

Economics

Indonesia Inflation Rises On Food Prices, With More Pressure Ahead

Highlights

- **Current inflation edged higher in Sep 26 to 3.28% yoy**, driven by foodstuffs, transportation, and personal care, while core inflation eased to 2.84% on weaker domestic demand and lower global gold prices. Volatile food inflation jumped to 5.03% due to El Niño-related supply shortages in chicken, beef, chilli, and rice.
- **Near-term pressures remain contained but are expected to build**, as businesses hold off on price hikes amid tepid consumer demand and ongoing layoffs, and as subsidised fuel prices cap headline inflation. However, a strong El Niño could add 0.2-0.3ppt to headline inflation through end-26 and into early-27, with imported inflation possibly spilling over around the new year or Lebaran festivities.
- **Monetary policy faces a tightening bias**, as elevated global bond yields and declining foreign bond inflows weaken the effectiveness of BI's swap discount policy. This is expected to push BI to raise its policy rate by 25bp to 6.00% by end-26, with a further hike to 6.25% possible if the Fed raises rates again in Dec 26.

Analysis

- **Indonesia's headline inflation rose to 3.28% yoy in Sep 26**, up from 3.19% the previous month, closely in line with the market expectation of 3.30%. The increase was attributed to higher prices for foodstuffs, transportation, and personal care.
- **Core inflation declined from 2.92% to 2.84%, driven by lower global gold prices and weaker domestic demand.** Administered inflation fell from 3.32% yoy to 3.25% yoy due to a decline in airfare ticket prices. Volatile food inflation increased significantly from 4.06% to 5.03%, caused by higher prices for chicken meat, beef, chilli, and rice amid the El Niño weather phenomenon.
- **On a monthly basis, inflation slightly rose 0.30% mom** (from 0.21% in Aug 26) due to higher food prices. Meanwhile, monthly inflation for consumer-related components such as transportation and lifestyle goods declined.
- **Financial market reaction was relatively subdued** as global factors took centre stage. The 10-year government bond yield inched up to 7.13%, and the rupiah weakened to 17,965 to the US dollar due to the recent hike in the US Treasury 10-year yield, which surged to 5.32%, its highest since 2000.

Outlook

- **As anticipated, we forecast Sep 26 inflation at 3.32% yoy** (0.33% mom) due to rising foodstuff prices. Until now, inflationary pressures have been relatively moderate. This was also supported by the government's decision to maintain subsidised gasoline prices despite high global oil prices, which again breached US\$100 per barrel. However, the government's decision is increasingly precarious, as it will endanger the fiscal deficit, which is rising towards the legal 3% limit.
- **Furthermore, there is little evidence of rising imported inflation due to rupiah depreciation (6.79% ytd).** This may be because businesses remain reluctant to raise prices, as consumer demand remains tepid and cautious amid continuing layoffs. This is despite wholesale price index inflation accelerating to 6.76% in Sep 26.
- **Looking ahead, we think inflationary pressures may gradually build from this point**, though the pace could remain moderate in the near term. The intensifying El Niño effect has caused a significant decline in the supply of key foodstuffs, importantly red chillies and red onions, which are staples across the archipelago. Further analysis shows that an especially strong El

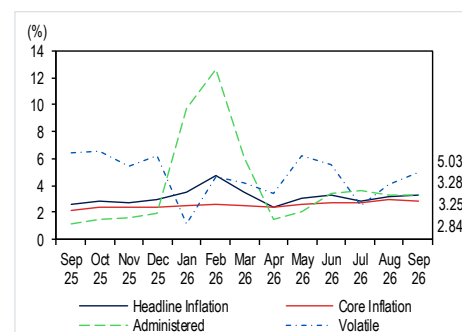
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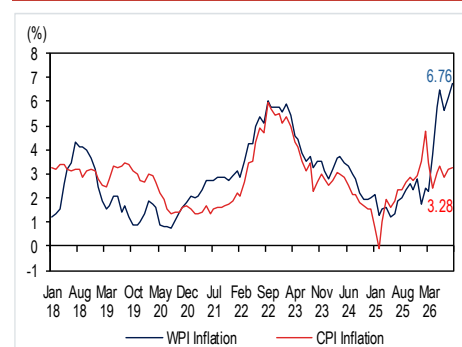
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Indonesia Yearly Headline Inflation



Source: BPS

Indonesia Wholesale Price Index And Consumer Price Index Inflation



Source: BPS

Niño could add 0.2-0.3 ppt to headline inflation for Oct-Dec 26, with some further increase possible into early-27. This could be further compounded by pressures from imported inflation, which may eventually spill over to CPI inflation, probably at the start of the new year or nearing the Lebaran festivities.

- **On the monetary policy front, the worsening global bond crisis and elevated bond yields may soon compel BI to tighten monetary policy through a rise in SRBI yields.** This is because declining foreign inflows into the bond market have reduced the effectiveness of BI's swap discount policy, limiting its ability to attract and retain foreign capital. In the end, we think this will push the central bank towards increasing its BI rate by 25bp to 6.00% by the end of this year. There is also a possibility that the central bank may have to increase it to 6.25% if the Fed raises its rate by another 25bp in Dec 26.

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