Session 2 – Managing Inflationary and Balance of Payment Pressures

Presentation

The Experience of Indonesia

By

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Managing Inflationary and Balance of Payment Pressures: The Experience of Indonesia

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ESCAP-Bank Indonesia High-level Policy Dialogue
Macroeconomic Policies for Sustainable Growth with Equity
15-17 May 2013, Yogyakarta
Outline

The Global Economy
- Global Economic Outlook

Indonesia’s Economy
- Overview
- The Resiliency of Economic Growth
- The Risk of Balance of Payment, Exchange Rate and Inflation

Bank Indonesia’s Policy
- Policy Mix in 2010-2012
- Policy Directions in 2013
The Global Economy
Global Economic Outlook

Global growth in 2013 is not expected to be as high as earlier predictions, while for 2014 is predicted to improve gradually.

- Consensus Forecast predicts the global economy in 2012 grew 3.12% (yoy), down from the previous month at 3.16% (yoy). For the year 2013, the world economy is expected to grow 3.41% (yoy).
- World Bank Global Economic Prospect (GEP) predicted world economic growth of 3.4% (yoy) and 3.9% (yoy) in 2013 and 2014.
The Global Economy

**U.S growth is expected to be held back by fiscal constraints, although there are some indication of improvements in its consumption and production.**

- U.S. Economic indicators improved, supported by strong consumption and industry activity (PMI Manufacture) still in expanding phase.
- European economy predicted still contracted according to fiscal austerity policies by several Eurozone countries.
- Industry as the Japanese economic engine reflected a positive indications driven by improved export and domestic confidence optimism.
- China production activity increased following the increase in exports during Jan-Feb 2013.

**U.S. PMI Manufacture & Services**

**China PMI Manufacture & Services**

**U.S Payroll and Unemployment Rate**
Indonesia’s Economy
Overview Indonesia’s Economy

- **Indonesian economy remains strong with increasing macroeconomic risk.**
- **On the external side,** pressure in current account deficit is estimated to continue due to increasing domestic demand and fuel consumption amid slow recovery in export commodity prices.
- **Inflationary pressure remain high in March 2013 driven by rose in volatile foods prices pressure,** although decelerated in April.
- **During first quarter of 2013 depreciation pressure on rupiah continued at moderate level.**
Domestic Economy: Demand Side

Indonesia's economic growth remains sound, although moderated...

- Indonesia's economy is still showing a good performance, even though there are indications of growth moderation since Q4-2012 in line with global economic slowing down.
- Private consumption is still resilient
- Investment remains strong albeit moderated.
- Export volume expanded further to 3.4% yoy from 0.5% in 4Q12, while import decelerated.

<table>
<thead>
<tr>
<th>Component</th>
<th>2011</th>
<th>2012</th>
<th>2012</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Consumption Expenditure</td>
<td>4.7</td>
<td>4.9</td>
<td>5.2</td>
<td>5.6</td>
<td>5.3</td>
</tr>
<tr>
<td>Government Expenditure</td>
<td>3.2</td>
<td>6.4</td>
<td>8.6</td>
<td>(2.8)</td>
<td>(3.3)</td>
</tr>
<tr>
<td>Gross Fixed Capital Formation</td>
<td>8.8</td>
<td>10.0</td>
<td>12.5</td>
<td>9.8</td>
<td>7.3</td>
</tr>
<tr>
<td>Export of Goods and Services</td>
<td>13.6</td>
<td>8.2</td>
<td>2.6</td>
<td>(2.6)</td>
<td>0.5</td>
</tr>
<tr>
<td>Import of Goods and Services</td>
<td>13.3</td>
<td>8.9</td>
<td>11.3</td>
<td>(0.2)</td>
<td>6.8</td>
</tr>
<tr>
<td>Gross Domestic Product</td>
<td>6.5</td>
<td>6.3</td>
<td>6.4</td>
<td>6.2</td>
<td>6.1</td>
</tr>
</tbody>
</table>

Sources: BPS
From sectoral side, the main contributor of growth is from construction, trade, transport & telecommunication, as well as manufacturing.

<table>
<thead>
<tr>
<th>Component</th>
<th>2011</th>
<th>2012</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>I</td>
<td>II</td>
<td>III</td>
<td>IV</td>
</tr>
<tr>
<td>Agriculture</td>
<td>3.4</td>
<td>4.3</td>
<td>4.0</td>
<td>5.3</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>1.4</td>
<td>2.5</td>
<td>3.3</td>
<td>(0.3)</td>
</tr>
<tr>
<td>Manufacturing Industries</td>
<td>6.1</td>
<td>5.5</td>
<td>5.2</td>
<td>5.9</td>
</tr>
<tr>
<td>Electricity, Gas and Water Supply</td>
<td>4.8</td>
<td>5.7</td>
<td>6.5</td>
<td>6.1</td>
</tr>
<tr>
<td>Construction</td>
<td>6.6</td>
<td>7.2</td>
<td>7.3</td>
<td>7.6</td>
</tr>
<tr>
<td>Trade, Hotel &amp; Restaurant</td>
<td>9.2</td>
<td>8.7</td>
<td>8.7</td>
<td>7.2</td>
</tr>
<tr>
<td>Transport and Communication</td>
<td>10.7</td>
<td>10.0</td>
<td>9.9</td>
<td>10.4</td>
</tr>
<tr>
<td>Financial, Ownership and Business</td>
<td>6.8</td>
<td>6.4</td>
<td>7.1</td>
<td>7.5</td>
</tr>
<tr>
<td>Services</td>
<td>6.7</td>
<td>5.5</td>
<td>5.8</td>
<td>4.5</td>
</tr>
<tr>
<td><strong>Gross Domestic Product</strong></td>
<td><strong>6.5</strong></td>
<td><strong>6.3</strong></td>
<td><strong>6.4</strong></td>
<td><strong>6.2</strong></td>
</tr>
</tbody>
</table>

Sources: BPS
Household consumption is expected to grow positively, even though weakening...

- Consumption still grew, however slowing down.
- Consumers remain positively confident.
Unscathed by the global financial crisis, Indonesia’s annual GNI/person has continued to rise and reached $2500 in 2010.

The country is on track to become a higher middle income country.

Concurrent with this positive development, Indonesia’s middle class is on the rise.

Reasons for the Resiliency of Consumption:

- Rising middle class
- Rising productive age
In the late 1980s, 9 out of 10 Indonesians were poor or near poor with consumption expenditure less than $2 per person per day.

In the past 10 years, the proportion of the underprivileged has been declining significantly.

In end of 2010, at least 5 out of 10 Indonesians can be categorized as middle class.

A good size of core and upper middle class is emerging, with consumption expenditure between $4 - $20 / person / day).
As the most populous nation and the largest economy in Southeast Asia, the rise of Indonesia’s middle class contributes significantly to the expansion of domestic consumption.

### Table: Middle Class (% of Population)

<table>
<thead>
<tr>
<th>Survey Year</th>
<th>Lower MC ($2-$4)</th>
<th>Core MC ($4-$10)</th>
<th>Upper MC ($10-$20)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>15.6</td>
<td>37.2</td>
<td>27.5</td>
<td>80.4</td>
</tr>
<tr>
<td>Thailand</td>
<td>31.3</td>
<td>46.2</td>
<td>13.6</td>
<td>91.0</td>
</tr>
<tr>
<td>Filipina</td>
<td>33.7</td>
<td>20.3</td>
<td>3.6</td>
<td>57.7</td>
</tr>
<tr>
<td>Vietnam</td>
<td>39.8</td>
<td>15.1</td>
<td>1.7</td>
<td>56.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>37.3</td>
<td>15.0</td>
<td>1.6</td>
<td>53.9</td>
</tr>
</tbody>
</table>

*Source: PovcalNet - The World Bank*
The Expanding Middle Class Market

The rise of Indonesian middle class is happening both in rural and urban areas. Fueled by young (productive age) consumers, the expanding middle class market has dominated the market for consumer goods and services.
**Investment**

**Investment in first quarter 2013 is forecasted to grow even though moderated.**

- The increase is supported by growth in building investment indicated from steady growth cement sales.
- Business Survey (SKDU): Investment is expected to remain high in 2013 and mainly in form of new investments.
- Decreasing import of capital goods in February 2013, mainly from imports of machinery and transport equipment for industry, indicates a slower growth for non-building investments.

**Investment Realization and Plan - SKDU**

**Machinery Investment & Indicator**

**Sources:** Business Activity Survey DSM, BPS

Sources: BPS, CEIC, Buletin Eksim-DSM, proceed.
Export and Import

Expectation of global economy recovery amplify potential growth of export

- Positive signals of export increase have been seen in the elevation of world trade volume accompanied by moderate growth in commodity prices.
- Several Indonesia's main export destination is expected to chart higher growth compared to last year thereby encouraging the demand for Indonesian exports.
- Imports decelerated.
Indonesia’s Balance of Payments (BoP) Performance

Indonesia’s Balance of Payments (BoP) Performance in Q1 and Q2 2013 is expected to encounter a decline in deficit in line with improvement in capital and financial account.

- The improvement in the capital and financial account is mainly driven by increasing portfolio investment in line with strong Indonesia's economic fundamentals and accomodative global economic policy.
- However, the current account deficit is expected to increase primarily due to import which is still quite high, related to the high fuel consumption.
- Reserves at the end first quarter in 2013 reached 104.8 billion U.S. dollars, equivalent to 5.7 months of imports and goverment external debt.

<table>
<thead>
<tr>
<th>ITEMS</th>
<th>2011</th>
<th>2012</th>
<th>Q1*</th>
<th>Q2*</th>
<th>Q3*</th>
<th>Q4**</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Current Account</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. Goods</td>
<td>1,685</td>
<td>-3,105</td>
<td>-7,979</td>
<td>-5,336</td>
<td>-7,763</td>
<td>-24,183</td>
</tr>
<tr>
<td>-Exports</td>
<td>34,783</td>
<td>3,810</td>
<td>818</td>
<td>3,198</td>
<td>591</td>
<td>8,417</td>
</tr>
<tr>
<td>-Imports</td>
<td>200,788</td>
<td>48,253</td>
<td>47,338</td>
<td>45,549</td>
<td>46,706</td>
<td>188,146</td>
</tr>
<tr>
<td>B. Services</td>
<td>-10,632</td>
<td>-2,075</td>
<td>-2,893</td>
<td>-2,480</td>
<td>-3,322</td>
<td>-10,770</td>
</tr>
<tr>
<td>C. Income</td>
<td>-26,676</td>
<td>-5,898</td>
<td>-6,801</td>
<td>-6,915</td>
<td>-6,225</td>
<td>-25,839</td>
</tr>
<tr>
<td>D. Current transfers</td>
<td>4,211</td>
<td>1,058</td>
<td>898</td>
<td>861</td>
<td>1,193</td>
<td>4,009</td>
</tr>
<tr>
<td>II. Capital and Financial Account</td>
<td>13,567</td>
<td>2,256</td>
<td>5,225</td>
<td>6.015</td>
<td>11,145</td>
<td>24,911</td>
</tr>
<tr>
<td>A. Capital account</td>
<td>33</td>
<td>6</td>
<td>3</td>
<td>8</td>
<td>22</td>
<td>37</td>
</tr>
<tr>
<td>B. Financial account</td>
<td>13,534</td>
<td>2,250</td>
<td>5,222</td>
<td>6,007</td>
<td>11,193</td>
<td>24,873</td>
</tr>
<tr>
<td>III. Total (I + II)</td>
<td>15,252</td>
<td>-850</td>
<td>-2,754</td>
<td>679</td>
<td>3,652</td>
<td>729</td>
</tr>
<tr>
<td>IV. Net Errors and Omissions</td>
<td>-3,395</td>
<td>-184</td>
<td>-57</td>
<td>155</td>
<td>-476</td>
<td>-563</td>
</tr>
<tr>
<td>V. Overall Balance (III+IV)</td>
<td>11,857</td>
<td>-1,034</td>
<td>-2,811</td>
<td>834</td>
<td>3,176</td>
<td>965</td>
</tr>
<tr>
<td>VI. Reverses and related items</td>
<td>-11,857</td>
<td>1,034</td>
<td>2,811</td>
<td>-834</td>
<td>-3,176</td>
<td>-965</td>
</tr>
<tr>
<td>Memorandum:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Reserve Assets Position</td>
<td>110,123</td>
<td>110,493</td>
<td>106,502</td>
<td>110,172</td>
<td>112,781</td>
<td>112,781</td>
</tr>
<tr>
<td>- In months of imports &amp; official debt repayment</td>
<td>6.5</td>
<td>6.2</td>
<td>5.8</td>
<td>6.1</td>
<td>6.1</td>
<td>6.1</td>
</tr>
<tr>
<td>- Current Account (% GDP)</td>
<td>0.2</td>
<td>-1.4</td>
<td>-3.6</td>
<td>-2.4</td>
<td>-3.6</td>
<td>-2.8</td>
</tr>
<tr>
<td>- Debt Service Ratio (%)</td>
<td>21.3</td>
<td>30.3</td>
<td>36.7</td>
<td>34.9</td>
<td>39.5</td>
<td>35.3</td>
</tr>
</tbody>
</table>

Notes:
1) In terms of free-on-board (fob)
2) Excludes reserves and related items
3) Negative represents surplus and positive represents deficit.
Pressure on balance of trade is expected to increase.

- Increase in the deficit is associated with low trade balance surplus and the high deficit on services and income balance.
- The low trade balance surplus is the impact from slow global economic recovery and limited growth of commodity prices amid strong domestic economic expansion.
- Meanwhile, the high activity of imports and capital inflows push the higher deficit in services and income balance.
The capital and financial account is expected to improve in Q1 and Q2 2013.

- FDI inflows continue due to positive domestic economy prospect and large market potential.
- Foreign investment in portfolio investment continued to grow in first quarter of 2013 due to attractive yield in the domestic financial market.
Depreciation pressure on rupiah tend to moderate..

- Depreciation pressure is mainly due to trade balance deficit condition and net demand in domestic forex market.
- Depreciation pressure moderated by high capital inflows to the domestic market due to attractive yield in rupiah asset.
- Bank Indonesia maintains the exchange rate stability in line with its fundamentals by strengthening foreign exchange intervention mechanism and implementing foreign exchange term deposit (TD), as well as foreign exchange market deepening.
- On average, the exchange rate of rupiah depreciated 0.7% (qtq) to a level of Rp9.680 per US dollar from Rp9.613 per USD. In point-to-point, exchange rate has depreciated 0.82% (qtq) and closed at Rp9.718 per US dollar at the end of first quarter.
Rising CPI Inflation, even though showing deflation recently ...

- Trend in CPI inflation is rising, although in the last month is showing a falling rate...
- Inflation is stemmed from volatile foods ...
The stability of interbank money market reflected in steady movement at the lower band of the corridor.

- In March 2013, average O/N interbank rate was 4.17%
- In terms of risk, the perception of risk in the interbank market was still relatively maintained and below the normal average threshold. This was reflected in the spread of O/N interest rate in March 2013 still below the normal range.
- Volume of transactions in the interbank market increased in March 2013 with stable rate and maintained risk indicate a deepening of interbank money market.
Bank Indonesia’s Policy
## Policy Mix for Managing Inflationary and BoP Pressures in 2010-11

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Policy in 2010</th>
<th>Policy in 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Interest rate policy</strong></td>
<td>Keep BI Rate at 6.5%</td>
<td>Increased BI Rate 25 bps to 6.75% on February 2011, decreased to 6.50% on October, to 6% on November and subsequently fixed</td>
</tr>
<tr>
<td><strong>2. Exchange rate policy</strong></td>
<td>Decrease on Rupiah appreciation (4.6%) on 2010 compare to 2009 (14.9%)</td>
<td>Rupiah appreciation in line with regional appreciation</td>
</tr>
<tr>
<td><strong>3. Reserve accumulation</strong></td>
<td>Reserve increased from USD 66.0 bio at the end of 2009 become USD 96.2 bio at the end of 2010</td>
<td>Reserve amount USD 119.7 bio at the end June 2011, or equivalent with 6.8 months import and government foreign debt payment</td>
</tr>
</tbody>
</table>
| **4. Macroprudential policy for capital flows** | • One Month Holding Period (OMHP) policy for SBI since June 2010  
• Shifting from SBI to Term Deposit to decrease SBI supply that foreign investor can buy | • Six Month Holding Period (SMHP) policy for SBI since May 2011  
• Limitation on bank short term foreign debt max 30% from capital at the end of January 2011  
• Increasing on Foreign exchange RR from 1% became 5% (March 2011) and 8% (June 2011) |
| **5. Macroprudential policy to manage domestic liquidity** | • Strengthening monetary operation strategy through June 15, 2010 package  
• Increased primary reserve become 8% on November 2010 and LDR reserve on March 2011 | Continue to strengthen monetary operation strategy through June 15, 2010 package |
<table>
<thead>
<tr>
<th>Instrument</th>
<th>Policy in 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Interest rate policy</td>
<td>Decreased BI Rate by 25 bps to 5.75% on February 2012, and subsequently fixed</td>
</tr>
<tr>
<td>2. Exchange rate policy</td>
<td>Managing Rupiah stability in line with fundamental economy: Orderly Rp depreciation, Intervention vs Reserve</td>
</tr>
</tbody>
</table>
| 3. Macroprudential policy for capital flows    | • Implementation of export proceed & external debt proceed  
• Application of anticipatory measures to increase the supply of foreign exchange as part of the stabilization dollars (relaxation hedging period) |
| 4. Macroprudential policy to manage domestic liquidity | • Widening lower corridor of overnight interbank money market (PUAB) rate to 200 bps.  
• LTV for Housing & Motor Vehicle  
• Policy for financial market deepening & strengthen monetary operation management (forex TD) |
In 2012, BI Policy: Orderly Adjustment ....

BI's policy response should be directed to external balance, through market perception management to remain conducive, both exchange rate stability and inflation expectations.

**Policy Concerns (Risk Factors):**
- Weak global economic & reduction on Rp appreciation pressure:
  - Global economy worsened
  - High uncertainty cause financial market risk on-off

- Pressure on Rp depreciate:
  - Prospect of global economy worsened
  - Investment grade
  - Decrease on commodity prices

- Increase pressure on Rp & inflation:
  - High pressure on global economy
  - Uncertainty on fuel price policy

**Orderly External Adjustment?**
- Application of anticipatory measures to increase the supply of foreign exchange as part of the stabilization dollars (relaxation hedging period)

**Policy Flexibility (Room)?**
- Orderly Rp depreciation
- Intervention vs Reserve
- Interest rate responses
- FX Financial deepening
- Communication and Coordination

**Policy Challenges:**
- Persistence of Rp depreciation pressure?
- Domestic demand still strong, CA deficit widen
- Inflation expectation trend to fall

**Policy Response**
- Putting sand in the wheel implantation: Increase forex RR, 6MHP for SBI, Foreign Debt
- Widening lower corridor of overnight PUAB rate to 200 bps
- Implementation of export proceed & external debt proceed
- LTV for Housing & Motor Vehicle
- Policy for financial market deepening & strengthen monetary operation management (forex TD)
- Application of anticipatory measures to increase the supply of foreign exchange as part of the stabilization dollars (relaxation hedging period)
- Widen lower corridor of overnight PUAB rate to 200 bps
- Implementation of export proceed & external debt proceed
- LTV for Housing & Motor Vehicle
- Policy for financial market deepening & strengthen monetary operation management (forex TD)

**Inflation and appreciation Rp pressure:**
- Large capital inflow
- Liquidity excess
- Plan of increase fuel price
- Global financial market pressure due to decrease of US rating (6 Aug 2011)
Going forward, Bank Indonesia policy will be directed to manage domestic demand in line with efforts to maintain external balance. Bank Indonesia will continue to strengthen the policy mix through five pillars.

**5 PILARS of BANK INDONESIA POLICIES IN 2013**

**Interest rate**
- Consistent with inflation target

**Exchange Rate**
- Consistent with economic fundamental

**Macroprudential**
- Maintain the stability of the financial system and promote internal and external balance

**Communication**
- Managing Inflation Expectation

**Policy Coordination**
- Supporting macroeconomic management, particularly in strengthening the economic structure and sources of economic financing, strengthening the supply side response, as well as monitoring macro risk and crisis management
THANK YOU