

**Indonesia: Tenth Review Under the Extended Arrangement and Request for Waiver of Applicability—Staff Report; Staff Supplement; and Press Release on the Executive Board Discussion**

In the context of the eighth review under the extended arrangement and request for waiver of performance criteria, the following documents have been released and are included in this package:

- the staff report for the eighth review under the extended arrangement and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **August 11, 2003**, with the officials of Indonesia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on September 17, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of **October 3, 2003** updating information on recent developments.
- a Press Release summarizing the **views of the Executive Board as expressed during its October 8, 2003 discussion** of the staff report that completed the request and review.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Indonesia\*

\*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

INDONESIA

**Tenth Review Under the Extended Arrangement and  
Request for Waiver of Applicability**

Prepared by the Asia and Pacific Department  
(In consultation with other departments)

Approved by David Burton and Leslie Lipschitz

September 17, 2003

- Discussions were held in Jakarta during July 30–August 11. The mission met with Coordinating Minister for Economic Affairs Dorodjatun Kuntjoro-Jakti, Minister of Finance Boediono, Minister of State-Owned Enterprises Laksamana Sukardi, Bank Indonesia Governor Burhanuddin Abdullah, other senior officials, and parliamentarians. The mission also had discussions with academics as well as with representatives of the donor community and private sector.
- The staff team comprised Messrs. Citrin (head), Schwartz, Bingham, Wolfson, and Ms. Richter Hume (all APD), Messrs. Baldacci (FAD) and Tadesse (PDR), and Ms. Menon (assistant, APD), and was assisted by Messrs. Nellor, Khatri, and Taylor of the Fund's Jakarta office. Mr. Burton also participated in some of the discussions; Ms. Indrawati (ED) attended many of the meetings. The mission worked closely with overlapping FAD and MFD technical assistance teams, and with the World Bank and AsDB.
- The present Extended Arrangement (SDR 3.6 billion) was approved on February 4, 2000, and was extended on January 28, 2002 by an additional year, through end-2003. To date, nine reviews have been completed and a total of SDR 2.9 billion has been purchased, bringing Indonesia's obligations to the Fund to SDR 6.5 billion (Annex I and Table 1). A purchase of SDR 344 million will become available on completion of the review.
- In completing the last review (June 25, 2003), Directors commended the authorities for their continued satisfactory policy implementation, and were encouraged by the improvement in macroeconomic conditions and the economy's resilience to shocks. They underscored the importance of pursuing structural reforms to improve Indonesia's investment climate. Legal, judicial, and labor market reforms were listed as priorities, as well as further efforts to strengthen public sector governance and transparency. Directors noted that the authorities were considering to graduate from Fund financial support upon expiration of the present arrangement. They viewed the financing situation for 2004 as manageable, but underscored the importance of maintaining market confidence, which would require staying the course with fiscal consolidation efforts and pressing ahead with the unfinished reform agenda.
- As described in the attached supplementary LOI, all end-June quantitative performance criteria and indicative targets were met (LOI, Table 2). Good progress has also been made against the June structural benchmarks (Table 2). In view of the continued progress in policy implementation, the staff supports the authorities' requests for waiver of applicability for the end-September quantitative performance criteria and completion of the review.

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## EXECUTIVE SUMMARY

### Background

- **Macroeconomic performance has evolved in line with program projections, and financial market sentiment remains strong.** The financial market impact of the Marriott bombing in early August was very limited, with the stock market and exchange rate recovering quickly. Real GDP growth (year-on-year) rose to 3.8 percent in the second quarter (from 3.5 percent), driven by private consumption, with investment remaining weak. Inflation has continued to decline, standing at 6.4 percent in August.
- **The government has announced that it will not seek a successor arrangement when the current arrangement expires at end-2003.** The staff has stressed that continued sound policy implementation will be crucial to maintain investor confidence and ensure a smooth transition from exceptional financing, and as next year's general elections approach. The authorities' economic program for 2004, which focuses on ensuring macroeconomic stabilization, strengthening the financial system, and improving the investment climate, provides a potentially useful framework for policies through the election period. After the EFF expires, the authorities plan to maintain a close policy dialogue with the Fund in the context of post-program monitoring.

### Policy implementation

- **Macroeconomic policies are on track, and all end-June quantitative targets were met with margins:**
  - Interest rates have declined further, on the back of continued declines in inflation and a generally stable rupiah. However, the scope for further cuts in the period ahead is now limited. In light of the performance to date, the authorities have agreed to raise the program's NIR floor, and lower the NDA and base money ceilings.
  - Fiscal policy is on track, with the budget deficit through the first half of the year well below the program target. With revenues running below expectations, close monitoring of revenue performance in the remainder of the year would help reduce the risk of expenditure compression to meet the program's deficit target.
- **Performance against the program's structural benchmarks through June was broadly satisfactory.** All but one of the benchmarks through June have now been completed (including one benchmark carried over from April).
  - IBRA asset recoveries are on track and the bank divestment program is advancing satisfactorily, as is the development of a financial sector safety net. Progress is also being made to strengthen the decentralization framework.
  - However, the governance of state banks needs to be strengthened, as their performance is a source of concern. Progress on legal reforms and other reforms to strengthen the investment climate has also been slow.

## I. BACKGROUND AND PERFORMANCE UNDER THE PROGRAM

### A. Background

1. **Macroeconomic performance has continued to improve, but weaknesses in the investment climate are holding back a stronger recovery.** Real GDP growth of 3½–4 percent is expected this year, notwithstanding a series of external and domestic shocks, including most recently the Marriott hotel bombing in Jakarta in early August. However, growth remains below that needed to absorb new entrants into the labor force and has been sustained largely by private consumption, with investment yet to revive. The priority going forward is to enhance medium-term growth prospects by strengthening the investment climate which, in addition to addressing the security situation, will require acceleration of structural reforms to address weaknesses in public sector governance and the legal system.
2. **While the political situation remains stable, electoral politics are expected to intensify in advance of next year’s general elections.**<sup>1</sup> President Megawati was not seriously challenged during the annual session of the People’s Consultative Assembly (MPR) that concluded in early August, and she is still among the favored candidates to win the election in 2004. The government has also continued to succeed in securing parliamentary support for key reforms under the program. Nevertheless, with political maneuvering increasing, the climate for reforms could become more difficult in the coming months.
3. **As expected, the government announced in August that it would not seek a successor arrangement with the Fund after the EFF expires at end-year.** The decision was announced ahead of the MPR session, and followed a review of the authorities’ strategic options by an “exit strategy team” commissioned by the President. To help meet the challenge of maintaining market confidence as the Fund arrangement expires and the elections approach, the authorities decided that they will enter into post-program monitoring (PPM), and have issued a “White Paper” outlining their economic strategy. The staff has reiterated its support of the government’s decision, in the absence of an immediate balance of payments need, and will maintain a close policy dialogue in the context of PPM.

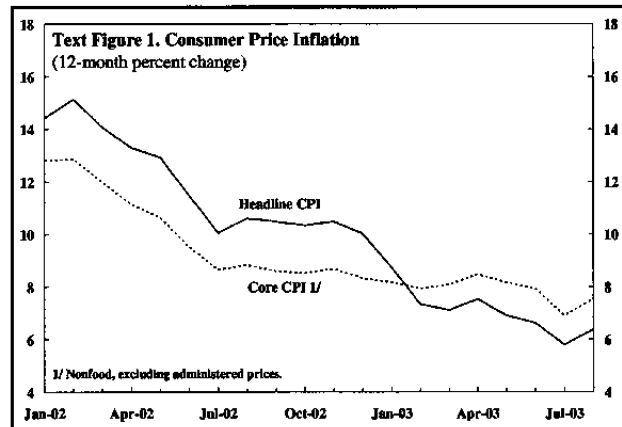
### B. Performance Under the Program and Near-Term Outlook

4. **Macroeconomic performance continues to evolve broadly in line with program projections** (Table 3 and Figures 1 and 2):
  - **The staff’s GDP growth projection of 3½ percent for 2003 remains attainable.** The second quarter GDP growth rate (year-on-year) picked up to 3.8 percent (from 3.5 percent

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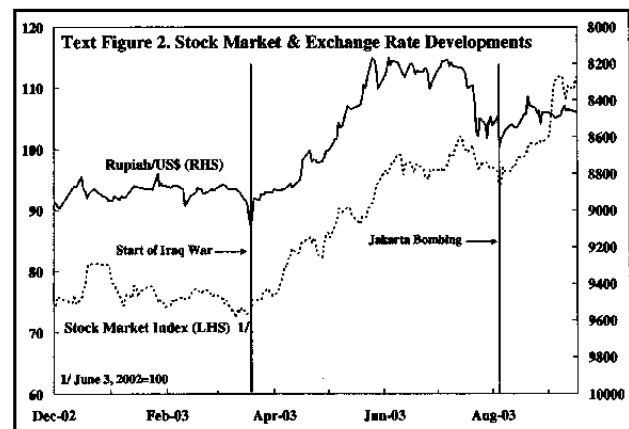
<sup>1</sup> Parliamentary and presidential elections are scheduled, respectively, for April 5 and July 5, 2004 (a runoff will be held in September if no presidential candidate wins a majority). The new government is scheduled to take office on October 20.

in the first quarter), largely on the back of a continued increase in private consumption. The authorities are continuing to target an annual growth rate of 4 percent which, while possible, will require robust growth during the remainder of the year, at a time when tourism and investment remain weak.



- Inflation has continued to fall, and is expected to end the year at around 5-6 percent** (well below the staff's projection of 8 percent at the last review) (Text Figure 1). Headline inflation (12-month) was 6.4 percent in August, a modest upturn from the previous month (reflecting mainly an increase in education fees). Core inflation, which had persisted at around 8 percent in recent months, has also now declined, to 7-7½ percent in July-August.
- Overall external developments continue to evolve favorably** (Table 4). Notwithstanding some modest intervention in late July to contain exchange market pressures related to capital outflows associated with the sell-off in the U.S. bond market, gross reserves remain comfortably above target, at about \$33½ billion. Driven largely by a continued improvement in exports, the projected current account surplus for the year has been revised upward to \$5½ billion (2.7 percent of GDP). With the over-performance of gross reserves, the end-year projection has been revised upward by \$½ billion to \$34.8 billion.

- Financial market sentiment remains strong** (Text Figure 2). The mid-July sell-off in the U.S. bond market, which resulted in a significant narrowing of the yield differential, put some pressure on Indonesian markets. The rupiah depreciated sharply (by about 5 percent against the U.S. dollar over a one-week period), but stabilized by the end of the month. The hotel bombing in early August had a surprisingly limited impact, with security concerns perhaps already priced into the market. The exchange rate recovered quickly, and the stock market has since rallied to a three-year high.



## **Recent program performance and monitoring**

5. **All end-June quantitative performance criteria were met, and structural reforms are broadly on track.** As discussed below, in light of the strong performance to date, it is proposed to revise the program's September and December performance criteria and indicative targets for NIR, NDA, and base money.<sup>2</sup> No changes are proposed to the other quantitative targets or structural benchmarks. The authorities have indicated that they intend to draw the remaining purchases under the arrangement, in order to build a further cushion against shocks after the arrangement expires.

6. **Base money remained well below the program path through mid-year, with the end-June NIR and NDA performance criteria again met with margins** (similar in magnitude to those achieved at end-March) (Table 5 and Figure 3). Bank Indonesia (BI) responded to the exchange market pressures in late July with modest intervention and by slowing the decline in interest rates, holding its key policy rate, the FASBI (the overnight deposit facility rate), at 9 percent between mid-July and late August. With inflation remaining subdued and the rupiah having stabilized, BI reduced the overnight rate by another 50 basis points at the end of August (bringing the cumulative decline for the year to 360 basis points). The one-month SBI rate has followed closely, and now stands at around 8¾ percent.

7. **The budget deficit at end-June was well within the program ceiling, amounting to Rp 2.2 trillion, against a limit of Rp 15.6 trillion** (Table 6). Revenues were slightly below target, in part reflecting temporary factors.<sup>3</sup> These shortfalls were more than offset by lower-than-expected expenditure on domestically financed development projects, delays in disbursement of subsidies, and lower interest payments.

8. **Performance against the program's structural benchmarks through June was generally satisfactory.** All but one of the benchmarks for the tenth review have now been met, albeit with some minor delays. In addition, the blueprint for strengthening the treasury and budget functions of the Ministry of Finance was finalized in early September (originally an April benchmark). The outstanding June benchmark relates to the sale of BI's overseas subsidiary (Bank Indover). As indicated at the last review, the transfer of the subsidiary's impaired assets has taken longer than originally anticipated, and the sale is now expected to be concluded by the end of the year (rather than during the third quarter as indicated at the last review).

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<sup>2</sup> As the Board meeting is scheduled for after end-September (due to the calendar of the Annual Meetings), waiver of applicability has been requested for the end-September quantitative performance criteria (the targets are, nevertheless, expected to be observed).

<sup>3</sup> Shortfalls in oil and gas receipts arose from delays in transfers from Pertamina to the budget, and lower-than-expected non-oil tax revenues were due in part to special factors affecting income tax and VAT collections (such as a large fire at a key textiles market).



## II. POLICY DISCUSSIONS

9. **The discussions focused on ensuring further progress in the reform agenda, and establishing a sound policy framework for 2004.** The authorities indicated that they were committed to ensuring a successful completion of the program, and to developing a credible and comprehensive policy framework for next year. They agreed that achieving these goals would be crucial to securing a smooth transition from exceptional financing at the end of the year, and maintaining market confidence as the elections approach.

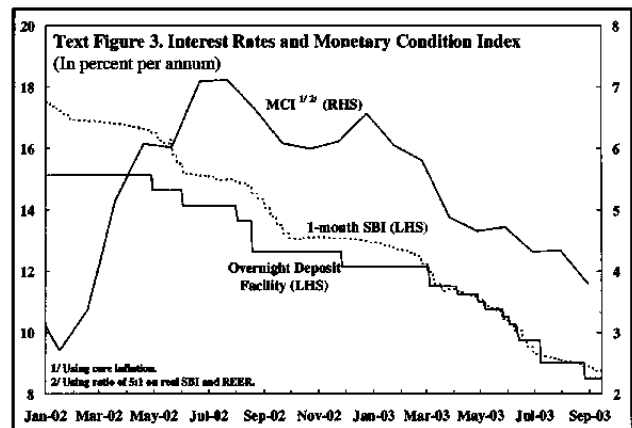
### A. Macroeconomic Policies

10. **The authorities broadly agreed with the staff's assessment of the economic outlook for the remainder of 2003 and for 2004.** The main risk to the near-term outlook was the impact the Jakarta bombing might have on investor and consumer confidence, and on tourism (which prior to the attack had showed tentative signs of recovering from the Bali bombing and SARS). On the other hand, the global recovery now seemed to be picking up steam, and on balance the authorities believed that their previous growth target of 4 percent for 2004 remained achievable. Given the risks, however, it was agreed to continue basing the program targets on a point estimate for growth of 3½ percent. With the global economy expected to continue recovering in 2004, the staff and authorities viewed a range of 4–5 percent growth next year as achievable, provided that policy implementation remains on track and the election process proceeds smoothly.

11. **The authorities also agreed that it was now likely that inflation for 2003 would finish at 6 percent, if not lower, in line with the staff's projection of 5–6 percent.** The staff encouraged the authorities to build on recent progress in reducing inflation by aiming for a target of around 5 percent for next year, all the more so given the relatively low inflation rate among Indonesia's trading partners. For the time being, however, the authorities preferred a more conservative target for 2004, on the order of 7 percent, as the current level of inflation was low by historical standards.

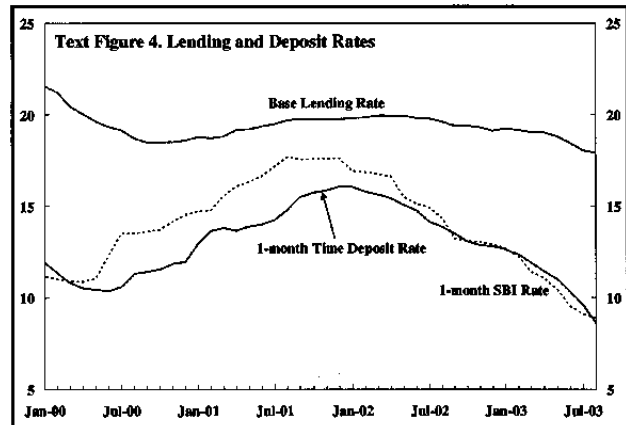
### Monetary and exchange rate policy

12. **The mission held discussions with the new Governor of BI on the conduct of monetary policy during the remainder of the year.** While commending the Governor on the continued decline in inflation, the mission urged caution with respect to a further easing of monetary conditions in the period ahead, as interest rates had been reduced sharply in recent months and the differential with overseas rates had



narrowed significantly (Text Figure 3). The mission proposed, and the Governor and his staff agreed, to lower the program's NDA and base money targets, and to raise the NIR floor, in order to bring them closer in line with current levels. They also agreed to evaluate the scope for further interest rate reductions in the near term carefully. In the event, as noted above, BI's policy rate was subsequently reduced by 50 basis points in late August. In the staff's view, monetary conditions remain broadly appropriate, but the aggressive pace of interest rate reductions could put the gains in inflation and exchange rate stability at risk. Indeed, the growth of monetary aggregates has also picked up in recent months (base money growth rose to an annualized rate of about 18 percent in the three months through August).

13. **With the decline in short-term interest rates having fed through quickly to bank deposit rates, bank lending spreads had increased significantly in recent months (Text Figure 4).** This had led to some pressure on BI to urge banks (particularly the state banks) to lower their lending rates. Together with the overlapping MFD team, the mission discouraged the authorities from using moral suasion to lower lending rates, as this could undermine bank profitability at a time when the



financial system was still recovering from the crisis. Moreover, the relatively slow adjustment of lending rates appears to reflect largely structural rigidities and the risky nature of lending in Indonesia, which should be addressed through further financial sector and legal reforms. In any event, lending rates, which had already showed signs of declining, would fall further as banks adjusted to the low inflation and interest rate environment.

14. **The mission agreed with the authorities that the present level of the exchange rate remained broadly appropriate.** Despite the strong appreciation of the rupiah over the past two years, Indonesia's real effective exchange rate is still about 20 percent below precrisis levels. Moreover, non-oil exports have held up reasonably well during the first half of the year, and the depreciation of the rupiah since early July was expected to contribute further to this trend.

### Fiscal policy

15. **With the budget outturn for the first half of the year well within program ceilings, the 2003 program deficit target is expected to be achieved (Rp 34.4 trillion, or 1.9 percent of GDP).** However, in the context of their mid-year budget review the authorities have presented to Parliament a revised annual deficit target of 2.0 percent of GDP, slightly above the program ceiling. The revision is a conservative projection based on a slightly weaker-than-anticipated outcome for non-oil tax revenue and a recognition of some pressures for additional outlays, including those stemming from higher subsidies in the event of higher

oil prices, preparations for the 2004 elections, and the conflict in Aceh. In reviewing the budget outlook for the remainder of the year, however, the staff and authorities agreed that any revenue shortfalls are likely to be offset by lower spending on interest payments (due to falling interest rates), development spending (reflecting delays in project implementation), and allocation of the contingency fund (already accounted for in the budget). Accordingly, the original budget target was achievable and the authorities remain committed to meeting the original program ceiling.

16. **The mission noted that good progress has been made in the tax and customs administration reform program.** In particular, procedures to simplify VAT refunds are being finalized, progress has been made in the formulation of a medium-term modernization strategy for tax administration, and the first phase of the customs reform program (trade facilitation, governance, and payments system) is well underway. The mission encouraged the authorities to take specific steps to support revenue gains during the remainder of the year, drawing on the recommendations of FAD technical assistance, and to begin identifying the measures needed to achieve the revenue goals for next year (see ¶18). For the remainder of this year, priorities include the expansion of the large taxpayer offices (in line with achieving the end-year structural benchmark), simplifying refund and audit procedures, and enhancing the flow of information between the budget and tax authorities.

17. **Progress has also been made in other elements of the fiscal reform agenda.** Work is proceeding to implement the blueprint for the restructuring of the Ministry of Finance (with the assistance of a recent FAD mission). Encouraging progress has also been made in the area of fiscal decentralization, with more than 85 percent of regions reporting on their 2002 budget outturns (a June structural benchmark).

18. **The mission also discussed the authorities' 2004 budget proposal, which was subsequently presented to Parliament in mid-August (Box 1).** The proposal aims to reduce the budget deficit further to 1.4 percent of GDP, through a 1½ percentage point adjustment in the non-oil primary balance.<sup>4</sup> The target is based on the elimination of fuel subsidies (with the exception of that on household kerosene), some reduction in transfers to regions, and an increase in non-oil revenues stemming from further efforts to strengthen tax

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<sup>4</sup> The authorities' budget presentation shows a target of 1.2 percent of GDP, reflecting (i) their preference to treat deposit insurance premia as above-the-line revenue, and (ii) the budget's higher nominal GDP assumption. The deficit target is slightly higher (by 0.1–0.2 percent of GDP) than envisaged at the last review.

### Box 1. 2004 Budget Proposal

The broad parameters of the government's 2004 budget proposal were presented by President Megawati in her speech to Parliament on August 15. The detailed budget will be discussed by Parliament in the coming months. Final approval is expected by November.

The 2004 budget proposal targets a fiscal deficit of 1.4 percent of GDP,<sup>1</sup> compared to a deficit of 1.9 percent of GDP projected for 2003. Although the primary surplus is to remain broadly unchanged (at 2.1 percent of GDP), the proposal targets a significant decline in the non-oil primary deficit (by 1.6 percent of GDP), predicated largely on a reduction in fuel subsidies and transfers to regions. The underlying macroeconomic assumptions are shown in the accompanying table.

	2003		2004	
	Budget	Staff	Budget	Staff
GDP				
Growth	4.0	3.5	5.0	4.5
Nominal GDP (In trillions of rupiah)	1,940	1,775	2,003	1,945
Inflation				
Period average	9.0	6.6	7.0	5.4
Exchange rate				
Period average	9,000	8,575	8,700	8,700
Interest rate				
Period average	13.0	10.0	9.0	8.0
Indonesian oil price (\$/bbl)	22.0	27.4	21.0	22.6
Oil production ('000 bpd)	1,270	1,100	1,150	1,150

**Revenue is projected to fall by 1.1 percent of GDP due to a sharp decline in oil and gas**

revenues. The decline in the latter reflects a combination of lower prices and production. Non-oil and gas revenues are projected to rise by 0.4 percent of GDP, reflecting an increase in tax revenues, which are projected to rise by 0.5 percent of GDP, primarily through continued efforts to strengthen tax administration. No new tax policy measures are envisaged for 2004. A small fall in nontax revenues (non-oil) as a share of GDP is projected owing mainly to lower transfers of profits to the budget from state-owned enterprises.

**Expenditure is targeted to decline by 1.7 percent of GDP.** Part of the decline (0.6 percent of GDP) reflects lower interest payments, in line with the projected decline in domestic interest rates. Primary spending is projected to fall by 1.1 percent of GDP due to: (i) lower spending on subsidies (0.8 percent of GDP), as a result of the impact of lower oil prices (0.6 percent of GDP) and the elimination of fuel subsidies (except on household kerosene);<sup>2</sup> and (ii) lower transfers to regions (0.7 percent of GDP), reflecting the decline in oil and gas revenues, as well as some streamlining of the special autonomy fund. These savings are to be partly offset by an increase in other current expenditure, mostly related to the cost of holding the elections. (The budget also proposes a 13 percent increase in wages.)

**Development spending is projected to increase by 14 percent,** representing an increase of 0.1 percent of GDP. More than 70 percent of the development budget is financed by domestic sources. The bulk of the development budget is allocated to education (25 percent), transportation (16 percent), and health and social assistance (11 percent). Irrigation, agriculture, industrial investment, and energy sectors absorb a combined 16 percent of the resources allocated for development. About 3 percent of the development budget is to be spent on social assistance programs to alleviate poverty.

<sup>1</sup>The deficit ratio is based on staff's estimate of nominal GDP and the program treatment of deposit insurance premia (shown below the line).

<sup>2</sup>The proposal assumes that kerosene prices will be raised to Rp 800 per liter from Rp 700 per liter.

administration.<sup>5</sup> Notwithstanding some differences in macroeconomic assumptions, the staff's outlook for the 2004 fiscal deficit does not differ from that of the authorities. The mission agreed that the deficit target, which is ambitious, is achievable, and also agreed that it was prudent to aim for a relatively tight budget given the constrained financing outlook for next year.<sup>6</sup>

**19. In the absence of further debt rescheduling, the financing of the deficit in 2004 is expected to shift toward domestic sources**

(Text Table 1). As envisaged at the last review, net bank financing is expected to rise sharply, with a step-up in net domestic debt issuance and a significant drawdown of the government's deposits at the central bank.<sup>7</sup> Given the high level of liquidity in the banking system, the staff's assessment continues to be that the net debt issuance can be absorbed while still allowing sufficient room for private sector credit growth. The authorities agreed that care would need to be taken to coordinate the envisaged drawdown of government deposits with BI, to ensure that it is sterilized effectively. The authorities are also considering a sovereign bond issue of around \$400 million, the timing of which would depend on market conditions.

	2003	2004 Staff Projection
Budget deficit	1.9	1.4
Amortization	3.3	3.3
Domestic 1/	0.8	1.0
External	2.5	2.3
Gross financing	5.2	4.7
External	2.6	1.3
Of which: Rescheduling	1.4	0.0
Privatization	0.3	0.1
IBRA	1.0	0.3
Other domestic 2/	1.3	2.9

1/ Excludes debt-buybacks and IBRA bond redemptions.  
2/ Deposit withdrawals and issuance of government bonds.

<sup>5</sup> The elimination of fuel subsidies, originally part of the 2003 budget, was delayed last January in the face of popular protest. The authorities plan to eliminate the subsidies by phasing in an automatic fuel price adjustment mechanism, possibly beginning in the current year, if and when oil prices decline in line with current projections.

<sup>6</sup> The implementation of politically sensitive measures (such as the elimination of fuel subsidies and reduction of transfers to regions, which together account for 0.3 percent of GDP) could be difficult in an election year, although these risks are balanced by the fact that the budget is based on a conservative oil price assumption (\$21 per barrel, compared to the WEO-based projection of \$24).

<sup>7</sup> In particular, a drawdown of balances of investment funds, which now stand at about Rp 35 trillion.

**2004 and medium-term outlook**

20. **The mission updated the 2004 external financing outlook and medium-term sustainability assessment** (Text Table 2 and Annex II). As assessed at the last review, financing needs are projected to be manageable without recourse to exceptional financing, provided that investor confidence and political stability are maintained. A modest loss in international reserves is projected (gross reserves would decline by about \$2 billion), but reserve coverage should remain comfortable in relation to imports and short-term debt. Over the medium term, public and external debt ratios are projected to decline steadily, a conclusion that is robust to a variety of shocks. The primary risks over the medium term relate to possible slippages in the fiscal consolidation effort and exchange rate depreciation.

	2003	2004 Projection
Gross financing needs	9.3	9.8
Current account deficit	-5.5	-4.2
Debt amortization	8.1	7.7
Other flows (net)	5.4	5.4
IMF repayments	1.3	0.9
Available financing	9.3	9.8
Foreign direct investment	2.3	2.5
Loan disbursements	4.8	5.5
IMF purchases	1.9	0.0
Rescheduling	3.1	0.0
Use of reserves	-2.8	1.8

21. **To shore up confidence, the authorities plan to maintain a close dialogue with the Fund in the context of PPM, and have published their economic strategy for 2004** (Box 2). The “White Paper” focuses appropriately on the need to maintain macroeconomic stability, strengthen the financial system, and improve the investment climate. While the strategy is comprehensive in scope, its success will depend on implementation.

**B. Structural Reforms**

22. **The mission reviewed progress under the structural reform agenda, with a view to ensuring that key measures under the 2003 program are in place.** The main priorities are to achieve a successful conclusion of the IBRA asset recovery process, the substantive completion of IBRA’s bank divestment program, and substantial progress in state bank restructuring, as well as the implementation of the major elements of a strengthened financial sector safety net. The mission also emphasized the importance of pushing ahead with legal and other reforms to strengthen the investment climate.<sup>8</sup>

<sup>8</sup> A number of ongoing high profile cases involving international investors (e.g., APP) in recent months have served further to undermine the investment climate.

## **Box 2. The Government of Indonesia's Economic Program for 2004**

The government has released a detailed program setting out its economic policy objectives for the remainder of 2003 and 2004. A key motivation for issuing the document was to bridge the potential "credibility gap" that could emerge following Indonesia's graduation from the IMF-supported program. The document, which sets out both broad policy objectives and specific reform measures (including implementation dates), focuses on three key areas:

- **Macroeconomic stability.** Over the medium term, the program aims to further fiscal consolidation (targeting budget balance by 2005–06), reduce inflation, maintain exchange rate stability, and ensure a sufficient level of foreign reserves.<sup>1</sup> Ongoing efforts to improve tax policy, modernize tax and customs administration, enhance expenditure efficiency, and address remaining weaknesses in the fiscal decentralization framework are to be continued.
- **Financial sector restructuring.** The principal objective is to strengthen the financial sector safety net, by clarifying Bank Indonesia's lender of last resort function, improving supervision and regulation, and establishing a deposit guarantee agency and a financial services authority. The program also aims to continue with bank divestment (including of state-owned banks) and improvements in the governance of state-owned banks. Addressing remaining deficiencies in the anti-money laundering framework and strengthening governance in state-owned enterprises are also key objectives.
- **Investment, exports, and employment.** Improving the investment climate and promoting exports are identified as key instruments for bolstering growth, generating employment, and reducing poverty. Legal certainty for business is to be increased by amending the bankruptcy law and harmonizing regional and national regulations. Other reforms include rehabilitating infrastructure, streamlining trade and investment regulations, establishing a fair labor policy framework, improving the provision of public services, and enhancing internal security.

### **Assessment**

The 2004 program presents a comprehensive policy framework that largely continues with the reform agenda launched under Indonesia's Fund-supported programs. In this regard, it is a good start toward bridging the "credibility gap," although more policy specificity is still needed in some areas. There are a couple of measures that may raise questions. Specifically, the paper includes a reference to moral suasion on banks to increase lending, and a proposal to use official "counter-trade" (barter) deals to increase exports. Such steps could undermine the market orientation of policies.

The program's ability to maintain investor confidence will ultimately depend on how the plan is implemented. In that regard, it will be important to prioritize the reform measures contained in the comprehensive plan, and to coordinate and monitor their implementation closely.

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<sup>1</sup> The government's macroeconomic targets for 2004 were presented in President Megawati's budget speech to Parliament on August 15.

## **Financial sector**

23. **IBRA's bank divestment program is proceeding well.** The sale of Bank Lippo is underway and should be completed in October/November (slightly later than previously envisaged due to the time needed to secure parliamentary approval), the sale of BII has now been launched, and the sale of Bank Permata (IBRA's remaining bank), is expected to be well in process prior to the end of IBRA's mandate in early 2004. IBRA has also begun divesting its minority shareholdings, with the recent sale of 20 percent stakes in Danamon and Niaga.
24. **The divestment of shares in state banks is also gaining momentum.** The initial public offering (IPO) for Bank Mandiri was concluded successfully in mid-July, with the offering raised to a 20 percent stake (from the announced 10–15 percent) in the face of strong investor demand. Preparations for the launch of the IPO for BRI are well advanced, and the authorities are considering the sale of a stake in BNI in 2004.
25. **Despite a general improvement in banking indicators, important fragilities remain, notably in the state banks (Box 3).** The pursuit of high-growth strategies, consisting of rapid credit extension to the corporate sector and a heavy reliance on high-cost funding, remains a concern. The authorities shared the mission's concerns and are accelerating efforts to strengthen oversight of the state banks. Most immediately, the government intends to take a number of steps to strengthen the management of the state banks, including the appointment of additional commissioners and changes to the banks' Board of Directors.
26. **The authorities also noted that progress had been made more generally in strengthening the governance of the state banks.** All state banks had prepared corrective action plans based on the results of their external audits, and the government, as shareholder, had developed benchmarks to ensure that the plans are properly implemented. Additional commissioners had also been appointed at BRI and BTN, bringing all state banks (with the exception of BTN, for which three commissioners is considered sufficient) up to a complement of four commissioners.
27. **Working with the overlapping MFD team, the mission assessed progress in the implementation of the authorities' plan to strengthen the financial sector safety net.** The immediate priorities are to establish a deposit insurance scheme (to eventually replace the blanket deposit guarantee) and to provide BI with an effective lender-of-last-resort facility. Work in these areas is well advanced, with the relevant legislation expected to be submitted shortly to Parliament. As the new deposit insurance agency—which will assume bank resolution powers currently assigned to IBRA—is not scheduled to begin operations until January 2005, the mission stressed the need to ensure that appropriate arrangements are put in place to manage bank resolution during the interim period (see ¶31 below).



### Box 3. Banking System Status

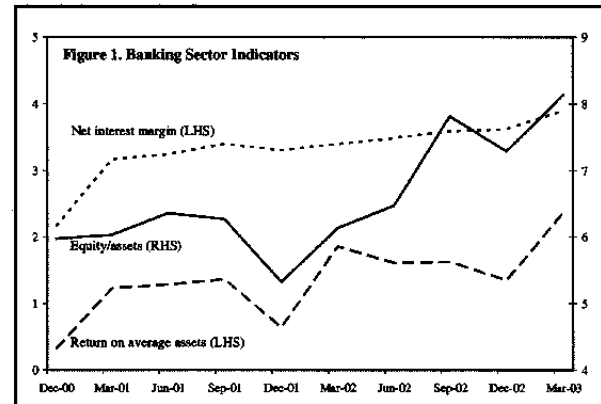
**The Indonesian banking sector has made steady progress in recovering from the 1997–98 crisis.**

Following the divestment of a number of IBRA banks, the government now holds majority stakes in banks representing slightly over 50 percent of banking system assets, down from almost 75 percent in the immediate aftermath of the crisis. Financial intermediation has also begun to pick up recently, with annual credit growth through June 2003 of 25 percent. As a result, the share of loans (net of provisions) in total assets increased to 29 percent at end-March 2003 from 20 percent at end-2000.<sup>1</sup>

**Indicators of bank soundness have improved steadily over the past two years (Figure 1):**

- *Earnings have increased.* The return on average assets reached 2.4 percent at end-March 2003, up from 0.3 percent at end-2000. While temporary factors (including trading gains and reductions in provisions) have contributed, core earnings and the net interest margin have also improved.

- *Capital has also strengthened.* Capital adequacy ratios (CAR) have averaged around 20 percent since 2000,<sup>2</sup> and broader measures of capital adequacy have also improved. By March 2003, the equity-to-assets ratio had risen to 8 percent (from 6 percent in 2000), and the Tier 1 capital-to-assets ratio was up to 6.4 percent (from 3.8 percent). Both measures are now above the international benchmarks (of 6 percent and 4 percent, respectively).



**However, these improvements mask a number of important fragilities, particularly among the state banks** (which account for over 40 percent of the banking system). The banking system has a weak capital base and is susceptible to a deterioration in asset quality in light of high risks in the corporate sector. Moreover, the financial indicators of the state banks are significantly weaker than the private banks (Table 1). In particular, high levels of potential “problem” loans imply weakened capital positions (compromised assets<sup>3</sup> net of provisions account for 100 percent of Tier 1 capital). These problems would be compounded by high-growth strategies which would squeeze liquidity and increase the reliance on high-cost deposits.

Table 1. Banking Indicators, March 2003

	Private Banks	State Banks
Capital adequacy ratio	25.0	21.0
Equity/assets	9.3	7.3
Tier 1 capital/assets	7.3	5.8
Core earnings/average assets	2.5	2.1
Compromised assets/total loans	13.3	27.7
Net compromised assets/Tier 1 capital	22.4	114.7
Liquid assets/total assets	26.1	9.5
Core deposits/total assets	39.9	31.3

<sup>1</sup> All data are for the 15 largest banks, which account for 75 percent of banking system assets.

<sup>2</sup> This measure is somewhat misleading in the Indonesian context given the predominance of zero-risk-weighted recapitalization bonds, and the correspondingly limited lending to the private sector.

<sup>3</sup> In addition to NPLs, compromised assets include restructured loans, loans purchased from IBRA, and foreclosed assets.

28. **Progress is being made in resolving a number of issues related to the reform of BI's operations.** Following its approval by Parliament in July, the BLBI burden-sharing arrangement has been formally implemented, and the old BLBI bonds on BI's balance sheet have now been replaced with a new redeemable note.<sup>9</sup> The government and BI have also resolved the main outstanding differences on amendments to the BI law. The key issue in that regard had concerned how best to improve the accountability of the central bank. Following further advice from two independent experts,<sup>10</sup> the parties have agreed to establish an independent supervisory board, broadly in line with the recommendations of the original 2001 report of the independent panel of experts. Amendments to the BI law consistent with this agreement are being discussed with Parliament, and the authorities are hopeful that they will be adopted by year-end.

### **IBRA issues**

29. **IBRA's cash recoveries through June were comfortably above the mid-year target** (Rp 9.7 trillion against a Rp 7 trillion target) (Table 7). The full-year cash target of Rp 18 trillion remains achievable, pending the success of the ongoing sales programs, in which the bulk of IBRA's remaining assets are being offered. In this regard, the sale of IBRA's holdings relating to its largest debtors, which could potentially raise around Rp 6–7 trillion, is underway, with completion expected in late September or early October. The mechanisms for these sales have been vetted by the Oversight Committee to ensure that the sales are conducted in a transparent and market-based fashion.

30. **Progress is also being made, albeit slowly, to resolve the bank shareholder settlement agreements.** Most of the outstanding legal and procedural issues related to the larger agreements, for banks closed in 1998–99, have now been resolved. The majority of the assets pledged under the agreements have been transferred to IBRA and are in the process of being sold. Some progress has been made on the smaller agreements, those relating to banks closed in 1999–2000, with about half of the agreements close to being settled. IBRA is expected to launch bankruptcy proceedings against debtors who fail to meet their obligations, and has already launched legal and nonjudicial actions against noncooperative debtors.

31. **Preparations for winding down IBRA's operations when its mandate expires in February 2004 are well advanced.** IBRA intends to conclude its asset disposal program by

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<sup>9</sup> As recommended by the advisory team headed by Mr. Volcker in 2001, the note bears interest if BI's capital falls below a given threshold (set at 3 percent of monetary liabilities), while BI is to transfer profits, to be credited toward the note's redemption, when its capital position rises above a given threshold (10 percent).

<sup>10</sup> Stephen Axilrod (former senior U.S. Federal Reserve official) and Goran Lind (Special Advisor to the Governor of the Swedish central bank, Sveriges Riksbank).

end-2003, and administrative preparations for the closure are underway. The government is still developing its strategy for handling IBRA's unsold (and most problematic) assets. The most likely scenario—and the staff's preferred option—is that they will be transferred to holding companies (most likely state-owned, but with private participation) which would be better suited to managing and selling these assets. IBRA's bank resolution responsibilities would be transferred to the Ministry of Finance until the new deposit insurance agency is established. Another option is to extend IBRA's mandate until the asset disposal process is complete, but the authorities are unlikely to favor such a course.

### **Other structural reforms**

32. **The mission encouraged the authorities to expedite progress on legal reforms.** As noted at the last review, preparations for the Anti-Corruption Commission had fallen behind schedule due to a delay in appointing members of the nomination committee, which is responsible for selecting candidates to serve as commissioners on the ACC. The mission urged the authorities to address the delay as it could jeopardize the goal of making the ACC operational by end-year, as required under the enabling law. Progress in other areas of the legal reform agenda has also been slow. Although work on the Commercial Court and the Judicial Commission is proceeding satisfactorily, Parliament has yet to debate the amendments to the bankruptcy and foundations laws (the latter is to clarify the powers of the Supreme Audit Agency to audit military and other foundations), as both have been held up by a backlog of pending bills in the relevant parliamentary commissions.

33. **Progress is being made with other structural reforms:**

- **The outlook for privatization receipts in 2003 has improved**, following the better-than-expected results from the Mandiri IPO. With the planned sale of shares in bank BRI and PGN (a natural gas supply company), receipts should be Rp 1–2 trillion higher than the Rp 5 trillion projected at the last review (but still below the original budget target of Rp 8 trillion).
- **With regard to public sector governance**, the third round of performance audits for state-owned enterprises is expected soon to be largely completed and the government has recently launched a fourth round of audits that includes the state-owned bank BNI.

### **Other issues**

34. **The mission reviewed ongoing efforts to strengthen BI's external audit mechanism, in line with the Fund's safeguards policy.**<sup>11</sup> As noted in previous staff reports,

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<sup>11</sup> The safeguards assessment identified a number of weaknesses in the capacity of BI's constitutionally appointed auditor, the State Audit Agency (BPK), to audit the central bank. This culminated in a June 30, 2002 review of foreign reserves by PricewaterhouseCoopers that identified a number of new issues previously undetected by BPK.

progress has been made by BI in implementing many of the staff's recommendations (e.g., an independent audit committee has been established and the control and accounting weaknesses identified in the 2001 review of BI's foreign exchange reserves have been addressed); as noted above, the creation of an independent supervisory board should enhance accountability. However, while BI's progress in addressing these issues is encouraging, the staff believes that the continued involvement of an independent accounting firm is necessary to provide assurances of the quality of BI's financial statements. In view of the delays in reaching agreement with BPK on the involvement of such a firm in its 2002 audit, the staff will now propose that a mid-2003 review of the complete BI balance sheet take place (under the same modalities as the mid-2002 review of foreign exchange reserves).

35. **The mission, together with the MFD team, stressed the importance of addressing remaining deficiencies in Indonesia's anti-money laundering (AML) framework.** The Financial Action Task Force on Money Laundering (FATF) had been concerned about delays in the passage of amendments to the AML law, as well as further progress on legislation to strengthen international cooperation against money laundering through mutual legal assistance.<sup>12</sup> Presidential regulations needed to formally establish and fund the Financial Intelligence Unit also remain pending. If the deficiencies were not addressed, there would be a risk that the FATF could recommend the imposition of countermeasures in October. In response, the authorities stated that they were working to expedite the passage of the AML amendments, and were hopeful that the presidential regulations would be issued shortly.

### III. STAFF APPRAISAL

36. **Further progress has been made in policy implementation under the program, and economic performance continues to improve.** Monetary and fiscal policies remain on track, and the structural reform agenda has advanced. The economic fallout from the terrorist attack in Jakarta in early August has been limited, and financial market sentiment remains strong. This is further evidence that the authorities' sound policy implementation under the program has served to strengthen the economy's resilience to shocks, and has helped to maintain the economic recovery. Nevertheless, the investment climate remains weak, and growth remains below potential.

37. **The budget outturn through the first half of the year was again well within the program's deficit ceiling.** The staff welcomes the authorities' intention to aim to achieve the annual deficit target of 1.9 percent of GDP. However, the revised deficit ceiling presented to Parliament (even though only a little higher) may signal a weakening in the authorities' ability to maintain policy discipline, particularly as the elections approach. As revenue performance was weaker than expected during the first half of the year, achieving the deficit

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<sup>12</sup> The amendments to the AML law relate to the abolition of the minimum limits on criminal transactions and the criminalization of disclosing to potential offenders that they are being investigated.

target will require a close monitoring of revenue developments during the remainder of the year, in order to avoid an undesirable compression of spending. The staff commends the authorities for their continued efforts to strengthen tax and customs administration.

38. **The government's 2004 budget proposal, which targets a deficit of 1.4 percent of GDP, represents a welcome step toward further fiscal consolidation.** The deficit plan is also appropriate in light of the financing outlook for 2004, which is constrained by the absence of further debt rescheduling. The budget proposal is based on gains from further efforts to strengthen tax and customs administration, and on the elimination of fuel subsidies (except on household kerosene) through the reintroduction of the automatic fuel price adjustment mechanism, which was delayed from this year. The macroeconomic assumptions underlying the budget proposal are within reasonable ranges, although the staff encourages the authorities to aim for a more ambitious inflation target in 2004, which is achievable on the basis of recent trends.

39. **Inflation has trended down and the rupiah has stabilized after a brief period of volatility in July.** These developments have enabled BI to reduce interest rates further, after a pause from early July. Given the pace of recent interest rate declines and with inflation having picked up in the latest month, however, the room for further rate reductions in the near term is now very limited. Should such a pace of interest rate reductions continue, recent gains in inflation and exchange rate stability could be jeopardized, necessitating an abrupt reversal of monetary policy. The staff therefore welcomes the authorities' intention to maintain a cautious monetary stance. The proposed downward adjustments to the monetary targets, intended to bring them in line with current levels, are also welcome.

40. **IBRA cash recoveries remain on track, and the full-year target should be met.** IBRA's efforts to ensure a successful conclusion to its current loans sales program, which includes the holdings of its largest debtors, are welcome, as are steps to resolve the remaining shareholder settlement agreements with former bank owners. Meanwhile, IBRA is well advanced in its preparations for winding down its operations when its mandate expires in February 2004, and the authorities are making good progress toward developing a strategy for handling IBRA's unsold assets. It is also encouraging that the bank divestment program is proceeding as planned, with the sale of Bank Lippo well underway and preparations for the divestment of the two remaining banks (BII and Permata) in process.

41. **While the overall health of the financial system has improved, fragilities remain, especially with respect to the governance of the state-owned banks.** In this regard, the staff urges the authorities to monitor closely the condition of the state banks, whose rapid growth strategies could raise concerns about their lending practices and financial health. In this regard, the authorities' recent steps to strengthen the governance and monitoring of the state banks are welcome.

42. **Progress in other areas of the structural reform agenda has been mixed.** In the area of legal and judicial reform, the staff urges the authorities to take the steps needed to ensure that the ACC becomes operational by end-year. The immediate priority is to establish

the long-delayed nominating committee for the selection of ACC commissioners. It will also be important to accelerate progress in other legal reforms, including with respect to parliamentary passage of the amendments and clarifications of the bankruptcy and foundations laws. The recent launching of the fourth round of audits of state-owned enterprises is a welcome step in efforts to enhance public sector governance.

**43. The staff supports the authorities' decision to graduate from exceptional financing when the current arrangement expires and to engage in PPM.** The government faces the challenge of maintaining investor confidence as the Fund-supported program expires and the elections approach. Security concerns surrounding the recent terrorist bombing in Jakarta only add to the challenge. Maintaining investor confidence and achieving a successful completion of the program will require continued sound policy implementation, including pressing ahead with the unfinished reform agenda. The government's "White Paper" is a good start in this direction; it will now be essential for the government to ensure adequate prioritization of reforms, and their consistent and timely implementation. The staff looks forward to continuing to support the authorities with their policy implementation during the remainder of the program, and thereafter in the context of PPM.

Table 1. Indonesia: Schedule of Reviews and Purchases

Date	Purchases		Conditions
	In Millions of SDR	In Percent of Quota	
<b>Completed purchases</b>			
February 4, 2000	260.00	12.5	Approval of extended arrangement
June 2, 2000	281.50	13.5	First review completed by the Board
September 10, 2000	309.65	14.9	Second review completed by the Board
September 10, 2001	309.65	14.9	Third review completed by the Board
January 28, 2002	275.24	13.2	Fourth review completed by the Board
April 26, 2002	275.24	13.2	Fifth review completed by the Board
June 21, 2002	275.24	13.2	Sixth review completed by the Board
December 5, 2002	275.24	13.2	Seventh review completed by the Board
March 28, 2003	344.06	16.5	Eighth review completed by the Board
June 25, 2003	344.06	16.5	Ninth review completed by the Board
<b>Total</b>	<b>2,949.88</b>	<b>141.9</b>	
<b>Remaining purchases</b>			
October 3, 2003	344.06	16.5	Tenth review and end-June 2003 performance criteria
November 15, 2003	344.06	16.5	Eleventh review and end-September 2003 performance criteria
<b>Total</b>	<b>688.12</b>	<b>33.1</b>	
<b>Total</b>	<b>3,638.00</b>	<b>175.0</b>	

Table 2. Indonesia: Structural Benchmarks

Measures	Status <sup>1</sup>
<p><b>March 2003</b></p> <ul style="list-style-type: none"> <li>• Finalize comprehensive plan for financial sector safety net.</li> <li>• Formulate plans and targets for audits, tax arrears collection, and registration of taxpayers.</li> <li>• Collect at least Rp 3 trillion in cash by IBRA (net of expenses).</li> <li>• Adopt implementation schedule for the restructuring of BTN.</li> </ul>	<p>Finalized in June.</p> <p style="text-align: center;">✓</p> <p>Total collection of Rp 4.1 trillion, of which Rp 1.2 trillion in cash.</p> <p>Implementation schedule adopted in May.</p>
<p><b>April 2003</b></p> <ul style="list-style-type: none"> <li>• Conclude majority divestment of Bank Danamon.</li> <li>• Launch majority divestment of Bank Lippo.</li> <li>• Finalize blueprint for strengthening the treasury and budget functions of the Ministry of Finance.</li> <li>• Issue ministerial decree liberalizing conditions under which VAT refund claims may be approved.</li> </ul>	<p>Completed in May.</p> <p>Launched in August.</p> <p>Finalized in September.</p> <p>Completed in June.</p>
<p><b>June 2003</b></p> <ul style="list-style-type: none"> <li>• Collect at least Rp 7 trillion in cash by IBRA (net of expenses).</li> <li>• List IPO for Bank Mandiri on the stock exchange.</li> <li>• Appoint additional commissioners to ensure each state bank has four to five commissioners in place.</li> <li>• Launch a fourth round of performance audits of state enterprises.</li> <li>• Produce report on 2002 local government finances, with coverage of at least 85 percent of jurisdictions.</li> <li>• Complete sale of BI's subsidiary.</li> </ul>	<p style="text-align: center;">✓</p> <p>Completed in July.</p> <p>All state banks except BTN now have four commissioners.<sup>2</sup></p> <p>Concluded in September.</p> <p>Completed in July.</p> <p>Sale now expected by December (preparatory step of restructuring nearly completed).</p>
<p><sup>1</sup> ✓ indicates that benchmark was completed on time.</p> <p><sup>2</sup> BTN has three commissioners, which is considered sufficient given its small size.</p>	



Table 3. Indonesia: Selected Economic Indicators, 1998/99–2004 1/

	1998/99	1999	2000	2001	2002 Est.	2003 Proj.	2004 Proj.
Real GDP (percent change)	-13.6	0.8	4.9	3.4	3.7	3.5	4.0
Domestic demand	-17.2	-2.1	4.0	5.1	1.9	4.2	4.2
<i>Of which:</i>							
Private consumption	-5.5	4.6	1.6	4.4	4.7	4.1	4.3
Gross fixed investment	-37.9	-18.2	16.7	7.7	-0.2	2.5	3.5
Net exports 2/	4.0	2.9	1.0	-1.5	1.8	-0.5	0.0
Errors and omissions 2/	-1.5	-0.9	-1.1	-0.5	-2.4	0.0	0.0
Savings and investment (in percent of GDP)							
Gross fixed capital investment	22.7	20.1	21.8	21.8	20.2	21.6	22.0
Gross national savings	26.5	23.7	27.2	26.7	24.5	24.2	23.9
Foreign savings	-3.9	-3.6	-5.3	-4.9	-4.3	-2.6	-1.9
Prices (12-month percent change)							
Consumer prices (end period)	46.5	2.0	9.3	12.5	10.0	5.5	5.0
Consumer prices (period average)	64.8	20.7	3.8	11.5	11.9	6.6	5.4
Public finances (in percent of GDP)							
Central government revenue 3/	14.9	16.8	20.0	20.8	18.6	18.7	17.3
Central government expenditure	17.2	18.3	21.1	24.5	20.4	20.7	18.7
Central government balance	-2.3	-1.5	-1.1	-3.7	-1.8	-1.9	-1.4
Central government debt	66.6	88.6	100.3	90.9	80.6	67.0	64.7
Money and credit (percent change; end of period)							
Rupiah M2	39.9	17.0	13.8	13.6	7.9	9.3	9.6
Base money	32.5	35.5	22.8	2.1	8.3	8.9	9.6
Private sector credit (at current exchange rate)	-26.3	-54.3	16.8	11.6	18.3	18.2	11.1
One-month SBI rate (period average)	48.2	22.7	12.4	16.5	14.9	10.0	8.0
Balance of payments (in billions of U.S. dollars)							
Oil and gas (net)	4.2	5.9	8.6	6.4	5.2	5.6	5.0
Non-oil exports (f.o.b)	41.1	41.0	50.3	44.8	46.3	48.9	51.7
Non-oil imports (c.i.f)	-30.7	-29.0	-37.1	-31.3	-31.1	-34.9	-38.2
Current account balance	4.6	5.8	8.0	6.9	7.4	5.5	4.2
Overall balance	0.9	0.0	1.2	-2.9	0.9	-0.8	-0.9
Gross reserves							
In billions of U.S. dollars (end period) 4/	20.3	24.3	29.4	28.0	32.0	34.8	33.0
In months of imports	5.3	5.3	7.1	6.6	6.9	7.2	6.4
As a percent of short-term debt 5/	60.3	78.1	97.1	84.6	130.6	194.4	209.4
External debt (medium- and long-term)							
in billions of U.S. dollars	149.9	148.7	141.7	131.2	129.8	126.8	120.6
(In percent of GDP)	144.9	94.9	94.3	92.7	74.9	61.4	54.0
Exchange rate							
Rupiah per U.S. dollar (period average)	9,849	7,855	8,422	10,246	9,295	8,575	...
Nominal effective exchange rate 6/	28.0	33.7	32.3	28.0	30.7	30.7	29.9
Real effective exchange rate 6/	49.5	63.9	62.6	59.6	72.5	76.2	77.0
Memorandum items:							
Indonesia oil production ('000 bcpd)	1,476	1,471	1,388	1,320	1,260	1,200	1,150
Indonesian oil price (US\$/bbl)	11.9	17.4	28.1	23.6	23.5	27.4	22.6
Nominal GDP (in trillions of rupiah)	1,019	1,100	1,265	1,449	1,610	1,775	1,945
Nominal GDP (in billions of U.S. dollars)	104	140	150	141	173	207	224

Sources: Data provided by the Indonesian authorities; and Fund staff estimates.

1/ Fiscal year 1998/99 (starting April 1). Calendar years from 1999 onward, with the exception of public finances for 1999 and 2000 which are based on fiscal year 1999/00 and the nine-month fiscal year from April to December, respectively.

2/ Contribution to GDP growth. Errors and omissions includes stockbuilding.

3/ Includes grants.

4/ From 2002 onward reflects higher reserves reported in general ledger.

5/ Short-term debt is on a remaining maturity basis before rescheduling and including IMF repurchases. Series updated to reflect revised data on corporate sector amortizations.

6/ Period average (June 1997=100).

Table 4. Indonesia: Balance of Payments, 2000-04  
(In billions of U.S. dollars)

	2000	2001	2002	2003	2004
	Actual	Actual	Estimate	Projection	Projection
<b>Current account</b>	<b>8.0</b>	<b>6.9</b>	<b>7.4</b>	<b>5.5</b>	<b>4.2</b>
Trade balance	21.8	19.8	20.5	19.5	18.4
Exports (fob)	65.4	57.4	58.8	62.5	63.3
Oil and gas	15.1	12.6	12.5	13.6	11.6
Non-oil and gas	50.3	44.8	46.3	48.9	51.7
Imports (cif)	-43.6	-37.5	-38.3	-43.0	-44.9
Oil and gas	-6.5	-6.2	-7.2	-8.0	-6.7
Non-oil and gas	-37.1	-31.3	-31.1	-34.9	-38.2
Services (net)	-13.8	-12.9	-13.0	-14.0	-14.2
Nonfactor services (net)	-6.5	-7.1	-7.4	-8.2	-8.2
Factor services	-7.2	-5.8	-5.6	-5.9	-6.0
<b>Capital account</b>	<b>-6.9</b>	<b>-9.8</b>	<b>-6.6</b>	<b>-6.3</b>	<b>-5.1</b>
Nonfinancial public sector	-0.9	-2.7	-3.6	-4.0	-2.8
Disbursements	4.0	2.9	2.3	2.3	3.2
Amortization	-4.9	-5.6	-6.0	-6.3	-6.0
Banking sector (net)	-1.7	0.1	0.9	0.8	0.6
Disbursements	1.3	2.0	2.5	2.5	2.3
Amortization	-3.0	-1.9	-1.6	-1.7	-1.7
Private sector (net)	-4.3	-7.2	-3.9	-3.1	-2.8
FDI	2.8	2.6	2.3	2.3	2.5
Other	-7.0	-9.8	-6.2	-5.4	-5.4
Portfolio investment	-1.9	-0.2	1.2	1.4	1.4
Other private sector (net)	-5.1	-9.5	-7.4	-6.8	-6.8
<b>Overall balance</b>	<b>1.2</b>	<b>-2.9</b>	<b>0.9</b>	<b>-0.8</b>	<b>-0.9</b>
<b>Financing</b>	<b>-1.2</b>	<b>2.9</b>	<b>-0.9</b>	<b>0.8</b>	<b>0.9</b>
NIR	-3.5	0.0	-4.5	-2.2	0.9
Gross reserves	-5.0	1.4	-3.6	-2.8	1.8
Reserve liabilities	1.5	-1.4	-0.9	0.5	-0.9
Public sector rescheduling <sup>1/</sup>	2.4	2.9	3.6	3.1	0.0
Memorandum items:					
Gross reserves (e.o.p.) <sup>2/</sup>	29.4	28.0	32.0	34.8	33.0
In months of imports of goods and nonfactor services	7.1	6.9	6.9	7.2	6.4
As a ratio to short-term debt	0.97	0.85	1.31	1.94	2.09
Non-oil and gas exports, volume growth (percent)	17.6	-7.9	-1.2	1.0	4.0
Non-oil and gas imports, volume growth (percent)	28.9	-13.1	-6.5	6.0	8.0
Terms of trade, percent change	10.0	-1.4	0.2	-0.8	-0.8
Current account (in percent of GDP)	5.3	4.9	4.3	2.7	1.9
Stock of public sector external debt (excluding state-owned banks)	80.0	75.8	78.4	77.6	73.9
(In percent of GDP)	53.3	53.6	45.3	37.5	33.0
Nonfinancial public sector debt service/XGNFS <sup>3/</sup>	12.4	17.4	18.1	16.2	14.9
Indonesian oil price	27.4	23.3	24.2	27.4	22.6
GDP (in billions of U.S. dollars)	150	141	173	207	224

Sources: Data are provided by the Indonesian authorities; and Fund staff estimates.

<sup>1/</sup> For 2003, consists of debt relief amounting to \$3.0 billion from Paris Club creditors and \$0.1 billion from other creditors.

<sup>2/</sup> From 2002 onward reflect higher reserves reported in BI's general ledger.

<sup>3/</sup> Before rescheduling and including IMF repurchases.

Table 5. Indonesia: Monetary Survey, December 2002–December 2003  
(In trillions of rupiah, unless otherwise indicated) 1/

	2002		2003					
	Dec.	Mar.	Jun.		Sep.		Dec.	
		Actual	Program	Actual	Program	Revised	Program	Revised
(End-of-period)								
<b>Monetary Survey</b>								
Net foreign assets	178.8	181.1	189.4	186.9	192.1	184.8	194.9	186.9
(In billions of U.S. dollars)	25.5	25.9	27.1	26.7	27.4	26.4	27.8	26.7
Net domestic assets	674.6	667.3	710.2	687.0	734.0	715.1	766.3	748.1
Net claims on government	515.2	518.6	521.7	507.0	511.8	496.0	507.4	507.4
Claims on private sector	369.0	380.0	391.9	404.0	419.8	423.0	454.9	443.7
Rupiah claims	295.7	305.0	317.8	327.0	344.3	345.9	377.9	366.6
Foreign exchange claims	73.3	75.0	74.1	77.0	75.5	77.1	77.0	77.1
Other items (net)	-209.6	-231.3	-203.4	-224.0	-197.6	-203.9	-196.0	-203.0
Broad money (M2)	853.4	848.4	899.6	873.9	926.1	899.9	961.2	935.0
Rupiah broad money	743.4	740.2	783.1	759.5	806.2	782.2	837.8	813.9
Currency	80.7	72.3	81.1	77.1	83.7	79.9	94.2	91.0
Deposits 2/	662.8	667.9	702.0	682.4	722.5	702.3	743.6	722.8
Foreign exchange deposits	110.0	108.2	116.5	114.4	119.9	117.7	123.4	121.1
<b>Bank of Indonesia</b>								
Net international reserves	155.1	162.1	155.4	165.3	155.5	161.0	155.6	161.0
Net domestic assets	-16.8	-36.9	-19.4	-33.3	-15.6	-25.4	0.6	-9.0
Net claims on government 3/	172.0	175.9	198.1	188.1	195.9	175.1	193.1	184.2
Claims on private sector	8.3	8.4	8.3	8.6	8.3	8.6	8.3	8.6
Claims on DMBs	-80.9	-96.2	-109.6	-110.5	-103.6	-109.8	-84.6	-102.6
Open market operations	-113.3	-127.9	-142.1	-142.6	-136.0	-141.9	117.0	-134.7
Other items (net)	-116.3	-125.1	-116.3	-119.5	-116.3	-99.3	-116.3	-99.3
Base money 4/	138.3	125.2	136.0	132.0	139.9	135.6	156.2	152.0
Currency outside banks	80.7	72.3	81.1	77.1	83.7	79.9	94.2	91.0
DMBs	56.0	51.0	53.2	53.1	54.5	54.0	60.4	59.2
Nonbank deposits	1.6	1.9	1.6	1.8	1.6	1.8	1.6	1.8
Memorandum items:								
Base money test date 5/	132.2	123.0	134.5	128.7	138.1	134.1	150.4	146.6
NIR of BI (billions USD)	22.2	23.2	22.2	23.6	22.2	23.0	22.2	23.0
Money multiplier (rupiah broad money)	5.4	5.9	5.8	5.8	5.8	5.8	5.4	5.4
Base money velocity 6/	11.7	14.2	14.0	13.6	14.0	13.5	12.5	12.0
Rupiah broad money velocity 6/	2.2	2.4	2.4	2.4	2.4	2.3	2.3	2.2
Annual percentage change:								
Broad money (constant exchange rate)	7.6	7.4	10.9	7.7	11.9	8.7	12.6	9.6
Rupiah broad money	7.9	8.6	11.9	8.5	12.5	9.2	12.7	9.5
Base money	8.3	7.1	13.4	10.0	12.9	9.5	13.0	9.9
Private sector claims 7/	21.9	24.9	22.6	25.0	22.3	22.8	23.3	20.1

Sources: Data provided by Indonesian authorities; and Fund staff estimates.

1/ All foreign currency denominated components are valued at the program exchange rate.

2/ Includes nonbank private sector deposits held at BI (Rp 1.6 trillion at December 2002).

3/ As part of the BLBI resolution, BI's net claims on government were reduced by Rp 20.2 trillion (reflected in the figures from September 2003). BI's capital reserves (under other items, net) have been reduced by a corresponding amount.

4/ Data on base money differ from those presented in Table 2 of the MEFP, which are based on period averages rather than end point values.

5/ Test date outcome based on 30-day average centered at end-month.

6/ Calculated using end-period quarterly GDP, annualized.

7/ Adjusted for transfers to and from IBRA. Projections make allowance for credit growth associated with IBRA bond-for-loan swaps, IBRA loan and asset sales, and privatization.

Table 6. Indonesia: Summary of Central Government Operations, 2001–04

	2001	2002	2003		2004	
			9th Review	Proj.	Budget 1/	Staff Proj.
(In trillions of rupiah)						
Revenues and grants	301.1	300.1	333.4	332.4	342.1	336.4
Oil and gas revenues	104.1	77.2	73.9	77.0	54.0	55.2
Non-oil and gas revenues	196.5	222.9	259.5	255.4	288.0	281.2
Tax revenues	162.4	193.7	233.7	228.1	258.7	253.3
Nontax revenues 2/	34.5	29.1	25.8	27.4	29.3	27.9
Expenditure and net lending	354.4	328.4	367.8	366.8	368.8	363.2
Central government expenditure	273.3	229.8	249.6	249.8	253.9	249.0
Current expenditure	226.1	192.8	193.2	196.4	193.0	188.1
Personnel	38.7	39.8	50.2	50.4	56.9	56.9
Subsidies	77.4	40.0	28.0	36.3	23.3	23.9
Interest	94.9	89.9	77.4	72.3	68.5	68.1
External	28.9	25.4	25.5	23.4	24.7	23.6
Domestic	66.0	64.5	51.9	48.9	43.8	44.5
Other	15.0	23.1	37.6	37.3	44.3	39.2
Development expenditure 3/	41.6	35.4	56.4	53.4	61.0	61.0
Statistical discrepancy	5.6	1.6	0.0	0.0	0.0	0.0
Transfers to regions	81.1	98.5	118.2	117.1	114.9	114.2
Overall balance	-53.3	-28.3	-34.4	-34.4	-26.8	-26.8
Financing	53.3	28.3	34.4	34.4	26.8	26.8
Domestic	46.5	24.0	26.1	33.4	41.7	45.6
Bank financing 4/	7.2	-21.8	-5.4	-1.1	29.9	35.6
Cash recovery of bank assets 5/	28.0	43.3	26.0	26.0	5.0	5.0
Privatization of nonfinancial assets	3.5	7.6	5.0	6.0	5.0	2.5
Other	7.8	-5.1	0.5	2.5	1.8	2.5
External	6.8	4.3	8.3	1.0	-14.9	-18.8
(In percent of GDP)						
Revenues and grants	20.8	18.6	18.3	18.7	17.6	17.3
Oil and gas revenues	7.2	4.8	4.0	4.3	2.8	2.8
Non-oil and gas revenues	13.6	13.8	14.2	14.4	14.8	14.4
Tax revenues	11.2	12.0	12.8	12.8	13.3	13.0
Nontax revenues 2/	2.3	1.8	1.4	1.5	1.5	1.4
Expenditure and net lending	24.5	20.4	20.2	20.7	19.0	18.7
Central government expenditure	18.9	14.3	13.7	14.1	13.1	12.8
Current expenditure	15.6	12.0	10.6	11.1	9.9	9.7
Personnel	2.7	2.5	2.8	2.8	2.9	2.9
Subsidies	5.3	2.5	1.5	2.0	1.2	1.2
Interest	6.6	5.6	4.2	4.1	3.5	3.5
External	2.0	1.6	1.4	1.3	1.3	1.2
Domestic	4.6	4.0	2.8	2.8	2.3	2.3
Other	1.0	1.4	2.1	2.1	2.3	2.0
Development expenditure 3/	2.9	2.2	3.1	3.0	3.1	3.1
Statistical discrepancy	0.4	0.1	0.0	0.0	0.0	0.0
Transfers to regions	5.6	6.1	6.5	6.6	5.9	5.9
Overall balance	-3.7	-1.8	-1.9	-1.9	-1.4	-1.4
Financing	3.7	1.8	1.9	1.9	1.4	1.4
Domestic	3.2	1.5	1.4	1.9	2.1	2.3
Bank financing 4/	0.5	-1.4	-0.4	-0.1	1.5	1.8
Cash recovery of bank assets 5/	1.9	2.7	1.4	1.5	0.3	0.3
Privatization of nonfinancial assets	0.2	0.5	0.4	0.3	0.3	0.1
Other	0.5	-0.3	0.0	0.1	0.1	0.1
External	0.5	0.3	0.5	0.1	-0.8	-1.0
Memorandum items:						
Primary balance	2.9	3.8	2.4	2.1	2.1	2.1
Non-oil primary balance	-4.3	-1.0	-1.7	-2.2	-0.6	-0.7
Non-oil overall balance	-10.9	-6.6	-5.9	-6.3	-4.2	-4.2
GDP (in trillions of rupiah)	1,449	1,610	1,825	1,775	1,945	1,945

Sources: Data provided by the Indonesian authorities; and Fund staff estimates.

1/ With the authorities' estimate of nominal GDP (Rp 2,003 trillion), the budget deficit in Fund format (i.e., treating deposit insurance premia as financing) would be 1.3 percent of GDP.

2/ Includes grants (Rp 0.5 trillion in 2001, Rp 0.3 trillion in 2002 and 2003, and Rp 0.6 trillion in 2004).

3/ Excludes military expenditures, which are included in other current expenditure.

4/ In 2003, includes net issuance of domestic debt.

5/ For 2002 and 2003, includes total IBRA receipts (rather than only the amount needed to finance the deficit).

Table 7. IBRA Asset Recovery and Official Targets, 2003 1/  
(In trillions of rupiah)

	Q1		Q2		Q3	Q4	Total
	Actual	Target	Actual	Target	Target	Target	Target
Total cash receipts (net of expenses)	1.1	...	8.6	...	...	...	...
AMC (loans and noncore assets)	0.7	3.0	5.2	3.2	9.3	0.1	15.6
Of which: Loan sales	-0.2	...	2.2	...	...	...	...
AMI (industrial and other assets)	0.5	0.4	0.4	1.3	2.9	1.9	6.4
BRU (bank equity)	0.0	0.0	3.0	3.0	1.0	0.0	4.0
Other income 2/	0.1	...	0.2	...	...	...	...
Expenses	-0.2	...	-0.1	...	...	...	...
Total bond receipts	2.9	...	0.4	...	...	...	...
Total cash and bond receipts	4.5	3.4	9.2	7.5	13.2	1.9	26.0
Memorandum item							
Cumulative net cash collections (actual) and targets (SBs) under the IMF program	1.6	3.0	10.4	7.0	18.0	...	...

Source: Finance and Accounting (IBRA).

1/ Official IBRA targets are set for total quarterly receipts (i.e., cash and bonds) net of operational expenses. IMF program targets (structural benchmarks) are set for cumulative cash collections net of operational expenses.

2/ Comprises investment income (and excludes deposit guarantee premia).

Table 8. Indonesia: Indicators of External Vulnerability, 1996/97–2003

	1996/97	1997/98	1998/99	1999	2000	2001	2002	2003
<b>Key economic and market indicators</b>								
Real GDP growth (in percent)	8.2	1.7	-13.6	0.8	4.9	3.4	3.7	3.5
CPI inflation (period average, in percent)	5.7	11.9	64.8	20.7	3.8	11.5	11.9	6.6
Short-term (ST) interest rate (in percent)	12.1	15	48.2	22.7	12.4	16.5	14.9	10.0
EMBI plus secondary market spread (bps, end of period)	114	508	839	458	677	479	347	...
Exchange rate NC/US\$ (end of period)	2,419	8,325	8,685	7,085	9,595	10,400	8,950	...
<b>External sector</b>								
Current account balance (in percent of GDP)	-3.4	-1.1	4.5	4.1	5.3	4.9	4.3	2.7
Net FDI inflows (in percent of GDP)	3.7	6.3	5.5	2.4	1.8	1.8	1.3	1.1
Export growth (U.S. dollar value, GNFS)	9.7	6.8	-15.4	1.8	26.5	-10.9	2.3	4.3
Real effective exchange rate (1995 = 100)	106.6	81.3	53.9	69.7	68.3	65.1	79.1	83.2
Gross international reserves (GIR) (in billions of U.S. dollars)	25.8	10.7	20.3	24.3	29.4	28.0	32.0	34.8
GIR in percent of short-term debt at remaining maturity	84.1	30.3	66.4	73.8	84.3	89.6	131.3	152.1
Net international reserves (NIR) (in billions of U.S. dollars)	26.7	13.3	15.9	16.0	17.8	18.3	22.2	24.0
Total gross external debt (in percent of GDP)	60.3	99.4	156.9	113.2	99.6	97.5	75.8	62.1
Of which: Short-term debt (original maturity in percent of GDP)	6.1	6.5	12.1	6.9	5.3	4.7	0.9	0.7
Private sector debt (in percent of GDP)	22.9	46.1	66.7	43.0	43.5	42.3	32.0	25.6
Total gross external debt in percent of exports of GNFS	243.2	237.1	308.0	285.0	212.7	220.2	205.0	192.0
<b>Public sector 1/</b>								
Overall balance (in percent of GDP)	0.8	-1.6	-2.2	-1.5	-1.1	-3.7	-1.8	-1.9
Primary balance (in percent of GDP)	2.0	0.0	0.9	2.4	4.0	2.9	3.8	2.1
Debt-stabilizing primary balance (in percent of GDP) 2/	...	...	...	...	2.3	2.5	2.3	2.1
Public sector gross debt (in percent of GDP) 3/	24.5	66.1	70.1	92.1	104.1	94.2	82.7	68.3
External debt from official creditors (in percent of total)	65.3	63.4	49.3	34.0	44.4	43.8	42.3	43.9
External debt from private creditors (in percent of total)	28.2	29.6	22.6	13.3	0.6	0.5	0.4	0.3
Domestic debt linked to foreign currency (in percent of total)	0.0	0.0	0.0	2.8	2.6	2.9	1.9	1.0
Domestic debt linked to ST interest rate or inflation (in percent of total)	0.0	0.0	0.0	19.8	16.7	16.1	17.8	18.7
Public sector net debt (in percent of GDP)	...	...	...	...	...	...	...	...
<b>Financial sector</b>								
Capital adequacy ratio (in percent) 4/ 5/ 6/	11.8	9.2	-52.2	-8.1	21.6	18.2	20.1	22.6
NPLs in percent of total loans 4/ 6/	...	11.3	50.9	32.9	14.2	11.0	6.3	5.9
Provisions in percent of NPLs 4/ 6/	36.4	34.4	34.5	87.0	88.8	94.0	119.6	153.8
Return on average assets (in percent) 4/ 6/	...	...	...	-8.7	0.3	0.6	1.3	2.4
FX deposits (in percent of total deposits)	22.2	31.5	25.9	19.2	20.8	20.2	18.2	16.9
FX deposits (in percent of gross international reserves)	82.0	123.7	72.9	65.6	30.8	52.5	49.0	49.7
FX loans (in percent of total loans)	20.0	39.8	36.9	37.6	39.8	32.6	28.9	20.3
<b>Financing requirements</b>								
Gross external financing requirement (GEFR) (in billions of U.S. dollars)	25.3	40.4	29.7	22.7	14.8	18.9	10.1	10.8
Of which: Amortization of MLT debt, public (in percent of total GEFR) 7/	40.8	20.1	42.4	43.8	53.3	49.6	97.7	86.8
Amortization of MLT debt, private (in percent of total GEFR) 8/	-29.4	51.7	31.2	38.7	47.5	51.5	61.0	50.0
Maturing ST debt (in percent of total GEFR)	56.8	24.0	42.0	42.9	53.5	35.5	14.9	13.9
Current account balance (in percent of total GEFR)	31.8	4.2	-15.5	-25.4	-54.4	-36.6	-73.6	-50.7
Gross public sector financing requirements (GPSFR) (in billions of U.S. dollars) 9/	4.3	6.3	5.3	4.9	5.2	11.8	9.9	12.6
Of which: Amortization of MLT debt (in percent of total GPSFR) 10/	143.9	62.4	56.6	55.2	17.3	30.1	46.1	41.6
Maturing short-term debt (in percent of total GPSFR)	...	...	...	...	3.2	1.4	1.7	1.3
Overall public sector deficit (in percent of total GPSFR)	-43.9	37.6	43.4	44.8	24.7	43.9	30.6	31.7

1/ Nonfinancial public sector (including state-owned enterprises). For 1999 and 2000, data are for FY 1999/00 and FY 2000, respectively.

2/ Based on GDP growth of 2.4 percent (annual average for 1995/96–2002) and a real interest rate of 5 percent.

3/ Medium- and long-term debt. Excludes outstanding IMF purchases.

4/ From 1999 onward, top 15 banks only (which account for over 80 percent of total deposits).

5/ Data for 1996/97 and 1997/98 are for December 1996 and December 1997, respectively.

6/ End-March data for 2003.

7/ Includes banking sector amortizations and IMF repurchases.

8/ Due to data deficiencies, this item represents net MLT capital flows to the corporate sector (which were positive prior to 1997/98) and net portfolio investment flows.

9/ Includes short-term debt (all external).

10/ Based on fiscal data for external MLT amortization (net of rescheduling), domestic debt amortization, and IMF repurchases.

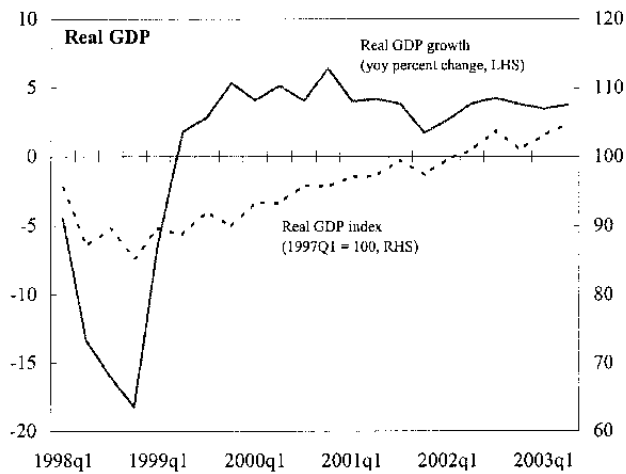
Table 9. Indonesia: Indicators of Debt Service to the Fund, 2001–10  
(In billions of U.S. dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Debt service to the Fund										
Charges	0.48	0.28	0.27	0.26	0.22	0.19	0.16	0.12	0.08	0.06
Repurchases	1.75	2.37	1.35	0.93	1.01	1.32	1.77	2.21	1.22	0.57
In percent of exports of goods and nonfactor services	3.6	4.1	2.4	1.8	1.7	2.0	2.4	2.8	1.5	0.7
In percent of total nonfinancial public sector debt service	20.3	22.8	15.3	12.1	11.8	14.1	19.3	22.2	13.5	7.2
In percent of reserves of Bank Indonesia 1/	8.0	8.3	4.7	3.6	3.9	4.9	6.1	7.1	3.7	1.6
Outstanding Fund credit	9.21	8.83	9.53	8.59	7.10	5.78	4.01	1.80	0.57	0.00
In percent of GDP	6.5	5.1	4.6	3.8	3.0	2.3	1.5	0.6	0.2	0.0
In percent of nonfinancial public debt	12.4	11.3	12.3	11.6	10.2	8.8	6.4	3.0	1.0	0.0
In percent of reserves of Bank Indonesia 1/	32.9	27.6	27.4	26.0	22.5	18.6	12.7	5.4	1.6	0.0
In percent of quota	348.8	313.5	332.6	300.0	262.7	213.8	148.5	66.5	21.2	0.0
Total nonfinancial public sector debt service										
In percent of exports of goods and nonfactor services	17.6	18.1	15.8	14.5	14.5	14.3	12.6	12.5	10.9	9.4
In percent of GDP	7.8	6.7	5.1	4.4	4.3	4.2	3.6	3.6	3.1	2.6

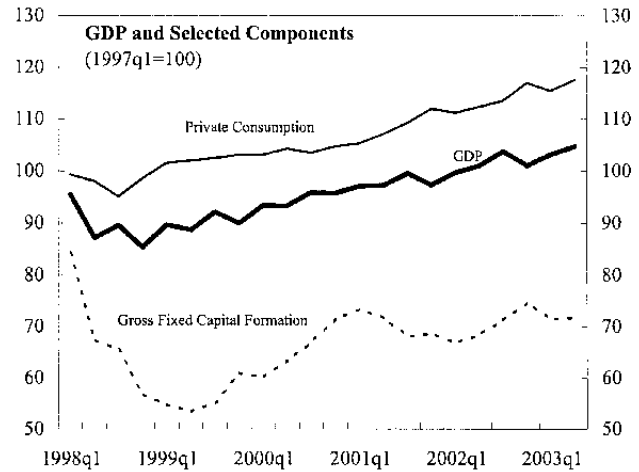
1/ End of period reserves.

**Figure 1. Recent Macroeconomic Developments**

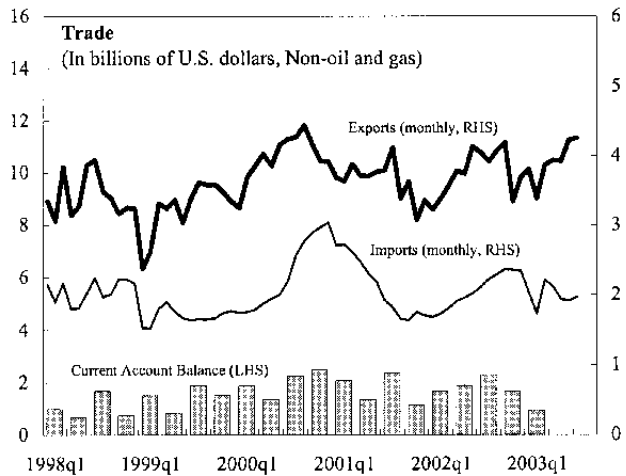
*GDP growth has remained steady...*



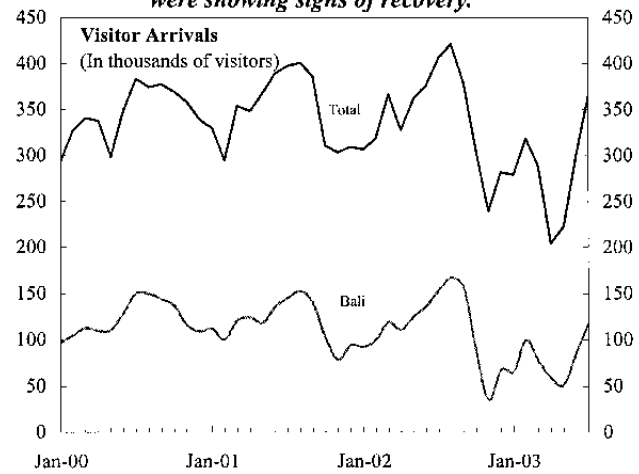
*...on the strength of private consumption, with investment still weak.*



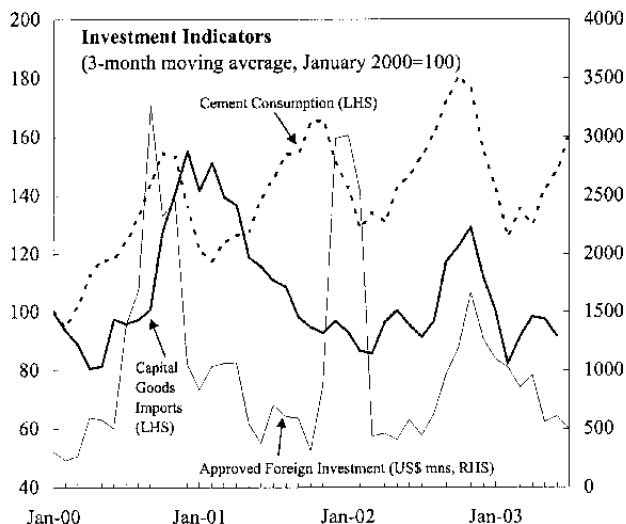
*Merchandise exports have picked up modestly...*



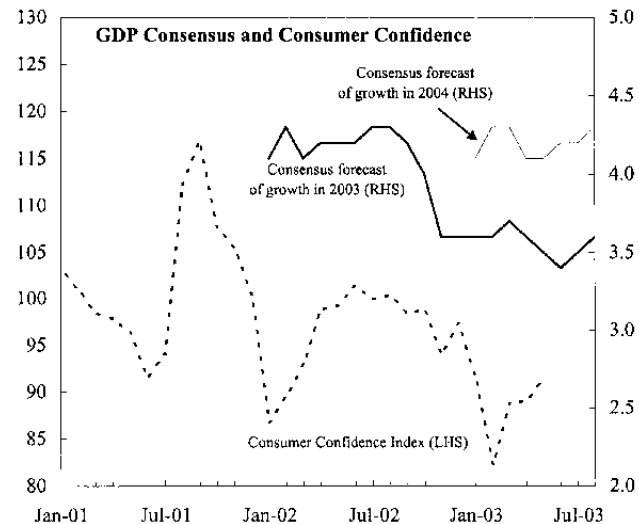
*...and tourist arrivals (prior to the Jakarta bombing) were showing signs of recovery.*



*Although investment remains sluggish...*



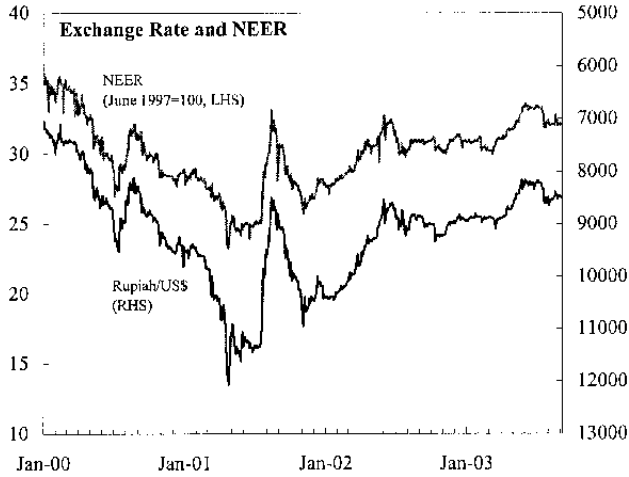
*...the outlook for growth remains generally positive.*



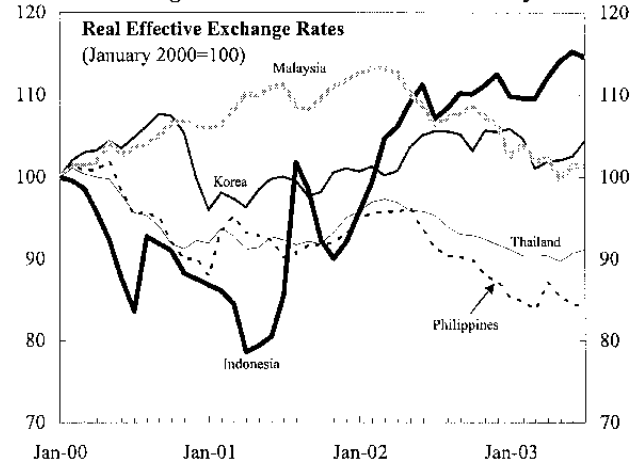


**Figure 2. Market Sentiment and Financial Indicators**

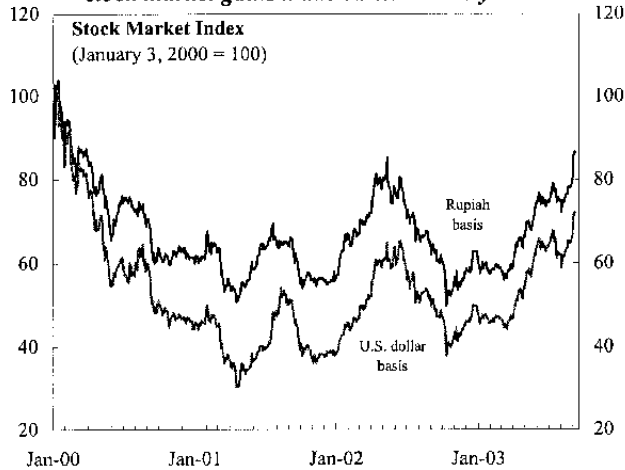
*Although the exchange rate has weakened somewhat in recent months...*



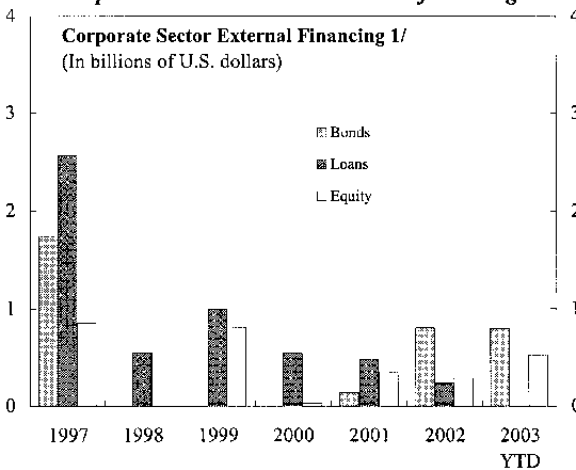
*...the rupiah has appreciated significantly relative to other regional currencies over the last two years.*



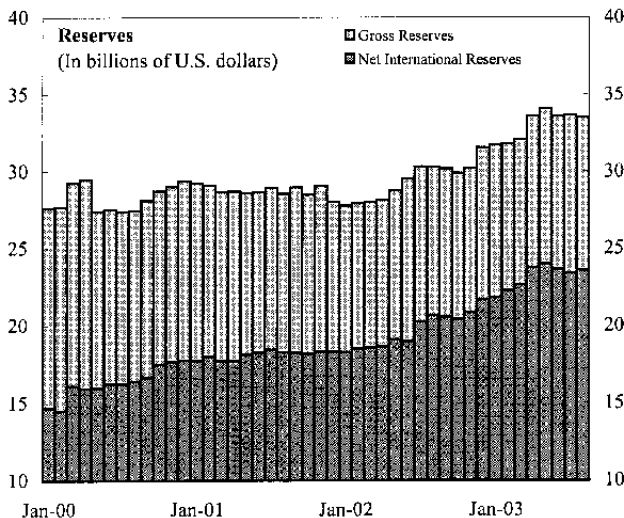
*Positive market sentiment has sustained stock market gains made earlier in the year...*



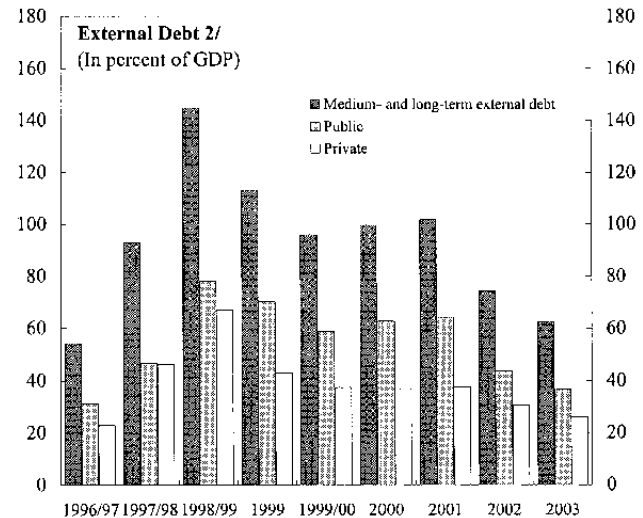
*...and continues to facilitate corporate sector access to external financing.*



*External reserves remain comfortable...*



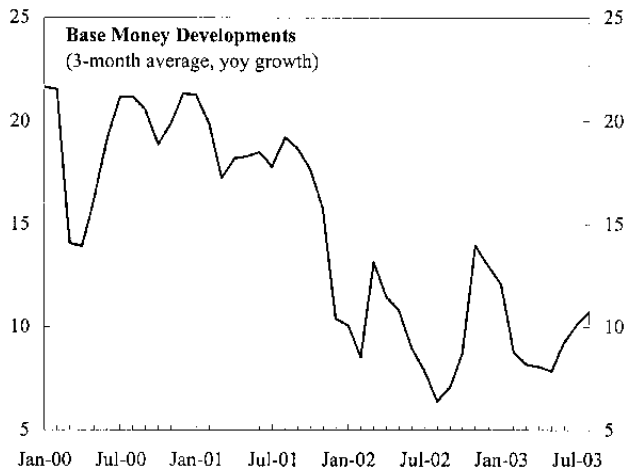
*...and external debt continues to decline.*



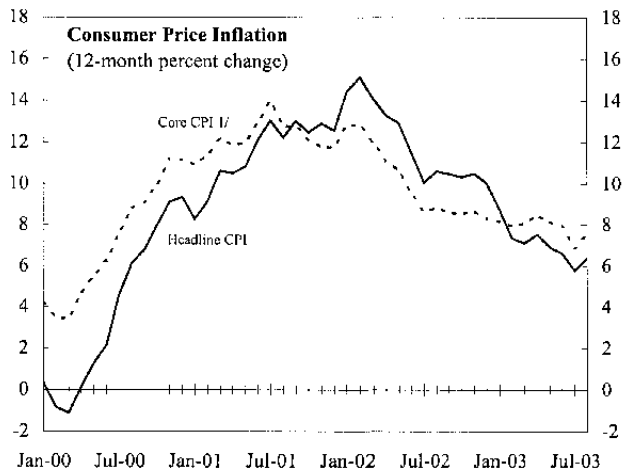
1/ Includes financial sector. For 2003 data are for January - July.  
2/ End of period, except for 2003 (June data).

**Figure 3. Monetary and Banking Developments**

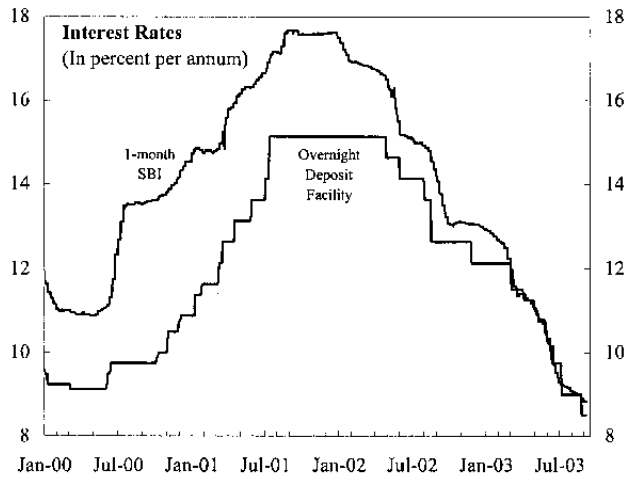
*Base money growth has begun to edge up.*



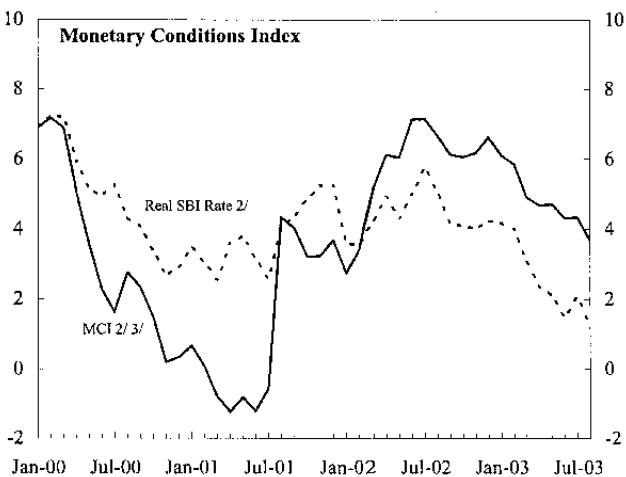
*Inflation continues to trend down...*



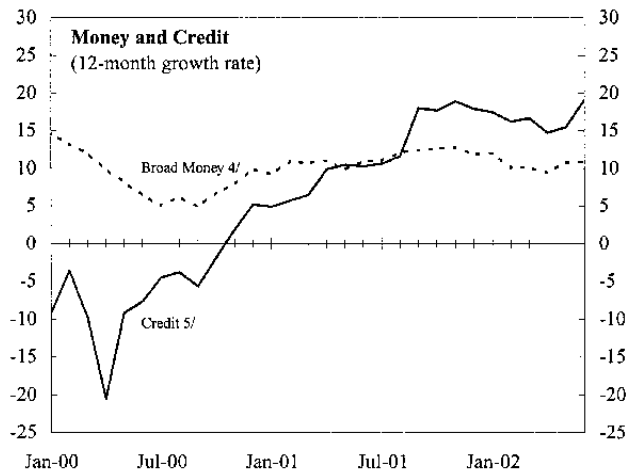
*...enabling policy rates to be lowered further...*



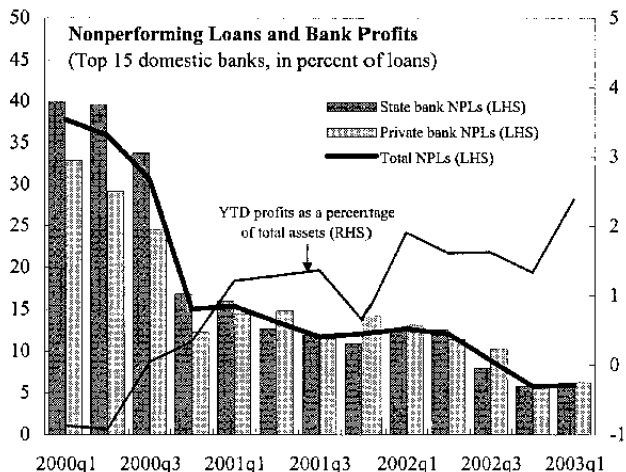
*...contributing to an easing of monetary conditions.*



*Credit growth continues to outpace broad money growth...*



*...with increased intermediation supported by an improvement in bank financial indicators.*



Sources: Data provided by the Indonesian authorities; CBIC; and Fund staff estimates.

1/ Nonfood, excluding administered prices.

2/ Using core inflation.

3/ Using ratio of 5:1 on real SBI and REER.

4/ At constant exchange rate.

5/ Data adjusted to account for loan transfers to and from IBRA.

**INDONESIA: FUND RELATIONS**  
As of August 31, 2003

**I. Membership Status:** Joined February 21, 1967; Article VIII

<b>II. General Resources Account</b>	<u>SDR Millions</u>	<u>Percent of Quota</u>
Quota	2,079.30	100.00
Fund holdings of currency	8,388.01	403.41
Reserve position in Fund	145.50	7.00

<b>III. SDR Department</b>	<u>SDR Millions</u>	<u>Percent of Allocation</u>
Net cumulative allocation	238.96	100.00
Holdings	12.91	5.40

<b>IV. Outstanding Purchases and Loans</b>	<u>SDR Millions</u>	<u>Percent of Quota</u>
Extended arrangements	6,454.20	310.40

<b>V. Financial Arrangements</b>				
<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved</u>	<u>Amount Drawn</u>
			<u>(SDR Millions)</u>	<u>(SDR Millions)</u>
EFF	Feb. 04, 2000	Dec. 31, 2003	3,638.00	2,949.88
EFF	Aug. 25, 1998	Feb. 04, 2000	5,383.10	3,797.70
Stand-by	Nov. 05, 1997	Aug. 25, 1998	8,338.24	3,669.12

**VI. Projected Obligations to Fund** (SDR Millions; based on existing use of resources and present holdings of SDRs):

	<u>Forthcoming</u>				
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	227.24	678.07	774.81	1,015.64	1,359.70
Charges/Interest	<u>33.97</u>	<u>128.26</u>	<u>112.85</u>	<u>95.77</u>	<u>72.88</u>
Total	261.21	806.34	887.66	1,111.42	1,432.58

**VII. Exchange Arrangements**

The rupiah has floated since August 14, 1997. The market exchange rate was Rp 8,470 per U.S. dollar on August 29, 2003. Indonesia has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions. A multiple currency practice arising from the foreign exchange subsidy for food imports was abolished on December 31, 1998.

### **VIII. Article IV Consultation**

While the extended arrangement is effective, Indonesia is on a 24-month consultation cycle, subject to the terms of Decision 12794-(02/79), adopted July 15, 2002, as amended. The last Article IV consultation report (EBS/02/65) was discussed by the Executive Board on April 26, 2002.

### **IX. Safeguards Assessments**

Under the Fund's safeguards assessment policy, Bank Indonesia (BI) is subject to the transitional procedures with respect to the EFF arrangement, approved on February 4, 2000 and scheduled to expire on December 31, 2003. The transitional procedures require a review of only BI's external audit mechanism. This assessment determines whether BI publishes annual financial statements that are independently audited in accordance with internationally accepted standards. The assessment of BI's external audit mechanism completed on March 15, 2002, revealed significant weaknesses and recommended remedial actions to address identified vulnerabilities. The recommendations concerning the establishment of an independent audit committee at BI and the publication of BI's audited financial statements have been implemented. A mid-year audit of BI's foreign exchange reserves (conducted by the independent accounting firm of PricewaterhouseCoopers) was completed in October 2002. The report indicated that international reserves data reported to the Fund had been underestimated at June 30, 2002, due to timing issues and other compilation discrepancies. The audit also found control weaknesses in BI's foreign reserves operations, which have since been mostly addressed. The staff has recommended the continued involvement of an independent firm in BI's external audit mechanism and is following this up with the authorities.

### INDONESIA: PUBLIC AND EXTERNAL DEBT SUSTAINABILITY

The staff has updated its assessment of Indonesia's medium-term public and external debt dynamics, under a scenario that assumes the maintenance of sound macroeconomic policies and continued progress in structural reform (Tables II.1 and II.2). The principal results of the analysis are as follows:

- **The public debt-to-GDP ratio could fall from a projected 67 percent of GDP in 2003 to below 50 percent by 2007.** This assumes that primary surpluses are maintained at above 2 percent of GDP; real GDP growth rises to 5 percent; and the real exchange rate remains stable over the medium term.
- **Results from the sensitivity analysis show that this conclusion is robust to a variety of shocks.** In particular, the use of historical values for real GDP growth, interest rates, and the primary surplus would still show the public debt-to-GDP falling to below 50 percent by 2007. However, risks for public debt sustainability could come from a large exchange rate depreciation and from weaker fiscal consolidation efforts, both of which would keep the public debt-to-GDP ratio at 60 percent in 2007.
- **As in the case of public debt, Indonesia's external debt-to-GDP ratio is expected to fall by roughly 20 percentage points over the medium term.** For external debt, this reflects large upcoming payments on multilateral debt as well as the continued reliance on mostly concessional sources of government external financing. Modest net repayments on private external debt—similar to the levels observed in the past three years—are also expected over the medium term. The debt-to-export ratio is expected to show a sharper decline during the projection period (from 192 percent in 2003 to 133 percent in 2007), owing to the recovery of both non-oil exports and services receipts from their relatively depressed levels.
- **External debt sustainability is most vulnerable to shocks in the exchange rate and the GDP deflator.** A 30 percent depreciation or a shock to the GDP deflator would each have the effect of raising the debt-to-GDP ratio above 80 percent, reversing much of the progress made in lowering the external debt burden during the past few years. By contrast, the debt-to-GDP ratio is quite robust to shocks in the external interest rate or GDP growth, even when these parameters are set at two standard deviations worse than their historical average.

While the stress tests considered above represent fairly extreme shocks, macroeconomic policies that aim to continue fiscal consolidation efforts and minimize disruptive movements in the exchange rate or deflator would offer increased assurances of a sustainable medium-term debt outlook.

# Annex Table II.1. Country: Public Sector Debt Sustainability Framework, 1997–2007

(In percent of GDP, unless otherwise indicated)

	Actual						Projections				
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>I. Baseline Medium-Term Projections</b>											
1 Public sector debt 1/	72.3	68.2	90.1	98.2	90.9	80.3	67.2	62.4	57.3	52.8	48.3
Of which: Foreign-currency denominated	72.3	68.2	68.8	49.0	42.4	36.9	29.6	28.1	25.7	22.9	20.8
2 Change in public sector debt	47.5	-4.1	21.9	8.1	-7.4	-10.6	-13.1	-4.8	-5.1	-4.5	-4.5
3 Identified debt-creating flows (4+7+12)	10.3	57.6	23.9	3.7	-1.7	-14.2	-10.7	-6.3	-5.3	-5.2	-4.7
4 Primary deficit	-0.4	-0.9	-2.4	-3.0	-2.9	-3.8	-2.1	-2.1	-2.5	-3.0	-3.0
5 Revenue and grants	15.4	14.9	16.9	15.3	20.7	18.6	18.7	17.3	17.0	16.9	16.8
6 Primary (non-interest) expenditure	15.1	14.1	14.5	12.2	17.8	14.8	16.6	15.2	14.5	13.9	13.8
7 Automatic debt dynamics 2/	10.6	56.7	-15.2	-2.0	3.3	-7.2	-6.7	-2.9	-2.2	-1.8	-1.2
8 Contribution from interest rate/growth differential 3/	-6.5	-11.2	-3.4	-7.0	-6.1	-3.5	-4.1	-3.4	-3.0	-2.1	-1.4
Of which: Contribution from real interest rate	-6.2	-19.0	-1.3	-4.0	-3.1	-0.5	-1.6	-0.9	-0.2	0.5	1.0
Of which: Contribution from real GDP growth	-0.3	7.8	-2.1	-3.1	-2.9	-3.0	-2.5	-2.4	-2.8	-2.6	-2.4
11 Contribution from exchange rate depreciation 4/	17.1	67.9	-11.8	5.0	9.3	-3.7	-2.6	0.4	0.8	0.3	0.2
12 Other identified debt-creating flows	0.0	1.8	41.4	8.7	-2.1	-3.1	-1.9	-1.2	-0.6	-0.5	-0.5
13 Privatization receipts (negative)	0.0	-0.2	-1.5	-1.4	-2.1	-3.1	-1.9	-1.2	-0.6	-0.5	-0.5
15 Other (bank recapitalization)	0.0	2.0	42.9	10.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
16 Residual, including asset changes (2-3)	37.2	-61.7	-2.0	4.5	-5.6	3.6	-2.4	1.5	0.3	0.7	0.2
Public sector debt-to-revenue ratio 1/	469.3	456.9	534.7	642.4	439.4	430.9	358.8	360.8	337.1	312.4	287.4
Gross financing need 5/	...	...	...	...	8.3	7.7	10.5	7.0	5.1	4.5	4.1
In billions of U.S. dollars	...	...	...	...	11.7	13.3	21.7	15.7	12.1	11.6	11.3
<b>Key macroeconomic and fiscal assumptions</b>											
Real GDP growth (in percent)	1.7	-13.6	3.5	3.9	3.4	3.7	3.5	4.0	5.0	5.0	5.0
Average nominal interest rate on public debt (in percent) 6/	8.2	6.4	6.2	5.0	7.5	6.8	5.6	5.7	5.7	5.7	5.7
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-24.7	-27.0	-1.7	-4.2	-3.0	-0.3	-1.8	-1.2	0.0	1.2	2.2
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	-48.2	-52.6	31.2	-10.8	-17.8	10.2	8.4	-1.4	-2.8	-1.4	-1.1
Inflation rate (GDP deflator, in percent)	43.6	45.8	7.9	9.6	10.8	7.2	7.5	7.0	5.7	4.5	3.5
Growth of real primary spending (deflated by GDP deflator, in percent)	3.5	-5.6	4.6	-11.0	47.2	-13.7	14.9	-6.4	-0.2	-0.3	3.8
<b>II. Stress Tests for Public Debt Ratio</b>											
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2004–2007							67.2	62.4	57.4	52.9	48.0
2. Real interest rate is at historical average plus two standard deviations in 2004 and 2005							67.2	64.0	59.7	55.2	50.8
3. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005							67.2	66.1	64.9	59.9	55.0
4. Primary balance is at historical average minus two standard deviations in 2004 and 2005							67.2	64.7	62.1	57.6	53.2
5. Combination of 2-4 using one standard deviation shocks							67.2	66.0	64.5	59.2	54.1
6. One time 30 percent real depreciation in 2004 7/							67.2	79.0	73.4	68.6	63.9
7. 10 percent of GDP increase in other debt-creating flows in 2004							67.2	72.4	67.0	62.2	57.6
8. Revenue-to-GDP ratio at historical average minus two standard deviations in 2004–05							67.2	67.1	66.2	61.5	57.0
Historical statistics for key variables (past 10 years)											
			Historical		Standard				Average		
			Average		Deviation				2003–07		
Primary deficit			-2.1		1.1				-2.6		
Real GDP growth (in percent)			3.2		2.5				4.5		
Nominal interest rate (in percent) 6/			6.8		0.9				5.7		
Real interest rate (in percent)			-2.5		1.9				0.1		
Inflation rate (GDP deflator, in percent)			9.4		1.9				5.6		
Revenue to GDP ratio			16.2		2.0				17.4		

Note: Sensitivity tests are based on historical averages excluding 1998 and 1999, as these years represented extreme outliers.

1/ Gross debt of central government.

2/ Derived as  $[(r - \pi(1+g) - g + \alpha\epsilon(1+r)] / [(1+g+\pi+g\pi)]$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $\alpha$  = share of foreign-currency denominated debt; and  $\epsilon$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\alpha\epsilon(1+r)$ .

5/ Defined as public sector deficit, plus amortization of medium- and long-term public sector debt, plus short term debt at end of previous period.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

7/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Annex Table II.2. Indonesia: External Debt Sustainability Framework, 1997–2007 (Sensitivity Analysis excluding 1998 and 1999)

(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>I. Baseline Medium-Term Projections</b>											
External debt	67.9	167.4	112.1	94.3	94.1	75.8	61.5	53.4	47.9	42.9	38.9
Change in external debt	14.6	99.5	-55.3	-17.8	-0.2	-18.3	-14.3	-8.1	-5.5	-5.0	-4.0
Identified external debt-creating flows (4+8-11)	6.2	83.8	-59.5	-14.2	-0.7	-23.6	-17.3	-9.0	-6.2	-5.8	-5.1
Current account deficit, excluding interest payments	-1.6	-13.4	-9.0	-10.4	-9.1	-6.7	-4.7	-3.9	-3.3	-2.8	-2.4
Deficit in balance of goods and services	1.8	-3.8	-9.3	-10.1	-9.0	-7.5	-5.4	-4.5	-3.7	-3.3	-2.8
Exports	29.7	59.3	39.3	46.9	44.3	37.0	32.0	29.9	29.4	29.2	29.2
Imports	31.5	55.5	30.1	36.7	35.2	29.4	26.6	25.4	25.7	25.9	26.4
Net nondebt creating capital inflows (negative)	1.7	2.4	-1.1	-0.7	-1.7	-2.0	-1.8	-1.7	-1.8	-1.8	-1.8
Net foreign direct investment, equity	-0.5	-0.4	2.4	2.0	1.8	1.3	1.1	1.1	1.2	1.2	1.2
Net portfolio investment, equity	-1.2	-2.0	-1.3	-1.3	-0.2	0.7	0.7	0.6	0.6	0.6	0.6
Automatic debt dynamics	6.2	94.8	-49.4	-3.0	10.0	-14.9	-10.8	-3.4	-1.2	-1.2	-0.9
Denominator: $(1 + g) + gp$	1.0	0.4	1.5	1.1	0.9	1.2	1.2	1.1	1.1	1.1	1.1
Contribution from nominal interest rate	3.4	9.2	5.0	5.1	4.2	2.4	2.1	2.1	1.9	1.7	1.5
Contribution from real GDP growth	-2.6	20.2	-1.0	-5.1	-3.4	-2.8	-2.2	-2.2	-2.5	-2.3	-2.0
Contribution from price and exchange rate changes	5.3	65.5	-53.4	-3.0	9.3	-14.4	-10.7	-3.2	-0.5	-0.6	-0.4
Residual, including change in gross foreign assets (2-3)	8.3	15.6	4.2	-3.6	0.5	5.3	3.0	0.9	0.7	0.8	1.1
External debt-to-exports ratio (in percent)	228.6	282.3	285.0	201.3	212.6	205.0	192.0	178.9	162.5	146.8	133.2
Gross external financing need (in billions of U.S. dollars)	40.6	32.7	23.1	26.5	27.6	30.9	23.0	14.6	13.4	13.2	12.4
In percent of GDP	18.8	34.2	16.3	17.7	19.5	17.9	11.0	6.4	5.5	5.1	4.5
<b>Key macroeconomic and external assumptions</b>											
Nominal GDP (U.S. dollars)	216	95	141	150	141	173	209	229	242	258	273
Real GDP growth (in percent)	4.5	-13.1	0.8	4.9	3.4	3.7	3.5	4.0	5.0	5.0	5.0
Exchange rate appreciation (U.S. dollar value of local currency, change in percent)	-19.3	-70.9	27.5	-6.7	-17.8	10.2	9.3	0.0	-3.9	-2.1	-2.0
GDP deflator in U.S. dollars (change in percent)	-9.1	-49.1	46.8	2.8	-8.9	18.1	16.4	5.4	1.0	1.3	0.9
Nominal external interest rate (in percent)	6.0	6.0	4.4	4.9	4.2	3.1	3.3	3.7	3.7	3.8	3.8
Growth of exports (U.S. dollar terms, in percent)	15.1	-11.7	-1.8	26.6	-11.0	2.3	4.3	2.2	4.5	5.5	5.9
Growth of imports (U.S. dollar terms, in percent)	7.6	-21.9	-19.8	29.8	-9.6	2.3	8.8	4.6	7.4	7.3	7.7
<b>II. Stress Tests for External Debt Ratio</b>											
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and nondebt inflows are at historical average in 2003–07						75.8	76.9	75.8	74.5	73.4	72.6
2. Nominal interest rate is at historical average plus two standard deviations in 2003 and 2004						75.8	63.6	57.1	51.4	46.3	42.3
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004						75.8	62.0	54.6	49.0	44.0	40.0
4. Change in U.S. dollar GDP deflator is at historical average minus two standard deviations in 2003 and 2004						75.8	82.1	87.9	81.6	75.8	71.1
5. Non-interest current account is at historical average minus two standard deviations in 2003 and 2004						75.8	72.0	72.9	67.0	61.5	57.1
6. Combination of 2–5 using one standard deviation shocks						75.8	83.9	90.5	84.2	78.3	73.6
7. One time 30 percent nominal depreciation in 2003						75.8	86.1	76.7	70.6	65.1	60.6
Historical statistics for key variables (past 10 years)											
		Historical		Standard		Average					
		Average		Deviation		2002–07					
		excl 98&99		excl 98&99							
Current account deficit, excluding interest payments		-2.9		4.3		-4.0					
Net nondebt creating capital inflows		-2.2		...		1.8					
Nominal external interest rate (in percent)		5.4		0.6		3.5					
Real GDP growth (in percent)		6.4		1.8		4.4					
GDP deflator in U.S. dollars (change in percent)		0.7		6.2		7.2					

Note: Sensitivity tests are based on historical averages excluding 1998 and 1999, as these years represented extreme outliers.

COORDINATING MINISTER OF ECONOMIC AFFAIRS  
REPUBLIC OF INDONESIA

Jakarta, Indonesia  
September 16, 2003

Mr. Horst Köhler  
Managing Director  
International Monetary Fund  
Washington, DC 20431

Dear Mr. Köhler:

1. This letter updates progress under our economic program for 2003 as described in the Memorandum of Economic Policies (MEFP) of March 18, 2003 and the supplementary letter of June 11, 2003. In recent months we have continued to make progress in policy implementation and in meeting the program's objectives. Notwithstanding the fallout from the recent terrorist attack in Jakarta, the rupiah is stable, inflation is on a firmly declining trend, the foreign reserves position continues to improve, and the economic recovery is advancing. Our updated macroeconomic framework for 2003 maintains a GDP growth target of 4 percent and, on the basis of recent positive price developments, we now expect inflation to be around 6 percent or lower by the end of the year (Table 1).
2. All end-June quantitative performance criteria and indicative targets were met (Table 2), and we have now implemented all but one of the structural benchmarks set for this review (i.e., for June; Table 3). The outstanding benchmark relates to the sale of BI's overseas subsidiary which, with its restructuring nearing completion, is expected by December. With the recent finalization of the blueprint for strengthening the treasury and budget functions of the Ministry of Finance, we have also implemented the one benchmark carried over from the previous review.
3. Budget performance is on track to achieve the 2003 program ceiling of 1.9 percent of GDP, with the deficit outturn for the first half of the year well within programmed levels. Nevertheless, non-oil tax revenues are running below expectations, due in part to temporary factors and, in the context of our mid-year budget review, we have presented to Parliament a slightly higher deficit limit of 2.0 percent of GDP. Given the budget execution so far and our plans to maintain expenditure restraint, however, we will continue to target the deficit outturn for the year to remain in line with the original program ceiling. We have continued to strengthen tax and customs administration, and the estimated revenue gains so far are in line with the anticipated yields. We are expanding the number of taxpayers under large taxpayer offices, with a view by the end of the year to covering one-third of all non-oil tax revenues, and we plan to issue regulations to streamline audit procedures for the VAT and income tax. Our efforts to strengthen provincial and local budget reporting are also yielding results, with compliance now above 85 percent for the end-2002 reports, in line with the June benchmark. Our 2004 budget proposal, presented to Parliament in August, aims to advance fiscal consolidation further by targeting a deficit of 1.2 percent of GDP.
4. The stability of the rupiah and decline in inflation in recent months have enabled further interest rate reductions. Bank Indonesia (BI) will maintain a cautious monetary policy stance in the period ahead. The program's monetary and reserves targets have again been met with sizeable margins; we propose to adjust the targets for the remainder of the year to bring them in line with recent performance and the current policy stance.
5. With regard to financial sector policies, we are pressing ahead with our efforts to develop a sound financial sector safety net, with a view to implementing the comprehensive plan adopted in June by the Ministry of Finance and BI. In addition, following consultation with Parliament,



we have implemented the agreement to resolve issues related to the extension of bank liquidity credits during the crisis. Accordingly, a new government bond has been placed on BI's balance sheet. We are also discussing with Parliament amendments to the BI Law. The amendments include proposals for a lender of last resort facility as well as a supervisory board aimed at enhancing institutional credibility while preserving policy independence.

6. IBRA is making good progress toward meeting its annual asset recoveries target. Cash collections through June exceeded their target, and proceeds from ongoing sales (which include IBRA's largest loans) should enable the full-year target to be met. In the area of bank divestment, preparations for the sales of Lippo and BII are well advanced. In addition, compliance under the shareholder settlement agreements with former bank owners has improved. There have been further payments under the agreements related to banks closed in 1999-2000; at the same time the payment deadline has been extended to end-September to allow proceeds from the ongoing sale of assets to be credited toward the obligations.

7. We continue our efforts to strengthen the oversight and accountability of the state banks. Following the successful IPO of Mandiri, we are appointing an additional commissioner and will strengthen the bank's management by the end of September; we are also monitoring closely the bank's performance under its business plan. With the recent appointment of additional commissioners at BRI and BTN, all state banks will have a full complement of commissioners. As expected, the state banks have all prepared corrective action plans, based on the results of their external audits. The Ministry of State-Owned Enterprises has reviewed these plans and established benchmarks to monitor implementation. Meanwhile, preparations for the IPO of BRI are underway.

8. Improving public sector governance remains an important element of our structural reform agenda. We continue to work toward making the Anti-Corruption Commission operational by the end of the year. The fourth round of special audits of public enterprises has also now been launched.

9. In view of the progress made under the program, we request completion of the tenth review under the Extended Arrangement. As discussed above, we propose to revise our monetary and reserves targets for the remainder of the year, as shown in Table 2. We request waivers of applicability for the end-September quantitative performance criteria; while we expect them to be observed, the data needed to assess the targets will not be fully available at the time the review is to be considered. We will continue to consult with the Fund in the period ahead on economic policies, and we expect to complete the final review under the arrangement by December 2003.

10. To provide a strong framework for economic policy in 2004, we have developed a comprehensive economic program that was announced on September 15. The program aims to maintain macroeconomic stability, strengthen the financial sector, and generate higher investment, exports, and employment. As we implement our program, we intend to maintain a close policy dialogue with the Fund and the rest of the international community.

Sincerely yours,

/sd/

Dorodjatun Kuntjoro-Jakti  
Coordinating Minister for  
Economic Affairs

/sd/

Boediono  
Minister of Finance

/sd/

Burhanuddin Abdullah  
Governor  
Bank Indonesia

Table 1. Indonesia: Macroeconomic Framework, 2002–03

	2002	2003
Real GDP growth	3.7	4.0
Inflation (end of period)	10.0	5-6
Current account balance		
In billions of U.S. dollars	7.4	5.5
In percent of GDP	4.3	2.7
Gross reserves (in billions of U.S. dollars)	32.0	34.8
Central government balance (in percent of GDP)	-1.8	-1.9
Revenues and grants	18.6	18.7
Expenditures and net lending	20.4	20.7
Base money growth (end of period)	8.3	10–11

Table 2. Indonesia: Quantitative Performance Criteria (PC) and Indicative Targets (IT)  
Under the Extended Arrangement, 2002–03 1/

	2002		2003						
	Dec.	Mar.		Jun.		Sep.		Dec.	
	Actual	PC	Actual	PC 2/	Actual	PC Orig.	Rev.	IT Orig.	Rev.
<b>Monetary and fiscal targets</b>									
Net domestic assets (NDA) of Bank Indonesia	-16.8	-24.5	-36.9	-18.0	-32.9	-15.6	-25.4	0.6	-9.0
Base money (indicative target) 3/	132.2	129.3	123.0	134.5	128.7	138.1	134.1	150.4	146.6
Overall central government balance 4/	-28.3	-7.6	10.1	-15.6	-2.2	-25.6	-25.6	-34.4	-34.4
<b>External targets (in billions of U.S. dollars)</b>									
Net international reserves (NIR) of Bank Indonesia 5/	22.2	22.2	23.2	22.0	23.6	22.2	23.0	22.2	23.0
Contracting or guaranteeing of new noncessional external debt 6/	0.8	0.3	0.2	0.6	0.2	1.0	1.0	1.5	1.5
<i>Of which</i> : Government debt to commercial creditors	0.1	0.2	0.0	0.2	0.0	0.2	0.2	0.2	0.2
Stock of short-term external debt outstanding	0.5	2.5	0.3	2.5	0.1	2.5	2.5	2.5	2.5

1/ Definitions are contained in the Technical Memorandum of Understanding (EBS/03/35, Supplement 1). Continuous performance criteria are: the nonaccumulation of public external arrears and no securitization or forward sale of receipts from natural resources.

2/ Adjusted targets for NIR and NDA.

3/ Base money targets are one-month averages centered on end-month.

4/ Cumulative balances from beginning of fiscal year (floor). Central government bonds issued to district and provincial government are included as financing of the central government deficit.

5/ Outstanding stocks (floor).

6/ Cumulative amounts from beginning of fiscal year (ceilings).

Table 3. Indonesia: Structural Benchmarks

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**March 2003**

- Finalize comprehensive plan for financial sector safety net.
- Formulate plans and targets for audits, tax arrears collection, and registration of taxpayers.
- Collect at least Rp 3 trillion in cash by IBRA (net of expenses).
- Adopt implementation schedule for the restructuring of BTN.

**April 2003**

- Conclude majority divestment of Bank Danamon.
- Launch majority divestment of Bank Lippo.
- Finalize blueprint for strengthening the treasury and budget functions of the Ministry of Finance.
- Issue ministerial decree liberalizing conditions under which VAT refund claims may be approved.

**June 2003**

- Collect at least Rp 7 trillion in cash by IBRA (net of expenses).
- List IPO for Bank Mandiri on the stock exchange.
- Appoint additional commissioners to ensure each state bank has four to five commissioners in place.
- Launch a fourth round of performance audits of state enterprises.
- Produce report on 2002 local government finances, with coverage of at least 85 percent of jurisdictions.
- Complete sale of BI's overseas subsidiary.

**September 2003**

- Collect at least Rp 18 trillion in cash by IBRA (net of expenses).
- Launch IPO for BRI.
- Finalize strategy for the resolution of assets that may remain unsold at the end of IBRA's mandate.

**December 2003**

- Launch majority divestment of remaining two IBRA banks.
  - Announce strategic plan for future of Bank Mandiri.
  - Complete the expansion of large taxpayer offices to increase coverage to 35 percent of the tax collections of the Directorate General of Taxation.
  - Ensure that the Anti-Corruption Commission is fully operational.
  - Achieve budget privatization target of Rp 8 trillion.
-

INTERNATIONAL MONETARY FUND

INDONESIA

**Tenth Review Under the Extended Arrangement and  
Request for Waiver of Applicability**

**Supplementary Information**

Prepared by the Asia and Pacific Department  
(In consultation with other departments)

Approved by David Burton and Leslie Lipschitz

October 3, 2003

1. **This supplement updates economic and policy developments since the staff report was issued on September 18, 2003.** The staff appraisal remains valid.

**I. RECENT DEVELOPMENTS**

2. **Financial market sentiment has been lifted further by a Moody's upgrade at end-September of Indonesia's sovereign credit rating (to B2 from B3).** The rating agency cited the strengthening external financial position and an improved trend in government debt ratios as the main factors behind the upgrade. Nevertheless, the new rating is still several notches below investment grade and the ratings of other emerging markets in the region. In recent weeks the rupiah has remained in a narrow range around Rp 8,400 per dollar and the stock market has rallied further, rising to a 3½ year high (up close to 50 percent for the year).

3. **Inflation eased to 6.2 percent in September, year-on-year (from 6.4 percent the previous month).** The decline was driven largely by lower food prices, with core inflation remaining broadly unchanged at 7½ percent. The staff's outlook for end-year inflation remains around 5–6 percent.

**II. PERFORMANCE UNDER THE PROGRAM**

4. **Preliminary data indicate that the end-September performance criteria on NIR and NDA were achieved** (that data suggest that NIR was \$0.6 billion above the floor, and NDA was Rp 4½ trillion below the corresponding ceiling).<sup>1</sup> It is possible that the indicative

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<sup>1</sup> The end-September performance criteria (PC) would have applied for this purchase, given that the Executive Board meeting is being held in October. However, as final data to assess the PCs are not yet available, it has been proposed in the staff report to waive their applicability. The PCs will apply to the next scheduled purchase for the eleventh review.

target on base money may be missed by a small margin, but full data are not yet available, as the test period (a four-week average measure) runs through October 15.

5. **Parliament passed the revised 2003 Budget on September 23** (Table 1). As anticipated, the revised budget targets an annual deficit of 2.0 percent of GDP, slightly higher than the program ceiling of 1.9 percent of GDP owing to a downward revision of national income. Relative to what had been anticipated in the staff report, Parliament has authorized somewhat higher spending (mainly on development spending and for the allocation of the contingency fund). The revised budget assumes higher revenues, consisting mainly of nontax revenues (from increased transfers from state-owned enterprises) and higher non-oil tax receipts. While the staff considers the revenue outlook in the revised budget to be optimistic, the original budget target appears achievable given the budget performance to date, which indicate continued shortfalls in spending.

6. **Available information on the performance against the three end-September structural benchmarks indicates the following** (see Table 2 of the staff report; a more complete assessment will be provided at the next review):

- (i) The IPO for the state bank BRI has been launched.
- (ii) Data on IBRA cash recoveries are still being collected, but it is unlikely that the third quarter target of Rp 18 trillion will be met. Nevertheless, given the asset sales in the pipeline, this target, which is also the full-year cash recoveries target, should be achieved by end-year.
- (iii) IBRA has now finalized proposals for resolving assets unsold at the end of its mandate (see ¶32 of the staff report), broadly in line with those envisaged in the staff report. The government expects to reach a decision on this issue in the coming weeks.

7. **There has been welcome progress on the Anti Corruption Commission (ACC) and on the anti-money laundering (AML) initiatives.** With regard to the former, the nominating committee responsible for selecting the commissioners of the ACC has been established. It is expected that the committee will present a short-list of candidates for commissioners to the President by end-November. On the latter, Parliament has passed amendments to the AML legislation that addresses the concerns of the Financial Action Task Force (FATF), thereby averting the imposition of counter measures.

Table 1. Indonesia: Summary of Central Government Operations, 2002–2003

	2002	2003		
		Ninth Review	Staff Projection	Revised Budget
(In trillions of rupiah)				
Revenues and grants	300.1	333.4	332.4	340.3
Oil and gas revenues	77.8	73.9	77.0	78.5
Non-oil and gas revenues	222.2	259.5	255.1	261.8
Tax revenues	193.1	233.7	228.1	230.4
Nontax revenues 1/	29.1	25.8	27.4	31.4
Expenditure and net lending	328.4	367.8	366.8	377.2
Central government expenditure	229.9	249.6	249.8	257.9
Current expenditure	192.9	193.2	196.4	199.0
Personnel	39.8	50.2	50.4	50.4
Subsidies	40.0	28.0	36.3	34.7
Interest	89.9	77.4	72.3	72.2
External	25.4	25.5	23.4	23.3
Domestic	64.5	51.9	48.9	48.9
Other	23.2	37.6	37.3	41.7
Development expenditure 2/	35.6	56.4	53.4	58.9
Statistical discrepancy	1.4	0.0	0.0	0.0
Transfers to regions	98.5	118.2	117.1	119.3
Overall balance	-28.3	-34.4	-34.4	-36.9
Financing	28.3	34.4	34.4	36.9
Domestic	24.0	26.1	33.4	34.0
Bank financing 3/	-21.8	-5.4	-1.1	-2.5
Recovery of bank assets 4/	43.3	26.0	26.0	27.6
Privatization	7.6	5.0	6.0	6.4
Other	-5.1	0.5	2.5	2.5
External	4.3	8.3	1.0	2.9
(In percent of GDP)				
Revenues and grants	18.6	18.3	18.7	19.0
Oil and gas revenues	4.8	4.0	4.3	4.4
Non-oil and gas revenues	13.8	14.2	14.4	14.6
Tax revenues	12.0	12.8	12.8	12.9
Nontax revenues 1/	1.8	1.4	1.5	1.8
Expenditure and net lending	20.4	20.2	20.7	21.1
Central government expenditure	14.3	13.7	14.1	14.4
Current expenditure	12.0	10.6	11.1	11.1
Personnel	2.5	2.8	2.8	2.8
Subsidies	2.5	1.5	2.0	1.9
Interest	5.6	4.2	4.1	4.0
External	1.6	1.4	1.3	1.3
Domestic	4.0	2.8	2.8	2.7
Other	1.4	2.1	2.1	2.3
Development expenditure 2/	2.2	3.1	3.0	3.3
Statistical discrepancy	0.1	0.0	0.0	0.0
Transfers to regions	6.1	6.5	6.6	6.7
Overall balance	-1.8	-1.9	-1.9	-2.1
Financing	1.8	1.9	1.9	2.1
Domestic	1.5	1.4	1.9	1.9
Bank financing 3/	-1.4	-0.3	-0.1	-0.1
Recovery of bank assets 4/	2.7	1.4	1.5	1.5
Privatization	0.5	0.3	0.3	0.4
Other	-0.3	0.0	0.1	0.1
External	0.3	0.5	0.1	0.2
Memorandum items:				
Primary balance	3.8	2.4	2.1	2.0
Non-oil primary balance	-1.0	-1.7	-2.2	-2.4
Non-oil overall balance	-6.6	-5.9	-6.3	-6.4
GDP (in trillions of rupiah)	1,610	1,825	1,775	1,791

Sources: Data provided by the Indonesian authorities; and Fund staff estimates.

1/ Includes grants (Rp 0.3 trillion in 2002 and 2003).

2/ Excludes military expenditures, which are included in other current expenditure.

3/ In 2003, includes net issuance of domestic debt.

4/ In 2002 and 2003, includes total IBRA receipts (rather than the amount needed to finance the deficit).



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FOR IMMEDIATE RELEASE  
October 8, 2003

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Completes Tenth Review of Indonesia Program, Approves US\$493 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) completed today its tenth review of Indonesia's performance under a SDR 3.6 billion (about US\$5.2 billion) Extended Fund Facility arrangement (see [Press Release No. 00/4](#)). This opens the way for release of a further SDR 344 million (about US\$493 million), bringing the total amount drawn under the arrangement to SDR 3.3 billion (about US\$4.7 billion).

At the conclusion of the Executive Board's discussion on Indonesia's economic and structural reform program, Anne Krueger, First Deputy Managing Director and Acting Chair, stated:

"Indonesia's economic performance has continued to evolve favorably under the Fund-supported program, with a sustained economic recovery, a continued easing of inflation, and a further increase in external reserves. These favorable developments have bolstered financial market sentiment toward Indonesia, and have further reduced the economy's vulnerability to external shocks.

"Fiscal policy is on track, with the budget deficit outturn through the first half of the year well within the mid-year target for 2003. The government's 2004 budget proposal represents a further welcome step toward fiscal consolidation. To enhance Indonesia's tax base, the government is pressing ahead with efforts to strengthen tax and customs administration. Work is also proceeding with the restructuring of the Ministry of Finance, to strengthen its treasury and budget operations.

"The authorities are to be commended for the continued downward trend in inflation which, together with the stable exchange rate, has enabled interest rates to be reduced further in support of the economic recovery. Bank Indonesia's commitment to maintain a cautious monetary stance is also welcome given the need to consolidate the recent gains in inflation and exchange rate stability.

"The authorities have continued to advance important financial sector reforms, and the divestment of government ownership in banks is proceeding well. Efforts toward implementing the government's plan for a strengthened financial sector safety net, including the establishment of a deposit insurance scheme and clarification of the Bank Indonesia's role as lender of last resort, are well advanced. The on-going improvement in the health of the banking system is



welcome, and the authorities are taking appropriate steps to strengthen the governance and monitoring of state banks. The structural reform program is also progressing in other areas. The Indonesian Bank Restructuring Agency is, for example, expected to complete its asset sales programs ahead of its scheduled closure in early 2004.

“Nevertheless, the authorities need to make further progress to strengthen the investment climate to enable Indonesia to realize its economic potential. They need to redouble efforts to strengthen governance and sustain the momentum of legal and judicial system reforms, for example, through the early establishment of the Anti-Corruption Commission.

“The government’s decision to graduate from exceptional financing when the current arrangement expires is welcome. Indonesia’s challenge is to maintain investor confidence through the continuation of sound policy implementation after the Fund-supported program concludes and as the 2004 elections draw near. The government’s detailed “White Paper” laying out the economic strategy will play an important role in this regard. It will be essential for the government to ensure an adequate prioritization, and consistent and timely implementation, of reforms. The authorities can look forward to continued support with their policy implementation during the remainder of the program and to maintaining a close policy dialogue with the Fund thereafter in the context of post-program monitoring,” Ms. Krueger stated.