers like BYD to seek new customer bases overseas. Recognizing Indonesia as Southeast Asia’s largest economy, BYD’s investment is not only a strategic move but also underscores the effectiveness of the government initiatives, including grants and tax breaks for automakers dealing with imported EVs, in enticing foreign investors to contribute to the burgeoning EV industry.

To further augment Indonesia’s position as a key player in the evolving EV industry, policymakers should implement more measures related to supply chain. *Chart 3* shows that investment in the EV Original Equipment Manufacturer (OEM) is still behind mining and battery production. Therefore, the government should seize the opportunity by expediting permits to setting up manufacturing facilities and encourage sustainable supply chain. These measures will enhance the industry’s resilience and reputation on the international stage.

Chart 3. EV Supply Chain Investment



Source: IESR

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Indonesia's Selected Economic Indicators

	2021	2022	2023E	2024E
National Accounts				
Real GDP (% y-o-y)	3.7	5.3	5.2	4.9
Domestic demand ex. inventory (% y-o-y)	2.8	3.8	5.1	5.0
Real Consumption: Private (% y-o-y)	2.0	4.9	5.1	5.0
Real Gross Fixed Capital Formation (% y-o-y)	3.8	3.9	4.5	4.2
GDP (USD bn) — nominal	1,186	1,391	1,472	1,553
GDP per capita (USD) — nominal	4,350	4,783	5,256	5,475
Open Unemployment Rate (%)*	6.0	5.9	5.3	5.0
External Sector				
Exports (% y-o-y, BoP Basis)	42.5	25.6	8.5	-3.6%
Imports (% y-o-y, BoP Basis)	39.9	21.6	17.2	-1.6%
Trade balance (USD bn, BoP Basis)	43.8	62.7	47.9	40.9
Current account (% of GDP)	0.3	1.0	-0.4	-1.0
Central government debt (% of GDP)	41.0	39.6	37.3	36.8
International Reserves –IRFCL (USD bn)*	144.9	137.2	146.4	142.5
Reserve Cover (Months of imports & ext. debt)*	7.8	5.9	6.5	6.4
Currency/USD (Year-end)*	14,253	15,573	15,399	15,120
Currency/USD (Average)*	14,296	14,855	15,244	14,901
Other				
BI 7-Day Reverse Repo rate (% year end)*	3.50	5.50	6.00	5.50
Consumer prices (% year end)*	1.87	5.51	2.61	2.89
Fiscal balance (% of GDP; FY)*	-4.65	-2.38	-1.65	-2.00
S&P's Rating – FCY*	BBB	BBB	BBB	BBB

Source: CEIC, E= Danamon Estimates, *actual 2023

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