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INDONESIA

March 2015

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR INDONESIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Indonesia, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 9, 2015, following discussions that ended on December 17, 2014, 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 February 17, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Staff Statement** of March 9, 2015 updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its March 9, 2015 consideration of the staff report that concluded the Article IV consultation with Indonesia.
- A **Statement by the Executive Director** for Indonesia.

The document listed below has been or will be separately released.

Selected Issues Paper

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

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

February 17, 2015

KEY ISSUES

Context: Indonesia has strengthened policy and reserve buffers since mid 2013, in the face of global headwinds from the commodity down-cycle and episodes of volatility affecting emerging market economies. Policies have aimed at containing external and inflation pressures, helping to preserve macroeconomic and financial stability. With growth slowing, the new government is keen to jump start supply-side reforms aimed at raising potential growth while strengthening the external position. Upfront actions to curb fuel subsidies have opened fiscal space to support infrastructure spending.

Near-term outlook: After slowing in 2014, growth is projected to tick up to 5.2 percent in 2015, factoring in an anticipated jump in public investment in infrastructure. Inflation has temporarily risen on earlier fuel price increases, but is expected to return to within the target band by year end. Notwithstanding soft commodity prices, the current account deficit is projected to narrow further in 2015. Risks to the outlook arise mainly from a deeper-than-expected slowdown in emerging market trading partners and surges in global financial market volatility, which could exacerbate strains on the domestic banking and corporate sectors.

Policy mix: The current policy mix aims at improving growth potential while consolidating recent stability gains and containing vulnerabilities. Fiscal policy should be geared towards securing space for more social and capital spending, underpinned by a broad-based strategy for increasing nonoil tax revenues, while pursuing moderate deficit reduction over the medium term. Monetary policy needs to remain focused on anchoring inflation expectations and facilitating external adjustment, supported by continued exchange rate and bond yield flexibility. Bank funding pressures, while showing signs of easing, will need to be managed through stronger policy coordination and improved market functionality. Financial stability is expected to be preserved through enhanced risk assessment and effective prudential measures, anchored by a strong crisis management framework. Structural reforms should be aimed at easing supply bottlenecks and improving the investment climate in order to create new jobs, bolster medium-term growth prospects, and strengthen the external position.

Approved By
Hoe Ee Khor and Vivek Arora

Mission dates: December 3–17, 2014
Mission Team: David Cowen (Head), Seng Guan Toh, Jongsoon Shin (all APD), Masahiro Nozaki (FAD), Phakawa Jeasakul (MCM), Lawrence Dwight, and Brett Rayner (both SPR), and Benedict Bingham (Senior Resident Representative). Hoe Ee Khor (APD) and Keiko Utsunomiya (COM) joined part of the mission.
Agnes Isnawangsih and Nong Jotikasthira (APD) assisted in the preparation of this report.

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Glossary

AML	Anti-Money Laundering
ASEAN	Association of Southeast Asian Nations
Bapepam-LK	Capital Market and Financial Institution Supervisory Agency
BI	Bank Indonesia
BKPM	Indonesia Investment Coordinating Board
BOP	Balance of Payments
BPS	Badan Pusat Statistik
CA	Current Account
CASA	Current and Savings Account
CFT	Combating the Financing of Terrorism
DSA	Debt Sustainability Analysis
EBA	External Balance Assessment
EMEs	Emerging Market Economies
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
FSSN	Financial System Safety Net
FX	Foreign Exchange
GDP	Gross Domestic Product
JISDOR	Jakarta Interbank Spot Dollar Rate
LCR	Liquidity Coverage Ratio
LDR	Loan-to-Deposit Ratio
LPS	Lembaga Penjamin Simpanan
MRA	Master Repo Agreement
MOF	Ministry of Finance
MBFI	Nonbank Financial Institution
NIIP	Net International Investment Position
NPL	Nonperforming Loan
OJK	Otoritas Jasa Keuangan
PPT	Percentage Point
RR	Reserve Requirement
RAM	Risk Assessment Matrix
REER	Real Effective Exchange Rate
SOEs	State-Owned Enterprises
TA	Technical Assistance

BACKGROUND AND CONTEXT

1. **Since mid 2013, Indonesia has taken significant steps to strengthen policy and reserve buffers**, in the face of strong headwinds confronting major commodity exporters and episodes of heightened market volatility in emerging market economies (EMEs).[1] Aided by enhanced policy credibility and global push factors, external inflows to Indonesia have been supportive the past 18 months. Equity prices rebounded in the first half of the 2014, including relative to most EME peers. Government bond yields have stabilized, with the fixed-income market buoyed by strong foreign inflows, which has led to an increase in reserves and helped keep the rupiah relatively stable against the U.S. dollar (Box 1).

2. **However, the economy continues to be buffeted by a shift in the terms of trade against commodity exporters, with significant macro-financial implications** (Figure 1). The commodity down-cycle has weakened the current account, dampened new investment, and resulted in a growth slowdown.[2] As a consequence, corporate cash flows have been constrained, which has caused bank deposit growth to slow sharply and contributed to funding pressures. More recently, credit growth has decelerated, in part due to monetary and macro prudential policy measures, which have led to a moderate tightening in financial conditions (Figure 2). Household demand for credit has also slowed, affecting private consumption and property prices. At the same time, private external borrowing has risen, with firms taking advantage of lower borrowing costs abroad.

3. **Against this backdrop, the 2014 Article IV consultation focused on the challenge of charting a course to higher growth while preserving macro-financial stability and strengthening the external position**. With a change in government in October 2014, the new administration appears keen to ease longstanding supply bottlenecks through a reform strategy that aims to raise potential growth. As a first step, it has taken decisive action to remove most fuel subsidies with a view to freeing up space in the government budget for more growth-critical spending. In keeping with this, the authorities have been steadfast in their commitment to macroeconomic and financial stability, as Indonesia transitions away from commodity-supported to more competitiveness-driven growth in a challenging global environment.

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[1] Indonesia is a significant commodity producer and exporter. Coal, palm oils, natural gas, crude oil, and processed rubber are the top five commodity-related exports, with this category accounting for slightly more than half of total exports in 2014.

[2] See selected issues paper (SIP) on "The Impact of Major Commodities on the Corporate Sector and Banking System," (2015).

Box 1. Indonesia: Managing Market Pressures

Since the taper tantrum in mid 2013, Indonesia has deployed a set of policy actions and strengthened economic fundamentals to increase resilience to market shocks. Monetary and macro prudential policies have been tightened and exchange rate and bond yield flexibility has increased in response to market conditions.[1] These actions have helped anchor inflation expectations, reduce external pressures, and facilitate a rebuilding of reserves. In addition, financial market deepening measures to improve the functionality of FX and money markets and to encourage prudent hedging by corporates (including state-owned enterprises) have been initiated. Furthermore, the fiscal deficit has been held in check through energy subsidy reforms and made more resilient to exchange rate shocks and financing pressures, including through a freeing up of fuel prices and well-timed external bond issuances.

Due in part to these policy actions, Indonesia has weathered several bouts of market volatility in 2014 relatively well. Most notably, during the Argentine debt default episode of January 2014, Indonesia and India "…improved their current account and hardly witnessed a move in their currencies in January compared with the May-December [2013] period when they had depreciated substantially."[2] Throughout much of 2014, capital inflows to Indonesia have been highly supportive, although some outflows occurred in the last quarter of the 2014 with a general decline in risk appetite toward emerging markets (EMs). Nevertheless, Indonesia again fared better than most large EMs, with equity prices and bond yields remaining broadly stable. Meanwhile, the relatively large movements in the exchange rate helped absorb some of the pressure and limit reserve losses.

Nevertheless, risks of further surges in global financial market volatility remain (see Appendix I). While fundamentals have improved, the current account deficit remains sizable, financial markets are still relatively shallow, and the large share of rupiah bonds held by nonresidents poses potential rollover risks. Nevertheless, following heightened volatility in the last quarter of 2014, bond yields have fallen moderately since the beginning of the year, broadly in line with other EMs, with global financial conditions still supportive, while equity prices have also rebounded on foreign buying.

Looking ahead, capital inflows to Indonesia are expected to slow in 2015, but remain supportive. Recent market performance suggests that spillovers from a strong U.S. dollar, lackluster EM growth, and continued oil market uncertainty remain manageable. Indonesia's financial account could be subject to further bouts of market volatility, but the current policy framework is expected to continue unpinning positive sentiment.[3] Meanwhile, FDI, which comes largely from Japan and other ASEAN countries, is expected to stay supportive. Policy settings in Indonesia are also consistent with those recommended to other large EMs facing potential balance of payments pressures—including Brazil, India, and Philippines—where IMF advice has emphasized monetary policy tightness and exchange rate flexibility.

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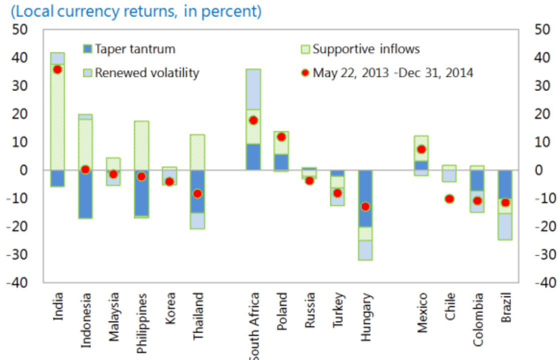
[1] See Box 1 in *Indonesia—Staff Report for the 2013 Article IV Consultation* (IMF Country Report No. 13/362) for more details on policy measures taken in the aftermath of the mid 2013 taper tantrum.
[2] See R. Sahay, V. Arora, T. Arvanitis, H. Faruqee, P. N'Diaye, T. Mancini-Griffoli, and an IMF Team, 2014, "Emerging Market Volatility: Lessons from The Taper Tantrum," IMF Staff Discussion Note No. 14/09.
[3] On January 9, 2015, the government of Indonesia issued US$4 billion in FX bonds (equally split between 10- and 30-year bonds), which represents more than half of its targeted foreign currency issuance in 2015.

Box 1. Indonesia: Managing Market Pressures (Concluded) 1/

Indonesian equities were affected by the taper tantrum, but have weathered recent volatility well…

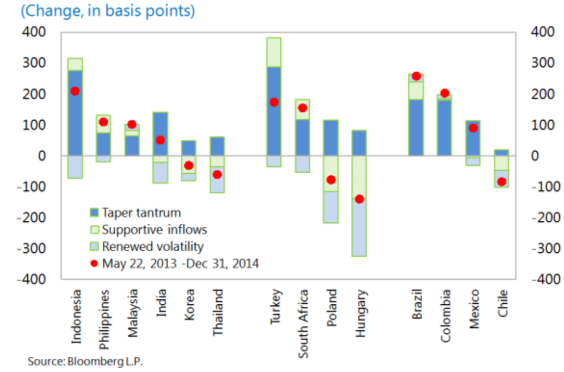
Equity Prices
(Local currency returns, in percent)



Source: Bloomberg L.P.

…while the behavior of bond yields has mirrored equity prices.

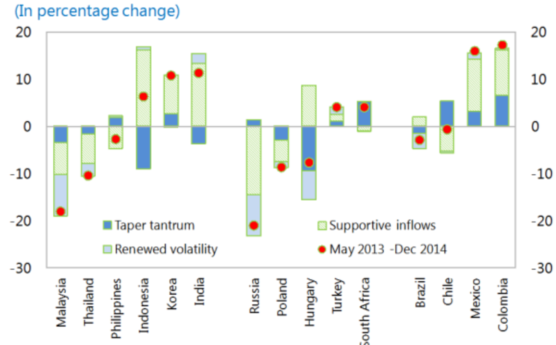
Ten-Year Local Currency Bond Yields
(Change, in basis points)



Source: Bloomberg L.P.

Indonesia lost significant reserves during the taper tantrum, but maintained them during recent volatility.

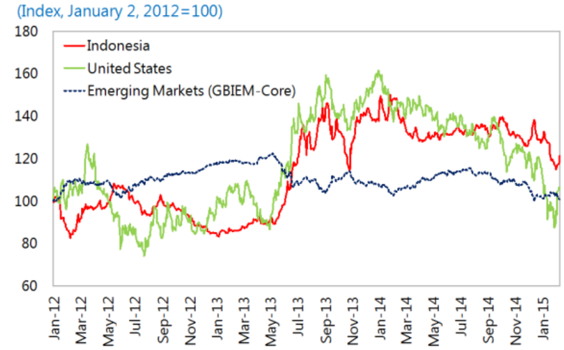
Reserves
(In percentage change)



Source: Bloomberg L.P.

Bond yields have recently declined in line with global trends.

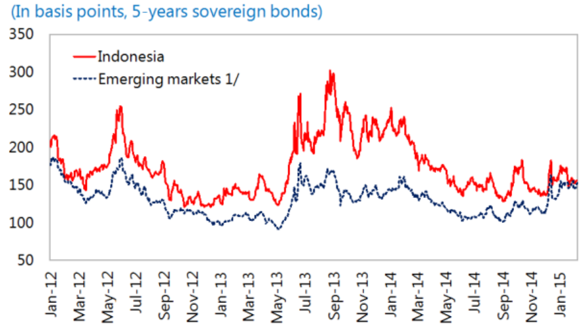
Ten-Year Local Currency Bond Yield
(Index, January 2, 2012=100)



Sources: Bloomberg L.P.; and IMF staff estimates.

CDS spreads have narrowed significantly since the taper tantrum…

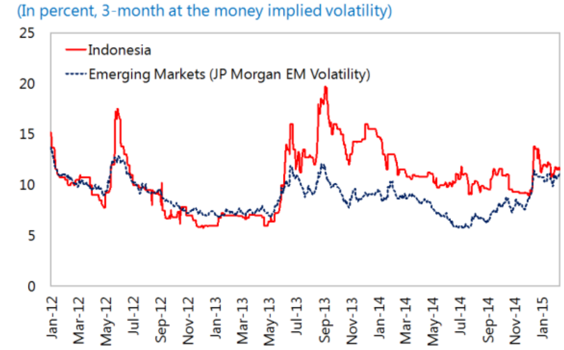
CDS Spreads
(In basis points, 5-years sovereign bonds)



Source: Bloomberg L.P.
1/ Simple average of Brazil, South Africa, Turkey, Colombia, Malaysia, Peru, Mexico, Chile, and Philippines.

… and exchange rate volatility has moderated as well.

Exchange Rate Volatility
(In percent, 3-month at the money implied volatility)



Source: Bloomberg L.P.

[1] Taper tantrum: May 22 – September 30, 2013; Supportive inflows: October 1, 2013 –September 30, 2014; Renewed volatility: September 30, 2014 – December 31, 2014.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

4. Macroeconomic performance. Growth in Indonesia moderated to 5.1 percent in 2014 from 5.7 percent in 2013—in line with staff's expectations and to its slowest pace in five years (Table 1 and Figure 3).[3] While the growth in domestic demand was broadly unchanged, the contribution from net exports was significantly weaker in 2014 owing to slowing EME growth, notably in China, and the raw mineral ore export ban.[4] However, the current account deficit likely narrowed moderately in 2014, owing to the effects of the real effective exchange rate (REER) depreciation (about 7 percent since mid 2013) and of lower oil prices on imports. Headline inflation moved back above BI's target band towards end 2014 following administered fuel price hikes in November. Vulnerability indicators improved modestly in 2014, except financial ones, which weakened slightly (Table 2).

5. The near-term outlook will continue to be complicated by cross currents in the global economy affecting financial conditions and commodity prices. While growth is expected to be weighed down by commodity-related activities, prospects should improve as the domestic reform momentum gathers pace. The impact of the fall in oil prices should help dampen inflation pressures and buttress the current account through lower oil imports.

- **Real GDP growth** is projected to tick up to 5.2 percent in 2015, with the output gap effectively closed based on staff's latest estimates of potential growth. Net exports are likely to remain constrained by weak external demand, notwithstanding one-off factors that are expected to boost oil and mineral exports.[5] Private consumption growth is expected to slow due mainly to reduced commodity incomes. While total investment growth should rise moderately, the impulse is expected to come mainly from higher public infrastructure spending. Private investment growth will likely remain subdued because of funding constraints. Barring a pick up in public investment, real GDP growth could be lower in 2015. Funding pressures could also intensify if capital inflows are lower than envisaged and/or budgetary pressures affect system-wide liquidity, limiting space for new lending.

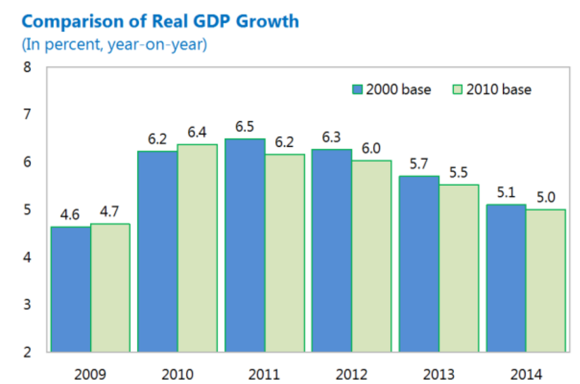
[3] A new GDP series, rebased to 2010, was issued in February 2015 (Box 2). It lowered real GDP growth rates by an average of 0.1 percentage points during 2009–14, while recording a slowdown in growth to 5.0 percent in 2014 from 5.5 percent in 2013. The new series also raised nominal GDP, marginally affecting key macro indicators such as the current account and fiscal balances, as well as investment and saving ratios. The analysis and projections in this report are based on the old (2000 base) GDP series.

[4] The ban, approved in the Mining Law (2009), requires all raw mineral ores to be processed onshore to increase domestic value added. When implementation commenced in early 2014, export taxes of 20-25 percent were initially imposed on mining companies seeking a temporary waiver from the ban. The biggest impact was on copper concentrate. In mid 2014, interim arrangements were reached allowing the resumption of copper exports while granting tax concessions until new processing plants are built onshore.

[5] The main factors are new production from the Cepu oil field and the full year effect of resumed copper exports.

Box 2. Indonesia: Rebased Gross Domestic Product

Statistics Indonesia (BPS) published a rebased GDP series in February 2015. The base year was revised to 2010 from 2000 to reflect changes over the intervening decade in the country's economic structure, particularly in IT and transportation, and the emergence of new products. On the production side, the industrial classification was expanded to 17 sectors from 9 sectors.



Sources: BPS.

Under the newly rebased series, nominal GDP in 2010 increased by around Rp 400 trillion or 6.5 percent. Meanwhile, real GDP growth rates were revised downward on average by around 0.1 percentage points during 2009–14 owing to revised estimates derived from the expanded sectoral classifications. The increase in the nominal GDP reflects two factors: the implementation of the *System of National Accounts 2008* and changes in volumes and prices. The increase appears modest compared to other countries that have rebased GDP upward recently, such as Singapore (by 1.3 percent), Malaysia (3.2 percent), Kenya (25.0 percent), and Nigeria (59.5 percent).

- **Headline inflation** is expected to decline in 2015, with reductions in retail gasoline and diesel prices under the new fuel price regime along with the passing through of the earlier price increase expected to bring inflation back within BI's target band (4.0±1 percent) by year end, supported by maintenance of a relatively tight monetary stance.

- **The current account deficit** is projected to narrow slightly in 2015 (Table 3 and Figure 4), mainly due to a reduction in net oil imports, but adjustment is expected to be partially offset by lower nonfuel commodity prices and weak external demand. The **balance of payments** (BOP) recorded a sizeable surplus in 2014 on strong capital inflows, but a smaller surplus is expected in 2015 on shifts in global financial conditions. **Reserves** at end 2014 were US$111.9 billion, equivalent to 7 months of prospective imports of goods and services or 160 percent of the IMF's reserve metric for a floating currency, which should be sufficient to deal with most shocks.

6. Risks and contingencies. Downside risks emanate mainly from external sources, but they could exacerbate strains in the banking system and corporate sector (Appendix I: Risk Assessment Matrix). Spillovers are predominantly inward, with outward spillovers negligible. Among the most significant risks, a sharp slowdown in trading partner growth could dampen external demand and commodity prices. Unexpected surges in global financial market volatility could increase BOP and bank funding pressures. Relatively high dependence on foreign investors in the rupiah government bonds market could heighten vulnerabilities. Persistent strength in the U.S. dollar could place further strain on corporations' balance sheets, with their foreign currency-denominated debt reaching 22 percent of GDP at end September 2014. Distress at small or mid-sized banks and among corporates could be amplified by an incomplete crisis management framework and inadequate hedging of foreign currency debt. In the event of an adverse BOP shock, tighter aggregate demand management and continued exchange rate flexibility could help contain risks, with reserves used cautiously to smooth excessive volatility. Contingent financing totaling US$76 billion is currently available, inclusive of the Chiang Mai Initiative Multilateralization and bilateral swap arrangements.

7. **Medium-term outlook**. The medium-term baseline is in line with the authorities' announced policy intentions. It assumes the use of expanded fiscal space and implementation of structural reforms aimed at closing infrastructure and skills gaps and raising private investment. Growth is projected to rise to 6 percent by 2018, factoring in positive reform momentum, which is also expected to raise growth potential through increases in factor productivity and capital stock (Table 4). The current account deficit would narrow to 2½ percent of GDP in the medium term, factoring in increased investment-related imports as well as a subdued outlook for commodity prices. Gross FDI would continue to grow while portfolio inflows would remain supportive, with reserves expected to remain above six months of imports. Risks to this outlook are moderately to the downside, given the possibility of less supportive global financial conditions, more muted growth in major trading partners, and slower and narrower reforms than envisaged in the current baseline.

8. **Authorities' views**. The authorities generally agreed with staff on macroeconomic prospects for 2014, but were more optimistic on the growth outlook in 2015 on expectations of a faster rise in public investment. Views were broadly aligned on the inflation forecast and the external outlook. The authorities generally concurred on the assessment of major risks facing the economy and appropriate policy responses, noting that since the mid 2013 taper tantrum, the economy had weathered several mini-episodes of EME turbulence comparatively well.

9. **External position and debt sustainability**. Indonesia's external position is assessed as moderately weaker than implied by medium-term fundamentals and desirable policies, in line with the 2014 Pilot ESR. Staff estimate the current account gap as 0–2 percent of GDP weaker and the REER 0−10 percent overvalued for 2014 (Box 3 and Appendix II). The main conclusions from the Debt Sustainability Analysis (Appendix III) are broadly unchanged from the last Article IV consultation. External debt remains at a moderate level, notwithstanding a rise in recent years owing largely to private external borrowing and exchange rate depreciation. Debt and debt service ratios are projected to be somewhat higher in the near term, but increases in FDI and equity inflows should help reduce the share of debt financing over the medium term. Public debt also is relatively low, with both it and external debt sustainable over the medium term.

Box 3. Indonesia: External Sector Assessment

Indonesia's external position is found to be moderately weaker than implied by medium-term fundamentals and desirable policies.

- Staff assesses the current account (CA) gap to be 0 percent to -2 percent of GDP, which is similar to EBA CA estimates (Appendix II). Policy actions since mid 2013 should continue to gradually improve the external position (Box 1).
- The latest EBA CA estimates imply a gap of -1.9 percent of GDP, based on a cyclically adjusted CA balance of –2.3 percent of GDP and a norm of -0.4 percent of GDP. However, taking uncertainties into account, staff believes a norm of –1.5 percent of GDP (±1 percent of GDP) more accurately reflects Indonesia's significant investment needs.
- In contrast, EBA ES estimates suggest the CA is about 1 percent of GDP above the level needed to stabilize Indonesia's net international investment position (NIIP) over the medium term.
- EBA REER estimates suggest an undervaluation at end 2014 of about 8 percent. However, staff assesses the REER to be overvalued by 0–10 percent, consistent with the recent erosion in Indonesia's terms of trade and projected falls in oil and gas production over the long run.

Indonesia Estimated Policy Contributions to Current Account Gap, 2014

(In percent of GDP)

Cyclically-adjusted CA	-2.3
CA norm	-0.5 to -2.5
Estimated CA Gap	0 to -2
Of which:	
Partners' fiscal deficits	0.7
Domestic capital controls	0.6
Partner policies, other	-0.4
Domestic policies, other	-0.2
Residual	-2.6

Indonesia's CA deficit is projected to improve gradually. The 2014 deficit is expected to be about 3.0 percent of GDP (compared to 3.3 percent of GDP in 2013), as rising manufacturing exports and falling oil prices have compensated for declines in other commodity exports. Looking ahead, manufacturing is expected to continue to perform well, in line with increasing growth momentum in the United States and the lagged effect of exchange rate depreciation.

For most of 2014, capital inflows, mainly in the form of FDI and investment in government bonds, were above trend, but slowed in the latter part of the year. Going forward, they could further dissipate with a large shock. Bank Indonesia built up reserves by US$13 billion in 2014 to US$112 billion at year end (160 percent of the IMF's reserve metric for a floating currency and 7 months of imports), partly reflecting the government's intake of dollar-based oil revenues and proceeds from sovereign issues.[1] While the composite metric may not adequately account for commodity price volatility, the current level of reserves should be sufficient to absorb most shocks, with predetermined drains also manageable.

The NIIP and external debt are at moderate levels and projected to remain stable. At end September 2014, Indonesia's NIIP was about -49 percent of GDP, compared to -44 percent of GDP at end 2013. Gross external liabilities were about 76 percent of GDP, up from 67 percent of GDP at end 2013. Gross external debt is expected to be about 35 percent at end 2014, with short-term debt at around 6 percent of GDP. The debt sustainability analysis (Appendix III) indicates that external and public debt are sustainable over the medium term.

[1] Since mid 2013, Indonesia has shifted towards a more flexible exchange rate policy framework, with a floating regime better facilitating adjustments in exchange rates to market conditions.

POLICY DISCUSSIONS

10. Policy discussions focused on improving growth potential while consolidating recent stability gains and containing vulnerabilities. In the near term, the macroeconomic policy mix appears broadly appropriate. To achieve its main policy objectives, the government will need a clear revenue strategy to buttress its fiscal stance. A moderately low deficit would help contain bank funding pressures and facilitate external adjustment. The monetary stance is well calibrated until inflation and external pressures firmly ease. Financial stability is expected to be preserved through prudential measures and close monitoring of vulnerabilities. Structural policies aim to raise potential growth, with timely implementation also key to strengthening the external position. Staff recommendations draw on recent IMF technical assistance (TA), the 2010 FSAP, and previous discussions, as well as other EMEs' experiences. Against the recommendations made at the time of the 2013 Article IV consultation, major actions have been taken on energy subsidy reform, monetary management, and the exchange rate framework (Appendix IV).

A. Fiscal Policy and Reforms—Creating Lasting Space

11. Main issues. The government's fiscal rule has provided a sound nominal anchor, with public debt as a share of GDP falling by around three-quarters since the late 1990s.[6] Budgetary pressures in recent years stem mainly from rising energy subsidies and weak revenue collections, which has limited space for growth-critical social and infrastructure spending (Figure 5 and Tables 5 and 6). The new administration seeks to move decisively to reverse the trend of under-investment in infrastructure (Box 4). Fuel subsidy and revenue reforms are at the heart of their strategy. The government also looks to pursue more multilateral loans and raise the borrowing capacity (including from external sources) of state-owned enterprises (SOEs) to support infrastructure development. The recent sharp drop in oil prices is proving to be a significant headwind for the government's strategy, as lower oil and gas revenues will largely offset space created by the reduction in fuel subsidies in the near term (Box 5). Reversing broader declines in revenues, which mainly reflect structural weaknesses in tax revenues and a trend decline in oil production, may take time. The government will also have to manage potential funding risk given the current reliance on foreign bond investors.

[6] The rule limits the general government deficit to 3 percent of GDP. Based on historical experience, it generally means a cap on the central government deficit of 2½ percent of GDP.

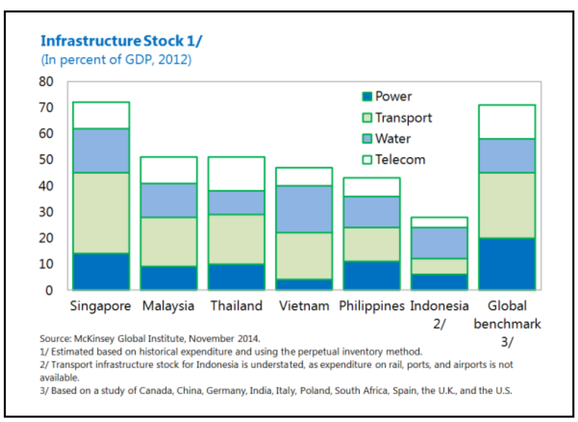
Box 4. Indonesia: Closing the Infrastructure Gap

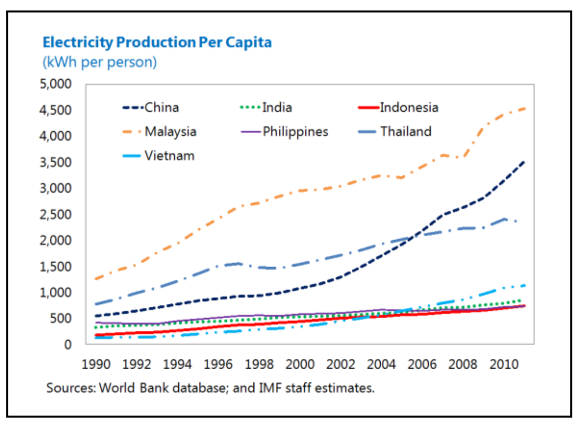
Indonesia's infrastructure gap remains wide compared to its peers, particularly in transport and power. As a result, logistics costs account for around 24 percent of GDP in Indonesia, compared to Thailand (20 percent), China (18 percent), and Malaysia (13 percent).[1] Electricity production per capita is only 20–60 percent of its peers, implying significant constraints on power generation, and the electrification ratio is at 82 percent, well below Malaysia, Thailand and China (with each close to 100 percent).[2]

Infrastructure investment has been subdued over the past decade, with under-investment affecting growth by catalyzing less private investment and dampening productivity gains. On average, it has been at 3−4 percent of GDP a year, compared to more than 7 percent in the mid 1990s.[3] Most of the decline was due to lower private and state-owned enterprise (SOE) investment in infrastructure.[4] According to the World Economic Forum, Indonesia ranked 56th out of 144 countries on infrastructure, compared with Malaysia (25th), China (46th), and Thailand (48th) in 2014.

The slow progress in reducing the infrastructure gap is due to several factors, including a complex land acquisition process, weak implementation capacity, and poor inter-agency coordination.[3] While the government's budget for capital spending has been constrained in recent years by the substantial amount of energy subsidies (which averaged 3½ percent of GDP a year during 2011−14), the actual execution of capital spending has been at only around 85 percent. The government has tried to tap public-private partnerships in power plants, toll roads, and water supply, but they have yet to take off significantly due in part to a weak institutional framework.

The new administration has voiced an upfront commitment to boosting infrastructure spending through a multipronged effort. The government aims, *inter alia*, to reduce logistics costs to 19 percent of GDP and improve the electrification ratio to 97 percent by 2019. It estimates that infrastructure financing needs during 2015−2019 will be around Rp 5,000 trillion, or on average 8−9 percent of GDP a year, with about half of this possibly financed off-budget, including through SOE borrowing and PPPs. To support this process, the government plans to inject new capital into infrastructure-related SOEs, including to PT Sarana Multi Infrastructure (a government infrastructure financing company set up in 2009), thereby enabling them to leverage their balance sheets and launch strategic infrastructure projects and PPPs. With a view to jump-starting investment, the government also aims in 2015 to streamline the investment process through a one-stop service at the Indonesia Investment Coordinating Board (BKPM) and implement the revamped Land Acquisition Law to remove bottlenecks to large infrastructure projects.





[1] Center of Logistics and Supply Chain Studies, *State of Logistics Indonesia 2013*; and KPMG, *On the Move in China*, 2011.

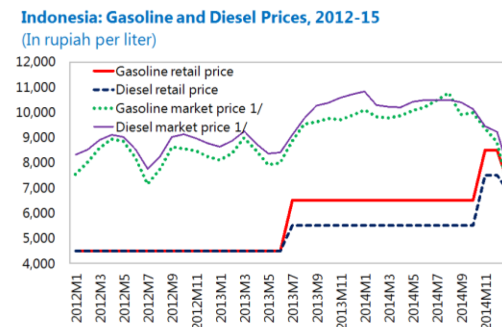
[2] World Bank, 2014; "Indonesia: Avoiding the Trap," *Development Policy Review 2014*.

[3] Ministry of National Development Planning, *Infrastructure Development Strategy in Indonesia,* 2011.

[4] World Bank, 2013, "Continuing Adjustment," *Indonesia Economic Quarterly* October 2013.

Box 5. Indonesia: Fuel Subsidy Reform and the Fiscal Impact of Low World Oil Prices

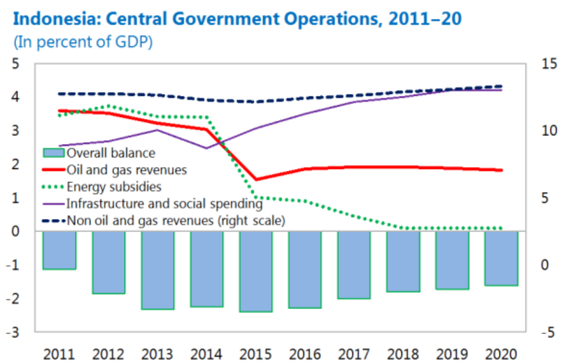
Two major reforms on fuel subsidies came into effect on January 1, 2015. First, subsidies on gasoline were effectively discontinued. Second, a fixed per-liter subsidy scheme of Rp 1,000 per liter (US$0.08) for diesel was adopted. Going forward, the retail fuel prices will be adjusted twice a month by the Ministry of Energy to reflect the economic cost of the fuel products, including taxes. These reforms will not only generate substantial fiscal savings (gasoline consumption is around twice that of diesel), but also protect the budget against future fluctuations in oil prices and exchange rates. Indonesia is among several countries in the region that have recently implemented energy-pricing reforms. India deregulated diesel prices and increased petrol excise rates. China increased the gasoline tax rate twice (by 40 percent in total). Malaysia took final steps to eliminate diesel and gasoline subsidies, while Thailand began to gradually reduce fuel subsidies and partially reinstate diesel excises.



Sources: Indonesia, Ministry of Finance; Bloomberg L.P.; and IMF staff estimates.
1/ Based on the Mean of Platts Singapore (MOPS) price of the oil product.

Measures have been taken in Indonesia to mitigate negative income shocks emanating from the November 2014 administered fuel price hike, while falling world oil prices have provided added relief. Cash transfers equivalent to 0.1 percent of GDP were made to 15.5 million low-income households (bottom 25 percent of income distribution) shortly after the November price hike. This move followed a similar approach to the June 2013 price hike, which kept the poverty rate unchanged, according to the World Bank. The rationale for the price hikes—a need to reallocate fuel subsidies to infrastructure spending—was also communicated effectively to the public. Under the new pricing regime, the government was also able to cut gasoline and diesel prices by around 22 and 15 percent, respectively, in January 2015, aided by the precipitous fall in oil prices.

Recent fuel subsidy reform potentially opens sizable fiscal space for priority spending. The fuel subsidy bill is projected to decrease by about 1¾ percentage points (ppts) of GDP in 2015, factoring in the new pricing regime for gasoline and diesel. Lower world oil price will also reduce kerosene and LPG subsidies, whose retail prices are still fixed in nominal terms. In addition, the electricity subsidy bill will be cut by around ½ ppts of GDP, following discontinuation of subsidies for medium and large users in mid 2014. As a result, the energy subsidy bill is expected to decrease to 6 percent of total expenditure in 2015 from 19 percent in 2014. Under the current baseline, this savings will be partially offset in 2015 by a loss in oil and gas revenues by more than 1½ ppts of GDP.



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

A further drop in the oil price could worsen the fiscal balance and constrain space for priority spending. Under a fairly extreme scenario with an average world crude oil price of US$30 per barrel in 2015, the fiscal deficit would increase by 0.4 ppts of GDP. Further losses in oil and gas revenues would amount to 0.6 ppts of GDP, partially offset by additional savings in the subsidy bill for kerosene, LPG, and electricity, as well as in revenue sharing with local governments, which would total around 0.2 ppts of GDP.

12. Policy developments. The new administration submitted a revised 2015 budget proposal to Parliament in early January that aims to carve out significant new space for capital spending, while maintaining a prudent fiscal stance. To this end, the revised budget seeks to target a central government deficit of 1.9 percent, against 2.2 percent of GDP in the original budget and preliminary outturn of 2.3 percent of GDP in 2014. Under the current proposal, the government expects to offset the large reduction in oil and gas revenues with ambitious increases in non-oil tax revenues, while allocating most subsidy-bill savings to capital spending. Despite the lower deficit target in 2015, the revised budget may require a substantially larger net issuance of government bonds in order to finance a significant recapitalization of SOEs (equivalent to 0.5 percent of GDP in the budget proposal), as part of plans to leverage their support for infrastructure investment.

13. Staff Position

- **2015 budget**. Staff welcomed the proposal to target a deficit of around 2.0 percent of GDP in 2015, given the need to support external adjustment and manage funding pressures. It noted that a shift in resources away from poorly targeted energy subsidies to infrastructure spending with higher multipliers would help support growth and still leave space for automatic stabilizers to operate in case of an extreme slowdown. To achieve this target, staff indicated that the revised budget would need to be underpinned by some upfront revenue measures to bolster its credibility and by capital spending targets in keeping with absorptive capacity. Full transparency in the fuel price adjustments would help shield the space opened by earlier subsidy reforms. Staff also proposed a more phased approach to SOE recapitalization to ensure governance, accounting, and procurement frameworks are sufficiently robust and government domestic borrowing is contained.

- **Near-term outlook**. Based on more conservative revenue and expenditure targets and factoring in the expected decline in oil and gas revenues, staff indicated that the overall fiscal deficit would likely be around 2.4 percent of GDP, as shown in the current baseline. To safeguard performance in 2015, staff recommended a moderate increase in fuel excises (equivalent to around 0.3 percent of GDP), which could be more easily absorbed by consumers given recent reductions in retail fuel prices. Higher taxes on tobacco and luxury goods could provide additional revenues. Sufficient space would still exist to increase the capital budget by about 0.5 percent of GDP in 2015 and protect social spending, notably on health care coverage for the poor, as well as for safety nets to defray higher fuel costs.

- **Medium-term framework**. Over the medium term, staff recommended a small primary deficit, in order to keep debt levels stable and safeguard against a reversal in inflows. In support, the authorities were urged to pursue tax reforms along the lines of recent FAD TA, focused initially on broadening the base, streamlining exemptions (notably the VAT), and enhancing risk-based tax administration. Staff noted that these reforms would take time to prepare and implement properly, with only a gradual increase in tax revenues built into the current baseline. A more ambitious rise would require broader, complementary reforms, including rationalizing corporate tax rates, strengthening the property tax regime, and raising the VAT rate and select excises. A phase out of energy subsidies by end 2017 is also assumed in the baseline, in keeping with G-20 commitments, potentially opening more space in the budget. Staff cautioned that fiscal risks warranted careful management, in particular those arising from expanded balance sheets of and new external borrowing by SOEs.[7] The impact of lower oil prices on the finances of Pertamina (the state oil and natural gas corporation) would also need to be monitored closely, given its sizable presence in upstream production in Indonesia.[8]

14. Authorities' view. The authorities recognize the need to maintain sound fiscal management in the current environment. In doing such, they wish to seize the opportunity created by subsidy reforms to ramp up infrastructure investment, with an initial focus on rural roads and irrigation. They are also keen to improve national connectivity in support of sustained growth and to reduce regional inequalities through better transport infrastructure (including maritime) and more power generation. This effort is expected to be backed by implementation of streamlined approval processes, procurement reforms, and the Land Acquisition Law. The authorities note it will also require substantially more resources, seeing the two-pronged approach of seeking more domestic revenues and larger external borrowing as consistent with maintaining a solid fiscal position and minimizing risks. On revenue targets, the authorities see substantial gains from improved tax administration, anchored by a strengthening in the capacity of the Directorate-General of Taxation under the Ministry of Finance. They also expect more buoyant growth than envisaged by staff in 2015 to contribute to tax collections. On external borrowing, they noted the low level of external and public debt and favorable borrowing costs as driving their strategy.

B. Monetary Policy and Foreign Exchange Management—Striking the Right Balance

15. Main issues. Bank Indonesia continues to maintain a relatively tight monetary stance in order to anchor inflation expectations and manage external pressures in light of current vulnerabilities. Broad money and private credit growth have slowed, while real interest rates have risen moderately (Figure 6 and Table 7). However, banks still hold sizable excess reserves in order to self-insure for liquidity purposes, which speaks to the need to further develop the interbank money market as the main channel of monetary transmission.[9] At the same time, they have faced increased

[7] See selected issues paper on "Managing Fiscal Risks in Indonesia," (2015).

[8] Currently, Pertamina is the second largest oil producer in Indonesia behind the U.S.-owned Chevron Pacific Indonesia. Its daily output of oil in 2013 averaged around 121,000 barrels—about 15 percent of national oil output. It is the third largest gas producer, accounting for 13 percent of gas output in 2013.

[9] See selected issues paper on "Recent Developments in Banking System Liquidity," (2015).

funding pressures, as credit growth outpaced deposit growth through the first half of 2014. Funding conditions in 2014 were also affected by changes in guidance on loan-to-deposit ratios (LDRs) and by the government's front-loading of rupiah bond issuances in the first half of the year, all of which led to intensified competition for term deposits.[10] Conditions began to ease in the second half of 2014, aided by seasonal factors and lower credit growth.

16. Policy developments. Following the November 2014 fuel price hike, BI promptly raised its benchmark and lending facility rates for the first time in a year by 25 bps and 50 bps, respectively to 7.75 percent and 8.00 percent, but left its deposit facility rate unchanged to discourage a further increase in excess reserves held by banks. To mitigate the adverse effects of banks' competition for deposits, the Financial Services Agency (OJK) imposed interest rate caps on deposits at larger banks in October 2014.[11] In the meantime, BI continued to make progress in deepening the interbank money market, supported by MCM TA on financial deepening. A mini Master Repo Agreement (MRA) was launched at end 2013 for collateralized transactions, while the Jakarta Interbank Spot Dollar Rate (JISDOR) established a viable reference rate following its launch in mid 2013. The use of onshore hedging instruments has also picked up.

17. Staff Position

- **Monetary policy stance and exchange rate management**. Staff broadly agreed with BI's current monetary stance, which provides scope for future adjustments as inflation and external pressures ease. Under the new fuel pricing regime, inflation volatility could rise, reinforcing the importance of maintaining strong policy credibility within BI's inflation targeting framework. Staff noted the need for continued exchange rate and bond yield flexibility as the primary response against external shocks, with BI limiting intervention in the FX market to smoothing volatility and ensuring orderly market conditions, in line with the current practice. The authorities were also urged to remove the deposit rate caps to improve the signaling effects of monetary policy and strengthen policy transmission.

- **Monetary operations and market deepening**. Staff noted that further improvements in the monetary operations framework, complemented by BI's ongoing market deepening efforts, would also help strengthen the transmission mechanism. To this end, staff recommended moving to reserve requirement averaging, easing supervisory stigma tied to accessing BI's lending facility, and conducting rupiah and FX market operations consistent with reducing excess reserves. Progress on making legacy government securities on BI's

[10] Bank Indonesia raised the secondary reserve requirement (RR) to 4.0 percent from 2.5 percent, with full effect from December 2013; earlier, it tightened the LDR-linked RR by lowering its applicability to banks with both an LDR in excess of 92 percent (from 100 percent) and a capital adequacy ratio of less than 14 percent.

[11] Deposit rates offered on all bank deposits up to Rp 2 billion were capped at no more than the maximum guaranteed rate of the deposit insurance agency (currently 7.75 percent). Furthermore, deposit rates for large deposits (above Rp 2 billion) were capped at (i) 200 bps above the current BI rate for the largest banks (i.e., Buku 4 banks—i.e., core capital above Rp 30 trillion) and (ii) 225 bps above the current BI rate for medium to large banks (i.e., Buku 3 banks—i.e., core capital between Rp 5 trillion and Rp 30 trillion).

balance sheet marketable would also help. Staff suggested that market deepening focus on building a benchmark yield curve and also welcomed the authorities' effort to develop a global MRA for the repo market.

- **Liquidity management**. To help alleviate funding pressures, staff recommended relaxing recent guidance (including supervisory) on LDRs. Staff noted that plans by BI to include non-deposit long-term market funding in the LDR calculation might temporarily ease these pressures, but further suggested that liquidity risk could be better managed by adopting prudential tools such as a liquidity coverage ratio (LCR). In addition, a more evenly paced issuance of rupiah government bonds in 2015, along with moderate government borrowing, would help banks better manage their funding needs.

18. Authorities' views. The authorities broadly agreed with staff's assessment of recent developments. Bank Indonesia reiterated it will maintain its current monetary policy stance in the near term. At the same time, they saw adjustments in macro prudential policies playing a balancing role in supporting credit growth while maintaining financial stability. On deposit rate caps, OJK noted that they are intended to be temporary measures aimed at curbing excessive deposit competition, but expect the caps will become less binding over time given slower credit growth and easing funding pressures observed more recently. The authorities see further progress on financial market development as key to managing liquidity stresses. While the collateralized mini-MRA achieved some success, BI noted that the uncollateralized money market continue to be hampered by counterparty risks. The authorities view guidance on LDRs and related ratios as transitory measures as financial markets deepened.

C. Financial and Corporate Sector Issues—Keeping Close Watch

19. Recent performance. Indonesia's financial system continues to evolve rapidly, posing myriad challenges to the authorities, who themselves are adapting to changes in their own mandates. Banks on a system-wide basis remain generally sound, although as growth slows, nonperforming loans (NPLs) have begun to rise, but from low levels, with new NPLs mainly from corporate loans (Box 6 and Table 8). Currently, capital buffers are adequate to handle the recent deterioration in credit quality. At the same time, some small and mid-sized banks appear more susceptible to liquidity risks given their more volatile funding structures. Corporate sector performance remains strong against EME peers, but vulnerabilities arise from weakening debt-servicing capacity, inadequate hedging of foreign currency debt, and declining profitability of commodity-related firms (Box 7).

Box 6. Indonesia—Banking System Soundness

The banking sector appears generally sound, but some divergence exists within the system. As a whole, banks are well capitalized and highly profitable, benefiting from wide net interest margins. However, nonperforming loans (NPLs) edged up in the first half of 2014, although they remained at a low level. Notwithstanding their larger capital buffers, smaller banks tend to be less profitable due to higher funding costs and greater credit risk. Overall liquidity remains manageable, with heightened funding pressures in the first half of 2014 having subsided. Nonetheless, compared with emerging market peers, the Indonesian banking system appears more vulnerable to potential funding outflows. Smaller banks are exposed to greater liquidity risk given that their funding is more dependent on short-dated term deposits, whereas larger banks receive more of their funding from current and savings account (CASA) deposits. In Indonesia, term deposits, which look similar to money market instruments, tend to be more volatile than CASA deposits.

Despite these generally sound conditions, banks could face some risks from both the liquidity and solvency perspectives. On the liquidity front, banks could experience renewed funding pressures if deposit growth lags credit growth again—similar to early 2014 when banks faced heightened competition for deposits. With regards to solvency, banks' balance sheets could be weakened on the back of tightening financial conditions, slowing economic growth, and pronounced market volatility. While the recent rise in NPLs has been modest, it is more concentrated in corporate loans. Going forward, the quality of these loans could worsen, especially to foreign currency borrowers with inadequate hedging and/or to businesses facing deteriorating financial conditions (e.g., those tied to the resources sector). Moreover, with tighter financial conditions, banks' profitability could decline as a result of narrowing net interest margins.

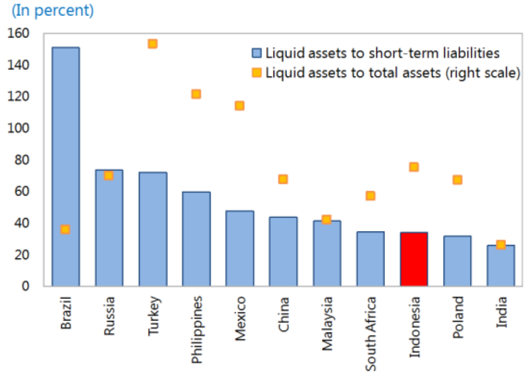
Nonetheless, the banking system as a whole remains in a strong position to withstand severe shocks. Susceptibility to systemic liquidity risk appears limited, given that the bulk of short-term liabilities comes from relatively stable retail deposits, while capital buffers seem generally adequate to absorb substantial credit and market losses. Based on staff's stress scenarios, the following observations are made:

- **Liquidity buffers**: About three-quarters of banks have sufficient high-quality liquid assets such as cash, securities, and placements at Bank Indonesia to withstand a sizable deposit outflow concurrently with a complete withdrawal of short-term wholesale funding. Based on end-June 2014 data, the total liquidity gap of banks facing liquidity shortages was estimated at Rp 13.5 trillion (0.3 percent of total funding). Smaller banks appear less equipped to handle potential liquidity stress. However, the banking sector could face a foreign currency funding shortage of up to US$25 billion in the event of an extreme system-wide shock to foreign currency liabilities, including withdrawals of deposits and drawdowns on commitments, with a concentration of the shortage in the larger banks.
- **Capital buffers**: The system-wide capital adequacy ratio would fall by 4 percentage points to 15 percent at end 2015 if all restructured, special-mention, and problem loans were classified as loss loans, concurrently with an increase in government bond yields by 500 bps and the inclusion of a few other stress-related factors (see footnote 2 in Box 6 panel chart). Under this extreme stress scenario, around a quarter of banks would likely breach the minimum capital requirement (8 percent), with capital shortfalls amounting to Rp 57.0 trillion (0.6 percent of GDP). Even after realizing the abovementioned losses, the banking sector as a whole would still be adequately capitalized, able to withstand a further increase in the NPL ratio by 9.2 percentage points from the current level.

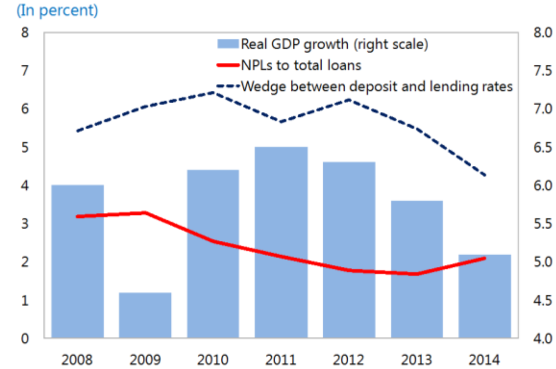
Box 6. Indonesia: Banking System Soundness (Concluded)

Commercial Banks' Risks and Buffers

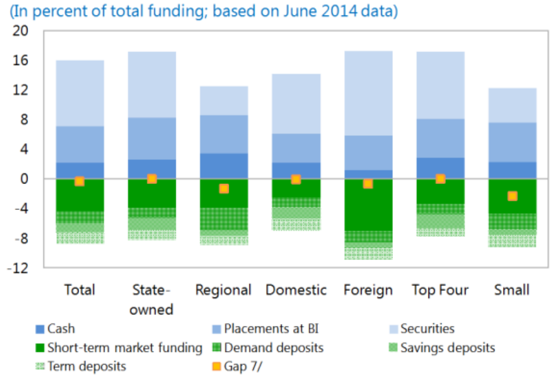
Liquidity Risk—International Comparison, 2014:Q2
(In percent)



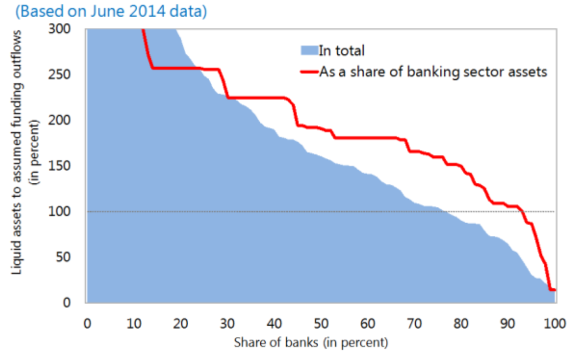
Solvency Risk—Key Macro-Financial Risk Factors
(In percent)



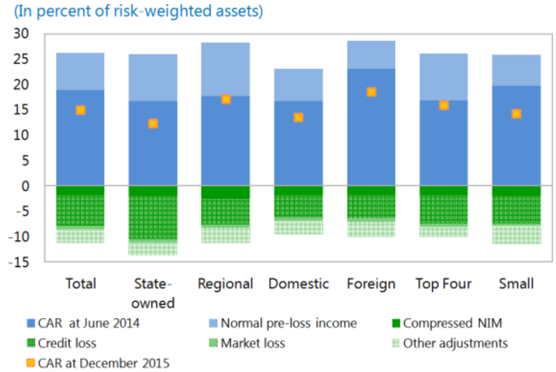
Liquid Assets and Assumed Funding Outflows 1/
(In percent of total funding; based on June 2014 data)



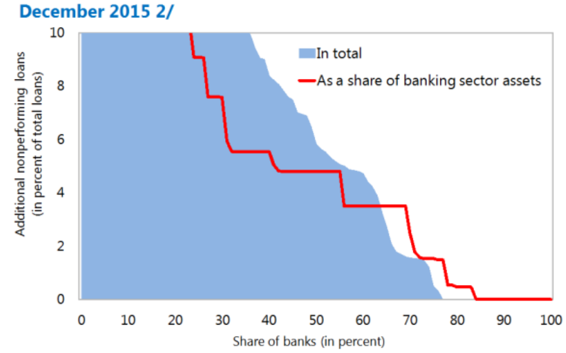
Banks' Distribution of Ratios of Liquid Assets to Assumed Funding Outflows 1/
(Based on June 2014 data)



Banks' Capital Buffers, December 2015 2/
(In percent of risk-weighted assets)



Banks' Ability to Absorb Credit Losses: Distribution of Additional Nonperforming Loans That Banks Could Absorb, December 2015 2/



Sources: Bank Indonesia; and IMF, *Financial Soundness Indicators* database, and staff estimates.

[1] Assume an outflow of demand, savings, and term deposits by 7.1 percent, 4.8 percent, and 3.6 percent, respectively (equivalent to two standard deviation of month-to-month fluctuations), as well as complete drawdown on short-term wholesale funding. Securities could be sold to meeting liquidity needs, subject to a 5 percent haircut.

[2] Estimated at end December 2015, after accounting for complete write-downs associated with restructured, special-mention and problem loans. The estimation also assumes an expansion of balance sheets by 10 percent a year, a compression of net interest margins by 100 bps, and mark-to-market losses associated with an increase in treasury bond yields by 500 bps.

Box 7. Indonesia: Corporate Sector Vulnerabilities

Corporate sector performance is showing signs of strain on the back of slowing economic growth and rising funding costs. Overall profitability and debt servicing capacity of listed companies in Indonesia have weakened. On the former, the return on assets fell slightly to 14.7 percent in the first three quarters of 2014, still high relative to international peers. On the latter, the share of companies with income insufficient to cover interest expenses increased to 21 percent in 2013, while the share of debt of these companies jumped to 30 percent—in excess of its peak in 2008. Stress appears more concentrated in the resources sector as a result of sluggish mining activities and falling commodity prices.

Pockets of vulnerabilities exist owing to rising corporate indebtedness, increasing concentrated leverage and corporate insolvency, and unhedged foreign currency debt.

- **Corporate debt has increased rapidly in recent years**, reaching 34 percent of GDP as of end September 2014 (latest figures available) compared to 23 percent at end 2010, in part spurred by easy financial conditions in the aftermath of the global financial crisis. About 45 percent of the increase in corporate debt was financed by borrowings from abroad. Corporate external debt was US$118 billion (around 15 percent of GDP) at end September 2014—up by US$66 billion since end 2010, although about 60 percent of this increase was either FDI-related (i.e., financed by parent or affiliated entities) or incurred by state-owned enterprises (SOEs). The greater reliance on external funding could also pose a refinancing risk, possibly exacerbated by major corporate distress, with about US$10 billion of bond and syndicated loans maturing in 2015.
- **Concentrated leverage at highly indebted companies has also increased, coupled with rising corporate insolvency**. Companies that were already highly indebted became even more indebted over the past few years, despite only a marginal increase in system-wide average leverage ratios. This concentration is seen in the aggregate debt-to-assets ratio of listed companies (weighted by individual companies' outstanding debt), which has increased substantially to a level near its peak in 2009. In addition, the share of listed companies with negative equity has risen sharply, indicating potential for more widespread corporate defaults.
- **Exposure to foreign exchange (FX) risk is not negligible**. About half of corporate debt is denominated in foreign currency. Although around 70 percent of non-SOE foreign currency debt is estimated to have been incurred by companies with FDI-related funding and/or with FX cash flows, some companies are still subject to FX risk.[1] A large rupiah depreciation could significantly undermine balance sheets of companies with inadequate hedging of their FX exposure, with market reports also suggesting that most hedging now in place will knock out at specific levels of the exchange rate.

The banking sector as a whole remains resilient in light of these corporate sector vulnerabilities given strong capital buffers. However, some mid-sized and regional banks could possibly face significant credit losses tied to resources-related activities from both corporate and household loans.

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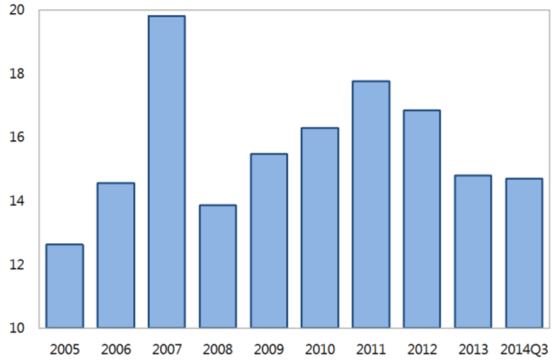
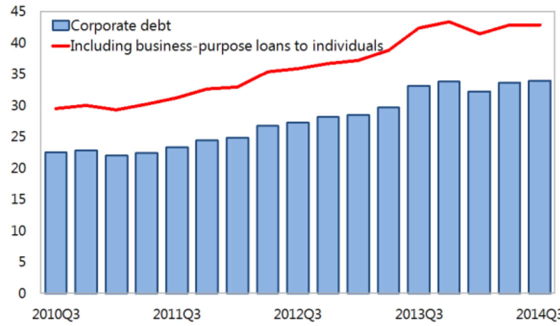
[1]Assumes that companies in the manufacturing and mining sectors have natural hedging.

Box 7. Indonesia: Corporate Sector Vulnerabilities (Concluded)

Profitability—Return on Assets of Listed Companies
(In percent)

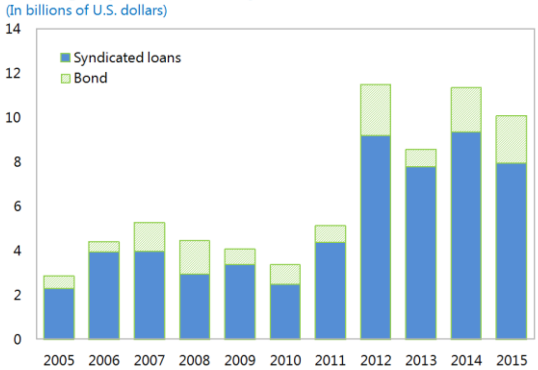


Corporate Debt 1/
(In percent of GDP)

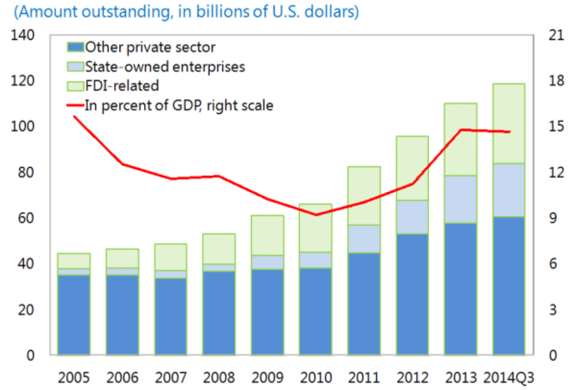


1/ Estimated based on outstanding credit from both domestic and foreign financial institutions, as well as outstanding debt securities issued domestically and internationally.

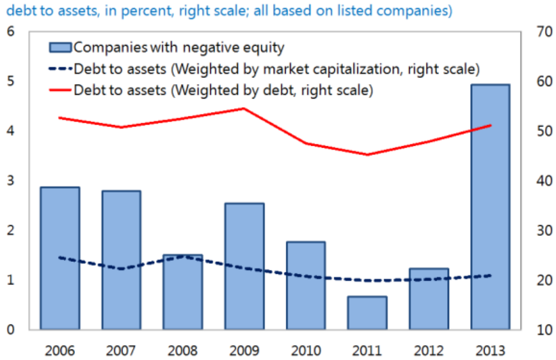
Maturing Corporate Bond and Syndicated Loans
(In billions of U.S. dollars)



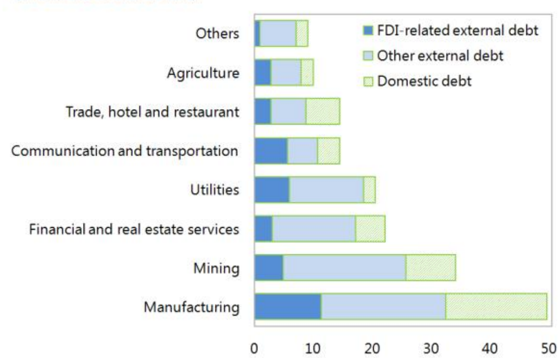
Nonfinancial Private Sector External Debt
(Amount outstanding, in billions of U.S. dollars)



Corporate Insolvency and Concentrated Leverage
(Share of companies with negative equity, in percent of total assets; debt to assets, in percent, right scale; all based on listed companies)



Foreign Currency Corporate Debt, 2014:Q3
(In billions of U.S. dollars)



Sources: Bank Indonesia; BIS, *Debt Securities* Statistics; Bloomberg L.P.; Worldscope; and IMF staff estimates.

20. Policy developments. In January 2014, OJK took control over banking supervision and regulation from BI, following the agency's earlier assumption of oversight of nonbank financial institutions (NBFIs) and capital markets from the former Capital Market and Financial Institution Supervisory Agency (Bapepam-LK). Bank Indonesia retained its macro prudential responsibilities, with development of a policy framework being supported by MCM TA. Banks began to implement Basel III capital standards in early 2014, with larger banks expected to adopt the LCR requirement in 2016. Gaps remain in the financial stability architecture absent a fully developed regime for bank resolution and emergency liquidity assistance and harmonized arrangements for crisis management. To close them, the draft Financial System Safety Net (FSSN) law is being revised for resubmission to Parliament in 2015. In the interim, support to troubled banks would rely on the use of presidential decrees. The anti-money laundering and combating the financing of terrorism (AML/CFT) framework, now under OJK, requires strengthening to comply with Financial Action Task Force (FATF) recommendations.

21. Staff Position

- **Banking and corporate soundness**. Continued vigilance will be needed to ensure adequate liquidity buffers at banks and to contain corporate vulnerabilities. In staff's view, the LCR requirement should be applied to all banks to contain liquidity risks. In addition to BI's plan to improve monitoring of riskier corporate borrowers, new regulations issued in December 2014 on hedging offshore foreign currency borrowing should help manage risks.[12]

- **Financial supervision**. To strengthen its risk-based supervision, OJK will need to improve its capacity to assess banks' risk profile (e.g., stress testing). Staff urged closer collaboration among supervisors across sectors in order to enhance consolidated/group-wide supervision and ensure the resilience of financial conglomerates, supported by strengthened oversight by OJK, especially for NBFIs (including insurance) and capital markets.

- **Macro prudential oversight and coordination**. The macro prudential policy framework will need to be supported by effective inter-agency arrangements for sharing information, conducting joint surveillance activities (such as stress testing exercises and on-site examinations), and formulating and implementing macro prudential policy. Staff welcomed progress in delineating responsibilities through Standard Operating Procedures as the basis for effective coordination between BI and OJK. Plans by BI to strengthen its capacity to conduct systemic risk assessments should buttress financial stability.

- **Financial stability architecture**. Progress is being made to close gaps in the crisis management framework. In welcoming recent work on the draft FSSN law, staff noted the

[12]The regulation requires nonbank corporations that obtain foreign currency-denominated debt from abroad to hedge at least 20 percent of their net foreign liabilities due over the next six months and to maintain the ratio of current foreign assets to current foreign liabilities (up to three months) at a minimum of 50 percent. Corporations would also be required to be rated at least BB- from 2016 onwards to contract new borrowing abroad.

need to set out clear principles for exercising special powers under a systemic event, with responsibilities of all relevant authorities being clearly defined. Also emphasized was the need for comprehensive reforms, underpinned by a simultaneous amendment of all relevant financial sector laws to ensure a fully developed and consistent legal framework. Moreover, staff urged a strengthening of the banking resolution regime, giving the Deposit Insurance Corporation (LPS) a full range of tools to resolve banks in a timely, cost-effective manner.

- **AML/CFT issues**. To avoid FATF sanctions, staff urged action to address key deficiencies regarding the development and implementation of a legal framework and procedures for identifying and freezing of terrorist assets.

22. Authorities' views. The authorities were in broad agreement with staff's assessments and recommendations. Bank Indonesia assesses the banking system to be generally sound, noting that while NPLs have ticked up, they are still near historically low levels. On corporate sector vulnerabilities, concerns mainly center on unhedged private external borrowing, which are being addressed by newly introduced regulations. The authorities place importance on strengthening the financial stability architecture, pointing out that the FSSN law is on a priority list for parliamentary consideration.

D. Structural Reform Priorities—Cementing Jobs, Growth, and Sustainability

23. Main issues. The new administration recognizes the need for significant supply-side reforms aimed at stimulating job creation, raising potential growth, and strengthening the external position. Staff noted that upfront actions would send an important signal to investors and lend support to the government's ambitious growth target of 7 percent by 2017. Discussions focused on the following:

- **Growing the export base**. The authorities are rightly focused on boosting exports, focusing on more processed agricultural products and manufactured goods. An initial push to streamline business licensing and investment approvals appears appropriate. Greater emphasis on ports and maritime development also bodes well for trade. However, staff noted that these initiatives would need to be supported by a trade policy more oriented towards export promotion and less focused on import restrictions than in recent years. The start of the ASEAN Economic Community at end 2015 provides an opportunity to signal a shift in this direction.

- **Ensuring a supportive labor market**. Wage settlements should be aligned with productivity increases in order to manage costs and improve competitiveness. Moving away from annual negotiations of minimum wages would also reduce uncertainty to employers and possibly spur more hiring. In view of ambitious development plans, a manpower strategy is needed to close skilled labor gaps, identifying additional resources for education and training and considering policies for easing entry by foreign skilled labor.

- **Developing financial markets**. A wider range of financial instruments would help mobilize domestic savings and finance long-term investment. Under a multi-pronged approach, staff noted the need to lengthen banks' funding profiles, develop securitized products, and deepen relatively small, illiquid capital markets, as well as to grow the domestic institutional investor base, while keeping the financial sector open to foreign participation. A national task force on financial deepening is being set up and a master plan on sector development is being formulated, with the experience of regional peers possibly instructive.

- **Providing a comprehensive energy policy**. A comprehensive energy policy that incentivizes more upstream and downstream investment in the oil and gas sector should be established, with lower world prices necessitating greater efficiencies and better governance over the sector. Staff noted that more intensive use of renewable sources of energy could also spur new investment, facilitate external adjustment, and balance environmental challenges presented by greater domestic usage of coal.

24. Authorities' views. The authorities broadly recognize the importance of export promotion as a vital part of Indonesia's new growth strategy and to facilitate external adjustment, supported by envisaged reforms to streamline export and import licensing. They are exploring ways of linking wage settlement to labor productivity and plan to devote more public resources to vocational and technical training in support of higher quality job creation. Better governance in the energy sector is also a top priority of the new administration, with the authorities noting measures already taken to strengthen the energy regulator SKK Migas with a view to cutting the cost of energy production and formulating a more transparent regulatory framework in support of investment.

STAFF APPRAISAL

25. Sound macroeconomic management and exchange rate flexibility have bolstered policy credibility and external resiliency in Indonesia over the past 18 months. In the face of Fed tapering and headwinds posed by falling commodity prices, policy and reserve buffers have been strengthened through a clearer policy framework and better policy coordination. Markets have responded favorably, as evidenced by large portfolio inflows in 2014, supported by global push factors. However, financial and corporate sector health shows signs of strain, as growth slows, funding conditions tighten, and with external pressures remaining elevated.

26. Notwithstanding commodity sector weakness and global uncertainties, the near-term outlook is broadly positive. Led by a pickup in public investment, growth should reach around 5¼ percent this year. Credit expansion will likely remain moderate, as funding conditions stay relatively tight. Inflation is expected to return within BI's target band by year end, given the current monetary stance and anticipated fuel price declines. The current account deficit should also narrow slightly, with a lower oil import bill offsetting pressures arising from nonoil commodity exports, with reserves expected to remain adequate.

27. However, risks remain to the downside, requiring continued vigilance. They emanate mainly from external sources, which could feed into those facing the banking and corporate sectors. Continued exchange rate flexibility coupled with tighter demand management could help mitigate external shocks, with a modest use of reserves possibly smoothing volatility. Accelerated structural reforms could yield a more diversified export base and deeper financial markets, making Indonesia less vulnerable to spillovers affecting the commodities sector and to volatile capital flows. Stronger prudential measures would help contain risks in the financial sector, backed by strengthened frameworks for risk assessment and protocols on crisis management.

28. Indonesia's main challenge is to chart a course to higher, more inclusive growth, while preserving macro-financial stability and further strengthening its external position. The new administration appears keen to ease supply bottlenecks through a reform strategy that aims to raise potential growth. Upfront, the strategy's success will hinge on reducing skills and infrastructure gaps. As a first step and in keeping with the authorities' commitment to macroeconomic and financial stability, decisive actions have been taken to remove most fuel subsidies with a view to freeing up space in the government budget for more growth-critical spending. While Indonesia's external position is found to be moderately weaker than implied by medium-term fundamentals and desired policies, current policies appear well geared towards strengthening it. Debt levels remain sustainable and resilient to standard shocks.

29. The macro-financial policy mix is broadly appropriate, but vigilance is warranted in the current setting, with sound fiscal policy a key anchor to growth and stability objectives. Budgetary pressures could re-emerge without new revenue measures to support much-needed infrastructure spending. Over the medium term, broader reforms will be needed to boost nonoil tax revenues in order to sustain increases in development expenditure and maintain a strong fiscal position, with moderate deficit reduction also enhancing resilience to shocks. The expanded space sought by plans to use state-owned enterprises to raise funds for infrastructure investment should also be pursued judiciously, foremost to ensure the strategy is consistent with sound debt management and external sustainability.

30. Monetary policy tightening since mid 2013 and a more flexible exchange rate policy have been instrumental in reducing imbalances, while helping rebuild reserves. The current monetary stance has also aided a credit growth deceleration, in keeping with policy objectives. Going forward, maintaining a relatively tight stance appears appropriate until inflation and external pressures firmly ease. Further progress in improving monetary operations and deepening money markets are expected to improve the effectiveness of monetary transmission. Stronger policy coordination and improved market functionality would help ease funding pressures.

31. Financial and corporate sector vulnerabilities appear manageable, but require close watch in light of the growth slowdown. The banking system remains generally sound, but system stability needs to be underpinned by an effective macro prudential policy framework to mitigate systemic risk and a robust crisis management framework to handle bank distress effectively, backed by joint surveillance and policy coordination among financial authorities and a new Financial System Safety Net law. Corporate sector vulnerabilities warrant careful monitoring, with the support of steps being taken to regulate external borrowing. Key legal deficiencies in the AML/CFT framework should also be addressed in a timely manner.

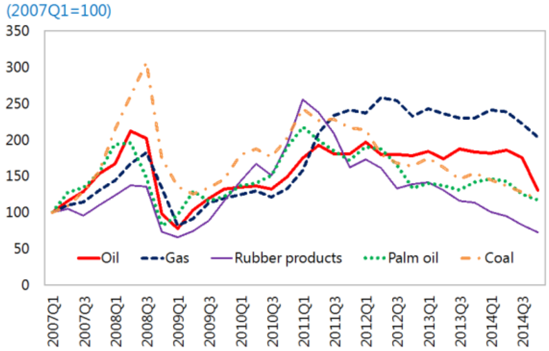
32. Structural reforms aimed at easing supply bottlenecks and improving the investment climate could buttress growth prospects and strengthen the external position. Upfront actions would send an important signal to investors that the new administration is taking a constructive approach towards the trade and investment regime, on labor market issues and human resource development, and with regard to energy policy. Reforms in these areas could boost potential growth and create more jobs for Indonesia's youthful population, while helping contain macroeconomic imbalances, all with a view to moving quickly to higher income status and reducing inequality.

33. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Indonesia: Macro-Financial Developments

Key commodity prices have declined since 2012, with significant macro-financial implications for Indonesia…

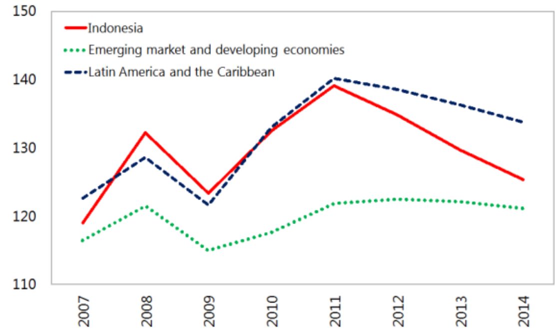
Key Commodity Prices
(2007Q1=100)



Sources: IMF, Commodity Price System database; and staff estimates.

…while the terms of trade has deteriorated more sharply than in other economies.

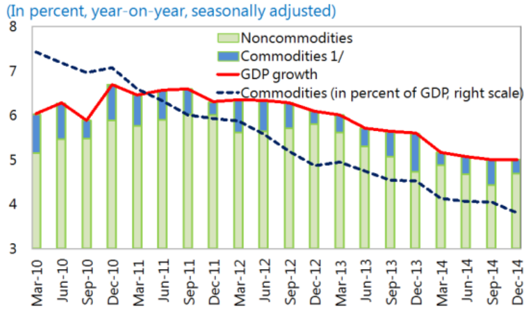
Global Terms of Trade
(Index 2000=100)



Source: IMF, *World Economic Outlook*.

Economic growth has moderated in recent years, with the commodity sector's contribution to growth a factor.

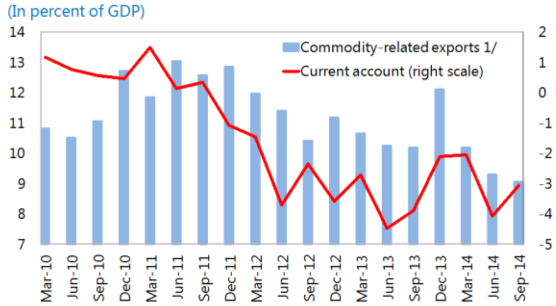
Commodity Share and Contribution to Real Growth
(In percent, year-on-year, seasonally adjusted)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.
1/ Includes agriculture, mining and quarrying, petroleum and gas, and wood products.

The shift of the current account balance into a deficit has also been driven by commodity-related exports.

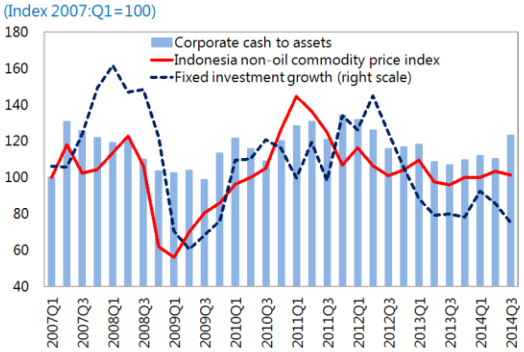
External Developments
(In percent of GDP)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.
1/ Includes agriculture products, palm oils, processed rubber, oil products, and mining products.

The commodity cycle weakness has affected corporate cash positions and slowed investment activity, which is still heavily dependent on internal financing.

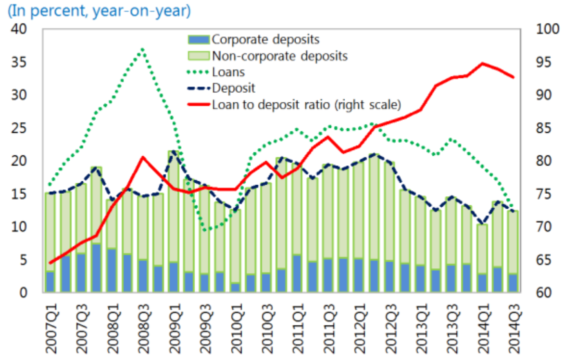
Commodity Prices, Corporate Cash and Fixed Investment
(Index 2007:Q1=100)



Sources: CEIC Data Co. Ltd; Bloomberg L.P.; and IMF staff estimates.

At the same time, these factors have weighed on bank deposit growth, while monetary policy tightening has slowed bank credit growth but with a lag.

Loan and Deposit Growth
(In percent, year-on-year)



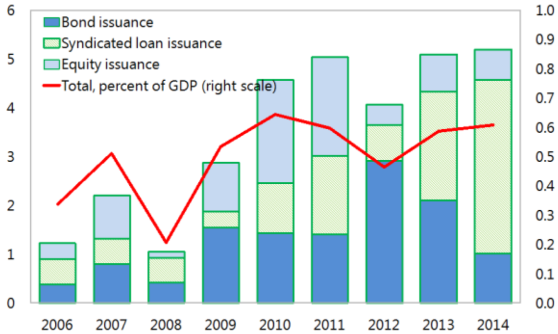
Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

Figure 1. Indonesia: Macro-Financial Developments (Concluded)

Corporate borrowing has risen significantly, with firms tapping into lower borrowing costs by contracting debt abroad.

Indonesia: Issuance of Debt and Equity Securities

(In billions of U.S. dollar)



Sources: Dealogic; and IMF staff estimates.

However, the corporate sector shows growing signs of strains, particularly firms in resource-related activity.

Companies with Low Debt Servicing Capacity and Debt at Risk[1]

(In percent)

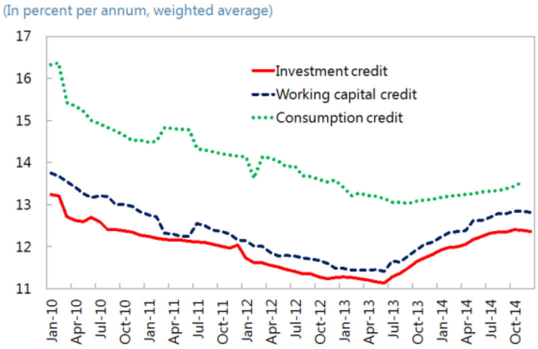
1/ Based on listed companies. Companies with interest coverage ratios (ICRs) less than 1 are considered to have low debt servicing capacity, with their debt at risk. The ICR is equal to earnings before interest expenses and taxes (EBIT) divided by interest expenses.

Sources: WorldScope database; and IMF staff estimates.

Banks' lending rates have risen since the second half of 2013, with Bank Indonesia's monetary tightening a factor.

Commercial Banks' Lending Rates

(In percent per annum, weighted average)

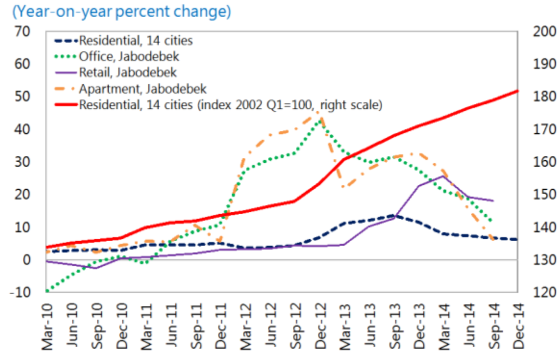


Source: CEIC Data Co. Ltd.

Higher borrowing costs and macro prudential measures have helped moderate growth in property prices.

Property Prices

(Year-on-year percent change)

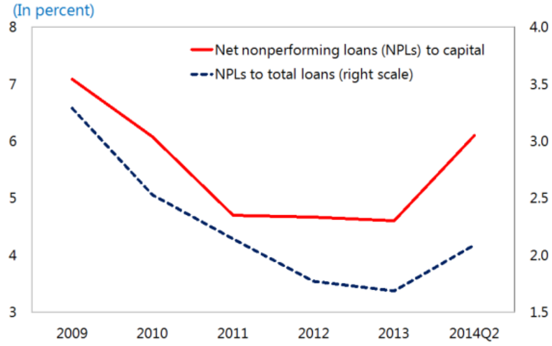


Source: Bank Indonesia, *Commercial Property Survey*.

Nonperforming loans in the banking system have begun to tick up with the turn in the credit cycle, but are still relatively low.

Commercial Bank Loan Quality

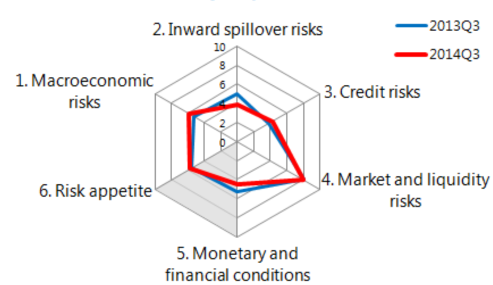
(In percent)



Sources: CEIC Data Company Ltd.; and IMF staff estimates.

On balance, macro-financial risks remain manageable, but market and liquidity risks are more elevated than others.

Indonesia: Financial Stability Map 1/



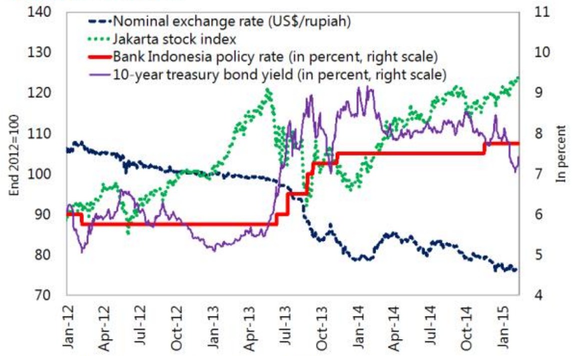
Source: IMF staff estimates.

1/ Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

Figure 2. Indonesia: Recent Market Developments

Greater policy credibility and supportive global conditions have helped stabilize financial markets in Indonesia....

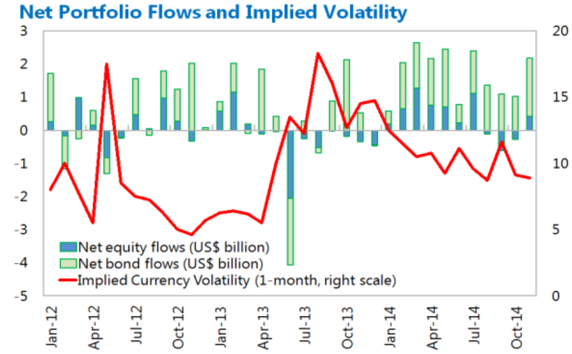
Financial Conditions



Source: Bloomberg LP; and IMF staff estimates.

...with portfolio inflows into local bond and equity markets supportive and implied volatility declining in 2014.

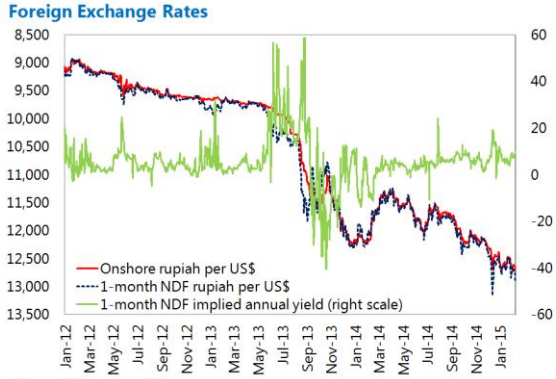
Net Portfolio Flows and Implied Volatility



Source: Bloomberg L.P.

Exchange rates have adjusted to absorb external pressures, aided by improvements in FX market functioning.

Foreign Exchange Rates

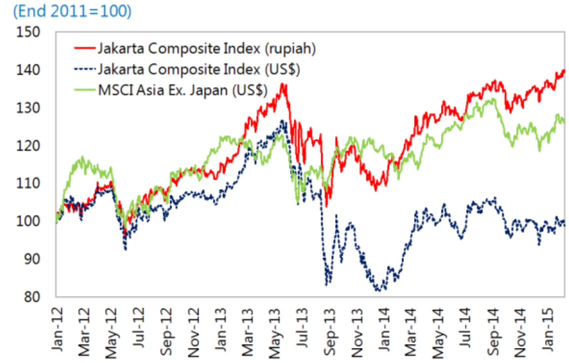


Source: Bloomberg L.P.

Equity prices, which fell by more than 25 percent during the mid-2013 sell-off, have recouped their losses.

Equity Market Indices

(End 2011=100)

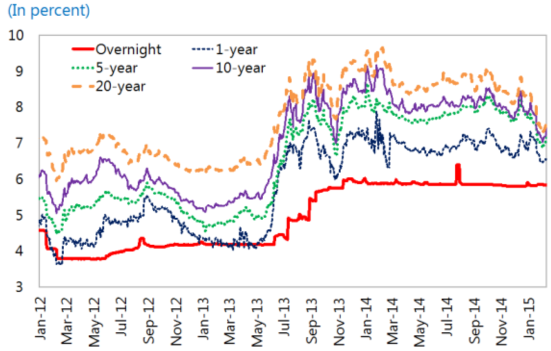


Sources: Bloomberg L.P.; and IMF staff estimates.

Domestic bond yields also stabilized in 2014, with the recent drop possibly reflective of lower inflation expectations and global monetary conditions.

Domestic Government Bond Yields

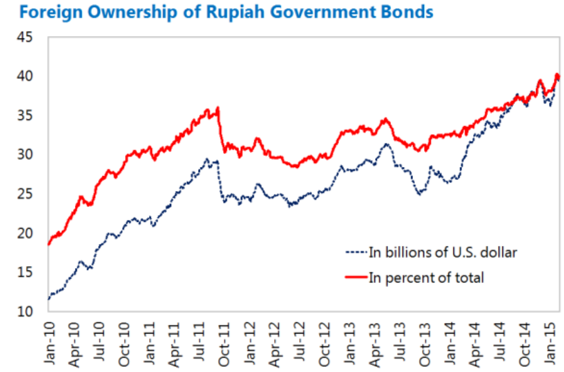
(In percent)



Source: Bloomberg L.P.

Key support has come from foreign investors, with their ownership of rupiah government bonds reaching record highs.

Foreign Ownership of Rupiah Government Bonds



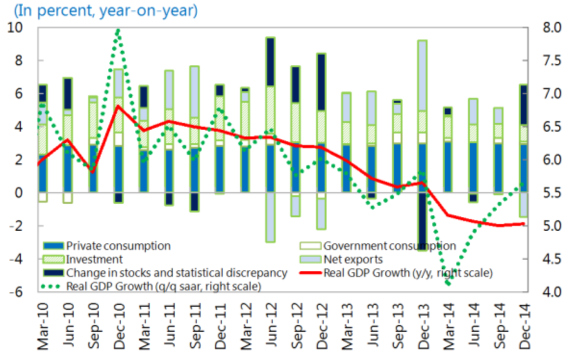
Sources: Bloomberg L.P.; and CEIC Data Co., Ltd.

Figure 3. Indonesia: Real Sector Activity

On the expenditure side, the growth slowdown is seen mainly in tepid investment demand and less supportive net exports given a sluggish resource sector.

Contribution to Real GDP Growth

(In percent, year-on-year)

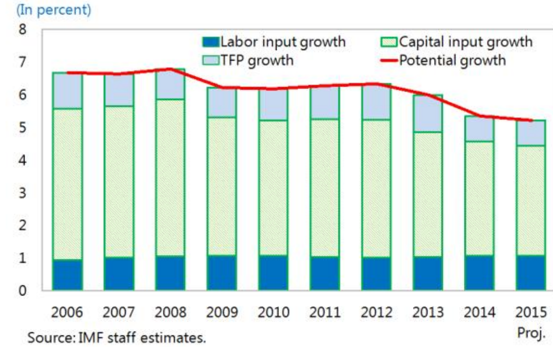


Sources: CEIC Data Company Ltd.; and IMF staff estimates.

Declines in potential growth appear to reflect lower capital accumulation and factor productivity related to the commodity down cycle.

Contribution to Potential GDP Growth

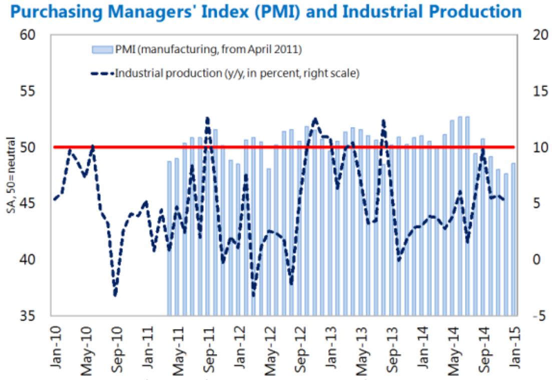
(In percent)



Source: IMF staff estimates.

Production indicators also point to slowing growth, with domestic factors likely weighing larger lately.

Purchasing Managers' Index (PMI) and Industrial Production

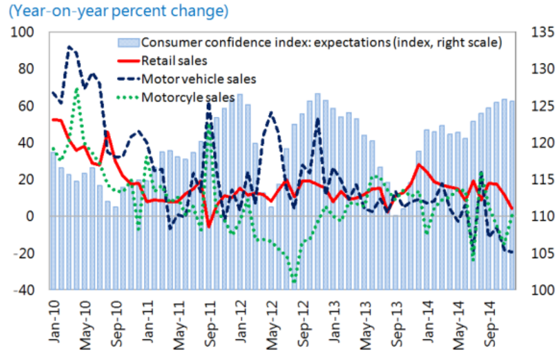


Sources: Haver Analytics; and CEIC Data Company Ltd.

Retail sales have softened, with weaker commodity related incomes, higher borrowing costs, and November 2014 fuel price increases as contributing factors.

Retail and Transport Sales and Consumer Sentiment

(Year-on-year percent change)

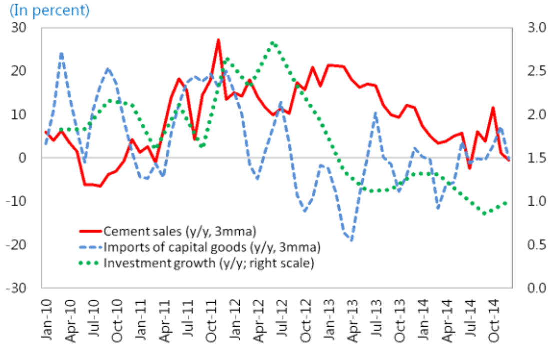


Sources: CEIC Data Company Ltd.

…while domestic cement sales and capital goods imports have followed similar trends to investment activity.

Investment Activity Indicators

(In percent)

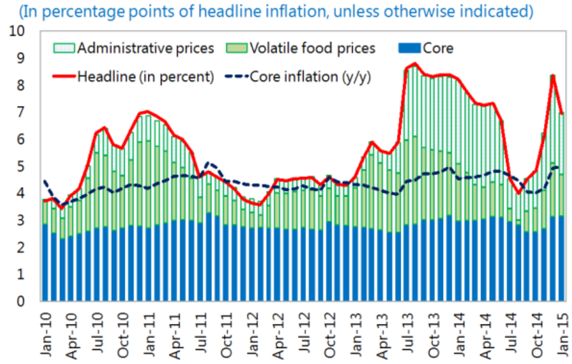


Source: CEIC Data Company Ltd.

Inflation peaked most recently in December 2014 on the heels of large increases in administered fuel prices, but has since fallen under more market-based fuel prices.

Inflation Developments

(In percentage points of headline inflation, unless otherwise indicated)



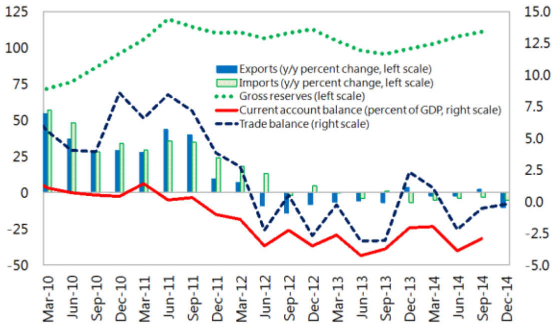
Sources: CEIC Data Company Ltd; and IMF staff estimates.

Figure 4. Indonesia: External Sector Developments

Notwithstanding continued pressures from commodities, the current account deficit has narrowed modestly in 2014…

External Developments

(In billions of U.S. dollar, unless otherwise indicated)

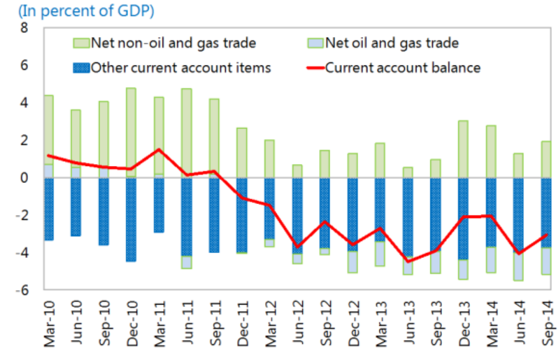


Source: CEIC Data Company Ltd.

…mainly due to improvement in the non-oil and gas trade surplus.

Current Account Balance

(In percent of GDP)

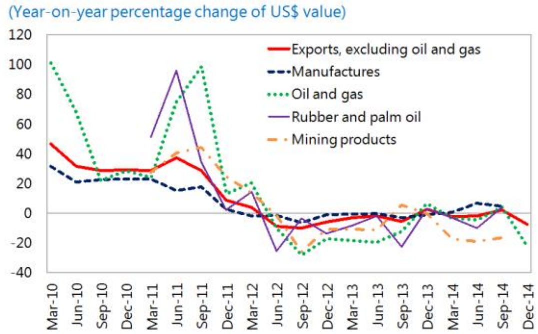


Sources: CEIC Data Company Ltd.; and IMF staff estimates.

This improvement has been spearheaded by a moderate pickup in manufactures exports growth…

Exports of Goods

(Year-on-year percentage change of US$ value)

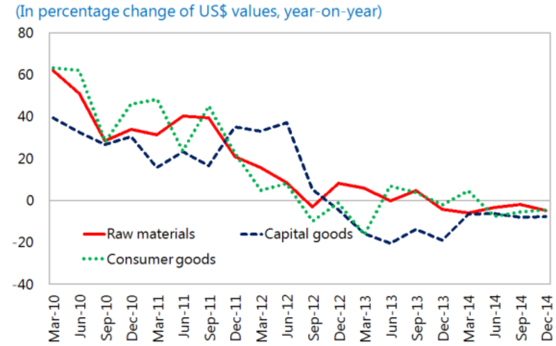


Sources: CEIC Data Company Ltd.; and IMF staff estimates.

…and has also been reflective of a slowdown in import growth, in line with adjustment measures and the rupiah's depreciation.

Imports of Goods

(In percentage change of US$ values, year-on-year)

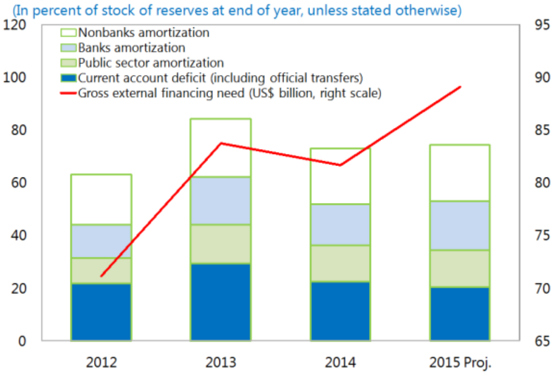


Source: CEIC Data Company Ltd.

External financing needs will remain sizeable in 2015, although they are expected to be stable as a share of foreign reserves.

Projected Gross External Financing Needs, 2015

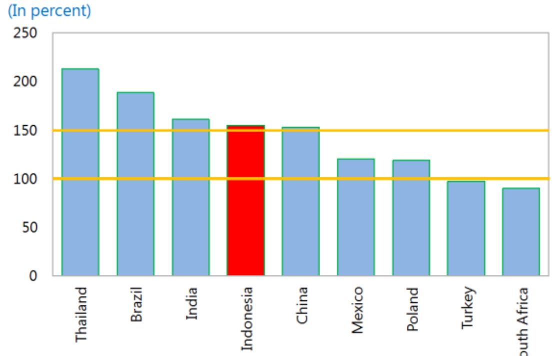
(In percent of stock of reserves at end of year, unless stated otherwise)



Indonesia's level of reserves is seen as sufficient to deal with most shocks and compares well against emerging market peers.

Reserve Adequacy Composite Metric, 2014

(In percent)

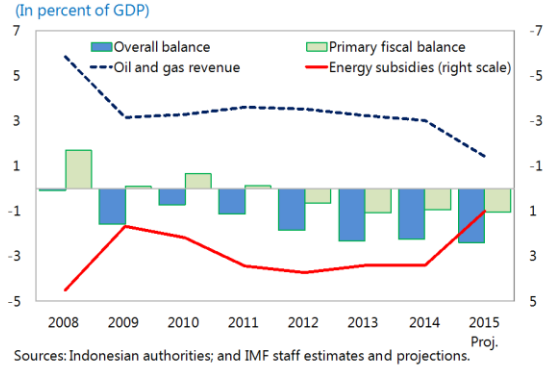


Sources: IMF, *International Financial Statistics*; and IMF staff estimates.

Figure 5. Indonesia: Fiscal Sector Performance

The central government fiscal deficit has widened since 2010, until recently driven by the rise in energy subsidies, while the fall in oil and gas revenues may limit improvements in 2015.

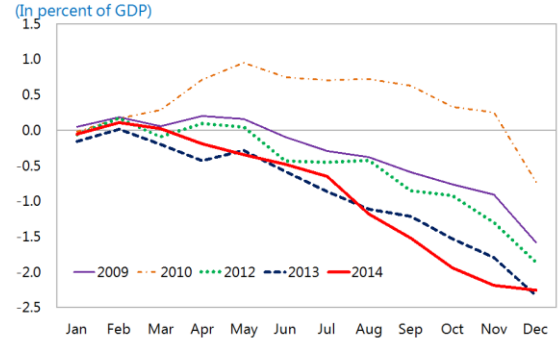
Fiscal Developments
(In percent of GDP)



Sources: Indonesian authorities; and IMF staff estimates and projections.

Budgetary pressures continued in 2014, although they eased somewhat toward year end because of the administered fuel price hike, which curbed fuel subsidies.

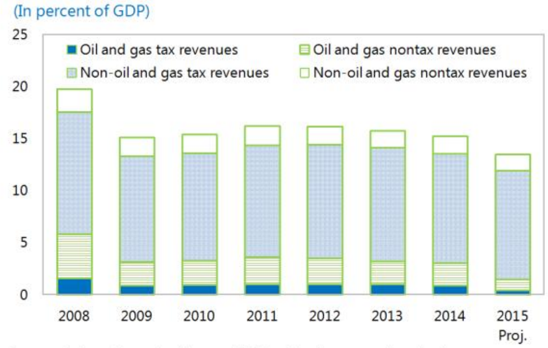
Fiscal Deficit Path, 2010-2014
(In percent of GDP)



Sources: Indonesian authorities; and IMF staff estimates.

Tax revenue as a share of GDP has stagnated with limited progress on nonresource revenue mobilization…

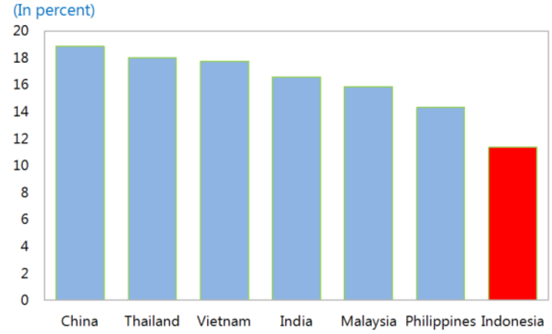
Central Government Revenue
(In percent of GDP)



Sources: Indonesian authorities; and IMF staff estimates and projections.

…leaving Indonesia with the lowest tax-to-GDP ratio among its regional peers.

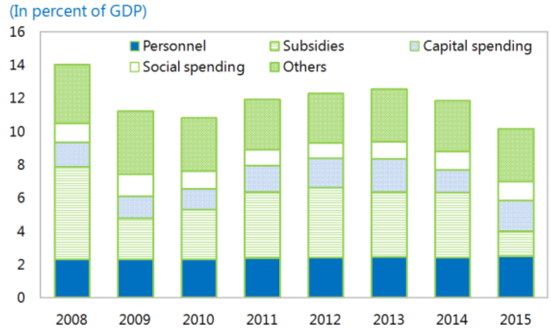
General Government Tax-to-GDP Ratio, 2014
(In percent)



Source: IMF, WEO database.

Fuel subsidy reforms are expected to free up space for growth-critical capital spending in 2015.

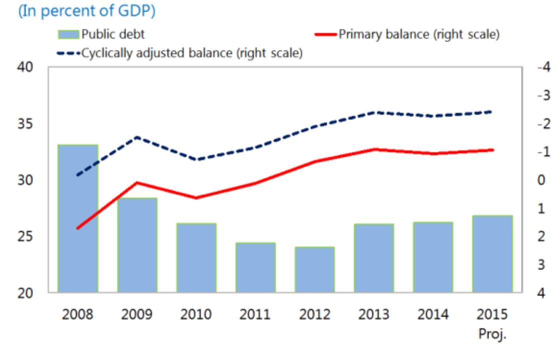
Central Government Expenditure 1/
(In percent of GDP)



Sources: Indonesian authorities; and IMF staff estimates and projections.
1/ Excludes transfers to local governments.

The public debt-to-GDP ratio has risen in recent years on weaker fiscal performance and currency depreciation, but it is expected to remain at a comparatively low level.

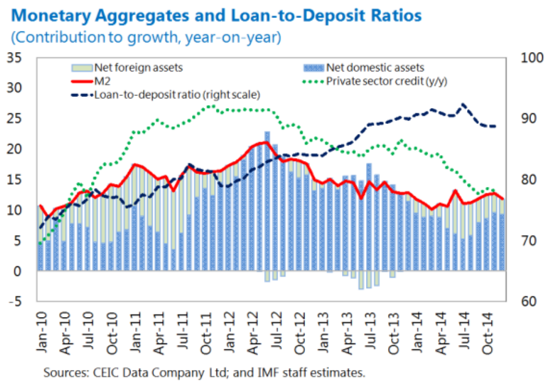
Public Debt, Primary, and Cyclically Adjusted Balance
(In percent of GDP)



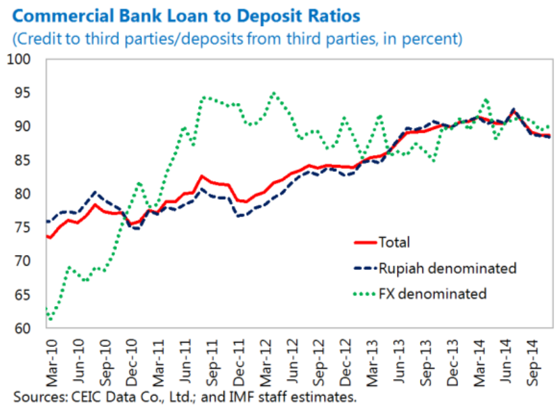
Sources: Indonesian authorities; and IMF staff estimates and projections.

Figure 6. Indonesia: Monetary Sector and Bank Liquidity Developments

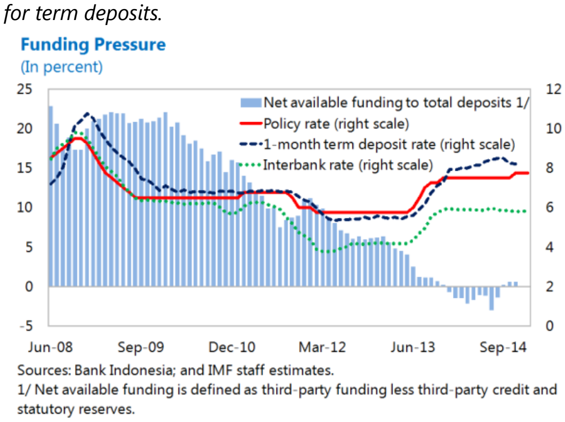
As noted earlier, credit growth has moderated, due to monetary policy tightening and macro prudential controls.



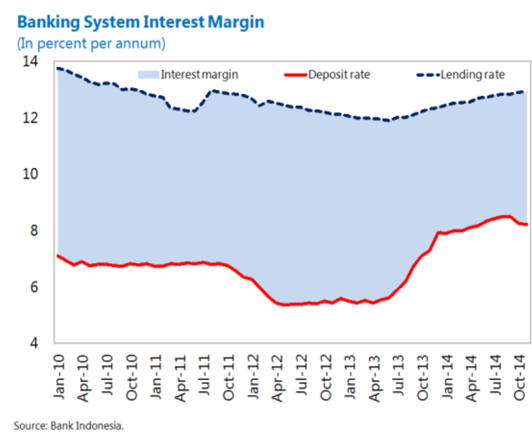
Despite slowing credit growth, loan-to-deposit ratios remain elevated.



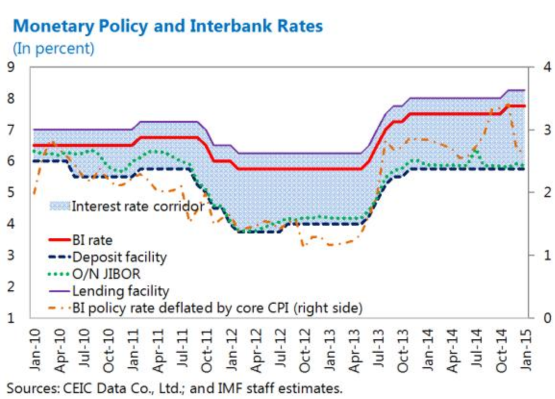
Net available funding has fallen sharply driven by slowing deposit growth, resulting in banks competing more intensely for term deposits.



Banks' interest margins have compressed, as deposit rates have risen sharply.



Bank Indonesia (BI) has maintained a tight monetary stance with higher real interest rates, but structural liquidity problems hamper policy transmission.



Banks still hold sizable excess reserves in BI's deposit facility, reflecting their self insurance in liquidity management until financial deepening measures firmly take hold.

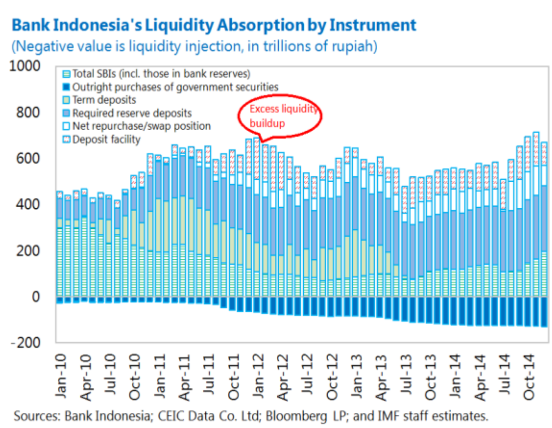


Table 1. Indonesia: Selected Economic Indicators, 2010–16

Nominal GDP (2014): Rp 10,095 trillion or US$851 billion
Population (2013): 248.8 million
Main exports (percent of total, 2013): Oil and gas (18.3), coal (13.3), palm oil (9.0), processed rubber (5.1)
GDP per capita (2013): US$3,510
Unemployment rate (August 2014): 5.94 percent
Poverty headcount ratio at national poverty line (2013): 11.4 percent of population

	2010	2011	2012	2013	2014			2015	2016
				Est.	Latest		Prel. 1/	Proj.	Proj.
Real GDP (percent change)	6.2	6.5	6.3	5.7	...	...	5.1	5.2	5.5
Domestic demand	5.4	6.0	7.9	5.2	...	...	5.1	4.8	5.1
Of which:									
Private consumption	4.7	4.7	5.3	5.3	...	...	5.5	5.0	5.0
Government consumption	0.3	3.2	1.3	4.9	...	...	2.1	3.4	4.2
Gross fixed investment	8.5	8.3	9.7	4.9	...	...	4.2	5.1	6.9
Change in stocks 2/	0.1	0.4	1.6	0.2	...	...	0.4	0.0	-0.2
Net exports 2/	0.9	1.5	-1.4	2.1	...	...	0.3	0.9	0.9
Saving and investment (in percent of GDP)									
Gross investment 3/	32.3	32.9	34.7	33.6	...	...	33.5	33.5	33.9
Gross national saving	33.0	33.1	31.9	30.3	...	...	30.5	30.7	31.2
Prices (12-month percent change)									
Consumer prices (end period)	7.0	3.8	3.7	8.1	...	...	8.4	4.5	4.8
Consumer prices (period average)	5.1	5.3	4.0	6.4	...	...	6.4	6.8	5.8
Public finances (in percent of GDP)									
Central government revenue	15.4	16.3	16.3	15.8	...	...	15.2	13.5	14.1
Central government expenditure	16.2	17.5	18.1	18.2	...	...	17.5	15.9	16.4
Of which: Energy subsidies	2.2	3.4	3.7	3.4	...	...	3.4	1.0	0.9
Central government balance	-0.7	-1.1	-1.9	-2.3	...	...	-2.3	-2.4	-2.3
Primary balance	0.6	0.1	-0.6	-1.1	...	...	-0.9	-1.1	-0.8
Central government debt	26.1	24.4	24.0	26.1	...	...	26.1	26.8	26.8
Money and credit (12-month percent change; end of period)									
Rupiah M2	16.5	17.4	14.4	9.4	14.5	Nov	13.5	13.5	...
Base money	28.9	18.3	14.9	16.7	13.9	Nov	11.6	11.9	...
Private sector credit	19.6	25.4	22.3	20.0	13.2	Nov	11.8	12.5	...
One-month interbank rate (period average)	6.4	6.2	4.4	5.8	...	...	7.5	...	...
Balance of payments (in billions of U.S. dollars, unless otherwise indicated)									
Current account balance	5.1	1.7	-24.4	-29.1	-20.0	Q1-Q3	-25.7	-24.3	-25.5
In percent of GDP	0.7	0.2	-2.8	-3.3	...	...	-3.0	-2.8	-2.7
Trade balance	31.0	33.8	8.7	5.8	4.5	Q1-Q3	7.8	11.3	11.7
Of which: Oil and gas (net)	3.2	-0.7	-5.2	-9.7	-9.1	Q1-Q3	-10.4	-7.4	-7.9
Inward direct investment	13.8	19.2	19.1	18.8	17.6	Q1-Q3	21.5	22.9	24.5
Overall balance	30.3	11.9	0.2	-7.3	12.8	Q1-Q3	13.6	8.0	5.6
Non-oil and gas exports, volume growth	0.2	10.4	7.4	4.3	...	...	2.4	3.6	6.5
Non-oil and gas imports, volume growth	16.8	12.3	16.5	-1.2	...	...	-5.0	2.5	7.4
Terms of trade, percent change (excluding oil)	10.4	7.3	-2.9	-3.5	...	...	-3.3	-4.1	1.4
Gross reserves									
In billions of U.S. dollars (end period)	96.2	110.1	112.8	99.4	...	...	111.9	119.9	125.5
In months of prospective imports of goods and services	6.1	6.2	6.4	6.0	...	...	7.2	7.2	6.9
As a percent of short-term debt 4/	224	236	206	175	...	...	173	178	179
Total external debt 5/									
In billions of U.S. dollars	202.4	225.4	252.4	265.6	292.3	Q3	297.5	316.7	333.4
In percent of GDP	28.5	26.7	28.7	30.5	34.3	Q3	35.0	36.2	35.6
Exchange rate									
Rupiah per U.S. dollar (period average)	9,088	8,774	9,375	10,414	...	...	11,862	...	...
Rupiah per U.S. dollar (end of period)	8,979	9,075	9,638	12,171	...	...	12,435	...	...
Memorandum items:									
Jakarta Stock Exchange (12-month percentage change, composite index)	46.1	3.2	12.9	-1.0	...	...	22.3	...	...
Oil production (thousands of barrels (bbls) per day)	945	907	860	830	...	...	794	825	840
Nominal GDP (in trillions of rupiah)	6,447	7,419	8,231	9,087	...	...	10,095	11,309	12,621

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

1/ For 2014, if an observation is shown in the "Latest" column, then the "Prel." column is a projection.
2/ Contribution to GDP growth (percentage points).
3/ Includes changes in stocks.
4/ Short-term debt on a remaining maturity basis.
5/ Public and private external debt.

Table 2. Indonesia: Selected Vulnerability Indicators, 2010–15

	2010	2011	2012	2013	2014 Prel.	2015 Proj. or latest	Observation
Key economic and market indicators							
Real GDP growth (in percent)	6.2	6.5	6.3	5.7	5.1	5.2	Proj.
CPI inflation (in percent, end of period (e.o.p.))	7.0	3.8	3.7	8.1	8.4	4.5	Proj.
Short-term (ST) interest rate (in percent, e.o.p.) 1/	6.3	4.9	4.8	7.6	6.6	6.5	Jan. 2015
Ten-year government bond yield (in percent, e.o.p.)	7.6	6.0	5.3	8.5	7.8	7.2	Jan. 2015
Indonesia EMBI spread (basis points (bps), e.o.p.)	183	274	179	292	266	282	Jan. 2015
Exchange rate (rupiah per U.S. dollar (e.o.p.))	8,979	9,075	9,638	12,171	12,435	12,670	Jan. 2015
External sector							
Current account balance (in percent of GDP)	0.7	0.2	-2.8	-3.3	-3.0	-2.8	Proj.
Net FDI inflows (in percent of GDP)	1.6	1.4	1.6	1.6	1.9	2.0	Proj.
Exports of goods and nonfactor services (GNFS) (percentage change, in US$ terms)	25.5	27.8	-0.9	-2.8	-4.4	-6.0	Proj.
Real effective exchange rate (e.o.p.; 2010=100)	100.3	99.4	94.5	83.6	92.5	92.2	Jan. 2015
Gross international reserves (in US$ billion)	96.2	110.1	112.8	99.4	111.9	114.2	Jan. 2015
In percent of ST debt at remaining maturity (RM)	224.2	235.5	206.4	175.4	172.7	176.4	Jan. 2015
Total gross external debt (in percent of exports of GNFS)	121.5	105.8	119.6	129.5	151.8	171.9	Proj.
Gross external financing requirement (in US$ billion) 2/	26.5	41.2	71.1	83.7	82.4	89.1	Proj.
Public sector (PS) 3/							
Overall balance (in percent of GDP)	-0.7	-1.1	-1.9	-2.3	-2.3	-2.4	Proj.
Primary balance (in percent of GDP)	0.6	0.1	-0.6	-1.1	-0.9	-1.1	Proj.
Gross PS financing requirement (in percent of GDP) 4/	3.3	2.5	3.9	3.9	4.2	4.0	Proj.
Public sector gross debt (PSGD) (in percent of GDP)	26.1	24.4	24.0	26.1	26.1	26.8	Proj.
Of which : Exposed to rollover risk (in percent of total PSGD) 5/	7.0	7.9	6.9	7.0	7.0	7.4	Proj.
Exposed to exchange rate risk (in percent of total PSGD) 6/	46.3	45.1	44.5	46.7	44.2	42.7	Proj.
Exposed to interest rate risk (in percent of total PSGD) 7/	9.0	8.3	7.4	5.2	4.0	2.9	Proj.
Financial sector (FS)							
Capital to risk-weighted assets (in percent) 8/	16.2	16.1	17.3	19.8	18.9	...	Jun. 2014
Nonperforming loans (in percent of total loans)	2.5	2.1	1.8	1.7	2.3	...	Oct. 2014
Foreign currency deposits at commercial banks (in percent of total deposits)	14.5	13.6	14.3	17.0	15.8	...	Nov. 2014
Foreign exchange loans at commercial banks (in percent of total loans)	14.6	15.6	15.0	16.5	15.5	...	Nov. 2014
Government debt held by financial system (percent of total financial system assets)	8.4	6.4	5.7	5.9	5.5	...	Nov. 2014
Total credit outstanding of banking system (annual percentage change)	23.3	24.7	23.1	21.4	11.7	...	Nov. 2014

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

1/ One-month Jakarta Interbank Offered Rate.
2/ Defined as current account deficit, plus amortization on medium- and long-term debt and short-term debt at end of previous period.
3/ Public sector covers central government only.
4/ Overall balance plus debt amortization.
5/ Short-term debt and maturing medium- and long-term debt.
6/ Debt in foreign currency or linked to the exchange rate.
7/ Government securities at variable interest rates.
8/ Includes capital charge for operational risk.

Table 3. Indonesia: Balance of Payments, 2010–16

(In billions of U.S. dollars, unless otherwise indicated)

	2010	2011	2012	2013	2014 Proj.	2015 Proj.	2016 Proj.
Current account	5.1	1.7	-24.4	-29.1	-25.7	-24.3	-25.5
Goods, net (trade balance)	31.0	33.8	8.7	5.8	7.8	11.3	11.7
Exports, f.o.b.	150.0	191.1	187.3	182.1	172.0	160.3	173.2
Oil and gas	28.7	38.1	35.6	33.6	29.0	16.3	19.3
Non-oil and gas 1/	121.3	153.0	151.8	148.5	143.1	144.0	153.9
Of which : Manufacturing	98.2	122.3	115.0	112.1	114.6	113.9	121.5
Palm Oil	13.4	19.4	18.4	16.6	16.8	15.2	16.0
Rubber Products	9.2	14.1	10.4	9.3	7.0	7.0	7.9
Other Manufacturing	75.5	88.7	86.2	86.3	90.8	91.7	97.6
Mining	25.5	34.3	31.4	31.1	23.1	24.4	26.3
Imports, f.o.b.	-119.0	-157.3	-178.7	-176.3	-164.2	-148.9	-161.5
Oil and gas	-25.4	-38.7	-40.8	-43.3	-39.4	-23.7	-27.2
Non-oil and gas	-93.5	-118.6	-137.9	-133.0	-124.8	-125.2	-134.3
Services, net	-9.8	-9.8	-10.6	-12.1	-11.1	-12.5	-12.8
Income, net	-20.7	-26.5	-26.6	-26.9	-27.3	-28.0	-29.6
Current transfers, net	4.6	4.2	4.1	4.0	4.9	4.9	5.2
Capital and financial account	26.5	13.6	24.9	22.0	42.3	32.3	31.1
Capital account	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Financial account	26.5	13.6	24.9	21.9	42.2	32.2	31.1
Direct investment, net	11.1	11.5	13.7	13.7	16.3	17.7	19.0
Abroad, net	-2.7	-7.7	-5.4	-5.2	-5.2	-5.2	-5.5
In Indonesia (FDI), net	13.8	19.2	19.1	18.8	21.5	22.9	24.5
Portfolio investment, net	13.2	3.8	9.2	9.5	25.8	17.6	15.7
Assets, net	-2.5	-1.2	-5.5	-1.3	-1.1	-2.1	-2.3
Liabilities	15.7	5.0	14.7	10.8	27.0	19.7	18.0
Equity securities	2.1	-0.3	1.7	-1.8	3.8	2.0	2.2
Debt securities	13.6	5.3	13.0	12.6	23.2	17.7	15.8
Other investment	2.3	-1.8	1.9	-0.9	0.4	-2.7	-3.2
Assets	-1.7	-6.8	-5.4	-3.4	-4.6	-5.6	-5.7
Public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	-1.7	-6.8	-5.4	-3.4	-4.6	-5.6	-5.7
Liabilities	4.0	5.0	7.3	2.5	5.1	2.9	2.5
Public sector	1.8	-2.3	2.5	-1.4	-2.6	-1.1	-1.8
Private sector	2.2	7.2	4.8	3.9	7.7	3.9	4.2
Total	31.7	15.3	0.5	-7.2	16.6	8.0	5.6
Errors and omissions 2/	-1.3	-3.5	-0.3	-0.2	-3.0	0.0	0.0
Overall balance	30.3	11.9	0.2	-7.3	13.6	8.0	5.6
Valuation changes	-0.2	2.1	2.4	-6.1	-1.1	0.0	0.0
Change in reserve assets (- = increase)	-30.1	-13.9	-2.7	13.4	-12.5	-8.0	-5.6
Memorandum items:							
Reserve assets position (eop)	96.2	110.1	112.8	99.4	111.9	119.9	125.5
In months of prospective imports of goods and services	6.1	6.2	6.4	6.0	7.2	7.2	6.9
In percent of short-term (ST) debt at remaining maturity (RM)	224	236	206	175	173	178	179
In percent of ST debt at RM plus the current account deficit	233	155	135	121	126	129	130
Current account (- deficit, percent of GDP)	0.7	0.2	-2.8	-3.3	-3.0	-2.8	-2.7
Non-oil and gas exports, volume growth	0.2	10.4	7.4	4.3	2.4	3.6	6.5
Non-oil and gas imports, volume growth	16.8	12.3	16.5	-1.2	-5.0	2.5	7.4
Terms of trade, percent change (excluding oil)	10.4	7.3	-2.9	-3.5	-3.3	-4.1	1.4
Terms of trade, percent change (including oil)	7.4	5.0	-3.1	-3.8	-2.3	7.9	-1.3

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

1/ Includes "other exports" category.
2/ For 2014, based on actual data for first three quarters.

Table 4. Indonesia: Medium-Term Macroeconomic Framework, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
		Est.				Proj.			
Real GDP (percent change)	6.3	5.7	5.1	5.2	5.5	5.8	6.0	6.0	6.0
Domestic demand	7.9	5.2	5.1	4.8	5.1	5.7	6.0	6.0	6.0
Of which:									
Private consumption	5.3	5.3	5.5	5.0	5.0	5.3	5.6	5.6	5.6
Gross fixed investment	9.7	4.9	4.2	5.1	6.9	7.6	7.8	7.8	7.8
Change in stocks 1/	1.6	0.2	0.4	0.0	-0.2	0.0	0.0	0.0	0.0
Net exports 1/	-1.4	2.1	0.3	0.9	0.9	0.7	0.7	0.6	0.6
Saving and investment (in percent of GDP)									
Gross investment 2/	34.7	33.6	33.5	33.5	33.9	34.4	34.8	35.3	35.8
Gross national saving	31.9	30.3	30.5	30.7	31.2	31.8	32.3	32.8	33.3
Foreign saving (external current account balance)	2.8	3.3	3.0	2.8	2.7	2.6	2.6	2.5	2.5
Prices (12-month percent change)									
Consumer prices (end period)	3.7	8.1	8.4	4.5	4.8	4.8	4.8	4.8	4.8
Consumer prices (period average)	4.0	6.4	6.4	6.8	5.8	4.8	4.8	4.8	4.8
Public finances (in percent of GDP)									
Central government revenue	16.3	15.8	15.2	13.5	14.1	14.4	14.7	14.8	14.9
Of which: Non-oil and gas tax revenues	10.9	10.9	10.5	10.5	10.7	10.9	11.2	11.3	11.5
Central government expenditure	18.1	18.2	17.5	15.9	16.4	16.4	16.4	16.5	16.6
Of which: Energy subsidies	3.7	3.4	3.4	1.0	0.9	0.4	0.1	0.1	0.1
Development expenditure	2.7	3.0	2.5	3.0	3.4	3.7	3.9	4.1	4.1
Central government balance	-1.9	-2.3	-2.3	-2.4	-2.3	-2.0	-1.8	-1.7	-1.6
Primary balance	-0.6	-1.1	-0.9	-1.1	-0.8	-0.6	-0.4	-0.4	-0.3
Central government debt	24.0	26.1	26.1	26.8	26.8	26.5	26.1	25.5	25.0
Balance of payments (in billions of U.S. dollars)									
Current account balance	-24.4	-29.1	-25.7	-24.3	-25.5	-26.7	-28.6	-29.9	-32.3
In percent of GDP	-2.8	-3.3	-3.0	-2.8	-2.7	-2.6	-2.6	-2.5	-2.5
Trade balance	8.7	5.8	7.8	11.3	11.7	13.2	15.1	16.8	17.4
Of which: Oil and gas (net)	-5.2	-9.7	-10.4	-7.4	-7.9	-9.0	-10.5	-12.3	-15.3
Overall balance	0.2	-7.3	13.6	8.0	5.6	7.9	7.4	5.6	5.4
Gross reserves									
In billions of U.S. dollars (end period)	112.8	99.4	111.9	119.9	125.5	133.4	140.8	146.4	151.8
In months of prospective imports of goods and services	6.4	6.0	7.2	7.2	6.9	6.8	6.6	6.3	6.2
As a percent of short-term debt 3/	206.4	175.4	172.7	177.8	179.3	183.0	185.6	186.0	185.9
Total external debt									
In billions of U.S. dollars	252.4	265.6	297.5	316.7	333.4	352.2	371.3	388.7	406.4
In percent of GDP	28.7	30.5	35.0	36.2	35.6	34.4	33.5	32.4	31.3
Memorandum items:									
Oil production (thousands of barrels per day)	860	830	794	825	840	810	780	750	720
Indonesian oil price (period average, in U.S. dollars per barrel)	112.7	105.8	96.2	51.4	59.9	65.1	68.3	70.3	71.7
Nominal GDP (in trillions of rupiah)	8,231	9,087	10,095	11,309	12,621	13,994	15,546	17,269	19,184
Nominal GDP (in billions of U.S. dollars)	878	871	851	...	...	...	...	...	...

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

1/ Contribution to GDP growth.
2/ Includes changes in stocks.
3/ Short-term debt on a remaining maturity basis.

Table 5. Indonesia: Summary of Central Government Operations, 2010–15

	2010	2011	2012	2013	2014		2015		
					Revised Budget	Prel. Est.	Budget	Revised Budget (proposed) 1/ 2/	Proj. 2/
					(In trillions of rupiah)				
Revenues and grants	995	1,211	1,338	1,439	1,635	1,537	1,794	1,769	1,529
Of which : Tax revenues	723	874	981	1,077	1,246	1,143	1,380	1,485	1,230
Oil and gas revenues	212	267	289	292	296	304	313	147	161
Tax revenues	59	73	83	89	84	87	89	51	46
Nontax revenues	153	193	206	204	212	217	224	96	115
Non-oil and gas revenues	781	939	1,043	1,140	1,337	1,230	1,477	1,619	1,364
Tax revenues	664	801	897	989	1,162	1,056	1,291	1,434	1,184
Nontax revenues	116	138	146	151	175	174	186	185	180
Grants	3	5	6	7	2	3	3	3	4
Expenditure and net lending	1,042	1,295	1,491	1,651	1,877	1,765	2,039	1,995	1,802
Current expenditure	548	695	790	864	1,023	943	1,132	956	812
Personnel	148	176	198	222	257	241	293	293	279
Subsidies	193	295	346	355	403	393	415	233	172
Of which : Energy subsidies	140	256	306	310	350	342	345	158	115
Fuel	82	165	212	210	246	240	276	82	63
Electricity	58	90	95	100	104	102	69	77	51
Interest	88	93	101	113	135	133	152	155	153
Other	119	130	145	175	227	176	272	275	208
Development expenditure	149	189	221	273	258	248	260	374	335
Capital spending	80	118	145	181	161	137	175	260	210
Social assistance spending	69	71	76	92	97	112	86	114	125
Transfers to local governments	345	411	481	513	597	574	647	664	655
Overall balance	-47	-84	-153	-212	-241	-227	-246	-226	-273
Financing	47	84	153	212	241	227	246	226	273
Domestic	26	72	121	159	...	195	...	...	201
External	20	13	32	53	...	32	...	...	72
					(In percent of GDP)				
Revenues and grants	15.4	16.3	16.3	15.8	16.3	15.2	16.1	14.9	13.5
Of which : Tax revenues	11.2	11.8	11.9	11.9	12.4	11.3	12.4	12.5	10.9
Oil and gas revenues	3.3	3.6	3.5	3.2	2.9	3.0	2.8	1.2	1.4
Tax revenues	0.9	1.0	1.0	1.0	0.8	0.9	0.8	0.4	0.4
Nontax revenues	2.4	2.6	2.5	2.2	2.1	2.1	2.0	0.8	1.0
Non-oil and gas revenues	12.1	12.7	12.7	12.5	13.3	12.2	13.3	13.6	12.1
Tax revenues	10.3	10.8	10.9	10.9	11.5	10.5	11.6	12.1	10.5
Nontax revenues	1.8	1.9	1.8	1.7	1.7	1.7	1.7	1.6	1.6
Grants	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	16.2	17.5	18.1	18.2	18.7	17.5	18.3	16.8	15.9
Current expenditure	8.5	9.4	9.6	9.5	10.2	9.3	10.2	8.0	7.2
Personnel	2.3	2.4	2.4	2.4	2.5	2.4	2.6	2.5	2.5
Subsidies	3.0	4.0	4.2	3.9	4.0	3.9	3.7	2.0	1.5
Of which : Energy subsidies	2.2	3.4	3.7	3.4	3.5	3.4	3.1	1.3	1.0
Fuel	1.3	2.2	2.6	2.3	2.4	2.4	2.5	0.7	0.6
Electricity	0.9	1.2	1.1	1.1	1.0	1.0	0.6	0.6	0.5
Interest	1.4	1.3	1.2	1.2	1.3	1.3	1.4	1.3	1.4
Other	1.9	1.8	1.8	1.9	2.3	1.7	2.4	2.3	1.8
Development expenditure	2.3	2.5	2.7	3.0	2.6	2.5	2.3	3.2	3.0
Capital spending	1.2	1.6	1.8	2.0	1.6	1.4	1.6	2.2	1.9
Social assistance spending	1.1	1.0	0.9	1.0	1.0	1.1	0.8	1.0	1.1
Transfers to local governments	5.3	5.5	5.8	5.6	5.9	5.7	5.8	5.6	5.8
Overall balance	-0.7	-1.1	-1.9	-2.3	-2.4	-2.3	-2.2	-1.9	-2.4
Financing	0.7	1.1	1.9	2.3	2.4	2.3	2.2	1.9	2.4
Domestic	0.4	1.0	1.5	1.7	...	1.9	...	...	1.8
External	0.3	0.2	0.4	0.6	...	0.3	...	...	0.6
Memorandum items:									
Net issuance of government securities (in trillions of rupiah)	91	120	160	225	265	265	277	308	343
Primary balance (percent of GDP)	0.6	0.1	-0.6	-1.1	-1.1	-0.9	-0.8	-0.6	-1.1
Cyclically-adjusted primary balance (percent of GDP)	0.7	0.1	-0.7	-1.1	...	-0.9	...	...	-1.1
General government debt (percent of GDP)	26.1	24.4	24.0	26.1	...	26.1	...	...	26.8
Indonesian crude oil price (US$ per barrel)	79.4	111.5	112.7	105.8	105.0	96.2	105.0	70.0	51.4
Oil production (thousands of barrels per day)	945	907	860	830	818	794	900	849	825
GDP (in trillions of rupiah)	6,447	7,419	8,231	9,087	10,063	10,095	11,147	11,881	11,309

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

1/ Submitted to Parliament on January 9, 2015.

2/ Incorporates additional issuance of government securities to recapitalize state-owned enterprises (equivalent to 0.5 percent of GDP), as envisaged in the revised budget proposal.

Table 6. Indonesia: Summary of General Government Operations, 2010–15

	2010	2011	2012	2013	2014 Prel. Est.	2015 Proj.
			(In trillions of rupiah)			
Total revenue and grants	1,074	1,336	1,486	1,632	1,752	1,769
Taxes	771	947	1,075	1,181	1,259	1,360
Taxes on income, profits, and capital gains	357	431	465	506	548	562
Taxes on goods and services	297	355	433	493	523	598
VAT and luxury taxes	231	278	338	385	405	458
Excise	66	77	95	108	118	140
Taxes on international trade and transactions	29	54	50	47	43	35
Taxes not elsewhere classified	88	107	127	134	145	165
Grants	3	5	6	7	3	4
Other revenue	300	384	406	444	490	406
Total expenditure	1,159	1,383	1,623	1,823	1,980	2,042
Expense	905	1,062	1,255	1,389	1,554	1,506
Of which :						
Compensation of employees	347	404	465	517	570	647
Purchases/use of goods and services	98	125	141	170	163	194
Interest	88	93	101	113	133	153
Fuel subsidies	140	256	306	310	342	115
Net acquisition of nonfinancial assets	254	320	367	433	426	537
Net lending/borrowing	-85	-47	-137	-190	-227	-273
Net acquisition of financial assets	1	55	-1	29	23	64
Of which : policy lending	9	4	4	4	0	0
Net incurrence of liabilities	87	102	136	219	251	337
			(In percent of GDP)			
Total revenue and grants	16.7	18.0	18.1	18.0	17.4	15.6
Taxes	12.0	12.8	13.1	13.0	12.5	12.0
Taxes on income, profits, and capital gains	5.5	5.8	5.7	5.6	5.4	5.0
Taxes on goods and services	4.6	4.8	5.3	5.4	5.2	5.3
VAT and luxury taxes	3.6	3.7	4.1	4.2	4.0	4.0
Excise	1.0	1.0	1.2	1.2	1.2	1.2
Taxes on international trade and transactions	0.4	0.7	0.6	0.5	0.4	0.3
Taxes not elsewhere classified	1.4	1.4	1.5	1.5	1.4	1.5
Grants	0.0	0.1	0.1	0.1	0.0	0.0
Other revenue	4.7	5.2	4.9	4.9	4.9	3.6
Total expenditure	18.0	18.6	19.7	20.1	19.6	18.1
Expense	14.0	14.3	15.3	15.3	15.4	13.3
Of which :	0.0	0.0	0.0	0.0	0.0	0.0
Compensation of employees	5.4	5.4	5.7	5.7	5.6	5.7
Purchases/use of goods and services	1.5	1.7	1.7	1.9	1.6	1.7
Interest	1.4	1.3	1.2	1.2	1.3	1.4
Fuel subsidies	2.2	3.4	3.7	3.4	3.4	1.0
Net acquisition of nonfinancial assets	3.9	4.3	4.5	4.8	4.2	4.7
Net lending/borrowing	-1.3	-0.6	-1.7	-2.1	-2.3	-2.4
Net acquisition of financial assets	0.0	0.7	0.0	0.3	0.2	0.6
Of which : policy lending	0.1	0.1	0.0	0.0	0.0	0.0
Net incurrence of liabilities	1.3	1.4	1.7	2.4	2.5	3.0

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

Table 7. Indonesia: Monetary Survey, 2010–2015

(In trillions of rupiah, unless otherwise indicated, end of period)

	2010	2011	2012	2013	2014 Proj.	2015 Proj.
Bank Indonesia						
Net foreign assets	774	958	1,056	1,166	1,349	1,541
Net domestic assets	-256	-345	-351	-343	-431	-513
Monetary base	518	613	705	823	918	1,028
Monetary survey						
Net foreign assets	810	904	965	1,008	1,173	1,205
Net domestic assets	1,661	1,973	2,343	2,723	3,007	3,505
Net claims on central government	375	403	471	493	559	748
Claims on other nonfinancial public sector	101	104	161	211	241	277
Private sector credit	1,684	2,111	2,581	3,098	3,465	3,898
Other items, net	-499	-645	-871	-1,079	-1,258	-1,417
Broad money 1/	2,471	2,877	3,308	3,730	4,180	4,710
Rupiah M2	2,140	2,513	2,874	3,144	3,568	4,050
Currency in circulation	260	308	362	400	529	608
Deposits	1,880	2,205	2,512	2,744	3,115	3,535
Foreign currency deposits	322	350	423	564	592	640
			(Annual percentage change)			
Broad money	15.4	16.4	15.0	12.8	12.1	12.7
Rupiah M2	16.5	17.4	14.4	9.4	13.5	13.5
Deposits	16.7	17.3	13.9	9.2	13.5	13.5
Monetary base	28.9	18.3	14.9	16.7	11.6	11.9
Private sector credit	19.6	25.4	22.3	20.0	11.8	12.5
Memorandum items:						
Money multiplier (rupiah M2)	4.1	4.1	4.1	3.8	3.9	3.9
Base money velocity 2/	12.4	12.1	11.7	11.0	11.0	11.0
Rupiah M2 velocity 2/	3.0	3.0	2.9	2.9	2.8	2.8
Credit by borrower (annual percentage change)						
Corporate	...	23.9	25.8	25.2	...	...
Non-corporate	...	24.4	20.6	18.1	...	...
Credit by sector (annual percentage change)						
Agriculture	19.6	25.6	29.4	23.9	...	...
Mining	45.6	41.4	18.9	22.8	...	...
Manufacturing	11.4	25.0	29.5	29.3	...	...
Services	27.6	23.4	22.8	23.0	...	...
Household	...	24.4	19.9	14.1	...	...

Sources: Bank Indonesia; and IMF, *International Financial Statistics,* and staff projections.

1/ Includes securities classified as broad money.
2/ Calculated using end-period quarterly GDP, annualized.

Table 8. Indonesia: Financial Soundness Indicators, 2009-2014:Q2

(In percent, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014:Q2
Depository institutions						
Capital adequacy						
Regulatory capital to risk-weighted assets	17.8	16.2	16.1	17.3	19.8	18.9
Regulatory Tier-1 capital to risk-weighted assets	16.0	15.1	14.7	15.7	18.3	17.7
Capital to assets	10.1	10.7	11.0	12.2	12.5	12.7
Nonperforming loans, net of provisions to capital	7.1	6.1	4.7	4.7	4.6	6.1
Large exposures to capital	3.1	1.4	0.5	0.5	0.8	0.7
Net open position in foreign exchange to capital	3.3	3.1	3.0	3.3	1.7	1.9
Gross asset position in financial derivatives to capital	3.4	2.2	1.8	1.6	4.2	2.7
Gross liability position in financial derivatives to capital	2.5	1.4	1.7	1.5	4.9	3.1
Asset quality						
Nonperforming loans to total gross loans	3.3	2.5	2.1	1.8	1.7	2.1
Specific provisions to nonperforming loans	62.3	57.1	60.7	52.0	50.9	46.8
Earning and profitability						
Return on assets	2.6	2.7	2.9	3.1	3.1	2.9
Return on equity	26.8	25.9	25.4	25.3	24.5	22.6
Interest margin to gross income	62.5	60.5	59.8	65.0	68.8	68.0
Trading income gross income	4.2	4.6	3.5	3.2	3.2	2.7
Noninterest expenses to gross income	47.1	49.2	49.0	48.8	49.2	48.6
Personnel expenses to noninterest expenses	40.9	37.3	36.0	40.5	41.3	41.7
Liquidity and funding						
Liquid assets to total assets	28.7	27.2	26.2	25.7	23.5	23.6
Liquid assets to short-term liabilities	33.9	32.1	31.2	36.4	30.5	34.3
Non-interbank loans to customer deposits	77.5	80.4	84.4	93.2	99.6	99.2
Sensitivity to market risk						
Foreign currency denominated loans to total loans	14.9	15.6	16.6	15.2	17.0	16.1
Foreign currency denominated liabilities to total liabilities	17.8	16.5	16.3	18.6	24.4	22.0
Nonfinancial corporations						
Corporate debt (in percent of GDP) 1/	24.1	22.9	24.5	28.2	33.9	33.6
Leverage 2/						
Total liabilities to total assets	46.1	45.4	45.6	45.0	46.8	50.9
Profitability 2/						
Return on assets	15.5	16.3	17.8	16.9	14.8	14.5
Liquidity 2/						
Current assets to current liabilities	207.6	216.6	213.0	211.5	249.1	251.1
Liquid assets to current liabilities	132.5	135.1	131.4	123.8	172.3	182.7
Debt servicing capacity						
Companies with negative equity (in percent of total assets)	2.5	1.8	0.7	1.2	4.9	...
Companies with financial distress (in percent of total debt) 3/	21.8	13.6	11.2	23.3	29.6	...
Households						
Household debt (in percent of GDP) 4/	14.5	16.3	17.9	19.2	20.3	20.0
Real estate markets						
Residential real estate prices (year-on-year percentage change)	2.3	2.9	5.0	6.8	11.5	7.4
Residential real estate loans to total loans	...	7.7	8.2	7.8	8.0	8.5
Commercial real estate loans to total loans	...	6.1	6.0	6.0	6.3	6.8

Sources: Bank Indonesia; BIS, *Debt Securities Statistics*; Bloomberg L.P.; IMF, *Financial Soundness Indicators* database; WorldScope; and IMF staff estimates.

1/ Corporate debt is estimated based on outstanding credit from domestic and foreign financial institutions, as well as outstanding debt securities issued in Indonesia and abroad, using the types-of-borrowers concept.

2/ Based on capitalization-weighted average of listed companies.

3/ Companies with financial distress are those with earnings before interest, tax, depreciation and amortization (EBIT) less than interest payments.

4/ Household debt comprises credit from domestic financial institutions to other private sector including social foundations, cooperatives, and individuals, as compiled and reported by Bank Indonesia, based on the types-of-borrowers concept.

Table 9. Indonesia: Key Social Indicators

Life expectancy at birth, total	70.6	years	(2012)
Mortality rate, under 5	29.3	per 1,000 live births	(2013)
Secondary school enrollment:			
Total	82.5	percent	(2012)
Female	83.9	percent	(2012)
GINI index	35.6		(2010)
Income share held by highest 20 percent	43.7	percent	(2010)
Income share held by lowest 20 percent	7.6	percent	(2010)
CO2 emissions	1.8	metric tons per capita	(2010)
Population with access to safe water	84.9	percent	(2012)
Population with access to sanitation	58.8	percent	(2012)
Human development index	0.68		(2013)
Rank	108		
Gender inequality index	0.50		(2013)
Rank	103		
Labor force participation rate, female for ages 15–64	53.3		(2011)

Sources: World Bank; and United Nations Development Program.

Appendix I. Indonesia—Risk Assessment Matrix[1]

	Source of Risks	Relative Likelihood	Expected Impacts	Recommended Policy Responses
Global	**Protracted period of slower growth in advanced and emerging economies, accompanied by a sustained decline in commodity prices**	**High**	**High** Lower demand or prices for commodity exports could widen the current account deficit, adding to balance of payments (BOP) pressures and reserve losses. The fiscal balance would deteriorate on weaker resource revenues and knock-on effects to domestic demand, while the financial sector could be exposed to losses from loans to the commodity sector and a broader slowdown in the economy. The corporate sector could be vulnerable to declining profits stemming from commodity related activities and incomplete hedging of external borrowing.	Maintain exchange rate flexibility to help reduce the current account deficit and limit reserve losses. Fiscal measures to contain the budget deficit might be necessary if the slowdown in EMs were accompanied by protracted financial market volatility that restricts funding. Accelerate infrastructure spending and structural reforms to boost productivity, employment in non-resource sectors and export diversification.
Global	**Side-effects from changes in global financial conditions:** • **A surge in financial market volatility, as investors reassess underlying risk and move to safe-haven assets, given slow and uneven growth as well as asymmetric monetary exit**	**High**	**High** Portfolio and FDI inflows could be curtailed by weaker investor appetite due to re-weighting of EM assets, with tighter funding conditions adding to pressure on the BOP, government financing, and the financial and corporate sectors. Bank funding could become constrained, raising domestic borrowing costs. A severe pinch in credit growth or spike in lending rates could hit corporate and household balance sheets (including property) and reinforce negative growth dynamics through asset price corrections and confidence losses.	Maintain exchange rate flexibility. Further boost investor confidence by maintaining a prudent fiscal position, while allowing automatic stabilizers to work in case of an extreme economic slowdown, and using contingent financing if market access is restricted. Monetary policy tightening would need to be combined with targeted measures to alleviate funding pressures faced by some segments of the banking system to avoid reinforcing financial stresses brought on by market volatility and capital outflows.
Global	• **Persistent dollar strength, with improving U.S. economic prospects versus the rest of the world leading to a further dollar surge, boosting non-U.S. trade but creating balance sheet strains for dollar debtors**	**Medium**	**Medium** Capital outflows accompanying a more persistent and disorderly adjustment of exchange rates could have disruptive effects on financial asset prices while tightening domestic financial conditions. Adverse financial spillovers associated with balance sheet mismatches could intensify corporate vulnerabilities, given the sharp rise in foreign currency borrowing by firms in recent years, although overall levels are still moderate.	Similar policy response as above combined with heightened monitoring of corporate sector vulnerabilities and firm implementation of measures to encourage hedging of corporate external debt. Maintain vigilance on exchange rate pass-through to inflation.
Domestic	**Bank liquidity pressures causing distress at small banks, exacerbated by gaps in the financial stability architecture**	**Medium**	**Medium** Gaps in existing financial safety nets or reluctance to trigger corrective actions at smaller banks facing pressures amplify risks for the financial system as a whole.	Ensure crisis management framework is fully tested, with clear lines of communications among financial regulators and agreed protocols on bank resolution and emergency liquidity support, absent passage of the Financial System Safety Net Law.
Domestic	**Failure of a major corporate group, triggered by excessive FX exposure or debt leverage and possibly exacerbated by commodity sector weakness, affecting investor confidence, with banking system spillovers**	**Low-Medium**	**Medium** Business and investor confidence would be affected, with the failure raising NPLs, increasing the country risk premium, and creating knock-on effects in the banking system. A second-round impact could come through subsequent layoffs and weaker domestic demand. Refinancing risk for the sector as a whole could also rise.	Closely monitor highly leveraged corporate borrowers with large FX exposures. Undertake expeditious corporate debt restructuring, with timely and well coordinated supervisory actions to preserve banking system soundness.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Appendix II. Indonesia—External Assessment

(Updated January 2015)

Foreign asset and liability position and trajectory	**Background**. At end September 2014, Indonesia's net international investment position (NIIP) position stood at -49 percent of GDP, compared to -44 percent of GDP at end 2013. The components as a percent of GDP were reserves (+13), net FDI (-26), net equities (-12), net portfolio debt (-10), and other investment (-13). About half of the change was due to strong equity inflows in 2014. At end September 2014, gross external liabilities stood at 74 percent of GDP (up from 66 percent of GDP at end 2013). Indonesia's gross external debt is relatively low at 34 percent of GDP as of end September 2014. **Assessment**. The EBA external sustainability approach suggests Indonesia's cyclically-adjusted current account (CA) deficit is 2.5 percent of GDP, better than the 3.5 percent needed to stabilize the NIIP. The level and composition of the NIIP and gross external debt indicate that Indonesia's external position is sustainable, but non-resident holdings of rupiah debt could be affected by global volatility, which at end October 2014 stood at 5.3 percent of GDP.
Current account	**Background**. Indonesia's CA deficit is projected at 3.0 percent of GDP in 2014, compared to 3.3 percent of GDP in 2013. Rising manufacturing exports and falling oil prices have compensated for declines in other commodity exports. The CA deficit is projected to fall to 2.8 percent of GDP in 2015, in part due to a depreciation of the real effective exchange rate (REER) since mid-2013, continued support from manufactured exports, and an expected continuation of relatively tight monetary policy. **Assessment**. The EBA CA results suggest a gap of -1.9 percent of GDP for 2014 (based on a cyclically adjusted CA balance of –2.3 percent of GDP and a norm of -0.4 percent of GDP). However, taking uncertainties into account, staff believes a norm of –1.5 percent of GDP (±1 percent of GDP) more accurately reflects Indonesia's significant investment needs. This suggests a CA gap of about -1 percent of GDP (±1 percent of GDP), which reflects domestic policy gaps in social spending and capital account controls, as well as external policy gaps (particularly fiscal deficits) in partner countries.
Real exchange rate	**Background**. After sizable depreciation in the second half of 2013, the REER appreciated at end 2014 reflecting a temporary increase in inflation related to fuel price increases. **Assessment**. EBA REER results suggest an undervaluation of about 8 percent at end 2014, compared with undervaluation of 2 percent for 2013. The change in the estimates is driven by movement in the unexplained residual, i.e. the fall in the actual REER, even though the REER norm remained relatively unchanged. Using the CA gap estimate of -1 percent of GDP (± 1 percent of GDP) and standard elasticities, staff's assessment is that the REER is overvalued by around 5 percent (± 5 percent). Over the medium term, the lagged effects of the weaker rupiah should help lower the CA deficit. However, with commodities making up nearly half of Indonesia's exports, the impact of a weaker rupiah on the CA deficit could be largely offset by falling world commodity prices and/or Indonesia export volumes. With reduced fuel subsidies and monetary policy focused on low and stable inflation and balance of payments adjustment, staff recommends continued exchange rate flexibility and broad-based structural reforms to absorb external shocks and strengthen Indonesia's competitiveness.
Capital and financial accounts: flows and policy measures	**Background**. Indonesia's gross external financing requirement is expected to be 9.6 percent of GDP for 2014, with amortization at 6.7 percent, of GDP. Net inward FDI and new borrowing are projected at 2.5 percent and 9.4 percent of GDP, respectively, with a reserves increase accounting for the rest. On capital controls, Indonesia ranks as more restrictive than other countries in the sample. **Assessment**. Net and gross financial flows appear sustainable, but could dissipate or reverse in the event of large domestic or external shocks. Continued strong policies focused on strengthening the fiscal position, keeping inflation in check, and easing supply bottlenecks would help sustain capital inflows in the medium term.
FX intervention and reserves level	**Background**. Since mid 2013, Indonesia has had a more flexible exchange rate policy framework. Its floating regime has better facilitated adjustments in exchange rates to market conditions. As of end 2014, reserves stood at US$111.9 billion (equal to 160 percent of IMF's reserve adequacy metric—assuming a floating exchange rate—and 7 months of imports of goods and services). In addition, the government has in place contingencies and swap lines equivalent to around US$76 billion. **Assessment**. Continued external imbalances or volatile capital flows could cause reserves to decline significantly. Nonetheless, current levels of reserves should be sufficient to absorb such shocks. Intervention should aim primarily at smoothing volatility, while allowing the exchange rate to adjust to external shocks.

Overall Assessment

Overall Assessment:

Indonesia's external position in 2014 is moderately weaker than implied by medium-term fundamentals and desirable policies.

However, policy actions since mid 2013 (monetary policy tightening exchange rate and bond yield flexibility, and fuel subsidy reforms) should help improve the external position. External financing appears sustainable, but could be affected by domestic or external shocks.

Potential Policy Responses

Monetary policy should continue to focus on containing inflation within Bank Indonesia's target band and facilitating external adjustment. Fiscal policy can support monetary policy in bringing external adjustment and help contain vulnerability to funding pressures by aiming for a small primary deficit over the medium term, led by reforms aimed at increasing the tax take. Continued flexibility of the exchange rate and use of market-determined interest rates would also help facilitate adjustment and absorb shocks. Easing trade and investment restrictions, expanding public infrastructure, deepening financial markets, and improving labor markets would promote growth and competitiveness over the medium term.

Appendix III. Indonesia—Debt Sustainability Analysis

Indonesia's external debt remains at a moderate level and is projected to be sustainable over the medium term. Growth in private external debt is expected to slow as global financial conditions tighten and borrowing costs rise. Public debt remains low, but contingent liabilities arising from borrowing by state corporations pose some fiscal risk.

External Debt Sustainability

1. **Indonesia's external debt-to-GDP ratio has been rising in recent years, but total external debt remains at a moderate level**. The main reasons for the increase have been a rise in private external borrowing (including by state-owned enterprises (SOEs)) and the depreciation of the exchange rate. As a share of GDP, external debt was 30½ at end 2013, up from a low of 26¾ percent at end 2011, and is expected to have reached 35 percent at end 2014 (Figure 1 and Table 1).

2. **Looking ahead, external debt is projected to stabilize in the medium term**. Under the baseline, debt rises slightly to 36 percent of GDP at end 2015 before declining to 32 percent by end 2019 in line with a gradual narrowing of the current account deficit and increase in FDI and equity inflows. The modest improvements in the current account balance would be aided by trade and investment reforms that boost manufactured exports and by comparatively lower oil prices than in recent years. Public external debt may increase above the current baseline if the government increases reliance on external financing (including multilateral loans) to help fund infrastructure projects. With the exception of borrowing by SOEs, which may also be used for infrastructure development, the growth in private external debt is expected to slow owing mainly due to an expected tightening in global financial conditions. Real growth is projected to average about 5½ percent over the medium term and 6 percent in the longer run.

3. **External sustainability is robust to interest rate and GDP shocks, but is more sensitive to current account and exchange rate shocks** (Figure 2). A further deterioration in the current account balance from the current level would cause the external debt ratio to rise moderately (a one standard deviation shock would raise the external debt to GDP ratio to 37 percent by 2019). Exchange rate depreciation would have the largest impact; a 30 percent depreciation would raise the external debt to GDP ratio to about 50 percent in 2015 followed by a small decline to 45 percent of GDP by 2019.

Public Debt Sustainability

4. **Public sector debt remains low in Indonesia**. General government debt as a percent of GDP declined steadily from 95 percent in 2000 to 24 percent in 2012, owing to a prudent fiscal stance, which has been anchored by the fiscal rule since in 2003 that caps the general government deficit at 3 percent of GDP a year. The debt dynamics have also been favorable, with strong GDP growth and moderate real interest rates. Exchange rate depreciation has

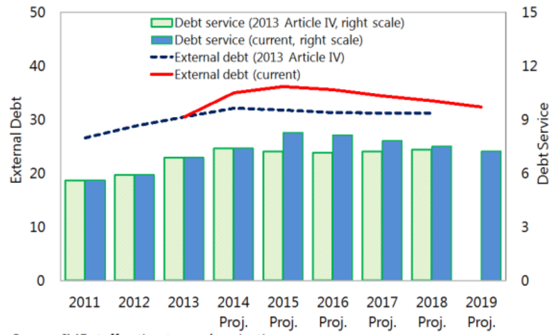
increased the debt ratio moderately since 2012. At the same time, foreign currency denominated debt has fallen to less than half of total public sector debt, as issuance in the domestic rupiah bond market has grown rapidly and attracted strong foreign interests. Notwithstanding, dependence on foreign investors remains sizable, with the share of foreign ownership of rupiah-denominated government bonds rising from about 20 percent in 2009 to 38 percent as of end 2014.

5. **Under the baseline scenario, public sector debt is expected to remain stable** (Figure 3). The debt to GDP ratio is expected to decline slightly to 25½ percent of GDP by 2019, underpinned by moderate fiscal consolidation over the medium term. Debt dynamics would remain favorable, with a negative interest rate-growth differential at more than 5 percent, with the small primary deficit projected in 2019 well below the debt-stabilizing level. Gross funding needs are also expected to decrease gradually and be less than 4 percent of GDP over the medium term.

6. **Public debt is sustainable and robust to macroeconomic shocks** (Figure 4). Standard stress tests suggest that the debt ratio is likely to remain modest even under shocks from contingent liabilities, sharp exchange rate movements, lower economic growth, and higher interest rates. The debt ratio rises only marginally in an alternative scenario where the primary deficit is maintained at the current level of 0.9 percent of GDP. Nevertheless, fiscal risks, in particular those arising from expanding balance sheets of key state corporations, will need to be managed carefully. Pertamina and PLN—the two largest SOEs in Indonesia—already had combined total liabilities equivalent to 9.4 percent of GDP at end 2013. Also, lower world oil prices will affect Pertamina's revenue from upstream activities.

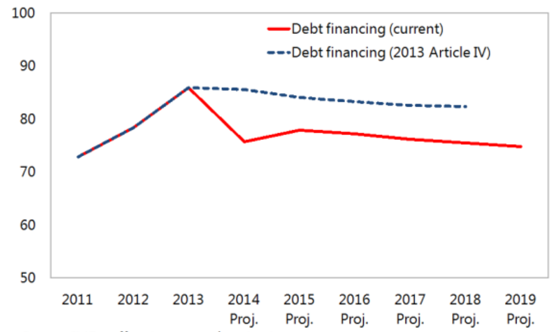
Figure 1. Indonesia: External Debt and Debt Service

Indonesia: External Debt Projections, 2011-19
(In percent of GDP)



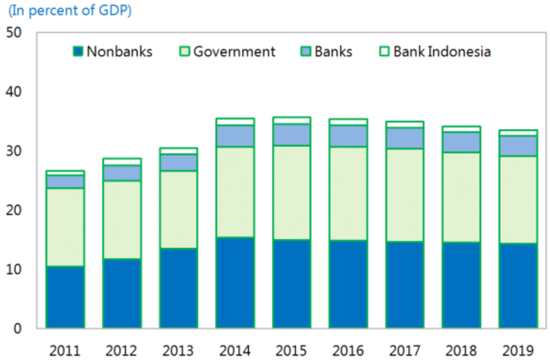
Source: IMF staff estimates and projections.

Indonesia: Debt Financing, 2011–19
(In percent of the gross external financing requirement)



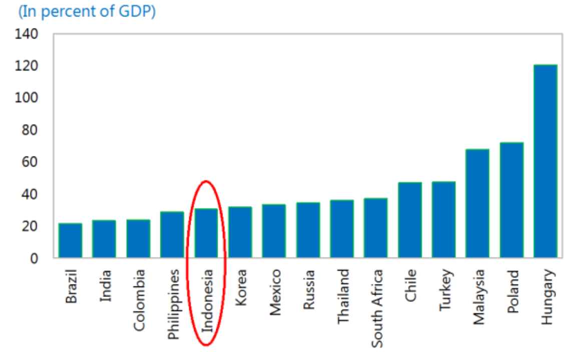
Source: IMF staff estimates and projections.

Indonesia: Composition of External Debt, 2011-19
(In percent of GDP)



Source: IMF staff estimates and projections.

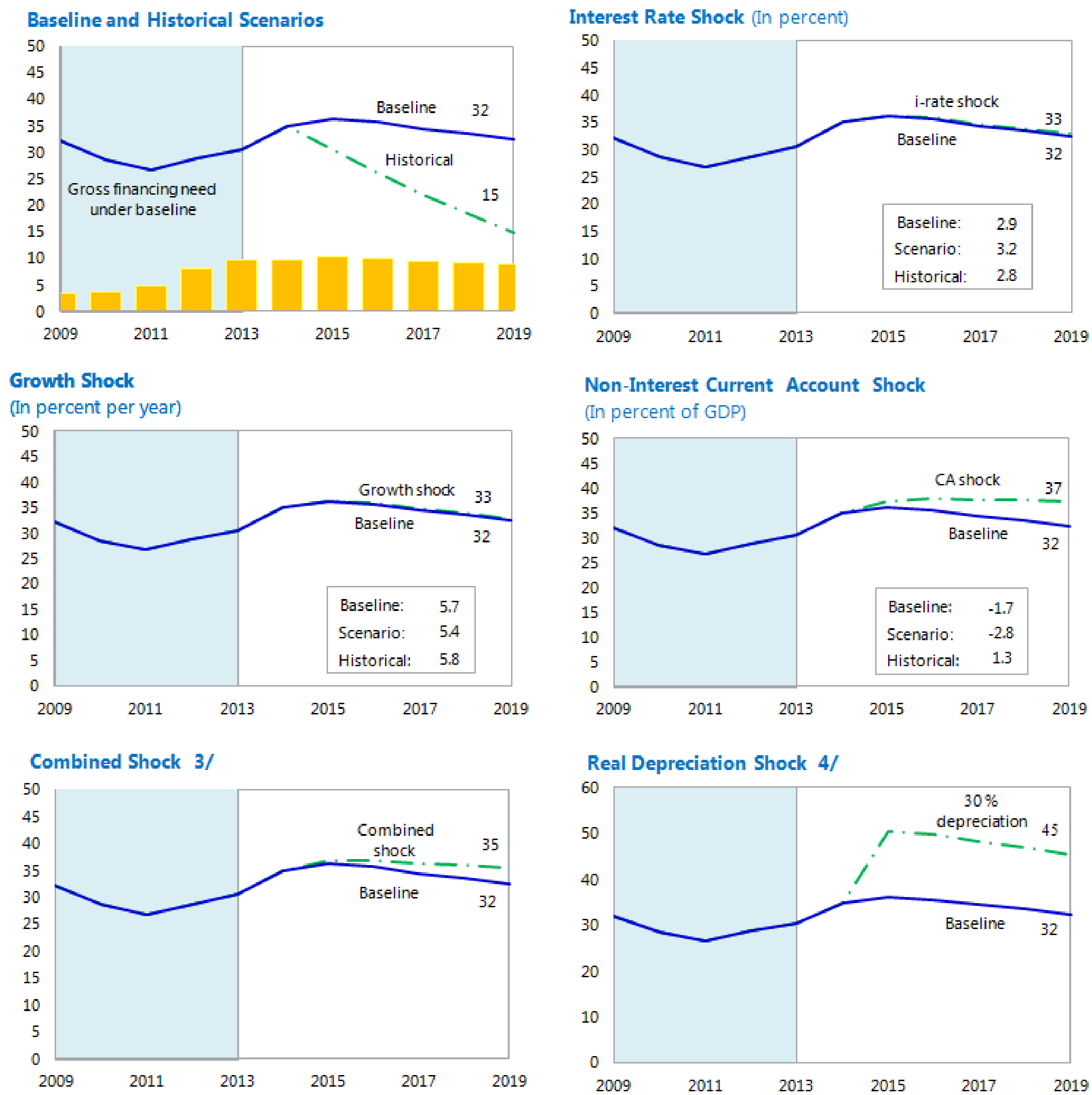
External Debt, 2013
(In percent of GDP)



Source: IMF, *World Economic Outlook*.

Figure 2. Indonesia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt, in percent of GDP)



Sources: International Monetary Fund; country desk data; and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2015.

Table 1. Indonesia: External Debt Sustainability Framework, 2009–2019

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	32.1	28.5	26.7	28.7	30.5			35.0	36.2	35.6	34.4	33.5	32.4	-3.9
2 Change in external debt	1.7	-3.6	-1.9	2.1	1.8			4.5	1.2	-0.6	-1.2	-0.9	-1.1	
3 Identified external debt-creating flows (4+8+9)	-4.3	-10.1	-6.0	-0.1	1.9			-0.9	-1.2	-1.4	-1.5	-1.6	-1.6	
4 Current account deficit, excluding interest payments	-2.8	-1.4	-0.7	2.2	2.7			2.3	1.9	1.8	1.6	1.6	1.6	
5 Deficit in balance of goods and services	-3.9	-3.0	-2.8	0.2	0.7			0.4	0.1	0.1	0.1	0.0	-0.1	
6 Exports	24.7	23.5	25.2	24.0	23.6			23.0	21.0	21.3	21.1	21.2	21.3	
7 Imports	20.7	20.5	22.3	24.2	24.3			23.4	21.2	21.4	21.2	21.2	21.2	
8 Net nondebt creating capital inflows (negative)	-0.6	-1.9	-1.3	-1.8	-1.4			-2.4	-2.3	-2.3	-2.3	-2.2	-2.2	
9 Automatic debt dynamics 1/	-0.9	-6.8	-4.0	-0.6	0.5			-0.8	-0.9	-0.9	-0.9	-1.0	-0.9	
10 Contribution from nominal interest rate	0.8	0.7	0.5	0.6	0.6			0.7	0.9	0.9	1.0	0.9	0.9	
11 Contribution from real GDP growth	-1.3	-1.5	-1.6	-1.6	-1.7			-1.6	-1.8	-1.9	-1.9	-1.9	-1.9	
12 Contribution from price and exchange rate changes 2/	-0.4	-6.0	-3.0	0.4	1.6			...	...	...	...	...	...	
13 Residual, including change in gross foreign assets (2-3) 3/	6.0	6.5	4.2	2.2	-0.1			5.4	2.4	0.8	0.4	0.7	0.5	
External debt-to-exports ratio (in percent)	130.2	121.5	105.8	119.6	129.5			151.8	171.9	167.4	162.9	158.1	152.2	
Gross external financing need (in billions of U.S. dollars) 4/	18.9	26.5	41.2	71.1	83.7			82.4	89.1	93.0	96.7	101.5	105.8	
In percent of GDP	3.5	3.7	4.9	8.1	9.6			9.7	10.2	9.9	9.4	9.2	8.8	
Scenario with key variables at their historical averages 5/								35.0	30.4	26.0	22.0	18.4	14.9	-2.8
Key macroeconomic assumptions underlying baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	4.6	6.2	6.5	6.3	5.7	5.8	0.6	5.1	5.2	5.5	5.8	6.0	6.0	
GDP deflator in U.S. dollars (change in percent)	0.8	24.0	11.9	-2.3	-6.2	8.1	9.7	-7.0	-2.2	1.4	3.3	2.1	2.1	
Nominal external interest rate (in percent)	2.8	2.8	2.2	2.3	2.1	2.8	0.6	2.4	2.6	2.8	3.0	3.0	3.0	
Growth of exports (U.S. dollar terms, in percent)	-14.2	25.5	27.8	-0.9	-2.8	10.7	13.5	-4.4	-6.0	8.1	8.6	8.6	8.7	
Growth of imports (U.S. dollar terms, in percent)	-23.0	30.2	30.0	12.7	-0.8	13.6	17.6	-5.6	-7.0	8.0	8.3	8.3	8.5	
Current account balance, excluding interest payments	2.8	1.4	0.7	-2.2	-2.7	1.3	2.2	-2.3	-1.9	-1.8	-1.6	-1.6	-1.6	
Net nondebt creating capital inflows	0.6	1.9	1.3	1.8	1.4	1.2	0.5	2.4	2.3	2.3	2.3	2.2	2.2	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. 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 [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 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/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 3. Indonesia: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP, unless otherwise indicated)

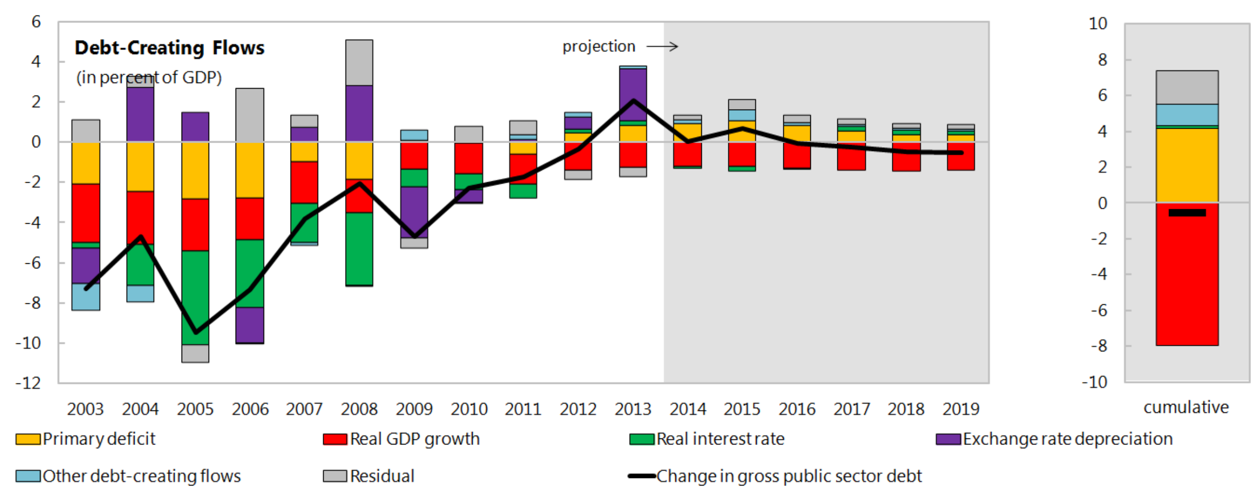
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	38.8	24.0	26.1	26.1	26.8	26.8	26.5	26.1	25.5
Public gross financing needs	3.0	3.9	3.9	4.2	4.0	4.0	3.3	3.2	3.4
Real GDP growth (in percent)	5.6	6.3	5.7	5.1	5.2	5.5	5.8	6.0	6.0
Inflation (GDP deflator, in percent)	10.7	4.4	4.4	5.7	6.5	5.8	4.8	4.8	4.8
Nominal GDP growth (in percent)	17.0	10.9	10.4	11.1	12.0	11.6	10.9	11.1	11.1
Effective interest rate (in percent) [4/]	5.7	5.6	5.7	5.5	5.8	5.9	5.9	5.9	5.9

As of November 03, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		235
5Y CDS (bp)		142
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	BB+	BB+
Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-4.8	-0.4	2.1	0.0	0.7	0.0	-0.2	-0.5	-0.5	-0.6	
Identified debt-creating flows	-5.6	0.1	2.5	-0.2	0.2	-0.4	-0.5	-0.7	-0.8	-2.4	
Primary deficit	-1.5	0.4	0.8	0.9	1.1	0.8	0.6	0.4	0.4	4.1	-1.1
Primary (noninterest) revenue and grants	18.8	18.1	18.0	17.4	15.6	16.3	16.5	16.8	16.9	99.5	
Primary (noninterest) expenditure	17.3	18.5	18.8	18.3	16.7	17.1	17.1	17.2	17.3	103.6	
Automatic debt dynamics [5/]	-3.9	-0.5	1.6	-1.3	-1.5	-1.4	-1.2	-1.2	-1.2	-7.8	
Interest rate/growth differential [6/]	-4.1	-1.2	-1.0	-1.3	-1.5	-1.4	-1.2	-1.2	-1.2	-7.8	
Of which : real interest rate	-2.0	0.2	0.2	-0.1	-0.2	0.0	0.2	0.2	0.2	0.2	
Of which : real GDP growth	-2.1	-1.4	-1.2	-1.2	-1.2	-1.3	-1.4	-1.4	-1.4	-8.0	
Exchange rate depreciation [7/]	0.1	0.6	2.6	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.2	0.2	0.1	0.2	0.6	0.1	0.1	0.1	0.1	1.2	
Privatization (negative)	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Miscelleneous domestic non-borrowing financing	-0.1	0.2	0.1	0.2	0.6	0.1	0.1	0.1	0.1	1.2	
Residual, including asset changes [8/]	0.8	-0.5	-0.5	0.3	0.5	0.3	0.3	0.3	0.2	1.9	



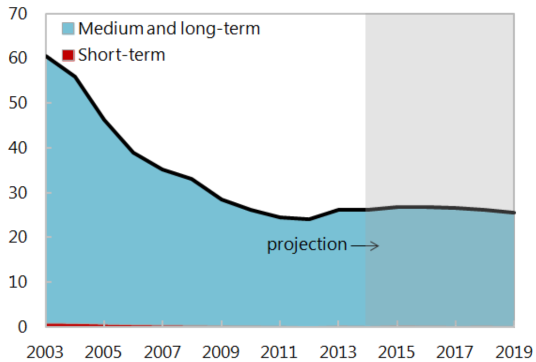
Source: IMF staff.

1/ Public sector is defined as general government.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

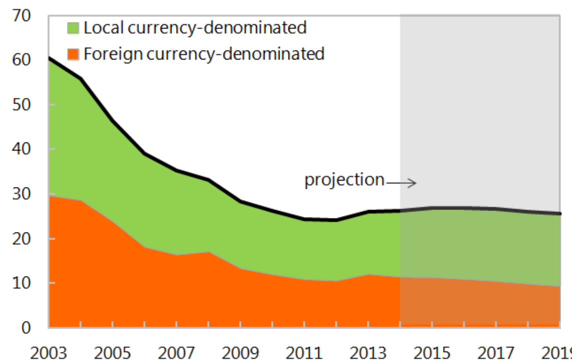
Figure 4. Indonesia: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



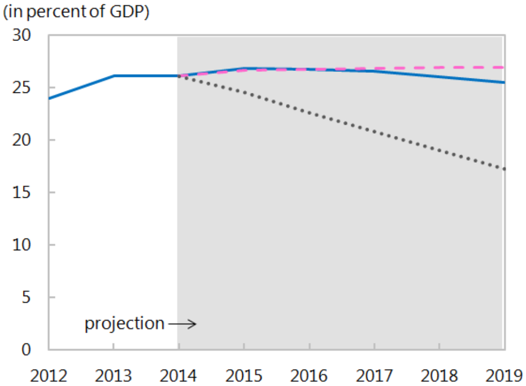
By Currency
(in percent of GDP)



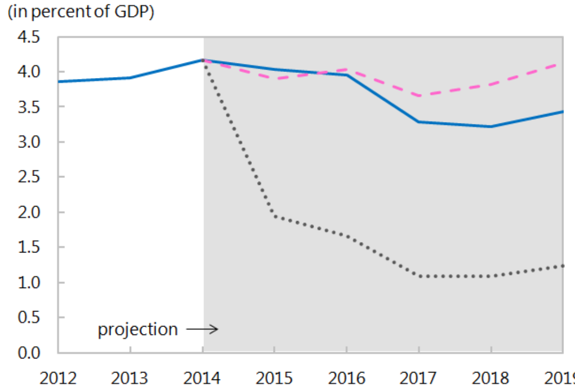
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	5.1	5.2	5.5	5.8	6.0	6.0
Inflation	5.7	6.5	5.8	4.8	4.8	4.8
Primary Balance	-0.9	-1.1	-0.8	-0.6	-0.4	-0.4
Effective interest rate	5.5	5.8	5.9	5.9	5.9	5.9
Constant Primary Balance Scenario						
Real GDP growth	5.1	5.2	5.5	5.8	6.0	6.0
Inflation	5.7	6.5	5.8	4.8	4.8	4.8
Primary Balance	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Effective interest rate	5.5	5.8	5.9	5.9	5.9	5.8

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	5.1	5.8	5.8	5.8	5.8	5.8
Inflation	5.7	6.5	5.8	4.8	4.8	4.8
Primary Balance	-0.9	1.0	1.0	1.0	1.0	1.0
Effective interest rate	5.5	5.8	5.5	5.1	5.0	4.7

Source: IMF staff.

Appendix IV. Indonesia—Response to Recent IMF Policy Advice

Fund Recommendations	Authorities' Response
Monetary and Exchange Rate Policies	
• Further tighten monetary policy if projected inflation remains outside the target band.	Bank Indonesia (BI) preemptively raised its benchmark and lending rates in November 2014 by 25 and 50 bps, respectively, to 7.75 and 8.00 percent to help anchor inflation expectations. The action was taken immediately after administered fuel price hikes, which pushed headline inflation above the target band. Policy communications have been clear.
• Ensure BI's inflation targeting framework is supported by a strengthened monetary transmission mechanism and deeper money markets by narrowing the interest corridor and using OMO more aggressively to guide short-term rates back to the middle of the corridor.	The introduction of tradable OMO instruments and ongoing IMF technical assistance (TA) to develop secured lending among banks are expected to deepen market activity and make the banking system more resilient to liquidity shocks. A mini-Master Repo Agreement among banks has been in place since January 2014.
• Continue to limit foreign exchange (FX) market intervention to smoothing volatility and encourage state-owned enterprises (SOEs) to meet FX needs in the interbank market.	The exchange rate has been allowed to move to reflect market conditions. Foreign exchange sales have been scaled back to SOEs. New regulations were introduced by BI in September 2014 to encourage prudent hedging by SOEs of their FX exposures, followed by regulations effective 2015 on corporate private external borrowing.
Fiscal Policy	
• Keep the overall deficit capped at 2 percent of GDP in 2013, to bolster credibility and reduce vulnerability to funding pressures.	In 2013, the fiscal deficit was 2.3 percent of GDP, in line with the revised budget but higher than recommended. Tax revenue shortfalls were partially offset by lower-than-budgeted current spending.
• Pursue moderate fiscal consolidation in 2014 and over the medium term, limiting the deficit to 1½ percent of GDP in 2014 to help contain external pressures and funding needs, and anchor medium term consolidation by rationalizing the energy subsidy regime and mobilizing tax revenues to bring the primary deficit into balance.	In 2014, the fiscal deficit was 2.3 percent—slightly lower than targeted in the revised budget. However, the 2014 deficit was still higher than staff recommended mainly due to underperformance of non-oil and gas revenues and a larger-than-envisaged energy subsidy bill. Nevertheless, subsidized fuel consumption was capped for the year and significant energy subsidy reforms were implemented, with electricity tariffs increased for large industrial users in July 2014, administered fuel prices raised by an average of 33 percent in November 2014, and fuel pricing reform undertaken in January 2015.
• Strengthen cash and debt management by shortening the maturity profile of primary auctions of government debt, consolidating line ministry accounts in banks, and replacing nonmarketable government securities on BI's balance sheet.	Treasury bill issuances have been larger in primary auctions in 2014 than in the previous year.
Financial and Corporate Sector	
• Monitor closely banks' and corporates' financial soundness and risk management practices, while continuing to manage carefully the move of bank supervision to OJK (the financial services agency).	The transfer of banking supervision to OJK occurred smoothly, with work ongoing to improve the supervisory framework. Bank Indonesia is developing tools to ensure systemic stability and improve corporate monitoring.
• Fill gaps in existing crisis management protocols, in the absence of passage of the Financial System Safety Net (FSSN) law, and revise relevant financial legislation to ensure legal consistency.	A review of the draft FSSN law is underway to fill in gaps in the financial stability architecture.
• Establish a well functioning macro prudential framework, with BI taking the lead role in systemic risk monitoring and OJK driving implementation of all prudential tools.	Bank Indonesia issued its macro prudential regulation in July 2014, but clarification of micro and macro prudential responsibilities is needed. Bank Indonesia is also strengthening its capacity for systemic risk monitoring, supported by IMF TA.

INTERNATIONAL MONETARY FUND

INDONESIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 17, 2014

Prepared By | Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of January 31, 2015)

Membership Status: Joined February 21, 1967; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	2,079.30	100.00
Fund holdings of currency	1,933.80	93.00
Reserve position in Fund	145.50	7.00

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	1,980.44	100.00
Holdings	1,761.11	88.93

Outstanding Purchases and Loans: None

Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Millions)	Amount Drawn (SDR Millions)
EFF	02/04/00	12/31/03	3,638.00	3,638.00
EFF	08/25/98	02/04/00	5,383.10	3,797.70
Stand by	11/05/97	08/25/98	8,338.24	3,669.12

Projected Payments to Fund (SDR millions; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2015	2016	2017	2018	2019
Principal					
Charges/Interest	0.12	0.12	0.12	0.12	0.12
Total	0.12	0.12	0.12	0.12	0.12

Exchange Arrangements

The rupiah has had a *de jure* free floating exchange arrangement since August 14, 1997, and the current *de facto* arrangement is floating. The market exchange rate was Rp 12,739 per U.S. dollar as of January 31, 2015. 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.

Article IV Consultation

The last Article IV consultation report (IMF Country Report No. 13/362) was discussed by the Executive Board on November 15, 2013.

Resident Representative

Mr. Benedict Bingham has been the Senior Resident Representative since September 2012.

WORLD BANK-IMF COLLABORATION

Background

The working relationship between the IMF and the World Bank in Indonesia is very strong, with joint working programs in a number of areas and close coordination through frequent meetings between resident offices and with headquarters missions, including the Article IV consultation.

Key Areas with Joint Programs

Budget Reforms

- The reform agenda for budget and treasury remains a high priority for both institutions. Currently, the World Bank's support is being provided through the Government Financial Management and Revenue Administration Project (GFMRAP) program, trust funds, and development policy loans (DPLs), with elements in support of (a) efficient treasury operations, including accounting reforms, improved in-year budget disbursement, and regulatory reform; (b) improved linkages between planning and budget preparation through the implementation of a medium-term expenditure framework, performance budgeting, and the enhancement of budget flexibility at the service delivery level; and (c) improved capacity for budget oversight through systems and organizational reform. The IMF has complemented this work through recent technical assistance (TA) on subsidy reform and social safety nets aimed at ensuring longer-run fiscal sustainability.

Taxation Issues

- Revenue (tax and nontax revenue) issues are a priority for the IMF and the World Bank, with broadening the revenue base and increasing revenues an important issue for both macro-fiscal stability and the investment climate. The Fund conducted a mission on tax policy and administration in September 2014 to identify key reform options in each of these areas. The Bank provides support through TA to DG Tax through a multi-donor trust fund and preparation of an investment loan in support of a comprehensive program for tax administration reform. The Bank has also been providing analytical support on nontax revenue administration.

Asset-Liability Management

- The World Bank and IMF have been leading an effort to improve asset-liability management, including at the Treasury and Debt Management Office of the Ministry of Finance and at Bank Indonesia, with continued collaboration envisaged, as needed.

Crisis Preparedness

- In recent years, the World Bank has focused on supporting the authorities in Indonesia to create a robust crisis prevention and management framework. Most recently, this support has included analysis of the financial sector stability framework through the 2010 FSAP and a series of crisis simulation exercises. Since 2012, the Bank's Program for Economic Resilience, Investment and Social Assistance in Indonesia (PERISAI) DPL has also supported the authorities in this area. The IMF has supported work in this area through past TA on reviewing the legal framework underpinning Indonesia's financial stability architecture and in its current surveillance dialogue with the authorities and exchange of views with the Bank.

Financial Sector

- The World Bank has focused on broad monitoring of the financial sector. Most recently, through its Financial Sector and Investment Climate Reform and Modernization DPL, the Bank is supporting the implementation of reforms aimed at maintaining stability, increasing diversification, and enhancing financial sector inclusion in Indonesia. The IMF has concentrated on the banking system, with emphasis on regulation and supervision, with a resident advisor placed at the Financial Services Agency (OJK) in January 2015. It has also embarked on TA in financial deepening, focused initially on money and foreign exchange market development and more recently on monetary operations and the transmission mechanism. In addition, the Fund has provided recent TA on the macro prudential policy framework. A joint World Bank-IMF FSAP was completed in 2010 and some recommendations have been followed through by the authorities. The Bank is to provide TA to implement select FSAP recommendations concerning the nonbank financial sector.

Statistics

- The World Bank has a major program of capacity building with the statistics agency that was launched in 2011. The Statistical Capacity Building-Change and Reform for the Development of Statistics (STATCAP-CERDAS) program is designed to focus on improvements in key statistical series that should improve the ability to understand the Indonesian economy, executed through an institution-wide approach, which includes significant business, IT and HR/organizational reforms. The IMF has focused recent training and TA on government finance statistics, monetary and financial statistics, and sectoral balance sheets.

Macroeconomics

- The IMF continues to take the lead in macroeconomic areas, with the Article IV mission and staff visits, focusing on fiscal, monetary, and exchange rate policies; macrofinancial linkages, financial sector reforms, and crisis management, as well as the external position and spillover effects. The Fund also updates the Debt Sustainability Analysis at the time of the Article IV consultation, with inputs from the World Bank and other development partners. The Bank has also taken on a larger role, including on macroeconomic monitoring, public policy dialogue, and capacity building, with ongoing coordination with the Fund. The Bank team continues to assist the Ministry of Finance's Fiscal Policy Office to improve capacity for macroeconomic monitoring, forecasting, and evidence-based macroeconomic and fiscal policy analysis.

These threads of work are expected to be continued by both institutions, with periodic meetings aimed at keeping each other informed about ongoing work and joint areas of interest. Issues being addressed by the IMF include domestic and external vulnerabilities, exchange rate management, medium-term external and fiscal sustainability, and macro/financial linkages and financial stability risks; and by the Bank the link between macro/fiscal policy and real economic outcomes, including growth and poverty, resource-sector fiscal revenues, and longstanding problems in the implementation and effectiveness of government spending.

Indonesia: Joint Managerial Action Plan, 2014–15			
Title	**Products**	**Provisional Timing of Missions**	**Expected Delivery Date (Tentative)**
A. Mutual Information on Relevant Work Programs			
Bank work program for next 12 months	Indonesia Economic Quarterly World Bank follow-up work related to WB/IMF Financial System Assessment Program missions (October 2009 and February–March 2010) Energy DPL Fiscal reform DPL		Launched in April 2012; the latest issue published in December 2014 Ongoing Ongoing Possible (under discussion)
IMF work program for next 12 months	**Macroeconomic surveillance** 2014 Article IV consultation 2015 staff visit 2015 Article IV consultation **Technical assistance** Financial deepening and market development Tax policy and revenue administration Statistical policies Consolidated supervision (resident advisor) Financial stability architecture	 December 2014 Mid 2015 Late 2015 Ongoing Ongoing Ongoing January 2015 Mid 2015	 Board discussion will take place in March 2015 Periodic visits
B. Request for Work Program Inputs			
Fund request to Bank	Assessment of economic developments and structural policies Information sharing		Ongoing Ongoing
Bank request to Fund	Assessment of macroeconomic developments and policies Information sharing		Ongoing Ongoing
C. Agreement on Joint Products and Missions			
Joint work program	Coordination of a follow-up FSAP starting in 2015	Late 2016 (tentative)	2016–2017

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of December 2014)

Asian Development Bank (ADB) loans to Indonesia have totaled US$30 billion since 1969.[1] The ADB approved a total of US$554.4 million in loans to Indonesia in 2014.[2] The sectors with the largest shares in cumulative lending are public sector management (19.1 percent), energy (14.5 percent), agriculture and natural resources (13.6 percent), and finance (13.6 percent).[3]

Between 1969 and 2014, the ADB provided Technical Assistance (TA) grants to Indonesia amounting to US$430 million. The TA grants were financed from the ADB's TA Special Fund, the Japan Special Fund and other sources.

The ADB is preparing a new Country Partnership Strategy (CPS) 2015−2019 with the government of Indonesia covering the period 2015−2019. The strategy will be aligned with the government's medium-term development plan for 2015−2019. The CPS will be closely attuned to the needs of Indonesia as a large middle-income country and guided by the government's commitment on development. The CPS will also maintain consistency with the priorities set out in ADB's Mid-Term Review of Strategy 2020.

1 Through the third quarter of 2014.
2 As of December 5, 2014.
3 See Table 2.

Table 1. Sovereign and Nonsovereign Loan Approvals and Disbursements to Indonesia
(In millions of U.S. dollars)

	2007	2008	2009	2010	2011	2012	2013	2014 (October)
Loan approvals	1,187.1	1,085.0	2,184.2	785.0	580.0	1,232.8	1,013.9	554.4
Loan disbursements	1,136.3	949.6	739.3	1,079.8	631.9	862.5	588.1	84.0

Source: Indonesia Resident Mission, Republic of Indonesia, *Country Information Note, 6 January 2015*.

Table 2. Cumulative Lending to Indonesia
(As of December 2014)

Sector	Loans (No.)	Amount (US$ millions)	Percent 1/
Agriculture and natural resources	100	4,092.52	13.62
Education	33	2,297.35	7.65
Energy	35	4,354.55	14.50
Finance	23	4,086.10	13.60
Health and social protection	13	1,068.30	3.56
Industry and trade	12	645.70	2.15
Public sector management	22	5,724.97	19.06
Transport and information and communications technology	36	3,593.86	11. 96
Water supply and other municipal Infrastructure and services	35	2,183.84	7.27
Multisector	21	1,993.22	6.64
Total	330	30,040.41	100.00

Source: Asian Development Bank, *Indonesia Fact Sheet 2013* and *Country Information Note*, *6 January 2015*.

1/ Total may not add up because of rounding.

STATISTICAL ISSUES

Assessment of Data Adequacy for Surveillance

General: Indonesia's macroeconomic statistics are broadly adequate to conduct effective surveillance.

National accounts: Statistics Indonesia (BPS) disseminates annual and quarterly GDP (QGDP) by economic activity and expenditure components at current prices and in volume terms regularly. The base year of GDP was revised to 2010 recently. Revised GDP estimates are based on the supply and use tables, international standard of industrial classification Revision 4, updated source data, and latest international methodologies following the *System of National Accounts 2008 (2008 SNA)*. These changes resulted in an upward revision of 6.5 percent in nominal GDP for the year 2010, out of which 2.4 percent was attributed to the 2008 SNA implementation. The QGDP estimates are based on a limited set of indirect indicators. Some sectors are influenced strongly by seasonality, with seasonally adjusted data are prepared but not published. BPS has been leading the work on developing sectoral accounts and balance sheets jointly with Bank Indonesia (BI) with technical assistance (TA) from STA. BPS and BI expect to finalize the annual nonfinancial accounts, financial flows, and stocks for the year 2010 during 2015, and quarterly financial flows and stocks starting from Q1:2015 in 2017.

Price statistics: Price statistics are broadly adequate for surveillance. In October 2013, BPS released the new industrial Producer Price Index (PPI) covering agriculture, mining and quarrying, and manufacturing with 2010 as the base period, and has published the PPI index quarterly. BPS has also expanded the mining sample to include oil and natural gas extraction, coal, and gold, and starting or completing work for 15 service industries. A TA mission was conducted in October 2014 to advise the BPS on continuing development of the PPI that conforms to international standards as presented in the *Producer Price Index Manual (PPI Manual)*, 2004.

Government finance statistics: Available government finance data suffer from a number of weaknesses, in terms of classification, coverage, and timeliness. Data on the budget of the central government are available with a one-month lag, but subnational (provincial and local) government data are available only with a lag of two years, and the quality of these data varies widely. Problems in budget and accounting systems have been compounded by recent decentralization initiatives, which have shifted substantial resources to the subnational governments. Significant efforts are being made to overcome these problems, ranging from the planned adoption of advanced accounting and statistical standards to the introduction of best-practice budget management processes and the development of computerized financial management information systems.

Against this background, the Ministry of Finance (MOF) is committed to keeping the requirements of fiscal statistics at the forefront of ongoing fiscal reforms, with better statistical monitoring one of the goals of the current efforts. The coverage and timeliness of public debt statistics is generally adequate. The new expenditure classification introduced in the 2005 budget is generally consistent with the *Government Finance Statistics Manual 2001* (*GFSM 2001*) on functional codes and classification, although the data are compiled on a cash basis.

The authorities have committed to adopting *GFSM 2001* standards. To this end, IMF staff have recommended in the short term: (i) establishment of a register of all extrabudgetary units; and (ii) inclusion of the economic codes consistent with the *GFSM 2001* in the chart of accounts to ensure that general government units report all transactions and balances over which they exert control. Over the medium term, priority should be given to (i) establishment of the underlying reporting arrangements necessary to obtain timely preliminary data for local government statistics; and (ii) development of a *GFSM 2001* operating statement, statements of sources and uses of cash, and partial balance sheets, all of which should be published on the MOF's website. Currently, a system has been set up to allow for an automatic conversion of budget files to *GFSM 2001* data; however, these data are yet to be published on the MOF's website.

The MOF's continued efforts to compile GFS data for the general government sector, as part of ongoing public financial management reforms, are being assisted by STA.

Monetary and financial statistics (MFS) and financial soundness indicators (FSIs): Good quality monetary statistics are compiled by BI on a timely basis. BI compiles and reports monetary data using the Standardized Report Forms (SRFs), from which an integrated database and alternative presentations of monetary statistics can be drawn to meet the needs of BI and the IMF. Additional challenges include timely revisions of published banking sector data after supervisory verification. BI also compiles monetary data for other financial corporations (OFCs), but covering only finance companies. In October 2014, an STA mission supported BI in expanding the coverage of the OFCs survey with the inclusion of data from insurance companies, pension funds, the state owned pawn shop (PT Pegadaian), and the Indonesian export financing institution (Eximbank). The mission also assisted BI in advancing the production of flow-based monetary statistics and quarterly financial accounts. BI compiles and reports two STA 11 core and 12 encouraged financial soundness indicators (FSIs) for deposit takers, two encouraged FSIs for OFCs, and three encouraged FSIs for the real estate sector, which are published on the Fund's FSI website. Starting with Q4:2011 data, BI began reporting these FSIs on a quarterly basis. STA recommended that BI coordinate with other relevant institutions to explore the possibility of compiling FSIs for nonfinancial corporations and households.
Balance of payments (BOP): Trade data have been improved in recent years. Import and export transactions of free trade zones and bonded warehouses are captured in goods data of BOP statistics. For the capital and financial account, the methodological basis for the compilation of FDI data needs substantial improvement. Inflows are currently calculated based on loan disbursements to companies that have foreign equity using a fixed ratio to estimate equity inflows. Surveys conducted by BI to collect FDI data have improved the coverage of the directory of enterprises in recent years. Other areas that need improvement include the recording of trade credits and the asset data for portfolio investment and other investment transactions. The magnitude of the errors and omissions item in the BOP has been large at times and appears to be related to the under-coverage of assets in the financial account. Financial transactions data are reconciled with changes in the International Investment Position (IIP), except data on direct investment. Annual and quarterly IIP data are compiled and published, but the underlying data are weak in several areas, notably for FDI. External debt statistics have improved considerably with the introduction of an *External Debt Information System* (EDIS) in 2002 and the recent initiative to publish monthly indicators. Also, as a result of the ongoing reconciliation of data conducted by BI, the IIP and external debt data are fully consistent. However, improvements are still needed with respect to components of private corporate sector data, particularly in distinguishing between scheduled and actual debt service, in estimating the accumulation/reduction of private sector payments arrears, and in estimating reschedulings/debt reductions received by the private sector from external creditors.

Data Standards and Quality

Subscriber to the Special Data Dissemination Standard (SDDS) since September 1996, observing most of the SDDS requirements. Indonesia uses the SDDS flexibility options for the timeliness of the labor market categories (employment, unemployment, and wages/earnings) and general government operations. It is also availing itself of flexibility options for the periodicity of labor market categories (employment and unemployment).	Data *Reports on the Observance of Standards and Codes* (ROSC) completed in 2005.

Indonesia: Table of Common Indicators Required for Surveillance

(As of January 31, 2015)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]	Memorandum Items: Data Quality—Methodological Soundness[2]	Memorandum Items: Data Quality—Accuracy and Reliability[3]
Exchange rates	1/30/15	1/30/15	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities[4]	1/15	2/15	M	M	M		
Reserve/base money	12/14	1/15	W/M	W/M	W/M	O, LO, O, O	LO, O, O, LO, O
Broad money	11/14	1/15	M	M	M		
Central bank balance sheet	12/14	1/15	M	M	M		
Consolidated balance sheet of the banking system	11/14	1/15	M	M	M		
Interest rates[5]	1/30/15	1/30/15	D	D	D		
Consumer price index	1/15	2/15	M	M	M		
Revenue, expenditure, balance and composition of financing[6]—central government	12/14	1/15	M	M	Mid-year	LNO, LNO, LO, LNO	LNO, LO, LO, LO, LNO
Stocks of central government and central government–guaranteed debt	12/14	1/15	Q	Q	Q		
External current account balance	9/14	12/14	Q	Q	Q	LO, LO, LO, LO	LO, O, LO, O, O
Exports and imports of goods and services	11/14	1/15	M	M	M		
GDP/GNP	12/14	2/15	Q	Q	Q	LO, LO, O, LO	LO, LO, LO, LO, LNO
Gross external debt[7]	9/14	12/14	Q	Q	Q		
International investment position[8]	9/14	12/14	Q	Q	Q		

1 Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); NA: Not Available.
2 Reflects the assessment provided in the data ROSC published on July 20, 2005 (based on the findings of the mission that took place during March 28-April 11, 2005), for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
3 Including currency and maturity composition, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.
4 Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
5 Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
6 Foreign, domestic bank, and domestic nonbank financing.
7 Including currency and maturity composition.
8 Includes external gross financial assets and liability positions vis à vis nonresidents.

Statement by IMF Staff Representative on Indonesia
March 9, 2015

The information below has become available following the issuance of the staff report. It does not alter the thrust of the staff appraisal.

1. Recent data releases are broadly consistent with staff's view on the near-term macroeconomic outlook.

- The current account deficit for 2014 was in line with expectations at about US$26 billion. It remained on a downward trend, narrowing in the last quarter of 2014 to US$6.2 billion (2.9 percent of GDP), which was largely attributable to a smaller oil import bill. The overall BOP surplus was slightly larger than expected in 2014 at US$15.2 billion, with non-portfolio capital inflows the main factor. Turning to 2015, the trade surplus rose to US$0.7 billion in January from US$0.2 billion in December, with oil and gas imports further shrinking.

- Headline inflation declined further to 6.3 percent (y/y) in February 2015, benefiting from lower food and transportation prices, but core inflation stayed around 5 percent. Bank Indonesia's latest (February) consumer survey index showed price expectations continuing to fall.

2. Parliament approved a revised 2015 budget in mid February with an overall deficit target of 1.9 percent of GDP, in keeping with the government's initial proposal. To achieve this target and boost capital spending, the budget relies on an ambitious increase in non-oil and gas revenues, which is expected to come mainly from administrative measures. The budget also provides for a recapitalization of state-owned enterprises (0.4 percent of GDP) within the financing items.

3. Bank Indonesia (BI) cut its benchmark and deposit facility rates by 25 bps to 7.5 percent and 5.5 percent, respectively, effective February 18, while leaving its lending facility rate unchanged at 8.0 percent, citing recent improvement in inflation performance and the current account. Broad money and private credit growth slowed in December 2014, as expected, to around 12 percent and 12½ percent (y/y), respectively.

4. Financial market developments have remained broadly favorable. Since BI's rate cut, the 10-year bond yield has declined by about 30 basis points while the rupiah has weakened slightly against the U.S. dollar. Portfolio inflows continue to be supportive.

Press Release No. 15/123
FOR IMMEDIATE RELEASE
March 19, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with Indonesia

On March 9, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Indonesia.

Sound macroeconomic management and exchange rate flexibility have bolstered policy credibility and external resiliency in Indonesia over the past 18 months. In the face of Fed tapering and headwinds posed by slumping commodity prices, policy and reserve buffers have been strengthened through a clearer policy framework and better policy coordination. Markets have responded favorably, as evidenced by large portfolio inflows in 2014 and so far in 2015. Overall, the banking system remains sound and well capitalized, while the corporate sector has been affected by a cyclical slowdown. Key risks, which emanate mainly from external sources, are moderately to the downside, requiring continued vigilance by policymakers.

Notwithstanding commodity sector developments and global risk factors, the near-term outlook is broadly positive. Led by a pickup in public investment, growth should reach around 5¼ percent this year. Inflation is expected to return to within BI's target band of 3 to 5 percent by year end, given the current monetary stance and fuel price outlook. The current account deficit should also narrow slightly, with a lower oil import bill offsetting pressures arising from non-oil commodity exports, while foreign reserves are expected to rise moderately.
Decisive fiscal policy actions taken since late 2014 on fuel subsidy reforms have opened space in the budget to support government plans to increase social and infrastructure spending, but lower oil and gas revenues may constrain available resources in the near term. Monetary policy continues to provide a strong anchor to inflation expectations and facilitate external adjustment, with the latter also aided by flexibility in the exchange rate and bond yields. Financial sector policies have been aimed at deepening market activity, enhancing macro and micro prudential oversight, and increasing corporate sector resilience.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Looking ahead, the main challenge for Indonesia is to chart a course to higher, more inclusive growth, while preserving macro-financial stability and further strengthening the external position. Moderate fiscal consolidation would help improve funding conditions and facilitate external adjustment. It should be underpinned by a broad tax revenue strategy and supported by prudent borrowing, with a view to generating ample resources for growth-critical spending and maintaining debt sustainability. The current monetary stance appears appropriate until inflation and external pressures firmly ease. Financial stability is expected to be preserved through prudential measures backed by strengthened frameworks for risk assessment and protocols on crisis management. Structural policies should address longstanding supply bottlenecks, deepen financial markets, and create a more supportive trade and investment climate in order to expand the export base, stimulate job creation, and raise potential growth.

Executive Board Assessment[2]

Executive Directors commended the authorities for their sound macroeconomic management, which has strengthened policy and reserve buffers. Directors, however, noted that the economy faces downside risks, particularly those arising from external sources. In this context, Directors agreed that policy priorities and structural reforms should continue to focus on consolidating recent stability gains, containing vulnerabilities, and boosting growth potential.

Directors encouraged the authorities to continue to maintain a prudent fiscal stance to enhance resilience to shocks. They welcomed the decisive measures taken to eliminate the bulk of fuel subsidies. Directors supported the use of the expanded fiscal space to increase growth-critical social and capital spending, noting that bridging infrastructure needs would enhance Indonesia's longer-term growth prospects. To achieve this goal, they underscored the importance of raising nonoil tax revenues, including by strengthening tax administration. Directors also encouraged further efforts to phase out the remaining subsidies, while protecting the most vulnerable households. In addition, they recommended close monitoring of risks related to state-owned enterprises and public-private partnerships.

Directors considered the current monetary policy stance to be broadly appropriate to anchor inflation expectations and support external adjustment. They noted that continued exchange rate and bond yield flexibility would help mitigate the impact of external shocks. Directors supported efforts to deepen money markets to improve liquidity management and strengthen monetary transmission.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors observed that Indonesia's financial system remains sound. With the system having transitioned to a new regulatory and supervisory architecture, they stressed the importance of further progress to enhance macro- and microprudential oversight, strengthen the capacity for risk assessment, and expeditiously put in place an effective crisis management framework, including by enacting the Financial System Safety Net Law. A number of Directors advised removal of interest caps on deposits. They supported efforts to strengthen corporate sector resilience, including by better managing rising external debt. Noting the progress made in the AML/CFT framework, Directors encouraged further efforts to address the remaining deficiencies.

Directors welcomed the authorities' emphasis on supply-side reforms to alleviate infrastructure bottlenecks, deepen financial markets, and streamline investment approvals in order to bolster employment and growth prospects. Going forward, they highlighted the importance of improving the trade and investment regime, addressing labor market issues, including by aligning wage settlements with productivity increases, and fostering human resource development, focusing particularly on investment in education. Efforts to broaden the export base will also be important.

Indonesia: Selected Economic Indicators, 2010–16

	2010	2011	2012	2013	2014	2015	2016
					Est.	Proj.	
Real GDP (percent change)	6.2	6.5	6.3	5.7	5.1	5.2	5.5
Domestic demand	5.4	6.0	7.9	5.2	5.1	4.8	5.1
Net exports 1/	0.9	1.5	-1.4	2.1	0.3	0.9	0.9
Saving and investment (in percent of GDP)							
Gross investment 2/	32.3	32.9	34.7	33.6	33.5	33.5	33.9
Gross national saving	33.0	33.1	31.9	30.3	30.5	30.7	31.2
Prices (12-month percent change)							
Consumer prices (end period)	7.0	3.8	3.7	8.1	8.4	4.5	4.8
Consumer prices (period average)	5.1	5.3	4.0	6.4	6.4	6.8	5.8
Public finances (in percent of GDP)							
Central government revenue	15.4	16.3	16.3	15.8	15.2	13.5	14.1
Central government expenditure	16.2	17.5	18.1	18.2	17.5	15.9	16.4
Of which: Energy subsidies	2.2	3.4	3.7	3.4	3.4	1.0	0.9
Central government balance	-0.7	-1.1	-1.9	-2.3	-2.3	-2.4	-2.3
Primary balance	0.6	0.1	-0.6	-1.1	-0.9	-1.1	-0.8
Central government debt	26.1	24.4	24.0	26.1	26.1	26.8	26.8
Money and credit (12-month percent change; end of period) 3/							
Rupiah M2	16.5	17.4	14.4	9.4	13.5	13.5	...
Base money	28.9	18.3	14.9	16.7	11.6	11.9	...
Private sector credit	19.6	25.4	22.3	20.0	11.8	12.5	...
One-month interbank rate (period average)	6.4	6.2	4.4	5.8	7.5	...	...
Balance of payments (in billions of U.S. dollars, unless otherwise indicated) 3/							
Current account balance	5.1	1.7	-24.4	-29.1	-25.7	-24.3	-25.5
In percent of GDP	0.7	0.2	-2.8	-3.3	-3.0	-2.8	-2.7
Trade balance	31.0	33.8	8.7	5.8	7.8	11.3	11.7
Of which: Oil and gas (net)	3.2	-0.7	-5.2	-9.7	-10.4	-7.4	-7.9
Inward direct investment	13.8	19.2	19.1	18.8	21.5	22.9	24.5
Overall balance	30.3	11.9	0.2	-7.3	13.6	8.0	5.6
Terms of trade, percent change (excluding oil)	10.4	7.3	-2.9	-3.5	-3.3	-4.1	1.4
Gross reserves							
In billions of U.S. dollars (end period)	96.2	110.1	112.8	99.4	111.9	119.9	125.5
In months of prospective imports of goods and services	6.1	6.2	6.4	6.0	7.2	7.2	6.9
As a percent of short-term debt 4/	224	236	206	175	173	178	179
Total external debt 3/ 5/							
In billions of U.S. dollars	202.4	225.4	252.4	265.6	297.5	316.7	333.4
In percent of GDP	28.5	26.7	28.7	30.5	35.0	36.2	35.6
Exchange rate							
Rupiah per U.S. dollar (period average)	9,088	8,774	9,375	10,414	11,862	...	...
Rupiah per U.S. dollar (end of period)	8,979	9,075	9,638	12,171	12,435	...	...
Memorandum items:							
Jakarta Stock Exchange (12-month percentage change, composite index)	46.1	3.2	12.9	-1.0	22.3	...	...
Oil production (thousands of barrels (bbls) per day)	945	907	860	830	794	825	840
Nominal GDP (in trillions of rupiah)	6,447	7,419	8,231	9,087	10,095	11,309	12,621

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

1/ Contribution to GDP growth (percentage points).
2/ Includes changes in stocks.
3/ For 2014, figures are projections.
4/ Short-term debt on a remaining maturity basis.
5/ Public and private external debt.

Statement by Wimboh Santoso, Executive Director for Indonesia and Evie Akbar, Advisor to Executive Director
March 9, 2015

1. On behalf Indonesian authorities, we would like to thank the IMF mission team for the constructive and candid discussions during the Article IV consultation. The discussions focused on the new administration' policies to manage vulnerabilities and boost potential growth in the medium-term. We are encouraged by staff' recognition that the authorities' sound macroeconomic management has bolstered policy credibility and strengthened the external resiliency of Indonesian economy.

2. As clearly described by staff, the Indonesian economy continues to demonstrate its resilience and is on better footing to weathering the unfavorable and headwinds of global development. Macroeconomic stability is preserved and economic rebalancing progresses to a more sustainable path, underpinned by economic stabilisation policy and structural reforms. Financial system stability is also maintained with the support of steadfast banking system resilience and sound financial market performance. To arrive at this stage, the authorities have continuously strengthened the economic fundamental, including taking bold and pre-emptive macroeconomic policies to withstand a spillover impact from global economic adjustment.

3. Moreover, successful elections in mid 2014 have brought momentum and optimism to the country. The new government has put structural reforms as its priority to address infrastructure bottlenecks and sustain a balanced growth in the medium-term. This has brought back investor confidence as reflected in substantial capital inflows in 2014. Moving forward, the authorities have set out clear strategies to secure macroeconomic and financial stability. They have also laid solid foundation to maintain a balanced and sustainable growth in the longer term. These include maintaining prudent fiscal management by managing the fiscal deficit at the low level, and keeping debt to the GDP ratio at the sustainable level. Exchange rate will also be kept flexible, to function as a shock absorber, as well as a facilitator of external adjustment.

Recent Economic Development and Outlook

4. The Indonesian economy grew 5.02 percent (yoy) in 2014; remain strong despite slowing from 5.6 percent in 2013. The lower economic growth in 2014 was inevitably as a result of slower-than expected global growth which in turn affects export performance. Furthermore, domestic demand growth moderated, in line with the authorities' policies to prioritize economic stabilization. In 2015, the authorities expect the growth to accelerate to 5.4 -5.8 percent, higher than staff's projection of 5.2 percent. Strong household consumption and greater fiscal capacity to support economic activity will swiftly catalyze higher economic growth.

5. CPI inflation escalated to 8.36 percent in December 2014, mostly due to the rise in administered price components. The fuel price adjustment in November 2014 has temporary put upward pressure on inflation. Nevertheless, the core inflation was relatively well managed at 4.93 percent, showing that the monetary policy stance could contain the second round effect of fuel prices hike. The authorities believe that the inflation has reached its peak in December 2014 as illustrated in declining level of CPI inflation in first two months of 2015, which fell to 6.3 percent (y/y) in February. Going forward, the authorities are assured that the inflation will be contained and reach the target of 4±1 percent in 2015.

6. On the fiscal side, the authorities continue to maintain sound fiscal management and keep debt to GDP ratio at a safe level to secure fiscal sustainability. Recognizing the importance of infrastructure to lift the potential output in the medium-term, the focus of fiscal policy is increasing budget allocation for infrastructure investment and poverty alleviation.

External Sector Assessment

7. Coherent stabilization policies in monetary and fiscal front, as well as improved investor confidence have significantly enhanced the Balance of Payments (BOP) in 2014. The BOP recorded a surplus of US$ 15.2 billion, against a deficit of US$7.3 billion in 2013 as the current account improved and financial account recorded a sizable surplus. The current account deficit narrowed to US$26.2 billion (2.95 percent of GDP) from US$ 29.1 billion (3.18 percent of GDP) in 2013. It is worth to note that the improvement in the current account was supported by higher the non-oil/gas trade balance as a result of stronger manufacturing exports, and declining imports due to subdued domestic demand. Furthermore, the large influx of foreign capital made the financial and capital account register a surplus of US$43.6 billion. This includes a rise in Foreign Direct Investment (FDI) inflows that extended to manufacturing, agriculture, mining, and transportation & communication sectors.

8. The authorities view that Indonesia's external position is in line with its medium-term fundamental. The current account deficit is within the range as suggested by the EBA, a model that the authorities have replicated to ensure their assessment is comparable to Fund's suggested best practice. The current policies, including the flexible exchange rate, have facilitated external adjustments in the current account toward a sound level as well as better composition. Manufacturing sectors have improved and could ultimately compensate a decline in commodity export following a decrease in commodity prices. Furthermore, Indonesia is on the crossroad to move up from middle income country group. Increasing the economic activity still requires more import contents that may lead to the current account deficit. In this regard, staff could have provided more granular recommendation on how to balance between effort to promote economic activity and to maintain healthy external balance.

Monetary Policy and Exchange Rate Policy

9. The authorities are cognizant of the importance of anchoring inflation expectation and managing external shocks. In this regard, Bank Indonesia (BI) launched the policy mix by adopting tight monetary policy to control inflation, maintaining flexible exchange rate to promote an adjustment on the current account, and introducing capital flow management (CFM) to dampen short-term excessive volatility. The rise in policy and lending facility rates to 7.75 percent and 8.00 percent following the fuel prices adjustment in November 2014 had brought down the spike in inflation rate; meanwhile flexible exchange rate and CFM have supported the authorities in narrowing the current account deficit and strengthening external resiliency.

10. On February 2015, BI lowered the policy rate and the deposit facility rate 25 bps to 7.50 percent and 5.50 percent respectively. This decision was taken after the authorities' comprehensive assessment concluded that a drop in the expected oil prices along with benign development in domestic food prices and manageable domestic demand will present considerable downside risks to expected inflation. Hence the authorities are confident that inflation will remain under control and will fall at the lower end of the 4 ± 1 percent target range in 2015 and 2016.

11. The authorities would consistently adopt flexible exchange rate in line with its economic fundamental value. This would help to facilitate external adjustments and safeguard current account sustainability. The authorities' also share staff's assessment on the importance of strengthening monetary policy transmission; thus, they would further enhance the monetary operations frameworks. Recognizing the importance of deepening financial market, the authorities move forward with efforts to address shallow financial market. These include amending BI's regulation on hedging activities to increase hedged market liquidity, and introducing Islamic Foreign Currency Term-Deposit. Bond yield flexibility will also be continued to complement primary response against external shocks as currently practiced.

Fiscal Policy

12. As acknowledged by staff, the government's fiscal rule has provided a solid nominal anchor. The authorities deliberately adopt prudent fiscal policy by maintaining the deficit below 2.5 percent and managing public debt at a low level. In 2014, the fiscal deficit was targeted at 2.4 percent of GDP and public debt was successfully retained below 30 percent of GDP. Initiatives to maintain strong fiscal position were in place, ranging from enhancing revenue to improving the quality of spending. In terms of optimizing revenue, tax reforms will continuously be pursued. Meanwhile, on improving the quality of spending, the recent fuel price adjustment was the main policy measures to cut spending. The reforms on energy subsidies provide significant fiscal space to anticipate undesirable impacts from global economic development, as well as to invest in infrastructure projects. Considering the impact of rising fuel prices to the low-income and

vulnerable people, the authorities launched a compensation program by distributing cashless smart cards system that covers education, cost of living, and health insurance and medical benefit.

13. Moving forward, the authorities reiterate its commitment to maintain sound fiscal management. Fiscal policy will focus on improving budget structure to buttress real sector activities and reduce poverty while maintaining macroeconomic stability and boosting potential growth in the medium term. Continued efforts to improve the current account would also be enforced by providing fiscal incentives for industries that produce intermediate goods and re-investing their dividends, as well as strengthening reinsurance and local shipping industry. In light of this, the authorities expect the fiscal deficit to be around 1.91 percent of GDP in 2015.

14. The authorities are mindful that continued decline in oil prices will have an impact on non-tax revenue. They will strive to substantially increase tax revenue in order to offset lower non-tax revenue. In this connection, the authorities will persevere to maintain sustainable revenue sources by revamping tax administration, increasing compliance of individual taxpayers, strengthening enforcement and reducing tax distortion in strategic sectors, broadening tax based, optimizing custom and excise policies and enhancing the VAT system.

15. On the expenditure side, budget spending is intended to stimulate the economy through increasing capital expenditure to improve competitiveness and production capacity. The authorities would also reallocate budget to productive spending to generate employment and alleviate poverty. In this regard, additional budget would be allocated to village funds to induce productive activity in the remote areas and promote more inclusive growth, as well as capital injection to SOEs to support infrastructure development.

Financial Sector

16. Indonesia financial sector remains strong amidst challenging macroeconomic environment in 2014. Industry wide, banks are well capitalized and equipped with ample liquidity, with Capital Adequacy Ratio (CAR) is maintained at 19.36 percent, much higher than required minimum level. Credit and liquidity risks are also contained, underpinned by solid capital structure. Despite showing an uptick, Non Performing Loans (NPLs) were retained at low level of 2.2 percent. Meanwhile credit growth decelerated to 11.6 percent, in line with subsiding domestic economy activity. Sound banking system is confirmed by stress test conducted by the authorities which demonstrates that Indonesian banking sector possesses strong resilience to weather severe shocks.

17. While staff has concern on the possibility of renewed funding pressures in banking system in the event that deposit growth lags credit growth, the authorities are confident that the concern is unlikely to materialize. Heightened funding pressures in

early 2014 were owing to segmented market and seasonal factor due to government fiscal contraction, while banking liquidity remains sufficient. The liquidity condition has been improved during the second half of 2014, in line with the fiscal expansion and improvement in deposit growth. Furthermore, demand for credit was low, thus it lessened funding pressures.

18. The authorities continue to employ macro-prudential policy to maintain financial stability. They will also launch measures to enhance funding resources for banks while promoting financial market deepening and extending loan to productive sectors. Steps to strengthen financial sector regulation and supervision continue to progress, among others, by developing integrated risk based supervision, increasing banks' capital to meet Basel III standard, adjusting capital requirements and product enrichment for insurance industry and encouraging more firms to accumulate funds through capital market.

19. Meanwhile, risk form the corporate sector is expected to be contained as the authorities have issued regulation to promote prudent external debt management for non-bank corporations[1]. The purpose of this regulation is to further deepen the financial market as well as to mitigate risks on private external debt vulnerability, primarily currency risk, liquidity risk, and over-leverage risk. To confront the aforementioned risks, Bank Indonesia requires non-bank corporations holding external debt to fulfill three requirements, namely a minimum hedging ratio to mitigate currency risk, a minimum forex liquidity ratio to mitigate liquidity risk and a minimum credit rating to mitigate over-leverage risk. In addition to ensuring prudential principles, the minimum hedging ratio required by the regulation will also contribute in expanding the hedging market. While the corporate moves toward better prudent practices, banking sector has cushioned themselves with the sufficient capital buffers.

20. Furthermore, acknowledging the importance of crisis management framework, the work on finalizing the Financial Sector Safety Net (FSSN) Law is on progress and has become a top priority of the new government to be completed this year.

Structural Reforms

21. We concur with staff on the need of upfront actions to enhance structural reforms. In light of this, the new government has a strong commitment on structural reforms to improve productivity, explore new source of growth, develop financial markets and undertake a comprehensive energy policy. Fuels subsidy reforms taken at the end of 2014 demonstrated the authorities' swift actions to advance structural reforms. The main focus of structural reforms is to address supply bottlenecks, diversify the economy from commodity sector and raise potential growth. In this connection, the new government has

[1] This includes Bank Indonesia regulation No. 16/20/PBI/2014 concerning Prudential Principles for the Management of Non-Bank Corporate External Debt to corporate borrowers of foreign loans on 28th October 2014 which was further amended with BI Regulation No. 16/21/PBI/2014 dated 29 December 2014.

set up infrastructure investment plan for 2015-2019 that covers many sectors, such as transportation, energy, clean water and telecommunications.

22. The implementation of infrastructure development is complemented by efforts to improve business climate. In doing so, the authorities implement One Stop Service to streamline approval process, improve the quality of public service and governance, step up with the implementation of the Land Acquisition Law, increase productivity by providing incentives for research and development activity, as well as strengthen labor policy. The authorities would also develop agriculture and fishery sectors to support food security and generate employment.

23. Finally we are pleased to share that we continuously improve our AML/CFT compliance and this effort has been acknowledged by the FATF in its February 2015 public statement.

Conclusion

24. In summary, amidst the global uncertainty, Indonesia moves forward to transform into a better, more sound and sustainable economy. Nevertheless, the authorities recognize the challenges that lie ahead and do not want to loose sight. They will closely monitor the latest development of both domestic and global economy in order to maintain consistent and bold policy measures. The authorities also reiterate their commitment to remain vigilant and stand ready to take proactive measures to ensure that macroeconomic and financial stability are well preserved. Having said that, the authorities would benefit from staff's advice that not only helps Indonesia to stay in current stage, but also takes Indonesia to reach a higher level. In that regard, they look forward to a continued constructive engagement with the Fund.