

**Indonesia: Eleventh Review Under the Extended Arrangement—Staff Report; and  
Press Release on the Executive Board Discussion**

In the context of the fourth review under the stand-by 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 eleventh review under the extended arrangement, prepared by a staff team of the IMF, following discussions that ended on **November 13, 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 December 10, 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 Press Release summarizing the **views of the Executive Board as expressed during its December 19, 2003 discussion** of the staff report that completed the review.

The documents listed below have been separately released.

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

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

**Eleventh Review Under the Extended Arrangement**

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

Approved by David Burton and Leslie Lipschitz

December 10, 2003

- Discussions for the final review under the extended arrangement were held in Jakarta during November 3–13. 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, parliamentarians, and representatives of the 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. Fisher (Assistant, APD), and was assisted by Messrs. Nellor, Khatri, and Taylor of the Fund's Jakarta Office. The mission worked closely with overlapping FAD, LEG, and MFD technical assistance teams, and with the World Bank and AsDB.
- The 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. Ten reviews have been completed and a total of SDR 3.3 billion has been purchased, bringing Indonesia's obligations to the Fund to SDR 6.7 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 (October 8, 2003), Directors welcomed the favorable progress under the program and were encouraged by the continued improvement in macroeconomic performance. They emphasized that maintaining sound policy implementation would be essential to preserving investor confidence after the Fund program concludes at the end of the year. Also, further progress was needed to strengthen the investment climate, especially in the areas of governance and legal reform, as economic growth remained below potential. Consistent and timely implementation of the economic strategy laid out in the government's "White Paper" would be key in this regard.
- All end-September quantitative performance criteria were met, although the indicative target on base money was exceeded by a small margin (LOI, Table 1). Progress against the September structural benchmarks was also satisfactory (LOI, Table 2). In view of the continued progress in policy implementation, the staff supports the authorities' request for completion of the review.
- The attached report is an update of developments for the final program review. A more comprehensive assessment of economic developments and overall performance under the program will be provided at the time of the Article IV consultation in early 2004.

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## EXECUTIVE SUMMARY

### Performance under the program

- **While macroeconomic developments continue to evolve in line with the program's objectives, investment has yet to revive as needed to boost long-term prospects.** GDP growth edged up to 3.9 percent in the third quarter (year-on-year), driven by private consumption with investment remaining sluggish. Inflation continues to trend down, to 5.3 percent in November, and external reserves have risen further. Although still generally positive, financial market sentiment has cooled off. The rupiah is stable and the stock market has remained near a 3½ year high, but government bond yields have risen sharply.
- **Macroeconomic policies are on track, and all end-September quantitative performance criteria were met with margins.** However, the indicative target for base money was exceeded by a small margin. Key issues included:
  - With bond yields rising and base money growth increasing, the mission stressed that further interest rate cuts at this stage could put the recent gains in exchange rate stability and inflation at risk. The authorities agreed to maintain policy interest rates at current levels for the time being.
  - Fiscal policy remains on track to achieve the 2003 deficit target (1.9 percent of GDP), although revenues continue to underperform. The 2004 budget targets a further decline in the deficit to 1.3 percent of GDP. Nevertheless, the step-up in domestic financing (in the absence of debt rescheduling) will need to be managed carefully.
- **Performance against the program's structural benchmarks through September has been broadly satisfactory:**
  - The bank divestment program is proceeding well, boosted by the IPO of state bank BRI, and IBRA recoveries should exceed the full-year target. Progress has also been made in strengthening the financial sector safety net and advancing privatization.
  - However, a recent scandal at bank BNI and continuing concerns about the state banks' growth strategies highlight the need to strengthen their accountability and governance. Further efforts are also needed on legal and other reforms to improve the investment climate.

### Post-program relations with the Fund

- **The authorities intend to maintain a close policy dialogue with the Fund in the context of Post Program Monitoring (PPM).** In addition to safeguarding Fund resources, it is expected that PPM will provide the authorities with a useful external assessment of economic conditions and policy developments.
- **Two PPM Board meetings are anticipated in 2004.** The first of these will coincide with the Article IV consultation, which will undertake a retrospective of Indonesia's recovery and policy performance. Staff visits will complement the PPM missions.

## I. PERFORMANCE UNDER THE PROGRAM AND ECONOMIC OUTLOOK

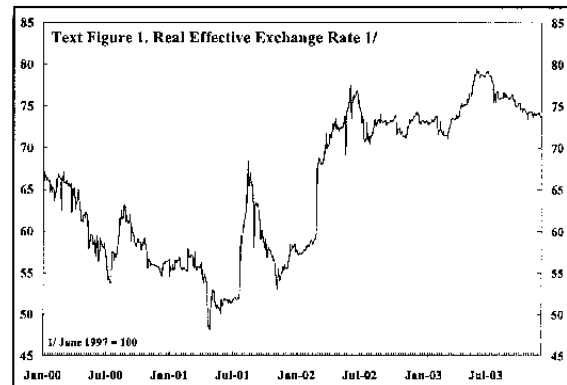
1. **As the arrangement draws to a close, policy implementation has continued to be satisfactory, and the economic recovery is advancing.** GDP growth is slowly gaining pace, inflation continues to decline, and a further increase in external reserves is helping to reduce the economy's vulnerability to external shocks. Nevertheless, significant challenges remain to maintain economic stability and investor confidence as the program ends and next year's elections draw near. Efforts to strengthen the investment climate also need to be intensified, as Indonesia continues to perform below its economic potential.

### Performance under the program

2. **Macroeconomic developments have continued to evolve in line with the objectives under the program (Table 2 and Figure 1):**

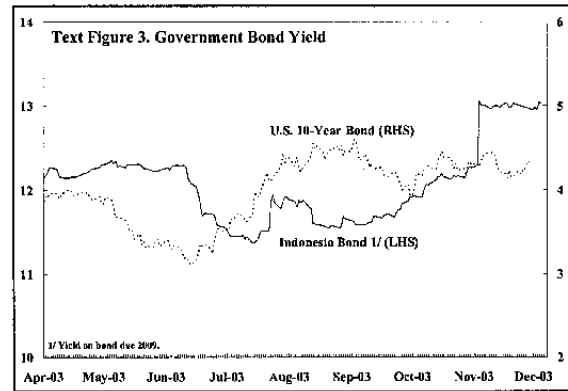
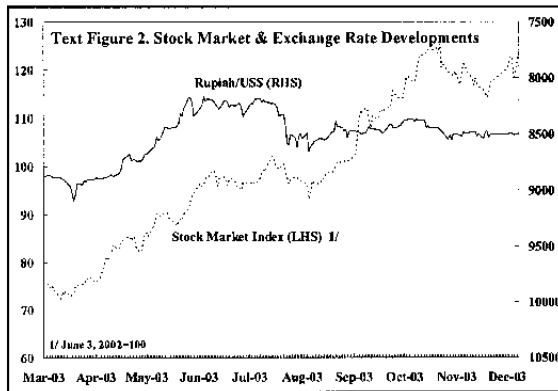
- **GDP growth in 2003 is still expected to be in the range of 3½ to 4 percent.** Growth in the third quarter rose to 3.9 percent (year-on-year) from 3.8 percent in the second quarter. With private consumption growth remaining strong, GDP growth could reach the upper end of the range envisaged under the program. Investment remains sluggish, however (up less than 3 percent so far this year).
- **Inflation should end the year below 6 percent** (in line with staff projections at the tenth review). Headline inflation dropped to 5.3 percent in November (year-on-year), from about 6 percent the previous two months, reflecting largely a decline in food price inflation. Core inflation was 7.0 percent, unchanged from October and down only slightly from 7.3 percent in September.
- **The external current account surplus is turning out higher than expected, but this has been offset by lower private capital inflows** (Table 3). With gas exports and worker remittances running above target, the current account surplus has been revised upward further to \$7¼ billion (3.5 percent of GDP). However, the latest data suggests that private capital inflows, notably foreign direct investment, have been weaker than expected. The end-year projection for gross reserves has consequently been left broadly unchanged at \$35 billion.

- **The real effective exchange rate has remained broadly stable this year, and remains around 25 percent more depreciated than its pre-crisis level** (Text Figure 1). Given the depreciation of the dollar against other currencies, Indonesia's NEER has declined by about 3 percent so far this year.



- **While financial market sentiment remains generally positive, it is somewhat less bullish than at the time of the last review** (Text Figures 2 and 3). Although the rupiah has remained stable and the stock market remains near a 3½ year high,

bond yields have risen sharply. While the latter partly reflects rising global interest rates, and a sell-off of bonds by bank-sponsored mutual funds (driven partly by technical factors), it also reflects some retrenchment in the previously strong sentiment toward rupiah assets.<sup>1</sup>



3. **All end-September performance criteria were met and satisfactory progress was made against the structural benchmarks for this review (through September).** As discussed below, progress is also being made toward achieving the quantitative targets and structural benchmarks set for end-December.

4. **Although the end-September NIR and NDA targets were met with margins, the base money target was missed by a small amount (Table 4).** However, with inflation continuing to decline and the exchange rate remaining stable, Bank Indonesia (BI) continued to ease interest rates, reducing its key policy rate (the overnight deposit facility rate) by a further 25 basis points in late October (the one-month SBI rate has eased correspondingly, to just under 8½ percent).

5. **The budget deficit (Rp 16.2 trillion) was well within the end-September ceiling of Rp 25.6 trillion, with expenditure running significantly below budget (Table 5).** Revenues, however, have continued to underperform, owing mainly to lower-than-expected income tax receipts (reflecting lower interest withholding and corporate taxes, as well as higher refunds). The revenue shortfalls were more than offset by lower recurrent spending (partly reflecting delays in subsidy payments). Implementation of the development budget has picked up, following an acceleration of project execution in the third quarter.

6. **Performance against the structural reform objectives under the program is broadly on track (Table 6).** The bank divestment program is proceeding (although the sale of Bank Lippo has been delayed and has had to be relaunched—see ¶19), and while the third quarter target for IBRA cash recoveries was not met, the full-year target is expected to be

<sup>1</sup> There were significant net withdrawals from bank-sponsored mutual funds in October and November (Rp 12 trillion or 15 percent), following steps to tighten supervision of these funds. In addition to clarifying that the funds were not covered by the blanket deposit guarantee, banks will be required to cease guaranteeing returns to investors in their mutual funds (prompting some banks to unwind their funds).

met, if not exceeded (see ¶25). All the remaining structural benchmarks through September have been met, with the exception of the sale of BI's overseas subsidiary, which, as noted at the tenth review, is running slightly behind schedule. (The sale was launched later than expected and will now be completed early next year.)

### **2004 economic outlook**

7. **The mission reviewed the macroeconomic outlook for 2004.** With GDP growth in 2003 now likely to be in the middle of the 3½–4 percent range, and with the external environment strengthening, the staff's projection for 2004 has been raised to 4½ percent (from 4 percent). With lower inflation expectations beginning to take hold, and administered prices remaining unchanged (see ¶18), the staff projects inflation to decline to around 5 percent in 2004, assuming that the rupiah stays stable and Bank Indonesia maintains a cautious monetary stance. (Core inflation is projected to decline to 5½ percent.)<sup>2</sup>

8. **Indonesia's external financing needs are still expected to be manageable in 2004 provided that investor confidence is maintained.** International reserves are projected to decline by about \$1½ billion without the recourse to exceptional financing of recent years, but this loss should start to reverse in subsequent years, provided that fiscal consolidation remains on track and private capital flows start to pick up from their presently depressed levels. In the meantime, reserves should remain comfortable in relation to imports and short-term debt. Provided market confidence is maintained, the budget financing outlook should also remain manageable (Table 7). The staff's assessment of Indonesia's debt sustainability remains unchanged from the last review, with public and external debt ratios projected to decline steadily over the medium term. A more comprehensive assessment of the medium-term financing outlook and debt sustainability will be undertaken at the time of the 2004 Article IV consultation.

## **II. POLICY DISCUSSIONS**

9. **The main priority of the mission was to seek assurances that policies were on track to facilitate a smooth transition to the post-program environment.** To this end the mission focused on ensuring the continuation of a sound macroeconomic framework and adequate progress in the structural reform agenda. The latter discussions focused primarily on bringing IBRA's operations to a successful conclusion and ensuring that steps were being taken to place the state banks on a sounder footing. The mission also continued to emphasize the importance of pushing ahead with legal and other reforms to strengthen the investment climate.

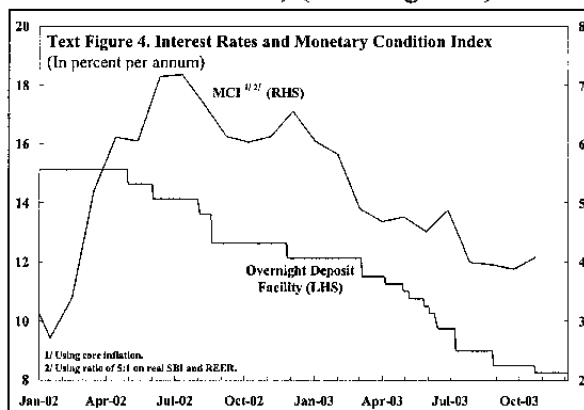
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<sup>2</sup> The authorities broadly agree with this outlook, although they have a slightly higher growth projection (4.8 percent) and wish to retain a more conservative inflation target (6½ percent).

## A. Macroeconomic Policies

### Monetary and exchange rate policy

10. **The mission expressed concern about the recent pace of interest rate reductions** (a cumulative decline of 225 basis points between June and October) (Text Figure 4). While welcoming that the fall in inflation this year has facilitated a decline in interest rates, the mission noted that base money growth remained high and that with indications that the risk premium for rupiah assets might be widening, the scope for further interest rate cuts in the period ahead had narrowed significantly. Also, the latest interest rate cut in late October (25 basis points) came during the days when the rupiah was under some pressure and government bond yields were rising.<sup>3</sup> In the event, it was agreed that absent a significant improvement in inflation, interest rates should be kept unchanged at their present levels. BI also noted that it expected base money to come back in line with the program path, and expressed confidence that the end-year indicative target would be met.



11. **Since the mission, BI has left policy rates unchanged, despite the decline in inflation in November** (the data was released on December 1). BI has so far kept its overnight deposit facility rate unchanged at 8¼ percent and the Governor has stated publicly that interest rates now have less scope to decline. The one-month SBI rate has remained broadly stable (at 8½ percent) as a result.

12. **The mission continued to support a gradual move to an inflation-targeting framework.** BI is preparing the groundwork for a gradual move to inflation targeting during 2004. However, as technical preparations for such a move are not yet complete, BI agreed that monetary policy should continue to be guided by a base-money path in 2004 (see ¶5 of LOI) to avoid unsettling markets through an abrupt shift in the monetary regime at the end of the Fund arrangement.

### Fiscal policy

13. **The mission agreed with the authorities that the 2003 budget deficit (1.9 percent of GDP) remained achievable.** While revenues were likely to be lower than projected in the revised budget (perhaps by as much as Rp 7 trillion or 0.3 percent of GDP), these shortfalls should be offset by lower expenditure, provided that spending remains relatively restrained in

<sup>3</sup> The rupiah came under some pressure for a few days in October, in the wake of the sell-off in mutual funds and the revelation of a major fraud at bank BNI, but soon stabilized at around Rp 8,500 per dollar.



the fourth quarter. The authorities noted that, while the revised budget had approved higher spending on the development budget, this would in practice be difficult to realize, and there was also further room to contain spending as some contingency funds remain unallocated. Efforts would also be made to raise revenue collections, so as to avoid an undesirable compression of expenditure, and budget execution would be monitored closely over the remainder of the year to ensure that the budget deficit target was achieved (see ¶4 of LOI).

14. **The 2004 budget was approved by Parliament in early November** (Box 1). The budget targets a deficit of 1.3 percent of GDP (slightly lower than the 1.4 percent of GDP envisaged at the time of the tenth review).<sup>4</sup> The primary surplus is expected to be broadly unchanged (at around 2 percent of GDP), with a decline in oil revenues (due to lower oil prices<sup>5</sup>), offset by lower outlays on subsidies and transfers to the regions (the latter primarily reflects the effect of lower oil prices on subsidies and lower oil revenues on transfers). The budget also provides for an increase in development spending.

15. **The mission discussed the authorities' plans to contain a number of risks to the 2004 budget outlook.** These related primarily to the revenue outlook and the risks associated with the significant increase in the domestic financing requirement in 2004:

- Revenue risks** (Text Table 1). The mission welcomed the development of a detailed action plan to further strengthen tax administration (yielding 0.2 percent of GDP), but noted that the increase in non-oil tax revenue assumed in the budget (0.8 percent of GDP) appeared optimistic. The authorities acknowledged that the revenue target is ambitious, but considered this appropriate in light of the need to raise the non-oil revenue effort. In their view, there remained significant upside potential on the revenue side, particularly if the recent efforts to increase tax compliance and reduce tax avoidance were sustained. They also noted that the budget is based on a conservative oil price assumption. To the extent that downside risks remained, they believed that, as in previous years, there was sufficient room for maneuver on the spending side to ensure that the budget deficit target would be achieved. The budget contains a significant allocation for contingencies (0.5 percent of GDP).

|                         | 2003  | 2004   |       |
|-------------------------|-------|--------|-------|
|                         | Proj. | Budget | Staff |
| Revenue                 | 18.7  | 17.7   | 17.7  |
| Oil                     | 4.4   | 2.9    | 3.5   |
| Tax 1/                  | 12.4  | 13.2   | 12.6  |
| Non-tax 1/              | 1.9   | 1.6    | 1.6   |
| Expenditure             | 20.7  | 19.1   | 19.1  |
| Deficit                 | 1.9   | 1.3    | 1.3   |
| Memorandum items:       |       |        |       |
| Primary balance         | 2.1   | 2.0    | 2.1   |
| Non-oil primary balance | -2.3  | -0.9   | -1.4  |
| 1/ Non oil.             |       |        |       |

- Financing risks.** The mission noted that the recent increase in bond yields illustrated that the outlook for domestic financing (in particular the projected step-up in domestic bond issuance) still contained some downside risks, particularly with respect to the price at which

<sup>4</sup> The official deficit target is 1.2 percent of GDP, as the budget treats deposit insurance premia as revenue (rather than financing) and has a higher assumption for nominal GDP.

<sup>5</sup> The budget assumes a price for Indonesian oil (\$22 per barrel) that is somewhat lower than implied by the latest WEO projections (\$26½ per barrel).

### BOX 1. 2004 BUDGET

The 2004 budget was approved by Parliament on November 10. The main parameters are broadly unchanged from the government proposal presented in August, with the following key features:

- **A budget deficit target of 1.3 percent of GDP** (down from 1.9 percent of GDP projected for 2003).<sup>1</sup> The primary surplus is expected to remain broadly unchanged in 2004 (at around 2 percent of GDP), with a decline in oil revenues offset by an increase in non-oil tax revenues, a decline in outlays on subsidies and lower transfers to the regions. The underlying macroeconomic assumptions are broadly unchanged (see table).

- **Total revenue is targeted to decline by 1.0 percent of GDP**, consisting of: (i) a 1.5 percent of GDP decline in oil and gas revenues, reflecting lower oil prices; (ii) a projected decline of 0.3 percent of GDP in nontax revenue, owing mainly to lower profit transfers from state-owned enterprises; and (iii) an increase in tax revenues by 0.8 percent of GDP, from continued improvement in tax administration (0.2 percent of GDP) and ongoing efforts to increase tax compliance.

- **Expenditure is budgeted to decline by 1.6 percent of GDP.**

Interest payments are projected to decline by 0.7 percent of GDP, in line with the assumed decline in domestic interest rates. Primary spending is projected to fall by 0.9 percent of GDP due mainly to: (i) lower subsidy outlays (0.6 percent of GDP), arising from lower oil prices (0.4 percent of GDP)<sup>2</sup>, and some reduction in non-fuel subsidies (e.g., the subsidized interest credit program); and (ii) lower transfers to regions (0.6 percent of GDP), reflecting the decline in oil and gas revenues, as well as some streamlining of the special autonomy fund.

- **Development spending is projected to rise by 0.2 percent of GDP in 2004.** The largest share of the development budget is allocated to education, transportation, and health and social assistance and programs targeted at poverty alleviation.

- **The budget deficit will be financed primarily from domestic sources** (see table). In the absence of debt rescheduling, net external debt repayments are projected to rise to 0.8 percent of GDP (from 0.2 percent in 2003). The budget assumes foreign loans of \$3.3 billion (of which \$1 billion in program loans) against projected amortization payments of \$5.2 billion. With proceeds from privatization and IBRA asset sales projected to decline to 0.5 percent of GDP (from 1.9 percent of GDP), net domestic financing from other sources is projected to rise to 1.6 percent of GDP. This net financing requirement is to be covered partly by government bonds (net issues of 0.5 percent of GDP),<sup>3</sup> a drawdown of central bank deposits (1.0 percent of GDP) and deposit insurance premia (0.1 percent of GDP).

|                               | 2003  | 2004   |       |
|-------------------------------|-------|--------|-------|
|                               | Staff | Budget | Staff |
| GDP                           |       |        |       |
| Growth                        | 3.8   | 4.8    | 4.5   |
| Nominal GDP                   | 1,780 | 2,000  | 1,962 |
| (In trillions of rupiah)      |       |        |       |
| Inflation                     |       |        |       |
| Period average                | 6.6   | 6.5    | 5.4   |
| Exchange rate                 |       |        |       |
| Period average                | 8,575 | 8,600  | 8,600 |
| Interest rate                 |       |        |       |
| Period average                | 10.0  | 8.5    | 8.5   |
| Indonesian oil price (\$/bbl) | 27.4  | 22.0   | 26.5  |
| Oil production ('000 bpd)     | 1,100 | 1,150  | 1,150 |

|                    | 2003 | 2004   |
|--------------------|------|--------|
|                    |      | Budget |
| Budget deficit     | 1.9  | 1.3    |
| Amortization       | 2.8  | 3.4    |
| Domestic 1/        | 1.7  | 1.1    |
| External 2/        | 1.1  | 2.3    |
| Gross financing    | 4.7  | 4.7    |
| External 3/        | 0.9  | 1.4    |
| Privatization/IBRA | 1.9  | 0.5    |
| Other domestic 4/  | 1.9  | 2.8    |

1/ Includes debt-buybacks and IBRA bond redemptions.  
2/ Net of rescheduling.  
3/ Excludes sovereign bond issuance.  
4/ Deposit withdrawals and issuance of government bonds.

<sup>1</sup> The deficit ratios reported in this box are based on staff's estimates of nominal GDP and the program treatment of deposit insurance premia (shown below the line).

<sup>2</sup> The budget assumes that fuel prices will remain unchanged from current levels in 2004.

<sup>3</sup> The budget assumes gross bond issuance of 1.7 percent of GDP, partly covered by a sovereign bond issue.

the government will be able to place its bonds next year.<sup>6</sup> In response, the authorities indicated that they have some flexibility in their funding sources to minimize such risks. Over and above the levels assumed in the budget, Parliament has authorized a larger sovereign bond issue<sup>7</sup> and there is also scope for increasing the drawdown of government deposits at the central bank (financing from this source will need to be coordinated carefully with BI to ensure consistency with the monetary program).

**16. The mission welcomed the good progress that continued to be made on the reform of tax and customs administration.** The program to expand large taxpayer offices is proceeding, although the increase in the number of taxpayers under such offices may fall somewhat short of the end-December benchmark (35 percent of tax collections). Satisfactory progress has also been made on the reform of customs administration (focused on trade facilitation, improving governance and strengthening the payments system). As noted above, plans for extending the reforms in 2004 are well advanced. In addition to securing the revenue goals for next year (through further efforts to enhance taxpayer registration, audit coverage, and arrears collection), the priority will be to: (i) further the modernization of tax administration (by reforming audit procedures, expanding the large taxpayer offices and introducing a pilot office for medium-size taxpayers); (ii) simplify VAT administration; (iii) strengthen the governance framework; and (iv) modernize tax office information technology.

**17. Satisfactory progress has also been made on the other elements of the fiscal reform agenda.** The decrees implementing the restructuring of the Ministry of Finance are being finalized and the reorganization is expected to commence in early 2004 (the initial focus will be on the creation of a new treasury department and the rationalization of the budget preparation and execution functions). In the area of fiscal decentralization, steady progress is being made to improve regional budget reporting. (The annual accounts for 2001 and 2002, covering over 95 percent of the regions, show that the regions have been running a combined surplus of ½–1 percent of GDP in the last two years). The timeliness of budget reporting needs further improvement, however (only 30 percent of regions have reported their March 2003 outturns), and the introduction of a new budget classification will need to be managed carefully to avoid confusion at the regional level.

**18. The authorities' plans to reintroduce an automatic fuel price adjustment mechanism and eliminate fuel subsidies have been put on hold.** The authorities have concluded that implementing such a sensitive reform in an election year would pose insurmountable difficulties. As the budgetary impact of delaying this reform is modest (0.2 percent of GDP) the authorities have decided to keep domestic fuel prices and electricity

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<sup>6</sup> The budget assumes that bonds issued next year will carry a yield of 13 percent. A 100 basis point increase in yields would raise interest costs by 0.1 percent of GDP.

<sup>7</sup> The budget assumed a sovereign bond issue of \$500 million. This could be increased to up to \$1 billion.

tariffs unchanged at their present levels for the time being.<sup>8</sup> Although the impact on the budget is small, the mission encouraged the authorities to reinstate an automatic fuel price mechanism as soon as international oil prices return to more normal levels.

## B. Structural Reforms

### Financial sector

19. **The mission discussed the status of IBRA's bank divestment program.** While the sale of bank BII was being completed (ahead of schedule), IBRA suspended the sale of bank Lippo in late October, as the bids received in the sale launched in August were unacceptably low (less than 65 percent of IBRA's floor price). The authorities are determined to sell Lippo and have just relaunched the sale with a view to completing it by February (see ¶7 of LOI). The divestment of IBRA's remaining bank, Permata, is still scheduled for launch in early 2004, once pending legal issues are resolved. (These relate to the financial scandal which affected Bank Bali, one of Permata's constituent banks, in 1999.)

20. **The divestment of shares in state banks is also proceeding.** The initial public offering for bank BRI has been completed, in which a 40 percent share in the bank was offered for sale. The offering, which was heavily oversubscribed, raised Rp 4 trillion, of which Rp 2.7 trillion will accrue to the government (the remainder will be used to strengthen the bank's capital base).

21. **The mission expressed concern, however, about the continued fragilities in the state banks.** In addition to general concerns about the financial condition of the state banks, serious questions have been raised about bank BNI (the second largest bank), following the exposure of a major fraud in one of its branches. The fraud, which involved fictitious letters of credit, is expected to cost the bank around Rp 1¼ trillion, almost half the bank's profits in 2003. (BI had previously formally notified BNI about its weak internal controls and procedures, but the management had taken no action.)

22. **Steps have been taken to address the problems at BNI.** The government has called an extraordinary general meeting for December to change the management of the bank and is taking measures to ensure that the systemic problems with the bank's internal controls are addressed. In this regard, the first task of the new management of the bank will be to submit to BI an action plan to address the weakness in the bank's internal controls and management systems (see ¶9 of LOI).

23. **The mission urged the authorities to maintain close oversight of the other state banks.** In late September, three new external commissioners were appointed at Bank Mandiri, and an action plan to strengthen the bank's financial condition is in place.<sup>9</sup>

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<sup>8</sup> The budgetary impact is limited to the effect of keeping kerosene prices unchanged, as any higher subsidies associated with rising oil prices would be more than offset by higher oil revenue.

<sup>9</sup> The plan sets specific targets for improving the bank's liquidity, earnings, and cost of funds, and reducing its exposure to corporate borrowers.

Nevertheless, concerns about state banks' performance remain, particularly with regard to the pace of corporate lending. In this regard, the authorities agreed with the need to monitor closely Bank Mandiri's compliance with its action plan (see ¶9 of LOI). The mission welcomed that Mandiri's 2004 business plan would maintain a tight limit on its corporate lending. However, it encouraged the authorities to expedite work on the development of a strategic plan for the future of the Mandiri (and the other state banks) that would provide a framework for increasing private sector participation.

24. **In conjunction with the overlapping MFD team, the mission reviewed progress in reforming the financial sector safety net.** Work in the key areas is well advanced. Legislation establishing the new deposit insurance agency was submitted to Parliament in early November, and reforms to BI's lender of last resort facility have been finalized for inclusion in the amendments to the BI Law.<sup>10</sup> The mission welcomed the progress made, but urged both the government and BI to work cooperatively with Parliament toward a timely passage of these amendments, as well as to finalize transitional arrangements for managing bank resolution after IBRA's mandate expires in early 2004 (the deposit insurance agency will not be established until early 2005). With regard to the latter, the authorities have decided that, in the interim, routine cases of bank resolution will be managed by BI; systemic cases will be resolved by the government in consultation with BI (see ¶8 of LOI). The deposit guarantee will be transferred to the Ministry of Finance.

#### **IBRA issues**

25. **IBRA's cash recoveries are expected to exceed the annual target of Rp 18 trillion.** Recoveries through September (Rp 13.8 trillion) fell short of the third-quarter benchmark (also Rp 18 trillion). However, payments due from recently completed sales, amounting to around Rp 7 trillion, should be sufficient to ensure that the annual target is met.

26. **Further progress has been made in resolving the bank shareholder settlement agreements.** The transfer to IBRA of the remaining assets pledged under the large agreements for banks closed in 1998–1999 is nearly complete, and their sale has raised Rp 3.5 trillion so far in the fourth quarter. To expedite recoveries under the large agreements, IBRA has decided to offer for sale the promissory notes pledged under the four agreements (the so-called "MRNIAs") that were only partially collateralized (rather than continue to press the shareholders to settle their obligations in full).<sup>11</sup> With respect to the remaining smaller agreements, progress remains slow (only half the agreements are close to being settled) and the enforcement of agreements of noncooperative shareholders continues to be disappointing. Nevertheless, the authorities remain committed to bringing the outstanding cases to closure before IBRA's mandate expires in early 2004.

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<sup>10</sup> Parliamentary consideration of amendments to the BI law are yet to be completed. The aim is to have a comprehensive package of reforms, including the lender of last resort facility, the establishment of a new supervisory agency, and the creation of a supervisory body for BI enacted in one set of amendments.

<sup>11</sup> The sales have a floor price to ensure that returns are comparable to those realized from the other agreements.

27. **IBRA is making progress in resolving the cases of some of its largest debtors:**

- **Texmaco.** After a setback, IBRA is now making progress resolving its holdings of convertible bonds (\$3.1 billion) in its largest obligor, Texmaco.<sup>12</sup> (The bonds had been offered for sale in September, but no bids were received.) To address the problem that the financially troubled conglomerate, as a single entity, is not an attractive investment, the authorities are finalizing a strategy to sell the bonds of the two constituent divisions separately (see ¶7 of LOI). (This would require some restructuring of the terms of the bonds to remove cross-collateral provisions.) The authorities emphasized that they were determined to avoid any further bail out of the conglomerate and that their aim was to dispose of the government's claims on Texmaco to private investors as soon as possible.
- **APP.** In late October, APP signed a Master Restructuring Agreement with IBRA and official creditors who together represent about 40 percent of the debt of its Indonesian subsidiaries. While private creditors have been disappointed by the terms of the agreement, it may well be approved by sufficient numbers to make the agreement effective (at least three-quarters of the creditors need to approve), given the poor prospects of securing a more favorable settlement through the legal system in Indonesia.<sup>13</sup> IBRA is proceeding with the sale of its APP debt positions (with a face value of around \$950 million).

28. **The government has finalized its strategy for handling the assets that remain unsold when IBRA's mandate expires in February 2004.** The remaining assets will be transferred to public holding companies, with the strategic aim of selling the assets as soon as possible. Given the poor quality of the remaining assets, recoveries in 2004 and beyond are likely to be low, although sales of bank shares will help achieve next year's budget target (Rp 5 trillion).

**Legal reform and public sector governance**

29. **The mission reviewed the preparations for the Anti-Corruption Commission and the status of other legal reforms.** While the process of selecting the ACC's commissioners is now in train—the authorities expect the commissioners to be appointed by end-December—the mission urged the authorities to expedite other necessary steps, such as appointing the ACC Secretary General, needed to make the ACC operational. (Even if the Commissioners are appointed in December, as expected, the ACC will not be operational until early 2004, at the earliest.) Work on the Commercial Court is proceeding satisfactorily. Parliament has completed a draft bill establishing the Judicial Commission, and has submitted it to the President for consideration. However, parliamentary discussion of the

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<sup>12</sup> Texmaco is a major industrial conglomerate (employing some 20,000 workers), consisting of two basic units (textiles and engineering). In 2001, IBRA restructured Texmaco's nonperforming loans, in an agreement that was widely considered as being excessively favorable to the conglomerate. Texmaco is in significant financial difficulties, and has recently defaulted on bonds owed to IBRA.

<sup>13</sup> A few creditors, representing a little less than 10 percent of total debt outstanding, have launched legal action to obtain more favorable terms.

amendments of the bankruptcy law and the foundations law has continued to be delayed by the backlog of bills for discussion in Parliament.

30. **Progress has been made on the agenda to strengthen public sector governance.** The third round of special audits of state-owned enterprises has been completed, with the exception of the cement company Semen Gresik whose audit is still underway. (The government hopes to complete Semen Gresik's audit by end-year.) The fourth round of audits is underway and is expected to be completed in the second half of 2004.

#### **Other reforms**

31. **Privatization receipts are performing better than expected.** The recent divestment of Indocement (October) and bank BRI (November) raised Rp 3.8 trillion, bringing total privatization receipts so far this year to Rp 6.2 trillion. With the recently launched IPO for PGN, the state-owned natural gas company, expected to raise another Rp 1½–2 trillion, the original budget target of Rp 8 trillion could be achieved (provided the IPO is completed by year-end).

32. **The mission reviewed the authorities' plans to further efforts to strengthen Indonesia's anti-money laundering (AML) framework.** The Financial Action Task Force on Money Laundering (FATF) has indicated that "significant progress" will need to be made in the implementation of Indonesia's AML framework in 2004, for it to be removed from FATF's list of non-complying countries. In addition to the submission of an implementation plan to FATF by February 2004, other pending issues, such as the funding of the Financial Intelligence Unit and the protection of witnesses and informants, will need to be addressed.

#### **Relations with the Fund and other issues**

33. **The mission discussed the modalities for post-program monitoring (PPM).** It was agreed that, in addition to safeguarding Fund resources, PPM would provide a useful vehicle for maintaining a close dialogue with the authorities and providing the Fund's assessment of economic conditions and policy developments to the donor and international investor communities. The authorities agreed with the staff's proposal to have two formal PPM discussions in 2004, complemented by staff visits. The first PPM discussion would coincide with the 2004 Article IV consultation (scheduled for April). The latter would also provide an opportunity to undertake an in-depth retrospective of Indonesia's performance under the series of Fund-supported programs of recent years.

34. **The mission reviewed progress in strengthening BI's external audit mechanism in line with the Fund's safeguards policy.** The mission welcomed the progress BI had made in implementing staff recommendations to strengthen audit and accounting procedures (all of the main recommendations have now been implemented), but indicated that staff continue to believe that the involvement of an independent accounting firm in BI's external audit mechanism, along the lines of the mid-2003 review of foreign exchange reserves, would provide the necessary assurances of the quality of BI's financial statements. The Supreme Audit Agency, BI's constitutionally appointed auditor, while acknowledging the need to continue efforts to strengthen BI's external audit, is still not convinced of the merits of recruiting an independent accounting firm to undertake this work. It continues to prefer to work with its peers in other countries as a way of building up capacity in the agency. The

State Audit Agency also reaffirmed its interest in obtaining technical assistance from the Fund.

### III. STAFF APPRAISAL

35. **As the current arrangement draws to a close, Indonesia's economic performance has continued to improve.** The economic recovery is slowly gaining pace, inflation has continued to ease, and a further increase in external reserves is helping to reduce the economy's vulnerability to external shocks. Sound macroeconomic management combined with steady progress in key structural reforms has helped restore confidence and lay the foundations of a durable recovery.

36. **Nevertheless, significant challenges remain.** Chief among these is the need to maintain investor confidence and macroeconomic stability after the program expires. Skillful economic management will be required and remaining fragilities will need to be addressed, notably with respect to governance in the state banks. Further efforts are also needed to strengthen the investment climate, as business fixed investment remains weak and Indonesia continues to perform below its long-term economic potential.

37. **Maintaining recent progress in fiscal consolidation remains a key priority.** The budget deficit was well within the end-September ceiling, and while revenues have continued to underperform, the annual deficit target of 1.9 percent of GDP remains achievable. The 2004 budget, which targets a deficit of 1.3 percent of GDP, is a welcome further step toward fiscal consolidation. The government's plans to extend the reform of tax and customs administration in 2004 and to push ahead with the restructuring of the Ministry of Finance to strengthen expenditure management are also welcome, but staff encourages the authorities to reintroduce an automatic fuel price mechanism as soon as practicable. Achievement of the budget deficit target will require careful management as the revenue targets set by Parliament are ambitious. The large step-up in reliance on domestic debt financing in the 2004 budget, while manageable, highlights the importance of maintaining market confidence next year.

38. **The staff urges the authorities to maintain a cautious monetary stance.** The steady decline in inflation and the stability of the rupiah this year have facilitated a welcome reduction in interest rates. However, with inflation risks becoming more balanced, an over-aggressive easing of interest rates at this stage could jeopardize recent gains in inflation and exchange rate stability. The staff supports the authorities' intention to move gradually to inflation targeting, and to continue to use base-money targets as a guide for monetary policy in the meantime.

39. **IBRA is continuing to make good progress toward completing its asset sales program.** While cash recoveries fell short of the September benchmark, IBRA is expected to meet its full year target. The bank divestment program is proceeding, despite a temporary setback in the sale of bank Lippo, further progress has been made in resolving the bank shareholder settlement agreements, and the authorities are taking steps toward resolving the case of IBRA's largest debtor, Texmaco. The strategy for handling IBRA's unsold assets after its mandate expires in February 2004 has also been finalized, as have the plans for managing bank resolution responsibilities until the new deposit insurance agency is established.



40. **The exposure of irregularities at bank BNI has underlined the need to strengthen the oversight and accountability of the state banks.** The authorities' actions to strengthen the management of the bank, as well as the steps planned to overhaul the bank's internal controls, are welcome. Efforts to strengthen oversight of Bank Mandiri, through the appointment of additional external commissioners, are also commendable. However, close oversight of the bank in the period ahead remains important to ensure that the bank continues to comply with the action plan to strengthen its financial condition. It will be critical that the government, as majority shareholder, continues to support efforts in this area.

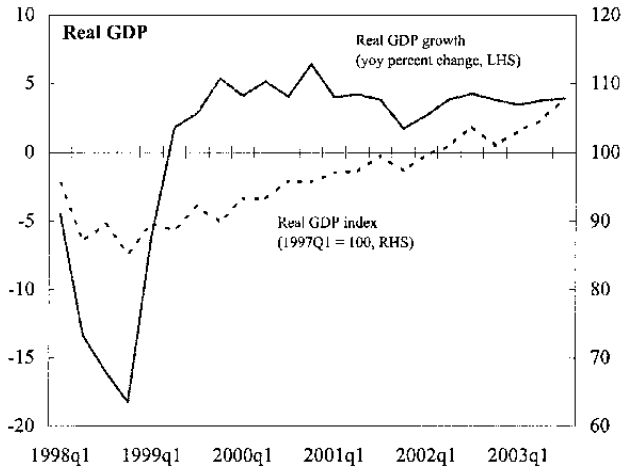
41. **Other areas of the structural reform agenda are, for the most part, proceeding on schedule.** The privatization program is performing better than expected, and with the successful completion of the IPO of state bank BRI, the original Rp 8 trillion target for receipts may now be achieved. Further progress has been made toward the establishment of a strengthened financial safety net, but timely passage of amendments to the BI Law are needed to take this process forward.

42. **Further efforts are needed to accelerate legal reforms and strengthen public sector governance.** The staff welcomes the progress being made to develop the Commercial Court and the Judicial Commission as well as to strengthen governance of state-owned enterprises. However, although the process of selecting the commissioners for the Anti-Corruption Commission is now in train, the objective of making the ACC operational by end year is running behind schedule. The staff urges the authorities to ensure that this is achieved as early as possible in 2004. Staff also urges the authorities to work with Parliament to secure the long-delayed passage of the amendments to the bankruptcy law and the foundations law.

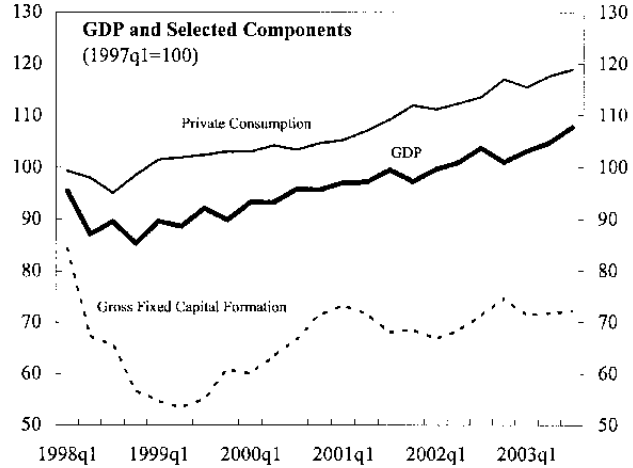
43. **In view of the continued progress in policy implementation, the staff supports the completion of the eleventh and final review under the extended arrangement.** Much has been achieved under the program and the economy has been placed on a sounder footing. The authorities recognize that the immediate challenge in the period ahead will be to maintain investor confidence after the program draws to a close, and that this will require the maintenance of sound macroeconomic management as well as consistent and timely implementation of the economic strategy laid out in the government's White Paper. The staff looks forward to continuing to support the authorities in the implementation of their economic program and welcomes their intention to maintain a close policy dialogue with the Fund in the context of post-program monitoring.

**Figure 1. Recent Macroeconomic Developments**

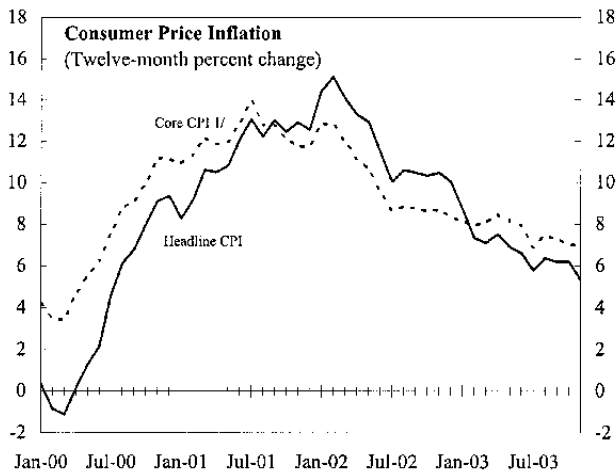
*GDP growth has held up...*



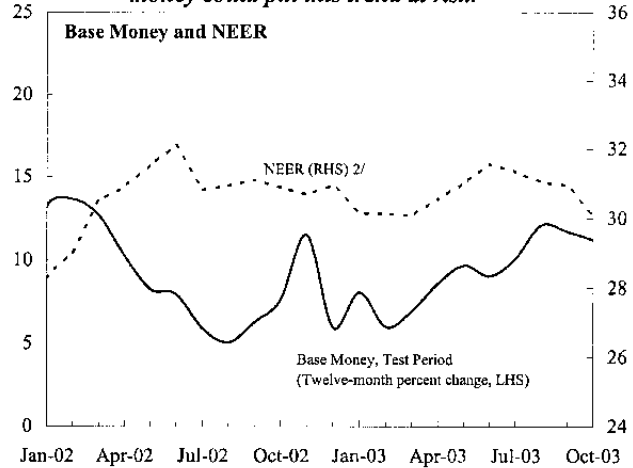
*...on the strength of private consumption, with investment still weak.*



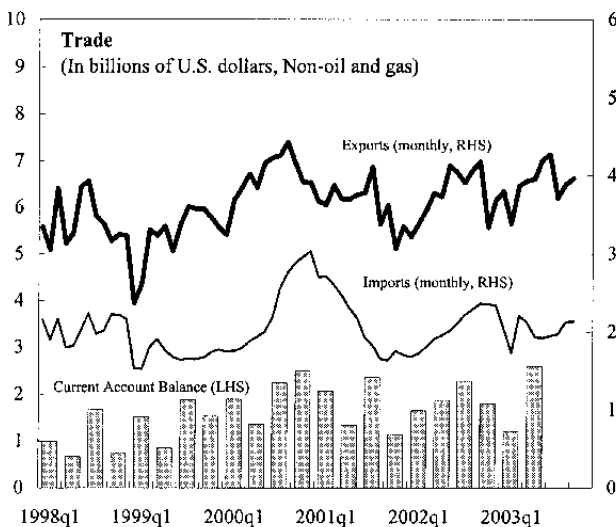
*Inflation has continued to trend down...*



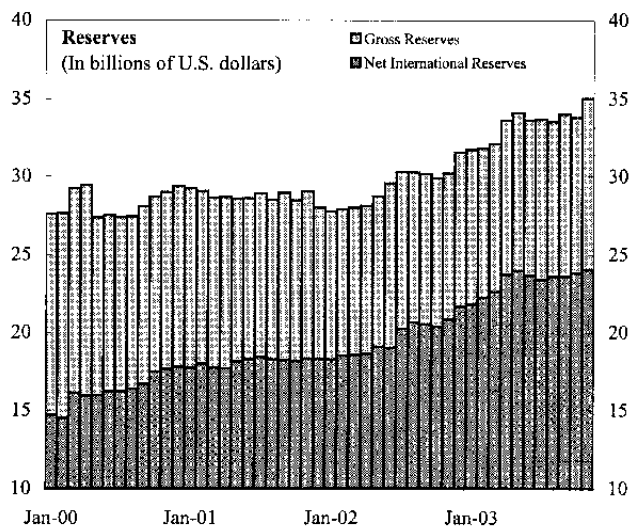
*...although the recent rise in base money could put this trend at risk.*



*A substantial current account surplus...*



*...has facilitated a further strengthening of reserves.*



Sources: Data provided by the Indonesian authorities; CEIC; Danareksa Research Institute; and Fund staff estimates.

1/ Nonfood, excluding administered prices.

2/ June 1997=100.

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                         |
| October 8, 2003            | 344.06             | 16.5                | Tenth review completed by the Board                         |
| <b>Total</b>               | <b>3,293.94</b>    | <b>158.4</b>        |   |
| <b>Remaining purchases</b> |                    |                     |   |
| December 19, 2003          | 344.06             | 16.5                | Eleventh review and end-September 2003 performance criteria |
| <b>Total</b>               | <b>344.06</b>      | <b>16.5</b>         |   |
| <b>Total</b>               | <b>3,638.00</b>    | <b>175.0</b>        |   |

Table 2. Indonesia: Selected Economic Indicators, 1998/99–2004 1/

|   | 1998/99 | 1999  | 2000  | 2001   | 2002<br>Est. | 2003<br>Proj. | 2004<br>Proj. |
|---|---------|-------|-------|--------|--------------|---------------|---------------|
| Real GDP (percent change)                         | -13.6   | 0.8   | 4.9   | 3.4    | 3.7          | 3.8           | 4.5           |
| Domestic demand                                   | -17.2   | -2.1  | 4.0   | 5.1    | 1.9          | 4.5           | 4.7           |
| <i>Of which:</i>                                  |         |       |       |        |              |               |               |
| Private consumption                               | -5.5    | 4.6   | 1.6   | 4.4    | 4.7          | 4.5           | 5.0           |
| 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         | 21.0          | 20.7          |
| Gross national savings                            | 26.5    | 23.7  | 27.2  | 26.7   | 24.7         | 24.5          | 23.4          |
| Foreign savings                                   | -3.9    | -3.6  | -5.3  | -4.9   | -4.5         | -3.5          | -2.6          |
| 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          | 17.7          |
| Central government expenditure                    | 17.2    | 18.3  | 21.1  | 24.5   | 20.4         | 20.7          | 19.1          |
| Central government balance                        | -2.3    | -1.5  | -1.1  | -3.7   | -1.8         | -1.9          | -1.3          |
| Central government debt                           | 66.6    | 88.6  | 100.3 | 90.9   | 80.2         | 66.9          | 61.9          |
| Money and credit (percent change; end of period)  |         |       |       |        |              |               |               |
| Rupiah M2   | 39.9    | 17.0  | 13.8  | 13.6   | 7.9          | 9.5           | 11.0          |
| Base money  | 32.5    | 35.5  | 22.8  | 2.1    | 8.3          | 9.9           | 11.0          |
| Private sector credit (at current exchange rate)  | -26.3   | -54.3 | 16.8  | 11.6   | 18.3         | 18.2          | 12.2          |
| One-month SBI rate (period average)               | 48.2    | 22.7  | 12.4  | 16.5   | 14.9         | 10.0          | 8.5           |
| Balance of payments (in billions of U.S. dollars) |         |       |       |        |              |               |               |
| Oil and gas (net)                                 | 4.2     | 5.9   | 8.6   | 6.4    | 5.6          | 5.9           | 6.0           |
| 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        | -34.3         | -38.2         |
| Current account balance                           | 4.6     | 5.8   | 8.0   | 6.9    | 7.8          | 7.3           | 6.0           |
| Overall balance                                   | 0.9     | 0.0   | 1.2   | -2.9   | 0.9          | -0.5          | -0.6          |
| Gross reserves                                    |         |       |       |        |              |               |               |
| In billions of U.S. dollars (end period) 4/       | 20.3    | 24.3  | 29.4  | 28.0   | 32.0         | 35.1          | 33.6          |
| In months of imports                              | 5.3     | 5.3   | 7.1   | 6.6    | 7.0          | 7.2           | 6.4           |
| As a percent of short-term debt 5/                | 60.3    | 78.1  | 97.1  | 84.6   | 130.6        | 196.4         | 208.5         |
| External debt (medium- and long-term)             |         |       |       |        |              |               |               |
| In billions of U.S. dollars                       | 149.9   | 148.7 | 141.7 | 131.2  | 129.8        | 127.6         | 122.4         |
| (In percent of GDP)                               | 144.9   | 94.9  | 94.3  | 92.7   | 74.9         | 61.6          | 53.7          |
| 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          | 30.2          |
| Real effective exchange rate 6/                   | 49.5    | 63.9  | 62.6  | 59.6   | 72.5         | 76.6          | 78.0          |
| Memorandum items:                                 |         |       |       |        |              |               |               |
| Indonesia oil production ('000 bcpd)              | 1,476   | 1,471 | 1,388 | 1,320  | 1,260        | 1,200         | 1,150         |
| Indonesia oil price (US\$/bbl)                    | 11.9    | 17.4  | 28.1  | 23.6   | 23.5         | 27.4          | 26.5          |
| Nominal GDP (in trillions of rupiah)              | 1,019   | 1,100 | 1,265 | 1,449  | 1,610        | 1,780         | 1,962         |
| Nominal GDP (in billions of U.S. dollars)         | 104     | 140   | 150   | 141    | 173          | 209           | 229           |

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 3. Indonesia: Balance of Payments, 2000–04  
(In billions of U.S. dollars)

|  | 2000<br>Actual | 2001<br>Actual | 2002<br>Estimate | 2003<br>Projection | 2004<br>Projection |
|--|----------------|----------------|------------------|--------------------|--------------------|
| <b>Current account</b>   | <b>8.0</b>     | <b>6.9</b>     | <b>7.8</b>       | <b>7.3</b>         | <b>6.0</b>         |
| Trade balance  | 21.8           | 19.8           | 20.9             | 20.4               | 19.5               |
| Exports (fob)  | 65.4           | 57.4           | 59.2             | 63.3               | 66.4               |
| Oil and gas  | 15.1           | 12.6           | 12.9             | 14.4               | 14.7               |
| Non-oil and gas  | 50.3           | 44.8           | 46.3             | 48.9               | 51.7               |
| Imports (cif)  | -43.6          | -37.5          | -38.3            | -42.9              | -46.9              |
| Oil and gas  | -6.5           | -6.2           | -7.2             | -8.6               | -8.7               |
| Non-oil and gas  | -37.1          | -31.3          | -31.1            | -34.3              | -38.2              |
| Services (net)   | -13.8          | -12.9          | -13.0            | -13.1              | -13.5              |
| Nonfactor services (net)   | -6.6           | -7.0           | -7.4             | -7.5               | -7.6               |
| Factor services  | -7.2           | -5.9           | -5.6             | -5.6               | -5.9               |
| <b>Capital account</b>   | <b>-6.8</b>    | <b>-9.8</b>    | <b>-7.0</b>      | <b>-7.8</b>        | <b>-6.6</b>        |
| Nonfinancial public sector   | -0.8           | -2.6           | -3.6             | -4.3               | -2.6               |
| Disbursements  | 4.1            | 2.9            | 2.3              | 2.0                | 3.5                |
| Amortization   | -4.9           | -5.5           | -6.0             | -6.3               | -6.0               |
| Banking sector (net)   | -0.6           | 0.5            | 0.9              | 1.9                | 1.3                |
| Disbursements  | 1.3            | 2.2            | 2.5              | 3.6                | 3.0                |
| Amortization   | -1.9           | -1.7           | -1.6             | -1.7               | -1.7               |
| Private sector (net)   | -5.4           | -7.7           | -4.3             | -5.4               | -5.3               |
| FDI, gross inflows   | 3.0            | 2.3            | 2.3              | 1.6                | 1.8                |
| Other  | -8.4           | -10.0          | -6.6             | -7.0               | -7.1               |
| Portfolio investment   | -1.9           | -0.2           | 1.2              | 1.4                | 1.4                |
| Other private sector (net)   | -6.4           | -9.8           | -7.8             | -8.4               | -8.4               |
| <b>Overall balance</b>   | <b>1.2</b>     | <b>-2.9</b>    | <b>0.9</b>       | <b>-0.5</b>        | <b>-0.6</b>        |
| <b>Financing</b>   | <b>-1.2</b>    | <b>2.9</b>     | <b>-0.9</b>      | <b>0.5</b>         | <b>0.6</b>         |
| NIR  | -3.5           | 0.0            | -4.5             | -2.6               | 0.6                |
| Gross reserves   | -5.0           | 1.4            | -3.6             | -3.1               | 1.5                |
| Reserve liabilities  | 1.5            | -1.4           | -0.9             | 0.5                | -0.9               |
| Public sector rescheduling 1/                                      | 2.4            | 2.9            | 3.6              | 3.1                | 0.0                |
| Memorandum items:  |                |                |                  |                    |                    |
| Gross reserves (e.o.p.) 2/   | 29.4           | 28.0           | 32.0             | 35.1               | 33.6               |
| In months of imports of goods and nonfactor services               | 7.1            | 6.6            | 7.0              | 7.2                | 6.4                |
| As a ratio to short-term debt                                      | 0.97           | 0.85           | 1.31             | 1.96               | 2.08               |
| 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             | 4.2                | 8.0                |
| Terms of trade, percent change                                     | 10.0           | -1.4           | 0.2              | -0.9               | -1.4               |
| Current account (in percent of GDP)                                | 5.3            | 4.9            | 4.5              | 3.5                | 2.6                |
| Stock of public sector external debt (excluding state-owned banks) | 80.0           | 75.8           | 78.4             | 77.3               | 73.8               |
| (In percent of GDP)  | 53.3           | 53.6           | 45.3             | 37.1               | 32.4               |
| Nonfinancial public sector debt service/XGNFS 3/                   | 12.4           | 17.4           | 18.0             | 15.9               | 14.3               |
| Indonesian oil price   | 27.4           | 23.3           | 24.2             | 27.4               | 26.5               |
| GDP (in billions of U.S. dollars)                                  | 150            | 141            | 173              | 209                | 229                |

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

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

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

3/ Before rescheduling and including IMF repurchases.

Table 4. Indonesia: Monetary Survey, December 2002–December 2003  
(In trillions of rupiah, unless otherwise indicated) 1/

|   | 2002   | 2003           |                |         |                |                 |
|---|--------|----------------|----------------|---------|----------------|-----------------|
|   | Dec.   | Mar.<br>Actual | Jun.<br>Actual | Program | Sep.<br>Actual | Dec.<br>Program |
| (End-of-period)                         |        |                |                |         |                |                 |
| <b>Monetary Survey</b>                  |        |                |                |         |                |                 |
| Net foreign assets                      | 178.8  | 181.1          | 186.9          | 184.8   | 193.4          | 186.9           |
| (In billions of U.S. dollars)           | 25.5   | 25.9           | 26.7           | 26.4    | 27.6           | 26.7            |
| Net domestic assets                     | 674.6  | 667.3          | 687.0          | 715.1   | 695.0          | 748.1           |
| Net claims on government                | 515.2  | 518.6          | 507.0          | 496.0   | 484.2          | 507.4           |
| Claims on private sector                | 369.0  | 380.0          | 404.0          | 423.0   | 425.8          | 443.7           |
| Rupiah claims                           | 295.7  | 305.0          | 327.0          | 345.9   | 348.3          | 366.6           |
| Foreign exchange claims                 | 73.3   | 75.0           | 77.0           | 77.1    | 77.5           | 77.1            |
| Other items (net)                       | -209.6 | -231.3         | -224.0         | -203.9  | -215.0         | -203.0          |
| Broad money (M2)                        | 853.4  | 848.4          | 873.9          | 899.9   | 888.4          | 935.0           |
| Rupiah broad money                      | 743.4  | 740.2          | 759.5          | 782.2   | 773.7          | 813.9           |
| Currency                                | 80.7   | 72.3           | 77.1           | 79.9    | 81.1           | 91.0            |
| Deposits 2/                             | 662.8  | 667.9          | 682.4          | 702.3   | 692.6          | 722.8           |
| Foreign exchange deposits               | 110.0  | 108.2          | 114.4          | 117.7   | 114.7          | 121.1           |
| <b>Bank of Indonesia</b>                |        |                |                |         |                |                 |
| Net international reserves              | 155.1  | 162.1          | 165.3          | 161.0   | 165.4          | 161.0           |
| Net domestic assets                     | -16.8  | -36.9          | -33.3          | -25.4   | -29.4          | -9.0            |
| Net claims on government 3/             | 172.0  | 175.9          | 188.1          | 175.1   | 182.6          | 184.2           |
| Claims on private sector                | 8.3    | 8.4            | 8.6            | 8.6     | 9.2            | 8.6             |
| Claims on DMBs                          | -80.9  | -96.2          | -110.5         | -109.8  | -122.6         | -102.6          |
| Open market operations                  | -113.3 | -127.9         | -142.6         | -141.9  | -154.3         | -134.7          |
| Other items (net)                       | -116.3 | -125.1         | -119.5         | -99.3   | -98.7          | -99.3           |
| Base money 4/                           | 138.3  | 125.2          | 132.0          | 135.6   | 135.9          | 152.0           |
| Currency outside banks                  | 80.7   | 72.3           | 77.1           | 79.9    | 81.1           | 91.0            |
| DMBs                                    | 56.0   | 51.0           | 53.1           | 54.0    | 53.1           | 59.2            |
| Nonbank deposits                        | 1.6    | 1.9            | 1.8            | 1.8     | 1.7            | 1.8             |
| <b>Memorandum items:</b>                |        |                |                |         |                |                 |
| Base money test date 5/                 | 132.2  | 123.0          | 128.7          | 134.1   | 135.0          | 146.6           |
| NIR of BI (in billions of U.S. dollars) | 22.2   | 23.2           | 23.6           | 23.0    | 23.6           | 23.0            |
| Money multiplier (rupiah broad money)   | 5.4    | 5.9            | 5.8            | 5.7     | 5.7            | 5.4             |
| Base money velocity 6/                  | 11.7   | 14.2           | 13.6           | 13.5    | 13.5           | 12.0            |
| Rupiah broad money velocity 6/          | 2.2    | 2.4            | 2.4            | 2.3     | 2.4            | 2.2             |
| <b>Annual percentage change:</b>        |        |                |                |         |                |                 |
| Broad money (constant exchange rate)    | 7.6    | 7.4            | 7.7            | 8.7     | 7.3            | 9.6             |
| Rupiah broad money                      | 7.9    | 8.6            | 8.5            | 9.2     | 8.0            | 9.5             |
| Base money                              | 8.3    | 7.1            | 10.0           | 9.5     | 9.7            | 9.9             |
| Private sector claims 7/                | 21.9   | 24.9           | 25.0           | 22.8    | 23.6           | 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 5. Indonesia: Summary of Central Government Operations, 2001–04

|                                      | 2001  | 2002  | 2003           |       | 2004      |
|--------------------------------------|-------|-------|----------------|-------|-----------|
|                                      |       |       | Revised Budget | Proj. | Budget 1/ |
| (In trillions of rupiah)             |       |       |                |       |           |
| Revenues and grants                  | 301.1 | 300.1 | 340.3          | 333.3 | 348.1     |
| Oil and gas revenues                 | 104.1 | 77.2  | 78.6           | 78.6  | 57.1      |
| Non-oil and gas revenues             | 196.5 | 222.9 | 261.7          | 254.4 | 290.5     |
| Tax revenues                         | 162.4 | 193.7 | 230.4          | 221.4 | 259.2     |
| Nontax revenues 2/                   | 34.5  | 29.1  | 31.3           | 33.4  | 31.9      |
| Expenditure and net lending          | 354.4 | 328.4 | 377.3          | 367.8 | 374.3     |
| Central government expenditure       | 273.3 | 229.8 | 258.0          | 249.6 | 255.3     |
| Current expenditure                  | 226.1 | 192.8 | 199.0          | 195.0 | 191.5     |
| Personnel                            | 38.7  | 39.8  | 50.4           | 49.7  | 56.7      |
| Subsidies                            | 77.4  | 40.0  | 34.7           | 34.2  | 26.3      |
| Interest                             | 94.9  | 89.9  | 72.2           | 72.2  | 65.7      |
| External                             | 28.9  | 25.4  | 23.3           | 23.3  | 24.4      |
| Domestic                             | 66.0  | 64.5  | 48.9           | 48.9  | 41.3      |
| Other                                | 15.0  | 23.1  | 41.7           | 38.8  | 42.8      |
| Development expenditure 3/           | 41.6  | 35.4  | 59.0           | 54.6  | 63.8      |
| Statistical discrepancy              | 5.6   | 1.6   | 0.0            | 0.0   | 0.0       |
| Transfers to regions                 | 81.1  | 98.5  | 119.3          | 118.2 | 119.0     |
| Overall balance                      | -53.3 | -28.3 | -36.9          | -34.4 | -26.2     |
| Financing                            | 53.3  | 28.3  | 36.9           | 34.4  | 26.2      |
| Domestic                             | 46.5  | 24.0  | 34.0           | 37.7  | 42.4      |
| Bank financing 4/                    | 7.2   | -21.8 | -2.5           | 1.2   | 30.7      |
| Cash recovery of bank assets 5/      | 28.0  | 43.3  | 27.6           | 26.0  | 5.0       |
| Privatization of nonfinancial assets | 3.5   | 7.6   | 6.4            | 8.0   | 5.0       |
| Other                                | 7.8   | -5.1  | 2.5            | 2.5   | 1.8       |
| External                             | 6.8   | 4.3   | 2.9            | -3.2  | -16.2     |
| (In percent of GDP)                  |       |       |                |       |           |
| Revenues and grants                  | 20.8  | 18.6  | 19.0           | 18.7  | 17.7      |
| Oil and gas revenues                 | 7.2   | 4.8   | 4.4            | 4.4   | 2.9       |
| Non-oil and gas revenues             | 13.6  | 13.8  | 14.6           | 14.3  | 14.8      |
| Tax revenues                         | 11.2  | 12.0  | 12.9           | 12.4  | 13.2      |
| Nontax revenues 2/                   | 2.3   | 1.8   | 1.8            | 1.9   | 1.6       |
| Expenditure and net lending          | 24.5  | 20.4  | 21.1           | 20.7  | 19.1      |
| Central government expenditure       | 18.9  | 14.3  | 14.4           | 14.0  | 13.0      |
| Current expenditure                  | 15.6  | 12.0  | 11.1           | 11.0  | 9.8       |
| Personnel                            | 2.7   | 2.5   | 2.8            | 2.8   | 2.9       |
| Subsidies                            | 5.3   | 2.5   | 1.9            | 1.9   | 1.3       |
| Interest                             | 6.6   | 5.6   | 4.0            | 4.1   | 3.3       |
| External                             | 2.0   | 1.6   | 1.3            | 1.3   | 1.2       |
| Domestic                             | 4.6   | 4.0   | 2.7            | 2.7   | 2.1       |
| Other                                | 1.0   | 1.4   | 2.3            | 2.2   | 2.2       |
| Development expenditure 3/           | 2.9   | 2.2   | 3.3            | 3.1   | 3.2       |
| Statistical discrepancy              | 0.4   | 0.1   | 0.0            | 0.0   | 0.0       |
| Transfers to regions                 | 5.6   | 6.1   | 6.7            | 6.6   | 6.1       |
| Overall balance                      | -3.7  | -1.8  | -2.1           | -1.9  | -1.3      |
| Financing                            | 3.7   | 1.8   | 2.1            | 1.9   | 1.3       |
| Domestic                             | 3.2   | 1.5   | 1.9            | 1.9   | 2.2       |
| Bank financing 4/                    | 0.5   | -1.4  | -0.1           | 0.1   | 1.6       |
| Cash recovery of bank assets 5/      | 1.9   | 2.7   | 1.5            | 1.5   | 0.3       |
| Privatization of nonfinancial assets | 0.2   | 0.5   | 0.4            | 0.3   | 0.3       |
| Other 6/                             | 0.5   | -0.3  | 0.1            | 0.1   | 0.1       |
| External                             | 0.5   | 0.3   | 0.2            | -0.2  | -0.8      |
| Memorandum items:                    |       |       |                |       |           |
| Primary balance                      | 2.9   | 3.8   | 2.0            | 2.1   | 2.0       |
| Non-oil primary balance              | -4.3  | -1.0  | -2.4           | -2.3  | -0.9      |
| Non-oil overall balance              | -10.9 | -6.6  | -6.4           | -6.4  | -4.2      |
| GDP (in trillions of rupiah)         | 1,449 | 1,610 | 1,791          | 1,780 | 1,962     |

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

1/ In the authorities' presentation (i.e., treating deposit insurance premia as nontax revenues) and using their estimate of nominal GDP (Rp. 2,000 trillion), the deficit 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).

6/ Deposit insurance premia in 2003 and 2004.

Table 6. Indonesia: Structural Benchmarks

| Measures  | Status <sup>1</sup>   |
|---|---|
| <p><b>September 2003</b></p> <ul style="list-style-type: none"> <li>• Collect at least Rp 18 trillion in cash by IBRA (net of expenses).</li> <li>• Launch IPO for BRI.</li> <li>• Finalize strategy for the resolution of assets that may remain unsold at the end of IBRA's mandate.</li> </ul>   | <p>Expected by year end (cash collection of Rp 13.8 trillion through September)</p> <p>IPO concluded in November</p> <p>Completed in December</p>                             |
| <p><b>December 2003</b></p> <ul style="list-style-type: none"> <li>• Launch majority divestment of remaining two IBRA banks.</li> <li>• Announce strategic plan for future of Bank Mandiri.</li> <li>• Complete the expansion of large taxpayers' offices to increase coverage to 35 percent of the tax collections of the Directorate General of Taxation.</li> <li>• Ensure that the Anti-Corruption Commission is fully operational.</li> <li>• Achieve budget privatization target of Rp 8 trillion.</li> </ul> | <p>BII sale being finalized; launch of new Permata expected early 2004</p> <p>In process</p> <p>In process</p> <p>In process</p> <p>Receipts projected at Rp 7–8 trillion</p> |
| <p><sup>1</sup> All structural benchmarks through June 2003 have been completed, with the exception of the sale of BI's overseas subsidiary (now expected in early 2004).</p>   |   |



Table 7. Indonesia: Medium-Term Fiscal Projections, 2001–05

|   | 2001                | 2002  | 2003 | 2004 | 2005 |
|---|---------------------|-------|------|------|------|
|   | (In percent of GDP) |       |      |      |      |
| Fiscal accounts                                   |                     |       |      |      |      |
| Primary balance                                   | 2.9                 | 3.8   | 2.1  | 2.1  | 2.5  |
| Interest 1/                                       | 6.5                 | 5.6   | 4.1  | 3.5  | 3.4  |
| Overall balance                                   | -3.7                | -1.8  | -1.9 | -1.3 | -0.9 |
| Financing   |                     |       |      |      |      |
| Gross requirements                                | 8.3                 | 5.5   | 6.2  | 4.8  | 4.5  |
| Deficit   | 3.7                 | 1.8   | 1.9  | 1.3  | 0.9  |
| Amortization                                      | 4.6                 | 3.8   | 4.2  | 3.5  | 3.6  |
| External  | 3.3                 | 3.1   | 2.5  | 2.3  | 2.1  |
| Domestic 2/                                       | 1.2                 | 0.7   | 1.7  | 1.2  | 1.5  |
| Sources   | 8.3                 | 5.5   | 6.2  | 4.8  | 4.5  |
| External disbursements (including rescheduling)   | 3.8                 | 3.3   | 2.4  | 1.4  | 1.4  |
| Privatization and asset recoveries                | 2.1                 | 3.2   | 1.9  | 0.6  | 0.5  |
| Other domestic financing 3/                       | 2.4                 | -1.0  | 1.9  | 2.9  | 2.7  |
| Public debt                                       |                     |       |      |      |      |
| Total   | 90.9                | 80.3  | 66.8 | 61.1 | 57.1 |
| External 4/                                       | 41.8                | 35.4  | 29.9 | 27.0 | 24.8 |
| Domestic 5/                                       | 49.1                | 44.9  | 36.9 | 34.1 | 32.4 |
| Memorandum items:                                 |                     |       |      |      |      |
| Other domestic financing (in trillions of rupiah) | 34.0                | -15.5 | 33.7 | 56.3 | 57.6 |
| Deficit financing                                 | 3.7                 | 1.8   | 1.9  | 1.3  | 0.9  |
| Net domestic financing                            | 3.2                 | 1.5   | 2.1  | 2.2  | 1.6  |
| Net external financing                            | 0.5                 | 0.3   | -0.2 | -0.8 | -0.8 |
| Key assumptions                                   |                     |       |      |      |      |
| Real GDP growth (annual rate)                     | 3.4                 | 3.7   | 3.8  | 4.5  | 5.0  |
| Domestic interest rate (short-term real)          | 4.5                 | 2.9   | 3.0  | 3.5  | 4.0  |

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

1/ Includes interest assumed on a new BLBI-related note, estimated at Rp 1 trillion (0.05 percent of GDP) in 2004, and Rp 5.2 trillion (0.2 percent of GDP) in 2005.

2/ Excludes amortization on the stock of hedge bonds and BI indexed bonds, which are to be rolled over. In 2003, includes IBRA debt redemption of Rp 8 trillion, and debt buybacks of Rp 8.5 trillion.

3/ Includes domestic debt issuance.

4/ Includes short-term debt.

5/ In 2003 includes Rp 51.5 trillion for debt write-off related to BLBI resolution.

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   | 3.8   |
| 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  |
| Sovereign bond 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    | 4.5   | 3.5   |
| Net FDI inflows (in percent of GDP)   | 3.7     | 6.3     | 5.5     | 2.4   | 1.8   | 1.8    | 1.3   | 0.8   |
| Export growth (U.S. dollar value, GNFS)   | 9.7     | 6.8     | -15.4   | 1.8   | 26.5  | -10.9  | 2.9   | 5.1   |
| Real effective exchange rate (1995 = 100)   | 106.6   | 81.3    | 53.9    | 69.7  | 68.3  | 65.1   | 79.1  | 83.6  |
| Gross international reserves (GIR) (in billions of U.S. dollars)                    | 25.8    | 10.7    | 20.3    | 24.3  | 29.4  | 28.0   | 32.0  | 35.1  |
| GIR in percent of short-term debt at remaining maturity                             | 84.1    | 30.3    | 60.3    | 78.1  | 97.1  | 84.6   | 130.6 | 196.4 |
| Net international reserves (NIR) (in billions of U.S. dollars)                      | 26.7    | 13.3    | 15.9    | 16.0  | 17.8  | 18.3   | 22.2  | 24.2  |
| Total gross external debt (in percent of GDP)                                       | 60.3    | 99.4    | 156.9   | 102.7 | 99.6  | 97.5   | 75.8  | 62.3  |
| 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   | 28.2  | 22.5  |
| Total gross external debt in percent of exports of GNFS                             | 243.2   | 237.1   | 308.0   | 285.0 | 212.7 | 220.2  | 203.8 | 190.7 |
| <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   | 82.3  | 68.2  |
| External debt from official creditors (in percent of total)                         | 65.3    | 63.4    | 49.3    | 34.0  | 44.4  | 43.8   | 42.5  | 43.6  |
| 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  | 21.4  |
| NPLs in percent of total loans 4/ 6/  | ...     | 11.3    | 50.9    | 32.9  | 14.2  | 11.0   | 6.2   | 5.6   |
| Provisions in percent of NPLs 4/ 6/   | 36.4    | 34.4    | 34.5    | 87.0  | 88.8  | 94.0   | 130.0 | 152.5 |
| Return on average assets (in percent) 4/ 6/   | ...     | ...     | ...     | -8.7  | 0.3   | 0.6    | 1.4   | 2.3   |
| FX deposits (in percent of total deposits)  | 22.2    | 31.5    | 25.9    | 19.2  | 20.8  | 20.2   | 18.2  | 16.6  |
| FX deposits (in percent of gross international reserves)                            | 82.0    | 123.7   | 72.9    | 65.6  | 30.8  | 52.5   | 49.0  | 46.7  |
| FX loans (in percent of total loans)  | 20.0    | 39.8    | 36.9    | 37.6  | 39.8  | 32.6   | 28.9  | 22.6  |
| <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  | 10.5  |
| 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   | 97.5  | 89.3  |
| Amortization of MLT debt, private (in percent of total GEFR) 8/                     | -29.4   | 51.7    | 31.2    | 38.7  | 47.5  | 51.5   | 65.0  | 66.0  |
| Maturing ST debt (in percent of total GEFR)   | 56.8    | 24.0    | 42.0    | 42.9  | 53.5  | 35.5   | 14.8  | 14.3  |
| Current account balance (in percent of total GEFR)                                  | 31.8    | 4.2     | -15.5   | -25.4 | -54.4 | -36.6  | -77.3 | -69.7 |
| 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   | 9.8   | 12.5  |
| Of which: Amortization of MLT debt (in percent of total GPSFR) 10/                  | 143.9   | 62.4    | 56.6    | 55.2  | 17.3  | 30.1   | 46.9  | 42.1  |
| Maturing short-term debt (in percent of total GPSFR)                                | ...     | ...     | ...     | ...   | 3.2   | 1.4    | 0.0   | 0.0   |
| Overall public sector deficit (in percent of total GPSFR)                           | -43.9   | 37.6    | 43.4    | 44.8  | 24.7  | 43.9   | 31.2  | 32.2  |

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-June 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 |
|---|-------|-------|-------|-------|-------|-------|-------|------|------|------|
| <b>Debt service to the Fund</b>                             |       |       |       |       |       |       |       |      |      |      |
| 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   | 1.7   | 1.7   | 2.0   | 2.4   | 2.7  | 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   | 4.6   | 3.6   | 3.9   | 4.8   | 6.0   | 7    | 3.6  | 1.6  |
| <b>Outstanding Fund credit</b>                              | 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   | 2.9   | 2.2   | 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  | 27.1  | 25.8  | 22.3  | 18.4  | 12.6  | 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  |
| <b>Total nonfinancial public sector debt service</b>        |       |       |       |       |       |       |       |      |      |      |
| In percent of exports of goods and nonfactor services       | 17.6  | 18.0  | 15.6  | 14.1  | 14.3  | 14.1  | 12.3  | 12.3 | 10.8 | 9.3  |
| In percent of GDP   | 7.8   | 6.7   | 5.1   | 4.3   | 4.3   | 4.2   | 3.6   | 3.6  | 3.1  | 2.6  |

1/ End of period reserves.

**INDONESIA: FUND RELATIONS**  
(As of October 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            | 8,646.96            | 415.86                  |
| 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                   | 38.36               | 16.05                        |

| <b>IV. Outstanding Purchases and Loans</b> | <u>SDR Millions</u> | <u>Percent of Quota</u> |
|--|---------------------|-------------------------|
| Extended arrangements                      | 6,713.16            | 322.86                  |

| <b>V. Financial Arrangements</b> |                      |                        |  |                                       |
|----------------------------------|----------------------|------------------------|--|---------------------------------------|
| <u>Type</u>                      | <u>Approval Date</u> | <u>Expiration Date</u> | <u>Amount Approved</u><br>(SDR Millions) | <u>Amount Drawn</u><br>(SDR Millions) |
| EFF                              | Feb. 04, 2000        | Dec. 31, 2003          | 3,638.00                                 | 3,293.94                              |
| 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        | 142.13             | 678.07        | 774.81        | 1,015.64      | 1,359.70     |
| Charges/Interest | <u>35.21</u>       | <u>142.10</u> | <u>125.92</u> | <u>108.02</u> | <u>84.02</u> |
| Total            | 177.35             | 820.18        | 900.73        | 1,123.67      | 1,443.72     |

**VII. Exchange Arrangements**

The rupiah has floated since August 14, 1997. The market exchange rate was Rp 8,495 per U.S. dollar on October 31, 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.

COORDINATING MINISTER OF ECONOMIC AFFAIRS  
REPUBLIC OF INDONESIA

Jakarta, Indonesia  
December 10, 2003

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

Dear Mr. Köhler:

1. This letter marks the final review under Indonesia's Extended Arrangement with the Fund, which concludes at end-2003. Over the four-year period of the arrangement, macroeconomic stability has been restored, the banking system has been recapitalized, and most banks taken over during the crisis have been divested. In addition, balance of payments vulnerability has been reduced sharply with a fall in external debt and a rebuilding of foreign reserves. While important challenges remain, the key objectives under the program have largely been met, and we believe the external financing situation next year can be managed without further exceptional balance of payments support from the international community. Our Economic Policy Package announced in September reaffirms our efforts to foster economic growth by maintaining macroeconomic stability and further advancing structural reforms.
2. Turning to progress under our economic program for 2003, a good record of policy implementation has been achieved, and we are on track to meet our broad macroeconomic objectives. In particular, GDP growth of 4 percent in 2003 is expected, and inflation should finish the year at around 6 percent. With the global recovery gaining strength, GDP growth should pick up next year to close to 5 percent, and we expect inflation to remain moderate at 6 to 7 percent.
3. All end-September quantitative performance criteria were met; the indicative target on base money was exceeded by a small margin, but the target for end-December is expected to be achieved (Table 1). With regard to the September structural benchmarks set for this review (Table 2): (i) the IPO for BRI has been successfully completed; (ii) we have decided on the resolution strategy for assets that may remain unsold at the end of IBRA's mandate (see below); and (iii) while IBRA cash collections through September were somewhat lower than expected owing to a slight delay in certain sales programs, our cash collections are on track to meet the full-year target.
4. Achieving a sustainable fiscal position remains a key priority. The deficit outturn for the first three-quarters of the year was well within programmed levels. To achieve the 2003 program budget deficit ceiling of 1.9 percent of GDP, we are monitoring revenue developments closely and are exercising restraint over non-priority spending. Parliament has approved the 2004 budget, targeting a deficit of 1.2 percent of GDP. The budget strives to increase non-oil revenues through continued efforts to strengthen tax and customs administration, while preserving priority development and other social spending. With no further external debt rescheduling from Paris Club creditors, the financing of the budget will shift toward domestic sources.

5. The stability of the rupiah and decline in inflation over the past year have enabled Bank Indonesia (BI) to achieve a significant reduction in interest rates. The scope for further reductions in interest rates in the period ahead is now limited. Looking ahead, BI will continue to implement a cautious monetary policy stance. In this context, while we are preparing the groundwork for a gradual shift to a formal inflation targeting framework, monetary policy in 2004 will continue to be guided by a base money path consistent with our inflation objective.

6. Discussions with Parliament on amendments to the BI Law continue. We are working to reach agreement with Parliament on amendments to establish a lender of last resort facility administered by BI, a new financial supervisory agency in due course, and a supervisory body aimed at enhancing institutional credibility while preserving policy independence.

7. With regard to IBRA, as noted above we continue to make good progress toward asset sales. We are finalizing, ahead of schedule, the sale of a 51 percent stake in bank BII, and plan to sell another 20 percent to retail investors by the end of the year. The majority divestment of bank Lippo was recently postponed, due to unacceptably low bids, but was relaunched in December, with completion expected by February. The divestment of a majority stake in Permata, the remaining IBRA bank, will be launched in early 2004, subject to resolving outstanding legal issues. We are working on a plan to resolve outstanding obligations of IBRA's largest debtor, the Texmaco group. The plan would ensure that there will be no further public financial assistance to the conglomerate. It is based on the existing Master Restructuring Agreement signed between IBRA and the group in 2001, and aims to dispose of the group's exchangeable bonds held by IBRA in two bundles, with the textiles and engineering divisions offered separately so as to maximize investor interest.

8. IBRA's existing mandate expires in February 2004. We have decided to transfer the remaining assets to several self-liquidating holding companies for future disposal. These holding companies will be managed by the Ministry of State-Owned Enterprises. Until such time as the new deposit insurance agency is established, IBRA's deposit guarantee responsibilities will be transferred to the Ministry of Finance. Its bank resolution functions related to individual banks will be managed by Bank Indonesia and in systemic cases by the government in coordination with Bank Indonesia according to the prevailing banking and central bank laws.

9. As part of our efforts to restore the soundness of the banking sector, we are strengthening the oversight and accountability of the state banks. At bank Mandiri's shareholders meeting last September, we appointed additional independent commissioners, and we are also monitoring closely the bank's performance under its business plan. Also, a business plan for the bank is being drawn up for 2004, which we will review shortly. As has been well publicized, recent irregularities at BNI have surfaced, revealing serious control weaknesses in the bank's operations. We are taking prompt steps to address these weaknesses through changes in the bank's management, and the adoption of a time-bound action plan to strengthen the bank's internal controls.

10. We are also making progress to improve public sector governance, an important element of our structural reform agenda. The selection of commissioners of the Anti-

Corruption Commission (ACC) is underway, and resources have been allocated in the budget for its operations. The appointment of the commissioners is expected to be completed by the end of December. These steps will enable the ACC to commence operations in early 2004. We remain committed to working with Parliament to ensure the expedited passage of amendments to the Bankruptcy and Foundations Laws, and the Judicial Commission Bill.

11. In view of the progress in policy implementation, we request completion of the eleventh review under the Extended Arrangement. The challenge in the period ahead will be to maintain investor confidence through the maintenance of sound policies. For this purpose, we are committed to the timely implementation of our Economic Policy Package, which aims to maintain macroeconomic stability, strengthen the financial sector, and generate higher investment, exports, and employment. As we implement our economic policies, we intend to maintain a close policy dialogue with the Fund and the international community.

Sincerely yours,

/s/

/s/

/s/

Dorodjatun Kuntjoro-Jakti  
Coordinating Minister for  
Economic Affairs

Boediono  
Minister of Finance

Burhanuddin Abdullah  
Governor  
Bank Indonesia



Table 1. Indonesia: Quantitative Performance Criteria (PC) and Indicative Targets (IT)  
Under the Extended Arrangement, 2003 1/

|  | Mar.  |        | Jun.  |        | Sep.  |        | Dec.  |
|--|-------|--------|-------|--------|-------|--------|-------|
|  | PC    | Actual | PC 2/ | Actual | PC 2/ | Actual | IT    |
| Monetary and fiscal targets                                      |       |        |       |        |       |        |       |
| Net domestic assets (NDA) of Bank Indonesia                      | -24.5 | -36.9  | -18.0 | -32.9  | -21.9 | -28.9  | -9.0  |
| Base money (indicative target) 3/                                | 129.3 | 123.0  | 134.5 | 128.7  | 134.1 | 135.0  | 146.6 |
| Overall central government balance 4/                            | -7.6  | 10.1   | -15.6 | -2.2   | -25.6 | -16.2  | -34.4 |
| External targets (in billions of U.S. dollars)                   |       |        |       |        |       |        |       |
| Net international reserves (NIR) of Bank Indonesia 5/            | 22.2  | 23.2   | 22.0  | 23.6   | 22.5  | 23.6   | 23.0  |
| Contracting or guaranteeing of new noncessional external debt 6/ | 0.3   | 0.2    | 0.6   | 0.2    | 1.0   | 0.6    | 1.5   |
| <i>Of which</i> : Government debt to commercial creditors        | 0.2   | 0.0    | 0.2   | 0.0    | 0.2   | 0.0    | 0.2   |
| Stock of short-term external debt outstanding                    | 2.5   | 0.3    | 2.5   | 0.1    | 2.5   | 0.1    | 2.5   |

1/ Definitions are contained in the Technical Memorandum of Understanding (EBS/03/35, Supplement I). 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 2. Indonesia: Structural Benchmarks

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|  |            |
|--|------------|
| <b>March 2003</b>  |            |
| • 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).  | Rp 1.2 tn  |
| • Adopt implementation schedule for the restructuring of BTN.  | ✓          |
| <b>April 2003</b>  |            |
| • 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.  | ✓          |
| <b>June 2003</b>   |            |
| • Collect at least Rp 7 trillion in cash by IBRA (net of expenses).  | Rp 9.7 tn  |
| • 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.   | In process |
| <b>September 2003</b>  |            |
| • Collect at least Rp 18 trillion in cash by IBRA (net of expenses).   | Rp 13.8 tn |
| • Launch IPO for BRI.  | ✓          |
| • Finalize strategy for the resolution of assets that may remain unsold at the end of IBRA's mandate.  | ✓          |
| <b>December 2003</b>   |            |
| • 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.  |            |

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Press Release No. 03/225  
FOR IMMEDIATE RELEASE  
December 19, 2003

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Completes Eleventh and Final Review of Indonesia's EFF Program, Approves US\$505 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) completed today its 11th and final review of Indonesia's performance under an SDR 3.6 billion (about US\$5.3 billion) Extended Fund Facility arrangement (see [Press Release No. 00/4](#)). The completion of the review enables the release of SDR 344 million (about US\$505 million), which would bring total disbursements under the program to SDR 3.6 billion (about US\$5.3 billion).

At the conclusion of the Executive Board's discussion on Indonesia's economic and structural reform program, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, stated:

"The Indonesian authorities are to be commended for bringing their Extended Arrangement with the Fund to a successful conclusion. An impressive fiscal consolidation and disinflation effort, together with reduced external vulnerability, have laid the basis for a sustained improvement in growth and employment prospects in the period ahead. The Fund is encouraged by the government's determination to build on these achievements by further strengthening the institutional and governance underpinnings for a durable recovery of investment and business activity.

"Policy performance since the last review has continued to evolve favorably. Fiscal consolidation continues to advance. Budget execution is on track to achieve the 2003 deficit target. The 2004 budget, underpinned by ongoing reforms to tax and customs administration, represents a further step towards a sustainable fiscal position. Maintenance of market confidence will help ease the transition to the increased reliance by the authorities on domestic financing sources expected in 2004.

"A stable exchange rate and continued declines in inflation have allowed reductions in interest rates in support of the economic recovery. With inflation risks now more balanced, Bank Indonesia's commitment to maintain a cautious monetary stance will help safeguard the hard-won gains in inflation and exchange rate stability.

"Satisfactory progress continues to be made with key structural reforms. The divestment of government ownership in banks is proceeding well; the Indonesia Bank Restructuring Agency is making good progress in bringing its asset sales programs to a successful conclusion; and

preparations toward the establishment of a strengthened financial safety net are at an advanced stage. It will be important to sustain these reform efforts and, in particular, to follow up decisively on the recent steps to address the financial irregularities at a major state bank by strengthening the governance and monitoring of state banks.

“In the period ahead the challenge before the Indonesian authorities will be to maintain investor confidence through the continuation of sound policies, while acting vigorously to strengthen the investment climate to enable Indonesia to realize its economic potential. The government’s economic package for 2004, as set out in its “White Paper”, provides a sound framework for meeting this challenge. The Fund will continue to work closely with the authorities to assist with the implementation of these reforms, and looks forward to maintaining a close policy dialogue in the context of post-program monitoring,” Mr. Sugisaki stated.