October 2011
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Indonesia: 2011 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; 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 2011 Article IV consultation with Indonesia, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on July 21, 2011, with the officials of Indonesia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on September 21, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of October 7, 2011 updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its October 7, 2011 discussion of the staff report that concluded the Article IV consultation.

- 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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INDONESIA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

September 21, 2011

KEY ISSUES

Outlook: The size and strength of domestic demand, as well as large policy buffers, limit downside risks from deteriorating global conditions. Indeed, in the absence of a significant further deterioration in global conditions, the strength of domestic demand could lead to higher inflationary pressures in 2012. Ambitious medium term growth objectives are achievable if long standing issues related to infrastructure, the investment climate, and legislative reforms are addressed.

Managing capital flows and exchange rate policy: Continued exchange rate flexibility will be important in managing volatile capital flows while the buildup in reserves over the past eighteen months should help buffer any deterioration of international financial conditions.

Monetary policy: While immediate pressures on headline inflation have abated, core inflation is projected to rise later this year and into 2012 as credit growth and strong activity add to domestic demand. Bank Indonesia should be prepared to adjust its monetary policy stance to contain inflationary pressures and achieve its more ambitious inflation target in 2012, as long as global conditions do not deteriorate substantially.

Fiscal policy: The fiscal deficit is projected to increase in 2011 due to increasing energy subsidies. In spite of recent reform measures to improve budget implementation, development spending in the first six months followed historical patterns of low execution. An overall lack of flexibility limits the scope for countercyclical fiscal policy. In the medium term, subsidy reform and increased revenue mobilization will be needed to provide the fiscal space necessary for higher public infrastructure investment and social expenditures.

Financial policies: Current domestic financial conditions are benign. Some key recommendations of the 2010 FSAP have already been implemented. Additional measures should be taken, and prudential controls strengthened to limit possible risks arising from expanding bank lending. Passage of the Financial System Safety Net (FSSN) law would strengthen the legal foundation for crisis management.

Approved By
Mahmood Pradhan and Aasim Husain

Discussions took place in Jakarta during July 7–21, 2011. The team comprised Thomas Rumbaugh (head), Geoffrey Heenan, Sarah Zhou (all APD), Dora Benedek (FAD), Mali Chivakul (SPR), and Nancy Rawlings (MCM). Aida Budiman, Iss Hafid (both OED) and Milan Zavadjil (Senior Resident Representative) also participated in the discussions. The staff of the IMF office in Jakarta provided valuable assistance to the mission. The team met with Bank Indonesia Governor Darmin Nasution, Minister of Trade Mari Pangestu, Vice Minister of Finance Anny Ratnawati, other senior officials, and private sector representatives.

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CONTEXT

1. **The Indonesian economy proved resilient during the global financial crisis, and has since continued to grow at a robust rate**. This resilience reflects the prudent macroeconomic policies pursued over the last decade. Both public and private indebtedness have fallen sharply, international reserves have been rebuilt, and inflation has been contained. Key banking system vulnerabilities have been reduced by improvements in financial regulation, and other structural reforms are continuing. Political stability and favorable demographic trends provide an opportunity for even stronger economic performance over the medium term.

2. **Despite the current strong fundamentals, the achievement of higher sustained and equitable growth remains challenging**. Infrastructure bottlenecks could increasingly limit growth. More fiscal resources are needed to fund public infrastructure projects and social spending, and capital markets remain shallow.

3. **The joint IMF-World Bank Financial Sector Assessment Program (FSAP), completed in 2010, found that the banking sector was resilient**. The banking system had a large capital buffer, ample liquidity, and remained profitable even through the economic slowdown in 2009. Stress tests found that a limited number of banks were vulnerable to extreme liquidity shocks and a few large banks susceptible to concentration risk. Exchange rate and contagion risks were not major concerns. The FSAP also identified further reform areas to enhance financial sector resilience. Key reform priorities centered around strengthening the legal and governance framework for supervision, coordination of macro microprudential supervision and crisis management, securing BI's financial independence, and developing capital markets.

4. **In concluding the 2010 Article IV consultation (August 27, 2010), the Fund commended the Indonesian authorities for their impressive policy performance, which successfully steered the economy through the global financial crisis**. Directors commended Indonesia's progress over the last decade in improving financial stability and welcomed the steps being taken by the authorities to further strengthen the resilience of the financial sector in line with the recommendations of the FSAP. Directors considered that maintaining exchange rate flexibility was an important part of the toolkit to manage the volatility of capital flows. They advised that BI should signal its readiness to respond to rising inflationary pressures to anchor inflation expectations within the target range. To reduce sterilization costs, Directors recommended the gradual conversion of the nonmarketable government bonds on BI's balance sheet to marketable bonds, thereby also expanding BI's operational toolkit. Directors endorsed the

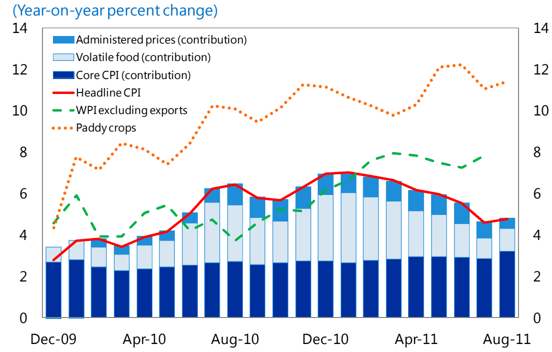
overall fiscal stance for 2010, but noted that further fiscal reforms would be necessary to support sustained high growth. Specifically, reducing energy subsidies would create additional fiscal space for much needed infrastructure spending and transfer programs for the poor.

RECENT DEVELOPMENTS: ROBUST GROWTH WITH SOME INFLATIONARY PRESSURES

5. **Indonesia's macroeconomic performance remains very strong**. Real GDP grew 6.5 percent y/y in the first half of the year, and growth has become more balanced, with investment adding to consumption and exports as the main engines of growth. The strength of domestic demand has been mirrored in the rapid expansion of the services sector, which has contributed about two thirds of total economic growth. Retail sales and consumer confidence remained robust in the second quarter while industrial production growth and business confidence also strengthened.

6. **Headline inflation has eased in recent months on slowing food price rises**. At end-2010, rising food prices had pushed CPI inflation to 7 percent y/y, exceeding BI's 4–6 percent target range. Headline inflation started to ease since February 2011, falling to 4.8 percent y/y in August. Food prices had been held down by good local harvests and increased rice imports, but rose in July August, reflecting seasonal demand during Ramadan. Core inflation rose steadily through 2010 and into 2011, reaching 5.2 percent in August. Producer price inflation and inflationary expectations remain elevated. Public sector wages are also expected to increase as a result of administrative reforms while private sector wage growth has also accelerated in the mining and agricultural sectors.

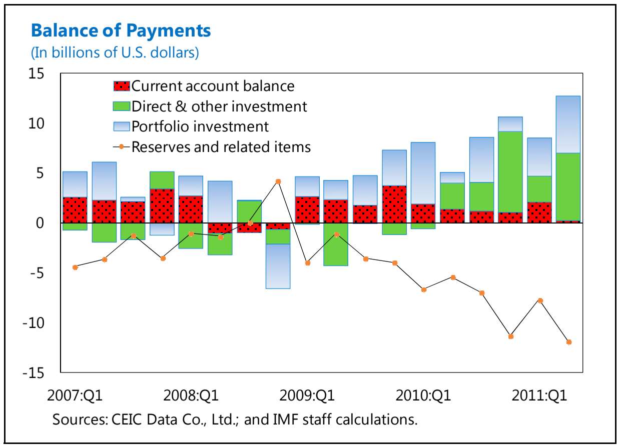
Wholesale Prices and CPI Inflation
(Year-on-year percent change)



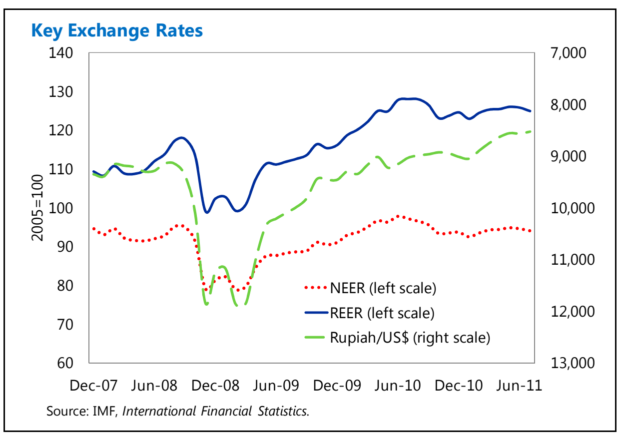
Sources: CEIC Data Co., Ltd.; and IMF staff calculations.

7. **The current account surplus has declined in line with strengthening domestic demand, but capital inflows have increased**. Export revenues continue to rise, buoyed by higher commodity prices and strong regional growth. Strong portfolio inflows have continued this year, reflecting mainly large nonresident purchases of government bonds (SUNs) and, to a lesser extent, central bank bills (SBIs) and equities. The surge in gross portfolio inflows has averaged 2 percent of GDP per quarter since June 2009. As a result, over one-third of SUNs and SBIs are now owned by nonresidents. Foreign direct investment inflows have also

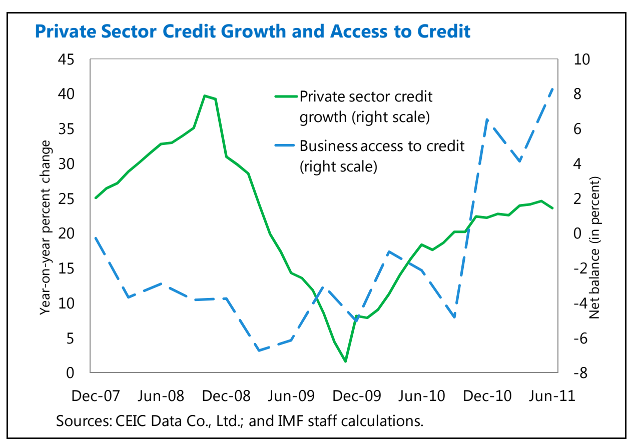
picked up sharply this year, not only to the resources industry, but also to the manufacturing and retail sectors.



8. **International reserves almost doubled since end-2009, reaching $125 billion at end-August 2011, while over the past six months, the rupiah has resumed its appreciation against the dollar**. CGER estimates indicate that the real exchange rate appears to be broadly in line with fundamentals, with two of the three measures showing a slight undervaluation (Box 1).



9. **Since October 2010, Bank Indonesia (BI) has used a wide range of instruments to stem mounting inflationary pressures and strong foreign investor demand for its sterilization instruments**. The central bank raised its policy rate by 25 bps to 6.75 percent in February 2011. Prior to this, the BI rate had been unchanged since August 2009. BI has also implemented other measures to tighten policy, including raising reserve requirements on both local currency and foreign currency deposits. However, to stimulate transactions in the money market under the continuing large excess liquidity BI lowered the bottom of the interest rate corridor in September 2011 by 50 bps to 5.25 percent while keeping the policy rate unchanged. BI has also been able to curtail foreign investor demand for central bank bills (SBIs) by extending the holding period requirement on these securities from one month to six months, lengthening the maturity of SBI issues to nine months, and introducing longer maturity nontradable term deposits available only to banks. Despite substantial sterilization efforts, liquidity has increased, and credit growth remains high at 23.6 percent y/y in August, while bank lending surveys indicate that credit growth is expected to remain at this rate through 2011. Lending growth has been strongest to the mining sector but has also been broad based across investment and consumption. Since end-June, overnight money market rates have fallen by around 100 bps and are now 145 bps below the BI policy rate. More notably, the yield on BI's open market operations have fallen by around 150 bps. Moreover, yields on short term treasury securities are now well below money market rates. Demand for these securities has been driven by foreign investors unable to purchase new SBIs, implying expectations of further rupiah appreciation.



Box 1. Indonesia: Exchange Rate Assessment

After a large depreciation following the Lehman event in the fourth quarter of 2008, the real effective exchange rate (REER) returned to its pre crisis high by Q1 of 2010 and continued on an appreciating trend in 2011. The appreciation has been accompanied by strong export growth in 2010 and the first half of 2011. Although exports have been driven by buoyant commodity prices, noncommodity goods have also performed well, with y/y growth in manufacturing exports averaging about 30 percent. As a result, Indonesia's world market share has improved steadily during the last two years.

World Market Penetration
(In percent of total world imports)
Source: IMF, *Direction of Trade Statistics*.

The staff exchange rate assessment (CGER) suggests that the REER is close to equilibrium. The macro balance approach estimates Indonesia's current account deficit norm in the medium term at 0.7 percent of GDP, close to the staff's projection of a medium-term current account deficit of about 1 percent of GDP, implying that the REER is slightly overvalued. The other two approaches, which compute the current account position that would stabilize Indonesia's net foreign assets at the 2010 level of 35 percent of GDP (external sustainability approach), and estimate equilibrium based on a regression analysis, suggest that the REER is slightly undervalued. However, on average, and taking into account the confidence interval, Indonesia's REER is in line with its fundamentals.

Indonesia: Real Exchange Rate Assessment

	Percent Deviation from Estimated Equilibrium
Macro balance approach (MB) 1/	4
External sustainability approach (ES) 1/	-9
ERER approach (ER), 2011 2/	-4
ERER approach (ER), 2016	-6
Memorandum items (in percent of GDP):	
Current account norm	-0.7
NFA-stabilizing current account at 2010 level	-2.5

Source: IMF staff estimates.

1/ Based on April 2011 WEO projections.

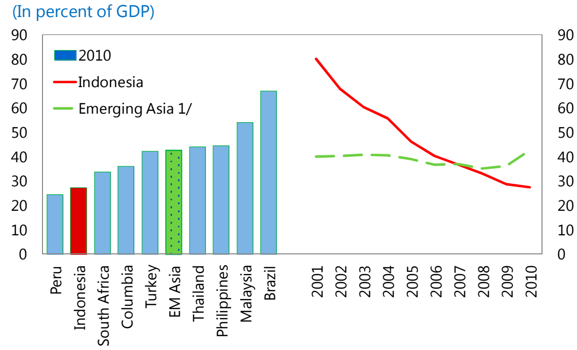
2/ Based on April 2011 REER value.

10. **Capital inflows and robust economic growth have underpinned substantial gains in other financial markets**. Despite the recent market correction, stocks have outperformed other bourses in the region, rising over 4 percent year to date in U.S. dollar terms by mid-September, with net inflows to equities of nearly $1.4 billion over the same period. Forward looking price/earnings estimates are closer to the high end of historical patterns but do not appear excessive. While there is anecdotal evidence of strong price increases for some high end residential segments and for industrial land, aggregate property price indices are only rising in line with CPI inflation. Strong growth prospects, solid debt and external fundamentals, and the potential for a ratings upgrade to investment status have caused external debt spreads to narrow. Since the start of the year, Indonesia's sovereign

ratings were upgraded to one notch below investment grade by Moody's and Standard and Poors. Both Standard and Poors and Fitch have positive ratings outlooks.

11. The moderate fiscal stimulus provided in 2009 was reduced in 2010. The 2010 central government budget deficit was 0.6 percent of GDP, well below the government's revised budget deficit target of 2.1 percent. The outturn reflected ongoing implementation problems, with capital expenditures 19 percent below the budget allocations. Revenue collection exceeded the budget target, buoyed by strong nominal GDP growth. Public debt to GDP fell to 27 percent, underscoring Indonesia's strong fiscal position

General Government Gross Debt
(In percent of GDP)



Source: IMF, *Fiscal Monitor*, April 2011.
1/ PPP GDP-weighted average.

relative to its own historical performance and its emerging market peers. At end-2010, the government reformed expenditure and budgeting procedures to improve execution, but this has not yet been reflected in increased spending. Spending units were provided greater flexibility to reallocate expenditures within their overall budget allocation. In addition, pilot performance-based budgeting and medium-term expenditure frameworks have been expanded to more line ministries to improve spending effectiveness.

12. Indonesian banks continue to be profitable and generally well capitalized, consistent with the findings of the 2010 FSAP. Capital adequacy ratios slipped 1 percent between March 2010 and May 2011, mainly due to the introduction of the operational risk component of Basel II. However, the system remains well capitalized. The impact of completing the Basel II transition and moving towards Basel III is expected to be minimal. Asset quality is generally satisfactory, with the nonperforming loan ratio remaining below 3 percent, and the loan to deposit ratio edging upwards over the past year following a cyclical pickup in lending. Indonesia is in the process of addressing deficiencies in the framework for AML/CFT noted by the Financial Action Task Force (FATF), including passage of the AML/CFT Act in October 2010 and the Fund Transfer Act in March 2011.

OUTLOOK AND RISKS

13. **Immediate risks to economic stability are manageable**. Staff projects growth to be sustained at 6.4 percent in 2011 and 6.3 percent in 2012 despite the lower global growth projected in the September 2011 *World Economic Outlook*. The most likely risk is a reversal in portfolio inflows related to a sudden drop in foreign investor demand for government debt (such as a new round of risk aversion caused by spillovers from advanced economies). Foreign ownership in government rupiah debt is high at 35 percent, but Indonesia is now in a better position to manage such an event with strong reserves and fiscal room (including substantial cash reserves). Public debt remains on a sustainable path and is expected to decrease to around 25 percent of GDP by end-2011 (see Appendix I). A sharp rise in bond yields would affect the banking system through increases in funding costs, market losses, and loan defaults, but the banks' current high profitability and capital positions should be sufficient to buffer these shocks. That said, the lack of a financial safety network is a major weakness and could allow an individual bank failure to become a systemic problem.

14. **The external outlook, however, remains highly uncertain**. Indonesia is not immune to spillovers from a global financial shock that would lead to another recession in advanced economies. It could be affected through the trade, financial, and commodity price channel. On the trade side, the effect would mainly feed through commodity exports as Indonesia is less integrated in the regional supply chain for manufactured goods. In this regard, China's demand and its policy response in such a shock scenario would be crucial to investors' sentiment in Indonesia, as commodity exports to China have increased significantly in recent years. The financial channel is not expected to play a big role, as the private sector and banks are not dependent on foreign financing. While foreign currency borrowing has increased rapidly in the past year, it remains low relative to corporate balance sheets and to GDP. Indonesia's relatively large domestic economy could prove resilient if consumption and domestic investment can carry the momentum even if FDI and commodity related investment slowed down significantly as part of an adverse global scenario.

15. **Market prices indicate that risks remain low but are sensitive to changes in global sentiment**.[1] Correlations between the European periphery's and Indonesia's financial assets have been low, compared to other G-20 emerging markets. In the recent bout of global risk aversion, CDS spreads and EMBI spreads have risen, but they remain below 2010 highs. In fact, Indonesia's EMBI spreads have performed better than other large emerging markets. The stock market index has declined from a high level while domestic bond yields, as well as the rupiah, have returned to second quarter levels as of mid-September (Figure 5). A ratings upgrade would substantially widen the foreign investor base and trigger inflows from funds that have mandates restricting them to investment grade assets, and this

[1] For a more detailed discussion of financial spillovers to Indonesia, see Chapter IV of the accompanying selected issues papers.

could push both local and global bond yields even lower.

16. Over the medium term, staff projects growth to reach 7 percent, underpinned by both public and private sector investment, provided that the government's ambitious infrastructure and structural reform agenda is implemented. The current account is projected to move to small deficits starting in 2012, due to robust investment demand and a trend decline in the terms of trade. Strong capital inflows—both FDI and portfolio investment—are expected to continue since planned structural reforms and infrastructure spending will expand private investment opportunities.

17. The Government's recently released Master Plan[2] **aims to make Indonesia one of the world's largest economies by 2025**. The first pillar of the plan is the development of six regional economic corridors through investments in sectors with high growth prospects and clear comparative advantages. This will be supported by the second and third pillars, namely improving connectivity and strengthening human resources and science and technology. The Master Plan targets investments of $468 billion over 2011–2025, of which 45 percent will be in infrastructure. One-fifth of the total investment is expected to come from the government. The Master Plan's assumptions for GDP growth and private investment, in particular, are very ambitious and will require a substantial acceleration in the reform agenda and increased political commitment to implementation.

18. Indonesia's growth path will depend on the success of the government's reform program in accelerating public infrastructure projects and increasing human capital. A growth accounting framework (Box 2) suggests that if little further progress is made on infrastructure investment and other reforms, capital accumulation and total factor productivity growth could slow, and growth could be limited to 6 percent (or less) over the medium term. However, potential growth could reach 8 percent if more ambitious reforms are enacted, and spending on infrastructure is substantially increased.

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[2] *Masterplan for the Acceleration and Expansion of Indonesia Economic Development 2011–2025.*

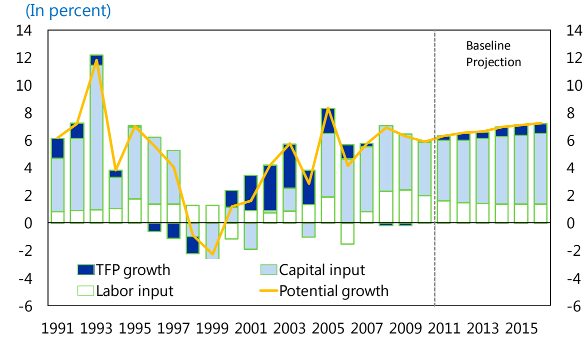
Box 2. Indonesia: Estimating Potential Growth 1/

Using growth accounting methods, Indonesia's potential growth rate was estimated, and the change in output decomposed into the contributions of capital and labor and the efficiency with which the factors are combined. Estimating potential growth is highly dependent on the quality of the underlying data, and assumptions were necessary to calculate historical series for both capital and labor inputs.

Prior to the Asian crisis (1991–1997), estimated potential growth was robust at 6.5 percent and predominantly input driven, specifically by capital accumulation. After becoming negative immediately after the Asian crisis, estimated potential growth recovered partly to 4 percent during 2001–2005, with productivity gains dominating during this period owing to institutional reforms and growth conducive policies. Since 2006, potential growth picked up to around 6 percent, again being driven by growth in labor and capital inputs rather than by efficiency.

Indonesia: Potential GDP Growth Rate by Growth Accounting

(In percent)



Source: IMF staff calculations.

Indonesia's potential growth rate in the baseline scenario is estimated to gradually rise to 7 percent, mostly reflecting the increase in capital accumulation and efficiency. For a downside scenario, if there were slow progress on infrastructure and other structural reforms, the growth rate would stagnate to about 6 percent. Raising Indonesia's potential growth to 8 percent over the medium term would require substantial enhancements in capital and efficiency.

Indonesia: Contribution to Potential Growth Under Three Scenarios, 2016

(In percent)

	Delayed Reform	Baseline	Intensive Reform
Potential growth	6.0	7.2	8.2
Capital services	4.4	5.2	5.5
Stock of capital	4.1	4.8	5.2
Capacity utilization	0.3	0.3	0.3
Labor services	1.3	1.4	1.5
1-NAIRU	0.2	0.2	0.3
Labor force participation rate	0.3	0.3	0.4
Average hours worked	0.0	0.0	0.0
Working age population	0.8	0.8	0.8
Total factor productivity	0.2	0.7	1.1

Sources: BPS; Haver Analytics; WEO database; and IMF staff estimates.

For Indonesia to raise its growth potential, it will need greater efforts to address longstanding constraints, including weaknesses in infrastructure and the need to raise overall efficiency. Ample investment is needed so that capital stock growth can contribute to raising potential growth. Supportive policies for infrastructure development, such as a more effective fiscal policy through improved budget execution, would be crucial to this effort. Improvements in efficiency, or TFP, which includes a wide range of country specific factors related to Indonesia's business environment, will further promote growth. Ongoing efforts in carrying out structural reforms, such as greater openness to trade and FDI, financial development, and reform of the regulatory framework can help enhance growth via closing technology gaps and increasing efficiency.

1/ For a more detailed discussion, see Chapter I of the accompanying selected issues papers.

POLICY DISCUSSIONS

A. Monetary and Exchange Rate Policy: Controlling Liquidity amid Sustained Inflows

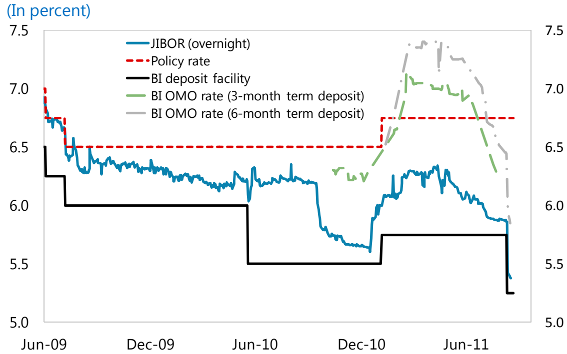
19. Headline inflation has eased in recent months as rice imports and the harvest have tempered food price increases, but upward pressure on core inflation is expected to remain. Excess liquidity remains high, wages and real credit growth are increasing, and the fiscal stance is expected to add stimulus in the second half of the year. The future path of food prices will play a major role in the evolution of inflation, but recent increases in rice stocks and plans to import rice limit the risk of a repeat of last year's sharp spike in headline inflation. Nevertheless, as the output gap is estimated to have closed by 2011:Q3, core inflation is projected by staff to remain at 5 percent in 2011 and could increase further in 2012, assuming that planned reductions in energy subsidies take place. This would push headline inflation to around 6½ percent in 2012, well above BI's target band of 4.5 ±1.0 percent.

20. Under these circumstances, and given the lags in monetary policy transmission, BI will need to contain inflationary expectations and limit second-round effects from energy price increases. Unless there is a substantial deterioration in the external environment, Indonesia's growth momentum will remain solid and broadly based. Therefore, there is little risk that monetary policy tightening will cause an unintended economic downturn, and the current accommodative conditions will eventually need to be withdrawn. Keeping inflation within the target range will also increase the credibility of BI and help achieve a sustained reduction in inflation over the medium term. The current volatility surrounding the global economic outlook and market sentiment suggests that an increase in the policy rate can be delayed until the situation becomes clearer.

21. Staff recommended that BI use all instruments at its disposal to constrain any rise in inflationary pressures and the pace of credit growth. A combination of policy rate increases, liquidity withdrawal (including through additional increases in reserve requirements), and further exchange rate appreciation would help broaden transmission channels and increase policy effectiveness. Complementary macroprudential measures could also be used to help manage macroeconomic risks stemming from rising credit growth. This broad approach would provide a strong signal of BI's resolve to lower inflation, which will help it attain its more ambitious 2012 inflation target and its medium term commitment to lower inflation to 3 percent. BI should also guide price expectations around planned energy price increases by providing projections of the direct effects on inflation of such measures ahead of time, and explicitly stating how much of the first round effects it will accommodate in its inflation target. Assuming that demand conditions remain robust, as in the baseline forecast, staff believes that increases in the real policy rates will be necessary and emphasized that timely action would help control expectations to limit the size of the eventual adjustment.

22. Strengthening the transmission from BI's monetary operations to liquidity conditions, interest rates, and ultimately domestic demand, is crucial to improving the effectiveness and credibility of monetary policy. Staff noted that, while BI had made significant improvements to its monetary operations and taken steps to encourage money market development, persistent excess liquidity and weak money market activity were dampening the impact of changes in BI policy on banks' cost of funds. Improving the effectiveness of monetary operations will require a coordinated and sustained series of reforms aimed at absorbing excess liquidity, providing more consistent interest rate signals from monetary instruments, and improving money market functioning (Box 3). In this regard, staff advised that BI should be more proactive with its monetary operations to withdraw liquidity and bring the overnight interbank rate closer to the policy rate. Failing to do so could cause confusion in the market and for the wider public about the central bank's policy intentions.

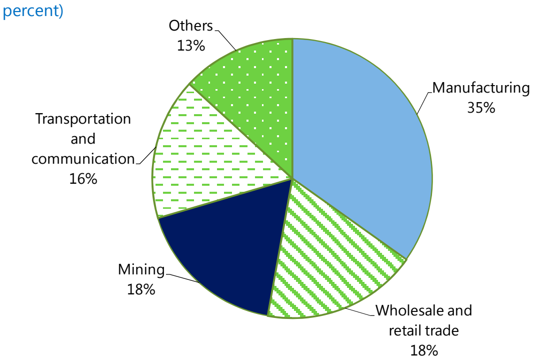
Indonesia: Policy Rate, OMO Rates and Overnight Rate
(In percent)



Source: Bloomberg L.P.

23. Strong capital flows are projected to continue. Portfolio inflows are projected to slow down for the rest of 2011, as the 6 month holding period of SBIs imposed in May will limit the supply of these instruments available to foreign investors. Although foreign investors have switched to T-bills and shorter maturity government bonds, the available amount is smaller and trading thin. FDI inflows, however, are projected to increase further. These inflows have been broad-based, attracted by Indonesia's large consumer base, low labor costs, and profitable commodity projects. Given the strong prospects for Indonesia and the region, FDI inflows should become a larger and perhaps less volatile source of support for the capital account than portfolio inflows.

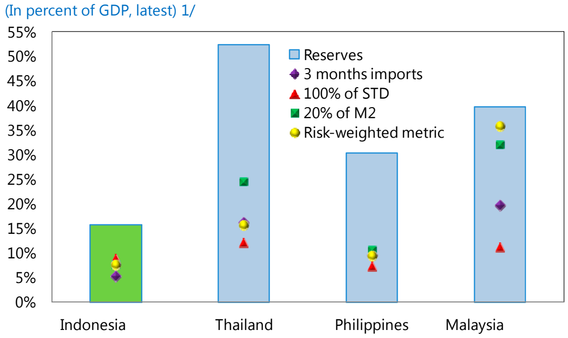
Indonesia: FDI by Economic Sector, 2010–2011:Q1
(In percent)



Source: Bank Indonesia.

24. With reserves at comfortable levels, staff supported BI's stance to allow greater exchange rate flexibility in the face of strong inflows. Accordingly, there should be less emphasis on reserve accumulation going forward with intervention limited to dampening volatility of the exchange rate. In the authorities' view, the rupiah's recent appreciation has been in line with others in the region and has not hurt its price competitiveness. Staff concurred with the authorities that portfolio inflows could reverse, especially if the crisis in the Euro Area intensifies. The Indonesian authorities successfully rode out the Lehman Brothers shock through the appropriate use of reserves and exchange rate adjustment with limited impact on financial stability and the real economy, and they are now in an even stronger position to withstand a similar shock. The international reserve buffers and government cash reserves built in the last year could help alleviate pressure on the exchange rate and local bond markets if a sharp reversal were to occur. With the recent increase, reserves are now above existing adequacy metrics. The authorities and staff also concurred that while additional capital flow management measures remain part of the toolkit, they are not likely to be needed at this time.

International Reserves, Risk-Weighted Metric and Traditional Metrics
(In percent of GDP, latest) 1/



Sources: IMF, *International Financial Statistics*; and IMF staff calculations.
1/ Risk-weighted metric is based on Assessing Reserves Adequacy, IMF Policy Paper, 2011. Reserves and GDP data for Indonesia are as off Q1 2011. Other data are as off end-2010.

25. Existing measures to influence portfolio flows have successfully shifted the composition of inflows away from BI's sterilization instruments. The recent imposition of a six-month holding period for SBIs will lead to some outflows during the rest of the year because foreign investors will be unable to roll over their existing holdings. Additional capital flow measures do not seem advisable given the need to further develop and deepen capital markets. The authorities have put in place a series of backstops for the bond market if outflows were to lead to undue volatility in bond yields and the exchange rate. These include a market stabilization mechanism that would be funded by a combination of budget resources, cash reserves, and balance sheets of state owned enterprises, and BI has announced it could conduct auctions to buy rupiah denominated government bonds in order to reduce excessive currency volatility. Staff advised that a flexible approach should be taken, in the context of the planned crisis management protocol, to implement these market support mechanisms so as to avoid providing implicit insurance by reducing potential volatility for foreign investors, which could end up attracting more inflows.

26. Sterilization costs have been an increasing drain on the central bank's financial resources, as its assets are mainly low yielding foreign reserves and noninterest bearing government securities. This has led to an ongoing erosion of BI's capital base. The financial position of the central bank should be strengthened in the context of the government's broader asset liability management program, including the exchange of the nonmarketable government debt held by BI for marketable securities, which could then be used for monetary operations and to support the development of both the money and government debt markets (Box 3).

27. Authorities' views: Bank Indonesia noted that the current pace of credit growth was not excessive. Credit to GDP, at 28 percent, was low relative to other countries in the region, and the recent increase in lending was more heavily weighted to investment and working capital. This should ultimately reduce inflationary pressures by boosting productive capacity. While recognizing that there would be further pressures on inflation, BI felt that the upward pressure would be limited and could be managed by adjusting reserve requirements and tightening prudential controls. Bank Indonesia also agreed that money market development is a key priority and had taken

Box 3. Policy Options for Reducing Excess Liquidity, Improving Money Market Operations and Money Market Development[1/]

The framework for monetary operations, the management of system liquidity by the central bank, and money market development are all interlinked, and all contribute to the effectiveness of monetary policy. In the case of Indonesia, structural excess liquidity, along with impediments to money market development, especially of repo and swap markets, need to be addressed if both monetary operations and market functioning are to improve.

BI should use a combination of increased reserve requirements and a predictable calendar of longer tenor open market operations to provide a structural withdrawal of liquidity. Reserve requirements should be generally uniform across banks. The uneven distribution of liquidity among banks is better addressed by improving the incentives for surplus banks to provide liquidity to deficit banks.

To increase the clarity regarding the intent of BI's monetary operations, the structure of its open market operations could be simplified. Nontradable term deposits should be phased out because their illiquidity affects their pricing, complicates banks' liquidity management, and impedes money market development. Instead, BI should expand its use of reverse repos to manage liquidity. Structural operations could be conducted using variable rate auctions on a regular calendar. Eventually these rates will serve as useful benchmarks and provide indications of market expectations regarding the policy rate.

The capacity for further expansion of the interbank market is limited by the contraction in interbank credit limits since the global financial crisis, especially for smaller banks. This has lead to some segmentation in the money market. Measures to improve the infrastructure for interbank repo markets, including adoption of the new global master repurchase agreement, should be implemented. Expanded use of repos by BI should also provide more eligible collateral for interbank repos.

Replacing the nonmarketable, noninterest bearing government debt currently held by BI with marketable debt is a key prerequisite for the reform program outlined above. This will supply the collateral needed by both BI and banks, improve BI's policy credibility by providing it with the financial resources to expand its liquidity withdrawal, and support further development of the local government debt market.

1/ For a more detailed discussion, see Chapter II of the accompanying selected issues papers.

several measures in the last few months, including strengthening the compilation and dissemination of interbank data and increasing the use of reverse repos for liquidity withdrawal. A new *Global Master Repurchase Agreement*, drafted in coordination with the Ministry of Finance (MOF), the securities industry regulators, and market participants, should be adopted by year end. Both BI and MOF agreed it was important to address the impact of sterilization costs on the central bank's balance sheet and were discussing possible modalities for implementing the asset liability management agenda, including replacing the nonconvertible government debt held by BI.

B. Fiscal Policy: Improving the Structure of the Budget

28. The stance of fiscal policy has been a source of macroeconomic strength, but the postponement of subsidy reforms limits the flexibility to increase much needed infrastructure and social spending. Higher oil prices have pushed projected subsidy costs to 3.2 percent of GDP in 2011, compared with projected development expenditure of 2.3 percent of GDP. Nevertheless, Staff project that the 2011 budget deficit will be 1.3 percent of GDP, compared with the proposed revised budget target of 2.1 of GDP, largely based on a historical pattern of under spending. In spite of recent reform measures to improve budget implementation, execution of spending in the first six months remained low.

29. The limited flexibility of the budget constrains the use of fiscal policy for countercyclical purposes. This places a greater burden on monetary policy to respond to economic fluctuations. If economic growth were to falter (in response to a deterioration in global economic conditions, for example), there is considerable fiscal space to provide stimulus if needed. However, automatic stabilizers are small, and implementation capacity to expand discretionary spending in a timely manner is very limited. Alternatively, if economic developments remain robust, staff noted that any overperformance in revenue collections in 2011 could be used to reduce the overall deficit. For 2012, staff urged the authorities to improve the targeting of subsidies while increasing infrastructure spending.

30. Staff stressed Indonesia's own prior achievements in reducing energy subsidies, combined with expanding cash transfer programs to vulnerable groups. Indonesia successfully implemented such programs in 2005 and 2008. However, energy subsidies have risen in line with oil prices and now account for 18 percent of expenditures. Moreover, fast increasing domestic fuel demand, volatile oil prices and uncertainties in oil and gas production would pose risks to the budget going forward. Raising administrative fuel prices, and moving to a flexible pricing policy, would mean only temporary upward pressure on inflation if other policies are directed to limiting second round effects. Lower subsidies would help provide the necessary fiscal space for increasing infrastructure and social spending that would support higher economic growth.

31. Raising the tax revenue ratio from its current low level (12 percent of GDP) will require not only improved tax administration, but also closing of exemptions and broadening the tax base. Tax efficiency is low relative to regional peers. Staff emphasized that tax administration reform should continue to focus on increasing tax compliance and improving auditing. Staff identified other areas of the income tax and the value added tax where base broadening could be achieved (Box 4).

Box 4. Indonesia: Revenue Mobilization 1/

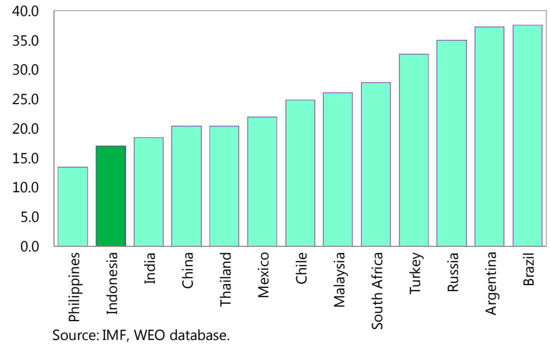
Indonesia faces the challenge of mobilizing revenue to provide space for poverty relief and infrastructure improvement. However, simply increasing revenue by further taxing compliant taxpayers can cause distortions and increase inequalities. Raising revenues in an increasingly globalized economy requires strengthening broad-based taxes and improving tax compliance, and should lead to a more efficient and more equitable tax system that enhances economic growth.

The tax revenue to GDP ratio in Indonesia is one of the lowest in the G-20. Personal income tax revenues are as low as 1 percent of GDP, while value-added tax and corporate income tax each raise about 4 percent of GDP.

While the number of personal income taxpayers multiplied in recent years, increasing compliance of those already in the tax net still remains a challenge. This requires further efforts in revenue administration. Tax efficiency is low by regional standards. Overall tax effort—measured as the ratio of actual tax revenue to estimated tax capacity—is around 54 percent. A realistic target range could be between the median for lower middle-income and the median of upper middle-income countries. These give a range of potential tax revenue of 13.4−16.4 percent of GDP in the medium term, which is a 2−5 percentage point improvement from current levels. This target would require both broadening tax bases and increasing tax compliance.

General Government Revenue, 2010

(In percent of GDP)



Source: IMF, WEO database.

The following measures could be considered to broaden the tax base over time:

- *Limiting VAT exemptions*: Many goods and services are exempt. Reducing the number of exemptions would expand the tax base and raise VAT revenues.
- *Limiting tax holidays and corporate income tax exemptions*: Many companies receive preferential treatment, such as investment tax allowances, accelerated depreciation, special tax rates for certain industries, etc. CIT revenues could be increased substantially by removing these inefficiencies. Tax holidays and exemptions should be targeted to a few well-specified sectors, with clear and transparent criteria, and for a well-defined preset period of time.
- *Taxing fringe benefits*: The personal income tax system is well designed and reasonably simple, including a widespread withholding of tax at source. However, fringe benefits remain exempt from personal income tax. Taxing this source of income could raise substantial additional revenues.

1/ For a more detailed discussion of tax mobilization issues, see Chapter III of the accompanying selected issues papers.

32. Authorities' views: The authorities noted that the delays in capital expenditures so far in 2011 were caused by recent changes to procurement procedures, which forced the reissuance of some tenders originally initiated in late-2010, and they expect implementation to improve in coming months. There is widespread agreement among government officials and the public that fuel prices must be raised, but the decision remains a political one. There are plans to restrict fuel subsidies to private vehicles on Java, but significant implementation hurdles remain. In addition to continuing the tax administration reforms, the authorities also saw some scope to increase nontax revenues by raising dividend and royalty income. The authorities agreed that increasing revenues will be crucial for fiscal reform.

C. Financial Policies: Strengthening Safety Nets

33. Bank Indonesia has made progress towards the FSAP recommendation to establish a legally mandated Prompt Correction Action (PCA) mechanism that would improve its ability to resolve weak banks in a timely and transparent manner. BI has issued a new regulation on problem bank exit, which improves the existing framework by expanding the criteria to place a bank under "intensive" supervision, introducing a time limit for resolving weaknesses, and requiring a capital injection to exit from special surveillance. In addition, the authorities have requested technical assistance to guide further reforms. Further strengthening the regime will provide a critical line of defense in maintaining financial stability, particularly given the absence of a robust financial safety net. Additional steps could include amending the Banking Act to require early supervisory corrective actions based on capital adequacy and other indicators, tightening the rule for recognizing a failed bank and transferring the bank from special surveillance to the deposit insurance agency (LPS), and amending the LPS law to provide for a wider array of bank resolution tools.

34. Over the past year, BI supervisors have focused on developing and implementing a new risk rating system for the banks. The new rating system, which is more forward-looking and uses more qualitative methodology, is a landmark shift from the existing system. A regulation has been issued, training has commenced, and full implementation is on track for the January 2012 deadline. In connection with the new rating system, BI has issued a new fit and proper regulation and a regulation on implementing pillar I of Basel II. Government officials have been discussing changes in single ownership limits for banks as a way to improve governance. Since there are other tools available to address governance concerns, including fit and proper requirements for strategic ownership positions, staff noted that ownership limits could make it more difficult for banks to raise capital.

35. Bank Indonesia supervisors have been making good use of their stress testing framework. Following on from work carried out during the FSAP, BI's Financial System Stability Bureau conducts stress testing on a monthly basis and reports the results to the Board and informs the supervisors, who utilize the tool as a basis for discussions with the banks. As a result, and in anticipation of further credit growth, many banks have raised their capital levels. While the strong GDP growth outlook suggests vulnerabilities remain low, supervisors should be alert to aggressive growth strategies pursued by some banks and move forward on discussions to revise the loan classification standards. The staff recommended other macroprudential measures that could limit risks from rapid expansion of bank lending, including raising risk weights on the fastest growing sectors, such as consumer and foreign currency corporate lending, and adopting forward looking provisioning requirements. A small number of Indonesian banks are still vulnerable to interest rate shocks on their banking books; however, the most recent interest rate risk sensitivity analysis shows that these risks have declined further since the FSAP. The proposed law to establish an independent financial supervision agency (OJK) continues to stall, as details regarding the composition of the Board of Commissioners are being discussed in parliament. This longstanding issue was also addressed during the FSAP and a subsequent technical assistance mission. The FSAP stressed that there were significant risks to bank supervision being transferred out of BI and noted that close cooperation between BI and the OJK (if forthcoming) would be essential.[3]

36. The adoption of the Financial System Safety Net (FSSN) law remains outstanding. As noted in the FSAP, the FSSN law would provide a legal foundation for crisis management and address certain issues, such as emergency lending. While the various financial sector regulatory agencies are proceeding with developing their individual crisis management protocols, passage of the FSSN remains critical to ensure that a legal basis exists for decisions that would need to be taken if a crisis were to occur. Other financial sector laws currently under review, such as the BI Act, the Banking Act, and the Capital Markets law, should be amended to provide a proper bank resolution framework and to ensure consistency with the FSSN law.

37. Authorities' views: The authorities expressed appreciation for the assistance provided during the FSAP to build capacity for stress testing, which has now been incorporated into BI's surveillance function. In addition, there is widespread agreement that an FSSN law is important for safeguarding financial stability and managing crisis. However, efforts taken thus far to strengthen the financial safety net by introducing an exit policy regulation (PCA) were viewed by BI as providing an adequate mechanism to deal with any issues that might emerge at this time while efforts continue to adopt the FSSN.

[3] See IMF Country Report No. 10/288.

D. Trade and Development Policies

38. The government is pursuing a number of trade policy initiatives. Efforts are underway to make the decision making process for nontariff barriers more transparent and to improve the coordination between various government departments responsible for these measures. In the context of food security, Indonesia has improved its own procedures for importing rice and is using its position as the ASEAN Chair this year to promote regional rice reserves and trade protocols.

39. The authorities expressed disappointment over the stalled Doha Round talks and hoped for more leadership by advanced economies in multilateral trade negotiations. They noted that Indonesia was now involved in bilateral trade discussions, mostly in the Asian region, and felt that the positive impact of these arrangements could be enhanced further if they were complemented by progress at the multilateral level.

40. Capital market development is needed to diversify funding sources. Strengthening investor confidence will be an important factor in propelling the markets forward. To this end, and as noted in the MOF's Master Plan, ensuring that high quality financial information is provided by market players should remain a top priority, and the transitioning to International Financial Reporting Standards is a positive move. This process will be aided by strengthening other infrastructure elements, such as the Capital Markets Law and increasing public awareness of products. Encouraging state owned enterprises to list on the domestic exchange and expanding the institutional investor base by supporting pension fund industry development would also assist in market development.

41. The authorities were hopeful that a critical weight of reforms could be achieved in the next few months that would catalyze additional foreign direct investment. Passage of the Land Acquisition Act and the successful negotiation of two more major public private partnership infrastructure projects to complement a central Java power project, recently launched, would be critical. Overseas interest in investing in Indonesia was mostly coming from the Asian region but is now increasing from other regions as well. Investors have focused on labor intensive manufacturing, where there is some evidence that firms are shifting production to Indonesia, and on sectors serving a growing Indonesia consumer market, such as retail, personal care, and automobiles.

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42. Immediate outlook: Indonesian GDP growth is projected to remain robust at around 6–6½ percent y/y in both 2011 and 2012. Increases in both foreign and domestic investment, including an anticipated increase in government infrastructure spending, are expected to offset lower growth contributions from net exports as import demand rises. Accelerating credit growth and an anticipated reduction in energy subsidies should push core inflation modestly higher this year and into 2012. Although the current account could move into deficit next year, the overall balance of payments will remain in surplus as capital inflows continue.

43. Risks: A key risk to the near-term outlook would be a further deterioration in growth for advanced economies, resulting from the continuing turmoil in Europe and budgetary issues in the United States. In addition to reduced global demand for Indonesian exports and lower commodity prices, this would cause a sharp increase in global risk aversion, which could lead to capital outflows from Indonesia. However, given strong fundamentals, and low dependence on external demand, the downside risks for Indonesia appear to be manageable.

44. Continued exchange rate flexibility will be important in managing volatile capital flows, and the buildup in reserves over the past eighteen months will help buffer any deterioration of international financial conditions. While FDI inflows are expected to continue, portfolio inflows could reverse, especially if the crisis in the Euro Area intensifies. There are no signs of any misalignment in the exchange rate, and exports (including manufacturing) are strong. The current level of international reserves is adequate, including after taking into account foreign investor holdings of local currency government debt.

45. Given rising domestic demand pressures and lags in monetary policy transmission, BI should be prepared to tighten its policy stance in the future to achieve its lower inflation target for 2012. Since current demand indicators are robust, the staff sees little risk of a policy-induced slowdown in growth, assuming no major further deterioration in global prospects. To broaden policy transmission channels, BI should use a combination of policy rate increases, macroprudential measures and liquidity absorption to limit excessive domestic demand growth and control inflationary expectations, and focus its communications on its commitment to the inflation target. Macroprudential measures should be considered to reduce risks associated with accelerating credit growth. These could include raising risk weights on sectors with rapidly growing credit, such as consumer credit, and countercyclical capital and forward-looking provisioning requirements.

46. Persistent excess liquidity and the underdeveloped interbank market limit the effectiveness of monetary policy. BI's operational framework should be adjusted to more effectively direct short-term interbank rates towards its policy rate while promoting market development. Absorption of structural excess liquidity through a combination of reserve requirement increases and open market operations will be a key first step. The current uneven distribution of liquidity among banks should be addressed by improving money market functioning, including promoting the use of instruments that limit credit risk such as repos and swaps.

47. The government should act quickly to strengthen BI's financial resources by replacing nontradable noninterest-bearing government debt currently held by BI with marketable securities, and replenishing its capital base. This would increase BI's capacity to absorb liquidity inflows, contribute to money market development, and improve the credibility of BI's commitment to low inflation. Further, it would contribute to the deepening of the market for government securities.

48. To provide a legal foundation for crisis management, the adoption of the Financial System Safety Net (FSSN) law should be a top priority. The FSSN law would address crisis management issues, such as emergency lending and, while the various financial sector regulatory agencies are proceeding with developing their individual crisis management protocols, passage of the FSSN remains critical to ensure that a legal basis exists for decisions that would need to be taken if a crisis were to occur. Other financial sector laws should also be reviewed to ensure consistency with the FSSN law.

49. The authorities' efforts to strengthen supervisory oversight by developing a new risk-based bank rating system are appropriate. The new system will require more qualitative judgment in assessing a bank's safety and soundness and will expand the range of actions supervisors could take to address problems. The new supervisory risk-based rating system for banks will also aid the introduction of a risk-based premium deposit insurance system. A move to such a system from the existing flat-rate premium scheme, potentially supported by additional capital for LPS, will help ensure that the deposit insurance scheme has sufficient resources.

50. Fiscal developments are consistent with the government's firm commitment to sustainability and strong public finances. However, increasing fuel subsidies are distorting the structure of the budget and increasing the deficit in 2011, providing a significant demand stimulus and increasing the burden on monetary policy. In the current outlook, any revenue collections in excess of the 2011 budget estimates should be saved so as to reduce the stimulus from fiscal policy. If there were to be a deterioration in the economic outlook, there is considerable fiscal space to provide stimulus, but the ability to do so in a timely manner is likely to be constrained by implementation capacity. The overall fiscal stance in 2012 should place further emphasis on infrastructure spending. To support these objectives, the government should implement its commitment to reduce, and better target, subsidies this year. The burgeoning cost of the current subsidy schemes limits the flexibility of fiscal policy and the ability to fund priority expenditures, as well as contributing to uncertainty regarding inflation and other macroeconomic outcomes.

51. The medium term fiscal strategy should balance the authorities' wish for further public debt consolidation with improving the effectiveness of fiscal policy to support growth. A lack of infrastructure remains one of the biggest constraints to boosting Indonesia's growth potential. Significant improvements to the regulatory framework are needed to support infrastructure spending and PPP projects. Weak budget implementation is also an obstacle to higher public investment. Social safety nets should be better targeted towards vulnerable groups while increased, and more effective, education and health spending will be needed to promote improvements in human capital and generate more equitable growth. To support these objectives, continued efforts are also needed to raise the tax revenue ratio from its current low level to provide greater fiscal space. Improving tax efficiency will require broadening tax bases through increasing tax compliance with revenue administration reforms and containing the use of tax incentives.

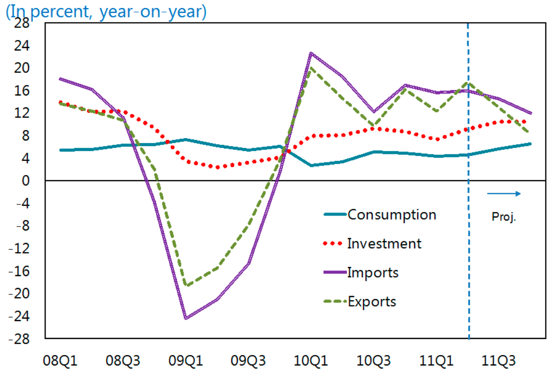
52. It is proposed that the next Article IV consultation with Indonesia take place on the standard 12-month cycle.

Figure 1. Indonesia: Macroeconomic Developments and Outlook

Following solid performance in 2010, GDP growth is expected to continue in 2011…

Growth of GDP Components

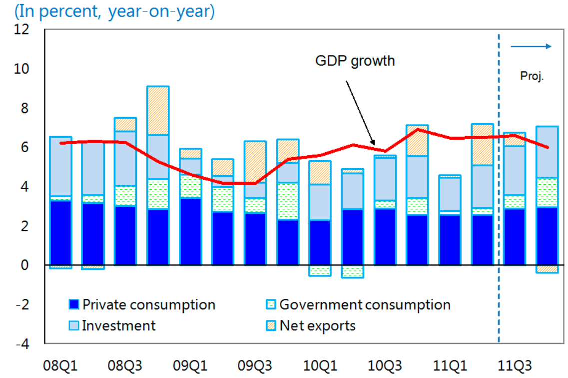
(In percent, year-on-year)



… driven by domestic demand…

Contribution to GDP Growth

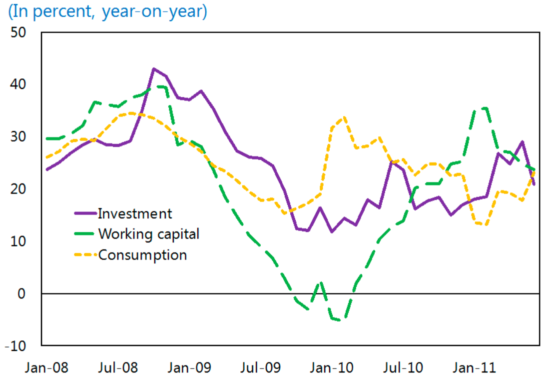
(In percent, year-on-year)



…and supported by accelerating credit expansion.

Credit Growth by Usage

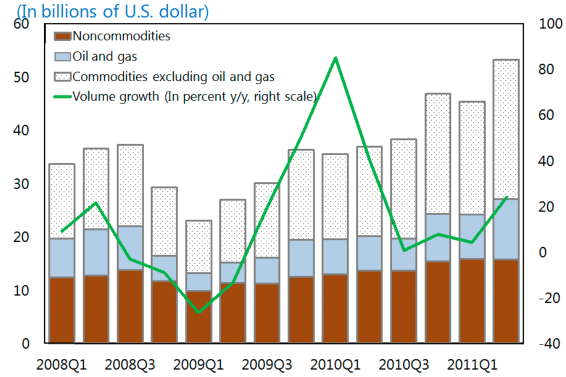
(In percent, year-on-year)



Export performance remains strong…

Exports of Goods

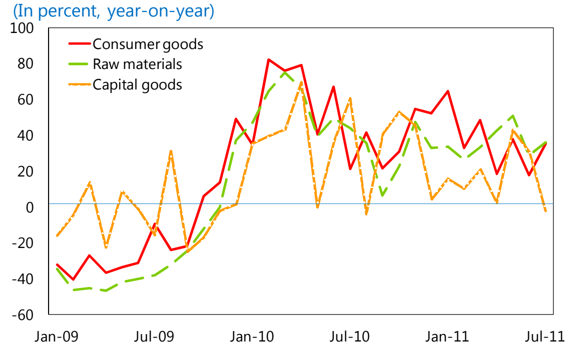
(In billions of U.S. dollar)



…but buoyant growth in imports…

Import Growth

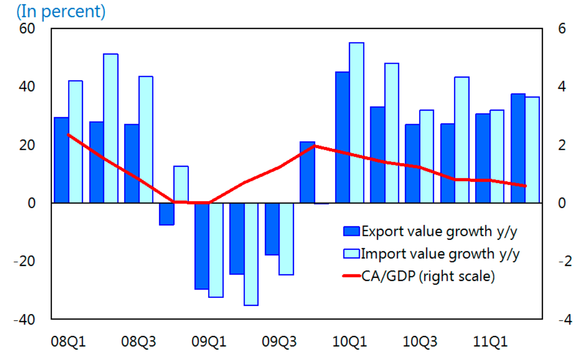
(In percent, year-on-year)



…has led to a declining current account surplus.

Trade Growth and Current Account

(In percent)

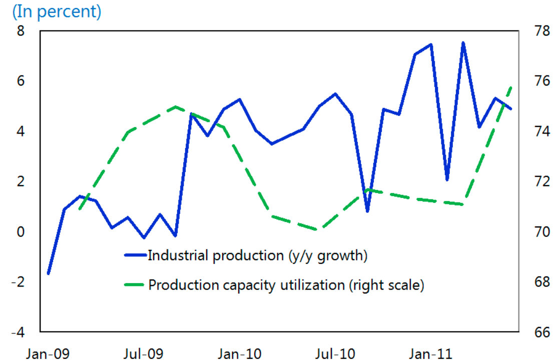


Sources: CEIC Data Co., Ltd.; and IMF staff calculations and estimates.

Figure 2. Indonesia: Business Activity Indicators

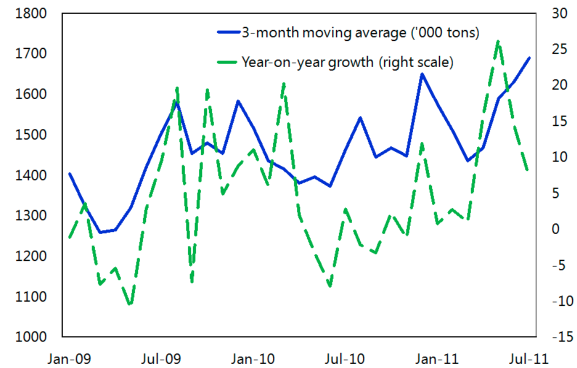
Solid industrial production growth, rising capacity utilization,...

Industrial Production and Capacity Utilization
(In percent)



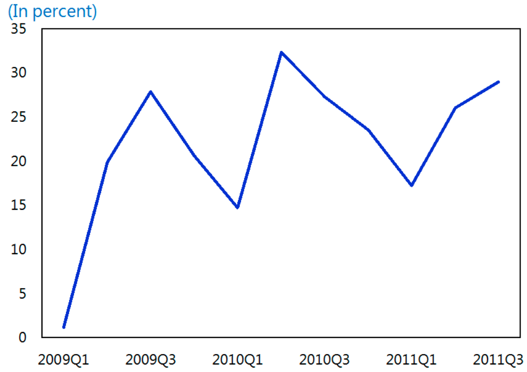
... strong cement sales, and ...

Cement Sales



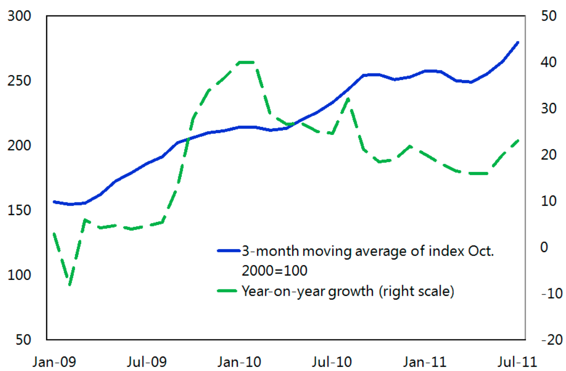
... an upbeat outlook by business suggest further growth of investment demand.

Business Survey: Business Activity Expectation
(In percent)



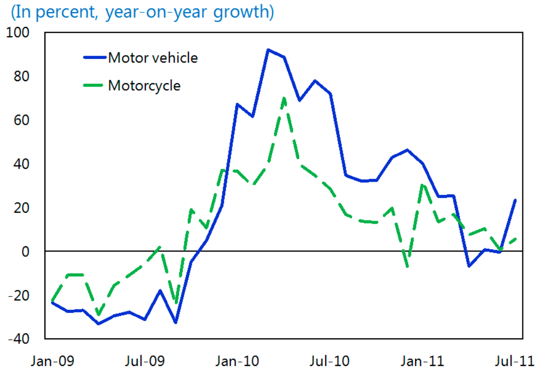
Rising retail sales growth...

Retail Sales



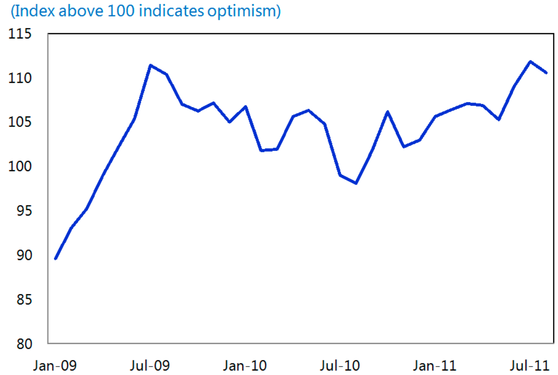
...along with continued strength of motor vehicle and motorcycle sales...

Motor Vehicle Sales and Motorcycle Sales
(In percent, year-on-year growth)



...and rising consumer confidence—all point to resilient consumption.

Consumer Confidence
(Index above 100 indicates optimism)

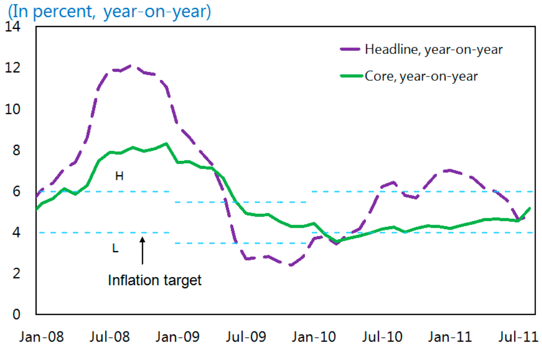


Sources: CEIC Data Co., Ltd.; Country authorities; and IMF staff calculations.

Figure 3. Indonesia: Inflation and Monetary Developments

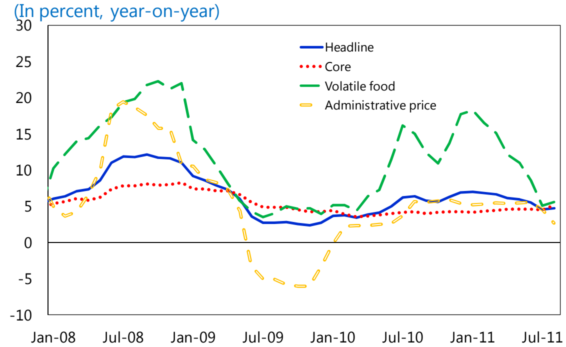
Inflation started to ease in February 2011...

CPI Inflation
(In percent, year-on-year)



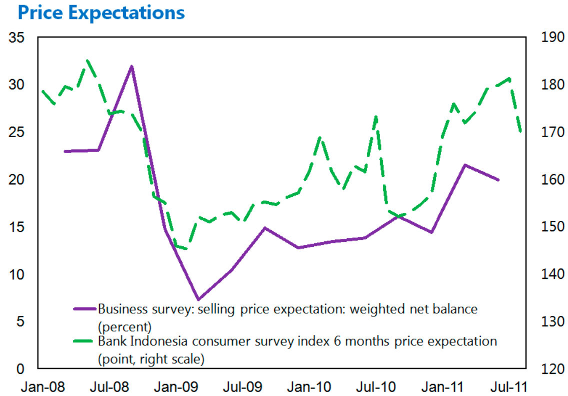
...reflecting food price declines with prices in other categories, and the core CPI still edging up.

Inflation Components
(In percent, year-on-year)



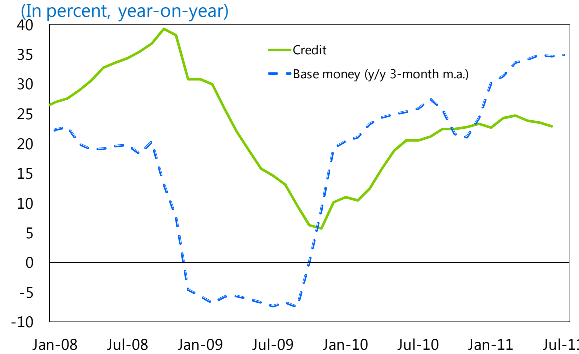
High price expectations,...

Price Expectations



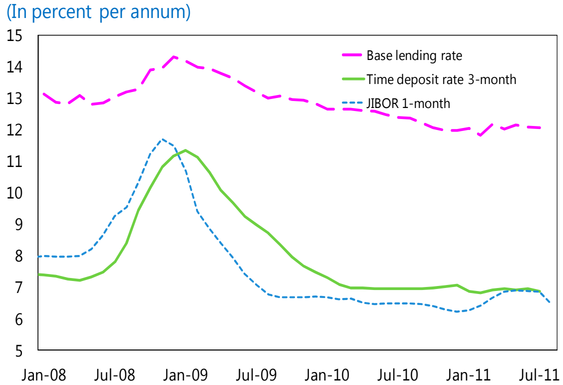
... robust growth of money and credit aggregates, ...

Credit and Money Growth
(In percent, year-on-year)



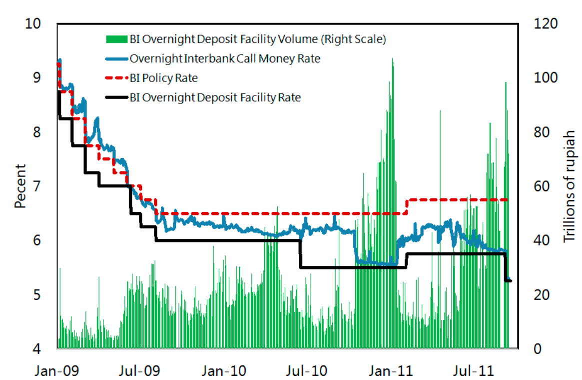
...and falling interest rates suggest that inflationary pressures could rise and that ...

Interest Rates
(In percent per annum)



... the current accommodative monetary stance may have to be tightened in the future.

Policy and Interbank Rates and Excess Liquidity



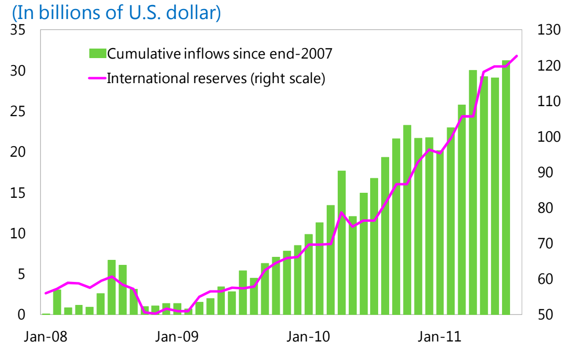
Sources: CEIC Data Co., Ltd.; Indonesian authorities; and IMF staff calculations.

Figure 4. Indonesia: Financial Market Performance

Portfolio inflows continued in 2011, contributing to additional reserves accumulation,…

Reserves and Cumulative Portfolio Inflows

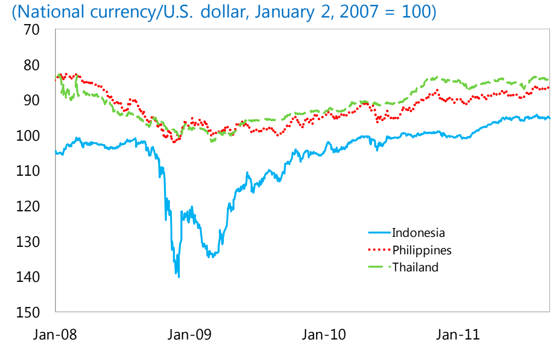
(In billions of U.S. dollar)



…steady appreciation of the rupiah beyond pre crisis levels,…

Exchange Rates

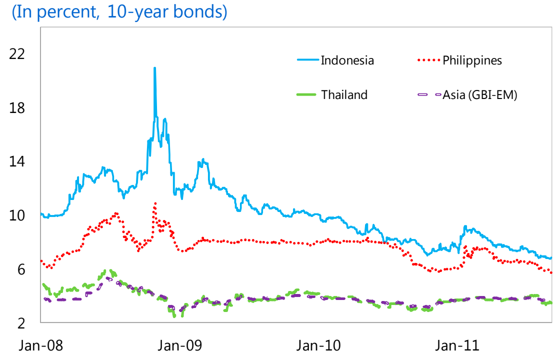
(National currency/U.S. dollar, January 2, 2007 = 100)



…further falls in local currency bond yields,…

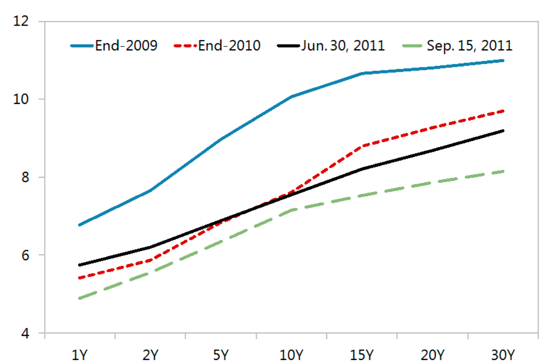
Government Bonds Yield

(In percent, 10-year bonds)



… across all tenors as foreign investors sought both yield pickup and expected currency gains .

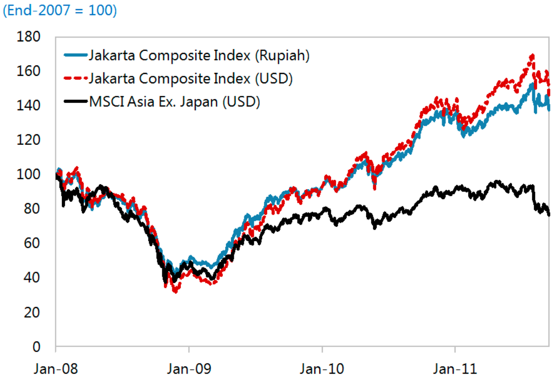
Government Bond Yield Curve



Indonesia stocks outperformed the rest of the region…

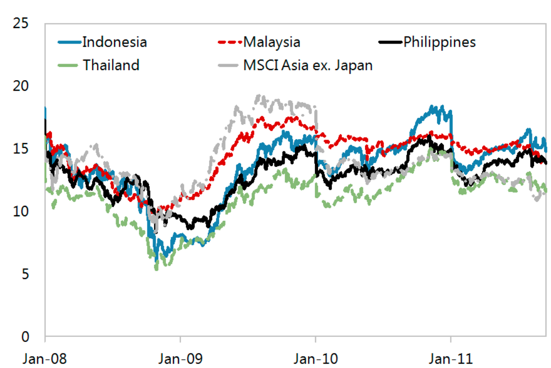
Equity Market Indicies

(End-2007 = 100)



… and current high valuations are not excessive compared with recent trends and other Asian bourses.

Estimated Equity Price/Earnings Ratios

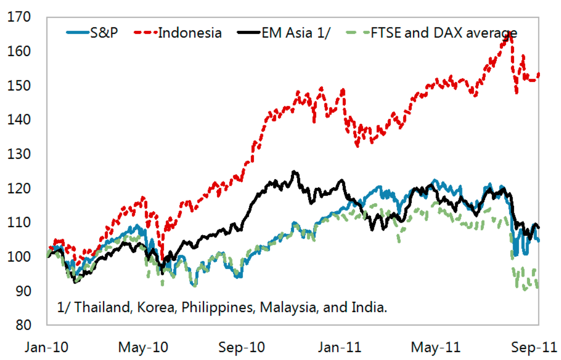


Sources: Bloomberg L.P.; CEIC Data Co., Ltd.; and IMF staff estimates.

Figure 5. Indonesia: Limited Spillovers from Rising Global Sovereign Risk Concerns

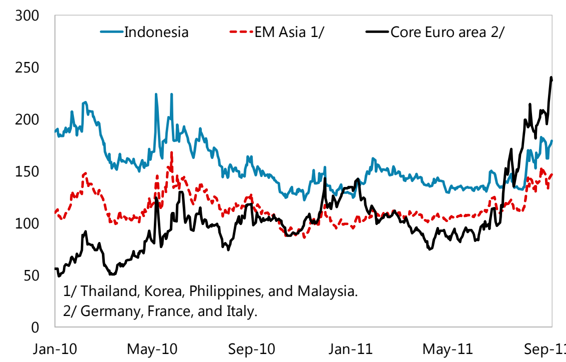
Despite the deterioration in global market sentiment, Indonesia's stock market continues to outperform both core and other emerging markets…

Stock Market Index
(1/1/2010=100)



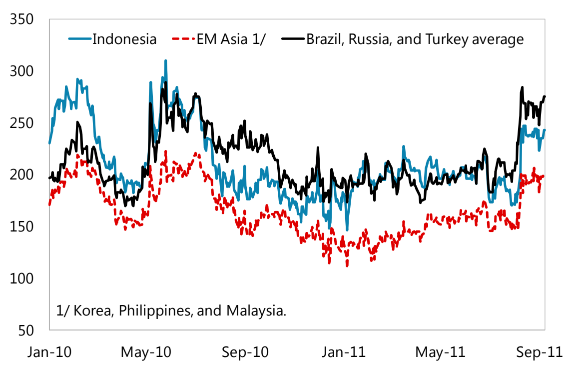
…while CDS spreads have remained relatively low, reflecting strong fundamentals.

Five-year CDS Spreads
(In basis points)



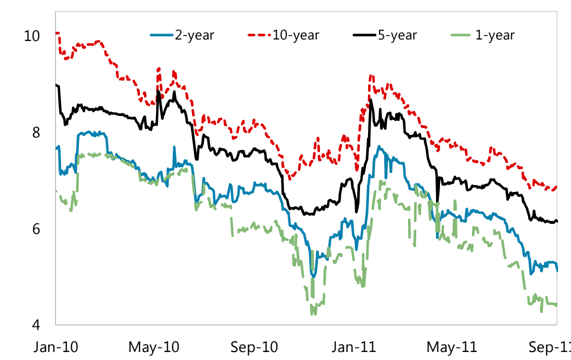
External spreads have yet to reach the highs of May 2010…

EMBI Spreads
(In basis points)



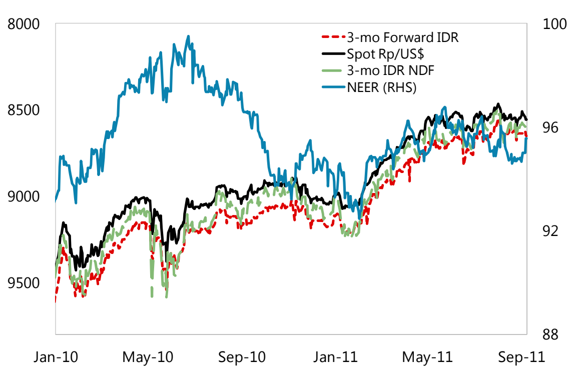
…and local bond yields have also remained relatively low.

Domestic Government Bond Yields
(In percent)



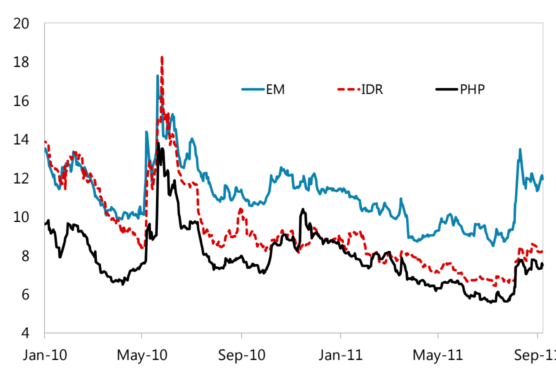
Exchange rate appreciation has slowed since May…

Exchange Rates



…and the recent global turmoil has had less impact on implied volatility for the rupiah.

Three-month FX Implied Volatility

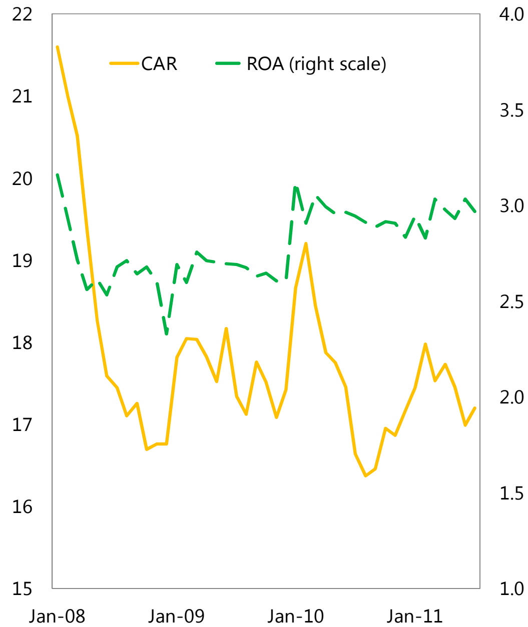


Sources: Datastream, Thomson Financial; Bloomberg L.P.; and IMF staff calculations.

Figure 6. Indonesia: Banking Indicators

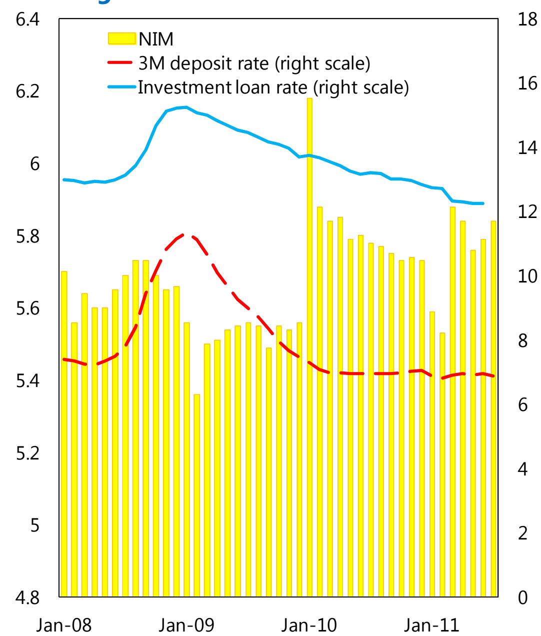
Banks remain profitable and well capitalized.

Commercial Bank Capitalization and Profitability



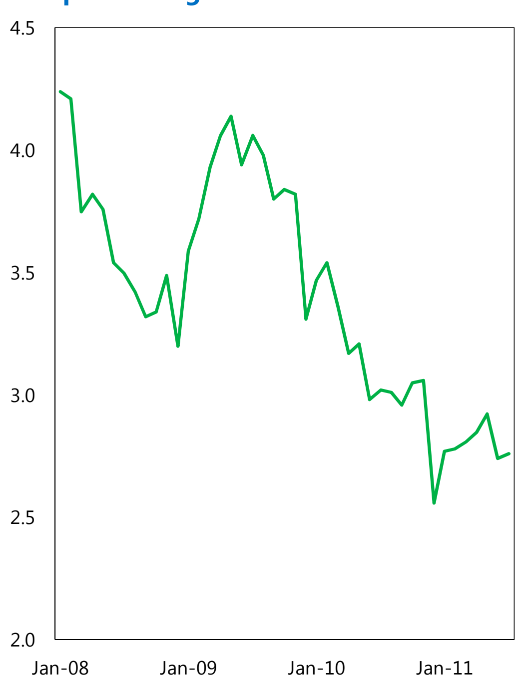
Widening spreads have raised net interest margins.

Net Interest Margin, Deposit and Lending Rates



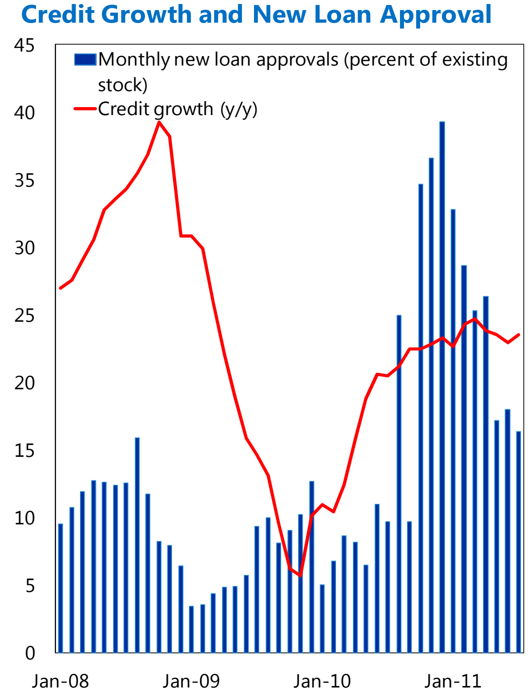
Loan quality remains good ...

Nonperforming Loans to Total Loans



... but could deteriorate if the recent acceleration in credit growth leads to lower lending standards.

Credit Growth and New Loan Approval



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

Table 1. Indonesia: Selected Economic Indicators, 2007–12

Nominal GDP (2010): Rp 6,423 trillion or US$707 billion
Main exports (percent of total, 2010): mineral fuels (36), manufactured goods (23), machinery and transport equipment (13)
GDP per capita (2010): US$2974
Unemployment rate (Feb. 2011): 6.8 percent
Poverty headcount ratio at national poverty line (2010): 13.3 percent of population

	2007	2008	2009	2010	2011 Proj.	2012 Proj.
Real GDP (percent change)	6.3	6.0	4.6	6.1	6.4	6.3
Domestic demand	4.1	7.6	5.2	5.7	6.4	6.7
Of which:						
Private consumption	5.0	5.3	4.9	4.6	4.9	5.0
Gross fixed investment	9.3	11.9	3.3	8.5	9.4	10.5
Change in stocks 1/	-1.6	0.1	-0.2	0.4	0.1	0.0
Net exports 1/	0.6	0.7	1.2	0.8	0.6	0.3
Statistical discrepancy 1/	2.1	-1.4	-1.2	0.2	0.0	0.0
Saving and investment (in percent of GDP)						
Gross investment 2/	24.9	27.8	31.0	32.5	32.9	34.4
Gross national saving	27.3	27.8	33.5	33.3	33.1	34.0
Foreign saving	-2.4	0.0	-2.5	-0.8	-0.2	0.4
Prices (12-month percent change)						
Consumer prices (end period)	5.4	11.1	2.8	7.0	5.0	6.4
Consumer prices (period average)	6.0	9.8	4.8	5.1	5.7	6.5
Public finances (in percent of GDP)						
Central government revenue	17.9	19.8	15.1	15.8	16.4	15.9
Central government expenditure	19.1	19.9	16.7	16.4	17.7	17.2
Central government balance	-1.2	-0.1	-1.6	-0.6	-1.3	-1.3
Primary balance	0.8	1.7	0.1	0.8	0.1	0.1
Central government debt	36.9	33.2	28.6	27.4	25.2	23.9
Money and credit (12-month percent change; end of period)						
Rupiah M2	19.6	12.7	13.8	16.5	...	...
Base money	27.8	-9.2	16.7	28.9	...	...
Private sector credit	25.1	30.9	8.2	22.2	...	...
One-month interbank rate (period average)	8.5	9.4	7.8	6.5	...	...
Balance of payments (in billions of U.S. dollars)						
Oil and gas (net)	5.7	7.8	8.3	3.2	2.3	1.2
Non-oil exports (f.o.b)	93.1	107.9	99.0	129.4	159.1	163.5
Non-oil imports (f.o.b)	-66.1	-92.8	-73.5	-102.0	-128.4	-135.3
Current account balance	10.5	0.1	13.6	5.6	1.5	-4.0
Foreign direct investment	2.3	3.4	1.9	10.6	11.6	11.2
Overall balance	12.7	-1.9	14.2	30.3	30.2	20.8
Gross reserves						
In billions of U.S. dollars (end period)	56.9	51.6	66.1	96.2	126.4	147.2
In months of imports	4.7	5.7	5.2	5.9	7.4	8.1
As a percent of short-term debt 3/	198.6	178.5	211.0	226.5	252.3	276.5
Total external debt						
In billions of U.S. dollars	133.6	155.0	172.8	202.4	216.1	230.0
In percent of GDP	30.9	30.3	32.1	28.6	25.9	24.6
Exchange rate (period average)						
Rupiah per U.S. dollar	9,141	9,699	10,390	9,090	...	...
Nominal effective exchange rate (2005=100)	100.3	90.8	86.6	95.2	...	...
Memorandum items:						
Oil production (thousands of barrels per day)	899	927	960	954	945	945
Indonesian oil price (US$/bbl)	70.7	96.6	61.4	78.6	103.7	100.5
Nominal GDP (in trillions of rupiah)	3,951	4,949	5,604	6,423	7,223	8,175
Nominal GDP (in billions of U.S. dollars)	432	511	538	707	834	936

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

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

Table 2. Indonesia: Balance of Payments, 2007–12

(In billions of U.S. dollars)

	2007 Act.	2008 Act.	2009 Act.	2010 Act.	2011 Proj.	2012 Proj.
Current account	10.5	0.1	13.6	5.6	1.5	-4.0
Goods, net (trade balance)	32.8	22.9	33.9	30.6	33.1	29.3
Exports, f.o.b.	118.0	139.6	119.5	158.1	198.4	203.1
Of which: Oil and gas	24.9	31.7	20.5	28.7	39.3	39.6
Non-oil and gas	93.1	107.9	99.0	129.4	159.1	163.5
Imports, f.o.b.	-85.3	-116.7	-85.6	-127.4	-165.3	-173.8
Of which: Oil and gas	-19.2	-23.9	-12.1	-25.4	-36.9	-38.5
Non-oil and gas	-66.1	-92.8	-73.5	-102.0	-128.4	-135.3
Services, net	-11.8	-13.0	-9.7	-9.3	-11.7	-12.1
Income, net	-15.5	-15.2	-15.1	-20.3	-24.6	-26.1
Current transfers, net	5.1	5.4	4.6	4.6	4.7	4.9
Capital and financial account	3.6	-1.8	3.5	26.2	28.6	24.8
Capital account	0.5	0.3	0.1	0.1	0.1	0.1
Financial account	3.0	-2.1	3.5	26.1	28.5	24.7
Direct investment, net	2.3	3.4	1.9	10.6	11.6	11.2
Abroad, net	-4.7	-5.9	-2.9	-2.7	-2.8	-2.9
In Indonesia (FDI), net	6.9	9.3	4.9	13.3	14.3	14.1
Portfolio investment, net	5.6	1.8	10.3	13.2	12.8	11.4
Assets, net	-4.4	-1.3	-0.1	-2.5	-0.5	-0.5
Liabilities	10.0	3.1	10.5	15.7	13.3	11.9
Equity securities	3.6	0.3	0.8	2.1	1.5	1.7
Debt securities	6.4	2.7	9.7	13.6	11.8	10.2
Other investment	-4.8	-7.3	-8.8	2.2	4.1	2.1
Nonfinancial public sector	-2.4	-1.4	-1.2	-0.3	0.3	0.0
Banking sector	0.1	1.4	0.7	-0.6	0.7	0.6
Disbursements	1.1	2.5	2.2	1.9	3.3	3.4
Repayments	-1.0	-1.1	-1.6	-2.5	-2.7	-2.8
Corporate sector	1.1	2.8	2.4	0.9	2.7	3.5
Other 1/	-3.6	-10.1	-10.7	2.1	0.4	-2.1
Total	14.1	-1.7	17.1	31.8	30.2	20.8
Errors and omissions	-1.4	-0.2	-3.0	-1.5	0.0	0.0
Overall balance	12.7	-1.9	14.2	30.3	30.2	20.8
Reserves and related items	-12.7	1.9	-14.2	-30.3	-30.2	-20.8
Memorandum items:						
Reserve assets position (eop)	56.9	51.6	66.1	96.2	126.4	147.2
in months of imports of goods and services	4.7	5.7	5.2	5.9	7.4	8.1
in percent of short-term debt at remaining maturity	199	178	211	226	252	277
in percent of ST debt at RM and foreign holding of IDR debt 2/	157	143	159	158	173	…
Current account (percent of GDP)	2.4	0.0	2.5	0.8	0.2	-0.4
Non-oil and gas exports, volume growth	0.7	2.6	7.0	10.7	1.7	8.2
Non-oil and gas imports, volume growth	6.4	29.7	-14.3	24.8	12.6	6.3
Terms of trade, percent change (excluding oil)	6.7	4.3	-7.1	6.1	2.8	-1.3
Terms of trade, percent change (including oil)	4.1	3.2	-5.8	3.8	2.3	-1.6
Stock of nonfinancial public sector external debt 3/	81.0	89.5	105.5	125.7	136.3	146.4
in percent of GDP	18.7	17.5	19.6	17.8	16.3	15.6
Nonfinancial public sector debt service (percent of exports)	6.9	6.5	8.0	5.5	4.5	4.8

Sources: Data provided by Bank Indonesia; and Fund staff estimates.

1/ Includes unrecorded capital flows and exceptional financing.
2/ Denominator includes short-term debt at remaining maturity plus foreign holding of long-term government bonds in rupiah.
3/ Includes nonfinancial state-owned enterprises.

Table 3. Indonesia: Monetary Survey, 2007–11

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

	2007	2008	2009	2010	Mar-11	Apr-11	May-11	Jun-11	Jul-11
Bank Indonesia									
Net foreign assets	523.1	555.4	606.2	852.0	867.0	921.2	952.5	962.3	977.4
Net domestic assets	-143.5	-210.7	-204.1	-333.6	-360.2	-400.5	-426.6	-420.7	-422.3
Net claims on central government	257.5	176.9	210.0	187.4	134.6	81.9	51.9	55.4	58.6
Liquidity operations, net 1/	-232.3	-155.1	-205.9	-432.6	-450.9	-432.8	-437.5	-423.0	-437.7
Claims on other sectors 2/	14.2	12.5	13.2	11.5	11.5	11.5	11.5	17.8	17.4
Other items, net	-183.0	-245.0	-221.3	-99.9	-55.4	-61.2	-52.5	-70.8	-60.8
Monetary base	379.6	344.7	402.1	518.4	506.8	520.7	525.9	541.6	555.0
Monetary survey									
Net foreign assets	503.0	590.4	700.4	887.9	891.5	936.6	948.7	937.6	939.8
Net domestic assets	1,146.7	1,305.5	1,441.0	1,583.3	1,559.8	1,497.9	1,526.6	1,585.2	1,624.8
Net claims on central government	515.6	392.1	438.4	374.7	328.0	262.5	235.1	231.5	226.8
Claims on other nonfinancial public sector	40.6	48.9	67.6	101.0	93.5	90.9	89.5	97.0	100.4
Private sector credit	1,046.7	1,370.4	1,482.3	1,812.1	1,873.9	1,907.8	1,962.2	2,021.7	2,048.6
Other items, net	-456.1	-506.0	-547.3	-704.4	-735.6	-763.3	-760.2	-765.0	-751.0
Broad money 3/	1,649.7	1,895.8	2,141.4	2,471.2	2,451.4	2,434.5	2,475.3	2,522.8	2,564.6
Rupiah M2	1,432.1	1,613.4	1,836.7	2,140.2	2,108.5	2,104.1	2,148.0	2,199.3	2,230.9
Currency in circulation	183.0	209.7	226.0	260.2	241.6	252.0	254.1	261.5	275.4
Deposits	1,249.1	1,403.7	1,610.7	1,880.0	1,866.9	1,852.1	1,893.9	1,937.8	1,955.5
Foreign currency deposits	214.1	279.1	301.1	321.9	334.9	321.9	317.7	313.3	323.2
Memorandum items:									
Net international reserves (US$ billions)	54.6	49.9	63.8	94.1	98.9	106.7	110.8	111.1	114.4
Money multiplier (rupiah M2)	3.8	4.7	4.6	4.1	4.2	4.0	4.1	4.1	4.0
Base money velocity 4/	10.9	15.0	14.4	12.6	13.7	13.3	13.2	12.8	12.5
Rupiah M2 velocity 4/	2.9	3.2	3.2	3.1	3.3	3.3	2.8	2.8	3.8
Annual percentage change:									
Broad money	19.3	14.9	13.0	15.4	16.1	15.0	15.5	13.1	15.6
Rupiah M2	19.6	12.7	13.8	16.5	17.1	16.2	16.3	14.8	17.7
Monetary base	27.8	-9.2	16.7	28.9	35.4	35.1	34.2	34.9	35.7
Private sector credit	25.1	30.9	8.2	22.2	23.9	24.2	24.6	24.1	25.2

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

1/ Net outstanding monetary instruments, including overnight deposits, term deposits, repurchase and reverse repurchase agreements, central bank securities (excluding those held by banks for reserves), and government securities held by Bank Indonesia for monetary policy purposes.

2/ Includes claims on banks not related to monetary operations.

3/ Includes securities classified as broad money.

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

Table 4. Indonesia: Summary of Central Government Operations, 2008–12

	2008 Act.	2009 Act.	2010 Act.	2011 Approved budget	2011 Prel. revised budget	2011 Staff proj.	2012 Staff proj.
			(In trillions of rupiah)				
Revenues and grants	981.6	848.8	1,016.6	1,104.9	1,167.9	1,182.9	1,301.7
Oil and gas revenues	288.6	175.8	211.6	204.9	236.7	285.1	256.3
Tax revenues	77.0	50.0	58.9	55.6	63.6	76.5	75.1
Nontax revenues	209.7	125.8	152.7	149.3	173.2	208.5	181.2
Non-oil and gas revenues	690.7	671.3	802.2	896.3	926.6	893.2	1,044.6
Tax revenues	581.7	569.9	685.5	794.7	813.5	781.0	917.3
Nontax revenues 1/	109.0	101.4	116.6	101.6	113.1	112.2	127.3
Grants	2.3	1.7	2.8	3.7	4.7	4.7	0.8
Expenditure and net lending	985.8	937.3	1,056.4	1,229.5	1,313.4	1,277.1	1,411.1
Current expenditure	562.8	479.0	566.3	637.4	703.9	715.0	760.6
Personnel	112.8	127.7	147.8	180.8	183.9	183.9	215.7
Subsidies	275.3	138.1	214.0	187.6	244.5	288.3	253.3
Of which : energy subsidies	223.0	94.6	139.9	136.6	187.2	225.4	188.6
Interest	88.4	93.7	88.3	115.2	107.0	101.1	114.9
Other	86.3	119.6	116.2	153.8	168.5	141.6	176.7
Development expenditure 2/	130.5	149.7	145.4	199.1	204.4	164.8	207.2
Transfers to regions	292.4	308.5	344.7	393.0	405.1	397.3	443.3
			(In percent of GDP)				
Revenues and grants	19.8	15.1	15.8	15.7	16.6	16.4	15.9
Oil and gas revenues	5.8	3.1	3.3	2.9	3.4	3.9	3.1
Non-oil and gas revenues	13.9	12.0	12.5	12.8	13.2	12.4	12.7
Tax revenues	11.7	10.2	10.7	11.3	11.6	10.8	11.2
Nontax revenues 1/	2.2	1.8	1.8	1.4	1.6	1.6	1.6
Grants	0.0	0.0	0.0	0.1	0.1	0.1	0.0
Expenditure and net lending	19.9	16.7	16.4	17.5	18.7	17.7	17.2
Current expenditure	11.4	8.5	8.8	9.1	10.0	9.9	9.3
Personnel	2.3	2.3	2.3	2.6	2.6	2.5	2.6
Subsidies	5.6	2.5	3.3	2.7	3.5	4.0	3.1
Of which : energy subsidies	4.5	1.7	2.2	1.9	2.7	3.1	2.3
Interest	1.8	1.7	1.4	1.6	1.5	1.4	1.4
Other	1.7	2.1	1.8	2.2	2.4	2.0	2.2
Development expenditure 2/	2.6	2.7	2.3	2.8	2.9	2.3	2.5
Transfers to regions	5.9	5.5	5.4	5.6	5.8	5.5	5.4
Overall balance	-0.1	-1.6	-0.6	-1.8	-2.1	-1.3	-1.3
Financing	0.1	1.6	0.6	1.6	2.2	1.3	1.3
Domestic	-0.4	1.2	0.4	1.7	2.2	0.9	0.7
External	0.5	0.3	0.3	0.0	0.0	0.4	0.6
Memorandum items:							
Primary balance	1.7	0.1	0.8	-0.1	-0.5	0.1	0.1
Cyclically adjusted primary balance	1.5	0.2	0.8	...	...	0.1	0.1
Central government debt	33.2	28.6	27.4	...	...	25.2	23.9

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

1/ From 2004 onwards, deposit insurance premia are treated as nontax revenues.

2/ From 2005 onwards, comprises capital spending and social assistance spending.

Table 5. Indonesia: Selected Vulnerability Indicators, 2006–11

	2006	2007	2008	2009	2010	2011 1/	Latest Observation
Key economic and market indicators							
Real GDP growth (in percent)	5.5	6.3	6.0	4.6	6.1	6.4	Proj.
CPI inflation (in percent, end of period)	6.6	5.4	11.1	2.8	7.0	5.0	Proj.
Short-term (ST) interest rate (in percent) 2/	9.5	7.9	11.4	6.7	6.3	6.3	Aug-11
Ten-year government bond yield (in percent)	10.2	10.0	11.9	10.1	7.6	6.9	Aug-11
Indonesia EMBI spread (bps, end of period)	153	275	381	230	183	223	Aug-11
Rupiah/US$ (end of period)	9,020	9,419	10,950	9,400	8,991	8,578	Aug-11
External sector							
Current account balance (percent of GDP)	3.0	2.4	0.0	2.5	0.8	0.2	Proj.
Net FDI inflows (percent of GDP)	0.6	0.5	0.7	0.4	1.5	1.4	Proj.
Exports (percentage change of US$ value, GNFS)	15.1	13.4	18.7	-14.0	31.2	23.5	Proj.
Real effective exchange rate (end period; 2005=100)	116.6	109.4	102.4	116.2	124.7	125.4	Aug-11
Gross international reserves (GIR) in US$ billion	42.6	56.9	51.6	66.1	96.2	124.6	Aug-11
GIR in percent of ST debt at remaining maturity (RM)	203.0	198.6	178.5	211.0	226.5	252.3	Proj.
Total gross external debt in percent of exports of GNFS	110.1	102.4	100.1	129.7	115.8	100.1	Proj.
Gross external financing requirement (US$ billion) 3/	32.8	33.6	59.1	44.2	54.2	71.0	Proj.
Public sector (PS) 4/							
Overall balance (percent of GDP)	-1.0	-1.2	-0.1	-1.6	-0.6	-1.3	Proj.
Primary balance (percent of GDP)	1.4	0.8	1.7	0.1	0.8	0.1	Proj.
Gross PS financing requirement (in percent of GDP) 5/	3.3	3.7	2.1	3.5	2.6	2.6	Proj.
Public sector gross debt (PSGD, in percent of GDP)	40.4	36.9	33.2	28.6	27.4	25.2	Proj.
Of which: Exposed to rollover risk (in percent of total PSGD) 6/		1.6	3.0	4.0	3.7	4.2	Proj.
Exposed to exchange rate risk (in percent of total PSGD) 7/	46.8	47.0	51.6	46.4	44.2	43.4	Proj.
Exposed to interest rate risk (in percent of total PSGD) 8/	13.8	12.4	9.2	9.4	8.6	8.3	Proj.
Financial sector (FS)							
Capital adequacy ratio (in percent)	17.8	17.5	17.1	17.4	17.6	17.2	Jul-11
NPLs in percent of total loans	6.0	4.1	3.2	3.3	2.6	2.8	Jul-11
FX deposits (in percent of total deposits)	14.8	14.6	16.6	15.7	14.5	13.9	Jun-11
FX loans (in percent of total loans)	19.7	20.1	18.5	13.9	14.6	15.1	Jun-11
Government debt held by FS (percent of total FS assets)	14.3	13.0	9.3	9.0	8.4	7.7	Jun-11
Total credit outstanding (annual percent change)	14.0	26.0	30.8	10.1	23.3	22.9	Jun-11

1/ Staff estimates, projections, or latest available observations as indicated in the last column.
2/ One-month Jakarta Interbank Offered Rate
3/ Current account deficit plus amortization of external debt.
4/ Public sector covers central government only.
5/ Overall balance plus debt amortization.
6/ Short-term debt and maturing medium- and long-term debt, domestic debt only.
7/ Debt in foreign currency or linked to the exchange rate, domestic and external, excluding external debt on concessional terms.
8/ Short-term debt and maturing medium- and long-term debt at variable interest rates for domestic debt. Information on external debt is not available.

Table 6. Indonesia: Medium-Term Macroeconomic Framework, 2009–16

	2009	2010	2011	2012	2013	2014	2015	2016
	Act.		Proj.					
Real GDP (percent change)	4.6	6.1	6.4	6.3	6.7	7.0	7.0	7.0
Domestic demand	5.2	5.7	6.4	6.7	7.0	7.3	7.6	7.6
Of which:								
Private consumption	4.9	4.6	4.9	5.0	5.0	5.1	5.0	5.0
Gross fixed investment	3.3	8.5	9.4	10.5	11.7	11.9	11.9	12.1
Change in stocks 1/	-0.2	0.4	0.1	0.0	0.0	0.0	0.0	0.0
Net exports 1/	1.2	0.8	0.6	0.3	0.4	0.4	0.1	0.1
Statistical discrepancy 1/	-1.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Saving and investment (in percent of GDP)								
Gross investment 2/	31.0	32.5	32.9	34.4	35.9	37.2	38.5	40.0
Gross national saving	33.5	33.3	33.1	34.0	35.2	36.3	37.4	38.7
Foreign saving (external current account balance)	-2.5	-0.8	-0.2	0.4	0.6	0.8	1.1	1.3
Prices (12-month percent change)								
Consumer prices (end period)	2.8	7.0	5.0	6.4	5.5	5.2	4.5	4.3
Consumer prices (period average)	4.8	5.1	5.7	6.5	5.4	5.3	4.7	4.5
Public finances (in percent of GDP)								
Central government revenue	15.1	15.8	16.4	15.9	16.0	16.1	16.3	16.6
Tax revenues	10.2	10.7	10.8	11.2	11.6	11.9	12.4	13.0
Central government expenditure	16.7	16.4	17.7	17.2	17.2	17.2	17.5	17.6
Central government balance	-1.6	-0.6	-1.3	-1.3	-1.2	-1.2	-1.2	-1.0
Primary balance	0.1	0.8	0.1	0.1	0.1	0.1	0.1	0.3
Central government debt	28.6	27.4	25.2	23.9	22.6	21.3	20.1	18.9
Balance of payments (US$ billions)								
Oil and gas (net)	8.3	3.2	2.3	1.2	-1.1	-3.2	-5.6	-8.2
Non-oil exports (f.o.b)	99.0	129.4	159.1	163.5	175.9	188.0	199.6	214.7
Non-oil imports (f.o.b)	-73.5	-102.0	-128.4	-135.3	-146.1	-156.6	-168.0	-181.7
Current account balance	13.6	5.6	1.5	-4.0	-6.6	-9.4	-14.2	-18.1
Direct foreign investment	1.9	10.6	11.6	11.2	12.3	14.0	15.6	15.7
Overall balance	14.2	30.3	30.2	20.8	17.6	17.9	15.2	11.6
Gross reserves								
In billions of U.S. dollars (end period)	66.1	96.2	126.4	147.2	164.8	182.6	197.8	209.4
In months of imports	5.2	5.9	7.4	8.1	8.5	8.8	8.9	8.8
As a percent of short-term debt 3/	211.0	226.5	252.3	276.5	296.6	317.5	329.1	333.0
Total external debt								
In billions of U.S. dollars	172.8	202.4	216.1	230.0	241.7	253.9	266.3	278.9
In percent of GDP	32.1	28.6	25.9	24.6	23.4	22.3	21.3	20.2
Memorandum items:								
Oil production (000bcpd)	960	954	945	945	945	945	945	945
Indonesian oil price (US$/bbl)	61.4	78.6	103.7	100.5	100.0	98.0	97.0	96.0
Nominal GDP (US$ billions)	538	707	834	936	1,032	1,137	1,253	1,382

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

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

APPENDIX I: INDONESIA—PUBLIC AND EXTERNAL DEBT SUSTAINABILITY

A. Public Debt

Public sector debt has been declining as a share of GDP since 2000 despite the global shock in 2009. The ratio fell to a record low level of 27 percent in 2010 (Figure I.1) owing to prudent fiscal management, which led to primary fiscal surpluses averaging 1.6 percent of GDP per year in the last decade and a modest fiscal stimulus in response to the global shock in 2009. Lower interest rates and high real GDP growth also contributed to debt consolidation. Foreign currency debt (mostly to multilateral institutions) has fallen markedly to less than half of total debt, as the improved fiscal position facilitated government access to the domestic capital market.

The baseline scenario projects a further moderate decline in public sector debt. Despite a larger fiscal deficit, public debt is likely to fall to about 25 percent of GDP in 2011, reflecting rupiah appreciation, falling interest rates, and robust economic growth. In the medium term, gradual fiscal adjustment—based on subsidy reduction and tax administration reforms and continued strong economic growth—will support a further decline in public debt to 21 percent of GDP by 2016. Such a strategy will ensure a primary balance near zero, but also accommodate extra resources for development spending.

Public debt is sustainable and robust to macroeconomic and oil price shocks. All the standard stress tests suggest that the debt ratio is likely to remain modest even under shocks from contingent liabilities, sharp exchange rate movements, and higher interest rates (Figure I.1). Fiscal contingent liabilities amounting to 10 percent of GDP could raise public sector debt to 30 percent of GDP by 2016 (still below the 2008 level), while currency depreciation of 30 percent would raise the debt ratio to about 25 percent of GDP. An increase in real interest rates would have a smaller, but still sizeable, effect with the debt ratio reaching 23 percent by 2015. Other macroeconomic shocks have an even more limited impact.

B. External Debt

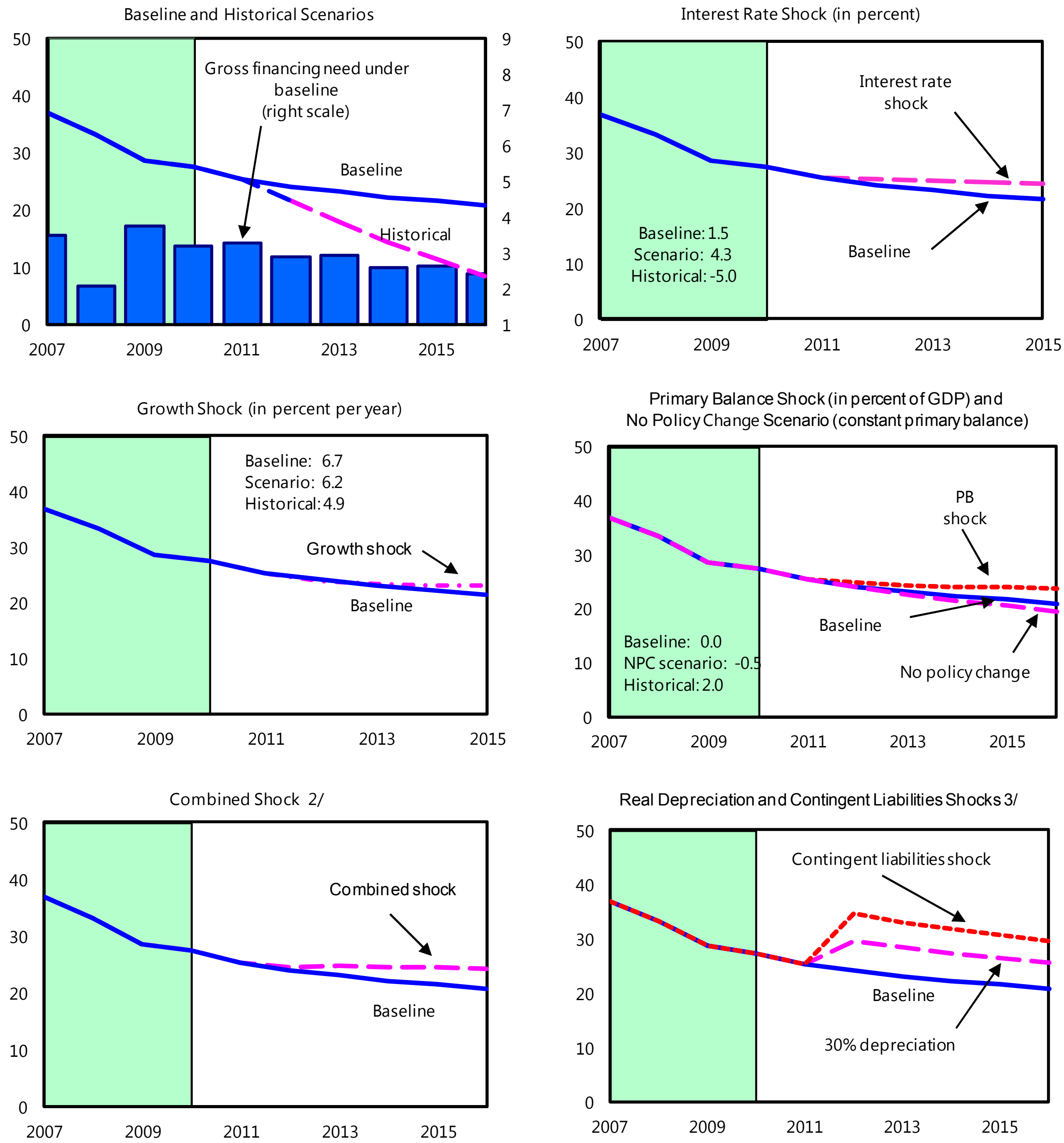
Indonesia's external debt continues on a steady downward trend, after a temporary increase in 2009. Following a decade of a continuously improving external position, the sharp nominal depreciation of late 2008 and early 2009 temporarily led to an increase in the external debt to GDP ratio from 30 percent to 32 percent. However, strong growth and the rapid turnaround in the exchange rate are quickly reversing this increase, with the ratio projected to decline to about 27 percent of GDP as early as end 2011 (Figure I.2).

The baseline scenario projects external debt to continue on a declining path over the medium term, reaching 21 percent of GDP by 2016. A weakening current account balance—projected to reach about −1 percent of GDP by 2016—is expected to be more than offset by: (i) sustained high real GDP growth in the range of 6.5−7.0 percent per year; (ii) increasing nondebt creating (i.e., FDI) flows; and (iii) some further real appreciation. At −0.5 percent of GDP, the medium term noninterest current account balance would remain comfortably above the debt stabilizing level (−3.4 percent of GDP).

External sustainability is robust to most shocks. The external debt ratio is expected to follow a declining path and remain at manageable levels under all standardized shock scenarios. A one-time 30 percent real exchange rate depreciation would have the largest impact, raising the debt ratio by 11 percentage points in 2012, and 9 percentage points over the baseline by 2016.

Figure I.1. Indonesia: Public Debt Sustainability: Bound Tests 1/

(Public debt in percent of GDP)



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

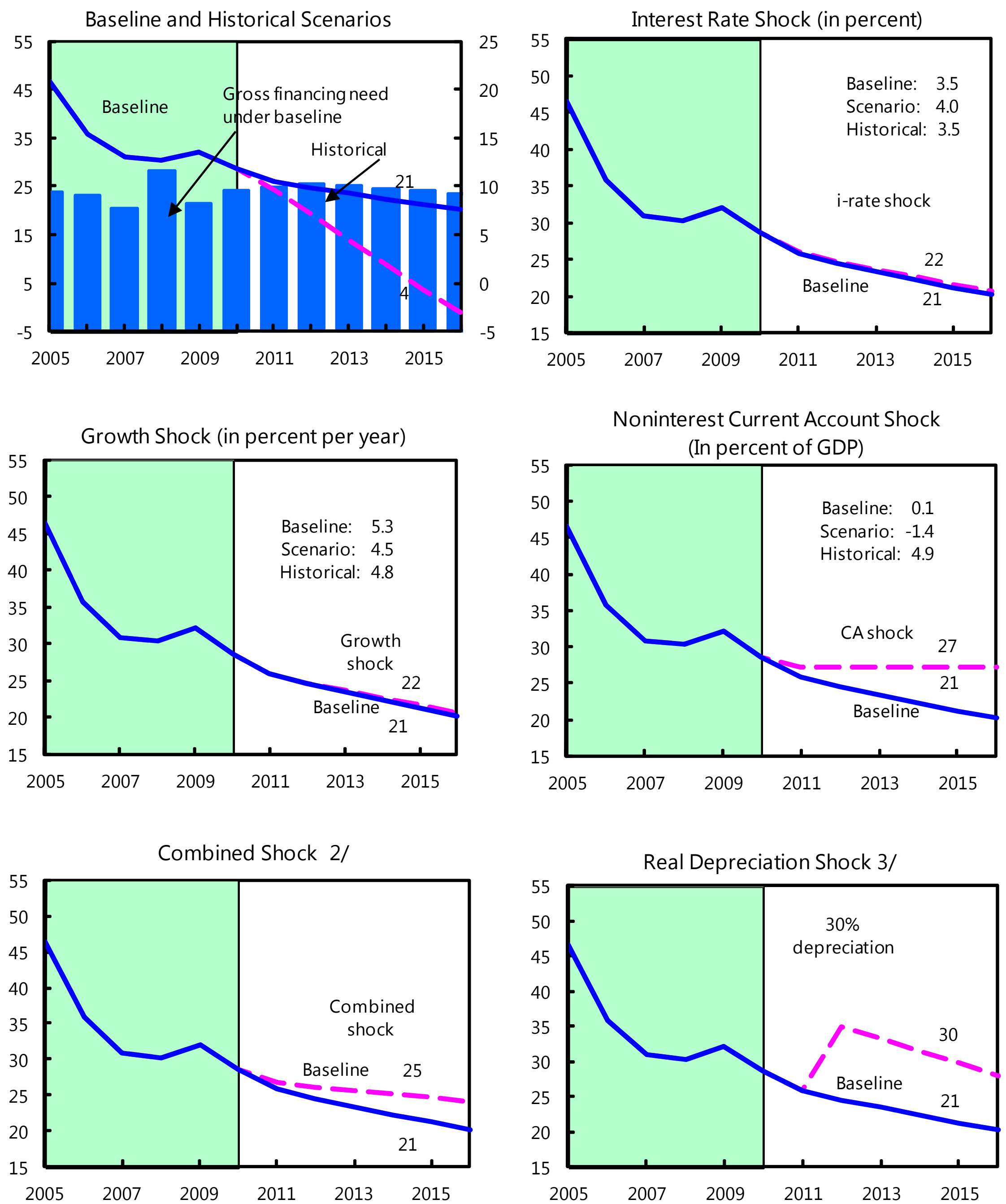
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP

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

(External debt, in percent of GDP)



Sources: International Monetary Fund; Country desk data; and Fund 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2012.

Table I.1. Indonesia: Public Sector Debt Sustainability Framework, 2004–2016

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Debt-stabilizing primary balance 9/
1 Baseline: Public sector debt 1/	55.8	46.3	40.4	36.9	33.2	28.6	27.4	25.4	24.1	23.1	22.2	21.5	20.8	-1.0
Of which: foreign-currency denominated	28.7	24.0	18.2	16.5	17.1	13.3	12.1	10.9	10.3	9.6	9.0	8.5	7.9	
2 Change in public sector debt	-4.7	-9.5	-5.9	-3.6	-3.6	-4.6	-1.2	-2.0	-1.3	-0.9	-1.0	-0.6	-0.7	
3 Identified debt-creating flows (4+7+12)	-5.5	-8.6	-9.8	-4.5	-5.3	-4.3	-3.0	-1.2	-1.7	-1.2	-1.1	-0.8	-0.8	
4 Primary deficit	-2.1	-3.1	-2.6	-1.0	-1.8	0.1	-0.2	0.6	0.1	0.1	0.1	0.2	0.1	
5 Revenue and grants	19.3	19.4	20.3	19.3	21.3	16.5	17.1	17.6	17.5	17.7	17.7	17.9	18.2	
6 Primary (noninterest) expenditure	17.2	16.3	17.8	18.3	19.5	16.6	16.9	18.2	17.6	17.8	17.8	18.1	18.3	
7 Automatic debt dynamics 2/	-2.0	-5.7	-7.2	-3.5	-3.5	-4.4	-2.8	-1.8	-1.7	-1.3	-1.3	-1.0	-1.0	
8 Contribution from interest rate/growth differential 3/	-4.7	-7.2	-5.5	-4.2	-5.7	-2.2	-2.3	-1.8	-1.7	-1.3	-1.3	-1.0	-1.0	
9 *Of which*: contribution from real interest rate	-2.1	-4.6	-3.4	-2.1	-3.9	-0.9	-0.8	-0.2	-0.3	0.1	0.2	0.3	0.4	
10 *Of which*: contribution from real GDP growth	-2.7	-2.6	-2.1	-2.1	-1.8	-1.3	-1.5	-1.6	-1.4	-1.4	-1.4	-1.4	-1.3	
11 Contribution from exchange rate depreciation 4/	2.8	1.4	-1.8	0.7	2.2	-2.2	-0.5	...	...	...	...	...	...	
12 Other identified debt-creating flows	-1.5	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	-1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g., bank recapitalization)	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2–3) 5/	0.8	-0.9	3.9	0.9	1.6	-0.3	1.8	-0.8	0.3	0.3	0.2	0.2	0.1	
Public sector debt-to-revenue ratio 1/	289.1	239.1	198.7	191.0	156.2	173.6	160.9	144.1	137.4	130.8	125.4	120.2	114.2	
Gross financing need 6/	2.6	0.8	2.2	3.5	2.1	3.7	3.2	3.3	2.9	2.9	2.6	2.6	2.4	
In billions of U.S. dollars	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Scenario with key variables at their historical averages 7/								25.4	21.5	17.8	14.4	11.3	8.4	-1.0
Scenario with no policy change (constant primary balance) in 2009–2014								25.4	23.9	22.6	21.4	20.4	19.5	-0.8
Key macroeconomic and fiscal assumptions underlying baseline														
Real GDP growth (in percent)	5.0	5.7	5.5	6.3	6.1	4.5	6.1	6.5	6.5	6.7	7.0	7.0	7.0	
Average nominal interest rate on public debt (in percent) 8/	5.1	5.3	6.1	5.9	6.1	5.7	5.5	5.8	6.3	6.4	6.6	7.0	7.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-3.4	-9.1	-7.9	-5.4	-12.1	-2.7	-2.5	-0.5	-0.7	0.8	1.2	2.1	2.4	
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	-9.3	-5.5	9.3	-4.3	-13.8	16.1	4.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	8.6	14.3	14.1	11.3	18.2	8.4	8.0	6.2	7.0	5.6	5.4	4.9	4.9	
Growth of real primary spending (deflated by GDP deflator, in percent)	11.9	0.2	14.8	9.7	12.8	-11.1	8.0	14.7	3.0	8.2	6.9	9.0	8.2	
Primary deficit	-2.1	-3.1	-2.6	-1.0	-1.8	0.1	-0.2	0.6	0.1	0.1	0.1	0.2	0.1	

1/ Coverage of public sector debt consists of the gross debt of the central government.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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).

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

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

5/ For projections, this line includes exchange rate changes.

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

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

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

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.

Table I.2. Indonesia: External Debt Sustainability Framework, 2005–16

(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Debt-stabilizing noninterest current account 6/
1 Baseline: External debt	46.5	35.8	30.9	30.3	32.1	28.6	25.9	24.6	23.4	22.3	21.3	20.2	-3.1
2 Change in external debt	-6.9	-10.6	-4.9	-0.6	1.8	-3.5	-2.7	-1.3	-1.1	-1.1	-1.1	-1.1	
3 Identified external debt-creating flows (4+8+9)	-7.1	-14.0	-9.5	-5.5	-4.6	-3.9	-3.3	-2.4	-2.2	-2.1	-1.7	-1.4	
4 Current account deficit, excluding interest payments	-1.8	-4.3	-3.5	-0.9	-3.3	-1.4	-0.7	0.0	0.3	0.5	0.8	0.8	
5 Deficit in balance of goods and services	-2.9	-5.4	-4.8	-1.9	-4.5	-3.0	-2.6	-1.8	-1.6	-1.3	-1.0	-0.7	
6 Exports	35.0	31.6	30.2	30.3	24.7	24.7	25.9	23.7	22.8	21.8	20.8	20.0	
7 Imports	32.0	26.1	25.4	28.4	20.3	21.7	23.3	21.8	21.2	20.5	19.8	19.2	
8 Net nondebt creating capital inflows (negative)	-1.6	-1.0	-1.5	-0.7	-0.5	-1.6	-1.6	-1.4	-1.4	-1.4	-1.5	-1.3	
9 Automatic debt dynamics 1/	-3.7	-8.7	-4.6	-3.9	-0.8	-0.9	-1.1	-1.0	-1.1	-1.1	-1.1	-0.9	
10 Contribution from nominal interest rate	1.7	1.3	1.0	0.9	0.8	0.6	0.5	0.4	0.4	0.4	0.4	0.5	
11 Contribution from real GDP growth	-2.7	-2.0	-1.9	-1.6	-1.3	-1.5	-1.6	-1.5	-1.5	-1.5	-1.4	-1.3	
12 Contribution from price and exchange rate changes 2/	-2.7	-8.0	-3.7	-3.2	-0.2	...	...	...	...	...	...	...	
13 Residual, including change in gross foreign assets (2–3) 3/	0.1	3.4	4.6	4.9	6.4	0.5	0.6	1.1	1.1	1.0	0.7	0.3	
External debt-to-exports ratio (in percent)	133.0	113.5	102.4	100.1	129.7	115.8	100.1	103.8	102.9	102.5	102.3	101.0	
Gross external financing need (in billions of U.S. dollars) 4/	26.7	32.8	33.6	59.1	44.2	68.0	82.0	96.5	103.8	110.3	119.1	127.8	
In percent of GDP	9.3	9.0	7.8	11.6	8.2	9.6	9.8	10.3	10.1	9.7	9.5	9.2	
Scenario with key variables at their historical averages 5/						28.6	24.2	19.1	13.8	8.7	3.7	-1.2	-1.3
Key macroeconomic assumptions underlying baseline													
Real GDP growth (in percent)	5.7	5.5	6.3	6.0	4.6	6.1	6.4	6.3	6.7	7.0	7.0	7.0	
GDP deflator in U.S. dollars (change in percent)	5.2	20.8	11.6	11.6	0.7	23.7	11.0	5.6	3.3	3.0	3.0	3.0	
Nominal external interest rate (in percent)	3.5	3.7	3.4	3.4	2.7	2.3	1.9	1.8	1.7	1.8	1.8	2.5	
Growth of exports (U.S. dollar terms, in percent)	20.7	15.1	13.4	18.7	-14.0	31.2	23.5	2.6	6.0	5.5	5.0	6.1	
Growth of imports (U.S. dollar terms, in percent)	28.0	4.1	15.0	32.3	-24.7	40.8	26.7	5.0	7.1	6.4	6.6	7.2	
Current account balance, excluding interest payments	1.8	4.3	3.5	0.9	3.3	1.4	0.7	0.0	-0.3	-0.5	-0.8	-0.8	
Net nondebt creating capital inflows	1.6	1.0	1.5	0.7	0.5	1.6	1.6	1.4	1.4	1.4	1.5	1.3	

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 noninterest current account and nondebt 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.

APPENDIX II: INDONESIA—TRANSITION TO GFSM 2001

The presentation of central government operations in the main text of the staff report is currently compatible with the national presentation of the budget. The accounting of government operations in Indonesia is on a cash basis, covers only the central government and is, therefore, not fully compatible with the GFSM 2001 format. To ensure the comparability of IMF staff projections with the authorities' forecast, the staff report table is in the same format as the budget presentation. However, to promote international comparability of government operations, preliminary data consolidated to the general government level in a GFSM 2001 compatible format is also presented in this appendix.

The Indonesian authorities are in the process of moving to accrual accounting, and they are planning for full implementation by 2015. Although budget reporting by local governments is beginning to improve, it is still subject to long lags, does not follow GFS reporting standards, and does not have a homogenous classification of expenditures. The Ministry of Finance does not obtain comprehensive and timely information on borrowing and debt, making it difficult to monitor general government debt trends. Although the authorities are aware of these limitations and have plans to address them, they have not yet set a target date for moving to a consolidated general government presentation.

Table II.1. Indonesia: Summary of General Government Operations, 2005–2010

(In trillions of rupiah)

	2005	2006	2007	2008	2009	2010
Revenue	537.8	679.4	762.2	1,053.1	924.7	1,095.1
Taxes	346.8	409.1	491.4	658.7	619.9	744.4
Taxes on income, profits, and capital gains	175.3	208.8	238.7	327.5	317.6	356.7
Taxes on goods and services	134.6	160.8	199.7	260.9	249.8	318.3
VAT and luxury taxes	101.3	123.0	155.0	209.6	193.1	252.1
Excise	33.3	37.8	44.7	51.3	56.7	66.2
Taxes on international trade and transactions	15.2	13.2	20.9	36.3	18.7	28.9
Taxes not elsewhere classified	21.7	26.2	32.2	34.0	33.9	40.6
Grants	1.3	1.9	1.7	2.3	1.7	2.8
Other revenue	189.7	268.5	269.1	392.1	303.1	347.9
Total expenditure	520.3	671.8	803.0	1,053.2	1,023.4	1,173.4
Expense	388.7	459.4	582.1	800.8	748.7	922.4
Of which :						
Compensation of employees	124.3	158.1	211.3	261.3	295.8	346.4
Purchases/use of goods and services	33.1	47.1	51.3	56.0	80.7	96.0
Interest	67.7	79.0	79.5	88.4	93.7	88.3
Fuel subsidies	95.7	64.2	116.9	223.0	94.6	139.9
Net acquisition of nonfinancial assets	131.6	212.5	220.9	252.4	274.7	251.0
Net lending/borrowing	17.5	7.5	-40.9	-0.1	-98.7	-78.3
Net acquisition of financial assets	41.2	22.6	-7.9	70.7	-8.6	9.4
Of which : policy lending	0.0	0.0	0.0	0.0	6.2	4.7
Net incurrence of liabilities	23.7	15.1	33.0	70.9	90.1	87.6

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

INTERNATIONAL MONETARY FUND

INDONESIA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

September 21, 2011

Prepared By | Asia and Pacific Department

CONTENTS

ANNEX I: FUND RELATIONS

(As of August 31, 2011)

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

II. General Resources Account

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

III. SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	1,980.44	100.00
Holdings	1,761.69	88.95

IV. Outstanding Purchases and Loans: None

V. 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

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

	Forthcoming				
	2011	2012	2013	2014	2015
Principal					
Charges/interest	0. 22	0.84	0.84	0.84	0.84
Total	0.22	0.84	0.84	0.84	0.84

VII. Exchange Arrangements

The rupiah has floated since August 14, 1997. The market exchange rate was Rp 8,578 per U.S. dollar as of end-August 2011. Indonesia has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions.

VIII. Article IV Consultation

The last Article IV consultation report (IMF Country Report No. 10/284) was discussed by the Executive Board on August 27, 2010.

IX. Resident Representative

Mr. Milan Zavadjil has been Senior Resident Representative since 2008.

ANNEX II: WORLD BANK-IMF COLLABORATION

(As of September 1, 2011)

Background

The working relationship between the IMF and the World Bank in Indonesia is acknowledged by both sides to be very strong with joint working programs in many 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

- The reform agenda for budget and treasury remains a high priority for both institutions. The strategic framework for joint work is built into joint Bank/Fund budget missions. Currently, the Bank support is being provided through the GFMRAP program (recently restructured), trust funds and 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, and the enhancement of budget flexibility at the service delivery level; and (c) improved capacity for budget oversight through organizational reform. In addition to the Fund's overall strategic guidance, the Fund team takes the lead in the development of the budget reform strategy, treasury single account, and cash planning. Moving forward this assignment of responsibilities is expected to continue.

Taxation

- Taxation is a priority for the Fund and the Bank with improving tax revenues an important issue for both macroeconomic security and the investment climate. The Fund has a longstanding program of support for the tax department in Indonesia. This program has, in recent years, focused on tax policy and donor coordination, with donor coordination quite important given the size of support for a solid program of tax reform in Indonesia. The Bank involvement is now also quite large. Support for tax administration reform will largely be executed through the Program for Indonesian Tax Administration Reform program which is now being prepared. The participants will check with their respective colleagues but generally anticipate that the current division of labor will continue.

Asset Liability Management

- The Bank and Fund have been leading an effort to improve asset liability management, including at the Treasury and Debt Management Office of the Ministry of Finance and Bank Indonesia. We envision that the Bank and Fund team will continue to work together as needed.

Financial Sector

- The Bank has focused on broad monitoring of the financial sector with special emphasis on issues that are important for the investment climate (as part of the Development Policy Loan series). The Bank has engaged more actively on nonbank financial sector policy and most recently on access to finance. The Fund has concentrated on the banking system per se, with emphasis on bank regulation and supervision. A joint Bank/Fund FSAP was completed last year that may lead to changed priorities and work programs going forward.

Statistics

- The Bank has a major program with the statistics agency that was launched in 2010. The program is being 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, i.e., including significant IT and personal/institutional reforms. There is a need for quick wins while the longer-term reform plays out, and the Fund has indicated that it is prepared to continue to assist in the area of government finance statistics.

Macroeconomics

- The Fund continues to take the lead in macroeconomic areas, with the Article IV and other missions, staff reports and policy notes on arising issues, including the stance of fiscal, monetary, and exchange rate policies, the credibility and effectiveness of monetary policy, macrofinancial linkages, and how events in the global economy are likely to impact Indonesia. The Bank has also begun to play a larger role, including on macroeconomic monitoring and capacity building, and there is an ongoing need for close coordination with the Fund. The Bank team has been assisting the Ministry of Finance, Fiscal Policy Office, to improve macroeconomic monitoring and forecasting capacity. In addition, the Bank team has been working on longer term macro/fiscal capacity and forecasting with the planning agency.

These threads of work are expected to be continued by both parties, and regular meeting(s) will explore other ways to improve existing synergies. These include keeping each other informed about ongoing work, and requests to each other in areas of interest and through periodic meetings. Issues being addressed include, for the Fund, the impact of structurally high inflation rates and associated higher volatility on real interest rates; and for the Bank, the link between macro/fiscal policy and real economic outcomes, potential growth, employment, and longstanding problems in the implementation and effectiveness of government spending.

Indonesia: JMAP Implementation			
Title	**Products**	**Provisional Timing of Missions**	**Expected Delivery Date (tentative)**
A. Mutual Information on Relevant Work Programs			
Bank work program	Indonesia Economic Quarterly		Launched in March and June 2011; next issues due September and December 2011
	World Bank follow up work related to WB/IMF Financial System Assessment Program missions (October 2009 and February/March 2010)		Ongoing
	Development Policy Loan 8		Winter 2011
IMF work program	2011 Article IV mission	July 2011	Board discussion expected in September 2011
	Tax administration technical assistance	July 2011	Ongoing
	2012 Staff Visit	January 2012	
	2012 Article IV mission	July 2012	
B. Request for Work Program Inputs			
Fund request to Bank	Assessment of economic developments and structural policies		Ongoing
	Information sharing		Ongoing
Bank request to Fund	Assessment of macroeconomic developments and policies		Ongoing
	Information sharing		Ongoing
	Government Financial Statistics training	June 2011	
C. Agreement on Joint Point Products and Missions			
Joint work program	Asset liability management	December 2010	

ANNEX III: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

(As of August 11, 2011)

Asian Development Bank (ADB) cumulative loans to Indonesia reached $26.5 billion as of end-December 2010. In 2009, the ADB approved a total of $2,184 million or 16.5 percent of the total loans approved by the institution for the year. More than 90 percent of the loans approved in 2009 were provided through four policy based operations. Two loans supported the Government's efforts to mitigate the effects of the global economic crisis. The remaining two continued to support the Government's medium term term reform agenda in capital market development, the investment climate, public financial management, and poverty alleviation.

ADB is preparing a Country Partnership Strategy with the Government of Indonesia to cover the period 2011–2015. The strategy will be aligned with the Government's medium-term development plan (RPJM) for 2010–2014 as well as the Masterplan for the Acceleration and Expansion of Indonesia Economic Development 2011–2015. It will support the government's objectives to achieve higher levels of sustainable growth and to foster social development. It is anticipated that assistance will be provided in the core areas identified in ADB's Long Term Strategic Framework—transport, energy, financial sector, natural resource management, water supply and sanitation, and education. Support for good governance, gender equity, environmental sustainability and regional cooperation will be encouraged in all sectors where relevant. Special emphasis will be provided to assist the Government to implement its climate change action plan.

Between 1967 and 2010, ADB provided 504 Technical Assistance grants to Indonesia amounting to $282.9 million. The TA grants were financed from ADB's Technical Assistance Special Fund, the Japan Special Fund, and other sources. Measured by cumulative TA approvals, Indonesia is the second largest recipient of TA support from the ADB.

[1] Prepared by the ADB staff.

Table III.1. Sovereign and Nonsovereign Loan Approvals and Disbursements to Indonesia

(In millions of U.S. dollars)

	2004	2005	2006	2007	2008	2009	2010
Loan approvals	225.00	1,145.69	784.80	1,187.10	1,085.00	2,184.20	785.00
Loan disbursement	593.50	1,014.99	1,025.88	1,136.30	949.60	739.30	1,079.80

Sources: Asian Development Bank, *Annual Report (various editions)*, and ADB staff.

Table III.2. Cumulative Lending to Indonesia

(As of December 31, 2010)

Sector	Loans (No.)	Amount (US$ millions)	Percent 1/
Agriculture and natural resources	99	4,047.00	15.28
Education	32	2,222.35	8.39
Energy	32	3,831.05	14. 46
Finance	21	3,826.10	14.44
Health and social protection	13	1,068.30	4.03
Industry and trade	12	645.70	2.44
Public sector management	18	4,567.22	17.24
Transport and ICT	33	2,713.86	10.24
Water supply and other municipal Infrastructure and services	32	1,984.74	7.49
Multisector	16	1,586.22	5.99
Total	308	26,492.54	100.00

Sources: Asian Development Bank, *Indonesia Fact Sheet as of 31 December 2010;* and ADB staff.

1/ Total may not add up because of rounding.

ANNEX IV: STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance

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

National accounts: Quarterly GDP data are published in a timely manner for both expenditure and production sides. The annual national accounts have 2000 as the base year. The estimates are based on a limited set of indirect indicators of uncertain quality. Some sectors are influenced strongly by seasonality, and seasonally adjusted data are prepared but not published. In addition, no survey of nonfinancial services is prepared. The Fund has recommended: (i) development of a system to continuously update the census of businesses; (ii) introduction of comprehensive annual establishment surveys for nonfinancial services industries; (iii) publication of annual GDP estimates, including a time series of at least 20 years; (iv) development of a set of annual supply and use tables (SUTS) starting from 2000; and (v) enhancing the convergence exercise on trade data between Bank Indonesia (BI) and Ministry of Finance (MOF).

Price statistics: Price statistics are broadly adequate for surveillance.

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 this data is variable. Problems in budget and accounting systems have been compounded by the recent decentralization initiatives, which have shifted substantial resources to the subnational governments. Substantial efforts are in train, and significant progress has been 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 MOF and the Ministry of Home Affairs are committed to keeping the requirements of fiscal statistics at the forefront of ongoing fiscal reforms, so as to make 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, the Fund staff has 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) establishing the underlying reporting arrangements necessary to obtain timely preliminary data for local government statistics; and (ii) developing GFSM 2001 operating statements, statements of sources and uses of cash, and partial balance sheets, all of which should be published on the MOF websites. 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 website.

Monetary statistics: Good quality monetary statistics are compiled by BI on a timely basis. With STA assistance, BI has developed an integrated database from which alternative presentations of monetary statistics can be drawn to meet the needs of BI and the Fund. To strengthen monetary statistics, STA missions have also recommended the expansion of the coverage of monetary statistics to include mutual funds. Additional challenges include timely revisions of published banking sector data after supervisory verification.

Balance of payments: Trade data are affected by some significant shortcomings. While customs sources utilized by the BI are considered generally reliable, coverage of merchandise trade flows is insufficient. Also, when the online reporting system for exports and imports was introduced in 2004, the historical series were reconstructed only as far back as 2003. As a result, prior to 2003, balance of payments statistics are not entirely consistent with the national accounts estimates. Exports and imports volume data, and consequently trade deflator data, is incorrectly computed as aggregate indexes that do not weight sub category volumes by their economic value.

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 a low response rate and the coverage of the directory of enterprises should be improved. 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 has been significant at times and appears to be related to the methodology used, for instance, for unrecorded assets in the financial account. Financial transactions data have not been reconciled with changes in the International Investment Position (IIP).

An annual IIP is compiled, but the underlying data are weak in several areas, notably for FDI, and published data should include a higher degree of disaggregation (only main items are reported). 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. 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 rescheduling and debt reductions received by the private sector from external creditors.

II. Data Standards and Quality

Subscriber to the Special Data Dissemination Standard (SDDS) since September 1996, observing most of the SDDS requirements.	Data ROSC completed in 2005.

Indonesia: Table of Common Indicators Required for Surveillance

(As of August 18, 2011)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memorandum Items:	
						Data Quality – Methodological soundness[7]	Data Quality – Accuracy and Reliability[8]
Exchange rates	8/18/11	8/18/11	D	D	W/M		
International reserve assets and reserve liabilities of the monetary authorities[1]	7/22/11	8/18/11	D	M	M		
Reserve/base money	6/11	8/11	D	D	W/M	O, LO, O, O	LO, O, O, LO, O
Broad money	6/11	8/11	M	M	M		
Central bank balance sheet	7/11	8/11	M	M	M		
Consolidated balance sheet of the banking system	6/11	8/11	M	M	M		
Interest rates[2]	8/18/11	8/18/11	D	D	W/M		
Consumer price index	7/11	8/1/11	M	M	M		
Revenue, expenditure, balance and composition of financing[3]–central government	7/11	8/11	M	M	Mid year	LNO, LNO, LO, LNO	LNO, LO, LO, LO, LNO
Stocks of central government and central government–guaranteed debt	4/11	7/11	M	M	M		
External current account balance	6/11	8/11	Q	Q	Q	LO, LO, LO, LO	LO, O, LO, O, O
Exports and imports of goods and services	6/11	8/11	M	M	M		
GDP/GNP	6/11	8/11	Q	Q	Q	LO, LO, O, LO	LO, LO, LO, LO, LNO
Gross external debt[4]	4/11	7//11	M	M	M		
International investment position[5]	2009	5/11	A	A	A		

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] Including currency and maturity composition.
[5] Includes external gross financial assets and liability positions vis à vis non residents.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); NA: Not Available.
[7] 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).
[8] Same as footnote 7, 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.

Statement by the IMF Staff Representative on Indonesia
October 7, 2011

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

1. Similar to other emerging markets, Indonesian financial markets have recently been experiencing large sell-off pressures as concerns about advanced economies intensified (see chart). On the back of heavy foreign selling, the Jakarta equity index plunged by almost 13 percent and Indonesia's EMBI and CDS spreads rose 110-125 bps from end-August to October 3, in line with other emerging markets. At the same time, the rupiah has depreciated by about 4 percent against the U.S. dollar. Bank Indonesia (BI) intervened to stabilize the exchange rate and both BI and the government purchased government securities to support the bond market. Indonesian markets have recovered in the last week, with both bonds and the rupiah retracing most of their initial losses. Local 10-year government bond yields, for example, have fallen back to near their end-August levels, after rising 119 bps during September 9-22.

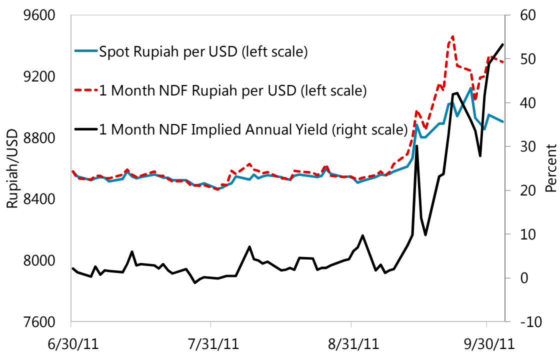
2. Headline inflation eased to 4.6 percent y/y in September from 4.8 percent in August reflecting a larger-than-expected fall in food prices after Ramadan and base effects related to the timing of the holiday relative to last year. Core inflation has slowed to 4.9 percent y/y from 5.2 percent y/y in August. The trade surplus widened to US$3.8 billion in August, from US$1.2 billion the previous month. Exports (f.o.b.) grew 37.1 percent y/y, while import growth (c.i.f.) slowed to 23.7 percent y/y in August.

3. On October 3, 2011, BI issued a new regulation requiring that export proceeds and external borrowing in the form of non revolving loan agreements and debt securities be received by domestic banks. However, there is no minimum period for which these funds need to be kept at a domestic bank, implying that firms are free to transfer them offshore immediately afterwards. The regulation will not take effect until January 2012, and there will be a one-year transition period.

Indonesia: Financial Market Performance during the Recent Global Turmoil

While central bank intervention has supported the spot rupiah rate, offshore NDF markets remain stressed.

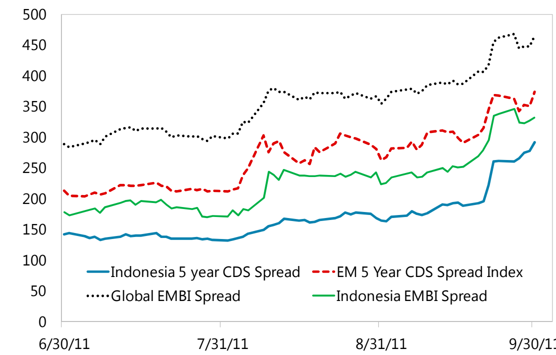
Foreign Exchange Rates



External spreads have risen in line with other emerging markets.

External Bond and Credit Default Swap Spreads

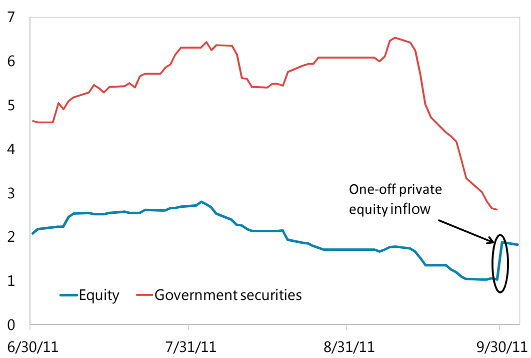
(basis points)



Foreign investors have reduced their holdings of rupiah-denominated assets.

Portfolio Inflows

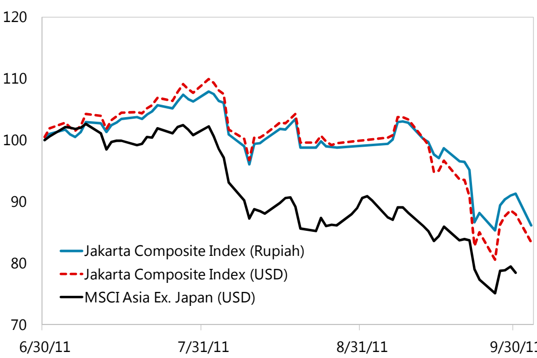
(Year to date, billions of US$)



Indonesian equity prices have fallen in recent weeks, but remain among the better performers in the region.

Equity Market Indicies

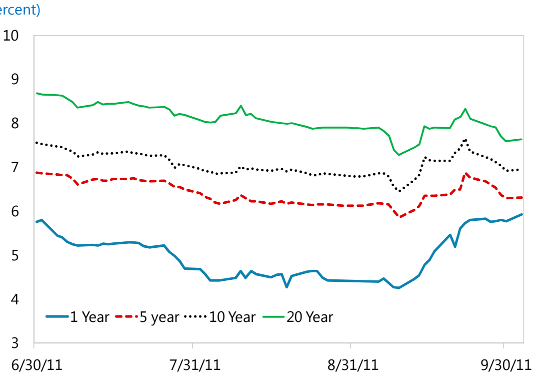
(End-June 2011 = 100)



After a sharp sell-off in mid-September, bond markets have recovered, supported by government and BI purchases.

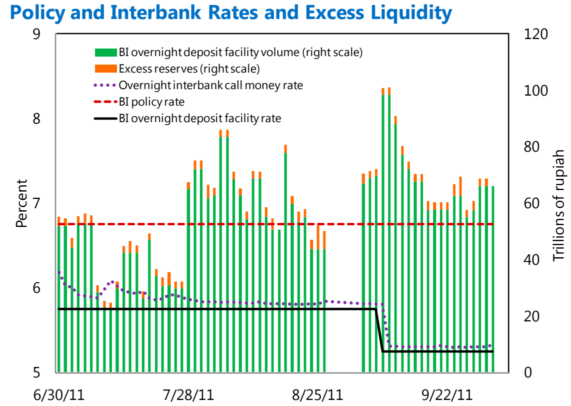
Local Currency Government Bond Yields

(percent)



There is little sign of rupiah liquidity problems in the banking system.

Policy and Interbank Rates and Excess Liquidity



Sources: CEIC Data Co., Bloomberg L.P.; and IMF staff calculations.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 11/128
FOR IMMEDIATE RELEASE
October 21, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with Indonesia

On October 7, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Indonesia.[1]

Background

Continuing the impressive performance during the global financial crisis, Indonesia's economy expanded 6.1 percent in 2010 and accelerated to 6.5 percent in the first half of 2011. Growth has also become more balanced, with investment adding to consumption and exports as the main engines of growth. In the absence of a significant further deterioration in global conditions, GDP growth is projected to remain robust at about 6−6.5 percent in both 2011 and 2012, increasingly driven by investment, which is offsetting a lower contribution from net exports.

Headline inflation has eased in recent months on softening food prices, but upward pressure on core inflation is expected to continue. At end-2010, rising food prices had pushed CPI inflation to 7 percent; exceeding Bank Indonesia's (BI) 4−6 percent target range. Headline inflation started to ease since February 2011, falling to 4.6 percent in July, as good local harvests and increased rice imports helped hold down food prices. Core inflation rose steadily through 2010 and into 2011, reaching 5.2 percent in August 2011. The future path of food prices will play a major role in the evolution of inflation. Nevertheless, a closing output gap, accelerating credit

[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. 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.

growth and elevated inflation expectations from an anticipated reduction in energy subsidies are projected to push core inflation higher in the second half of this year and into 2012.

The current account surplus has declined, but capital inflows have increased. Exports have been robust, buoyed by higher commodity prices and growing demand from major emerging market partners. Imports are also rising rapidly, in line with strengthening domestic demand. Strong growth prospects, solid macroeconomic fundamentals, and the potential for a ratings upgrade to investment status have continually led to large portfolio inflows, boosting bond and equity prices to all time highs. Foreign direct investment inflows have picked up and become broader based, and should provide greater support for the balance of payments. International reserves have more than doubled from the 2008 level, increasing to $125 billion by end August 2011. The rupiah has appreciated about 5 percent against the dollar from end 2010 to end August 2011, and external debt spreads have narrowed.

Indonesian banks continue to be profitable and are generally well capitalized. In line with the findings of the 2010 Financial Sector Assessment Program (FSAP), capital adequacy ratios remain high at 17.5 percent, and asset quality is satisfactory, with the nonperforming loan ratio at about 3 percent as of March 2011. BI has made progress towards the FSAP recommendation to establish a legally mandated Prompt Correction Action (PCA) mechanism, but the adoption of the Financial System Safety Net (FSSN) law remains outstanding.

Since October 2010, BI has used a wide range of instruments to stem mounting inflationary pressures and strong foreign demand for its sterilization instruments. The central bank raised its policy rate by 25 basis points to 6.75 percent in February 2011, after holding it unchanged at a historical low of 6.5 percent since August 2009. Reserve requirements on both local currency and foreign currency deposits have also been raised. BI has successfully shifted the composition of inflows away from central bank bills (SBI) by extending the holding requirement, lengthening the maturity of issues, and introducing longer maturity nontradable term deposits available only to banks.

The moderate fiscal stimulus provided in 2009 was reduced in 2010. The 2010 central government budget deficit was 0.6 percent of GDP, well below the government's revised budget deficit target of 2.1 percent, reflecting ongoing problems in implementing spending programs. Public debt to GDP fell to 27 percent, one of the lowest among G20 countries. The overall budget deficit in 2011 is projected to increase slightly to about 1.25 percent of GDP, reflecting higher energy subsidies.

Executive Board Assessment

Executive Directors commended the authorities for cautious policymaking, which has underpinned a strong macroeconomic performance during the global crisis and a favorable growth outlook. Given Indonesia's strong fundamentals, significant policy buffers, and vigorous domestic demand, Directors agreed that the risks from a deterioration in global economic conditions appear to be manageable. Looking ahead, improved infrastructure, better targeted social spending, and deeper structural reforms will be crucial to lifting the long-term prospects for growth.

While taking note of the authorities' view that inflation may not be an immediate concern, Directors nonetheless considered that Bank Indonesia should be prepared to tighten monetary policy, in view of high credit growth and a planned reduction in energy subsidies. The timing of such move should, however, be mindful of global developments and the likely impact on capital flows. Directors suggested a combination of policy rate increases, macro-prudential measures, and liquidity absorption to tighten monetary conditions, and encouraged the central bank to focus its communications on its commitment to the inflation target.

To improve the effectiveness of monetary policy, Directors suggested that the central bank's operational framework be adjusted to link interbank rates to the policy rate more effectively while promoting money market development. Directors also recommended strengthening the central bank's financial resources by increasing the share of marketable securities in its balance sheet and replenishing its capital base.

Directors agreed that domestic financial conditions are generally sound. They welcomed the authorities' progress in implementing the recommendations of the 2010 Financial Stability Assessment Program and efforts to reinforce supervisory oversight through a new risk-based bank rating system. In this regard, Directors noted that the adoption of the Financial System Safety Net law remains key to an improved framework for crisis management and resolution.

Directors commended the authorities' commitment to strong public finances and a prudent fiscal policy. They encouraged the authorities to phase out poorly targeted subsidies with a view to creating room in the 2012 budget for needed infrastructure and other priority expenditures. Noting that implementation constraints still hamper policy flexibility, they called for further improvements in budget execution and public financial management, as well as tax reforms that could create the budgetary space for high-priority social expenditures.

Directors considered that further structural reforms are critical for higher potential growth and the achievement of the authorities' longer-term development targets. In this regard, they recommended renewed efforts to improve regulation, strengthen governance, and bolster the business climate.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2011 Article IV Consultation with Indonesia is also available.

Indonesia: Selected Economic Indicators, 2007–12

Nominal GDP (2010): Rp 6,423 trillion or US$707 billion

Main exports (percent of total, 2010): mineral fuels (36), manufactured goods (23), machinery and transport equipment (13)

GDP per capita (2010): US$2974

Unemployment rate (Feb. 2011): 6.8 percent

Poverty headcount ratio at national poverty line (2010): 13.3 percent of population

	2007	2008	2009	2010	2011 Proj.	2012 Proj.
Real GDP (percent change)	6.3	6.0	4.6	6.1	6.4	6.3
Domestic demand	4.1	7.6	5.2	5.7	6.4	6.7
Of which:						
Private consumption	5.0	5.3	4.9	4.6	4.9	5.0
Gross fixed investment	9.3	11.9	3.3	8.5	9.4	10.5
Change in stocks 1/	-1.6	0.1	-0.2	0.4	0.1	0.0
Net exports 1/	0.6	0.7	1.2	0.8	0.6	0.3
Statistical discrepancy 1/	2.1	-1.4	-1.2	0.2	0.0	0.0
Saving and investment (in percent of GDP)						
Gross investment 2/	24.9	27.8	31.0	32.5	32.9	34.4
Gross national saving	27.3	27.8	33.5	33.3	33.1	34.0
Foreign saving	-2.4	0.0	-2.5	-0.8	-0.2	0.4
Prices (12-month percent change)						
Consumer prices (end period)	5.4	11.1	2.8	7.0	5.0	6.4
Consumer prices (period average)	6.0	9.8	4.8	5.1	5.7	6.5
Public finances (in percent of GDP)						
Central government revenue	17.9	19.8	15.1	15.8	16.4	15.9
Central government expenditure	19.1	19.9	16.7	16.4	17.7	17.2
Central government balance	-1.2	-0.1	-1.6	-0.6	-1.3	-1.3
Primary balance	0.8	1.7	0.1	0.8	0.1	0.1
Central government debt	36.9	33.2	28.6	27.4	25.2	23.9
Money and credit (12-month percent change; end of period)						
Rupiah M2	19.6	12.7	13.8	16.5	...	...
Base money	27.8	-9.2	16.7	28.9	...	...
Private sector credit	25.1	30.9	8.2	22.2	...	...
One-month interbank rate (period average)	8.5	9.4	7.8	6.5	...	...
Balance of payments (in billions of U.S. dollars)						
Oil and gas (net)	5.7	7.8	8.3	3.2	2.3	1.2
Non-oil exports (f.o.b)	93.1	107.9	99.0	129.4	159.1	163.5
Non-oil imports (f.o.b)	-66.1	-92.8	-73.5	-102.0	-128.4	-135.3
Current account balance	10.5	0.1	13.6	5.6	1.5	-4.0
Foreign direct investment	2.3	3.4	1.9	10.6	11.6	11.2
Overall balance	12.7	-1.9	14.2	30.3	30.2	20.8
Gross reserves						
In billions of U.S. dollars (end period)	56.9	51.6	66.1	96.2	126.4	147.2
In months of imports	4.7	5.7	5.2	5.9	7.4	8.1
As a percent of short-term debt 3/	198.6	178.5	211.0	226.5	252.3	276.5
Total external debt						
In billions of U.S. dollars	133.6	155.0	172.8	202.4	216.1	230.0
In percent of GDP	30.9	30.3	32.1	28.6	25.9	24.6
Exchange rate (period average)						
Rupiah per U.S. dollar	9,141	9,699	10,390	9,090	...	...
Nominal effective exchange rate (2005=100)	100.3	90.8	86.6	95.2	...	...
Memorandum items:						
Oil production (thousands of barrels per day)	899	927	960	954	945	945
Indonesian oil price (US$/bbl)	70.7	96.6	61.4	78.6	103.7	100.5
Nominal GDP (in trillions of rupiah)	3,951	4,949	5,604	6,423	7,223	8,175
Nominal GDP (in billions of U.S. dollars)	432	511	538	707	834	936

Sources: Data provided by the Indonesian authorities; and IMF staff estimates.
1/ Contribution to GDP growth (percentage points).
2/ Includes changes in stocks.
3/ Short-term debt on a remaining maturity basis.

Statement by Aida Budiman, Alternate Executive Director for Indonesia and Iss Savitri Hafid, Advisor October 7, 2011

The Indonesian authorities would like to thank the IMF team for the fruitful dialogue during this year's Article IV consultation and the useful inputs from the Staff Report and the Selected Issues paper. They welcome staff's appraisal on the resiliency of the economy, garnered from adoption of prudent macroeconomic and financial measures, a series of structural reform policies, combined with a transition toward a more democratic and stable political system.

Recent Economic Development and Outlook

1. Despite the bleak prospect of the global economy which has intensified recently, the Indonesian economy continues to demonstrate an impressive progress as well as stability. The sources of economic growth have been more balanced as investment activity gains momentum, owing to stronger economic fundamentals and improved business climate. Government expenditure will continue to play an important role in providing stimulus to the economy, while at the same time preserving a prudent fiscal position. Nevertheless, the recent downward revision of global outlook has led the authorities to lower its GDP and inflation forecast, in particular for 2012. In 2011 and 2012, the GDP is forecasted to reach 6.6% and 6.5%, respectively; while for the inflation rate is 4.9% and 5%, respectively.

2. These developments have placed the economy on a better footing. The level of reserves has reached an all-time high, in which this position is sufficient to cover more than 7 months of imports and external debt services of the Government. Furthermore, external debt has been on a steady downward path, including public debt, in line with the medium-term fiscal target to build up fiscal space. The composition of capital inflows has furthered improved as reflected by FDI flows surpassing net portfolio flows beginning second-half of this year. This change in the nature of inflows to more longer-term flows will further enhance the resilience of the economy. In addition, financial stability continues to be preserved, as reflected by the high level of capital adequacy ratio and the markedly lower level of NPL. Likewise, government bond price and stock market index are on a rising trend. Backed by sound fundamentals, the Rupiah exchange rate has been on an appreciating trend, alleviated the temporary pressures due to global sentiment triggered by uncertainty of the US and Euro area economic prospects. Taking into account favorable growth prospects, Indonesia's credit rating has been upgraded to one notch below the investment grade by two rating agencies this year and one rating at the end of last year.

3. The authorities are cognizant of the challenges that lie ahead and broadly agree with the staff's assessment on the Indonesian economy. The authorities' top priority is to sustain the growth momentum without compromising stability, while improving the quality of growth.

Monetary policy

4. The objective of monetary policy is always to achieve and safeguard price stability. The policy responses toward inflationary pressures would need to be assessed carefully in view of the uncertainties in the global economy, massive capital inflows and the possibility of capital reversal, as well as gaps in market development. The policy rate remains a part of the policy tool-kit to maintain macroeconomic and financial stability, in addition to other monetary and macro-prudential policies, including continued efforts to strengthen monetary policy operation and promote financial deepening. While authorities acknowledge the possibility of higher inflation pressures in 20121, two important factors should be taken into consideration in formulating policy responses to inflation going forward. First, any adjustment in administered prices should be viewed as a one-time and temporary shock. Second, authorities are also concerned over the possibility of a more pronounced global economic slowdown, hence less pressure from commodity and oil price. Due to these two considerations, the authorities will focus their attention to limit any second-round effects of this adjustment to headline inflation. Authorities have successfully demonstrated their ability to achieve this during the episode of food price increase in 2010.

5. Various indicators have been and will be closely monitored to ensure that price stability remains in check. To track demand side pressures, the decomposition of core inflation has been analyzed. The result shows that the current uptrend in core inflation has been mainly due to gold. Core inflation excluding gold as well as non-food core inflation excluding gold, are still in the low levels of 4.2% and 4% respectively, lower than core inflation of 5.2%. In addition, inflation expectation indicators also indicate a declining trend in public expectations for both for 2011 and 2012. Authorities will also ensure sufficient supply of food and its smooth distribution, while strengthening the communication strategy to ensure that public expectation is well-anchored. These efforts will be complemented by continued use of the exchange rate as an economic shock absorber, which so far has been effective in containing inflationary pressures and impact of capital flows.

6. Expansion in credit growth is important to boost the economic capacity. Unlike the situation in 2009 where credit growth was dominated by consumption loan, the rapid credit growth in 2010 and 2011 has witnessed broad-based expansion, including in working capital and investment loans. Taking into account the share of credit, most funds are channeled to productive sectors which in turn will boost the economic capacity and address infrastructure bottlenecks.

Fiscal Policy

7. The authorities are firmly committed to ensuring fiscal sustainability as improving public finance management. This is of utmost importance in order to achieve the medium-term fiscal strategy of attaining public debt consolidation and improving the quality of government expenditure. Public debt to GDP has steadily declined from 36.9% in 2007 and is targeted to fall to less than 24% at the end of 2011. On the revenue side, authorities continue their efforts to increase the tax revenue ratio, including through broadening tax base

and continuing administration reform agenda. Meanwhile, the improvement in the budget structure will be addressed through implementation of a gradual phase-out of subsidies, reallocation of spending towards infrastructure and alleviation of poverty and unemployment. To support these efforts, authorities are currently seeking TA programs that may help to design the blueprint and implementation strategy for strategic government projects.

8. Efforts to adhere to good corporate governance in fiscal operation are in progress. To enhance the effectiveness and efficiency of budget management, the authorities are implementing a multi-year performance-based budgeting (PBB) and a medium-term expenditure framework (MTEF) in the period 2010-14. Further, a Presidential Decree on procurement was adopted in 2010 to maintain governance while aiming to streamline procurement-related regulations. However, owing to the transitional period and operational guidelines, the new regulation contributed to the current low execution of government spending. Realizing this condition, corrective actions have been taken, among others by introducing an incentive system to ministries and government institution that are capable of optimizing their budget by March 2011. In addition, the Ministry of Finance has delegated some authority for budget virement to Treasury regional offices and line ministries.

Financial Sector Policy

9. The authorities have sustained efforts to optimize the intermediary function of the financial system while continuously maintaining the financial stability. Indonesia has undertaken intensive financial sector reform and is in the stage of implementing the FSAP recommendations. In this regard, the authorities welcome TA programs to help address concerns in the priority sectors. Likewise, reforms in the banking sector, such as Basel II implementation and principle-based supervisory approach, have progressed according to the timeline. On the capital market side, the Bapepam-LK continues to implement the five-year development plan with five area for development, namely increasing accessible and efficient source of fund, improving ease of transaction, promoting a stable, resilient and liquid industry, enhancing fair and transparent regulatory framework which guarantees legal certainty, and promoting a credible, reliable international standard infrastructure.

10. Despite the sound and solid banking condition, the authorities continue to strengthen the Crisis Management Framework. In view of the pending enactment of the Financial Stability Safety Net Law, a concerted effort has been made to establish a national crisis management protocol, and is in the progress of harmonizing this protocol among related agencies. In the banking sector, Bank Indonesia has revamped the system for individual banking and sharpened the Prompt Corrective Action measure with the introduction of Risk Based Bank Rating (RBBR) to preemptively determine bank supervisory status and exit policy. In terms of the government bond market, the Ministry of Finance and Bank Indonesia have taken a coordinated initiative to provide back-stop mechanism as it deems necessary, to avoid excessive volatility in the market. This initiative is considered important as bond price fluctuation has significant role in building up market expectations.

Structural reform

11. Understanding the need to address the infrastructure bottlenecks, the government has strengthened the provision of government guarantees and direct contribution for infrastructure projects, as well as accelerated and streamlined the procurement process. A clear target for infrastructure development is set annually. The 2011 target is projects related to national food security, transportation connectivity, communications, energy security, water resource and flood management. Efforts towards achieving investment grade status are in progress. The authorities have intensified the engagement with investors by actively improving communication channels and data transparency. Based on the IIF's 2011 assessment, the Investors Relations Unit of Indonesia has been ranked first, together with a few other emerging market countries. This positive achievement is expected to contribute to increased longer-term financing from abroad, including those supporting the most needed infrastructure financing, and at better cost.

To conclude, Indonesia has successfully weathered the deep global crisis in 2008 and registered continued notable economic growth. This progress is a result of intensive reform and prudent macroeconomic policies which lays a solid foundation to entail sustainable economic growth. In years to come, the authorities envisage to improve the quality of growth, aiming to bring more people out of poverty line so as to deliver equality in social welfare. Indonesia also resolves to play a greater role in cushioning a potential global economic slowdown, together with other EMDCs.