

Inflation and BI Rate Outlook

1 October 2009

Indonesian inflation accelerated faster than expected last month at 1.05% mom or 2.83% yoy. The festive season of Ramadan normally witnessed higher consumption and thus, higher prices that might explain significantly the faster-than-expected inflationary pressures in September. The steady core inflation at 4.86% yoy in September vis-a-vis 4.84% proves the stability of the key component of inflation drivers. The food and transportation components are likely to be the main driving factors for last month's inflation rate. The commodity prices have generally been quite stable despite its uptrend bias, so the contribution might be significantly lower compared to that in 2008 (H2 notably) whereby inflation grew at double-digit. The Reuters-Jefferies index climbed 14.24% since its lowest point in late February this year and still approximately 18% from last year's high. Stronger rupiah has contributed to lower imported inflation recently, and going forward, we might see reasonably low and stable inflation rates until at least the first quarter of next year, barring any unforeseen circumstance that oil and other commodity prices were to spike sooner rather than later.

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On the international trade front, Indonesian exports contracted less than expected at -15.4% yoy, suggesting export recovery might be underway in tandem with pickups in the global economic condition. Imports also contracted less than expected at -24.6% yoy, rendering higher than expected trade balance in August at USD1.25bn vis-à-vis USD1.02bn expected previously.

At this point in time, the monetary authority of Indonesia is likely to keep rates unchanged and possibly start to monitor the development of commodity prices closely before embarking on rate hikes. BI will probably be the forerunner of rate hikes in Asia, along with other central banks like the Bank of Korea. BI might start raising rates around the end of Q1 2010, likely to be grounded on a possibility of the return of higher inflationary pressures as global liquidity condition remains flushed, as well as domestically, and might create an environment of cost-push inflation while the return of that in the demand-pull is likely to be lagging. Secondly, commodity prices are also expected to rise as well, notably the oil and CPO prices with the latter potentially caused by El Nino that is forecast to come striking by the end of this year. In anticipation, the government might raise retail fuel prices next year if the average crude oil prices rise 10% or more from the current forecast of USD65/bbl, according to the country's Finance Minister Sri Mulyani yesterday. Our forecast for the upcoming BI rate is as follows.

Oct. 5: 6.50%
End 4Q-2009: 6.50%
End 1Q-2010: 6.75%
End 2Q-2010: 7.25%
End 3Q-2010: 7.75%
End 4Q-2010: 8.50%

The recently approved macroeconomic assumption for the 2010 budget projects growth at 5.5%, inflation at 5.0%, 3-month SBI rate at 6.5%, USD-IDR at 10,000. Our 2010 forecast stands at 4.80% for growth and 5.5% for inflation.

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