

## January 2008

### CPI AND SBI OUTLOOK

#### January 2008 Inflation Outlook: Unstable Rice Prices!

- ❑ High rice prices pushed up the consumer price index (CPI) by 1.10% in December 2007. As such, the YoY (year-on-year) inflation rate fell slightly from 6.71% in November to 6.59% in December.
- ❑ Looking ahead, rice prices are expected to put upward pressures on inflation in January. Furthermore, the flooding in parts of the country shall put some additional pressure on inflation in the first two months of 2008.
- ❑ Against this backdrop, the Indonesian central bank is not likely to cut interest rates in the first quarter of 2008.

#### DRI Forecast for January 2008

<b>Inflation</b>	
MoM (%)	0.84
YoY (%)	6.37

<b>SBI</b>	
End of period (% p.a)	8.00

#### Forecast for 2008

Inflation (%)	6.13
SBI (% p.a)	7.50

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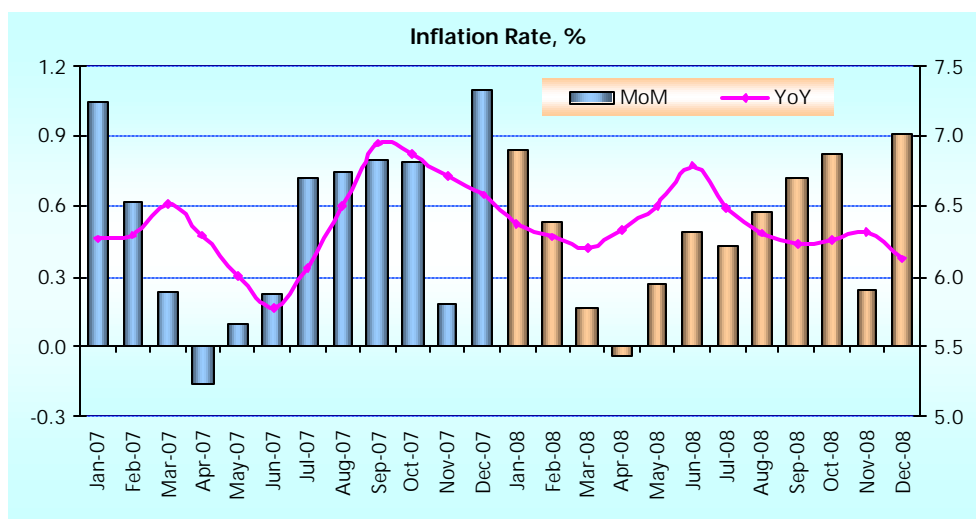
## January 2008 Inflation Outlook: Unstable Rice Prices!

In December 2007, the consumer price index (CPI) shot up 1.10% MoM (month-on-month), after a 0.18% MoM rise in November. As such, the YoY (year-on-year) inflation rate fell slightly from 6.71% in November to 6.59% in December.

Prices rose in all components of the CPI. The largest increase was seen in the Foodstuffs component (up 2.47% MoM), followed by the clothing component (up 0.99% MoM), the housing component (up by 0.63% MoM), the processed foods component (up 0.91%), the medical care component (up 0.41% MoM), the transportation component (up 0.22% MoM), and the education component (up 0.12% MoM).

The December inflation figure was higher than we had expected. We knew that seasonality factors (Christmas and New Year) would push up the price of rice in December. Nonetheless, we did not expect foodstuff prices (especially rice prices) to increase as sharply as they did. In the previous year, the price of rice climbed higher due to the long dry season that delayed rice planting and led to rumors of rice scarcity. Also, the government agency responsible for maintaining the sustainability of the rice supply (Bulog) was apparently ill prepared to deal with the problem. Furthermore, rice imports could not be conducted in a timely manner due to the lengthy debate over whether such a policy would hurt the country's rice farmers.

This year, however, a delay in the rice planting season is not likely to occur given that the rainy season seems to have arrived promptly. Furthermore, Bulog is now better prepared to tackle the issue of rice scarcity, and has already imported rice early enough. As such, we had not expected rice prices to increase as much as they did. Indeed, our month-on-month inflation forecast for December was around 0.6 percent. Nevertheless, the flooding that has afflicted certain parts of the country since December has triggered speculation of rice scarcity again. Too much water in the paddy fields is feared to lead to poor harvests in the upcoming months. As such, rice prices rose sharply in December.



Against this backdrop, rice prices rose significantly in December. And the increase in rice prices was used by sellers as an excuse to increase the selling price of other foodstuffs as well. And since the increase in prices of foodstuffs means higher costs for the prepared foods industry, producers of prepared foods passed on the increase in production costs to consumers.

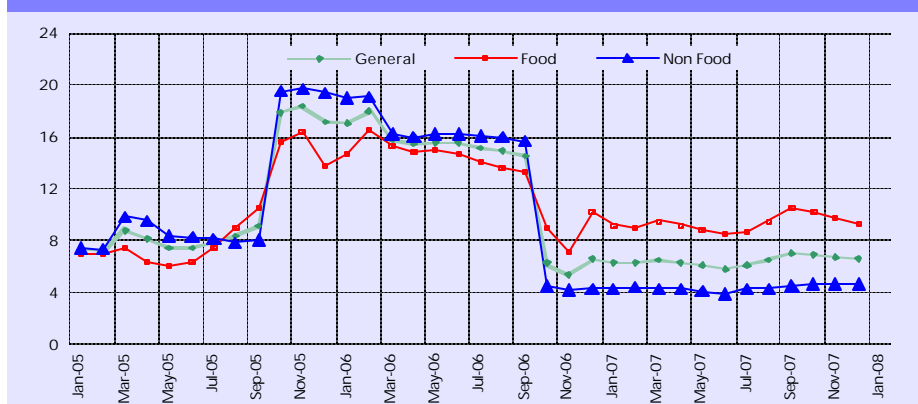
Looking ahead, we still expect seasonality factors to put upward pressures on prices in January. It seems that the government has not yet found an effective way to reduce the sharp rice price variations between the harvesting and planting seasons. Furthermore, the flooding in parts of the country shall put some additional pressure on inflation in the first two months of 2008. Nevertheless, we expect the monthly inflation figure in January to be lower than in December 2007.

Against this backdrop, we predict inflation in January 2008 to reach 0.84% M-o-M. This will push down the YoY inflation rate to 6.37%.

The higher than expected inflation in December will slightly alter the long-term inflation trend. Initially, we had believed that the long-term inflation trend in Indonesia was falling, and that inflation could easily fall to around 5 percent. However, the significant rice price increases in December over the last two years might alter inflation expectations; that is, people might expect inflation to be significantly higher in December 2008. This would push up inflation expectations by several basis points. As such, inflation may not fall below 6 percent. For the whole of 2008, we expect inflation to reach 6.13%.

The seasonality impact on inflation will prevent the Indonesian central bank from cutting interest rates in the first quarter of 2008. In April, however, the Central Bank may have room again to lower its benchmark rate further if inflation is benign (on the back of the harvesting season). As such, we expect the Indonesian Central Bank to lower its benchmark rate to around 7.5 percent by year-end.

GRAPH 1 THE YOY INFLATION RATE DECREASED TO 6.59% IN DECEMBER 2007



## Changes in Consumer Price Index (percent)

	M-on-M changes			Y-on-Y changes			YTD (Jan-Dec)		
	Oct-07	Nov-07	Dec-07	Oct-07	Nov-07	Dec-07	2005	2006	2007
FOODSTUFF	1.87	0.04	2.47	12.64	11.96	11.26	13.91	12.94	11.26
PREPARED FOOD	0.51	0.43	0.91	6.67	6.63	6.41	13.71	6.36	6.41
HOUSING	0.21	0.12	0.63	5.18	4.99	4.88	13.94	4.83	4.88
CLOTHING	2.05	1.66	0.99	6.49	7.50	8.42	6.92	6.84	8.42
MEDICAL CARE	0.45	0.26	0.41	5.14	4.98	4.31	6.13	5.87	4.31
EDUCATION	0.21	0.11	0.12	8.69	8.77	8.83	8.24	8.13	8.83
TRANSPORTATION	0.47	-0.27	0.22	1.19	1.13	1.25	44.75	1.02	1.25
<b>GENERAL</b>	<b>0.79</b>	<b>0.18</b>	<b>1.10</b>	<b>6.88</b>	<b>6.71</b>	<b>6.59</b>	<b>17.11</b>	<b>6.60</b>	<b>6.59</b>
<b>Food and Non-Food</b>									
FOOD	1.31	0.20	1.84	10.16	9.74	9.26	13.82	10.14	9.26
NON-FOOD	0.47	0.17	0.49	4.55	4.55	4.58	19.38	4.32	4.58

Source : BPS

GRAPH 2 CORE INFLATION CONTRIBUTED 0.39% TO THE HEADLINE INFLATION IN DECEMBER

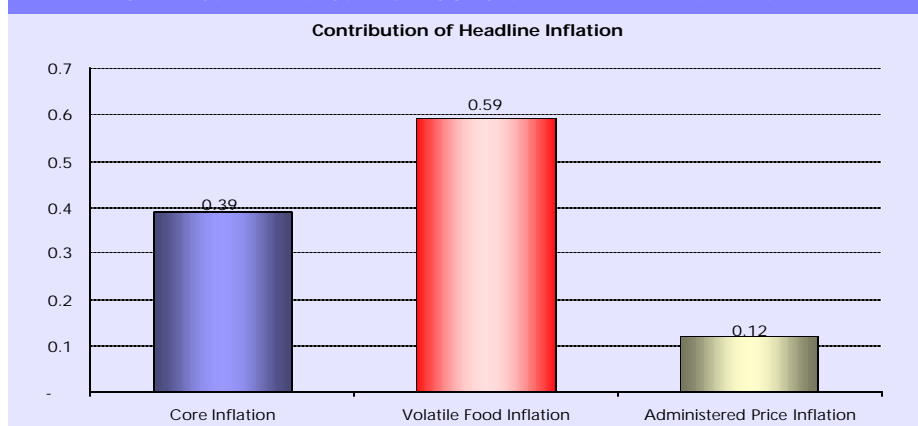


TABLE 2. DRIVERS OF PRICE CHANGES IN DECEMBER

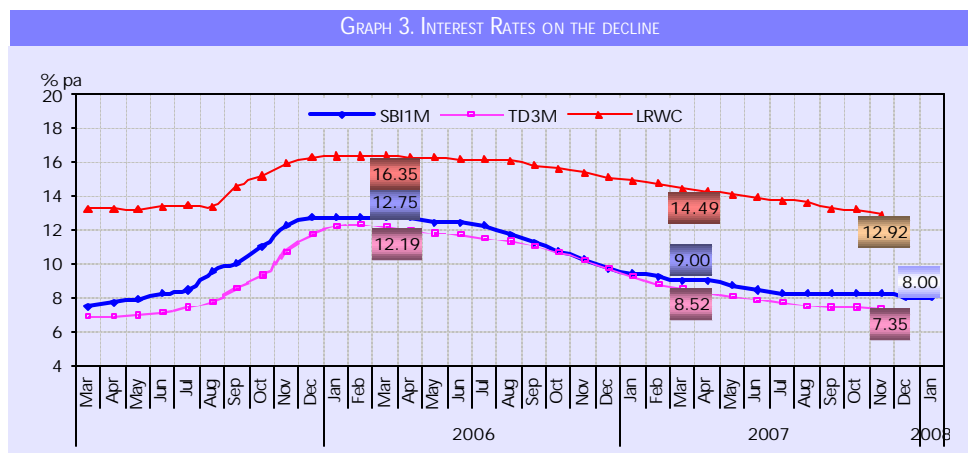
Component	Change (%)	Drivers	Contribution (%)
Foodstuffs	2.47	Shallot, rice, fresh fish, cooking oil, dry noodles instant, egg, cabbage, raw tofu, wheat flour, meat, powdered milk, long peanuts, tempe, wine, small chilli, coconut	0.67
Prepared foods, beverages and cigarettes	0.91	Clove-flavoured cigarette, noodles, white bread, biscuit, rice cake, wet cake, martabak, rice and the side dish, filtered cigarette	0.15
Housing	0.63	Kerosene, cement, craftsmen's salary, bricks, concrete rent iron, house rent fee, sand	0.16
Clothing	0.99	Gold and Jewelry	0.06
Medical care	0.41	Body treatment and cosmetic	0.01
Education, recreation and sports	0.12	Recreation cost	0.01
Transportation and communications	0.22	-	0.04
<b>General</b>			<b>1.10</b>

TABLE 3. JANUARY 2008 INFLATION FORECAST

	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08
<b>M-on-M changes</b>	1.21	1.04	0.62	0.24	-0.16	0.10	0.23	0.72	0.75	0.80	0.79	0.18	1.10	<b>0.84</b>
<b>Y-on-Y changes</b>	6.60	6.26	6.30	6.52	6.29	6.01	5.77	6.06	6.51	6.95	6.88	6.71	6.59	<b>6.37</b>
<b>Yearly*</b>	6.42	6.10	6.13	6.34	6.13	5.86	5.64	5.91	6.34	6.76	6.34	6.52	6.41	<b>6.20</b>

\* 12-month cumulative

GRAPH 3. INTEREST RATES ON THE DECLINE



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