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Indonesia: Post-Program Monitoring Discussions—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Indonesia

In the context of the Post-Program Monitoring Discussions with Indonesia, the following documents have been released and are included in this package:

- the staff report for the Post-Program Monitoring Discussions, prepared by a staff team of the IMF, following discussions that ended on December 9, 2004, 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 January 12, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of February 9, 2005 updating information on recent developments.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its February 14, 2005 discussion of the staff report that completed the Post-Program Monitoring consultation.

- a statement by the Executive Director for 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

Report for the Post-Program Monitoring Discussions

Prepared by the Asia and Pacific Department

(In consultation with other departments)

Approved by Daniel Citrin and Carlo Cottarelli

January 12, 2005

- The mission visited Jakarta during December 1–9, 2004, and met with Vice President Jusuf Kalla, Coordinating Minister of Economic Affairs Aburizal Bakrie, Minister of Finance Jusuf Anwar, Minister of National Development Planning Sri Mulyani Indrawati, Minister of State-Owned Enterprises Sugiarto, Minister of Mines and Energy Purnomo Yusgiantoro, Minister of Labor Fahmi Idris, Minister of Trade Mari Pangestu, Bank Indonesia Governor Burhanuddin Abdullah, other senior government officials, parliamentarians, and representatives of the private sector and key donor countries.

- The mission was headed by Daniel Citrin and Odd Per Brekk, and also comprised Nita Thacker, Emanuele Baldacci, Ashok Bhundia (all APD), and Helaway Tadesse (PDR). The Resident Representatives, Stephen Schwartz and Yougesh Khatri, participated in the mission, and Mr. Burton joined the discussions during the last two days. Mr. Sukada (Alternate Executive Director) attended the policy meetings. The team liaised with the World Bank and the Asian Development Bank.

- On December 26, the massive earthquake off the coast of Sumatra and the associated tsunami hit Indonesia with devastating force, causing untold human suffering and loss of lives. While it is too early to assess the economic effects of the calamity with any precision, the overall impact on growth is expected to be fairly limited considering that the affected areas account for a small share of Indonesia's economic activity. The main effects may be felt in terms of loss of wealth, and budget spending for disaster relief and reconstruction and associated financing flows from donors. A summit meeting initiating the international community's coordinated assistance to the region was held in Jakarta on January 6, with high-level participation of major donor countries and international agencies, and was followed by a Paris Club meeting considering debt relief for the stricken countries on January 12. A Consultative Group meeting for Indonesia (CGI) is scheduled for January 19–20. A supplement to this staff report, providing an assessment of the implications of the disaster for the economic outlook, the budget, and the balance of payments will be issued following the latter meeting.

- Indonesia's extended Fund arrangement expired in December 2003. Outstanding obligations amount to SDR 6.3 billion (305 percent of quota), and are projected to remain above 100 percent of quota until 2008 (expectation basis); see Annex I. The first PPM discussions were completed in May 2004, together with the Article IV consultation. The World Bank Board approved the first Development Policy Loan ($300 million) for Indonesia and a project loan to support improvements in public resource management ($60 million) on December 21.

Contents Page

I. Introduction

1. **Last year marked a turning point in Indonesian politics**. Dr. Susilo Bambang Yudhoyono was sworn in as Indonesia's first directly elected President on October 20, ending a protracted election cycle that began with parliamentary elections in April. Dr. Yudhoyono's landslide victory, with 61 percent of the votes, in large part reflected the public's frustration with Indonesia's drawn out recovery from the crisis. In his inaugural speech, President Yudhoyono stated his commitment to sound economic policies and promised to personally lead the anti-corruption campaign. In mid-December, Vice President Jusuf Kalla became the leader of Golkar—the largest party in Parliament, holding 23 percent of the 550 seats. This development is likely to help build parliamentary support for the new government's reform agenda, and could also strengthen the Vice President's role in the government.

2. **At the time of the mission, the new government was in the process of formulating its economic strategy**. In mid-November, the President had announced the government's 100-day plan, aimed at ensuring security, improving governance, and sustaining economic growth. In the economic area, the plan contains a number of actions toward improving the business climate, including increased flexibility in the labor market, tax policy and tax administration reforms, and trade policy and deregulation aimed at improving competitiveness and reducing transactions costs. On infrastructure, the plan seeks to revise the regulatory framework governing public-private partnerships to revitalize investment. Anti-corruption initiatives feature prominently in the action plan. On the macroeconomic policy front, the plan calls for budget restraint helped by strengthening of government revenue collection. Finally, poverty reduction measures are also included in the near-term agenda. In recognition that the implementation of such a wide range of measures inevitably will take time, the government had toned down its statements regarding the 100-day plan, and shifted its attention to the development of a more detailed medium-term development plan.

3. **With the new government having recently assumed office and about to embark on a new chapter in Indonesia's post-crisis economic reforms, the mission provided a timely opportunity to take stock of the achievements to date and to discuss the road ahead**. Economic growth had continued, while inflation had remained low and the external position satisfactory. The previous government restored macroeconomic stability, put the banking system on a sounder footing, and undertook a range of structural reforms. Nevertheless, a strengthened policy effort is needed to fully realize Indonesia's economic potential and deal with pervasive unemployment and poverty. To this end, the new government was rightly focusing on maintaining macroeconomic stability and redoubling efforts to improve the private investment climate.

4. **While the government's attention since late December has been on managing the devastating effects of the natural calamity, the President has reiterated the government's commitment to a sound economic strategy**. The President has restated his determination to maintain macroeconomic stability, address corruption, strengthen the

judicial system, and upgrade infrastructure. Over the longer term, these are the policies that will be needed to realize Indonesia's growth potential and enable it to deal with poverty and human suffering. Meanwhile, the government has developed a three-pronged approach to deal with the aftermath of the natural catastrophe, with a focus on disaster management during 2005, followed by reconstruction and rehabilitation over the medium term. Financial markets have taken the calamity in stride. In part, this is because the overall growth impact is expected to be limited, the substantial loss of capital notwithstanding, as the province which was most severely hit (Aceh) accounts only for about 2½ percent of GDP, the energy industry in the area remains unscathed, and there is virtually no tourism in the region. However, major financing needs will arise both from the disaster management and from reconstruction, which could have budgetary consequences.

5. **The international community has responded expeditiously and generously to the disaster**. First, a high-level summit in Jakarta on January 6 reaffirmed the international community's intention to respond to the disaster with generous support for the affected countries. Following up on this summit, on January 12, the Paris Club offered a moratorium on public debt service for affected countries, providing time for a more tailored approach to debt relief for individual countries. It is likely that Indonesia will avail itself of the moratorium. On January 19-20, the Consultative Group donors meeting for Indonesia will go ahead as planned.[1] In its contacts with the government, Fund staff have stressed its willingness to assist Indonesia in any way that the authorities would find useful, be it in the form of analyzing macroeconomic and financing implications of the disaster, providing financial support under the emergency assistance facility, or extending technical assistance, especially in regard to banking and payment system issues and budget management. The staff expects to remain in close contact with the authorities in the coming period, as they develop their plans and strategies.

II. Recent Economic Developments

6. **Macroeconomic and financial market developments were on the whole favorable in 2004**:

- **Real GDP growth is estimated at 5 percent** (Table 1). While private consumption remained the main driver behind the recovery, there were tentative signs of a pick-up in private investment and exports (Figure 1).[2] Nevertheless, indications are that

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[1] A supplement to this staff report will be issued following the CGI meeting, providing an assessment of the macroeconomic implications, as well as the needs and outlook as regards financing.

[2] The data presented are based on revised national accounts data; see Box 1 for a discussion of the national accounts revisions.

BOX 1. THE REVISED NATIONAL ACCOUNTS

In May 2004, the Indonesian statistics agency (BPS) published revised quarterly national account estimates. The new data series, which goes back to 2000Q1, updates the GDP base year from 1993 to 2000, and improves the coverage of goods and services and reporting entities in the data that underpin the GDP estimates.

Revisions to the national accounts are conducted every decade to capture changes in the structure of the economy. The overall scale of economic activity is estimated using an input-output table. The revised estimates are based on the 2000 input-output table that has been updated to include new products in some areas, such as information technology, while removing other products. A breakdown of GDP by its expenditure components has been estimated using survey responses from corporations and households.

The revised national accounts show GDP as substantially higher than previously estimated. Nominal GDP is almost 10 percent higher in 2000 and as much as 17 percent higher in 2003 (see table). The upward revision to nominal GDP thus has a significant impact on key macroeconomic ratios. Moreover, growth in real GDP for the period 2001–2003 is higher by an annual average of about ½ percentage points.

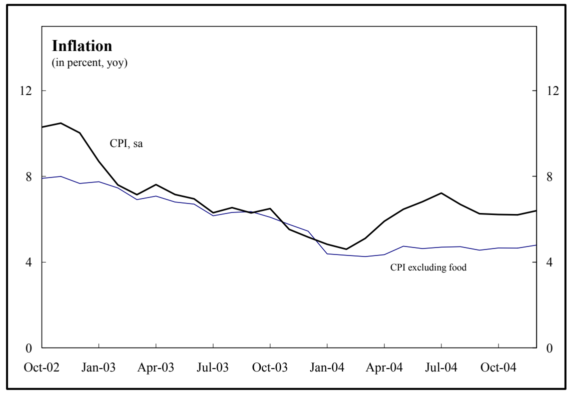
	Nominal GDP (Rp trillions)			Real GDP growth (percent)	
	1993 base	2000 base	Percent difference	1993 base	2000 base
2000	1265	1390	9.9	4.9	...
2001	1468	1684	14.7	3.5	3.8
2002	1611	1898	17.8	3.7	4.3
2003	1787	2087	16.8	4.1	4.5

Source: BPS.

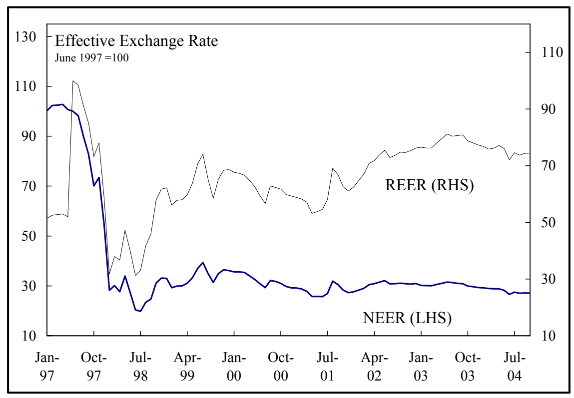
The composition of GDP by expenditure has also changed significantly. The share of consumption in total GDP has been revised down. Over the period 2000-2003, private consumption has been revised down from 69 percent of GDP to 61 percent, while government consumption has been lowered marginally. Nevertheless, consumption remains the main driver of growth, providing the largest contribution to growth over the period. The share of investment in GDP is also lower by an average of 2½ percentage points. The share of exports has been revised up substantially, from an average of just under 30 percent to almost 40 percent of total GDP. Imports have also been revised up, albeit by less than exports.

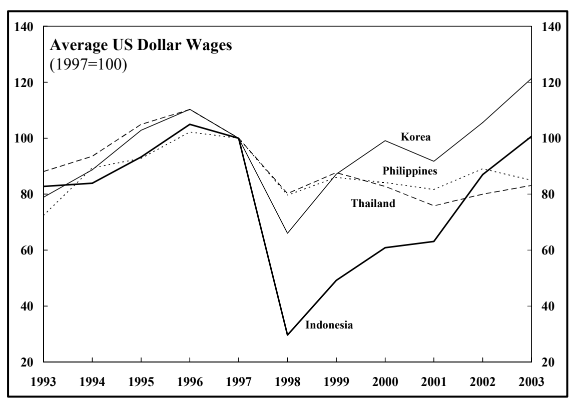
Further revisions may be forthcoming. Notwithstanding the methodological improvements to the revised estimates, the new estimates use a combination of 1993 and 2000 price deflators. The estimate of nominal GDP may change once all price deflators have been updated to the 2000 base year. BPS expects to publish the revised set of price deflators at the time of 2005Q1 GDP release.

unemployment continue to increase as labor demand lags behind the expansion of the labor force.



- **Inflation, after a temporary increase, peaking at 7¼ percent (y/y) in July, edged back down, ending the year at 6½ percent**. The swings in inflation in the course of 2004 mainly reflected movements in food prices; the increase in international oil prices did not have a significant effect on inflation as consumer prices for major fuel products, being subsidized, were kept unchanged.



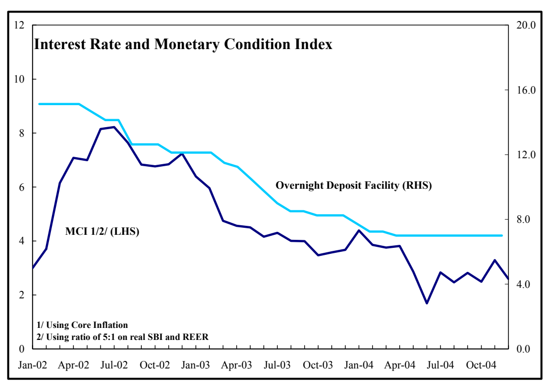


- **External developments were favorable**. A recovery in tourism and non-oil exports, coupled with high oil and gas prices, helped keep the current account in surplus, despite a surge in imports of raw materials and capital goods. The current account is estimated to have registered a surplus of close to 3 percent of GDP in 2004 (Table 2). At the same time, as a result of higher external debt repayments, international reserves remained flat during 2004. Reserves nevertheless were comfortable at about $36 billion, or 160 percent of short-term debt. The REER (CPI-based) depreciated somewhat in 2004, after having appreciated over the previous years. While the recent depreciation would tend to ease any immediate concerns about external competitiveness, growing labor costs as a result of increases in minimum wages and a strong currency over the last few years underscore that competitiveness still bears close watch.

- **Financial markets were on the whole strong in 2004, a trend which has continued in the aftermath of the disaster**. Following a period of weakness in the spring months of 2004—which reflected concerns about the inflation outlook and higher global interest rates, as well as political uncertainty in the run-up to the presidential election—markets have steadily recovered, boosted by the peaceful election process and by the outcome. The stock market was up by some 45 percent for the year as a whole. Meanwhile, the exchange rate recovered from its lows in early June. The markets responded calmly to the natural disaster at the end of 2004, reflecting expectations that the calamity will have limited effects on the overall economy, that there will be generous official financial assistance to defray the costs, and that commercial debt will not be affected under the debt relief proposals put forward. Indeed, in the wake of the disaster, the exchange rate and interest rates have remained stable, while the stock market has continued its ascent.

7. **Besides a benign external environment, these favorable developments were helped by the overall sound economic policies pursued over the last few years**. Specifically:

- **Preliminary information indicates that the fiscal deficit, despite some slippage, was reduced from 2¼ percent of GDP in 2003 to an estimated 1½ percent of GDP in 2004** (Table 3).[3] This estimated outturn is somewhat higher than the initial budget target. On the spending side, higher fuel subsidies contributed to the higher deficit, while on the revenue side income tax collections were lower than the optimistic budget projections and profit transfers from Pertamina (the state-owned oil company) fell short. Delays in mutual transfers between the central government and Pertamina, which acts as a conduit for the payment of fuel subsidies, have tended to complicate budget management. With negative net external financing, the borrowing requirement was met from domestic sources, including government bond sales and divestment of assets, mainly of state banks. Government debt continued to decline, falling from 59 percent of (revised) GDP at end-2003 to an estimated 55 percent of GDP at end-2004.



- **The easing of monetary policy conditions came to an end around mid-year**. In response to the financial market pressures in the spring, Bank Indonesia (BI) stopped cutting interest rates at mid-year. The central bank raised reserve requirements in July to absorb liquidity, and short-term interest rates subsequently remained flat. Base money continued to grow rapidly, however, and growth in bank credit to the private sector, especially consumer loans, remained robust (Table 4, and Box 2).

[3] These figures are quoted in terms of the old GDP series. In terms of the new GDP series, the 2004 deficit is estimated at 1¼ percent, down from 2 percent in 2003.

BOX 2. BANK BALANCE SHEETS VULNERABILITIES AND LENDING GROWTH

The financial condition of the banking system continued to improve through September 2004. Bank earning indicators increased, reflecting declining funding costs, as interest rates were lower than in 2003. Widening interest margins pushed core earnings up both in public and private banks. Liquidity indicators remained at comfortable levels through the third quarter of 2004, despite the rise in reserve requirements introduced by BI in August.

Nevertheless, vulnerabilities remained, particularly in state-owned banks. Private banks have overall been successful in cleaning up their loan books and returning to high levels of profitability after the crisis. However, important fragilities still remain in the state bank sector, which represents over a third of banking sector's assets and includes the two largest banks. While asset quality ratios have improved, the stock of nonperforming loans (NPLs) has not declined despite the reported increase in lending, as the more buoyant economy did not lead to higher loan repayments. Compromised assets (defined as officially reported NPLs plus restructured loans classified as pass and special mention, foreclosed real estate, and debt equity swaps) rose to Rp 62 trillion in the second quarter of 2004, the highest level since June 2003, and then declined to a still-high Rp 58 trillion by end-September. While capital adequacy asset ratios are relatively high and have improved time, this is in large part due to the reliance of state banks on zero-risk government bonds, which reduces the loan-to-deposit ratios of these banks.

Banking Indicators, End-September 2003-04

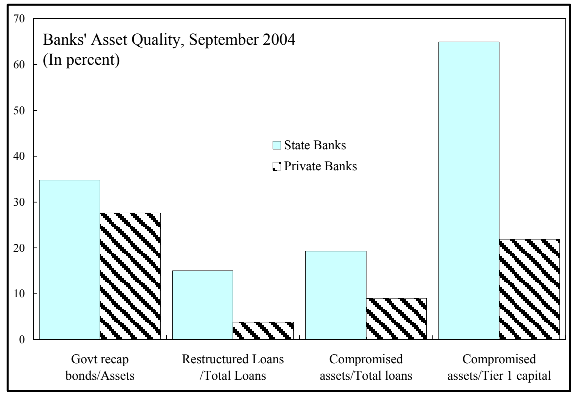
	2003		2004	
	Private Banks	State Banks	Private Banks	State Banks
Capital adequacy ratio	24.9	21.4	22.7	22.2
Loan growth (annual)	22.5	22.4	28.2	19.5
Equity/assets	10.1	7.5	10.9	10.0
Core earnings/ average assets	2.5	2.3	2.9	3.5
NPLs/total loans	5.6	6.2	3.9	6.0
Compromised assets/total loans 1/	11.2	23.9	9.0	19.3
Net compromised assets/Tier 1 capital	17.4	96.9	21.9	64.9
Loan-loss reserves/compromised assets	69.2	36.8	52.8	39.3
Liquid assets/total assets	28.0	12.9	21.7	11.6

1/ Compromised assets include NPLs, restructured loans, and foreclosed real estate and equities.

During the past two years credit growth has been strong, concentrated in the consumer loan sector. Annual credit growth averaged 20 percent during 2002–03, and maintained the momentum through end-September 2004. With a scarcity of creditworthy corporates, the bulk of the new lending went to consumer loans and SMEs.

The deterioration in the financial condition of the banking system in the first few years after the financial crisis does not appear to explain the sluggish growth in bank credit to the corporate sector. Econometric analysis suggests that financial soundness indicators for a sample consisting of the 16 largest Indonesian banks were weakly correlated with lending rates during 2000–04. Loan growth was positively correlated to the capital adequacy ratio and negatively related to the net compromised asset ratio. However, there was no clear evidence of a strong effect of the deterioration in bank's balance sheets on loan growth that would be consistent with a "credit crunch" hypothesis. Other balance sheet indicators such as loan loss provisions, profitability, liquidity and asset structure were also not significant in the regressions. These results point to a complex mix of factors explaining the growth in bank credit, including weak risk assessment capacity and poor legal protection for creditors (not captured in the regressions). Moreover, the demand for credit may have been weak in the years following the crisis as the corporate and household sectors restructured their balance sheets and their risk aversion to borrowing increased.

- **Further progress was made in bank restructuring**. With the completion of the sale of Bank Permata in December, all banks taken over during the crisis have been returned to private ownership. In addition, the government divested part of its remaining shares in two banks (Bank Danamon and Bank Niaga) in October/November.[4] Also, the deposit insurance law—a key building block of the financial safety net—was passed. Meanwhile, overall bank profits and liquidity indicators continued to strengthen. Fragilities nevertheless persist. In particular, state banks remain relatively weak, with compromised assets being high and provisions, earnings, and liquidity low. Moreover, the suspension of operations of a smaller bank in December, after its capital adequacy ratio had fallen precipitously in a matter of months, highlights that risks still exist also in the private banking sector. The placement under special surveillance of another small private bank shortly thereafter further underscores these risks.



- **Legislative reforms moved ahead, although actual implementation was lagging.** A number of important but long-delayed legislative changes were enacted by the outgoing Parliament in 2004, including the adoption of a new bankruptcy law, which is now operative, and laws and amendments relating to the Judicial Commission, social security, and decentralization. However, implementing regulations and institutional arrangements still need to be put in place in some cases before the reforms become effective. Also, the recently-passed social security law leaves the determination of key parameters to be defined in implementing regulations, which could potentially weaken the fiscal position. Similarly, amendments to the decentralization laws do not contain sufficiently specific provisions to ensure firm control of budget and debt management across all levels of government.

III. Vulnerabilities, Economic Outlook, and Capacity to Repay the Fund

8. **Building on the progress over the last few years, a further reduction in vulnerabilities was achieved during 2004, which should help underpin sustained economic growth in a stable environment** (Table 5). Most notably, during 2004:

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[4] With the sale of these minority stakes, the government's share in Bank Danamon (accounting for 6 percent of banking system assets) was reduced to 10½ percent and Bank Niaga (3 percent of total assets) to 5¼ percent.

- **Government debt**, which stood at 78 percent of GDP at end-2001, declined further to an estimated 55 percent.

- **The external position** remained sound. International reserves, as noted above, remained comfortable judged by standard indicators. Moreover, the current account remained in surplus.

- **Sovereign spreads** fell, although the ratings stayed below investment grade; Fitch upgraded Indonesia's outlook to "positive" in October, while Standard and Poor's upgraded its sovereign ratings from B to B+ for foreign currency debt and from B+ to BB for domestic currency debt in December.

9. **Notwithstanding these improvements, remaining risks warrant close watch.** Besides continued weaknesses in the state banks, mentioned above, vulnerabilities relate, in particular, to:

- **The still-high level of public debt and the medium-term debt outlook**. Indonesia's debt ratio is still high compared with similar emerging market countries, and also in light of Indonesia's low and unstable government revenues and large revenue share devoted to debt service (Figure 2). Moreover, debt sustainability analysis underscores the debt position's sensitivity to changes in interest rates and the exchange rate. For instance, an interest rate shock that increases the real interest rate two standard deviations above its historical average would increase the debt-to-GDP ratio by 15–20 percentage points compared to the baseline over the medium term, and a one-off 30 percent depreciation in the exchange rate would raise the debt-GDP ratio by 10–15 percentage points (Annex II).

- **The near-term financing needs of the government**. Considering the lower net external financing and recovery of bank assets expected in 2005, a significant step-up in gross issuance of government bonds will be required. With prudent budget policies, careful debt management, and close monitoring of borrowing costs, the larger borrowing requirement should be met, however, without undue crowding out of the private sector. From this perspective, the spending and financing implications of the disaster programs will also need to be carefully monitored and administered.

10. **With sound policies, the risks could be managed and medium-term economic growth in the 6–7 percent range achieved**. Attaining sustained growth in this range would facilitate increased job creation and greater inroads in poverty reduction. Key to achieving such growth is an improved climate for private sector investment and business activities. Dealing with remaining vulnerabilities, maintaining macroeconomic stability, and accelerating structural reforms would create a favorable environment for private investment. The staff's medium-term projections, based on such a policy framework, envisage an increase in the investment ratio, from 20 percent of GDP in 2004 to 22 percent of GDP in 2009 (Table 6). With productivity gains flowing from investment in new productive capacity and better infrastructure, such an increase in investment could sustain a gradual pick-up in

growth, to 5½ percent in 2005 and further to 6½ percent over the medium term, with unemployment gradually declining (Box 3).[5] Risks to this outlook relate to the possibility of a stronger-than-anticipated slowdown in export markets (especially for textiles) and a generalized change in sentiment vis-à-vis emerging market economies. Indeed, a less favorable than anticipated external environment would tend to keep investment low, putting an even higher premium on strong policies in order to reach the growth rates necessary to reduce unemployment and poverty.

11. **Indonesia's ability to repay the Fund remains relatively robust under the staff's baseline macroeconomic framework**. Outstanding Fund credit currently stands at around $9 billion, amounting to one quarter of the central bank's reserves. Although repayments to the Fund will average as much as $1½ billion per year to the end of the decade, annual repayments would remain below 3 percent of Indonesia's exports of goods and services (Table 7).

IV. Policy Discussions

12. **The authorities and the staff agreed that continued macroeconomic prudence and a broadening of structural reforms hold the key to sustained accelerated growth.** The new government has been given a strong mandate by the electorate, but is also facing high expectations to deliver in the short run. Encouragingly, its initial policy statements have emphasized the need for sound policies and for patience and realism on behalf of the populace. As regards the new government's medium-term economic program, the officials stressed their commitment to fiscal restraint, underpinned by a strengthening of tax administration, a phasing out of the poorly targeted fuel subsidy, and a reorientation of government spending toward high priority areas. Also, they emphasized the need to improve the private investment environment, notably by expediting legal and judicial reforms and the fight against corruption, encouraging private sector participation in infrastructure development through public private partnerships (PPPs), and improving the functioning of input and output markets by introducing more flexibility in the labor market and scaling back domestic regulations and trade restrictions. Bank Indonesia would continue a prudent monetary policy geared toward low inflation, while the flexible exchange rate regime will impart resilience to the economy. The President has reiterated the government's intentions in these areas also in the aftermath of the natural disaster at the end of 2004.

13. **The staff supported the government's overall approach**. At the same time, staff noted that market sentiment remains susceptible to adverse domestic and external events and, going forward, will hinge on the new government's ability to deliver on its agenda. Some

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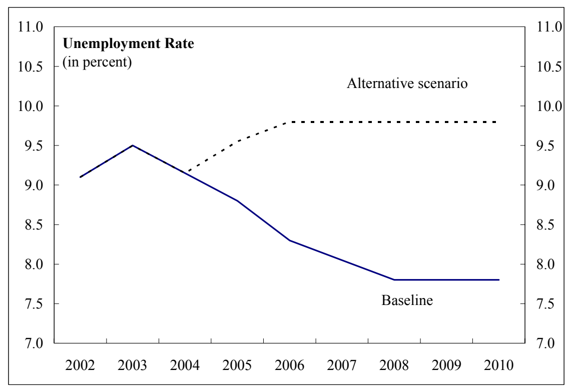
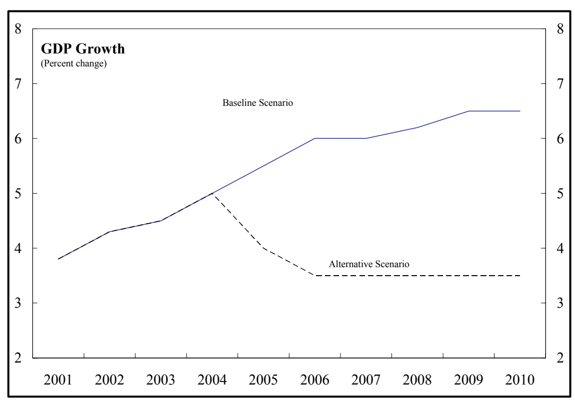
[5] This is in line with the government's tentative growth projection of 5½ percent for 2005 and its objective of 6–7 percent annual growth over the medium term. As noted above, the natural calamity *per se* is expected to have only limited adverse effects on economic growth.

BOX 3. GROWTH AND EMPLOYMENT OUTLOOK

The economic recovery has not been sufficiently strong to prevent an increase in unemployment. On average, only 4 out of every 10 of the 2–2.5 million people that entered the labor force each year since the economic crisis in 1998 have found work. As a result there has been an upward trend in the number of unemployed, with the unemployment rate reaching 9½ percent in 2003 (see chart). Moreover, the level of underemployment is likely to be larger still. In addition to inadequate economic growth, increases in minimum wages and severance payments in recent years are likely to have had a negative impact on formal sector employment.

Economic growth in the range of 6–7 percent per annum, as projected under the baseline scenario, should help lower unemployment significantly over the medium term. Analysis based on an elasticity of unemployment to growth comparable to that found in representative cross-country studies suggests that under the baseline macroeconomic scenario, the unemployment rate would fall to some 7–8 percent by 2010 (see chart). As economic activity recovers to levels close to potential, labor demand is expected to increase significantly, thereby reducing the degree of underemployment of workers and allowing informal sector workers to move into the formal sector. More flexibility in labor market regulations would help labor absorption. Such a decline in unemployment would also help reduce poverty, given that labor income is the main determinant of household income, especially for the poorest deciles of the population.





However, a less favorable external environment or backtracking on the envisaged reform agenda would likely result in much weaker growth and higher unemployment. If the current impediments to growth are not addressed decisively, as illustrated in the alternative scenario, investment is likely to remain low and growth could languish in the 3–4 percent range. In turn, this would result in high unemployment and undermine the government's drive to create jobs and reduce poverty.

policy pressures were evident. Notably, there had been calls for directed lending by state banks, especially for SMEs and infrastructure, and the government was considering the introduction of a tax amnesty. The staff noted the risks inherent in such policies. On the other hand, the staff welcomed the government's endeavors to resolve long-standing disputes with foreign investors and take on corrupt officials early on, as such steps would send the right signal about its determination to deal with the entrenched problems of judicial and regulatory uncertainty as well as corruption.

A. Fiscal Policy

14. **The authorities aim to keep fiscal policy geared toward a further reduction in the burden of government debt**, recognizing that the debt level remains at the high end of what would be considered prudent for an emerging market country with a weak and volatile revenue base and rigid government spending structure. The mission supported this overall goal, which would also help free resources for private investment. There would be room for an increase in the fiscal deficit target from the 0.8 percent of GDP envisaged in the approved 2005 budget, provided that the key objective of a steady deficit and debt reduction remains for 2005 (and beyond), broadly along the lines earlier contemplated. The scenario presented in this staff report assumes that the government would increase the 2005 fiscal deficit target to 1 percent of GDP in the revised budget to be presented in the spring of this year. This would be in line with the government's plans discussed during the mission; and Finance Minister Anwar in recent days stated that the government's view is that this target should be retained in spite of the disaster.[6] Confidence would also be helped by a clear demonstration that fiscal policy implementation remains under firm control and that determined efforts are being made to improve the quality of fiscal policy.

15. **The government seeks to achieve the targeted deficit in 2005 through a rationalization of spending and strengthening of revenue collection**. In 2005, budget pressures could emanate from new tax legislation, the financing of infrastructure projects, and the planned tax amnesty (see below). The government is mindful of the need to proceed with caution in implementing such initiatives, and the likely need for further measures. Also, the disaster management program will have budgetary implications. The budget position would be protected by:

- **Reducing the fuel subsidy**. As oil prices have risen, spending on the fuel subsidy has increased strongly, reaching some 3 percent of GDP in 2004. The government had decided to phase out of the subsidy, starting in early 2005. This subsidy reduction would entail significant savings, and could release additional resources for other spending.[7] Indeed, to gain political support, the government was explaining to the

[6] The supplement to this staff report will provide an assessment of the budget and financing outlook based on the outcome of the January 19 Consultative Group meeting.

[7] For illustrative purposes, the staff projections contained in this report assume that fuel subsidies will be phased out over a three-year period.

public that the phasing out would create room for higher-priority spending—including infrastructure, health and education—and would be supplemented by targeted schemes to protect the most vulnerable. While this is a difficult reform, the government has reiterated its commitment to move ahead, also after the disaster. Looking further ahead, the mission suggested that the government adopt an automatic adjustment mechanism for domestic fuel prices once the domestic prices have been aligned with international levels, to ensure that the pricing process is transparent, provides for swift pass-through when international oil prices move, and confines the scope for political discretion in ongoing price adjustments.

- **Attracting private investment in infrastructure**. Given the limited budget room, the government is considering the use of PPPs and the setting up of an investment fund to help finance infrastructure projects (see paragraph 23 below).

- **Further strengthening tax administration and ensuring that tax policy changes are revenue neutral**.[8] Building on the significant progress that has been made in these areas over the last few years, the government was in the process of formulating its tax reform strategy. On the tax administration side, staff recommended a continuation of the reforms undertaken by the previous government, focusing on further steps toward registering taxpayers, broadening audit coverage, enforcing collection of tax arrears, and ensuring prompt filing of tax returns, as well as more fundamental reforms of the tax office, including on the legislative side. On the tax policy side, the new tax legislation under consideration since early 2004—which envisages a reduction in the corporate income tax, the introduction of a reduced CIT rate for small businesses, and a doubling of the basic allowance on personal income taxes—could entail a revenue loss of some ½ percent of GDP in 2005. The new government indicated that it may reconsider some of the provisions of the legislation. In this connection, with a view to ensuring that the tax reforms are revenue neutral, the staff recommended that the government consider broadening the VAT base by eliminating some exemptions, abolishing the luxury tax with revenue losses offset by higher VAT rates and excises on selected goods, simplifying the corporate and personal income taxes, and strengthening the land and property taxation.

16. **The authorities recognized the risks, but are likely to introduce a tax amnesty**. The mission stressed that an amnesty was not advisable, as it is likely to undermine tax collections. Moreover, the mission emphasized that if the government were to move ahead, it would need to adopt measures to improve tax compliance before implementing the amnesty. Also, the government would be well advised to refrain from starting new spending programs or expanding existing ones on the basis of expected increases in tax collections from the amnesty, as such collections, if any, are likely to be temporary. The government recognized

[8] FAD has played a central role in the provision of TA in the tax administration area, and an overlapping FAD mission discussed possible future TA in tax administration with the new government. The government expressed an interest in continued TA, and is considering the modalities.

the need for measures to limit moral hazard, but nevertheless thought that additional revenue could be raised through an amnesty. The staff advised that needed improvements include changes to the laws governing tax administration (particularly the provisions involving penalties, powers of auditors and collectors, and access to information, notably banking information), introduction of new enforcement methods, an increase in the number of tax auditors, and upgrading of the tax authority's computer systems.

17. **Budget and public debt management is in need of strengthening**.[9] The mission recommended that the government proceed quickly to make the Treasury system fully operational, in order to strengthen control over fiscal activity. Specifically, establishing a Single Treasury Account, consolidating bank accounts, and reforming the payments system would all be important to make the system operationally effective. The government is also working to improve its control over the finances of the state-owned oil company, Pertamina. To this end, the government indicated its intention to have independent audits carried out of the company's balance sheet. To follow up on these audits, the regulations governing the mutual transfer of funds between Pertamina and the budget should be better enforced through the adoption of sanctions in the case of delays. To further improve the management of public resources, the government should consider developing a comprehensive debt management strategy to assess the appropriate means to meet its near-term financing needs. The strategy should include considerations to reduce vulnerabilities to exchange rate risk.

B. Monetary Policy and Financial Sector Reforms

18. **Monetary policy is oriented around keeping inflation on a gradual downward path over the medium term**. For the immediate period, BI will continue to monitor inflation carefully and take measures as needed to ensure that inflation remains on a downward path. In view of the current inflation outlook, the mission agreed with BI that there was no immediate need for increasing interest rates. However, BI is keeping a close eye on base money, which has expanded strongly, as well as a range of other indicators of inflationary pressures, and stands ready to take action as necessary to prevent a renewed increase in inflation. In particular, the central bank is mindful of the need to prevent the removal of the fuel subsidy from setting off an inflationary cycle, by aiming for a more ambitious target for underlying inflation and avoiding second-round effects.[10]

19. **Looking further ahead, Bank Indonesia intends to move to formal inflation targeting**. The mission agreed that such a move would help anchor inflation at a low level by enhancing the transparency and credibility of the monetary policy framework. In that regard, the mission suggested that BI clarify the operational framework by announcing the interest

[9] Improvements in budget management are supported by a World Bank project (with Fund participation), approved by the Bank's Executive Board on December 21, 2004.

[10] Staff and Bank Indonesia analyses suggest that each 10 percentage point increase in fuel prices would raise the CPI by about ½ percentage point.

rate that it will use to signal the monetary policy stance and by publishing inflation reports. While the BI representatives indicated that the adoption of fully-fledged inflation targeting is some time away, they stressed that they are already taking preparatory steps.

20. **A continuation of the floating exchange rate regime will act as a shock absorber and help the effectiveness of formal inflation targeting**. Inflation targeting countries typically have floating exchange rate regimes, which help remove potential conflicts between exchange rate and inflation targets. Foreign exchange interventions should generally be geared toward smoothing volatility.

21. **Protecting the soundness of the banking system remains a high priority**. Two areas require particular attention in this regard:

- **The strengthening of asset quality and governance at state banks**. While the performance of the financial sector as a whole has improved, state banks, which account for almost half of total banking system assets, remain a source of vulnerability. With this in mind, the mission discouraged the authorities from exerting pressure on state banks to accelerate their lending, stressing that decision making should be left to the banks. While the authorities agreed with this in principle, they thought that state banks needed to be more forthcoming in lending to the SME sector and for infrastructure projects. They concurred, however, with the mission's emphasis on continued use of management performance contracts and careful monitoring of their results, to ensure that lending policies and internal controls are consistent with sound banking practices.

- **The completion of the financial sector safety net reforms**, on which the government is making good progress. With the recent passage of legislation creating the deposit insurance agency, the government now plans to move ahead with the gradual phasing out of the blanket guarantee, starting in April 2005. The financial safety net law, which will formalize the framework for dealing with problem banks, is scheduled to be submitted to Parliament in early 2005. These efforts are being complemented by further steps to strengthen banking supervision. Notably, the authorities have consolidated the supervision of all nonbank financial institutions under a single agency. This is a first step toward the creation of a fully-fledged financial sector authority that would integrate the supervision of bank and nonbank financial institutions under one roof.

22. **The efforts to revitalize the banking sector will need to be sustained over the medium term**. A central objective of a medium-term strategy should be to entrench sound governance at state banks and ensure that the banks become efficient and competitive. To these ends, the mission suggested strategic privatization as a medium-term option. It cautioned against merging state banks—as had been proposed by some government officials—as this would not in itself improve the health of the banks and would increase concentration further. The authorities raised concerns that in the absence of state banks, small borrowers' access to credit may become limited. The mission agreed that there could be

some scope for the public sector to remain involved in promoting micro credits and other selected activities, but suggested that the bulk of banking sector activities are better left to be handled by the private sector.

C. Structural Reforms

23. **The new government emphasized its commitment to addressing long-standing weaknesses in Indonesia's investment environment**. While the government is developing a sweeping agenda of structural reforms, the discussions focused on the following macro-critical areas:

- **Anti-corruption efforts and strengthening of the judicial and regulatory system**. The new government views these as top priorities, and the President has taken a lead by personally visiting tax offices, customs offices, and courts during his first days in office. Moreover, the government is pressing ahead to resolve a handful of long-pending investment disputes involving foreign investors, which it sees as a way of building confidence in the rule of law. Also, it aims for speedy implementation of the existing blueprints to improve the functioning of the Commercial Court, the Anti-Corruption Court, and the Supreme Court, and the appointment of the Judicial Commission.

- **Trade policy and regulatory reforms**. In regard to external trade policies, the Minister of Trade favors a liberal approach. The Ministry of Trade was reviewing existing trade restrictions, with a view to eliminating them over time; however, the ban on rice imports introduced last year has recently been extended on a temporary basis to mid-2005 to allow the government to formulate a proper tariff schedule to replace the import ban. The Ministry is also reviewing regulations on domestic economic activities that are causing red tape, with a view to simplifying and lowering the costs of starting up and running businesses. In this regard, ensuring consistency in regulations and taxes introduced at different levels of government is a high priority for improving the investment environment.

- **The strategy to improve infrastructure**. While redirection of public spending could create considerable room for publicly funded infrastructure projects, the government intends also to attract private investment through PPPs. In this regard, the authorities concurred that it will be important to establish an institutional framework for PPP projects that ensures that projects with the highest social rate of return are chosen, and that prevents the creation of unfunded liabilities for the budget. It will also be important that the fiscal implications of possible PPPs be transparently accounted for and reported. The government is also considering the establishment of an investment fund for infrastructure investment. To communicate its policy drive in this area, the government is planning to hold a high-level Infrastructure Summit already in January 2005, with participation of investors, as well as foreign government officials and IFIs.

- **Implementation of the labor law**. The current provisions in minimum wages setting, severance pay, and outsourcing add to labor cost. While the previous Parliament passed a new labor law in 2003, which provides a basic formula for an effective labor market, several implementing regulations are pending. In formulating these regulations, the mission advised the government to establish standards for minimum wages, severance pay, and outsourcing that would preserve Indonesia's competitiveness vis-à-vis its neighbors and attract investment in labor-intensive production. To help ease the move to more flexible labor relations, mechanisms could be developed to facilitate transition between jobs, notably unemployment insurance, retraining, and other active labor market policies. The authorities indicated that they were committed to scaling back rigidities in the labor market and that work in this area had already begun.

V. Staff Appraisal

24. **The government's response to the natural disaster at the end of 2004 should help limit human suffering, and the support expressed by the international community is welcome**. The government has moved expeditiously to put together a plan for disaster management and for medium-term reconstruction and rehabilitation. It will be important that, once adopted, this plan be followed through, both by the Indonesian government in terms of implementation and by donors in terms of financial and other assistance. By the same token, a continuation of the underlying economic reforms will ultimately lay the basis for the sustained growth in incomes and employment that is needed to improve the economic wellbeing of the population. From this perspective, President Yudhoyono's commitment to combine the vital efforts at disaster management, rehabilitation, and reconstruction with a continuation of the government's agenda of general economic reforms, including prudent macroeconomic policies, holds out hope for the future.

25. **The election has given the new government a strong mandate to tackle the economic reforms needed to revitalize the economy**. Over the last several years, commendable progress has been made toward achieving macroeconomic stability and restoring a healthy banking system, and headway has also been made toward strengthening the institutions and policies needed for an attractive business environment. The challenge for the new government will be to maintain stability, while broadening reforms in a prompt manner. Success in this regard holds the key to attracting private investment, reducing remaining vulnerabilities, and achieving higher growth on a lasting basis. The staff therefore supports the new government on its announced broad economic policy strategy. While the specifics remain largely to be formulated, the government's overall approach—centered on fiscal and monetary restraint, coupled with more aggressive structural reforms to facilitate private investment—is the right one.

26. **The government's commitment to fiscal prudence is welcome**. As the government is reconsidering its budget for 2005 in light of the natural disaster, it should be mindful of the need to continue the policy of underlying fiscal consolidation. The phasing out of the fuel subsidy being contemplated by the government should help in that regard, and would also

create room for making the budget more growth oriented and better targeted toward supporting the poor and dealing with the aftermath of the natural calamity. The government's focus on improving infrastructure is appropriate; when considering the options in this regard, the government needs to be mindful of the need to prevent unfunded liabilities.

27. **The planned tax amnesty carries significant risks for tax collections**. The staff recommends against proceeding with the plans for a tax amnesty. Should the government proceed, the staff would strongly recommend that it undertake reforms to improve tax compliance and enforcement before any amnesty goes ahead. This will be critical to minimize the loss of credibility in tax collection at a time when every effort should be made to strengthen the tax agency's clout.

28. **The focus of monetary policy on further disinflation is appropriate**. During 2004, BI was successful in keeping inflation on a downward path in an uncertain environment. Looking ahead, BI's attention to developments in base money and other indicators of future inflation, and readiness to act to avoid a re-emergence of inflation, is welcome. The staff supports the authorities' intention to adopt formal inflation targeting, which will help enhance the credibility of monetary policy and assist in anchoring inflation at a low and stable level. BI's preparatory steps in this regard, including the plans for an inflation report, are helpful. The continuation of a flexible exchange rate regime will help facilitate effective inflation targeting and provide a safety valve to deal with external shocks.

29. **Continued efforts will be needed to ensure a banking system that is sound and supportive of economic growth**. While the overall performance of the banking sector has improved, the situation at state banks remains a matter of concern. In light of the relatively weak asset quality and profitability of these banks, the authorities need to continue making efforts to strengthen these banks' management and operations. The progress in strengthening overall bank supervision will help limit the scope for new banking problems to emerge, and the progress in putting in place a financial sector safety net is commendable.

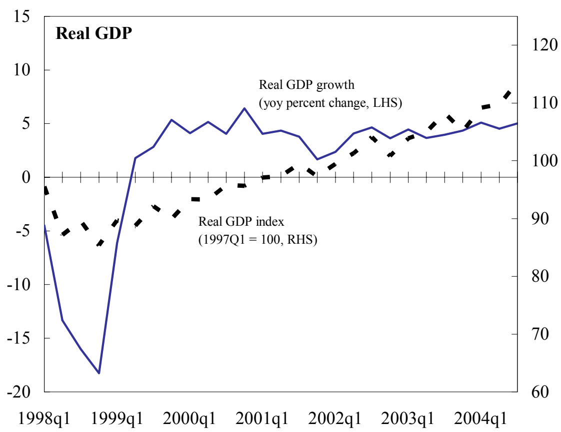
30. **The staff welcomes the government's commitment to improving the investment climate**. In this context, pushing ahead with reforms in the legal and judicial systems, addressing corruption, improving tax administration, strengthening infrastructure, scaling back domestic regulations and external trade restrictions, including freeing up rice imports, and increasing the flexibility of the labor market should all help make Indonesia a more favored investment destination. The problems in these areas are well known and long standing. The new government, having assumed office with strong support, faces a historic opportunity to make a final breakthrough and convince investors that Indonesia is an attractive place to run a business.

31. **In conclusion, the new government's initial indications regarding its economic strategy are encouraging and hold the promise of realizing Indonesia's economic potential**. Obviously, the natural disaster presents massive new challenges. At the same time, substantial progress toward putting the economy on a better footing has been made since the 1997–98 crisis, and both external and domestic vulnerabilities have been reduced. The new

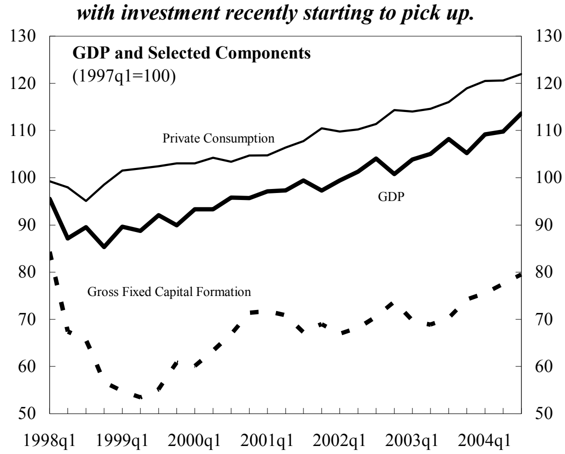
government has set for itself the right goals and the overall approach to getting there is sound. In the staff's assessment, with the implementation of the economic reform agenda as envisaged, the new government would create the conditions for sustained growth and improvements in living standards that it aims for.

Figure 1. Recent Macroeconomic Developments

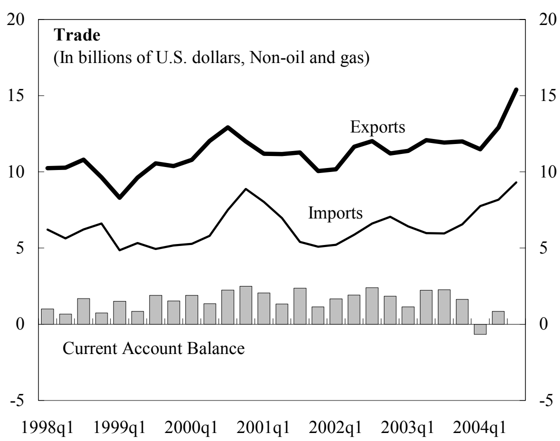
GDP growth has picked up ...



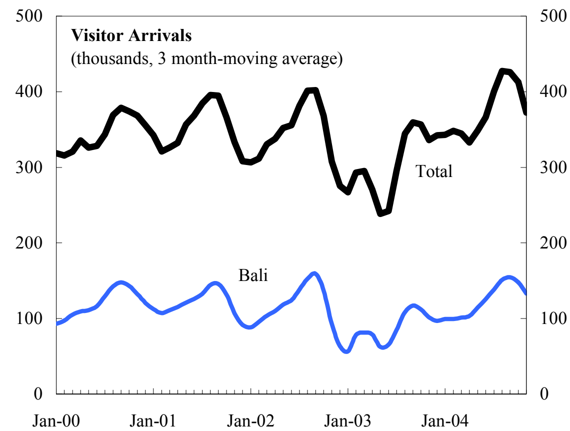
…on the strength of private consumption, with investment recently starting to pick up.



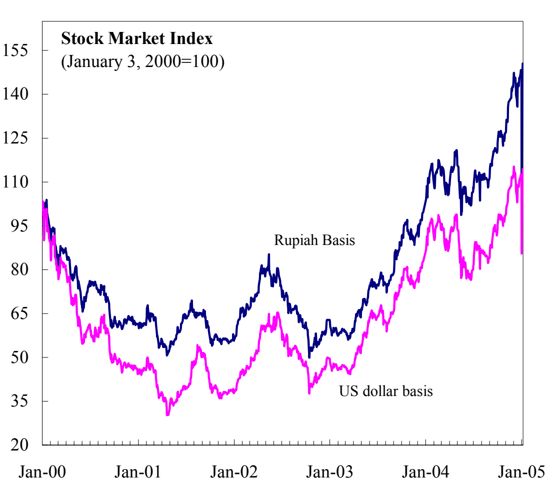
Export performance is improving...



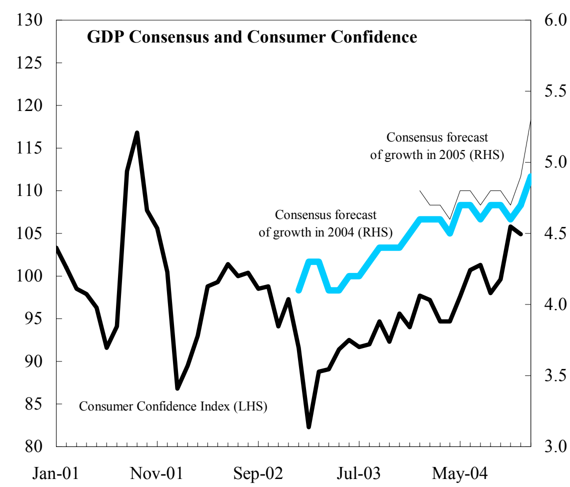
…and tourist arrivals have been recovering.



The stock market is at a record high...

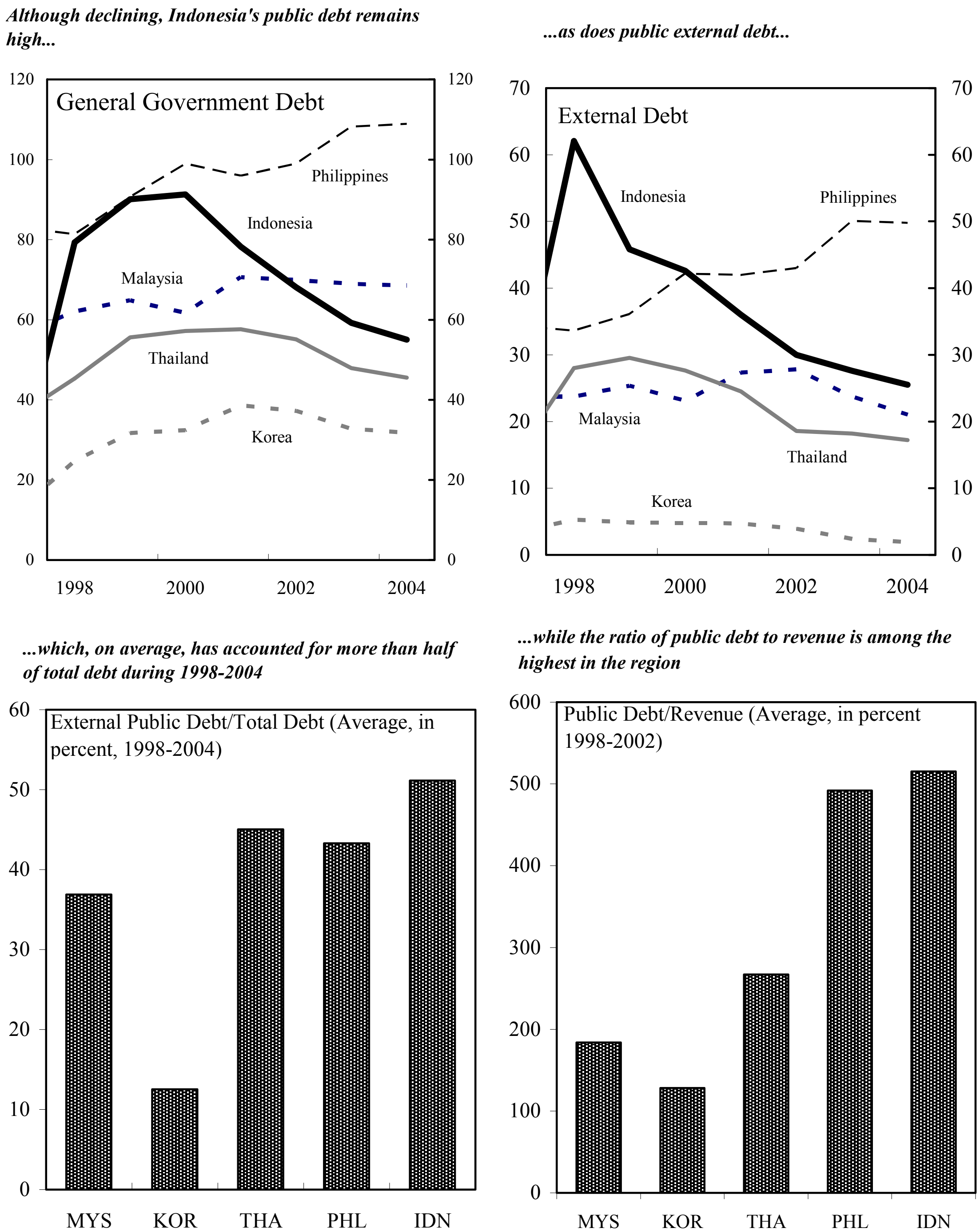


...and the outlook for growth remains generally positive.



Source: Data provided by Indonesian authorities, CEIC, Danareksa Research Institute, and Fund staff estimates.

Figure 2. Public Sector Debt: Regional Comparisons 1/
(in percent of GDP, unless specified otherwise)



1/ Coverage: Non-financial public sector for Malaysia, Thailand, and Philippines, general government for Korea and Indonesia.

Table 1. Indonesia: Selected Economic Indicators, 2001-05 1/

	2001	2002	2003	2004	2005
		Act		Est.	Proj.
Real GDP (percent change)	3.8	4.3	4.5	5.0	5.5
Domestic demand	4.8	2.6	3.6	5.8	6.3
Of which:					
Private consumption	3.4	3.8	4.0	5.0	6.6
Gross fixed investment	6.5	0.2	1.4	7.0	9.0
Net exports 2/	-1.2	1.1	0.7	-0.5	-0.5
Errors and omissions 2/	0.2	-1.1	-0.5	0.0	0.0
Savings and investment (in percent of GDP)					
Gross fixed capital investment	21.4	20.3	19.7	19.9	20.2
Gross national savings	25.6	24.1	22.7	22.7	22.1
Foreign savings	-4.2	-3.8	-3.0	-2.8	-1.9
Prices (12-month percent change)					
Consumer prices (end period)	12.5	10.0	5.1	6.4	6.0
Consumer prices (period average)	11.5	11.9	6.6	6.1	6.0
Public finances (in percent of GDP)					
Central government revenue	17.9	15.8	16.0	17.4	16.1
Central government expenditure	21.0	17.3	18.0	18.6	17.1
Central government balance	-3.2	-1.5	-2.0	-1.2	-1.0
Central government debt	78.2	68.1	59.2	55.0	49.8
Money and credit (percent change end of period)					
Rupiah M2	13.6	7.9	10.0	11.3	14.0
Base money (averaged)	2.1	8.3	20.5	14.5	12.0
Private sector credit 3/	18.0	21.9	22.0	26.3	14.3
One-month SBI rate (period average)	16.5	14.9	10.0	7.4	7.5
Balance of Payments (in billions of US$)					
Oil and gas (net)	6.4	5.6	6.7	6.6	6.2
Non-oil exports (f.o.b)	44.8	46.3	48.0	53.7	56.4
Non-oil imports (c.i.f)	-31.3	-31.1	-33.7	-39.9	-42.7
Current account balance	6.9	7.8	7.3	7.3	5.5
Direct foreign investment 4/	3.1	5.2	3.2	3.4	4.0
Overall balance	-2.9	0.9	0.6	1.1	0.6
Gross reserves					
In billions of US dollars (end period)	28.0	32.0	36.2	36.3	35.8
In months of imports	6.6	7.0	6.6	6.2	5.7
As a percent of short-term debt 5/	79	129	146	159	165
External debt					
In billions of US dollars	133.2	131.3	134.9	129.9	124.9
In percent of GDP	81.0	64.3	55.4	49.8	43.3
Exchange rate (period average)					
Rupiah per US$ (period average)	10,246	9,291	8,578	8,927	...
Nominal effective exchange rate (1997=100)	28.0	30.7	30.5	...	...
Real effective exchange rate (1997=100)	59.7	72.5	76.6	...	...
Memorandum items:					
Indonesia oil production (000bcpd)	1,320	1,260	1,200	1,070	1,070
Indonesian oil price (US$/bbl)	23.3	24.2	27.4	36.2	35.5
Nominal GDP (in trillions of Rupiah)	1,684	1,898	2,087	2,329	2,610
Nominal GDP (in billions of US$)	164	204	243	262	288

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

1/ National accounts figures (and ratios to GDP) are the new official national accounts (2000 prices).

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

3/ At constant exchange rate, adjusted for loan transfers to and from IBRA.

4/ FDI includes privatization and IBRA sales to nonresidents.

5/ Short-term debt is on a remaining maturity basis, before rescheduling, and including IMF repurchases.

Table 2. Indonesia: Balance of Payments, 2001–05
(In billions of U.S. dollars)

	2001	2002	2003	2004	2005
	Actual			Est.	Proj.
Current Account	6.9	7.8	7.3	7.3	5.5
Trade balance	19.8	20.9	21.0	20.4	19.8
Exports (fob)	57.4	59.2	63.3	72.5	75.3
Oil and Gas	12.6	12.9	15.2	18.8	19.0
Non-oil and gas	44.8	46.3	48.0	53.7	56.4
Imports (cif)	-37.5	-38.3	-42.2	-52.1	-55.5
Oil and Gas	-6.2	-7.2	-8.5	-12.2	-12.8
Non-oil and gas	-31.3	-31.1	-33.7	-39.9	-42.7
Services (net)	-12.9	-13.0	-13.8	-13.1	-14.3
Nonfactor services, net	-7.0	-7.2	-9.0	-9.2	-9.9
Travel inflow	5.3	5.3	4.0	5.0	5.2
Travel outflow	-3.4	-3.3	-3.1	-3.5	-3.7
Other nonfactor services	-8.9	-9.2	-10.0	-10.7	-11.5
Factor services	-5.9	-5.8	-4.7	-3.9	-4.4
Capital Account	-9.8	-7.0	-6.7	-6.2	-4.9
Nonfinancial public sector	-2.6	-3.6	-3.5	-2.6	-3.3
Disbursements	2.9	2.4	2.2	3.8	3.6
Amortization due	-5.5	-6.0	-5.7	-6.5	-6.9
Banking Sector (net)	0.4	0.8	2.7	3.8	2.5
Disbursements	2.0	2.4	4.1	5.3	3.5
Amortization due	-1.7	-1.6	-1.4	-1.4	-1.0
Private Sector (net)	-7.5	-4.1	-5.9	-7.4	-4.1
FDI, gross inflows 1/	3.1	5.2	3.2	3.4	4.0
Of which : Privatization and IBRA-related	0.9	1.4	0.8	0.4	0.5
Other private sector flows	-10.7	-9.3	-9.1	-10.8	-8.2
Portfolio investment (net)	-0.2	1.2	2.3	2.4	3.0
Other (net) 2/	-10.4	-10.5	-11.3	-13.2	-11.2
Overall balance	-2.9	0.9	0.6	1.1	0.6
Financing	2.9	-0.9	-0.6	-1.1	-0.6
NIR	0.0	-4.5	-3.6	-1.1	-0.6
Gross reserves	1.4	-3.6	-4.2	-0.1	0.5
Reserve liabilities (IMF)	-1.4	-0.9	0.6	-1.0	-1.1
Public sector rescheduling	2.9	3.6	3.1	0.0	0.0
Memorandum items					
Gross reserves (eop) 3/	28.0	32.0	36.2	36.3	35.8
months of imports of goods and services	6.6	7.0	6.6	6.2	5.7
in percent of short-term debt	79	129	146	159	165
Non-oil and gas exports, vol gwth (rev estimate)	-7.7	1.0	-7.6	2.6	4.5
Non-oil and gas imports, vol gwth (rev estimate)	-11.4	-3.0	-3.1	7.7	8.0
Terms of trade, percent change (excluding oil)	0.8	0.2	-0.3	-1.2	1.2
Current account (% of GDP)	4.2	3.8	3.0	2.8	1.9
Stock of nonfinancial public sector external debt	75.8	78.4	85.8	82.3	77.8
in percent of GDP	46.1	38.4	35.3	31.4	27.0
Nonfinancial public sector debt service/XGNFS	17.5	18.0	14.8	13.8	13.6
Indonesian oil price (actuals for 2000-03)	23.3	24.2	27.4	36.2	35.5
US$ GDP (revised series)	164	204	243	262	288

1/ FDI series has been revised to include privatization and IBRA sales to nonresidents. From 2002 onward, the definition of FDI has been updated in line with a change in methodology of the official statistics (the ownership threshold has been reduced from 50 percent to 10 percent).
2/ Comprised largely of private sector debt repayments, changes in banks' foreign currency balances, and errors and omissions.
3/ Data from 2002 onward reflect higher reserves reported in BI's general ledger.

Table 3. Indonesia: Summary of Central Government Operations, 2003–05

	2003	2004			2005		
	Act.	Initial budget 1/	Revised budget	Staff Est.	Budget Old GDP	Budget New GDP	Staff projection
			(In trillions of rupiah)				
Revenues and grants	336.3	349.9	403.8	402.3	380.4	380.4	421.2
Oil and gas revenues	80.4	57.1	110.7	113.7	60.7	60.7	105.5
Non-oil and gas revenues	255.5	292.3	292.3	288.1	318.9	318.9	314.9
Tax revenues	218.0	259.2	256.1	252.8	284.2	284.2	283.8
Nontax revenues	37.5	33.1	36.2	35.3	34.7	34.7	31.1
Grants	0.4	0.6	0.7	0.5	0.8	0.8	0.8
Expenditure and net lending	375.8	374.3	430.0	436.8	397.7	397.7	447.3
Central government expenditure	255.1	255.3	300.0	306.0	266.2	266.2	305.9
Current expenditure	194.9	191.5	235.2	243.2	209.1	209.1	233.7
Personnel	46.6	56.7	54.2	53.7	60.2	60.2	60.2
Subsidies	39.9	26.3	69.9	82.4	31.2	31.2	52.9
Interest	71.7	65.7	63.2	63.4	64.1	64.1	67.1
External	22.9	24.4	23.4	23.4	25.1	25.1	26.1
Domestic	48.8	41.3	39.8	40.0	39.0	39.0	41.0
Other	36.7	42.8	47.9	43.8	53.5	53.5	53.5
Development expenditure 2/ 3/	58.0	63.8	64.8	62.7	57.2	57.2	72.1
Domestically financed	44.3	46.9	49.1	48.1	44.4	44.4	59.4
Foreign financed	13.7	16.9	15.7	14.6	12.8	12.8	12.8
Statistical discrepancy	2.3	0.0	0.0	0.0	0.0	0.0	0.0
Transfers to regions	120.7	119.0	130.0	130.9	131.5	131.5	141.4
Measures needed	0.0	0.0	0.0	5.6	0.0	0.0	0.0
Overall balance	-39.6	-24.4	-26.3	-29.0	-17.4	-17.4	-26.1
Financing	39.6	24.4	26.3	29.0	17.4	17.4	26.1
Domestic	39.8	32.0	41.4	43.5	33.3	33.3	45.1
Bank financing 4/	4.0	22.0	23.5	23.5	25.8	25.8	37.5
Recovery of bank assets 5/	26.1	5.0	12.9	16.5	4.0	4.0	4.0
Privatization of nonfinancial assets	7.3	5.0	5.0	3.5	3.5	3.5	3.5
Other 6/	2.4	0.0	0.0	0.0	0.0	0.0	0.0
External	-0.2	-7.6	-15.1	-14.5	-15.9	-15.9	-19.0
			(In percent of GDP) 7/				
Revenues and grants	16.1	17.6	17.3	17.3	17.4	14.6	16.1
Oil and gas revenues	3.9	2.9	4.8	4.9	2.8	2.3	4.0
Non-oil and gas revenues	12.2	14.7	12.5	12.4	14.6	12.2	12.1
Tax revenues	10.4	13.0	11.0	10.9	13.0	10.9	10.9
Nontax revenues	1.8	1.7	1.6	1.5	1.6	1.3	1.2
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	18.0	18.8	18.5	18.8	18.2	15.2	17.1
Current expenditure	9.3	9.6	10.1	10.4	9.5	8.0	9.0
Personnel	2.2	2.8	2.3	2.3	2.7	2.3	2.3
Subsidies	1.9	1.3	3.0	3.5	1.4	1.2	2.0
Interest	3.4	3.3	2.7	2.7	2.9	2.5	2.6
Other	1.8	2.1	2.1	1.9	2.4	2.1	2.1
Development expenditure 2/ 3/	2.8	3.2	2.8	2.7	2.6	2.2	2.8
Transfers to regions	5.8	6.0	5.6	5.6	6.0	5.0	5.4
Measures needed	0.0	0.0	0.0	0.2	0.0	0.0	0.0
Overall balance 3/	-2.0	-1.2	-1.1	-1.2	-0.8	-0.7	-1.0
Memorandum items:							
Overall balance with old GDP series	-2.2	-1.2	-1.3	-1.5	-0.8	---	-1.2
Primary balance	1.4	2.1	1.6	1.5	2.1	1.8	1.6
Non-oil primary balance	-2.4	-0.8	-3.2	-3.4	-0.6	-0.5	-2.5
Crude oil price (US $ per barrel)	28.8	22.0	36.0	36.2	24.0	24.0	35.5
Oil production (mbpd)	1.200	1.150	1.072	1.070	1.125	1.125	1.070
SBI rate	10.0	8.5	7.5	7.4	6.5	6.5	7.5
GDP growth rate	4.5	4.8	4.8	5.0	5.4	5.4	5.5
Inflation	6.6	6.5	7.0	6.1	5.5	5.5	6.0
Exchange rate (Rupiah per US$)	8,578	8,600	8,900	8,900	8,600	8,600	9,050
GDP new series (in trillions of rupiah)	2,087	---	2,329	2,329	---	2,610	2,610
GDP old series (in trillions of rupiah)	1,787	1,993	1,993	1,993	2,191	---	2,233

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

1/ From 2004 onward, as in the authorities' presentation, deposit insurance premia are treated as nontax revenues.
2/ Excludes military expenditures, which are included in other current expenditure.
3/ In 2005, comprises capital spending and social assistance spending.
4/ Includes net issuance of domestic debt.
5/ Total IBRA receipts. After 2003, PPA receipts.
6/ Includes unpaid scheduled interest to BI (in 2003 includes deposit insurance premia).
7/ Revised GDP series, except for 2004 initial budget and 2005 budget presented by the authorities, as indicated.

Table 4. Indonesia: Monetary Survey, December 2001–December 2004
(In trillions of rupiah, unless otherwise indicated, end of period) 1/

	2001	2002	2003				2004			
	Actual		Actual				Actual			Dec.
			March	June	Sept	Dec	March	June	Sept	Est.
Monetary Survey										
Net foreign assets	141.9	178.8	180.9	186.9	193.4	216.9	219.9	198.7	193.2	213.6
(In US$ billions)	20.3	25.5	25.8	26.7	27.6	31.0	31.4	28.4	27.6	30.5
Net domestic assets	651.6	674.6	667.4	687.0	695.0	715.7	689.1	738.5	760.4	816.0
Net claims on government	539.3	515.2	515.5	507.0	484.2	482.1	453.7	478.1	481.2	506.0
Claims on private sector	294.8	369.0	379.9	404.0	425.8	450.2	459.2	521.7	551.0	573.1
Rupiah claims	224.2	295.7	305.0	327.0	348.3	370.9	378.3	439.9	467.8	486.1
Foreign exchange claims	70.7	73.3	74.9	77.0	77.5	79.3	80.9	81.8	83.2	87.0
Other items (net)	-182.6	-209.6	-228.1	-224.0	-215.0	-216.6	-223.7	-261.3	-271.8	-263.0
Broad money (M2)	793.5	853.4	848.3	873.9	888.4	932.6	909.0	937.2	953.7	1029.6
Rupiah broad money	689.3	743.4	740.2	759.5	773.7	817.5	793.2	827.2	846.6	909.6
Currency	76.3	80.7	72.3	77.1	81.1	95.5	86.9	97.6	99.5	108.1
Deposits 2/	612.9	662.8	667.9	682.4	692.6	722.0	706.3	729.6	747.1	801.5
Foreign exchange deposits	104.2	110.0	108.1	114.4	114.7	115.1	115.8	110.0	107.1	120.0
Bank of Indonesia										
Net international reserves	128.1	155.1	162.1	165.3	165.4	169.4	169.4	165.4	165.6	170.8
Net domestic assets	-0.5	-16.8	-36.9	-33.3	-29.4	-2.8	-27.6	-11.1	11.3	14.8
Net claims on government	166.8	172.0	176.0	188.1	182.6	175.5	160.7	200.9	207.1	199.4
Claims on private sector	7.8	8.3	8.4	8.6	8.7	8.5	11.6	41.2	41.0	40.1
Claims on DMBs	-69.6	-80.9	-96.2	-110.8	-122.8	-105.6	-126.3	-121.6	-94.6	-101.6
Open market operations	-102.6	-113.3	-127.9	-142.6	-154.3	-136.5	-156.9	-152.8	-139.3	-144.5
Other items (net)	-105.5	-116.3	-125.1	-119.2	-98.0	-81.2	-73.6	-131.6	-142.2	-123.0
Base money	127.7	138.3	125.2	132.0	135.9	166.6	141.9	154.3	177.0	185.6
Currency outside banks	76.3	80.7	72.3	77.1	81.1	95.5	86.9	97.6	99.5	108.0
DMBs	49.6	56.0	51.0	53.1	53.1	70.4	54.2	55.8	76.7	77.0
Nonbank deposits	1.7	1.6	1.9	1.8	1.7	0.7	0.8	0.9	0.7	0.6
Memorandum items:										
NIR of BI (in billions of US$, constant exchange rate)	18.3	22.2	23.2	23.6	23.6	24.2	24.2	23.6	23.7	24.4
Money multiplier (rupiah broad money)	5.4	5.4	5.9	5.8	5.7	4.9	5.6	5.4	4.8	4.9
Base money velocity 3/	11.4	11.7	14.1	13.3	13.4	10.8	13.9	12.7	11.5	10.7
Rupiah broad money velocity 3/	2.1	2.2	2.4	2.3	2.3	2.2	2.5	2.4	2.4	2.3
Annual percentage change:										
Broad money (constant exchange rate)	11.9	7.6	7.4	7.7	7.3	9.3	7.2	7.2	7.3	10.4
Rupiah broad money	13.6	7.9	8.6	8.5	8.0	10.0	7.2	8.9	9.4	11.3
Base money	2.1	8.3	7.0	10.0	9.7	20.5	13.3	16.9	30.2	11.4
Private sector claims	18.0	21.9	24.9	25.0	23.6	22.0	20.9	29.1	29.4	27.3

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

1/ All foreign currency denominated components are valued at the constant exchange rates.
2/ Includes nonbank private sector deposits held at BI.
3/ Calculated using end-period quarterly GDP, annualized.

Table 5. Indonesia: Indicators of Vulnerability, 2001–04

	2001	2002	2003	2004 1/	Date of latest observation
	Actual				
Key Economic and Market Indicators					
Real GDP growth (in percent)	3.8	4.3	4.5	5.0	
CPI inflation (period average, in percent)	11.5	11.9	6.6	6.1	
Short-term (ST) interest rate (in percent)	16.5	14.9	8.3	7.4	6-Jan-05
EMBI secondary market spread (bps, end of period)	479	345	282	234	5-Jan-05
Exchange rate Rupiah/US$ (end of period)	10,400	8,950	8,425	9,305	6-Jan-05
External Sector					
Exchange rate regime: float					
Current account balance (percent of GDP)	4.2	3.8	3.0	2.8	
Net FDI inflows (percent of GDP)	1.9	2.5	1.3	1.3	
Export growth (US$ value, GNFS)	-11.0	2.9	4.4	15.2	
Real effective exchange rate (end of peroid, 1997 = 100)	62.4	76.3	77.3	74.4	Oct-04
Gross international reserves (GIR) in US$billion	28.0	32.0	36.2	36.3	5-Jan-05
GIR in percent of ST debt at remaining maturity	78.9	128.6	146.5	154.5	Oct-04
Net international reserves (NIR) in US$billion	18.3	21.7	26.4	24.4	4-Jan-05
Total gross external debt in percent of GDP	81.0	64.3	55.4	51.2	May-04
Of which : ST debt (original maturity in percent of GDP)	4.1	0.7	1.0	1.1	May-04
Private sector debt (in percent of GDP)	34.9	25.9	20.1	19.7	May-04
Total gross external debt in percent of exports of GNFS	212.6	203.8	200.4	173.0	May-04
Gross external financing requirement (in US$ billion)	19.5	18.1	11.8	15.8	
Public Sector 2/					
Overall balance (percent of GDP)	-3.2	-1.5	-2.0	-1.2	
Primary balance (percent of GDP)	2.5	3.2	1.4	1.5	
Gross public sector financing requirement (in percent of GDP)	7.1	4.7	5.2	4.3	
Public sector gross debt (PSGD, in percent of GDP)	78.2	68.1	59.2	55.0	
Of which : External debt from official creditors (in percent of total PSGD)	43.8	42.5	43.6	...	
External debt from private creditors (in percent of total PSGD)	0.5	0.4	0.3	...	
Domestic debt linked to foreign currency (in percent of total PSGD)	3.0	1.6	0.8	0.0	Nov- 04
Domestic debt at variable interest rate or indexed to inflation (in percent of total PSGD)	37.7	42.5	27.8	25.1	Nov- 04
Financial Sector 3/					
Capital adequacy ratio (in percent)	18.2	20.1	22.3	22.4	Sep-04
NPLs in percent of total loans	11.0	6.2	5.8	5.1	Sep-04
Provisions in percent of NPLs	94.0	130.0	137.5	126.8	Sep-04
Return on average assets (in percent)	0.6	1.3	1.7	2.8	Sep-04
FX deposits (in percent of total deposits)	20.2	18.2	16.6	12.5	Oct-04
FX deposits (in percent of gross international reserves)	52.5	49.0	46.7	43.4	Oct-04
FX loans (in percent of total loans)	32.6	28.9	22.6	20.7	Oct-04

1/ Staff estimates for 2004 or actual data for period indicated in the next column.
2/ Nonfinancial public sector (including state-owned enterprises).
3/ Top 16 banks (which account for over 80 percent of total deposits).

Table 6. Indonesia: Medium-Term Framework, 2001–09

	2001	2002	2003	2004	2005	2006	2007	2008	2009
	Act.			Est.	Projected				
Output and prices (percent change)									
GDP	3.8	4.3	4.5	5.0	5.5	6.0	6.0	6.2	6.5
Consumer prices (end period)	12.5	10.0	5.1	6.4	6.0	6.0	5.5	4.0	3.0
Consumer prices (period average)	11.5	11.9	6.6	6.1	6.0	6.0	5.5	4.5	3.5
Savings and investment (percent of GDP)									
Gross fixed capital investment	21.4	20.3	19.7	19.9	20.2	20.5	20.7	20.9	21.6
Gross national savings	25.6	24.1	22.7	22.7	22.1	21.9	21.5	21.1	21.4
Foreign savings	-4.2	-3.8	-3.0	-2.8	-1.9	-1.4	-0.8	-0.2	0.2
Public finances (central government, in percent of GDP)									
Revenue	17.9	15.8	16.0	17.4	16.1	15.7	15.3	15.1	14.9
Expenditure	21.0	17.3	18.0	18.6	17.1	16.0	15.3	14.8	14.4
Primary balance	2.5	3.2	1.4	1.5	1.6	2.2	2.2	2.2	2.2
Development expenditure 1/	2.5	1.9	2.8	2.6	2.8	2.6	2.7	3.1	3.0
Overall balance	-3.2	-1.5	-2.0	-1.2	-1.0	-0.3	-0.1	0.2	0.5
Debt	78.2	68.1	59.2	55.0	49.8	44.8	40.2	35.8	31.7
Balance of payments (billions of U.S. dollars)									
Current account balance	6.9	7.8	7.3	7.3	5.5	4.4	2.8	0.9	-0.8
Oil and gas (net)	6.4	5.6	6.7	6.6	6.2	5.5	4.7	4.0	3.2
Non-oil exports (f.o.b)	44.8	46.3	48.0	53.7	56.4	59.3	62.9	67.1	72.0
Non-oil imports (c.i.f)	-31.3	-31.1	-33.7	-39.9	-42.7	-46.2	-49.9	-54.3	-59.2
Capital account balance	-9.8	-7.0	-6.7	-6.2	-4.9	-2.7	1.0	3.7	5.3
Overall balance	-2.9	0.9	0.6	1.1	0.6	1.7	3.8	4.6	4.5
Gross reserves									
In billions of U.S. dollars (end period)	28.0	32.0	36.2	36.3	35.8	36.0	37.8	39.9	43.0
As a share of short-term debt	79.0	129.0	146.0	159.0	165.0	186.0	205.0	243.0	279.0
External debt									
In billions of U.S. dollars	133.2	131.3	134.9	129.9	124.9	120.5	117.8	115.5	114.8
In percent of GDP	81.0	64.3	55.4	49.6	43.3	37.8	34.2	30.9	28.1
Memorandum items:									
Indonesia oil production (000bcpd)	1,320	1,260	1,200	1,070	1,070	1,070	1,070	1,070	1,070
Indonesian oil price (US$/bbl)	23.3	24.2	27.4	36.2	35.5	34.5	32.3	32.3	32.3
Nominal GDP in trillions of rupiah	1,684	1,898	2,087	2,329	2,610	2,938	3,285	3,646	4,019
Nominal GDP in billions of U.S. dollars	164	204	243	262	288	318	344	374	408

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

1/ From 2005, comprises capital spending and social outlays.

Table 7. Indonesia: Indicators of Debt Service to the Fund, 2001-10
(In billions of U.S. dollars, unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Debt service to the Fund										
Charges	0.48	0.28	0.28	0.22	0.20	0.17	0.13	0.09	0.04	0.01
Repurchases	1.75	2.37	1.36	1.01	1.14	1.50	2.00	2.51	1.39	0.65
In percent of goods and nonfactor services	3.6	4.1	2.4	1.6	1.7	2.0	2.4	2.8	1.5	0.6
In percent of total nonfinancial public sector debt service	20.3	22.8	16.8	11.8	12.4	15.0	20.8	24.6	14.9	7.3
In percent of reserves of Bank Indonesia 1/	8.0	8.3	4.5	3.4	3.7	4.6	5.7	6.5	3.3	1.4
Outstanding Fund credit	9.21	8.83	9.84	9.32	8.05	6.55	4.55	2.04	0.65	0.00
In percent of GDP	5.6	4.3	4.0	3.6	2.8	2.1	1.3	0.5	0.2	0.0
In percent of nonfinancial public debt	12.4	11.3	11.5	11.3	10.4	8.9	6.5	3.0	1.0	0.0
In percent of reserves of Bank Indonesia 1/	32.9	27.6	27.2	25.7	22.5	18.2	12.0	5.1	1.5	0.0
In percent of quota	348.8	313.5	332.6	300.0	262.7	213.8	148.5	66.5	21.2	0.0
Total nonfinancial public sector debt service										
In percent of goods and nonfactor services	17.6	18.0	14.5	13.5	13.4	13.2	11.7	11.4	9.8	8.8
In percent of GDP	6.7	5.7	4.0	4.0	3.7	3.5	3.0	2.8	2.4	2.1

Sources: Indonesian authorities, and Fund staff estimates.
1/ End of period reserves.

INDONESIA: FUND RELATIONS
(As of November 30, 2004)

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

II. General Resources Account	SDR Millions	Percent of Quota
Quota	2,079.30	100.00
Fund holdings of currency	8,336.40	400.92
Reserve position in Fund	145.50	7.00

III. SDR Department	SDR Millions	Percent of Allocation
Net cumulative allocation	238.96	100.00
Holdings	53.54	22.41

IV. Outstanding Purchases and Loans	SDR Millions	Percent of Quota
Extended arrangements	6,345.58	305.18

V. Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Millions)	Amount Drawn (SDR Millions)
EFF	Feb. 04, 2000	Dec. 31, 2003	3,638.00	3,638.00
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; expectation basis, based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	108.57	774.81	1,015.64	1,359.70	1,703.76
Charges/Interest		191.37	166.21	131.81	86.64
Total	108.57	966.18	1,181.85	1,491.51	1,790.40

VII. Exchange Arrangements

The rupiah has floated since August 14, 1997. The market exchange rate was Rp 9,305 per U.S. dollar on January 6, 2005. 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.

VIII. Article IV Consultation

The last Article IV consultation report was discussed by the Executive Board on May 3, 2004.

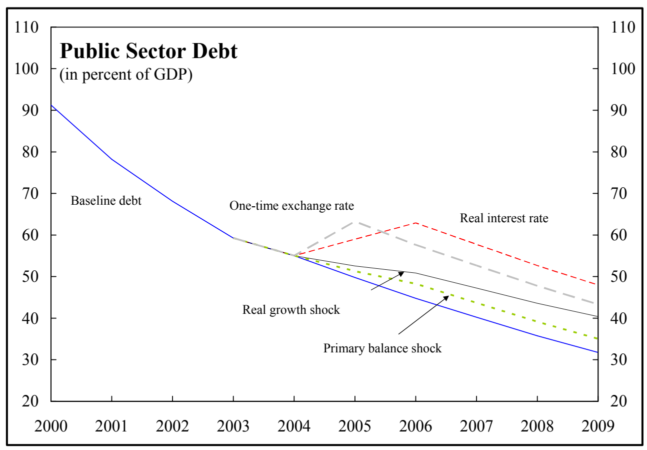
IX. Safeguards Assessments

Under the Extended Arrangement, Bank Indonesia (BI) was subject to the transitional procedures under the Fund's safeguards assessment policy. This required a review of BI's external audit mechanism, which was completed on March 15, 2002. The assessment recommended remedial actions to address a number of vulnerabilities. The main recommendations have been implemented, including the establishment of an independent audit committee at BI and the publication of BI's audited financial statements.

Indonesia: Public and External Debt Sustainability

The staff has updated the debt sustainability assessment undertaken at the time of the 2004 Article IV consultation. Under the baseline scenario, that is, assuming sound macroeconomic policies, including continued fiscal consolidation, the debt-to-GDP ratio would decline from about 55 percent in 2004 to 32 percent in 2009, assuming primary surpluses in the range of 2–2¼ percent of GDP. However, if policy implementation does not materialize as envisaged, and little progress is made on addressing the weaknesses in the investment climate, the growth and employment objectives set by the government would not be achieved. More specifically, if the government uses fiscal expansion and directed lending to “jump-start” growth while failing to gain momentum in implementing structural reforms, GDP growth could linger in the 3–4 percent range. Under such a scenario, and with higher interest rates and a more depreciated exchange rate, both the overall public debt-to-GDP and external debt-to-GDP ratio are higher by 10 percentage points compared to the baseline in the medium term.

In order to assess Indonesia’s public debt sustainability under various shocks, the robustness of the baseline scenario to selected shocks was analyzed. The Text Figure shows the impact on overall public sector debt of two standard deviation shocks, lasting two years, to the real interest rate, real GDP growth, and primary balance, as well as the impact of a one-off 30 percent depreciation of the rupiah. The increase in real interest rates raises the debt-to-GDP ratio by 15–20 percentage points compared to the baseline projection. The impact from the other shocks is also quite significant, although somewhat less than the impact from a real interest rate shock.



External debt sustainability is most vulnerable to variations in the exchange rate and the GDP deflator. A one-off depreciation in the exchange rate by 30 percent or a shock to the GDP deflator could increase the debt-to-GDP ratio by about 15 percentage points above the baseline scenario.

Indonesia: Public Sector Debt Sustainability Framework, 2000–2009
(In percent of GDP, unless otherwise indicated)

	Actual						Projections							
	2000	2001	2002	2003			2003	2004	2005	2006	2007	2008	2009	
							I. Baseline Projections							**Debt-stabilizing primary balance 10/**
1 **Public sector debt** 1/	91.3	78.2	68.1	59.2			**59.2**	**55.0**	**49.8**	**44.8**	**40.2**	**35.8**	**31.7**	**-1.8**
o/w foreign-currency denominated	45.5	36.5	31.3	26.1			26.1	25.6	23.2	20.1	18.1	16.4	14.8	
2 Change in public sector debt	1.1	-13.1	-10.1	-8.9			-8.9	-4.2	-5.2	-5.0	-4.5	-4.5	-4.0	
3 Identified debt-creating flows (4+7+12)	8.3	-6.6	-13.7	-7.8			-7.8	-4.9	-5.0	-5.2	-4.3	-4.2	-4.0	
4 Primary deficit	-2.8	-2.5	-3.2	-1.4			-1.4	-1.5	-1.6	-2.2	-2.2	-2.2	-2.2	
5 Revenue and grants	14.2	17.8	15.8	16.0			16.0	17.4	16.1	15.7	15.3	15.1	14.9	
6 Primary (noninterest) expenditure	11.4	15.3	12.6	14.6			14.6	15.9	14.6	13.5	13.1	12.9	12.7	
7 Automatic debt dynamics 2/	3.0	-2.3	-7.8	-4.7			-4.7	-2.4	-2.9	-2.6	-1.8	-1.7	-1.5	
8 Contribution from interest rate/growth differential 3/	-7.8	-5.7	-3.0	-2.5			-2.5	-3.3	-3.3	-3.0	-2.4	-2.0	-1.6	
9 Of which contribution from real interest rate	-4.0	-2.9	-0.4	0.1			0.1	-0.8	-0.6	-0.4	0.0	0.2	0.5	
10 Of which contribution from real GDP growth	-3.8	-2.8	-2.6	-2.6			-2.6	-2.6	-2.7	-2.7	-2.4	-2.2	-2.1	
11 Contribution from exchange rate depreciation 4/	10.8	3.4	-4.8	-2.2			-2.2	1.0	0.4	0.4	0.7	0.4	0.2	
12 Other identified debt-creating flows	8.1	-1.8	-2.6	-1.6			-1.6	-1.0	-0.5	-0.4	-0.4	-0.4	-0.4	
13 Privatization receipts (negative)	-1.3	-1.8	-2.6	-1.6			-1.6	-1.0	-0.5	-0.4	-0.4	-0.4	-0.4	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	9.4	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3)	-7.1	-6.5	3.7	-1.1			-1.1	0.6	-0.2	0.2	-0.2	-0.2	0.0	
Public sector debt-to-revenue ratio 1/	642.4	439.4	430.9	370.1			370.1	316.9	308.4	284.8	263.8	237.6	213.4	
Gross financing need 5/	.	.	6.5	8.1			8.1	5.4	4.3	4.2	3.6	2.8	2.7	
in billions of U.S. dollars	.	.	13.3	19.8	10-Year Historical Average	10-Year Standard Deviation	19.8	14.2	12.4	13.3	12.5	10.6	10.8	Projected Average
Key Macroeconomic and Fiscal Assumptions														
Real GDP growth (in percent)	4.9	3.5	3.7	4.1	5.5	2.0	4.1	4.8	5.5	6.0	6.0	6.2	6.5	5.4
Average nominal interest rate on public debt (in percent) 6/	5.0	7.5	6.8	5.5	6.8	1.1	5.5	5.1	5.2	5.7	5.7	5.4	5.2	5.5
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-4.7	-3.3	-0.3	0.3	-6.6	11.9	0.3	-1.2	-1.0	-0.5	0.2	0.9	1.7	-0.2
Nominal appreciation (increase in US dollar value of local currency, in percent)	-20.9	-7.7	16.2	8.4	-10.9	26.6	8.4	-3.6	-1.7	-1.9	-3.4	-2.1	-1.0	-0.7
Inflation rate (GDP deflator, in percent)	9.6	10.8	7.2	5.2	13.4	12.4	5.2	6.3	6.2	6.2	5.5	4.5	3.5	5.7
Growth of real primary spending (deflated by GDP deflator, in percent)	-11.0	47.2	-13.7	21.3	6.3	19.9	21.3	14.4	-3.2	-1.6	2.3	4.6	5.0	6.3
Primary deficit	-2.8	-2.5	-3.2	-1.4	-2.0	0.9	-1.4	-1.5	-1.6	-2.2	-2.2	-2.2	-2.2	-1.8
							II. Stress Tests for Public Debt Ratio							**Debt-stabilizing primary balance 10/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 7/							**59.2**	**55.0**	**46.5**	**39.5**	**33.0**	**26.9**	**21.6**	**-1.5**
A2. Primary balance under no policy change in 2005-09							**59.2**	**55.0**	**49.8**	**45.4**	**41.4**	**37.5**	**34.1**	**-1.8**
A3. Alternative scenario 8/							**59.2**	**55.0**	**51.5**	**49.2**	**46.8**	**44.3**	**42.0**	**-1.4**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006							**59.2**	**55.0**	**59.0**	**62.9**	**57.7**	**52.6**	**48.0**	**-2.5**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006							**59.2**	**55.0**	**52.6**	**50.8**	**47.2**	**43.6**	**40.4**	**-2.2**
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005							**59.2**	**55.0**	**51.3**	**48.3**	**43.7**	**39.1**	**35.0**	**-2.0**
B4. Combination of 2-4 using one standard deviation shocks							**59.2**	**55.0**	**54.5**	**54.5**	**49.5**	**44.7**	**40.2**	**-2.2**
B5. One time 30 percent real depreciation in 2004 9/							**59.2**	**55.0**	**63.3**	**57.6**	**52.6**	**47.8**	**43.3**	**-2.3**
B6. 10 percent of GDP increase in other debt-creating flows in 2004							**59.2**	**55.0**	**59.8**	**54.3**	**49.4**	**44.5**	**40.1**	**-2.2**

1/ Central government gross debt.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Weak policy scenario of lower growth, higher interest rates, and greater depreciation than in the baseline.
9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Indonesia: External Debt Sustainability Framework, 1999–2009
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	1999	2000	2001	2002	2003			2004	2005	2006	2007	2008	2009	
								I. Baseline Projections						**Debt-stabilizing non-interest current account 7/**
1 **External debt**	112.1	85.8	81.0	64.3	55.4			**49.8**	**43.1**	**37.6**	**33.8**	**30.5**	**27.8**	**-3.6**
2 Change in external debt	-55.3	-26.3	-4.8	-16.7	-8.9			-5.7	-6.7	-5.5	-3.7	-3.3	-2.7	
3 Identified external debt-creating flows (4+8+9)	-59.5	-13.4	-1.7	-20.9	-16.0			-7.5	-6.8	-6.1	-5.2	-4.4	-3.8	
4 Current account deficit, excluding interest payments	-9.0	-9.5	-7.9	-5.9	-4.7			-4.6	-3.4	-2.7	-2.0	-1.3	-0.8	
5 Deficit in balance of goods and services	-9.3	-9.2	-7.8	-6.7	-4.9			-4.3	-3.4	-2.7	-2.0	-1.4	-0.8	
6 Exports	39.3	42.6	38.1	31.5	27.7			29.7	27.8	26.3	25.3	24.4	23.7	
7 Imports	30.1	33.4	30.3	24.9	22.7			25.4	24.4	23.6	23.3	23.1	22.8	
8 Net non-debt creating capital inflows (negative)	-1.1	-0.9	-1.8	-3.1	-2.2			-2.2	-2.4	-2.4	-2.3	-2.2	-2.1	
9 Automatic debt dynamics 1/	-49.4	-3.0	8.0	-12.0	-9.1			-0.7	-0.9	-1.0	-0.9	-0.9	-0.9	
10 Contribution from nominal interest rate	5.0	5.1	3.8	2.1	1.7			1.8	1.5	1.3	1.2	1.1	1.0	
11 Contribution from real GDP growth	-1.0	-5.1	-3.1	-2.5	-2.2			-2.5	-2.5	-2.3	-2.1	-1.9	-1.8	
12 Contribution from price and exchange rate changes 2/	-53.4	-3.0	7.2	-11.6	-8.6			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	4.2	-12.9	-3.1	4.2	7.1			1.8	0.1	0.5	1.4	1.1	1.0	
External debt-to-exports ratio (in percent)	285.0	201.3	212.6	203.8	200.4			167.6	154.9	143.0	133.7	125.0	117.5	
Gross external financing need (in billions of US dollars) 4/	23.1	24.5	27.6	30.6	20.3			17.5	17.4	17.2	16.6	17.6	17.2	
in percent of GDP	16.3	14.8	16.8	15.0	8.3	10-Year Historical Average	10-Year Standard Deviation	6.7	6.0	5.4	4.8	4.6	4.2	Projected Average
Key Macroeconomic Assumptions 8/														
Real GDP growth (in percent)	0.8	4.9	3.5	3.7	4.1	5.5	2.0	4.8	5.5	6.0	6.0	6.2	6.5	5.8
GDP deflator in US dollars (change in percent) 8/	46.8	2.8	-7.8	16.7	15.4	4.0	9.3	2.4	5.3	4.5	2.4	2.4	2.4	3.2
Nominal external interest rate (in percent)	4.4	4.9	4.3	3.1	3.1	4.8	1.2	3.5	3.4	3.4	3.4	3.4	3.4	3.4
Growth of exports (US dollar terms, in percent)	-1.8	26.6	-11.0	2.9	4.4	5.7	12.0	15.2	4.0	4.6	4.6	4.9	5.7	6.5
Growth of imports (US dollar terms, in percent)	-19.8	29.8	-9.6	2.0	8.8	4.3	16.8	19.9	6.6	7.1	7.2	7.6	8.0	9.4
Current account balance, excluding interest payments	9.0	9.5	7.9	5.9	4.7	3.7	3.8	4.6	3.4	2.7	2.0	1.3	0.8	2.5
Net non-debt creating capital inflows	1.1	0.9	1.8	3.1	2.2	2.4	2.1	2.2	2.4	2.4	2.3	2.2	2.1	2.3
								II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 7/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 5/								**49.8**	**44.1**	**38.5**	**33.0**	**27.3**	**21.7**	**-3.3**
A2. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation 6/								**49.8**	**43.9**	**38.3**	**34.5**	**31.1**	**28.3**	**-3.6**
A3. Alternative Scenario 9/								**49.8**	**46.2**	**43.4**	**41.5**	**40.7**	**41.1**	
B. Bound Tests														
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**49.8**	**44.8**	**40.7**	**36.8**	**33.3**	**30.5**	**-3.7**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**49.8**	**44.9**	**41.1**	**37.2**	**33.7**	**30.8**	**-3.9**
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**49.8**	**53.9**	**58.9**	**54.2**	**49.7**	**45.8**	**-5.6**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								**49.8**	**50.4**	**51.0**	**46.7**	**42.7**	**39.4**	**-4.2**
B5. Combination of B1-B4 using one standard deviation shocks								**49.8**	**54.1**	**58.7**	**53.4**	**48.6**	**44.7**	**-5.1**
B6. One time 30 percent nominal depreciation in 2005								**49.8**	**61.9**	**55.2**	**50.6**	**46.3**	**42.6**	**-5.2**

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ The implied change in other key variables under this scenario is discussed in the text.
7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.
8/ The calculation of the average and standard deviation for the key macroeconomic variables (listed in footnote 5) excludes the years 1998 and 1999, which represented extreme outliers due to the depth of the crisis in Indonesia
9/ Weak policy scenario of lower growth, higher interest rates, and greater depreciation than in the baseline.

INTERNATIONAL MONETARY FUND

INDONESIA

Report for the Post-Program Monitoring Discussions

Supplementary Information

Prepared by the Asia and Pacific Department

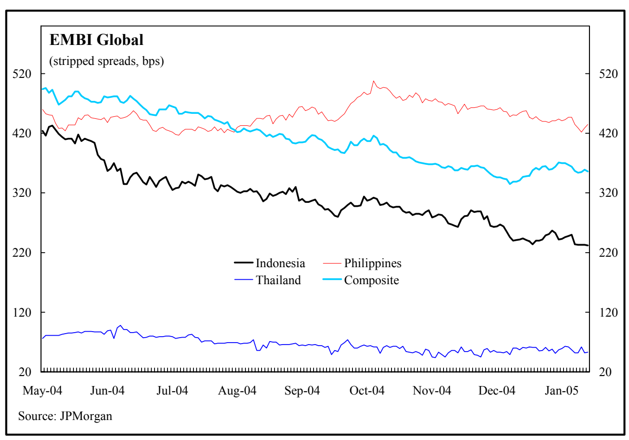
Approved by Daniel Citrin and Carlo Cottarelli

February 8, 2005

1. **This supplement provides an update on developments since the issuance of the staff report[1] and an assessment of the economic implications of the earthquake and tsunami disaster**. Notwithstanding the immeasurable human losses and severe damage to property and infrastructure in the province of Nanggroe and Aceh Darussalam (Aceh), the overall macroeconomic effects for Indonesia are likely to be modest. In the wake of the disaster, the government has restated its commitment to sound macroeconomic policies and strengthened reforms. Indeed, the government went ahead with the Infrastructure Summit and the Consultative Group meeting in January as scheduled, at both events reiterating its commitment to move ahead with fundamental economic reforms. Accordingly, the thrust of the appraisal contained in the staff report remains unchanged.

I. Recent Economic Developments and Policies

2. **Recent economic data have been generally favorable**. Latest data for motor vehicle sales and consumer confidence indicate that private consumption remains strong. Also, private investment may be gaining ground, as suggested by data on imports of capital goods and investment approvals. Financial markets remain strong, and Fitch upgraded Indonesia's sovereign debt in mid-January. The buoyant market sentiment led to a large oversubscription in the government's first domestic bond issue this year with the

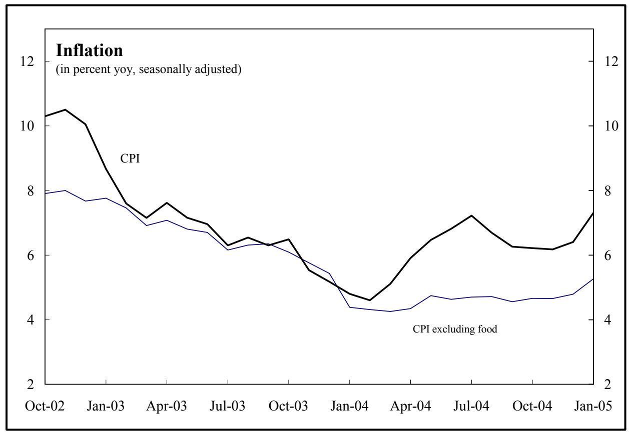


[1] January 13, 2005.

yield declining to 10 percent, and has also caused a further drop in international bond spreads.

3. **Additional data, while still preliminary, indicate that the budget deficit was in fact on the order of 1½ percent of (old) GDP in 2004**. Government non-oil and gas revenues picked up somewhat towards the end of the year, reflecting stronger revenue collections and higher profit transfers from state-owned enterprises. At the same time, high oil prices contributed to further increases in spending on fuel subsidies in line with staff projections.

4. **Price pressures continue to bear close watch**. Base money growth dropped to 11¾ percent in January, after peaking at nearly 20 percent (y/y) in October in connection with the religious holidays. However, inflation picked up to 7.3 percent (y/y) in January from 6.4 percent in December; this pick up may have been in part caused by temporary effects of the tsunami.



5. **Reflecting the government's focus on increasing infrastructure investment, an Infrastructure Summit was held in mid-January**. The summit was well attended, with a large number of investors from 22 countries participating. The government presented its Declaration on Developing Infrastructure, which lays out the broad framework for private sector participation, including PPPs. Investors expressed interest in infrastructure projects in the roads, oil and gas, ports, and power sectors.

6. **Bank Indonesia issued new banking regulations in mid-January**. The regulations aim to support infrastructure investment and lending in Aceh, and to facilitate bank consolidation. To these ends, the regulations *inter alia* increase the lending concentration limit for commercial banks from 20 percent of capital to 30 percent for infrastructure projects carried out by state-owned enterprises, and also allow banks to acquire other banks by lifting the 10 percent limit on bank investment in subsidiaries (provided that the combined bank is in compliance with supervisory standards on a consolidated basis). At the same time, the regulations tighten provisions regarding overall asset quality, consolidated supervision, and transparency.

7. **The government announced its medium-term economic strategy at the Consultative Group meeting in mid-January**. Building on the 100-day plan announced in November, the medium-term strategy focuses on (i) ensuring national security, (ii) strengthening governance through legal sector reforms, improved delivery of public services, and clarified roles of regional and central governments, (iii) generating higher growth and employment and reducing poverty by accelerating investment and exports, while maintaining macroeconomic stability, and (iv) improving infrastructure.

II. Economic Implications of the Natural Disaster

8. **The effects of the tsunami on growth and inflation are expected to be limited**. Aceh accounts for only about 2 percent of national GDP, and the oil and gas sector, representing almost half of the region's GDP, remains intact. The negative supply-side effect of the tsunami is expected to be small, and would be largely offset by reconstruction spending. All told, the net impact in 2005 is expected to be a lowering of overall GDP growth of 0–¼ percentage point from the 5½ percent projected in the staff report (Table 1). Notwithstanding the January inflation outturn, inflation is expected to stay in the 6 percent range in 2005. For 2006 and beyond, the macroeconomic outlook would remain as described in the staff report, provided that the authorities follow through on their economic strategy.

9. **However, the total cost of reconstruction is considerable, tentatively projected at US$4–5 billion for the coming five years**. The Ministry of Planning, with the assistance of the World Bank, the AsDB, the Fund, and the international donor community, completed a preliminary assessment of the economic damage done by the tsunami ahead of the Consultative Group meeting. A detailed sector-by-sector study assessed the destruction of physical assets, such as housing, roads, and infrastructure. As this study aimed to estimate replacement costs, the cost projections are likely to evolve over time as the actual cost will depend on the eventual strategies chosen for replacing destroyed capital.

10. **The financing need arising from reconstruction is expected to be largely met through financial assistance from the international community**. At the CGI meeting, donors pledged nearly US$4 billion to finance reconstruction in 2005–09. Of this total, US$1.7 billion was pledged for 2005, of which US$1 billion would be on-budget and the remainder disbursed directly or through NGOs; one third of the budget support for 2005 would take the form of grants and two thirds the form of concessional loans. These figures do not include debt relief that may be forthcoming in the context of the Paris Club offer of a temporary suspension of debt service, which the authorities have responded to positively in principle; for the first quarter of 2005, such suspension would amount to some US$350 million. In addition to the official support, substantial amounts of private inflows are also being provided. The authorities are mindful of the need to ensure transparency and efficiency in the management of donor funds, and have decided to set up a multi-donor trust fund for this purpose.

11. **The international assistance will enable the government to maintain the underlying budget stance for 2005 earlier envisaged and will also protect the balance of payments position**. The substantial donor resources pledged for financing reconstruction would go a long way towards covering the financing need for reconstruction. Reflecting the fact that part of the reconstruction outlays would be financed by concessional loans (as opposed to grants only), the overall budget deficit could be somewhat higher than earlier planned—i.e., on the order of 1¼ percent of GDP. As for the balance of payments, import needs for reconstruction should be financed from donor flows and, with Aceh's key oil and gas exports unaffected, the overall balance of payments effect of the tsunami is likely to be

broadly neutral. Moreover, the assistance is being offered on highly concessional terms and should therefore not threaten medium-term debt sustainability.

12. **Fund staff remain in close contact with the authorities and have offered to help in any way that the government would find useful**. During his visit to Indonesia in early January for the Emergency Summit on Tsunami-Affected Countries, the Managing Director offered emergency financial assistance as well as technical assistance in the Fund's areas of expertise. While Indonesia is unlikely to avail itself of Fund financial assistance, Fund staff have been closely involved in assessing the macroeconomic impact of the tsunami and are exploring with the authorities the possibility of providing technical assistance, including in setting up the system for management of donor flows and in the rebuilding of the payment system and banking services in Aceh in the aftermath of the tsunami.

Table 1. Indonesia: Selected Economic and Social Indicators, 2004–06

	2004	2005 Pre-tsunami	2005 Post-tsunami	2006
GDP and Inflation (in percent)				
Real GDP growth	5.0	5.5	5.25 - 5.5	6.0
Consumer prices (average)	6.1	6.0	6.0	6.0
Consumer prices (end period)	6.4	6.0	6.0	6.0
Public Finances (in percent of GDP)				
Revenue (including grants)	17.4	16.1	16.2	15.7
Expenditure	18.6	17.1	17.5	16.3
Reconstruction spending	...	...	0.5	0.3
Overall balance	-1.2	-1.0	-1.3	-0.7
Net domestic financing	1.9	1.7	1.7	0.9
Foreign financing	-0.7	-0.7	-0.5	-0.2
Financing gap	...	...	0.1	...
Balance of payments (in billions of U.S. dollars)				
Current account balance (including grants)	7.3	5.5	6.0	4.3
Current account balance (in percent of GDP)	2.8	1.9	2.1	1.4
Grants (official only)	0.1	0.1	0.3	0.1
Capital account	-6.2	-4.9	-5.1	-2.2
Official financial inflows	3.4	3.3	4.0	4.8
Overall balance	1.1	0.6	1.0	2.1
Official reserves				
In billions of U.S. dollars	36.3	35.8	36.1	36.8
In months of imports	6.1	5.7	5.7	5.4
In percent of short-term debt	158.8	165.4	168.5	190.0
External public debt				
In billions of U.S. dollars	82.3	77.8	78.5	75.0
In percent of GDP	31.4	27.0	27.2	23.5
Memorandum items				
Deaths (persons) 1/ 2/	...	...	225,000	...
Displaced (persons) 2/	...	...	>425,000	...
Damage estimate (in billions of U.S. dollars)	...	...	4 - 5	...

1/ Including missing persons.
2/ Government of Indonesia estimates as of February 1, 2005.

Statement by Hooi Eng Phang, Executive Director for Indonesia and Made Sukada, Alternate Executive Director February 14, 2005

Introduction

1. On behalf of our Indonesian authorities, we thank staff for their balanced and well-written reports. Our authorities would like to reiterate their deep appreciation and gratitude to the Executive Board, management, and staff, as well as the international community, for their condolence and prompt humanitarian response to the recent calamity, including the offer of debt relief as expressed during the high-level summit in Jakarta and reaffirmed in the Paris Club meeting in early January. The Indonesian authorities also welcome the continued support from the Consultative Group for Indonesia (CGI), including their special pledge for the tsunami relief and recovery.

2. Indonesia was the most adversely affected by the earthquake and tsunami, with an unprecedented death toll. Hundreds of thousands are missing, and even more are becoming refugees. The calamity has also caused massive physical damage to the public infrastructure as the city of Banda Aceh and the surrounding areas were wiped out by the tidal waves. Preliminary estimates of the damages and losses reached about USD 4.5 billion, representing 2 percent of GDP. Nevertheless, the impact of the tsunami on the overall GDP growth is expected to be limited as the oil and gas sector, which accounted for half of Aceh's output, was not affected. In addition, the contribution of Aceh's economy to the national GDP has been relatively small.

Macroeconomic Developments

3. The devastating calamity in our region occurred in the midst of encouraging economic and political developments. The Indonesian economy entered a new phase in 2004, following the completion of the IMF stabilization program at the end of 2003 and a transitional year towards greater democracy as direct general elections were held for the first time in the country's history. Overall, Indonesia's economic performance in 2004 was favorable, with real GDP growth rising from 4.5 percent in 2003 to 5 percent, amidst moderate inflation, and stable rupiah exchange rate. While growth was still lower than the pre-crisis level, it marked the fourth consecutive year of increase. It is also gratifying to note that the growth has taken place across a wider spectrum of economic sectors, while investment and exports have begun to pick up. Imports have increased at a higher rate, attributed primarily to the import of raw materials and capital goods to support domestic production and investment. Inflation, measured by year on year CPI, was contained within the target range, reaching 6.4 percent. The budget deficit to GDP ratio declined from 2.2 percent to 1.4 percent, albeit marginally higher than budgeted. External developments were favorable with continued current account surplus and a comfortable level of the international reserves in relation to imports (6.1 month of imports) and short-term debt (159 percent). At the same time, the debt to GDP ratio continued to decline to around 53 percent as end of 2004.

4. The favorable market sentiment, as reflected in a realistic rupiah exchange rate and rebounding of the stock market, was driven by the progress made on economic reforms, encouraging macroeconomic indicators, and peaceful political elections The smooth political transition to the new government further added value to the positive market sentiment. As the Staff report underscores, the authorities are strongly committed to implementing prudent macroeconomic policies and broaden structural reforms. To build on the achievements of reforms undertaken in the last few years and in support of the wide-ranging reform agenda of the new government, the World Bank approved a First Development Policy Loan (DPL) to Indonesia in December. These positive developments further enhanced market confidence and led to upgrades by rating agencies. In October, Fitch upgraded Indonesia's outlook to "positive" while Standard and Poor's raised Indonesia's sovereign ratings from B to B+ for foreign currency debt and from B+ to BB for domestic currency debt in December. In January 2005, Fitch upgraded again Indonesia's long-term foreign and local currency debt ratings by one notch to BB minus, lauding its reduced political risk, stronger growth and improving external finance.

The Five Year Development Plan, 2005-2009

5. The new President has set the policy direction to ensure sustainable economic growth and reduce unemployment and poverty through maintaining sound macroeconomic policies and improving the investment climate. To address the challenges, the new government has adopted a medium-term strategy as outlined in the Five-Year Development Plan of 2005-2009. It is aimed at achieving three broad objectives, namely: i) ensuring a safe and peaceful environment, including expeditious resolution of conflicts in specific regions of Indonesia, and firm measures against terrorism; ii) upholding justice and democracy, including restoring public confidence through a clear demonstration of commitment to the enforcement of laws and improvement of governance; and iii) improving prosperity through sustainable and equitable economic growth.

6. The Five Year Development Plan of 2005-2009 aims to promote economic growth at an average rate of 6.5 percent, reduce the unemployment rate from 9.7 percent to 5.1 percent and poverty from 16.6 percent to 8.2 percent. The average economic growth rate target of 6.5 percent requires an increase in investment to GDP ratio from the current level of 20.5 percent. In the last few years, public and private investment only contributed marginally to economic growth. Public investment even declined sharply during the period 1997-2001 and has only started to recover marginally since then. Against this background, the authorities are determined to increase public infrastructure investment during the period of 2005-2009 by pursuing a Public Private Partnership (PPPs). The government has announced its investment strategy whereby only 20 percent of the infrastructure will be financed by the government budget. The authorities are cognizant of the significant challenges ahead for attaining the ambitious development objectives which require private involvement in the supply of public infrastructure assets. An Infrastructure Summit was held on January 17-18, 2005 in Jakarta with strong participation of global investors to facilitate this objective. The government has already identified 91 infrastructure investment projects with a total value of over $22.5 billion, as the first batch to be offered to investors. An open tender process for these projects will be launched soon. The second batch of infrastructure

projects will be offered in November 2005. The authorities are confident that some of the projects will be executed this year and will contribute to the economic growth target of 5.5 percent in 2005 and the average annual growth of 6.5 percent for 2005-2009.

Fiscal Policy

7. Our authorities are fully committed to the strategy of fiscal consolidation which has lowered the overall budget deficit to1.4 percent of GDPand the primary balance to 1.5 percent of GDP. The budget outturn for 2004 showed a higher than expected tax revenue by Rp. 1.6 trillion and non-tax revenue by Rp. 2.9 trillion, while expenditures increased by Rp.5.6 trillion, mainly attributed to the increase in fuel subsidies. The deficit was financed domestically, primarily from the divesting recapitalized banks, privatization of state-owned enterprises, and the net sale of government bonds. The government's target of lowering the budget deficit for 2005 to 0.8 percent of GDP was approved by the previous parliament in August 2004.

8. The 2005 budget is nevertheless being reviewed and the overall deficit might increase slightly to 1.0 percent of GDP in light of developments in world oil prices and current policy priorities to increase public investment spending, including those affected by the resent tsunamis. The government remains committed to phasing out the oil subsidies and creating budget savings, while protecting the poor through better targeted social programs. Efforts are being made to widen the tax base and increase tax collection, through amendment of the tax laws and continued modernization of the tax administration, including expansion of the Large Taxpayer Offices.

9. In order to further strengthen public finance management, a wide range of legal reforms to enhance transparency and governance in public finance has been undertaken, including the passage of law on the Audit of State Finance Management and Responsibility, and the law on National Development Planning System. The new laws clarify the activities and responsibilities of government institutions in relation to the budget planning, implementation, supervision, and accountability. Reforms within the Ministry of Finance are also underway; the budget and the treasury functions have been separated. Moreover, a single treasury account and consolidated debt management have been established.

10. The government has adopted a prudent debt strategy in accordance with the guidelines of Government Regulation Number 33 of 2003. The Regulation restricts the deficit of the State Budget to a maximum of 3 percent of GDP and likewise the debt of the Central Government to a maximum of 60 percent of GDP. The ratio of government debt to GDP has declined from 91.3 percent in 2000 to 53 percent in 2004. The government's strong commitment to maintain fiscal sustainability is reflected in the lowering of the overall budget deficit target in 2005, while introducing the Public Private Partnership strategy as the main source of financing for infrastructure investment. Nevertheless, the authorities do share the concerns of staff on the vulnerability of the government debt to changes in the domestic interest rate and the rupiah exchange rate. In this regard, the authorities are committed to implementing sound macroeconomic policies so that inflation expectation can be contained, thereby reducing upward pressure on domestic interest rates and reducing Rupiah exchange

rate volatility. The continued support of donor countries and other development partners for providing long-term financing would play an important role in reducing Indonesia's debt vulnerability in the coming years. The government's debt to GDP ratio at the end of 2005 is estimated to decline to below 50 percent in view of the expected decline in the stock of debt and the increase in GDP.

Monetary Policy

11. Monetary policy remained geared towards achieving a downward path of the medium-term inflation target. The stability of the rupiah exchange rate has also contributed to inflation (CPI) being within the target range, at 6.4 percent in 2004. While higher than the previous year, inflation mainly reflected movement in food prices. Although capacity utilization continued to increase, inflationary pressures from the output gap were minimized given the adequate supply of goods and relatively stable exchange rates.

12. Bank Indonesia has pursued a cautious tight-bias monetary policy to contain financial market pressures on the exchange rate of the rupiah, which started to pick up in the second quarter of the year, reflecting concerns about political uncertainty, higher global interest rates and inflation expectation. In response, Bank Indonesia raised reserves requirement from 5 percent to an average of 7.3 percent in July. At the same time, Bank Indonesia managed liquidity in the domestic money markets to prevent short-term interest rates from further decline. Since April 2004, the policy (SBI) rates for 1-month and 3-month rates, which had been on a declining trend over the last two years, have stabilized at 7.33 percent and 7.25 percent, respectively, and have even increased slightly towards the end of the year. The rupiah exchange rate has stabilized and depreciated only slightly in 2004. Inflation in January 2005 was 7.32 percent (yoy). While higher than expected, it was partly attributed to the increase in food prices due to temporary supply disruptions while base money growth dropped in January to 11.75 percent, which is much lower than its average growth path. As noted in the Staff report, Bank Indonesia is keeping a close eye on inflationary pressures, and stands ready to take action as necessary to keep inflation within the target range of 6.0 percent in 2005.

13. The legal base for better policy coordination between Bank Indonesia and the government, while preserving Central Bank independence, has also been enhanced with the signing of the Memorandum of Understanding (MOU) in July 2004, in accordance with Bank Indonesia Act Number 3 (2004). This is to ensure consistency of monetary policy and fiscal policy in achieving the medium-term inflation target. The Bank Indonesia Act Number 3 states that the inflation target, which was previously set and executed by Bank Indonesia, is set by the Government in consultation with the Central Bank to enhance the accountability of the Central Bank. Final preparations for the implementation of an inflation targeting framework are also under way, to further improve the transparency, credibility, and effectiveness of monetary policy.

14. As the staff report underscores, the exchange rate policy has continued to serve the economy well. The authorities have maintained the commitment to adopt a flexible exchange rate system since it has provided support to the inflation targeting framework. Intervention of

Bank Indonesia in the foreign exchange market has taken place only to smooth exchange rate volatility. The REER of the rupiah depreciated marginally in 2004, reflecting market conditions.

Financial Sector Policy

15. The overall performance of the banking sector continued to improve in 2004 as reflected in lower NPLs, and higher deposits, credits, LDR and profitability, as well as the stable capital condition of banks which was much higher than the minimum required CAR of 8 percent. Even though the loan to deposit ratio is much lower than the pre-crisis level, bank loans have increased considerably, attributed to the substantial increase in credit extended by state banks. The authorities note the concern of staff on the weaker performance of the state banks as a group in cleaning up their loan books and improving asset quality. The authorities have taken measures to address the problems by strengthening their supervision to ensure compliance with prudential regulations and that banks' credit growth is consistent with their business plans. . Bank Indonesia has consistently enforced the laws on banks which violate prudential regulations. An example of this was the recent freezing of Bank Global's operations subsequently followed by its closure, after the authorities found the bank had violated prudential regulations. The closure had only a meager impact on the financial market and strengthened confidence in the banking system. Bank Indonesia continues to make improvements to banking supervision and regulations in close compliance with international standards. Improvements to banking regulations include incorporating market risk in the calculation of capital adequacy whilst the approach to supervision has gradually shifted from compliance-based to a risk-based approach.

16. In January 2005, Bank Indonesia issued a list of 8 new regulations to facilitate the strengthening of the banking industry and enhance risk management and its intermediation function. The new regulations place considerable emphasis on putting in place comprehensive and effective good corporate governance principles. The regulatory package covers a number of critical areas such as maximum lending limits, foreign debt held by banks, transparency and accountability for client information, the resolution of customer complaints, special credit facilities with respect to customers in areas recently devastated by the tsunami, and a debitor information system. The authorities have consolidated the supervision of all nonbank financial institutions under a single agency, as an intermediate step towards the integration of bank and nonbank supervision under one authority in the future.

17. On the structural side, the divestment of the recapitalized banks progressed well in 2004. The sale of the government's ownership in Bank Permata and majority shares in Bank Danamon and Bank Niaga with a total value of around Rp. 6.2 trillion, equivalent to $ 700 million, were completed. The speedy progress of divestments attests to the strong commitment of the government to enhance the transparency and efficiency of the banking sector.

18. The government has made good progress on financial safety net reforms. The authorities have made concerted efforts to finalize the preparations for phasing out the

existing blanket guarantee scheme, starting in 2005. Internal regulations of Bank Indonesia and the Ministry of Finance have been completed as required by Law Number 3 of 2004 on the amendment of Bank Indonesia Law Number 23 of 1999. The amendment allows Bank Indonesia to provide emergency liquidity assistance to a problem bank that is considered to have systemic risk to the banking system. The operational procedures on emergency liquidity assistance have been accommodated in Bank Indonesia's regulations and a Minister of Finance Decree. The Deposit Insurance Corporation (DIC) Law Number 24 of 2004 was approved by the parliament in September 2004. The Law authorizes the DIC to administer the deposit insurance for commercial banks and rural banks as well as to resolve problem (insolvent) banks. Work on the operational procedures for the implementation of the DIC Law is in progress.

Structural Reforms and Improvement in Investment Climate

19. The authorities fully recognize that improving the investment climate is one of the key priorities in accelerating economic growth. The new government has indicated its strong commitment to continue the ambitious and multi-faceted program of reforms aimed at improving the investment climate and encouraging private sector growth. The authorities have been making continued efforts to improve the legal base, revise tax and customs regulations, enhance good governance, and eradicate corruption. In this regard, the parliament has passed the following laws:(i) In October 2004, the parliament amended the two decentralization laws, Number 22 and Number 25, which provide clarification for the decentralization of responsibilities across different levels of government. This is expected to reduce the potential for economically harmful taxes and charges to be imposed by local government; (ii) In October 2004, the bankruptcy law was amended by Law Number 37 on Bankruptcy and Debt Moratorium. Under the new law, approval of the Minister of Finance is required prior to the court action against insurance firms.

20. Rapid progress has been made in the area of tax and customs to improve the quality of service to taxpayers and to increase tax revenue collection. Major reforms have been implemented in a number of pilot tax offices in an effort to modernize tax administration with the support of the Fund's technical assistance. The main features of the reforms are the establishment of Large Tax Payers Offices with new organizational arrangements, and improvement of the tax administration procedures and computer system. The government also has undertaken measures to improve competitiveness and reduce trade distortions. The overall program design and schedule, including exemptions and implementation of the harmonized tariff system with a flat tariff rate of 5 percent is being developed, with initial implementation scheduled for 2005. With respect to international trade, the government has intensified its effort to reduce export and import impediments, as well as to enhance regional cooperation and bilateral trade negotiations. In addition, 21 regulations related to labor rigidity issued by local governments have been revoked by the Minister of Internal Affairs Decree.

21. The new President has placed anti-corruption efforts as another top priority agenda for his administration. A Presidential Decree Number 5 of 2004 was issued to enhance the transparency, efficiency, and accountability of public management. All state officials must

report their wealth to the Anticorruption Commission every year. A reform program of the commercial court was issued and a training program to improve the capacity of judges and law enforcement agencies is underway. The Anticorruption Commission is fully operational, with the installation of judges for the Anti-corruption Court and a number of legal cases currently being processed.

22. Continued efforts have been devoted to improving data quality and capacity building, particularly in the areas of monetary, banking, and government finance. The authorities appreciate the Fund's support in providing technical assistance in these fields.

Conclusion

23. It was so unfortunate that in the midst of encouraging economic developments, parts of our country suffered a devastating natural disaster. Although the impact of the calamity on economic growth and the balance of payments might be minor, the disaster has brought about more challenges to the Indonesian economy. Nevertheless, our Indonesian authorities are committed to making all possible efforts toward ensuring macroeconomic stability and improving the investment climate, which they regard as key factors in achieving high and sustainable economic growth, creating employment opportunities and eradicating poverty. On behalf of our authorities, we thank management, the Executive Board and the staff for their continued support for Indonesia's economy and in line with their continued commitment to transparency, they consent to the publication of the staff report as well as the Supplement.

INTERNATIONAL MONETARY FUND
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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes Second Post-Program Monitoring Discussion with Indonesia

On February 14, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the second Post-Program Monitoring Discussion with Indonesia.[1]

Background

Last year saw landmark accomplishments, but also a major tragedy in Indonesia.
The parliamentary and the first direct presidential elections were conducted peacefully, with President Yudhoyono's new government taking office on October 20, completing a historical transition. Moreover, macroeconomic and financial market developments were on the whole favorable. Toward the end of the year, the tsunami disaster resulted in untold loss of lives and human suffering, as well as severe damage to property in the province of Aceh.

The economy performed well in 2004, helped by sound macroeconomic policies. Real GDP growth is estimated at 5 percent, with private consumption the main driver behind the recovery, although private investment and exports showed signs of recovery. Inflation ended the year at 6½ percent. Buoyant tourism and non-oil exports, coupled with high oil and gas prices helped keep the current account in surplus. International reserves remained adequate at $36 billion or 159 percent of short-term debt.

Macroeconomic policies contributed importantly to these favorable developments. The fiscal deficit was reduced from 2¼ percent of GDP in 2003 to 1½ percent of GDP in 2004[2] and public

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[1] Post-Program Monitoring provides for frequent consultations between the Fund and members whose Fund arrangements have expired but who continue to have substantial Fund credit outstanding. Particular focus is placed on policies that have a bearing on external viability.

[2] While the national accounts data have been revised, for comparability with the original budget targets, these ratios are cited in terms of the old GDP series.

debt declined from 59 percent of GDP in 2003 to an estimated 53 percent of GDP in 2004. Bank Indonesia's conduct of monetary policy helped contain financial market pressure during the spring months and kept inflation in check.

Important progress was made on financial sector reforms in 2004. Bank Permata, the last of the IBRA banks, was returned to private ownership, and the government divested part of its remaining shares in Bank Danamon and Bank Niaga. Although overall banking sector performance improved, aided by the decline in interest rates, asset quality, especially at state banks, remained weak. The deposit insurance law was passed and a schedule to gradually phase out the blanket guarantee system, starting in April 2005, has been announced. Less progress has been made in improving the private investment environment, where weak implementation and enforcement of legislation, poor governance, and labor market rigidities remain key concerns.

Financial markets have been strong, reacting favorably to the presidential elections and the new government's announced economic policy intentions. The stock market was up by 45 percent last year and the exchange rate has recovered from its lows in early June. The financial market strength has continued in the aftermath of the tsunami disaster, reflecting markets' assessment that the disaster will have limited impact on the overall economy, that reconstruction costs will be largely covered by donor flows, and that the new government is committed to sound economic policies. Indeed, the government recently announced its four-pronged medium-term strategy, focused on (i) ensuring security, (ii) improving governance, (iii) generating growth and employment, and (iv) enhancing infrastructure.

To manage and coordinate immediate relief to the tsunami-affected areas, the Indonesian government set up a Joint Disaster Management Center with the United Nations at the office of the Vice-President on January 11. The Ministry of Planning, with the assistance of the World Bank, the Asian Development Bank (AsDB) and the Fund, has completed a preliminary assessment of the damage and the associated replacement costs, which indicates that the total replacement costs could be in the $4–5 billion range. At the Consultative Group meeting for Indonesia on January 19–20, donors pledged nearly $4 billion to finance reconstruction spending in 2005–2009. In addition, several private donors, as well as domestic and international non-governmental organizations (NGOs), are providing substantial financial support and help in immediate relief operations.

Indonesia's economic performance is expected to improve in 2005 with GDP growth projected at some 5½ percent, underpinned by continued strong growth in consumption combined with a recovery in investment. While the economy of Aceh has been severely hit by the tsunami, the province's contribution to national GDP is only about 2 percent, and the negative supply side effects will be offset by reconstruction spending so that the net impact on growth will be minimal. Moreover, inflation is expected to generally remain in the 6 percent range, notwithstanding in the pick-up registered in January. Fiscal consolidation is set to continue with the government aiming at budget deficit of around 1 percent of GDP in 2005, which would allow further reduction in the debt-to-GDP ratio. Over the medium term, Indonesia's economy could grow in the 6–7 percent range, provided that the government follows through with its economic agenda.

Executive Board Assessment

Executive Directors expressed deep sympathy for the losses suffered by Indonesia in the wake of the earthquake and tsunamis at the end of last year, and commended the authorities on moving expeditiously to put together a plan for disaster management and for medium-term reconstruction and rehabilitation. Directors welcomed the generous international financial assistance for the tsunami relief and reconstruction efforts, and looked forward to its prompt delivery. Directors also welcomed the commitment of the authorities, at the highest level, to economic reforms, including prudent macroeconomic policy and accelerated structural reforms to improve the investment climate, while addressing the urgent need for reconstruction of Aceh. Ultimately, it will be the fundamental economic reforms that will help Indonesia realize its economic potential and address its unemployment and poverty problems.

Directors welcomed the favorable performance of the Indonesian economy last year, against a backdrop of parliamentary and presidential elections. Over the last few years, Indonesia has made considerable progress toward achieving macroeconomic stability, lowering public debt, restoring a healthy banking system, and reducing vulnerabilities. Maintaining stability, while broadening reforms to attract private investment, will be key for placing Indonesia on a high and sustained growth path. In this context, Directors noted that the government's medium-term strategy is appropriate and, if fully implemented as envisaged, will help Indonesia achieve its objectives. They emphasized that the election has given the new government a strong mandate to tackle the needed economic reforms.

Directors commended the authorities for their continued emphasis on fiscal consolidation, which will help to further reduce the public debt burden and vulnerabilities. They congratulated Indonesia on its success in reducing the budget deficit last year, despite it being an election year, and welcomed the new government's commitment to continued fiscal prudence. In this context, they noted that externally-financed reconstruction spending may raise the deficit somewhat in 2005, from its previous target, but were pleased to learn that the government is still committed to an underlying budget deficit of 1 percent of GDP. Directors welcomed the authorities' efforts to coordinate the relief and reconstruction efforts efficiently, and to ensure the transparent allocation and effective use of international aid.

Directors urged the authorities to continue their efforts to improve tax administration so as to raise non-oil revenues. This will help avoid undue reliance on oil revenues and strengthen the budget position. In this regard, Directors expressed concern about the government's plan to provide a tax amnesty, and urged caution in ensuring that this does not result in revenue losses, as often seen in other countries. Directors welcomed the government's intention to reorient public expenditures toward more productive and growth-oriented spending. In particular, they saw merit in the authorities' plans to phase out the fuel subsidy and to channel the savings to development spending, including infrastructure, health and education. A strengthening of budget management will underpin the efforts to establish a better budget structure. Directors also agreed that private sector participation in much needed infrastructure investment could complement government efforts, but noted that it will be important to ensure that this does not create unfunded liabilities, in particular through the establishment of a transparent institutional framework and appropriate risk management. Directors also encouraged the authorities to consider developing a comprehensive debt management strategy, including with a view to reducing vulnerabilities to exchange rate risk.

Directors commended Bank Indonesia (BI) for its conduct of monetary policy, which had helped to contain financial market pressure during the spring of last year and to keep inflation in check. Looking ahead, Directors welcomed the BI's readiness to act to avoid any re-emergence of inflation. They also supported the authorities' intention to move to formal inflation targeting, and encouraged the authorities to continue to work on the necessary preparatory steps.

Directors emphasized the need for continued efforts to ensure a banking system that is sound and supportive of economic growth. To this end, Directors urged the authorities to address weak asset quality and governance, especially at state banks, and to further strengthen bank supervision. In this regard, several Directors also stressed the importance of the government refraining from directed lending. Directors congratulated Indonesia on the passage of the deposit insurance law and urged the authorities to gradually phase out the blanket guarantee system per the adopted timetable.

Directors welcomed the new government's commitment to improve the investment climate and underscored the need to take early and decisive action to help bolster investor confidence. In this context, early action to resolve investor disputes will be important, as will strengthened implementation of legislation, improved governance, enhanced labor market flexibility, and a better regulatory environment facilitating private sector investment, including in infrastructure development.

In conclusion, Directors endorsed the new government's overall economic policy approach, which deserves the support of the international community. Directors wished the new government success in its endeavors and were pleased that the authorities are maintaining a close policy dialogue with the Fund. They stressed that the Fund stands ready to support Indonesia, both in the reconstruction efforts and in the implementation of its overall economic strategy.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Table 1. Indonesia: Selected Economic Indicators, 2001–05 1/

	2001	2002	2003	2004	2005
		Act		Est.	Proj.
Real GDP (percent change)	3.8	4.3	4.5	5.0	5.5
Domestic demand	4.8	2.6	3.6	5.8	6.3
Of which:					
Private consumption	3.4	3.8	4.0	5.0	6.6
Gross fixed investment	6.5	0.2	1.4	7.0	9.0
Net exports 2/	-1.2	1.1	0.7	-0.5	-0.5
Errors and omissions 2/	0.2	-1.1	-0.5	0.0	0.0
Savings and investment (in percent of GDP)					
Gross fixed capital investment	21.4	20.3	19.7	19.9	20.2
Gross national savings	25.6	24.1	22.7	22.7	22.1
Foreign savings	-4.2	-3.8	-3.0	-2.8	-1.9
Prices (12-month percent change)					
Consumer prices (end period)	12.5	10.0	5.1	6.4	6.0
Consumer prices (period average)	11.5	11.9	6.6	6.1	6.0
Public finances (in percent of GDP)					
Central government revenue	17.9	15.8	16.0	17.4	16.1
Central government expenditure	21.0	17.3	18.0	18.6	17.1
Central government balance	-3.2	-1.5	-2.0	-1.2	-1.0
Central government debt	78.2	68.1	59.2	53.0	...
Money and credit (percent change end of period)					
Rupiah M2	13.6	7.9	10.0	11.3	14.0
Base money (averaged)	2.1	8.3	20.5	14.5	12.0
Private sector credit 3/	18.0	21.9	22.0	26.3	14.3
One-month SBI rate (period average)	16.5	14.9	10.0	7.4	7.5
Balance of Payments (in billions of US$)					
Oil and gas (net)	6.4	5.6	6.7	6.6	6.2
Non-oil exports (f.o.b)	44.8	46.3	48.0	53.7	56.4
Non-oil imports (c.i.f)	-31.3	-31.1	-33.7	-39.9	-42.7
Current account balance	6.9	7.8	7.3	7.3	5.5
Direct foreign investment 4/	3.1	5.2	3.2	3.4	4.0
Overall balance	-2.9	0.9	0.6	1.1	0.6
Gross reserves					
In billions of US dollars (end period)	28.0	32.0	36.2	36.3	35.8
In months of imports	6.6	7.0	6.6	6.2	5.7
As a percent of short-term debt 5/	79	129	146	159	...
External debt					
In billions of US dollars	133.2	131.3	134.9	129.9	124.9
In percent of GDP	81.0	64.3	55.4	49.8	43.3
Exchange rate (period average)					
Rupiah per US$ (period average)	10,246	9,291	8,578	8,927	...
Nominal effective exchange rate (1997=100)	28.0	30.7	30.5	...	...
Real effective exchange rate (1997=100)	59.7	72.5	76.6	...	...
Memorandum items:					
Indonesia oil production (000bcpd)	1,320	1,260	1,200	1,070	1,070
Indonesian oil price (US$/bbl)	23.3	24.2	27.4	36.2	35.5
Nominal GDP (in trillions of Rupiah)	1,684	1,898	2,087	2,329	2,610
Nominal GDP (in billions of US$)	164	204	243	262	288

Sources: Data provided by the Indonesian authorities; and IMF Staff estimates.

1/ National accounts figures (and ratios to GDP) are the new official national accounts (2000 prices).
2/ Contribution to GDP growth. Errors and omissions include stockbuilding.
3/ At constant exchange rate, adjusted for loan transfers to and from IBRA.
4/ FDI includes privatization and IBRA sales to nonresidents.
5/ Short-term debt is on a remaining maturity basis, before rescheduling, and including IMF repurchases.