

October 2007**CPI AND SBI OUTLOOK****October 2007 Inflation Outlook: To Remain High**

- In September 2007, the consumer price index (CPI) rose 0.80% MoM (month-on-month), after rising 0.75% MoM in August 2007. As such, the YoY (year-on-year) inflation rate rose to 6.95% in September from 6.51% in August.
- Prices rose in all components of the CPI: the foodstuffs component rose by 1.81% MoM, the education component by 1.70% MoM, the clothing component by 1.22% MoM, the processed foods component by 0.45% MoM, the medical care component by 0.44% MoM, the housing component by 0.18% MoM, and the transportation component by 0.07% MoM.
- The inflation figure in September was slightly above our expectations (we had expected inflation in September to reach only 0.62% MoM). While we had anticipated the significant increase in the education component (due to the beginning of the new academic year for universities) and in the clothing component (due to the impact of Ramadan), the increase in the foodstuffs component was greater than expected. Besides the impact of Ramadan, we also believe that hikes in toll road tariffs and surging cooking oil prices have given traders an excuse to jack up their selling prices to an excessively large degree.
- Looking ahead, we expect the month-on-month inflation figure to remain high in October. Seasonal factors are likely to continue putting upward pressures on general prices in this month. Note that prices typically rise over the Ramadan and Lebaran period due to the strong demand for foodstuffs, prepared foods, and clothing. In addition, prices in the transportation component are likely to tick up in October since transportation companies are allowed by the government to hike their fares several days prior to, as well as after, the Lebaran festivities.
- Against this backdrop, we predict that inflation will reach 0.87% MoM in October 2007, with the YoY inflation rate rising to 6.96%.
- Over the next several months the year-on-year inflation figure is likely to hover close to 7.0 percent. We still believe, however, that there is a good chance that the year-on-year inflation figure shall fall significantly in December to around 6.25%. Note that in December 2006 there was an upward shock from rice prices due to the extended dry season. Thus, if the government can anticipate rice scarcity this year (should an extended dry season take place) and import rice several months in advance, then a similar shock should be avoided. Indeed, signs are that the government has already started to import rice in various qualities several months in advance. As such, a rice price shock is not likely to occur in December. We therefore expect a rather sharp downward adjustment in the year-on-year inflation figure in December.

DRI Forecast for October 2007**Inflation**

MoM (%)	0.87
YoY (%)	6.96

SBI

End of period (% p.a)	8.25
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Forecast for 2007

Inflation (%)	6.25
SBI (% p.a)	8.25

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The Impacts on Interest Rate

❑ Limited Room for Further Cuts in the Benchmark Rate.

The rupiah has started to strengthen again on the back of increasing capital flows into the country. The year-on-year inflation figure, however, has increased over the last three months. And the year-on-year inflation figure is likely to stay at a relatively higher level over the next two months. As such, we do not expect the central bank to ease its monetary policy further given that the central bank has formally adopted an Inflation Targeting (IT) monetary policy framework. Under this framework, the central bank's sole goal is to keep inflation in check. This can be achieved by either hiking interest rates or maintaining interest rates at a relatively high level. As such, we do not expect the central bank to cut rates from their current level of 8.25% in early October.

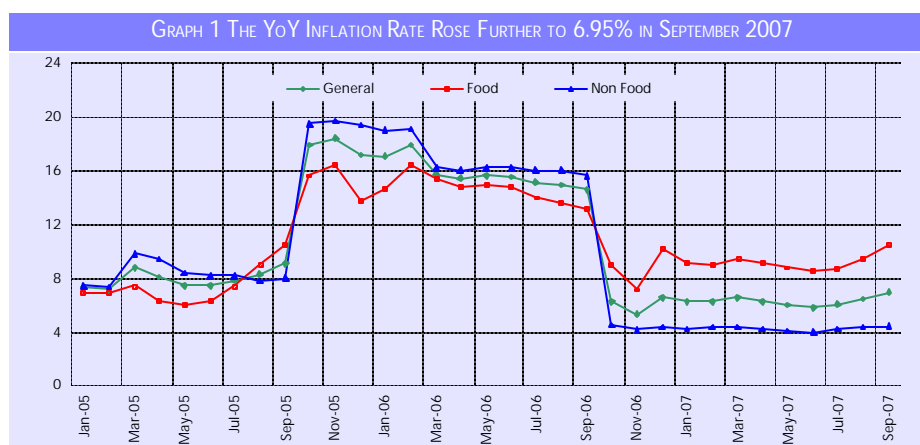
❑ The benchmark rate should stay at 8.25 percent by year-end.

With the prospect of relatively high inflation over the next two months, we do not expect the central bank to ease its monetary policy further for the rest of the year. However, the central bank may have room to ease its monetary policy further in January 2008 after the Statistical Bureau publishes the December 2007 inflation data (expected to be around 6.25 percent).

The Impact on the Capital Market

❑ Neutral-positive:

Although inflation in September is slightly higher than the market had expected, inflation is still well within the central bank's target ($6 \pm 1\%$). As such, the inflation figure should not create negative sentiment in the market.



Changes in Consumer Price Index (percent)

	M-on-M changes			Y-on-Y changes			YTD (Jan-Sep)		
	Jul-07	Aug-07	Sep-07	Jul-07	Aug-07	Sep-07	2005	2006	2007
	FOODSTUFF	1.35	0.79	1.81	10.41	11.66	12.99	5.03	6.41
PREPARED FOOD	0.40	0.48	0.45	6.34	6.47	6.82	7.04	3.96	4.38
HOUSING	0.32	0.77	0.18	4.84	5.33	5.22	4.94	3.44	3.81
CLOTHING	0.61	0.49	1.22	3.82	3.97	5.39	3.76	4.82	3.44
MEDICAL CARE	0.35	0.24	0.44	4.93	4.84	4.97	3.84	3.97	3.12
EDUCATION	2.89	3.18	1.70	10.40	8.73	8.57	6.33	7.75	8.13
TRANSPORTATION	0.05	0.04	0.07	1.08	1.10	1.18	11.77	0.66	0.82
GENERAL	0.72	0.75	0.80	6.06	6.51	6.95	6.23	4.00	4.33
Food and Non-Food									
FOOD	0.95	0.66	1.26	8.70	9.48	10.39	5.87	5.35	5.57
NON-FOOD	0.54	0.77	0.43	4.23	4.33	4.44	6.48	3.24	3.36

Source : BPS

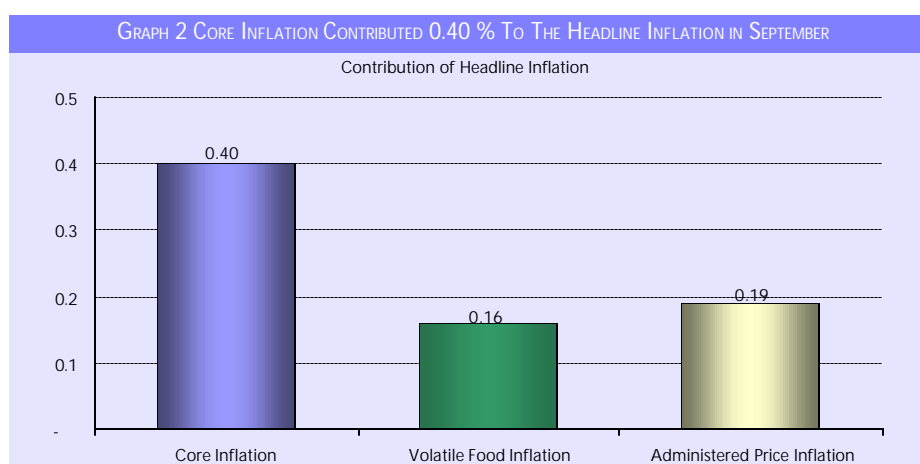


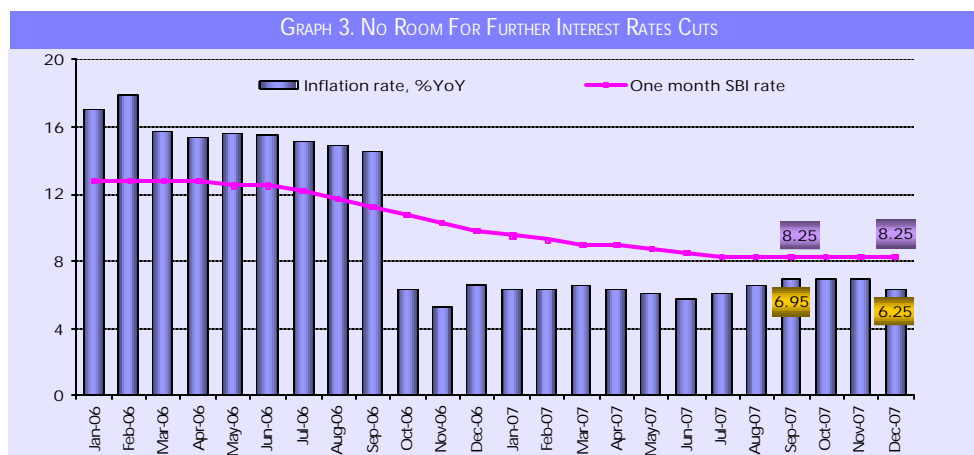
TABLE 2. DRIVERS OF PRICE CHANGES IN SEPTEMBER

Component	Change (%)	Drivers	Contribution (%)
Foodstuffs	1.81	Fish, chicken meat, chicken egg, beef, banana, coconut cooking oil, rice, soybean fermented cake	0.47
Prepared foods, beverages	0.45	Biscuit, noodle, rice with side dish, tea, clove-flavoured cigarette, filter cigarette	0.08
Housing	0.18	PAM subscribe fee, house lease fee, cement, house rental fee	0.03
Clothing	1.22	Jewelry, women's wear	0.07
Medical care	0.44	Toilet soap	0.02
Education, recreation and sports	1.70	Education fee	0.12
Transportation and communications	0.07	-	0.01
General			0.80

TABLE 3. OCTOBER 2007 INFLATION FORECAST

	Oct-06	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07
M-on-M changes	0.86	0.34	1.21	1.04	0.62	0.24	-0.16	0.10	0.23	0.72	0.75	0.80	0.87
Y-on-Y changes	6.29	5.27	6.60	6.26	6.30	6.52	6.29	6.01	5.77	6.06	6.51	6.95	6.96
Yearly*	6.13	5.16	6.42	6.10	6.13	6.34	6.13	5.86	5.64	5.91	6.34	6.76	6.75

* 12-month cumulative



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